## REVIEW TEAM: 2016-17

| ACCOUNTANCY: CLASS XII |  |  |
| :---: | :---: | :---: |
| SI. No. | Name | Designation |
| 1. | Mrs. Rajni Rawal (Principal) [Team Leader] | Govt. Girls Sr. Sec. School No. 1 Tagore Garden, Delhi |
| 2. | Mr. Anil Kumar (DESWAL) (Lecturer) | Rajkiya Pratibha Vikas Vidyalaya, Sector XI, Rohini, Delhi-85 |
| 3. | Mr. Rajesh Kumar (lecturer) | SBV, Anandvas, Delhi- 34 |
| 4. | Dr. Sunil Kumar Arora (Lecturer) | S.V. Co-ed. Sec-3. Rohini Delhi-85 |
| 5. | Ms. Jyotsna Davar (Lecturer) | Rajkiya Pratibha Vikas Vidyalaya, Tyagraj Nagar, New Delhi- 110003 |
| 6. | Ms.Sudha Bajaj (Lecturer) | S.B.V Ashok Nagar, New Delhi110027 |
| 7. | Laxmi Narain Goel (Lecturer) | G.B.S.S.S. No. 2, Keshav Puram, Delhi-35 |
| 8. | Rajni Verma (Lecturer) | G.S.K.V. B-3, Paschim Vihar, New Delhi-63 |
| 9. | Amit Paul Chadha (Lecturer) | S. Co. Ed. V., L-block, Hari Nagar, Delhi-64 |
| 10. | JyotiKaushik (Lecturer) |  |

Accountancy (Code No. 055)
Class-XII (2016-17)

| One paper |  | 3 hours | Theory: 80 Marks |  |
| :---: | :---: | :---: | :---: | :---: |
| Unit |  |  | Period | Marks |
| Part A | Accounting for Partnership Firms and Company |  |  |  |
|  | Unit 1. Accounting for Partnership Firms |  | 90 | 35 |
|  | Unit 2. Accounting for Companies |  | 60 | 25 |
|  |  |  | 150 | 60 |
| Part B | Financial Statement Analysis |  |  |  |
|  | Unit 3. Analysis of Financial Statement |  | 30 | 12 |
|  | Unit 4. Cash Flow Statement |  | 20 | 8 |
|  |  |  | 50 | 20 |
| Part C | Project Work |  | 40 | 20 |
|  | Project work will include: |  |  |  |
|  | Project File | 4 Marks |  |  |
|  | Written Test | 12 Marks (One Hour) |  |  |
|  | Viva Voce | 4 marks |  |  |
|  | OR |  |  |  |
| Part B | Computerized Accounting |  |  |  |
|  | Unit 3. Computerized Accounting |  | 50 | 20 |
| Part C | Practical Work |  | 26 | 20 |
|  | Practical work will include: |  |  |  |
|  | Practical file | 4 Marks |  |  |
|  | Practical Examination | 12 Marks (One Hour) |  |  |
|  | Viva Voce | 4 Marks |  |  |

# Part A: Accounting for Partnership Firm and Companies 

60 Marks
150 Periods
Unit 1: Accounting for Partnership firms
90 Periods

Units/Topics

- Partnership: features, Partnership Deed.
- Provisions of the Indian Partnership Act 1932 in the absence of partnership deed. Fixed v/s fluctuating capital accounts. Preparation of profit and loss Appropriation accountdivision of profit among partners, guarantee of profits.
- Past adjustments (relating to interest on capital, interest on drawing, salary and profit sharing ratio).
- Goodwill: nature, factor affecting and methods of valuationaverage profit, super profit and capitalization.
- Scope: Interest on partner's loan is to be treated as charge against profits.
Accounting for Partnership FirmsReconstitution and Dissolution.
- Change in the Profit Sharing Ratio among the existing partners- sacrificing ratio, gaining ratio, accounting for revaluation of assets and reassessment of liabilities and treatment of reserves and accumulated profits. Preparation of revaluation account and balance sheet.
- Admission of a partner- effect of admission of a partner on change in the profit sharing ratio,treatment of goodwill (as per AS 26),

After going through this unit, the students will be able to:

- State the meaning of partnership, partnership firm and partnership deed.
- Describe the characteristic features of partnership and the contents of partnership deed. explain the significance of provision of Partnership Act, in the absence of partnership deed.
Differentiate between fixed and fluctuating capital, outline the process and develop the understanding of preparation of Profit and Loss Appropriation Account.
- Develop the understating of preparation profit and Loss appropriation account involving guarantee of profit.
- Develop the understanding of making past adjustments.
- State the meaning, nature and factors affecting goodwill.
- Develop the understanding of valuation of goodwill using different methods of valuation of goodwill.
- Describe the meaning of sacrificing ratio, gaining ratio and the change in profit sharing ratio among existing partner.
- Develop the understanding of accounting treatment of assets and re-assessment of liabilities
treatment for revaluation of assets and re-assessment of liabilities, treatment of reserves and accumulated profits, adjustment of capital accounts and preparation of 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 and reserves, adjustment of capital accounts and preparation of 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, executor's account and preparation of balance sheet.
- Dissolution of partnership firm: types of dissolution of a firm. Settlement of accountspreparation 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 partners(s)).


## - Note:

(i ) The realized value of each asset must be given at the time of dissolution.
and treatment of reserves and accumulated profits by preparing revaluation account and balance sheet.

- Explain the effect of change in profit sharing ratio in admission of a new partner.
- Develop the understanding of treatment of goodwill as per AS26. Treatment of revaluation of assets and re-assessment of liabilities, treatment of reserves and accumulated profits, adjustment of capital accounts and preparation of balance sheet of the new firm.
- Explain the effect retirement/ death of a partner on change in profit sharing ratio.
- State the meaning of sacrificing ratio.
- Develop the understating of accounting treatment of goodwill, revaluation of assets and reassessment of liabilities and adjustment of accumulated profits 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 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.
(ii) In case, the realization expenses are borne by a partner, clear indication should be given regarding the payment thereof.

Accounting for Share Capital

- Share and share capital: nature and types.
- 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 |  |
| :--- | :---: |
| Accounting for Share Capital |  |
| - Accounting for share capital: |  |
| Issue and allotment to equity |  |
| shares, private placement of |  |
| shares, Employee Stock Option |  |
| Plan (ESOP). Public subscription |  |
| of shares-over subscription and |  |
| under subscription of shares; |  |
| issued at par and at premium, |  |
| calls in advance and arrears |  |
| (excluding interest) issue shares |  |
| for consideration other than cash. |  |
| - Concept of Private Placement. |  |

- Accounting treatment of forfeiture and re-issue of shares.
- Disclosure of share capital in company's Balance Sheet.


## Accounting for Debentures

- Debentures: 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.
- Redemption of debentures for immediate cancellation: Lump

60 Periods
After going through this unit, the students will be able to:

- State the meaning of share and share capital and differentiate between equity shares and preference shares and different types of share capital.
- Understand the meaning of private placement of shares and Employee Stock Option Plan.
- Develop the understanding of accounting treatment of Employee Stock Option Plan (ESOP), forfeiture and re-issue of forfeited shares.
- Describe the presentation of share capital in the balance sheet of the company as per scheduled -III part of I of the Companies Act 2013.
- Explain the accounting treatment of different categories of transactions related to issue of debentures.
- Understand the concept of collateral security and its presentation in balance sheet.
sum, draw of lots, purchase in the open market (excluding exinterest and cum-interest) and conversion. Creation of Debenture Redemption Reserve.
- Conversion method.

Note: Related sections of the Indian Companies Act, 2013 will apply.

- Develop the skill of calculating interest on debentures and its accounting treatment.
- State the meaning of redemption of debentures.
- Develop the understanding of accounting treatment of transactions related to redemption of debentures by lump sum, draw of lots, purchase in open method and conversion method.

Part B: Financial Statement Analysis
20 Marks
30 Periods
Unit 3: Analysis of Financial Statement

| Units/Topics |  |  |
| :---: | :---: | :---: |
| - Financial statements of a |  |  | company: Statement of Profit and Loss and Balance Sheet in the prescribed from with major headings and sub headings (as per Scheduled III to the Companies Act, 2013).

- Scope: Exceptional items, extraordinary items and profit (loss) from discontinued operations are excluded.
- Financial Statement Analysis: Objectives, importance and limitations.
- Tools for Financial Statement Analysis: Comparative statements, common size statements, cash flow analysis, ratio analysis.
- Accounting Ratio: Objectives, classification and computation.
Liquidity Ratio: Current ratio and Quick ratio. Solvency Ratio: Debt to Equity Ratio, Total Asset to


## After going through this unit, the

 students will be able to:- Develop the understanding of major headings and sub-headings (as per Schedule III to the Companies Act, 2013) of balance sheet as per the prescribed norms/formats.
- State the meaning, objectives and limitations of financial statement analysis.
- Describe the meaning of different tools of 'financial statements analysis'.
- Develop the understanding of preparation of comparative and common size financial statement.
- Know the meaning, objectives and significance of different types of ratios.
- Develop the understanding of computation of current ratio and quick ratio.

| Debt Ratio, Proprietary Ratio and Interest Coverage Ratio. <br> Activity Ratio: Inventory Turnover Ratio, Trade Receivables Turnover Ratio, Trade Payables Turnover Ratio and Working Capital Turnover Ratio. <br> Profitability Ratios: Gross Profit Ratio, Operating Ratio, Operating Profit Ratio, Net Profit Ratio and Return of Investment. | - Develop the skill of computation of debt equity ratio, total asset to debt ratio, proprietary ratio and interest coverage ratio. <br> - Develop the skill of computation of inventory turnover ratio, trade receivables and trade payables ratio and capital turnover ratio. <br> - Develop the skill computation of gross profit ratio, operating ratio, operating profit ratio, net profit ratio and return on investment. |
| :---: | :---: |

Note: Net Profit Ratio is to be calculated on before and after tax.
Unit 4: Cash Flow Statement

| Units/Topics | Learning Outcomes |
| :--- | :--- |
| - Meaning, objectives and | After going through this unit, the |
| preparation (as per AS | students will be able to: |
| 3(Revised) (Indirect Method only) | - State the meaning and objectives |
| Scope: | of cash flow statement. |
| (i) Adjustments relating to | Develop the understanding of |
| depreciation and amortization, | preparation of Cash Flow |
| profit or loss on sale of assets | Statement using Indirect Method |
| including investments, dividend | as per AS-3 with given |
| (both final and interim) and tax. | adjustments. |
| (ii) Bank overdraft and cash credit |  |
| to be treated as short term |  |
| borrowings. |  |
| (iii) Current Investments to be |  |
| taken as Marketable securities |  |
| unless otherwise specified. |  |

## Project Work

Note: Kindly refer to the Guidelines Published by the CBSE

# Suggested Question Paper Design <br> Accountancy (Code No. 055) <br> Class XII (2016-17) March 2017 Examination 

## One paper

 Theory: 80 MarksDuration: 3 hrs.

| $\begin{aligned} & \text { S. } \\ & \text { No } \end{aligned}$ | Typology of Questions | Very short Ans. 1Mark | $\begin{gathered} \text { Short } \\ \text { Ans. I } \\ 3 \\ \text { Marks } \end{gathered}$ | Short Ans. II 4 Marks | Long Ans. I 6 Marks | Long Ans. II 8 Marks | Marks | \% |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| 1. | Remembering - (Knowledge based Simple recall questions, to know specific facts, terms, concepts, principles, or theories; Identify, define, or recite, information) | 3 | 1 | 1 | 1 | - | 16 | 20\% |
| 2. | Understanding - (Comprehension to be familiar with meaning and to understand conceptually, interpret, compare, contrast, explain, paraphrase, or interpret information) | 2 | - | 2 | 1 | 1 | 24 | 30\% |
| 3. | Application - (Use abstract information in concrete situation, to apply knowledge to new situations; Use given content to interpret a situation, provide an example, or solve a problem) | - | 2 | 2 | 1 | - | 20 | 25\% |
| 4. | High Order Thinking Skills (Analysis \& Synthesis - classify, compare, contrast, or differentiate between different pieces of information; organise and/or integrate unique pieces of information from a variety of sources) | 2 | - | - | 1 | 1 | 16 | 20\% |
| 5. | Evaluation- (Appraise, judge, and/or justify the value or worth of a decision or outcome, or to predict outcomes based on values) | 1 | 1 | - | - | - | 04 | 05\% |
|  | TOTAL | $\begin{gathered} 8 \times 1= \\ 8 \end{gathered}$ | $\begin{gathered} 4 \times 3= \\ 12 \end{gathered}$ | $\begin{gathered} 5 \times 4= \\ 20 \end{gathered}$ | $\begin{gathered} 4 \times 6= \\ 24 \end{gathered}$ | $\begin{gathered} 2 \times 8= \\ 16 \end{gathered}$ | $80(23)$ $20$ <br> Project | 100\% |

Scheme of options: All question carrying 8 marks will have an internal choice.
Note: The Board has introduced Learning Outcomes in the Syllabus to motivate students to constantly explore all levels of learning. However, these are only indicative. These do not in any way restrict the scope of questions asked in the examinations. The examination questions will be strictly based on the prescribed question paper design and syllabus.

## CONTENTS

## PART-A

## Chapter 1

Accounting for Partnership Firms: Fundamentals 13

## Chapter 2

Goodwill: Nature and Valuation 54

## Chapter 3

Reconstitution of Partnership 68

## Chapter 4

Accounting for Partnership Firms: Admission of a Partner 89
Chapter 5
Retirement/Death of a Partner 74
Chapter 6
Dissolution of a Partnership Firm 93
Chapter 7
Accounting for Share Capital 110

## Chapter 8

Accounting for Issue of Debentures 147

## Chapter 9

Company Accounts-Redemption of Debenture 168

## PART-B

Chapter 1
Financial Statements of a Company ..... 186
Chapter 2
Financial Statement Analysis ..... 201
Chapter 3
Tools for Financial Statement Analysis ..... 203
Chapter 4
Accounting Ratios ..... 212
Chapter 5
Cash Flow Statement ..... 233
Model Papers ..... 298

## PART-A

CHAPTER 1

## ACCOUNTING FOR PARTNERSHIP FIRMS FUNDAMENTALS

## Accounting for partnership firms(fundamentals)



## Meaning and Features of Partnership

According to Section-4 of the Indian Partnership Act, 1932:
"Partnership is the relations between two or more persons who have agreed to share the profits of a business carried on by all or any one of them acting for all."


1. No. of partners: Minimum-2, Maximum- 50 (as per companies Act 2013)
2. Partnership Agreement/ Deed: Must come into existence (written/oral)
3. Profit sharing ratio: may be decided and stated in partnership deed.
4. Business must be legal
5. Agency relationship exists between partners.

## Features of Partnership

1. There must be at least two persons to form a valid partnership. The maximum number of partners prescribed by companies rules, 2014 which is 50 .
2. Partnership comes into existence by an agreement (either written or oral) among the partners. The written agreement among the partners is called Partnership Deed.
3. A partnership can be formed for the purpose of carrying on legal business.
4. An agreement between the partners must be aimed at sharing the profits. Specific provision in the deed may allow some partners not to bear losses.
5. A partnership can be carried on by all or any one of them acting for all.
6. Agent - Principal relationship exist between partners.

## Partnership Deed

The partnership deed is a written agreement among the partners which contains the terms of agreement. A partnership deed should contain the following points:

1. Name and address of the firm as well as partners.
2. Name and addresses of the partners.
3. Nature and place of the business.
4. Terms of partnership.
5. Capital contribution by each partner.
6. Interest on capital.
7. Drawings and interest on drawings.
8. Profit sharing ratio.
9. Interest on loan.
10. Partner's Salary/commission etc.
11. Method for valuation of goodwill and assets.
12. Accounting period of the firm and duration of partnership.
13. Rights and duties of partners how disputes will be settled.
14. Decisions taken if some partner becomes insolvent.
15. Opening of Bank Account - whereas it will be in the name of firm or partners.
16. Rules to be followed in case of admission \& settlement of accounts or retirement or death of partner.

## Benefits of Partnership Deed

(1) Helps to avoid dispute in future.
(2) It is an evidence in the court.
(3) Facilitates functioning of business by avoiding misunderstanding.

Rules applicable in the absence of partnership deed

| Profit sharing Ratio | Equal |
| :--- | :--- |
| Interest on Capital | No Interest on Capital is to be allowed <br> to any Partner |
| Interest on Drawings | No interest on Drawings is to be <br> charged from any partner |
| Salary or Commission to a Partner | Not allowed |
| Interest on loan by a Partner | Interest is allowed @ 6\% per annum. |

Rules applicable in the absence of partnership deed.


## Points to Remember

- Interest on capital is to be calculated on opening capital
- Provisions of Indian Partnership Act 1932: In the absence of Partnership deed -

Interest on Loan @ 6\% p.a. to be given to partner.
Profit sharing Ratio: Equal ratio

- Two circumstances in which fixed capital may change:
a) Items in debit side of Capital Account under

Fixed Capital Account:
Capital Withdrawal: To Bank A/C
Closing Balance: To Balance c/d
b) Items on credit side of capital Account under

Fixed Capital Account:
Opening Balance: By Balance b/d
Additional Capital: By Bank A/C

- Mutual agency: agency relationship refers to the relation between person who have agreed to share profit of a business carried on by all or any of them acting for all.
- Objectives of preparation of Profit and Loss Appropriation A/c: Distribution of profit among Partners.
- Reasons for preparing partnership deed-
- To provide clarity of partnership rules
- To settle disputes
- For smooth functioning and obtaining stability
- A partner can be exempted from sharing the losses of the firm only if the partnership deed provides for.
- Interest on capital can be treated as an appropriation or charge against profit, as mentioned in the deed.


## Distribution of Profits among Partners

A Profit and Loss Appropriation Account is prepared to show the distribution of profits among partners as per the provision of Partnership Deed (or as per the provision of Indian Partnership Act, 1932 in the absence of Partnership Deed). It is an extension of Profit and Loss Account. It is a nominal account.
The Journal Entries regarding Profit and Loss Appropriation Account are as follows

| Date | Particulars | L.F | Debit ${ }^{\text { }}$ | Credití |
| :---: | :---: | :---: | :---: | :---: |
| 1. | For transfer of balance of Profit and Loss Account: <br> Profit and Loss A/c Dr. <br> To Profit and Loss Appropriation A/c <br> (Being net profit transferred to P\&L <br> Appropriation A/c) |  |  |  |
| 2. | For Interest on Capital: <br> (a)For allowing Interest on Capital Interest on Capital A/c <br> To Partners Capital/Current A/cs <br> (Being interest on Capital allowed @ \% p.a.) |  |  |  |
|  | (b) For transferring Interest on Capital to Profit and Loss Appropriation A/C <br> Profit and Loss Appropriation A/c <br> To interest on Capital A/c <br> (Being Interest on Capital transferred to P\&L Appropriation A/c) |  |  |  |
|  | For Salary or Commission payable to a Partner: <br> (a) For allowing Salary or Commission to a partner- <br> Partner's Salary or Commission A/c Dr. <br> To Partner's Capital/Current A/c's <br> (Being Salary/ Commission payable to partner) |  |  |  |
| 3. | (b) For transferring Partner's  <br> salary/Commission A/C to Profit and Loss  <br> Appropriation A/c   <br> Profit and Loss Appropriation A/c Dr.  <br> To Partner's Salary/Commission A/c   |  |  |  |
| 4. | For transfer of Reserves: <br> Profit and Loss Appropriation A/c <br> To Reserve A/c <br> (Being reserve created) |  |  |  |


|  | For Interest on Drawings: <br> (a) For charging interest on partner's drawings <br> 5. <br> Partner's Capital/Current A/c Dr. <br> To interest on Drawings A/c <br> (Being interest on drawings changed @o p.a.) |  |  |
| :---: | :--- | :--- | :--- |
| 6. <br> (b) For transferring interest on drawings to <br> Profit and Loss Appropriation A/c: <br> Interest on Drawings A/c <br> To Profit and Loss Appropriation A/c Dr. <br> (Being interest on drawings transferred to P\&L <br> Appropriation A/c) |  |  |  |
|  | For transfer of profit (Credit balance of profit <br> and loss appropriation account) to partners <br> Profit and Loss Appropriation A/c <br> To Partner's Capital/Current A/cs <br> (Being profits distributed among partners in profit <br> sharing ratio) |  |  |

## SPECIMEN OF PROFIT AND LOSS APPROPRIATION ACCOUNT

## Profit and Loss Appropriation Account

 For the year ending on $\qquad$Dr.

| Particulars | ₹ | Particulars | ₹ |
| :--- | :--- | :--- | :--- |
| To Interest on Capital : |  | By Profit and Loss A/c |  |
| A |  | (Net Profits transferred |  |
| B |  | from P \& L A/c) |  |
| To Partner's Salary/ |  | By Interest on Drawings : |  |
| Commission |  | A |  |
| To Reserves |  | B |  |
| To Profits transferred to |  |  |  |
| Capital A/cs of : |  |  |  |
| A |  |  |  |
| B |  |  |  |

Illustration 1 : Radha and Raman are partners in a firm sharing profits and losses in the ratio of $5: 2$. Capital contributed by them is ₹ 50,000 and ₹ 20,000 . Radha was given salary of ₹ 10,000 and Raman ₹ 7,000 per annum. Radha advanced a

Ioan of ₹ 20,000 to firm without any agreement to rate of interest in deed while in deed rate of interest on capital was mentioned as 6\% p.a. Profits for the year are ₹ 29,400. Prepare Profit and Loss Appropriation Account for the year ending 31st March 2016.

Profit and Loss Appropriation Account
For the year ending on 31.03.2016

| Particular | ₹ | Particular | ₹ |
| :---: | :---: | :---: | :---: |
| To Interest on Capital |  | By Profit \& Loss A/c |  |
| Radha 3,000 |  | (Net Profit) 29,400 |  |
| Raman 1,200 | 4,200 | Less : Interest |  |
| To Partner's Salary |  | On Radha's loan 1,200 | 28,200 |
| Radha 10,000 |  |  |  |
| Raman $\quad 7,000$ | 17,000 |  |  |
| To profit transferred to Capital A/cs of |  |  |  |
| Radha 5,000 |  |  |  |
| Raman $\quad \underline{\text { 2,000 }}$ | 7,000 |  |  |
|  | 28,200 |  | 28,200 |

## When appropriation are more than available profits

In such case available profits are distributed in the ratio of appropriation.
Illustration 2: Ram and Shyam are partners sharing profits and losses in ratio of 3:2. Ram being non-working partner contributes ₹ $20,00,000$ as his capital \& Shyam being a working party, gets a salary of ₹ 8000 per month. As per partnership deed interest on Capital is paid @ 8\% p.a. \& salary is allowed. Profits before providing that for year ending 31st March 2015 were ₹ 80,000 . Show the distribution of profits.

Profit\& Loss Appropriation Account for the year ended 31.3.15
Dr.
Cr.

| Particulars | ₹ | Particulars | ₹ |
| :---: | :---: | :---: | :---: |
| To Ram's Capital A/c (Interest) <br> To Shyam's Capital A/c (Salary) | 50,000 | By Profit \& Loss A/c (Net Profits) | 80,000 |
|  | 30,000 |  |  |
|  | 80,000 |  | 80,000 |

Working Notes: Interest on capital $=20,00,000 \times \frac{8}{100}=$ ₹ $1,60,000$
Salary $=8000 \times 12=₹ 96,000$

Total
$2,56,000$
This is more than available profits.
Ratio of Interest \& Salary $=1,600,000: 96,000=5: 3$
Profits share given to Ram $=\frac{5}{8} \times 80,000=₹ 50,000$

$$
\text { Shyam }=\frac{3}{8} \times 80,000==₹ 30,000
$$

## Partner's Capital Account

Partner's Capital Account: It is an account which represents the partner's interest in the business.

In case of partnership business, a separate capital account is maintained for each partner. The capital accounts of partners may be maintained by any of the following two methods.

1. Fixed Capital Accounts
2. Fluctuating Capital Accounts

## 1. Fixed Capital Accounts

Under this method the following two accounts are maintained:

## (1) Capital Account

This account will always show a credit balance. Balance of Capital account remains fixed and only the following two transactions are recorded in the Fixed Capital Accounts:

- Additional Capital Introduced
- Capital Withdrawn or Drawings out of Capital only


## Partner's Capital A/c

Dr.
Cr.

| Particulars | $\mathbf{X}$ (₹) | $\mathbf{Y}$ (₹) | Particulars | $\mathbf{X}$ (₹) | $\mathbf{Y}$ (₹) |
| :--- | :--- | :--- | :--- | :--- | :--- |
| To Cash/Bank A/c |  |  | By Balance b/d <br> (Opening Cr. <br> (Capital Withdrawn) |  |  |
| To Balance c/d  <br> (Closing balance)  <br> Balance)  <br> By Cash/Bank A/c  <br> Additional Capital  <br> Introduced  |  |  |  |  |  |
|  |  |  |  |  |  |

## (1) Current Account

The Current account may show a debit or credit balance. All the usual adjustments such as Interest on Capital, partner's salary/commission, drawings (out of profits), interest on drawings and share in profits or losses etc. are recorded in this account.

## Partner's Current A/cs

## Dr. <br> Cr.

| Particulars | X ( ${ }^{\text {( }}$ ) | Y ( F ) | Particulars | X (₹) | Y ( ${ }^{\text {( }}$ ) |
| :---: | :---: | :---: | :---: | :---: | :---: |
| To Balance b/d <br> (Opening Dr. <br> Balance) <br> To Drawings <br> (out of Profits) <br> To Interest on <br> Drawings <br> To Profit and Loss A/c <br> (Share in losses) <br> To Balance c/d <br> (Closing credit Balance) |  |  | By Balance b/d <br> (Opening Cr. <br> Balance) <br> By Interest on Capital <br> By Partner's Salary or Commission <br> By Profit and Loss <br> Appropriation A/c <br> (Share in Profits) <br> By Balance c/d <br> (Closing Dr. <br> Balance) |  |  |

## Note:

1. Debit balance of Current Account is shown in Assets side of Balance Sheet.
2. Credit balance of Current Account is shown in Liabilities side of Balance Sheet.
3. Balance of Fixed Capital Accounts are always shown in Liabilities side of Balance Sheet.

## 3. Fluctuating Capital Accounts

In this method only one account i.e., Capital Account of each and every partner is prepared and all the adjustments, such as interest on capital, interest on drawings etc. are recorded in this account under this method, Capital account may show a
debit or credit balance and the balance of this account changes frequently. Therefore, it is called fluctuating Capital Account.

Partners' Capital Accounts

| Dr. |  |  |  |  | Cr. |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Particulars | X ( ${ }^{\text {) }}$ | Y ( F ) | Particulars | X ( F ) | Y (₹) |
| To Balance b/d (Opening Dr. Balance) To Cash/Bank A/c (Capital Withdrawn) To Drawings (out of profits) To Interest on Drawings To Profit and Loss A/c (Share in losses) To Balance c/d (Closing credit Balance) |  |  | By Balance b/d (Opening Cr. Balance) <br> By Cash/Bank A/c <br> (Additional Capital Introduced) <br> By Interest on Capital <br> By Partner's Salary <br> or <br> Commission <br> By Profit and Loss |  |  |
|  |  |  | (Share in Profits) <br> By Balance c/d <br> (Closing Dr. Balance) |  |  |

Illustration 3 : Amit and Sumit commenced business as partners on 01.04.2014. Amit contributed $₹ 40,000$ and Sumit $₹ 25,000$ as their share of capital. The partners decided to share their profits in the ratio of $2: 1$. Amit was entitled to salary of ₹ 6,000 p.a. Interest on capital was to be provided @ 6\% p.a. The drawings of ₹ 4,000 was made by Amit and ₹ 8,000 was made by Sumit. The profits after providing salary and interest on capital were ₹ 12,000 .

Draw up the capital accounts of the partners

1. When capitals are fluctuating
2. When capitals are Fixed

Solution:

1. When capitals are fluctuating

## Capital Accounts of Amit and Sumit

Dr.
Cr.

2. When capitals are Fixed

## Capital Accounts

Dr.
Cr.

| Particulars | Amit <br> $₹$ | Sumit <br> $₹$ | Particulars | Amit <br> $₹$ | Sumit <br> $₹$ |
| :---: | :---: | :---: | :--- | :--- | :---: |
| To Balance c/d | 40,000 | 25,000 | By Bank A/c <br> (Capital) | 40,000 | 25,000 |
|  | $\mathbf{4 0 , 0 0 0}$ | $\mathbf{2 5 , 0 0 0}$ |  | $\mathbf{4 0 , 0 0 0}$ | $\mathbf{2 5 , 0 0 0}$ |

## Current Accounts

Dr.
Cr.

| Particulars | Amit ₹ | Sumit ₹ | Particulars | Amit ₹ | Sumit ₹ |
| :---: | :---: | :---: | :---: | :---: | :---: |
| To Drawing A/c | 4,000 | 8,000 | By Salary A/c | 6,000 |  |
| To Balance c/d | 12,400 |  | By Interest on capital A/c <br> By Profit and Loss Appropriation A/c <br> To Balance c/d <br> (Closing Balance) | 2,400 | 1,500 |
|  |  |  |  | 8,000 | 4,000 |
|  |  |  |  | - | 2,500 |
|  | 16,400 | 8,000 |  | 16,400 | 8,000 |

Working Notes: Profits after salary and interest ₹ 12,000
Amit share $=2 / 3 \times 12,000=8,000$
Sumit share $=1 / 3 \times 12,000=4,000$

Difference between Fixed Capital Account \& Fluctuating Capital Account:

| Basis | Fixed Capital Account | Fluctuating Capital Account |
| :--- | :--- | :--- | :--- |
| 1. No. of | Two accounts for each | Only one account is |
| Accounts |  |  |
| maintained | partner are maintained. <br> Capital Account \& current <br> Account. | maintained for each <br> partner, i.e., capital <br> Account. |
| 2. Balance <br> change | Balance does not change <br> except under specific <br> circumstances (introduction <br> of additional capital and <br> capital withdrawn) | \begin{tabular}{l}
\end{tabular} |
| frequently from period to |  |  |
| period. |  |  |


| 3. Adjustments | All adjustments for drawing, <br> interest on drawing, interest <br> on capital, salary, <br> commission and profit/loss <br> are made in current account. | All adjustments for <br> drawings, interest on <br> drawing \& capital, salary, <br> profit/loss are made in <br> Capital Accounts. |
| :--- | :--- | :--- |
| 4. Balance | Capital Account always have <br> credit balances However, |  |
| Fluctuating Capital Account <br> current account may have have debit or credit <br> debit or credit balance. | balance. |  |

## INTEREST ON CAPITAL

Interest on partners' capital will be allowed only when it has been specifically mentioned in the partnership deed. Interest on Capital can be treated as either:
a. An Appropriation of profit; or
b. A charge against profit.
A. Interest on Capital : An Appropriation of Profits :

| In case of Losses | Interest on Capital is NOT ALLOWED |
| :--- | :--- |
| In cases of Sufficient Profits | Interest on Capital is ALLOWED IN <br> FULL |
| In case of Insufficient Profits | Interest on Capital is allowed only to the <br> extent of profits in the ratio of interest on <br> capital of each partner. |

## B. Interest on Capital : As a Charge against Profits :

Interest on Capital is always allowed in full irrespective of amount of profits or losses.

Illustration 4 : X and Y invested ₹ 20,000 \& ₹ 10,000 . Interest on capital is allowed @ 6\% per annum. Profits are shared in ratio of 2:3. Profits for year ending 31.3.15 is ₹ 1,500 . Show allocation of profits when partnership deed.
(a) Allows interest on capital \& deed is silent on treating interest as charge
(b) Interest is charge against profit.

## Solution :

(a) When partnership deed is silent on treating interest as a charge.

Profit \& Loss Appropriation Account for the year ending 31.3.15
Dr.
Cr.

| Particulars |  | ₹ | Particulars | ₹ |
| :--- | ---: | ---: | :--- | :---: |
| To Interest on Capital |  |  | By Profit \& Loss A/c | 1,500 |
| X | 1000 |  | (Net Profits) |  |
| Y | 500 | 1,500 |  |  |
|  |  | 1500 |  | 1500 |

Working Notes : Interest on X's Capital $=20,000 \times \frac{6}{100}=1200$
Y's Capital $=10,000 \times \frac{6}{100}=600$
Total Interest $=1800$

$$
\text { Ratio of Interest }=1200: 600=2: 1
$$

Interest allowed to partner $=$ Profit $\times \frac{\text { interest to be given to partner }}{\text { Total Interest }}$

Interest to $X=1500 \times \frac{1200}{1800}=₹ 1000$

Interest allowed to $y=1500 \times \frac{600}{1800}=₹ 500$
(b) Interest is charge against profit - In such case full interest will be given \& loss is transferred to partner's capital accounts, in their profit sharing ratio.

Profit \& Loss Appropriation is not prepared in this case instead Profit \& Loss Account is prepared \& deficit is treated as loss.

| Date | Particulars | L.F | Debit <br> ₹ | Credit <br> $₹$ |
| :--- | :--- | :---: | :---: | :---: |
|  | (a) In case of sufficient profits: <br> Profit and Loss A/c <br> To interest on Capital A/c <br> (Being interest capital transferred to P\&L A/c) |  |  |  |
|  | (b) In case of insufficient Profits or Losses: <br> Profit and Loss/ Profit and Loss Adjustment A/c Dr. <br> To interest on Capital A/c <br> (Being interest on capital transferred to P\&L <br> Adjustment A/c) |  |  |  |

Profit \& Loss Account
For the year ending on 31.3.2013
Dr
Cr.

| Particulars | ₹ | Particulars | ₹ |
| :---: | :---: | :---: | :---: |
| To Interest on Capital  <br> $X$ 1200 <br> $Y$ 600 | 1800 | By Profit before Interest By Loss transferred to Capital A/cs | $\begin{array}{r} 1,500 \\ 300 \end{array}$ |
|  | 1800 |  | 1800 |

## Note:

## Interest on Capital is always calculated on the OPENING CAPITAL.

If Opening Capital is not given in the question, it should be ascertained as follows:
Opening Capital $=$ Capital at the end + Drawing + Interest on Drawing + Losses during the year - Additional capital - profits during the year

| Particulars |  | ( $)^{\text {) }}$ |
| :---: | :---: | :---: |
| Capital at the End |  |  |
| Add:1. Drawing | xxxxxx |  |
| 2.Interest on Drawings | xxxxxx |  |
| 3.Losses during the year | $\underline{x x x x x x}$ | XXXX |
| Less: 1. Additional Capital Introduced | ( $\mathrm{x} x \mathrm{x} x \mathrm{xxx}$ ) | (XXX) |
| 2.Profits during the year | (xxxxxx) |  |
| Opening Capital |  | (.....................) |

Illustration 5 : $A$ and $B$ are partners in business. Their capitals at the end of year were ₹ 48,000 \& ₹ 36,000 respectively. During the year ended March 31st 2015 A's Drawings and B's drawings were ₹ 8,000 \& ₹ 12,000 respectively. Profits before charging interest on capital during the year were ₹ 32,000 . Calculate Interest on partners' capitals @ 10\% p.a.

## Solution

## Statement showing calculation of opening capitals

| Particulars | A (₹) | B (₹) |
| :--- | ---: | ---: |
| Closing Capital | 48,000 | 36,000 |
| Add : Drawings already credited | 8000 | 12,000 |
|  | 56,000 | 48,000 |
| Less : Profits already credited | 16,000 | 16,000 |
| Opening capitals or capitals in the beginning | 40,000 | 32,000 |
| Interest on Capital @ 10\% p.a. | 4,000 | 3,200 |
|  |  |  |

For additional capital interest is calculated for period for which capital is utilized e.g. if additional capital is introduced on 1 April in firm where accounts are closed on 31st December.

Interest $=$ Amount introduced $\times \frac{\text { Rate }}{100} \times \frac{9}{12}$
As money is utilized for 9 months

## INTEREST ON DRAWINGS

Interest on drawings is charged by the firm only when it is clearly mentioned in Partnership Deed. It is calculated with reference to the time period for which the money was withdrawn.

## Case 1: When Rate of Interest on Drawings is given in \%

Interest on Drawings is calculated with a flat rate irrespective of date of drawing.

## Case 2 : When Rate of Interest on Drawings is given in \% p.a.

## 1. When date of Drawings is not given

Interest on Drawing $=$ Total Drawings $\times \frac{\text { Rate }}{100} \times \frac{6}{12}$
Note : Interest is calculated for a period of 6 months

## 2. When date of Drawings is given

Interest on Drawing =
Total Drawings $\times \frac{\text { Rate }}{100} \times \frac{\text { Time left after drawings(in months) }}{12}$
Case 3 : When different amount are withdrawn on different date :
We have the following two methods to calculate the amount of Interest on Drawing:

## 1. Simple Interest Method

In this method, interest on drawing is calculated for each amount of drawing individually on the basis of periods for which it remained withdrawn.

## 2. Product Method

In this method, the amounts of drawings are multiplied by the period for which it remained withdrawn during the period; Interest for 1 month is calculated on the sum of these products.

We can explain the above mentioned two methods with the help of an example.

Example 6 : Aarushi and Simran are partners in a firm. During the year ended on 31st March, 2015 Aarushi makes the drawings as under:

| Date of Drawing | Amount (₹) |
| :---: | ---: |
| $01-08-2014$ | 5,000 |
| $31-12-2014$ | 10,000 |
| $31-03-2015$ | 15,000 |

Partnership Deed provided that partners are to be charged interest on drawing @ $12 \%$ p.a. Calculate the interest chargeable to Aarushi Drawing by using Simple Interest Method and Product Method.

## Solution:

## 1. Simple Interest Method

| Date of <br> Withdrawal | Amount of <br> Drawings (₹) | Months till March <br> $\mathbf{3 1 , 2 0 1 5}$ | Interest <br> @ 12\% pm(₹) |
| :---: | :---: | :---: | :---: |
| 01.08 .2014 | 5,000 | 08 | 400 |
| 31.12 .2014 | 10,000 | 03 | 300 |
| 31.03 .2015 | 15,000 | 00 | 000 |
|  |  |  | 700 |

2. Product Method

| Date of <br> Withdrawal | Amount of <br> Drawings (₹) | Months for which <br> Amount has <br> Withdrawn till <br> December 31, 2014 | Product <br> (₹) |
| :---: | :---: | :---: | :---: |
| 01.08 .2014 | 5,000 | 08 | 40,000 |
| 31.12 .2014 | 10,000 | 03 | 30,000 |
| 31.03 .2015 | 15,000 | 00 | 00000 |
|  |  |  | 70,000 |

Interest on Drawing $=$ Total Product $\times \frac{\text { Rate }}{100} \times \frac{1}{12}$ (in months)

$$
=70,000 \times \frac{12}{100} \times \frac{1}{12}=₹ 700
$$

## Case 4 : When an equal amount is withdrawn regularly

Interest on Drawing can be calculated using either Product Method or Direct Method (i.e. Short Cut Method)

Direct Method will be used only if all the following three conditions are satisfied:
1.Amount should be same throughout the period
2.Date of Drawings should be same throughout the period
3.Drawings should be made regularly without any gap.
4.Interest on Drawing $=$ Total Drawings $\times \frac{\text { Rate }}{100} \times \frac{T}{12}$
$\mathrm{T}=$ Time (in months) for which interest is to be charged
$\mathrm{T}=\frac{\text { Time left after first drawing + Time left after last drawing }}{2}$

Value of T under Different circumstances will be as under:

|  | Monthly <br> Drawings for <br> $\mathbf{1 2}$ Months | Quarterly <br> Drawings for <br> $\mathbf{1 2}$ Months | Half yearly <br> Drawings for <br> $\mathbf{1 2}$ Months | Monthly <br> Drawings for <br> 06 Months <br> (last 6 <br> months) |
| :--- | :---: | :---: | :---: | :---: |
| When drawing <br> are made in <br> the Beginning <br> of each period | 6.5 | 7.5 | 9 | 3.5 |
| When drawing <br> are made in <br> the Middle of <br> each period | 6 | 6 | 6 | 3 |
| When drawing <br> are made in <br> the End of <br> each period | 5.5 | 4.5 | 3 | 2.5 |

Similarly, Interest can be calculated by following formulas Half Yearly Drawings for year when
(a) Drawings are made in the beginning of each period (half-year)

Interest on drawing $=$ Amount $\times \frac{\text { Rate }}{100} \times \frac{9}{12}$
(b) Drawings are made in the middle of each period (half year)

Interest on drawing $=$ Amount $\times \frac{\text { Rate }}{100} \times \frac{6}{12}$
(c) Drawings are made at the end of each period (half year)

Interest on drawing $=$ Amount $\times \frac{\text { Rate }}{100} \times \frac{3}{12}$

For monthly drawing for 6 months (Last 6 months)
(a) Drawings are made in the beginning of each month.

Interest $=$ Amount $\times \frac{\text { Rate }}{100} \times \frac{3.5}{12}$
(b) When drawings are made in the middle of each month.

Interest $=$ Amount $\times \frac{\text { Rate }}{100} \times \frac{3}{12}$
(c)Drawings are made at the end of each month.

Interest $=$ Amount $\times \frac{\text { Rate }}{100} \times \frac{2.5}{12}$

## Interest on Drawings

Example 7 : Calculate interest on drawings of Peeku @ 10\% p.a. in different cases if he withdraws ₹ 10,000. Case I - monthly, II-Quarterly, III-half yearly, IV- monthly for 6 months.

| Interest on Drawings $=$ Amount of annual drawing $\times$ Rate of interest $\times \frac{\text { Time }}{12}$ |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| $\text { Period } \rightarrow$ | Monthly drawing for 12 months | Quarterly drawing for 12 months | Half-Yearly drawing for 12 month | Monthly drawing for 6 months |
| Case |  |  |  |  |
| When drawing are made in the beginning of each period. | $\begin{aligned} & (10,000 \times 12) x \\ & \frac{10}{100} \times \frac{6.5}{12}=6500 \end{aligned}$ | $\begin{aligned} & (10,000 \times 4) \mathrm{x} \\ & \frac{10}{100} \times \frac{7.5}{12}=2500 \end{aligned}$ | $\begin{aligned} & (10,000 \times 2) x \\ & \frac{10}{100} \times \frac{9}{12}=1500 \end{aligned}$ | $\begin{aligned} & (10,000 \times 6) x \\ & \frac{10}{100} \times \frac{3.5}{12}=1750 \end{aligned}$ |
| When drawing are made in the middle of each period. | $\begin{aligned} & (10,000 \times 12) \times \\ & \frac{10}{100} \times \frac{6}{12}=6000 \end{aligned}$ | $\begin{aligned} & (10,000 \times 4) x \\ & \frac{10}{100} \times \frac{6}{12}=2000 \end{aligned}$ | $\begin{aligned} & (10,000 \times 2) x \\ & \frac{10}{100} x \frac{6}{12}=1000 \end{aligned}$ | $\begin{aligned} & (10,000 \times 6) x \\ & \frac{10}{100} x \frac{3}{12}=1500 \end{aligned}$ |
| When drawing are made in the end of each period | $\begin{aligned} & (10,000 \times 12) x \\ & \frac{10}{100} \times \frac{5.5}{12}=5500 \end{aligned}$ | $\begin{aligned} & (10,000 \times 4) x \\ & \frac{10}{100} \times \frac{4.5}{12}=1500 \end{aligned}$ | $\begin{aligned} & (10,000 \times 2) x \\ & \frac{10}{100} \times \frac{3}{12}=500 \end{aligned}$ | $\begin{aligned} & (10,000 \times 6) x \\ & \frac{10}{100} \times \frac{2.5}{12}=1250 \end{aligned}$ |

## INTEREST ON PARTNERS LOAN

It is a charge against profits. It is provided irrespective of profits or loss. It will also be provided in the absence of Partnership Deed @ 6\% per annum.

The following entries are passed to record the interest on partner's loan


## It is always DEBITED to Profit and Loss A/c <br> Rent paid to a partner is also a charge against profits and it will also be DEBITED to Profit and Loss A/c

Illustration 8 : A and B entered into partnership on 1st April, 2014 without any partnership deed. They introduced capitals of ₹ $5,00,000$ and ₹ $3,00,000$ respectively. On 31st October, 2014, A advanced ₹ $2,00,000$ by way of loan to the firm without any agreement as to interest.

The Profit and Loss Account for the year ended 31-03-2015 showed a profit of
₹ $4,30,000$ but the partners could not agree upon the amount of interest on Loan to be charged and the basis of division of profits. Pass a Journal Entry for the distribution of the Profits between the partners and prepare the Capital A/c of both the partners and Loan $A / C$ of ' $A$ '.

## Solution :

Profit and Loss Appropriation Account
For the year ending on 31st March, 2015


Partner's Capital A/c's

| Dr. |
| :--- |
| Date Particular A ₹ B ₹ Date Particular A ₹ B ₹ <br> 31.3 .2015 To <br> balance <br> c/d $7,12,500$ $5,12,500$ 1.4 .2014 By Bank A/c 500000 300000 <br>       By Profit and <br> Loss <br> appropriation <br> A/c $2,12,500$ |

Journal

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 31.03 .15 | Profit and Loss Appropriation A/C $\quad$ Dr. |  | $4,25,000$ |  |  |
|  | To A's Capital A/c |  |  |  | $2,12,500$ |
|  | To B's Capital A/c |  |  |  | $2,12,500$ |
|  | (Being profit distributed among <br> partners) | the |  |  |  |

## A's Loan A/c

Dr.
Cr.


Note: Interest on A's Loan =

$$
\begin{aligned}
& \text { Loan Amount } \times \frac{\text { Rate }}{100} \times \frac{\text { Time left after loan taken }}{12} \\
& =2,00,000 \times \frac{6}{100} \times \frac{05}{12}=₹ 5,000
\end{aligned}
$$

In absence of partnership deed no interest on capital will be allowed \& profits will be divided equally.

## PAST ADJUSTMENTS

If, after preparation of Final Accounts of firm, it is found that some errors or omission in accounts has occurred than such errors or omissions are rectified in the next year by passing an adjustment entry.

A statement is prepared to ascertain the net effect of such errors or omissions on partner's capital/current accounts in the following manner.

| Particulars | $\mathbf{A}(₹)$ | $\mathbf{B ~ ( ₹ ) ~}$ | $\mathbf{C}(₹)$ |
| :--- | :---: | :---: | :---: |
| A. Amount to be given credited |  |  |  |
| * Interest on Capital |  |  |  |
| (Not allowed or provided at a lower rate) |  |  |  |
| * Partner's Salary or Commission etc. |  |  |  |


| (Omitted to be recorded) <br> * Actual Profit <br> (To be distributed in correct ratio) |  |  |  |
| :--- | :--- | :--- | :--- |
| Total A |  |  |  |
| B. Amount already given to be taken now <br> debited <br> * Interest on Capital <br> (If given at a higher rate) <br> * Interest on Drawing <br> (If not changed) <br> * Profit already distributed in wrong ratio <br> (debited now) |  |  |  |
|  | Total B | +/- | +/- |
| Net Effect (A-B) | +/- |  |  |

> + Indicates Amount to be Credited to Partner's Capital Account - Indicate Amount to be Debited to Partner's Capital Account

Journal

| Date | Particulars | LF. | Debit(₹) | Credit(₹) |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
|  | Partners Capital A/c | Dr. |  |  |  |
|  | (Amount to be Debited) |  |  |  |  |
|  | To Partners' Capital A/c |  |  |  |  |
|  | (Amount to be Credited) |  |  |  |  |
|  | (Being adjustment entry passed) |  |  |  |  |

During Past Adjustment it is not compulsory that capital accounts of all partners are affected. More than one partners Capital Account may be debited or credited but amount of debit \& credit should be equal.
Illustration 9: Manoj Sahil and Dipankar are partners in a firm sharing profits and losses equally. The have omitted interest on Capital @ 10\% per annum for three
years ended on 31st March, 2015. Their fixed Capital on which interest was to be calculated throughout were:

| Manoj | ₹ $3,00,000$ |
| :--- | :--- |
| Sahil | ₹ $2,00,000$ |
| Dipankar | ₹ $1,00,000$ |

Give the necessary adjusting journal entry with working notes.

## Solution:

Books of Manoj, Sahil and Dipankar Journal

| Date | Particulars | LF. | Debit <br> $(₹)$ | Credit <br> $(₹)$ |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
| 31.3.2015 | Dipankar's Current A/c <br> To Manoj's Current A/c <br> (Bing adjustment entry passed) | Dr. |  | 30,000 | 30,000 |
|  |  |  |  |  |  |

## STATEMENT SHOWING ADJUSTMENT

| Particulars | Manoj (₹) | Sahil(₹) | Dipankar(₹) |  |
| :--- | ---: | ---: | ---: | ---: |
| A. Amount to be given (Credited) <br> Interest on Capital for 3 years | 90,000 | 60,000 | 30,000 |  |
|  | Total A | 90,000 | 60,000 | 30,000 |


| B. Amount already given to be taken back <br> now (Debited) : <br> Excess Profit taken back from the <br> partners distributed in their profit sharing <br> ratio <br> (₹ $90,000+60,000+30,000=1,80,000)$ | 60,000 | 60,000 | 60,000 |
| :--- | ---: | ---: | ---: |
| Total B | 60,000 | 60,000 | 60,000 |
| Net Effect (A-B) | 30,000 | Nil | 30,000 |
|  | Credit |  | Debit |

Illustration $10: A$ and $B$ are partners in a firm sharing profits and losses in the ratio of 3:2. The following was the Balance Sheet of the firm as on 31.3.2015.

## Balance Sheet

As on 31-3-2015

| Liabilities | ₹ | Assets | $₹$ |  |
| :--- | ---: | :---: | :--- | :---: |
| Capitals: |  |  | Sundry Assets | 80,000 |
| A | 60,000 |  |  |  |
| B | $\underline{20,000}$ | 80,000 |  |  |
|  |  | 80,000 |  | 80,000 |

The profits ₹ 30,000 for the year ended 31-03-2015 were divided between the partners without allowing interest on capital @ 12\% p.a. and salary to A ₹1,000 per month. During the year A withdrew ₹ 10,000 and B ₹ 20,000 .

Pass the necessary adjustment entry and show your working clearly.

## Solution

## Book of A and B

Journal

| Date | Particulars | LF. | Debit (₹) | $\operatorname{Credit(₹)}$ |
| :--- | :--- | ---: | ---: | ---: |
|  | B's Capital A/c  <br>  To A's Capital A/c <br> (Being interest on capital and salary to A not <br> Charged, now rectified)  <br> 5,280 5,280 |  |  |  |

## Working Notes :

1. Calculation of Opening Capital: As Closing Balance Sheet is given so before calculation of interest opening capital should be calculated.

| Particulars | A (₹) | B (₹) |
| :--- | ---: | ---: |
| Capital at the End | 60,000 | 20,000 |
| Add: Drawings | 10,000 | 20,000 |
| Less: Profits during the year | 70,000 | 40,000 |
| Opening Capital | $(18,000)$ | $(12,000)$ |
|  |  | 52,000 |

## 2. Calculation of Net Effect

STATEMENT SHOWING ADJUSTMENT

| Particulars | A (₹) | B (₹) |
| :---: | :---: | :---: |
| A. Amount to be given (Credited) Interest on Capital <br> (Not provided) <br> Salary to A <br> (Not provided) | 6,240 12,000 | 3,360 |
| Total A | 18,240 | 3.360 |
| B. Amount already given to be taken back now (Debited) : <br> Loss to the firm due to Interest on Capital and Salary A be debited to the partners in their profit sharing ratio $\text { (₹ } 18,240+3,360=21,600)$ | 12,960 | 8,640 |
| Total B <br> NET Effect (A-B) | 12,960 | 8,640 |
|  | 5,280 | 5,280 |
|  | Credit | Debit |

## When interest is less charged

Illustration 11: Ram, Shyam \& Mohan are partners in a firm sharing profits \& losses in the ratio of 2:1:2. Their fixed capitals were ₹ $3,00,000$, ₹ $1,00,000$ and ₹ $2,00,000$ respectively. Interest on capital for the year ending 31st March, 2015 was credited to them @ 9\% p.a. instead of $10 \%$ p.a. The profits for the year before charging interest was ₹ $2,50,000$. Prepare necessary adjustment entry.

## Solution:

Journal

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :--- | :--- | ---: | ---: | ---: | ---: |
| 31.3.12 | Shyam's Current A/c Dr. <br>  Mohan's Current A/c Dr. <br> To Ram's Current A/c  <br> (For Interest less charged on capital now <br> rectified)  | 400 |  |  |

## Working Notes :

Table Showing Adjustment

|  | Ram <br> (₹) | Shyam <br> (₹) | Mohan <br> (₹) | Total |
| :---: | :---: | :---: | :---: | :---: |
| Interest already credited @ 9\% <br> Interest that should have been credited @ 10\% | $\begin{aligned} & 27,000 \\ & 30,000 \end{aligned}$ | $\begin{aligned} & 9,000 \\ & 10,000 \end{aligned}$ | $\begin{aligned} & 18,000 \\ & 20,000 \end{aligned}$ | $\begin{aligned} & 54,000 \\ & 60,000 \end{aligned}$ |
| Partners less credited <br> Debit profits which were reduced | $\begin{aligned} & \hline 3,000 \\ & 2,400 \end{aligned}$ | $\begin{aligned} & 1,000 \\ & 1,200 \end{aligned}$ | $\begin{aligned} & \hline 2,000 \\ & 2,400 \end{aligned}$ | $\begin{aligned} & \hline 6,000 \\ & 6,000 \end{aligned}$ |
|  | $\begin{gathered} 600 \\ \mathrm{Cr} . \end{gathered}$ | $\begin{gathered} 200 \\ \text { Dr. } \end{gathered}$ | 400 | - |

## When interest has been charged at higher rate

Illustration 12 : A, B \& C are patterns in a firm sharing profits \& losses in ratio of $2: 3: 5$. Their fixed capitals were ₹ $15,00,000$, ₹ $30,00,000$ \& ₹ $60,00,000$ respectively.. For the year ended 31st March 2015, interest was credited @12\% instead of $10 \%$. Pass the necessary adjustment entry.

## Solution

Journal

| Date | Particulars | L.F. | Debit ( $₹$ ) | Credit ( $₹$ ) |  |
| :---: | :--- | :---: | ---: | ---: | ---: |
| 31.3.15 | C's Current A/c | Dr. |  | 15,000 |  |
|  | To A's Current A/c |  |  |  | 12,000 |
|  | To B's Current A/c |  |  | 3,000 |  |
|  | (For interest excessive charged now |  |  |  |  |
|  | rectified) |  |  |  |  |

Table Showing Adjustment

|  | A (₹) | B (₹) | C (₹) | Total |
| :---: | :---: | :---: | :---: | :---: |
| Interest already credited @ 12\% Interest that should have been credited @ 10\% | $\begin{aligned} & 1,80,000 \\ & 1,50,000 \end{aligned}$ | $\begin{aligned} & 3,60,000 \\ & 3,00,000 \end{aligned}$ | $\begin{aligned} & 7,20,000 \\ & 6,00,000 \end{aligned}$ | $\begin{aligned} & 12,60,000 \\ & 10,50,000 \end{aligned}$ |
| Partners over credited with <br> By recovering this interest profits will be increased by ₹ $2,10,000$ \& divided in 2:3:5 | $\begin{aligned} & 30,000 \\ & 42,000 \end{aligned}$ | $\begin{aligned} & 60,000 \\ & 63,000 \end{aligned}$ | $\begin{aligned} & 1,20,000 \\ & 1,05,000 \end{aligned}$ | $\begin{aligned} & 2,10,000 \\ & 2,10,000 \end{aligned}$ |
| Net Effect | $12,000$ Cr. | $\begin{array}{r} 3,000 \\ \mathrm{Cr} . \end{array}$ | $15,000$ Dr. | - |

## GUARANTEE OF PROFITS TO A PARTNER

Guarantee is an assurance given to the partner of the firm that at least a fixed amount shall be given to him/her irrespective of his/her actual share in profits of the firm. If actual share in profits is less than the guaranteed amount in that case the deficit amount shall be borne either by the firm or by any partner as the case may be.

Note: Guarantee to a partner is given for minimum share in profits. If the actual share in profits is more than the minimum guaranteed amount, then the actual profits will be allowed to the partner.

Case: 1. When guarantee is given by FIRM (i.e. by all the Partners of the firm)

1. If share in actual profits is less than the guaranteed amount, then. Guaranteed amount to a partner is written in Profit and Loss Appropriation A/c.
2. Remaining profits are distributed among the remaining partners in the remaining ratio.

Case 2 : When guarantee is given by a partner or partners to another partner.

1. Calculate the share in profits for the partner to whom guarantee is given.
2. If share in actual profits is more than the guaranteed amount, distribute the profit as per the profit and loss sharing ratio in usual manner.
3. If share in profits is less than the guaranteed amount, find the difference between the share in profits and the guaranteed amount and the difference known as Deficiency.

Deficiency is contributed by the partner or partners who have guaranteed in certain ratio and subtracted from his or their respective shares.

Illustration 13: $A$ and $B$ were partners in a firm sharing profits and losses in the ratio of $3: 2$. They admit $C$ for $1 / 6$ th share in profits and guaranteed that his share of profits will not be less than ₹ 25,000 . Total profits of the firm for the year ended $31^{\text {st }}$ March, 2015 were ₹ 90,000 . Calculate share of profits for each partner when:

1. Guarantee is given by firm.
2. Guarantee is given by A
3. Guarantee is given by $A$ and $B$ equally.

## Solution:

Case 1. When Guarantee is given by firm.
Profit and Loss Appropriation Account
For the year ending on 31st March, 2015
Dr. Cr.

| Particulars | (₹) | Particulars | (₹) |
| :---: | :---: | :---: | :---: |
| To A's Capital A/c |  | By Profit and Loss, A/c | 90,000 |
| (3/5 of ₹ 65,000 ) | 39,000 |  |  |
| To B's Capital A/c |  |  |  |
| (2/5 of ₹ 65,000 ) | 26,000 |  |  |
| To C's Capital A/c |  |  |  |
| (1/6 of ₹ 90,000 or | 25,000 |  |  |
| ₹25,000 whichever is more | 90,000 |  | 90,000 |

Case 2. When Guarantee is given by $\mathbf{A}$
Profit and Loss Appropriation Account
For the year ending on 31st March, 2015


Case 3. When Guarantee is given by $A$ and $B$ equally.
Profit and Loss Appropriation Account
For the year ending on 31st March, 2015
Dr. Cr.

| Particulars | (₹) | Particulars | (₹) |
| :---: | :---: | :---: | :---: |
| To A's Capital A/c <br> (3/6 of ₹90,000) $45,000$ |  | By Profit and Loss A/c (Net Profits) | 90,000 |
| Less : Deficiency Borne for C <br> ( $1 / 2$ of ₹ 10,000 ) $\quad \underline{5,000}$ | 40,000 |  |  |
| To B's Capital A/c (2/6 of ₹ 90,000 ) $\quad 30,000$ |  |  |  |
| Less : Deficiency Borne for C $(1 / 2 \text { of } ₹ 10,000) \quad \underline{5,000}$ |  |  |  |
| To C's Capital A/c <br> ( $1 / 6$ of ₹ 90,000 ) <br> 15,000 | 25,000 |  |  |
| Add : Deficiency |  |  |  |
| Recovered from A 5,000 |  |  |  |
| Deficiency |  |  |  |
| Recovered from B 5,000 | 25,000 |  |  |
|  | 90,000 |  | 90,000 |

## Evaluation Type Questions

Q. 1 Fill in the missing figures in the following Accounts-

Profit \& Loss A/c
For the year ended $31^{\text {st }}$ March 2016
Dr.

| Particulars | ₹ | Particulars | ₹ |
| :---: | :---: | :---: | :---: |
| To Manager's <br> Commission $10 \%$ of <br> (b)  <br> To Net profit transferred to P/L Appropriation A/C |  | By Profit for the year | (a) |
|  | 18,000 |  |  |
|  | (c) |  |  |
|  | (d) |  | (e) |

## Profit and Loss Appropriation A/c

For the year ended $31^{\text {st }}$ March 2016
Dr.
Cr.

| Particulars | $₹$ | Particulars | $₹$ |
| :--- | :---: | :--- | :---: |
| To Interest on cap @ p.a. |  | By Profit \& Loss A/c | $\underline{\text { (g) }}$ |
| X-40 000 |  |  |  |
| Y-50000 | (f) |  |  |
| To Profit transferred to Capital |  |  |  |
| A/c's |  |  |  |
| X- $\frac{4}{9}$ | (h) |  |  |
| Y- $\frac{5}{9} \quad \underline{40000}$ | (i) |  | (k) |

Answers:
(a) ₹ 180,000
(b) ₹ 180,000
(c) ₹ 162,000
(d) ₹ 180,000
(e) ₹ 180,000
(f) ₹ 90,000
(g) ₹ 162,000
(h) ₹ 32,000
(i) ₹ 72,000
(j) ₹ 162,000
(k) ₹ 162,000
Q. 2 Manya and Vanya are partners in a firm. Manya was to get a commission of $10 \%$ on the net profits before charging any commission. However, Vanya was to get a commission of $10 \%$ on the net profits after charging all commissions. Fill in the missing figures in the profit \& Loss Appropriation Account for the year ended 31 ${ }^{\text {st }}$ March 2016.

## Profit \& Loss Appropriation A/c

For the year ended $31^{\text {st }}$ March 2016
Dr.


## Answers:

(a) ₹ 110,000
(b) ₹ 110,000
(c) ₹ 10,000
(d) ₹ 44,500
(e) ₹ 44,500
(f) ₹ 89,000
(g) ₹ 110,000
(h) ₹ 110,000
Q. 3 A, B, and C entered into partnership on $1^{\text {st }}$ July 2014 to share profit and losses in the ratio of 2:2:1. A personally guaranteed that C's share of profit after charging interest on capital @ 10\% p.a. would not be less than ₹ 36000 p.a. the capital contributed by A- ₹ $2,00,000$; B- ₹ $1,00,000$; C- ₹ $1,00,000$. Profit for the year ended on $31^{\text {st }}$ March 2015 was ₹ $1,76,000$. Find missing figures in profit \& loss Appropriation A/c.

Profit \& Loss Appropriation A/c
For the year ended $31^{\text {st }}$ March 2016
Dr.
Cr.

| Particulars | $₹$ | Particulars | $₹$ |
| :---: | :---: | :---: | :---: |
| To Interest on Capital <br> A- (b) <br> B- (c) <br> C (d) <br> To profit transferred to capital account | (e) | By Profit \& Loss A/c ( Net Profit) | (a) |
|  |  |  |  |
|  |  |  |  |
|  |  |  |  |
|  |  |  |  |
| A- <br> (f) |  |  |  |
| B- (g) |  |  |  |
| C- 36000 |  |  |  |
|  | (h) |  |  |
|  | (i) |  | (i) |

Answers :
(a) ₹ 176000
(b) ₹15000
(c) ₹ 7500
(d) ₹ 7500
(e) ₹ 30,000
(f) ₹ 51600
(g) ₹ 58400
(h) ₹146000
(i) ₹176000
(j) ₹176000
Q. 4 Taxy and Maxy entered into partnership on $1^{\text {st }}$ April 2015. They do not have partnership deed. They contributed capitals of ₹ 400,000 and ₹ 500,000 respectively. On $1^{\text {st }}$ Oct. 2015 Taxy advanced a loan of ₹ 200,000 to the firm without any agreement as to interest. Books are closed on $31^{\text {st }}$ March every year. Fill the missing figures in the following accounts.

Profit \& Loss A/c
For the year ended $31^{\text {st }}$ March 2016

| Dr. |  |  | Cr. |
| :---: | :---: | :---: | :---: |
| Particulars | ₹ | Particulars | ₹ |
| To <br> (b) | (c) | By Net Profit | (a) |
| To Net Profit transferred to Profit Loss Appropriation | $150000$ |  |  |
|  | (d) |  | (e) |

Profit \& Loss Appropriation A/c
For the year ended $31^{\text {st }}$ March 2016

| Dr. |  |  |  |
| :---: | :---: | :---: | :---: |
| Particulars | $₹$ | Particulars | ₹ |
| To Profit transferred to Capital Account <br> Taxy- <br> -(g) <br> Maxy- <br> -(h) |  | By Profit and Loss A/c | (f) |
|  |  |  |  |
|  | (i) |  |  |
|  | (i) |  | (k) |

Partner's Capital Accounts
Dr.

| Particulars | Taxy ₹ | Maxy ₹ | Particulars | Taxy ₹ | Maxy ₹ |
| :---: | :---: | :---: | :---: | :---: | :---: |
| To Balance C/d | (l) | $\underline{(\mathbf{m})}$ | By Bank A/c | $\underline{(p)}$ | $\underline{(\mathbf{q})}$ |
|  |  |  | By Profit \& Loss <br> Appropriation A/c | $\underline{(\mathbf{r})}$ | $\underline{(\mathbf{s})}$ |
|  | $\underline{(\mathbf{n})}$ | $\underline{(\mathbf{0})}$ |  | $\underline{(\mathbf{u})}$ |  |

## Taxy's Loan A/c

Dr
Cr.

| Particulars | ₹ | Particulars |  |
| :---: | :---: | :---: | :---: |
| By Balance C/d | $\underline{\text { (v) }}$ | By $\quad \underline{(\mathbf{x})}$ | -- |
|  | By | (y) | -- |
|  | $\underline{(w)}$ |  | $\underline{(w)}$ |

Answers:
(a) ₹ 156000
(b)Taxy’s Loan A/c (int. loan) ₹6000
(c) ₹ 6000
(d) ₹ 156000
(e) ₹ 156000
(f) ₹ 150000
(g) ₹ 75000
(h) ₹ 75000
(i) ₹ 150000
(j) ₹ 150000
(k) ₹ $1,50,000$
(I) ₹ $4,75,000$
(m) ₹ $5,75,000$
(n) ₹ $4,75,000$
(O) ₹ $5,75,000$
(p) ₹ $4,00,000$
(q) ₹ $5,00,000$
(r) ₹ 75,000
(s) ₹ 75,000
(t) ₹ $4,75,000$
(u) ₹ $5,75,000$
(v) ₹ 2,06,000
(W) ₹ 2,06,000
(x) By Bank A/c ₹ 2,00,000
(y) Profit/Loss A/c (int. on loan) ₹ 6,000

## Practice Question

1. Reena and Anu were partners in a firm sharing profits in the ratio of 7.5 . Their respective fixed capitals were Reena ₹ 10,00,000 and Anu ₹ 7,00,000. The partnership deep provided for the following:
(i) Interest on capital @ 12\% p.a.
(ii) Reena's salary ₹ $6,000 /$ - per month and Anu's salary ₹ $60,000 /$ - per year.

The profit for the year ended $31^{\text {st }}$ March 2016 was ₹ $5,04,000 /$ - which was distributed equally without providing for the above. Pass an adjustment entry. What value is followed here?
2. Ajay and Sudha started a partnership firm on $1^{\text {st }}$ April 2015, without a partnership deed. They introduced capitals of ₹ $5,00,000$ and ` $3,00,000$ respectively. On $1^{\text {st }}$ November 2015 Ajay advanced ₹ $2,00,000$ by way of loan to the firm, without any agreement as to interest. Books are being closed on $31^{\text {st }}$ March every year. Fill the missing information in the following accounts.

Profit and Loss Account for the year ended 31 ${ }^{\text {st }}$ March 2016
Dr.

| Particulars | Amounts (₹) | Particulars | Amount (₹) |
| :--- | :---: | :--- | :---: |
| To | $\underline{(1)}$ | By Net Profit |  |
| To Profit Transferred <br> to Profit and Loss <br> Appropriation A/C | $4,25,000$ |  | (2) |

## Profit and Loss Appropriation Account

For the year ended 31st March 2016
Dr.

| Particulars | Amount (₹) | Particular | Amount (₹) |
| :--- | :---: | :--- | :---: |
| To Ajay's Capital A/c |  | By Profit \& Loss A/c | $\underline{(3)}$ |
| To Sudha's Capital A/c | $\underline{(4)}$ |  |  |
|  |  |  |  |

Partner's Capital Accounts

| Dr. |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Date | Particulars | $\begin{aligned} & \text { Ajay } \\ & \text { (₹) } \end{aligned}$ | $\begin{array}{\|l\|} \hline \begin{array}{l} \text { Sudha } \\ \text { (₹) } \end{array} \\ \hline \end{array}$ | Date | Particulars | $\begin{array}{\|l} \hline \begin{array}{l} \text { Ajay } \\ \text { ( } \mathrm{F}) \end{array} \\ \hline \end{array}$ | Sudha <br> (₹) |
| 31.3.16 | To Bal. C/d | (8) | -- | 1.4.15 | By Bank <br> By Profit and Loss <br> Appropriation A/c | -- | $\frac{(6)}{(7)}$ |
|  |  |  |  |  |  |  |  |

Ajay's Loan Account
Dr.
Cr.

| Dated | Particulars | Amount $(₹)$ | Dated | Particulars | Amount(₹) |
| :--- | :--- | :---: | :--- | :--- | :---: |
| 2016 <br> March | To Bal. C/d | (11) | 2015 | By | (9) |
|  |  |  | Nov 1 | By - | (7) |

Hints to Practice Question
Question 1:
(i) Prepare adjustment table showing all items as mentioned in partnership deed
(ii) Calculate net effect of adjustment

Journal

| Date | Particulars | L.F | Debit (₹) | Credit (₹) |
| :--- | :--- | :--- | :--- | :--- |
|  | Anu's current A/cTo Reema's current A/c <br> (Being wrong distribution of <br> profit and omission of interest <br> on capital and salary, now <br> adjusted) |  | 38,000 | 38,000 |

Value: Profits are shared equally
Question-2

1. 5,000
2. $4,30,000$
3. $4,25,000$
4. $4,25,000$
5. $A: 2,12,500 ; B: 2,12,500$
6. $A: 5,00,000 ; B: 3,00,000$
7. $A: 2,12,500$;

B: 2,12,500
8. A: $7,12,500$;

B: 5,12,500
9. 2,00,000
10. 5,000
11. $2,05,000$

## CHAPTER - 2

## GOODWILL NATURE AND VALUATION

## Points to Remember

- Normal profits are the profits calculated on the basis of expected rate of return. There are earned by other firm in the same industry.
- No. of years' purchase refers to the period, which the business expect that it will earn at least the average maintainable profits during coming periods.
- Need for valuation of goodwill arises when reconstitution of partnership takes place.
- Two important factors affecting goodwill of the firm are: Favourable location and efficiency of management.
- The firm that produces high value products or has stable demand will be able to earn more profit and more goodwill.

Goodwill places the organization at a good position due to which the organization is able to earn higher profits without any extra efforts. Goodwill cannot be seen and touched but felt. Therefore, goodwill is called an intangible asset.

Goodwill is divided into two categories.


I. Purchased Goodwill: Purchased goodwill means goodwill for which a consideration has been paid e.g. when business is purchased the excess of purchase consideration of its net assets i.e. (Assets - Liabilities) is the Purchased Goodwill

## Characteristics

(i) It arises on purchase of a business or brand.
(ii) Consideration is paid for it so recorded in books.
(iii) Shown in balance sheet as an asset.
(iv) It is amortised (depreciated).
(v) Value is a subjective judgement and ascertained by agreement of seller and purchaser.
II. Self-generated Goodwill also called as inherent goodwill. It is an internally generated goodwill which arises from a number of factors that a running business possesses due to which it helps to generate higher profits.

## Features

(i) It is generated internally over the years.
(ii) According to AS-26 it is intangible asset \& not recorded in books.
(iii) Value depends on subjective judgement of the valuer.

## Factors Affecting the Value of Goodwill

1. Efficient management
2. Quality of products
3. Location of business
4. Availability of raw materials
5. Favourable contracts

Need for Valuing Goodwill: Whenever the mutual rights of the partners changes then party which makes a sacrifice must be compensated. This basis of compensation is goodwill so we need to calculate goodwill.

Mutual rights change under following circumstances

1. When profit sharing ratio changes
2. On admission of a partner
3. On Retirement or death of a partner
4. When amalgamation of two firms takes place
5. When partnership firm is sold.

## Method of valuation of goodwill

1. Average profit method
2. Super profit method
3. Capitalization method

## Average Profit Method

The profit earned by a Firm during previous accounting periods on an average basis is called average profit. Goodwill is calculated on the basis of average profit due to future expectations of earning capacity of the firm.

Formula for calculation of goodwill
Goodwill = Average Profits $\times$ Number of years of purchase
Number of years of purchase means for how many years the firm will earn the same amount of profits.

Average Profits $\boldsymbol{=}$ Total Profits/Number of years

Illustration 1. (Average Profit Method) : Akansha, Chetna and Dipanshu are partners in a firm sharing profits and losses in the ratio of 3:2:1. They decide to take Jatin into partnership from January 1, 2015 for $1 / 5$ share in the future profits. For this purpose, goodwill is to be valued at 2 times the average annual profits of the previous four years. The average profits for the past four years were.

| Year | $(₹)$ |
| :---: | :---: |
| 2012 | 96,000 |
| 2013 | 60,600 |
| 2014 | 62,400 |
| 2015 | 84,400 |

Calculate the value of goodwill.

## Solution:

Formula
Average Profit $=$ Total Profits/No. of Years.
Goodwill $=$ Average Profit $\times$ Number of years purchase.

| Year | (₹) |
| :---: | :---: |
| 2012 | 96,000 |
| 2013 | 60,600 |
| 2014 | 62,400 |
| 2015 | 84,400 |

Average profit $=3,03,400 / 4=₹ 75,850$
Goodwill $=75,850 \times 2=₹ 151,700$
Weighted Average Profit Method: In this Method each year's profit is assigned a weight. The highest weight is attached to profit of most recent year. Each year profits are multiplied by assigned weights. Products are added and divided by total number of weights. Weighted average is multiplied by agreed Number of years of Purchase.

Weighted Average Profit: $=\frac{\text { Total product of profits }}{\text { Total of weights }}$

Goodwill $=$ Weighted Average Profit $\times$ No. of years of purchase .
Illustration 2: The profits of a firm for the last five years were :

| Year $\rightarrow$ | 2011 | 2012 | 2013 | 2014 | 2015 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Profits $(₹)$ | 43,000 | 50,000 | 52,000 | 65,000 | 85,000 |

Calculate the value of goodwill on the basis of two years of purchase of weighted average profits, the weights to be used are
2011-1, 2012-2, 2013-3, 2014-4 \& 2015-5

## Solution:

| Year | Profit (₹) | Weights | Weights <br> Profit $\times$ Weight |
| :---: | :---: | :---: | :---: |
| 2011 | 43,000 | 1 | 43,000 |
| 2012 | 50,000 | 2 | $1,00,000$ |
| 2013 | 52,000 | 3 | $1,56,000$ |
| 2014 | 65,000 | 4 | $2,60,000$ |
| 2015 | 85,000 | 5 | $4,25,000$ |
| Total |  | 15 | $9,84,000$ |

Weighted Average Profit $=\frac{\text { Total product of profits }}{\text { total of weights }}$

$$
=\frac{9,84,000}{15}=₹ 65,600
$$

Goodwill $=$ Weighted Average Profit $\times$ No. of years of purchase
₹ $65600 \times 2$ = ₹ $1,31,200$

## Super Profit Method

Super Profit are the excess of actual profit over normal profits. Where Normal profits are profits earned by similar business.

If a firm earns higher profit in comparison to normal profit (generally earned by other firms of same industry) then the difference is called Super Profit. Goodwill is calculated on the basis of Super profit due to future expectations of earning capacity of the firm.

> Goodwill is calculated by the formula Goodwill = Super Profit $\times$ Number of years of purchase
> Super profit = Average profit - Normal profit
> Normal Profit = Investment (Capital Employed) $\times \frac{\text { Normal Rate of Returm }}{100}$
> Capital Employed = Capital + Free Reserves - fictitious Assets (if any)

## OR

All Assets - (Goodwill, Fictitious assets and non-trade Investment) - Outsider's Liability

## Illustration 3 : (Super Profit Method)

A firm earned net profits during the last three years as :

| Year | $2012-13$ | $2013-14$ | $2014-15$ |
| :--- | :---: | :---: | :---: |
| Profit (₹) | 36,000 | 40,000 | 44,000 |

The capital investment of the firm is $₹ 1,20,000$. A fair return on the capital having regard to the risk involved is $10 \%$. Calculate the value of goodwill on the basis of three years purchase of the super profit for the last three years.

## Solution:

Average profit: $=\frac{36,000+40,000+44,000}{3}=40,000$
Normal profit $=\frac{\text { Capital Employeed } \times \text { Normal rate of return }}{100}$
Normal Profit $=\frac{1,20,000 \times 10}{100}=₹ 12,000$
Super profit = Average profit - Normal profit
$=₹ 40,000-12,000=₹ 28,000$
Goodwill $=$ Super profit $\times$ number of years purchased
$=₹ 28,000 \times 3=₹ 84,000$

## Capitalisation Method

(A) Capitalisation of Average Profit Method: In this method capitalised value of the firm is calculated on the basis of normal rate of return. Difference between the capitalized value and actual capital employed is called goodwill.

Capitalised value of the firm $=\frac{\text { Average profits } \times 100}{\text { Normal rate of return }}$
Net Assets/Capital employed = Total assets - Outside liabilities
Goodwill = Capitalized value - Capital Employed
Illustration 4 (Capitalisation Method): A earns ₹ $1,20,000$ as its annual profits, the rates of normal profit being $10 \%$. The assets of the firm amounted to ₹ $14,40,000$ and liabilities to $₹ 4,80,000$. Find out the value of goodwill by capitalisation method.

## Solution:

Capitalised value of the firm Average Profit $\times \frac{100}{\text { Normal Rate of Return }}$

|  | $=₹ \frac{1,20,000 \times 100}{100}=₹ 12,00,000$ |
| ---: | :--- |
| Capital employed | $=$ Total assets - liabilities |
|  | $₹ 14,40,000-4,80,000=₹ 9,60,000$ |

Goodwill $=$ Capitalised value - Capital Employed

$$
=₹ 12,00,000-9,60,000=₹ 2,40,000
$$

Illustration 5. (Average profit method) : A and $B$ are partners in a firm. They admit C into the firm. The goodwill for the purpose is to be calculated at 2 years purchase of the average normal profits of the last three years which were ₹10,000, ₹15,000 and ₹ 30,000 respectively. Second years' profit included profit on sale of Machinery ₹ 10,000 . Find the value of goodwill of the firm on C's Admission.

## Solution:

(1)Calculation of Average Profit:

| Year ended | $₹$ |
| :--- | ---: |
| 1st Year | 10,000 |
| 2nd Year (₹15,000-₹10,000) | 5,000 |
| 3rd Year | $\underline{30,000}$ |
| Total Profits | $\underline{45,000}$ |

$$
\begin{aligned}
& \text { Average profit }=\frac{\text { Total prof it }}{\text { No.of Years }}=\frac{45000}{3}=₹ 15,000 \\
& \text { Goodwill }=\text { Average profit } \times \text { No. of years of purchase } \\
& =₹ 15000 \times 2=₹ 30,000
\end{aligned}
$$

Illustration 6 (Super profit method) : The average net profits expected of a firm in future are ₹ 68,000 per year and capital invested in the business by the firm is ₹ $3,50,000$. The rate of interest expected from capital invested in this class of business is $12 \%$. The remuneration of the partners is estimated to be ₹ 8,000 for the year. You are required to find out the value of goodwill on the basis of two years' purchase of super profits.

## Solution

Average Profit $=$ Average Net Profit - Partner's remuneration
(i) Average profit $=$ ₹ $68,000-₹ 8,000=₹ 60,000$
(ii) $\quad$ Normal profit $=\frac{\text { Capital employed } \times \text { Normal rate of return }}{100}$

$$
=₹ 3,50,000 \times \frac{12}{100}=₹ 42,000
$$

(iii) Super Profit = Average profit - Normal profit

$$
\text { = ₹ } 60,000-₹ 42,000=₹ 18,000
$$

(iv) Value of goodwill $=$ Super profit $\times$ No. of years' purchase

$$
=₹ 18,000 \times 2=\quad ₹ 36,000
$$

Illustration 6 : (Super profit method) : On April 1st, 2014 an existing firm had assets of ₹ 75,000 including cash of ₹ 5,000 . The partners' capital accounts showed a balance of ₹ 60,000 and reserves constituted the rest. If the normal rate of return is $20 \%$ and the goodwill of the firm is valued at ₹ 24,000 at 4 years purchase of super profits, find the average profits of the firm.

## Solution:

## (1) Calculation of Normal Profit

$$
\begin{aligned}
& =\frac{\text { Capital Employed } \times \text { Normal Rate }}{100} \\
& =\frac{75,000 \times 20}{100}=₹ 15,000
\end{aligned}
$$

(2) Calculation of Super Profit:

Goodwill $=$ Super profit $\times$ No. of years' purchase
₹ $24,000=$ Super Profit $\times 4$
Super Profit $=\frac{24,000}{4}=₹ 6,000$
(3) Calculation of Average Profit:

Super Profit = Average Profit - Normal Profit
₹ $6,000=$ Average Profit - ₹ 15,000
Average Profit $=₹ 6,000+₹ 15,000=₹ 21,000$
(B) Capitalisation of super profit method: Under this method, goodwill is calculated by capitalising the super profit on the basis of Normal Rate of return.

$$
\text { Goodwill }=\text { Super Profit } \times \frac{100}{\text { Normal Rate of Return }}
$$

Illustration 7: M/s Aradhya having the assets of ₹ $10,00,000$ and Liabilities of ₹ $4,20,000$. The firm earns the annual profit of ₹ 90,000 . The rate of interest expected from the capital having regard to the risk involved is 15. Calculate the amount of Goodwill by Capitalisation of Super Profit method.

## Solution:

Super Profit $=$ Average/Actual Profits- Normal Profits
Actual Profits= ₹ 90,000

Normal profit=Capital Employed $\times \frac{\text { Normal Rate of Return }}{100}$
Capital Employed=Total Assets-Outsider's Liabilities

$$
\begin{aligned}
& =₹ 10,00,000-₹ 4,20,000 \\
& =₹ 5,80,000
\end{aligned}
$$

Normal Profit $=₹ 5,80,000 \times \frac{15}{100}$
= ₹ 87,000

Super Profit= ₹ 90,000-₹ 87,000
= ₹ 3,000

Goodwill $\quad=$ Super Profits $\times \frac{100}{\text { Normal Rate of Return }}$

$$
=₹ 3,000 \times \frac{100}{15}
$$

Ans. Goodwill = ₹ 20,000

## Evaluation Type Question

Q. 1 Goodwill of the firm is valued at ₹ $2,70,000$ at 3 years' purchase of super profit determine the missing figures or value.
Average profit $=\frac{640000}{4}$

$$
=160000
$$

Normal Profit $=₹ \underline{(a)} \times \frac{10}{100}$

$$
=₹(b)
$$

Super Profit = Average Profit- Normal Profit

$$
\begin{aligned}
& =160000-\underline{(c)} \\
& =₹ \underline{(d)}
\end{aligned}
$$

Goodwill = Super Profit X No. of years' purchase
Ans:
(a) ₹ 700000
(b) /
(c) ₹ 70000
(d) ₹ 90000

Ques. 2 A firm earned net profits during the last four years as

| Year | 2011 | 2012 | 2013 | 2014 |
| :--- | :--- | :--- | :--- | :--- |
| Profit (₹) | 18000 | 17000 | 22000 | 23000 |

The capital investment of the firm is ₹ 80000 . A fair rate of return on the capital having regard to the risk involved is $10 \%$. Determine missing figures if value of goodwill on the basis of three years' purchase of the average super profit for the last four years.

$$
\begin{aligned}
\text { Average Profit } & =\frac{?(\mathbf{a})}{4}=\underline{?(b)} \\
\text { Normal Profit } & =\underline{(c) ?} \times \frac{10}{100} \\
& =\underline{?(d)} \\
\text { Super Profit }= & \text { Average Profit }- \text { Normal Profit } \\
& =20000-\underline{?(\mathrm{e})} \\
& =12000
\end{aligned}
$$

Goodwill = Super Profit No. of years' purchase

$$
\begin{aligned}
& =?(\mathrm{f}) \times 3 \\
& =\underline{?(g)}
\end{aligned}
$$

Ans.
(a) ₹ 80000
(b) ₹ 20000
(c) ₹ 80000
(d) ₹ 8000
(e) ₹ 8000
(f) ₹ 12000
(g) ₹ 36000

Ques. 3 The profits of a firm for the last five years were as follows:

| Year at <br> (ended at <br> $31^{\text {st }}$ march) | 2012 | 2013 | 2014 | 2015 | 2016 |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Profit | 40,000 | 52,000 | 55,000 | 63,000 | 75,000 |

You are required to fill missing figures to calculate the value of goodwill on the basis of two years' purchase of weighted average profits. Weights are to be used in chronological order starting from one.

| Year (ended on <br> $\mathbf{3 1} \mathbf{s t}^{\text {march) }}$ | Profit | Weight | Product |
| :---: | ---: | :---: | ---: |
| 2012 | 86,000 | $?$ | 86,000 |
| 2013 | $1,00,000$ | $?$ | $?$ |
| 2014 | $1,00,000$ | 3 | $?$ |
| 2015 | $1,30,000$ | $?$ | $?, 20,000$ |
| 2016 | $1,70,000$ | $?$ | $?$ |
|  |  | $\mathbf{?}$ | $\boldsymbol{?}$ |

Weighted Average Profit $=\frac{?}{15}$
$=₹(?)$
Goodwill =? X 2
= ?
Ques. 4 A firm's average profit are ₹ 55000 . It includes an abnormal profit of ₹ 5000. Capital employed in the business is ₹ 300000 and normal rate of return is 10. Find out missing figures to calculate goodwill at 3 years' purchases of Super profit.

Average profit
$=55,000$
(+/-)? Abnormal profit
$=\underline{5,000}$
Actual Average profit

$$
=50,000
$$

Normal profits $=$ capital employed $\times \frac{\text { Normail Rate of Return }}{100}$

$$
\begin{aligned}
& =3,00,000 \times \frac{10}{100} \\
& =30,000
\end{aligned}
$$

$$
\begin{aligned}
\text { Super profit } & =\text { Actual Average profit- Normal profit } \\
& =50,000-30,000 \\
& =₹ 20,000
\end{aligned}
$$

$$
\begin{aligned}
\text { Goodwill } & =\text { Super profit } X \text { No. of years' purchase } \\
& =20,000 \times 3 \\
& =₹ 60,000
\end{aligned}
$$

Ques. 5 Samy and Hunny are partner in a firm. Their capitals were: ₹ 600000. Samy; ₹ 4,00,000 Hanny. During the year ended $31^{\text {st }}$ March 2016, the firm earned a profit of ₹ $2,25,000$. Find missing values to calculate goodwill amount of average profit assuming that the normal rate of return is $15 \%$.
Capitalised value of $=$ Average Profit $\times \frac{100}{\text { Normal Rate of Return }}$
$=? \times \frac{100}{15}=$ ?
Capital Employed $=?+\square$
= 10,00,000
Goodwill = Capitalised value of average profit - capital Employed
$=?-10,00,000$
= ?

## CHAPTER 3

## Reconstitution of Partnership

## Meaning of Reconstruction

Any change in agreement of partnership or profit sharing ratio is called reconstitution of partnership firm. In following circumstances, a partnership firm may be reconstituted:

1. Change in Profit Sharing Ratio
2. Admission of a partner
3. Retirement/Death of a partner.

Circumstances for Reconstitution/Reconstruction of Partnership

(iv)


Points to Remember

- Reconstitution can take place in the following circumstances:
> Change in profit sharing ratio among existing partners
> Admission of new partner
> Retirement of an existing partner
> Death of a partner
> Amalgamation of two partnership firms.
- Sacrificing Ratio: Ratio in which partners have agreed to sacrifice their share in profit in favour of other partners.
- Sacrificing Ratio is computed when
> Profit sharing ratio of existing partner change
> There is admission of new partner
- Gaining Ratio: One or more partners gain their profit share, it is called gaining ratio.
- Accumulated profit: Undistributed profits and reserves of the past period e.g. credit balance of Profit and Loss A/c, General Reserve, Reserve fund etc.
- Revaluation Account: This is a nominal account. It is prepared to revalue assets and reassess the liabilities at the time of reconstitution of the firm.
- If partners have agreed to record the net effect of revaluation of assets and reassessment of liabilities through their capital accounts, without affecting the valuation of assets and liabilities, a single adjustment entry is passed based on gain/sacrifice of partners.

Entry:


- Treatment of Goodwill issued by Institute of chartered Accountants of India According to AS-26, Goodwill should be recorded in the book of accounts, only when some consideration of money or money's worth has been paid for it.


## CHANGE IN PROFIT SHARING RATIO AMONG THE EXISTING PARTNERS

Meaning: A Change in profit sharing ratio means one or more partners acquire interest from another partner or partners. Here if share of profit of one or more partners increases then share of one or more partner decreases to same extent.

When all the partners of a firm agree to change their profit sharing ratio, the ratio may be changed.

New profit sharing ratio: The ratio in which the partners agree to share the profits in future on reconstitution is known as New profit sharing ratio.

Gaining Ratio: It is the ratio in which the profit sharing ratio of gaining partners increases. It is calculated by taking difference between New profit sharing ratio and old profit sharing ratio.

Sacrificing Ratio: It is the ratio in which the profit sharing ratio of sacrificing partner's decreases. It is calculated by taking difference between old profit sharing ratio and new profit sharing ratio.

## Accounting Treatment of Goodwill

In case of change in profit sharing ratio, the gaining partner must compensate the sacrificing partner by paying the proportionate amount of goodwill.

Illustration 1: Amit and Kajal were partners in a firm sharing profits in the ratio of 3:2. With effect from January 1, 2015 they agreed to share profits equally. For this purpose, the goodwill of the firm was valued at ₹ 60,000 . Pass the necessary journal entry.

## Solution

Old ratio of Amit and Kajal = 3:2
New ratio of Amit and Kajal = 1:1

## Sacrifice or Gain

Amit $=3 / 5-1 / 2=\frac{6}{10}-\frac{5}{10}=\frac{1}{10}$ (Sacrifice)
Kajal $=2 / 5-1 / 2=\frac{4}{10}-\frac{5}{10}=\frac{1}{10}$ (Gain)

| Date | Particulars | L.F. <br> 2015 Jan.1 <br> Kajal capital A/c $\left(60,000 \times \frac{1}{6}\right) \quad$ Dr. <br> $(₹)$ <br> To Amit's capital A/c $\left(60,000 \times \frac{1}{6}\right)$ <br> (Adjustment for goodwill on change in <br> profit sharing ratio) | Credit <br> $(₹)$ |
| :---: | :---: | :---: | :---: | :---: |
| ( |  | 6,000 | 6,000 |

## Accounting Treatment of Reserves and Accumulated Profits

## Case (i) when reserves and accumulated profits/losses are to be distributed

At the time of change in profit sharing ratio, if there are some reserves or accumulated profits/losses existing in the books of the firm, these should be distributed to partners in their old profit sharing ratio.

## Change in Profit Sharing Ratio



Find the differences and not down:
1.
2.
3.
4.
5.
6.

Answers of understanding are:

1) Changed constitution
2) Change in profit-sharing
3) Sacrifice (Ratio/share)
4) Gain (Ratio/share)
5) Old Ratio
6) New Ratio

## Journal



Illustration 2: Vaishali, Vinod and Anjali are partners sharing profits in the ratio of 4:3:2. From April 1, 2015; they decided to share the profits equally. On that date
their book their books showed a credit balance of ₹ $3,60,00$ in the profit and loss account and a balance of $₹ 90,000$ in the General reserve. Record the journal entry for distribution of these profits and reserves.

## Solution:

## Journal

| Date | Particulars | L.F. | Debit <br> (₹) | Credit <br> (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2011 | Profit \& Loss A/c Dr. |  | 3,60,000 |  |
| Apr. 1 | General Reserve A/c Dr. |  | 90,000 |  |
|  | To Vaishali's Capital A/c |  |  | 2,00,000 |
|  | To Vinod's Capital A/c |  |  | 1,50,000 |
|  | To Anjali's Capital A/c |  |  | 1,00,000 |
|  | (Profits and general reserve distributed in old ratio) |  |  |  |

Illustration 3 : Anjun and Kanchan are partner sharing profits and losses in the ration of 3:2, From April 1, 2015 they decided to share the profits in the ratio of 2:1.

On that date, profit and loss account showed a debit balance of ₹ $1,20,000$. Record the Journal for transferring this to partner's capital accounts.

## Solution:

## Journal

| Date | Particulars | L.F. | Debit <br> (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2011 | Anjun's capital A/c Dr. |  | 72,000 |  |
| Apr. 1 | Kanchan's capital A/c <br> To Profit and Loss A/c <br> (Undistributed losses transferred to partners' capital accounts in old ratio) |  | 48,000 | 1,20,000 |

## Case (ii) : When accumulated profits/losses are not be distributed at the time of change in ratio

Partners may decide that reserves and accumulated profits/losses will not affect and remains in the books with same figure. In this case, the gaining partner must compensate the sacrificing partner by the share gained by him i.e.,

Gaining Partner's Capital A/c
To Sacrificing Partner's Capital A/c

Illustration 4 : Keshav, Meenakshi and Mohit sharing profit and losses in the ratio of 1:2:2, decide to share future profit equally with effect from April 1, 2015. On that date general reserve showed a balance of ₹ $2,40,000$. Partners do not want to distribute the reserves. You are required to give the adjusting entry.

Solution : Keshav ;Meenakshi; Mohit

Old ratio 1/5: 2/5:2/5

New ratio $1 / 3: 1 / 3: 1 / 3$
Sacrifice or Gain :
Keshav $\quad=1 / 5-1 / 3=\frac{3}{15}-\frac{5}{15}=\frac{2}{15}$ (gain)
Meenakshi $=2 / 5-1 / 3=\frac{6}{15}-\frac{5}{15}=\frac{1}{15}$ (sacrifice)
Mohit $\quad=2 / 5-1 / 3=\frac{6}{15}-\frac{5}{15}=\frac{1}{15}$ (sacrifice)

Journal

| Date | Particulars | L.F. | Debit <br> $(₹)$ | Credit <br> $(₹)$ |
| :--- | :--- | :--- | :---: | :---: |
| 2011 <br> Apr. 1 | Keshav's capital A/c $\left(2,40,000 \times \frac{2}{15}\right) \quad$ Dr. |  | 32,000 |  |
| To Meenakshi capital A/c $\left(2,40,000 \times \frac{1}{15}\right)$ |  | 16,000 |  |  |
| To Mohit's capital A/c $\left(2,40,000 \times \frac{1}{15}\right)$ |  | 16,000 |  |  |
| Adjustment for General reserve on change in <br> profit sharing ratio) |  |  |  |  |

Illustration 5: Neha, Niharika, and Nitin are partners sharing profits and losses in the ratio of 2:3:4. They decided to change their ratio and their new ratio is 4:3:2. They also decided to pass a single journal entry to adjust the following without affecting their book values.

General Reserve 40,000
Advertisement Suspense A/c 30,000
You are required to give the single journal entry to adjust the above.
Solution:

| Profit \& Loss Account | 80,000 |
| :--- | ---: |
| Add : General Reserve | 40,000 |
|  |  |
| Less : Advertisement Suspense | $1,20,000$ |
| Total amount to be adjusted | 30,000 |

Neha

| Old ratio | $2 / 9$ | $3 / 9$ | $4 / 9$ |
| :--- | :--- | :--- | :--- |
| New ratio | $4 / 9$ | $3 / 9$ | $2 / 9$ |

Niharika
Nitin
4/9
2/9

Sacrifice or Gain
Neha $=2 / 9-4 / 9=2 / 9$ (Gain)
Niharika $=3 / 9-3 / 9=0$ (No change)
Nitin $=4 / 9-2 / 9=2 / 9$ (Sacrifice)
Sacrifice or Gain

Journal

| Date | Particulars | L.F. | Debit <br> $(₹)$ | Credit <br> $(₹)$ |
| :---: | :---: | :---: | :---: | :---: |
|  | Neha's capital A/c $\left(90,000 \times \frac{2}{9}\right)$ | Dr. |  | 20,000 |
|  | To Nitin's capital A/c $\left(90,000 \times \frac{2}{9}\right)$ |  | 20,000 |  |
|  | (Adjustment for Profit \& Loss A/c, General <br> Reserves and Advertisement Suspense A/c) |  |  |  |

## Accounting treatment for Revaluation of Assets and Reassessment of

 Liabilities on change in Profit sharing ratio:At the time of change in profit sharing ratio of existing partners, Assets and liabilities of a firm must be revalued because actual realizable value of assets and liabilities may different from their book values. Change in the assets and liabilities belongs to the period prior to change in profit sharing ratio and therefore it must be shared in old profit sharing ratio.

Revaluation of assets and liabilities may be treated in two ways:
(i) When revised values are to be shown in the books.
(ii) When revised values are not to be shown in the books.

## When revised values are to be shown in the books:

In this case revaluation of assets and liabilities is completed with the help of "Revaluation Account". This account is also known as "Profit and Loss Adjustment Account". All losses due to revaluation are shown in debit side of this account and all gains due to revaluation are shown in credit side of this account.

JOURNAL


## SPECIMEN/PROFORMA OF REVALUATION ACCOUNT

Revaluation Account

| Dr |  |  | r. |
| :---: | :---: | :---: | :---: |
| Particulars | (₹) | Particulars | (₹) |
| To Assets (individually) <br> Decrease in value <br> To Liabilities increase <br> on revaluation <br> To Unrecorded Liability <br> To profits transferred to partner's capital A/c |  | By Assets (individually) increase in value of Asset <br> By Liabilities (individually) <br> Decrease on revaluation <br> By Unrecorded asset <br> By Loss transferred to partners <br> Capital A/c (in old ratios) |  |

Illustration 6 Piyush, Puja and Praveen are partners sharing profits and losses in the ratio of 3:3:2. There balance sheet as on March 31st 2015 was as follows :

| Liabilities | (₹) | Assets | (₹) |  |
| :--- | ---: | ---: | :--- | ---: |
| Sundry creditors | 48,000 | Cash at bank | 74,000 |  |
| Bank Loan | 72,000 | Sundry debtors | 88,000 |  |
| Capital : |  | Stock | $2,40,000$ |  |
| Piyush | $4,00,000$ |  | Machinery | $3,18,000$ |
| Puja | $3,00,000$ |  | Building | $4,00,000$ |
| Praveen | $3,00,000$ | $10,00,000$ |  |  |
|  |  | $11,20,000$ |  | $11,20,000$ |

Partners decided that with effect from April 1, 2015, they would share profits and losses in the ratio of 4:3:2. It was agreed that:
(i) Stock be valued at ₹ $2,20,000$.
(ii) Machinery is to be depreciated by $10 \%$.
(iii) A provision for doubtful debts is to be made on debtors at 5\%.
(iv) Building is to be appreciated by $20 \%$.
(v) A liability for ₹ 5,000 included in sundry creditors is not likely to arise. Partners agreed that the revised value are to be recorded in the books. You are required to prepare journal, revaluation account, partner's capital Accounts and revised Balance Sheet.

Journal

| Date | Particulars | L.F. | Debit <br> (₹) | Credit <br> (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2015 <br> April <br> 1 | Revaluation A/c <br> To Stock <br> To Machinery <br> To Provision for doubtful debts A/c <br> (Revaluation of assets) |  | 56,200 | $\begin{array}{r} 20,000 \\ 31,800 \\ 4,400 \end{array}$ |
| April <br> 1 | Building A/c <br> Sundry creditor A/c <br> To Revaluation A/c <br> (Revaluation of assets and liabilities) |  | $\begin{array}{r} 80,000 \\ 5,000 \end{array}$ | 85,000 |
| April <br> 1 | Revaluation A/c <br> To Piyush's capital A/c <br> To Pooja's capital A/c <br> To Praveen's capital A/c <br> (Profit on revaluation) |  | 28,800 | $\begin{array}{r} 10,800 \\ 10,800 \\ 7,200 \end{array}$ |

## Revaluation Account

Dr
Cr.

| Liabilities | (₹) | Assets | (₹) |
| :--- | ---: | :--- | ---: |
| To Stock | 20,000 | By Building | 80,000 |
| To Machinery | 31,800 | By Sundry creditors | 5,000 |
| To Provision for doubtful debts | 4,400 |  |  |
| To profits transferred to capital |  |  |  |
| accounts of: |  |  |  |
| Piyush | 10,800 |  |  |
| Pooja | 10,800 |  |  |
| Praveen | $\underline{7,200}$ | 28,800 |  |
|  |  | 85,000 |  |

Partner's Capital A/cs

| Particulars | Piyush | Pooja | Praveen | Particulars | Piyush | Pooja | Praveen |
| :--- | :--- | :--- | :--- | :--- | :--- | :---: | :---: |
| To <br> balance <br> c/d | 410,800 | $3,10,800$ | $3,07,200$ | By bal. b/d <br> By <br> Revaluation <br> A/c | $4,00,000$ <br> 10,800 | $3,00,000$ | $3,00,000$ |
| 10,800 | 7,200 |  |  |  |  |  |  |
|  | $4,10,800$ | $3,10,800$ | $3,07,200$ |  | $4,10,800$ | $3,10,800$ | $3,07,200$ |

Balance Sheet
As on April 1, 2015

| Liabilities | (₹) | Assets | (₹) |
| :---: | :---: | :---: | :---: |
| Sundry creditors | 43,000 | Cash at bank | 74,000 |
| Bank Loan | 72,000 | Sundry debtors 88,000 |  |
| Capital account: |  | Less: provision 5\% 4,400 | 83,600 |
| Piyush 4,10,000 |  | Stock | 2,20,000 |
| Pooja 3,10,800 |  | Machinery | 2,86,200 |
| Praveen 3,07,200 |  | Build in 10,28,800 | 4,,80,00 |
|  | 11,43,800 |  | 11,43,800 |

## When revised values are not to be shown in the books.

Illustration 7: In Illustration 6, Partners agreed that the revised value of assets and liabilities are not to be shown in the books. You are required to record the effect by passing a single journal entry. Also prepare the revised Balance Sheet.

## Gain due to revaluation

| Building | Total A | 80,000 |
| :---: | :---: | :---: |
| Sundry creditors |  | 5,00 |
|  |  | 85,000 |
| Less: Loss due to revaluation |  | 20,000 |
| Stock |  | 31,800 |
| Machinery |  | 4,400 |
| Provision for doubtful debts | Total B |  |
|  |  | 56,200 |
| Not gain from revaluation | Total(A-B) | 28,800 |

Old Ratio $=3: 3: 2$
New Ratio = 4:3:2
Sacrifice or Gain
Piyush $\quad=3 / 8-4 / 9=-5 / 72$ (Gain)
Pooja $\quad=3 / 8-3 / 9=3 / 72$ (Sacrifice)
Praveen $\quad=2 / 8-2 / 9=2 / 72$ (Sacrifice)
Amount to be adjusted:
Piyush $=28,800 \times 5 / 72=₹ 2,000$ Debit
Pooja $=28,800 \times 3 / 72=₹ 1,200$ Credit
Praveen $=28,800 \times 2 / 72=₹ 800$ Credit

Journal

| Date | Particulars | L.F. | Debit <br> $(₹)$ | Credit <br> $(₹)$ |
| :--- | :--- | :---: | :---: | :---: | :---: |
| 2015 | Piyush's capital A/c <br> Apr. 1 <br> To Pooja's capital A/c <br> To Praveen's capital A/c <br> (Adjustment for profit on revaluation) |  | 2,000 | 1,200 |

## Capital Accounts

Dr. Cr.

| Particulars | Piyush | Pooja | Praveen | Particulars | Piyush | Pooja | Praveen |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| To Pooja's <br> To <br> Praveen <br> Capital A/c <br> To Balance <br> c/d | 1,200 | - | - | By Balance b/d <br> By Piyush's <br> Capital A/c | 4,00,000 | 3,00,000 | 3,00,000 |
|  | 800 |  |  |  |  | 1,200 | 800 |
|  | 3,98,000 |  |  |  |  |  |  |
|  |  | 3,01,200 | 3,09,800 |  |  |  |  |
|  | 4,00,000 | 3,01,200 | 3,00,800 |  | 4,00,000 | 3,01,200 | 3,00,800 |

Balance Sheet
As on April 1, 2005

## Balance Sheet of Piyush, Puja and Praveen

| Liabilities | $(₹)$ | Assets | $(₹)$ |
| :--- | :--- | :--- | ---: |
| Sundry creditors | 48,000 | Cash at bank | 74,000 |
| Bank Loan | 72,000 | Sundry debtors | 88,000 |
| Capital account: |  | Stock | $2,40,000$ |
| Piyush |  | Machinery | $3,18,200$ |
| Puja | $3,98,000$ |  | Build in 10,28,800 |

Note:
Golden rule of accounting treatment for any adjustment related to goodwill / reserves/ accumulated profit or losses among partners is:

| Date | Particulars | L.F. | Debit | Credit |
| :--- | :--- | :--- | :--- | :--- |
|  | Gaining Partners' capital/Current A/c Dr |  |  |  |
|  | To sacrificing partners' capital/current A/c <br> (Adjustment for Goodwill/ reserves A/c <br> Profit/ loss due to change in profit sharing) |  |  |  |

## Value based and Evaluation Type Question

Q. $1 \mathrm{X}, \mathrm{Y}$ and Z are partners sharing profits and losses in the ratio of 7:5:4.

From $1^{\text {st }}$ April 2016, they decided to share profits and losses in the ratio of 3:2:1. Complete journal entry.

| Date | Particulars | L.F | Debit (₹) | Credit (₹) |  |
| :--- | :--- | ---: | :--- | :---: | :---: |
|  | X's capital A/c | Dr |  | (a) |  |
| Y's capital Ac/ | Dr |  | (b) | 14400 |  |
| To Z's capital A/c <br> (For adjustment for goodwill due to <br> change in profit sharing ratio) |  |  |  |  |  |

Identify the violated value.
Q. 2 Annu and Bannu are partners in a firm sharing profit in the ratio of $3: 2$, with effect from $1^{\text {st }}$ April 2016, they agreed to share profits equally. Goodwill of the firm is valued at ₹ 24,000 . You are required to calculate missing figures and state value associated in given situation.

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2016 April 1 | Bannu's Capital A/c Dr |  | (a) |  |
|  | To Annu's Capital Ac/ |  |  | (b) |
|  | For (c) |  |  |  |

Q. $3 \quad \mathrm{P}, \mathrm{Q}$ and R partners in a firm sharing profits and losses in the ratio of $3: 3: 2$. Their Balance Sheet as at $31^{\text {st }}$ March 2016 was:

| Liabilities | $(₹)$ | Assets | $(₹)$ |
| :--- | ---: | :--- | ---: |
| Sundry Creditors | 24,000 | Cash at Bank | 27,000 |
| General Reserve | 36,000 | Sundry Debtors | 50,000 |
| Capital A/cs |  | Stock | $1,20,000$ |
| P- 2,00,000 |  | Machinery | $1,59,000$ |
| Q- 2,00,000 |  | Building | $2,00,000$ |
| R- 1,00,000 | $5,00,000$ | Advertisement | 4,000 |
|  |  | Expenditure |  |
|  |  |  | $5,60,000$ |

Partners decided that with effect from $1^{\text {st }}$ April, 2016, they would share profits and losses in the ratio of $4: 3: 2$. It was agreed that:
(i) Stock is to be valued at $₹ 1,1,000$.
(ii) Machinery is to be depreciated by $10 \%$.
(iii) A provision for doubtful debts is to be made on debtors @ 5\%.
(iv) Building to be appreciated by $20 \%$.
(v) A liability for ₹ 3000 included in Sundry Creditors are not likely to arise.

Partners agreed that revised values of assets and liabilities are to be recorded in the books. They decided to retain the General Reserve in the books. Find missing figures in Journal.

Journal

Q. 4 Amar, Akbar and Anthony are partners in a firm sharing profit \& Losses in the ratio of 4:2:1. Their Balance Sheet as at $31^{\text {st }}$ March 2016 stood as follows:

| Liabilities | $₹$ | Assets | ₹ |
| :--- | ---: | :--- | :---: |
| Sundry Creditors | 40,000 | Sundry Assets | $7,20,000$ |
| Reserves | $1,30,000$ |  |  |
| Profit \& Losses A/c | 50,000 |  |  |
| Capital A/cs |  |  |  |
| Amar- |  |  |  |
| $2,00,000$ |  |  |  |
| Akbar- | $2,00,000$ | $5,00,000$ |  |
| Anthony - | $1,00,000$ | $7,20,000$ |  |
|  |  |  |  |

From the $1^{\text {st }}$ April 2016, partners decided to change their profit sharing ratio to 5:3:2. For this purpose goodwill was valued at ₹ 100000. The partners do not want to record the goodwill and also not to distribute to reserves and surplus profit. You are required to find missing figures also state value highlighted in the given problem.
Journal

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2016 | To (e) (for adjustment for goodwill <br> reserves \& undistributed <br> profits due to change in profit <br> sharing ratio) |  |  | 20000 |
| April 1 | ( |  |  |  |

## Balance Sheet

As at $1^{\text {st }}$ April 2016

| Liabilities | ₹ | Assets | ₹ |
| :---: | :---: | :---: | :---: |
| Sundry Creditors | (f) | Sundry Assets | (g) |
| (h)----------- | 1,30,000 |  |  |
| Profit and Loss A/c | (i) |  |  |
| Amar (j) |  |  |  |
| Akbar (k) |  |  |  |
| Anthony (l) | 5,00,000 |  |  |
|  | (m) 72,000 |  | 7,20,000 |

## Answers and Hints

1. (a) 10,800
(b) 3,600

Value violated in this firm: Profits are not shared equally
2. (a) 2,400 (b) 2,400
(c) Adjustment for goodwill due to change in profit sharing ratio:

Annu's Sacrifice: /10;
Bannu's gain 1/10
3. (a) 28,400
(b) 10,000
(c) 15,900
(d) 2,500
(e) 40,000
(f) 14,600
(g) $\quad 5,475$
(h) 5,475
(i) 3,650
(j) 1,500
(k) 1,000
(I) 1,500
(m) 1,500
(n) 1,000
(o) Advertisement Expenditure A/c
(p) Old profit sharing ratio
4. (a) Akbar's Capital A/c
(b) 4,000
(c) Antjony's Capital A/c
(d) 16,000
(e) Amar's A/c
(f) 40,000
(g) $7,20,000$
(h) Reserves
(i) 50,000
(j) $2,20,000$
(k) $\quad 1,96,000$
(I) 84,000
(m) 7,20,000
(n) 7,20,000

## CHAPTER 4

## ACCOUNTING FOR PARTNERSHIP FIRMS: ADMISSION OF A PARTNER

## Meaning

When a new partner is admitted in a running business due to the requirement of more capital or may be to take advantage of the experience and competence of the newly admitted partner or any other reason, it is called admission of a partner in partnership firm.

According to section 31(1) of Indian Partnership Act, 1932, "A new partner can be admitted only with the consent of all the existing partners"

At the time of admission of new partner, following adjustments are required:

1. Calculation of new profit sharing ratio and sacrificing ratio.
2. Accounting treatment of Goodwill.
3. Accounting treatment of accumulated profit, reserves and accumulated losses.
4. Accounting treatment of revaluation of assets and reassessment of liabilities.
5. Adjustment of capital in new profit sharing ratio.

## Points to be noted in case of Admission

1. First of all, profit sharing Ratio must be noted of the question
2. When old ratio and New Ratio are given, first calculate sacrificing Ratio.
3. When a New partner does not bring his share of premium for goodwill. It will be clearly mentioned.
4. Accumulated profits \& Losses must be distributed to the old partners in old ratio.
5. Answer should be given of that part which in asked, other should be done as a working Notes if necessary.
6. Treatment of goodwill should be done accordingly to question demand.
7. Revaluation of Assets and re-assessment of liabilities.
8. Appeared Goodwill in balance sheet must be written off from the Books by the old partner in old ratio.

## 1. Calculation of new profit sharing ratio

Following types of problems may arise for the calculation of new profit sharing ratio.

## Case (i) When old ratio is given and share of new partner is given.

Illustration 1: (When new partner acquires his share from old partners in their old ratio).
$A$ and $B$ are partners in a firm sharing profits and losses in the ratio 1:2. They admitted $C$ into the partnership and decided to give him $1 / 3$ rd share of the future profits. Find the new ratio of the partners.
(CBSE 2003)

## Solution:

(i) Calculation of Sacrifice Share:

A's sacrifice $=1 / 3$ of $1 / 3=1 / 9$
B's sacrifice $=2 / 3$ of $1 / 3=2 / 9$
Sacrificing Ratio $=1 / 9: 2 / 9=1: 2$
which is equal to old ratio
(ii) Calculation of new Profit sharing Ratio:

New share = Old share - Sacrifice share
A's new share $=1 / 3-1 / 9=\frac{3-1}{9}=\frac{2}{9}$
B's new share $=2 / 3-2 / 9=\frac{6-2}{9}=\frac{4}{9}$
C's new share $=1 / 9+2 / 9=3 / 9$
New ratio among A, B and C: 2/9: 4/9:3/9 $=2: 4: 3$ respectively
Note: Unless agreed otherwise, it is presumed that the new partner acquires his share in profits from the old partners in their old profit sharing ratio.

Alternative Method:
Old Ratio = $\quad \mathrm{A}: \mathrm{B}$
1:2

Let the total profit of the firm =1
C's share (New Partner) $=1 / 3$
Remaining Profit $=1-1 / 3=2 / 3$
Now this profit $2 / 3$ will be divided between the old partners in their old ratio i.e., 1:2
A's new Profit $=1 / 3$ of $2 / 3=1 / 3 \times 2 / 3=2 / 9$
B's new Profit $=2 / 3$ of $2 / 3=2 / 3 \times 2 / 3=4 / 9$
C's profit $=1 / 3$ or $1 / 3 \times 3 / 3=3 / 9$
Hence the new ratio $=2: 4: 3$
Note: In this case only New Partners share is given then
Sacrificing ratio $=$ Old Ratio $=1: 2$ there is no need to calculate it

## Case (ii) When new partner acquires his/her share from old partners in agreed share.

Illustration 2: (When new partner acquires his share from old partners in agreed share) $L$ and $M$ are partners in a firm sharing profits and losses in the ratio of 7:3. They admitted $N$ for $3 / 7$ th share which he takes $2 / 7$ th from $L$ and $1 / 7$ from $M$ Calculate the new profit sharing ratio.
(CBSE 1999 Compt., 2001, 2003)

## Solution

(i) As sacrifice share of old partners are given in the question itself, hence there is no need to calculate it.
(ii) Calculation of New profit sharing ratio:

New share = old share - sacrifice share
L's new share $=7 / 10-2 / 7=\frac{49-20}{70}=\frac{29}{70}$
M's new share $=3 / 10-1 / 7=\frac{21-10}{70}=\frac{11}{70}$
N's new share $=2 / 7+1 / 7=3 / 7$ (given)
New ratio among L, M and $N=29 / 70$ : $11 / 70: 3 / 7=29: 11: 30 / 70=29: 11: 30$

Case (iii) When new partner acquires his/her share from old partners in certain ratio.

Illustration 3: X and Y are partners in a firm sharing profit and losses in the ratio of $3: 2 \mathrm{Z}$ is admitted as partner in the firm for $1 / 6$ th share in profits. Z acquires his share from X and Y in the ratio of 2: 1 Calculate new profit sharing ratio of partners.
(CBSE 2003)

## Solution:

(i)

## Calculation of Sacrifice share:

Given sacrificing Ratio $=X: Y$ 2:1,
therefore,
X's sacrifice share $=2 / 3$ of $1 / 6=2 / 18$
Y's sacrifice share $=1 / 3$ of $1 / 6=1 / 18$
(ii) Calculation of New Profit Sharing Ratio:

New share = Old share - Sacrifice share
$X$ 's new share $=3 / 5-2 / 18=\frac{54-10}{90}=\frac{44}{90}$
Y's new share $=2 / 5-1 / 18=\frac{36-5}{90}=\frac{31}{90}$
Z's new share $=2 / 18+1 / 18$ or $1 / 6$ (Given)
New ratio among $X, Y$ and $Z=44 / 90: 31 / 90: 1 / 6=44: 31: 15 / 90=44: 31: 15$
Case (iv) When new partner acquires his/her share from old partners as a fraction of their share.

Illustration 4: (When new partner acquires his share from old partners as a fraction of their share).
$A$ and $B$ are partners in a firm sharing profit and losses in the ratio of 5:3. A surrenders $1 / 5$ th of his share, whereas B surrenders $1 / 3$ of his share in favour of C, a new partner. Calculate the new profit sharing ratio. (CBSE 2003, Al 2004)

## Solution:

(i) Calculation of sacrifice share

A sacrifices $1 / 5$ of his share i.e. $1 / 5$ of $5 / 8=1 / 8$
B sacrifices $1 / 3$ th of his share i.e. $1 / 3$ of $3 / 8=3 / 24$ or $1 / 8$
(ii) Calculation of New profit sharing Ratio

New share = Old share - sacrifice share
A's new share $=5 / 8-1 / 8=4 / 8$
B's new share $=5 / 8-1 / 8=2 / 8$
C's new share $=1 / 8+1 / 8=2 / 8$
New ratio among A, B and C = 4/8:2/8:2/8 = 4:2:2/8 = 2:1:1

## Case (v) When new partner does not acquire his/her share from all partners.

Illustration 5. (When new partner does not acquire his share from all partners) A, $B$ and $C$ are partners sharing profits in the ratio of 3:2:1. They admit $D$ for $1 / 6$ share. C would retain his old share. Calculate new ratio of all partners.
(CBSE 2002 Compt.)

## Solution:

(i) Calculation of sacrifice share: (Only A and B sacrifice in ratio of 3 :2)
(ii) A's sacrifice $=3 / 5$ of $1 / 6=3 / 30$ or $1 / 10$

B's sacrifice $=2 / 5$ of $1 / 6=2 / 30$ or $1 / 15$
C's sacrifice $=$ Nil
(iii) Calculation of new profit sharing ratio:

New share = Old share - Sacrifice share
A's new share $=3 / 6-1 / 10=\frac{30-6}{60}=\frac{24}{60}$
B's new share $=2 / 6-1 / 15=\frac{30-6}{90}=\frac{24}{90}$
C's new share $=1 / 6-0=1 / 6$

$$
\text { D's new share }=1 / 10+1 / 15=\frac{3+2}{30}=5 / 30=1 / 6
$$

New ratio among $A, B, C$ and $D$

$$
24 / 60: 24 / 90: 1 / 6: 1 / 6=\frac{72: 48: 30: 30}{180}=12: 8: 5: 5
$$

## Case (vi) When more than one partner is admitted.

Illustration 6. (When more than one partner is admitted simultaneously): $X$ and $Y$ are partners sharing profits in the ratio of $3: 2$. They admit $P$ and $Q$ as new partners. $X$ surrendered $1 / 3$ of his share in favour of $P$ and $Y$ surrendered $1 / 4$ of his share in favour of Q . Calculate the new profit sharing ratio of $\mathrm{X}, \mathrm{Y}, \mathrm{P}$ and Q .
(CBSE 2002 Compt.)

## Solution:

## (i) Calculation of Sacrifice Ratio

X surrenders $1 / 3$ of his share in favour of $P=1 / 3 \times 3 / 5=3 / 15$
Y surrenders $1 / 4$ of his share in favour of $Q=1 / 4 \times 2 / 5=2 / 20$
$X$ 's new share $=\frac{3}{5}-\frac{3}{15}=\frac{9-3}{15}=\frac{6}{15}$
Y's new share $=\frac{2}{5}-\frac{2}{20}=\frac{8-2}{20}=\frac{6}{20}$
New profit sharing ratio $=X: Y: P: Q=6 / 15: 6 / 20: 3 / 15: 2 / 20$

$$
=4: 3: 2: 1
$$

## 2. Accounting Treatment of Goodwill

At the time of admission of a partner, treatment of Goodwill is necessary to compensate the old partners for their sacrifice. The incoming partner must compensate the existing partners because he is going to acquire the right to share future profits and his share is sacrificed by old partners. If goodwill (Premium) is
paid to old partners privately or outside the business by the new partner, then no entry is required in the books of the firm.

There may be different situations about the treatment of goodwill at the time of the admission of the new partner.
(i) Goodwill (premium) brought in by the new partner in cash and retained in the business

Illustration 7. (Old partners sacrifice): $A$ and $B$ partners sharing profits and losses in the ratio of $3: 2$. They admit $C$ into partnership for $1 / 4$ share in profits. C brings ₹ $3,00,000$ as capital and ₹ $1,00,000$ as goodwill. New profit sharing ratio of the partners shall be 3:3:2. Pass necessary Journal entries.
(CBSE 2003)
Journal

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c <br> To Premium for Goodwill A/c <br> To C's Capital A/c <br> (Being the amount of goodwill and capital brought in by new partner C) |  | 1,00,000 | $\begin{array}{\|l\|} \hline 1,00,000 \\ 3,00,000 \end{array}$ |
|  | Premium for Goodwill A/c <br> To A's capital A/c <br> To B's capital A/c <br> (Being the amount of goodwill distributed between $A$ and $B$ in their sacrificing ratio i.e., 9: 1) |  |  | $\begin{aligned} & 90,000 \\ & 10,000 \end{aligned}$ |

Note: Sacrificing = Old ratio - New ratio

$$
\begin{aligned}
& \mathrm{A}=3 / 5-3 / 8=\frac{24-15}{40}=\frac{9}{40} \\
& \mathrm{~B}=2 / 5-3 / 8=\frac{16-15}{40}=\frac{1}{40}
\end{aligned}
$$

This sacrificing ratio between $A$ and $B$ i.e., 9: 1 .

Illustration 8. (a) (Sacrificing ratio is to be calculated): $A$ and $B$ are partners in a firm sharing profits and losses in the ratio of 3:2. C is admitted as a new partner. A surrenders $1 / 5$ of his share and $B 2 / 5$ of his share in favour of $C$. For purpose of C's admission, goodwill of the firm is valued at ₹ 75,000 and $C$ brings his share of goodwill in cash which is retained in the firm's books. Journalise the above transactions.
(CBSE 2003)

## Journal

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c Dr. To Premium for Goodwill A/c (Being the amount of goodwill and capital brought in by new partner C) |  | $\begin{aligned} & 21,000 \\ & 21,000 \end{aligned}$ | $\begin{array}{r} 21,000 \\ 9,000 \\ 12,000 \end{array}$ |
|  | Premium for Goodwill A/c Dr. To A's capital A/c To B's capital A/c (Being the amount of goodwill distributed between A and B in their sacrificing ratio i.e., $3: 4$ ) |  |  |  |

Note (i) Calculation of sacrificing ratio:
A's sacrifice, $1 / 5$ of his share $=1 / 5$ of $3 / 5=3 / 25$
B's sacrifice, $2 / 5$ of his share $=2 / 5$ of $2 / 5=4 / 25$ Sacrificing ratio between $A$ and $B$ i.e., $3 / 25: 4 / 25=3: 4$
(ii) Calculation of C's share of profit:

C's share of profit $=3 / 25+4 / 25=7 / 25$
(iii) Calculation of C's share of goodwill:
$75,000 \times 7 / 25=21,000$
Q. 8 (b) Vikram and Abhishek are partners sharing profits and Losses in the ratio of 8:5. They admit' Avishi' and decide that the profit sharing ratio between 'Abhishek' and 'Avishi' shall be the same as existing between 'Vikram' and 'Abhishek'.

Calculate new profit sharing ratio and the sacrificing Ratio.
Ans. $\{64: 40: 25\}$ S.R. 8:5
Q.. 8 (c) A, B and C are partners in a firm for the profit sharing ratio 4:3:1. They admitted ' $D$ ' as a new partner for $\qquad$ Share. 'A' sacrifice $1 / 3^{\text {rd }}$ of his share in favour of ' $D$ ' and ' $B$ '. sacrifice $1 / 4^{\text {th }}$ from his share in favour of new partner. C in neutral.

Calculate new profit sharing ratio.
Ans. $\{8: 3: 3: 10\}$
Hints 8 (b) Vikram: Abhishek


8 : 5

$$
64: 40: 25
$$

If goodwill already appears in the balance sheet, it should be written off by debiting old partners in their old profits sharing ratio.

Illustration 9. (Existing goodwill to be written off) : A and $B$ are partners in a firm sharing profits and losses in the ratio of $3: 2$. They admit $C$ into partnership for $1 / 5$ share. C brings ₹ 30,000 as capital and ₹ 10,000 as goodwill. At the time of admission of $C$, goodwill appears in the balance sheet of $A$ and $B$ at ₹ 3,000 . New Profit sharing ratio of partners shall be 5:3:2. Pass necessary entries.

Journal

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | A's Capital A/c Dr. <br> B's Capital A/c  <br> To Goodwill A/c  <br> (Being existing goodwill written off <br> between old partners in their old ratio <br> i.e., 3:2)  |  | $\begin{aligned} & 1,800 \\ & 1200 \end{aligned}$ | 3,000 |
|  | Bank A/c Dr. To Premium for Goodwill A/c To C's Capital A/c (Being the amount of goodwill and capital brought in by new partner C) |  | 40,000 | $\begin{aligned} & 30,000 \\ & 10,000 \end{aligned}$ |
|  | $\begin{aligned} & \text { Premium for Goodwill A/c Dr. } \\ & \text { To A's Capital A/c } \\ & \text { To B's Capital A/c } \\ & \text { (Being the amount of goodwill } \\ & \text { distributed between A and B in their } \\ & \text { sacrificing ratio i.e., 1:1) } \end{aligned}$ |  | 10,000 | $\begin{aligned} & 5,000 \\ & 5,000 \end{aligned}$ |

Notes: Sacrificing ratio = Old ratio - New ratio

$$
\begin{aligned}
& \text { A }=3 / 5-5 / 10=\frac{6-5}{10}=\frac{1}{10} \\
& \text { B }=2 / 5-3 / 10=\frac{4-3}{10}=\frac{1}{10}
\end{aligned}
$$

Sacrificing ratio between $A$ and $B=1$ : 1 i.e., equal.

## Case (ii) Premium brought in kind

Illustration 10. (premium brought in kind) : Anubhav and Babita are partners in a firm sharing profits and losses in the ratio of 3:2. On April 1, 2015 they admit Deepak as a new partner for $3 / 13$ share in the profits. Deepak contributed the following assets towards his capital and for his share of goodwill.

Land ₹ 90,000 , Machinery ₹ 70,000 stock ₹ 60,000 and debtors ₹ 4,000 . On the date of admission of Deepak, the goodwill of the firm was valued at ₹ $5,20,000$, which is not appear in the books. Record necessaries journal entries in the books of the firm. Show your calculations clearly.
(NCERT, CBSE 2004 Compt.)

| Date | Particulars | L.F. | Debit(\%) | Credit ( ${ }^{\text {( }}$ ) |
| :---: | :---: | :---: | :---: | :---: |
| 2015 <br> April-1 | Land A/c Dr. <br> Machinery A/c Dr. <br> Stock A/c Dr. <br> Debtors A/c Dr. <br> To Premium for Goodwill A/c  <br> (5,20,000×3/13)  <br> To Deepak's Capital A/c (Balancing <br> figure)  <br> (Being the amount of goodwill and <br> capital brought in kind by new partner)  |  | $\begin{aligned} & \hline 90,000 \\ & 70,000 \\ & 60,000 \\ & 40,000 \end{aligned}$ | $\begin{aligned} & 1,20,000 \\ & 1,40,000 \end{aligned}$ |
| April-1 | Premium for Goodwill A/c <br> To Anubhav's Capital A/c <br> To Babita's Capital A/c <br> (Being the amount of goodwill distributed <br> between Anubhav and Babita in their sacrificing ratio i.e., $3: 2$ ) |  | 1,20,000 | $\begin{aligned} & 72,000 \\ & 48,000 \end{aligned}$ |

Note: Here Sacrificing Ratio = Old Ratio i.e., 3 :2

Case (iii) Amount of goodwill which was brought in by new partner, is withdrawn by old partners:

In this case one additional Journal entry may be passed:
Old Partners' Capital A/c
Dr.
To Bank/Cash A/c
(Cash withdrawn by old partners)
Case (iv) when the new partner is unable to bring his share of goodwill in cash.

Sometimes the new partner does not bring his share of goodwill in cash. Then his share of goodwill is calculated and adjusted by the following Journal entry

| New partner's Capital A/c / Current A/c <br> To Sacrificing Partners Capital A/cs <br> (in the sacrificing ratio) | Dr. | L.F. | Dr. | Cr. |
| :--- | :--- | :--- | :--- | :--- |

Illustration 11: Neeta and Sumita are partners sharing profits and losses in the ratios of 2:1. They admit Geeta as a partner for 1/4th Share. Geeta pays ₹ 50,000 as capital but does not bring any amount for goodwill. The goodwill of the new firm is valued at ₹ 36,000 . Give Journal entries.
(CBSE 1997, 2003)

## Solution

## Journal



## Working Note:

(1) As nothing is given about sacrifice etc. except the old ratio and the new partners share of profit.
Sacrificing Ratio $=$ Old Ratio $=2: 1$
(2) Goodwill of the firm $=₹ 36,000$

Geeta's share of profit $=1 / 4$
Geeta's share of Goodwill $=₹ 36,000 \times 1 / 4=₹ 9,000$

## Case (v) Goodwill is partly brought in by new partner:

Illustration 12. (Partly premium brought in cash): Sheetal and Raman share profits equally. They admit Chiku into partnership. Chiku pays only ₹ 1,000 for premium out of his share of premium of ₹ 1,800 for $1 / 4$ share of profit. Goodwill Account appears in the books at ₹ 6,000 . All partners have decided that goodwill should not appear in the books of the new firm. Journalise. (CBSE: 1997/2003)

Journal

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c <br> To Premium for Goodwill A/c <br> (Being the amount of goodwill brought in cash by new partner) |  | 1,000 | 1,000 |
|  | Premium for Goodwill A/c Dr. <br> Chiku's Capital A/c Dr. <br> To Sheetal's Capital A/c  <br> To Raman's Capital A/c  <br> (Being Chiku's share of goodwill transferred  <br> to sacrificing partners in their sacrificing  <br> ratio i.e., 1:1)  |  | $\begin{gathered} 1,000 \\ 800 \end{gathered}$ | $\begin{aligned} & 900 \\ & 900 \end{aligned}$ |
|  | Sheeta's Capital A/c Dr. <br> Raman's Capital A/c Dr. <br> To Goodwill A/c  <br> (Being existing goodwill written of between <br> old partners in their old ratio i.e., equal)  |  | $\begin{aligned} & 3,000 \\ & 3,000 \end{aligned}$ | 6,000 |

## Case (vi) Gain made by an old partner:

Illustration 13. (Sacrifice/Gain made by an old partner) : Ashok and Ravi were partners in a firm sharing profits and losses in the ratio of 7:3. They admitted Chander as a new partner. The new profit ratio between Ashok, Ravi and Chander will be 2:2:1. Chander brought ₹ 24,000 for his share of goodwill.

Pass necessary journal entries for the treatment of goodwill.
(CBSE 2000)
Solution:
Journal

| Date | Particulars | L.F. | Debit ( ${ }^{\text {P }}$ ) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c <br> To Premium for Goodwill A/c <br> (Being the amount of goodwill brought in by new partner) |  | 24,000 | 24,000 |
|  | Premium for Goodwill A/c Dr. |  | 24,000 |  |
|  | Ravi's Capital A/c |  |  |  |
|  | (Being the goodwill credited to Ashok's capital A/c) |  |  | 36,000 |

Note: Calculation of sacrifice/gain share of partners(s) :
Sacrificing ratio = Old ratio - New ratio
Ashok $=7 / 10-2 / 5=\frac{7-4}{10}=\frac{3}{10}$
Ravi $=3 / 10-2 / 5=\frac{3-4}{10}=\left(\frac{1}{10}\right)$ gain
Being negative result, it shows gain. Since Ravi is gaining equal to $1 / 10$ in the profits, therefore, he will also compensate Ashok proportionately. For $1 / 5$ share Chander brought ₹ 24,000 , therefore, Ravi will compensate Ashok by ₹ 12,000 i.e., ₹ $24,000 \times 5 / 1 \times 1 / 10$.

## Case (vii) Hidden Goodwill

Illustration 14: A and B are partners with capitals of ₹ 26,000 and ₹ 22,000 respectively. They admit C as partner with 1/4th share in the profits of the firm. C brings ₹ 26,000 as his share of capital. Give journal entry to record goodwill on C's admission.
(CBSE 2001 Compt.)
Journal

| Date | Particulars | L.F. | Debit | Credit |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c <br> To C's capital A/c <br> (Being the amount of goodwill brought in by new partner) |  | $\begin{array}{r} 26,000 \\ \\ 7,500 \end{array}$ | 26,000 |
|  | C's Capital A/c <br> To A's capital A/c <br> To B's capital A/c <br> (Being the goodwill credited to sacrificing partners' capital a/cs in their sacrificing ratio i.e., equal) |  |  | $\begin{aligned} & 3,750 \\ & 3,750 \end{aligned}$ |

## Note:

(1) Calculation of C's share of goodwill:

Total capital of new firm no basis of C's capital i.e., $26,000 \times 4 / 1=₹ 1,04,000$

Total capital of A and B and C i.e., ₹ $26,000+₹ 22,000+₹ 26,000=₹ 74,000$ )

Goodwill of the firm = total capital of new firm - combined capital $=$ ₹ $1,04,000$ - ₹ $74,000=$ ₹ 30.000

Thus C's share of goodwill $=30,000 \times 1 / 4=₹ 7,500$
(2) In the absence of information, profits will be shared equally.

## 3. Accounting treatment of Accumulated Profits

Accumulated profits and reserves are distributed to partners in their old profit sharing ratio. If old partners are not interested to distribute, these accumulated profits are adjusted in the same manner as goodwill and the following adjusting entry will be passed.
New Partner's capital A/c
Dr. (New share)
Gaining Partner's Capital, A/c
Dr. (Gaining share)

To Sacrificing partner's capital A/c (Sacrificing ratio)

## 4. Accounting treatment for revaluation of assets and re-assessment of liabilities

The assets and liabilities are generally revalued at the time of admission of a new partner. Revaluation Account is prepared for this purpose in the same way as it was in case of change in profit sharing ratio. This account is debited with all losses and credited with all gains. Balance of Revaluation Account is transferred to old partners in their old ratio.

Illustration 15 : Following is the Balance Sheet of Shashi and Ashu sharing profit as $3: 2$.

| Particulars | (₹) | Assets |  | (₹) |
| :--- | ---: | :--- | ---: | :---: |
| Creditors | 18,000 | Debtors | 22,000 |  |
| General reserve | 25,000 | Less: Provision for DD | 1,000 | 21,000 |
| Workmens compensation fund | 15,000 | Land and Building | 18,000 |  |
| Capital: Shashi | 15,000 | Plant and machinery | 12,000 |  |
| Ashu |  |  |  | 10,000 |
|  |  | Stock | Bank | 11,000 |
|  |  |  | 21,000 |  |
|  | 83,000 |  | 83,000 |  |

On admission of Tanya for $1 / 6$ th share in the profit it was decided that:
(i) Provision for doubtful debts to be increased by ₹ 1,500 .
(ii) Value of land and building to be increased to ₹ 21,000 .
(iii) Value of stock to be increased by ₹ 2,500 .
(iv) The liability of workmen's compensation fund was determined to be ₹ 12,000 .
(v) Tanya brought in as her share of goodwill ₹ 10,000 in cash.
(vi) Tanya was to bring further cash of ₹ 15,000 for her capital.

Prepare Revaluation A/c, Capital A/cs and the Balance Sheet of the new firm.
(CBSE 2001)

Solution:
Revaluation Account


## Partners' Capital Account

Dr.
Cr.

| Particulars | Shashi | Ashu | Tanya | Particulars | Shashi | Ashu | Tanya |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| To balance c/d | 40,200 | 26,800 | 15,000 | By balance b/d | 15,000 | 10,000 | - |
|  |  |  |  | By general reserve | 15,000 | 10,000 |  |
|  |  |  |  | By workmen's compensation A/c | 1,800 | 1,200 | - |
|  |  |  |  | By Revaluation | 2,400 | 1,600 | - |
|  |  |  |  | By Bank A/c |  |  | 15,000 |
|  |  |  |  | By Premium for goodwill | - 6 | 4,000 | - |
|  | 40,200 | 26,800 | 15,000 |  | 4,02,000 | 26,800 | 15,000 |

## Balance Sheet of the New Firm

| Liabilities |  | (₹) | Assets | (₹) |
| :---: | :---: | :---: | :---: | :---: |
| Creditors |  | 18,000 | Debtors 22,000 |  |
| Liability for Work <br> ompensation |  |  | Less: provision for D.D. $\underline{\text { 2,500 }}$ | 19,500 |
|  |  | 12,000 | Land and Building | 21,000 |
|  |  | 40,200 | Plant and Machinery | 12,000 |
| Capital: | Shashi | 26,800 | Stock | 13,500 |
|  | Ashu | 15,000 | Bank | 46,000 |
|  | Tanya | 1,12,000 |  | 1,12,000 |

Illustration 16: A, B and C are partners sharing profits and the ratio of 2:3:5.
On 31st March 2015, their Balance Sheet was as follows

| Particulars |  | $(₹)$ | Particulars | $(₹)$ |
| :--- | :---: | :---: | :--- | :--- |
| Capital |  |  | Cash | 18,000 |
| A | 36,000 |  | Bills receivable | 24,000 |
| B | 44,000 |  | Furniture | 28,000 |
| C | $\underline{52,000}$ | $1,32,000$ | Stock | 44,000 |
| Creditors | 64,000 | Debtors | 42,000 |  |
| Bill Payable | 32,000 | Investments | 32,000 |  |
| Profit and Loss Account |  | 14,000 | Machinery | 34,000 |
|  |  | Goodwill | 20,000 |  |

They admit D into partnership on the following terms:
(i) Furniture and Machinery to be depreciated by $15 \%$.
(ii) Stock is revaluated at ₹ 48,000.
(iii) Goodwill to be valued at ₹ 24,000 .
(iv) Outstanding rent amount ₹ 1,800 .
(v) Prepaid salaries ₹ 800.
(vi) D to bring ` 32,000 towards his capital for $1 / 6$ th share.

Prepare Revaluation Account, Partners Capital Accounts and Balance Sheet of the new firm.
(CBSE 2001)

## Solution:

Dr.

| Particulars | (₹) | Particulars | (₹) |  |
| :--- | :---: | :--- | :--- | ---: |
| To Furniture A/c | 4,200 | By Stock A/c | 4,000 |  |
| To Machinery A/c | 5,100 | By Prepaid Salaries A/c | 800 |  |
| To Outstanding rent A/c | 1,800 | By Capital A/c (loss): |  |  |
|  |  | A | $2 / 10$ | 1,260 |
|  |  | B | $3 / 10$ | 1,890 |
|  | C | $5 / 10$ | $\underline{3,150}$ |  |
|  |  |  |  | 11,100 |

Partners' Capital Accounts
Dr.

| Particulars | A (₹) | B (₹) | C (₹) | D (₹) | Particulars | A (₹) | B (₹) | C (₹) | D (₹) |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| To Revaluation A/c | 1,260 | 1,890 | 3,150 | - | By <br> balance <br> c/d | 36,000 | 44,000 | 52,000 | - |
| To <br> Goodwill <br> A/c | 4,000 | 6,000 | 10,000 | - | $\begin{array}{lr} \text { By } & \mathrm{P} / \mathrm{L} \\ \mathrm{~A} / \mathrm{c} & \end{array}$ | 2,800 | 4,200 | 7,000 | - |
| To A's capital | - | - | - | 800 | By D's <br> Capital A/c | 800 | 1,200 | 2,000 | - |
| To B's capital | - | - | - | 1,200 | $\begin{aligned} & \text { By Cash } \\ & \text { A/c } \end{aligned}$ | - | - | - | 32,000 |
| To C's capital | - | - | - | 2,000 |  |  |  |  |  |
| To Balance c/d | 34,340 | 41,510 | 47,850 | 28,000 |  |  |  |  |  |
|  | 39,600 | 49,400 | 61,000 | 32,000 |  | 39,600 | 49,400 | 61,000 | 32,000 |

## May be

## Balance Sheet of the New Firm

| Liabilities |  | $(₹)$ | Assets | $(₹)$ |
| :--- | :--- | :---: | :--- | :---: |
| Capital: |  | Cash | 50,000 |  |
| A | 34,340 |  | Bill Receivable | 24,000 |
| B | 41,510 |  | Furniture | 23,800 |
| C | 47,850 |  | Stock | 48,000 |
| D | $\underline{28,000}$ | $1,51,700$ | Debtors | 42,000 |
|  |  | Investment | 32,000 |  |
| Creditors | 64,000 | Machinery | 28,900 |  |
| Bills Payable | 32,000 | Prepaid salaries | 800 |  |
| Outstanding rent |  | 1,800 |  | $\mathbf{2 , 4 9 , 5 0 0}$ |

## 5. Adjustment of Capital in New Profit Sharing Ratio

Illustration 17: A, B and C are partners sharing profits and losses in the ratio of 5:3:2. On March 31st, 2015 their Balance Sheet was as follows:

| Liabilities |  | (₹) | Assets | $(₹)$ |
| :--- | :---: | :---: | :--- | :---: |
| Capital: |  | Cash | 18,000 |  |
| A | 36,000 |  | Bills receivable | 14,000 |
| B | 44,000 |  | Stock | 44,000 |
| C | 52,000 | $1,32,000$ | Debtors | 42,000 |
| Creditors | 64,000 | Machinery | 94,000 |  |
| Bills Payable | 32,000 | Goodwill | 20,000 |  |
| General Reserve | 14,000 |  |  |  |
|  | $2,32,000$ |  | $2,32,000$ |  |

They decided to admit $D$ into the partnership on the following terms:
(i) Machinery is to be depreciated by $15 \%$.
(ii) Stock is to be revalued at ₹48,000.
(iii) Outstanding rent is ₹ 1,900 .
(iv) $\quad D$ is to bring $₹ 6,000$ as goodwill and sufficient capital for a $2 / 5$ th share in the capitals of firm.

Prepare Revaluation A/c, Partner's Capital A/cs, Cash A/c and Balance Sheet of the new firm.
(CBSE 2001 Compt.)

## Solution.

Revaluation Account
Dr.
Cr.

| Particulars | (₹) | Particulars |  | (₹) |  |
| :--- | ---: | :--- | :--- | :--- | :---: |
| To Machinery A/c | 14,100 | By Stock A/c |  | 4,000 |  |
| To Outstanding Rent | 1,900 | By Capital A/c (Loss) : |  |  |  |
|  |  | A | $5 / 10$ | 6,000 |  |
|  |  | B | $3 / 10$ | 3,600 |  |
|  |  | C | $2 / 10$ | $\underline{2,400}$ | 12,000 |
|  |  | 16,000 |  |  | 16,000 |

## Partner's Capital Account

| Particulars | A ₹ | B ₹ | C ₹ | D ₹ | Particulars | A ₹ | B ₹ | C ₹ | D ₹ |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| To Goodwill A/c | 10,000 | 6,000 | 4,000 | - | By <br> Balance <br> b/d | 36,000 | 44,000 | 52,000 | - |
| To Revaluation A/c | 6,000 | 3,600 | 2,400 | - | By General reserve | $7,000$ | 4,200 | 2,800 | - |
| To <br> Balance c/d |  |  |  |  | By <br> Premium <br> for <br> goodwill <br> By Cash <br> A/c | 3,000 - | 1,800 - | 1,200 | - |
|  | 30,000 | 40,400 | 49,600 | 80,000 |  |  |  |  |  |
|  | 46,000 | 50,000 | 56,000 | 80,000 |  | 46,000 | 50,000 | 56,000 | 80,000 |
|  |  |  |  |  | By <br> balance <br> b/d | 30,000 | 40,400 | 49,600 | 80,000 |

Note: Combined capital of A, B and C for $3 / 5(1-2 / 5)=₹ 1,20,000$
Thus total capital of the firm $=1,20,000 \times 5 / 3=₹ 2,00,000$
D's share of capital $=2,20,000 \times 2 / 5=₹ 80,000$

Balance Sheet of the New Firm

| Liabilities | (₹) | Assets | (₹) |
| :--- | ---: | :--- | ---: |
| Creditors | 64,000 | Cash | $1,04,000$ |
| Bill Payable | 22,000 | Bills receivable | 14,000 |
| Outstanding rent | 1,900 | Stock | 48,000 |
| Capital: |  | Debtors | 42,000 |
| A | 30,000 |  | Machinery |
| B | 40,400 |  |  |
| C | 49,600 |  |  |
| D | 80,000 | $2,00,000$ |  |
|  |  | $2,87,900$ |  |
|  |  |  | $2,87,900$ |

Illustration 18: Following is the Balance Sheet of $A, B$ and $C$ sharing profits and losses in the ratio of 6:5:3 respectively.

| Liabilities | $(₹)$ | Assets | $(₹)$ |
| :--- | :---: | :--- | ---: |
| Creditors | 37,000 | Cash | 3,700 |
| Bill Payable | 12,600 | Debtors | 52,920 |
| General reserve | 21,000 | Stock | 58,800 |
| A's capital | 70,800 | Furniture | 14,700 |
| B's capital | 59,700 | Land and Building | 90,300 |
| C's capital | 29,100 | Goodwill | 10,500 |
|  | $2,31,000$ |  | $2,31,000$ |

They agreed to admit $D$ into partnership giving $\frac{1}{8}$ th share in profit on the following terms:
(a) Furniture to be depreciated by ₹ 1,840 Stock by $10 \%$
(b) A provision of ₹ 2,640 to be made for an outstanding bill for repairs.
(c) That land and building be brought up to ₹ $1,19,700$.
(d) That the goodwill is valued at ₹ 28,140 .
(e) That D should bring in ₹ 35,400 as his capital and his share of goodwill
(f) After making the above adjustments the capital of old partners be adjusted in proportion to D's Capital by bringing in cash or excess to be paid off.

Prepare Revaluation Account, Capital Account of Partners and Balance Sheet of new firm.
(CBSE 1997 Compt.)

## Solution:

## Revaluation Account

| Particulars | (₹) | Particulars | (₹) |
| :---: | :---: | :---: | :---: |
| To Furniture A/c | 1,840 | By Land and Building A/c | 29,400 |
| To Stock A/c | 5,880 |  |  |
| To Outstanding repairs A/c | 2,640 |  |  |
| To capital A/cs (profit): |  |  |  |
| A 6/4 8,160 |  |  |  |
| B 5/14 6,800 |  |  |  |
| C 3/14 | 19,040 |  |  |
|  | 29,400 |  | 29,400 |

Partners' Capital Account

| Particulars | A (₹) | B (₹) | C (₹) | D (₹) | Particulars | A (₹) | B (₹) | C (₹) | D (₹) |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| To Goodwill A/c | 4,500 | 3,750 | 2,250 | - | By <br> Balance b/d | 70,800 | 59,700 | 29,100 | - |
|  |  |  |  |  | By General reserve | 9,000 | 7,500 | 4,500 | - |
|  |  |  |  |  | By revaluatio $n \mathrm{~A} / \mathrm{c}$ | 8,160 | 6,800 | 4,080 | - |
|  |  |  |  |  | By <br> Premium <br> for <br> Goodwill <br> A/c | 1,508 | 1,256 | 754 | - |
| To balance c/d | 95,646 | 79,705 | 47,823 | 31,882 | By cash A/c | 10,678 | 8,199 | 11,639 | 31,882 |
|  | 1,00,146 | 81,455 | 50,073 | 35,400 |  | 100,146 | 83,455 | 50,073 | 35,4000 |
|  |  |  |  |  | Balance b/d | 95,646 | 79,705 | 47,823 | 31,882 |

Balance Sheet of the New Firm

| Liabilities | (₹) | Assets | $(₹)$ |
| :--- | ---: | :--- | ---: |
| Creditors | 37,800 | Cash | 69,696 |
| Bills Payable | 12,600 | Debtors | 52,920 |
| Outstanding repairs |  | 2,640 | Stock |
| Capital |  | Furniture | 52,920 |
| A | 95,646 |  | Land Building |
| B | 79,705 |  |  |
| C | 47,823 |  | 12,860 |
| D | $\underline{31,882}$ | $2,55,056$ |  |
|  |  | $3,08,096$ |  |

Note: Calculation of New Profit Sharing Ratio:

1. Share given to $D=1 / 8$, Balance of profit $=1-1 / 8=7 / 8$.

Hence, A's Share $=7 / 8 \times 6 / 4=42 / 112$

B's Share $=718 \times 5 / 14=35 / 112$

C's Share $=7 / 8 \times 3 / 14=21 / 112$
$A: B: C: D$

New Ratio: 42/112:35/112:21/112:1/8=42:35:21:14/112 or $6: 5: 3: 2$

Capital of $D=₹ 35,400-₹ 3518=₹ 31,882$
Total capital of Firm $=₹ 31882 \times 16 / 2=₹ 255056$

Capital of $A=₹ 255056 \times 6 / 16=₹ 95,646$
Capital of $B=₹ 255056 \times 5 / 16=₹ 79705$

Capital of $C=₹ 255056 \times 3 / 16=₹ 47,823$
2. Calculation of new capital of $A, B$, and $C$ based on D's Capital for $1 / 8$ share is ₹ 31,882 . Thus

Capital of whole firm $=31,882 \times 8 / 1=₹ 2,55,056$.
Therefore, A's Capital $=2,55,056 \times 6 / 16=₹ 95,646$
B’s Capital $=2,55,056 \times 5 / 16=₹ 79,705$
C's Capital $=2,55,056 \times 3 / 16=$ ₹ $47,823$.
Illustration 19: $A$ and $B$ are partners in a firm sharing profits and losses in the ratio of 3:2. Their balance sheet was as follows on 1st January, 2015:

| Liabilities |  | ₹ | Assets | ₹ |
| :---: | :---: | :---: | :---: | :---: |
| Sundry Creditors |  | 15,000 | Plant | 30,000 |
| Capital |  |  | Patents | 10,000 |
| A | 30,000 |  | Stock | 20,000 |
| B | $\underline{25,000}$ | 55,000 | Debtors | 18,000 |
| General reserve |  | 10,000 | Bank | 2,000 |
|  |  | 80,000 |  | 80,000 |

C is admitted as a partner on the above date on the following terms:
(i) He will pay ₹ 10,000 as goodwill for one-fourth share in the profit of the firm.
(ii) The assets are to be valued as under:

Plant at ₹ 32,000 ; Stock at ₹ 18,000 ; Debtors at book figure less a provision of 5 percent for bad debts.
(iii) It was found that the creditors included a sum of ₹ 1,400 which was not be paid. But it was also, found that there was a liability for compensation to workers amount in to ₹ 2,000 .
(iv) C was to introduce ₹ 20,000 as capital and the capitals of other partners were to be adjusted in the new profit sharing ratio for this purpose, current accounts were to be opened.

Prepare Revaluation Account, Capital Account and Balance Sheet after C's admission.
(CBSE 1994)

## Solution:

## Revaluation Account

| Dr. |  |  | Cr. |
| :---: | :---: | :---: | :---: |
| Particulars | ₹ | Particulars | ₹ |
| To Stock A/c | 2,000 | By Plant A/c | 2,000 |
| To Provision for Doubtful Debts. |  | By Creditors A/c | 1,400 |
| A/c | 900 | By Capital A/c (loss): |  |
| To Outstanding liability A/c | 2,000 | A 3/5 900 |  |
|  |  | B $2 / 5600$ | 1,500 |
|  | 4,900 |  | 4,900 |

Capital Account
Dr. $\quad$ Cr.

| Particulars | A ( F ) | B (₹) | C (₹) | Particulars | A (₹) | B (₹) | C (₹) |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| To <br> Revaluation <br> A/c <br> To Balance c/d | 90041,100 | 60032,400 | 20,000 | By Balance b/d <br> By General Reserve <br> By Bank <br> A/c <br> By <br> Premium <br> for goodwill <br> A/c | 30,000 | 25,000 |  |
|  |  |  |  |  | 6,000 | 4,000 |  |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  | - | 20,000 |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  | 6,000 | 4,000 |  |
|  | 42,000 | 33,000 | 20,000 | By balance b/d | 42,000 | 33,000 | 20,000 |
| To Current A/c <br> To Balance c/d | 5,100 | 8,400 | 20,000 |  | 41,100 | 32,400 | 20,000 |
|  | 36,000 | 24,000 |  |  | 41,000 | 32,400 | 20,000 |
|  | 41,100 | 32,400 | 20,000 |  |  |  |  |

Partner's Current Account
Dr.
Dr.

| Particulars | $\mathrm{A}(₹)$ | $\mathrm{B}(₹)$ | $\mathrm{C}(₹)$ | Particulars | $\mathrm{A}(₹)$ | $\mathrm{B}(₹)$ | $\mathrm{C}(₹)$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | ---: |
| To <br> c/d | balance | 5,100 | 8,400 | - | By Capital A/cs | 5,100 | 8,400 |
| - |  |  |  |  |  |  |  |

Balance Sheet
(after C/s admission) As on $1^{\text {st }}$ Jan. 2015

| Liabilities |  | ₹ | Assets |  | ₹ |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Sundry Creditors |  | 13,600 | Plant |  | 32,000 |
| Outstanding liability |  | 2,000 | Patents |  | 10,000 |
| Capital A/cs : |  |  | Stock |  | 18,000 |
| A | 36,000 |  | Debtors | 18,000 |  |
| B | 24,000 |  | Less: provision |  |  |
| C | 20,000 | 80,000 | for D.D. | (900) | 17,100 |
| Current A/cs: R |  |  | Bank |  | 32,000 |
| A | 5,100 |  |  |  |  |
| B | 8,400 | 13,500 |  |  |  |
|  |  | 1,09,100 |  |  | 1,09,100 |

Note: Calculate of new profit sharing ratio
Share given to $C=1 / 4$; Balance of Profit $=1-1 / 4=3 / 4$
A's share $=3 / 4 \times 3 / 5=9 / 20$
B's share $=3 / 4 \times 2 / 5=6 / 20$
C's share $($ given $)=1 / 4$
A B C
$\frac{9}{20}: \frac{6}{20}: \frac{1}{4}=\frac{9: 6: 5}{20}=9: 6: 5$
(2) New capital of A and B : Based on C's capital, the total capital of the firm will work out i.e.,

C's capital for $1 / 4$ th share $=20,000$
Thus the capital of whole firm $=20,000 \times 4 / 1=₹ 80,000$
Therefore, based on their new profit new profit sharing ratio, the capital of $A$ and $B$ will be.

A's share of capital $=80,000 \times 9 / 20=₹ 36,000$
B's share of capital $=80,000 \times 6 / 20=₹ 24,000$

Adjustment of capital on basis of old partners' calculation of proportionate capital of New Partners'.

Illustration 20: Sahaj \& Nimish are partners in a firm. They share profits \& losses in ratio of 2:1. Since both of them are especially abled sometimes they find it difficult to run a business so admitted Gauri a common friend decided to help them. Therefore, they admitted her into partnership for $1 / 3$ share. She brought her share of goodwill in cash \& proportionate capital. At the time of her admission Balance Sheet of Sahaj \& Nimish was as under

| Liabilities | ₹ | Assets | ₹ |  |
| :--- | ---: | ---: | :--- | ---: |
| Capital A/c |  |  | Machinery | $1,20,000$ |
| Sahaj | $1,20,000$ |  | Furniture | 80,000 |
| Nimish | $\underline{80,000}$ | $2,00,000$ | Stock | 50,000 |
| General Reserve |  | 30,000 | Sundry Debtors | 30,000 |
| Creditors | 30,000 | Cash | 20,000 |  |
| Employees Provident Fund | 40,000 |  |  |  |
|  |  | $3,00,000$ |  | $3,00,000$ |

It was decided to:
(a) Reduce the value of stock by ₹ 5,000
(b) Depreciate furniture by $10 \%$ and appreciate machinery by $5 \%$.
(c) ₹ 3,000 of the debtors proved bad. A provision of $5 \%$ was to be created on Sundry Debtors for doubtful debts.
(d) Goodwill of the firm was valued at ₹45,000

Prepare Revaluation Account, Partner's Capital Accounts and Balance Sheet of reconstituted firm. Identify the values conveyed.

## Solution:

## Revaluation Account

| Dr. |  |  | Cr. |
| :---: | :---: | :---: | :---: |
| Particulars | ₹ | Particulars | ₹ |
| To Stock A/c | 5,000 | By Machinery A/c | 6,000 |
| To Furniture | 8,000 | By Less transferred to |  |
| To (Sundry Debtors) Bad debts | 3,000 | Sahay's capital A/c 7,567 |  |
| To provision for bad debts | 1350 | Nimish's capital A/c 5,783 | 11,350 |
| $(30,000-3000) \times \frac{5}{100}$ | 17,350 |  | 17,350 |

## Partner's capital Accounts

Dr.

| Particulars | (₹) Sahaj | (₹) <br> Nimish | (₹) Gauri | Particulars | (₹) Sahaj | (₹) <br> Nimish | (₹) Gauri |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| To <br> Revaluation A/c <br> To balance c/d | 7,567 | 3783 |  | By Balance b/d <br> By General | 1,20,000 | 80,000 |  |
|  | 1,42,433 | 91,217 | 1,16,825 | Reserve <br> By <br> Premium for goodwill A/c | 20,000 | 10,000 |  |
|  |  |  |  | By Bank A/c | 10,000 | 5,000 | 1,16,825 |
|  | 1,50,000 | 95,000 | 1,16825 |  | 1,50,000 | 95,000 | 1,16825 |

Balance Sheet of New Firm

| Liabilities | (₹) | Assets |  | (₹) |
| :---: | :---: | :---: | :---: | :---: |
| Capital A/c |  | Machinery |  | 1,26,000 |
| Sahaj 1,42,433 |  | Furniture |  | 72,000 |
| Nimish 91,217 |  | Stock |  | 45,000 |
| Gauri $\quad 1,16,825$ | 3,50,475 | Sundry Debtors | 30,000 |  |
| Creditors | 30,000 | Less Bad debts | $(3,000)$ | 25,650 |
| Employees provident Fund | 40,000 | Less Provision | (1,350) | 20,000 |
|  |  | Cash |  | 1,31,825 |
|  | 4,20,475 | Bank |  | 4,20,475 |

Values conveyed: Friendship, Sympathy. Working Notes:

Gauri's share of goodwill $=₹ 45000 \times 1 / 3=₹ 15,000$
Total adjusted capital of old partner for $2 / 3$ share $=₹ 1,42,433+91,217=$ ₹ $2,33,650$
Proportionate capital of Gauri $1 / 3$ share $=2,33,650 \times 3 / 2 \times 1 / 3=₹ 233650 / 2=$ ₹1,16,855

Bank A/c

| Dr. |  |  | Cr. |
| :---: | :---: | :---: | :---: |
| Particulars | ₹ | Particulars | ₹ |
| To Gauri's Capital <br> To Premium for goodwill | 1,16,825 | By balance c/d | 1,31,825 |
|  | 15,000 |  |  |
|  | 1,31,825 |  | 1,31,825 |

Illustration 21: Anthony and Boni were partners in a firm sharing profit in the ratio of 5:3. Their Balance Sheet as on 31-3-1015 was as follows:

| Liabilities | (₹) | Assets | (₹) |  |
| :--- | ---: | :--- | ---: | ---: |
| Bank overdraft | 60,000 | Cash | 20,000 |  |
| Creditors | 50,000 | Debtors | 100,000 |  |
| General Reserve |  | 48,000 | Less: Provision 2,000 | 98,000 |
| Capital Accounts: |  | Bills receivables | 38,000 |  |
| Anothony | $1,50,000$ |  | Stock | 40,000 |
| Boni | $\underline{1,00,000}$ | $2,50,000$ | Building | $1,50,000$ |
|  |  | Land | 62,000 |  |
|  |  | $4,08,000$ |  | $4,08,000$ |

On 01.04.2015, they admitted Heena into partnership for $1 / 4^{\text {th }}$ share in future profit of the firm. Assets and Liabilities were revalued. Goodwill of the firm was valued at ₹ 80,000

Fill in the missing information/figure in the following ledger accounts and balance sheet.


Partner's Capital Account

| Particulars | Anthony | Boni | Heena | Particulars | Anthony | Boni | Heena |
| :---: | :---: | :---: | :---: | :--- | :---: | :---: | :---: |
| To Bal. c/d | - | - | 80,000 | By <br> Balance <br> b/d <br> By General | - | - | - |
| Reserve | - | - | - |  |  |  |  |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  | By <br> Premium <br> for <br> goodwill <br> A/c <br> By...... A/c | - |

## Balance Sheet

As at 01.04.2015

| Liabilities | (₹) | Assets | $(₹)$ |  |
| :--- | ---: | ---: | :--- | ---: |
| Bank overdraft | 60,000 | Cash | - |  |
| Creditors | 50,000 | Debtors | - |  |
| Capital Accounts: |  | Bills receivables | 38,000 |  |
| Anothony | - | Stock | - |  |
| Boni |  | Building | $1,50,000$ |  |
| Heena | - | Land | 68,200 |  |
|  | $\underline{80,000}$ |  | - | - |
|  |  |  |  |  |

## Solution:

## Revaluation Account

Dr.

| Particulars | ₹ | Particulars | ₹ |
| :--- | :---: | :---: | :---: |
| To provision for Bad Debts A/c | 3,000 | By Land A/c | 6,200 |
| To Stock A/c | 2,000 |  |  |
| To Profit transferred to |  |  |  |
| Anthony's Capital A/c 750 |  |  |  |
| Bonis capital A/c | $\underline{450}$ | 1,200 |  |
|  |  | 6,200 |  |

Revaluation Account

| Particulars | Anthony | Boni | Heena | Particulars | Anthony | Boni | Heena |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| To Bal. c/d | 193,250 | 1,25,950 | 80,000 | By Balance <br> b/d <br> By General <br> Reserve <br> By <br> Revaluation <br> A/c <br> By Premium <br> for goodwill <br> A/c <br> By Cash A/c | 1,50,000 | 1,00,000 | - |
|  |  |  |  |  | 30,000 | 18,000 | - |
|  |  |  |  |  | 750 | 450 | - |
|  |  |  |  |  | 12,500 | 7500 | 80,000 |
|  | 193,250 | 1,25,950 | 80,000 |  | 193,250 | 1,25,950 | 80,000 |

Balance Sheet
As at 01.04.2015

| Liabilities |  | (₹) | Assets |  | (₹) |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Bank overdraft |  | 60,000 | Cash |  | 1,20,000 |
| Creditors |  | 50,000 | Debtors | 1,00,000 |  |
| Capital Accounts: |  |  | Less: Provision | 5,000 | 95,000 |
| Anthony | 193,250 |  | Bills receivables |  | 38,000 |
| Boni | 1,25,950 |  | Stock |  | 38,000 |
| Heena | 80,000 | 3,99,200 | Building |  | 1,50,000 |
|  |  |  | Land |  | 68,200 |
|  |  | 5,09,200 |  |  | 5,09,200 |

Q. 22 The following in the Balance sheet of $P$ and $Q$ as at 31.3.2016, $R$ is admitted as a partner at that date.

| Liabilities | $₹$ | Assets | $₹$ |
| :--- | ---: | :--- | ---: |
| P's capital | 12,000 | Goodwill | 15,000 |
| Q's capital | 9,000 | Debtor | 11,000 |
| Creditors | 10,000 | Stock | 12,000 |
| General Reserve | 40,000 | Building | 8,000 |
| Workmen Compensation | 12,000 | Advertisement Suspense A/c | 25,000 |
| Reserve |  | Profit \& Loss A/c | 12,000 |
|  | 83,000 |  | 83,000 |

P and Q share profit in the ratio of 3:2. The following term of admission are agreed upon:
a) The liabilities on workmen compensation reserve in determined at ₹ 15,000 .
b) Revaluation of asset: Building ₹ 17,000 ; stock ₹ 16,000 .
c) $\quad R$ brought in cash as his share of premium for goodwill ₹ 12,000 .
d) $\quad R$ was to bring in further cash as would make his capital equal to $30 \%$ of the combined capital of ' $P$ ' and ' $Q$ ' after above adjustment.
e) The future profit-sharing ratio were $=\mathrm{P}-4 / 10^{\text {th }}, \mathrm{Q}-3 / 10^{\text {th }}$ and $\mathrm{R}-3 / 10^{\text {th }}$. Prepare necessary ledger A/c.

## Solution:

Revaluation A/c
Dr $\mathbf{C r}$

| Particulars |  | ₹ | Particulars | ₹ |
| :---: | :---: | :---: | :---: | :---: |
| Liabilities for compensation | workmen | 3,000 | By Building <br> By stock | $\begin{aligned} & 9,000 \\ & 4,000 \end{aligned}$ |
| To profit (transfer) |  |  |  |  |
| P's capital- | 6,000 |  |  |  |
| Q's capital- | 4,000 | 10,000 |  |  |
|  |  | 13,000 |  | 13,000 |

## Partner's Capital Account

| Particulars | P | Q | R | Particulars | P | Q | R |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| To Goodwill A/c | 9,000 | 6,000 | - | By balance b/d | 12,000 | 9,000 | - |
| To Adv. Suspense | 15,000 | 10,000 | - | By cash A/c | - | - | 9,300 |
| A/c |  |  | - | By premium for <br> goodwill A/c | 8,000 | 4,000 | - |
| To Profit \& Loss Ac/ | 7,200 | 4,800 | -1600 |  |  |  |  |
| To Balance d/d | 18,800 | 12,000 | 9,300 | By General Reserve | 24,000 | 16,000 | - |
|  |  |  |  | By Revaluation A/c | 6,000 | 4,000 | - |
|  | 50,000 | 33.000 | 9.300 |  | 50,000 | 33,000 | 9,300 |

## Balance Sheet

| Liabilities | ₹ | Assets | ₹ |
| :---: | :---: | :---: | :---: |
| Capitals A/c |  | Debtors | 11,000 |
| P - 18,800 |  | Stock | 16,000 |
| Q - 12,200 |  | Building | 17,000 |
| R - 9 | 40,300 | Cash | 21,300 |
| Creditors | 10,000 |  |  |
| Workmen compensation claim | 15,000 |  |  |
|  | 65,300 |  | 65,300 |

Working Notes:
Sacrificing share =Old share- New Share

$$
\begin{aligned}
& P=\frac{3}{5}-\frac{4}{10}=\frac{6-4}{10}=\frac{2}{10} \quad \text { S.R. }=2: 1 \\
& Q=\frac{2}{5}-\frac{3}{10}=\frac{4-3}{10}=\frac{1}{10}
\end{aligned}
$$

Combined capital of $P$ \& $Q$ is $=18,800+12,200=31,000$
R's share $=3100 \varnothing \times \frac{3 \varnothing}{1 \varnothing \varnothing}=9300$
Q. 23 Rajesh and Sunil are partners in a firm sharing profits in the ratio of 3:2. They admitted 'Goel' as a New partner for $1 / 3^{\text {rd }}$ share in the profit. 'Goel' brings ` 20,000 for goodwill. He also brings capital equal to $30 \%$ of the total capital of the new firm. The balance sheet of Rajesh and Sunil was as at 31.3.2016

## Balance Sheet of Rajesh and Sunil

| Liabilities | ₹ | Assets | ₹ |
| :---: | :---: | :---: | :---: |
| General Reserve | 50,000 | Debtors | 40,000 |
| Creditors | 30,000 | Stock | 50,000 |
| Bills payable | 20,000 | Investment in Maruti Com | 1,00,000 |
| Capital A/cs |  | Furniture | 12,000 |
| Rajesh 2,00,000 |  | Machinery | 88,000 |
| Sunil $\quad 1,00,000$ | 30,0000 | Cash | ? |
|  | 4,00,000 |  | 4,00,000 |

It was decided to:
(a) Make a provision A 10\% on Sundry Debtors for Bad and doubtful debts.
(b) Revalue stock at ₹ 46,000 .
(c) Depreciate furniture by 10\% and depreciate Machinery by $2.5 \%$.

Prepare Revaluation A/c, partner's capital a/c and the Balance Sheet of the New Firm.

| Revaluation Account |  |  |  |
| :---: | :---: | :---: | :---: |
| Dr Particulars |  |  | Cr |
|  | ₹ | Particulars | ₹ |
| To provision for doubtful Debts <br> To Stock A/c <br> To machinery A/c | 4,000 | By Furniture A/c | 1,200 |
|  |  | By loss on Revaluation |  |
|  | 4,000 | transfer to partner's capital |  |
|  | 2,200 | A/c |  |
|  |  | Rajesh- 5,400 |  |
|  |  | Sunil - 3,600 | 9,000 |
|  | 10,200 |  | 10,200 |

## Partner's Capital Account

| Dr. |
| :--- |
| Particulars Rajesh ₹ Sunil ₹ Goel ₹ Particular's Rajesh ₹ Sunil ₹ Goel ₹ <br> To <br> Revaluation <br> A/c (Loss) 5,400 3,600  By balance <br> b/d $2,00,000$ $1,00,000$  <br> To balance        <br> c/d $2,36,600$ $1,24,400$ $1,54,714$ By cash A/c <br> By General <br> Reserve <br> By premium <br> for goodwill 12,000 8,000 20,000 |

Balance Sheet
Dr.

| Liabilities |  | ₹ | Assets | ₹ |
| :---: | :---: | :---: | :---: | :---: |
| Creditors |  | 30,000 | Debtors | 36,000 |
| Bills payable |  | 20,000 | Stock | 46,000 |
| Capitals |  |  | Investment in Maruti Com | 1,00,000 |
| Rajesh - | 2,36,600 |  | Furniture | 13,200 |
| Sunil | 1,24,400 |  | Machinery | 85,800 |
| Goel | 1,54,714 | 5,15,714 | $\begin{aligned} & \text { Cash } \\ & \{110000+20,000+1,54,714\} \end{aligned}$ | 2,84,714 |
|  |  | 5,65,714 |  | 5,65,714 |

## Working Notes

Let total capital of the firm = 1

$$
\text { Goel share }=30 \% \text { of the capital }
$$

$$
=\frac{3 \varnothing}{10 \emptyset}=\frac{3}{10}
$$

Remaining Share $=1-\frac{3}{10}=\frac{7}{10}$
Capital of Rajesh \& Sunil $=2,36,600$

$$
\frac{1,24,400}{3,61,000}
$$

For 7/10th Share capital $=361000$
For 1 Sh. Of capital $=36100 \times \frac{7}{10}$
For $3 / 10^{\text {th }}$ Sh. Of capital $=361000 \times \frac{1 \phi}{7} \times \frac{3}{1 \varnothing}$
Goel' Share of capital $=\frac{1083000}{7}$
$=154714.28$
$=154714$

## CHAPTER 5

## RETIREMENT/DEATH OF A PARTNER

Retirement of a partner means ceasing to be partner of the firm. A partner may retire (i) if there is agreement to this effect (ii) all partners give consent (iii) At will by giving written notice.

## Introduction

Like admission and changes in profit sharing ratio, in case of retirement or death also the existing partnership deed comes to an and the new one comes into existence among the remaining partners. There is not much difference in the accounting treatment at the time of retirement or in the event of death of a partner.

## Amount due to Retiring / Deceased Partner (To be credited to his capital account)

1. Credit Balance of his capital.
2. Credit Balance of his current account (if any).
3. Share of Goodwill. (To be given by gaining partners)
4. Share of Reserves or Undistributed Profits.
5. His share in the profit on revaluation of assets and reassessment of liabilities.
6. Share in profits up to the date of Retirement/Death.
7. Interest on capital if involved.
8. Salary if any

Deduction from the above sum (to be debited to the capital account)

1. Debit balance of his current account (if any)
2. Share of existing Goodwill to be written off.
3. Share of Accumulated loss.
4. Drawings and interest on drawings (if any).
5. Share of loss on account of Revaluation of assets and liabilities.
6. His share of business loss up to the date of Retirement/Death (To P \& L suspense A/c)

## Things to Remember

1. At first, goodwill already appeared in the books must be written off i.e. debiting old/all partner's Capital Accounts in old profit sharing ratio.
2. All Balance sheet item e.g. Accumulated Profit like general reserve, P\&L credit balance, workmen's compensation reserve, Investment Fluctuation Reserve, Accumulated losses advertisement suspense A/c, P \& L A/c debit balance is to be distributed among old Partners in their old ratio.
(a) Assets side item is to be debited to Partner's Capital A/c's whereas
(b) Liabilities side item is to be credited to the Partner's Capital A/cs
3. Revaluation Profit/ Loss is to be distribute in old Profit sharing ratio among old partners.
4. In case of specific fund, like investment fluctuation fund market value of investment must be considered. For Workman compensation fund, actual liabilities for workman compensation must be considered (to be deducted from fund).
5. Valuation of goodwill: Gaining Partner's Capital A/c debited \& Sacrificing partner's capital A/c is to be credited with their respective gained or sacrificed share. (goodwill A/c need not to be opened for this treatment)

## Accounting Treatment

1. Calculation of new profit sharing ratio and gaining ratio
2. Treatment of goodwill.
3. Revaluation a/c preparation with the adjustment in the respect of unrecorded assets/liabilities.
4. Distribution of reserves and accumulated profits/loss.
5. Ascertainment of share of profit/loss till the date of retirement/death.
6. Adjustment of capital if required.
7. Settlement of the Accounts due to Retired/Deceased partner.

## New Profit Sharing Ratio \& Gaining Ratio

New Profit Sharing Ratio: It is the ratio in which the remaining partners will share future profits after retirement/death.

Gaining ratio: It is the ratio in which the continuing partners have acquired the share from the outgoing partner. Gaining Ratio = New Ratio - Old Ratio.

Calculation of the two ratios.

## Following situations may arise

## 1. When no information about new ratio or gaining ratio is given in the question

In this case it is considered that the share of the retiring partner is acquired by the remaining partners in the old ratio. Then no need to calculate the new ratio/gaining ratio as it will be the same as before.

Illustration 1: $A, B$ and $C$ are partners sharing profit and loss in the ratio of 3:2:1 then on retirement of a partner; the gaining ratio/new, ratio will be
On A's Retirement 2: 1
On B's Retirement 3: 1
On C's Retirement 3: 2
2. Gaining ratio is given which is different than the old ratio in this case New share of continuing partner = old share + share gained from the outgoing partner.
Illustration 2: $A, B, \& C$ share profit in the ratio 3:2:1. On C's death his share is taken by $A$ and $B$ in the ratio of $2: 1$ Calculate new ratio.
Solution: In this case gaining ratio $=2: 1$ (given)
A's old share $-3 / 6$, B's old share $=2 / 6 \& C$ 's share $=1 / 6$
A's gain $=2 / 3$ of C's share $2 / 3^{*} 1 / 6=2 / 18$
B's gain $=1 / 3$ of C's share $=1 / 3^{*} 1 / 6=1 / 18$

A's new share $=$ A's old + A's gain
$=3 / 6+2 / 18=11 / 18$
B's new share $=$ B's old share $+B$ 's gain
$=2 / 6+1 / 18=7 / 18$ New ratio $=11: 7$

## 3. If the new ratio is given the Gaining ratio $=$ New Ratio-Old Ratio

Illustration $3: A, B$ and $C$ are partners in the ratio of $3: 2: 1 \mathrm{C}$ retires and $A \& B$ decide to share future profit in the ratio of $5: 3$. Calculate Gaining ratio of $A$ and $B$.

Solution: A's Gain $=5 / 8-3 / 6=3 / 24$
B's Gain $=3 / 8-2 / 6=1 / 24$
Gaining ratio $=3: 1$
Illustration 4: $A, B$ and $C$ are partners sharing profits and losses in the ratio of $3: 2: 1$. B retires and gifted $\frac{1}{2}$ of his share in favour of $A$ and sells remaining share to $A$ and $C$ in the ratio of 1:2. Find out gaining ratio and new ratio.
Solution:
B's share $=\frac{2}{6}=\frac{1}{3} ;$ gifted to $A=\frac{1}{3} \times \frac{1}{2} \times \frac{1}{6}$
Remaining shares of $B=\frac{1}{3}-\frac{1}{6}=\frac{2-1}{6}=\frac{1}{6}$
A's gain $=$ Gifted share of $B+$ Share sold by B
Share sold by B to A $=\frac{1}{6} \times \frac{1}{3}=\frac{1}{18}$
A's gain $=\frac{1}{6}+\frac{1}{18}=\frac{3+1}{18}=\frac{4}{18}$ or $\frac{2}{9}$
C's gain $=\frac{1}{6} \times \frac{2}{3}=\frac{2}{18}$ or $\frac{1}{9}$
Gaining ratio $=\frac{2}{9}: \frac{1}{9}$ or 2:1
A's new share $=\frac{3}{6}+\frac{2}{9}=\frac{9+4}{18}=\frac{13}{18}$

C's new share $=\frac{1}{6}+\frac{1}{9}=\frac{3+2}{18}=\frac{5}{8}$
New profit sharing ratio of $A$ and $C$ is $\frac{13}{18}: \frac{5}{18}$ or 13:5
Distinction between the Sacrificing and Gaining Ratio

| Basis | Sacrificing Ratio | Gaining Ratio |
| :---: | :--- | :--- |
| 1. Meaning | It is the ratio in which <br> the old partners <br> surrender a part of their <br> share of profits in it <br> favour of a new partner. | It is the ratio in which <br> the remaining partners <br> acquire the outgoing <br> partner's share of <br> profit. |
| 2. Formula | Sacrificing Ratio= Old <br> Ratio- New Ratio | Gaining Ratio= New <br> Ratio- Old Ratio |
| 3. Purpose | New partners share of <br> goodwill is divided <br> between old partner in <br> this ratio. | Retiring or deceased <br> partners share of <br> goodwill is paid by the <br> continuing partners in <br> this ratio. |

## TREATMENT OF GOODWILL

According to Accounting Standards -26, Goodwill account can't be raised as only purchased goodwill is recorded in books. Therefore, only adjustment entry is done for goodwill.

## Steps to be followed

1. When old goodwill appears in the books then first of all this is written off in the old ratio. Remember Old Goodwill in Old Ratio.
All Partner's capital A/c
Dr.

To Goodwill A/c
2. After written off old goodwill adjustment of retiring partner's share of goodwill will be made through the following journal entry.

Remaining Partner's Capital A/c Dr. (in gaining ratio)
To Retiring / Deceased Partner's Capital A/c

Illustration 5: $A, B$ and $C$ were partners sharing profits in the ratio of 6:4:5. On $1^{\text {st }}$ April, 2016, B retired from the firm and the new profit sharing ratio between A and C was decided as 11:4 on B's retirement, the goodwill of the firm valued at ₹ $1,80,000$. Pass journal entry for treatment of goodwill on B's retirement.
(CBSE Delhi)

## Solution:

## JOURNAL

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 2016 April,1 | A's Capital A/c | Dr. |  | 60,000 |  |
|  | To B's Capital A/c |  |  |  | 48,000 |
|  | To C's Capital A/c |  |  |  | 12,000 |
|  | (Being adjustment of | goodwill |  |  |  |
|  | made on B's retirement) |  |  |  |  |

## Working Notes:

Gaining Ratio $=$ A's gain $=\frac{11}{15}-\frac{6}{15}=\frac{11-6}{15}=\frac{5}{15}$
C's gain $=\frac{4}{15}-\frac{5}{15}=-\frac{1}{15}$ (sacrificed)
B's share is goodwill $=1,80,000 \times \frac{4}{15}=₹ 48,000$
A will compensate C to the extent of sacrifice made by C i.e. $1,80,000 \times \frac{1}{15}$

$$
\text { = ₹ } 12,000
$$

Illustration 6: M. N. \& P are partners in a firm Pretires \& the goodwill of the firm is valued at ₹ 30000 . M \& N decide to share future profits in the ratio of $3: 2$. Pass necessary adjustment entries.

1. If goodwill A/c already appears in the books at ₹ 18000
2. When no goodwill $\mathrm{A} / \mathrm{c}$ appears in the books.

## Solution:

Old ratio of $M, N \& P=1: 1: 1$ (since profit sharing ratio is not given it is treated as equal) New ratio $=3: 2$

$$
\begin{array}{ll}
\text { M's gain } & =3 / 5-1 / 3=4 / 15 \\
\text { N's gain } & =2 / 5-1 / 3=1 / 15 \\
\text { Gaining ratio } & =4: 1 \\
\text { Ps share of goodwill } & =30,000 \times 1 / 3 \\
& =₹ 10,000
\end{array}
$$

Journal

| Date | Particulars | LF. | Debit ( ${ }^{\text {( })}$ | Credit( ${ }^{\text {( }}$ ) |
| :---: | :---: | :---: | :---: | :---: |
|  | M's Capital A/c Dr. |  | 9,000 |  |
|  | N's Capital A/c Dr. |  | 6,000 |  |
|  | P's Capital A/c Dr. |  | 6,000 |  |
|  | To Goodwill A/c <br> (Being the existing goodwill written off in old ratio i.e. 1:1:1) |  |  | 18,000 |
|  | M's Capital A/c Dr. |  | 8,000 |  |
|  | N's Capital A/c Dr. <br> To P's Capital A/c |  | 2,000 | 10,000 |
|  | (Being adjustment made for goodwill on retirement in gaining ratio i.e. 4:1) |  |  |  |

Case 2 : When No goodwill appears in the books then only second entry will be done.

## Hidden Goodwill

Sometimes goodwill is not given in the question directly, but if a firm agrees to pay a sum which is more than retiring partner's balance in capital after making all adjustment with respect to reserves, revaluation of assets and liabilities etc. then excess amount is treated as his share of goodwill (known as hidden goodwill)

Illustration 7 : R, S \& T are partners in a firm sharing profit \& loss in the ratio of 2:2:1. T Retires and his balance in capital a/c after adjustment for reserve \& revaluation of assets \& liabilities comes out to be ₹ 50000 . R \& S agree to pay him ₹ 60000. Give journal entry for the adjustment of goodwill.

## Solution:

New ratio between $R$ \& $S=$ gaining ratio $=2: 2$ or 1:1
T's share of goodwill (hidden) $=60000-50000=10000$
Hence adjustment entry is
Journal

| Date | Particulars | L.F. | Debit <br> (₹) | Credit <br> (₹) |
| :--- | :--- | ---: | :---: | :---: | :---: |
| R's capital A/c capital A/C  <br> To T's capital A/c  <br> (T's share of goodwill adjusted in gaining ratio <br> i.e. 1:1 Dr. |  | 5,000 |  |  |

Illustration 8: $\mathrm{X}, \mathrm{Y}$ and Z are partners sharing profits in the ratio of 3:2:1. Y retires selling his share to $X$ and $Z$ for ₹ 36,000 ; ₹ 24,000 being paid by $X$ and $₹$ 12,000 by Z. The profit after Y's retirement is ₹ 63,000 .

Pass necessary journal entries to
(i) Record the sale of $Y$ 's share to $X$ and $Z$ and
(ii) Distribute the profit between $X$ and $Z$.

## Solution:

## JOURNAL



Working Notes:
Gaining ratio $=24000: 12000=2: 1$
Y's share $=\frac{2}{6}$
X's gaining share $=\frac{2}{6} \times \frac{2}{3}=\frac{4}{18}$
Z's gaining share $=\frac{2}{6} \times \frac{1}{3}=\frac{2}{18}$
$X$ 's new share is $=\frac{3}{6} \times \frac{4}{18}=\frac{9+4}{18}=\frac{13}{18}$
Z's new share is $=\frac{1}{6}+\frac{2}{18}=\frac{3+2}{18}=\frac{5}{8}$
New Profit sharing Ratio between $X$ and $Z=13$ : 5

## 3. Revaluation of Assets and Reassessment of Liabilities

Revaluation $A / c$ is prepared in the same way as in the case of admission of a new partner. Profit and loss on revaluation is transferred among all the partners in old ratio.

## 4. Adjustment of Reserves and Surplus (Profits)

(Appearing in the Balance Sheet - Liability Side)
(a) General Reserve A/c
Dr.
Reserve Fund $\mathrm{A} / \mathrm{c}$
Dr.
Profit \& Loss A/c (Credit Balance)
Dr.
To all partners' Capital/Current A/c (in old ratio)

Illustration 9: $\mathrm{X}, \mathrm{Y}$ and Z are partners in a firm sharing profits and losses in the ratio of 2:1:1. Y retires on 31st March, 2016. On that date, there was a balance of $₹ 24,000$ in general reserve and ₹ 16,000 in profit and loss A/c of the firm. Give Journal entries.

## Solution:

Journal

| Date | Particulars | L.F. <br> Debit <br> (₹) | Credit <br> (₹) |  |  |
| :---: | :--- | :---: | :---: | :---: | :---: |
|  | General Reserve A/c | Dr. |  | 24,000 |  |
|  | P \&LA A/c | Dr. |  | 16,000 |  |
|  | To X's capital A/c |  |  |  | 20,000 |
|  | To Y's capital A/c |  |  | 10,000 |  |
|  | To Z's capital A/c |  |  | 10,000 |  |
|  | (Reserve \& Surplus amount distributed in <br> old ratio on Y's retirement) |  |  |  |  |

(b) Specific Funds - if the specific funds such as workmen's compensation fund or investment fluctuation fund are in excess of actual requirement, the excess will be transferred to the Capital $A / c$ in old ratio.

Workmen Compensation Fund $A / c \quad$ Dr.
Investment Fluctuation Funds A/c
Dr.
To All Partner's Cap A/c's (in old ratio)

Illustration 10: $P, Q$ and $R$ are partner's sharing profits and losses in the ratio of $3: 2: 1$. P retires and on that date there was workmen's compensation fund amount ₹ 30,000 in the Balance Sheet. But actual liability on this account was for ₹ 12,000 only on that date. Give Journal Entry.

## Solution

Excess amount in Workmen's Compensation Fund = $₹ 30,000-₹ 12,000=₹ 18,000$ (Cr.)

This will be transferred to all partner's Capital A/c in old ratio
Journal Entry

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Workmen Compensation Fund A/c <br> To P's capital A/c <br> To Q's capital A/c <br> To R's capital A/c <br> To Claim for workmen compensation fund $\mathrm{A} / \mathrm{c}$ <br> (Excess amount in workmen compensation fund capital $A / c$ in old ratio) is transferred to parties |  | 30000 |  |

## (c) For distributing accumulated losses

(i.e. P \& L A/c debit balance shown on the Asset side of Balance Sheet)

All partner's Capital/Current A/c Dr. (in old ratio)

To P \& L A/c

Illustration 11: $A, B$ and $C$ are equal partners. A retires and on that date there was a debit balance of ₹ 15,000 in P \& L A/c. Give Journal entry.

## Solution:

| Date | Particulars | LF. | Debit <br> (₹) | Credit (₹) |  |
| :--- | :--- | ---: | ---: | ---: | :---: |
|  | A's Capital A/c | Dr. |  | 5,000 |  |
|  | B's Capital a/c | Dr. |  | 5,000 |  |
|  | C's Capital A/c | Dr. |  | 5,000 |  |
|  | To P\&L A/c |  |  | 15,000 |  |
|  | (Loss in P\&L A/c written off (in old ratio) on |  |  |  |  |
|  | A's retirement |  |  |  |  |

## Disposal of the Amount Due to the Retiring Partner

The outgoing partner's A/c is settled as per the terms of partnership deed. Three cases may be there as given below-

1. When the retiring partner is paid full amount either in cash or by cheque.
Retiring Partner's Capital, A/c
Dr.
To Cash or Bank, A/c
2. When the retiring partner is paid nothing in cash then the whole amount due is transferred to his loan A/c

Retiring Partner's Capital, A/c Dr.
To Retiring Partner's Loan A/c
3. When Retiring Partner is partly paid in cash and the remaining amount is treated Loan.
Retiring Partner's Capital, A/c
Dr. (Total Amount due)
To Cash/Bank A/c (Amount Paid)
To Retiring Partner's Loan A/c (Amount of Loan)

## Settlement of Loan of the Retiring Partner

Loan of the retiring partner is disposed of accordingly to the pre decided terms and conditions among the partners. Normally the Principal amount is paid in few equal
instalments. In such cases interest is credited to the Loan A/c on the basis of the amount outstanding at the beginning of each year and the amount paid is debited to loan A/c. The following Journal entries are done
a. For interest on Loan.

> Interest A/c

Dr.
To Retiring Partner's Loan A/c
b. For the payment of instalment.

Retiring Partner's Loan, A/c Dr.

To Cash/Bank A/c (including interest)
Illustration 12: $A, B$, and $C$ are partners in a firm. $B$ retires from the firm on 1st Jan 2015. On the date of his retirement ₹ 66,000 were due to him. It was decided that the payment will be done in 3 equal yearly instalments together with interest @ 10\% p.a. on the unpaid balance, Prepare B's Loan A/c.

## B's Loan A/c

Dr.
Cr.

| Date | Particulars | LF | ₹ | Date | Particulars | LF | ₹ |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| 2015 | Bank A/c |  |  | $\begin{aligned} & \hline 2015 \\ & \text { Jan } 1 . \\ & \text { Dec } \\ & 31 \end{aligned}$ | B's Capital A/c | 660006600 |  |
| Dec 31 | (22000+6600) |  | 28600 |  |  |  |  |
|  | Balance c/d |  | 44000 |  | By Interest A/c ( $10 \%$ of 66000 ) |  |  |
| $\begin{aligned} & 2016 \\ & \text { Dec } 31 \end{aligned}$ |  |  | 7260 |  |  |  | 72600 |
|  | Bank A/c <br> Balance c/d |  | 26400 | $\begin{aligned} & 2016 \\ & \text { Jan } 1 \end{aligned}$ | Balance b/d <br> Br. Interest A/c (10\% of 44000) |  | 44000 |
|  |  |  | 22000 |  |  |  | 4400 |
| $\begin{aligned} & 2017 \\ & \text { Dec } 31 \end{aligned}$ | Bank A/c (Final Payment) |  | 48400 | $\begin{aligned} & 2017 \\ & \text { Jan } 1 \\ & \text { Dec } \\ & 31 \end{aligned}$ |  |  | 48400 |
|  |  |  |  |  | Balance b/d Interest A/c (10\% of 22000) |  | 22000 |
|  |  |  | 24200 |  |  |  | 2200 |
|  |  |  | 24200 |  |  |  | 24200 |

## Adjustment of Capitals

At the time of retirement /death, the remaining partners may decide to adjust their capitals in their new profit sharing Ratio. Then

- The sum of their capitals will be treated as the total capital of the new firm which will be divided in their New Profit Sharing Ratio.
- Excess or Deficiency of capital in the individual capital $\mathrm{A} / \mathrm{c}$ is calculated.
- Such excess or shortage is adjusted by withdrawal or contribution in cash or transferring to Partner's current A/cs.


## Journal Entries

(a) For excess Capital withdrawn by the Partners

Partner's capital A/c Dr.
To Cash/Bank A/c / Partner's Current A/c
(b) For deficiency, cash will be brought in by the partner

Cash/Bank A/c /Partner's Current A/c Dr.
To Partner's Capital A/c
Illustration 13: $\mathrm{X}, \mathrm{Y}$ and Z are partners in a firm sharing profits in the ratio of 2:2:1 $X$ retires and after all adjustments the Capital $A / c s$ of the $Y$ and $Z$ have a balance of ₹ 70,000 and ₹ 50,000 respectively. They decided to adjust their capitals in new profit sharing ratio by withdrawing or bringing cash. Give necessary Journal entries and show your working clearly.

## Solution

The capital of the new firm
$=$ Total Capital of Y and Z after adjustments
$=70,000+50,000$
$=1,20,000$

|  | $\mathbf{Y}(₹)$ | $\mathbf{Z}(₹)$ |
| :--- | ---: | ---: |
| New Capital based on New Ratio i.e. 2:1 <br> (total being 1,20,000) <br> Existing capital after adjustments | 80000 | 40,000 |
| Cash is being brought or paid off | 70,00 | 50,000 |
|  | 10,000 <br> (brought in) | 10,000 <br> (to be paid) |

Journal Entries

|  | Particulars | L.F | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 1. | Bank A/c <br> To Y's Capital A/c <br> (Amount to be withdrawn by Z) |  | 10,000 | 10,000 |
| 2. | Z's Capital A/c Dr To Bank A/c (Amount to be withdrawn by Z) |  | 10,000 | 10,000 |

Illustration 14: Nandan, John and Rosa are partners sharing profit in the ratio of 4:3:2. On $1^{\text {st }}$ April 2016, John gave a notice to retire from the firm. Nandan and Rosa decided to share future pofits equally. The Capital accounts of Nandan and Rosa after all adjustments showed a balance of ₹ 43,000 and ₹ 80,500 respectively. This total amount was to be paid by John was ₹ 95,500 . This amount was to be paid by Nandan and Rosa in such a way that their capitals become proportionate to their new ratio. Pass necessary journal entries in the books of firm for the above transactions. Show your working clearly.
(CBSE 2013, set/ outside Delhi)

## Solution:

## Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
| :---: | :---: | :---: | :---: | :---: |
| April 1 | Cash A/c / Bank A/c Dr. |  | 95,500 |  |
| 2016 | To Nandan's Capital A/c |  |  | 66,500 |
|  | To Rosa's Capital A/c (Being cash brought in by existing partners) |  |  | 29,000 |
| April 1 | John's Capital A/c <br> To Cash A/c Bank A/c <br> (Being payment made to John) |  | 95'500 | 95,500 |

Working Notes: total Capital of the new firm = Nandan's Capital + Rosa's Capital + Amount paid to John $=43000+80,500+95,500$
= ₹ 2,19,000

| Particulars | Nandan (₹) | Rosa (₹) |
| :--- | ---: | ---: |
| (i)New Capital (₹ 2,19,000 divided in equal ratio) | $1,09,500$ | $1,09,500$ |
| (ii) Less: Existing Capital | 43,000 | 80,500 |
| Cash to be paid off or brought in | 66,500 | 29,000 |

Illustration 15: (Preparation of balance sheet of the reconstituted firm) Vijay, Vivek and Vinay are partners in a firm sharing profits in 2:2:1 ratio, On 31.3.2015 Vivek retires from the firm. On the date of Vivek's retirement the balance sheet of the firm was as follows:

Balance Sheet of Vijay, Vivek and Vinay

| Liabilities | ₹ | Assets | ₹ |
| :---: | :---: | :---: | :---: |
| Creditors | 54,000 | Bank | 55,200 |
| Bills Payable | 24,000 | Debtor 12,000 |  |
| Outstanding Rent | 4,400 | Less: Provision for |  |
| Provision for Legal Claim | 12,000 | Doubtful $\underline{800}$ | 11,200 |
| Capitals: |  | Stock | 18,000 |
| Vijay 92,000 |  | Furniture | 8,000 |
| Vivek 60,000 |  | Premises | 1,94,000 |
| Vinay $\quad$ 40,000 | 1,92,000 |  |  |
|  | 2,86,400 |  | 2,86,400 |

## On Vivek's retirement it was agreed that:

i. Premises will be appreciated by $5 \%$ and furniture will be appreciated by ₹ 2,000 . Stock will be depreciated by $10 \%$
ii. Provision for bad debts was to be made at $5 \%$ on debtors and provision for legal damages to be made for ₹ 14,400 .
iii. Goodwill of the firm is valued at ₹ 48,000 .
iv. ₹ 50,000 from Vivek's Capital A/c will be transferred to his loan A/c and the balance will be paid by cheque.

Prepare revaluation a/c, partners' Capital A/c's and Balance Sheet of Vijay and Vinay after Vivek's retirement.
(CBSE 2007 (Outside Delhi)

## Solution :

> Revaluation Account

Dr. Cr.

| Particular | $₹$ | Particular | $₹$ |
| :--- | ---: | :--- | ---: |
| To Stock | 1,800 | By Premises | 9,700 |
| To Provision for legal | 2,400 | By Furniture | 2,000 |
| Claim |  | By Provision For | 200 |
| To Profit transferred to capital |  | Doubtful debts |  |
| A/c of |  |  |  |
| Vijay |  |  |  |
| Vivek | 3,080 |  |  |
| Vinay | 3,080 |  |  |
|  | 1,540 | 7,700 |  |
|  |  | $\mathbf{1 1 , 9 0 0}$ |  |

Capital Account
Dr.

| Particulars | Vijay | Vivek | Vinay | Particulars | Vijay | Vivek | Vinay |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Vivek's Capital <br> Vivek's Loan Bank | 12,800 | $\begin{aligned} & 50,00 \overline{0} \\ & 32,280 \end{aligned}$ | 6,400 | By Balance b/d <br> By revaluation <br> A/c <br> By Vijay's <br> Capital <br> By Vinay's Capital | 92,000 | 60,000 | 40,000 |
|  |  |  | - |  | 3,080 | 3,080 | 1,540 |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  | - | 12,800 | - |
| Balance c/d | 82,280 |  |  |  | - | 6,400 | - |
|  | 95,080 | 82,280 | 41,540 |  | 95,080 | 81,280 | 41,540 |

Balance Sheet
As at 31st March 2006

| Liabilities | $₹$ | Assets |  | $₹$ |
| :--- | ---: | :--- | ---: | ---: |
| Creditors | 54,400 | Bank | $(55,200-32,280)$ | 22,920 |
| Bills Payable | 24,000 | Debtors | 12000 |  |
| Outstanding Rent | 4,400 | Less provision | $(600)$ | 11,400 |
| Provision for legal claims | 14,400 | Stock | 16,200 |  |
| Vivek's Loan | 50,000 | Furniture | 10,000 |  |
| Vijay's Capital | 82,280 | Premises | $2,03,700$ |  |
| Vinay's Capital | 35,140 |  |  |  |
|  | $\mathbf{2 , 6 4 , 2 2 0}$ |  | $\mathbf{2 , 6 4 , 2 2 0}$ |  |

## Working Note:

1. New Provision of bad debts on debtors $(5 \%)=5 \%$ of $₹ 12,000=600$ Old provision ₹ 800 as given in the balance Sheet. Excess of ₹ 200 is profit and transferred to revaluation $\mathrm{A} / \mathrm{c}$
2. Goodwill of the firm $=48,000$ Vivek share $=48,000 * 2 / 5=₹ 19,200$ will be given by Vijay \& Vinay in Gaining Ratio i.e. 2:1

Goodwill contributed by Vijay = ₹19200×2/3 = ₹12800.
Goodwill contributed by Vijay $=₹ 19200 \times 1 / 3=₹ 6,400$
3. Vivek's total amount due on retirement $=₹ 82,280$ Less: amount transferred to his loan A/c = ₹ 50,000

Amount to be paid by cheque ₹ 32,280

## DEATH OF A PARTNER

Accounting treatment in the case of death is same as in the case of retirement except the following:

1. The deceased partners claim is transferred to his executer's account.
2. Normally the retirement takes place at the end of the Accounting Period but the death may occur at any time. Hence the claim of deceased partner shall also include his share of profit or loss, interest on capital and drawings if any from the date of the last balance sheet to the date of his death.

## 1. Calculation of Profits/ Loss for the intervening Period

It is calculated by any one of the two methods given below:
a. On Time Basis: In this method proportionally profit for the time period is calculated either on the basis of last year's profit or on the basis of average profits of last few years and then deceased partner's share is calculated based on his share of profits.

Illustration 16: $A, B$ and $C$ are partner sharing profits in the ratio of 3:2:1. A dies on 31st July 2015. The profits of the firm for the year ending 31st March 2015 were ₹ 42000. Calculate A’s share for the period from 1st April to 31st July 2015 on the basis of last year's profits. Pass necessary journal entry also.

## Solution

$$
\begin{aligned}
& \text { A's Profit }=\text { Preceding year's profit } \times \text { Proportionate Period } \times \text { Share of A } \\
& =₹ 42,000 \times 4 / 12 \times 3 / 6 \\
& =₹ 7,000
\end{aligned}
$$

Journal Entries

| Date | Particulars | L.F | Debit <br> (₹) | Credit <br> (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2015 <br> July 31 | Profit and Loss Suspense A/c Dr. To A's Capital A/c <br> (A's share of profit transferred to his capital A/c) |  | 7,000 | 7,000 |

b. On Turnover or Sales Basis: in this method the profits upto the date of death for the current year are calculated on the basis of current year's sales upto the date of death by using the formula.

Profits for the current year upto the date of death =
(Sales of the current year upto the date of death/total sales of last year) $\times$ Profit for the last year.

Then from this profit the deceased partner's share of profit is calculated.
Illustration 17: If in the example-1 given above the sales for the last year are ₹ 2 , 10,000 and for the current year upto 31st July are say ₹ 90,000 then Profits from Ist April to 31st July 2015.

$$
\begin{aligned}
& =\frac{90,000}{2,10,000} \times 42,000 \\
& =₹ 18,000
\end{aligned}
$$

A's share $=₹ 18,000 \times 3 / 6=9,000$

## Journal Entry will be

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
| :--- | :--- | :---: | :---: | :---: | :---: |
| 2015 | P \& L Suspense A/c |  |  |  |
| July 31 | To A's Capital A/c <br> (Being A's share of profit till date of his <br> death transferred to his capital A/c) |  | 9,000 | 9,000 |

Illustration 18: (Death of a partner) $\mathrm{M}, \mathrm{N}$ and 0 were partners in a firm sharing profits and losses equally.

Their Balance Sheet on 31-12.2014 was as follows:

| Liabilities |  | ₹ | Assets | ₹ |
| :---: | :---: | :---: | :---: | :---: |
| Capitals: |  |  | Plant and machinery | 60,000 |
| M | 70,000 |  | Stock | 30,000 |
| N | 70,000 |  | Sundry Debtors | 95,000 |
| 0 | 70,000 | 2,10,000 | Cash at Bank | 40,000 |
| General Reserve Creditors |  | 30,000 | Cash in Hand | 35,000 |
|  |  | 20,000 |  |  |
|  |  | 2,60,000 |  | 2,60,000 |

N died on 14th March, 2015. According to the Partnership Deed, executers of the deceased partner are entitling to:
(i) Balance of partner's capital A/c
(ii) Interest on capital @ 5\% p.a.
(iii) Share of goodwill calculated on the basis of twice the average of past three years' profits.
(iv) Share of profits from the closure of the last accounting year till the date of death on the basis of twice the average of three completed year's profits before death. Profits for 2012, 2013 and 2014 were ₹ 80,000 , ₹ 90,000 , ₹ $1,00,000$ respectively. Show the working for deceased partner's share of goodwill and profits till the date of his death. Pass the necessary journal entries and prepare N's Capital A/c to be renderer to his executers.
(CBSE 2011 Modified)

## Solution

Journal

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2015 March, $14^{\text {th }}$ | General Reserve A/c <br> To N's Capital A/c <br> (Being transfer of N's share of general reserve of his Capital A/c) |  | 10,000 | 10,000 |
|  | Interest on Capital A/c Dr. $\quad$ To N's Capital A/c (Being interest 5\% p.a. credited to N's Capital A/c upto 14.03.2010) |  | 700 | 700 |
|  | M's Capital A/c Dr. <br> O's Capital A/c Dr. <br> To N's Capital A/c  <br> (Being goodwill adjusted in gaining ratio i.e. 1:1)  |  | $\begin{aligned} & 30,000 \\ & 30,000 \end{aligned}$ | 60,000 |
|  | Profit and Loss Suspense A/c Dr. To N's Capital A/c (Being the transfer to N's share of profit to his capital A/c) |  | 12,000 | 12,000 |
|  | N's Capital A/c Dr. To N's Executor A/c (Being the transfer of amount due to N's executor A/c) |  | 1,52,700 | 1,52,700 |

N's Capital A/c
Dr.

| Particulars | (₹) | Particulars | (₹) |
| :--- | :--- | :--- | ---: |
| To N's Executors A/c | $1,52,700$ | By Balance b/d | 70,000 |
|  |  | By General Reserve A/c | 10,000 |
|  |  | By Interest on Capital A/c |  |
|  |  | (70,000*5/100*73/365) | 700 |
|  |  | By M's Capital A/c | 30,000 |
|  |  | By O's Capital A/c | 30,000 |
|  |  | By Profit \& Loss |  |
|  |  | Suspense A/c |  |
|  |  | $\left(90,000^{*} 2^{*} 73 / 365^{*} 1 / 3\right)$ | 12,000 |

## Working Note:

1. Calculation of Goodwill

Average profit for 3 years
(₹80,000+90,000+1,00,000)/3 = ₹ 90,000
Goodwill of the firm = Average Profit $\times$ No. Of year of Purchase
$=90,000 \times 2=₹ 1,80,000$
N's Share in Goodwill $=1,80,000 \times 1 / 3=60,000$
2. Time from the date of last balance Sheet (31st December, 2014) to the date of death (14th March, 2015)
$=31$ days of January +28 days of Feb (2015 is not a leap year) +14 days of March = 73 days

Payment for deceased partner: Payment to deceased partner's executor is made either in lump sum or in instalments.
a. When payment is made in full (lump sum)

Accounting entry in this case will be
Deceased Partner's Executor A/c Dr.
To Bank A/c
b. When Payment is made in instalments. When payment is made in instalments interest is paid on instalments at agreed price or @ 6\% per annum Journal entries are
(i) When interest is allowed

Interest A/c
Dr.
To Deceased Partner's Executor A/c
(ii) When instalment is paid

Deceased partner's Executors A/c Dr.
To Bank A/c (interest \& instalment amount)

Illustration 19: The balance sheet of $P, Q \& R$ as at 31 st Dec. 2012 was as follows.

| Liabilities | ₹ | Assets | ₹ |
| :---: | :---: | :---: | :---: |
| Bills Payable | 20,000 | Cash at Bank | 1,58,000 |
| Employees Provident Fund | 50,000 | Bills Receivable | 8,000 |
| Workmen compensation | 90,000 | Stock | 90,000 |
| reserve |  | Sundry Debtors | 1,60,000 |
| Loan | 1,71,000 | Furniture | 20,000 |
| Capital Accounts |  | Plant \& Machinery | 65,000 |
| P 2,27,500 |  | Building | 3,00,000 |
| Q 1,52,500 |  | Advertisement |  |
| $R \quad 1,20,000$ | 5,00,000 | Suspense | 30,000 |
|  | 8,31,000 |  | 8,31,000 |

The profit ratio was 3:2:1 R died on 30th April 2013. The partnership deed provides that:
a. Goodwills is to be calculate on the basis of 3 years purchase of preceding 5 years' average profits. The profits were 2012. ₹ 2,40,000, 2011 ₹ 1,60,000, 2010 ₹ $2,00,000$, 2009 ₹ $1,00,000$ and 2008 - ₹ $50,000$.
b. Deceased partner should be given share of profits upto the date of death on the basis of previous your profits.
c. The assets have been revalued as under

Stock ₹1,00,000, Debtors ₹ $1,50,000$, Furniture ₹ 15,000 . Plant and Machinery ₹ 50,000 , Building ₹ $3,50,000$. A bill for ₹ 6000 was found worthless.
d. A sum of ₹ 72,330 was paid immediately to R's executor \& balance is paid in two equal instalments (annual) with interest of $10 \%$ p.a. on outstanding amount. Ist instalment was paid on 30th April 2014.
Prepare Revolution account \& R's executor account till it is finally settled. Accounts are closed on 31st December each year.

## Solution:

## Revaluation Account

Dr.
Cr.

| Particulars | $₹$ | Particulars | $₹$ |
| :--- | ---: | :--- | :---: |
| To Provision for Doubtful debts | 10,000 | By Stock | 10,000 |
| To Furniture | 5,000 | By Building | 50,000 |
| To Plant \& Machinery | 15,000 |  |  |
| To Bill Receivable | 6,000 |  |  |
| To profits transferred to |  |  |  |
| P's capital A/c | 12,000 |  |  |
| Q's Capital A/c | 8,000 |  |  |
| R's Capital A/c | $\underline{4000}$ | 24,000 |  |
|  |  | $\mathbf{6 0 , 0 0 0}$ |  |

R's Capital Account

| Dr. |  |  |  |  | Cr. |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Date | Particular | ₹ | Date | particular | ₹ |
| 30.04.13 | To advertisement <br> Suspense A/C $\left(30,000 \times \frac{1}{6}\right)$ <br> To R's Executor A/c |  | 1.1.13 | By balance b/d <br> By workmen <br> Compensation reserve <br> By Revaluation A/c <br> By P's Capital A/c <br> (Goodwill) <br> By Q's capital A/c <br> (Goodwill) <br> By P\&L Suspense A/c | 1,20,000 |
|  |  |  |  |  | 15,000 |
|  |  | 5,000 |  |  |  |
|  |  |  |  |  | 4,000 |
|  |  | 2,22,333 |  |  | 45,000 |
|  |  |  |  |  |  |
|  |  |  |  |  | 30,000 |
|  |  |  |  |  |  |
|  |  |  |  |  | 13,333 |
|  |  | 2,27,333 |  |  | 2,27,333 |

## R's Executor Account

Dr.
Cr.

| Date | Particulars | ₹ | Date | particular | ₹ |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 30.4.13 | To Bank A/c | 72,333 | 30.4.13 | By R's capital A/c | 2,22,333 |
| 31.12.13 | To Balance c/d | 1,60,000 | 31.12.13 | By interest A/c ( $10 \%$ on $1,50,000 \times \frac{8}{-}$ ) | 10,000 |
| 30.4.14 | To Bank A/c 75000 <br>  $\underline{15000}$ | 2,32,333 | 1.1.14 | By Balance b/d | 2,32,333 |
|  |  |  |  |  | 1,60,000 |
|  |  | 90,000 | 30.4.14 | By Interest A/c <br> 10 |  |
| 30.12.14 | To Balance c/d | 80,000 |  | $\left(\frac{10}{100} \times 1,50,000 \times \frac{4}{12}\right)$ | 5,000 |
| 30.4.15 | To Bank A/c 75,000 <br> Add Interest $\underline{7,500}$ |  | 31.12.14 | $\left(\frac{10}{100} \times 75,000 \times \frac{8}{12}\right)$ | 5,000 |
|  |  | 1,70,000 |  |  | 1,70,000 |
|  |  |  | 1.1.15 | By interest A/c | 80,000 |
|  |  | 82,500 | 30.4.15 | $\left(\frac{10}{100} \times 75,000 \times 4\right)$ | 2,500 |
|  |  | 82,500 |  |  | 82,500 |

## Working Note:

Average Profit $=2,40,000+1,60,000+2,00,000+1,00,000+50,000 / 5$
$=₹ 1,50,000$ Goodwill $=₹ 1,50,000 \times 3=₹ 4,50,000$
R's share $=4,50,000 \times \frac{1}{6}=₹ 75,000$
contribution by P\&Q in ratio 3:2
P's share $=\frac{3}{5} \times 75000=₹ 45000$ Q's share $\frac{2}{5} \times 75,000=₹ 30,000$

R's share of profits $=2,40,000 \times \frac{4}{12} \times \frac{1}{6}=₹ 13,333$

## Section 37 of the Indian Partnership Act,1932:

In case of any partner has died or retired and the remaining partners carry on the business of the firm without any final settlement of accounts then in the absence of any contrary agreement the retiring or executors of deceased partner has the option to receive-
(i) Interest @ 6\% p.a. on the outstanding amount
(ii) The share of profit earned on the unsettled/ outstanding amount for the period till his/her dues are settled by the firm.

Share of profit
$=\frac{\text { Amount due to outgoing partner }}{\text { Capital of remaining partners }+ \text { Amt.due to outgoing partner }} \times\left\{\begin{array}{c}\text { Profit from date of } \\ \text { retirement till the } \\ \text { end of current } \\ \text { financial year }\end{array}\right\}$
Illustration 20: $A, B$ and $C$ were partners in a firm sharing profits and losses in the ratio of 5:3:2. C retired on 1 July, 2015, the total amount payable to $C$ was $₹$ $1,00,000$. The amount due to $C$ is not paid by the firm until year ended $31^{\text {st }}$ March, 2016. The firm earned a profit of ₹ $1,20,000$ after the C's retirement to year ended $31^{\text {st }}$ March, 2016. The Capital of A and B for this period was ₹ $1,80,000$ and ₹ $1,20,000$ respectively. Calculate the amount under section 37 for which C's is entitled to receive.

Solution: According to the provision of sec. 37 of the Indian Partnership Act, 1932 C has the choice to get either of the following option till final settle is made.
(i) Interest @ 6 p.a. on the balance amount

$$
=1,00,000 \times \frac{6}{100} \times \frac{9}{12}=₹ 4,500
$$

(ii) Share in profit earned proportionate his amount outstanding to total capital

$$
\begin{aligned}
= & \frac{1,00,000}{1,80,000+1,20,000+1,00,000} \times 1,20,000 \\
& =\frac{1,00,000}{4,00,000} \times 1,20,000=₹ 30,000
\end{aligned}
$$

C should exercise option (ii) as amount under this option is more as compare to option (i).

## Check your Understanding

Q. 1 Why it is necessary to revalue the assets and reassessments of liabilities in case of retirement or death of a partner?
Q. 2 What are the different ways in which a partner can retire from the firm?
Q. 3 Why a retiring/deceased partner is entitled to a share of goodwill of the firm?
Q. 4 Narang, Suri and Bajaj are partners in a firm sharing profits and losses in proportion of $1 / 2,1 / 6$ and $1 / 3$ respectively. The balance sheet on April 1,2016 was as follows:

Books of Suri, Narang and Bajaj
Balance sheet as on April 1, 2016


Bajaj retires from the business and the partners agree to the following:
a) Freehold premises and inventories are to be appreciated by $20 \%$ and $15 \%$ respectively.
b) Machinery and furniture are to be depreciated by $10 \%$ and $7 \%$ respectively.
c) Bad Debts reserve is to be increased to ₹ 1,500 .
d) Goodwill is valued at ₹ 21,000 on Bajaj's retirement.
e) The continuing partners have decided to adjust their capitals in their new profit sharing ratio after retirement of Bajaj. Surplus/ deficit. If any, in their Capital accounts will be adjusted through current accounts.

Prepare necessary ledger accounts and draw the balance sheet of the reconstituted firm.

## Hints to answer:

1. Profit on Revaluation ₹ 6,960 .
2. Goodwill adjustment journal entry:

| Narang;s Capital A/c | Dr. | 5,250 |
| :--- | :--- | :--- |
| Suri's Capital A/c | Dr. | 1,750 |

(Being adjustment made for goodwill in gaining ratio)
3. Amount transfer to Bajaj's loan A/c ₹ 41,320.
4. Narang's Capital before adjustment of Capital $=₹ 44,230$

> Suri's Capital before adjustment of capital $=₹ 21,410$ Total Capital of the New firm $=44,230+21,410=₹ 65,640$
> Narang's adjusted Capital $=65,640 \times \frac{3}{4}=₹ 49,230$
> Suri's adjusted Capital $=65,640 \times \frac{1}{4}=₹ 16,410$
5. Calculation of Current Account Balance:

| Particulars | Narang (₹) | Suri (₹) |
| :--- | ---: | ---: |
| (a) New Capital after adjustment | 49,230 | 16,410 |
| (b) Old Capital before adjustment of capital | 44,230 | 21,410 |
|  |  |  |
|  | 5,000 (c) Current A/c balance (a-b) | 5,000 (cr.) |

Q. 5 (Hidden goodwill): $\mathrm{X}, \mathrm{Y}$ and Z are partners sharing profits in the ratio of 2:1:1. Their balance sheet as on 31.3.2016 was as follow:

## Balance sheet

As at 31.3.2016

| Liabilities | ₹ | Assets | ₹ |
| :---: | :---: | :---: | :---: |
| Sundry creditors | 45,000 | Cash | 17,500 |
| Capitals: |  | Debtors | 22,000 |
| X 12,000 |  | Stock | 26,000 |
| $\mathrm{Y} \quad 6,000$ |  | Investment | 10,000 |
| Z 6,000 | 24,000 | Goodwill | 4,000 |
| Bills Payable | 4,000 |  |  |
| Workmen's compensation fund | 4,000 |  |  |
| Investment fluctuation fund | 2,500 |  |  |
|  | 79,500 |  | 79,500 |

$Z$ retires on 01.04.2016. The following adjustment are agreed upon:
(a) Z's share is determined at ₹ 9,375 . Z's would be paid₹ 4,375 in cash and balance would be transferred to his loan account.
(b) The provision for Bad \& Doubtful debts on debtors to be maintained at $5 \%$.
(c) The value of stock to be increased to ₹ 26,600 .
(d) Market value of investment is ₹ 9,500 .
(e) Claim in workmen's compensation is ₹2,000.
(f) $\quad \mathrm{Z}$ 's share in profit is taken over by X and Y equally.
(g) There was a contingent liability in respect of a bill discounted ₹ 1,000 .

Prepare revaluation account, partner's capital accounts to record the above transactions and show the new balance sheet.

## Hints to answer:

1. Less revaluation ₹ 500 .
2. Calculate of goodwill:

Total amount Payable to $Z=₹ 9,375$
Total Capital of Z after all adjustment = ₹ 5875
(6000+500+500-125-1000)
So, Z's share of goodwill = ₹ 3,500
X's Capital A/c and Y's Capital A/c will be debited by ₹ 1,750 each and $Z$ 's Capital A/c will be credited by ₹ 3,500 .
3. Capital A/c balance of X's ₹ 10,000 and Y's ₹ 4,125 C's loan A/c ₹ 5,000
4. Balance sheet total ₹ 70,125

Cash A/c balance ₹ 13,125
Q. 6 (Loan Account): L, M, N were partners sharing profits of 5:3:2. N retires on 01.01.2013 for the purpose of settlement of his dues his Capital Account shows a net credit balance ₹ 23,500 after all necessary adjustment. He was paid 3,500 immediately on the date of retirement and balance was transferred to his loan account. In each of the following alternative cases, prepare N's loan account till it is paid off:
a) When balance due to him is to be paid in four equal annual instalments together (plus) with interest @ 12\% p.a. Books are being closed on $31^{\text {st }}$ December every year.
b) When balance due to him is to be paid in four equal annual instalments together with (plus) interest @ 12\% p.a. Books are being closed on $31^{\text {st }}$ March every year.
c) When payment is made in four equal yearly instalments including interest @ $12 \%$ p.a. on unpaid balance. Books are being closed on $31^{\text {st }}$ December every year.
d) When they agree to pay three yearly instalments of 6,000 including interest @ $12 \%$ p.a. on the outstanding balance during the first three years and the
balance including interest in the fourth year. Books are being closed on $31^{\text {st }}$ December every year.
(NCERT Modified)

## Hints to answer:

Case I. Payment made on 31.12.2013 (₹5000+₹ 2400 Interest) = ₹ 7,400
Payment made on 31.12.2014 (₹5000+₹ 1800 Interest) $=$ ₹ 6,800
Payment made on 31.12.2015 (₹5000+₹ 1200 Interest) = ₹ 6,200
Payment made on 31.12.2016 (₹5000 + ₹ 600 Interest) = ₹ 5,600

Case II. Payment made on 31.12.2013, 31.12.14, 31.12.15 and 31.12.2016 will be same but books are being closed on $31^{\text {st }}$ March every year to interest to be calculate on the date of payment ( $31^{\text {st }}$ Dec.) and closing books both date ( $31^{\text {st }}$ March).
calculation of annuity amount $=\frac{A}{1-\left(\frac{100}{100+R}\right) n} \times \frac{R}{100}\left[\begin{array}{c}\mathrm{A}=\text { Loan Amount } \\ \mathrm{R}=\text { Rate of Interest } \\ \mathrm{n}=\text { No. of instalments }\end{array}\right]$
Case III. The annual instalment of payment in 4 years at 12\% p.a. interest works out at ₹ $6585-00$ (annually of ₹ 0.329234 as per annuity Table x ₹ 20,000 ) (round upto ₹)

Interest charged on 31.12.2013 ₹ 2400 \& payment made ₹6585.
Interest charged on 31.12.2014 ₹ 1898 \& payment made ₹ 6585.
Interest charged on 31.12.2015 ₹ 1335 \& payment made ₹ 6585.
Interest charged on 31.12.2016 ₹ 705 \& payment made ₹ 6583.

## Case IV.

Interest charged on 31.12.2013 ₹ 2400 \& payment made ₹ 6,000.
Interest charged on 31.12.2014 ₹1968 \& payment made ₹ 6000.
Interest charged on 31.12.2015 ₹ 1484 \& payment made ₹ 6000.
Interest charged on 31.12.2016 ₹ 942 \& payment made ₹ 8794.
Q. $7 \mathrm{P}, \mathrm{Q}$ and R are partners sharing profits in the ratio of their Capitals. Q retired from the firm on 31.03.2016. their balance as at 31.03 .2016 was as follows:

## Balance sheet of $P, Q$ and $R$

As at 31.03.2016

| Liabilities |  | Amount | Assets | Amount |
| :---: | :---: | :---: | :---: | :---: |
| Sundry cr |  | 48,000 | Cash | 43,000 |
| Bills Paya |  | 20,000 | Debtors 40,000 |  |
| Capitals: | ₹ |  | Less provision $\quad(3,000)$ | 37,000 |
| P | 1,80,000 |  | Stock | 60,000 |
| Q | 1,44,000 |  | Fixed Assets (Tangible) | 3,48,000 |
| R | 1,08,000 | 4,32,000 | Goodwill | 12,000 |
|  |  | 5,00,000 |  | 5,00,000 |

Goodwill of the firm is to value at $₹ 72,000$. New profit sharing ratio of $P$ and $R$ is 3:2.

Fill in the missing information/figures in the following Ledger accounts and Balance of the firm

| Revaluation Account |  |  |  |
| :---: | :---: | :---: | :---: |
| Dr. Revaluation Account |  |  | Cr. |
| Particulars | ₹ | Particulars | ₹ |
| To stock A/c | - | By Fixed Assets | 69,600 |
| To profit transferred to |  |  |  |
| P's Capital A/c |  |  |  |
| Q's Capital A/c |  |  |  |
| R's Capital A/c |  |  |  |
|  |  |  |  |
|  |  |  | - |
|  |  | 8 [Cla | untancy] |

## Partner's Capital Account



Balance sheet of P and R (After Retirement)
As at 31.03.2016


## Hints to answer:

Stock ₹ 6,000 , Rev. Profit ₹ 63,600 (distributed in old ratio 5:4:3)
Q's goodwill share $=72,000 \times \frac{4}{12}=24,000$ (in gaining ratio of $P$ and $R$ )
Balance sheet total ₹ $5,51,600$.
Q. $8 \mathrm{~L}, \mathrm{M}$ and N were partners in a firm sharing profits in the ratio of $3: 1$. The firm close its books on 31st March every year and balance of general reserve as on 31.03.2016 was ₹ 12,000.
$N$ died on $1^{\text {st }}$ Oct. 2016. It was agreed between his executors and the remaining partners that:
a) Goodwill be valued at 3 years purchase of the average profits of the previous eight years. The average profits of previous eight years were ₹ 12,000.
b) Revaluation profit was ₹ 18,000 .
c) Profit for the year 2016-2017 be taken as having accrued at the same rate as the previous year which was ₹ 30,000 .
d) Interest on Capital be provided @ 10\% p.a.

Fill in the missing figures in the following accounts:
N's Capital Account
Dr.
Cr.


N's Executor's Account
Dr.

| Particulars | Amount (₹) | Particulars | Amount (₹) |
| :--- | :--- | :--- | :--- |
| To cash |  |  |  |
| To Executors Loan A/c | 25,000 |  | - |
|  |  |  |  |
|  |  |  |  |

Hints to answer:
a) Gen. Reserve share $=12000 \times \frac{1}{6}=₹ 2,000$
b) $\quad$ Revaluation profit $=3,000$
c) $\quad P$ and $L$ Suspense $A / c=30,000 \times \frac{6}{12} \times \frac{1}{6}=₹ 2,500$
d) Valuation of Goodwill = Average profit $\times 3$ year purchases

$$
=12,000 \times 3=36,000
$$

N's share $=36000 \times \frac{1}{6}=6,000$

| L's Capital A/c | Dr. | 3,600 |
| :--- | :--- | :--- |
| M's Capital A/c | Dr. | 2,400 |

To N's Capital A/c 6,000
(Being adjustment of goodwill made)
e) Total of N's Capital A/c $=₹ 29,250$

Less: total amount of credit given to N
$2,000+3000+2,500+3600+2400=₹ 13,500$
Balance is N's opening Capital \& interest on Capital
$29,250-13,500=₹ 15,750$

$$
\text { Let } \begin{aligned}
& \text { N's Capital }=₹ x \\
& \text { Interest on capital }=x \times \frac{10}{100} \times \frac{6}{12}=\frac{x}{20} \\
& ₹ 15,750=x+\frac{x}{20} \\
& ₹ 15,750=\frac{21 x}{20} \\
& x=15,750 \times \frac{20}{21}=₹ 15,000 \\
& \text { N's Capital (opening) }=₹ 15,000 \\
& \text { Interest on Capital }=15000 \times \frac{10}{100} \times \frac{6}{12} \\
& \text { Interest N's Capital }=₹ 750
\end{aligned}
$$

## CHAPTER 6

## DISSOLUTION OF A PARTNERSHIP FIRM

## Points to Remember:

1. Dissolution of partnership 'firm' means that the firm closes down its business and comes to an end.
2. Dissolution of a firm may take place without the intervention of court or by the order of the court.
3. Upon dissolution all the existing accounts of firm are closed by transferring them to a newly opened nominal account called Realisation Account.
4. The amount realised from sale of assets of the firm shall be applied first of all to pay the outside debts of the firm, then the loans advances by the partners, thereafter for returning their capital balances. Balance if any, would be divided among partners in their profit sharing ratio.
5. If any partner has given loan to the firm, 'Partner's Loan A/c' is separately prepared and payment is made to partner who has advanced loan before capital repayments.
6. If nothing is mentioned about payment of outside liabilities, it is assumed that these are paid in FULL.


## In this chapter we will study about

Dissolution of a 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 ends. All the assets of the firm are disposed off and all outsiders' liabilities and partners' loan and partner capital are paid.

## Till now we have studied about

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 partner.

It may or may not result into closing down of the business as the remaining partners may decide to carry on the business under a new agreement.

Types of dissolution of firms: A Partnership firm can be dissolved in any of the following ways:
(A) Without the intervention of the court;
(1) When all partners agree to dissolve the firm (Sec.40);
(2) Compulsory Dissolution (Sec. 41)
(i) When all or partners except one become insolvent.
(ii) When business of the firm become unlawful.
(3) On the happening of any of the following events: (Sec. 42)
(i) On the insolvency of a partner.
(ii) On the fulfilment of the objective of the firm for which the firm was formed.
(iii) On the expiry of the (period) for which the firm was formed.
(4) By Notice (Sec. 43): When the duration of the partnership firm is not fixed and it is at will of the partners. Any partner by giving notice to other partners can dissolve the firm.
(B) Dissolution by order of the court (Sec 44) : A court on application by a partner may order the dissolution of the firm under the following circumstances:
(1) When a partner has become of unsound mind.
(2) When a partner has become permanently incapable of performing his duties as a partner
(3) When a partner is found guilty of misconduct that may harm the partnership.
(4) When a partner consistently and deliberately commits breach of partnership agreement.
(5) When a partner transfer whole of his interest in the business firm to a third party, without the consent of existing partners.
(6) When the court is satisfied that the partnership firm cannot be carried on except at a loss.
(7) When the court finds that the dissolution of firm is justified and equitable

## ACCOUNTING TREATMENT ON DISSOLUTION

On dissolution of a firm, the following accounts are prepared to close the books of the firm.

- Realisation Account;
- Partner's Loan Account;
- Partner's Capital Accounts; and
- Cash or Bank Account.

Realisation Account: It is nominal account opened on the dissolution of a firm to ascertain the profit or loss on realisation of assets and payment of outsider's liabilities. This account is closed by transferring the balance (i.e., profit or loss on realisation) to partner's capital accounts.

## PREPARATION OF REALISATION ACCOUNT

The following Journal Entries are passed:

## A. For closing Assets Accounts

Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Realisation A/c <br> To Sundry Assets A/c <br> (Being assets transferred to realisation A/c) |  |  |  |

## Note:

1. Cash and Bank balance are not transferred to Realisation Account.
2. Assets (tangible and intangible) are transferred to Realisation Account at their Gross Value
3. Fictitious Asset such as Debit balance of Profit and Loss Account or Advertisement Suspense Account etc. are not transferred to Realisation Account. These are directly debited to partners' capital accounts in their profit sharing ratio by passing the following entry:

Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |  |
| :--- | :--- | :---: | :---: | :---: | :---: |
|  | Partner's capital A/c | Dr. |  |  |  |
|  | c/d : |  |  |  |  |
| To Profit and Loss A/c |  |  |  |  |  |
| To Advertisement Suspense A/c <br> (Being balance of losses transferred to <br> capital accounts) |  |  |  |  |  |

4. Provision against assets such as Provision for Depreciation or Provision for Bad \& Doubtful debts etc. are transferred to Realisation Account by passing a Separate entry:

Provision for Bad Debts A/c
Dr.
Provision for Depreciation A/c
Dr.

Investment Fluctuation Fund $A / c$ Dr.

Machinery Replacement Reserve A/c
Dr.
To Realisation A/c
(Being Provision \& Reserves Against Assets transferred to Realisation Account)
B. For Closing Liabilities Accounts

| Date | Journal |  |  |  |
| :--- | :--- | :--- | :--- | :--- |
|  | Sundry Liabilities A/c <br> To Realisation A/c <br> (Being sundry liabilities transferred to <br> Realisation A/c) | L.F. | Dr. <br> (₹) | Cr. (₹) |

## Note:

1. Only third parties' liabilities/outsiders 'liabilities are transferred to Realisation A/c
2. Balance of Partner's Loan Account is not transferred to Realisation Account. Separate accounts is opened to settle such liabilities.
3. Undistributed profits and reserves are also not transferred to Realisation A/c These are directly credited to partners' capital accounts in their profit sharing ratio by passing the following entry:

Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Profit and loss A/c Dr . <br> General reserves A/c Dr . <br> Reserve fund A/c Dr . <br> Contingency Reserve A/c Dr . <br> To Partner's Capital A/c's  <br> (Being balance of undistributed <br> transferred to capital accounts) profits |  |  |  |

4. Provident Fund is a liability of the firm towards employees and hence it is transferred to Realisation A/c.
5. If any liability is expected to arise against any fund or reserve e.g., Workmen's Compensation Fund, then an amount equal to such liability is transferred to Realisation A/c and balance, if any, distributed among the partners in their profit-sharing ratio by passing the following entry.

Journal

| Date | Particulars | L.F. | Dr. <br> (₹) | Cr. <br> (₹) |
| :--- | :--- | :--- | :--- | :--- |
|  | Workmen's Compensation Fund A/c Dr. <br> To Realisation A/c (Liability) <br> To Partner's Capital A/c (Balance if any) <br> (Being liability against workmen's <br> compensation fund transferred to Realisation <br> A/c and balance distributed among partners) |  |  |  |

Example: Workmen's Compensation Fund shown in the liability side of Balance Sheet is ₹ 50,000 . At the time of dissolution liability against this fund is estimated at ₹ 30,000 . Pass necessary Journal Entry:

Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Workmen's Compensation Fund A/c Dr. |  | 50,000 |  |
|  | To Realisation A/c |  |  | 30,000 |
|  | To A's Capital A/c |  |  | 10,000 |
|  | To B's Capital A/c |  |  |  |
|  | (Being liability against workmen's <br> compensation fund transferred to Realisation |  |  |  |
|  | A/c and balance distributed among partners) |  |  |  |

C. For Realisation of assets (whether recorded or unrecorded)
(a) When assets are sold for cash

Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |  |
| :---: | :--- | :--- | :--- | :--- | :--- |
|  | Cash/Bank A/c <br> To Realisation A/c <br> (Being assets sold for cash) | Dr. |  |  |  |

(b) When assets are taken over by any partne

Journal

| Date | Particulars | L.F. | Dr. <br> (₹) | Cr. (₹) |
| :--- | :---: | :---: | :---: | :---: |
|  | Partner's Capital A/c <br> To Realisation A/c <br> (Being assets taken over by any partner) |  |  |  |

(c) When assets are taken over by any creditor in part of full payment of his dues:
I. In case of Full Settlement:
(i) NO ENTRY is passed for the transfer of assets to the creditor.
(ii) NO ENTRY is passed for the payment to creditor

## II. In case of Part Settlement:

i. NO ENTRY is passed for the transfer of assets to the creditor.
ii. The agreed amount of asset is deducted from the claims of the creditors and the balance is paid to him.

Note: 1.The realised value of each assets must be given at the time of dissolution.
D. For Payment of Liabilities
(a) When liabilities are paid in cash

Journal

| Date | Particulars | L.F. | Dr.(₹) | Cr. (₹) |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
|  | Realisation A/c <br> To Cash/ Bank A/c <br> (Being liabilities paid in cash) | Dr. |  |  |  |

(b) When liabilities are taken over by any partner

Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
|  | Realisation A/c <br> To Partner's capital A/c <br> (Being liabilities taken over by a partner) | Dr. |  |  |  |

Note: If nothing is stated regarding the settlement of any outside liability, then it should be assumed that the amount equal to book value is paid.


## E. For Realisation Expenses

(a) When expenses are paid by firm and borne by firm

Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
| :--- | :--- | ---: | ---: | ---: | :---: |
|  | Realisation A/c <br> To Cash/Bank A/c <br> (Being realisation expenses paid in cash) |  |  |  |

(b) When expenses are paid by any partner and borne by firm

Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Realisation A/c   <br> To Partner's capital A/c   <br> (Being realisation expenses <br> partner) paid by | a |  |  |  |

(c) When expenses are paid by firm (on behalf of any partner) and borne by a partner

## Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
| :--- | :--- | ---: | :---: | :---: | :---: |
|  | Partner's Capital A/c |  |  |  |
| To cash/Bank A/c <br> (Being realisation expenses paid on behalf <br> of a partner) |  |  |  |  |

(d) When expenses are paid by any partner and borne by same partner

No Entry
(e) When a partner is paid a fixed amount for bearing realisation expenses; then actual expenses are not to be considered.

Journal

| Date | Particulars |  | L.F. | Dr. (₹) | Cr. (₹) |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Realisation A/c <br> To Partner's capital A/c <br> (Being realisation expenses <br> partner) | paid | by | a |  |

Note: with fixed amount paid to Partner.
(f) When expenses are paid by one partner and borne by another partner.

Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
| :--- | :--- | :--- | :--- | :--- |
|  | Partner's capital A/c (who bears expenses) |  |  |  |
| Dr. | To partner's capital A/c (who pays the <br> expense) <br> (Being realisation expenses paid by one <br> partner and borne by another partner) |  |  |  |

In case the realisation expenses are borne by a partner, clear indication should be given regarding the payment there of.

## F. For closing Realisation Account:

(a) When Realisation A/c discloses profit ( in case total of credit side is more than the total of debit side)

## Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
| :--- | :--- | :--- | :--- | :--- |
|  | Realisation A/c <br> To Partner's capital A/c <br> (Being profit on realisation transferred to <br> partner's capital A/c in profit sharing ratio) |  |  |  |

(b) When Realisation A/c discloses loss (in case total of debit side is more than the total of credit side.

Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
| :--- | :--- | ---: | :---: | :---: | :---: |
|  | Partner's Capital A/c's <br> To Realisation A/c <br> (Being loss on realisation transferred to <br> partners capital A/c's) |  |  |  |

## FORMAT OF REALISATION ACCOUNT

Realisation Account

| Particulars | ₹ | Particulars | ₹ |
| :---: | :---: | :---: | :---: |
| To Sundry Assets A/c <br> Sundry Liabilities A/c <br> (Excluding cash or bank balance, fictitious assets, Debit of P\&L A/c, Debit balance of partner's Capital/ current A/c, Loans to partners) <br> To Cash/Bank A/c <br> (Amount paid for discharging Liabilities- recorded and unrecorded) <br> To Cash/ Bank A/c <br> (Expenses on Realisation) <br> To Partner's Capital A/c <br> (Liabilities taken over by a Partner commission payable to him or any expenses payable to him) <br> To Partner's Capital A/c's (for transferring profit on Realisation) |  | By Sundry Liabilities A/c <br> (Excluding credit Balance of P\&L A/c, reserves, Partners Capital/ current A/c, Loan from partner and Bank overdraft) <br> By Provision on any Assets A/c <br> (Such as provision for Depreciation, Provision for Doubtful Debts, Joint Life Policy Reserve etc.) <br> By cash/Bank A/c <br> (Amount received on realisation of assets-recorded and unrecorded) <br> By Partner's capital A/c <br> (Assets taken over by a partner recorded or unrecorded) <br> By partner's capital A/c's <br> (For transferring loss on realisation) |  |
|  | - |  | - |

## PREPARATION OF PARTNERS' LOAN ACCOUNT

If a partner has given any loan to firm, his loan will be paid

- After payment of all the outside liabilities: but
- Before making any payment to partners on account of capital

Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
| :---: | :--- | :---: | :---: | :---: | :---: |
|  | Partner's loan A/c <br> To Cash/ Bank A/c <br> (Being loan of a partner paid) | Dr. |  |  |

## Partner's Loan A/c

Dr.

| Particulars | ₹ | Particulars |  |
| :---: | :---: | :--- | :---: |
| To Cash/Bank A/c |  | By Balance b/d |  |
|  | - |  | - |

If the firm has given a loan to any partner then such loan account will show a debit balance and will appear on the asset side of Balance Sheet of the firm. Such loan accounts are settled through partner's capital account by passing the following entry:

Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
| :--- | :--- | :--- | :--- | :--- |
|  | Partner's Capital A/c <br> To Partner's Loan A/c <br> (Being loan of a partner transferred to his <br> Capital A/c) |  |  |  |

## Preparation of Partners' capital Accounts

## After the transfer of

- Opening Capital balance
- Undistributed profits and reserves
- Profit on Realisation
- Any liability taken over by any partner

And

- Undistributed losses and fictitious assets
- Loss on realisation
- Any assets taken over by any partner

The balance of partners' capital A/cs are closed in the following manner:
a. For making final payment to a partner (if total of credit side is more than the total of debit side)

Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
| :---: | :--- | :---: | :---: | :---: |
|  | Partner's Capital A/c <br> To Cash/ Bank A/c <br> (Being final payment made to Partner in cash) |  |  |  |

OR
b. For any amount received from a partner against debit balance in his capital account.

Journal

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Cash/Bank A/c | Dr. |  |  |  |
|  | To Partner's Capital A/c <br> (Being cash brought in by the partner) |  |  |  |  |

Partner's Capital A/c

| Dr. |  |  | $\stackrel{C}{\text { Cr }}$ |
| :---: | :---: | :---: | :---: |
| Particulars | ₹ | Particulars |  |
| To Balance b/d <br> (Dr. Balance) <br> To profit and Loss A/c <br> To Advertisement Suspense A/c <br> To Realisation A/c <br> (Assets taken) <br> To realisation A/c <br> (Loss on Realisation) <br> To Cash/ Bank A/c <br> (Excess cash paid) |  | To Balance b/d <br> (Cr. Balance) <br> By General Reserve A/c <br> By Profit and Loss A/c <br> By Workmen's <br> Compensation Fund <br> By Realisation A/c <br> (Liabilities taken) <br> By Realisation A/c <br> (Profit on Realisation) <br> By Cash/Bank A/c (cash brought in) |  |

## Preparation of Cash or Bank Account

This account is prepared at the end and closed last of all. This account helps in verification of the arithmetically accuracy of accounts as both sides of this account must be equal.

Note: If cash and bank balance both are given in the Balance Sheet, one A/c is prepared, either a Cash $A / c$ or a Bank $A / c$ If Cash $A / c$ is opened, an entry of withdrawing the bank balance is made:

## Cash A/c

Dr.
To Bank A/c
(Being cash withdrawn from Bank)
If Bank $A / c$ is opened, an entry for depositing the cash into bank is passed.
Bank A/c
Dr.

To Cash A/c
(Being cash deposited into Bank)
Cash/Bank A/c
Dr.

| Particulars | ₹ | Particulars | ₹ |
| :---: | :---: | :---: | :---: |
| To Balance <br> (Cash in Hand or Cash at Bank) <br> To Realisation A/c <br> (Assets Realised) <br> To Partner' Capital A/c's <br> (Cash brought in by partner) |  | By Balance b/d <br> (Bank overdraft) <br> By Realisation A/c <br> (Liabilities Paid) <br> By Realisation A/c <br> (Realisation Expenses Paid) <br> By Partner's Loan A/c <br> (Partner's Loan Paid) <br> By Partner's Capital A/c's <br> (Excess cash paid to partner |  |

## Distinction between Revaluation Account Realisation Accounts

| Basis of Difference | Revaluation Account | Realisation Account |
| :--- | :--- | :--- |
| Purpose | It is prepared to show <br> assets and liabilities in <br> the books at their revised <br> values. | It is prepared to ascertain <br> profit or loss on sale of <br> assets and repayment of <br> Liabilities. |
| When to be prepared | It is prepared at the time <br> of change in profit <br> sharing ratio among the <br> existing partner, <br> admission, retirement <br> and death of a partner. | It is prepared at the time <br> of dissolution of a firm. |
| Preparation of Account | This account may be <br> prepared at a number of <br> times during the life of a <br> firm. | This account is prepared <br> once during the life of a <br> firm. |
| Content | This account records <br> only those assets and <br> liabilities whose book <br> values have been <br> changed. | This account records all <br> assets (except cash, <br> fictitious assets etc.) and <br> all outside liabilities. |
| Result | A Firm continues its <br> business even after the <br> preparation of <br> revaluation account. | A firm comes to an end <br> after preparation of <br> realisation account. |

PREPARATION OF MEMORANDUM BALANCE SHEET
If the balance sheet on the date of dissolution is not given in the question, then it is always advisable to prepare Memorandum Balance Sheet on the date of dissolution to ascertain the amount of balancing figure.

## Note

- In the absence of any other information "Sundry Assets" should be treated as balancing figure on the assets side of Balance Sheet.
- If the balance of Partner's Capital $A / c$ 's are not given as on the date of dissolution, first we will find the balance of partners' capital accounts as on the dissolution by recasting the capital accounts.
- When "Sundry Assets" are given in the question and nothing is specified about the difference on the assets side of Balance Sheet, the difference should be treated as Dr. Balance of profit and Loss A/c.

Some common mistakes committed by students

- Entries for Assets or liabilities taken by partners
- Dissolution Expenses
- Realisation of unrecorded assets
- Payment of Unrecorded Liabilities
- Treatment of Fictitious Assets

Due care should be taken while showing the effect of above mentioned items.

## Practical Problem

Q1. Following is the Balance Sheet of $X$ and $Y$, who share profits and losses in the ratio of 4.1, as at 31st March, 2015

BALANCE SHEET As on 31st March, 2011

| Particulars | $₹$ | Particulars | ₹ |  |
| :--- | ---: | :--- | ---: | :---: |
| Sundry Creditors | 8,000 | Bank | 20,000 |  |
| Bank Overdraft | 6,000 | Debtors | 17,000 |  |
| X's Wife Loan | 8,000 | Less : Provision $\quad(2,000)$ | 15,000 |  |
| Y's Loan | 3,000 | Stock | 15,000 |  |
| Investment Fluctuation fund | 5,000 | Investments | 25,000 |  |
| Capital |  | Buildings | 25,000 |  |
| X | 50,000 | Goodwill | 10,000 |  |
| Y | 40,000 | Profit and Loss A/c | 10,000 |  |
|  |  |  |  |  |
|  | $1,20,000$ |  | $1,20,000$ |  |

The firm dissolved on the above date and the following arrangement was decided upon:
(i) X agreed to pay off his wife's loan.
(ii) Debtors of ₹ 5,000 proved bad.
(iii) Other assets realised-Investment 20\% less; and Goodwill at 60\%
(iv) One of the creditors for ₹ 5,000 was paid only ₹ 3,000
(v) Buildings were auctioned for ₹ 30,000 and auctioneer's commission amounted to ₹ 1,000 .
(vi) Y took over part of Stock at ₹ 4,000 (being $20 \%$ less that the book value. Balance stock realised 50\%.
(vii) Realisation expenses amounted to ₹ 2,000.

Prepare Realisation A/c, Partner's Capital A/cs and Bank A/c
Realisation Account

| Dr. |  |  | Cr. |
| :---: | :---: | :---: | :---: |
| Particulars | ₹ | Particulars | ₹ |
| To Goodwill | 10,000 | By Investment Fluctuation |  |
| To Buildings | 25,000 | Fund | 5,000 |
| To Investments | 25,000 | By Provision for Doubtful |  |
| To Stock | 15,000 | Debts | 2,000 |
|  |  | By Creditors | 8,000 |
| To Debtors <br> To X's Capital A/c (X's wife loan) | 17,000 | By Bank overdraft | 6,000 |
|  |  | By X's Wife Loan | 8,000 |
|  | 8,000 | By Bank A/c (Asset realised) |  |
| To Bank A/c (Bank overdraft) | 6,000 | Debtors 12,000 |  |
|  |  | Investment 20,000 |  |
| To Bank A/c (Creditors) (3000+3000) | 6,000 | Goodwill 6,000 |  |
|  |  | Buildings 30,000 |  |
| To Bank A/c | $\begin{aligned} & 2,000 \\ & 1000 \end{aligned}$ | Stock $\quad$ 5,000 | 73,000 |
| (Expenses on Realisation |  |  |  |
| To Bank A/c auctioneer Commission |  | By Y's Capital A/c (Stock) <br> By Loss transferred to: <br> $\begin{array}{ll}\text { X's Capital A/cs } & 7,200 \\ \text { Y's Capital A/cs } & \underline{1,800}\end{array}$ | 4,000 |
|  |  |  |  |
|  |  |  |  |
|  |  |  |  |
|  |  |  | 9,000 |
|  | 1,15,000 |  | 1,15,000 |


| Y's Loan A/c |  |  |  |
| :---: | :---: | :---: | :---: |
| Dr. |  |  | Cr. |
| Particulars | ₹ | Particulars | ₹ |
| To Bank A/c | 3,000 | By Balance b/d | $\underline{\underline{3,000}}$ |


| Partner's Capital A/cs |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Dr. |  |  |  |  | Cr. |
| Particulars | ₹ | ₹ | Particulars | ₹ | ₹ |
| To Profit and Loss A/c <br> To Realisation A/c (Assets taken) To Realisation A/c (Loss on Realisation To Bank A/c (Excess cash paid) | 8,000 | 3,000 | By Balance b/d (Cr. Balance) (By Realisation A/c <br> Liabilities taken) | 50,000 | 40,000 |
|  | - | 4,000 |  | 8,000 |  |
|  |  |  |  |  |  |
|  | 7,200 | 1,800 |  |  |  |
|  | 42,800 | 32,200 |  |  |  |
|  | 58,000 | 58,000 |  | 58,000 | 40,000 |

Cash/Bank A/c

| Dr. |
| :--- |
| Particulars ₹ Particulars ₹r. <br> To Balance b/d <br> (Cash at Bank) <br> To Realisation A/c <br> (Assets Realised) 20,000 By Balance b/d <br> (Bank Overdraft) <br> By Realisation A/c 6,000 <br> (Liabilities Paid)    <br> By Realisation A/c    |
| By Realisation A/c <br> (Exp. Paid) |

Q2. A and $B$ were partners in a firm from 1-4-2008 with capitals of ₹ 60,000 and ₹ 40,000 respectively. They shared profits and losses in the ratio of 3:2. The carried on business for 2 years. In the first year, they made a profit of ₹ 50,000 and in the 2nd year ending on 31st March, 2010, they incurred a loss of ₹ 20,000 . As the business was no longer profitable, they decided to wind up. Creditors on that date were ₹ 20,000 . The partners withdrew ₹ 8,000 each per year for their personal expenses. The assets realised $₹ 1,00,000$. The expenses on realisation were ₹ 3,000 . Prepare Realisation A/c and Partner’s Capital A/c and shows your working clearly.

## Partner's Capital Accounts

| Dr. <br> Particulars | A ₹ | B ₹ | Particulars |  | Cr. |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  | A ₹ | B ₹ |
| To Realisation A/c (loss) <br> To Bank A/c (Final Payment) | $\begin{aligned} & 12,600 \\ & 49,400 \end{aligned}$ | $\begin{array}{r} 8,400 \\ 27,600 \end{array}$ | By Balance b/d | 62,000 | 36,000 |
|  | 62,000 | 36,000 |  | 62,000 | 36,000 |
|  |  |  |  |  |  |

Bank A/c
Dr. Cr.

| Particulars | ₹ | Particulars | ₹ |
| :---: | :---: | :---: | :---: |
| To Realisation A/c (Assets Realised) |  | By Realisation A/c | 20,000 |
|  | 1,00,000 | By Realisation A/c | 3,000 |
|  |  | A's Capital A/cs | 49,400 |
|  |  | B's Capital A/cs | 27,600 |
|  | 1,00,000 |  | 1,00,000 |


| Realisation A/c |  |  |  |
| :---: | :---: | :---: | :---: |
| Dr. |  |  | Cr. |
| Particulars | ₹ | Particulars | ₹ |
| To Sundry Assets <br> To Bank A/c <br> (Creditors) <br> To Bank A/c <br> (Expenses on Realisation | 1,18,000 | By Creditors <br> By Bank A/c <br> (Assets realised) <br> By Loss transferred to: <br> A's Capital A/cs 126000 <br> B's Capital A/cs 8,4000 | 20,000 |
|  |  |  |  |
|  | 20,000 |  | 1,00,000 |
|  |  |  |  |
|  | 3,000 |  |  |
|  |  |  | 21,000 |
|  | 1,41,000 |  | 1,41,000 |

Working Notes: (i)

## Partner's Capital A/cs

Dr.


## Memorandum Balance Sheet

| Liabilities |  | $₹$ | Assets | ₹ |
| :--- | ---: | :---: | :--- | :---: |
| Capital | ₹ |  | Sundry Assets | $1,18,000$ |
|  | 62,000 |  | (Balancing Figure) |  |
| A | $\underline{36,000}$ | 98,000 |  |  |
| B |  | 20,000 |  |  |
|  |  | $1,18,000$ |  | $1,18,000$ |

Q3. A and B share profits and losses in the ratio of 5:2. They have decided to dissolve the firm. Assets and external liabilities have been transferred to Realisation A/c. Pass the Journal Entries to affect the following:
(a) Bank Loan of ₹ 12,000 is paid off.
(b) "A" was to bear all expenses of Realisation for which he is given a commission of ₹ 400.
(c) Deferred Advertisement Expenditure A/c appeared in the book at ₹ 28,000 .
(d) Stock worth ₹1,600 was taken over by B at ₹1,200.
(e) As unrecorded Computer realized ₹7,000.
(f) There was an outstanding bill for repairs for ₹ 2,000 . Which was paid off.

## Solution:

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |  |
| :--- | :--- | ---: | ---: | ---: | ---: |
| (a) | Realisation A/c <br> To Bank A/c <br> (Being bank Loan discharged) | Dr. |  | 12,000 | 12,000 |
| (b) | Realisation A/c <br> To A's Capital A/c <br> (c) <br> (Being commission credited to A) | Dr. |  | 400 | 400 |


Q.4 $A$ and $B$ entered into partnership on 1.1.2015 sharing profits in the ratio of 3:2. Their capitals were ₹ 50,000 and ₹ 30,000 respectively. They decided to dissolve the firm on 31.12.2015 on which date their position was:

Bank ₹ 5,000 ; Debtors ₹ 20,000 ; B/R ₹ 8,000 ; stock ₹ 25,000 ; furniture ₹ 5,000 ; plant ₹ 27,000 ; creditors ₹ 25,000 and $B / P$ ₹ 6,000 .

A took over stock at 10\% discount and took over creditors. B took over debtors amounting to ₹ 15,000 for ₹ 13,000 and remaining debtors realised below $10 \%$. $B / P$ were due after 2 months and $B / R$ after 3 months so $B / P$ were paid and $B / R$ realised at a rebate of 12 p.a. Plant realised ₹ 20,000 and furniture ₹ 4,500. Partners also agreed to allow interest on Capital@ 10\% p.a.

Prepare necessary accounts to close the books of accounts

## Solution:

## Memorandum Balance sheet as on 31.12.2015

| Liabilities |  | ₹ | Assets | ₹ |
| :---: | :---: | :---: | :---: | :---: |
| Creditors B/P <br> Capitals: <br> A <br> B |  | 25,000 | Bank | 5,000 |
|  |  | 6,000 | Debtors | 20,000 |
|  |  |  | B/R | 8,000 |
|  | 50,000 |  | Stock | 25,000 |
|  | 30,000 | 80,000 | Furniture | 5,000 |
|  |  |  | Plant | 27,000 |
|  |  |  | Profit \& Loss (balancing Fig.) | 21,000 |
|  |  | 1,11,000 |  | 1,11,000 |

Realisation A/c

| Particular | ₹ | particulars | ₹ |
| :---: | :---: | :---: | :---: |
| To sundry Assets: ₹ <br> Debtors 20,000 <br> B/R 8,000 <br> Stock 25,000 <br> Furniture 5,000 <br> Plant $\underline{27,000}$ <br> To A/s Capital A/c (creditors)  <br> To Bank A/c:  <br> B/P (6000-120)  | $\begin{array}{r} 85000 \\ 25000 \\ 5880 \end{array}$ | By Sundry liabilities: $₹$ <br> Creditors $\underline{25,000}$ <br> B/P $\underline{6,000}$ <br>   <br> By A's capital A/c (stock)  <br> By B's capital A/c (debtors)  <br> By Bank A/c:  <br> Debtors (20000-15000) less  <br> 10\% 4500 <br> B/R (8000-240) 7760 <br> Plant 20,000 <br> Furniture $\underline{4500}$ <br> By loss trff to: 7,572 <br> A's capital A/c $\underline{5,048}$ <br> B's capital A/c  | 31,000 <br> 22,500 <br> 13,000 <br> 36,760 <br> 12620 |
|  | 1,15,880 |  | 1,15,880 |

## Partner's capital Account

| Particulars | A | B | Particulars | A | B |
| :---: | :---: | :---: | :---: | :---: | :---: |
| To Realisation A/c (Assets) | 22,500 | 13,000 | By balance b/d <br> By realisation A/c (creditors) | $50,000$ | 30,000 |
| To P \& L A/c | 12,600 | 8,400 |  | 25,000 |  |
| To realisation $\mathrm{A} / \mathrm{c}$ (Loss) | 7,572 | 5,048 |  |  |  |
| To bank A/c (Bal. Fig.) | 32,328 | 3,552 |  |  |  |
|  | 75,000 | 30,000 |  | 75,000 | 30,000 |

Bank Account

| Particulars | $₹$ | Particulars | $₹$ |
| :--- | ---: | :--- | ---: |
| To balance b/d | 5,000 | By realisation A/c (B/P) | 5,880 |
| To realisation A/c | 36,760 | By A's capital A/c | 32,328 |
| (Assets) |  | By B's capital A/c | 3,552 |
|  |  |  | 41,760 |
|  | 41,760 |  |  |
|  |  |  |  |

## Notes:

1. Rebate on $B / P=6000 \times \frac{12}{100} \times \frac{2}{12}=₹ 120$
2. rebate on $B / R=8000 \frac{12}{100} \times \frac{3}{100}=₹ 240$
3. interest on capitals of partners is not charged as there is a loss.
Q. 5 Pass Journal entries for the following transactions in the book of the firm on its dissolution:
A) Bills receivable of ₹ 20000 discounted with the bank is dishonoured as drawee was declared insolvent and $30 \%$ amount is received in cash from him.
B) 100 shares of Bajaj Auto Ltd. acquired at a cost of ₹ 3,600 had been written off from the books. These were valued at ₹ 12 per share, and were divided among partner's $A$ and $B$ in 2:1.
C) Mr. Verma, a creditor to whom ₹ 6,000 are due, accepted office equipment at ₹ 4,000 and the balance paid to him by cash.
D) Debtors of ₹ 50,0000 and provision for doubtful debts of ₹ 20,000 transferred to realisation account. On dissolution bad debts were ₹ 100,000 and remaining debtors realised at $30 \%$ discount.
E) Loan owed by B towards firm is ₹ 30,000 . It was decided by the firm that B will pay to the creditor ₹ 25,000 in settlement of his loan.
F) The firm had borrowed ₹ 35,000 from Rashmi, a partner. The firm got dissolved; Rashmi decided to take over furniture against the payment of her loan.

| Particular | L.F. | Amount(₹) | Amount(₹) |
| :---: | :---: | :---: | :---: |
| (a) Cash A/c <br> To Realisation A/c <br> (Being 30\% realized from drawer) <br> Realisation A/c <br> To Bank A/c <br> (Being full amount paid to Bank) |  | 6000 20,000 | 6000 20,000 |
| (b) A/s Capital A/c Dr. <br> B's Capital A/c Dr. <br> To Realisation A/c  <br> (Being shares taken by A and B)  |  | $\begin{aligned} & 800 \\ & 400 \end{aligned}$ | 1200 |
| (c) Realisation A/c To Cash A/c <br> (Being paid to creditors) |  | 2000 | 2000 |
| $\begin{array}{ll}\text { (d) Cash A/c } & \text { Dr. } \\ \text { To Realisation A/c } & \\ \text { (Being 70\% realised from Debtors) } & \end{array}$ |  | 280,000 | 280,000 |
| (e) Realisation A/c Dr. <br> To B's Loan A/c  <br> (Being B's loan transferred)  |  | 30,000 | 30,000 |
| (f) Rashmi's Loan A/c <br> To Realisation A/c <br> (Being loan settled by providing furniture) |  | 35,000 | 35,000 |

Q. 6 Pass necessary Journal entries at the time of dissolution.

1. Expenses of realisation ₹ 10,000 .
2. Expenses of realisation ₹ 15,000 were paid by a partner.
3. Realisation expenses of ₹ 20,000 were to be paid met by Tanu, a partner, but were paid by the firm.
4. Sushma, a partner was paid remuneration of ₹ 5000 and she was to bear all expenses.
5. Vikas, a partner, was paid remuneration of ₹ 10,000 and he was to bear all expenses. Actual expenses amount to ₹ 18,000 .
6. Realisation expenses amounted to ₹ 15,000 . Out of this ₹ 12,000 were to be borne by ' A ' a partner and the balance by the firm.
7. Vinay, a partner, paid realisation expenses of $₹ 10,000$ and these were to be borne by him.
Solution:
Journal

| Particulars | L.F. | Amount(₹) | Amount( F ) |
| :---: | :---: | :---: | :---: |
| (a) Realisation $\mathrm{A} / \mathrm{c}$ To Bank $\mathrm{A} / \mathrm{c}$ (Being realisation expenses paid) |  | 10,000 | 10,000 |
| (b) Realisation $\mathrm{A} / \mathrm{c}$ <br> To Partner's capital A/c <br> (Being realisation expenses paid by partner on behalf of firm) |  | 15,000 | 15,000 |
| (c) Tanu's Capital A/c <br> To Bank A/c <br> (Being realisation expenses paid by firm on behalf of the partner) |  | 20,000 | 20,000 |
| (d) Realisation A/c <br> To Sushma's Capital A/c <br> (Being expenses paid by partner on behalf of firm) <br> (e) Realisation A/c <br> To Vikas's Caoital A/c <br> (Being remuneration allowed to partner to carry out dissolution) |  | 5,000 10,000 | 5,000 10,000 |


| (f) A's Capital A/c | Dr. |  | 12,000 |  |
| :--- | ---: | ---: | ---: | ---: |
| Realisation A/c | Dr. |  | 3,000 |  |
| To Bank A/c |  |  | 15,000 |  |
| (Realisation expenses paid by the <br> firm. Firm shares of expenses debited <br> to realisation A/c and balance to <br> partners' capital A/c) |  |  |  |  |
| (g) No Entry |  |  |  |  |

Q. 7 X and Y were partners sharing profits and losses in ration 4:1. Their firm was dissolved on 31.3.15. Complete the missing information:

Realisation Account

| Particulars | ₹ | Particulars | ₹ |
| :---: | :---: | :---: | :---: |
| To Goodwill A/c | 10,000 | By Investment Fluctuation | 5,000 |
| To building A/c | 25,000 | Fund A/c |  |
| To Investments A/c | 25,000 | By Provision for Doubtful | 2,000 |
| To Stock A/c | 15,000 | Debts A/c |  |
| To Debtors A/c | 20,000 | By Creditors A/c | 8,000 |
| To X's Capital A/c (Brother's Ioan) | (a) | By Bank Overdraft A/c | 6,000 |
|  |  | By X's Brother Loan | 8,000 |
|  |  | By Bank A/c (Assets |  |
| To Bank A/c's: ₹ |  | Realised) ₹ |  |
| Creditors 6000 |  | Debtors 12,000 |  |
| Bank Overdraft $\underline{6000}$ | 12,000 | Investments 20,000 |  |
|  |  | Goodwill 7,000 |  |
| To Bank A/c (Realisation Expenses) | (b) | Buildings 30,000 |  |
|  |  | Stock (50\% of 10,000) 5,000 | 74,000 |
|  |  | By Y's Capital A/c(stock) |  |
|  |  | By loss transferred to: | (c) |
|  |  | X's Capital A/c (d) |  |
|  |  | Y's Capital A/c (e) |  |
|  | (f) |  | (f) |

## Partner's Capital Account

| Particulars | X ( F ) | Y ( $\mathrm{F}^{\text {) }}$ | Particulars | X ( F ) | Y ( $)^{\text {) }}$ |
| :---: | :---: | :---: | :---: | :---: | :---: |
| To profit \& Loss | 8,000 | 2,000 | By Balance b/d | 50,000 | 40,000 |
| A/c |  |  | By Realisation | (k) |  |
| To Realisation |  | 4,000 | A/c |  |  |
| A/c (Stock) |  |  |  |  |  |
| To Realisation | (g) | (h) |  |  |  |
| A/c (Loss) |  |  |  |  |  |
| To Bank A/c (Bal. | (i) | (i) |  |  |  |
|  | (1) | (m) |  | (I) | (m) |

Bank Account

| Particulars | ₹ | Particulars | ₹ |
| :---: | :---: | :---: | :---: |
| To Balance b/d To Realisation A/c | $\begin{aligned} & 20,000 \\ & \text { (n) } \end{aligned}$ | By Y's loan A/c | 6,000 |
|  |  | By Realisation A/c (liabilities paid off) | 12,000 |
|  |  | By Realisation Expenses A/c | 20,000 |
|  |  | By X's Capital A/c | (0) |
|  |  | By Y's Capital A/c | (p) |
|  | (q) |  | (q) |

## Hints:

a) Brother's ₹ 8000 (Given on Cr. Side of Realisation A/c)
b) Realisation Expenses ₹ 2000 (From Bank A/c Cr. side)
c) Stock ₹ 4000 (From Y's Capital A/c Dr. side)
d) ₹ 8000 Balancing figures obtained
e) ₹ 2000 \}
f) ₹ 117000
g) ₹ 8000 Same as (d) and (e)
h) ₹ 2000 \}
i) ₹ 42000 balancing Fig. obtained
j) ₹ 32000 \}
k) ₹ 8000 ( X took over his Brother's loan)
I) ₹ 58000
m) ₹ 40000
n) ₹ 74000 (From Realisation A/c)
o) ₹ 42000 Same as (i) and (j)
p) ₹ 32000$\}$
q) ₹ 94000

## Company Accounts - Accounting for Share Capital

## Points to Remember: -

One-person Company: A company having only person as a member.
Share: Smaller unit into which share capital of a company is devided


Share capital: Capital raised through issue of either Equity or Preference share.
Authorised/Registered/Nominal Share Capital: Maximum share capital which a company can raise through issues of shares. It is specified in 'capital clause' in Memorandum of Association.

Issued share capital: Capital issued by the company for subscription to the public.
Subscribed share capital: Part of the capital which is subscribed by the public. It can further be divided into two parts (a) subscribed and fully paid-up: The amount which the company has called and also received the entire face value of the share, (b)Subscribed but not fully paid-up: Part of subscribed capital that has not been fully paid up yet.

Reserve Capital: Part of subscribed Capital that a company resolves to call at the time of winding up of the company, to protect the interests of the creditors, As per section 65 of the companies Act, 2013 only an unlimited company having a share capital while converting into a limited company may have reserve capital.

Issue of Shares at Par: When the issue price (Let ₹ 10) of the share is equal to the face value (Let ₹ 10 )

Issue of Shares at Premium: When the issue price (Let Rs.15) of the share is more than the face value (let ₹10). The excess of issue price over face value is called Securities Premium Reserve.

Issues of a Share at a Discount: When the issue price (Let ₹ 8) of the share is less than the face value (let ₹ 10). Only Sweat equity shares (or shares in Employee stock option plan) can be issued at a Discount.

Full subscription: When number of shares applied for are equal to number of shares offered to the public (Shares applied for = Shares offered)

Under Subscription: When number of shares applied for are less than number of shares offered to the public (Shares applied for < Shares offered)

Over Subscription: When number of shares applied for are greater than number of shares offered to the public (Shares applied for > Shares offered)

Minimun Subscription


Pro-rata Allotment: Allotment of offered shares in proportion to shares applied for to the applicants.

Calls-in-Advance: Amount of call which has not been called-up by the company but paid by the shareholders and received by the company.

Calls-in Arrears: Part of calls which has been called-up by the company but calls not received by the company.
Forfeiture of shares: Cancellation of allotted shares because of calls-in-arrears.
Re-issue of Share: Issuing forfeited share to other shareholders.
Private placement of shares: When shares are offered by the company to a selected group of persons, not the public, It is called private placement of shares. In this, the letter of the placement with the terms of the issue, not the prospectus, is issued by the company. This is very cost effective method.
Preferential allotment of shares: Allotment of shares at a pre-determined price to the pre-identified people who wish to take a strategic stake in the company such as Promoters, Financial institutions, Venture capitalists etc.

## Point to Remember:

1. First of all, read the question carefully to know what is required in answer whether Journal entries, Ledger Account or only the calculation part.
2. Prepare the table for questions of pro-rata allotment that makes the calculation easy and journal entries can be passed without any error.

|  |  | Application money* Transferred to |  |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Application <br> Received | Shares <br> Allotted | Application <br> Money <br> Received | Share <br> Capital | Sec. <br> Premium <br> Res. | Share <br> Allotment | Calls in <br> Advance <br> (Bank) | Refund |

*If nothing is mentioned in the question, Excess application money is utilized towards sum due on share allotment only, if still left, will be refunded.
3. While doing questions related to pro-rata allotment, below mentioned formula can be used to ascertain the amount of calls in arrears on share allotment a/c:
$=\frac{\text { Money Required in Cash on Share allotment } *}{\text { No.of shares alloted in that category }} \times$ Share held by Def aulter shareholder
*Money Required in Cash on Share allotment= Share allotment money due - Excess Application money adjusted in particular category.
4. In question of issue of share at Premium, if nothing is mentioned it is assumed that Securities Premium Reserve will be received with allotment only.
5. In Question of disclosure of share capital in Balance Sheet, "Subscribed and fully paid up" will include only the amount of shares which has been fully called up by the company and paid by the shareholders. Shares on which Company has not called up fully will not come under this in spite of the fact that shareholder have been paid the amount in full.
6. While calculating the amount to be transferred to Capital Reserve, check carefully whether all the forfeited shares have been reissued or not.
7. If all the forfeited shares are not reissued by the company, then amount of capital reserve be ascertained through formula given below:
$\left(\frac{\text { Amount Forfeited }}{\text { No.of shares forfeited }} \times\right.$ No. of shares Reissued $)-$ Discount given on Reissue

## CHAPTER 7

## ACCOUNTING FOR SHARE CAPITAL

(Share and Share Capital: Nature and types)
"A Company is an artificial person created by law, having separate entity with a perpetual succession and a common seal."

Definition given by Prof. Haney
(Meaning of a Company)


## Characteristics (Features) of a company

1. The certificate of incorporation of a company is issued by registrar of companies as per procedure/guidelines given in the Companies Act, 2013. The law considers a company as an artificial legal person.
2. A Company is a separate legal entity from its owner (shareholders).
3. A company has perpetual existence, not affected by the death, lunacy or insolvency of its shareholders. It can be winded up only by the law (Court or registrar of company.)
4. Every company has it own common seal, which act as the official signature of the company.
5. The share of a company is transferable subject to certain conditions (e.g. some conditions for private company.)
6. The company is managed by the 'Board of Directors', the directors are representative of the shareholders (owners). So, management and ownership are separate in company organization.
7. The liability of a shareholder is limited upto the nominal price of shares subscribed by one.
(Incorporation of a Company)


Promotion $\longrightarrow$ Registration $\longrightarrow$ Capital $\longrightarrow$ Subscription $\longrightarrow$ Commencement of Business

## Types of Companies:

(i) Private Company-Section 2(68) of the companies Act,2013 defines "A private company which by its articles of Association.
(a) Restricts the right to transfer its shares;
(b) Limit the number of its members to 200 excluding its past or present employee members;
(c) Prohibits any invitation to public to subscribe for any of its securities.
(d) The name of every private Company must end with the words 'Private Limited'.

(ii) Public Company- According to section 2(71) of the companies Act, 2013. A public company means a company which is not a private company. Private company which is a subsidiary of a company not being a private company shall be deemed a public company.

Public Company


## (iii) One Person Company-

Section 2(62) of the Companies Act, 2013 states one-person company is a company which has only one person as a member.

Rule 3 of the Companies (Incorporation) Rules, 2014 provides that (i) Only an Indian citizen resident in India can form on Person Company; (ii) Its paid-up capital is not more than 50 lakhs; (iii) Its Average annual turnover should not exceed ₹ 2 Cores; (iv) it cannot carry out Non-banking financial Investment activities.


An OPC is mandatorily converted into Private/Public company. When the paid-up share Capital is increased beyond ₹ 50 Lakhs or its average annual turnover exceed 2 Crore)

## Class / Types of Shares: There are two classes of shares

1. Preference shares: are shares which carry preferential right in respect of
(a) Right of dividend
(b) Repayment of capital on winding up of the company.
2. Equity shares: The shares which are not preference shares are called equity shares and do not have any Preferential right.

Distinction between Equity Share and Preference Share

| Basics of difference | Equity Share | Preference Share |
| :--- | :--- | :--- |
| 1. Refund of Capital | On Winding up, the equity <br> share capital is paid after <br> payment to preference <br> share capital or equity <br> shareholder receive <br> residual amount. | On winding up, the <br> preference shares capital is <br> paid before the Equity <br> share capital or preference <br> shareholder have <br> preference to get refund of <br> capital over Equity <br> shareholder. |
| 2. Right of Dividend | Dividend is paid on Equity <br> shares after payment of <br> dividend on preference <br> shares. | Dividend is paid on <br> preference share before <br> payment of dividend on <br> Equity shares. |
| 3. Right of Dividend | No fixed rate of dividend. <br> It is decided by board of <br> directors every year and <br> vary periodically. | Fixed rate of dividend <br> prescribed on the face of <br> preference shares e.g., 9\% <br> Preference share in this <br> case rate of dividend is 9\%. |
| 4. Right to Vote | Equity shareholders have <br> the right to vote in meeting <br> of shareholders and they <br> elect director for <br> managing the company. | ln normal course of <br> business, preference <br> shareholders do not enjoy <br> the right to vote in the <br> meeting of shareholder <br> except |
| circumstances. special |  |  |

## Types OR Classes of Preference Shares

## (a) With Reference to Dividend:

(i) Cumulative Preference shares: Cumulative preference shares are those preference shares, the holders of which are entitled to receive arrears of dividend before any dividend is paid on equity shares. If in any year, Profits are not sufficient, then dividend gets accumulated.
(ii) Non-cumulative preference shares: Non-cumulative preference shares are those preference share, the holders of which do not have the right to receive arrear of divided. If no dividend is declared in any year due to any reason, such shareholders get nothing, nor they can claim unpaid dividend in any subsequent years.
(b) With Reference to Participation
(i) Participating preference shares: such shares, in addition to the fixed preference dividend, carry a right to participate in the surplus profit, if any, after providing dividend at a stipulated rate to equity shareholders.
(ii) Non-Participating preference shares: Such shares get only a fixed rate of dividend every year and do not have a right to participate in the surplus profit.
(c) With Reference to convertibility
(i) Convertible preference shares are those preference shares which have the right/option to be converted into equity shares.
(ii) Non-convertible preference shares: are those preference shares which do not have the right/option to be converted into Equity shares.
(d) With Reference to Redemption
(i) Redeemable preference share: are those preference shares the amount of which can be redeemed by the company at the time specified for their repayment or earlier.
(ii) Irredeemable preference share: are those preference shares the amount of which cannot be returned by the company unless the company is winded up. Now a company cannot issue irredeemable preference shares.

## Some important Terms used in Accounting for Share Capital

Minimum Subscription (Section 39): It is the minimum amount stated in the prospectus that must be subscribed by the public before on allotment of any security is made.

Prospectus: It is an invitation to public for subscription of shares or debentures.
Capital: means amount invested in the business for the purpose of earning revenue. In case of company money is contributed by public and people who contributed money are called shareholders.

Share Capital: Capital raised by issue of shares is called shares capital.
Authorised Capital: Also Called as Nominal or registered capital. It is the maximum amount of capital a company can issue. It is stated in Memorandum of Association.

Issued Capital: This is part of authorized capital which is offered to public for subscription. It cannot exceed authorized capital.

Called Up Capital: It is the amount of nominal value of shares that has been called up by the company for payment by the subscriber towards the share.

Paid Up Capital: It is part of called up capital that the members of company or shareholders have paid.

Reserve Capital: It is part of issued capital and or portion of uncalled share capital of an unlimited company which can be called only in case of winding up of the company.

Capital Reserve: It is capital profit not available for distribution as dividend. It is represented in balance sheet of company as Reserves and Surplus under the heading Shareholders' Funds.

## Disclosure of share capital in Company's Balance Sheet.

Illustration 1: S T L Global Ltd. was formed with a nominal Share Capital of ₹ $40,00,000$ divided into $4,00,000$ shares of ₹ 10 each. The Company offered $1,30,000$ shares to the public payable ₹ 3 per share on Application, ₹ 3 per share
on Allotment and the balance on First and Final Call. Applications were received for 1,20,000 shares. All money payable on allotment was duly received, except on 2,000 shares held by. Y. First and Final Call was not made by the Company.

How would you show the relevant items in the Balance Sheet of STL Global Ltd.?

## Solution 1

## Balance Sheet (Extract) of S T L Global Ltd. (Relevant Part only) As at <br> $\qquad$

| Particulars | Note No. | (₹) |
| :--- | :---: | :---: |
| Equity and Liabilities |  |  |
| Shareholder's Funds : |  |  |
| (a) Share Capital | (1) | $7,14,000$ |
|  |  |  |
| Assets |  | 7,14,000 |

Note to Accounts:

| Particulars | Details | (₹) |
| :--- | :--- | :---: |
| (1) Share Capital <br> Authorised Capital: <br> $4,00,000$ shares of ₹ 10 each <br> Issued Capital: <br> 1,30,000 shares of ₹10 each <br> Subscribed but not Fully Paid Capital: <br> 1,20,000 shares of ₹ 10 each; ₹ 6 per share <br> called-up |  | $40,00,000$ |
| Less: Calls in Arrears (2,000 shares $\times$ ₹ 3) |  |  |

Illustration 2. On 1st April, 2012, Janta Ltd. was formed with an authorized capital of ₹ $50,00,000$ divided into $1,00,000$ equity shares of ₹50 each. The company issued prospectus inviting application for 90,000 Shares. The issue price was payable as under:

On Applicant : ₹15
On Allotment : ₹ 20
On call : Balance amount
The issue was fully subscribed and the company allotted shares to all the applicants. The company did not make the call during the year.
Show the following:
(a) Share capital in the Balance sheet of the company as per revised schedule III, Part-I of the companies Act, 2013.
(b) Also prepare' Notes to Accounts for the same.

Solution:

## Balance Sheet of Janta Ltd.

As at
(As per revised schedule III)

| Particulars | Note No. | Amount <br> Current <br> Years ₹ | Amount <br> Previous <br> Years ₹ |
| :--- | :---: | :---: | :---: |
| Equity \& liabilities <br> 1. Shareholder's funds <br> (a) Share Capital | 1. | $31,50,000$ | - |

Notes to Accounts

| Particulars | (₹) |
| :---: | :---: |
|  |  |
| Authorised Capital |  |
| 1,00,000 equity shares of ₹50 each | 50,00,000 |
| Issued Capital <br> 90,000 equity shares of ₹50 each |  |
| 90,000 equity shares of $₹ 50$ each | 45,00,000 |
| Subscribed Capital |  |
| Subscribed but not fully paid |  |
| 90,000 shares of ₹ 50 each ₹ 35 called up | 31,50,000 |

## Issue of Shares

Shares can be issued in two ways

1. for cash
2. for consideration other than cash

## Terms of Issue of Shares

Shares can be issued in two ways.

1. Issue of shares at Par
2. Issue of shares at Premium

Issue of shares against Lump sum payment: When whole amount due on shares is payable in one instalment i.e, at the time of application. The journal entries will be as follow:

Illustration 3: Vaibhav Ltd. issued 1, 00,000 shares of ₹10 each at per. The whole amount was payable with application. Pass the necessary journal entries in the books of company.

## Solution

## Journal

| Date | Particulars | LF | Debit ( ₹) | Credit ( ₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c <br> To Share Application and Allotment A/c <br> (Being the application money received on $1,00,000$ shares at $₹ 10$ per share) |  | 10,00,000 | 10,00,000 |
|  | Share Application and Allotment A/c Dr. <br> To Share Capital A/c <br> ( Being share allotted and transfer of application money on 1,00,000 shares to shares capital account) |  | 10,00,000 | 10,00,000 |

## Shares Payable in Instalments

1. First instalment paid along with application is called as applications money.
2. Second instalment paid on allotment is called as allotment money.
3. Subsequent instalments paid are called as call money. Calls can be more than one and are called First call, second call or as the case may be

Issue of Shares for Cash at Par: This means shares are issued at face value
Journal Entries

| For Application money | Bank Account <br> To Share Application A/c | (N0. of Application X <br> Application amount <br> per share) |
| :--- | :--- | :--- |
| On acceptance of <br> Applications | Share Application A/c Dr. <br> To Share Capital A/c | (No. of Share Allotted <br> X application amount <br> per share) |
| For allotment money due | Share Allotment A/c Dr. <br> To Share Capital A/c | (No. of Shares allotted <br> X amount called on <br> allotment per share) |
| On receipt of allotment <br> money | Bank A/c Dr. <br> To Share Allotment A/c | (No. of share allotted <br> X Amount received on <br> allotment for each <br> share) or actual <br> amount received. |
| For call money due | Share Call A/c Dr. <br> To Share Capital A/c | (No. of shares allotted <br> X amount called on <br> each share) |
| On receipt of Calls <br> money | Bank A/c <br> To Share Call A/c | Call money due- calls <br> in arrears. |

Illustration 4 : X Ltd. invited application for 10,000 shares of the value of ₹ 10 each. The amount is payable as ₹2 on application and ₹ 5 on allotment and balance on First and final Call. The whole of the above issue was applied and cash duly received. Give Journal entries for the above transaction.

## Journal

| Date | Particulars | L.F. | Debit ( $\left.{ }^{( }\right)$ | Credit ( $₹$ ) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c <br> To Share Application A/c <br> (Being the application money received on 10,000 shares at ₹ 2 per share) |  | 20,000 | 20,000 |
|  | Share Application A/c <br> To Share Capital A/c <br> (Being the transfer of application money on 10,000 shares to share capital account). |  | 20,000 | 20,000 |
|  | Share Allotment A/c $\quad$ To Share Capital A/c (Being the amount due on 10,000 shares at ₹ 5 per share) |  | 50,000 | 50,000 |
|  | Bank A/c <br> To Share Allotment A/c <br> (Being the receipt of allotment money on 10,000 shares) |  | 50,000 | 50,000 |
|  | Share first \& final call A/c <br> To Share Capital A/c <br> (Being the amount due on 10,000 shares at ₹ 3 per share) |  | 30,000 | 30,000 |
|  | Bank A/c Dr. $\quad$ To share first \& final call A/c (Being the receipt of ₹ 3 on 10,000 shares) |  | 30,000 | 30,000 |

Note: For each entry narration is compulsory
Issues of Shares at Premium: It is issue of shares at a price more than its face value.

This premium can be utilized for: (Section 52 of the Companies Act 2013 states that premium can be utilized for :-)

1. Issue of fully paid bonus shares to the shareholders.
2. Write off preliminary expenses of the company.
3. Writing off securities issue expenses, commission paid and discount on issue of securities.
4. For providing the premium payable on redemption of Redeemable preference shares or debentures of the company.
5. For Buy back of its own shares as per Section 68A.

The securities premium may be collected by the company with application money / Allotment money / First call/Final Call depend upon the terms of issue of shares. If questions is silent regarding the securities premium amount due, it is assumed that securities premium money is due with the allotment money. Following are the various situation of securities premium received with application, allotment and call.

Journal Entries for accounting of securities premium

| 1. For Application Money | $\begin{gathered} \hline \text { Bank Account } \\ \text { To Share Application A/c } \end{gathered}$ | (No. of Application X Application amount per share) |
| :---: | :---: | :---: |
| On acceptance of Applications | Share Application A/c <br> To Share Capital A/c <br> To Securities Premium <br> Reserve A/c | (No. of Share alloted X application amount called on cash) <br> (Amount of Securities Premium Received if any) |
| 2. For allotment money due | Share Allotment A/c <br> To Share Allotment A/c <br> To Securities Premium <br> Reserve A/c | (No. of Shares alloted X amount called on allotment for each share (Securities Premium due) |
| On receipt of allotment money | Bank Account Dr. <br> To Share Allotment A/c  | (No. of allotment share $\times$ Amount received on allotment for each share) or actual amount received) |
| 3. For call money due | Share Call A/c Dr. To Share Capital A/c To Securities Premium A/c | (No. of shares allotted $x$ amount called on each call share) (Securities Premium due) |
| On receipt of Calls money | Bank A/c <br> To Share Call A/c | (No. of application allotted $x$ Amount received on each share) |

Illustration 5: Vikram Ltd. Issued 20,000 Equity shares of ₹ 10 each at a premium of ₹ 3 payable as follows:
On Application ₹ 4
On Allotment ₹ 5 (including Securities Premium Reserve)

## On First Call ₹ 2

## On Final Call ₹ 2

All shares were duly subscribed and all money duly received. Pass necessary Journal Entries.

## Solution:

## In the Book of Vikram Ltd.

| Date | Particulars | L.F. | Debit(₹) | Credit(₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c <br> To Equity Share Application A/c <br> (Being the application money received on 20,000 Equity Shares ar ₹ 4 per Equity Share) |  | 80,000 | 80,000 |
|  | Equity Share Application A/c <br> To Equity Share Capital A/c <br> (Being the transfer of application money on 20,000 Equity Share capital account) |  | 80,000 | 80,000 |
|  | Equity Share Allotment A/c <br> To Equity share Capital A/c <br> To Securities Premium Reserve A/c <br> (Being the amount due on 10,000 Equity <br> shares at ₹ 5 including Premium ₹ 3 shares) |  | 1,00,000 | 40,000 60,000 |
|  | Bank A/c <br> To Equity Share Allotment A/c (Being the receipt of $L 5$ on 10,000 Equity Shares) |  | 1,00,000 | 1,00,000 |
|  | Equity Shares First Call A/c <br> To Equity Share Capital Account <br> (Being the amount due on 20,000 Equity <br> Shares at ₹ 2 per Equity Share) |  | 40,000 | 40,000 |
|  | Bank A/c <br> To Equity Share First Call A/c <br> (Being the receipt of $₹ 2$ on 20,000 Equity shares) |  | 40,000 | 40,000 |
|  | Equity Share Final Call A/c Dr.To Equity Share Capital A/c(Being the receipt of₹ 20,000 Equity <br> Shares) |  | 40,000 | 40,000 |
|  | Bank A/c <br> To Equity Share Final Call A/c <br> (Being the receipt of $₹ 2$ on 20,000 Equity Shares) |  | 40,000 | 40,000 |

## Issue of Shares at Discount (Section 53)

A Company cannot issue share at discount other than sweat equity share.

## Shares Issued for Consideration other than Cash

When a company purchases any fixed asset or business and makes the payment to the vendor in form of shares in place of cash it is called the issue of shares for consideration other than cash.

Share can be issued at par or at premium
Journal entries for issue of shares to vendors/consideration other than cash
JOURNAL

| Date | Particulars | L.F. | Debit(₹) | Credit( ${ }^{\text {P }}$ ) |
| :---: | :---: | :---: | :---: | :---: |
|  | On Purchase of asset: <br> Sundry Asset A/c <br> Dr. <br> To vender | Amount of purchase price <br> Consideration -Net Assets <br> Agreed Value |  | Agreed value purchase consideration <br> Agreed Value Purchase Consideration Difference |
|  | On Purchase of business: <br> When purchase consideration is more than net asset <br> Sundry Assets A/c <br> Goodwill (B/F) A/c <br> To Sundry liability <br> To Vender |  |  |  |
|  | When purchase consideration is less than net asset <br> Sundry Assets Account <br> To Liabilities <br> To Vendor <br> To capital Reserve A/c (B/F) |  |  |  |
|  | On Issue of share <br> (a) at Par <br> Vendor's A/c <br> Dr. <br> To Share Capital A/c <br> (b)On Issue of share at Premium Dr. Vender A/c <br> To Share Capital A/c <br> To Securities Premium Reserve A/c |  |  |  |

Note: When name of vendor is given write the name of vendor
Illustration 6: Ajay Co. Ltd. Purchased a machine from Vikram Co. for ₹ 64,000. It was decided to pay ₹ 10,000 in cash and balance paid by issue of shares of ₹ 10 each,

Pass journal entries if shares are
(a) Issued at par
(b) Issued at premium of $20 \%$

## Solution:

## Journal

| Date | Particulars | L.F. | Debit( ${ }^{\text {F }}$ ) | Credit(₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Machinery Account <br> To Vikram Ltd. <br> (Being the machine purchased) Dr. |  | 64,000 | 64,000 |
|  | Vikram Ltd Dr. <br> To Bank A/c  <br> (Being amount paid)  |  | 10,000 | 10,000 |
|  | (a) When shares are issued at par Dr. <br> Vikram Ltd. (Vendor) <br> To Share Capital <br> (Being 5,400 shares of ₹10 each issued par to Vikram Ltd.) |  | 54,000 | 54,000 |
|  | (b) When shares are issued at premium Vikram Ltd. (Vendor) To Share Capital Account To Security Premium Reserve Account (Being 4,500 shares of issued to vendor at a premium of ₹ 2 per share) |  | 54,000 | $\begin{array}{r} 45,000 \\ 9,000 \end{array}$ |

## Working Note:

(b) No. of shares to be issued $=\frac{\text { Amount Payable }}{\text { Issue Price }}=\frac{54000}{12}=4500$ shares

Illustration 7 : A company issued 15,000 fully paid up equity shares of ₹ 100 each for the purchases of the following assets and liabilities from Gupta Bros.

Plant - ₹ $3,50,000$; Stock ₹ $4,50,000$;
Land and Building ₹ $6,00,000$; Sundry Creditors ₹ 1,00,000 Pass
necessary Journal entries.

## Solution:

## Journal



Note: Calculation: Goodwill = Purchases consideration + Liabilities - assets $=₹$ $15,00,000+₹ 1,00,000-₹ 14,00,000=₹ 2,00,000$.

Illustration 8: A company purchased a running business from Mahesh for a sum of ₹1,50,000 payable as ₹, 1,20,000 in fully paid equity shares of ₹ 10 each and balance in cash. The assets and liabilities consisted of the following

Plant and Machinery ₹40,000; Stock ₹50,000; Building ₹40,000; Cash ₹20,000
Sundry debtors ₹30,000; Sundry creditors ₹20,000

Pass necessary Journal entries.

## Solution

| Date | Particulars | L.F | Debit ( $₹$ ) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Plant and machinery A/c Dr. <br> Buildings A/c Dr. <br> Sundry Debtors A/c Dr. <br> Stock A/c Dr. <br> Cash A/c Dr. <br> To Sundry Creditors  <br> To Mahesh  <br> To Capital Reserve A/c (B/f)  <br> (Being the purchase of business)  |  | $\begin{aligned} & 40,000 \\ & 40,000 \\ & 30,000 \\ & 50,000 \\ & 20,000 \end{aligned}$ | $\begin{array}{r} 20,000 \\ 1,50,000 \\ 10,000 \end{array}$ |
|  | Mahesh Dr. To Equity Shares Capital A/c To Bank A/c (Being the payment made to Mahesh in form of shares) |  | 1,50,000 | $\begin{array}{r} 1,20,000 \\ 30,000 \end{array}$ |

Note : Calculation; Net assets - liabilities = ₹ $1,80,000-₹ 20,000=$ ₹ $1,60,000$
Capital reserve $=$ Net Asset - Purchase consideration $=₹ 1,60,000-₹ 1,50,000=$ ₹ 10,000

Illustration 9 : Pass necessary journal entries for the following transactions in the Books of Rajan Ltd.
(a) Rajan Ltd. purchased machinery of ₹ 7,20,000 from Kundan Ltd. The payment was made to Kundan Ltd. by issue of equity shares of ₹100 each at $20 \%$ premium.
(b) Rajan Ltd. purchased a running business from Vikas Ltd. for a sum of ₹2,50,000 payable as ₹2,20,000 in fully paid equity shares of ₹10 each and balance by a bank draft. The assets and liabilities consisted of the following:

Plant \& Machinery ₹90,000; Buildings ₹ 90,000 ;
Sundry Debtors ₹ 30,000 ; Stock ₹50,000; Cash ₹ 20,000;
Sundry Creditors ₹ 20,000

## Solution

## Rajan Ltd

Journal


Private Placement of shares [Section 42]: This is an issue of shares to institutional investors or some selected group of person's subject to prior approval of existing shareholders.

There is no need of issuing formal prospectus and it is cost and and time saving method of raising capital.

Under subscription: When the number of Share application received is less than the number of shares offered to public it is under subscription.

Over subscription: When the number of Share application received is more than the number of shares offered to public it is over subscription

A company has the following three alternatives in case of over subscription of shares:

1. Either reject the excess applications
2. Make pro-rata allotment
3. partially refund amount and for balance applications, pro-rata allotment is made.

Calls in arrear: Any Amount which has been called or demand by company from shareholders but not paid by the shareholder till the last date mentioned in call letter, is called as call in arrear, Company can charge interest on this at rate mentioned in Article of Association or 10\% as per Table F.

Calls in advance: Any amount paid in excess of what shareholder has been asked to pay, is called as call in advance. Interest is paid on this at rate mentioned in Article of Association or $12 \%$ pa as per Table F.

Forfeiture of shares: If any shareholder fails to pay the amount on any call, his already paid money is forfeited or withheld by company this is called forfeiture of shares.

Forfeiture of share refers to the cancellation or termination of membership of a shareholder by taking away the shares and rights of membership.

Forfeiture of Shares Issued at par
Journal

| Date | Particulars | LF | Debit (₹) | Credit (₹) |
| :---: | :---: | :--- | :--- | :--- |
|  | Share Capital A/c <br> To Various Calls/calls in Arrear A/c <br> To Forfeited Share A/c |  | Amount <br> Called-up | (Unpaid Amt.) <br> (Amount Received) |

Illustration 10: Ram holding 10 shares of ₹10 each of which ₹2 on application ₹3 on allotment but could not pay ₹3 on first call. His shares were forfeited by the Directors. The Final call is not made yet. Give Journal entries in the book of company.

## Solution

Journal

| Date | Particulars | LF. | Debit(₹) | Credit(₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Share Capital A/c $(10 \times 8)$ <br> To Share First Calls/calls in arrear A/c <br> To Forfeited Share A/c <br> (Being 10 Shares forfeited for nonpayment of first call money) |  | 80 | 30 50 |

Forfeiture of Shares Issued at Premium: (i) when the premium has been received; (ii) When the premium has not been received.

Case 1: When the premium has been received: In such cases premium received will not be forfeited and will not record anywhere in the entry of forfeiture of shares.

Journal

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :--- | :--- | :---: | :--- | :--- |
|  | Share Capital A/c |  | Amount called <br> (Excluding <br> Premium) |  |
| To Various Calls/calls in arrear A/c <br> To Forfeited Share A/c |  | Unpaid Amt. <br> Amt. received <br> (Excluding <br> Premium) |  |  |

Illustration 11 : 1,000 shares of $₹ 10$ each issued at a premium of ₹ 2 per share are forfeited on which ₹ 8 (including premium) have been received. Final call of ₹ 4 has not been received. Pass necessary journal entry in the books of company.

## Solution :

Journal

| Date | Particulars | LF. | Debit ( ${ }^{\text {( }}$ ) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Share Capital A/c (1000 $\times 10$ ) <br> To Various Calls/calls in Arrears A/c <br> To Forfeited Share A/c (1000 $\times 6$ ) <br> (Being 1000 Shares forfeited for non-payment of Final call money) |  | 10,000 | $\begin{aligned} & 4,000 \\ & 6,000 \end{aligned}$ |

Case 2 : The premium has not been received : In such case security premium reserve is debited with the amount for premium called but not received by the company.

## Accounting Treatment

Journal

| Date | Particulars |  | LF. | Debit (₹) | Credit (₹) |
| :--- | :--- | :--- | :--- | :--- | :--- |
|  | Share Capital A/c | Dr. |  | (Amount <br> called) |  |
|  | Securities Premium Reserve A/c | Dr. |  | (Premium <br> not <br> received) |  |
|  | To Various Calls/calls in arrear A/c |  |  | (Unpaid <br> Amt. <br> Including <br> premium) <br> (Net Amt. <br> Recd.) |  |
|  | To Forfeited Share A/c |  |  |  |  |

Illustration 12: 1,000 Shares of ₹ 10 each issued at a premium of ₹ 2 per share are forfeited on which only application money of ₹ 4 has been received and ₹ 8 (including premium) has not been received. Pass necessary entries.

## Solution:

Journal

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Share Capital A/c Dr. <br> Securities Premium Reserve A/c Dr. <br> $\quad$ To Various Calls/calls in arrear A/c  <br> $\quad$ To Forfeited Share A/c  <br> (Being 1,000 shares forfeited for non-payment  <br> of allotment and calls money)  |  | $\begin{array}{r} 10,000 \\ 2,000 \end{array}$ | $\begin{aligned} & 8,000 \\ & 4,000 \end{aligned}$ |

Reissue of forfeited shares: forfeited shares can be issued to some investor. This is called as reissue of shares These can be issued at par, premium or discount but discount cannot exceed the forfeited amount on the reissued shares.

Journal

| Date | Particulars | LF. | Debit (₹) | Credit( F$)$ |
| :---: | :---: | :---: | :---: | :---: |
|  | When shares Reissued at par. <br> Bank A/c <br> To Share Capital A/c <br> When shares Reissued at Premium <br> Bank A/c <br> To Share Capital A/c <br> To Securities Premium Reserve A/c <br> When shares Reissued at Discount. <br> Bank A/c <br> Forfeited Shares A/c <br> To Share Capital A/c <br> (After reissue of share, the balance related to reissued shares in forfeiture account (Profit on Reissue of shares) transferred to capital reserve A/c) <br> Forfeited Shares A/c <br> To Capital Reserve A/c |  |  |  |

Illustration 13: Abhishek Ltd. Forfeited 200 shares of ₹ 10 each fully called up held by X for non-payment of allotment money of ₹ 3 per share and First \& Final call of ₹ 4 per share. He paid the application money of ₹ 3 per share. These shares were reissued to $Y$ for ₹ 8 per shares. Pass necessary journal entries.

## Solution:

Journal

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Share Capital A/c <br> To share Allotment Account (200×3) <br> To Shares First \& Final Call Account ( $200 \times 4$ ) <br> To Shares Forfeited Account ( $200 \times 3$ ) <br> (Being 200 shares forfeited held by X ) |  | 2,000 | 600 800 600 |
|  | Bank Account ( $200 \times 8$ ) <br> Forfeited Shares Account (200×2) <br> To Share Capital Account ( $200 \times 10$ ) <br> (Being re-issued of forfeited shares to Y ) |  | 1,600 400 | 2,000 |
|  | Forfeited Shares Account <br> To Capital Reserve Account <br> (Being the transfer of profit on reissue to Capital Reserve) |  | 200 | 200 |

Forfeiture of Shares originally issued at premium and reissued at a discount
Illustration 14: A Ltd. Forfeited 100 shares of ₹ 100 each issued at a premium of $50 \%$ to be paid at time allotment on which first call of ₹ 30 per equity share was not received, final call of ₹ 20 is yet to be made. These shares were reissued at ₹ 70 per share at ₹ 80 paid up. Pass necessary journal entries.

## Solution:

Journal

| Date | Particulars | LF. | Debit (₹) | Credit ( $₹$ ) |
| :---: | :---: | :---: | :---: | :---: |
|  | Share Capital A/c (100x80) <br> To Shares First Call Account (100x30) <br> To Shares Forfeited Account (100x50) <br> (Being 100 shares forfeited for non-payment of first call money) |  | $8,000$ | $\begin{aligned} & 3,000 \\ & 5,000 \end{aligned}$ |
|  | Bank A/c (100×70) <br> Forfeited Shares A/c (100×10) Dr. <br> To Share Capital Account ( $100 \times 80$ ) <br> (Being re-issued of 100 forfeited shares at ₹ 70 per share at L 80 paid up) |  | $\begin{aligned} & 7,000 \\ & 1,000 \end{aligned}$ | $8,000$ |
|  | Forfeited Shares Account (40x100) <br> To Capital Reserve Account <br> (Being the transfer of profit on reissue to Capital Reserve) |  | 4,000 | 4,000 |

Pro-Rata-Allotment When there is oversubscription of shares either the excess amount is refunded or proportionate shares are allotted. Allotment of proportionate shares is Pro-Rata Allotment.

Illustration 15: AB Ltd. invited applications for 1,00,000 Equity Shares ₹ 10 each payable as ₹ 2 application, ₹ 3 on Allotment and the balance on first and final call. Application were received for $3,00,000$ shares and shares were allotted on prorata basis. The excess application money was to be adjusted against allotment only. Ram, a shareholder who has applied for 3,000 shares failed to pay the call money and his shares were forfeited and re-issued at ₹ 8 per share as fully paid. Pass necessary journal entries in the books of company.

## Solution :

Journal

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c <br> To Equity Share Application A/c <br> (Being the application money received on 3,00,000 Equity Shares at L 2 per Equity Shares) |  | 6,00,000 | 6,00,000 |
|  | Equity Share Application A/c <br> To Equity Share Capital Account <br> To Equity Share Allotment Account <br> To Bank A/c <br> (Being the transfer of application money into share capital and allotment and balance refunded) |  | 6,00,000 | $\begin{aligned} & 2,00,000 \\ & 3,00,000 \\ & 1,00,000 \end{aligned}$ |
|  | Equity Share Allotment A/c <br> To Equity Share Capital A/c <br> (Being the amount due on 1,00,000 Equity Shares at ₹ 3 Share) |  | 3,00,000 | 3,00,000 |
|  | Equity Share First \& Final call A/c <br> Dr. <br> To Equity Share Capital A/c <br> (Being the amount due on 1,00,000 Equity Shares at ₹ 5 per Equity Share) |  | 5,00,000 | 5,00,000 |
|  | Bank A/c <br> To Equity Share First \& Final call A/c (Being the receipt of L5 on 99,000 Equity Shares) |  | 4,95,000 | 4,95,000 |
|  | Equity Share Capital A/c <br> To Equity First \& Final A/c <br> To Forfeited Share A/c <br> (Being 1000 Shares Forfeited due to non-payment of first and final call money) |  | 10,000 | 5,000 5,000 |



Note: there is no bank account on allotment as all due money has been already received

> When Cash Book Entries are asked in the question, all cash transactions are to be recorded in Cash Book, other non-cash transaction should be entered in the Journal.

Illustration 16: If in Illustration 15 the company prepare Cash Book and journal for the above transaction then the Cash Book and journal entries will be made as follow:

## Solution:

Journal

| Date | Particulars | LF. | Debit ( $₹$ ) | Credit ( $\left.{ }^{( }\right)$ |
| :---: | :---: | :---: | :---: | :---: |
|  | Equity Share Application A/c <br> To Equity Share Capital A/c <br> To Equity Share Allotment A/c <br> (Being the transfer of application money into share capital and allotment and balance refunded) |  | 5,00,000 | $\begin{aligned} & 2,00,000 \\ & 3,00,000 \end{aligned}$ |



Cash Book (Bank Column only)
Dr.

| Particulars | $₹$ | Cr. Particulars | $₹$ |
| :--- | ---: | :---: | ---: |
| To Equity Share | $6,00,000$ | Application A/c |  |
| Application A/c | $4,95,000$ | By Balance c/d | $1,00,000$ |
| To Equity Share First |  |  | $10,03,000$ |
| \& Final Calls A/c |  |  |  |
| To Equity Share Capital A/c | 8,000 |  |  |
|  | $\mathbf{1 1 , 0 3 , 0 0 0}$ |  | $\mathbf{1 1 , 0 3 , 0 0 0}$ |

Illustration 17: AB Ltd. invites application for 75,000 equities of ₹ 100 each at premium of ₹ 30 per share. The amount was payable as follows
On Application and allotment - ₹ 85 per share (including premium)
On First and final call - The balance amount.
Application for $1,27,500$ shares were received. Applications for 27,500 shares were rejected and shares were allotted on pro-rata basis to remaining applicants. Excess money received on application and allotment was adjusted towards sum due on first and final call. The calls were made. A shareholder who applied for 1,000 shares, failed to pay the first and Final call money. His shares were forfeited. All the forfeited shares were reissued at ₹150 per share fully paid up.
Pass necessary journal entries for the above transactions in the books of $A B L t d$.

## Solution:

Ab Ltd.
Journal

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c Dr. <br> To Equity Share Application and allotment A/c (Application received for 1,27,500 Shares) |  | 1,08,37,500 | 1,08,37,500 |
|  | Equity Share Application and Allotment A/c <br> To Equity Share Capital Account <br> To Securities Premium Reserve A/c <br> To Equity Share first and final call A/c <br> To Bank A/c <br> (Shares allotment \& Refund of 27500 Shares Application money) |  | 1,08,37,500 | $\begin{aligned} & 41,25,000 \\ & 22,50,000 \\ & 21,25,000 \\ & 23,37,500 \end{aligned}$ |
|  | Equity Share First and Final call A/c <br> To Equity Share Capital A/c <br> (First final amount due on 75000 shares @ ₹ 45) |  | 33,75,000 | 33,75,000 |


|  | Bank A/c <br> To Equity Share First \& Final call A/c (Call money received Except 750 Shares) | 12,37,500 | 12,37,500 |
| :---: | :---: | :---: | :---: |
|  | Equity Share Capital A/c <br> To Equity First \& Final call A/c <br> To Forfeited Share A/c <br> (750 Shares Forfeited) | 75,000 | 12,500 62,500 |
|  | Bank A/c <br> To Equity Share Capital A/c <br> To Securities Premium Reserve A/c <br> (75 Equity Shares issued @ at ₹ 150 per share) | 1,12,500 | 75,000 37,500 |
|  | Forfeited Shares A/c <br> To Capital Reserve A/c <br> (Forfeited amount transfer to Capital Reserve) | 62,500 | 62,500 |

Illustration: 18: Fill in the missing figures
Journal

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Machinery A/c Dr. <br> Furniture A/c Dr <br> Deities A/c Dr <br> Goodwill A/c Dr <br> To Sundry creditors A/c  <br> To Lakshika  <br> (Being Assets and liabilities acquired)  <br> Lakshika  <br> To Equity Share Capital A/c  <br> To Securities Premium Reserve A/c  <br> (Being Equity Share of ₹10 each issued at a premium  <br> of ₹5 per share)  |  | $\begin{array}{r} \hline 3,00,000 \\ 100,000 \\ 50,000 \\ ------- \\ \\ 3,00,000 \end{array}$ |  |

Illustration: 19: Fill in the missing figure in the following journal entries.

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Building A/c Dr. <br> Bills Receivable A/c Dr <br> To Bills Payable A/c  <br> To Sundry creditors A/c  <br> To Anannya Ltd.  <br> To Capital Reserve A/c  <br> (Being Assets and liabilities acquired) Dr. <br> Anannya Ltd.  <br> To Bank A/c  <br> (Being Part Payment mode) Dr. <br> Anannya Ltd.  <br> To Equity Share Capital A/c  <br> To Securities Premium Reserve A/c  <br> (Being Equity Share of ₹10 each issued at issued at  <br> 10\% premium)  |  | $\begin{aligned} & 8,00,000 \\ & 2,00,000 \end{aligned}$ $\qquad$ <br> 4,40,000 |  |

Illustration: 20: Fill in the missing figures on the following journal entries:
Journal

| Date | Particulars | LF. | Debit ( ${ }^{\text {( }}$ ) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Equity Share Capital A/c <br> To Equity Share Allotment A/c <br> To Equity Share First Call A/c <br> To Share Forfeited A/c <br> (Being 900 equity share forfeited for non-payment of allotment and I call money of ₹ 30 and ₹ 20 per share respectively) |  | 67,500 |  |


|  | Bank A/c Dr. <br> To Equity Share Capital A/c <br> To Securities Premium Reserve A/c <br> (Being 900 shares were re-issued @ ₹ 90 per share, <br> 75 paid up) <br> Share Forfeited A/c Dr. <br> To Capital Reserve A/c <br> (Being the profit on reissue of shares transferred) |  |  | $67,500$ $\qquad$ $\qquad$ |
| :---: | :---: | :---: | :---: | :---: |

Illustration: 21: Fill in the missing figures:

> Journal

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Equity Share Capital A/c Dr. <br> Securities Premium Reserve A/c Dr. <br> To Equity Share Allotment A/c  <br> To Equity Share First Call A/c  <br> To Equity Share final call A/c  <br> To Share Forfeited A/c  <br> (Being 200 shares of ₹ 10 each forfeited for non-  <br> payment of allotment money of ₹ 8 per share  <br> (including ₹5 premium) first call of ₹ 2 and final call of  <br> ₹ 3 per share) Dr. <br> Bank A/c <br> Share forfeited A/c <br> To Equity Share Capital A/c  <br> (Being 125 shares were re-issued @ ₹ 90 per share, <br> as fully paid up) <br> Share Forfeited A/c <br> To Capital Reserve A/c <br> (Being profit on re-issue of 125 shares transferred)  |  |  | 1600 <br> -------- <br> 600 <br> -------- <br>  <br> ------- <br>  <br>  |

## EMPLOYEE STOCK OPTION PLAN/SCHEME

Employees stock option or sweat equity refers to option granted by any company to its employees to subscribe its shares at a price lesser than market price. It is employees' right to exercise or not to exercise the option, it is not an obligation on the employees to subscribe it. The difference between the market price and issue price is an expense for the company and this is accounted over the vesting period on proportionate basis on straight line basis.

## Objectives/Significance of ESOP:

1. It helps in creating a long term wealth for the employees.
2. It motivates the employees to have a higher participation in the company
3. It helps the company to attract efficient employees and keep them retained on long term basis.

## Some Important Terms Related with ESOP

Grant date: The date at which the company and its employees agree to the conditions of ESOP.

Vesting Period: Period between Grant date and the date on which all the conditions are fulfilled.

Exercise Period: Period within which employees have to exercise the option granted under ESOP.

Exercise Price: Price to be paid by the employee on exercising the options.

## Accounting Treatment

a. At the time of accounting the expense (Passed for each year of vesting period)
Employees Compensation Expense A/c Dr.
To Share Options Outstanding A/c

## b. Transfer of Employees Compensation Expense

Statement of Profit and Loss Dr.

Dr.
To Employees Compensation Expense A/c
c. At the same time of exercise of the option
Bank A/c ..... Dr.
Shares Options Outstanding A/cTo Share Capital A/cTo Securities Premium Reserve A/c(No. of options x Exercise Price) Dr. (No. of Options x difference b/w Market price and Exercise price)
(No. of options x Face Value)
(No. of options $\times$ difference b/w Market value - face value)
d. When all the options are not exercised and the options have expired

Bank A/c

Shares Options Outstanding A/c

To Share Capital A/c
To Security Premium Reserve A/c

To General Reserve A/c

Dr.
(No. of options x Exercise price)
Dr.
(No. of Options x difference b/w Market price and Exercise price) (No. of options x Face value)
(No. of options $x$ difference $\mathrm{b} / \mathrm{w}$ Market price - Face Value)
(Option not exercised $x$ difference b/w Market price and Exercise price)

Illustration: 22

Rohini Ltd. grants options to its 500 employees to subscrive 30 shares each of ₹ 10 each within six months from the end of vesting period of 3 years. The market value of each share is ₹ 80 and price offered to employees is ₹ 65 .

Pass the journal entries for the above assuming that all the employees exercised their options.

## Solutions:

In the Books of Rohini Ltd.
Journal

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| $\begin{aligned} & \text { Year } \\ & 1 \end{aligned}$ | Employees compensation Expense A/c Dr. $\quad$ To Share Option Outstanding A/c (Being the expense recognised) |  | 75,000 | 75,000 |
| $\begin{aligned} & \text { Year } \\ & 2 \end{aligned}$ | Employees compensation Expense A/c <br> To Share Option Outstanding A/c <br> (Being the expense recognised) |  | 75,000 | 75,000 |
| $\begin{aligned} & \text { Year } \\ & 3 \end{aligned}$ | Employees compensation Expense A/c Dr. To Share Option Outstanding A/c (Being the expense recognised) |  | 75,000 | 75,000 |
| $\begin{aligned} & \text { Year } \\ & 4 \end{aligned}$ | Bank A/c Dr. <br> Shares Option Outstanding A/c Dr. <br> To Share Capital A/c  <br> To Securities Premium Reserve A/c  <br> (Being the only options exercised by all the <br> employees)  |  | $\begin{aligned} & 9,75,000 \\ & 2,25,000 \end{aligned}$ | $\begin{array}{r} 1,50,000 \\ 10,50,000 \end{array}$ |

## Working Notes:

## Amount of Employees Compensation Expense Recognized

$=(500 \times 30 \times 15) / 3$
$=2,25,000 / 3=₹ 75,000$

## Practice Question

Question-1: Bajaj Ltd. was formed on 15 December, 2015, with a capital of ₹ $25,00,000$ divided into shares of ₹ 10 each. It offered $60 \%$ of the shares to the public.

The issue price was payable as follows:
$25 \%$ of the face value per share was payable with application, $30 \%$ of the face value per share was payable with allotment.

The balance as and when required. The company did not call for the balance during the year.

All the shares offered by the company were subscribed for. The company did not receive the allotment money on 5000 shares.

You are required to
(iii) Show the share capital in the Balance Sheet of the company as per schedule III of the Companies Act, 2013 at the end of the financial year.
(iv) Prepare necessary notes to accounts.
(Hint: Shares offered to public 25,00,000X60/100 = ₹ $15,00,000$; Money payable as ₹ 2.50 per share on Application, ₹ 3 per share on allotment and balance ₹ 4.50 on calls, Money received be shown under sub heading "Subscribed but not fully paid up" in the Balance Sheet)

Question-2: Dawar Ltd. issued 50,000 shares of 10 each at a premium of $10 \%$ payable at ₹ 2 per share on application, ₹ 3 on allotment, ₹ 3 each on first and final call. Applications were received for 70,000 shares. It was decided that:
(a) Refuse allotment to the applicants for 10,000 shares;
(b) Allot 20,000 shares to Pawan who had applied for similar number and
(c) Allot the remaining shares on pro-data basis.

Pawan failed to pay the allotment money and Monan who belonged to the category ' $C$ ' and was allotted 3,000 shares, paid both the calls with allotment.

Calculate the amount received on allotment.
(Hint: Allotment due $50,000 \times 3=1,50,000$, Excess application money adjusted ₹ 20,000; Calls received in Advanced ₹18,000; Amount Received on Allotment ₹ $88,000(1,50,000-20,000-60,000+18,000)$ )

Question-3: Rama Ltd. issued 40,000 shares of ₹ 10 each at a premium of ₹ 2.50 per share. The amount was payable as follows:

On Application - ₹ 2 per share

| On Allotment | - | $₹ 4.50$ per share |
| :--- | :--- | :--- |
| And on First and Final Call | - 6 per share |  |

Owning to the heavy subscription the allotment was made on pro-rate basis as follows:
(i) Applicants for 20,000 shares were allotted 10,000 shares.
(ii) Applicants for 56,000 shares were allotted 14,000 shares.
(iii) Applicants for 48,000 shares were allotted 16,000 shares.

It was decided that excess amount received on applications would be utilized on allotment and the surplus, If any, would be refunded.

The directors decided to forfeit the shares of one shareholder Shyam, to whom, 1000 shares were allotted, who belongs to category (i), failed to pay allotment money. Shares were forfeited after final call.

You are required to
A. Pass necessary journal entries in the books of Rama Ltd. for the issue and forfeiture of shares,
B. Rama Ltd. decided to provide cabs to its employees on pooling basis so that employees can reach to the office well in time and avoid excessive use of personal cars. State the value involved in such decision.
(Hint: (1) Transfer of share application money to Share Capital A/c ₹ 80,000 ; to Share Allotment A/c ₹ 1,47,000; to bank A/c ₹ 21,000. (2) Share Allotment Money Received in Cash ₹ 30,500, (3) Amount forfeited ₹ 4,000 . (4) Value Involved; Reduction in Pollution, Saving of Petroleum Products, Value time, solving the parking issue etc.)

## CHAPTER 8

## ACCOUNTING FOR DEBENTURES

Debentures: It is a document issued by a company under its common seal acknowledging the debt and it also contains the terms of repayment of debt and payment of interest at a specified rate.

Section 2(30) of companies Act,2013 defines debentures as "Debentures includes debenture stock, bond or any other instrument of a company evidencing a debt, whether constituting a charge on the company's assets or not."

Debentures are generally freely transferable by the debenture holder. Debenture holders have no rights to vote in the company's general meetings of shareholders. The interest paid to them usually half yearly is a charge against profit in the company's financial statements.

## TYPES OF DEBENTURES



Convertibility point of view: There are two types of debentures:
Convertible debentures are those debentures, which can be converted into equity shares of the issuing company after a predetermined period of time.

These may be Partly Convertible Debentures (PCD): A part of these instruments are converted into Equity shares in the future at notice of the issuer. The issuer decides the ratio for conversions. This is normally decided at the time of subscription.

Fully convertible Debentures (FCD): These are fully convertible into Equity shares at the issuer's notice. The ratio of conversion is decided by the issuer. Upon conversion the investors enjoy the same status as ordinary shareholders of the company.

Non-convertible debentures, which are simply regular debentures, cannot be converted into equity shares of the issuing company. These are debentures without the convertibility feature; these usually carry higher interest rates than their convertible counterparts.

On basis of Security, debentures are classified into:
Secured Debentures: These instruments are secured by a charge on the fixed assets of the issuer company. So if issuer company fails to pay either the principal or interest amount, its assets can be sold to repay the liability towards debenture holders.

Unsecured Debentures: These instruments are unsecured in the sense that if the issuer defaults on payment of the interest or principal amount, the holder of these debentures is treated like other unsecured creditors of the company.

From Redemption point of view
Redeemable Debentures: Redeemable debentures are those which are redeemed or paid off after the termination of fixed term. The amount paid off includes the principal amount and the current year's interest. The company always has the option of either to redeem a specific number of debentures each year or redeem all the debentures at specified date.

Irredeemable or Perpetual Debentures: Irredeemable debentures are those debentures which do not have any fixed date of redemption. They are redeemed either in the event of winding up or at a very remote period of time. Irredeemable or perpetual debenture holders can never force the company to redeem their debentures.

Distinguish between a Share and Debenture

| Basis | Share | Debenture |
| :--- | :--- | :--- |
| Return | Dividends are paid out of <br> surplus profits and may <br> fluctuate. | Interest is paid irrespective of <br> profits or loss and remains <br> fixed. |
| Discount on <br> issue | Restriction on issue of shares <br> at a discount. | No restrictions on issue of <br> debentures at a discount. |
| Ownership | Shareholders are the owners <br> of company | Debenture holders are the <br> lenders of company |
| Form of return | Dividend | Interest |
| Security | Not secured <br> Voting right <br> Equity shareholders have the <br> voting right <br> Secured by a charge on <br> assets of the company <br> course of business <br> RiskMore risk as compare to <br> Debentures | Risk Free due to secured <br> Debentures |

Debentures are shown under the head 'Non-Current Liabilities.' But the part of debentures becoming due within 12 months of the date of Balance Sheet will be shown under 'Other Current Liabilities'

## Issue of Debentures

Debentures can be issued in following ways

1. for cash
2. for consideration other than cash
3. As collateral security

## Terms of Issue

Debentures can be issued in following ways:

1. Issue of Debentures at Par
2. Issue of Debenture at Premium
3. Issue of Debentures at Discount.

Issue of Debentures for Cash
(a) When Debentures amount received in lump sum with the application

| On receipt of <br> application money | Bank A/c Dr. <br> To Debenture Application and <br> Allotment, A/c | With the application <br> money received |  |  |
| :--- | :---: | :--- | :---: | :--- |
| On acceptance of <br> application money | Debenture Application and <br> Allotment A/c | (With Amount of <br> Dr. | To X\% Debentures A/c | Money on allotted <br> debentures, <br> And Excess amount <br> refunded. |

(b) When Debentures amount received in instalments.

In this case accounting entries will be same as at the time of issue of shares in instalments with small change in the name of term like the share capital word replaced with the X\% Debentures A/c, and Share word replaced with Debentures e.g. Equity share capital into 8\% Debentures, Equity share application into Debentures Application and follows on.

## Debenture Payable in Instalment

1. First instalment paid along with application is called as application money.
2. Second instalment paid on allotment is called as allotment money
3. Subsequent instalments paid are called as call money calls can be more than one and called First call, second call or as the case may be.

AT Par: It means debentures are issued of face value
Illustration 1: Raj Ltd. Issued 2,000 12\% Debentures of ₹100 each at par payable ₹ 25 on Application, ₹ 50 on Allotment and the balance on first and final call. In all 3,000 applications were received.

Allotment was made to 2,000 applicants other were rejected. Give Journal entries.

## Solution:

In the Books of X Ltd.

| Date | Particulars | L.F. | Debit ( $\mathrm{F}^{\text {) }}$ | Credit ( F ) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c <br> To Debentures Application A/c <br> (Being the application money received on 3,000 Debentures at ₹ 25 per Debentures) |  | 75,000 | 75,000 |
|  | Debentures Application A/c <br> To 12\% Debentures A/c <br> To Bank A/c <br> (Being the transfer of application money on 2,000 Debentures to $12 \%$ debentures $\mathrm{A} / \mathrm{c}$ ) |  | 75,000 | $\begin{aligned} & 50,000 \\ & 25,000 \end{aligned}$ |
|  | Debentures Allotment A/c <br> To 12\% Debentures A/c <br> (Being the amount due on 2,000 Debentures at ₹ 50 per Debentures) |  | 1,00,000 | 1,00,000 |
|  | Bank A/c <br> To Debentures Allotment A/c <br> (Being the receipt of ₹ 50 on 2,000 Debentures) |  | 1,00,000 | 1,00,000 |
|  | Debentures First \& Final Call A/c <br> Dr. <br> To 12\% Debentures A/c <br> (Being the amount due on 2,000 Debentures at ₹ 25 per Debentures) |  | 50,000 | 50,000 |
|  | Bank A/c <br> To Debentures First \& Final call A/c <br> (Being the receipt of ₹ 25 on 2,000 Debentures) |  | 50,000 | 50,000 |

Issue of Debentures at premium: It means issue of Debenture at a price more than its face value.

Note: Premium is presumed to be demanded on Allotment unless specified and Credited to Securities Premium Reserve Account

Illustration 2: Z Ltd. Invited application for 5,000, 8\% Debentures of ₹ 100 each at a premium of $2 \%$, ₹ 40 were payable on Application and balance on allotment. Applications were received for 4,800 shares and accepted in full. All money duly received. Journalise the transactions.

Solution:

## In the books of $\mathbf{Z}$ Ltd.

| Journal |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| Date | Particulars | L.F. | Debit ( ${ }^{\text {( }}$ ) | Credit ( ${ }^{\text {( }}$ ) |
|  | Bank A/c Dr. To Debenture Application A/c (Being the application money received on 4800 debentures @ ₹ 40 per debenture) |  | 1,92,000 | 1,92,000 |
|  | Debentures Application A/c Dr. <br> To 8\% Debenture A/c <br> (Being the transfer of application money to $8 \%$ debentures account) |  | 1,92,000 | 1,92,000 |
|  | Debenture Allotment A/c <br> To 8\% Debenture A/c <br> To Security Premium Reserve A/c <br> (Being the allotment money due on <br> 4,800 debentures @ ₹ 60 and premium of ₹ 2 <br> share) |  | 2,97,600 | $\begin{array}{r} 2,88,000 \\ 9600 \end{array}$ |
|  | Bank A/c Dr. Dr <br> To Debenture Allotment A/c  <br> (Being the application money received)  |  | 2,97,600 | 2,97,600 |

Oversubscription of debentures: In such case excess application are rejected or partial or Pro-rata allotment is done or combination of both is carried on.

Illustration 3: Ganga Ltd. issued 2,000 12\% debentures of ₹ 100 each at a premium of $10 \%$ payable ₹ 25 on application; ₹ 40 (including premium) payable on
allotment and balance on First and final Call. In all 3,500 applications were received 500 applications were rejected and allotment was made to applicants to 3,000 debentures on Pro-rata basis. The excess money was adjusted on allotment. Give journal entries.

## Solution:

Journal


## Issue of Debentures for Consideration other than cash

When Debentures are issued for purchase of asset

| When Debentures are Issued for purchase of Asset at par | Sundry Asset A/c Dr. <br> To Vendor | With the purchases consideration |
| :---: | :---: | :---: |
|  | Vendor Dr. To \% Debenture A/c |  |
| When Debentures are issued for purchase of asset at premium | Sundry Assets A/c Dr. <br> To Vendor | With the purchase Consideration <br> No. of debentures par value No. of debentures $x$ premium per debentures |
|  | Vendor Dr. <br> To Debenture A/c <br> To Security Premium Reserve A/c |  |
| When business is Purchased | When Purchase consideration is equal to net value of assets <br> Sundry Assets A/c Dr. <br> To Sundry Liabilities A/c <br> To Vendor | Value of asset <br> Value of liabilities <br> Purchases consideration <br> Value of asset <br> Excess of purchase value (B/F) <br> Value of liabilities <br> Purchase consideration <br> Value of asset <br> Value of liabilities <br> Difference (B/F) <br> Purchase consideration |
|  | When Purchase consideration more than net value of assets <br> Sundry Asset A/c <br> Dr. <br> Goodwill A/c (B/F) Dr. <br> To Sundry Liabilities A/c <br> To Vendor |  |
|  | When Purchase consideration is less than net value of asset <br> Sundry Assets A/c <br> To Sundry Liabilities A/c <br> To Capital Reserve (B/f) <br> To vendor's A/c |  |

Illustration 4: A company purchased assets of book value of ₹ 99,000 from Girish. It was agreed that Purchase consideration be paid by issuing 11\% Debentures of ₹ 100 each. Assume Debentures have been issued (i) at par (ii) at a premium of $10 \%$ Give journal entries in the books of company.

## Solution

Journal

| Date | Particulars | L.F. | Debit (₹) | Credit ( F ) |
| :---: | :---: | :---: | :---: | :---: |
| (i) | Sundry Assets A/c <br> To Girish <br> (Assets Purchased from Girish) |  | 99,000 | 99,000 |
| (ii) | Debentures are issued at par <br> Girish <br> To 11\% Debentures A/c <br> (For the issue of debenture at par) |  | 99,000 | 99,000 |
| (iii) | Debentures are issued at premium: <br> Girish <br> Dr <br> To 11\% Debentures A/c <br> To Security Premium Reserve A/c <br> (For issue of 900 Debentures of ₹100 each at $9,00010 \%$ premium) |  | 99,000 | $\begin{array}{r} 99,000 \\ 9,000 \end{array}$ |

When Purchases consideration is more than net value of assets
Illustration 5: A Company issued debentures of $₹ 100$ each at par for the purchases of the following assets and liabilities from Gupta Bros. at purchase consideration of ₹ $15,00,000$

| Plant- | ₹ $3,50,000$ | Stock | ₹ $4,50,000$ |
| :--- | :---: | :---: | :---: |
| Land and Building | ₹ $6,00,000$ | Sundry Creditors | ₹ $1,00,000$ |

Pass necessary Journal entries.

## Solution:

Journal


Calculation: Goodwill $=$ Purchases consideration + liabilities - assets $=$
$₹ 15,00,000+₹ 1,00,000-₹ 14,00,000=₹ 2,00,000$

## When Purchases consideration is less than net value of assets

Illustration 6: Zee Ltd. Took over the following assets and liabilities of business of Usha Ltd. Assets: Machinery- ₹ 1, 00,000, Furniture ₹ 1, 80,000 Stock ₹ 20,000 Liabilities-Creditors ₹ 80,000

The purchases price was agreed at ₹ $1,08,000$. This is to settle by issue of $12 \%$ Debentures at premium of $20 \%$ pass necessary Journal entries.

Solution:
Journal


Calculations Net assets = Total assets-liabilities = ₹ 3,00,000 - ₹ 80,000
= ₹ $2,20,000$ Capital reserve $=$ Net assets - Purchases consideration $=₹ 2,20,000$

- ₹ $1,08,000$ = ₹ $1,12,000$

Illustration 7: Kirloskar Multimedia Ltd. Purchased machinery costing ₹ 16,72,000. It was agreed that the purchase consideration be paid by issuing 13\% Debentures of ₹ 100 each. Assume debentures are issued (i) at par, (ii) at a premium of $10 \%$ and (iii) at a discount of $5 \%$. Give necessary journal entries

Journal

| Date | Particulars | LF. | Debit (₹) | Credit ( ${ }^{\text {( }}$ ) |
| :---: | :---: | :---: | :---: | :---: |
| (i) | Machinery A/c <br> To Vendor <br> (Machinery purchased from vendor) |  | 16,72,000 | 16,72,000 |
|  | Vendor <br> To 13\% Debentures <br> ( 16,720 13\% debentures of $₹ 100$ each issued at par) |  | 16,72,000 | $16,72,000$ |


| (ii) | Vendor <br> To 13\% Debentures <br> To Securities Premium Reserve A/c <br> ( $15,20013 \%$ debentures of ₹ 1,00 each issued at a premium of $10 \%$ ) | Dr. | 16,72,000 | $\begin{array}{r} 15,20,000 \\ 1,52,000 \end{array}$ |
| :---: | :---: | :---: | :---: | :---: |
| (iii) | Vendor <br> Discount on Issue of Debentures A/c <br> To 13\% Debentures A/c <br> (17,600 13\% debentures of ₹ 100 each issued at a discount of $5 \%$ ) | $\begin{aligned} & \mathrm{Dr} \\ & \mathrm{Dr} . \end{aligned}$ | $\begin{array}{r} 16,72,000 \\ 88,000 \end{array}$ | 17,60,000 |

No. of Debentures to be issued $=\frac{\text { Purchase Consideration }}{\text { Issue price of debenture }}$
In all the cases Vendor will be debited with ₹ $16,72,000$
(ISSUE OF DEBENTURES AS COLLATERAL SECURITY)
Collateral Security: Collateral security means security provided to lender in addition to the principal security. It is a subsidiary or secondary security. Whenever a company takes loan from bank or from any financial institution it may issue its debentures as secondary security which is in addition to the principal security. Such an issue of debentures is known as "issue of debentures as collateral security". The lender will have a right over such debentures only when company fails to pay the loan amount and the principal security is exhausted. In case the need to exercise the right does not arise debentures will be returned back to the company. No interest is paid on the debentures issued as collateral security because company pays interest on loan.

If the lender has any surplus from sale of Primary security after meeting his dues, he will return the same to the Co.

Interest is not payable on debentures issued as Collateral security.
In the accounting books of the company issue of debentures as collateral security can be credited in two ways.
(i) First method: No Journal entry to be made in the books of accounts of the company for debentures issued as collateral security. A note of this fact is given in this case.
(ii) Second method: Entry to be made in the books of accounts of the company. A journal entry is made on the issue of debentures as a collateral security; Debentures Suspense Account is debited because no cash is received for such issue

Following journal entry will be made
Journal

| Date | Particulars | L.F. | Debit (₹) | Credit <br> (₹) |
| ---: | :--- | :--- | :--- | :--- |
|  | Debenture Suspense A/c <br> To \% Debentures A/c <br> (Being the issue of Debentures of ₹..... <br> issued as collateral security) |  |  |  |

Illustration 8: X Ltd. Had ₹ 12,00,000, 11\% Debentures outstanding on 1st April, 2012. During the year, it took a loan of ₹4 Lakh from Canara Bank for which company deposited debentures of ₹ 5 Lakh as collateral security.

Pass journal entries and show how these transactions will appear in Balance Sheet of the company.

FIRST METHOD. NO ENTRY IS PASSED FOR DEBENTURES

| Journal |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| Date | Particulars | L.F. | Debit (₹) | Credit ( $₹$ ) |
| $20121^{\text {st }}$ <br> April | Bank A/c <br> To Canara Bank's loan A/c <br> (Loan taken from bank against collateral security of debentures worth ₹ 5 Lakhs) |  | 4,00,000 | 4,00,000 |

## Balance Sheet of X Ltd.

As at 1st April, 2012

| Particulars | Notes No. | (₹) |
| :--- | :---: | :---: |
| Equity and Liabilities |  |  |
| 3. Non-Current Liabilities | 1 | $16,00,000$ |

Notes to Accounts

|  |  |
| :--- | ---: |
| Note No. 1 | (₹) |
| Long-Term Borrowings: |  |
| 11\% Debentures |  |
| Bank Loan (Against collateral security of debentures ₹5,00,000 | $12,00,000$ |
|  | $4,00,000$ |
|  | $\mathbf{1 6 , 0 0 , 0 0 0}$ |

Second method. Entry for issue of debentures is passed.
Journal

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| ---: | :--- | ---: | ---: | ---: | ---: |
| Bank A/c <br> To Canara Bank's loan A/c <br> (Loan taken from bank) | Dr. | $4,00,000$ |  |  |
|  | Debentures Suspense A/c <br> To 11\% Debentures A/c <br> (Issue of ₹ 5,00,000 Debentures issued <br> as collateral Securities) | Dr. |  | $5,00,000$ |

Presentation of debenture and Bank loan will remain same as explained in Balance
Sheet under 1st methods, however, presentation of information in note will differ.

Balance Sheet of X Ltd.
As at 31st March, 2012 (ASSUMED)

| Particulars | Notes No. | (₹) |
| :--- | :---: | :---: |
| 1. Equity and Liabilities |  |  |
| 3. Non-Current Liabilities <br> (a) Long-term Borrowings | 1 | $16,00,000$ |

IInd method
Notes to Accounts

|  | (₹) | (₹) |
| :---: | :---: | :---: |
| Note No. 1 |  | 12,00,000 |
| Other Long-term Borrowings: |  |  |
| 11\% Debentures (12,00,000 + 5,00,000) | 17,00,000 |  |
| Less: Debentures Suspense A/c | 5,00,000 |  |
| Bank Loan (Against collateral security of debentures ₹ $5,00,000$ ) |  | 4,00,000 |
|  |  | 16,00,000 |

Illustration 9: On 1st April, 2012 A Ltd. took a loan of ₹ 5,00,000 from the State Bank of India for which the company issued $8 \%$ Debentures of ₹ $6,00,000$ as collateral security. Record the issue of debentures in the books of the A. Ltd. and also show how the debentures and bank loan will appear in the Balance Sheet of the company.

## Solution:

Journal

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |  |
| ---: | :--- | ---: | ---: | ---: | ---: |
|  | Bank A/c <br> To Bank's loan A/c <br> (Loan taken from bank) <br>  <br>  <br> Debentures Suspense A/c <br> To 8\% Debentures A/c <br> (Issue of ₹ 6,00,000 debenture as <br> collateral Securities) | Dr. |  | $5,00,000$ | $5,00,000$ |

## Balance Sheet of A Ltd.

As at 1st April, 2012

| Particulars | Notes <br> No. | Figure as at the end of current accounting period <br> (₹) | Figure as at the end of Previous accounting period (₹) |
| :---: | :---: | :---: | :---: |
| Equity and Liabilities <br> (1) Shareholder's Funds <br> (2) Share Application Money Pending Allotment <br> (3) Non - Current Liabilities <br> (a) Long term Borrowings. <br> Total | 1 |  |  |


|  | (₹) | (₹) |
| :---: | :---: | :---: |
| Note No. 1 |  | $\begin{array}{r} \text { Nil } \\ 5,00,000 \end{array}$ |
| Long-term Borrowings: |  |  |
| 8\% Debentures | 6,00,000 |  |
| Less: Debentures Suspense A/c | $(6,00,000)$ |  |
| Bank Loan |  |  |
| Total |  | 5,00,000 |

Illustration 10: ABC Ltd had ₹ $15,00,000,10 \%$ Debentures outstanding as on April, 2012. On 1st Sept. 2012 Company took a loan of $₹ 5,00,000$ from the Punjab National Bank for which the company placed with the bank, 10\% Debentures for ₹ $7,00,000$ as collateral Security. Pass journal entries, if any. Also show how the debentures and Bank Loan will appear in the company's Balance Sheet as on 31st March, 2013

Journal of ABC Ltd.


Balance Sheet of ABC Ltd.
As at 31 march 2013
( $\mathrm{F}^{\mathrm{F}} \mathrm{in} \times 000$.)

| Particulars | Notes No. | 2012-13 | 2011-12 |
| :---: | :---: | :---: | :---: |
| 1. EQUITY AND LIABILITIES |  |  |  |
| (1) Shareholder's Funds |  |  |  |
| (2) Non-Current Liabilities |  |  |  |
| $\quad$ Long-term Borrowing |  |  |  |
| (3) Current Liabilities |  |  |  |

Notes to Accounts:
Note 1.


## (Issue of Debentures from Redemption Point of View)

Various cases for the issue of debentures from Redemption point of view

- At the time of issue, terms are laid down regarding the redemption of debentures.
- Debentures cannot be redeemed at a discount.

1. When Debentures are issued at par and redeemable at par Journal


Illustration 11: Larson and Turbo Ltd. Issued 50,000 8\% debentures of ₹ 100 each payable on Application at par and redeemable at par any time after 7 years from the date of the issue. Record necessary entries for the issue of debentures in the book of Company.
Solution:
In the books of Larson \& Toubro Ltd. Journal

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c Dr. To \% Debenture Application and Allotment A/c (Being the application money received) |  | $50,00,000$$50,00,000$ | $\begin{aligned} & 50,00,000 \\ & 50,00,000 \end{aligned}$ |
|  | Debenture Application and Allotment A/c Dr. <br> To 8\% Debentures A/c <br> (Being the transfer of application money to debenture account) |  |  |  |

## 2. When Debentures are issued at Premium redeemable at par Journal

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c <br> To \% Debenture Application and Allotment A/c <br> (Being the application money received) <br> Debenture Application and Allotment A/c <br> Dr. <br> To \% Debentures A/c <br> To Securities Premium Reserve A/c <br> (Being the debenture issued at premium and redeemable at par) |  |  |  |

Illustration 12: Green Ltd. Issued ₹80,000, 9\% Debenture at a premium of 5\% redeemable at par. Give the necessary Journal entry

## Solution:

Journal

| Date | Particulars | L.F. | Debit ( F ) | Credit <br> (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c <br> To 9\% Debenture Application and Allotment A/c <br> (Being the application money received) |  | 84,000 | $84,000$ |
|  | 9\% Debenture Application and Allotment A/c <br> To 9\% Debentures A/c <br> To Securities Premium Reserve A/c <br> (Being the debenture issued at premium and redeemable at par) |  | 84,000 | $\begin{aligned} & 8,000 \\ & 4,000 \end{aligned}$ |

3. When Debentures are issued at par redeemable at premium

Journal

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c <br> To \% Debenture Application and Allotment A/c <br> (Being the application money received) <br> \% Debenture Application and Allotment A/c <br> Loss on Issue of Debenture A/c <br> To \% Debentures A/c <br> To Premium on Redemption of Debentures A/c <br> (Being the debenture issued at premium and redeemable at premium) |  |  |  |

Illustration 13: White Ltd. Issued ₹ 60,000 Debenture at par and redeemable at $10 \%$ premium. Give the necessary Journal entry.

## Solution:

Journal

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c <br> To \% Debenture Application and Allotment A/c <br> (Being the application money received) |  | $60,000$ | 60,000 |
|  | Debenture Application and Allotment A/c <br> Loss on issue of Debenture A/c <br> To \% Debentures A/c <br> To Premium on Redemption of Debentures A/c <br> (Being the debenture issued at premium and redeemable at premium) |  | $\begin{array}{r} 60,000 \\ 6,000 \end{array}$ | $\begin{array}{r} 60,000 \\ 6,000 \end{array}$ |

4. When Debentures are issued at Premium redeemable at premium Journal

| Date | Particulars | L.F. | Debit (₹) | Credit ( ${ }^{\text {( })}$ |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c <br> To \% Debenture Application and Allotment A/c Dr. <br> (Being the application money received)  <br> \%Debenture Application and Allotment A/c Dr. <br> Loss on Issue of Debenture A/c Dr. <br> To \% Debentures A/c  <br> To Securities Premium Reserve A/c  <br> To Premium on redemption of debenture A/c  <br> (Being the debenture issued at premium and redeemable  <br> at premium)  |  |  |  |

Illustration 14: Gives Journal Entry assuming the face value of $10 \%$ debentures at ₹ 100 issued at ₹ 105 and repayable at ₹ 110 .

## Solution:

Journal


## 5. When Debentures are issued at Discount but Redeemable at Par

Journal

| Date | Particulars | L.F. | Debit (₹) | Credit ( F ) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c <br> To 10 \% Debenture Application and Allotment A/c <br> (Being the application money received) <br> Debenture Application and Allotment A/c <br> Discount on Issue of Debenture A/c <br> To \% Debentures A/c <br> (Being the debenture issued at discount but redeemable at part) |  |  |  |

6. When Debentures are issued at Discount and Redeemable at premium Journal

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Bank A/c <br> To \% Debenture Application and Allotment A/c <br> (Being the application money received) <br> \% Debenture Application and Allotment A/c <br> Discount on issue of Debenture $A / c$ <br> Loss on Issue of Debenture A/c <br> To \% Debentures A/c <br> To Premium on Redemption of Debenture A/c <br> (Being the debenture issued at discount but redeemable at premium) |  |  |  |

Illustration 15: Claris Life Sciences Ltd. issued 5,000 14\% Debentures of ₹100 each at a discount of $10 \%$. Pass the necessary journal entries in the books of the company for the issue of debentures when debentures were to be:
(i) Redeemed at par.
(ii) Redeemed at a premium of $5 \%$.

Journal

| Date | Particulars | LF. | Debit ( F ) | Credit ( $)^{\text {) }}$ |
| :---: | :---: | :---: | :---: | :---: |
| (i) | Bank A/c <br> To Debenture Application and Allotment <br> (Application money received on 5,000 <br> debentures @ ₹90 each) |  | 4,50,000 | 4,50,000 |
|  | Debenture Application and Allotment <br> Discount on issue of debentures <br> To 14\% Debentures <br> ( 5,000 14\% Debentures of ₹ 100 each <br> Issued at a discount of $10 \%$ ) |  | $\begin{array}{r} 4,50,000 \\ 50,000 \end{array}$ | 5,00,000 |
|  | Debenture Application and Allotment Dr. <br> Loss on issue of debenture A/c <br> To 14\% Debentures <br> To Premium on redemption of Debentures <br> ( $5,000,14 \%$ debentures of $₹ 100$ each issues at a discount of $10 \%$ but redeemable at a premium of $5 \%$ ) |  | $\begin{array}{r} \text { 4,50,000 } \\ 75,000 \end{array}$ | $\begin{array}{r} 5,00,000 \\ 25,000 \end{array}$ |

## INTEREST ON DEBENTURES

Interest on Debentures is calculated at a fixed rate on its face value and is usually payable half yearly. Interest on debentures is to be paid even company is suffering from loss because it is charge against profit.

Income Tax is deducted from interest before payment to debentureholders. It is called T.D.S. (Tax deducted at source).

JOURNAL ENTRIES

1. Debenture's Interest $\mathrm{A} / \mathrm{c}$

To Debentureholder A/c
To Income Tax Payable A/c
2. When interest is paid

Debentureholder A/c
To Bank A/c
3. On payment of Income Tax to Government Income Tax Payable A/c

To Bank A/c

Dr. (Gross Interest)
(Net interest)
(Income Tax deducted)

Dr. (With Interest)

Dr. (Amount of Income)
(Tax deducted at source)
4. On transfer of Interest on debenture to Statement of

Profit and Loss
Statement of Profit \& Loss Dr. (Amount of Interest)
To Debenture Interest A/c
(1) Illustration 16: ABC Company Ltd., had 6\% debentures of ₹ $1,00,000$ on 1st April 2009 on which interest is payable on $30^{\text {th }}$ September and 31st March. Pass necessary journal entries for the payment of interest for the year 2009-10, 10\% tax is deducted at source from interest and remitted immediately. If books are closed on 31st March, given necessary journal entries of interest on debentures only.

## Solution :

ABC Ltd.
Journal


Illustration 17: B.G. Ltd. issued 2,000, 12\% debentures of ₹ 100 each on 1st April 2012. The issue was fully subscribed. According to the terms of issue, interest on debentures is payable half yearly on 30th September and 31st Mach and tax deducted at source is $10 \%$.

Pass necessary journal entries related to the debenture interest for the half-yearly ending 31st March, 2013 and transfer of interest on debentures of the year to the Statement of Profit \& Loss.

## Solution:

## Books of B.G. Ltd. Dr. Journal Cr.

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2013 | Interest on Debentures A/c Dr. |  | 12,000 |  |
| March 31 | To Debentureholder's A/c |  |  | 10,800 |
|  | To Income Tax Payable A/c |  |  | 1,200 |
|  | TDS from Debenture interest $\mathrm{A} / \mathrm{c}$ |  |  |  |
|  | (Half yearly interest due on debentures |  |  |  |
|  | and tax deducted at source) |  |  |  |
|  | Debentureholder's A/c Dr. |  | 10,800 |  |
| March 31 | To Bank A/c |  |  | 10,800 |
|  | (Payment of Interest) |  |  |  |
|  | Income Tax Payable / TDS from Dr. |  | 1,200 |  |
| March 31 | Debentures Interest A/c |  |  |  |
|  | To Bank A/c |  |  | 1,200 |
|  | (TDS deposited with income tax authorities) |  |  |  |
|  | Statement of Profit \& Loss Dr. |  | 24,000 |  |
| March 31 | To Interest on Debentures A/c |  |  | 24,000 |
|  | (Interest transferred to Statement of P/L) |  |  |  |

## Practice Questions

Question 1:- Fill in the missing figures in the following entries

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | Case 1 <br> Bank A/c <br> To Debenture Application \& Allotment A/c <br> (Being application money received) |  | 1---------- | 1--------- |
|  | Debenture Application \& Allotment A/c <br> Loss on Issue of Debentures A/c <br> To 10\% Debenture A/c <br> To Premium on Redemption of Debentures A/c (Being issue of ₹ $400,10 \%$ Debenture of 100 each at per and redeemable at premium of $10 \%$ ) |  | $\begin{array}{r} 40,000 \\ 2-------- \end{array}$ | 3 $\qquad$ <br> 4- |
|  | Case 2 <br> Bank A/c <br> Dr. <br> To Debentures Application \& Allotment A/c <br> (Being Application money received) |  | $5-$ | 5--------- |
|  | Debenture Application \& Allotment A/c <br> Loss on issue of Debentures A/c <br> To 12\% Debentures A/c <br> To Premium on Redemption of Debentures A/c (Being 200, 12\% Debentures issued at ₹90 repayable at ₹110) |  | $\begin{aligned} & \text { 6----------------- } \\ & \text { 7---- } \end{aligned}$ | 8 <br> 9 |
|  | Case 3 <br> Bank A/c <br> Dr. <br> To Debenture Application \& Allotment A/c <br> (Being Application Money received) |  | $10$ | $10$ |



Solution: (1) 40,000, 18,000

(13) 10,000, 14) 500 (15) 1000
Q. 2 A company suffers a huge loss. In order to make payment of interest on debentures, it took a loan from a bank, which value has been fulfilled by the company?

Ans. The company fulfilled the value of:

1. Confidence and trustworthiness by making payment of interest on due date.
2. Concern and care for debentureholders
3. Fulfilment of duties.
Q. 3 In a company, the return on investment (ROI) is $15 \%$ and the borrowing cost is $20 \%$.
(a) What value has been ignored if the company raises funds only through debentures?
(b) What value has been fulfilled by the company if it raises funds through issue of fresh share capital

Ans. (a) Company has ignored the value of democratic management as the debentureholders do not have voting rights.
(b) Company has fulfilled the value of democratic management as the shareholders will have voting rights and better returns on investment.
Q. 4 Alpha Ltd. issued 2,000;10\% debentures of ₹ 100 each on $1^{\text {st }}$ April 2015. Interest is payable in June and December. Books are closed on 31 ${ }^{\text {st }}$ march.

Find out (i) Interest accrued but not due (ii) Interest accrued and due if interest has not been paid on $31^{\text {st }}$ December.

Also state the head and subhead in the Balance Sheet.
Ans. (i) Interest accrued but not due $=2,00,000 \times \frac{10}{100} \times \frac{3}{12}=₹ 5000$
(from Jan 2016 to march 2016)
(ii) Interest accrued and due $=2,00,000 \times \frac{10}{100} \times \frac{6}{12}=₹ 10,000$
(from June 2015 to Dec.2015)
In the Balance Sheet:
Head- 'current liabilities’
Sub head- 'other current liabilities'
Q. 5 On $1^{\text {st }}$ April 2016, Beta Ltd. issued 10,00,00,6\% Debentures of ₹100 each at a discount of $4 \%$, redeemable at a premium of $5 \%$ after three years, payable ₹ 50 on application and balance on allotment. Record the necessary Journal entries for issue.

Ans.

## - Journal

| Date | Particulars | LF. | Dr (\%) | Cr (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2016 <br> April 1 | Bank A/c Dr. |  | 5,00,00,000 |  |
|  | To Debenture Application A/c (being debenture application money received) |  |  | 5,00,00,000 |
|  | Debenture Application A/c <br> To 6\% Debentures A/c <br> (being transfer of application money) |  | 5,00,00,000 | 5,00,00,000 |


Q. 6 You are required to fill in the missing figures:

Journal


Balance Sheet
As at $31^{\text {st }}$ March 2016

| Particulars | Note <br> No. | Current year <br> (₹) | Previous <br> year (₹) |
| :---: | :--- | :--- | :--- |
| 1. Equity And Liabilities <br> Non-Current Liabilities <br> $\ldots . . . . . .6$ | 1 | $\ldots \ldots . . . .7$ |  |

## Notes to Accounts

| Particulars |  |  |  |  | (₹) |
| :---: | :---: | :---: | :---: | :---: | :---: |
| (1) Long-term Borrowings |  |  |  |  |  |
| ₹ 34,00,000, 15\% Debentures of ₹ 100 each 34,00,000 |  |  |  |  |  |
| $\begin{array}{cc}\text { Less Debentures Suspense A/c } & 34,00,000 \\ \text { Bank Loan(on collateral security of Debenture of ₹ } 30,00,000 \text { ) }\end{array}$ |  |  |  |  |  |
|  |  |  |  |  | .... 8 |
|  |  |  |  |  | ..... 9 |
| Ans. | 1 | ₹ $30,00,000$ | 2 ₹ $30,00,000$ |  |  |
|  | 3 | Debenture Suspense A/c | 4. ₹ $34,00,000$ |  |  |
|  | 5 | ₹ $34,00,000$ | 6 | ₹ Long-term borrowings |  |
|  | 7. | ₹ $30,00,000$ | 8. | ₹ $30,00,000$ |  |
|  |  | ₹ $30,00,000$ |  |  |  |

## CHAPTER 9

COMPANY ACCOUNTS-REDEMPTION OF
DEBENTURE
Meaning: Redemption of debentures means repayment of the due amount of debentures to the debenture holders. It may be at par or at premium.

## Time of Redemption

(a) At maturity: - When repayment is made at the date of maturity of debentures which is determined at the time of issue of debentures.
(b) Before maturity: If articles of association and terms of issue mentioned in prospectus allows, then a company can redeem its debentures before maturity date.

## Redemption Methods

(1) Redemption in Lump-sum: When redemption is made at the expiry of a specific period, as per the terms of issue.
(2) Redemption by draw of lots: In this method a certain proportion of debentures are redeem each, year, the debenture for which repayment is to be made is selected by draw of lots.
(3) Redemption by purchases in open market: If articles of association of a company authorize, it may purchase its own debentures from open market i.e. stock exchange.

Advantages of this Method
(1) When market price of own debentures is low than the redeemable value is less than the amount payable on maturity.
(2) Decrease the amount of interest payable to outsiders.
(3) If term of issue is provided that debentures are to be redeemed at premium, then such premium can be reduced.


Sometimes company can purchase the debentures at more than the redeemable value due to the following reasons:

1. To maintain the solvency ratio.
2. To utilize the surplus money or funds which are lying idle with the company.
3. When rate of interest on debentures is more than the current market rate of interest on debentures in the industry.

## Sources of Redemption of Debentures

1. Proceeds from fresh issue of Share Capital or Debentures.
2. From accumulated profit.
3. Proceeds from sale of fixed assets.
4. A company may purchase its own debentures out of its surplus funds. Two terms which are used in the redemption of debentures:
5. Redemption out of capital: When a company has not used its reserve or accumulated profit for redemption of its debentures, it is called redemption out of capital, So company using this method have not transferred its profit to DRR A/c. But as per Companies Act, 2013 it is necessary for a company to transfer $25 \%$ amount of nominal value of debentures to be redeemed in DRR A/c before redemption of debentures commence.
6. Redemption out of profit: Redemption out of profit means that adequate amount of profits are transferred to DRR A/c from Balance in Statement of Profit \& Loss A/c before the redemption of debenture commences. This reduces the amount available for dividends to shareholders.

Debenture Redemption Reserve (DRR): Section 71 (4) of the Companies Act, 2013 requires the company to create DRR out of the profits available for dividend and the amount credited in DRR shall not be utilizes for any purpose except redemption.

Rule 18(7) of Companies (Share Capital and Debentures) Rules, 2014 requires every Company to create DRR of an amount equal to $25 \%$ of the value of Debentures.

## Exemption to Create DRR

a) NBFc registered with RBI
b) Financial institutions other than All India finance Companies registered by RBI
c) Housing finance Companies registered with National Housing Bank. DRR is required for publicly issued debentures by the above three classes of companies, not for privately placed.
d) Any other Company (Whether listed or unlisted), DRR to be created for Public and Private placed debentures.

As per Rule 18(7)(c), every company required to create/maintain DRR shall invest or deposit before $30^{\text {th }}$ April in specified securities a sum which shall not be less
than $15 \%$ of the amount of debentures maturing for payment during the year ending $31^{\text {st }}$ March of the next year.

## (A) Redemption at Par

Illustration 1: X Ltd. Redeemed its 10,000 10\% Debentures of ₹10 each at par on 31 ${ }^{\text {st }}$ March 2015.

X Ltd.

| Date | Particulars | L.F | Debit (₹) | Credit ( $)^{\text {) }}$ |
| :---: | :---: | :---: | :---: | :---: |
| 2014 <br> March <br> $31^{\text {st }}$ | Balance in Statement of Profit \& Loss A/c <br> To Debenture Redemption Reserve A/c. (Being transfer of profit to Debenture Red. Reserve) |  | 25,000 | 25,000 |
| 2014 <br> April <br> $30^{\text {th }}$ | Debenture Redemption Investment A/c <br> Dr. <br> To Bank A/c <br> (Being Investment made in specified securities) |  | 15,000 | 15,000 |
| $\begin{aligned} & 2015 \\ & 31^{\text {st }} \\ & \text { March } \end{aligned}$ | Bank A/c <br> To Debenture Redemption Investment A/c (Investment being enclosed) |  | 15,000 | 15,000 |
| $31^{\text {st }}$ <br> March | 10\% Debenture A/c <br> To Debenture holder A/c <br> (Being the amount due to Debenture holders) |  | 1,00,000 | 1,00,000 |
| $31^{\text {st }}$ <br> March | Debenture holder A/c <br> To Bank A/c <br> (Being the amount paid to Debenture holder) |  | 1,00,000 | 1,00,000 |
| $31^{\text {st }}$ <br> March | Debenture Redemption Reserve A/c <br> Dr. <br> To General Reserve A/c <br> (Being DRR A/c closed by transfer to General Reserve A/c after redemption of all Debentures) |  | 25,000 | 25,000 |

## (B) Redemption at Premium

Illustration 2: Z Ltd. Redeemed its 1, 00,000 10\% Debentures of ₹10 each at 5\% premium on 31 March 2015.

Z Ltd.

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2014 <br> 31st <br> March | Balance in Statement of Profit \& Loss A/c <br> To Debenture Redemption Reserve A/c <br> (Being transfer of profit to Debenture Redemption Reserve) |  | 2,50,000 | 2,50,000 |
| $\begin{aligned} & 2014 \\ & \text { April } \\ & 30 \end{aligned}$ | Debenture Redemption Investment A/c <br> To Bank A/c <br> (Being Investment made in specified securities) |  | 1,50,000 | 1,50,000 |
| 2015 <br> March <br> 31 | Bank A/c <br> To Debenture Redemption Investment A/c <br> (Being Investment enclosed) |  | 1,50,000 | 1,50,000 |
| 31st <br> March | 10\% Debenture A/c <br> Premium on Redemption of Debentures A/c <br> To Debentureholders A/c <br> (Being the amount due to Debentures holders) |  | 10,00,000 50,000 | 10,50,000 |
| 31st <br> March | Debentureholders A/c <br> Dr. <br> To Bank A/c <br> (Being the amount paid to Debenture holders) |  | 10,50,000 | 10,50,000 |
| 31st <br> March | Debenture Redemption Reserve A/c <br> To General Reserve A/c <br> (Being DRR A/c closed by transfer to General Reserve A/c after redemption of all Debentures) |  | 2,50,000 | 2,50,000 |

Illustration 3: Rajesh Export Ltd. has 2,000, 9\% Debentures of ₹100 each due on redemption on 31st march 2015. Debentures redemption reserve has a balance of ₹ 30,000 on that date. Record the necessary journal entries at the time of redemption of debentures.

Rajesh Export Ltd.

| Date | Particulars | LF | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2014 <br> 31st <br> March | Balance in Statement of Profit \& Loss A/c Dr. <br> To Debenture Redemption Reserve A/c <br> (Being transfer of profit to Debenture Redemption Reserve) |  | 20,000 | 20,000 |
| $2014$ <br> April <br> 30 | Debenture Redemption Investment A/c <br> Dr. <br> To Bank A/c <br> (Being investment in specified securities made) |  | 30,000 | 30,000 |
| $\begin{aligned} & 2015 \\ & 31 \text { st } \end{aligned}$ | Bank A/c <br> To Debenture Redemption Investment A/c <br> (Being Investment enclosed) |  | 30,000 | 30,000 |
| 31st <br> March | 10\% Debentures A/c <br> Dr. <br> To Debentureholders A/c <br> (Being the amount due to Debenture holders) |  | 2,00,000 | $2,00,000$ |
| 31st <br> March | Debenturesholders A/c <br> Dr. <br> To Bank A/c <br> (Being the amount paid to Debentures holders) |  | 2,00,000 | 2,00,000 |
| 31st <br> March | Debenture Redemption Reserve A/c <br> To General Reserve A/c <br> (Being DRR A/c closed by transfer to General <br> Reserve A/c after redemption of all Debentures) |  | 50,000 | 50000 |

Illustration 4: Rahul Ltd. has 50,000 9\% Debentures of ₹ 50 each due on redemption on 31st March 2015. Debentures redemption reserve has a balance of ₹ $5,00,000$ on that date. Record the necessary journal entries at the time of redemption of debentures.

Journal

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2014 <br> 31st <br> March | Balance in Statement of Profit \& Loss A/c <br> To Debenture Redemption Reserve A/c <br> (Being transfer of profit to Debenture Redemption Reserve) |  | 1,25,000 | 1,25,000 |
| 2014 <br> April <br> 30 | Debenture Redemption Investment A/c <br> Dr. <br> To Bank A/c <br> (Being Investment is specified securities made) |  | 3,75,000 | 3,75,000 |
| $31^{\text {st }}$ <br> March | Bank A/c <br> To Debenture Redemption Investment A/c <br> (Being investment enclosed) |  | 3,75,000 | 3,75,000 |
| $\begin{aligned} & 2015 \\ & 31^{\text {st }} \\ & \text { March } \end{aligned}$ | 10\% Debentures A/c <br> Dr. <br> To Debentureholders A/c <br> (Being the amount due to Debenture holders) |  | 25,00,000 | 25,00,000 |
| $31^{\text {st }}$ <br> March | Debentureholders A/c <br> Dr. <br> To Bank A/c <br> (Being the amount paid to Debenture holder) |  | 25,00,000 | 25,00,000 |
| $\begin{aligned} & 2015 \\ & 31^{\text {st }} \\ & \text { March } \end{aligned}$ | Debenture Redemption Reserve A/c <br> To General Reserve A/c <br> (Being DRR A/c Closed by transfer to General Reserve A/c after redemption of all debentures |  | 6,25,000 | 6,25,000 |

Illustration 5: HDFC Bank Ltd has outstanding 10,000, 9\% Debentures of ₹ 50 each due on redemption on $31^{\text {st }}$ March 2015. Record the necessary journal entries at the time of redemption of debentures

HDFC Bank Ltd.

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| $\begin{aligned} & \hline 2015 \\ & 31^{\text {st }} \\ & \text { March } \end{aligned}$ | $10 \%$ Debenture A/c Dr. <br> To Debentureholders A/c  <br> (Being the amount due to Debenture holder)  |  | $5,00,000$ | 5,00,000 |
| $31^{\text {st }}$ <br> March | Debentureholder A/c Dr.  <br> To Bank A/c Dr <br> (Being the amount paid to Debenture holders)  |  | 5,00,000 | 5,00,000 |

Note: The Banking Companies are exempted from creating DRR as per Rule 18(7) of Companies (Share Capital and Debentures) Rules, 2014.

Illustration 6: ICICI Bank Ltd., a banking company has outstanding 10 lac, 9\% Debentures of ₹ 5 each due for redemption on $30^{\text {th }}$ Sept. 2015. Record the necessary entries at the time of redemption of Debentures.

Journal of ICICI Bank Ltd.

| Date | Particulars | L.F. | Debit (₹ in lakh) | Credit <br> (₹) |
| :---: | :---: | :---: | :---: | :---: |
| $\begin{aligned} & 2015 \\ & 30^{\text {th }} \\ & \text { Sept. } \end{aligned}$ | 9\% Debenture A/c <br> To Debentureholders A/c <br> (Being the amount due to Debenture holder on Redemption) |  | 50 | 50 |
| $30^{\text {th }}$ <br> Sept. | Debentureholders A/c Dr. To Bank A/c (Being the amount due to Debenture holders paid) |  | 50 | 50 |

Note: As per Companies Rules, 2014 Banking companies are exempted from creating Debenture Redemption Reserve.

Illustration 7: Abha Ltd. has 5,000 10\% Debentures of ₹ 20 each due for redemption on 30th Sept. 2015. Debenture Redemption Reserve has a balance of ₹ 20,000 on that date. Record the necessary entries at the time of redemption of debentures.

Journal in the Books of Abha Ltd.

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2015 <br> March <br> 30 | Balance in Statement of Profit and Loss $\mathrm{A} / \mathrm{c}$ <br> Dr. <br> To Debenture Redemption Reserve A/c <br> (Being the require amount transferred to DRR) |  | 5,000 | 5,000 |
| $\begin{aligned} & \text { April } \\ & 30 \end{aligned}$ | Debenture Redemption Investment A/c <br> To Bank A/c <br> (Being investment made) |  | 15,000 | 15,000 |
| $\begin{aligned} & 30^{\text {th }} \\ & \text { Sept } \end{aligned}$ | Bank A/c <br> To Debenture Redemption Investment A/c <br> (Being investment enclosed) |  | 1,00,000 | 15,000 |
| $30^{\text {th }}$ <br> Sept. | 10\% Debenture A/c <br> To Debentureholders A/c <br> (Being the amount due to Debenture holder on redemption) |  |  | 1,00,000 |
| $\begin{aligned} & 30^{\text {th }} \\ & \text { Sept } \end{aligned}$ | Debentureholders A/c <br> To Bank A/c <br> (Being the amount due to Debenture holder paid) |  | 1,00,000 | 1,00,000 |
| $30^{\text {th }}$ <br> Sept. | Debenture Redemption Reserve A/c <br> Dr. <br> To General Reserve A/c <br> (Being the DRR transfer to General Reserve) |  | 25,000 | 25,000 |

Illustration 8: Vivek Transport Ltd. Has 5,000; 10\% Debentures of ₹ 20 each due for redemption on 30th Sept. 2015. Debenture Redemption Reserve has a Balance of ₹ 80,000 on that date. Record the necessary entries at the time of redemption of debentures.

## Solution :

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| $\begin{aligned} & \hline 2015 \\ & 31^{\text {st }} \\ & \text { March } \end{aligned}$ | Balance in Statement of Profit and Loss A/c Dr. <br> To Debenture Redemption Reserve A/c <br> (Being debenture Red. Reserve created upto 100\% of amount of debentures) |  | 20,000 | 2,000 |
| $\begin{gathered} 30 \\ \text { April } \end{gathered}$ | Debenture Redemption Investment A/c Dr. <br> To Bank A/c <br> (Being investment made for debentures redemption) |  | 15,000 | 15,000 |
| $\begin{aligned} & 30^{\text {th }} \\ & \text { Sept } \end{aligned}$ | Bank A/c <br> To Debenture Redemption Investment A/c <br> (Being investment encashed) |  | 15,000 | 15,000 |
| $30^{\text {th }}$ <br> Sept. | 10\% Debenture A/c <br> To Debenture holders A/c <br> (Being the amount due to Debenture holder on redemption) |  | 1,00,000 | 1,00,000 |
| $\begin{aligned} & 30^{\text {th }} \\ & \text { Sept } \end{aligned}$ | Debenture holders A/c <br> Dr. <br> To Bank A/c <br> (Being the amount paid to Debenture holder) |  | 1,00,000 | 1,00,000 |
| $30^{\text {th }}$ <br> Sept. | Debenture Redemption Reserve A/c <br> To General Reserve A/c <br> (Being the Debenture Redemption Reserve Amount transfer to General Reserve) |  | 1,00,000 | 1,00,000 |

Note: DRR exist in the books more than $25 \%$ of the debentures face value, so it assumed that redemption is out profit. In this case DRR is to be created upto 100\%
face value of Debentures. So DRR A/c is credited with the difference amount i.e. ₹ $1,00,000$ - ₹ $80,000=₹ 20,000$.
Illustration 9: Rahul Ltd. redeemed ₹ $25,00,000 ; 12 \%$ Debentures at a premium of $5 \%$ out of Profit on 30th Sept. 2015. Pass the necessary journal entries for the redemption of debentures.

## Solution:

| .Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| $\begin{aligned} & 2015 \\ & 31 \mathrm{st} \\ & \text { Apr. } \end{aligned}$ | Balance in Statement of Profit and Loss A/c <br> To Debenture Redemption Reserve A/c <br> (Being the required amount transferred to DRR) |  | 25,00,000 | 25,00,000 |
| $\begin{aligned} & 30^{\text {th }} \\ & \text { April } \end{aligned}$ | Debenture Redemption Investment A/c Dr. <br> To Bank A/c <br> (Being Investment made equal to $15 \%$ of the debenture to be redeemed in current financial year) |  | 3,75,000 | 3,75,000 |
| $\begin{aligned} & 30^{\mathrm{th}} \\ & \text { Sep. } \end{aligned}$ | Bank A/c Dr. <br> To Debenture Redemption Investment A/c  <br> (Being Deb. Red. Investment encashed)  |  | 3,75,000 | 3,75,000 |
| $\begin{aligned} & 30^{\mathrm{th}} \\ & \text { Sep. } \end{aligned}$ | $10 \%$ Debentures A/c Dr. <br> Premium on Redemption of Debentures A/c Dr. <br> To Debentureholder's A/c  <br> (Being the amount due to Debenture holders)  |  | $\begin{array}{r} 25,00,000 \\ 1,25,000 \end{array}$ | 26,25,000 |
| $\begin{aligned} & 30^{\text {th }} \\ & \text { Sep. } \end{aligned}$ | Bank A/c <br> To Debenture Redemption Investment A/c (Being Debenture Redemption Investment encashed) |  | 3,75,000 | 3,75,000 |
| $\begin{aligned} & 30^{\mathrm{th}} \\ & \text { Sep. } \end{aligned}$ | Debenture holder's A/c <br> To Bank A/c <br> (Being the amount due to Debenture holders paid) |  | 26,25,000 | 26,25,000 |
| $\begin{aligned} & 30^{\mathrm{th}} \\ & \text { Sep. } \end{aligned}$ | Debenture Redemption Reserve A/c Dr. To General Reserve A/c (Being the DRR transferred to General Reserve) |  | 25,00,000 | 25,00,000 |

Note: (1) If in any question it is mentioned that redemption of debenture is out of profit, then the Debenture Redemption Reserve A/c should be created with the full face value ( $100 \%$ ) of debentures. If DRR is created only with $25 \%$ of the total amount of debentures, it would mean that remaining $75 \%$ of the debentures have been redeemed out of capital.
(2) So, it would be clear if in a question it is mentioned that the redemption is out of profit, then an amount equal to total amount of debentures ( $100 \%$ of face value of debentures) is to be transferred to DRR A/c. in all other case (except Companies exempted by the SEBI) DRR would be created with the $25 \%$ of the face value of the total debentures.

## Redemption method: 2 Draw of lots

Illustration 11: S Ltd. redeemed its ₹ 10,000, $8 \%$ Debentures out of capital by drawing a lot on 30 Nov. 2015. Journalise.

## Solution

Journal of S. Ltd.

| Date | Particulars | LF. | Debit( ${ }^{\text {( }}$ ) | Credit(₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2015 <br> March 31 | Balance in Statement of Profit \& Loss A/c <br> To Debenture Redemption Reserve A/c <br> (Being transfer of profit to Debenture Redemption Reserve) |  | 2,500 | 2,500 |
| $\begin{aligned} & 2015 \\ & 30^{\text {th }} \\ & \text { April } \end{aligned}$ | Debenture Redemption Investment A/c <br> To Bank A/c <br> (Being Investment in specified securities made) |  | 1,500 | 1,500 |
| $\begin{aligned} & 30^{\text {th }} \\ & \text { Nov. } \end{aligned}$ | Bank A/c Dr. <br> To Debenture Redemption Investment A/c  <br> (Being investment Encashed)  |  | 1,500 | 1,500 |
| $30^{\text {th }}$ <br> Nov. | 10\% Debentures A/c <br> To Debentureholders A/c <br> (Being the amount due to Debentureholders) |  | 10,000 | 10,000 |
| $\begin{aligned} & 30^{\text {th }} \\ & \text { Nov. } \end{aligned}$ | Debentureholders A/c <br> To Bank A/c <br> (Being the amount paid to Debentureholders) |  | 10,000 | 10,000 |

Note: The DRR Balance will be transferred to General Reserve after all the debentures are redeemed.

Illustration 12: Y Ltd redeemed its ₹ 20,000 , $9 \%$ debentures out of profit by drawing of lot on 30th Nov. 2015 Journalise.

Y Ltd.

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 20 <br> Apr. <br> 2015 | Balance in Statement of Profit \& Loss A/c <br> To Debenture Redemption Reserve A/c <br> (Being transfer of profit to Debenture Redemption Reserve) |  | 20,000 | 20,000 |
| $\begin{aligned} & 2015 \\ & 30^{\text {th }} \\ & \text { Nov. } \end{aligned}$ | Debenture Redemption Investment A/c Dr. $\quad$ To Bank A/c (Being Investment made) |  | 3,000 | 3,000 |
| $\begin{aligned} & 2015 \\ & 30^{\text {th }} \\ & \text { Nov. } \end{aligned}$ | Bank A/c Dr. <br> $\quad$ To Debenture Redemption Investment A/c  <br> (Being investment encashed)  |  | 3,000 | 3,000 |
| $30^{\text {th }}$ <br> Nov. | $10 \%$ Debentures A/c Dr. <br> To Debentureholders A/c  <br> (Being the amount due to Debentureholders)  |  | 20,000 | 20,000 |
| $\begin{aligned} & 30^{\text {th }} \\ & \text { Nov } \end{aligned}$ | Debentureholders A/c Dr. <br> To Bank A/c  <br> (Being the amount paid to Debentureholders)  |  | 20,000 | 20,000 |

Note: The DRR Balance will be transferred to General Reserve after all the debentures are redeemed.

Illustration 13: Pass the necessary journal entries for this issue and redemption of Debentures in the following cases:
(i) $10,000,10 \%$ debentures of ₹ 120 each issued at $5 \%$ premium, repayable at par.
(ii) $20,000,9 \%$ Debentures of ₹ 200 each issued at $20 \%$ premium, repayable at $30 \%$ premium.

Journal


Note- 1. It is assumed that Company has investment $15 \%$ of the redeemable amount on April 30 and enchased it as per Companies Act, 2013.
2. It is assumed that Company has created Debenture Redemption Reserve @ $25 \%$ of the redeemable debenture and transferred it to General Reserve after redemption of all the debentures.

Redemption Method 3: Redemption of debentures by the purchase of own debentures in the open market. According to the Companies Act, a company can redeem its debentures in full or in part by purchasing its own debentures in the open market (Stock exchange) provided the company is authorised to do so by its Articles of Association.

## Suitability of this Method

1. When interest rate on own debentures is higher than the market interest rate.
2. When own debentures are quoted at a discount in the open market, a company can earn profit on redemption as debentures are available at below its nominal value in the market, otherwise normal redemption may be at part or at premium.

Debenture Redemption Reserve: Creation of Debenture Redemption Reserve (DRR) is necessary if debentures have been purchased for cancellation. Unless otherwise stated in question, it is assumed that the company has adequate balance in DRR before initiating the process of purchase of debentures for cancellation.


## Accounting Treatment

(a) When Debentures are purchased from the open market for immediate cancellation: The purchase cost (market price paid + Brokerage + other purchase exp.) of own debentures may be equal to or less than the nominal value of debentures.
(i) When own debentures are purchased: e.g. if a company purchase 1,000 of its own debentures of ₹ 50 each at ₹ 49 (including all purchase exp.) in the open market for immediate cancellation.

Journal

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
| :--- | :--- | ---: | ---: | ---: |
|  | Own debentures A/c <br> To Bank A/c <br> (Being the purchase of 1000 own debentures @ 49 <br> each) |  | 49,000 | 49,000 |

(ii) For cancellation of own debentures:

There may be three case - (a) when own debentures are purchased at nominal price - the entry passed is for cancellation:

X\% Debentures Dr. (Nominal Face Value of Deb.)
To Own Debentures A/c \{Purchase Cost\}
(b) When own debentures are purchased at price below Nominal value of Debentures: the entry passed is for cancellation:
(i) $\mathrm{X} \%$ Debentures $\mathrm{A} / \mathrm{c}$

Dr. [Nominal/Face Value Debentures]
To Own Debentures A/c (Purchase cost of own Deb.)
To Gain/Profit on Cancellation of own Debentures A/c (Profit)
Hint: (Profit on cancellation is the Excess of nominal value over purchase cost of own debentures cancelled)

Profit on cancellation of own debentures is a capital profit and therefore, is transferred to capital Reserve (or it may be used to write off discount/Loss on issue of debentures) the entry is:

To writing off Capital losses.
(ii) Profit on cancellation of own debentures $\mathrm{A} / \mathrm{c}$ or

To Capital Losses (if any) A/c
To Capital Reserve A/c
In above example the entries for cancellation of B (debentures will be :
Journal

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |  |
| :--- | :--- | :--- | ---: | ---: | ---: |
|  | X\% Debentures A/c | Dr. |  | 50,000 |  |
|  | To Own Debentures A/c |  |  | 49,000 |  |
|  | To Profit on cancellation of own debentures A/c |  |  | 1,000 |  |
|  | (Cancellation of own debentures) |  |  |  |  |
|  | Profit on Cancellation of Own Debentures A/c | Dr. |  | 1,000 |  |
|  | To Capital Reserve |  |  | 1,000 |  |
|  | (Profit on conciliation of own Debentures |  |  |  |  |
|  | is transferred to capital Reserve) |  |  |  |  |

(C) When own debentures are purchased at a price above its face value. e.g. Debentures of the face value of ₹ 40,000 are purchased in the open market at ₹ 42,000 , the entry will be

Journal

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |  |
| :---: | :--- | :---: | ---: | ---: | ---: |
|  | Own Debentures A/c |  | 42,000 |  |  |
|  | To Bank A/c |  |  |  | 42,000 |
|  | (Purchases of own debentures for L42000) |  |  |  |  |
|  | X\% Debentures A/c |  | 40,000 |  |  |
|  | Loss on Redemption of Debentures A/c | Dr. |  | 2,000 |  |
|  | To own Debentures A/c |  |  | 42,000 |  |
|  | (Cancellation of own debentures) |  |  |  |  |

'Loss on Redemption of Debentures' is a capital loss and is therefore written off against capital profit or in the absence of capital profit is written off from statement of profit and loss.

Illustration 14: Raj Electrical Ltd. had ₹ $5,00,000 ; 10 \%$ Debentures of 100 each outstanding on 31st Jan 2015. On this date, company decided to purchase ₹ 50,000 worth debentures at ₹ 97 in the open market.

Give Journal entries if Debentures are purchased for immediate cancellation.

## Solution

## I. Debentures Purchased for Immediate Cancellation

Journal

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2015 <br> Jan. 31 | Own Debentures A/c <br> Dr. <br> To Bank A/c <br> (₹50,000 debentures Purchased at ₹97 per debentures for cancellation) |  | 48,500 | 48,000 |
| Jan. 31 | 10\% Debentures A/c <br> To Own Debentures A/c <br> To Profit on Conciliation of Own Debt A/c <br> (Cancellation of own debenture) |  | 50,000 | $\begin{array}{r} 48,500 \\ 1,500 \end{array}$ |
| March 31 | Profit cancellation of Own Debentures A/c Dr. To Capital Reserve A/c <br> (Profit cancellation transferred to Capital Reserve) |  | 1,500 | 1,500 |

## REDEMPTION OF DEBENTURES

Question-1: Fill in the missing figures in the following Journal entries


Question-2: Fill in the following figures

## Journal Entries

| Date | Particulars | LF. | Debit ( F ) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | CASE 1 <br> Own Debentures A/c <br> Dr. <br> To Bank A/c <br> (Being 500 own debentures of ₹100 each purchased at ₹97 for immediate cancellation) |  | -------- | -------- |
|  | 10\% Debentures A/c <br> Dr. <br> To Own Debentures A/c <br> To Profit on Redemption of Own Debentures A/c (Being own debentures cancelled) |  | -------- | -------- |
|  | $\qquad$ <br> To $\qquad$ <br> (Being profit on redemption transferred to capital reserve) |  | -------- | -------- |
|  | CASE 2 $\qquad$ <br> Dr. <br> To Bank A/c <br> (Being 200 own debentures of ₹100 each purchased ₹96 plus 150 for brokerage) |  | -------- | -------- |
|  | 8\% Debenture A/c <br> To Own Debentures A/c <br> To $\qquad$ A/c <br> (Being own debentures cancelled) |  | -------- |  |
|  | Profit on Cancellation of Own Debenture A/c Dr. <br> To $\qquad$ A/c <br> (Being profit on Cancellation transferred) |  | -------- | -------- |

Question-3: Fill in the missing information in following Journal entries Journal Entries

| Date | Particulars | LF. | Debit (₹) | Credit (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2010 <br> April 1 | Bank A/c <br> To Debenture Application and Allotment, A/c (Being application money received) |  | -------- | -------- |
| 2010 <br> April, 1 | Debenture Application and Allotment A/c Dr <br> Loss on Issue of Debenture A/c. Dr . <br> To 8\% Debentures A/c  <br> To Premium on Redemption of Debentures $\mathrm{A} / \mathrm{c}$  <br> (Being Debenture issued at discount of $5 \%$  <br> repayable at $10 \%$ premium)  |  | ------------- | 2,00,000 |
| Mar. 31 | Balance in statement of $P$ \& LA/c <br> To Debenture Redemption Reserve A/c <br> (Being profit transfer to DRR) |  |  | -------- |
| April,30 | Debenture Redemption Investment A/c <br> To Bank A/c <br> (Being Investment @15\% of Redeemable amount made in specified securities) |  | ---- | -------- |
| Mar. 31 | Bank A/c Dr. To Debenture Redemption Investment A/c (Being Investment enclosed) |  | ---- | -------- |
|  | 8\% Debenture A/c <br> Premium on Redemption of Debenture A/c Dr. <br> To Debentureholder A/c <br> (Being Debenture due for redemption) |  |  | -------- |
|  | Debentureholder A/c <br> To Bank A/c <br> (Being amount paid due to Debentureholders) |  | 2,20,000 | 2,20,000 |
|  | Debenture Redemption Reserve A/c <br> To General Reserve A/c <br> (Being Balance of DRR transferred to General Reserve A/c) |  | --- | -------- |

Redemption of Debentures by Conversion: it means redeeming the debentures by converting them into shares-equity or preference shares or new Class of debentures. A company may issue debentures which are compulsorily convertible into shares or new class of debentures to convert the debentures.
At the time of conversion of debentures, Shares may be issued at par or at a premium but Debentures may be issued at par, at premium or at discount.

## Debentures Redemption Reserve (DRR):

1. When debentures are fully convertible - D.R.R. is not created
2. For partly convertible debentures- D.R.R. is created for non-convertible part of the debentures.

Debenture Redemption Investment (DRI): In addition to the transfer of amount to DRR, a company is required to invest in specific securities on amount that is at least 15 percent of the normal value of the debentures to be redeemed.

## Journal Entries for Conversion

1. Redemption at par
\% Debenture A/c
Dr (Nominal value)

To Debenturesholder A/c
2. Redemption At Premium
\% Debenture A/c Dr. (Nominal value)
Premium on Redemption of Debenture A/c Dr. (Premium payable)
To Debenturesholders A/c

## For issuing shares or Debentures:

(i) Shares/Debentures issued at par

Debentureholders $\backslash \mathrm{A} / \mathrm{c}$
Dr. (amount due)
To Share Capital A/c (Nominal value) OR

To ......\% Debentures A/c
(ii) Shares/ Debentures issued at a Premium:

Debentureholders' A/c Dr. (amount due)
To Share Capital A/c/New Debentures A/c (Nominal value)
To Securities Premium Reserve A/c (Premium on issue)
(iii) Debentures issued at a discount:

Debenture holder's A/c
Dr.
Discount on issue of New Debentures A/c Dr.
To \% Debentures A/c
Q. 1 A company converted ₹6,00,000, 8\% Debentures of ₹ 100 each redeemable at a premium of $10 \%$ into equity shares of ₹10 each at a premium of 2 per shares. Pass the necessary Journal entries at the time of redemption of debentures.

Ans.
JOURNAL

| Date | Particulars | L.F | Dr. (₹) | Cr. (₹) |
| :---: | :---: | :---: | :---: | :---: |
|  | 8\% Debentures A/c Dr. <br> Premium on Redemption of Debentures A/c Dr. <br> To Debenture holders' A/c  <br> (being the amount due on redemption of debentures)  |  | $\begin{array}{r} 6,00,000 \\ 60,000 \end{array}$ | 6,60,00 |
|  | Debenture holders' A/c <br> To Equity Share Capital A/c. <br> To Securities Premium Reserve A/c <br> (being issue of equity shares of ₹10 each at a premium of ₹ 2 per share on conversion) |  | 6,60,000 | $\begin{aligned} & 5,50,000 \\ & 1,10,000 \end{aligned}$ |

Q. 2 On $31^{\text {st }}$ March 2010, ABC Ltd. converted its ₹ 36,00,000;10\% Debentures into Equity shares of ₹ 10 each at a premium of ₹2 per share. Pass Journal entries.

Ans.

## JOURNAL

| Date | Particulars | L.F. | Dr.(₹) | Cr.( ₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2010 <br> March <br> 31 | 10\% Debentures A/c <br> To Debentureholders' A/c <br> (being the amount due to debenture holders) |  | $36,00,000$ | 36,00,000 |
|  | Debentureholders' A/c <br> Dr. <br> To Equity Share Capital A/c <br> To Securities Premium Reserve A/c <br> (being issue of shares at ₹ 2 per share on conversion) |  | 36,00,000 | $\begin{array}{r} 30,00,000 \\ 6,00,000 \end{array}$ |

Note: No. of equity Shares: $=₹ \frac{36,00,000}{12}=3,00,000$ Shares
Q. 3 A Company issued 10,000.12\% Debentures of ₹ 100 each at a discount of $10 \%$, redeemable after five years. Pass necessary Journal entries in the following cases if redemption takes place before maturity.
I. 10,000 debentures were redeemed by conversion into equity shares of $₹$ 10 each at the end of third year.
II. 10,000 debentures were redeemed by conversion into new $10 \%$ debentures of ₹ 100 each issued at ₹ 80 .
III. Debentures holders holding 4000 debentures exercised the option of conversion into equity shares of ₹ 10 each.
IV. Debentures holders holding 4000 debentures exercised the option of conversion into equity shares of ₹ 10 each issued at ₹ 12.

Ans.
JOURNAL

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
| :---: | :---: | :---: | :---: | :---: |
| $\begin{aligned} & \hline \text { Case (i) } \\ & 1 . \end{aligned}$ | Bank A/c Dr. To Debentures Application \& Allotment A/c (Being application money received) |  | 9,00,000 | 9,00,000 |
| 2. | Debentures Application \& Allotment A/c Dr. <br> Discount on Issue of Debenture A/c <br> To 12\% Debentures A/c <br> (Being or transfer of application money) |  | $\begin{aligned} & 9,00,000 \\ & 1,00,000 \end{aligned}$ | 10,00,000 |
| 3. | 12\% Debentures A/c <br> To Discount on issue of Debentures A/c <br> To Debentureholders A/c <br> (Being amount due to debenture holders on conversion) |  | 10,00,000 | $\begin{aligned} & 1,00,000 \\ & 9,00,000 \end{aligned}$ |
| 4. | Debentureholder A/c <br> To Equity Share Capital <br> (Conversion of debentures into equity shares) |  | 9,00,000 | 9,00,000 |
| Case (ii) | First two entries will be the same 12\% Debenture A/c <br> To Debenture holders A/c |  | 10,00,000 | 10,00,000 |
| Case <br> (iii) | Debenture holders A/c <br> Discount on issue of Debentures A/c <br> To 10\% Debentures A/c <br> (Being conversion of debentures into new debentures issued at a discount) |  | $\begin{gathered} 10,00,000 \\ 2,50,000 \end{gathered}$ | 12,50,000 |
|  | First two entries will be same |  |  |  |
|  | 12\% Debentures A/c <br> To Discount on issue of Debentures A/c <br> To Debenture holders A/c <br> (Being amount due to debenture holder on conversion) |  | 4,00,000 | $\begin{array}{r} 40,000 \\ 3,60,000 \end{array}$ |


Q. $4 X$ Ltd. Company issued $15,000,10 \%$ Debentures of ₹ 100 each on $1^{\text {st }}$ Jan. 2013. These are repayable at a premium of $15 \%$ on $31^{\text {st }}$ Dec 2015. On due date, Company redeemed Debentures out of profit. Statement of Profit \& Loss shows a credit balance of ₹ $20,00,000$.

Pass Journal entries for redemption of debentures, if company follows sec. 71(4) of the Companies Act, 2013.

Ans.
JOURNAL

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
| :---: | :---: | :---: | :---: | :---: |
| 2015 <br> March <br> 31 | Surplus of Statement of Profit \& Loss Dr. <br> To Debenture Redemption Reserve A/c <br> (Being profit transferred to DRR) |  | 15,00,000 | 15,00,000 |
| $\begin{aligned} & 2015 \\ & \text { Dec } 31 \end{aligned}$ | Debenture Redemption Investment A/c Dr. To Bank <br> (Being investment made equal to $15 \%$ of value of debenture) |  | 2,25,000 | 2,25,000 |

[Class XII: Accountancy]

Q. 5 A Company issued 2, 00,000 12\% Debentures of ₹10 each at $8 \%$ premium, repayable at par. Pass Journal entries for issue and redemption of Debentures as per provisions of Companies Act, 2013.

Ans.
JOURNAL

| Date | Particulars | L.F. | Dr. (₹) | Cr. ( $)^{\text {) }}$ |
| :---: | :---: | :---: | :---: | :---: |
| $\begin{aligned} & \text { For } \\ & \text { Issue } \end{aligned}$ | Bank A/c Dr. To Debentures Application \& Allotment A/c (Being application money received) |  | 21,60,000 | 21,60,000 |
|  | Debentures Application \& Allotment A/c Dr. <br> To $12 \%$ Debentures A/c  <br> To Securities Premium Reserve A/c  <br> (Being issued at premium repayable at par)  |  | 21,60,000 | $\begin{array}{r} 20,00,000 \\ 1,60,000 \end{array}$ |


| Before Redem ption | Surplus of Statement of Profit \& Loss Dr. <br> To Debentures Redemption Reserve A/c (Being DRR created with $25 \%$ of value of debenture) | 5,00,000 | 5,00,000 |
| :---: | :---: | :---: | :---: |
| For Redem ption | Debenture Redemption Investment A/c Dr. To Bank A/c (Being $15 \%$ of value of debentures invested) | 3,00,000 | 3,00,000 |
|  | Bank A/c Dr. To Debentures Redemption Investment A/c (Being Investment realised) | 3,00,000 | 3,00,000 |
|  | 12\% Debentures A/c <br> To Debentureholders A/c <br> (Being redemption amount due) | 20,00,000 | 20,00,000 |
|  | Debentureholders A/c Dr. <br> To Bank A/c  <br> (Being debentures holders paid)  | 20,00,000 | 20,00,000 |

## Redemption of Debentures

## Points to Remember:

- Redemption of debentures means repayment of debentures
- Debentures can be redeemed by the following methods:
I. Lump sum payment
II. Instalment by draw of lots
III. Conversion into shares or debentures
IV. Purchase of debentures from open market.
- The Company redeeming the debentures is required to transfer out of amount available for payment as dividend to debenture Redemption Reserve at least $25 \%$ of the face value of debentures to be redeemed.

The Company is also required to invest or deposit at least $15 \%$ of the amount of debentures maturing for payment on or before, $30^{\text {th }}$ April each year for debentures to be redeemed during year ending $31^{\text {st }}$ March.

- D.R.R. is transferred to General Reserve after the redemption of all debentures of that class
- In case of fully convertible Debentures, D.R.R. is not created.
- Gain on Cancellation of own debentures is a capital profit and is transferred to Capital Reserve A/c.
- Profit earned on sale of own debentures kept as investment is of revenue nature and is credited to statement of Profit \& Loss.


## PART-B

## CHAPTER 1

## FINANCIAL STATEMENTS OF A COMPANY



## Accounting Process

- Financial Statements are the end products of accounting process and are prepared at end of the accounting period to reveal the financial position of the enterprise at a particular date and the result of its business operations during an accounting period.
- As per Section 2(40) of the Companies Act, 2013 Financial Statements includes:

1. Balance Sheet or Position Statement
2. Statement of Profit and Loss or Income Statement
3. Notes to Accounts.
4. Cash Flow Statement.

- Balance Sheet: It is a statement of assets, liabilities and Equities of a business and it is prepared to show the financial position of the company at a particular date.

A balance sheet of a company is prepared as per the format prescribed in Part I of Schedule III of the Companies Act, 2013.

- The Schedule III prescribes only the vertical format for presentation of financial statements. Thus, a company will now not have an option to use horizontal format for the presentation of financial statements.


## Important contents of Balance Sheet

- An asset is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise.
- A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.
- Equity is the residual interest in the assets of the enterprise after deducting all its liabilities.

Part-I - Form of Balance Sheet

| Particulars | $\begin{array}{\|l} \hline \text { Note } \\ \text { No } \end{array}$ | Figures as at the end of current reporting period | Figures as at the end of the previous reporting period |
| :---: | :---: | :---: | :---: |
| 1 | 2 | 3 | 4 |
| I. EQUITY AND LIABILITIES <br> (1) Shareholders' funds <br> (a) Share capital <br> (b) Reserves and surplus <br> (c) Money received against share warrants <br> (2) Share application money pending allotment <br> (3) Non-current liabilities <br> (a) Long-term borrowings <br> (b) Deferred tax liabilities (Net) <br> (c) Other Long term liabilities <br> (d) Long-term provisions <br> (4) Current liabilities <br> (a) Short-term borrowings <br> (b) Trade payables <br> (c) Other current liabilities <br> (d) Short-term provisions <br> TOTAL |  |  |  |



## I. Equity and Liabilities

I. (1) Shareholders' Fund

Under this head, following line items are to be disclosed:

- Share Capital;
- Reserves and Surplus;
- Money received against Share Warrants.


## I. (1) b. Reserves and Surplus

(i) Reserves and Surplus shall be classified as:
(a) Capital Reserves;
(b) Capital Redemption Reserve;
(c) Securities Premium Reserve;
(d) Debenture Redemption Reserve;
(e) Revaluation Reserve;
(f) Share Options Outstanding Account;
(g) Other Reserves - (specify the nature and purpose of each reserve and the amount in respect thereof such as Subsidy Reserve, Tax Reserve);
(h) Surplus i.e. Balance in Statement of Profit \& Loss.
(ii) Debit balance of statement of Profit and Loss shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, if any, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative.

Illustration 1: A Ltd. has an opening credit balance of ₹ $2,00,000$ in surplus i.e., Balance in statement of Profit and Loss. During the year ended on $31^{\text {st }}$ March,2016, it earned a net profit of ₹ $3,00,000$. Prepare Notes to Accounts on Reserve and Surplus showing the amount to be shown in balance Sheet.

## Solution:

Note to Accounts

| Particulars | ₹ |
| :--- | ---: |
| Reserve and Surplus |  |
| Surplus i.e., Balance in statement of Profit and Loss: | $2,00,000$ |
| Opening Balance | $3,00,000$ |
| Add- Profit for the year | $5,00,000$ |

The balance of ₹ $5,00,000$ in surplus i.e., Balance in statement of Profit and Loss will be shown under Reserves and Surplus in the Balance Sheet.

Illustration 2: B Ltd. has an opening debit balance of ₹ $2,00,000$ in Surplus i.e., Balance in statement of Profit and Loss. During the year ended on $31^{\text {st }}$ March, 2016, it earned a net profit of ₹ $3,00,000$. Prepare Notes to accounts on Reserve and Surplus showing the amount to be shown in Balance Sheet.

## Solution:

Note to Accounts

| Particulars | ₹ |
| :--- | ---: |
| Reserve and Surplus |  |
| Surplus i.e., Balance in statement of Profit and Loss: |  |
| Opening Balance | $(2,00,000)$ |
| Add- Net Profit for the year | $3,00,000$ |
|  | $1,00,000$ |

The balance of ₹ $1,00,000$ in Surplus i.e., Balance in Statement of Profit and Loss will be shownd under Reserve and Surplus in the Balance Sheet.

Illustration 3: C Ltd. has an opening credit balance of ₹ $2,50,000$ in Securities Premium Reserve and also debit balance of 5,00,000 in Surplus i.e., Balance in statement of Profit and Loss in Reserve and Surplus. During the year ended $31^{\text {st }}$ march, 2016, it incurred a loss of ₹ $3,00,000$. Prepare Notes to Account on Reserve and Surplus showing the amount to be shown in Balance Sheet.

## Solution:

## Note to Accounts

| Particulars | ₹ |
| :--- | :---: |
| Reserve and Surplus <br> (a) Securities Premium Reserve <br> (b) Surplus i.e., Balance in statement of Profit \& Loss <br> $(5,00,000)$ <br> Opening Balance <br> Add- Profit (loss) for the year$(3,00,000)$ | $2,50,000$ |

₹ $(5,50,000)$ will be shown against Reserve and Surplus under shareholders' funds in the Balance Sheet.

### 1.3 Non-current liabilities

A liability shall be classified as non-current if it is not a current liability. The following items shall be disclosed under non-current liabilities:

Long-term borrowings;
Deferred tax liabilities (Net);
Other Long term liabilities;
Long-term provisions.

## I.3.a. Long-term borrowings:

1.3. a.1. Long-term borrowings shall be classified as:
(a) Bonds/debentures;
(b) Term loans;
from banks;
from other parties;
(c) Deferred payment liabilities;
(d) Deposits;
(e) Loans and advances from related parties;
(f) Long term maturities of finance lease obligations;
(g) Other loans and advances (specify nature).

## 1.3.c. Other Long-term liabilities

This should be classified into:
(a) Trade payables; (payable after 12 months from date of Balance Sheet or after operating cycle); and
(b) Others.

A payable shall be classified as 'trade payable' if it is in respect of amount due on account of goods purchased or services received in the normal course of business operations.

## 1.3.d. Long-term Provisions

The amounts shall be classified as:
(a) Provision for employee benefits. Example: Provision for Provident Fund, Provision for Employees retirement benefits.
(b) Others (specify nature). Example: Provision for Warranties.

### 1.4. Current Liabilities

1. A liability shall be classified as current when it satisfies any of the following criteria:
(a) it is expected to be settled in the company's normal operating cycle; or
(b) it is held primarily for the purpose of being traded; or
(c) it is due to be settled within twelve months after the reporting date; or
(d) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counter party, result in its settlement by the issue of equity instruments do not affect its classification.
2. An operating cycle is the time between the acquisition of an asset for processing and their realization in cash or cash equivalents. Where the normal operating cycle cannot be identified, it is assumed to have a duration of 12 months.

Current Liabilities should be classified on the face of the Balance Sheet as follows:

Short-term borrowings;
Trade payables; (Creditors \& Bills Payables)
Other current liabilities;
Short-term provisions.

## I.4.a Short-term borrowing

Short-term borrowings are the borrowings which are payable within 12 months from the date of Balance Sheet or within the period of operating cycle. The following items are included in short term borrowings:
a) Loans repayable on demand;
b) Bank overdraft and Cash Credit limit from banks;
c) Loans from other parties repayable within 12 months;
d) Deposits; and
e) Other loans and advances (nature to be specified)

## I.4.c Other current liabilities

The amounts shall be classified as:
(a) Current maturities of long-term debt;
(b) Current maturities of finance lease obligations;
(c) Interest accrued but not due on borrowings;
(d) Interest accrued and due on borrowings;
(e) Income received in advance;
(f) Unpaid dividends;
(g) Application money received for allotment of securities and due for refund and interest accrued thereon;
(h) Unpaid matured deposits and interest accrued thereon;
(i) Unpaid matured debentures and interest accrued thereon;
(j) Calls- in Advance
(k) Other payables (specify nature).

## I.4.d. Short-term Provisions

Provisions which are expected to mature within 12 months are classified as short term provisions.

The amounts shall be classified as:
(a) Provision for employee benefits;
(b) Others (specify nature).

Others would include Proposed Dividend, Provision for Taxation, Provision for Expenses, Warranty Provisions, etc. These amounts should be disclosed separately specifying nature thereof.

## II. Assets

I. Non-Current Assets
(a) Fixed Assets
(i) Tangible Assets
(ii) Intangible Assets
(iii) Capital work-in-progress
(iv) Intangible assets under development
(b) Non-current investments
(c) Deferred Tax Assets (net)
(d) Long-term loans and advances
(e) Other non-current assets

## II. 1.a.i. Tangible Assets

Tangible assets are the assets which have a physical existence. Assets that can be touched and seen are known as tangible assets.

The company shall disclose the following in the notes to accounts as per Part I of the Schedule III:
(a) Land;
(b) Buildings;
(c) Plant and Equipment;
(d) Furniture and Fixtures;
(e) Vehicles;
(f) Office equipment;
(g) Others (specify nature)

## II.1.a.ii. Intangible Assets

Intangible assets are the assets which do not have a physical existence. These assets cannot be seen and touched.
(i) Classification shall be given as:
(a) Goodwill;
(b) Brands/trademarks;
(c) Computer software;
(d) Mastheads and publishing titles;
(e) Mining rights;
(f) Copyrights, patents and other intellectual property rights, services and operating rights;
(g) Recipes, formulae, models, designs and prototypes;
(h) Licenses and franchise;
(i) Others (specify nature).

## II.1.a.iii Capital Work-in-Progress

It includes Fixed Assets which are under construction by the company itself.

## II.1.a.iv. Intangible Assets under Development

Intangible assets under development should be disclosed under this head provided they can be recognized based on the criteria laid down in AS-26. Examples are patents, computer software under development.

## 11.1.b. Non-Current Investments

(i) Non-current investment shall be classified as:
i. Trade investments; and
ii. Other investments.

## Trade Investment

The "trade investment" is an investment made by a company in shares or debentures of another company, to promote the trade or business of the first company.

Non-Current Investments is further classified as:
(f) in Mutual Funds;
(g) Investments in partnership firms;
(h) Investment in property;
(i) Investments in Equity Instruments;
(j) Investments in preference shares;
(k) Investments in Government or trust securities;
(I) Investments in debentures or bonds.
(m) Investments Other non-current Investments (specify nature)

Note: If a debenture is to be redeemed partly within 12 months and balance after 12 months, the amount to be redeemed within 12 months should be disclosed as current and balance should be shown as non-current.

## II.1.d. Long-term loans \& advances

Loans and advances that are not expected to be received back in cash or in the form of an asset within 12 months are known as Long-Term loans and advances.
(i) Long-term loans and advances shall be classified as:
(a) Capital Advances;
(b) Security Deposits;
(c) Loans and advances to related parties (giving details thereof);
(d) Other loans and advances (specify nature).

Capital advances are advances given for procurement of fixed assets which are non-current assets.

## II.1.e. Other Non-Current Assets

Other non-current assets shall be classified as:
(i) Long Term Trade Receivables (including trade receivables on deferred credit terms);
(ii) Other (specify nature)

A receivable shall be classified as 'trade receivable' if it is in respect of the amount due on account of goods sold or services rendered in the normal courses of business.

Important: The Schedule III does not contain any specific disclosure requirement for the unamortized portion of expense items such as share issue expenses, ancillary borrowing cost and discount or premium relating to borrowings.

We should disclose the unamortized portion of such expenses as "Unamortized expenses", under the head 'Other current/non-current assets", depending on whether the amount will be amortized in the next 12 months or thereafter.

## II.2. Current Assets

1. An asset shall be classified as current when it satisfies any of the following criteria:
(a) it is expected to be realized in, or is intended for sale or consumption in the company's normal operating cycle; or
(b) it is held primarily for the purpose of being traded; or
(c) it is expected to be realized within twelve months after the reporting date; or
(d) it is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.
All other assets shall be classified as non-current.
2. An operating cycle is the time between the acquisition of an asset for processing and their realization in cash or cash equivalents. Where the normal operating cycle cannot be identified, it is assumed to have duration of 12 months.

## II.2.a. Current Investments

Current Investments are the investments which are held to be converted into cash within, short period, i.e., within 12 months.

Current investments shall be classified as:
(a) Investments in Equity Instruments;
(b) Investments in Preference Shares;
(c) Investments in Government or trust securities;
(d) Investments in debentures or bonds;
(e) Investments in Mutual Funds;
(f) Investments in partnership firms.
(g) Other investments (specify nature).

## II.2.b. Inventories

Inventories shall be classified as:
(a) Raw materials;
(b) Work-in-progress;
(c) Finished goods;
(d) Stock-in-trade (in respect of goods acquired for trading);
(e) Stores and spares;
(f) Loose tools;
(g) Other (specify nature).

The heading Finished Goods should comprise of all finished goods other than those acquired for trading purposes.

## II.2.c. Trade Receivables (current)

A receivable shall be classified as a 'trade receivable' if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business.

A trade receivable will be treated as current if it is likely to be realized within 12 months from the date of Balance Sheet or Operating cycle of the business.

## II.2.d. Cash and Cash Equivalents

As defined in AS-3(Revised), Cash flow Statement, cash and cash equivalents are short term highly liquid investments that are readily convertible into known amount of cash and which are subject to an insignificant risk of change in value.
(i) Cash and cash equivalents shall be classified as:
(a) Balances with banks;
(b) Cheques, drafts in hand,
(c) Cash in hand;
(d) Others (specify nature).

## II.2.e. Short-term Loans and Advances

(i) Short-term loans and advances shall be classified as:
(a) Loan and advances to related parties (giving details thereof):
(b) Others (specify nature).
(ii) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.

## II.2.e.f. Other Current Assets (specify nature)

This is an all-inclusive heading, which incorporates current assets that do not fit into any other asset, categories e.g. Unbilled Revenue, Unamortised Premium on Forward Contracts prepaid expenses, dividend receivable, advance taxes etc.

## Statement of Profit and Loss

Statement of Profit and Loss: It is a statement prepared to show the result of business operations during an accounting period.

It shows the operating performance of a company during the accounting period.
A Statement of Profit \& Loss of a Company is prepared as per the format prescribed in Part II of Schedule III of the Companies Act, 2013.

## PART II - FORM OF STATEMENT OF PROFIT AND LOSS

## Statement of Profit \& Loss

For the year ended.......
(₹ in . . . . .)


## CONTENTS OF STATEMENT OF PROFIT AND LOSS

1. Revenue from Operations: It refers to the revenue earned by the company from its business operations.

For example:
(1) Revenue from sale of products or services
(2) Revenue from sale of scrap.
2. Other Income: It refers to the revenue earned by the company from activities other than its business operations.
For example:
(i) Interest Income
(ii) Dividend Income
(iii) Profit from sale of investments or fixed assets.
(iv) Bad debts recovered
(v) Excess provisions written back.
(vi) Rental income etc.

## 3. Cost of Material Consumed:

= Opening inventory of Raw Materials + Net Purchases of Raw Materials Closing Inventory of Raw Materials.

Note: Inventory of work-in-progress, finished goods and Stock-in-trade are not considered for calculating cost of material consumed.
4. Purchase of Stock-in-Trade: It includes goods purchased for resale purpose in same form i.e., without any further processing.
5. Changes in Inventories of work-in-progress, finished goods and stock-in-trade.
= Opening Inventories - Closing Inventories
6. Employees Benefit Expenses: It includes all expenses incurred by the company on its employees such as:
(i) Wages, salaries, bonus etc.
(ii) Leave encashment, staff welfare expenses, etc.
(iii) Contribution to employee's provident fund and other funds.
7. Finance Cost: It means cost incurred by a company on its borrowings i.e., debentures issued or loan taken by it.

Borrowing costs such as loan processing fees are also included in finance cost.

Finance Costs include the following:
i. Interest paid on Term loan from Bank.
ii. Interest paid on Overdraft and Cash Credit limit from Bank
iii. Interest paid on Debentures, Bonds and Public Deposits.
iv. Discount or loss on issue of debentures written off.
v. Premium payable on redemption of debentures written off
vi. Loan processing fees
vii. Guarantee charges
viii. Commitment charges etc.
8. Depreciation and Amortisation expenses: Depreciation is the cost of tangible fixed assets written off over their useful life such as on building, plant \& machinery etc.

Amortisation is the cost of intangible fixed assets written off over their useful life such as on patents, trademarks, computer software etc.
9. Other Expenses: Expenses that are not shown in any of the above mentioned heads are shown here.

For example:
(i) Carriage Inwards/Outwards
(ii) Audit Fees
(iii) Insurance charges
(iv) Rates \& taxes
(v) Bank charges
(vi) Advertisement expenses
(vii) Administrative expenses
(viii) Selling and distribution expenses
(ix) Power and electricity expenses
(x) Repairs of Fixed Assets etc.
(xi) Rent
(xii) Telephone expenses
(xiii) Sundry expenses

Illustration 4: Under which major sub-heading the following items will be placed in the Balance Sheet of a Company as per Schedule-III, Part I of the Companies Act, 2013 :
(i) Accrued Incomes
(ii) Loose Tools
(iii) Provision for employee's benefits
(iv) Unpaid dividend
(v) Short-term loans
(vi) Long-term loans

## Solution:

| Item | Sub-heading |
| :--- | :--- |
| Accrued Incomes | Other Current Assets |
| Loose tools | Inventories |
| Provision for Employees benefits | Long-term provisions |
| Unpaid Dividends | Other Current Liabilities |
| Short-term loans | Short-term borrowings/Short-term loans |
|  | and advances |
| Long-term loans | Long-term borrowings/Long-term loans |
|  | and advances |

Illustration 5: List the items which are shown under the heading, 'Current Assets' in the Balance Sheet of a company as per provisions of Schedule III,of the Companies Act, 2013.

## Solution:

(a) Current Investments
(b) Inventories
(c) Trade Receivables
(d) Cash and cash equivalents
(e) Short-term loans and advances
(f) Other Current Assets

Illustration 6: Name the major headings under which the Equity and Liabilities side of a company's Balance Sheet is organised and presented.

## Solution:

The major headings on the Equity and Liabilities side are:
I. Shareholder's funds
II. Share Application money pending allotment
III. Non-Current Liabilities
IV. Current Liabilities

Illustration 7: List the items that are included under Inventories.

## Solution:

(i) Raw materials
(ii) Work-in-progress
(iii) Finished goods
(iv) Stock-in-trade
(v) Stores and spares
(vi) Loose tools

Illustration 8: Name any three items that are shown under the head "Other Current Liabilities" and any three items that are shown under the head "Other Current Assets" in the Balance Sheet of a company as per Schedule III of the Companies Act, 2013.

## Solution:

Other Current Liabilities:
a) Unpaid Dividend
b) Interest accrued and due on borrowings
c) Calls in advance
d) Outstanding expenses etc.

Other Current Assets:
a) Prepaid expenses
b) Accrued Incomes
c) Advance Tax

## CHAPTER-2

## FINANCIAL STATEMENT ANALYSIS



Financial statement analysis is a systematic process of studying the relationship among the various financial factors contained in the financial statements to have a better understanding of the working and the financial position of a business.
"Financial Analysis consists in separating facts according to some definite plan, arranging them in groups according to certain circumstances and then presenting them in a convenient and easily read and understandable form."
— Finney and Miller

## Objectives or Purposes of Financial Statement Analysis

- To measure the Profitability or Earning Capacity of the business
- To measure the Financial Strength of the business
- To make Comparative Study within the firm (intra-firm) and with other firms (inter-firm)
- To judge the Efficiency of Management
- To provide Useful Information's to the Management
- To find out the Capability for payment of interest, dividend etc.
- To measure the Short-term and Long-term Solvency of the business


## Limitation of Financial Statement Analysis

- Based on basic financial statement which themselves suffer from certain limitations.
- Ignores changes in price level.
- Affected by the personal ability and bias of the analyst.
- Lack of qualitative analysis as only those transaction and events are recorded which can be measured in terms of money.
- When different accounting policies are followed by the two firms then comparison between their financial statement becomes unreliable.
- Analysis of single year's financial statement have limited use.
- Also affected by the Window dressing


## Types of Financial Statement Analysis

There are two main approaches for the analysis of financial statements.
Horizontal Analysis: In this type of analysis, figure in the financial statements for two or more years are compared and analysed. It helps in knowing the trends of the business over a period of time. It is also known as Time series analysis or Dynamic Analysis. Comparative statements and cash flow statements are example of horizontal analysis.

Vertical Analysis: In this type of analysis, figures in the financial statement for a single year are analysed. It involves the study of relationship between various items of Balance Sheet or Statement of Profit \& Loss of a single year or period. It is also
known as Static Analysis. Ratio Analysis relating to a particular accounting period are examples of this type of analysis.

## Significance or Importance of Financial Analysis:

- For Management: To know the profitability, liquidity and solvency position; to measure the effectiveness of its own decisions taken and to take corrective measure in future.
- For Investors: Investors want to know the earning capacity and future growth prospects of the business which helps in assessing the safety of their investment and reasonable return.
- For Creditors: Short-term creditors want to know the liquidity position of the business where as long term creditors want to know about the solvency position and ability to pay the interest consistently.
- For Govt.: To know the profitability position for taking taxation decision and to take decisions about the price regulations.
- For Employees: To know the progress of the company for assessing bonus, possible increase in wages and to ensure stability of their jobs.
- For Customers: To know about the continuance of the business in future.


## CHAPTER 3

## TOOLS FOR FINANCIAL STATEMENT ANALYSIS

The various tools used for analysis of financial statements are:

- Comparative Statement: Financial Statements of two years are compared and changes in absolute terms and in percentage terms are calculated. It is a form of Horizontal Analysis.
- Common Size Statement: Figures of Financial Statements are converted in to percentage with respect to some common base.
- Ratio Analysis: It is a technique of Study of relationship between various items in the Financial Statements.
- Cash Flow Statement: It is a statement that shows the inflow and outflow of cash and cash equivalents during a particular period which helps in finding out the causes of changes in cash position between the two balance sheet dates.




## Comparative Financial Statements

It is a tool of financial Analysis that shows changes in each item of the financial statement in absolute amount and in percentage, taking the amounts of the preceding accounting period as the base.

Types of Comparative Statement:

1. Comparative Balance Sheet; and
2. Comparative Statement of Profit and Loss.
3. Comparative Balance Sheet: It shows the increases and decreases in various items of assets, equity and liabilities in absolute term and in percentage term by taking the corresponding figures in the previous year's balance sheet as a base.

Format for a Comparative Balance Sheet as per CBSE Circular No. 43 dated 2,July 2013

Comparative Balance Sheet of $\qquad$ Ltd.

As at $31^{\text {st }}$ March 2016-2017

| Particulars | $2016$ | $\begin{gathered} 2017 \\ \text { ₹ } \end{gathered}$ | Absolute Change ₹ | Percentage Change \% |
| :---: | :---: | :---: | :---: | :---: |
| EQUITY AND LIABILITIES: |  |  |  |  |
| Shareholders' funds |  |  |  |  |
| Share Capital |  |  |  |  |
| Reserve and Surplus |  |  |  |  |
| Non-Current Liabilities |  |  |  |  |
| Long term Borrowings |  |  |  |  |
| Other long term liabilities |  |  |  |  |
| Long term provisions |  |  |  |  |
| Current liabilities |  |  |  |  |
| Short term Borrowings |  |  |  |  |
| Trade payables |  |  |  |  |
| Other current liabilities |  |  |  |  |
| Short term provision |  |  |  |  |
| ASSETS: |  |  |  |  |
|  |  |  |  |  |
| Non-current Assets |  |  |  |  |
| Fixed Assets |  |  |  |  |
| Non-current investments |  |  |  |  |
| Long term Loans and Advances |  |  |  |  |
| Current Assets |  |  |  |  |
| Current investments |  |  |  |  |
| Inventories |  |  |  |  |
| Trade receivables |  |  |  |  |
| Cash and cash equivalents |  |  |  |  |
| Short term loans and advances |  |  |  |  |
| Other current assets |  |  |  |  |
|  |  |  |  |  |

Absolute Change = Current year figure - Previous year figure
$\%$ change $=\frac{\text { Related absolute change }}{\text { Related figures of Previous year }} \times 100$

Illustration 1: From the following Balance Sheet of XYZ Ltd. as at $31^{\text {st }}$ March 2016 and 2015. Prepare a comparative Balance Sheet.


## Solution:

## Comparative Balance Sheet of XYZ Ltd.

 As at $31^{\text {st }}$ March 2015 \& 2016

Steps for Capital Calculations:

1. Absolute amount of share capital for $31-3-2015=10,00,000$ \& for 31-3-2016 = 20,00,000

Absolute change in share capital $=$ Current year figure - Previous year figure $=20,00,000-10,00,000=10,00,000$
$\%$ change $=\frac{\text { absolute change }}{\text { Previous year } \text { figure }} \times 100$

$$
=\frac{10,00,000}{10,00,000} \times 100=100 \%
$$

2. For Reserves \& Surplus $\frac{2,00,000}{6,00,000}=33.33 \%$

Here absolute change is in negative figure
$\therefore \%$ change will also be in bracket indicating -ve \%
3. So no

## COMPARATIVE STATEMENT OF PROFIT AND LOSS/COMPARATIVE INCOME STATEMENT

Comparative Income Statement: It shows the increases and decreases in various items of income Statement in absolute amount and in percentage amount by taking the corresponding figures in the previous year's Income Statement as a base.

Format for a Comparative statement of Profit \& Loss as per CBSE Cr. No. 43 dated 2 July 2013

## Comparative Statement of Profit and Loss

For the year ended on $31^{\text {st }}$ March, 2016 and 2017

| Particulars | $2016$ | $2017$ | Absolute Change ₹ | Percentage Change \% |
| :---: | :---: | :---: | :---: | :---: |
| I. Revenue from Operations |  |  |  |  |
| II. Add: Other Income |  |  |  |  |
| III. Total Revenue I + II |  |  |  |  |
| IV. Expenses: |  |  |  |  |
| a. Cost of Material Consumed |  |  |  |  |
| b. Purchases of Stock-in-Trade |  |  |  |  |
| c. Changes in inventories of Finished Goods, work-in-progress and Stock-in-Trade |  |  |  |  |
| d. Employees benefit expenses |  |  |  |  |
| e. Finance costs |  |  |  |  |
| f. Depreciation |  |  |  |  |
| g. Other expenses |  |  |  |  |
| Total Expenses |  |  |  |  |
| V. Profit before tax (III-IV) |  |  |  |  |
| Less: Income Tax |  |  |  |  |
| VI. Profit after tax |  |  |  |  |

Importance of Comparative Financial Statements

- To make the data simple and more understandable.
- To indicate the trend with respect to the previous year.
- To compare the Firm's performance with the performance of other firm in the same business.

Illustration 2: From the following information of 'Anjali' Ltd. Prepare comparative statement of Profit \& Loss.

| Particulars | Note <br> No. | $\mathbf{3 1}^{\text {st }}$ March <br> $\mathbf{2 0 1 6}(₹)$ | $\mathbf{3 1}^{\text {st }}$ March <br> $\mathbf{2 0 1 5}$ (₹) |
| :--- | ---: | ---: | ---: |
| Revenue from operations |  | $20,00,000$ | $16,00,000$ |
| Employees Benefit Expenses |  | $10,00,000$ | $8,00,000$ |
| Depreciation \& Amortisation Expenses |  | 25,000 | 20,000 |
| Other expenses |  | 75,000 | $1,80,000$ |

Tax Rate 30\%

## Solution:

Comparative statement of profit \& Loss
For the year ended $31^{\text {st }}$ March 2015-2016

| Particulars | $\begin{gathered} \text { Not } \\ \text { e } \end{gathered}$ No. | 31-3-2015 <br> (₹) | 31-3-2016 <br> (₹) | Absolute change(₹) OR | $\begin{gathered} \% \\ \text { Change( } \\ \text { \%) } \end{gathered}$ |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | I | II | III=II - I | $\mathrm{IV}=\frac{I I I}{I} \times 100$ |
| A. Revenue from Operations |  | 16,00,000 | 20,00,000 | 4,00,000 | 25\% |
| B. Expenses <br> (i) Employee Benefit Expenses |  | 8,00,000 | 10,00,000 | 2,00,000 | 25\% |
| (ii) Depreciation \& Amortisation Expenses |  | 20,000 | 25,000 | 5,000 | 25\% |
| (iii) Other Expenses |  | 1,80,000 | 75000 | 1,05,000 | 58.33\% |
| Total Expenses |  | 10,00,000 | 11,00,000 | 1,00,000 | 10\% |
| C. Profit before $\operatorname{tax}(\mathrm{A}-\mathrm{B})$ |  | 6,00,000 | 9,00,000 | 3,00,000 | 50\% |
| D. Less |  | 1,80,000 | 2,70,000 | 90,000 | 50\% |
| E. Profit after tax(C-D) |  | 4,20,000 | 6,30,000 | 2,10,000 | 50\% |

## Common Size Financial Statements 100\% statements

Common Size Financial Statements are the statements in which amounts of the various items of financial statements are converted into percentages to a common base.

## Types of Common Size Statements:

1. Common Size Balance Sheet; and
2. Common Size Statement of Profit and Loss.

Common Size Balance Sheet: It is a statement in which every item of assets, equity and liabilities is expressed as a percentage to the total of all assets or to the total of Equity and Liabilities.

Total Assets or Total Equity \& Liabilities are taken as Common base

## Format for a Common Size Balance Sheet:

As per CBSE Cr. No. 43 dated 2 July 2013
Common Size Balance Sheet of $\qquad$ Ltd.

As at 31 ${ }^{\text {st }}$ March 2016 and 2017

| Particulars |  | Absolute Amounts |  | Percentage of Balance Sheet Total |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 2016 ₹ | 2017 ₹ | 2016 \% | 2017 |
| EQUITY AND LIABILITIES: <br> Shareholders' Funds <br> Share Capital <br> Reserve and Surplus <br> Non-Current Liabilities <br> Long term Borrowings <br> Other long term liabilities <br> Long term provisions <br> Current liabilities <br> Short term Borrowings <br> Trade payables <br> Other current liabilities <br> Short term provision | Total |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  | 100 | 100 |
|  |  |  |  |  |  |
|  | 325 |  | [Clas | I: Acco | tanc |


| ASSETS: |  |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Non-current Assets |  |  |  |  |  |
| Fixed Assets |  |  |  |  |  |
| Non-current investments |  |  |  |  |  |
| Long term Loans and Advances |  |  |  |  |  |
| Current Assets |  |  |  |  |  |
| Current investments |  |  |  |  |  |
| Inventories |  |  |  |  |  |
| Trade receivables |  |  |  |  |  |
| Cash and cash equivalents <br> Short term loans and advances <br> Other current assets |  |  |  | 100 | 100 |

Common Size Income Statement or Statement of Profit \& Loss: It is a statement in which every item of Statement of Profit and Loss is expressed as a percentage to the amount of Revenue from Operations.
Sales (Revenue from operations) is taken as base
Format for a Common Size Statement of Profit and Loss
As per CBSE Cr. No. 43 dated 2 July 2013

## Common Size Statement of Profit and Loss

For the years ended on $31^{\text {st }}$ March, 2016 and 2017


Illustration 3: Prepare a 'Common Size Balance Sheet' on the basis of the information given in the Balance Sheet of Z Ltd. as at 31st March 2016.

| Particulars | Note <br> No. | 31-3-16 |
| :---: | :---: | :---: |
| I. EQUITY AND LIABILITIES |  |  |
| 1. Shareholders' Funds |  |  |
| (a) Share Capital |  | 6,00,000 |
| (b) Reserve and Surplus |  | 1,00,000 |
| 2. Non-Current Liabilities |  |  |
| (a) Long term borrowings |  | 2,50,000 |
| 3. Current Liabilities |  |  |
| (a) Trade Payable |  | 50,000 |
| Total |  | 10,00,000 |
| II. ASSETS |  |  |
| 1. Non-Current Assets |  |  |
| (a) Fixed Assets |  |  |
| (i) Tangible Assets |  | 6,50,000 |
| (b) Non-Current Investments |  | 1,50,000 |
| 2. Current Assets |  |  |
| (a) Inventories |  | 70,000 |
| (b) Trade Receivables |  | 50,000 |
| (c) Cash and cash equivalents |  | 80,000 |
| Total |  | 10,00,000 |

## Solution:

## Common Size Balance Sheet of Z Ltd.

As at $31^{\text {st }}$ March, 2016


## Steps for Calculation:

1. Absolute Amount of share capital $=₹ 6,00,000 \%$ of Balance Sheet Total
$=\frac{6,00,000}{10,00,000} \times 100=60 \%$
2. For Reserves \& Surplus $\frac{1,00,000}{10,00,000} \times 100=100 \%$
3. Similarly, for tangible Assets $\frac{6,50,000}{10,00,000} \times 100=65 \%$
\& so on.......

Illustration 4: From the following information for the years ended on $31^{\text {st }}$, March, 2014 and 2015, prepare a 'Comparative Statement of Profit \& Loss' of Beta Ltd.

| Particulars | Note No. | $\mathbf{2 0 1 4 - 2 0 1 5}$ | $\mathbf{2 0 1 3 - 1 4}$ |
| :--- | ---: | ---: | ---: |
| Revenue from operations |  | $7,00,000$ | $5,00,000$ |
| Expenses |  | $4,50,000$ | $3,75,000$ |
| Other Incomes |  | 75,000 | $1,00,000$ |

Rate of Income Tax was 50\%

## Solution:

## Comparative Statement of Profit and Loss of Beta Ltd for the years ended

 31st March, 2014 and 2015| Particulars | Note <br> No. | $\mathbf{2 0 1 3 - 1 4}$ | $\mathbf{2 0 1 4 - 1 5}$ | Absolute <br> change | Change <br> in $\%$ |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Revenue from operations |  | $5,00,000$ | $7,00,000$ | $2,00,000$ | $40 \%$ |
| Add: Other Income |  | $1,00,000$ | 75,000 | $(25,000)$ | $(25 \%)$ |
| Total Revenue |  | $6,00,000$ | $7,75,000$ | $1,75,000$ | $29.17 \%$ |
| Less: Expenses |  | $3,75,000$ | $4,50,000$ | 75,000 | $20 \%$ |
| Profit before tax |  | $2,25,000$ | $3,25,000$ | $1,00,000$ | $44.44 \%$ |
| Less: tax @ 50\% |  | $1,12,500$ | $1,62,500$ | 50,000 | $44.44 \%$ |
| Profit after tax |  | $1,12,500$ | $1,62,500$ | 50,000 | $44.44 \%$ |

Illustration 5: Prepare a Comparative Income Statement and Common Size Statement of Profit and Loss from the following information:

| Particulars | $\mathbf{3 1}^{\text {st }}$ March |
| :--- | :--- | :--- |
| $\mathbf{2 0 1 4}$ |  | | 31st March |
| :---: |
| $\mathbf{2 0 1 5}$ |$|$| Revenue from operations | $125 \%$ | $140 \%$ |
| :--- | :--- | :--- |
| (\% of cost of Material Consumed) |  |  |
| Cost of Material Consumed | $2,40,000$ | $2,50,000$ |
| Other expenses (\% of Revenue from Operations) | $10 \%$ | $12 \%$ |
| Other Income | 15,000 | 20,000 |
| Tax Rate | $30 \%$ | $30 \%$ |

## Solution

COMMON SIZE STATEMENT OF PROFIT AND LOSS OF
For the years ended on 31st March 2014 and 2015

| Particulars | Absolute | Amounts | Percentage of Revenue from operation (Net Sales) |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2014 (₹) | 2015 (₹) | 2014 \% | 2015 \% |
| I. Revenue from operations | 3,00,000 | 3,50,000 | 100.00 | 100.00 |
| II. Add: Other Income | 15,000 | 20,000 | 5.00 | 5.71 |
| III. Total Revenue (I+II) | 3,15,000 | 3,70,000 | 105.00 | 105.71 |
| IV. Expenses: | 2,40,000 | 2,50,000 | 80.00 | 71.43 |
| a) Cost of Material Consumed | 30,000 | 42,000 | 10.00 | 12.00 |
|  | 2,70,000 | 2,92,000 | 90.00 | 83.43 |
| V. Profit before tax (III-IV) | $\begin{array}{r} 45,000 \\ (13,500) \end{array}$ | $\begin{array}{r} 78,000 \\ (23,400) \end{array}$ | $\begin{aligned} & 15.00 \\ & (4.50) \end{aligned}$ | $\begin{aligned} & 22.28 \\ & (6.69) \end{aligned}$ |
| VI. Profit after tax | 31,500 | 54,600 | 10.50 | 15.59 |

COMPARATIVE INCOME STATEMENT
For the years ended on 31st March 2014 and 2015

| Particulars | Absolute | Amount | Absolute Change | Percentag e Change |
| :---: | :---: | :---: | :---: | :---: |
|  | 2014 (₹) | 2015 (₹) | (₹) | \% |
| I. Revenue from operations | 3,00,00 | 3,50,000 | 50,000 | 16.67 |
| II. Add: Other Income | 15,000 | 20,000 | 5,000 | 33.33 |
| III. Total Revenue ( $\mathrm{l}+\mathrm{II}$ ) | 3,15,000 | 3,70,000 | 55,000 | 17,46 |
| IV. Expenses: <br> a. Cost of Material Consumed <br> b. Other expenses | $\begin{array}{r} 2,40,000 \\ 30,000 \end{array}$ | $\begin{array}{r} 2,50,000 \\ 42,000 \end{array}$ | $\begin{aligned} & 10,000 \\ & 12,000 \end{aligned}$ | $\begin{gathered} 4.16 \\ 40.00 \end{gathered}$ |
| Total Expenses | 2,70,000 | 2,92,000 | 22,000 | 8.15 |
| V. Profit before tax (III-IV) | $\begin{array}{r} 45,000 \\ (13,500) \end{array}$ | $\begin{gathered} 78,000 \\ (23,400) \end{gathered}$ | $\begin{aligned} & 33,000 \\ & (9,900) \end{aligned}$ | $\begin{gathered} 73.33 \\ (73.33) \end{gathered}$ |
| VI. Profit after tax | 31,500 | 54,600 | 23,100 | 73.33 |

Illustration 6: Fill in the missing information in the following comparative statement of profit and loss.

Comparative Statement of Profit and Loss for the year ended 31 ${ }^{\text {st }}$ March 2014 and 2015.

| Particulars | Note No. | $\begin{gathered} 2013-14 \\ \text { (₹) } \end{gathered}$ | 2014-15 <br> (₹) | Absolute Change (₹) | $\begin{gathered} \text { Percentage } \\ \text { Change } \\ \% \end{gathered}$ |
| :---: | :---: | :---: | :---: | :---: | :---: |
| I. Revenue from operations <br> II. Add: Other Income <br> III. Total Revenue (I+II) |  --------- <br>  25,000 |  | -------------- |  |  |
|  |  |  | 65,000 | -------- |
|  |  |  | --------- | --------- | --------- |
| IV. Expenses: <br> a. Cost of Material Consumed |  | ---------- |  | 6,00,000 | 2,00,000 | 60\%---- |
| Other expenses Total Expense |  | --------- | --------- | --------- | --------- |
| V. Profit before tax (III-IV) |  | --------- | --------- | --------- | --------- |
| Less: Income Tax @ 30\% <br> VI. Profit after tax |  | --------- | --------- | --------- | --------- |

## Solution

## Comparative Statement of Profit and Loss

For the year ended $31^{\text {st }}$ March 2014 and 2015

| Particulars | Note No. | $\begin{gathered} \text { 2013-14 } \\ \text { (₹) } \end{gathered}$ | $\begin{aligned} & \text { 2014-15 } \\ & \text { (₹) } \end{aligned}$ | Absolute Change (₹) | Percentage Change \% |
| :---: | :---: | :---: | :---: | :---: | :---: |
| I. Revenue from operations <br> II. Add: Other Income <br> III. Total Revenue I+II |  | 6,00,000 | 8,00,000 | 2,00,000 | 33.33\% |
|  |  | 25,000 | 90,000 | 65,000 | 260\% |
| III. Total Revenue I+II |  | 6,25,000 | 8,90,000 | 2,65,000 | 42.4\% |
| IV. Expenses: <br> a. Cost of Material Consumed <br> b. Other expenses |  | $\begin{array}{r} 4,00,000 \\ 25,000 \end{array}$ | $\begin{array}{r} 6,00,000 \\ 40,000 \end{array}$ | $\begin{array}{r} 2,00,000 \\ 15,000 \end{array}$ | $\begin{aligned} & 50 \% \\ & 60 \% \end{aligned}$ |
|  |  | 4,25,000 | 6,40,000 | 2,15,000 | 50.59\% |
| Total Expenses |  | 2,00,000 | 2,50,000 | 50,000 | 25\% |
| c. Profit before tax (III-IV) |  | 60,000 | 75,000 | 15,000 | 25\% |
| d. Profit after tax |  | 1,40,000 | 1,75,000 | 35,000 | 25\% |

## Things to Remember

> Why do we use tools for financial Analysis?
Financial statements are not ready to use/understand to the users. Therefore, we require tools to analyse them to be easily understandable by all the users.
> What are the tools for financial Analysis? Comparative financial statements common size financial statements Ratio Analysis cash flow statement
> List any two purposes of comparative statements?
$1 . \leftarrow$ To make the information simple \& easily understandable.
2. $\leftarrow$ To show the trend of changes.
> What are the steps for formation of comparative financial statement?
Step 1: Take the figure of previous year
Step 2: Take the figure of current year
Step 3: Find absolute change=current year figure-Previous year figure
Step 4: Find $\%$ change $=\frac{\text { Absolute change of an item }}{\text { Previous year figure of that item }} \times 100$
> How to show the negative change in any item
By putting brackets, we can show the negative change
> Name the types of comparative financial statements

1. Comparative Balance sheet
2. Comparative Income Statement/comparative statement of profit \& loss
> What is change in Inventories in inventories = opening stock-closing stock
> Common Size statements are also known as $\qquad$
Vertical Analysis and 100\% statements
> Why do we call common size statements as vertical Analysis?
> Why do we call common size statements as $100 \%$ statements? Because all the items of financial statements have to be expressed in terms of a base i.e. 100.
> Give any 2 utility of common size statements.
3. To create a relationship b/w base items \& other items of financial statements
4. To establish common base for comparison purposes.
> List 2 types of common size financial statements.
5. Common size Balance sheet
6. Common size income statement or common size statement of Profit \& Loss
$>\quad$ What are the steps for formation of common size financial statement?
Step 1: Take the figure of previous year
Step 2: Take the figure of current year
Step 3: Calculate \% total of each item to total of base which is 100 for previous year.

Step 4: Calculate \% total of each item to total of base which is 100 for current year.
$>\quad$ What is the common base in common size Balance sheet?
> Total of equity \& Liabilities or total Assets.
$>\quad$ What is the common base in common size income statement? Revenue from operations
> What are the 2 types of comparisons in comparative financial statement.

1. Intra firm comparison
2. Inter firm comparison
> Give any 2 limitation of comparison financial statement
3. Historical records only
4. Affected by personal judgement
> Can we prepare common size statement for a year (yes)
> Can we prepare comparative financial statements for a year (no)

## CHAPTER 4

## ACCOUNTING RATIOS

Accounting Ratio: It is an arithmetical relationship between two accounting variables.

Ratio Analysis: It is a technique of analysis of financial statements to conduct a quantitative analysis of information in a company's financial statements.
"Ratio analysis is a study of relationship among various financial factors in a business."


Expression of ratios: Ratios are expressed in following four ways:

- $\quad$ Pure Ratio Like 2:1. All liquidity and solvency ratios are expressed in pure form.
- Percentage e.g. $15 \%$. All profitability ratios are presented in percentage form.
- Times Like 4 times. All turnover ratios and Interest Coverage Ratio are presented in this form.
- $\quad$ Fraction like 3/4.

Classification or Types of Ratios:


Ratios can be classified into following 4 categories:

1. Liquidity Ratios/Short Term Solvency Ratios
2. Solvency Ratios/ Long Term Solvency Ratios
3. Activity Ratios also known as Turnover Rations or Performance Ratios.
4. Profitability Ratios.

## IMPORTANT POINT

Note: For Calculation of ratios Formula must be written as it carries marks

Liquidity Ratios: These ratios are used to measure short term solvency, i.e. the firm's ability to pay its current dues. In Liquidity Ratios the following two ratios are included.

## 1. Current Ratio also called Working Capital Ratio.

2. Liquid Ratio also called Quick Ratio or Acid Test Ratio.
3. Current Ratio: It shows the relationship of current assets with current liabilities.

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

## Current Assets

An asset shall be classified as current when it satisfies any of the following criteria:
(a) it is expected to be realized in, or is intended for sale or consumption in, the company's normal operating cycle:
(b) it is held primarily for the purpose of being traded:
(c) it is expected to be realized within twelve months after the reporting date; or
(d) it is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

The following items are included under Current Assets:
(a) Current investments
(b) Inventories (Excluding Loose tools \& stores \& spares)
(c) Trade receivables (Debtors and Bills Receivables after deducting any provision for Doubtful Debts)
(d) Cash and cash equivalents
(e) Short term loans and advances
(f) Other current assets (Restricted to prepaid expenses, accrued incomes and advance tax only)

## Current Liabilities

A liability shall be classified as current when it satisfies any of the following criteria:
(a) It is expected to be settled in the company's normal operating cycle;
(b) It is held primarily for the purpose of being traded:
(c) It is due to be settled within twelve months after the reporting date; or
(d) The company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counter party' result in its settlement by the issue of equity instruments does not affect its classification.

The following items are included under Current Liabilities:

- Short term borrowings
- $\quad$ Trade payables (Creditors and Bills Payable)
- Other current liabilities
- Short terms provisions
> Significance: It assesses the ability of a business to pay its short term liability on time.
> Ideal Ratio: 2:1 is considered as best.
- A Low ratio indicates that the company cannot meet its short term liability on time.
- A High ratio indicates that funds have not been used efficiently and lying idle.

2. Quick Ratio: It shows the relationship of quick assets with current liabilities

$$
\text { Liquid/ Quick Ratio }=\frac{\text { Quick Assets or Liquid Assets }}{\text { Current liabilities }}
$$

Quick Assets = Current Assets - Inventory - Prepaid Expenses Advance Tax - Accrued Income

## OR

## Quick Assets = Current Assets - Other Current Assets- Inventory

- $\quad$ Significance: It assesses the ability of a business to pay its short term liability promptly.
- Ideal Ratio: 1: 1 is considered as best.

Illustration 1: Working Capital ₹ 36,000 ; Current Ratio 2.8:1; Inventory ₹ 16,000. Calculate Current Assets, Current Liabilities and Quick Ratio.

## Solution

Current Ratio $=\frac{\text { Current Assets }}{\text { Current liabilities }}=\frac{2.8}{1}$
Let the Current Liabilities be ₹ X
The Current Assets will be ₹ 2.8 X
Working Capital = Current Assets - Current Liabilities
$36,000=2.8 X-X=1.8 X$
$X=\frac{36,000}{1.8}=20,000$
Current Assets $=2.8 \times 20,0000=₹ 56,000$
Current Liabilities = ₹ 20,000
Quick Ratio $=\frac{\text { Quick Assets or Liquid Assets }}{\text { Current liabilities }}$
Liquid Assets = Current Assets - Inventory
₹ $56,000-16,000=$ ₹ 40,000
Quick Ratio $=\frac{40,000}{20,000}=2: 1$

Illustration 2: Current Assets of a company are ₹ $15,00,000$. Its current Ratio is 2.5 and liquid Ratio is 0.85 . Calculate Current liabilities, Liquid Assets and Inventory.

## Solution

$$
\begin{aligned}
& \text { Current Ratio }=\frac{\text { Current Assets }}{\text { Current liabilities }} \\
& 2.5=\frac{15,00,000}{\text { Current liabilities }} \\
& \text { Current Liabilities }=\frac{15,00,000}{2.5}=₹ 6,00,000 \\
& \text { Liquid Ratio }=\frac{\text { Liquid Assets }}{\text { Current liabilities }} \\
& 0.85=\frac{\text { Liquid Assets }}{6,00,000} \\
& \text { Liquid Assets }=₹ 6,00,000 \times 0.85=₹ 5,10,000 \\
& \text { Inventory }=\text { Current Assets }- \text { Liquid Assets } \\
& =₹ 15,00,000-₹ 5,10,000 \\
& =₹ 9,90,000
\end{aligned}
$$

Solvency Ratios: Solvency ratios convey an enterprise's ability to meet its long term obligations as and when they become due.

Important solvency ratios are:

1. Debt to Equity Ratio
2. Total Assets to Debt Ratio
3. Proprietary Ratio
4. Interest Coverage Ratio
5. Debt Equity Ratio: It show relationship between Debts (Long term Liabilities or Non-Current Liabilities) and Equity (Shareholders' Funds).

| Debts Equity Ratio $=$ | $\frac{\text { Debts or Long Term Liabilities }}{\text { Equity or Shareholders'sFunds }}$ |
| ---: | :--- |
| Debts $=$ Long-term borrowings + Long-term provisions |  |
| Equity/Shareholders' Funds $=$ | Share Capital + Reserves and Surplus |
|  | - Non-Trading Investments |
| Equity/Shareholders' Funds $=$ | OR |
|  | + Non-Current Investment (Excluding |
|  | Non-Trading investment) + Long |
|  | Terms Loans and Advances + Current |
|  | Assets-Current Liabilities - Long-term |
|  | Borrowings-Long-term provision |

- $\quad$ Significance: It assesses the long term soundness of financial position of a business.
- Ideal Ratio: 2: 1 is considered as best but it should not be more than this.

Illustration 3: Calculate 'Debt-Equity Ratio’ from the following information:
Total Assets: ₹ 3,50,000
Total Debt: ₹ 2,50,000
Current Liabilities: ₹ 80,000

## Solution

Debts Equity Ratio $=\frac{\text { Debts or Long Term Liabilities }}{\text { Equity or Shareholder'sFunds }}$

$$
\begin{aligned}
\text { Debts } & =\text { Total Debt }- \text { Current Liabilities } \\
& =₹ 2,500,000-₹ 80,000=₹ 1,70,000
\end{aligned}
$$

$$
\begin{aligned}
& \text { Equity }=\text { Total Assets - Total Debts } \\
& \qquad=₹ 3,50,000-2,50,000=₹ 1,00,000
\end{aligned} \text { Debt - Equity Ratio }=\frac{1,70,000}{1,00,000}=1.7: 1
$$

Illustration 4: From the following information, Compute Debt to Equity Ratio

|  | $₹$ |  | $₹$ |
| :--- | :---: | :--- | ---: |
| Long term borrowings | $2,00,000$ | Non-current Assets | $3,60,000$ |
| Long term Provisions | $1,00,000$ | Current Assets | 90,000 |
| Current Liabilities | 50,000 |  |  |

## Solution:

Debt to Equity Ratio $=\frac{\text { Debt }}{\text { Equity }(\text { Shareholders'funds })}=\frac{3,00,000}{1,00,000}=3: 1$
Debt $=$ Long term Borrowings + Long term Provisions
=₹ $2,00,000+₹ 1,00,000=₹ 3,00,000$
Equity (Shareholders' funds) = Non-current Assets + Current Assets - Long term Borrowings + Long term Provisions + Current liabilities
= ₹ $3,60,000$ + ₹ $90,000-(₹ 2,00,000+₹ 1,00,000+₹ 50,000)$
= ₹ $4,50,000$ - ₹ $3,50,000=₹ 1,00,000$
2. Total Assets to Debt Ratio: It shows the relationship between Total Assets and Debts.
Total Assets To Debt Ratio $=\frac{\text { Total Assets }}{\text { Debts or } \text { Long term Liabilities }}$

Total Assets = Fixed Assets (Tangible and Intangible) + Non-Current Investment
(Excluding Non-Trading Investment) + Long Term Loans and Advances + Current Assets

Debts = Long-term borrowings + Long-term provisions
> Significance: It measures the safety margin available to the providers of long term loans.
> Ideal Ratio: No ideal ratio but a high ratio indicates higher safety to lenders and low ratio represents risky position.
Illustration 5: Calculate Total Assets to Debt Ratio from the following:

|  | ₹ |
| :--- | ---: |
| Total Debt | $3,00,000$ |
| Shareholder's funds | $1,20,000$ |
| current Assets | $1,50,000$ |
| Working Capital | 90,000 |

Solution:
Total Assets to Debt Ratio $=\frac{\text { Total Assets }}{\text { Debt }}$
Current Liabilities $=$ Current Assets- Working Capital

$$
=₹ 1,50,000-₹ 90,000=₹ 60,000
$$

Debt or Long Term Debts = Total Debt- Current Liabilities
= ₹ 3,00,000 - ₹ 60,000 = ₹ 2,40,000

Total Assets $=$ Total Debts + Shareholder's funds $=₹ 3,00,000+₹ 1,20,000$
= ₹ 4,20,000

Total Assets to Debt Ration $=\frac{4,20,000}{2,40,000}=1.75: 1$
> Proprietary Ratio: It shows the relationship between Proprietors' Funds/ Shareholders' Funds and Total Assets of the business.

Proprietary Ratio $=\frac{\text { Equity or Shareholders' Funds }}{\text { Total assets }}$
Proprietors' Funds = Share Capital + Reserves and Surplus - Non Trading Investment

## OR

Equity/Proprietors' Funds $=$ Fixed Assets (Tangible and intangible) + NonCurrent investments (Excluding Non-Trading investment) +Long Terms Loans and Advances +Current Assets - Current Liabilities - Long-term Borrowings-Long term provisions.

Total Assets= Fixed Assets (Tangible and Intangible) + Non-Current Investment (Excluding Non-Trading Investment) + Long Term Loans and Advances + Current Assets

- Significance: It measures the proportion of total assets financed by the Proprietors of the business. It shows the safety margin available to the lenders of the business as they can ascertain the portion of the shareholders in the business.
- Ideal Ratio: No ideal ratio but a high ratio indicates higher safety to lenders and low ratio represents risky position from lender's point of view.

Illustration 6: From the following information calculate Proprietary Ratio and Total Assets to Debt Ratio

Balance Sheet of ABC Ltd.

| Particulars | Note <br> No. | Figure for <br> Current Years (₹) |
| :--- | :---: | :---: |
| Equity and Liabilities <br> 1. Shareholders' Funds <br> (a) Share Capital <br> (b) Reserve and Surplus <br> 2. Non-Current Liabilities <br> Long Term borrowing (12\% Debentures) <br> 3. Current Liabilities <br> Trade Payable (Creditors) |  |  |
| Total |  | $4,50,000$ |
| Assets |  | $1,80,000$ |
| 1. Non Current Assets |  | 75,000 |
| (a) Fixed Assets |  |  |
| (b) Non-Current Investments |  | $7,50,000$ |
| 2. Current Assets |  |  |
| Inventory |  | $3,75,000$ |
| Total |  | $2,25,000$ |

## Solution

Proprietary Ratio $=\frac{\text { Equity or Shareholders's Funds }}{\text { Total Assets }}$
Shareholders' Funds = Share Capital + Reserves and Surplus

$$
=₹ 4,50,00+₹ 1,80,000=₹ 6 \cdot 30,000
$$

Proprietary Ratio $=₹ \frac{6,30,000}{7,50,000}=0.84: 1$

$$
\begin{aligned}
& =\frac{\text { Total Assets }}{\text { Debt Long Tarm Liabilities }} \\
& =₹ \frac{7,50,000}{75,000}=10
\end{aligned}
$$

Total Assets to Debt Ratio = 10: 1
4. Interest Coverage Ratio: This ratio establishes relationship between the

Net Profit before Interest \& Tax and interest payable on long term debts (Fixed Interest Charges)

$$
\text { Interest Coverage Ratio }=\frac{\text { Net Profit before Interest \& Tax }}{\text { Fixed Interest Charges }}
$$

$>$ Since interest is a charge on profits, net profit taken to calculate this ratio is before interest \& tax.
$>$ Its objective is to ascertain the amount of profit available to cover the interest charge. It determines ease with which a company can pay interest expense on outstanding debt.

High Ratio is better for lenders as it indicates higher safety margin.
Illustration7: Calculate Interest Coverage Ratio from the following information:
Net Profit (after taxes) = ₹ $1,00,000$
Fixed interest charges on long term borrowing $=₹ 20,000$
Rate of Income Tax 50\%

## Solution

$$
\begin{aligned}
\text { Interest Coverage Ratio } & =\frac{\text { Net Profit before Interest \& Tax }}{\text { Fixed Interest Chareges }} \\
& =₹ \frac{1,00,000+1,00,000(\operatorname{tax})+20,000}{20,000} \\
& =₹ \frac{2,20,000}{20,000}=11 \text { Times }
\end{aligned}
$$

Illustration 8: From the following information calculate interest coverage ratio:

|  | $₹$ |
| :--- | ---: |
| 10,000 equity shares of ₹ 10 each | $1,00,000$ |
| $8 \%$ Preference Shares | 70,000 |
| $10 \%$ Debentures | 50,000 |
| Long term Loans from Banks | 50,000 |
| Interest on long term loans from bank | 5,000 |
| Profit after tax | 75,000 |
| Tax | 9,000 |

## Solution

$$
\begin{aligned}
& \text { Interest on Debentures = ₹ } 50,000 \times 10 / 100=₹ 5000 \\
& \text { Profit before Interest \& Tax = Profit after tax + Tax + Interest on debentures } \\
& + \text { Interest on Long Term Loans } \\
& =₹ 75,000+9,000+5000+5000=₹ 94,000 \\
& \begin{array}{r}
\text { Interest Coverage Ratio }=\frac{\text { Net Profit before Interest \& Tax }}{\text { Fixed Interest Chareges( Interest on Debentures }} \\
+ \text { Interest on long term loans form Bank) } \\
=94,000 / 10,000=9.4 \text { Times }
\end{array}
\end{aligned}
$$

Illustration9: From the following information compute Debt-Equity Ratio:

|  | ₹ |
| :--- | ---: |
| Long term borrowing | $8,00,000$ |
| Long term provisions | $4,00,000$ |
| Current Liabilities | $2,00,000$ |
| Non-Current Assets | $14,40,000$ |
| Current Assets | $3,60,000$ |

## Solution

Debt Equity Ratio $=\frac{\text { Debt }}{\text { Equity }}$
Debt= Long term borrowing + Long term Provision
= ₹ $8,00,000+4,00,000$
= ₹ $12,00,000$
Equity $=$ Non-Current Assets + Current Assets - Debt-Current Liabilities
= ₹ $14,40,000+3,60,000-12,00,000-2,00,000$
= ₹ $18,00,000-14,00,000$
= ₹ $4,00,000$
Debt Equity Ratio $=\frac{12,00,000}{4,00,000}=3: 1$

## Activity Ratios/Turnover Ratios/Performance Ratios

These ratios measure the efficiency of asset management and measure the effectiveness with which an enterprise uses resources at its disposal. These show rotation of concerned item within an accounting period. Important Turnover ratios are:

1. Stock Turnover Ratio/Inventory Turnover Ratio
2. Debtor Turnover Ratio/Trade Receivables Turnover Ratio
3. Creditors Turnover Ratio/Trade Payables Turnover Ratio
4. Working Capital Turnover Ratio
5. Inventory Turnover Ratio: It is also called as Stock turnover ratio. This ratio shows relationship between the Cost of goods sold i.e., Cost of Revenue from Operations during a particular period of time and the Cost of average inventory during a particular period. It is expressed in number of times.

| Inventory/Stock | turnover |
| :--- | :--- |
| Ratio $=\frac{\text { Cost of Goods Sold(Cost of Revenue from Operations) }}{\text { Average Inventary }}$ |  |

1. Cost of Goods Sold = Opening Stock + Net Purchases + Direct Expenses - Closing Stock

## OR

= Sales (Revenue from Operations) - Gross Profit
2. Cost of Revenue from Operation $=$ Cost of Materials Consumed + Net Purchases of Stock in Trade + Changes in inventories of Finished Goods, Work in Progress and Stock-in-Trade + Direct Expenses
3. Cost of Materials Consumed = Raw Materials Purchased + Changes in inventory of Raw Materials
4. Changes in inventory = Opening Inventory - Closing Inventory
5. Average Inventory $($ Stock $)=\frac{\text { Opening Inventory+Closing Inventory }}{2}$

This ratio indicates whether investment in stock is within proper limit or not.
$>\quad$ This shows how quickly inventory is sold. Generally higher ratio is considered better but very high ratio shows over trading and low ratio means stock is piled up or over investment in stock.

Example 10: Cost of Revenue from Operations is $₹ 5,00,000$. The opening stock is ₹ 40,000 and the closing stock is ₹ 60,000 (at cost). Calculate inventory turnover ratio.

## Solution

Inventory Turnover Ratio $=\frac{\text { Cost of Revenue from operation }}{\text { Average stock }}$
Average Stock $=\frac{\text { Opening Stock }+ \text { Closing stock }}{2}$
$=₹ 40,000+₹ 60,000 / 2=₹ 50,000$
Inventory Turnover Ratio $=₹ \frac{5,00,000}{50,000}=10$ Times

## Illustration 11:

Cost of Revenue from operation= ₹ 2,00,000
Inventory Turnover Ratio= ₹ 8 Times
Inventory in the beginning is 1.5 times more than the inventory at the end. Calculate values of opening and closing inventory.

## Solution:

Inventory Turnover Ratio $=\frac{\text { Cost of Revenue from operation }}{\text { Average stock }}$
$8=₹ \frac{2,00,000}{\text { Average Inventary }}$

Average Inventory $=₹ \frac{2,00,000}{8}=₹ 25,000$

Average Inventory -₹ $25,000=\frac{\text { Opening Inventory }+ \text { Closing Inventory }}{2}$

Opening Inventory + Closing Inventory $=25000 \times 2=$ ₹ 50,000
Let the closing Inventory $=x$
then opening Inventory will be $=x+1.5 x=2.5 x$

$$
\text { Hence } \begin{aligned}
x+2.5 x & =5,0000 \\
3.5 x & =50,000 \\
x & =\frac{50,000}{3.5}=14,286
\end{aligned}
$$

Closing Inventory = ₹ 14,286
Opening Inventory $=14,286 \times 2.5$

$$
=₹ 35,714
$$

Illustration:12 From the following information, calculation Inventory Trunover Ratio.

Net sales ₹ 40,000 , Average Inventory ₹ 5,500 , Gross Loss on sales is $10 \%$.

## Sollution:

Inventory Turnover Ratio $=\frac{\text { Cost of } \text { Revenue from Operations (Cost of goods sold) })}{\text { Average Inventory }}$

$$
=₹ \frac{44,000}{55,00}=8 \text { Times }
$$

Gross Loss $=10 \%$ of $₹ 40,000=₹ 4,000$
Cost of Revenue from operations $=$ Net Sales + Gross Loss

$$
=₹ 40,000+₹ 4,000=₹ 44,000
$$

## 2. Debtors Turnover Ratio/Trade Receivables Turnover Ratio:

It shows the relationship between Net Credit Sales i.e., Net Credit Revenue from Operations and Average Debtors/Average Trade Receivables (Debtors + Bills Receivables).

This ratio is expressed in TIMES.

| Trade Receivable/Debtors Turnover Ratio $=$ |
| :---: |
| $\frac{\text { Net Credit sales(Credit Revenue from Operations) }}{\text { Average Debtor(Average Trade Receivable) }}$ |

> Net Credit Sales = Total Sales - Sales Return (i.e., Returns inwards) - Cash Sales
> Average Trade Receivable $=\frac{\text { (Opening Trade Receivable }+ \text { Closing Trade Receivables) }}{2}$
$>\quad$ Receivable are taken before deducting any Provision for Doubtful Debts.
> If details regarding cash and credit sales are not given, then all the sales are taken on credit basis.
> If details regarding opening and closing values of trade receivable are not given, then closing trade receivables are used for calculation of this ratio.
> This ratio indicates the number of times the trade receivables are turned in relation to credit sales over a year.
> This shows how quickly cash is realized from trade receivables. Generally higher is the ratio, the more efficient is the management of the trade receivables.

Debt collection period or Average Collection Period
Debt collection period $=\frac{365}{\text { Trade Receivables Turnover Ratio }}=$ No. of days
OR
$=\frac{12}{\text { Trade Receivables Turnover Ratio }}=$ Number of months
Illustration13: Calculate Debtors Turnover Ratio if Closing Debtors are ₹ 40,000; Opening Debtors ₹ 60,000 ; Cash Sales is $25 \%$ of Credit Sales and Total Sales are ₹ 2,00,000.

## Solution

Debtors Turnover Ratio $=\frac{\text { Net Credit Sales }(\text { Net Credit Revenue from operations })}{\text { Average Debtors }(\text { Average Trade Receivable })}$
Cash Sales $=25 \%$ of Credit Sales
Let the Credit Sales be ₹ X
Then Cash Sales is $25 \%$ of $X=X \times 25 / 100=X / 4$
Total Sales $=$ Cash Sales + Credit Sales $=X+X / 4=5 X / 4$
₹ $2,00,000=5 x / 4$
X = Credit Sales = ₹ $2,00,000 \times 4 / 5=₹ 1,60,000$
Average Debtors $=($ Opening Debtors + Closing Debtors $) / 2$
$=(60,000+40,000) / 2=50,000$
Debtors Turnover Ratio $=\frac{1,60,000}{50,000}=3.2$ Times

## 3. Creditors Turnover Ratio/Trade Payable Turnover Ratio:

It shows the relationship between Net Credit Purchases and Average Creditors/Average Trade Payables (Creditors + Bills Payable).

This ratio is expressed in TIMES.

$$
\text { Trade Payable (Creditors turnover) Ratio }=\frac{\text { Net Credit Purchase }}{\text { Average Creditors(Average Trade Payable) }}
$$

> Net Credit Purchases = Total Purchases - Purchases Return/Returns Outwards - Cash Purchases.
> Average Trade Payable $=\frac{(\text { Opening Trade Payable }+ \text { Closing Trade Payable })}{2}$
> If details regarding cash and credit purchases are not given then all the purchases are taken on credit basis.
> If details regarding opening and closing values of trade payables are not given, then closing trade payables are used for calculation of this ratio.
> This ratio indicates the number of times the Trade Payables are turned over in relation to credit purchases over a year.
> This shows how quickly cash is paid to Trade Payables. Generally lower ratio indicates that more credits are available for a longer period.

## Average Payment Period

Average payment period $=\frac{365 \text { days or } 12 \text { month }}{\text { Trade } \text { Payable } \text { Turnover Ratio }}$
Illustration:14 Calculate Trade Payable Turnover Ratio from the following information:
₹
Credit Purchase during this year 62,00,000
Purchase Return (out of credit purchase) 2,00,000

| Opening creditors | $10,00,000$ |
| :--- | ---: |
| Opening Bill payable | $2,50,000$ |
| Closing Creditors | $14,00,000$ |
| Closing Bill payable | $3,50,000$ |

## Solution:

Trade Payable Turnover Ratio $=\frac{\text { Net credit } \text { Purchases }}{\text { Average creditors }+ \text { Average } B / P}=\ldots$. Times
Net Credit Purchase $=₹ 6,20,000-₹ 2,00,000=₹ 60,00,000$
Average creditors $B / P=₹ \frac{10,00,000+14,00,000+2,50,000+3,50,000}{2}$
$=₹ 15,00,000$
Trade Payable Turnover Ratio $=₹ \frac{6000000}{1500000}=4$ Times
4. Working Capital Turnover Ratio: It establishes the relationship between Net Working Capital and Revenue from Operations i.e., Net Sales.

Working Capital Turnover Ratio $=\frac{\text { Revenue from Operation }(\text { Net Sales) }}{\text { Net Working Capital }}$
> Net Working Capital = Current Assets excluding Fictitious assets - Current liabilities.
> This ratio can also be calculated on the basis of the Cost of Revenue from Operations i.e., cost of Goods Sold.
$>\quad$ This Ratio is Calculated in Times
> This ratio indicates the number of times the working capital has been turned over in relation to revenue from operations over a year.
> Generally, a higher ratio indicates efficient use of working capital and vice versa.

Illustration: 15 Compute Working Capital Turnover Ratio from the following information:

|  | $₹$ |
| :--- | ---: |
| Cash Sales | $1,30,000$ |
| Credit Sales | $3,80,000$ |
| Sales Return | 10,000 |
| Liquid Assets | $1,40,000$ |
| Inventory | 90,000 |
| Current Liabilities | $1,05,000$ |

## Solution

Working Capital Turnover Ratio $=\frac{\text { Revenue from Operations }(\text { Net Sales })}{\text { Net Working Capital }}$
Net Sales $=$ Cash Sales + Credit Sales - Sales Return
$=1,30,000+3,80,000-10,000=₹ 5,00,000$
Current Assets = Liquid Assets + Inventory
$=1,40,000+90,000=₹ 2,30,000$
Working Capital = Current Assets - Current Liabilities
Working Capital $=2,30,000-1,05,000=₹ 1,25,000$
Working Capital Turnover Ratio $=5,00,000 / 1,25,000=4$ Times

## Profitability Ratio:

These ratios are used to assess the profitability or earning capacity of the business. These ratios are very important as profitability is the measurement of the overall performance and efficiency of the management.

The important Profitability ratios are:

1. Gross Profit Ratio
2. Operating Ratio
3. Operating Profit Ratio
4. Net Profit Ratio
5. Return on Investment or Return on Capital Employed.
$>\quad$ All Profitability ratios are shown in percentage form.
6. Gross Profit Ratio: It shows the relationship between Gross Profit and Net Sales i.e., Net Revenue from Operations.

$$
\text { Gross Profit Ratio }=\frac{\text { Gross Profit }}{\text { Net Sales }(\text { Net Revenue from Operations })} \times 100=\ldots \%
$$

This Ratio indicates the margin of gross profit available on Revenue from Operations. Generally, a higher ratio indicates better profitability.

Illustration:16 Calculate 'Gross Profit Ratio' from the following information:

|  | $₹$ |
| :--- | :---: |
| Net Revenue from Operations | 80,000 |
| Cost of Revenue from Operations | 60,000 |
| Operating Expenses | 10,000 |
| Indirect Expenses | 6,000 |

## Solution

Gross Profit Ratio $=\frac{\text { Gross Profit }}{\text { Net Revenue from Operations }} \times 100$
Gross Profit $=$ Net revenue from operations - Cost of revenue from operations
= ₹ $80,000-60,000=₹ 20,000$
= ₹ $20,000 / 80,000 \times 100=25 \%$
2. Operating Ratio: It shows the relationship between Operating Costs and Net Sales i.e., Net Revenue from Operations.

Operating Ratio $=\frac{\text { Opertaing Cost }}{\text { Net Sales (Net Revenue from Operations) }} \times 100=\ldots \%$

Operating Cost $=$ Cost of Revenue from Operations + Operating Expenses

Operating Expenses = Office and Administration Expenses + Selling and Distribution Expenses+ Depreciation + Bad debts + Discount on Debtors + Interest on Short term loans.

OR
Operating Cost $=$ Cost of Materials Consumed + Net Purchases of Stock in Trade + Changes in Inventories of Finished Goods, Work in Progress and Stock-in-Trade + Direct Expenses + Employees Benefit Expenses + Other

Expenses such as Office Administration Expenses + Selling and Distribution Expenses + Depreciation + Bad debts + Discount on Debtors + Interest on Short term loans.

This ratio indicates the percentage of Operating costs to Revenue from Operations

Generally, a lower ratio indicates better cost management and profitability.
3. Operating Profit Ratio: It shows the relationship between Operating Profit and Net Sales i.e., Net Revenue from Operations.

$$
\text { Operating profit Ratio }=\frac{\text { Operating Profit }}{\text { Net Sales }(\text { Net Revenue from Operations) }} \times 100=\ldots \%
$$

Operating Profit $=$ Net Revenue from Operations $\boldsymbol{-}$ Operating Cost
OR
Operating Profit $=$ Gross Profit $\boldsymbol{-}$ Operating Expenses

OR

## Operating Profit = Net Profit + Non- Operating Expenses - Non Operating Income

> This ratio indicates the margin of operating profits available on Revenue from Operations to cover non-operating expenses such as indirect Expenses and Financial Expenses.
> Generally, a higher ratio indicates better profitability.
$>\quad$ Operating Ratio + Operating Profit Ratio $=1$
Illustration 17: Calculate 'Operating Profit Ratio' and 'Operating Ratio' from the following information:

|  | ₹ |
| :--- | :---: |
| Net Revenue from Operations | 80,000 |
| Cost of Revenue from Operations | 60,000 |
| Operating Expenses | 10,000 |
| Indirect Expenses | 6,000 |

## Solution:

$$
\begin{aligned}
& \text { Operating Profit Ratio }=\frac{\text { Operating Profit }}{\text { Net Revenue from Operations }} \times 100 \\
& \text { Operating Profit }=\text { Net Revenue from Operations }- \text { Operating Cost } \\
& \text { Operating Cost }=\text { Cost of Revenue from Operations }+ \text { Operating Expenses } \\
& =₹ 60,000+10,000=₹ 70,000
\end{aligned}
$$

$$
\text { Operating Profits }=80,000-70,000=₹ 10,000
$$

$$
\text { Operating Profit Ratio }=\frac{10,000}{80,000} \times 100=12.5 \%
$$

$$
\text { Operating Ratio }=\frac{\text { Operating Costs }}{\text { Net Revenue from Operations }} \times 100
$$

$$
=70,000 / 80,000 \times 100=87.5 \%
$$

4. Net Profit Ratio: It shows the relationship between Net Profits and Net Sales i.e., Net Revenue from Operations.

Net Profit ratio $=\frac{\text { Net Profit Before /after Tax }}{\text { Net Sales (Net Revenue from Operations) }} \times 100=\ldots \%$
Net Profit $=$ Net Revenue from Operations $\boldsymbol{-}$ Operating Cost - Non Operating expenses + Non-Operating Income

## OR

## Net Profit = Gross Profit - Operating Expenses - Non Operating Expenses

 + Non-Operating Income
## OR

Net Profit = Operating Profit - Non Operating Expenses + Non-Operating Income
> This ratio indicates the percentage of net profits in relation to Revenue from Operations.
> Generally, a higher ratio indicates better profitability.
Illustration 18: Calculate 'Net Profit Ratio' from the following Information:
₹
Net Revenue from Operations $\quad 80,000$

Cost of Revenue from Operations 60,000
Operating Expenses 10,000
Indirect Expenses 6,000
Indirect Income 4,000
Solution
Net Profit Ratio $=\frac{\text { Net Prof it }}{\text { Net Revenue from Operations }} \times 100$

Net Profit = Net Revenue from Operations - Cost of Revenue from operations Operating Expenses - Indirect Expenses + Indirect Income
$=₹ 80,000-60,000-10,000-6,000+4,000=₹ 8,000$
$=8,000 / 80,000 \times 100=10 \%$

## 5. Return on Investment or Return on Capital Employed:

It shows the relationship between Net Profit before interest, Tax and Dividend and Capital Employed of the business.

> This Ratio indicates the percentage of Net profits before interest, tax and dividend in relation to Capital Employed of the business.
> This Ratio is considered as best measurement of the overall performance of the enterprise.
> Generally, a higher ratio indicates better profitability.
> As we are not including Non Trading Investments as part of Capital Employed Therefore Income from Non Trading Investments will not be taken into account for calculation of Net Profits.
> If profits after tax are given in the question, then we will find profits before tax with the help of the following formula:

Proft before Tax $=\frac{\text { Profit after Tax }}{(100-\text { Tax Rate })} \times 100$
Illustration 19: Calculate 'Return on Investment' with the following information:

| Net Profit after interest and Tax | $2,10,000$ |
| :--- | ---: |
| Rate of income Tax | $30 \%$ |
| Shareholders' Funds | $13,00,000$ |
| $12 \%$ Long term Debts | $1,00,000$ |
| $10 \%$ Debentures | $2,00,000$ |

## Solution

Return on Investment $=\frac{\text { Net Profit before interest,Tax \& Dividend }}{\text { Capital Employed }} \times 100$
Profit before Tax $=$ Profit after Tax $/(100-$ Tax Rate $) \times 100$
$=2,10,000 /(100-30) \times 100=2,10,000 / 70 \times 100=3,00,000$
Profits before Interest, Tax and Dividend = Profits before Tax + Interest on
Long Debts + Interest on Debentures $=3,00,000+12,000+20,000=3,32,000$
Capital Employed $=$ Shareholders' Funds $+12 \%$ Long term debts $+10 \%$

Debentures $=13,00,000+1,00,000+2,00,000=16,00,000$
Returns on Investment $=3,32,000 / 16,00,000 \times 100=20.75 \%$
Illustration 20: The Quick Ratio of $X$ Ltd. is 1:1. State with reason which of the following transactions would (i) increase; (ii) decrease or (iii) not change the ratio:

1. Included in the trade payable was a Bills payable of ₹ 3,000 which was met on maturity.
2. Debentures of ₹ 50,000 were converted into Equity Shares.

## Solution

(1) No Change

Reason: Both current Assets and current Liabilities are decreasing with the same amount.
(2) No Change

Reason:Neither current Assets nor current Liabilities are changing.
Illustration 21: Calculate 'Return on Investment' and 'Debt-Equity Ratio' from the following information:

|  | $₹$ |
| :--- | ---: |
| Net Profit after interest and Tax | $6,00,000$ |
| $10 \%$ Debentures | $10,00,000$ |
| Tax Rate | $40 \%$ |
| Capital Employed | $80,00,000$ |

## Solution

Return on Investment $=\frac{\text { Net Profit before Interest,Tax }}{\text { Capital Employed }} \times 100$
Net Profit Tax before Tax $=\frac{\text { Net Profit after Tax } \times 100}{(100-\text { Tax Rate })}$

$$
=\frac{6,00,00 \times 100}{(100-40)}=₹ 10,00,000
$$

Interest on 10\% Debentures= ₹ $10,00,000 \times \frac{10}{100}=₹ 1,00,000$
Net Profit before Interest and Tax $=₹ 10,00,000+₹ 1,00,000$
= ₹11,00,000

Return on Investment $=\frac{11,00,000}{80,00,000} \times 100=13.75 \%$
Debt - Equity Ratio $=\frac{\text { Debt }}{\text { Equity }}$
Debt $=10 \% \leftarrow$ Debentures $=10,00,000$
Equity = Capital Employed - Debt
$=₹ 80,00,000-10,00,000=₹ 70,00,000$
Debt Equity Ratio $=\frac{10,00,000}{70,00,000}=1: 7$

$$
=0.14: 1
$$

Illustration 22: Complete the Balance Sheet of Raj Ltd. from the following information

## Balance Sheet

As at $31^{\text {st }}$ March, 2015

| Particular | Note no. | Amount ₹ |
| :---: | :---: | :---: |
| I. EQUITY AND LIABILITY <br> 1. Shareholder's Funds: <br> (a) Share Capital <br> (b) Reserve and Surplus <br> 2. Non-current Liabilities - long term borrowings <br> 3. Current Liability - Trade Payables |  | $\begin{aligned} & --- \\ & 50,000 \\ & 14,00,000 \\ & 1,00,000 \end{aligned}$ |
| II ASSETS <br> 1. Non-Current Assets <br> (a) Fixed Assets <br> 2. Current Assets <br> (a) Inventories <br> (b) Trade Receivables <br> (c) Cash and Cash Equivalents |  | $70,000$ |

## Additional Information:

1. Current Ratio is $2: 5: 1$
2. Debt-equity Ratio is $2: 1$
3. Inventory Turnover Ratio is 8 Times
4. Cost of Revenue from operations is ₹ $4,00,000$.

Solution:
(i) Inventory Turnover Ratio $=\frac{\text { Cost of Revenue from Operation }}{\text { Inventory }}$
$8=\frac{4,00,000}{\text { inventor } y}$
Inventory $=\frac{4,00,000}{8}=₹ 50,000$
(ii) Current Ratio $=\frac{\text { Current Assets }}{\text { Current Liability }}$
$2.5=\frac{\text { Current Assets }}{1,00,000}$
Current Assets = ₹ $1,00,000 \times 2.5$
= ₹ $2,50,000$
(iii) Current Assets $=$ Inventories + Trade Receivable + Cash and Cash equivalents
$\therefore$ Cash and Cash Equivalents $=₹ 50,000+₹ 1,20,000$
= ₹ $1,30,000$
(iv) Debt Equity Ratio $=\frac{\text { Debt }}{\text { Equity }}$

$$
\begin{aligned}
2 & =₹ \frac{14,00,000}{\text { Equity }} \\
\text { Equity }=₹ \frac{14,00,000}{2} & =₹ 7,00,000 \\
\text { Equity } & =\text { Share Capital }+ \text { Reserves and Surplus } \\
₹ 7,00,000 & =\text { Share Capital }+50,000 \\
\text { Share Capital } & =₹ 7,00,000-50,000 \\
& =₹ 6,50,000
\end{aligned}
$$

## Balance Sheet

As at $31^{\text {st }}$ March, 2015


Illustration 23: Following is the comparative statement of profit and loss of Ikshika Ltd. for two consecutive years:

## Comparative Statement of Profit \& Loss

For the year ended $31^{\text {st }}$ Mar., 2015 \& 2016

| Particulars | Note No. | 2014-15 | 2015-16 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 1 |  | $\begin{aligned} & 2 \\ & \text { A } \\ & \text { ₹ } \end{aligned}$ | $\begin{aligned} & \hline 3 \\ & \text { B } \\ & \text { ₹ } \\ & \hline \end{aligned}$ | $\begin{gathered} 4 \\ B-A=C \\ ₹ \end{gathered}$ | $\frac{5}{\frac{C}{A} \times 100=\mathrm{D} \%}$ |
| I. Revenue from Operations <br> II. Less: Expenses Cost of material consumed other expenses <br> III. Profit before Tax <br> IV. Less: Tax 40\% Profit after Tax |  |  | $\begin{array}{r} \hline \text { 1,80,000 } \\ \text {--------- } \\ 20,000 \\ -------------- \\ \hline 15,600 \end{array}$ |  |  |

You are required to
(a) Fill in the missing figures in the Comparative statement of profit \& Loss;
(b) Compute the Net Profit Ratio for both the years

## Solution:

Ikshika Ltd.

## Comparative Statement of Profit \& Loss

For the year ended $31^{\text {st }}$ Mar., 2015 \& 2016

| Particulars | Note No. | 2014-15 | 2014-15 | Absolute change | \% Change <br> $\uparrow^{\text {OR }} \downarrow$ |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 1 |  | $\begin{aligned} & 2 \\ & \text { A } \\ & \text { ₹ } \end{aligned}$ | $\begin{aligned} & \hline 3 \\ & B \\ & \text { ₹ } \end{aligned}$ |  | $\begin{gathered} 5 \\ \frac{C}{A} \times 100=\mathrm{D} \% \end{gathered}$ |
| V. Revenue from Operations | , | 1,32,000 | 180,000 | 48,000 | 36.36 |
| Cost of material consumed |  | 1,00,000 | 1,34,000 | 34,000 | 34.00 |
| Other expenses |  | 14,000 | 20,000 | 6,000 | 42.86 |
| Total Expenses (I-III) |  | $\begin{array}{r} 1,14,00 \\ 0 \end{array}$ | 1,54,000 | 40,000 | 35.09 |
| VII. Profit before Tax |  |  |  |  |  |
| VIII. Less: Tax 40\% |  | 18,000 | 26,000 | 8,000 | 44.44 |
| Profit after Tax |  |  |  | $\begin{aligned} & 3,200 \\ & 4,800 \end{aligned}$ | 44.44 |
|  |  | $\begin{array}{r} 7,200 \\ 10,800 \end{array}$ | $15,600$ |  | 44.44 |
|  |  |  |  |  |  |

Profit after $40 \%$ tax is given.
Hence, Profit before tax:
In year 2014-15: 10,800 $\times \frac{100}{60}=₹ 18,000$

In year 2015-16: 15,600 $\times \frac{100}{60}=₹ 26,000$
Total expenses for 2014-15 1,32,000-18,000=₹ 1,14,000
For 2015-16 1,80,000-26,000 $=1,54,000$
(b) Net Profit Ration $=\frac{\text { Net Profit After Tax }}{\text { Revenue Operations }} \times 100$
$2014-15=\frac{10,800}{1,32,000} \times 100=8.18 \%$
$2015-16=\frac{15,600}{1,80,000} \times 100=8.67 \%$
Things to Remember
$>\quad$ What is a Ratio?
It is an arithmetical relationship between 2 variables.
$>\quad$ What is Accounting Ratio?
It is an arithmetical relationship between 2 accounting variables.
> In how many ways a Ratio may be expressed

1. Pure
2. Times
3. \%
4. Fraction
> Give 2 objectives of Ratio Analysis
5. To find out the weak areas of business
6. To help in formulation of plans for future
> List 2 uses of Accounting Ratios
7. To Analyse the financial statements
8. To simplify the Accounting Data
> Write 2 limitations of Accounting Ratios
9. Ignoring Price level changes
10. Ignoring qualitative aspect
> Liquidity Ratios are also known as short term solvency Ratios
> List 2 Ratios included in liquidity Ratios
11. Current Ratio
12. Quick Ratio
> Current Ratio is also known as - working capital Ratio
> Quick Ratio is also called as-Acid test Ratio or Liquid Ratio
Write formula for working capital Ratio
Working capital Ratio $=\frac{\text { Current Assets }}{\text { Current Liabilities }}$
> What are current Assets?
Assets which may be converted into cash or cash equivalent within, 12 months from the date of Balance sheet or operating cycle.
> What are current liabilities?
Liabilities which are to be paid within 12 months from the date of Balance sheet or operating cycle.
> Give examples of current liabilities?
Short term borrowing(including Bank overdraft), trade payables(Bills payables and sundry creditors),other current liabilities.
$>$ What are liquid Assets?
These assets which can be converted into cash or cash equivalents within short period of time.
> Give examples of Liquid Assets
Current investments, trade receivables, cash and cash equivalents, short term loans and advances.
> What do you mean by solvency Ratios?
Those ratios which show whether the business will be able to pay its long term commitment/ payments on time.
> How can we calculate debt?
Debt=long term borrowings
+long term provisions

## OR

=Total Debt-current liabilities
> How to deal with debit balance of statement of P\&L account?
It is to be deducted from equity /shareholders' funds
$>\quad$ What are long term provisions?
Provisions for those liabilities to be paid after 12 months from the date of balance sheet or after operating cycle.
$>\quad$ Give examples of long term provisions?
Employees benefit expenses like provision for gratuity, provision for warranty.
> Activity Ratios are also known as performance Ratios/ turnover Ratios.
> How to deal with change in inventory Add change in inventory if opening inventory>closing inventory.

Subtract change in inventory if opening inventory<closing inventory.
Give a reason for $\boldsymbol{4}$ or $\downarrow \quad$ in gross profit Ratio.

Higher selling price with constant cost of revenue from operation results in ${ }^{4}$ in gross profit ratio.

Higher cost of revenue from operation with constant selling price results in ${ }^{\boldsymbol{*}}$ in gross profit ratio.
> Give examples of non-operating incomes: interest received, dividend received, profit on sale of fixed assets.
> Give examples of non-operating expenses: Interest on long term loans, loss on sale of non-current assets.

## CHAPTER 5

## CASH FLOW STATEMENT

Meaning: It is a statement that shows flow (Inflow or outflow) of cash and cash equivalents during a given period of time.

As per Accounting Standard-3 (Revised) the changes resulting in the flow of cash \& cash equivalent arises on account of three types of activities i.e.,
(1) Cash flow from Operating Activities.
(2) Cash flow from Investing Activities.
(3) Cash flow from Financing Activities.

Cash: Cash comprises cash in hand and demand deposits with bank.
Cash equivalents: Cash equivalents are short-term, highly liquid investment that are readily convertible into known amount of cash and which are subject to an insignificant risk of change in the value e.g. short-term investment. Generally, these investments have a maturity period of less than three months.

Some examples of cash equivalent: Short-term deposits, marketable securities, treasury bills, commercial papers, money market funds, investment in preference shares if redeemable within three months provided that there is no risk of the failure of the company.

Some types of transaction which are considered movement between cash and cash equivalents are given below:

1. Cash deposited into bank.
2. Cash withdrawn from bank.
3. Sale of cash equivalent securities (e.g. Sale of short-term investment, sale of commercial papers)
4. Purchases of cash equivalent securities (e.g. Purchase of short-term investment, Purchases of Treasury bills).

The above types of transaction are part of cash and equivalents, so these are included in opening and closing cash and cash equivalent only. So these types of transaction should not be included in cash flow from different activities like operating, investing, financing activities.

## Cash Flow Statement



Preparation of cash flow statement

| Cash flow from operating activities (A) |  |
| :---: | :---: |
| Cash flow from investing activities (B) | ................ |
| Cash flow from financing activities (C) | ............... |
| Net increase/decrease in cash \& cash equivalent (Total of the above three activities) $(A+B+C)$ | $\ldots$ |
| Add: Cash \& Cash equivalent in the beginning of the year (Given in opening balance sheet) |  |
| Cash \& Cash equivalent at the end of the year | ............. |

Note 1: The student should ensure that the Cash \& Cash equivalent at the end of the year as calculated above will be same as cash \& cash equivalent given in closing balance sheet.

Note 2:A,B.C can have negative balance as well indicating cash used in operating investing \& financing activities respectively.

## Objectives of Cash Flow Statement

1. To ascertain how much cash or cash equivalents have been generated or used in different activities i.e., operating/investing/financing activity.
2. To ascertain the net changes in cash and cash equivalents.
3. To assess the causes of difference between actual cash \& cash equivalent and related net earnings/income.
4. To help in formulation of financial policies such as dividend policy, fixed assets policy, capital structure related policy.
5. To help in short-term financial planning.
6. To ascertain the liquidity of enterprises.

## Limitations of Cash Flow Statement

1. Non cash transactions are not taken into consideration like shares or debentures issued to vendors, depreciation charged during the year.
2. It is a statement related with past data.
3. It is not used for judging the profitability of enterprise.
4. Accrual accounting concept is ignored in this statement e.g. credit sales, credit purchases, outstanding expenses, accrued income are not included.

## Computation of Cash flows from different activities.

(1) Cash flow from operating activities: Operating activities are the main revenue generating activities of the enterprises. It also includes all those transactions which are not included in investing and financing activities.

Indirect Method of calculating the cash flow from Operating Activities: Under this method Net Profit before Tax and Extra-ordinary Item is the starting point for further calculations.

## (A) Calculation of Net Profit before Tax and Extra-ordinary Items:

Difference between closing balance and opening balance of Balance in Statement of Profit \& Loss A/c

## Add: 1. Proposed dividend for current year

$\qquad$
2. Interim Dividend paid during the year $\qquad$
3. Profit Transferred to Reserve $\qquad$
(If reserve of current year increased from previous year) $\qquad$
4. Provision for Taxation made during the year $\qquad$
5. Preference Dividend
6. Extra Ordinary Item if any Debited to Statement of Profit \& Loss

Less: 1. Refund of Tax credited to Statement of P\&L $\qquad$
2. Extraordinary-item if any credited to Statement of P\&L (................)
3. Reserves transferred back to statement of Profit and Loss (.............)

Net Profit before Tax and Extra-ordinary items (................).
Extraordinary items: These items are not related to normal business operation.
Format :Cash Flow from Operating Activities

| Particulars | ₹ |
| :--- | :---: | :---: |
| 1. Cash Flow from Operating Activities |  |
| (A) Net Profit Before Tax and Extra - Ordinary Items (as calculated |  |
| above) |  |
| Adjustment for Non- cash and Non-operating items | $\ldots . . . . . . . . . . . .$. |
| Add: 1. Depreciation charged during the current year | $\ldots \ldots . . . . . . . .$. |
| 2.Preliminary expenses, Discount on issue of debentures, share issue <br> expenses etc. Written off | $\ldots . . . . . . . . . . . .$. |


| 3. Goodwill, Patents and Trademark amortized/written off | .... |
| :---: | :---: |
| 4. Interest on Long term borrowing and Debentures | ................ |
| 5. Loss on sale of Fixed Assets/Investment | (...............) |
| Less: 1. Interest income | (...............) |
| 2. Dividend Income | (...............) |
| 3. Rental income | (..............) |
| 4. Profit on sale of Fixed Assets/Investments | ........... |
| Operating Profit before Working Capital changes |  |
| Adjustment for changes in Working Capital: |  |
| Add: Increase in Current Liabilities and Decrease in Current Assets (other than cash and cash equivalent) | (...............) |
| Less: Increase in Current Assets (other than cash and cash equivalent) and Decrease in Current Liabilities) |  |
| Cash Generated from operations before tax and extraordinary items. | (.........................) |
| Less: income tax paid (Net of Refund received) |  |
| Cash flow before Extraordinary item | ................ |
| Extraordinary items +/- | ................ |
| Net Cash from (or used in) Operating Activities | .............. |

For the calculation of Proposed Dividend during the current year the proposed dividend account is to be prepared as follows:

Proposed Dividend Account

| Dr. |  |  |  |  | Cr. |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Date | Particulars | ₹ | Date | Particulars | ₹ |
|  | To Bank (Dividend Paid during the year) <br> To Balance c/d | $\ldots$ |  | By Balance b/d <br> By Balance in Statement <br> of P\&L A/c <br> (Proposed dividend during the current year) |  |

For the calculations of Provision for Taxation made during the current year, the Provision for Taxation A/c is to be prepared as follows.

## Provision for Taxation Account

Dr. Cr.


Illustration1. X Ltd. made a profit of ₹ $1,00,000$ after considering the following items:

1. Depreciation of fixed assets
₹ 20,000
2. Writing off preliminary expenses
₹ 10,000
3. Loss on sale of furniture
₹ 1,000
4. Provision of Taxation
₹ 1,60,000
5. Transfer to General reserve
₹14,000
6. Profit on sale of Machinery
₹ 6,000

The following additional information is available to you:

| Particulars | 31.03 .2014 <br> $(₹)$ | 31.03 .2015 <br> $(₹)$ |
| :--- | ---: | ---: |
| Debtors | 24,000 | 30,000 |
| Creditors | 20,000 | 30,000 |
| Bills Receivables | 20,000 | 17,000 |
| Bills Payables | 16,000 | 12,000 |
| Prepaid Expenses | 400 | 600 |

Calculate Cash Flow from Operating Activities.

## Solution:

Calculation of Net Profit before Tax and Extra-ordinary items:

| Net Profit (Given) | ₹ $1,00,000$ |
| :--- | ---: |
| Add: Provision for Taxation | ₹ $1,60,000$ |
| Transfer to general reserve | ₹ 14,000 |
| Net Profit before Tax and Extra-ordinary item | ₹ $2,74,000$ |

## Cash Flow from Operating Activities

| Particulars | ₹ | ₹ |
| :---: | :---: | :---: |
| 1. Cash flow from Operating Activities <br> Net Profit Before Tax And Extra-ordinary Item Adjustment for non-cash and non-operating items: <br> Add: Depreciation on fixed assets <br> Preliminary expenses written off <br> Loss on sale of furniture | $\begin{array}{r} 20,000 \\ 10,000 \\ 1,000 \end{array}$ | $2,74,000$ <br> 31,000 |
| Less: Profit on sale on machinery | 6000 | $\begin{array}{r} 3,05,000 \\ (6,000) \end{array}$ |
| Operating Profit before working capital changes <br> Adjustment for Working Capital Changes <br> Add: Increase in creditors <br> Decrease in Bills Receivables | $\begin{array}{r} 10,000 \\ 3,000 \end{array}$ | $2,99,000$ $13,000$ |
| Less: Increase in Debtors <br> Increase in prepaid Expenses | $\begin{array}{r} 6,000 \\ 200 \\ 4,000 \end{array}$ | $\begin{aligned} & 3,12,000 \\ & (10,200) \end{aligned}$ |
| Cash generated from operation before Tax |  | $\begin{array}{r} 3,01,800 \\ (1,60,000) \end{array}$ |
| Less: Income tax Paid <br> Net Cash inflow from Operating Activities |  | 1,41,800 |

## 2. Cash Flow from Investing Activities

Investing activities are those activities which are related to the acquisition (buying) and disposal (selling) of fixed assets and investment (other than cash equivalents). It also includes income from fixed assets and investment like rent received, interest received on investment, dividend received on investment in shares and mutual funds.

| Inflows of Cash: (Plus items) | Outflows of Cash (minus items) |
| :--- | :--- |
| Cash Received from sale of Fixed Assets. | Cash paid for purchase of fixed assets. |
| Cash Received from sale of Investment. | Cash paid for purchase of investment. |
| Cash Received from sale of intangible | Cash paid for purchase of intangible |
| Assets like Patents. | Fixed assets like goodwill, patents and |
| Interest Received, | copy rights. |
| Dividend Received, |  |
| Rent Received |  |

For the calculation of sale or purchase of fixed assets and investment, the following accounts are prepared:

## 1. Fixed Assets Account <br> 2. Investment Account

Fixed Assets Account: Fixed assets accounts may be prepared by two methods:
(a) At written down value method (when provision for depreciation account/ accumulated depreciation account is not maintained):

Fixed Assets Account (at written down value).

| Dr. |  |  |  |  | Cr. |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Date | Particulars | ₹ | Date | Particulars | ₹ |
|  | To Balance b/d <br> To Bank A/c (Additional Purchase) <br> To Profit on sale of fixed assets A/c | $\ldots$ |  | By Bank A/c <br> (Sale of investment) <br> By Depreciation A/c <br> (Depreciation on fixed assets sold) <br> By Loss on sale of fixed assets A/c <br> By Depreciation A/c <br> (Current year Depreciation on remaining fixed assets) <br> By Balance c/d |  |

(b) fixed Assets (at cost); When provision for depreciation account or accumulated depreciation account has been separately maintained. In this method two separate accounts named Fixed Assets Account and Provision for Depreciation account are maintained

## Fixed Assets Account (at original cost)


Provision for Depreciation Account


Preparation of Investment Account:
Dr.
Investment Account
Cr.


Illustration2. From the following information calculate cash flow from investing activities:

| Particulars | 31-03-2014 (₹) | 31-03-2015 (₹) |
| :--- | ---: | ---: |
| Machinery (at Cost) | $5,00,000$ | $5,50,000$ |
| Accumulated Depreciation | $1,00,000$ | $1,20,000$ |
| Patents | $2,00,000$ | $1,20,000$ |
| Goodwill | $1,50,000$ | $1,00,000$ |
| Investment | $2,50,000$ | $5,00,000$ |

## Additional Information

(i) During the year, a machine costing ₹ 50,000 with its accumulated depreciation of ₹ 25,000 was sold for ₹ 20,000 .
(ii) Patents were written off to the extent of ₹ 60,000 and some patents were sold at a profit of ₹ 10,000 .
(iii) $40 \%$ of the investments held in the beginning of the year were sold at $10 \%$ Profit.
(iv) Interest received on investment ₹ 25,500 .
(v) Dividend received on investment ₹ 8,500 .
(vi) Rent received ₹ 5,000 .

## Solution:

Cash Flow from Investing Activities

| Particulars | $₹$ |
| :--- | ---: |
| Proceeds from sale of machinery | 20,000 |
| Proceeds from sale of investment | $1,10,000$ |
| Proceeds from sale of Patents | 30,000 |
| Cash paid for purchase of machinery | $(1,00,000)$ |
| Cash paid for purchase of Investment | $(3,50,000)$ |
| Interest Received | 25,500 |
| Dividend Received | 8,500 |
| Rent Received | 5,0000 |
| Net Cash Used in Investing Activities | $(2,51,000)$ |

## Working Notes:

## Investment Account

Dr. Cr


Machinery Account (at original cost)
Dr.
Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | To Balance b/d <br> To Bank A/c (additional Purchase) (B/F) | $\begin{array}{\|l\|} \hline 5,00,000 \\ 1,00,000 \end{array}$ |  | By Bank A/c | 20,000 |
|  |  |  |  | (Sale of investment) |  |
|  |  |  |  | By Provision for | 25,000 |
|  |  |  |  | Depreciation A/c |  |
|  |  |  |  | By Loss on sale of |  |
|  |  |  |  | Machinery A/c | 5,000 |
|  |  |  |  | By balance c/d | 5,50,000 |
|  |  | 6,00,000 |  |  | 6,00,000 |

Provision for Depreciation Account
Dr.
Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | To Machinery A/c <br> (Total Depreciation on Machinery sold) <br> To Balance c/d | $\begin{gathered} 25,000 \\ 1,20,000 \end{gathered}$ |  | By Balance b/d <br> By Statement of Profit \& Loss <br> (Depreciation charged on machinery during the current year) (B/F) | $\begin{array}{r} 1,00,000 \\ 45,000 \end{array}$ |
|  |  | 1,45,000 |  |  | 1,45,000 |

Patents Account


## 3. Cash Flow from Financing Activities

Financing activities are those activities that result in the change in size and composition of the share capital (equity and preference) and borrowed fund of the business enterprises. Generally cost related to these funds are also included in financing activities like interest paid on loans and debentures and dividend paid on equity and preference share capital.

| Inflows of Cash: (Plus items) | Outflows of Cash (minus items) |
| :---: | :---: |
| 1. Proceeds from Issue of equity shares capital. <br> 2. Proceeds from Issue of preference share capital. <br> 3. Proceeds from taking long-term loan and issue of debentures. <br> 4. Proceeds from Bank Overdraft and Cash credit. | 1. Amount paid for repayment of long-term loan. <br> 2. Redemption of Preference share capital in cash. <br> 3. Redemption of Debenture in cash. <br> 4. Buy back of Equity shares (ExtraOrdinary Item) <br> 5. Payment of Bank Overdraft and Cash Credits. <br> 6. Interest paid on long term loan and debentures <br> 7. Final Dividend paid. <br> 8. Interim dividend paid. <br> 9. Dividend paid on Preference Shares. |

Illustration3. From the following information, calculate the net cash flow from Financing Activities.

| Particulars | $31-3-2014$ <br> $(₹)$ | $31-3-2015$ <br> $(₹)$ |
| :--- | ---: | ---: |
| Equity Share Capital | $10,00,000$ | $16,00,000$ |
| 9\% Debentures | $1,50,000$ | $1,00,000$ |
| Proposed Dividend | $3,00,000$ | $3,50,000$ |
| Dividend Payable | $\ldots \ldots \ldots \ldots \ldots$ | 50,000 |
| 10\% Preference Share Capital | $2,00,000$ | $3,00,000$ |

## Additional Information

1. Interest paid on Debentures ₹ 12,500 .
2. During the year 2014-2015, company issued bonus shares to equity shareholders in the ratio of 2:1 by capitalizing reserve.
3. The interim dividend of $₹ 75,000$ has been paid during the year.
4. $9 \%$ Debentures were redeemed as $5 \%$ premium.

Solution:

## Cash Flow from Financing Activities

| Particulars | $₹$ |
| :--- | ---: |
| Proceeds from Issue of Equity Share Capital | $1,00,000$ |
| Proceeds from Issue of 10\% Preference Share Capital | $1,00,000$ |
| Cash paid for Redemption of 9\% Debentures $(50,000 \times 105 \%)$ | $(52,500)$ |
| Interest paid on Debentures | $(12,500)$ |
| interim Dividend paid | $(75,000)$ |
| Final Dividend paid (3,00,000-50,000) | $(2,50,000)$ |
| Net Cash Used in Financing Activities) | $1,90,000$ |

## Note:

1. Bonus shares worth ₹ $5,00,000$ issued to equity shareholder are not to be shown in the cash flow statement because there is no flow of cash by this activity.
2. If any other information is not given in the question about final dividend paid amount then the previous year proposed dividend is assumed as dividend payable in current year. Current year proposed dividend amount is assumed as proposed dividend in current year and to be added in operating activities to calculated net profit before tax and extraordinary items.
3. Previous year proposed dividend- unpaid dividend $=$ final dividend paid during the current year is cash used in financing activities.
Financing Business Enterprise Transaction Treatment in Cash Flow Statement
Financing business enterprises are the business enterprises which deal in finance like investment companies, mutual fund house, banks. These enterprises purchases and sale of securities as their stock, so it is treated as operating activities and interest received, dividend received and interest paid are considered as routine business activities and included in their operating activities.

Comprehensive Illustration 4: From the following Balance Sheets of X Ltd. as on 31.03.2014 and 31.03.2015. Prepare a cash flow statement.

Balance Sheet as at 31st March, 2014 and 2015


|  |  |  |  |
| :--- | :--- | ---: | ---: |
| II. Assets |  |  |  |
| (1) Non-current assets |  |  |  |
| (a) Fixed assets |  |  |  |
| (i)Tangible Assets |  | 46,700 | 83,000 |
| (2) Current Assets |  |  |  |
| Inventories |  | 11,000 | 13,000 |
| Trade receivables |  | 18,000 | 19,500 |
| Cash and cash equivalents |  | 3,000 | 3,000 |
|  |  | $\mathbf{7 8 , 7 0 0}$ | $\mathbf{1 , 1 8 , 5 0 0}$ |

Notes to Accounts

| Particulars | Figures as at the <br> end of 31.3 .2014 <br> $(₹)$ | Figures as at the <br> end of 31.3 .2015 <br> $(₹)$ |
| :--- | ---: | ---: |
| Note No.1. Reserve and Surplus: General <br> Reserve <br> Balance in Statement of P\&L A/c <br> Total | 15,000 <br> 10,000 | 27,500 <br> 15,000 |

## Additional Information:

(i) Depreciation on fixed assets for the year 2014-15 was ₹ 14,700 .
(ii) An interim dividend ₹ 7,000 has been paid to the shareholders during the year.

## Solution:

| Calculation of Net Profit before Tax and Extraordinary item: | ₹ |
| :--- | ---: |
| Net Profit as per Balance in Statement of Profit \& Loss A/c (15000- | 5,000 |
| $10,000)$ | 12,500 |
| Add: Transfer to General Reserve (27,500 - 15,000) | 7,000 |
| Add: Interim dividend paid during the year | 24,500 |
| Net Profit before Tax and Extraordinary item |  |

## Cash Flow Statement

For the year ended 31st March 2015


Fixed Assets Account


Illustration 5: Prepare a cash Statement on the basis of the information given in the Balance Sheets of Liva Ltd. as at 31.3.2015 and 31.3.2014:

| Particulars | Note No. | $31.3 .2015$ <br> (₹) | 31.3.2014 <br> (₹) |
| :---: | :---: | :---: | :---: |
| I. Equity and Liabilities |  |  |  |
| (1) Shareholders' funds |  |  |  |
| (a) Share capital |  | 2,10,000 | 1,80,000 |
| (b) Reserves and surplus | 1 | 1,32,000 | 24,000 |
| (2) Non-current Liabilities |  |  |  |
| (a) Long term-borrowings |  | 1,50,000 | 1,50,000 |
| (3) Current Liabilities |  |  |  |
| (a) Trade Payables |  | 75,000 | 27,000 |
| Total |  | 5,67,000 | 3,81,000 |
| II. Assets |  |  |  |
| (1) Non-current Assets |  |  |  |
| (a) Fixed Assets |  |  |  |
| (i) Tangible Assets |  | 2,94,000 | 2,52,000 |
| (b) Non-current Investments |  | 48,000 | 18,000 |
| (2) Current Assets |  |  |  |
| (a) Current-Investments (Marketable) |  | 54,000 | 60,000 |
| (b) Inventories |  | 1,07,000 | 24,000 |
| (c) Trade Receivables |  | 40,000 | 17,500 |
| (d) Cash and Cash-equivalents |  | 24,000 | 9,500 |
| Total |  | 5,67,000 | 3,81,000 |

## Notes to Accounts:

Note-1

| Particulars | $2015(₹)$ | $2014(₹)$ |
| :--- | ---: | :---: |
| Reserve and Surplus <br> Surplus (Balance in statement of profit and loss) | $1,32,000$ | 24,000 |

## Solution:

## Cash Flow Statement of Liva Ltd.

For the year ended 31st March 2015 as per AS-3 (Revised)


Illustration 6: From the following information, complete the Cash flow Statement of RK Ltd.

## Cash flow Statement

For the year ended on 31-3-2015

\begin{tabular}{|c|c|c|}
\hline Particulars \& ₹ \& ₹ \\
\hline \begin{tabular}{l}
A. Cash flow from operating Activities: \\
Net profit before tax and Extraordinary items \\
Adjustment for Non-cash and non operating items: \\
Depreciation \\
Loss on sale of Machinery \\
Operating profit before working capital changes \\
Adjustment for charges in working Capital: \\
Capital: \\
Decrease in Trade Payables \\
Increase in Inventory \\
Cash generated from operations before tax \& extraordinary items \\
Less: Income tax paid
\end{tabular} \& \[
\begin{gathered}
\ldots . . . . . . \\
\\
(8,000) \\
(\ldots \ldots . .) \\
\hline 50,000 \\
(\ldots \ldots . .) \\
\hline
\end{gathered}
\] \& \\
\hline \begin{tabular}{l}
B Cash flow from Investing Activities: \\
Purchase of Machinery \\
Sale of Machinery \\
Net cash flow from Investing Activities \\
C . Cash flow from Financing Activities: \\
Proceeds from Issue of Shares \\
Net cash flow from Financing Activities
\end{tabular} \& (.......) \& .........

......... <br>

\hline (A+B+C)net Increase in cash \& Cash Equivalents during the year Add: Cash \& cash equivalents at the beginning of the period Cash \& cash equivalents at the end of the period \& \& | ......... |
| :--- |
| $\ldots \ldots \ldots .$. |
| $\ldots . . . .$. | <br>

\hline
\end{tabular}

Notes to Account

| Particulars | $31-3-2015$ <br> $(₹)$ | $31-3-2014$ <br> $(₹)$ |
| :--- | ---: | ---: |
| Note 1. Reserve \& Surplus |  |  |
| General Reserve | 55,000 | 40,000 |
| Balance in Statement of Profit \& Loss | 70,000 | 50,000 |
|  |  |  |
| Note 2. Cash and Cash equivalents Cash at Bank | $1,25,000$ | 90,000 |
| Note 3. Short term Provisions 52,000 <br> Provision for Taxation 52,000 | 37,000 |  |
|  |  | 27,000 |

## Additional Information:

1. Depreciation charges on Building for the year 2014-15 was ₹ 10,000 .
2. During the year 2014-15, machinery of ₹ $1,38,000$ was purchased.
3. A part of machinery costing ₹ 20,000 with accumulated depreciation of ₹ 6,500 was sold for ₹ 8,500 .
4. Income tax paid during the year 2014-15 was ₹ 18,000 .

Solution:

## Cash flow Statement

For the year ended on 31-3-2015

| Particulars | ₹ | ₹ |
| :---: | :---: | :---: |
| B. Cash flow from operating Activities: <br> Net profit before tax and Extraordinary items <br> Adjustment for Non-cash and non-operating items: <br> Depreciation <br> Loss on sale of Machinery <br> Operating profit before working capital changes <br> Adjustment for charges in working Capital: <br> Decrease in Trade Payables <br> Increase in Inventory <br> Cash generated from operations before tax \& extraordinary items <br> Less: Income tax paid | 58,000 <br>  <br> 10,000 <br> 5,000 <br> 73,0000 <br>  <br> $(8,000)$ <br> $(15,000)$ <br> 50,000 <br> $(18,000)$ |  |
| B Cash flow from Investing Activities: <br> Purchase of Machinery <br> Sale of Machinery | $\begin{gathered} (1,38,000) \\ 8,500 \\ \hline \end{gathered}$ |  |
| C . Cash flow from Financing Activities: <br> Proceeds from Issue of Shares <br> Net cash flow from Financing Activities | 1,12,500 | 1,12,500 |
| $(A+B+C)$ net Increase in cash \& Cash Equivalents during the year Add: Cash \& cash equivalents at the beginning of the period Cash \& cash equivalents at the end of the period |  |  |

## Working Notes

1. Calculation of Net Profit before tax and extraordinary items:

| Difference in Balance in Statement of P\&L (70,000-50,000) | 20,000 |
| :--- | :--- |
| Add: Transfer to General Reserve | 15,000 |
| Provision for Taxation | $\underline{23,000}$ |
|  | $\underline{58,000}$ |

2. Provision for Taxation Account
Dr.
Cr.

| Particulars | ₹ | Particulars | ₹ |
| :---: | :---: | :---: | :---: |
| To Bank A/c (Tax paid) To Balance c/d |  | By balance b/d | 20,000 |
|  | 18,000 | By Statement of P\&L <br> (Balancing Figure- Provision made during the year) |  |
|  | 25,000 |  | 23,000 |
|  | 43,000 |  | 43,000 |

## Note:

1. There is no need to prepare Machinery A/c as both purchase and sale values are given in the question.
2. Proceeds from issue of share have been calculated by moving backwards from the figure of Net Increase in cash \& cash Equivalents i.e.;
i.e. $15,000=$ ₹ $32,000+(129500)+$ Cash flow from financing activity Illustration 7: Following is the Balance sheet of Thermal Power Ltd. as at 31-32013 and 31-3-2014.

| Particulars | 2013-14 (₹) | 2012-13 (₹) |
| :---: | :---: | :---: |
| I. Equity and Liabilities <br> (1) Shareholders' funds |  |  |
| (a) Share capital | 12,00,000 | 11,00,000 |
| (b) Reserves and surplus (Statement of Profit \& Loss) <br> (2) Non-current Liabilities | 300,000 | 200,000 |
| (a) Long term-borrowings <br> (3) Current Liabilities | 240,000 | 170,000 |
| (a) Trade Payables | 1,79,000 | 204,000 |
| (b) Short term provision | 50,000 | 77,000 |
| Total | 19,69,000 | 17,51,000 |
| II. Assets <br> (1) Non-current Assets <br> (a) Fixed Assets |  |  |
| 2013-14 2012-13 |  |  |
|  | 10,70,000 | 8,50,000 |
| Less Depreciation Provision (200,000) (Intangible): Goodwill | 40,000 | 1,12,000 |
| (2) Current Asset |  |  |
| $(150,000)$ |  |  |
| (a) Current-Investments | 2,40,000 | 1,50,000 |
| (b) Inventories | 1,29,000 | 1,21,000 |
| (c) Trade Receivables | 1,70,000 | 1,43,000 |
| (d) Cash and Cash-equivalents | 3,20,000 | 3,75,000 |
| Total | 19,69,000 | 17,51,000 |

## Additional Information:

During the year, a piece of machinery costing 24,000 on which accumulated depreciation was 16,000 was sold for 6,000 . Prepare cash flow statement.
(CBSE 2015)

## Solution:

## Cash flow statement

| $\begin{gathered} \text { S. } \\ \text { No. } \end{gathered}$ | Particulars | Details <br> (₹) | Amount (₹) |
| :---: | :---: | :---: | :---: |
| A | Cash Flow from Operating Activities <br> Net Profit before tax and extraordinary items: <br> (1,00,000Profit + 50,000Provision for tax) <br> Items to be Added <br> Goodwill (Written off) <br> Depreciation (during the year) <br> Loss on sale of Tangible Assets | $\begin{array}{r} 72,000 \\ 66,000 \\ 2,000 \end{array}$ | $1,50,000$ $1,40,000$ |
|  | Operating Profit before working Capital Changes <br> Less: increase in current assets, decrease in current liabilities <br> Decrease in Trade Payables <br> Increase in Inventories <br> Increase in Trade Receivables | $\begin{array}{r} (25,000 \\ (8,000) \\ (27,000) \end{array}$ | 2,90,000 |
|  |  |  | $(60,000)$ |
|  | Less: Tax Paid |  | $\begin{array}{r} 2,30,000 \\ (77,000) \\ \hline \end{array}$ |
|  | Net cash flow from operating activities |  | 1,53,000 |
| B | Cash Flow from Investing Activities: Purchase of Tangible Assets (Machine) Sale of Tangible Assets (Machine) | $\begin{array}{r} (2,94,000) \\ 6,000 \\ \hline \end{array}$ | $(2,88,000)$ |
|  |  | $(2,88,000)$ |  |
| C | Cash Flow from Financing Activities: Issue of Share Capital Issue of Long Term Loan | $\begin{array}{r} 1,00,000 \\ 70,000 \end{array}$ | 1,70,000 |
|  | Net Increase or Decrease in Cash \& Cash Equivalents $(\mathrm{A}+\mathrm{B}+\mathrm{C})$ |  | 35,000 |
| D | Cash \& Cash Equivalents: Opening Balance Current Investment | $\begin{aligned} & 3,75,000 \\ & 1,50,000 \end{aligned}$ | 5,25,000 |
| E | Cash \& Cash Equivalents: Closing balance Current Investment | $\begin{aligned} & 3,20,000 \\ & 2,40,000 \end{aligned}$ | 5,60,000 |

## Note:

1. Cash and Cash Equivalents includes cash and current investment (assuming their maturity to be less than 3 months)
2. Short term provision is assumed as provisions for tax.

Working Notes:
1.

## Machinery A/c

| Particulars | Amount $(₹)$ | Particulars | Amount $(₹)$ |
| :--- | :--- | :--- | :--- |
| To bal B/d | $10,00,000$ | By Depreciation <br> provision | 16,000 |
| To Bank A/c (Balancing <br> Figure) | $2,94,000$ | By Bank (Sale) <br> By loss on sale of <br> Machinery | 2,000 |
|  |  | By bal c/d | 12,000 |
|  | $12,94,000$ |  | $12,94,000$ |

2. 

## Provision for Depreciation A/c

| Particulars | Amount $(₹)$ | Particulars | Amount $(₹)$ |
| :--- | :--- | :--- | :--- |
| To Machinery A/c | 16,000 | By balance b/d | $1,50,000$ |
| To balance c/d | $2,00,000$ | By Statement of Profit <br> \& loss (Depreciation) | 66,000 |
|  |  |  |  |
|  | $2,1,6,000$ |  |  |

Q. P Ltd. earned a profit of ₹ 25,000 after charging the following items:

| S. No. | Particulars | $(₹)$ |
| :--- | :--- | :--- |
| 1. | Depreciation on Fixed Tangible Assets (Machinery) | 20,000 |
| 2. | Loss on Sale of Fixed Tangible Assets (Furniture) | 2,000 |
| 3. | Writing off Goodwill | 9,000 |
| 4. | Provision for Doubtful Debts | 2500 |
| 5. | Provision for Taxation | 35,000 |
| 6. | Transfer to General Reserve | 15,000 |
| 7. | Gain on sale of Fixed Tangible Assets (Machinery) | 8,000 |

The following information about assets and Liabilities is given

| Particulars | 31.3 .2015 <br> $(₹)$ | 31.3 .2016 <br> $(₹)$ |
| :--- | :--- | :--- |
| Trade Receivable (All Good) | 50,000 | 62,000 |
| Trade Payables | 45,000 | 55,000 |
| Inventory | 12,000 | 8,000 |
| Income Received in Advance | 8,000 | $\ldots \ldots$. |
| Outstanding Expenses | 6,000 | 3,000 |
| Prepaid Expenses | $\ldots .$. | 5,000 |

You are required to calculate Cash from operating Activities.
Hints to Answer:
(i) Net profit before Tax and Extraordinary items: ₹ 3,02,500
(ii) Operating profit before working Capital changes: ₹ $3,25,500$
(iii) Cash flow from operation Activities ₹ 2,76,500
Q. 1 When interest is received considered as financing activity?

Ans. Interest received on calls in Arrears is a financing activity.
Q. 2 How is depreciation treated while computing cash flow from operating activity under indirect Method?
Ans. Added to net Profit.
Q. 3 Give an example of activity which remains financing activity for every enterprise?
Ans. Payment of Dividend, Issue of Shares for cash.
Q. 4 Identify the following into:
(i) Operating Activities
(ii) Investing Activities
(iii) Financing Activities
(iv) Cash and Cash Equivalents
(a) Dividend received by finance company
(b) Dividend received by Non-finance company

Ans. (a) Operating Activity
(b) Investing Activity
Q. 5 State any two items cash equivalent uses while preparing cash flow statement

Ans. Treasury Bills, Short term deposits.
Q. 6 'Shri Ltd.' was carrying on a business of packaging in Delhi and earned good profit in the past years. The company wanted to expand its business and required additional funds. To meet its requirement, the company issued equity shares of $₹ 30,00,000$. It purchased a computerised machine of ₹ $20,00,000$. It also purchased raw material amounting to ₹ $2,00,000$.

During current year the Net Profit of the company was ₹ $15,00,000$. Find out cash from operating activities from the above transactions
(CBSE Comptt, 2015)
Sol. ₹ $15,00,000$
Q. 7 Under which type of activity will you classify' Commission and Royalty Received' while preparing cash flow statement.

Ans. Operating Activity
Q. 8 State whether cash deposited in bank will result in inflow, outflow or no flow of cash.

Ans. No flow as cash deposited in bank simply, represents movement between items of cash or cash equivalents.
Q. 9 Under which type of activity will you classify 'sale of shares of another company' while preparing cash flow statement.
Ans. Investing activity
Q. 10 State with reason whether 'Discount received on making payment to suppliers' would result into inflow, out flow or no flow of cash.

Ans. No flow of cash
Reason: Discount received on payment to suppliers does not involve cash.

## QUESTION PAPER

## ACCOUNTANCY

Time allowed: 3 hours
Maximum marks: 80

## General Instructions:

(i) This question paper contains two parts $\mathbf{A}$ and $\mathbf{B}$.
(ii) Part A is compulsory for all.
(iii) Part B has two options- Option-I Analyses of Financial Statements and Option-II Computerized Accounting.
(iv) Attempt only one option of part B.
(v) All parts of a question should be attempted at one place.

PART-A

## (Accounting for Partnership Firms and Companies)

1. What is the maximum number of partners that a partnership firm can have? Name the Act that provides for the maximum number of partners in a partnership firm.
2. $\mathrm{A}, \mathrm{B}$ and C were partners in a firm sharing profits in the ratio of 3:2:1. They admitted $D$ as a new partner for $1 / 8^{\text {th }}$ share in the profits, which he acquired $1 / 16^{\text {th }}$ from $C$.

Calculate the new profit sharing ration of $A, B, C$ and $D$
3. Distinguish between 'Dissolution of Partnership' and 'Dissolution of Partnership Firm' on the basis of 'Economic Relationship'.
4. State the provisions of the Companies Act, 2013 for the creation of 'Debenture Redemption Reserve'.
5. On 1.1.2016 the first call of ₹. 3 per share became due on 1,00,000 equity shares issued by Kamini Ltd. Karan a holder of 500 shares did not pay the
first call money. Arjun a shareholder holding 1000 shares paid the second and final call of ₹ 5 per share along with the first call.

Pass the necessary journal entry for the amount received by opening 'Calls-in-arrears' and 'Calls-in-advance' account in the books of the company.(1)
6. Nusrat and Sonu were partners in a firm sharing profits in the ratio of 3:2. During the year ended 31.3.2015 Nusrat had withdrawn ₹ 15,000. Interest on her drawings amounted to ₹ 300 .

Pass necessary journal entry for charging interest on drawings assuming that the capitals of the partners were fixed.
7. KTR Ltd. issued 365, $9 \%$ Debentures of $₹ 1,000$ each on 4.3.2016. Pass necessary journal entries for the issue of debentures in the following situations:
a) When debentures were issued at par redeemable at a premium of 10\%
b) When debentures were issued at 6\% discount redeemable at 5\% premium.
8. State any three circumstances other than (i) admission of a new partner; (ii) retirement of a partner and (iii) death of a partner, when need for valuation of goodwill of a firm may arise.
9. Sandesh Ltd. took over the assets of ₹ $7,00,000$ and liabilities of ₹ $2,00,000$ from Sanchar Ltd. for a purchase consideration of ₹ $4,59,500$. ₹ 8,500 were paid by accepting a draft in favour of Sanchar Ltd. payable after three months and the balance was paid by issue of equity shares of ₹10 each at a premium of $10 \%$ in favour of Sanchar Ltd.

Pass necessary journal entries for the above transactions in the books of Sandesh Ltd.
10. To provide employment to the youth and to develop the Naxal affected backward areas of Chhattisgarh. X Ltd. decided to set-up a power plant. For raising funds, the company decided to issue $7,50,000$ equity shares of ₹ 10 each at a premium of $50 \%$. The whole amount was payable on application. Applications for 20,00,000 shares were received. Applications for 50,000 shares were rejected and shares were allotted to the remaining applicants on pro-rata basis.

Pass necessary journal entries for the above transactions in the books of the company and identify any two values which X Ltd. wants to propagate. (3)
11. $P$ and $Q$ were partners in a firm sharing profits in the ratio of 5:3. On 1.4.2014 they admitted $R$ as a new partner for $1 / 8^{\text {th }}$ share in the profits with a guaranteed profit of ₹ 75,000 . The new profit sharing ratio between $P$ and $Q$ will remain the same but they agreed to bear any deficiency on account of guarantee to R in the ratio $3: 2$. The profit of the firm for the year ended 31.3.2015 was ₹ $4,00,000$.

Prepare Profit and Loss Appropriation Account of P, Q and R for the year ended 31.3.2015.
12. Alok, Samir and Sagar were partners in firm sharing profit in the ratio of 2:2:1. The firm closes its books on $31^{\text {st }}$ March every year. On 31.12.2015 Sagar died. On that date his capital account showed a credit balance of ₹ $3,80,000$ and Goodwill of the firm was valued at ₹ $1,20,000$. There was a debit balance of ₹ 50,000 in the profit and loss account. Sagar share of profit in the year of his death was to be calculated on the basis of the average profit of last five years. The average profit of last five years was ₹ 75,000.

Pass necessary journal entries in the books of the firm on Sagar death.
13. $L$ and $M$ were partners in a firm sharing profits in the ratio of $2: 3$. On 28.2.2016 the firm was dissolved. After transferring assets (other than cash) and outsiders' liabilities to realization account you are given the following information:
(a) A creditor for ₹ $1,40,000$ accepted building valued at ₹ $1,80,000$ and paid the firm ₹ 40,000 .
(b) A second creditor for ₹ 30,000 accepted machinery valued at ₹ 28,000 in full settlement of his claim.
(c) A third creditor amounting to ₹ 70,000 accepted ₹ 30,000 in cash and investments of the book value of ₹ 45,000 in full settlement of his claim.
(d) Loss on dissolution was ₹ 4,000 .

Pass necessary journal entries for the above transactions in the books of the firm assuming that all payments were made by cheque.
14. Ashok, Bhim and Chetan were partners in a firm sharing profits in the ratio of 3:2:1. Their Balance Sheet as on 31.3.2015 was as follows:

Balance Sheet of Ashok, Bhim and Chetan as on 31.3.2015

| Liabilities | Amount <br> (₹) | Assets | Amount <br> (₹) |
| :--- | ---: | :--- | ---: |
| Creditor | $1,00,000$ | Land | $1,00,000$ |
| Bills Payable | 40,000 | Building | $1,00,000$ |
| General Reserve | 60,000 | Plant | $2,00,000$ |
| Capitals: |  | Stock | 80,000 |
| Ashok $2,00,000$ |  | Debtors | 60,000 |
| Bhim |  | Bank | 10,000 |
| Chetan | 500,000 | 50,000 | $3,50,000$ |
|  |  |  |  |
|  | $5,50,000$ |  | $\mathbf{5 , 5 0 , 0 0 0}$ |

Ashok, Bhim and Chetan decided to share the future profits equally, w.e.f. April 1, 2015. For this it was agreed that:
(i ) Goodwill of the firm will be valued at ₹ $3,00,000$
(ii) Land be revalued at ₹ $1,60,000$ and building be depreciated by $6 \%$.
(iii) Creditors of ₹ 12,000 were not likely to be claimed and hence be written off.

Prepared Revaluation Account, Partners' Capital Accounts and Balance Sheet of the reconstituted firm.
15. On 1.4.2013 JN Ltd. had 10,000, 9\% Debentures of ₹ 100 each outstanding.
(i) On 1.4.2014 the company purchased in the open market 2,000 of its own debentures for ₹ 101 each and cancelled the same immediately.
(ii) On 1.4.2015 the company redeemed at per debentures of ₹ $4,00,000$ by draw of a lot.
(iii) On 28.2.2016 the remaining debentures were purchased for immediate cancellation for ₹ $3,97,000$.

Pass necessary journal entries for the above transactions in the books of the company ignoring debenture redemption reserve and interest on debentures.
16. KS Ltd. invited applications for issuing 1,60,000 equity shares of $₹ 10$ each at a premium of ₹ 6 per share. The amount was payable as follows:

On Application ₹ 4 per share (including premium ₹ 1 per share)
On Allotment ₹ 6 per share (including premium ₹ 3 per share)
On First and Final Call- Balance
Applications for $3,20,000$ shares were received. Applications for 80,000share were rejected and application money refunded. Shares were allotted on pro-rata basis to the remaining applicants. Excess money received with applications was adjusted towards sums due on allotment. Jain holding 800 shares failed to pay the allotment money. His shares were forfeited immediately after allotment. Afterwards the final call was made.

Gupta who had applied for 1200 shares failed to pay the final call. This shares were also forfeited. Out of the forfeited shares 1000 were re-issued at ₹ 8 per share fully paid up. The re-issued shares included all the forfeited shares of Jain.

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

## OR

GG Ltd. had issued 50,000 equity shares of ₹ 10 each at a premium of ₹ 2 per share payable with application money. The incomplete journal entries related to the issue are given below. You are required to complete these blanks.

Books of GG Ltd.
JOURNAL

| Date | Particulars | L.F | Debit Amount (₹) | Credit Amount (₹) |
| :---: | :---: | :---: | :---: | :---: |
| $\begin{aligned} & \text { 2015, } \\ & \text { Jan. } 10 \end{aligned}$ | $\ldots . . . . . .$. Dr. <br> To........... <br> (Amount received on application for 70,000 shares @ ₹ 5 per share including premium) |  |  | .......... |
| Jan. 16 | Equity Share Application A/C Dr. <br> To.. $\qquad$ <br> To $\qquad$ <br> To. $\qquad$ <br> To $\qquad$ <br> (Transfer of application money to share capital securities premium, money refunded for 8000 shares for rejected applications and balance adjusted towards amount due on allotment as shares were allotted on Pro-rata basis. |  |  |  |
| Jan. 31 | $\ldots \ldots \ldots . .$. <br> To $\ldots \ldots .$. <br> (Amount due on allotment @ Rs <br> share) |  | . |  |
| Feb. 20 |  |  | .......... | .......... |


| April 01 |  | $\qquad$$1,500$ |  |
| :---: | :---: | :---: | :---: |
| April 20 | $\ldots \ldots . . . . .$. Dr <br> Calls-in-arrears A/c <br> To $\ldots \ldots \ldots \ldots \ldots \ldots .$. <br> (Money received on first and final call)  |  |  |
| Aug. 27 | $\ldots \ldots \ldots \ldots \ldots$. To $\ldots \ldots \ldots .$. To $\ldots \ldots \ldots .$. (Forfeited the shares on which call money was not received) | ........... |  |
| Oct. 3 | $\ldots \ldots \ldots \ldots \ldots \ldots$. Dr. <br> $\ldots \ldots \ldots \ldots \ldots .$. Dr. <br> To $\ldots \ldots \ldots .$.  <br> (Re-issued the forfeited shares @ <br> share fully paid up)  | ........... | ......... |
| $\ldots$ | To $\qquad$ |  | ........ |

17. $A, B$ and $C$ were partners in a firm sharing profits in the ratio of $3: 2: 1$. On 31.3.2015 their Balance sheet was as follows:

Balance Sheet of $A, B$ and $C$ as on 31.3.2015

| Liabilities | Amount (₹) | Assets | Amount $\text { ( }{ }^{\prime} \text { ) }$ |
| :---: | :---: | :---: | :---: |
| Creditors | 84,000 | Bank | 17,000 |
| General Reserve | 21,000 | Debtors | 23,000 |
| Capitals: |  | Stock | 1,10,000 |
| A 60,000 |  | Investments | 30,000 |
| B $\quad 40,000$ |  | Furniture \& Fitting | 10,000 |
| C $\quad 20,000$ | 1,20,000 | Machinery | 35,000 |
|  | 2,25,000 |  | 2,25,000 |

On the above date $D$ was admitted as a new partner and it was decided that:
(i) The new profit sharing ratio between $A, B, C$ and $D$ will be 2:2:1:1.
(ii) Goodwill of the firm was valued at ₹ 90,000 and D brought his share of goodwill premium in cash.
(iii) The market value of investment was ₹ 24,000 .
(iv) Machinery will be reduced to ₹ 29,000 .
(v) A creditor of ₹ 3,000 was not likely to claim the amount and hence to be written off.
(vi) D will bring proportionate capital so as to given him $1 / 6^{\text {th }}$ share in the profits of the firm.

Prepare Revaluation Account, Partner's Capital Accounts and the Balance Sheet of the reconstituted firm.

OR
$X, Y$ and $Z$ were partners in a firm sharing profit's in the ratio of 5:3:2. On 31.3.2015 their Balance Sheet was as follows.

## Balance Sheet of $\mathrm{X}, \mathrm{Y}$ and Z as on $31^{\text {st }}$ March, 2015

| Liabilities | Amount(₹) | Assets | Amount(₹) |
| :---: | :---: | :---: | :---: |
| Creditors | 21,000 | Land and Building | 62,000 |
| Investment Fluctuation |  | Motor Vans | 20,000 |
| Fund | 10,000 | Investments | 19,000 |
| P \&L Account | 40,000 | Machinery | 12,000 |
| Capitals: |  | Stock | 15,000 |
| $X \quad 50,000$ |  | Debtors 40,000 |  |
| $Y$ 40,000 |  | Less: Provision 3,000 | 37,000 |
| Z 20,000 | 1,10,000 | Cash | 16,000 |
|  | 1,81,000 |  | 1,81,000 |

On the above date Y retired and X and Z agreed to continue the business on the following terms:
(1) Goodwill of the firm was valued at ₹ 51,000 .
(2) There was a claim of $₹ 4,000$ for Workmen's Compensation.
(3) Provision for bad debts was to be reduced by ₹ 1,000 .
(4) Y will be paid ₹8,200 in cash and the balance will be transferred in his loan account which will be paid in four equal yearly instalments together with interest @ 10\% p.a.
(5) The new profit sharing ratio between $X$ and $Z$ will be $3: 2$ and their capitals will be in their new profit sharing ratio. The capital adjustments will be done by opening current accounts.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the reconstituted firm.

## PART -B

## Option-I

## (Analysis of Financial Statements)

18. 'An enterprise may hold securities and loans for dealing or trading purposes in which case they are similar to inventory acquired specifically for resale'. Is the statement correct? Cash flows from such activities will be classified under which type of activity while preparing Cash Flow Statement?
19. Give the meaning of 'Cash Equivalents' for the purpose of preparing Cash Flow Statement.
20. (a) One of the objectives of 'Financial Statements Analysis' is to identify the reasons for change in the financial position of the enterprise. State two more objectives of this analysis.
(b) Name any two items that are shown under the head 'Other Current Liabilities' and any two items that are shown under the head 'Other Current Assets' in the Balance Sheet of a company as per Schedule III of the Companies Act,2013. 2+2=4
21. (a) What is meant by solvency of business?
(b) From the following details obtained from the financial statements of Jeev Ltd., calculate interest coverage ratio:

Net Profit after tax ₹ $1,20,000$
12\% Long -term Debt ₹ $20,00,000$
Tax Rate 40\%
$2+2=4$
22. Following is the statement of Profit and Loss of Sun India Ltd. for the year ended $31^{\text {st }}$ March,2015.

| Particulars | Note No. | 31.3.2015 <br> (₹) | 31.3.2014 <br> (₹) |
| :---: | :---: | :---: | :---: |
| Revenue from operations <br> Other Income <br> Employee benefit-expenses <br> Other expenses <br> Tax Rate |  | $\begin{aligned} & 25,00,000 \\ & 1,00,000 \end{aligned}$ <br> $60 \%$ of total Revenue $10 \%$ of employee benefit expenses 50\% | $\begin{aligned} & 20,00,000 \\ & 5,00,000 \end{aligned}$ <br> $50 \%$ of total Revenue $20 \%$ of employee benefit expenses 40\% |

The motto of sun India Ltd. is to produce and supply green energy in the rural areas of India. It has also taken up a project of constructing a road that will pass through five villages, so that these villages could be connected to the nearby town. It will use the local resources and employ local people for construction of the road.

You are required to prepare a Comparative Statement of Profit and Loss of Sun India Ltd. from the given statement of Profit and Loss. Also identify any two values that the company wishes to convey to the society.
23. Following is the Balance Sheet of K.K. Ltd. as at 31.3.2015
K.K. Ltd. Balance Sheet as at 31.3.2015

| Particulars | Note No. | 31.3.2015 <br> (₹) | 31.3.2014 <br> (₹) |
| :---: | :---: | :---: | :---: |
| I. Equity and Liabilities: |  |  |  |
| (1) Shareholders' Funds: |  |  |  |
| (a)Share Capital |  | 10,00,000 | 8,00,000 |
| (b) Reserves and Surplus | 1 | 4,00,000 | $(1,00,000)$ |
| (2) Non-current Liabilities |  |  |  |
| Long-term borrowings | 2 | 9,00,000 | 10,00,000 |
| (3) Current Liabilities: |  |  |  |
| (a) Short-term borrowings | 3 | 3,00,000 | 1,00,000 |
| (b) Short-term provisions | 4 | 1,40,000 | 1,80,000 |
| Total: |  | 27,40,000 | 19,80,000 |
| (1) Non-current Assets: |  |  |  |
| (a) Fixed Assets |  |  |  |
| (i) Tangible | 5 | 20,06,000 | 14,40,000 |
| (ii) Intangible | 6 | 40,000 | 60,000 |
| (b) Non-current Investments |  | 2,00,000 | 1,50,000 |
| (2) Current Assets |  |  |  |
| (a) Current Investments |  | 1,00,000 | 1,20,000 |
| (b) Inventories | 7 | 2,14,000 | 90,000 |
| (c) Cash and Cash Equivalents |  | 1,80,000 | 1,20,000 |
| Total: |  | 27,40,000 | 19,80,000 |

Notes to Accounts:

| Note | Particulars | $\mathbf{3 1 . 3 . 2 0 1 5}$ | $\mathbf{3 1 . 3 . 2 0 1 4}$ |
| :--- | :--- | :---: | :---: |
| No |  |  |  |
| 1 | Reserves and Surplus <br> (Surplus i.e. Balance in | $4,00,000$ | $(1,00,000)$ |
|  | Statement of Profit and Loss) | $\mathbf{4 , 0 0 , 0 0 0}$ | $\mathbf{( 1 , 0 0 , 0 0 0 )}$ |
|  |  | $9,00,000$ | $10,00,000$ |


| 2 | Long-term borrowings: 12\% Debentures | 9,00,000 | 10,00,000 |
| :---: | :---: | :---: | :---: |
|  |  | 3,00,000 | 1,00,000 |
| 3 | Short -term borrowings <br> Bank Overdraft <br> Short-term provisions <br> Provision for tax | 3,00,000 | 1,00,000 |
| 4 |  | 1,40,000 | 1,80,000 |
|  |  | 1,40,000 | 1,80,000 |
| 5 | Tangible Assets: <br> Machinery <br> Accumulated Depreciations | $\begin{aligned} & 24,06,000 \\ & (4,00,000) \end{aligned}$ | $\begin{aligned} & 16,42,000 \\ & (2,02,000) \end{aligned}$ |
|  |  | 20,06,000 | 14,40,000 |
| 6 | Intangible Assets: Goodwill | 40,000 | 60,000 |
|  |  | 40,000 | 60,000 |
| 7 | Inventories: Stock in trade | 2,14,000 | 90,000 |
|  |  | 2,14,000 | 90,000 |

Additional Information:
(i) $12 \%$ Debentures were redeemed on 31.3.2015
(ii) Tax ₹ $1,40,000$ was paid during the year

Prepare Cash Flow Statement.
(6)

| Q. set no. |  |  | Marking Scheme 2015-16 Accountancy (055) Delhi - 67/1/1 Expected Answers / Value points |  |
| :---: | :---: | :---: | :---: | :---: |
| $\begin{array}{\|l\|} \hline 67 / \\ 1 / 1 \end{array}$ | 67/ | $\begin{aligned} & \hline 67 / \\ & 1 / 3 \end{aligned}$ |  | Distributi -on of marks |
| 1 | 6 | 6 | Q. What is the $\qquad$ firm. <br> Ans <br> - Maximum number of partners: 50 <br> - Companies Act, 2013 | $\begin{gathered} 1 / 2+1 / 2 \\ =1 \\ \text { Mark } \end{gathered}$ |
| 2 | 3 | 5 | Q. A, B and C $\qquad$ C and D. <br> Ans. <br> $\left.\begin{array}{l}\text { A's share }=3 / 6 \\ \text { B's share }=2 / 6-1 / 16=26 / 96 \\ \text { C's share }=1 / 6-1 / 16=10 / 96\end{array}\right\} \quad 1 / 2$ <br> D's share $=1 / 8$ <br> Thus, the New Profit sharing ratio for $\mathrm{A}, \mathrm{B}, \mathrm{C}$ and D will be $\left.\begin{array}{l} =3 / 6: 26 / 96: 10 / 96: 1 / 8 \\ =24: 13: 5: 6 \end{array}\right\} \quad 1 / 2$ | $\begin{gathered} =1 \\ \text { Mark } \end{gathered}$ |
| 3 | 5 | 4 | Q. Distinguish $\qquad$ economic relationship'. <br> Ans. | 1 Mark |
| 4 | 2 | 3 | Q. State the $\qquad$ Redemption Reserve. <br> Ans. According to the provisions of the Companies Act, 2013, the companies are required to create Debenture Redemption Reserve of at least $25 \%$ of the face value of debentures before the redemption of debentures commences. | 1 Mark |





410
[Class XII: Accountancy]


411
[Class XII: Accountancy]

|  |  |  | $\begin{aligned} & \hline \text { Dec } \\ & 31 \end{aligned}$ |  |  | $\begin{aligned} & 20,000 \\ & 20,000 \\ & 10,000 \end{aligned}$ | $\begin{aligned} & \hline 10,000 \\ & 50,000 \end{aligned}$ |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | Dec. $31$ | Profit \& Loss suspense A/c <br> To Vaibhav's Capital A/c <br> (Being Vaibhav's share of profit upto the date of death transferred to his capital A/c) |  | 11,250 | 11,250 | 1 1 |
|  |  |  | $\begin{aligned} & \text { Dec. } \\ & 31 \end{aligned}$ | Vaibhav's Capital A/c <br> Dr. <br> To Vaibhav's executor's A/c <br> (Being amount due to Vaibhav transferred to his executor's A/c) |  | 4,05,250 | 4,05,250 | $=4$ <br> Marks |
| 13 | - | - | $\overline{\text { Q. La }}$ <br> Ans. | nd $M$ were $\qquad$ made by che Journal of $L$ and $M$ |  |  |  |  |
|  |  |  | Date | Particulars | LF | $\operatorname{Dr}\left(\chi^{\prime}\right)$ | Cr (₹) |  |
|  |  |  | (a) | Bank A/c Dr. <br> $\quad$ To Realisation A/c  <br> (Being payment received from  <br> creditors)  |  | 40,000 | 40,000 | $11 / 2$ |
|  |  |  | (b) | No Entry |  |  |  |  |
|  |  |  | (c) | Realisation A/c Dr. To Bank A/c / Cash A/c (Being partial payment made to creditors through cheque) |  | 30,000 | 30,000 | $11 / 2$ 1112 |
|  |  |  | (d) | L's Capital A/c Dr. <br> M's Capital A/c Dr. <br> To Realisation A/c  <br> (Being loss on realisation  <br> transferred to partner's capital A/c) |  | $\begin{aligned} & \hline 1,600 \\ & 2,400 \end{aligned}$ | 4,000 | $\begin{gathered} 11 / 2 \\ =6 \end{gathered}$ <br> Marks |




|  |  |  | $\begin{aligned} & 2016 \\ & \text { Apr } 1 \end{aligned}$ | To Profit on Redemption ofDebentures $\mathrm{A} / \mathrm{c}$(Being redemption of debentures)Profit on Redemption of DebenturesA/c Dr.To Capital Reserve A/c(Being transfer of profit on <br> redemption of debentures to capital <br> reserve) |  | 3,000 | 3,000 | $\begin{gathered} =2 \\ \text { Marks } \\ = \\ 2+2+2 \\ =6 \\ \text { Marks } \end{gathered}$ |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| 16 | 17 | 17 | Q. KS Ltd. $\qquad$ book of KS Ltd. Ans. <br> KS Ltd. Journal |  |  |  |  |  |
|  |  |  | Date | Particulars | LF | Dr (₹) | Cr (₹) |  |
|  |  |  |  | Bank A/c Dr. To Equity Share Application A/c (Being application money received on shares) |  | 1280000 | 1280000 | 1/2 |
|  |  |  |  | Equity Share Application A/c Dr. To Equity Share Capital A/c To Securities Premium Reserve A/c To Bank A/c To Equity share Allotment A/c (Being application money transferred to share capital A/c) |  | 1280000 | $4,80,000$ <br> $1,60,000$ <br> $3,20,000$ <br> $3,20,000$ | 1 |
|  |  |  |  | Equity Share Allotment A/c Dr. To Equity Share Capital A/c To securities Premium Reserve A/c (Being share allotment made due) |  | 9,60,000 | 4,80,000 | 1/2 |
|  |  |  |  |  |  | $\begin{array}{r} \hline 6,36,800 \\ \\ 6,36,800 \\ 3,200 \end{array}$ | 6,36,800 $6,40,000$ | 1 |



| 16 | $\begin{aligned} & 17 \\ & \text { or } \end{aligned}$ | $\begin{aligned} & 17 \\ & \text { or } \end{aligned}$ | Q. CG Ltd. Had $\qquad$ blanks. Ans. <br> CG Ltd. Journal |  |  |  |  | $1 / 2$ |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | Date | Particulars | LF | Dr(₹) | $\mathrm{Cr}(\mathrm{Y})$ |  |
|  |  |  | $\begin{aligned} & 2015 \\ & \text { Jan } \\ & 10 \end{aligned}$ | Bank A/c <br> To Equity Share Application A/c (Being received on application 70,000 shares@ ₹ 5 per share including premium) |  | 3,50,000 | 3,50,000 |  |
|  |  |  | $\begin{aligned} & \text { Jan } \\ & 16 \end{aligned}$ | Equity Share Application A/c Dr. <br> To Equity Share Capital A/c <br> To Securities Premium Reserve A/c <br> To Bank A/c <br> To Equity share Allotment A/c <br> (Transfer of application money to share capital, Securities premium, money refunded for 8000 shares for rejected, applications and balance adjusted towards amount due on allotment as share were allotted on pro rata basis) |  | 3,50,000 | $\begin{array}{\|r\|} \hline 1,50,000 \\ 1,00,000 \\ \\ 40,000 \\ 60,000 \end{array}$ | 1 |
|  |  |  | $\begin{aligned} & \text { Jan } \\ & 31 \end{aligned}$ | Equity Share Allotment A/c Dr. <br> To Equity Share Capital A/c <br> To securities Premium Reserve A/c (Amount due on allotment @ ₹4 per share) |  | 2,00,000 | 2,00,000 | 1/2 |
|  |  |  | $\begin{array}{\|l\|} \hline \text { Feb } \\ 20 \\ \hline \end{array}$ | Bank A/c $\mathbf{D r}$ To equity share allotment A/c (Balance amount received on allotment |  | 1,40,000 | 1,40,000 | 1 |
|  |  |  | $\begin{array}{\|l\|} \hline \text { Apr } \\ 01 \end{array}$ | Equity Share First and Final call A/c Dr. To Equity Share Capital A/c (First and final call money due) |  | 1,50,000 | 1,50,000 | 1 |
|  |  |  | $\begin{aligned} & \text { Apr } \\ & 20 \end{aligned}$ |  |  | $\begin{array}{r} \hline 1,48,500 \\ 1,500 \end{array}$ | 1,50,000 | 1 |





|  |  |  | Q.(b) Name any two items $\qquad$ Companies Act 2013. <br> Ans. (b) <br> Other Current liabilities (Any two) <br> (i) Unpaid Dividend <br> (ii) Interest accrued and due on borrowings <br> (iii) Interest accrued but not due on borrowing <br> (iv) Income received in advance <br> (v) Calls in advance <br> (vi) Interest on calls in advance <br> (vii) Current maturities of long term debts <br> (viii) Application money received for allotment of securities and due for refund and interest due there on. <br> (ix) Unpaid matured deposits and interest accrued there on. <br> (x) Unpaid other matured debentures and interest accrued thereon. <br> (xi)Unpaid other matured payables (outstanding expenses, provident fund payable, ESI payable, CST payable, VAT payable etc.) <br> Other Current Assets (Any two) <br> (i) Prepaid expenses <br> (ii) Accrued incomes <br> (iii) Advance Taxes <br> (iv) Unamortised expenses /losses (to be written off within 12 months from the date of balance sheet) | $\begin{gathered} 1 / 2 x 2 \\ =1 \end{gathered}$ <br> Mark |
| :---: | :---: | :---: | :---: | :---: |
| 21 | - | - | Q. (a) What is meant $\qquad$ of business? <br> Ans. (a) Solvency of business refers to the ability of the business to pay its long term liabilities. <br> Q.(b) From the following $\qquad$ Tax rate @ 40\%. <br> Ans. $\text { Interest Coverage Ratio }=\frac{\text { Net Profit before interest and Tax }}{\text { Fixed Interest Charges }}$ <br> Net Profit after tax $=₹ 1,20,000$ <br> Tax rate $=40 \%$ <br> Net Profit before tax=₹ $1,20,000 \times 100 / 60=₹ 2,00,000$ <br> Add: Interest <br> $12 \%$ Long term debt i.e. $12 / 100 x ₹ 20,00,000=2,40,000$ <br> Profit before Interest and Tax $\quad 4,40,000$ <br> Interest Coverage Ratio $=₹ 4,40,000$ <br> ₹ $2,40,000$ <br> $=1.833$ times | 2 <br> $1 / 2$ <br> 1 <br> $1 / 2$ $=4$ <br> Marks |

421
[Class XII: Accountancy]




