STUDENT STUDY MATERIAL

CLASS XII

ACCOUNTANCY

(055)

SESSION 2023-24

KENDRIYAVIDYALAYASANGATHAN
REGIONAL OFFICE JAIPUR

INSPIRATION

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SYLLABUS
ACCOUNTANCY(CodeNo.055)Class-XII(2023-24)

Theory:80Marks **Time: 3Hours**
Project:20Marks

Units		Periods	Marks
PartA	**AccountingforPartnershipFirmsandCompanies**		
	Unit1.AccountingforPartnershipFirms	105	36
	Unit2.AccountingforCompanies	45	24
		150	**60**
PartB	**FinancialStatementAnalysis**		
	Unit3.AnalysisofFinancialStatements	30	12
	Unit4.CashFlowStatement	20	8
		50	**20**
PartC	**ProjectWork**	20	20
	Projectworkwillinclude:		
	ProjectFile		12
	VivaVoce		8
Or			
PartB	**ComputerizedAccounting**		
	Unit4.ComputerizedAccounting	50	20
PartC	**PracticalWork**	20	20
	Practicalworkwillinclude:		
	ProjectFile		12
	VivaVoce		8

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SuggestedQuestionPaperDesignAccountancy

(CodeNo.055)

ClassXII(2023-24)

Theory:80Marks *Time: 3 Hours*

Project:20Marks

S.No.	TypologyofQuestions	Marks	Percentage
1	**RememberingandUnderstanding**:Exhibitmemoryofpreviouslylearnedmaterialbyrecallingfacts,terms,basicconcepts,and answers. Demonstrateunderstandingoffactsandideasbyorganizing,comparing,translating, interpreting, giving descriptions, andstatingmainideas	44	55%
3	**Applying**:Solveproblemstonew situationsbyapplyingacquiredknowledge,facts,techniquesandrulesina differentway.	19	23.75%
4	**Analysing,EvaluatingandCreating:** Examineandbreakinformationintopartsbyidentifyingmotivesorcauses.Make inferencesandfindevidencetosupportgeneralizations. Present and defend opinions by making judgments aboutinformation, validityof ideas, orqualityofworkbasedonasetofcriteria. Compileinformationtogetherinadifferentwaybycombiningelementsinanewpattern orproposingalternativesolutions.	17	21.25%
	TOTAL	**80**	**100%**

PART-A - ACCOUNTING FOR PARTNERSHIP FIRMS AND COMPANIES

AccountingforPartnership:BasicConcepts

Partnership: Partnershipisarelationbetweenpersonswhohaveagreedtosharetheprofitsofabusinesscarriedonbyalloranyofthemactingforal l.

Features of Partnership

1. Two or more persons 2. Agreement3. Existence of business and profit motive4. Sharing of Profits 5. Business carried on by all or any of them acting for all6. Relationship of Principal and Agent

PartnershipDeed: PartnershipDeedisawrittenagreementamongthepartnersdetailingthetermsandconditionsofthepartnership.

Provisionsof the Indian Partnership Act 1932 intheabsenceofPartnershipDeed:

1.Profitandlossesaretobesharedequallyamongpartners.2.Nointerestistobeallowedoncapital.3.Nointerestistobechargedondrawings.4.Nosalary,commission,remunerationtoanypartner.5InterestonPartner'sloan@6%perannum.

DifferentCasesRelatedtoInterestonCapital:

Case1 Whenpartnershipagreementissilentaboutinterestoncapital-Notallowed.**Case2**Whenpartnershipagreementprovidesthatinterestoncapitalistobeallowed.Situation1Incasethereisaloss Notprovided

Situation2Incasetherearesufficientprofits Fullyallowed

Situation3Iftherearеinsufficientprofits Profitsaretobedistributedintheratioofcapital.

Case3 Whenpartnershipagreementsaysinterestoncapitalistobeprovidedasacharge-Fullyallowed.

Note: InterestonCapitalisalwayscalculatedontheopeningbalanceofcapitalinayear.

Incasethequestiongivesclosingcapital,thenopeningcapitalwillbecalculatedfirstbyusingthefollowingformula

OpeningCapital=ClosingCapital+Drawings–Profit–AdditionalCapital

InterestonPartner'sDrawings:

CaseI.WhenFixedAmountiswithdrawnatFixedintervals

$$\text{InterestonDrawings} = \text{AnnualDrawings} \times \frac{\text{RateofInterest}}{100} \times \frac{\text{AveragePeriod}}{12}$$

	AveragePeriod			
VarioussituationsofDrawings	MonthlyDrawingsfor12months	QuarterlyDrawingsfor12months	Half-yearlyDrawingsfor12months	MonthlyDrawingsfor6months
Whendrawingsaremadeinthebeginningofeachperiod	**6.5**	**7.5**	**9**	**3.5**
Whendrawingsaremadeinthemiddleofeachperiod	**6**	**6**	**6**	**3**
Whendrawingsaremadeintheendofeachperiod	**5.5**	**4.5**	**3**	**2.5**

CaseII.WhenUnequalAmountiswithdrawnatFixeddifferentdates

1. **SimpleMethod:** $\text{InterestonDrawings} = \text{AmountofDrawings} \times \frac{\text{RateofInterest} \times \text{MonthsRemaining}}{100}$

2. **ProductMethod:** $\text{InterestonDrawings} = \text{TotalofProducts} \times \frac{\text{RateofInterest}}{100} \times 1/12$

ProfitandLossAppropriationAccount

Dr. fortheyearended… **Cr.**

Particulars	Rs.	Particulars	Rs.
ToProfitandLossA/c{NetLoss} ToInterestonPartner'sCapitals ToPartner'sSalary ToPartner'sCommission ToGeneralReserve ToProfittransferredtoPartners'Cap./CurrentA/cs		ByProfitandLossA/c{NetProfit} ByInterestonPartner'sDrawings ByLosstransferredtoPartners'Cap./CurrentA/cs	

MethodsofCapitalAccounts:

I. WhenCapitalareFixed:(i)FixedCapitalAccounts(ii)CurrentAccounts

Dr.Partners'CapitalAccountCr.

Particulars	Rs.	Particulars	Rs.
ToCash/BankA/c{WithdrawalofCapital} ToBal.c/d{ClosingCapital}		ByBal.b/d{OpeningCapital} ByCash/BankA/c{AdditionalCapital}	

Dr. Partners'CurrentAccountCr.

Particulars	Rs.	Particulars	Rs.
ToBalanceb/d{incaseofDr.openingBal.} ToDrawingsA/c ToInterestonDrawingsA/c ToPandLAppr. A/c{ShareofLoss,incaseofLoss} ToBalancec/d{Cr.ClosingBalance}		ByBalanceb/d{incaseofCr.openingBal.} ByInterestonCapitalA/c ByPartner'sSalaryA/c ByPartner'sCommissionA/c ByPandLAppr.A/c{ShareofProfit,incaseofProfit}	

II. WhenCapitalareFluctuating:FluctuatingCapitalAccounts

Dr. Partners'CapitalAccountCr.

Particulars	Rs.	Particulars	Rs.
ToBalanceb/d{incaseofDr.openingBal.} ToDrawingsA/c ToInterestonDrawingsA/c ToPandLAppr.A/c{ShareofLoss,incaseofLoss} ToBal.c/d{ClosingCapital}		ByBal.b/d{OpeningCapital} ByCash/BankA/c{AdditionalCapital}ByInterestonCapitalA/c ByPartner'sSalaryA/c ByPartner'sCommissionA/c ByP.andL.Appr.A/c{ShareofProfit,in caseofProfit}	

<u>PastAdjusments:</u>

AdjustmentJournalEntry:

GainingPartners'Capital/CurrentA/c Dr.

ToSacrificingPartners'Capital/CurrentA/c

(Beingpartners'capitalaccountsadjustedforpastadjustment)

<u>Working Note:-</u>

StatementsShowingAdjustmentstobemade

Particulars	**A**		**B**		**Firm**	
	Dr.	**Cr.**	**Dr.**	**Cr.**	**Dr.**	**Cr.**
WrongAppropriation(I)	XXX		XXX			XXX
{Profitswronglycredited}						
CorrectAppropriation(II)				XXX	XXX	
AppropriationstobetakenintoA/c				XXX	XXX	
(i) InterestonCapital(Cr.)		XXX				
(ii) Salary/Commission(Cr.)	XXX	XXX	XXX			XXX
(iii) InterestonDrawings(Dr.)				XXX	XXX	
(iv) NetDivisibleProfitinP/SRatio(Cr.)orDivisibleLoss(Dr.)		XXX				
NeteffectDr./Cr.(I)–(II)	**Dr./Cr.Balance**		**Dr./Cr.Balance**		**NIL**	

<u>GuaranteeofProfittoaPartner:</u>

Sometimes apartner is admittedintothe firm witha guarantee of certain minimum amount by way of his share of profits of thefirm. Such assurance may be given by all the old partners in a certain ratio or by any of the old partners, individually to the newpartner.Theminimumguaranteedamountshallbepaidtosuchnewpartnerwhenhisshareofprofitasperthe profit-sharingratioislessthantheguaranteedamount.

JournalEntry:

Guarantor'sPartner'sCapital/CurrentA/cDr.

ToGuaranteedPartner'sCapital/CurrentA/c

(Beingguaranteeofprofitadjusted)

Difference between fixed capital method and fluctuating capital method

Basis	**Fixed Capital Method**	**Fluctuating Capital Method**
Number of Accounts	Under this method two accounts are maintained for each partner viz.capital account and currentaccount.	Under this method there is only one account for each partner, i.e. capital account.
Adjustments	All adjustments are recorded in a separate account known as current account.	All adjustments are recorded in the capital account itself.
Fixed Balance	The capital account balance remains unchanged unless thereis addition to or withdrawal of capital.	The balance of the capital account fluctuates from year to year.
Credit Balance	The capital accounts always show a credit balance.	The capital account sometimes shows a debit balance.
Appearance in the Balance Sheet	Both capital and current account balance will appear	Only capital account balance appears.

Note: Profit & Loss A/c –> Profit & Loss Adjustment A/c –> Profit & Loss Appropriation A/c (All these accounts are Nominal Account)

Difference between appropriation of profit and charge against profit:

Appropriation of profit	**Charge against profit**
1. It is the distribution of net profit to variousheads like interest on capital, partners salary etc. as per agreement.	1.It should be deducted from revenue to calculate net profit or net loss, takes place in P & L A/C
2. It is possible only if there is profit	2. It should be charged even if there is a loss.
3. It is done after the creation of all charges against profit.	3. It should be done before the appropriation of profit.
4. It is debited to the P & L Appropriation Account.	4. It is debited to Profit and loss account.
5. Eg.Interest on capital, partner's salary, partner's commission ,amount transferred to reserve etc.	5. Eg.staff salary, managers commission, interest on loan, advertisement etc

Q.1 A, B and C are partners in a firm sharing profit in the ratio of 3:2:1. C has guarantee from A and B that his profit will not be less than Rs. 30,000 in any year. The profit for the year ending 31st March, 2020 is Rs. 1,20,000. Pass necessary Journal entries for the above information.

Solution: The actual share of profit of C is = 1/6th of 1,20,000 = 20,000. Therefore, his profit is less than the guaranteed amount of profit Rs. 30,000.

Hence, Rs. 10,000 deficit profit will be sacrificed by A and B in their profit-sharing ratio between them i.e. in 3:2 ratio.

Journal Entries

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
1	Profit & Loss Appropriation A/c Dr.		1,20,000	
	To A's Capital A/c			60,000
	To B's Capital A/c			40,000
	To C's Capital A/c			20,000
	(being profit distributed in 3:2:1 ratio)			
	A's Capital A/c (3/5th of 10,000) Dr.		6,000	
2	B's Capital A/c (2/5th of 10,000) Dr.		4,000	
	To C's Capital A/c			10,000
	(being guarantee of profit adjusted)			

Note: If there is fluctuating capital then adjustment entry will be passed with "Capital Accoun t" instead of "Current Account".

QUESTION BANK

Q1. In the absence of partnership deed, interest on capital is allowed at the rate of:

a) 6% p.a. simple interest b) 6% p.a. compound interest

c) 12% simple interest d) None of the above.

Q2. Rent to a partner is shown in:

a) Dr. side of Profit And Loss Appropriation A/c
b) Cr. side of Profit And Loss Appropriation A/c
c) Dr. side of Profit And Loss A/c
d) Cr. side of Profit And Loss A/c.

Q3. Interest on capital will be paid to the partners if provided for in the partnership deed but only out of:

a) Profits b) Reserves c) Accumulated profits d) Goodwill.

Q4. A and B are partners sharing profits and losses equally. They admitted C as a partner with an equal share giving him a guarantee of minimum Rs.50,000 profit p.a. The profit for the year after C's admission was Rs.1,20,000. What will be the net amount that will be credited to A's Capital A/c?

a) Rs.50,000 b) Rs.40,000

c) Rs.35,000 d) Rs.80,000.

Q5. X and Y are partners sharing profits and losses in the ratio of 3:2 with capitals Rs.5,00,000 each. According to the partnership deed, interest on capital is allowed @ 10% p.a. The profit for the year is Rs. 50,000. What amount will be credited to X and Y in such a condition?

a) Rs.50,000 to A and B each
b) Rs.25,000 to A and B each
c) Rs.30,000 to A and Rs.20,000 to B
d) None of the above.

Q6. P and Q are partners sharing profits and losses in the ratio of 2:1 with capitals Rs.1,00,000 andRs.80,000 respectively. The interest

on capital has been provided to them @ 8% instead of 10%. In the rectifying adjustment entry, Q will be:

a) Debited by Rs.400
b) Credited by Rs.400
c) Debited by Rs.1600
d) Credited by Rs.1600.

Q7. Akhil and Ravi are partners sharing profits and losses in the ratio of 7:3 with capitals ofRs.8,00,000 and Rs.6,00,000 respectively. According to partnership deed interest on capital is to be provided @ 8% p.a. and is to be treated as a charge. Profit for the year is Rs.80,000. Choose the correct option:

a) A will be credited by Rs. 64,000 and B will be credited by Rs. 48,000.
b) A will be credited by Rs. 56,000 and B will be credited by Rs. 24,000.
c) A will be credited by Rs. 22,400 and B will be credited by Rs. 9,600.
d) A will be credited by Rs. 41,600 and B will be credited by Rs. 38,400.

Q8. A and B are partners. B draws a fixed amount at the end of every month. Interest on drawings is charged @15% p.a. At the end of the year interest on B's drawings amounted to Rs.8,250. Drawings of B were:

a) Rs.12,000 p.m. b) Rs.10,000 p.m.

c) Rs.9,000 p.m.d) Rs.8,000 p.m.

Q9. R and S are partners sharing profits in the ratio of 2:1. S has advanced a loan of Rs.1,00,000 to the firm on 1st October, 2020. The net profit earned by the firm for the year ending 31st March, 2021 is Rs. 90,000. What amount will be credited to S's capital account?

a) Rs.60,000 b) Rs.30,000

c) Rs.29,000 d) Rs.32,000.

Q10.

I	Interest on Capital	A	Cr. Side of Profit and Loss Appropriation A/c
II	Interest on Drawings	B	Dr. side of Profit and Loss Appropriation A/c
III	Interest on Partner's Loan	C	Dr. side of Profit and Loss A/c

a) I-A; II-B; III-C b) I-B; II-A; III-C c) I-C; II-B; III-A d) I-B; II-C; III-A

Q11.

I	Rent paid to a partner	A	Charge against profits
II	Salary paid to a partner	B	Appropriations out of profits.
III	Partner's Commission		

a) I-A; II-B; III-B b) I-A; II-A; III-B c) I-A; II-B; III-A d) I-B; II-A; III-B

Case Study Based Questions

Read the following information carefully and answer the questions that follow:

X and Y are partners in 3:2. Their capital balances as on 1st April 2020 amounting to Rs.2,00,000 each. On 1st February, 2021, X contributed an additional capital of Rs.1,00,000. Following are the terms of deed:

a) Interest on capital @ 6% per annum
b) Interest on drawings @ 8% per annum
c) Salary to X Rs.1500 per month
d) Commission to Y @10% on net profit after charging interest on capital, salary and his commission.

Drawings of the partners were Rs.20,000 and Rs.30,000 respectively during the year. Net profit earned by the firm was Rs.2,08,000.

Choose the correct option based on the above information:

Q12. What is the amount of interest on drawings of X and Y:

a) Rs. 1200 and Rs. 1800 respectively
b) Rs. 800 and Rs. 1200 respectively
c) Rs. 1200 and Rs. 800 respectively
d) Rs. 1600 Rs. 2400 respectively

Q13. What is the amount of commission payable to Y?

a) Rs. 15000
b) Rs. 16500
c) Rs. 20800
d) None of these

Q14. What will be the closing capital of X after all adjustments?

a) Rs. 422200
b) Rs. 401400
c) Rs. 300000
d) Rs. 423000

Read the following information carefully and answer the questions that follow:

A, B and C were partners sharing profits in the ratio of 1:2:3. Their fixed capitals on 1st April, 2020 were: A Rs.3,00,000; B Rs.4,50,000 and C Rs.10,00,000. Their partnership deed provided the following:

i. A provides his personal office to the firm for business use charging yearly rent of Rs.1,50,000.
ii. Interest on capitals @8% p.a. and interest on drawings @ 10% p.a.
iii. A was allowed a salary @ Rs. 10,000 per month.
iv. B was allowed a commission of 10% of net profit as shown by Profit and Loss account, after charging such commission.
v. C was guaranteed a profit of Rs.3,00,000 after making all adjustments.

The net profit for the year ended 31st march, 2021 was Rs.10,30,000 before making above adjustments.

You are informed that A has withdrawn Rs.5,000 in the beginning of each month, B has withdrawnRs.5,000 at the end of each month and C has withdrawn Rs. 24,000 in the beginning of each quarter.

Choose the correct option based on the above information:

Q15. Net profit for the year is:

a) Rs.10,30,000 b) Rs.11,80,000
c) Rs.7,30,000 d) Rs.8,80,000

Q16. What will be the divisible profit?

a) Rs.5,56,000 b) Rs.5,50,000

c) Rs.5,52,000 d) Rs.5,53,000.

Q17. What will be the commission of B?

a) Rs.8,00,000 b)Rs.96,000

c) Rs.80,000 d) Rs.72,000.

Q18. **Assertion (A):** In the absence of Partnership deed profits and losses are divided equally among the partners.

Reason(R): This rule is applicable according to Indian partnership Act, 1932.

a) Both (A) and (R) are true and (R) is the correct explanation of (A)
b) Both (A) and (R) are true and (R) is not the correct explanation of (A)
c) (A) is true, bur (R) is false
d) (A) is false, but (R) is true.

Q19. **Assertion (A):** Personal properties of a partner may also be used to pay off the firm's debts.

Reason(R): All partners have limited liability in the firm.

a) Both (A) and (R) are true and (R) is the correct explanation of (A)
b) Both (A) and (R) are true and (R) is not the correct explanation of (A)
c) (A) is true, but (R) is false
d) (A) is false, but (R) is true.

Q20. **Assertion (A):** Partnership firm is a form of organisation where two or more persons carry on business activity on the basis of agreement among them.

Reason(R): The profit or loss arising from the partnership business is shared by the partners in the agreed ratio.

a) Both (A) and (R) are true and (R) is the correct explanation of (A)
b) Both (A) and (R) are true and (R) is not the correct explanation of (A)
c) (A) is true, but (R) is false
d) (A) is false, but (R) is true.

Q21. **Assertion (A):** Rent to partner is not shown in Profit and Loss Appropriation Account.

Reason(R): Rent to a partner is a charge against profit..

a) Both (A) and (R) are true and (R) is the correct explanation of (A)
b) Both (A) and (R) are true and (R) is not the correct explanation of (A)
c) (A) is true, but (R) is false
d) (A) is false, but (R) is true.

Q22. **Assertion (A):** Interest on Partner's capital may be shown in Profit and Loss Account.

Reason(R): If Partners treat interest on capital as a charge.

a) Both (A) and (R) are true and (R) is the correct explanation of (A)
b) Both (A) and (R) are true and (R) is not the correct explanation of (A)
c) (A) is true, but (R) is false
d) (A) is false, but (R) is true.

Q23. **Assertion (A):** Rent payable to partner is credited to Partner's Capital account.

Reason(R): Rent is payable to partner for letting the firm use his personal property for business.

a) Both (A) and (R) are true and (R) is the correct explanation of (A)
b) Both (A) and (R) are true and (R) is not the correct explanation of (A)
c) (A) is true, but (R) is false
d) (A) is false, but (R) is true.

Q24. **Assertion (A):** For calculating Interest on Drawings, product method is used.

Reason(R): Partners withdraw different amounts of money at different intervals of time.

a) Both (A) and (R) are true and (R) is the correct explanation of (A)
b) Both (A) and (R) are true and (R) is not the correct explanation of (A)
c) (A) is true, but (R) is false
d) (A) is false, but (R) is true.

Q25. **Assertion (A):** Guarantee of minimum profit may be given to a partner**.**

Reason(R): It is compulsory as per Indian Partnership Act, 1932.

a) Both (A) and (R) are true and (R) is the correct explanation of (A)

b) Both (A) and (R) are true and (R) is not the correct explanation of (A)
c) (A) is true, but (R) is false
d) (A) is false, but (R) is true.

Answer Key and Explanation of the answer

Q.NO.	Answer	Reason/Hint/Explanation
1	D	Interest on Capital is not allowed if there is no partnership deed.
2	C	Rent to a partner is a charge against profit.
3	A	Since Interest on capital is an appropriation out of profits, it is paid only out of profits.
4	C	Share of A in profit= 40,000 less Deficiency paid to C=5,000. So net amount received by A=35,000.
5	B	Interest payable to A and B=50,000 each. So the profit will be divided in an equal ratio between A and B. When appropriations are more than profits then the available profit is distributed between the partners in the ratio of net amount payable to them.
6	B	Q will be credited by Rs.1,600 (interest@2% to be given to Q) and Q will be debited by Rs.1,200(share of Q in loss to the firm). So, finally Q will be credited with Rs.400.
7	D	IOC to Akhil= Rs.64,000 less share of loss= Rs.22,400 (32,000*7/10). Net amount paid to Akhil= Rs.41,600. IOC to Ravi= Rs.48,000 less share of loss= Rs.9,600 (32000*3/10). Net amount paid to Ravi= Rs.38,400.
8	B	8,250*(100/15)*(12/5.5) =1,20,000/12= 10,000.
9	C	Net profit of the firm=90,000-3,000(interest on loan) = 87,000. S's share in profit=87,000*1/3= 29,000. Only share of profit is credited to Partner's Capital a/c, interest on loan is credited to Partner's Loan A/c.
10	B	IOC is transferred to Dr. side of P& L Appropriation A/c; IOD to Cr. Side of P & L Appropriation A/c and Interest on Partner's Loan to the Dr. side of P & L A/c.
11	A	Rent paid to a partner is a charge against profit; Salary and commission paid to a partner are both appropriations out of profits.
12	B	IOD will be calculated for an average period of six months since time of drawings are not given.
13	A	2,08,000-13,000-12,000(IOC)-18,000(salary)= 1,65,000*10/110= 15,000.
14	B	Closing capital of X= 2,00,000(opening capital)+1,00,000(addl. capital)+13,000(IOC)+18,000(salary)+91,200(profit share)-20,000(drawings)- 800(IOD)= 4,01,400.
15	D	10,30,000-1,50,000(rent to the partner)= 8,80,000
16	B	IOD for A= 60,000*10/100*6.5/12=3,250 IOD for B=60,000*10/100*5.5/12=2,750 IOD for C=16,000*10,100*7.5/12=6,000. Total IOD= 3,250+2,750+6,000= 12,000.
17	C	8,80,000(N.P.) +12,000(IOD)-24,000-36,000-80,000(IOC)-80,000(commission)-1,20,000(salary)= 5,52,000.

18	A	In the absence of partnership Deed, profits are shared equally among the partners, as per the provisions of Indian partnership act, 1932.
19	C	All partners have unlimited liability.
20	B	Both the statements are two different facts.
21	A	Charge against profit is shown in the P & L account.
22	A	Charge against profit is shown in the P & L account.
23	D	Rent payable to a partner is not shown in the Capital account; it is shown in the Rent payable account.
24	A	Both the statements are true and R is the correct explanation of A.
25	C	Guarantee of minimum profit to a partner depends on mutual consent of partners, it is not compulsory.

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Reconstitution of Partnership- Change in Profit sharing Ratio

Goodwill: Nature and Valuation

Meaning: - Goodwill is good name or the reputation of the business, which is earned by a firm through the hardwork and honesty of its owners. If a firm renders good service to the customers, the customers who feel satisfied will come again and again and the firm will be able to earn more profits in future.

Thus, goodwill is the value of the reputation of a firm which enables it to earn higher profits in comparison to the normal profits earned by other firms in the same trade.

Features of Goodwill

1. It is an intangible asset.2. It is a valuable asset3. It is helpful in earning excess profits.4. Its value is liable to constant fluctuations.
5. It is valuable only when entire business is sold.6. It is difficult to place an exact value on goodwill.

Need for Valuing Goodwill:

Whenever the mutual rights of the partners change the party which makes a sacrifice must be compensated. This basis of compensation is goodwill so we need to calculate goodwill.

Factors Affecting the Value of Goodwill

1. Efficient management2. Quality of products3. Location of business 4. The Longevity of the business 5. Monopolistic and other Rights

ValuationofGoodwill: -

Averageprofitmethod:-AverageprofitxNumberofyearspurchase

Averageprofit: -Sumtotalofprofitsorloss/Numberofyears

Superprofitmethod: -superprofitxnumberofyearspurchase

Superprofit:Averageprofit-Normalprofit

Normalprofit: CapitalEmployedxNormalrateofReturn/100

QUESTION BANK

1. Under the capitalisation method, the formula for calculating the goodwill is

A) Super profits multiplied by the rate of return

B) Average profits multiplied by the rate of return

C) Super profits divided by the rate of return

D) Average profits divided by the rate of return

Answer: C

2. The total capital employed in the company is ₹8,00,000 a reasonable rate of return is 15% and the profit of the year is 12,00,000. The

value of goodwill of the company as per the capitalisation method will be

A) ₹ 82,00,000 B) ₹ 12,00,000 C) ₹ 72,00,000 D) ₹ 42,00,000

Answer: C

3. A firm earns ₹1,00,000. The normal rate of return is 10%. The assets of the company amounted to ₹11,00,000 and liabilities to ₹1,00,000. Value of goodwill by the capitalisation of average actual profit will be

A) ₹ 2,00,000 B) ₹ 10,000 C) ₹ 5,000 D) ₹ 1,00,000

Answer: D

4. When there is a change in the current partners' association that results in ending the existing agreement and initiate a formation of a new agreement is known as

A) Revaluation of Partnership B) Reconstitution of Partnership C) Realisation of Partnership D) None of the Above

Answer: B

5. X, Y, and Z are partners in a company sharing profits in the ratio 4:3: 2. Their balance sheet as at 31-3-2018 showed a debit balance of Profit and Loss A/c ₹1,80,000. From 1-4-2018 they will share profits equally. In the journal entry to give effect to the above arrangement when X, Y, and Z decide not to close the profit and loss account.

A) Dr X by ₹ 20,000, Cr Z by ₹20,000 B) Cr X by ₹ 20,000, Dr Z by ₹20,000

C) Dr X by ₹ 40,000, Cr Z by ₹40,000 D) Cr X by ₹ 20,000, Dr Z by ₹20,000

Answer: B

6. (Average Profit Method): Akansha, Chetna and Dipanshu are partners in a firm shring profits and losses in the ratio of 3:2:1. They decide to lake jatin into partnership form January 1, 2015 for1/5 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	(Rs.)
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 × Number of years of purchase

Year	(Rs.)
2012	96,000
2013	60,600
2014	62,400
2015	84,400
Total Profits	**Rs. 3,03,400**

Average profit = 3,03,400/4 = Rs. 75,850

Goodwill = $75,850 \times 2$ = Rs. 151,700

7: The profits of a firm for the last five years were:

Year →	2011	2012	2013	2014	2015

Profits (Rs.)	**45,000**	**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 and 2015-5

Solution:

Year	Profit (Rs.)	Weights	Weights Profit $\times$ Weight
2011 2012 2013 2014 2015	43,000 50,000 52,000 65,000 85,000	1 2 3 4 5	43,000 1,00,000 1,56,000 2,60,000 4,25,400
Total		15	9,84,400

Weighted Average Profit: = $\frac{Total\ product\ of\ profits}{Total\ of\ weights}$ = $\frac{9,84,000}{15}$ = 65,600

Goodwill = Weighted Average Profit $\times$ No. of years of purchase.

Rs. 65600×2 = Rs. 1,31,200

8: (Super Profit Method)

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

Year	2012-13	2013-14	2014-15
Profits (Rs.)	**36,000**	**40,000**	**44,000**

The capital investment of the firm is Rs. 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 : $\frac{36,000+40,000+44,000}{3}$ = Rs. 40,000

Normal profit = $\frac{Capital\ Employed \times Normal\ Rate\ of\ Return}{100}$

Normal profit = $\frac{1,20,000 \times 10}{100}$ = Rs. 12,000

Super profit = Average profit – Normal profit

= Rs. 40,000 – 12,000 = Rs. 28,000

Goodwill = Super profit $\times$ No. of years of purchase.

= Rs. $28,000 \times 3$ = Rs. 84,000

---

9. (Capitalisation Method): A earns Rs. 1,20,000 as its annual profits, the rates of normal profit being 10%. The assets of the firm amounted to Rs. 14,40,000 and liabilities to Rs. 4,80,000. Find out the value of goodwill by capitalization method.

Solution:

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

= Rs. $\frac{1,20,000 \times 10}{100}$ = Rs. 12,00,000

Capital employed = Total assets – liabilities

= Rs. 14,40,000 – 4,80,000 = Rs. 9,60,000

Goodwill = Capitalised value – Capital Employed

= Rs. 12,00,000 – 9,60,000 = Rs. 2,40,000

---

10. (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 year's purchase of the average normal profits of the last three years which were Rs. 10,000, Rs. 15,000 and Rs. 30,000 respectively. Second years profit included profit on sale of Machinery Rs. 10,000. Find the value of goodwill of the firm on C's Admission.

Solution:

(1) Calculation of Average Profit:

Year ended Rs.

1st Year10,000

2nd Year (Rs. 15,000 – Rs. 10,000)5,000

3rd Year30,000

Total ProfitsRs. 45,000

Average profit = $\frac{Total\ profit}{No.of\ years} = \frac{45000}{3}$ =Rs. 15,000

Goodwill = Average profit $\times$ No. of years of purchase

= 15000×2 = Rs. 30,000

---

11. (Super profit method): The average net profits expected of a firm in future are Rs. 68,000 per year and capital invested in the business by the firm is Rs. 3,50,000. The rate of interest expected from capital invested in this class of business in 12 %. The remunerating of the partners is estimated to be Rs. 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 =Rs. 68,000 – Rs. 8,000 = Rs. 60,000

(ii) Normal profit = $\frac{Capital\ employed \times Normal\ rate\ of\ return}{100}$

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

(iii)Super Profit = Average profit – Normal profit

= Rs. 60,000 –Rs. 42,000 = Rs. 18,000

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

= Rs. $18,000 \times 2$ = Rs. 36,000

---

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

Solution:

(1) Calculation of Normal Profit

= $\frac{Capital\ employed \times Normal\ rate}{100}$

= $\frac{75,000 \times 20}{100}$ = Rs. 15,000

(2) Calculation of Super Profit:

Goodwill = Super profit $\times$ No. of years' of purchase

Rs. 24,000 = Super profit $\times$ 4

Super profit = $\frac{24,000}{4}$ = Rs. 6,000

(3) Calculation of Average Profit:

Super Profit = Average profit – Normal profit
Rs. 6,000 = Average Profit – Rs. 15,000
Average Profit Rs. 6,000, Rs. 15,000, Rs. 21,000
(B) Capitalisation of super profit method: Under this method, goodwill is calculated by capitalizing the super profit on the basis of Normal Rate of Return.

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

13: M/s Aradhya having the assets of Rs 10,00,000 and Liabilities of Rs 4,20,000. The firm earns the annual profit of Rs. 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 = Rs. 90,000

Normal Profit = $Capital\ Employed \times \frac{Normal\ Rate\ of\ Return}{100}$
Capital Employed = Total Assets – Outside's Liabilities
= Rs. 10,00,000 –Rs. 4,20,000
= Rs. 5,80,000

Normal Profit = Rs. $5,80,000 \times \frac{15}{100}$
= Rs. 87,000
Super Profits = Rs. 90,000 – Rs. 87,000
= Rs. 3,000

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

= $3,000 \times \frac{100}{15}$
Ans : Goodwill = Rs. 20,000
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 taken place**5.** when partnership firm is sold.

ReconstitutionofPartnershipAnychangeintheexistingagreementofpartnershipiscalledreconstitutionofafirm.**ModesofReconstitution**

1) Changeinprofitsharingratio
2) Admissionofanewpartner
3) Retirementofanexistingpartner
4) Deathofapartner
5) Amalgamationoftwopartnershipfirm.
6) Changeinprofitsharingratio

Whenoneormorepartnersacquireaninterestinthebusinessfromanotherexistingpartner.Itissaidtobeachangeinprofitsharingratio.
Newprofit-sharingratio-Itistheratioinwhichpartnersaretoshareprofits/lossesinfuture.

Sacrificingratio-Itisratioinwhichthepartnerhastoagreetosacrificetheirshareofprofitinfavourofanotherpartner.

SacrificeRatio=Oldratio-Newratio

Gainingratio-Itisratioinwhichthepartnerhastoagreetogaintheirshareofprofitfromanotherpartner.

GainingRatio=Newratio-Oldratio

AccountingtreatmentofGoodwillatthetimeofchangeinratio

I)Forwriting-offgoodwillappearinginthebalancesheet	Allpartner'scapital/currentA/c Dr. ToGoodwillA/c	Inoldratio
II)ForrecordingofGoodwillwithoutopeninggoodwillaccount	Gainingpartner'scapital/currentA/c.Dr. Tosacrificingpartner'scapital/currentA/c	InGR InSR

AccountingtreatmentofAccumulatedprofits,Reservesandlosses

Whenwanttotransfer/distributeornospecific informationisgiven	a. FortransferofreservesandaccumulatedprofitsReserves/ profitsA/c. Dr.Workmen compensation Res. A/c .Dr. InvestmentfluctuationRes.A/c. Dr. Toallpartner'scapital/currentA/c b. Fortransfersofaccumulatedlosses. Allpartner'scapital/currenta/c. Dr. ToProfitandlossa/c. ToadvertisementsuspenseA/c. TodeferredRevenueExpenditureA/c	In oldRatio
Whendon'twanttotransfer/distribute orasktopasssinglejournalentry	Gainingpartner'scapital/currentA/c. Dr. Tosacrificingpartner'scapital/currentA/c(Withtheamountofneteffect)	In GRIn SR

AccountingtreatmentofRevaluationofAssetsandLiabilities

I) whenrevisedvaluesaretoberecordedinthebooks:

Dr. RevaluationAccount Cr.

Particulars	₹	Particulars	₹
ToDecreaseinvalueofassetsToIncreaseinvalueofliabilitiesToUnrecordedliabilities ToProfittransferredtooldpartners'capital/currentA/c	.... ______ ______	ByIncreaseinvalue of assetsByDecreaseinvalueofliabilities ByUnrecordedassets ByLosstransferredtooldpartners' capital/currentA/c	.... ______ ______

Whenrevisedvaluesarenottoberecordedinthebooksofaccounts:(singleentrywillbepass)Firstly,calculate theneteffectthroughworkings

ForProfitonRevaluation	Gainingpartner'scapital/currentA/c. Dr. ToSacrificingpartner'scapital/currentA/c(Withtheamountofneteffect)
ForLossonRevaluation	Sacrificingpartner'scapital/currentA/c. Dr. ToGainingpartner'scapital/currentA/c.

Question Bank

Q.1 If at the time of Change in profit sharing ratio, there is some unrecorded asset, it will be __________to ______________ Account.

(a) Debited, Revaluation (b) Credited, Revaluation

(c) Debited, Goodwill (d) Credited, Partners' Capital

Q.2 When Goodwill treatment is made at the time of change in profit sharing ratio. goodwill account is__________________.

(a) Never be raised in the book (b) Be raised in the book

(c) Be partially raised in the books (d) Be raised as per the agreement of the partners.

Q.3 At the time of change in profit sharing ratio, amount remaining in Investment Fluctuation Reserve after meeting the fall in value of Investment is:

(a) Credited in Sacrificing Ratio (b)Credited in New Profit Sh. Ratio
(c) Credited in Old Profit-Sharing Ratio (d) Credited in Gaining Ratio

Q.4P, Q and R were partners in a firm in the ratio of 5:4:3. It is agreed that Q would retain his original share. If P & R future share will be the equal than who will be sacrificed for whom.

(a) P to R (b) R to P
(c) No Sacrifice (d) None of the above

Q.5 Accumulated Losses or deferred Revenue expenditure (Advertisement suspense) are transferred to partners' capital accounts at the time of reconstitution in:

(a) Old profit-sharing ratio (b) Sacrificing Ratio
(c) Gaining ratio (d) New profit-sharing ratio

Q.6 Revaluation account is debited, when________________.

(a) Value of liability is Increases (b) Value of assets is Decreasing.
(c) Both (A) & (B) (d) Either (A) or (B)

Q.7 Amit and Bimal are partners in a firm sharing profits in the ratio of 3: 2. They decided to share future profits 2/3 and 1/3. Calculate Amit's gain or sacrifice

(a) 1/15 (gain) (b) 5/10 (gain)
(c) 1/10 (Gain) (d) 1/15 (sacrifice)

Q.8 A, B and C were partners in a firm sharing profits in the ratio of 3:4:1. They decided to share profits equally w.e.f from 1 .4.2019. On that date the profit and loss account showed a credit balance of 96,000. Instead of closing the profit and loss account, it was decided to record an
adjustment entry reflecting the change in profit sharing ratio. In the journal entry:

(a) Dr. A by 4,000; Dr. B by 16,000; Cr C by 20,000 (b) Cr. A by 4,000; Cr. B by 16,000; Dr C by 20,000
(c) Cr. A by 16,000; Cr. B by 4,000; Dr C by 20,000 (d) Dr. A by 16,000; Dr. B by 4,000; Cr C by 20,000

Q.9 P, Q and R were partners in a firm sharing profits in 5 : 3 : 2 ratio. They decided to share the future profits in 2 : 3 : 5. For this purpose the goodwill of the firm was valued at ₹1,20,000. In adjustment entry for the treatment of goodwill due to change in the profit sharing ratio :

(a) Cr. P by ₹24,000; Dr. R by ₹24,000 (b) Cr. P by ₹60,000; Dr. R by ₹60,000
(c) Cr. P by ₹36,000; Dr. R by ₹36,000 (d) Dr. P by ₹36,000; Cr. R by ₹36,000

Q.10 X, Y and Z are partners sharing profits and losses in the ratio 5 : 3 : 2. They decide to share the future profits in the ratio 3 : 2 : 1. Workmen compensation reserve appearing in the balance sheet on the date if no information is available for the same will be :

(a) Distributed to the partners in old profit sharing ratio
(b) Distributed to the partners in new profit sharing ratio
(c) Distributed to the partners in capital ratio
(d) Carried forward to new balance sheet without any adjustment

Directions (Q. No. 11-12): Each of the following questions consists of two statements, one is Assertion (A) and the other is Reason (R). Give answer:

(a) Both Assertion (A) and Reason (R) are true and Reason(R) is the correct explanation of Assertion (A)
(b) Both Assertion (A) and Reason (R) are true but Reason(R) is not the correct explanation of Assertion (A)
(c) Assertion (A) is true but Reason (R) is false
(d) Assertion (A) is false but Reason(R) is true

Q.11 **Assertion(A):** Change in profit sharing ratio among partners increase the combined shares of Partners.
Reason (R): Partners whose profit shares have decreased as a result of change in profit sharing ratio are known as sacrificing partners.

Q.12 **Assertion (A):** It is necessary to adjust goodwill at the time of Change in profit sharing ratio.
Reason (R): At the time of Change in profit sharing ratio, gaining partner compensate for sacrificing a partner by paying him goodwill.

Directions (Q.No. 13-15) Case Study Based Questions:

R, S and T were partners in a firm sharing profits in the ratio of 1:2:3. on 31.03.2021 their Balance Sheet was as follows:

Balance Sheet as at 31.03.2021

Liabilities	Amount(Rs.)	Assets	Amount (Rs.)
Creditors	50,000	Land	50,000
Bills Payable	20,000	Building	50,000
General Reserve	30,000	Plant	1,00,000
Capital :		Stock	40,000
		Debtor	30,000
R 1,00,000		Bank	5,000
S 50,000			
T 25,000	1,75,000		
	2,75,000		**2,75,000**

R, S, and T decided to share the profits equally with effect from 1.04.2021. For this it was agreed that:

a. Goodwill of the firm is valued at Rs.1,50,000.
b. Land was revalued at Rs.80,000 and buildings depreciated by 6%.
c. Creditors of Rs.6,000 were not likely to be claimed and hence to be written off.

Q.13 What amount is transferred to the S Capital account on behalf of the Revaluation account?

(a) Rs.11,000 Credit (b) Rs.11000 Debit
(c) Either (a) or (b) (d) Neither (a) nor (b)

Q.14 What is the journal entry of Goodwill accounting treatment of the above problem?

(a) Goodwill ac. Dr.150000/ To R Cap 25000; To S Cap50000 & To T Cap75000
(b) R a/c Dr. & T a/c Cr by Rs.25,000
(c) Premium for Goodwill Dr. 150000/ To R Cap 25000; To S Cap50000 &To T Cap75000
(d) None of the above

Q.15 What is the T's Capital account Balance after all adjustments:

(a) Rs.55,000 (b) Rs.81500
(c) Neither (a) or (b) (d) Rs.85500

Answer Key:

Q. No	**Suggested answer**	**Q. No**	**Suggested answer**
1	(b) Credited, Revaluation	**9**	(c) Cr. P by ₹36,000; Dr. R by ₹36,000
2	(a) Never be raised in the book	**10**	(a) Distributed to the partners in old profit sharing ratio
3	(c) Credited in Old Profit Sharing Ratio	**11**	(d)
4	(b) R to P	**12**	(a)
5	(a) Old profit-sharing ratio	**13**	(a) Rs.11,000 Credit
6	(c) Both (A) & (B)	**14**	R a/c Dr. & T a/c Cr by Rs.25,000
7	(a) 1/15 (gain)	**15**	(b) Rs.81500
8	(b) Cr. A by 4,000; Cr. B by 16,000; Dr C by 20,000		

Q.1 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, 2021. On that date the general reserve showed a balance of Rs.2,40,000. Partners do not want to distribute the reserves. You are required to give the adjusting entry.

Solution: Journal

Date	**Particulars**	**L.F.**	**Debit**	**Credit**
2011 Apr. 1	Keshav's capital A/c Dr.		32,000	
	To Meenakshi's capital A/c To Mohit's capital A/c (Adjustment for General reserve on change in profit sharing ratio)			16,000 16,000

Working Notes:

Keshav: Meenakshi: Mohit

Old ratio 1/5 2/5 2/5

New ratio 1/3 1/3 1/3

Sacrifice or Gain:

Keshav = 1/5 – 1/3 = 3-5/15 = 2/15 (Gain)

Meenakshi = 2/5 – 1/3 = 6-5/15 = 1/15 (Sacrifice)

Mohit = 2/5 – 1/3 = 6-5/15 = 1/15 (Sacrifice)

Q.2 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:

Profit & Loss account	80,000
General Reserve	40,000
Advertisement Suspense A/c	30,000

You are required to give a single journal entry to adjust the above.

Solution: **Journal**

Date	Neha's capital A/c Dr.		20,000	
	To Nitin's capital A/c (adjustment for profit & loss A/c, General reserves and advertisement Suspense A/c)			20,000

Working Notes:

Profit & Loss account	80,000
Add: General Reserve	<u>40,000</u>
	1,20,000
Less: Advertisement Suspense	<u>30,000</u>
Total amount to be adjusted	**<u>90,000</u>**

	Neha	Niharika	Nitin
Old ratio	2/9	3/9	4/9
New ration	4/9	3/9	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)

Q.3 A firm actual profits of the year Rs. 1,20,000 with capital employed Rs. 10,00,000. The normal rate of return in the same line of business is 10% p.a.

Find the value of goodwill of the firm under the super profit method by 3 purchase yea

Sol. Goodwill = Super profits x No of purchase year

Super Profit = Actual profits – Normal Profits

Normal Profits = Capital employed x NRR /100

Normal Profits = (10,00,000 x 10) / 100 = 1,00,000

Super profit = 1,20,000 – 1,00,000 = 20,000

Goodwill = 20,000 x 3 = **Rs. 60,000.**

Q.4 A firm has an average profit of Rs. 90,000. The capital employed in the firm is Rs. 10,00,000. The normal rate of return is 6% p.a. Find the value of goodwill by capitalization of average profits method.

Sol.: Goodwill = Capitalized Value of Average Profits – Capital Employed Capitalized

Value of Average Profits = (90,000 x 100) / 6 = 15,00,000

Goodwill = 15,00,000 – 10,00,000 = **Rs. 5,00,000**.

Q. 3 A firm has an average profit of Rs. 90,000. The capital employed in the firm is Rs. 10,00,000. The normal rate of return is 6% p.a. Find the value of goodwill by capitalization of the Super Profit method.

Sol.: Goodwill = (Super profits x 100) / NRR Super Profits = Average profits – normal profits

Normal Profits = (Capital Employed X 6) / 100 = 60,000 Super profits = 90,000 -60,000 = 30,000Goodwill = (30,000 x 100) / 6 = **Rs. 5,00,000**

AdmissionofaPartner

CalculationofNewRatioandSacrificingRatio:

NewRatio=OldRatio-SacrificingRatio SacrificingRatio=OldRatio-NewRatio

AccountingtreatmentofGoodwillatthetimeofadmissionofpartner:

When goodwill alreadyappearsinthebooks	Oldpartner'scapital/currentA/c Dr. ToGoodwillA/c	InOldRatio
Case I When premium forgoodwill is paid by newpartnerprivately	Noentryinthebooksofthefirm.Forcap italbringbynewpartner Cash/BankA/c. Dr. ToNewpartner'scapitalA/c	
Case II(a) When premiumfor goodwill is brought bynew partner in cash / kindandretainedinthebusi ness (b) When not retained inbusinessorgoodwillwith drawn	Cash/Bank/AssetsA/c. Dr. ToNewpartner'scapital A/c ToPremiumforgoodwillA/c PremiumforgoodwillA/c Dr. To(Old)Sacrificingpartner'scapital/currentA/c Inadditionofabovetwoentries (Old)Sacrificingpartner'scapital/currentA/c. Dr. ToCash/BankA/c	In Sacrificing Ratio

CaseIII Whenthenewpartner is unable to bringhis share of premium forgoodwillincash	Newpartner'CurrentA/c Dr. To(Old)Sacrificingpartner'scapital/currentA/c	with the shareof new partnerinG/WinGR
Case IV When the newpartner brings only a part ofpremium forgoodwillincash	Cash/Bank/AssetsA/c. Dr. ToNewpartner'scapitala/c ToPremiumforgoodwilla/c Premiumforgoodwilla/c. Dr. Newpartner'Currenta/c Dr. To(Old)Sacrificingpartner'scapital/currenta/c	IncashNoti ncash(InSR)

Transfer/distributeornospecificinformatio nisgiven	**a)** FortransferofreservesandaccumulatedprofitsReserves/Profit& Loss a/c. Dr.WorkmenCompensationReserveA/c. Dr.InvestmentFluctuationReserveA/c. Dr. ToOldpartner'scapital/currenta/c **b)** Fortransfersofaccumulatedlosses. Oldpartner'scapital/currenta/c. Dr. ToProfitandlossa/c. ToAdvertisementsuspensea/c. ToDeferredRevenueExpenditurea/c	In oldratio

HiddenGoodwill:

CalculationofHiddenGoodwill ₹

Totalcapitalofthefirmonthebasisofnewpartner'scapital ....

(Capitalofnewpartner'sCapitalxReciprocalofshareofnewpartner)

Less:Adjusted Capitalofallpartner(includingcapital ofnewpartner) ... ...

Hiddengoodwill

Accounting treatment of revaluation of Assets and liabilities will be same as given in changes in profit sharing ratio (revisedvalue)

The journal entries recorded for revaluation of assets and reassessment of liabilities are as follows:

(i) **For increase in the value of an asset**
Asset A/c Dr.
To Revaluation A/c (Gain)

(ii) **For reduction in the value of an asset**
Revaluation A/c Dr.
To Asset A/c (Loss)

(iii) **For appreciation in the amount of a liability**
Revaluation A/c Dr.
To Liability A/c (Loss)

(iv) **For reduction in the amount of a liability**
Liability A/c Dr.
To Revaluation A/c (Gain)

(v) **For an unrecorded asset**
Unrecorded Assets A/c Dr.
To Revaluation A/c (Gain)

(vi) **For an unrecorded liability**
Revaluation A/c Dr.
To Unrecorded Liabilities A/c (Loss)

(vii) **For transfer of gain on Revaluation**
Revaluation A/c Dr.
To Old Partners Capital A/cs (Old ratio)
(individually)

(viii) **For transferring loss on revaluation**
Old partner's Capital A/cs Dr.
(Individually) (Old ratio)
To Revaluation A/c

Note: **Entries (i), (ii), (iii) and (iv) are recorded only with the amount increase and decrease in the value of assets and liabilities.**

<u>Question bank</u>

Q. 1 Sacrificing ratio is used to distribute ----------------- in case of admission of a partner.
(a) Premium of Goodwill b)Revaluation Profit or Loss

(c) Profit and Loss Account (Credit Balance)   (d)Both b and c

Q. 2 . At the time of admission of a partner, what will be the effect of the following information? Balance in Workmen compensation reserve ₹ 2,80,000. Claim for workmen compensation ₹2,20,000.

(A) ₹ 2,80,000 Debited to the Partner's capital Accounts.   (B) ₹ 2,20,000 Debited to Revaluation Account.
(C) ₹ 60,000 Credited to the Partner's capital Accounts.   (D) ₹ 60,000 to Debited Revaluation Account.

Q. 3 Himanshu and Naman share profits & losses equally. Their capitals were Rs.1,20,000 and Rs. 80,000 respectively. There was also a balance of Rs. 60,000 in General reserve and revaluation gain amounted to Rs. 15,000. They admit friend Ashish with 1/5 share. Ashish brings Rs.90,000 as capital. Calculate the amount of goodwill of the firm.

a) Rs.1,00,000   b) Rs. 85,000   c) Rs.20,000   d) None of the above

Q. 4 Yash and Manan are partners sharing profits in the ratio of 2:1. They admit Kushagra into partnership for 25% share of profit. Kushagra acquired the share from old partners in the ratio of 3:2. The new profit sharing ratio will be:

a) 14:31:15
b) 3:2:1
c) 31:14:15
d) 2:3:1

Q. 5 At the time of admission of a partner, what will be the effect of the following information? Balance in Workmen compensation reserve ₹40,000. Claim for workmen compensation ₹45,000.

(A) ₹45,000 Debited to the Partner's capital Accounts.
(B) ₹40,000 Debited to Revaluation Account.
(C) ₹5,000 Debited to Revaluation Account.
(D) ₹5,000 Credited to Revaluation Account.

Q. 6 At the time of admission of a partner, Employees Provident Fund is:

a) Distributed to partners in the old profit sharing ratio
b) Distributed to partners in the new profit sharing ratio
c) Adjusted through gaining ratio
d) None of the above

Q. 7 The firm of P, Q and R with profit sharing ratio of 6:3:1, had the balance in General Reserve Account amounting Rs. 1,80,000. S joined as a new partner and the new profit sharing ratio was decided to be 3:3:3:1. Partners decide to keep the General Reserve unchanged in the books of accounts. The effect will be:

a) P will be credited by Rs. 54,000
b) P will be debited by Rs. 54,000
c) P will be credited by Rs. 36.000
d) P will be debited by Rs. 36,000

Q. 8 Match the following with respect to journal entries for treatment of goodwill.

i.	Incoming partner brings his share of goodwill	A	No Entry
ii.	Incoming partner does not bring his share of goodwill	B	Premium for Goodwill A/c Dr. Incoming Partner's Current A/c Dr. To Sacrificing Partners Capital A/c
iii.	Incoming partner pays his share of goodwill privately	C	Premium for Goodwill A/c Dr. To Sacrificing Partners Capital A/c
iv.	Incoming partner brings only a part of his share of goodwill	D	Incoming Partner's Current A/c Dr. To Sacrificing Partners Capital A/c

a) i- B, ii-C, iii-A, iv-D
b) i- C, ii-D, iii-A, iv-B
c) i- D, ii-C, iii-A, iv-B
d) i- D, ii-C, iii-B, iv-A

Q.9. Arun and Vijay are partners in a firm sharing profits and losses in the ratio of 5:1.
Balance Sheet (Extract)

Liabilities ₹	Assets ₹
	Machinery 40,000

If the value of machinery reflected in the balance sheet is overvalued by 33 %, find out the value of Machinery to be shown in the new Balance Sheet:

(A) ₹ 44,000 (B) ₹48,000 (C) ₹ 32,000 (D) ₹30,000

10. Given below are two statements, one labelled as Assertion (A) and the other labelled as Reason (R)

Assertion (A): On reconstitution of a firm, 'Interest on Drawings' is shown in P & L Appropriation A/c.

Reason (R): On admission of a partner, ' Interest on Drawings' are charge against the profits.

In the context of the above statements, which one of the following is correct?

Codes:

(A) (A) is correct, but (R) is wrong.
(B) Both (A) and (R) are correct.
(C) (A) is wrong, but (R) is correct.
(D) Both (A) and (R) are wrong.

Answers:

1. A 2. C 3. B 4. C 5. C 6. D 7. D 8. A 9. C 10. B 11. D 12. A

Long Answer Type Questions 6 Marks

Q. 1 X and Y are in partnership sharing profits and losses in the ratio of 3:2. Their Balance Sheet as at 31st March, 2023 was as under:

Liabilities	Rs.	Assets		Rs.
Creditors	15,000	Cash		5,000
General Reserve	12,000	Debtors	20,000	
Capital Accounts:		Less: Provisions	800	19,200
X	60,000	Patents		14,800
Y	30,000	Investments		8,000
Current Accounts:		Fixed Assets		72,000
X	10,000	Goodwill		10,000
Y	2,000			
	1,29,000			1,29,000

They admit Z on 1st April, 2023 on the following terms:

1. A provision of 5% is to be maintained on debtors.
2. Accrued Income of Rs. 1,500 does not appear in the books and Rs. 5,000 are outstanding for salaries.
3. Present market value of Investments is Rs. 6,000. X take over the Investments at this value.
4. New profit sharing ratio of partners will be 4:3:2. Z will bring in Rs. 20,000 as his capital.
5. Z is to pay in cash an amount equal to his share in firm's goodwill valued at twice the average profits of the last 3 years which were Rs. 30,000; Rs. 26,000 and Rs. 25,000 respectively.
6. Half the amount of goodwill is withdrawn by old partners.

You are required to pass Journal entries for the firm.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
2023	General Reserve A/c……………………………………Dr.		12,000	
Apr. 1	To X's Current A/c			7,200
	To Y's Current A/c			4,800
	(Being General Reserve transferred to old partners.)			
	Revaluation A/c…………………………………………Dr.			
	To Provision for Doubtful Debts A/c		5,200	
	To Outstanding Salaries A/c			200
	(Provision for D/D and outstanding salaries.)			5,000
	Accrued Income A/c……………………………………Dr.			
	To Revaluation A/c		1,500	
	(Accrued Income)			1,500
	X's Current A/c……………………………………Dr.			
	Revaluation A/c……………………………………Dr.		6,000	
	To Investments A/c		2,000	
	(Investments taken over by X at revised value.)			8,000

	X's Current A/c……………………………………Dr. Y's Current A/c…………………………………..Dr. To Revaluation A/c. (Loss on revaluation transferred to old partners.)		3,420 2,280	 5,700
	X's Current A/c……………………………………..Dr. Y's Current A/c………………………………………Dr. To Goodwill A/c (Goodwill A/c in books written off in the old ratio.)		6,000 4,000	 10,000
	Cash A/c………………………………………………..Dr. To Z's Capital A/c To Premium for goodwill A/c (Z brings in capital and goodwill amount in cash.)		 32,000	 20,000 12,000
	Premium for goodwill A/c……………………………Dr. To X's Current A/c To Y's Current A/c (Premium for goodwill shared by old partners in their sacrificing ratio i.e., 7:3)		 12,000	 8,400 3,600
	X's Current A/c……………………………………..Dr. Y's Current A/c……………………………………….Dr. To Cash A/c. (Half the amount of goodwill withdrawn.)		 4,200 1,800	 6,000

Q.2 A and B are partners in a firm sharing profits and losses in the ratio 3:2. ON 31st March, 2023 their Balance Sheet was as under:

Liabilities		₹	Assets	₹
Creditors		90,000	Bank	60,000
Capital A/cs			Debtors	1,20,000
A	1,50,000		Stock	60,000
B	80,000	2,30,000	Furniture	50,000
			Goodwill	30,000
		3,20,000		**3,20,000**

On the above data C is admitted as a partner. *A* surrendered 1/6th of his share and B 1/3rd of his share in favor of C. Goodwill is valued at ₹1,20,000. C brings in only ½ of his share of goodwill in cash and ₹1,00,000 as his capital. Following adjustments are agreed upon:

(i) Stock is to be reduced to ₹56,000 and furniture by ₹5,000.
(ii) There is an unrecorded asset worth ₹50,000.
(iii) One month 's rent of ₹15,000 is outstanding.
(iv) A creditor for goods purchased for ₹40,000 had been omitted to be recorded although the goods had been correctly included in stock.
(v) Insurance premium amounting to ₹8,000 was debited to P&L A/c of which ₹2,000 is related to the period after 31st March 2023.

You are required to prepare Revaluation Account, Partner's Capital Accounts of the new firm.

Solution: REVALUATION ACCOUNT

To stock	4,000	By unrecorded assets		50,000
To furniture	5,000	By prepaid insurance		2,000
To outstanding rent	15,000	By loss transferred to:		
To creditors	40,000	A's capital	7,200	
		B's capital	4,800	12,000
	64,000			64,000

PARTNERS CAPITAL ACCOUNTS

Particulars	A	B	C	Particulars	A	B	C

To revaluation	7,200	4,800		By balance b/d	1,50,000	80,000	
To goodwill a/c	18,000	12,000		By premium	6,000	8,000	
To balance c/d	1,36,800	79,200	1,00,000	By C's current a/c	6,000	8,000	
				By Bank			1,00,000
	1,62,000	96,000	1,00,000		1,62,000	96,000	1,00,000

Working Notes: C' Share = 1/6 X 3/5 + 1/3 X 2/5 = 7/30

Sacrificing Ratio: 3/30 : 4/30 = 3:4

C's Share of Goodwill = 120000x7/30=Rs. 28000

Q.3 Annie and Bonnie are partners in a firm, sharing profit and losses equally. Their balance sheet as at 31[s]march 2023 was as follows:

Balance sheet of ANNIE and BONNIE

As at 31[st] march 2023

liabilities	₹	assets	₹
Sundry creditors	**21000**	**Cash at Bank**	**20000**
General Reserve	**15000**	**Sundry Debtors 22000**	
Capital A/c		**Less: provision for doubtful debts(1000)**	**21000**
Annie 45000		**Stock**	**10000**
Bonnie 40000	**85000**	**Plant & Machinery**	**60000**
		Building	**10000**
	121000		**121000**

Carl was to be taken as partner for 1/4[th] share in the profits of the firm, with effect from 1[st] April, 2023 on the following terms:

(a) Bad debts amounting to Rs 1500 to be written off.

(b) Stock to be taken over by Annie at ₹ 12000.

(c) Plant and machinery to be valued at ₹ 50000.

(d) Goodwill of the firm to be valued at ₹ 20000.

(e) Carl to bring in ₹ 50000 as his capital. He was unable to bring in cash his share of goodwill.

(f) General reserve not to be distributed. For this it wasdecided that carl would compensate the old partners through his current accounts.

You are required to :

(1) Pass journal entries on the date of Carl's admission.

(2) Prepare the capital accounts.

Solution:

Date	particulars	Dr Amount Rs	Cr Amount Rs
(1)	Provision for Doubtful Debts A/c Dr Revaluation A/c Dr To sundry debtors A/c (Bad Debts written off)	1000 500	 1500
(2)	Stock A/c Dr To Revaluation A/c (increase in the value of stock)	2000	 2000
(3)	Annie capital A/c Dr To stock A/c (Stock taken over by Annie)	12000	 12000
(4)	Revaluation A/c Dr To plant and machinery A/c (Decrease in the value of plant and machinery)	10000	 10000
(5)	Annie's capital A/c Dr	4250	

	Bonnie's capital A/c Dr To Revaluation A/c (Loss on revaluation transferred in old ratio)	4250	 8500
(6)	Bank A/c Dr To Carl's capital a/c (Amount brought in by Carl for capital)	50000	 50000
(7)	Carl's Current A/c Dr To Annie's capital A/c To Bonnie's capital A/c (Adjustment for Goodwill in sacrificing ratio)	5000	 2500 2500
(8)	Carl's Current A/c Dr To Annie's capital A/c To Bonnie's capital A/c (Adjustment for general reserve in sacrificing ratio)	3750	 1875 1875

Dr PARTNER'S CAPITAL ACCOUNTS Cr

Particulars	Annie	Bonnie	Carl	particulars	Annie	Bonnie	Carl
To Revaluation A/c	4250	4250		By balance b/d	45000	45000	
			-	By Bank			50000
To stock A/c	12000	-	-	By Carl's current A/c	2500	2500	
				By Carl's current A/c	1875	1875	
To balance c/d	33125	40125	50000				
	49375	44375	50000		49375	44375	50000

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<u>RETIREMENT AND DEATH OF A PARTNER</u>

Meaning: When any partner leaves/retires from a firm due to any reason, it is called retirement of a partner. It results in **RECONSTITUTION OF FIRM** under which an old agreement comes to an end and new partnership agreement comes into existence among continuing/remaining partners.

Section 32(1) of Indian Partnership Act, 1932 states that a partner may retire:

a) With the consent of all partners.
b) In accordance with an express agreement amongst the partners.
c) By issuing a notice in writing to all the partners stating the intention to retire.

Following are the important accounting concepts related to retirement of a partner:

1. <u>CALCULATION OF NEW PROFIT SHARING RATIO</u>

<u>New Profit Sharing Ratio</u>

CASE 1: When no information is given, **NEW RATIO OF REMAINING PARTNERS WILL BE SAME AS OLD RATIO.**

CASE 2: When retiring partner's share is taken/acquired by remaining partners in a specified ratio, the acquired share is added to their existing share to calculate their new share.

- **New Ratio = Old Share + Acquired Share (from Retiring partner)**

2. CALCULATION OF GAINING RATIO

Gaining Ratio = New Share – Old Share

Case 1: When no information regarding New Profit Sharing Ratio	Case 2: New agreement amongst Partners for New Profit Sharing Ratio.	Case 3: When Retiring partner's share is acquired by one partner only.
↓	↓	↓
Remaining partners continue to share profits in their Old profit sharing ratio.	**Gaining Ratio will be calculated by such an agreement.**	**Then only gaining partner will provide for the share of goodwill of the retiring partner.**

Difference between Gaining Ratio and Sacrificing Ratio:

	Basis of Difference	Sacrificing Ratio	Gaining Ratio
1.	Meaning	It is the ratio in which the old partners sacrifice/surrender a part of their share in favour of a new partner.	It is the ratio in which the remaining partners acquire the share of a retiring/deceased partner.
2.	Need for calculation	At the time of Admission of a new partner.	At the time of Retirement or Death of a partner.
3.	Formula	S.R.= Old Ratio – New Ratio	G.R. = New Ratio – Old Ratio
4.	Purpose	To know the ratio in which new partner share of goodwill will be compensated to sacrificing partners.	To know the ratio in which gaining partners will compensate retiring partner's/deceased partner's share of goodwill.

3. TREATMENT OF GOODWILL IN CASE OF RETIREMENT/DEATH OF A PARTNER

GOODWILL

When Goodwill appears in the Balance Sheet	When Goodwill is **Valued** for the purpose of Retirement/Death of a partner
↓	↓
All Partners' Capital/Current A/c Dr. To Goodwill A/c	Gaining Partners' Capital/Current A/c Dr. To Retiring/Deceased Partners' Capital/Current A/c

HIDDEN GOODWILL – Sometimes the firm agrees to settle the retiring partner or deceased partner's account by payment of a lumpsum amount.

Hidden Goodwill = Total Amount paid to Retiring/Deceased Partner – Adjusted Capital of retiring/deceased partner

4. REVALUATION OF ASSETS AND REASSESSMENT OF LIABILITIES

Revaluation A/c (It is a Nominal Account)

(Debit all Losses & Expenses, Credit all Incomes & gains)

Particulars	Amount	Particulars	Amount

To Decrease in value of Assets (Loss) To Increase in value of Liabilities (loss) To Unrecorded liabilities (at agreed value) To Profit transferred to Old Partners' Capital/Current A/c (in old ratio	-- -- --	By Increase in value of Assets (Gain) By decrease in value of liabilities By Unrecorded Assets(at agreed value) By Loss transferred to Old Partners' Capital/Current A/c (in old ratio)	-- -- --

5. ADJUSTMENT OF CAPITALS IN CASE OF RETIREMENT OF A PARTNER

When New Capital of the firm is given.

1. Find New Ratio of Remaining Partners.
2. Remaining partner's new capital = Firm's capital * his new share.
3. Difference between Adjusted Capital and New Capital of remaining partners is the amount to be brought in or withdrawn by them.

When Remaining Partners bring in cash to pay off Retiring/Deceased partner

1. Find New Profit Sharing Ratio of remaining partners.
2. Find Remaining partners' Adjusted Capitals.
3. Calculate Firm's New Capital = Adjusted Capitals * Reciprocal of combined share of remaining partners
4. Compare Adjusted and new capitals of Remaining Partners to know the amount brought in or withdrawn by them.

Date	Particulars	Rs.	Date	Particulars	Rs.
	To Drawings A/c To Interest on drawings A/c To Revaluation A/c (loss) To Profit & loss A/c (Loss) To Goodwill A/c (W/Off) To Bank A/c (Amount paid to retiring partner) To Retiring Partner's Loan A/c To Deceased Partner's Executor A/c			By Balance b/d By Interest on Capital A/c By Gaining Partners' Capital A/c By Revaluation A/c (Profit) By Profit & Loss A/c (Profit) By Reserves A/c By Salary A/c By Profit & Loss Suspense A/c (If partner **retires during**an accounting year)	

7. CALCULATION OF DECEASED PARTNER'S SHARE OF PROFIT

On the basis of Time: Deceased partner's share in profit on the basis of last year's profit or Average Profits of last years' upto the date of his death.

On the basis of Sales
Deceased partner's share of profit =

$$\frac{\text{Profit (Previous year)}}{\text{Sales (Previous year)}} \times \text{Sales (Upto date of death)} \times \text{his share of Profits}$$

Journal Entry (For Deceased Partner's Share of Profit)

Through Capital Transfer
When there is a change in PSR of remaining partners
Gaining Partner's Capital/Current A/c Dr.
To Deceased Partner's Capital/Current A/c
(In Gaining Ratio)

Through Profit & Loss Suspense A/c
When there is no change in PSR of remaining partners
Profit & Loss Suspense A/c Dr.
To Deceased Partner's Capital/Current A/c

NOTE - In case of loss, Reverse Entries will be passed.

8. RETIREMENT AND SETTLEMENT OF LOAN

It may be agreed among the partners that the principal amount will be paid in a few equal instalments. In such case, interest will be credited to the Loan Account on the basis of the amount outstanding at the beginning of each year and the amount paid will be debited to the Loan Account.

If partnership deed is silent then Rate of Interest on Partner's loan is 6% p.a.

Journal Entries:

Partner's Capital Account Dr.
To Partner's Loan Account
Interest on loan A/c Dr.
To Partner's Loan A/c
Partner's Loan A/c Dr.
To Bank A/c

Journal Entries for settlement of Deceased Partner's Executor's A/c

Journal Entries:

Deceased Partner's Capital Account Dr.
To Deceased Partner's Executor's A/c
Interest A/c Dr.
To Deceased Partner's Executor's A/c
Deceased Partner's Executor's A/c Dr.
To Bank A/c

Treatment of Accumulated (Undistributed) Profits/Losses and Reserves

(i) Profit and Loss A/c(credit balance) Dr.
(ii) General Reserve A/c Dr.
To All Partners' Capital/Current A/cs (In old ratio)

For distributing accumulated losses and fictitious assets

All Partners' Capital/Current A/cs Dr.
To Profit and Loss A/c(debit balance)
To Advertisement Suspense A/c

Q.1X, Y and Z are partners sharing profits in the ratio 1:2:3. Z retires on 1st April, 2018 and his capital after making all adjustments for reserves and profit on revaluation stands at Rs 2,40,000. X and Y here agreed to pay him Rs 3,00,000 in full settlement of his claim Record necessary journal entry for the treatment of goodwill if the new profit-sharing ratio is decided as 1:3.

Date	Particulars	L.F	Dr.	Cr.
2018 April1	X's Capital A/c Dr. Y's Capital A/c Dr. To Z's Capital A/c		10,000 50,000	 60,000

Working Notes:

(1) Calculation of Hidden Goodwill

Amount agreed to be paid in full settlement to Z 3,00,000

Less: Z's Capital (After all adjustments) 2,40,000

Hidden Goodwill 60,000

(2) Calculation of Gaining Ratio:

New Ratio=1:3 and Old ratio=1:2:3

X's gain=1/4-1/6=1/12

Y's gain=3/4-2/6=5/12

Q.2 Ajay, Pranav and Vijay are in partnership sharing profits in the ratio of 4:3:1. Pranav takes retirement on 30th June,2019 The firm's profits for various years were :2014 (profit Rs 3,24,444),2015(profit Rs 80,000),2016(profit Rs 10,000),2017 (loss Rs 10,000),2018 (profit Rs 40,000) and 2019 (profit Rs 50,000).

Ajay and Vijay decided to share future profits in the ratio of 3:2. Goodwill is to be valued on the basis of 2 years' purchase of average profit of 4 completed years immediately preceding the year of retirement of a partner. Pass the journal entry to record Pranav's share of goodwill.

Sol. JOURNAL

Date	Particulars	L.F	Amt(Dr.)	Amt(Cr.)
2019 June 30	Ajay's Capital A/c(22500*4/15) Vijay's Capital A/c(22500*11/15) To Pranav's Capital A/c		6,000 16,500	 22,500

Working Notes

1. Gaining Ratio=New share-Old share

   Ajay's gain=3/5-4/8=4/40;Vijay's gain=2/5-1/8=11/40

2 Average profit of 4 years=80,000+10,000+(10,000)+40,000/4=Rs 30,000

Firm's goodwill=30,000*2=Rs 60,000

Pranav's share of goodwill=60,000*3/8=Rs 22,500

Q.3 A,B and C are partners with profit sharing ratio 5:3:2. Their balance sheet is as follows

Balance Sheet

As at 31st March, 2020

Liabilities	Rs	Assets	Rs
Creditors	80,000	Bank	40,000
Bills Payable	60,000	Debtors	60,000
General Reserve	30,000	Furniture	40,000
Reserve for Contingency	20,000	Investment	30,000
Workmen Comp.Fund	40,000	Building	1,00,000
Provident Fund	40,000	Prepaid Insurance	10,000
Cap A 40,000		Goodwill	20,000
B 30,000		Patents	30,000
C 30,000	1,00,000	Profit &Loss	40,000
	3,70,000		3,70,000

Adjustments:

(i) C takes retirement,new ratio of A and b is 3:2.

(ii) Rs 10,000 given to C in cash and balance transferred to C's Loan account.

(iii) Prepaid insurance is no more required.

(iv) Rs 10,000 unrecorded typewriter has to be shown in the balance sheet.

(v) Investment is valued at Rs 20,000 and is taken over by A at this value.

(vi) Make 5% provision for discount on creditors.

(vii) Outstanding repair bills due Rs 10,000

(viii) Provident fund decreased by Rs 10,000

(ix) Accrued commission by Rs 5,000

(x) Building increased by 20%

(xi) Goodwill of the firm valued at Rs 40,000

Prepare necessary ledger.

Solution Dr. Revaluation Account Cr.

Particulars	Rs	Particulars	Rs
To Prepaid Insurance	10,000	By Typewriter(Unrecorded)	10,000
To Investment	10,000	By Prov. for Creditors A/c	4,000
To Outstanding Repair Bill	10,000	By Provident Fund	10,000
To Profit transfer to A's capital A/c 9,500 B's capital 5,700 C's capital 3,800	19,000	By Accrued Comm.	5,000
		By Building a/c	20,000
	49,000		49,000

Dr. Partner's Capital Account Cr.

Particulars	A	B	C	Particulars	A	B	C
To Investment	20,000	-	-	By Bal. b/d	40,000	30,000	30,000
To Goodwill	10,000	6,000	4,000	By Gen. res	15,000	9,000	6,000
To Profit & loss	20,000	12,000	8,000	By Res. For Contingency	10,000	6,000	4,000
To C's cap	4,000	4,000	-	By work. com. fund A/c	20,000	12,000	8,000
To Cash	----	--	10,000	By A's cap A/c	--	---	4,000
To c's loan	-----	-----	37,800	By B's cap. A/c	---	----	4,000
To Bal. c/d	40,500	40,700	----	By Rev A/c	9,500	5,700	3,800
	94,500	62,700	59,800		94,500	62,700	59,800

Dr. Bank A/c Cr.

Particulars	Rs	Particulars	Rs
To bal.b/d	40,000	By C's cap. A/c	10,000
		By Bal. c/d	30,000
	40,000		40,000

Balance Sheet
As at 1st April, 2020

Liabilities	Rs	Assets	Rs
Creditors (80,000-40,00)	76,000	Bank	30,000
Outst. Repair bill	10,000	Typewriter(Unrecorded)	10,000
Provident Fund (40,000-10,000)	30,000	Accrued Comm	5,000
Bills Payable	60,000	Building(1,00,000+20,000)	1,20,000
C's loan	37,800	Debtors	60,000
Capital A/c A 40,500		Furniture	40,000
B 40,700	81,200	Patents	30,000
	2,95,000		2,95,000

Working Notes:
1 Calculation of Gaining Ratio
A=3/5-5/10=1/10; B=2/5-3/10=1/10 in a firm in the ratio of 5:3:2.
2 C's share in Goodwill =40,000x2/10=Rs 8,000

CASE STUDY

Q.4 R, N and P were partners in a firm that prepares ice cream for various 'Ice cream Parlours' in the city. N decided to retire from the firm as she was interested to join a restaurant business with her friend in Jaipur. At the time of retirement of N, the Workmen compensation reserve was shown at Rs 70,000 in the books of accounts. However there was a claim of Rs 25,000 against it.

After making adjustments for Reserves and Revaluation of Assets and Liabilities, the balance in N 's capital account was Rs 1,20,000. R and P paid Rs 1,80,000 in full settlement to N.

There was an 'Investment Fluctuation Reserve' of Rs 15,000 at the time of retirement of n, when Balance Sheet shows investment (Market value Rs 23,500) at Rs 20,000.

The firm's balance sheet show Employees' Provident Fund at Rs 12,000. The accountant of the firm is of the opinion to distribute the amount of Employees' Provident fund to all the partners

Based on the above information, you are required to answer the following questions:

(i) Is the retirement of a partner means reconstitution of a firm?

(ii) Why does a firm revalue its assets and liabilities on retirement or death of a partner?

(iii) Which journal entry will be passed for the distribution of workmen compensation Reserve at the time of retirement of N?

(iv) Identify the item for which R and P paid Rs 60,000 more to Neeti.

(v) What will be the treatment of Investment Fluctuation Reserve? Show by passing a journal entry.

(vi) Is the accountant correct in his opinion regarding Employees' Provident Fund?

Solution:

(i) Yes, on the retirement of a partner,the old partnership comes to an end but the firm continues and a new partnership comes into existence. So a retirement means reconstitution of firm

(ii) On the retirement or death of a partner,the retiring partner or the representative of deceased partner must be given his share of profits/loss arising out of change due to the revaluation of assets and reassessment of liabilities. That is why assets and liabilities are revalued on retirement or death of a partner.

(iii)

Date	Particulars	L.F	Dr.	Cr.
	Workmen Comp Res A/c Dr		70,000	
	To R's cap A/c			15,000
	To N's cap A/c			15,000
	To P's cap A/c			15,000
	To Prov. For WCC A/c			25,000

(iv) N was given her share of goodwill

(v)

Date	Particulars	L.F	Dr.	Cr.
	Invtt. Fluc Res A/c Dr.		15,000	
	To R's cap A/c			5,000
	To P's cap A/c			5,000
	To N's cap A/c			5,000

(vii) No, the accountant is not correct in his approach, as employees' provident fund ia a liability due to employees and not an accumulated profit. Hence,it should not have been distributed among the partners.

DEATH OF A PARTNER (SOLVED EXAMPLES)

Q.1 Rex,Tex and Flex are partners in a firm in the ratio of 5:3:2. As per their partnership agreement,the share of deceased partner is to be calculated on the basis of profits and turnover of previous accounting year. Tex expired on 31st December,2019. Turnover till the date of death was Rs 18,00,000. Their profits and turnover for the year 2018-19 amounted to Rs 4,00,000 and Rs 20,00,000 respectively. An amount of ________willbe given to his executors as his share of profits till the date of death.

Solution--- Profit from the date of last balance sheet to the date of death

=(Turnover till the date of death/Previous Year's Turnover) x Previous Year's Profit

=18,00,000/20,00,000*4,00,000=**3,60,000**

Tex's share in profits=3,60,000*3/10=Rs **1,08,000**

Q.2 Riva, Meetu and Asha were partners in a firm sharing profits and losses in the ratio of 1:2:3. Meetu died on 31st july,2019. According to the partnership agreement,her share of profit from the closure of last accounting year till the date of her death was to be calculated on the basis of total profits of two completed years before her death. Profits of the firm for the year ending 31st March,2018 and 31st March,2019 were Rs 46,000 and Rs 44,000 respectively. The firm closes its books on 31st march every year. Meetu's share of profit till the date of her death will be?

Solution--- Profit of the last 2 years=46,000+44,000=90,000

Meetu's share in profit till her death=90,000*2/6*4/12=Rs 10,000

CASE STUDY

Q.3 Jag, Pravesh and Chander are partners in a firm sharing profits in the ratio of 5:3:2 respectively. Firm closes its accounts on 31st March every year. Jag died of Covid-19 during its second wave on 30th Septenber,2021. There was a balance of Rs 47,000 in Jag's Capital Account in the beginning of the year. At the event of death of any partner,the partnership Deed provides for the share of profit till the date of death will be calculated on the basis of sales. It is also specified that the sales during the year 2020-21 were Rs 10,00,000. The sales from 1st April 2021 to 30th September 2021 were Rs 2,00,000. The profit of the firm for the year ending 31st March,2021 was Rs 1,00,000. Pravesh and Chander decided to share future profits in equal ratio after the retirement of Jag.

There was on "Investment Fluctuation Reserve" of Rs 40,000 at the time of death of Jag, when investments(market value Rs 1,90,000) appears at Rs 2,00,000 in the balance sheet.

Read above information and answer the following questions

(i) State the basis of calculating the amount of profit payable to the legal representative of a deceased partner in the year of death.

(ii) Name the account which is opened to credit the share of profit of the deceased partner, till the time of his death to his Capital Account.

(iii) Calculate the share of profit that will be credited to Jag's Capital Account at 31st September,2020.

(iv) Which journal entry will be passed for the treatment of investment Fluctuation Reserve?

SOLUTION: (i) Profit may be estimated:

(a) On the basis of last year's profit/Average profits of last given number of years

(b) On the basis of Turnover/sales

(ii) Profit and Loss Suspense Account

(iii) Jag's share of profit till the date of death:

Percentage of profit on sales=Profit/Sales *100=1,00,000/10,00,000*100=**10%**

Profit on sale (1st April,2017 to 30th September,2017)=2,00,000*10/100=**20,000**

Jag's share of profit=20,000*5/10=**Rs 10,000**

Jag's share of profit will be contributed through Partners' Capital accounts in their gaining ratio.

(iv)

Date	Particulars	L.F	Dr	Cr.
	Investment Fluctuation Reserve A/c Dr. To Investments A/c To Jag's cap A/c To Pravesh's cap To Chander's cap		40,000	 10,000 15,000 9,000 6,000

Q. 4. Mahesh, Mukesh and Raju were partners in a firm sharing profit and losses in the ratio of 2:1:1. Their balance sheet as at 31st March,2019 was as follows:

Balance Sheet
As at 31st March, 2019

Liabilities	Rs	Assets	Rs
Creditors	10,200	Cash in hand	680
General Reserve	10,880	Cash at bank	17,000
Cap Mahesh	34,000	Furniture	30,600
Mukesh	17,000	Stock	13,600
Raju	17,000	Debtors	20,400
		B/R	6,800
	89,080		89,080

On 30th June, 2019 Raju retired. As per the provisions of a partnership deed,he was entitled to the following

(i) The capital to his credit at the date of last balance sheet
(ii) Interest on capital @10% p.a.
(iii) Share of goodwill on the basis of three year's purchase of the average profits of last three years

The profits of the firm during the previous three years were
(a) Rs 17000;(b) Rs 30,600;(c) Rs 23,800

Prepare Raju's capital account.

Solution:

Raju's capital Account

To Raju's Loan A/c	37,995	By bal b/d	17,000
		By Interest on cap A/c	425
		By Mahesh's cap A/c	11,900
		By Mukesh's cap A/c	5,950
		By General Reserve A/c	2,720
	37,995		37,995

Working Note:
Average profit=17000+30600+23,800/3=Rs 23,800
Firm's goodwill=23,800*3=Rs 71,400;Raju's share of goodwill=71400*1/4=Rs 17,850 (in gaining ratio 2:1)

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DISSOLUTION OF PARTNERSHIP FIRM

Dissolution of Partnership means termination of the old partnership agreement and new agreement comes into existence.
The partnership is dissolved in any of the following cases:

a) Change in profit sharing ratio
b) Admission of a Partner
c) Retirement of a Partner
d) Death of a Partner
e) Insolvency of a Partner
f) Expiry of the period of partnership

Dissolution of Partnership Firm means the firm closes down its business and comes to an end.
On the dissolution of firm, the assets of the firm are sold and liabilities are paid off and out of the remaining amount, the accounts of partners are settled.

MODES OF DISSOLUTION OF PARTNETSHIP FIRM

WITHOUT INTERVENTION OF COURT

1. **By Mutual Agreement** (Sec 40)
   a) Voluntary dissolution through mutual agreement amongst partners.
2. **Compulsory Dissolution** (Sec 41)
   a) When the business of the firm is declared illegal.
   b) When all the partners except one decide to retire from the firm.
   c) When all the partners or all except one partner are declared insolvent.
3. **On Happening of an event** (Sec 42)
   a) On the insolvency of a partner.
   b) Completion of venture
   c) On the fulfilment of the objective of firm.
   d) On the expiry of the period of partnership.
4. **By Notice** (Sec 43)
   In case of partnership at will, the firm may be dissolved if anyone partner gives a notice in writing to the other parties.

BY ORDER OF THE COURT (Section 44)

1. When a partner has become mentally disturbed or has unsound mind.
2. When a partner has become permanently incapable of performing his duties.
3. When a partner has transferred whole of his interest in the firm to a third party.
4. When a partner deliberately commits breach of contract relating to the management of the firm.

SETTLEMENT OF ACCOUNTS IN CASE OF DISSOLUTION OF FIRM (SECTION 48)

1. Treatment of Losses

- First out of profits
- Next out of capital
- Lastly, by the partners individually in their profit sharing ratio (Sec 48(a))

2. Application of Assets

- First to pay firm's debts to the third parties.
- Then to pay loans to partners
- Then payment of capitals of partners

Realisation and Revaluation Account

S.No.	Basis of difference	Realisation Account	Revaluation Account
1	Time of preparation	This account is prepared at the time of dissolution of firm	This account is prepared at the time of Reconstitution of the firm
2	Object	This account is prepared to find out the profit or loss on realization of assets and payment of liabilities	This account is prepared to find out the profit or loss on revaluation of assets and liabilities
3	Value of assets and Liabilities	Assets and liabilities are shown in this account at their book value	The amount of increase or decrease in the value of assets and liabilities are shown in this account
4	Expenses	Usually dissolution expenses are shown in this account	No expenses are shown in this account.

DIFFERENCE BETWEEN DISSOLUTION OF PARTNERSHIP AND DISSOLUTION OF FIRM

Basis	Dissolution of Partnership	Dissolution of Firm
1. **Termination of business**	The business is not terminated.	The business of the firm is closed.
2. **Settlement of Assets and liabilities**	Assets and liabilities are revalued and new balance sheet is drawn.	Assets are sold and liabilities are paid-off.
3. **Court's Intervention**	Court does not intervene because partnership is dissolved by mutual agreement.	A firm can be dissolved by court's order.
4. **Economic Relationship**	Economic relationship between partners continues.	Economic relationship between partners comes to end.
5. **Closure of books**	Closure of books is not required because business is not terminated.	The books of accounts are closed.

FIRM'S DEBTS AND PRIVATE DEBTS

Basis	Firm's Debts	Private Debts
1. Meaning	Firm's debts are liabilities to be paid by the firm.	Private debts are liabilities payable by a partner.
2. Liability	Firm/All partners are liable to pay firm's debts jointly.	Partner is personally liable to pay his private debts.
3. Payment of debts	• First of all, firm's assets are applied to pay firm's debts. • If any surplus is available, it is distributed among partners.	• First of all, partner's share will be used to pay his private debts. • If there is any surplus available, then it will be used to pay off firm's debts.

Note:

(i) If the realized value of tangible assets is not given it should be considered as realized at book value itself.

(ii) If the realized value of intangible assets is not given it should be considered as nil (zero value).

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

ACCOUNTING TREATMENT OF WORKMEN'S COMPENSATION RESERVE

Example: Workmen Compensation Reserve (appearing in balance sheet) is Rs. 40,000.

1. If there is no information, WCR of Rs. 40,000 will be distributed among partners in their profit sharing ratio.

Workmen Comp. Reserve A/c	Dr. 40,000	
To Partner's Capital A/c		40,000
(For WCR credited to partner's capital a/c in profit sharing ratio)		

2. If amount of liability is Rs. 35,000 then WCR of Rs. 35,000 will be credited to Realisation A/c and remaining Rs.5,000 will be credited to Partners' Capital A/c

Workmen Comp. Reserve A/c	Dr. 40,000	
To Partner's Capital A/c		5,000
To Realisation A/c		35,000
(For WCR credited to partner's capital a/c in profit sharing ratio)		

3. If amount of liability and amount of Workmen Compensation reserve is equal i.e. Rs. 40,000 then WCR of Rs. 40,000 will be credited to Realisation A/c and liability of Rs.40,000 will be paid through Realisation

.Workmen Comp. Reserve A/c	Dr.40,000	
To Realisation A/c		40,000
Realisation A/c	Dr.40,000	
To Bank A/c		40,000

4. If amount of liability is Rs. 43,000 then WCR of Rs. 40,000 will be credited to Realisation A/c and liability of Rs.43,000 will be paid through Realisation A/c

.Workmen Comp. Reserve A/c	Dr.40,000	
To Realisation A/c		40,000
Realisation A/c	Dr.43,000	
To Bank A/c		43,000

REALISATION ACCOUNT (It is a Nominal A/c)

Particulars	Amount	Particulars	Amount
To Assets (excluding cash/bank balance, fictitious assets, Dr. balance of P & L A/c, Dr. balance of Partner's Capital/Current A/c, Loan to partner) To Bank/Cash A/c (Payment of liabilities) To Bank/Cash A/c (Payment of Realisation Expenses) To Partner's Capital A/c (Liability taken over by Partner) To Partner's Capital A/c (Expenses paid by partner) By Partner's Capital A/c (For transferring Profit on realisation)		By Liabilities (Excluding Cr. balance of P & L, Partner's Capital/Current A/c, Loan from Partners) By Provision on any asset By Bank/ Cash A/c (Assets realised) By Partner's Capital A/c (Asset taken over by partner) By Partner's Capital A/c (For transferring loss on realisation)	

Dr. **Partners' Capital Account** Cr.

Particulars	X	Y	Particulars	X	Y
To balance b/d (debit balance)			By Balance b/d(Credit balance)		
To Profit and Loss A/c(loss)			By General Reserve A/c		
To Advertisement Expenditure A/c			By Profit and Loss A/c(Profit)		
To Realisation A/c (Assets taken over)			By Workmen's Compensation Fund A/c		
To Realisation A/c(Loss on realization)			By Realisation A/c(Liabilities taken over)		
To Cash/Bank A/c(Excess cash paid)			By Realisation A/c(Profit on realization)		
			By Cash/Bank A/c		

Entry Settlement of Partner's Loan

Partner's Loan A/c Dr.
To Cash/Bank A/c

Dr. **Cash/Bank Account** Cr.

Particulars	Rs	Particulars	Rs
To balance b/d (cash in hand or cash at bank)		By Balance b/d(Bank overdraft)	
To Realisation A/c(Assets realised)		By Realisation A/c(Liabilities paid)	
To Partner's Capital A/c(Cash brought in by a partner)		By Realisation A/c(Realisation expenses paid)	
		By Partner's loan A/c(Partner's loan paid)	
		By Partner's Capital A/c(Excess cash paid to partner)	

Solved Examples on Dissolution

Q.1 Pass journal entries for the following transactions

(i)	Realisation expenses amounted to Rs 40,000
(ii)	Realisation expenses amounted to Rs 20,000 were paid by a partner
(iii)	Realisation expenses amounted to Rs 20,000 were paid by the firm on behalf of a partner
(iv)	A partner was paid remuneration (including expenses) of Rs 30,000 to carry out dissolution of the firm. Actual expenses were Rs 40,000
(v)	Dissolution expenses were Rs 32,000.Out of the said expenses, Rs 12,000 were to be borne by the firm and balance by a partner, Rs 3200 are paid by the firm
(vi)	Dissolution expenses were Rs 32,000,Rs 12,000 were to be borne by the firm and the balance by a partner. The expenses were paid by a partner.
(vii)	Realisation expenses of Rs 20,000 were to be borne and paid bya partner.
(viii)	Rohit, a partner is paid remuneration of Rs 20,000 for dissolution of the firm.Realisation expenses of Rs 32,000 are met by the firm

(ix)	Rohit, a partner agreed to take over the responsibility of completing dissolution at an agreed remuneration of Rs 4,000 and to bear all realization expenses. Actual realization expenses amounted to Rs 3,200 were paid by Rohit out of his private funds.
(x)	Rohit one of the partners was to receive 2% of the value of assets realized as remuneration for completing the dissolution work and was to bear realization expenses. Realisation expenses were Rs 4,000 paid by Rohit. The assets(including cash at bank Rs 12,000) realized Rs 6,12,000
(xi)	Rohit one of the partners was to receive 2% of the net cash realized from dissolution and was to bear realization expenses. Realisation expenses were Rs 4,000. The assets (including cash at bank Rs 12,000) realized Rs 6,12,000 and cash paid for outsider's liabilities amounted to Rs 1,60,000.
(xii)	Realisation expenses of Rs 2,000 were to be borne by Raju,a partner. However,it was paid by Sanju.

Solution: **JOURNAL**

Date	Particulars	L.F.	Amt(Dr.)	Amt (Cr.)
(i)	Realisation A/c Dr To Cash/Bank A/c		40,000	 40,000
(ii)	Realisation A/c Dr. To Partner's Cap. A/c		20,000	 20,000
(iii)	Partner's Cap. A/c Dr. To Cash/Bank A/c		20,000	 20,000
(iv)	Realisation A/c Dr. To Partner's Cap.A/c		30,000	 30,000
(v)	Realisation A/c Dr. Partner's Cap. A/c Dr. To Cash/Bank A/c		12,000 20,000	 32,000
(vi)	Realisation A/c Dr. To Partner's Capital A/c		12,000	 12,000
(vii)	No entry			
(viii)	(a)Realisation A/c Dr. To Rohit's Cap. A/c (b)Realisation A/c Dr. To cash/bank A/c		20,000 32,000	 20,000 32,000
(ix)	Realisation A/c Dr. To Rohit's Cap. A/c		4,000	 4,000
(x)	Realisation A/c Dr. To Rohit's Cap. A/c		12,000	 12,000
(xi)	(a) Realisation A/c Dr. To Rohit's Cap. A/c (b) No entry		8,800	 8,800
(xii)	Raju's Cap. A/c Dr. To Sanju's Cap. A/c		2,000	 2,000

Q.2 (Case study)

Rajat and Joe were partners in a firm, manufacturing polythene bags. After the strict ban on the use of polythene bags by the Govt. of India, the partners decided to dissolve the firm.
Following is the Balance Sheet of Rajat and Joe as on 31st march,2021:

Balance Sheet

Liabilities	**Rs**	**Assets**	**Rs**
Rajat's Capital	10,000	Building	15,000
Joe's Capital	10,000	Plant	20,000
General reserve	10,000	Goodwill	4,000
Mrs Rajat's loan	5,000	Investment	10,000
Mrs. Joe's Loan	10,000	Stock-in-trade	5,000
Sundry Creditors	30,000	Debtors 20,000 Less: Provision 2,000	 18,000
Investment Fluctuation Reserve	1,000	Cash at Bank	8,000

Bills Payable	8,000	Cash in hand	500
		Profit and Loss Account	3,500
	84,000		84,000

The firm was dissolved and at that date:

Creditors and Bills payable were due, on an average basis, one month after 31st March, but they were paid immediately on 31st March,@6% discount per annum.

There was an old manufacturing machine in the firm which had been written off completely from the books. It was now estimated to realize Rs 8,000. It was taken away by Joe at this estimated price.

On the basis of the above information, you are to suggest the answers of the following questions?

(i) What will be the required amount to be paid to the creditors?
(ii) What will be the amount to be paid to the Bills payable?
(iii) How will be old manufacturing machine will be recorded at the time of dissolution firm?
(iv) Realization expenses of Rs 4,800 were to be borne by Rajat. However, it was paid by Joe. How they will be recorded in the books of accounts?

Solution

(i) The amount to be paid to the creditors:
Discount on creditors=30,000*6/100*1/12=Rs 150
Amount to be paid=30,000-150=Rs 29,850

(ii) The amount to be paid to Bills Payable:
Discount on B/P=8,000*6/100*1/12=Rs 40
Amount to be paid=8,000-40=Rs 7,960

(iii) Joe's Capital A/c Dr. 8,000
To Realisation A/c 8,000

(iv) Rajat's Capital A/c Dr. 4,800
To Joe's Cap. A/c 4,800

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Part-B Accounting of Companies

Chapter-1 ACCOUNTING FOR SHARE CAPITAL

Features of a Company:-

• **Body Corporate**: A company is formed according to the provisions of Law enforced from time to time.
• **Separate Legal Entity**: A company has a separate legal entity which is distinct and separate from its members
• **Limited Liability**: The liability of the members of the company is limited to the extent of unpaid amount of the shares held by them
• **Perpetual Succession**: The company being an artificial person created by law continues to exist irrespective of the changes in its membership
• **Common Seal**: The company being an artificial person, cannot sign its name by itself
• **Transferability of Shares**: The shares of a public limited company are freely transferable
• **May Sue or be Sued**: A company being a legal person can enter into contracts and can enforce the contractual rights against others. It can sue and be sued in its name if there is a breach of contract by the company.

Share: Capital of a company is divided in certain units of a fixed amount. These units are known as Shares. It's the basis of ownership in a company.

Kinds of a Company

Companies registered under the Companies Act, 2013, may be classified as below:

Joint Stock Company

Unlimited Company | Company Limited by Guarantee | Company Limited by Shares

(i) Private Company | (ii) Public Company | (iii) One Person Company

Type of shares:

(1) Preference Shares:-According to Section 43 of The Companies Act, 2013, a preference share is one, which fulfils the following conditions :

(a) That it carries a preferential right to dividend to be paid either as a fixed amount payable to preference shareholders or an amount calculated by a fixed rate of the nominal value of each share before any dividend is paid to the equity shareholders.

(b) That with respect to capital it carries or will carry, on the winding up of the company, the preferential right to the repayment of capital before anything is paid to equity shareholders.

(2) Equity Shares: According to Section 43 of The Companies Act, 2013, an equity share is a share which is not a preference share. In other words, shares which do not enjoy any preferential right in the payment of dividend or repayment of capital, are termed as equity/ordinary shares.

DIFFERENTIATE BETWEEN PREFERENCE SHARES AND EQUITY SHARES

BASIS	PREFERENCE SHARES	EQUITY SHARES
DIVIDEND	Dividend paid at fixed rate	Rate of dividend is not fixed
RIGHT TO RECEIVE DIVIDEND	They have a right to receive dividend before any dividend paid on equity shares	Payment of dividend is made after the payment of preference dividend.
PAYMENT OF CAPITAL	They have right to return of capital in the case of winding up, before any capital is returned to equity shareholders	Equity share capital is paid only when preference share capital is paid out fully.
VOTING RIGHTS	Preference shareholders do not have any voting rights	Equity shareholders enjoy voting rights
PARTICIPATION IN MANAGEMENT	They do not have a right to participate in management of the company	They have full right to participate in management of the company.

Share Capital of a Company: A company, being an artificial person, cannot generate its own capital which has necessarily to be collected from several persons. These persons are known as shareholders and the amount contributed by them is called share capital. Since the number of shareholders is very large, a separate capital account cannot be opened for each one of them. Hence, innumerable streams of capital contribution merge their identities in a common capital account called a 'Share Capital Account'.

Categories of Share Capital: From accounting point of view the share capital of the company can be classified as follows:

• **Authorised Capital**: Authorised capital is the amount of share capital which a company is authorised to issue by its Memorandum of Association. It is also called Nominal or Registered capital. The authorised capital can be increased or decreased as per the procedure laid down in the Companies Act. It should be noted that the company need not issue the entire authorised capital for public subscription at a time. Depending upon its requirement, it may issue share capital but in any case, it should not be more than the amount of authorisedcapital.

• **Issued Capital:** It is that part of the authorised capital which is actually issued to the public for subscription including the shares allotted to vendors and the signatories to the company's memorandum. The authorised capital which is not offered for public subscription is known as 'unissued capital'. Unissued capital may be offered for public subscription at a later date.

• **Subscribed Capital**: It is that part of the issued capital which has been actually subscribed by the public. When the shares offered for public subscription are subscribed fully by the public the issued capital and subscribed capital would be the same. It may be noted that ultimately, the subscribed capital may be equal to or less than issued capital. Incase the number of shares subscribed is less than what is offered, the company allots only the number of shares for which subscription has been received. In case it is higher than what is offered, the allotment will be equal to the offer.

• **Called up Capital**: It is that part of the subscribed capital which has been called up on the shares, i.e., what the company has asked the shareholders to pay. The company may decide to call the entire amount or part of the face value of the shares, For example, if the face value (also called nominal value) of a share allotted is Rs. 10 and the company has called up only Rs. 7 per share, in that scenario, the called up capital is Rs. 7 per share. The remaining Rs. 3 may be collected from its shareholders as and when needed.

• **Paid up Capital**: It is that portion of the called up capital which has been actually received from the shareholders. When the shareholders have paid all the called amount, the called up capital is the same as the paid up capital. If any of the shareholders has not paid an amount on calls, such an amount may be called as 'calls in arrears'.

Paid up capital =Called-up Capital - Call in arrears.

• **Uncalled Capital**: That portion of the subscribed capital which has not yet been called up.

• **Reserve Capital**: A company may reserve a portion of its uncalled capital to be called only in the event of winding up of the company. Such an uncalled amount is called 'Reserve Capital' of the company. It is available only for the creditors on winding up of the company.

DISTINCTION BETWEEN RESERVE CAPITAL AND CAPITAL RESERVES

S. No.	Basis of Distinction	Reserve Capital	Capital Reserve
1.	**Meaning and Creation**	It refers to that portion of increased nominal capital or uncalled share capital which shall not be called up, except in the event of winding up.	Capital Reserve is that reserve which is created out of Capital profits such as profit on sale of fixed assets, profit on revaluation of fixed assets, premium on issue of shares and debentures, profit on redemption of debentures etc. These profits are not earned in the normal course of business.
2.	**Necessity**	It is not necessary to create Reserve Capital.	It is necessary to create Capital Reserve, in case of Capital profits.
3.	**Resolution**	A resolution is required for its creation.	No resolution is required for the creation of Capital Reserves.
4.	**Realised or not realised**	It refers to the amount which has not been received.	It refers to the amount which has already been received.
5.	**Disclosure in Balance Sheet**	It is not shown in the Company's balance sheet.	It is shown as the first item under the head, 'Reserves and Surplus' on the equity & liabilities side of the balance sheet.
6.	**Time when it can be used**	It can be used only at the time of winding up of the Company.	It can be used to write off Capital losses or to declare a share bonus any time during the life of the Company.

Sweat Equity Shares:

A Company may issue sweat equity shares as per Sec. 54 of Companies Act, 2013. Sweat equity shares means equity shares issued by the Company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available intellectual property rights. Such shares cannot be resold by their holders within a period of 3 years, called lock-in period.

Private Placement: The term "Private Placement" has been defined under section 42 of the Companies Act, 2013 as: "Any offer to a group selected by the company to subscribe its securities via issuing a private placement offer letter and satisfying the conditions specified in section 42 of the Companies Act,2013. One of the conditions specified under section 42 of the act is that such offer or invitation shall not be made to more than 50 persons or as may be prescribed in a particular financial year"

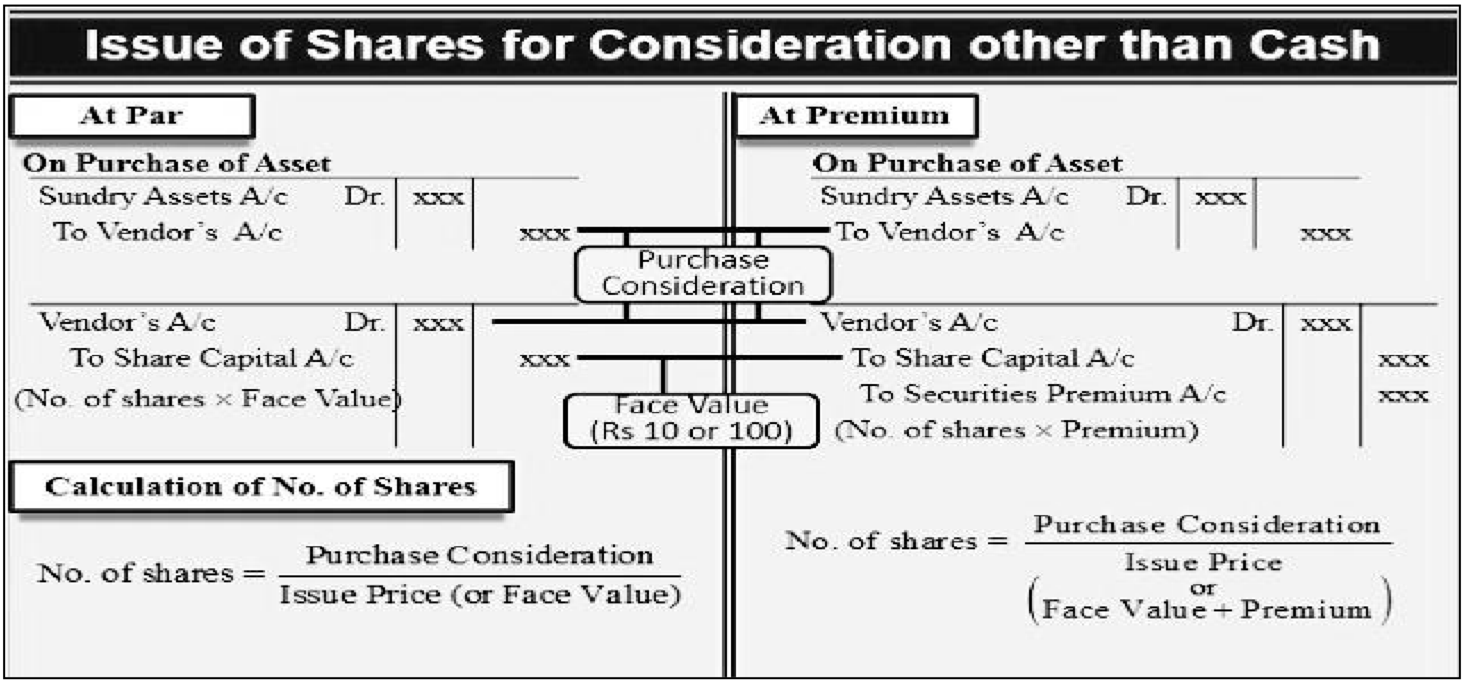
What does it mean to have an ESOP plan?

An ESOP (Employee stock option plan) refers to an employee benefit plan which offers employees an ownership interest in the organization. Employee stock ownership plans are issued as direct stock, profit-sharing plans or bonuses, and the employer has the sole discretion in deciding who could avail of these options.
Under the Employee stock option plan (ESOP), an "option" granted to the company employee carries the right, but not the obligation, to buy a promised number of shares at a predetermined price. Employee Stock Options are complex call options granted by the companies as a part of the remuneration package.
Stages of Share Issue: The issue of shares for cash is required to be made in strict conformity with the procedure laid down by law for the same. When shares are issued for cash, the amount on them can be collected at one or more of the following stages:

(i) Application for shares: The application money should be at least 5% of the face value of the share.
(ii) Allotment of shares
(iii) Call/Calls on shares.:

(***The amount on any call should not exceed 25% of the face value of shares. There must be an interval of at least one month between the makings of two calls unless otherwise provided by the articles of association of the company.)***

Issue of Shares for Consideration other than Cash: There are instances where a company enters into an arrangement with the vendors from whom it has purchased assets, whereby the latter agrees to accept the payment in the form of fully paid shares of the company issued to them. Normally, no such cash is received for issue of shares. These shares can also be issued either at par, at premium or at discount, and the number of shares to be issued will depend upon the price at which the shares are issued and the amount payable to the vendor. The number of shares to be issued to the vendor will be calculated as follows:



Calls in Arrears: Sometimes, the full amount called on allotment and/or call (calls) is not received from the allottees/shareholders. The amount not so received are cumulatively called 'Unpaid calls' or 'Calls in Arrears'. (if Articles are silent on this account, Table F is applicable which provides for interest on calls in arrear at a rate not exceeding 10% per annum.)
Calls in Advance :- Any amount paid by a shareholder in the excess of the amount due from him on allotment/call (calls) is known as 'Calls in Advance' for which a separate account is maintained. (if Articles are silent on this account, Table F is applicable which provides for interest on calls in advance at a rate not exceeding 12% per annum.)
Over Subscription: It is possible for the shares of some companies to be oversubscribed which means that applications for more shares are received than the number offered for subscription. If the amount of **minimum subscription** is not received to the extent of 90%, the issue dissolves.
Under Subscription: In case the applications received are less than the number of shares offered to the public, the issue is termed as

'under subscribed'.

Issue of Shares at Premium: Shares are issued at a premium, i.e. at an amount more than the nominal or par value of shares, the amount of premium is credited to a separate account called 'Securities Premium Reserve Account', the use of which is strictly regulated by law.

According to Section 52(2) of the Companies Act, **Securities Premium Account** may be used by the company for the following purposes only:

1) To fully paid bonus shares;
2) To writing-off preliminary expenses;
3) To writing-off expenses such as expenses, commission or discount on issue of shares or debentures;
4) To provide premium payable on redemption of debentures or preference shares;
5) In buying-back its own shares.

Issue of Shares at Par :The issue of shares at par implies that the shares have been issued for an amount exactly equal to their face or nominal value.

- **Issue of Shares**

  The important steps in the procedure of share issue are:-

  • *Issue of Prospectus:*

  • *Receipt of Applications:*

  • Allotment of Shares:

- **Accounting Treatment**

  On application: The amount of money paid with various installment represents contribution to share capital and should ultimately be credited to share capital. However, for the sake of convenience, initially individual accounts are opened for each installment. All money received along with application is deposited with a scheduled bank in a separate account opened for the purpose. The journal entry is as follows:

  Bank A/c Dr.

  To Share Application A/c

  (Amount received on application for — shares @ Rs. ______ per share)

- ***On allotment***

  When minimum subscription has been received and certain legal formalities on the allotment of shares have been duly compiled with, the directors of the company proceed to make the allotment of shares.

- The journal entries with regard to allotment of shares are as follows:

  1. For Transfer of Application Money

  Share Application A/c Dr.

  To Share Capital A/c

  (Application money on _____ Shares allotted/ transferred to Share Capital)

  2. For Money Refunded on Rejected Application

  Share Application A/c Dr.

  To Bank A/c

  (Application money returned on rejected application for ___shares)

  3. For Amount Due on Allotment

  Share Allotment A/c Dr.

  To Share Capital A/c

  4. For Adjustment of Excess Application Money

  Share Application A/c Dr.

  To Share Allotment A/c

  (Application Money on __Shares @ Rs__per shares adjusted to the amount due on allotment).

  5. For Receipt of Allotment Money

  Bank A/c Dr.

  To Share Allotment A/c

  (Allotment money received on ___Shares @ Rs. — per share Combined Account)

  Note:- The journal entries (2) and (4) can also be combined as follows:

  Share Application A/c

  To Share Allotment A/c

To Bank A/c
(Excess application money adjusted to share allotment and balance refunded)

On Calls: The amount on any call should not exceed 25% of the face value of shares. There must be an interval of at least one month between the making of two calls unless otherwise provided by the articles of association of the company.
When a call is made and the amount of the same is received, the journal entries are as given below:
1. For Call Amount Due
Share Call A/c Dr.
To Share Capital A/c
(Call money due on ___Shares @ Rs. ____ per share)
2. For Receipt of Call Amount
Bank A/c Dr.
To Share Call A/c
(Call money received)

Calls in Arrears: It may happen that shareholders do not pay the call amount on due date. When any shareholder fails to pay the amount due on allotment or on any of the calls, such amount is known as 'Calls in Arrears'/'Unpaid Calls'.
Calls in Arrears A/c Dr.
To Share First Call Account A/c
To Share Second and Final Call Account A/c
(Calls in arrears brought into account)

Forfeiture of Shares: Sometimes, shareholders fail to pay one or more installments on shares allotted to them. In such a case, the company has the authority to forfeit shares of the defaulters. This is called 'Forfeiture of Shares'. Forfeiture means the cancellation of allotment due to breach of contract and to treat the amount already received on such shares as forfeited to the company.

JOURNAL ENTRY:
(a) *Forfeiture of Shares issued at Par:*
Share Capital A/c..........(Called up amount) Dr.
To Share Forfeiture A/c...........(Paid up amount)
To Calls in Arrear A/C (OR)
To Share Allotment A/c
To Share Calls A/c (individually)
(..... shares forfeited for non-payment of allotment money and calls made)

Forfeiture of Shares issued at a Premium: If shares were initially issued at a premium and the premium amount has been fully realised, but some of the shares are forfeited due to non-payment of call money, the accounting treatment for forfeiture shall be on the same pattern as in the case of shares issued at par.
(b) *Forfeiture of Shares issued at Premium:*
Share Capital A/c..........(Called up amount) Dr.
Securities Premium Reserve A/c(Unpaid amount)
To Share Forfeiture A/c...........(Paid up amount)
To Calls in Arrear A/C (unpaid amount) (OR)
To Share Allotment A/c
To Share Calls A/c (individually)
(..... shares forfeited for non-payment of allotment money and calls made)

Reissue of Shares: The management of a company is vested with the power to reissue the shares once forfeited by it, subject of course, to the terms and conditions in the articles of association relating to the same. The shares can be reissued even at a discount provided the amount of discount allowed does not exceed the credit balance of the Share forfeiture account relating to shares being reissued. Therefore, discount allowed on the reissue of forfeited shares is debited to Share forfeiture account.

Reissued Forfeited Shares at Premium:
Bank A/c………………………………… Dr.

To Securities Premium Reserve A/c(excess amount)
To Share Capital A/c (paid up amount)
(Reissue of .... shares forfeited premium)

Reissued Forfeited Shares at Discount:

Bank A/c………………………………… Dr.
Share Forfeiture A/c(Deficit amount)
To Share Capital A/c (paid up amount)
(Reissue of .... shares forfeited less than the paid up value)

Reissued Forfeited Shares at Par:

Bank A/c………………………………… Dr.
To Share Capital A/c (paid up amount)
(Reissue of .... shares forfeited at paid up value)

Capital Reserve :-Once all the forfeited shares have been reissued, any credit balance on Share forfeiture account is transferred to the Capital Reserve representing profit on forfeiture of shares. In the event of all forfeited shares not being reissued, the credit amount on the Share forfeiture account relating to shares yet to be reissued is carried forward and the remaining balance on the account only is credited to the capital reserve account.

Share Forfeiture A/c Dr.
To Capital Reserve
(Profit on ………. reissued shares transferred to capital reserve)

CALCULATION OF CAPITAL RESERVE: 1 AMOUNT FORFEITED ON REISSUED SHARE $= \frac{Total\ Amount\ forfeited}{No\ of\ share\ forfeited}$ X No of shares reissued	XXXXX
2.: Less: if any Loss on Reissue	(XX)
3. Capital Reserve	XXXXX

<u>**Tips:** Calculate amount forfeited on one share and then multiply it by shares reissued then deduct loss on share reissued. You will get a capital reserve quickly.</u>

<u>Disclosure of Share Capital into the Balance Sheet of a Company</u>

Balance Sheet of a Company (As on)

Equity & Liabilities	Note No.	Amt. in ₹
(A) Shareholders Fund:		
(a) Share Capital	1	**XX**
(b) Reserve & Surplus	2	**XX**
(B) Non-Current Liabilities	3	
(C) Current Liabilities	4	

Notes to Account:

Particulars		
1. Share Capital **Authorised Capital** **(………… shares of ₹…….each share)**		**XXXX**
Issued Capital **(………… shares of ₹…….each share)**		**XXXXX**
Subscribed Capital		
Subscribed and Fully paid up **(………… shares of ₹…….each share)**	**XXXXX**	
Add: Share forfeiture Account ***XXX*** **(………… shares of ₹…….each share)**		
Subscribed but not fully paid up **(………… shares of ₹…….each share)**	**XXXXX**	**XXXXX**
Less: Calls in Arrear Account	***(XXXX)*****(………… shares of ₹…….each share)**	

Total Share capital	

QUESTION BANK

	SECTION A	
1	Which of the following statements is/are true? (i) Authorized Capital < Issued Capital (ii) Authorized Capital ≥ Issued Capital (iii) Subscribed Capital ≤ Issued Capital (iv) Subscribed Capital > Issued Capital **(a) (i) only (b) (i) and (iv) Both (c) (ii) and (iii) Both (d) (ii) only**	1
2	Name the head of Capital Clause of Memorandum of Association of a company in which the maximum amount of share capital mentioned is called _____. **(a) Reserve Capital (b) Subscribed Capital (c) Authorised Capital (d) Issued Capital**	1
3	The part of uncalled capital, to be called only in the liquidation of a company is called: **(a) Un-reserved Capital (b) Reserve Capital (c) Capital Reserve (d) Calls-in Arrears**	1
4	A shareholder allotted 9,000 shares of ₹ 10 per share failed to pay first & final of ₹ 2 per share. ₹ 18,000 to be recorded in the books of company with _____ **(a) Dr. to Calls-in Arrears A/c (b) Dr. to Share Forfeiture A/c** **(c) Cr. to Calls-in Arrears A/c (d) Cr. to Share Forfeiture A/c**	1
\5	**Read the following statement carefully and give the answer for the questions 06 and 07:** Kokun Ltd is authorised to issue shares 5,00,000 of ₹ 100 each. Company raised the capital by issuing 2,00,000 shares through e-IPO. As per the decision of the Managing Board of Directors of the company, the company issued 75,000 shares to their parent company and 40,000 shares issued to existing employees of the company as per their choice and option at the below price than the market price. "Company issued 75,000 shares to their parent company" is an example of ______. **(a) Public Issue (b) Private Placement (c) ESOP (d) Issue other than cash**	1
6	40,000 shares issued to existing employees of the company as per their choice and option at the below price than the market price." Is an example of _______ **(a) Public Issue (b) Private Placement (c) ESOP (d) Issue oth er than cash**	1
7	Vibhuti Ltd. forfeited 20 shares of ₹10 each, ₹8 called up, on which John had paid application and allotment money of ₹5 per share, of these, 15 shares were reissued to Parker as fully paid up for ₹6 per share. What is the balance in the share Forfeiture Account after the relevant amount has been transferred to Capital Reserve Account? **(a) ₹0 (b) ₹5 (c) ₹25 (d) ₹10 0**	1
8	Which of the following is a temporary representative personal account of shareholders? **(a) Share Application A/c (b) Share Allotment A/c (c) Share Application & Allotment A/c (d) All of these**	1
9	XYZ Ltd took over business of Bizare ltd and paid for it by issue of 30,000, Equity Shares of ₹100 each at a par along with 6% Preference Shares of ₹1,00,00,000 at a premium of 5% and a cheque of ₹8,00,000. What was the total agreed purchase consideration payable to Bizare ltd. **(a) ₹1,05,00,000. (b) ₹1,43,00,000. (c) ₹1,40,00,000. (d) ₹1,35,00,0 00.**	1
10	Ashok a shareholder of a company allotted shares to whom 12,000 of ₹ 100 each, failed to pay allotment ₹ 30 per share and first & final call ₹ 30 per share. Ashok had paid only application money. Pro-rata allotment proportion is 6:5. What will be the amount of calls-in arrears on allotment, from the following: **(a) ₹ 3,60,000 (b) ₹ 2,64,000 (c) ₹ 96,000 (d) None of these**	1
11	The allowed amount of discount on re-issue of shares will be _____ **(a) @ 10% of issue price (b) Up to the amount of forfeited money** **(c) Could not issue at discount (d) None of these**	1
12	As per SEBI guidelines application money should not be less than...........of the issue price of each share. **a) 10% b) 15% c) 25% d) 50%**	1
13	Minimum subscription amount of 90% is related to which share capital.... **a) Authorised Capital b) Issued Capital c) Paid up Capital d) Reserve capital**	1

14	Kaar Ltd forfeited 4,000 shares of ₹20 each, fully called up, on which only application money of ₹6 has been paid. Out of these 2,000 shares were reissued and ₹8,000 has been transferred to capital reserve. Calculate the rate at which these shares were reissued. **(a) ₹20 Per share (b) ₹18 Per share (c) ₹22 Per share (d) ₹8 Per share**	1
15	Shares issued by a company to its employees or directors in consideration of 'Intellectual Property Rights'(IPR) are called……. a) **Right equity Shares b) Private Equity shares c)Sweat Equity Share d) Bonus Equity shares**	1
16	Reserve capital is a part of … **a) Paid up Capital b) Forfeited share capital** **c) Asset d) Capital to be called up only on liquidation of company.**	
17	As per Section 52 of Companies Act 2013, Securities Premium Reserve cannot be utilised for: (**a) Writing off capital losses. (b) Issue of fully paid bonus shares.** **(c) Writing off discount on issue of securities. (d) Writing off preliminary expenses**.	1
18	……………….is transferred to the Capital Reserve. **a)Profit from sale of fixed assets b) Premium on issue of shares** **c) Profit on forfeiture of shares d) all of the above**	1
19	Given below are two statements, one labelled as Assertion (A) and the other labelled as Reason (R): **Assertion (A):** In case of shares issued on Pro–rata basis, excess money received at the time of application can be utilised till allotment only. **Reason (R**): Company has to pay interest on calls in advance @12% p.a. for amounts adjusted towards calls (if any). In the context of the above two statements, which of the following is correct? **(a) Both (A) and (R) are true, but (R) is not the explanation of working capital management.** **(b) Both(A) and (R) are true and (R) is a correct explanation of (A).** **(c) Both (A) and (R) are false.** **(d) (A) is false, but (R) is true**.	1

ANSWERS			
1	c	11	B
2	c	12	b
3	b	13	c
4	a	14	b
5	b	15	b
6	c	16	c
7	c	17	d
8	b	18	a
9	b	19	d
10	b	20	d

Q.1XY Ltd. is in carpet weaving business and in the process of setting up a new unit. It decided to set up the new unit in Kashmir with a view to help the people through employment who lost heavily in the floods. It also decided to adopt a school in the area and donated school furniture initially ,as it was destroyed. XY ltd. had an authorized capital of Rs 5,00,000 divided into equity shares of Rs 10 each. The company offered for subscription Rs. 3,00,000 shares. The issue was fully subscribed. The amount payable on application was Rs 2 per share. Rs 4 per share were payable each on allotment and first and final call. A shareholder holding 300 shares did not pay allotment. His share forfeited. The company did not make the first and final call.

Show how the 'Share capital' will be shown in the Balance Sheet of the company.

Solution: Authorised capital Rs. 5,00,000

Issued capital Rs. 3,00,000

Subscribed capital:

Fully paid up Nil

Not Fully paid up Rs.1,78,200

Share Forfeited A/c 600

Shareholder Funds(Share capital) Rs. 1,78,800

Q.2 Jindal and Company purchased a machine from High Life Machine Limited for Rs.3,80,000. As per purchase agreement, Rs. 20,000 were paid in cash and balance by issue of shares of Rs.100 each. What will be the entries passed if the shares are issued : (a) at par (b) at 20% premium.

Solution: (a) 3600 Shares (b) 3000 Shares

Q. 4From the following information complete journal entries:

JOURNAL

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
	Share Capital A/c…………………………………Dr.		?	
	Securities Premium A/c………………………Dr.		2,000	
	To Share forfeiture A/c			?
	To calls in arrears A/c			6,000
	(Being …..?....shares forfeited for non payment of…?.... including premium of Rs.2 per share)			
	Bank A/c…………………………………………………Dr.		?	
	Share forfeiture A/c………………………………Dr.		?	
	To share Capital A/c			?
	(Being …?... shares reissued @ Rs. 9 per share as fully paid)			
	Share forfeiture A/c………………………………Dr.		1,800	
	To Capital Reserve A/c			1,800
	(Being forfeiture money transferred to capital reserve account.)			

Dr. SHARE FORFEITURE A/C Cr.

Particulars	Amount	Particulars	Amount
To share capital A/c	?	By share Capital A/c	4,000
To Capital Reserve A/c	1,800		
To Balance C/d	1,600		
	4,000		4,000

(Face value of shares is Rs. 10 each)

Solution: JOURNAL

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
	Share Capital A/c…………………………………Dr.		8,000	
	Securities Premium A/c………………………Dr.		2,000	
	To Share forfeiture A/c			4,000
	To calls in arrears A/c			6,000
	(Being 1,000 shares forfeited for non-payment of Rs. 6 p.s.including premium of Rs.2 per share)			
	Bank A/c…………………………………………………Dr.		5,400	
	Share forfeiture A/c………………………………Dr.		600	
	To share Capital A/c			6,000
	(Being 600 shares reissued @ Rs. 9 per share as fully paid)			
	Share forfeiture A/c………………………………Dr.		1,800	
	To Capital Reserve A/c			1,800
	(Being forfeiture money transferred to capital reserve account.)			

Dr. SHARE FORFEITURE A/C Cr.

Particulars	Amount	Particulars	Amount
To share capital A/c	600	By share Capital A/c	4,000
To Capital Reserve A/c	1,800		
To Balance C/d	1,600		
	4,000		4,000

Q.4Hema ltd invited applications for issuing 30000 equity shares of ₹ 100 each at a premium of ₹ 20 each.The amount was payable

as follows:
On application and allotment ₹ 40(including premium ₹ 10) per share
On first call ₹ 50 (including premium ₹ 10) per share
On second and final call – balance
Applications for 75000 shares were received .Applications for 15000 share were rejected and the money received from them was refunded .Shares were allotted on pro rata to the remaining applicants. All calls were made. A who had applied for 2000 shares failed to pay the first call and second and final call on the shares allotted to him.B who was allotted 1000 shares failed to pay the second and final call .The shares of both A and B were forfeited.The forfeited share were reissued at ₹ 160 fully paid.
Pass necessary journal entries in the books of the company for the above transactions.
Solution:

Journal Entries

Particulars	**L.F**	**DR** ₹	**CR** ₹
Bank A/c Dr To Equity share Application and allotment A/c (being application and allotment money received for 75000 shares @ ₹ 40 per share including premium of ₹ 10)		3000000	300000
Equity share application and allotment A/c Dr To equity share capital A/c To securities Premium reserve A/c To Equity share first call A/c To Bank A/c (being first call money due on 30000 shares transferred to equity share capital account and excess applications for 15000 shares refunded)		300000	900000 300000 1200000 600000
Equity share first call A/c Dr To equity share capital A/c To securities premium reserve A/c (Being first call money due on 30000 shares @ ₹ 50 per share including premium of ₹ 10)		1500000	1200000 300000
Bank A/c Dr To Equity share first call A/c (Being share first call money received)		290000	290000
Equity share second and final call A/cDr To equity share capital A/c (being share second and final call money received)		900000	900000
Bank A/c Dr To Equity share second and final call A/c (Being share second and final call money received)		840000	840000
Securities premium reserve A/c Dr Equity share capital a/c Dr To share forfeited To equity share first call A/c To equity share second and Final call A/c (Being forfeiture of 2000 share for non payment of first call and second and final call money)		10000 200000	140000 10000 60000
Bank A/c Dr To Equity share capital A/c To securities Premium reserve A/c (being reissue of 2000 shares @ Rs 160 per share)		320000	200000 120000
Share forfeited A/c Dr To capital reserve A/c		140000	140000

(being profit on reissue transferred to capital reserve A/c)			

Working notes:

1. Calculation and adjustment of amount received on application

   Total application money received = 75000 shares

   Applications rejected =15000 shares

   Balance = 60000 shares

   Pro rata allotment made on 60000 shares

   Excess money received on application and allotment

   = 30000 shares X 40 = ₹ 1200000

   Money refunded = 15000 shares X 40 = ₹ 600000

2. No. of shares allotted to A = 2000 X 30000 = 1000 shares

   60000

   Application and allotment money received from A

   = 2000 shares X 40 = 80000

   Amount utilized for application and allotment = 40000

   Excess money retained for first call = 40000

Amount of first call due from A = 1000 shares X 50 = ₹ 50000

Less: amount received in advance for first call with application = Rs 40000

Amount not received of first call = 10000

3. Calculation of amount received on share first call

   Total amount due on first call = 30000 shares X 50 = ₹ 1500000

   Less: amount adjusted on first call received in advance = ₹ 1200000

   Amount to be received on first call = ₹ 300000

   Less: amount adjusted on first call not received from A = ₹ 10000

   Amount not received ₹ 290000.

****

ACCOUNTING FOR DEBENTURES

Meaning of debenture- It is an instrument acknowledging a debt issued under the common seal of the company.

According to Section 2(30) of the companies Act, 2013, "Debenture includes debenture stock, bonds and any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not."

As per Schedule III, debentures shall be shown in the equity and liabilities part of the balance sheet under the major head **'non-current liabilities'** and sub head **'long-term borrowings'.**

ISSUE OF DEBENTURES

- ❖ At PAR - When Issue Price and the face value is **same.**
- ❖ At Premium -When Issue Price is **more than** the face value.
- ❖ At Discount -When Issue Price is **less than** the face value.

Issue of Debentures for Cash

Accounting treatment of issue of debentures can be discussed under two heads:

1. **When debenture amount is received in Lump sum (if the full amount is payable along with application)**

On receipt of application money-	Bank A/c --------------------Dr. To Debenture Application and Allotment A/c
When money adjusted on allotted debentures	Debenture Application and Allotment a/c Dr. To % Debentures A/c
When debentures are issued at premium	Debenture Application and Allotment A/c Dr. To % Debentures A/c To Securities Premium Reserve a/c
When debentures are issued at discount	Debenture Application and Allotment A/c Dr.

	Discount on issue of debentures A/cDr. To % Debentures A/c

2. **When Debentures Amount is Received in Installments**

On receipt of application money	Bank a/c Dr. To Debenture application a/c	
When application money adjusted on allotted debentures	Debenture Application a/c Dr. To % Debentures a/c	
When Allotment Money Due on debenture holder	Debenture Allotment a/c Dr. To % Debentures a/c	At par
	Debenture Allotment a/c Dr. To % Debentures a/c To Sec. Premium Reserve a/c	At premium
	Debenture Allotment A/c Dr. Discount on issue of deb. a/c Dr. To Debentures A/c	At discount
On adjustment of excess money	Debenture application a/c Dr. To Debenture allotment a/c	
On refund of excess debenture application money	Debenture application a/c Dr. To Bank a/c	
On receipt of allotment money	Bank a/c Dr. To Debenture allotment a/c	
When money due on calls	Debenture call a/c Dr. To % Debentures a/c	
On receipt of call money	Bank a/c Dr. To Debenture call a/c	

TYPES OF DEBENTURES

1. **SECURED /MORTGAGE** Debentures are those that are secured against some particular assets of a company.
2. **NAKED/UNSECURED** Debentures are those which are not secured against any assets of a company.
3. **REGISTERED Debentures** are those which can be transferred by executing regular transfer deed.
4. **BEARER Debentures** are those which can be transferred by way of mere delivery.
5. **CONVERTIBLE Debentures** are those, the holder of which are given an option to convert into shares and new debentures.
6. **NON-CONVERTIBLE Debentures** are those, the holder of which has no right to convert them into shares and new debentures.
7. **REDEEMABLE Debentures** are those that will be repaid by the company at the end of a specified period.
8. **IRREDEEMABLE/PERPETUAL Debentures** are those that are not repayable during the lifetime of the company. These debentures are not issued in India.

DISTINCTION BETWEEN SHARES AND DEBENTURES

Basis	**Shares**	**Debentures**
Capital/Loan	It is the part of capital of the company.	It is part of loan of the company.
Dividend/Interest	Dividend is paid on shares only when there are profits in the company.	Interest has to be paid, irrespective of the company earning a profit or suffering a loss.
Rate	Rate of dividend may change from time to time.	Rate of interest is fixed at the time of issue.
Convertibility	Cannot be converted into debentures.	Can be converted into shares.
Issue at a discount	Under sec 53 of the Companies Act 2013, cannot be issued at discount.	No restriction on issue of debentures at a discount.
Voting Right	Yes	No

ISSUE OF DEBENTURES FOR CONSIDERATION OTHER THAN CASH

When debentures are issued to vendors against purchase of assets or against purchase of business, it is termed as issue of debentures for consideration other than cash.

Issue of debentures to Vendors

On purchase of Assets or Business	• **When assets are purchased** Sundry Assets a/c Dr. To Vendor's a/c
	• **When business is purchased** Sundry Assets a/c Dr. ***Goodwill a/c** Dr. To Sundry Liabilities a/c To Vendor's a/c ***To Capital Reserve a/c**
On issue of Debentures **No. of Deb.** = $\frac{\textbf{Amount payable to vendor}}{\textit{Issued Price}}$	• **When debentures are issued at par** Vendor's a/c Dr. To % Debentures a/c
	• **When debentures are issued at premium** Vendor's a/c Dr. To % Debentures a/c To Securities Premium Reserve a/c
	• **When debentures are issued at discount** Vendor's a/c Dr. Discount on issue of debentures a/c Dr. To % Debentures a/c

2. Issue of debentures to Promoters

Making promotion expenses due	Formation Expenses/Incorporation Cost Dr. To Promoter's A/c
Issuing debentures to Promoters	Promoter's a/c Dr. To % Debentures a/c

3. Issue of debentures to Underwriters

Making Underwriting Expenses due	Underwriting Expenses a/c Dr. To Underwriters a/c
Issuing Debentures to Underwriters	Underwriters a/c Dr. To % Debentures a/c
	Statement of Profit and Loss a/c Dr. To Underwriting Expenses A/c

DEBENTURES ISSUED AS COLLATERAL SECURITY

Collateral security refers to the additional or secondary security addition to the primary security. When a company takes a loan, it may provide primary security on its assets. However the lending institution may insist on some more assets as secondary or collateral security. In such a situation, the company may issue debentures as a collateral security to the lender.

Debentures issued as collateral security can be dealt in two ways

1. **First Method.** In this method, debentures have been issued as collateral security is disclosed in the balance sheet, by way of information below debentures, which are shown as long-term borrowings under non-current liabilities or as short-term borrowings under current liabilities (redeemable within 12 months).
2. **Second Method.** Following journal entry will be passed for issue of debentures as collateral security

Debentures Suspense a/c Dr. To % Debentures a/c

In balance sheet, debentures issued as collateral security must be shown separately from other debentures.

Interest on Debentures

Interest on debentures is considered as an expense. It is charge against profits of the company and is payable irrespective of the fact whether there are profits or not.

1. When interest is due	Debenture Interest a/c Dr. To Debenture holders' a/c
2. When interest is paid	Debenture holders' a/c Dr. To Bank a/c
3. On transfer of interest on Debenture	Statement of Profit and Loss a/c Dr. To Debenture Interest a/c

Note: Interest is not payable on debentures issued as collateral security.

Various cases from the Point of view of Redemption

Meanings of Redemption- it means repayment of the amount of debentures to the debenture holders. It implies of the principle amount as well as interest due on debentures.

1. When Debentures are Issued at Par and Redeemable at Par	Bank a/c Dr. To Debenture Application A/c Debenture Application A/c Dr. To % Debentures A/c
2. When Debentures are Issued at Par and Redeemable at Premium	Bank a/c Dr. To Debenture Application A/c Debenture Application A/c Dr. Loss on issue of Debentures Dr. To % Debentures A/c To Premium on Redemption of Deb.
3. When Debentures are Issued at Discount and Redeemable at Par	Bank a/c Dr. To Debenture Application A/c Debenture Application A/c Dr. Discount on issue of Debentures Dr. To % Debentures A/c
4. When Debentures are Issued at Discount and Redeemable at Premium	Bank a/c Dr. To Debenture Application A/c Debenture Application A/c Dr. Discount on issue of Debentures Dr. Loss on issue of Debentures Dr. To % Debentures A/c To Premium on Redemption of Deb.
5. When Debentures are Issued at Premium and Redeemable at Par	Bank a/c Dr. To Debenture Application A/c Debenture Application A/c Dr. To % Debentures A/c To Securities Premium Reserve A/c
6. When Debentures are Issued at Premium and Redeemable at Premium	Bank a/c Dr. To Debenture Application A/c Debenture Application A/c Dr. Loss on issue of Debentures A/c Dr. To % Debentures A/c To Premium on Redemption of Deb.

	To Securities Premium Reserve A/c

Writing – off Discount/Loss on issue of Debentures

'Discount/Loss on issue of Debentures' is to be written off from the company books by utilizing 'Securities Premium Reserve' or surplus, i.e. balance in statement of profit and loss, under the head 'Reserve and Surplus' as Financial Cost (AS 16) in that order.

It will be written off in same year (at the end) in which this discount/loss occurred.

Accounting Treatment

Securities Premium Reserve A/c Dr. Statement of Profit and Loss A//c Dr. To Discount/Loss on issue of Debentures A/c

Note: If 'Securities Premium Reserve' not exists in the question, then loss/discount is completely written-off by debiting statement of profit and loss account.

QUESTIONS

1. XYZ Ltd. invited applications for issuing 3,000, 12% Debentures of ₹ 100 each at a discount of 6%. The full amount was payable on application. Applications were received for 3,600 debentures. Applications for 600 debentures were rejected and the application money was refunded. Debentures were allotted to the remaining applicants. Pass journal entries for the above transactions.

Sol. **In the books of XYZ Ltd.**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank a/c Dr. To Debenture Application A/c (For application money received)		3,38,400	 3,38,400
	Debenture Application A/c Dr. Discount on issue of Debentures Dr. To 12% Debentures A/c To Bank A/c (for allotment of 3,000 debentures)		3,38,400 18,000	 3,00,000 56,400

2. Shourya Ltd. issued 20,000, 12% debentures of ₹100 each payable ₹40 on application and ₹60 on allotment. The public applied for 24,000 debentures. Applications for 18,000 debentures were accepted in full; applications for 3,000 debentures were allotted 2,000 debentures and the remaining applications were rejected. All money was duly received. Journalize the transactions.

Sol. **In the books of Shourya Ltd.**

Date	Particulars	L.F.	Dr. (₹)	Cr.(₹)
	Bank a/c Dr. To Debenture Application A/c (For application money received)		9,60,000	 9,60,000
	Debenture Application A/c Dr. To 12% Debentures A/c To Debenture Allotment A/c To Bank A/c (Being debentures application money transferred to debenture a/c and excess refunded)		9,60,000	 8,00,000 40,000 120,000
	Debentures Allotment a/c Dr. To 12% Debentures a/c (Being Allotment money is due)		12,00,000	 12,00,000

	Bank a/c Dr. To Debenture Allotment a/c (Being allotment money received)		11,60,000	 11,60,000

3. Give journal entries for issue of debentures in each of the following cases.
   (i) 10,000, 9% debentures of ₹ 100 each issued at Par and repayable at Par
   (ii) ₹ 3,00,000, 9% Debentures of ₹100 each issued at ₹120 repayable at ₹100
   (iii) 635, 9% debentures of ₹ 500 each issued at 5% Discount but repayable at par.
   (iv) P Ltd. issued 365, 9% debentures of ₹ 1,000 each at Par but redeemable at Premium of 10%.
   (v) 4,000, 9% debentures of ₹ 100 each issued at ₹ 95 redeemable at ₹ 105.
   (vi) 25,000 debentures of ₹100 each issued at ₹ 105 redeemable at ₹ 110

Sol. **JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	Bank A/c Dr. To Debenture Application A/c (For debenture application money received)		10,00,000	 10,00,000
	Debenture Application A/c Dr. To 12% Debentures A/c (Being debentures application money transferred to debentures a/c)		10,00,000	 10,00,000
(ii)	Bank A/c Dr. To Debenture Application A/c (For application money received)		3, 60,000	 3, 60,000
	Debenture Application A/c Dr. To 12% Debentures A/c To Securities Premium Reserve A/c (for debentures application money adjusted))		3,60,000	 3,00,000 60,000
(iii)	Bank A/c Dr. To Debenture Application A/c (For debenture application money received)		3,01,625	 3,01,625
	Debenture Application A/c Dr. Discount on issue of Debentures A/c Dr. To 9% Debentures A/c (Being debentures application money transferred to debentures a/c)		3,01,625 15,875	 3,17,500

(iv)	Bank A/c Dr. To Debenture Application A/c (For application money received)		3, 65,000	 3, 65,000
	Debenture Application A/c Dr. Loss on issue of debentures A/c Dr. To 12% Debentures A/c To Premium on Redemption A/c (for debentures application money and premium on redemption adjusted)		3,65,000 36,500	 3,65,000 36,500
(v)	Bank A/c Dr. To Debenture Application A/c (For application money received)		3,80,000	 3, 80,000
	Debenture Application A/c Dr. Loss on issue of debentures A/c Dr.		3,80,000 40,000	

	To 12% Debentures A/c To Premium on Redemption A/c (for debentures application money and premium on redemption adjusted)			4,00,000 20,000
(vi)	Bank A/c Dr. To Debenture Application A/c (For application money received)		26,25,000	 26,25,000
	Debenture Application A/c Dr. Loss on issue of debentures A/c Dr. To 12% Debentures A/c To Securities Premium Reserve A/c To Premium on Redemption A/c (for debentures application money and premium on redemption adjusted)		26,25,000 2,50,000	 25,00,000 1,25,000 2,50,000

4. LMN Ltd. took over assets of ₹ 23,00,000 and liabilities of ₹ 8,00,000 from PQR Ltd. LMN Ltd. paid the purchase consideration by issuing 15,000 9% debentures of ₹ 100 each at a premium of 10% and accepting a bill payable of ₹ 3,50,000 payable after 4 months. Such debentures are repayable after 5 years at 5% premium. Compute purchase consideration and pass journal entries in the books of LMN Ltd.

Sol. Computation of purchase consideration

Nominal value of debentures = ₹ 15,00,000
Securities Premium Reserve = ₹ 1,50,000
Bills Payable = ₹3,50,000
Total Purchase consideration = ₹ 20,00,000

In the books of LMN Ltd.

Date	Particular	LF	Dr. (₹)	Cr. (₹)
	Sundry Assets a/c Dr. Goodwill a/c Dr. To Sundry Liabilities a/c To PQR Ltd. (Being purchase of assets and liabilities of PQR Ltd.)		23,00,000 5,00,000	 8,00,000 20,00,000
	PQR Ltd. Dr. Loss on issue of Debentures a/c Dr. To 9% Debentures a/c (15,000 X ₹100) To Securities Premium a/c To Bills Payable a/c To Premium on Redemption a/c (being debentures issued and PRD also adjusted.)		20,00,000 75,000	 15,00,000 1,50,000 3,50,000 75,000

5. ABC Ltd. purchased assets of the book value of ₹ 8,00,000 and took over the liabilities of ₹1,00,000 from XYZ Ltd. it was agreed that the purchase consideration, settled at ₹ 7,60,000, be paid by issuing 11% debentures of ₹ 100 each.

What journal entries will be made in the following three cases if debentures are issued (i) at par, (ii) at discount of 10% and at a premium of 10%? It was agreed that any fraction of debentures be paid in cash.

Sol. **In the books of ABC Ltd.**

Date	Particular	LF	Dr. (₹)	Cr. (₹)
	Sundry Assets a/c Dr. Goodwill a/c Dr. To Sundry Liabilities a/c To XYZ Ltd. (Being assets and liabilities took over from XYZ Ltd.)		8,00,000 60,000	 1,00,000 7,60,000
	XYZ Ltd. Dr. To 11% Debentures a/c (Being the issue of 11% debentures of 7600[760000/100]at par)		7,60,000	 7,60,000
	XYZ Ltd. Dr.		7,60,000	

	Discount on issue of Debenture a/c Dr. To 11% Debentures a/c To Cash a/c (Being the issue of 11% debentures of 8444 [760000/90]at 10% discount)		84,440	 8,44,400 40
	XYZ Ltd. Dr. To 11% Debentures a/c To Securities Premium Reserve a/c To Cash A/c (Being the issue of 11% debentures of 6909[760000/110]at premium)		7,60,000	 6,90,900 69,090 10

6. On 1st May, 2020 Solar Energy Ltd. issued 50,000, 9% debentures of ₹100 each at a discount of 10% redeemable at par after five years. All the debentures were subscribed. It has a balance of ₹ 3,00,000 in securities premium reserve which the company decided to use for writing off the loss and also decided to write off the remaining discount in the first year itself.
Pass the journal entries for issue of debentures. Also prepare discount on issue of debenture account.

Sol. **In the books of Solar Energy Ltd.**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank a/c Dr. To Debenture Application and allotmentA/c (For debenture application money received)		45,00,000	 45,00,000
	Debenture Application A/c Dr. Discount on issue of Debentures Dr. To 9% Debentures A/c (Being debentures application money transferred to debentures a/c)		45,00,000 5,00,000	 50,00,000

Dr. **Discount on issue of Debentures A/c** Cr.

Date	Particulars	Amt. (₹)	Date	Particular	Amt.(₹)
1 May 2020	To 9% Debentures A/c	5,00,000	2021 Mar 31	By Sec. Pre. Reserve a/c By Statement of Profit and Loss A/c	3,00,000 2,00,000
		5,00,000			5,00,000

7. Solar Ltd. had 5,000, 9% debentures of ₹ 100 each at par for cash and also raised a loan of ₹ 1,80,000 from America Bank, for which the company placed with the bank ₹ 2,00,000, 9% debentures as collateral security. How will you show the debentures in the balance sheet of the company and also pass journal entries?

Sol. **Balance Sheet as at…..**

Particulars	Note No.	Amount (₹)
I. EQUITY AND LIABILITIES		
1. Non-current Liabilities		
Long-term Borrowings	1	6,80,000
Notes to Accounts:		
1. Long-term Borrowings		
Loan from Bank		1,80,000
Debentures		
5,000, 9% Debentures of ₹ 100 each		5,00,000
2,000,9% debentures of ₹ 100 each Issued as Collateral Security 2,00,000		
(-) Debentures Suspense (2,00,000)		-

Journal Entries:

Date	Particular	L. F.	Amt. (Dr.)	Amt. Cr.

	Bank A/c Dr. To Bank Loan A/c (Being bank loan raised from America Bank)		1, 80, 000	1, 80, 000
	Debenture Suspense a/c Dr. To 9% Debentures a/c (Being 2000, 9% Debentures of ₹ 100 issued as collateral security)		2, 00, 000	2, 00, 000

Case Based MCQs

8. Star Blankets Ltd. are the manufacturers of woolen blankets. Blankets of the company are exported to many countries. To meet the requirements of funds, the company issued 50,000, 10% debentures of ₹ 100 each and 8% debentures of ₹ 100 each issued at 20% premium to the vendor of the machinery purchased for ₹ 7,20,000.
   (i) Debentures issued to vendor of machinery would be classified as________?
   (ii) How many debentures are issued in total?
   (iii) How many debentures should be issued, if 8% debentures of ₹ 100 each are issued at 20% discount amounting to ₹ 2, 00,000?
   (iv) Calculate total interest payable by the company to the in first year ?
   (v) How much amount will be transferred to Securities Premium Reserve Account?
   (vi) What is the nature of discount on debentures A/c?

   Sol. (i) Issue of debentures for consideration other than cash (ii) 56,000
   (iii) No. of debentures issued = 2,00,000/80= 2,500
   (iv) (50,000, 10% @ ₹100 = 5,00,000), (6,000, 8% @ ₹100 = 48,000)= 5,48,000
   (v) ₹ 1,20,000 (6,000 X 20) (vi) Nominal A/c

9. Accounts Expert Ltd. an educational company founded in 2010 deals in providing offline educational services to the schools, colleges and private institutes. During Covid-19 pandemic situation, the entire education system went online and the company was bound to shift from offline to online. For this, the company required fund and decided to raise the required funds through debentures. For this, Company invited applications for 20,000, 12% debentures of ₹100 each at a premium of ₹60 per debenture, repayable after 5 years along with same amount of premium. The full amount was payable on application. Applications were received for 23, 000 debentures.
   (i) How much amount will be received at the time of application?
   (ii) While issuing debentures, what amount will be credited to 12% Debentures Account?
   (iii) How much amount will be credited to Securities Premium Reserve Account?
   (iv) How much amount will be credited to Premium on Redemption Account?
   (v) What journal entry will be passed to write off the loss on issue of debentures Account?
   (vi) If the balance in Securities Premium Reserve is insufficient than from where the balance of loss on issue of debentures will be written off?

   Sol. (i) ₹36,80,000 (ii) ₹20,00,000 (iii) ₹12,00,000 (iv) ₹12,00,000
   (v) Securities Premium Reserve A/c Dr. 12,00,000
   To Loss on issue of Debentures A/c 12,00,000
   (vi) Statement of Profit and Loss

10. Sunlight India Ltd. is to produce and distribute green energy in the backward areas of India. It has also taken up project of giving vocational training to the girls belonging to the backward areas of Rajasthan. To meet this requirement of funds to serve the purpose, company issued 10,000, 8% Debentures of ₹100 each on 1st April 2020 redeemable at a premium of 10% after 4 years. The issue was subscribed by 95%.
   According to the terms of issue, interest on debentures is payable half-yearly on 30th September and 31st March.
   (i) What is the nature of interest on debentures?
   (ii) What journal entry will be passed for charging interest on debentures on 30th September, 2020?
   (iii) What journal entry will be passed for writing off the interest on debentures at the end of the year?
   (iv) At the time of issue of debentures what amount will be credited to premium on redemption of debentures account?
   (v) What is the ownership status of debenture holders in a company?
   (vi) In case of loss will the interest on debentures be payable? Give reason.

   Sol. i. Charge against profit.
   ii. Debentures Interest a/c Dr. 38,000

To Debenture Holders a/c			38,000
Debenture Holders a/c	Dr.	38,000	
To Bank a/c			38,000
iii. Statement of Profit and Loss A/c	Dr.	76,000	
To Debenture Interest a/c			76,000

iv. Credited by ₹95,000 v. Creditors/lenders of the company. vi. Yes, Because it is a charge against profit.

****

Financial Statements of a Company

Meaning of Financial Statements

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

Nature of Financial Statements:

1. *Recorded Facts:* Financial statements are prepared on the basis of facts in the form of cost data recorded in accounting books(The original cost or historical cost). As these are not based on market prices, the financial statements do not show current financial condition of the concern.
2. *Accounting Conventions:* Certain accounting conventions are followed while preparing financial statements. The use of accounting conventions makes financial statements comparable, simple and realistic.
3. *Postulates:* Financial statements are prepared on certain basic assumptions (pre-requisites) known as postulates such as going concern postulate, money measurement postulate, realization postulate, etc.
4. *Personal Judgements:* Under more than one circumstance, facts and figures presented through financial statements are based on personal opinion, estimates and judgements.

Uses and Importance of Financial Statements:

1. *Report on stewardship function:* Financial statements report the performance of the management to the shareholders. The gaps between the management performance and ownership expectations can be understood with the help of financial statements.
2. *Basis for fiscal policies:* The fiscal policies, particularly taxation policies of the government, are related with the financial performance of corporate undertakings.
3. *Basis for granting of credit:* Corporate undertakings have to borrow funds from banks and other financial institutions for different purposes. Credit granting institutions take decisions based on the financial performance of the undertakings.
4. *Basis for prospective investors:* The investors include both short-term and long-term investors. Their prime considerations in their investment decisions are security and liquidity of their investment with reasonable profitability. Financial statements help the investors to assess long-term and short-term solvency as well as the profitability of the concern.
5. *Guide to Present shareholders:*Shareholders of companies are interested in knowing the status, safety and return on their investment.
6. *Aids trade associations in helping their members:* Trade associations may analyse the financial statements for the purpose of providing service and protection to their members.
7. *Helps stock exchanges:* Financial statements help the stock exchanges to understand the extent of transparency in reporting on financial performance and enables them to call for required information to protect the interest of investors.

Types of Financial Statements:

The financial statements generally include two statements:
(1) Balance Sheet (2) Statement of Profit and Loss
Apart from these, there is also a need to know about movements of funds and changes in the financial position of the company. For this purpose, a cash flow statement is prepared.

Format of Balance Sheet(in accordance with the manner prescribed in the revised Schedule III to the Companies Act, 2013-Part I):

Balance Sheet as at 31st March, 20.....

Particulars	Note No.	Figure as at the end of Current reporting	Figure as at the end of Previous reporting

		period	period
I. EQUITY AND LIABILITIES			
1) Shareholder's Funds			
(a) Share Capital			
(b) Reserves and Surplus			
(c) Money received against share warrants			
2) Share Application money pending allotment			
3) Non-current Liabilities			
(a) Long term borrowings			
(b) Deferred tax liabilities (net)			
(c) Other long term liabilities			
(d) Long term provisions			
4) Current Liabilities			
(a) Short-term borrowings			
(b) Trade payables			
(c) Other current liabilities			
(d) Short-term provisions			
Total			
II. ASSETS			
1) Non-Current Assets			
(a) Plant, Property and Equipment and Intangible Assets			
(i) Plant, Property and Equipment			
(ii) Intangible assets			
(iii) Capital work-in-progress			
(iv) Intangible assets under development			
(b) Non-current investments			
(c) Deferred tax assets (net)			
(d) Long-term loans and advances			
(e) Other non-current assets			
2) Current Assets			
(a) Current investments			
(b) Inventories			
(c) Trade receivables			
(d) Cash and cash equivalents			
(e) Short term loans and advances			
(f) Other current assets			
Total			

IMPORTANT Points:

(1) Disclosure on the face of the financial statements or in the notes are essential and mandatory.

(2) Current and Non-current Classification: The classified balance sheet in terms of current and non-current assets and current and non-current liabilities have been introduced.

An item is classified as current:

- if it is involved in entity's operating cycle or,
- is expected to be realised/settled within twelve months or,
- if it is held primarily for trading or,
- is cash and cash equivalent or,
- if entity does not have on unconditional rights to defer settlement of liability for atleast 12 months after the reporting period,
- Other assets and liabilities are non-current.

Note: Now 'Fixed Assets' term is replaced with 'Plant, Property and Equipment and Intangible Assets'. Wherever it is required now use the new term.

(3) Preliminary expenses are to be written-off completely in the year in which such expenses are incurred. They should be written-off first from securities premium and the balance if any, from statement of profit & loss.

(4) Borrowing costs such as discount on issue of debentures should be written-off in the same year in which debentures are issued.

(5) Current maturities to long-term loan include amount repayable within twelve months/operating cycle under other current liabilities with Note to Account.

(6) Proposed dividend is shown as contingent liability.

Note:Exceptional items, extraordinary items and profit (loss) from discontinued operations are excluded.

The items of **Balance Sheet** are discussed as follows:

1) Shareholders Fund: a) Share Capital

i) Authorised Capital
ii) Issued Capital
iii) Subscribed and Fully Paid-up
iv) Subscribed and not Fully Paid-up
Less: Unpaid calls/Calls-in-arrears
Add: Forfeited shares/Share Forfeiture

b) Reserve and Surplus

(i) Capital Reserve (ii) Capital Redemption Reserve (iii) Securities Premium Reserve
(iv) Debenture Redemption Reserve/Sinking Fund (v) Revaluation Reserve
(vi) Share Options Outstanding Account (vii) Other Reserves (Specifying nature and purpose) like Workmen Compensation Reserve/Fund, Investment Fluctuation Reserve/Fund and Contingencies' Reserve etc.
(viii) Surplus: Balance in statement of profit and loss; disclosing allocations and Appropriation such as dividend, bonus shares, transfer to/from reserve, etc.('Debit' balance of statement of profit and loss shall be shown as a negative figure under 'Surplus' head.)

c) Money Received against share warrants: It is the amount received by the company which is converted into shares at a specified date on a specified rate. The instrument issued against the amount so received as share warrants.

2) Share Application money pending allotment: Amount of share application received but allotment is pending on the date of preparing Balance Sheet.

3) Non-current Liabilities: (a) Long term borrowings: Loans which are repayable in more than twelve months/operating cycle are classified as long-term borrowings on the face of balance sheet. e.g. Debentures, Bank Loans, Mortgage Loans, Public deposits, loans from Financial Institutions etc.

(b) Deferred tax liabilities (net): are always non-current. This is in accordance with Schedule III of the Companies Act.

(c) Other long term liabilities: e.g. Trade payables & Provident fund to be settled beyond 12 months from the date of balance sheet or beyond the operating cycle are classified under "other long-term liabilities"

(d) Long term provisions: The amount of provision settled beyond 12 months from balance sheet date or operating cycle period from date of its recognition is classified as long term provisions and shown under non-current liabilities. e.g. Provision for Encashment of Earned leave/Gratuity etc.

4) Current Liabilities: (a) Short-term borrowings: Loans repayable on demand or whose original tenure is not more than twelve months/operating cycle are classified as short-term borrowings on the face of balance sheet.

(b) Trade payables: Purchase of goods and services in normal course of business on Credit settled within 12 months or within the operating cycle

(c) Other current liabilities: Obligations to be settled within 12 months from balance sheet date or within operating cycle period from date of its recognition other than Short Terms Borrowings and Trade Payables.

(d) Short-term provisions: The amount of provision settled within 12 months from balance sheet date or within operating cycle period from date of its recognition is classified as short term provisions and shown under current liabilities. e.g Provisions for Repairs & Maintenance.

1) Non-Current Assets: (a) Plant, Property and Equipment and Intangible Assets: Useful life is beyond 12 Months.

(i) Plant, Property and Equipment: Assets which can be touched and seen and useful life is beyond 12 Months.

(ii) Intangible assets: assets which cannot be touched and seen and useful life is beyond 12 Months.

(iii) Capital work-in-progress: Tangible assets under construction or making.

(iv) Intangible assets under development: Intangible assets under its process of development.

(b) Non-current investments: Investments expected to realise beyond twelve months are considered as non-current investments under non-current assets.

(c) Deferred tax assets (net): are always non-current. This is in accordance with Schedule III of the Companies Act.

(d) Long-term loans and advances: Loans advanced to outsiders or advances given for trading purpose to be settled by them beyond 12 months from balance sheet date or beyond operating cycle period from date of its recognition.

(e) Other non-current assets: Trade receivables realised beyond twelve months from reporting date/ operating cycle starting from the date of their recognition are classified as "Other non-current assets" under the head non-current assets with Note to Accounts. Fictitious assets to be written off beyond 12 months etc.

2) Current Assets: (a) Current investments: Investments expected to realise within twelve months are considered as current investments under current assets.

(b) Inventories: Materials left unsold and unused at the end of the accounting period.
(c) Trade receivables: Sale of goods or services rendered in normal course of business on credit.
(d) Cash and cash equivalents: 'Cash' comprises cash in hand and demand deposits with banks, and 'Cash equivalents' means short-term highly liquid investments that are readily convertible into known amounts *of cash and which are subj*ect to an insignificant risk of changes in value. An investment normally qualifies as cash equivalents only when it has a short maturity, of say, three months or less from the date of acquisition.
(e) Short term loans and advances: Loans advanced to outsiders or advances given for trading purpose to be settled by them within 12 months from balance sheet date or within operating cycle period from date of its recognition.
(f) Other current assets: Fictitious assets to be written off within 12 months, Prepaid expenses etc.

Form and content of Statement of Profit and Loss

Statement of Profit and Loss for the year ended ____________

Particulars	Note No.	Figure as at the end of Current reporting period	Figure as at the end of Previous reporting period
I Revenue from operations			
II Other income			
III Total Revenue (I+II)			
IV Expenses:			
Cost of materials consumed			
Purchases of stock-in-trade			
Changes in inventories of finished goods			
Work-in-progress and stock-in-trade			
Employee benefits expense			
Finance costs			
Depreciation and amortisation expense			
Other expenses			
Total expenses			
V Profit before tax(III-IV)			
VI Tax			
VII Profit after tax(V-VI)			

The items of **statement of profit and loss** are discussed as follows:

1. Revenue from operations

This includes:
(i) Sale of products (ii) Sale of services (iii) Other operating revenues
In respect to a finance company, revenue from operations shall include revenue from interest, dividend and income from other financial services.

2. Other income

(i) Interest income (in case of a company other than a finance company), (ii) Dividend income, (iii) Net gain/loss on sale of investments, (iv) Other non-operating income (net of expenses directly attributable to such income).

3. Expense

Expenses incurred to earn the income shown under various heads as discussed below:

(a) Cost of Materials	It applies to manufacturing companies. It consists of raw materials and other materials consumed in manufacturing of goods.
(b)Purchase of Stock in-trade	It means purchases of goods for the purpose of trading.
(c) Changes in inventories of finished goods, WIP and stock-in-trade	It is the difference between opening inventory (stock) of finished goods, WIP and stock-in-trade and closing stock-in-trade
(d)Employees benefit expenses	Expenses incurred on employees towards salary, wages, leave encashment, staff welfare, etc., are shown under this head. Employees benefit expenses may be further categorised into direct and indirect expenses.
(e) Finance cost	It is the expenses towards interest charges during the year on the borrowings. Only the interest cost is to be shown under this head. Other financial expenses such as bank charges are shown under "Other Expenses".
(f) Depreciation	Depreciation is the diminution in the value of fixed assets whereas amortisation is

	writing off the amount relating to intangible assets.
(g) Other expenses	All other expenses which do not fall in the above categories are shown under other expenses. Other expenses may further be categorised into direct expenses, indirect expenses and non-operating expenses.

Balance Sheet (Important Terms)

Calls-Arrears	Shareholders' Funds	Share Capital
Share forfeiture Account	Shareholders' Funds	Share Capital
Capital Reserve	Shareholders' Funds	Reserve & Surplus
Subsidy Reserve	Shareholders' Funds	Reserve & Surplus
Capital Redemption Reserve	Shareholders' Funds	Reserve & Surplus
Debenture Redemption Reserve/ Debenture Sinking Fund/Sinking Fund	Shareholders' Funds	Reserve & Surplus
Capital Redemption Reserve	Shareholders' Funds	Reserve & Surplus
Securities Premium Reserve	Shareholders' Funds	Reserve & Surplus
General Reserve/Contingency Reserve	Shareholders' Funds	Reserve & Surplus
Surplus in Statement of Profit &Loss(Cr.)	Shareholders' Funds	Reserve & Surplus
Loss in Statement of Profit &Loss(Dr.)	Shareholders' Funds	Reserve & Surplus
Workmen Compensation Reserve/Fund	Shareholders' Funds	Reserve & Surplus
Investment Fluctuation Reserve/Fund	Shareholders' Funds	Reserve & Surplus
Debentures	Non-Current Liabilities	Long Term Borrowings
Public Deposits	Non-Current Liabilities	Long Term Borrowings
Mortgage Loans	Non-Current Liabilities	Long Term Borrowings
Bank Loan (Repayable within More than 1 year)	Non-Current Liabilities	Long Term Borrowings
Trade Payables (Repayable within more than 1 year)	Non-Current Liabilities	Other Long term liabilities
Premium on redemption of Debentures	Non-Current Liabilities	Other Long term liabilities
Liability Towards Purchase of Fixed Assets-Installments/Hire Purchase (Repayable within More than 1 year)	Non-Current Liabilities	Other Long term liabilities
Provident Fund	Non-Current Liabilities	Other Long term liabilities
Provision for Encashment of Earned Leave/Gratuity	Non-Current Liabilities	Long term Provisions
Provision for employees benefit	Non-Current Liabilities	Long term Provisions
Bank Overdraft	Current Liabilities	Short Term Borrowings
Loans repayable on demand	Current Liabilities	Short Term Borrowings
Commercial Paper	Current Liabilities	Short Term Borrowings
Bank Loan (Repayable within 1 year)	Current Liabilities	Short Term Borrowings
Bills Payable	Current Liabilities	Trade Payables
Trade/Sundry Creditors	Current Liabilities	Trade Payables
Outstanding Expenses	Current Liabilities	Other Current liabilities
Calls in advance	Current liabilities	Other Current Liabilities
9% Debentues repayable during the current year	Current liabilities	Other Current Liabilities
Accrued Interest on Calls in Advance	Current liabilities	Other Current Liabilities
Interest Accrued but not due on Debentures	Current liabilities	Other Current Liabilities
Interest Accrued and due on Debentures	Current liabilities	Other Current Liabilities
Unearned Incomes	Current liabilities	Other Current Liabilities
Provision for tax	Current liabilities	Short term Provisions
Provision for Repairs & Maintenance	Current liabilities	Short term Provisions

Proposed dividend	Contingent Liabilities & Commitments	Contingent Liabilities
Plant and Machinery /Furniture/Building/Motor Vehicle/Land	Non-Current Assets	Fixed Assets-Tangible
Live stock	Non-Current Assets	Fixed Assets Tangible
Computer software	Non-Current Assets	Fixed Assets-Intangible
Goodwill	Non-Current Assets	Fixed Assets-Intangible
Mining Rights	Non-Current Assets	Fixed Assets-Intangible
Publishing Titles	Non-Current Assets	Fixed Assets-Intangible
Patents	Non-Current Assets	Fixed Assets-Intangible
Copyrights	Non-Current Assets	Fixed Assets-Intangible
Trademarks	Non-Current Assets	Fixed Assets-Intangible
Capital work-in-progress	Non-Current Assets	Fixed Assets
Patents/Software etc. being developed by the company	Non-Current Assets	Fixed Assets- Intangible Assets under development
Shares in State Bank of India	Non-Current Assets	Non-Current Investments
Investment in Debentures	Non-Current Assets	Non-Current Investments
Trade Advances (Maturity more than 1 Year)	Non-Current Assets	Long Term Loans and Advances
Loans Given(Maturity more than 1 Year)	Non-Current Assets	Long Term Loans and Advances
Share Issue Expenses(To be written off After next year)	Non-Current Assets	Other Non-Current Assets
Trade Receivables(settled after 1 year)	Non-Current Assets	Other Non-Current Assets
Long term Investments with maturity period less than six months	Current assets	Current Investments
Treasury Bills	Current assets	Current Investments
Marketable Securities	Current assets	Current Investments
Debtors	Current assets	Trade Receivables
Bills Receivables	Current assets	Trade Receivables
Stock of Raw Materials/Finished Goods	Current assets	Inventories
Work In progress	Current assets	Inventories
Loose Tools/SpareParts	Current assets	Inventories
Cheques and Bank Drafts in Hand	Current assets	Cash & Cash Equivalents
Wallet Money	Current assets	Cash & Cash Equivalents
Bank Balance	Current assets	Cash & Cash Equivalents
Trade Advances (Maturity Less than 1 Year)	Current Assets	Short Term Loans & Advances
Loans Given(Maturity less than 1 Year)	Current Assets	Short Term Loans & Advances
Interest accrued on investment	Current assets	Other current Assets
Interest due on calls in arrears	Current Assets	Other Current Assets
Prepaid Expenses	Current Assets	Other Current Assets
Share Issue Expenses(To be written off in next year)	Current Assets	Other Current Assets

Important Questions(1/3/4 Marks)

Q.1 State under which major headings and sub-headings will the following items be presented in the Balance Sheet of a company as per Schedule-III, Part-I of the Companies Act, 2013.
(i) Prepaid Insurance (ii) Investment in Debentures (iii) Calls-in-arrears (iv) Unpaid dividend
(v) Capital Reserve (vi) Loose Tools (vii) Capital work-in-progress
(viii) Patents being developed by the company. (4 Marks)

Q.2 Under which major headings and subheadings will the following items be presented in the Balance Sheet of a company as per Schedule III, Part I of the Companies Act, 2013 ?
(i) Interest accrued and due on debentures (ii) Mining Rights
(iii) Accrued interest on calls in advance (iv) Interest due on calls in arrears

(v) Trademarks (vi) Premium on redemption of debentures (vii) Plant and Machinery
(viii) Patents (4 Marks)

Q.3 Under which major headings and subheadings will the following items be presented in the Balance Sheet of a company as per Schedule III, Part I of the Companies Act, 2013 ?
(i) Balance of the Statement of Profit and Loss (ii) Interest accrued on investments
(iii) Livestock (iv) Licenses and Franchise (v) Securities Premium Reserve
(vi) Cheques and Bank Drafts in Hand (vii) Work in Progress
(viii) 9% Debentures repayable during the current year (4 Marks)

Q.4 Under which major heads and sub-heads will the following items be placed in the Balance Sheet of the company as per Schedule III, Part I of the Companies Act, 2013?
(i) Long-Term Investments with maturity period less than six months (ii) Publishing titles
(iii) Debtors (iv) Debit balance in the Statement of Profit and Loss
(v)) Provision for Taxation (vi) Bank Overdraft (vii) Debenture Redemption Reserve
(viii) Capital Redemption Reserve (4 Marks)

Q.5 Which of the following is ***not*** a subhead under the Current Assets?
(A) Cash and Cash Equivalents (B) Trademarks
(C) Short-term Loans and Advances (D) Inventories (1 Mark)

Q.6 'Public Deposits' appear in the company's Balance Sheet under the head/subhead:
(A) Intangible Assets (B) Current Liabilities
(C) Shareholders' Funds (D) Non-Current Liabilities (1 Mark)

Q.7 'Income received in advance' appears in the Balance Sheet of a company under the sub-head __________.
(1 Mark)

Q.8 Employee benefit expenses include __________. (bonus/depreciation/income tax) (1 Mark)

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<u>Analysis of Financial Statements</u>

<u>Meaning of Analysis of Financial Statements:</u>

The process of critical evaluation of the financial information contained in the financial statements in order to understand and make decisions regarding the operations of the firm is called 'Financial Statement Analysis'.

It is basically a study of relationship among various financial facts and figures as given in a set of financial statements, and the interpretation thereof to gain an insight into the profitability and operational efficiency of the firm to assess its financial health and future prospects.

The term 'financial analysis' includes both 'analysis and interpretation'. These two are complimentary to each other. Analysis is useless without interpretation, and interpretation without analysis is difficult or even impossible.

The term analysis means simplification of financial data by methodical classification given in the financial statements.

Interpretation means explaining the meaning and significance of the data.

<u>Significance/Importance of Analysis of Financial Statements:</u>

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

(b) *Top management:* Financial analysis helps the management in measuring the success of the company's operations, appraising the individual's performance and evaluating the system of internal control.

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

(d) *Lenders:* Suppliers of long-term debt are concerned with the firm's long-term solvency and survival. They analyse the firm's profitability over a period of time, its ability to generate cash, to be able to pay interest and repay the principal and the relationship between various sources of funds.

(e) *Investors:* Investors, who have invested their money in the firm's shares, are interested about the firm's earnings. As such, they concentrate on the analysis of the firm's present and future profitability. They are also interested in the firm's capital structure to ascertain its influences on firm's earning and risk.

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

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

Objectives of Analysis of Financial Statements:

• to assess the **current profitability and operational efficiency** of the firm as a whole as well as its different departments so as to judge the financial health of the firm.

• to ascertain the **relative importance of different components of the financial position** of the firm.

• to identify the **reasons for change in the profitability/financial position** of the firm.

• to judge the **ability of the firm to repay its debt** and assessing the **short-term as well as the long-term** liquidity position of the firm.

Limitations of Financial Analysis:

1. Financial analysis does not consider price level changes.

2. Financial analysis may be misleading without the knowledge of the changes in accounting procedure followed by a firm.

3. Monetary information alone is considered in financial analysis while non-monetary aspects are ignored.

4. The financial statements are prepared on the basis of accounting concept, as such, it does not reflect the current position.

Tools of Analysis of Financial Statements:

1. *Comparative Statements:* These are the statements showing the profitability (statement of profit and loss) and financial position(balance sheet) of a firm for different periods of time in a comparative form to give an idea about the position of two or more periods. This analysis is also known as **'Horizontal Analysis'**.

2. *Common Size Statements:* These are the statements which indicate the relationship of different items of a financial statement with a common item by expressing each item as a percentage of that common item. Common size statements are useful, both, in intra-firm comparisons over different years and also in making inter-firm comparisons for the same year or for several years. This analysis is also known as **'Vertical analysis'**.

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

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

profit and loss of a firm. As a technique of financial analysis, accounting ratios measure the comparative significance of the individual items of the income and position statements. It is possible to assess the profitability, solvency and efficiency of an enterprise through the technique of ratio analysis.

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

Important Questions(3/4 Marks)

Q.1 Explain briefly any four objectives of 'Analysis of Financial Statements'. (4)
Q.2 Explain briefly any four limitations of 'Analysis of Financial Statements.' (4)
Q.3 Explain the importance of financial analysis for (i) labour unions, and (ii) creditors. (3/4)
Q.4 Which of the following is ***not*** a tool of Financial Statements Analysis?
(A) Comparative Balance Sheet (B) Cash Flow Statement
(C) Statement of Profit and Loss (D) All of the above (1)
Q.5 Which of the following is not a limitation of analysis of financial statements?
(a) Window Dressing (b) Price level changes ignored
(c) Subjectivity (d) Intra firm comparison possible (1)
Q.6 Which of the following is a limitation of financial analysis?
(a) It is just a study of reports of the company.
(b) It judges the ability of the firm to repay its debts.
(c) It identifies the reasons for change in financial position.
(d) It ascertains the relative importance of different components of the financial position of the firm. (1)
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***

Comparative Statement:

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

- The figures in the comparative statements can be used for identifying the direction of changes and also the trends in different indicators of performance of an organisation.

The following steps may be followed to prepare the comparative statements:
Step 1: List out absolute figures in rupees relating to two points of time (as shown in columns 2 and 3).
Step 2: Find out change in absolute figures by subtracting the first year (Col.2) from the second year (Col.3) and indicate the change as increase (+) or decrease (–) and put it in column 4.
Step 3: Preferably, also calculate the percentage change as follows and put it in column 5.
Absolute Increase or Decrease (Col.4)/ First year absolute figure (Col.2) × 100

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

Q. From the following particulars, prepare comparative statement of profit and loss of Jamuna Ltd. for the year ended March 31, 2020 and 2021:

Particulars	**Note No.**	***2020-21* (Rs.)**	***2019-20* (Rs.)**

1.Revenue from operations		40,00,000	35,00,000
2.Other Income		50,000	5,000
3. Cost of material consumed		15,00,000	18,00,000
4. Changes in inventories of finished goods		10,000	(15,000)
5. Employee benefit expenses		2,40,000	2,40,000
6. Depreciation and amortisation		25,000	22,500
7. Other expenses		2,66,000	30,200
8. Profit		20,09,000	14,27,300

Comparative Statement of Profit& Loss
For the year ended March 31, 2020 & March 31, 2021

Particulars	**Note No.**	***2019-20* (Rs.)**	***2020-21* (Rs.)**	**Absolute Change- Increase/Decrease Rs**	**Percentage Change- Increase/Decrease %**
1.Revenue from operations		35,00,000	40,00,000	5,00,000	14.29
2.Other Income		5,000	50,000	45,000	900
3. Total Revenue		**35,05,000**	**40,50,000**	**5,45,000**	**15.55**
4. Expenses					
a) Cost of material consumed		18,00,000	15,00,000	(3,00,000)	(16.67)
b) Changes in inventories of finished goods					
c) Employee benefit expenses		(15,000)	10,000	25,000	116.67
d) Depreciation and amortization		2,40,000	2,40,000	0	0
e) Other expenses		22,500	25,000	2,500	11.11
Total Expenses		30,200	2,66,000	2,35,800	780.79
5. Profit		**20,77,700**	**20,41,000**	**36,700**	**1.77**
		14,27,300	20,09,000	5,81,700	40.76

Common Size Statement:

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

Here, each item in the statement is stated **as a percentage of the aggregate**, or revenue from operations of which that item is a part. For example, a common size balance sheet shows the percentage of each asset to the **total assets**, and that of each liability to the **total liabilities**. Similarly, in the common size statement of profit and loss, the items of expenditure are shown as a percentage of the **revenue from operations**.

- Inter-firm comparison or comparison of the company's position with the related industry as a whole is possible with the help of common size statement analysis.

The following procedure may be adopted for preparing the common size statements.
1. List out absolute figures in rupees at two points of time, say year 1, and year 2 (Column 2 &4).
2. Choose a common base (as 100). For example, revenue from operations may be taken as base (100) in case of statement of profit and loss and total assets or total liabilities (100) in case of balance sheet.
3. For all items of Col. 2 and 3 work out the percentage of that total. Column 4 and 5 shows these percentages.

Particulars	First Year	Second Year	Percentage of Year 1	Percentage of Year 2
1	2	3	4	5
			%	%

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

Particulars	Note No.	31-3 2020 (Rs.)	31-3 2021 (Rs.)

I EQUITY AND LIABILITIES			
1. Shareholder's Funds:			
a. Share Capital		15,00,000	12,00,000
b. Reserve and Surplus		5,00,000	5,00,000
2. Non-current liabilities			
Long-term borrowings		6,00,000	5,00,000
3. Current Liabilities:			
a. Trade Payable		15,50,000	10,50,000
Total		41,50,000	32,50,000
II ASSETS			
1. Non-Current Assets:			
a. Fixed Assets:			
i. Tangible Assets		14,00,000	8,00,000
ii. Intangible Assets		16,00,000	12,00,000
b. Non-current investments		10,00,000	10,00,000
2. Current Assets			
a. Inventories		1,50,000	2,50,000
Total		41,50,000	32,50,000

Ans. Common size Balace Sheet of X Co. Ltd.
as at March 31, 2020 and March 31, 2021

Particulars	**Note No.**	**as at March 31, 2020**	**as at March 31, 2021**	**% of Total March 31, 2020**	**% of Total March 31, 2021**
I EQUITY AND LIABILITIES					
1. Shareholder's Funds:					
a. Share Capital		15,00,000	12,00,000	36.14	36.93
b. Reserve and Surplus		5,00,000	5,00,000	12.05	15.38
2. Non-current liabilities					
Long-term borrowings		6,00,000	5,00,000	14.46	15.38
3. Current Liabilities:					
a. Trade Payable		15,50,000	10,50,000	37.35	32.31
Total		41,50,000	32,50,000	100	100
II ASSETS					
1. Non-Current Assets:					
a. Fixed Assets:					
i. Tangible Assets		14,00,000	8,00,000	33.73	24.62
ii. Intangible Assets		16,00,000	12,00,000	38.55	36.92
b. Non-current investments		10,00,000	10,00,000	24.10	30.77
2. Current Assets					
a. Inventories		1,50,000	2,50,000	3.62	7.69
Total		41,50,000	32,50,000	100	100

Important Questions(3/4 Marks)

Q.1 Following information is extracted from the Statement of Profit and Loss of Delko Ltd. for the year ended 31st March, 2019:

Particulars	**Note No.**	2018 – 19 **(Rs.)**	2017 – 18 **(Rs.)**

1.Revenue from operations 2. Employee benefit expenses 3. Depreciation and amortisation 4. Other expenses Tax Rate 50%		60,00,000 30,00,000 7,50,000 5,50,000	45,00,000 22,50,000 6,00,000 10,00,000

Prepare Comparative Statement of Profit and Loss.

Q.2 Prepare a Common-Size Statement of Profit and Loss of 'Hari Darshan Ltd.' from the following information:

Particulars	**Note No.**	2018 – 19 **(Rs.)**	2017 – 18 **(Rs.)**
1.Revenue from operations 2. Purchase of Stock in Trade 3. Changes in Inventories 4. Other expenses 5. Other incomes Tax Rate 50%		20,00,000 7,70,000 1,20,000 52,000 60,000	10,00,000 4,20,000 80,000 30,000 50,000

Q.3 From the following information prepare Comparative Balance Sheet of X Ltd.:

Particulars	**Note No.**	2018 – 19 **(Rs.)**	2017 – 18 **(Rs.)**
Share Capital Reserves and Surplus Long-term Borrowings Current Liabilities Fixed Assets Investments (Non-Current) Current Assets		25,00,000 6,00,000 16,00,000 5,00,000 35,00,000 10,50,000 6,50,000	25,00,000 10,00,000 15,00,000 4,50,000 25,00,000 15,00,000 14,50,000

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ACCOUNTING RATIOS

Meaning of Accounting Ratios: As stated earlier, accounting ratios are an important tool of financial statements analysis. A ratio is a mathematical number calculated as a reference to relationship of two or more numbers and can be expressed as a fraction, proportion, percentage and a number of times. When the number is calculated by referring to two accounting numbers derived from the financial statements, it is termed as accounting ratio.

Objectives of Ratio Analysis:

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

Advantages of Ratio Analysis:

1. *Helps to understand efficacy of decisions:* The ratio analysis helps you to understand whether the business firm has taken the right kind of operating, investing and financing decisions.
2. *Simplify complex figures and establish relationships:* Ratios help in simplifying the complex accounting figures and bring out their relationships.
3. *Helpful in comparative analysis:* The ratios are not be calculated for one year only. When many year figures are kept side by side, they help a great deal in exploring the trends visible in the business.
4. *Identification of problem areas:* Ratios help business in identifying the problem areas as well as the bright areas of the business.
5. *Enables SWOT analysis:* Ratios help a great deal in explaining the changes occurring in the business. The information of change helps the management a great deal in understanding the current threats and opportunities and allows business to do its own SWOT (Strength- Weakness-Opportunity-Threat) analysis.

6. *Various comparisons:* Ratios help comparisons with certain bench marks to assess as to whether firm's performance is better or otherwise. For this purpose, the profitability, liquidity, solvency, etc., of a business, may be compared: (i) over a number of accounting periods with itself (Intra-firm Comparison/Time Series Analysis), (ii) with other business enterprises (Inter-firm Comparison/Cross-sectional Analysis) and (iii) with standards set for that firm/industry (comparison with standard (or industry expectations).

Types of Ratios:

There is a two way classification of ratios: (1) traditional classification, and (2) functional classification.

(1) Traditional Classification:

1. *'Statement of Profit and Loss Ratios:* A ratio of two variables from the statement of profit and loss is known as statement of profit and loss ratio.
2. *Balance Sheet Ratios:* In case both variables are from the balance sheet, it is classified as balance sheet ratios.
3. *Composite Ratios:* If a ratio is computed with one variable from the statement of profit and loss and another variable from the balance sheet, it is called composite ratio.

(2) Functional Classification:

1. Liquidity Ratios: To meet its commitments, business needs liquid funds. The ability of the business to pay the amount due to stakeholders as and when it is due is known as liquidity, and the ratios calculated to measure it are known as 'Liquidity Ratios'. These are essentially **short-term** in nature.

2. Solvency Ratios: Solvency of business is determined by its ability to meet its contractual obligations towards stakeholders, particularly towards external stakeholders, and the ratios calculated to measure solvency position are known as 'Solvency Ratios'. These are essentially **long-term** in nature.

3. Activity (or Turnover) Ratios: This refers to the ratios that are calculated for measuring the efficiency of operations of business based on effective utilisation of resources. Hence, these are also known as **'Efficiency Ratios'**.

4. Profitability Ratios: It refers to the analysis of profits in relation to revenue from operations or funds (or assets) employed in the business and the ratios calculated to meet this objective are known as 'Profitability Ratios'.

Computation:

1. ***Liquidity Ratios:*** Liquidity ratios are calculated to measure the **short-term solvency** of the business, i.e. the firm's ability to meet its current obligations. The two ratios included in this category are **Current Ratio** and **Liquidity Ratio**.

(a) ***Current Ratio:*** Current ratio is the proportion of current assets to current liabilities.

Current Ratio = Current Assets: Current Liabilities or **Current Assets/ Current Liabilities**

Current assets include current investments, inventories(**excluding loose tools& spare parts)**, trade receivables (debtors and bills receivables), cash and cash equivalents, short-term loans and advances and other current assets such as prepaid expenses, advance tax and accrued income, etc.

Current liabilities include short-term borrowings, trade payables (creditors and bills payables), other current liabilities and short-term provisions.

Significance: The ratio should be **reasonable**. It should neither be very high or very low. Both the situations have their inherent disadvantages. Normally, it is safe to have this ratio within the range of **2:1.**

A **very high current ratio** implies heavy investment in current assets which is not a good sign as it reflects under utilisation or **improper utilisation of resources**.

A **low ratio** endangers the business and puts it at risk of facing a situation where it will **not be able to pay its short-term debt** on time.

Illustration 1: Calculate Current Ratio from the following information:

	Rs.		Rs.
Inventories	60,000	Trade receivables	60,000
Advance tax	14,000	Cash and cash equivalents	40,000
Trade payables	1,10,000	Short-term borrowings (bank overdraft)	14,000

Solution:

Current Ratio = Current Assets/ Current Liabilities

Current Assets = Inventories + Trade receivables + Advance tax + Cash and cash equivalents

= Rs. 60,000 + Rs. 60,000 + Rs. 14,000 + Rs. 40,000 = **Rs. 1,74,000**

Current Liabilities = Trade payables + Short-term borrowings = Rs. 1,10,000 + Rs. 14,000

= **Rs. 1,24,000**

Current Ratio: **Rs. 1,74,000/ Rs. 1,24,000=1.40:1**

(b) Quick or Liquid Ratio: It is the ratio of quick (or liquid) asset to current liabilities.
Quick ratio = Quick Assets: Current Liabilities **orQuick Assets/Current Liabilities**
The quick assets are defined as those assets which are quickly convertible into cash. While calculating quick assets we exclude the inventories at the end and other current assets such as prepaid expenses, advance tax, etc., from the current assets. Because of exclusion of non-liquid current assets it is considered better than current ratio as a measure of liquidity position of the business. It is calculated to serve as a supplementary check on liquidity position of the business
and is therefore, also known as **'Acid-Test Ratio'**.
Significance*:* The ratio provides a measure of the capacity of the business to meet its short-term obligations **without any flaw**. Normally, it is advocated to be safe to have a ratio of **1:1** as unnecessarily **low ratio** will be very **risky** and a **high ratio** suggests unnecessarily deployment of resources in otherwise **less profitable** short-term investments.

Illustration 2: Calculate quick ratio from the information given in illustration 1.
Solution: Quick Ratio = Quick Assets/ Current Liabilities
Quick Assets = Current assets – (Inventories + Advance tax)
= Rs. 1,374,000 – (Rs. 60,000 + Rs. 14,000) = **Rs. 1,00,000**
Current Liabilities = **Rs. 1,24,000**
Quick Ratio = Rs. 1,00,000/ Rs. 1,24,000 = **0.81 :1**

Illustration 3: X Ltd., has a current ratio of 3.5:1 and quick ratio of 2:1. If excess of current assets over quick assets represented by inventories is Rs. 30,000, calculate current assets and current liabilities.
Solution: Current Ratio = 3.5:1
Quick Ratio = 2:1
Let Current Assets=3.5 and Quick Assets=2 and Current Liabilities=1
As, Current Assets-Quick Assets= Inventories
That is why, Inventories= 3.5-2=**1.5** *which represents* **Rs.30,000** (Given)
Now, Current Assets=*Rs.30,000/1.5*****3.5**=**Rs.70,000**
Quick Assets= *Rs.30,000/1.5*****2**=**Rs.40,000**
Current Liabilities= *Rs.30,000/1.5*****1**=**Rs.20,000**
Effect on Ratios after any Transaction:

When the Ratio is→/ When↓	**1:1**	**Less than 1:1 e.g. 0.7:1 or 1:2**	**More than 1:1 e.g. 1.25:1**
Only Numerator Increases	Improved	Improved	Improved
Only Numerator Decreases	Reduced	Reduced	Reduced
Only Denominator Increases	Reduced	Reduced	Reduced
Only Denominator Decreases	Improved	Improved	Improved
Both Numerator & Denominator Increases **Same Amount**	**No Change**	**Improved**	**Reduced**
Both Numerator & Denominator Decreases **Same Amount**	**No Change**	**Reduced**	**Improved**

2. Solvency Ratios**:** Solvency ratios are calculated to determine the ability of the business to service its debt in the long run. The following ratios are normally computed for evaluating solvency of the business.
1. Debt-Equity Ratio; 2. Debt to Capital Employed Ratio;
3. Proprietary Ratio; 4. Total Assets to Debt Ratio; 5. Interest Coverage Ratio
(a) Debt-Equity Ratio: Debt-Equity Ratio measures the relationship between long-term debt and equity. If debt component of the total long-term funds employed is small, outsiders feel more secure.
Debt-Equity Ratio = **Long-term Debts/Shareholders' Funds*where***
Long-term debts= Long-term borrowings+ other non-current liabilities+ Long-term provisions.
Shareholders' Funds (Equity) = Share capital + Reserves and Surplus + Money received against share warrants + Share application money pending allotment
Share Capital = Equity share capital + Preference share capital **or**
Shareholders' Funds (Equity) = Non-current Assets + Working capital – Non-current liabilities

Working Capital = Current Assets – Current Liabilities

Significance:Normally, it is considered to be safe if debt equity ratio is 2: 1. A **low** debt equity ratio reflects **more security**. A **high ratio**, on the other hand, is considered **risky** as it may put the firm into difficulty in meeting its obligations to outsiders. However, from the perspective of the owners, greater use of debt (trading on equity) may help in ensuring higher returns for them if the rate of earnings on capital employed is higher than the rate of interest payable.

(b) Debt to Capital Employed Ratio: The Debt to capital employed ratio refers to the ratio of long-term debt to the total of external and internal funds (capital employed or net assets).

Debt to Capital Employed Ratio **= Long-term Debt/Capital Employed (or Net Assets)**

Capital employed=Long-term debt + Shareholders' funds

Alternatively, Net assets=Total assets– Current liabilities

Significance*:* Like debt-equity ratio, it shows proportion of long-term debts in capital employed. Low ratio provides security to lenders and high ratio helps management in trading on equity.

(c) Proprietary Ratio: Proprietary ratio expresses relationship of proprietor's (shareholders) funds to net assets.

Proprietary Ratio **= Shareholders', Funds/Capital employed (or net assets)**

Significance: Higher proportion of shareholders' funds in financing the assets is a positive feature as it provides security to creditors.

(d) Total Assets to Debt Ratio: This ratio measures the extent of the coverage of long-term debts by assets.

Total assets to Debt Ratio = **Total assets/Long-term debts**

Significance*:* This ratio primarily indicates the rate of external funds in financing the assets and the extent of coverage of their debts are covered by assets.

Illustration 4: Calculate 'Debt to Capital Employed Ratio', 'Proprietary Ratio', 'Total Assets to Debt ratio' and 'Debt Equity Ratio' from the following information:

	Rs		Rs
Equity Share Capital	4,00,000	General Reserve	70,000
Long Term Borrowings	1,80,000	Current Liabilities	30,000
Surplus i.e. Balance in statement of Profit & Loss	1,00,000	Long Term Provisions	1,20,000

Solution:

Total Assets= Total Liabilities= Equity Share Capital + Long Term borrowings + Surplus +General reserve + Current Liabilities + Long term Provisions

=Rs.4,00,000 + Rs.1,80,000 + Rs.1,00,000 + Rs.70,000 + Rs.30,000 + Rs.1,20,000 =Rs.9,00,000

Debt/Long-term debts = Long Term borrowings+ Long term Provisions

= Rs.1,80,000 + Rs.1,20,000 =Rs.3,00,000

Equity/Shareholders' Funds = Equity Share Capital + Surplus+ General reserve

= Rs.4,00,000 + Rs.1,00,000+ Rs.70,000=Rs.5,70,000

Capital Employed=Total Assets-Current Liabilities=Rs.9,00,000 - Rs.30,000=Rs.8,70,000

Debt to Capital Employed Ratio=Long-term Debts/Shareholders' Funds=

Rs.3,00,000/ Rs.8,70,000=**0.345:1**

Proprietary Ratio= Shareholders', Funds/Capital employed= Rs.5,70,000/ Rs.8,70,000=**0.655:1**

Total assets to debt Ratio= Total assets/ debt =Rs.9,00,000/Rs.3,00,000 =**3:1**

Debt Equity Ratio=Debt/Equity=Rs.3,00,000/Rs.5,70,000=**0.526:1**

(e) Interest Coverage Ratio: It is a ratio which deals with the servicing of interest on loan. It is a measure ofsecurity of interest payable on long-term debts. It expresses the relationshipbetween profits available for payment of interest and the amount of interestpayable.

Interest Coverage Ratio = **Net Profit before Interest and Tax/Interest on long-term debts**

Significance: It reveals the number of times interest on long-term debts is covered by the profits available for interest. A **higher ratio** ensures **safety of interest on debts**.

Illustration 5: From the following details, calculate interest coverage ratio:

Net Profit after tax Rs. 60,000; 15% Long-term debt 10,00,000; and Tax rate 40%.

Solution: Net Profit before tax = Net profit after tax × 100/(100 – Tax rate)

= Rs. 60,000 × 100/ (100 – 40) = Rs. 1,00,000

Interest on Long-term Debt = 15% of Rs. 10,00,000 = Rs. 1,50,000
Net profit before interest and tax = Net profit before tax + Interest
= Rs. 1,00,000 + Rs. 1,50,000 = Rs. 2,50,000
Interest Coverage Ratio = Net Profit before Interest and Tax/Interest on long-term debt
= Rs. 2,50,000/Rs. 1,50,000 = 1.67 times.

3. Activity (or Turnover) Ratio: The activity ratios express the number of times assets employed, or, for that matter, any constituent of assets, is turned into sales during an accounting period. Higher turnover ratios means better utilisation of assets and signify improved efficiency and profitability, and as such are known as ***efficiency ratios***. The important activity ratios calculated under this category are:
1. Inventory Turnover 2. Trade receivables Turnover 3. Trade payables Turnover;
4. Investment (Net assets) Turnover 5. Fixed assets Turnover 6. Working capital Turnover.

(a) Inventory Turnover Ratio: It determines the number of times inventory is converted into revenue from operations during the accounting period under consideration. It expresses the relationship between the cost of revenue from operations and average inventory.
Inventory Turnover Ratio = **Cost of Revenue from Operations / Average Inventory**
Average inventory= Opening Inventory+ Closing Inventory/2
Cost of revenue from operations=Revenue from operations-Gross profit **OR**
Opening Inventory+ Net Purchases+ All Direct Expenses-Closing Inventory
Significance:It studies the frequency of conversion of inventory of finished goods into revenue from operations. It is also a measure of liquidity. **Low turnover** of inventory may be due to **bad buying, obsolete inventory**, etc., and is a danger signal**. High turnover** is **good** but it must be **carefully** interpreted as it **may be due to buying in small lots or selling quickly** at low margin to realise cash.
Illustration 6: From the following information, calculate inventory turnover ratio:

	Rs.		Rs.
Inventory in the beginning	18,000	Wages	14,000
Inventory at the end	22,000	Revenue from operations	80,000
Net purchases	46,000	Carriage inwards	4,000

Solution: **Inventory Turnover Ratio** =Cost of Revenue from Operations/Average Inventory
Cost of Revenue from Operations = Inventory in the beginning + Net Purchases + Wages + Carriage inwards – Inventory at the end
= Rs. 18,000 + Rs. 46,000 + Rs. 14,000 + Rs. 4,000 – Rs. 22,000 = Rs. 60,000
Average Inventory = Inventory in the beginning + Inventory at the end/2
=Rs. 18,000 + Rs. 22,000/2 = Rs. 20,000
Inventory Turnover Ratio =Rs. 60,000/Rs. 20,000 = **3 Times**

(b) Trade Receivables Turnover Ratio: It expresses the relationship between credit revenue from operations and trade receivable.
Trade Receivable Turnover ratio=**Net Credit Revenue from Operations/Average Trade Receivable**
Average Trade Receivable = (Opening Debtors and Bills Receivable + ClosingDebtors and Bills Receivable)/2
It is to be noted that debtors should be taken **before making any provision for doubtful debts**.
Significance: The liquidity position of the firm depends upon the speed with which trade receivables are realised. This ratio indicates the number of times the receivables are turned over and **converted into cash** in an accounting period. **Higher turnover** means **speedy collection** from trade receivable. This ratio also helps in working out-
Average collection period=Number of days or Months or weeks/Trade receivables turnover ratio

Illustration 7: Calculate opening and closing trade receivables from the following information:
Trade Receivable turnover ratio 4 times; Cost of Revenue from Operations Rs. 3,20,000; Gross profit ratio 20%; Closing trade receivables were Rs. 15,000 more than opening trade receivables; cash revenue from operations being 25 % of credit revenue from operations.
Solution: Let Revenue= 100, Gross Profit= 20 and
Cost of Revenue= 100-20=80 which represents Rs.3,20,000
So, **Revenue from operations= 3,20,000/80*100= Rs.4,00,000**
Cash revenue from operations=25 % of credit revenue from operations
Let Credit Revenue=100, Cash Revenue will be=25 and
Total Revenue= 100+25=125 whuch represents Rs.4,00,000
So, **Credit Revenue from Operations= Rs.4,00,000/125*100= Rs.3,20,000**
Trade receivable turnover ratio= Net Credit Revenue from operation/Average Trade Receivables
4=Rs.3,20,000/ Average Trade Receivables i.e.

Average Trade Receivables= Rs.3,20,000/4= Rs.80,000
As, Difference between Opening Trade Receivables and Closing Trade Receivables is Rs.15,000, difference from Average Trade Receivables will be Rs.15,000/2=Rs.7,500.
Therefore, Opening Trade Receivables= Rs.80,000-Rs.7,500=Rs.72,500
Closing Trade Receivables= Rs.80,000+Rs.7,500=Rs.87,500

(c) Trade Payable Turnover Ratio: Trade payables turnover ratio indicates the pattern of payment of trade payable.
Trade Payables Turnover ratio = **Net Credit purchases/ Average trade payable**
Where **Average Trade Payable** = (Opening Creditors and Bills Payable + Closing Creditors and Bills Payable)/2
Average Payment Period = No. of days/month/weeks in a year/Trade Payables Turnover Ratio
Significance: It reveals average payment period. **Lower ratio** means **credit allowed by the supplier is for a long period** or it may reflect **delayed payment** to suppliers which is not a very good policy as it may affect the reputation of the business. The average period of payment can be worked out by days/months in a year by the Trade Payable Turnover Ratio**.**

Illustration 8: From the following information, calculate –
(i) Trade receivables turnover ratio (ii) Average collection period
(iii) Trade rayable turnover ratio (iv) Average payment period
Given:

	Rs.		**Rs.**
Revenue from Operations	8,75,000	Bills receivable	48,000
Creditors	90,000	Bills payable	52,000
Purchases	4,20,000	Trade debtors	59,000

Solution: (i) **Trade Receivables Turnover Ratio**
=Net Credit Revenue from operation/Average Trade Receivable
= Rs. 8,75,000/(Rs. 59,000 + Rs. 48,000) = **8.18 times**
(ii) **Average Collection Period** =365/Trade Receivables Turnover Ratio=365/8.18= **45 days**
(iii) **Trade Payable Turnover Ratio** = Purchases /Average Trade Payables
=4,20,000/90,000 + 52,000=4,20,000/1,42,000= **2.96 times**
(iv) **Average Payment Period** =365/Trade Payables Turnover Ratio =365/2.96= **123 days**
Note: (1) As Separate balances of opening and closing is not given it will be treated as **Average**.
(2) As **Purchases and Revenue** are not termed as Cash/Credit/Total it will be **treated as Credit**.

(d) Net Assets or Capital Employed Turnover Ratio: It reflects relationship between revenue from operations and net assets (capital employed) in the business. Net Assets or Capital Employed Turnover ratio =**Revenue from Operation/Capital Employed**
Significance: **Higher turnover** means **better activity and profitability**.

(e) Fixed Assets Turnover Ratio: Net Revenue from Operation/Net Fixed Assets
Significance: **High turnover** of fixed assets is a good sign and implies **efficient utilisation** of resources.

(f) Working Capital Turnover Ratio: **=** Net Revenue from Operation/Working Capital
Significance: **High turnover** of working capital is a good sign and implies **efficient utilisation** of resources**.**
Illustration 9: From the following information, calculate (i) Net assets turnover, (ii) Fixed assetsturnover, and (iii) Working capital turnover ratios:

	(Rs.)		***(Rs.)***
Preference shares capital	4,00,000	Plant and Machinery	8,00,000
Equity share capital	6,00,000	Land and Building	5,00,000
General reserve	1,00,000	Motor Car	2,00,000
Balance in Statement of Profit and Loss	3,00,000	Furniture	1,00,000
15% debentures	2,00,000	Inventory	1,80,000
14% Loan	2,00,000	Debtors	1,10,000
Creditors	1,40,000	Bank	80,000
Bills payable	50,000	Cash	30,000
Outstanding expenses	10,000		

Revenue from operations for the year 2016-17 were Rs. 30,00,000
Solution:
Capital Employed = Share Capital + Reserves and Surplus + Long-term Debts (or Net Assets)
= (Rs.4,00,000 + Rs.6,00,000) + (Rs.1,00,000 + Rs.3,00,000) + (Rs.2,00,000 + Rs.2,00,000)
= Rs. 18,00,000
Fixed Assets = Rs.8,00,000 + Rs.5,00,000 + Rs.2,00,000 + Rs.1,00,000 = Rs. 16,00,000
Working Capital = Current Assets – Current Liabilities = Rs.4,00,000 – Rs.2,00,000
= Rs. 2,00,000
Net Assets Turnover Ratio = Rs.30,00,000/Rs.18,00,000 = **1.67 times**
Fixed Assets Turnover Ratio = Rs.30,00,000/Rs.16,00,000 = **1.88 times**
Working Capital Turnover Ratio = Rs.30,00,000/Rs.2,00,000 = **15 times**

4. Profitability Ratios: The profitability or financial performance is mainly summarised in the statement of profit and loss. Profitability ratios are calculated to analyse the earning capacity of the business which is the outcome of utilisation of resources employed in the business. There is a close relationship between the profit and the efficiency with which the resources employed in the business are utilised. The various ratios which are commonly used to analyse the profitability of the business are:
1. Gross profit ratio 2. Operating ratio 3. Operating profit ratio 4. Net profit ratio
5. Return on Investment (ROI) or Return on Capital Employed (ROCE)

(a) Gross Profit Ratio: Gross profit ratio as a percentage of revenue from operations is computed tohave an idea about gross margin.
Gross Profit Ratio = **Gross Profit/Net Revenue of Operations×100**
Significance:It indicates gross margin on products sold. A **low ratio** may indicate **unfavourable** purchase and sales policy. **Higher** gross profit ratio is always a good sign.

(b) Operating Ratio: It is computed to analyse cost of operation in relation to revenue from operations.
Operating Ratio = **(Cost of Revenue from Operations + Operating Expenses)/Net Revenue from Operations ×100**
Operating expenses include office expenses, administrative expenses, selling expenses, distribution expenses, depreciation and employee benefit expenses etc.

(c) Operating Profit Ratio*:* It is calculated to reveal operating margin. It may be computed directly or as aresidual of operating ratio.
Operating Profit Ratio **= 100 – Operating Ratio or**
Operating Profit/ Revenue from Operations × 100
Where Operating Profit = Revenue from Operations – Operating Cost
Significance: It helps to analyse the performance of business and throws light on the **operational efficiency** of the business. It is very useful for **inter-firm as well as intra-firm comparisons.** Lower operating ratio is a very healthy sign.

Illustration10: Given the following information:
Revenue from Operations Rs.3,40,000, Cost of Revenue from Operations Rs.1,20,000, Selling expenses Rs.80,000, Administrative Expenses Rs.40,000
Calculate Gross profit ratio, Operating ratio and operating profit ratio.
Solution: Gross Profit = Revenue from Operations – Cost of Revenue from Operations = Rs. 3,40,000 – Rs. 1,20,000 = Rs. 2,20,000
Gross Profit Ratio = Gross Profit/ Revenue from operation× 100
=Rs. 2,20,000/ Rs. 3,40,000× 100 = **64.71%**
Operating Cost = Cost of Revenue from Operations + Selling Expenses + Administrative Expenses = Rs. 1,20,000 + 80,000 + 40,000 = Rs. 2,40,000
Operating Ratio = Operating Cost/Net Revenue from Operations × 100
= Rs. 2,40,000/ Rs. 3,40,000 × 100 = **70.59%**
Operating Profit Ratio= 100- Operating Ratio= 100-70.59%=**29.41%**

(d) Net Profit Ratio: Net profit ratio is based on all inclusive concept of profit. It relates revenue fromoperations to net profit after operational as well as non-operational expensesand incomes. Net Profit Ratio = **Net profit/Revenue from Operations × 100**
Generally, Net profit refers to profit after tax (PAT), but it is also to be calculated profit before tax (PBT).

***Significance**:* It reflects the **overall efficiency/profitability** of the business, assumes great significance from the point of view of investors.

Illustration11: Gross profit ratio of a company was 25%. Its credit revenue from operations was Rs. 20,00,000 and its cash revenue from operations was 20% of the total revenue from operations. If the indirect expenses of the company were Rs.25,000, calculate its net profit ratio.

Solution: Cash Revenue from Operations = Rs.20,00,000 × 20/80 = Rs.5,00,000
Hence, total Revenue from Operations are = Rs.25,00,000
Gross profit = 25,00,000 × 25/100 = Rs.6,25,000
Net profit = Rs.6,25,000 – 25,000 = Rs.6,00,000
Net profit ratio = Net profit/Revenue from Operations × 100
= Rs.6,00,000/Rs.25,00,000 × 100 = **24%.**

(e) Return on Capital Employed or Investment: It explains the overall utilisation of funds by a business enterprise. Capital employed means the long-term funds employed in the business and includes shareholders' funds, debentures and long-term loans. Alternatively, capital employed may be taken as the total of non-current assets and working capital.
Return on Investment) **= Profit before Interest and Tax/ Capital Employed × 100**
Significance: It reveals the **efficiency** of the business in utilisation of funds entrusted to it by shareholders, debenture-holders and long-term loans. For **inter-firm comparison**, return on capital employed funds is considered a good measure of **profitability**.

Illustration12: Net profit after interest and tax of M Ltd. was Rs. 1,00,000. Its Current Assets were Rs. 4,00,000 and Current Liabilities were Rs. 2,00,000. Tax rate was 50%. Its Total Assets were Rs. 10,00,000 and 10% Long term debt was Rs. 4,00,000. Calculate Return on Investment.

Solution:Return on Investment = Profit before interest and tax/ Capital employed x 100
Profit before interest and tax =Rs.1,00,000 + Rs.1,00,000 + Rs.40,000 = Rs.2,40,000
Capital employed = Rs.8,00,000
Therefore, Return on Investment = Rs.2,40,000/Rs.8,00,000 x 100 = 30%

Important Questions (1/3/4 Marks)

Q.1 From the following data, calculate Current ratio and Liquid Ratio.
Liquid Assets Rs. 75,000, Prepaid expenses Rs.10,000, Working Capital Rs. 60,000 and
Inventories (Includes Loose Tools of Rs.20,000) Rs. 35,000
Ans.1 Current Ratio -2.5:1, Liquid Ratio -1.875:1

Q.2 What will be the effect on current ratio if a bills payable is discharged on maturity?
Ans.2 The current ratio will increase.

Q.3 The two basic measures of operational efficiency of a company are
a) Inventory Turnover Ratio & Working Capital Turnover Ratio
b) Liquid Ratio and Operating Ratio c) Liquid Ratio and Current Ratio
d) Gross Profit Margin and Net Profit Margin
Ans.3 a) Inventory Turnover Ratio and Working Capital Turnover Ratio

Q.4 Debt Equity Ratio of a company is 1:2. Purchase of a Fixed asset for Rs.5,00,000 on long term deferred payment basis will increase, decrease or not change the ratio?
Ans.4 Increased
Q.5 From the following details calculate Interest Coverage Ratio:
Net profit after tax - Rs. 7,00,000
6% debentures of Rs. 20,00,000 and Tax Rate 30%
Ans.5 Interest Coverage Ratio = 9.33 times

Q.6 What will be the Current ratio of a company whose Net Working Capital is Zero?
Ans.6 1:1

Q.7 The __________ may indicate that the firm is experiencing stock outs and lost sales.
a. Average payment period b. Inventory turnover ratio
c. Average collection period d. Quick ratio
Ans.7 b. Inventory turnover ratio

Q.8 Calculate proprietary ratio, if Total assets to Debt ratio is 2:1. Debt is Rs.5,00,000. Equity shares capital is 0.5 times of debt. Preference Shares capital is 25% of equity share capital. Net profit before tax is Rs.10,00,000 and rate of tax is 40%.
Ans.8 Proprietary Ratio = 0.912:1

Q.9 Current ratio of Adaar Ltd. is 2.5:1. Accountant wants to maintain it at 2:1. Following options are available.
(i) He can repay Bills Payable (ii) He can purchase goods on credit
(iii) He can take short term loan
Choose the correct option.
(A) Only (i) is correct (B) Only (ii) is correct
(C) Only (i) and (iii) are correct (D) Only (ii) and (iii) are correct
Ans.9 (D) Only (ii) and (iii) are correct
Q.10 The following groups of ratios primarily measure risk:
(A) solvency, activity, and profitability (B) liquidity, efficiency, and solvency
(C) liquidity, activity, and profitability (D) liquidity, solvency, and profitability
Ans.10 (D) liquidity, solvency, and profitability

Q.11 Calculate amount of Opening Trade Receivables and Closing Trade Receivables from the following figures:

Trade Receivable Turnover ratio	5 times
Cost of Revenue from Operations	Rs. 8,00,000
Gross Profit ratio	20%

Closing Trade Receivables were Rs. 40,000 more than in the beginning
Cash sales being ¼ times of Credit sales
Ans.11 Opening Trade Receivables = Rs. 1,40,000, Closing Trade Receivables = Rs.1,80,000

Q.12 Calculate Revenue from operations of BN Ltd. From the following information:
Current assets Rs. 8,00,000, Quick ratio is 1.5:1, Current ratio is 2:1 and Inventory turnover ratio is 6 times. Goods were sold at a profit of 25% on cost.
Ans.12 Revenue from operations Rs.15,00,000

Q.13 The Operating ratio of a company is 60%. State whether 'Purchase of goods costing Rs. 20,000' will increase, decrease or not change the operating ratio.
Ans.13 'Purchase of goods costing Rs.20,000' will not change the operating ratio.

Q.14 State whether the following statement is true or false.
'Inventory Turnover Ratio measures the level of financial leverage.'
Ans.14 False

Q.15 The total debtors of X Ltd. were Rs. 9,00,000. It had created a provision of 10% for bad and doubtful debts. What amount of debtors will be used for calculating the 'Trade Receivables Turnover Ratio'?
Ans.15 Rs.9,00,000

Q.16 From the following information obtained from the books of P. Ltd., calculate, (i) Return on Investment, and (ii) Debt-Equity Ratio:
Information:
Net Profit after interest and tax Rs. 6,00,000; 6% Debentures Rs. 10,00,000; Capital employed Rs. 20,00,000, and Tax rate 40%.
Ans.16 Return on Investment- 53% Debt Equity Ratio-1:1

Q.17 Rate of Gross profit on Revenue from operations of a company is 25%. Its Gross profit is Rs. 5,00,000. Its Shareholders' Funds are Rs. 25,00,000; Non-current Liabilities are Rs. 8,00,000 and Non-current Assets are Rs. 23,00,000. Calculate its Working Capital Turnover Ratio.
Ans.17 2 times

Q.18 From the given information, calculate the following ratios:
(i) Operating Ratio (ii) Inventory Turnover Ratio
Information:
Cash Revenue from Operations: Rs. 10,00,000
Credit Revenue from Operations: 120% of Cash Revenue from Operations
Operating Expenses: 10% of Total Revenue from Operations, Rate of Gross Profit: 40%
Opening Inventory: Rs. 1,50,000
Closing Inventory: Rs. 20,000 more than Opening Inventory
Ans.18 Operating ratio = 70%, Inventory Turnover ratio =8.25 times
****
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CASH FLOW STATEMENT AS-3(Revised)

Meaning of Cash Flow Statement: A statement which shows inflow and outflow of cash and cash equivalents of a company during a financial year.

Objectives of cash flow statement:

- To assess cash flow of dividend policy.
- Helps in formulation of dividend policy.
- Helps in financial planning
- Helps in preparing cash budget.
- For judging the operational efficiency.
- Statutory requirement.

Cash: Cash comprises of **cash** as well as **cash equivalents** i.e.cash in hand and demand deposits with the bank, current investments, marketable securities, commercial papers.

Activities in Cash flow statement

Operating **Investing** **Financing**

- **Cash Flow from Operating Activities:** Activities related to core or principal/main revenue generating activities of an enterprise.

  Cash Inflows: from Cash Sales, from Debtors, as Commission and Royalty

  Cash Outflows: Cash Purchases, Payment to creditors, Payment of wages
- **Cash Flow from Investing Activities:** Activities related to sale and purchase of long-term fixed assets and investments.

  Cash Inflows: Proceeds from sale of Fixed Assets and Investments, Interest and dividend received

  Cash Outflows: Purchase of long-term fixed assets such as Land & Building, Plant & Machinery, Investments etc.
- **Cash Flow from Financing Activities:** Activities related to change in capital structure of a company i.e. capital or long-term funds of an enterprise.

  Cash Inflows: Proceeds from Issue of Shares and Debentures for Cash Proceeds from Long-term Borrowings such as Bonds, Loans etc.

  Cash Outflows: Repayment of Loans**,** Redemption of Preference Shares and Debentures**,** Buy-back of Equity Shares**,** Payment of Dividend and Interest etc.

Transactions not regarded as Cash Flow: These are the transactions that are mere movements in between the items of Cash and Cash Equivalents. This includes cash deposited in bank, cash withdrawn from the bank and purchase or sale of marketable securities.

Non-cash transactions: These are the transactions in which the inflow or outflow of Cash or Cash Equivalent does not take place. Therefore, these non-cash transactions are not considered while preparing the Cash Flow Statements. These transactions include depreciation, amortisation, issue of bonus, etc.

Types of Businesses and Impact on Cash Flow:

Financial Enterprise: An enterprise that basically deals in lending (advancing loans) and borrowing of funds (accepting deposits), such as Banks.

Non-Financial Enterprise: An enterprise that basically deals in areas other than finance (purchase of raw material and sale of goods) For an activity to be classified as 'Operating' or 'not' focus, Nature of Business is guiding factor, i.e. Core Business Activity of the business.

Classification of Lending and Borrowing Functions				
Function	**Advancing Loans**		**Accepting Deposits from Public**	
Business Activity	Interest Received	Dividend Received	Interest Paid	Dividend Paid
Trading or Non-Financial Enterprise	Investing Activity	Investing Activity	Financing Activity	Financing Activity
Financial Enterprise	Operating Activity	Operating Activity	Operating Activity	Financing Activity

Paid on capital raised from External sources

Extraordinary Items:

All the incomes and expenses that arise from events or transactions that are clearly distinct from the ordinary course of business of the enterprise are termed as extraordinary items. All such items are not expected to recur frequently or regularly.It includes items such as payment to shareholders in the event of buy back of shares, claim for damages received, etc.

FORMAT OF CASH FLOW STATEMENT (INDIRECT METHOD)

Cash Flow Statement for the year ended xxxx

Particulars	Details	Amount
I. Cash Flow from Operating Activities		
(A) Net Profit before Taxation and Extraordinary Items		–
Adjustment for Non-cash and Non-operating Items		
(B) *Add*: **Items to be Added**		
(C) *Less*: **Items to be Deducted**		
(D) Operating Profit before Working Capital changes (A + B – C)		…
(E) *Add*: **↓ in CA and ↑ in CL**		
(F) *Less*: **↑ in CA and ↓ in CL**		
(G) Cash generated from Operations (D + E – F)		…
Less: Income Tax Paid (Net of Tax Refund received)		(…)
Cash Flow before Extraordinary Items		
Extraordinary Items (+/–)		…
(H) Net Cash from (or used in) Operating Activities		…
II. Cash Flow from Investing Activities		
Proceeds from Sale of Fixed Assets		…
Purchase of Fixed/Intangible Assets		(…)
Extraordinary Items (+/–)		…
(I) Net Cash from (or used in) Investing Activities		
III. Cash Flow from Financing Activities		
Proceeds from Issue of Shares or Debentures		…
Proceeds from Other Long-term Borrowings		…
Repayment of Loan		(…)
Redemption of Shares or Debentures		(…)
Bank Overdraft		…
Extraordinary Items (+/ –)		…
(J) **Net Cash from (or used in) Financing Activities**		…
IV. Net ↑/↓ in Cash & Cash Equivalents (I + II		
Add: Cash & Cash Equivalents in the begin		
V. Cash & Cash Equivalents at the end of t		

Steps to Ascertain Net Profit before Tax and Extraordinary Items.

Steps to Prepare Cash Flow Statement (*from Operating Activities*)

Ascertain Net Profit before Taxation & Extraordinary Items

Difference b/w Closing Balance & Opening Balance of P&L A/c	
Add:	Transfer to reserve (In case of increase)
	Proposed dividend for CY
	Interim dividend paid during the year
	Prov. for tax made during the CY
	Extraordinary item, if any, debited to the P&L A/c
Less:	Extraordinary item, if any, credited to the P&L A/c
	Decrease in reserve
	Refund of tax credited to P&L A/c
Net Profit before Taxation & Extraordinary Items	

Steps to Ascertain Operating Profit Before Working Capital Changes—

Steps to Prepare Cash Flow Statement (*from Operating Activities*)

Ascertain Operating Profit before Working Capital Changes

	Net Profit before Taxation & Extraordinary Items
Add:	Depreciation
	Preliminary Expenses/Discount on issue of Debentures (written off)
	Goodwill/Patents/Trademarks amortised
	Interest on Borrowings and Debentures
	Loss on sale of Fixed Assets
Less:	Interest/Dividend/Rent received
	Profit on sale of Fixed Assets
	Operating Profit before Working Capital Changes

Treatment of Special Adjustments

- **Bank Overdraft:** Treated as short-term borrowings shown under Financing Activities

Accounting Treatment

(i) Increase in Bank O/D - Cash Inflows
→ Added under Financing Activity

(ii) Decrease in Bank O/D - Cash Outflows
→ Deducted under Financing Activity

- **Interim Dividend:** The dividend declared and paid by the Board of Directors before its Annual General Meeting during the current year. (Always given as adjustment and is not affected by ProposedDividend)

I. Interim Dividend Paid: Dividend Paid

↓ Deducted from Financing Activities

↓ Added to Profit in Operating Activities

- **Proposed Dividend:** As per AS-4, Contingencies and Events Occurring after the Balance Sheet Date, Proposed dividend is shown in the Notes to Accounts. It will be shown as contingent liability since it becomes a liability after it is declared (approved) by the shareholders. Proposed dividend of previous year after declaration (approved) by the shareholders will be debited to surplus i.e., Balance in Statement of Profit and Loss. While preparing cash flow statement, previous year's proposed dividend will be added to Act Profit under operating activities and will be shown under financial activity. Proposed Dividend for current year will be declared in the next financial year. Hence it will have no effect on Cash Flow Statement.

- **Provision for tax —**

Accounting Treatment

(i) Taxes Made (CY) → Added to Profit in Operating Activities
(ii) Taxes Paid (PY) → Deducted from Operating Activities

Provision for Tax Account

Particulars	Amt	Particulars	Amt
Bank A/c (*Bal. Fig.- Tax Paid*)		Balance b/d (PY's Bal.)	
Balance c/d (CY's Bal.)		Profit & Loss A/c (Tax *Made*)	

CY Balance	PY Balance	Related Adjustment	Treatment
Given	Given	No	CY Balance → Add to Profit in Operating Activities PY Balance → Deduct from Operating Activities
No	Given	No	PY Balance → Deduct from Operating Activities
Given	No	No	CY Balance → Add to Profit in Operating Activities
No	No	Taxes Paid Given	Taxes Paid → Deduct from Operating Activities
Given	Given	Given	Through Account

- Fixed Asset Account:

a. **If assets are shown at their Written Down Value i.e. after providing depreciation:b. If assets are**

Account prepared: Fixed Assets A/c

Dr. **Fixed Assets Account** Cr.

Particulars	Amt	Particulars	Amt
Bal. b/d	xxx	Dep. A/c (*Charged during the year*)	xxx
P&L A/c (Profit)	xxx	P&L A/c (Loss)	xxx
Bank A/c (Purchase)	xxx	Bank A/c (Sale)	xxx
		Bal. c/d	xxx

Accounting Treatment

a) Operating Activities
Add. Depreciation charged during the year
Subtract: Profit on Sale of Asset
Add. Loss on Sale of Asset

b) Investing Activities
Subtract: Purchase of Fixed Assets
Add. Sale of Fixed Asset

shown at their Original Value (Accumulated Depreciation balances given)

Accounts prepared: Fixed Assets A/c, and Accumulated Depreciation A/c

Dr. **Fixed Assets Account** Cr.

Particulars	Amt	Particulars	Amt
Bal. b/d	xxx	Dep. A/c (*on part of asset*)*	xxx
P&L A/c (Profit)	xxx	P&L A/c (Loss)	xxx
Bank A/c (Purchase)	xxx	Bank A/c (Sale)	xxx
		Bal. c/d	xxx

Dr. **Accumulated Depreciation Account** Cr.

Particulars	Amt	Particulars	Amt
Fixed Assets A/c (*Dep. on part*)*	xxx	Bal. b/d	xxx
Bal. c/d	xxx	P&L A/c (*Dep. charged during the year*)	xxx

Accounting Treatment

a) Operating Activities

Add. Depreciation charged during the year

Subtract: Profit on Sale of Asset

Add. Loss on Sale of Asset

b) Investing Activities

Subtract: Purchase of Fixed Assets

Add. Sale of Fixed Asset

Questions:

1. Identify activities as operating/investing/financing/cash and cash equivalent in each of the following
   a. Interest received on loans granted by financial company
   b. Payment of dividend on equity shares
   c. Rent received on building
   d. Bank overdraft

   Solution: a. Operating activity b. Financing activity c. Investing activity d. Financing activity
2. State whether following activities will result into inflow/outflow/no flow of cash
   a. Purchase of goods on credit
   b. Sale proceeds of building
   c. Proposed dividend paid
   d. Purchase of fixed assets at 10% less cost price

   Solution: a. No flow b. Inflows c. Outflows d. Outflows
3. What is meant by cash equivalents?

   Solution: Cash equivalents mean short-term highly liquid investments that are readily convertible into known amount of cash and which are subjected to an insignificant risk of change in value.
4. State with reason whether the issue of 9% debentures to the vendors for the purchase of machinery of Rs 50,000 will result into inflow, outflow or no flow of cash.

   Solution: There is no flow of cash by the issue of 9% debentures to the vendors for the purchase of machinery of Rs 50,000 because this transaction will not change the balance of cash and cash equivalents.
5. Under which type of activity will you classify ‘refund of income tax received’ while preparing the cash flow statement?

   Solution: Operating activity.
6. Give an example of the activity which remains financing activity for every enterprise.

   Solution: Dividend paid.
7. Following is the Balance Sheet of GIC Ltd as on 31 March 2020. Prepare cash flow statement.

Particulars	Note no.	31.3.2020	31.3.2019
I.EQUITY AND LIABILITIES:		₹	₹
1. Shareholder's Funds			
(a) Share Capital		70,000	60,000
(b)Reserves and Surplus	1	44,000	8,000
2. Non-Current Liabilities			
(a) Long-term Borrowings	2	50,000	50,000
3. Current Liabilities			
(a) Trade Payables		25,000	9,000
TOTAL		1,89,000	1,27,000
II. ASSETS:			
Non-Current Assets			
Fixed Assets			
Tangible Assets		98,000	84,000
Non-current Investments			
2. Current Assets		16,000	6,000
(a) Current investments		18,000	20,000
(b) Inventories		49,000	12,000
(c)Cash and Cash Equivalents		8,000	5,000
TOTAL		1,89,000	1,27,000

Notes to Accounts

		31.3.2020	31.3.2019
1.	Reserve & Surplus:		
	General Reserve	30,000	20,000
	Surplus i.e. Balance in Statement of Profit &Loss.	14,000	(12,000)
		44,000	8,000
2.	Long Term Borrowings:		
	Debentures	50,000.	50,000

Additional Information: Depreciation provided on tangible assets (Machinery) during the year ₹8,000.Interest paid on debentures ₹5,000.

Solution:

CASH FLOW STATEMENT
For the year ended 31st March,2020

Particulars	**Details**	**Amount**
Cash flows from operating Activities:		
Net profit before tax		36,000
Adj.non-cash/non-op.		
Add: Depreciation	8,000	
Interest on debentures	5,000	13000
		....
Operating profit before Working Capital changes		49000
Add: Increase in current liabilities		
Trade payables	16,000	
Less: Increase in current assets		
Inventories	(37,000)	(21000)
		....
Net cash flow from operating activities		28,000
Cash flow from Investing Activities:		
Purchase of fixed Tangible assets	(22,000)	
Purchase of Non-current investments	(10,000)	
Cash used in investing activities		(32,000)
Cash flows from financing activities:		

Proceeds from issue of equity share capital Interest paid on debentures **Net cash flow from financing activities**	10,000 (5,000)	 5,000 ……………………..
Net increase in cash & cash equivalents (A+B+C) Add: Cash and Cash Equivalents in the beginning Cash and Cash Equivalents at the end of the year		1,000 25,000 26,000

Working Notes-

1. NET PROFIT BEFORE TAX:

Net profit for the current year(14,000+12,000) = 26,000
Add: transfer to general reserve = 10,000
36,000

2. FIXED TANGIBLE ASSETS A/C

To balance b/d	84,000	By Depreciation.	8,000
To bank (purchase) (bal. fig.)	22,000	By balance c/d.	98,000
	1,06,000		1,06,000

8. Welprint Ltd. has given you the following information: Rs

MachineryasonApril01,2020	50,000
Machinery as on March 31,2021	60,000
Accumulated Depreciation on April01,2020	25,000
Accumulated Depreciation on March31,2021	15,000

During the year, a Machine costing Rs. 25,000 with Accumulated Depreciation Rs. 15,000 was sold for Rs.13,000.

Calculate cash flow from Investing Activities on the basis of the information.

Solution:*Cash flows from investing activities*

	Rs.
Sale of Machinery	13,000
Purchase of Machinery	(35,000)
Net cash used in Investing Activities	**(22,000)**

Working Notes:

*Dr.***Machinery Account***Cr.*

Particulars	*J.F.*	*Amount (Rs.)*	*Particulars*	*J.F.*	*Amount (Rs.)*
Balance b/d		50,000	Cash (proceeds from sale ofmachine)		13,000
StatementofProfitandLoss (profit on sale of machine)		3,000	Accumulated Depreciation		*15,000*
Cash (*balancing figure:newmachinerypurchased*)		35,000	Balancec/d		60,000
		88,000			**88,000**

Dr. **Accumulated Depreciation Account** Cr.

Particulars	*J.F.*	*Amount (Rs.)*	*Particulars*	*J.F.*	*Amount (Rs.)*
Machinery		15,000	Balance b/d		25,000
Balance c/d		15,000	Statement of Profit and Loss (Depreciation provided during the year)		5,000
		30,000			**30,000**

9. FromthefollowingBalanceSheetsofXeroxLtd.,Preparecashflowstatement.

Particulars	*Note No.*	*31stMarch 2021(Rs.)*	*31stMarch 2020(Rs.)*
I. Equity and Liabilities			
Shareholders'Funds			
Sharecapital		15,00,000	10,00,000
Reserve and surplus (Balance inStatement of Profit andLoss)		7,50,000	6,00,000
Non-current Liabilities			
Long-termborrowings	1	1,00,000	2,00,000
Current Liabilities			
Trade payables		1,00,000	1,10,000
Short-term provisions (Provision fortaxation)		95,000	80,000
Total		**25,45,000**	**19,90,000**
II. Assets			
Non-currentassets			
Fixedassets			
Tangibleassets	2	10,10,000	12,00,000
Intangible assets (Goodwill)		1,80,000	2,00,000
Non-currentinvestment		6,00,000	-
Currentassets			
Inventories		1,80,000	1,00,000
TradeReceivables		2,00,000	1,50,000
Cash and cashequivalents	3	3,75,000	3,40,000
Total		**25,45,000**	**19,90,000**

Notes to accounts

Particulars		***31stMarch 2021(Rs.)***	***31stMarch 2020(Rs.)***
1. Long-term borrowings:			
i) 9%Debentures			**2,00,000**
ii) 5% Bank loan		**1,00,000**	
		1,00,000	**2,00,000**
2. Tangible Assets			
i)Land and building		**6,50,000**	**8,00,000**
ii) Plant and machinery		**3,60,000**	**4,00,000**
		10,10,000	**12,00,000**
3. Cash and cash equivalents			
i) Cash in hand		**70,000**	**50,000**
ii) Bank balance		**3,05,000**	**2,90,000**
		3,75,000	**3,40,000**

Additionalinformation:

1. Proposed dividend 2020-21 is Rs. 2,25,000 and for 2019-20 is Rs. 1,50,000.
2. IncometaxpaidduringtheyearincludesRs.15,000onaccountofdividendtax.
3. LandandbuildingbookvalueRs.1,50,000wassoldataprofitof10%.
4. Therateofdepreciationonplantandmachineryis10%.
5. 9%debenturesredeemedonApril2021,5%bankloanwasoptedonMarch 31, 2021

Sol.

Cash FlowStatement

Particulars		*(Rs.)*
I. Cash flows from OperatingActivities		
Net Profit before Taxation and Extraordinary Items		3,95,000
Adjustment for –		
+ Depreciation		40,000
+ Goodwillwritten-off		20,000
– Profit on Sale ofLand		(15,000)
= Operating Profit before working capital changes		4,40,000
– Decrease in TradePayables		(10,000)
– Increase in TradeReceivables		(50,000)
– Increase inInventories		(80,000)
= Cash generated from Operations		3,00,000
– Income Tax Paid(1)		(65,000)
A. Cash Inflows from Operations		**2,35,000**
II. Cash flows from InvestingActivities		
Proceeds from Sale of Land and Building		1,65,000
Purchase of Investment		(6,00,000)
B. Cash used in Investing Activities	**4,35,000**	
III. Cash flows from Financing Activities		
Proceeds from issue of Equity Share Capital		5,00,000
Redemption of Debentures		2,00,000
Proceeds from raising Bank Loan		1,00,000
Dividend Paid		1,50,000
Dividend Distribution Tax Paid		15,000
C. Cash flows from Financing Activities		**2,35,000**
Net Increase in cash and cash equivalents (A+B+C)		35,000
+ CashandCashEquivalentsinthebeginning		3,40,000
Cash and Cash Equivalent at the end		**3,75,000**

Working Notes:

(1) Total tax paid during theyear Rs. 80,0000

(2) (–) Dividend Distribution taxpaid(given) Rs.(15,000)

Income tax paid for operatingactivities **Rs.65,000**

(3) Netprofitearnedduringtheyearaftertaxanddividend

= Rs. 7,50,000 – 6,00,000 = Rs. 1,50,000

(4) Net profit beforetax

=Netprofitearnedduringtheyearaftertaxanddividend+Provisionfortax made + DeclaredDividend

= Rs. 1,50,000 + Rs. 95,000 (See provision for taxation)+ Rs. 1,50,000

= Rs. 3,95,000

Bank Account

Particulars	*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Balance c/d	1,00,000	Cash	1,00,000
	1,00,000		1,00,000

Provision for Taxation Account

Dr. *Cr.*

Particulars	*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Cash (Tax paid:which includes Rs. 15,000 as dividend	80,000	**Balance b/d**	80,000
Balance c/d	95,000	Statement of Profit and Loss(Provision made during the year)	95,000
	1,75,000		1,75,000

Land and Building Account

Dr. *Cr.*

Particulars	*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Balance b/d	8,00,000	Cash	1,65,000
Statement of Profit andLoss (Profit on sale)	15,000	**Balance c/d**	6,50,000
	8,15,000		8,15,000

Plant and Machinery Account

Dr. *Cr.*

Particulars	*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Balance b/d	4,00,000	**Depreciation**	40,000
		Balance c/d	3,60,000
	4,00,000		4,00,000