KENDRIYA VIDYALAYA SANGATHAN, RANCHI REGION.

STUDY MATERIAL ACCOUNTANCY (055)

CLASS- XII

Session 2023-24

STUDY MATERIAL 2023-24

OUR PATRON:
Sh.D.P.Patel *Deputy Commissioner,* *KVS, RO, Ranchi*

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SUBJECT CONVENER

Sh.M. MARDI, Principal, KV DHANBAD

ACKNOWLEDGEMENT

We are happy to provide useful study material keeping in view the academic progress of the students.

Our important objective is to help them to achieve their goals with ease and convenience.

Firstly, we would like to thank Sri. D. P. PATEL, Hon'ble Deputy Commissioner, KVS RO Ranchi. Sir showed his concern for our slow bloomer students and suggested to prepare the material.

Again, we would like to thank Sri. M. Mardi, Principal, KV Dhanbad cum Convener. Sir guided us to prepare the material.

This study material provides conceptual clarity and application expertise. It gives a positive direction to the thinking of the students. Our main objective is to reduce stress and pressure of board exams amongst students.

We, the editorial team feel proud to contribute in the study material for low achievers; they must be able to enrich their subject related information and will be successful in Board Examination 2024.

With best wishes

Editorial Team:

COMPILATION AND DESIGNED BY: -			
SH. AJEET KUMAR PGT, COMMERCE KV MEGHAHATUBURU.		SH. BIKASH ANAND PGT, COMMERCE KV BARKAKANA.	
SL. NO.	**NAME OF PGT (COMMERCE)**	**NAME OF KV**	**CHAPTER NAME**
1	SH. JAI SHANKAR SHARMA	BOKARO NO.3	1.Change in profit sharing ratio 2.Admission of a Partner
2	SH. BIKASH ANAND	BARKAKANA	1.Dissolution of a partnership firm
3	SH. D.P. TEWARY	DHANBAD NO.1	1.Retirement of a Partner 2.Death of a Partner
4	MRS. KUMARI KANAK LATA	NAMKUM, RANCHI	1.Financial Statement Analysis 2.Tools of Financial Statement Analysis
5	SH. PRADEEP KUMAR VERMA	GOMOH	Company Accounts 1. Accounting for share capital 2. Issue of Debentures
6	SMT. SOUMYA V.R.	CRPF, RANCHI	1.Accounting Ratios 2.Cash Flow Statement
7	SH. AJEET KUMAR	MEGHAHATUBURU	1.Partnership Fundamentals 2.Valuation of Goodwill

Points deserve your attention while taking examination: -

- Use proper format with correct heading.

- Write the narration for every journal entry.

- Write the amount in proper sequence (i.e, once digit number below once and so on).

- Close particular cell after every journal entry.
- Show the working note clearly.
- Always do a numerical question from a fresh page, try to complete an account/ statement on a single page.

- Don't draw the margin line, just fold the answer sheet from both the sides (Left and right).

- Put the question number clearly on the middle of the page and highlight it by underlining.
- Solve all the parts of the question together.
- Do your calculations in a separate rough column or on the last one or two pages of the answer-sheet
- Utilize the early 15 minutes to read the question paper carefully. Plan and organize your answers in mind. Try to ascertain the level of difficulty of various questions and decide the sequence in which the paper is to be attempted. Also try to analyze and break a long question in small parts for easy understanding.
- Do not spend more than requisite time on a particular question.
- Use your watch to keep track of time so as to finish the paper well in time and do a quick revision before the exam ends.
- Solve Latest CBSE sample papers available at CBSE's website.

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SYLLABUS

ACCOUNTANCY (Code No.- 055)

Class-XII (2023-24)

Theory: 80 Marks 3 Hours

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

Project: 20 Marks

Class XII (2023-24)

Theory: 80 Marks *3hrs*

Project: 20 Marks

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

CHAPTER 1: ACCOUNTING FOR PARTNERSHIP FIRMS – FUNDAMENTALS

Meaning: A partnership is a form of business which enables two or more persons to co-own an organization, and they agree to share the profits and losses of the company. Each member of such a business is called a Partner, and collectively they are known as a partnership firm.

In a partnership, every owner contributes something to the welfare of the firm. These can be in the form of ideas, property, money and sometimes a combination of all these. Owners of a Partnership share profits and losses in proportion to their respective investments.

Features of Partnership:

- Sharing of profits and losses.
- Mutual agency.
- Unlimited liability.
- Lawful business.
- Contractual relationship.

Rights of a partner:

1.Every partner has the right to share profits or losses with other partner in the agreed ratio.
2. Every partner has the right to take part in the conduct of the business.
3. Every partner has the right to disallow the admission of a new partner.
4. Every partner has a right to retire from the firm after giving a proper notice.

Rules Applicable in the absence of Partnership Deed
1. Profit – Sharing Ratio – Shared equally
2. Interest on Capital – No interest on Capitals
3. Interest on Drawings - No interest on Drawings
4. Salary to a Partner – No partner is entitled to any salary
5. Interest on loan - @ 6% per annum
6. Admission of a New Partner – Without the consent of all existing partners no new partner can be admitted.

Duties of a partner

- Duty to act in good faith. The partners must act in good faith for the greater common advantage.
- Duty to Render true accounts.
- Duty to Indemnify for fraud.
- Duty not to compete.
- Duty to be Diligent.
- Duty to properly use the property of the firm.

- Duty to account for personal profits.

Format of Profit and Loss Appropriation Account

Format of Profit and Loss Appropriation Account

Profit and Loss Appropriation Account
Dr for the year ended........ Cr

Particulars		Amt (₹)	Particulars		Amt (₹)
To Profit and Loss A/c		...	By Profit and Loss A/c (Net profit subject to appropriations)		...
To Interest on Capitals A/c			By Interest on Drawings A/c		
A	...		A	...	
B	...	...	B	...	...
To Partners' Salaries A/c		...			
To Partners' Commission A/c		...			
To Reserve A/c		...			
To Profit Transferred to					
*A's Capital A/c	...				
**(or A's Current A/c)					
*B's Capital A/c	...	...			
**(or B's Current A/c)					
		...			...

*Under Fluctuating Capital Method **Under Fixed Capital Method

Methods of maintaining Capital Accounts of Partners:
1. Fixed Capital Accounts
2. Fluctuating Capital Accounts

FIXED CAPITAL ACCOUNTS

(i) **Capital account**

Dr **Partners' Capital Account** Cr

Particulars	X (₹)	Y (₹)	Particulars	X (₹)	Y (₹)
To Cash/Bank A/c (Capital withdrawn)			By Balance b/d (Opening credit balance)		
To Balance c/d (Closing balance)			By Cash/Bank A/c (Additional capital introduced)		

(ii) **Current account**

Dr **Partners' Current Account** Cr

Particulars	X (₹)	Y (₹)	Particulars	X (₹)	Y (₹)
To Balance b/d (Opening debit balance)			By Balance b/d (Opening credit balance)		
To Drawings A/c (Out of profits)			By Interest on Capital A/c		
To Interest on Drawings A/c			By Partner's Salary or Commission A/c		
To Profit and Loss A/c (Share in losses)			By Profit and Loss Appropriation A/c (Share in profits)		
To Balance c/d (Closing credit balance)			By Balance c/d (Closing debit balance)		

FLUCTUATING CAPITAL ACCOUNTS

Partner's Capital Account

Dr. *Cr.*

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Balance b/d (in case of debitclosing balance)		xxx		Balance b/d (in case of credit opening balance)		xxx
	Drawings				Bank (fresh capital introduced)		xxx
	Interest on drawings		xxx		Salaries		xxx
	Profit and Loss A/c (for share of loss)		xxx		Interest on capital		xxx
	Balance c/d (in case of credit closing balance)		xxx		Profit and Loss Appropriation (for share of profit)		xxx
					Balance b/d (in case of debit closing balance)		xxx
			xxxx				xxxx

Fig. 2.2: *Proforma of Partner's Capital Account under Fluctuating capital Method.*

Calculation of Interest on Drawings

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

MCQs

1- Sleeping partners are those who
(A) take active part in the conduct of the business but provide no capital. However, salary is paid to them.
(B) do not take any part in the conduct of the business but provide capital and share profits and losses in the agreed ratio
(C) take active part in the conduct of the business but provide no capital. However, share profits and losses in the agreed ratio.
(D) do not take any part in the conduct of the business and contribute no capital. However, share profits and losses in the agreed ratio.

Answer – B

2- In the absence of Partnership Deed, the interest is allowed on partner's capital:
(A) @ 5% p.a.
(B) @ 6% p.a.
(C) @ 12% p.a.
(D) No interest is allowed

Answer – D

3- A, B and C were Partners with capitals of ₹50,000; ₹40,000 and 30,000 respectively carrying on business in partnership. The firm's reported profit for the year was ₹80,000. As per provision of the Indian Partnership Act, 1932, find out the share of each partner in the above amount after taking into account that no interest has been provided on an advance by A of ₹20,000 in addition to his capital contribution.
(A) ₹26,267 for Partner B and C and ₹27,466 for Partner A.
(B) ₹26,667 each partner.
(C) ₹33,333 for A ₹26,667 for B and ₹20,000 for C.
(D) ₹30,000 each partner.

Answer – A

4- On 1st June 2018 a partner introduced in the firm additional capital ₹50,000. In the absence of partnership deed, on 31st March 2019 he will receive interest:
(A) ₹3,000
(B) Zero
(C) ₹2,500
(D) ₹1,800

Answer – B

5- According to Profit and Loss Account, the net profit for the year is ₹1,50,000. The total interest on partner's capital is ₹18,000 and interest on partner's drawings is ₹2,000. The net profit as per Profit and Loss Appropriation Account will be:
(A) ₹1,66,000
(B) ₹1,70,000
(C) ₹1,30,000
(D) ₹1,34,000

Answer- D

6- A and B are partners. According to Profit and Loss Account, the net profit for the year is ₹2,00,000. The total interest on partner's drawings is ₹1,000. As salary is ₹40,000 per year and B's salary is ₹3,000 per month. The net profit as per Profit and Loss Appropriation Account will be:
(A) ₹1,23,000
(B) ₹1,25,000
(C) ₹1,56,000
(D) ₹1,58,000

Answer- B

7- If a fixed amount is withdrawn by a partner in each quarter, interest on the total amount is charged for ……………….. months
(A) 3
(B) 6
(C) 4.5
(D) 7.5

Answer- B

8- Anuradha is a partner in a firm. She withdrew ₹6,000 in the beginning of each quarter during the year ended 31st March, 2019. Interest on her drawings @ 10% p.a. will be:
(A) ₹900
(B) ₹1,200
(C) ₹1,500
(D) ₹600

Answer- C

PRACTICAL PROBLEMS

Q1. Mention any four provisions of the Partnership Act, in the absence of Partnership Deed.
Ans. Rules Applicable in the absence of Partnership Deed
1. Profit – Sharing Ratio – Shared equally
2. Interest on Capital – No interest on Capitals
3. Interest on Drawings - No interest on Drawings
4. Salary to a Partner – No partner is entitled to any salary
5. Interest on loan - @ 6% per annum
6. Admission of a New Partner – Without the consent of all existing partners no new partner can be admitted to the firm.

Q2. Name any four-item shown in the Debit side of Profit and Loss Appropriation Account.

Ans.1. Salaries of Partners
2.Commission to Partners
3.Interest to Partner`s Capitals
4.Reserve A/c

Q3. Mention the items that may appear on the credit side of the Capital Account of a partner when the capitals are fluctuating.

Ans.1. Cash/Bank A/c (Additional Capital)
2.Interest on Capital
3.Partner`s Salary
4.Partner`s Commission

Q4. Mention the items that may appear on the Debit side of the Capital Account of a partner when the capitals are fluctuating.
Ans.1.Cash/Bank A/c (Drawing against Capital)
2.Drawings (Drawing against Profit)

3.Interest on Drawings
4.P.& L. A/c (Share of loss)

Q5.Ajay, Binod and Chandra entered into partnership on 1st April 2019 with capitals Rs.3,00,000, Rs. 2,00,000 and 1,00,000 respectively. In addition to capital, Chandra has advanced a loan of Rs. 1,00,000. Since they had no agreement to guide them, they faced following issues during and at the end of the year:

1. Ajay wanted interest on capital to be provided @ 8% P.a but Binod and Chandra did not agree.
2. Chandra wanted that interest on loan be paid to him @ 10% P.a but Ajay and Binod wanted to pay @ 5% p.a.
3. Ajay and Binod demanded to share profits in the ratio their capital contribution, Chandra is not in agreement with this proposal.
4. Binod, being working partner, demands a lump sum payment of Rs.40,000 as remuneration for which other partners are not in agreement.

You are required to suggest and help them resolve these issues.
Ans. 1. No interest is payable on Capitals
2.Interest on loan by partner will be paid @ 6% P.a
3.Profits will be shared equally
4.No salary / remuneration is payable to any partner

Q6.B, C and D are partners sharing profits in the ratio of 1:1:1. As per the partnership deed salary is allowed to the partners as follows:

- B is entitled to a salary of ₹ 2,000 per month.
- C is entitled to salary of ₹ 16,000 p.a.
- D is entitled to a salary of ₹ 4,000 quarterly.

Calculate the amount of salary payable to the partners in the following cases:
Case 1. When there is profit of ₹ 62,000
Case 2. When there is profit of ₹ 35,000
Case 3. When there is loss ₹ 20,000
Answer-
Case 1
Profit is enough to pay the salary to the partners B's Salary will be paid ₹ 24,000; C ₹ 16,000 and D ₹ 16,000 and remaining profit 6,000 will be shared equally by all the partners
Case 2
Profit is not enough to pay salary to partners Profit will be shared in the ratio of salary 24,000: 16,000: 16,000 i.e., 3:2:2. B will get 15,000; C ₹ 10,000 and D ₹ 10,000.
Case 3
Salary will not be paid to any partner, because there is loss. Salary is not a charge in this case, it is treated as an appropriation.

Q7. Garry, Harry and Robert were partners in a firm sharing profits in the ratio of 7:4:9. Their capitals on 1st April 2021 were: Garry ₹ 2,00,000; Harry ₹ 75,000 and Robert ₹ 3,50,000. Their partnership deed provided for the following:

(i) 10% of the net profit to be transferred to General Reserve.
(ii) Interest on capital is to be allowed @ 9% p.a.
(iii) Salary of ₹ 6,000 per month to Harry
(iv) Interest on Drawings @ 6% p.a.

Drawings made against the anticipated profits, by Garry during the year ₹ 25,000, Harry withdrew ₹ 5,000 at the end of each quarter, Robert withdrew ₹ 25,000 on1st June 2021 for personal use. During the year ended 31st March 2022 the firm earned profits of ₹ 1,70,000. Prepare Profit and Loss Appropriation Account.

Solution-

PROFIT AND LOSS APPROPRIATION ACCOUNT

Particulars		**Amount**	**Particulars**		**Amount**
To General Reserve		17,000	By Profit and Loss, A/c (NP)		1,70,000
To Interest on Capital A/c			To Interest on		
Garry	18,000		Drawings A/c		
Harry	6,750		Garry	750	
Robert	31,500	56,250	Harry	450	
To Partner's Salary A/c			Robert	1,250	2,450
Harry (6,000×12)		72,000			
Distribution of Profit:					
To Garry's Capital A/c	9,520				
To Harry's Capital A/c	5,440				
To Robert's Capital A/c	12,240	27,200			
		1,72,450			**1,72,450**

Q8. Manoj and Billu are equal partners. Manoj is a sleeping partner and Billu is an Active working partner. Their capitals on 1st April 2021 were: Manoj ₹ 6,000 Credit and Billu (₹ 20,000) Debit.

Mr. Manoj has given a loan to the firm ₹ 10,000 on 1st April 2021 @ 10% p.a. Partnership deed allows 10% p.a. interest on capital. Salary to every Active working partner @ 3,000 p.a. but partnership deed is silent on interest on loan payable to any partner, in case any partner provides loan to the firm. Profit for the year ending 31st March 2022 was ₹ 7,000 before providing above.

Prepare Profit and Loss Appropriation Account.

Solution-

PROFIT AND LOSS APPROPRIATION ACCOUNT

Particulars	Amount	Particulars	Amount
To Interest on Capital A/c Manoj To Partner's Salary A/c Billu	 4,000 2,000	By Profit and Loss, A/c (Net Profit) (7,000-1,000 interest on loan)	 6,000
	6,000		6,000

Note:

InterestonCapitaltoManoj6,000andSalarytoBillu3,000butprofitisonly6,000Profitwill be shared in the ratio of appropriation:6,000:3,000=2:1

NointerestoncapitaltoBillubecausehiscapitalisshowinganegativebalance.

Q9. On 31st March, 2021, the balance in the capital accounts of Asha, Nisha and Disha after making adjustments for profits and drawings were ₹ 1,50,000, ₹ 1,20,000 and ₹ 90,000 respectively. Subsequently, it was discovered that interest on capital and interest on drawings had been omitted. The partners were entitled to interest on capital @ 10% p.a. Interest on drawings was also to be charged @ 10% p.a. The drawings during the year were: Asha ₹ 50,000, Nisha ₹ 60,000 and Disha ₹ 30,000. The net profit for the year ending 31st March, 2021 amounted to ₹ 1,00,000. The profit-sharing ratio was 2: 2: 1. Pass the necessary adjustment entry. Also show your workings clearly.

JOURNAL		
Particulars	**Dr. (Amount)**	**Cr. (Amount)**
Nisha's capital A/c Dr. To Asha's capital A/c To Disha's capital A/c (Omission of interest on capital and commission, now rectified)	2,200	 300 1,900

Solution-

Working note

Partners	Interest On	Interest on	Profits	Net Effect

	capital Cr. ₹	Drawings Dr. ₹	Dr. ₹	Dr. ₹	Cr. ₹
Asha	16,000	2,500	13,200	----------	300
Nisha	14,000	3,000	13,200	2,200	----------
Disha	10,000	1,500	6,600	----------	1,900
	40,000	7,000	33,000	2,200	2,200

Calculation of Interest on capital:

Calculation of Opening Capitals:

Particulars	**Asha** ₹	**Nisha** ₹	**Disha** ₹
Closing Capitals	1,50,000	1,20,000	90,000
Add: Drawings	50,000	60,000	30,000
Less: Profits	(40,000)	(40,000)	(20,000)
Opening Capitals	1,60,000	1,40,000	1,00,000
Interest on Capital @ 10% p.a.	**16,000**	**14,000**	**10,000**

Q10.Ram, Mohan and Sohan were partners sharing profits in the ratio of 2: 1: 1. Ram withdrew ₹ 3,000 every month and Mohan withdrew ₹ 4,000 every month. Interest on drawings @ 6% p.a. was charged, whereas the partnership deed was silent about interest on drawings. Showing your working clearly, pass the necessary adjustment

JOURNAL

Date	Particulars		Dr. Amount ₹	Cr. Amount ₹
	Ram's Capital A/c	Dr.	180	
	Sohan's Capital A/c	Dr.	630	
	To Mohan's Capital A/c (Adjustment entry for interest on drawings wrongly charged)			810

Pass journal entry to rectify the error.

Adjustment Table

Particulars	Ram (₹)	Mohan (₹)	Sohan (₹)
Interest on drawings, wrongly debited	1080	1440	----------
Loss to be debited	(1260)	(630)	(630)
Net Effect	180 (Dr.)	810 (Cr.)	630 (Dr.)

Q11Jay, Vijay and Karan were partners of an architect firm sharing profits in the ratio of 2: 2: 1. Their partnership deed provided the following:

I. A monthly salary of ₹ 15,000 each to Jay and Vijay.
II. Karan was guaranteed a profit of ₹ 5,00,000 and Jay guaranteed that he will earn an annual fee of ₹ 2,00,000. Any deficiency arising because of guarantee to Karan will be borne by Jay and Vijay in the ratio of 3: 2.

During the year ended 31st March, 2022 Jay earned fee of ₹ 1,75,000 and the profits of the firm amounted to ₹15,00, 000Showing your workings clearly prepare Profit and Loss Appropriation Account.

PROFIT AND LOSS APPROPRIATION ACCOUNT

Particulars		Amount ₹	Particulars	Amount ₹
To salary			By Net profit	15,00,000
Jay's Capital A/c	1,80,000		By Jay's Capital A/c	25,000
Vijay's Capital A/c	1,80,000	3,60,000	(2,00,000-1,75,000)	
To Profit transferred			Deficiency in	
to :			guaranteed fees	
Jay's Capital A/c	4,66,000			
-guaranteed to Karan	(1,60,200)	3,05,800		
Vijay's Capital A/c	4,66,000			
-guaranteed to Karan	(1,06,000)	3,59,200		
Karan's Capital A/c	2,33,000			
Add guarantee	2,67,000	5,00,000		
		15,25,000		15,25,000

PRACTICE QUESTIONS

Unsolved Questions

Q8. Mansi, Simran and Namita started business on 1st April 2019 with capital of Rs.56,000, Rs.44,800 and Rs.33,600 respectively. After distributing the profit of Rs.67,200 for the year ended 31st March, 2020 in their agreed ratio of 3:1:1, it was found that following items were not taken into consideration in the books of accounts:

i) Interest on capital @ 10% p.a.

ii) Commission to Mansi was Rs.6,720.

iii) Salary to Mansi and Simran Rs.11,200 and Rs.16,800 respectively.

iv) Interest on drawings: Mansi Rs.784, Simran Rs.560 and Namita Rs.336.

You are required to pass a single adjustment entry to rectify the errors. Show your workings clearly.

Q9. Rohit, Raman and Raina are partners in a firm. Their capital accounts on 1st April, 2019, stood at Rs.2,00,000, Rs.1,20,000 and Rs.1,60,000 respectively. Each partner withdrew Rs.15,000 during the financial year 2019-20.

As per the provisions of their partnership deed:

(a) Interest on capital was to be allowed @ 5% per annum.

(b) Interest on drawings was to be charged @ 4% per annum.

(c) Profits and losses were to be shared in the ratio 5:4:1.

The net profit of Rs.72,000 for the year ended 31st March 2020, was divided equally amongst the partners without providing for the terms of the deed.

You are required to pass a single adjustment entry to rectify the error (Show workings clearly).

Prepared by: Ajeet Kumar, PGT commerce, KV Meghahatuburu

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CHAPTER 2- VALUATION OF GOODWILL

Meaning of Goodwill - Goodwill is an intangible asset that accounts for the excess purchase price of another company. Items included in goodwill are proprietary or intellectual property and brand recognition, which are not easily quantifiable.

Characteristics or Features of Goodwill-

1. Goodwill is an intangible asset. It is non-visible but it is not a fictitious asset.

2. It cannot be separated from the business and therefore cannot be sold like other identifiable and separable assets, without disposing off the business as a whole.

3. The value of goodwill has no relation to the amount invested or cost incurred in order to build it.

4. Valuation of goodwill is subjective and is highly dependent on the judgment of the valuer.

5. Goodwill is subject to fluctuations. The value of goodwill may fluctuate widely according to internal and external factors of business.

Types of Goodwill

There are two distinct types:

- **Purchased**: Purchased goodwill is the difference between the value paid for an enterprise as a going concern and the sum of its assets less the sum of its liabilities, each item of which has been separately identified and valued.
- **Inherent:** It is the value of the business in excess of the fair value of its separable net assets. It is referred to as internally generated goodwill, and it arises over a period of time due to the good reputation of a business. It can also be called as self-generated or non-purchased goodwill.

For example, suppose you are selling an outstanding product or providing excellent service consistently. In that case, there is a high chance of an increase in goodwill.

Factors Affecting Goodwill

The following factors have an impact on the goodwill, which are:

1. **Location of the business**: A business which is located in a suitable location will have a more favourable chance of higher goodwill than a business located in a remote location.
2. **Quality of goods and services**: A business which is providing a higher quality of goods and services stands a great chance of earning more goodwill than competitors who provide inferior goods and services.
3. **Efficiency of management**: An efficient management results in increase in profit of the business which enhances the goodwill of the business.
4. **Business Risk**: A business having lesser risk has a better chance of creating goodwill than a high-risk business.
5. **Nature of business:** It means the type of products that business deals with, the level of competition in the market, demand for the products and the regulations impacting the business. A business having a favourable outcome in all these areas will have a greater goodwill.
6. **Favourable Contracts**: A firm will enjoy a higher goodwill if it has access to favourable contracts for sale of products.
7. **Possession of trade mark and patents**: Firms that have patents and trademarks will enjoy monopoly in the market, which will contribute to the increase in the goodwill of the firm.

8. **Capital**: A firm with a higher return on investment along with lesser capital investment will be considered by buyers as more profitable and having more goodwill.

Need for Valuation of Goodwill

- The difference in the profit-sharing ratio (PSR) amongst the existing partners
- Admission of a new partner
- Retirement of a partner
- Death of a partner
- Dissolution of an enterprise involving the sale of the business as a trading concern
- Consolidation of partnership firms

Methods of Valuation of Goodwill

The significant methodologies of valuation are mentioned:

- Average Profits Method
- Super Profits Method
- Capitalisation Method

Average profit Method:

Average Profit method is one of the simplest methods of goodwill valuation that is used commonly. In this method, the value of goodwill is calculated by multiplying the average estimated profit or average future profit with the number of years of purchase.

There are two different methods of calculating average profit which are:

1. Simple average

2. Weighted average

Simple average: In the simple average method, the goodwill is calculated by multiplying the average profit with the agreed number of years of purchase.

Goodwill = Average Profit x No. of years of purchase

Weighted Average: In the weighted average method, weights are assigned to the profits of each year with more weightage for the recent years. The goodwill is calculated by multiplying the weighted average profit with the number of years of purchase.

Weighted Average Profit = Sum of Weighted profits / Sum of weights

Goodwill = Weighted Average Profit x No. of years of purchase

If the profits are observed to be constant over a period of few years, then there should be equal weightage given for all the years which is the simple average method.

And if the profit is fluctuating every year, then the preference shifts to weighted average method with necessary weightage given to profits obtained from recent years.

Super Profit Method

Super profit is the excess of estimated future profit than the normal profit. It is a way of determining the extra profits that are earned by the business. The goodwill is determined by multiplying the value of super profits by a certain number (that number being the number of years of purchase).

Steps to calculate Goodwill using Super Profit Method

The following steps are involved in the calculation of goodwill using super profit method.

1. Calculate the total capital of the business. It will be the sum total of all the net current and fixed assets along with the shareholders equity.

2. Determine the normal profit by multiplying the total capital employed with the normal rate of return.

3. Calculate the average estimated profit or average manageable profit

4. Calculate super profit by subtracting the value of normal profit from the average estimated profit to determine the super profit.

5. Multiply the super profit by the number of years of purchase to determine the goodwill.

It can be expressed in formula as follows:

Normal Profit = Capital Employed x (Normal Rate of Return/100)

Super Profit = Average estimated profit – Normal Profit

Goodwill = Super Profit x No. of years of purchase

Capitalisation Method

Capitalisation method is one of the methods that is used for goodwill valuation. In this method, the value of goodwill is calculated by deducting actual capital employed from the capitalisation value of average profits based on the normal rate of return.

There are two ways of calculating profits in capitalisation method and these methods are:

1. Capitalisation of Average Profit Method

2. Capitalisation of Super Profits Method

Capitalisation of Average Profit Method: In the method of capitalisation of average profit, the goodwill value is determined by subtracting the actual capital employed from the capitalised value of the average profits on the basis of normal rate of return.

Goodwill = Normal Capital – Actual Capital Employed or

Goodwill = Capitalised Average Profits – Actual Capital Employed

where,

Capitalised Average Profits or Normal Capital = Average estimated profits x 100 / Normal Rate of Return

Actual capital employed or Net Asset of Business = Total Assets (excluding goodwill, non-traded investments and fictitious assets) – Outsiders liabilities

Steps in calculating goodwill by capitalisation of average profit method

Step 1: Calculate average estimated profits

Step 2: Calculate the capitalised average profits

Step 3: Calculate the value of Actual capital employed or net assets of the business

Step 4: Calculate goodwill by subtracting the actual capital employed from the capitalised average profit

Capitalisation of Super Profits Method: In this method, the goodwill valuation is determined by capitalising the super profit on the basis of normal rate of return.

The formula for the Capitalisation of Super Profits Method is

Capitalisation of Super Profits Method = Average of Annual Super Profits x 100 / Normal rate of return

Short Answer Type Questions

Q1. Define Goodwill?

It is 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 business.

Q2. What Is the Nature of Goodwill?

It is the intangible asset which does not have a physical existence. It is not a fictitious asset. It can be sold with the sale of the business itself.

Q3. Why Is ‘goodwill’ Considered An ‘intangible Asset’ But Not A ‘fictitious Asset’?

It is considered an intangible asset as it cannot be seen or touched. However, it is not a fictitious asset as it can be sold for money or money's worth.

Q4. Mention the Two Characteristics of Goodwill?

(i) Goodwill is an intangible asset and not a fictitious asset.

(ii) Goodwill enables to earn a super profit.

Q5. Name Any Two Factors Affecting Goodwill of a Partnership Firm?

(i) The favourable location of the Business

(ii) The efficiency of Management

Q6. Name Any Two Methods of Valuation of Goodwill?

(i) Average Profit Method

(ii) Super Profit Method

MCQs

1. The excess amount which the firm can get on selling its assets over and above the saleable value of its assets is called

A) Surplus

B) Super Profit

C) Reserve

D) Goodwill

Answer: D

2. A firm's goodwill is not affected by

A) Location of the firm

B) The reputation of the Firm

C) Better Customer Service

D) None of the Above

Answer: D

3. Weighted average method of calculating goodwill is used when

A) Profits are not equal

B) Profits show an increasing or decreasing trend

C) Profits are Fluctuating

D) None of the Above

Answer: B

4.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

5.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

6.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

7.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

Practical Problems

Q1. Akansha, Chetna and Dipanshu are partners in a firm sharing 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:

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 x 2 = 1,51,700.

Q2. 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 × Weight
2011	43,000	1	43,000
2012	50,000	2	1,00,000
2013	52,000	3	1,56,000
2014	65,000	4	2,60,000
2015	85,000	5	4,25,400
Total		15	9,84,400

Weighted Average Profit: Total Product of Profits/ Total Weights = 9,84,000/15 = 65,600

Goodwill = weighted average profits x years of purchase

= 65,600 x 2 = 1,31,200

Q3. A firm earned net profits during the last three years as:

Year	2011-13	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 = $\frac{36,000+40,000+44,000}{3}$ = 40,000

Normal Profit = $\frac{1,20,000 \times 10}{100}$ = 12,000

Super profit = Average profit – Normal profit
= Rs. 40,000 – 12,000 = Rs. 28,000
Goodwill = Super profit x years of purchase = 28,000 x 3 = 84,000

Q4. From the following information, calculate value of goodwill of the firm by applying Capitalisation Method. Total capital of the firm is Rs.16,00,000.
Normal rate of return 10%. Profit for the year is Rs. 2,00,000.

Solution: Calculation of Capitalised Value of Profit:

Capitalised Value of profit= [Profit x100]/ Normal Rate of Return

= [200000x100]/10

= 2000000

Step 2: Calculation of Total Capital:

Total Capital= 1600000

Step 3: Calculation of Goodwill:

Goodwill= Capitalised Value of Profit- Total Capital

= 2000000-1600000

= 400000

PRACTICE QUESTIONS

1. Anita and Anaya are partners sharing profits in the ratio of 3: 2. They admit Ashna into partnership. It was agreed to value goodwill at three year's purchase on the basis of weighted average profit for the past 5 years. Weights being assigned to each year were: -
   The profits of 5 years were: -

Year ended	**Profits**
31^{st} March, 2015	1,80,000
31^{st} March, 2016	1,60,000
31^{st} March, 2017	2,50,000

31st March, 2018	3,00,000
31st March, 2019	3,50,000

Book revealed:

- **a.** An abnormal gain of Rs. 20,000 was earned in the year ended 31st March, 2016.
- **b.** An abnormal loss of Rs. 10,000 was incurred in the year ended 31st March, 2017.
- **c.** Expense of 50,000 incurred to overhaul a machine on 1st April, 2017 was debited to profit and loss account instead of being debited to machinery account. Depreciation is charged on machinery @20% on written down value method.
- **d.** Closing stock as on 31st March 2018 was undervalued by Rs. 20,000. Calculate the value of goodwill.

Q2. RG and MK are the partners in the firm. Their capitals are 3, 00,000 and 2,00,000. During the year ended 31st March, 2010 the firm earned a profit of 1,50,000. Assuming that the normal rate of return is 20%. Calculate the value of goodwill of the firm:

1. By capitalization method
2. By super profit method if the goodwill is valued at 2 years purchase of super profit.

Q3. A and B are partners sharing profits and losses in the ratio of 5: 3. On 1st April, 2019, C is admitted to the partnership for 1/4th share of profits. For this purpose, goodwill is to be valued at two years' purchase of the last three years' profits (after allowing partners' remuneration). Profits to be weighted 1: 2: 3, the greatest weight being given to last year. Net profit before partners' remuneration were: 2016-17: ₹ 2,00,000; 2017-18: ₹ 2,30,000; 2018-19: ₹ 2,50,000. The remuneration of the partners is estimated to be ₹ 90,000 p.a. Calculate the amount of goodwill.

Q4. Dinesh and Mahesh are partners sharing profits and losses in the ratio of 3: 2. They admit Ramesh into partnership for 1/4th share in profits. Ramesh brings in his share of goodwill in cash. Goodwill for this purpose shall be calculated at two years' purchase of the weighted average normal profit of past three years.

Weights being assigned to each year 2017−1; 2018−2 and 2019−3. Profits of the last three years were: 2017 − Profit ₹ 50,000 (including profits on sale of assets ₹ 5,000). 2018 − Loss ₹ 20,000 (including loss by fire ₹ 35,000). 2019 − Profit ₹ 70,000 (including insurance claim received ₹ 18,000 and interest on investments and dividend received ₹ 8,000).

Calculate the value of goodwill. Also, calculate the goodwill brought in by Ramesh.

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CHAPTER-3

Change in Profit Sharing Ratio among the Existing Partners and Admission of a New Partner

Reconstitution of a Partnership Firm – Any change in the relationship of existing partners which results in an end of the existing agreement and enforces making of a new agreement is called Reconstitution of a Partnership Firm.

Modes of Reconstitution of a Partnership Firm

- Admission of a new partner
- Change in profit sharing ratio of the existing partner
- Retirement of and existing partner
- Death of a partner

Admission of a New Partner

According to the Partnership Act 1932, a new partner can be admitted into the firm only with the of all the existing partners unless otherwise agreed upon.

The following categories of individuals cannot be admitted as a new partner:

- Persons of unsound mind/Lunatic persons
- Insolvent persons
- Any other person who has been disqualified by law

With the admission of a new partner, the partnership firm is reconstituted and a new agreement is entered into to carry on the business of the firm.

A newly admitted partner acquires two main rights in the firm:

i. Right to share the assets of the partnership firm
ii. Right to share profits of the partnership firm

For the right to acquire share in the assets and profits of the partnership firm, the partners bring an agreed amount of capital either in cash or kind.

In the case of an established firm which may be earning more profits than the normal rate of return on its capital the new partner is also required to contribute some additional amount known a premium for Goodwill.

Premium for Goodwill: - Share of goodwill brought in cash by the new partner, to compensate the existing partners for loss of their share in profits of the firm, is called Premium for Goodwill.

** New partner's share of Goodwill = Goodwill of the Firm x new partner's share

Various matters that need adjustments at the time admission of a new partner

i. New profit-sharing ratio and Sacrificing ratio
ii. Valuation and adjustment of goodwill
iii. Distribution of accumulated profits (Reserves)
iv. Revaluation of assets and Reassessment of liabilities and
v. Adjustment of partner's capitals

NEW PROFIT-SHARING RATIO AND SACRIFICING RATIO

Sacrificing Ratio: - The ratio in which the old partners agree to sacrifice their share of profit in favour of the incoming partner is called sacrificing ratio.

Sacrifice by a Partner = Old share of Profit – New share of Profit

Question: - Rohit and Mohit are partners in a firm sharing profits in the ratio of 5:3. They admit Bijoy as a new partner for 1/7 share in the profit. The new profit-sharing ratio is 4:2:1.

Solution; - Rohit sacrifice = 5/8-4/7 = 3/56

Mohit sacrifice = 3/8-2/7 = 5/56

Thus, sacrifice ratio between Rohit and Mohit will be 3:5

- On admission of a new partner, the profit-sharing ratio among the old partners will change keeping in view their respective contribution to the profit sharing of the incoming partner. Hence, there is a need to ascertain the new profit-sharing ratio among all the partners.

  Case 1: Old Profit-sharing ratio and proportionate share of the new partner are given. Nothing is specified as to the ratio in which the new partner acquires his share from the old partners.
  Question: - Anil and Vishal are partners sharing profits in the ratio of 3:2. They admitted Sumit as a new partner for $1/5^{th}$ share in the future profits of the firm.
  Solution: - Sumit's share = 1/5.
  Therefore, combined share of Anil and Vishal = 1-1/5= 4/5
  Anil's new share = 3/5X4/5= 12/25
  Vishal's new share = 2/5X4/5=8/25
  New profit-sharing ratio of Anil, Vishal and Sumit = 12/25:8/25:1/5 = 12:8:5.

- Old profit-sharing ratio, share of the new partner and the new ratio between old partners are given
  Question: - Amar and Bahadur are partners in a firm sharing profits in the ratio of 3: 2. They admitted Mary as a new partner for $1/4^{th}$ share. The new profit-sharing ratio between Amar and Bahadur will be 2:1.
  Solution: - Mary's share = 1/4
  Combined share of Amar and Bahadur = 1-1/4 =3/4, which is to be shared by Amar and Bahadur in 2:1.

Thus, Amar's new share = 2/3X3/4=6/12
Bahadur's new share = 1/3X3/4 =6/12
Therefore, new profit sharing of Amar, Bahadur and Mary = 6/12:3/12:1/4 = 2:1:1

- Old partners old profit-sharing ratio, new partners share and sacrificing ratio are given
Question: - Akshay and Bharti are partners sharing profits in the ratio of 3:2. They admit Dinesh as a new partner for $1/5^{th}$ share in the future profits of the firm which he gets equally from Akshay and Bharti.
Solution: - Sacrificing Ratio of Akshay and Bharti = 1:1
Therefore, Akshay 's sacrifice = Bharti's sacrifice = 1/2X1/10= 1/10
Calculation of new profit-sharing ratio: new share of an existing partner = Old Share – Sacrificing share
Akshay's new share = 3/5-1/10 = 5/10
Bharti's new share = 2/5 – 1/10 = 3/10
Therefore, new profit-sharing ratio between Akshay, Bharti and Dinesh = 5/10: 3/10:1/5 = 5:3:2
- Old partner's old profit-sharing ratio, new partner's share and old partner's absolute sacrificing share are given
Question: - Anshu and Nitu are partner's sharing profits in the ratio of 3:2. They admitted Jyoti as a new partner for 3/10 share which she acquired 2/10 from Anshu and 1/10 from Nitu.
Solution: - Sacrificing ratio of Anshu and Nitu = 2/10 : 1/10 = 2:1
Calculation of new profit-sharing ratio: New share of an existing partner = Old Share – Sacrificing share
Anshu's new share = 3/5-2/10=4/10
Nitu's new share = 2/5-1/10= 3/10
Therefore, new profit-sharing ratio between Anshu, Nitu and Jyoti = 4:3:3
- Old Partner's old profit-sharing ratio and their relative sacrificing share are given
Question: - Ram and Shyam are partners in a firm sharing profits in the ratio of 3:2. They admit Ghanshyam as a new partner. Ram surrenders ¼ of his share and Shyam 1/3 of his share in favour of Ghanshyam.
Solution:- Share surrendered by Ram = 1/4X3/5 = 3/20
Shyam's sacrifice share = 1/3X2/5 = 2/15
Therefore, Sacrificing Ratio of Ram and Shyam = 3/20:2/15 = 9:8
Calculation of new profit-sharing ratio: new share of an existing partner = Old Share – Sacrificing share
Ram's new share = 3/5-3/20 = 9/20
Shyam's new share = 2/5-2/15 = 4/15
Ghanshyam's share = Ram's sacrificing share + Shyam's sacrificing share = 3/20+2/15=17/60
Therefore, New profit-sharing ratio among Ram, Shyam and Ghanshyam = 9/20:4/15:17/60 = 27:16:17

TREATMENT OF GOODWILL

When a new partner is admitted, there may be two methods of treatment of goodwill.

1. When the new partner pays his share of goodwill in cash

2. When the new partner does not bring in his share of goodwill in cash

1. New partner brings goodwill in cash

- Goodwill (Premium) Paid privately – No Entry
- Goodwill (Premium) paid through the firm which is retained in the business

Journal

Date	Particulars	L.F	Dr.	Cr.
(i)	Cash/Bank A/c Dr To Premium for Goodwill A/c (Amount brought by new partner as premium)			
(ii)	Premium for Goodwill A/c Dr To Existing Partners Capital, A/c (Goodwill distributed among the existing partners in their sacrificing ratio)			

- Goodwill (premium) brought by the new partner and the same withdrawn by the sacrificing partners fully or partly.

Journal

Date	Particulars	L.F	Dr.	Cr.
	Existing Partner's Capital A/C (Individually) Dr To Cash/Bank A/c			

- Goodwill (premium) brought in kind

Journal

Date	Particulars	L.F	Dr.	Cr.
	(a.) For bringing capital and share of premium (goodwill) in the form of assets: Assets A/c Dr To New Partners Capital A/c To Premium for Goodwill A/c (b.) For transferring premium for goodwill to the capital accounts of the sacrificing partners: Premium for Goodwill A/c Dr. To Sacrificing Partners Capital A/c			

- When the new partner brings in his share of goodwill in cash and some amount of goodwill already exists in the Balance Sheet.

Journal

Date	Particulars	L.F	Dr	Cr
	Old Partners Capital/Current A/c Dr To Goodwill A/c			

- When the new partner brings in his share of goodwill in cash, some amount of goodwill already exists in Balance Sheet and it is decided that the existing goodwill should continue to appear in the books at its old value.

  If it is decided that the existing goodwill should continue to appear in the books at its old value, the amount to be brought in by new partner will have to be proportionately reduced i.e. he will be required to bring cash only for his share of the excess of the agreed value of goodwill over the amount of goodwill already appearing in the books. Hence, no journal entry will be recorded for writing off the existing amount of goodwill.

2. When the new partner does not bring in his share of goodwill in cash :- Goodwill is adjusted in two alternative ways:-
   A. Goodwill Account is raised and written off at its full value.
   B. Goodwill is adjusted through Partner's Capital /Current Account

A. Goodwill Account is raised and written off at its full value.

- When no goodwill exists in the books

Journal

Date	Particulars	L.F	Dr	Cr
	For raising goodwill at full value in the old ratio Goodwill A/c Dr To Old Partner's Capital/Current A/c For writing off goodwill at full value in the new ratio All Partner's Capital/Current A/c Dr To Goodwill A/c			

- When goodwill already exists in the books
  i. When the value of goodwill appearing in the books is less than the value of goodwill

Journal

Date	Particulars	L.F	Dr	Cr
	Goodwill A/c Dr To Old Partner's Capital/Current A/c For writing off goodwill at full value in the new ratio All Partner's Capital/Current A/c Dr To Goodwill A/c			

  i. When the value of goodwill appearing in the books is more than the value of goodwill

Date	Particulars	L.F	Dr	Cr
i. ii.	Old Partners Capital/Current A/c Dr To Goodwill A/c All Partner's Capital/Current A/c Dr			

	To Goodwill A/c			

Hidden Goodwill- When the value of goodwill of the firm is not given but has to be inferred on the bases of net worth of the firm, it is called 'Hidden Goodwill'

ADJUSTMENT FOR ACCUMULATED PROFITS AND LOSSES

- At the time of admission of a new partner the firm may have accumulated profits (Undistributed Profits). These are usually in the form of General Reserve, Reserve Fund, Credit Balance of Profit and Loss Account. They appear on the liabilities side of the balance sheet.

Journal

Date	Particulars	L.F	Dr	Cr
	Reserve/Profit and Loss A/c Dr To Old Partners Capital/Current A/c (Accumulated profits distributed in old profit sharing ratio)			

- If there are some accumulated losses in the form of Debit Balance of Profit and Loss Account (appearing on the assets side of the balance sheet), the same should be transferred to the old partners' capital/current accounts i.e. debited in old profit sharing ratio.

Date	Particulars	L.F	Dr	Cr
	Old Partners Capital/Current A/c Dr To Profit and Loss A/c (Accumulated profits distributed in old profit sharing ratio)			

TREATMENT OF DEFERRED REVENUE EXPENDITURE – Deferred revenue expenditure (e.g., Advertisement Suspense A/c) appears on the assets side of the Balance Sheet. On admission of a new partner, it is debited in old partners' capital/current accounts in their old profit-sharing ratio.

REVALUATION OF ASSETS AND REASSESSMENT OF LIABILITIES

Revaluation account is prepared to reevaluate assets and liabilities on reconstitution of a firm. Two reasons for preparation of Revaluation Account at the time of admission of a partner are:

- To record the effect of revaluation of assets and liabilities.
- To ensure that the profits or losses on revaluation of assets and liabilities may be divided amongst the old partners.

Revaluation Account

Particulars	Amount	Particulars	Amount
To Assets A/c (Decrease in value of Asset)	XXX	By Assets A/c (Increase in value of Asset)	XXX

To Liability A/c (Increase in amount of liability) To Unrecorded Liability or Cash/Bank A/c To Profit credited to old partners' Capital/Current	XXX XXX XXX	By Liability A/c (Decrease in amount of liability) By Unrecorded Assets or Cash/Bank A/c To Loss debited to old partners' Capital/Current	XXX XXX XXX
	XXXX		XXXX

The Journal entries recorded for revaluation of assets and reassessment of liabilities are as follows;

Journal

Date	Particulars	L. F	Dr	Cr

1. 2. 3. 4. 5. 6. 7.(a) (b)	For increase in the value of an assets: Assets A/c (Gain) Dr To Revaluation A/c For reduction in the value of a liability: Liability A/c (Gain) Dr To Revaluation A/c For recording or selling an unrecorded asset: Unrecorded Assets or Cash/Bank A/c Dr To Revaluation A/c For reduction in the value of an asset: Revaluation A/c Dr To Assets A/c(Loss) For increase in the amount of a liability: Revaluation A/c Dr To Liability A/c (Loss) For recording or making payment of an unrecorded liability: Revaluation A/c Dr To Unrecorded Liability or Cash/Bank A/c For transfer of gain on revaluation in old ratio: Revaluation A/c Dr To Old partners' Capital/Current A/c Or For transferring loss on revaluation in old ratio Old partners' Capital/Current A/c Dr To Revaluation A/c			

MULTIPLE CHOICE QUESTIONS

1. Purpose of admitting a new partner in a firm:
   a. The requirement of new capital
   b. Managerial help
   c. Both (a) and (b) for the expansion of business
   d. None of these
   Ans. c Both (a) and (b) for the expansion of business
2. The circumstance in which sacrificing ratio may be applied are …………….
   a. Admission of a partner
   b. Change in profit-sharing ratio
   c. Retirement of a partner
   d. Both (a) and (b)
   Ans. D. Both (a) and (b)
3. X and Y were partners in a firm sharing profits in the ratio of 7:3. Z was admitted for $1/5^{th}$ share in the profits which he took 75% from X and remaining from Y. The sacrificing ratio of X and Y will be…………….
   a. 7:3
   b. 3:1

c. 1:1
d. 5:1

Ans. b. 3:1

4. For which of the following situations, the old profit sharing ratio of person is used at the time of admission of a new partner
   a. When new partner brings only a part of his share of goodwill.
   b. When new partner is not able to bring his share of goodwill.
   c. When, at the time of admission, goodwill already appears in the balance sheet.
   d. When new partner brings his share of goodwill in cash.

   Ans. c. When, at the time of admission, goodwill already appears in the balance sheet.

5. Puneet and Deepak were in partnership sharing profits and losses in the ratio of 2:1. They admitted Manya as a new partner. Manya brought Rs. 1,00,000 as her share of goodwill premium, which was entirely credited to Puneet's capital account. On the date of admission, goodwill of the firm was valued at Rs.3,00,000. The new profit sharing ratio of Puneet, Deepak and Manya will be………………..
   a. 2:1:1
   b. Equal
   c. 2:1:2
   d. None of these
   Ans. b. Equal

MULTIPLE CHOICE QUESTIONS (MCQ) ON ASSERTION – REASONING TYPE/STATEMENTS

1. Give below are two statement – Assertion (A) and Reason (R) . Choose the correct alternative:
   Assertion (A) : A new partner should contribute towards goodwill on his/her admission.
   Reason (R) .It is because the new partner has to compensate the existing partners for the sacrifice they make in his /her favour.
   a. Both (A) and (R) are true ,but (R) is not the correct explaination of (A)
   b. Both (A) and (R) are true ,but (R) is a correct explaination of (A)
   c. Both (A) and (R) are false
   d. (A) is false, but (R) is true

   Ans. Both (A) and (R) are true ,but (R) is a correct explanation of (A)

2. Give below are two statement – Assertion (A) and Reason (R) . Choose the correct alternative:
   Assertion (A): There is a need for the revaluation of assets and liabilities on the admission of a partner.
   Reason (R) : It is always desirable to ascertain whether the assets and liabilities of the firm are shown in books at their current value

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

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

c. Only (R) is correct

d. Both (A) and (R) are wrong

Ans. Both (A) and (R) are true, but (R) is a not correct explanation of (A)

3. Give below are two statement – Assertion (A) and Reason (R) . Choose the correct alternative:
   Assertion (A) : It is necessary to revalue assets and liability of A firm in case of admission of a partner
   Reason (R) : It is because the incoming partner is neither put to an advantage nor to disadvantage due to change in the value of assets and liabilities
   a. Both (A) and (R) are true ,but (R) is the correct explanation of (A)
   b. Both (A) and (R) are true, but (R) is a not correct explanation of (A)
   c. Only (R) is correct
   d. Both (A) and (R) are wrong

   Ans. Both (A) and (R) are true ,but (R) is the correct explaination of (A)

4. Give below are two statement – Assertion (A) and Reason (R) . Choose the correct alternative:
   Assertion (A): Change in the profit-sharing ratio of the existing partner amount to dissolution of the partnership firm
   Reason (R) :): Change in the profit-sharing ratio of the existing partner results in a change in the existing agreement between the partners leading to reconstitution of the firm.
   a. (A) is correct but (R) is wrong
   b. (A) is wrong but (R) is correct
   c. Both (A) and (R) are correct
   d. Both (A) and (R) are wrong

   Ans. (A) is wrong but (R) is correct

5. Give below are two statement – Assertion (A) and Reason (R) . Choose the correct alternative:
   Assertion (A): Goodwill exists only when the firm earn Super Profits.
   Reason (R) : Any firm that earns normal profit or is incurring losses has no goodwill
   a. Both (A) and (R) are true ,but (R) is not the correct explaination of (A)
   b. Both (A) and (R) are true ,but (R) is a correct explaination of (A)
   c. Both (A) and (R) are false

d. (A) is false, but (R) is true

Ans. Both (A) and (R) are true ,but (R) is a correct explaination of (A)

CASE– BASED MULTIPLE CHOICE QUESTIONS (MCQ)

1. Amit and Mahesh were partners in a fast-food corner sharing profits and losses in ratio 3:2. They Sold fast food items across the counter and did home delivery too. Their initial fixed capital contribution was Rs. 1,20,000 and Rs 80,000 respectively. At the end of first year their profit was Rs 1,20,000 before allowing the remuneration of Rs 3000 per quarter to Amit and Rs 2000 per half year of Mahesh. Such a promising performance for first year was encouraging, therefore, they decide to expand the area of operations. For this propose, they needed a delivery van, a few Scotties and an addition person to support. Six months into the accounting year they decided to admit Sundaram as a new partner and offered him 20% as a share of profits along with monthly remuneration of Rs 2500. Sundaram was asked to introduce Rs 130000 for capital and Rs 70000 for premium for goodwill. Besides this Sundaram was required to provide Rs 100000 as loan for two years. Sundaram readily accepted the offer. The terms of the offer were duly executed and he was admitted as partner.

Answer the question no 1-4 on the basis of the above case

Q.1. Remuneration will be transferred to ___________ of Amit and Mahesh at the end of the accounting period.

(a) Capital account
(b) Loan account
(c) Current account
(d) None of this

Ans. Current Account

Q2. Upon the admission of Sundaram the sacrifice for providing his share of profits would be done:

(a) By Amit only
(b) By Mahesh only
(c) By Amit and Mahesh equally
(d) By Amit and Mahesh in the ratio of 3:2

Ans. By Amit and Mahesh in the ratio of 3:2

Q3. Sundaram will be entitle to a remuneration of __________ at the end of the year.

(a) RS 15000

(b) RS 30000
(c) RS 2500
(d) RS 12000

Ans. Rs. 15,000

Q4. While taking up the accounting procedure for this reconstitution the accountant of the firm MR. Suraj Marwaha faced a difficulty. For the amount of loan that Sundaram has agreed to provide, he is entitled to interest thereon at the rate of ___________.

(a) 6% p.a.
(b) 12% p.a.
(c) 20% p.a.
(d) NIL

Ans. 6% p.a

IMPORTANT QUESTIONS

1. Yash and Karan were partners in an interior designer firm. Their fixed capitals were Rs. 6,00,000 and Rs.4,00,000 respectively. There were credit balance in their current accounts of Rs. 4,00,000 and Rs.5,00,000 respectively. The firm had a balance of Rs.1,00,000 in General Reserve. The firm did not have any liability. They admitted Radhika into partnership for 1/4th share in the profits of the firm. The average profits of the firm for the last five years were Rs.5,00,000. Calculate the value of the firm by capitalization of average profits method. The normal rate of return in the business is 10%.

   Solution. Goodwill = Capitalised value of the firm – Firm's Capital
   Capitalised value of the firm = Average Profits X 100/NRR = 500000X100/10
   = 5000000
   Firm's Capital = Yash's Capital + Karan's Capital + Yash's Current Account + Karan's Current Account+ General Reserve
   = 6,00,000 + 4,00,000 + 4,00,000+5,00,000+1,00,000
   = 20,00,000
   Goodwill = 50,00,000 – 20,00,000 = 30,00,000

2. Ahuja and Barua are partners in a firm sharing profits and losses in the ratio of 3:2. They decide to admit Chaudhary into partnership for 1/5th share of profits, which he acquires equally from Ahuja and Barua. Goodwill is valued at Rs. 30,000. Chaudhary brings in Rs.16,000 as his capital but is not in a position to bring any amount for goodwill. Goodwill amount exists in books of the firm at Rs.15,000. Record the necessary journal entries.

   Sol. Journal

Date	Particulars	L.F	Dr	Cr
	Bank A/c Dr		16,000	 16,000

	To Chaudhary's Capital A/c (Amount brought for capital) Chaudhary's Current A/c Dr To Ahuja's Capital A/c To Barua's Capital A/c (Goodwill credited to sacrificing partner's account) Ahuja's Capital A/c Dr Barua's Capital A/c Dr To Goodwill A/c (Goodwill already appearing in books written off in the old ratio)		6,000 9,000 6,000	 6,000 15,000

3. The following was the Balance Sheet of Anurag and Bhawana, who were sharing profits in the ratio of 2/3 and 1/3 as at 31st March, 2021 :-

Liabilities	Amount	Assets	Amount
Creditors	65,900	Cash	1,200
Capitals:		Sundry Debtors	9,700
Anurag	30,000	Stock	20,000
Bhawana	20,000	Plant and Machinery	35,000
		Building	50,000
	1,15,000		1,15,000

On 1st April,2021 they agreed to admit Monika into partnership on the following terms: -

a. Monika was to be given 1/3 share in profits, and was to bring as Capital and Rs. 6,000 as share of goodwill.
b. That the value of stock and Plant & Machinery were to be reduced by 10%.
c. That a provision of 5% was to be created for doubtful debts.
d. That the building account was to be appreciated by 20%.
e. Investments worth Rs.1,400 (not mentioned in the Balance Sheet) were to be taken into account.
f. That the amount of goodwill was to be withdrawn by the old partners.

Solution.

Revaluation Account

Particulars	Amount	Particulars	Amount
To Stock A/c	2,000	By Building A/c	10,000
To Plant & Machinery A/c	3,500	By Investment A/c	1,400
To Provision for Doubtful debts A/c	485		
To Profit Transferred to: Anurag's Capital A/c 3610 Bhawna 's Capital A/c 1805	5,415		

	11,400		11,400

Partner's Capital Account

Particulars	Anurag	Bhawna	Monika	Particulars	Anurag	Bhawna	Monika
To Cash A/c To Balance c/d	4,000 33,610	2,000 21,805	 15,000	By Balance b/d By Revaluation A/c By Cash A/c By Premium for Goodwill A/c	30,000 3,610 4,000	20,000 1,805 2,000	 15,000
	37,610	23,805	15,000		37,610	23,805	15,000

Balance Sheet
As at 1st April, 2021

Liabilities	Amount	Assets	Amount
Sundry Creditors Capitals Anurag – 33610 Bhawna – 21805 Monika - 15000	65,900 70,415	Cash in Hand Sundry Debtors 9700 Less: Prov. (485) Stock Investments Plant & Machinery Building	16,200 9215 18,000 1,400 31,500 60,000
	1,36,315		1,36,315

4. A and B share the profits of a business in the ratio of 5:3. They admit C, into the firm for 1/4th share in the profits to be contributed equally by A and B. On the date of admission of C, the Balance Sheet of the firm was as follows:

Liabilities	Amount	Assets	Amount
A's Capital B's Capital Workmen's Compensation Reserve Creditors Provident Fund	40,000 30,000 4,000 2,000 10,000	Machinery Furniture Stock Debtors Bank	30,000 20,000 15,000 15,000 6,000
	86,000		86,000

Terms of C's admission were as follows :

a. C will bring Rs.30,000 for his share of capital and goodwill.
b. Goodwill of the firm has been valued at 3 years purchase of the average super profits of last four years. Average profits of the last four years are Rs.20,000 while the normal profits that can be earned with the capital employed are Rs. 12,000.
c. Furniture is undervalued by Rs.12,000 and the value of stock is reduced to Rs.13,000. Provident Fund be raised by Rs.1,000.
d. Creditors are unrecorded to extent of Rs.6,000.

Prepare Revaluation Account, Partner's Capital Accounts and the new Balance Sheet of A,B and C.

Solution.

Revaluation A/c

Particulars	Amount	Particulars	Amount
To Stock A/c	2,000	By Furniture A/c	12,000
To Provident Fund A/c	1,000		
To Creditors	6,000		
To Profit transferred to			
A's Capital A/c 1875			
B's Capital A/c 1125	3,000		
	12,000		12,000

Partner's Capital Account

Particulars	A	B	C	Particulars	A	B	C
To Balance c/d	47,375	35,625	24,000	By Balance b/d	40,000	30,000	
				By W.C.R	2,500	1,500	
				By Revaluation A/c	1,875	1,125	
				By Bank A/c			24,000
				By Premium for Goodwill A/c	3,000	3,000	
	47,375	35,625	24,000		47,375	35,625	24,000

Balance Sheet

Liabilities	Amount	Assets	Amount
Creditors	8,000	Machinery	30,000
Provident Fund	11,000	Furniture	32,000
Capital Accounts:		Stock	13'000
A	47,375	Debtors	15,000
B	35,625	Bank	36,000
C	24,000		
	1,26,000		1,26,000

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On the retirement or death of a partner, the existing partnership deed comes to an end, and in its place, a new partnership deed needs to be framed whereby, the remaining partners continue to do their business on changed terms and conditions. A partner has right to retire from the firm after giving due notice in advance. There is not much difference in the accounting treatment at the time of retirement or in the event of death. Partner can retire from the firm in the following circumstances.

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

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

Following accounting treatment required while retiring a partner:

(a). Calculation of a new ratio and gaining/sacrificing ratio (in some cases) ratio.
(b). Treatment of goodwill.
(c). Adjustment of revaluation of assets and reassessment of liabilities.
(d). Adjustment of undistributed reserves and profits and losses A/c.

Ascertaining the Amount Due to Retiring/ Deceased Partner

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

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

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

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

CALCULATION OF NEW RATIO AND GAINING RATIO:

New profit-sharing ratio is the ratio in which the remaining partners will share future profits after the retirement or death of any partner. The new share of each of the remaining partner will consist of his acquired from the retiring /deceased partner own share in the firm plus the share acquired from the retiring /deceased partner.

*New ratio=Old Ratio+New Ratio

Gaining Ratio: - The ratio in which the continuing partners have acquired the share from the retiring or deceased partner is called the gaining ratio. Normally, the continuing partners acquire the share of retiring/deceased partner in their old profit-sharing ratio, in that case, the gaining ratio of the remaining partners will be the same as their old profit-sharing ratio among them and there is no need to compute the gaining ratio.

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

*Gaining ratio=New ratio–Old ratio

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

JOURNAL ENTRY for Treatment of Goodwill: -

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

MCQ

1. On the death of a partner, his share in the profits of the firm till the date of death is transferred to the:

(a). Dr. of Profit & Loss A/c	(b). Cr. of Profit & Loss A/c
(c). Dr. of Profit & Loss Suspense A/c	(d). Cr. of Profit & Loss Suspense A/c

Ans.: - (c). Dr. of Profit & Loss Suspense A/c

2. Gaining Ratio means:

(a). Old Ratio-New Ratio	(b). New Ratio-Old ratio
(c). Old Ratio-Sacrificing Ratio	(d). New Ratio-Sacrificing Ratio

Ans.: - (b) New Ratio-Old Ratio

3. **Retiring partner is compensated for parting with the firm's future profits in favor of remaining partners. The remaining partners contribute to such compensation amount in:**

(a). Gaining Ratio	(b). Capital Ratio
(c). Sacrificing Ratio	(d). Profit Sharing Ratio

Ans. (a) Gaining Ratio

4. **At the time of retirement of a partner, profit on revaluation will be credited to:**

(a) Capital Account of remaining partner
(b) Capital Account of all partners in their old profit-sharing ratio
(c) Capital Accounts of the remaining partners in their old profit-sharing ratio
(d) Capital Accounts of the remaining partners in their new profit-sharing ratio

Ans. (b) Capital Account of all partners in their old profit-sharing ratio

5. **On the death of a partner, the amount due to him will be credited to:**

(a) All partners' capital account
(b) Remaining partners' capital accounts
(c) His Executors account
(d) Governments revenue account

Ans. (c) His Executors account

6. **A, B and C are partners sharing profits in the ratio of ½: ¼: ¼. New ratio on the retirement of B will be:**

(a). 2:4	(b). 1:2
(c). 2:1	(d). ¼: ½

Answer(c) 2:1

7. A, B and C were partners sharing profits in the ratio of 2:2:1. B died on 30th June, 2023 and profit for the accounting year ended 31st march, 2023 was ₹6,00,000. If profits share of deceased partner is to be calculated based on previous year's profit, amount of credited to B's Capital Account will be:

(a). ₹72,000	(b). ₹60,000
(c). ₹1,44,000	(d). ₹2,80,000

Ans.:- (b). 60,000

8. A, B and C are partners sharing profits in the ratio of 5:2:1.If the new ratio on the retirement of A is3:2.Whatwillbe the gaining ratio?

(a). 11:14	(b). 3:2
(c). 2:3	(d). 14:11

Ans.(d)14:11

Long answer type questions

1. L, M and N were partners sharing profits and losses in the ratio of5:3:2. On31st March, 2023 their Balance Sheet was as under:

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

N retired on31st March2023 and it was agreed that: Goodwill of the firm is to be valued at ₹2,00,000. Machinery be valued at₹1, 40,000; Patents at₹40, 000and Property at₹1,50,000onthisdate.

Prepare Revaluation Account, Partners' Capital/cand Balance sheet.
Ans.

Revaluation A/c

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

Partner's Capital A/c

Particulars	L	M	N	Particulars	L	M	N
To N's Loan A/C			85,000	By balance b/d	1,50,000	1,25,000	75,000
To balance c/d	1,80,000	1,45,000		By Profit on Revaluation A/c	15,000	10,000	5,000
				By General Reserve A/	15,000	10,000	5,000
	1,80,000	1,45,000	85,000		1,80,000	1,45,000	85,000

Balance Sheet of New Firm

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

2. A, B and C are partners in a firm whose books are closed on March31st each year. A died-on 30th June 2022 and according to the agreement the share of profits of a deceased partner up to the date of death is to be calculated on the basis of the average profits for the last five years. The net profits for the last five years have been: 2018 ₹14,000, 2019 ₹18,000, 2020 ₹16,000, 2021 ₹10,000(loss), 2022 ₹16,000. Calculate A's share of the profits up to the date of death and pass necessary journal entry assuming:

(a). There is no change in the profits haring ratio of remaining partners.

(b). There is change in the profit-sharing ratio of remaining partners, new ratio being 3:2.

Ans. Total profit=14,000+18,000+16,000-10,000+16,000=54,000

Average profits=54,000÷5=10,800
3Monthsprofit=10,800x3/12=2,70
0

1/3rd share of A upto the date of death=2,700x1/3=900 Case (i) journal entry

Profits and loss Suspense A/c	Dr.	900	
To A's Capital A/c			900

Case(ii) journal entry

B's Capital A/c	Dr.	720	
C's Capital A/c	Dr.	180	
To A's Capital A/c			900

3. Ram, Mohan and Sohan were partners sharing profits and losses in the ratio of 5:3:2. On 31st March, 2022 their Balance Sheet was as under:

Liabilities	₹	Assets	₹
Capitals		Leasehold	1,25,000
Ram	1,50,000	Patents	30,000
Mohan	1,25,000	Machinery	1,50,000
Sohan	75,000	Stock	1,90,000
Workmen's Compensation Reserve	30,000	Cash at Bank	40,000
Creditors	1,55,000		
	5,35,000		**5,35,000**

Sohan died on 1st August, 2022. It was agreed that:
(i) Goodwill of the firm is to be valued at ₹ 1,75,000.
(ii) Machinery be valued at ₹1,40,000; Patents at ₹40,000; Leasehold at ₹1,50,000 on this date.
(iii) For the purpose of calculating Sohan's share in the profits of 2022-23, the profits should be taken to have accrued on the same scale as in 2021-22, which were₹75,000. Prepare Sohan's Capital Account and Revaluation Account.

Particulars	Amt	Particulars	Amt
Machinery	10,000	Leasehold	25000
Profit transferred to partners' cap. A/cs		Patents	10,000
Ram	12500		
Mohan	7500		
Sohan	5000		
	35000		35000

Sohan's capital Account

Particulars	₹	Particulars	₹
		By Balance b/d	75000
To Sohan's Executor's account	1,26,000	By Revaluation a/c	5000

		By Ram's Capital a/c	21875
		By Mohan's capital a/c	13125
		By P & L Suspense A/c	13125
		By Workmen's Comp. Res. a/c	6000
	1,26,000		**1,26,000**

Working Note :
a)Total Goodwill of the firm = 1,75,000
Sohan's share of goodwill = 1,75,000 X 2/10 = 35000 (to be divided in the ratio of 5:3 i.e gaining ratio)
b) Sohan's share of profit = 75000 X 4/12 x 2/10 = ₹5000

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Ch-5: Dissolution of Partnership Firm

ACCOUNTING TREATMENT OF DISSOLUTION

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

· Realisation Account;

· Partner's Loan Account;

· Partner's Capital Accounts; and

· Cash or Bank Account.

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

PREPARATION OF REALISATION ACCOUNT

The following Journal Entries:

A. For Closing Assets Accounts:
Realisation A/c Dr. 1000
To sundry Assets A/c 1000
(Being assets transferred to Realisation A/c)
Note:
1. Cash and Bank balance are not transferred to Realisation Account.

2. Assets (tangible and intangible) are transferred to Realisation Account to their Gross Value

3. Fictitious Asset such as Debit balance of Profit and Loss Account of Advertisement Suspense's Account etc. are not transferred to Realisation Account. These are directly debited to partners' capital accounts in their profit-sharing ratio by passing the following entry.

Partner's capital A/c Dr.

To Profit and Loss A/c

To Advertisement Suspense A/c

(Being Balance of losses transferred to capital accounts)

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

Provision's for Bad Debts A/cDr.

Provision's for Depreciation A/cDr.

Investment Fluctuation Fund A/cDr.

Machinery Replacement Reserve A/cDr.

To Realisation A/c

(Being Provision & Reserves Against Assets transferred to Realisation Account)

B. For Closing Liabilities Accounts:

Sundry Liabilities A/cDr.

To Realisation A/c

(Being sundry liabilities transferred to Realisation A/c)

Note :

1. Only third parties liabilities/outsiders 'liabilities are transferred to Realisation A/c

2. Balance of Partner's Loan Accounts are not transferred to Realisation Account Separate accounts are opened to settle such liabilities.

3. Undistributed profits and reserves are also not transferred to Realisation A/c. These are directly credited to partners' capital accounts in their profit sharing ratio by passing the following entry.

Profit and Loss A/cDr.

General Reserves A/cDr.

Reserve fund A/cDr.

Contingency Reserve A/cDr.

To Partner's Capital A/cs

(Being balance of undistributed profits transferred to capital accounts)

4. Provident Fund is a liability on the firm towards employees and hence it is transferred to Realisation A/c.

***5.** If any liability is expected to arise against any found or reserve e.g., Workmen's Compensation Fund, then an amount equal to such liability is transferred to Realisation A/c balance, if any, distributed among the partners in their profit-sharing ratio by passing the following entry.

Workmen's Compensation Fund A/C Dr.

To Realisation A/c(Liability)

To Partners' Capital A/cs(Balance, if any)

(Being liability against workmen's compensation fund transferred to Realisation A/c and balance Distributed among partners.

C. For Realisation of Assets (Whether recorded or unrecorded)

a. When assets are sold for cash

Cash/Bank A/c Dr.
To Realisation A/c
(Being assets sold for cash)

b. When assets are taken over by any partner.
Partner's Capital A/c Dr.
To Realisation A/c
(Being assets taken over by any partner)

c. When assets are taken over by any creditor in part of full payment his dues :

I. In case of Full Settlement:

i. NO ENTRY is passed for the transfer of assets to the creditor.
ii. NO ENTRY is passed for the payment to creditor.

II. In case of Part Settlement:
i. NO ENTRY is passed for the transfer of assets to the creditor.
ii. The agreed amount of asset is deducted from the claims of it creditors and the balance is paid to him.

Note :
1. The realized value of each asset must be given at the time of dissolution.
D. For Payment of Liabilities
a. When liabilities are paid in cash
Realisation A/c Dr.
To Cash/Bank A/c
(Being liabilities paid in cash)
b. When liabilities are taken over by any partner
Realisation A/c Dr.
To Partner's Capital A/c
(Being liabilities taken over by a partner)
Note : If nothing is stated regarding the settlement of any outside liability, then it should be assume that the amount equal to book value is paid.

E. For Realisation Expenses

a. When expenses are paid by firm and borne by firm:
Realisation A/c Dr.
To Cash/Bank A/c
(Being realization expenses paid in cash).

b. When expenses are paid by any partner and borne by firm :
Realisation A/c Dr.
To Partner's Capital A/c
(Being realization expenses paid by a partner).

c. When expenses are paid by firm (on behalf of any partner) and born by an partner.
Partner's Capital A/c Dr.
To Cash/Bank A/c
(Being realization expenses paid on behalf of partner).

d. When a partner is paid a fixed amount for bearing realization expenses then: Actual expenses are not be considered;
ii. Realization A/c Dr. (With Fixed Amount)
To Partner's Capital A/c
(Being realization expenses paid by a partner)

e. When expenses are paid by one partner and borne by another partner;
Partner's Capital A/c Dr. (Who borne the expenses)
To Partner's Capital A/c (Who pays the expenses)
(Being realization expenses paid by one partner and borne by another partner).
In case the realization expenses are borne by a partner, clear indication should be given regarding the payment there of.

F. For Closing Realisation Account

a. When Realization A/c Discloses profit (in case total of credit side is more than the total of debit side)
Realisation A/c Dr.
To Partner's Capital A/cs
(Being profit on realization transferred to partners' capital A/cs)
b. When Realisation A/c discloses loss (in case total of debit side is more than the total of credit side)
Partners' Capital A/c Dr.
To Realisation A/c
(Being loss on realization transferred to partners' capital A/cs)

FORMAT OF REALISATION ACCOUNT

Realization Account

Particulars	**(Rs.)**	**Particulars**	**(Rs.)**
To sundry Assets A/c (Excluding cash or bank balance. Fictitious assets. Dr. balance of P & Lac, Dr. balance of partner's Capital/current A/cs, Loans to partners) **To Cash/Bank A/c** (Amount paid for discharging Liabilities-recorded and unrecorded) **To Cash Bank A/c** (Expenses on Realisation) **To Partner's Capital A/cs** (Liabilities taken over by a Partner commission payable to him or any expenses payable to him) **To Partner' Capital A/cs** (For transferring profit on Realisation)		**By Sundry Liabilities A/c** (Excluding Cr. Balance of P & L A/c, Reserves, Partners' Capital/Current A/cs, Loan from partner and Bank Overdraft) **By provision on any Assets A/c** (Such as provision for Depreciation, Provision for Doubtful Debts, Joint Life Policy Reserve etc.) **By Cash/Bank A/c** **(**Amount received on realization of assets-recorded and unrecorded) **By Partners' Capital A/c** (Assets taken over by a partner recorded or unrecorded) **By partners' Capital A/cs** (For transferring loss on Realisation)	

PREPARATION OF PARTNERS' LOAN ACCOUNT

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

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

Partner's Loan A/c Dr.
To Cash/Bank A/c
(Being loan of a partner paid)

Partner's Loan A/c

Particulars	**(Rs.)**	**Particulars**	**(Rs.)**
To Cash/Bank A/c		By Balance b/d	

If the firm has given a loan to any partner, then such loan account will show a debt balance and will appear on the asset side of Balance Sheet of the firm. Such loan accounts are settled through partner's capital account by passing the following entry:
Partner's Capital A/c Dr.
To Partner's Loan A/c
(Being loan to partner transferred to his Capital A/c)

Preparation of partner capital Accounts
After the Transfer of
· Undistributed profits and reserves
· Profit on Realisation
· Any liability taken over by any partner
And
· Undistributed losses and fictitious assets
· Loss on realization
· Any assets taken over by any partner
The balance of partners' capital A/cs are closed in the following manner
a. For making final payment to a partner (if total of credit side is more than the total of debit side)
Partner's Capital A/c Dr.
To Cash/Bank A/c
(Being excess paid to partner in cash)
b. For any amount received form a partner against debit balance in his capital account.
Cash/Bank A/c Dr.
To Partner's Capital
(Being cash brought in by any partner)

Partner's Capital A/c

Particulars	(Rs.)	Particulars	(Rs.)

To Balance c/d (Dr. Balance) **To Profit and Loss A/c** **To Advertisement Suspense A/c** **To Realisation A/c** (Assets taken) **To Realisation A/c** (Loss on Realisation) **To Cash/Bank A/c** (Excess cash paid)		**By balance b/d** (Cr. Balance) By General Reserve A/c By Profit and Loss A/c By workmen's Compensation Fund By Realisation A/c (Liabilities taken) **By Realisation A/c** (Profit on Realisation) By Cash/Bank A/c Cash brought in	

Preparation of Cash or Bank Account

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

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

Cash A/c Dr.

To Bank A/c

(Being cash withdrawn from Bank)

If Bank A/c is opened, an entry for depositing the cash into bank is passed.

Bank A/c Dr.

To Cash A/c

(Being cash deposited into Bank)

Cash/Bank A/c

Particulars	(Rs.)	Particulars	(Rs.)

To Balance A/c (Cash in Hand or Cash at Bank) To Realisation A/c (Assets Realisation) To Partner' Capital A/cs (Cash brought in by partner)		By balance bid (Bank overdraft) By Realisation A/c (Liabilities Paid) By Realisation A/c (Realisation Expenses Paid) By Partner's Loan A/c (Partner's Loan Paid) By Partner's Capital A/cs (Excess cash paid to partner)	

Distinction between Revaluation Account Realisation Accounts

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

PREPARATION OF MEMORANDUM BALANCE SHEET

If a balance sheet on the date of dissolution is not given in the question, there is always advisable to prepare Memorandum Balance Sheet on the date of dissolution to ascertain the amount of balancing figure.

Note

· In the absence of any other information "Sundry Assets" should be treatment as balancing figure on the **assets side of Balance Sheet.**

· If the balance of Partners' Capital A/cs are not given as on the date on dissolution, first we will find the balance of partners' capital accounts as on the date of dissolution by **recasting the capital accounts.**

· When "Sundry Assets" are given in the question and nothing is specified about the difference on the asset side of Balance Sheet, the different should be treated as **Dr. balance of Profit and Loss A/c.**

Some common mistakes committed by students

· Entries for assets or liabilities taken by partners

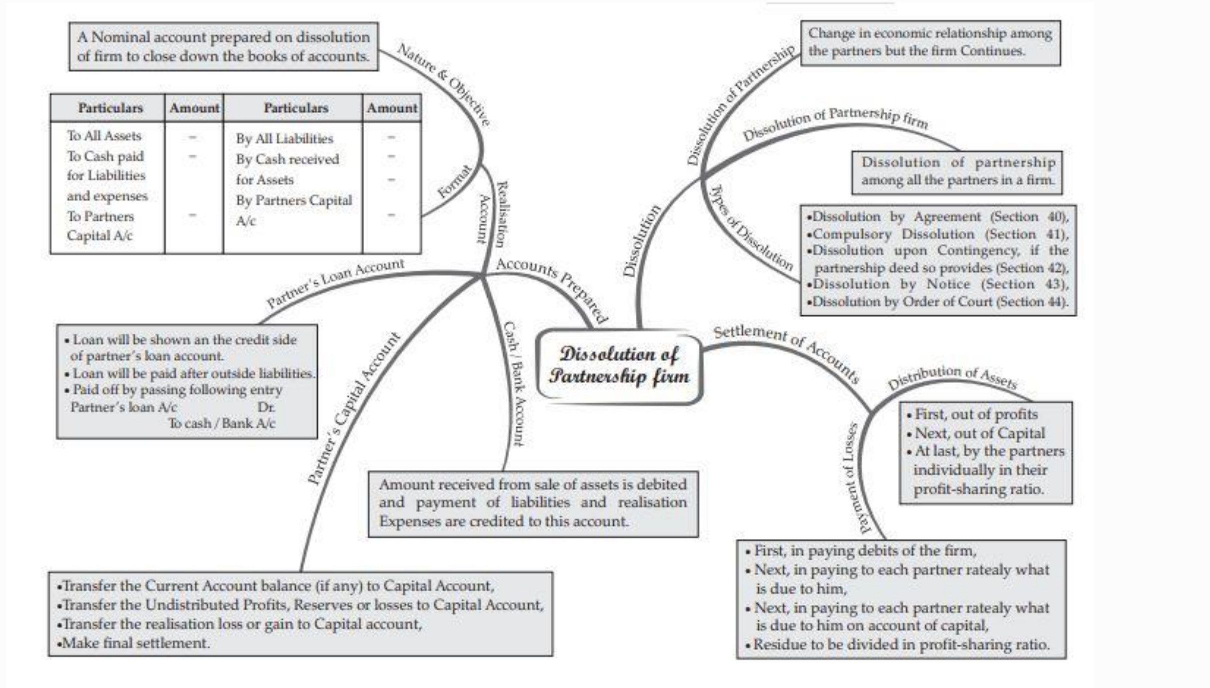
· Dissolution Expenses

· Realisation of unrecorded assets

· Payment of Unrecorded Liabilities

· Treatment of Fictitious Assets.

MIND MAP



Dissolution

Dissolution of partnership

Change in economic relationship among the partners but the firm Continues.

Dissolution of partnership firm

Dissolution of partnership among all the partners in a firm.

Types of Dissolution

- Dissolution by Agreement (Section 40),
- Compulsory Dissolution (Section 41),
- Dissolution upon Contingency, if the partnership deed so provides (Section 42),
- Dissolution by Notice (Section 43),
- Dissolution by Order of Court (Section 44).

Settlement Account

Distribution of Assets

- First, out of profits
- Next, out of Capital
- At last, by the partners individually in their profit-sharing ratio.

Payments of Losses

- First, in paying outside debts of the firm,
- Next, in paying to each partner rateably what is due to him on account of loan,
- Next, in paying to each partner rateably what is due to him on account of capital,
- Residue to be divided in profit-sharing ratio.

Accounts Prepared

Cash/Bank Account

Amount received from sale of assets is debited and payment of liabilities and realisation Expenses are credited to this account.

Partner's Capital Account

- Transfer the Current Account balance (if any) to Capital Account,
- Transfer the Undistributed Profits, Reserves or losses to Capital Account,
- Transfer the realisation loss or gain to Capital account,
- Make final settlement.

Partner's Loan Account

- Loan will be shown the credit side of partner's loan account.
- Loan will be paid after outside liabilities.
- Paid off by passing following entry
  Partner's loan A/c Dr.
  To cash / Bank A/c

Realisation

Nature and Objective: A Nominal account prepared on dissolution of firm to close down the books of accounts.

Format:

Particular	Amount	Particular	Amount
To All Assets	-	By all Liabilities	-
To Cash paid for liabilities and expenditure	-	By cash recieved for assets	-
To partners capital A/c	-	By partner capital A/c	-

PRACTICE WORK FOR STUDENT

1) WHAT IS DISSOLUTION OF PARTNERSHIP FIRM?

ANSWER- IT MEANS TERMINATION OF PARTNERSHIP AMONGST ALL THE PARTNERS OF THE FIRM. WHEN A FIRM IS DISSOLVED, THE BUSINESS OF THE FIRM TERMINATES. ALL THE ASSETS THE FIRM ARE DISPOSED OFF AND ALL OUTSIDERS' LIABILITIES AND PARTNERS' LOAN AND PARTNER CAPITAL ARE PAID.

2) GIVE CIRCUMSTANCES WHEN PARTNERSHIP FIRM IS DISSOLVED?

ANSWER- **(A)Without the intervention of the court:**

(1) When all partners agree to dissolve the firm (Sec. 40);

(2) Compulsory Dissolution (Sec. 41)

(i) When all or except but one partner of the firm become insolvent

(ii) When business of the firm become unlawful.

(3) On the happening of any of the following events: (Sec. 42)

(i) On the insolvency of a partner.

(ii) On the fulfilment of the objective of the firm for which the for was formed.

(iii) On the expiry of the (period) for which the firm was formed.

4) By Notice (Sec. 43): When the duration of the partnership firm is a fixed and it is at will of the partners. Any partner by giving notice other partners can dissolve the firm.

(B) Dissolution by order of the court (Sec. 44): A court on application by a partner may order the dissolution of the firm under the following circumstances:

(1) When a partner has become of unsound mind.

(2) When a partner has become permanently incapable of performing his duties as a partner.

(3) When a partner is found quality of misconduct that may harm the partnership.

(5) When a partner transfer whole of is interest in the business firm to a third party, without the consent of existing partners.

(6) When the court is satisfied that the partnership firm cannot be carried on except at a loss.

(7) When the court finds that the dissolution of firm is justified and equitable.

3) WHY IS REALISATION ACCOUNT PREPARED?
ANSWER- IT IS PREPARED TO FIND OUT PROFIT OR LOSS ON REALISATION OF ASSETS AND PAYMENT OF LIABILITIES.

4) WHAT IS SECTION 48?
ANSWER- IT INCLUDES SETTLEMENT OF ACCOUNTS ON DISSOLUTION OF PARTNERSHIP FIRM (FIRST LOSS IS PAID OUT OF PROFIT NEXT OUT OF CAPITAL AND THEN FROM PARTNERS IN THEIR PROFIT SHARING RATIO

5) WHAT IS SECTION 49?
ANSWER- IT INCLUDES PAYMENT OF FIRMS DEBTS AND PAYMENT OF PRIVATE DEBTS.

3 MARKS QUESTIONS

1) GIVE ONE DIFFERENCE BETWEEN DISSOLUTION OF PARTNERSHIP AND DISSOLUTION OF PARTNERSHIP FIRM

ANSWER-

S.NO.	Dissolution of partnership	Dissolution of partnership firm
1	It means change in business relations among partners.	It means closure of the firm and end of business relationship among partners.
2	Business will continue.	Business comes to an end.
3	It may or may not involve dissolution of firm.	It involves dissolution of partnership

2) State any one point of difference between Realisation Account and Revaluation Account.

ANSWER-

S.NO.	Realization account	Revaluation account
1	It records the realization of assets and settlement of liabilities	It records the effect of revaluation of assets and reassessment of liabilities.
2	This account is prepared only once during the life of firm	This account may be prepared at a number of occasions during the life of firm.
3	Prepared at the time admission, retirement, death of partner.	Prepared at the time of dissolution of firm.

3)DIFFERENTIATE BETWEEN FIRM DEBT AND PRIVATE DEBT

ANSWER-

Firm's debts	Private debts
It means the debt owed by the firm to outsiders.	It means debt owed by a partner in his personal capacity to any other person.

4) ON DISSOLUTION OF THE FIRM, WHAT PAYMENT ENTRY IS MADEOF AN UNRECORDED LIABILITY?

ANSWER-

REALISATION A/C DR

TO CASH A/C

5) GIVE JOURNAL ENTRY FOR THE TREATMENT OF PARTNERS LOAN APPEARING ON THE ASSETS SIDE OF THE BALANCE SHEET ON DISSOLUTION OF PARTNERSHIP FIRM

ANSWER- PARTNERS CAPITAL A/C DR
TO PARTNERS LOAN A/C

6 MARKS QUESTIONS:-

1) Pass journal entries for the following transactions on the dissolution of the firm of T and P after various assets and liabilities have been transferred to realization account:

a. Bank loan Rs.34,000 paid
b. Furniture worth Rs.70,000 was taken by partner at Rs.43,000.
c. Partner p agreed to pay a creditor Rs. 7,500.
d. A computer previously written off, realized Rs.3,900.
e. Expenses of realization Rs.3,200 paid by T.
f. profit on realization Rs. 4,800 was distributed in 5:3.

Ans 1 -

DATE	PARTICULARS	L.F	AMOUNT (Dr)	AMOUNT (Cr)
a	Realisation A/c Dr To Bank (Being repayment of loan)		34,000	 34,000
b	T's capital A/c Dr To Realisation (Being T took over Furniture)		43,000	 43,000
c	Realisation A/c Dr To P,s capital (Being P took over creditors)		7,500	 7,500
d	Bank A/c Dr To Realisation (Being Computer realised)		3,900	 3,900
e	Realisation A/c Dr To T,s capital (Being Realisation expenses took over by T)		3,200	 3,200
f	Profit on realisation A/c Dr To T's capital To P's capital (Being Realisation profit distributed)		4,800	 3,000 1,800

2) X and Y, who were sharing profits and losses in the ratio of 3:1 respectively, decided to dissolve the firm on 31st March 2018 at which date some of the balances were:

X's Capital Rs. 1,00,000; Y's Capital Rs.10,000 (Debit balance);Profit and loss a/c Rs.8,000(Debit balance);Trade creditors Rs.30,000; Loan from X Rs.10,000; Cash at bank Rs.2,000.

Assets (other than cash) realized Rs.1,10,000 and liabilities were paid at 5% discount. Realisation expenses amounted to Rs.1,000

Prepare Realization A/c,Partner's Capital Account and Cash Account.

Ans2

Memorandum Balance sheet

LIABILITIES	AMOUNT	ASSETS	AMOUNT
Creditors	30,000	Cash	2,000
Loan from X	10,000	Y's capital	10,000
Capitals:		Profit and loss	8,000
X 1,00,000	1,00,000	Sundry assets	1,20,000
		(Balancing figure)	
	39,450		39,450

Realisation Account

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
To Sundry Assets	1,20,000	By S Liabilities	
To Cash		Creditors 30,000	
Creditors 28,500		Loan from X 10,000	40,000
Loan from X 9,500			
Real expenses 1,000	39,000	By Cash	
		Sundry assets 1,10,000	1,10,000
		By loss transferred	
		X 6,750	
		Y 2,250	9,000
	1,59,000		1,59,000

PARTNER'S CAPITAL A/C

PARTICULARS	X	Y	PARTICULARS	X	Y
To balance b/d	--------	10,000	By balance b/d	1,00,000	-------
To profit and loss	6,000	2,000	By cash	-------	14,250
To realization loss	6,750	2,250			
To realization a/c	87,250	-------			
	1,00,000	14,250		1,00,000	14,250

Bank Account

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
To balance b/d	2,000	By realization a/c	39,000
To realization a/c	1,10,000	By X's capital	87,250
To Y's capital	14,250		
	1,26,750		1,26,750

3) Shanti and Satya were partners in a firm sharing profits in the ratio of 4:1 on 31st March 2018, their Balance sheet was as follows:

BALANCE SHEET

LIABILITIES	AMOUNT	ASSETS	AMOUNT
Creditors	45,000	Bank	55,000
Workmen compensation reserve	40,000	Debtors	60,000
		Stock	85,000
Satya's current a/c	65,000	Furniture	1,00,000
Capital A/Cs		Machinery	1,30,000
Shanti	2,00,000	Shanti's current a/c	20,000
Satya	1,00,000		
	4,50,000		4,50,000

On the above date the firm was dissolved:
Shanti took over 40% of the stock at 10% less than its book value and the remaining stock was sold for Rs.40,000. Furniture realized Rs.80,000.
An unrecorded investment was sold for Rs.20,000. Machinery was sold at a loss of Rs.60,000.Debtors realized Rs.55,000.
There was an outstanding bill for repairs for which Rs.19,000 was paid.
Prepare Realisation Account.

Ans3-

Realisation Account

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
To Sundry Assets		By Creditors	45,000
Debtors 60,000		By shanti capital A/c	
Stock 85,000		Stock 30,600	30,600
Furniture 1,00,000		By Bank	
Machinery 1,30,000	3,75,000	Stock 40,000	
To Bank		Furniture 80,000	
O/s Bills 19,000		Investment 20,000	
Creditors 45,000	64,000	Machinery 70,000	
		Debtors 55,000	2,65,000
		By loss transferred	
		Shanti 78,720	
		Satya 19,680	98,400
	4,39,000		4,39,000

4) C and D were partners in a firm sharing profits in the ratio of 3:2. On February, 2018 yhr firm was dissolved. After transferring assets and outsider's liabilities to realization a/c, you are given the following information:

a) A creditor for Rs. 2,00,000 accepted building of Rs.2,80,000 at Rs.2,20,000 and paid the firm Rs.20,000.
b) A second creditor for Rs. 75,000 accepted furniture at Rs.60,000 in full settlement of his claim.
c) A third creditor amounting to Rs.80,000 accepted Rs.20,000 in cash and investments of the book value of Rs.65,000 in full settlement of his claim.
d) Loss on realization was Rs.75,000.

Pass necessary journal entries for the above transactions in the books of the firm assuming that all payments were made by cheque.

DATE	PARTICULARS	L.F	Amount(Dr)	Amount (Cr)
a	Bank A/c Dr To Realisation (Being creditors settled by taking over asset)		20,000	20,000
b	No entry , asset is taken over by creditor in full settlement.		------------	----------
c	Realisation A/c Dr To Bank (Being creditors settled by taking over asset)		3,000	3,000
D	C A/c Dr D A/c Dr To Realisation (Being loss on realization distributed)		4,500 3,000	7,500

Ans4-

5) GIVE NECSSARY JOUNAL ENTRIES IN EACH OF THE FOLLOWING CASES:

A) REALIZATION EXPENSES AMOUNTED TO RS. 500
B) REALIZATION EXPENSES PAID BY THE FIRM AMOUNTED TO RS. 500 AND THE PARTNER HAS TO BEAR REALIZATION EXPENSES
C) A ONE OF THE PARTNERS WAS TO BEAR ALL THE REALISATION EXPENSES FOR WHICH HE WAS GIVEN A COMMISSION OF 2% OF NET CASH REALISED FROM DISSOLUTION. CASH REALISED FROM ASSETS WAS 25000 AND CASH PAID FOR LIABILITIES AMOUNTED TO RS. 5000

ANSWER5=

DATE	PARTICULARS	L.F	Amount(Dr)	Amount(Cr)
a	REALISATION A/c Dr To BANK A/C (Being payment of Realisation expenses)		500	 500
b	PARTNERS CAPITAL A/C DR TO BANK A/C		500	 500
c	BANK A/c Dr To REALISATION A/C (Being amount realised on sale of asset)		25000	 25000

Prepared by- Mr. Bikash Anand, PGT Commerce, KV Barkakana

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CH-6 Issue of Shares

List of Most Important Topics:

- **Issue of shares to vendors for purchase consideration other than cash.**
- **Forfeiture and Re-Issue of shares - At Par and At Premium**
- **Presentation of Share Capital in the Balance Sheet o the Company.**
- **Forfeiture and Re-issue in case of Pro-Rata allotment of shares.**

Q.1. Software Solution India Ltd. invited applications for 25,000 equity shares of ₹ 100 each, payable ₹ 40 on application, ₹ 30 on allotment and ₹ 30 on first and final call. The company received applications for 32,000 shares. Application for 2,000 shares were rejected and money returned to applicants. Applications for 10,000 shares were accepted in full and applicants for 20,000 shares allotted remaining shares and excess application money adjusted into allotment. All money due on allotment and call was received.

Pass necessary Journal Entries.

Solution:

JOURNAL ENTRIES

Sl. No.	Particulars	L.F	Dr. Amount	Cr. Amount
1.	Bank A/C Dr. (32,000 * 40)		1280000	
	To Share Application A/C			1280000
	(Being application money received)			
2.	Share Application A/C Dr.		1280000	

	To Share Capital A/C (25,000 * 40)			1000000
	To Bank A/C (2,000 * 40)			80000
	To Share Allotment A/C			200000
	(Being application money transferred and adjusted)			
3	Share Allotment A/C Dr. (25,000 * 30)		750000	
	To Share Capital A/C			750000
	(Being Allotment money due)			
4	Bank A/C Dr. (750000 – 200000)		550000	
	To Share Allotment A/C			550000
	(Being money received on allotment)			
5	Share 1st and Final Call A/C Dr. (25,000 * 30)		750000	
	To Share Capital A/C			750000
	(Being 1st call money due)			
6	Bank A/C Dr.		750000	
	To Share 1st and Final Call A/C			750000
	(Being money received on final call)			

Working Note:

	No. of Shares Applied	No. of shares Allotted
(i)	2,000	Nil
(ii)	10,000	10,000
(iii)	20,000	15,000

Q.2. Rupak Ltd. issued 10,000 shares of ₹ 100 each payable ₹ 20 per share on application, ₹ 30 per share on allotment and balance in two calls of ₹ 25 per share. The application and allotment money were duly received. On first call, all members paid their dues except one member holding 200 shares, while another member holding 500 shares paid for the balance due in full. Final call was not made.

Pass necessary journal entries.

JOURNAL ENTRIES

Sl. No.	Particulars	L.F	Dr. Amount	Cr. Amount
1.	Bank A/C Dr. (10,000 * 20)		200000	
	To Share Application A/C			200000
	(Being application money received)			
2.	Share Application A/C Dr.		200000	
	To Share Capital A/C			200000

	(Being application money transferred)			
3	Share Allotment A/C Dr. (10,000 * 30)		300000	
	To Share Capital A/C			300000
	(Being Allotment money due)			
4	Bank A/C Dr.		300000	
	To Share Allotment A/C			300000
	(Being money received on allotment)			
5	Share 1st call A/C Dr. (10,000 * 25)		250000	
	To Share Capital A/C			250000
	(Being 1st call money due)			
6	Bank A/C Dr.		257500	
	Calls in Arrears A/C Dr		5000	
	To Share 1st call A/C			250000
	To Calls in Advance A/C			12500
	(Being money received on 1st call along with calls in advance)			

Working Note:

Amount of Calls in Arrears = 200 * 25 = 5,000

Amount of Calls in Advance = 500 * 25 (final call) = 12,500

Q.3. Mohit Glass Ltd. issued 20,000 shares of ₹ 100 each at ₹ 110 per share, payable ₹ 30 on application, ₹ 40 on allotment (including Premium), ₹ 20 on first call and ₹ 20 on final call. The applications were received for 24,000 shares, full allotment was made to 20,000 shares. Balance shares were rejected and amount returned thereon. The money was duly received.

Give journal entries.

JOURNAL ENTRIES

Sl. No.	Particulars	L.F	Dr. Amount	Cr. Amount
1.	Bank A/C Dr. (24,000 * 30)		720000	
	To Share Application A/C			720000
	(Being application money received)			
2.	Share Application A/C Dr.		720000	
	To Share Capital A/C (20,000 * 30)			600000

	To Bank A/C (4,000 * 30)			120000
	(Being application money transferred and excess money refunded)			
3	Share Allotment A/C Dr. (20,000 * 40)		800000	
	To Share Capital A/C (20,000 * 30)			600000
	To Securities Premium Reserve A/C (20000 * 10)			200000
	(Being Allotment money due)			
4	Bank A/C Dr.		800000	
	To Share Allotment A/C			800000
	(Being money received on allotment)			
5	Share 1st Call A/C Dr. (20,000 * 20)		400000	
	To Share Capital A/C			400000
	(Being 1st call money due)			
6	Bank A/C Dr.		400000	
	To Share 1st Call A/C			400000
	(Being money received on final call)			
7	Share 2nd and Final Call A/C Dr. (20,000 * 20)		400000	
	To Share Capital A/C			400000
	(Being final call money due)			
8	Bank A/C Dr.		400000	
	To Share 2nd and Final Call A/C			400000
	(Being money received on final call)			

Working Note:

	No. of Shares Applied	No. of shares Allotted
(i)	20,000	20,000
(ii)	4,000	Nil

Q.4. Kumar Ltd. purchased assets of ₹ 6,30,000 from Bhanu Oil Ltd. Kumar Ltd. issued equity share of ₹ 100 each fully paid in consideration. What journal entries will be made, if the shares are issued:

(a) at par, and

(b) at premium of 20%.

Pass necessary entries.

JOURNAL ENTRIES

Sl. No.	Particulars	L.F	Dr. Amount	Cr. Amount
1	Sundry Assets A/C Dr.		630000	
	To Bhanu Oil Ltd.			630000
	(Being assets purchased)			
2	When shares issued at Par:			
	Bhanu Oil Ltd. Dr.		630000	
	To Share Capital A/C (6300 * 100)			630000
	(Being 6300 shares issued to Bhanu oil Ltd.)			
3	When shares issued at premium of 20%:			
	Bhanu Oil Ltd. Dr.		630000	
	To Share Capital A/C (5250 * 100)			525000
	To Securities Premium Reserve A/C (5250 * 20)			105000
	(Being 5250 shares issued to Bhanu Oil Ltd at premium of 20%)			

Working Note:

Case (a): No. of shares issued = 630000 / 100 = 6300 shares

Case (b): No. of shares issued = 630000 / (100+20%)

= 630000 / 120 = 5250 shares

Try it Yourself:

Q.5. Bansal Heavy Machine Ltd. purchased machine worth ₹ 3,80,000 from Handa Trader. Payment was made as ₹ 50,000 cash and remaining amount by issue of equity shares of the face value of ₹ 100 each fully paid at an issue price of ₹ 110 each.

Give journal entries to record the above transaction.

Hint:

No. of shares issued = 3,000 shares

Q.6. Kishna Ltd. issued 15,000 shares of ₹ 100 each at a premium of ₹ 10 per share, payable as follows:

On application ₹ 30

On allotment ₹ 50 [including premium]

On first and final call ₹ 30

All the shares subscribed and the company received all the money due, with the exception of the allotment and call money on 150 shares. These shares were forfeited and reissued to Neha as fully paid share at an issue price of ₹ 120 each.

Give journal entries in the books of the company.

JOURNAL ENTRIES

Sl. No.	Particulars	L.F	Dr. Amount	Cr. Amount
1.	Bank A/C Dr. (15,000 * 30)		450000	
	To Share Application A/C			450000
	(Being application money received)			
2.	Share Application A/C Dr.		450000	
	To Share Capital A/C			450000
	(Being application money transferred)			
3	Share Allotment A/C Dr. (15,000 * 50)		750000	
	To Share Capital A/C (15,000 * 40)			600000
	To Securities Premium Reserve A/C (15000 * 10)			150000
	(Being Allotment money due with premium)			
4	Bank A/C Dr.		742500	
	Calls in Arrears A/C Dr.		7500	
	To Share Allotment A/C			750000
	(Being money received on allotment)			
5	Share 1st and final Call A/C Dr. (15,000 * 30)		450000	
	To Share Capital A/C			450000
	(Being 1st call money due)			
6	Bank A/C Dr.		445500	
	Calls in Arrears A/C Dr.		4500	
	To Share 1st and final Call A/C			450000
	(Being money received on final call)			
7	Share capital A/C Dr. (150 * 100)		15000	
	Sec. Premium Reserve A/C Dr. (150 * 10)		1500	
	To Calls in Arrears A/C (7500 + 4500)			12000
	To Share Forfeited A/c			4500
	(Being 150 shares forfeited)			
8	Bank A/c Dr. (150 * 120)		18000	
	To Share Capital A/c (150 * 100)			15000

	To Sec. Premium Reserve A/c			3000
	(Being 150 shares re issued at 120 per share)			
9	Share forfeited A/c Dr.		4500	
	To Capital Reserve A/c (4500 – 0)			4500
	(Being balance of forfeited transferred to capital reserve)			

Working Note:

Amount of Calls in Arrears:

Allotment : 50 * 150 = 7500

First Call : 30 * 150 = 4500

Try it Yourself:

Q.7. Arushi Computers Ltd. issued 10,000 equity shares of ₹ 100 each at 10% premium. The net amount payable as follows:

On application ₹ 20

On allotment ₹ 50 (₹ 40 + premium ₹ 10)

On first call ₹ 30

On final call ₹ 10

A shareholder holding 200 shares did not pay final call. His shares were forfeited. Out of these 150 shares were reissued to Ms. Sonia at ₹ 75 per share.

Give journal entries in the books of the company.

Hint:

Amount received on final call = 98,000

Amount transferred to capital reserve= 18000 – 3750 = 14250

Q.8. Raunak Cotton Ltd. issued a prospectus inviting applications for 6,000 equity shares of ₹ 100 each at a premium of ₹ 20 per shares, payable as follows:

On application ₹ 20

On allotment ₹ 50 [including premium]

On first call ₹ 30

On final call ₹ 20

Applications were received for 10,000 shares and allotment was made pro-rata to the applicants of 8,000 shares, the remaining applications being refused. Money received in excess on the application was adjusted toward the amount due on allotment.

Rohit, to whom 300 shares were allotted failed to pay allotment and calls money, his shares were forfeited. Ritika, who applied for 600 shares, failed to pay the two calls and her shares were also forfeited. All these shares were sold to Kartika as fully paid for ₹ 80 per share.

Give journal entries in the books of the company.

Solution:

JOURNAL ENTRIES

Sl. No.	Particulars	L.F	Dr. Amount	Cr. Amount
1.	Bank A/C Dr. (10,000 * 20)		200000	
	To Share Application A/C			200000
	(Being application money received)			
2.	Share Application A/C Dr.		200000	
	To Share Capital A/C (6,000 * 20)			120000
	To Bank A/C (2,000 * 20)			40000
	To Share Allotment A/C			40000
	(Being application money transferred and adjusted)			
3	Share Allotment A/C Dr. (6,000 * 50)		300000	
	To Share Capital A/C (6000 * 30)			180000
	To Sec. Premium Reserve A/c (6,000 * 20)			120000
	(Being Allotment money due with premium)			
4	Bank A/C Dr. (260000 – 13000)		247000	
	Calls in arrears A/c Dr.		13000	
	To Share Allotment A/C (300000 – 40000)			260000
	(Being money received on allotment)			
5	Share 1st Call A/C Dr. (6,000 * 30)		180000	
	To Share Capital A/C			180000
	(Being 1st call money due)			
6	Bank A/C Dr.		157500	
	Calls in Arrears A/c Dr. (9000 + 13500)		22500	
	To Share 1st Call A/C			180000
	(Being money received on final call)			
7	Share 2nd and Final Call A/C Dr. (6,000 * 20)		120000	
	To Share Capital A/C			120000
	(Being final call money due)			
8	Bank A/C Dr.		105000	
	Calls in Arrears A/c Dr. (6000 + 9000)		15000	
	To Share 2nd and Final Call A/C			120000

	(Being money received on final call)			
9	Share capital A/c Dr. (300 * 100)		30000	
	Sec. Premium Reserve A/c Dr. (300 * 20)		6000	
	To Calls in Arrears A/c (13000+9000+6000)			28000
	To Shares Forfeited A/c			8000
	(Being 300 shares of Rohit forfeited for non-payment of allotment and calls money)			
10	Share capital A/c Dr. (450 * 100)		45000	
	To Calls in Arrears A/c (13500+9000)			22500
	To Shares Forfeited A/c			22500
	(Being 450 shares of Ritika forfeited for non-payment of calls money)			
11	Bank A/c Dr. (80 * 750)		60000	
	Shares forfeited A/c Dr. (20 * 750)		15000	
	To Shares Capital A/c (100*750)			75000
	(Being 750 shares re-issued for 80 per shares as fully paid)			
12	Share forfeited A/c Dr.		15500	
	To Capital Reserve A/c (8000+22500-15000)			15500
	(Being balance of forfeited account transferred to capital reserve)			

Working Note:

	No. of Shares Applied	No. of shares Allotted
(i)	8,000	6,000
(ii)	2,000	Nil

Calculation of calls in arrears of Rohit:

No. of shares allotted	:	300 shares	
No. of shares Applied	:	(8000/6000) * 300	= 400 shares
Excess application Money	:	(400 – 300) * 20	= 2000
Net arrear on allotment	:	(300*50) – 2,000	= 13,000
Net arrear on first call	:	300 * 30	= 9,000
Net arrear on final call	:	300 * 20	= 6,000

Calculation of calls in arrears by Ritika:

No. of applied shares	:	600 shares	
No. of allotted shares	:	(6000/8000) * 600	= 450 shares

Arrears on first call	:	450 * 30	= 13,500
Arrears on final call	:	450 * 20	= 9,000

Try it Yourself:

Q.9. Himalaya Company Limited issued for public subscription of 1,20,000 equity shares of ₹ 10 each at a premium of ₹ 2 per share payable as under:

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

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

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

Record journal entries.

Hint:

Arrears on Allotment : (4800*5) – (6400 – 4800) * 3 = 24000 – 4800 = 19200

Amount received on allotment	: 600000 – 120000 – 19200	= 460800
Amount received on 1st call	: 240000 – 9600	= 230400
Amount received on final call	: 240000 – 9600	= 230400
Capital reserve	: 19200 – 14400	= 4800

Q.10. Alfa Limited invited applications for 4,00,000 of its equity shares of ₹ 10 each on the following terms:

Payable on application	**₹ 5 per share**
Payablle on allotment	**₹ 3 per share**
Payable on first and final call	**₹ 2 per share**

Applications for 5,00,000 shares were received. It was decided:

a) **to refuse allotment to the applicants for 20,000 shares;**
b) **to allot in full to applicants for 80,000 shares;**
c) **to allot the balance of the available shares on pro-rata basis among the other applicants; and**
d) **to utilise excess application money in part as payment of allotment money.**

One applicant, whom shares had been allotted on pro-rata basis, did not pay the amount due on allotment and on the call, and his 400 shares were forfeited. The shares were reissued @ ₹ 9 per share. Show the journal entries.

Solution:

JOURNAL ENTRIES

Sl. No.	Particulars	L.F	Dr. Amount	Cr. Amount
1.	Bank A/C Dr. (5,00,000 * 5)		2500000	
	To Share Application A/C			2500000
	(Being application money received)			
2.	Share Application A/C Dr.		2500000	
	To Share Capital A/C (4,00,000 * 5)			2000000
	To Bank A/C (20,000 * 5)			100000
	To Share Allotment A/C			400000
	(Being application money transferred and adjusted)			
3	Share Allotment A/C Dr. (4,00,000 * 3)		1200000	
	To Share Capital A/C			1200000
	(Being Allotment money due)			
4	Bank A/C Dr. (800000 – 700		799300	
	Calls in arrears A/c Dr.		700	
	To Share Allotment A/C (1200000 – 400000)			800000
	(Being money received on allotment)			
5	Share 1st and final Call A/C Dr. (4,00,000 * 2)		800000	
	To Share Capital A/C			800000
	(Being 1st call money due)			
6	Bank A/C Dr.		799200	
	Calls in Arrears A/c Dr.		800	
	To Share 1st and final Call A/C			800000
	(Being money received on final call)			
7	Share capital A/c Dr. (400 * 10)		4000	
	To Calls in Arrears A/c (700+800)			1500
	To Shares Forfeited A/c			2500
	(Being 400 shares forfeited for non-payment of allotment and calls money)			
8	Bank A/c Dr. (400 * 9)		3600	
	Shares forfeited A/c Dr.		400	

	To Shares Capital A/c (400*10)			4000
	(Being 400 shares re-issued for 9 per shares as fully paid)			
12	Share forfeited A/c Dr.		2100	
	To Capital Reserve A/c (2500 – 400)			2100
	(Being balance of forfeited account transferred to capital reserve)			

Working Note:

No. of Shares Applied		No. of shares Allotted
(i)	20,000	Nil
(ii)	80,000	80,000
(iii)	4,00,000	3,20,000

Calculation of calls in arrears:

No. of shares allotted	:	400 shares	
No. of shares Applied	:	(400000/320000) * 400	= 500 shares
Excess application Money	:	(500 – 400) * 5	= 500
Net arrear on allotment	:	(400*3) – 500	= 700
Net arrear on final call	:	400 * 2	= 800

Q.11. Journalise the following transactions in the books B Ltd.:

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

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

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

JOURNAL ENTRIES

Sl. No.	Particulars	L.F	Dr. Amount	Cr. Amount
	Case (a)			
1	Share capital A/c Dr. (200 * 80)		16000	
	Sec. Premium Reserve A/c Dr. (200 * 10)		2000	
	To Calls in Arrears A/c (200 * 60)			12000
	To Shares Forfeited A/c			6000
	(Being 200 shares forfeited for non-payment of allotment money)			

2	Bank A/c Dr. (200 * 70)		14000	
	Shares forfeited A/c Dr. (200 * 30)		6000	
	To Shares Capital A/c (200 * 100)			20000
	(Being 200 shares re-issued for 70 per shares as fully paid)			
3	Share forfeited A/c Dr.		Nil	
	To Capital Reserve A/c (6000 – 6000)			Nil
	(Being balance of forfeited account transferred to capital reserve)			
	Case (b)			
1	Share capital A/c Dr. (150 * 6)		900	
	Sec. Premium Reserve A/c Dr. (150 * 4)		600	
	To Calls in Arrears A/c (150 * 8)			1200
	To Shares Forfeited A/c			300
	(Being 150 shares forfeited for non-payment of allotment money)			
2	Bank A/c Dr. (150 * 15)		2250	
	To Shares Capital A/c (150*10)			1500
	To Sec. Premium Reserve A/c (150 * 5)			750
	(Being 150 shares re-issued for 15 per shares as fully paid)			
3	Share forfeited A/c Dr.		300	
	To Capital Reserve A/c			300
	(Being balance of forfeited account transferred to capital reserve)			
	Case (c)			
1	Share capital A/c Dr. (400 * 50)		20000	
	To Calls in Arrears A/c (400 * 10)			4000
	To Shares Forfeited A/c			16000
	(Being 400 shares forfeited for non-payment of calls money)			
2	Bank A/c Dr. (400 * 45)		18000	
	Shares forfeited A/c Dr. (400* 5)		2000	
	To Shares Capital A/c (400*50)			20000
	(Being 400 shares re-issued for 45 per			

	shares as fully paid)			
3	Share forfeited A/c Dr.		14000	
	To Capital Reserve A/c (16000 – 2000)			14000
	(Being balance of forfeited account transferred to capital reserve)			

Try it Yourself:

Q.12. Ashoka Limited Company which had issued equity shares of ₹ 20 each at a premium of ₹ 4 per share, forfeited 1,000 shares for non-payment of final call of ₹ 2 per share. 400 of the forfeited shares were reissued at ₹ 14 per share out of the remaining shares of 200 shares reissued at ₹ 20 per share. Give journal entries for the forfeiture and reissue of shares.

Hint: Amount transferred to capital reserve = (i) 4,800 and (ii) 3600

Q.13. X Ltd. Was registered with an Authorised capital of ₹ 60,00,000, divided into equity shares of ₹ 100 each. During the year it issued 45,000 shares to the public at Par, payable ₹ 30 on application, ₹ 40 on Allotment and balance on call.

Public applied for 40,000 shares and the company allotted shares to them.

One applicant Mr. Arvind holding 2,500 shares did not pay money due on allotment and call. His shares were forfeited.

Show the share capital in the company's balance sheet and also prepare Notes to Account.

Solution:

Balance Sheet of X Ltd.

Particulars	Note No.	Amt. Curr. Year	Amt. Prev. Year
I. Equity & Liabilities		**₹**	**₹**
1. Shareholders' Fund:			
a) Share Capital	1	38,25,000	---

Notes to Accounts:

Note No.	Particulars	Amount
1	Share Capital:	
	Authorized Capital:	
	(60,000 shares of ₹ 100 each)	60,00,000
	Issued capital:	
	(45,000 shares of ₹ 100 each)	45,00,000
	Subscribed and fully paid Capital:	
	(37,500 shares of ₹ 100 each, fully called)	37,50,000
	Add: Balance of share forfeited A/c (2,500 * 30)	75,000

			38,25,000

Try it Yourself:

Q.14. A company was registered with a Nominal Capital of 75,00,000, divided into equity shares of ₹ 100 each. During the year it issued 55,000 shares at Par, Payable as follows:

On application	**: ₹ 25**
On Allotment	**: ₹ 40**
On first call	**: ₹ 15**
On final call	**: balance as and when required**

The public had applied for 52,000 shares and all the shares were allotted to them. All the money was duly received except on 2,000 shares who failed to pay allotment and first call money and his shares were forfeited by the directors.

The company did not make the final call.

Show the share capital in the company's balance sheet and also prepare Notes to Account.

Hint:

No. of Subscribed and Fully paid share	:	Nil
No. of Subscribed but not fully paid shares	:	50,000 shares
Total of shares capital	:	₹ 40,00,000 + ₹ 50,000 = ₹ 40,50,000

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Ch7 Issue of Debentures

List of Most Important Topics:

- **Issue of Debentures for Purchase Consideration other than cash.**
- **Interest of debentures**
- **Cases for issue and redemption of Debentures (Six Cases)**
- **Writing off Discount/Loss on issue of Debentures.**

Q.1.Amrit Company Limited purchased assets of the value of ₹ 2,20,000 from another company and agreed to make the payment of purchase consideration by issuing 2,000, 10% debentures of ₹ 100 each at a premium of 10%.

Record necessary journal entries.

JOURNAL ENTRIES

Sl. No.	Particulars	L.F	Dr. Amount	Cr. Amount
1	Sundry Assets A/C Dr.		220000	
	To Amrit Company Ltd.			220000
	(Being assets purchased)			

2	Amrit Company Ltd. Dr.		220000	
	To 10% Debentures A/c (2,000 * 100)			200000
	To Securities Premium Reserve A/C (2000 * 10)			20000
	(Being 2000 Debentures issued to Amrit Company Ltd. at premium of 10%)			

Q.2. A company purchased assets of the value of ₹ 1,90,000 from another company and agreed to make the payment of purchase consideration by issuing 2,000, 10% debentures of ₹ 100 each at a discount of 5%.
Record necessary journal entries.

JOURNAL ENTRIES

Sl. No.	Particulars	L.F	Dr. Amount	Cr. Amount
1	Sundry Assets A/C Dr.		190000	
	To Vendors A/c			190000
	(Being assets purchased)			
2	Vendors A/c Dr.		190000	
	Discount on issue of Deb. A/c Dr. (2000 * 5)		10000	
	To 10% Debentures A/c (2,000 * 100)			200000
	(Being 2000 Debentures issued to vendors at discount of 5%)			

Q.3. Nikhil Limited bought business of Agarwal Limited consisting sundry assets of ₹ 3,60,000 and sundry creditors ₹ 1,00,000, for a consideration of ₹ 3,07,200. It issued 14% debentures of ₹ 100 each fully paid at a discount of 4% in satisfaction of purchase consideration.
Record necessary journal entries.

JOURNAL ENTRIES

Sl. No.	Particulars	L.F	Dr. Amount	Cr. Amount
1	Sundry Assets A/C Dr.		360000	
	Goodwill A/c (b/fig.)		47200	
	To Sundry Creditors A/c			100000
	To Agarwal Ltd. A/c			307200
	(Being assets and liabilities purchased)			
2	Agarwal Ltd. A/c Dr.		307200	
	Discount on issue of Deb. A/c Dr. (3200 * 4)		12800	
	To 10% Debentures A/c (3,200 * 100)			320000
	(Being 3200 Debentures issued to vendors			

	at discount of 4%)			

Working Note:

No. of Debentures Issued = 307200 / (100 - 4%)
= 307200 / 96
= 3200 Debentures

Try it Yourself:

Q.4. Chinki Ltd. purchased assets of a book value of ₹ 99,000 from another company. It was agreed that the purchase consideration be paid by issuing 13% Debentures of ₹ 100 each.

Assume that the debentures have been issued:

a) At par
b) At a discount of 10%, and
c) At a premium of 10%.

Pass the necessary journal entries in the books of the purchasing company.

Q.5. A company purchased and took over assets of ₹ 12,00,000 and liabilities of ₹ 1,50,000 of another company for the purchase consideration of ₹ 8,80, 000. The purchase consideration was paid by the company by issuing its 17% Debentures of ₹ 100 each at 10% premium. Provide the journal entries.

Q.6. Star Automobiles Ltd. took over assets of ₹ 2,35,000 and liabilities of ₹ 40,000 of Ashoka Automobiles Ltd. for the purchase consideration of ₹ 2,20,000.

Purchase consideration was payable by issuing debentures of ₹ 100 at 10% premium.

Give journal entries in the books of Star Automobiles Ltd.

Q.7. Hassan Limited took a loan of ₹ 30,00,000 from a bank against primary security worth ₹ 40,00,000 and issued 40,000, 6% debentures of ₹ 100 each as a collateral security. The company again after one year took a loan of ₹ 50,00,000 from bank against Plant as primary security and deposited 60,000, 6% debentures of ₹ 100 each as collateral security.

Record necessary journal entries.

JOURNAL ENTRIES

Sl. No.	Particulars	L.F	Dr. Amount	Cr. Amount
	First Year:			
1	Bank A/c Dr.		3000000	
	To Bank Loan A/c			3000000
	(Being loan taken from bank)			
2	Debenture Suspense A/c Dr.		4000000	
	To 6% Debentures A/c (40000 * 100)			4000000
	(Being 40000 debentures issued to bank as collateral securities)			

	Second Year:			
3	Bank A/c Dr.		5000000	
	To Bank Loan A/c			5000000
	(Being loan taken from bank)			
4	Debenture Suspense A/c Dr.		6000000	
	To 6% Debentures A/c (60000 * 100)			6000000
	(Being 60000 debentures issued to bank as collateral securities)			

<u>Try it Yourself:</u>

Q.8. AB Limited took a loan of ₹ 25,00,000 from a bank against primary security worth ₹ 20,00,000 and issued 30,000, 6% debentures of ₹ 100 each as a collateral security. The company again after one year took a loan of ₹ 45,00,000 from bank against Plant as primary security and deposited 50,000, 6% debentures of ₹ 100 each as collateral security.

Record necessary journal entries.

Q.9. Neena Limited issued 50,000, 10% debentures of ₹ 100 each on the basis of the following conditions:

- **a) Debentures issued at par and redeemable at par.**
- **b) Debentures issued at discount @ 5% and redeemable at par.**
- **c) Debentures issued at premium @ 10% and redeemable at par.**
- **d) Debentures issued at par and redeemable at premium @ 10%.**
- **e) Debentures issued at discount of 5% and redeemable at a premium of 10%.**
- **f) Debentures issued at premium of 6% and redeemable at a premium of 4%.**

Record necessary journal entries in the above mentioned cases at the time of issue of debentures.

JOURNAL ENTRIES

Sl. No.	Particulars	L.F	Dr. Amount	Cr. Amount
	Case (a):			
1	Bank A/c Dr.		5000000	
	To 10% Debenture Application & Allotment A/c			5000000
	(Being 50000 debentures issued at Par)			
2	10% Deb. Application & Allotment A/c Dr.		5000000	
	To 10% Debentures A/c			5000000
	(Being money transferred to Debenture)			
	Case (b):			

1	Bank A/c Dr. (50000 * 95)		4750000	
	To 10% Debenture Application & Allotment A/c			4750000
	(Being 50000 debentures issued at discount of 5%)			
2	10% Deb. Application & Allotment A/c Dr.		4750000	
	Discount on issue of Deb. Dr.		250000	
	To 10% Debentures A/c			5000000
	(Being money transferred to Debenture)			
	Case (c):			
1	Bank A/c Dr. (50000 * 110)		5500000	
	To 10% Debenture Application & Allotment A/c			5500000
	(Being 50000 debentures issued at Premium of 10%)			
2	10% Deb. Application & Allotment A/c Dr.		5500000	
	To 10% Debentures A/c			5000000
	To Sec. Premium Reserve A/c			500000
	(Being money transferred to Debenture)			
	Case (d):			
1	Bank A/c Dr.		5000000	
	To 10% Debenture Application & Allotment A/c			5000000
	(Being 50000 debentures issued at Par)			
2	10% Deb. Application & Allotment A/c Dr.		5000000	
	Loss on issue of deb. A/c (50000*10) Dr.		500000	
	To 10% Debentures A/c			5000000
	To Premium on redemption of debenture A/c			500000
	(Being money transferred to Debenture and loss adjusted)			
	Case (e):			

1	Bank A/c Dr. (50000*95)		4750000	
	To 10% Debenture Application & Allotment A/c			4750000
	(Being 50000 debentures issued at discount of 5%)			
2	10% Deb. Application & Allotment A/c Dr.		4750000	
	Loss on issue of Deb. A/c (50000*15) Dr.		750000	
	To 10% Debentures A/c			5000000
	To Premium on redemption of debenture A/c			500000
	(Being money transferred to Debenture and loss adjusted)			
	Case (f):			
1	Bank A/c Dr. (50000*106)		5300000	
	To 10% Debenture Application & Allotment A/c			5300000
	(Being 50000 debentures issued at Premium of 6%)			
2	10% Deb. Application & Allotment A/c Dr.		5300000	
	Loss on issue of Deb. A/c (50000*4) Dr.		200000	
	To 10% Debentures A/c			5000000
	To Premium on redemption of debenture A/c			200000
	To Sec. Premium Reserve A/c (50000*6)			300000
	(Being money transferred to Debenture and loss adjusted)			

Try it Yourself:

Q.10. Record necessary journal entries in each of the following cases:

a) **27,000, 7% debentures of ₹ 100 each issued at par, redeemable at par.**
b) **25,000, 7% debentures of ₹ 100 each issued at par redeemable at 4% premium.**
c) **20,000, 7% debentures of ₹ 100 each issued at 5% discount and redeemable at par.**
d) **30,000, 7% debentures of ₹ 100 each issued at 5% discount and redeemable at 2½ % premium.**

e) **35,000, 7% debentures of ₹ 100 each issued at 4% premium and redeemable at premium of 5%.**

Q.11. On 1st April 2022, India Ltd. Issued 7,00,000, 8% debentures of ₹ 100 each at par. Interest is to be paid on these debentures half-yearly on September 30 and March 31, every year.

Record necessary journal entries for the amount of interest.

JOURNAL ENTRIES

Sl. No.	Particulars	L.F	Dr. Amount	Cr. Amount
30.9.2022	Interest on Debentures A/c Dr.		2800000	
	To Debenture Holders A/c			2800000
	(Being interest due to debenture holder)			
30.9.2022	Debenture Holders A/c Dr.		2800000	
	To Bank A/c			2800000
	(Being interest paid to debenture holders)			
31.3.2023	Interest on Debentures A/c Dr.		2800000	
	To Debenture Holders A/c			2800000
	(Being interest due to debenture holder)			
31.3.2023	Debenture Holders A/c Dr.		2800000	
	To Bank A/c			2800000
	(Being interest paid to debenture holders)			
31.3.2023	Statement of P/L A/c Dr.		5600000	
	To Interest on Debentures A/c			5600000
	(Being interest transferred to statement of P/L)			

Calculation of Interest on Debentures:

On 30th Sep, 2022 : 8% of 70000000 for 6 months = ₹ 28,00,000

On 31st Mar, 2023 : 8% of 70000000 for 6 months = ₹ 28,00,000

<u>Try it Yourself:</u>

Q.12.On 1st July, 2022, Agni Ltd. Issued 60,000, 12% debentures of ₹ 100 each at par. Interest is to be paid on these debentures half-yearly on September 30 and March 31, every year.

Record necessary journal entries for the amount of interest.

Hint:

Interest on Debentures Payable on 30th Sept, 2022 = **₹ 1,80,000**
Interest on Debentures Payable on 31st Mar, 2023 = **₹ 3,60,000**

Q.13. Z Ltd. issued 36,000 10% debentures of ₹ 100 each at discount of 9%, repayable at Par after 5 years. Pass necessary entries for issue and writing off discount on issue of debentures. Also prepare Discount on issue of Debentures A/c.

JOURNAL ENTRIES

Sl. No.	Particulars	L.F	Dr. Amount	Cr. Amount
1	Bank A/c Dr. (36000 * 91)		3276000	
	To 10% Debenture Application & Allotment A/c			3276000
	(Being 50000 debentures issued at discount of 9%)			
2	10% Deb. Application & Allotment A/c Dr.		3276000	
	Discount on issue of debentures A/c Dr.		324000	
	To 10% Debentures A/c			3600000
	(Being money transferred to Debenture)			
3	Statement of P/L A/c Dr.		324000	
	To Discount on issue of debentures A/c			324000
	(Being discount written off through P/L A/c)			

Discount on Issue of Debentures A/c

Date	Particulars	Amt.	Date	Particulars	Amt.
	To 10% Debentures A/c	324000		By Statement of P/L A/c	324000

Q.14. XY Ltd. issued 40,000 10% debentures of ₹ 100 each at discount of 6%, repayable at premium of 10% at the end of 4 years. The company had a balance of ₹ 4,80,000 in Securities Premium Reserve A/c. The directors decided to utilize the amount of Securities Premium Reserve to write off Discount/Loss on issue of debentures A/c.
Pass necessary entries for issue of debentures and to write off discount/loss on issue of debenture. Also prepare Discount/Loss on issue of Debentures A/c.

JOURNAL ENTRIES

Sl. No.	Particulars	L.F	Dr. Amount	Cr. Amount

1	Bank A/c Dr. (40000 * 94)		3760000	
	To 10% Debenture Application & Allotment A/c			3760000
	(Being 50000 debentures issued at discount of 6%)			
2	10% Deb. Application & Allotment A/c Dr.		3760000	
	Loss on issue of debentures A/c (40000*16) Dr.		640000	
	To 10% Debentures A/c			4000000
	To Premium on redemption of debenture A/c			400000
	(Being money transferred to Debenture)			
3	Sec. Premium Reserve A/c Dr.		480000	
	Statement of P/L A/c Dr.		160000	
	To Loss on issue of debentures A/c			640000
	(Being discount written off through SPR and balance through statement of P/L A/c)			

Loss on Issue of Debentures A/c

Date	Particulars	Amt.	Date	Particulars	Amt.
	To 10% Debentures A/c	240000		By Sec. Premium Reserve A/c	480000
	To Premium on ROD	400000		By Statement of P/L A/c	160000

<u>Try it Yourself:</u>

Q.15. A company issued 45,000, 10% debentures of ₹ 100 each at Par, repayable at Premium of 8% after 3 years. The company didn't have any balance in SPR as on that date.

Pass necessary journal entries for issue and to write off Loss on issue of debentures. Also prepare Loss on Issue of Debentures A/c.

Q.16. AB Ltd. issued 25,000 10% debentures of ₹ 100 each at discount of 5%, repayable at premium of 12% at the end of 4 years. The company had a balance of ₹ 2,00,000 in Securities Premium Reserve A/c. The directors decided to utilize the amount of Securities Premium Reserve to write off Discount/Loss on issue of debentures A/c.

Pass necessary entries for issue of debentures and to write off discount/loss on issue of debenture. Also prepare Discount/Loss on issue of Debentures A/c.

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Prepared by -Mr. Pradeep Kumar Verma, PGT Commerce, KV Gomoh, Ranchi Region.

Ch 8 Financial statement Analysis and Tools of financial statement analysis

Meaning

Financial statement analysis means to analyses the complex data and present it in a simple and understandable way.

Main features of financial analysis are:

1. Present complex data in simple and understandable form.

2. To classify the items of financial statements in convenient groups.

3. To make comparisons to help to draw conclusions.

Types of financial statement Analysis

These are of following types:

1. External Analysis: This analysis is made by the outsiders of the business like: investors, banks, financial institutions, creditors, government agencies, researchers etc. This research serves only a limited purpose.

2. Internal Analysis: This analysis is made by the persons who have access for the detailed internal records of the business. The main objective of such analysis is to assist the management in taking appropriate financial decisions.

3. Horizontal Analysis: It is also known as Dynamic Analysis. In this type of analysis, the financial statement of a number years is analysed. It is a time series or trend analysis. Figures of two or more years are compared and helps to find the strength and weakness of the enterprises.

4. Vertical Analysis: It is also known as Static Analysis or Cross- Sectional Analysis. In this type of analysis financial statements for a single year or a particular date are reviewed and analysed with the help of proper devices like Ratios. The items in the financial statements are expressed as a percentage to total which is taken as 100. This statement is called ‘common size statement’.

INTRA – FIRM ANALYSIS:

It is a comparison of financial variables of an enterprise for two or more accounting periods. It is also called ‘Time Series Analysis ‘or ‘Trend Analysis’.

INTER – FIRM ANALYSIS: It is a comparison of financial variables of two or more enterprises for the same accounting period to determine their competitive position. It is called 'Cross – Sectional Analysis'.

OBJECTIVES OF FINANCIAL ANALYSIS:

1. To measure the earning capacity or Profitability:
   Financial statement analysis helps in ascertaining whether adequate profits are being earned on the capital invested .
2. To measure the solvency :
   Financial statement analysis helps to find out whether the company is in a position to pay the short term and long term liabilities or not.

3. To measure the financial strength :

Financial statements helps to find out whether the business is in a position meet all the financial requirements or not.

4. To make comparative study with other firms :

Financial statements helps the management to compare the various variables with the variables of other firms.

5. To measure the capability of payment of interest and dividend :

Financial statement helps in finding out whether sufficient profit is available to pay the amount of interest and dividend or not. It also finds out whether dividend can be paid at a higher rate in future or not.

IMPORTANCE OF FINANCIAL ANALYSIS TO INTERESTED PARTIES:

1. MANAGEMENT : Management is interested in finding out the solvency, profitability and capital structure of the company. It also wants to find out the effectiveness of its own policies and decisions.

2. INVESTORS :

There are two types of creditors – i) short – term creditors ; ii) long – term creditors.

Short term creditors wants to know liquidity of the business.

Long term creditors wants to know whether the company will be able to pay the interest regularly and whether the company will be able to pay their debts or not.

3. GOVERNMENT :

Through financial statement analysis government takes the decision whether GST should be reduced or increased.

4. FINANCIAL INSTITUTIONS :

Financial institutions wants to know the earning capacity of the business and its long term solvency.

5. EMPLOYEES :

The employees can assess how much bonus or increase in wages is possible.

6. TAXATION AUTHORITIES :

Taxation authorities tries to find out whether the assessment of GST and income tax is correct or not.

LIMITATION OF FINANCIAL ANALYSIS :

1. AFFECTED BY WINDOW – DRESSING :

Some firms do not record the purchases made at the end of the year or they may overvalue their closing stock to cover up bad financial position. This misleads the result obtained by analysis of financial statements.

2. DO NOT REFLECT CHANGES IN PRICE LEVEL :

Figures given in financial statements do not show the effect of changes in price level.

3. DIFFICULTY IN FORECASTING :

Forecasting cannot be done on the basis of the past records as modern business is fast changing.

4. LACK OF QUALITATIVE ANALYSIS :

Financial Statements record only those events and transactions which can be expressed in terms of money. The reputation of the business, efficiency of management etc. are not recorded. Thus qualitative analysis cannot be done.

5. EFFECT OF PERSONAL ABILITY AND BIAS OF THE ANALYST :

The personal ability and knowledge of the analyst effects the conclusions obtained from the analyst.

Major Headings and Subheadings of Schedule III of the Companies Act 2013.
Format of Balance Sheet (given in Part 1)

Format of Statement of Profit and Loss (given in Part II)

Format of Balance Sheet as prescribed in Part I of Schedule III of the Companies Act, 2013.

Balance Sheet of .... (Name of Company)
as at

Particulars	Note no	Amount of current year	Amount of previous year

1. EQUITY AND LIABILITIES (1) Shareholders' 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) Long-term Provisions (4) Current Liabilities: (a) Short-term Borrowings (b) Trade Payables (c) Other Current Liabilities (d) Short-term Provisions			
Total			
II. ASSETS (1) Non-current assets: (a) Fixed assets Tangible assets Intangible assets (b) Non-current investment (c) Long term loan and advances (2) Current assets (a) Current investment (b) Inventories (c) Trade receivables (d) Cash and cash equivalents (e) Short term loan and advance (f) Other current investment			
Total			

Under what major headings and sub-headings are the following items recorded in a Company's Balance Sheet:

Items	Major headings	Sub headings
(i)Sundry creditors and bills payable (ii) Interest accrued and due on borrowings (iii) Fixed Deposits (Credit) (iv) Provision for tax (v) Interest accrued but not due on borrowings (vi) Debtors and B/R (vii) Motor Car (viii) Patents/Goodwill (ix) Investment in Government Bonds/Securities, Preference Shares (x) Finished Goods (xi) Furniture (xii) Stock-in-Trade (xiii) Live Stock (xiv) Leasehold Property (xv) Public deposits for 12 months (xvi) Payment of advance tax (xvii) Provident Fund (xviii) Trade Investment	Current Liabilities Current Liabilities Non-current Liabilities Current Liabilities Current Liabilities Current Assets Non-current Assets Non-current Assets Non-current Assets Current Assets Non-current Assets Current Assets Non-current Assets Non-current Assets Current Liabilities Current Assets Non-current Liabilities	Trade payables Other current liabilities Long term borrowings Short term provision Other current liabilities Trade receivables Fixed assets(tangible) Fixed assets(intangible) Non –current investment Inventories Fixed assets(tangible) Inventories Fixed assets(tangible) Fixed assets (tangible) short term borrowings other current assets long term provision non-current investment other current assets

(xix) Prepaid Expenses (Insurance)	Non-current Assets Current Assets	other current liabilities
(xx) Outstanding salary	Current Liabilities	other current liabilities
(xxi) unpaid or unclaimed dividend	Current Liabilities	long term provision
(xxii) Encashment of earned leave payable on retirement of employees	Non-current Liabilities	notes to accounts (as contingent liability)
(xxiii) Proposed dividend for current year	-	

MCQ

1.	Which of the following are the tools of vertical analysis ? i. Ratio Analysis ii. comparative statements iii. common size statements a. only (iii) b. both (i) and (iii) c. both (i) and (ii) d. only (i) ans. B
2.	Which of the following *is not a tool of Financial Statements Analysis ?* *a. comparative statements* *b. financial statements* *c. Common size statement* *d. Ratio Analysis.* *Ans. B*
3.	Parties interested in financial analysis are: a. investors b. government c. financial institutions d. all of the above ans. D
4.	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 ans. D
5.	When a bad position of the business is tried to be depicted as good, it is known as ----------------. a. Personal Bias b. price level changes c. window dressing d. All of the above ans. C

ABQ

1	Assertion (A) : Horizontal analysis can be done by preparing Comparative Statements. Reason (R) : In Horizontal analysis figures of two or more years are placed side – by – side to facilitate comparison . As such , Comparative Statements are Horizontal Analysis. In context of the above two statements , which of the following is correct ? Codes : (A) Both (A) and (R) are true, but (R) is not correct explanation of (A). (B) Both (A) and (R) are true and (R) is the correct explanation of (A). (C) Both (A) and (R) are false. (D) (A) is false , but (R) is true. Ans. B
2	Assertion (A) : Intra – firm analysis means comparing the financial data of the same firm for two or more accounting periods. Reason (R) : Inter – firm analysis means comparing the financial data of two or more enterprises for the same accounting period. In the context of the above two statements , which of the following is correct ? Codes : (A) Both (A) and (R) are true , but (R) is not the correct explanation of (A). (B) Both (A) and (R) are true and (R) is the correct explanation of (A). (C) Both (A) and (R) are false. (D) (A) is false , but (R) is true. Ans. A
3	Assertion (A) : Tools for financial analysis include Comparative Statements , Common – size Statements , Balance Sheet , Statement of Profit & Loss etc. Reason (R) : Tools for financial analysis include Comparative Statements , Common – size Statements and Balance Sheet . In the context of the above two statements , which of the following is correct ? Codes : (A) Both (A) and (R) are correct and (R) is the correct reason of (A).

	(B) Both (A) and (R) are correct but (R) is not the correct reason of (A). (C) Only (R) is correct. (D) Both (A) and (R) are wrong. Ans. D
4	Assertion (A) : Analysis of Financial statements helps to assess the current profitability and operational efficiency of the business as a whole as well as its different departments. Reason (R) : Financial Analysis considers the impact of price level changes on the business. In the context of the above statements , which of the following is correct ? (A) Both (A) and (R) are correct , but (R) is not the correct reason of (A). (B) Both (A) and (R) are correct and (R) is the correct reason of (A). (C) Both (A) and (R) are incorrect. (D) (A) is correct , but (R) is incorrect. Ans .D
5	Assertion (A) : Since financial analysis is strictly based upon financial statements , there is no scope of effect of personal ability and bias of analyst on such analysis. Reason (R) : Financial analysis suffers from personal ability and bias of analyst because analysis is based on financial statements . In the context of the above two statements , which of the following is correct ? Codes : (A) Both (A) and (R) are correct and (R) is the correct reason of (A). (B) Both (A) and (R) are correct but (R) is not the correct reason of (A). (C) Only (R) is correct. (D) Both (A) and (R) are wrong. Ans. C

Question – Answer Type

1	List any two uses of analyzing the financial statements.
2	What is Horizontal analysis and Vertical Analysis ?
3	How is ‘ window – dressing ‘ a limitation of financial statements analysis?
4	What is meant by ‘ Financial Analysis ‘ ?List any two objectives of analysing the financial statements.
5	What is the interest of shareholders or Investors in the analysis of financial statements ?

3/4 marks questions

1.Under which major heads the following items will appear in the Statement of Profit and Loss of a Company:

(i) Sale of Product
(ii) Salaries and wages
(iii) Goodwill amortized
(iv) Rent received
(v)Interest income
(vi)Interest paid on Debentures

(vii)Selling and Distribution Expenses
(viii)Profit on sale of investment

Ans-(i) revenue from operation

(ii) Employees benefit expenses

(iii) Depreciation

(iv) Other income

(v) other income

(vi) finance costs

(vii) other expenses

(viii) other income

2.Under which major heads the following items will appear in the Statement of Profit and Loss of a Company:
(i) Sale of services
(ii) Net loss on sale of investment
(iii) Rent paid
(iv)Bonus to Employees
(vii) Interest on Bank Loan

3.Under which heads will the following items appear in the Balance Sheet of a company as per Schedule Ill Part I of the Companies Act, 2013?
(i) Loose Tools (ii) Capital Reserve (iii) Bills Payable

4.How will you disclose the following items in the Balance Sheet of a company:
(i) Loose tools
(ii) Uncalled liability on partly paid-up shares

(iii) Debentures redemption reserve
(iv) Mastheads and publishing titles
(v) 10% debentures
(vi) Proposed dividend
(vii) Capital redemption reserve
(viii) Work-in-progress
(ix) Mining rights

5.Under what heads and sub-heads the following items will appear in the Balance Sheet of a company as per Schedule III, Part-1 of the Companies Act 2013:
(i) Premium on redemption of Debentures
(ii) Tax Reserve

(iii) Interest on Calls in Advance

6.Under what heads and sub-heads will the following items appear in the Balance Sheet of a company per Schedule III Part I of the Companies Act 2013:
(i) Debentures;

(ii) Securities against telephone

(iii) Calls-in-arrears.

(iv) Gain on reissue of forfeited equity shares.

7.Under which heads and sub-heads will the following items appear in the Balance Sheet of a company as per Schedule III Part I of the Companies Act 2013:

(i) Subsidy Reserve;

(ii) Vehicles

(iii) Provision for doubtful debts.

(iv) Trade payables to be settled beyond 12 months from the date of Balance Sheet.2013

8.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 1 of the Companies Act, 2013?

(i) Cheques and Bank Drafts in Hand

(ii) Loose tools

(iii) Securities Premium Reserve

(iv) Long-term Investments with maturity period less than six months

(v) Work-in-Progress

(vi) Mining Rights

(vii) Publishing titles

(viii) Debtors

1	Name the most widely known tools for financial analysis.	1
2	Give any two objectives of common – size statement.	1
3	State any one limitation of common – size statements.	1
4	What is another name of common size balance sheet?	1
5	Mention one advantage of comparative statement of profit and loss.	1
6	State any one purpose of comparative financial statements.	1
7	Why do we use tools for financial analysis ?	1
8	Prepare a common – size statement of profit and loss from the following	3

information for the year ended 31st March, 2021 :

Particulars	Note No.	31.3.2021
Revenue from operations		17,00,000
Cost of revenue from operations		9,20,000
Employees benefit expenses		3,40,000
Other incomes		90,000
Taxes payable @ 50%		

9 Prepare a comparative statement of statement of profit and loss from the following information : **3**

Particulars	Note No.	2020-21	2019-20
Revenue from operations		20,00,000	15,00,000
Other income		10,00,000	4,00,000
Expenses		21,00,000	15,00,000

Rate of income tax was 50 %.

10 Prepare a common size balance sheet of KJ Ltd. From the following information : **3**

Particulars	Note no.	31.3.2021	31.3.2020
I .Equity and liabilities			
1. Shareholder's funds		8,00,000	4,00,000
2. Non – current liabilities		5,00,000	2,00,000
3. current liabilities		3,00,000	2,00,000
Total		16,00,000	8,00,000
II . Assets			
1. Non – current assets		10,00,000	5,00,000
2. Current assets		6,00,000	3,00,000
Total		16,00,000	8,00,000

11 What is meant by comparative statements ? Explain its limitation . **6**

12 Prepare a comparative statement of profit and loss from the following information extracted from the statement of profit and loss for the year ended 31st March , 2020 and 2021 : **8**

Particulars	2020-21	2019-20
Revenue from operations	12,00,000	10,00,000
Other income (% of revenue from operations)	25%	25%
Employee benefit expenses (% of total revenue)	40%	30%
Tax Rate	40%	40%

13 What do you mean by inter- firm comparison ? **1**

14	From the following information , prepare a comparative Balance Sheet of Depth Ltd.	3

Particulars	**31.3.2020**	**31.3.2021**
Equity shares capital	25,00,000	25,00,000
Fixed assets capital	36,00,000	30,00,000
Reserves and surplus	6,00,000	5,00,000
Investments (non – current)	5,00,000	5,00,000
Long – term loans	15,00,000	15,00,000
Current assets	10,50,000	15,00,000
Current liabilities	5,50,000	5,00,000

15	From the following information related to statement of profit and loss of Moon Ltd., for the years ended 31st March 2020 and 2021 , prepare a comparative statement of profit and loss :	6

Particulars	Note no.	2020-21	2019-20
Revenue from operations		20,00,000	16,00,000
Employee benefits expenses		10,00,000	8,00,000
Other expenses		1,00,000	2,00,000
Tax rate		40%	40%

Prepared by: Mrs. Kumari Kanak Lata, PGT commerce, KV Namkum, Ranchi

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Ch 9 ACCOUNTING RATIOS

Accounting ratio may be expressed as an arithmetical relationship between two Accounting variables.

The technique of accounting ratios is used for analyzing the information contained in financial statements for assessing the solvency, efficiency and profitability of the firms.

OBJECTIVES OF RATIO ANALYSIS

- ✓ To simplify the accounting information
- ✓ To determine the liquidity(short term and long term financial obligations)
- ✓ To assess the operational efficiency of the business
- ✓ To analyse the profitability of the business
- ✓ To help in comparative analysis (inter firm and intra firm comparisons)

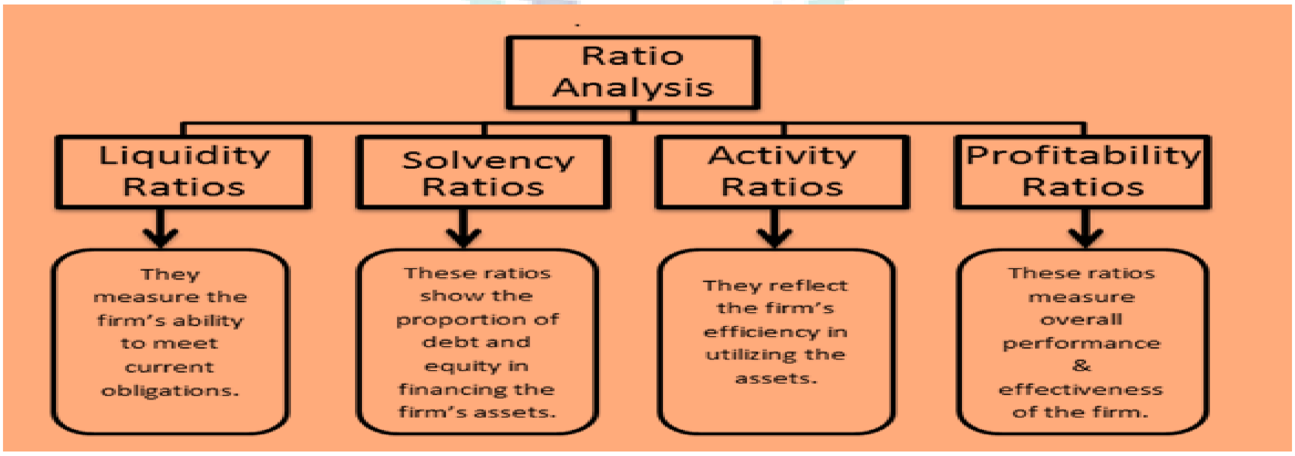
ADVANTAGES OF ACCOUNTING RATIOS

- ✓ Useful tool for analysis of financial statements
- ✓ Simplifies accounting data
- ✓ Useful for forecasting
- ✓ Useful in inter firm and intra firm comparison
- ✓ Useful in locating the weak areas.
- ✓ Useful in assessing the operational efficiency of business

LIMITATIONS OF ACCOUNTING RATIOS

- ✓ It can give false result
- ✓ Qualitative factors are ignored
- ✓ Lack of standard ratio
- ✓ May not be comparable
- ✓ Price level changes are not considered
- ✓ Leads to window dressing
- ✓ Leads to personal bias

CLASSIFICATION OF ACCOUNTING RATIO



Liquidity ratios

Liquidity is a very critical part of a business. Liquidity is required for a business to meet its short term obligations. Liquidity ratios are a measure of the ability of a company to pay off its short-term liabilities.

Liquidity ratios determine how quickly a company can convert the assets and use them for meeting the dues that arise. The higher the ratio, the easier is the ability to clear the debts and avoid defaulting on payments.

This is a very important criterion that creditors check before offering short term loans to the business. An organisation which is unable to clear dues results in creating impact on the creditworthiness and also affects credit rating of the company.

Let us now discuss the different types of liquidity ratios.

Types of Liquidity Ratio

There are following types of liquidity ratios:

1. Current Ratio or Working Capital Ratio
2. Quick Ratio also known as Acid Test Ratio
3. Cash Ratio also known Cash Asset Ratio or Absolute Liquidity Ratio
4. Net Working Capital Ratio

SOLVENCY RATIOS

Solvency is the ability of a company to meet its long-term debts and financial obligations. Solvency ratios also known as leverage ratios determine an entity's ability to service its debt. Solvency ratios includes

1.Debt-Equity Ratio
2. Proprietary Ratio
3. Total Assets to Debt Ratio
4. Interest Coverage Ratio

PROFITABILITY RATIOS

Efficiency in business is measured by profitability. "Profitability" refers to financial performance of the business. These ratios are expressed in percentage. The profitability ratios are :

- ✓ Gross profit Ratio
- ✓ Operating Ratio

- ✓ Operating profit Ratio
- ✓ Net profit Ratio
- ✓ Return on investment Ratio

ACTIVITY RATIOS OR TURNOVER RATIOS

These ratios indicate the speed at which, activities of the business are being performed. These ratios are usually expressed in number of times. These ratios are also called efficiency ratios. The important activity ratios are:
i). Inventory Turnover; ii). Trade receivable Turnover;
iii). Trade payable Turnover; iv). Investment (Net assets) Turnover
v). Fixed assets Turnover; vi). Working capital Turnover.

MULTIPLE CHOICE QUESTIONS

1.Two basic measures of liquidity are:

(A) Inventory turnover and Current ratio
(B) Current ratio and Quick ratio
(C) Gross Profit ratio and Operating ratio
(D) Current ratio and average Collection period

Ans:B

2.Current ratio is:

(A) Solvency Ratio
(B) Liquidity ratio
(C) Activity Ratio
(D) Profitability Ratio

Ans:B

3.Current Ratio is :

(A) Liquid Assets/Current Assets
(B) Fixed Assets/Current Assets
(C) Current Assets/Current Liabilities
(D) Liquid assets/Current Liabilities

Ans:C

4.Liquid Assets do not include:

(A) Bills Receivable
(B) Debtors
(C) Inventory

(D) Bank Balance

Ans:C

5.Ideal Current Ratio is:

(A) 1:1
(B) 1:2
(C) 1:3
(D) 2:1

Ans:D

6. Working Capital is the :

(A) Cash and Bank Balance
(B) Capital borrowed from Banks
(C) Difference between Current Assets and Current Liabilities
(D) Difference between Current Assets and Fixed assets

Ans:C

7.Current assets include only those assets which are expected to be realized within……

(A) 3 months
(B) 6 months
(C) 1 year
(D) 2 years

Ans:C

8.A Company's liquid assets are Rs.5,00,000 and its current liabilities are Rs.3,00,000.Thereafter, it paid Rs.1,00,000 to its trade payables. Quick ratio will be:

(A) 1.33:1
(B) 2.5:1
(C) 1.67:1
(D) 2:1

Ans:D

9.A Company's Quick Ratio is 1.5:1; Current Liabilities are Rs.2,00,000 and Inventory is Rs.1,80,000.Current Ratio will be:

(A) 0.9:1
(B) 1.9:1
(C) 1.4:1
(D) 2.4:1

Ans:D

10.Fixed Assets Rs.5,00,000; Current Assets Rs.3,00,000; Equity Share Capital Rs.4,00,000; Reserve Rs.2,00,000;Long –term debts Rs.40,000.Proprietory Ratio will be:

(A) 75%
(B) 80%
(C) 125%
(D) 133%

Ans:A

11.If Debt equity ratio exceeds ……………., it indicates risky financial position.

(A) 1:1
(B) 2:1
(C) 1:2
(D) 3:1

Ans:B

12.Equity Share Capital Rs.20,00,000; Reserves Rs.5,00,000; Debentures Rs.10,00,000; Current Liabilities Rs.8,00,000. Debt-equity ratio will be:

(A) 0.4 : 1

(B) 0.32 : 1

(C) 0.72 : 1

(D) 0.5 : 1

Ans:A

13. On the basis of following data, the Debt-Equity Ratio of a Company will be: Equity Share Capital Rs.5,00,000; General Reserve Rs.3,20,000; Preliminary Expenses Rs.20,000; Debentures Rs.3,20,000; Preliminary Expenses Rs.20,000; Debentures Rs.3,20,000; Current Liabilities Rs.80,000.

(A) 1:2

(B) 0.52:1

(C) 0.4:1

(D) 0.37:1

Ans:C

14. On the basis of the following information received from a firm, its Proprietory Ratio will be:

Fixed Assets Rs.3,30,000; Current Assets Rs.1,90,000; Preliminary Expenses Rs.30,000; Equity share Capital Rs.2,44,000; Preference Share capital Rs.1,70,000; Reserve Fund Rs.58,000.

(A) 70%
(B) 80%
(C) 85%
(D) 90%

Ans:C

15. On the basis of the following information received from a firm, its Total Assets-Debt ratio will be:

(A) 40%

(B) 60%

(C) 30%

(D) 70%

Ans:A

16. Opening Inventory Rs.1,00,000; Closing Inventory Rs.1,50,000; Purchases Rs.6,00,000; Carriage Rs.25,000; wages Rs.2,00,000. Inventory Turnover Ratio will be:

(A) 6.6 Times

(B) 7.4 Times

(C) 7 Times

(D) 6.2 Times

Ans:D

17. Revenue from Operations Rs.2,00,000; Inventory Turnover ratio 5; Gross Profit 25%. Find out the value of Closing Inventory, if Closing Inventory is Rs.8,000 more than the Opening Inventory.

(A) Rs.38,000

(B) Rs.22,000

(C) Rs.34,000

(D) Rs.26,000

Ans:C

18.Total revenue from operations Rs.9,00,000; Cash revenue from operations Rs.3,00,000; Debtors Rs.1,00,000; Debtors Rs.1,00,000; B/R Rs.20,000. Trade Receivables Turnover Ratio will be:

(A) 5 Times

(B) 6 Times

(C) 7.5 Times

(D) 9 Times

Ans:A

19. A firm's credit revenue from operations is Rs.3,60,000, cash revenue from operations is Rs.70,000. Cost of revenue from operations is Rs.3,61,200. Its gross profit ratio will be:

(A) 11%

(B) 15%

(C) 18%

(D) 16%

Ans:D

20. Revenue from Operations Rs.6,00,000; Gross Profit 20%; Office Expenses Rs.30,000;Selling Expenses Rs.48,000.Calculate operating ratio.

(A) 80%

(B) 85%

(C) 96.33%

(D) 93%

Ans:D

21.State whether the following statement is True or False:

Solvency refers to the ability of the enterprise to meet its current obligations.

Ans: True

22. State whether the following statement is True or False:

Current ratio improves with increase in sales at profir.

Ans: True

23.Fill in the blanks with appropriate word:

An ideal Quick Ratio is ……………

Ans: 1:1

24. Fill in the blanks with appropriate word:

……………is the process of determining and interpreting numerical relationship between figures of the financial statements.

Ans: Ratio Analysis

25. State whether the following statement is True or False:

Lower the Gross Profit Ratio, higher will be the profitability of a company.

Ans: False

ASSERTION REASONING TYPE QUESTIONS

1 .Assertion (A): Accounting ratio is an arithmetic relationship between two independent variables.
Reason (R): Accounting ratios can be expressed in pure form, percentage, times or fraction.
e) Both A and R are correct
f) A is correct, but R is wrong
g) A is wrong, but R is correct
h) Both A and R are wrong

2.Assertion (A): Ratio analysis helps to simplify accounting information for various users.
Reason (R): Various types of ratios helps to make comparative analysis.
a) Both A and R are correct
b) A is correct, but R is wrong
c) A is wrong, but R is correct
d) Both A and R are wrong
3.Assertion (A): An ideal current ratio of 2: 1 indicates good financial health of a company.
Reason (R): Increased current ratio is an indicator of ideal funds.
a) Both A and R are correct
b) A is correct, but R is wrong
c) A is wrong, but R is correct
d) Both A and R are wrong

4.Assertion (A): An ideal quick ratio is 1: 1.
Reason (R) : Quick asset does not include inventory.
a) Both A and R are correct
b) A is correct, but R is wrong
c) A is wrong, but R is correct
d) Both A and R are wrong

5.Assertion (A): A lower trade receivables turnover ratio is preferred by company.
Reason (R) : Trade receivables turnover ratio is an indicator of how promptly company collects its debts.
a) Both A and R are correct
b) A is correct, but R is wrong
c) A is wrong, but R is correct
d) Both A and R are wrong
6.Assertion (A): Firms ability to meet long term obligation is assessed through solvency ratio.
Reason (R): Solvency ratio establishes relation between various variables like debt, share holders' fund, asset and interest coverage.
a) Both A and R are correct
b) A is correct, but R is wrong

c) A is wrong, but R is correct
d) Both A and R are wrong
7.Assertion (A): Return on investment is a significant ratio to find overall performance of an enterprise.
Reason (R): For determining return on investment, net profit after tax is taken.
a) Both A and R are correct
b) A is correct, but R is wrong
c) A is wrong, but R is correct
d) Both A and R are wrong
8.Assertion (A): Operating profit ratio and operating ratio are complementary to each other.
Reason (R): A higher operating ratio indicates decline in efficiency.
a) Both A and R are correct
b) A is correct, but R is wrong
c) A is wrong, but R is correct
d) Both A and R are wrong
9.Assertion (A): A low inventory turnover ratio means inefficient use of investment in inventory and accumulation of inventory.
Reason (R) ; An increase in closing inventory leads to decrease in inventory ratio.
a) Both A and R are correct
b) A is correct, but R is wrong
c) A is wrong, but R is correct
d) Both A and R are wrong
10.Assertion (A): Activity ratio is directly related to profitability ratio.
Reason (R): All the turnover ratio measure how well the resources have been used by the enterprises.
a) Both A and R are correct
b) A is correct, but R is wrong
c) A is wrong, but R is correct
d) Both A and R are wrong
ANSWERS

1	2	3	4	5	6	7	8	9	10
C	A	B	b	c	a	b	b	a	a

SHORT ANSWER TYPE QUESTIONS
1: Working Capital Rs. 36,000; Current Ratio 2.8:1; Inventory Rs. 16,000. Calculate Current Assets, Current Liabilities and Quick Ratio.
Solution :

Current Ratio = CURRENT ASSET/CURRENT LIABILITY
Let the Current Liabilities be Rs. X
The Current Assets will be Rs. 2.8X
Working Capital = Current Assets – Current Liabilities
36,000 = 2.8X – X = 1.8 X

X = = Rs. 20,000

Quick Ratio =QUICK ASSET/CURRENT LIABILITY
Liquid Assets = Current Assets – Inventory

Rs. 56,000 – 16,000 = Rs. 40,000

Quick Ratio = = 2:1

2: Current Assets of a company are Rs. 15,00,000. Its current ratio 2.5 and liquid Ratio is 0.85. Calculate Current liabilities, Liquid Assets and Inventory.
Solution :

Current Ratio = 2.5

Current Liabilities =Rs. 6,00,000

Liquid Ratio =0.85

Liquid Assets = Rs. 5,10,000
Inventory = Current Assets – Liquid Assets
= Rs. 15,00,000 – Rs. 5,10,000
= Rs. 9,90,000

3: Calculate 'Debt-Equity Ratio' from the following information:
Total Assets : Rs. 3,50,000
Total Debt : Rs. 2,50,000
Current Liabilities : Rs. 80,000
Solution :

Debt Equity Ratio =
Debt = Total Debt – Current Liabilities
= Rs. 2,500,000-Rs. 80,000 = Rs. 1,70,000
Equity = Total Assets – Total Debts
= Rs. 3,50,000 – Rs. 2,50,000 = Rs. 1,00,000

Debt – Equity Ratio = = 1.7:1

4: Calculate Interest Coverage Ratio from the following information
Net Profit (after taxes) = Rs. 1,00,000
Fixed interest charges on long term borrowing = Rs. 20,000
Rate of Income Tax 50%
Solution :

Interest Coverage Ratio =220000/20000
Interest Coverage Ratio = 11 Times

5: From the following information calculate interest coverage ratio:
Rs.
10,000 equity shares to Rs. 10 each 1,00,000
8% Preference Shares 70,000
10% Debentures 50,000
Long term Loans from Banks 50,000
Interest on longs term loans from bank 5,000

Profit after tax 75,000
Tax 9,000
Solution :
Interest Coverage Ratio = Net profit before interest and taxes/interest on long term debts

Rs. 5000
Profit before Interest & Tax = Profit after tax + Interest on debentures + Interest Long term Loans
= Rs. 75,000+9,000+5000+5000 = Rs. 94,000

Interest Coverage Ratio = 94000/10000

= = 9.4 Times

6: For the following information compute Debt-Equity Ratio :

	Rs.
Long term borrowing	**8,00,000**
Long term provisions	**4,00,000**
Current Liabilities	**2,00,000**
Non Current Assets	**14,40,000**
Current Assets	**3,60,000**

Solution :

Debt Equity Ratio =
Debt = Long term borrowing + Long term Provision
= Rs. 8,00,000+4,00,000
= Rs. 12,00,000
Equity = Non Current Assets + Current Assets – Debt – Current Liabilities
= Rs. 14,40,000+360,000-12,00,000-2,00,000
= Rs. 18,00,000-14,00,000
= Rs. 4,00,000

Debt Equity Ratio = = 3 : 1

7 : The Quick ratio of X Ltd. Is 1:1. State with reason which of the following transactions would (i) increase; (ii) decrease or (iii) not change the ratio:
1. Included in the trade payable was a Bill payable of Rs. 3,000 which was met on maturity .
2. Debentures of Rs. 50,000 were converted into Equity Shares.
Solution:
(1) No Change
Reason: Both current Assets and current Liabilities are decreasing with the same amount.
(2) No Change
Reason: Neither current Assets and current Liabilities are decreasing with the same amount.

8. Handa Ltd. has inventory of ₹ 20,000. Total liquid assets are ₹ 1,00,000 and quick ratio is 2 : 1. Calculate current ratio.

Given that

Quick Ratio=2:1

⇒Liquid Assets/Current Liabilities⇒2/1

=

⇒ Liquid Assets=2 × Current Liabilities

=

2 × Current Liabilities=₹ 1,00,000

⇒ Current Liabilities=₹ 50,000

Given that

Inventory=₹ 20,000

∴ Current Assets=Liquid Assets + Inventories

=₹ 1,00,000 + ₹ 20,000

=₹ 1,20,000

∴ Current Ratio=Current Assets/Current Liabilities

=₹ 1,20,000/₹ 50,000

=12/5=2.4:1

9. Calculate debt-equity ratio from the following information:

Total Assets₹ 15,00,000

Current Liabilities₹ 6,00,000

Total Debts₹ 12,00,000

We know that

Debt-Equity Ratio=Long-term Debts/Shareholders' Funds

Long-term Debts=Total Debts – Current Liabilities

=₹ 12,00,000 – ₹ 6,00,000

=₹ 6,00,000

Shareholders' Funds

=Total Assets – Total Debts

=₹ 15,00,000 – ₹ 12,00,000

=₹ 3,00,000

So,

Debt-Equity Ratio

=

Long-term Debts/Shareholders' Funds

=

₹ 6,00,000₹/ 3,00000

=2/1

=2:1

10. Calculate Current Ratio if:

Inventory is ₹ 6,00,000; Liquid Assets ₹ 24,00,000; Quick Ratio 2 : 1.

We know that

Quick Ratio

=Liquid Assets/Current Liabilities

Given that

Quick Ratio=2:1

⇒Liquid Assets/Current Liabilities=2/1

=⇒ Current Liabilities=Liquid Assets/2
=₹ 24,00,000/2
=₹ 12,00,000
Now
Current Assets=Liquid Assets + Inventories
=₹ 24,00,000 + ₹ 6,00,000
=₹ 30,00,000
∴ Current Ratio=Current Assets/Current Liabilies
=₹ 30,00,000/₹ 12,00,000
=5/2=2.5:1

11.From the following data calculate current ratio and quick ratio

Liquid assets	**75000**
Inventories (includes loose tools of 20000)	**35000**
Prepaid expenses	**10000**
Working capital	**60000**

Solution: Current assets =Liquid assets= Inventories (excluding loose tools) + Prepaid expenses

=75000+15000+10000= 100000

Working capital = Current asset- Current liabilities
Current liabilities= Current Assets-Working Capital= 100000-60000=40000

Current Ratio= $\frac{\text{Current Assets}}{\text{Current liabilities}} = \frac{1000000}{40000}$ =2.5: 1

Liquid Ratio = $\frac{\text{Liquid Assets}}{\text{Current Liabilities}} = \frac{75000}{40000}$ =1.875:1

PRACTICE THESE QUESTIONS

Q1. (a) A business has a current ratio of 3: 1 and quick ratio of 1.2:1. If the working capital is Rs. 1,80,000/-, calculate the total Current Assets and value of Stock. (2)
(b) From the given information calculate the Stock turnover ratio. Sales Rs. 2,00,000; GP: 25% on cost; Stock at the beginning is 1/3 of the stock at the end which was 30% of sales. (2)

Q2. Assuming that the Debt-Equity ratio is 2. State giving reasons whether this ratio would increase, decrease or remain unchanged in the following cases: (ANY FOUR) (4)
(a) Purchase of fixed asset on a credit of 2 months. (b) Purchase of fixed asset on a long term deferred payment basis. (c) Issue of New shares for cash. (d) Issue of Bonus shares. (e) Sale of fixed asset at a loss of Rs. 3,000.
Q3. On the basis of the following information calculate: (4)
(i) Debt-Equity Ratio and
(ii) Working Capita; Turnover Ratio

Prepared by: Smt. Somya V R. PGT commerce, KV CRPF, Ranchi

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Ch 10 Cash Flow Statement

A cash flow statement is the financial statement that measures the cash generated or used by a company in a given period. A cash flow statement provides information about the historical changes in cash and cash equivalents of an enterprise by classifying cash flows into operating, investing and financing activities.
A Cash Flow statement may be defined as a summary of receipts and disbursements of cash for a particular period of time.

Objectives of Cash Flow Statement

The primary objective of the cash flow statement is to help management in taking a decision and making a plan by providing current information on cash inflow and outflow of any accounting period. The other objectives are:

i) Ensuring future positive cash flow of particular concern.
ii) Ensuring the capacity of an organization to pay a dividend.
iii) Identifying non-cash items ensuring cash income and expenses of a concern.
iv) Comparing various items of the current year with those of last year.

Benefits of Cash Flow Statement

i) Cash Flow Statement helps in knowing the exact figure of cash inflows and outflows from various operations of the business.

ii) Cash flow statement used in preparing the cash budget for future needs.

iii) It provides the information about various investing and financing cash transactions takes place during the year.

iv) It reveals the key changes required for the financial positioning of the business.

v) Cash flow information is useful in assessing the ability of the enterprise to generate cash and cash equivalents.

vi) It also helps the comparability of the reporting of operating performance by different enterprises

Cash and Cash Equivalents:

Cash flow statement shows inflows and outflows of cash and cash equivalents from various activities of an enterprise during a particular period.

As per AS-3, ‘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.

An investment normally qualifies as cash equivalents only when it has a short maturity. Investments in shares are excluded from cash equivalents. Short-term marketable securities which can be readily converted into cash are treated as cash equivalents.

Cash Flows: Cash Flows is the net amount of cash and cash-equivalents being transferred into and out of a business. It implies the movement of cash in and out due to some non-cash items. Receipt of cash from a non-cash item is termed as cash inflow while cash payment in respect of such items as cash outflow.

Classification of Activities for the Preparation of Cash Flow Statement:

As per AS-3,Cash flow activities are to classified into three categories

(1) Operating activities

(2) Investing activities

(3) Financing activities

Cash Inflows from operating activities

❑ cash receipts from sale of goods and the rendering of services.

❑ cash receipts from royalties, fees, commissions and other revenues.

Cash Outflows from operating activities

❑ Cash payments to suppliers for goods and services.

❑ Cash payments to an insurance enterprise for premiums and claims, annuities, and other policy benefits.

❑ Cash payments of income taxes unless they can be specifically identified with financing and investing activities. (2). Cash from Investing Activities:

As per AS-3, investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. Investing activities relate to purchase and sale of long-term assets or fixed assets.

Cash Outflows from investing activities

• Cash payments to acquire fixed assets including intangibles and capitalized research and development.

• Cash payments to acquire shares, warrants or debt instruments of other enterprises except those held for trading purposes.

• Cash advances and loans made to third party.

Cash Inflows from Investing Activities

• Cash receipt from disposal of fixed assets including intangibles.

• Cash receipt from the repayment of advances or loans made to third parties

• Cash receipt from disposal of shares, warrants or debt instruments of other enterprises except those held for trading purposes.

• Interest received in cash from loans and advances.

• Dividend received from investments in other enterprises

. **Cash from Financing Activities**

As per AS-3, financing activities are activities that result in changes in the size and composition of the owners' capital and borrowings of the enterprise.

Cash Inflows from financing activities

• Cash proceeds from issuing shares (equity or/and preference).

• Cash proceeds from issuing debentures, loans, bonds and other short/ long term borrowings.

Cash Outflows from financing activities

• Cash repayments of amounts borrowed.

• Interest paid on debentures and long-term loans and advances.

• Dividends paid on equity and preference capital

CASH FLOW STATEMENT FOR THE YEAR ENDED MARCH 31 2023

(MAIN HEADS ONLY)

A.	CASHFLOWS FROM OPERATING ACTIVITIES	XXX
B.	CASHFLOWS FROM INVESTING ACTIVITIES	XXX
C.	CASHFLOWS FROM FINANCING ACTIVITIES	XXX

(A+B+C)

NET INCREASE OR DECREASE IN CASH AND CASH EQUIVALENTS	XXXX
ADD: CASH AND CASH EQUIVALENTS IN THE BEGINNING	XXXX

1 CALCULATION OF CASH FLOW FROM OPERATING ACTIVITIES

NET PROFIT BEFORE TAX AND EXTRA ORDINARY ITEMS *******

ADD: TRANSFER TO GENERAL RESERVE

PROVISION FOR TAXATION (CLOSING PROVISION)

LOSS DUE TO THEFT,EARTH QUAKE OR FLOOD ETC.,

PROPOSED DIVIDEND (CLOSING PROPOSED DIVIDEND

INTERIM DIVIDEND, PREFERENCE DIVIDEND, IF ANY

LESS: REFUND OF INCOME TAX , IF ANY

INSURANCE FROM FAMINE SETTLEMENT IF ANY

NET PROFIT BEFORE TAX AND EXTRA ORDINARY ITEMS ** * ****

ADD: NON CASH AND NON OPERATING ITEM

DEPRECIATION

GOODWILL, PATENTS WRITTEN OFF

PRELIMINARY EXPENSES

LOSS ON SALE OF FIXED ASSETS OR EQUIPMENTS

INTEREST PAID/ INTEREST ONDEBENTURES/INTEREST ON PUBLIC DEPOSIT

PROVISION FOR TAXATION (OPENING PROVISION) or INCOME TAX PAID

PROVISION FOR DOUBTFUL DEBTS IF ANY

SHARE ISSUE EXPENSES WRITTEN OFF

LESS: PROFIT ON SALE OF FIXED ASSET

INTEREST RECEIVED

DIVIDEND RECEIVED (NON OPERATING INCOME)

OPERATING PROFIT BEFORE WORKING CAPITAL CHANGES *****

OPERATING PROFIT BEFORE WORKING CAPITAL CHANGES	********

ADD: DECREASE IN CURRENT ASSETS	****	
INCREASE IN CURRENT LIABILITIES	** **	
LESS:		
INCREASE IN CURRENT ASSETS	** **	
DECREASE IN CURRENT LIABILITIES	****	
CASH FROM OPERATIONS	*********	
LESS: INCOME TAX PAID	**********	
ADD: REFUND OF INCOME TAX	**********	
NET CASH FROM OPERATION	***************	

2. CASH FROM INVESTING ACTIVITIES

ADD :	PROCEEDS FROM SALE OF FIXED ASSETS	XXX
	PROCEEDS FROM SALE OF INVESTMENTS	XXX
	PROCEEDS FROM SALE OF INTANGIBLE ASSETS	XXX
	INTEREST AND DIVIDEND RECEIVED	XXX
LESS :	RENT INCOME	XXX
	PURCHASE OF FIXED ASSETS	XXX
	PURCHASE OF INVESTMENT	XXX
	PURCHASE OF INTANGIBLE ASSETS	XXX
NET CASH FROM (OR USED IN) INVESTING ACTIVITIES		XXXX

3 CASH FLOWS FROM FINANCING ACTIVITIES

ADD:	Issue of share capital	XXXX	
	Issue of preference share capital	XXXX	
	Issue of debentures	XXXX	
	Public deposits accepted	XXXX	
	Proceeds from long term borrowings	XXXX	
	Short term borrowings	XXXX	
LESS:	Redemption of debentures	(XXX)	
	Redemption of preference share capital	(XXX)	
	Repayment of loan if any	(XXX)	
	Interest on debentures paid	(XXX)	
	Interest on public deposits paid	(XXX)	
NET CASH FLOW FROM FINANCING ACTIVITIES			XXXX

Treatment of Some Peculiar Items

Extraordinary items: Extraordinary items are not the regular phenomenon, e.g., loss due to theft or earthquake or flood. They are non-recurring in nature and hence cash flows associated with extraordinary items should be classified and disclosed separately as arising from operating, investing or financing activities.

Interest and Dividend: In case of a financial enterprise (whose main business is lending and borrowing), interest paid, interest received and dividend received are classified as operating activities while dividend paid is a financing activity.

In case of a non-financial enterprise, as per AS-3, payment of interest and dividends are classified as financing activities whereas receipt of interest and dividends are classified as investing activities.

Taxes on Income and Gains:

Tax on operating profit should be classified as operating cash flows.

Dividend tax, i.e., tax paid on dividend should be classified as financing

activity along with dividend paid.

Capital gains tax paid on sale of fixed assets should be classified under investing activities.

Non-cash Transactions: As per AS-3, investing and financing transactions that do not require the use of cash or cash equivalents should be excluded from a cash flow statement.

Ascertaining Cash Flow from Operating Activities

As per AS-3, an enterprise should report cash flows from operating activities

Indirect Method: In indirect method of ascertaining cash flow from operating activities begins with the amount of net profit/loss.

Cash Flows from Operating Activities

(Indirect Method)

Net Profit/Loss before Tax and Extraordinary Items		xxxxx
+ Deductions already made in Statement of Profit and Loss on account of Non-cash items such as Depreciation, Goodwill to be Written-off.		xxxxx
+ Deductions already made in Statement of Profit and Loss on Account of Non-operating items such as Interest.		xxxxx
– Additions (incomes) made in Statement of Profit and Loss on account of Non-operating items such as Dividend received, Profit on sale of Fixed Assets.		(xxx)
Operating Profit before Working Capital changes		xxxxx
+ Increase in Current liabilities		xxxx
+ Decrease in Current assets		xxxx
– Increase in Current assets		(xxx)
– Decrease in Current Liabilities		
Cash Flows from Operating Activities before Tax and Extraordinary Items	xxxx	
– Income Tax Paid	(xxx)	
+/– Effects of Extraordinary Items		
Net Cash from Operating Activities	xxxx	

Note: while working out the cash flow from operating activities, the starting point is the 'Net profit before tax and extraordinary items' and not the 'Net profit as per Statement of Profit and Loss'. Income tax paid is deducted as the last item to arrive at the net cash flow from operating activities.

SEBI (Securities Exchange Board of India) Guidelines recommend for only direct method.

MULTIPLE CHOICE QUESTIONS

Q1 From the following particulars, what will be the amount of provision for tax made during the year?

Provision for Taxation

31.3.2011 50,000

31.3.2012 40,000

The Company paid taxes Rs 45,000 for the year 2011-2012.

(a) Rs 45,000

(b) Rs 35,000

(c) Rs 40,000

(d) Rs 50,000

Q2. From the following information, the outflow of cash for the purchase of machinery will be:

Written down value of machinery as on 1.4.2011 - Rs 5,00,000

Written down value of machinery as on 31.3.2012 -Rs7,00,000

Depreciation on machinery charged during the year Rs 60,000

Machinery having book value Rs 25,000 sold for Rs 20,000

(a) Rs 2,70,000

(b) Rs 2,80,000

(c) Rs 2,75,000

(d) Rs 2,85,000

Q3. Which of the following transactions would result inflow of cash:

(a) Cash withdrawn from Bank for office use.

(b) Purchase of machinery worth Rs 2,00,000 and issued shares in consideration thereof.

(c) Sale of furniture for Rs 3,000 to Mr. Mohan.

(d) Cash received from Debtors Rs 6,000

Q4 . From the following information find the cash generated from operations:

Operating Profit before working capital changes 1,00,000

Depreciation on fixed assets 15,000

Loss on sale of Furniture 5,000

Interest paid 13,000

Dividend received

Increase in debtors 8,000

Decrease in stock 7,000

Increase in creditors 4,000

(a) Rs 1,18,000

(b) Rs 1,24,000

(c) Rs 1,03,000

(d) Rs 1,00,000

Q5Which of the following transactions would not create a cash flow ?

(a) A company purchased some of its own stock from a stockholder

(b) Amortization of a patent

(c) Payment of a Cash Dividend

(d) Sale of equipment at book value

Q6. Bank Overdraft and cash credit are to be treated as:

(a) Cash Equivalents

(b) Non Current Liabilities

(c) Investing Activity

(d) Short Term Borrowings

Q7. From the following information find out the inflow of cash

Office Equipment `

31st March, 2014 60,000

31st March, 2013 1,00,000

` Additional Information:

Depreciation for the year 2013-14 is Rs 7,000, Purchase of office Equipment during the year Rs 10,000 Part of Office Equipment sold at a profit of Rs 6,000

(a) Rs 48,000

(b) Rs 49,000

(c) Rs 44,000

(d) Rs 33,000

Q8 From the following information find out the cash flow from financing activities.

Liabilities

Proposed Dividend

31st March 2013 20,000

31st March 2014 15,000

Additional Information: Equity Share Capital raised 3,00,000 10% Debentures Redeemed 1,00,000 Preference Share capital Redeemed 50,000. Interim Dividend paid during the year 20,000

(a) Rs 1,25,000

(b) Rs 1,00,000

(c) Rs1,50,000

(d) Rs 1,30,000

Q9Declaration of Final Dividend would result in ___

(a) Outflow in Financing activities.

(b) Outflow in Operating activities.

(c) Inflow in Operating activities.

(d) No Flow of cash.

Q10. From the following information find out the cash outflow cash outflow from financing activities.

	Year - I	Year - II
Proposed Dividend Rs	1,20,000	1,50,000
12% Debentures Rs	4,00,000	5,00,000

Additional Information: Additional Debentures were issued at the end of year.

Interim Dividend paid 50,000.

Preference Share capital issued Rs 2,00,000.

(a) Rs 82,000

(b) Rs 2,08,000

(c) Rs 2,38,000

(d) Rs 2,48000

Q11 From the following information find out the inflow of cash

	31st March, 2015	31st March, 2014
Plant and Machinery Account `	Rs 6,00,000	Rs 4,50,000
Accumulated Depreciation `	Rs1,60,000	Rs 1,00,000

Additional Information: Depreciation for the year 2014-15 is Rs 80,000. During the year Machinery was Purchased for Rs 2,50,000 and a part of asset was sold at a profit of Rs 40,000.

(a) Rs 1,20,000;

(b) Rs 1,00,000;

(c) Rs 80,000;

(d) Rs40000

Q12 Which of the following transactions would result in neither cash inflow nor outflow of cash and cash equivalents.

a.Issue of share capital

b.Issue of bonus shares

redemption of debentures

d.Traderecievable realized.

Q13 Gain on sale of tangible current asset is an

a.Operating activity

B.Investing activity

c.Financing activity

d.Cash and Cash Equivalents

Q14 Interest collected by an automobile company selling a car on instalment basis will be classified as

a.Investing activity

b.Operating activity

C.Financing activity

d.Cash and cash equivalents

Q15 A decrease in outstanding expense would result in

a.Decrease in cash balance

b.Increase in cash balance

c.Unaltered

d.Would change the current liabilities.

Q16 Pick the odd one out

a.Long term borrowings

b.Reserves and surplus

c.Share capital

d.Public deposits.

Q17 Dividend received by Atal Pharma Limited will be a i.)………………………for the organization .and will be classifies as ii.)…………………activity.

a.Inflow,investing

b.Inflow,financing

c.Outflow ,financing

d.Inflow,Operating

Q18 Expenses paid in advance at the end of the year are i…….in ……ii activities while preparing cash flow statement

a. Added, Operating

b. subtracted, Operating

c. Added, Investing

d. Subtracted, Investing

Q19 Gain on sale of tangible non-current asset is an

a.Operating activity

B.Investing activity

c.Financing activity

d.Cash and Cash Equivalents

Q20 Which of the following shall be considered as an outflow of cash in cash flow statement.

a.Decrease in Public Deposits

b.Issue of share capital

c.Increase in accounts payable

d.Decrease in accounts receivables.

Answers

1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
b	**d**	**d**	**c**	**b**	**d**	**b**	**b**	**d**	**d**

11	**12**	**13**	**14**	**15**	**16**	**17**	**18**	**19**	**20**
a	**b**	**a**	**a**	**d**	**b**	**a**	**a**	**a**	**a**

<u>Fill in the Blanks</u>

1.The basis of Cash Flow Statement is ____________________

2.Debentures issued for consideration other than cash are not shown in the Cash Flow Statement because ________________is not received against the issue.

3.Loss on issue of debentures written off is shown by way of deduction from___________________ of the debentures.

4.Patents purchased and completely amortized in the year of purchase is added under_____ _________and shown as an outflow under_____________

5.Purchase of securities by a non- finance company is ________________

1	2	3	4	5
Cash basis	Cash	Face value	Operating, Investing	Investing

<u>State True of False</u>

1.Gratuity paid to a retiring employee is an Operating activity.

2.Issue of Bonus shares is shown as a financing activity.

3.Shares issued to promoters in consideration of their services are shown as a financing activity.

4.Operating activities are principal revenue producing activities of an enterprise and those activities that are not investing or financing activities.

5.Buy Back of shares is an extraordinary item for Financing activity.

1	2	3	4	5
T	F	F	T	T

1.From the following particulars, Calculate cash flow from Operating activities:

Particulars	31st March,2019(₹)	31st March,2018 (₹)
General Reserve	1,50,000	1,00,000
Surplus, Balance in statement of profit and loss	70,000	(60,000)
10% Debenture	3,10,000	2,10,000
Trade Payables	11,75,000	75,000
Cash & Cash Equivalents	1,30,000	90,000
Goodwill	80,000	1,00,000
Machinery	4,60,000	5,00,000
10% non-current investment	1,60,000	60,000
Inventories	2,45,000	60,000
Provision for Doubtful Debts	1,50,000	1,00,000
Trade Payables	21,00,000	10,00,000
Discount on issue of Debentures	…	10,000

Solution

CASH FLOW FROM OPERATING ACTIVITIES

Particulars		Amount (₹)
Net Profit before Tax and Extraordinary (WN1)		**1,80,000** (1)
Adjustment for Non-cash and Non-operating Items:		
Add: Depreciation on Machinery	40,000	
Provision for doubtful debts	50,000	
Goodwill Amortised	20,000	
Discount on issue of Debentures	10,000	
Interest on Debentures	21,000	
Less: Interest on Investments	(6,000)	
Operating profit before working capital changes		**3,15,000** (2)
Add: increase in current liabilities		
Trade payables	11,00,000	
Less: increase in Current Assets:		
Inventories	(1,85,000)	
Trade Payables	(11,00,000)	
Cash flow from Operating Activities		**1,30,000** (2)

Working notes:

Calculation of net profit before Tax and extraordinary items:

Surplus, ie., Balance in statement of profit and loss A/c (70,000 + 60,000) = 1,30,000

Add: Transfer to General Reserve = 50,000

1,80,000

Practice Question

	Note		

particulars	NO.	2022 (Rs)	2021 (Rs)
L EQUITY AND LIABILITIES			
l. Shareholders' Funds			
(a) Share Capital		7,00,000	6,00,000
(b)Reserves and Surplus (Balance statement of profit and loss)		2,00,000	1,10,000
2. Non-current Liabilities			
Long-term Borrowings		3,00,000	2,00,000
3. Current Liabilities			
Trade Payables		30,000	25,000
Total		12,30,000	9,35,000
11. ASSETS			
1. Non-current Assets			
Fixed Assets			
Tangible Assets		11,00,000	8,00,000
2. Current Assets			
(a) Inventories		70,000	60,000
(b) Trade Receivable		32,000	40,000
(c)Cash and Cash Equivalents		28,000	35,000
Total		12,30,000	9,35,000

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