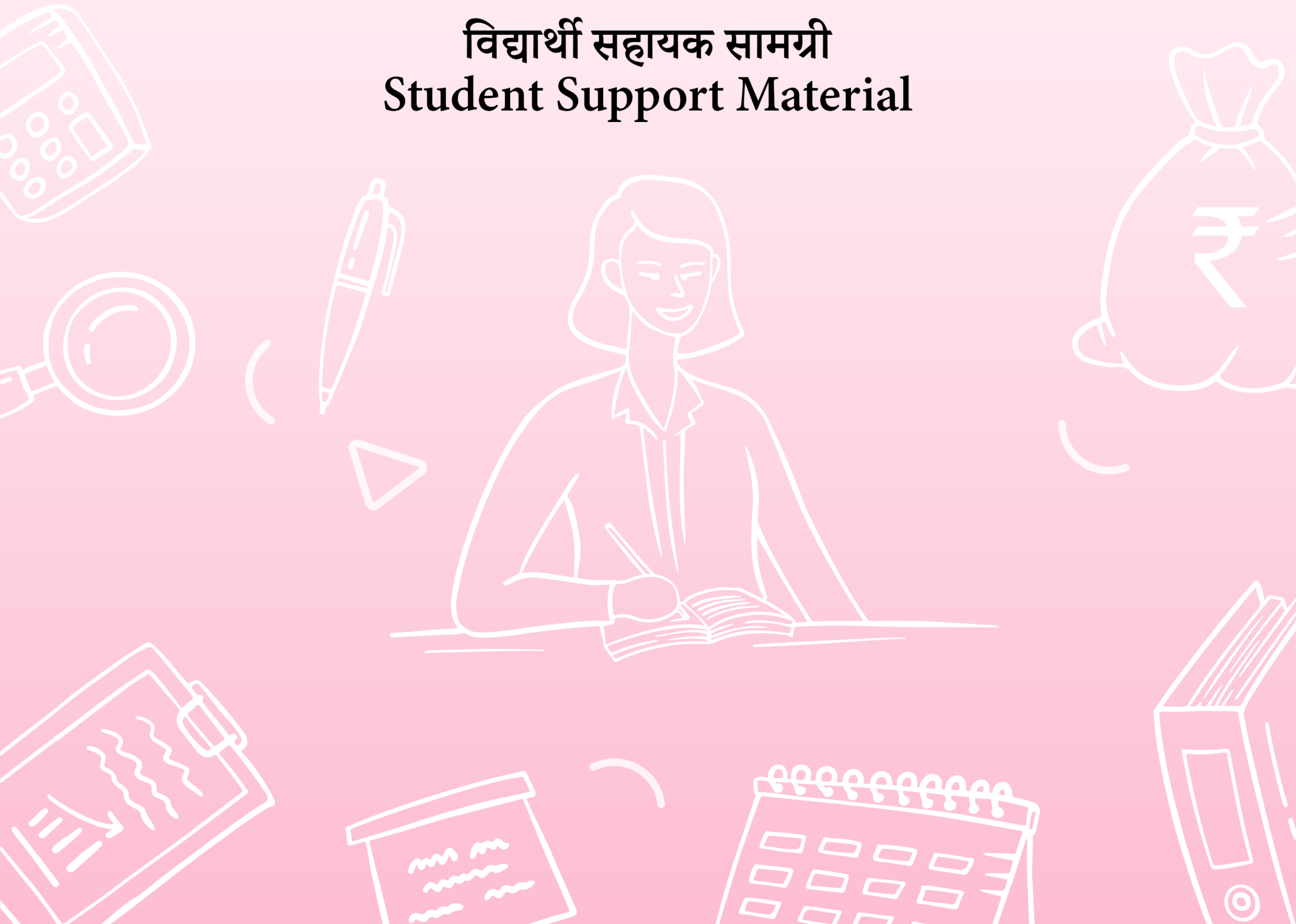
तत् त्वं पूषन् अपावृणु
केन्द्रीय विद्यालय संगठन

लेखाशास्त्र
Accountancy

कक्षा / Class XII
2025-26

विद्यार्थी सहायक सामग्री
Student Support Material



केन्द्रीय विद्यालय संगठन~Kendriya Vidyalaya Sangathan

संदेश

विद्यालयी शिक्षा में शैक्षिक उत्कृष्टता प्राप्त करना एवं नवाचार द्वारा उच्च - नवीन मानक स्थापित करना केन्द्रीय विद्यालय संगठन की नियमित कार्यप्रणाली का अविभाज्य अंग है। राष्ट्रीय शिक्षा नीति 2020 एवं पी. एम. श्री विद्यालयों के निर्देशों का पालन करते हुए गतिविधि आधारित पठन-पाठन, अनुभवजन्य शिक्षण एवं कौशल विकास को समाहित कर, अपने विद्यालयों को हमने ज्ञान एवं खोज की अद्‌भुत प्रयोगशाला बना दिया है। माध्यमिक स्तर तक पहुँच कर हमारे विद्यार्थी सैद्धांतिक समझ के साथ-साथ, रचनात्मक - विशेषणात्मक एवं आलोचनात्मक चिंतन भी विकसित कर लेते हैं। यही कारण है कि वह बोर्ड कक्षाओं के दौरान विभिन्न प्रकार के मूल्यांकनों के लिए सहजता से तैयार रहते हैं। उनकी इस यात्रा में हमारा सतत योगदान एवं सहयोग आवश्यक है - केन्द्रीय विद्यालय संगठन के पांचों आंचलिक शिक्षा एवं प्रशिक्षण संस्थान द्वारा संकलित यह विद्यार्थी सहायक- सामग्री इसी दिशा में एक आवश्यक कदम है । यह सहायक सामाग्री कक्षा 9 से 12 के विद्यार्थियों के लिए सभी महत्वपूर्ण विषयों पर तैयार की गयी है। केन्द्रीय विद्यालय संगठन की विद्यार्थी सहायक- सामग्री अपनी गुणवत्ता एवं परीक्षा संबंधी - सामग्री संकलन की विशेषज्ञता के लिए जानी जाती है और शिक्षा से जुड़े विभिन्न मंचों पर इसकी सराहना होती रही है। मुझे विश्वास है कि यह सहायक सामग्री विद्यार्थियों की सहयोगी बनकर निरंतर मार्गदर्शन करते हुए उन्हें सफलता के लक्ष्य तक पहुँचाएगी।

शुभाकांक्षा सहित ।

निधि पांडे

आयुक्त , केन्द्रीय विद्यालय संगठन

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CO-ORDINATOR

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COVER DESION

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EDITORS:

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ZIETs to add the names of teachers

S/No.	Name of the Teacher	Name of KV
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INDEX

SYLLABUS

ACCOUNTANCY (Code No. - 055) **Class-XII (2025-26)**

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

Project: 20 Marks

S.No.	Particulars	Periods	Marks
Part-A	**Accounting for Partnership Firm and Companies**		
	Unit-1: Accounting for Partnership Firm	**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 File		**12**
	Viva Voce		**8**
	OR		
Part-B	**Computerized Accounting**		
	Unit 4. Computerized Accounting	**50**	**20**
Part C	**Practical Work**	**20**	**20**
	Practical work will include:	`	
	Practical File		**12**
	Viva Voce		**8**

Part A: Accounting for Partnership Firms and Companies

Unit 1: Accounting for Partnership Firms

Units/Topics	Learning Outcomes
• Partnership: features, Partnership Deed. • Provisions of the Indian Partnership Act 1932 in the absence of partnership deed. • Fixed v/s fluctuating capital accounts. Preparation of Profit and Loss Appropriation account- division of profit among partners, guarantee of profits. • Past adjustments (relating to interest on capital, interest on drawing, salary and profit-sharing ratio). • Goodwill: meaning, nature, factors affecting and methods of valuation - average profit, super profit and capitalization. ***Note:*** *Interest on partner's loan is to be treated as a* *charge against profits.*	**After going through this Unit, the students will be able to:** • state the meaning of partnership, partnership firm and partnership deed. • describe the characteristic features of partnership and the contents of partnership deed. • discuss the significance of provision of Partnership Act in the absence of partnership deed. • differentiate between fixed and fluctuating capital, outline the process and develop the understanding and skill of preparation of Profit and Loss Appropriation Account. • develop the understanding and skill of preparation profit and loss

Goodwill: meaning, factors affecting, need for valuation, methods for calculation (average profits, super profits and capitalization), adjusted through partners capital/ current account. • accounts and preparation of capital, current account and balance sheet. • **Retirement and death of a partner:** effect of retirement / death of a partner on change in profit sharing ratio, treatment of goodwill (as per AS 26), treatment for revaluation of assets and reassessment of liabilities, adjustment of accumulated profits, losses and reserves, adjustment of capital accounts and preparation of capital, current account and balance sheet. Preparation of loan account of the retiring partner. • Calculation of deceased partner's share of profit till the date of death. Preparation of deceased partner's capital account and his executor's account. • **Dissolution of a partnership firm:** meaning of dissolution of partnership and partnership firm, types of dissolution of a firm. Settlement of accounts - preparation of realization account, and other related accounts: capital accounts of partners and cash/bank a/c (excluding piecemeal distribution, sale to a company and insolvency of partner(s)). **Note:** (i) If the realized value of tangible assets is not given it should be considered as realized at book value itself. (ii) If the realized value of intangible assets is not given it should be considered as nil (zero value). (ii) In case, the realization expenses are borne by a partner, clear indication should be given regarding the payment thereof. **Accounting for Partnership firms - Reconstitution and Dissolution.** • **Change in the Profit-Sharing Ratio** among the existing partners - sacrificing ratio, gaining ratio, accounting for revaluation of	appropriation account involving guarantee of profits. • develop the understanding and skill of making past adjustments. • state the meaning, nature and factors affecting goodwill • develop the understanding and skill of valuation of goodwill using different methods. • state the meaning of sacrificing ratio, gaining ratio and the change in profit sharing ratio among existing partners. • develop the understanding of accounting treatment of revaluation assets and reassessment of liabilities and treatment of reserves and accumulated profits by preparing revaluation account and balance sheet. • explain the effect of change in profit sharing ratio on admission of a new partner. • develop the understanding and skill of treatment of goodwill as per AS-26, treatment of revaluation of assets and re-assessment of liabilities, treatment of reserves and accumulated profits, adjustment of capital accounts and preparation of capital, current account and balance sheet of the new firm. • explain the effect of retirement / death of a partner on change in profit sharing ratio. • develop the understanding of accounting treatment of goodwill, revaluation of assets and re-assessment of liabilities and adjustment of accumulated profits, losses and reserves on retirement / death of a partner and capital adjustment.

assets and reassessment of liabilities and treatment of reserves, accumulated profits and losses. Preparation of revaluation account and balance sheet. • **Admission of a partner** - effect of admission of a partner on change in the profit-sharing ratio, treatment of goodwill (as per AS 26), treatment for revaluation of assets and re- assessment of liabilities, treatment of reserves, accumulated profits and losses,	• develop the skill of calculation of deceased partner's share till the time of his death and prepare deceased partner's and executor's account. • discuss the preparation of the capital accounts of the remaining partners and the balance sheet of the firm after retirement / death of a partner. • understand the situations under which a partnership firm can be dissolved. • develop the understanding of preparation of realization account and other related accounts.
Unit-2 Accounting for Companies	
Accounting for Share Capital • Features and types of companies. • Share and share capital: nature and types. • Accounting for share capital: issue and allotment of equity and preferences shares. Public subscription of shares - over subscription and under subscription of shares; issued at par and at premium, calls in advance and arrears (excluding interest), issue of shares for consideration other than cash. • Concept of Private Placement and Employee Stock Option Plan (ESOP), Sweat Equity. • Accounting treatment of forfeiture and re-issue of shares. • Disclosure of share capital in the Balance Sheet of a company. **Accounting for Debentures** • Debentures: Meaning, types, Issue of debentures at par, at a premium and at a discount. Issue of debentures for consideration other than cash; Issue of debentures with terms of redemption;	**After going through this Unit, the students will be able to:** • state the meaning of share and share capital and difference between Equity shares and Preference shares and different types of share capital. • understand the meaning of private placement of shares and Employee Stock Option Plan. • explain the accounting treatment of share capital transactions regarding issue of shares. • develop the understanding of accounting treatment of forfeiture and re-issue of forfeited shares. • describe the presentation of share capital in the balance sheet of the company as per schedule III part I of the Companies Act 2013. • explain the accounting treatment of different categories of transactions related to issue of debentures.

<table>
<tr><td>debentures as collateral security-concept, interest on debentures (concept of TDS is excluded). Writing off discount / loss on issue of debentures.

Note: Discount or loss on issue of debentures to be written off in the year debentures are allotted from Security Premium Reserve (if it exists) and then from Statement of Profit and Loss as Financial Cost (AS 16)</td><td>• develop the understanding and skill of writing of discount / loss on issue of debentures.
• understand the concept of collateral security and its presentation in balance sheet.
• develop the skill of calculating interest on debentures and its accounting treatment.
• state the meaning of redemption of debentures.</td></tr>
<tr><td colspan="2">Part B: Financial Statement Analysis
Unit 4: Analysis of Financial Statements</td></tr>
<tr><td>Financial statements of a Company:
Meaning, Nature, Uses and importance of financial Statement.
Statement of Profit and Loss and Balance Sheet in prescribed form with major headings and sub headings (as per Schedule III to the Companies Act, 2013)
Note: Exceptional items, extraordinary items and profit (loss) from discontinued operations are excluded.
• Financial Statement Analysis: Meaning, Significance Objectives, importance and limitations.
• Tools for Financial Statement Analysis: Comparative statements, common size statements, Ratio analysis, Cash flow analysis.
• Accounting Ratios: Meaning, Objectives, Advantages, classification and computation.
• Liquidity Ratios: Current ratio and Quick ratio.
• Solvency Ratios: Debt to Equity Ratio, Total Asset to Debt Ratio, Proprietary Ratio and Interest Coverage Ratio. Debt to Capital Employed Ratio.
• Activity Ratios: Inventory Turnover Ratio, Trade Receivables Turnover Ratio, Trade Payables Turnover Ratio, Fixed Asset Turnover Ratio, Net Asset Turnover Ratio and Working Capital Turnover Ratio.</td><td>After going through this Unit, the students will be able to:
• develop the understanding of major headings and sub-headings (as per Schedule III to the Companies Act 2013) of the balance sheet as
per the prescribed norms / formats.
• state the meaning, objectives and limitations of financial statement analysis.
• discuss the meaning of different tools of 'financial statements analysis'.
• develop the skill of preparation of preparation of comparative and common size statement, understand their uses and difference between the two.
• state the meaning, objectives and significance of different types of ratios.
• develop the understanding of computation of current ratio and quick ratio.
• develop the skill of computation of debt equity ratio, total asset to debt ratio, proprietary ratio and interest coverage ratio.
• develop the skill of computation of inventory turnover ratio, trade receivables and trade payables ratio</td></tr>
</table>

• **Profitability Ratios:** Gross Profit Ratio, Operating Ratio, Operating Profit Ratio, Net Profit Ratio and Return on Investment. **Note:** Net Profit Ratio is to be calculated on the basis of profit before and after tax.	and working capital turnover ratio and others. • develop the skill of computation of gross profit ratio, operating ratio, operating profit ratio, net profit ratio and return on investment.
Unit 5: Cash Flow Statement	
• Meaning, objectives Benefits, Cash and Cash Equivalents, Classification of Activities and preparation (as per AS 3 (Revised) (Indirect Method only) ***Note:*** ***(i)*** *Adjustments relating to depreciation and amortization, profit or loss on sale of assets including investments, dividend (both final and interim) and tax.* ***(ii)*** *Bank overdraft and cash credit to be treated as short term borrowings.* ***(iii)*** *Current Investments to be taken as Marketable securities unless otherwise specified.*	**After going through this Unit, the students will be able to:** • state the meaning and objectives of cash flow statement. • develop the understanding of preparation of Cash Flow Statement using indirect method as per AS 3 with given adjustments.

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

Project Work

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

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

OR

Part B: Computerised Accounting

Unit 4: Computerised Accounting

Overview of Computerised Accounting System

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

Accounting Application of Electronic Spreadsheet.

- Concept of electronic spreadsheet.
- Features offered by electronic spreadsheet.

• Application in generating accounting information - bank reconciliation statement; asset accounting; loan repayment of loan schedule, ratio analysis
• Data representation- graphs, charts and diagrams.

Using Computerized Accounting System.

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

Part C: Practical Work

Prescribed Books:

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

Suggested Question Paper Design
Accountancy (Subject Code 055)
Class XII (2025-26)

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

S N	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	32	40%
3	**Applying**: Solve problems to new situations by applying acquired knowledge, facts, techniques and rules in a different way.	24	30%
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.	24	30%
	TOTAL	**80**	**100%**

PART-I: Accounting for Partnership
Ch-01: Accounting for Partnership – BASIC CONCEPTS

Meaning: Partnership is an association between two or more persons who agree to do business and share its profits and losses.

Definition

According to **Section 4 of the Partnership Act 1932** "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all"

Features of partnership Firm

1) Association of two or more persons: There must be at least two persons and maximum of 50 persons to form a partnership and they must be competent to contract.
2) Partnership Agreement or Deed: There must be an agreement among partners to form a partnership. It can be written or oral.
3) Legal Business: The business of the partnership firm must be a legally allowed business.
4) Sharing of Profits or Losses: The partners must share profits or losses in a certain ratio.
5) Mutual Agency: The partners mutually take part in daily routine work or the work may be carried on by one or more partners on behalf of the other partners. Every partner is legally liable for the acts of all other partners, whether he is taking part in the activities of the firm or not.
6) Unlimited Liability: Partners' liability to the third parties is unlimited. If there are losses, and the firm is not able to pay its debts fully, then all the partners shall be jointly and severally liable to pay the debts of the firm to an unlimited extent.

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

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

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

(b) **Interest on Capital**: No interest on capital is payable if the partnership deed is silent on the issue.

(c) **Interest on Drawings**: No interest is to be charged on the drawings made by the partners, if there is no mention in the deed.

(d) **Interest on Advances**: If any partner has advanced some money to the firm beyond the amount of his capital for the purpose of business, he shall be titled to get an interest on the amount at the rate of 6% per annum.

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

Fixed and Fluctuating Capital Accounts of Partners

There are two methods by which the capital accounts of partners can be maintained. These are:

(i) Fixed capital method (ii) fluctuating capital method.

Fixed Capital Method: Under the fixed capital method, **the capitals of the partners shall remain fixed** unless additional capital is introduced or a part of the capital is withdrawn as per the agreement among the partners. All items like share of profit or loss, interest on capital, drawing interest on drawings, etc. are recorded in separate accounts, called Partner's Current Account. The partners' capital accounts will always show a credit balance, which shall remain the same (fixed) year after year unless there is any addition or withdrawal of capital.

The partners' current account on the other hand, may show a debit or a credit balance. Thus, under this method, two accounts are maintained for each partner viz., capital account and current account, While the partners' capital accounts shall always appear on the liabilities side in the balance sheet, the partners' current account's balance shall be shown on the liabilities side, if they have credit balance and on the assets side, if they have debit balance.

The partner's capital account and the current account under the fixed capital method would appear as shown below:

Dr. **Partner's Capital Account** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	To Bank A/c(permanent withdrawal of capital) To Balance c/d (closing balance)		xxx xxx		By Balance b/d (opening balance) By Bank A/c (fresh capital introduced)		xxx xxx
			xxx				xxx

Dr. **Partner's Current Account** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	To Drawings To Interest on drawings To Profit and Loss Appropriation A/c (for share of loss) To Balance c/d		xxx xxx xxx xxx xxx		By Balance b/d By Salaries/Commission By Interest on capital By Profit and Loss Appropriation A/c (for share of profit)		xxx xxx xxx xxx xxx
			xxx				xxx

Fluctuating Capital Method: Under the fluctuating capital method, only one account, i.e. capital account is maintained for each partner. All the adjustments such as share of profit and loss, interest on capital, drawings, interest on drawings, salary or commission to partners, etc. are recorded directly in the capital accounts of the partners. This makes the balance in the capital account to fluctuate from time to time. That's the reason why this method is called fluctuating capital method. **In the absence of any instruction, the capital account should be prepared by this method.** The proforma of capital accounts prepared under the fluctuating capital method is given below:-

Dr. **Partner's Capital Account** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	To Drawings		xxx		By Balance b/d		xxx
	To Bank (permanent withdrawal of capital)		xxx		By Bank (fresh capital introduced)		xxx
	To Interest on drawings		xxx		By Salaries/Commission		xxx
	To Profit and Loss Appropriation A/c (for share of loss)		xxx		By Interest on capital		xxx
	To Balance c/d		xxx		By Profit and Loss Appropriation A/c (for share of profit)		xxx
			xxxx				xxxx

Distribution of Profit among Partners

The profits and losses of the firm are distributed among the partners in an agreed ratio. However, if the partnership deed is silent, the firm's profits and losses are to be shared equally by all the partners.

You know that in the case of sole partnership the profit or loss, ascertained by the profit and loss account is transferred to the capital account of the proprietor. In case of partnership, however, certain adjustments such as interest on drawings, interest on capital, salary to partners, and commission to partners are required to be made. For this purpose, it is customary to prepare a Profit and Loss Appropriation Account of the firm and as certain the final figure of profit and loss to be distributed among the partners, in their profit-sharing ratio.

The Proforma of Profit and Loss Appropriation Account is given as follows:

Dr. **Profit and Loss Appropriation Account** **Cr.**

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Profit and Loss A/c (if there is loss)	xxx	By Profit and Loss A/c (if there is profit)	xxx
To Interest on Capital A/c	xxx	By Interest on Drawings	xxx
To Salary/Commission to Partner A/c	xxx	By Partners' Cap A/cs or Current A/cs (distribution of loss)	xxx
To General Reserve A/c			
To Partners' Cap A/cs or Current A/cs (Distribution of Profit)	xxx		
	xxxx		xxxx

***Note: Interest on partner's loan is to be treated as a charge against profits.**

Partner's Capital Account

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	To Drawings		xxx		By Balance b/d		xxx
	To Bank (permanent withdrawal of capital)		xxx		By Bank (fresh capital introduced)		xxx
	To Interest on drawings		xxx		By Salaries/Commission		xxx
	To Profit and Loss Appropriation A/c (for share of loss)		xxx		By Interest on capital		xxx
	To Balance c/d		xxx		By Profit and Loss Appropriation A/c (for share of profit)		xxx
			xxxx				xxxx

Distribution of Profit among Partners

The profits and losses of the firm are distributed among the partners in an agreed ratio. However, if the partnership deed is silent, the firm's profits and losses are to be shared equally by all the partners.

You know that in the case of sole partnership the profit or loss, ascertained by the profit and loss account is transferred to the capital account of the proprietor. In case of partnership, however, certain adjustments such as interest on drawings, interest on capital, salary to partners, and commission to partners are required to be made. For this purpose, it is customary to prepare a Profit and Loss Appropriation Account of the firm and as certain the final figure of profit and loss to be distributed among the partners, in their profit-sharing ratio.

The Proforma of Profit and Loss Appropriation Account is given as follows:

Calculation of interest of Drawings

TABLE SHOWING THE AVERAGE PERIOD WHEN WITHDRAWALS ARE MADE REGULARLY

	DATE OF WITHDRAWAL	AVERAGE PERIOD
1	Beginning of every month	(12+1)/2 = 6.5
	Middle of every month	(11.5+0.5)/2 = 6
	End of every month	(11+0)/2 = 5.5
2	Beginning of every quarter	(12+3)/2 = 7.5
	Middle of every quarter	(10.5+1.5)/2 = 6
	End of every quarter	(9+0)/2 = 4.5
3	Beginning of half year	(12+6)/2 = 9
	End of half year	(6+0)/2 = 3

Past Adjustments

If after closing the accounts for the year it is the discovered that some errors have been committed, then these errors have to be rectified. Some adjustment entries have to be passed to rectify the error. The entries are made through Profit & Adjustment A/c. These entries are to rectify the errors committed in past, therefore, they are known as 'Past Adjustments'. Generally, the following types of errors are committed:

(i) Interest on Capital and on Drawings have been omitted.

(ii) Interest on Capital and on Drawings have been provided at higher or lower rates than the rates agreed in the Deed.

(iii) Salary or commission to partners either not given or a higher or lower amount has been given.

(iv) Profit shared in a wrong ratio.

Guarantee of Profit to a Partner

Guarantee of profit means a minimum amount of profit to be paid to a partner. This amount shall be given to him if his share of profit is lower than the guaranteed amount. The deficit shall be borne either by one of the old partners or by all the old partners in a particular agreed ratio. If there is no agreement, then in their old profit-sharing ratio, if his actual share of profit is more than the guaranteed amount, then, he will be given his actual share of profit. He gets the guaranteed amount or the actual share of profit, **whichever is higher.**

(a) Guarantee given by all partners

Compare the amount of guarantee and his actual share of profit. If guaranteed amount

(i) is more than his actual share of profit, then the guaranteed amount will be debited to profit and loss Appropriation Account and the partner's account will be credited with the guaranteed amount.

(ii) The deficiency shall be shared by other partners in their profit-sharing ratio.

(b) Guarantee given by One Partner only

First calculate his share of profit. Compare it with the guaranteed amount. The amount of deficiency is to be charged from the partner who gave guarantee.

(c) Guarantee given to a partner by other partners in a ratio different from their profit-sharing ratio

Distribute profit among all the partners in the profit-sharing ratio. Work out the amount of deficiency by comparing it with the guaranteed amount and his actual share of profit. The other partners will bear the deficiency in an agreed new ratio.

MCQ (For test your knowledge go to google form link)

FUNDAMENTAL-1 TEST LINK: https://forms.gle/T3Bbie2EsV4Nct6i6

FUNDAMENTAL-2 TEST LINK: https://forms.gle/bMNC3EFjHMS9BxEe6

FUNDAMENTAL -3 TEST LINK: https://forms.gle/giiGzoE5AQnZBi3A9

Ch - 02: Reconstitution of a Partnership Firm –

Change in Profit-Sharing Ratio and Valuation of Goodwill

GOODWILL

Meaning of Goodwill

Over a period of time, a well - established business develops an advantage of good name, reputation and wide business connections. This helps the business to earn more profits as compared to a newly setup business. In accounting, the monetary value of such advantage is known as “goodwill”.

Definition: Goodwill is an intangible asset that represents the value of a firm's reputation, brand, customer relations, and other non-physical assets that contribute to earning potential. It is often considered when calculating the value of a business during acquisitions or mergers.

Factors Affecting the Value of Goodwill

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

1. Nature of business: A firm that produces high value-added products or having as table demand disable to earn more profits and therefore has more goodwill.
2. Location: If the business is centrally located or is at a place having heavy customer traffic, the goodwill tends to be high.
3. Efficiency of management: A well-managed concern usually enjoys the advantage of high productivity and cost efficiency. This leads to higher profits and so the value of good will also be high.
4. Market situation: The monopoly condition or limited competition enables the concerned to earn high profits which leads to higher value of goodwill.
5. Special advantages: The firm that enjoys special advantages like import licenses, low rate and assured supply of electricity, long-term contracts for supply of materials, well-known collaborators, patents, trademarks etc. enjoy higher value of goodwill.

Need for Valuation of Goodwill

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

1. Change in the profit-sharing ratio amongst the existing partners;
2. Admission of new partner;
3. Retirement of a partner;
4. Death of a partner; and
5. Dissolution of a firm involving sale of business as a going concern.
6. Amalgamation of partnership firm

Methods of Valuation of Goodwill

1. Average Profits Method

(a) Simple Average

Stepwise procedure to calculate Goodwill under this method:

Step1: Work out profits or losses given for each of the past year after taking into account abnormalities, if any.

Step2: Calculate average by dividing the total profit of all the years by the number of years.

Step3: Goodwill= Average Profit x Number of year's purchase.

(b) Weighted Average

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

Then Goodwill = Weighted average x number of years' purchase

2. Super Profit Method

Stepwise procedure to calculate Goodwill under this method:

Calculate the average profit,

1. Calculate the normal profit on the capital employed on the basis of the normal rate of return, Formula = Normal Profit = Capital Employed x NRR /100
2. Calculate the super profits by deducting normal profit from the average profits, Formula- Super Profit = Average Profit - Normal Profit
3. Goodwill = Super profits x number of years' purchase.

3. Capitalisation Method

Under this method the goodwill can be calculated in two ways: (a) by capitalizing the average profits, or (b) by capitalizing the super profits.

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

(i) As certain the average profits based on the past few years' performance.

(ii) Capitalize the average profits on the basis of the normal rate of return to ascertain the capitalised value of average profits as follows:

Average Profits x 100/Normal rate of Return

(iii) As certain the actual capital employed (net assets) by deducting outside liabilities from the total assets (excluding goodwill).

Capital Employed/Net Assets = Total Assets (excluding goodwill) – Outside Liabilities

(iv) Compute the value of goodwill by deducting net assets from the capitalised value of average profits, i.e. (ii)–(iii).

Capitalisation of Super Profits: It involves the following steps.

(i) Calculate capital employed of the firm, which is equal to total assets minus outside liabilities.

(ii) Calculate normal profit = Capital Employed X Normal Rate of Return/100

(iii) Calculate average profit for past years, as specified.

(iv) Super profits = average profits/Actual profit - normal profits

(v) Goodwill = Super Profits × 100/ Normal Rate of Return

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

PRACTICAL PROBLEMS:

Q-1: Asha and Babita were partners in a firm. Their capitals were ₹ 15,00,000 and ₹ 10,00,000 respectively. The normal rate of return was 15%. The profits of the last four years were :

2019 – 20…….. ₹2,50,000
2020 – 21………..₹ (50,000)
2021 – 22 ………..₹ 8,00,000
2022 – 23……………₹5,00,000
The closing stock for the year 2022 – 23 was undervalued by ₹ 1,00,000. Goodwill is to be valued at two years purchase of the last four years' average super profits. Calculate the value of Goodwill. (CBSE-2024)

(ANSWER--- GOODWILL ₹50,000)

Q-2: Jatin, Keshav and Lalit were partners in a firm with fixed capitals of ₹ 1,20,000, ₹ 1,00,000 and ₹ 80,000 respectively. As per the partnership deed, there was a provision for allowing interest on capitals @ 10% p.a.,

but entries for the same had not been made for the last two years.

The profit sharing ratio during the last two years was as follows :

Year	Jatin	Keshav	Lalit
2021 – 22	5	3	2
2022 – 23	1	1	1

Pass an adjustment entry of the beginning of the third year, i.e., on 1st April, 2023. (CBSE-2024)

(ANSWER--- JATIN'S CURRENT ACCOUNT Dr. 1000

TO KESHAV'S CURRENT ACCOUNT 1000)

Q-3: Meera, Neena and Ojas were partners in a firm sharing profits and losses in the ratio of 5 : 3 : 2. The partnership deed provided for charging interest on drawings @ 10% p.a. The drawings of Meera, Neena and Ojas during the year ended 31st March, 2023 amounted to ₹ 60,000, ₹ 50,000 and ₹ 40,000 respectively. After the final accounts had been prepared, it was discovered that interest on drawings had not been taking into consideration.

Pass the necessary adjustment entry. (CBSE-2024)

(ANSWER---- NEENA'S CAPITAL ACCOUNT Dr. 250
OJAS'S CAPITAL ACCOUNT Dr. 500
TO MEERA'S CAPITAL ACCOUNT 750)

Q-4: On 01.04.2022, Ravi, Kavi and Avi started a partnership firm with fixed capitals of ₹ 6,00,000, ₹ 6,00,000 and ₹ 3,00,000 respectively. The partnership deed provided for the following :

(i) Interest on capital @ 10% per annum.
(ii) Interest on drawings @ 12% per annum.
(iii) An annual salary of ₹ 1,20,000 to Avi.
(iv) Profits and losses were to be shared in the ratio of their capitals.
The net profit of the firm for the year ended 31.03.2023 was ₹ 3,08,000. Interest on partner's drawings was Ravi
₹ 4,800, Kavi ₹ 4,200 and Avi ₹ 3,000.

Prepare Profit and Loss Appropriation Account of Ravi, Kavi and Avi for the year ended 31.03.2023. (CBSE-2023)
(ANSWER---- DIVISIBLE PROFIT 50,000 ₹)

Q-5: P and Q were partners in a firm sharing profits and losses in the ratio of 2 : 1. On 01.04.2022, they admitted R as a new partner for 1/10th share of profits with a guaranteed minimum of ₹ 50,000. P and Q continued to

share profits as before but agreed to share any deficiency on account of guarantee to R in the ratio of 3 : 2. The net profit of the firm for the year ended 31.03.2023 was ₹ 3,00,000.

Pass necessary journal entries in the books of P and Q for the above transactions. (CBSE-2023)
(ANSWER--- Profit & Loss Appropriation A/c Dr. 3,00,000

To P's Capital A/c	1,68,000
To Q's Capital A/c	82,000
To R's Capital A/c	50,000

Q-6: Sharma and Verma were partners in a firm sharing profits and losses in the ratio of 3 : 2. Their fixed capitals were ₹ 14,00,000 and ₹ 10,00,000 respectively. The partnership deed provided for the following :

(i) Interest on capital @ 10% per annum.
(ii) Interest on drawings @ 12% per annum.
During the year ended 31.03.2023, Sharma withdrew ₹ 2,00,000 and Verma withdrew ₹ 1,00,000. After preparing the accounts for the year ended 31.03.2023, it was realised that interest on capital was not allowed and interest on drawings was not charged.
Showing your working notes clearly pass necessary journal entries in the books of the firm to rectify the above error. (CBSE-2023)
(ANSWER---- SHARMA'S CURRENT ACCOUNT Dr. 5200
TO VERMA'S CURRENT ACCOUNT 5200

Q-7: Yadu, Vidu and Radhu were partners in a firm sharing profits in the ratio of 4 : 3 : 3. Their fixed capitals on 1st April, 2018 were ₹ 9,00,000, ₹ 5,00,000 and ₹ 4,00,000 respectively. On 1st November, 2018, Yadu gave a loan of ₹ 80,000 to the firm. As per the partnership agreement:

(i) The partners were entitled to an interest on capital @ 6% p.a.

(ii) Interest on partners' drawings was to be charged @ 8% p.a.

The firm earned profits of ₹ 2,53,000 (after interest on Yadu's loan) during the year 2018-19. Partners' drawings for the year amounted to Yadu : ₹ 80,000, Vidu : ₹ 70,000 and Radhu : ₹ 50,000.

Prepare Profit and Loss Appropriation Account for the year ending 31st March, 2019. (CBSE-2020)

(ANSWER---- PROFIT Yadu's current A/c 61,200 Vidu's current A/c 45,900 Radhu's current A/c 45,900)

Q-8: Hari and Krishan were partners sharing profits and losses in the ratio of 2 : 1. They admitted Shyam as a partner for 1/5th share in the profits. For this purpose, the Goodwill of the firm was to be valued on the

basis of three years' purchase of last five years average profits. The profits for the last five years were:

Year 2013 – 14 2014 – 15 2015 – 16 2016 – 17 2017 – 18

Profit (₹) 50,000 40,000 75,000 (25,000) 50,000

Calculate Goodwill of the firm after adjusting the following: The profit of 2014 – 15 was calculated after charging ₹ 10,000 for abnormal loss of goods by fire. (CBSE-2019)

(ANSWER---- VALUE OF GOODWILL ₹1,20,000)

Q-9: Sunil & Anil are partners sharing profit in the ratio 3:2. They admit Deepak into partnership. It was agreed to value goodwill at three years purchase on the basis of average profit of the past five years. The Profits for these 5 years were Year Ended Profit (`) 31st March 2015 1,80,000 31st March 2016 1,60,000 31st March 2017 2,50,000 31st March 2018 3,00,000 31st March 2019 3,50,000 Following additional Information is given: (i) An abnormal gain of ` 20,000 was earned in the year ended 31st March, 2016. (ii) Expenses of ` 50,000 incurred to overhaul a machine on 1st April, 2017 was debited to P&L A/c instead of being debited to Machinery Account. Depreciation is charged on machinery @ 20 % on Written Down Value Method. (iii) The closing stock for the year ended 31st March, 2018 was undervalued by ` 20,000. Calculate the value of goodwill.

Solution:

Calculation of Adjusted Profit

Year Ended	Profit (`)	Adjustment (`)	Normal Profit (`)
31st March, 2015	180000	-----	180000
31st March, 2016	160000	(20000)	140000
31st March, 2017	250000	--------	250000
31st March, 2018	300000	50000+(10000)+20000	360000
31st March, 2019	350000	(8000)+(20000)	322000
		TOTAL	**1252000**

Calculation of Goodwill:

Average Profit = Total Normal Profit No. of years = ` (180, 000 + 1,40000 + 250,000 + 3,60,000+ 3,22,000) = ` 2,50,400 5

Value of Goodwill = Average Profit x No. of years' Purchase Value of Goodwill = ` 2,50,400 x 3 = ` 7,51,200

Q-10: Average profit earned by a firm is ` 75,000 which includes undervaluation of stock of ` 5000 on average basis. The capital invested in the business is ` 8,00,000 & the normal rate of return is 8 %. Calculate goodwill of the firm on the basis of 5 times the Super Profit.

Solution:

Average Adjusted Profit = Average Profit + Undervaluation of Stock = ` 75000 + ` 5000 = ` 80,000 Normal Profit = Capital Employed x Normal Rate of Return /100 = ` (8,00,000 x 8/100) = ` 64,000 Super Profit = Adjusted Average Profit - Normal Profit = ` (80,000 – 64,000) = ` 16000

Value of Goodwill = ` 16000 × 5 = ` 80,000

Q-11: Bharat and Bhusan are partners in a retail business. Balances in their Capital & Current Accounts as on 31st March, 2019 were as follows:

	Capital Account (`)	Current Account (`)
Bharat	4,00,000	4,80,000
Bhusan	1,00,000	20,000 (Dr)

The firm earned an average profit of ` 97,000. If the normal rate of return is 8 %, find the value of goodwill.

Solution:

Capital Employed = ` (400,000 + 4,80, 000 + 10,00,00 - 20,000) = ` 9,60,000
Capitalized value of the business = Average Profit x Normal Rate of Return/100 = ` 97,000 x 8/100 = ` 12,12,500
Value of Goodwill = ` 12,12,500 - ` 9,60,000 = ` 2,52,500

CHANGE IN PROFIT SHARING RATIO

Reconstitution of firm: Any change in existing agreement among partners amount to reconstitution of the firm this result in the end of an existing agreement and a new agreement comes into existence however the firm continues

Concept of Change in the Profit Sharing Ratio among existing partners: i. It means reconstitution of the firm whereby the profit-sharing ratio among all the partners changes. ii. It can be due to change in capital contribution or increased participation in management by one or more partners. iii. It can also be on account of one or more partner(s) acquiring share of profit in the business from another partner(s). Therefore, the aggregate amount of gain of one (or more) partner(s) is equal to the aggregate amount loss/sacrifice borne by other partner(s). iv. Therefore, if the share of one (or more) partner(s) increases then share of profit of one (or more) partner(s) decreases. v. It leads to dissolution of partnership but not the dissolution of the firm. This is because the existing partnership agreement ends and the new agreement comes into effect.

Adjustment for Change in Profit Sharing Ratio: Issues that need to be considered at the time of change in Profit Sharing Ratio: i. Determining Sacrificing and Gaining ratio, ii. Treatment for Goodwill, iii. Accounting treatment for Reserves and Accumulated Profit or losses, iv. Revaluation of Assets and Reassessment of Liabilities, and v. Adjusting the capital accounts of the partners for the same.

Computation of Sacrificing and Gaining Ratio: The prime purpose of computing the sacrificing and gaining ratio is to determine the amount of compensation (goodwill) that the gaining partner shall pay to the sacrificing part

Computation of Sacrificing Ratio: Sacrificed Share = Old Share – New Share

Computation of Gaining Ratio: Gaining Share = New Share – Old Share

EFFECT ON ACCUMULATED RESERVE AND SURPLUS: - in case of reconstitution of firm old accumulated reserves and surplus are distributed among partners in their old ratio.

A) In case of distribution of accumulated profits/reserves etc.

Reserve A/C Dr.

TO Partner's cap/current A/c (individually)

In case of loss will be reserved entry

B) in case partners don't want share distributer

Gaining partners' capital/current A/c Dr.

To Sacrificing partners' capital/current A/c

WORKMEN	WORKMEN COMP CLAIM	JOURNAL ENTRY RESERVE
1. No claim	Distribute all partners in reserve A/c dr.	Workmen compensation To partner's capital A/c

2. Claim less than WCR	Transfer the amount of claim to claim A/c Distribute the balance partners in their old PSR	Workmen compensation reserve A/c To provision for compensation claim A/C TO partner's capital A/c
3. Claim is equal to WCR	Transfer the whole of WCR to claim A/c	Workmen compensation reserve A/c Dr. To provision for workmen compensation claim A/C
4. Claim is more than WCR to claim	Transfer the whole of	i) Workmen compensation reserve A/c Dr.
	• Difference will be Dr. to revaluation A/c • Revaluation loss will be distributed to partners	Revaluation A/c Dr. To provision for workmen compensation claim A/C ii) partners capital A/c Dr. To Revaluation A/c

<u>Treatment of revaluation of assets and liabilities</u>:

<u>Journal entries</u>

1. **Increase in the value of an asset:**

Date	Particulars	L.F.	Amount (Dr.)	Amount (Cr.)
	Assets A/c Dr. To Revaluation A/c (Being the value of an asset increased)		XXXX	 XXXX

2. Decrease in the value of an asset:

Date	Particulars	L.F.	Amount (Dr.)	Amount (Cr.)
	Revaluation A/c Dr. To Asset A/c (Being the value of the asset decreased)		XXXX	 XXXX

3. Increase in the value of a liability:

Date	Particulars		L.F.	Amount (Dr.)	Amount (Cr.)
	Revaluation A/c	Dr.		XXXX	
	To Liability A/c				XXXX
	(Being the value of a liability increased)				

4. Decrease in the value of a liability:

Date	Particulars		L.F.	Amount (Dr.)	Amount (Cr.)
	Liability A/c	Dr.		XXXX	
	To Revaluation A/c				XXXX
	(Being the value of a liability decreased)				

5. Recording Unrecorded assets:

Date	Particulars		L.F.	Amount (Dr.)	Amount (Cr.)
	Unrecorded Asset A/c	Dr.		XXXX	
	To Revaluation A/c				XXXX
	(Being unrecorded asset recorded)				

6. Recording Unrecorded Liability:

Date	Particulars		L.F.	Amount (Dr.)	Amount (Cr.)
	Revaluation A/c	Dr.		XXXX	
	To Unrecorded Liability A/c				XXXX
	(Being unrecorded liability recorded)				

7. Transferring the balance of the Revaluation Account:

(a) In case of Profit:

Date	Particulars		L.F.	Amount (Dr.)	Amount (Cr.)
	Revaluation A/c	Dr.		XXXX	
	To Partner's Capital/Current A/c				XXXX
	(Being profit distributed in old profit-sharing ratio)				

(b) In case of Loss:

Date	Particulars		L.F.	Amount (Dr.)	Amount (Cr.)
	Partner's Capital/Current A/c	Dr.		XXXX	
	To Revaluation A/c				XXXX
	(Being Loss Transferred in old profit-sharing ratio)				

QUESTTION

Q1. A, B and C were partners in a firm sharing profits in 3:3:2 ratio. They admitted D as a new partner for 4/7 profit. D acquired his share 2/7 from A, 1/7 from B and 1/7 from C. Calculate new profit-sharing ratio.

Q2. Read the following hypothetical text and answer the given questions: A, B and C are partners in a firm sharing profits in the ratio of 2:1:1. D is admitted into the firm for 1/4th share in profits, which he gets as 1/8th from A and 1/8th from B. The total capital of the firm is agreed upon as ₹1,20,000 and D is to bring in cash equivalent to 1/4th of this amount as his capital. The capitals of other partners are also to be adjusted in the ratio of their respective shares in profits. The capitals of A, B and C after all adjustments are ₹40,000, ₹ 35,000 and 30,000 respectively.

a) What will be the new profit sharing ratio?

b) What is the amount of D's capital?

c) What amount will be brought or withdrawn by A for the adjustment of his capital?

Q3. B and S are partners in a firm, sharing profits and losses in the ratio of 3:2. On 31st March, 2018 their Balance Sheet was as under:

Balance Sheet as at 31st March 2018

Liabilities	Amt (₹)	Assets	Amt(₹)
Sundry creditors	13,800	Furniture	16,000
General Reserve	23,400	Land & Building	56,000
Invst.Fluct. Fund	20,000	Investment	30,000
B's capital	50,000	Trade receivables	18,500
S's capital	40,000	Cash in hand	26,700
	1,47,200		1,47,200

The partners have decided to change their profit-sharing ratio to 1:1 with immediate effect. For this purpose, they decided that:

a) Investments to be valued at ₹ 20,000

b) Goodwill of the firm valued at ₹ 24,000

c) General reserve not to be distributed between the partners.

You are required to pass necessary journal entries in the books of the firm. Show workings.

Q4 B and N are partners in a firm carrying on a tiffin services in Hyderabad. B noticed that a lot of food is left at the end of the day. To avoid wastage, she suggested that it can be distributed to the needy. N gave a proposal that if his share in the profit increased, he will not mind free distribution of left-over food. B happily agreed. So, they decided to change their profit-sharing ratio 1:2 with immediate effect.

On that date the book of the firm shows the following balances:

General reserve ₹45,000 Profit & Loss A/c ₹ 6,000 (Dr)

Workmen compensation fund ₹ 14,000

On the above date the firm was reconstituted and it was decided that:

a) The plant was reduced by ₹4,000.

b) Goodwill of the firm was valued at ₹ 90,000.

c) The claim for workmen compensation has been estimated at ₹ 6,000.

Based on the above information you are required to answer the following question.

a) Pass journal entry for General reserve, if partners decided not to distribute it.

b) For Goodwill, B's capital account will be debited with ………………

c) Revaluation account is credited by ₹ 4,000 for reduction in value of plant (True or False)

d) Workmen compensation fund of ……………. was distributed between B and N in their ………….

<u>ANSWERS</u>

ANSWER1: New profit sharing ratio of the existing partner =old share- share sacrificed A's new share=3/8-2/7 =5/56 B's new share = 3/8-1/7 =13/56, C,s new share =2/8-1/7=6/56 Therefore new profit sharing ratio of A,B,C and D =5:13:6:32

ANSWER2: a) A's new share =2/4-1/8 =3/8

B's new share = 1/4-1/8 =1/8

C's new share = 1/4x2/2 =2/8 D's new share =1/4x 2/2 = 2/8

new profit-sharing ratio = 3:1:2:2

b) D's capital =1, 20,000x1/4= ₹30,000

c) A, s new capital= 1, 20,000x3/8= ₹45,000

Amount to be brought by A =45,000-40,000=₹5000

ANSWER3:

DATE	PARTICULAR	L.F.	AMT (₹)	Amt(₹)
2018 March 31	Investment Fluct. fund A/c Dr To investment A/c To B's capital A/c To S's capital A/c (Being investment Fluctuation Fund adjusted against the fluctuation in market value and balance distributed amongst partners)		20000	 10000 6000 4000
March 31	S's capital A/c Dr. To B's capital A/c (Being adjustment of goodwill made between partners due to change in PSR)		2400	 2400
March 31	S's capital A/c Dr. To B's capital A/c (Being general reserve adjusted among the partners without writing off)		2340	 2340

Working Note:

Sacrificing ratio = Old ratio – New ratio

B's = 3/5-1/2 = 1/10 sacrifice

S's = 2/5-1/2 = (1/10) gain

ANSWER4:

a) Dr. B's capital A/c by ₹ 7,500 and Cr. N's capital A/c by ₹ 7,500

b) ₹ 15,000

c) False, Revaluation account was debited by ₹ 4,000

d) ₹ 8,000, old ratio

Ch - 03: Reconstitution of a Partnership Firm –

Admission of a Partner

Admission of a partner means a new member is admitted to the firm along with capital, and the new partner will bring a premium for goodwill.

The new partner acquires the right:

- **Right to share the profits /losses** (to get this right, the new partner brings a premium for goodwill)
- **Right to share the assets (**to get this right, the new partner brings an amount of capital)

The old partners sacrifice their share of profits in favour of a new partner and get the amount of the premium of goodwill.
Goodwill is an intangible asset, is recognised in the books only if it is purchased goodwill. It is written off by debiting old partners' capital/current accounts in their old profit-sharing ratio.
Self-generated goodwill is adjusted through partners' capital/current accounts.

The Following Adjustments are needed at the time of admission of a New Partner:

1. Calculation of New Profit-Sharing Ratio & Sacrificing Ratio
2. Accounting treatment of Goodwill
3. Accounting treatment for revaluation of assets and reassessment of liabilities.
4. Accounting treatment of reserves and accumulated profits
5. Accounting treatment of Deferred Revenue Expenditure (Advertisement expenses)
6. Adjustment of Partners' Capital on the basis of new profit sharing ratio.

➢ **Calculation of New Profit-Sharing Ratio**

When a new partner is admitted, he acquires his share of profits from the old partners. In other words, on the admission of a new partner, the Old Partners Sacrifice share of their profit in favour of the new partner.
However, if nothing is specified as to how the new partner acquires his share from the old partners, it may be assumed that he gets it from them in their old profit-sharing 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 the sacrificing ratio.

Sacrifice by a Partner = Old Share of Profit - New Share of Profit

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

Rohit's sacrifice = 5/8 - 4/7 = 3/56
Mohit's sacrifice = 3/8 - 2/7 = 5/56

Thus, the sacrificing ratio between Rohit and Mohit will be 3:5.

❖ If nothing is specified as to how does the new partner acquires his share from the old partners, it may be assumed that he gets it from them in their old profit-sharing ratio (i.e., sacrificing ratio = old profit-sharing ratio).

CASE I
The 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.

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

Sumit's share = 1/5. Therefore, the combined share of Anil and Vishal = 1 - 1/5 = 4/5.
Anil's new share = 3/5 * 4 / 5 = 12/25
Vishal's new share = 2/5 * 4 / 5 = 8/25
New profit sharing ratio of Anil, Vishal and Sumit = 12/25 : 8 / 25: 1/ 5 = 12:8:5

CASE II
The old profit sharing ratio, share of the new partner and the new ratio between old partners are given.

EXAMPLE
Amar and Bahadur are partners in a firm sharing profits in the ratio of 3:2. They admitted Mary as a new partner for a 1/4 share. The new profit-sharing ratio between Amar and Bahadur will be 2:1.

Mary’s share=1/4.
Therefore, the 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 = 2/3 * 3 / 4 = 6/12
Bahadur's new share = 1/3 * 3 / 4 = 3/12
Therefore, the new profit sharing ratio of Amar, Bahadur and Mary = 6/12: 3/12: 1/4 = 2:1:1.

Calculation of Sacrificing Ratio: Old ratio - New ratio
Amar's sacrifice = 3/5 - 2/4 = 2/20
Bahadur's sacrifice = 2/5 - 1/4 = 3/20.
Therefore, the sacrificing ratio between Amar and Bahadur = 2:3

CASE III
Old partners' old profit sharing ratio, new partner's share and sacrificing ratio are given

EXAMPLE
Akshay and Bharti are partners sharing profits in the ratio of 3:2. They admit Dinesh as a new partner for a 1/5th share in the future profits of the firm, which he gets equally from Akshay and Bharti.
Sacrificing ratio of Akshay and Bharti = 1:1
Therefore, Akshay's sacrifice = Bharti's sacrifice =1/2 * 1 / 5 = 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, the new profit sharing ratio between Akshay, Bharti and Dinesh = 5/10: 3/10: 1/5 =5:3:2

CASE IV
Old partners' old profit sharing ratio, new partner's share and old partners' absolute sacrificing

share are given

EXAMPLE
Anshu and Nitu are partners sharing profits in the ratio of 3:2. They admitted Jyoti as a new partner for a 3/10 share, which she acquired 2/10 from Anshu and 1/10 from Nitu.

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, the new profit sharing ratio between Anshu, Nitu and Jyoti = 4/10: 3/10: 3/10 =4:3:3

CASE V

Old partners' old profit sharing ratio and their relative sacrificing share are given.

EXAMPLE
PLE 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 1/4 of his share and Shyam 1/3 of his share in favour of Ghanshyam.

Share surrendered by Ram (Ram's sacrificing share) = 1/4 * 3 / 5 = 3/20
Shyam's sacrificing share = 1/3 * 2 / 5 = 2/15
Therefore, the Sacrificing Ratio of Ram and Shyam = 3/20: 2/15 = 9:8
Calculation of new profit-sharing ratio:
New share of a 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 sacrifice 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

Absolute and Relative sacrificing share
If A and B are partners, who share profits and losses in the ratio 3:2, admitted C is admitted as a partner.

- A sacrifices 1/4 from his share, which means that 1/4 is the absolute sacrificing share of A. Therefore, A's sacrifice=1/4
- A sacrifices 1/4 of his share means that ¼ is not the absolute sacrificing share of A, but the relative sacrificing share i.e, A’s sacrifice = ¼ * 3/5 = 3/20. Thus 3/20 is A’s absolute sacrificing share

EXAMPLE
Ramesh and Suresh are partners in a firm sharing profits in the ratio of 4:3. They admitted Mohan as a new partner. The profit sharing ratio of Ramesh, Suresh and Mohan will be 2:3:1

Ramesh's sacrifice = old share - new share = 4/7-2/6 = 10/42
Suresh's sacrifice = old share - new share = 3/7-3/6 = -3/42 (gain)

Thus, Suresh gains 3/42th share of profit on Mohan's admission. So, he will also compensate an amount equal to "Goodwill of the firm x 3/42" to Ramesh.

(Ramesh's sacrifice = Suresh's gain + Mohan's share (gain) = 3/42 + 1/6 = 10/42. In this case, the whole sacrifice is by Ramesh.)

- **<u>Accounting treatment of Goodwill</u>**

Case 1:	**When a premium for goodwill is paid privately by a new partner** No entry
Case 2:	**When a premium for goodwill is brought in business by a new partner and retained in the business**, Cash/Bank A/c Dr. To Premium for Goodwill A/c Premium for Goodwill A/c Dr. To sacrificing Partner's Capital/Current A/cs (Premium distributed among the sacrificing partners in their sacrificing ratio)
Case 3:	**When a premium for goodwill is brought in kind**, Assets A/c Dr. To Premium for Goodwill A/c To New Partner's Capital A/c Premium for Goodwill A/c Dr. To Sacrificing Partner's Capital/Current A/c
Case 4:	**If the sacrificing partners withdraw their amounts of goodwill (in full or in part), the following additional entry will be passed <u>in addition to Case 2</u>:** Sacrificing Partner's Capital/Current A/c Dr. To Cash/Bank A/c
Case 5:	**When the new partner is unable to bring his share of the premium for goodwill in cash,** New Partner's Current A/c Dr. To Sacrificing Partner's Capital/Current A/c

SITUATION:
When goodwill <u>already exists</u> <u>in the books of the firm</u>, it is written off at the time of admission of a partner by debiting the old partner's capital account in the old profit sharing ratio.

Old Partner's Current/capital A/c Dr.
To Goodwill A/c
(Existing goodwill written off in old ratio)

When a new partner brings cash and assets for his capital, the entry will be
Cash/ Bank A/c Dr.
Assets A/c Dr.
To new partners' capital A/c

- **<u>Accounting treatment for revaluation of assets and reassessment of liabilities</u>**

At the time of admission of a partner, assets are revalued, and liabilities are re-assessed. The change in value of assets and liabilities is adjusted through an account titled **Revaluation Account.**

Profit/Loss of revaluation account is transferred to old partners' capital accounts in their old profit-sharing ratio.

The journal entries passed on revaluation of assets and reassessment of liabilities are:

1.	For an increase in the value of assets	Assets A/c (Individually) ...Dr. To Revaluation A/c
2.	For a decrease in the value of assets	Revaluation A/c Dr. To Assets A/c (Individually)
3.	For an increase in the amount of liabilities	Revaluation A/c Dr. To Liabilities A/c (Individually)
4.	For a decrease in the amount of liabilities	Liabilities A/c (Individually) Dr. To Revaluation A/c
5.	For accounting Unrecorded Assets	Unrecorded Assets A/c (Individually) Dr. To Revaluation A/c
6.	For accounting Unrecorded Liabilities	Revaluation A/c Dr. To Unrecorded Liabilities A/c (Individually)
7.	For transfer profit on revaluation (if credit balance)	Revaluation A/c Dr. To old partners' capital/current A/c (in their old ratio)
8.	For transfer loss on revaluation	old partners' capital/current A/c Dr. To Revaluation A/c (in their old ratio)

Dr. REVALUATION ACCOUNT Cr.

Particulars	Amt.	Particulars	Amt.
To decrease in value of Assets (Loss)	XXX	By Increase in value of Assets (Profit)	XXX
To increase in value of Liabilities (Loss)	XXX	By Decrease in value of Liabilities (Profit)	XXX
To Unrecorded Liabilities	XXX	By Unrecorded Assets (At an Agreed Value)	XXX
To the partners' capital account (remuneration)	XXX	By Loss Transferred to old Partners Capital / Current A/c (In old ratio)	XXX
To bank A/c (Expenses)			
To Profit Transferred to Old Partners Capital/Current A/c (In old ratio)	XXX		
	XXX		XXX

➢ <u>**Accounting treatment of reserves and accumulated profits**</u>

1. For accumulated profit:

Profit & Loss A/c Dr.
Reserve A/c Dr.
To old Partners' capital/current A/c
(In the old profit-sharing ratio)

2. For Losses:

Old Partners' capital A/c Dr.
To profit & loss A/c
To Deferred revenue expenses A/c
(In the old profit-sharing ratio)

3. **Treatment of workmen's compensation fund**

CASE 1
If there is a workmen's compensation claim, it will be set off from the Workmen's Compensation Fund/Reserve.
The surplus of Workmen's Compensation Fund/Reserve (i.e. workmen's compensation fund/reserve - workmen's compensation claim) will be distributed among the existing partners in their old profit sharing ratio, i.e. credited to their capital/current accounts.
The following Journal Entry will be passed:

Workmen's Compensation Fund A/c Dr.
To Workmen's Compensation Claim A/c
To Old Partners' Capital A/cs (Individually)

CASE 2
In case there is no workmen's compensation claim, the total amount of the Workmen's Compensation Fund will be distributed among the existing partners in their old profit-sharing ratio.
The following Journal Entry will be passed:

Workmen's Compensation Fund A/c Dr.
To Old Partners' Capital A/cs (Individually)

CASE 3
In case, Workmen's Compensation Claim exceeds the Workmen's Compensation Fund, the excess amount of liability (i.e. Workmen's Compensation Claim - Workmen's Compensation Fund) will be debited to Revaluation A/c.
The following Journal Entry will be passed:

Workmen's Compensation Fund A/c Dr.
Revaluation A/c Dr.
To Workmen's Compensation Claim

4. Treatment of Investment Fluctuation Fund Reserve
Investment Fluctuation Fund/Reserve is created to meet the loss on account of a decrease in the market value of investments made by the partnership firm, say in Shares in X Ltd., x% Govt. Bonds, etc.

CASE 1

Loss due to a fall in the market value of investments will be set off from the Investment Fluctuation Fund/Reserve.

The Surplus of Investment Fluctuation Fund/Reserve (i.e. Investment Fluctuation Fund/Reserve - Decrease in market value investments) will be distributed among the old partners in their old profit-sharing ratio, i.e. credited to their Capital/Current Accounts.

The following Journal Entry will be passed:

Investment Fluctuation Fund A/c Dr.
To Investments A/c (decrease in value of investment)
To Old Partners' Capital A/cs (Individually, in their old ratio)

CASE 2

In case there is no decrease in the value of investments:

The total amount of Investment Fluctuation Fund will be distributed among the old partners in their old profit-sharing ratio.

The following Journal Entry will be passed:

Investment Fluctuation Fund A/c Dr.
To Old Partners' Capital A/cs (Individually, in their old ratio)

CASE 3

In case, fall in value of investments exceeds the Investment Fluctuation Fund:

The excess amount of loss will be debited to the Revaluation A/c. The following Journal Entry will be passed:

Investment Fluctuation Fund A/c Dr.
Revaluation A/c Dr.
To Investments A/c (decrease in value of investment)

- **<u>Adjustment of Partners' Capital on the basis of new profit-sharing ratio</u>**

TYPE 1: *Partners agree that their capitals should be adjusted so as to be proportionate to their new profit-sharing ratio.*

In such a situation, if the capital of the new partner is given, the same can be used as a base for calculating the new capital of the old partners. The new capitals thus ascertained should be compared with their old capitals after all adjustments relating to goodwill, reserves and revaluation of assets and liabilities, etc. have been made, and then the partner whose capital falls short, will bring in the necessary amount to cover the shortage and the partner who has a surplus, will withdraw the excess amount of capital.

STEP 1: Calculation of total capital of the new firm on the basis of new partners' capital and their share in profits

$$\text{Total capital of the new firm} = \text{New partner's capital} \times \frac{1}{\text{New Partner's Share}}$$

STEP 2: Divide the total capital of the new firm in the new profit-sharing ratio to calculate new capitals of old partners.

STEP 3: Compare adjusted capitals of old partners (i.e, old capitals after all adjustments relating to goodwill, reserves and revaluation of assets and liabilities, etc.) with new capitals to calculate excess/shortage of capital.

STEP 4: Adjustment of Excess/Shortage of capital through cash/bank or current accounts.

TYPE 2: *New partner has to bring his proportionate capital when new partner's capital is not given in the question.*

$$\text{New partners' Capital} = \text{Sum of adjusted capitals of old partners} \times \frac{1}{(1-\text{New Partner's Share})} \times \text{New partner's share}$$

EXAMPLE

Ashoo and Rahul are partners sharing profits in the ratio of 5:3. Gaurav was admitted for a 1/5 share and was asked to contribute proportionate capital and ₹4,000 for premium (goodwill). The Capitals of Ashoo and Rahul, after all adjustments relating to revaluation, goodwill etc., worked out to be ₹ 45,000 and ₹ 35,000 respectively.

Gaurav's share in the profits = 1/5
Therefore, the combined share of Ashoo and Rahul after Gaurav's admission = 1 - 1/5 = 4/5.

Combined capital of Ashoo and Rahul after all adjustments = 45,000 + 35,000 = ₹80,000 (for 4/5th share). Thus, total capital of the new firm = 80,000 × 5/4 = ₹1,00,000.

Hence, Gaurav's capital = ₹1,00,000 × 1/5 = ₹ 20,000.

Note that Gaurav's capital has been calculated as follows:

Sum of adjusted capitals of Ashoo and Rahul x 1/(1 - 1/5) x 1/5 =₹ 80,000 x 5/4 × 1/5

= ₹ 20,000

Question:

Given below is the Balance Sheet of A and B, who are carrying on partnership business on 31.12.2006. A and B share profits and losses in the ratio of 2:1.

Balance Sheet of A and B
as on December 31, 2006

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Bills Payable		10,000	Cash in Hand	10,000
Creditors		58,000	Cash at Bank	40,000
Outstanding Expenses		2,000	Sundry Debtors	60,000
			Stock	40,000
Capitals			Plant	1,00,000
A	1,80,000		Buildings	1,50,000
B	1,50,000	3,30,000		
		4,00,000		4,00,000

C is admitted as a partner on the date of the balance sheet on the following terms:

(i) C will bring in Rs. 1,00,000 as his capital and Rs. 60,000 as his share of goodwill for 1/4 share in the profits.

(ii) Plant is to be appreciated to Rs. 1,20,000 and the value of buildings is to be appreciated by 10%.
(iii) Stock is found over valued by Rs. 4,000.
(iv) A provision for bad and doubtful debts is to be created at 5% of debtors.
(v) Creditors were unrecorded to the extent of Rs. 1,000. Pass the necessary journal entries, prepare the revaluation account and partners' capital accounts, and show the Balance Sheet after the admission of C

Solution:

Journal Entries

Date	Particulars		LF	Amt. (Dr)	Amt. (Cr)
(i)	Revaluation A/c	Dr		8,000	
	To Stock A/c				4,000
	To Provision for Doubtful Debts A/c				3,000
	To Creditor's A/c				1,000
	(Being decrease in stock provision for doubtful debts created and creditors increased)				
(ii)	Plant A/c	Dr		20,000	
	Building A/c	Dr		15,000	
	To Revaluation A/c				35,000
	(Being plant and building increased in value)				
(iii)	Revaluation A/c	Dr		27,000	
	To A's Capital A/c				18,000
	To B's Capital A/c				9,000
	(Being gain on revaluation distributed among old partners in old ratio)				
(iv)	Cash A/c	Dr		1,60,000	
	To C's Capital A/c				1,00,000
	To Premium A/c				60,000
	(Being new partner paid capital and his share of goodwill in cash)				
(v)	Premium A/c	Dr		60,000	
	To A's Capital A/c				40,000
	To B's Capital A/c				20,000
	(Being premium distributed among old partners is sacrificing ratio)				

Dr **Revaluation Account** Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
Stock		4,000	By Plant	20,000
Provision for Doubtful Debts		3,000	By Building	15,000
Creditors/ Unrecorded)		1,000		
To A's Capital	18,000			
To B's Capital	9,000	27,000		
		35,000		35,000

Dr **Partners' Capital Account** Cr

Particulars	A	B	C	Particulars	A	B	C
				By Balance b/d	1,80,000	1,50,000	
				By Gain in Revaluation	18,000	9,000	
To Balance c/d	2,38,000	1,79,000	1,00,000	By Cash			1,00,000
				By Premium	40,000	20,000	
	2,38,000	1,79,000	1,00,000		2,38,000	1,79,000	1,00,000

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Bills Payable		10,000	Cash in Hand		10,000
Creditors	58,000		Cash at Bank		2,00,000
(+) Provision	1,000	59,000	Sundry Debtors	60,000	
Outstanding Expenses		2,000	(–) Provision for Doubtful Debts	(3,000)	57,000
Capital			Stock	40,000	
A	2,38,000		(–) Depreciation	(4,000)	36,000
B	1,79,000		Plant	1,00,000	
C	1,00,000	5,17,000	(+) Appreciation	20,000	1,20,000
			Building	1,50,000	
			(+) Appreciation	15,000	1,65,000
		5,88,000			5,88,000

Question:

Azad and Babli are partners in a firm sharing profits and losses in the ratio of 2:1. Chintan is admitted into the firm with 1/4 share in profits. Chintan will bring in Rs. 30,000 as his capital and the capitals of Azad and Babli are to be adjusted in the profit sharing ratio. The Balance Sheet of Azad and Babli as on December 31, 2006 (before Chintan's admission) was as follows:

Balance Sheet of A and B
as on 31.12.2006

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Creditors		8,000	Cash in Hand	2,000
Bills Payable		4,000	Cash at Bank	10,000
General Reserve		6,000	Sundry Debtors	8,000
Capital Accounts			Stock	10,000
Azad	50,000		Furniture	5,000
Babli	32,000	82,000	Machinery	25,000
			Buildings	40,000
		1,00,000		1,00,000

It was agreed that:
i) Chintan will bring in Rs. 12,000 as his share of goodwill premium.
ii) Buildings were valued at Rs. 45,000 and Machinery at Rs. 23,000.
iii) A provision for doubtful debts is to be created @ 6% on debtors.
iv) The capital accounts of Azad and Babli are to be adjusted by opening current accounts.
Record necessary journal entries, show necessary ledger accounts and prepare the Balance Sheet after admission.

Solution:

Journal Entries

Date	Particulars		LF	Amt. (Dr)	Amt. (Cr)
(i)	General Reserve A/c	Dr		6,000	
	To Azad's Capital A/c				4,000
	To Babli's Capital A/c				2,000
	(Being general reserve written off among old partners in old ratio)				
(ii)	Revaluation A/c	Dr		2,480	
	To Machinery A/c				2,000
	To Provision for Doubtful Debts A/c				480
	(Being decrease in value of asset and provision created for doubtful debts)				
(iii)	Building A/c	Dr		5,000	
	To Revaluation A/c				5,000
	(Being increase in value of building)				
(iv)	Revaluation A/c	Dr		2,520	
	To Azad's Capital A/c				1,680
	To Babli's Capital A/c				840
	(Being profit on revaluation distributed among old partners)				

(v)	Cash A/c Dr		42,000	
	To Chintan's Capital A/c			30,000
	To Premium A/c			12,000
	(Being amount of capital and goodwill brought in by Chintan)			
(vi)	Premium A/c Dr		12,000	
	To Azad's Capital A/c			8,000
	To Babli's Capital A/c			4,000
	(Being premium distributed among old partners in sacrificing ratio)			
(vii)	Azad's Capital A/c Dr		3,680	
	To Azad's Current A/c			3,680
	(Being excess of capital transferred for partners' current account)			
(viii)	Babli's Capital A/c Dr		8,840	
	To Babli's Current A/c			8,840
	(Being excess of capital transferred to partners' current account)			

Dr **Revaluation Account** Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Machinery		2,000	By Building	5,000
To Provision for Doubtful Debts		480		
To Transfer of Profit on Revaluation Account				
Azad	1,680			
Babli	840	2,520		
		5,000		5000

Dr **Partners' Capital Account** Cr

Particulars	Azad	Babli	Chintan	Particulars	Azad	Babli	Chintan
To Current A/c	3,680	8,840	–	By Balance b/d	50,000	32,000	
To Balance c/d	60,000	30,000	30,000	By General Reserve	4,000	2,000	
				By Profit on Revaluation	1,680	840	
				By Cash			30,000
				By Premium	8,000	4,000	
	63,680	38,840	30,000		63,680	38,840	30,000

Balance Sheet of Azad, Babli and Chintan

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Sundry Creditors		8,000	Cash in Hand		44,000
Bills Payable		4,000	Cash at Bank		10,000
Partners's Current Account			Sundry Debtors	8,000	
Azad	3,680		(–) Provision for		7,520
Babli	8,840	12,520	Doubtful Debts	(840)	
Capitals			Stock		10,000
Azad	60,000		Furniture		5,000
Babli	30,000		Machinery		23,000
Chintan	30,000	1,20,000	Building		45,000
		1,44,520			1,44,520

Note *Calculate new profit sharing ratio. Then, calculate full capital of firm on basis of new partners, capital and finally new capital of existing partners.*

$$\text{Capital of Chintan} = 30{,}000$$
$$\text{His share} = \frac{1}{4}$$
$$\text{Total capital of the firm} = 30{,}000 \times \frac{4}{1} = 1{,}20{,}000$$

New profit sharing ratio

$$\text{Chintan's share} = \frac{1}{4}$$
$$\text{Remaining profit} = 1 - \frac{1}{4} = \frac{3}{4}$$
$$\text{Azad's new share} = \frac{3}{4} \times \frac{2}{3} = \frac{6}{12}$$
$$\text{Babli's new share} = \frac{3}{4} \times \frac{1}{3} = \frac{3}{12}$$
$$\text{Chintan's share} = \frac{1}{4} \times \frac{3}{3} = \frac{3}{12}$$
$$\text{New profit sharing ratio} = \frac{6}{12} : \frac{3}{12} : \frac{3}{12};\ 2:1:1$$

or
$$\text{Azad's capital} = 1{,}20{,}000 \times \frac{2}{4} = 60{,}000$$
$$\text{Babli's capital} = 1{,}20{,}000 \times \frac{1}{4} = 30{,}000$$
$$\text{Chintan's capital} = 1{,}20{,}000 \times \frac{1}{4} = 30{,}000$$

PRACTICAL PROBLEMS

1 mark Questions

Q.1 Akshita and Anurag are partners in a firm sharing profits in the ratio of 2:1. Akshat is admitted in the firm with a 1/3 share in profits. Akshat acquires 2/3 of his share from Akshita and 1/3 of his share from Anurag. The new profit-sharing ratio of Akshita, Anurag and Akshat will be

(a) 3:2:4 (b) 4:3:2 (c) 2:1:1 (d) 4:2:3.

(ans: d)

Q.2 Atul, Beena and Sita were partners in a firm sharing profits and losses in the ratio of 8:7:5. Damini was admitted as a new partner for a 1/5th share in the profits, which she acquired entirely from Atul. The new profit-sharing ratio after Damini's admission will be

(a) 7:7:5:1 (b) 4:7:5:4 (c) 8:7:5:4 (d) 7:5:8:4

(ans: b)

Q.3 Amit and Sumit were partners in a firm with fixed capitals of ₹ 6,00,000 and ₹ 4,00,000 respectively. Kavi was admitted as a new partner for a 1/5th share in the profit of the firm. Kavi brought 40,000 as his share of goodwill premium and ₹3,00,000 as his capital. The amount of Goodwill premium credited to Sumit will be

(a) 20,000 (b) 24,000 (c) 16,000 (d) ₹40,000

(ans: a)

Q.4 Assertion (A): In a partnership firm, at the time of admission, the new partner brings in an agreed amount of capital either in cash or in kind.

Reason (R): In a partnership firm, at the time of admission, the new partner acquires the right to share the assets and the profits of the partnership firm.

Choose the correct option from the following:

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

(ans: a)

Q.5 When a new partner is admitted, the balance of 'General Reserve' appearing in the Balance Sheet at the time of admission is credited to

(a) Profit & Loss Appropriation Account (c) Capital Accounts of Old Partners

(b) Capital Accounts of all the partners (d) Revaluation Account

(ans: c)

Case Study-Based Questions

Sara and Jaspal are teachers in a private school, teaching Accountancy and Business Studies respectively. After teaching for 10 years together and gaining experience in their respective subjects, they both decided to quit their jobs and open a YouTube channel called "COMMERCE ACADEMY' as a registered partnership firm where they will teach their respective subjects. They decided to share profits in the ratio of 5:4. After receiving requests from students and parents, they decided to introduce Economics as one of the subjects to their YouTube channel. For this, they admitted their ex-colleague and a well-experienced teacher, Raj, as a partner for a 1/5th share in the profits. Sara and Jaspal decided to share profits equally in future. Raj brings ₹1,20,000 as capital and ₹54,000 as his share of goodwill in cash.

At the time of admission of Raj, Goodwill existed in their books of account at ₹ 36,000, Based on the above information, answer the following questions:

Q.6 Journal entry passed for funds brought by Raj would be:

1. Cash A/c Dr. 1,74,000
   To Raj's Capital A/c 1,20,000
   To Premium for Goodwill A/c 54,000

2. Revaluation A/ ...Dr. 1,74,000
   To Raj's Capital A/c 1,20,000
   To Premium for Goodwill A/c 54,000

3. Bank A/c ...Dr. 1,74,000
   To Raj's Current A/c 1,20,000
   To Premium for Goodwill A/c 54,000

4. Revaluation A/ ...Dr. 1,74,000
   To Raj's Current A/c 1,20,000
   To Premium for Goodwill A/c 54,000 (ans :1)

Q.7 New profit-sharing ratio of Sara, Jaspal and Raj will be

a. 1:1:1 b. 5:4:1 c. 2:2:1 d. 5:4:5 (ans: c)

Q.8 In what ratio would Sara and Jaspal sacrifice their shares?

a. 1:1 b. 7:2 c. 5:4 d. 2:1 (ans: b)

3 Marks Questions

Q. 9 Niti and Aditi were partners in a firm sharing profits and losses in the ratio of 2:3. They admitted John into partnership for a 1/4th share in the profits of the firm, which he acquired equally from Niti and Aditi. John brought ₹5,00,000 as his capital and ₹1,00,000 as premium for goodwill. One-fourth of the goodwill was withdrawn by the old partners.

Pass the necessary Journal entries for the above transactions in the books of the firm.

(Ans.) **JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c ...Dr.		6,00,000	
	To John's Capital A/c			5,00,000
	To Premium for Goodwill A/c			1,00,000
	(John brought his share of goodwill and capital)			
	Premium for Goodwill A/c ...Dr.		1,00,000	
	To Niti's Capital A/c			50,000
	To Aditi's Capital A/c			50,000
	(Premium for goodwill credited to sacrificing partners in their sacrificing ratio, i.e, 1:1)			

Niti's Capital A/c	...Dr.	12,500	
Aditi's Current A/c	...Dr.	12,500	
To Bank A/c			25,000
(1/4th Premium for Goodwill withdrawn by partners)			

4 mark Questions

Q.10 P, Q and R were in partnership sharing profits and losses in the ratio of 6:3:1. They admitted S into partnership with effect from 1st April, 2025. New profit-sharing ratio among P, Q, R and S will be 3:3:3:1. They also decide to record the effect of the following without affecting their book values, by passing an adjustment entry:

	Book Values (₹)
General Reserve	1,80,000
Contingency Reserve	30,000
Profit & Loss A/c (Cr.)	90,000
Advertisement Suspense A/c (Dr.)	1,20,000

Pass the adjustment entry.

(ans:) **ADJUSTMENT JOURNAL ENTRY**

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2025					
April 1	R's Capital A/c (1,80,000 × 2/10)	...Dr.		36,000	
	S's Capital A/c (1,80,000 × 1/10)	...Dr.		18,000	
	To P's Capital A/c (1,80,000 × 3/10)				54,000

(Adjustment for reserves, accumulated profits, and losses)

Q.11 C and D are partners in a firm sharing profits in the ratio of 4:1. On 31.3.2025, their Balance Sheet was as follows:

Balance Sheet of C and D as at March 31, 2025

Liabilities	Amount (₹)	Assets	Amount (₹)
Sundry Creditors	40,000	Cash	24,000
Provision for Bad Debts	4,000	Debtors	36,000
Outstanding Salary	6,000	Stock	40,000
General Reserve	10,000	Furniture	80,000
Capitals: C 1,20,000 D 80,000	2,00,000	Plant and Machinery	80,000
	2,60,000		2,60,000

On the above date, E was admitted for 1/4 1/4th share in the profits.

- Debtors ₹2,000 will be written off as bad debts, and a provision of 4% will be created on debtors for bad and doubtful debts.
- Stock will be reduced by ₹2,000, furniture will be depreciated by ₹4,000, and 10% depreciation will be charged on plant and machinery.
- Investments of ₹7,000 not shown in the Balance Sheet will be taken into account.
- There was an outstanding repair bill of ₹ 2,300, which will be recorded in the books.

Pass necessary journal entries for the revaluation of assets and reassessment of liabilities.

(ans) **Journal**

Date	Particulars		L.F	Dr. (₹)	Cr. (₹)
(i)	**Bad debts A/c**	**Dr.**		**2,000**	
	To Debtors A/c				**2,000**
	(Being debtors, 2,000 written off)				
(ii)	**Provision for Doubtful debts A/c**	**Dr.**		**2,000**	
	To Bad debts A/c				**2,000**
	(Being provision utilised for writing off bad debts)				
(iii)	**Provision for Doubtful debts A/c**	**Dr.**		**640**	
	To Revaluation A/c				**640**
	(Being provision for bad debts decreased)				
(iv)	**Revaluation A/c**	**Dr.**		**14,000**	
	To Stock A/c				**2,000**
	To Furniture A/c				**4,000**
	To Plant & Machinery A/c				**8,000**
	(Being decrease in assets recorded)				
(v)	**Investments A/c**	**Dr.**		**7,000**	
	To Revaluation A/c				**7,000**
	(Being increase in investments is recorded)				
(vi)	**Revaluation A/c**	**Dr.**		**2,300**	
	To Outstanding Repairs A/c				**2,300**
	(Being increase in liabilities recorded)				
(vii)	**C's Capital A/c**	**Dr.**		**6928**	
	D's Capital A/c	**Dr.**		**1,732**	
	To Revaluation A/c				**8,660**
	(Being loss on revaluation transferred to Partner's Capital A/c)				

Q.12 On 31st March, 2019, the Balance Sheet of A and B, who were sharing profits in the ratio of 3:2 was as follows:

BALANCE SHEET OF A & B as at 31st March, 2019

Liabilities	**₹**	**Assets**	**₹**
Creditors	30,000	Cash at Bank	20,000
Investment Fluctuation Fund	12,000	Debtors 85,000	
General Reserve	25,000	Less: Provision for Bad Debts 5000	80,000

Capital A/cs: A 1,60,000 B 1,40,000	3,00,000	Stock Investments Furniture	1,30,000 60,000 77,000
	3,67,000		3,67,000

On 1st April, 2019, they decided to admit C as a new partner for a 1/5th share in the profits on the following terms:

(i) C brought ₹1,00,000 as his capital and ₹50,000 as his share of premium for goodwill.

(ii) Outstanding salaries of ₹2,000 be provided for.

(iii) The market value of investments was ₹ 50,000.

(iv) A debtor whose dues of ₹ 18,000 were written off as bad debts paid ₹12,000 in full settlement.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the new firm.

(ans)

Profit on revaluation: 10,000
Partners' Capital A/c Balance: A - 2,12,200 , B- 1,74,800 , C - 1,00,000
Total of Balance Sheet: 5,19,000

6 Mark Questions

Q.13 Sanju and Manju were partners in a firm sharing profits and losses in the ratio of 3:2. Their Balance Sheet on 31st March, 2023 was as follows:

BALANCE SHEET OF SANJU AND MANJU as at 31st March, 2023

Liabilities	**₹**	**Assets**	**₹**
Creditors	1,80,000	Cash at Bank	1,36,000
		Debtors 76,000	
General Reserve	40,000	Less: Provision for Doubtful Debts 4000	72,000
Capital A/cs: Sanju 1,40,000 Manju 1,20,000	2,60,000	Furniture Investments Plant & Machinery	1,32,000 60,000 80,000
	4,80,000		4,80,000

On 1st April, 2023, Uday was admitted into the firm for a 1/4th share in profits on the following terms:

(i) Furniture was to be depreciated by ₹ 6,000.

(ii) Investments were valued at ₹72,000.

(iii) Plant and Machinery were taken over by Sanju and Manju in their profit-sharing ratio.

(iv) Uday will bring in proportionate capital and₹10,000 as his share of the goodwill premium in cash.

Prepare Revaluation Account and Partners' Capital Accounts.

(ans)

Profit on revaluation: 6000
Partners’ Capital A/c Balance: Sanju-1,25,600 , Manju- 1,10,400 , Uday-78,667

Q.14 Anikesh and Bhavesh are partners in a firm sharing profits in the ratio of 7: 3. Their Balance Sheet as on 31st March, 2023, was as follows:

BALANCE SHEET OF ANIKESH AND BHAVESH as at 31st March, 2023

Liabilities	**₹**	**Assets**	**₹**
Creditors	60,000	Cash	36,000
Outstanding Wages	9,000	Debtors 54,000	
General Reserve	15,000	Less: Provision for Doubtful Debts 6000	48,000
Capital A/cs: Anikesh 1,20,000 Bhavesh 1,80,000	3,00,000	Furniture Stock Machinery	1,20,000 60,000 1,20,000
	3,84,000		3,84,000

On 1st April, 2023, Chahat was admitted for a 1/4th share in the profits on the following terms:

(i) Chahat will bring ₹90,000 as her capital and ₹30,000 as her share of the Goodwill premium.

(ii) Outstanding wages will be paid.

(iii) Stock will be reduced by 10%.

(iv) A creditor of ₹6,300, not recorded in the books, was to be taken into account.

Pass the necessary Journal entries for the above transactions in the books of the firm.

(ans) Loss on revaluation: 12,300

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Ch - 04 : Reconstitution of a Partnership Firm –

Retirement and Death of a Partner

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+ Gaining 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 (in Gaining Ratio) Dr.

To Retiring/Deceased Partner's Capital/c (With the Share of Goodwill)

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

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

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

Capital Account of remaining partner
Capital Account of all partners in their old profit-sharing ratio
Capital Accounts of the remaining partners in their old profit-sharing ratio

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

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

All partners' capital account
Remaining partners' capital accounts
His Executors account
Governments revenue account

Ans. (c) His Executors account

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
(c). 2:1

(b). 1:2
(d). ¼: ½

Answer(c) 2:1

A, B and C were partners sharing profits in the ratio of 2:2:1. B died on 30^{th} June, 2023 and profit for the accounting year ended 31^{st} 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

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

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Death of a Partner

When a partner in a partnership dies, the partnership, by default, is dissolved, unless the partnership agreement stipulates otherwise. The deceased partner's estate becomes responsible for their share of the firm's assets and liabilities, and the remaining partners may choose to continue the business as a new partnership. The deceased partner's share is typically valued and paid to their legal representatives or executors.

In the event of a death of a partner we generally required to prepare the Deceased Partner Capital a/c and his balance will be transfer to his executor

Deceased Partner Capital A/c

Particulars	₹	Particulars	₹
Drawing A/c	As per Deed	Balance b/d	Upto Death
Interest on Drawing	His Share as	Interest on capital	His Share as per
Goodwill a/c	per balance	General Reserve	balance Sheet
	Sheet	Profit and Loss A/c	Profit Share
Profit and Loss A/c	Loss Share	Workmen Comp Reserve	Upto Death
Adv Suspense A/c	Upto Death	Revaluation a/c	
P & L suspense A/c	Loss Share	Salary to partner	
		Commission to Partner	
Revaluation a/c			Profit Share Upto
Deceased Partner	Net Balance	P & L suspense A/c	Death
Executor A/c			Goodwill share
		Remaining Partner Capital A/c	
		Partner Loan A/c	Upto Death
		Int on Partner Loan	
Total		Total	

Accounting Adjustments:

Revaluation of Assets and Liabilities:

Assets and liabilities are revalued to reflect their current market values.

Reserves and Profits Distribution:

Reserves and accumulated profits are distributed among all partners, including the deceased partner, in their old profit-sharing ratio.

Goodwill Adjustment:

If the firm has goodwill, it's adjusted, and the deceased partner's share of goodwill may be credited to their capital account,

Interest on Partners Loan

If deceased partner given a loan to the business then in the absence of any adjustment interest will be given to deceased partner @6% p.a.

Profit Calculation:

The deceased partner's share of profits up to the date of death is calculated. This may be done on a time basis (using previous year's profit) or a sales basis or average profit basis.

A) On the basis of Last Year Profit

Last Year Profit X his Share X period/12

B) On the basis of Average Profit

Average Profit X his Share X period/12

C) On the Basis of Sales

<u>Last Year Profit</u> X Current Year Sales X his Share
Last year Sales

Settlement with Executor:

The deceased partner's capital account is closed by transferring the due amount to their executor.

Long answer type questions

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₹1,50,000

Prepare Revaluation a/c and Partners capital A/c

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/c	15,000	10,000	5,000
	1,80,000	1,45,000	85,000		1,80,000	1,45,000	85,000

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=2,700

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:

Goodwill of the firm is to be valued at ₹ 1,75,000.

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

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.

SOLUTION:

REVALUATION A/C

Particulars	Amt	Particulars	Amt

Machinery	10,00 0	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 - 05 : Reconstitution of a Partnership Firm –

Dissolution of a Partnership Firm

As per 39 of the partnership act 1932, "Dissolution of the firm means dissolution of partnership among all the partners in the firm." Its means business of the firm ends. All the assets of the firm are disposed off and all outside Liabilities and partner capital are paid.

Mode of dissolution of firm

1. Dissolution by agreement

2. Compulsory Dissolution

3. On happening of an event like insolvency of a partner

4. Dissolution by notice

5. Dissolution by court

Dissolution of partnership V/S Dissolution of firm

BASIS	Dissolution of Partnership	Dissolution of firm
1.End of business	The business of the firm continue	The business of the firm closed
2.Settlement of assets & liabilities	Liabilities are reassessed and new balance sheet is opened	Assets are realized and liabilities are paid off.
3.Economic relationship	Economic relationship between the partners are changed	Economic relationship between the partners are to end.
4.Court's intervention	No intervention of the court can be dissolved by mental agreement.	A firm can be dissolved by the court's order
5. Closer of books and accounts	Books of accounts of the firm need not to be closed.	Books of accounts of the firm are closed.
6. Effect	It may or may not dissolution of firm	It necessarily in dissolution of partnership.

SETTLEMENT OF ACCOUNTS

As per section 48 of the partnership act 1932, the following rules shall apply.

1. Treatment of losses: losses including deficiencies of capital, shall be paid :- (i) first out of profit, (ii) next out of capital and (iii) if necessary, by the partners individually in the profit sharing ratio.

2. Application of assets: Assets of the firm shall be applied in the following manner. (i) In paying firm's debts to the third party. (ii) In paying each partner proportionately what is due to him on a/c of loan(i.e. partner's loan) (iii) In paying each partner proportionately what is due to him on a/c of capital (iv) The residue, if any shall be divided among the partners in their profit sharing ratio.

PRIVATE DEBTS V/S FIRM'S DEBTS

SEC 49 of the act applied as follows: (i) Firms property is applied first for settling the firms debts, surplus if any can be utilized for payment of their private debts up to received share.
(ii) Private property is applied first for private debts then towards firms liability.

Settlement of Accounts Section 48 of the Indian Partnership Act, 1932 deals with the settlement of accounts
when the firm is dissolved. In brief, when firm is dissolved, assets are realised, liabilities are paid and the balance, if any, is distributed among the partner` On dissolution of the firm, the accounting treatment involves preparation of following accounts:

Realisation A/c
Loan by Partner A/c(If any)
Loan by firm to Partner A/c(If any)
Partners' Capital/Current A/c
Cash/Bank A/c

REALISATION ACCOUNT - It is prepared on the dissolution of a firm.
It is prepared to find out Gain/loss on the realisation of assets and payment of liabilities. It's a nominal A/c

STEPS INVOLVED IN PREPARATION OF REALISATION ACCOUNT

1. Transfer all assets from balance sheet to the debit side of realisation A/c except: Cash/Bank balance, Loan to partner(s). Partners" capital/current a/c, Partners' Drawings. Accumulated losses, fictitious assets.
2. Transfer all liabilities from balance sheet to the credit side of realisation A/c Except: Partners' capital/current A/c, Loan by partner(s), General reserve, Accumulated Profits, Workmen compensation reserve (surplus only).
3. Record the sale of assets at given realised value and assets(s) taken over by the partner(s) against credit side of realisation account. As per CBSE Tangible assets are realised either at given value or. Book values
4. Record the payment of liabilities or agreed to be paid by partner (whether recorded or unrecorded) to the debit side of realisation A/c except investment fluctuation reserve, provision for doubtful debts, provision for depreciation, Provision for discount on debtors. If amount payable is not given for a liability then it is paid at book value.
5. Record Dissolution expenses and remuneration payable to a partner (if any).
6. Find gain/loss on account of realisation of assets and repayment of liabilities by balancing the account and distribute it among partners in their profit sharing ratio.

JOURNAL ENTRIES

1. TRANSFER THE ASSETS TO REALISATION A/c

Realisation A/c Dr.
To Assets (Individually) A/c
(Being assets are transferred to realisation A/c)

2. TRANSFER THE LIABILITIES TO REALISATION A/c

Liabilities (individually) Dr.
To Realisation A/c
(Being liabilities are transferred to realisation A/c)

3. a For sale of assets

Cash/Bank A/c Dr.
To Realisation A/c
(Being assets sold at given value)

3. b Asset(s) taken over by the partner

Partners capital/current A/c Dr.
To Realisation A/c
(Being asset(s) taken over by the partner at an agreed value)

4 a To pay liabilities
Realisation A/c Dr.
To Bank A/c
(Being liability paid)
4 b Liability assumed by the partner
Realisation A/c Dr.
To Partners' capital/current A/c
(Being liability assumed by the partner)
5 Remuneration to a Partner
Realisation A/c Dr
To Partners' capital/current A/c
(Being partner credited for remuneration)
6 TO DISTRIBUTE GAIN ON REALISATION
Realisation A/c Dr.
To Partners' capital/current A/c
(Being partners credited for gain on realisation in old ratio)
7 To distribute Loss on Realisation
Partners Capital/current A/c Dr.
To Realisation A/c

8. General Reserve, P & L A/c credit Balance, Contingency Reserve
General Reserve A/c Dr.
P & L A/c Dr.
Contingency Reserve A/c Dr.
To Partners capital A/c
9. P & L A/c Debit Balance, Advertisement suspense A/c
Partner’s capital A/c Dr.
To profit and loss A/c
To deferred revenue expenditure (Advertisement suspense A/c)
10. Workmen Compensation Reserve
(i) Workmen compensation Reserve
To Realisation A/c (To the extent of claim) (if any)
(ii) Workmen compensation A/c Dr.
To Partner’s capital A/c (Surplus in workman compensation reserve A/c after claim)
JOURNAL ENTRIES FOR FEW IMPORTANT ITEMS
1. TO SETTLE LOAN GIVEN BY PARTNER TO THE FIRM
Partners' loan A/c Dr.
To Cash/Bank / Realisation A/c (for asset given against loan)
To Realisation A/c (if any, difference)
(Being partners' loan discharged)
2. TO SETTLE LOAN GIVEN TO PARTNER BY THE FIRM
Bank/ Capital A/c (if liability assumed against the loan) A/c Dr.
Realisation A/c (if any, difference) Dr.
To Partners' loan A/c (Being loan to partner recovered)
Note : Until unless specified Loan to partner is not debited to his/her capital/current A/c but received in cash/bank.
3. Asset(s) taken over by the creditor
In full settlement of his/her claim
No Entry

I. Claim > value of asset(s) Entry for bal. amount due to creditors

Realisation A/c Dr.

To cash/bank A/c

Ii Claim < value of asset(s) Entry for bal. amount due to creditors

Cash/bank A/c Dr.

To Realisation A/c

4. Realisation Expenses

To be Borne by	Paid paid by
1. Firm	Firm
2. Firm	Partner
3. Partner	Same Partner
4. Partner	Firm
5. Partner	Another partner

Note: If it is not mentioned that who is bearing expenses it is assumed to be borne by FIRM

REALISATION A/C

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

Partner's Capital A/C

Particulars	LF	A (₹)	B (₹)	Particulars	LF	A (₹)	B (₹)
To Realisation A/c (Loss on Realisation)		xxx	xxx	By balance b/d		xxx	xxx
To Realisation A/c (Asset taken over)		xx	xxx	By General Reserve		xxx	xx

To Bank A/c(final Payment)(Bal . Fig.)		xxx	xxx	By P/L A/c		xxx	xxx
				By Realisation A/c (Profit on realization)		xxx	xxx
		xxxx	xxxx			xxxx	xxxx

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

Distinction between Revaluation Account and Realisation Account

Basis 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 from 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.

LONG QUESTIONS FOR PRACTICE:-

Q1) Journalise the following transactions regarding realisation expenses:

Realisation expenses amounted to ₹ 2,500

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

Realisation expenses ₹ 2,300 borne by Tarun, personally.

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

	Particulars	LF	Debit **(₹)**	Credit **(₹)**

	Realisation A/c.... Dr. To Bank A/c		2,500	 2,500
	Realisation A/c.... Dr. To Ashok's capital a/c		3,000	 3,000
	No Entry			
	Realisation A/c... Dr. To Amit's capital a/c		4,000	 4,000

Q2) Sun and Kiran are partners sharing profits and losses equally. They decided to dissolve their firm. Assets and Liabilities have been transferred to Realisation Account. Pass necessary Journal entries for the following:

All partners are agreed that the process of realisation at the time dissolution will be accomplished by Sun for which he will be paid ₹10,000 along with the amount of expense which amounted to 2% of total value realised from the Assets on dissolution. Some assets were sold for Cash at a cumulative Value of ₹12,00,000 and the remaining were taken over by creditors at a valuation of ₹3,00,000.

Deferred Advertisement Expenditure A/c appeared in the books at ₹28,000.

Out of the Stock of ₹1,20,000; Kiran (a partner) took over 1/3 of the stock at a discount of 25% and 50% of remaining stock was took over by a Creditor of ₹30,000 in full settlement of his claim. Balance amount of stock realized at ₹25,000.

An outstanding bill for repairs and renewal of ₹3,000 was settled through an unrecorded asset which was valued at ₹10,000. Balance being settled in Cash. (CBSE 2024)

Date	Particulars	L.F.	Dr(Rs)	Cr (Rs)
a)	Realisation A/c Dr. To Sun's Capital Account (Remuneration and expenses payable to sun)		40,000	 40,000
b)	Sun's Capital A/c Dr Kiran"s Capital A/c Dr To Deferred Revenue Expenditure A/c Advertisement suspense account debited to partners capital account)		14,000 14,000	 28,000

c)	Kiran's Capital A/c Dr. To realisation Account (⅓ Stock taken by Kiran) No Entry		30,000	 30,000
d)	Bank A/c To realisation A/c (Stock realised) Cash A/c Dr. To realisation A/c (Amount realised from unrecorded asset after payment of outstanding bill)		25,000 7,000	 25,000 7,000

3.Prateek, Neeraj and Umang were partners in a firm, sharing profits and losses in the ratio of 7:2:1. The firm was dissolved on 31st March, 2021. After transfer of assets (other than cash) and external liabilities to the realisation Account, the following transactions took place. Pass journal entry. (a) Furniture of ₹ 45,000 was sold by auction for ₹ 66,000 and the auctioneer's commission amounted to ₹ 2,000. (b) Office equipment was sold ₹ 90, 000 was taken over by creditors of the book value of ₹ 82,000 in full settlement. (c) Umang had given a loan of ₹1, 09,000 to the firm. He accepted ₹1, 00,000 in full settlement of his loan. (d) Investments were ₹ 53,000 out of which ₹ 23,000 was taken by Neeraj at ₹ 25,000. Balance of the investments was sold for ₹ 35,000. (e) Expenses incurred on dissolution were ₹ 21,000 and were paid by Prateek. (f) Loss on revaluation was ₹ 40,000.

Ans. a) Cash/Bank A/c Dr 64,000
To Realization A/c 64,000
(b) Realisation A/c Dr 2,000
To Bank A/c 2,000
(c) No Entry
(d) Umang's Capital A/c Dr 1,90,000
To Cash/Bank A/c 1,00,000
To Realization A/c 90,000
(e) Neeraj's Capital A/c Dr 25,000
Cash/Bank A/c Dr 35, 000
To Realization A/c 60,000
(f) Realisation A/c Dr 21,000
To Prateek's Capital A/c 21,000
(g) Prateek's Capital A/c Dr 28,000
Umang Capital A/c Dr 4,000
Neeraj Capital A/c Dr 8,000
To Realization A/c 40,000

4. 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) 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

Ans.

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

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

Realisation Account

Dr. Cr.

Particulars	₹	Particulars		₹
To Goodwill	10,000	By Investment Fluctuation Fund		5,000
To Buildings	25,000	By Provision for Doubtful Debts		2,000
To Investments	25,000	By Creditors		8,000
To Stock	15,000	By Bank overdraft		6,000
To Debtors	17,000	By X's Wife Loan		8,000
To X's Capital A/c (X's wife loan)	8,000	By Bank A/c (Asset realised)		
To Bank A/c (Bank overdraft)	6,000	Debtors 12,000		
To Bank A/c (Creditors) (3000+3000)	6,000	Investment 20,000		
To Bank A/c (Expenses on Realisation)	2,000	Goodwill 6,000		
To Bank A/c (auctioneer Commission)	1000	Buildings 30,000		
		Stock	5,000	73,000
		By Y's Capital A/c (Stock)		4,000
		By Loss transferred to:		
		X's Capital A/cs	7,200	
		Y's Capital A/cs	1,800	9,000
	1,15,000			1,15,000

Y's Loan A/c

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Bank A/c	3,000	By balance b/d	3,000
	3,000		3,000

Partner's Capital A/cs

Dr. Cr.

Particulars	₹	₹	Particulars	₹	₹
To Profit and Loss A/c	8,000	2,000	By Balance b/d	50,000	40,000
To Realisation A/c			(Cr. Balance)		
(Assets taken)	——	4,000	(By Realisation A/c	8,000	——
To Realisation A/c			Liabilities		
(Loss on Realisation	7,200	1,800	taken)		
To Bank A/c					
(Excess cash paid)	42,800	32,200			
	58,000	40,000		58,000	40,000

Bank A/c

Dr. Cr.

Particulars	₹	Particulars	₹
To Balance b/d	20,000	By Balance b/d	6,000
(Cash at Bank)		(Bank Overdraft)	
To Realisation A/c	73,000	By Realisation A/c	1,000
(Assets Realised)		(Liabilities Paid)	
		By Realisation A/c	6,000
		By Realisation A/c	2,000
		(Exp. Paid)	
		By Y's Loan A/c	3,000
		(Partner's Loan Paid)	
		By X' Capital A/c	42,000
		By Y's Capital A/c	32,200
	93,000		93,000

• Fill in the correct word(s)

1. All assets (except cash/bank and fictitious assets) are transferred to the ———— (Debit/Credit) side of ————— Account (Realisation/Capital).

Answer: Debit, Realisation

2. All ———— (internal/external) liabilities are transferred to the ———— (Debit/Credit) side of ————acccount (Bank/Realisation).

Answer External, Credit, Realisation

3. Accumulated losses are transferred to ———— (Current/Capital Accounts) in ————— (equal ratio/profit sharing ratio).

Answer Capital account, Profit sharing ratio

4. If a liability is assumed by a partner, such Partner's Capital Account is ——— ——— (debited/credited)..

Answer Credited

If a partner takes over an asset, such (Partner's Capital Account) is —————— (debited/credited).

Answer Debited

6. No entry is required when a ———————— (partner/creditor) accepts a fixed asset in payment of his dues.
Answer Creditor
7. When creditor accepts an asset whose value is more than the amount due to him, he will ——————— (pay/not pay) the excess amount which will be credited ————————— Account.
Answer Pay, Realisation
8. When the firm has agreed to pay the partner a fixed amount for realisation work irrespective of the actual amount spent, such fixed amount is debited to (Realisation/Capital) Account and Credited to (Capital/Bank) Account.
Answer Realisation, Capital
9. Partner's loan is ——————— (recorded/not recorded) in the (Realisation Account).
Answer Not recorded
10. Partner's current accounts are transferred to respective ————————— Partners' (Loan/Capital) Accounts.
Answer Capital
MCQs:

Q1) On dissolution of a firm, realisation account is debited with

(A) All assets to be realised
(B) All outside liabilities of the firm
(C) Cash received on sale of assets
(D) Any asset taken over by one of the partners
Ans: (A) All assets to be realised

Q2) On dissolution of a firm, out of the proceeds received from the sale of assets will be paid first of all

(A) Partner's Capital
(B) Partner's Loan to Firm
(C) Partner's additional capital
(D) Outside Creditors
Ans: (D) Outside Creditors

Q3) Unrecorded liability, when paid on dissolution of a firm is debited to :

(A) Partner's Capital A/'cs
(B) Realisation A/c
(C) Liabilities A/c
(D) Asset A/c
Ans: (B) Realisation A/c

Q4) In the event of dissolution of firm, the partner's personal assets are first used for payment of the :
(A) Firm's liabilities
(B) The personal liabilites
(C) None of the two
(D) Any of the two

Ans: (B) The personal liabilities

Q5) A partnership firm is compulsorily dissolved :
(A) When the business of the firm is declared illegal
(B) When a partner of the firm dies
(C) When a partner of the firm becomes insolvent
(D) When a partner transfers his share to some other person without consent of partners

Ans: (A) When the business of the firm is declared illegal

Q6) Assertion (A) : Realisation account is prepared at the time of dissolution of partnership.
Reason (R) : Realisation account records the cash release from sale of assets and amount paid to external liabilities.
Both Assertion (A) and Reason (R) are True and Reason (R) is correct explanation of Assertion.
Both Assertion (A) and Reason (R) are True and Reason (R) is not correct explanation of Assertion.
Assertion (A) is true, Reason (R) is false.
Assertion (A) is false, Reason (R) is true.
Ans: (D) Assertion (A) is false, Reason (R) is true.

Q7) A and B are partners sharing profits equally. The firm is going to be dissolved. At that time Mrs A has given loan of ₹ 50,000 to the firm @6% interest and simultaneously A has also given loan of ₹ 1,00,000. The assets realized ₹ 10,00,000. Who will be paid first?
Partner A
Partner B
Mrs. A
Partner A and Partner b in their profit-sharing ratio
Ans: (C) Mrs A
Q8) Assertion (A) : Dissolution expenses paid by the firm on behalf of a partner is recorded on the debit side of realisation account.
Reason (R) : Such expenses are a Non-business expense.
Both Assertion (A) and Reason (R) are True and Reason (R) is correct explanation of Assertion.
Both Assertion (A) and Reason (R) are True and Reason (R) is not correct explanation of Assertion.
Assertion (A) is true, Reason (R) is false.
Assertion (A) is false, Reason (R) is true.
Ans: (D) Assertion is false, Reason is true

Q9) An unrecorded asset was valued at Rs 100000. On Firm's dissolution, it was sold for 52%. Realisation Account will be credited with

A. Rs 48000
B. Rs 100000
C. Rs 52000
D. Rs 40000

Ans: (c) Rs 52,000

Q10) In case of dissolution, total creditors of the firm were Rs 40,000; creditors worth Rs10000 were given a piece of furniture costing Rs8000 in full and final settlement. Remaining creditors allowed a discount of 10%. What will be the amount with which cash will be credited in the realisation account for payment to creditors:

A. 28,000
B. 27,000
C. 20,000
D. 25,000

Ans: (b) 27,000

PART-II: Accounting for Companies
UNIT-2
Chapter -06: Issue of Share Capital

Accounting for Share Capital

Meaning and definition of company Meaning of company: A company is an organization formed by an association of persons through a process of law for undertaking (usually) a business venture.

Definition – "Company means a company incorporated under this Act or any previous company - Section 2(20) of the Companies Act, 2013.

Kinds of Companies

(i) **Companies Limited by Shares**: In this case, the liability of its members is limited to the extent of the nominal value of shares held by them.

(ii) Companies Limited by Guarantee: In this case, the liability of its members is limited to the amount they undertake to contribute in the event of the company being wound up. Thus, the liability of the members will arise only in the event of its winding up.

(iii) Unlimited Companies: When there is no limit on the liability of its members, the company is called an unlimited company. companies can be divided into three categories as follows:

(i) **Public Company:** A public company means a company which (a) is not a private company; (b) is a company which is not a subsidiary of a private company.

(ii) Private Company: A private company is one which by its articles of association:

(a) Restricts the right to transfer its shares;

(b) A private company must have at least 2 persons, except in case of one person company;

(c) Limits the number of its members to 200 (excluding its employees);

(iii) One Person Company (OPC):

Sec. 2 (62) of the companies Act, 2013, defines OPC as a "company which has only one person as a member".

Share Capital of company- Schedule III of the Companies Act, 2013 classified Share Capital as:

i. Authorized Share Capital is the maximum amount of share capital which a company is authorised to issue by its Memorandum of Association

ii. ii. Issued share capital is that part of the authorised capital which is actually issued to the public for subscription

iii. iii. Subscribed share capital is a part of issued share capital that is subscribed. Subscribed share capital is shown as

(a) Subscribed and fully paid – up

(b) Subscribed but not fully paid – up

iv. Called–up capital is that part of the subscribed capital which has been called up on the shares, i.e., what the company has asked the shareholders to pay.

v. Paid–up capital is that portion of the called-up capital which has been actually received from the shareholders. Paid up capital is equal to the called-up capital minus call in arrears.

vi. Reserve capital is a portion of its uncalled capital to be called only in the event of winding up of the company. . It is available only for the creditors on winding up of the company.

TYPES OF SHARES

a. PREFERENCE SHARES - These are the shares that carry preferential right as to dividend at fixed rate and preferential right as to repayment of capital on winding up of Company

b. EQUITY SHARES – These shares are the shares that are not preference shares. These shares do not enjoy any preferential right in the payment of dividend or repayment of capital.

PRIVATE PLACEMENT OF SHARES

It refers to issue and allotment of shares to a selected group of persons. In other words, an issue, which is not a public issue but offered to a selected group of persons, is called Private Placement of Shares.

EMPLOYEES STOCK OPTION PLAN (ESOP) –

It is the plan for granting options to subscribe shares by employees and employee directors. A company may issue stock (shares) options fulfilling the following conditions:

(a) These shares are of the same class of shares already issued;

(b) It is authorized by a special resolution passed by the company;

(c) The resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

(d) Not less than one year has, at the date of issue, elapsed since the date on which the company had commenced business and

(e) These shares are issued in accordance with SEBI regulations, if the shares are listed

ISSUE OF SHARES

Shares can be issued

(i) for cash and
(ii) (ii) for consideration other than cash.
Further, the shares can be issued
(i) at par, or (ii) at premium

SECURITIES PREMIUM –

It can be utilized for the purpose prescribed in section 52(2) of the Companies Act, 2013, which are:

(i) writing off preliminary expenses;

(ii) Writing off expenses such as share such as share issue expenses, commission, discount allowed on issue of securities;

(iii) Providing for the premium payable on redemption of debentures or Preference Shares;
(iv) in buying-back its own shares.
(v) Issuing fully paid bonus shares; CALL – It is a demand by a company from the holders of partly paid shares to pay a further instalment towards full nominal value.

CALLS-IN-ARREARS:

It is the amount not yet received by the company against the call or calls demanded. "calls in arrears is shown as deduction from called up capital".

CALLS IN ADVANCE:

It is the amount received by the company from its allotters against the calls not yet made. Calls- In-Advance is shown as 'Other Current Liability' under 'Current Liabilities' in the Balance Sheet.

Journal Entries Regarding Issue of Shares

1. ISSUE OF SHARES FOR CASH
1). Amount Payable in Lump Sum:
On Receipt of Share Application Money:
Bank a/c….………………………………………..Dr.
To Share Application and Allotment a/c
(Being the application money received)
On Transfer of Application Money:
Share Application and Allotment a/c……. Dr
To Share Capital a/c [With Nominal (face) Value]
To Securities Premium a/c [if issued at Premium Amount]
(Being the shares against share application and allotment money received)

2). Amount payable in instalments
On Receipt of Application Money
Bank A/c. Dr.
To Share Application Account
(Amount received with application).
On Allotment of Shares:
Share application A/c …………………………..Dr
To share capital Account
(Application money on allotted shares)
On Amount due on Allotment:
Share allotment A/c Dr
To Share Capital Account
(Amount due on allotment)
On receipt of allotment money:
Bank A/c ……………………………………..Dr
To Share allotment Account
(Amount received on allotment)
On first and final call due:

Share first & final call A/c………………………………………… Dr

To Share capital Account

On receipt of first and final call:

Bank A/c ……………………………………………Dr

To Share first and final call Account

(Amount received on first and final call)

<u>To record Calls in Arrear</u>

Calls in Arrears A/c. Dr.

To Share First Call Account

To Share Second and Final Call

(Amount not received on calls)

On receipt of Calls-in Arrears

Bank A/c. Dr

To Calls in Arrears Account

(Calls in Arrear Amount received)

<u>To record Calls in Advance</u>

Bank A/c Dr

To Calls in Advance

(Amount received on Calls in Advance)

On the due date of the calls, the amount of Calls in Advance adjusted

Calls in Advance A/c. Dr

To Particular Call A/c

(Calls in advance adjusted with the call money due)

UNDER SUBSCRIPTION OF SHARES –

It means shares applied for are less than the shares offered for subscription.

Under subscription is a situation where number of shares applied for is less than the number for which applications have been invited for subscription.

OVER SUBSCRIPTION OF SHARES –

It means shares applied for are more than the shares offered for subscription. Three alternatives are available to deal with the situation:

(1) Accept some applications in full and totally reject the others;

(2) Pro-rata allotment to all; and

(3) Combination of the above two alternatives

PRO RATA ALLOTMENT –

It means allotment of shares in a fixed proportion to the shares applied by the applicants. Pro rata allotment takes place only when the shares are oversubscribed.

Accounting Entries in Case of Over subscription

1. For Application Money Received

   Bank A/c …………………….Dr

   To Share Application A/c

2. Transfer of Application Money to Share capital

   Share Application A/c ………………………..Dr

   To Share Capital A/c

3. Excess Application Money Refund

   Share Application A/c …………………………Dr

   To Bank A/C

4. Adjustment of excess application money to Allotment & Calls
   Share Application A/c ……………………………Dr
   To Share Allotment A/c
   To Calls – in- Advances A/c
   OR
5. Combined Entry for recording the above
   Share Application A/c ……………………………Dr
   To share Capital A/c
   To Bank A/c
   To Share Allotment A/c
   To Calls-in–Advance A/c

ISSUE OF SHARES FOR CONSIDERATION OTHER THAN CASH

The number of shares to be issued to the vendor will be calculated as follows:

Number of shares to be issued=Amount Payable /Issue Price

The journal entries passed are:

(a) On Purchase of Assets

Sundry Assets A/cs (Individually) …Dr [With the amount of purchase price]
To Vendor's A/cs [With purchase consideration]

(b) On Purchase of Business

Sundry Assets A/cs … Dr [Agreed value of assets]
Goodwill A/c* … .Dr
To Sundry Liabilities A/c [Agreed value of liabilities]
To Vendor's A/c ** [With purchase consideration]
To Capital Reserve A/c***

Note: Purchase consideration is an amount paid by purchasing company in consideration for purchase of assets/business from other enterprise. It may be given in the question otherwise it will be equal to net assets, i.e, sundry assets minus sundry liabilities.

*If purchase consideration given is more than net assets, then the difference is debited in Goodwill Account.
** Vendor is credited by purchase consideration payable to him.
*** If purchase consideration given is less than the net assets, then the difference is credited to Capital Reserve.
Either Goodwill or Capital Reserve will appear at a time.

(c) On Issues of Shares If shares are issued to vendor at par:

Vendor's A/c ……………………………Dr [With the nominal value of share allotted]
To share Capital A/c

If shares are issued to vendor at a premium:

Vendor's A/c ………………………………………Dr [With the purchase price]
To share Capital A/c [With the nominal value of share allotted]
To Securities Premium Reserve A/c [With the amount of premium]

FORFEITURE & REISSUE OF SHARES

FORFEITURE OF SHARES-

It means cancellation of share capital due to non payment of allotment or call money when they are due and forfeiting the amount received against these shares. Forfeiture of shares takes place when a shareholder fails to pay the calls made.

A. Forfeiture of shares issued at par:

Shares capital a/c…………………………….. Dr (called up value)

To Share Forfeiture A/c (Amount paid up)

To share allotment A/c

To share call A/c

OR alternatively

Shares capital a/c…………………………….. Dr (called up value)

To Calls in arrears A/c (with the amount due from share holder)

To Share Forfeiture A/c (Amount paid up)

B. Forfeiture of shares which were originally issued at premium:

i .Securities premium amount received; and

ii. Securities Premium amount has not been received.

Accounting Entries for Forfeiture of Shares Issued at a Premium:

i) If premium has been received:

Share Capital a/c Dr.

To Share Forfeiture A/c (paid up amount- securities premium)

To Share Allotment a/c

To Share Call/calls a/c

ii) If premium has not been received:

Share Capital a/c Dr.

Securities Premium a/c Dr.

To Share Allotment a/c. (Amt due on allotment including Sec premium)

To Share call / calls a/c

To Share Forfeiture A/c

REISSUE OF FORFEITED SHARES-

Forfeited Shares can be reissued and they might have been reissued at par at premium or at a discount. But the discount on reissue of a share cannot be more than the forfeited amount of that share credited to Forfeited Share account at the time of forfeiture.

Regarding Reissue of Forfeited Shares, always keep in mind that:

1. Discount on reissue cannot exceed the forfeited amount.

2. If the discount on reissue is less than the amount forfeited, the surplus (i.e., gain on reissue of shares) is transferred to Capital Reserve.

3. When only a part of the forfeited share is reissued then the gain on reissue of such share only is transferred to Capital Reserve.

4. The forfeited amount on shares not yet reissued is shown in the Balance Sheet as an addition to the paid-up share capital.

5. When the shares are reissued at discount, such discount is debited to Forfeited Shares Account.

6. If the shares are reissued at a price which is more than the nominal (face) value of the shares, the excess amount is credited to Securities Premium Reserve Account.

7. In case of the Forfeited Shares are reissued at a price higher than the paid- up value, the excess of issue price over paid up value is credited to 'Securities Premium Reserve Account'.

REISSUE OF FORFEITED SHARES

a. If reissued at par, accounting entry is:
   Bank A/c………………………………………………….
   To Share Capital
b. If reissued at discount,
   Bank A/c………………………………………………… Dr.
   Share forfeited A/c…………………………………….. Dr
   To Share Capital a/c
c. If the forfeited shares are reissued at a price higher than that of paid-up value, the excess of reissues price over paid-up value is credited to Securities Premium Reserve a/c.
   Following entry is passed:
   Bank a/c Dr.
   To Share capital a/c
   To Securities Premium a/c

NOTE: Maximum Permissible Discount on Reissue of Forfeited Shares:

Maximum Permissible Discount on Reissue of Forfeited Shares is the amount forfeited, i.e., the amount credited to the forfeited shares.

1 MARK QUESTIONS

1	Nominal share capital is : (i) that part of the authorised capital which is issued by the company. (ii) (ii) the amount of capital which is actually applied for by the prospective shareholders. (iii) (iii) the maximum amount of share capital which a company is authorised to issue. (iv) (iv) the amount actually paid by the shareholders Ans: (iii) the maximum amount of share capital which a company is authorised to issue
2	Shares issued as sweat equity can be (I) Issued at par. (II) (ii) Issued at discount.

	(III) (iii) Issued at a premium. Which of the following is correct? A. Only (i) is correct B. Both (i) and (iii) are correct. C. All are correct. D. Only (ii) is correct. Ans: C - All are correct
3	2,000 shares allotted to Ms. Regal, on which ₹ 80 each called up and ₹ 50 paid were forfeited and reissued for ₹ 70 each as ₹ 90 paid up. Amount transferred to capital reserve A/c is A. ₹ 1,00,000 B. ₹ 60,000 C. ₹ 40,000 D. ₹ 20,000 Ans: B - ₹ 60,000
4	Mohit had applied for 900 shares, and was allotted in the ratio 3 : 2. He had paid application money of ₹ 3 per share and couldn't pay allotment money of ₹ 5 per share. First and Final call of ₹ 2 per share was not yet made by the company. His shares were forfeited. The following entry will be passed Share Capital A/c Dr. X To Share Forfeited A/c Y To Share Allotment A/c Z Here X, Y and Z are: A. ₹ 6,000; ₹ 2,700; ₹ 3,300 B. ₹ 4,800; ₹ 2,700; ₹ 2,100 C. ₹ 4,800; ₹ 1,800; ₹ 3,000 D. ₹ 6,000; ₹ 1,800; ₹ 4,200 Ans: B- ₹ 4,800; ₹ 2,700; ₹ 2,100
5	A company forfeited 6,000 shares of ₹ 10 each, on which only application money of ₹ 3 has been paid. 4,000 of these shares were re-issued at ₹ 12 per share as fully paid up. Amount of Capital Reserve will be _______. A. ₹ 18,000 B. ₹ 12,000 C. ₹ 30,000 D. ₹ 24,000 Ans: B -₹ 12,000
6	A company forfeited 3,000 shares of ₹10 each, on which only ₹5 per share (including ₹1 premium) has been paid. Out of these few shares were re-issued at a discount of ₹1 per share were and ₹6,000 were transferred to Capital Reserve. How many shares were re-issued? a) 3,000 shares b) 1,000 shares c) 2,000 shares d) 1,500 shares Ans: c). 2,000 Shares
7	If 10,000 shares of ₹10 each were forfeited for non-payment of final call money of ₹3 per share and only 7,000 of these shares were re-issued @₹ 11 per share as fully paid up, then what is the minimum amount that company must collect at the time of re-issue of the remaining 3,000 shares?

	a) ₹ 21,000 b) ₹ 9,000 c) ₹ 16,000 d) ₹ 30,000 Ans: b) ₹ 9,000
8	Mayfair Ltd. forfeited 2,000 shares of Rs.10 each, Rs.7 called up, on which only Rs. 4 per share (including Rs.2 premium) and Rs.2 per share on first call has not been paid. Out of these 500 shares were re-issued as fully paid that Rs. 750 was transferred to Capital Reserve. On reissue, how much amount will be transferred to Bank A/c? (a) Rs. 3,250 (b) Rs. 4,250 (c) Rs. 2,250 (d) Rs. 5,500 Ans: (b) Rs. 4,250
9	Read the following statements: Assertion (A) and Reason (R). Choose the correct alternative from those given below. Assertion (A) :- Under Section 62(1)(b) of the Companies Act, 2013, a Company may offer shares to its employees under a scheme of 'Employees Stock Option' which means the option (right) given to the whole-time directors, officers or permanent employees of a company to purchase or subscribe the securities offered by the company at a future date, at a pre-determined price, which is lower than the market price. Reason (R) :- The company need not to pass a special resolution to this effect. Alternatives: (a) Both Assertion (A) and Reason (R) are Correct and Reason (R) is the correct explanation of Assertion (A) (b) Both Assertion (A) and Reason (R) are Correct, but Reason (R) is not the correct explanation of Assertion (A) (c) Assertion (A) is incorrect, but Reason (R) is Correct. (d) Assertion (A) is correct, but Reason (R) is incorrect Ans: (d) Assertion (A) is correct, but Reason (R) is incorrect
10	According to Sec 50 of the Companies Act 2013, the amount of Calls in Advance can be accepted by the Company only when it is authorised by: (a) Board of Directors (b) Equity Shareholders (c) Articles of Association (d) Memorandum of Association Ans: (c)Articles of Association
11	Jeewan Ltd. invited applications for 2,00,000 shares of ₹ 10 each payable ₹ 5 on application, ₹ 3 on allotment and ₹ 2 on call. Public has applied for 3,80,000 shares. Pro-rata allotment was made in the ratio 7:4. Determine the amount to be refunded by the company at the time of allotment of shares. A. ₹ 3,00,000 B. ₹ 9,00,000 C. ₹ 1,50,000 D. ₹ 7,50,000 Ans: A) 3,00,000
12	As per section 52 of Companies Act 2013, securities premium can be utilised for which of the following purpose: I. Writing off discount allowed to debtors

	II. Providing for premium payable on redemption of debentures III. Issuing fully paid debentures as bonus IV. Issuing fully paid shares as bonus V. Buyback of shares A. Only I, II and III B. Only II, III and IV C. Only II, IV and V D. Only II and IV Ans: C) only II , IV and V
13	An issue of shares that is not a public issue but offered to a selected group of persons is called: A. Public offer B. Private placement of shares C. Initial Public offer D. Preferential allotment Ans: B) Private Placement
	Rajesh, an applicant of 8,000 shares, was allotted 5,000 shares. He paid application money of ₹ 4 (including ₹ 1 premium) but failed to pay ₹ 6 on allotment (including ₹ 2 premium) and final call of ₹ 3 His shares were forfeited and out of these 3,000 shares were re-issued @ ₹ 12 per share as fully paid up. On the basis of above hypothetical situation, answer Questions 14 and 15:
14	What amount would be reflected in Share forfeiture account upon forfeiture of shares held by Rajesh? A. ₹ 32,000 B. ₹ 20,000 C. ₹ 15,000 D. ₹ 27,000 Ans: D) ₹ 27,000
15	What amount will be transferred to Capital Reserve after re-issue of 3,000 shares? A. ₹ 16,200 B. ₹ 19,200 C. ₹ 10,200 D. Nil Ans: A) ₹ 16,200
	Nidiya limited was incorporated on 1stApril 2017 with registered office in Mumbai. The capital clause of memorandum of Association reflected a registered capital of 8,00,000 equity shares of Rs.10 each and 1,00,000 preference shares of Rs.50 each. Since some large investments were required for building and machinery the company in consultation with vendors, Ms.VPS Enterprises, issued 1,00,000 equity shares and 20,000 preference shares at par to them in full consideration of assets acquired. Besides this the company issued 2,00,000 equity shares for cash at par payable as Rs 3 on application, 2 on allotment, 3 on first call and 2 on second call. Till date second call has not yet been made and all the shareholders have paid except Mr. Ajay who did not pay allotment and calls on his 300 shares and Mr. Vipul who did not pay first call on his 200 shares. Shares of Mr. Ajay were then forfeited and out of them 100 shares were reissued at Rs.12 per share. Based on above information you are required to answer the questions 16 to 19:
16	Shares issue to vendors of building and machinery, Ms. VPS Enterprises, would be classified as:

	a. Preferential Allotment b. Employee Stock Option Plan c. Issue for Consideration other than cash d. Right Issue of Shares Ans: (c) Issue for consideration other than cash.
17	How many equity shares of the company have been subscribed? a. 3,00,000 b. 2,99,500 c. 2,99,800 d. None of these Ans: (c) Rs.2,99,800
18	What is the amount of security premium reflected in the balance sheet at the end of the year? a. ₹200 b. ₹600 c. ₹400 d. ₹ 1,000 Ans: (c) Rs.400
19	What amount of share forfeiture would be reflected in the balance sheet? a. ₹600 b. ₹900 c. ₹200 d. ₹ 300 Ans: (a) Rs. 600
	Yuvraj Ltd., a pharmaceutical company is in need of finance to meet its increased demand. Therefore, it decided to issue 60,000 equity shares of ₹100 each at ₹120 per share payable at ₹50 on application (including premium), ₹40 on allotment and the balance on the first and final call. Applications for 80,000 shares had been received. Out of the cash received ₹2,00,000 was returned and 8,00,000 was applied to the amount due on allotment all shareholders paid the call the due, with the exceptions of one shareholder of 15,000 shares. These shares were forfeited and reissued as fully paid at ₹70 per share. Answer the questions 20 to 25 on the basis of above information:
20	Excess application on_______ shares is adjusted to share allotment account. (A)16,000 (B)12,000 (C)14,000 (D)10,000 Ans: .(A)16,000
21	The amount of Calls in Arrears will be________. (A)1,50,000 (B)3,00,000 (C)4,50,000 (D)1,00,000 Ans: .(C)4,50,000
22	. At the time of forfeiture of share, Share Capital Account will be debited with______. (A)18,00,000 (B)15,00,000 (C)10,00,000 (D)12,00,000

	Ans: (b)15,00,000
23	What amount will be credited to Shares Forfeited Account at the time of forfeiture of 15,000 Shares? (A)1,50,000 (B)13,50,000 (C)10,50,000 (D)15,00,000 Ans: (c)10,50,000
24	At the time of reissue of forfeited share, how much amount will be debited to Shares Forfeited Account? (A)12,00,000 (B)10,50,000 (C)4,50,000 (D)15,00,000 Ans: (c)4,50,000
25	What amount will be transferred to capital reserve? (A)4,50,0000 (B)10,50,000 (C)6,00,000 (D)16,00,000 Ans: (c)6,00,000

3 MARKS QUESTIONS

S.NO	QUESTIONS
1	Lilly Ltd. forfeited 100 shares of ₹10 each issued at10% premium (₹8 called up) on which a shareholder did not pay ₹3 of allotment (including premium) and first call of ₹2. Out of these 60 shares were reissued to Ram as fully paid for ₹8 per share and 20 shares to Suraj as fully paid up @ ₹12 per share at different intervals of time. Prepare Share Forfeiture account.
2	A company forfeited 8,000 shares of ₹ 10 each on which ₹ 8 were called (including ₹ 1 premium) and ₹ 6 was paid (including ₹ 1 premium). Out of these 5,000 shares were reissued at maximum possible discount. Pass necessary journal entries.
3	Bansal Heavy Machine Ltd. purchased machine worth Rs.3,80,000 from Handa Trader. Payment was made as Rs.50,000 cash and remaining amount by issue of equity shares of the face value of Rs. 100 each fully paid at an issue price of Rs.110 each. Give journal entries to record the above transaction.
4	Journalise the following transactions in the books Bhushan Oil Ltd.: 200 shares of Rs.100 each issued at a premium of Rs.10 were forfeited for the non-payment of allotment money of Rs.60 per share. The first and final call of Rs.20 per share on these shares were not made. The forfeited shares were reissued at Rs.70 per share as fully paid-up.
5	150 shares of Rs.10 each issued at a premium of Rs.4 per share payable with allotment were forfeited for non-payment of allotment money of Rs.8 per share including premium. The first and final calls of Rs.4 per share were not made. The forfeited shares were reissued at Rs.15 per share fully paid-up. Give journal entries to record the above transaction.

Answers of 3 Marks Questions

1. **Share Forfeiture A/c**

Particulars	Amt(₹)	Particulars	Amt(₹)
To Share Capital A/c	120	By Share Capital A/c	400
To Capital Reserve A/c	120		
To Capital Reserve A/c	80		
To Balance c/d	80		
	400		400

2.

Date	Particulars		Debit	Credit
	Share Capital A/c	Dr	56,000	
	To Shares Forfeited A/c To Calls in arrears A/c			40,000 16,000
	(Being Shares forfeited)			
	Bank A/c	Dr	10,000	
	Shares Forfeited A/c	Dr	25,000	
	To Share Capital A/c			35,000
	(Being 5000 shares reissued at discount)			

Ans 3:

Numbers of shares issued = 3,000 shares

Ans 4 Capital Reserve NIL

Ans 5 Capital Reserve 300

4 MARKS QUESTIONS

S.NO	QUESTIONS
1	Atishyokti Ltd. company was registered with an authorized capital of ₹ 20,00,000 divided into 2,00,000 Equity Shares of ₹ 10 each, payable ₹ 3 on application, ₹ 6 on allotment (including ₹ 1 premium) and balance on call. The company offered 80,000 shares for public subscription. All the money has been duly called and received except allotment and call money on 5,000 shares held by Manish and call money on 4,000 shares held by Alok. Manish's shares were forfeited and out of these 3,000 shares were re-issued ₹ 9 per share as fully paid up. Show share capital in the books of the company. Also prepare notes to accounts.
2	Rihaan Ltd had an authorised capital of 4,00,000 equity shares of ₹10 each. The company offered for subscription 1,00,000 shares. The issue was fully subscribed . The amount payable on application was ₹2 per share, ₹4 per share were payable each on allotment and first and final call. A shareholder holding 100 shares failed to pay the allotment money. His shares were forfeited immediately after the allotment. Show how the 'Share Capital will be shown in the company's balance sheet (as per Schedule III, Part I of the Company's Act, 2013) if the final call has not yet been made. Also prepare Notes to Accounts for same.

3	Jindal and Company purchased a machine from High Life Machine Limited for Rs.3,80,000. As per purchase agreement, Rs. 20,000 were paid in cash and balance by issue of shares of Rs.100 each. What will be the entries passed if the shares are issued : (a) at par (b) at 20% premium
4	The director of Poly Plastic Limited resolved that 200 equity shares of Rs.100 each be forfeited for non-payment of the second and final call of Rs.30 per share. Out of these, 150 shares were re-issued at Rs.60 per share to Mohit. Show the necessary journal entries
5	Ashoka Limited Company which had issued equity shares of Rs.20 each at a premium of Rs. 4 per share, forfeited 1,000 shares for non-payment of final call of Rs.2 per share. 400 of the forfeited shares were reissued at Rs.14 per share out of the remaining shares of 200 shares reissued at Rs.20 per share. Give journal entries for the forfeiture and reissue of shares and show the amount transferred to capital reserve and the balance in Share Forfeiture Account

ANSWERS TO 4 MARKS QUESTIONS

Ans1.

Balance Sheet (Extract) as at

Particulars	Note No	Amount
I. EQUITY AND LIABILITIES		
(1) Shareholder's Funds		
(a) Share Capital	1	7,78,000

Notes to Accounts:

Note 1

Particulars	**Amount (Rs)**
1. Share Capital	
Authorised Capital	
2,00,000 Equity shares of Rs.10 each	20,00,000
Issued Capital	
80000 Equity shares of 10 each	8,00,000
Subscribed capital	
Subscribed and fully paid up	
74,000 equity shares of 10 each	740000
Subscribed but not fully paid-up	
4000 equity shares of Rs 10 each 40000	
Less: calls in arrears (4,000x2) 8000	32000
Add Forfeited Shares	
2,000 equity shares@3	6000
	778000

Ans2. **Balance Sheet of Rihaan Limited as at 31St March-**

---------- As per Schedule – III

Particulars	Note No	Amount(Rs)
Equity and Liabilities Shareholders Funds	1	599600

Notes To Account:

Autorised Capital 4000000

Issued Capital 1000000

Subscribed Capital 599600

Ans 3. Number of shares will be calculated as follows:
(a) When shares issued at par
Rs. 3,60,000 = 3,600 shares
Rs.100
(b) When shares issued at premium
Rs . 3 , 6 0 , 0 0 0 = 3,000 shares
Rs.120

Books of Jindal and Company
Journal

Machine A/c	Dr.	3,80,000	
To Bank A/c			20,000
To High Life Machine Limited			3,60,000
(Machine purchased and Rs. 20,000 paid in cash and the balance paid by issue of share)			

(a) *When shares are issued at par*

High Life Machine Limited	Dr.	3,60,000	
To Share Capital A/c			3,60,000
(3,600 Shares are Rs.100 each)			

(b) *When shares are issued at premium*

High Life Machine Limited	Dr	. 3,60,000	
To Share Capital A/c			3,00,000
To Securities Premium Reserve A/c			60,000
(3,000 shares issued at Rs.120 per share)			

Ans4

Books of Poly Plastic Limited
Journal

Share Capital A/c	Dr.	20,000	
To Shares Forfeiture A/c			14,000
To Share Second and Final Call A/c			6,000
(200 shares forfeited for non-payment of final call at Rs.30 per share)			
Bank A/c	Dr	. 9,000	
Shares Forfeiture A/c	Dr.	6,000	
To Share Capital A/c			15,000
(Reissue of 150 shares of Rs.100 each, issued as fully paid for Rs.60 each)			
Shares Forfeiture A/c	Dr.	4,500	
To Capital Reserve A/c			4,500
(Profit on reissue of 150 forfeited shares transferred to capital reserve)			

Working Notes :
Rs.
Total amount forfeited on 200 shares = 14,000 (200 shares × Rs. 70)
Amount forfeited on 150 shares = 10,500 (150 shares × Rs. 70)
Amount of loss on reissue of 150 shares = 6,000 (150 shares × Rs. 40)

Amount of profit on reissued shares
transferred to capital reserve = 4,500 (Rs. 10,500 – Rs. 6,000)
Amount forfeited on 50 shares = 3,500 (50 shares × Rs. 70)
Balance left in share forfeited account = 3,500 (Rs.14,000 – Rs. 6,000
(equal to amount forfeited on 50 shares) – Rs. 4,500)

Ans5

Capital Reserve = Rs. 8,400, Balance of Share Forfeiture Account:
Rs. 7200)

6 MARKS QUESTIONS

S.NO	QUESTIONS
1	The Directors of Rockstar Ltd. invited applications for 2,00,000 Shares of ₹ 10 each, issued at 20% premium. Share was payable as ₹ 5 on application, ₹ 4 (including premium) on allotment and balance on call. Public had applied for 3,20,000 shares out of which applications for 20,000 shares were rejected and remaining were alloted on pro-rata basis. Simba, an applicant of 15,000 shares failed to pay allotment and call money. His shares were forfeited and out of these 6,000 shares were reissued at a discount of ₹2 per share. Journalise.
2	K.N. Ltd. invited applications for issuing 6,00,000 equity shares of ₹10 each at a premium of ₹3 per share. The amount was payable as follows:

	On Application and Allotment - ₹3 per share; On First Call -₹4 per share; On Second and Final Call — Balance (including premium). The issue was oversubscribed by 1,50,000 shares. Applications for 50,000 shares were rejected and the application money was refunded. Shares were allotted to the remaining applicants as follows: I: Those who had applied for 4,00,000 shares were allotted 3,00,000 shares on pro- rata basis. Category II: The remaining applicants were allotted the remaining shares. Excess application money received with applications was adjusted towards sums due on first call. Rakesh to whom 6,000 shares were allotted (out of Category I) failed to pay the first call money. His shares were forfeited. The forfeited shares were re-issued at ₹13 per share fully paid up after the second call. Pass necessary journal entries for the above transactions in the books of K.N. Ltd.
3	Royal Fans Ltd. invited applications for 1,00,000 Equity Shares of Rs.100 each at a premium of 10%. The amount was payable as follows: On Application Rs. 50 per share On Allotment Rs. 35 per share (including premium) On First and Final Call Rs. 25 per share Applications for 1,50,000 shares were received. Applicants for 25,000 shares did not get any allotment and their money returned. Allotment was made pro-rata to the remaining applicants. Excess application money was adjusted towards sum due on allotment. Mr. Hanoz who was allotted 600 shares failed to pay the amount due on allotment and call money. The company forfeited his shares and subsequently re-issued at Rs 110 per share fully paid-up. You are required to pass journal entries to record the above transactions in the books of the company.
4	Priyanshu Ltd invited applications for issuing 80,000 equity shares of ₹ 100 each at a premium of ₹ 10. The amount was payable as follows: On Application – ₹ 30 ; On allotment – ₹ 30 (including a premium of ₹ 10) ; On first call –balance Applications of 2,30,000 shares were received. Allotment was made on pro rata basis to applicants of 1,80,000 shares and remaining were sent letters of regret. Excess money on application was to be utilised towards allotment and subsequent calls. David, who was allotted 1,600 shares, paid nothing after application. These shares were forfeited after the first call. 1,000 of these shares were re-issued to Sundar for ₹ 95 per share as fully paid. Pass necessary journal entries in books of Priyanshu Ltd
5	X Ltd. issued for public subscription 40,000 equity shares of Rs. 10 each at premium of Rs. 2 per share payable as under : On application Rs. 4 per share On Allotment Rs. 5 per share (including premium) On Call Rs. 3 per share Applications were received for 60,000 shares. Allotment was made pro-rata to the applicants for 48,000 shares, the remaining applications being rejected. Money overpaid on application was applied towards sums due on allotment. Shri Chitnis, to whom 1,600 shares were allotted, failed to pay the allotment money and Shri Jagdale, to whom 2,000 shares were allotted, failed to pay the call money. These shares were subsequently forfeited.

	Record journal entries in the books of the company to record the above transactions.
6	Ashok Limited issued 3,00,000 equity shares of Rs. 10 each at a premium of Rs. 2 per share, payable as Rs. 3 on application, Rs. 5 on allotment (including premium) and the balance in two calls of equal amount. Applications were received for 4,00,000 shares and pro-rata allotment was made to all the applicants. The excess application money was adjusted towards allotment. Mukesh who was allotted 800 shares failed to pay both the calls and his shares were forfeited after the second call. Record necessary journal entries in the books of Ashok Limited.

ANSWERS TO 6 MARKS QUESTIONS:

Ans 1 Journal Entries in the Books of Rockstar Ltd.

i)	Bank A/c Dr. To Share Application A/c (Being Application money received)		16,00,000	 16,00,000
ii)	Share Application A/c Dr. To Share Capital A/c To Share Allotment A/c To Bank A/c (Being Application money utilised)		16,00,000	 10,00,000 5,00,000 1,00,000
iii)	Share Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c (Being allotment due with premium)		8,00,000	 4,00,000 4,00,000
iv)	Bank A/c Dr. Calls in Arrears A/c Dr. To Share Allotment A/c (Being allotment received except of Simba)		2,85,000 15,000	 3,00,000
v)	Share First and Final Call A/c Dr. To Share Capital A/c (Being call money due)		6,00,000	 6,00,000
vi)	Bank A/c Dr. Calls in Arrears A/c Dr. To Share First and Final Call A/c (Being call money received except of Simba)		5,70,000 30,000	 6,00,000
vii)	Share Capital A/c Dr. Securities Premium A/c dr. To Share Forfeited A/c To Calls in Arrears A/c (Being Simba’s shares forfeited)		1,00,000 15,000	 70,000 45,000
viii)	Bank A/c Dr. Share Forfeited A/c Dr. To Share Capital A/c (Being forfeited shares re-issued)		48,000 12,000	 60,000

ix)	Share Forfeited A/c Dr. To Capital Reserve A/c (Being gain on re-issue transferred to Capital Reserve)		30,000	 30,000

Ans 2.

Particulars	Debit	Credit
Bank A/c To Share Application and allotment A/c (Being Application and allotment money received)	22,50,000	 22,50,000
Share Application and allotment A/cDr To Equity Share Capital A/c To Share First call A/c To Bank A/c (Being application and allotment money adjusted and excess refunded)	22,50,000	 18,00,000 3,00,000 1,50,000
Share 1st Call A/c Dr To Equity Share Capital A/c (Being call money due)	24,00,000	 24,00,000
Bank A/c Dr	20,82,000	
Calls In arrears A/c Dr To Share 1st Call A/c (Being call money received except on 6,000 shares)	18,000	 21,00,000
Share Capital A/c Dr To Shares Forfeited A/c To Calls in arrears (Being 6000 shares forfeited)	42,000	 24,000 18,000
Share 2nd Call A/c Dr To Share Capital A/c To Securities Premium A/c (Being 2nd Call money due)	35,64,000	 17,82,000 17,82,000
Bank A/c Dr To Share 2nd Call A/c (Being 2nd Call money received)	35,64,000	 35,64,000
Bank A/c Dr	78,000	

To Share Capital A/c To Securities Premium A/c (Being forfeited shares reissued)		60,000 18,000
Shares Forfeited A/c Dr To Capital Reserve A/c (Being balance transferred to capital reserve)	24,000	24,000

Ans 3. **Journal**

Date	Particulars	L.F	Dr.	Cr.
	Bank A/c (1,50,000 X 50) Dr		75,00,000	
	To Share Application A/c			75,00,000
	(Application money received on 1,50,000 shares)			
	Share Application A/c Dr		75,00,000	
	To Share Capital A/c (1,00,000 X 50)			50,00,000
	To Share Allotment A/c			12,50,000
	To Bank A/c			12,50,000
	(Amount transferred to share capital and excess adjusted)			
	Share Allotment A/c Dr		35,00,000	
	To Share Capital A/c			25,00,000
	To Securities Premium A/c			10,00,000
	(Allotment due)			
	Bank A/c Dr		22,36,500	
	To Share Allotment A/c			22,36,500
	(Allotment money received)			
	Share First & Final Call A/c Dr		25,00,000	
	To Share Capital A/c			25,00,000
	(Call money due)			
	Bank A/c(99,400 x 25) Dr		24,85,000	
	To Share First & Final Call A/c			24,85,000
	(Call money received)			
	Share Capital A/c(600 x 100) Dr		60,000	

	Securities Premium A/c		6,000	
	D			37,500
	r To Share Forfeiture A/c			13,500
	To Share Allotment A/c			15,000
	To Share First & Final Call A/c			
	(Shares forfeited for non-payment of allotment &			
	call) Bank A/c(600 x 110) Dr		66,000	
	To Share Capital A/c			60,000
	To Securities Premium A/c			6,000
	(Shares reissued at fully paid-			
	up)		37,500	
	Share Forfeiture A/c Dr			37,500
	To Capital Reserve A/c			
	(Gain on reissued shares transferred)			

Working notes:

Working notes:

Mr. Hanoz has been allotted 600 shares
If shares allotted were 600, shares applied for were = 1,25,000/1,00,000 x 600 = 750 shares Excess Application money received from Mr. Hanoz:
750 shares – 600 shares = 150 shares x Rs. 50 = 7500
Amount due from Mr. Hanoz on Allotment:

600 shares x Rs. 35 = Rs. 21,000
Less:- Excess received on application from Mr. Hanoz = 7500
Net amount due from Mr. Hanoz, not been received= Rs. 13500

Total amount due on allotment 1,00,000 x Rs. 35 = Rs. 35,00,000

Less:- Excess received on applications = Rs. 12,50,000

Less:- Amount not been received from Mr. Hanoz = Rs. 13,500

Net amount received on allotment in cash = Rs. 22,36,500

Ans 4.

1	Bank A/c – Dr	69,00,000	
	To Share Application A/c		69,00,000
	(Being Share application money received)		

2	Share Application A/c – Dr	69,00,000	
	To Share Capital A/c		24,00,000
	To Share Allotment A/c		24,00,000
	To Call in advance A/c		6,00,000
	To Bank A/c		15,00,000
	(Being application money transferred to capital, allotment and calls in advance and excess refunded)		
3	Share Allotment A/c – Dr	24,00,000	
	To Share Capital A/c		16,00,000
	To Security Premium A/c		8,00,000
	Being Share allotment money including premium due)		
4	Share 1st Call A/c – Dr	40,00,000	
	To Share Capital A/c		40,00,000
	(Being first call money due)		
6	Bank A/c – Dr	33,32,000	
	Calls In Arrears A/c – Dr	68,000	
	Call in advance A/c	6,00,000	
	To Share 1st Call A/c		40,00,000
	(Being first call money received and calls in advance adjusted)		
7	Share Capital A/c – Dr	1,60,000	
	To Forfeited Shares A/c		92,000
	To Calls In Arrears A/c		68,000
	(Being shares forfeited)		
8	Bank A/c – Dr	95,000	
	Share forfeiture a/c - Dr	5,000	
	To Share Capital A/c		1,00,000
	(Being shares reissued)		
9	Forfeited Shares A/c Dr	52,500	
	To Capital Reserve A/c		52,500
	(Being share forfeiture money transferred to Capital Reserve)		

Ans 5

Books of X Ltd.
Journal

Bank A/c	Dr	. 2,40,000	
To Equity Share Application A/c			2,40,000
(Money received on applications for 60,000 shares @ Rs. 4 per share)			

Equity Share Application A/c	Dr.	2,40,000	
To Equity Share Capital A/c			1,60,000
To Equity Share Allotment A/c			32,000
To Bank a/c			48,000
(Application amount transferred to share capital, excess application money under pro-rata distribution credited to share allotment and money refunded on rejected application			
Equity Share Allotment A/c	Dr.	2,00,000	
To Equity Share Capital A/c			1,20,000
To Securities Premium Reserve A/c			80,000
(Amount due on allotment of 40,000 shares @ Rs. 5 per share including premium)			
Bank A/c	Dr.	1,61,280	
Calls-in-Arrears A/c	Dr.	6,720	
To Equity Share Allotment A/c			1,68,000
(Money received consequent upon allotment)			
Equity Share Call A/c	Dr	. 1,20,000	
To Equity Share Capital A/c			1,20,000
(First call money due on 40,000 shares @ Rs. 3 per share)			
Bank A/c	Dr	. 1,09,200	
Calls-in-Arrears A/c	Dr.	10,800	
To Equity Share Call A/c			1,20,000
(Money received on first call)			
Equity Share Capital A/c	Dr.	36,000	
Securities Premium Reserve A/c	Dr.	3,200	
To Share Forfeiture A/c			21,680
To Call-in-Arrears A/c			17,520
(Entry for forfeiture of 3,600 shares)			

Ans 6

Books of Ashok Limited
Journal

Bank A/c	Dr.	12,00,000	
To Equity Share Application A/c			12,00,000
(Application money received on 4,00,000 shares)			
Equity Share Application A/c	Dr.	12,00,000	
To Equity Share Capital A/c			9,00,000
To Equity Share Allotment A/c			3,00,000

(Application money on 3,00,000 shares transferred
to share capital account and the excess amount
adjusted to share allotment account)

Equity Share Allotment A/c	Dr.	15,00,000	
To Equity Share Capital A/c			9,00,000
To Securities Premium Reserve A/c			6,00,000
(Allotment money due on 3,00,000 shares)			
Bank A/c	Dr.	12,00,000	
To Equity Share Allotment A/c			12,00,000
(Allotment amount received after adjusting excess money received with application)			
Equity Share First Call A/c	Dr.	6,00,000	
To Equity Share Capital A/c			6,00,000
(First Call amount due on 3,00,000 shares			
Bank A/c	Dr.	5,98,400	
Calls in Arrears A/c	Dr.	1,600	
To Equity Share First Call A/c			6,00,000
(First Call amount received on 2,99,200 shares)			
Equity Share Second and Final Call A/c	Dr.	6,00,000	
To Equity Share Capital A/c			6,00,000
(Second Call amount due on 3,00,000 Shares)			
Bank A/c	Dr.	5,98,400	
Calls in Arrears A/c	Dr.	1,600	
To Equity Share Second and Final Call A/c			6,00,000
(Amount on 2,99,200 shares received)			
Equity Share Capital A/c	Dr.	8,000	
To Share Forfeiture A/c			4,800
To Call in Arrears A/c			3,200
(Forfeiture of 800 shares)			

Chapter- 07 : Issue of Debentures

Accounting for Debentures

Chapter at a Glance:

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

A Debenture is a written document acknowledging debt.

Types of Debentures
A. From Security point of view-
1. Secured debentures- Debentures which are secured by a charge on the assets of the company.
2. Unsecured debentures- Debentures which are not secured by charge on the assets of the company.

B. From Redemption point of view
1. Redeemable debentures- Debentures having a fixed life after which they will be redeemed.
2. Irredeemable debentures- Debentures having no fixed date of redemption.

C. From registration point of view-
1. Registered debentures- Debentures which are registered in the name of the debenture holders in company's records.
2. Unregistered/bearer debentures- Debentures which are not registered in the name of the debenture holders.

D. From convertibility point of view-
1. Convertible debentures- Debentures which can be converted into shares after a fixed period of time.
2. Non-convertible debentures- Debentures which cannot be converted into shares.

Issue of debentures- For Cash

1. Bank A/c Dr.
   To Debentures Application & Allotment A/c
   (being application money received)
2. Debentures Application & Allotment A/c Dr.
   To __% Debentures A/c
   (Being debentures allotted)
3. Debentures Application & Allotment A/c Dr.
   To Bank A/c
   (being excess money refunded)

When Debentures are issued at premium-
Debentures Application & Allotment A/c Dr.
To ___% Debentures A/c
To Securities premium A/c

When debentures are issued at discount-

Debentures Application & Allotment A/c Dr.
Discount on issue of debentures A/c Dr.
  To __% Debentures A/c

Issue of debentures for consideration other than cash

Issue of Debentures to promoters-

Incorporation Expenses/preliminary Expenses A/c Dr.
  To Promoters' A/c

Issue of debentures to underwriters

Underwriting Commission A/c Dr.
  To Underwriters A/c

Issue of debentures to vendors

Sundry Assets A/c Dr
Goodwill A/c Dr*
  To Sundry Liabilities A/c
  To Vendor's A/c
  To Capital Reserve A/c*

Payment made-

Promoters'/Underwriters'/Vendors' A/c Dr.
Discount on issue of debentures A/c Dr.*
  To ___% Debentures A/c
  To Securities Premium A/c*

* either of the two will appear

Issue of debentures as a collateral security

1. Without passing entry- debentures are shown as a note along with loan in balance sheet.

2. By journal entry-

Debenture suspense A/c Dr.
  To __% Debentures A/c

Issue of debentures from point of view of redemption

1. **Issue at par and redeemable at par**
   Bank A/c Dr.
     To Debentures Application & Allotment A/c

   Debentures Application & Allotment A/c Dr.
     To ___% Debentures A/c
2. **Issue at discount and redeemable at par**
   Bank A/c Dr.
     To Debentures Application & Allotment A/c

   Debentures Application & Allotment A/c Dr.
   Discount on issue of debentures A/c Dr.
     To ___% Debentures A/c

3. **Issue at premium and redeemable at par**
   Bank A/c Dr.
   To Debentures Application & Allotment A/c

   Debentures Application & Allotment A/c Dr.
   To ___% Debentures A/c
   To Securities premium A/c
4. **Issue at par and redeemable at premium**
   Bank A/c Dr.
   To Debentures Application & Allotment A/c

   Debentures Application & Allotment A/c Dr.
   Loss on issue of debentures A/c Dr.
   To ___% Debentures A/c
   To Premium on redemption A/c
5. **Issue at discount and redeemable at premium**
   Bank A/c Dr.
   To Debentures Application & Allotment A/c

   Debentures Application & Allotment A/c Dr.
   Discount on issue of debentures A/c Dr.
   Loss on issue of debentures A/c Dr.
   To ___% Debentures A/c
   To Premium on redemption A/c
6. **Issue at premium and redeemable at premium**
   Bank A/c Dr.
   To Debentures Application & Allotment A/c

   Debentures Application & Allotment A/c Dr.
   Loss on issue of debentures A/c Dr.
   To ___% Debentures A/c
   To Premium on redemption A/c
   To Securities premium A/c

Interest on debentures- applied on Face value of debentures

1. Debenture interest A/c Dr.
   To Debenture holders A/c
2. Debenture holders A/c Dr.
   To Bank A/c
3. Statement of P&l Dr.
   To Debenture interest A/c

Writing off discount or Loss on issue of debentures- Written off in the year debentures are allotted

Securities premium A/c Dr.
Statement of P&l Dr.
To Discount or loss on issue of debentures A/c

Question Bank

MCQs/ VSAs (1 Mark)

Q1. Debenture holders are:

(A) Owners of the Company
(B) Debtors of the Company
(C) Creditors of the Company
(D) Promoters of the Company

Q2. Debentures of a Company can be issued:

(A) For Cash
(B) For Consideration other than Cash
(C) As a Collateral Security
(D) Any of the above

Q3. Interest on Debenture is:

(A) Appropriation of profit
(B) Capital gain
(C) Charge against profit
(D) Dividend

Q4. Debentures which are transferable by mere delivery are
(A) registered debentures
(B) first debentures
(C) **bearer debentures**
(D) second debentures.

Q5. When debentures are issued at par and redeemable and premium the loss on such an issue is debited to:
(A) profit and loss account
(B) debenture application and allotment account
(C) **loss on issue of debentures account**
(D) discount on issue of debentures account

Q6. ABC took over the assets of Rs7,60,000 and liabilities of Rs80,000 of Y limited for purchase consideration of Rs5,85,000 payable by the issue of 12% debentures of Rs100 each at a discount of 10%. The number of debentures to be issued is:
(A) 6600
(B) **6500**
(C) 4500
(D) 5400

Q7. Collateral security means ____________security:
(A) primary
(B) **secondary**
(C) government
(D) valuable.

Q8. If X ltd issued 1,000; 10% Debentures of Rs100 each at a discount of 5% but redeemable after 4 years at a premium of 6%, loss on issue of Debentures a/c will be debited by ________________________. (Rs11,000)

Q9. If X ltd purchased plant worth Rs5 lakh from Y ltd but agreed to issue 5250 10% Debentures of Rs100 each to Vendor. The difference in the amount will be adjusted in ____________account. (goodwill)

Q10. Match the following:

List 1	List 2
1.Debentures are transferable by Mere Delivery	A) Bearer Debentures
2.Debentures redeemable either in Lump Sum or Installments	B) Redeemable Debentures
3. Excess Value of Net Assest consideration.	C) Capital Reserve
4. Excess of Purchase consideration over Value of net assest.	D)Goodwill Account

Ans- 1- A, 2-B, 3-C, 4-D

Q11. Give journal entry when 30,000, 8% debentures of Rs 100 each are issued as a collateral security against a loan raised from the bank amounting Rs 20,00,000.

Ans- Debenture suspense a/c Dr 30L
To 8% Debenture account 30L
(being 30,000 debentures issued as a collateral security)

Q12. Assertion(A) : Debenture holder gets interest at the stated rate whether the company earns profit or not
Reason(R) : interest on debenture is treated as an appropriation of profit
a. Both Assertion (A) and Reason(R) are true and reason is correct explanation of assertion.
b. Assertion(A) and Reason(R) both are true but reason is not the correct explanation of assertion.
c. Assertion(A) is true, Reason(R) is false.
d. Assertion(A) is false, Reason(R) is true

Q13. Assertion (A): Interest is paid by the company on Debentures issued as collateral security.
Reason(R) : Interest is paid by the company on Debentures, including debentures issued as collateral security
In the context of the above statements, which of the following is correct?
A. Both Assertion (A) and Reason (R) are True and Reason (R) is the correct explanation of Assertion (A) B. Both Assertion (A) and Reason (R) are True and Reason (R) is not the correct explanation of Assertion (A)
C. Assertion (A) is True but Reason (R) is False.
D. Assertion (A) and Reason (R) are incorrect

Q14. Anoop ltd bought business of Agrawal ltd consisting assets of ₹ 3,60,000 and liabilities of ₹1,00,000 for a purchase consideration of ₹3,07,200. It issued 10%debentures of ₹100 each at a discount of 4%. The amount by which goodwill A/C or Capital reserve will be debited or credited will be__________

a) ₹50,000 Goodwill (debited)

b) ₹47,200 Goodwill (debited)

c) ₹47,200 Capital reserve (debited)

d) ₹50,000 Capital reserve (credited)

Q15. Anoop ltd bought business of Agrawal ltd consisting assets of ₹ 3,60,000 and liabilities of ₹1,00,000 for a purchase consideration of ₹3,07,200. It issued 10%debentures of ₹100 each

at a discount of 4%. Find out the number of debentures to be issued to Agrawal ltd.
a) 4,000
b) 6,500
c) 3,200
d) 1,200

Q16. A company can issue debenture with voting rights. (TRUE/FALSE)
Ans- False

Q17. In case a company issued 1200 8% debentures of ₹10 each with a premium of 5% which are redeemable at premium of 10%. Mark out the wrong treatment out of the given options.
a) Security premium account Debited with 600
b) Security premium account credited with 600
c) Premium on redemption of debenture Credited with 1200
d) Loss on issue of debentures debited with 1200

Q18. Which of the following is correct about loss on issue of debentures?
(a) It is written-off out of securities premium reserve only
(b) It is written-off out of statement of profit and loss only
(c) It is written-off out of discount on issue of debentures account
(d) It is written-off out of securities premium and statement of profit and loss

Q19. Debentures are shown in the balance sheet of the company under the head of ;
A) Non current liabilities
B) Current liability
C) Share capital
D) None of the these

Q20. In case of debenture of RS 10,000 are issued at par but redeemable at a premium of 10% , The premium payable is debited to :
A) Debenture suspense account
B) Premium on redemption of debentures
C) Loss on issue of debentures
D) A & B both

3/4 marks Questions
Q1. Give journal entries in each of the following cases if the face value of a debenture is Rs.100:
(i) A debenture issued at Rs.110 repayable at Rs.100.
(ii) A debenture issued at Rs.100 repayable at Rs.105.
(iii) A debenture issued at Rs.105 repayable at Rs.105.
Ans-
Case 1. (i) Bank A/c Dr. 110;
To Debenture Application & Allotment A/c Cr.110
(ii) Debenture Application & Allotment A/c Cr. 110;
To Debentures Cr 100;
To Securities premium Cr 10
Case 2. (i) Bank A/c Dr. 100;
To Debenture Application & Allotment A/c Cr.100

(ii) Debenture Application & Allotment A/c Dr.100;
Loss on issue Dr.5;
To Debentures Cr 100;
To Premium on Redemption Cr 5
Case 3. (i) Bank Dr 105;
To Debenture Application & Allotment A/c Cr. 105
(ii) Debenture Application & Allotment A/c Dr. 105;
Loss on issue Dr 5;
To Debentures Cr 100;
To Securities Premium Cr 5;
To Premium on Redemption Cr 5.

Q2. a) CNC Ltd. Acquired assets worth ₹ 2,90,000 and liabilities worth ₹ 40,000 of Alpha ltd.for ₹ 2,40,000 and issued 10% debentures of Rs. 100 at a premium of 20% to vendor on 1st April 2016.

b) On 1st June 2016 it took bank loan for ₹ 1,30,000 from Dena bank and issued debentures worth ₹ 1,50,000 as collateral security.

Record these transactions in the books of CNC ltd.
Ans- a) Sundry assets a/c dr. 290000
To creditor a/c 40000
To alpha ltd. 240000
To capital reserve a/c 10000(balancing figure)
(for business of alpha ltd. Purchase for ₹. 2,40,000)
Alpha Ltd A/c Dr. 240000
To 10% Debentures A/c 200000
To Securities premium A/c 40000
b) Bank a/c dr. 130000
To bank loan a/c 130000
Debenture suspense a/c 130000
To 9% debenture account 130000

Q3. Times sports ltd. Issued 15,000; 10% debentures of ₹ 100 each on 1st April,2016. The issue was fully subscribed. According to the terms of issue, interest is payable on half-yearly basis. Pass journal entries for interest for the year ended 31st march,2017(ignore TDS).

Ans.

Date	Particulars	l.f.	Dr.(₹)	Cr.(₹)
2016 Sept. 30	Debentures interest a/c dr. To debenture holders' a/c (being the interest on debenture payable for the half-year ended 30th Sept,2017)		75,000	 75,000
	Debenture holders a/c dr. To bank a/c (being the interest paid to debenture holders)		75,000	 75,000

2017 March 31	Debentures' interest a/c dr. To debenture holder' a/c (being the interest on debenture payable for the half-year ended 31st march,2017)		75,000	75,000
	Debenture holders a/c dr. To bank a/c (being the interest paid to debenture holders)		75,000	75,000
March 31	Statement of profit and loss (finance cost) dr. To debentures' interest a/c (being the interest on debentures transferred to statement of profit and loss)		1,50,000	1,50,000

Q4. X ltd made the following issue of debentures

a) For cash at 95% Rs 4,00,000 8% Debentures of Rs 100 each

b) To a creditor who supplied furniture worth Rs 2,60,000, 2800 8% debentures of Rs 100 each

c) To bank as a collateral security 2000 12% debentures of Rs 100 each against bank loan raised Rs 1,60,000

Journalize the following transactions in the books of X Ltd.

Ans-

a) Bank a/c Dr 3,80,000
To 8% Debenture application Allotment a/c 3,80,000
(Being debenture application and allotment received)

8% Debenture application allotment a/c Dr 380000
Discount on issue of debenture a/c Dr 20000
To 8% Debenture a/c 400000
(being debenture application and allotment transferred to Debenture account)
b) Vendor a/c Dr 2,60,000
Discount on issue of debenture a/c Dr 20000
To 8% Debenture a/c 280000
(Being debentures issued to the vendor)
c) Debenture suspense a/c Dr 200000
To 12% Debenture a/c 200000
(Being debentures issued as a collateral security)

Q5. Read the passage given below and answer the following question -
Bee ltd purchased the following assets of See ltd. Land and building of Rs55,00,000 at Rs 75,00,000; Furniture Rs20,00,000; and Machinery Rs 30,00,000. The purchase consideration was Rs 1,00,00,000. Payment of Rs 10,00,000 was made through cheque and remaining amount by issue of 9% debentures of Rs100 each at a premium of 20%
1. According to Companies Act 2013, what is the maximum rate of premium at which debentures can be

issued ?

a. 10% b. 15% c. 20% **d. maximum limit not specified**

2. Amount credited to Capital Reserve A/c is

a.25,00,000 b. 20,00,000 c. 15,00,000 d,1 0,00,000

3. What is the number of debentures to be issued?

a.65,000 b.70,000 **c. 75,000** d. 80,000

4. Securities premium A/c is to be credited with

a.10,00,000 **b.15,00,000** c.20,00,000 d.25,00,000

Q6. Read the passage given below and answer the following questions -

ABC decided to acquire the running business of Y ltd, so it took over the assets of Rs 6,60,000 and liabilities of Rs 80,000 of Y limited for a purchase consideration of Rs5,85,000 payable by the issue of 12% debentures of Rs100 each at a discount of 10%.

1. Goodwill A/c will be debited with

a.10,000 b 15,000 **c 5,000** d.8,000

2. Discount on issue of debenture is written off, in the year debentures are allotted, in the following sequence—

a. Securities premium, statement of Profit and loss

b. Securities premium reserve, statement of Profit and loss, capital reserve

c. capital reserve, securities premium reserve, statement of Profit and loss

d. statement of Profit and loss, capital reserve, securities premium reserve

3. The number of debentures to be issued is:

a. 6600 **b. 6500** c. 4500 d. 5400.

4. 12% Debentures Account is credited with

a. 6,50,000 b.7,00,000 **c. 6,00,000** d.7,50,000

Q6. Read the passage given below and answer the following questions -

ABC decided to acquire the running business of Y ltd, so it took over the assets of Rs 6,60,000 and liabilities of Rs 80,000 of Y limited for a purchase consideration of Rs5,85,000 payable by the issue of 12% debentures of Rs100 each at a discount of 10%.

1. Goodwill A/c will be debited with

a.10,000 b 15,000 **c 5,000** d.8,000

2. Discount on issue of debenture is written off, in the year debentures are allotted, in the following sequence—

a. Securities premium, statement of Profit and loss

b. Securities premium reserve, statement of Profit and loss, capital reserve

c. capital reserve, securities premium reserve, statement of Profit and loss

d. statement of Profit and loss, capital reserve, securities premium reserve

3. The number of debentures to be issued is:

a. 6600 **b. 6500** c. 4500 d. 5400.

4. 12% Debentures Account is credited with

a. 6,50,000 b.7,00,000 **c. 6,00,000** d.7,50,000

Q7. Y Ltd. issued Rs. 2,00,000, 10% Debentures at a discount of 5% .The terms of issue provide the repayment at the end of 4 years . Y Ltd. has a balance of Rs. 5, 00,000 in Securities Premium Reserve. The company decided to write off discount on issue of debentures from Securities Premium Reserve in the first year

Ans- Securities Premium A/c Dr 10000

To Discount on issue of debentures A/c 10000

(Being Discount on issue of debentures written off)

Note: Discount on issue of Debentures = 2, 00,000×5% = Rs 10,000

Q8. X Ltd. Has 4,000, 12% debentures of Rs.100 each on 1st April 2023. According to the terms of issue, interest on debentures is payable half yearly on 30th September and 31st March. Pass necessary journal entries for interest on debentures as on 31st March, 2024.

Ans-

Date	Particulars	l.f.	Dr.(₹)	Cr.(₹)
2023 Sept. 30	Debentures interest a/c dr. To debenture holders' a/c (being the interest on debenture payable for the half-year ended 30th Sept,2017)		24,000	24,000
	Debenture holders a/c dr. To bank a/c (being the interest paid to debenture holders)		24,000	24,000
2024 March 31	Debentures' interest a/c dr. To debenture holder' a/c (being the interest on debenture payable for the half-year ended 31st march,2017)		24,000	24,000
	Debenture holders a/c dr. To bank a/c (being the interest paid to debenture holders)		24,000	24,000
March 31	Statement of profit and loss (finance cost) dr. To debentures' interest a/c (being the interest on debentures transferred to statement of profit and loss)		48,000	48,000

Q9. X ltd purchased the whole business of Y ltd as under:

Plant and machinery ₹ 8,00,000

Land and building ₹ 72,00,000

Creditors ₹ 10,00,000

The purchase consideration was ₹ 80,00,000. ₹ 20,00,000 were paid through bank and the remaining amount by issue of 6% debentures of ₹ 100 each at a premium of 20%.

Pass the journal entries in the books of X ltd.

Ans- Plant and machinery A/c Dr. 8,00,000

Land and building A/c Dr. 72,00,000

Goodwill A/c Dr. 10,00,000

To Creditors A/c 10,00,000

To Y ltd 80,00,000

Y ltd Dr. 80,00,000

To Bank A/c 20,00,000
To 6% debentures A/c 50,00,000
To Security premium A/c 10,00,000
No. of debentures = 60,00,000/120= 50,000

Q10. Y ltd purchased machinery for ₹ 90,000. Half of the payment was paid in cash and the remaining half by issuing 12% debentures of ₹100 each at a discount of 10%. Pass the journal entries.

Ans- Machinery A/c Dr. 90,000
To Vendor A/c 90,000
Vendor A/C 90,000
Discount on issue of debentures A/C(500*10) 5,000
To Bank A/C 45,000
To 12% Debentures A/c(500 *100) 50,000

Q11. Star textiles ltd purchased assets of Modern textiles ltd as under:

Land and building of ₹ 40,00,000

Plant and machinery of ₹ 7,50,000

Furniture of ₹ 1,00,000 for purchase consideration of ₹ 45,00,000. Star textiles ltd paid ₹ 3,00,000 by issuing bank draft and remaining by issue of 9% debentures of ₹500 each at a premium of 5%. Record the necessary journal entries in the book of Star textiles ltd.

Ans- Land and building A/c Dr. 40,00,000
Plant and machinery A/c Dr. 7,50,000
Furniture A/c Dr. 1,00,000
To Capital Reserve A/c 3,50,000
To Modern textiles ltd 45,00,000
Modern textiles Ltd A/c Dr. 45,00,000
To Bank draft A/c 3,00,000
To 9% debentures A/c 40,00,000
To security premium A/c 2,00,000
No. of debentures = 42,00,000/525= 8000

6 Marks Questions

Q1. Beeta Ltd. issued 5,000, 9% debentures of Rs. 500 each. Pass the necessary journal entries for the issue of Debentures in the books of the company in the following cases:

(I) When debentures are issued at 10% premium and redeemable at par.
(II) When debentures are issued at par and redeemable at 10% premium.
(III) When debentures are issued at 5% premium and redeemable at 10% premium.
(IV) When debentures are issued at a premium of 25% to the vendors for machinery purchased for Rs. 6, 25,000

Ans-

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
Case 1	Bank A/c Dr. To Debenture Application & Allotment A/c (Debenture Application money received)		27,50,,000	 27,50,000
	Debenture Application & Allotment A/c Dr. To 9% Debentures A/c To Security Premium A/c (Debentures issued at a premium of 10%)		27,50,000	 25,00,000 2,50,000
Case 2	Bank Dr. To Debenture Application & Allotment A/c (Debenture Application money received)		25,00,000	 25,00,000
	Debenture Application & Allotment A/c Dr. Loss of issue of Debentures A/c Dr. To 9% Debentures A/c To Premium of Redemption of Debentures A/c (Debentures issued at par, redeemable at a premium of 10%)		25,00,000 2,50,000	 25,00,000 2,50,000
Case3	Bank Dr. To Debenture Application & Allotment A/c (Debenture Application money received)		26,25,000	 26,25,000
	Debenture Application & Allotment A/c Dr. Loss of issue of Debentures A/c Dr. To 9% Debentures A/c To Securities Premium A/c To Premium of Redemption of Debentures A/c (Debentures issued at par, redeemable at a premium of 10%)		26,25,000 2,50,000	 25,00,000 1,25,000 2,50,000
Case 4	Machinery A/c Dr. To Vendors (Machinery Purchased)		6,25,000	 6,25,000
	Vendors A/c Dr. To 9% Debentures A/c To Securities Premium A/c (Issue of 1,000 Debentures of Rs. 500 each at 25% Premium calculated as 6,25,000/625* = 1,000)		6,25,000	 5,00,000 1,25,000

Q2. X Ltd. obtained loan of Rs. 8,00,000 from State Bank of India and issued 10,000; 9% Debentures of Rs. 100 each as collateral security. How will issue of debentures be shown in the Balance Sheet? Discuss both the methods

Ans- I. First Method (When Journal Entry is not Passed):

AN EXTRACT OF BALANCE SHEET OF X LTD. as at…

Particulars	Note no.	Rs.

I.	**EQUITY AND LIABILITIES** **Non-Current Liabilities** Long-term Borrowings	1	8,00,000

Note to Accounts

1.	**Long-term Borrowings** Loan from State Bank of India (Secured by issue of 10,000;9% Debentures of Rs. 100 each as collateral Security)	**Rs.** 8,00,000

II. Second Method (When Journal Entry isPassed):

Date	Particulars	LF.	Dr. (RS.)	Cr. (RS.)
	Debentures Suspense A/c …Dr. To 9% Debentures A/c (Being the issue of 10,000; 9% Debentures of Rs. 100 each as collateral security for a loan taken from State Bank of India)		10,00,000	 10,00,000

AN EXTRACT OF BALANCE SHEET OF X LTD. as at…

Particulars		Note no.	Rs.
I.	**EQUITY AND LIABILITIES** **Non-Current Liabilities** Long-term Borrowings	1	8,00,000

Note to Accounts

1.	**Long-term Borrowings** Loan from State Bank of India 10,000; 9% Debentures of Rs. 100 each issued as Collateral Security Less: Debentures Suspense A/c	 10,00,000 10,00,000	**Rs.** 8,00,000
			8,00,000

Q3. On July 01, 2022, Panther Ltd. issued 20,000, 9% Debentures of Rs. 100 each at 8% premium and redeemable at a premium of 15% in four equal instalments starting from the end of the third year. The balance in Securities Premium on the date of issue of debentures was Rs. 80,000. Interest on debentures was to be paid on March 31 every year. Pass Journal entries for the financial year 2022-23. Also prepare Loss on Issue of Debentures account .

Ans-

July 1	Bank A/c Dr.	21,60,000	
2022	To Debenture Application andAllotment, A/c		21,60,000
	(Being Application money received)		
July1	Debenture Application and Allotment Dr.	21,60,000	
2022	Loss on Issue of Debentures A/c Dr.	3,00,000	20,00,000
	To 9% Debentures A/c		1,60,000
	To Securities Premium A/c		3,00,000
	To Premium on Redemption of Debentures A/c		
	(Being Debentures issued)		
Mar.31	Debenture Interest A/c Dr.	1,35,000	
2022	To Debenture holders A/c		1,35,000
	(Being Interest due on debentures)		
Mar.31	Debenture holders A/c Dr.	1,35,000	
2022	To Bank A/c		1,35,000
	(Being interest paid to debenture holders)		
	Statement of Profit and Loss Dr.	1,35,000	
Mar.31	To Debenture Interest A/c		1,35,000
2022	(Interest on Debentures charged from		
	Statement of P&L)		
Mar.31	Securities Premium A/c Dr.	2,40,000	
2022	Statement of Profit and Loss Dr	60,000	
	To Loss on Issue of Debentures A/c		3,00,000
	(Loss on Issue of Debentures written off)		

Loss on Issue of Debentures A/C

Date	Particulars	Amount	Date	Particulars	Amount
01 July 2022	To Premium on Redemption of Debentures A/c	3,00,000	31 Mar. 2023	By Securities Premium A/c By Statement of Profit and Loss	2,40,000 60,000
		3,00,000			3,00,000

Q4. Pass the journal entries related to the issue of debentures in the following cases.

(i) Issued ₹2,00,000 9% debentures of ₹ 100 each at a discount of 10% payable at a premium of 15%.

(ii) Issued ₹1,00,000 12% debentures of ₹ 100 each with a premium of 10%, payable at a premium of 5%.

(iii) Issued ₹3,00,000 9% debentures of ₹ 100 each at par and payable at a premium of 5%.

Ans-

(i)	Bank A/c Dr. To debenture app and allot A/c	1,80,000	 1,80,000
	Deb app and allot A/c Dr. Loss on issue of Deb A/c Discount on issue of deb A/c To 9% debentures A/c To premium on redemption of deb A/c	1,80,000 30,000 20,000	 2,00,000 30,000
(ii)	Bank A/c Dr. To debenture app and allot A/c	1,10,000	 1,10,000
	Deb app and allot A/c Dr. Loss on issue of Deb A/c To 12% debentures A/c To security premium A/c To premium on redemption of deb	1,10,000 5.000	 1,00,000 10,000 5,000
(iii)	Bank A/c Dr. To debenture app and allot A/c	3,00,000	 3,00,000
	Deb app and allot A/c Dr. Loss on issue of Deb A/c To 9% debentures A/c To premium on redemption of deb	3,00,000 15,000	 3,00,000 15,000

Q5. Pass Journal entries to record the following transaction:
1. A Ltd. issued 15000; 8% Debentures of Rs. 100 each at discount of 5% to be repaid at par at the end of 5 years.
2. A Ltd. Issues 10% Debentures of Rs. 100 each for the total nominal value of Rs. 80,00,000 at a premium of 5% to be redeemed at par.
3. A Ltd. Issues Rs. 50,00,000; 9% Debentures of Rs. 100 each at par but redeemable at the end of 10 years at 105%.
4. A Ltd. Issued Rs40,00,000, 12% debentures of Rs. 100 each at a discount of 5% repayable at a premium of 10% at the end of 5 years.
5. A Ltd issued ` 70,000; 12% debentures of ` 100 each at a premium of 5% repayable at 110% at the end of 10 years.
6. A Ltd issued 2,000; 12% debentures of Rs.100 each at par, redeemable also at par.

Ans-

Date	Particulars	LF	Amount	Amount
	Bank A/c Dr. To Debenture application and allotment, A/c (Being the debenture application money record) Debenture application & Allotment A/c Dr. Discount on issue of Debentures A/c Dr To Debentures A/c (Being the issue of 15,000, 8% debentures of Rs. 100 each at a discount of 5%)		14,25,000 14,25,000 75,000	 14,25,000 15,00,000

	Bank A/c Dr.		84,00,000	
	To Debenture application and allotment, A/c (Being the debenture application money received)			84,00,000
	Debenture application and allotment A/c Dr.		84,00,000	
	To 10% Debenture A/c			80,00,000
	To security premium A/c			4,00,000
	(Being the issue of 80,000, 10% debenture of Rs. 100 each at a premium of 5%)			
	Bank A/c Dr.		50,00,000	
	To Debenture application and allotment A/c			50,00,000
	(Being the debenture application money received)			
	Debenture application and allotment A/c Dr.		50,00,000	
	Loss on issue of debenture A/c Dr.		2,50,000	
	To 12% Debenture A/c			5000000
	To premium on Redemption of Debenture A/c			250,000
	(Being the issue of 50,000, 12% debenture of Rs. 100 each at par redeemable at 105%			
	Bank A/C Dr.		38,00,000	
	To Debenture application and allotment A/C			38,00,000
	(Being the debentures application money received)			
	Debenture application and allotment A/C Dr		38,00,000	
	Loss on issue of debenture A/C Dr.		6,00,000	
	To 12% debenture A/C			4000000
	To premium on redemption of debenture A/c			400000
	(Being the issue of 40,000, 12% debenture of Rs. 100 each at a discount of 5% and repayable at a premium 10%)			
	Bank A/c Dr.			
	To Debenture application and allotment A/c		73,50,000	
	(Being the debenture application money second)			73,50,000
	Debenture application and allotment A/c Dr.			
	Loss on issue of debenture A/c Dr.		73,50,000	
	To 12% Debenture A/c		7,00,000	
	To security Premium A/c			70,00,000
	To premium on redemption of debenture A/c.			3,50,000
	(Being the issue of 70,000, 12% debentures of Rs. 100 each at a premium of 5% and repayable at a premium of 10%)			7,00,000
	Bank A/c Dr.			
	To 12% Debenture application and allotment A/c		2,00,000	
	(Being the debenture application money second)			2,00,000
	12% Debenture application and allotment Dr.			
	To 12% Debenture A/c		2,00,000	
	(Transfer of Application money to Debenture A/c)			2,00,000

Q6. Pass Journal entries to record the following transaction:

1. A Ltd. issued 15000; 8% Debentures of Rs. 100 each at discount of 5% to be repaid at par at the end of 5 years.

2. A Ltd. Issues 10% Debentures of Rs. 100 each for the total nominal value of Rs. 80,00,000 at a premium of 5% to be redeemed at par.
3. A Ltd. Issues Rs. 50,00,000; 9% Debentures of Rs. 100 each at par but redeemable at the end of 10 years at 105%.
4. A Ltd. Issued Rs40,00,000, 12% debentures of Rs. 100 each at a discount of 5% repayable at a premium of 10% at the end of 5 years.
5. A Ltd issued ` 70,000; 12% debentures of ` 100 each at a premium of 5% repayable at 110% at the end of 10 years.
6. A Ltd issued 2,000; 12% debentures of Rs.100 each at par, redeemable also at par.

Ans-

Date	Particulars	LF	Amount	Amount
	Bank A/c Dr.		14,25,000	
	To Debenture application and allotment, A/c			14,25,000
	(Being the debenture application money record)			
	Debenture application & Allotment A/c Dr.		14,25,000	
	Discount on issue of Debentures A/c Dr		75,000	
	To Debentures A/c			15,00,000
	(Being the issue of 15,000, 8% debentures of Rs. 100 each at a discount of 5%)			
	Bank A/c Dr.		84,00,000	
	To Debenture application and allotment, A/c (Being the debenture application money received)			84,00,000
	Debenture application and allotment A/c Dr.		84,00,000	
	To 10% Debenture A/c			80,00,000
	To security premium A/c			4,00,000
	(Being the issue of 80,000, 10% debenture of Rs. 100 each at a premium of 5%)			
	Bank A/c Dr.		50,00,000	
	To Debenture application and allotment A/c			50,00,000
	(Being the debenture application money received)			
	Debenture application and allotment A/c Dr.		50,00,000	
	Loss on issue of debenture A/c Dr.		2,50,000	
	To 12% Debenture A/c			5000000
	To premium on Redemption of Debenture A/c			250,000
	(Being the issue of 50,000, 12% debenture of Rs. 100 each at par redeemable at 105%			
	Bank A/C Dr.		38,00,000	
	To Debenture application and allotment A/C			38,00,000
	(Being the debentures application money received)			

	Debenture application and allotment A/C Dr		38,00,000	
	Loss on issue of debenture A/C Dr.		6,00,000	
	To 12% debenture A/C			4000000
	To premium on redemption of debenture A/c			400000
	(Being the issue of 40,000, 12% debenture of Rs. 100 each at a			
	discount of 5% and repayable at a premium 10%)			
	Bank A/c Dr.			
	To Debenture application and allotment A/c		73,50,000	
	(Being the debenture application money second)			73,50,000
	Debenture application and allotment A/c Dr.			
	Loss on issue of debenture A/c Dr.		73,50,000	
	To 12% Debenture A/c		7,00,000	
	To security Premium A/c			70,00,000
	To premium on redemption of debenture A/c.			3,50,000
	(Being the issue of 70,000, 12% debentures of Rs. 100 each at a			7,00,000
	premium of 5% and repayable at a premium of 10%)			
	Bank A/c Dr.			
	To 12% Debenture application and allotment A/c		2,00,000	
	(Being the debenture application money second)			2,00,000
	12% Debenture application and allotment Dr.			
	To 12% Debenture A/c		2,00,000	
	(Transfer of Application money to Debenture A/c)			2,00,000

PART-III: ANALYSIS OF FINANCIAL STATEMENTS

UNIT -3

Chapter -08: Financial Statements of Company

FINANCIAL STATEMENT OF A COMPANY

Meaning

Financial statements are the formal annual reports through which the corporate management communicates financial information to its owners and various other external parties .

NATURE

1. Recorded Facts*:* Financial statements are prepared on the basis of facts in the form of cost data recorded in accounting books. The original cost or historical cost is the basis of recording transactions.
2. Accounting Conventions*:* Certain accounting conventions are followed while preparing financial statements. For ex. The convention of valuing inventory at cost or market price, whichever is lower, is followed.
3. Postulates: Financial statements are prepared on certain basic assumptions (pre-requisites) known as postulates such as going concern postulate, money measurement postulate, realisation postulate, etc.

Objectives of financial statement

1. To provide information about economic resources and obligations of a business
2. To provide information about the earning capacity of the business
3. To provide information about cash flows
4. To judge effectiveness of management
5. Information about activities of business affecting the society

Uses/Importance of financial statement

1. Information about Financial Performance: Statement of Profit and Loss which is an essential part of financial statements provides information about profit earned or loss incurred during the accounting period.

2. Information about Financial Position: Balance Sheet which is also an essential part of financial statements provides information about financial position i.e., assets, liabilities and capital employed in the business.
3. Assistance to Management: Financial Statements are helpful to the management while making plans, taking decisions and exercising control over the affairs of the business.
4. Enables Comparative Study: Financial Statements enable the management to compare one year's costs, expenses, sales and profit etc. with those of other years.
5. Helpful in Raising Loans: Financial Statements are of great help while raising loans from banks or other financial institutions.
6. Information to Users of Financial Statements: Financial Statements provide sufficient and reliable information to various parties who have interest in the business enterprise.
7. Helpful in Assessment of Tax Liability: Financial Statements are of great help when the firm is assessed to Income Tax, Goods and Services Tax and Excise Duty.
8. Evidence in Legal Matters: Financial Statements, supported by authenticated documents are accepted by the courts as firm evidence.

The financial statements generally include two statements:
(1) Balance Sheet (2) Statement of Profit and Loss

(1) FORMAT OF BALANCE SHEET
The format of balance sheet prescribed in Part I of schedule III of Companies Act 2013, is as follows:
BALANCE SHEET OF……Ltd. As at …………..

Particulars	Note No..	Figures at the end of the current reporting period	Figures at the end of the previous reporting period
1	2	3	4
I.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) Deferred tax liabilities (net) (c) Other Long-term liabilities (d) Long-term provisions (4) Current liabilities (a) Short-term borrowings (b) Trade payables (c) Other current liabilities (d) Short-term provisions			
TOTAL			
II.ASSETS: (1) Non-current assets (a) Property, Plant and Equipment and Intangible Assets (i) Property, Plant and Equipment (ii) Intangible assets (iii) Capital work-in-progress (iv) Intangible assets under development (b) Non-current investments (c) Deferred tax assets (net) (d) Long-term loans and advances (e) Other non-current assets (2) Current assets (a) Current investments (b) Inventories (c) Trade receivables (d) Cash and cash equivalents (e) Short-term loans and advances (f)Other current assets			
TOTAL			

(2) Statement of Profit and Loss

PART II

Format of Statement of Profit and Loss

	Particulars	Note No.	Figures for the current reporting period	Figures for the previous reporting period
I.	Revenue from Operations			
II.	Other Income			
III.	TOTAL INCOME (I+II)			
IV.	Expenses: Cost of materials consumed Purchases of Stock-in-Trade Changes in inventories of finished goods, work-in progress and Stock-in-Trade Employee benefits expenses Finance costs Depreciation and amortization expenses Other expenses			
	TOTAL EXPENSES			
V.	Profit before Tax (III–IV)			
VI.	Tax			
VII.	Profit after Tax (V–VI)			

Questions regarding Major Headings and Sub- Headings to be shown in a company's balance sheet as per schedule III of the Companies Act, 2013

(3/4 marks)

1**.**Under which major headings/sub-headings will the following items be shown in a Company's Balance Sheet as per Schedule-III Part I of the Companies Act, 2013?

(i) Provision for Warranties
(ii) Provision for Tax
(iii) Bank Overdraft
(iv) Goodwill
(v) Unclaimed Dividend
(vi) Loose tools

Ans.

S.No.	Items	Major Head	Sub Head
(i)	Provision for Warranties	Non-Current Liabilities	Long term Provisions
(ii)	Provision For Tax	Current Liabilities	Short-Term Provisions
(iii)	Bank overdraft	Current Liabilities	Short-Term Borrowings
(iv)	Goodwill	Non-Current Assets	Property, Plant and Equipment and Intangible Assets — Intangible Assets
(v)	Unclaimed Dividend	Current Liabilities	Other Current Liabilities Inventories
(vi)	Loose Tools	Current Assets	Inventories

2. How will you show the following items in the Balance Sheet of a Company.

(i) Long-term Borrowings
(ii) Short-term Borrowings
(iii) Long-term Loans
(iv) Short-term Loans
(v) Computer
(vi) Computer Software
(vii) Building

Ans

S.No.	Item	Major Head	Sub Head
(i)	Long-term Borrowings	Non-Current Liabilities	Long term Borrowings
(ii)	Short-term Borrowings	Current Liabilities	Short term Borrowings
(iii)	Long-term Loans	Non-Current Assets	Long term Loans

(iv)	Short-tern Loans	Current Assets	Short term Loans
(v)	Computer	Non-Current Assets	Property, Plant and Equipment and Intangible Assets - Property, Plant and Equipment
(vi)	Computer Software	Non-Current Assets	Property, Plant and Equipment and Intangible Assets — Intangible Assets
(vii)	Building	Non-Current Assets	Property, Plant and Equipment and Intangible Assets — Property, Plant and Equipment

3.Name the major heads and sub-heads under which the following items will be presented in the Balance Sheet of a company as per Schedule III of the Companies Act, 2013:

(i) Balance of the Statement of Profit and Loss
(ii) Loan of 1,00,000 payable after three years
(iii) Short-term deposits payable on demand
(iv) Loose tools
(v) Trade marks
(vi) Land
(vii) Cash at Bank
(viii) Trade payables

S.No.	Items	Major Heads	Sub-heads
(i)	Balance of the Statement of Profit and Loss	Shareholder's Funds	Reserve and Surplus
(ii)	Loan of 1,00,000 payable after three years	Non-Current Liabilities	Long-term Borrowings
(iii)	Short-term deposits payable on demand	Current Liabilities	Short-term Borrowings
(iv)	Loose tools	Current Assets	Inventory
(v)	Trade marks	Non-Current Assets	Property, Plant and Equipment and Intangible Assets-Intangible Assets
(vi)	Land	Non-Current Assets	Property, Plant and Equipment and Intangible Assets-Property, Plant and Equipment
(vii)	Cash at Bank	Current Assets	Cash and Cash equivalents
(viii)	Trade Payables	Current Liabilities	Trade Payables

4.Name the major heads and sub-heads under which the following items will be presented in the Balance Sheet of a company as per Schedule III of the Companies Act, 2013:

(i)Loose Tools
(ii)Loan repayable on demand
(iii)Provision for Retirement benefits

(iv)Prepaid Insurance
(v)Capital advances
(vi)Shares in Listed Companies

Solution:

S.No.	Items	Heading	Sub-heading
(i)	Loose Tools	Current Assets	Inventories
(ii)	Loan repayable on demand	Current Liabilities	Short Term Borrowings
(iii)	Provision for Retirement benefits	Non-Curren Liabilities	Long Term Provisions
(iv)	Prepaid Insurance	Current Assets	Other Current Assets
(v)	Capital advances	Non-Current Assets	Long Term Loans and Advances
(vi)	Shares in Listed Companies	Non-Current Assets	Non-Current Investments

Google form link for mcq

https://docs.google.com/forms/d/e/1FAIpQLSdrC35ZE5hFfX_6DxNRyZwbl9VNv8Vo2_CPPxNGQtostAulMw/viewform?usp=sf_link

CH-09: ANALYSIS OF FINANCIAL STATEMENTS

ANALYSIS OF FINANCIAL STATEMENTS:

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

Significance of Analysis of Financial Statements

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

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

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

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

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

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

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

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

Tools of Analysis of Financial Statements:

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

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

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

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

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

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

Detailed look at these methods:

1. Horizontal Analysis:

Purpose: To compare financial data across different periods, typically from one period to the next, to identify trends and changes in key financial metrics like revenue, expenses, and net income.

How it works: Calculates the percentage change between periods for specific items.

Example: Comparing a company's net income for the current year versus the previous year to see if it's growing or declining.

2. Vertical Analysis:

Purpose:

To analyze the relationships between different components within a single financial statement (either the balance sheet or income statement).

How it works:

Expresses each line item as a percentage of a base figure (e.g., total revenue for the income statement or total assets for the balance sheet).

Example:

Analyzing an income statement by expressing each expense as a percentage of total revenue to understand which expenses are most significant.

3. Ratio Analysis:

Purpose:

To calculate and interpret financial ratios derived from financial statements to assess a company's performance and financial condition.

How it works:

Uses various ratios like current ratio, debt-to-equity ratio, gross profit margin, and return on assets to evaluate liquidity, solvency, profitability, and efficiency.

Example:

Calculating the current ratio (current assets divided by current liabilities) to assess a company's ability to meet its short-term obligations.

4.Cash Flow Statement Analysis

With the income statement and balance sheet under our belt, let's look at the cash flow statement and all the insights it tells us about the business.

The cash flow statement will help us understand the inflows and outflows of cash over the time period we're looking at.

Cash flow statement overview

The cash flow statement, or statement of cash flow, consists of three components:

- Cash from operations
- Cash used in investing
- Cash from financing

Each of these three sections tells us a unique and important part of the company's sources and uses of cash over a specific time period.

Comparative Statements:

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

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

of Exhibit 4.1).

Step 2: Find out change in absolute figures by subtracting the first year (Col.2) from the second year

(Col.3) and indicate the change as increase (+) or decrease (–) and put it in column 4.

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

Absolute Increase or Decrease (Col.4) × 100

First year absolute figure (Col.2)

Objectives of Financial Statements:-

(a) To assess the profitability of the organization.
(b) To assess the operational efficiency.
(c) To judge the financial health of the organization.
(d) To assess the solvency position of the organization.
Limitations of Financial Statements:-
(a) Financial analysis does not consider price level changes.
(b) Financial analysis may be misleading without the knowledge of the changes in accounting procedure followed by a firm.
(c) Financial analysis is just a study of reports of the company.
(d) Monetary information alone is considered in financial analysis while non-monetary aspects are ignored.
(e) The financial statements are prepared on the basis of accounting concept, as such, it does not reflect the current position.
Comparative Statement: Comparative statements refer to the statement of profit and loss and the balance sheet prepared by providing columns for the figures for both the current year as well as for the previous year and for the changes during the year, both in absolute and relative terms.
FORMAT of Comparative Statement:

Particulars	First Year	Second Year	Absolute Increase (+) or Decrease (–)	percentage Increase (+) or Decrease (–)
1	**2**	**3**	**4**	**5**
	Rs.	**Rs.**	**Rs.**	**%**

Illustration 1:-

From the following statement of profit and loss of Mohan Co. Ltd., prepare comparative statement of profit and loss for the year ended March 31, 2023 and 2024:

PARTICULARS	NOTE NO.	2022-2023	2023-2024
(i) Revenue from operations		50, 00,000	75, 00,000
(ii) Other incomes		1, 40,000	1, 20,000
(iii) Expenses		44, 00,000	50, 60,000
(iv) Income tax		25%	30%

Solution: Comparative statement of profit and loss of Mohan Co. Ltd. for the year ended 31st March, 2023 & 2024:

Particulars		2022-2023	2023-2024	Absolute Increase (+) or Decrease (–)	percentage Increase (+) or Decrease (–)
I.	Revenue from operations	**50,00,000**	**75,00,000**	25,00,000	**50**
II.	Add: Other incomes	**1,40,000**	**1,20,000**	20,000	**14.28**
III.	Total Revenue I+II	**51,40,000**	**76,20,000**	24, 80,000	**48.25**
IV.	Less: Expenses	**44,00,000**	**50,60,000**	6, 60,000	**15**
V.	Profit	**7,40,000**	**25,60,000**		**245**
	before tax	**1,80,000**	**7,68,000**	**18,20,000**	**327**
VI.	Less: Tax	**5,55,000**	**17,92,000**	**5,88,000**	**223**
VII.	Profit after tax			**12,37,000**	

Illustration 2:- The following are the Balance sheets of XYZ Ltd. As at March 2022 & 2023. Prepare a Comparative Balance Sheet.

PARTICULARS	**NOTE NO.**	**2021-2022**	**2022-2023**
I. Equity and Liabilities			
1. Shareholder's Funds			
a) Share Capital		20, 00,000	15, 00,000
b) Reserve and Surplus		3, 00,000	4, 00,000
2. Non- current Liabilities			
Long-term borrowings		9, 00,000	6, 00,000
3. Current Liabilities			
Trade Payables			
Total		3, 00,000	2, 00,000
		35,00,000	**27,00,000**
II Assets			
1. Non-Current Assets			
a) Fixed Assets			
- Tangible Assets			
- Intangible Assets		20, 00,000	15, 00,000
2. Current Assets		9, 00,000	6, 00,000
- Inventories			
- Cash and Cash Equivalents		3, 00,000	4, 00,000

TOTAL		3, 00,000 **35,00,000**	2, 00,000 **27,00,000**

SOLUTION: comparative statement of XYZ Ltd.

PARTICULARS	**2021-2022**	**2022-2023**	Absolute Increase (+) or Decrease (–)	% Increase (+) or Decrease (–)
I. Equity and Liabilities				
1. Shareholder's Funds				
a) Share Capital	20, 00,000	15, 00,000	**5, 00,000**	33.33
b) Reserve and Surplus	3, 00,000	4, 00,000	**(1, 00,000)**	(25.00)
2. Non- current Liabilities				
Long-term borrowings	9, 00,000	6, 00,000	**3, 00,000**	50.00
3. Current Liabilities				
Trade Payables				
Total	3, 00,000	2, 00,000	**1, 00,000**	50.00
	35,00,000	**27,00,000**	**8,00,000**	-------------------
II Assets				**29.6**
1. Non-Current Assets				
a) Fixed Assets				
- Tangible Assets			5, 00,000	33.33
- Intangible Assets	20, 00,000	15, 00,000	3, 00,000	50.00
2. Current Assets	9, 00,000	6, 00,000		
- Inventories			(1, 00,000)	(25.00)
- Cash and Cash Equivalents	3, 00,000	4, 00,000	1, 00,000	50
	3, 00,000	2, 00,000		-------------------
TOTAL	**35,00,000**	**27,00,000**	**8,00,000**	
				29.6

Common Size Statement:

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

FORMAT of Coman size Statement:

Particulars	First Year	Second Year	Percentage of first year	percentage of second year
1	**2**	**3**	**4**	**5**

ILLUSTRAION:3

PARTICULARS	2022-23	2021-22
Net Sales	**18, 00,000**	**25, 00,000**
Cost of goods sold	**10, 00,000**	**12, 00,000**
Operating Expenses	**80,000**	**1, 20,000**
Non-operating expenses	**12,000**	**15,000**
Depreciation	**20,000**	**40,000**
wages	**10,000**	**20,000**

SOLUTION:

PARTICULARS	2021-22	2022-23	2021-22 % OF SALE	2022-23% OF SALE
Net Sales	**25, 00,000**	**18, 00,000**	**100**	**100**
Cost of goods sold	**12, 00,000**	**10, 00,000**	**48**	**55.56**
GROSS PROFIT	**13,00,000**	**8,00,000**	**52**	**44.44**
LESS:Operating Expenses	**1,20,000**	**80,000**	**4.80**	**4.44**
	18,80,000	**7,20,000**	**47.20**	**40**
OPERATING INCOME	**15,000**	**12,000**	**.60**	**.67**
LESS: Non-operating expenses				
PROFIT	**11,65,000**	**7,08,000**	**46.60**	**39.33**

ILLUSTRATION :4

FROM THE FOLLOWING BALANCE SHEET OF SHREYA LTD. AS AT 31ST MARCH2020, PREPARE COMMON SIZE BALANCE SHEET:

Balance Sheet of Shreya Ltd. as on 31st March 2020

Particulars	Note No.	31st March 2020 (₹)	31st March 2019 (₹)
I. Equity and Liabilities: **1. Shareholder's Funds:**			
a) Share Capital		10,00,000	4,50,000
b) Reserves and Surplus		1,00,000	50,000
2. Non-current Liabilities:			
a) Long-term Borrowings		6,00,000	2,50,000
3. Current Liabilities:			
a) Trade Payables		3,00,000	2,50,000
Total		**20,00,000**	**10,00,000**
II. Assets: **1. Non-current Assets:**			
a) Property, Plant and Equipment, and Intangible Assets:			
i) Property, Plant, and Equipment		10,00,000	5,00,000
2. Current Assets:			
a) Inventories		9,50,000	4,00,000
b) Cash & Cash Equivalents		50,000	1,00,000
Total		**20,00,000**	**10,00,000**

SOLUTION:

Common-size Balance Sheet of Shreya Ltd.
as on 31st March 2020

Particulars	Note No.	Absolute Amounts		Percentage of Balance Sheet Total	
		31st March 2019 ₹	31st March 2020 ₹	31st March 2019 %	31st March 2020 %
I. Equity and Liabilities: **1. Shareholder's Funds:**					
a) Share Capital		4,50,000	10,00,000	45	50
b) Reserves & Surplus		50,000	1,00,000	5	5
2. Non-current Liabilities:					
a) Long-term Borrowings		2,50,000	6,00,000	25	30
3. Current Liabilities:					
a) Trade Payables		2,50,000	3,00,000	25	15
Total		**10,00,000**	**20,00,000**	**100**	**100**
II. Assets: **1. Non-Current Assets:**					
a) Property, Plant and Equipment and Intangible Assets:					
i) Property, Plant, and Equipment		5,00,000	10,00,000	50	50
2. Current Assets:					
a) Inventories		4,00,000	9,50,000	40	47.50
b) Cash & Cash Equivalents		1,00,000	50,000	10	2.50
Total		**10,00,000**	**20,00,000**	**100**	**100**

MCQ AND IMPORTANT QUESTIONS ON COMPARATIVE AND COMMON SIZE STATEMENTS:

1. https://docs.google.com/document/d/1UNTJl-uUQb51ZdSlcnSXPxQlCxHc-a-o/edit?usp=drivesdk&ouid=107280844915645727661&rtpof=true&sd=true
2. https://docs.google.com/document/d/1htMqKXSW2SMw4itSoEmwO63HF3eHHm2V/edit?usp=drivesdk&ouid=107280844915645727661&rtpof=true&sd=true.

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Chapter -10: Accounting Ratios

RATIO ANALYSIS

Meaning of Accounting Ratios

A ratio is a mathematical number calculated as a reference to relationship of two or more numbers and can be expressed as a fraction, proportion, percentage and a number of times.

Ratios calculated on the basis of accounting information, are called accounting ratio.

Ratio analysis is a technique which involves regrouping of data by application of arithmetical relationships.

Objectives of Ratio Analysis

1. To know about the attention seeking areas.
2. To know about the potential areas on which improvement can be done.
3. To know about the liquidity, solvency, profitability and efficiency of business.
4. To provide cross sectional analysis.
5. To facilitate comparison with best industry standards.
6. To provide information which are useful for making future estimates and projections.

Advantages of ratio analysis

1. Facilitate Comparison : It facilitates comparison with benchmarks to assess whether the firm is performing better or not.

2. Identification of problem and bright areas: It helps the firm to identify the weak and bright areas of the business.

3. Simplifying figures and establishing relationships: It simplifies the complex accounting figure into simple form and establishing relationships by summarizing the financial information.

4. Enables SWOT Analysis: Ratios offer a great help in explaining the changes occurring in business. It allows the business to do its own SWOT analysis (Strengths- Weakness- Opportunities-Threats)

5. Helps to understand the efficacy of business: It helps the business to understand whether the business has taken right decision regarding operating investing and financing activities. It indicates how far these have helped the business in improving performance.

CLASSIFICATION OF ACCOUNTING RATIOS

The classification of ratios is done on the basis of the functions they perform. The functional classification is based on the purpose for which a ratio is computed.

A) Liquidity Ratios: The ability of the business to pay the amount due to stakeholders as and when it is due is known as liquidity, and the ratios calculated to measure it are known as ‘Liquidity Ratios’.

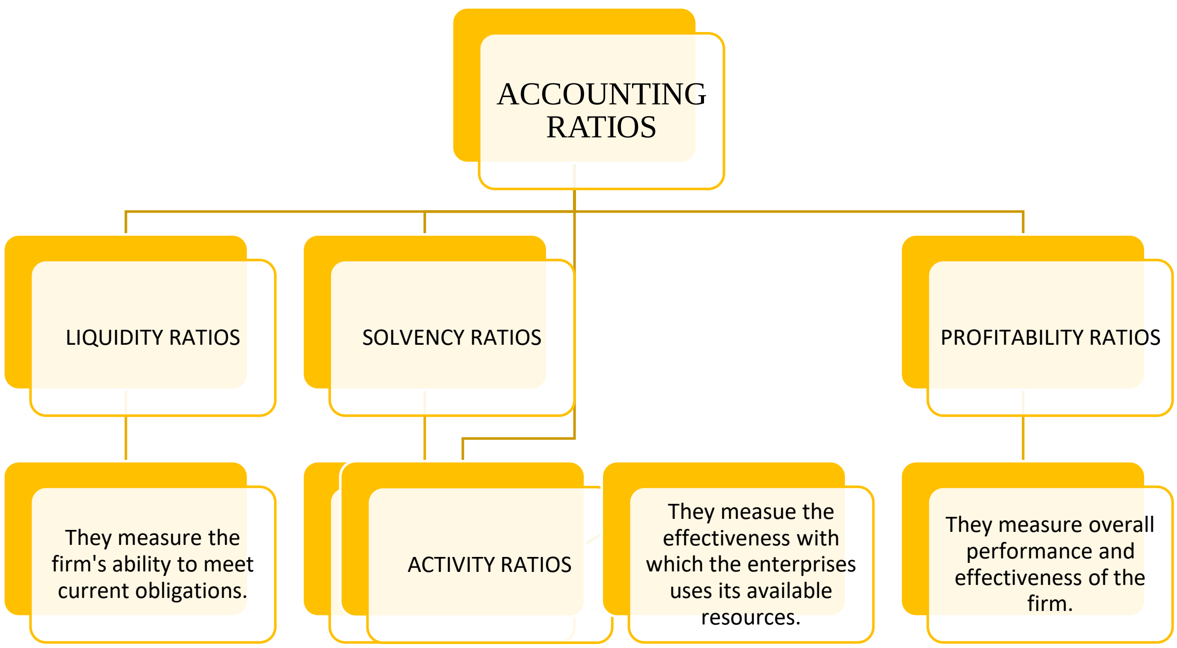
These are essentially **short-term** in nature.

B) Solvency Ratios: Solvency of business is determined by its ability to meet its contractual obligations towards stakeholders, particularly towards external stakeholders, and the ratios calculated to measure solvency position are known as ‘Solvency Ratios’.

These are essentially **long-term** in nature.

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

D) Profitability Ratios: It refers to the analysis of profits in relation to revenue from operations or funds (or assets) employed in the business.



A <u>Liquidity Ratios</u>

(a) <u>Current Ratio</u>

Current Ratio = Current Assets/ Current Liabilities

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

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

An ideal current ratio is 2:1

(b) <u>Liquid Ratio/ Quick Ratio/ Acid Test Ratio</u>

It is the ratio of quick (or liquid) asset to current liabilities.

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

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

The ideal Quick ratio is 1:1

B Solvency Ratios

a) **Debt Equity Ratio**: -
Debt Equity Ratio measures the relationship between Long-term Debt and Equity.

Debt Equity Ratio = $\frac{\textbf{Long- term Debts}}{\textbf{Shareholders' Funds}}$

Shareholders' Funds (Equity) = Share capital + Reserves and Surplus + Money received against share warrants
Share Capital = Equity share capital + Preference share capital
Or
Shareholders' Funds (Equity) = Non-current assets + Working capital – Non current liabilities
Working Capital = Current Assets – Current Liabilities
Debt = Long-term Borrowings and Long-term Provisions.

Ideal Debt Equity ratio is 2:1.

b) **Total Assets to Debt Ratio:**
Total assets to Debt ratio establish relationship between Total Assets and Long-term Debt.

Total Assets to Debt Ratio= $\frac{\textbf{Total Assets}}{\textbf{Long-term debts}}$

c) **Proprietary ratio:**
Proprietary ratio expresses relationship of proprietors' (shareholders) funds to total assets and is calculated as follows:

Proprietary Ratio = Shareholders' Funds /Total Assets

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

d) **Interest Coverage Ratio:**
It expresses the relationship between profits available for payment of interest and the amount of interest payable. It is calculated as follows:
Interest Coverage Ratio = Net Profit before Interest and Tax/ Interest on long-term debts
A higher ratio is considered better for the lender's.

e) **Debt to Capital Employed Ratio:**

The Debt to capital employed ratio refers to the ratio of long-term debt to the total of external and internal funds (capital employed or net assets). It is computed as follows:

Debt to Capital Employed Ratio = Long-term Debt/Capital Employed (or Net Assets)
C Activity (or Turnover) Ratio

a) Inventory Turnover Ratio:
It measures the efficiency of inventory management.
Inventory Turnover Ratio = Cost of Revenue from Operations / Average Inventory
Where average inventory = opening inventory + closing inventory/ 2
Cost of revenue from operations = Revenue from operations – Gross Profit.

b) Trade Receivables Turnover Ratio :
It expresses the relationship between credit revenue from operations and average trade receivable. It is calculated as follows:
Trade Receivable Turnover ratio=Net Credit Revenue from Operations/Average Trade Receivable
Average Trade Receivable = (Opening Debtors and Bills Receivable + Closing Debtors and Bills Receivable)/2
It is to be noted that provision for doubtful debts is not deducted from trade receivables.

c) Trade Payable Turnover Ratio :

Trade Payables Turnover ratio = Net Credit purchases / Average trade payable
Where, Average Trade Payable = (Opening Creditors and Bills Payable + Closing Creditors and Bills Payable) / 2

d) Net Assets or Capital Employed Turnover Ratio:

It reflects relationship between revenue from operations and net assets (capital employed) in the business. Higher turnover means higher liquidity and profitability.
Net Assets or Capital Employed Turnover ratio = Revenue from Operation/Capital Employed
E) Fixed Assets Turnover Ratio: Revenue from Operations/Net Fixed Assets

Net Fixed Assets= Gross Fixed Assets – Accumulated Depreciation

f) Working Capital Turnover Ratio : It is calculated as follows:

Working Capital Turnover Ratio = Revenue from Operations/ Working Capital

D Profitability Ratios
Profitability ratios are calculated to analyze the earning capacity of the business which is the outcome of utilization of resources employed in the business.

a) Gross Profit Ratio
Gross profit ratio as a percentage of revenue from operations is computed to have an idea about gross margin. It is computed as follows:
Gross Profit Ratio = Gross Profit/ Revenue from Operations × 100

b) <u>Operating Ratio</u>

It is computed to analyze cost of operation in relation to revenue from operations. It is calculated as follows:

Operating Ratio = (Cost of Revenue from Operations + Operating Expenses)/ Revenue from Operations ×100

Operating expenses include office expenses, administrative expenses, selling expenses, distribution expenses, depreciation and employee benefit expenses etc.

c) <u>Operating Profit Ratio</u>

Operating Profit/ Revenue from Operations × 100

Where Operating Profit = Revenue from Operations – Operating Cost

d) <u>Net Profit Ratio</u>

It reflects the overall efficiency of the business.

Net Profit Ratio = Net profit/Revenue from Operations × 100

Generally, Net profit refers to profit after tax (PAT)

e) **Return on Capital Employed or Investment**

It explains the overall utilization of funds by a business enterprise. It assesses overall performance of the enterprise.

Return on Investment (or Capital Employed) = Net Profit before Interest, Tax and Dividend/Capital Employed × 100

<u>1 MARK QUESTIONS</u>

1	Quick Ratio of Rahul Ltd is 1.5 :1. Which of the following transaction will decrease the ratio? a) Sale of goods costing ₹ 20,000 for ₹ 24,000 b) Cash collected from trade receivables ₹ 82,000 c) Purchase of goods for cash ₹ 38,000 d) Creditors were paid ₹ 11,000	
2	--------- ratios are calculated to determine the ability of the business to service its debt in the long run a) Liquidity b) Solvency c) Profitability d) Turnover	
3	-----------ratios are also known as Efficiency ratios a) Liquidity Ratios b) Turnover Ratios c) Activity Ratios d) Both b and c	
4	Which of the following are included in a traditional classification of ratios? (i)Liquidity ratios. (ii)Statement of profit and loss ratios.	

(iii) Balance sheet ratios.
(iv) Profitability ratios.
(v) Composite ratios
(vi) Solvency ratios.
Codes:
(a) (ii), (iii) and (v)
(b) (i), (iv) and (vi)
(c) (i), (ii) and (vi)
(d) All (i), (ii), (iii), (iv), (v), (vi)

5 Current Ratio is 2:1 and Quick Ratio is 0.5: 1, a transaction involving decrease in both Current Ratio and Quick Ratio is
(a) Sale of Non-current Asset for cash.
(c) Cash payment of a Current Liability.
(b) Sale of Stock-in-Trade at loss.
(d) Purchase of Stock-in-Trade on credit

6 Assertion (A): Accounting ratio is an expression of arithmetical relationship between two related items of accounting data.
Reason (R): Ratio is an analytical tool of data. When ratio analysis is applied on accounting data, the result is termed as accounting ratio.
In the context of above two statements, which of the following options is correct?
(A)Both Assertion and reason are true and reason is correct explanation of assertion (A).
(B)Assertion and reason both are true but reason is not the correct explanation of assertion (A).
(C) Assertion is true, reason is false.
(D) Assertion is false, reason is true

7 Which one of the following is correct?
(i) Quick Ratio can be more than Current Ratio
(ii) High Inventory Turnover Ratio is good for the organization, except when goods are bought in small lots or sold quickly at low margins to realize cash.
(iii) Sum of Operating Ratio and Operating Profit Ratio is always 100%.
(a) All are correct.
(b) Only (i) and (iii) are correct.
(c) Only (ii) and (iii) are correct
(d) Only (i) and (ii) are correct.

8 Match List 1 (Accounting Ratios) with List II (Formulae) and select the correct answer using the codes given below the lists.

	List 1		List 2
A	Operating Profit Ratio	1	$\frac{\text{Total Assets}}{\text{Long-term debts}}$
B	Total Assets to Debt Ratio	2	$\frac{\text{Quick Assets}}{\text{Current Liabilities.}}$
C	Working Capital Turnover Ratio	3	100 – Operating Ratio
D	Quick Ratio	4	Revenue from Operation/ Working Capital

	a) A-1, B-2, C-3, D-4 b) A-3, B-1, C-4, D-2 c) A-4, B-3, C2, D-1 d) A-2, B-4, C-1, D-3	
9	Non-Current Asset ₹2,60,000 Total Assets ₹ 3,00,000 Non-Current Liabilities ₹ 80,000 Shareholder funds ₹ 2,00,000 Current Ratio calculated on the basis of above information will be (a) 0.5: 1. (b) 2:1. (c) 1.5: 1. (d) 1:1	
10	If the Operating Ratio of Aman Ltd. is 70%, its Operating Profit Ratio will be (a) 100%. (b) 60%. (c) 30%. (d) 160%.	

ANSWERS

1	**c)** Purchase of goods for cash ₹ 38,000	
2	b) Solvency	
3	d) Both b and c	
4	(a) (ii), (iii) and (v)	
5	(d) Purchase of Stock-in-Trade on credit	
6	**(A)**Both Assertion and reason are true and reason is correct explanation of assertion (A).	
7	(c) Only (ii) and (iii) are correct	
8	b) A-3, B-1, C-4, D-2	
9	(b) 2:1.	
10	(c) 30%.	

3-4 MARKS QUESTIONS

1	The Revenue from operations of a firm is 8,00,000. Its inventory turnover ratio is 3 times. If gross profit ratio is 10%, **calculate its opening inventory and closing inventory**. The opening inventory is 25% of closing inventory .	

2	**Calculate Gross Profit Ratio from the following information** Revenue from Operations ₹ 20,00,000; Purchases ₹ 4,60,000; Carriage Inwards ₹ 60,000; Employee benefit Expenses ₹ 2,00,000 (including Wages of ₹ 60,000); Opening Inventory ₹ 60,000 and Average Inventory ₹ 80,000	
3	Profit after tax amounted to ₹ 8,00,000, and tax rate was 20%. If earnings before interest and tax was ₹ 15,00,000 and Nominal Value of Debentures amounted to ₹20,00,000 (assuming the only debt of the company), **determine the rate of interest on debentures**	
4	**Calculate opening and closing Trade payables from the following information** Total purchases ₹20, 00,000 Cash purchases are 25% of credit purchases Trade payable turnover ratio is 5 times Closing trade payable are 2 times of opening trade payable	
5	**From the following information, calculate Return on Investment** Non-Current Asset ₹16,00,000 Current Assets ₹ 5,00,000 Current Liabilities ₹ 1,00,000 10% Debentures ₹ 8,00,000 Shareholder funds ₹ 12,00,000 Net profit after tax was₹ 5,00,000 and tax amount to ₹ 50,000	
6	Yoksha Ltd has a current ratio of 3:1 Quick Ratio is 2:1. The excess of current assets over Quick assets is ₹ 48,000. **Calculate current assets and current liabilities.**	
7	**From the following information, calculate Total assets to debt Ratio** Current Assets ₹ 22,00,000 Working Capital= 13,00,000 Shareholder funds ₹ 15,00,000 Total debt= ₹39,00,000 Reserve and Surplus= ₹ 5,00,000	
8	**From the following information, calculate Working Capital Turnover Ratio** Gross Profit Ratio 25% Gross Profit 10,00,000 Shareholder funds ₹ 50,00,000 Non-Current Liabilities ₹ 16,00,000 Non-Current Assets ₹ 46,00,000	
9	Calculate Operating Profit Ratio from the following information Revenue from Operations ₹ 10,00,000 Gross Profit 25%on cost Office and Administrative expenses ₹ 28,000 Selling and distribution expenses ₹ 12,000 Loss by theft ₹ 40,000	

10 **Calculate Current Ratio and Debt Equity Ratio from the following Information**

Non-Current Assets ₹ 16,00,000
Current Assets ₹ 4,00,000
Working Capital ₹ 2,00,000
Non-Current Liabilities ₹ 12,00,000

11. Current Ratio of a company is 2:1. **State giving reasons, which of the following transactions would improve, reduce or not change the ratio**:

(a) Purchased goods on credit ₹ 40,000.
(b) Sale of furniture of 8,000 at a loss of ₹ 2,000.
(c) Cash received from trade receivables ₹15,000.
(d) Issued equity shares ₹ 6,00,000.

12 **<u>CASE BASED QUESTIONS</u>**

Star Ltd., an electronic company, is interested to analyze its credit policy and see how much amount usually invested in Trade Receivables. Following information is provided by the company.

Particulars	
Trade Receivables Turnover Ratio	4 Times
Cost of Revenue from Operations	₹ 3,00,000
Gross Profit	25% of Revenue from Operations
Opening Trade Receivables	₹ 50,000

Cash Revenue from Operations is 20% of Total Revenue from Operations.

From the information given above, answer the following questions:

(A) Revenue from Operations is
a. ₹3,80,000 b) ₹4,80,000
c ₹4,00,000 d) ₹4,60,000

(B) Credit Revenue from Operations is
a. ₹ 3,00,000 b) 3,20,000
c. ₹ 3,60,000 d) 2,80,000

C Closing Trade Receivables is
a. ₹ 1,00,000 b) ₹ 1,05,000
C ₹ 1,10,000 d) ₹ 1,20,000

13 **<u>Missing Value Questions</u>**

A) Debt Equity Ratio = <u>?</u>
₹5,00,000 =0.25:1

B) Inventory Turnover Ratio = ₹ <u>5,40,000</u>
(₹ 70,000+ ₹x)/2 = 6 Times

SOLUTIONS

1	Cost of Revenue from Operations = Revenue from Operations - Gross Profit ₹ 8,00,000-10% of ₹ 8,00,000= ₹ 7,20,000 Inventory Turnover Ratio = Cost of Revenue from Operations / Average Inventory 3= 7,20.000/ Average Inventory Average Inventory= ₹ 7,20,000/3= ₹ 2,40,000 Average inventory = opening inventory + closing inventory/ 2 Let closing inventory= x opening inventory = 25% of x (x+ x/4)/2= ₹ 2,40,000 x+ x/4= ₹ 4,80,000 x=4,80,000*4/5, x =3,84,000 closing inventory= closing inventory opening inventory= 25% of 3,84, 000= ₹ 96,000	
2	Gross Profit Ratio = Gross Profit / Revenue from Operations * 100 Revenue from Operations = Rs 20,00,000 Cost of Revenue from Operations = Purchases + Opening Inventory + Direct Expenses– Closing Inventory 60,000+ 4,60,000 + 60,000+60,000- 1,00,000= 5,40,000 (Average Inventory = Opening Inventory + Closing Inventory / 2 80,000 = 60,000 + Closing Inventory / 2 Closing Inventory = 1,00,000) Gross Profit = 20,00,000 – 5,40,000 = 14,60,000 Gross Profit Ratio = 14,60,000/20,00,000 * 100 = 73%	
3	Net Profit Before Interest & Tax = Profit after Tax + Tax + Interest (Tax = 8,00,000 * 20/80 = 2,00,000) 15,00,000 = 8,00,000 + 2,00,000 + Interest Interest = Rs 5,00,000 Interest on Debentures = Nominal value of Debentures * Rate of Interest/100 5,00,000 = 20,00,000 * Rate of Interest/100= 25%	
4	Trade payables turnover ratio= Net Credit purchases/ Average Trade Payables Total purchases = Cash purchases+ Credit purchases ₹20,00,000= 1/4 Credit purchases + Credit purchases ₹20,00,000= 5/4 Credit Purchases Credit purchases= ₹16,00,000 Trade payables turnover ratio= Net Credit purchases/ Average Trade Payables 5 =₹16,00,000/ Average Trade Payables Average Trade Payables= ₹3,20,000 Average Trade Payables= (Opening Trade Payables + Closing Trade Payables)/2 ₹3,20,000 = (Opening Trade Payables + 2 Opening Trade Payables)/2 Opening Trade Payables= ₹2,13,333 Closing Trade Payables= 2 x Opening Trade Payables Closing Trade Payables = ₹426,666	

5	Return on Investment= Profit before interest and tax/ Capital Employed x 100 Profit before Interest and Tax= Net profit after tax + Tax + Interest on Debentures Profit before Interest and tax= ₹ 630,000 Capital employed= Shareholders Funds+ Debentures Capital employed= 20,00,000 Or Capital employed= non-current assets + Current Assets - Current Liabilities Capital employed= 16,00,000+5,00,000-1,00,000 Capital employed= 20,00,000 Return on investment= 31.5%	
6	Current Ratio = Current Assets/ Current Liabilities 3= CA//CL 3CL=CA Quick Ratio = Quick Assets/ Current Liabilities 2= QA/CL 2CL=QA and CA-QA=48000 CL =48000 CA=48000*3= ₹ 144,000	
7	Total assets to debt Ratio= Total assets /Debt (long term) Total assets = Shareholders Funds+ Total Debt = 15,00,000+39,00,000= 54,00,000 Debt = Total debt- Current Liabilities Debt= 39,00,000-9,00,000= 30,00,000 Total assets to debt Ratio= 1.8:1	
8	Working Capital Turnover Ratio = Net Revenue from Operation/ Working Capital Revenue from Operation= 10,00,000*100/25 = ₹ 40,00,000 Working Capital= Shareholder funds+ Non-Current Liabilities- Non-Current Assets Working Capital= ₹20,00,000 Working Capital Turnover Ratio= 2 Times (Current Liabilities are assumed to be Nil.}	
9	Let Cost = ₹ 100 Profit = ₹25 (25% on cost) Then Revenue from operations= 100+25= ₹125 Revenue from operations= ₹10,00,000*25/125 = ₹ 2,00,000 Operating Profit = Gross Profit- Other operating expenses ₹ 2,00,000- ₹28,000- ₹12,000 = ₹1,60,000 **Operating Profit = Operating Profit / Revenue from Operations × 100** ₹1,60,000/ ₹10,00,000*100= 16% Loss by theft is a non-operating expense.	

<table>
<tr><td>10</td><td>Working Capital = Current Assets- Current Liabilities
₹ 2,00,000 = ₹ 4,00,000- Current Liabilities
Current Liabilities = ₹ 4,00,000- ₹ 2,00,000= ₹2,00,000
Current Ratio = Current Assets/ Current Liabilities
= ₹ 4,00,000/ ₹ 2,00,000= 2:1
Debt= ₹ 12,00,000
Equity = Non-current Assets+ working capital- Non-Current Liabilities= ₹ 6,00,000
Debt Equity Ratio= 2:1</td><td></td></tr>
<tr><td>11</td><td><table>
<tr><th>S.no</th><th>Effect on Ratio</th><th>Reason</th></tr>
<tr><td>a)</td><td>Reduce</td><td>Both the Total Current Assets and Total Current Liabilities have increased by the same amount</td></tr>
<tr><td>b)</td><td>Improve</td><td>Total Current Assets have increased by ₹ 6,000 Current Liabilities remain same.</td></tr>
<tr><td>c)</td><td>No change</td><td>Current Assets have increased and decreased by the same amount.</td></tr>
<tr><td>d)</td><td>Improve</td><td>Only Current Assets have increased while Current Liabilities remain same.</td></tr>
</table></td><td></td></tr>
<tr><td>12</td><td>A-c) B-b) C-c)</td><td></td></tr>
<tr><td>13</td><td>A ₹ 1,25,000 B ₹ 1,10,000</td><td></td></tr>
</table>

Chapter-11: Cash Flow Statement

CASH FLOW STATEMENT

Meaning of Cash flow statement :-

Cash flow statement shows inflows and outflows of cash and cash equivalents from operating, investing and financing activities of an enterprise during a particular period.

Inflows are those transactions that increase the cash and cash equivalents and outflows are those transactions that decrease the cash and cash equivalents.

Objectives of Cash Flow Statements :-

1.To ascertain the sources of cash and cash equivalents under operating, investing & financing activities by the enterprise.

2.To ascertain the applications of cash and cash equivalents under operating, investing & financing activities by the enterprise.

3.To ascertain net change in cash and cash equivalents being the difference between inflows & outflows under operating, investing and financing activities of the enterprise that take place between the dates of two balance sheets.

Importance /Benefits/ Uses of Cash Flow Statements :

- **(i)** Facilitates in Ascertaining Cash Flow from operating, investing & financing activities.
- **(ii)** To assess Liquidity and Solvency.
- **(iii)** To manage Cash Efficiently.
- **(iv)** Facilitates Capital Budgeting Decisions.

Procedure of Preparing Cash Flow Statements:-

The Institute of Chartered Accountants of India has issued Accounting Standard AS-3 Revised, for preparing a cash flow statement.

According to AS-3 Revised, the cash flow statement summarizes the cash inflows & cash outflows and the net changes (increase or decrease) in cash and cash equivalents resulting from operating, investing and financing activities of a firm during a period.

The following terms are used for preparing a cash flow statement:

Cash:

It comprises cash in hand and demand deposits with banks i.e., deposits which are repayable by banks on demand.

Cash Equivalents:

These are short-term, highly liquid investments that are readily convertible in known amounts of cash and which are subject to an insignificant risk of changes in value.

In simple words Cash and Cash Equivalents includes

(a) Cash in Hand,
(b) Cash at Bank,
(c) Cheques and Drafts on Hand,
(d) Current/Short-term Investments,
(e) Marketable Securities,

(f) Short term Deposits in Banks etc.

Classification of Cash Flows for Cash Flow Statement:

As per Accounting Standard-3 (Revised), Cash Flows Statement requires that all the inflows and outflows of the cash and cash equivalent during a particular period should be classified under 3 different activities as per the nature of transactions.

These three activities are:

<table>
<tr><th colspan="2">OPERATING ACTIVITIES</th></tr>
<tr><th>CASH INFLOW</th><th>CASH OUTFLOW</th></tr>
<tr><td>IN CASE OF NON- FINANCE COMPANIES
• Cash sales
• Cash received from Trade receivables
• Royalty, Fee, Commission Received
• Income Tax Refund*

IN CASE OF FINANCE COMPANIES
• Receipt of Interest and Dividends
• Proceeds from sale of securities (held for sale)
• Brokerage received by a stock broker</td><td>IN CASE OF NON- FINANCE COMPANIES
• Cash purchases
• payment to trade payables
• payment of operating expenses
• payment of wages
• Income Tax paid (unless identified with investing or financing activities)

IN CASE OF FINANCE COMPANIES
Payment for interest
payment for purchase of securities (for sale)</td></tr>
</table>

***Income Tax paid is normally shown as net of income tax refund.**

INVESTING ACTIVITIES	
CASH INFLOW	**CASH OUTFLOW**
• Proceeds from sale of fixed assets • Proceeds from sale of non-current Investments • Interest received on investment • Dividend received • Rent received from property held as investment	• Purchase of fixed assets • Purchase of non-current investment • Brokerage paid on purchases of investment

FINANCING ACTIVITIES	
CASH INFLOW	**CASH OUTFLOW**
• Proceeds from issue of shares • Proceeds from issue of debentures • Proceeds from long term borrowing • Increase in balance of bank overdraft or cash credit account	• Payment of loans • Payment for redemption of preference shares • Payment for buyback of equity shares • Payment of dividend • Payment of interest • Brokerage or underwriting Commission paid on issue of shares or debentures • Decrease in balance of bank overdraft or cash credit account

Transactions not regarded as Cash Flow: These are the transactions that are mere movements in between the items of Cash and Cash Equivalents. This includes cash deposited in bank, cash withdrawn from the bank and purchase or sale of marketable securities.

Non-Cash transactions: These are the transactions in which the inflow or outflow of Cash or Cash Equivalent does not take place. Therefore, these non-cash transactions are not considered while preparing the Cash Flow Statements. These transactions include depreciation, amortisation of intangible assets etc.

ABC LTD.
CASH FLOW STATEMENT FOR THE YEAR ENDED……………………..
(INDIRECT METHOD)
{As per Accounting Standard-3 (Revised)

Particulars	₹	₹
I. CASH FLOW FROM OPERATING ACTIVITIES		
(A) *Net profit before tax and extraordinary items* (as per working note)	xxxxx	
(B) Add: Items to be added		
Depreciation	…….	
Goodwill, Patents and Trademarks amortized	…….	
Interest on Bank Overdraft/Cash Credit	…….	
Interest on Borrowings and Debentures	…….	
Loss on Sale of Fixed Assets	……	
Preliminary Exp written off	……	
*Increase in Provision for doubtful debts	……	
	xxxx	
(C) Less: Items to be deducted		
Interest Income	(……)	
Dividend Income	(……)	
Rental Income	(……)	
Gain on Sale of Fixed Assets	(……)	
*Decrease in Provision for doubtful debts	(……)	
(D) *Operating profit before Working Capital changes* (A+B-C)	xxxx	
(E) Add: Decrease in Current Assets & Increase in Current Liabilities	……	
(F) Less: Increase in Current Assets & Decrease in Current Liabilities	(……)	
(G) *Cash generated from Operations* (D+E-F)	xxxx	
(H) Less: Income tax paid (Net of tax refund)	(……)	
Cash Flow From (or used in) Operating Activities (G-H)		*******
II.CASH FLOW FROM INVESTING ACTIVITIES		
●Proceeds from sale of fixed assets	…….	
●Proceeds from sale of long-term Investments	…….	
●Proceeds from sale of intangible assets	……	
●Interest and Dividend received (for non-financial companies Only)	…….	
●Rent received	……..	
●Payment for Purchase of Fixed Assets	(……)	
●Payment for Purchase of Long-term Investments	(……)	
●Payment for purchase of intangible assets like goodwill	(……)	
●Extraordinary items (e.g. Insurance Claim against fire) (+/-)		
Cash Flow From (or used in) Investing Activities.		*******

III. CASH FLOW FROM FINANCING ACTIVITIES ●Proceeds from Issue of Shares and Debentures ●Proceeds from Other Long-term Borrowings ●Increase/decrease in Bank Overdraft/Cash Credit ●Payment of Final Dividend ●Payment of Interim Dividend ●Payment of Interest on Debentures and Loans ●Repayment of Loans ●Redemption of Debentures/Preference Shares ●Payment of Share Issue Expenses ●Payment for Buy-back of Shares as Extraordinary Activities **Cash Flow From (or used in) Financing Activities**	……… ……… …….. (……) (……) (……) (……) (……) (……) (……)	********
IV. Net Increase/Decrease in cash & Cash Equivalents (I+II+III)		……….
V. Add: Cash & Cash Equivalents in the beginning of the year		……….
VI. Cash & Cash Equivalents at the end of the year		……….

NOTES:

1. Amounts in brackets mean amounts that are to be deducted.
2. *Alternatively increase/decrease in provision for doubtful debts may be treated under increase/decrease in current liabilities.

WORKING NOTE:

For Net Profit Before tax and extraordinary items:

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

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

Net Profit Before Tax and Extraordinary Items.

** ***Extraordinary Items:*** Cash flows relating to extraordinary items such as bad debts recovered, claims received from insurance companies, winning of a lottery or a law suit etc. should be disclosed separately as arising from operating, investing or financing activities. For example, the amount received from insurance company on account of loss of inventory by fire, earthquake, floods etc., should be reported as cash flows from operating activities.

Calculation of Cash Flow from Operating Activities:-

Following are the steps to be followed under indirect method:

-Indirect Method: In this method, Cash Flow from Operating Activity is calculated from statement of Profit & Loss and Balance Sheet with the help of following steps:

-Step 1: Calculate the Net Profit before Tax and Extraordinary Items.

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

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

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

Net Profit Before Tax and Extraordinary Items.

-Step 2: Calculate the Operating Profit before Working Capital Changes.

(A) Net profit before tax and extraordinary items (as per working note)

(B) Add: Items to be added
*Depreciation
*Goodwill, Patents and Trademarks amortized
*Interest on Bank Overdraft/Cash Credit
*Interest on Borrowings and Debentures
*Loss on Sale of Fixed Assets
*Preliminary Exp written off
*Increase in Provision for doubtful debts

(C) Less: Items to be deducted
*Interest Income
*Dividend Income
*Rental Income
*Gain on Sale of Fixed Assets
*Decrease in Provision for doubtful debts

(D) Operating profit before Working Capital changes (A+B-C)

-Step 3: Compute the Cash generated from Operating Activities.

(D) Operating profit before Working Capital changes (A+B-C)

(E) Add: Decrease in Current Assets & Increase in Current Liabilities
Decrease in stock
Increase in trade payable

(F) Less: Increase in Current Assets & Decrease in Current Liabilities
Increase in stock
Decrease in trade payable

(G) Cash generated from Operations (D+E-F)

-Step 4: Compute the Cash flow from Operating Activities before Extraordinary Items
Less Tax paid

Step 5: Compute the Cash flow from (or used in) Operating Activity.

<u>Calculation of Cash Flow from Investing Activities:-</u>

1. Ascertain Cash inflows from Investing Activities
   -Proceeds from Sale of Fixed Assets
   -Proceeds from Sale of Investments
   -Interest and Dividend received (Non-Financial Company)
   -Rent Income
2. Ascertain Cash outflows from Investing Activities
   -Purchase of Fixed Assets
   -Purchase of Investments
   -Purchase of Intangible Assets like Goodwill

<u>Calculation of Cash Flow from Financing Activities:-</u>

1. Compute Cash inflows from Financing Activities
   >Proceeds from Issue of shares or Debentures
   >Proceeds from Long-term Borrowings/loans
   >Increase in Bank Overdraft & Cash Credit
2. Compute Cash outflows from Financing Activities
   >Repayment of Loan
   >Redemption of Pref. shares or Debentures
   >Dividend Paid
   >Interest on Debentures Paid
   >Decrease in Bank: Overdraft & Cash Credit

*Bank Overdraft: Treated as short-term borrowings shown under Financing Activities
(i) Increase in Bank O/D…. Cash Inflows Added Under Financing Activity
(ii) Decrease in Bank O/D …. Cash Outflows Deducted under Financing Activity

<u>TREATMENT OF SPECIAL ADJUSTMENTS</u>

(1) <u>DIVIDEND PAID:-</u>

Interim Dividend: It is declared (approved) by the board of directors and is paid within 30 days of it being declared.

(a) Add Interim Dividend to the current year's profit under Cash Flow from Operating Activities.
(b) Show it as Cash Used (Outflow) in Cash Flow from Financing Activities.

Proposed Dividend: It is paid on Equity Shares and Preference Shares which is proposed by the Board of Directors and declared by the Shareholders in their Annual General Meeting.

(a) Dividend proposed by the Directors for current year is shown in the Notes to Accounts as Contingent Liability

(b) Proposed (Final) Dividend of previous year is shown as appropriation, i.e., as deduction from Surplus. Balance in Statement of Profit & Loss. The amount is added to determine Net Profit before Tax Extraordinary Items because it is an outflow of cash to be shown under Financing Activity.

(2) ***PROVISION OF TAX:-***Tax paid is deducted from Cash Generated from Operations (Operating Activities) to determine Cash Flow from Operating Activities.

Case 1: Opening and Closing balances of Provision for Tax are given and no other information is given:

Provision for Tax of Current Year (**closing balance**) is shown as Tax provision made and added to determine Net Profit before Tax and Extraordinary Items

Provision for Tax of Previous Year (**opening balance**) is shown as tax paid during the year as outflow of cash from operating activities. [deducted from Cash Generated from Operations]

Case 2: In case 'Tax paid' for the year is given with opening and closing balances of Provision for tax, Provision for Tax Account is prepared to determine 'Provision Made' for the year.

. Provision for Tax Account

PARTICULARS	Amt	PARTICULARS	Amt
To Bank A/c (Tax Paid)		By bal b/d (PY's Bal)	
To bal c/d (CY's Bal)		**By Statement of Profit & Loss A/c (Bal Fig-Provision for Tax Made)**	

Case 3: If Provision for Tax made during the year is given with opening and closing balances of Provision for tax, Provision for Tax Account is prepared determine tax paid during the year.

Dr. Provision for Tax Account Cr.

PARTICULARS	Amt	PARTICULARS	Amt
To Bank A/c (Bal. Fig-Tax Paid)		By bal b/d (PY's Bal)	
To bal c/d (CY's Bal)		By Statement of Profit & Loss A/c (Provision for Tax Made)	

**Tax paid is always shown as deduction under cash flow from operating Activities.
** Provision for Tax made during the year is added back to current year's profit to determine Net Profit before Tax and Extraordinary Items

2.***<u>TREATMENT OF GOODWILL:-</u>***

- Decrease in value of Goodwill between two accounting years means Goodwill is written-off or amortised.
- Increase in value of Goodwill between two accounting years means amount paid for the Purchase of Goodwill, it is shown as cash outflow in Investing Activity.

(2) <u>Treatment of adjustment related to investment</u>

Dr. Investment Account Cr.

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

(3) ***ASCERTAINING MISSING AMOUNTS OF FIXED ASSETS OR DEPRECIATION***: -

Case 1: When fixed asset is shown at original cost.

Dr. **Fixed Asset A/c (at original cost)** Cr.

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

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

- *Either of the two will appear.

Dr. Accumulated Depreciation A/c Cr.

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

	xxxx		xxxx

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

Case 2: When fixed asset is shown at written down value, i.e., cost less depreciation.

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

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

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

- *Either of the two will appear.

Dr. Accumulated Depreciation A/c Cr.

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

ACCOUNTING TREATMENT

(a) Cash Flow from Operating Activities
Add. Depreciation charged during the year
Subtract: Profit on Sale of Asset
Add. Loss on Sale of Asset
(b) Cash Flow from Investing Activities
Subtract: Purchase of Fixed Assets
Add: Sale of Fixed Asset

Steps for Preparation of Cash Flow Statement: --

-Step 1: Compute cash flow from Operating Activities.
-Step 2: Compute cash flow from Investing Activities.
-Step 3: Compute cash flow from Financing Activities.
Step 4: Adding Step 1, Step 2 and Step 3 above, compute the net increase or decrease in Cash and Cash Equivalents.

-Step 5: Amount computed in Step 4 is to be added to the balance of Cash and Cash Equivalents in the beginning of the year.

-Step 6: Adding Step 4 and Step 5 will give the balance of Cash and Cash Equivalents at the end of the year which will match the balance as per Balance Sheet.

PRACTICE QUESTIONS

Ques.1: Classify the following into Cash flows from Investing /Financing/Operating activities while preparing a Cash Flow Statement**:**

(A) Purchase of Machinery (B) Payment of Dividend (C) Issue of Debentures (D) Payment of Income Tax.

Ques.2: List any two objectives of preparing the cash flow statement.

Ques.3: Classify the following into cash flows from Investing activities/Financing activities while preparing a Cash Flow Statement**:**

(A) Redemption of Preference Shares
(B) Receipt of Dividend
(C) Sale of Non-Current Assets
(D) Interest Received.

Ques.4: From the following information find out the inflow of Cash by sale of Office equipment's

Particulars	31.3.2022(₹)	31.3.2021(₹)
Office Equipment	2,00,000	3,00,000

Additional Information:
Depreciation for the year 2021-22 was ₹ 40,000
Purchase of Office Equipment purchased during the year ₹ 30,000
Part of Office Equipment sold at a profit of ₹ 12,000
A) ₹ 1,00,000
B) ₹ 1,02,000
C) ₹ 90,000
D) ₹ 1,12,000

Ques.5: While computing cash from operating activities, which of the following item(s) will be added to the net profit?
(i) Decrease in value of inventory
(ii) Increase in share capital
(iii) Increase in the value of trade receivables
(iv) Increase in the amount of outstanding expenses
A) Only (i)
B) Only (i) and (ii)
C) Only (i) and (iii)
D) Only (i) and (iv)

Ques.6: Which of the following statements is correct?
A. Investments in shares are excluded from cash equivalents unless they are in, substance, cash equivalents.
B. Short-term marketable securities which can be readily converted into cash are not treated as cash equivalents
C. In case of a financial enterprise, interest received, and dividend received are classified as investing activities while dividend paid and interest paid on debentures are operating activities.
D. Provision for tax made during the year should be classified as an outflow from operating activities.

Ques.7: Statement-I: 'Shree Ltd.' was carrying on a business of packaging in Delhi and earned good profits in the past years. The company wanted to expand its business and required additional funds. To meet its requirements the company issued equity shares of ₹30,00,000. It purchased a computerized machine of ₹20,00,000. During the current

year the Net Profit of the company was ₹15,00,000. Cash flows from operating, investing and financing activities from the above transactions will be ₹15,00,000: (₹20,00,000); ₹30,00,000 respectively.
Statement-II: The patents of X Ltd. increased from ₹3,00,000 in 2021-22 to ₹3,50,000 in 2022-23. It will be taken as purchase of Patents of 50,000 and will be shown under Cash outflow from Investing Activities.

A. Both the statements are true.
B. Both the statements are false.
C. Only Statement-I is true.
D. Only Statement-II is true.

Ques.8:
Statement I:- Sale of Marketable Securities will result in no flow of Cash.
Statement II:- Debentures issued as collateral security will result in inflow of cash.

A. Both Statements are correct.
B. Both Statements are incorrect.
C. Statement I is correct and Statement II is incorrect.
D. Statement I is incorrect and Statement II is correct.

Ques.9:
What will be the effect of issue of Bonus shares on Cash Flow Statement?

A. No effect
B. Inflow in Financing Activity
C. Inflow in Operating activity
D. Inflow in Investing Activity

Ques.10:

Group A	Group B
1.Receipt of Dividend	A. Financing Activity
2.Purchase and sale of securities by a Finance compa	B. Investing Activity
3.Buy back of shares	C. Operating Activity

Select the correct answer
A.1-B,2-A,3-C
B. 1-B,2-C,3-A
C. 1-A,2-C,3-B
D. 1-A,2-B,3-C

Six marks question's

Ques.11: a) From the following information, calculate Cash flow from Operating Activities.

Particulars	**31 March 2023**	**31 March 2024**
Surplus i.e. Balance in Statement of Profit and Loss	6,00,000	5,00,000
Provision for Tax	1,00,000	1,20,000
Trade Receivables	2,00,000	2,40,000
Trade Payables	1,50,000	2,00,000
Goodwill	2,00,000	1,50,000

Additional Information: -
Proposed Dividend for the year ended March 31, 2023 and March 31, 2024 was ₹ 1,50,000 and ₹ 1,80,000 respectively.

b): From the following information calculate the Cash from Investing Activities.

Particulars	**31 March 2023**	**31 March 2024**
Machinery (Cost)	20,00,000	28,00,000
Accumulated Depreciation	4,00,000	6,50,000

Additional Information: -

(i) Machinery costing ₹ 50,000 (Book Value ₹ 40,000) was lost by fire and insurance claim of ₹ 32,000 was received.
(ii) Depreciation charged during the year was ₹ 3,50,000.
(iii)A part of Machinery costing ₹ 2,50,000 was sold at a loss of ₹ 20,000.

Ques.12: Read the following hypothetical text and answer the given questions on the basis of the same:

Pallavi, an alumnus of CBSE School, initiated her start up Smart pay, in 2015. Smart pay is a service platform that processes payments via UPI and POS, and provides credit or loans to their clients. During the year 2023-24, Smart pay issued bonus shares in the ratio of 5:1 by capitalizing reserves. The profits of Smart pay in the year 2023-24 after all appropriations was ₹ 7,50,000. This profit was arrived after taking into consideration the following items: -

Particulars	Amount (₹)
Interim Dividend paid during the year	90,000
Depreciation on Machinery	40,000
Loss of Machinery due to fire	20,000
Insurance claim received for Loss of Machinery due to Fire	10,000
Interest on Non-Current Investments received	30,000
Tax Refund	20,000

Additional Information:

Particulars	31.3.24(₹)	31.3.23 (₹)
Equity Share Capital	12,00,000	10,00,000
Securities Premium Account	3,00,000	5,00,000
General Reserve	1,50,000	1,50,000
Investment in Marketable Securities	1,50,000	1,00,000
Cash in hand	2,00,000	3,00,000
Machinery	3,00,000	2,00,000
10% Non-Current Investments	4,00,000	3,00,000
Bank Overdraft	2,50,000	2,00,000
Goodwill	30,000	80,000
Provision for Tax	80,000	60,000

(i) Goodwill purchased during the year was ₹ 20,000.
(ii) (ii) Proposed Dividend for the year ended March 31, 2023 was ₹ 1,60,000 and for the year ended March 31,2024 was ₹ 2,00,000.

You are required to:
1. Calculate Net Profit before tax and extraordinary items.
2. Calculate Operating profit before working capital changes.
3. Calculate Cash flow from Investing activities.
4. Calculate Cash flow from Financing activities.
5. Calculate closing cash and cash equivalents.

Answers:

A.1

A) Investing
B) Financing
C) Financing
D) Operating

A.2 **1.** To ascertain the sources of cash and cash equivalents under operating, investing & financing activities by the enterprise

2.To ascertain the applications of cash and cash equivalents under operating, investing & financing activities by the enterprise.

A.3. a. Financing b. Investing c. Investing d. Investing

A.4) B) ₹ 1,02,000
A.5) D. Only (i) and (iv)
A.6) A
A.7) A. Both the statements are true.
A.8) C. Statement I is correct and Statement II is incorrect.
A.9) A. No effect
A.10) B. 1-B,2-C,3-A

A.11) a) Cash flow from operating activities ₹ 1,30,000
b) Investing Activities
Sale of Machinery 1,40,000
Claim received from Insurance Company 32,000
Machinery Purchased (11,00,000)
Cash Outflow from Investing Activities (9,28,000)

A.12) 1. Net Profit before tax and extraordinary items=Net Profit for the year+ Interim Dividend + Loss of assets due to fire + Provision for Tax + Proposed Dividend - Insurance claim received for Loss due to Fire – Tax refund = 7,50,000 + 90,000 + 20,000 + 80,000 + 1,60,000 – 10,000 – 20,000 = ₹ 10,70,000

2. Operating profit before working capital changes= Net Profit before tax and extraordinary items + Adjustments for non-cash and non-operating expenses and goodwill amortised – Adjustments for non-cash and non-operating incomes = 10,70,000 + 40,000 + 70,000** – 30,000 = 11,50,000 ** Goodwill amortised = Opening goodwill + Goodwill purchased - Closing goodwill

3. Cash flow from Investing Activities = Interest on Non-Current Investments + Insurance claim for loss of assets due to fire – Purchase of Investments – Purchase of Machinery – Goodwill purchased = 30,000 + 10,000 – 1,00,000 - 1,60,000 – 20,000 = ₹ (2,40,000) Outflow

4. Cash flow from Financing Activities: Raise of Bank overdraft – Interim Dividend Paid – Final Dividend paid = 50,000 – 90,000 – 1,60,000 = ₹ (2,00,000) Outflow

5. Closing Cash and Cash Equivalents: Cash in Hand + Investment in Marketable Securities = 2,00,000 + 1,50,000 =3,50,000

……………………………………………XXXXXXXXXXXXXXX………………………………………….