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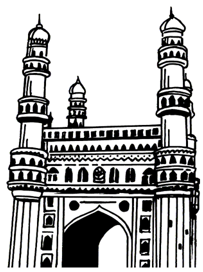

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UNIT I	**Partnership Accounts - I :** Meaning – Partnership Deed - Capital Accounts (Fixed and Fluctuating) – Admission of a Partner – Retirement and Death of a Partner (Excluding Joint Life Policy) (Including problems)

1.1 Partnership Accounts-I

Q1. What is Partnership ? Explain its features.

Ans : **(Dec.-18, June-18, Imp.)**

Meaning

Section 4 of the Indian Partnership Act, 1932 defines a Partnership as: "The relationship between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

This definition brings forth the following three distinct elements namely : (1) There must be an agreement between all the persons concerned; (2) The object of the agreement must be to share the profits of a business (3) The business must be carried on by all or any of the persons concerned acting for all. It must be noted that all the three essentials must be present to form a partnership. A partnership firm is not a legal entity in the eyes of law.

Essential Features of a Partnership

Following are the essential features of a partnership firm

i) Persons

In order to constitute a partnership firm, there must be at least two persons. The maximum number in a partnership is 20 in case the firm is doing ordinary business, and 10 in case the firm is engaged in banking business.

ii) Agreement

In order to have a partnership, it is necessary that there must be an agreement between partners.

iii) Sharing of profits

It is one of the important terms to constitute a partnership firm. Generally sharing of profits or losses is one of the important element to constitute a firm.

iv) Business

It includes trade, vocation and profession. The firm must be engaged in a lawful business.

v) Management

Management of the partnership firm will be done either by all the partners or any one of them on behalf of all other partners. There is mutual agency among the partners.

1.1.1 Partnership Deed

Q2. What is Partnership Deed ? Explain.

Ans : **(July-19, Dec.-18, May-18, Dec.-17)**

It is desirable that all the partners must have either verbal or written agreement in order to avoid the future dispute among the partners. Usually agreement in black and white is preferred so that it can be referred as and when need arises. The document which contains the terms and conditions regarding the conduct of partnership business, is called partnership deed. The terms and conditions are inserted in the form of clauses in the deed.

Important clauses in a partnership deed

1. The name of the firm.
2. The nature of the business which the firm is supposed to do.
3. The amount of capital and how this capital will be contributed by each partner.
4. The proportion in which the partner will share profit and losses.

5. The amount of drawings which a partner can draw from the firm.
6. If interest on capital will be allowed then what will be the rate of interest charged on the drawings of the partners ?
7. What will be the authority of each partner ? Will some restrictions be imposed on the duties of the partners ?
8. Duration of the firm: Whether the firm will be dissolved at will or will continue for a fixed period or till the happening of a particular event or on the completion of a particular venture ?
9. How the amount of the goodwill of the firm will be ascertained at the time of change in profit sharing ratio, admission, retirement or death of a partner ?
10. Will some salary or remuneration or commission be allowed, any of the partners because of his working in the firm ?
11. How the annual accounts of the firm will be prepared ? Will the accounts be audited by an independent Chartered Accountant ? How the auditor will be appointed ?
12. In case of retirement or death of a partner, how the amount which is to be paid to the partner or his legal representatives is ascertained ? If the partners have taken a joint life policy or individual policies, the premium of which is being charged to the Profit and Loss Account and on the death of a partner, how the amount received from the insurance company and their surrender value will be distributed among the partners.
13. If a partner has given any amount of loan besides his capital, will interest be allowed to him ? If so, what will be the rate ?
14. In case a partner becomes insolvent, how the accounts of the firm will be settled? Will the rule of Garner vs. Murray be applicable in this case?
15. The circumstances in which the firm will be dissolved and the manner in which the accounts will be settled in case of dissolution of a firm.
16. In case some dispute arises among the partners, how will it be settled ? Will it be referred to some arbitrator ?
17. Any other clause on which the partners may agree at the time of agreement.

Q3. What are the rules applicable, When the agreement is not existed in between partners ?

Ans :

Rules Applicable in Absence of an Agreement

When there is no agreement among the partners, the following rules will be applicable for proper accounting of the partnership firm :

1. Profits or losses of the firm will be shared equally by the partners.
2. Interest on capital will not be allowed to any partner. If agreed the interest will be allowed only out of profits of the firm. Similarly, no interest will be charged on drawings of the partners unless agreed upon.
3. If any partner has given a loan to the firm besides his share of capital, he will be allowed 6% interest on such loan.
4. No salary or remuneration will be allowed to any of the partners.
5. Every partner must take part in the management of the partnership business.
6. No person can be admitted without the consent of all existing partners.
7. The partnership books are to be kept at the place of business of the partnership and every partner may have access to and inspect and copy any of them.

1.1.2 Capital Accounts (Fixed and Fluctuating)

Q4. Explain about Capital Accounts ?

Ans :

i) Fixed Capital Accounts

It may be provided in the Partnership Deed that the amount of capital introduced by each partner shall remain fixed or unaltered at the original figure during the life of the Partnership. In other words Under this arrangement the capital accounts of partners are not debited or credited with any other transactions relating to partners; they are credited only with capital contributions and debited with specific withdrawals of capital only. This method is called fixed capital method.

From this, it is evident that some additional account must be opened to record such transactions as drawings, interest on capital, interest on drawings, salaries and share of profits or losses. This additional account is called Current Account which is opened in the name of each partner such as A's Current Account, B's Current Account and so on.

The Current Account of each partner is

Debited with

(i) his/her drawings (in cash or kind);

(ii) interest on such drawings, if any;

(iii) his/her share in the loss of business.

Credited with

(a) interest on his/her capital account, if any;

(b) salary or commission payable to him/ her;

(c) his/her share in the profit of the business.

Current Account is a personal account and is shown as a separate account in the balance sheet. It will usually show a credit balance indicating that the partner has not withdrawn the whole of the profit and the interest due to him. It is then shown in the liabilities side of the balance sheet. The current account may sometimes have a debit balance indicating that the partner has withdrawn in excess of his share of profit and interest due to him or there is loss in the business. It will then appear in the assets side of the balance sheet without disturbing the capital account.

ii) Fluctuating Capital Accounts

Under this system, the balance in the capital account changes from year to year. The reason is that all transactions relating to the amount of capital contributed, drawings, interest on capital and drawings, salary and share of profit or loss are recorded in the capital account itself. As a result of these adjustments, the capital at the end of each accounting period is different from what it is at the beginning of the period.

In the absence of any specific hint in an examination problem, capital account of a partner means a Fluctuating Capital Account. However, when current accounts (even when there is only one) are given, capital accounts would mean Fixed Capital Accounts.

Q5. Explain about the following (i) Loan Account (ii) Interest on Capital (iii) Drawings (iv) Interest on Drawings (v) Salary/Commission (vi) Capital ratio.

Ans :

i) Loan Account

When a partner gives some loan to the firm (besides his own contribution of capital), it should be credited to a separate loan account. In the absence of agreement, Partnership Act provides that interest @ 6% p.a. shall be allowed on such loan, irrespective of the profit. Interest on such loan should be credited either to Loan Account or Current Account.

ii) Interest on Capital

This is allowed to partners as per agreement between them. In absence of agreement among the partners, no interest is allowed. But interest on capital is allowed in those cases where capitals of the partners are equal but they share profits not in equal ratio or when capitals are unequal but they share profits and losses equally. This is necessary to balance capital accounts equitably so that any of the partners may not enjoy an unfair advantage over the others. Interest on capital is loss or expense to the firm and thus debited to Profit & Loss Appropriation Account. Partners' Capital or Current Accounts are credited with the amount of interest as it is an income or gain to the partners.

iii) Drawings

Partners may be allowed to draw either money or goods from the business to meet their private expenses. This is subject to the provisions in the partnership deed. It is not necessary that drawings of the partners should be equal. A separate drawing account for each partner is opened and closed by transferring its balance to capital account (if capitals are fluctuating) or current account (if capitals are fixed). But current account is not transferred to capital account.

iv) Interest on Drawings

If interest on capital is allowed, it is but natural that interest on drawings should also be charged subject to the provisions of the partnership deed. Interest on drawings may not be charged, if the partners draw a specific amount. But if any partner's drawings exceed that limit, then he is required to pay interest on drawings. Where drawings of the partners are unequal, interest on drawings must be charged to equitably adjust the partners capital accounts. Interest on drawings is an income to the firm and should be credited to Profit and Loss Appropriation Account. It should be debited to partners capital/current accounts being a loss to the partners. It is essential to know the amount of drawings, the period and the rate of interest for calculation of interest on drawings.

v) Partner's Salary or Commission

If a partner devotes more time to the working of the business or does some special work or renders service, then an additional benefit in the name of salary or some percentage of commission is allowed. Commission is payable either before charging such commission or after charging such commission. Salary/commission is loss to the business and is debited to Profit & Loss Appropriation Account and credited to Partners' Capital/Current Accounts being income or gain to them.

Usual Adjustments in Partnership Accounts

Following journal entries will be passed for distribution of profits among partners.

(i) For Interest on Capital

Profit and Loss Appropriation Account Dr.

To Partners' Capital (or Current) A/cs

(ii) For Salary or Commission Payable to Partners

Profit and Loss Appropriation A/c Dr.

To Partners' Capital (or Current) A/cs

(iii) For Interest on Drawings

Partners' Capital (or Current) A/cs Dr.

To Profit and Loss Appropriation A/c

(vi) For Distribution of Profit

Profit and Loss Appropriation A/c Dr.

To Partners' Capital (or Current) A/cs

Note : If loss, reverse entry will be passed.

Capital Ratio

Sometimes, partners agree to share their profits on the basis of effective capital employed. If capitals are fixed, profit will be distributed in that fixed capital ratio. But if capitals are fluctuating and partners introduced or withdraw capitals during the year, weighted average with reference to time has to be worked out to determine the ration in which profit or loss will be shared.

Q6. What is Profit and Loss appropriation Account ? Explain.

Ans :

Profit and Loss Appropriation Account

In a partnership, profit has to be divided between the partners in a certain profit sharing ratio after making necessary adjustments stated in the partnership deed such as interest on capitals, drawings and loans; salaries or/and commission to partners etc. Accordingly an additional account is prepared and net profit is transferred from the debit side of the profit and loss account to the credit side of this new account which is called Profit and Loss Appropriation Account and before the profit is divided between partners, it is necessary to record the above stated adjustments in this account.

Example : (When the partners have no partnership deed).

A and B commenced business in partnership on 1 January 2013. No partnership agreement was made either oral or written. They contributed Rs. 40,000 and Rs. 10,000 respectively as capital. In addition A also advanced Rs. 20,000 on 1 July 2013. A met with an accident on 1 April 2013 and could not attend to the partnership business upto 30 June

2013. The profits for the year ended on 31 December 2013 amounted to Rs. 50,600. Disputes having been arisen between them for sharing the profits.

A claims : (i) He should be given interest at 10% p.a. on capital and loan (ii) Profit should be distributed in proportion of capital.

B claims : (i) Net profit should be shared equally, (ii) He should be allowed remuneration of Rs. 1,000 p.m. during the period of A's illness, (iii) Interest on capital and loan should be given @ 6% p.a.

You are required to settle the dispute between them and distribute the profits according to law. State reasons for you answer.

Solution

Profit And Loss Appropriation Account For 2013

Particulars	Rs.	Particulars	Rs.
Interest on loan (6% on		Net Profit b/d	50,600
Rs. 20,000 for six months)	600		
A's Capital Account	25,000		
B's Capital Account	25,000		
	50.600		50,600

In the absence of any agreement to the contrary : (a) no interest is allowed on capital. (b) 6% interest is allowed on the loan advanced. (c) Profits and Losses shall be shared equally. (d) No remuneration is allowed to any partner for taking part in the conduct of the business.

1.2 Admission of A Partner

Q7. Explain about Admission of a Partner.

Ans : **(Dec-19, Imp)**

Admission of a Partner

It is not uncommon to admit a new person into an existing partnership business as a new partner. Even in the case of a sole proprietorship, the business may be converted into partnership on the admission a new person as an owner of the enterprise. The reason may be to require additional resources or managerial help or both. According to Partnership Act 1932, a new partner can be admitted into the firm only with the consent of all the existing partners [Section 31]. Admission of a new partner results in the reconstitution of partnership firm in the sense that a new agreement to carry on the business as a partnership business comes into existence. A new partner becomes entitled to:

(i) Share in the assets of the firm and

(ii) In the future profits of the firm.

For his right to share in the assets of the firm, the new partner brings in an agreed amount of capital either in cash or in kind (that is, in the form assets like building, machine, furniture, patents etc.). And for his right to share in the future profits of the firm, the new partner is generally required to bring some amount (in cash or kind) which is known as premium (i.e. his share of goodwill). The reason is that the new partner will get the benefits at the cost of sacrifices made by someone else in the past, When a new partner is admitted into the firm, future share of the existing partners (or a partner) is reduced to the extent of profit of the new partner. So the old or existing partners must be compensated in the firm by some additional payment in the form of premium.

From accounting point of view, the admission of a new partner requires the following adjustments:

(i) Changes in the profit sharing ratio

(ii) Calculation of the value of goodwill

(iii) Revaluation of assets and reassessment of liabilities

(iv) Distribution of accumulated profits (or losses) and reserves at the time of admission

(v) Adjustment or re-arrangement of capital account

(vi) Adjustment of joint life policy.

1.2.1 Changes in Profit Sharing Ratio

Q8. What are the changes will occur in the profit sharing ratio after admission of a partner ?

Ans :

Changes in Profit Sharing Ratio

The profit of a business enterprise is usually taken as one (unit). When a new partner is admitted, there is naturally a change in the profit sharing ratio because the old partners will not get the same one unit profit after admission. A part of that one unit of profit will be given to the new partner, and the old partners (or a sole trader) will have to share the remaining profit that is left after deducting new partner's share from the said one unit profit. However, the new partner may purchase his share exclusively from either one or more of the old or existing partners. It means that the old partners have to make sacrifice when a new partner gets a share in the future profits. It is therefore necessary to calculate not only the new profit sharing ratio of all partners but also the calculation of sacrificing ratio of old or existing partners for the purpose of determining their share in the premium brought in by the new partner.

(i) If the new partner's share is given and nothing else is mentioned in the question, then it is presumed that the remaining partners will share the rest of the profits in the old ratio.

For example, X and Y are partners sharing profits and losses in proportion of 2:1. They admit a new partner Z whom they give 1/6th share in profits. The new profit sharing ration will be calculated as under:

Suppose the total share is 1.

The new partner Z takes 1/6 share out of 1.

Rest of share $1-\frac{1}{6}=\frac{5}{6}$

X's New Share $=\frac{5}{6}\times\frac{2}{3}=\frac{10}{18}$

Y's New Share $=\frac{5}{6}\times\frac{1}{3}=\frac{5}{18}$

$\therefore$ X : Y : Z $=\frac{10}{18}:\frac{8}{18}:\frac{3}{18}=10:5:3$

(ii) The new partner, in some cases, purchases his share of profit from the old partners in a particular ratio. New profit sharing ratio of the old partners will be calculated by deducting the proportion given to the new partner from the shares of old partners.

For example, X and Y are partners sharing profits and losses in the proportion of 7 : 5. They agree to admit Z into partnership who is to get 1/6th share in profits. He acquires this share as 1/24th from X and 1/8th from Y. New profit sharing ratio will be calculated as under.

The new partner Z acquires $\frac{1}{6}$ th share in profits.

Which he takes $\frac{1}{24}$ from X and $\frac{1}{8}$ from Y.

$\therefore$ X is new share $=\frac{7}{12}-\frac{1}{24}=\frac{14-1}{24}=\frac{13}{24}$

$\therefore$ Y is new share $=\frac{5}{12}-\frac{1}{8}=\frac{10-3}{24}=\frac{7}{24}$

Now X,Y,Z will share $=\frac{13}{24}:\frac{7}{18}:\frac{4}{24}=13:7:4$

(iiii) In some cases, old partner surrenders a particular proportion of his share in favour of a new partner. In this case, first of all surrendered proportion is to be calculated for each partner and then this will he deducted from his old profit sharing ratio in order to calculate his new profit sharing ratio.

For example, A and B share profits in the ratio of 7 : 3. C was admitted as a partner. A surrendered 1/7th of his share and B 1/3rd of his share in favour of C. The new profit sharing ratio will be calculated as under :

A's old share $= \frac{7}{10}$

He surrenders $\frac{1}{7}$ th of his share,

i.e., $\frac{1}{7}$ of $\frac{7}{10} = \frac{1}{10}$

$\therefore$ A's new share $= \frac{7}{10} - \frac{1}{10} = \frac{7-1}{10} = \frac{6}{10}$

B's old share $= \frac{3}{10}$

He surrenders $\frac{1}{3}$ th of his share,

i.e., $\frac{1}{3}$ of $\frac{3}{10} = \frac{1}{10}$

$\therefore$ B's new share $= \frac{3}{10} - \frac{1}{10} = \frac{3-1}{10} = \frac{2}{10}$

C's new share $= \frac{1}{10} + \frac{1}{10} = \frac{1+1}{10} = \frac{2}{10}$

$\therefore$ New ratio of A, B & C

$= \frac{6}{10} : \frac{2}{10} : \frac{2}{10} = 6 : 2 : 2 = 3 : 1 : 1$

(iv) Sometimes a new partner acquires his share from the old partners in a particular ratio. Then it becomes necessary to calculate the fraction of share which he got from each partner. This fraction should be deducted from the share of old partners in order to calculate the new profit sharing ratio.

For, example, Ram and Shyam are partners sharing profits and losses in the ration 3 : 1. They agreed to admit Mohan into the partnership firm. Mohan is given 1/4th share of future profits which he acquires in the ration of 2 : 1 from Ram and Shyam. The new profit sharing ratio will be calculated as under :

Mohan gets from Ram $= \frac{1}{4} \times \frac{2}{3} = \frac{2}{12}$

Mohan gets from Shyam $= \frac{1}{4} \times \frac{1}{3} = \frac{1}{12}$

$\therefore$ Ram's share $= \frac{3}{4} - \frac{2}{12} = \frac{7}{12}$

Shyam share $= \frac{1}{4} - \frac{1}{12} = \frac{2}{12}$

New profit sharing ratio of Ram:Shyam:Mohan

= 7 : 2 : 3

Sacrificing Ratio

When the new partner is admitted, the old partner forgoes a fraction of his share in favour of the new partner and thus reducing the share of profit or loss of the old partner. Sacrifice made by the old partners can be found out by deducing their new share from the old share, i.e., Sacrificing Ratio = Old Ratio – New Ratio.

If in addition to the old ratio of the old partners, the new ratio of the incoming partners is given then in the absence of the details of the sacrifice made by the old partners the normal presumption is that the loss is suffered by the old partners in their old profit sharing ratio.

Example: P and Q are sharing profits in the ratio of 4 : 3. R is admitted in the business and new ration among P, Q and R is 2: 2 : 3. Find out the sacrificing ratio.

Solution :

Sacrificing Ratio = Old ratio – New Ratio

A's sacrifice $= \frac{4}{7} - \frac{2}{7} = \frac{2}{7}$

B's sacrifice $= \frac{3}{7} - \frac{2}{7} = \frac{1}{7}$

$\therefore$ Sacrificing ratio = 2 : 1

1.2.2 Good Will

Q9. What is Good Will ? Explain about factors influencing the good will.

Ans :

Goodwill is some thing very easy to describe but very difficult to define because there are so many factors which generate goodwill in each individual business. It is a benefit or an advantage of the good name, reputation or connection of a business. It is the attractive force which brings in customers. "Goodwill simply means that old customers will resort to the old place; if the old customers do not patronise the old place, business will almost decline certainly."

"Goodwill is the excess of the price paid for a business as a whole over the book values or over the market value of all tangible assets purchased.

Professor Dicksee states that when a man pays for goodwill, he pays for something which places him in a position of being able to earn more money than he would be able to do by his own efforts. Thus the capacity of a business to earn super profits in the future is basically what is meant by term goodwill.

Goodwill is an intangible asset; it cannot be seen; it cannot be felt; it cannot be transported physically. Even then it is very real. From accounting point of view, it is necessary that it has some monetary or saleable value.

Factors

The following factors are generally taken into consideration while computing the value of goodwill:

(i) The quality of the goods sold.

(ii) The personal reputation of the owners i.e., their ability to attract the customers.

(iii) The location of the business premises e.g., a good position in a congested market.

(iv) The possession of near monopoly right e.g. main agent for a particular vehicle like, Maruti car, Bajaj scooter, etc.

(v) The possession of trade marks and patents.

(vi) The presence of managerial skill.

(vii) The cost of research and development which enables the production at low cost and of good quality.

(viii) The possession of special contracts for the availability of materials.

1.2.3 Valuation Methods of Goodwill

Q10. Explain about Goodwill valuation Methods ?

Ans :

Valuation of goodwill is generally mentioned in the partner-ship deed. Following are the main methods of valuing the goodwill of a business

1. Average Profit Method

Under this method, average of the profits of last three or four years is calculated. The average profit is multiplied by the number of years in which the anticipated profit will be available.

For example, if the profits of 2011, 2012 and 2013 are Rs.8,000, Rs.10,000 and Rs.12,000 respectively and the goodwill is to be valued at twice of the average of the last three years' profits, the value of the goodwill will be calculated as under :

Total Profit = Rs.8,000 + Rs.10,000 + Rs.12,000

= Rs.30,000

Average Profit = Rs.10,000

Value of Goodwill = Rs.10,000 x 2

= Rs. 20,000

2. Super Profit Method

Super profits refer to the extra profits earned by a business over and above the usual return on investment in Similar business.

Under this method, it is assumed that a normal percentage of profit can be earned in the same type of business or industry on a certain amount of investment.

For example, if the investment in the business is Rs.50,000 and the normal rate of profit is 15%, then the normal profit will be Rs.7,500 (i.e., Rs.50,000 x 15/100). This normal profit is compared with the actual profit earned. If the actual profit is more than the normal profit, there will be super profit. Suppose further that the actual profit is Rs.10,000. Then Rs.2,500 (i.e., Rs.10,000 - Rs.7,500) will be super profit. This super profit is multiplied by the number of years in which the super profit will be available in future. For example, if the super profit will be available for three years, the value of goodwill will be Rs.2,500 x 3 = Rs.7,500.

3. Capitalisation Method

Under this method, the average profits are capitalised taking into consideration the general expectation in the same industry. Suppose the actual profits are Rs.7,500 and the general expectation in the same type of industry is 10%, then the total value of the net assets (i.e., assets minus liabilities) will be Rs.75,000 (i.e., Rs.7,500 x 100/10). If the actual net assets are Rs.70,000, then the value of goodwill will be Rs.5,000 (i.e., Rs.75,000 - Rs.70,000).

Example on Average Profits, Super Profits and Capitalization Methods

Shiv and Mohan are partners in a firm sharing profits and losses equally. On 31st March, 2013, the balances of their capital accounts were Rs.3,00,000 and Rs.2,00,000 respectively. The average profits of the firm are Rs.1,36,000 and the rate of normal profit is 20%.

On 1st April, 2013 they agreed to admit Hari as a partner for one fourth share. Hari will bring Rs.1,00,000 as capital.

You are required to compute the value of the goodwill of the firm on admission of Hari, if goodwill is to be calculated on the basis of

a) 5 years purchase of super profit,

b) Capitalization method,

c) 3 years purchase of average profit.

Sol :

a) 5 year purchase of super profit

	Rs.
Average Profit	1,36,000
Less : Normal Profit @ 20% of (Rs. 3,00,000 + Rs. 2,00,000)	(1,00,000)
Super Profit	36,000

Value of Goodwill = 5 × Super Profit = 5 × Rs.36,000 = Rs. 1,80,000

Value of Goodwill of the firm will be Rs. 1,80,000

b) Capitalisation Method

$$\text{Normal Value of Business} = \frac{\text{Average Profit}}{\text{Normal Rate of Profit}} = \frac{1,36,000}{20\%} = \text{Rs. } 6,80,000$$

Normal Value of Business		6,80,000
Less : Actual Capital Employed — Shiv	3,00,000	
— Mohan	2,00,000	
		(5,00,000)
Value of Goodwill of the firm will be		1,80,000

c) 3 years Purchase of Average Profits

Goodwill = 3 × Average Profit = 3 × 1,36,000 = Rs. 4,08,000

Value of goodwill of the firm will be Rs. 4,08,000

Q11. What is necessity of Valuation of Goodwill on admission of partnership?

Ans : **(June-18, Imp.)**

The need for valuing the goodwill in case of partnership firm arises in the following circumstances

(i) When the profit sharing ratio is changed, (ii) When a new partner is admitted, (iii) When a partner retires or dies, (iv) When two firms are amalgamated, (v) When a firm's business is dissolved or sold to a company.

When the Profit Sharing Ratio is Changed

If the partners of a firm decide to change the existing profit sharing ratio, then the partner who gains in this ratio will have to compensate the other partner. The compensation is the value of goodwill represented by the gain in the profit sharing ratio which one partner is purchasing from the other, previously belonging to the latter. Suppose A and B are partners sharing profits and losses in the ratio of 5 : 3. They decide that in future profit sharing ratio will be 3 : 1. The goodwill is valued at Rs.80,000. A gains l/8th share (i.e., 3/4 - 5/8) and he must pay B Rs.10,000 (i.e., 1/8 of Rs.80,000) for his share of profit which he gained from B.

According to AS-12 goodwill should be recorded in the books only when some consideration in money or money's worth has been paid. Goodwill should not be raised in the books of the firm as and when there is change in the constitution of the firm as no consideration in money or money's worth is paid for it. If any partner brings any premium, over and above his capital contribution at the time of admission, such premium should be distributed among the existing partners. If goodwill is evaluated at the time of change in the constitution of the firm, goodwill should not brought in books as it is inherent goodwill. If it is raised, then it should be immediately written off from the books of the firm.

When a New Partner is Admitted

The various methods of treating goodwill in the books of the firm at the time of admission of a new partner are as under :

(i) When the amount of goodwill is paid privately.

Occasionally the goodwill is not brought into the partnership books at all but is paid by separate cheque to the old partners by the newcomer and is treated as a matter outside the business. This method is most unscientific. In this case no entry is made in the books of accounts of the firm.

(ii) When the goodwill is received in cash and retained in the business.

In this case, the amount of goodwill received is entered in the firm's books and is retained in the business as additional working capital after the old partners capital accounts have been duly credited with their legitimate shares i.e., in the sacrificing ratio. Following journal entries will be passed in the books of the firm

(a) Cash A/c Dr.

To Premium A/c

(Being cash brought in credited to premium account)

(b) Premium A/c Dr.

To Old Partners' Capital A/cs (in sacrificing ratio)

Alternatively only one entry may be passed as given below :

Cash A/c Dr.

To Old Partners' Capital Accounts (in sacrificing ratio)

(iii) **When the amount of goodwill is received in cash and withdrawn by old partners.**

In this case, the goodwill is recorded as received in the books of the firm but is withdrawn immediately in cash by the old partners in the ratio of sacrifice made by them. Following entries are necessary to record the receipt and withdrawal of goodwill amount by old partners :

(a) When the amount of good will is credited to old partners in the ratio of sacrifice made by them.

(i) Cash A/c Dr.
To Premium A/c
(ii) Premium A/c Dr.
To Old Partners' Capital A/cs (in the sacrificing ratio

Alternatively, the following entry may be passed:

Cash A/c Dr.
To Old Partners' Capital Accounts

(b) When the amount is withdrawn by old partners in cash.

Old Partners' Capital Accounts Dr.
To Cash Account

(iv) When the goodwill is not brought in cash.

Sometimes the amount of goodwill is not brought in cash by the newcomer an adjustment of goodwill is made by debiting new partner's capital account and crediting the old partners capital accounts in their sacrificing ratio. This entry will be for new partner's share of goodwill. The journal entry to be made in this case is as under:

New Partner's Capital A/c Dr.

To Old Partners' Capital Accounts (in sacrificing ratio)

(v) When the goodwill is already appearing in the books.

When the goodwill is already appearing in the firm's books, first of all goodwill is to be written off from the books by debiting old partners capital accounts in their profit sharing ratio and crediting the goodwill account. Then the following entry is to be passed in the books of the firm for new partner's share of goodwill:

New Partner's Capital Account Dr.

To Old Partner's Capital Accounts (in their sacrificing ratio)

(vi) Sometimes new partner is unable to bring cash equal to his share of goodwill and goodwill is also appearing in the Balance Sheet.

In this case, first of all write off the amount of goodwill shown in the books debiting the old partners' capital accounts in their profit sharing ratio. The cash brought by the new partner for goodwill and the difference in share of goodwill not brought in cash is to be debited to the capital account of new partner and corresponding credit is to be given to old partners capital accounts in their sacrificing ratio.

The journal entries to be passed are as under :

(a) Old Partners' Capital A/cs Dr.

To Goodwill A/c

(Being goodwill written off from the books)

(b) Cash A/c Dr. (Cash brought in by new partner)

New Partner's Capital A/c Dr. (Difference not brought in cash)

To Old Partners' Capital A/cs (in sacrificing ratio)

(Being goodwill credited to old partners in sacrificing ratio.

(vii) When goodwill is hidden (i.e., not clearly given in the Balance Sheet or otherwise stated).

In this case the goodwill is to be derived from the facts given in the question. For example A and B are equal partners with Capitals of Rs. 8,000 and Rs. 7,000 respectively. They admit C as a partner with l/4th share in the profits of the firm. C brings Rs. 8,000 as his share of Capital. In this case the goodwill will be derived as under:

For 1/4 share Capital of C is Rs. 8,000

$\therefore$ Total Capital of the firm is Rs. 32,000.

But the Capital of A, B and C together is Rs. 8,000 + Rs. 7,000 + Rs. 8,000

= Rs. 23,000

$\therefore$ Value of Goodwill = Total Estimated Capital - Actual Capital = Rs. 32,000 – Rs. 23,000

= Rs. 9,000

Adjustment of Capital to be Proportionate to Profit Sharing Ratio

It is often agreed among the partners that capital accounts of the partners should be adjusted on the admission of a partner, so that they may be in proportion to the new profit sharing ratio. This may be done either on the basis of new partner's capital or the newcomer may bring his share of capital on the basis of old partners capital after adjustment.

(i) When the capitals are to be adjusted on the basis of new partner. The total capital can be calculated on the basis of new partner's share and the amount of capital. Capital required for each partner can also be calculated on the basis of new profit sharing ratio. The required amount of capital will now be compared with the balance of amount in the capital account of each partner after all adjustments are made. If the balance is more than that required balance, the excess will be withdrawn by the partner from the firm or will be transferred to his current account. But if the balance is less than the required amount of capital, the deficiency will be brought by the partner in cash or will be transferred to his current account. Instructions in this respect must be noted carefully from the language of the question.

Revaluation of Assets and Liabilities

Usually, on the admission of a partner the assets and liabilities of the firm are revalued as on the date of admission. These adjustments are done by opening a new account called Revaluation Account. It is debited with any reduction in the value of assets and increase in the amount of liabilities. If there is an increase in the value of any asset or reduction in the value of liabilities, this account is credited. The profit or loss arising due to revaluation of assets and liabilities is transferred to the capital accounts of the Old Partners in the old profit sharing ratio. The entries are as follows

(i) For the increase in the value of assets

Assets Account..... Dr.

To Revaluation A/c

(The asset account should be debited individually with increase in the value of assets

(ii) For decrease in the Value of assets

Revaluation..... Dr.

To Asset A/c

(The asset account should be Credited individually with decrease in the value of assets

Note

For decrease in the value of Investment, Sundry Debtors credit would be given to concerned Reserve or Provision Account

(iii) For any increase in the value of liabilities

Revaluation A/c..... Dr.

To Liabilities A/c

(iv) For any decrease in the value of liabilities

Liability Account..... Dr.

To Revaluation A/c

(v) For the transfer of profit on revaluation

Revaluation Account..... Dr.

To Old partners capital A/c

PROBLEMS ON ADMISSION OF PARTNER

1. Following is the Balance Sheet of A, B and C sharing profits and losses in the proportion of 6 : 5 : 3 respectively :

Liabilities	Rs.	Assets	Rs.
Creditors	18,900	Cash	1,890
Bills Payable	6,300	Debtors	26,460
General Reserve	10,500	Stock	29,400
A's Capital	35,400	Furniture	7,350
B's Capital	29,850	Land and Buildings	45,150
C's Capital	14,550	Goodwill	5,250
	1,15,500		1,15,500

They agreed to take D into partnership and give him 1/8 share on the following terms: (i) That furniture be depreciated by Rs. 920 ; (ii) That stock be depreciated by 10% ; *(iii)* That a provision of Rs. 1,320 be made for outstanding repair bills ; (iv) That the value of land and building having appreciated be brought upto Rs. 59,850 ; (v) That the value of goodwill Rs. 16,800 and D's share of goodwill is adjusted through capital accounts ; (vi) That D should bring Rs. 16,100 as his capital; (vii) That after making the above adjustments the total capital of the firm should be Rs. 1,12,000 and be adjusted on the basis of the new profit sharing ratio in the business. Actual cash to be paid off or brought in by the partners as the case may be.

Pass the necessary journal entries and prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet of the new firm.

Solution

Journal Entries

S. No	Particulars		Debit (Rs.)	Credit (Rs.)
1	Revaluation A/c	Dr.	5,180	
	To Furniture A/c			920
	To Stock A/c			2,940
	To Provision for Outstanding Repairs A/c			1,320
	(Being the reduction in the value of assets and provision made for unpaid repair bill)			
2	Land & Building A/c	Dr.	14,700	
	To Revaluation A/c			14,700
	(Being appreciation in the value of land and building)			
3	Revaluation A/c	Dr.	9,520	
	To A's Capital A/c			4,080
	To B's Capital A/c			3,400
	To C' Capital A/c			2,040
	(Being Revaluation Profit distributed among the partners in the old profit sharing ratio)			
4	General Reserve A/c	Dr.	10,500	
	To A's Capital A/c			4,500
	To B's Capital A/c			3,750
	To C's Capital A/c			2,250
	(Being general reserve distributed among the partners in the old profit sharing ratio)			
5	Goodwill A/c	Dr.	2,100	
	To A's Capital A/c			900
	To B's Capital A/c			750
	To C's Capital A/c			450
	(Being D's share of Goodwill distributed to old partners in the old profit sharing ratio)			
6	Cash A/c	Dr.	16,100	
	To D's Capital A/c			16,100
	(Being the amount brought in by D as capital)			

7	A's Capital A/c	Dr.	2,250	
	B's Capital A/c	Dr.	1.875	
	C's Capital A/c	Dr.	1.125	
	To Goodwill A/c	Cr.		5,250
	(Being existing amount of goodwill written of from the books)			
8	A's Capital A/c	Dr.	630	
	B's Capital A/c	Dr.	875	
	To Cash A/c			1505
	(Being cash paid to A and B being excess of their share of proportionate capital)			
9	Cash A/c	Dr.	2,835	
	To C's Capital A/c			2,835
	(For cash brought in by C being short of his share of proportional capital)			

Dr **Revaluation Account** **Cr**

Particulars	Rs.	Particulars	Rs.
To Furniture A/c	920	By Land and Buildings A/c	14,700
To Stock A/c	2,940		
To Provision for Outstanding Repairs A/c	1,320		
To Profit transferred to Capital A/c			
A 4,080			
B 3,400			
C 2,040	9,520		
	14,700		14,700

Dr **CAPITAL ACCOUNTS** **Cr**

Particulars	A	B	C	D	Particulars	A	B	C	D
	Rs.	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.	Rs.
To Capital A/cs	–	–	–	2,100					
To Goodwill	2,250	1,875	1,125	–	By Balance b/d	35,400	29,850	14,550	–
To Cash	630	875	–	–	" Cash A/c	–	–	–	16,100
To Balance c/d (2)	42,000	35,000	21,000	14,000	" General Reserve A/c	4,500	3,750	2,250	–
					" Revaluation Ac/	4,080	3,400	2,040	–
					" D's Capital A/c	900	750	450	–
					" Cash A/c	–	–	2,835	–
	44,880	37,750	22,125	16,100		44,880	37,750	22,125	16,100

Balance Sheet of A, B, C & D

Liabilities		Rs.	Assets	Rs
Sundry Creditors		18,900	Cash (Rs. 1,890 + Rs. 16,100 – Rs. 630 – Rs. 875 + Rs. 2,835)	19,320
Bills Payable		6,300	Sundry Debtors	26,460
Provision for Outstanding Repairs		1,320	Stock	26,460
Capital A/cs : (see note 2)			Furniture	6,430
			Land & Building	59,850
A	42,000			
B	35,000			
C	21,000			
D	14,000	1,12,000		
		1,38,520		1,38,520

Working Note

1 Net profit sharing Ratio

Profit of the whole firm = 1

D got 1/8th share

Remaining Share $1 - \frac{1}{8} = \frac{7}{8}$

A's new Share $= \frac{7}{8} \times \frac{6}{14} = \frac{6}{16}$

B's new Share $= \frac{7}{8} \times \frac{5}{14} = \frac{5}{16}$

C's new Share $= \frac{7}{8} \times \frac{3}{14} = \frac{3}{16}$

New Shares are A : B : C : D

$= \frac{6}{16} : \frac{5}{16} : \frac{3}{16} : \frac{2}{16} = 6 : 5 : 3 : 2$

2. Total Capital of the Firm

A's Capital $= 1,12,000 \times \frac{6}{16} =$ Rs. 42,000

B's Capital $= 1,12,000 \times \frac{5}{16} =$ Rs. 35,000

C's Capital $= 1,12,000 \times \frac{3}{16} =$ Rs. 21,000

2. X and Y start business with capitals of `. 90,000 and `. 45,000 on 1st Jan. 2008. Y is entitled to a salary of `. 600 p.m. Interest is allowed on capitals and is charged on drawings at 5% p.a. Profit are to be distributed equally after making the above adjustments. During the year X withdrew `. 10,000 and Y `. 12,000. Profit before the adjustment amounted to `. 52,000. Assuming the capitals to be fixed prepare the profit and loss appropriation account and the capital accounts relating to partners.

Sol :

Dr Profit & Loss Appropriation A/c Cr

Particulars	Rs.	Paticulars	Rs.
To Salaries		By Profit	80,000
Ravi	12,000		
Giri	9,000		
To Interest on capital			
Ravi	9,000		
Giri	7,200		
To Net Profit *			
Ravi – 24,880			
Giri – 17,920	42,800		
	80,000		**80,000**

- Distribution of profit

	Ravi	Giri
Upto Rs. 18,000	10,000	8,000
above Rs. 18,000, 3:2	14,880	9,920

Dr Current A/c's Cr

Particulars	Ravi (Rs.)	Giri(Rs.)	Particulars	Ravi (Rs.)	Giri (Rs.)
To Balance	–	3,000	By Balance	8,000	–
To Drawings	6,000	5,000	By Interest on Capital	9,000	7,200
			By Salary	12,000	9,000
To Balance C/d	47,880	26,120	By P & L App A/c	24,880	17,920
	53,880	**34,120**		**53,880**	**34,120**
			By Bal b/d	47,880	26,120

3. A, B and C are partners sharing profits and losses in proportion to their capitals at the beginning of the year. They are entitled annually to draw Rs. 6,000; Rs. 5,000 and Rs. 4,000 respectively out of their anticipated share of profits. Any drawings in excess of these amounts are to be regarded as advances taken from the firm and are subjected to interest at an average rate of 6 percent per annum. The capitals as at the beginning of the year to be allowed interest at an average rate of 5 per annum.

The capitals of the partners as at the beginning of the year were :

A Rs. 80,000; B Rs. 60,000; C Rs. 40,000

The credit balances of their current accounts were :

A Rs. 2,304; B Rs. 3,728; C Rs. 1,152

Their drawings during the year were:

A Rs. 10,000; B Rs. 12,000; C Rs. 5,000

The profits for the year were Rs. 30,096 before making any adjustments for interest as above. Draw up the Capital and Current Accounts of the partners.

Sol :

Dr — Profit and Loss A/c's — Cr

Particulars	Rs.	Particulars	Rs.
To Interest on Capital		By Profit	30,096
A = 4,000		By Interest on Drawings	
B = 3,000		A – 240	
C = 2,000	9,000	B – 420	
To Net Profit		C – 60	720
			30,816
A = 9696			
B = 7272			
C = 4848	21,816		
	30,816		**30,816**

Dr — Current A/c's — Cr

Particulars	A	B	C	Particulars	A	B	C
To Drawings	10,000	12,000	5,000	By Balance	2,304	3,728	1,152
To interest on Drawing	240	420	60	By Interest on Capital	4,000	3,000	2,000
To Balance C/d	5760	1580	2940	By P & L App	9,696	7,272	4,848
	16,000	**14,000**	**8,000**		**16,000**	**14,000**	**8,000**
				By Balance b/d	**5,760**	**1,580**	**2,940**

Dr — Capital A/c's — Cr

Particulars	A (Rs.)	B(Rs.)	C(Rs.)	Particulars	A(Rs.)	B(Rs.)	C(Rs.)
				By Balance	80,000	60,000	40,000
To Balance C/d	80,000	60,000	40,000				
	80,000	**60,000**	**40,000**	**By Balance b/d**	**80,000**	**60,000**	**40,000**

4. A and B are partners in a firm sharing profits and losses in the ratio of 3 : 2 their Balance Sheet was as follows on 01 -01-2015.

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	100000	Plant and Machinery	200000
General Reserve	60000	Patents	50000
Profit and Loss Account	15000	Stock	100000
		Debtors	80000
Capital Accounts :		Bills Receivable	10000
A	200000	Cash in hand	60000
B	125000		
	500000		500000

C is admitted as a partner on the above date on the following terms :

a) C will pay Rs.75000 as Goodwill and Rs.1,50,000 as capital for 1/4th share.

b) The assets are to be valued as under

Plant and Machinery at Rs. 2,25,000 ; Stock at Rs. 80,000 ; Debtors and Bill Receivable at book figure less provision of 10%.

c) It was found that the Creditors included a sum of Rs. 7,500 which was not to be paid. But it was also found that there was a liability for compensation to worker amounting Rs. 9,500

Prepare

i) Revaluation Account

ii) Capital Accounts

iii) New Balance Sheet.

Sol :

Revaluation Account

Particulars	Rs.	Particulars	Rs.
To depreciation on stock	20,000	By appreciation on plant	
To PBD [80,000 × 10%]	8,000	and machinery	25,000
To reserve on B/R		By discount on creditors	7,500
[10,000 × 10%]	1,000	By loss c/d	6,000
To liability for workmen		A - 3600	
compensation	9,500	B - 2400	
	38,500		38,500

Journal Entries in the books of the firm

Particulars		(Rs.) Debit	(Rs.) Credit
(1) Cash A/c	Dr.	1,50,000	–
To is capital		–	1,50,000
[Being capital brought by 'c']			
(2) (a) Cash A/c	Dr.	75,000	–
To goodwill A/c		–	75,000
[Being goodwill brought by 'c']			
(b) Goodwill A/c	Dr.	75,000	–
To A's capital A/c		–	45,000
To B's capital A/c		–	30,000
[Being goodwill distributed to old partners in the ratio of 3 : 2]			
(3) General reserve A/c	Dr.	60,000	–
To A's capital A/c		–	36,000
To B's capital A/c		–	24,000
[Being general reserve distributed to old partners in the ratio of 3 : 2]			
(4) Profit and Loss A/c	Dr.	15,000	–
To A's capital A/c		–	9,000
To B's capital A/c		–	6,000
[Being profit and loss distributed to old partners in the ratio of 3 : 2]			
(5) A's capital A/c	Dr.	3,600	–
B's capital A/c	Dr.	2,400	–
To Revaluation A/c		–	6,000
[Being revaluation loss distributed to old partners in the ratio of 3:2]			

Dr. Cash Account Cr.

Particulars	Rs.	Particulars	Rs.
To balance b/d	60,000	By balance c/d	2,85,000
To c's capital A/c	1,50,000		
To goodwill	75,000		
	2,85,000		2,85,000

Capital Accounts

Dr. Cr.

Particulars	A (Rs.)	B (Rs.)	C (Rs.)	Particulars	(Rs.) A	(Rs.) A	(Rs.) A
To revaluation [loss]	3,600	2,400	–	By balance b/d	2,00,000	1,25,000	–
To balance c/d	2,86,400	1,82,600	1,50,000	By cash A/c	–	–	1,50,00
				By goodwill	45,000	30,000	–
				By general reserve	36,000	24,000	–
				By profit & loss A/c	9,000	6,000	–
	2,90,000	1,85,000	1,50,000		2,90,000	1,85,000	1,50,000

New Balance Sheet of A, B, C as on 1-1-2015

Dr. Cr.

Liabilities		Rs.	Assets		Rs.
Capital Accounts			Plant and Machinery	2,00,000	
A		2,86,400	(+) appreciation	25,000	2,25,000
B		1,82,600	Patents		50,000
C		1,50,000	Stock	1,00,000	
Sundry creditors	1,00,000		(–) Decrease	20,000	80,000
(–) Discount on creditors	7,500	92,500	Debtors	80,000	
Liability for workmen compensation		9,500	(–) PBD	8,000	72,000
			Bills receivable	10,000	
			(–) reserve on B/R	1,000	9,000
			Cash		2,85,000
		7,21,000			7,21,000

5. Rajesh and Ajay are partners in a firm sharing profits and losses in the ratio of 2:1. Their Balance Sheet was a follows on 1st January 2005.

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	20,000	Plant and Machinery	40,000
General Reserve	15,000	Patents	10,000
Capital Accounts		Stock	20,000
Rajesh	40,000	Debtors	18,000
Ajay	25,000	Cash at Bank	12,000
	1,00,000		**1,00,000**

Vijay is admitted as a partner on the above date on the following terms :

a) He will pay `.15,000 as Goodwill and `. 30,000 as capital for 1/4th share in the profits of the firm. Goodwill is to be retained in the business.

b) The assets are to be valued as under

Plant and Machinery at `. 45,000

Stock at `.16,000

Debtors at book figure less Provision of 5%

c) It was found that the creditors included a sum of `.1,500 which was not to be paid. But it was also found that there was liability for compensation to worker amounting to Rs.1,900

Give journal entries to record the above and prepare the balance sheet of the firm after Vijay's admission

Sol :

Journal Entries

Sl. No	Particulars	Debit (Rs.)	Credit (Rs.)
1.	Bank A/c	45,000	
	To Vijay Capital A/c		30,000
	To Goodwill A/c		15,000
	(Being the capital and Goodwill introduced by vijay)		
2.	Goodwill A/c	15,000	
	To Rajesh A/c		10,000
	To Ajay A/c		5,000
	(Being the good will distributed among old partners)		
3.	Revaluation A/c	4,900	
	To Stock		4,000
	To Provision for Doubtful Debts		900
	(Being the reduce the asset value and provide provision for Doubtful debts on debtors)		
4.	Liable to creditor A/c	1,500	
	Plant & Machinery A/c	5,000	
	To Revaluation		6,500
	(Being the increase in value of Assets and Decrease in liability)		
5.	Revaluation A/c	1,900	
	To Liable for compensation		1,900
	(Being the compensation will be taken)		
6.	Rajesh A/c	200	
	Ajay A/c	100	
	To Revaluation A/c		300
	(Revaluation loss distributed among old partners)		
7.	General Reserve A/c	15,000	
	To Rajesh A/c		10,000
	To Ajay A/c		5,000
	(General Reserve distributed among old partners)		

Dr Revaluation A/c Cr

Particulars	Rs.	Particulars		Rs.
To Stock –	4,000	By Creditors		1,500
To Provision for Doubtful Debts		900 By Plant & Machinery		5,000
To Liable for compensation	1,900	By Loss		
		Rajesh	200	
		Ajay	100	300
	6,800			**6,800**

Dr Rajesh A/c Cr

Particulars	Rs.	Particulars	Rs.
To Revaluation (Loss)	200	By Balance b/d	40,000
To Bal C/d	59,800	By Goodwill	10,000
		By General Reserve	10,000
	60,000		**60,000**
		By Bal b/d	59,800

Dr Ajay A/c Cr

Particulars	Rs.	Particulars	Rs.
To Revaluation (Loss)	100	By Balance b/d	25,000
To Bal C/d	34,900	By Goodwill	5,000
		By General Reserve	5,000
	35,000		**35,000**
		By Bal b/d	34,900

Dr Vijaya A/c Cr

Particulars	Rs.	Particulars	Rs.
To Bal C/d	30,000	By Bank	30,000
	30,000		**30,000**
		By Bal b/d	30,000

Dr Cash A/c Cr

Particulars	Rs.	Particulars	Rs.
To Balance	12,000	By Balance C/d	42,000
To Vijay	30,000		
	42,000		**42,000**
To Bal b/d	42,000		

Balance Sheet as on 1-1-2005

Liabilities		Rs.	Assets		Rs.
Creditors –		18,500	Cash –		42,000
Liable for Compensation –		1,900	Goodwill		15,000
Capital A/c			Debtors	18,000	
Rajesh	59,800		(–)Prov. D.D	900	17,100
Ajay	34,900		Stock	20,000	
Vijay	30,000	1,24,700	(–) Reduction	4,000	16,000
			Plant & Machinery	40,000	
			(+) Additonal	5,000	45,000
			Patents		10,000
		1,45,100			**1,45,100**

6. The following is the Balance Sheet of A, B and C sharing profits and losses in proportion of 6/14, 5/14 and 3/14 respectively

Liabilities	Rs.	Assets	Rs.
Creditors	18,900	Cash	1,890
Bills Payable	6,300	Debtors	26,460
General Reserve	10,500	Stock	29,460
A' Capital	35,400	Furniture	7,350
B' Capital	29,850	Land & Buildings	45,150
C's Capital	14,550	Goodwill	5,250
	1,15,500		1,15,500

They agreed to take D into partnership and give him 1/8th share on the following terms : (i) That furniture be depreciated by `.920 (ii) That stock be depreciated by 10% (iii) a provision of `.1,320 be made for outstanding repair bills (iv) That the value of land & buildings having appreciated to be brought upto `. 59,850 (v) that D should bring in as his share of goodwill `.14,070. (vi) that D should then bring in `.14,700 as his capitals (vii) that after making the above adjustments the capital accounts of old parents be adjusted on the basis of D' Capital to his share in the business i.e., actual cash to be paid off or brought in by the old partners as the case may be

Pass the necessary journal entries and prepare the Balance Sheet of the new firm.

Sol :

Sl. No.	Particulars	Debit (Rs.)	Credit (Rs.)
1.	Bank A/c	14,700	
	To D's Capital A/c		14,700
	(Being the capital introduced by D)		
2.	Revaluation A/c	5,180	
	To Furniture A/c		920
	To Stock A/c		2,940
	To O/s Repair Bill A/c		1,320
	(Being the Assets are reduced)		
3.	Land & Buildings A/c	14,700	
	To Good Will A/c	8,820	
	To Revaluation A/c		23,520
	(Being the Assets are appreciated)		
4.	Revaluation A/c	18,340	
	To A's Capital		7,860
	To B's Capital		6,550
	To C's Capital		3,930
	(Being the profit distributed among old partners as per old ratio)		

5.	Gen. Reserve A/c	10,500	
	To A's Capital A/c		4,500
	To B's Capital A/c		3,750
	To C's Capital A/c		2,250
	(Being the Gen reserve distributed among old partners)		
6.	A's Capital A/c	3,660	
	B's Capital A/c	3,400	
	To Bank A/c		7,060
	(Being the excess of capital withdrawn)		
7.	Bank A/c	13,320	
	To C's Capital		1,320
	(Being the shortage of Capital paid)		

Dr Revaluation A/c Cr

Particulars		Rs.	Particulars	Rs.
To Furniture –		920	By Land & Building –	14,700
To Stock		2,940	By Good will	8,820
To O/s Repair bill –		1,320		
To Profit *				
A	7,860			
B	6,550			
C	3,930	18,340		
		23,520		**23,520**

* Distribution of Profit

A = 18,340 × 6/14 = 7,860

B = 18,340 × 5/14 = 6,550

C = 18,340 × 3/14 = 3,930

Dr Cash A/c Cr

Particulars	Rs.	Particulars	Rs.
To Balance	1,890	By A's Capital	3,660
To D's Capital	14,700	By B's Capital	3,400
To C's Capital	1,320	By Bal C/d	10,850
	17,910		**17,910**
By Bal b/d	10,850		

Dr A's Capital A/c Cr

Particulars	Rs.	Particulars	Rs.
To Bank	3,660	By Balance	35,400
To Bal C/d	44,100	By Revaluation A/c	7,860
		By General Reserve	4,500
	47,760		**47,760**
		By Bal b/d	44,100

Dr B's Capital A/c Cr

Particulars	Rs.	Particulars	Rs.
To Bank	3,400	By Balance	29,850
To Bal C/d	36,750	By Revalutaion A/c	6,550
		By General Reserve	3,750
	40,150		**40,150**
		By Bal b/d	36,750

Dr C's Capital A/c Cr

Particulars	Rs.	Particulars	Rs.
To Bal C/d	22,050	By Balance A/c	14,550
		By Revaluation A/c	3,930
		By General Reserve	2,250
		By Bank	1,320
	22,050		**22,050**
		By Bal b/d	22,050

Dr D's Capital A/c Cr

Particulars	Rs.	Particulars	Rs.
To Bal C/d	14,700	By Bank A/c	14,700
	14,700		**14,700**
		By Bal b/d	14,700

Balance Sheet as on ......

Liabilities	Rs.	Assets		Rs.
Creditors	18,900	Cash A/c	–	10,850
O/s Repair bill	1,320	Debtors	–	26,460
Bills payable	6,300	Stock	–	26,460
Capitals				
A	44,100	Furniture		6,430
B	36,750	Land & Buildings		59,850
C	22,050	Good will		14,070
D	14,700			
	1,44,120			**1,44,120**

7. The following was the Balance Sheet of Khan, Ismail and Nandu who share profit and losses in proportion of one-half, one-third and one-sixth respectively

Liabilities	Rs.	Assets	Rs.
Creditors	5,000	Land & Buildings	48,000
Capitals		Machinery	7,000
Khan	57,000	Stock	29,000
Ismail	32,000	Debtors	25,200
Nandu	16,000	Cash	800
	1,10,000		1,10,000

They agreed to take Ashish into partnership as from 1st January 2005 giving him 1/16th share in the profits on the following terms:

a) That Ashish should bring ` 3,000 as Goodwill and ` 8,000 as his capital .

b) That Machinery be depreciated by 12 percent.

c) That a reserve of 5 percent be created for doubtful debts.

d) That stock be depreciated by 10 percent

e) That the value of land and buildings be brought upto ` 62,000.

f) That after making the above adjustments the Capital of the old partners be adjusted according to their new profit sharing proportions, actual amount to be brought in by or to be paid off to them as the case may be.

Prepare the Revaluation Accounts Partners Capital Accounts and the opening Balance Sheet of the firm as newly constituted.

Sol :

Dr Revaluation A/c Cr

Particulars		Rs.	Particulars	Rs.
To Machinery –		840	By Land & Building –	14,000
to Stock –		2,900	(62000 - 48000)	
To Provision for Doubtful debts –		1,260		
To Profit				
Khan	4,500			
Ismail	3,000			
Nandu	1,500	9,000		
		14,000		**14,000**

Dr Khan's Capital A/c Cr

Particulars	Rs.	Particulars	Rs.
To Bank	3,000	By Balance	57,000
To Bal C/d	60,000	By Goodwill	1,500
		By Revaluation	4,500
	63,000		**63,000**
		By Bal b/d	60,000

Dr **Ismail Capital A/c** **Cr**

Particulars	Rs.	Particulars	Rs.
		By Balance	32,000
		By Goodwill	1,000
To Bal C/d	40,000	By Revaluation	3,000
		By Bank	4,000
	40,000		**40,000**
		By Bal b/d	40,000

Dr **Nandu Capital A/c** **Cr**

Particulars	Rs.	Particulars	Rs.
		By Balance	16,000
		By Goodwill	500
To Bal C/d	20,000	By Revaluation	1,500
		By Bank	2,000
	20,000		**20,000**
		By Bal b/d	20,000

Dr **Ashish's Capital A/c** **Cr**

Particulars	Rs.	Particulars	Rs.
To Bal C/d	8,000	By Balance	8,000
	8,000		**8,000**
		By Bal b/d	8,000

Balance Sheet as on .....

Liabilities	Rs.	Assets		Rs.
Creditors	5,000	Cash	–	14,800
Capitals		Debtors	25,200	
Khan	60,000	(–) Prov DD	1,260	23,940
Ismail	40,000	Stock		26,000
Nandu	20,000	Machinery		6,160
Ashish	8,000	Land & Buildings		62,000
	1,33,000			**1,33,000**

Working Note :

- Now profit sharing ratio's after giving the share of profit

  Khan = 15/16 × 1/2 = 15/32

  Ismail = 15/16 × 1/3 = 5/16

  Nandu = 15/16 × 1/6 = 5/32

- Calculation of capital as per Ashish capital

Khan = $\frac{15}{32} \times 8{,}000 = 60{,}000$

Ismail = $\frac{5}{16} \times 8{,}000 = 40{,}000$

Nandu = $\frac{5}{32} \times 8{,}000 = 20{,}000$

8. The following is the Balance Sheet of A and B as at 31st March 2006 C is admitted as a partner on that date when position of A and B was a under.

Liabilities	Rs.	Assets	Rs.
A's Capital –	10,000	Debtors –	11,000
B's Capital	8,000	Land and Buildings	8,000
Creditors	12,000	Plant and Machinery	10,000
General Reserve	16,000	Stock of goods	12,000
Workmen's Compensation Fund	4,000	Cash and Bank Balance	9,000
	50,000		50,000

A and B shared profit in proportion of 3 : 2. The following terms of admission are agreed upon.

1) Revaluation of assets : Land and Buildings `. 18,000; Stock of Goods `. 16,000
2) The liability on workmen's compensation fund is determined at `. 2,000.
3) C brought in as his share of goodwill `. 10,000 in cash
4) C was to bring further cash as would make his capital equal to 20 percent of the combined Capital of partners A and B after above revaluation and adjustments are carried out
5) The future profit sharing proportion were as under : A–2/5th B–2/5th and C1/5th. Prepare the new Balance Sheet of the firm and Capital Accounts of the Partners.

Sol :

Dr Revaluation A/c Cr

Particulars		Rs.	Particulars	Rs.
	–		By Land & Buildings –	100,00
To Profit			By Stock –	4,000
A	9,600		By workmens compensation –	2,000
B	6,400	16,000		
		16,000		**16,000**

Dr A's Capital A/c Cr

Particulars	Rs.	Particulars	Rs.
To Bal C/d	35,200	By Balance b/d	10,000
		By Revaluation	9,600
		By General Reserve	9,600
		By Good Will	6,000
	35,200		**35,200**
		By Bal b/d	35,200

Dr B's Capital A/c Cr

Particulars	Rs.	Particulars	Rs.
		By Balance b/d	8,000
		By Revaluation	6,400
		By General Reserve	6,400
To Bal C/d	24,800	By Good Will	4,000
	24,800		**24,800**
		By Bal b/d	24,800

Dr C's Capital A/c Cr

Particulars	Rs.	Particulars	Rs.
To Bal C/d	12,000	By Bank	12,000
	12,000		**12,000**
		By Bal b/d	12,000

Balance Sheet as on .....

Liabilities	Rs.	Assets	Rs.
Creditors –	12,000	Cash –	31,000
Workmens Compensation	2,000	Debtors –	11,000
Capital		Stock –	16,000
A's	35,200	Land & Building	18,000
B's	24,800	Goodwill	10,000
C's	12,000		
	86,000		**86,000**

1.3 Retirement of a Partner

Q12. Explain about retirement of Partner ship firm.

Ans : **(June-18, Imp.)**

Retirement of a Partner

The only difference between admission and retirement of a partner is that in case of the former, the new partner joins the firm whereas in case of retirement, the old partner leaves the firm because of certain reasons as old age, ill health etc.

The main points which require attention in case of retirement of a partner are :

i) Treatment of goodwill.

ii) Revaluation of assets and liabilities.

iii) Calculation of gaining ratio.

iv) Treatment of undistributed profits or losses.

v) Share of profit upto the date of retirement.

vi) Share in life policy.

vii) Calculation of total amount due to a retiring partner.

viii) Adjustment of capitals after retirement in order to be proportionate to the new profit sharing ratio.

ix) Settlement of total amount due to the retiring partner.

(i) Treatment of Goodwill

Goodwill is valued according to any of the methods (discussed previously) and as per provisions of the partnership deed. Following treatment may be given :

If any amount of goodwill is appearing in the Balance Sheet at the retirement of a partner, that should be written off by debiting all partners capital accounts and crediting goodwill account. Further, retiring partner's share of goodwill is to be calculated and credited to his capital account, the corresponding debit to be given to continuing partners capital accounts in gaining ratio. In some cases, even the continuing partner may loose some share, in that case his account will also be credited with proportionate amount of premium (as compared to retiring partner's share) and corresponding debit given to other partner's capital account who has gained his share.

Continuing Partners Capital A/cs. (in gaining ratio)

To Retiring Partner's Capital A/c

(ii) Revaluation of Assets and Liabilities

Revaluation of assets and liabilities is done on the same basis as was done in case of admission of a partner. The only difference is that profit or loss on revaluation is to be divided among all the partners (including the retiring partner) in the profit sharing ratio in case of retirement of a partner. Assets and liabilities will then appear in the Balance Sheet at changed values.

Example

A, B and C are partners in a business, sharing profits and losses in ratio of 3 : 2 : 1. Their Balance sheet on 30th June, 2013 was follows:

Liabilities	Rs.	Assets	Rs
Sundry Creditors	1,600	Cash at Hand	600
Reserve Fund	6,000	Cash at Bank	1,000
Capitals		Sundry Debtors	9,000
A	10,000	Stock in Hand	7,000
B	10,000	Machinery	6,000
C	10,000	Factory Building	14,000
	37,600		**37,600**

On that date C retires from business. It is agreed to adjust the values of assets as follows :

a) To make a provision of 5% on sundry debtors for doubtful debts;

b) To depreciate stock by 5% and machinery by 10%; (c) Factory buildings to be revalued at Rs. 15,100,

Show Revaluation Account and Partners' Capital Accounts and prepare Balance Sheet of the continuing partners as on July1, 2013.

Sol. :

Dr Revaluation A/c Cr

Particulars	Rs.	Particulars		Rs
To Provision for Doubtful Debts	450	By Factory Buildings		1,100
To Stock	350	By Loss transferred to Capital A/cs		
To Machinery	600	A	150	
		B	100	
		C	50	300
	1,400			1,400

Dr Capital A/c Cr

Particulars	A	B	C	Particulars	A	B	C
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Revaluation A/c	150	100	50	By Balance b/d	10,000	10,000	10,000
To C's Loan A/c	–	–	10,950	By Reserve fund	3,000	2,000	1,000
To balance c/d	12,850	11,900	–				
	13,000	12,000	11,000		13,000	12,000	11,000

BALANCE SHEET OF M/s A, B, C & CO
as on July 1, 2013

Liabilities		Rs.	Assets		Rs
Sundry Creditors		1,600	Cash in Hand		600
C's Loan		10,950	Cash at Bank		1,000
Capital A/cs	Rs.		Sundry Debtors	9,000	
A	12,850		Less : Provision for Doubt		
B	11,900	24,750	full Debts	450	8,550
			Stock		6,650
			Machinery		5,400
			Factory Building		15,100
		37,300			**37,300**

Calculation of Gaining or Benefit Ratio

On the retirement or death of a partner, his share in the profit would be taken by the remaining partners. In other words, they get additional share which is obviously a gain or benefit. The calculation of gaining ratio or benefit ratio is done as follows:

(i) When the new ratio is given, gaining ratio is calculated by deducting their new share of profits from the old share.

(ii) When the new profit sharing ratio is not given and the remaining partners share the future profits in the same ratio as before, the gaining ratio would be the old profit sharing ratio.

Observe the following table

Between Remaining Partners

Status of Ratio	New Ratio	Gaining or Benefit Ratio
i) When new ratio is given	As given in the examination Problem	New Ratio minus Old ratio
ii) When the new Ratio is not given	The same old ratios between them	The same old ratios between them
iii) When gaining or benefit ratio is given	Old Ratio + Gaining ratio	As given in the question

Note

(i) In the absence of specific information, it is assumed that the remaining partners get the share of profit of the retiring/dead partner in their old profit sharing ratio.

(ii) Unless otherwise given, it is presumed that the continuing partners gain or benefit in their old profit sharing ratio.

1.3.1 Difference Between Sacrificing Ratio and Gaining Ratio

Q13. How sacrificing Ratio differ with Gaining Ratio ?

Ans :

Difference between Sacrificing Ratio and Gaining Ratio

Points of Difference	Sacrificing Ratio	Gaining Ratio
1. Meaning	It is ratio which shows the sacrifice made by the old partners on admission of a new partner	It is the ratio in which remaining remaining partners gain or benefit benefit from the retirement or death of a partner
2. Object	It is calculated to find out the amount of compensation to be given to the old partner	It is calculated to find out the compensation to be given to the outgoing partner by each of the remaining partners
3. Mode of Calculation	It is calculated by finding out the difference between old ratio and new ratio	It is calculated by finding out the difference between new ratio and old ratio
4. Time of Calculation	It is calculated at the time of admission of a partner	It is calculated on the retirement or death of a partner.

Q14. Explain the Treatment of Undistributed Profits or Losses.

Ans :

General reserve or credit balance of profit and loss account will be distributed by crediting to all the partners capital accounts in their profit sharing ratio and will not be shown on the liabilities side of the Balance Sheet after distribution. Alternately, only retiring partner's share of these items may be credited to his account and residual amount of such accounts may be shown on the liabilities side of the Balance Sheet. Reverse treatment will be given if there is debit balance of profit and loss account on the assets side of the Balance Sheet.

If some undistributed profits appear in the name of General Reserve or Profit and Loss Account (credit balance), that should be divided among the old partners in the old profit sharing ratio by passing the following journal entry :

General Reserve or Profit and Loss A/c Dr.

To Old Partners' Capital A/cs

The effect of this will be that in the new Balance Sheet no balance of General Reserve or Profit and Loss (Cr. balance) will appear. Similarly, if Profit and Loss Account (Dr. balance) is appearing on the assets side of the Balance Sheet, it should be closed by transfer to old partners' capital accounts in their old profit sharing ratio by passing the following entry :

Old Partners' Capital Accounts Dr.

To Profit and Loss A/c

No loss will appear on the assets side in the new Balance Sheet.

Share of Retiring Partner's Profit Upto the Date of Retirement

If a partner retires in between the accounting year due to some reasons, his share of profit upto the date of retirement is to be calculated (on the basis of last year's profit or otherwise) and credited to his capital account, the corresponding debit to be given to profit and loss suspense account.

Calculation of Total Amount Due to a Retiring Partner

The total amount due to a retiring partner may include *(i)* capital on the date of last Balance Sheet, *(ii)* Interest or salary, if any, payable to him, *(iii)* share of profit or loss to the date of retirement, (iv) share in the goodwill of the firm, (v) share in the profit or loss on revaluation of assets and liabilities, *(vi)* share in the general reserve or profit and loss account appearing in the Balance Sheet. The total amount calculated will be transferred to the retiring partner's loan account. The entry will be :

Retiring Partner's Capital A/c

To Retiring Partner's Loan A/c

Adjustment of Capitals after Retirement in Order to be Proportionate to the profit Sharing Ratio

Sometimes after the retirement of a partner, the continuing partners decide to have a certain sum as to be the capital of the firm and that too should be in their new profit sharing ratio. From the total amount of the capital, the capital required by each partner is calculated with reference to his profit sharing ratio and compared with the existing balance in the capital account after making all adjustments. If surplus, the amount will be withdrawn by the partner concerned and if the balance is less than the required amount of his share of capital, he will have to bring the difference of amount in cash in firm's books.

Settlement of the Total Amount Due to the Retiring Partner

Retiring partner will demand immediate payment of the balance due to him at the time of retirement but the financial resources of the firm may not permit the total amount due to a retiring partner to be paid in one instalment. Some amount may be paid immediately and the rest may be treated as retiring partner's loan to the firm at a certain rate of interest. Partner's loan account will be continuously shown on the liabilities side of the Balance Sheet till all the outstanding amount of loan is paid by the firm to the retiring partner.

PROBLEM

9. Balance Sheet of A, B and C who were sharing profits in proportion to their capital stood as follows on December 31,2012.

Liabilities		Rs.	Assets	Rs
Sundry Creditors		2,400	Cash at Bank	5,500
General Reserve		4,500	Sundry Debtors	5,000
Capital A/cs			Stock	18,000
A	20,000		Machinery	23,400
B	15,000			
C	10,000			
		45,000		
		51,900		51,900

B retired on the above-mentioned date on the following terms :

(i) A provision for doubtful debts be made @ 5 % of sundry debtors, (ii) Machinery be depreciated by Rs. 650. (iii) Goodwill of the entire firm be fixed at Rs. 1,10,800 and without raising a Goodwill Account B's share of it be adjusted into the accounts of A and C who are going to share future profits in the ratio of 5 : 3 respectively, (iv) Capital of the new firm be fixed at Rs. 48,000 ; A and C to bring in cash to make their capital proportionate to their profit-sharing ratio, (v) Amount due to B be paid in cash.

Journalise the above mentioned transactions, show Capital Accounts and prepare the initial Balance Sheet of the new firm.

Sol :

Journal Entries

Sl. No.	Particulars		Rs.	Rs.
1. 2012				
Dec. 31	Revaluation A/c	Dr	900	
	To Provision for Doubtful Debts A/c			250
	To Machinery A/c			650
	(Being depreciation on machinery and provision for doubtful debts made)			
2.	A's Capital A/c	Dr.	400	
	B's Capital A/c	Dr.	300	
	C's Capital A/c	Dr.	200	
	To Revaluation A/c			900
	(Being loss on revaluation transferred to old partners' capital accounts)			

3.	General Reserve A/c	Dr	4,500	
	To A's Capital A/c			2,000
	To B's Capital A/c			1,500
	To C's Capital A/c			1,000
	(Being general reserve distributed among the partners in the profit sharing ratio)			
4.	A's Capital A/c	Dr.	1,950	
	C's Capital A/c		1,650	
	To B's Capital A/c			3,600
	(Goodwill credited in gaining ratio)			
	B's Capital A/c	Dr.	19,800	
	To Cash A/c			19,800
	(Cash paid to B on retirement)			
5.	Cash A/c		19,200	
	To A's Capital A/c	Dr.		10,350
	To C's Capital A/c			8,850
	(Being brought by A and C in order to adjust their capitals in new profit sharing ratio)			

Dr **Capital A/c's** **Cr**

Particulars	A (Rs.)	B (Rs.)	C (Rs.)	Particulars	A (Rs.)	B (Rs.)	C (Rs.)
To Revaluation A/c				By Balance b/d	20,000	15,000	10,000
(Loss)	400	300	200	By General Reserve	2,000	1,500	1,000
To A's Capital A/c	1,950	–	1,650	By Capital A/cs	–	3,600	–
To Cash	–	19,800	–	By Cash	10,350	–	8,850
To Balance c/d	30,000	–	18,000				
	32,350	20,100	19,850		32,350	20,100	19,850

BALANCE SHEET OF M/s A & C
as on 1-1-2013

Liabilities		Rs.	Assets		Rs
Creditors		2,400	Cash at Bank (See note)		4,900
Capital Accounts :			Sundry Debtors	5,000	
A	30,000		Less : Provision for D/D	250	4,750
B	18,000	48,000			
			Stock		18,000
			Machinery	23,400	
			Less : Depreciation	650	22,750
		50,400			50,400

Dr **Cash A/c** **Cr**

Particualrs	Rs.	Particulars	Rs.
To Balance b/d	5,500	By C's Capital A/c	19,800
To A's Capital A/c	10,350	By Balance c/d	4,900
To C's Capital A/c	8,850		
	24,700		24,700

1.4 Death of a Partner

Q15. How the profits will be distribute at the time of Death of a partner ?

Ans : **(Imp.)**

The problem which arise in case of death of a partner are similar to those of a retiring partner except that the death of a partner may occur at any time whereas the retirement of a partner is planned, i.e., he is allowed to retire on the last date of accounting period. The deceased partner's capital account is credited with the balance of capital at the beginning of the year, interest on capital (if allowed), share of profit on revaluation of assets and liabilities, share of undistributed profits, share of profit to the date of death, his share of goodwill and the amount which is received from the Life Insurance Corporation of India (or surrender value in case of individual policies) and debited with drawings to the date of death, interest on drawings (if charged) and the balance is transferred to the executor's account of the deceased partner.

Moreover, under Section 37 of the Partnership Act, the executors of the deceased partner would be entitled at their discretion either interest at 6% per annum on the amount due from the date of death to the date of payment or to that portion of the profit that is earned by the firm with the amount due to the deceased partner. Most of the points have already been discussed in the retirement of a partner but the following two points require special attention.

(i) Calculation of deceased partner's share of profit.

(it) Treatment of life policy or policies.

These will be discussed one by one.

Calculation of Deceased Partner's Share of Profit

The deceased partner's share of profit is to be determined either on the basis of time or turnover.

a) On the basis of time

In this case, it is assumed that the profit during the previous year has been earned uniformly in all months during the year, provided previous year is taken as the base for calculation of profit. Sometimes average profits of the past three or four years is taken as base rather than the previous year. Whatever base may be taken it is to be multiplied by the period for which the deceased partner remained in the firm and also by his profit sharing ratio at the time of his death.

For example A, B and C are partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. B dies on 14th March, 2013. The average profit of the last three years is Rs. 30,000. B's share of profit on the basis of time is calculated as under :

Average yearly profit = Rs. 30,000

Profit for 73 days, i.e., Jan. 1 to March 14,2013 = $\frac{\text{Rs.}30{,}000 \times 73}{365}$ = Rs. 6,000

$\therefore$ B's share = 2/6 × Rs. 6,000 = Rs. 2,000

b) On the basis of turnover

In this method, average past profit is divided into two portions ***i.e.,*** before the death and after the death on the basis of ratio of turnover to the date of death to average turnover and then deceased partner's share is calculated and credited to his capital account.

For example, A, B and C are partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. B dies on 14th March, 2013. Turnover from 1st January, to 14th March, 2013 is Rs. 42,000. Average turnover of the last three years is Rs. 60,000 and profit is Rs. 30,000. B's share of profit on this basis will be calculated as under:

Average turnover = Rs. 60,000

Sales to the date of death = Rs. 42,000

Profit to the date of death $= \text{Rs. } 42,000 \times \frac{\text{Rs.} 30,000}{\text{Rs.} 60,000} = \text{Rs. } 21,000$

B's share of profit = Rs. 1/3 × Rs. 21,000 = Rs. 7,000

PROBLEMS ON RETIREMENTS AND DEATH OF PARTNERS

10. A, B and C were carrying on business in partnership sharing profits and losses in the ratio 3:2:1. On 31st December 2005 Balance Sheet of the firm stood as follows:

Liabilities		Rs.	Assets		Rs.
Sundry Creditors	–	13,590	Cash	–	5,900
Capital Accounts		8,000	Debtors		8,000
A	15,000		Plant and Machinery		10,000
B	10,000		Stock		11,690
C	10,000	35,000	Buildings		23,000
					50,000
		48,590			**48,590**

B retired on the above mentioned date on the following terms :

i) Buildings be appreciated by `.7,000

ii) Provision for bad debts be made @ on debtors

iii) Goodwill of the firm be valued at `. 9,000 and adjustment in this respect be made without raising Goodwill Account

iv) `.5,000 be paid to B immediately and the balance due to him be treated as a loan carrying interest @ 6% per annum.

Pass journal entries to record the above transactions and show the Balance Sheet of the firm as it would appear immediately after B's retirement

Sol :

Sl. No.	Particulars	Debit (Rs.)	Credit (Rs.)
1.	Revaluation A/c Dr	400	
	To Provision for Doubt debts		400
	(Being the providing provision for D Debts)		
2.	Building A/c Dr	7,000	
	To Revaluation A/c		7,000
	(Being the Asset value Appreciated)		

3.	Revaluation A/c	Dr	6,600	
	To A's Capital A/c			3,300
	To B's Capital A/c			2,200
	To C's Capital A/c			1,100
	(Being the Revaluation A/c profit transferred to partners Capital A/c's)			
4.	A's Capital A/c	Dr	2,250	
	C's Capital A/c	Dr	750	
	To B's Capital A/c			
	(being A and C, capital A/c are transfered to B A/c			3,000
5.	B's Capital A/c	Dr	10,200	
	To B's Loan A/c			
	(being B capital A/c amount convert as B loan)			10,200
6.	B's Capital A/c	Dr	5,000	
	To Cash A/c			
	(Being cash paid by 'B')			5,000

Dr Revaluation A/c Cr

Particulars		Rs.	Particulars	Rs.
To Provision for Doubtful Debts	–	400	By Building –	7,000
To Profit	–			
A	3,300			
B	2,200			
C	1,100	6,600		
		7,000		**7,000**

Profit Distributed through partners as follows :

Profit = 6,600

A's Share = 6,600 × 3/6 = 3,300

B's Share = 6,600 × 2/6 = 2,200

C's Share = 6,600 × 2/6 = 1,100

Dr A's Capital A/c Cr

Particulars	Rs.	Particulars	Rs.
To B's Capital	2,250	By Balance	15,000
To Bal C/d	16,050	By Revalutaion A/c	3,300
	18,300		**18,300**
		By Bal b/d	16,050

Dr B's Capital A/c Cr

Particulars	Rs.	Particulars	Rs.
To Cash	5,000	By Balance	10,000
To Loan A/c	10,200	By Revalutaion A/c	2,200
		By A's Capital	2,250
		By C's Capital	750
	15,200		**15,200**

Dr **C's Capital A/c** Cr

Particulars	Rs.	Particulars	Rs.
To B's Capital	750	By Balance	10,000
To Bal C/d	10,350	By Revalutaion A/c	1,100
	11,100		**11,100**
		By Balance B/d	10,350

Balance Sheet as on .....

Liabilities		Rs.	Assets		Rs.
Creditors	–	13,590	Cash A/c	–	900
B Loan A/c		10,200	Debtor	8,000	
			(–)Doubtful Debts	400	7,600
Capital A/c					
A's	16,050		Stock		11,690
C's	10,350		Building		36,000
		50,190			**50,190**

11. C, P and S were partners sharing profits 2/5th, 3/10th and 3/10th respectively. Their Balance Sheet on 31st December 2005 was as follows :

Liabilities	Rs.	Assets		Rs.
Capital :		Buildings		18,000
C	16,000	Plant		14,000
P	12,000	Motor Car		4,000
S	10,000	Stock		10,000
Reserve	5,000	Debtors	7,000	
Bills Payable	2,000	Less Provision	1,000	6,000
Creditors	8,000	Cash at Bank		1,000
	53,000			**53,000**

P retires on that date of the following terms :

i) The goodwill of the firm is to be valued at ` 7,000

ii) Stock and Buildings are to be appreciated by 10%

iii) Plant and Motor Car are to be depreciated by 10 percent

iv) Liability for the payment of gratuity to worker ` 2,000 is not yet recorded in books, but the same is to be provided for

v) Provision for bad debts is no more necessary.

vi) It is decided not a maintain goodwill account in the books.

vii) The amount payable to P is to be paid in 3 equal annual installments beginning from 1st January 2006 with interest at 10 percent p.a.

You are required to prepare (1) Revaluation Account (2) Partner's Capital Accounts (3) New Balance Sheet of C & S.

Sol :

Dr Revaluation A/c Cr

Particulars		Rs.	Particulars		Rs.
To Plant	–	1,400	By Buildings	–	1,800
To Motor Car		400	By Stock	–	1,000
To Gratuity Payable		2,000	By Provision for Debtors		1,000
		3,800			**3,800**

Dr P Capital A/c Cr

Particulars		Rs.	Particulars		Rs.
To C loan A/c	–	15,600	By Balance	–	12,000
			By Goodwill	–	2,100
			By Reserve		1,500
		15,600			**15,600**

Dr S Capital A/c Cr

Particulars		Rs.	Particulars		Rs.
To Goodwill	–	900	By Balance	–	10,000
To Balance		10,600	By Reserve		1,500
		11,500			**11,500**

Dr C Capital A/c Cr

Particulars		Rs.	Particulars		Rs.
To Goodwill	–	1,200	By Balance	–	16,000
To Balance		16,800	By Reserve		2,000
		18,000			**18,000**

Balance Sheet of C & S as on 31-12-2005

Liabilities		Rs.	Assets		Rs.
Bills Payable	–	2,000	Cash at Bank	–	1,000
Creditors		8,000	Debtors		700
P Loan		15,600	Stock		1,100
Gratuity Payable		2,000	Car		3,600
Capital			Plant		12,600
C		16,800	Buildings		19,800
S		10,600			
		55,000			**55,000**

12. X, Y and Z were partners sharing profits in the ratio of $\frac{1}{2} : \frac{1}{4} : \frac{1}{4}$ respectively. The Balance Sheet of the firm on 31st December 2005 was :

Liabilities		Rs	Assets		Rs
Sundry Creditors		20,000	Cash at Bank		2,000
Reserve Fund		16,000	Debtors	22,800	
Capital accounts			Less Provision	1,800	21,000
X	30,000		Stock		20,000
Y	20,000		motor Vehicle		10,000
Z	15,000	65,000	Plant & Machinery		30,000
			Building		18,000
		1,01,000			**1,01,000**

Y retires on that date subject to the following conditions

i) Goodwill of the firm to be value at ` 20,000

ii) Plant and Machinery to be depreciated by 10% and Motor Vans by 20%

iii) Stock and buildings to be appreciated by 20%

iv) Provision for doubtful debts to be increased by `. 10,000

v) Liability for women's compensation to the extent of `. 500 is to be brought into account

It was agreed that X and Z will share profits in future in the ratio of 3/5th and 2/5th . Pas journal entries and prepare Balance Sheet when (1) the change in the values is to be recorded in the books and (2) when assets and liabilities are to continue to appear at their old figures.

Sol :

I) If change in values are recorded

Sl. No.	Particulars	Debit (Rs.)	Credit (Rs.)
1	Revaluation A/c	6,500	
	To Plant & Machinery		3,000
	To Motor Van		2,000
	To Provision for Doughtful Debts		1,000
	To Liable for work compensation		500
	(Being the Assets are depreciated)		
2	Stock A/c	4,000	
	Buildings A/c	3,600	
	To Revaluation A/c		7,600
	(Being the Asset are Appreciated)		
3	Revaluation A/c	1,100	
	To X Capital		550
	To Y Capital		275
	To Z Capital		275

4	Reserve fund	20,000	
	To X Capital		10,000
	To Y Capital		5,000
	To Z Capital		5,000
	(Goodwill distributed among partners)		
5	Reserve fund	16,000	
	To X Capital		8,000
	To Y Capital		4,000
	To Z Capital		4,000
	(Being the reserve is distributed among partners)		
6	Y Capital	29,275	
	To Y Capital		29,275
	(Being the retirement of Y, his capital treated as loan)		

Dr Balance Sheet of X & Y Cr

Liabilities	Rs.	Assets		Rs.
Creditors	20,000	Cash at Bank		2,000
Liable for workmen	500			
Y Loan	29,275	Debtor	22,800	
Compensation		(–) Provision	2,800	20,000
Capital		Stock		24,000
X	48,550	Motor Van		8,000
Y	24,275	Plant & Machinery		27,000
		Buildings		21,600
		Good will		20,000
	1,22,600			**1,22,600**

II) If changes of value are not recorded

Dr Memorandum Revalutaion A/c Cr

Particulars		Rs.	Particulars	Rs.
To Plant		3,000	By Stock	4,000
To Motor		2,000	By Buildings	3,600
To Debtors		1,000		
To Workmen Compensation		500		
To Profit				
X –	550			
Y –	275			
Z –	275	1,100		
		7,600		**7,600**

Journal Entries

Sl. No.	Particulars	Debit (Rs.)	Credit (Rs.)
a.	X Capital A/c	2,400	
	Y Capital A/c	1,600	
	To Z Capital		4,000
	(Being Reserve Credited to Y Debited to X and Y)		
b.	Goodwill	20,000	
	To X Capital		10,000
	To Y Capital		5,000
	To Z Capital		5,000
	(Goodwill distributed among partners)		
c.	X Capital	12,000	
	Z Capital	8,000	
	To Goodwill		20,000
d.	Memorandum revaluation A/c	1,100	
	To X Capital		550
	To Y Capital		275
	To Z Capital		275
	(Profit transferred to Partner)		
e.	X Capital A/c	660	
	Z Capital	440	
	To memorandum Revaluation		1,100
f.	Y Capital	29,275	
	To Y Loan		29,275

Balance Sheet of X & Y

Liabilities	Rs.	Assets		Rs.
Creditors	20,000	Cash at Bank		2,000
Reserve fund	16,000	Debtors	22,800	
Y Loan	29,275	(–) Provision	2,800	21,000
Capital		Stock		20,000
X	25,490	Motor Vehicle		10,000
Y	10,235	Machinery		30,000
		Buildings		18,600
	1,01,000			**1,01,000**

13. The following was the Balance Sheet of Anand, Bhat and Charles on 1st January, 2010.

Liabilities		Rs.	Assets		Rs.
Sundry Creditors		4,000	Cash		800
Bank Overdraft		8,000	Furniture		6,000
Reserves		6,000	S. Debtors	20,000	
Capital Accounts			Less: Reserve for DD	800	19,200
Anand	12,000		Patents		11,200
Bhat	16,000		Plant & Machinery		16,800
Charles	20,000	48,000	Land & Buildings		12,000
		66,000			**66,000**

On the above date; Charles, retired from business and the following revaluations were agreed upon by the partners :

1. Depreciate Furniture by ` 320.
2. Reserve for Doubtful Debts to be raised to 5% on Debtors.
3. Value of Plant and Machinery to be reduced by 10%
4. Land and Buildings to be appreciated by 10%
5. Interest on overdraft to be provided for six months at 5% per annum.
6. Goodwill of the business was to be valued at three times the average profits for the last five years, which were :

2004	–	` 8,000
2005	–	` 12,000
2006	–	` 16,000
2007	–	` 4,000
2008	–	` 8,000 (Loss)

Prepare the necessary ledger accounts and show the Balance Sheet of the continuing partners.

Sol :

Dr Realisation A/c Cr

Particulars	Rs.	Particulars		Rs.
To Furniture A/c –	320	By Land & Building A/c –		1,200
To Reserve for Doubtful		By Loss on Revaluation		
Doubtful Debts A/c	200	transferred to the capital		
To Plant & Machinery A/c	1,680	Accounts of :		
To Provision for interest				
on Overdraft	200			
$\left(\frac{5}{100}\times\text{`}\ 8,000\times\frac{6}{12}\right)$		Anand $\left(\frac{1}{3}\times 1200\right)$	400	
		Bhat $\left(\frac{1}{3}\times 1200\right)$	400	
		Charles $\left(\frac{1}{3}\times 1200\right)$	400	1,200
	2,400			**2,400**

Since the profit - sharing ratio is not given, losses and accumulated profits will be divided equally among the partner.

Dr. Capital Accounts Cr

Particulars	Anand `	Bhat `	Particulars	Anand `	Bhat `
To Revaluation A/c Loss	400	400	By Balance b/d	12,000	16,000
To Goodwill A/c	3,200	3,200	By Reserve A/c	2,000	2,000
To Balance	10,400	14,400			
	14,500	**18,000**		**14,000**	**18,000**
			By Balance b/d	10,400	14,400

Dr Charle's Capital Account Cr

Particulars	Amt	Particulars	Amt
To Revaluation A/c Loss	400	By Balance b/d	20,000
To Charle's Loan		By Reserve A/c	2,000
A/c transfer	28,000	By Goodwill A/c	6,400
	28,400		**28,400**

Anand and Bhat
Balance Sheet as on 1st January, 2010

Liabilities		Amt	Assets		Amt
Sundry Creditors		4,000	Cash		800
Bank Overdraft		8,000	Furniture		5,680
Charle's Loan A/c		28,000	S. Debtors	20,000	
Provision for interest on			Less : RDD	1,000	19,000
Bank Overdraft		200	Patents		11,200
Capital Accounts			Plant and Machinery		15,120
Anand	10,400		Land and Buildings		13,200
Bhat	14,400	24,800			
		65,000			**65,000**

Note :

Goodwill is calculated as follows :

Total Profits 8,000 + 12,000 + 16,000 + 4,000 – 8,000 = 32,000

Average Profits 32,000/5 = 6,400

Goodwill = 6,400 × 3 = 19,200

Share of Charles = 19,200 $\times \frac{1}{3}$ = 6,400

Since, Anand and Bhat continue to share equally the gain ratio will be equal. So, each of the partners is debited with ` 3,200 $\left(\frac{1}{2} \times 6,400\right)$ for goodwill being written off.

14. White, Black and Green were in partnership, sharing Profits and Losses in the ratio of 3 : 2 : 1. On 1.1.2010, Black retires, on which date, the Balance Sheet was :

Liabilities		Amt	Assets	Amt
Bills Payable		8,000	Cash	1,500
Creditors		12,000	Debtors	7,000
Capital of:			Stock	23,000
White	24,000		Motor Vans	19,000
Black	20,000		Buildings	25,000
Green	16,000	60,000	Profit and Loss A/c	4,500
		80,000		**80,000**

The terms were :

a) Goodwill was to be valued at 15,000

b) The new ratio between White and Green will be 3 : 2

c) Stock to be valued at 25,400; Motor Vans to be valued at 10% less than the book value; Buildings are to be valued at 10% more than the book value.

d) The total capital of the newly constituted firm was to be 60,000 and capitals of White and Green were to be in their profit sharing ratio; adjustments to be made in cash.

Prepare revaluation A/c, Capital Accounts of partners and the Balance Sheet of the new firm.

Sol :

Dr Realisation A/c Cr

Particulars		Amt	Particulars		Amt
To Motor Vans A/c	–	1,900	By Stock	–	2,400
To Profit on Revaluation			By Buildings A/c		2,500
transferred to Capital					
Amounts of					
White $\left(\frac{3}{6}\times 3,000\right)$	1,500				
Black $\left(\frac{2}{6}\times 3,000\right)$	1,000				
Green $\left(\frac{1}{6}\times 3,000\right)$	500	3,000			
		4,900			**4,900**

Dr **Capital A/c** Cr

Particulars	White `	Green `	Particulars	White `	Green `
To Profit & Loss A/c	2,250	750	By Balance b/d	24,000	16,000
To Goodwill A/c	1,500	3,500	By Realisation A/c (Profit)	1,500	500
To Balance c/d	36,000	24,000	By Cash A/c (Deficit in Capital brought in)	14,250	11,750
	39,750	**28,250**		**39,750**	**28,250**
			By Balance b/d	**36,000**	**24,000**

Dr **Black's Capital A/c** Cr

Particulars	Amt	Particulars	Amt
To Profit & Loss A/c	1,500	By Balance b/d	20,000
To Cash A/c (Final payment made)	24,500	By Revaluation A/c (Profit)	1,000
		By Goodwill A/c $\left(` 15,000 \times \frac{2}{6}\right)$	5,000
	26,000		**26,000**

Balance Sheet as on 1st January, 2010

Liabilities		Amt	Assets	Amt
Bills Payable		8,000	Cash	3,000
Creditors		12,000	Debtors	7,000
Capitals			Stock (23,000 + 2,400)	25,400
White	36,000			
Green	24,000	60,000	Motor Vans (19,000 – 1,900)	17,100
			Buildings (25,000 + 2,500)	27,500
		80,000		**80,000**

Note :

1. Goodwill has been raised only to the extent of the share of the retiring partner in it, i.e.,

   $15,000 \times \frac{2}{6} = 5000$

2. Goodwill is written off to the continuing partners in the ratio in which they gain on the retirement of Black.

The gain ratio is :

White (his new share minus his old share)

$= \frac{3}{5} - \frac{3}{6} = \frac{18-15}{30} = \frac{3}{30}$

Green (his new ratio minus his old ratio)

$= \frac{2}{5} - \frac{1}{6} = \frac{12-5}{30} = \frac{7}{30}$

The gain ratio is 3 : 7

Therefore goodwill written off is :

White $\frac{3}{10} \times 5{,}000 = 1{,}500$

Green $\frac{7}{10} \times 5{,}000 = 3{,}500$

The closing cash balance is ascertained by preparing a cash account as follows:

Dr **Cash Account** **Cr**

Particulars	Amt	Particulars	Amt
To Balance b/d	1,500	By Black's Capital A/c	24,500
To White's Capital A/c	14,250	(Balance due to	
To Green's Capital A/c	11,750	Black paid)	
(Cash introduced by		To Balance c/d	3,000
White and Green			
	27,500		**27,500**

4. The debit balance in profit and loss account has been transferred to all the partners including the retiring partner, in the old profit-sharing ratio

5. It is assumed that Black, the retiring partner, has been paid off in cash.

15. Tall, Medium and Short are partners sharing profits in the ratio of 2:2:1. The Balance Sheet of the firm was as under on 31.12.2008.

Liabilities		Rs	Assets	Rs
Sundry Creditors		9,000	Bank	7,000
Bills Payable		6,000	Stock	8,000
Capital Accounts	`		Bills Receivable	5,000
Tall	40,000		Debtors	20,000
Medium	35,000		Furniture	30,000
Short	15,000	90,000	Buildings	35,000
		1,05,000		**1,05,000**

Short died on 1st September, 2009. His dependents were entitled to the following :

i) His capital as on the date of death

ii) His share of goodwill. The total Goodwill of the firm was valued at two year's purchase of average profits of the last three preceding years. Such profits were :

2006 – 10,000

2006 – 14,000

2008 – 12,000

iii) Annual commission 6,000

iv) Interest on Capital at 6% p.a.

v) The profit till the date of death is based on the profits of the year just prior to his death. Prepare Short's Executor's Account

Sol :

Dr **Short Executors A/c** **Cr**

Particulars	Rs	Particulars	Rs
To Balance b/d	26,000	By Short's Capital A/c	15,000
		By Goodwill A/c	4,800
		By Commission $\left(\text{`}6,000 \times \frac{8}{12} \right)$	4,000
		By interest on Capital $\left(\text{`}15,000 \times \frac{6}{100} \times \frac{8}{12} \right)$	600
		By Profit & Loss Suspense A/c	1,600
	26,000		**26,000**
		By Balance b/d	26,000

1) Goodwill is calculated as follows :

Total Profit for three years :

10,000 + 14,000 + 12,000 = 36,000

Average profit = 36,000 ÷ 3 = 12,000

Goodwill 12,000 × 2 = 24,000

Share of Short in Goodwill = 24,000 $\times \frac{1}{5}$ = 4,800

2) Profit upto the date of death of Short

Last year's (profit prior to the

year of death) Profit 12,000

Profit for 8 months (upto the

date of death) = $\frac{8}{12} \times 12,000$

= 8,000

Share of Short = $\frac{1}{5} \times$ 8,000

= 1,600

16. Ram, Shyam and Gopi were partners in a firm sharing profits and losses in the ratio of 2:2:1. They get interest on their Capitals at 5%. They receive Salaries of ` 500, ` 400 and ` 300 p.m. respectively. Their balance Sheet is given below :

Balance Sheet as on 31.12.2009

Liabilities		Rs	Assets	Rs
Capital Accounts			Cash at Bank	19,000
Ram	70,000		Debtors	48,000
Shyam	50,000		Stock	32,000
Gopi	40,000	1,60,000	Plant & Machinery	61,000
		1,60,000		**1,60,000**

Gopi dies on1-7-2010. According to Partnership Deed the Executors of the Deceased Partner are entitled to claim :

a) Capital of Gopi
b) Interest on Capital
c) Salary
d) Share of Goodwill

The goodwill of the firm is ` 40,000. You are asked to prepare Gopi's Capital Account.

Sol :

Dr. Gopi's Capital A/c Cr.

Particulars	Rs	Particulars	Rs
To Gopi's Executors A/c	50,800	By Balance b/d	40,000
		By Interest on Capital $\left(\frac{5}{100} \times ` 40{,}000 \times \frac{6}{12}\right)$	1,000
		Black paid)	
		To Balance c/d	3,000
		By Salary (` 300 $\times$ 6)	1,800
		By goodwill $\left(` 40{,}000 \times \frac{1}{5}\right)$	8,000
	50,800		**50,800**

17. Karthik, Deepak and Pushpak were partners sharing profits and losses in the ratio of 3 : 2 : 1 On 1st January 2002, Deepak retired. On that date, their balance sheet was as follows :

Liabilities	Rs.	Assets	Rs.
General Reserve	5,000	Patents	2,000
Bills Payable	6,000	Plant	33,000
Outstanding expenses	3,000	Stock	10,000
Creditors	12,000	Debtors	9,000
Capitals :		Cash	2,000
Karthik	15,000		
Deepak	10,000		
Pushpak	5,000		
	56,000		56,000

The terms were :

(i) Goodwill was valued at Rs. 10,000 but no goodwill account was to be raised.

(ii) Outstanding expenses are to be brought down to Rs. 2,500. Plant is to be valued at 10% Less and Patents at Rs. 1,000.

(iii) New ratio between Karthik and Pushpak will be 3 : 2.

(iv) The total capital of new firm will be fixed at Rs. 25,000 to be contributed by partners in profit sharing ratio.

Prepare ledger accounts and Balance Sheet after Deepak's retirement.

Sol :

Dr **Revaluation A/c** **Cr**

Particulars	Rs.	Particulars	Rs.
To Plant A/c	3,300	By Outstanding Expenses	500
To Patents A/c 1,000		By Karthik Capital A/c	
		(3,800 $\times \frac{3}{6}$)	1,900
		By Deepak Capital A/c	
		(3,800 $\times \frac{2}{6}$)	1,267
		By Pushpak Capital A/c	
		(3,800 $\times \frac{1}{6}$)	633
	4,300		4,300

Dr **Deepak A/c** **Cr**

Particulars	Rs.	Particulars	Rs.
To Revaluation A/c	1,267	By Balance (b/d)	10,000
To Loan A/c (Bal. Fig.)	13,733	By General Reserve	
		(5,000 $\times \frac{3}{6}$)	1,667
		By Goodwill A/c	
		(10,000 $\times \frac{2}{6}$)	3,333
	15,000		15,000

Dr Partners Capital A/c Cr

Particulars	Karthik	Pushpak	Particulars	Karthik	Pushpak
To Revaluation A/c	1,900	633	By Balance (b/d)	15,000	5,000
To Goodwill A/c	6,000	4,000	By General reserve	2,500	833
			By Goodwill a/c	5,000	1,667
To Balance (c/d)	15,000	10,000	By Cash (Bal. fig.)	400	7,133
	22,900	14,633		22,900	14,633

Balance Sheet of Karthik and Pushpak

Liabilities		Rs.	Assets		Rs.
Bills Payable		6,000	Patents	2,000	
Outstanding expenses		2,500	Less : Depreciation	1,000	1,000
Creditors		12,000	Plant	33,000	
			Less : Depreciation	3,300	29,700
Deepak Loan a/c		13,733	Stock		10,000
Capitals			Debtors		9,000
Karthik	15,000		Cash		9,533
Pushpak	10,000	25,000			
		59,233			59,233

Dr Cash A/c Cr

Particulars	Rs.	Particulars	Rs.
To Balance (b/d)	2,000	By Balance (c/d) (Bal. fig.)	9,533
To Karthik Capital A/c	400		
To Pushpak Capital A/c	7,133		
	9,533		9,533

Short Question and Answers

Q1. What is Partnership ?

Ans :

Meaning

Section 4 of the Indian Partnership Act, 1932 defines a Partnership as: "The relationship between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

This definition brings forth the following three distinct elements namely : (1) There must be an agreement between all the persons concerned; (2) The object of the agreement must be to share the profits of a business (3) The business must be carried on by all or any of the persons concerned acting for all. It must be noted that all the three essentials must be present to form a partnership. A partnership firm is not a legal entity in the eyes of law.

Q2. What are the Essential Features of a Partnership ?

Ans :

Following are the essential features of a partnership firm

i) Persons

In order to constitute a partnership firm, there must be at least two persons. The maximum number in a partnership is 20 in case the firm is doing ordinary business, and 10 in case the firm is engaged in banking business.

ii) Agreement

In order to have a partnership, it is necessary that there must be an agreement between partners.

iii) Sharing of profits

It is one of the important terms to constitute a partnership firm. Generally sharing of profits or losses is one of the important element to constitute a firm.

iv) Business

It includes trade, vocation and profession. The firm must be engaged in a lawful business.

v) Management

Management of the partnership firm will be done either by all the partners or any one of them on behalf of all other partners. There is mutual agency among the partners.

Q3. What is Partnership Deed ?

Ans :

It is desirable that all the partners must have either verbal or written agreement in order to avoid the future dispute among the partners. Usually agreement in black and white is preferred so that it can be referred as and when need arises. The document which contains the terms and conditions regarding the conduct of partnership business, is called partnership deed. The terms and conditions are inserted in the form of clauses in the deed.

Q4. What are the rules applicable, When the agreement is not existed in between partners ?

Ans :

Rules Applicable in Absence of an Agreement

When there is no agreement among the partners, the following rules will be applicable for proper accounting of the partnership firm :

1. Profits or losses of the firm will be shared equally by the partners.
2. Interest on capital will not be allowed to any partner. If agreed the interest will be allowed only out of profits of the firm. Similarly, no interest will be charged on drawings of the partners unless agreed upon.
3. If any partner has given a loan to the firm besides his share of capital, he will be allowed 6% interest on such loan.
4. No salary or remuneration will be allowed to any of the partners.
5. Every partner must take part in the management of the partnership business.
6. No person can be admitted without the consent of all existing partners.
7. The partnership books are to be kept at the place of business of the partnership and every partner may have access to and inspect and copy any of them.

Q5. Loan Account

Ans :

When a partner gives some loan to the firm (besides his own contribution of capital), it should be credited to a separate loan account. In the absence of agreement, Partnership Act provides that interest @ 6% p.a. shall be allowed on such loan, irrespective of the profit. Interest on such loan should be credited either to Loan Account or Current Account.

Q6. Drawings

Ans :

Partners may be allowed to draw either money or goods from the business to meet their private expenses. This is subject to the provisions in the partnership deed. It is not necessary that drawings of the partners should be equal. A separate drawing account for each partner is opened and closed by transferring its balance to capital account (if capitals are fluctuating) or current account (if capitals are fixed). But current account is not transferred to capital account.

Q7. Partner's Salary or Commission

Ans :

If a partner devotes more time to the working of the business or does some special work or renders service, then an additional benefit in the name of salary or some percentage of commission is allowed. Commission is payable either before charging such commission or after charging such commission. Salary/ commission is loss to the business and is debited to Profit & Loss Appropriation Account and credited to Partners' Capital/Current Accounts being income or gain to them.

Q8. Capital Ratio

Ans :

Sometimes, partners agree to share their profits on the basis of effective capital employed. If capitals are fixed, profit will be distributed in that fixed capital ratio. But if capitals are fluctuating and partners introduced or withdraw capitals during the year, weighted average with reference to time has to be worked out to determine the ration in which profit or loss will be shared.

Q9. What is Profit and Loss appropriation Account ? Explain.

Ans :

Profit and Loss Appropriation Account

In a partnership, profit has to be divided between the partners in a certain profit sharing ratio after making necessary adjustments stated in the partnership deed such as interest on capitals, drawings and loans; salaries or/and commission to partners etc. Accordingly an additional account is prepared and net profit is transferred from the debit side of the profit and loss account to the credit side of this new account which is called Profit and Loss Appropriation Account and before the profit is divided between partners, it is necessary to record the above stated adjustments in this account.

Q10. Explain about Admission of a Partner.

Ans :

Admission of a Partner

It is not uncommon to admit a new person into an existing partnership business as a new partner. Even in the case of a sole proprietorship, the business may be converted into partnership on the admission a new person as an owner of the enterprise. The reason may be to require additional resources or managerial help or both. According to **Partnership Act 1932,** a new partner can be admitted into the firm only with the consent of all the existing partners **[Section 31].** Admission of a new partner results in the reconstitution of partnership firm in the sense that a new agreement to carry on the business as a partnership business comes into existence. A new partner becomes entitled to:

(i) share in the assets of the firm and

(ii) in the future profits of the firm.

Q11. Sacrificing Ratio

Ans :

When the new partner is admitted, the old partner forgoes a fraction of his share in favour of the new partner and thus reducing the share of profit or loss of the old partner. Sacrifice made by the old partners can be found out by deducing their new share from the old share, i.e., Sacrificing Ratio = Old Ratio – New Ratio.

If in addition to the old ratio of the old partners, the new ratio of the incoming partners is given then in the absence of the details of the sacrifice made by the old partners the normal presumption is that the loss is suffered by the old partners in their old profit sharing ratio.

Example : P and Q are sharing profits in the ratio of 4 : 3. R is admitted in the business and new ration among P, Q and R is 2: 2 : 3. Find out the sacrificing ratio.

Q12. What is Goodwill ?

Ans :

Goodwill is some thing very easy to describe but very difficult to define because there are so many factors which generate goodwill in each individual business. It is a benefit or an advantage of the good name, reputation or connection of a business. It is the attractive force which brings in customers. “Goodwill simply means that old customers will resort to the old place; if the old customers do not patronise the old place, business will almost decline certainly.”

“Goodwill is the excess of the price paid for a business as a whole over the book values or over the market value of all tangible assets purchased.

Q13. Average Profit Method

Ans :

Under this method, average of the profits of last three or four years is calculated. The average profit is multiplied by the number of years in which the anticipated profit will be available.

Q14. Super Profit Method

Ans :

Super profits refer to the extra profits earned by a business over and above the usual return on investment in Similar business.

Under this method, it is assumed that a normal percentage of profit can be earned in the same type of business or industry on a certain amount of investment.

Q15. Capitalisation Method

Ans :

Under this method, the average profits are capitalised taking into consideration the general expectation in the same industry

Q16. What is necessity of Valuation of Goodwill ?

Ans :

The need for valuing the goodwill in case of partnership firm arises in the following circumstances

(i) When the profit sharing ratio is changed, *(ii)* When a new partner is admitted, *(iii)* When a partner retires or dies, (iv) When two firms are amalgamated, (v) When a firm’s business is dissolved or sold to a company.

Q17. What are the Main points which require attention in case of retirement of a partner?

Ans :

(i) Treatment of goodwill.

(ii) Revaluation of assets and liabilities.

(iii) Calculation of gaining ratio.

(iv) Treatment of undistributed profits or losses.

(v) Share of profit upto the date of retirement.

(vi) Share in life policy.

(vii) Calculation of total amount due to a retiring partner.

(viii) Adjustment of capitals after retirement in order to be proportionate to the new profit sharing ratio.

(ix) Settlement of total amount due to the retiring partner.

Q18. How sacrificing Ratio differ with Gaining Ratio ?

Ans :

Difference between Sacrificing Ratio and Gaining Ratio

Points of Difference	Sacrificing Ratio	Gaining Ratio
1. Meaning	It is ratio which shows the sacrifice made by the old partners on admission of a new partner	It is the ratio in which remaining remaining partners gain or benefit benefit from the retirement or death of a partner
2. Object	It is calculated to find out the amount of compensation to be given to the old partner	It is calculated to find out the compensation to be given to the outgoing partner by each of the remaining partners
3. Mode of Calculation	It is calculated by finding out the difference between old ratio and new ratio	It is calculated by finding out the difference between new ratio and old ratio
4. Time of Calculation	It is calculated at the time of admission of a partner	It is calculated on the retirement or death of a partner.

Q19. How the profits will be distribute at the time of Death of a partner ?

Ans :

The problem which arise in case of death of a partner are similar to those of a retiring partner except that the death of a partner may occur at any time whereas the retirement of a partner is planned, i.e., he is allowed to retire on the last date of accounting period. The deceased partner’s capital account is credited with the balance of capital at the beginning of the year, interest on capital (if allowed), share of profit on revaluation of assets and liabilities, share of undistributed profits, share of profit to the date of death, his share of goodwill and the amount which is received from the Life Insurance Corporation of India (or surrender value in case of individual policies) and debited with drawings to the date of death, interest on drawings (if charged) and the balance is transferred to the executor’s account of the deceased partner.

The following two points require special attention.

i) Calculation of deceased partner’s share of profit.

it) Treatment of life policy or policies.

Choose the Correct Answers

1. An ordinary partnership business can have [b]

   a) Not more than 50 partners. b) Not more than 20 partners.

   c) Any number of partners. d) Any number than 2 partners.

2) In the absence of an agreement profit and loss are divided by partners in the ratio of [b]

   a) Capital b) Equally

   c) Time devoted by each partners. d) None of these.

3) In the absence of an agreement, Interest on loan advanced by the partner to the firm is allowed at the rate of [a]

   a) 6% b) 5%

   c) 12% d) 9%

4) Current accounts of the partners should be opened when the capitals are [b]

   a) Fluctuating b) Fixed

   c) Either fixed or fluctuating d) None of these

5) Partnership is formed by the partners by [c]

   a) Written agreement b) Oral agreement

   c) Written or oral d) None of these

6) The written agreement of partnership is called [a]

   a) Partnership deed b) Articles of association

   c) Memorandum of association d) Certificate of incorporation

7) The object of partnership is to [a]

   a) Earn profit b) Not to earn profit

   c) Welfare of members d) None of these

8) At the time of admission an incoming partner contributes as goodwill [c]

   a) In cash b) Does not pay cash

   c) May or may not pay cash for good will d) None of these

9) Good will of the firm is valued Rs. 30000. C an incoming partner purchase ¼ share of total profit Good will be raised in the books. [a]

   a) Rs. 30000 b) Rs. 7500

   c) Rs. 120000 d) Rs. 7000

10) Good will is valued as two years purchase of the average profits of three previous years are Rs. 15000, the value of good-will be [b]

   a) Rs. 15000 b) Rs. 30000

   c) Rs. 20000 d) Rs. 50000

Fill in the Blanks

1) Any partner who investments in the business but does not take active part in the business is ________
2) A new partner may be admitted to a partnership ________
3) The revaluation account will be prepared at the time of ________
4) An incoming partner pays his share of good will in cash, and profit sharing ration of old partner is changed, Good – will be distributed among old partners As ________
5) In the revaluation account a decrease in the value of plant and machinery Appears on the ________
6) Investment in partnership is made by introducing in ________
7) Sacrificing Ratio ________
8) Decrease in the value of asset ________
9) Two (or) more persons start a business is called ________
10) ________ is the excess of the price paid for a business as a whole.

ANSWERS

1. Sleeping Partner
2. With the consent of are partners
3. Joining of a partner
4. Sacrifice ratio
5. Debit side
6. Either cash (or) non-cash asset
7. Old Ratio - New Ratio
8. Depreciation
9. Partnership
10. Goodwill

UNIT II	**Partnership Accounts - II** Dissolution of Partnership – Insolvency of a Partner (excluding Insolvency of all partners) – Sale to a Company (Including problems)

2.1 Dissolution of Partnership

Q1. Explain about Dissolution of Partnership.

Ans :

The Indian Partnership Act, 1932 recognises the difference between the 'dissolution of partnership' and 'dissolution of firm'. The definitions of the two terms are given as follows :

According to section 39 of the Indian Partnership Act, 1932, "the dissolution of partnership between all the partners of a firm is called the dissolution of the firm." Thus, the dissolution of a firm is the complete breakdown of a partnership and partners do not continue the firm.

On the other hand, dissolution of the partnership means a reconstitution of the firm due to the retirement of a partner or the insolvency of a partner or the death of a partner and the remaining partners provide for the continuance of the firm in pursuance of an express or implied agreement to that effect.

On dissolution of a firm the firm's assets are realised and the liabilities are discharged because the firm is to be closed, whereas on dissolution of a partnership, the share of the outgoing partner is ascertained and the firm is not closed.

Distinction Between Dissolution of Partnership and Dissolution of a Firm

Following are the main distinctions between dissolution of partnership and dissolution of a firm

Point of Distinction	*Dissolution of Partnership*	*Dissolution of a Firm*
1. Meaning	It means discontinuance of relationship between partners but the business is not terminated.	It means dissolution of partnership of all partners of the firm along with winding up of the business of the entire firm. The business of the firm is closed.
2. Books of Accounts	In this case, books of accounts may not be closed.	In this case, books of accounts are closed.
3. Dissolution	It does not means dissolution of firm.	It means dissolution of partnership also.
4. Nature	It is voluntary and is dissolved by mutual agreement and through the process of reconstitution.	It may be both voluntary and compulsory. A firm can be dissolved by Court's orders.
5. Settlement of Assets and Liabilities	In this case, assets and liabilities are revalued and new balance sheet is drawn.	In this case, assets are sold and realised and liabilities are paid off.
6. Economic Relationship	Such relationship may remain and changes	Such relationship between the partners comes to an end.

Q2. What are the reasons for dissolution of Partnership ?

Ans :

The dissolution of firm may occur due to following reasons :

(a) When all the partners agree to dissolve the firm, i.e. by means of an agreement .

(b) Compulsory dissolution [Section 41] : A firm is compulsorily dissolved if (i) all the partners except one are insolvent or all the partners are insolvent; (ii) the business of the firm has become illegal;

(c) On the happening of certain contingencies : In the absence of any agreement to the contrary, a firm is dissolved : (i) on the expiry of the term for which the firm was formed (i.e., when the partnership is for a fixed term); (ii) on the completion of venture(s) for which the firm was formed; (iii) on the death of a partner; and (iv) on the declaration of a partner as an insolvent [Section 42].

(d) By notice : When partnership is at will, any partner can give notice in writing to all other partners of his intention to dissolve the firm [Section 43].

(e) Dissolution by court [Section 44]: The court may at the initiative of any partner, dissolve a firm, when

(i) a partner has become of unsound mind;

(ii) a partner has become permanently incapable of performing his duties as a partner;

(iii) a partner is guilty of misconduct which is likely to affect prejudicially the business of the firm

(iv) a partner wilfully and persistently commits breach of agreement regarding management of the affairs of the firm and it is not reasonably practical for other partners to carry on business in partnership with him

(v) a partner has transferred the whole of his interst to a third party;

(vi) the business of the firm cannot be carried on except at a loss and

(vii) the court is satisfied that it is just and equitable to dissolve the firm.

Settlement of Accounts [Section-48]

When the firm is dissolved, the assets of the firm must be realised for the purpose of meeting all claims on it including those of the partners. Section 48 of the Act deals with the mode of settlement of accounts. In brief it provides for that the money available will be applied or used in the following manner : (I) Payment of expenses on disposing of the assets and collecting the debts due to the firm, (ii) Payment of outside liabilities of the firm e.g., creditors, bank overdraft, bills payable, loans from partners' wives, etc. (iii) Repayment of the loans received from the partners, (iv) Repayment of the capital contributions of the partners, (v) If there is still any surplus left after meeting the claims stated in (i) to (iv), it will be shared by the partners in their profit-sharing ratio.

2.2 Accounting Treatment of Dissolution of Partnership

Q3. Explain about the Account Treatment of dissolution of a firm.

Ans : **(July-19, Dec.-18, Imp.)**

The accounting treatment follows the same sequence as outlined above in respect of settlement of accounts on dissolution. Thus the different stages would be: (i) Realisation of assets, (ii) Paying the expenses on realisation, (iii) Paying of liabilities. (iv) Distribution of the remaining cash (or assets) among the partners. A separate account called Realisation Account (a Nominal Account), will have to be opened showing what amounts were realised on the sale of the assets, what liabilities were paid and finally the net result of dissolution i.e., profit or loss.

Journal Entries

1 For closing the accounts of various assets

Each asset account is closed by transferring it to realisation account at its book value. The journal entry is

Realisation Account Dr.

To Assets' Account (individually) e.g..

To Building Account

To Plant and Machinery Account

To Stock Account

To Debtors' Account etc., etc..

2. For closing the accounts of various liabilities

The accounts of various .liabilities due to third parties only would be closed by transfer to Realisation Account. For example, partners' loans and capitals should be excluded. The loan given to the firm by a partner's wife is a liability to third party.

Sundry Creditors Account Dr.

Bills Payable Account Dr.

Mrs. X (Partner's wife) Loan Account etc. Dr.

To Realisation Account

3. Disposing or realising the assets for cash

a) When each asset is sold and the amount realised in cash, the entry for the total amount realised would be

Bank Account Dr.

To Realisation Account

b) If Assets taken over by partners

Partner's Capital/Current Account Dr.

To Realisation Account

Note :

(i) As stated above, this entry will be made at the price at which the asset has been taken over by any partner.

(ii) It must be repeated that assets accounts are not credited when the assets are either sold for cash or taken over by the partner(s) if the accounts of the assets are alrealy closed by transfer to Realisation Account.

5. Payment of liabilities in cash

Realisation Account Dr.

[With the actual payment]

To Bank Account

6. Payment of liabilities by any of the partner(s)

Realisation Account Dr.

To Partner(s) Current/Capital Account

[with the agreed amount]

7. For expenses on dissolution or realisation:

(a) When the actual expenses are incurred during dissolution, the entry is

Realisation Account Dr.

To Bank Account

(b) Sometimes a partner may be paid commission at a certain rate calculated on the amount of asset(s) realised and he is required to bear all expenses of realisation. In such a case the journal entry is:

Realisation Account Dr.

To Partner's Current/Capital Account

[With the amount of commission]

Generally no entry is made for the actual expenses paid by the partner. However, the actual expenses incurred by the partner may be treated as drawings by the partner in which case the entry would be

Partner's Capital Account Dr.

To Bank Account

8. For closing realisation account : The balance in the realisation account would show either profit or loss made or suffered on dissolution.

If the total of the credit side is more than the debit side, there is a porfit and the following entry is made

a) Realisation Account Dr.

To Partner's Current/Capital Accounts (Individually)

b) The debit side is more than the credit side, it would mean loss on dissolution and entry is:

Partner's Current/Capital Account (individually)Account Dr.

To Realisation Account

Profit or loss on dissolution would be distributed amnong partners in the profit sharing ratio.

9. For payment of partner's loans: The jounral entry is:

Partner's Loan Account Dr.

To Bank Account

10. Closing of current accounts: When the capitals are fixed, there would be current accounts in the examination problem. The current accounts would be closed by transfer to respective capital accounts of the partners. The entry is :

(a) When the current account has a credit balance :

Partner's Current Account Dr.

To Partner's Capital Account

(b) When the current account indicates the debit balance

Partner's Capital Account Dr.

To Partner's current Account

11. Repayment of final claims of the partners : In case a partner's capital account has a debit balance then he will have to contribute the necessary cash equal to the debit balance in his account, provided, he is solvent. When this is done, the entry will be

a) Bank Account Dr.

To Partner's Capital Account

Now the balance in the bank account will be equal exactly to the amount standing in the credit balances of the partners' capital accounts.

On final payment, the entry would be

b) Partner's Capital Account Dr.

To Bank Account

When all the necessary foregoing steps have been taken and entries made and posted to respective accounts, all accounts should balance or close. The end result can be verified by preparing the Bank Account.

2.3 Revaluation account Vs Realisation Account

Q4. How Revaluation account differentiate with Realisation Account ?

Ans : **(Imp.)**

S.No.	Points of Difference	Revaluation Account	Realisation Account
(i)	Meaning	It records the effect of the revaluation of assets and liabilities	It records the sale of various assets to outsiders and partners and partners and payment of liabilities by the firm or any of the partners
(ii)	Time	It is prepared at the time of the reconstitution of the firm eg., on admission of a new partner or on the retirement/death of a partner or amalgamation of partnership firms	It is prepared only at the time of dissolution of the firm only
(iii)	Purpose	To find out the profit (orloss) on the revaluation of assets and liabilities	To find out the profit (or loss) on the realisation of assets and settlement of liabilities
(iv)	Contents	It contains only those assets and liabilities which are revalued	It contains generally all assets and all assets and all liabilities
(v)	Balance	The balance is transferred only to the old partners's capital account	The balance is transferred to the capital accounts of all partners

(vi)	Basis of entries	Entries are made on the basis of the difference between book values and revalued figures	The entires are always made at their book values
(vii)	Effect on assets	The accounts of assets and liabilities on revaluation, are not closed	The accounts of assets and liabilities are closed

Q5. Explain the treatment of Goodwill on Dissolution of a firm.

Ans : **(Imp.)**

Unlike problems on admission or retirement in the partnership accounts, goodwill does not present any difficulty in the case of dissolution of a firm. Goodwill appearing in the balance sheet: If the goodwill account appears in the balance sheet, it will be treated like any other asset and the account will be closed by transfer to Realisation Account at book value. Goodwill not appearing in the balance sheet : In case 'Goodwill Account' does not appear in the balance sheet, it is not transferred to realisation account and if some amount is realised on its sale (based on arbitrary figure given in the question or based on some procedure indicated in the question), the same is credited to realisation account by making the following entry :

Bank Account Dr.

To Realisation Account

This entry is passed when any sum is realised on the sale of goodwill irrespective of the fact whether goodwill account appears in the balance sheet or not

Good will purchased by any partner

When the goodwill of the firm is purchased by any of the partner(s) because he want sto carry on the business in the name of the firm, the agreed amount would be credited to realistation account and debited to Partners Capital Account

Partner's Loan Account Dr.

To Realisation Account

This entry is made whether goodwill account appears in the balance sheet or not

Unrecorded Assets and Liabilities

It is not uncommon to find in examination problems a reference to some of the assets not appearing in the balance sheet. The reason might not be the deliberate omission but the fact that though these assets have been completely written off yet they are physically present in the business. On dissolution these assets might be either sold or taken over by any patner or a creditor at agreed prices. The following accounting treatment is given to the unrecorded assets

(a) When sold for cash

Bank Account Dr.

To Realisation Account

(b) When taken over by a partner

Partner's Capital Account Dr.

To Realisation Account

(c) When taken over buy a creditor in full settlement of his claim : No payment will be made to him.

It must be kept in mind that the unrecorded asset would NEVER be transferred to Realisation Account because the amount realised from its sale is in the nature of a gain and the realisation account is only credited accordingly. Similarly an unrecorded liability might arise in the course of dissolution, e.g., contingent libilitiy in respect of dishonour of bills receivable discounted or claim for a disputed payment, etc. The accounting treatment is :

(a) When unrecorded liability is paid by the firm

Realisation Account Dr.

To Bank Account

(b) When taken over by or paid by a partner

Realisation Account Dr.

To Partner's Capital Account

It must be kept in mind that the unrecorded liability is NEVER transferred to Realisation Account. The reason is that its payment is in the nature of a loss and Realisation Account is only debited with the actual payment.

2.4 Insolvency of a Partner (Excluding Insolvency of all Partners)

Q6. Explain about Insolvency of a partner and Accounting Treatment ?

Ans : **(July-19, Dec-17, Imp.)**

When all the adjustments have been made in respect of realisation profit or loss and accumulated profits or losses etc., the capital account of a partner may show a debit balance. Such a partner then is a debtor to the firm to that extent and he has to bring in the necessary cash to clear debit balance (or deficiency) in his capital account. But if the partner with a debit balance (or deficiency) in his capital account is unable to bring in the necessary cash, he is said to be insolvent. Then the irrecoverable debit balance is a further loss which will have to be borne by the solvent partners in addition to the loss on realisation. The reason is that the liability of the partners in a partnership firm is unlimited. The important question then is : In what proportion the deficiency of the inslovent partner would be borne by the solvent partners ?

Decision in Garner Vs. Murray

There is no specific provision in the Indian Partnership Act regarding this matter. But if the partners have stated in the Partnership Deed that loss arising from the deficiency of insolvent partner shall be shared by solvent partners in the profit sharing ratio or any other ratio, it would be binding on the partners. But the difficulty arises when the Partnership Deed is also silent on this point. In England, the matter came up for decision in the leading case of Garner vs. Murray (1903). In this case it was held that, in the absence of any agreement to the contrary, the deficiency on the insolvent partner's capital account (debit balance) must be borne by the other solvent partners in proportion to their capitals, after each solvent partner has brought in cash equal to his own share of loss on realisation. It means that :

(i) The solvent partners in the first instance would bring in cash equal to the loss on realisation debited to their respective capital accounts.

(ii) The deficiency on the capital account of the insolvent partner (i.e., irrecoverable debit balance) should be divided between solvent partners in proportion to their capitals. The effect of the decision is that :

   (a) The loss on account of realisation is a normal loss and therefore to be borne by all the partners including the insolvent partner in their profit sharing ratio;

   (b) The loss on account of the deficiency of the capital account of the insolvent partner is an abnormal or special loss and therefore must be shared by the solvent partners in the ratio of their capitals just prior to dissolution.

In order to apply the decision in an examination problem, the student must see that the following three conditions are fulfilled in the question:

1. There are two or more than two solvent partners with credit capital balances on the date of dissolution.
2. One or more of the partners are insolvent.
3. The capitals are not in profit-sharing ratio.

2.5 Accounting Treatment For Accumulated Reserves, Profits, Losses And Fund Accounts

Q7. Explain about Accounting Treatment for (i) Accumulated reserves (ii) Profit & Loss (iii) Fund Accounts ?

Ans :

Any balance in the accumulated Reserves (e.g., general reserves), Profit and Loss account (credit balance), Reserve Fund Account and other fund accounts like Workmen's Compensation Fund Account (against which there is no liability) on the date of dissolution, shall be credited to the current accounts, if the capitals are fixed and to the capital accounts, if the capitals are fluctuating in the profit-sharing ratio. Any debit balance in the Profit and Loss Account (Loss) would be debited to current accounts or capital accounts, as the case may be.

1. Undistributed Profits, Reserves etc. should be transferred to Current Accounts of the partners. The entry is

   General Reserve A/c Dr.

   Profit & Loss A/c Dr.

   To Partners Current Accounts

   How ever, if there is any Profit & Loss (Debit balance) then Current Accounts should be debited and Profit & Loss A/c Credited

2. Loss on Realisation should be transferred to Current Accounts of the Partners. The entry is

   Parteners Current Dr.

   To Realisation A/c

3. Each solvent partner is required to bring in this respective share of loss on realisation. The entry is

   Bank A/c Dr.

   To Solvent Partner's Current Accounts

4. The insolvent Partners Current Accounts should be trransferred to his Capital Account. if the Current Account shows debit balance, the entry for transfer is

   Insolvent Partner's Capital A/c Dr.

   To Solvent Partners Current A/c

5. If any amount is realised from the estate of insolvent partner then the should be credited to this Capital Account. The entry is

   Bank Account Dr.

   To insolvent Partner's Capital A/c

6. The Capital Deficiency (ie., the net debit balance) of the insolvent partner should be transferred to the Current Accounts of the Solvent Partners in proportion to their Capitals as on the date of balance Sheet. The entry is

   Solvent Partners Current Accounts Dr.

   To Insolvent Partners Capital A/c

7. The solvent partners Current Accounts should now be closed by transfer to their respective Capital Accounts. The entry for the transfer of credit balance in Current Account to Capital Account is :

   Solvent Partner's Current Accountss Dr.

   To solvent partners capital accounts

8. If any Solvents Partner's Capital Accounts shows Debit balance, then he is required to bring the amount due from him before making payment to other solvent partners.

   In such a case the entry is

   Solvent Partbner's Capital Accounts. Dr.

   To Bank Account

Fixed Vs. Fluctuating Capitals

Where the capitals are fixed : Where the capitals of the partners have been maintained on the Fixed Capitals System, the deficiency of the insolvent partner would be borne by the solvent partners in proportion to their original contributions subject, of course, to any agreed additions or withdrawals of capitals during the period. It therefore follows that if there are any undistributed profits at the date of dissolution in the Balance Sheet as the credit balance of the profit and loss account, reserve fund or any account similarly named, these will have to be transferred to partners' current accounts in their respective profit sharing ratios. Similarly if there happens to be any losses given in the Balance Sheet, the same will have to be transferred directly to the current accounts of the partners in their usual profit sharing ratio.

Accounting Treatment

The following accounting entries are required when the capitals are fixed

1. Transfer the accumulated profits, if any, to each Partner's Current Account in the profit sharing ratio

   Profit and Loss Account Dr.

   Reserve Fund Account Dr.

   Any other Fund Account Dr.

   To partner's Current Account

2. Profit on Realisation in the profit sharing ratio will be transferred with the help of following entry

   Realisation Account Dr.

   To Partner's Current Account Dr.

   The entry will be reversed in case of Realisation loss.

3. For bringing in cash equal to Realisation Loss resepctively by the slovent partners

   Bank Account Dr. [This entry is optional]

   To solvent Partner's Current Account

4. **Now the debit or credit balance of the current account of the insolvent partner would be transferred to his capital account to determine the total deficiency.**

(a) For debit current account balance

Insolvent Partner's Current Account Dr.

To insolvent Partner's Capital Account

(b) For credit current account balance

Insolvent Partner's Current Account Dr.

To insolvent Partner's Capital Account

5. **For distributing the deficiency among the solvent partners in the ratio of their fixed capitals**

Solvent Partner's Respective Current or Capital Accounts Dr.

To Insolvent Partner's Current Account

6. In the end the current accounts of the solvent partners would be closed by transfer to their respective capital accounts. Each partner will then he paid what is due to him.

Where the capitals are fluctuating Where the capitals are maintained on the Fluctuating or floating method, the true capital of each partner at the date of dissolution is determined by adjustment of the balance of reserve find, debit or credit balance of profit and loss account etc., given in the balance sheet. The loss or gain on realisation is, in this case, adjusted straight on the capital accounts of the partners. Where there is a loss on realisation, each solvent partner will bring in cash his share of loss on realisation. In this way his capital balance before dissolution will remin unaffected.

PROBLEMS ON INSOLVENCY OF PARTNER SHIP

1. **A, B and C are in partnership sharing profits and losses equally. The firm's balance sheet on 31 March, 2013 was as follow**

Liabilities		Rs.	Assets		Rs
Sundry Creditors		64,000	Cash		1,600
Capital A/cs	Rs.		Sundry Debtors		53,000
A	24,000		Stock		22,200
B	8,000		Plant and Machinery		26,000
C	4,000	36,000	Current Accounts		
A's Current Account		10,800	B	2,000	
			C	6,000	8,000
		1,10,800			**1,10,800**

It was decided to dissolve the firm on that date. The plant and machinery, stock and debtors were sold by the firm for Rs. 70,000. Assuming that C is insolvent and could not meet his liability to the firm, show necessary ledger accounts in the books of the firm applying Garner V Murray principle

Sol :

Dr Realisation Account Cr

Particulars	Rs.	Particulars	Rs.
To Sundry Debtors	53,000	By Sundry Creditors	64,000
To Stock	22,200	By Cash	70,000
		By loss	31,200
To Plant and Machinery	26,000	A's Current Account 10,400	
To Cash (Creditors)	64,000	B's Current Account 10,400	
		C's Current Account 10,400	
	1,65,200		**1,65,200**

Dr C's Current Account Cr

Particulars	Rs.	Particulars	Rs.
To Balance b/d	6,000	By C's Capital Account c/d(Transfer)	16,400
To Realisation Account	10,400		
	16,400		**16,400**

Dr A's Capital Account Cr

Particulars	Rs.	Particulars	Rs.
		By Balance b/d	4,000
		By A's Capital Account	9,300
		(3/4 of Rs. 12,400)	
		By B's Capital Account	3,100
To A's Current Account c/d (Bal)	16,400	(1/4 of Rs. 12,400)	
	16,400		**16,400**

Dr A's Current Account Cr

Particulars	Rs.	Particulars	Rs.
To Realisation Account	10,400		
To A's Capital Account (Transfer)	400	By Balance b/d	10,800
	10,800		**10,800**

Dr A's Capital Account Cr

Particulars	Rs.	Particulars	Rs.
To C's Capital Account	9,300	By Balance b/d	24,000
To Cash Account	15,100	By A's Current Account	400
	24,400		**24,400**

Dr B's Current Account Cr

Particulars	Rs.	Particulars	Rs.
To Balance b/d	2,000	By B's Capital Account (Transfer)	12,400
To Realisation	10,400		
	12,400		**12,400**

Dr B's Capital Account Cr

Particulars	Rs.	Particulars	Rs.
To B's Current Account	12,400	By Balance b/d	8,000
To C's Capital Account	3,100	By Cash A/c	7,500
	15,500		**15,500**

Note

i) There is no need for A and B to bring cash equivalent to their respective share in realisation loss because capitals are fixed

ii) Deficiency of C has been borne by A and B in their Capital ratios i.e., 24,000 : 8,000 or 3 : 1

iii) Since B is Solvent, the has brought Rs. 7,500 to clear his debit balance.

Cash Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d	1,600	By Realisation Account	64,000
To Realisation Account	70,000	By A's Capital Account	15,100
To B's Capital Account	7,500		
	79,100		**79,100**

2. The position of X, Y and Z on June 30, 2014 was a follows

Particulars	Rs.	Particulars	Rs.
Sundry Creditors	63,000	Cash	25,000
X's Loan	40,000	Sundry Assets	1,70,000
X's Capital	64,000	Z's Capital	78,000
Y's Capital	36,000		
Profit and Loss Account	70,000		
	2,73,000		**2,73,000**

Profits and losses are shared : X–4/7, Y–1/7 and Z–2/7. Z became insolvent and the firm was dissolved on the above date. Sundry assets realise Rs. 1,40,000. Sundry creditors are paid Rs. 60,000 in full settlement. Expenses amount to Rs. 8,000

Assume the capitals are not fixed. Close the books of the firm by opening necessary ledger accounts.

Sol :

Dr. Realisation Account Cr.

Particulars	Rs.	Particulars	Rs.
To Sundry Assets	1,70,000	By Sundry Creditors	63,000
To Cash Account (Creditors)	60,000	By Cash (Assets Realised)	1,40,000
		By loss	35000
To Cash (Expenses)	8,000	X's Capital Account 20,000	
To Y's Capital	36,000	Y's Capital Account 5,000	
To Profit and Loss Account	70,000	Z's Capital Account 10,000	
	2,38,000		**2,38,000**

Dr. Z's Capital Account Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	78,000	By Profit and Loss Account	20,000
To Realisation Account	10,000	By X's Capital Account	47,147
		By Y's Capital Account	20,853
	88,000		**88,000**

Dr. X's Capital Account Cr.

Particulars	Rs.	Particulars	Rs.
To Realisation Account	20,000	By Balance b/d	64,000
To Z's Capital Account	47,147	By Profit and Loss Account	40,000
To Cash Account	56,853	By Cash (For realisaton loss)	20,000
	1,24,000		**1,24,000**

Dr. Y' Capital Account Cr.

Particulars	Rs.	Particulars	Rs.
To Realisation Account	5,000	By Balance b/d	36,000
To Z's Capital Account	20,853	By Profit and Loss Account	10,000
To Cash Account	25,147	By Cash (For realisaton loss)	5,000
	51,000		**51,000**

Dr. Cash Account Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	25,000	By Realisation Account	60,000
To Realisation Account	1,40,000	By Realisation Account	8,000
To X's Capital Account	20,000	By X's Loan Account	40,000
To Y's Capital Account	5,000	By X's Capital Account	56,853
		By Y's Capital Account	25,147
	1,90,000		**1,90,000**

Note

i) X and Y have introduced cash amounting to Rs. 20,000 and Rs. 5,000 respectively being their share of realisation loss.

ii) Since the capitals are fluctuating the deficiency of Z has been borne by X and Y in the ratio of their capitals which stood before the date of dissolution as

	X	Y
Balance in the Capital Accounts	64,000	8,000
Add : Balance in the Profit and Loss Account	40,000	10,000

Capital Ratio 1,04,000 : 46,000 or 104 : 46

iii) Thus X's share of Z's deficiency is

$$\frac{104}{150} \times \text{Rs. } 68,000 = \text{Rs. } 47,147 \text{ (App.)}$$

Y's share of Z's deficiency :

$$\frac{46}{150} \times \text{Rs. } 68,000 = \text{Rs. } 20,853 \text{ (App.)}$$

3. Somesh and Venkatesh were in partnership and agreed to dissolve. The assets realized Rs.400000. The liabilities were as follows; Sundry creditors Rs.90,000; bills payable Rs.45,000; bank overdraft Rs.45,000; loan from Somesh Rs.80,000; Somesh's capital Rs.40,000, Venkatesh's capital Rs.60,000. They shared profits and losses in proportions Somesh 3/5th and Venkatesh 2/5th pass journal entries to give effect to the above and show the necessary ledger accounts.

Sol :

Opening Balance Sheet A/c

Liabilities	Rs.	Assets	Rs.
Sundry creditors	90,000	Assets (B/F)	3,60,000
Bills Payable	45,000		
Bank overdraft	45,000		
Loan from somesh	80,000		
Capital Somesh	40,000		
Venkatesh	60,000		
	3,60,000		3,60,000

Dr. **Ralisation A/c** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Assets A/c	3,60,000	By Sundry creditors A/c	90,000
To Cash A/c	1,80,000	By Bills payable A/c	45,000
(90,000 + 45,000 + 45000)		By Bank overdraft A/c	45,000
To Somesh capital A/c	24,000	By Cash A/c	4,00,000
(40,000 × 3/5)			
To Venkatesh capital A/c	16,000		
(40,000 ×2/5)			
	5,80,000		5,80,000

Dr. **Capital Accounts** **Cr.**

Particulars	Somesh	Venkatesh	Particulars	Somesh	Venkatesh
To Cash a/c	64,000	76,000	By Balanced b/d	40,000	60,000
(Final payment)			By Realisation a/c	24,000	16,000
	64,000	76,000		64,000	76,000

Dr. **Cash A/c** **Cr.**

Particulars	Rs.	Particulars	Rs.
To A realisation A/c	4,00,000	By Realisation A/c	1,80,000
		By Somesh Capital A/c	64,000
		By Venkatesh capital A/c	76,000
		By Loan A/c	80,000
	4,00,000		4,00,000

Journal Entries A/c

S.No.	Particulars		Debit `	Credit `
1.	Realisation a/c	Dr	3,60,000	–
	To Assets a/c			3,60,000
	(Being assets transferred to realisation)			
2.	Sundry creditors a/c	Dr	90,000	–
	Bills Payable a/c	Dr	45,000	–
	Bank overdraft a/c	Dr	45,000	–
	To Realisation a/c			1,80,000
	(Being liabilities transferred to realisation)			

3.	Cash a/c	Dr	4,00,000	-
	To Realisation a/c			4,00,000
	(Being assets realised)			
4.	Realisation a/c	Dr	1,80,000	
	To Cash a/c			1,80,000
	(Being liabilities paid)			
5.	Somesh loan a/c	Dr	80,000	
	To Cash a/c			80,000
	(Being somesh loan paid)			
6.	Somesh capital a/c	Dr	64,000	
	Venkatesh capital a/c	Dr	76,000	
	To Cash a/c			1,40,000
	(Being final payment)			

2.6 Sale to a Company

Q8. Explain about Sale of Partnership to a limited company.

Ans : **(Imp.)**

Sometimes a Partnership firm may be converted into a company. In such a case, the firm is dissolved and the business carried by the firm is acquired by the company. Technically, this is called sale to a company. When a Partnership firm is sold, the procedure regarding closing of the books of accounts of the firm is same as in the case of dissolution of a firm. The partnership firm is sold to company for a price known as purchase consideration. Purchase consideration is the price agreed to be paid by the purchasing company to the firm.

Methods of Purchase Consideration

The purchase consideration can be ascertained by any of the following methods.

1. **Lump Sum Method** under this method purchase consideration is stated as a Lump Sum. If X Co purchases the business of ABC firm and agrees to pay ? 50,000 then ? 50,000 is the purchase consideration

2. **Net Payment Method** under this method, the purchase consideration is ascertained by adding the various payments made by the company in the form of cash, share or defentures. It is calculated as under.

Cash	XX
Agreed Price of Equity Shares issued	XX
Agreed Price of Preference Shares Issued	XX
Agreed Price of Debentures Issued	XX
Total Payment i.e. Purchase Consideration	XX

3. **Net Assets Method** When details of cash, shares or debentures issued by the company is not given, purchase consideration is ascertained by calculating the 'net woth' of the assets taken over by the company i.e.

Agreed Value of Assets taken Over at agreed value	XX
Less agreed value of liabilities taken over at agreed value	XX
Purchase Consideration	**XX**

Q9. Explain the accounting treatment sale of a company.

Ans :

As stated above, purchase consideration may be paid by the company partly in cash and partly by the allotment of shares and debentures. The shares received from the company, is the absence of any agreement, should be distributed among the partners in the profit sharing ratio and the remaining un paid balances of capital accounts are paid in cash

Journal Entries in the books of the firm:

1. **For transfer of Assets to Realization Account**

Realisation A/c Dr (with book value of theassets)

To Sundry Assets (individually)

Note: If the purchasing company takes over cash and bank balances, then that should also be transferred to Realisation A/c

2. **For transfer of liabilities to realization A/c**

Liabilities A/c (individually) Dr

To Realisation A/c

(with book value)

3. **For purchase consideration agreed upon**

and consideration due Purchasing company Dr

To Realization Account

Cash A/c or Bank A/c Dr

Equity shares in purchaseing company Dr

Debentures in purchasing company Dr

To Purchasing company A/c Cr

Equity shares in Purchasing co Preference shares in purchasing co Debentures in purchasing co To Purchasing Company

4. **For sale of assets not taken over by purchasing company**

Cash / Bank Dr

To Realization A/c

5. **For payment of liabilities not taken over by purchasing co**

Realization A/c

To Cash / Bank Dr

6. For Assets taken over by the partners partners

Capital A/c Dr

To Realization A/c

7. For liabilities taken over by the partners partners

Realisation A/c Dr

To Partner Capital A/c

8. For payment of realization expenses

Realizsation A/c Dr

To Bank A/c

9. For profit on realization

Realisation A/c

To Partners Capital Accounts

Note : In case of loss, the above entry is reversed

10. For transfer of accumulated profits and Reserves

Profit & Loss A/c Dr

Reserves A/c Dr

To Partners Capital Accounts

Note: In case of accumulated losses partners capital accounts should be debited and concerned loss account should be credited

11. For payment of partners loan

Partners Loan A/c Dr

To Cash/Bank

12. For distribution of cash / shares / debentures

Partners Capital Accounts Dr

To Cash

To Cash

To Shares in purchasing company

To Debentures in purchasing company

Entries in the books of Purchasing Company

13. For purchase Consideration due:

Business Purchase A/c Dr

To Vendor Firm A/c

14. For Assets and Liabilities takenover (at agreed Value):

Individual Assets A/c Dr

To Individual Liabilities A/c

To Business purchase A/c

Note: When the total of liabilities and business purchase is more than assets, the difference is treated as Goodwill and whn the total assets are more than total of liabilities and business purchase, then the diffeence is treated as Capital Reserve.

15. For Discharge of Purchase Consideration:

Vendor Firm A/c Dr

To Cash/Bank A/c

To Shares Capital A/c

To Debentures A/c

Vendor Accounts

When there is sale of a firm to a limited company, the following Ledger Accounts are opened in the books of the Vendor firm for clasing the books of accounts:

1. Realisation Account
2. Purchasing Company Account
3. Shares in Purchasing Company Account
4. Debentures in Purchasing Company Account
5. Partner’s Loan Account
6. Partner’s Capital Account
7. Cash / Bank Account

Key Points to be remembered while preparing the following accounts :

1. Realisation Account

This account is debited with all assets at Book Value, and all liabilities at Book Value. If the purchasing company does not take over certain assets then they are sold away in the market or it may be taken over by the partner through realisation account. Loss or gain due to this is automatically incorporated in the realisation loss or gain. In the same way, if the purchasing company does not take over some liabilities of the firm, then, such liabilities are paid or taken over by the partners through the realisation account. No seperate treatement is required for incorporation loss or gain on payment of such liabilities.

It must be noted that generally all assets including cash and bank balance are taken over by the Purchasing Company. If it is specifically mentioned that the purchasing company has not taken over cash then, cash cannot be transferred to realisation account. However, it should be shown as openeing balance in the Cash/Bank Account.

PROBLEMS

4. A, B and C are partners sharing profits in the ration of $\frac{1}{2}$, $\frac{1}{3}$ and $\frac{1}{6}$ respectively. They dediced to convert their partnership into a company on which date their balance sheet was as follows:

Liabilities		Rs.	Assets		Rs.
Creditors	–	8,000	Buildings	–	11,000
Capitals			Stock	–	10,000
A		17,400	Debtors	10,000	
B		8,000	Less : Reserve	1,000	9,000
C		6,000	Cash		6,000
			Profits & Loss A/c		3,000
		39,400			**39,400**

The new company took over the assets and liabilities and agreed to pay purchase price of `32,900 by the allotment of 1,800 Equity Shares ofn `10 each and the balance in cash.

The partners agreed to share the shares in their profit sharing ratio.

Pass the journal entries to close the books of the firm and also prepare the necessary ledger accounts.

Sol :

In the books of the firm

Journal Entries

Particulars		Debit Rs	Credit Rs
1. Realisation A/c	Dr.	37,400	
To Building A/c			11,400
To Stock A/c			10,000
To Debtors A/c			10,000
To Cash A/c			6,000
[Being the transfer of assets]			

2. Creditors A/c	Dr.	8,000	
Reserve A/c	Dr.	1,000	
To Realisation A/c			9,000
[Being the transfer of liabilities]			
3. Purchasing Company A/c	Dr.	32,900	
To Realisation A/c			32,900
[Being the Purchase Consideration due]			
4. Shares in Purchasing Compnay A/c	Dr.	18,000	
Cash A/c	Dr.	14,900	
To Purchasing Company A/c			32,900
[Being the Purchasing Consideration received]			
5. Realisation A/c	Dr.	4,500	
To A's Capital A/c			2,250
To B's Capital A/c			1,500
To C' Capital A/c			750
[Being the profit on realisation transferred]			
6. A's Capital A/c	Dr.	1,500	
B's Capital A/c	Dr.	1,000	
C' Capital A/c	Dr.	500	
To Profit and Loss A/c			3,000
[Being The loss transferred]			
7. A's Capital A/c	Dr.	18,150	
B's Capital A/c	Dr.	8,500	
C' Capital A/c	Dr.	6,250	
To Shares in Purchasing Company A/c			18,000
To Cash A/c			14,900
[Being the final payment to partners]			

Dr. Realisation Account Cr.

Particulars	Rs`	Particulars	Rs`
To Buildings –	11,400	By Creditors –	8,000
To Stock –	10,000	By Reserve –	1,000
To Debtors –	10,000	By Purchasing Company A/c	32,900
To Cash –	6,000		
To Profit on realisation			
A = 4500 × $\frac{1}{2}$ = 2,250			
B = 4500 × $\frac{1}{3}$ = 1,500			
C = 4500 × $\frac{1}{6}$ = 750	4,500		
	41,900		**41,900**

Dr. **Purchasing Company A/c** Cr.

Particulars	`Rs	Particulars	`Rs
To Realisation A/c –	32,900	By Shares –	18,000
		By Cash	14,900
	32,900		**32,900**

Dr. **Shares in Purchasing Company A/c** Cr.

Particulars	R`S	Particulars	`Rs
To Purchasing Company A/c	18,000	By A's Capital A/c	9,000
		By B' Capital A/c	6,000
		By C's Capital A/c	3,000
	18,000		**18,000**

Dr. **Capital A/c** Cr.

Particulars	A Rs	B Rs	C Rs	Particulars	A Rs	B Rs	C Rs
To Profit & Loss A/c	1,500	1,000	500	By Balance b/d	17,400	8,000	6,000
To Shares	9,000	6,000	3,000	By Realisation A/c			
To Cash b/f	9,150	2,500	3,250	(Profit)	2,250	1,500	750
	19,650	**9,500**	**6,750**		**19,650**	**9,500**	**6,750**

Dr. **Cash A/c** Cr.

Particulars	Rs`	Particulars	R`s
To Balance b/d	6,000	By Realisation A/c	6,000
To Purchasing Company A/c	14,900	By A's Capital A/c	9,150
		By B's Capital A/c	2,500
		By C's Capital A/c	3,250
	20,900		**20,900**

Note: Calculation of number of shares distributed to partners.

A – 1,800 × $\frac{1}{2}$ = 900 Shares of Rs. 10 each = Rs. 9,000

B – 1,800 × $\frac{1}{3}$ = 600 Shares of Rs. 10 each = Rs. 6,000

C – 1,800 × $\frac{1}{6}$ = 300 Shares of Rs. 10 each = Rs. 3,000

5. P and Q were partners sharing profits in the ratio of 2:1. Their balance sheet on 31-3-2001 on which date they converted their business into a company was as follows:

Liabilities	Rs	Assets		Rs
Creditors	60,000	Cash	–	14,000
Mortgage on freehold premises	20,000	Debtors	–	52,000
Capitals		Stock		32,000
P	40,000	Machinery		10,000
Q	20,000	Freehold Premises		32,000
	1,40,000			**1,40,000**

The company took over all the assets and liabilities except mortgage on freehold premises for a purchase price of `. 1,20,000 payable as to `. 24,000 in cash, `. 48,000 in debentures and the balance in equity shares of `. 100 each.

Close the books of the firm after the above transations have been carried out mortgage loan has been paid and partners agreeed to share the debentures and shares in proportion to their capitals.

Prepare the ledger accounts in the books of the firm and journal entries and balance sheet in the books of purchasing company

Sol :

Note : Calculate of Purchase Consideration

1.	By Cash	24,000
2.	By Debentures	48,000
3.	By Shares	48,000
		1,20,000

Ledger Accounts in the books of firm

Dr. **Realisation Account** **Cr.**

Particulars			R`s	Particulars		`Rs
To Cash		–	14,000	By Creditors	–	60,000
To Debtors		–	52,000	By Mortgage on	–	
To Stock		–	32,000	freehold premises		20,000
To Machinery		–	10,000	By Purchasing Company A/c		1,20,000
To Freehold premises		–	32,000			
To Profit on realisation						
P 40,000 $\times \frac{2}{3}$	26,667					
Q 40,000 $\times \frac{1}{3}$	13,333		40,000			
			2,00,000			**2,00,000**

Dr. **Capital Accounts** Cr.

Particulars	P Rs	Q Rs	Particulars	P Rs	Q Rs
To Shares	32,000	16,000	By Balance b/d	40,000	20,000
To Debentures	32,000	16,000	By Realisation A/c		
To Cash (Balancing figure)	2,667	1,333	(Profit)	26,667	18,333
	66,667	**33,333**		**66,667**	**33,333**

Dr. **Purchasing Company A/c** Cr.

Particulars	`Rs	Particulars	Rs`
To Realisation A/c	1,20,000	By Cash	24,000
		By Shares	48,000
		By Debentures	48,000
	1,20,000		**1,20,000**

Dr. **Shares in Purchasing Company A/c** Cr.

Particulars	R`s	Particulars	R`s
To Purchasing		By P's Capital A/c	32,000
Company A/c	48,000	By Q' Capital A/c	16,000
	48,000		**48,000**

Dr. **Debentures in Purchasing Company Account** Cr.

Particulars	Rs`	Particulars	`Rs
To Purchasing		By P's Capital A/c	32,000
Company A/c	48,000	By Q' Capital A/c	16,000
	48,000		**48,000**

Dr. **Cash Account** Cr.

Particulars	R`s	Particulars	R`s
To Balance b/d	14,000	By Realisation A/c	14,000
To Purchasing Company A/c	24,000	By Realisation A/c	20,000
		By P's Capital A/c	2,667
		By Q's Capital A/c	1,333
	38,000		**38,000**

Note : Calculation of Final Capital Balance Ratio or Final Claim Ratio

P	66,667	2
Q	33,333	1

Journal Entries

Particulars		Debit `s	Credit `Rs
Business Purchase A/c	Dr.	1,20,000	
To Vendor Firm A/c			1,20,000
[For the Purchase Consideration due]			
Cash A/c	Dr.	14,000	
Debtors A/c	Dr.	52,000	
Stock A/c	Dr.	32,000	
Machinery A/c	Dr.	10,000	
Goodwill (Balance figure)	Dr.	72,000	
To Creditors			60,000
To Business Purchase A/c			1,20,000
[For the assets and liabilities takenover]			
Vendor Firm A/c	Dr.	1,20,000	
To Cash A/c			24,000
To Debentures A/c			48,000
To Share Capital A/c			48,000
[For discharge of purchase consideration]			

Balance Sheet

Liabilities	Rs`	Assets	`Rs
Creditors	60,000	Debtors	52,000
Debenturess	48,000	Stock	32,000
Share Capital	48,000	Machinerfy	10,000
Bank overdraft	10,000	Goodwill	72,000
	1,66,000		**1,66,000**

Note:

1. Distribution of Debentures

$P = 48{,}000 \times \frac{2}{3} = 32{,}000$

$Q = 48{,}000 \times \frac{1}{3} = 16{,}000$

In the Books of Purchasing Company

2. Cash at Bank:

Taken over from Partnership Firm = 14,000

Less : Paid to the firm in

Part payment of the purchase price = 14,000

Bank overdraft = 10,000

Distribution of shares :

P $480 \times \frac{2}{3}$ = 320 shares at 100 each = 32,000

Q $480 \times \frac{1}{3}$ = 160 shares at 100 each = 16,000

6. The Balance Sheet of A, B and C stood as follows as on 31st December 1998:

Liabilities	R`s	Assets		Rs`
Creditors	20,000	Cash		9,000
B/P	5,000	Stock		26,000
Capital Accounts		Machinery		19,000
A	24,000	Furniture		10,000
B	24,000	Debtors	25,000	
C	14,000	Less : Reserve	2,000	23,000
	87,000			**87,000**

It was decided to sell the business to PQR Co. Ltd., on the compnay agreeing to allot 7,500 full paid Shares of `10 each and `1,800 in cash in full satisfaction of the purchases consideration. The company assumed all liabilities except the B/P and took over all assets except cash. The expenses amounted to ` 800 which were paid by the firm itself. The partners shared profits and losses in $\frac{1}{2}$, $\frac{1}{3}$ and $\frac{1}{6}$ respectively.

Prepare the necessary ledger accounts showing the final settlement among the partners.

Sol :

Note : Calculation of purchase consideration:

1.	By Equity shares	= 7,500 shares of `. 10 each	= 75,000
2.	By cash		= 1800
	Purchase consideration		76,800

Ledger Accounts in the books of the firm

Dr. **Realisation Account** **Cr.**

Particulars	Rs`	Particulars	Rs`
To Stock –	26,000	By Reserve –	2,000
To Machinery –	19,000	By Creditors –	20,000
To Furnitures –	10,000	By B/P	5,000
To Debtors –	25,000	By PQR Co. Ltd. (Purchase consideration)	76,800
To Cash A/c (expenses) –	800		
To Cash A/c (B/P)	5,000		
To Profit on realisation	18,000		
A – 18,000 × $\frac{1}{2}$ = 9,000			
B – 18,000 × $\frac{1}{3}$ = 6,000			
C – 18,000 × $\frac{1}{6}$ = 3000			
	1,03,800		**1,03,800**

Dr. **PQR Company Account** **Cr.**

Particulars	`Rs	Particulars	Rs`
To Realisation A/c –	76,800	By Shares A/c	75,000
		By Cash A/c	1,800
	76,800		**76,800**

Dr. **Shares in Purchasing Company A/c** **Cr.**

Particulars	R`s	Particulars	Rs`
To PQR Co. Ltd., A/c	75,000	By A's Capital A/c	30,940
		By Q' Capital A/c	28,120
		By C's Capital A/c	15,940
	75,000		**75,000**

Dr. **Cash Account** **Cr.**

Particulars	Rs`	Particulars	R`s
To Balance b/d	9,000	By Realisation A/c	800
To PQR Co. Ltd.,	1,800	By Realisation A/c	5,000
		By A's Capital A/c	2,060
		By B's Capital A/c	1,880
		By C's Capital A/c	1,060
	38,000		**10,800**

Capital Accounts

Dr. **Cr.**

Particulars	A Rs	B Rs	C Rs	Particulars	A Rs	B Rs	C Rs
To Shares A/c	30,940	28,120	15,940	By Balance b/d	24,000	14,000	14,000
To Cash A/c				By Real A/c	9,000	6,000	3,000
(Balancing figure)	2,060	1,880	1,060				
	33,000	**30,000**	**17,000**		**33,000**	**30,000**	**17,000**

Note:

2. Calculation of Capital Ratio

   33,000 : 30,000 : 17,000

   33 : 30 : 17

3. Distribution of Shares

A = 7,500 × $\frac{33}{80}$ = 3,094 Shares of Rs. 10 each = ` 30,940

B = 7,500 × $\frac{30}{80}$ = 2,812 Shares of Rs. 10 each = ` 28,120

C = 7,500 × $\frac{17}{80}$ = 1,594 Shares of Rs. 10 each = `.15,940

7. Rocket, Rani and Raja were partners in a firm sharing profits and losses in the ratio of respectively. They decided to sell their firm to ABC Pvt. Ltd. on 31st March 2001. Their Balance Sheet as at that date was as folows:

Liabilities	Rs`	Assets		Rs`
Sundry Creditors	24,000	Machinery	–	34,200
Capital Accounts		Stock	–	30,000
Rocket	52,200	Debtors	30,000	
Rani	24,000	Less : Provision	3,000	27,000
Raja	18,000	Cash		18,000
		Profit & Loss A/c		9,000
	1,18,200			**1,18,200**

ABC Pvt, Ltd., was registered on 31st March 2001 with an authorised capital of `. 1,50,000 [Shares of `. 100 each] for the purpose of purchasing the partnership business. The purchase pride was agreed at `. 98,700. The company paid the purchase price by issue of 540 fully paid shares and the balance in cash.

Prepare the necessary ledger accounts to close the books of the firm.

Sol :

Note : 1. Calculation of purchase consideration:

1. 540 shares of `. 100 each = 54,000
2. cash = 44,700

Purchase consideration = **98,700**

Ledger Accounts in the books of the firm.

Dr. Realisation Account Cr.

Particulars		R`s	Particulars		Rs`
To Machinery	–	34,200	By Provision	–	3,000
To Stock	–	30,000	By Sundry Creditors		24,000
To Debtors	–	30,000	By ABC Pvt		98,700
To Cash	–	18,000	Co. Ltd., A/c		
To Profit on realisation (transfer to Capital Accounts)					
Rocket – 13,500 × $\frac{1}{2}$	6,750				
Rani – 13,500 × $\frac{1}{3}$	4,500				
Raja – 13,500 × $\frac{1}{6}$	2,250	13,500			
		1,25,700			**1,25,700**

Dr. ABC Pvt. Company Account Cr.

Particulars	`Rs	Particulars	`Rs
To Realisation A/c	98,700	By Equity Shares A/c	54,000
		By Cash A/c	44,700
	98, 700		**98,700**

Dr. Shares in Purchasing Company Cr.

Particulars	R`s	Particulars	`Rs
To ABC. Pvt Co.,Ltd.,	54,000	By Rocket's Capital A/c	29,800
		By Rani's Capital A/c	13,900
		By Raja's Capital A/c	10,300
	54,000		**54,000**

Dr. Capital Accounts Cr.

Particulars	A Rs	B Rs	C Rs	Particulars	A Rs	B Rs	C Rs
To Profit & Loss A/c	4,500	3,000	1,500	By Balance b/d	52,200	24,000	18,000
To Shares A/c	29,800	13,900	10,300	By Realisation A/c	6,750	4,500	2,250
To Cash A/c							
(Balancing figure)	24,650	11,600	8,450				
	58,950	**28,500**	**20,250**		**58,950**	**28,500**	**20,250**

Note : Calculate of Capital Ratio:

Particular	Rocket	Rani	Raja
Credit Balance	58,950	28,500	20,250
(–)Debit Balance	4,500	3,000	1,500
	54,540	25,500	18,750
	1089	: 510	: 375
	363	: 170	: 125

3. Distribution of Shares

Rocket $= 540 \times \frac{363}{658}$ = 298 Shares of Rs. 100 each = `. 29,840

Rocket $= 540 \times \frac{170}{658}$ = 139 Shares of Rs. 100 each = `. 13,900

Rocket $= 540 \times \frac{125}{658}$ = 103 Shares of Rs. 100 each = `. 10,300

Dr. **Cash Account** Cr.

Particulars	`Rs	Particulars	`Rs
To Balance b/d	18,000	By Realisation A/c	18,000
To ABC Pvt. Co. Ltd.,	44,700	By Rocket's Capital A/c	24,650
		By Rani's Capital A/c	11,600
		By Raja's Capital A/c	8,450
	62,700		**62,700**

8. Anand and Bishan carrying on business in partnership decided to dissolve the firm and sell off the business to 'C' Company Ltd., on 31.3.2001 when the firms position is as under:

Liabilities	R`s	Assets	`Rs
Capital Accounts		Land	40,000
A	33,000	Furniture	3,320
B	17,000	Stock	15,380
Creditors	22,250	Debtors	8,430
		Cash	5,120
	72,250		**72,250**

The arrangement with the company is as follows:

a) Land purchased at `. 50,000

b) Furniture and stock are taken at 10% below the book values.

c) Goodwill of the firm is valued at `. 7,500

d) Debtors are taken at `. 8,000 but the creditors at the Balance Sheet figure.

e) The P.C. is to be discharged by the Purchaged Company in fully paid equity shares of `. 10 each. Show the realisation account, capital account, 'C' Co., account and equity shares account in the books of the firm.

Sol :

1. Calculation of Purchase Consideration (Net Assets Method)

Assets taken over value

Land	50,000	
Furniture	2,980	(3,320 – 332)
Stock	13,842	(15,380 – 1,538)
Debtors	8,000	
Goodwill	7,500	
Cash	5,120	
	87,450	

Less : Liabilities agreed = 22,250

65,200

Purchase consideration = `. 65,200

2. Discharge of Purchase Consideration or Mode of Payment

By issue of 6,520 shares of `. 10 each = `. 65,200

Ledger Accounts in the books of firm

Dr. Realisation Account Cr.

Particulars	Rs`	Particulars	`Rs
To Land –	40,000	By Creditors –	22,250
To Furniture –	3,320	By 'C' Company A/c	65,200
To Stock –	15,380		
To Debtors –	8,430		
To Cash –	5,120		
To Profit on realisation transferred to Capital Accounts			
A = 15,200 × $\frac{1}{2}$ = 7,600			
B = 15,200 × $\frac{1}{2}$ = 7,600	15,200		
	87,450		**87,450**

Dr. 'C' Company Account Cr.

Particulars	R`s	Particulars	R`s
To Realisation A/c	65,200	By Shares A/c	65,200
	65, 200		**65,200**

Dr. Shares in Purchasing Company A/c Cr.

Particulars	R`s	Particulars	`Rs
To 'C'Company.A/c	65,200	By A's Capital A/c	40,600
		By B's Capital A/c	24,600
	65,200		**65,200**

Dr. **Capital Accounts** **Cr.**

Particulars	P Rs	Q Rs	Particulars	P Rs	Q Rs
To Shares			By Balance b/d	33,000	17,000
To Cash (Balancing figure)	40,600	24,600	By Realisation A/c	7,600	7,600
	40,600	**24,600**		**40,600**	**24,600**

9. Mahadev and Govind are partners sharing profits in the ratio 2:1 and their Balance Sheet on 31st March 2001 was as follows:

Liabilities	Rs`	Assets		Rs`
Creditors	20,000	Cash in hand		150
Bills payable	5,000	Bills receivable		2,500
M's Capital	10,000	Debtors	30,000	
M's Capital	15,000	Less: Reserve	1,500	28,500
G's Capital	10,000	Stock		21,850
Reserve Fund	3,000	Machinery		10,000
	63,000			**63,000**

They agreed to seel the business to a limited company and the company to take over the assets and liabilities as follows:

Machinery at `. 8,000

Stock at `. 17,500

Debtors at `. 25,350

Bills Receivable at `. 2,500

Goodwill at `. 3,000

The company agreed to take over creditors at `. 19,500. The expenses of realisation amounted to `. 150.

The firm received `. 20,000 of the purchase price in `. 10 fully paid equity shares and the balance in cash. Pass Journal entries and prepare necessary ledger accounts in the books of the firm.

Sol :

In the books of the firm

Journal Entries

Particulars		Debit Rs`	Credit Rs`
1. Realisation A/c	Dr.	64,500	
To Cash			150
To Bills Receivable			2,500
To Debtors			30,000

To Stock			21,850
To Machinery			10,000
[For transfer of assets at book value]			
Creditors A/c	Dr.	20,000	
Bills Payable A/c	Dr.	5,000	
Provision A/c	Dr.	1,500	
To Realisation A/c			26,500
[For transfer of liabilities at book value]			
Purchasing Company A/c	Dr.	32,000	
To Realisation A/c			32,000
[For the amount of purchase consideration]			
Realisation A/c	Dr.	150	
To Cash / bank A/c			150
[For the amount of purchase consideration]			
M's A/c	Dr.	4,100	
G's A/c	Dr.	2,050	
To Realisation A/c			6,150
[For loss on realisation]			
Equity shares in purchasing company A/c	Dr.	20,000	
Cash A/c	Dr.	12,000	
To Purchasing Company A/c			32,000
[For receipt of purchse consideration]			
Reserve A/c	Dr.	3,000	
To M' Capital A/c			2,000
To G's Capital A/c			1,000
[For transfer of Reserves in the Profit and Loss ratio]			
M's LoanA/c	Dr.	10,000	
To Cash A/c			10,000
[For paymehnt of loan]			
M's Capital A/c	Dr.	12,900	
To Equity Shares in Purchasing Company A/c			11,810
To Cash			1090
[For distribution of of shares and cash]			
G's Capital A/c	Dr.	8,950	
To Equity Shares in Purchasing Company A/c			8,190
To Cash			760
[For distribution of of shares and cash]			

Discharge of Payment

1) By Equity shares 20,000
2) By cash 12,000

32,000

Ledger accounts in the books of the firm

Dr. Realisation Account Cr.

Particulars		Rs`	Particulars		`Rs
To Cash	–	150	By Creditors	–	20,000
To Bills receivable	–	2,500	By Bills payable	–	5,000
To Debtors	–	30,000	By Provision	–	1,500
To Stock	–	21,850	By Purchasing Co. A/c	–	32,000
To Machinery	–	10,000	By Loss on realisation		
To Cash (expenses)	–	150	By Loss on realisation transferred to Capital A/c :		
			M – 6,150 × $\frac{2}{3}$ = 4,100		
			G – 6,150 × $\frac{1}{3}$ = 2,050		6,150
		64,650			**64,650**

Dr. Purchasing Company A/c Cr.

Particulars	R`s	Particulars	Rs`
To Realisation .A/c	32,000	By Equity Shares A/c	20,000
		By By Cash A/c	12,000
	32,000		**32,000**

Dr. Equity Shares Account Cr.

Particulars	R`s	Particulars	`Rs
To Purchasing Company .A/c	20,000	By M's Capital A/c	11,810
		By G's Capital A/c	8,190
	32,000		**20,000**

Dr. Capital Accounts Cr.

Particulars	M Rs	G Rs	Particulars	M Rs	G Rs
To Realisation A/c	4,100	2,050	By Balance b/d	15,000	10,000
To Equity Shares	11,810	8,190	By Reserve fund	2,000	1,000
To Cash (Balancing figure)	1,090	760			
	17,000	**11,000**		**17,000**	**11,000**

Note : 2. Calculation of Final Capital Ratio

	M	G
	Rs	**Rs**
Total credit Balance	17,000	11,000
Less : Debt Balance	4,100	2,050
	12,900	8,950
	1,290 :	895
	258 :	179

Ledger Accounts in the books of the firm.

Dr. 'C' Company Account Cr.

Particulars	**`Rs**	**Particulars**	**`Rs**
To Cash	10,000	By Balance b/d	10,000
	10,000		**10,000**

Dr. Cash Account Cr.

Particulars	**`Rs**	**Particulars**	**`Rs**
To Balance b/d	150	By Realisation A/c (M A/c)	150
To Purchasing Company A/c	12,000	By Realisation A/c (G A/c)	150
		By M's Capital A/c	1,090
		By G's Capital A/c	760
		By M's Loan	10,000
	12,150		**12,150**

2. Calculate of Purchase Consideration

Assets taken over value

Particulars	**`Rs**
Machinery	8,000
Cash	150
Bills Receivable	2,500
Debtors	25,350
Stock	17,500
Goodwill	3,000
	56,500
Less : Liabilities agreed	
Creditors & Bills Payable	24,500
Purchase consideration	32,000

Note 3. Distribution of Shares

$$M \ -2{,}000 \times \frac{258}{437} = 1{,}180.77 = 1{,}181 \text{ shares of `. 10 each} = \text{`. } 11{,}810$$

$$G \ -2{,}000 \times \frac{179}{437} = 819 \text{ shares of `. 10 each} = \text{`. } 8{,}190$$

10. David and Eshwar shring profits and losses equally decided to convert their business into a limited company on 31.12.1998 when their Balance Sheet stood as follows:

Liabilities	**R`s**	**Assets**	**`Rs**
Sundry Creditors	24,000	Cash	33,000
Loan Creditors	20,000	Debtors	7,000
Bank overdraft	8,000	Bills Receivable	5,000
Reserve fund Capital	3,000	Stock	8,000
D	20,000	Patents	4,000
E	20,000	Machinery	8,000
		Land & Buildings	30,000
	95,000		**95,000**

The company has agreed to base the purchase consideration on the following

1. The goodwill of the firm will be valued at 2 years purchase of the average profits of the previous 3 years

   Profit for 1995 – Rs. 18,000; 1996 – Rs. 21,000 and 1997 – Rs. 21,000.

2. The company will take over the loan creditors by offereing 9% preference shares. The company will not take over the sundry creditors and bank overdraft.

3. Land and buildings will be valued at Rs. 50,000, Machinery at Rs. 12,000 and all other assets taken (except cash) valued at their book values

4. The vendors to be allotted equity shares of Rs. 10 each to the amount equivalent to the purchase consideration.

You are required to show the necessary ledger accounts in the books of the firm.

Sol :

Note 1. Calculation of Goodwill

$$\text{Average Profit} = \frac{\text{Total Profit}}{\text{Number of Years}}$$

Total Profit = 18,000 + 21,000 + 21,000 = 60,000

$$\text{Average Profit} = \frac{60{,}000}{3} = \text{Rs. } 20{,}000$$

Goodwill = Averafge profit × 2year purchase

Goodwill = ` 20,000 × 2

Goodwill = ` 40,000

2. Calculate of Purchase Consideration

Assets taken over

Particulars	**`Rs**
Goodwill	40,000
Debtors	7,000
Bills Receivable	5,000
Stock	8,000
Patents	4,000
Machinery	12,000
Land & Building	50,000
	1,26,000

Less : Liabilities taken over :	
Loan Creditors	20,000
Purchase Consideration	**1,06,000**

3. Discharge of Purchase Consideration of Mode of Payment

By Equity Shares Rs. 1,06,000

[1,06,000 shares of Rs. 10 each]

Ledger Accounts in the books of the firm.

Dr. Realisation Account Cr.

Particulars		**Rs`**	**Particulars**		**`Rs**
To Debtors	–	7,000	By Sundry Creditors	–	24,000
To Bills receivable	–	5,000	By Loan Creditors	–	20,000
To Stock	–	8,000	By Bank overdraft	–	8,000
To Patents	–	4,000	By Purchasing Co. A/c	–	1,06,000
To Machinery	–	8,000			
To Land & Building	–	30,000			
To Cash A/c					
[Creditors + Bank Overdraft]		32,000			
To Profit on realisation					
transferred to Capital Account :					

D $-64,000 \times \frac{1}{2}$	32,000			
E $-64,000 \times \frac{1}{2}$	32,000	64,000		
		1,58,000		**1,58,000**

Dr. **Purchasing Company A/c** **Cr.**

Particulars	`Rs	Particulars	`Rs
To Realisation .A/c	1,06,000	By Equity Shares A/c Purchasing Company	1,06,000
	1,06,000		**1,06,000**

Dr. **Equity Shares Purchasing Company Account** **Cr.**

Particulars	`Rs	Particulars	`Rs
To Purchasing Company A/c	1,06,000	By D's Capital A/c	53,000
		By E's Capital A/c	53,000
	1,06,000		**1,06,000**

Dr. **Capital Accounts** **Cr.**

Particulars	M Rs	G Rs	Particulars	M Rs	G Rs
To Equity Shares			By Balance b/d	20,000	20,000
in purchasing companyn A/c	53,000	53,000	By Reserve Fund	1,500	1,500
To Cash (Balancing figure)	500	500	By Realisation A/c		
			(Profit)	32,000	32,000
	53,500	**53,500**		**53,500**	**53,500**

Note : 4. Calculation of Final Capital Balance Ratio or Final Claim Ratio

53,500 : 53,500

1 : 1

5. Calculation of distribution of shares

D $-10,600 \times \frac{1}{2}$ = 5,300 shares of Rs` 10 each = Rs` 53,000

D $-10,600 \times \frac{1}{2}$ = 5,300 shares of Rs` 10 each = Rs` 53,000

Dr. **Capital Accounts** **Cr.**

Particulars	`Rs	Particulars	`Rs
To Balance b/d	33,000	By Realisation A/c	32,000
		By D's Capital A/c	500
		By E's Capital A/c	500
	33,000		**33,000**

Short Question and Answers

Q1. Dissolution of Partnership.

Ans :

Dissolution of the partnership means a reconstitution of the firm due to the retirement of a partner or the insolvency of a partner or the death of a partner and the remaining partners provide for the continuance of the firm in pursuance of an express or implied agreement to that effect.

Q2. Distinction Between Dissolution of Partnership and Dissolution of a Firm

Ans :

Following are the main distinctions between dissolution of partnership and dissolution of a firm

Point of Distinction	Dissolution of Partnership	Dissolution of a Firm
1. Meaning	It means discontinuance of relationship between partners but the business is not terminated.	It means dissolution of partnership of all partners of the firm along with winding up of the business of the entire firm. The business of the firm is closed.
2. Books of Accounts	In this case, books of accounts may not be closed.	In this case, books of accounts are closed.
3. Dissolution	It does not means dissolution of firm.	It means dissolution of partnership also.
4. Nature	It is voluntary and is dissolved by mutual agreement and through the process of reconstitution.	It may be both voluntary and compulsory. A firm can be dissolved by Court's orders.
5. Settlement of Assets and Liabilities	In this case, assets and liabilities are revalued and new balance sheet is drawn.	In this case, assets are sold and realised and liabilities are paid off.
6. Economic Relationship	Such relationship may remain and changes	Such relationship between the partners comes to an end.

Q3. What are the reasons for dissolution of Partnership ?

Ans :

The dissolution of firm may occur due to following reasons :

(a) When all the partners agree to dissolve the firm, i.e. by means of an agreement .

(b) Compulsory dissolution [Section 41] : A firm is compulsorily dissolved if (i) all the partners except one are insolvent or all the partners are insolvent; (ii) the business of the firm has become illegal;

(c) On the happening of certain contingencies : In the absence of any agreement to the contrary, a firm is dissolved : (i) on the expiry of the term for which the firm was formed (i.e., when the partnership is for a fixed term); (ii) on the completion of venture(s) for which the firm was formed; (iii) on the death of a partner; and (iv) on the declaration of a partner as an insolvent [Section 42].

(d) By notice : When partnership is at will, any partner can give notice in writing to all other partners of his intention to dissolve the firm [Section 43].

(e) Dissolution by court [Section 44]

Q4. Settlement of Accounts [Section-48]

Ans :

When the firm is dissolved, the assets of the firm must be realised for the purpose of meeting all claims on it including those of the partners. Section 48 of the Act deals with the mode of settlement of accounts. In brief it provides for that the money available will be applied or used in the following manner : (I) Payment of expenses on disposing of the assets and collecting the debts due to the firm, (ii) Payment of outside liabilities of the firm e.g., creditors, bank overdraft, bills payable, loans from partners' wives, etc. (iii) Repayment of the loans received from the partners, (iv) Repayment of the capital contributions of the partners, (v) If there is still any surplus left after meeting the claims stated in (i) to (iv), it will be shared by the partners in their profit-sharing ratio.

Q5. How Revaluation account differentiate with Realisation Account ?

Ans :

Points of Difference	Revaluation Account	Realisation Account
(i) Meaning	It records the effect of the revaluation of assets and liabilities	It records the sale of various assets to outsiders and partners and partners and payment of liabilities by the firm or any of the partners
(ii) Time	It is prepared at the time of the reconstitution of the firm eg., on admission of a new partner or on the retirement/death of a partner or amalgamation of partnership firms	It is prepared only at the time of dissolution of the firm only
(iii) Purpose	To find out the profit (orloss) on the revaluation of assets and liabilities	To find out the profit (or loss) on the realisation of assets and settlement of liabilities
(iv) Contents	It contains only those assets and liabilities which are revalued	It contains generally all assets and all assets and all liabilities
(v) Balance	The balance is transferred only to the old partners's capital account	The balance is transferred to the capital accounts of all partners
(vi) Basis of entries	Entries are made on the basis of the difference between book values and revalued figures	The entires are always made at their book values
(vii) Effect on assets	The accounts of assets and liabilities on revaluation, are not closed	The accounts of assets and liabilities are closed

Q6. Decision in Garner Vs. Murray

Ans :

There is no specific provision in the Indian Partnership Act regarding this matter. But if the partners have stated in the Partnership Deed that loss arising from the deficiency of insolvent partner shall be shared by solvent partners in the profit sharing ratio or any other ratio, it would be binding on the partners. But the difficulty arises when the Partnership Deed is also silent on this point. In England, the matter came up for decision in the leading case of Garner vs. Murray (1903). In this case it was held that, in the absence of any agreement to the contrary, the deficiency on the insolvent partner's capital account (debit balance) must be borne by the other solvent partners in proportion to their capitals, after each solvent partner has brought in cash equal to his own share of loss on realisation.

Q7. Explain about Sale of Partnership to a limited company.

Ans :

Sometimes a Partnership firm may be converted into a company. In such a case, the firm is dissolved and the business carried by the firm is acquired by the company. Technically, this is called sale to a company. When a Partnership firm is sold, the procedure regarding closing of the books of accounts of the firm is same as in the case of dissolution of a firm. The partnership firm is sold to company for a price known as purchase consideration. Purchase consideration is the price agreed to be paid by the purchasing company to the firm.

Q8. Methods of Purchase Consideration

Ans :

The purchase consideration can be ascertained by any of the following methods.

1. **Lump Sum Method** under this method purchase consideration is stated as a Lump Sum. If X Co purchases the business of ABC firm and agrees to pay ? 50,000 then ? 50,000 is the purchase consideration
2. **Net Payment Method** under this method, the purchase consideration is ascertained by adding the various payments made by the company in the form of cash, share or defentures.
3. **Net Assets Method** When details of cash, shares or debentures issued by the company is not given, purchase consideration is ascertained by calculating the 'net woth' of the assets taken over by the company i.e.

Agreed Value of Assets taken Over at agreed value	XX
Less agreed value of liabilities taken over at agreed value	XX
Purchase Consideration	**XX**

Q9. Vendor Accounts

Ans :

When there is sale of a firm to a limited company, the following Ledger Accounts are opened in the books of the Vendor firm for clasing the books of accounts:

1. Realisation Account
2. Purchasing Company Account
3. Shares in Purchasing Company Account
4. Debentures in Purchasing Company Account
5. Partner's Loan Account
6. Partner's Capital Account
7. Cash / Bank Account

Choose the Correct Answers

1) The partnership may come to an end due to the: [d]

(a) Death of a partner (b) Insolvency of partner

(c) By giving notice (d) All of the above

2) In case of retirement of a partner full good will is credited to the accounts of: [a]

(a) All partners (b) Only retiring partner

(c) Only remaining partner (d) None of the above

3) Revaluation account is operated to find out gain or loss at the time of: [d]

(a) Admission of a partner (b) Retirement of a partner

(c) Death of a partner (d) All of above

4) The accounting procedure at the retirement of partner is valued: [d]

(a) Revaluation of assets and liabilities (b) Ascertaining his share of good will

(c) Finding the amount due to him (d) All of above

5) If the remaining partner want to continue the business, after the retirement of a partner, a new partnership agreement: [a]

(a) Necessary (b) Not necessary

(c) Optioned (d) None of above

6) Retirement or death of a partner. [a]

(a) Is dissolution of partnership agreement

(b) Is dissolution of a firm

(c) May or may not be a dissolution of partnership agreement

(d) None of above

7) If all the partners, but one are insolvent it is: [7]

(a) Dissolution of an agreement (b) Dissolution of firm

(c) May or may not cause dissolution (d) None of above

8) At the time of dissolution: [c]

(a) All the assets are transferred to realization A/c

(b) Only current assets are transferred to realization A/c

(c) Non cash assets are transferred to realization A/c

(d) Only liquid and current asset are transferred to realization A/c

9) If a partner takes over an asset of the firm, his capital account [a]

(a) Will be debited with the amount as agreed

(b) Will be credited with the market value of the asset

(c) Will be debited with book value of the asset

(d) None of above

10) Loss on realization is distributed among partners: [a]

(a) According to profit and loss ratio

(b) According to capital ratio

(c) As decided among them

(d) None of above

Fill in the Blanks

1. Partners equity is effected due to the ________
2. An account operated to ascertain the loss or gain at the death of a partner is called ________
3. Amount due to out going partner is shown in the balance sheet as his ________
4. The loss or gain an account of revaluation at the time of retirement of a partner is shared by ________
5. On the retirement of a partner any reserve being should be transferred to the capital account of ________
6. If all the partners, but one, are solvent , then it is ________
7. When all partners are insolvent creditors will be paid as ________
8. Revolution A/c is a ________
9. The decision is Garner Vs Murray was given in the year ________
10. At the time of dissolution all the assets of firm are transferred to the realization A/c ________ (Book value)

Answers

1. Retirement of a partner/Admission of a partner/ Death of a partner
2. Revaluation account
3. Loan Account
4. All partners
5. All partners in the old profit sharing ratio
6. Dissolution of firm
7. rate ably
8. Nominal A/c
9. 1904
10. Book value

UNIT III

Issue of Shares, Debentures, Underwriting and Bonus Shares :

Issue of Shares at par, premium and discount - Prorata allotment – Forfeiture and Re-issue of Shares – Issue of Debentures with Conditions of Redemption – Underwriting:Meaning –Conditions- Bonus Shares: Meaning – SEBI Guidelines for Issue of Bonus Shares – Accounting of Bonus Shares (Including problems)

3.1 Meaning of Company

Q1. What is company ? Explain its characteristics.

Ans :

The word company is derived from the *Latin* words namely, *Com* which means with or together and *panis,* that is, bread. It means an association of persons or merchants discussing matters and taking food together. In a general sense, a company means an association of persons united for performing an economic or even non-economic activity. Accordingly, a company is an organisation to make, buy or sell goods or to provide services for a profit; or to promote art, science, education or some charitable purpose.

According to Section 3(l)(i) of the Companies Act 1956, "a company means a company formed and registered under this Act or an existing company". An existing company means, "A company formed and registered under any of the previous Companies Law".

It will be noticed that the Companies Act fails to define company in terms of its features. It means that the Companies Act does not bring out clearly all the characteristics which an association of persons must possess so that it may be called a company in its true sense.

According to Chief Justice Marshal : "A company is a person artificial, invisible, intangible and existing only in the eyes of the law. Being a mere creature of law, it possesses only those properties which the charter of its creation confers upon it either expressly or as incidental to its very existence. It has no physical existence but exists only in contemplation of law."

Thus a company exists only in the eyes of law and it has no physical existence. A company is a legal person separate from the lives of its members. Separate legal entity is therefore its most important feature.

Characteristics of a Company

The main characteristics of a company may be listed as under :

(i) An incorporated association: A company comes into existence on registration under the Companies Act. A joint stock company may be incorporated as a private or public company

(ii) Legal entity: A company formed and registered under the Companies Act is a legal entity separate and distinct from its members. It has no physical body and exists only in the eyes of law.

(iii) Continuity of life : As the life of the company is not affected by changes in individual shareholders, it is said to have continuity of life or perpetual succession. Even the death or insolvency of a member (or all members) does not affect the corporate existence of the company. Members may come and members may go, but the company continues its operations unless it is wound up.

(iv) Right to transfer : Shareholders have the right to transfer their shares. The shares of a company are freely transferable and can be sold or purchased in the stock exchange. However, in the case of a private company, certain restrictions are placed on the rights of a member to transfer his shares.

(v) Limited liability of members : It means that the liability of the shareholders is limited upto the value of the shares held by them. Once the shareholders have paid the full nominal value of the shares they have agreed to take, they cannot be held responsible for any of the debts of the company which cannot be met from company's assets.

(vi) No joint ownership of company' property : The property of the company is not considered as the joint property of the shareholders although the same has been purchased from the capital contributed by the shareholders.

(vii) Common seal : A company, being an artificial person, cannot sign its name on any documents. So a company functions with the help of a Common Seal which is the official signature of a company. A document not bearing a common seal is not binding on the company.

(viii) The management of the company is delegated to a board of directors.

(ix) Section 77A permits a limited company to buy back its own shares under certain circumstances.

(x) A company is not a citizen and therefore cannot enjoy the fundamental rights like right to vote which are available to citizens only.

3.1.1 Kinds of Companies

Q2. Explain about different types of Companies.

Ans : **(Imp.)**

From the point of view of formation, companies are of three types.

i) Chartered Companies

These companies were formed during British rule. The companies which were incorporated under a special charter by the king or a sovereign such as East India Company are called Chartered Companies. The powers and nature of business of such companies are defined by the charter which incorporate it.

ii) Statutory Companies

Companies which are formed by a special act of Parliament or State Legislature are called Statutory Companies. Examples are Reserve Bank of India, Life Insurance Corporation of India, Food Corporation of India, etc. These companies are governed by the Acts creating them.

iii) Registered Companies

Companies incorporated under Companies Act, 1956 or earlier Companies Acts are called Registered Companies. They come into existence when they are registered under the Companies Act.

According to Section 12(2) of the Companies Act, 1956, a company registered under the Companies Act, may be :

a) **Companies Limited by Shares** : Most commonly companies are limited by shares. In such companies, the liability of members is limited to the unpaid amount of the shares held by them. If the shares are fully paid the shareholders do not have any further liability.

b) **Companies Limited by Guarantee :** In case of these companies, the liability of its members is limited by the amounts undertaken by them. In the Memorandum of Association, the members specify the amount guaranteed by them. In the event of winding up, the members Viability is limited to the amount guaranteed them. This clause applies to non-trading companies.

c) **Unlimited Companies :** In case of unlimited companies, the liability is not limited. The liability of each member extends to the whole amount of the company's liabilities. We rarely find such companies.

From the point of view of investment, companies can be classified as :

a) Private Companies and

b) Public Companies

a) Private Companies Sec.2(68)

A private company means a company which has a minimum paid up capital of Rs. 1,00,000 such higher amount as may be prescribed; and which, by its Articles,

i) **Restricts :** The right to transfer its shares, if any.

ii) **Limits :** The number of its members to 50.

iii) **Prohibits :** Any invitation to public to subscribe for any shares in or debentures of the company; and

iv) **Prohibits :** Any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

A private company must have at least two directors. A private limited company must add the words "Private Limited" at the end of its name.

b) Public Company Sec.2(71)

Public company means a company which is not a private company. A public company should have minimum seven members. It should have a minimum paid up capital of Rs.5,00,000 or such higher paid up capital as may be prescribed.

A public company may be a limited company either limited by shares or limited by guaranty or an unlimited company. If it is a limited company, it must add the words "Limited" at the end of its name.

A public company must have at least three directors.

On the basis of control, the companies may be grouped as under

i) Government Company Sec 2(45)

Any company in which at least 51% of paid up share capital is held by (a) the Central Government; or (b) Any State Government or partly by one or more State Governments and include a company which is a subsidiary of a government company as thus defined.

ii) Non-Government Company

A company which may not be termed as a Government Company as defined in Sec.617 of Indian Companies Act, 1956 is regarded as a non-government company.

iii) Foreign Company Sec 2(42)

A company which is incorporated in a country outside India under the law of that country

3.1.2 Nature and Types of Share Capital

Q3. What is share ? Explain about different types of share capital.

Ans : **(Imp.)**

Meaning : A share is a fractional part of the (Share) capital and provides the basis for ownership in the company.

Nature of a share

(i) share gives some rights and liabilities to the shareholder

(ii) shareholder is not part owner of the company or its property during the life time of the company.

(iii) the share is a movable property

(iv) share is goods

The Companies Act 1956 does not define share capital. The words capital and share capital are synonymous in the case of a joint stock company. Share capital means the capital raised by the company by issue of shares. In short, there is one consolidated capital account called share capital account.

Types of Share Capital

(i) **Authorised or nominal or registered capital** : Authorised share capital is the maximum amount of share capital, mentioned in the memorandum of association, which the company is entitled to issue.

(ii) **Issued capital:** It is that portion of authorised share capital for which offers have been invited for subscription. This includes any bonus shares allotted by the corporate enterprise. It also includes shares allotted to vendors of assets or promoters for consideration other than cash.

That portion of authorised share capital for which offers have not been invited for subscription is called unissued share capital. The issued capital can never exceed its authorised capital.

(iii) Subscribed capital : It represents that part of the issued share capital which has actually been subscribed and allotted. This includes any bonus shares allotted by the corporate enterprise. It is also called allotted capital. It is immaterial whether the shares are fully paid or partly paid.

(iv) Called-up capital : It is that part of the subscribed share capital which the company actually demands from the shareholders.

(v) Paid-up share capital : It means the total amount paid up or credited as paid up on the subscribed capital. Some of the shareholders may fail to pay the amount due from them on account of a call which is termed as cails-in-arrears or unpaid capital.

(vi) Uncalled share capital : It is that amount which is not yet demanded by the company on the shares subscribed and allotted and which the shareholders are liable to pay as and when called

(vii) Reserve capital : It is that portion of the subscribed capital which has not been called up and which, the company has resolved by special resolution, can be called up only in the event of and for the purpose of the company being wound up, that is, capital which has been reserved for winding up. Under Section 99 of the Companies Act the word 'reserve capital' has been substituted by the more accurate expression : "reserve liability of limited company".

Q4. Explain about Classification of Shares?

Ans :

Under the existing provisions of Sec.86 of the Companies Act, now only two kinds of shares may be issued. They are (i) Preference shares and (ii) Equity shares

I. Preference Shares

According to Section 43 of Companies Act 2013, a preference share is one which carries the following two preferential rights.

- Right to receive dividend before any dividend is paid on equity shares.
- Right to receive refund of capital on winding up of company before the equity capital is refunded.

Preference shares carry a fixed rate of dividend.

Types of Preference Shares

- **Cumulative Preference Shares :**

  Preference shares on which arrears of dividends accumulate are called "Cumulative Prefer-ence Shares". In any year, if the company's profits are not sufficient to pay preference dividends in full, such arrears of dividends accumulate to next year. In the later years, when the company earns profits, first the preference dividends, along with arrears should be paid in full and then if any surplus remains, it can be paid to equity share holders as dividends. Unless otherwise stated preference shares are always deemed to be cumulative preference shares.

- **Non-cumulative Preference Shares:**

  Preference shares on which dividends do not accumulate are called non-cumulative prefer-ence shares i.e., if in any year, the profits are not sufficient to pay the preference dividends, they will not be accumulated and will not be paid in the later years even if the company earns sufficient profits. Preference shares will be non-cumulative if there is an express provision in the Articles of Association regarding the same.

- **Participating Preference Shares :**

  If preference share holders are given one or more of the following rights by an express provisions in the Articles of Association, they are called "Participating Preference Shares".

- A right to participate in the surplus profits left after paying dividend upto a limit to equity share holders; and
- A right to participate in the surplus assets left after the repayment of capital to equity share holders on the winding up of the company.

- **Non-Participating Preference Shares**

  Preference shares which are not with above stated two participative reputes are known as non-participating preference shares. They are entitled to only a fixed rate of dividend. Unless otherwise stated, preference shares are deemed to be non-participating preference shares.

- **Convertible Preference Shares :**

  Those which confrer a right of getting converted into equity shares.

- **Non-convertible Preference Shares:**

  Those which do not confer on the holders the right of conversion into equity shares. Unless preference shares are stated to be convertible, they are deemed to be non-convertible prefer-ence shares.

- **Redeemable Preference Shares :**

  Redeemable preference shares are those which are redeemable within a stipulated period in accordance with the terms of issue. According to Section 55 of the Companies Act 2013 no Company limited by shares shall issue Irredeemable Preference shares or Preference Shares redeemable after the expiry of 20 years from the date of issue.

II. Equity Shares :

The capital raised through issue of equity shares is called equity share capital and the persons who subscribe for the equity shares are called equity share holders. The main features of equity shares are :

- The equity share holders generally enjoy voting rights (after the commencement of the Companies (Amendment)Act, 2000, the companies can issue equity shares without voting right or with disproportionate voting rights. They have right to elect directors and to participate in the management.
- The rate if equity dividend is not fixed and can vary from year to year.
- Equity capital is generally not redeemable during the life time of the company unless the company decides to buy back its shares.

Sweat Equity Shares : Sec 79(A)

The Equity Shares issued by a company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value addition are called Sweat Equity Shares.

A company may issue sweat equity shares of a class of shares already issued if the following conditions are fulfilled.

a) the issue of sweat equity shares is authorised by a special resolution passed by the company in the general meeting.

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

c) not less than one year has, at the date of the issue elapsed since the date on which the company was entitled to commence business.

d) the sweat equity shares of a company whose equity shares are listed on a recognised stock exchange are issued in accordance with the regulations made by the Securities Exchange Board of India in this behalf.

3.1.3 Difference Between Shares and Stock

Q5. How stocks are differ with shares ?

Ans :

The distinction between shares and stock may be summarised as follows :

(i) Shares are in units of share capital and have a fixed nominal value whereas stock is divisible into smaller portions each having nominal value as desired.

(ii) Shares can be issued directly; stock cannot be issued directly.

(iii) Shares may or may not be fully paid but stock must be fully paid.

(iv) Shares should be numbered whereas stock is not numbered.

(v) Shares cannot be transferred in fractional amounts but stock can be transferred in fractional amounts although the articles may provide the minimum fractional amount of stock which can be transferred.

(vi) Formalities of voting and transfer of shares and stock are also different.

(vii) As noted above, shares may be subsequently converted into stock when fully paid up. But the share capital of the company cannot be offered directly in the form of stock.

3.1.4 Difference between equity and preference shares

Q6. What are Equity Shares ? Explain the differences between equity and preference shares?

Ans : **(Dec.-17, Imp)**

Equity Shares

An equity share is a share which is not a Preference share. Equity shareholders do not have any right to get fixed rate of dividend. Rate of dividend may vary from year to year. Equity shareholder will get dividend and repayment of capital after meeting the claim of preference shareholders.

Difference between Preference Shares and Equity Shares

Preference Shares	Equity Shares
1. Preference Dividend is paid before paying any dividend on equity shares	1. Equity shareholders, will get dividend only after paying dividend to preference shareholders
2. At the time of liquidation, after payment of creditors, preference shares are redeemed	2. Equity shares are repaid after full repayment is made on preference shares
3. The rate of dividend is fixed	3. Rate of dividend is not fixed, it may vary from year to year
4. In case of preference shares (cumshares) arrears of dividend will accumulate	4. There is no question of accumulation of arrears of dividend
5. Preference Shares (conventible Pref. Shares) can be converted into Equity Shares	5. Equity shares cannot be converted into preference shares
6. Preference shareholders to not have voting	6. Equity shareholders have voting right
7. Redeemable preference share are redeemable according to the provisions of Sec 55 of the Companies Act 2013.	7. There is no provision for redemption of equity shares

3.1.5 Issues of Shares at Par

Q7. Explain the following

i) Issues of Shares

ii) Over and under Subscription

Ans :

i) Issues of Shares

The capital of the company is divided into units of small denomination called shares. Holders of these shares are called the share holders or members of the company. There are two categories of shares - Preference Shares and Equity Shares. Preference share holders have priority over equity -hare holders both in payment of dividends and in refunding capital at the time of liquidation.

Usually the issue price of the shares is collected in installments. The first installments is collected along with application which is called "application money". When the shares are allotted, the "allotment money" is collected. The remaining money is collected in one or two "calls". They are called "first call" "second call" etc. The last call is called "final call".

ii) Over-subscription and Under-subscription

- **Over-subscription :** Sometimes the applications received will be for more number of shares than are issued to the public. However, allotment can be made only equal to the number of shares that are issued. In such a case, Directors will have to refuse allotment to some applicants.

Excess money on Application : When the pro rata system of allotment is made, the applica-tion money received will be in excess of the number allotted. This excess money received on un-allotted shares can be either, (a) refunded to the respective applicants, or (b) used for adjusting the amount due on the shares allotted.

- **Under-subscription :** Sometimes the application for shares is received for less than the number of shares issued. This is called under-subscription. In such a case, the allotment will be equal to the number of shares subscribed for and not to the shares issued.

Accounting Treatment

Issue of Shares at Par : Journal Entries

1. When application money is received

   Bank A/c Dr.

   To Share Application A/c

   (Being application money received)

2. For transferring the application money :

   a) Transferred from share application account to share capital A/c with the following entry.

   Share Application A/c Dr.

   To Share Capital A/c

   (Being application money transferred to share capital A/c)

   b) If any applications are totally rejected the application money should be refunded to the applicants. The following entry is passed for the refund.

   Share application A/c. Dr.

   To Bank A/c

   (Being application money refunded)

3. For the allotment money due on the shares the following entry is passed.

   Share Allotment A/c Dr.

   To Share Capital A/c

   (Being Allotment money due)

4. When allotment money is received :

   Bank A/c Dr

   To Share Allotment A/c

   (Being the allotment money received)

   It should be noted that the above entry should be passed with the actual amount received towards allotment money.

5. When the company makes the first call

   Share First Call A/c Dr.

   To Share Capital A/c

   (Being the first call money due)

   This entry should be passed with the amount called up on first call.

6. When first call money is received :

   Bank A/c Dr.

   To Share first call A/c

   (Being first call received)

   This entry is passed with the actual amount received on first call.

Similar entries are made for every call. The last call is called the final call. If there is only one call, it is known as first and final call.

PROBLEMS

1. Raghavendra Company Limited issued 10,000 Equity shares of ` 10 each and the money was payable as under :

   on application ` 2

   on allotment ` 3.

   on First and Final calls `5 per share.

9,000 shares were subscribed by the public. All the shares were allotted and the money duly received. Pass Journal Entries.

Sol :

Journal Entries in the Books of Raghavendra Ltd.

Sl. No.	Particulars	LF	Debit `	Credit `
1	Bank A/c Dr.		18,000	
	To Equity Share Application A/c			18,000
	(Being share application money received on 9000 shares of ` 2 each			

2	Equity Share Application A/c Dr. To Equity Share Capital A/c (Being Share application money transferred)		18,000	18,000
3	Equity Share Allotment A/c Dr. To Equity Share Capital A/c (Being Share allotment money due)		27,000	27,000
4	Bank A/c Dr. To Equity Share Allotment A/c (Being Share allotment money received)		27,000	27,000
5	Equity Share First & Final Call A/c Dr. To Equity Share Capital A/c (Being Share First and Final Call Money due)		45,000	45,000
6	Bank A/c Dr. To Share First & Final A/c (Being Share First & Final Call Money received)		45,000	45,000

3.1.6 Call In Advance Calls in Arrears

Q8. What is calls in advance and calls in arrears ?

Ans :

i) Calls in Advance

Calls in advance refer to the amount paid by shareholders in excess of the amount due from them. A company may accept calls in advance only if authorised by the Articles. Such amount should be credited to a separate account called "Calls in Advance" account and not to share capital account. The amount is transferred from calls in advance account to the respective call account as and when the calls are made. If the calls are not made before the balance sheet date, the amount in calls in advance account is added to paid up capital in the balance sheet. The directors must pay interest on calls in advance at a rate of 12% p.a.

Journal Entries

1) Interest on calls in advance A/c Dr.

To Shareholders A/c

(Being interest payable on calls in advance)

2) Shareholders A/c Dr.

To Bank A/c

(Being interest paid to members)

ii) Calls in Arrears

Calls in arrears refers to the amount called by the company which is not paid by the share-holders before the due date fixed for payment. Generally such amount is transferred to special account called "calls in arrears account".

Journal Entries

1) Calls in Arrears A/c Dr.

To share allotment A/c A/c

To Share call A/c

(if money received from defaulting share holders)

2) Bank A/c Dr.

To calls in arrears A/c

(Being interest paid to members)

2. XYZ Co. Ltd., registered with a nominal capital of ` 5,00,000 in shares at ` 100 each, 3,000 of which were issued, payable as to ` 12.50 on application, ` 12.50 on allotment, ` 25 three months after allotment and the balance to be called up as and when required. All the money upto allotment were duly received, but as regards the call of ` 25, a shareholder holding 100 shares did not pay the amount due. Another shareholder who was allotted 150 shares paid them up in full.

Pass journal entries.

Sol :

In the Books of XYZ Co. Ltd.,

Journal Entries

S. No.	Particulars	LF	Debit `	Credit `
1	Bank A/c Dr. To Share Application A/c (Being share application money received on 3,000 shares at ` 12.50 per share)		37,500	37,500
2	Share Application A/c Dr. To Share Capital A/c (Being transfer of share application money to share capital A/c)		37,500	37,500
3	Share Allotment A/c Dr. To Share Capital A/c (Being share allotment money due on 3,000 share at ` 12.50 per share]		37,500	37,500
4	Bank A/c Dr. To Share Allotment A/c (Being share allotment money received)		37,500	37,500
5	Share First Call A/c Dr. To Share Capital A/c (Being share first call money due on 3,000 shares at ` 25 per share)		75,000	75,000

6	Bank A/c (2900 × 25) Dr. Calls-in-Arrears A/c (100 × 25) Dr. To Share First Call A/c (Being share first call received on 2,900 shares at ` 25 per share)		72,500 2,500	 75,000
7	Bank A/c Dr. To Calls-in-Advances A/c (Being calls in advance received on 150 shares at ` 50 per share)		7,500	 7,500

3. The National Trading Company Ltd, with a registered capital of 100,000 issued 5,000 equity shares of ` 10 each, payable ` 2 on application, ` 2 on allotment, ` 3 on first call and ` 3 on final call. All the shares were subscribed and the money duly received except the first call on 500 shares and the final call on 1,000 shares.

Pass journal entries.

Sol :

In the Books of National Trading Co.,
Journal Entries

S. No.	Particulars	LF	Debit `	Credit `
1.	Bank A/c Dr. To Equity share application A/c (Being application money recorded on 5,000 shares @ ` 2 per share)		10,000	 10,000
2.	Equity share application A/c Dr. To Equity share capital A/c (Being application money to share capital a/c)		10,000	 10,000
3.	Equity share allotment A/c Dr. To Equity share capital A/c (Being share allotment money due on 5,000 shares at ` 2 per shares)		10,000	 10,000
4.	Bank A/c Dr. To Equity share allotment A/c (Being allotment money received)		10,000	 10,000
5.	Equity share first call A/c Dr. To Equity share capital A/c (Being first call money due on 5,000 shares at ` 3 per share)		15,000	 15,000

6.	Bank A/c (4500 × 3) Dr. Calls in arrears A/c (500 × 3) Dr. To Equity share first call A/c (Being first call money received on 4,500 shares at ` 3)		13,500 1,500	 15,000
7.	Equity share final call A/c Dr. To Equity share capital A/c (Being final call money due on 5,000 shares at ` 3 per share)		15,000	 15,000
8.	Bank A/c (400 × 3) Dr. Calls in Arrears A/c Dr. To Equity share final call A/c (1000 × 3) (Being final call money received on 4,000 shares at ` 3 per share)		12,000 3,000	 15,000

3.1.7 Issues of Shares at Premium and Discount

Q9. Explain about issue of shares at premium and Discount.

Ans : **(Imp.)**

(i) Issue of Shares at Premium

Companies may issue shares at premium i.e., at a price higher than its face value. The difference between issue price and face value is a capital profit and therefore should be credited to a separate account called "Securities Premium Account". According to Section 52 of the Companies Act, 2013, Share premium can be used for the following purposes.

i) For the issue of fully paid bonus shares to the members of the company.

ii) For writing off preliminary expenses of the company.

iii) For writing off expenses of commission paid or discount allowed on any issue of shares or debentures of the company; and

iv) For providing premium payable on the redemption of any redeemable preference shares or debentures of the company.

Unless otherwise stated, premium is included in allotment installment.

Journal Entries

If the Share Premium is received alongwith the allotment money, then Following entries will be passed :

(i) Share Allotment A/c Dr.

To Share Capital A/c

To Share Premium A/c

(Being the allotment money alongwith Share Premium money due on shares)

(ii) Bank A/c Dr.

To Share Allotment A/c

(Being the receipt of allotment alongwith share premium account)

(ii) Issue of Shares at Discount

"At discount" means at a price less than the nominal value. When the company issues shares at a price which is less than the face value (or nominal value or par value) of the share, it is said that shares have been issued at discount.

According to Section 53 of the Companies Act 2013, a Company cannot issue shares at a discount except in case of issue of sweat equity shares (issued to employees and directions).

For example if a share of Rs. 100 is issued for a cash consideration of Rs. 95, it is issued at a discount of Rs. 5 per share.

However when shares are issued at a price lower than the market price but not below the nominal value of the shares, such an issue is not an issue at discount.

Accounting Treatment

The discount on the issue of the shares must be debited to a separate account called 'Discount on Issue of Shares Account' and this account has to be distinctly shown in the balance sheet on the assets side under the heading 'Miscellaneous Expenditure' until it is written off.

Issues of Shares for consideration other than cash

a) To Vendor for the purchase of assets

i) Sundry Assets A/c (individually) Dr.

To Vendor's Account

ii) Vendor's Account Dr.

To Share Capital A/c.

To Share Premium

Account (if any)

(with the purchase price agreed upon

b) To Promoters for the services rendered by them

Goodwill Dr.

To Share Capital Account

(with the nominal value of the allotted)

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4. Hindustan Mills Limited issued to public 50,000 Equity Shares of ` 10 each on 1.4.2016 at a premium of ` 6 per share payable.

` 5 on application

` 8 on allotment including premium and Balance on first and final call. By 15.4.2016 the issue was fully subscribed and allotment was made on 28.4.2016. The allotment money was received on full by 28.5.2016. The call was made on 15.9.2016.

Pass Journal Entries in the books of company for the above transactions. Solution:

Sol :

Journal Entries in the Books of Hindustan Limited

Date	Particulars	LF	Debit (`)	Credit (`)
15.4.2016	Bank A/c Dr.		2,50,000	
	To Equity Share Application A/c			2,50,000
	(Being share application money received on 50,000 shares of ` 5)			
15.4.2016	Equity Share Application A/c Dr.		2,50,000	
	To Equity Share Capital A/c			2,50,000
	(Being transfer of share application money)			
28.4.2016	Equity Share Allotment A/c (50,000 × 8) Dr.		4,00,000	
	To Equity Share Capital A/c (50,000 × 2)			1,00,000
	To Securities Premium A/c (50,000 × 6)			3,00,000
	(Being share allotment money due on 50,000 shares of ` 8 each including premium of ` 6 each)			
28.5.2016	Bank A/c Dr.		4,00,000	
	To Equity Share Allotment A/c			4,00,000
	(Being share allotment money received)			
15.9.2016	Equity Share First & Final Call A/c Dr.		1,50,000	
	To Equity Share Capital A/c			1,50,000
	(Being share first and final call money due)			

5. Ms.Kaveri Company Limited issued 6,000 shares of ` 100 each at a discount of ` 5 per share. The amount was payable as follows:

   ` 20 on application, ` 40 on allotment, ` 35 on First and Final Call.

   All the shares were subscribed and the amount were duly received.

   Give the Journal Entries in the books of the company.

Sol :

In the Books of Kaveri Company Ltd.,
Journal Entries

S. No.	Particulars	LF	Debit (`)	Credit (`)
1	Bank A/c Dr.		1,20,000	
	To Share Application A/c			1,20,000
	(Being share application money received on 6,000 share of ` 20 each)			
2	Share Application A/c Dr.		1,20,000	
	To Share Capital A/c			1,20,000
	(Being transfer of share application money)			

3	Share Allotment A/c (6000 × 40) Dr. Discount on issue of Share A/c (6000 × 5) Dr. To Share Capital A/c (Being share allotment money due)		2,40,000 30,000	 2,70,000
4	Bank A/c Dr. To Share Allotment A/c (Being share allotment money received)		2,40,000	 2,40,000
5	Share First & Final Call A/c (6000 × 35) Dr. To Share Capital (Being share first and final call money due)		2,10,000	 2,10,000
6	Bank A/c Dr. To Share First & Final Call A/c (Being first and final call money received on 1,000 shares of ` 35)		2,10,000	 2,10,000

3.1.8 Prorata Allotment

Q10. What is Prorata allotment ? Explain.

Ans :

Over Subscription of Shares

When the number of shares applied for is more than the number of shares offered to the public, the issue is said to be oversubscribed. In such a situation, the directors allot shares on some reasonable basis because the company can allot only that number which is actually offered for subscription. In brief, the procedure adopted on oversubscription may be as follows :

(i) total rejection of some applications because of some technical defect e.g., insufficient application money;

(ii) acceptance of some applications in full, that is, full allotment;

(iii) allotment to the remaining applicants on *pro-rata* basis.

Treatment of excess application money

(i) When the surplus application money is equal to the allotment money due on the shares allotted, the concerned shareholders are not required to pay any amount on allotment.

(ii) When the excess application money is less than the allotment money due, the allottee has to pay only the balance of allotment money.

(iii) When surplus application money is more than allotment money due, the excess amount is utilised: (a) first in adjusting the allotment money in full; (b) the balance may be either refunded or credited to calls-in-advance account, if permitted by the articles, It will be adjusted on calls that will become due in the near future.

Pro-Rata Allotment

In the case of pro-rata allotment no application for shares is refused and no applicant is allotted the shares in full. Each applicant receives the shares in the same proportion, that is, the total shares offered are allotted to total shares applied for.

For example if the number of shares offered is 50,000 and the number of shares applied for is 60,000, then the ratio of shares applied to allotment would be 600 : 500 or 6:5. In other words for every 600 shares applied for, 500 shares will be allotted.

The necessary journal entries for refund of application money the applicants who are not allotted any shares and transfer of excess application money to the applicants who are alloted shares on Pro-rata basic is as follows

1. For refund of application money

   Share Application A/c Dr.

   To Bank A/c

2. For transfer of application money to Allotment/Calls

   To Share Application A/c Dr.

   To Share Calls A/c / Calls paid in Advance A/c

6. Arvind Ltd. issued 10,000 Equity Shares of ` 100 each at par payable as follows:

   ` 20 on application, ` 30 on allotment

   ` 25 on First Call, ` 25 on second and Final call.

   12,000 shares were applied by public. The Company received the amount on all calls except the final call on 100 shares.

   Prepare Journal Entries in the books of the company.

Sol :

In the Books of Arvind Ltd.,
Journal Entries

Sl. No.	Particulars	LF	Debit `	Credit `
1	Bank A/c Dr. To Share Application A/c (Being application money received on 12,000 shares of ` 20 each)		2,40,000	2,40,000
2	Share Application A/c Dr. To Share all A/c (Being transfer of application money)		2,00,000	2,00,000
3	Share Application A/c Dr. To Bank A/c (Being refund of excess application money)		40,000	40,000

4	Share Allotment A/c (10,000 × 30) Dr. To Share Capital A/c (Being share allotment money due)		3,00,000	3,00,000
5	Bank A/c Dr. To Share Allotment A/c (Being share allotment money received)		3,00,000	3,00,000
6	Share First Call A/c (10,000 × 25) Dr. To Share Capital A/c (Being share first call money due)		2,50,000	2,50,000
7	Bank A/c Dr. To Share First Call A/c (Being share first call money received)		2,50,000	2,50,000
8	Share Final Call A/c (10,000 × 25) Dr. To Share Capital A/c (Being share final call money due)		2,50,000	2,50,000
9	Bank A/c (9900 × 25) Dr. Calls in Arrears A/c (100 × 25) Dr. To Share Final Call A/c (Being share final call money received on 9,900 shares of ` 25 each)		2,47,500 2,500	2,50,000

3.1.9 Forfeiture of Shares

Q11. What is forfeiture of share?

Ans : **(Dec.-19, Imp.)**

Meaning

A member is liable to pay the full issue price of his shares and the amount unpaid on his shares is a debt due from him to the company. Thus if a shareholder fails to pay any valid call or instalment of a call on due date, his shares may be forefeited by the Board if authorised by the articles of association of the company.

Journal Entries

Share Capital A/c Dr. (No. of shares × Amount call for share)

To forfeited Shares A/c Dr. (with the amount already paid)

To various calls A/c Dr. (with the amount remains on unpaid on calls)

Following entry is passed at the time of forfeiture of shares

Share Capital A/c Dr. (with the called amount on such shares as capital)

Share Premium A/c	Dr. (if not received)
	(with amount which became due but not paid)
To Discount on Issue of Shares A/c	(if shares are issued at discount)
To Shares Forfeited A/c	(with the amount already received on such shares)
To various calls accounts	(With Amount that remains unpaid calls)

Reissue of All Forfeited Shares

Forfeited shares may be reissued by the company directors for any amount but if such shares are issued at a discount then the amount of discount should not exceed the actual amount received on forfeited shares plus original discount on reissued shares, if any. The purchaser of forfeited reissued shares is liable for payment of all future calls duly made by the Company.

Following journal entry on such reissue is passed :

Bank A/c	Dr. (Amount received on such reissue)
Discount on Issue of Shares A/c	Dr. (with original rate of discount if the shares originally were issued at discount)
Shares Forfeited A/c	Dr. (loss on reissue of shares)
To Share Capital A/c	(with face value of shares)
To Share Premium A/c	(If shares are reissued at premium)

Note : If rate of discount on reissue of forfeited shares is lower than the original rate of discount on issue of shares, Discount on Issue of Shares Account will be debited with the lower rate of discount.

After reissue of all forfeited shares if there is no balance in shares forfeited account, then there will be no capital profit. But where there is profit on the reissue of forfeited shares, *i.e.,* shares forfeited account is showing credit balance after reissue of all forfeited shares, such profit should be treated as capital profit and the balance or amount relating to shares reissued will be transferred to capital reserve by passing the following entry :

Shares Forfeited A/c	Dr.
To Capital Reserve A/c	

Capital reserve will be shown on the liabilities side of Balance Sheet and can be used for writing off capital losses.

7. On 1.4.2015 the Directors of Laxmi Trading Company Ltd. resolved that 1,000 Equity Shares of ` 10 each are to be forfeited for the Non-payment of Final Call Money of per share on 1.2.2005 the above Forfeited shares were Re-issued at ` 8 per share as fully paid up.

   Give the Journal Entries to record the above transactions.

Sol :

In the Books of Laxmi Trading Co. Ltd.
Journal Entries

Date	Particulars		LF	Debit `	Credit `
1.4.2015	Share Capital A/c	Dr.		10,000	
	To Share Forfeiture A/c				7,000
	To Share Final Call A/c				3,000
	(Being forfeiture of 1,000 shares of ` 10 each for non-payment of final call of ` 3 each)				
1.5.2015	Bank A/c	Dr.		8,000	
	Share Forfeiture A/c	Dr.		2,000	
	To Share Capital A/c				10,000
	(Being re-issue of 1,000 forfeited shares at ` 8 each)				
1.5.2015	Share Forfeiture A/c (3000 + 2000)	Dr.		5,000	
	To Capital Reserve A/c				5,000
	(Being transfer of balance of share forfeiture A/c balance)				

3.2 Issue of Debentures with Conditions of Redemption

Q12. What is Debenture ? Explain its features of a debenture.

Ans :

Debentures are therefore part of loan capital and the company is liable to pay interest thereon whether there are profits or not. Section 2 (30) of the Companies Act, 2013 states that: "a debenture includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of a company or not" It is clear that this definition does not describe the true nature of a debenture.

According to Topham: "Debenture is a document given by a company as evidence of debt to the holder usually arising out of a loan and most commonly secured by a charge".

Basic characteristics of a Debenture

The main characteristics of a debenture may be listed as under :

(i) Document in writing: Debenture is issued by the company in the form of a certificate like share certificate. So a debenture is a document in writing.

(ii) Acknowledgment of a debt: A debenture certificate contains an acknowledgement of the debt of a stated sum the company owes to the person named therein.

(iii) Compulsory payment of interest : The document promises that fixed rate of interest will be paid periodically, to the person named in the certificate until the principal amount is paid back. It is immaterial whether the company makes a profit or not.

(iv) Repayment of borrowed sum : The document usually states the sum borrowed will be repaid by the company on or before a certain date.

(v) Common seal : Debentures are generally issued under the common seal of the company. However, it has been held that a debenture certificate signed by two directors of a company and without bearing the seal of a company is still a valid debenture certificate.

(vi) No voting right: Debentures carry no voting rights at any meeting of the company.

3.2.1 Debentures and Shares

Q13. Difference between Debenture and shares?

Ans : **(June-18, Imp.)**

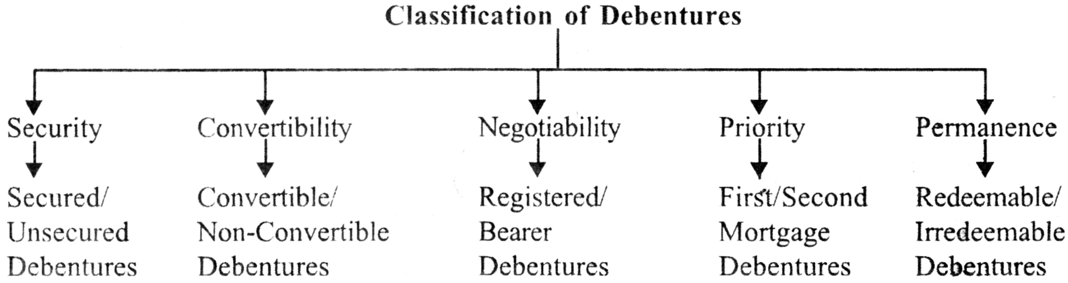
	Point of difference	Debentures	Shares
1.	**Status**	Debenture holders are the creditors of the company	Shareholders are the owners of the company
2.	**Control**	Debenture holders have no voting rights. Therefore can not exercise control over the affairs of the company	Shareholders have voting rights they can exercise control over the affairs of the company
3.	**Payment**	Interest on debentures is paid at a predetermined fixed rate. It is payable, whether there is any profit or not	Dividend on Preference shares are paid at a fixed rate, but dividend on equity shares depend on the profits available after meet ing all the expenses.
4.	**Type**	There are different types of debentures like secured types debentures, redeemable debentures, convertible	Shares are mainly of two (a) Equity shares (b) Preference shares
5.	**Tax**	Debenture interest is a charge against the profits and can be deductible as expense while computing taxable income	Dividends are appropriation of profits and are not deductable while computing the taxable income
6.	**Conversion**	As per the terms of issue of debentures They can be converted into shares Convertible debentures can be issued	Shares cannot be converted into debentures
7.	**Repayment**	According to the terms and conditions of redemption debentures can be paid back on maturity	Preference shares can be paid back back on maturity, but equity shares can be paid only on the liquidation of the company.
8.	**Preference in payment**	Debenture holders have priority over the payment of interest irrespective of profits and principal amount at the time of liquidation	Shareholders have no priority in payment. They are paid after the payment of debenture holders, creditors etc.
9.	**Balance Sheet**	In the balance sheet of the company, debentures are shown under the head 'secured loans'.	In the balance sheet shares are shown under the head share capital'.
10.	**Forfeiture**	As per the provisions of sec. 122, debentures cannot be forfeited for non payment of the amount due	Shares can be forfeited for non payment of allotment and call moneys.
11.	**Mortgage**	Assets of the company can be mortgaged in favor of debenture holders	Assets of the company cannot be mortgaged in favor of share holder

3.2.2 Types of Debentures

Q14. Explain about different types of Debentures.

Ans : **(Dec.-18, Imp.)**

Debentures may be classified into the following type based on different considerations such as security, convertibility, negotiability, priority and permanence.



I. On the basis of security

On the basis of security offered to the debenture holders, they may be classified as a) Secured Debentures and b) Unsecured Debentures

a) Secured Debentures : The debentures, which carry security fully or partly with regard to repayment of interest and principal amount, are called as secured or mortgage debentures. They create a charge on some or all assets of the company.

There are two types of charge a) fixed change b) floating charge.

A fixed charge is a charge on specific assets, which can be sold with out the consent of debenture holders. The proceeds on sale of these asset are first used in repayment of debenture holders.

A floating charge is a mortgage on all the assets of the company, which includes future assets also.

b) Unsecured debentures : The debentures, which don't carry any security in respect of repayment of interest and principal amount, are called unsecured debentures. They are also called Naked or Simple debentures.

II. On the basis of convertibility :

a) Convertible debentures : The debentures, which can be fully or partly convertible into equity or preference shares at a specified rate of exchange after a certain period are called convert-ible debentures.

The debentures that are fully convertible are called "Fully convertible deben-tures" and those that are partly convertible are called "partly convertible debentures'

b) Non-convertible debentures : The debentures, which cannot be converted into shares, are called non-convertible debentures. These are called 'Kahoka' in the market.

III. On the basis of Negotiability :

On the basis of negotiability debentures may be classified as

a) Registered Debentures and b) Bearer Debentures

a) **Registered debentures:** The debentures, which have been registered in the name of debenture holders are said to be registered debentures. The name, address and' particulars of holdings of registered holder are recorded in the register of Debenture holders.

b) **Bearer debentures:** The Debentures which are payable to the bearer of documents are called bearer Debentures. They are treated as negotiable instrument and transferable by mere delivery. The interest on these debentures is payable to the bearer. The company does not maintain the details of Debenture holders.

IV. On the basis of priority :

On the basis of priority, Debentures may be classified as a) First Debentures and b) Second debentures

a) **First debentures:** These are the debentures that are paid first before payment is made to other type of debentures.

b) **Second debentures :** These are the debentures that are paid after the first debentures have been paid.

V. On the basis of permanence :

On the basis of the period after which the repayment is to be made the debentures may be classified as a) Redeemable Debentures and b) Irredeemable Debentures

a) **Redeemable debentures:** The debentures which are payable on the expiry of certain period are called redeemable debentures. Sometimes these debentures may be redeemed by the company on demand by the holders or at the direction of the company.

b) **Irredeemable debentures:** These debentures are not redeemable on the expiry of stipulate period. These are repayable at the time of liquidation of the company. They are also called perpetual debentures. As they are not redeemable during the lifetime of the company, they become permanent component of capital structure of companies.

3.2.3 Accounting Treatment Issue of Debenture

Q15. Explain about accounting treatment in issue of Debentures.

Ans :

Issue of Debentures for Cash

The procedure for the issue of debentures for cash is very much similar to that adopted for the issue of share capital because a prospectus is prepared and issued, applications are invited, letters of allotment are issued and soon. The debentures may also be issued : (i) at par or (ii) at a premium or (iii) at a discount. When the debentures are issued for cash, the amount to be collected on them may be payable in instalments or in lump sum.

i) Journal Entries when debentures are issued at Par :

Bank A/c Dr

To Debentures A/c

(Being debentures issued at par)

ii) When debentures are issued at discount :

Bank A/c Dr.

Discount on issue of debenture A/c Dr.

To Debentures A/c

iii) When debentures are issued at premium

Bank A/c Dr

To Premium on issue of Debentures A/c

To Debentures A/c

(Being debentures issued at premium)

iv) Debentures issued at par or discount but redeemable at premium

Bank A/c Dr (with actual amount received)

Loss on Issue Debentures A/c Dr (with the difference between amount repayable and amount received)

To Debentures A/c (with Face Value)

To Premium on Redemption of

Debentures Account (with premium payable on redemption

b) Debentures issued for consideration other than cash :

Debentures may be issued as purchase consideration when a company purchases asset- from a vendor. In this case, when purchase price is less than the net value of assets, the difference is to be credited to capital reserve. If purchase price is more than the net value of assets, difference is to be debited to good will. The following journal entries are recorded in this regard.

i) For purchase of sundry assets when Purchase price is less than net value of assets :

Assets A/c Dr

To vendor A/c

To capital reserve A/c

ii) When Purchase price is more than net value of assets

Assets A/c Dr.

Good will A/c Dr.

To vender A/c

iii) When Debentures are issued as a consideration for purchase price of the Asset:

Assets A/c Dr.

Vendor A/c Dr.

To Debentures A/c

(**Note :** In these instances also debentures can be issued at par, at premium or at discount.)

c) As collateral Security

Security that is offered in addition to the principal security is called collateral security. Such security is to be realized only when principal security fails to meet the full amount or part of the amount of loan.

Companies can issue debentures as collateral security. Such debentures become alive only when the company does not repay loan amount. Debentures issued, as collateral security can be dealt in two methods.

1) First Method: In this method no journal entry is passed in the books. But the fact about the security is to be clearly mentioned in the Balance sheet on the liabilities side under the head loan and debentures till the company repays it. It is shown in the Balance Sheet as note with the

   (Loan A/c indicating such Debentures each have been issued as collateral security)

2) Second Method : In this method the journal entry given below can be passed in the books.

   Debentures suspense A/c Dr.

   To Debentures A/c

Whenever the loan is repaid by the company the above entry gets cancelled by passing a reverse entry.

Under this method it appears in the balance sheet as follows :

Balance Sheet

Liabilities	Assets
Debentures	Debenture suspense Account
(_________Debentures of	(Debentures issued as collateral
(Rs._________each loan)	security for loan as per contract)

8. A Ltd company purchased the business of B Ltd. taking assets of Rs.3,40,000 discharging liabilities of Rs.50,000 at an agreed price of Rs.2,70,000. Purchase consideration being paid by issuing debentures of Rs.100 each at 10% discount. Give Journal entries in the books of A. Ltd.

Sol :

Date	Particulars		LF	Debit (₹)	Credit (₹)
	Sundry Assets A/c	Dr.		3,40,000	
	To Liabilities A/c				50,000
	To B Ltd. A/c				2,70,000
	To capital reserve A/c				20,000
	(Being purchase of assets and liabilities of B Ltd, since net value of sundry assets is more than purchase price difference being credited to capital reserve)				
	B Ltd A/c	Dr.		2,70,000	
	Discount on issue of debentures A/c	Dr.		30,000	
	To Debentures A/c				3,00,000
	(Being issue of 3000 debentures of ₹100 each at 10% discount)				

Working Note :

Calculation of number of debentures issued to B Ltd:

If for every payment of `. 90 (100 - 10) one debenture is issued.

For making payment of `. 2,70,000 number of debentures issued is equivalent to:

2,70,000 × 1/90 = 3000

Nominal value of 3000 debentures = 3000 × 100 = 3,00,000

Discount on 3000 debentures = 3000 × 10 = 30,000

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9. Wipro Software Company Limited issued 20,000 debentures of ` 50 each. The amount was payable as follows :

` 10 on application

` 25 on allotment

` 12 on First Call and

` 3 on Final Call.

All the debentures was subscribed and the money duly received.

Give the Journal Entries in the books of the company.

Sol :

In the Books of Wipro Software Company Limited
Journal Entries

S. No.	Particulars	LF	Debit `	Credit `
1	Bank Account (20,000 × 10) Dr. To Debenture Application A/c (Being debenture application money received)		2,00,000	2,00,000
2	Debenture Application A/c Dr. To Debenture's A/c (Being Debenture application money transferred)		2,00,000	2,00,000
3	Debenture Allotment A/c (20,000 × 25) Dr. To Debenture's A/c (Being Debenture allotment money due)		5,00,000	5,00,000
4	Bank A/c Dr. To Debenture Allotment A/c (Being Debenture allotment money received)		5,00,000	5,00,000
5	Debenture First Call A/c (20,000 × 12) Dr. To Debenture's A/c (Being Debenture First Call money due)		2,40,000	2,40,000

6	Bank A/c Dr. To Debenture First Call A/c (Being Debenture first call money received)		2,40,000	 2,40,000
7	Debenture Final Call A/c (20,000 × 3) Dr. To Debenture's A/c (Being Debenture Final call money due)		60,000	 60,000
8	Bank A/c Dr. To Debenture Final Call A/c (Being Debenture final call money received)		60,000	 60,000

10. TATA Company Limited issued 5,000 debentures of ` 1,000 each at a premium of ` 100 each. The amount was payable as follows:

` 250 on application

` 600 on allotment (including premium)

` 250 on First and Final Call

All the debentures subscribed, amount duly received except on 200 debenture on First and Final Call.

Give Journal Entries in the books of the company

Sol :

In the Books of TATA Company Limited
Journal Entries

Sl. No.	Particulars	LF	Debit `	Credit `
1	Bank A/c (5000 × 250) Dr. To Debenture Application A/c (Being application money received)		12,50,000	 12,50,000
2	Debenture Application A/c Dr. To Debenture's A/c (Being application money transferred)		12,50,000	 12,50,000
3	Debenture Allotment A/c (5000 × 600) Dr. To Debentures A/c (5000 × 500) To Debenture Premium A/c (5000 × 100) (Being allotment money due)		30,00,000	 25,00,000 5,00,000
4	Bank A/c Dr. To Debenture Allotment A/c (Being allotment money received)		30,00,000	 30,00,000

5	Debenture First & Final A/c (5000×1250) Dr. To Debenture A/c (Being Debenture first and final call money due)		12,50,000	12,50,000
6	Bank A/c (14800×250) Dr. To Debenture First & Final Call A/c (Being debenture first and final call money received on 4,800 debenture of ` 250 each)		12,00,000	12,00,000

11. M/s.Kaveri Company Limited issued 60,000, 10% debentures of ` 100 each at a discount of ` 5 per debenture. The amount was payable as follows:

` 20 on application

` 40 on allotment

` 35 on First and Final Call.

All debentures were subscribed and the amount were duly received. Give Journal Entries in the books of the company..

Sol :

Entries in the Books of M/s.Kaveri Company Limited

Sl. No.	Particulars	LF	Debit `	Credit `
1	Bank A/c (60,000×20) Dr. To Debenture Application A/c (Being application money received)		12,00,000	12,00,000
2	Debenture Application A/c Dr. To 10% Debenture's A/c (Being application money transferred)		12,00,000	12,00,000
3	Debenture Allotment A/c (60,000×40) Dr. Discount on issue Debenture A/c (60,000×5) Dr. To 10% Debenture's A/c (Being allotment money due)		24,00,000 3,00,000	27,00,000
4	Bank A/c Dr. To Debenture Allotment A/c (Being allotment money received)		24,00,000	24,00,000
5	Debenture First & Final Call A/c (60,000×35) Dr. To 10% Debenture's A/c (Being first and final call money due)		21,00,000	21,00,000
6	Bank A/c Dr. To Debenture First & Final Call A/c (Being First and Final Call money received)		21,00,000	21,00,000

12. BATA Limited issued 10,000, 10% debentures of ` 100 each. Give Journal Entries if the debentures are

1) issued at par and redeemable at par;
2) issued at a discount of 10% and redeemable at par;
3) issued at a premium of 10% and redeemable at par;
4) issued at par and redeemable at a premium of 10% and
5) issued at a discount of 10% and redeemable at a premium of 10%.

Sol :

In the Books of BATA Limited
Journal Entries

Sl. No.	Particulars		LF	Debit `	Credit `
1	Bank A/c	Dr.		10,00,000	
	To 10% Debenture A/c				10,00,000
	(Being issue of 10,000 debentures of ` 100 each redeemable at par)				
2	Bank A/c	Dr.		9,00,000	
	Discount on issue of Debentures A/c	Dr.		1,00,000	
	To 10% Debenture A/c				10,00,000
	(Being issue of 10,000 debentures of ` 100 each at a discount of 10% redeemable at par)				
3	Bank A/c	Dr.		11,00,000	
	To 10% Debenture A/c				10,00,000
	To Premium on issue of Debenture A/c				1,00,000
	(Being issue of 10,000 debentures of ` 100 each at a premium of 10% redeemable at par)				
4	Bank A/c	Dr.		10,00,000	
	Loss on issue of Debenture A/c	Dr.		1,00,000	
	To 10% Debentures A/c				10,00,000
	To Premium on Redemption of Debentures A/c				1,00,000
	(Being issue of Debentures at par redeemable at 10% premium)				
5	Bank A/c	Dr.		9,00,000	
	Discount on issue of Debentures A/c	Dr.		1,00,000	
	Loss on issue of Debentures A/c	Dr.		1,00,000	
	To 10% Debenture's A/c				10,00,000
	To Premium on redemption of Debentures A/c				1,00,000
	(Being issue of 10,000 debentures of ` 100 each at a discount of 10% redeemable at a premium of 10%)				

13. ABC Limited, issued Debentures in the following manner:

1. 8,000, 12% Debentures of ` 100 were given to a creditors who supplied plant of ` 7,50,000.
2. 4,000, 8% Debentures of ` 100 each at a premium of 5%.
3. A loan of ` 3,00,000, has been taken from a Bank and 4,000, 7% Debentures of ` 100 each have been deposited with Bank as Collateral Security.

Pass the Journal Entries.

Sol :

ABC Limited
Journal Entries

Sl. No.	Particulars	LF	Debit `	Credit `
1	Creditor A/c Dr. Goodwill A/c Dr. To 12% Debentures A/c (Being issue of 8,000, 12% debentures of ` 100 each to a creditor who supplied plant worth ` 7,50,000, balance of ` 5,000 is treated as goodwill)		7,50,000 50,000	 8,00,000
2	Bank A/c Dr. To 8% Debentures A/c (4000 × 100) To Premium on Debentures A/c (Being issue of Debentures at a premium)		4,20,000	 4,00,000 20,000
3	Bank A/c Dr. To Bank Loan A/c (Being loan taken from bank and deposited 4,000, 7% Debentures of ` 100 each as Collateral Security)		4,00,00 –	– 4,00,000

3.2.4 Terms Of Issue Of Debentures (Including Terms and Redemption)

Q16. Explain about terms of issue of Debentures and Accounting Treatment.

Ans :

A limited company may issue debentures on certain terms as to their issue price at par or discount or premium and also as to their redemption as outlined below:

Possibility	Conditions of Issue	Conditions of Redemption
(i)	Issued at par	Redeemable at par
(ii)	Issued at discount	Redeemable at par
(iii)	Issued at premium	Redeemable at par
(iv)	Issued at par	Redeemable at premium
(v)	Issued at premium	Redeemable at premium

It would be noticed that the debentures may be issued either at par or at discount or at premium but the redemption is only either at par or at premium. The journal entries for different terms of issue and redemption are as follows :

(i) Issued at par and redeemable at par

Share Capital A/c	Dr.	(with the called amount on such shares as capital)
Bank Account	Dr.	(with the nominal value received)
To Debentures Account		(with the nominal value of the debentures)

(ii) Issued at discount, repayable at par

Bank Account	Dr.	(with the actual amount received)
Discount on Issue of Debentures Account	Dr.	(with the amount of discount)
To Debentures Account		(with the nominal value)

(iii) Issued at premium, redeemable at par

Bank Account	Dr.	(with the total amount received)
To Debentures Account		(with the nominal value)
To Securities Premium Account		(with the amount of premium)

(iv) Issued at par, redeemable at premium

Bank Account	Dr.	(with the nominal value received)
Loss on the Issue of Debentures	Dr.	(with the amount of premium Account on redemption)
To Debentures Account		(with the nominal value
To Premium on the Redemption of Debenture, Account		(with the premium on) redemption)

(v) Issued at discount but redeemable at premium

Bank Account	Dr.	(with the actual amount received)
Discount on the Issue of Debentures Account	Dr.	(with the discount on issue)
Loss on the Issue of Debentures Account		(with the premium payable on redemption)
To Debentures Account		(with the nominal value)
To Premium on Redemption of Debentures Account		(with the premium on redemption)

Alternatively, both discount on issue and premium payable on redemption may be combined and debited to a single account namely, 'loss on the issue of debentures account.' The entry then would be :

Bank Account	Dr.	(with the amount received)
Loss on the Issue of Debentures Account	Dr.	(with the amount of discount on issue plus premium on redemption)
To Debentures Account		(with the nominal value)
To Premium on Redemption of Debentures Account		(with the premium payable at the time of redemption)

Comments

(i) Premium on redemption is a personal account because it is a liability on the company to pay in future, that is, at the time of redemption. Hence it is a provision and is shown under the head : Current Liabilities and Provisions until debentures' are repaid.

(ii) Since the company promises to pay more in the form of premium on redemption, there is a loss of equal amount which is debited under the heading: Loss on the Issue of Debentures Account. It is a capital loss and it is written off gradually every year against the profit and loss account or securities premium account. The unwritten amount is-shown in the assets side of the balance sheet under the capiton 'Miscellaneous Expenditure'. Similar is the nature and treatment of 'Discount on the Issue of Debentures Account.'

(iii) At the time of redemption, 'Premium on Redemption of Debentures Account' is transferred to debenture holders' account who are then paid off the total amount.

(iv) In all the five cases, the 'Debentures Account' would appear at nominal value in the balance sheet.

Illustration (Terms of issue and redemption)

Give journal entries for the following :

(a) Issue of Rs. 1,00,000 — 9% Debentures at par and redeemable at par.

(b) Issue of Rs. 1,00,000 — 9% Debentures at premium of 5% but redeemable at par.

(c) Issue of Rs. 1,00,000 — 9% Debentures at a discount, repayable at par.

(d) Issue of Rs. 1,00,000 — 9% Debentures at par but repayable at a premium of 5%.

(e) Issue of Rs. 1,00,000 — 9% Debentures at discount of 5% but redeemable at premium of 5%.

Journal Entries

S.No.	Particulars		Rs.	Rs.
(a)	Bank Account	Dr.	1,00,000	
	To 9% Debentures Account			1,00,000
	(Being the issue of debentures at par and repayable at par)			
(b)	Bank Account	Dr.	1,05,000	
	To 9% Debentures Account			1,00,000
	To Securities Premium Account			5,000
	(Being issue of debentures ait premium but repayable at par)			
(c)	Bank Account	Dr.	95,000	
	Discount on Issue of Debentures Account	Dr.	5,000	
	To 9% Debentures Account			1,00,000
	(Being issue of debentures at a discount but redeemable at par)			
(d)	Share Allotment A/c	Dr.	1,00,000	
	Loss on Issue of Debentures Account		5,000	
	To 9% Debentures Account			1,00,000
	To Premium on Redemption of Debentures Account			5,000
	(Being Issue of debentures at par repayable at premium)			

(e)	Bank A/c	Dr.	95,000	
	Loss on Issue of Debentures Account	Dr.	10,000	
	To 9% Debentures Account			1,00,000
	To Premium on Redemption of Debentures A/c		5,000	
	(Being Issue of debentures at discount and repayable at premium)			

3.3 Underwriting

3.3.1 Meaning

Q17. What is Underwriting ?

Ans : **(Dec.-19, Dec.-17, Imp)**

Meaning

A private company can start its business activities by getting the certificate of incorporation. But to start the business, a public company must get certificate of commencement of business apart from getting of certificate of incorporation. To get this certificate a company must raise at least minimum subscription amount from the sale of shares. Companies are not sure whether the public may take up the shares and debentures offered for subscription. There arises a risk to ensure the success of issue. Therefore, the companies make an arrangement with financial institution that agree to take up or guarantee to subscribe all shares of debentures of the company for which public sub-scriptions have not been obtained. Such an arrangement or agreement is known as underwriting and the institutions with which such agreement is entered are called 'underwriters'. The underwriters may be persons, firms or companies. Thus an underwriter is a person who undertakes to take-up the whole or a portion of the shares or debentures offered by a company to the public for subscription in the circumstances, if the public does not subscribe them.

Q18. Differentiate between under writers and Brokers.

Ans : **(Imp)**

Underwriters may be persons or institutions, who undertake the responsibility of buying whole or part of shares or debentures offered to public if public does not subscribe them. Brokers are persons or institutions who helps in subscribing shares or debentures offered to the public for brokerage. The specific differences between underwriters and brokers are given below.

	Underwriters	Brokers
1.	An underwriter agrees to take up specified shares or debentures, which are not sub-scribed by the public.	A broker helps in subscripting the shares and debentures of a company.
2.	Underwriters have responsibility and held liable to take up shares and debentures in case the public fails to subscribe.	Brokers have no responsibility hence they are not liable.
3.	An underwriter gives guarantee of underwriting shares or debentures	A broker provides the service in subscribing the shares.
4.	An under writer gets under-Writing commission	A broke gets brokerage

3.3.2 SEBI Guidelines

Q19. Explain about SEBI Guidelines for Underwriting.

Ans :

Following are the SEBI guidelines with regard to underwriting.

a) Underwriting of shares and debentures is not compulsory. It is the optional. But if the issue is not underwritten and the minimum subscription 90% of the issue is not received, the entire amount received as subscription must be returned in full by a company.

b) If the issue is underwritten and minimum subscription of 90% of the issue from public is not received plus accepted devilment from underwriters is not attained with in 120 days from the date of opening of the issue the company shall refund the amount of subscription"

c) The company must satisfy about the net worth of the under writers and outstanding commitment and disclose the same to SEBI.

d) The underwriting agreements may be filed with the stock exchanges.

3.3.3 Types of Underwriting

Q20. Explain about types of underwriting and agreement.

Ans :

Following are the main types of underwriting agreements :

(i) Complete Underwriting: If the whole issue of shares or debentures of a company is underwritten, it is called complete underwriting. In such a case the whole issue is underwritten either by an individual/ institution agreeing to take the entire risk or by a number of firms or institutions each agreeing to take the risk to a limited extent.

(ii) Partial Underwriting: If part of the issue of shares or debentures of a company is underwritten, it is said to be partial underwriting such a case the part of the issue is underwritten either by an individual/ institution or by a number of firms or institutions each agreeing to take the risk to a limited extent.

(iii) Firm Underwriting: Firm underwriting means when an underwriter agrees to buy a definite number of shares or debentures in addition to the shares or debentures he has to take under the underwriting agreement.

(iv) Partial Underwriting along with Firm Underwriting: In this type of underwriting, unless otherwise agreed, individual underwriter does not get the benefit of firm underwriting in determination of number of shares or debentures to be taken up by him.

(v) Syndicate Underwriting is one in which, two or more agencies or underwriters jointly underwrite an issue of securities. Such an arrangement is entered into when the total issue is beyond the resources of one underwriter or when he does not want to block up large amount of funds in one issue.

(vi) Sub-underwriting is one in which an underwriter gets a part of the issue further underwritten by another agency. This is done to diffuse the risk involved in underwriting. The name of every under-writer is mentioned in the prospectus along with the amount of securities underwritten by him.

Disclosure of Underwriting Agreement

As per the provisions of the companies act, 1956, the disclosure of underwriting agreement is as follows.

Disclosure in prospectus :

Prospectus should specify the following about underwriting :

1. The names of the underwritten and the opinions of the directors that the resources of the underwriters are sufficient to discharge their obligations

2. As per provisions of section 76 of the companies Act the number of shares of debentures which the underwriters have agreed to subscribe along with the amount or rate of com-mission payable.

3.3.4 Underwriting Commission

Q21. What are the restrictions on payment of under writing commission and Brokerage ?

Ans :

Restrictions on payment of underwriting commission as per section 40(6) of the Companies Act of 2013:

1. The Payment of commission is authorised by the Articles of Association of the Company
2. The rate of commission must not exceed 5% of the issue price of shares or the amount or rate authorised by the Articles whichever is less and in case of Debentures. 2.5% of issue price of debentures or amount or rate authorised by the Articles whichever is less. How Sebi has allowed underwirting commission only at the rate of 2.5% of the issue price of equity shares.
3. The commission paid or agreed to be paid should be disclosed in the prospectus, and if no prospectus is issued, in the statement in lieu of prospectus.
4. The number of shares or debentures which underwriters have agreed to subscribe absolutely or conditionally should be disclosed in the prospectus.
5. A copy of the underwirting agreement should be delivered to the Registrar
6. No underwriting commission is payable on the shares taken up the promoters,
7. Commission is payable only if the shares or debentures are offered to the general public. Commission is not payable if the issue is privately placed.
8. Commission is payable on the whole issue underwritten, even if the whole issue is taken over by the public.

The following rates for the payment of underwriting commission are in force :

	Items	on amounts devolving on the underwriters (Percentage)	on amount subscribed by by the public (percentage)
1.	Equity Shares	25	25
2.	Preference shares/convertible and		
	on convertible debentures	2.5	1.5
	a) For amounts upto Rs. 5 lakhs		
	b) For amounts in excess of 5 lakhs	2	1

(**Note :** The rates mentioned above are the maximum rates. The companies can freely negotiate such rates with underwriters).

Payment of Brokerage

Following are the (restrictions) rules with regard to payment of brokerage:

1. The rate of brokerage is fixed at 1.5% for all types of securities issued by the companies whether the issue is underwritten or not.
2. The listed companies are allowed to pay brokerage on private placement of capital at the maximum rate of 0.5%.

3. Brokerage is not paid on the amount of securities taken by promoters. It is also not paid when the institutions and banks against their underwriting commitment make the applications.
4. The expenses for advertising the issue among public will be borne by the brokers. A clause to this effect must be given in the agreement.

Fees of the Managers to the issue

When the companies appoint one or more agencies as managers to the-issue, they pay Certain amount as fees to such persons. But such fees should not be paid i) on the amounts agreed to be underwritten by financial institutions as underwriters, ii) on amounts subscribed on right basis, iii) on promoters quota. The fees paid by the companies shall not exceed the following limits.

a) For issue up to Rs. 5 crores - 0.5%

b) For issue over Rs. 5 crores - 0.2%

PROBLEMS

14. A company issues 50,000 shares of Rs. 10 each at par. The whole issue has been underwritten by X & Co. for a commission of 4%. The company received applications only for 47,000 shares. The applications were accepted. Give journal entries to record the above transactions and prepare the Balance Sheet at this stage assuming that all amounts due have been received.

Sol :

Journal entries

Sl. No.	Particulars	LF	Debit `	Credit `
1	Bank A/c Dr. To Equity Share Capital A/c (Being issue of 47,000 shares of Rs. 10 each at par)		4,70,000	4,70,000
2	X & Co. A/c Dr. To Equity Share Capital (Being the allotment of 3,000 shares of Rs. 10 each not taken up by the public)		30,000	30,000
3.	Commission on Issue of Shares A/c Dr. To X & Co. A/c (Being Commission due to X & Co. @ 4% on Rs. 50,000 shares)		20,000	20,000
4	Bank A/c Dr. To Equity Share Capital A/c (Being issue of 47,000 shares of Rs. 10 each at par)		4,70,000	4,70,000
5	Bank A/c Dr. To X & Co. (Being balance due from X & Co. received)		10,000	10,000

BALANCE SHEET OF...

as on......

Liabilities	Rs.	Assets	Rs
Share Capital		Cash at Bank	4,80,000
50,000 shares of Rs. 10 each			
fully paid	5,00,000	Commission on issue of shares	20,000
	5,00,000		5,00,000

15. Krishna underwrites the new issue of 2,000 shares of Rs. 100 each of Rama Company Limited. The agreed commission was 5% payable as 60% in cash and the rest in fully paid shares. The public subscribed for 800 shares and the rest had to be taken up by the underwirter. The shares were subsequently quoted in the market at 15% discount.

    Make necessary journal entries in the books of the company and underwriter and prepare shares account in the books of the underwriter.

Sol :

In the Books of Company

Journal Entries

S. No.	Particulars	LF	Debit `	Credit `
1	Bank A/c (800 × 100) Dr.		80,000	
	To Share Capital A/c			80,000
	(For the amount of 800 shares subscribed by public)			
2	Krishna Dr.		1,20,000	
	To Share Capital A/c			1,20,000
	(For 1,200 shares issued to Krishna, the underwriter)			
3	Underwirting Commission A/c Dr.		10,000	
	To Krishna			10,000
	(5% Commission on Rs. 2,00,000 credited to Krishna)			
4	Krishna Dr.		4,000	
	To Share Capital A/c			4,000
	(40% of the Commission paid by issuing fully paid shares)			
5	Bank A/c Dr.		1,14,000	
	To Krishna			1,14,000
	(Balance received in cash from Krishna)			

In the Books of Krishna
Journal Entries

S. No.	Particulars	LF	Debit `	Credit `
1	Shares in Rama Co. A/c Dr. To Rama Co. (Received shares not taken over by the public)		1,20,000	 1,20,000
2	Rama Co. Dr. To Underwriting Commission A/c (Commission earned on underwriting shares issued by Rama Co.)		10,000	 10,000
3	Shares in Rama Co. A/c Dr. To Rama Co. (Received shares in Rama Co. for 40% commission)		4,000	 4,000
4	Rama Co. Dr. To Bank A/c (Balance due to Rama Co. paid)		1,14,000	 1,14,000
5	Underwriting Commission A/c Dr. Profit & Loss A/c Dr. To Shares in Rama Co. A/c (Shares of Rama Co. brought down to market price i.e., 15% of Rs. 1,24,000)		10,000 8,600	 18,600

Shares in Rama Co. Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Rama Company	1,20,000	By Underwriting Commission A/c	10,000
To Rama Company	4,000	By P & L A/c (balancing figure)	8,600
		By balance c/d $\left(\frac{\text{Rs.}1,24,000 \times 85}{100}\right)$	
	1,24,000		1,24,000

16. Messrs Yesman Ltd, issued 80,000 Equity shares which were underwritten as follows:

Mr. 48,000 Equity Shares ; Messr Y & Co. 20,000 Equity Shares ; Messrs Z Corp. 12,000 Equity Shares

The above mentioned underwirters made “firm” underwriting as follows :

Mr. X–6,400 Equity Shares ; Messrs Y & Co. 8,000 Equity Shares ; Messrs Z Corp. 2,400 Equity Shares.

The total applications excluding "firm" underwriting but including market applications were for 40,000 Equity Shares.

The marked applications were as under:

Mr. X 8,000 Equity Shares ; Messrs Y & Co. 10,000 Equity Shares ; Messrs Z Corp. 4,000 Equity Shares.

(The underwriting contracts provide that underwriters be given credit for firm application and that credit for the marked applications be given in proportion to the shares underwritten).

You are required to show allocation of liability.

Sol :

Statement shown liability of underwriters in numbers of shares

Particulars	Mr.X	M/s Y & Co.	Z Corp	Total
Gross Liability (No. of Shares)	48,000	20,000	12,000	80,000
Unmarked Applications				
(40,000 – 22,000 = 18, 000) (Ratio 48:20:12)	10,800	4,500	2,700	18,000
	37,200	15,500	9,300	62,000
(–) Marked Applications	8,000	10,000	4,000	22,000
	29,200	5,500	5,300	40,000
(–) Firm Underwriting	6,400	8,000	2,400	16,800
Balance to be taken under the contract	22,800	–2,500	2,900	23,200
(–) Credit for excess of Y & Co. (Ratio 48:12)	2,000	+2,500	500	
Net Liability	20,800	–	2,400	23,200
Add : Firm Underwriting	6,400	8,000	2,400	16,800
Total liability	**27,200**	**8,000**	**4,800**	**40,000**

3.4 Bonus Shares

3.4.1 Meaning

Q22. What is Bonus Share ? Explain its Provisions.

Ans : **(June-19, Dec.-17, Imp.)**

When a company wants to mobilise any portion of its accumulated profits, the company may issue bonus (free) shares to its existing shareholders. Issue of bonus shares means issue of shares thus increasing the share capital by distribution of accumulated profits/reserves to the shareholders without any cash payment to them. Therefore, issue of bonus shares amounts to payment of dividend in kind i.e., in the form of shares issued without any cash payment.

By issuing bonus shares, the company is able to follow the policy of 'Retention' of profits in the business. A bonus issue may be made out of the retained profits of the current or the past years and may include the revenue as well as any capital profit also.

Provisions of the Companies Act Regarding Issue of Bonus Shares

According to Section 52, the securities premium may be applied in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Section 55 provides that the capital redemption reserve account may be applied by the company in paying up unissued shares to the company to be issued to members of the company as fully paid bonus shares. As per Section 63 of the Companies Act, 2013, a company may issue fully paid-up bonus shares to its members in any manner, out of –

(i) its free reserves

(ii) the securities premium account; or

(iii) the capital redemption reserve account

3.4.2 SEBI Guidelines for Issue of Bonus Shares

Q23. What are the SEBI Guidelines for Issue of Bonus Shares.

Ans :

The company shall, while issuing bonus shares, ensure the following

a) The bonus issue is made out of free reserves built out of the genuine profits or securities premium reserve collected in cash only.

b) Reserves created by revaluation of fixed assets are not capitalised.

c) The declaration of bonus issue, in lieu of dividend, is not made.

d) The bonus issue is not made unless the partly paid shares, if any existing, are made fully paid-up

e) The company has not defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption thereof and has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus etc.

f) A company which announces its bonus issue after the approval of the Board of Directors must implement the proposal within a period of six months from the date of such approval and shall not have the option of changing the decision.

g) There should be a provision in the Articles of Association of the company for capitalisation of reserves, and if not, the company shall pass a resolution as its general body meeting making provisions in the Articles of Association for capitalisation

h) Consequent to the issue of bonus shares if the subscribed and paid-up capital exceed the authorised share capital, a resolution shall be passed by the company at its general body meeting for increasing the authorised capital.

i) The company shall get a resolution passed at its general body meeting for bonus issue and in the said resolution the management's intention regarding the rate of dividend to the declared in the year immediately after the bonus issue should be indicated.

j) No bonus issue will be made which will dilute the value of rights of the holders of debentures, convertible fully or partly.

Free Reserves that can be used for Issue of Bonus Shares

1. Surplus Account (i.e., credit balance of profit and Loss A/c carried forward)
2. General reserve
3. Dividend equalisation reserve.
4. Capital reserve arising from profit on sale of fixed assets received in cash.
5. Balance in debenture redemption reserve after redemption of debentures
6. Capital Redemption Reserve Account created at the time of redemption of redeemable preference shares out of the profits
7. Securities Premium Reserve collected in cash only

It may be remembered that both the above accounts (Item nos. 6 & 7) can be utilised only for issuing fully paid bonus shares and not for making partly paid shares fully paid shares.

If Reserves Not Available for Issue of Bonus Shares

1. Capital reserve arising due to revaluation of assets
2. Securities Premium Reserve arising on issue of shares on amalgamation or take over.
3. Investment allowance reserve/Development rebate reserve before expiry of 4 years of creation.
4. Balance in debenture redemption reserve account before redemption takes place.
5. Surplus arising from a change in the method of charging depreciation.

3.4.3 Accounting Treatment of Bonus Shares

Q24. Explain about Accounting treatment for Issue of Bonus Shares.

Ans :

A. If the bonus is utilised for making partly paid shares as fully paid shares as fully paid shares the entries will be

i. Profit and loss Account Dr.
or General Reserve Account Dr.
or Capital Reserve Account Dr.
To Bonus To shareholder Account
(Being the amount transferred to bonus to shareholders account

ii. Share Final Call Account Dr.
To share Capital Account
(Being final call due on shares)

iii. Bonus to Shareholders Account Dr.
To Share final Account
(Being the Bonus to shareholders utilised towards share final call a/c)

B. For issuing full paid Bonus Shares

i. Profit and Loss A/c Dr.
or General Reserve A/c Dr.
or Capital Reserve A/c Dr.
or Securities Premium A/c Dr
or Capital Redemption Reserve A/c Dr.
or Any other Reserve A/c Dr.
To Bonus to Shareholders A/c
(Being the Profit & Loss A/c and reserves transferred to Bonus to Shareholders A/c)

ii. Bonus to Shareholders A/c Dr.
To Share Capital A/c
To Securities Premium A/c (if any)
(Being the issue of Bonus Shares)

PROBLEMS ON BONUS SHARES

17. The Balance Sheet of ABC Ltd on 31.03.2013, as follows:

Liabilities	₹	Assets	₹
40,000 Equity shares of Rs. 100 each Rs. 80 paidup	3,20,000	Sundry Assets	10,00,000
Share Premium	60,000		
Capital Redemption Reserve	70,000		
General REserve	1,00,000		
Profit & Liss A/c	3,00,000		
Sundry Creditors	1,50,000		
	10,00,000		10,00,000

The directors recommended the following with a view to capitalize the whole of Share Premium Account, capital Redemption Reserve Account, General Reserve and Rs. 90,000 out of Profit and Loss Account

i) The existing shares be made fully paid without the share holders having to pay anything

ii) Each Share holder to be given fully paid Bonus Shares for the remaining Amount in proportion to their holdings.

Give journal entries and prepare Balance Sheet After the above resoultions are implemented and also shown in that proportions Bonus Shares will be distributed among the share holders.

Sol :

Date	Particulars	LF	Debit (₹)	Credit (₹)
1.	Profit & Loss A/c Dr		80,000	
	To Bonus to shareholders A/c			80,000
	(Being the amount transferred to bonus to share holders A/c)			
2.	Share Final Call A/c Dr		80,000	
	To Share Capital A/c			80,000
	(Being final call due on shares)			
3.	Bonus to share holders A/c Dr		80,000	
	To Share Final Call A/c			80,000
	(Being the bonus to share holders utilised towards share final call a/c) For issuing fully paid bonus shares			
4.	Security premium A/c Dr		60,000	
	Capital Redemption A/c Dr		70,000	
	General Reserve A/c Dr		100,000	
	P & L A/c Dr		10,000	
	To Bonus Shareholders a/c			2,40,000
	(Being reserves and the P&L a/c transferred to bonus to shareholders a/c)			

5. Bonus to Shareholders A/c Dr		2,40,000	
To Share capital A/c			2,40,000
(Being the issue of bonus shares)			

Working Notes :

- Calculation of total amount available for issue of fully paid bonus shares.

  Share premium + Capital Redemption Reserve + General Reserve + Balance in P & L A/c

  60,000 + 70,000 + 1,00,000 + 10,000

  = 2,40,000

- Calculation of Bonus shares to be issued

$$= \frac{\text{Total amount available}}{\text{Face value of equity share}}$$

$$= \frac{2,40,000}{100}$$

= 2400 bonus shares

For 4,000 shares – 2,400 bonus shares

4000 – 2400

5 : 3

For every 5 shares – Co. issuing 3 bonus shares.

18. Liabilities and Assets of Sowmya Ltd on 31st March, 2013 were as follows.

Liabilities	Amount Rs.	Assets	Amount Rs.
4000 Equity shares of Rs. 100 each, Rs. 80 paid up	3,20,000	Sundry Assets	9,20,000
Securities premium account	70,000		
Capital redemption reserve	80,000		
General reserve	1,00,000		
Profit and loss account	1,50,000		
Sundry creditors	2,00,000		
	9,20,000		9,20,000

The directors recommended the following with a view to capitalizing whole of capital redemption reserve, securities premium account, general and Rs. 30,000 out of profit and loss account.

1. The existing shares are made fully paid without the share holders having to pay anything.
2. Each shareholder to be given fully paid bonus share for every two shares held by them.

Assuming that the scheme is accepted and all the formalities are gone through. Give journal entries and also show the balance sheet after bonus issue.

Sol : **Journal Entries in the Books of Soumya Ltd.**

Particulars			Rs. Debit	Rs. Credit
I.	**Party paid up shares converted into fully paid up shares**			
	Bonus = 4000 shares × Rs. 20 = Rs. 80,000			
	i) Profit & Loss A/c	Dr	30,000	-
	General Reserve A/c	Dr	50,000	-
	To Bonus to share holders A/c		-	80,000
	[Being profit & loss A/c General Reserve transferred to Bonus to share holders A/c]			
	ii) Share final call A/c	Dr	80,000	-
	To share capital A/c		-	80,000
	[Being share final call due]			
	iii) Bonus to share holders A/c	Dr	80,000	-
	To share final call A/c		-	80,000
	[Being Bonus to share holders utilised towards share final call]			
II.	**Free fully paid bonus share issued**			
	Total Bonus		2,80,000	
	[70,000 + 80,000 + 1,00,000 + 30,000]			
	(–) Bonus amount of partly shares	80,000		
		2,00,000		
	1. Securities premium A/c	Dr	70,000	-
	Capital redemption reserve A/c	Dr	80,000	-
	General Reserve A/c	Dr	50,000	-
	To Bonus to share holders A/c		-	2,00,000
	[Being securities premium, CRR, General Reserve transferred to Bonus to share holders]			
	2. Bonus to share holders A/c	Dr	2,00,000	-
	To share capital A/c		-	2,00,000
	[Being free fully paid bonus shares issued]			

SOWMYA Ltd

Balance Sheet as on 31st/March/2013

Particulars	Note No	Current Year	Prev Yr
Equity & Liabilities			
I. Share Holders Funds			
a) Share capital	01	6,00,000	-
b) Reserves & Surplus	02	1,20,000	-
II. Non-Current Liabilities			
III. Current Liabilities			
a) Trade payables (sundry creditors)		2,00,000	-
Total		9,20,000	-
Assets			
I. Non-Current Assets			
a) Sundry assets		9,20,000	-
II. Current Assets		-	
		9,20,000	-

Note to Balance Sheet

Note 1 : Share Capital

Total shares

No. of equity shares	4,000
(+) No. of shares issued as Bonus $\left[\frac{2,00,000}{100}\right]$	2,000
	6,000
(i) Share capital [6000 shares of Rs. 100 each]	6,00,000

Note 2 : Reserves & Surplus

(i) Profit & Loss [1,50,000 – 30,000] 1,20,000

19. Liabilities and Assets of Sowmya Ltd on 31st March, 2013 were as follows.

Liabilities	Amount Rs.	Assets	Amount Rs.
5000 Equity shares of Rs. 100 each, Rs. 80 paid up	4,00,000	Sundry Assets	11,40,000
Securities premium account	80,000		
Capital redemption reserve	90,000		
General reserve	1,20,000		
Profit and loss account	2,50,000		
Sundry creditors	2,00,000		
	11,40,000		11,40,000

At the annual general body meeting it was resolved:

1. To convert partly paid shares into fully paid by utilizing profit and loss account and
2. To issue one bonus share for every two shares held as on the date of last balance sheet.

   Pass necessary journal entries to give effect to the resolution and prepare balance sheet after bonus issues.

Sol :

Journal Entries

Particulars	Rs. Debit	Rs. Credit
I. Party paid up shares converted into fully paid up shares		
Bonus = 5000 shares × Rs. 20 = Rs. 1,00,000		
i) Profit & Loss A/c Dr	1,00,000	-
To Bonus to share holders A/c	-	1,00,000
[Being profit & loss transferred to Bonus to share holders A/c]		
ii) Share final call A/c Dr	1,00,000	-
To share capital A/c	-	1,00,000
[Being share final call due		
iii) Bonus to share holders A/c Dr	1,00,000	-
To share final call A/c	-	1,00,000
[Being Bonus to share holders utilised towards share final call]		
II. Free fully paid bonus share issued		
For every 2 shares – 1 Bonus share		
For 5000 shares – ?		
$\frac{5000 \times 1}{2}$ = 2500 Bonus share		
Bonus amount = 2500 × Rs. 100 = Rs. 2,50,000		
1. Securities premium A/c Dr	80,000	-
Capital redemption reserve A/c Dr	90,000	-
General Reserve A/c Dr	80,000	-
To Bonus to share holders A/c	-	2,50,000
[Being securities premium, CRR, General Reserve transferred to Bonus to share holders]		
2. Bonus to share holders A/c Dr	2,50,000	-
To share capital A/c	-	2,50,000
[Being 2500 free fully paid bonus shares are issued at Rs. 100 each]		

SOWMYA Ltd

Balance Sheet as on 31st/March/2013

Particulars	Note No	Current Year	Prev Yr
Equity & Liabilities			
I. Share Holders Funds			
a) Share capital	01	7,50,000	-
b) Reserves & Surplus	02	1,90,000	-
II. Non-Current Liabilities			
Long term borrowings		-	-
III. Current Liabilities			
Trade payables (sundry creditors)		2,00,000	-
Total		11,40,000	-
Assets			
I. Non-Current Assets			
a) Fixed assets [sundry assets]		11,40,000	-
II. Current Assets		-	
		11,40,000	-

Notes Related to Balance Sheet

1. Share Capital

a) Issued capital [5000 shares × Rs. 100]	=	5,00,000
b) Additional shares issued as Bonus [2500 × Rs. 100]	=	2,50,000
		7,50,000

2. Reserve and Surplus

a) Profit and Loss A/c [2,50,000 – 1,00,000]	1,50,000
b) General reserve [1,20,000 – 80,000]	40,000
	1,90,000

Short Question and Answers

1. What is company?

Ans :

According to Section 3(l)(i) of the Companies Act 1956, "a company means a company formed and registered under this Act or an existing company". An existing company means, "A company formed and registered under any of the previous Companies Law".

According to Chief Justice Marshal : "A company is a person artificial, invisible, intangible and existing only in the eyes of the law. Being a mere creature of law, it possesses only those properties which the charter of its creation confers upon it either expressly or as incidental to its very existence. It has no physical existence but exists only in contemplation of law."

2. Explain about types of Companies.

Ans :

1. Chartered Companies
2. Statutory Companies
3. Registered Companies
   (i) Companies Limited by Shares
   (ii) Companies Limited by Guarantee
   (iii) Unlimited Companies
4. Private Companies Sec. 2(68)
5. Public Company Sec. 2(71)
   (i) Government Company Sec. 2(45)
   (ii) Non-Government Com-pany
   (iii) Foreign Company Sec. 2(42)

3. What is share ? Explain about types of share capital.

Ans :

A share is a fractional part of the (Share) capital and provides the basis for ownership in the company.

Nature of a share

(i) share gives some rights and liabilities to the shareholder

(ii) shareholder is not part owner of the company or its property during the life time of the company.

(iii) the share is a movable property

(iv) share is goods

Types of Share Capital

(i) Authorised or nominal or registered capital

(ii) Issued capital

(iii) Subscribed capital

(iv) Called-up capital

(v) Paid-up share capital

(vi) Uncalled share capital

(vii) Reserve capital

4. Explain about Classification of Shares?

Ans :

I. Preference Shares

Types of Preference Shares

- Cumulative Preference Shares
- Non-cumulative Preference Shares
- Participating Preference Shares
- Non-Participating Preference Shares
- Convertible Preference Shares
- Non-convertible Preference Shares
- Redeemable Preference Shares

II. Equity Shares

5. How stocks are differ with shares ?

Ans :

The distinction between shares and stock may be summarised as follows :

(i) Shares are in units of share capital and have a fixed nominal value whereas stock is divisible into smaller portions each having nominal value as desired.

(ii) Shares can be issued directly; stock cannot be issued directly.

(iii) Shares may or may not be fully paid but stock must be fully paid.

(iv) Shares should be numbered whereas stock is not numbered.

(v) Shares cannot be transferred in fractional amounts but stock can be transferred in fractional amounts although the articles may provide the minimum fractional amount of stock which can be transferred.

(vi) Formalities of voting and transfer of shares and stock are also different.

(vii) As noted above, shares may be subsequenly converted into stock when fully paid up. But the share capital of the company cannot be offered directly in the form of stock.

6. Difference between Preference Shares and Equity Shares

Ans :

Preference Shares	Equity Shares
1. Preference Dividend is paid before paying any dividend on equity shares	1. Equity shareholders, will get dividend only after paying dividend to preference shareholders
2. At the time of liquidation, after payment of creditors, preference shares are redeemed	2. Equity shares are repaid after full repayment is made on preference shares
3. The rate of dividend is fixed	3. Rate of dividend is not fixed, it may vary from year to year
4. In case of preference shares (cumshares) arrears of dividend will accumulate	4. There is no question of accumulation of arrears of dividend
5. Preference Shares (conventible Pref. Shares) can be converted into Equity Shares	5. Equity shares cannot be converted into preference shares
6. Preference shareholders to not have voting	6. Equity shareholders have voting right
7. Reddemable preference share are redeemable according to the provisions of Sec 55 of the Companies Act 2013.	7. There is no provision for redemption of equity shares

7. Over-subscription and Under-subscription

Ans :

- **Over-subscription :** Sometimes the applications received will be for more number of shares than are issued to the public. However, allotment can be made only equal to the number of shares that are issued. In such a case, Directors will have to refuse allotment to some applicants.

  Excess money on Application : When the pro rata system of allotment is made, the applica-tion money received will be in excess of the number allotted. This excess money received on un-allotted shares can be either, (a) refunded to the respective applicants, or (b) used for adjusting the amount due on the shares allotted.

- **Under-suhscription :** Sometimes the application for shares is received for less than the number of shares issued. This is called under-subscription. In such a case, the allotment will be equal to the number of shares subscribed for and not to the shares issued.

8. What is calls in advance and calls in arrears ?

Ans

Calls in Advance

Calls in advance refer to the amount paid by shareholders in excess of the amount due from them. A company may accept calls in advance only if authorised by the Articles. Such amount should be credited to a separate account called "Calls in Advance" account and not to share capital account.

Calls in Arrears

Calls in arrears refers to the amount called by the company which is not paid by the share-holders before the due date fixed for payment. Generally such amount is transferred to special account called "calls in arrears account".

9. Issue of Shares at Premium

Ans :

Companies may issue shares at premium i.e., at a price higher than its face value. The difference between issue price and face value is a capital profit and therefore should be credited to a separate account called "Securities Premium Account". According to Section 52 of the Companies Act, 2013, Share premium can be used for the following purposes.

i) For the issue of fully paid bonus shares to the members of the company.

ii) For writing off preliminary expenses of the company.

iii) For writing off expenses of commission paid or discount allowed on any issue of shares or debentures of the company; and

iv) For providing premium payable on the redemption of any redeemable preference shares or debentures of the company.

10. Issue of Shares at Discount

Ans :

"At discount" means at a price less than the nominal value. When the company issues shares at a price which is less than the face value (or nominal value or par value) of the share, it is said that shares have been issued at discount.

Acording to Section 53 of the Companies Act 2013, a Company cannot issue shares at a discount except in case of issue of sweat equity shares (issued to employees and directions).

For example if a share of Rs. 100 is issued for a cash consideration of Rs. 95, it is issued at a discount of Rs. 5 per share.

11. What is Prorata allotment ?

Ans :

Over Subscription of Shares

When the number of shares applied for is more than the number of shares offered to the public, the issue is said to be oversubscribed. In such a situation, the directors allot shares on some reasonable basis because the company can allot only that number which is actually offered for subscription. In brief, the procedure adopted on oversubscription may be as follows :

(i) total rejection of some applications because of some technical defect e.g., insufficient application money;

(ii) acceptance of some applications in full, that is, full allotment;

(iii) allotment to the remaining applicants on *pro-rata* basis.

Pro-Rata Allotment

In the case of pro-rata allotment no application for shares is refused and no applicant is allotted the shares in full. Each applicant receives the shares in the same proportion, that is, the total shares offered are allotted to total shares applied for.

12. What is forfeiture of share?

Ans :

A member is liable to pay the full issue price of his shares and the amount unpaid on his shares is a debt due from him to the company. Thus if a shareholder fails to pay any valid call or instalment of a call on due date, his shares may be forefeited by the Board if authorised by the articles of association of the company.

13. What is Debenture ?

Ans :

Debentures are therefore part of loan capital and the company is liable to pay interest thereon whether there are profits or not.

Section 2 (30) of the Companies Act, 2013 states that: "a debenture includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of a company or not" It is clear that this definition does not describe the true nature of a debenture.

According to Topham: "Debenture is a document given by a company as evidence of debt to the holder usually arising out of a loan and most commonly secured by a charge".

14. Basic characteristics of a Debenture

Ans :

The main characteristics of a debenture may be listed as under :

(i) **Document in writing:** Debenture is issued by the company in the form of a certificate like share certificate. So a debenture is a document in writing.

(ii) **Acknowledgement of a debt**: A debenture certificate contains an acknowledgement of the debt of a stated sum the company owes to the person named therein.

(iii) **Compulsory payment of interest** : The document promises that fixed rate of interest will be paid periodically, to the person named in the certificate until the principal amount is paid back. It is immaterial whether the company makes a profit or not.

(iv) **Repayment of borrowed sum** : The document usually states the sum borrowed will be repaid by the company on or before a certain date

(v) **Common seal** : Debentures are generally issued under the common seal of the company. However, it has been held that a debenture certificate signed by two directors of a company and without bearing the seal of a company is still a valid debenture certificate.

(vi) **No voting right**: Debentures carry no voting rights at any meeting of the company.

15. What is Underwriting ?

Ans :

A private company can start its business activities by getting the certificate of incorporation. But to start the business, a public company must get certificate of commencement of business apart from getting of certificate of incorporation. To get this certificate a company must raise at least minimum subscription amount from the sale of shares. Companies are not sure whether the public may take up the shares and debentures offered for subscription. These arises a risk to ensure the success of issue. Therefore, the companies make an arrangement with financial institution that agree to take up or guarantee to subscribe all shares of debentures of the company for which public sub-scriptions have not been obtained. Such an arrangement or agreement is known as underwriting and the institutions with which such agreement is entered are called 'underwriters'.

16. What is Bonus Share ?

Ans :

When a company wants to mobilise any portion of its accumulated profits, the company may issue bonus (free) shares to its existing shareholders. Issue of bonus shares means issue of shares thus increasing the share capital by distribution of accumulated profits/reserves to the shareholders without any cash payment to them. Therefore, issue of bonus shares amounts to payment of dividend in kind i.e., in the form of shares issued without any cash payment.

Choose the Correct Answers

1. The term company is defined under which sec of the Act? [c]

   (a) Section 2 (4) (b) Section 4 (2)

   (c) Section 3 (1) (d) Section 1 (3)

2. Which company shares can be freely transferable [a]

   (a) Private Company (b) Public Company

   (c) Both (a) & (b) (d) None of the above

3. Minimum number of members in case of public company [d]

   (a) 1 (b) 2

   (c) 5 (d) 7

4. Minimum number of members in case of private company is [b]

   (a) 1 (b) 2

   (c) 3 (d) 5

5. Minimum subscription should be received with in ________ days [c]

   (a) 130 (b) 125

   (c) 120 (d) 135

6. If minimum subscription is not received application money should be refunded with in ________ days. [d]

   (a) 20 (b) 25

   (c) 30 (d) 10

7. Liability of a member in case of a private company is [c]

   (a) Limited (b) Unlimited

   (c) Both(a)or(b) (d) None of the above

8. Minimum paid up share capital in case of a private company is ________ [a]

   (a) 1 Lakh (b) 2 Lakhs

   (c) 3 Lakhs (d) 4 Lakhs

9. Minimum paid up share capital in case of a public company is ________ [c]

   (a) 1 Lakh (b) 3 Lakhs

   (c) 5 Lakhs (d) 7 Lakhs

10. Equity share holders are the ________ of the company [c]

    a) Partners b) Directors

    c) Owners d) Managers

Fill in the Blanks

1. In general cases Bonus shall be paid with in ________.
2. Allotment of shares or debentures must be made after getting ________ subscription against entire public issue as per SEBI guidelines.
3. As per SEBI guidelines the application money should be minimum of ________.
4. ________ includes any amount borrowed by a company.
5. Maximum period that can be extended by appropriate Government for payment of Bonus ________.
6. ________ is a charge created on a class of assets related to ordinary course of business.
7. The companies which are formed under companies Act. 1956. They will be called as ________.
8. Debenture holders are ________ of the company.
9. Preferance share holders are preferred in ________.
10. Sweat equity shares are issued to only ________.

Answers

1. 8 months
2. 90%
3. 25%
4. Deposits
5. 2 years
6. Flotationg charge
7. Registered Companies
8. Creditors
9. Distribution of Profits
10. Directors and Employees

UNIT IV

Company Final Accounts and Profit Prior to Incorporation :
Companies Act 2013: Structure – General Instructions for preparation of Balance Sheet and Statement of Profit and Loss – Part-I: Form of Balance Sheet – Part-II: Statement of Profit and Loss – Preparation of Final Accounts of Companies - Profits Prior to Incorporation- Accounting treatment. (Including problems)

4.1 Companies Act 2013

Q1. Explain about Company final Accounts as per companies Act, 2013.

Ans :

According to Section 128 Companies Act, 2013 every company shall keep at its registered office proper books of accounts regarding :

a. all sums of money received and expended by the company and matters in respect of which the receipts and expenditure take place;

b. all sales and purchases of goods by the company.

c. the assets and liabilities of the company, and

d. in case of a company pertaining to any class of companies engaged in production, processing, manufacturing or mining activities, such particulars relating to utilization of material or labour or to other items of cost as may be prescribed.

Books of Accounts

According to Companies Act, 2013 the companies should generally maintain the following books of accounts.

1. Cash Book to record cash and bank transactions.
2. Purchases Book to record credit purchases.
3. Sales Day Book to record credit sales.
4. Returns Inwards Book or Sales Returns Book to record goods returned by customers.
5. Returns Outwards Book or Purchases Returns Book to record goods returned by the company to suppliers.
6. Bills Receivable Book to record the details of bills receivable.
7. Bills Payable Book to record the details of bills payable.
8. Journal proper to record opening, closing and adjusting entries.
9. General Ledger showing all accounts other than the accounts of customers and suppliers.
10. Debtors Ledger showing accounts of customers.
11. Creditors Ledger showing accounts of suppliers.

Statutory Books

As per the requirements of the Companies Act, 2013 the following statutory books have to be maintained.

1. Registers of Investments held in Company's name.
2. Register of Charges.
3. Register of Members.
4. Register of Debenture holders..
5. Copies of Annual Returns.
6. Minutes Books of General Meetings and Meetings of Board of Directors.
7. Register of Contracts, Companies and firms in which directors are interested.

8. Register of directors, managers, managing directors and secretary.

9. Registers of Directors' shareholdings etc.

10. Register of Loans made to other companies under the same management.

Statistical Books

In addition to books of account and statutory books companies usually maintain the following books which give detailed information regarding holding and transfer of shares and debentures, calls made on shareholders and debenture holders, interest paid to debenture holders,, share warrants etc.,

1) Share Application and Allotment Book (2) Share Call Book (3) Debenture Application and Allotment Book (4) Debenture Call Book (5) Register of Share Transfer (6) Shareholders Dividend Book (7) Debenture Interest Book (8) Debenture Transfer Register (9) Register of share certificates (10) Agenda Books etc.

Annual Accounts

The final accounts of a company consists of two basic financial statements namely statement of Profit and Loss and Balance Sheet Under section 129 of the companies Act, 2013 at the annual general meeting of a company the Board of Directors of the company shall lay financial statements before the company. Financial Statements as per section 2(40) of the companies Act 2013, interalia include.

a. A Balance Sheet as at the end of the financial year

b. A Profit and Loss statement

c. Cash flow statement

As per section 129 of the Act, Financial Statements shall give a true and fair view of the State of Affairs of the company. While preparing final accounts the following points should be noted carefully.

1. Requirements of the schedule III of the Companies Act

2. Other statutory requirements

3. Accounting standards issued by the Institute of chartered Accountants of India notified by the Central Govt.

4. Statements and guidance Notes issued by the Institute of Chartered Accountants of India.

As per Section 133 of the Companies Act it is mandatory to comply with Accounting Standards notified by the Central Government from time to time.

Features of Schedule III

Schedule III of the Company Act, 2013, provides that the manner in which a company (whether public or private) shall prepare its Balance Sheet and Statement Profit or Loss and notes there to. It has been introduced to bring more transparency and to make financial statements more comprehensive by more disclosure requirements. The important features of Schedule III are summarised below :

1. It is investor friendly, easily readable and transparent.

2. New detailed disclosure requirements have been introduced.

3. Disclosure of Schedule III are in addition to and not in substitution of disclosures required under Accounting Standards and Companies Act, 2013.

4. Schedule III gives prescribed formats for both the Balance Sheet and the statement of Profit or Loss.

5. Schedule III prescribes only vertical format for presentation of financial statements.

6. Only broad and significant items are to be shown of the face of the financial statements additional information are to be provided in the notes to accounts.
7. All the elements in the Balance Sheet are to be classified as assets, liabilities or equity.
8. The most significant feature of Schedule III is that all items of assets and liabilities an current or non-current and presented separately on the face of the balance sheet. Accordingly, current maturities of a long-term borrowing will now be classified under the head 'other current liabilities'.
9. Details pertaining to aggregate number and class of shares allotted for consideration other than cash, bonus shares and shares bought back shall be disclosed only if such an event has occurred during a period of 5 years immediately preceding the balance sheet date.
10. Debit/negative balance of any reserve or statement of profit and loss shall be shown only under the head 'reserves and surplus', even if the total is negative.
11. Bifurcation of fixed assets into tangible and intangible as separate items on the face of the balance sheet is a new requirement under Schedule III.
12. The terms 'sundry debtors' and 'sundry creditors' have been replaced by the terms 'trade receivables' and 'trade payables' respectively. Hence debtors/creditors other than for goods and services cannot be grouped under trade receivables/payables. These are to be disclosed separately in the balance sheet. Bills receivable will form part of trade receivables and bills payable part of trade payables.
13. The format for statement of profit and loss does not list any appropriation item on its face. All appropriations are to be shown as 'notes to accounts' under 'reserves and surplus' in the balance sheet.
14. Unamortised portion of expenses such as ancillary borrowing costs, discount or premium on borrowings either to called as 'miscellaneous expenditure') no longer to be shown as a separate head under assets. These have to be disclosed under 'other current/non- current assets' depending on whether the amount will be fully amortised in the next 12 months or thereafter.
15. Specific disclosures are prescribed for share application money dividing the same into two parts as under :
    a) Share application money not exceeding the capital offered for issuance and to the extent not refundable will be shown separately on the face of the balance sheet under equity.
    b) Share application money refundable will be shown under the head 'other current liabilities.
16. Capital advances (i.e., advances given for acquiring fixed assets) are now required to " presented separately under the head 'long-term loans and advances' rather than as 'capital work-in-progress'. These are treated as non-current because on receiving the fixed assets the capital advance would get transferred into another non-current asset.
17. Details of all commitments are to be disclosed and not only of capital commitments.

4.1.1 Forma of Balance Sheet

Q2. Explain the format of Balance Sheet.

Ans : **(Imp.)**

The new vertical format of the balance sheet as prescribed in part I of the schedule III is as follows :

Balance Sheet of ..... Company Limited as on 31st March

	Particulars	Note No.	Amount (Rs.)
EQUITY AND LIABILITIES		1	
1	**Shareholder's Funds:**		
	a) Share Capital		
	b) Reserves and Surplus		
	c) Money received against share warrants		(Not to be evaluated)
2	Share Application Money pending allotment :		(Not to be evaluated)
3	**Non – Current Liabilities**		
	a) Long-term borrowings		
	b) Deferred Tax Liabilities (Net)		(Not to be evaluated)
	c) Other Long Term Liabilities		(Not to be evaluated)
	d) Long-term provisions		
4	**Current Liabilities :**		
	a) Short-term borrowing		
	b) Trade payables		
	c) Other current liabilities		
	d) Short-term provisions		
	TOTAL (1+2+3+4)		
II. ASSETS			
1. Non-Current Assets			
a)	**Fixed Assets**		
	i) Tangible Assets		
	ii) Intangible Assets		
b)	**Non-Current Assets :**		
c)	**Long Term Loans & Advances**		
d)	**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 [1 + 2]		

4.1.2 General Instructions for Preparation of Balance Sheet

Q3. What are the General instructions while preparing the balance sheet ?

Ans : **(Dec.-17, Imp.)**

I) Items Appearing under the Head Equity and Liabilities in the Balance Sheet

1) Shareholders Funds

a) The number of shares and amount of shares authorized

b) The number of shares issued

c) The number of shares subscribed

d) The number of shares fully subscribed

e) The number of shares subscribed but not fully paid

f) The par value per share

g) Amount of calls unpaid

h) The number of shares forfeited

Note : Equity Share Capital and Preference Share Capital to be shown separately.

2) Reserves and Surplus : The following items are shown under this head :

i) Capital Reserves

ii) Capital Redemption Reserve

iii) Securities Premium

iv) Debenture Redemption Reserve

v) Revaluation Reserve (Accounting Treatment-Not to be evaluated)

vi) Share options Outstanding Account (Accounting Treatment-Not to be evaluated);

vii) Other reserves (restricted to General Reserve only);

The balance of 'Reserve and Surplus', after adjusting negative balance of surplus, if any, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in negative.

3) Money received against share warrants : (Accounting Treatment-Not to be evaluated)

4) Share application money pending allotment : (Accounting Treatment-Not to be evaluated)

5) Deferred Tax Liabilities : (Net) (Accounting Treatment - Not to be Evaluated)

6) Non-current liabilities : Current and Non-Current Liabilities is defined in the Companies Act as follows 'Non-Current Liabilities.' are those liabilities which are not current liabilities. The term 'Current Liabilities' is defined as follows : "Current Liability' is that liability which is

i) Expected to be settled in company's normal operating cycle.

ii) Due to be settled within 12 months after the reporting date i.e. Balance Sheet.

iii) Held primarily for the purpose of being traded.

iv) There is no unconditional right to defer settlement for at least 12 months after the reporting date

Operating Cycle : Operating cycle is the time between the acquisition of an asset for processing and realisation in cash and cash equivalents. Operating cycle, normally, is of 12 months.

7) Long Term borrowing : Debentures/Bonds, Bank Loans, Long Term Loans, Mortgage Loans, public Deposits etc.

8) Other Long Term Liabilities : Accounting Treatment - Not to be evaluated.

Intercompany Owings from associates, subsidiaries or other companies, long term trade payable.

9) Long Term Provisions : Provisions for Employee Benevolent/Welfare Fund, Provident Fund, Gratuity Fund, Provision for Warranties, Provision for Pension Fund etc.

10) Current Liabilities :

a) Short-term borrowings : Loans repayable on demand from banks and other parties, Bank Overdraft, Cash credits.

b) Trade Payables : Sundry Creditors, Bills payable, Outstanding Expenses

c) Other Current Liabilities : Unpaid dividends, Interest accrued and due or not due on borrowings, Income received in advance, Calls in advance, o/s Interest on calls in advance.

d) Short-term Provisions : provisions for tax and proposed dividend

II) Items Appearing under the Head Assets in the Balance Sheet

1. Non-current Assets :

a) Fixed Assets :

i) Tangible Assets : Land, Building, Plant and Equipment, Furniture & Fixture, Vehicles, Office Equipment, Live Stock, Railway sidings etc.

ii) Intangible Assets :

a) Goodwill

b) Brand/Trademarks

c) Computer Software & Mining rights

d) Masthead and Publishing titles.

e) Copyrights, and patents and other intellectual property rights, services and operating rights,

f) Receipts, formulae, models, designs and prototypes

g) Licenses and franchise

iii) Capital work in Progress : (Accounting Treatment - Not to be evaluated)

iv) Intangible Assets under Development : like patents, intellectual property rights, etc. which are being developed by the company. (Accounting Treatment - Not to be evaluated).

b) Non-Current Investments **:** Investments/ Trade Investments and Non-trade investment (If it is a long term)

Investments Classified in the following :

a) Investments in equity and preference shares

b) Investments in govt. and trust securities

c) Investments in debentures & bonds

d) Investments in mutual funds.

c) Deferred Tax Assets (Net) : Accounting Treatment - Not to be evaluated.

d) Long-term Loans and Advances : Only capital Advances and Security Deposits

e) Other non-current assets :

- Preliminary Expenses
- Discount on Issue of shares/debentures
- Underwriting Commission
- Deferred revenue expenses/Discount on issue of shares/debenture/Share expenses.

2. Current Assets

a) Current Investments :

(Investments in Equity Instruments (Shares), Preference shares, Government Securities, Debentures, and Mutual Funds etc.) (for short duration, i.e, meant for resale)

b) Inventories : Inventories include the following :

i) Raw material

ii) Work-in-progress

iii) Finished goods

iv) Stock-in-trade (in respect of goods acquired for trading)

v) Stores and Spares

vi) Loose Tools

c) Trade Receivables : Debtors and Bills receivables.

d) Cash and Cash equivalents :

a) balance with banks

b) Cheques, drafts on hand

c) Cash in hand

d) Deposit with banks

e) Short-term Loans and Advances : (short term loans/advances given to employees)

f) Other Current Assets : (Restricted to prepaid expenses, accrued incomes, interest accrued on investments, advance tax)

Provision for Doubtful Debts

As per note and explanation for the preparation of financial statements it is stated that Allowance of bad and doubtful debts shall be disclosed under the relevant head separately. It leads to two approaches. First Approach the Provision for doubtful debts is shown under either Long term provision or short term provisions depending on whether trade Receivables are longterm or short-term.

Second Approach

The amount of Provision for doubtful debts is shown by way of deduction from the amount shown under Trade Receivables.

3. Contingent Liabilities and Capital Commitments (Not to be evaluated)

a) Contingent Liabilities - Those liabilities which may or may not arise because they are dependent on a happening in future. It is not recorded in the books of accounts but is disclosed in the Notes to Accounts for the information of the users. (Claims against the company not acknowledged as debts, Guarantees, Other money for which the company is contingently liable).

b) Capital commitments - A future liability for capital expenditure in respect of which contacts have been made. (Uncalled liability on shares and other investments partly paid etc.)

4. Revenue from Operations:

In respect of a company other than finance company shall disclose

i) Sale of Products

ii) Sale of Services

iii) Other Operating revenues Less Excise Duty

5. Other Income

a) Interest Income

b) Dividend Income

c) Gain/ Loss on Sale of Investments

6. Changes in inventories of finished goods, work in progress and stock in trade : The opening and closing inventories of Fineshed Goods, Work-in Progress and Stock in Trade are to be compared. If the net opening balance of these items is more than closing balance, the difference is positive. In case the closing inventories of these items is more then it is a negative. This item will appear in Profit and Loss statement.

7. Finance Costs

a) Interest Expenses : Interest on Debentures, Interest on public Deposits etc.

b) Other borrowing costs

8. Employees Benefit Expense

a) Salaries and wages, medical expenses

b) Contribution to provident other funds...

9. Other Expenses

a) Consumption of Stores and Spare parts

b) Power and Fuel.

c) Rent

d) Repairs to Buildings, Machinery

e) Insurance

f) Rate and Taxes

g) Miscellaneous Expenses

Rounding off of the figures

Depending upon the turnover of the company, the Figures appearing in financial statements may be rounded as follows :

	Turnover	Rounding off
1)	Less than one hundred crores rupees	To the nearest hundreds, thousands, Lakhs or millions or decimals there of
2)	One hundred crores or more	To the nearest Lakhs, millions or crores, or decimals there of.

4.1.3 Statement of Profit and Loss A/c

Q4. Explain about Profit and Loss Account as per company Act, 2013.

Ans :

Part II of Schedule III lays down a format for the presentation of Statement of Profit and Loss. This format of Statement of Profit and Loss does not mention any appropriation of item on its face. The new vertical format of the Balance Sheet as prescribed in Part I of the Schedule III is as follows:

Format of P&L Account

P & L Account of ......Company Limited for the year ended 31st March...

Particulars	Note No	Amount
i) Revenue from Operations		xxx
ii) Other Income		xxx
iii) Total revenue (I+II)		xxx
iv) Expenses :		
a) Material Consumed		xxx
b) Purchases		xxx
c) Changes in Inventories		
(Finished goods, work-in-progress & stock-in-trade)		xxx
d) Employees benefit expenses		xxx
e) Finance Cost		xxx
f) Depreciation and Amortization Exp		xxx
g) Other Expenses		xxx
Total Expenses (a+b+c+d+e+f+g)		xxx
v) Profit & Loss before Tax		xxx
vi) Provision for Tax		xxx
vii) Profit / Loss after Tax (V-VI)		

Explanation

i. Revenue from operations (Cash sales + Credit sales Less Sales returns Less Excise Duty)

ii. Other Income (All incomes other than sales)

iii. Total Revenue (I + II)

iv. Expenses

a) Cost of materials consumed (it given specifically; No need to calculate if not given)

b) Purchases of stock-in-trade (purchases)

c) Changes in inventories of finished goods, work-in-progress & stock-in-trade. (Opening stock less closing stock)

d) Employees Benefits Expenses (salaries, wages, canteen expenses, all their employee welfare expenses, PF contribution of the employer)

e) Finance cost (Interest on borrowings)

f) Depreciation & Amortisation expenses (Dep. On fixed tangible assets & amortisation of intangible asset)

g) Ot7her expenses (All other revenue expenses & losses + loss by theft/fire etc.

4.1.3.1 General Instructions

Q5. Explain the for preparation of Profit and Loss Account.

Ans :

(i) Preliminary Expenses

The term 'Preliminary Expenses' normally includes the following (1) Legal charges for drafting the Memorandum of Association and Articles of Association and agreement between the company and other persons relating to setting up of the company. (2) Printing expenses of Memorandum of Association and Articles of Association of company (3) Registration fees of the company under the provisions of Companies Act. (4) Expenses in connection with public issue of shares and debentures.

Under the Revised Schedule 'Miscellaneous Expenditure (to the extent not written off or adjusted) is not to be shown in the Balance Sheet. Schedule III does not suggest or prescribe any specific treatment for this item. Even in general instructions for preparation of Balance Sheet and Statement of Profit and loss in the revised schedule III there is no guideline for treatment of Preliminary expenses. In the absence of any instruction any of the following treatment may be followed with Note

1. Show this item in Statement of Profit and loss under the head 'Other Expenses'.
2. Deduct 'Preliminary Expenses' from Surplus of the Current year in the Balance Sheet under 'Reserves and Surplus'.
3. Show this item in the Balance Sheet under the main heading 'Reserves and Surplus' as a negative item.
4. If in the Problem, it is instructed that part of the preliminary Expenses is to be written off then;

1) Take the amount to be written off in Statement of profit and loss under the head other expenses.

2) Show the balance (which is not written off) in the Balance Sheet Under :

Main Head : Current Assets

Sub Head : Other Current Assets or

under the Main Head 'Reserves and Surplus as Negative item.

As per para 56 of AS 26 Preliminary Expenses are not to be shown in Balance Sheet.

(ii) Discount on the Issue of Share and Discount

The Discount on issue of Shares and Debentures must be treated as a loss of capital nature and should be debited to a separate account called Discount on Issue of Shares/Debentures Account.) Such discount on issue of shares or debentures should be written off over a number of years. Under the old schedule VI Discount on Issue of Shares/Debentures not written off was required to be shown on the Assets side under the Head 'Miscellaneous Expenditure (to the extent not written off or adjusted). Under the new schedule III this Head Miscellaneous Expenditure does not exist. Hence, instructions given in the problem have to be followed. If no instruction is given in the Problem, Discount on Issue of Shares / Debentures should be written off against General Reserve or Profit loss Balance.

(iii) Interest on Debentures

Interest on Debentures is a charge against Profit and it is payable to the debenture holders whether the company has earned Profit or not. It is an implied adjustment i.e. outstanding interest on debentures has to be provided, whether it is given as adjustment or not.

(iv) Provision for Taxation

Since the actual amount payable as Income-Tax will be known only when assessment is made by Income Tax Department the liability for Income Tax has to be estimated and provided in the books. The treatment for income tax in the financial statements will be as follows:

(v) Profit and Loss Statement

Profit before Tax	
Tax expenses	xx
(Taxable Income x Rate)	xx
Profit after Tax	xxx

Balance Sheet

Current Liabilities	(Main Head)
Short-term provisions	(Sub-Head)

(vi) Notes and Explanations

Short-Term Provisions

Provision for Taxation

Advance Payment of Tax:

A company has to pay tax in advance in the previous year itself on its probable income of the accounting year. The amount of advance tax is computed in accordance with the Provisions of Income-Tax Act. When advance tax is paid, the following entry is passed.

Tax paid in Advance A/c Dr.

To Bank

If the Provision of Taxation and Advance Payment of Tax both appear in the Problem, then

(a) If Advanced Payment of Tax is more than provision for Taxation, then it will appear in Balance Sheet as under :

Main Head	Current Assets
Sub-Head	Short term Loans and Advances

In Notes and explanation to accounts; advance payment of tax less provision for taxation b) If provision for taxation is more than Income tax paid then, it will appear in Balance Sheet

Main Head	Current liabilities
Sub-Head	Short-Term Provisions

In Notes and explanation:

Provision for Taxation

Less Advance Payment of Tax

(viii) Transfer of Profit to Reserves

According to Sec. 123(1) the Board of Directors may transfer an appropriate Percentage of Profit to Reserve before declaring dividend. Previously Companies were required to transfer fixed percentage of Profits to reserve depending upon the rate of dividend proposed now, this provision has been removed

(viii) Divisible Profits

The amount of Profits which is available for distribution to shareholders is called Divisible Profit. Profit disclosed by Profit and loss Statement in every case is not available for distribution as dividend. The availability of Profits for distribution depends upon a number of factors such as composition of Profit, the amount of Provisions and appropriation that must he made out of them.

(ix) Dividends

Dividend is a distribution of divisible profit of a company among the members according to the number of shares held by each of them in the capital of the company. According to Sec 123(1) of the Companies Act, 2013 dividends can be paid only.

➢ Out of the profits of current financial year.

➢ Out of undistributed profits of the previous financial year or years. Dividends can be declared by a company only out of profits or free reserves. Free Reserves mean such reserves which are not specified for any particular purpose and are available for distribution as dividends.

➢ Out of both of the above

➢ Out of money provided by the Central Government or State Government in pursuance of the guarantee given by them.

Capital cannot be returned to the shareholders by way of dividend. Depreciation must be provided to the extent specified in schedule II Before declaring any dividend, the company must provide for past Losses and arrears of depreciation relating to previous year *(s).*

The rate of the dividend declared must not exceed the average rate of dividend declared in 3 years immediately preceding that year. The term 'Dividend' includes. 'Interim Dividend'. The amount of dividend including Interim Dividend must be deposited in a separate Bank Account within 5 days of the declaration of the dividend and the same shall be used for payment of dividend.

When dividend declared by the company has not been paid or claimed within 30 days from the date of declaration by the shareholders the company shall, within 7 days from the date of the expiry of the said 30 days transfer the total amount of dividend which in unpaid or unclaimed to a separate account 'Unpaid Dividend Account' in a scheduled bank.

(x) Interim Dividend and Final Dividend / Proposed Dividend

Dividend declared by board of directors before the preparation of final accounts is termed as 'Interim Dividend' Interim Dividend is the dividend between two Annual general Meetings.

The payment of Interim Dividend should be authorized by the Articles of Association. Interim Dividend is paid of during the year and it will appear in the Trial Balance on the debit side. When Interim Dividend is paid the following entry is passed.

Interim Dividend A/c Dr.

To Bank

The Dividend recommended by the Board of Directors and then approved by the shareholders in the Annual General Meeting in Called 'Final Dividend' or 'Proposed Dividend. A company cannot declare a further dividend after having declared a final dividend as its Annual General Meeting.

According revised Schedule -III 'Proposed Dividend' are not to be shown in Balance Sheet and Statement of Profit and loss. It is to be declared separately in 'Notes to accounts'.

PROBLEMS ON FINAL ACCOUNTS

1. From the following is the trial balance of Vishal Ltd., prepare the Balance Sheet of the company as on 31st March 2015 as per Schedule III of the Companies Act.

Trial Balance as on 31st March 2015

Debit	Rs.	Credit	Rs.
Advance to employees	3,00,000	Equity Share Capital	52,00,000
Cash at Bank	3,14,320	Capital Reserve	60,000
Furniture & Fixture	7,50,000	Loan from SBI	8,00,000
Premises	41,09,940	Provision for Employees Welfare Fund	6,00,000
Patents	10,00,000	Proposed Dividend	1,64,000
Discount on issue of shares (unwritten off)	25,000	Short term loan from bank	4,90,200
Trade Receivables	3,66.240	Unpaid dividend	64,800
Advance Tax	50,000	Profit & Loss A/c	42,980
8% Govt. Bonus	3,36,000	Bills Payable	85,100
Stock in trade	3,55,600	Sundry Creditors	1,00,000
	76,07,100		**76,07,100**

Balance Sheet of Vishal Limited as on 31st March 2014

	Particulars	Note No.	Amount (Rs.)
EQUITY AND LIABILITIES			
1	**Shareholder's Funds:**		
	a) Share Capital		52,00,000
	b) Reserves and Surplus	1	1,02,980
2	**Share Application Money pending allotment :**		Nil
3	**Non – Current Liabilities**		
	a) Long-term borrowings		8,00,000
	b) Deferred Tax Liabilities (Net)		6,00,000
4	**Current Liabilities :**		
	a) Short-term borrowing		4,90,200
	b) Trade payables	2	1,85,120
	c) Other current liabilities		64,800
	d) Short-term provisions		1,64,000
	TOTAL		**76,07,100**

II. ASSETS			
1. Non-Current Assets			
a)	**Fixed Assets**		
	i) Tangible Assets	3	48,59,940
	ii) Intangible Assets		10,00,000
b)	**Non-Current Assets :**		25,000
2. Current Assets			
a)	Current investments		3,36,000
b)	Inventories		3,55,600
c)	Trade receivables		3,66,240
d)	Cash and cash equivalents		3,14,320
e)	Short-term loans and advances		3,00,000
f)	Other current assets		50,000
	TOTAL		**76,07,100**

Sol :

Notes to the Financial Statement :

1. Reserve and Surplus

Capital Reserve	60,000
Profit & Loss A/c (Cr. Bal.)	42,980
Total	**1,02,980**

2.	**Trade Payable**	
	Sundry creditors	1,00,000
	Bills payable	85,000
	Total	**1,85,100**
3.	**Tangible Fixed Assets**	
	Premises	41,09,940
	Furniture & Fixture	7,50,000
	Total	**48,59,940**

2. From the following Ledger of Varun LTD., Prepare the Balance Sheet of the company as on 31st March 2014 as per Schedule III of the Companies Act.

Particulars	Rs.	Particulars	Rs.
Plant & Machinery	6,00,000	Immovable Property	10,00,000
8% Debenture	8,00,000	Public deposit	5,00,000
Employee's Provident Fund	1,30,000	Provision for Taxation	1,80,000
Securities premium	80,000	Drafts on hand	5,00,000
Cash at bank	34,000	Bills Receivable	2,40,000
24000 fully paid Equity shares of Rs. 100 each		Brokerage on issue of shares	1,10,000
Rs. 50 called up	12,00,000		
Sundry Creditors	1,16,000	Bank Overdraft	1,50,000
Loan to Manager	70,000	Security Deposit	1,24,000
Deposits with ICICI Bank (5 years)	1,98,000	Trade marks	1,80,000
Prepaid insurance	1,00,000		

Sol :

Balance Sheet of Vishal Limited as on 31st March 2014

	Particulars	Note No.	Amount (Rs.)
EQUITY AND LIABILITIES			
1	**Shareholder's Funds:**		
	a) Share Capital	1	12,00,000
	b) Reserves and Surplus		80,000
2	**Share Application Money pending allotment :**		Nil
3	**Non – Current Liabilities**		
	a) Long-term borrowings	2	13,00,000
	b) Deferred Tax Liabilities (Net)		1,30,000
4	**Current Liabilities :**		
	a) Short-term borrowing		1,50,000
	b) Trade payables		1,16,000
	d) Short-term provisions		1,80,000
TOTAL			**31,56,000**

II. ASSETS			
1. Non-Current Assets			
a)	Fixed Assets		
	i) Tangible Assets	3	16,00,000
	ii) Intangible Assets		1,80,000
b)	Non-current investment		1,98,000
c)	Non-Current Assets		1,24,000
d)	Other non-current assets		1,10,000
2. Current Assets			
a)	Trade receivables		2,40,000
b)	Cash and cash equivalents	4	5,34,000
c)	Short-term loans and advances		70,000
d)	Other current assets		1,00,000
TOTAL			**31,56,000**

Notes to the Financial Statement :

		Rs.
1.	**Share Capital**	
	Authorised Capital	24,00,000
	(24000 Equity Shares of Rs. 100 each)	—
	Issued & Subscribed capital	24,00,000
	(24,000 Equity shares of Rs. 100 each)	—
	Called up & Paid up capital	
	(24000 Equity shares of 80 each	12,00,000
	Total	**12,00,000**
2.	**Long Term borrowings**	
	80% Debentures	8,00,000
	Public deposits	5,00,000
	Total	**13,00,000**
3.	**Tangible Assets**	
	Plant & Machinery	6,00,000
	Immovable property	10,00,000
	Total	**16,00,000**
4.	**Cash & Cash equivalent**	
	Cash in hand	34,000
	Drafts on hand	5,00,000
	Total	**5,34,000**

3. From the following ledger balances of Regal Limited as on 31st March 2015. You are required to prepare the Balance Sheet as on 31st March 2015 as per Revised schedule III of the Indian Companies Act.

Particulars	Rs.	Particulars	Rs.
Office Equipment	4,80,600	General Reserve	4,15,000
9% Debentures in APCO Ltd.,	2,45,000	Creditors for Goods	1,68,500
Loose Tools	1,63,000	Creditors for expenses	36,000
Plant & machinery	18,00,000	Cash Credit	75,000
Computer Software	83,250	Mortgage Loan	3,10,000
Debtors for goods	1,90,000	8% Preference share capital	5,50,000
Advertisement (unwritten off)	30,000	Equity Share Capital	15,00,000
Stores & Spares	1,00,200	Staff Welfare Fund	85,000
Interest accrued on investment	51,000	Provision for Taxation	26,550
Cash at Bank	23,000		

Balance Sheet of Regal Limited as on 31st March 2015

Sol :

Particulars	Note	Amount (Rs.)
I. Equity and Liabilities		
1. Shareholders funds :		
a) Share capital : i) Equity Share Capital		15,00,000
ii) Preference Share Capital		5,50,000
b) Reserve and surplus		4,15,000
2. Share application money pending allotment :		Nil
3. Non-current liabilities		
a) Long-term borrowings		3,10,000
b) Long-term provisions		85,000
4. Current Liabilities		
a) Short-term borrowings		75,000
b) Trade payables	1	2,04,500
d) Short-term provisions		26,550
Total		**31,66,050**
II. ASSETS		
1. Non-current Assets		
a) Fixed assets: i) Tangible assets	2	22,80,600
ii) Intangible assets		83,250
e) Other non-current assets		30,000

2.	**Current assets**		
	a) Current investments		2,45,000
	b) Investories	3	2,63,200
	c) Trade receivables		1,90,000
	d) Cash and cash equivalents		23,000
	e) Other current assets		51,000
	Total		**31,66,050**

Notes to the Financial Statement :

1. Trade payable

Creditors for Goods	1,68,500
Creditors for expenses	36,000
Total	**2,04,500**

2. Tangible Fixed Assets

Office Equipment	4,80,000
Plant and machinery	18,00,000
Total	**22,80,600**

3. Inventories

Loose tools	1,63,000
Stores & Spares	1,00,200
Total	**2,63,200**

4. Prepare Balance Sheet of Darshan Ltd., in the prescribed pro forma as on 31st March 2015 from the following Trial Balance

Trial Balance as on 31st March 2015

Liabilities	Rs.	Assets	Rs.
Leasehold property	16,00,000		
Bank balance	1,05,000	Share Capital	20,65,000
Plant & Machinery	9,00,000	Staff Provident fund	8,00,000
Goodwill	3,00,000	Capita redemption reserve	2,20,000
Investment in a subsidiary Co.	11,50,000	General reserve	1,90,000
P & L A/c	70,000	Deposits from public	9,00,000
Stock of finished goods	1,20,000	Accounts payable	2,10,000
Accounts receivable	2,40,000	Short Term loan from SBI	1,78,000
Preliminary Expenses	39,000	Unclaimed dividend	6,000
Underwriting commission	45,000		
	46,69,000		**45,69,000**

Sol :

Balance Sheet of Darshan Limited as on 31st March 2014

Particulars	Note	Amount (Rs.)
I. Equity and Liabilities		
1. Shareholders funds :		
a) Share capital :		20,65,000
b) Reserve and surplus		3,40,000
2. Share application money pending allotment :		
3. Non-current liabilities		
a) Long-term borrowings		9,00,000
b) Long-term provisions		8,00,000
4. Current Liabilities		
a) Short-term borrowings		1,78,000
b) Trade payables	1	2,10,000
c) Short-term provisions		6,000
Total		**44,99,000**
II. ASSETS		
1. Non-current Assets		
a) Fixed assets: i) Tangible assets	2	25,00,000
ii) Intangible assets		3,00,000
b) Non-current Investment		11,50,000
c) Other Non-current assets	3	84,000
2. Current assets		
a) Investories		1,20,000
b) Trade receivables		2,40,000
d) Cash and cash equivalents		1,05,000
Total		**44,99,000**

Notes to the Financial Statement :

1. Reserve and Surplus

Capital Redemption Reserve	2,20,000
General Reserves	1,90,000
Debit balance of P & L	(70,000)
Total	**3,40,000**

2. Tangible Fixed Assets

Underwriting Commission	45,000
Preliminary expenses	39,000
Total	**84,000**

5. From the following ledger balance of Sunshine Co., Ltd., prepare the Balance Sheet of the company as on 31st March 2014 as per Schedule VI of the Companies Act.

Particulars	Rs.	Particulars	Rs.
Equity Share Capital	26,00,000	Advances to employees	1,50,000
General Reserves	30,000	Discount on issue of debentures (unwritten off)	12,500
12% Debenture	4,00,000	Tools and equipment	3,75,000
Land & Building	15,54,,970	Gratuity Fund	3,00,000
Goodwill	10,00,000	Debtors	1,38,520
Bank Overdraft	2,45,100	Cash at Bank	1,57,160
Proposed Dividend	82,000	Stores & Spares	1,77,800
Prepaid insurance	25,000	Profit & Loss A/c (credit)	21,490
Mutual Fund	1,68,000	Bills Receivable	44,600
Interest payable	32,400	Sundry Creditors	92,500

Sol :

Balance Sheet of Sunshine Company Limited as on 31st March 2014

Particulars	Note	Amount (Rs.)
I. Equity and Liabilities		
1. Shareholders funds :		
a) Share capital :		26,00,000
b) Reserve and surplus		51,490
2. Share application money pending allotment :		NIL
3. Non-current liabilities		
a) Long-term borrowings		4,00,000
b) Long-term provisions		3,00,000
4. Current Liabilities		
a) Short-term borrowings		2,45,100
b) Trade payables	1	92,560
c) Other Current Liabilities		32,400
c) Short-term provisions		82,000
Total		**38,03,550**
II. ASSETS		
1. Non-current Assets		
a) Fixed assets: i) Tangible assets	2	19,29,970
ii) Intangible assets		10,00,000
b) Other Non-current assets		12,500

2.	**Current assets**		
	a) Current investments		1,68,000
	b) Investories		1,77,800
	c) Trade receivables	3	1,83,120
	d) Cash and cash equivalents		1,57,160
	e) Short-term loan and advances		1,50,000
	f) Other current assets		25,000
	Total		**38,03,550**

Notes to the Financial Statement :

1. Reserve and Surplus

General Reserves	30,000
Profit & Loan A/c (Cr. Bal.)	21,490
Total	**51,490**

2. Tangible Fixed Assets

Land & Buildings	15,54,970
Tools & Equipment	3,75,000
Total	**19,29,970**

3. Trade Receivables

Sundry Debtors	1,38,520
Bills Receivable	44,600
Total	**1,83,120**

6. You are given the following information from the books of Siraj Co. Ltd. as on 31st March, 2015.

Siraj Co. Ltd
Trial Balance as on 31st March, 2015

Particulars	Amt (Rs)	Particulars	Amt (Rs)
Depreciation on premises	8,000	Sales	12,40,000
Materials Consumer	8,00,000	Equity Share Capital	8,00,000
Opening Stock	40,000	Outstanding Wages	6,000
Salaries	1,14,000		
Bad Debts	3,800		
Bonus to employees	20,000		
Interest on Loan	16,000		
Depreciation ion machinery	18,000		
Conveyance	4,000		

Loss on sales of machinery	20,000		
Insurance	16,200		
Sales Returns	40,000		
Provision for Tax	60,000		
Machinery	6,00,000		
P.F. Contribution	86,000		
Premises	1,60,000		
Computer	40,000		
	20,46,000		**20,46,000**

Sol :

Siraj Co. Ltd.,

Statement of Profit and Loss as on 31st March, 2015

Particulars	Note	(Rs.)
I. Revenue from Operators	**1**	**12,00,000**
II. Other income		**-**
III. Total Revenue		**12,00,000**
IV. Expenses		
a) Material Consumed		8,00,000
b) Purchases		0
c) Changes in Inventories	2	(80,000)
d) Employees benefit expenses	3	2,20,000
e) Finance Cost		16,000
f) Depreciation and Amortization Exp	4	26,000
g) Other Expenses	5	44,000
Total Expenses		10,26,000
V. Profit & Loss before Tax (III-IV)		**1,74,000**
VI. Provision for Tax		**(60,000)**
VII. Profit Loss after Tax (V-VI)		**1,14,000**

Notes :

1. Revenue from Operations

Sales	12,40,000
Less Sales Returns	40,000
Total	**12,00,000**

2. Changes in Inventories

Opening Stock	40,000
Less Closing Stock	(1,20,000)
Total	**(80,000)**

3.	**Employees benefit expenses**	
	Salaries	1,14,000
	PF Contribution	86,000
	Bonus to Employees	20,000
	Total	**2,20,000**
4.	**Depreciation & Amortisation**	
	Depreciation on Premises	8,000
	Depreciation on machinery	18,000
	Total	**26,000**
5.	**Other Expenses**	
	Bad debts	3,800
	Conveyance	4,000
	Loss on sale of machinery	20,000
	Insurance	16,200
	Total	**44,000**

7. From the following Trial balance of Glory Co. Ltd., as on 31st March, 2015. Prepare a statement of P & L Account as per schedule III of the companies Act.

Glory Co. Ltd

Trial Balance as on 31st March, 2015

Particulars	Amount	Particulars	Amount
Interest on Debentures	32,400	Share Transfer Fees	15,000
Travelling expenses	10,000	12% Debentures	2,70,000
Delivery van expenses	5,100	Commission received	7,400
Bad Debts	6,500	Sales	6,45,500
Discount	7,000	Share Capital	5,00,000
Purchases	3,15,800		
Opening Stock	72,000		
Freight outward	8,400		
Free Samples	5,000		
Depreciation	38,900		
Showroom expenses	11,400		
Bank balance	1,58,600		
Wages	93,000		
Land & Building	4,00,000		
Office Equipment	1,45,000		
Insurance	6,000		
Furniture	1,22,600		
Total	**14,37,900**	**Total**	**14,37,900**

Sol :

Siraj Co. Ltd.,
Statement of Profit and Loss as on 31st March, 2015

Particulars	Note	(Rs.)
I. Revenue from Operators		**6,45,500**
II. Other income	**1**	**22,400**
III. Total Revenue		**6,67,900**
IV. Expenses		
a) Material Consumed		0
b) Purchases		3,15,800
c) Changes in Inventories	2	(13,300)
d) Employees benefit expenses		93,000
e) Finance Cost		32,400
f) Depreciation and Amortization Exp	4	38,900
g) Other Expenses	3	59,600
Total Expenses		5,26,400
V. Profit & Loss before Tax (III-IV)		**1,41,500**
VI. Provision for Tax		**0**
VII. Profit Loss after Tax (V-VI)		**1,41,500**

Notes :

1. Other Income

Share Transfer Fees	15,000
Commission Received	7,400
Total	**22,400**

2. Changes in Inventories

Opening Stock	72,000
Less Closing Stock	(85,500)
Total	**(13,500)**

3. Other Expenses

Travelling Expenses	10,200
Delivery Van Expenses	5,100
Bad Debts	6,500
Discount	7,000
Freight Outward	8,400
Free samples	5,000
Showroom expenses	11,400
Insurance	6,000
Total	**59,600**

8. You are given the following extracts of ledger balances taken from Vihar Co. Ltd., for the year ending 31st March 2015.

Prepare a statement of P & L A/c as per revised schedule III

Glory Co. Ltd
Trial Balance as on 31st March, 2015

Particulars	Rs.
Excise Duty	8,000
Provision for Tax	10,000
Depreciation on Machinery	3,300
Sundry expenses	7,000
Rent	4,000
Salaries	7,500
Materials consumer	90,000
Machinery	25,000
Directors remuneration	20,000
Factory Expenses	2,500
Sales	4,55,000
Returns inward	5,000
Purchases	2,35,000
Closing stock	75,000
opening Stock	82,000
Wages	30,000
Bank Loan	40,000
Interest on Bank Loan	4,000
Interest on Investment	5,000
Rent received	3,000
Motive power	12,000
Transport Charges	1,000

Sol :

Vihar Co. Ltd.,

Statement of Profit and Loss as on 31st March, 2015

Particulars	Note	(Rs.)
I. Revenue from Operators	**1**	**4,42,000**
II. Other income	**2**	**8,000**
III. Total Revenue		**4,50,000**
IV. Expenses		
a) Material Consumed		90,000
b) Purchases		2,35,000

c) Changes in Inventories	2	7,000
d) Employees benefit expenses		37,500
e) Finance Cost		4,000
f) Depreciation and Amortization Exp	4	3,300
g) Other Expenses	3	46,500
Total Expenses		4,23,300
V. Profit & Loss before Tax (III-IV)		**26,700**
VI. Provision for Tax		**(10,000)**
VII. Profit Loss after Tax (V-VI)		**16,700**

Notes :

1. Revenue from Operations

Sales	4,55,000
Less : Commission Received	5,000
Excise Duty	8,000
Total	**4,42,000**

2. Other Income

Interest on investment	5,000
Rent received	3,000
Total	**8,000**

3. Changes in Inventories

Opening Stock	82,000
Less Closing Stock	(75,000)
Total	**7,000**

4. Employees benefit expenses

Salaries	7,500
Wages	30,000
Total	**37,500**

5. Other expenses

Sundry expenses	7,000
Rent	4,000
Directors remuneration	20,000
Factory expenses	2,500
Motive power	12,000
Transport charges	1,000
Total	**46,500**

9. You are given the following extracts of ledger balances taken from Chanakya Co. Ltd., for the year ending 31st March 2015.

Prepare a statement of P & L A/c as per revised schedule III

Particulars	Rs.
Opening stock of finished goods	1,90,500
Cost of material consumer	2,92,000
Salaries to office staff	68,000
Closing stock of finished goods	2,03,000
Interest on debentures paid	16,250
General expenses	8,250
Discount earned	4,900
Cash sales	2,66,000
Credit sales	3,87,500
Income tax refund	11,500
Provision for taxation	30,000
Goodwill written off	18,000
Sales returns	17,000
Provision for bad debts	8,200
Delivery expenses	7,200
Printing & Stationery	22,600
Factory expenses	82,000
Bonus to employees	32,000
Depreciation on Plant & Machinery	50,000

Sol :

Chanakya Co. Ltd.,

Statement of Profit and Loss as on 31st March, 2015

Particulars	Note	(Rs.)
I. Revenue from Operators	**1**	**6,36,500**
II. Other income	**2**	**16,400**
III. Total Revenue		**6,52,900**
IV. Expenses		
a) Material Consumed		2,92,000
b) Purchases		0
c) Changes in Inventories	3	(12,500)

d) Employees benefit expenses	4	1,00,000
e) Finance Cost		16,250
f) Depreciation and Amortization Exp	5	68,000
g) Other Expenses	6	1,28,250
Total Expenses		5,92,000
V. Profit & Loss before Tax (III-IV)		**60,900**
VI. Provision for Tax		**(30,000)**
VII. Profit Loss after Tax (V-VI)		**30,900**

Notes :

1. Revenue from Operations

Cash Sales	2,66,000
Credit sales	3,87,500
Less: Sales returns	(17,000)
Total	**6,36,000**

2. Other Income

Discount earner	4,900
Income tax refund	11,500
Total	**16,400**

3. Changes in inventories

Opening Stock	1,90,500
Less : Closing Stock	2,03,000
Total	**12,500**

4. Employees benefits expenses

Salaries to office staff	68,000
Bonus to employees	32,000
Total	**1,00,000**

5. Depreciation & Amortisation

Goodwill written off	18,000
Dep. on Plant & Machinery	50,000
Total	**68,000**

6. Other Expenses

General expenses	8,250
Provision for Bad Debts	8,200
Freight on purchases	7,200
Printing & stationery	22,600
Factory expenses	82,000
Total	**1,28,250**

10. Following ledger balance are taken from Virupaksh Ltd. for the year ending 31/03/2015. Prepare P & L Account in vertical form with major heads

Particulars	Rs.
Stock of finished goods as on 01-04-2014	2,90,000
Stock of work-in - progress as on 01-04-2014	3,93,000
Stock of finished goods as on 31-03-2015	1,84,000
Stock of work-in-progress as on 31-03-2015	2,60,000
Material consumer	3,15,000
Wages	74,000
Coal & Coke	87,500
Live work	1,00,600
Patents written off	25,200
Directors fees	57,000
Sales	10,95,000
Depreciation on plan	38,000
Bad debts	16,570
Provision for taxation	18,000
royalty received	18,300
Bank loan	4,00,000
Administrative expenses	37,400
Interest on loan	60,000

Sol :

Virupaksh Co. Ltd.,

Statement of Profit and Loss as on 31st March, 2015

Particulars	Note	(Rs.)
I. Revenue from Operators		**10,95,000**
II. Other income		**18,300**
III. Total Revenue		**11,13,300**
IV. Expenses		
a) Material Consumed		3,15,000
b) Purchases		0
c) Changes in Inventories	1	2,39,000
d) Employees benefit expenses		74,000
e) Finance Cost		60,000
f) Depreciation and Amortization Exp	2	63,200
g) Other Expenses	3	1,98,470
Total Expenses		9,49,670
V. Profit & Loss before Tax (III-IV)		**1,63,630**
VI. Provision for Tax		**(18,000)**
VII. Profit Loss after Tax (V-VI)		**1,45,630**

Notes :

1. Changes in Inventories

Opening Stock		
Work-in-progress	3,93,000	
Finished Goods	2,90,000	
	6,83,000	
LESS Closing Stock		
Work-in-progress	2,60,000	
Finished Goods	1,84,000	
Total	**4,44,000**	**2,39,000**

2. Depreciation & Amortisation

Depreciation on plant	38,000
Patents written off	25,200
Total	**63,200**

3. Other Expenses

Coal & Coke	87,500
Bad debts	16,570
Administrative expenses	37,400
Directors fees	57,000
Total	**1,98,470**

4.2 Profits Prior to Incorporation

Q6. Explain the concept of Profits Prior to Incorporation.

Ans : **(Imp.)**

A company comes into existence from the date of issue of the certificate of incorporation by the Registrar of Companies. Sometimes, a newly incorporated company agrees to take over a running business w.e.f. a date prior to its incorporation. Such an agreement is made to avoid the necessity of preparing the final accounts of the vendor's business from the date it prepared its last final accounts till the date on which the business is actually acquired. The assets and liabilities of the vendor's business are agreed as per the date of its last balance sheet. In such a case, the company becomes entitled to the entire profit or liable for the entire loss since the date it agrees to acquires the vendor's business.

For example, a company incorporated on 1 April 2001, agrees to take over a running business from 1 January 2001 and it closes its accounts on 31 December, the company is entitled (or liable) not only to the profit (or loss) made by the business from 1 April to 31 December, but also to the profit (or loss) made by the vendor from 1 January to 31 March. Any profit (or loss) to which the company is entitled (or liable) before its incorporation is termed as 'profit (or loss) prior to incorporation' and is of a capital nature. While preparing its final accounts, it is necessary that such profit or loss is separated from the profit or loss earned or suffered by the company after its incorporation such profit while any should be transferred to capital reserve. While any loss prior to incorporation being of capital nature should be debited to separate account called Loss Prior to Incorporation Account, and shown under Miscellaneous Expenditure on the assets side of Balance Sheet to the extent not written off.

Loss prior to incorporation can be dealt with in any of the following manner :

i) It may be written off against capital profits of the company

ii) It may be treated as Goodwill and debited to Goodwill Account

iii) Such loss can be treated as Deferred Revenue Expenditure and written off out of the profits of the company over a period of years.

Cut-off Date

A private company can commence business soon after its incorporation, while a public company can commence business only after obtaining the certificate of commencement of business. This means that in case of a private company, any profit made before incorporation and in case of a public company any profit made before commencement of business should be taken as a capital profit. However, it has now been widely accepted that since once the certificate of commencement of business is given, the company's power to carry on the business related back to the date of incorporation and hence the date of incorporation should be taken as the relevant date for apportionment of profits between pre- and post-incorporation periods.

Basis of Apportionment

In order to apportion the profit between pre- and post-incorporation periods, the following steps should be taken:

(i) The gross profit to the business should generally be calculated for the full period without apportioning it between pre- and post-incorporation periods.

(ii) The gross profit calculated as above should be divided between pre- and post-incorporation periods on the basis of sales of the two periods. In the absence of any instructions in the question, the sales may be presumed to be evenly made over the whole period.

(iii) Expenses which vary in proportion to sale, *e.g.* bad debts, commission on sales etc., should be divided in sales ratio between pre- and post-incorporation periods.

(iv) Expenses which vary according to time *e.g.* rent, salary, depreciation, interest etc., should be divided in time ratio between pre- and post-incorporation periods.

(v) Expenses which solely relate to pre-incorporation period, should be charged to the pre- incorporation period only. For example, salary to partners, interest on capital should be charged only to the profits of the pre-incorporation period.

(vi) Expenses which relate solely to the post-incorporation period, should be charged only against the profits of that period. Examples of such expenses are, interest on debentures, dividends, preliminary expenses, etc.

(vii) Expenses which may relate to both pre and post-incorporation periods should be charged to both the periods on time basis. For example, auditor's fee may be charged to both pre and post-incorporation periods. However, since getting accounts audited is compulsory in case of companies, the entire amount of audit fee may be charged solely to the post-incorporation period. Similarly, interest paid to the vendors for delay in payment of purchase consideration to them should be charged over both the pre- and post-incorporation periods depending upon the period up to which the interest has been paid.

(i) Profit made during pre-incorporation period, should be transferred to capital reserve. It is not available for distribution as dividend among the shareholders of the company.

4.2.1 Accounting Treatment

Q7. How while preparing the final accounts of the company profit prior to Incorporation treated ?

Ans : **(July-19, Dec.-19, June-18, Dec.-18, Imp.)**

First method

Under this method, a separate Profit and Loss Account is prepared for the pre-incorporation period. On the date of incorporation, stock is taken, final accounts are prepared and the old books of account are closed. This method of profit determination is no doubt simple and accurate but at the same time inconvenient and expensive because the business activities have to be suspended for a few days for stock taking. For this reason, this method is generally not followed in practice.

Second Method

Under this method, the following steps are involved for ascertaining the profit or loss prior to incorporation.

1. A Trading Account should be prepared for the whole period (pre-incorporation and post incorporation combined) to ascertain the Gross Profit.
2. Calculate the following two ratios:
   a) Sales Ratio: Calculate the sales for the pre-incorporation and post incorporation periods, and calculate sales ratio.
   b) Time Ratio: This is calculated by considering the period falling between the last date of the balance sheet and the date of incorporation and the period between the date of incorporation and the date of present final accounts. If business is purchased on 1st Jan. 1989 and the certificate of incorporation is granted on 1st April 1989 and if final accounts are being prepared on 31st December, 1989 then the time ratio is 3:9 or 1:3.
3. Divide the gross profit of the full period into two periods on the basis of sales ratio. This gives gross profit separately for pre and post incorporation periods.
4. Expenses related to sales e.g. commission on sales, discount allowed, bad debts, advertising, etc. should be apportioned on the basis of sales ratio of the two periods.
5. Expenses related to time e.g. rent, rates and taxes, insurance, depreciation, salaries of general staff should be allocated on the basis of time ratio.
6. Expenses which are exclusively related to pre-or post incorporation period must be charged entirely to that period's profit. Debenture interest, preliminary expenses, director's fees are to be charged against post-incorporation profit. Partner's salaries, interest on partners' capital etc. are to be charged against the profit of the pre-incorporation period.

Calculation of Sales Ratio

Certain expenses such as commission, advertisement etc. are apportioned between pre and post incorporation period in the sales ratio. Leaving some simple cases, where turnover is evenly spread over the whole financial period, sales normally fluctuate from month to month according to the nature of the product. For example, in case of wollen garments sales for the period from October to January will be much different from other months. Under such circumstances, the sales ratio is determined taking into consideration the relationship of monthly sales with that of total sales.

Calculation of Weighted ratios

It is often seen that total pay bill of certain expenses such as salary, wages etc. does not remain constant throughout the year. If they remain constant then they can be divided in the time ratio. But the difficulty arises when the number of employees change with the conversion of firm into a limited company. The ratio for this purpose is arrived at after considering time and number of wage earners in the pre-and post-incorporation periods.

PROBLEMS

11. Sai Deep Ltd., was incorporated on 1st August 2006. to take over the running business of Krishna Bros, with effect from 1st April 2006. The company received the certificate of commencement of business on 1st October 2006. The following Profit & Loss A/c was prepared for the year ended 31st March 2007.

PROFIT AND LOSS ACCOUNT
for the year ended 31st March, 2007

Dr **Cr**

Particulars	(Rs)	Particulars	(Rs)
To Office salaries	21,000	By Gross Profit b/d	80,000
To Partners' salaries	6,000	BY Share transfer fees	1,000
To Advertisement	4,400		
To Printing & stationery	1,500		
To Travelling exp.	4,000		
To Office rent	9,600		
To Electricity charges	900		
To Auditors charges	600		
To Directors charges	1,000		
To Bad debts	1,200		
To Commission on sales	4,000		
To Preliminary exps.	700		
To Debenture interest	1,600		
To Interest on capital	1,800		
To Depreciation	2,100		
To Net profit	20,600		
	81,000		81,000

Additional Information :

1) Total Sales for the year, which amounted to Rs 8,00,000 arose evenly up to the date of certificate of commencement, whereafter they recorded an increase of 2/3 during the year. Gross profit was at an uniform rate of 10% of selling price throughout the year and a commission of 0.5% was paid on sales.

2) Office Rent was paid @ Rs 8,400 p.a. up to 30th September 2006, and thereafter it was paid @ Rs 10,800 p.a.

3) Travelling expenses include Rs 1,600 towards sales promotion.

4) Bad Debts written off.

   a) A debt of Rs 400 taken over from the vendor.

   b) A debt of Rs 800 in respect of goods sold in September 2006.

Depreciation includes Rs 600 for assets acquired in the post-incorporation period. Show the "pre" and "post" incorporation results and also state how the results are dealt with.

Sol :

M/s. Sai Deep Limited
PROFIT & LOSS ACCOUNT
Dr for the year ended 31.03.2007 Cr

(Figures in Rs)

Expenses	Basis	Pre Inc.	Post Inc.	Income	Basis	Pre Inc.	Post Inc.
To Office salaries	Time 1:2	7,000	14,000	By Gross profit	sales 1:3	20,000	60,000
To Partners' salaries	Actual	6,000	-	By Share transfer fee	Actual	-	1,000
To Advertisement	Sales	1,100	3,300	By Balance transferred to goodwill A/c		2,800	
To Printing & stationary	Time 1 :2	500	1,000				
To Travelling exp.	Sales	1,000	3,000				
To Sales promotion	3:1	400	1,200				
To Travelling exp.	Time	800	1,600				
To Office rent	Time	2,800	6,800				
To Electricity chgs.	Time	300	600				
To Director's fees	Actual	-	1,000				
To Auditor's fees	Time	200	400				
To Bed debts	Time	400	800				
To Common. on sales	Sales	1,000	3,000				
To Preliminary exp.	Actual	-	700				
To Debenture int.	Actual	-	1,600				
To Interest on capital	Actual	1,800					
To Depreciation	Time	500	1,600				
To Balance b/d		-	23,400				
		22,800	61,000			22,800	61,000

Note: Pre-incorporation loss has been transferred to goodwill account.

Working Notes :

i) Sales Ratio

Pre-incorporation Post-incorporation

April	May	June	July	August	Sept.	Oct.	Nov.	Dec.	Jan	Feb.	March
1	1	1	1	1	1	1.2/3	1.2/3	1.2/3	1.2/3	1.2/3	1.2/3

Pre incorporation sales - 4. Post incorporation sales - 12. Therefore, sales ratio = 4 :12, i.e. 1 : 3

Let average sales of first six months be Rs 3 per month. Therefore, average sales of remaining six months (Rs 3 + 2/3 of Rs 3 i.e. Rs 3 + 2 = 5 per month) Sales ratio 12 : 36. [4 months = 3 Rs per month = 4x3=12. For 2 months = 3 Rs per month = i.e. 2x3=6; and For 6 months @ 5 Rs per month = i.e. 6x5 = 30. Total 30 + 18 = 48).

ii) Allocation of office rent

	Pre	Post
April to July	$\frac{8400 \times 4}{12} = 2,800$	$10,800 \times \frac{6}{12} = 5,400$ Oct. to Mar.
Aug. to March		$8,400 \times \frac{2}{12} = 1,400$ Aug to Sept
		6,800

iii) Allocation of depreciation

On post incorporation assets	-	600
Balance Rs 1,500 on time ratio 4 : 12	500	1,000

12. The following trial balance was extracted from the books of Heera Pvt. Ltd. formed by Mr. Chand of Faizabad on 1st April, 2004 but was incorporated on 1st July, 2004. No entries relating to the transfer of the business were entered in the books which was carried on until 31st March, 2005 :

TRIAL BALANCE
as on 31st March, 2005

Particulars	Dr. (Rs)	Cr. (Rs)
Stock (1.4.2004)	42,940	-
Sales	-	2,79,300
Purchases	1,96,780	-
Carriage outwards	1,650	-
Traveller's commission	6,150	-
Office salaries	16,640	-
Rent and taxes	1,640	-
Office expenses	2,400	-
Capital account of Mr. Chand (1.4.2004)	-	2,00,000
Director's salary	15,000	-
Fixed assets	1,25,000	-
Current liabilities	-	31,660
Current assets (other than stock)	1,01,200	-
Preliminary expenses	1,560	-
	5,10,960	5,10,960

Further Information :

i) Stock on 31st March, 2005 amount to Rs 35,420.

ii) Purchase consideration Rs 2,50,000 to be paid by the issue of 25,000 equity shares of Rs 10 each.

iii) Gross profit percentage is fixed, turnover is double in April, November and December, iv) Preliminary expenses are to be written off.

v) Carriage outward and traveller's commission vary in direct proportion to sales. Prepare trading and profit and loss account for the year ended 31st March, 2005 appropriating between the pre and post incorporation periods and a balance sheet as on 31st March, 2005.

Sol :

Heera Pvt. Ltd.

TRADING ACCOUNT

Dr. for the year ended 31.3.2005 Cr.

Particulars		Rs.	Particulars	Rs.
To Opening stock		42,940	By Sales	2,79,300
To Purchases		1,96,780	By Closing stock	35,420
To Gross Profit c/d				
April 1 to June 30, 1999	20,000			
July 1 March 31, 2000	55,000	75,000		
		3,14,720		3,14,720

Heera Pvt. Ltd.

PROFIT AND LOSS ACCOUNT

Dr. for the year ended 31.3.2005 Cr.

Particulars	Basis	Apr.Jun.	Jul-Mar.	Particulars	Apr.-Jun.	Jul-Mar.
To Carriage outward	Sales	440	1,210	By Gross Profit b/d	20,000	55,000
To Traveller's commission	Sales	1,640	4,510			
To Office salaries	Time	4,160	12,480			
To Office expenses	Time	600	1,800			
To Rent and taxes	Time	410	1,230			
To Director's salary						
Post incorporation		–	15,000			
To Pre-incorporation profit transferred to goodwill A/c		12,750	–			
To Bal. of profit c/d		–	17,210			
		20,000	55,000		20,000	55,000

* The amount could have been also charged against pre-incorporation profits in place of writing off against post-incorporation profits.

Heera Pvt. Ltd.

BALANCE SHEET as at 31.3.2005

Liabilities	Rs	Assets		Rs
Share Capital :		**Fixed Assets :**		
Authorised Issued,	-	Goodwill	50,000	
Subscribed and Called up :		Less: Pre-incorporation		
25,000 equity shares of		Profit	12,750	37,250
Rs 10 each fully paid-up	2,50,000	Other fixed assets		1,25,000
(All the above-mentioned shares		Current Assets, Loans and		
have been issued to vendor for		Advances :		
consideration other than cash)		A) Current assets		
Reserves and Surplus:		Current assets other than stock		1,01,200
Profit and loss A/c	17,210	Stock		35,420
Current Liabilities and Provisions:		B) Loans and advances		Nil
A) Current liabilities	31,660			
B) Provisions	Nil			
	2,98,870			2,98,870

Working Notes :

i) Calculation of ratio of sales for Pre- and Post-Incorporation periods :

	Pre-incorporation	Post-incorporation
April (2 units) + May + June =	4 units	
July-October		4
November		2
December		2
January to March		3
Rate = 4 : 11	4	11

ii)	Cost of Goodwill-Purchase consideration	2,50,000
	Less : Ram Chand's Capital	2,00,000
		50,000

13. ABC Company Ltd., was incorporated on 30th September 2015 to take over the business of K. Mohan as from 1st April 2015. The financial accounts of the business for the year ended 31st March 2016 disclosed the following information :

Particulars	`	`
Sales :		
April to September	1,20,000	
October to March	1,80,000	3,00,000
Less :		
Purchases:		
April to September	75,000	
October to March	1,20,000	1,95,000
Gross Profit		1,05,000
Less :		
Salaries	15,000	
Selling expenses	3,000	
Depreciation	1,500	
Director's remuneration	750	
Debenture Interest	90	
Administration expenses (Rent, Rates etc.)	4,500	24,840
Profit for the year		80,160

You are requested to prepare a statement apportioning the balance of profit between the periods prior to and after incorporation and show the income statement for the year ended 31st March 2016.

Sol :

Income Statement

Dr. for year ended 31st March, 2016 Cr.

Particular	Ratio	Pre-incor-poration `	Pre-incor-poration `
Gross Profit	2:3	42,000	63,000
Total		42,000	63,000
Expenses			
Salaries	1:1	7,500	7,500
Selling Expenses	2:3	1,200	1,800
Depreciation	1:1	750	750
Director's remuneration	Post	-	750
Debenture Interest		–	90
Administration Expenses	1:1	2,250	2,250
Net Profit transferred to:			
Capital Reserve Account		30,300	
Profit & Loss Appropriation Account		-	49,860
		42,000	63,000

Note : 1. Time Ratio :

Pre-incorporation = April-1, 2015 to September 30, 2015 = 6 Months

Post-incorporation = October 1, 2015 to March. 31, 2016 = 6 Months

∴ Time Ratio = 1:1

2. Sales Ratio :

Pre-incorporation = ` 1,20,000

Post-incorporation = ` 1,80,000

∴ Sales Ratio 2 : 3

14. (Ascertainment of Pre- and Post Incorporation Profit)

A company was incorporated on 30th September 2015 to acquire the business of Mohan as from 1st April 2015. The accounts for the year ended 31st March 2016 disclosed the following :

a) There was a gross profit of ` 2,40,000.

b) The sales for the year amounted to ` 12,00,000 of which ` 5,40,000 were for the first six months.

c) The expenses debited to Profit and Loss Account included Director's fees ` 15,000, Bad Debts `.3,600. Advertising ` 12,000 (under a contract amounting to ` 1,000 p.m.), Salaries and general expenses ` 64,000, Preliminary Expenses written off ` 5,000 and Donation to Political Party given by the company ` 5,000. Prepare a statement showing the amount of profit made before and after incorporation.

Sol :

Dr. **Income Statement for the year ended 31st Dec.2011** **Cr.**

Particular	Ratio	Pre-incorpo--ration	Post-incorporation
Gross Profit	9:11	1,08,000	1,32,000
Total		1,08,000	1,32,000
Expenses			
Bad Debts	9:11	1,620	1,980
Advertising	Actual	6,000	6,000
Salaries & General Expenses	1:1	32,000	32,000
Director's Fees	Post	-	15,000
Preliminary Expenses	Post	-	5,000
Donation to Political Parties	Post	-	5,000
Net Profit (Note 3)			
Capital Reserve		68,380	
P/L Appropriation Account			67,020
		1,08,000	1,32,000

Working Notes :

Time Ratio :

Pre-incorporation = April 1, 2015 to September 30, 2015 = 6 Months

Post-incorporation = October 1, 2015 to March 31, 2016 = 6 Months

Time Ratio = 1:1

Sales Ratio :

Pre-incorporation = ` 5,40,000

Post-incorporation = ` 6,60,000

∴ Sales Ratio 9:11

Pre-incorporation Profit is transferred Capital Reserve and Post-incorporation Profit is transferred to Profit and Loss Appropriation Account.

15. (Ascertainment of Pre- and Post Incorporation Profit)

Victory Ltd., was incorporated on August 1,2015 to take over the business of Camlin Ltd., as a going concern from 1st April 2015. The Profit and Loss Account for the year ending on 31st March 2016 is as follows :

The Victory Ltd.

Dr. Income Statement for the year ended 31st March 2016 Cr.

Particulars	`	Particulars	`
To Rent and Taxes	24,000	By Gross Profit	3,10,000
To Insurance	6,000		
To Electricity charges	4,800		
To Salaries	72,000		
To Director's Fees	6,200		
To Auditors fees	3,000		
To Commission	12,000		
To Advertisement	8,000		
To Discount	7,000		
To Office Expenses	15,000		
To Carriage	6,000		
To Bank Charges	3,000		
To Preliminary Expenses	13,000		
To Bad Debts	4,000		
To Interest on Loan	6,000		
To Net Profit	1,20,000		
	3,10,000		3,10,000

The total turnover for the year ending 31-3-2016 was ` 10,00,000 divided into ` 3,00,000 for the period upto 1-8-2015 and ` 7,00,000 for the remaining period.

Ascertain the profits earned prior to and post incorporation period.

Sol :

The Victory Limited

Dr. Income Statement for the Year ended 31st Dec. 2011 Cr.

Particular	Ratio	Pre-incorporator (Rs.)	Post-incorporation (Rs.)
Gross Profit	3:7	93000	2,17,000
Total		93,000	2,17,000
Expenses			
Rent & Taxes	1:2	8,000	16,000
Insurance	1:2	2,000	4,000
Electricity Charges	1:2	- 1,600	3,200
Salaries	1 : 2	24,000	48,000
Director's fees	Post	-	6,200
Audit Fees	1 : 2	1,000	2,000
Commission	3 : 7	3,600	8,400
Advertisement	3:7	2,400	5,600
Discount	3 : 7	2,100	4,900
Office Exp.	1:2	5,000	10,000
Carriage	3:7	1,800	4,200
Bank Charges	1:2	1,000	2,000
Preliminary Exp.	Post	-	13,000
Bad Debts	3:7	1,200	2,800
Interest on Loan	1 : 2	2,000	4,000
Net Profit transferred to:			
Capital Reserve		37,300	–
Profit and Loss App. A/c		–	82,700
		93,000	2,17,000

Notes :

Time Ratio :

Pre-incorporation = April 1, 2015 to July 31, 2015 = 4 Months

Post-incorporation = August 1, 2015 to March 31, 2016 = 8 Months

∴ Time Ratio = 1 : 2

Sales Ratio :

Pre-incorporation = ` 3,00,000

Post-incorporation = ` 7,00,000

∴ Sales Ratio 3 : 7

16. (Problem with Fluctuations in Sales and Rent)

Shankar Pvt. Ltd. Co. took over the business of Shankar on 1-4-2015 and it was incorporated on 1-7-2015. The Profit and Loss Account of Shankar Pvt. Ltd. on 31-3-2016 was as follows :

Particular	`	Particular	`
To Commission (Sales)	2,625	By Gross Profit	98,000
To Advertising	5,250	By Bad Debts Recovered	500
To M.D's remuneration	9,000		
To Depreciation	2,800		
To Salaries	18,000		
To Insurance	600		
To Preliminary Expenses written off	700		
To Rent and Taxes	3,000		
To Discount	350		
To Bad Debts	1,250		
To Net Profit	54,925		
	98,500		98,500

Further Details :

a) The average monthly sales after incorporation was twice the average monthly sales before.

b) Rent, which was paid for the first three months at 200 per month, increased by 50 per month for the balance of the period.

c) Bad Debts of 350 related only to the period after 1 -9-2015 and the balance related to the sales made up 1-9-2015.

d) The Bad Debts realised belonged to the Bad Debts which were written off in 2014-15. Find out the profits before and after incorporation.

Sol :

In the books of Shankar Pvt.Ltd.

Dr. Income Statement for the year ended 31st March 2016 Cr.

Particular	Ratio	Pre incorpo-ration `	Post incorpo-ration `
Gross Profit	2 : 5	16,000	40,000
Bad debts realised	Pre	500	–
Total		14,500	84,000
Expenses			
Commission	1 : 6	375	2,250
Advertising	1 : 6	750	4,500
Managing Director's Remuneration	Post	–	9,000
Depreciation	1 : 3	700	2,100
Salaries	1 : 3	4,500	13,500
Insurance	1 : 3	150	450
Preliminary Expenses	Post	–	700
Rent(Note)		600	2,250
Taxes(Note)	1 : 3	38	112

Discount	1 : 6	50	300
Bad debts(Note)		386	864
Net Profit transfered to :			
– Capital Reserve A/c		6,951	–
– Profit & Loss App. A/c		–	47,974
		14,500	84,000

Calculations :

1) Time Ratio :

Pre-incorporation = April 1, 2015 to July 1, 2015 = 3 Months

Post-incorporation = July 1, 2015 to March 31, 2016 = 9 Months

Time Ratio = 1:3

2) Sales Ratio :

Average monthly sales of Post-incorporation is twice the average monthly sales of Pre-incorporation. Therefore:

Let the Pre-incorporation average monthly sales be - 1

To Post-incorporation average monthly sales will be - 2

So, Pre-incorporation sales = 1×3 months = 3

Post-incorporation sales = 2×9 months = 18

Sales Ratio = 1:6

3) Bad debts :

If the total bad debts of `. 1,250, x 350 related to Post-incorporation period after 1-9-2015. The balance of `. 900 (1,250 - 350) related both Pre-incorporation (i.e. 3 months) and Post-incorporation (i.e. 1-7-2015 to 1-9-2015 i.e., 2 months). Therefore `. 900 should be distributed between Pre-incorporation and Post-incorporation period on the basis of sales per month. Pre-incorporation sales = 1 x 3 months = 3 Post-incorporation sales = 2 (Twice) x 2 months = 4 Ratio for apportionment of bad debt = 3:4 Thus, Pre-incorporation bad debts = 3/7 x 900 = `. 386

Post-incorporation bad debts = 350 + 4/7 x 900 = `. 864

4) Rent :

Pre-incorporation 3 x 200 =	`.	600
Post-incorporation 9 x 250 =	`.	2,250
	`.	2,850

5) Taxes :

Rent and Taxes - Rent

`. 3000 - 2850 = `. 150

Pre-incorporation Taxes = 1/4 x 150 = `. 37.50 or `. 38.

Post-incorporation Taxes = 3/4 x 150 112.50 or `. 112

Note : Taxes are apportioned on the basis of time ratio.

Short Question and Answers

1. Explain about Company final Accounts as per companies Act, 2013.

Ans :

According to Section 128 Companies Act, 2013 every company shall keep at its registered office proper books of accounts regarding :

a. all sums of money received and expended by the company and matters in respect of which the receipts and expenditure take place;

b. all sales and purchases of goods by the company.

c. the assets and liabilities of the company, and

d. in case of a company pertaining to any class of companies engaged in production, processing, manufacturing or mining activities, such particulars relating to utilisation of material or labour or to other items of cost as may be prescribed.

2. Books of Accounts

Ans :

According to Companies Act, 2013 the companies should generally maintain the following books of accounts.

1. Cash Book to record cash and bank transactions.
2. Purchases Book to record credit purchases.
3. Sales Day Book to record credit sales.
4. Returns Inwards Book or Sales Returns Book to record goods returned by customers.
5. Returns Outwards Book or Purchases Returns Book to record goods returned by the company to suppliers.
6. Bills Receivable Book to record the details of bills receivable.
7. Bills Payable Book to record the details of bills payable.
8. Journal proper to record opening, closing and adjusting entries.

3. Profits Prior to Incorporation

Ans :

A company comes into existence from the date of issue of the certificate of incorporation by the Registrar of Companies. Sometimes, a newly incorporated company agrees to take over a running business w.e.f. a date prior to its incorporation. Such an agreement is made to avoid the necessity of preparing the final accounts of the vendor's business from the date it prepared its last final accounts till the date on which the business is actually acquired.

The assets and liabilities of the vendor's business are agreed as per the date of its last balance sheet. In such a case, the company becomes entitled to the entire profit or liable for the entire loss since the date it agrees to acquires the vendor's business.

4. Cut-off Date

Ans :

A private company can commence business soon after its incorporation, while a public company can commence business only after obtaining the certificate of commencement of business. This means that in case of a private company, any profit made before incorporation and in case of a public company any profit made before commencement of business should be taken as a capital profit. However, it has now been widely accepted that since once the certificate of commencement of business is given, the company's power to carry on the business related back to the date of incorporation and hence the date of incorporation should be taken as the relevant date for apportionment of profits between pre- and post-incorporation periods.

5. Basis of Apportionment

Ans :

In order to apportion the profit between pre- and post-incorporation periods, the following steps should be taken :

(i) The gross profit to the business should generally be calculated for the full period without apportioning it between pre- and post-incorporation periods.

(ii) The gross profit calculated as above should be divided between pre- and post-incorporation periods on the basis of sales of the two periods. In the absence of any instructions in the question, the sales may be presumed to be evenly made over the whole period.

(iii) Expenses which vary in proportion to sale, *e.g.* bad debts, commission on sales etc., should be divided in sales ratio between pre- and post-incorporation periods.

(iv) Expenses which vary according to time *e.g.* rent, salary, depreciation, interest etc., should be divided in time ratio between pre- and post-incorporation periods.

(v) Expenses which solely relate to pre-incorporation period, should be charged to the pre- incorporation period only. For example, salary to partners, interest on capital should be charged only to the profits of the pre-incorporation period.

(vi) Expenses which relate solely to the post-incorporation period, should be charged only against the profits of that period. Examples of such expenses are, interest on debentures, dividends, preliminary expenses, etc.

(vii) Expenses which may relate to both pre and post-incorporation periods should be charged to both the periods on time basis. For example, auditor's fee may be charged to both pre and post- incorporation periods. However, since getting accounts audited is compulsory in case of companies, the entire amount of audit fee may be charged solely to the post-incorporation period. Similarly, interest paid to the vendors for delay in payment of purchase consideration to them should be charged over both the pre- and post-incorporation periods depending upon the period up to which the interest has been paid.

(i) Profit made during pre-incorporation period, should be transferred to capital reserve. It is not available for distribution as dividend among the shareholders of the company.

6. Sales Ratio

Ans :

Certain expenses such as commission, advertisement etc. are apportioned between pre and post incorporation period in the sales ratio. Leaving some simple cases, where turnover is evenly spread over the whole financial period, sales normally fluctuate from month to month according to the nature of the product. For example, in case of wollen garments sales for the period from October to January will be much different from other months. Under such circumstances, the sales ratio is determined taking into consideration the relationship of monthly sales with that of total sales.

7. Weighted ratios

Ans :

It is often seen that total pay bill of certain expenses such as salary, wages etc. does not remain constant throughout the year. If they remain constant then they can be divided in the time ratio. But the difficulty arises when the number of employees change with the conversion of firm into a limited company. The ratio for this purpose is arrived at after considering time and number of wage earners in the pre-and post-incorporation periods.

Choose the Correct Answer

1. Public Ltd companies cannot issue [b]
   (a) Seet Eauity Shares (b) Deferred shares
   (c) Preference shares (d) Equity shares
2. Called up capital includes [c]
   (a) Discount of issue of shares (b) Securities premium
   (c) Both (d) None of the above
3. Redeemablen preference shares are redeemable [a]
   (a) Witin 20 years (b) Within 7 years
   (c) Both (d) None of the above
4. The provision for minimum subscription of 90% will not apply when shares are [b]
   (a) Offered to public (b) Solid through private placement
   (c) issue as right share (d) Bonus shares
5. Proceeds in connection with issue of shares at a premium would mean [b]
   (a) Only the net amount received (b) Face value of share issued
   (c) None of the above (d) None of the above
6. Call-in-arrear is shown [b]
   (a) Under the head current liabilities (b) By deducting from the called up capital
   (c) Under the head current liabilities (d) By adding from capital
7. The maximum allowable discount on Equity shares is [a]
   (a) 10% (b) 8%
   (c) 5% (d) 6%
8. Dividend is usually paid on [c]
   (a) Called-up-capital (b) Nominal capital
   (c) Paid-up-capital (d) Share capital
9. As per the SEBI's guidelines the minimum application money shall not be less than [a]
   (a) 25% of issue price (b) 10% of the issue price
   (c) 6% of the issue price (d) 5% of the issue price
10. Capital Redemption Reserve Account can be Utilized for [c]
    (a) Writing of past losses (b) Writing of capital losses
    (c) Issuing fully paid bonus shares (d) None of the above

Fill in the blanks

1. Share application account is a ________ Account.
2. Dividend declared between two annual general meetings is known as ________.
3. Pre-acquisition Profits are treated as ________ profit.
4. The minimum Share App;lication money is ________.
5. Consolidated Financial Statement are prepared as per Accounting Standard ________.
6. The protion of the authorized capital which can be called up only on the liquidation of the company is called ________
7. A debenture holder is the ________ of a company.
8. Preference Shares can be redeemed if they are ________.
9. PRemium received on issue of shares is shown in ________.
10. Difference between called up capital and paidup Capital is ________.

Answers

1. Personal
2. Interim Dividend
3. Capital
4. 5% of the face value of shares
5. 21
6. Reserve Capital
7. Creditor
8. Fully paid up
9. Balance Sheet
10. Unpaid Capital

UNIT V

Valuation of Goodwill and Shares :

Valuation of Goodwill: Need – Methods: Average Profits,Super Profits and Capitalization Methods -Valuation of Shares: Need –Net Assets, Yield and Fair Value Methods. (Including problems)

5.1 Valuation of Goodwill

5.1.1 Need

Q1. What is goodwill ? Explain its necessity for valuation of goodwill.

Ans : **(Dec.-19, Imp.)**

It is generally observed than an old and established firm in a position to earn a higher amount of profit as come to a new firm inspite of all other things (such as investment location, quality of goods etc.) remaining the same. The is because, over a period of time a firm establishes reputation on account of which not only do old customers continue to patronise the firm but they also bring in new customers. This enables the firm to earn excess profits compared to a new firm.

Goodwill has been define as "the present value of firm's anticipated excess earnings.

According to the Institute of Chartered Accountants of India, goodwill is "an intangible asset arise from business connections or trade name or reputation of an enterprise.

From the above, it can be concluded that goodwill is the estimated value of the reputation business.

Features of Goodwill

i) Goodwill can be sold only with the entire business or it cannot be sold in part or in isolation except on admission or retirement of a partner when new partner compensate the old partners or the retiring partner gives up his rights in favour of remaining partners.

ii) Goodwill is valuable only if it is capable of being transferred from one person to another. If it cannot be transferred then there will be no value of goodwill.

iii) Goodwill represents a non-physical value over and above the physical assets.

iv) Goodwill cannot have an exact cost as its value fluctuates from time to time due to internal or external factors which ultimately affect the fortune of the Company.

v) The value of goodwill is based on subjective judgement of the valuer.

Need for Valuation of Goodwill

The need for valuation of goodwill in a joint stock company arises in the following circumstance-

i) When the business of a company is taken over by another company, *e.g.,* in case of amalgamation or absorption.

ii) When the company's shares are not quoted on the stock exchange and their value is to determined for the purposes of estate duty and wealth tax, etc.

iii) When a person wants to purchase a large block of the company's shares with a view to acquire control over the management of the company,

(iv) When the business of the company is being taken over by the government.

(v) When the Management wants to write back goodwill which it wrote off earlier to reduce or eliminate the debit balance in the profit and loss account.

Factors Effecting the Value of Good will

The main factors affecting the goodwill are :

1. Profits expected to be earned by the concern. Profitability of a concern depends upon several factors such as nature of business,

favourable location or site, skill of management, possession of trade marks, patents and copyrights, future competition, Money Market conditions etc.

2. Capital requirement

3. Possibility of transfer of goodwill etc.

5.1.2 Methods of Valuation of Goodwill

Q2. Explain about methods of goodwill valuation.

Ans : **(Dec.-19, July-19, June-18, Imp.)**

The following are three basic methods for valuation of goodwill :

1. Simple profit method / Adding Profits Method

In this method goodwill is valued on the basis of a certain number of years' purchase of the average profits of the past few years.

For example, if the average annual profits of a business for the past 5 years are Rs 10,000 and goodwill is to be valued on the basis of 2 years' purchase of such average annual profits, the value of goodwill will be Rs 20,000.

2. Capitalization of profit method

In this method, the total value of the business is found out by capitalising the expected average profits on the basis of normal rate of return. The value of goodwill is the difference between the value of the business so found out and the actual capital employed in the business.

For example, if the average annual expected profit in a business is Rs 10,000, normal rate of return 10% and the actual capital employed in the business Rs 80,000, the value of goodwill will be Rs 20,000 (*i.e.* capitalised value of the business Rs 1,00,000—Actual capital employed Rs 80,000).

3. Super Profit Method

In case of this method, goodwill is based on the average annual super profit earned by the business. The term super profit means the profit over and above the normal profit.

This method is most popular for valuation of goodwill in case of joint stock companies.

$$\boxed{\text{Goodwill} = \text{Super profit} \times \text{No.of years purchased}}$$

Steps

1. Ascertain Capital Employed and Average Capital Employed.
2. Find the normal profits on the basis of normal rate of return. Normal profit is calculated generally on average capital employed.
3. Ascertain Future Maintainable Profits of the concern.
4. Calculate super profit by deducting normal profit from future maintainable profits.
5. Find out goodwill by multiplying super profits by the number of years they are expected to be earned.

Capital Employed

The yield expected by the investor is closely linked with the capital employed in the business. Capital employed can be calculated by any of the two methods given:

1) Assets side approach

Assets (other than goodwill and fictitious assets like preliminary expenses and non-trading assets such as Govt. Securities)	xx
Less : Liabilities due to outside parties	xx
Capital Employed	xx

2) Liabilities side approach

Share Capital	xx
Reserve Fund	xx
Profit & Loss A/c (Cr. Balance)	xx
Appreciation in the value of assets due to revaluation	xx
	xx
Less :	
Goodwill	xx
Preliminary Expenses & other fictitious assets	xx
Non-Trading Assets	xx
Fall in the value of assets due to revaluation	xx
Capital Employed	

Average Capital Employed

Is is ascertained as follows :

$$\frac{\text{Capital Employed at the end} + \text{Capital at the beginning}}{2}$$

If the capital employed in the beginning of the year is not given, average capital can be ascertained by deducting half of the profits of the year from the capital employed at the end of the year.

Normal Rate of Return : It is that rate of earning which investors in general expect on their investments in a particular type of industry. It differs from industry to industry.

Normal Profit : It is ascertained as follows

$$\text{Normal Profit} = \frac{\text{Normal Rate of Return}}{100} \times \text{Average Capital Employed}$$

Q3. How to ascertain the future maintainable profits ?

Ans :

Goodwill is payment for extra profits expected in future. It is not enough to have good profits in the past, it is also necessary that extra or super profits should be available in future. Future maintainable profits is ascertained by adjusting past profits in the light of changes that are expected to take place in future. It is ascertained as follows :

	Past Average Profits	xx	
Add :	Expenses charged to Profit & Loss A/c in the past but not likely to be incurred in future	xx	
Add :	Expected Profit on new product	xx	xx
		xx	
Less :	Expenses to be incurred in future but not charged to profit in the past such as		
	i) Salary to partner or additional remuneration to directors etc.	xx	
	ii) Depreciation on the increase in the value of fixed asset.	xx	
	iii) Increase in tax liability	xx	
	Income from Non-Trading assets	xx	xx
	Future Maintainable Profits		xx

While calculating future maintainable profits, it is advisable to average the profits for the past four or five years.

The super profit method of calculating goodwill is considered better than simple profit method since it gives due consideration to capital employed in the business which is absolutely ignored in case of simple profit method.

PROBLEMS ON GOODWILL

1. A, B and C are partners sharing profits and losses in the ratio of 2/5, 2/5 and 1/5 respectively. It was provided in the partnership agreement that in the event of the death or retirement of a partner, goodwill should be calculated on the basis of three years purchase of the average net profits for the preceeding five years. B retires on 31st December, 2005. Calculate the amount of goodwill due to B. Net profits for the previous five years were as follows :

2001 Rs. 32,000; 2002 Rs. 38,000 2003 Rs. 40,000

2004 Rs. 29,000; 2005 Rs. 41,000.

Sol :

Good will = Simple average profit × Number of purchasing years

$$\text{Simple average profit} = \left(\frac{\text{Total Profit}}{\text{Number of Years}}\right)$$

$$\left[\frac{32000+38000+40,000+29,000+41,000}{5}\right]$$

$$\Rightarrow \quad \frac{1,80,000}{5} = 36,000$$

Goodwill = 36,000 × 3

= 1,08,000

B' share = $1,08,000 \times \frac{2}{5}$

= 43,200.

2. Pravek Ltd., agrees to purchase the business carried on by Rohan Ltd. Goodwill for this purpose is agreed to be valued at three years purchase of we Weighted average profits of the previous five years, the weights to be used are :

1st year – 1, 2nd year – 2, 3rd year – 3, 4th year – 4, 5th year – 5

Profits for the five years are :

First years Rs. 30,000; Second year Rs. 36,080; Third year Rs. 45,000; Fourth year Rs. 49,000 and Fifth year Rs. 52,000.

Sol :

Good will = Weighted average profit × Number of purchasing years

Weight average profit = $\left(\frac{\text{Total Products}}{\text{Total weight}}\right)$

Year	Profit	Weight	Products
1	30,000	1	30,000
2	36,000	2	72,000
3	45,000	3	1,35,000
4	49,000	4	1,96,000
5	52,000	5	2,60,000
		15	6,93,000

$$= \frac{6,93,000}{15}$$

= 46,200

Goodwill = 46,200 × 3

= 1,38,600.

3. A Limited company agrees to purchase the business carried on by B. Limited goodwill for this purpose is agreed to be valued at 3 years purchase of average profits of the previous 5 years. Profits for 5 years are :

Ist – 15,000, IInd – 20,000 IIIrd – 25,000 IVth – 30,000, Vth – 35,000. Calculate the value of goodwill?

Sol :

Goodwill = weight average profit × Number of purchse years

$$\text{Weighted average profit} = \left(\frac{\text{Total Product}}{\text{Total Weight}}\right)$$

Year	Profit	Weight	Products
1	15,000	1	15,000
2	20,000	2	40,000
3	25,000	3	75,000
4	30,000	4	1,20,000
5	35,000	5	1,75,000
		15	4,25,000

$$= \frac{4,25,000}{15}$$

= 28,333

Goodwill = 28,333 × 3

= 84,999.

4. On the basis of the following, you are required to calculate (i) Capital Employed and (ii) Average Capital Employed.

		Rs.		Rs.
Share Capital		**3,00,000**	**Goodwill**	**25,000**
Reserves		**1,20,000**	**Buildings**	**1,75,000**
Profit of the current year		**50,000**	**Machinery**	**1,40,000**
Depreciation Fund:			**Current Assets**	**3,10,000**
Machinery	**40,000**			
Buildings	**10,000**	**50,000**		
8% Debentures		**1,00,000**		
S. Creditors		**30,000**		
		6,50,000		**6,50,000**

Sol :

a) i) Calculation of Capital Employed

Capital employed = Assets – Liabilities.

Particulars	Amount	Amount
Assets		
Buildings		1,75,000
Machinery		1,40,000
Current Assets		3,10,000
		6,25,000
(–) Liabilities		
Deperciation on furniture	50,000	
8% Debenture	1,00,000	
Creditors	30,000	1,80,000
Capital employeed		4,45,000

Average Capital Employeed

Capital employeed – 50% of curent year profit

4,45,000 – 50% on Rs. 50,000

4,45,000 – 25,000

4,20,000.

Average capital employed = 4,20,000.

5. **On the basis of the following Balance Sheet and subjoined information ascertain the capital employed in the business.**

Balance sheet as on 31st **December, 1988**

Liabilities	`	Assets	`
5,000 8% Preference Shares		**Goodwill**	**3,72,000**
of ` 100 each	**5,00,000**	**Premises at Cost**	**2,00,000**
1,00,000 Equity Shares		**Machinery at Cost**	**15,00,000**
of ` 10 each	**10,00,000**	**Vehicle at cost**	**20,000**
Reserves	**3,50,000**	**Stock**	**6,15,000**
Profit of the Current Year	**5,66,000**	**S. Debtors**	**2,00,000**
6% Debentures	**10,00,000**	**Investments (for the**	
Secured Loans	**1,00,000**	**replacement of machines)**	**8,00,000**
S. Creditors	**1,50,000**	**Bank Balance**	**96,00Q**
Provision for taxation	**1,50,000**	**Preliminary expenses**	**13,000**
	38,16,000		**38,16,000**

The present value of Premises is ` 6,00,000; Machinery ` 12,00,000: Investments ` 7,50,000. Stock is to be valued at book value, S. Debtors are bad to the extent of 10% and Vehicle is valued at ` 14,000.

Sol :

Calculation of Capital Employed

Capital employed = Assets – Liabilities.

Particulars	Amount	Amount
Assets		
Premises	6,00,000	
Machiney	12,00,000	
Vechicles	14000	
Stock	6,15,000	
Debtors [2,00,000–20,000]	1,80,000	
Investment	7,50,000	
Bank	96000	
		34,55,000
(–) Liabilities		
6% Debentures	10,00,000	
Secured loans	1,00,000	
Creditors	1,50,000	
Provision for taxation	1,50,000	14,00,000
Capital employeed		20,55,000

Average Capital Employeed

Capital employeed – 50% of current year profit

20,55,000 – 50% on 5,66,000

20,55,000 – 2,83,000

17,72,000.

Average capital employed = 17,72,000.

6. The Balance Sheet of 'X' Ltd., as on 31st March, 2005 is as follows :

Liabilities	Rs.	Assets	Rs.
8% 5,000 Preference Shares		Goodwill	10,000
of Rs. 10 each	50,000	Fixed Assets	1,80,000
10,000 Equity Shares		Investments (5% Govt, loan)	20,000
of Rs. 10 each	1,00,000	Current Assets	1,00,000
Reserves (including Provision		Preliminary Expenses	10,000
for taxation Rs. 10,000)	1,00,000	Discount on Debentures	5,000
8% Debentures	50,000		
Creditors	25,000		
	3,25,000		3,25,000

The average profit of the Company (after deducting interest on debentures and taxes) is Rs.31,000. The present market value of the machinery included in fixed assets is Rs.5,000 more.

Expected rate of return is 10%.

Evaluate the goodwill of the company at five times of the super profits.

Sol :

Calculation of Goodwill as per Super profit Method

Goodwill = Super Profit × Number of purchasing year

Super profit = Actual profit – Normal proift

1. Actual Profit

Average profit	31,000
(–) Income from investments $\left(20,000 \times \frac{5}{100}\right)$	1,000
Actual Profit	30,000

2. Normal Profit

Capital employed/Average capital employed × $\frac{\text{Normal Rate}}{100}$

Capital Employed

Assets – Liabilities

Particulars	Amount	Amount
Assets		
Fixed assets [1,80,000 + 5,000]		1,85,000
Current assets		1,00,000
		2,85,000
(–) Liabilities		
8% Debentures	50,000	
Creditors	25,000	
Provision for taxation	10,000	8,50,000
Capital employeed		2,00,000

Average Capital Employeed

Capital employeed – 50% of current year profit

2,00,000 – 50% of Rs. 30,000

2,00,000 – 15,000 $\frac{50 \times 30,000}{100}$

= 1,85,000

$$\text{Normal profit} = 1{,}85{,}000 \times \frac{10}{100}$$

$$= 18{,}500$$

Super profit = Actual Profit – Normal Profit

= 30,000 – 18,500

= 11,500

Goodwill = Super profit × Number of purchase year.

= 11,500 × 5

= 57,500

---

7. Given below is the Balance Sheet of ABC Co. Ltd., as at 31st December, 2005.

Liabilities		Rs.	Assets		Rs.
Share Capital :			Goodwill		30,000
20,000 Equity Shares of			Land and Buildings		80,000
Rs.10 each		2,00,000	Plant and Machinery		50,000
General Reserve		90,000	Investments		1,20,000
Profit & Loss A/c			Stock		1,00,000
Bal on 1-1-2005	12,000		Debtors	1,40,000	
Profit for the year	48,000		Less : Provision	20,000	
		60,000			1,20,000
8% Debentures		1,00,000	Cash at Bank		40,000
Creditors		60,000	Preliminary Expenses		10,000
Provision for Taxation		40,000			
		5,50,000			5,50,000

Profit for the year included Rs.6,000 income from investments. Investments are all in Government Securities. Land and Buildings are worth Rs.2,00,000 and Plant and Machinery Rs.40,000. Computer the value of goodwill on the basis of 3 year's purchase of super profit. Normal rate of return on capital employed in this type of business is 10%.)

Sol :

Calculation of Goodwill Under Super Profit Method

Good will = Super profit × No. of Purchasing year

Superprofit = Actual profit – Normal profit

1. Acutal profit

Average profit	48,000
(–) Income from investment	6,000
Actual profit	42,000

Normal Profit

$$\text{Capital employed / Average capital employed} \times \frac{\text{Normal rate}}{100}$$

Capital Employed

Assets - Liabilities

Particulars	Amount	Amount
Assets		
Land buildings	2,00,000	
Plant machinery	40,000	
Stock	1,00,000	
Debtors	1,20,000	
Cash at bank	40,000	
Total Assents		5,00,000
Liabilities		
8% Debentures	1,00,000	
Creditors	60,000	
Provision for taxation	40,000	2,00,000
Capital employed		3,00,000

Average capital employed

Capital employed - 50% current year profit

3,00,000 – 50% 42,000

3,00,000 – 21,000 = 2,79,000

$$\text{Normal profit} = 2{,}79{,}000 \times \frac{10}{100} = 27{,}900$$

Super profit = 42000 – 27900 = 14100

Good will = Super profit × No. of profit years

= 14100 × 3 = 42,300

8. Given below is the Balance Sheet of ABC Co. Ltd., as at 31st December, 2005.

Liabilities	Rs.	Assets	Rs.
Capital	1,64,000	Land and Buildings	36,000
General reserve	40,000	Plant	54,000
Creditors	38,040	Investments	30,000
		Stock	26,850
		Bank	75,990
		Debtors	19,200
	2,42,040		2,42,040

The following were the net profits for the year ended :

	Rs.
30th September, 2003	**32,280**
30th September, 2004	**36,870**
30th September. 2005	**43,350**

The above amounts include income from investments, Rs. 1,800 each year. You are required to value the good will of the above business at 2 years purchase of the average super profit for 3 years, taking into account the fact that the standard rate of return on capital employed in such type of business is 10% assuming that each year's profit is immediately withdrawn in full by Mr. Chandy.

Sol :

Good will = Super profit × No. of purchasing years

Super profit = Actual profit – Normal profit

i) Actual Profit

Year	Profit	Weight	Products
2003	32,280	1	32,280
2004	36,870	2	73,740
2005	43,350	3	1,300,50
		6	2,36,070

Weighted avg profit $= \dfrac{236070}{6}$

$= 39345$

Weighted avg profit	39345
(–) Income from investments	1800
Average profit	37,545

ii) Normal Profit

Assets - Liabilities

Particulars	Amount	Amount
Assets		
Land buildings	-	36,000
Plant		54,000
Stock		26,850
Bank		76,990
Debtors		19,200
Total Assets		2,12,040
Liabilities		
Creditors	38,040	38,040
Capital employed		1,74,000

$$\text{Normal profit - Capital employed} \times \frac{\text{Normal rate}}{100}$$

$$= 1{,}74{,}000 \times \frac{10}{100}$$

$$= 17{,}400$$

Super profit = Actual profit – Normal profit

= 37,545 – 17,400

= 20,145

Good will = 20,145 × 21

= 40,290

5.2 Valuation of Shares

Q4. What is valuation of Shares? Explain its necessity for valuation.

Ans : **(July-19, June-18, Imp.)**

Meaning

Valuation of shares is one of the most perplexing problems that confront students of accountancy. The basic principles are by no means difficult but their applications calls for a considerable degree of knowledge of the various technicalities involved.

Valuation and Stock Exchange Prices

In case of shares quoted on a recognised stock exchange, stock exchange prices are generally taken as the basis for the valuation of those shares. However, the stock exchange quotations are not generally acceptable when a large block of company's shares is involved. This is because stock exchange price is basically determined on the interactions of demand and supply and business cycles. They cannot form a fair and equitable or rational basis for compensation.

The Council of the London Stock Exchange has also expressed the same opinion in the following words :

"The stock exchange may be likened to a scientific recording instrument which registers, not its own actions and opinions but the actions and opinions of private institutional investors all over the country and indeed the world. These actions and opinions are the result of fear, guess work, intelligent or otherwise, good or bad investment policy and many other considerations. The quotations that result definitely do not represent valuation of a company by reference to its assets and its earning potential."

Need for Valuation

The need for valuation of shares arises in one or more of the following circumstances.

i) Assessments under estate duty, wealth tax, gift tax, etc.

ii) Purchase of a block of shares generally involving acquisition of controlling interest in the company.

iii) Formulations of schemes of amalgamation, absorption, etc.,

iv) Acquisition of interest of dissenting shareholders under reconstruction scheme

v) Conversion of preference shares into equity shares.

vi) Advancing loans on the security of shares

vii) compensating shareholders on the acquisition of their shares, by the government under a scheme of nationalization.

5.2.1 Factors Affecting Valuation of Shares

Q5. What are the factors affecting on valuation of shares ?

Ans : **(Imp.)**

The main factors effecting value of share are :

i) Capital employed

ii) Earning Capacity or Profitability and

iii) normal rate of return, the yield expected by investors in the industry to which the firm belongs.

In case of companies going into liquidation the net assets of the company is the most important factor. In case of going concerns, both earning capacity and net assets are considered while valuing shares. In case of professional concerns such as architects and engineering consultants valuation depends wholly on earning capacity not on the assets owned by the concern.

5.2.2 Methods of Valuation

Q6. What are the various methods of valuation shares?

Ans :

The methods of valuation of share may be broadly classified as follows :

1. Net Assets Backing Method,
2. Yield Method / Earnings basis / Market Value Method.
3. Dual method or Fair Value Method

Above methods are generally used for valuation of equity shares. However, they can also be used to some extent in case of preference shares, as explained later.

5.2.2.1 Net Assets Backing Method

Q7. Explain about net Assets Backing Method.

Ans : **(Imp.)**

This is also termed as balance sheet method or asset backing method or intrinsic or breakup value method. In case of this method, the net assets of the company (including goodwill and non-trading assets) are divided by the number of issued shares to arrive at the asset backing for each share.

The following points should be kept in mind while valuing shares according to this method:

i) A proper value should be placed on the goodwill of the business.

ii) fictitious assets, such as preliminary expenses, debit balance in the profit and loss account etc. should be excluded.

iii) All other assets, (including non-trading assets, such as investments) should be taken at their market values. In the absence of information in the question about the market values of the different assets, book values may rightly be taken as the market values of the different assets. Liabilities payable to third parties and preference share capital should be deducted from the total assets. It should be noted that items constituting part of the equity shareholders' funds *(e.g.* general reserve, profit and loss account credit balance, debentures redemption fund, dividends equalization reserve, contingency reserve etc.) should not be deducted.

iv) The net assets so arrived at should be divided by the number of equity shares to arrive at value of the share. However, this has to be done only when all shares are equally paid-up. In case the company's equity shares are of different paid-up values, the total net assets should allocated to the different paid-up value groups. Each such allocation should then be divided by the number of shares in each of such groups.

Thus, the value of an equity share, according to this method, can be found out as shown in the following statement:

Particulars		Rs.	Rs.
Goodwill as valued			....
Investments at market value			....
Other assets at market value			....
			....
Less:	Debentures	....	
	Accounts payable	....	
	Other liabilities	....	
	Preference capital	....	....
Net assets available for equity shareholders (i)			....
Number of equity shares (ii)			....
Value of an equity share (i)/(ii)			....

This method of valuation is generally not recommended for going concerns since in their case yield is the predominant factor. However, in case of companies like, investment companies, such a basis of valuation may be acceptable since yield, in their case primarily depends upon the assets position. Similarly in case of companies having highly uneven past results, this method of valuation may be the only choice since no reliable information is available about the expected earnings of the company. The method is also suitable for a company which has been showing consistent losses with no apparent prospect of recovery

5.2.2.2 Yield / Earnings / Market Value Method

Q8. Explain about Market Value Method.

Ans :

The yield basis of valuation may take any of the following two forms :

i) Valuation based on rate of return.

ii) Valuation based on productivity factor.

i) Valuation Based on Rate of Return

The term "rate of return" refers to the return which a shareholder earns on his investment. It may further be classified as (a) rate of dividend and (b) rate of earning.

(a) Valuation based on rate of dividend : This method of valuation is particularly suitable for valuing small block of shares. The value of a share according to this method can be found out by applying the following formula:

Paid-up value of share $\times$ Possible rate of dividend $\div$ Normal rate of dividend.

OR

$$\frac{\text{Dividend per Share (in Rupees)}}{\text{Normal rate of returns}} \times 100$$

(b) Valuation based on rate of earning : This method of valuation is particularly suitable for valuing a large block of the company's shares. A big investor is more interested in what the company earns and not simply in what the company distributes. This is because the rate of earning of the company explains the effective utilization of the company's assets. In case the company does not distribute 100 per cent of its earning among its shareholders, it, as a matter of fact, strengthens the financial position of the company

The value of a share according to this method can be calculated by the following formula :

$$\frac{\text{Expected Rate (of Return)}}{\text{Normal rate}} \times \text{Paid-up value of share}$$

$$\text{Expected Rate of Return} = \frac{\text{Expected Profit}}{\text{Equity Capital}} \times 100$$

Value of share based on rate of earnings can also be found out by capitalisation method

$$\text{Capitalised Value of Profit} = \frac{\text{Expected Profit}}{\text{Normal rate}} \times 100$$

$$\text{Value of Each Equity Shares} = \frac{\text{Capitalised Value of Profit}}{\text{Number of Equity Shares}} \times 100$$

(ii) Valuation Based on Productivity Factor

Productivity factor represents the earning power of the company in relation to the value of the assets employed for such earning. The factor is applied to the net worth of the company on the valuation date to arrive at the projected earnings of the company. The; projected earnings after necessary adjustments (as discussed later) are multiplied by the appropriate:.. . capitalization factor to arrive at the value of the company's business. The total value is divided by the number of equity shares to ascertain the value of each share.

The productivity factor based valuation is merely a method for ascertaining a reliable figure future profits. The steps involved in such a method of valuation are as follows:

(a) Average net worth of the business is ascertained by taking those number of years whose results are relevant to the future. It will be appropriate to determine the average net word* of each year on the basis of net worth of the business at the commencement and at close each of the accounting years under consideration. The average net worth of the business for the period under study would be calculated on the basis of the average net wore calculated as above for each of the accounting years.

(b) Net worth of the business on the valuation date is ascertained.

(c) Average profit earned for the period under consideration is ascertained on the basis of the profit earned by the business during the period by simple or weighted average method may be considered appropriate.

(d) The productivity factor is found out as:

$$\frac{\text{Average profit}}{\text{Average net worth}} \times 100$$

(e) The productivity factor calculated as above is applied to the net worth of the business on the valuation date to ascertain the projected income of the business in future.

(f) The projected income so calculated is adjusted further by making appropriations for replacement, tax, rehabilitation of plant and equipments, under-utilization of productive capacity, effects of restrictions on monopoly and dividend on preference shares. Thus, the profits available for the equity shareholders are ascertained.

(g) The normal rate of return for the company is ascertained keeping in view nature and size of the undertaking.

(h) Appropriate capitalization factor or multiplier based on normal rate of return is ascertained, as explained earlier.

(i) The capitalization factor obtained as above is applied to adjusted projected profits available for the equity shareholders to ascertain the capitalised value of the undertaking.

(j) The capitalised value of the undertaking as ascertained above is divided by the number of equity shares to arrive at the value per share.

5.2.2.3 Dual (or Fair Value) Method

Q9. Explain about fair value method.

Ans :

Many accountants are of the view that neither the net assets basis nor the earning basis of valuation os shares is correct, but the fair valuation method may be an average of the two methods of valuation of shares.

The formula for the valuation of shares according to the dual method or fair value method is as follows.

$$\text{Value of Share} = \frac{\text{Value of a share on net assets basis} + \text{Value of a share on earnings basis}}{2}$$

Since this method takes the average of the values obtained in net assets basis and earnings basis, it makes an attempt to minimise the demerits of both net assets basis and earnings basis methods.

PROBLEMS

9. The following is the summarised Balance of Shivakumar Ltd. as at December 31, 2004.

Liabilities	Rs.	Assets	Rs.
10,000 9% preference shares of Rs. 100 each, fully paid	10,00,000	Fixed assets	40,00,000
		Investments	10,00,000
		Current Assets:	
20,000 Equity shares of Rs. 100 each, fully paid	20,00,000	Stock in trade	6,00,000
		Stock Debtors	
Reserve and surplus :			
General reserve	15,00,000		
Profit & Loss A/c	10,00,000		
Secured loans :			
8% Debentures	10,00,000		
Current liabilities :			
S. Creditors	4,00,000		
Liabiliteis for expenses	1,00,000		
	70,00,000		70,00,000

For the purpose of valuation of shares, Fixed Assets are to be depreciated by 10%, Investments are to be revaluated at Rs. 11,00,000. Stock at Rs. 5,80,000. Debtors will realise Rs. 11,75,000.

Interest on Debentures is outstanding for six months and preference divided for 2004 is to be paid. Calculate the value of each Equity share.

Sol :

Calculation of Equity Share Value As Per Net Assets Method

$$\text{Equity share value} = \frac{\text{Assets available to equity share holder}}{\text{No. of equity shares}}$$

Assets Available to Equity Share Holder

Particulars	Amount	Amount
Assets		
Fixed asset (40,00,000 – 4,00,000)		36,00,000
Investments		11,00,000
Stock		5,80,000
Debtors		11,75,000
Cash and bank balance		2,00,000
		66,55,000

Liabilities		
8% Debenture	10,00,000	
Creditors	4,00,000	
Liabilities for expenses	1,00,000	
O/S interst on debentures		
$\left[10,00,000 \times \frac{8}{100/2}\right]$	4000	15,4000
Assets Available to total share holder		51,15,000
(–) 9% preference share capital		10,00,000
		41,15,000
(–) Preference share dividend $\left[10,00,000 \times \frac{9}{100} x\right] 1$		90,000
Assets available to equity share holder		40,25,000

$$\text{Equity share value} = \frac{40,25,000}{20,000} = 201.25$$

10. From the following information, find out value of each share.

Balance Sheet of X Company Ltd.

Liabilities	Rs.	Assets	Rs.
Share capital : 20,000		**Fixed assets :**	
Equity shares of		**Good will**	**1,90,000**
Rs. 10/- Each	**2,00,000**	**Investments**	**3,00,000**
Reserves and Surplus :		**Current assets, loans**	
Reserves	**2,50,000**	**and Advances :**	
Profit & Loss A/c	**30,000**	**(a) Current Assets**	**50,000**
Unsecured loans	**80,000**	**(b) Loans & Advances**	**30,000**
Current liabilities	**20,000**	**Misc. expenditure**	**10,000**
	5,80,000		**5,80,000**

For the purpose of valuation of shares goodwill shall be taken at two year's purchase of the average profit of the last five years. The profits for the last five years are : Rs. 60,000. Rs. 70,000; Rs. 40,000; Rs. 40,000; Rs. 50,000; and Rs. 50,000.

Sol :

Calculation of Goodwill as per simple average profit method

Good will Profit Method

Good will = simple avg profit × No. of purchasing year

$$\text{Simple avg profit} = \frac{\text{Total profit}}{\text{No. of years}}$$

$$= \frac{60,000 + 70,000 + 40,000 + 50,000 + 50,000}{5}$$

$$= \frac{2,70,000}{5} = 54,000$$

Good will = 54,000 × 2

= 1,08,000

Calculation of Equity share value as per net assets Method

$$\text{Equity share value} = \frac{\text{Assets available to equity share holder}}{\text{No. of equity shares}}$$

Assets vailable to equity share holder

Particulars	Amount	Amount
Assets		
Good will		1,08,000
Investments		3,00,000
Current assets		50,000
Loans & Advances		30,000
Total assets		4,88,000
(−) Liabilities		
Unsecured loans	80,000	
Current liabilities	20,000	1,00,000
Assets available total share holders		3,88,000
(–) perference share capital		Nil
Assets available equtiy share capital		3,88,000

$$\text{Equity share value} = \frac{3,88,000}{20,000}$$

= 19.44

11. It is provided in the articles of association that at the death of a shareholder his shares will be purchased by the remaining shareholders at a price to be settled ont he basis of the last balance sheet. It is further provided that goodwill shall be valued on the basis of three years purchase of the average annual profits for the last five years. The last Balance sheet is as follows.

Liabilities	Rs.	Assets	Rs.
20,000 Equity		Good will	2,00,000
Share of Rs. 10 each,	2,00,000	Investment at cost	
General reserve	2,00,000	(market value Rs. 2,50,000)	3,00,000
Profit & Loss A/c	1,70,000	Stock at cost	5,00,000
Workmen's saving fund	2,00,000	Debtors	4,00,000
Employer's provident fund	1,00,000	Bank balance	70,000
Creditors	6,00,000		
	14,70,000		14,70,000

The profits for the last five years were Rs. 15,000; Rs. 20,000; Rs. 25,000; Rs. 30,000 and Rs. 35,000. You are required to calculate the price to be paid for each share.

Sol :

Calculation of goodwill as weighted avg method.

Year	Profit	Weight	Products
I	15000	1	15,000
II	20,000	2	40,000
III	25,000	3	75,000
IV	30,000	4	1,20,000
V	35,000	5	1,15,000
			4,25,000

Good will = Weighted avg × No. of P.years profit.

$$\text{Weighted avg} = \frac{\text{Total product}}{\text{Total weight}}$$

$$= \frac{4,25,000}{15}$$

$$= 28,333.33$$

Good will = 28,333.33 × 3 = 85,000

$$\text{Equity share capital} = \frac{\text{Assets available to equity share holder}}{\text{No.of equity share}}$$

Particulars	Amount	Amount
Assets		
Good will		85,000
Investment		2,50,000
Stock		5,00,000
Debtors		4,00,000
Bank balance		70,000
Total Assets		13,05,000
(–) Liabilities		
Workmen funds	2,000,000	
Employee provident funds	1,00,000	
Creditors	6,00,000	9,00,000
Assets available total share holder		5,05,000
(–) Preference capital		Nil
Assets available equity share holder		4,05,000
Equity share value $= \frac{4,05,000}{20,000} = 20.25$		

12. The Balance Sheet of Piyush Company as on 31st March, 2004 is given below.

Liabilities	Rs.	Assets	Rs.
Share Capital		**Fixed Assets at Cost**	**5,00,000**
60% Cum. Preference Shares of Rs. 10 each fully paid	**1,00,000**	**Current Assets**	**2,60,000**
Equity Shares of Rs. 10 each, fully paid	**5,00,000**	**Preliminary Expences**	**35,000**
General Reserve	**15,000**	**Discount on Debentures**	**5,000**
Debentures Redemption Fund	**15,000**		
Depreciation Fund	**20,000**		
8% Debentures	**50,000**		
S. Creditors	**1,00,000**		
	8,00,000		**8,00,000**

Current Assets included Investments Rs.60,000, market price of whice is Rs. 55,000. Debtors included in Current Assets are doubtful to the extent of Rs. 8,000. Stcock at the end did not include a return of Rs. 3,000, through transaction was properly recorded and posted. There was a liability of Rs. 6,000 which remained unrecorded in books. Debenture interest is owing for one year and preference dividends are in arrears for two years. Assuming that the other assets are worth their book values, calculate the value of each equity share.

Sol :

Calculation of equity share value Asper Net Assets Method :

Equity share = Assets Available to capital = $\frac{\text{Equity share holders}}{\text{No.of Equity shares}}$

Assts Available to equity share holder :

Particulars	Amount	Amount
Assets		
Fixed Assets	5,00,000	
(–) Dep fund	20,000	4,80,000
Current Assets	2,60,000	
(–) loss on investment (60,000–55,000)	5000	
(–) Doubtful Debts	2,55,000	
	8000	
	2,47,000	
(+) Sales return not included	3000	
in stock		2,50,000
Total Assets		7,30,000
(–) Liability :		
8% Debentures	50,000	
Sundry creditors	1,00,000	
un Record liability	6000	
outstanding interest on Debentures $\left(50{,}000 \times \frac{8}{100}\right)$	4000	1,60,000
Assets available total share holders		5,70,000
(–) 6% preference capital share		1,00,000
		4,70,000
(–) preference $\left(1{,}00{,}00 \times \frac{6}{100} \times 2\right)$ dividends		12,000
Assets available equity share holder		4,58,000

Equity share value $\frac{4{,}58{,}000}{50{,}000}$

$\left[\frac{\text{Capital}}{\text{f}\cdot\text{c}} \frac{50{,}00{,}000}{10}\right] = 50{,}000$

= 9.16

13. From the following information, calculate the value of Equity share.

Liabilities

	Rs.
20,000 Equity Preference Shares of Rs. 100 eash	**2,00,000**
50,000 Equity shares of Rs. 10 each, Rs. 8 per share paid up	**4,00,000**
Expected profits per year before tax	**3,00,000**
Rate of tax	**50%**
Transfer of General reserve every year	**20% of Profit**
Normal rate of earning	**15%**

Sol :

Calculation of equity share value asper yield basis method :

Equity share = Expected = paidup value

$$\text{Value} = \frac{\text{Rate}}{\text{Normal Rate}} \times \text{equity share}$$

Expected Rate = profits available

$$\frac{\text{equity share holder}}{\text{equity share capital}} \times 100$$

Profits available to equity share holders

Particulars	Amount
Avg Profit	3,00,000
(–) Income tax (50%) $\left[3,00,000 \times \frac{50}{100}\right]$	1,50,000
	1,50,000
(–) Transfer to general Reserve (20%)	30,000
	1,20,000
(–) Prefrence share divided $\left(2,00,000 \times \frac{10}{100}\right)$	20,000
Profits available equity	1,00,000

$$\text{Expected Rate} = \frac{1,00,000}{4,00,000} \times 100$$

$$= 25$$

$$\text{Equity share value} = \frac{25}{15\%} \times 8$$

$$= 13.33$$

14. (Intrinsic Value Method when preference shares have priority)

The following is the Balance Sheet of Sunmate Ltd. as on 31.3.2015 :

Liabilities	`	Assets	`
2,000, 6% Preference Shares of `10 each	20,000	Buildings	55,000
8,000 Equity Shares of `10 each	80,000	Machinery	65,000
Reserve Fund	50,000	Patents	10,000
Profit & Loss A/c	16,000	Stock	28,000
Workmen's Saving A/c	15,000	Sundry Debtors	40,000
Sundry Creditors	49,000	Cash	26,000
		Preliminary expenses	6,000
	2,30,000		2,30,000

1. It was discovered that machinery was under depreciated by ` 5,000.
2. Value of buildings is ` 1,30,000 and Goodwill is ` 20,000.
3. ` 6,000 worth of debts are bad.
4. The preference shares have priority for capital repayment.

Findout the intrinsic value of both types of shares.

Sol :

Calculation of Intrinsic Value per Share

Particulars	`	`
Market value of Assets :		
Goodwill	20,000	
Buildings	1,30,000	
Machinery (`65,000 - `5,000)	60,000	
Patents	10,000	
Stock	28,000	
Sundry Debtors (40,000 - 6,000)	34,000	
Cash	26,000	3,08,000
Less: Total Liabilities:		
Workmen's Saving A/c	15,000	
Sundry Creditors	49,000	64,000
Net assets available for Share Holders		2,44,000
Less: Preference Share Capital		20,000
Net Assets available for Equity Shareholders		2,24,000

Calculation of Intrinsic value of each Equity Share

$$\text{Intrinsic value per equity share} = \frac{\text{Net assets available for equity share holders}}{\text{Number of equity shares}}$$

$$= \frac{2,24,000}{8000} = \text{Rs. } 28$$

Calculation of Intrinsic value of each Preference Share

$$\text{Intrinsic value per preference share} = \frac{\text{Total preference share capital}}{\text{Number of preference shares}}$$

$$= \frac{20,000}{2000} = \text{Rs. } 10$$

Note :

1. Workmen's Saving account refers to the amount due from the company to the workmen. It is a liability for the company. So, it should be deducted from the total values of assets along with other liabilities.
2. The Machinery was under depreciated by ` 5,000 therefore, the value of machinery should be reduced by ` 5,000 so as to get its market value.

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15. (Intrinsic Value and Yield Method)

Following information relates to Deepika Ltd.

4,000 10% preference shares of ` 100 each	` 4,00,000
5,000 equity shares of 100 each	` 5,00,000
Average profits before tax	` 3,22,580
Rate of tax	38%
Transfer to be made to Reserve	20%
Normal rate of return	15%

Ascertain the value of each equity share under yield method.

Sol :

Yield Method

Step 1 - Calculation of Average Profit	3,22,580
Step 2 & 3 - Calculation of Profit available for divided to equity shareholders	`
Average profit (Before depreciation and tax)	3,22,580
Less : Provision for Tax at 38%	1,22,580
	2,00,000
Less : Transfer to Reserve	40,000
	1,60,000
Less : Preference Dividend at 10% on ` 4,00,000	40,000
Profit available to Equity Shareholders	1,20,000

Step 4 - Calculation of Capitalised Profits.

$$\text{Capitalised Profit} = \frac{\text{Profit available for dividend to equity shareholder}}{\text{Normal rate of return}} \times 100$$

$$= \frac{1,20,000}{15} \times 100 = ` \ 8,00,000$$

Step 5 - Calculation of Market Value or Yield Value of share

$$\text{Market Value per share} = \frac{\text{Capital Profit}}{\text{Number of Equity Shares}}$$

$$= \frac{8,00,000}{5000} = ` \ 160 \text{ per share}$$

Alternatively :

Step 1 - Calculation of Average Profit	` 3,22,580
Step 2&3 - Calculation of profit available to Equity Shareholders	`
Average Profits before tax	3,22,580
Less : Provision for tax at 38%	1,22,580
	2,00,000
Less : Transfer to Reserve	40,000
	1,60,000
Less : Preference Dividend at 10% on ` 4,00,000	40,000
Profit available to Equity Shareholders	1,20,000

Step 4 - Calculation of Expected Rate of Return (ERR)

Expected Rate of Return = (Profits available to Equity Shareholders, Total paid up Equity Capital) x 100

= (1,20,000, 5,00,000) x 100 = 24%

Step 5. Calculation of Value of each Equity Share

Value of Equity Share = (ERR + NRR) x Paid up value of each Equity Share

= (24 – 15) x 100 = ` 160

16. (Intrinsic Value, Yield Method and Fair Market Value Per Equity Share)

Following is the summarised Balance Sheet of X Ltd. as on 31.3.2015 :

Liabilities	`	Assets	`
40,000 Shares of ` 10 each	4,00,000	Goodwill	1,00,000
Reserve Fund	1,00,000	Fixed Assets	4,50,000
Profit & Loss A/c	35,000	Current Assets	1,90,000
9% Debentures	1,00,000	Preliminary Expenses	25,000
Current Liabilities	1,30,000		
	7,65,000		7,65,000

For the purpose of valuation of Share, Fixed Assets were valued at Rs. 5,00,000 and Goodwill at ` 1,50,000. There is a necessity of R.B.D. at 10% on Debtors of ` 75,000. It is found that stock was over valued by ` 9,000. The net profit for three years were ` 69,000, ` 71,800 and ` 90,200 respectively after taxation out of this profit 20% was placed to reserve, the proportion being considered reasonable in the Industry in which the company is engaged and where the normal rate of return is 10%.

Compute the value of each Equity Share by Assets Method and Yield Method and also calculate the fair value of Share.

Sol :

Net Asset Method

Calculation of Intrinsic value per Share

Particulars	`	`
Market value of Assets :		
Goodwill	1,50,000	
Fixed Assets	5,00,000	
Current Assets (1,90,000 - 7,500 - 9,000)	1,73,500	
Market value of Assets		8,23,500
Less : Total Liabilities:		
9% Debentures	1,00,000	
Current Liabilities	1,30,000	2,30,000
Net assets available for Equity Shareholders		5,93,500

$$\text{Intrinsic value per equity share} = \frac{\text{Net assets available for equity share holders}}{\text{Number of equity shares}}$$

$$= \frac{5,93,500}{40,000}$$

$$= \text{Rs. } 14.84$$

Yield Method

a) Calculation of Average Profits

$$\text{Average profits} = \frac{\text{Total profits}}{\text{Number of years}}$$

$$= \frac{2,31,000}{3} = \text{` } 77,000$$

b) Calculation of profits available for Dividends

	`
Average profits of the company	77,000
Less : Transferred to reserve (77,000 x 20%)	15,400
Profits available for Equity dividend	61,600

c) Calculation of Capitalised Profits

$$\text{Capitalised profits} = \frac{\text{Profits available for equity dividends}}{\text{Normal rate}} \times 100$$

$$= \frac{61,600}{10} \times 100$$

= ` 6,16,000

d) Calculation of Market value per Share

$$\text{Market price per share} = \frac{\text{Capitalised Profits}}{\text{Number of equity shares}}$$

$$= \frac{6,16,000}{40,000}$$

= ` 15.40

e) Calculation of Fair value per Equity Share

$$\text{Intrinsic value per equity share} = \frac{\text{Total assets available for equity share holders}}{2}$$

$$= \frac{14.84 + 15.40}{2}$$

= ` 15.12

Note: The reserve for doubtful debts should not be deducted while calculating the average profits. It is only the actual bad debts written off must be adjusted while calculating the average profits of the company.

17. (Intrinsic Value, Yield Method and Earning Capacity Method)

On March 31, 2015, the Balance Sheet of a limited company reveals the following position :

Liabilities	`	Assets	`
Issued capital in `10 shares	4,00,000	Fixed assets	5,00,000
Reserves	90,000	Current assets	2,00,000
Profit & Loss A/c	20,000	Goodwill	40,000
5% Debentures	1,00,000		
Current liabilities	1,30,000		
	7,40,000		7,40,000

On March 31, 2015, the fixed assets were independently valued at Rs. 3,50,000 and the goodwill at ` 50,000. The Net Profits for the three years were : 2012-13 - `51,600; 2013-14 - `52,000; 2014-15 - ` 51,650 of which 20% was placed under reserve, this proportion being considered reasonable in the industry in which the company is engaged and where a fair investment return may be taken at 10%. Compute the value of the company's shares by (a) the Net Assets method, (b) the Yield Value method and (c) the Earning Capacity method.

Sol :

a) Net Assets Method

Calculation of Intrinsic value of shares Market value of Assets

Particulars	`	`
Market value of Assets :		
Current assets as per Balance Sheet		2,00,000
Market value of fixed assets		3,50,000
Goodwill (as per valuation)		50,000
Total market value of assets		6,00,000
Less: Total Liabilities:		
5% Debentures	1,00,000	
Current liabilities	1,30,000	2,30,000
Net value of assets available to shareholders or capital employed		3,70,000

$$\text{Intrinsic value per share} = \frac{\text{Net value of assets available to shareholders}}{\text{Number of equity shares}}$$

$$= \frac{3,70,000}{40,000} = \text{` } 9.25$$

b) Yield Method

i) Calculation of average Profits

$$\text{Average profits} = \frac{\text{Total profits}}{\text{Number of years}}$$

$$= \frac{51,600 + 52,000 + 51,650}{3}$$

$$= \frac{1,55,250}{3}$$

$$= \text{` } 51,750$$

ii) Calculation of Profits available to Equity Shareholders

	`
Average profits	51,750
Less: Transferred to reserve (51,750 x 20%)	10,350
Profits available to Shareholders	41,400

iii) Calculation of Capitalised Profits

$$\text{Capitalised profits} = \frac{\text{Profits available for shareholders}}{\text{Normal rate}} \times 100$$

$$= \frac{41,400}{10} \times 100$$

$$= \text{` } 4,14,000$$

iv) Calculation of market value per share

$$\text{Market price per share} = \frac{\text{Capitalised profits}}{\text{Number of equity shares}}$$

$$= \frac{4,14,000}{40,000}$$

$$= ` \ 10.35 \text{ per share}$$

c) Earning Capacity Method

i) Calculation of rate of Earnings

$$\text{Rate of earnings} = \frac{\text{Average profits}}{\text{Capital employed}} \times 100$$

$$= \frac{51,750}{3,70,000} \times 100$$

$$= 14\%$$

ii) Calculation of Market value per Share

$$\text{Market price per share} = \frac{\text{Rate of earning}}{\text{Number Rate of Return}} \times \text{paidup value per share}$$

$$= \frac{14}{10} \times 10$$

$$= ` \ 14 \text{ per share}$$

Short Question & Answers

1. Goodwill

Ans :

Goodwill has been define as "the present value of firm's anticipated excess earnings.

According to the Institute of Chartered Accountants of India, goodwill is "an intangible asset arise from business connections or trade name or reputation of an enterprise.

2. Features of Goodwill

Ans :

i) Goodwill can be sold only with the entire business or it cannot be sold in part or in isolation except on admission or retirement of a partner when new partner compensate the old partners or the retiring partner gives up his rights in favour of remaining partners.

ii) Goodwill is valuable only if it is capable of being transferred from one person to another. If it cannot be transferred then there will be no value of goodwill.

iii) Goodwill represents a non-physical value over and above the physical assets.

iv) Goodwill cannot have an exact cost as its value fluctuates from time to time due to internal or external factors which ultimately affect the fortune of the Company.

v) The value of goodwill is based on subjective judgement of the valuer.

3. Need for Valuation of Goodwill

Ans :

The need for valuation of goodwill in a joint stock company arises in the following circumstance-

i) When the business of a company is taken over by another company, *e.g.,* in case of amalgamation or absorption.

ii) When the company's shares are not quoted on the stock exchange and their value is to determined for the purposes of estate duty and wealth tax, etc.

iii) When a person wants to purchase a large block of the company's shares with a view to acquire control over the management of the company,

iv) When the business of the company is being taken over by the government.

v) When the Management wants to write back goodwill which it wrote off earlier to reduce or eliminate the debit balance in the profit and loss account.

4. Factors Effecting the Value of Good will

Ans :

The main factors affecting the goodwill are :

(i) Profits expected to be earned by the concern. Profitability of a concern depends upon several factors such as nature of business, favourable location or site, skill of management, possession of trade marks, patents and copyrights, future competition, Money Market conditions etc.

(ii) Capital requirement

(iii) Possibility of transfer of goodwill etc.

5. Methods of goodwill valuation.

Ans :

The following are three basic methods for valuation of goodwill :

(i) Simple profit method / Adding Profits Method

In this method goodwill is valued on the basis of a certain number of years' purchase of the average profits of the past few years.

For example, if the average annual profits of a business for the past 5 years are Rs 10,000 and goodwill is to be valued on the basis of 2 years' purchase of such average annual profits, the value of goodwill will be Rs 20,000.

(ii) Capitalization of profit method

In this method, the total value of the business is found out by capitalising the expected average profits on the basis of normal rate of return. The value of goodwill is the difference between the value of the business so found out and the actual capital employed in the business.

For example, if the average annual expected profit in a business is Rs 10,000, normal rate of return 10% and the actual capital employed in the business Rs 80,000, the value of goodwill will be Rs 20,000 (*i.e.* capitalised value of the business Rs 1,00,000— Actual capital employed Rs 80,000).

(iii) Super Profit Method

In case of this method, goodwill is based on the average annual super profit earned by the business. The term super profit means the profit over and above the normal profit.

This method is most popular for valuation of goodwill in case of joint stock companies.

Goodwill = Super profit × No.of years purchased.

6. Need for Valuation

Ans :

The need for valuation of shares arises in one or more of the following circumstances.

i) Assessments under estate duty, wealth tax, gift tax, etc.

ii) Purchase of a block of shares generally involving acquisition of controlling interest in the company.

iii) Formulations of schemes of amalgamation, absorption, etc.,

iv) Acquisition of interest of dissenting shareholders under reconstruction scheme

v) Conversion of preference shares into equity shares.

vi) Advancing loans on the security of shares

vii) compensating shareholders on the acquisition of their shares, by the government under a scheme of nationalization.

7. What are the factors affecting on valuation of shares ?

Ans :

The main factors effecting value of share are :

i) Capital employed

ii) Earning Capacity (or) Profitability and

iii) Normal rate of return, the yield expected by investors in the industry to which the firm belongs.

In case of companies going into liquidation the net assets of the company is the most important factor. In case of going concerns, both earning capacity and net assets are considered while valuing shares. In case of professional concerns such as architects and engineering consultants valuation depends wholly on earning capacity not on the assets owned by the concern.

8. Methods of Valuation

Ans :

The methods of valuation of share may be broadly classified as follows :

- Net Assets Backing Method,
- Yield Method / Earnings basis / Market Value Method.
- Dual method or Fair Value Method

Above methods are generally used for valuation of equity shares. However, they can also be used to some extent in case of preference shares, as explained later.

Multiple Choice Questions

1. Goodwill is to be valued when __________. [d]

   (a) amalgamation takes place

   (b) one company takes over another company

   (c) a partner is admitted

   (d) all of the above

2. Goodwill is paid for obtaining _________. [a]

   (a) future benefit (b) present benefit

   (c) past benefit (d) none of the above

3. Super profit is __________. [a]

   (a) excess of average profit over normal profit

   (b) extra profit earned

   (c) average profit earned by similar companies

   (d) none of the above

4. Normal profit is __________. [b]

   (a) average profit earned

   (b) profit earned by similar companies in the same industry

   (c) (a) and (b)

   (d) none of the above

5. Normal Rate of Return depends on __________. [c]

   (a) Rate of Interest (b) Rate of Risk

   (c) Both (a) and (b) (d) None of the above

6. While calculating capital employed, __________. [a]

   (a) Tangible trading assets should be considered

   (b) Intangible assets should be considered

   (c) Fictitious assets should be considered

   (d) None of the above

7. Any non-trading income included in the profit should be __________. [a]

   (a) eliminated

   (b) added

   (c) ignored

   (d) none of the above

8. Rate of interest is 11% and the rate of risk is 9%. The normal rate of return is _________. [c]

(a) 11% (b) 9%

(c) 20% (d) 2%

9. Under net asset method, value of a share depends on __________. [a]

(a) net assets available to equity shareholders

(b) net assets available to debentures holders

(c) net assets available to preference shareholders

(d) none of the above

10. Net asset value is also called as __________. [a]

(a) asset backing value (b) intrinsic value

(c) liquidation value (d) (a), (b) and (c)

Fill in the blanks

1. Goodwill is an ________ asset.
2. Goodwill has ________ value.
3. Goodwill may be ________ or ________.
4. Only ________ goodwill is accounted.
5. ________ is calculated on the basis of adjusted average profit.
6. ________ is equal to rate of interest plus rate of risk.
7. Investments are ________ assets.
8. ________ value depends on Net assets.
9. Yield value depends on ________.
10. Fair value is the ________ of intrinsic value and yield value.

Answers :

1. Intangible
2. Realisable
3. Purchased/Non-Purchased
4. Purchased
5. Fair Value Method
6. Nominal Rate of Return
7. Non-trading
8. Intrinsic
9. Net Profit
10. Average

FACULTY OF COMMERCE

B.Com. III - Semester (CBCS) Examination

November / December - 2019

(Common Paper for General / Computers / Computer Applications / Advertising / Foreign Trade and Tax Procedure Courses)

ADVANCED ACCOUNTING

Time : 3 Hours] [Max. Marks : 80

PART - A (5 × 4 = 20 Marks)

[Short Answer Type]

Note : *Answer any* **FIVE** *of the following questions.*

ANSWER

1. Fluctuating Capital

Ans :

Under this system, the balance in the capital account changes from year to year. The reason is that all transactions relating to the amount of capital contributed, drawings, interest on capital and drawings salary and share of profit or loss are recorded in the capital account. As a result of these adjustments the capital at the end of each accounting period is different from what it is at the beginning of the period.

2. P and Q are sharing profits in the ratio of 5:3 admit R on $3/7^{th}$ share in the new firm which he takes $2/7^{th}$ from P and $1/7^{th}$ from Q. Calculate the New Profit Sharing Ratio.

Ans :

R Admit on $\frac{3}{7}^{th}$ share in new firm. He takes $\frac{2}{7}^{th}$ from p and $\frac{1}{7}^{th}$ from Q.

P's share = $\frac{5}{8}$ out of which he surrenders $\frac{2}{7}$ infavour of R.

$$\text{P's new share} = \frac{5}{8} - \frac{2}{7}$$

$$= \frac{35-16}{56} = \frac{19}{56}$$

Q's old share is $\frac{3}{8}$ out of which he surrenders $\frac{1}{7}^{th}$ in favour of R.

$$\text{Q's new share} = \frac{3}{8} - \frac{1}{7}$$

$$\frac{21-8}{56} = \frac{13}{56}.$$

$$R = \frac{2}{7}+\frac{1}{7}-\frac{3}{7}$$

$$= \frac{3}{7}\times\frac{8}{8}=\frac{24}{56}$$

New profit sharing ratio of partners = 19 : 13 : 24.

3. Shyam, Ram and Bhim share profit and losses in the ratio of 1 : 2 : 2. Ram has retired in the month of December 2018 and is demanding his share of Goodwill. If the profits of the previous five years were 2014 – Rs. 40,000; 2015 – Rs. 50,000 ; 2016 – Rs. 60,000; 2017 – Rs. 35,000; 2018 – Rs. 25,000.

Ans :

Calculation of Goodwill

Goodwill = Average profit × Number of years

$$\text{Average profit} = \frac{\text{Total Profit}}{\text{Number of Years}}$$

$$\text{Average profit} = \frac{40,000+50,000+60,000+35,000+25,000}{5}$$

$$= \frac{2,10,000}{5} = 42,000$$

Goodwill = 42,000 × 2 = 84,000

Calculation of shyam share = 84,000 × $\frac{1}{5}$ = 16,800

Ram = 84,000 × $\frac{2}{5}$ = 33,600

Bhim = 84,000 × $\frac{2}{5}$ = 33,600

4. Issued Capital

Ans :

The Issued Capital refers to the number of shares issued by the company to the shareholders. In other words, the shares allotted or subsequently held by the shareholders is called the issued capital.

The Issued capital represents that part of an authorized capital, which a company is authorized to sell through the shares. A company can either sell all its shares or a portion of it depending on the need for finance. It is also called as a subscribed capital, as the number of shares purchased by the shareholders represents the amount of money invested in the firm.

5. Underwriting **(Unit-III, SQA - 15)**

6. Sacrificing Ratio **(Unit-I, SQA - 11)**

7. Reissue of Forfeited Shares. **(Unit-III, Q.No. 11)**

8. Capitalization Method of Valuation of Goodwill. **(Unit-V, SQA - 5)**

PART - B (5 × 12 = 60 Marks)

[Short Answer Type]

Note : *Answer* **ALL** *the questions.*

9. (a) What are the factors which necessitate the admission of a new partner? Explain the provisions of the Partnership Act, 1932 in relation to admission of the partner. **(Unit-I, Q.No. 7)**

OR

(b) Following is the Balance Sheet of R and D as at 30th June, 2019 on which date R retired and his son P joined that firm from 1st July, 2019, with one-fourth share in the profits of the business.

Liabilities		Rs.	Assets	Rs.
Creditors		10,000	Goodwill	12,000
Capitals : Rs.			Plant	40,000
R	50,000		Investment	14,000
D	31,000		Debtors	15,000
		81,000	Cash at Bank	10,000
		91,000		91,000

Following adjustments and arrangements have been agreed upon for the purposes of retirement and admission of partners :

(i) The value of Goodwill is Rs. 30,000 and Plant increased to Rs. 50,000

(ii) Sufficient money to be introduced so as to leave Rs. 11,000 each after payment of amount due to R.

(iii) D and P to provide such fund as would make their Capitals proportionate to their share of profit

Show the Journal Entries to record the above transactions assuming that D and P have paid in the cash due on 2nd July, 2019 and the amount due to R was paid on the same day.

Ans :

Journal Entries

Date	Particulars		LF	Debit	Credit
July 1	Goodwill A/c	Dr.		18,000	-
	To R capital A/c			-	9,000
	To D capital A/c			-	9,000
	(Being goodwill written off)				
July 1	Plant A/c	Dr.		10,000	-
	To Revaluation A/c			-	10,000
	(Being value of plant Increased)				
July 1	Revaluation A/c	Dr.		10,000	
	To R capital A/c			-	5,000
	To D capital A/c			-	5,000
	(Being profit on revaluation transferred to capital A/c)				
July 1	Bank A/c	Dr.		65,000	-
	To D capital A/c			-	37,500
	To P capital A/c			-	27,500
	(Being amount brought by partners to make their capital in proportion to profit sharing ratio)				
July 1	R capital A/c	Dr.		64,000	-
	To Bank A/c			-	64,000
	(Being payment of amount due to retired partner)				

Dr. Partner's Capital A/c Cr.

Particulars	R capital A/c	D capital A/c	P capital A/c	Particulars	R capital A/c	D capital A/c	P capital A/c
To Cash	64,000	–	–	By balance b/d	50,000	31,000	–
To Balance c/d	–	82,500	27,500	By good will A/c	9,000	9,000	–
				By Revaluations A/c	5,000	5,000	–
				By Cash A/c	–	37,500	27,500
	64,000	82,500	27,500		64,000	62,500	27,500
				By Balance c/d		82,500	27,500

Balance Sheet of D and P as on 1-7-2019

Liabilities		Amount	Assets	Amount
Creditors		10,000	Goodwill	30,000
Capital A/c's			Plant	50,000
D	82,500		Investments	14,000
P	27,500	1,10,000	Debtors	15,000
			Cash at Bank	11,000
		1,20,000		1,20,000

10. (a) Kamal, Bhushan and Raj were sharing profits in the ratio of 3:1:1 respectively. They decided to dissolve their firm on 31st March, 2019 when their position was as follows :

Liabilities		Rs.	Assets		Rs.
Capitals :	Rs.		Machinery		51,000
Kamal	82,500		Furniture		3,000
Bhushan	30,000		Stock		23,400
Raj	21,000		Debtors	72,600	
		1,33,500	**Less:** Provision for		
Loan		4,500	Bad Debts	3,600	
Sunday creditors		18,000			69,000
			Cash in Hand		9,600
		1,56,000			1,56,000

(i) Kamal agreed to take over Furniture at Rs. 2,400; Debtors amounting to Rs. 60,000 at Rs. 51,600 and also the Creditors at their book value.

(ii) Bhushan agreed to take over Stock at Rs. 21,000 and a part of the Machinery at Rs. 21,600. (being Book Value less 10%).

(iii) Raj agreed to take over the remaining Machinery at 90% of the Book Value less Rs. 300 as allowance. He also assumed the responsibility for the payment of loan together with accused interest Rs. 90 (not recorded in the books).

(iv) Dissolution expenses amounted to Rs. 810.

(v) The remaining Debtors were sold to a debt - collecting agency at 50% of Book Value.

Prepare important Ledger Accounts to close the Books of Account.

Ans :

Dr. Realization A/c Cr.

Particulars	Amount	Amount	Particulars	Amount	Amount
To Sundry Assets			**By Sundry liabilities A/c**		
B Machinery	51,000		Loan	4,500	
Furniture	3,000		Creditor	18,000	
Stock	23,400		Provision for bad debts	3,600	26,100
Debtors	72,600	1,50,000	Furniture	2,400	
To Kamal capital A/c		18,000	Debtors	51,600	54,000
To Raj capital Loan	4,500		By Bhushan's capital A/c		
Interest on Loan	90	4,590	Stock	21,000	
To cash A/c		810	Machinery	21,600	42,600
			By Raj capital A/c		24,000
			By Cash A/c		6,300
			By Loss		
			By Loss Kamal $\left(20,400\times\frac{3}{5}\right)$	12,240	
			Bhushan $\left(20,400\times\frac{1}{5}\right)$	4,080	
			Raj $\left(20,400\times\frac{1}{5}\right)$	4,080	20,400
		1,73,400			1,73,400

Dr. Partner's Capital A/c Cr.

Particulars	Kamal	Bhushan	Raj	Particulars	Kamal	Bhushan	Raj
To Realization A/c (Assets)	54,000	42,600	24,000	By balance b/d	82,000	30,000	21,000
To Realization A/c (Loss)	12,240	4,080	4,080	By Realization A/c	18,000	–	4,590
To cash A/c	34,260	–	–	By cash A/c	–	16,680	2,490
	1,00,500	46,680	28,080		1,00,500	46,680	28,080

Dr. **Cash A/c** **Cr.**

Particulars	Amount	Particulars	Amount
To Balance b/d	9,600	By Realization A/c (expenses)	810
To Realization a/c	6,300	By Kamal's capital A/c	34,260
To Capital a/c			
Bhushan	16,680		
Raj	2,490		
	35,070		35,070

(OR)

(b) A, B and C are in Partnership sharing Profits and Losses three- sixths, two-sixths, and one-sixth respectively. Balance Sheet on the date of dissolution was as follows :

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	38,500	Cash in Hand	9,860
A' Loan A/c	2,750	Sundry Debtors	30,560
A' Capital	15,200	Stock	18,440
B's Capital	11,200	Furniture	7,200
		C's Capital	1,590
	67,650		67,650

The assets realized :

Stock Rs. 13,840; Furniture Rs. 5,150, and Debtors Rs. 29,200. The Creditors were paid less discount Rs. 250. C is insolvent and is unable to bring in anything . The expenses of winding up were Rs. 520. Show the Ledger Accounts as per Gamer Vs. Murray decision.

Ans :

Dr. **Realization A/c** **Cr.**

Particulars	Amount	Particulars	Amount
To Sundry debtors A/c	30,560	By Sundry creditors A/c	38,500
To Stock A/c	18,440	By Stock	13,840
To Furniture A/c	7,200	By Furniture	5,150
To Cash A/c (38,500 – 250)	38,250	By Debtors	29,200
To cash A/c (Expenses)	520	By Loss	8,280
	94,970		94,970

Distribution of loss to partners $\frac{3}{6}, \frac{2}{6}, \frac{1}{6}$.

$$A = 8,280 \times \frac{3}{6} = 4,140$$

$$B = 8,280 \times \frac{2}{6} = 2,760$$

$$C = 8,280 \times \frac{1}{6} = 1,380$$

Dr. **Partner's Capital A/c** **Cr.**

Particulars	A	B	C	Particulars	A	B	C
To Balance b/d	–	–	1,590	By balance b/d	15,200	11,200	–
To Realization A/c (Loss)	4,140	2,760	1,380	By cash A/c (Loss)	4,140	2,760	–
To 'C' S deficiency A/c	1,710	1,260	–	By 'A' capital A/c	–	–	1,170
To cash A/c	13,490	9,940	–	By 'B' capital A/c	–	–	1,260
	19,340	13,960	2,970		19,340	13,960	2,970

Dr. **Cash A/c** **Cr.**

Particulars	Amount	Particulars	Amount
To Balance b/d	9,860	By Realization A/c	38,250
To Realization A/c	48,190	By Realiztion A/c	520
To A Capital A/c	4,140	By A Capital A/c	13,490
To B Capital A/c	2,760	By B capital A/c	9,940
		By C capital A/c	2,750
	64,950		64,950

11. (a) Jolly Brothers Ltd. offered for subscription 3,000 12% Preference Shares of Rs. 100 each at a premium of 20% on 1st January, 2019. The amount was payable as follows :

On Application Rs. 20; On Allotment Rs.40 (including Premium-due on 1st Feb).

On First Call Rs. 30 due on 1st March; On Second Call Rs. 30 due on 1st May.

All the Shares were subscribed by the public and subscription list was closed on 25th January, 2019, Money due on allotment and calls payable 15 days after the due dates. All the amounts were duly received in time except the second call on 200 shares.

Prepare Journal and Cash Book in the books of the Company and show them in the Balance Sheet.

Ans :

Date	Particulars		LF	Debit	Credit
Jan. 1	Bank A/c	Dr.		60,000	-
	To 12% preference share application A/c			-	60,000
	(Being Application money received for 3,000 shares @ 20 each)				
Jan. 25	12% preference share application A/c	Dr.		60,000	-
	To 12% preference share capital A/c			-	60,000
	(Being application money transferred to 12% preference share capital A/c)				
Feb. 1	12% preference share allotment A/c	Dr.		1,20,000	
	To 12% preference share capital A/c			-	60,000
	To Share premium A/c			-	60,000
	(Being allotment mode on 3,000 shares @ 40 Rs.)				
Feb. 15	Bank A/c	Dr.		1,20,000	-
	To 12% Share allotment A/c			-	1,20,000
	(Being share allotment money received)				
March 1	Share first call A/c	Dr.		90,000	-
	To Share capital A/c			-	90,000
	(Being first call money on 3,000 shares @ 30 per share)				
March 15	Bank A/c	Dr.		90,000	-
	To Share first call A/c			-	90,000
	(Being first call money on received)				
May 1	Share second call A/c	Dr.		90,000	-
	To share capital A/c			-	90,000
	(Being second call money on 3,000 shares @ 30 per share)				
May 15	Bank A/c	Dr.		84,000	-
	To share second call A/c			-	84,000
	(Being second call money received for 2,800 share)				

Share Capital A/c

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
May 1	To balance c/d	3,00,000	Jan. 25	By Share application A/c	60,000
2019			Feb. 1	By Share allotment A/c	60,000
			Mar. 1	By Share first call A/c	90,000
			May 1	By Share second call A/c	90,000
		3,00,000			3,00,000

Dr. **Cash A/c** **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
Jan. 1	To share application A/c	60,000	2019		
Feb. 15	To share allotment A/c	1,20,000	May 15	By Balance C/d (B/F)	3,54,000
Mar. 15	To share first call A/c	90,000			
May. 15	To share second call A/c	84,000			
		3,54,000			3,54,000

Balance Sheet of Jolly Brothers Ltd.

Liabilities		Amount	Assets	Amount
Authorized Capital 3,000 12%			Cash at bank	3,54,000
Preference shares of 100 each		3,00,000		
Issued Share Capital				
3,000 12% preference shares				
of 100 each.	3,00,000			
(–) calls in areas	6,000	2,94,000		
Shares Premium		60,000		
		3,54,000		3,54,000

OR

(b) Sharma Ltd. issued Rs. 1,00,000 10 percent Debentures on 1st April, 2019 at a discount of 5 percent repayable in annual drawings of Rs. 25,000 commencing from 31st December following. The company's year ends on 31st March.

Journalize the above transactions for four years 31st March, 2019, assuming that the company decided to write off Debenture Discount Account during the life of the Debentures.

Ans :

Journal Entries

Date	Particulars	LF	Debit	Credit
April 1 2009	Bank A/c Dr. To Debenture application and allotment A/c (1,00,000 × 5/100 = 5,000) (Being application money received on Issue of debenture).		95,000 -	- 95,000
April 1	Debenture application A/c Dr. Discount on Issue of Debenture A/c To 10% Debenture a/c (Being application money transferred to debenture A/c).		95,000 5,000	- 1,00,000
Mar. 31	Profit and Loss A/c Dr. To Discount on issue of debenture A/c $\left(5{,}000 \times \frac{15}{36} = 2083\right)$ (Being application money transferred to debenture A/c).		2,083 -	- 2,083
Mar. 31	Profit and Loss A/c Dr. To Discount on issue of debenture A/c $\left(5{,}000 \times \frac{11}{36}\right)$ (Being proportionate discount on issue of debenture written off).		1,528 -	- 1,528
Mar. 31	Profit and Loss A/c Dr. To Discount $\left(5{,}000 \times \frac{7}{36}\right)$ (Being proportionate discount on issue of debenture written off)		972 -	- 972
Mar. 31	Profit and Loss A/c Dr. To Discount $\left(5{,}000 \times \frac{3}{36}\right)$ (Being proportionate discount on issue of debenture)		417 -	- 417

12. (a) Following balances are extracted on 31st March, 2019 from the books of Vihaan Company Limited.

Particulars	Rs.	Particulars	Rs.
Lorries at cost	56,250	Share Capital	
Buildings at cost	3,37,500	22,500, 7% Pref. Shares of Rs.10 each	2,25,000
Sundry Debtors	90,750	45,000 Equity Shares of Rs. 10 each	4,50,000
Furniture at cost	2,58,750	Surplus	12,150
Bad Debts written off	2,138	Gross Profit for the year	1,84,708
General Expenses	14,625	Provision for doubtful debts	6,750
Cash in Hand and at Bank	51,375	Sundry Creditors	96,780
Rent, Rates and Taxes	21,300	Transfer Fees	187
Directors' Fees	2,700	Accrued Wages	9,638
Audit Fees	7,500	General Reserve	13,350
Stock on 31st March 2019	85,500		
Salaries and Wages	24,000		
Dividend paid on Pref. Shares	15,750		
Dividend paid on Equity Shares	11,250		
Rent and Taxes paid in advance	5,925		
	9,96,563		9,96,563

The provision for doubtful debts is to be made up to Rs. 7,650. The Buildings, Furniture and Lorries are to be depreciated at 3.83%, 15% and 20% respectively. The Authorized Capital of the Company is Rs. 7,50,000 divided into 75,000 Shares of Rs. 10 each You are required to prepare :

(i) A profit and Loss Account for the year ended 31st March, 2019

(ii) A Balance Sheet as at 31st March, 2019 in the form prescribed under the Companies Act, 2013, Previous year's figures are not required and also ignore taxation and transfer to reserves as required by law; you need not provide Corporate Dividend Tax.

Ans :

Vihaan Company Ltd., Profit and Loss Statement for Year Ending 31/3/2019

Particulars	Amount	Amount
I) Revenue from operations		
Gross Profit		1,84,708
II) Other Incomes		
Transfer fees		187
III) Total Revenue (I + II)		1,84,895
IV) Expenses:		
Employee Benefits Expenses salaries and wages		24,000

Depreciation		
Lorries $\left(56,250 \times \frac{20}{100}\right)$		11,250
Buildings $\left(3,37,500 \times \frac{3.83}{100}\right)$		12,926
Furniture $\left(2,58,750 \times \frac{15}{100}\right)$		38,813
Other expenses		
Bad debts written off		2,138
General expenses		14,625
Rent, Rates		21,300
Director's fee		2,700
Audit fee		7,500
Provision for doubtful debts	7,650	
(–) Old Provision	6,750	900
Total expenses		1,36,152
PBT (III – IV)		48,743
(–) Tax		–
Profit after tax		48,743

Balance Sheet as on 31/3/2019

Particulars	Note No.	Amount
I) Equity and Liabilities.		
1. Shareholder's funds		
a) Share capital	1	6,75,000
b) Reserves and surplus	2	35,993
2. Share application money		–
3. Non-current liabilities		
4. Current liabilities		
a) Trade payables		96,780
b) Short term provision		–
c) Other current liabilities		9,638
Total		8,17,411

Assets		
1. Non-current Assets		
a) Fixed Assets		
i) Tangible Assets	3	5,89,511
ii) In Tangible Assets		–
b) Non current investments		–
c) Long term loans and advances		–
2. Current Assets		
a) Trade Receivables	4	83,100
b) Cash and Cash equivalent		51,375
c) Inventories		85,500
d) Short term loans and advances		5,925
Suspense Account		2,000
Total		8,17,411

Working Notes

1. Share capital

22,500 7% preference shares of Rs. 10 each	2,25,000
45,000 equity shares of Rs. 10 each	4,50,000
	6,75,000

2. Reserves and Surplus

General Reserve	13,350
(+) Surplus	12,150
Profit for the year	48,743
(–) Dividend paid on preference shares	15,750
Dividend paid on equity share	11,250
Discount on issue of share	11,250
	35,993

3. Tangibles

Lorries	56,250
(–) Depreciation 20%	11,250
	45,000
Buildings	3,37,500
(–) Depreciation 3.83%	12,926
	3,24,574
Furniture	2,58,750
(–) Depreciation 15%	38,813
	2,19,937

4. Trade Receivable

Trade Receivable	90,750
(–) Doubtful debts	7,650
	83,100

OR

(b) How are Profits prior to Incorporation treated while preparing the Final Accounts of the Company ? **(Unit-IV, Q.No. 7)**

13. (a) Find out from the statement below, whether the expected Rate of Return is correct or not. Financial Position of Mr. Ashish is as follows :

	Rs.
Sundry Assets	4,63,671
Current Liabilities	26,246
Average Net Profit of the last four years	60,250
Average Capital Employed	4,50,000
Partners' Average Annual Remuneration	9,000
The Goodwill valued at 4 year's purchase of Super Profit	25,000
The Expected Rate of Return	15%

Ans :

Goodwill = 25,000

$$\text{Super profit} = \frac{25,000}{4} = 6,250$$

Calculation of Average Profit

Average net profit of last 4 years =	60,250
(–) Annual remuneration =	9,000
	51,250

Super profit = Actual profit – Normal profit

51,250 – 6,250

= 45,000

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

$$= \frac{45,000}{4,50,000} \times 100 = 10\%$$

The expected rate of return 15% not correct. The return should be 10%.

(OR)

(b) What is Goodwill ? How is Super Profits Method different from the other methods of valuing Goodwill ? **(Unit-V, Q.No. 2)**

FACULTIES OF COMMERCE

B.Com. (CBCS) III - Semester Examination

June / July - 2019

(Common Paper for General / Computers / Computer Applications / Advertising / Foreign Trade and Taxation Courses)

ADVANCED ACCOUNTING

Time : 3 Hours] **[Max. Marks : 80**

PART - A - (5 × 4 = 20 Marks)

[Short Answer Type]

Note : Answer any **FIVE** of the following questions.

1. What do you mean by Gaining Ratio?

Ans :

It is the ratio in which remaining partners gain or benefit from the retirement or death of a partner. It is calculated to find out the compensation to be given to the outgoing partner by each of the remaining partners. It is calculated by finding out the difference between new ratio and old ratio. It is calculated on the retirement or death of a partner.

2. Write a short note on Garner Vs. Murray Case.

Ans :

There is no specific provision in the Indian Partnership Act regarding this matter. But if the partners have stated in the Partnership Deed that loss arising from the deficiency of insolvent partner shall be shared by solvent partners in the profit sharing ratio or any other ratio, it would be binding on the partners. But the difficulty arises when the Partnership Deed is also silent on this point. In England, the matter came up for decision in the leading case of Garner vs. Murray (1903). In this case it was held that, in the absence of any agreement to the contrary, the deficiency on the insolvent partner's capital account (debit balance) must be borne by the other solvent partners in proportion to their capitals, after each solvent partner has brought in cash equal to his own share of loss on realization.

3. Radha and Rani carrying on business in partnership sharing profits in the ratio of 5:3 admitted Rukmini into partnership. Their new profit sharing ratio is 8:5:3. Find the Sacrificing Ratio of Radha and Rani Distribute the Goodwill Rs. 9,000 bought by Rukmini.

Ans :

Calculation of Sacrificing Ratio

Old partners = Old Share – New Share = Sacrificing Ratio

Radha $\frac{5}{8} - \frac{8}{16} : \frac{10-8}{16} = \frac{2}{16}$

Rani $\frac{3}{8} - \frac{5}{16} : \frac{6-5}{16} = \frac{1}{16}$

Radha : Rani

Sacrificing ratio = $\frac{2}{16} : \frac{1}{16}$

2 : 1

Distribution of Goodwill

Radha's share = $9{,}000 \times \frac{2}{3}$ = ` 6,000

Rani's share = $9{,}000 \times \frac{1}{3}$ = ` 3,000

4. Dhanush Ltd. issued 2,000 shares of Rs. 10 each, payable Rs 3 on application, Rs. 4 on allotment and Rs. 3 on first and final call. All the shares were duly subscribed and amount received. Pass Journal entries in the books of the Company.

Ans :

Entries in the books of Dhanush Ltd.

Date	Particulars		JF	Debit (`)	Credit (`)
1.	Bank A/c	Dr		6,000	
	To Share Applications A/c				6,000
	(Being share application money, received on 2,000 shares of ` 3/- each).				
2.	Share Application A/c	Dr		6,000	
	To Share Capital A/c				6,000
	(Being share application money transferred)				
3.	Share allotment A/c	Dr		8,000	
	To Share capital A/c				8,000
	(Being share allotment money due).				
4.	Bank A/c	Dr		8,000	
	To Share Allotment A/c				8,000
	(Being share allotment money received).				
5.	Share first and final call A/c	Dr		6,000	
	To Share capital A/c				6,000
	(Being share first and final call money due)				
6.	Bank A/c	Dr		6,000	
	To Share first and final call A/c				6,000
	(Being share first and final call money received)				

5. Following items appear in the Trial Balance of S Ltd. as on 31st March, 2018.

Particulars	Cr Amount (`)
4,500 Equity Shares of Rs. 100 each	4,50,000
Capital Reserve (including Rs. 40,000 being Profit on Sale of Plant)	90,000
Securities Premium Account	40,000
Capital Redemption Reserve	30,000
General Reserve	1,05,000
Surplus Account (Cr. Balance)	65,000

The company decided to issue to equity shareholders bonus shares at the rate of one share for every three shares held. Pass journal entries in the books of 'S' Ltd.

Ans :

Entries in the books of S. Ltd.

Date	Particulars		LF	Debit (`)	Credit (`)
	Issue of fully paid bonus shares.				
1.	Securities Premium A/c	Dr		40,000	
	Capital Redemption Reserve A/c	Dr		30,000	
	General Reserve A/c	Dr		80,000	
	To Bonus to share holders A/c				1,50,000
	(Being securities premium capital redemption reserve and general reserve transferred to bonus to share holders a/c)				
2.	Bonus to share holders A/c	Dr		1,50,000	
	To Equity share capital A/c				1,50,000
	(Being free fully paid Bonus shares issued)				

Working Notes

i) Calculation of bonus shares to be issued

For 3 equity shares – 1 Bonus share

For 4,500 equity shares - ?

$$4{,}500 \times \frac{1}{3} = 1{,}500 \text{ Bonus shares.}$$

ii) Calculation of amount required for Bonus Shares

1,500 Bonus shares × 100 each = 1,50,000/-

6. Kalyan Ltd decided to purchase a business. The profits for the last four years are: 2015 - Rs. 60,000, 2016 - Rs. 75,000, 2017 - Rs. 72,000 and 2018 - Rs. 69,000. The business was looked after by the management. Remuneration from alternative employment if not engaged on the business comes to Rs. 9,000 p.a. Find the amount of goodwill, if it is valued on the basis of 3 year purchase of the average net profit for the last four years.

Ans :

Calculation of Average Profit

Years	Profits	(–)	Remuneration Amount (`)	=	Actual Profit (`)
2015	60,000	(–)	9,000	=	51,000
2016	75,000	(–)	9,000	=	66,000
2017	72,000	(–)	9,000	=	63,000
2018	69,000	(–)	9,000	=	60,000
	2,76,000				2,40,000

$$\frac{\text{Actual Profit}}{\text{Number of Years}} = \frac{2,40,000}{4 \text{ Years}} = \text{` } 6,000$$

Calculation of Good Will

Average Profit × Number of Purchase year

` 6,000 × 3 years = ` 1,80,000.

7. In an organization there were 25 workers before incorporation and they were paid wages at Rs. 1,000 p.m. each. After incorporation there were 35 workers and they were paid Rs. 1,250 each per month. Find out the pre-incorporation, and post incorporation Wages.

Ans :

Calculation of Pre and Post Incorporation Period wages

Number of Worker × Wages Per worker per month (`)

Pre Incorporation Period = 25 × 1,000 = ` 25,000

Post Incorporation Period = 35 × 1,250 = ` 43,750

8. What is Reserve Capital?

Ans :

Part of the authorized capital of a firm that has not been called up and is, therefore available for drawing in case of a need. Creation of reserve capital is not mandatory.

PART - B (5 × 12 = 60 Marks)
[Essay Answer Type]

Note : Answer all the following questions in not exceeding 4 pages each.

9. (a) What do you mean by Partnership Deed? Distinguish between admission and retirement of a partner.

Ans :

Partnership Deed

Refer Unit-I, Q.No. 2

Admission and Retirement of a Partner

The only difference between admission and retirement is that in case of admission, the new partner joins the firm, whereas in case of retirement the old partner leaves the firm because of certain reasons, such as old age, ill health etc.

OR

(b) A, B and C are partners in a business, sharing profits and losses in 3:2:1. Their Balance Sheet as on 30th June 2017 was as follows:

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	1,600	Cash in Handle	600
Reserve Fund	6,000	Cash at Bank	1,000
Capitals:		Sundry Debtors	9,000
A	10,000	Stock in Hand	7,000
B	10,000	Machinery	6,000
C	10,000	Building	14,000
	37,600		37,600

On that date 'C' retires from business. It is agreed to adjust the values of assets as follows:

a) To make a provision of 5% on Sundry Debtors for Doubtful- debts

b) To depreciate Stock by 5% and Machinery by 10%

c) Buildings to be revalued at Rs.15,100.

Prepare Revaluation Account, Partners Capital Accounts and Balance Sheet continuing partners of the July 1, 2017.

Ans :

Dr. 1. Revaluation A/c Cr.

Particulars	`	`	Particulars	`	`
To provision for doubtful			By buildings A/c		1,100
debts (9,000 × 5%)		450	By loss (Transferred to)		
To stock (7,000 × 5%)		350	A's capital	150	
To Machinery (6,000 × 10%)		600	B's capital	100	
			C's capital	50	300
		1,400			1,400

Dr. 2. Capital A/c's Cr.

Particulars	A	B	C	Particulars	A	B	C
To Revaluation loss	150	100	50	By Balance b/d	10,000	10,000	10,000
To C's loan A/c	–	–	10,950	By Reserve Fund	3,000	2,000	1,000
To Balance c/d	12,850	11,900	–				
	13,000	12,000	11,000		13,000	12,000	11,000
				By Balance b/d	12,850	11,900	–

Dr. 3. C's Loan A/c Cr.

Particulars	`	Particulars	`
To Balance c/d	10,950	By C's capital A/c	10,950
	10,950		10,950
		By Balance b/d	10,950

Balance Sheet of A, B as on 30/6/2017

Liabilities	`	`	Assets	`	`
Sundry creditors		1,600	Cash		600
C's Loan A/c		10,950	Bank		1,000
Capital A/c's			Sundry debtors	9,000	
A		12,850	(–) 5% PBD	450	8,550
B		11,900	Stock	7,000	
			(–) 5% Dep.	350	6,650
			Machinery	6,000	
			(–) 10% Dep.	600	5,400
			Buildings	14,000	
			(+) Appreciation	1,100	15,100
		37,300			37,300

Working Notes

1. Calculation of Provision for Doubtful debts

$$\text{Debtors} \times \frac{\text{Rate}}{100}$$

$$9{,}000 \times \frac{5}{100} = \text{`}\ 450.$$

2. Calculation of Depreciation on

(a) Stock $7{,}000 \times \frac{5}{100} = \text{`}\ 350$

(b) Machinery $6{,}000 \times \frac{10}{100} = \text{`}\ 600$

3. Calculation of Appreciation on Buildings

New Value	–	Old Value	=	Appreciation
15,100	–	14,000	=	1,100

4. Distribution of Revaluation Loss

$$A - 300 \times \frac{3}{6} = ` 150$$

$$B - 300 \times \frac{2}{6} = ` 100$$

$$C - 300 \times \frac{1}{6} = ` 50$$

10. (a) Define dissolution partnership firms a firm. What are the steps involved on dissolution of partnership firms.

Ans :

According to section 39 of the Indian Partnership Act, 1932, "the dissolution of partnership between all the partners of a firm is called the dissolution of the firm." Thus, the dissolution of a firm is the complete breakdown of a partnership and partners do not continue the firm.

Refer to Unit-II, Q.No. 3

OR

(b) X, Y and Z were partners sharing profits and losses equally. Balance Sheet of the firm stood as follows on 31-03-2017.

Liabilities		`	**Assets**	`
Sundry Creditors		50,000	Cash at Bank	5,000
Bank Loan		20,000	Debtors	20,000
Capitals			Stock	60,000
X	50,000		Investments	10,000
Y	40,000		Plant	50,000
		90,000	Furniture	5,000
			Y's Capital Account	
			(Over drawn)	10,000
		1,60,000		1,60,000

The firm was dissolved on 31-03-2017. The firm assets realized as follows:

Plant Rs. 32,000, Stock Rs. 33,500 and Debtors Rs. 18,000.

'X' agreed to take over Investments at Book value and 'Z' took over Furniture at Rs. 14,000. The cost of realization amounted to Rs. 5,00. 'Y' is insolvent, but his partners recover Rs. 3,500 from his private estate. Close the books of the firm in accordance with the decision Garner Vs. Murray.

Ans :

Dr. **1. Realizations A/c**

Particulars	`	`	Particulars	`	`
To Debtors		20,000	By Sundry Creditors		50,000
To Stock		60,000	By Bank Loan		20,000
To Investments		10,000	By Bank A/c		
To Plant		50,000	Plant	32,000	
To Furniture		5,000	Stock	33,500	
To Bank A/c			Debtors	18,000	83,500
Realization exp	5,000		By 'x' capital A/c		10,000
Creditors and Bank	70,000	75,000	(Investments taken over)		
Loan			By 'z' capital A/c		14,000
			(Furniture taken over)		
			By loss (Transferred to)		
			X Capital	14,167	
			Y Capital	14,166	
			Z Capital	14,167	42,500
		2,20,000			2,20,000

Dr. **2. Capital A/c's** **Cr.**

Particulars	X	Y	Z	Particulars	X	Y	Z
To Balance b/d	–	10,000	–	By Balance b/d	50,000	–	40,000
To Realizations A/c	10,000	–	14,000	By Bank	14,167	3,500	14,167
To Realization A/c (Loss)	14,167	14,166	14,167	By 'X' Capital By 'Z' Capital	– –	11,481 9,185	– –
To 'Y' capital	11,481	–	9,185				
To Bank	28,519	–	16,815				
	64,167	24,166	54,167		64,167	24,166	54,167

Dr. **Bank A/c** **Cr.**

Particulars	`	`	Particulars	`	`
To Balance b/d		5,000	By Realization A/c		
To Realization A/c		83,500	Realization Exp.	5,000	
To 'X' capital		14,167	Creditor + Bank Loan	70,000	75,000
To 'Y' Capital		3,500	By 'X' Capital		28,519
To 'Z' Capital		14,167	By 'Z' Capital		16,815
		1,20,334			1,20,334

11. (a) What do you mean by Bonus Shares? What are the various sources from which these are issued?

Ans :

When a company wants to mobilize any portion of its accumulated profits, the company may issue bonus (free) shares to its existing shareholders. Issue of bonus shares means issue of shares thus increasing the share capital by distribution of accumulated profits/reserves to the shareholders without any cash payment to them. Therefore, issue of bonus shares amounts to payment of dividend in kind i.e., in the form of shares issued without any cash payment.

Free Reserves that can be used for Issue of Bonus Shares

1. Surplus Account (i.e., credit balance of profit and Loss A/c carried forward)
2. General reserve
3. Dividend equalization reserve.
4. Capital reserve arising from profit on sale of fixed assets received in cash.
5. Balance in debenture redemption reserve after redemption of debentures
6. Capital Redemption Reserve Account created at the time of redemption of redeemable preference shares out of the profits
7. Securities Premium Reserve collected in cash only

It may be remembered that both the above accounts (Item nos. 6 & 7) can be utilized only for issuing fully paid bonus shares and not for making partly paid shares fully paid shares.

If Reserves Not Available for Issue of Bonus Shares

1. Capital reserve arising due to revaluation of assets
2. Securities Premium Reserve arising on issue of shares on amalgamation or take over.
3. Investment allowance reserve/Development rebate reserve before expiry of 4 years of creation.
4. Balance in debenture redemption reserve account before redemption takes place.
5. Surplus arising from a change in the method of charging depreciation.

OR

(b) A company invited the public to subscribe for 1,00,000 Equity Shares of Rs. 10 each at a premium of Rs. 1 per share payable on allotment, payments are to be made as follows:

On application Rs. 3; On allotment Rs. 3 (including premium); On first call Rs. 3; and on final call Rs. 2.

Applications were received for 1,30,000 shares; applications for 20,000 shares were rejected and allotment was made proportionately of the remaining applicants Both the calls were made and all the moneys due were received except the final call on 3,000 shares which are forfeited after due notice. Later all these shares were reissued as fully paid at Rs. 8.50 per share. Pass Journal entries.

Ans :

Share Application	Shares Applied for	Shares Allotted	Applications Money received	Adjusted Towards				
				Application	Allotment	I call	Final call	Returned
1,10,000	1,10,000	1,00,000	3,30,000	3,00,000	30,000	–	–	–
20,000	20,000	–	60,000	–	–	–	–	60,000
1,30,000	1,30,000	1,00,000	3,90,000	3,00,000	30,000	–	–	60,000

Journal Entry

Date	Particulars	LF	Debit (`)	Credit (`)
1.	Bank A/c Dr		3,90,000	
	To Equity share application A/c			3,90,000
	(Being equity share application money received for 1,30,000 shares).			
2.	Equity share application A/c Dr		3,90,000	
	To Equity share capital A/c			3,00,000
	To Equity share allotment A/c			30,000
	To Bank A/c			60,000
	(Being equity share application money transferred to capital, equity share allotment and excess money returned).			
3.	Equity share allotment Dr		3,00,000	
	To Equity share capital A/c			20,00,000
	To Equity share premium A/c			1,00,000
	(Being equity share allotment money including premium due)			
4.	Bank A/c Dr		2,70,000	
	To Equity share allotment A/c			2,70,000
	(Being the balance due towards allotment received)			
5.	Equity Share 1st call A/c Dr		3,00,000	
	To Equity share capital A/c			3,00,000
	(Being the 1st call money due)			

6.	Bank A/c	Dr		3,00,000	
	To Equity share 1st call A/c				3,00,000
	(Being the first call money received)				
7.	Equity share final call A/c	Dr		2,00,000	
	To Equity share capital A/c				2,00,000
	(Being the final call money due)				
8.	Bank A/c	Dr		1,94,000	
	Calls-in-Arrears A/c	Dr		6,000	
	To Equity share final call A/c				2,00,000
	(Being the equity share final call money on 3,000 shares)				
9.	Equity share capital A/c	Dr		30,000	
	To calls-in-Areas A/c				6,000
	To Shares Forfeited A/c				24,000
	(Being the forfeiture of 3,000 shares)				
10.	Bank A/c	Dr		25,500	
	Shares forfeited A/c	Dr		4,500	
	To Equity share capital				30,000
	(Being the reissue of 3,000 forfeited shares)				
11.	Shares forfeited A/c	Dr		19,500	
	To capital reserve A/c				19,500
	(Being the balance of shares forfeited A/c transferred to capital reserve A/c)				

12. (a) How the profit prior to incorporation is ascertained and for what purpose can it be utilized.

Ans :

A company comes into existence from the date of issue of the certificate of incorporation by the Registrar of Companies. Sometimes, a newly incorporated company agrees to take over a running business w.e.f. a date prior to its incorporation. Such an agreement is made to avoid the necessity of preparing the final accounts of the vendor's business from the date it prepared its last final accounts till the date on which the business is actually acquired. The assets and liabilities of the vendor's business are agreed as per the date of its last balance sheet. In such a case, the company becomes entitled to the entire profit or liable for the entire loss since the date it agrees to acquires the vendor's business.

For example, a company incorporated on 1 April 2001, agrees to take over a running business from 1 January 2001 and it closes its accounts on 31 December, the company is entitled (or liable) not only to the profit (or loss) made by the business from 1 April to 31 December, but also to the profit (or loss) made by the vendor from 1 January to 31 March. Any profit (or loss) to which the company is entitled (or liable) before its incorporation is termed as 'profit (or loss) prior to incorporation' and is of a capital nature. While preparing its final accounts, it is necessary that such profit or loss is separated from the profit or loss earned or suffered by the company after its incorporation such profit while any should be transferred to capital reserve. While any loss prior to incorporation being of capital nature should be debited to separate account called Loss Prior to Incorporation Account, and shown under Miscellaneous Expenditure on the assets side of Balance Sheet to the extent not written off.

Loss prior to incorporation can be dealt with in any of the following manner :

i) It may be written off against capital profits of the company

ii) It may be treated as Goodwill and debited to Goodwill Account

iii) Such loss can be treated as Deferred Revenue Expenditure and written off out of the profits of the company over a period of years.

Cut-off Date

A private company can commence business soon after its incorporation, while a public company can commence business only after obtaining the certificate of commencement of business. This means that in case of a private company, any profit made before incorporation and in case of a public company any profit made before commencement of business should be taken as a capital profit. However, it has now been widely accepted that since once the certificate of commencement of business is given, the company's power to carry on the business related back to the date of incorporation and hence the date of incorporation should be taken as the relevant date for apportionment of profits between pre- and post-incorporation periods.

OR

(b) The following is the Trial Balance of 'R' Ltd as on December 31st 2017.

Particulars	Dr. (`)	Cr. (`)
Stock	12,500	
Sales	–	40,000
Purchases	34,500	
Wages	5,000	
Discount	700	
Salaries	750	
Rent	495	
General Expenses	1,705	
Surplus Account as at 1-1-17		2,003
Dividend paid	900	
Capital, 1000 shares of Rs. 10 each		10,000
Debtors and Creditors	3,750	1,750
Machinery	2,900	
Cash	1,620	
Reserve		11,550
Bad debts	483	
	65,303	65,303

Prepare Statement of Profit & Loss and Balance Sheet after taking into account the following information:

a) Closing Stock Rs. 30,000

b) Purchases include Rs. 500 machinery purchased on 1-7-17.

c) On 31-12-2017 goods worth Rs. 3,000 were sold to a customer. He has taken away the goods. But no entry is recorded.

d) Directors declared 10% as final dividend.

e) Income Tax Rs. 3,000.

f) Transfer to Reserve Fund Rs. 2,000.

Ans :

Profit and Loss Account of 'R' Ltd. for the year ended 31-12-2017

Particulars	Note No.	(`)
(I) Revenue from operations	1	43,000
(II) Other Income		–
(III) Total of Revenue		43,000
(IV) Expenses		
(a) Cost of Materials consumed		16,500
(b) Employee benefit expenses		5,750
(c) Other expenses		3,383
(V) Total of expenses		25,633
(VI) Profit before tax (PBT)		17,367
(VII) Income Tax		(3,000)
(VIII) Profit After Tax (PAT)		14,367

Balance Sheet of 'R' Ltd. As at 31-12-17

Particulars	Note No.	(`)
(I) Equity and Liabilities		
1. Share holders' funds		
(a) Share capital		10,000
(b) Reserves and surplus		26,920
2. Current Liabilities		
(a) Trade Payables		1,750
(b) Short-term Provision		3,100
Total		**41,770**
(II) Assets		
1. Non-current Assets		
(a) Fixed Assets		
(i) Tangible Assets		3,400
2. Current Assets		
(a) Inventories		30,000
(b) Trade receivables		6,750
(c) Cash and Cash equivalents		1,620
Total		**41,770**

Notes and Explanation

1. Revenue from Operations

Particulars	(`)
Sales	40,000
(+) Sales made but no entry is recorded	3,000
	43,000

2. Cost of Materials Consumed

Particulars	(`)	(`)
Opening Stock		12,500
Purchases	34,500	
(–) Purchase of machinery on 1-7-17, included	500	34,000
		46,500
(–) Closing stock		30,000
		16,500

3. Employee Benefit Expenses

Particulars	(`)
Wages	5,000
Salaries	750
	5,750

4. Other Expenses

Particulars	(`)
Rent	495
General Expenses	1,705
Bad debts	483
Discount	700
	3,383

5. Reserves and Surplus

Particulars	(`)	(`)
General Reserve	11,550	
Add : Transfer	2,000	13,550
Profit and Loss Statement		
Opening balance	2,003	
Add : Net Profit	14,367	
	16,370	
Less: Transfer to general reserve	(2,000)	
Less : 10% Dividend (900 + 100)	(1,000)	13,370
		26,920

6. Short Term Provisions

Particulars	(`)
Income - tax	3,000
Dividends payable	100
	3,100

7. Machinery

Particulars	(`)
Machinery	2,900
(+) Purchased additional machinery on 1-7-17	500
	3,400

8. Trade Receivables

Particulars	(`)
Debtors	3,750
(+) Sales made but no entry passed	3,000
	6,750

13. (a) What is the importance of valuation of shares? Discuss various methods for valuation of shares.

Ans :

Refer Unit-V, Q. No. 4

Methods for Valuation of Shares

The following are the 3 methods.

1. Net assets backing method
2. Yield method / Earning basis / Market value method.
3. Dual method / Fair value method

Above methods are generally used for valuation of equity shares. However, they can also be used to some extent in case of preference shares.

1. Net Assets Backing Method

This is also termed as balance sheet method or intrinsic method or breakup value method. In case of this method, the net assets of the company (including goodwill and non-trading assets) are divided by the number of issued shares to arrive at the assets backing for each share.

2. Yield Method

This is also termed as earning basis method, market value method. The yield basis of valuation may take any of the following two forms.

(A) Valuation based on rate of return.

(B) Valuation based on productivity factor

(A) Valuation Based on Rate of Return

The term "rate of return" refers to the return which a shareholder earns on his investment. It may further be classified as:

(a) Rate of dividend

(b) Rate of earning

(a) Rate of Dividend Method: This method of valuation is particularly suitable for valuing small block of shares.

(b) Rate of Earning Method: This method of valuation is particularly suitable for valuing a large block of the companys shares.

(B) Valuation Based on Productivity Factor

Productivity factor represents the earning power of the company in relation to the value of the assets employed for such earnings. The factor is applied to the net worth of the company on the valuation date to arrive at the projected earnings of the company. The, projected earning after necessary adjustments are multiplied by the appropriate capitalization factor to arrive at the value of the companies business. The total value is divided by the number of equity shares to certain the value of each share.

3. Dual Method

This is also termed as fair value method. Under this method the average of net assets method and yield method is considered as the value of the square.

OR

(b) Following is the Balance Sheet of ICM Co. Ltd. as on 31-12-2016.

Particulars	**`.**	**`.**
I Equity and Liabilities:		
1. Shareholder's Funds:		
a) Share Capital		
10,000 Equity shares of Rs. 10 each		1,00,000
b) Reserves and Surplus		
i) General Reserve		10,000
ii) Surplus Account:		
Balance as on 1-1-2016	5,000	
Profit Before Tax	40,000	
		45,000
2. Nor-Current Liabilities:		
6% Debentures		25,000
3. Current Liabilities		
a) Creditors		10,000
b) Provision for Taxation		5,000
Total		1,95,000

Particulars	Rs.
II. Assets :	
1 Non-Current Assets	
a) Fixed Assets:	
i) Tangible Assets:	
Land & Buildings	45,000
Plant	40,000
ii) Intangible Asset:	
Goodwill	20,000
b) Investment (Long term)	20,000
2 Current Assets	
Stock	25,000
Debtors	20,000
Bank	25,000
Total	1,95,000

The assets were revalued as under:

Plant Rs. 50,000; Land & Building Rs. 40,000; Investment Rs. 25,000;

Profit includes Rs. 1,000 Income from Investment.

Calculate the value of Goodwill on the basis of three years purchase of super profit. Normal rate of return in this type of business 12%. Tax rate is 50%, Depreciation on Plant is 5% and on Building is 10%.

Ans :

1. Calculation of Capital Employed

Particulars	`	`
Land and Buildings	40,000	
(–) 10% Depreciation	4,000	36,000
Plant	50,000	
(–) 5% Depreciation	2,500	47,500
Stock		25,000
Debtors		20,000
Bank		25,000
		1,53,500
(–) Outside liabilities		
6% Debentures	25,000	
Creditors	10,000	
Provision for taxation	5,000	40,000
Capital Employed		1,13,500

2. Calculation of Average Capital Employed

Capital employed – 1/2 of current year profit

1,13,500 – 1/2 of 39,000

1,13,500 – 19,500 = 94,000

3. Calculation of Normal Profit (NP)

$$\text{Average capital employed} \times \frac{\text{Normal Rate}}{100}$$

$$94{,}000 \times \frac{12}{100} = \text{`}\ 11{,}280$$

4. Calculation of Future Maintainable Profit

Particulars			`
Average Profit			40,000
Less: 1.	Interest on Investment	1,000	
2.	Income - Tax (50% on 40,000)	20,000	21,000
Future Maintainable Profits (FMP)			19,000

5. Calculation of Super Profits (S.P)

FMP – NP = SP

19,000 – 11,280 = 7,720

6. Calculation of Goodwill

S.P × Number of purchase years

7,720 × 3 years = ` 23,160

Working Notes

Calculation of Actual Current Year Profit

	`
Current year profit	40,000
(–) Interest on Investment	1,000
	39,000

FACULTY OF COMMERCE

B.Com. III - Semester (CBCS) Examination

November / December - 2018

(Common for General / Computers / Computer Applications / Advertising / Foreign Trade and Tax Procedure Courses)

ADVANCED ACCOUNTING

Time : 3 Hours] [Max. Marks : 80

PART - A (5 × 4 = 20 Marks)

***Note :** Answer any **FIVE** of the following questions.*

1. Explain partnership Deed.

Ans :

It is desirable that all the partners must have either verbal or written agreement in order to avoid the future dispute among the partners. Usually agreement in black and white is preferred so that it can be referred as and when need arises. The document which contains the terms and conditions regarding the conduct of partnership business, is called partnership deed.

2. What is Sacrificing Ratio ?

Ans :

When the new partner is admitted, the old partner forgoes a fraction of his share in favour of the new partner and thus reducing the share of profit or loss of the old partner. Sacrifice made by the old partners can be found out by deducing their new share from the old share, i.e., Sacrificing Ratio = Old Ratio – New Ratio.

3. What do you mean by Insolvent partner ?

Ans :

When all the adjustments have been made in respect of realisation profit or loss and accumulated profits or losses etc., the capital account of a partner may show a debit balance. Such a partner then is a debtor to the firm to that extent and he has to bring in the necessary cash to clear debit balance (or deficiency) in his capital account. But if the partner with a debit balance (or deficiency) in his capital account is unable to bring in the necessary cash, he is said to be insolvent.

4. Average profits of the company for the past five years are Rs. 22,000 and Assets and Liabilities are Liabilities are Rs. 2,75,000 and 75,000 respectively. The fair rate of return of return is 10%. Calculate the value of Goodwill by super profits method (one year purchase).

Ans :

Step 1 : Calculation of Capital Emplayed

Particulars	`
Assets	2,75,000
(–) Liasilities	75,000
Capital Emplayed	2,00,000

Step 2 : Calculation of Normal profit (N.P)

$$\text{Capital Emplayed} \times \frac{\text{Fair Rate}}{100} \quad 2,00,000 \times \frac{10}{100} = \text{`}\ 20,000$$

Step 3 : Calculation of F.M.P

Particulars	`
Average profit	22,000
Fair Market profit	22,000

Step 4 : Calculation of super profit (S.P)

FMP – N.P = S.P

22,000 – 20,000 = 2000

Step 5 : Calculation of Good will

S.P × No. of purchase years = Good will

2000 × 1 year = 2,000

5. From the following information, you are required to value the Equity Shares.

Particulars	`
Assets at Book Value	6,00,000
2,000, 6% Preference Share of Rs. 100 each	2,00,000
3,00,000 Equity Shares of Rs. 10 each	3,00,000
Sundry Liabilities	1,00,000

The market value of $\frac{1}{2}$ of the assets is considered at 10% more than the book values and that of the remaining at 5% less than the book value. There was a liability of Rs. 5,000 which remained unrecorded. Assume preference shares have no priority as to repayment of Capital or Dividend.

Ans :

Step 1. Calculation of amount available for Equity share holders

Particulars	`	`
$\frac{1}{2}$ of Assets at Book value		
$6,00,000 \times \frac{1}{2}$	3,00,000	
Add : 10% Increase in the value	30,000	3,30,000
$\frac{1}{2}$ of Remaing Assets at Book		
value $6,00,000 \times \frac{1}{2}$	3,00,000	
Less : 5% Less than the book value	15,000	2,85,000
		6,15,000
Less : 1) Unrecovered Liability	5,000	
2) Sundry Liabilities	1,00,000	1,05,000
Networth/Amt available for Shareholders		5,10,000

Step 2 : Calculation of Equity share value
Amount available for Equity shares

No. of Equity shares $\frac{510000}{30,000 \text{ Equity shares}}$ = ` 17

6. A company had purchased a business on 01-01-2017. The company received its certificate of Incorporation on 01-06-2017. The total sales during the year were Rs. 13,25,000. Find out the pre-incorporation and post-incorporation sales.

Ans :

Financial year of A Co., 1-1-2017 – 31-12-2017

Date of purchase 1-1-2017

Date of receiving certificate of Incorporation 1-6-2017

1. Calculation iof Pre Incorporation Period

Date of purchase - Date of receiving certificate of Incorporation.

1-1-2017 - 1-6-2017 i.e., 5 months

2. Calculation of Post Incorporation Period

Date of receiving - Date of certificate of Incorporation Balance sheet
1-6-2017 - 31-12-2017 i.e. 7 months

3. Calculation of Time Ratio

Pre Incorporation period : Post Incorporation Period 5 : 7

4. Calculation of Pre & Post incorporation sales

A) Pre Incorporation Sales = Total sales × $\frac{5}{12}$

$$13,25000 \times \frac{5}{12} = ` 5,52,083$$

B) Post Incorporation Sales = Total Sales × $\frac{7}{12}$

$$13,25,000 \times \frac{7}{12} = ` 7,72,917$$

7. Kalyan Ltd. issued 1000 equity shares to Rs. 10 each at a premium of Rs. 1 per share, payable Rs. 3 per share on application, Rs. 4 per share on allotment (including premium), Rs 4 on first and first call. The shares were all subscribed and all money due was received. Write the journal entries in the books of the Company.

Ans :

Journal

Date	Particulars	LF	Debit	Credit
1	Bank A/c Dr		3,000	
	To Equity share Application A/c			3,000
	(Being Equity share application money received.			

2	Equity Share Application A/c Dr To Equity Share capital A/c (Being transfer of equity share aplication		3,000	 3,000
3	amount to equity share capital etc. Equity share Allotment A/c Dr To Equity Share capital A/c To Equity share premium A/c (Being equity share allotment due)		 4,000	 3,000 1,000
4	Bank A/c Dr To Equity Share Allotment A/c (Being Equity share allotment money received		4,000	 4,000
5	Equity share first & finals call A/c Dr To Equity share capital A/c (Being Equity share first & final call money due)		4,000	 4,000
6	Bank A/c Dr To Equity share first final call A/c (Being Equity share first & final call A/c call money received)		4,000	 4,000

8. What is Debentures stock ?

Ans :

Loan contract issued by a Co., or public body specifying an abligation to return borrowed funds and pay interest secured by all or part of the Co., property. Certificates specifying the amount of stock with coupons for interest attached are usually issued to the lenders. The interest of stock holders may be protected by a trust deed naming a trustee who acts on behalf of the stockholders and against whom they actually have claim. In case of default, the debenture holder may appoint a receiver to seize and realise assets and repay the money secured.

PART - B (5 × 12 = 60 Marks)

Note : *Answer* **ALL** *the questions.*

9. (a) Define Partnership. Explain its essential features. **(Unit - I, Q.No. 1)**

OR

(b) The following is the Balance Sheet of Anil and Sunil who share profits in the ratio of 3 : 2.

Liabilities	Rs.	Assets	Rs.
Anil's Capital	10,000	Debtors	11,000
Sunil's Capital	8,000	Buildings	8,000
Creditors	12,000	Plant	10,000
General Reserve	16,000	Stock	12,000
Workmen's compensation fund	4,000	Cash	9,000
	50,000		50,000

They agreed to admit Vinil on the following terms :

(a) The value of Buildings to be increased to Rs. 18,000.

(b) The value of stock to be increased to Rs. 16,000.

(c) The liability on workmen's compensation fund was determined at Rs. 2,000.

(d) Vinil contributes Rs. 10,000 in cash towards Goodwill.

(e) Vinil as to bring further cash as would make his capital equal to 1/5th of the combined capital of Anil and Sunil after all adjustments.

Prepare necessary Ledger Accounts in the books of the firm.

Ans :

1. Revaluation A/c

Dr Cr

Particulars	`	`	Particulars	`	`
To Revaluation Profit			By Buildings		10,000
(Transfer to capital A/c's)			By Stock		4,000
Anil 16000 × 3/5	9,600		By workmen's		2,000
Sunil 16000 × 2/5	6,400		compersation fund}		
		16,000			
		16,000			16,000

2. Cash A/c

Dr Cr

Receipts	`	`	Payments	`	`
To Bal b/d		9,000	By Balance c/d		31,000
To vinil's Capital A/c		12,000			
To vinil's Goodwill A/c		10,000			
		31,000			31,000
To Balance b/d		31,000			

3. Capital A/c's

Dr Cr

Particulars	Anil	Sunil	Vinil	Particulars	Anil	Sunil	Vinil
To Balance c/d	35,200	24,800	12,000	By Balance b/d	10,000	8,000	–
				By Cash A/c	–	–	12,000
				By Revaluation profit	9,600	6,400	–
				By General Reserve	9,600	6,400	–
				By Goodwill	6,000	4,000	–
	35,200	24,800	12,000		35,200	24,800	12,000
				By Bal b/d	35,200	24,800	12,000

4. Good will A/c

Dr Cr

Particulars	`	`	Particulars	`	`
To Capital a/c's			By Cash A/c		10,000
Anil	6,000				
Sunil	4,000	10,000			
		10,000			10,000

Balance Sheet of Anil, sunil & Vinil as on

Liasilities	`	`	Assets	`	`
Capital A/s's			Debtors		11,000
Anil	35,200		Buildings	8,000	
Sunil	24,800		(+) Appreciation	10,000	18,000
Vinil	12,000	72,000	Plant		10,000
Creditors		12,000	Stock	12,000	
Workmen's compensation Fund		2,000	(+) Apreciation	4,000	16,000
			Cash		31,000
		86,000			86,000

W. Notes :

Old partners - Anil : Sunil

Sharing ratio - 3 : 2

1. Distribution of General Reverse

Anil share $16{,}000 \times \frac{3}{5} = 9600$

Sunil share $16{,}000 \times \frac{2}{5} = 6400$

2. Distribution of Good will

Anil share $10{,}000 \times \frac{3}{5} = 6{,}000$

Sunil share $10{,}000 \times \frac{2}{5} = 4{,}000$

3. Distribution of Revaluation Profit

Anil share $16{,}000 \times \frac{3}{5} = 9{,}600$

Sunil share $16{,}000 \times \frac{2}{5} = 6{,}400$

4. Calculation of Vinil's capital

After all adjustments

Anil Capital is	35,200
Sunil Capital is	24,800
Combined capital	60,000

Combined capital $\times \frac{1}{5}$

$60{,}000 \times \frac{1}{5} = 12{,}000$

10. (a) Explain the procedure of realization of assets and liabilities.

Ans :

When the firm is dissolved, the assets of the firm must be realised for the purpose of meeting all claims on it including those of the partners. For this purpose a separate account called Realisation Account will have to be opened showing what amounts were realised on the sale of the assets, what liasilities were paid and finally the net result of the dissolution i.e., profit or loss. Sec 48 of the Act deals with the mode of settlement of accounts. In brief it provides for that the money available will be applied or used in the following manner.

1. Payment of expenses on disposing of the assets and collecting the debts due to the firm.

2. Payment of outside liasilities of the firm.

   Ex : Creditors, bank O.D, bills payable, Loans from partner's wifes etc.

3. Repayment of the Loans received from the partners.

4. Repayment of the capital contributions of the partners.

5. If there is still any surplus left after meeting the claims stated in (i) to (iv) it will be shared by the partners in their profit sharing ratio.

(Unit - II Q.No. 3 (Journal Entries) up to 11 Entries)

(OR)

(b) Supriya and Monika are partners, who share profits in the ratio of 3 : 2 Following is the Balance Sheet as on March, 31, 2018.

Liabilities	`.	Assets		`.
Supriya's Capital	32,500	Cash at Bank		40,500
Monika's Capital	11,500	Stock		7,500
Sundry Creditors	48,000	Sundry Debtors	21,500	
Reserve Funds	13,500	(-) Provision for bad debts	5,00	21,000
		Fixed Assets		36,500
	1,05,500			1,05,500

The firm was dissolved on March 31, 2018. Close the books of the firm with following information :

(i) Debtors realised at a discount of 5%

(ii) Stock realised at Rs. 7,000

(iii) Fixed Assets ralised at Rs. 42,000

(iv) Realization Expenses of Rs. 1500

(v) Creditors are paid in bulls.

Prepared necessary Ledger Accounts.

Ans :

1. Realisation A/c

Particulars	`	`	Particulars	`	`
To Stock		7500	By RBD /PBD		500
To Debtors		21,500	By Creditors A/c		48,000
To Fixed Assets		36,500	By Bank A/c		
To Bank			(Assets Realised)		
Realisation Exp	1,500		Debtors	20,425	
Creditors paid	48,000	49,500	Stock	7,000	
To Realization profit			Fixed Assets	42,000	69425
(Transfered to)					
Supriya capital A/c					
2925 × 3/5	1,755				
Mounika capital A/c	1,170	2925			
2925 × 2/5		1,17,925			1,17,925

2. Bank A/c

Dr Cr

Receipts	`	`	Payments	`	`
To Balance b/d		40,500	By Realisation A/c		
To Realisation A/c		69,425	Realisation Exp	1500	
(Assets realised)			Creditors paid	48,000	49,500
			By capital A/c's		
			Supriya	42,355	
			Mounika	18,070	60,425
		1,09,925			1,09,925

3. Capital A/c's

Dr Cr

Particulars	Supriya	Mounika	Particulars	Supriya	Mounika
To Bank A/c	42,355	18,070	By Bal b/d	32,500	11,500
			By Reserve fund	8,100	5,400
			By Revaluation		
			profit	1,755	1,170
	42,355	18,070		42,355	18,070

W. Notes :

1. Distribution of Reserve fund

 Supriya's share $13{,}500 \times \frac{3}{5} = 8{,}100$

 Mounika share $13{,}500 \times \frac{2}{5} = 5{,}400$

2. Distribution of Realisation profit

 Supriya's share $= 2925 \times \frac{3}{5} = 1{,}755$

 Mounika share $= 2925 \times \frac{2}{5} = 1{,}170$

11. (a) What do you understand by a Debenture? Describe briefly the different types of Debentures.

Ans :

Debenture

Debentures are therefore part of loan capital and the company is liable to pay interest thereon whether there are profits or not. Section 2 (30) of the Companies Act, 2013 states that: "a debenture includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of a company or not" It is clear that this definition does not describe the true nature of a debenture.

According to Topham: "Debenture is a document given by a company as evidence of debt to the holder usually arising out of a loan and most commonly secured by a charge".

Types of Debentures

(Refer to Unit-III, Q.No. 14.)

OR

(b) Chandra Co. Ltd. offered to the public 20,000 Equity shares of Rs. 10 each at a premium of Rs. 1 per share, the payment was to be as follows.

On Application Rs 2, on Allotment Rs.4 (including premium)

On First call Rs 2 and on Final call Rs. 3

Applications received for 35,000 shares, money was received except 1,000

shares on first and final call money, these shares were forfeited. Write the journal entries in the books of a company.

Ans :

No. of share Applications	No. of shares Applied	No. of Shares Allotted	Application Money received	Adjusted towards				
				Application	Allotment	Icall	Final call	Returned
35,000	35,000	20,000	70,000	40,000	30,000	–	–	–

Journal

Date	Particulars	LF	Debit	Credit
			`	`
1	Bank A/c Dr To share App A/c (Being share application received)		70,000	 70,000
2	Sh. Application A/c Dr To share capital A/c To share Allotment A/c (Being share application money transfered to share capital & share allotment a/c's)		70,000	 40,000 30,000
3	Sh.Allotment A/c Dr To share capital A/c To share premium A/c (Being share allotment money due)		80,000	 60,000 20,000
4	Bank A/c Dr To share Allotment A/c (Being share allotment money after adjusting excess application money towards share allotment received)		50,000	 50,000
5	Share I call A/c To share capital A/c (Being I call money due)		40,000	 40,000
6	Bank A/c Dr I call in Arrears A/c Dr To share I call A/c (Being share I call money received except on 1,000 share @ 2/- each)		38,000 2,000	 40,000
7	Share final call A/c Dr To share capital A/c (Being share final call money due)		60,000	 60,000
8	Bank A/c Dr calls In Arrears A/c Dr To share final call A/c (Being share final call money received except on 1,000 share @ 3 each)		57,000 3,000	 60,000
9	Share capital A/c Dr To share for feited A/c To calls - In Arrears A/c (Being 1,000 shares for faited due to non payment of I & final call money)		10,000	 5,000 5,000

12. (a) What is profit prior to incorporation? Explain the treatment of pre-incorporation profit and loss.

Ans :

A company comes into existence from the date of issue of the certificate of incorporation by the Registrar of Companies. Sometimes, a newly incorporated company agrees to take over a running business w.e.f. a date prior to its incorporation. Such an agreement is made to avoid the necessity of preparing the final accounts of the vendor's business from the date it prepared its last final accounts till the date on which the business is actually acquired. The assets and liabilities of the vendor's business are agreed as per the date of its last balance sheet. In such a case, the company becomes entitled to the entire profit or liable for the entire loss since the date it agrees to acquires the vendor's business.

For example, a company incorporated on 1 April 2001, agrees to take over a running business from 1 January 2001 and it closes its accounts on 31 December, the company is entitled (or liable) not only to the profit (or loss) made by the business from 1 April to 31 December, but also to the profit (or loss) made by the vendor from 1 January to 31 March. Any profit (or loss) to which the company is entitled (or liable) before its incorporation is termed as 'profit (or loss) prior to incorporation.

Accounting Treatment

(Refer to Unit-IV, Q.No. 7.)

OR

(b) Following is the Trial Balance of Lakshmi Co. Ltd. as on 31st March, 2018.

Particulars	`.	`.
Stock on 31st March, 2017	75,000	-
Sales	-	3,50,000
Purchases	2,45,000	-
Wages	50,000	-
Discount	-	5,000
Furniture	17,000	-
Salaries	7,500	-
Rent	4,950	-
Sundry Expenses	7,050	-
Surplus Account 31st March, 2017	-	15,030
Dividends paid	9,000	-
Share Capital	-	1,00,000
Debtorts & Creditors	37,500	17,500
Machinery	29,000	-
Cash & Bank	16,200	-
Reserve	-	15,500
Patents	4,830	-
	5,03,030	5,03,030

Prepare statement of profit and loss for the year ended 31st March, 2018 and Balance Sheet as at that date. The following are the adjustments.

(i) Stock on 31st March, 2018 was valued at Rs. 82,000.

(ii) Depreciation of Fixed Assets @ 10%

(iii) Make a provision for tax Rs. 13,500

(iv) Ignore corporate Dividened Tax

Ans :

Statement of Profit & Loss

Profit & coss A/c of Lakshmi Co, Ltd for the year ended 31-3-18

Particulars	Note No's	Figures for current year	Figures for previous year
I. Reverse from operations		3,50,000	–
II. Other Incomes		5,000	–
III. Total Revenue		3,55,000	–
IV. EXPENSES			
Cost of materials consumed	1	2,38,000	–
Emplayee benefits expense	2	57,500	–
Depreciation and amortization expense		2,900	–
Other expenses	3	21,000	–
Total Expenses		3,19,400	–
V. Profit before tax		35,600	–
VI. Tax Expense		13,500	–
Profit for the period		22,100	–

Profit & coss A/c of Lakshmi Co, Ltd for the year ended 31-3-18

Particulars	Note No's	Figures for current year	Figures for previous year
Equity & Liabilities			
I. Share holder's Funds			
a) Share Capital		1,00,000	–
b) Reserves & Surplus	1	52,630	–
2. Current Liabilities			
a) Trade payables (creditors)		17,500	–
b) Short - Term provisions			
(Tax - provision)		13,500	–
Total		1,83,630	–

Assets		
1. Non current Assets		
a) Fixed Assets		
(i) Tangible assets	43,100	–
(ii) Intangible assets	4,830	–
2. Current Assets		
a) Inventories	82,000	–
b) Trade receivables (Debtors)	37,500	–
c) Cash & cash equivalests	16,200	–
	1,83,630	–

Notes and Explanation to A/c's

1.	Cost of materials consumed		
	Opening stock of R. Materials		75,000
	Add : Purchase of R. Materials		2,45,000
			3,20,000
	Less : Closing stock of R. materials		82,000
			2,38,000
2.	Employee Benefits expense		
	wages		50,000
	Salaries		7,500
			57,500
3.	Other Expenses		
	Rent		4,950
	Sunday expenses		7,050
	Dividends paid		9,000
			21,000
1.	Reserves & Surplus		
	Reserves		15,500
	P & L A/c statement		
	Opening Balance	15030	
	(+) Net profit	22,100	37,130
			52,630
2.	Tangible Assets		
	Furniture		17,000
	Machinery	29,000	
	(–) 10% Dep	2900	26,100
			43,100
3.	Intangible Assets		
	Patents		4,830

13. (a) What do you understand by Goodwill? Explain three important methods of Goodwill valuation.

Ans :

Goodwill is some thing very easy to describe but very difficult to define because there are so many factors which generate goodwill in each individual business. It is a benefit or an advantage of the good name, reputation or connection of a business. It is the attractive force which brings in customers. "Goodwill simply means that old customers will resort to the old place; if the old customers do not patronise the old place, business will almost decline certainly."

"Goodwill is the excess of the price paid for a business as a whole over the book values or over the market value of all tangible assets purchased.

Professor Dicksee states that when a man pays for goodwill, he pays for something which places him in a position of being able to earn more money than he would be able to do by his own efforts. Thus the capacity of a business to earn super profits in the future is basically what is meant by term goodwill.

Goodwill is an intangible asset; it cannot be seen; it cannot be felt; it cannot be transported physically. Even then it is very real. From accounting point of view, it is necessary that it has some monetary or saleable value.

Valuation Methods of Goodwill

(Refer to Unit-V, Q.No. 2.)

OR

(b) Compute the value of an equity share of each of the companies A and B on the basis of following information :

Particulars	**`.**	**`.**
Profits After tax	10,00,000	10,00,000
12% Preference capital (Shares of Rs. 100 each)	10,00,000	20,00,000
Equity Capital (share of Rs. 10 each)	50,00,000	40,00,000

Assume that market expectation is 15% and 80% of profits are distributed.

Ans :

1. Valuation based on rate of Earnings

Particulars	**Company A (`)**	**Company B (`)**
Profit after tax	10,00,000	10,00,000
(–) 12% dividend to preference share holders	1,20,000	2,40,000
	8,80,000	7,60,000

2. Valuation based on rate of dividend

Companies Formula

$$\frac{\text{Expected profit}}{\text{Equity share capital}} \times 100 = \text{Expected Rate of Return}$$

$$A = \frac{8,80000}{50,00,000} \times 100 = 17.60$$

$$B = \frac{7,60,000}{40,00,000} \times 100 = 19$$

Calculation of value of Equity Share

Companies $\frac{\text{Expected Rate of Return}}{\text{Normal Rate of Return}} \times$ Paid up value of share

$$A \quad \frac{17.60}{15} \times 10 = 11.73/-$$

$$B \quad \frac{19}{15} \times 10 = 12.67/-$$

Particulars	**Company**	**Company**
Profits (after dividends to Pref. share holders as calculated above	8,80,000	7,60,000
80% of profits available for dividend to Equity share holders	7,04,000	6,08,000

Calculation of Expected Rate of Dividend

$$\text{Expected Rate of dividend} = \frac{\text{Profit available for dividend}}{\text{Equity share capital}} \times 100$$

Company "A" $\frac{7,04,000}{50,00,000} \times 100 = 14.08$

Company "B" $\frac{6,08,000}{40,00,000} \times 10 = 15.20$

Calculation of value of Equity share

$$\frac{\text{Expected Rate of Return}}{\text{Normal rate of Return}} \times \text{Paid up value of shares} = \text{Equity share value}$$

Company 'A' $\frac{14.08}{15} \times 10 =$ ` 9.39SZ

Company 'B' $\frac{15.20}{15} \times 10 =$ ` 10.13

FACULTIES OF COMMERCE

B.Com. (CBCS) III - Semester Examination

May/June - 2018

ADVANCED ACCOUNTING

Time : 3 Hours] **[Max. Marks : 80**

SECTION - A (5 × 4 = 20 Marks)

Note: Answer any Five of the following questions

1. Define partnership. **(Unit-I, SQA - 1)**

2. What is a partnership deed? **(Unit-I, SQA - 3)**

3. A, B and C sharing profit and losses in the proportion of 2/5, 2/5 and 1/5 capitals contributed were A Rs. 30,000 ; B Rs. 10,000 and C Rs.4,000 ; cash in hand Rs. 10,000 and realization loss Rs.34,000. Show the necessary ledger accounts assuming that C is insolvent and is unable to bring in anything is respect of his deficiency.

Ans :

Dr. **Partner's Capital A/c** **Cr.**

Particulars	A	B	C	Particulars	A	B	C
To Realization Loss	13,600	13,600	6,800	By balance b/d	30,000	10,000	4,000
To 'C' capital A/c	1,400	1,400	–	By bank A/c	13,600	13,600	–
To bank A/c	28,600	8,600	–	By 'A' capital A/c	–	–	1,400
				By 'B' capital A/c	–	–	1,400
	43,600	23,600	6,800		43,600	23,600	6,800

Working Notes

Realization loss 34,000

$$A = 34{,}000 \times \frac{2}{5} = 13{,}600$$

$$B = 34{,}000 \times \frac{2}{5} = 13{,}600$$

$$C = 34{,}000 \times \frac{1}{5} = 6{,}800.$$

4. What is calls in arrears and calls in advance? **(Unit-III, SQA - 8)**

5. Ravi was holding 200 shares of Rana Company of Rs.100 each he paid Rs. 25 on application and Rs. 30 on allotment, but failed to pay first call and final call. His shares were forfeited and reissued at a later date at the rate of Rs.80 per share Journalise the transactions in the books of Rana company.

Ans :

Journal Entries

S. No.	Particulars		LF	Debit	Credit
1.	Share capital A/c	Dr.		20,000	-
	To share 1st call A/c			-	5,000
	To share final call A/c			-	6,000
	To share forfeiture A/c			-	9,000
	(Being 200 shares forfeited due to non-payment of first and final call)				
2.	Bank A/c	Dr.		16,000	-
	Forfeited share A/c	Dr.		4,000	-
	To Share capital A/c			-	20,000
	(Being forfeited issued to Ravi)				
3.	Share forfeited A/c	Dr.		5,000	-
	To capital Reserve A/c			-	5,000
	(Being forfeited amount transferred to capital reserve)				

6. Accounting period calendar year 2016; date of taking over of the business 1-1-2016; date of incorporation 01-05-2016; total sales Rs. 40,00,000 the monthly average of sales for the period of First four months of the year was one-half of the remaining period. Calculate sales ratio and time ratio of pre-incorporation and post incorporation.

Ans :

Sales Ratio

Sales = 40,00,000

Sales for first four months of the year was one half of the remaining period.

$$\frac{40,00,000}{4} = 10,00,000$$

40,00,000 – 10,00,000 – 30,00,000

$$\text{Ratio} = \frac{10,00,000}{30,00,000}$$

= 1 : 3

Time Ratio

Prior Incorporation = 1/1/2016 – 1/5/2016

= 4 Months

Post Incorporation = 12 – 4 = 8

= 4 : 8

Time Ratio = 1 : 2

7. What are the objectives of valuation of shares? **(Unit-V, Q.No. 4)**

8. Ascertain the yield value of shares of Sonu Ltd.

Average rate of dividend 15%

Normal rate of return 10%

Equity share value Rs.10

Paid up value of equity share Rs. 8

Ans :

$$\text{Yield value of share} = \frac{\text{Expected Rate}}{\text{Normal Rate}} \times \text{Paid up value of shares}$$

$$= \frac{15}{10} \times 8$$

$$= 12.$$

SECTION - B (12 × 5 = 60 M)

Note: *Answer the following questions not exceeding FOUR pages each*

9. (a) Explain the different methods of treating goodwill on admission and retirement of partner in a partnership firm. **(Unit-I, Q.No. 11, 12)**

OR

(b) Anil, Banu and Chandu were carrying on business in partnership sharing profits and losses in the ratio of 3 : 2 : 1 on 31^{st} December 2015 balance sheet of the firm stood as follows

Liabilities	`.	Assets	`.
Sundry Creditors	26,000	Cash in hand	10,000
Bills payable	180	Cash at bank	1,800
Bank overdraft	1,000	Debtors	16,000
Capital Accounts		Stock	23,380
Anil	30,000	Buildings	46,000
Banu	20,000		
Chandu	20,000		
	97,180		97,180

Banu retired on the above mentioned date on the following terms :

i) Buildings be appreciated by Rs.24,000

ii) Bad debts 5% on debtors

iii) Goodwill of the firm be valued at Rs.18000 and without raising

iv) Rs. 10,000 be paid to Banu and balance due to him be treated as loan account carrying interest @ 10% pa.

Prepare Revaluation Account, Capital Accounts and Balance Sheet after Banu retirement.

Ans :

Dr. Revaluation A/c Cr.

Particulars	Amount	Particulars	Amount
To Bad debts	800	By buildings	24,000
(16,000 × 5%)			
To Revaluation profit	23,200		
	24,000		24,000

Distribution of Revaluation Profit = 3 : 2 : 1

$$\text{Anil} = 23{,}200 \times \frac{3}{6} = 11{,}600$$

$$\text{Banu} = 23{,}200 \times \frac{2}{6} = 7{,}733$$

$$\text{Chandu} = 23{,}200 \times \frac{1}{6} = 3{,}867.$$

Dr. Partner's Capital A/c Cr.

Particulars	Anil	Banu	Chandu	Particulars	Anil	Banu	Chandu
To goodwill	4,500	–	1,500	By balance b/d	30,000	20,000	20,000
To cash	–	10,000	–	By profit A/c	11,600	7,733	3,867
To Banu loan	–	23,733	–	By Goodwill (Anil)	–	4,500	–
To Balance c/d	37,100	–	22,367	By Goodwill (Chandu)	–	1,500	–
	41,600	33,733	23,867		41,600	33,733	23,867

Balance Sheet

Liabilities	Amount	Assets		Amount
Creditors	26,000	Cash in hand		10,000
Amount due to Banu	10,000	Cash at bank		1,800
Bank Loan	23,733	Debtors	16,000	
Bills Payable	180	(–) Bad debts	800	15,200
Bank overdraft	1,000	Stock		23,380
Anil capital A/c	37,200	Buildings	46,000	
Chandu capital A/c	22,367	(+) Appreciation	24,000	70,000
	1,220,380			1,20,380

10. (a) Explain dissolution of firm and its accounting treatment. **(Unit-II, Q.No. 3)**

OR

(b) The partnership of Ram Rahim and Robert sharing profits and losses in the ratio of 4 : 3 : 2 is dissolved on Rabert becoming insolvent on 31st December 2016. Their balance sheet on that data is as follows.

Liabilities	`.	Assets	`.
Sundry Creditors	4,000	Cash in hand	1,000
Bank overdraft	6,000	Cash at bank	3,000
Capital Accounts:		Debtors	12,000
Ram	20,000	Stock	10,000
Rahim	10,000	Furniture	8,000
Reserve fund	7,200	Plant and Machinery	20,000
Profit and loss account	540	Robert capital account	1,540
	55,540		55,540

The assets realized : Debtors 20% less, furniture 15% less, machinery 20% less, stock is taken over by Ram at an agreed value of Rs.8000, expenses of realization amounted to Rs. 400. Rs. 800 is received from Robert in full settlement of his indebtedness to the firm. Prepare realization and capital accounts.

Ans :

In the given question liabilities side total is not equal with the asset side total. Incomplete problem.

11. (a) Distinguish between shares and debentures. **(Unit-III, Q.No. 13)**

OR

(b) The following is the summarized balance sheet of Sonu company.

Liabilities	`.	Assets	`.
Share capital 140000 shares of		Land and Buildings	78,00,000
Rs.20 each paid up Rs.16	22,40,000	Plant and Machinery	10,00,000
General Reserve	14,70,000	Furniture	3,00,000
Capital Redemption Reserve	7,00,000		
P & L A/c	11,90,000		
10% debentures	30,00,000		
Bank Loan	5,00,000		
	91,00,000		91,00,000

The directors of the company decided to issue bonus shares. For this purpose general reserve account is to be applied for converting partly paid shares into fully paid up and issue one bonus share of Rs.20 each for every five existing shares by utilizing capital redemption reserve. Give journal entries and the balance sheet after the bonus issue.

Ans :

Journal Entries

S. No.	Particulars	LF	Debit	Credit
1.	Equity share final call A/c Dr.		5,60,000	-
	To Equity share capital A/c		-	5,60,000
	(Being final call money due for 1,40,000 @ 4 per share)			
2.	General Reserve A/c Dr.		5,60,000	-
	To Bonus to equity share holder A/c		-	5,60,000
	(Being bonus payable on 1,40,000 shares @ 4 per Share)			
3.	Bonus to equity share holder A/c Dr.		5,60,000	-
	To equity share final call A/c		-	5,60,000
	(Being bonus utilized for converting partly paid up to fully paid up)			
4.	General reserve A/c Dr.		5,60,000	-
	To Bonus to equity share holders A/c		-	5,60,000
	(Being bonus issued to general reserve in the ratio of 1 : 5)			
5.	Bonus to Equity share holders A/c Dr.		5,60,000	-
	To equity share capital A/c		-	5,60,000
	(Being 28,000 bonus shares issued)			

Working Notes

1. Calculation of Number of equity shares = $\frac{22,40,000}{16}$ = 1,40,000.
2. Calculation of Amount required for partly paidup bonus shares = 1,40,000 × 4 = 5,60,000.
3. Calculation of Amount required for issuing fully paid up bonus shares.

$$= 1,40,000 \times \frac{1}{5} = 28,000, \text{ shares}$$

$$= 28,000 \times 20 = 5,60,000$$

4. Calculation of general reserve.

General Reserve	14,70,000
(–) amount required for partly paidup bonus shares	5,60,000
	9,10,000
(–) Amount required for fully paid up bonus shares	5,60,000
	3,50,000

Balance Sheet as on ....

Liabilities	Amount	Assets	Amount
Equity share capital	33,60,000	Land and Buildings	78,00,000
(1,68,000 × 20 Rs.)		Furniture	3,00,000
General Reserve	3,50,000	Plant and Machinery	10,00,000
Capital Redemption Reserve	7,00,000		
P and L A/c	11,90,000		
10% Debentures	30,00,000		
Bank Loan	5,00,000		
	91,00,000		91,00,000

12. (a) Explain general instructions to prepare statement of profit and loss under new schedules of company. **(Unit-IV, Q.No. 7)**

OR

(b) A firm which was carrying on business from 1st January 2015 gets itself incorporated as a company on 1st May 2015. The first accounts are drawn up to 30th September 2015. The gross profit for the period is Rs. 2,50,000. The general expenses are Rs. 70,000; directors fees Rs.60,000 p.a., formation expenses Rs.7,500. Rent upto 30th June is Rs. 6,000 p.a. after which it is increased to Rs. 15000 p.a. Salary of Manager, who upon incorporation of the company was made director is Rs. 30,000 p.a. His remuneration thereafter is included in the above figure of fees to directors. The net sales are Rs. 42,00,000, the monthly average of which for the first four months of 2015 is one half of that of the remaining period. The company earned a uniform profit. Give profit and loss account showing pre-and post-incorporation profits.

Ans :

Working Notes

1. Gross profit is allocated on the basis of sales ratio.

   4,000 : 10,000 = 2 : 5

2. General expenses are allocated on the basis of time ratio

   1st January - 30th April = 4 Months

   1st May - 30th September = 5 Months

   4 : 5

3. Rent calculated in 2 different rates.

   From 1st Jan - 30th June – 6,000

   1st July - 30th sep. = 15,000

   prior to incorporation is 4 Months

$$\frac{6,000}{12} \times 4 = 2,000$$

Post Incorporation Rent for 2 months

$$\frac{6,000}{12} \times 2 \text{ Months} = 1000$$

1st July – 30th sep

$$= \frac{15,000}{12} \times 3 \text{ months} = 3,750$$

i.e., = 1,000 + 3,750 = 4,750

4. Manager's salary = $\frac{30,000}{12} \times 4$ Months = 10,000

5. Director's fee = $\frac{60,000}{12} \times 5$ Months = 25,000.

Particulars	Basis	Prior Incor-poration	Post Incor-poration	Particulars	Basis	Prior Incor-poration	Post Incor-poration
To General expenses	Time	31,111	38,889	By Gross profit	Sales	71,429	1,78,751
To Directors fee	Direct	–	25,000				
To Formation expenses	Direct	–	7,500				
To Rent		2,000	4,750				
To Manager's salary		10,000	–				
To Capital Reserve		28,318	–				
To Net profit		–	1,02,432				
		71,429	1,78,751			71,429	1,78,751

13. (a) Discuss the various methods of valuation of Goodwill? **(Unit-V, Q.No. 2)**

OR

(b) The following is the balance sheet of Dhoni Company Ltd. as on 31st December 2016.

Liabilities	`.	Assets	`.
Equity share capital of Rs. 10 each	16,00,000	Fixed Assets	20,00,000
General Reserve	4,40,000	Cash in hand	4,00,000
10% Debentures	4,00,000	Cash at Bank	1,00,000
Creditors	2,20,000	Debtors	2,00,000
Bills payable	2,00,000	Stock	3,00,000
Bank Overdraft	3,00,000	Good will	1,60,000
	31,60,000		31,60,000

On March 31, 2016 the fixed assets were independently valued at Rs. 17,50,000 and goodwill at Rs. 2,50,000. The net profits for the three years were : 2014 Rs. 2,50,000 ; 2015 Rs. 2,60,000 and 2016 Rs. 2,40,000 of which 25% was placed to reserve. This company normal rate of return on fair investment may be taken at 15%. Compute the value of equity shares by fair value method.

Ans :

Assets Available to Equity Share holders

Particulars	Amount	Amount
Assets		
Fixed Assets	17,50,006	
Cash at bank	1,00,000	
Cash in hand	4,00,000	
Debtors	2,00,000	
Stock	3,00,000	
Goodwill	2,50,000	30,00,000
(–) Liabilities		
10% Debentures	4,00,000	
Creditors	2,20,000	
Bills payable	2,00,000	
Bank O.D	3,00,000	11,20,000
		18,80,000

Valuation of shares under yield basis method

$$\text{Average profit} = \frac{2,50,000 + 2,60,000 + 2,40,000}{3} = \frac{7,50,000}{3} = 2,50,000$$

(–) 25% of transferred to General reserve = 62, 500

1,87,500

$$\text{Expected Rate} = \frac{\text{Available profits}}{\text{Equity Share Capital}} \times 100 = \frac{1,87,500}{16,00,000} \times 100 = 11.72\%$$

$$\text{Yield value of share} = \frac{\text{Expected Rate}}{\text{Rate of Return}} \times \text{Paid up value of share}$$

$$= \frac{11.72}{15} \times 10 = 7.81$$

$$\text{Fair value of share} = \frac{11.72 + 7.81}{2} = 9.765$$

FACULTIES OF COMMERCE

B.Com. II Year III Semester Examination

December - 2017

ADVANCED ACCOUNTING

Time : 3 Hours] **[Max. Marks : 80**

SECTION - A (5 × 4 = 20 M)

Answer any 5 Questions

ANSWERS

1. What are the essential features of partnership Firm? **(Unit-I, SQA - 2)**
2. Distinguish between sacrificing ratio and gaining ratio. **(Unit-I, SQA - 18)**
3. Anil, Banu and Chandu sharing profit and losses in the ration of 2 : 2 : 1 capitals contributed were Anil Rs. 60,000 ; Banu Rs. 20,000 and Chandu Rs. 8,000; cash in hand Rs. 20,000 and realization loss Rs. 68,000. Show the necessary ledger accounts assuming that chandu is insolvent and is unable to bring anything in respect of his deficiency.

Sol :

Dr. **Partner's Capital A/c** **Cr.**

Particulars	Anil	Banu	Chandu	Particulars	Anil	Banu	Chandu
To Realization Loss	27,200	27,200	13,600	By balance b/d	60,000	20,000	8,000
To Chandu capital	2,800	2,800	–	By Bank A/c	27,200	27,200	–
To Bank	57,200	17,200	–	By Anil capital A/c	–	–	2,800
				By Banu capital A/c	–	–	2,800
	87,200	47,200	13,600		87,200	47,200	13,600

4. What you mean by Bonus shares? **(Unit-III, SQA - 16)**
5. Jeevani was holding 100 shares of Sony company of Rs. 100 each. She paid Rs. 20 on application and Rs. 30 on allotment, but failed to pay first call and final call, her shares were forfeited and reissued at later date at the rate of Rs. 70 per share journalize the transactions in the books of Sony company.

Sol : **Journal Entries**

S. No.	Particulars	LF	Debit	Credit
1.	Share capital A/c Dr.		10,000	-
	To Share 1st call A/c		-	2,000
	To Share final call A/c		-	3,000
	To Share forfeiture A/c		-	5,000
	(Being 100 shares forfeited non -payment of 1st and final call)			

2.	Bank A/c Dr. Forfeited shares A/c Dr. To Share capital A/c (Being forfeited shares Reissued at discount)		7,000 3,000 -	- - 10,000
3.	Share forfeited A/c Dr. To capital reserve A/c (Being forfeited amount transferrer to capital Reserve A/c)		2,000 -	- 2,000

6. Accounting period calendar year 2017, data of taking over of the business 2017, data of incorporation 01-04-2017; total sales Rs. 90,00,000 the monthly average of sales for the period of first three months of the year was one-half of the remaining period. Calculate sales ratio and time ratio of pre-incorporation and post incorporation.

Sol :

Sales Ratio

Sales for first four months of the year was one half of remaining period.

$$90{,}00{,}000 \times \frac{9}{12} = 67{,}50{,}000$$

$$67{,}50{,}000 \times 1.5 = 1{,}01{,}25{,}000$$

$$\frac{1{,}01{,}25{,}000}{3} = 33{,}75{,}000$$

$$= 90{,}00{,}000 - 33{,}75{,}000$$

$$= 56{,}25{,}000$$

$$= \frac{33{,}75{,}000}{56{,}25{,}000} = 3 : 5$$

Time Ratio

Prior Incorporation = 1/1/2017 to 1/4/2017

= 3 Months

Post Incorporation = 9 Months

= 3 : 9

= 1 : 3

7. What do you mean by super profits. **(Unit-V, SQA - 5)**

8. 2000 15% preference shares of Rs. 100 each Rs. 2,00,000 20,000 equity shares of Rs. 10 each Rs. 8 per share paid up Rs. 1,60,0,000 profit before tax Rs. 5,00,000 rate of tax 50% transfer to general reserve every year 25% of profit normal rate of return 18%. Calculate the value of an equity share.

Sol :

$$\text{Yield value of share} - \frac{\text{Expected Rate}}{\text{Normal Rate}} \times \text{Paid up value of each share}$$

Calculation of Available Profit

Particular	Amount
Profit before tax	5,00,000
(–) Tax 50%	2,50,000
PAT	2,50,000
(–) 15% dividend on preference shares (2,00,000 × 15%)	30,000
	2,20,000
(–) Transfer to General reserve (2,20,000 × 25/100)	55,000
	1,65,000

Equity share capital

$= 20{,}000 \times 10 = 2{,}00{,}000$

$$\text{Expected Rate} = \frac{1{,}65{,}000}{2{,}00{,}000} \times 100$$

$= 82.5\%$

$$\text{Value of share} = \frac{82.5}{18} \times 8$$

$= 36.67\%$

SECTION - B (5 × 12 = 60 M)

Answer all the Questions

9. (a) Explain the legal provisions in the absence of partnership deed. **(Unit-I, Q.No. 2)**

OR

(b) Ram and Naveen sharing profits in proportion of 3 : 1 and their balance sheet on 31-12-2016 as follows.

Liabilities	`	Assets	`
Bills payable	70,000	Cash in hand	10,000
Creditors	70,000	Cash at bank	70,000
General reserve	32,000	Debtors	1,16,000
Capital accounts		Stock	1,60,000
Ram	2,00,000	Furniture	44,000
Naveen	1,68,000	Land & Building	1,40,000
	5,40,000		**5,40,000**

They admit Venu into partnership on 1-1-2017 on the following conditions.

a) Venu pays Rs. 1,20,000 as his capital for 1/5 share in future profits.

b) Venu pays Rs. 1,60,000 as goodwill

c) The stock and furniture be reduced by 15% each

d) 10% provision for doubtful debts be created on debtors

e) Value of land and building be increased by 25%

f) The capital accounts of the partners be readjusted on the basis of their profit sharing ratio and additional amount be debited or credited to their current accounts prepare revaluation account, capital account and new balance sheet.

Sol :

Revaluation A/c

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To stock $\left(1,60,000 \times \frac{115}{100}\right)$	24,000	By Land and Buildings	35,000
To furniture $\left(44,000 \times \frac{15}{100}\right)$	6,600	By Revaluation loss	7,200
To provision for doubtful debts $\left(1,16,000 \times \frac{10}{100}\right)$	11,600		
	42,200		42,200

Working Notes

Loss on Revaluation

$$\text{Ram} = 7,200 \times \frac{3}{4} = 5,400$$

$$\text{Naveen} = 7,200 \times \frac{1}{4} = 1,800$$

Partner's Capital A/c

Dr. **Cr.**

Particulars	Ram	Naveen	Venu	Particulars	Ram	Naveen	Venu
To Revaluation Loss	5,400	1,800	–	By balance b/d	2,00,000	1,68,000	–
To Balance b/d	3,38,600	2,14,200	1,20,000	By cash A/c	–	–	1,20,000
				By General Reserve	24,000	8,000	–
				By Goodwill	1,20,00	40,000	–
	3,44,000	2,16,000	1,20,000		3,44,000	2,16,000	1,20,000

Balance Sheet as on 31/12/2017

Dr. **Cr.**

Liabilities	**Amount**	**Assets**		**Amount**
Creditors	70,000	Cash in hand		10,000
Bills payable	70,000	Cash at bank (1,20,000 + 1,60,000 + 70,000)		3,50,000
Ram	3,38,600	Debtors	1,16,000	
Naveen	2,14,200	(–) Provision	11,600	1,04,400
Venu	1,20,000	Stock	1,60,000	
		(–) Dep.	24,000	1,36,000
		Furniture	44,000	
		(–) Dep.	6,600	37,400
		Land and Buildings	1,40,000	
		(+) Appreciation	3,50,000	1,75,00
	8,12,800			8,12,800

10. (a) What do you mean by insolvency of a partner and what is rule under Garner Vs Murry judgements? **(Unit-II, Q.No. 6)**

OR

(b) Anil, Balu, Chandra and Dasu are in partnership and they decided to dissolve the partnership on 31st December 2015. When their balance sheet showed as under.

Liabilities	`	**Assets**	`
Creditors	76,000	Cash in hand	4,000
Bills payable	76,000	Cash at bank	20,000
Capital accounts		Land & Building	1,80,000
Anil	80,000	Chandra capital account	48,000
Balu	40,000	Dasu capital account	20,000
	2,72,000		**2,72,000**

The assets realized : Land and building Rs. 2,20,000, goodwill Rs. 40,000. The expenses of realization amounted to Rs. 8,000 "Chandra" has become insolvent and nothing was realized from his estate. Show realization and capital accounts of partners.

Ans :

Realisation A/c

Dr. Cr.

Particulars	Amount	Particulars	Amount
To Land and Buildings	1,80,000	By Sundry creditors	76,000
To Bank (Expenses)	8,000	By Bills Payable	76,000
To Bank A/c (Creditors)	76,000	By Goodwill	40,000
To Bills payable	76,000	By Land and Buildings	2,20,000
To Profit	72,000		
	4,12,000		4,12,000

Distribution of Profit

$$\text{Anil} = 72{,}000 \times \frac{1}{4} = 18{,}000$$

$$\text{Balu} = 72{,}000 \times \frac{1}{4} = 18{,}000$$

$$\text{Chandra} = 72{,}000 \times \frac{1}{4} = 18{,}000$$

$$\text{Dasu} = 72{,}000 \times \frac{1}{4} = 18{,}000$$

Capital A/c

Dr. Cr.

Particulars	Anil	Balu	Chandra	Dasu	Particular	Anil	Balu	Chandra	Dasu
To Balance b/d	–	–	48,000	20,000	By Balance b/d	80,000	40,000	–	–
To chandra deficiency	20,000	10,000	–	–	By Realization (profit)	18,000	18,000	18,000	18,000
To Bank A/c	78,000	48,000	–	–	By Anil Capital A/c	–	–	20,000	–
					By Balu	–	–	10,000	–
					By Bank	–	–	–	2,000
	98,000	58,000	48,000	20,000		98,000	58,000	48,000	20,000

11. (a) What is the difference between equity shares and preference shares also explain underwriting. **(Unit-III, Q.No. 6, 17)**

OR

b) Mani Ltd., issued 1,00,000 equity shares of Rs. 100 each payable as follows, Rs. 25 on application, Rs. 20 on allotment, Rs. 25 on First call and the balance on Final call. 7500 shares were applied and allotted. All money were received with the exception of first and final calls on 2500 shares. These shares were forfeited and reissued at a later date at the rate of Rs. 80 per share. Give Journal entries to prepare cash account, capital account and balance sheet of the company.

Ans :

Journal Entries

Date	Particulars		LF	Debit	Credit
1.	Bank A/c	Dr.		1,87,500	-
	To Share application A/c			-	1,87,500
	(Being share application money received 7,500 @ 25)				
2.	Share Application A/c	Dr.		1,87,500	-
	To Share capital A/c			-	1,87,500
	(Being share application money received)				
3.	Share allotment A/c	Dr.		1,50,000	-
	To Share capital A/c			-	1,50,000
	(Being share allotment due on 7,500 @ 20)				
4.	Bank A/c	Dr.		1,50,000	-
	To Share allotment A/c			-	1,50,000
	(Being share allotment money received)				
5.	Share first call A/c	Dr.		1,87,500	-
	Share final call A/c	Dr.		1,50,000	-
	To Share capital A/c			-	3,37,500
	(Being share first call, and final call due)				
6.	Bank A/c	Dr.		2,75,000	-
	To Share first call A/c			-	1,25,000
	To Share final Call A/c			-	1,50,000
	(Being share first call, and final call money received)				
7.	Share capital A/c	Dr.		2,50,000	-
	To Share first call A/c (2,500 × 25)			-	62,500
	To Share final Call A/c (2,500 × 30)			-	75,000
	To Share forfeited A/c (2,500 × 45)			-	1,12,500
	(Being 2,500 shares were forfeited)				

8.	Bank A/c Dr. Forfeited shares A/c Dr. To Share capital A/c (Being forfeited share are reissued 100 shares @ 80)		2,00,000 50,000 -	- 2,50,000
9.	Forfeited share A/c Dr. To Capital reserve A/c (Being forfeited amount transfer to capital reserve a/c)		62,500 -	- 62,500

Cash A/c

Dr. **Cr.**

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
	To share application		1,87,500		By balance c/d		8,12,500
	To share allotment A/c		1,50,000				
	To first call A/c		1,25,000				
	To final call A/c		1,50,000				
	To share capital		2,00,000				
			8,12,500				8,12,500

Capital A/c

Dr. **Cr.**

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
	To share 1st call		62,500		By share application		1,87,500
	To share final call		75,000		By share allotment		1,50,000
	To shares forfeited		1,12,500		By share first call		1,87,000
	To balance c/d		7,50,000		By share final call		2,25,000
					By cash a/c		2,00,000
					By forfeited		50,000
			10,00,000				10,00,000

Balance Sheet

Dr. **Cr.**

Liabilities	Amount	Assets	Amount
Subscribed and paid up capital	7,50,000	Cash at bank	8,12,500
Reserves	62,500		
	8,12,500		8,12,500

12. (a) Explain general instructions to accounts for preparation of balance sheet under new schedule. **(Unit-IV, Q.No. 3)**

(OR)

(b) Ramachandra Ltd. was incorporated on 1st may 2015 to take over the business of Mallesh as a going concern from 1st January 2015.

The profit and loss account for the year ending 31st December 2015 is as under.

Dr **Cr**

Particulars	`.	Particulars	`.
To Rent and Taxses	60,000	By Gross profit	6,20,000
To Insurance	24,000		
To Salaries	1,20,000		
To Electricity charges	9,600		
To Auditors fees	7,200		
To Office expenses	30,000		
To Directors fees	1,20,000		
To Advertisement	40,000		
To Discount	26,000		
To Bank charges	6,000		
To Bad debts	8,000		
To Interest on Loan	12,000		
To preliminary expenses	25,200		
To Net profit	2,40,000		
	6,20,000		6,20,000

The Total turnover for the year ending 31st December 2015 was Rs. 20,00,000 divided into Rs. 6,00,000 for the period upto 1st may 2015 and Rs. 1,40,000 for the remaining period.

Prepare profit and loss account to find out profit prior and post incorporations periods.

Ans :

Profit prior Incorporation

Particulars	Basis of Allocation	Prior to in corporation	Post Incorporation	Particulars	Basis of Allocation	Prior in Corporation	Post in Corporation
To Rent and Taxes	1 : 2	20,000	40,000	By Gross profit	3 : 7	1,86,000	4,34,000
To insurance	1 : 2	8,000	16,000				
To Salaries	1 : 2	40,000	80,000				
To Electricity charges	1 : 2	3,200	6,400				
To Audit fees	Direct	–	7,200				
To Office Exp.	1 : 2	10,000	20,000				
To Directors Exp.	Direct	-	1,20,000				
To Advertisement	3 : 7	12,000	28,000				
To Discount	3 : 7	7,800	18,200				
To Bank charges	1 : 2	2,000	4,000				
To Bad debts	3 : 7	2,400	5,600				
To Interest on loan	1 : 2	4,000	8,000				
To preliminary exp.	Direct	–	25,200				
To capital reserve		76,600	–				
To Net profit		–	55,400				
		1,86,000	4,34,000			1,86,000	4,34,000

Working Notes

i) Calculation of Time Ratio

Prior incorporation 1st Jan. to 30th April

Post incorporation = 1st May to 31st December

= 4 : 8

= 1 : 2

ii) Calculation of Sales Ratio

Sales = 20,00,000

Sales 1st January to 30th April = 6,00,000

Sales 1st May to 31st December = 14,00,000

6,00,000 : 14,00,000

3 7

= 3 : 7.

13. (a) What are the objects for valuation of Good will?

Ans :

The objects used for the evaluation of goodwill include,

1. Profitability
2. Normal rate of return and
3. Capital employed.

1. Profitability: According to Section 6, more emphasis has been laid down on the future profits of the firm, as the buyer's purchasing ability depends upon the capability of the firm to increase the profitability in future. The process of evaluation for the maintenance of profits in future by the firm is known as "Future Maintenance Profit". The estimation of future profits depends upon the past profits whose maintenance is influenced by the following factors,

(a) All types of operating expenses such as, depreciation and fixed assets, interest and debentures need to be considered.

(b) Appreciation related to only current assets need to be included, whereas the other appreciations including fixed assets need not be included.

(c) Provision must be provided for taxation and tax planning.

2. Normal Rate of Return: Every investor mainly focuses on the attainment of a fair return on their investments which is often referred to as the "rate of earnings". It changes from industry to industry as it is usually based on several factors like Bank rate, Nature of industry, Risk etc.

It involves the following components,

(a) Return at Zero Risk Level: The investments which are not associated with risk are referred to as investments with zero risk level, whereas the returns obtained from such investment become returns at zero risk level. Interest earned without any risk is known as "pure interest".

(b) Premium for Business Risk: It is a risky investment which yields high rate of return. There are variations in profit related to the degree of risk associated with a specific industry. Degree of risk is directly proportional to the returns of the investment i.e., the higher the risk, the more will be its return.

(c) Premium for Financial Risk: It involves the risk which is related to the capital structure. A margin is allowed to coverup the financial risks associated with the different transactions of business organizations. Business entity which possesses higher debt ratio in the capital structure is regarded as more risky.

3. Capital Employed: The capital employed acts as the most essential element for the valuation of goodwill. On the basis of the volume of profits earned by efficiently utilising the capital, it helps in the valuation of goodwill. Capital employed is an aggregate of fixed assets and net working capital. It is referred to as the combination of share capital, reserves and long-term loans.

However, it is not appropriate for the evaluation of goodwill of individual companies. Because, in case of these companies, the benefits accrued to the shareholders is not evaluated and needs to be carefully assessed prior to the evaluation of goodwill. The ascertainment of capital employed includes the following items,

(i) All fixed assets after computing or deducting the depreciation.

(ii) Trade investments.

(iii) All the current assets.

While computing the capital employed, the following items need not be included,

(i) Long-term liabilities.

(ii) All current liabilities.

(iii) Intangible assets (Examples : Goodwill, Patents and so on).

(iv) Non-trading assets.

(v) Fictitious assets.

OR

(b) The following is the balance sheet of Dhoni Company Ltd. as on 31st December 2016.

Liabilities	`	Assets	`
Share capital of 50,000		Land and Buildings	3,50,000
shares of Rs. 10 each	5,00,000	Plant and Machinery	3,00,000
General reserve	2,50,000	Furniture	50,0000
Tax provision	1,00,000	Trademarks	1,00,000
Sundry creditors	3,00,000	Stock	1,00,000
Profit and loss account	1,50,000	Debtors	2,40,000
		Cash in hand	50,000
		Cash at bank	75,000
		Preliminary expenses	35,000
	13,00,000		**13,00,000**

The plant and machinery is worth Rs. 2,40,000 furniture worth Rs. 60,000 and land and buildings are worth Rs. 6,50,000 as valued by an independent valuer Rs. 25,000 of the debtors is to be taken as bad. The profits of the company were 2014 Rs. 2,50,000 2015 Rs. 3,50,000 and 2016 and Rs. 3,00,000.

It is the practice of the company to transfer 25% of the profits to reserve, Goodwill of the company may be taken at Rs. 5,00,000 normal rate of return 15%.

Find out the value of its equity shares by fair value method.

Ans :

Assets Available to Equity Share Holders

Particulars		Amount	Amount
Assets			
Land and buildings		6,50,000	
Plant and machinery		2,40,000	
Furniture		60,000	
Trade Marks		1,00,000	
Stock		1,00,000	
Debtors	2,40,000		
(–) Bad debts	25,000	2,15,000	
Cash in hand		50,000	
Cash at bank		75,000	
Goodwill		5,00,000	19,90,000
Liabilities			
(–) Creditors			3,00,000
			16,90,000

$$\text{Value of equity shares} = \frac{16,90,000}{50,000}$$

$$= 33.80$$

Valuation of shares under yield basis.

$$\text{Average profit} = \frac{2,50,000 + 3,50,000 + 3,00,000}{3} = 3,00,000$$

(–) Less 25% profits transferred = 75,000

2,25,000

$$\text{Expected Rate} = \frac{2,25,000}{5,00,000} \times 100$$

$$= 45\%$$

$$\text{Yield share} = \frac{45}{15} \times 10$$

$$= 30\%.$$

FACULTIES OF COMMERCE

B.Com. II Year III-Semester(CBCS) Examination

(Common Paper for General / Computers / Computer Applications / Advertising / Foreign Trade / Tax procedure / and Honours Cources)

July - 2021

ADVANCED ACCOUNTING

Time : 2 Hours] **[Max. Marks : 80**

PART - A - (4 × 5 = 20 Marks)

Note : Answer the following any **Four** question.

ANSWERS

1. X,Y,Z are partners sharing profit and losses in the ratio of 5:3:2 They admit 'A' in to partnership and give him 1/5 share of profits. Find out New Profit shaing? Ratio.
2. Fixed Capital Method
3. Garner Vs Murray case
4. Green Limited issued 4,00,000 shares of Rs 10 each at a premium of Rs. 2.00 All the amount should he paid an application. 3,00,000 applications were received and fully allotted. Write the journal entry.
5. Underwriting
6. Distinguish between share forfeiture and share surrender.
7. The Profits of the last - 5 Yrs were 1- Rs 30,000; 2- Rs 36,000; 3-Rs (14000); 4-20,000; 5-Rs 8,000 Calculate the goodwill at 2 years Average profits of the last 5 years.
8. From the following information calculate fair value of share.

   Asset - Backing Method Fully paid share - 180; partly paid share value - 165 fully paid value share - 152; Partly paid share value-102

PART - B - (4 × 15 = 60 Marks)

Note : Answer the following any **Four** question.

9. The following was the Balance sheet of Raju and Ravi who were sharing profits in the ratio of 3:2. On 31st Dec 2018.

Balance Sheet as on 31st December 2018

Liabilities	Amount (Rs)	Assets	Amount (Rs)
General Reserve	30,000	Cash at bank	15,000
Creditors	70,000	Debtors	10,000
Raju's Capital	30,000	Stock	20,000
Ravi's Capital	20,000	Plant and Machinery	55,000
		Buildings	50,000
	1,50,000		1,50,000

They agreed to admit Vijay in to partnership on the following terms.

1) Vijay was to be given 1 /3rd share in profits and was to bring Rs. 25,000 as Capital and Rs. 15,000 as his share of Goodwill.

2) The value of Stock and pant were to be reduced by 10%

3) Create 5% provision for doubtful debts on debtons.

4) The Building Account was appreciated by 20%

5) That the Goodwill amount was to be withdrawn by the old partners. You are required to prepare to Revaluation account capital Accounts and Balance sheet of the firm.

10. Explain the valuation of Goodwill at the time of Retirement of a partner.

11. X and Y were in partnership and agreed to dissolve. The assets realized Rs.80,000. The Liabilities were as follows: Sundry Creditors Rs. 45,000 Loan from X Rs. 20,000; 'Xs capital Rs. 10,000; Y's Capital Rs. 15,000. They shard profits in the ration of 2:1. Show the had per Accounts and show how the cash realized should be distributed

12. The following was Balance sheet of P, Q, R, S as on 31st December 2017

Balance sheet 31st December 2017

Liabilities		Amount (Rs)	Assets	Amount (Rs)
Creditors		38,000	Cash at Bank	6,000
Capital A/c's			Sundry assets	45,000
P	20,000	30,000	R's Capital	12,000
Q	10,000			
			S's Capital	5,000
		68,000		68,000

The Assets realized: Sundry Assets Rs.55,000; Goodwill Rs. 10,000; Realization Expenses Rs. 2,000; 'R' has become insolvent and nothing was realized from his private estate show capital A/c's of partners.

13. Explain the procedure for issue of Debentures along with conditions of redemption

14. A limited issued 5000 Equity shaves of Rs. 10 each at a premium of Rs 2.00 per share payable as follows.

    On Application Rs. 2.00

    On Allotment Rs. 5.00 (including premium)

    On First call Rs. 3.00 and balance on final call. The shaves were all subscribed and amount received on calls Except The first call on 1,000 shaves and final call on 1500 shaves give journal entries and prepare its opening balance sheet.

15. From the following information prepare the Balance sheet of shiva Co. Ltd as on 31st March 2019.

Particulars	**Amount (Rs)**	**Particulars**	**Amount (Rs)**
Share capital	20,00,000	Share Premium	2,37,500
Debentures	5,00,000	Goodwill	25,000
Trade Payables	6,72,500	Gen. Reserve	10,25,000
Cash and Bank Balance	1,37,500	Investments	1,12,600
Advances	1,86,000	Loss for the year	1,79,000
Advance payment of Income Tax	27,500	Trade receivables	6,12,500
Provision for Taxation	85,000	Provision for Doubtful debts	10,100
Closing stock	5,75,000	Fixed Assets	26,75,000

16. Explain how sales Ratio and weighted time ratios are calculated Give examples.

17. Explain the methods of Valuation of Goodwill

18 From the following particulars calculate the value of Equity share.

    1,000 9% Preference shares of Rs. 100 each Rs. 1,00,000 20,000 Equity shares of Rs.10 each Rs. 8 per share called up and paid up Rs. 1,60,000.

    Expected profit per year before tax Rs. 2, 00,000 Rate of Tax 40%

    Transfer to General reserve every year 20% of profit Normal rate of Earnings 15%

FACULTY OF COMMERCE

B.Com. III - Semester (CBCS) Examination

Model Paper - I

(Common Paper for General / Computers / Computer Applications / Advertising / Foreign Trade and Tax Procedure Courses)

ADVANCED ACCOUNTING

Time : 3 Hours]	[Max. Marks : 80

PART - A (5 × 4 = 20 Marks)

[Short Answer Type]

Note : *Answer any* **FIVE** *of the following questions.*

ANSWER

1. What is Partnership Deed ? **(Unit-I, SQA - 3)**

2. How sacrificing Ratio differ with Gaining Ratio ? **(Unit-I, SQA - 17)**

3. How Revaluation account differentiate with Realisation Account ? **(Unit-II, SQA - 5)**

4. What is Underwriting ? **(Unit-III, SQA - 15)**

5. Ms.Kaveri Company Limited issued 6,000 shares of ` 100 each at a discount of ` 5 per share. The amount was payable as follows: **(Unit-III, Prob. 5)**
` 20 on application, ` 40 on allotment, ` 35 on First and Final Call.
All the shares were subscribed and the amount were duly received.
Give the Journal Entries in the books of the company.

6. Sales Ratio **(Unit-IV, SQA - 6)**

7. A, B and C are partners sharing profits and losses in the ratio of 2/5, 2/5 and 1/5 respectively. It was provided in the partnership agreement that in the event of the death or retirement of a partner, goodwill should be calculated on the basis of three years purchase of the average net profits for the preceeding five years. B retires on 31st December, 2005. Calculate the amount of goodwill due to B. Net profits for the previous five years were as follows : **(Unit-V, Q.No. Prob. 1)**

   2001 Rs. 32,000; 2002 Rs. 38,000 2003 Rs. 40,000

   2004 Rs. 29,000; 2005 Rs. 41,000.

8. Super Profit **(Unit-V, SQA - 5)**

PART - B (5 × 12 = 60 Marks)
[Short Answer Type]

Note : *Answer* **ALL** *the questions.*

9. (a) Explain about retirement of Partner ship firm. **(Unit-I, Q.No. 12)**

OR

(b) C, P and S were partners sharing profits 2/5th, 3/10th and 3/10th respectively. Their Balance Sheet on 31st December 2005 was as follows : **(Unit-I, Prob. 11)**

Liabilities	Rs.	Assets		Rs.
Capital :		Buildings		18,000
C	16,000	Plant		14,000
P	12,000	Motor Car		4,000
S	10,000	Stock		10,000
Reserve	5,000	Debtors	7,000	
Bills Payable	2,000	Less Provision	1,000	6,000
Creditors	8,000	Cash at Bank		1,000
	53,000			53,000

P retires on that date of the following terms :

i) The goodwill of the firm is to be valued at ` 7,000
ii) Stock and Buildings are to be appreciated by 10%
iii) Plant and Motor Car are to be depreciated by 10 percent
iv) Liability for the payment of gratuity to worker ` 2,000 is not yet recorded in books, but the same is to be provided for
v) Provision for bad debts is no more necessary.
vi) It is decided not a maintain goodwill account in the books.
vii) The amount payable to P is to be paid in 3 equal annual installments beginning from 1st January 2006 with interest at 10 percent p.a.

You are required to prepare (1) Revaluation Account (2) Partner's Capital Accounts (3) New Balance Sheet of C & S.

10. (a) Explain about Insolvency of a partner and Accounting Treatment ? **(Unit-II, Q.No. 6)**

OR

(b) A, B and C are in partnership sharing profits and losses equally. The firm's balance sheet on 31 March, 2013 was as follow **(Unit-II, Prob. 1)**

Liabilities		Rs.	Assets		Rs
Sundry Creditors		64,000	Cash		1,600
Capital A/cs	Rs.		Sundry Debtors		53,000
A	24,000		Stock		22,200
B	8,000		Plant and Machinery		26,000
C	4,000	36,000	Current Accounts		
A's Current Account		10,800	B	2,000	
			C	6,000	8,000
		1,10,800			1,10,800

It was decided to dissolve the firm on that date. The plant and machinery, stock and debtors were sold by the firm for Rs. 70,000. Assuming that C is insolvent and could not meet his liability to the firm, show necessary ledger accounts in the books of the firm applying Garner V Murray principle.

11. (a) What is share ? Explain about different types of share capital. **(Unit-III, Q.No. 3)**

OR

(b) Liabilities and Assets of Sowmya Ltd on 31st March, 2013 were as follows. **(Unit-III, Prob. 18)**

Liabilities	Amount Rs.	Assets	Amount Rs.
4000 Equity shares of		Sundry Assets	9,20,000
Rs. 100 each, Rs. 80			
paid up	3,20,000		
Securities premium account	70,000		
Capital redemption reserve	80,000		
General reserve	1,00,000		
Profit and loss account	1,50,000		
Sundry creditors	2,00,000		
	9,20,000		9,20,000

The directors recommended the following with a view to capitalizing whole of capital redemption reserve, securities premium account, general and Rs. 30,000 out of profit and loss account.

1. The existing shares are made fully paid without the share holders having to pay anything.
2. Each shareholder to be given fully paid bonus share for every two shares held by them. Assuming that the scheme is accepted and all the formalities are gone through. Give journal entries and also show the balance sheet after bonus issue.

12. (a) Explain the for preparation of Profit and Loss Account. **(Unit-IV, Q.No. 5)**

OR

(b) The following trial balance was extracted from the books of Heera Pvt. Ltd. formed by Mr. Chand of Faizabad on 1st April, 2004 but was incorporated on 1st July, 2004. No entries relating to the transfer of the business were entered in the books which was carried on until 31st March, 2005 : **(Unit-IV, Prob. 12)**

TRIAL BALANCE
as on 31st March, 2005

Particulars	Dr. (Rs)	Cr. (Rs)
Stock (1.4.2004)	42,940	-
Sales	-	2,79,300
Purchases	1,96,780	-
Carriage outwards	1,650	-
Traveller's commission	6,150	-
Office salaries	16,640	-
Rent and taxes	1,640	-
Office expenses	2,400	-
Capital account of Mr. Chand (1.4.2004)	-	2,00,000
Director's salary	15,000	-
Fixed assets	1,25,000	-
Current liabilities	-	31,660
Current assets (other than stock)	1,01,200	-
Preliminary expenses	1,560	-
	5,10,960	5,10,960

Further Information :

i) Stock on 31st March, 2005 amount to Rs 35,420.

ii) Purchase consideration Rs 2,50,000 to be paid by the issue of 25,000 equity shares of Rs 10 each.

iii) Gross profit percentage is fixed, turnover is double in April, November and December, iv) Preliminary expenses are to be written off.

v) Carriage outward and traveller's commission vary in direct proportion to sales. Prepare trading and profit and loss account for the year ended 31st March, 2005 appropriating between the pre and post incorporation periods and a balance sheet as on 31st March, 2005.

13. (a) Explain about methods of goodwill valuation. **(Unit-V, Q.No. 2)**

OR

(b) The following is the summarised Balance of Shivakumar Ltd. as at December 31, 2004. **(Unit-V, Prob. 9)**

Liabilities	Rs.	Assets	Rs.
10,000 9% preference shares of Rs. 100 each, fully paid	10,00,000	Fixed assets	40,00,000
		Investments	10,00,000
		Current Assets:	
20,000 Equity shares of Rs. 100 each, fully paid	20,00,000	Stock in trade	6,00,000
		Stock Debtors	
Reserve and surplus :			
General reserve	15,00,000		
Profit & Loss A/c	10,00,000		
Secured loans :			
8% Debentures	10,00,000		
Current liabilities :			
S. Creditors	4,00,000		
Liabiliteis for expenses	1,00,000		
	70,00,000		70,00,000

For the purpose of valuation of shares, Fixed Assets are to be depreciated by 10%, Investments are to be revaluated at Rs. 11,00,000. Stock at Rs. 5,80,000. Debtors will realise Rs. 11,75,000.

Interest on Debentures is outstanding for six months and preference divided for 2004 is to be paid. Calculate the value of each Equity share.

FACULTY OF COMMERCE

B.Com. III - Semester (CBCS) Examination

Model Paper - II

(Common Paper for General / Computers / Computer Applications / Advertising / Foreign Trade and Tax Procedure Courses)

ADVANCED ACCOUNTING

Time : 3 Hours] [Max. Marks : 80

PART - A (5 × 4 = 20 Marks)

[Short Answer Type]

Note : *Answer any* **FIVE** *of the following questions.*

		Answer
1.	What are the Essential Features of a Partnership ?	**(Unit-I, SQA - 2)**
2.	Sacrificing Ratio	**(Unit-I, SQA - 11)**
3.	Methods of Purchase Consideration	**(Unit-II, SQA - 8)**
4.	Decision in Garner Vs. Murray	**(Unit-II, SQA - 6)**
5.	Raghavendra Company Limited issued 10,000 Equity shares of ` 10 each and the money was payable as under : on application ` 2 on allotment ` 3. on First and Final calls `5 per share. 9,000 shares were subscribed by the public. All the shares were allotted and the money duly received. Pass Journal Entries.	**(Unit-III, Prob. 1)**
6.	Profits Prior to Incorporation	**(Unit-IV, SQA - 3)**
7.	Features of Goodwill	**(Unit-V, SQA - 2)**
8.	A Limited company agrees to purchase the business carried on by B. Limited goodwill for this purpose is agreed to be valued at 3 years purchase of average profits of the previous 5 years. Profits for 5 years are : I^{st} – 15,000, II^{nd} – 20,000 III^{rd} – 25,000 IV^{th} – 30,000, V^{th} – 35,000. Calculate the value of goodwill?	**(Unit-V, Prob. 3)**

PART - B (5 × 12 = 60 Marks)

[Short Answer Type]

Note : *Answer* **ALL** *the questions.*

9. (a) What is Partnership Deed ? Explain. **(Unit-I, Q.No. 2)**

OR

(b) Following is the Balance Sheet of A, B and C sharing profits and losses in the proportion of 6 : 5 : 3 respectively : **(Unit-I, Prob. 1)**

Liabilities	Rs.	Assets	Rs.
Creditors	18,900	Cash	1,890
Bills Payable	6,300	Debtors	26,460
General Reserve	10,500	Stock	29,400
A's Capital	35,400	Furniture	7,350
B's Capital	29,850	Land and Buildings	45,150
C's Capital	14,550	Goodwill	5,250
	1,15,500		1,15,500

They agreed to take D into partnership and give him 1/8 share on the following terms: (i) That furniture be depreciated by Rs. 920 ; (ii) That stock be depreciated by 10% ; *(iii)* That a provision of Rs. 1,320 be made for outstanding repair bills ; (iv) That the value of land and building having appreciated be brought upto Rs. 59,850 ; (v) That the value of goodwill Rs. 16,800 and D's share of goodwill is adjusted through capital accounts ; (vi) That D should bring Rs. 16,100 as his capital; (vii) That after making the above adjustments the total capital of the firm should be Rs. 1,12,000 and be adjusted on the basis of the new profit sharing ratio in the business. Actual cash to be paid off or brought in by the partners as the case may be. Pass the necessary journal entries and prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet of the new firm.

10. (a) Explain about the Account Treatment of dissolution of a firm. **(Unit-II, Q.No. 3)**

OR

(b) Anand and Bishan carrying on business in partnership decided to dissolve the firm and sell off the business to 'C' Company Ltd., on 31.3.2001 when the firms position is as under: **(Unit-II, Prob. 8)**

Liabilities	Rs.	Assets	Rs.
Capital Accounts		Land	40,000
A	33,000	Furniture	3,320
B	17,000	Stock	15,380
Creditors	22,250	Debtors	8,430
		Cash	5,120
	72,250		72,250

The arrangement with the company is as follows:

a) Land purchased at `. 50,000

b) Furniture and stock are taken at 10% below the book values.

c) Goodwill of the firm is valued at `. 7,500

d) Debtors are taken at `. 8,000 but the creditors at the Balance Sheet figure.

e) The P.C. is to be discharged by the Purchaged Company in fully paid equity shares of `. 10 each. Show the realisation account, capital account, 'C' Co., account and equity shares account in the books of the firm.

11. (a) Difference between Debenture and shares? **(Unit-III, Q.No. 13)**

OR

(b) Wipro Software Company Limited issued 20,000 debentures of ` 50 each. The amount was payable as follows : **(Unit-III, Prob. 9)**

` 10 on application

` 25 on allotment

` 12 on First Call and

` 3 on Final Call.

All the debentures was subscribed and the money duly received. Give the Journal Entries in the books of the company.

12. (a) How while preparing the final accounts of the company profit prior to Incorporation treated ? **(Unit-IV, Q.No. 7)**

OR

(b) Prepare Balance Sheet of Darshan Ltd., in the prescribed proforma as on 31st March 2015 from the following Trial Balance **(Unit-IV, Prob. 4)**

Trial Balance as on 31st March 2015

Liabilities	Rs.	Assets	Rs.
Leasehold property	16,00,000		
Bank balance	1,05,000	Share Capital	20,65,000
Plant & Machinery	9,00,000	Staff Provident fund	8,00,000
Goodwill	3,00,000	Capita redemption reserve	2,20,000
Investment in a subsidiary Co.	11,50,000	General reserve	1,90,000
P & L A/c	70,000	Deposits from public	9,00,000
Stock of finished goods	1,20,000	Accounts payable	2,10,000
Accounts receivable	2,40,000	Short Term loan from SBI	1,78,000
Preliminary Expenses	39,000	Unclaimed dividend	6,000
Underwriting commission	45,000		
	46,69,000		**45,69,000**

13. (a) On the basis of the following Balance Sheet and subjoined information ascertain the capital employed in the business. **(Unit-V, Prob. 5)**

Balance sheet as on 31st December, 1988

Liabilities	`	Assets	`
5,000 8% Preference Shares		Goodwill	3,72,000
of ` 100 each	5,00,000	Premises at Cost	2,00,000
1,00,000 Equity Shares		Machinery at Cost	15,00,000
of ` 10 each	10,00,000	Vehicle at cost	20,000
Reserves	3,50,000	Stock	6,15,000
Profit of the Current Year	5,66,000	S. Debtors	2,00,000
6% Debentures	10,00,000	Investments (for the	
Secured Loans	1,00,000	replacement of machines)	8,00,000
S. Creditors	1,50,000	Bank Balance	96,00Q
Provision for taxation	1,50,000	Preliminary expenses	13,000
	38,16,000		38,16,000

The present value of Premises is ` 6,00,000; Machinery ` 12,00,000: Investments ` 7,50,000. Stock is to be valued at book value, S. Debtors are bad to the extent of 10% and Vehicle is valued at ` 14,000.

OR

(b) Explain about net Assets Backing Method. **(Unit-V, Q.No. 7)**