"CA-IPCC REVISIONARY - A Series of one day revision classes" MAY 2016 Exam

ACCOUNTING – PAPER 1

14.04.2016

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AMALGAMATION

Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:
(*i*) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.
(*ii*) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.
(*iii*) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.
(*iv*) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.
(*v*) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

If any one or more of the above conditions are not satisfied in an amalgamation, such amalgamation is called *amalgamation in the nature of purchase*

Purchase Consideration

AS 14 defines the term purchase consideration as the "*aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company*". In simple words, it is the price payable by the transferee company to the transferor company for taking over the business of the transferor company.
It is notable that purchase consideration *does not include* the sum which the transferee company will directly pay to the creditors of the transferor company.

COMPUTATION OF PURCHASE CONSIDERATION

i) Lump Sum Method: The amount to be paid by the transferee company as consideration may be stated in the problem as a lump sum. In such a case, no calculation is required.

(ii) Net Assets Method: The amount of consideration or the amount of net assets is ascertained under this method in the following manner:
Assets taken over (at their revalued figures, if any, otherwise at their book figures).
Less: Liabilities taken over (at their agreed values, if any, otherwise at their book figures).
While determining the amount of consideration under this method care should be taken of the following:

1. The term "Assets" will always include cash in hand and cash at bank, unless otherwise stated but shall not include any fictitious asset like preliminary expenses, underwriting commission, discount on issue of shares or debentures, profit and loss account (debit balance), etc.
2. If any particular asset is not taken over by the transferee company, the same should not be included while computing purchase consideration.

3. If there is any goodwill or pre-paid expenses, the same should be included in the assets taken over unless otherwise stated.
4. The term "Liabilities" will mean all liabilities to third parties (the company being the first party and shareholders being the second party).
5. The term "Trade Liabilities" will mean trade creditors and bills payable and shall not include other liabilities to third parties, such as, bank overdraft, debentures, outstanding expenses, taxation liability, etc.
6. The term "Liabilities" shall not include any past accumulated profits or reserves, such as general reserve, reserve fund, sinking fund, dividend equalisation fund, capital reserve, securities premium account, capital redemption reserve account, profit and loss account etc. These are payable to the shareholders and not to the third parties.
7. If any fund or portion of any fund denotes liability to third parties, the same must be included in liabilities, such as, staff provident fund, workmen's' savings bank account, workmen's profit sharing fund, workmen's' compensation fund (up to the amount of claim, if any), etc.
8. If any liability is not taken over by the transferee company, the same should not be included.
9. The term "business" will always mean both the assets and the liabilities of the company.

(iii) Net Payment Method: The amount of consideration under this method is ascertained by adding up the total value of shares and other securities issued and the payments made in the form of cash and other assets by the transferee company to the transferor company in discharge of consideration. So the consideration constitutes the total payment in whatever form either in shares, debentures, or in cash to the liquidator of the transferor company for payment to the shareholders of the transferor company.
Significantly, the total payments made by the transferee company to discharge the claims of preference shareholders and/or equity shareholders of the transferor company may be construed as consideration.

In fact they can be satisfied by issuing preference shares/equity shares or debentures, at par, premium or discount and partly by cash. Now the question arises, suppose the transferee company has agreed to discharge the debentures of the transferor company by issuing its own debentures whether it is possible to include the debentures issued to the debenture holders as part of consideration.

In this case, according to AS-14, any payments made by the transferee company to other than the shareholders of the transferor company cannot be treated as part of consideration. Moreover, consideration implies the value agreed upon for the net assets taken over by the transferee company, hence payments made to discharge the liabilities of the transferor company may be excluded from consideration. Therefore payments made to the debentureholders should not be considered as part of consideration and they should treated separately and discharged as per the terms of agreement. The same principles may apply to the cost of amalgamation paid by the transferee company since such payment will not form part of purchase consideration and hence ignored. A separate entry will be made by the transferee company in this regard.

It may be noted that in this study material, by consideration, under net payment method we shall mean the total payments made by the transferee company to the shareholders of the transferor company for the value of net assets taken over which would have been available to the shareholders of the transferor company had there been no merger. Therefore, any payments made to debentureholders or to discharge the liabilities of the transferor company by the transferee company are excluded from the calculation of consideration. The practical problems in this study material are also worked out accordingly.

While determining the amount of consideration under this method, care should be taken of the following:

1. The value of assets and liabilities taken over by the transferee company are not to be considered in calculating the consideration.
2. The payments made by the transferee company for shareholders, whether in cash or in shares or in debentures must to be taken into account.
3. Where the liabilities are taken over by the transferee company and subsequently discharged such amount should not be added to consideration.
4. When liabilities are taken over by the transferee company they are neither deducted nor added to the amount arrived at as consideration.
5. Any payments made by the transferee company to some other party on behalf of the transferor company are to be ignored.
6. If the liquidation expenses of the transferor company are paid by the transferee company, the same should not be taken as a part of the consideration.

(iv) Shares Exchange Method: In this method, the consideration is ascertained on the basis of the ratio in which the shares of the transferee company are to be exchanged for the shares of the transferor company.
This exchange ratio is generally determined on the basis of the value of each company's shares.

Methods of Accounting for Amalgamations

Pooling of Interest Method
Under pooling of interests method, the assets, liabilities and reserves of the Transferor Company will be taken over by Transferee Company at existing carrying amounts unless any adjustment is required due to different accounting policies followed by these companies. As a result the difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of Transferor Company should be adjusted in reserves.

Purchase Method
Assets and Liabilities: the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation.
Reserves: No reserves, other than statutory reserves, of the transferor company should be incorporated in the financial statements of transferee company. Statutory reserves of the transferor company should be incorporated in the balance sheet of transferee company by way of the following journal entry.

Amalgamation Adjustment A/c Dr.
To Statutory Reserves

When the above statutory reserves will no longer be required to be maintained by transferee company, such reserves will be eliminated by reversing the above entry

Inter Company-owing - Should the purchasing company owe an amount to the vendor company or *vice versa,* the amount will be included in the book debts of one company and trade payables of the other. This should be adjusted by the entry:

Trade payables Dr.
To Trade receivables

The entry should be made after the usual acquisition entries have been passed. At the time of preparing the Realisation Account and passing the business purchase entries, no attention need be paid to the fact that the two companies involved owed money mutually.

Adjustment of the value of stock - Inter-company owings arise usually from purchase and sale of goods; it is likely, therefore, that at the time, of the sale of business, the debtor company also has goods in stock which it purchased from the creditor company - the cost of the debtor company will include the profit made by the creditor company. After the takeover of the business it is essential that such a profit is eliminated. The entry for this will be made by the purchasing company. If it is the vendor company which has such goods in stock, at the time of passing the acquisition entries, the value of the stock should be reduced to its cost to the company which is acquiring the business; automatically goodwill or capital reserve, as the case may be, will be adjusted. But if the original sale was made by the vendor company and the stock is with the company acquiring the business, the latter company will have to debit Goodwill (or Capital Reserve) and credit stock with the amount of the profit included in the stock.

ACCOUNTING ENTRIES IN THE BOOKS OF TRANSFEREE COMPANY

A. In case the Amalgamation is in the nature of Merger: (Pooling of Interest Method)

On amalgamation of the business	Business Purchase Account Dr To Liquidator of Transferor Company	(with the amount of consideration)
When assets, liabilities and reserves are taken over from the transferor company and incorporated in the books	Sundry Assets (Individually) Dr To Sundry Liabilities (Individually) To Profit and Loss A/c To Reserves To Business Purchase A/c **See (Note 1 & 2)**	(with the book value) (with the book value) (with the book balance) (with the book balance) (with the consideration)
When consideration is satisfied	Liquidator of Transferor Company Dr. To Equity Share Capital To Preference Share Capital To Bank **See (Note 3)**	(with the purchase consideration) (with the paid-up value of shares allotted) (with cash paid)
On discharge of liability	Debentures in Transferor Company Dr. (with the paid-up value of To Debentures debentures allotted)	
If the liquidation expenses of the transferor company are borne by the transferee company	General Reserve A/c Dr. (with the amount of expenses) To Bank	
For the formation expenses of the transferee company	Preliminary Expenses Account Dr. (with the amount of expenditure) To Bank	

Note:

1) Amalgamation in the nature of merger, all the assets, written off expenses, debit balance of Profit and Loss Account, outside liabilities and reserves of the transferor company have to be recorded in the books of the transferee company in the form and at the book values as they were appearing in the books of the transferor company on the date of amalgamation. However, if there is a conflict in the accounting policies of the transferee and transferor companies, changes in the book values may be made to ensure uniformity.
2) While passing the above journal entry, the difference between the amount of consideration payable by the transferee company to the transferor company and the amount of the share capital of the transferor company is adjusted in the general reserve or other reserves.
3) The shares may be allotted at premium or at discount, in which case share premium account and discount on issue of shares account should be stated. In the case of mergers the consideration receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares. However, the transferee company may issue preference shares to the preference shareholders of the transferor company. Moreover, the transferee company may allot securities other than equity shares and give cash and other assets to satisfy the dissenting shareholders of the transferor company.

B. In case the Amalgamation is in the nature of Purchase:

On acquisition of the business from the transferor company	Business Purchase A/c Dr. To Liquidator of Transferor Company	(with the amount of consideration)
When the assets and liabilities are taken over from transferor company	Sundry Assets A/c Dr. To Sundry Liabilities A/c (Individually) To Business Purchase A/c	(Individually excluding goodwill, with their revalued figures, if any, otherwise at their book figures) (with the figures at which they are taken over) (with the amount of consideration)
When the consideration is satisfied	Liquidator of Transferor Company Dr. To Preference Share Capital A/c To Equity Share Capital A/c To Debentures A/c To Bank	(with the amount of consideration) (with the face value of shares allotted) (with the face value of debentures allotted) (with the amount paid)
To record the statutory reserves of the transferor company in the books of the transferee company	Amalgamation Adjustment A/c Dr To Statutory Reserve A/c	(with the amount of statutory reserve)
If the liquidation expenses of the transferor company are borne by the	Goodwill Account Dr. To Bank	(with the amount of expenditure)

transferee company		
With the formation expenses of the transferee company	Preliminary Expenses A/c Dr. To Bank	(with the amount of expenditure)
If there are both goodwill and capital reserve, Goodwill may be written off against Capital Reserve	Capital Reserve A/c Dr. To Goodwill A/c	(with the amount written off)
If any liability is discharged by the transferee company	Respective Liability A/c Dr. To Share Capital A/c To Debentures A/c To Bank	(with the amount payable) (as the case may be)

ACCOUNTING ENTRIES IN THE BOOKS OF TRANSFEROR COMPANY
It involves the closing of accounts in the books of the transferor company. The following procedures are followed:

Open a Realisation Account and transfer all the assets except any fictitious assets like preliminary expenses, underwriting commission, discount on issue of shares or debentures, profit and loss account (Dr.) balance, etc., to it at their book value:	Realisation A/c Dr. To Sundry Assets A/c (Individually)	(with the total) (with their books value)
Transfer the liabilities taken over by the transferee company	Sundry Liabilities A/c Dr (individually) To Realisation A/c	(with their book figure) (with the total)
consideration becoming due	Transferee Company Dr To Realisation A/c	(with the amount of consideration)
If any assets (other than fictitious assets) is not taken over by the transferee company, the same has to be realised by the transferor company itself:	Bank Dr To Realisation A/c	(with the realised value)
On receiving the consideration from the transferee company:	Shares in Transferee Company Dr Transferee Company Dr Bank Dr	(as the case may be Debentures in according to the terms of discharge of the consideration)

	To Transferee Company	
If the liquidation expenses or realisation expenses are borne by the transferor company itself	Realisation A/c Dr To Bank	(with the amount of expenditure)
If the liquidation expenses or realisation expenses are borne by the transferee company:	In such a case, it is better not to pass any entry in the books of the transferor company. Alternatively, the following two entries may be passed, the effect of which will be practically nil: (i) Transferee Company Dr (with the amount of To Bank expenditure) (ii) Bank Dr (with the amount of To Transferee Company expenditure) Entry (i) is passed when the expenditure is incurred, and entry (ii) when it is reimbursed	
If any liability is not taken over by the transferee company, the same need not be transferred to the Realisation Account. On payment, the liability account should be debited and Bank Account is credited with the actual amount paid. But, if there is any profit or loss on redemption of the liability, the same must be shown in the Realisation Account.	(a) In case of Profit: Respective Liability A/c Dr To Realisation A/c (b) In case of Loss: Realisation A/c Dr To Respective Liability A/c	(with the profit, i.e difference between the amount due and the amount payable) (with the loss, i.e,difference between the amount payable and the amount due)
Now pay off the outside liabilities, if any, not taken over by the transferee company:	Respective Liability A/c Dr To Bank	(with the amount paid)
When the debentures are discharged: (not assumed or discharged by transferee company)	(a) Debentures A/c Dr To Debentureholders A/c (b) Debentureholders A/c Dr To Bank	(with the book value) (with the amount paid)
Now, pay off the	(a) Preference Share Capital A/c	(with the book figures)

preference shareholders, if any	Dr To Preference Shareholders A/c (b) Preference Shareholders A/c Dr To Preference Shares in Transferee Company To Equity Shares in Transferee Company (as the case may be) To Debentures in Transferee Company To Bank	(with the amount payable)
Now, close the Realisation Account and transfer the profit or loss on realisation to Equity Shareholders Account:	(a) In case of profit: Realisation A/c Dr To Equity Shareholders A/c (b) In case of loss: Equity Shareholders A/c Dr To Realisation A/c	(with the amount of profit) (with the amount of loss)
Before the equity shareholders are paid off, transfer equity share capital and the past accumulated profits and reserves to Equity Shareholders Account:	Equity Share Capital A/c Dr General Reserve A/c Dr Reserve Fund A/c Dr Capital Reserve A/c Dr Profit and Loss A/c Dr To Equity Shareholders A/c	(with the paid up value) (with their figures as the case may be) (with the total)
Similarly, transfer the past accumulated losses and fictitious assets, if any, to Equity Shareholders Account:	Equity Shareholders A/c Dr To Profit and Loss A/c To Preliminary Expenses A/c To Underwriting Commission A/c To Discount on Issue of Shares A/c To Discount on Issue of Debentures A/c	(with the total) (as the case may be)
Now, pay off the equity shareholders:	Equity Shareholders A/c Dr To Equity Shares in Transferee Co A/c To Preference Shares in Transferee Co A/c To Debentures in Transferee Co A/c To Bank	(with the amount payable) (as the case may be)

Notes:
(i) If cash in hand and cash at bank are not taken over by the transferee company, do not transfer them to Realisation Account. But, if it is taken over, then it must be transferred to the Realisation Account.

(ii) The asset not taken over by the transferee company has also to be transferred to the Realisation Account.
(iii) Goodwill and other intangible assets like trade marks, patent rights, etc. are also transferred to Realisation Account provided they have realisable value or they are taken over by the transferee company.

Notes:
1. If preference shareholders or debentureholders are paid more or less than the amount due to them as per balance sheet, the difference be transferred Equity Shareholders Account through Realisation Account.
2. After the equity shareholders are paid off, all the accounts in the book of the transferor company will be closed and not a single account will show any balance.
3. The net amount payable to the equity shareholders, after adjustment of accumulated profits and reserves, fictitious assets and profit or loss on realisation, must be equal to the amount of shares and debentures in transferee company and cash received from the transferee company left after discharge of all liabilities and preference share capital.

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"Nothing can stop the man with the right mental attitude from achieving his goal; nothing on earth can help the man with the wrong mental attitude."

-Thomas Jefferson

INTERNAL RECONSTRUCTION

Reconstruction is a process by which affairs of a company are reorganized by revaluation of assets, reassessment of liabilities and by writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares.
The object of reconstruction is usually to reorganize capital or to compound with creditors or to effect economies. Such a process is called *internal reconstruction* which is carried out without liquidating the company and forming a new one.

Accounting procedure
(i) In case of internal reconstruction by reducing capital, a "capital reduction account" is to be opened, which is credited with the amount sacrificed by the shareholders, debenture holders and creditors.
(ii) Then the amount of capital reduction is utilised for writing off fictitious assets, past losses and excess value of other assets.
(iii) If there is any balance of capital reduction account left after writing off the above losses, then it is to be transferred to capital reserve account.
(iv) The amount to be written off cannot exceed the amount credited to the capital reduction amount. But if any reserve appears on the liabilities side of the balance sheet, the same may be utilised in writing off the accumulated losses and assets.
(v) Write off all fictitious assets (including Goodwill and Patents) and eliminate all overvaluation of assets by crediting the accounts concerned and debiting the Capital Reduction (or Reconstruction) Account. For this purpose, any reserve appearing in the books of the company may be used. If any balance is left in the Capital Reduction (or Reconstruction) Account it should be transferred to the Capital Reserve Account.
(vi) If there is any contingent liability (like arrears of preference dividend etc.) and if the same is forgone for the claimant, then no entry will be passed.
(vii) If any contingent liability or unrecorded liability (like reconstruction expenses) is to be paid, then it will be paid out of capital reduction a/c.
(viii) In case there are any profits or gain occurs during the process of internal reconstruction then such profits or gains must be credited to capital reduction account.
(ix) In case of surrender of shares, shareholders surrender part of their holdings to the company, which are utilised to repay debenture holders, preference shareholders and other creditors of the company. Balance of unused shares surrendered is to be cancelled by transferring to capital reduction account.

Accounting Entries
1. Entry for share capital reduced without changing the face value of the shares
Share Capital A/c Dr.
        To Capital Reduction/Reconstruction/ Reorganization Account A/c
(with the amount of the reduction made)
2. Entry if face value of the shares is also changed on reduction of capital a new category of share capital is created
Share Capital A/c (Old) Dr.
        To Share capital A/c (New) *(with the amount treated as paid up)*
        To Capital reduction A/c *(with the difference amount)*
3. Entry When debenture holder and creditors are also ready to reduce their claim against company
Debenture A/c Dr.
Creditors A/c Dr.
        To Capital reduction A/c

4. Entry in case of appreciation in the value of any asset

Assets A/c Dr.
    To Capital reduction A/c

5. Entry if any contingent liability matures and is to be paid immediately the following entry is passed

Capital reduction A/c Dr.
    To Liability payable A/c

Liability Payable A/c Dr.
    To cash/ Bank/ share capital A/c

6. Entry for utilising the amount of capital reduction to write off accumulated losses.

Capital Reduction A/c Dr.
    To Profit & Loss A/c
    To Preliminary Expenses A/c
    To Discount on Shares /Debentures A/c
    To Goodwill A/c
    To Trade Assets A/c
    To Patents/Copy rights
    To Assets A/c

7. For transferring any balance left in the capital reduction account to capital reserve account

Capital reduction A/c Dr.
    To capital reserve A/c *(with the balance left)*

8. Variation of Shareholders Rights

(Old)% Cum. Pref. Share Capital A/c Dr.
    To (New)% Cum. Pref. Share Capital A/c

"The price of success is hard work, dedication to the job at hand, and the determination that whether we win or lose, we have applied the best of ourselves to the task at hand."

- Vince Lombardi

ISSUE OF BONUS SHARES

(*1*) 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.

However, no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

(*2*) No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares under (*1*) above, unless –

a) it is authorised by its articles;
b) it has, on the recommendation of the Board, been authorised in the general meeting of the company;
c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
d) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
e) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;
f) The company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same. [Rule 14 of Companies (Share Capital and Debentures) Rules, 2014]

(*3*) The bonus shares shall not be issued in lieu of dividend.

Accounting Treatment :

On capitalization of reserve for issue of shares	Capital Redemption Reserve Account Dr. Securities Premium Account Dr. Capital Reserve Account Dr. General Reserve Account Dr. Profit & Loss Account Dr. To Bonus to Shareholders Account.	(realised in cash only)
On issue of Bonus share	Bonus to Shareholders Account Dr. To Share Capital Account.	If some shares are party paid-up, first the shares are to me made fully paid up
converting partly paid shares into fully paid shares	Profit & Loss Account Dr. General Reserve Account Dr. Capital Reserve Account Dr. To Bonus to Shareholders Account	(realised in cash only)
On making the final call due	Share Final Call Account Dr. To Share Capital Account	
On adjustment of final call	Bonus to Shareholders Account Dr. To Share Final Call Account	

NOT FOR PROFIT ORGANISATION

- **Meaning and Characteristics of Not-for-Profit Organisation**

Not-for -Profit Organisations refer to the organisations that are for used for the welfare of the society and are set up as charitable institutions which function without any profit motive. Their main aim is to provide service to a specific group or the public at large. Normally, they do not manufacture, purchase or sell goods and may not have credit transactions. Hence they need not maintain many books of account (as the trading concerns do) and Trading and Profit and Loss Account. The funds raised by such organisations are credited to capital fund or general fund. The major sources of their income usually are subscriptions from their members donations, grants-in-aid, income from investments, etc. The main objective of keeping records in such organisations is to meet the statutory requirement and help them in exercising control over utilisation of their funds. They also have to prepare the financial statements at the end of each accounting period (usually a financial year) and ascertain their income and expenditure and the financial position, and submit them to the statutory authority called Registrar of Societies.

- ***The main characteristics of such organisations are***:

1. Such organisations are formed for providing service to a specific group or public at large such as education, health care, recreation, sports and so on without any consideration of caste, creed and colour. Its sole aim is to provide service either free of cost or at nominal cost, and not to earn profit.
2. These are organised as charitable trusts/societies and subscribers to such organisation are called members.
3. Their affairs are usually managed by a managing/executive committee elected by its members.
4. The main sources of income of such organisations are: (i) subscriptions from members, (ii) donations, (iii) legacies, (iv) grant-in-aid, (v) income from investments, etc.
5. The funds raised by such organisations through various sources are credited to capital fund or general fund.
6. The surplus generated in the form of excess of income over expenditure is not distributed amongst the members. It is simply added in the capital fund.
7. The Not-for-Profit Organisations earn their reputation on the basis of their contributions to the welfare of the society rather than on the customers' or owners' satisfaction.
8. The accounting information provided by such organisations is meant for the present and potential contributors and to meet the statutory requirement.

- ***Final Accounts or Financial Statements:*** The Not-for-Profit Organisations are also required to prepare financial statements at the end of the each accounting period. Although these organisations are non-profit making entities and they are not required to make Trading and Profit & Loss Account but it is necessary to know whether the income during the year was sufficient to meet the expenses or not. Not only that they have to provide the necessary financial information to members, donors, and contributors and also to the Registrar of Societies. For this purpose, they have to prepare their final accounts at the end of the accounting period and the general principles of accounting are fully applicable in their preparation as stated earlier, the final accounts of a 'not-for-profit organisation' consist of the following:

(i) Receipt and Payment Account
(ii) Income and Expenditure Account, and
(iii) Balance Sheet.

The Receipt and Payment Account is the summary of cash and bank transactions which helps in the preparation of Income and Expenditure Account and the Balance Sheet. Besides, it is a legal requirement as the Receipts and Payments Account has also to be submitted to the Registrar of Societies along with the Income and Expenditure Account, and the Balance Sheet. Income and Expenditure Account is akin to Profit and Loss Account. The
Not-for-Profit Organisations usually prepare the Income and Expenditure Account and a Balance Sheet with the help of Receipt and Payment Account. However, this does not imply that they do not make a trial balance. In order to check the accuracy of the ledger accounts, they also prepare a trial balance which facilitates the preparation of accurate Receipt and Payment Account as well as the Income and Expenditure Account and the Balance Sheet.
In fact, if an organisation has followed the double entry system they must prepare a trial balance for checking the accuracy of the ledger accounts and it will also facilitate the preparation of Receipt and Payment account. Income and Expenditure Account and the Balance Sheet.

▪***<u>Receipt and Payment Account</u>***
It is prepared at the end of the accounting year on the basis of cash receipts and cash payments recorded in the cash book. It is a summary of cash and bank transactions under various heads. For example, subscriptions received from the members on different dates which appear on the debit side of the cash book, shall be shown on the receipts side of the Receipt and Payment Account as one item with its total amount. Similarly, salary, rent, electricity charges paid from time to time as recorded on the credit side of the cash book but the total salary paid, total rent paid, total electricity charges paid during the year appear on the payment side of the Receipt and Payment Account. Thus, Receipt and Payment Account gives summarised picture of various receipts and payments, irrespective of whether they pertain to the current period, previous period or succeeding period or whether they are of capital or revenue nature. It may be noted that this account does not show any non cash item like depreciation. The opening balance in Receipt and Payment Account represents cash in hand/cash at bank which is shown on its receipts side and the closing balance of this account represents cash in hand and bank balance as at the end of the year, which appear on the credit side of the Receipt and Payment Account. However, if it is bank overdraft at the end it shall be shown on its debit side as the last item.

Receipts	***Payments***
1. Donations	1. Purchase of Fixed Assets
(a) General	2. Purchase of Sports Material
(b) Specific purpose	3. Investment in Securities
2. Entrance Fees	4. Printing and Stationery
3. Legacies	5. Postage and Courier Charges
4. Sale of Investments	6. Advertisements
5. Sale of Fixed Assets	7. Wages and Salary
6. Subscriptions from Members	8. Honorarium
7. Life Membership Fees	9. Telephone Charges
8. Sale of old Newspapers	10. Electricity and Water Charges
9. Sale of Old Sports Material	11. Repairs and Renewals
10. Interest on Fixed Deposits	12. Upkeep of Play Ground
11. Interest/ Dividend on Investments	13. Conveyance Charges
12. Proceed from Charity Shows	14. Subscription for Periodicals
13. Sale of Scrap	15. Audit Fees
14. Grant-in-aid	16. Entertainment Expenses
15. Interest/Dividend on Specific	17. Municipal Taxes
Fund Investments	18. Charity

16. Miscellaneous Receipts.	19. Insurance

Receipt and Payment Account for the year ending ————

Receipts	*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Balance b/d		Balance b/d (Bank overdraft)	xxx
Cash in Hand	xxx	Wages and Salaries	xxx
Cash at Bank	xxx	Rent	xxx
Subscriptions	xxx	Rates and Taxes	xxx
General Donations	xxx	Insurance	xxx
Sale of newspaper/	xxx	Printing and Stationery	xxx
periodicals/waste paper		Postage and courier	xxx
Sale of old sports materials	xxx	Advertisement	xxx
Interest on fixed deposits		Sundry expenses	xxx
Interest/Dividend on general	xxx	Telephone charges	xxx
investments		Entertainment expenses	xxx
Locker Rent	xxx	Audit fees	xxx
Sale of scraps	xxx	Honorarium	xxx
Proceeds from charity show	xxx	Repair and Renewals	xxx
Miscellaneous receipts	xxx	Upkeep of ground	xxx
Grant-in-aid**	xxx	Conveyance	xxx
Legacies	xxx	Newspapers and Periodicals	xxx
Specific Donations	xxx	Purchases of Assets	xxx
Sale of Investments	xxx	Purchase of Investments	xxx
Sale of Fixed Assets	xxx	Balance c/d	xxx
Life membership fees	xxx	Cash in hand	xxx
Entrance fees	xxx	Cash at Bank*	xxx
Receipts on account of	xxx		
specific purpose funds			
Interest on specific funds'	xxx		
investments			
Balance b/d (Bank Overdraft)*	xxx		
	xxxxx		xxxxx

It may be noted that the receipts side of the Receipt and Payment Account gives a list of revenue receipts (for past, current and future periods) as well as capital receipts. Similarly, the payments side of the Receipts and Payments Account lists the Revenue Payments (for past, current and future periods) as well as Capital Payments.

▪***Salient Features***

1. It is a summary of the cash book. Its form is identical with that of simple cash book (without discount and bank columns) with debit and credit sides. Receipts are recorded on the debit side while payments are entered on the credit side.
2. It shows the total amounts of all receipts and payments irrespective of the period to which they pertain . For example, in the Receipt and Payment account for the year ending on March 31, 2012, we record the total subscriptions received during 2011–12 including the amounts related to the years 2010–2011 and 2011-2012. Similarly, taxes paid during 2011–12 even if they relate to the years 2010–11 and 2012–2013 can also be recorded in this account of 2011-12.
3. It includes all receipts and payments whether they are of capital nature or of revenue nature.

4. No distinction is made in receipts/payments made in cash or through bank. With the exception of the opening and closing balances, the total amount of each receipt and payment is shown in this account.
5. No non-cash items such as depreciation outstanding expenses accrued income, etc. are shown in this account.
6. It begins with opening balance of cash in hand and cash at bank (or bank overdraft) and closes with the year end balance of cash in hand/ cash at bank or bank overdraft. In fact, the closing balance in this account (difference between the total amount of receipts and payments) which is usually a debit balance reflects cash in hand and cash at bank unless there is a bank overdraft.

▪***Steps in the preparation of Receipt and Payment Account***
1. Take the opening balances of cash in hand and cash at bank and enter them on the debit side. In case there is bank overdraft at the begining of the year, enter the same on the credit side of this account.
2. Show the total amounts of all receipts on its debit side irrespective of their nature (whether capital or revenue) and whether they pertain to past, current and future periods.
3. Show the total amounts of all payments on its credit side irrespective of their nature (whether capital or revenue) and whether they pertain to past, current and future periods.
4. None of the receivable income and payable expense is to be entered in this account as they do not involve inflow or outflow of cash.
5. Find out the difference between the total of debit side and the total of credit side of the account and enter the same on the credit side as the closing balance of cash/bank. In case, however, the total of the credit side is more than that of the total of the debit side, show the difference on the debit as bank overdraft and close the account.

▪ **Income and Expenditure Account**
It is the summary of income and expenditure for the accounting year. It is just like a profit and loss account prepared on accrual basis in case of the business organisations. It includes only revenue items and the balance at the end represents surplus or deficit. The Income and Expenditure Account serves the same purpose as the profit and loss account of a business organization does. All the revenue items relating to the current period are shown in this account, the expenses and losses on the expenditure side and incomes and gains on the income side of the account. It shows the net operating result in the form of surplus (i.e. excess of income over expenditure) or deficit (i.e. excess of expenditure over income), which is transferred to the capital fund shown in the balance sheet. The Income and Expenditure Account is prepared on accrual basis with the help of Receipts and Payments Account along with additional information regarding outstanding and prepaid expenses and depreciation etc. Hence, many items appearing in the Receipts and Payments need to be adjusted.

▪***Steps in the Preparation of Income and Expenditure Account***
Following steps may be helpful in preparing an Income and Expenditure Account from a given Receipt and Payment Account:
1. *Persue* the Receipt and Payment Account thoroughly.
2. Exclude the opening and closing balances of cash and bank as they are not an income.
3. Exclude the capital receipts and capital payments as these are to be shown in the Balance Sheet.
4. Consider only the revenue receipts to be shown on the income side of Income and Expenditure Account. Some of these need to be adjusted by excluding the amounts relating to the preceding and the succeeding periods and including the amounts relating to the current year not yet received.

5. Take the revenue expenses to the expenditure side of the Income and Expenditure Account with due adjustments as per the additional information provided relating to the amounts received in advance and those not yet received.
6. Consider the following items not appearing in the Receipt and Payment Account that need to be taken into account for determining the surplus/ deficit for the current year :
(a) Depreciation of fixed assets.
(b) Provision for doubtful debts, if required.
(c) Profit or loss on sale of fixed assets.

▪ **Balance Sheet**

'Not-for-Profit' Organisations prepare Balance Sheet for ascertaining the financial position of the organisation. The preparation of their Balance Sheet is on the same pattern as that of the business entities. It shows assets and liabilities as at the end of the year. Assets are shown on the right hand side and the liabilities on the left hand side. However, there will be a Capital Fund or General Fund in place of the Capital and the surplus on deficit as per Income and Expenditure Account shall be added to/deducted to this fund. It is also a common practice to add some of the capitalised items like legacies, entrance fees and life membership fees directly in the capital fund.
Besides the Capital or General Fund, there may be other funds created for specific purposes or to meet the requirements of the contributors/donors such as building fund, sports fund, etc. Such funds are shown separately in the liabilities side of the balance sheet. Some times it becomes necessary to prepare Balance Sheet as at the beginning of the year in order to find out the opening balance of the capital/general fund.

▪***Preparation of Balance Sheet***

The following procedure is adopted to prepare the *Balance Sheet*:
1. Take the Capital/General Fund as per the opening balance sheet and add surplus from the Income and Expenditure Account. Further, add entrance fees, legacies, life membership fees, etc. received during the year.
2. Take all the fixed assets (not sold/discarded/or destroyed during the year) with additions (from the Receipts and Payments account) after charging depreciation (as per Income and Expenditure account) and show them on the assets side.
3. Compare items on the receipts side of the Receipts and Payments Account with income side of the Income and Expenditure Account. This is to ascertain the amounts of: (a) subscriptions due but not yet received: (b) incomes received in advance; (c) sale of fixed assets made during the year; (d) items to be capitalised (i.e. taken directly to the Balance Sheet) e.g. legacies, interest on specific fund investment and so on.
4. Similarly compare, items on the payments side of the Receipt and Payment Account with expenditure side of the Income and Expenditure Account. This is to ascertain the amounts if: (a) outstanding expenses; (b) prepaid expenses; (c) purchase of a fixed asset during the year; (d) depreciation on fixed assets; (e) stock of consumable items like stationery in hand; (f) Closing balance of cash in hand and cash at bank as, and so on.

Proforma Balance Sheet

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capital fund:			
Opening Balance	……	*Cash in hand and /or Cash at Bank*	……
Add: Surplus			
OR		*Outstanding Incomes*	……
Less: Deficit		*Prepaid Expenses*	……

Add: Capitalised Income of the Current Year on account of:	……	*Stock of Consumable Items:*	
Legacies	……	Previous Balance	
Entrance Fees	……	*Add: Purchases in the current* period	
Life Membership Fees	……	*Less: Value consumed during* the period	……
Closing Balance	……		
Special Fund/Donations:		Previous Balance	……
Previous Balance (If any)		*Add: Purchases in the current* period	
Add: Receipts for the item during the period		*Less: Book Value of the Asset* sold/disposed off	
Add: Income earned on fund/Donations' Investments		*Closing Balance*	……
Less: Expenses paid out of fund/Donations			
Net Balance	……		
Creditors for Purchases and/or supplies	……		
Bank Overdraft	……		
Outstanding Expenses:			
Income received in Advance	……		
	……		……

▪***<u>Some Peculiar Items</u>***

Final accounts of the Not-for-Profit organisations are prepared on the similar pattern as that of a business orgnisation. However, a few items of income and expenses of such orgnisations are somewhat different in nature and need special attention in their treatment in final accounts. They are peculiar to these orgnisations. Some of the common peculiar items are explained as under:

<u>Subscriptions:</u> Subscription is a membership fee paid by the member on annual basis. This is the main source of income of such orgnisations. Subscription paid by the members is shown as receipt in the Receipt and Payment Account and as income in the Income and Expenditure Account. It may be noted that Receipt and Payment Account shows the total amount of subscription actually received during the year while the amount shown in Income and Expenditure Account is confined to the figure related to the current period only irrespective of the fact whether it has been received or not. For example, a club received Rs. 20,000 as subscriptions during the year 2010-11 of which Rs.3,000 relate to year 2009-10 and Rs.2,000 to 2011-12, and at the end of the year 2010-11 Rs.6,000 are still receivable. In this case, the Receipt and Payment Account will show Rs.20,000 as receipt from subscriptions. But the Income and Expenditure Account will show Rs. 21,000 as income from subscriptions for the year 2010-11, the calculation of which is given as below:

	Rs.
Subscriptions received in 2010-11	20,000
Less: Subscriptions for the year 2009-10	3,000
	17,000
Less: Subscription for the year 2011-12	2,000
	15,000
Add: Subscriptions outstanding for the year 2010-11	6,000
Income from subscriptions for the year 2010-11	**21,000**

The above amount of subscriptions to be shown as income can also be ascertained by preparing the subscription account as follows:

Subscription Account

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Balance b/d (outstanding at the beginning)		3,000		Balance b/d (received in advance during previous year)		Nil
	Income and Expenditure Account (balancing figure)		21,000		Cash (subscription received)		20,000
	Balance c/d (received in advance)		2,000		Balance c/d (outstanding at the end)		6,000
			26,000				**26,000**

Donation: It is art of gift in cash or property received from some person or organisation. It appears on the receipts side of the Receipts and Payments Account. Donation can be for specific purposes or for general purposes.
(i) Specific Donations: If donation received is to be utilised to achieve specified purpose, it is called Specific Donation. The specific purpose can be an extension of the existing building, construction of new computer laboratory, creation of a book bank, etc. Such donation is to be capitalized and shown on the liabilities side of the Balance Sheet irrespective of the fact whether the amount is big or small. The intention is to utilise the amount for the specified purpose only.
(ii) General Donations: Such donations are to be utilised to promote the general purpose of the organisation. These are treated as revenue receipts as it is a regular source of income hence, it is taken to the income side of the Income and Expenditure Account of the current year.
Legacies: It is the amount received as per the *will* of a deceased person. It appears on the receipts side of the Receipt and Payment Account and is directly added to capital fund/general fund in the balance sheet, because it is not of recurring nature. However, legacies of a small amount may be treated as income and shown on the income side of the Income and Expenditure Account.
Life Membership Fees: Some members prefer to pay lump sum amount as life membership fee instead of paying periodic subscription. Such amount is treated as capital receipt and credited directly to the capital/general fund.
Entrance Fees: Entrance fee also known as admission fee is paid only once by the member at the time of becoming a member. In case of organisations like clubs and some charitable institutions, is limited and the amount of entrance fees is quite high. Hence, it is treated as non-recurring item and credited directly to capital/general fund. However, for some organisations like educational institutions, the entrance fees is a regular income and the amount involved may also be small. In their case, it is customary to treat this item as a revenue receipt. However, if there is specific instruction, it is advisable to treat the entire amount as capital receipt and the relevant amount should be directly added to capital/general fund.
Sale of old asset: Receipts from the sale of an old asset appear in the Receipts and Payments Account of the year in which it is sold. But any gain or loss on the sale of asset is taken to the Income and Expenditure Account of the year. For example, if an item furniture with a book value of Rs. 800 is sold for Rs. 700, this amount of Rs. 700 will be shown as receipt in Receipts and Payments Account and Rs. 100 on the expenditure side of the Income and

Expenditure Account as a loss on sale of old asset and while showing furniture in the balance sheet Rs. 800 will be deducted from its total book value.

Sale of Periodicals: It is an item of recurring nature and shown as the income side of the Income and Expenditure Account.

Sale of Sports Materials: Sale of sports materials (*used* materials like old balls, bats, nets, etc) is the regular feature with any Sports Club. It is usually shown as an income in the Income and Expenditure Account.

Payments of Honorarium: It is the amount paid to the person who is not the regular employee of the institution. Payment to an artist for giving performance at the club is an example of honorarium. This payment of honorarium is shown on the expenditure side of the Income and Expenditure Account.

Endowment Fund: It is a fund arising from a bequest or gift, the income of which is devoted for a specific purpose. Hence, it is a capital receipt and shown on the Liabilities side of the Balance Sheet as an item of a specific purpose fund.

Government Grant: Schools, colleges, public hospitals, etc. depend upon government grant for their activities. The recurring grants in the form of maintenance grant is treated as revenue receipt (i.e. income of the current year) and credited to Income and Expenditure account. However, grants such as building grant are treated as capital receipt and transferred to the building fund account. It may be noted that some Not-for-Profit organisations receive cash subsidy from the government or government agencies. This subsidy is also treated as revenue income for the year in which it is received.

Special Funds

The Not-for-Profit Organisations office create special funds for certain purposes/ activities such as 'prize funds', 'match fund' and 'sports fund', etc. Such funds are invested in securities and the income earned on such investments is added to the respective fund, not credited to Income and Expenditure Account. Similarly, the expenses incurred on such specific purposes are also deducted from the special fund. For example, a club may maintain a special fund for sports activities. In such a situation, the interest income on sports fund investments is added to the sports fund and all expenses on sports deducted therefrom. The special funds are shown in balance sheet. However, if, after adjustment of income and expenses the balance in specific or Special fund is negative, it is transferred to the debit side of the Income and Expenditure Account or adjusted as per prescribed directions.

"Don't wait for PERFECT MOMENT,
take the MOMENT and make it PERFECT"

INVESTMENT ACCOUNT

Investments are assets held by an enterprise for earning income by way of dividends, interest and rentals, for capital appreciation, or for other benefits to the investing enterprise.
Investment Accounting is done as per AS-13 which deals with all kind of investments except:
(i) interest, dividends and rentals earned on investments
(ii) operating or financial leases
(iii) investment of retirement benefit plans and life insurance enterprises
(iv) mutual funds
(v) assets held as Stock-in-trade are not 'Investments'.

Classification of Investments

Current investment is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made.

- The carrying amount for current investments is the lower of cost and fair value.
- *Fair value* is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction. Under appropriate circumstances, market value or net realizable value provides an evidence of fair value.
- *Market value* is the amount obtainable from the sale of an investment in an open market, net of expenses necessarily to be incurred on or before disposal.
- Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss account.

Long-term investment is an investment other than a current investment.

- Long term investments are usually carried at cost.
- If there is a permanent decline in the value of a long term investment; the carrying amount is reduced to recognize the decline.
- The reduction in carrying amount is charged to the statement of profit and loss
- The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist.

Investment Acquisitions

- The cost of an investment includes acquisition charges such as brokerage, fees and duties.
- If the investment is acquired, or partly acquired, by the issue of shares or other securities,the acquisition cost is fair value of securities or asset issued
- If an investment is acquired in exchange, or part exchange, for another asset, the acquisition cost of the investment is determined by reference to the fair value of the asset given up. It may be appropriate to consider the fair value of the investment acquired if it is more clearly evident.

A separate Investment Account should be made for each scrip purchased. The scrips purchased may be broadly divided into two categories
i) Fixed income Bearing Securities:
ii) Variable Income Bearing Securities

i) Fixed income Bearing Securities:

The investment in Government securities or debentures comes under this category. In this type of scrip, the interest accrued from the date of last payment to the date of transaction can be easily calculated.
<u>In case the transaction is on 'Ex-interest' basis</u> i.e., the amount of interest accrued to the date of transaction has to be paid in addition to the price of security.

The following entries are made in the books of Purchaser:
Investment Account Dr. (With the price settled on ex- interest basis)*
Interest accrued Account Dr. (Accrued interest till the date of transaction)**
To Bank A/c (With total amount paid)
* This amount will appear in Capital Column of 'Investment A/c'.
** This amount will appear in Income Column of 'Investment A/c'.

<u>In case the transaction is on cum-interest basis</u>, a part of purchase price is related to the interest accrued from the date of the last interest paid to the date of transaction. And hence in this case the cost of investment has to be calculated by subtracting the amount of accrued interest from the Purchase Price.
The following entries are made in the books of Purchaser:
Investment Account Dr. (With the price settled on cum- interest less Interest Accrued)*
Interest accrued Account Dr. (Accrued interest till the date of transaction)**
    To Bank A/c (With total amount paid)
* This amount will appear in Capital Column of 'Investment A/c'.
** This amount will appear in Income Column of 'Investment A/c'.

When the interest amount is actually received, it is entered in the Income Column credit side. The net effect of these entries will be that the amount credited to the income will be only the interest arising between the date of purchase and the one on which it next falls due.
Note:
(*a*) Interest amount is always calculated with respect to nominal value.
(b) In case the quotation is not qualified, the same will be treated as ex-interest quotation.

<u>(ii) Variable Income Bearing Securities:</u>
The investment in equity shares comes under this category. The following points should be noted with respect to investment in equity shares:
(*a*) dividends from investments in shares are not recognised in the statement of profit and loss until a right to receive payment is established;
(*b*) the amount of dividend accruing between the date of last dividend payment and the date of purchase cannot be immediately ascertained;
(*c*) the dividend received for a particular period of time is assumed to be evenly distributed over the period.

In the following way the information is incorporated in the books of investor at the time of purchase:
Investment Account Dr. (With the entire purchase price)*
    To Bank A/c (With total amount paid)
* This amount will appear in Capital Column of 'Investment A/c'.
The adjustment with respect to dividend is made when the dividend is actually received as under:
Bank A/c Dr (with total dividend received)
    To Investment A/c (with the amount of dividend for the period for which the investor did not hold the share)*
    To Investment A/c (with the amount of dividend for the post – acquisition period)**
* This amount will appear in Capital Column of 'Investment A/c'.
** This amount will appear in Income Column of 'Investment A/c'.

- The important point with respect to investment in equity shares is that the amount of dividends for the period, for which the shares were not held by the investor, should not be treated as revenue receipt but they should be treated as capital receipt.
- When dividends on equity shares are declared from pre-acquisition profits, similar treatment is done *i.e.*, the amount of such dividend received by the investor is entered on the credit side in the capital column, so as to reduce the acquisition cost.
- If it is difficult to make an allocation between pre and post acquisition periods except on an arbitrary basis, the cost of investment is normally reduced by dividends receivable, if they clearly represent recovery of part of cost.

- When right shares offered are subscribed for, the cost of the right shares is added to the carrying amount of the original holding.

If rights are not subscribed for but are sold in the market, the sale proceeds are taken to the profit and loss statement as per para 13 of AS 13 " Accounting for Investment".

Where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value.
For *e.g.*, Mr. X acquires 200 shares of a company on cum-right basis for ₹ 50,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at ₹ 110 each. X subscribes for the right issue. Thus, the total cost of X's holding of 400 shares would amount to ₹ 72,000 (50,000 + 22,000).
Suppose, he does not subscribe but sells the rights for ₹ 15,000. The ex-right market value of 200 shares bought by X immediately after the rights falls to ₹ 40,000. In this case out of sale proceeds of ₹ 15,000, ₹ 10,000 may be applied to reduce the carrying amount to the market value ₹ 40,000 and ₹ 5,000 would be credited to the profit and loss account.

- Where an investment is acquired by way of issue of bonus shares, no amount is entered in the capital column of investment account since the investor has not to pay anything.

Disposal of Investments

- On disposal of an investment, the difference between the carrying amount and the disposal proceeds, net of expenses is recognised in the profit and loss statement.
- When a part of the holding of an individual investment is disposed, the carrying amount is required to be allocated to that part on the basis of the average carrying amount of the total holding of the investment.
- In respect of shares, debentures and other securities held as stock-in-trade, the cost of stocks disposed of may be determined by applying an appropriate cost formula (*e.g.* first-in, first-out, average cost, etc.). These cost formulae are the same as those specified in AS 2, 'Valuation of Inventories'.

(*i*) *Fixed Income Bearing Securities*: The amount of accrued interest from the date of last payment to the date of sale is credited in the income column and only the sale proceeds, net of accrued interest, is credited in the capital column of investment account.
In case the transaction is on 'Ex-interest' basis, entire sale proceeds is credited in the capital column and the amount of accrued interest from the date of last payment to the date of sale, separately received from the buyer will be taken to the credit side of the income column of investment account.
(*ii*) *Variable Income Bearing Securities*: In case of these securities, the entire amount of sale proceeds should be credited in the capital column of investment account, unless the amount of accrued dividend can be specifically established.

The entries in the books at the time of sale of investments will be just the reverse of the entries passed for their acquisition.

Valuation in case of Reclassification of Investment

- When Investments are classified from Current Investment to Permanent Investment, Permanent Investment is valued at Cost Price or Fair Value, whichever is less.
- When Investments are classified from Permanent Investment to Current Investment, Current Investment is valued at Cost Price or Carrying Amount, whichever is less.

PRE & POST INCORPORATION PROFIT

Item	*Basis of Apportionment between and Post incorporation period pre*
Gross Profit or Gross Loss	On the basis of turnover in the respective periods. Or On the basis of cost of goods sold in the respective periods in the absence of any information regarding turnover. Or On the basis of time in the respective periods in the absence of any information regarding turnover and cost of goods sold.
Variable expenses linked with Turnover [e.g. Carriage/Cartage outward, Selling and distribution expenses, Commission to selling agents/travelling agents, advertisement expenses, Bad debts (if actual bad debts for the two periods are not given), Brokerage, Sales Promotion.]	On the basis of Turnover in the pre and post incorporation.
Fixed Common charges [e.g. Salaries, Office and Administration Expenses, Rent, Rates and Taxes, Printing and Stationery, Telephone, Telegram and Postage, Depreciation, Miscellaneous Expenses]	On the basis of Time in the pre and post incorporation periods.
Expenses exclusively Incorporation period relating to [e.g. Interest pre-on Vendor's Capital]	Charge to pre-incorporation period but if the purchase consideration is not paid on taking over of business, interest for the subsequent period is charged to post incorporation period.
Expenses exclusively relating to post-incorporation period [e.g. Formation expenses, interest on debentures, director's fees, Directors' remuneration, Preliminary Expenses, Share issue Expenses, Underwriting commission, Discount on issue of securities.	Charge to Post-incorporation period

Audit Fees (i) For Company's Audit under the Companies Act. (ii) For Tax Audit under section 44AB of the Income tax Act, 1961	Charge to Post-incorporation period On the basis of turnover in the respective periods.
Interest on purchase consideration vendor: (i) For the period from the date acquisition of business to date incorporation. (ii) For the period from the date of Incorporation	Charge to Pre-incorporation period Charge to Post-incorporation period

Pre-incorporation profit is a capital profit and will be transferred to Capital Reserve.

"Intelligence without AMBITION is a bird without wings."

Accounting for Partnership: Basics Concepts

Provisions Affecting Accounting Treatment

In the absence of a written partnership deed or if the deed is silent on certain matters, following provisions for the Indian Partnership Act, 1932 will be applicable:

Particulars	**Treatment**
1. Profit Sharing	In the absence of partnership deed or if deed is silent on profit sharing, in such a case profits will be shared **equally** by the partners.
2. Interest on capital	No Interest on capital is allowed in absence of partnership deed.
3. Interest on Loan by Partner	If any partner, apart from his share of capital, advances some amount to the partnership firm as a loan, he is entitled to interest on such amount at the rate of **6% p.a**. Such interest will be paid to the partner whether there is profit or loss in the business. He is entitled for the full amount of interest on such loan.
4. Interest on Drawings	In the absence of partnership deed, no interest will be charged on the drawings made by the partners.
5. Salary / Remuneration to Partners	In the absence of partnership deed, no salary/remuneration will be paid to any partner whether his participation in the business is more than other partners.

Preparation of Profit & Loss Appropriation Account

In case of a partnership firm, all charge are shown in profit and loss account and all appropriations are shown in Profit and Loss Appropriation Account. The main purpose of preparing Profit and Loss Appropriation Account is to show the distribution of profits among partners as per the provision of Partnership Deed (or as per the provision of Indian Partnership Act, 1932 in the absence of Partnership Deed). It is an extension of Profit and Loss Account. It is a temporary account and by nature it is a nominal account.

The Journal Entries regarding Profit and Loss Appropriation Account are as follows:

1. When Profit or Loss from Profit and Loss Account is transferred to the P/L Appropriation A/c

(a) If Profit and Loss Account shows a credit balance (Net Profit)
Profit and Loss A/c Dr.

To Profit and Loss Appropriation A/c
(Being profit transferred to P & L Appropriation A/c)

(b) If Profit and Loss Account shows a debit balance (Net Loss)
Profit and Loss Appropriation A/c Dr.
To Profit and Loss A/c
(Being loss transferred to P & L Appropriation A/c)

2. For Interest on Capital

(a) For allowing Interest on capital
Interest on Capital A/c Dr.
To Partners' Capital/Current A/cs (individually)
(Being interest on capital allowed @ ___ % p.a)

(b) For transferring Interest on Capital to Profit and Loss Appropriation A/c :
Profit and Loss Appropriation A/c Dr.
To Interest on Capital A/c
(Being interest on capital transferred to P & L Appropriation A/c)

3. For Salary of Commission payable to a partner

(a) For allowing Salary or Commission to a partner :
Partner's Salary/Commission A/c Dr.
To Partner's Capital /Current A/cs (individually)
(Being salary/commission payable to a partner)

(b) For transferring Partner's Salary/Commission A/c to Profit and Loss Appropriation A/c :
Profit and Loss appropriation A/c Dr.
To Partner's Salary/ Commission A/c

4. For transfer of Reserves :
Profit and Loss Appropriation A/c Dr.
To Reserve A/c
(Being reserve created)

5. For Interest on Drawings :
(a) For charging interest on a partner's drawings :
Partner's Capital /Current A/c Dr.
To Interest on Drawings A/c
(Being interest on drawings charged @ ____%p.a.)

(b) For transferring Interest on drawings to Profit and Loss Appropriation A/c :
Interest on Drawings A/c Dr.
To Profit and Loss Appropriation A/c
(Being interest on drawings transferred to P & L Appropriation A/c)

6. For transfer of Profit or Loss (i.e. Balance of Profit and Loss Appropriation Account:
(a) If Profit
Profit and Loss Appropriation A/c Dr.
To Partners Capital A/cs
(Being profit distributed among partners)

(b) If Loss
Partners Capital A/cs Dr.
To Profit and Loss Appropriation A/c
(Being loss distributed among partners)

Proforma of Profit and Loss Appropriation Account

Particulars	Amount	Particulars	Amount
To, Profit & Loss A/c (Loss)	xxx	By Profit & Loss A/c (profit)	xxx
To Interest on Capital X xxx Y xxx	xxx	By interest on Drawings : X xxx Y xxx	xxx
To Partners Salary X xxx Y xxx	xxx	By Loss Distributed to X's Capital/Current A/c xxx Y's Capital/Current A/c xxx	xxx
To Partners Commission X xxx Y xxx	xxx		
To Transfer to Reserve	xxx		
To Profit Transferred to X's Capital/Current A/c xxx Y's Capital/Current A/c xxx	xxx		
	xxx		xxx

Preparation of Partners Capital Accounts

Partner's Capital Accounts : It is an account which represents the partner's interest in the business. In case of partnership business, a separate capital account is maintained for each partner. The capital accounts of partners may be maintained by following any of the following two methods:
(1) Fixed Capital Accounts: Under this method capitals of the partners remain fixed. Capital accounts of the partners will show always Credit balances. Under This method mainly two accounts are prepared i.e. Partners Capital Account and Partners Current Account. There are only two situations when fixed capitals of the partners may change :
Situation 1: When Additional Capital is introduced by the partners
Situation 2: When Some part of capital is withdrawn permanently by the partners
Only two items are shown in the credit side i.e. opening balance or capital introduced by the partners and additional capital (if any) introduced by the partners.
In the debit side withdrawn of capital (permanently) and closing balance is shown.

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

Particulars	A	B	Particulars	A	B
To Cash/bank (permanent withdrawn of capital)	xxx	xxx	By Balance b/d	xxx	xxx
To Balance c/d	xxx	xxx	By Cash/ Bank (fresh capital introduced)	xxx	xxx
	xxx	xxx		xxx	xxx

Dr. **Partners Current Account** **Cr.**

Particulars	A	B	Particulars	A	B
To Balance b/d (in case Debit Bal.)	xxx	xxx	By Balance b/d (Opening Credit Bal.)	xxx	xxx
To Drawing	xxx	xxx	By Interest on Capital	xxx	xxx
To Interest on Drawings	xxx	xxx	By Salary/Remuneration	xxx	xxx
To Profit & Loss Appropriation(Loss)	xxx	xxx	By Commission/Bonus	xxx	xxx
To balance c/d (credit closing Bal.)	xxx	xxx	By Profit & Loss Appropriation (Profit)	xxx	xxx
			By Balance c/d (if any)	xxx	xxx
	xxx	xxx		xxx	xxx

Note :
1. Debit balance of Current Account is shown in Assets side of Balance Sheet.
2. Credit balance of Current Account is shown in Liabilities side of Balance Sheet.
3. Balance of Capital Accounts are always shown in Liabilities side of Balance Sheet as this account will always show a credit balance when capital is fixed

(2) Fluctuating Capital Accounts: Under this method only one account i.e. Partners Capital Account is prepared for each partner. All the adjustments such as share of profit or loss, interest on capital, interest on drawings, drawings, salary or commission to partners etc. are recorded in the capital accounts of the partners. This makes the balance in the capital accounts to fluctuate from time to time. It may show Debit or Credit balance. In the absence of instruction the capital account should be prepared by this method.

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

Particulars	A	B	Particulars	A	B
To Cash/bank (withdrawn of capital)	xxx	xxx	By Balance b/d	xxx	xxx
To Drawings	xxx	xxx	By Cash/Bank (additional cap.)	xxx	xxx
To Int. on Drawings	xxx	xxx	By Interest on Capital	xxx	xxx
To P/L A/c (if loss)	xxx	xxx	By Salary/Remuneration	xxx	xxx
To balance c/d	xxx	xxx	By Commission/Bonus	xxx	xxx
			By Balance c/d (if any)	xxx	xxx
	xxx	xxx		xxx	xxx

INTEREST ON CAPITAL

Interest on partners' capital will be allowed only when it has been specifically mentioned in the partnership deed. Interest on Capital is generally provided for in two situations :

i. When the partners contribute unequal amounts of capitals but share profit equally.
ii. When the capital contribution is same but profit sharing is unequal.

Interest on Capital : An Appropriation of Profits:

When there is loss	Interest on Capital is not allowed because it is an appropriation and will be paid only when there is some profit
In Case of Sufficient Profits	Interest on Capital is allowed in full. All partners are entitled for the interest on capital at the agreed rate or rate of interest on capital already mentioned in the partnership deed.
In case of Insufficient Profits	Interest on Capital is allowed only to the extent of profits in the ratio of interest on capital of each partner. In this case partners do not get full amount of interest.

Journal Entries
a. In case of sufficient profits
Profit and Loss Appropriation A/c Dr.
To Interest on Capital A/c
(Being interest on capital transferred to P & L Appropriation A/c)
b. In case of Insufficient Profits or Losses
Profit and Loss / Profit and Loss Adjustment A/c Dr.
To Interest on Capital A/c
(Being interest on capital transferred to P&L Adjustment A/c)

Note : Interest on Capital is always calculated on the opening capital.

If Opening Capital is not given in the question, it should be ascertained as follows :

Calculation of Opening Capital	
Capital at the end (closing capital)	xxx
ADD : Drawings made during the year	xxx
ADD : Share of Loss During the year (if any)	xxx
Less : Additional Capital introduced (if any)	xxx
Less : Share of Profit during the year (if any)	xxx
Capital in the beginning	xxx

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

Interest = Amount introduced x Rate x 6/12 as money is utilized for 6 months

Interest on Drawings

Drawing means cash or goods withdrawn from the business by the proprietor for personal use. It reduces the capital of the proprietor. Interest on drawings will be charged from the partner's capital account, only if it is mentioned in the partnership deed. If partnership deed is silent, no interest on drawings will be charged. According to the business entity concept interest on drawings will be treated as income for the business and loss for the partners.

Distinction between drawings against profit and drawings against capital

	Drawings against profit	Drawings against capital
1.	This is the amount withdrawn from profits.	This is the amount withdrawn from capital.
2.	It is shown in the debit side of drawings account	It is shown on the debit side of capital account
3.	It is made out of profit, so does not affect the capital	It is made out of capital, it reduces the capital
4.	It is ignored at the time of calculation of interest on drawings	It is considered for the calculation of interest

<u>Methods for Calculation of interest on drawings</u>

1. When a fixed amount is withdrawn by the partners after regular intervals and rate of interest is given in the question with the word per annum
Step 1. Calculate average period :
Average period = (Time after first drawing + time after last drawing)/2
Step 2. Calculate interest on drawings :
Interest on drawings = Total drawings x Rate x Average period
2. When rate of interest is given without the word per annum
In such a case, Interest on Drawings is calculated with a flat rate irrespective of date of drawings.

3. When Different amounts are withdrawn at different time intervals
We have the following two methods to calculate the amount of Interest on Drawing :
a. Simple Interest Method : In this method, interest on drawing is calculated for each amount of drawing individually of the basis of periods for which
b. Product Method : In this method, the amounts of drawings are multiplied by the period for which it remained withdrawn during the period, Interest for 1 month is calculated on the sum of these products.

4. *<u>Half yearly Drawings</u>*:
(a) Drawings are made in the beginning of each half: Interest = Amount x Rate x 9/12
(b) Drawings are made in the middle of each half : Interest = Amount x Rate x 6/12
(c) Drawings are made at the end of each period half : Interest = Amount x Rate x 3/12

5. *<u>For monthly drawings</u>*
(a) Drawings are made in beginning of each month : Interest = Amount x Rate x 6.5/12
(b) Drawings are made in the middle of each month : Interest = Amount x Rate x 6/12

(c) Drawings are made in the end of each month : Interest = Amount x Rate x 5.5/12

6. *For Quarterly drawings*
(a) Drawings are made in beginning of each Quarter : Interest = Amount x Rate x 7.5/12
(b) Drawings are made in the middle of each Quarter : Interest = Amount x Rate x 6/12
(c) Drawings are made in the end of each Quarter : Interest = Amount x Rate x 4.5/12

When date of withdrawal is not specified
Sometimes date of withdrawal is not given in the question; amount withdrawn by the partners as drawings is given only. In such a case it is assumed that the amount is withdrawn at average basis or withdrawn evenly throughout the year and interest will be charged for the average period which will be assumed to be 6 months. It is assumed that amount is withdrawn in the middle of every month.
The following formula will be used.
Interest on Drawings = Total Drawings x Rate x 6/12

Important Points
1. When date of withdrawal is not given, it is mainly assumed to be in the middle of month.
2. When different amounts are withdrawn at different intervals, product method is used for the calculation of interest.
3. In the absence of partnership deed or if partnership deed is there but silent about interest, No interest will be charged on drawings.
4. Interest will be credited to P/L Appropriation Account and Debited to partners' capital/current Account.

Concept of Past Adjustment

Past Adjustments are concerned with the previous entries which were left out or omitted or wrongly entered in the accounts. If, after preparation of Final Accounts of firm, it is found that some errors or omission in accounts has occurred than such errors or omissions are rectified in the next year by passing an adjustment entry.
A statement is prepared to ascertain the net effect of such errors or omissions on partner's capital/current accounts in the following manner.

Adjustment Table

Particulars	A	B
Step 1. What Amount partners should get (Interest + Salary + Commission + Profits etc.)	xxx	xxx
Step 2. Less : Amount already received (wrong Profit)	xxx	xxx
	xxx	xxx

Now compare Step 1 and Step 2 and decide Partner is gainer or sacrificing.
After this make the following entry :

Gaining partner's A/c Dr.
To Sacrificing Partner's A/c

GUARANTEE OF PROFITS TO A PARTNER

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

Case : 1. When guarantee is given by FIRM (i.e., by all the Partners of the firm)
1. Guaranteed amount to a partner is written in Profit and Loss Appropriation A/c
2. Remaining profits are distributed among the remaining partners in their remaining ratio.

Case 2: When guarantee is given by a partner or partners to another partner
1. Calculate the share in profits for the partner to whom guarantee is given
2. If share in profits is more than the guaranteed amount, distribute the profits as per the profit and loss sharing ratio in usual manner.
3. If share in profits is less than the guaranteed amount, find the difference between the share in profits and the guaranteed amount and the difference is known as Deficiency. Deficiency is distributed among the partner or partners who guaranteed in a certain ratio and subtracted from his or their respective shares.

Methods for Valuation of Goodwill

Average Profit Method
This method is based on the assumption that a new business firm will not be able to earn high profits in the first few years of its operations. That is why goodwill is valued at an agreed number of years purchase of the average profits of the past few years. The profit earned by a Firm during previous accounting periods on an average basis is called average profit. Goodwill is calculated on the basis of average profit due to future expectations of earning capacity of the firm.

Steps of Calculating the Average Profits
Step 1. Calculate the adjusted Profits:
Sometimes profits for last few years are given with some adjustments.
To calculate the adjusted profits :
(+) Non Recurring Losses and Non Business Expenses.
(+) Recurring Incomes and Gains.
(-) Non Recurring incomes and Gains.
(-) Recurring expenses and losses.
Step 2. Calculate Average Profit :
Average Profits = Adjusted profits/No. of years

Step 3.Calculation of Goodwill Average Profit Method
After calculating the adjusted profit calculated goodwill by multiplying the adjusted profit with Agreed No. of Years Purchase.
Goodwill = Adjusted Average Profit x No. of Years Purchase

Weighted Average Profit Method :
When the profits are increasing at decreasing trend it is better to use the weighted average profit method. This method is modified version of average profit method. This method is better than the simple average method because it gives weightage to latest profit, which is likely to be maintained in the future by the firm. It is applicable when the profit shows a rising or falling trend. To calculate the goodwill by weighted average profit method, following steps should be taken:
Step 1. Multiply each years profits with the respective number of weights i.e., 1 ,2 , 3, 4, 5 etc., in order to find out the value of total products.
Step 2. Calculate weighted average profit : Total of Products of profits/total of weights
Step 3. Calculate the Goodwill: Weighted average profits x Agreed No. of years purchase

Super Profit Method
The Term super profit is described as excess profit of a business made over normal profit. In simple words, it is the difference (excess) between Average Annual Earning (actual) of the business and the expected or normal return on capital invested.
To calculate the goodwill under super profit method , first we calculate the actual average profit and than Normal Profit (which is calculated on the basis of capital employed) difference of average profit and normal profit is known as super profit.
If a firm earns higher profit in comparison to normal profit (generaly earned by other firms of same industry) then the difference is called Super Profit. Goodwil is calculated on the basis of Super profit due to future expectations of learning capacity of the firm.
Super profit = Average profit - Normal profit
Normal Profit = Investment (Capital Employed) x Normal Rate of Return/100

Distinction Between Average Profit Method and Super Profit Method

Basis	Average Profit Method	Super Profit Method
Meaning	This is the average of last few years profit divided by No. of years	This is the excess of average profit over normal profits
Calculation of Goodwill	Average Profit x No. of years Purchase	Super Profit x No. of years purchase

Capitalisation Method
In this method capitalized value of the firm is calculated on the basis of normal rate of return. Difference between the capitalized value and actual capital employed is called goodwill.
Capitalisation of Average Profit
Under this method, to find out the value of goodwill, deduct the actual capital employed (net assets) in the business from the capitalized value of the average profits on the basis of normal rate of return. This involves the following steps:
(i) First of all find out the average profit (on the basis of last few years profit)
(ii) Capitalize the average profits on the basis of the normal rate of return to ascertain the capitalised value of average profits as follows:
Average Profits × 100/Normal Rate of Return
(iii) Find out the actual capital employed (net assets) by deducting outside liabilities from the total assets (excluding goodwill).
Capital Employed = Total Assets (excluding goodwill) – Outside Liabilities
(iv) To find out the value of goodwill deduct net assets from the capitalised value of average profits, i.e. (iii) – (iv).

Capitalisation of Super Profit
Sometimes Goodwill can also be calculated by capitalising the super profit directly. Under this method there is no need to work out the capitalised value of average profits. It involves the following steps.
(i) Calculate capital employed of the firm, which is equal to total assets minus outside liabilities.
(ii) Calculate normal profits on capital employed.
(iii) Calculate average profit for past years, as specified.
(iv) Calculate super profits by deducting normal profits from average profits.
(v) Multiply the super profits by the required rate of return multiplier, that is,
Goodwill = Super Profits × 100/ Normal Rate of Return

Admission of a Partner

At the time of admission of a new partner, following adjustments are required:
1. Calculation of new profit sharing ratio and sacrificing ratio.
2. Accounting treatment of Goodwill.
3. Accounting treatment of accumulated profit.
4. Accounting treatment of revaluation of assets and reassessment of liabilities.
5. Adjustment of capital in new profit sharing ratio

'Section 31 of the Indian Partnership Act 1932' _____
Provides that a new partner can be admitted into a firm with the consent of all the partners. When a new partner is admitted, the existing partnership agreement comes to an end and a new agreement comes into effect. This is called reconstitution of partnership.

The Main Rights of a new partner:
1. Right to share in the future profits of the partnership firm.
2. Right to share the assets of the partnership firm.

Effects of admission of a Partner
1. Old partnership agreement comes to an end, and a new partnership agreement takes place.
2. He will share the future profits of the firm.
3. He will contribute capital and his share of premium for goodwill.
4. Goodwill of the firm is valued , assets are revalued, liabilities are Re-assessed and necessary adjustments are made.

Calculation of Ratios
Sacrificing Ratio **:** Ratio in which partners sacrifice their share of profit in favour of a new partner or incoming partner is called sacrificing ratio. It is the difference of old share and new share of the partners.

Sacrificing Ratio = Old Ratio - New Ratio

New Ratio = Old Ratio – Sacrificing ratio

Treatment of Goodwill

At the time of admission of a new partner goodwill is valued and Old goodwill (purchased goodwill) is written off by the old partners. Goodwill is the result of hard work and the efforts made by the existing partners. At the time of the admission of a new partner who will share the future profits of the firm, he must compensate the existing partners by making payment to them. This compensation is called premium for goodwill. From accounting point of view, there may be different situations related to treatment of goodwill which are given below:

1. When premium for goodwill is paid privately.
When premium for goodwill brought by a new partner is paid privately by new partner to the old partners without bringing that money into the business, In such a Case, no entry will be recorded in the books of Accounts.

2. When premium brought in cash and retained or withdrawn by Old Partners fully or partially.

Accounting Treatment :

For premium for Goodwill brought in cash by the new partner	Cash/Bank A/c Dr. To New Partners Capital A/c To Premium for Goodwill A/c
When Full premium is brought by New partner	Premium for Goodwill A/c Dr. To Sacrificing Partners Capital A/c
When only part of premium is brought by New partner	Premium for Goodwill A/c Dr. New Partners Capital A/c To Sacrificing Partners Capital A/c
For Withdrawal of premium fully or partially	Sacrificing Partner's Capital A/c To Cash / Bank A/c

3. When premium is brought in kind
A new partner instead of bringing in cash may bring his share of premium in the form of assets.
Following journal entries are recorded for the same:
Assets A/c Dr.
To Premium for Goodwill A/c
To New partner's Capital A/c
(Being capital and premium brought by the new partner)

Premium for Goodwill A/c Dr.
To Sacrificing partners capital / Current A/c
(Being premium transferred to sacrificing partners)

4. Goodwill already existing in books
At the time of admission of a new partner goodwill appearing in the balance sheet should be written off by the old partners in their old profit ratio.

Old Partners Capital A/c Dr.
To Goodwill A/c
(Being goodwill account written off)

5. Hidden Goodwill
When the value of Goodwill is not mentioned, it is assumed that goodwill is hidden or to be calculated. At the time of admission of a new partner the total goodwill of the firm is calculated to know the share of new partners. In such a case goodwill is calculated on the basis of an inferred method of profit sharing ratio or capitalization method.

Calculation of Hidden Goodwill

Step 1.	Calculate closing capital of old partner's. (Through Capital Accounts)
Step 2.	Calculate combined Capital : Combined Capital = Closing Capitals of old partners + Capital of new partner
Step 3.	Calculate Total Capital of the Firm : Total Capital = New partner's Capital x Reciprocal of his share For example if he brings Rs.20,000 as capital for 1/5th share in profits. Total capital of the firm will be : 20,000 x 5/1 = 1,00,000
Step 4.	Calculate Goodwill : Goodwill = Total Capital of the firm – Combined Capital

Note : This method is known as inferred method of Goodwill.

Revaluation of Assets and Re-assessment of liabilities

When a new partner is admitted to the partnership firm, he brings capital and his share of premium for goodwill. He acquires the ownership rights of the assets and also makes himself responsible for the firms liabilities. He can access freely all records and books of accounts, to know that assets and liabilities are correctly valued or revalued. At this time there may be increase or decrease in the value of assets and liabilities. Such increase or decrease are treated as partnership profits or losses and should be distributed among the old partners in old ratio.
For recording this, a separate account is opened, which is known as Profit and Loss Adjustment Account or Revaluation Account.
Following journal entries are recorded on Revaluation of assets and Re-assessment of liabilities.

For increase in the value of Assets	Asset A/c Dr. To Revaluation A/c
For Decrease in the value of Asset	Revaluation A/c Dr. To Asset A/c
For increase in the value of liabilities	Revaluation A/c Dr. To Liability A/c
For Decrease in the value of liabilities	Liability A/c Dr. To Revaluation A/c

When unrecorded assets are recorded	Asset A/c Dr. To Revaluation A/c
When unrecorded liabilities are recorded	Revaluation A/c Dr. To Liability A/c
When profit on revaluation transferred to old partners	Revaluation A/c Dr. To Old partners Capital A/c's
When loss on revaluation transferred to old partners	Old partner's Capital A/c's To Revaluation A/c

Proforma of Revaluation Account:

Particulars	Amount	Particulars	Amount
To Asset A/c	xxx	By Asset A/c	xxx
To Liabilities A/c	xxx	By Liabilities A/c	xxx
To Unrecorded liabilities A/c	xxx	By Unrecorded Asset A/c	xxx
To profit on revaluation transferred to old partners in old ratio.	xxx	By Loss on revaluation transferred to old partners in old ratio.	xxx
	xxx		xxx

Treatment of Reserve and Accumulated profits

At the time of admission of a new partner, A firm may have Reserves and accumulated profits or losses. All free Reserves and profits given in the liabilities side should be credited to partners capital accounts or Current Accounts (if capitals are fixed) and all fictitious Assets/Accumulated losses should be debited to the partners capital account or current Account (if capitals are fixed). A new partner is not entitled to any share in such accumulated balances of the firm while transferring these reserves and profits/ losses to the partners capital accounts, student must remember that these Reserves and profits/losses are only for old partners and should be transferred to them only, in old ratio.
Following journal entries are recorded in the books of accounts:

General Reserve A/c Dr.
Profit and Loss A/c Dr.
Workmen's Compensation Reserve A/c Dr.
To Old Partners Capital A/c's
(Being Reserves and Accumulated profits credited to old partners in their old Ratio)

Old Partner's Capital A/c's Dr.
To Preliminary Expense A/c
To Advertisement Suspense A/c
To Profit and Loss A/c
To Goodwill A/c
(Being Accumulated losses and fictitious assets debited to old partners in their old ratio)

Note : Do not distribute1) E.P.F or employee provident fund 2) Taxation reserve3) Machinery replacement fund

Adjustment of Capital

It is obvious to adjust the capitals at the time of admission of a new partner. When a new partner is admitted, the partners decide to adjust their capitals according to the new profit sharing ratio. Partners can adjust their capitals according to capital of the new partner, but sometimes a new partner may required to bring capital according to his share in profits of the firm. When the capital of new partner is given, total capital of the firm can be calculated easily.
For example if new partner brings Rs.50,000 as capital for 1/5 share in the profits, than total capital of the firm can be found as 50,000 x 5/1 = 2,50,000 (Total capital of firm)
After calculating total capital of the firm , Capital of the other partners can also be calculated on the basis of total capital. For example if ratio between three partners is 2 : 2 : 1
A's Capital = 2,50,000 x 2/5 = 1,00,000
B's Capital = 2,50,000 x 2/5 = 1,00,000
C's Capital = 50,000
After calculating these capitals, show these capitals as balance c/d in the partners capital A/c. And now see the difference coming on the debit side or credit side. If difference on debit side it means it is excess and should be withdrawn by the partner if difference on credit side it means partner will bring more capital (Adjust Difference through Cash A/c).
But sometime excess or deficiency is adjusted through current Accounts. There are different cases for the adjustment of capital.
1. When new partner's Capital is given and old partners adjust their capitals according to new partner's capital. Excess and deficiency will be adjusted though cash A/c.
2. When new partner's Capital is given and old partners adjust their capitals according to new partner's capital. Excess and deficiency will be adjusted though current A/c.
3. When new partner's Capital is not given.
4. When new partner's capital is not given and old partners also adjusting their capitals.
5. When Total capital of the firm is given in the adjustment.

Note :
To find out the total capital of the firm use following formula:
New partner's capital x Reciprocal of new partners share

Retirement/Death of a Partner

Amount payable to a Retiring partner
(To be credited to his capital account)
1. Credit Balance of his capital.
2. Credit Balance of his current account (if any)
3. Share of Goodwill.
4. Share of Reserves or Undistributed profits.
5. His share in the profit revaluation of assets and liabilities.
6. Share in profits up to the date of Retirement/Death.
7. Interest on capital if involved.
8. Salary if any

Deduction from the above sum(to be debited to the capital account)
1. Debit balance of his current account (if any)

2. Share of Goodwill to be writ en off.
3. Share of Accumulated loss.
4. Drawings and interest on drawings (if any)
5. Share of loss on account of Revaluation of assets and liabilities.
6. His share of business loss.

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

Death of a Partner

Amounts to be Credited in the Decease partners capital Account :
i) Balance of Capital
ii) Share in Revaluation Profit
iii) Interest on Capital
iv) Accumulated profits/ Reserves etc.
v) P/L Suspense A/c (Profit)
vi) Commission/ Salary etc.
vii) Any Liability taken over
Amounts to be Debited in the Decease partners capital Account :
i) Accumulated losses
ii) Goodwill A/c
iii) Interest on Drawings
iv) Drawings
v) Any Asset taken over
vi) Revaluation loss (if any)
vii) P/L Suspense A/c (Loss)

Profit till death of partner is calculated by any one of the two methods given below:-
a) On Time Basis: - in this method proportionaly profit for the time period is calculated either on the basis of last year's profit or on the basis of average profits of last few years and then deceased partner's share is calculated based on his share of profits.
b) On Turnover or Sales Basis- In this method the profits upto the date of death for the current year are calculated on the basis of current year's sales upto the date of death by using the formula. Profits for the current year upto the date of death = (Sales of the current year upto the date of death/total sales of last year) x Profit for the last year.

Then from this profit the deceased partner's share of profit is calculated.

Journal Entry for the Profit of deceased partner will be :
Profit and Loss Suspense A/c Dr.
To Deceased Partner's Capital/current A/c
(Being amount of profit transferred in deceased partners capital/current account)

Joint Life Policy

A partnership firm may decide to take a Joint Life Insurance Policy on the lives of all partners. The firm pays the premium and the amount of policy is payable to the firm on the death of any partner or on the maturity of policy whichever is earlier. The objective of taking such a policy is to minimise the financial hardships to the event of payment of a large sum to the legal representatives of a deceased partner or to the retiring partner.
The accounting treatment for the premium paid and the Joint Life Policy may be in any of the following ways:
1. When premium paid is treated as an expense: When premium is treated as an expense then it is closed every year by transferring to profit and loss account. In this case complete amount received from the insurance company either on a surrender of policy or on the death of the partner becomes a gain.
Accounting entries are:

(a) On payment of premium
Joint Life Policy Insurance Premium A/c Dr.
To Bank A/c
(b) On charging to Profit and Loss Account
Profit and Loss Account Dr.
To Joint Life Policy Insurance Premium A/c
(c) On maturity of the Policy
Insurance Company/ Bank Account Dr.
To Partners' Capital A/cs (individually)
(Including the account of the representative of a deceased partner)

2. When premium paid is treated as an asset: In this case insurance premium paid is first debited to life policy account and credited to bank account. At the end of the year the amount in excess of surrender value is treated as a loss and is transferred to Profit and Loss Account. In this case the amount received from the insurance company in excess of the surrender value results in a gain at the time of receipt of such amount which is transferred to Capital Accounts of the partners in the profit sharing ratio.
3. Creation of Joint Policy Reserve Account: Under this method, premium paid is debited to policy account and credited to bank account. At the end of the year, amount equal to premium is transferred from Profit and Loss Appropriation Account to Policy Reserve Account. After this, policy account is brought down to its surrender value by debiting the life policy reserve account with amount which exceeds the surrender value of the policy. Thus, in this method, policy account appears on the assets side and policy reserve account appears on the liabilities side of the Balance Sheet until it is realised. Both these accounts appear in the Balance Sheet at the surrender value of the policy. This method is different from the method discussed in (2) above only in respect of reserve account.
On the death of a partner Joint Life Policy Reserve Account is transferred to Joint Life Policy Account and then the balance is transferred to Partners' Capital Accounts.

Right of Outgoing Partner in Certain Cases to Share Subsequent

Profits As per provisions of Section 37 of the Indian Partnership Act., "Where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary, the outgoing partner or his estate is entitled at the option of himself or his representatives to such share of the profits made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm or to interest at the rate of six per cent per annum on the amount of his share in the property of the firm.

Provided that whereby contract between the partners an option is given to surviving or continuing partners to purchase the interest of a deceased or outgoing partner, and that option is duly exercised, the estate of the deceased partner, or the outgoing partner or his estate, as the case may be, is not entitled to any further or other share of profits; but if any partner assuming to act in exercise of the option does not in all material respects comply with the terms thereof, he is liable to account under the foregoing provisions of this section.

This way, the outgoing partner has the option to receive,

interest at the rate of 6% p.a.

or

the share of profit earned on the unsettled amounts for the period till his dues are settled by the firm in the absence of any contract made to the contrary.

"You can never be overdressed or overeducated."

INSURANCE CLAIM

Claim for Loss of Stock

Fire insurance being a contract of indemnity, a claim can be lodged only for the actual amount of the loss, not exceeding the insured value. In dealing with problems requiring determination of the claim the following point must be noted:

a. Total Loss: If the goods are totally destroyed, the amount of claim is equal to the actual loss, provided the goods are fully insured. However, in case of under insurance(i.e. insurable value of stock insured is more than the sum insured),the amount of claim is restricted to the policy amount.

b. Partial Loss: If the goods are partially destroyed, the amount of claim is equal to the actual loss provided the goods are fully insured. However in case of under insurance, the amount of claim will depend upon the nature of insurance policy as follows:

I) Without Average clause:- Claim is equal to the lower of actual loss or the sum insured.

II) With Average Clause:- Amount of claim for loss of stock is proportionately reduced, considering the ratio of policy amount (i.e. insured amount) to the value of stock as on the date of fire (i.e insurable amount) as shown below:

Amount of claim = Loss of stock x sum insured / Insurable amount (Total Cost)

• **Relevant points**

(i) Where stock records are maintained value of the stock as at the date of the fire can be easily arrived at.

(ii) Where either stock records are not available the value of stock at the date of the fire has to be estimated. The usual method of arriving at this value is to build up a Trading Account as from the date of last accounting year. After allowing for the usual gross profit, the figure of closing stock on the date of the fire can be ascertained as the balancing item.

(iii) Where the books of accounts are destroyed , the task of building up the trading account becomes difficult. In that case information is obtained from the customers and suppliers have to be circularized to ascertain the amount of sales and purchases.

(iv) After the insurance company makes payment for total loss, it has the same rights which the insured had over the damaged stock. These are subrogated to the insurance company. In practice, in determining the amount of the claim, credit is given for damaged and salvaged stock.

(v) Frequently salvaged stock can be made saleable after it is reconditioned. In that case, the cost of such stock must be credited to the Trading Account and debited to a salvaged stock account. The expenses on reconditioning must be debited and the sales credited to this account, the final balance being transferred to the Profit & Loss Account.

Loss of Stock

Amount of loss of stock is calculated as under:

Value of stock on the date of fire	XXXX
Less:- Value of Salvaged stock	XXXX
Amount of loss of stock	XXXX

Claim for Loss of Profit

The Loss of Profit Policy normally covers the following items:

(1) Loss of net profit

(2) Standing charges.
(3) Any increased cost of working

- *Gross Profit:* Net profit +Insured Standing charges *OR* Insured Standing charges – Net Trading Loss (If any) X Insured Standing charges/All standing charges of business
- *Net Profit:* The net trading profit (exclusive of all capital) receipts and accretion and all outlay properly (chargeable to capital) resulting from the business of the Insured at the premises after due provision has been made for all standing and other charges including depreciation.
- *Insured Standing Charges:* Interest on Debentures, Mortgage Loans and Bank Overdrafts, Rent, Rates and Taxes (other than taxes which form part of net profit) Salaries of Permanent Staff and Wages to Skilled Employees, Boarding and Lodging of resident Directors and/or Manager, Directors' Fees, Unspecified Standing Charges [not exceeding 5% (five per cent) of the amount recoverable in respect of Specified Standing Charges].
- *Rate of Gross Profit*: The rate of Gross Profit earned on turnover during the financial year immediately before the date of damage.
- *Annual Turnover:* The turnover during the twelve months immediately before the damage
    - *Standard Turnover:* The turnover during that period in the twelve months immediately before the date of damage which corresponds with the Indemnity Period
    - *Indemnity Period*: The period beginning with the occurrence of the damage and ending not later than twelve months
- The insurance for Loss of Profit is limited to loss of gross profit due to
  (*i*) reduction in turnover, and
  (*ii*) increase in the cost of working.
- *Amount of Indemnity Payable*: Gross Profit Lost + Claim for increased cost of working Capital – Saving in Insured standing Charges.

"Minds are like parachutes – they only function when open"- Thomas Dewar

Cash Flow Statement

- Cash comprises cash on hand and demand deposits with banks
- Cash equivalents are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.
- Cash flows are inflows and outflows of cash and cash equivalents.
- Operating activities are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.
- Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
- Financing activities are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise.

- Cash and Cash Equivalents

1. Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent, it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value.
2. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Investments in shares are excluded from cash equivalents unless they are, in substance, cash equivalents; for example, preference shares of a company acquired shortly before their specified redemption date (provided there is only an insignificant risk of failure of the company to repay the amount at maturity).
3. Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an enterprise rather than part of its operating, investing and financing activities. Cash management includes the investment of excess cash in cash equivalents.

- Reporting Cash Flows from Investing and Financing Activities

An enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs 22 and 24 are reported on a net basis.

- Reporting Cash Flows on a Net Basis

  Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:
  (a) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the enterprise; and
  (b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.

Examples of cash receipts and payments referred to in paragraph 22(a) are:
(a) the acceptance and repayment of demand deposits by a bank;
(b) funds held for customers by an investment enterprise; and
(c) rents collected on behalf of, and paid over to, the owners of properties.

Examples of cash receipts and payments referred to in paragraph 22(b) are advances made for, and the repayments of:
(a) principal amounts relating to credit card customers;
(b) the purchase and sale of investments; and
(c) other short-term borrowings, for example, those which have a maturity period of three months or less.

Cash flows arising from each of the following activities of a financial enterprise may be reported on a net basis:
(a) cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;
(b) the placement of deposits with and withdrawal of deposits from other financial enterprises; and
(c) cash advances and loans made to customers and the repayment of those advances and loans.

Foreign Currency Cash Flows

1. Cash flows arising from transactions in a foreign currency should be recorded in an enterprise's reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the cash flow. A rate that approximates the actual rate may be used if the result is substantially the same as would arise if the rates at the dates of the cash flows were used. The effect of changes in exchange rates on cash and cash equivalents held in a foreign currency should be reported as a separate part of the reconciliation of the changes in cash and cash equivalents during the period.
2. Cash flows denominated in foreign currency are reported in a manner consistent with Accounting Standard (AS) 11, The Effects of Changes in Foreign Exchange Rates. This permits the use of an exchange rate that approximates the actual rate. For example, a weighted average exchange rate for a period may be used for recording foreign currency transactions.
3. Unrealised gains and losses arising from changes in foreign exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at the end-of-period exchange rates.

- **Extraordinary Items**

1. The cash flows associated with extraordinary items should be classified as arising from operating, investing or financing activities as appropriate and separately disclosed.
2. The cash flows associated with extraordinary items are disclosed separately as arising from operating, investing or financing activities in the cash flow statement, to enable users to understand their nature and effect on the present and future cash flows of the enterprise. These disclosures are in addition to the separate disclosures of the nature and amount of extraordinary items required by Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

- **Investments in Subsidiaries, Associates and Joint Ventures**

When accounting for an investment in an associate or a subsidiary or a joint venture, an investor restricts its reporting in the cash flow statement to the cash flows between itself and the investee/joint venture, for example, cash flows relating to dividends and advances.

- **Acquisitions and Disposals of Subsidiaries and Other Business Units**

1. The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units should be presented separately and classified as investing activities.
2. An enterprise should disclose, in aggregate, in respect of both acquisition and disposal of subsidiaries or other business units during the period each of the following:
   (a) the total purchase or disposal consideration; and
   (b) the portion of the purchase or disposal consideration discharged by means of cash and cash equivalents.

3. The separate presentation of the cash flow effects of acquisitions and disposals of subsidiaries and other business units as single line items helps to distinguish those cash flows from other cash flows. The cash flow effects of disposals are not deducted from those of acquisitions.

- **Components of Cash and Cash Equivalents**

1. An enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.
2. In view of the variety of cash management practices, an enterprise discloses the policy which it adopts in determining the composition of cash and cash equivalents.
3. The effect of any change in the policy for determining components of cash and cash equivalents is reported in accordance with Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

- **Other Disclosures**

  An enterprise should disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by it.

  There are various circumstances in which cash and cash equivalent balances held by an enterprise are not available for use by it. Examples include cash and cash equivalent balances held by a branch of the enterprise that operates in a country where exchange controls or other legal restrictions apply as a result of which the balances are not available for use by the enterprise.

  Additional information may be relevant to users in understanding the financial position and liquidity of an enterprise. Disclosure of this information, together with a commentary by management, is encouraged and may include:
  (a) the amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities; and
  (b) the aggregate amount of cash flows that represent increases in operating capacity separately from those cash flows that are required to maintain operating capacity.

The separate disclosure of cash flows that represent increases in operating capacity and cash flows that are required to maintain operating capacity is useful in enabling the user to determine whether the enterprise is investing adequately in the maintenance of its operating capacity. An enterprise that does not invest adequately in the maintenance of its operating capacity may be prejudicing future profitability for the sake of current liquidity and distributions to owners.