ACCOUNTANCY

HIGHER SECONDARY – SECOND YEAR

VOLUME II

Untouchability is a sin
Untouchability is a crime
Untouchability is inhuman

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PREFACE

The book on Accountancy has been written strictly in accordance with the new syllabus framed by the Directorate of School Education, Government of Tamil Nadu.

As curriculum renewal is a continuous process, Accountancy Curriculum has been improved from time to time in accordance with the changing needs of the society. The present effort of reframing and updating the curriculum in Accountancy at the Higher Secondary level is an exercise based on the feed back.

The text book for Higher Secondary - First year deals with the basic framework of accounting in all its aspects. The next logical step is to utilise this subject matter for the maintenance of records of business enterprises of which Partnership firms and Companies are by far the most important.

The significance of Partnership and Companies in the sphere of business as also in the field of accounting can in no way be over-stressed, specially when the latter has become the primary vehicle of economic and industrial growth. Therefore, all the facets of Partnership and Company accounts, according to the syllabus of the second year , has been presented in four chapters , Volume II of the present book.

Each chapter starts with a simple and lucid discussion of the topic followed by properly arranged worked out illustrations and ends with theoretical questions and practical exercises.

Students are strongly advised to go through the "Reference Books" as **Questions for examinations need not be restricted to the exercises alone.**

R.Amutha
Chairperson

CONTENTS

VOLUME - II

Books for further reference:

1. Monilal Das – *Principles of Accounts for ISC - XII. Vol. II.*
2. Dr.R.K.Sharma, Dr.R.S.Popli - *Self Tutor, Accountancy.*
3. T.S.Grewal – *Double Entry Book Keeping*
4. S.Kr.Paul – Accountancy Vol. II.
5. A.K. Majumdar, R.G.Saxena – National Council of Educational Research and Training – *Accountancy - Text Book for Class XII*
6. G.C.Maheshwari, S.C.Jain, S.S.Sehrawat – National Council of Educational Research and Training – *Accountancy - Text Book for Class XII*
7. R.L.Gupta, Radha Swamy – *Advance Accountancy, Vol. II.*
8. Tamil Nadu Textbook Corporation – *Accountancy Higher Secondary Second Year*.
9. M.C.Shukla – *Advanced Accountancy*.
10. N.Vinayakam, V.Charumati – *Fnancial Accounting*.
11. Jain and Narang – *Advanced Accountancy*.
12. Dr.S.N.Maheswari – *Advanced Accountancy*.
13. R.L. Gupta, V.K.Gupta – *Financial Accounting*.
14. P.C.Tulsian – *Financial Accounts*.
15. A.K. Chattopadhyay & A.Mukhopadhyay – *Practical Guide to Accountancy*.
16. R.S.N. Pillay & Bagavathi – *Advance Accountancy*.
17. B.D. Agarwal – *Financial Accounting Advance - Vol. I.*

Chapter - 6

PARTNERSHIP ACCOUNTS - BASIC CONCEPTS

Learning Objectives

After studying this Chapter, you will be able to:

- *understand the meaning and the features of partnership.*
- *prepare the capital accounts of partners under fixed and fluctuating capital methods.*
- *understand the distribution of profits among the partners.*
- *prepare the Profit and Loss appropriation account.*
- *know the meaning, nature and methods of valuation of goodwill.*

A business may be organised in the form of a sole proprietorship, a partnership firm or a company. The sole proprietorship has its limitations such as limited capital, limited managerial ability and limited risk - bearing capacity. Hence, when a business expands, it needs more capital and involves more risk. Then two or more persons join hands to run it. They agree to share the capital, the management, the risk and the Profit or Loss of the business. Such mutual relationship based on agreement among these persons is termed as "**Partnership**". The persons who have entered into partnership are individually known as '**Partners**' and collectively as '**Firm**'.

6.1 Definition:

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

6.1.1 Features:

Based on the above definition, the essential features of partnership are as follows.

1. **An association of two or more persons:** To form a partnership, there must be atleast two persons. Regarding the maximum number of persons, it is limited to 10 in banking business and 20 in other business.
2. **Agreement between the Partners:** The relationship among the partners is established by an agreement. Such agreement forms the basis of their mutual relationship.
3. **Profit sharing:** The agreement between the partners must be to share the profits or losses of the business.
4. **Lawful business:** The agreement should be for carrying on some legal business to make profit.
5. **Business carried on by all or any of them acting for all:** Partnership business must be carried on by all or any of them acting for all. Mutual and implied agency is the essence of partnership.

6.1.2 Accounting rules applicable in the absence of Partnership deed:

Normally, a partnership deed covers all matters relating to mutual relationship among the partners. But, in the absence of agreement, the

following provisions of the Indian Partnership Act, 1932 shall apply for accounting purposes.

1. **Interest on Capital :** No interest is allowed on Capitals of the Partners. If as per the partnership deed, interest is allowed, it will be paid only when there is profit. If loss, no interest will be paid.
2. **Interest on Drawings :** No interest will be charged on drawings made by the partners.
3. **Salary/ Commission to partner :** No partner is entitled to salary/ commission from the firm, unless the partnership deed provides for it.
4. **Interest on loan :** If any partner, apart from his share capital, advances money to the firm as loan, he is entitled to interest on such amount at the rate of six percent per annum.
5. **Profit sharing ratio :** The partners shall share the profits of the firm equally irrespective of their capital contribution.

6.2 Partners' Capital Accounts:

In partnership firm, the transactions relating to partners are recorded in their respective capital accounts. Normally, each partners capital account is prepared separately. There are two methods by which the capital accounts of partners can be maintained. These are

- Fluctuating Capital method
- Fixed Capital method.

6.2.1 Fluctuating Capital method:

Under the fluctuating capital method, only one account, viz., the capital account for each partner, is maintained. It records all adjustments relating to drawings, interest on capital, interest on drawings, salary and share of profit or loss in the capital account itself. As a result, the balance in the capital accounts keep on fluctuating. In the absence of any instruction, the capital accounts of the partners should be prepared under this method.

Format: *(Fluctuating Capital Method)*

Capital Accounts

Dr. Cr.

Particulars	X Rs.	Y Rs.	Z Rs.	Particulars	X Rs.	Y Rs.	Z Rs.
To Drawings To Interest on drawings To Balance c/d				By Balance b/d By Interest on capital By Commission By Salary By Share of Profit			
				By Balance b/d			

6.2.2 Fixed Capital Method:

Under this method, two accounts are maintained for each partner viz., (i) Capital account and (ii) Current account. The capital account will continue to show the same balance from year to year unless some amount of capital is introduced or withdrawn. In the current account, the transactions relating to drawings, interest on capital, interest on drawings, salary, share of profit or loss etc., are recorded. Hence, the balance in the current accounts change every year.

Format : *(Fixed Capital Method)*

Capital Accounts

Dr. Cr.

Particulars	X Rs.	Y Rs.	Z Rs.	Particulars	X Rs.	Y Rs.	Z Rs.
To Balance c/d				By Balance b/d			
				By Balance b/d			

Current Accounts

Dr. Cr.

Particulars	X Rs.	Y Rs.	Z Rs.	Particulars	X Rs.	Y Rs.	Z Rs.
To Drawings To Interest on drawings To Balance c/d*				By Balance b/d* By Interest on capital By Commission By Salary By Share of Profit			
				By Balance b/d*			

* The balance may be on the opposite side also.

6.2.3 Distinction between Fixed Capital Method and Fluctuating Capital Method

The main differences between the two methods of maintaining capital accounts are as follows:-

Basis of distinction	Fixed Capital Method	Fluctuating Capital Method
1. Change in capital	The capital normally remains unchanged except under special circumstances.	The capital is changing from period to period.
2. Number of Accounts	Each partner has two accounts, namely, Captial Account and Current Account.	Each partner has only one account i.e., Capital Account.
3. Balance	Capital Account shows always a credit balance. Current account may sometimes show debit or credit balance.	Capital Account shows always a credit balance.
4. Adjust-ments	All adjustments relating to partners are recorded in the Current Accounts.	All adjustments relating to partners are recorded directly in the Capital Accounts itself.

6.2.4 Preparation of Capital Accounts:

Illustration : 1

Show how the following items will appear in the capital accounts of the partners, Anbu and Balu.

When their capitals are a) fixed and b) fluctuating.

	Anbu Rs.	Balu Rs.
Capital on 1.4.2004	90,000	70,000
Drawings during 2004 - 2005	12,000	9,000
Interest on drawings	360	270
Interest on capital	5,400	4,200
Partner's salary	12,000	---
Commission	---	6,000
Share of profit for 2004-05	6,000	4,000

Solution:

a) When capital accounts are fixed:

Capital Accounts

Dr. Cr.

Date	Particulars	Anbu Rs.	Balu Rs.	Date	Particulars	Anbu Rs.	Balu Rs.
2005 Mar 31	To Balance c/d	90,000	70,000	2004 Apr 1	By Balance b/d	90,000	70,000
		90,000	70,000			90,000	70,000
				2005 Apr 1	By Balance b/d	90,000	70,000

Dr **Current Accounts** Cr

Date	Particulars	Anbu Rs.	Balu Rs.	Date	Particulars	Anbu Rs.	Balu Rs.
2005 Mar 31	To Drawings	12,000	9,000	2005 Mar 31	By Interest on capital	5,400	4,200
,,	To Interest on drawings	360	270	,,	By Partners' salary	12,000	---
,,	To Balance c/d	11,040	4,930	,,	By Commission	---	6,000
				,,	By Profit & Loss A/c	6,000	4,000
		23,400	14,200			23,400	14,200
				2005 Apr 1	By Balance b/d	11,040	4,930

b) When capital accounts are fluctuating:

Dr **Capital Accounts** Cr

Date	Particulars	Anbu Rs.	Balu Rs.	Date	Particulars	Anbu Rs.	Balu Rs.
2005 Mar 31	To Drawings	12,000	9,000	2004 Apr 1	By Balance b/d	90,000	70,000
,,	To Interest on drawings	360	270	2005 Mar 31	By Interest on capital	5,400	4,200
,,	To Balance c/d	1,01,040	74,930	,,	By Salary	12,000	---
				,,	By Commission	---	6,000
				,,	By Profit & Loss A/c	6,000	4,000
		1,13,400	84,200			1,13,400	84,200
				2005 Apr 1	By Balance b/d	1,01,040	74,930

Illustration : 2

Write up the capital and current accounts of the partners, Kala and Mala from the following and show how these will appear in the Balance Sheet.

	Kala Rs.	Mala Rs.
Capital on 1.4.2004	1,50,000	1,00,000
Current accounts on 1.4.2004 (Cr.)	20,000	15,000
Drawings during 2004 – 2005	30,000	40,000
Interest on drawings	900	1,000
Share of profit for 2004 – 2005	10,000	8,000
Interest on capital	6%	6%

Solution:

Dr **Capital Accounts** Cr

Date	Particulars	Kala Rs.	Mala Rs.	Date	Particulars	Kala Rs.	Mala Rs.
2005 Mar 31	To Balance b/d	1,50,000	1,00,000	2004 Apr 1	By Balance b/d	1,50,000	1,00,000
		1,50,000	1,00,000			1,50,000	1,00,000
				2005 Apr 1	By Balance b/d	1,50,000	1,00,000

Dr **Current Accounts** Cr

Date	Particulars	Kala Rs.	Mala Rs.	Date	Particulars	Kala Rs.	Mala Rs.
2005 Mar 31	To Drawings	30,000	40,000	2004 Apr 1	By Balance b/d	20,000	15,000
,,	To Interest on drawings	900	1,000	2005 Mar 31	By Interest on capital	9,000	6,000
,,	To Balance c/d	8,100		,,	By Profit & Loss A/c	10,000	8,000
				,,	By Balance c/d		12,000
		39,000	41,000			39,000	41,000
2005 Apr 1	To Balance b/d		12,000	2005 Apr 1	By Balance b/d	8,100	

Balance Sheet of Kala and Mala as on 31.12.2004

Liabilities		Rs.	Assets	Rs.
Capital Accounts:			Current Account:	
Kala	1,50,000		Mala	12,000
Mala	1,00,000	2,50,000		
Current Account:				
Kala		8,100		

6.3 Distribution of Profits

In a sole trading concern, the net profit disclosed by the Profit and Loss Account belongs to the sole trader and is transferred to his capital account. However, in a partnership firm, the net profit as shown by the Profit and Loss Account need certain adjustments with regard to interest on capitals, interest on drawings, salary and commission to the partners. For this purpose, Profit and Loss Appropriation Account may be prepared. This is merely an extension of the Profit and Loss Account and is prepared to show how net profit has been distributed among the partners.

This account is credited with net profit and interest on drawings and debited with interest on capitals, salary or commission to partners. Net loss will be shown on the debit side. After these adjustments have been made, this account will show the amount of profit or loss which shall be distributed among the partners in the agreed profit sharing ratio.

The various adjustments made in the Profit and Loss Appropriation account are explained below:

6.3.1 Interest on capital:

Interest on capital is allowed to partners only, if the partnership deed specifically allows it. Interest is usually calculated on the opening capital and on the capital introduced during the year. If the date of additional capital introduced during the year is not given, the interest is to be calculated for six months.

Journal Entries:

(a) *To adjust interest on capital*

Interest on capital A/c	Dr.
To Partners' Capital A/c	
(In case of fluctuating capital)	
or	
To Partners' Current A/c	
(In case of fixed capital)	

(b) *To close the interest on capital account*

Profit & Loss Appropriation A/c	Dr.
To Interest on capital A/c	

Illustration : 3

Ravi and Raghu started business on April 1, 2003 with capitals of Rs.90,000 and Rs.70,000 respectively. Ravi introduced Rs.10,000 as additional capital on July 1, 2003. Interest on capital is to be allowed @ 10%. Calculate the interest payable to Ravi and Raghu for the year ending March 31,2004.

Solution:

a) Interest on Ravi's capital:

$$= \left[90,000 \times \frac{10}{100}\right] + \left[10,000 \times \frac{10}{100} \times \frac{9}{12}\right]$$

$$= \text{Rs. } 9,000 + \text{ Rs. } 750$$

$$= \text{Rs. } 9,750.$$

That is

Interest on Rs.90,000 for one year	=	Rs. 9,000
Interest on Rs.10,000 for nine months	=	Rs. 750
Total Interest payable to Ravi	=	Rs. 9,750

b) Interest on Raghu's capital $= 70,000 \times \frac{10}{100}$

That is

Interest on Rs. 70,000 for one year	=	Rs. 7,000
Interest payable to Raghu	=	Rs. 7,000

6.3.2 Interest on Drawings:

Drawings is the amount withdrawn in cash or in kind, for personal purposes. A Drawings Account is opened in the name of each partner and the drawings are debited to this account. At the end of every year, the Drawings Account is closed by a transfer to the respective partner's capital account or current account.

Interest on partners' drawings is charged only, if the Partnership Deed specifically allows it at a particular rate.

Journal Entries:

(a) *To charge interest on drawings*

Partners' Capital A/c *(In case of fluctuating capital)*	Dr.
or	
Partners' Current A/c *(In case of fixed capital)*	Dr.
To Interest on drawings A/c	

(b) *To close the interest on drawings account*

Interest on drawings A/c	Dr.
To Profit & Loss Appropriation A/c	

Interest on drawings can be calculated by applying the following two methods:

1) Product Method
2) Average Period Method

1) Product Method:

Under this method, the amount of drawings for each period is multiplied by the period for which the amount is going to be used. Then, the product is summed up and the following formula is used to find the interest on drawings.

$$\text{Interest on drawings} = \text{Product} \times \frac{\text{Rate of interest}}{100} \times \frac{1}{12}$$

If the amount is withdrawn at irregular period of months:

It is easier to calculate under Product Method.

2) Average Period Method:

Interest on drawings is to be calculated with reference to the average of the periods for which the money is withdrawn.

Interest on Drawings:

$$= \text{Total drawings} \times \frac{\text{Rate of interest}}{100} \times \frac{\text{Average period}}{12}$$

Calculation of Average Period :

The average period is calculated to take the period for the average of the periods applicable to the first instalment and the last instalment.

$$\text{Average Period} = \frac{\text{Beginning period of use} + \text{Ending period of use}}{2}$$

a) *If the fixed amount is withdrawn in the beginning of every month:*

Take the period at the average of the periods applicable to the first and last instalment.

The period of first instalment is 12 months.

The period of last instalment is 1 month.

$$\text{Average period} = \frac{12 + 1}{2} = 6\tfrac{1}{2} \text{ months}$$

$$= \frac{6\tfrac{1}{2}}{12} \text{ (or) } \frac{13}{24}$$

b) *If the fixed amount is withdrawn in the middle of every month:*

Take the period at the average of the periods applicable to the first and last instalment.

The period of first instalment is 11½ months.

The period of last instalment is ½ month.

$$\text{Average period} = \frac{11\tfrac{1}{2} + \tfrac{1}{2}}{2} = \frac{12}{2} = 6 \text{ months}$$

$$= \frac{6}{12} \text{ (or) } \frac{12}{24}$$

c) If the fixed amount is withdrawn at the end of every month:

Take the period at the average of the periods applicable to the first and last instalment.

The period of first instalment is 11 months.

The period of last instalment is 0 month.

$$\text{Average period} = \frac{11 + 0}{2} = 5\tfrac{1}{2} \text{ months}$$

$$= \frac{5\tfrac{1}{2}}{12} \text{ (or) } \frac{11}{24}$$

d) When the dates of drawings are not given:

The average of the total period is to be taken

$$\text{Average Period} = \frac{\text{Total period}}{2}$$

1) If the drawings are for one year without dates, the average period is calculated as follows:

$$\text{Average Period} = \frac{12 \text{ months}}{2} = 6 \text{ months}$$

2) If the drawings are for 6 months without dates, then,

$$\text{Average Period} = \frac{6 \text{ months}}{2} = 3 \text{ months}$$

Illustration : 4

A partner draws Rs.1,000 p.m. Interest is to be charged at 10% p.a. Calculate interest on drawings, if the drawings are made

i) in the beginning of the month;

ii) in the middle of the month and

iii) at the end of the month during the year.

Solution:

The total amount of drawings is Rs.12,000 (Rs.1,000 x 12 months). The rate of interest is 10%. Take the period at the average of the periods applicable to the first and the last instalments.

i) When drawings are made in the beginning of the month:

$$\text{Average Period} = \frac{12 + 1}{2} = \frac{13}{2} = 6\tfrac{1}{2} \text{ months}$$

$$\text{Interest on Drawings} = \text{Total Drawings} \times \frac{\text{Rate of interest}}{100} \times \frac{\text{Average Period}}{12}$$

$$= 12{,}000 \times \frac{10}{100} \times \frac{13}{24}$$

= Rs. 650.

ii) When drawings are made in the middle of the month:

$$\text{Average Period} = \frac{11\tfrac{1}{2} + \tfrac{1}{2}}{2} = \frac{12}{2} = 6 \text{ months}$$

10 6

Interest on Drawings $= 12{,}000 \times \frac{\quad}{100} \times \frac{\quad}{12}$

$= \text{Rs. } 600.$

iii) When drawings are made at the end of the month:

Average Period $= \frac{11 + 0}{2} = \frac{11}{2} = 5\tfrac{1}{2}$ months

Interest on Drawings $= 12{,}000 \times \frac{10}{100} \times \frac{11}{24}$

$= \text{Rs. } 550.$

i) **When drawings are made in the beginning of the month - Calculation of Interest on Drawings under Product Method:**

Date of drawings	Amount drawn Rs.	Period	Product Rs.
1.1.2004	1,000	12	12,000
1.2.2004	1,000	11	11,000
1.3.2004	1,000	10	10,000
1.4.2004	1,000	9	9,000
1.5.2004	1,000	8	8,000
1.6.2004	1,000	7	7,000
1.7.2004	1,000	6	6,000
1.8.2004	1,000	5	5,000
1.9.2004	1,000	4	4,000
1.10.2004	1,000	3	3,000
1.11.2004	1,000	2	2,000
1.12.2004	1,000	1	1,000
Sum of products			78,000

Interest on drawings @ 10% p.a. on Rs.78,000.

$= 78{,}000 \times \frac{10}{100} \times \frac{1}{12}$

$= \text{Rs. } 650.$

Illustration : 5

P, Q and R were partners sharing profits in the ratio of 3:2:1. P draws Rs.5,000 at the end of each quarter. Q draws Rs.10,000 at the end of each half year. R draws Rs.2,000 on 1.5.2004 Rs.3,000 on 31.10.2004, Rs.5,000 on 30.11.2004. Calculate interest on their drawings at 10% p.a. for the year ending 31.3.2005.

Solution:

Calculation of Interest on Drawings under Product Method:

a) Interest on drawings of P :

Date of drawings	Amount drawn Rs.	Period	Product Rs.
30.6.2004	5,000	9	45,000
30.9.2004	5,000	6	30,000
31.12.2004	5,000	3	15,000
31.3.2005	5,000	0	0
Sum of products			90,000

Interest on drawings at 10% p.a. on Rs.90,000

Interest on Drawings $= 90{,}000 \times \frac{10}{100} \times \frac{1}{12}$

$= \text{Rs. } 750.$

b) Interest on drawings of Q:

Date of drawings	Amount drawn Rs.	Period	Product Rs.
30.9.2004	10,000	6	60,000
31.3.2005	10,000	0	0
Sum of products			60,000

Interest on drawings at 10% p.a. on Rs.60,000

$$\text{Interest on Drawings} = 60{,}000 \times \frac{10}{100} \times \frac{1}{12}$$

$$= \text{Rs. } 500.$$

c) Interest on drawings of R:

Date of drawings	Amount drawn Rs.	Period	Product Rs.
1.5.2004	2,000	11	22,000
31.10.2004	3,000	5	15,000
30.11.2004	5,000	4	20,000
Sum of products			57,000

Interest on drawings at 10% p.a. on Rs.57,000

$$\text{Interest on Drawings} = 57{,}000 \times \frac{10}{100} \times \frac{1}{12}$$

$$= \text{Rs. } 475.$$

6.3.3 Salary or Commission to Partners:

Some partners may devote more time or possess better skills and experience in comparison with their fellow partners. As a result, they should be allowed a special compensation either in the form of salary or commission.

Commission may be allowed as a percentage of net profit before charging the commission or after charging the commission. Commission, under the two methods, is computed as under

i) Percentage of Net profit before charging such commission

$$\text{Net Profit before commission} \times \frac{\text{Rate of commission}}{100}$$

ii) Percentage of Net profit after charging such commission

$$\text{Net Profit before commission} \times \frac{\text{Rate of commission}}{100 + \text{Rate of commission}}$$

The accounting entries to be passed to adjust salary or commission:

a) *To adjust salary or commission to a partner*

Salary or Commission A/c... Dr.
To Partners' Capital A/c *(In case of fluctuating capital)*
or
To Partners' Current A/c *(In case of fixed capital)*

b) *To close the salary or commission account:*

Profit & Loss Appropriation A/c... Dr.
To Salary or Commission A/c...

6.3.4 Preparation of Profit and loss appropriation account:

Illustration : 6

Mahesh and Ramesh are partners sharing profits in the ratio of 3:2 with capitals of Rs.50,000 and Rs.40,000 respectively. Interest on capital is agreed at 8% p.a. Interest on drawings is fixed at 10% p.a. The drawings of the partners were Rs.15,000 and Rs.10,000, the interest for Mahesh Rs.750 and for Ramesh Rs.500. Mahesh is entitled to a salary of Rs.12,000 p.a. and Ramesh is entitled to get a commission of 10% on the Net Profit before charging such commission. The Net Profit of the firm before making the above adjustments was Rs.60,000 for the year ended 31st March, 2005.

Prepare the profit and loss appropriation account.

Solution :

In the Books of the Firm

Dr **Profit and Loss Appropriation Account** Cr

Date	Particulars	Rs.	Date	Particulars	Rs.
2005			2004		
Mar 31	To Interest on Capital		Mar 31	By Net profit b/d	60,000
	Mahesh 4,000		2005		
	Ramesh 3,200		Mar	By Interest on	
		7,200	31	Drawings	
,,	To Partners' salary			Mahesh 750	
	Mahesh	12,000		Ramesh 500	
,,	To Commission				1,250
	Ramesh	4,205			
	(10% on Rs. 42,050)				
,,	To Profit transferred				
	to capital A/c				
	Mahesh 22,707				
	Ramesh 15,138	37,845			
		61,250			61,250

Note: *Calculation of commission.*

Step 1 → Total the credit side of the Profit and Loss Appropriation Account. i.e., Rs.61,250.

Step 2 → Total the debit side of the Profit and Loss Appropriation Account. i.e., Rs. 19,200.

Step 3 → Find the balance. i.e., Rs. 42,050.

Step 4 → Apply the formula.

$$\text{Commission} = \text{Net Profit before commission} \times \frac{\text{Rate of commission}}{100}$$

$$\text{Commission} = 42{,}050 \times \frac{10}{100}$$

$$= \text{Rs.}4{,}205.$$

The Balance of Rs. 37,845 (Rs.42,050 – Rs.4,205) is transferred to Partners' Capital accounts in the ratio.

Illustration : 7

X and Y are partners in a firm, sharing profits and losses equally. X is entitled to a salary of Rs.5,000 p.m. Y is entitled to a commission of 10% of Net profit after charging such commission. Net profit before charging commission and salary was Rs.1,48,000. Show the Profit and loss appropriation account.

Solution:

a) Calculation of salary to X:

5,000 p.m. for 12 months = 12 x 5,000

= Rs. 60,000

b) Calculation of commission to Y:

Percentage of Net profit after charging the commission =

$$\text{Net Profit before commission} \times \frac{\text{Rate of commission}}{100 + \text{Rate of commission}}$$

Net Profit before commission = 1,48,000 – 60,000

= Rs. 88,000.

$$\therefore \text{Commission} = 88{,}000 \times \frac{10}{100 + 10}$$

$$= 88{,}000 \times \frac{10}{110}$$

= Rs. 8,000

In the Books of the Firm

Dr **Profit and Loss Appropriation Account** Cr

Date	Particulars	Rs.	Date	Particulars	Rs.
	To X's Salary	60,000		By Net profit b/d	1,48,000
	To Y's Commission	8,000			
	To Net profit transferred to:				
	X 40,000				
	Y 40,000	80,000			
		1,48,000			1,48,000

6.4 Goodwill:

When a firm is reconstituted, goodwill is valued and shared by the existing partners. Goodwill is the present value of a firm's anticipated excess earnings in future and the efforts had already made in the past. Goodwill really arises only if firm is able to earn higher profit than normal.

6.4.1 Meaning and Nature:

Goodwill is the value of the reputation of the firm which the business builds up due to its efficient service to its customers and quality of its products. It is a value of all favourable attributes relating to a business enterprise. It is not merely the past reputation but its continued existence in future that makes goodwill a valuable asset. It cannot be seen or touched. It is an intangible asset but not a fictitious asset.

6.4.2 Factors affecting the value of goodwill:

Goodwill relates to the profit earning capacity of the firm. Thus, the goodwill of a firm is affected by the following factors.

The factors are:

1. **Quality:** If the firm enjoys good reputation for the quality of its products, there will be a ready sale and the value of goodwill, therefore, will be high.

2. **Location:** If the business is located in a prominent place, its value will be more.

3. **Efficient management:** If the management is capable, the firm will earn more profits and that will raise the firm's value.

4. **Competition:** When there is no competition or competition is negligible , the value of those businesses will be high.

5. **Advantage of patents:** Possession of trade marks, patents or copyrights will increase the firm's value.

6. **Time:** A business establishes reputation in course of time which is running for long period on profitable line.

7. **Customers' attitude:** The type of customers which a firm has is important. If the firm has more customers, the value will be high.

8. **Nature of business:** A business having a stable demand is able to earn more profit and therefore has more goodwill.

6.4.3 Methods of valuation of goodwill:

There are three methods of valuation of goodwill.

They are:

1) Average Profit method
2) Super Profit method
3) Capitalisation method

However, we are discussing only the first two methods in this chapter.

a) Average profit method:

In this method, past profits of a number of years are taken into account. Such profits are added and the average profit is found out. The average profit is multiplied by a certain number of years to arrive at the value of goodwill.

The steps involved under this method are:

Step 1 → Calculate total profits by adding each years profit and deducging loss, if any.

Step 2 → Calculate the average profit by applying the following formula.

$$\text{Average Profit} = \frac{\text{Total Profits}}{\text{No. of years}}$$

Step 3 → Calculate the Goodwill by applying the following formula.

$$\text{Goodwill} = \text{Average Profit} \times \text{No. of years' purchase}$$

Illustration : 8

The Goodwill is to be valued at two years' purchase of last four years average profit. The profits were Rs.40,000, Rs.32,000, Rs.15,000 and Rs.13,000 respectively. Find out the value of goodwill.

Solution:

a) Calculation of average profit:

	Rs.
I year	40,000
II year	32,000
III year	15,000
IV year	13,000
Total Profit	1,00,000

$$\text{Average Profit} = \frac{\text{Total profits}}{\text{No. of years}}$$

$$= \frac{1,00,000}{4}$$

$$= \text{Rs. } 25,000$$

b) Calculation of Goodwill:

Goodwill = Average Profit x two years' purchase

= 25,000 x 2

= Rs. 50,000.

Illustration : 9

Three years' purchase of the last four years average profits is agreed as the value of goodwill. The profits and losses for the last four years are: I year Rs.50,000, II year Rs.80,000; III year Rs.30,000(Loss); IV year Rs.60,000.

Calculate the amount of goodwill.

Solution:

a) Calculation of average profit:

	Rs.
I year	50,000
II year	80,000
IV year	60,000
Profit of 3 years	1,90,000
III year loss	30,000
Total profit	1,60,000

$$\text{Average Profit} = \frac{\text{Total Profits}}{\text{No. of years}}$$

$$= \frac{1,60,000}{4}$$

= Rs. 40,000

b) Calculation of goodwill:

Goodwill = Average Profit x three years' purchase

= 40,000 x 3

= Rs. 1,20,000

b) Super Profit method:

The excess of average profit over normal profit is called **super profit**. The goodwill under the Super profits method is calculated by multiplying the super profits by certain number of years purchase.

The steps involved under this method are:

Step 1 → Calculate the average profit – it may be adjusted for partners remuneration.

Step 2 → Calculate the normal profit on capital employed by applying the following formula.

Normal Profit = Capital employed x Normal rate of return

Step 3 → Calculate the super profit.by applying the following formula.

Super profit = Average Profit - Normal profit

Step 4 → Calculate the value of goodwill by multiplying the amount of super profit by the given number of years' purchase

Goodwill = Super Profit x No. of years of purchase

Illustration : 10

A firm's net profits during the last three years were Rs.90,000 Rs.1,00,000 and Rs.1,10,000. The capital employed in the firm is Rs.3,00,000. A normal return on the capital is 10%. Calculate the value of goodwill on the basis of two years' purchase of super profit.

Solution:

a) Calculation of Average Profit:

	Rs.
I year	90,000
II year	1,00,000
III year	1,10,000
Total Profit	3,00,000

$$\text{Average Profit} = \frac{3,00,000}{3}$$

$$= \text{Rs. } 1,00,000$$

b) Calculation of Normal Profit:

Normal Profit = Capital employed x Normal rate of return

$$= \text{Rs. } 3,00,000 \times \frac{10}{100}$$

= Rs. 30,000.

c) Calculation of Super Profit:

= Average Profit – Normal Profit

= 1,00,000 – 30,000

= Rs. 70,000.

d) Goodwill at two years' purchase of super profit:

Goodwill = Super Profit x No. of years of purchase

= 70,000 x 2

= Rs. 1,40,000.

QUESTIONS

I. Objective Type

a) Fill in the blanks:

1. A sole trader business is owned and managed by ________ person.
2. Indian Partnership Act was enacted in the year ________.
3. Mutual and ________ agency is the essence of a partnership.
4. The profits and losses of the business will be shared among the partners in the ________ ratio.
5. Under fluctuating capital method, profit or loss in a year, will be transferred to the respective ________ accounts.
6. The capital accounts of partners may be ________ or fluctuating.
7. Under __________ capital arrangement, current accounts will not be maintained.
8. The debit balance of the current account, will be shown in the ________ side of the balance sheet.
9. Interest on partners' capital is allowed, only when the ________ specifically provides for it.
10. Money lent to the business by a partner is credited to his ________ account and not his capital account.
11. Interest on partners' loan should be paid, even if there is no ________ in a year.
12. Goodwill is an _______ asset.

13. The excess of average profit over normal profit is ________.

14. In the absence of partnership deed, no interest is to be charged on _________.

15. A partnership can be formed only for a _________ business.

16. The persons who entered into partnership are collectively known as _________.

(Answers: 1. one; 2. 1932; 3. implied; 4. agreed; 5. capital; 6. fixed; 7. fluctuating; 8. assets; 9. partnership agreement; 10. loan; 11. profit; 12. intangible; 13. Super profit; 14. drawings; 15. legal; 16. firm)

b) Choose the correct answer:

1. The minimum number of persons in a partnership firm is _______
   a) one
   b) two
   c) seven

2. In a partnership business, agreement is ________
   a) compulsory
   b) optional
   c) not necessary

3. In a partnership, partners share their profits and losses in ________ ratio
   a) their capital
   b) equal
   c) agreed

4. Under fixed capital system, the profits and losses of partners will be transferred to their ________ account
   a) current
   b) drawings
   c) capital

5. Interest on capital is calculated on the
   a) Opening Capital
   b) Closing Capital
   c) Average Capital

6. Current accounts for partners will be opened under
   a) Fixed capital method
   b) Fluctuating capital method
   c) Either fixed capital method or fluctuating capital method

7. In the absence of an agreement profits and losses are divided
   a) in the ratio of capitals
   b) in the ratio of time devoted by each partner
   c) equally

8. X and Y are partners sharing the profits and losses in the ratio of 2:3 with capitals of Rs.1,20,000 and Rs.60,000 respectively. Profits for the year are Rs.9,000. If the partnership deed is silent as to interest on capital. Show how profit is shared among X and Y.
   a) Profit : X - Rs. 6,000; Y - Rs.3,000
   b) Profit : X - Rs. 3,600; Y - Rs.5,400
   c) Profit : X - Rs. 3,000; Y - Rs.6,000

9. Where a partner is entitled to interest on capital such interest will be payable,

   a) Only out of profits

   b) Only out of capital

   c) Out of profits or out of capital

10. In the absence of partnership deed, partners shall

   a) be paid salaries

   b) not to be paid salaries

   c) paid salaries to those who work for the firm

11. Under fixed capital method salary payable to a partner is recorded

   a) in Current Account

   b) in Capital Account

   c) either in Current Account or Capital Account.

12. If a firm is maintaining both 'Capital Accounts' and 'Current Accounts' of the partners A and B. Additional capital introduced by B will be recorded in

   a) B's Current Account

   b) B's Capital Account

   c) either B's Capital Account or Current Account

(Answers : 1. (b); 2. (b); 3. (c); 4. (a); 5.(a); 6.(a); 7. (c); 8. (b); 9. (a); 10. (b); 11. (a); 12. (b))

II. Other Questions:

1. Define Partnership.
2. What is Drawings?
3. What is Goodwill?
4. What is Average profit?
5. What is Super profit?
6. What is Partner's Current Account?
7. What is Profit and Loss Appropriation Account?
8. What are the features of a partnership?
9. Explain the methods by which the partners' capital accounts are maintained.
10. In the absence of Partnership Deed, how are the following items dealt in the books of accounts of a firm?

    a) Interest on Capital

    b) Interest on drawings

    c) Salaries to partners

    d) Commission to partners

    e) Interest on partners loan

    f) profit sharing ratio

11. What are the differences between fixed capital account and fluctuating capital account?
12. What are the factors affecting goodwill?
13. Explain the methods of valuation of Goodwill.

14. If the Partners' Capital Accounts are fixed, where will you record the following items:
    a) Salary payable to a Partner
    b) Drawings made by a Partner
15. If a firm is maitaining both Capital Accounts and Current Accounts of partners A and B where will the following be recorded
    a) Fresh Capital introduced by B
    b) Share of profits earned by A and B.
16. Mention the items that may appear on the credit side of the capital accounts of a partner when the capitals are fluctuating.

III. Problems

Fixed and Fluctuating Capitals:

1. Show how the following items will appear in the Capital Accounts of the partners, Ramu and Somu, when their capitals are (a) Fluctuating and (b) Fixed.

	Ramu Rs.	Somu Rs.
Capital on 1.4.2004	90,000	60,000
Drawings during 2004-05	18,000	15,000
Interest on Drawings	500	300
Share of Profit for 2004-05	12,000	8,000
Interest on Capital	5,400	3,600
Partner's Salary	6,000	---

(Answer: When Capitals are Fluctuating:
Ramu's Capital Account Rs. 94,900
Somu's Capital Account Rs. 56,300
When Capitals are Fixed:
Ramu's Current Account Rs. 4,900 Cr.
Somu's Current Account Rs. 3,700 Dr.)

2. Prepare the Capital Accounts of the partners, Vani and Rani from the following details assuming that their capitals are fluctuating.

	Vani Rs.	Rani Rs.
Capital as on 1.4.2003	2,10,000	1,20,000
Drawings during 2003-04	18,000	12,000
Interest on Capital at 6%	?	?
Interest on Drawings	450	300
Share of Profit 2003-04	24,000	18,000
Partner's Salary	---	6,000
Commission	4,800	3,600
Interest on Rani's Loan A/c	3,000	---

(Answer: Vani's Capital Account Rs. 2,32,950
Rani's Capital Account Rs. 1,42,500)

Note: Interest on Loan should be taken to Loan A/c.

3. Write up the Capital and Current Accounts of the partners, Kannagi and Vasugi, from the following details:

	Kannagi Rs.	Vasugi Rs.
Capital on 1.4.2003	1,00,000	60,000
Current A/c on 1.4.2003	3,000 (Dr.)	2,000 (Cr.)
Drawings during 2003-04	8,000	5,000
Interest on Capital	5,000	3,000

Interest on Drawings	240	150
Share of Profit 2003-04	12,000	10,000
Partner's Salary	4,000	---

(Answer: Kannagi's Current A/c Rs. 9,760 Cr.
Vasugi's Current A/c Rs. 9,850 Cr.)

4. Prepare the Capital Accounts of the partners Ravi and Raja from the following details assuming that their capitals are fluctuating:

Particulars	Ravi Rs.	Raja Rs.
Capital as on 1.1.2001	80,000	50,000
Drawings during 2001	6,000	4,000
Interest on Capital at 6%	?	?
Interest on Drawing at 5%	?	?
Profit Shares of 2001	8,000	6,000
Partners' Salary	---	2,000
Commission	1,600	1,200
Interest on Raja's Loan A/c	---	3,000

(October 2002)

(Answer: Ravi's Capital Account Rs. 88,250
Raja's Capital Account Rs. 58,100)

Distribution of Profit:

5. Elavarasan and Amudharasan are partners with capitals of Rs.1,50,000 and Rs.1,00,000 respectively on 1st April 2004. The Trading Profit for the year ended 31st March, 2005 was Rs.60,000. Interest on capital is to be allowed at 6% per annum. Amudharasan entitled to a salary of Rs.15,000 per annum. The drawings of the partners were Elavarasan Rs.15,000 and Amudharasan Rs.10,000; The interest on drawings are Elavarasan Rs.500 and Amudharasan Rs.250. Assuming that Elavarasan and Amudharasan are equal partners. Prepare the Profit and Loss Appropriation Account and the Capital Accounts as on 31st March, 2005.

(Answer: Profit Rs. 30,750; Capital Accounts: Elavarasan Rs.1,58,875; Amudharasan Rs. 1,26,125)

6. Amuthan and Raman are partners in a firm showing Profits and Losses in the ratio 3:2. Their capitals on 1.4.2003 were Rs.1,60,000 and Rs.1,20,000 respectively. The Net Profit of the firm for the year ended 31st March 2004 before making adjustments for the above items was Rs.60,000. Drawings of the partners during the year were, Amuthan Rs.12,000 and Raman Rs.8,000. Their Partnership Deed provided for the following:

   1. Interest on Capital at 5% p.a.
   2. Interest on Drawings at 6% p.a.
   3. Amuthan and Raman to get a salary of Rs.10,000 each per annum.
   4. Amuthan to get a commission of 10% on the Net Profit before charging such commission.

Show the Profit and Loss Appropriation Account and Capital Accounts of the partners.

(Answer: a) Net Profit Rs. 23,940;
b) Capital Accounts: Amuthan : Rs. 1,82,664;
Raman : Rs. 1,37,336)

Note: In the absence of actual date of Drawings, Interest on them has to be calculated for an average period of 6 months.

7. Cheran, Pallavan are partners with capitals of Rs.60,000 and Rs.20,000 respectively on 1st January 2001. The Trading Profit (before taking into account the provision of the Deed) for the year ended 31st December, 2001 was Rs.12,000. Interest on capital

is to be allowed at 6% per annum. Pallavan is entitled to a salary of Rs.3,000 per annum. The drawings of the partners were Cheran Rs.2,000 and Pallavan Rs.1,000; the interest on drawings for Cheran being Rs.100 and for Pallavan Rs.50.

Assuming that Cheran, Pallavan are equal partners, prepare the Profit and Loss Appropriation Account and the partners' Capital Account (The capitals are fluctuating as at 31st December, 2001).

(June 2002)

(Answer: a) Net Profit Rs. 4350;
b) Capital Accounts: Cheran : Rs. 66,625;
Pallavan : Rs. 22,325)

Interest on Capital:

8. Manjula and Vennila started business on 1st April 2004 with capitals of Rs.60,000 and Rs. 50,000 respectively. On 1st July 2004 Manjula withdrew Rs.8,000 from his capital. Vennila introduced additional capital Rs.10,000 on 30.9.2004. Calculate interest on capital at 5% for the year ending 31st March 2005.

   (Answer: Interest on capital; Manjula : Rs. 2,700;
   Vennila : Rs. 2,750)

9. Prince, Queen and King had capitals of Rs. 80,000, Rs.60,000 and Rs.40,000 respectively on 1.4.2004. Queen withdrew Rs.8,000 from his capital on 30.9.2004, King introduced additional capital Rs. 12,000 on 31.12.2004. Calculate interest on capital at 6% for the year ending 31st March 2005.

   (Answer: Interest on capital; Prince : Rs. 4,800;
   Queen : Rs. 3,360; King : Rs.2,580)

10. X and Y had capitals of Rs.80,000 and Rs.40,000 respectively on 1.1.2000. X introduced additional capital of Rs.10,000, on 30.6.2000. Y withdrew Rs.5,000 from his capital on 1.10.2000. Calculate interest on capital at 5% for the year 2000.

   (October 2002)

   (Answer: Interest on capital; X : Rs. 4,250;
   Y : Rs. 1,937.50)

Interest on Drawings:

11. Sundar and Shanmugam are two partners sharing profits and losses equally. Sundar drew regularly Rs.2,000 at the end of every month during the year. Shanmugam draws Rs.4,000 regularly at the beginning of every month during the year. Calculate interest on their drawings at 10% p.a.

   (Answer: Interest on drawings;
   Sundar : Rs. 1,100; Shanmugam :Rs.2,600)

12. Pasupathi and Valayapathi are partners. Pasupathi draws Rs.900 regularly in the middle of each month during the year 2004. Valayapathi draws Rs.5,400 at the end of each half year. Calculate interest on their drawings at 5% p.a.

   (Answer: Interest on drawings;
   Pasupathi : Rs.270; Valayapathi : Rs.135)

13. Matheswaran and Nagarajan are partners sharing profits in the ratio of 3:2. Matheswaran draws Rs.3,000 regularly at the end of every month during the year 2004. Nagarajan draws Rs.10,000 on 1.4.2004, Rs.6,000 on 30.6.2004, Rs.8,000 on 1.10.2004 and Rs.4,000 on 30.11.2004. Calculate interest on their Drawings at 6% p.a.

   (Answer: Interest on drawings;
   Matheswaran : Rs. 990; Nagarajan : Rs. 770)

14. Hari and Karthi are two partners sharing profits and losses equally. Hari drew regularly Rs.400 at the end of every month during the

year. Karthi drew Rs.800 regularly at the beginning of every month during the year. Calculate interest on their drawings at 10% p.a.

(March 2003)

(Answer: Interest on drawings; Hari : Rs. 220; Karthi : Rs. 520)

Valuation of Goodwill:

15. Goodwill is to be valued at three years purchase of five year's average profits. The profits for the last five years of the firm were:

    2000 - Rs. 4,200; 2001 - Rs. 4,500; 2002 - Rs. 4,700; 2003 - Rs. 4,600 and 2004 - Rs. 5,000.

    (Ans. : Goodwill Rs. 13,800)

16. Calculate the amount of goodwill on the basis of two year's purchase of the last four years average profits. The profits for the last four year's are:

I Year	Loss	Rs.	10,000
II Year	Profit	Rs.	26,000
III Year	Profit	Rs.	34,000
IV Year	Profit	Rs.	50,000

(Ans. : Goodwill Rs. 50,000)

17. Goodwill is to be valued at three years purchase of four years average profits. The profits for the last four years of the firm were:

    2001 - Rs. 12,000; 2002 - Rs. 18,000; 2003 - Rs. 16,000; 2004 - Rs. 14,000.

    Calculate the amount of goodwill.

    (Ans. : Goodwill Rs. 45,000)

18. G, P, S were partners of a firm sharing profit and losses in the ratio 3:2:1. In view of G's retirement, goodwill was valued at two years' purchase of the average profits of last 4 years which are:

Ist year's Loss	Rs.	6,000
IInd year's Profit	Rs.	10,000
IIIrd year's Profit	Rs.	17,000
IVth year's Profit	Rs.	15,000

What entry would you pass to carry out their decision?

(October 2002)

(Ans. : Goodwill Rs. 18,000)

19. Calculate the amount of goodwill on the basis of two years' purchase of the last four years' average profits. The profits of the last four years are

1996	Profit	Rs.	20,000
1997	Profit	Rs.	30,000
1998	Loss	Rs.	6,000
1999	Profit	Rs.	16,000

(June 2003)

(Ans. : Goodwill Rs. 30,000)

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

I Year	Rs.	36,000
II Year	Rs.	40,000
III Year	Rs.	44,000

The Capital investment of the firm is Rs.1,20,000. A fair return on the capital having regard to the risk involved is 10%.

Calculate the value of goodwill on the basis of three years purchase of Super profits.

(Ans. : Goodwill Rs. 84,000)

21. From the following information, calculate the value of goodwill at three years' purchase of super profit.

i) Average Capital employed in the business Rs.6,00,000.

ii) Net trading profits of the firm for the past three years were Rs.1,07,600, Rs.90,700 and Rs.1,12,500.

iii) Rate of interest expected from capital having to the risk involved is 12%.

iv) Fair remuneration to the partners for their service Rs.12,000 p.a.

(Ans. : Goodwill Rs. 58,800)

22. The average net profits of the firm expected in the future are Rs.54,000 per year. The average capital employed in the business is Rs.3,00,000. The rate of interest expected from capital invested in the business is 10%. The remuneration of the partners is estimated to be Rs.9000 per annum.

Find out the value of goodwill on the basis of two years purchase of Super Profits.

(Ans. : Goodwill Rs. 30,000)

Chapter - 7

PARTNERSHIP ACCOUNTS - ADMISSION

Learning Objectives

After studying this Chapter, you will be able to:

- *understand the need for admission of a partner.*
- *calculate the new profit sharing ratio and the sacrificing ratio.*
- *understand how the revaluation of assets and liabilities is taken into account.*
- *understand the need for distribution of accumulated reserves, profits or losses.*
- *learn the accounting treatment of goodwill.*
- *prepare revaluation account, capital accounts and balance sheet of a new firm.*

A Partnership firm suffering from shortage of funds or administrative incapabilities may decide to admit a partner. Admission of a partner is one of the modes of reconstituting the firm. According to Section 31 (1) of the Indian Partnership Act 1932, a person can be admitted only with the consent of all the existing partners. A person who is admitted to the firm is known as **an incoming or a new partner**. On admission of a new partner, the existing partnership comes to an end and a new partnership comes into effect. In other words, a new firm is reconstituted under a fresh agreement.

Whenever a partner is admitted into the partnership firm, he acquires two rights.

a) Right to share the assets of the partnership firm.

b) Right to share the future profits of the partnership firm.

The amount that the new partner brings in for the right to share in the partnership assets is called his capital and is credited to his *Capital account*. Whereas the consideration which he pays to the old partners for the right to participate in the division of future profits is called *Goodwill*.

7.1 Adjustments:

While admitting a new partner, the following adjustments are necessary:

1. Recording the Capital of a new partner
2. Calculation of New Profit Sharing ratio and Sacrificing ratio
3. Revaluation of assets and liabilities
4. Transfer of Undistributed Profit or loss
5. Transfer of Accumulated reserves
6. Treatment of Goodwill

7.1.1 Recording of Capital of a New Partner

It is not compulsory that the new partner bring capital at the time of admission. He may be admitted in view of his talent, skill and reputation. However, in many cases, the incoming partner brings capital into the firm. With the consent of all the old partners, he may bring capital in cash or in kind or both.

The accounting treatment is

Cash A/c	Dr	.....	
Stock A/c	Dr	.....	
Furniture A/c	Dr	.....	
To New partners Capital A/c			.....

Illustration : 1

Anandan and Balaraman are partners in a firm with capitals of Rs.70,000 and Rs.50,000 respectively. They decided to admit Chandran into the firm with a capital of Rs.40,000. Give journal entry for Capital brought in by Chandran.

Solution:

Journal Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Cash A/c Dr		40,000	
	To Chandran's Capital A/c			40,000
	(Cash brought in by Chandran as capital)			

7.2 Calculation of New Profit Sharing ratio and Sacrificing Ratio

When a new partner is admitted, he acquires his share in profits from the old partners. This reduces the old partners' shares in profit hence, new profit sharing ratio for old partners have to be calculated.

New Profit Sharing Ratio:

The ratio in which all partners (including incoming partner) share the future profits and losses is known as the *new profit sharing ratio*.

The determination of new profit sharing ratio depends upon the ratio in which the incoming partner acquires his share from the old partners.

New share = Old share – Sacrifice

Sacrificing Ratio:

The ratio in which the old partners have agreed to sacrifice their shares in profit in favour of a new partner is called the *sacrificing ratio*.

Sacrificing ratio = Old profit sharing ratio – New profit sharing ratio

Sacrifice = Old share – New share

The purpose of this ratio is to determine the amount of compensation (goodwill) to be paid by the new partner to the old partners for the share of profit surrendered.

From the calculation point of view of sacrificing ratio, the following are the different situations:

1. *When the new share of the incoming partner is given.*
   a) Sacrifice of the old partners are not given (Sacrifice in the old ratio)
   b) Unequal sacrifice of the old partners (Unequal sacrifice)
   c) Equal sacrifice of the old partners (Equal sacrifice)
   d) Entire sacrifice by one of the partners.
2. *When the new share of the incoming partner is not given.*
   – Sacrifice of the old partners are given.
3. *New profit sharing ratio is given.*

1. *When the new share of the incoming partner is given.*

a) Sacrifice of the old partners are not given (Sacrifice in the old ratio)

Illustration : 2

A and B are partners sharing profits in the ratio of 3:2. They admit C for 1/5th share as new partner. Calculate new profit sharing ratio and sacrificing ratio of old partners.

Solution:

a) New Profit Sharing ratio:

Let the total profit be $= 1$

C's share $= \frac{1}{5}$

Remaining Share of A and B $= 1 - \frac{1}{5} = \frac{5-1}{5} = \frac{4}{5}$

		A	:	B	:	C
Old ratio	=	3	:	2		
Old share	=	$\frac{3}{5}$	:	$\frac{2}{5}$		
New Share	=	$\frac{4}{5} \times \frac{3}{5}$	:	$\frac{4}{5} \times \frac{2}{5}$	:	$\frac{1}{5}$
New Share	=	$\frac{12}{25}$	:	$\frac{8}{25}$	:	$\frac{5}{25}$
New Ratio	=	12	:	8	:	5

b) Sacrificing ratio:

Sacrifice = Old Share – New Share

A's sacrifice $= \dfrac{3}{5} - \dfrac{12}{25}$

$= \dfrac{15 - 12}{25} = \dfrac{3}{25}$

B's sacrifice $= \dfrac{2}{5} - \dfrac{8}{25}$

$= \dfrac{10 - 8}{25} = \dfrac{2}{25}$

Sacrificing ratio $= \dfrac{3}{25} : \dfrac{2}{25} = 3:2$

$= 3 : 2$

b) Unequal sacrifice of the old partners (Unequal sacrifice)

Illustration : 3

Rathai and Kothai are partners sharing profits in the ratio of 3:2. They admit Kanmani for 1/5th share of future profits which she acquires 3/20th from Rathai and 1/20th from Kothai. Calculate new Profit sharing ratio and sacrificing ratio of old partners.

Solution:

a) New ratio:

Rathai : Kothai : Kannan

Old ratio $= 3 : 2$

Old share $= \dfrac{3}{5} : \dfrac{2}{5}$

Sacrifice $= \dfrac{3}{20} : \dfrac{1}{20}$

New Share (Old share – Sacrifice) $= \dfrac{3}{5} - \dfrac{3}{20} : \dfrac{2}{5} - \dfrac{1}{20} : \dfrac{1}{5}$

$= \dfrac{12 - 3}{20} = \dfrac{9}{20} : \dfrac{8 - 1}{20} = \dfrac{7}{20} : \dfrac{1}{5}$

$= \dfrac{9}{20} : \dfrac{7}{20} : \dfrac{4}{20}$

$= \dfrac{9 : 7 : 4}{20}$

New ratio $= 9 : 7 : 4$

b. Sacrificing ratio:

	Rathai	:	Kothai
Sacrifice	$= \frac{3}{20}$	:	$\frac{1}{20}$
Sacrificing ratio	= 3 :1		

c) Equal sacrifice of the old partners (Equal sacrifice)

Illustration : 4

P and Q are partners sharing profits in the ratio of 3:2. They admit R for 1/5th Share which acquires equally from P and Q. Calculate new profit sharing ratio and sacrificing ratio of old partners.

Solution:

a) New Profit sharing ratio

	P	:	Q	:	R
Old ratio	= 3	:	2		
Old share	$= \frac{3}{5}$	:	$\frac{2}{5}$		
Sacrifice	$= \frac{1}{5} \times \frac{1}{2}$	:	$\frac{1}{5} \times \frac{1}{2}$		
	$= \frac{1}{10}$	:	$\frac{1}{10}$		

New Share
(Old Share – Sacrifice)

$$= \frac{3}{5} - \frac{1}{10} : \frac{2}{5} - \frac{1}{10} : \frac{1}{5}$$

$$= \frac{6-1}{10} = \frac{5}{10} : \frac{4\text{-}1}{10} = \frac{3}{10} : \frac{1}{5}$$

$$= \frac{5}{10} : \frac{3}{10} : \frac{2}{10}$$

New Profit sharing ratio = 5 : 3 : 2

b. Sacrificing ratio:

	P	:	Q
Sacrifice	$= \frac{1}{10}$	:	$\frac{1}{10}$
Sacrificing ratio	= 1 : 1		

d) Entire Sacrifice by one partner only :

Illustration : 5

G and H are partners sharing profits in the ratio of 3:2. They admit I for 1/5th share which he acquires entirely from G. Calculate a) new ratio and b) Sacrificing ratio.

Solution:

a) New ratio

	G	:	H	:	I
Old ratio	= 3	:	2		

$$\text{Old share} = \frac{3}{5} : \frac{2}{5}$$

$$\text{Sacrifice} = \frac{1}{5}$$

$$\text{New Share} = \frac{3}{5} - \frac{1}{5} : \frac{2}{5} : \frac{1}{5}$$

$$= \frac{2}{5} : \frac{2}{5} : \frac{1}{5}$$

$$\text{New ratio} = 2 : 2 : 1$$

b. Sacrificing ratio:

$$\text{G's Sacrifice} = \frac{1}{5}$$

Since, only one partner sacrifice his share of profit, it implied that other partner not incurred any loss.

2. When the new share of the incoming partner is not given.

– Sacrifice of the old partners are given.

Illustration : 6

S and T are partners sharing profits in the ratio of 3:2. They admit U as new partner. which he acquires 1/5th of S's share and 2/5 of T's share. Calculate a) New ratio and b) Sacrificing ratio.

Solution:

a) New ratio :

$$\text{S} : \text{T} : \text{U}$$

$$\text{Old ratio} = 3 : 2$$

$$\text{Old share} = \frac{3}{5} : \frac{2}{5}$$

$$\text{Sacrifice} = \frac{3}{5} \text{ x } \frac{1}{5} : \frac{2}{5} \text{ x } \frac{2}{5}$$

$$= \frac{3}{25} : \frac{4}{25}$$

New Share (Old share – Sacrifice)

$$= \frac{3}{5} - \frac{3}{25} : \frac{2}{5} - \frac{4}{25} : \frac{3}{25} + \frac{4}{25}$$

$$= \frac{15-3}{25} = \frac{12}{25} : \frac{10-4}{25} = \frac{6}{25} : \frac{7}{25}$$

$$= \frac{12}{25} : \frac{6}{25} : \frac{7}{25}$$

$$\text{New ratio} = 12 : 6 : 7$$

b. Sacrificing ratio:

	S	:	T
Sacrifice	$= \frac{3}{25}$	:	$\frac{4}{25}$
Sacrificing ratio	= 3 :4		

3. New profit sharing ratio is given

Illustration : 7

X and Y are partners sharing profits in the ratio of 3:2. They admit Z as a new partner. The new profit sharing ratio among X, Y and Z is 4:3:2. Find out the sacrificing ratio.

Solution:

	X	:	Y	:	Z
Old ratio	= 3	:	2		
Old share	$= \frac{3}{5}$	:	$\frac{2}{5}$		
New ratio	= 4	:	3	:	2
New share	$= \frac{4}{9}$	:	$\frac{3}{9}$	:	$\frac{2}{9}$

Sacrifice (Old Share – New Share) $= \frac{3}{5} - \frac{4}{9} : \frac{2}{5} - \frac{3}{9}$

$$= \frac{27-20}{45} = \frac{7}{45} : \frac{18-15}{45} = \frac{3}{45}$$

$$= \frac{7}{45} : \frac{3}{45}$$

Sacrificing ratio = 7 : 3

7.3 Revaluation of Assets and Liabilities

Revaluation is the valuation of assets and liabilities at the time of reconstitution of the partnership firm. At the time of admission of a partner, the assets and liabilities are revalued so that the profit and loss arising on account of such revaluation may be adjusted in the old partners' capital accounts in their old profit sharing ratio and the incoming partner may not be affected by the profit or loss on account of revaluation of assets and liabilities. For the purpose a **revaluation account** is opened.

Revaluation Account is credited with the following profit items:

1) Increase in the value of assets,
2) decrease in the amount of liabilities and
3) unrecorded assets now recorded.

Revaluation account is debited with the following loss items:

1) Decrease in the value of assets,
2) increase in the amount of liabilities,
3) unrecorded liabilities now recorded and
4) creation of a new liability.

The balance of Revaluation account shows the net effect on account of revaluation which is transferred to old partners' capital accounts in their old profit sharing ratio. The assets and liabilities appear in the Balance Sheet of the reconstituted firm at their revised values.

Accounting entries to record the revaluation of assets and liabilities:

a. For increase in the value of an asset

Concerned Asset A/c	Dr	......	
To Revaluation A/c			......

b. For decrease in the value of an asset

Revaluation A/c	Dr	......	
To Concerned Asset A/c			......

c. For increase in the amount of a liability

Revaluation A/c	Dr	......	
To Concerned Liability A/c			......

d. For decrease in the amount of liability

Concerned Liability A/c	Dr	......	
To Revaluation A/c			......

e. For recording an unrecorded asset

Unrecorded Asset A/c	Dr	......	
To Revaluation A/c			......

f. For recording an unrecorded liability

Revaluation A/c	Dr	......	
To Unrecorded Liability A/c			......

g. For recording a new liability

Revaluation A/c	Dr	......	
To New liability A/c			......

h. For transfer of balance in revaluation account

i) If credit side exceeds debit side (profit).

Revaluation A/c	Dr	......	
To Old Partners' capital A/cs			......

ii) If debit side exceeds credit side (loss)

Old Partners' Capital A/cs	Dr	......	
To Revaluation A/c			......

In short, only three entries are enough.

1. *For profit items:* i) Increase in the value of assets, ii) unrecorded assets recorded and iii) decrease in the amount of liabilities.

Concerned Assets A/c	Dr	......	
Concerned Liabilities A/c	Dr	......	
To Revaluation A/c			......

2. *For loss items:* i) Decrease in the value of assets, ii) increase in the amount of liabilities, iii) unrecorded liabilities recorded and iv) new liabilities created.

Revaluation A/c	Dr	......	
To Concerned Assets A/c			......
To Concerned Liabilities A/c			......

3. *To transfer profit or loss on revaluation*

a) If Profit:

Revaluation A/c	Dr	......	
To Partners' Capital A/cs			......

b) If Loss:

Partners' Capital A/cs	Dr	......	
To Revaluation A/c			......

Format:

Revaluation Account

Dr | Cr

Particulars	Rs.	Particulars	Rs.
To Assets (Individually) - (Decrease in the value)	......	By Assets (Individually) (Increase in the value and unrecorded)	......
To Liabilities (Increase in the amount, unrecorded and newly created)	......	By Liabilities (Decrease in the amount)	......
To Partners' capital A/c (Profit on revaluation)	......	By Partner's Capital A/c (Loss on revaluation)	......

Illustration : 8

Sankar and Saleem are partners in a firm sharing profits and losses in the ratio of 3:2 as on 31st March 2005. Their Balance Sheet was as under:

Liabilities		Rs.	Assets		Rs.
Creditors		90,000	Cash		5,000
Bills payable		25,000	Bank		40,000
Capital Accounts			Stock		60,000
Sankar :	1,50,000		Furniture		20,000
Saleem :	1,20,000	2,70,000	Land and Building		2,00,000
			Debtors	62,000	
			Less: Provision		
			for Bad debts	2,000	60,000
		3,85,000			3,85,000

On 1st April 2005, they admit Solomon into partnership on the following condition:

1. Solomon has brought Rs.1,00,000 as capital.
2. The value of land and building was to be increased by Rs.20,000.

3. Stock and furniture were to be depreciated by Rs.10,000 and Rs.4,000 respectively.
4. Rs.15,000 to be written off from Sundry creditors as it is no longer liability.
5. Provision for doubtful debts is to be increased by Rs.1,000.

Give journal entries, prepare Revaluation Account and the Balance Sheet.

Solution:

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2005	Land and Building A/c	Dr		20,000	
April 1	Sundry Creditors A/c	Dr		15,000	
	To Revaluation A/c				35,000
	(Profit items credited to Revaluation A/c)				
	Revaluation A/c	Dr		15,000	
	To Stock A/c				10,000
	To Furniture A/c				4,000
	To Provision for doubtful debts A/c				1,000
	(Loss items debited to Revaluation A/c)				
	Revaluation A/c	Dr		20,000	
	To Sankars Capital A/c				12,000
	To Saleems Capital A/c				8,000
	(Profit on revaluation transferred to old partner's capital accounts in the old ratio)				
	Bank A/c	Dr		1,00,000	
	To Solomon's Capital A/c				1,00,000
	(Capital brought in by Solomon)				

Revaluation Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Stock	10,000	By Land and Building	20,000
To Furniture	4,000	By Sundry Creditors	15,000
To Provision for doubtful debts	1,000		
To Profit on revaluation transferred to			
Sankar's Capital A/c 12,000			
Saleem's Capital A/c 8,000	20,000		
	35,000		35,000

Capital Accounts

Dr. Cr.

Particulars	Sankar Rs.	Saleem Rs.	Solomon Rs.	Particulars	Sankar Rs.	Saleem Rs.	Solomon Rs.
To Balance c/d	1,62,000	1,28,000	1,00,000	By Balance b/d	1,50,000	1,20,000	
				By Bank A/c			1,00,000
				By Revaluation A/c	12,000	8,000	
	1,62,000	1,28,000	1,00,000		1,62,000	1,28,000	1,00,000

Dr **Bank Account** Cr

Particulars	Rs.	Particulars	Rs.
To Balance b/d	40,000	By Balance c/d	1,40,000
To Solomon's Capital A/c	1,00,000		
	1,40,000		1,40,000

Balance Sheet of M/s. Sankar, Saleem & Solomon as on 1st April, 2005

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	75,000	Cash	5,000
Bills payable	25,000	Bank	1,40,000
Capital Accounts		Stock	50,000
Sankar 1,62,000		Furniture	16,000
Saleem 1,28,000		Land and Building	2,20,000
Solomon 1,00,000		Sundry Debtors 62,000	
	3,90,000	Less: Provision for doubtful debts 3,000	59,000
	4,90,000		4,90,000

Illustration : 9

Amar and Akbar are partners in a firm sharing profits and losses in the ratio of 2:1 as on 31st March 2005. Their Balance Sheet was as under:

Liabilities	Rs.	Assets	Rs.
Creditors	80,000	Cash	10,000
Bills payable	40,000	Bank	70,000
Capital Accounts		Stock	80,000
Amar : 2,70,000		Plant & Machinery	1,00,000
Akbar : 2,10,000	4,80,000	Land & Building	3,00,000
		Debtors	40,000
	6,00,000		6,00,000

On 1st April 2005, they admit Antony into partnership on the following conditions:

1. Antony has bring in a capital of Rs.1,50,000 for 1/5th share of the future profits.
2. Stock and machinery were to be depreciated by Rs.6,000 and Rs.15,000 respectively.

3. Investments of Rs.15,000 not recorded in the books brought into accounts.
4. Provision for doubtful debts is to be created at 5% on debtors.
5. A liability of Rs.4,000 for outstanding repairs has been omitted to be recorded in the books.

Give journal entries, prepare Revaluation Account, Capital Account, Bank Account and the Balance Sheet.

Solution:

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2005					
April 1	Investments A/c	Dr		15,000	
	To Revaluation A/c				15,000
	(Profit items transferred to Revaluation A/c)				
	Revaluation A/c	Dr		27,000	
	To Stock A/c				6,000
	To Machinery A/c				15,000
	To Provision for doubtful debts A/c				2,000
	To Outstanding repairs				4,000
	(Loss items transferred to Revaluation A/c)				
	Amar's Capital A/c	Dr		8,000	
	Akbar's Capital A/c	Dr		4,000	
	To Revaluation A/c				12,000
	(Loss on revaluation transferred to old partner's capital accounts in the old ratio)				
	Bank A/c	Dr		1,50,000	
	To Antony's Capital A/c				1,50,000
	(Capital brought in by Antony)				

Revaluation Account

Dr. Cr.

Particulars	Rs.	Particulars		Rs.
To Stock	6,000	By Investments		15,000
To Machinery	15,000	By Loss on revaluation transferred to		
To Provision for doubtful debts	2,000	Amar's Capital A/c	8,000	
To Provision for outstanding repairs	4,000	Akbar's Capital A/c	4,000	12,000
	27,000			27,000

Capital Accounts

Dr. Cr.

Particulars	Amar Rs.	Akbar Rs.	Antony Rs.	Particulars	Amar Rs.	Akbar Rs.	Antony Rs.
To Revaluation A/c	8,000	4,000		By Balance b/d	2,70,000	2,10,000	
				By Bank A/c			1,50,000
By Balance c/d	2,62,000	2,06,000	1,50,000				
	2,70,000	2,10,000	1,50,000		2,70,000	2,10,000	1,50,000

Bank Account

Dr Cr

Particulars	Rs.	Particulars	Rs.
To Balance b/d	70,000	By Balance c/d	2,20,000
To Antony's Capital A/c	1,50,000		
	2,20,000		2,20,000

Balance Sheet of M/s. Amar, Akbar & Antony as on 1st April, 2005

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	80,000	Cash	10,000
Bills payable	40,000	Bank	2,20,000
Outstanding repairs	4,000	Stock	74,000
Capital Accounts		Plant & Machinery	85,000
Amar 2,62,000		Investments	15,000
Akbar 2,06,000		Land and Building	3,00,000
Antony 1,50,000		Sundry Debtors 40,000	
	6,18,000	Less: Provision for	
		doubtful debts 2,000	38,000
	7,42,000		7,42,000

7.4 Transfer of Undistributed Profit or Loss

Some times, the balance sheet of the partnership firm may show undistributed profits in the form of profit and loss account in the liabilities side. The undistributed loss in the business is generally shown at the assets side of the old Balance Sheet. The new partner is not entitled to have any share in the undistributed profit or loss. Therefore the undistributed profit or loss should be transferred to the old partners capital accounts in the old profit sharing ratio.

The accounting treatment would be as follows:

a. For transfer of undistributed profit :

Profit and Loss A/c Dr .....
To Old Partners' Capital A/cs .....

2. For transfer of undistributed loss:

Old Partners' Capital A/cs Dr ....
To Profit and Loss A/c ....

Illustration : 10

Sumathi and Sundari are partners of a firm sharing profit and loss in the ratio of 4:3. Their Balance Sheet shows Rs.14,000 as Profit and Loss A/c in the liabilities side. Pass entry.

Solution:

Journal Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Profit and Loss A/c Dr		14,000	
	To Sumathi's Capital A/c			8,000
	To Sundari's Capital A/c			6,000
	(Undistributed profit transferred to Old Partners' Capital Accounts in the old ratio)			

Illustration : 11

Mahalakshmi and Dhanalakshmi are partners sharing profit and loss in the ratio of 3:2. They admit Deepalakshmi on 1st January 2005. On that date, their Balance Sheet showed an amount of Rs.25,000 as Profit and Loss A/c in the Asset side. Pass entry.

Solution:

Journal Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2005	Mahalakshmi's Capital A/c Dr		15,000	
Jan 1	Dhanalakshmi's Capital A/c Dr		10,000	
	To Profit and Loss A/c			25,000
	(Undistributed loss transferred to old partners Capital accounts in the old ratio)			

7.5 Transfer of Accumulated Reserve:

Sometimes, Partners of the firm, may set aside a portion or percentage of the profit earned to meet the unexpected or unforeseen losses arise in future in the name of Reserve, General Reserve, Reserve Fund, Contingency Reserve etc. At the time of admission of new partner, if there is any reserve, it should be transferred to the Capital accounts of the old partners in the old profit sharing ratio.

The accounting treatment would be as follows:

Reserve Fund A/c	Dr	.....	
To Old Partners' Capital A/cs			.....

Illustration : 12

Mahendran and Narasimhan are partners of a firm sharing profit and loss in the ratio of 5:4. On 31.3.2005 the firm's books showed a Reserve fund of Rs.36,000. They decided to admit Aparajitha on 1st April 2005 for 1/3rd share. Pass entry.

Solution:

Journal Entry

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2005	Reserve Fund A/c	Dr		36,000	
Apr 1	To Mahendran's Capital A/c				20,000
	To Narasimhan's Capital A/c				16,000
	(Reserve fund transferred to old partners' capital accounts in the old ratio)				

7.6 Treatment of Goodwill:

The goodwill is the result of the old partners' efforts in the past. Therefore, at the time of admission of new partner the goodwill is to be adjusted in the old partners' capital account.

From the accounting point of view, the Goodwill can be adjusted in one of the following three methods:

1. Revaluation Method
2. Memorandum Revaluation Method
3. Premium Method

Among the above three methods, revaluation method alone discussed in this chapter.

1. Revaluation Method:

Under this method, the new partner does not bring in cash for his share of goodwill. The following accounting treatment is required to adjust goodwill in the books of the firm.

a) Goodwill is raised in the books of the firm:

Goodwill does not appear as an asset in the balance sheet though it exists in the firm. It means that it is not yet recorded in its books and remains a silent asset. At the time of admission of a partner, Goodwill is raised to its present value and shared by the old partners in the old ratio.

The entry is

Goodwill A/c	Dr	.....	
To Old Partners' Capital A/cs			.....
(Goodwill raised to its present value and credited in the old partners' capital accounts)			

b) Goodwill appears in the books - understated

If goodwill appears in the balance sheet of the old partners at a value less than the present value then the difference between the present value and the recorded amount of goodwill is transferred to the old partners' capital accounts in the old ratio.

The entry is

Goodwill A/c Dr .....

To Old partners' capital A/cs .....

(Increase in the value of goodwill transferred to Partners' capital accounts in the old ratio)

c) Goodwill appears in the books - Over stated

If the goodwill appears in the balance sheet at a value more than the present value of goodwill, the reduction in the value of goodwill debited to the old partners capital accounts in the old profit sharing ratio.

The entry is

Old Partners' Capital A./c Dr .....

To Goodwill A/c .....

(Decrease in the value of goodwill transferred to old partners in the old ratio)

Illustration : 13

Damodaran and Jagadeesan are partners sharing profits in the ratio of 3:2. They decided to admit Vijayan for $1/5^{th}$ share of future profit. Goodwill of the firm is to be valued at Rs.50,000.

Give journal entries, if

a) There is no goodwill in the books of the firm.

b) The goodwill appears at Rs.30,000

c) The goodwill appears at Rs.60,000.

Solution:

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Case (a)				
	Goodwill A/c	Dr		50,000	
	To Damodran's Capital A/c				30,000
	To Jagadeesan's Capital A/c				20,000
	(Goodwill raised and credited)				
	Case (b)				
	Goodwill A/c	Dr		20,000	
	To Damodaran's Capital A/c				12,000
	To Jagadeesan's Capital A/c				8,000
	(Goodwill raised from Rs.30,000 to Rs.50,000, the difference of Rs.20,000 credited to the old partners)				
	Case (c)				
	Damodaran's Capital A/c	Dr		6,000	
	Jagadeesan's Capital A/c	Dr		4,000	
	To Goodwill A/c				10,000
	(Goodwill reduced from Rs.60,000 to Rs.50,000, the difference of Rs.10,000 debited to old partners)				

Note: Memorandum Revaluation Method and Premium method of Goodwill are beyond the scope of this book, they are not dealt.

7.7 Preparation of Revaluation Account, Capital Accounts and Balance Sheet after admission of Partner

Illustration : 14

Anitha and Vanitha are partners. They share profits and losses in the ratio of 3:1. Their Balance sheet as on 31st March 2005 is as follows:

Liabilities		Rs.	Assets	Rs.
Creditors		60,000	Cash	5,000
Bills payable		20,000	Debtors	70,000
General Reserve		40,000	Stock	30,000
Capitals:			Plant	25,000
Anitha	80,000		Buildings	1,00,000
Vanitha	40,000	1,20,000	Profit and Loss A/c	10,000
		2,40,000		2,40,00

On 1st April 2005, they agreed to admit Kavitha into the firm for 1/5th Share of future profits on the following terms:

a) Building is revalued at Rs.1,20,000
b) Stock is revalued at Rs.21,500
c) Goodwill is raised at Rs.40,000
d) Provision for bad debts is made at 5%
e) Kavitha to bring in a Capital of Rs.50,000

Give journal entries to give effect of above adjustments, prepare Revaluation account, Capital accounts, Cash account and the Balance Sheet of the reconstituted firm.

Solution:

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Building A/c	Dr		20,000	
	To Revaluation A/c				20,000
	(Building appreciated)				
	Revaluation A/c	Dr		12,500	
	To Stock A/c				8,500
	To Provision for doubtful debts				3,500
	(Stock depreciated and provision for doubtful debts transferred)				

	Revaluation A/c	Dr		8,000	
	To Anitha's Capital A/c				6,000
	To Vanitha's Capital A/c				2,000
	(Profit on revaluation transferred to old partners in the old ratio)				
	Anitha's Capital A/c	Dr		7,500	
	Vanitha's Capital A/c	Dr		2,500	
	To Profit & Loss A/c				10,000
	(Undistributed loss transferred)				
	Goodwill A/c	Dr		40,000	
	To Anitha's Capital A/c				30,000
	To Vanitha's Capital A/c				10,000
	(Goodwill raised and shared among old partners in the old ratio)				
	Cash A/c	Dr		50,000	
	To Kavitha's Capital A/c				50,000
	(Capital brought in by Kavitha)				
	General Reserve A/c	Dr		40,000	
	To Anitha's Capital A/c				30,000
	To Vanitha's Capital A/c				10,000
	(Accumulated reserve transferred to old partners in the old ratio)				

Revaluation Account

Dr. Cr.

Particulars		Rs.	Particulars	Rs.
To Stock		8,500	By Building A/c	20,000
To Provision for doubtful debts		3,500		
To Profit on revaluation transferred to Capital Accounts:				
Anitha	6,000			
Vanitha	2,000	8,000		
		20,000		20,000

Capital Accounts

Dr. Cr.

Particulars	Anitha Rs.	Vanitha Rs.	Kavitha Rs.	Particulars	Anitha Rs.	Vanitha Rs.	Kavitha Rs.
To Profit and Loss A/c	7,500	2,500	----	By Balance b/d	80,000	40,000	---
				By Cash A/c			50,000
To Balance c/d	1,38,500	59,500	50,000	By General Reserve	30,000	10,000	---
				By Goodwill	30,000	10,000	---
				By Revaluation A/c	6,000	2,000	---
	1,46,000	62,000	50,000		1,46,000	62,000	50,000

Cash Account

Dr Cr

Particulars	Rs.	Particulars	Rs.
To Balance b/d	5,000	By Balance c/d	55,000
To Kavitha's Capital A/c	50,000		
	55,000		55,000

Balance Sheet of Anitha, Vanitha and Kavitha as on 1.4.2005.

Liabilities		Rs.	Assets		Rs.
Creditors		60,000	Cash		55,000
Bills payable		20,000	Debtors	70,000	
Capitals:			Less: Provision		
Anitha	1,38,500		for Bad debts	3,500	66,500
Vanitha	59,500		Stock		21,500
Kavitha	50,000	2,48,000	Plant		25,000
			Buildings		1,20,000
			Goodwill		40,000
		3,28,000			3,28,000

Illustration: 15

Sankari and Sudha are partners sharing profit and loss in the ratio of 3:2. Their Balance Sheet as on 31st March 2005 is as under:

Liabilities		Rs.	Assets		Rs.
Capital:			Land & Buildings		1,20,000
Sankari	90,000		Plant & Machinery		90,000
Sudha	75,000	1,65,000	Stock		33,000
Profit and Loss A/c		30,000	Sundry Debtors	15,000	
Sundry Creditors		48,000	Less: Provision for		
Bills payable		50,000	doubtful debts	1,000	14,000
			Cash		6,000
			Goodwill		30,000
		2,93,000			2,93,000

They decided to admit Santhi into the partnership with effect from 1st April 2005 on the following terms:

a) Santhi to bring in Rs.60,000 as Capital for 1/3rd share of profits.
b) Goodwill was valued at Rs.45,000
c) Land was valued at Rs.1,50,000
d) Stock was to be written down by Rs.8,000
e) The provision for doubtful debts was to be increased to Rs.3,000
f) Creditors include Rs.5,000 no longer payable and this sum was to be written off.
g) Investments of Rs.10,000 be brought into books.

Prepare Revaluation A/c, Capital A/c and Balance Sheet of the new firm.

Solution:

Dr. **Revaluation Account** Cr.

Particulars		Rs.	Particulars	Rs.
To Stock		8,000	By Land	30,000
To Provision for doubtful debts		2,000	By Creditors	5,000
			By Investments	10,000
To Profit on revaluation:				
Sankari	21,000			
Sudha	14,000	35,000		
		45,000		45,000

Capital Accounts

Dr. Cr.

Particulars	Sankari Rs.	Sudha Rs.	Santhi Rs.	Particulars	Sankari Rs.	Sudha Rs.	Santhi Rs.
To Balance c/d	1,38,000	1,07,000	60,000	By Balance b/d	90,000	75,000	
				By Cash			60,000
				By Goodwill	9,000	6,000	
				By Profit and Loss A/c	18,000	12,000	
				By Revaluation A/c	21,000	14,000	
	1,38,000	1,07,000	60,000		1,38,000	1,07,000	60,000

Cash Account

Dr Cr

Particulars	Rs.	Particulars	Rs.
To Balance b/d	6,000	By Balance c/d	66,000
To Shanthi's Capital A/c	60,000		
	66,000		66,000

Balance Sheet of Sankari, Sudha and Santhi as on 1st April 2005

Liabilities		Rs.	Assets		Rs.
Capitals:			Land & Buildings		1,50,000
Sankari	1,38,000		Plant & Machinery		90,000
Sudha	1,07,000		Stock		25,000
Santhi	60,000	3,05,000	Sundry Debtors	15,000	
Sundry Creditors		43,000	Less: Provision for		
Bills payable		50,000	doubtful debts	3,000	12,000
			Goodwill		45,000
			Cash		66,000
			Investments		10,000
		3,98,000			3,98,000

QUESTIONS

I. Objective Type

a) Fill in the blanks:

1. In the event of admission of a new partner, legally there is _______ of old partnership.
2. At the time of admission of a new partner, _______ profit ratio should be found out.
3. At the time of admission of a new partner, _______ of assets and liabilities should be taken up.
4. When the value of an asset increases, it results in _______.
5. When an unrecorded liabilities is brought into books, it results in _______.
6. The balance of revaluation account shows __________ on revaluation.
7. The revaluation profit or loss is transferred to the old partners' capital accounts, in their _______.
8. The difference between old profit sharing ratio and new profit sharing ratio at time of admission is _______ ratio.
9. Undistributed Profit will appear on the _______ side of the Balance sheet.
10. At the time of admission, when goodwill is raised, the old partners capital account will be credited in the _______ ratio.
11. The partner admitted into partnership firm acquires two rights i.e., right to share in the _______ of the partnership and right to share in the _______.

12. The new profit sharing ratio will be determined by how the new partner acquires is _______ from the old partners.

13. Under _______ goodwill account is raised by crediting the old partners capital accounts in the old profit sharing ratio.

(Answers: 1. dissolution; 2. new; 3. revaluation; 4. profit; 5. loss; 6. profit or loss; 7. old ratio; 8. Sacrifice; 9. liabilities; 10.Old profit sharing; 11. assets, profits; 12. share of profit; 13. revaluation method)

b) Choose the correct answer:

1. When A and B sharing profits and losses in the ratio of 3:2, they admit C as a partner giving him 1/3 share of profits. This will be given by A and B.
   a) Equally
   b) In the ratio of their capitals
   c) In the ratio of their profits.

2. In admission, profit from revaluation of assets and liabilities will be transferred to the capital accounts of the old partners in the
   a) Old profit sharing ratio
   b) Sacrifice ratio
   c) New profit sharing ratio

3. If new share of the incoming partner is given without mentioning the details of the sacrifice made by the old partners then, the presumption is that old partners sacriffice in the _______.
   a) Old profit sharing ratio
   b) Gaining ratio
   c) Capital ratio

4. In order to maintain fair dealings, at the time of admission, it is necessary to revalue assets and liabilities of the firm to their ______.
   a) cost price
   b) cost price less depreciation
   c) true value

5. On admission of a partner if goodwill account is to be raised this should be debited to
   a) Partners' capital account
   b) Goodwill account
   c) Revaluation account

6. When A and B sharing profits and losses in the ration 3:2, admit C as a partner giving him 1/5 share of profits. This will be given by A and B.
   a) Equally
   b) in their capitals ratio
   c) in their profit sharing ratio

7. On admission of a new partner, increase in value of assets is debited to
   a) Asset account
   b) Proit & Loss adjustment account
   c) Old partners capital account

8. On admission of a new partner balance of General Reserve Account should be transferred to the capital account of
   a) all partners in their new profit sharing ratio
   b) old partners in their old profit sharing ratio
   c) old partners in their new profit sharing ratio

9. The old partners share all the accumulated profits and reserves in their

   a) new profit sharing ratio

   b) old profit sharing ratio

   c) capital ratio

10. The reconstitution of the partnership requires a revision of the _______ of the existing partners

    a) Profit sharing ratio

    b) Capital ratio

    c) Sacrificing ratio

11. ________ ratio is computed at the time of admission of a new partner

    a) Gaining ratio

    b) Capital ratio

    c) Sacrificing ratio

(Answer : 1.(c); 2.(a); 3. (a); 4. (c); 5. (d); 6. (c); 7. (a); 8. (b); 9. (b); 10. (a); 11. (c))

II. Other Questions:

1. What is meant by admission of a partner?
2. Who is an incoming partner?
3. What are the adjustments to be made in connection with admission?
4. What is new profit ratio on admission of a partner?
5. What is Sacrifice Ratio?
6. What is revaluation account?
7. Why revaluation account is to be prepared?

8. What are the entries for Revaluation of Assets and Liabilities of a firm in the event of admission of a partner?
9. How will you treat the undistributed profits and losses at the time of admission of a partner?
10. What is accumulated reserve?
11. What is Revaluation Method of Goodwill?

III. PROBLEMS

Calculation of New Profit Ratio and Sacrificing Ratio:

1. Sheela and Neela were sharing profits in the ratio of 4:3. Kamala was admitted with 1/5th share in profits of business. Calculated the New Profit Ratio and the sacrificing ratio.

   (Ans : New ratio 16:12:7; Sacrificing ratio = 4:3)

2. Kokila and Mala were sharing profits in the ratio of 4:3. Chandra was admitted in the business as a partner with 3/7th share in the profits of the firm which she takes 2/7th from Kokila and 1/7th from Mala. Find out New Profit Ratio and the sacrificing ratio.

   (Ans : New ratio 2:2:3; Sacrificing ratio = 2:1)

3. Anandan and Baskaran were partners in a firm sharing profit and loss in the ratio of 3:2. They admit Chandran into the partnership to 1/3rd share, the old partners sacrificing equally. Calculate the new profit - ratio and the sacrificing ratio.

   (Ans : New ratio 13:7:10; Sacrificing ratio = 1:1)

4. Kundran and Kumaran are partners sharing profit and losses in the ratio of 9:7. Kugan is admitted as partners; he acquires 3/16 of the profit entirely from Kundran. Calculate the new profit ratio and the sacrificing ratio.

   (Ans : New ratio 6:7:3; Sacrifice Kundran only 3/16)

5. Eswari and Ranikumari are partners sharing profits and losses in the ratio of 7:5. They agree to admit Chitra into partnership. Eswari surrenders 1/7th of her share and Ranikumari 1/5th of her share in favour of Chitra. Calculate the New Profit Ratio and the sacrificing ratio.

(Ans : New ratio 3:2:1; Sacrificing ratio = 1:1)

6. Ramesh and Suresh are sharing profits in the ratio of 4:3. Mahesh joins and the new ratio among Ramesh, Suresh and Mahesh is 7:4:3. Find out the sacrificing ratio.

(Ans.: Sacrificing ratio = 1:2)

7. Mani and Sundaram are partners in a firm sharing profits and losses in the ratio of 7:3. Muthian admitted as new partner. Mani surrenders 1/7th share of his profit in favour of Muthian and Sundaram surrenders 1/3rd of his share in favour of Muthian. Calculate New Profit Sharing Ratio and the sacrificing ratio.

(Ans : New ratio 3:1:1; Sacrificing ratio = 1:1)

8. Muthu and Siva were partners in a firm sharing profits in the ratio of 7:3. Bala was admitted on 1/5th shares in the profits. What would be their New Profit Ratio and their sacrificing ratio in each of the following cases:
   (a) If Bala acquired his shares equally, from the old partners.
   (b) If he acquired his profit - share in the original ratio of the old partners.
   (c) If he acquired it as 3/20th from Muthu and 1/20th from Siva.
   (d) If he acquires his share entirely from Muthu.

(Answer: New ratio (a) 3:1:1; (b) 14:6:5; (c) 11:5:4; (d) 5:3:2
Sacrificing ratio (a) 1:1; (b) 7:3; (c) 3:1; (d) Muthu only 1/5)

9. A and B are partners in a firm sharing profits and losses in the ratio of 6:4. C is admitted as a new partner. A surrenders 1/5th share of his profit in favour of C and B surrenders 2/5th of his share in favour of C. Calculate New Profit Sharing Ratio.

(March 2003)

(Answer: 12:6:7)

Revaluation of Assets and Liabilities:

10. Sridevi and Cynthia were partners sharing profit and loss in the ratio of 3:2. They decided to admit Fathima into the partnership and revalue their assets and liabilities as indicated here under:
    (a) To bring into record investment of Rs. 18,000 which had not so far been recorded in the books of the firm.
    (b) To depreciate stock, furniture and machinery by Rs.18,000, Rs.6,000 and Rs.30,000 respectively.
    (c) To provide for workmen's compensation of Rs.24,000.

    Pass the necessary journal entries and show the revaluation account.

(Ans: Revaluation Loss Rs. 60,000)

11. Raman and Laxmanan were partners sharing profit and losses in the ratio of 4:3. In view of Velan's admission, they decided to revalue their assets and liabilities as indicated below:
    (a) To increase the value of buildings by Rs. 60,000.
    (b) Provision for doubtful debts to be decreased by Rs.800.
    (c) To decrease machinery by Rs.16,000, furniture by Rs.4,000 and stock by Rs. 12,000.
    (d) A provision for outstanding liabilities was to be created for Rs.800

    Show the Revaluation Account.

(Ans.: Revaluation Profit Rs. 28,000)

12. M and G were partners sharing profit and loss in the ratio of 3:2. They decided to admit L into the partnership and revalue their assets and liabilities as under:

a) To bring into record investment of Rs.12,000 which had not so far been recorded in the books of the firm.

b) To depreciate stock, furniture and machinery by Rs.3,000, Rs.1,000 and Rs.5,000 respectively.

c) A provision for Outstanding Liabilities was to be created for Rs.4,000.

Give journal entries and show the Revaluation Account.

(March 2003)

(Answer: Revaluation Loss Rs.1,000)

13. Valluvan and Kamban were partners sharing profits and losses as 60% to Valluvan and 40% to Kamban. Their Balance Sheet as at 1st January, 2005 stood as under:

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	96,000	Cash in Hand	4,000
Bills payable	34,000	Sundry debtors	56,000
Capital Accounts:		Stock	40,000
Valluvan : 90,000		Plant & Machinery	80,000
Kamban : 80,000	1,70,000	Land & Buildings	1,20,000
	3,00,000		3,00,000

The partners agreed to admit Elangovan into the firm subject to revaluation of the following items:

(i) Stock was to be reduced by Rs. 4.000

(ii) Land and Buildings were to be valued at Rs.1,60,000

(iii) A provision of 2 ½% was to be created for doubtful debtors.

(iv) A liability of Rs. 2,600 for outstanding expenses had been omitted to be recorded in the books.

Prepare the revaluation account, capital accounts and the balance sheet after the above adjustment.

(Ans. : Profit on Revaluation : Rs.32,000 ;
Balance Sheet Total : Rs.3,34,600)

14. Set out below is the balance sheet of Narayanan and Perumal sharing profits and losses equally as at 1st April, 2005.

Liabilities	Rs.	Assets		Rs.
Sundry creditors	24,000	Cash in Hand		2,000
Capital Accounts:		Cash at Bank		19,000
Narayanan : 60,000		Sundry Debtors	12,000	
Perumal : 60,000	1,20,000	Less: Provision		
		for doubtful debts	1,000	11,000
		Furniture		8,000
		Buildings		80,000
		Stock		24,000
	1,44,000			1,44,000

On that date they admit Palani into the firm subject to the following terms of revaluation.

(a) Stock and furniture are to be reduced in value by 10%.

(b) Building are to be appreciated by Rs.15,000

(c) A Provision for doubtful debts to be increased to Rs.1,500.

Prepare the revaluation account, capital accounts and the Balance Sheet after the above adjustment.

(Ans. : Profit on Revaluation : Rs.11,300;
Balance Sheet Total : Rs.1,55,300)

15. Geetha and Seetha were partners sharing profits and losses in the ratio of 2:1. Their balance sheet as at 31st December, 2004 stood as under:

Liabilities	Rs.	Assets	Rs.
Sundry creditors	60,000	Bank	24,000
General Reserve	45,000	Land and Building	1,45,000
Profit and Loss A/c	60,000	Plant and Machinery	1,00,000
Capital Accounts:		Stock	60,000
Geetha : 1,40,000		Sundry debtors	56,000
Seetha : 80,000	2,20,000		
	3,85,000		3,85,000

On the above date, they decided to admit Latha subject to following items of revaluation.

(a) To appreciate land and buildings by 20%

(b) To depreciate plant and machinery by 5% and stock by 10%

(c) To create a provision for Rs.3,000 for a claim against the firm for damages.

Show revaluation account, capital accounts and balance sheet of the firm after the adjustments.

(Answer : Profit on Revaluation : Rs. 15,000
Balance Sheet Total : Rs.4,03,000)

Adjustment for Reserve and Undistributed Profit & Loss

16. Amala and Vimala were partners of a firm sharing profit and losses in the ratio of 5:3. On 1.4.2004, the firm's book showed a reserve fund of Rs.48,000. On the above date they decided to admit Komala into the partnership. Pass entry.

17. Gayathiri and Sumithra were partners of a firm sharing profit and loss is the ratio of 3:2. On 31st December 2002, the firm's books showed general reserve at Rs.50,000 and profit and loss A/c showing debit balance of Rs.30,000. On the above date they decided to admit Pavithra into the partnership. Pass entries to transfer the entire reserve and profit and loss to the capital accounts of the partners.

Treatment of Goodwill

18. Jabeen and Kathija were partners in a firm sharing profits and losses in the ratio of 2:1. They admitted Sultana as a partner and the new profit sharing ratio was 3:2:1. Goodwill did not appear on the date of the above admission in the partnership books and it was valued at Rs.36,000.

    Show the journal entry for the treatment of goodwill under the revaluation method.

19. Ponmalar and Thenmozhi were partners in a firm sharing profits and losses in the ratio of 7:3. They decided to admit Kanimozhi into the firm to one sixth share of profits. Goodwill account stood in their books at Rs.60,000 and it was on that above date of the admission valued at Rs.40,000. What is the entry for the goodwill account to its agreed value?

20. Kalavathi and Malathi are two partners sharing profits in the ratio of 4:3. Leelavathi is admitted for 1/3rd share of profits. Goodwill of the firm is to be valued at 2 years' purchase of 3 years' profits which have been Rs.44,000 Rs. 56,000, Rs. 68,000. Give journal entries if:

    (a) There is no goodwill in the books of the firm.

    (b) The goodwill account appears at Rs. 28,000

    (c) The goodwill already existing in the books is Rs. 1,68,000

(Ans. Goodwill Rs.1,12,000)

Combining Some (or) All Adjustments:

21. The following is the Balance Sheet of Amutha and Rama sharing profits 3:2, as on 31.3.2005.

Liabilities	Rs.	Assets	Rs.
Sundry creditors	80,000	Bank	10,000
Bills payable	20,000	Sundry debtors	30,000
Capital accounts		Stock	20,000
Amutha : 40,000		Machinery	40,000
Rama : 30,000		Land and Buildings	70,000
	70,000		
	1,70,000		1,70,000

On 1.4.2005 they decided to admit Latha Baskar into the partnership on the following terms:

(a) Latha Baskar shall bring in a capital of Rs.30,000

(b) Goodwill of the firm being valued at Rs.20,000

(c) Land and buildings be appreciated by 10%

(d) Stock be depreciated by Rs.3,000 and provision for outstanding liability be created at Rs.2,000.

Prepare the Revaluation account, Capital accounts, Bank account and the Balance Sheet of the reconstituted partnership.

(Ans. : Revaluation Profit : Rs. 2,000; B/s : Rs.2,24,000)

22. The following is the Balance Sheet of Lion and Tiger sharing profits and losses as to Lion - 65% and Tiger - 35% as at 31st March 2004:

Liabilities	Rs.	Assets	Rs.
Sundry creditors	25,000	Cash	2,000
Bank overdraft	13,000	Debtors	30,000
Profit and Loss A/c	14,000	Stock	20,000
Capital :		Furniture	8,000
Lion : 40,000		Land and Buildings	50,000
Tiger : 30,000	70,000	Goodwill	12,000
	1,22,000		1,22,000

They agree to take Leopard into the partnership to 1/10th share on the following terms:

(a) Leopard shall bring in a capital of Rs. 30,000.

(b) The goodwill of the firm be increased to Rs.15,000

(c) A provision of Rs.1,000 be made for outstanding repairs bill.

(d) The value of land and buildings be brought upto Rs.60,000 being their present worth.

Prepare the Revaluation account, Capital accounts, Bank account and the Balance Sheet of the New Firm.

(Ans. : Revaluation Profit : Rs. 9,000; B/s. : Rs.1,65,000)

23. Prasanna and Nirmala were partners sharing profit and loss in the ratio of 7:5. Their Balance Sheet as on 31st December, 2004 is as under:

Liabilities	Rs.	Assets		Rs.
Capital:		Land & Buildings		80,000
Prasanna : 60,000		Plant & Machinery		20,000
Nirmala : 50,000	1,10,000	Investments		40,000
Reserve fund	30,000	Stock		22,000
Sundry creditors	22,000	Sundry debtors	10,000	
Bills payable	13,600	Less: Provision		
		for doubtful debts	400	9,600
		Cash		4,000
	1,75,600			1,75,600

They decided to admit Parimala into the partnership with effect from 1st January, 2005 on the following terms.

(a) Parimala shall bring in a capital of Rs.40,000 for 1/3rd share of profits.

(b) Goodwill of the firm was valued at Rs.72,000.

(c) Land was to be revalued at Rs.90,000 and investments Rs.50,000.

(d) Stock was to be written down by Rs.4,000

(e) Provision for doubtful debts was to be increased Rs.600.

(f) Creditors includes Rs.1,000 no longer payable and this sum was to be written off.

Show revaluation account, capital accounts of partners and the Balance Sheet of the reconstituted partnership.

(Ans. : Revaluation Profit : Rs. 16,800; B/s. : Rs.3,03,400)

24. Lakshmi and Saraswathi are partners of a firm sharing profits and losses in proportion to capital. Their Balance Sheet as on 31st March 2005 is as under:

Liabilities	Rs.	Assets	Rs.
Sundry creditors	60,000	Bank	12,000
Bills payable	40,000	Sundry debtors	40,000
Capital accounts:		Stock	40,000
Lakshmi : 60,000		Plant	90,000
Sarswathi : 40,000	1,00,000	Furniture	18,000
	2,00,000		2,00,000

They decided to admit Sulochana into the partnership with effect from 1st April, 2005 on the following terms.

(a) Sulochana shall bring in a capital of Rs.50,000 for 1/5th share of profits.

(b) Goodwill is to be valued at Rs.40,000.

(c) Plant and furniture was to be depreciated by 5%.

(d) Provision for doubtful debts be created at 1½% on sundry debtors.

Show revaluation account, capital accounts, bank account and balance sheet of the reconstituted partnership.

(Ans. : Revaluation Loss : Rs.6,000 B/s : Rs.2,84,000)

25. The following are the Balance Sheet of Pandian, Pallavan and Chozhan sharing profits and losses in the proportion of 1/2, 1/3 and 1/6 respectively as at 31.12.2004.

Liabilities	Rs.	Assets	Rs.
Sundry creditors	94,500	Cash	10,000
Bills payable	31,500	Bank	1,20,000
Reserve fund	1,20,000	Land and Building	2,50,000
Outstanding expenses	4,000	Furniture	35,000
Capital:		Stock	1,45,000
Pandian : 1,80,000		Debtors	1,30,000
Pallavan : 1,65,000			
Chozhan : 95,000	4,40,000		
	6,90,000		6,90,000

They decided to admit Cheran into the partnership with effect from 1st January, 2005 on the following terms.

(a) Cheran should bring in Rs.80,000 as his capital for ¼ share of profits.

(b) Furniture be depreciated by Rs.3,500.

(c) Stock be depreciated by 10%.

(d) The value of land and buildings having appreciated be brought upto Rs.3,25,000.

Show revaluation account, capital accounts, bank account and the balance sheet of the reconstituted partnership.

(Ans. : Revaluation Profit Rs.57,000; Balance Sheet Total : Rs. 8,27,000)

26. A and B sharing pofits in the ratio of 6:4, admit C as a partner with 1/3 share in profits on 1st January, 2000. The terms agreed upon were,

a) C has to contribute Rs.25,000 as capital.

b) Goodwill of the firm be valued at Rs.26,000.

c) Land & building be appreciated by 40%.

d) Depreciate Plant & Machinery by 10%.

e) The provision for doubtful debts was to be increased by Rs.800.

f) A liability of Rs.1,000 included in the Sundry Creditors is not likely to arise.

The Balance sheet of A, B as on 31.12.1999 before C's admission was as follows:

Liabilities		Rs.	Assets		Rs.
Sundry creditors		29,000	Cash		9,000
Bills payable		6,000	Land & Building		25,000
Capitals:			Plant & Machinery		30,000
A	50,000		Stock		15,000
B	35,000	85,000	Sundry debtors	20,000	
General Reserve		16,000	Less: Provision for doubtful debts	1,000	19,000
			Goodwill		10,000
			Profit & Loss Account		28,000
		1,36,000			1,36,000

Pass necessary journal entries and prepare important Ledger Accounts and the new Balance Sheet as on 1.1.2000 after admission of C.

(June 2003)

(Answer: Revaluation Profit Rs.6,200; B/s Rs.1,55,200)

27. A and B were partners sharing profit and losses in the ratio of 3:2. Their Balance sheet as on 31st December, 2001 is as under:

Liabilities		Rs.	Assets		Rs.
Capital:			Land & Buildings		40,000
A	30,000		Plant & Machinery		10,000
B	25,000	55,000	Investments		10,000
Reserve fund		10,000	Stock		11,000
Sundry Creditors		16,000	Profit & Loss Account		10,000
Bills payable		6,800	Sundry Debtors	5,000	
			Less: Provision for doubtful debts	200	4,800
			Cash		2,000
		87,800			87,800

They decided to admit C into the partnership with effect from 1st January, 2002.

i) That C shall bring as a capital of Rs.20,000 for 1/3rd Profits.

ii) That goodwill of the firm was valued at Rs.36,000.

iii) Land was to be revalued at Rs.45,000 and investments at Rs.25,000.

iv) Stock was to be written down by Rs.2,000.

v) That provision for doubtful debts was to be increased to Rs.300.

vi) Creditors include Rs.500 no longer payable and this sum was to be written off.

Pass journal entries to carry out the above terms of admission. Also show Revaluation account, Capital accounts of partners and the Balance Sheet of the reconstituted partnership.

(October 2002)

(Answer: Revaluation Profit Rs.18,400; B/s Rs.1,51,700)

Chapter - 8

PARTNERSHIP ACCOUNTS - RETIREMENT

Learning Objectives

After studying this Chapter, you will be able to:

- *know the meaning and reasons for retirement.*
- *ascertain the new profit sharing ratio and the gaining ratio.*
- *prepare the revaluation account.*
- *understand the accounting treatment of goodwill.*
- *know the modalities of settlement of claim of the retiring partner.*

According to section 32(1) of the Indian Partnership Act 1932, a partner may retire from the firm

1) with the consent of all the partners
2) in accordance with an express agreement by the partners
3) where the partnership at will by giving notice in writing to all the other partners of his intention to retire.

Sometimes, a partner may decide to retire from the firm because of old age, ill health etc. Technically, on retirement, the old partnership

comes to an end and a new one comes into existence with the remaining partners. However, the firm as such continues. A person who is retired from the firm is known as an **outgoing partner** or a **retiring partner**. A retiring partner will be held liable for the debts incurred by the firm before his retirement. But, he will not be responsible for the firms' acts after his retirement.

When a partner retires, his share in the properties of the firm has to be ascertained and paid off. Certain adjustments have to be made in the books to ascertain the amount due to him from the firm. These adjustments are very similar to those which we saw in connection with the admission of a partner.

8.1 Adjustments:

When a partner retires, the following accounting adjustments are necessary

1. Calculation of New profit sharing ratio and Gaining ratio
2. Revaluation of assets and liabilities
3. Transfer of Undistributed Profit or loss
4. Transfer of Accumulated reserves
5. Treatment of Goodwill
6. Settlement of the retiring partner's claim.

8.1.1 Calculation of New Profit sharing ratio and Gaining ratio

At the time of retirement of a partner, the remaining partners acquire some portion of the retiring partner's share of profit. This necessitates the calculation of new profit sharing ratio of the remaining partners.

New Profit Sharing Ratio:

The ratio in which the continuing partners decide to share the future profits and losses is known as *new profit sharing ratio*.

New Profit sharing ratio = Old ratio + Gaining ratio

New share = Old share + Acquired share (gain)

Gaining Ratio:

The ratio in which the continuing partners acquire the outgoing partner's share is called as *gaining ratio*. This ratio is calculated by taking out the difference between new profit shareing ratio and old profit sharing ratio.

Gaining ratio = New ratio – Old ratio

Gain = New share – Old share

The purpose of this ratio is to determine the amount of compensation to be paid by each of the remaining partners as the firm to the retiring partner.

Distinction between Sacrificing Ratio and Gaining Ratio

Sacrificing Ratio and Gaining Ratio can be distinguished as follows:

Basis of Distinction	Sacrificing Ratio	Gaining Ratio
1. Meaning	It is the ratio in which the old partners have agreed to sacrifice their shares in profit in favour of new partner.	It is the ratio in which the continuing partners acquire the outgoing partner's share.
2. Purpose	It is calculated to determine the amount of compensation to be paid by the incoming partner to the sacrificing partners.	It is calculated to determine the amount of compensation to be paid by each of the continuing partners to the outgoing partner.
3. Calculation	It is calculated by taking out the difference between old ratio and new ratio.	It is calculated by taking out the difference between new ratio and old ratio.
4. Time	It is calculated at the time of admission of a new partner.	It is calculated at the time of retirement of a partner.

The following are the different situations while calculating the new profit sharing ratio and the gaining ratio.

1. Nothing is mentioned about the new ratio
2. Unequal gain
3. Equal gain
4. Entire gain by one partner
5. New profit sharing ratio is given

8.2 Calculation of New Profit sharing ratio and Gaining ratio

1. Nothing is mentioned about the new ratio

If nothing is mentioned about the new ratio, old ratio of the continuing partners is equal to their new ratio. It is proved in the following illustration.

Illustration : 1

A,B and C sharing profits in the ratio of 5:3:2. C retires. Find out the new profit sharing ratio and gaining ratio.

Solution:

A : B : C

Old ratio = 5 : 3 : 2

$$\text{Old share} = \frac{5}{10} : \frac{3}{10} : \frac{2}{10}$$

New ratio = 5 : 3

$$\text{New share} = \frac{5}{8} : \frac{3}{8}$$

$$\text{Gain} = \frac{5}{8} - \frac{5}{10} : \frac{3}{8} - \frac{3}{10}$$

$$= \frac{25-20}{40} = \frac{5}{40} : \frac{15-12}{40} = \frac{3}{40}$$

∴ Gaining ratio = 5 : 3

2) Unequal gain

Illustration 2:

D, E and F are partners sharing profits in the ratio of 5 : 3 : 2. F retires and his share was taken up by D and E in the ratio of 2 : 1. Find out the new profit sharing ratio of D and E.

Solution:

		D	:	E	:	F
Old ratio	=	5	:	3	:	2
Old share	=	$\frac{5}{10}$	:	$\frac{3}{10}$	:	$\frac{2}{10}$
Gaining ratio	=	2	:	1		

$$\text{Gain} = \frac{2}{3} \times \frac{2}{10} : \frac{1}{3} \times \frac{2}{10}$$

$$= \frac{4}{30} : \frac{2}{30}$$

$$\text{New share} = \frac{5}{10} + \frac{4}{30} : \frac{3}{10} + \frac{2}{30}$$

$$= \frac{15+4}{30} = \frac{19}{30} : \frac{9+2}{30} = \frac{11}{30}$$

New ratio = 19 : 11

3) Equal gain

Illustration 3:

G, H and I are partners sharing profits in the ratio of 5 : 3 : 2. I retires and his share was taken up by G and H equally. Find out the new Profit sharing ratio of G and H.

Solution:

		G	:	H	:	I
Old ratio	=	5	:	3	:	2
Old share	=	$\frac{5}{10}$	:	$\frac{3}{10}$	:	$\frac{2}{10}$
Gaining ratio	=	1	:	1		

$$\text{Gain share} = \frac{1}{2} \times \frac{2}{10} : \frac{1}{2} \times \frac{2}{10}$$

$$= \frac{2}{20} = \frac{1}{10} : \frac{2}{20} = \frac{1}{10}$$

$$\text{New share} = \frac{5}{10} + \frac{1}{10} : \frac{3}{10} + \frac{1}{10}$$

$$= \frac{6}{10} : \frac{4}{10}$$

New ratio $= 6 : 4$

$= 3 : 2$

4) Entire gain by one partner

Illustration 4:

J, K and L are partners sharing profits in the ratio of 5 : 3 : 2. L retires and his share was taken up entirely by K. Find out the new Profit sharing ratio and gaining ratio of continuing partners.

Solution :

a) New ratio:

		J		K		L
Old ratio	=	5	:	3	:	2
Old share	=	$\frac{5}{10}$	:	$\frac{3}{10}$	:	$\frac{2}{10}$

Share of Gain $= ---- : \frac{2}{10}$

New share $= \frac{5}{10} : \frac{3}{10} + \frac{2}{10} = \frac{5}{10}$

$= 5 : 5$

New ratio $= 1 : 1$ i.e. equal

b) Gaining ratio:

Gaining ratio = New ratio – Old ratio

J's Gain = New share – Old share

J's Gain $= \frac{5}{10} - \frac{5}{10}$ = Nil

K's gain $= \frac{5}{10} - \frac{3}{20}$

K's gain $= \frac{2}{10}$ or $\frac{1}{5}$

5) New ratio is given

Illustration 5:

X,Y and Z are partners sharing profits in the ratio of 5 : 3 : 2. Z retires and the ratio between X and Y is 3 : 2. Find out the gaining ratio

Solution:

		X		Y		Z
Old ratio	=	5	:	3	:	2
Old share	=	$\frac{5}{10}$	:	$\frac{3}{10}$	:	$\frac{2}{10}$
New ratio	=	3	:	2		
New share	=	$\frac{3}{5}$	:	$\frac{2}{5}$		

$$\text{Share of gain} = \frac{3}{5} - \frac{5}{10} : \frac{2}{5} - \frac{3}{10}$$

$$= \frac{1}{10} : \frac{1}{10}$$

∴ Gaining ratio = 1 : 1

8.3 Revaluation of assets and Liabilities

At the time of retirement of a partner, it is necessary to revalue the assets and liabilities of the firm. It is necessary that the retiring partner is given a share of all profits that have arisen till his retirement. Further, he is made to bear his share of losses that had occurred till his retirement. A Revaluation account is opened and credited with all the profit items and debited with all the loss items. The profit or loss on revaluation will be transferred to partners' capital accounts including the retiring partner in the old profit sharing ratio.

Entries for revaluation here are similar to those in admission. They are:

1. *For profit items:* a) Increase in the value of assets b) Decrease in the amount of Liabilities & c) Unrecorded assets recorded

Concerned Assets A/c	Dr	.....	
Concerned Liabilities A/c	Dr	.....	
To Revaluation A/c			.....

2. *For Loss items:* a) Decrease in the Value of assets b) Increase in the amount of Liabilities c) Unrecorded liabilities recorded and d) New liability created.

Revaluation A/c	Dr	......	
To Concerned Assets A/c			......
To Concerned Liabilities A/c			......

3. *For transfer of profit or loss on revaluation*

a) If Profit

Revaluation A/c	Dr	......	
To All partners' capital A/c			......

b) If Loss

All partners' capital A/c	Dr	......	
To Revaluation A/c			......

Illustration 6:

Prabha, Kavitha and Meena were partners of a firm sharing profit and loss in the ratio of 3 : 2 : 1. Meena wanted to retire. They decided to revalue the assets and liabilities of the firm as indicated below:

a) To write down Machinery by Rs.10,000 and Stock by Rs.4,000

b) To bring into books as unrecorded Investments Rs.5,000

c) To write off Rs.3,000 from sundry creditors as it was no longer liability.

Pass entries to give effect to the above adjustments. Show also Revaluation account.

Solution:

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Investments A/c	Dr		5,000	
	Sundry creditors A/c	Dr		3,000	
	To Revaluation A/c (Profit items of revaluation)				8,000

	Revaluation A/c Dr		14,000	
	To Machinery A/c			10,000
	To Stock A/c			4,000
	(Loss items of revaluation)			
	Prabha's capital A/c Dr		3,000	
	Kavitha's capital A/c Dr		2,000	
	Meena's capital A/c Dr		1,000	
	To Revaluation A/c			6,000
	(Loss on revaluation transferred to old partners in the old ratio)			

Revaluation Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
	To Machinery A/c	10,000		By Investments A/c	5,000
	To Stock A/c	4,000		By Sundry creditors A/c	3,000
				By Loss transferred to capital account	
				Prabha 3,000	
				Kavitha 2,000	
				Meena 1,000	6,000
		14,000			14,000

8.4 Transfer of Undistributed Profit or Loss

At the time of retirement of a partner, undistributed profit or loss of the old firm should be transferred to all partners' capital accounts in their old profit sharing ratio.

The accounting treatment would be as follows:

a. For transfer of undistributed profit :

Profit and Loss A/c Dr .....
To All Partners' Capital A/cs .....

2. For transfer of undistributed loss:

All Partners' Capital A/cs Dr ....
To Profit and Loss A/c ....

Illustration 7:

Bhanumathi, Bharathi and Shanthi are partners sharing. profits in the ratio of 5 : 3 : 2. On April 1, 2005 Shanthi decided to retire. On that date, there was a credit balance of Rs.60,000 in their profit and loss account. Pass entry.

Solution:

Journal Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2005 Apr 1	Profit and Loss A/c Dr		60,000	
	To Bhanumathi's capital A/c			30,000
	To Bharathi's capital A/c			18,000
	To Shanthi's capital A/c			12,000
	(Undistributed profit transferred to capital accounts in the old ratio)			

8.5. Transfer of Accumulated Reserve

Any amount kept aside as Reserve, General reserve, Reserve fund, contingency reserve etc., at the time of retirement of a partner, should be transferred to the capital accounts of all partners including retiring partner in the old profit sharing ratio.

The entry is

General Reserve A/c Dr ...

To All Partners' capital A/c ...

Illustration : 8

Thangamuthu, Anaimuthu and Vairamuthu are partners sharing profit and loss in the ratio of 3:3:2. Thangamuthu wanted to retire on 1st June 2005, the firms books showed a general reserve of Rs.40,000. Pass entry.

Solution :

Journal Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2005				
Jun 1	General Reserve A/c Dr		40,000	
	To Thangamuthu's capital A/c			15,000
	To Anaimuthu's Capital A/c			15,000
	To Vairamuthu's capital A/c			10,000
	(General reserve transferred partners capital accounts)			

8.6 Treatment of Goodwill

At the time of retirement of a partner, adjustment for goodwill of the firm, if any, has to be made as in admission. In retirement too, we confine to the Revaluation Method only.

a) Goodwill is raised in the books of the firm:

At the time of retirement, Goodwill is raised to its present value and brought into record.

The entry is

Goodwill A/c Dr ....

To All partners' capital A/c ...

(Goodwill raised and adjusted to the all partners' capital account)

b) Goodwill appears in the books -understated:

If the goodwill appears in the balance sheet at a value less than the present value of goodwill, the difference in the goodwill account is transferred to all partners' capital accounts in the old ratio.

The entry is

Goodwill A/c Dr ....

To All Partners' capital A/c ....

(Increase in the value of goodwill transferred to all partners' capital accounts in the old ratio)

c) Goodwill appears in the books - overstated :

If the goodwill appears in the balance sheet at a value more than the present value of goodwill, the difference in the goodwill is transferred to all partners in the old ratio.

The entry is

All Partners' Capital A/c Dr ...

To Goodwill A/c ...

(Decrease in the value of goodwill transferred to all partners' capital accounts in the old ratio)

Illustration : 9

Thamizhselvi, Kalaiselvi and Thenmozhi are partners sharing profits in the ratio of 5 : 3 : 2. Kalaiselvi decided to retire. Goodwill of the firm is to be valued at Rs.40,000. Give journal entries if

a) there is no goodwill in the books of the firm.

b) the goodwill appears at Rs.30,000

c) the goodwill appears at Rs.50,000

Solution:

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	(a)				
	Goodwill A/c	Dr		40,000	
	To Thamizhselvi A/c				20,000
	To Kalaiselvi A/c				12,000
	To Thenmozhi A/c				8,000
	(Goodwill raised and transferred to old partners in the old ratio)				
	(b)				
	Goodwill A/c	Dr		10,000	
	To Thamizhselvi A/c				5,000
	To Kalaiselvi A/c				3,000
	To Thenmozhi A/c				2,000
	(Increase in goodwill transferred)				
	(c)				
	Thamizh selvi A/c	Dr		5,000	
	Kalaiselvi A/c	Dr		3,000	
	Thenmozhi A/c	Dr		2,000	
	To Goodwill				10,000
	(Decrease in goodwill transferred to the old partners in the old ratio)				

8.7 Settlement of claim of the retiring partner

The retiring partner is entitled for the amount due to him from the firm. The amount due to the retiring partner is ascertained by preparing his capital account incorporating all the adjustments like the share of goodwill, undistributed profits or losses, accumulated reserves, profit or loss on revaluation of assets and liabilities etc.

The amount due is either paid off immediately or is paid in instalments. When it is not paid immediately, it will be transferred to his loan account.

a) *When the amount due is paid off immediately*

Retiring partner's capital A/c	Dr	....	
To Bank A/c			....

b) *When the amount due is not paid immediately*

Retiring partner's capital A/c	Dr	....	
To Retiring Partner's Loan A/c			....

c) *When the amount is paid partly at once and the balance in instalments*

Retiring partner's capital A/c	Dr	.....	
To Bank A/c			.....
To Retiring Partners loan A/c			.....

Illustration : 10

A, B and C are partners sharing profits and losses in the ratio of 5:3:2 respectively. A retires from the firm on 1st April 2005. After his retirement, his capital account shows a credit balance of Rs.1,35,000 after the necessary adjustments made. Give journal entries, if

a) the amount due is paid off immediately.

b) when the amount due is not paid immediately.

c) Rs. 45,000 is paid and the balance in future.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	(a)			
	C's capital A/c Dr		1,35,000	
	To Bank A/c			1,35000
	(The amount due Rs.1,35,000 is paid to C)			
	(b)			
	C's capital A/c Dr		1,35,000	
	To C's Loan A/c			1,35,000
	(The amount due to C is transferred to C's loan account)			
	(c)			
	C's Capital A/c Dr		1,35,000	
	To Bank A/c			45,000
	To C's Loan A/c			90,000
	(Rs.45,000 is paid and the balance transferred to C's loan A/c)			

8.8 Preparation of Revaluation Account, Capital Accounts, Bank Account and the Balance Sheet of the reconstituted partnership firm

Illustration : 11

Lalitha, Jothi and Kanaga were partners of a firm sharing profit and losses in the ratio of 3:2:3. Set out below was their balance sheet as on 31st March 2003.

Balance Sheet

Liabilities		Rs.	Assets	Rs.
Bills payable		32,000	Cash in Hand	750
Sundry Creditors		62,500	Cash at Bank	2,04,500
Capitals:			Book-debts	89,000
Lalitha	2,00,000		Stock	1,11,500
Jothi	1,25,000		Furniture	17,500
Kanaga	1,50,000	4,75,000	Plant & Machinery	48,750
Profit & Loss A/c		22,000	Building	1,20,000
Outstanding expenses		500		
		5,92,000		5,92,000

Lalitha retired from the partnership on 1st April 2004 on the following terms:

1. Goodwill of the firm was to be valued at Rs.30,000
2. The assets are to be valued as under: Stock Rs.1,00,000; Furniture Rs.15,000; Plant and Machinery Rs.45,000; Building Rs.1,00,000.
3. A provision for doubtful debts be created at Rs.4,250.
4. Lalitha was to be paid off immediately.

Show the journal entries, prepare revaluation account, capital accounts, Bank account and balance sheet of the reconstituted partnership.

Solution:

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Revaluation A/c	Dr.		42,000	
	To Stock A/c				11,500
	To Furniture A/c				2,500
	To Plant and machinery A/c				3,750
	To Building				20,000
	To Provision for doubtful debts A/c				4,250
	(Loss items transferred)				
	Lalitha's Capital A/c	Dr		15,750	
	Jothi's Capital A/c	Dr		10,500	
	Kanaga's Capital A/c	Dr		15,750	
	To Revaluation A/c				42,000
	(Loss on revaluation transferred to partners capital A/c)				
	Goodwill A/c	Dr		30,000	
	To Lalitha's Capital A/c				11,250
	To Jothi's Capital A/c				7,500
	To Kanaga's Capital A/c				11,250
	(Goodwill raised & transferred to partners capital A/c)				
	Profit and Loss A/c	Dr		22,000	
	To Lalitha's Capital A/c				8,250
	To Jothi's Capital A/c				5,500
	To Kanaga's Capital A/c				8,250
	(Undistributed profit transferred to Partners capital A/c)				
	Lalitha's Capital A/c	Dr		2,03,750	
	To Bank A/c				2,03,750
	(The amount due to Lalitha is paid off immediately)				

Revaluation Account

Dr. Cr.

Particulars	Rs.	Particulars		Rs.
To Stock A/c	11,500	By Loss transferred to		
To Furniture A/c	2,500	Lalitha's Capital A/c	15,750	
To Plant & Machinery A/c	3,750	Jothi's Capital A/c	10,500	
To Building A/c	20,000	Kanaga's Capital A/c	15,750	42,000
To Provision for doubtful debts A/c	4,250			
	42,000			42,000

Capital Accounts

Dr. Cr.

Particulars	Lalitha Rs.	Jothi Rs.	Kanaga Rs.	Particulars	Lalitha Rs.	Jothi Rs.	Kanaga Rs.
To Revaluation A/c	15,750	10,500	15,750	By Balance b/d	2,00,000	1,25,000	1,50,000
To Cash A/c	2,03,750	---	---	By Profit & Loss A/c	8,250	5,500	8,250
To Balance c/d	---	1,27,500	1,53,750	By Goodwill A/c	11,250	7,500	11,250
	2,19,500	1,38,000	1,69,500		2,19,500	1,38,000	1,69,500

Bank Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	2,04,500	By L's Capital A/c	2,03,750
		By Balance c/d	750
	2,04,500		2,04,500

Balance Sheet of Jothi and Kanaga as on 1.4.2004

Liabilities		Rs.	Assets		Rs.
Bills Payable		32,000	Cash in Hand		750
Sundry Creditors		62,500	Cash at Bank		750
Capital A/cs:			Book debts	89,000	
Jothi	1,27,500		Less: Provision for		
Kanaga	1,53,750	2,81,250	doubtful debts A/c	4,250	84,750
Outstanding Expenses		500	Stock		1,00,000
			Furniture		15,000
			Plant & Machinery		45,000
			Building		1,00,000
			Goodwill		30,000
		3,76,250			3,76,250

Illustration : 12

Pallavan, Pandian and Chozhan were carrying on partnership business sharing profits in the ratio of 3 : 2: 1. On March 31, 2005, the Balance Sheet of the firm stood as follows:

Balance Sheet

Liabilities		Rs.	Assets	Rs.
Creditors		30,000	Bank	65,000
General Reserve		15,000	Debtors	40,000
Capitals:			Stock	80,000
Pallavan	2,00,000		Building	2,50,000
Pandian	1,20,000		Profit and Loss A/c	30,000
Chozhan	1,00,000	4,20,000		
		4,65,000		4,65,000

Chozhan retired on April 1, 2005 on the following terms:

1. Building to be appreciated by Rs. 15,000
2. Provision for doubtful debts to be made at 6% on debtors
3. Goodwill of the firm is valued at Rs.18,000.
4. Rs.50,000 to be paid to chozhan immediately and the balance transferred to his loan account.

Prepare Revaluation Account, Capital Accounts, Bank Account and the Balance Sheet after Chozhan's retirement.

Solution:

Revaluation Account

Dr. Cr.

Particulars		Rs.	Particulars	Rs.
To Provision for doubtful debts		2,400	By Building A/c	15,000
To Gain transferred to				
Pallavan	6,300			
Pandian	4,200			
Chozhan	2,100	12,600		
		15,000		15,000

Capital Accounts

Dr. Cr.

Particulars	Pallavan Rs.	Pandian Rs.	Chozhan Rs.	Particulars	Pallavan Rs.	Pandian Rs.	Chozhan Rs.
To Profit & Loss A/c	15,000	10,000	5,000	By Balance b/d	2,00,000	1,20,000	1,00,000
To Bank A/c			50,000	By Goodwill A/c	9,000	6,000	3,000
To Chozhan's loan A/c			52,600	By Revalua -tion A/c	6,300	4,200	2,100
To Balance c/d	2,07,800	1,25,200	---	By Reserve	7,500	5,000	2,500
	2,22,800	1,35,200	1,07,600		2,22,800	1,35,200	1,07,600

Bank Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	65,000	By Chozhan's capital A/c	50,000
		By Balance c/d	15,000
	65,000		65,000

Balance Sheet of Pallavan and Pandian as on 1.4.2005

Liabilities		Rs.	Assets		Rs.
Creditors		30,000	Bank		15,000
Chozhan's Loan A/c		52,600	Debtors	40,000	
Capitals:			Loss: Provision for		
Pallavan	2,07,800		doubtful debts	2,400	37,600
Pandian	1,25,200	3,33,000	Stock		80,000
			Building		2,65,000
			Goodwill		18,000
		4,15,600			4,15,600

QUESTIONS

I. Objective Type

a) Fill in the blanks:

1. The retiring partner should be paid off or the amount due to him, will be treated as his _______ to the firm.
2. At the time of retirement of partners, the existing partners stand to _______.
3. If the value of liabilities decrease, it results in __________item.
4. At the time of retirement, the increase in the value of goodwill will be transferred to the _______ side of the capital accounts of all the partners.
5. At the time of retirement, the profit on revaluation of assets and liabilities will be transferred to the _______ side of the capital accounts of all the partners.
6. At the time of retirement, the revaluation profits of business will be shared by _______ partners.

(Mar. '99)

7. In the absence of any specific agreement between the partners, partners loan to the firms will carry an interest at the rate of ______ percentage.

(Oct. '99)

8. The accumulated reserves will be transferred to the old partners Capital account in the _______ ratio at the time of his retirement

(Mar'2000)

9. The amount due to the retiring partner is either ______ or is paid in ______.

10. _______ is calculated to determine the amount of compensation to be paid by each of the continuing partners to the outgoing partners.

11. A, B and C shares profit as 1/2 to A, 1/3 to B and 1/6 to C. If B retires then, the new profit sharing ratio is _________.

12. Sacrificing ratio is the ratio in which the old partners (existing) have agreed to sacrifice their _______ in favour of _______.

(Answer: 1. loan; 2. gain; 3.Profit; 4. credit; 5. credit; 6. all; 7. six; 8. old profit sharing; 9. paid off immediately, instalments; 10. Gaining ratio; 11. 3:1; 12. share of profit, incoming partner)

b) Choose the correct answers:

1. At the time of retirement of a partner, calculation of new profit ratio is _______
   a) not necessary
   b) necessary
   c) optional

2. Undistributed profits and losses ______ transferred to all the partners account at the time of retirement of a partner.
   a) should be
   b) should not be
   c) may be

3. At the time of retirement Balance sheet items like Profit & Loss account and General Reserve must be transferred to
   a) Revaluation A/c
   b) Partner's Capital A/c
   c) None of the above

4. If the goodwill account is raised for Rs.30,000, the amount is debited to:
   a) The capital accounts of partners
   b) Goodwill Account
   c) Cash Account

5. ________ ratio is calculated by taking out the difference between new profit sharing ratio and old profit sharing ratio.
   a) Gaining
   b) Capital
   c) Sacrifice

6. On retirement of a partner goodwill amount is credited to the account of
   a) only retiring partner
   b) all partners including retiring partner
   c) only remaining partner

7. A, B and C are sharing profits in the ratio of 2/5 : 2/5 : 1/5. C retired from business and his share was purchased equally by A and B. Then new profit sharing ratio shall be
   a) A – 1/2 & B – 1/2
   b) A – 3/5 & B – 2/5
   c) A – 2/5 & B – 3/5

8. When the amount due to an outgoing partner is not paid immediately, then it is transferred to
   a) Capital A/c
   b) Loan A/c
   c) Cash A/c

9. If the amount due to the outgoing partner is transferred to loan account then he is entitled to interest at ______ untill it is paid out.
   a) 9%
   b) 5%
   c) 6%

(Answer: 1. (b); 2. (a); 3. (b); 4.(b); 5. (a); 6. (b); 7. (a); 8. (b); 9.(c))

II. Other Questions:

1. What do you mean by retirement of a partner?
2. Who is an outgoing partner?
3. How can a partner retire from the firm?
4. What is new profit ratio on retirement of a partner?
5. What is gaining ratio?
6. What are the adjustments to be made in connection with Retirement?
7. What are the entries for Revaluation of Assets and Liabilities of a firm in the event of retirement of a partner?
8. How will you deal with the amount due to an outgoing partner?
9. Distinguish between sacrificing ratio and gaining ratio.

III. Problems

Determination of New Profit Ratio

1. The Old profit sharing ratio of A, B and C was 4:3:2. Calculate the new ratio and the ganing ratio when (i) A retires (ii) B retires (iii) C retires.

   (Answer: New ratio (i)3:2; (ii) 2:1; (iii)4:3;
   Gaining ratio (i)3:2; (ii) 2:1; (iii)4:3)

2. Mani, Nagappan and Ulaganathan are partners sharing profits in the ratio of 4:3:3. Ulaganathan retires and his share is taken up by Mani and Nagappan in the ratio of 3:2. Calculate the new ratio.

   (Answer: 29:21)

3. Sabapathi, Thirumalai and Umapathi are partners sharing profits in the ratio of 3:2:1. Thirumalai retires and his share is taken up by Sabapathi and Umapathi equally. Calculate the new ratio.

   (Answer : 2:1)

4. Roja, Meena and Shobana are partners sharing profits in the ratio of 5:4:3. Roja retires and her share is taken up entirely by Meena. Calculate the new ratio.

   (Answer : 3:1)

5. P, Q and R sharing profits in the ratio of 2:2:1. Q retires and the new profit ratio agreed between the continuing partners P and R is 4:3. Calculate gaining ratio.

   (Answer: 3:4)

6. X, Y and Z were sharing profits and losses in the proportion of 1/2 , 1/5 and 3/10 respectively. Y retires. Calculate the new ratio of X and Z.

   (Answer: 5:3)

7. A, B and C were partners in a firm sharing profits in the ratio 4:3:2. C retired. What would be their new ratio and gaining ratio in each of the following cases.
   a) If C’s share was taken up by A and B equally.
   b) If C’s share was taken up by A and B in the original ratio.
   c) If C’s share was take up by A and B in the ratio of 2:1.
   d) If C’s share was take up entirely by A.

   (Answer: New ratio - a)5:4; b)4:3; c)16:11; d)2:1;
   Gaining ratio - a)1:1; b)4:3; c) 2:1; d) A only 2/9)

Revaluation of Assets and Liabilities:

8. Sankar, Sekar and Sarathi were partners of a firm sharing profits and losses in the ratio of 3:2:1. As Sarathi wanted to retire, they decided to revalue their firms' assets and liabilities as indicated below:

   (a) To increase the value of buildings by Rs.33,000.

   (b) To bring into record at Rs.6,000 investments which have not so far been brought into account.

   (c) To decrease stock by Rs.3,000 and furniture by Rs.1,500.

   (d) To write off sundry creditors by Rs.1,500

   Pass the necessary journal entries and show the revaluation account.

   (Answer: Revaluation Profit Rs. 36,000)

9. Ramu, Somu and Gopu were partners of a firm sharing profit and losses in the ratio of 5:3:2. On 1st April 2005, Gopu wanted to retire, they decided to revalue their firms' assets and liabilities as indicated below:

   (a) Increase the value of premises by Rs.30,000.

   (b) Depreciate stock, furniture and machinery by Rs.10,000, Rs. 5,000 and Rs.23,000 respectively.

   (c) Provide for an outstanding liability of Rs.2,000.

   Pass journal entries and revaluation account in the books of the firm to carryout the above decision of its partners.

   (Answer : Revaluation Loss Rs.10,000)

10. C, D and E were partners of a firm sharing profit and loss in the ratio of 5:3:2. As D wanted to retire, they decided to revalue their firm's assets and liabilities as indicated below:

   a) To bring into books unrecorded investments Rs.3,000.

   b) To write off Rs.4,000 from Sundry Creditors.

   c) To write down machinery by Rs.1,000 and furniture by Rs.2,000.

   d) Goodwill of the firm be raised in its books at Rs.15,000.

   Pass journal entries and prepare revaluation account.

   (June 2003)

   (Answer: Revaluation Profit Rs.4,000)

11. Ganga and Yamuna were partners of a firm sharing profits in the ratio of 3/5 and 2/5. Their balance sheet as at 31st March, 2004 stood as under.

Liabilities	Rs.	Assets	Rs.
Capitals:		Machinery	58,500
Ganga : 60,000		Stock	48,000
Yamuna : 45,000	1,05,000	Debtors	45,000
Sundry creditors	15,000	Cash	1,500
Bills payable	33,000		
	1,53,000		1,53,000

Yamuna decides to retire from the business owing to illness and that Ganga will take over the business in order to admit Amaravathi on the following terms.

   (a) Depreciate machinery by 10% and stock by 15%.

   (b) A provision for doubtful debts be created at 5% on sundry debtors.

   (c) Provide for discount on creditors at 2%.

Show revaluation account, capital accounts and the opening balance sheet of Ganga.

(Answer : Revaluation Loss Rs. 15,000
Balance Sheet Total : Rs. 1,37,700)

Transfer of Accumulated Reserves and Undistributed Profit and Loss

12. A, B and C were partners sharing profit and losses in the ratio of 4:3:2. On 31st March, 2005, the firm's books showed general reserve at Rs.45,000. 'B' wanted to retire from 1.4.2005. Pass entry to transfer the entire reserve to the capital accounts of the partners.

13. Mohanraj, Nagaraj and Packiaraj were partners of a firm sharing profits and losses in the ratio of 5:3:2. On 31.3.2004, the firm's books showed a reserve fund of Rs.30,000 and undistributed loss Rs.20,000. Packiaraj wanted to retire from 1.4.2005. Pass entries to transfer the entire reserve and undistributed losses to their capital accounts.

14. Kumutha, Kuzhali and Kothai were partners of a firm sharing profit and losses in the ratio of 6:2:2. Set out below was their balance sheet as on 30.6.1994.

Liabilities		Rs.	Assets	Rs.
Sundry creditors		8,000	Cash in hand	3,000
Reserve fund		30,000	Cash at Bank	5,000
Capital Accounts:			Sundry debtors	45,000
Kumutha :	70,000		Stock	35,000
Kuzhali :	50,000		Machinery	30,000
Kothai :	30,000	1,50,000	Factory building	70,000
		1,88,000		1,88,000

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

(a) To provide a reserve of 5% on sundry debts.

(b) To depreciate stock by 5% and machinery by 10%.

(c) Factory building to be revalued at Rs.75,000.

Prepare revaluation account, capital accounts and the opening balance sheet of the reconstituted firm.

(Answer : Revaluation Loss Rs. 2,000
Balance Sheet Total : Rs. 1,86,000)

Treatment of Goodwill

15. O, P and Q were partners of a firm sharing profit and losses in the ratio of 7:5:3. In view of 'P' s' retirement, they valued their goodwill at Rs.45,000 and decided to raise the goodwill account which did not exist before. Pass entry.

16. A, B and C were partners of a firm sharing profit and losses in the ratio of 5:3:2. Goodwill account stood in their books at Rs.36,000. 'C' wanted to retire and in view of that the partners decided to update the value of goodwill to Rs.50,000. Pass entry.

17. G, P and S were partners of a firm sharing profit and losses in the ratio of 3:2:1. In view of G's retirement, goodwill was valued at two year's purchase of the average profits of last three years which were Rs.16,000, Rs.30,000 and Rs.26,000. Pass entry.

(Answer : Goodwill Rs.48,000)

18. Venus, Mercury and Jupitar are partners in a firm sharing profits and losses in the proportion of ½, 3/10 and 1/5 respectively. Their balance sheet as on 31.3.2005 is as under:

Liabilities		Rs.	Assets		Rs.
Sundry creditors		62,000	Cash at Bank		81,000
Reserve fund		40,000	Debtors	62,000	
Capital accounts:			Less: Provision for		
Venus :	1,60,000		doubtful debts	1,000	61,000
Mercury:	1,20,000		Stock		40,000
Jupitar :	60,000	3,40,000	Plant and machinery		1,00,000
			Buildings		1,60,000
		4,42,000			4,42,000

Jupitar retires on 1st April 2005 subject to the following terms.

(a) Buildings are to be appreciated by 10%.

(b) The provision for bad debts is to be raised to Rs.2,400.

(c) Goodwill is to be raised at Rs.40,000.

(d) The retiring partner is to be paid off immediately.

Pass journal entries to record the above transactions in the books of the firm and show the revaluation account, capital accounts and the balance sheet of the new firm after Jupitar's retirement.

(Answer : Revaluation Profit Rs.14,600; B/s : Rs. 4,17,680)

19. Selva kumar, Saravana kumar and Vinod kumar were partners of a firm sharing profits and losses in the ratio of 3:2:1. Set out below was their balance sheet as on 31st December 2004.

Liabilities	Rs.	Assets	Rs.
Bills payable	15,000	Cash in Hand	3,000
Sundry creditors	25,000	Cash at Bank	35,000
Capital Accounts:		Bills receivable	11,000
Selvakumar :80,000		Book debts	18,000
Saravanakumar:50,000		Stock	36,000
Vinod kumar :40,000	1,70,000	Furniture	7,000
Profit and Loss A/c	30,000	Plant & Machinery	50,000
		Building	80,000
	2,40,000		2,40,000

Selvakumar retired from the partnership on 1st January 2005 on the following terms:

(a) Goodwill of the firm was to be valued at Rs.30,000.

(b) Assets are to be valued as under: Stock Rs. 30,000: Plant and Machinery Rs. 40,000; Buildings Rs.1,00,000

(c) A provision for doubtful debts be created at Rs.1,000

(d) Rs.21,500 was to be paid to Selvakumar immediately and the balance was transferred to his loan account.

Show revaluation account, capital accounts, bank account and the balance sheet of the reconstituted partnership.

(Answer : Revaluation Profit Rs. 3,000; B/s. : Rs. 2,51,500)

20. Priya, Sudha and Vidya were partners of a firm sharing profits and losses in proportion to their capitals. Their balance sheet as on 31st December 2004 stood as under:

Liabilities	Rs.	Assets		Rs.
Creditors	21,000	Cash at Bank		16,000
Reserve fund	48,000	Debtors	20,000	
Capital accounts		Less: Provision for		
Priya : 90,000		doubtful debts	1,000	19,000
Sudha : 60,000		Stock		18,000
Vidya : 30,000	1,80,000	Machinery		48,000
		Land and Building		1,00,000
		Goodwill		48,000
	2,49,000			2,49,000

On 1st January, 2005, Sudha retired from the firm on the following terms:

(a) Goodwill of the firm was estimated at Rs.36,000.

(b) The land and building was appreciated by 10%

(c) Provision for doubtful debts was reduced by Rs.600.

(d) Out of the amount of insurance which was debited entirely to profit and loss account, Rs.2,000 be carried forward for unexpired insurance.

(e) A provision of Rs.3,000 was made in respect of an outstanding bill for repairs.

Show revaluation account, Capital accounts and the balance sheet of the reconstituted partnership.

(Answer : Revaluation Profit Rs. 9,600; B/s : Rs. 2,49,600)

21. Malligai and Mullai were partners of a firm sharing profits and losses in the ratio of 7:5. Set out below was their balance sheet as on 31st December, 2004.

Liabilities		Rs.	Assets	Rs.
Sundry creditors		40,000	Bank	52,000
General reserve		72,000	Sundry debtors	40,000
Workmen's Compensation Fund		60,000	Stock	72,000
			Machinery	1,60,000
Capital Accounts:			Profit and Loss A/c	48,000
Malligai	1,20,000			
Mullai	80,000	2,00,000		
		3,72,000		3,72,000

Mullai retired from the partnership from 1st January 2005 and that Malligai will take over the business on the following terms:

(a) Goodwill of the firm was to be valued at Rs.24,000.

(b) Machinery was depreciated at 10%.

(c) A provision for doubtful debts at created at 5% on sundry debtors.

(d) The liability on workmen's compensation fund is determined at Rs.36,000.

Show revaluation account, capital accounts and the balance sheet of Malligai after the adjustments have been made.

(Answer : Revaluation Loss Rs. 18,000 B/s. : Rs. 3,30,000)

22. Mathiazhagan, Govindarajan and Shanmugam were partners of a firm sharing profits and losses in the ratio of ½, 1/3 and 1/6 respectively. Set out below was their balance sheet as on 30th June, 2005.

Liabilities		Rs.	Assets	Rs.
Sundry creditors		1,20,000	Cash in Hand	18,000
Bills payable		40,000	Cash at Bank	1,70,000
Bank overdraft		80,000	Sundry debtors	52,000
General reserve		1,20,000	Stock	1,20,000
Capital accounts:			Furniture	80,000
Mathiazhagan	2,40,000		Plant	1,60,000
Govindarajan	1,60,000		Land and Building	2,80,000
Shanmugam	1,20,000	5,20,000		
		8,80,000		8,80,000

Shanmugam retired from the partnership from 1st July, 2005 on the following terms:

(a) Goodwill was to be raised at Rs.1,44,000.

(b) The value of land and building was to be increased by Rs.40,000.

(c) Furniture and plant were to be depreciated by Rs.4,000 and Rs.12,000 respectively.

(d) Shanmugam was to be paid off at once.

Show revaluation account, capital accounts, bank account and the opening balance sheet of the reconstituted firm.

(Answer : Revaluation Profit Rs. 24,000 B/s : Rs. 8,80,000)

23. X, Y and Z were partners of a firm sharing profit and losses in proportion of their capital. Their Balance Sheet as on 31.12.1994 stood as under:

Balance Sheet

Liabilities		Rs.	Assets		Rs.
Sundry creditors		10,500	Cash at Bank		8,000
Reserve fund		24,000	Sundry Debtors	10,000	
Capital Accounts:			Less: Provision for		
X	45,000		doubtful debts	500	9,500
Y	30,000		Stock		9,000
Z	15,000	90,000	Machinery		24,000
			Land & Buildings		38,000
			Goodwill		24,000
			Profit & Loss Account		12,000
		1,24,500			1,24,500

On 1st January, 1995, Z retired from the firm on the following terms:

a) That goodwill of the firm was estimated at Rs.18,000.

b) That the land and building be appreciated by 20%.

c) That provision for doubtful debts reduced by Rs.300.

d) That out of the amount of Insurance which was debited entirely to Profit and Loss Account, Rs.1,000 be carried forward for Unexpired Insurance.

e) That machinery be depreciated by 5%.

f) That a provision of Rs.1,100 be made in respect of an outstanding bill for repairs.

g) That Z be paid Rs.5,000 cash and the balance be transferred to his loan account.

Pass the journal entries to give effect to the terms of retirement. Show also Revaluation account, Capital account and the Balance Sheet of the reconstituted partnership.

(March 2003)

Answer: Revaluation Profit Rs.6,600, B/s. Rs. 1,09,200)

Chapter - 9

COMPANY ACCOUNTS

Learning Objectives

After studying this Chapter, you will be able to:

- *understand the definition and characteristics of a company.*
- *understand the different types of share capital and shares.*
- *make accounting treatment for issue of shares at par, premium and discount.*
- *pass necessary entries for over-subscription and under-subscription of shares.*
- *understand the accounting treatment for forefeiture and reissue of shares.*

Sole proprietorship is the most common type of business when the size of business is small. Partnership became popular as the size increased. As firms became very big requiring more amount of capital and involving more risks, it lead to the formation of **Companies**.

A company is an association of persons who contribute money or money's worth to a common stock (capital), for carrying on business for the purposes of profit. The capital is divided into shares, which are held by the members (shareholders) in any proportion and are transferable. It is a legal person, and in law exists like an individual, but with no physical existence.

Section 3(1)(i) of the Companies Act, 1956, defines a company as “a company formed and registered under this Act or an existing company”. An existing company means a company formed and registered under any of the previous Companies Act.

9.1 Characteristics

A company has the following essential characteristics:

1) Voluntary Association

It is a voluntary association of persons. No law can compel persons to form a company. It is their own creation and voluntary act.

2) Limited Liability

The liability of shareholders is limited to the amount he has agreed to pay to the company, either by purchasing shares or by giving a guarantee.

3) Separate Legal Entity

Company can hold, buy and sell properties. It can open bank account in its name and can enter into contracts. It can sue and be sued.

4) Common Seal

Being an artificial person, it cannot sign the documents and can act only through natural persons, called Directors. Every company must, therefore have a common seal with its name engraved on it. The common seal of the company is regarded as the official signature of the company. Any documents prepared by the directors belongs to the company only when it contains the common seal.

5) Perpetual Succession

It is independent of members and its existence is not affected by the coming in and going out of its members. Its continuity is not affected by the changes in the membership.

6) Ownership and Management are separated

As the number of shareholders are large in number, it becomes difficult for them to carry on the day-to-day affairs of the business so the ownership and management are separated. The management of the company is in the hands of the Board of Directors.

7) Transferability of shares

Shares are freely transferable without restriction.

8) Compulsory Registration

All companies must be registered under the Companies Act, 1956.

9) Maintenance of Books

A company is required by law to keep a prescribed set of account books and it has to observe the regulations carefully.

10) Periodic Audit

Audit of company’s accounts is compulsory by a practicing chartered accountant, who is appointed by the shareholders on the recommendation of Board of Directors, at the Annual General Meeting.

9.2 Sources of Finance

The company raises its finance through internal and external sources.

9.2.1 Internal Sources

It includes

a) Share capital

b) Undistributed profits of the companies.

9.2.2 External Sources

It includes

a) Issue of Debentures

b) Accepting Deposits from the public

c) Loans from Commercial Banks

d) Loans from Financial Institutions - such as, Industrial Finance Corporation, State Finance Corporation, Industrial Development Bank of India, Industrial Credit and Investment Corporation of India etc.

9.3 Share capital of a company

Part I Schedule VI of the Companies Act 1956 deals with this aspect. Every business is expected to have a capital. Generally 'capital' means a particular amount of money used in the business for the purpose of earning revenue. In the context of the Company Law, the capital may be:

Nominal or Authorised Capital

This is the maximum amount of capital which a company is authorised to raise and is stated in the Memorandum of Association. It can also be called as '**Registered Capital**'.

For example : A Ltd has been incorporated with an Authorised Capital of Rs.10,00,000 divided into 1,00,000 shares of Rs.10 each.

Issued Capital

This represents part of the authorised capital, which is issued to public for subscription, say 60,000 shares of Rs.10 each.

The difference between the authorised capital and the issued capital represents **unissued capital**. This can be offered to the public at a later date.

Subscribed capital

This refers to that part of the issued capital which has been subscribed by the public, say 50,000 shares of Rs.10/- each.

Unsubscribed Capital

The difference between the issued capital and subscribed capital represents unsubscribed capital, say 10,000 shares of Rs.10/- each in the above example.

Called-up Capital

This refers to that part of the subscribed capital which has been called up by the company for payment.

For example: If 50,000 shares of Rs.10/- each have been subscribed by the public of which Rs.5/- per share has been called up, then the subscribed capital of the company is Rs 5,00,000, of which the called up capital is Rs.2,50,000 (Rs.5 x 50,000).

Uncalled capital

The difference between subscribed and called up capital is called **uncalled capital**. Taking the previous example, uncalled capital would be Rs.2,50,000 (Rs.5 x 50000).

Paid up capital

This refers to that part of the called-up capital, which has been actually paid up by the shareholders. Some of the shareholders might have defaulted in paying a part of the called-up money. Such amount defaulted is known as **calls-in-arrears**.

In other words the difference between called-up capital and paid-up capital is known as calls-in-arrears.

For example, one shareholder holding 500 shares failed to pay the call @ Rs.2 per share, then paid up capital is Rs.2,49,000, and calls-in-arrears is Rs.1000.

Reserve Capital

A company can reserve part of its uncalled capital to be called up only at the time of winding up. A special resolution has to be passed for that purpose. This is called Reserve Capital. It is not disclosed in the companies balance sheet.

The different types of share capital can, for the sake of simplicity diagramatically presented as follows:

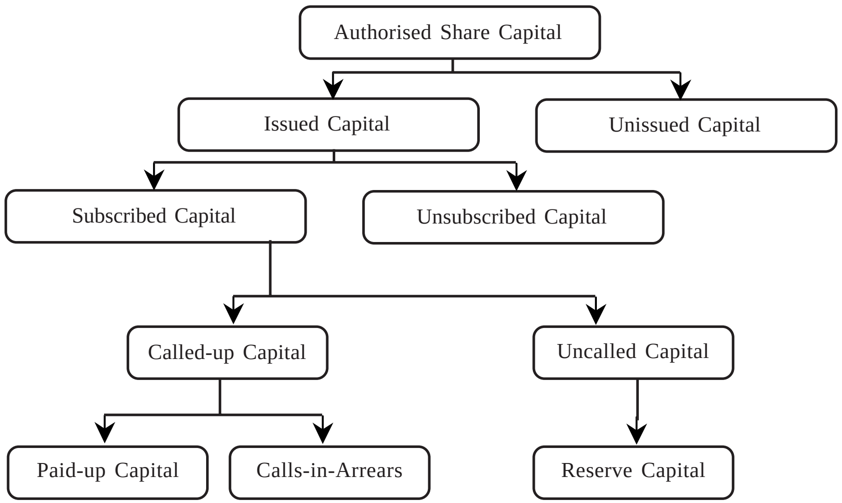


Illustration :1

A Company has been incorporated with an authorised capital of Rs.20,00,000 divided into 2,00,000 shares of Rs.10 each. It offered 1,90,000 shares to the public, but only 1,80,000 shares were subscribed for. The directors called for an amount of Rs.6 per share. All the amounts were received except the call money of Rs.2 on 1000 Shares. Calculate the amount of different categories of share capital.

Solution:

Categories of capital			Amount Rs.
Authorised	2,00,000	Shares of Rs.10 each	20,00,000
Issued	1,90,000	Shares of Rs.10 each	19,00,000
Subscribed	1,80,000	Shares of Rs.10 each	18,00,000
Called up	1,80,000	Shares of Rs. 6 each	10,80,000
Paid up	(1,80,000 Shares x Rs.6) – (1000 shares @ Rs.2)		10,78,000
Calls in arrears	1,000	Shares of Rs. 2 each	2,000

A specimen showing the extract of certain entries in the Balance Sheet is given below.

Extracts from Balance Sheet of .... Ltd. as on ....

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share Capital:			Current Assets:		
Authorised			Cash at Bank		xxx
...Shares of Rs...... each		xxx	Miscellaneous		
Issued			expenditure:		
...Shares of Rs..... each		xxx	Discount on issue of		
Subscribed:			shares		xxx
...Shares of Rs..... each		xxx			
Called-up					
...Shares of Rs..... each		xxx			
Paid up:					
Called up					
...Shares of Rs..... each	xxx				
Less: Calls-in-Arrears	xxx				
	xxx				
Add: Forfeited shares	xxx				
		xxx			
Reserves and Surplus :					
Securities Premium		xxx			
Capital Reserve		xxx			
		xxx			xxx

9.4 Shares:

The capital of the company is divided into units of small denomination. These units are called **shares**. Sec. 2(46) of the Companies Act explains the meaning of share as a share in the share capital of a company. Holders of shares are called **shareholders**.

For example : If the authorised capital Rs.10,00,000 is divided into 1,00,000 units of Rs.10 each, then each unit of Rs.10 is called a share of Rs.10 each. Thus, in the above case, the company is said to have 1,00,000 shares of Rs.10 each.

Shares must be numbered so that they may be identified. They are transferable in the manner provided by the Articles of Association.

9.4.1 Types of Shares

According to the Companies (Amendment) Act, 2000, the share capital of a company limited by share, shall be of two kinds only namely:

I) Preference Shares and

II) Equity Shares

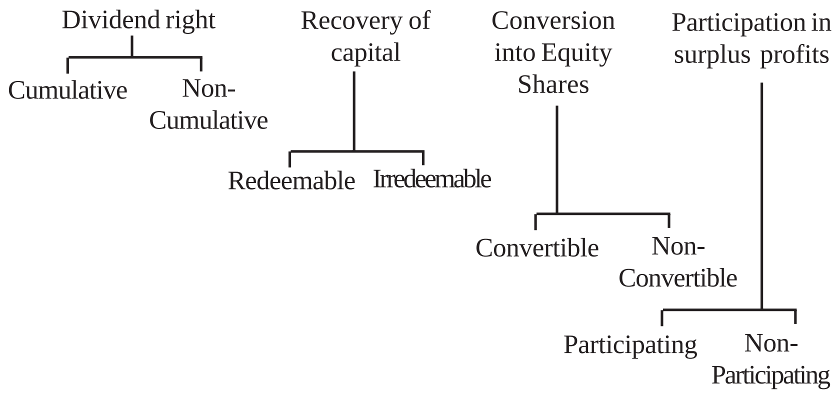
I. Preference Shares

The Companies Act, 1956, Sec. 85 deals with preference shares. Preference shares are those which satisfy the following two conditions.

1. The right to receive dividend at a specified rate before any dividend is paid.
2. Right to return of capital in case of winding up before the capital of equity share holders is returned.

Types of Preference Shares

Preference shares can be sub divided in different classes as follows:-



From the point of view of dividend payment

Cumulative Preference Shares: Holders of these shares have the right to receive arrears of dividend out of the subsequent years' profit.

Non cumulative Preference Shares: In this case, arrears of dividend are not paid.

From the point of view of redemption

Redeemable Preference Shares: These shares are redeemed or repaid in accordance with the terms of issue after a specified period. In India, companies can now issue only this category of preference shares.

Irredeemable Preference Shares: These are shares, which cannot be refunded before winding-up (Now all preference shares must be redeemable)

From the point of view of participating in profits

Participating Preference Shares: The holders of this class of preference shares have the right to share profits remaining after the payment of dividend to the equity shareholders. They also enjoy the right to participate in the surplus remaining after the repayment of capital of equity shareholders in case of winding-up of the company.

Non Participating Shares: It is as good as ordinary preference shares, which carry only fixed rate of dividend.

From the point of view of convertibility

Convertible Preference Shares: These are shares, which can be converted into an equity shares.

Non-Convertible Preference Shares: Shares which cannot be converted into equity shares, is called a non-convertible preference share. Unless the Articles or terms of issue provide preference shares are deemed to be non-convertible.

II. Equity Shares

Shares which are not preference shares are called **Equity Shares**. In other words, equity shares are those which are entitled to dividend and repayment of capital after the preference share holders are paid. The rate of dividend is decided by the Board of Directors. Normally, equity shareholders control the affairs of the business.

9.5 Issue of Shares

The shares of the company can be issued in two ways;

1) for consideration other than cash and

2) for cash

9.5.1 For consideration other than cash:

Some times the company agrees to pay the vendors from whom it has bought assets like land and building, etc., fully paid up shares of the company instead of giving cash for the same.

9.5.2 Issue of Shares for cash

The procedure of issuing shares for cash is given below:

1. Issue of Prospectus

When shares are issued to public for cash it should satisfy the provisions of the Companies Act and the Securities Exchange Board of India (SEBI) guidelines. Every public issue must be accompanied by an issue of prospectus. The terms and conditions of the issue of shares are stated in the prospectus. On reading the prospectus, the public will have to apply for the shares in the prescribed form.

2. Receipt of application money

Whenever a public company issues shares, advertisements appear in the leading newspapers about the issue. Those who are interested in purchasing the shares may get an application form along with a copy of the prospectus. If he is satisfied with the information available in the prospectus, he remits the application money along with the filled-in application form to any one of the banks (branches) mentioned in the application. The applicant is required to remit at least 5% of the nominal value of the share with the application as application money (Sec 69(3)). However, as per the SEBI guidelines, the minimum application should be 25% of its issue price. The accounting entry passed to record the same is

Bank (Cash) A/c	Dr.	[Total amount received on application]
To Share Application A/c		
(Amount received on application on ——— shares @ Rs —— per share)		

The banker will send the application money to the company along with a list of applicants. The public issue must be kept open for atleast three working days and not more than ten working days. The issue price of shares may be received in one instalment or in different instalments.

Note : *Journal Entries*

There are two types of journal entries connected with issue of shares. They are called **cash entries** and **transfer entries**. Cash entries involve the receipt of various instalments of the share. Transfer entries relate to transfer of these amounts to share capital. In case of share application, cash entry is made first followed by transfer entry. But in case of allotment and calls the transfer entry is passed first, then on receiving cash, cash entry is passed. This is because immediately allotment or call is made, money becomes due and therefore share capital is credited without waiting for the receipt of cash.

3. Allotment of Shares

While application is an offer to buy shares, allotment of shares by the company constitutes an acceptance of such offer. If the company does not receive the minimum subscription (is the least amount of shares which should be subscribed for by the public before the Directors can proceed to allotment) of 90% of the issued amount, the company has to refund the entire subscription. Once the shares are allotted, the applicants now get the status of shareholders or members of the company.

Transfer of Application money

On the date of allotment the company considers the application money on those shares which are allotted as a part of the share capital. Therefore the application money has to be transferred to share capital account. The accounting entry passed to record the same is:

Share Application A/c	Dr	[No. of shares allotted x
To Share Capital A/c		Application money per share]
(Application money on —— shares transferred to Share capital)		

Amount Due on Allotment

As soon as shares are allotted, the shareholders are liable to pay the allotment money, which is due. The accounting entry passed to record the same is:

Share Allotment A/c	Dr	[No. of shares allotted x
To Share Capital A/c		Allotment amount per share]
(Amount due on the allotment of — shares @ Rs.— per share)		

Receipt of Allotment money

On receipt of allotment money, the following entry is made:

Bank A/c	Dr
To Share Allotment A/c	
(Allotment money received)	

4. Call on Shares

If the shares are not fully called up after allotment the Directors have the right to call the remaining amount. Call is an instalment due on shares. A call letter will be generally issued to every shareholder. The maximum number of calls that a company can make is three. There should be at least one month gap between two calls unless otherwise provided by the Articles of Association of the company. The accounting entry passed to record the same is:

Amount due on Call

Share (First/ Second/ Third) Call A/c	Dr.	(No. of Shares x
To Share Capital A/c		Call amount per
(Call money due on — shares		share)
@ Rs – per share)		

On Receipt of Call money

Bank A/c Dr
  To Share (First/ Second/ Third) Call A/c
(Call money received)

Summary of the above journal entries is given below:

1. Receipt of Application Money:

Bank (Cash) A/c To Share Application A/c (Amount received on application ——— shares @ Rs —— per share)	Dr.	[Total amount received on application]

2. Transfer to share capital:

Share Application A/c To Share Capital A/c (Application money on —— shares transferred to Share capital)	Dr	[No. of shares allotted x Application money per share]

3. Allotment money due:

Share Allotment A/c To Share Capital A/c (Amount due on allotment of — shares @ Rs.— per share)	Dr	[No. of shares allotted x Allotment amount per share]

4. Receipt of allotment money:

Bank A/c Dr.
  To Share Allotment A/c
(Allotment money received)

5. Call Money due:

Share (First/ Second/ Third) Call A/c To Share Capital A/c (Call money due on — shares @ Rs – per share)	Dr.	[No. of Shares x Call amount per share]

6. Receipt of call money:

Bank A/c Dr
  To Share (First/ Second/ Third) Call A/c
(Call money received)

Terms of Issue:

Shares of a company may be issued in any of the following three ways;

a) Issue of shares at par

b) Issue of shares at premium and

c) Issue of shares at discount

The accounting treatment of issue of shares in case of each of the above is different. We shall now discuss these three situations in detail.

a) Issue of shares at par

If the issue price is equal to the face value, it is said to be issued at par. For example when shares of Rs 10 each (face value) are issued at Rs 10 only.

Illustration : 2

Bharat Limited had an authorised capital of Rs.4,00,000 divided into shares of Rs.100 each.

It offered to the public 3000 shares payable as follows.

On Application	Rs. 30
On Allotment	Rs.20
On First Call	Rs.25
On Second Call	Rs.25

The shares were duly subscribed for by the public and all money was received. Pass journal entries to record the above transactions.

Solution:

Journal Entries in the Books of Bharat Limited

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank A/c Dr		90,000	
	To Share Application A/c			90,000
	(Money received on 3000 shares @ Rs,30 per share)			
	Share Application A/c Dr		90,000	
	To Share Capital A/c			90,000
	(Transfer of Application money on 3000 shares to Share capital)			
	Share Allotment A/c Dr		60,000	
	To Share Capital A/c			60,000
	(Amount due on the allotment of 3000 shares @ Rs.20/- per Share)			
	Bank A/c Dr		60,000	
	To Share Allotment A/c			60,000
	(Allotment Money received)			
	Share First call A/c Dr		75,000	
	To Share Capital A/c			75,000
	(First call money due on 3000 Share @ Rs.25/- per Share)			
	Bank A/c Dr		75,000	
	To Share First Call A/c			75,000
	(First call money received)			
	Share Second & Final call A/c Dr		75,000	
	To Share Capital A/c			75,000
	(Final call money due on 3000 share @ Rs.25/- per share)			
	Bank A/c Dr		75,000	
	To Share second & final call A/c			75,000
	(Final call money received)			

Under-subscription

Due to poor response, all the shares offered may not be taken by the public. This is under-subscription. However the shares cannot be allotted if the minimum subscription is not received. Under-subscription does not require any special treatment. Journal entries are made on the basis of shares applied for.

***Illustration* : 3**

Govindha Ltd., offered 10,000 shares of Rs.100 each to the public on the following terms:

Rs. 30 on application

Rs. 20 on allotment

Rs. 20 on first call and

Rs. 30 on final call

The public applied for 9,000 shares which were allotted. All money due was received. Pass journal entries.

Solution:

Journal in the Books of Govindha Limited

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Bank A/c Dr		2,70,000	
	To Share Application A/c			2,70,000
	(Money received 9000 shares @ Rs.30 per share)			
	Share Application A/c Dr		2,70,000	
	To Share Capital A/c			2,70,000
	(Transfer of Application money on 9000 shares to share capital)			

Share Allotment A/c Dr		1,80,000	
To Share Capital A/c (Amount due on the allotment on 9000 shares @ Rs.20/- per share)			1,80,000
Bank A/c Dr		1,80,000	
To Share Allotment A/c (Allotment money received)			1,80,000
Share First call A/c Dr		1,80,000	
To Share Capital A/c (First call money due on 9000 shares @ Rs.20/- per share)			1,80,000
Bank A/c Dr		1,80,000	
To Share First Call A/c (First call money received)			1,80,000
Share Second & Final call A/c Dr		2,70,000	
To Share Capital A/c (Final call money due on 9000 shares @ Rs.30/- per share)			2,70,000
Bank A/c Dr		2,70,000	
To Share Second & Final call A/c (Final call money received)			2,70,000

Over-subscription

When the applications received are more than that has been issued to the public, it is called as over-subscription. A company cannot allot more shares than that were offered to public through the prospectus. When there is over subscription the allotment must follow SEBI guidelines to ensure proportional (Pro-rata) allotment.

When there is over - subscription the directors have three alternatives to deal with the situation.

1. Some applicants may not be allotted any shares – **rejection of shares**.
2. Some applicants may be allotted less number of shares than they applied for – **prorata allotment.**
3. Some applicants may be allotted full number of shares they applied for – **full allotment.**

We will be discussing the first two alternatives only in this chapter.

Rejection of shares:

Some applications may be rejected by the Directors due to over-subscription or certain other reasons. The company must refund the application money to those applicants to whom shares were not allotted. The accounting entry passed to record the same is:

Share Application A/c Dr. [No. of shares rejected x
To Bank A/c Application money per share]

(Application money returned on rejected applications for —— shares)

Illustration : 4

Perumal Ltd. issued 1,00,000 shares of Rs.10 each payable:

Rs.3 on application and

Rs.2 on allotment and the balance when required.

1,20,000 shares were applied for.

The directors decided to reject the excess applications. All money due was received. Pass journal entries.

Solution:

Journal in the Books of Perumal Limited

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Bank A/c Dr		3,60,000	
	To Share Application A/c			3,60,000
	(Money received on 1,20,000 shares @ Rs.3 per share)			
	Share Application A/c Dr		3,00,000	
	To Share Capital A/c			3,00,000
	(Transfer of Application money on 1,00,000 shares to share capital)			
	Share Application A/c Dr		60,000	
	To Bank A/c			60,000
	(Refund of excess application money on 20,000 @ Rs.3 per share)			
	Share Allotment A/c Dr		2,00,000	
	To Share Capital A/c			2,00,000
	(Amount due on the allotment of 1,00,000 shares @ Rs.2/- per share)			
	Bank A/c Dr		2,00,000	
	To Share allotment A/c			2,00,000
	(Allotment money received)			

Pro-rata allotment:

Some of the applicants may be allotted a certain number of shares lesser than the number they applied for. Instead of returning the excess application money, the same will be adjusted on money due on allotment. The accounting entry passed to record the same is:

Share Application A/c	Dr	[Application money received –
To Share Allotment A/c		(Application money transferred
(Excess application money		to share capital + Money
received on —— shares @		refunded)]
Rs.— transferred to allotment)		

Illustration : 5

Pradhiksha Ltd. issued 50,000 shares of Rs.10 each payable as

Rs.3 on application.

Rs.4 on allotment and

The balance on call.

Applications for 70,000 shares had been received.

Application for 8,000 shares were rejected and the remaining applicants were allotted the 50,000 shares on pro-rata basis. The excess amount on application was adjusted towards the amount due on allotment. All the shareholders paid the amount due. Journalise the transactions and prepare ledger accounts and show how the entries will appear in the balance sheet.

Solution:

I. Over subscription / Pro-rata Allotment:

Particulars	No.of Shares Rs.	Amount Rs.
Number of Applications received	70,000 x 3	2,10,000
Less : Transferred to share capital	50,000 x 3	1,50,000
Excess application money	20,000 x 3	60,000
Less : Refunded	8,000 x 3	24,000
Excess money to be adjusted towards allotment money	12,000 x 3	36,000

II. Calculation of allotment money to be received :

		Rs.
	50,000 shares of Rs.4 each	2,00,000
Less :	Excess Application money adjusted towards allotment money (12,000 x 3)	36,000
	Money to be received	1,64,000

Pradhiksha Ltd.
Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Bank A/c	Dr		2,10,000	
	To Share Application A/c (Application money received on 70,000 shares @ Rs.3 per share)				2,10,000
	Share Application A/c	Dr		1,50,000	
	To Share Capital A/c (Application money received on 50,000 shares @ Rs.3 per share transferred to share capital)				1,50,000
	Share Application A/c	Dr		24,000	
	To Bank A/c (Application money on 8,000 shares @ Rs.3 per share refunded)				24,000
	Share Application A/c	Dr		36,000	
	To Share Allotment A/c (Surplus application money on 12,000 shares @ Rs.3 per share adjusted towards allotment)				36,000
	Share Allotment A/c	Dr		2,00,000	
	To Share Capital A/c (Allotment money due on 50,000 shares @ Rs.4 per share)				2,00,000
	Bank A/c	Dr		1,64,000	
	To Share Allotment A/c (Allotment money received)				1,64,000
	Share First and Final Call A/c	Dr		1,50,000	
	To Share Capital A/c (Call money due on 50,000 shares @ Rs.3 per share due)				1,50,000
	Bank A/c	Dr		1,50,000	
	To Share First and Final Call A/c (Being call money received)				1,50,000

Ledger Accounts in the books of Pradhiksha Ltd.

Dr. **Bank Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Application A/c	2,10,000	By Share Application A/c	24,000
To Share Allotment A/c	1,64,000	By Balance c/d	5,00,000
To Share Call A/c	1,50,000		
	5,24,000		5,24,000
To Balance b/d	5,00,000		

Dr. **Share Application Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	1,50,000	By Bank A/c	2,10,000
To Bank A/c	24,000		
To Share Allotment A/c	36,000		
	2,10,000		2,10,000

Dr.		Share Allotment Account	Cr.
Particulars	**Rs.**	**Particulars**	**Rs.**
To Share Capital A/c	2,00,000	By Share Application A/c	36,000
		By Bank A/c	1,64,000
	2,00,000		2,00,000

Dr.		Share First and Final Call Account	Cr.
Particulars	**Rs.**	**Particulars**	**Rs.**
To Share Capital A/c	1,50,000	By Bank A/c	1,50,000
	1,50,000		1,50,000

Dr.		Share Capital Account	Cr.
Particulars	**Rs.**	**Particulars**	**Rs.**
		By Share Application A/c	1,50,000
		By Share Allotment A/c	2,00,000
To Balance c/d	5,00,000	By Share First & Final Call A/c	1,50,000
	5,00,000		5,00,000
		By Balance b/d	5,00,000

Extracts from Balance Sheet of Pradhiksha Ltd.

Liabilities	Rs.	Assets	Rs.
Share Capital:		Current Assets:	
Authorised:	....	Cash at Bank	5,00,000
Issued:			
50,000 shares of Rs.10 each	5,00,000		
Subscribed :			
50,000 shares of Rs.10 each	5,00,000		
Called-up :			
50,000 shares of Rs.10 each	5,00,000		
Paid up :			
50,000 shares of Rs. 10 each	5,00,000		
	5,00,000		5,00,000

Calls- in- Arrears

Sometimes shareholders may fail to pay the amount due on calls. The total amount not received on the calls by the company are called as **Calls-in-Arrears**. This amount is shown as a deduction from the called-up capital to arrive the paid up share capital in the Balance Sheet. The accounting entry passed to record the same is:

Calls-in-Arrears A/c Dr (Amount on unpaid calls)

To Share Call A/c

(Call money on .... shares @ Rs...... not received)

According to Table A, normally an interest of 5 % is charged on calls-in-arrears till such amount is actually paid. However the Directors can waive this interest or charge a higher rate at their discretion.

Illustration : 6

Robert & Co Ltd. issues 20,000 shares of Rs.10/- each payable Rs.3 on application, Rs. 2 on allotment, Rs. 2.50 on First call and the balance on final call.

All shares were subscribed and allotted. Calls were made in due course but the first call money on 1000 shares and final call money on 1500 shares were not yet received. Pass journal entries.

Solution:

Robert & Co. Ltd
Journal

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank A/c Dr		60,000	
	To Share Application A/c			60,000
	(Application money received on 20000 shares @ Rs.3 per share)			

Share Application A/c Dr		60,000	
To Share Capital a/c (Transfer of application money to share capital a/c)			60,000
Share Allotment A/c Dr		40,000	
To Share Capital A/c (Allotment money due on 20000 shares @ Rs.2 per share)			40,000
Bank A/c Dr		40,000	
To Share allotment A/c (Allotment money received)			40,000
Share First call A/c Dr		50,000	
To Share Capital A/c (First call amount due on 20000 shares @ Rs.2.50 per share)			50,000
Bank A/c Dr		47,500	
Calls-in-arrears a/c Dr		2,500	
To Share First Call A/c (First call money received on 19000 shares)			50,000
Share Second Call A/c Dr		50,000	
To Share Capital A/c (Final call money on 20000 shares @ 2.50 per share due)			50,000
Bank A/c Dr		46,250	
Calls in arrears A/c Dr		3,750	
To Share Second call a/c (Final call money received on 18,500 shares)			50,000

Calls-in-Advance

When an applicant sends more money than what is called by the company, the excess money is called **Calls-in-Advance**. The accounting entry passed to record the same is:

Bank A/c Dr
To Calls – in- Advance
(Call amount for .... shares @ Rs..... received in advance)

According to Section 92 calls-in-advance can be accepted only when a company is so authorised by its Articles. If a company has adopted Table A normally an interest at 6 % is to be paid on such calls-in-advance from the date of receipt till due date. When calls become actually due, calls-in-advance account is adjusted towards the call. The accounting entry passed to record the same is:

Transfer of Calls-in-Advance to particular call

Calls-in-Advance A/c Dr
To Particular Call A/c
(Calls-in-advance transferred to particular call account)

Illustration : 7

Somu Ltd. issued to the public 8000 equity shares of Rs.10 each payable as follows.

On Application	Rs. 2.50
On Allotment	Rs. 4.00
On First Call & Final Call	Rs. 3.50

All the shares were subscribed for and all money due were received. Akbar a shareholder who subscribed for 500 shares paid the call money along with the allotment money. Pass journal entries to record the same.

Solution:

Somu Ltd.

Journal Entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Bank A/c Dr To Share Capital A/c (Application money received on 8,000 shares @ Rs.2.50 per share)		20,000	 20,000
	Share Application A/c Dr To Share Capital A/c (Application money transferred to share capital A/c)		20,000	 20,000
	Share Allotment A/c Dr To Share Capital A/c (Allotment money due on 8,000 share @ Rs.4 per share)		32,000	 32,000
	Bank A/c Dr To Share Allotment A/c To Calls-in-advance A/c (Allotment money received with calls in advance)		33,750	 32,000 1,750
	Share First & Final call A/c Dr To Share Capital A/c (Call amount due on 8,000 shares @ Rs.3.50 per share)		28,000	 28,000
	Bank A/c Dr Calls-in-advance A/c Dr To Share First & Final call A/c (Call money received and calls-in-advance account transferred to call account)		26,250 1,750	 28,000

Issue of shares at premium

When a company issues its shares at a price more than the face value, it is said to be issued at premium. Premium is the excess money

collected over and above the face value of the share. When share of Rs.10 (face value) are issued at Rs.12, it is said to be issued at a premium of Rs.2.

When shares are issued at premium, the amount of premium shall be credited to a separate account called as '**Securities Premium Account**'[1]. It is not a part of the share capital. It is shown separately in the Balance sheet under the heading '**Reserves and Surplus**'. Under Sec. 78 the amount to the credit of the securities premium account may be used for the following purposes:

1) issue of fully paid bonus shares
2) writing off the preliminary expenses
3) writing off expenses like commission paid or discount allowed on shares / debentures and
4) for the premium payable on redemption of preference shares / debentures.

The amount of premium can be collected with the application money or with the allotment money. **But normally it is collected with the allotment money only**. The accounting entry passed to record the same is:

a) Share Allotment A/c	Dr	[No. of shares allotted x allotment and premium money per share]
To Share Capital A/c		[No. of shares allotted x allotment money per share]
To Securities Premium A/c		[No. of shares allotted x premium money per share]

(amount due on allotment of shares @Rs—per share including premium)

1 The term 'securities premium' has been used instead of 'share premium' in accordance with the provisions of the Companies (Amendment) Act, 1999.

b) Bank A/c Dr

To Share Allotment A/c
(money received on allotment
including premium)

Illustration : 8

Raja & Rani Ltd. issued 10,000 shares of Rs.10 each at a premium of Rs.2 per share payable as follows.

On application	Rs.3
On allotment	Rs.5 (including premium)
On first call	Rs.2
On second & final call	Rs.2

All these shares were duly subscribed and money due were fully received. Pass journal entries prepare ledger accounts and also show the entries in the Balance sheet.

Solution:

Raja & Rani Ltd.

Journal Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank A/c Dr		30,000	
	To Share Application A/c			30,000
	(Application money on 10,000 shares received @ Rs.3 per share)			
	Share Application A/c Dr		30,000	
	To Share Capital A/c			30,000
	(Application money transferred to share capital)			
	Share Allotment A/c Dr		50,000	
	To Share Capital A/c			30,000
	To Securities Premium A/c			20,000
	(Allotment money and share premium due on 10,000 shares)			
	Bank A/c Dr		50,000	
	To Share Allotment A/c			50,000
	(Allotment money and premium amount received)			
	Share First Call A/c Dr		20,000	
	To Share Capital A/c			20,000
	(First Call amount due on 10,000 shares @ Rs.2/- per share)			
	Bank A/c Dr		20,000	
	To Share First call A/c			20,000
	(First call amount received)			
	Share Second & Final Call A/c Dr		20,000	
	To Share Capital A/c			20,000
	(Final Call amount due on 10,000 shares @ Rs.2/- per share)			
	Bank A/c Dr		20,000	
	To Share Second & Final Call A/c			20,000
	(Being final call amount received)			

Raja & Rani Ltd.

Ledger Accounts

Dr. **Bank Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Share Application A/c	30,000	By Balance c/d	1,20,000
To Share Allotment A/c	50,000		
To Share First call A/c	20,000		
To Share Second & Final call A/c	20,000		
	1,20,000		1,20,000
To Balance b/d	1,20,000		

Dr. **Share Application Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Application A/c	30,000	By Bank A/c	30,000
	30,000		30,000

Dr. **Share Allotment Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	30,000	By Bank A/c	50,000
To Securities Premium A/c	20,000		
	50,000		50,000

Dr. **Securities Premium Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Balance c/d	20,000	By Share Allotment A/c	20,000
	20,000		20,000
		By Balance b/d	20,000

Dr. **Share First Call Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	20,000	By Bank A/c	20,000
	20,000		20,000

Dr. **Share Second and Final Call Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	20,000	By Bank A/c	20,000
	20,000		20,000

Dr. **Share Capital Account** Cr.

Particulars	Rs.	Particulars	Rs.
By Balance c/d	1,00,000	By Share Application A/c	30,000
		By Share Allotment A/c	30,000
		By First Call A/c	20,000
		By Second & Final Call A/c	20,000
	1,00,000		1,00,000
		By Balance b/d	1,00,000

Extracts from Balance Sheet of Raja & Rani Ltd.

Liabilities	Rs.	Assets	Rs.
Share Capital		Current Assets:	
Authorised Capital	----	Bank	1,20,000
Issued Capital 10,000 shares @ Rs.10 each	1,00,000		
Subscribed Capital 10,000 shares @ Rs.10 each	1,00,000		
Called up Capital 10,000 shares @ Rs.10 each	1,00,000		
Paid up Capital 10,000 shares @ Rs.10 each	1,00,000		
Reserves & surplus:			
Securities Premium	20,000		
	1,20,000		1,20,000

Issue of Shares at Discount

When a company issues its shares at a price less than the face value, it is said to be issued at discount. Discount is the difference between the face value and the issue price. For example a share of Rs.10 (face value) is issued at Rs 9, it is said that shares are issued at discount of Re.1.

A company can issue shares at a discount only when the following conditions are satisfied (Sec. 79).

a. Issue of shares at discount is authorised by an ordinary resolution passed by the company in its general body meeting and sanctioned by Company Law Board.

b. The shares must belong to a class already issued.

c. The maximum amount of discount can not exceed 10%, however, if the Company Law Board is convinced the shares can be issued at a higher discount rate.

d. The company has to be in existence at least for one year.

Whenever shares are issued at a discount the amount of discount is brought into account with the instalment due on allotment. The accounting entry passed to record the same is:

Share Allotment A/c	Dr.
Discount on issue of shares A/c	Dr.
To Share Capital A/c	
(Amount due on allotment of — shares @ Rs – per share and discount on issue brought into account)	

The shares will appear at the full face value on the liability side of the Balance Sheet. The amount of discount on issue of shares being loss of capital nature shown on the asset side and written off against the Profit and Loss account over a period of time. The amount of discount not yet written off will appear in the asset side of the Balance Sheet under the heading '**Miscellaneous Expenditure**'.

Illustration : 9

Senthil Ltd. issued 1,70,000 shares of Rs.10 each at discount of 10%. The shares were payable as under

on application	Rs.3
on allotment	Rs.4 (with adjustment of discount)
on first and final call	Rs.2

Public applied for 1,60,000 shares and the shares have been duly allotted. All money were duly received. Pass journal entries and prepare ledger accounts and also show the balance sheet.

Senthil Ltd.

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Bank A/c	Dr		4,80,000	
	To Share Application A/c (Application money received on 1,60,000 shares @ Rs.3 per share)				4,80,000
	Share Application A/c	Dr		4,80,000	
	To Share Capital A/c (Application money transferred to share capital)				4,80,000
	Share Allotment A/c	Dr		6,40,000	
	Discount on issue of shares A/c	Dr		1,60,000	
	To Share Capital A/c (Allotment money due on 1,60,000 shares with adjustment of discount)				8,00,000
	Bank A/c	Dr		6,40,000	
	To Share Allotment A/c (Allotment money received)				6,40,000

	Share First & Final Call A/c	Dr	3,20,000	
	To Share Capital A/c (Call money due on 1,60,000 shares @ Rs.2 per share)			3,20,000
	Bank A/c	Dr	3,20,000	
	To Share First & Final Call A/c (Call money received)			3,20,000

Senthil Ltd.
Ledger Accounts

Dr. **Bank Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Application A/c	4,80,000	By Balance c/d	14,40,000
To Share Allotment A/c	6,40,000		
To Share First and Final Call A/c	3,20,000		
	14,40,000		14,40,000
To Balance b/d	14,40,000		

Dr. **Share Application Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	4,80,000	By Bank A/c	4,80,000
	4,80,000		4,80,000

Dr. **Share Allotment Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	6,40,000	By Bank A/c	6,40,000
	6,40,000		6,40,000

Dr. **Discount on issue of shares Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	1,60,000	By Balance c/d	1,60,000
	1,60,000		1,60,000
To Balance b/d	1,60,000		

Dr. **Share First and Final Call Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	3,20,000	By Bank A/c	3,20,000
	3,20,000		3,20,000

Dr. **Share Capital Account** Cr.

Particulars	Rs.	Particulars	Rs.
		By Share Application A/c	4,80,000
		By Share Allotment A/c	6,40,000
		By Discount on Shares A/c	1,60,000
To Balance c/d	16,00,000	By Shares First and Final Call A/c	3,20,000
	16,00,000		16,00,000
		By Balance b/d	16,00,000

Extracts from Balance Sheet of Senthil Ltd.

Liabilities	Rs.	Assets	Rs.
Share Capital		Current Assets:	
Authorised Capital	----	Bank	14,40,000
Issued Capital		Miscellaneous Expenditure:	
1,70,000 shares @ Rs.10 each	17,00,000	Discount on issue of shares	1,60,000
Subscribed Capital			
1,60,000 shares @ Rs.10 each	16,00,000		
Called-up Capital			
1,60,000 shares @ Rs.10 each	16,00,000		
Paid up Capital			
1,60,000 shares @ Rs.10 each	16,00,000		
	16,00,000		16,00,000

Illustration : 10

Cholan Ltd., issued 1000 shares of Rs.100 each. Pass journal entry in the following cases.

a) Shares are issued at par

b) Shares are issued at a premium of Rs. 20.

c) Shares are issued at a discount of Rs.10.

Solution:

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Case a:				
	Bank A/c	Dr		1,00,000	
	To Share capital A/c (1000 shares issued @ Rs.100 per share)				1,00,000
	Case b:				
	Bank A/c	Dr		1,20,000	
	To Share capital A/c				1,00,000
	To Securities premium A/c (1000 shares issued @ Rs.100 per share with premium of Rs.20)				20,000
	Case c:				
	Bank A/c	Dr		90,000	
	Discount on issue of shares A/c	Dr		10,000	
	To Share capital A/c (1000 shares issued @ Rs.100 per share and discount Rs.10 brought into account)				1,00,000

Forfeiture of Shares

Sometimes a shareholder may fail to pay any of the instalments i.e allotment or call money. In such a situation after giving due notice and following the procedures laid down in the Articles of Association, the Directors of the company can forfeit the shares that were already issued. Forfeiture of shares means to cancel the allotment to the defaulting shareholder. Once the shares are forfeited, these shares will not form part of the share capital and the shareholders will not be the members of the company.

Forfeiture of shares – issued at Par

The effect of forfeiture is to cancel the allotment given to the shareholder. So, all entries passed earlier must be reversed now. The accounting entry passed to record the same is:

Share Capital A/c	Dr.	[No. of shares forfeited x Amount called up per share]
To Forfeited Share A/c		[Amount already received]
To Share Allotment A/c		[Amount due but was not
Or/and		received]
To Share (first / second/ third) Call A/c		

It should be noted that share capital is debited with the amount called up till the stage of forfeiture and not the nominal value of shares. The balance in the share forfeited account is shown as an addition to the total paid-up capital of the company under the heading 'Share Capital' on the liability side of the Balance Sheet.

Illustration : 11

Banu Ltd. issued 5000 shares of Rs.10 each at par payable on application Rs.3 per share, on allotment Rs.3 per share, on first call Rs.2 per share & final call Rs.2. Mr.Raju was allotted 50 shares. Give the necessary journal entry relating to forfeiture of shares in each of the following alternative cases.

a) If Mr.Raju failed to pay first call money and his shares were forfeited.

b) If Mr.Raju failed to pay both the calls and his shares were forfeited.

Solution:

Books of Banu Ltd.
Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Case a :				
	Share Capital A/c (50x8)	Dr		400	
	To Forfeited Shares A/c (50x6)				300
	To Share First call A/c (50x2)				100
	(50 shares forfeited for non payment of first call money)				
	Case b :				
	Share Capital A/c (50x10)	Dr		500	
	To Forfeited Share A/c (50x6)				300
	To Share First Call A/c				100
	To Share Final Call A/c				100
	(50 shares forfeited for non payment of first & final call)				

Forfeiture of shares – issued at Premium

1. When premium is received :

When shares originally issued at premium, on which premium amount has been received are forfeited, then the premium once collected cannot be cancelled (Sec.78). The accounting entry passed to record the same is:

Share Capital A/c	Dr.	[No. of shares forfeited x Amount called up per share]
To Forfeited Share A/c		[No. of shares forfeited x Amount already received excluding premium]
To Share Call A/c		[No. of shares forfeited x Amount not received]

2. When premium is not received:

When shares originally issued at a premium on which the premium amount has not yet been received are forfeited, Securities Premium account has to be debited now. The accounting entry passed to record the same is:

Share Capital A/c	Dr.	[No. of shares forfeited x Amount called-up per share]
Securities Premium A/c	Dr.	[No. of shares forfeited x Premium per share]
To Forfeited Share A/c		[No. of shares forfeited x Amount already received]
To Share Allotment A/c		[No. of shares forfeited x Amount not received including premium]
To Share Call A/c		[No. of shares forfeited x Amount not received]

Illustration : 12

Kumar Ltd issued 1000 shares of Rs.10 each at Rs.12 per share. The amount is payable as under

Rs.3 on application; Rs.5 on allotment (including premium); Rs.2 on first call; Rs.2 on final call.

The Company did not make the final call, Mr.Mani was allotted 25 shares. Give journal entries for forfeiture in the following cases.

a) If Mr.Mani failed to pay first call money and his shares were forfeited.

b) If Mr.Mani failed to pay first and final call money, his shares were forfeited .

Solution:

Books of Kumar Ltd.

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Case a:				
	Share Capital A/c (25x8)	Dr		200	
	To Forfeited Shares A/c (25x6)				150
	To Share First call A/c (25x2)				50
	(25 shares forfeited for non payment of First call money)				
	Case b:				
	Share Capital A/c (25x10)	Dr		250	
	To Forfeited Shares A/c (25x6)				150
	To Share First call A/c (25x2)				50
	To Share Final Call A/c (25x2)				50
	(25 shares forfeited for non payment of call money)				

Forfeiture of shares – issued at Discount:

When shares originally issued at discount are forfeited then discount on shares account should be cancelled. This can be done by crediting discount on shares account. The accounting entry passed to record the same is:

Share Capital A/c	Dr.	[No. of shares forfeited x Amount called up]
To Forfeited shares A/c		[No. of shares forfeited x Amount already received]
To Discount on issue of share A/c		[No. of shares forfeited x Discount per share]
To Share Call A/c		[No. of shares forfeited x Amount not received]

Illustration : 13

Nanda Ltd. issued 10000 shares of Rs.10 each to the public at discount of 10% payable as follows:

on application	Rs.2.50;
on allotment	Rs.3.00;
on first & final call	Rs.3.50.

All money due were received except from one shareholder Mr.Udhay, to whom 100 shares are allotted failed to pay the final call money. The directors forfeited shares after giving due notice. Pass journal entry for forfeiture.

Solution:

In the Books of Nanda Ltd.

Journal Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Share Capital A/c [100 x 10] Dr		1000	
	To Forfeited shares A/c [100 x 5.50]			550
	To Discount on issue of shares A/c [100 x 1]			100
	To Final Call A/c [100 x 3.50]			350
	(Forfeiture of 100 shares for non payment of final call money)			

Reissue of forfeited shares

The Directors of a company have the right to reissue the shares that were forfeited by them already as and when they find it suitable and convenient. In this connection the following points need to be noted.

Reissue Price:

Forfeited shares can be reissued at any price the company prefers. But the reissue price plus amount already collected from the defaulting member should not be less than the amount credited as paid up on reissue of shares.

When shares are fully paid: If a share of Rs.10 (face value) on which Rs.3 has been already been collected is now forfeited then the minimum reissue price should be Rs.7 (Rs.10 – Rs.3).

When shares are partly paid: In the above example if the company has called only Rs.8 then the minimum reissue price should be Rs.5 (Rs.8 – Rs.3).

Forfeited shares account:

The discount on reissue (paid-up value – reissue price) of forfeited shares is debited to 'Forfeited shares account'. The accounting entry passed to record the same is:

Bank A/c	Dr	[No of shares x reissue price]
Forfeited Shares A/c	Dr	[No of shares x (paid up value – reissue price]
To Share Capital A/c (Reissue of ____ shares at Rs.___)		[No of shares x paid up value]

Capital Reserve:

The balance if any in the forfeited share account is a capital profit and will be transferred to 'Capital reserve account'. The entry for transferring the balance in the Shares Forfeited Account is

Forfeited Shares A/c Dr
To Capital Reserve A/c
(Profit on reissue of forfeited
shares transferred to capital reserve)

Illustration : 14

The Directors of a Company after due notice forfeited 100 Shares of Rs.10 each on which the final call money of Rs.3 was not paid. Later these shares were reissued at Rs.8 per share. Pass entries.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Share Capital A/c [100 x 10] Dr.		1,000	
	To Forfeited shares A/c [100 x 7]			700
	To Share Final Call A/c [100 x 3]			300
	(100 shares forfeited for non payment of final call money)			

	Bank A/c [100 x 8] Dr		800	
	Forfeited Shares A/c [100 x 2] Dr		200	
	To Share Capital A/c [100 x 10] (100 Shares reissued at Rs.8)			1000
	Forfeited Shares A/c Dr		500	
	To Capital Reserve A/c (Profit on reissue of forfeited share transferred to Capital Reserve)			500

Note : Calculation of profit on reissue.

	Amount received on forfeiture	100 shares x Rs.7 =Rs. 700
Less:	Loss on reissue	100 shares x Rs.2 =Rs. 200
	Profit on reissue (Capital Reserve)	100 shares x Rs.5 =Rs. 500

Illustration : 15

A company forfeited 200 shares of Rs.10 each on which the first call money of Rs.3 and final call of Rs.2 per share were not received. These shares were subsequently reissued at Rs.7 per share fully paid up. Pass journal entries for forfeiture and reissue.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Share Capital A/c [200 x 10] Dr.		2,000	
	To Forfeited shares A/c [200 x 5]			1,000
	To Share First Call A/c [200 x 3]			600
	To Share Final Call A/c. [200 x 2] (200 shares forfeited for non payment of call money)			400

	Bank A/c [200 x 7] Dr		1,400	
	Forfeited Shares A/c [200 x 3] Dr		600	
	To Share Capital A/c [200 x 10] (200 Shares reissued at Rs.7)			2,000
	Forfeited Shares A/c Dr		400	
	To Capital Reserve A/c (Profit on reissue of forfeited share transferred to Capital Reserve)			400

Reissue of shares issued at Premium:

When shares previously issued at a premium on which premium has been already received fully, share premium need not be recorded again on reissue of shares.

Illustration : 16

A Company issued 10,000 equity shares of Rs.10 each at premium of Rs.3 per share payable as follows:

on application	Rs.4 per share
on allotment	Rs.5 per share (including premium)
on first and final call	Rs.4 per share

Subscriptions were received for 13,000 shares. The excess money was refunded and the allotment money was received in full. The first and final call was made in due course and the amount due was received with the exception of 100 shares. These shares were forfeited and subsequently re-issued as fully paid for Rs.8 per share. Pass Journal entries recording the above transactions.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Bank A/c Dr		52,000	
	To Share Application A/c			52,000
	(Application money received for 13,000 shares @ Rs.4 per share)			
	Share Application A/c Dr		52,000	
	To Share Capital A/c			40,000
	To Bank A/c			12,000
	(Application money received on 10,000 shares transferred to Share Capital A/c and that on 3,000 shares refunded)			
	Share Allotment A/c Dr		50,000	
	To Share Capital A/c			20,000
	To Securities Premium A/c			30,000
	(Allotment money due on 10,000 shares including premium,)			
	Bank A/c Dr		50,000	
	To Share Allotment A/c			50,000
	(Allotment money received)			
	Share First and Final Call A/c Dr		40,000	
	To Share Capital A/c			40,000
	(First and final call money due on 10,000 shares @ Rs.4 per share)			
	Bank A/c (Rs.40000 – 100 x 4) Dr		39,600	
	To Share First and Final Call A/c			39,600
	(First and Final call money received)			

	Share Capital A/c (100 x Rs.10) Dr		1,000	
	To Share First & Final Call A/c (100 x Rs. 4)			400
	To Forfeited Shares A/c (100 x Rs.6)			600
	(Forfeiture of 100 shares on which first and final call was due)			
	Bank A/c (100 x Rs.8) Dr		800	
	Forfeited Share A/c (100 x Rs.2) Dr		200	
	To Share Capital A/c			1,000
	(Re-issue of 100 forfeited shares at Rs.8 per share as fully paid up)			
	Forfeited Shares A/c Dr.		400	
	To Capital Reserve A/c			400
	(Profit on re-issue of forfeited shares transferred to Capital Reserve)			

Illustration : 17

Surya Ltd. issued 50,000 equity shares of Rs.10 each at premium of 10% payable as under:

on application	Rs.3
on allotment	Rs.5 (including premium)
on first and final call	Rs.3

The whole of the issue was called for by the company and all the money were duly received except call money on 500 shares. These shares were, therefore, forfeited and later on re-issued at Rs.9 per share as fully paid.

Solution:

In the Books of Surya Ltd.

Journal Entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Bank A/c Dr.		1,50,000	
	To Share Application A/c			1,50,000
	(Application money received for 50,000 shares @ Rs.3 per share)			
	Share Application A/c Dr		1,50,000	
	To Share Capital A/c			1,50,000
	(Transfer of share application money to share Capital A/c)			
	Share Allotment A/c Dr		2,50,000	
	To Share Capital A/c			2,00,000
	To Securities Premium A/c			50,000
	(Allotment money due on 50,000 shares including premium)			
	Bank A/c Dr		2,50,000	
	To Share Allotment A/c			2,50,000
	(Allotment money received)			
	Share First and Final Call A/c Dr		1,50,000	
	To Share Capital A/c			1,50,000
	(Final call money due on 50,000 shares @ Rs.3 per share)			
	Bank A/c Dr		1,48,500	
	To Share First and Final Call A/c			1,48,500
	(Final call money received on 49,500 shares)			
	Share Capital A/c Dr		5,000	
	To Share First and Final Call A/c			1,500
	To Forfeited Shares A/c			3,500
	(Forfeiture of 500 shares on which allotment and first call were due)			
	Bank A/c Dr		4,500	
	Forfeited Shares A/c Dr		500	
	To Share Capital A/c			5,000
	(Re-issue of forfeited shares as fully paid up at Rs.9 per share)			
	Forfeited Shares A/c Dr		3,000	
	To Capital Reserve A/c			3,000
	(Profit on re-issue transferred to capital reserve)			

Note: Securities Premium A/c has been debited on forfeiture because the amount of premium remains in arrear.

Reissue of shares issued at Discount:

When shares previously issued at discount are reissued after forfeiture the discount should be brought into account.

Illustration : 18

Madhina Company Ltd. issued 1000 shares of Rs.10 each at discount of Re.1 payable as follows:

Rs.3 on Application

Rs.3 on Allotment (along with discount)

Rs. 3 on First & Final call

All shares were duly subscribed and money was received except from a shareholder who failed to pay the final call amount on 100 shares. The directors forfeited the shares after giving due notice. Later these shares were reissued for Rs.8 fully paid. Pass entries to record forfeiture and reissue.

Solution:

In the Books of Madhina Company Ltd.

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Share capital A/c	Dr.		1000	
	To Forfeited shares A/c				600
	To Discount on issue of shares A/c				100
	To Final call A/c				300
	(Forfeiture of 100 shares for non-payment of call money)				
	Bank A/c.	Dr.		800	
	Discount on issue of shares A/c	Dr.		100	
	Forfeited shares A/c	Dr.		100	
	To Share capital A/c				1000
	(Reissue of 100 shares @ Rs.8 per share)				
	Forfeited shares A/c	Dr.		500	
	To Capital reserve A/c				500
	(Profit on reissue transferred to capital reserve)				

Illustration : 19

Kanchana Ltd. forfeited 1000 shares of Rs.10 each issued at a discount of 10% for non payment of first call Rs.2 and second call Rs.3

These shares were reissued to Mr.Arun upon a payment of Rs.7,000 as fully paid.

Solution:

In the books of Kanchana Ltd.

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Share Capital A/c	Dr		10,000	
	To Forfeited Shares A/c				4,000
	To Discount on Issue of Share A/c				1,000
	To First Call A/c				2,000
	To Second Call A/c				3,000
	(Forfeited of 1000 shares on non payment of call money)				
	Bank A/c	Dr		7,000	
	Discount on Issue of Share A/c	Dr		1,000	
	Forfeited Shares A/c	Dr		2,000	
	To Share Capital A/c				10,000
	(Reissued of Rs.7 as fully paid)				
	Forfeited Shares A/c	Dr		2,000	
	To Capital reserve				2,000
	(Profit on reissue transferred to Capital reserve)				

Partial Reissue :

When all forfeited shares are not reissued then only profit made on such reissued shares is transferred to capital reserve. The amount relating to that part of shares that are not reissued will remain in the shares forfeited account which will be transferred to the liability side of the Balance Sheet.

Illustration : 20

The Directors of a company forfeited 100 equity shares of Rs.10 each on which the first call of Rs.3 and final call of Rs.3 had not been paid. Of these 40 shares were reissued upon payment of Rs.300. Journalise the transactions of forfeiture and reissue of shares.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Share Capital A/c (100 x Rs.10) Dr. To Forfeited Shares A/c (100 x 4) To First Call A/c. (100 x 3) To Final Call A/c. (100 x 3) (100 shares of Rs.10 each forfeited for non-payment of calls)		1,000	 400 300 300
	Bank A/c (40 x Rs.7.50) Dr. Forfeited Shares A/c (40 x Rs.2.50) Dr. To Share Capital A/c. (40 of the forfeited shares reissued at Rs.300)		300 100	 400
	Forfeited Shares A/c. Dr. To Capital Reserve A/c. (Profit on reissue transferred to Capital Reserve Account)		60	 60

Note : Calculation of profit on reissue.

	Amount received on forfeiture	100 shares x Rs.4	= Rs. 400
	Amount received on forfeiture	40 shares x Rs.4	= Rs. 160
Less:	Loss on reissue	40 shares x Rs.2.50	= Rs. 100
	Profit on reissue (Capital Reserve)	40 shares x Rs.1.50	= Rs. 60

Note : The balance in the forfeited shares account Rs.240 will be shown as an addition to paid-up capital in the liabilities side of the Balance Sheet.

Ledger Accounts

Dr. **Forfeited Shares Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	100	By Share capital A/c	400
To Capital Reserve A/c	60		
To Balance c/d	240		
	400		400
		By Balance b/d	240

Two Types of Shares:

If a company issues both types of shares, Preference and Equity, the accounts will be prefixed by the terms 'Preference Share' or 'Equity Share' as the case may be.

Illustration : 21

Priya Ltd. offer to the public 1,00,000 Equity Shares and 50,000 Preference Shares of Rs.10 each payable as under.

	Equity Shares Rs.	Preference Shares Rs.
On Application	2	3
On Allotment	4	4
On First and Final Call	4	3

The public applied for 1,20,000 Equity Shares and 45,000 Preference Shares. Application for Preference Shares were accepted in full. All excess money received on equity shares was rejected. All money due was received. Pass entries, prepare important ledger accounts and extract from the Balance sheet.

Solution:

In the Books of Priya Ltd.

Journal Entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Bank A/c Dr To Equity Share Application A/c (Application money received on 1,20,000 Equity shares)		2,40,000	2,40,000
	Bank A/c Dr To Preference Share Application A/c (Application money received on 45,000 preference shares)		1,35,000	1,35,000
	Equity Share Application A/c Dr To Equity Share Capital A/c (Equity application money transferred to equity share capital)		2,00,000	2,00,000
	Preference share application A/c Dr To Preference share capital A/c (Preference share application money transferred to preference share capital)		1,35,000	1,35,000
	Equity Share Application A/c Dr To Bank A/c (Excess Equity share application money on 20,000 shares refunded)		40,000	40,000
	Equity Share allotment A/c Dr To Equity Share capital (Allotment money due on 1,00,000 Equity shares @ Rs.4 per share)		4,00,000	4,00,000

	Bank A/c Dr To Equity Share Allotment A/c (Allotment money received on equity shares)		4,00,000	4,00,000
	Preference share allotment A/c Dr To Preference share capital A/c (Allotment money on 45,000 preference shares due)		1,80,000	1,80,000
	Bank A/c Dr To Preference share allotment A/c (Allotment money received on preference shares)		1,80,000	1,80,000
	Equity First & Final call A/c Dr To Equity Share capital A/c (First & Final call amount due on 1,00,000 shares)		4,00,000	4,00,000
	Bank A/c Dr To Equity Share First & Final call A/c (First & Final call amount received on equity shares)		4,00,000	4,00,000
	Preference Share First & Final call A/c Dr To Preference Share capital A/c (Preference First & Final call amount due on 45,000 shares @ 3)		1,35,000	1,35,000
	Bank A/c Dr To Preference Share First & Final call A/c (Amount received on Preference first & final call)		1,35,000	1,35,000

Equity Share Capital

Particulars	Rs.	Particulars	Rs.
		By Equity Share Application A/c	2,00,000
		By Equity Share Allotment A/c	4,00,000
To Balance c/d	10,00,000	By Equity First & Final call A/c	4,00,000
	10,00,000		10,00,000
		By Balance b/d	10,00,000

Preference Share Capital

Particulars	Rs.	Particulars	Rs.
		By Preference Share Application A/c	1,35,000
		By Preference Share Allotment A/c	1,80,000
To Balance c/d	4,50,000	By Preference Share First & Final call A/c	1,35,000
	4,50,000		4,50,000
		By Balance b/d	4,50,000

Bank Account

Particulars	Rs.	Particulars	Rs.
To Equity Share Application A/c	2,40,000	By Equity Share Application	40,000
To Preference Share Application A/c	1,35,000		
To Equity Share Allotment A/c	4,00,000		
To Preference Share Allotment A/c	1,80,000		
To Equity First & Final call A/c	4,00,000		
To Preference First & Final call A/c	1,35,000	By Balance c/d	14,50,000
	14,90,000		14,90,000
To Balance b/d	14,50,000		

Extracts from Balance Sheet Entries of Priya

Liabilities	Rs.	Assets	Rs.
Share Capital:			
Authorised:	----	Current Assets:	
Issued :		Cash at Bank	14,50,000
50,000 Preference share @ Rs.10 each	5,00,000		
1,00,000 Equity share @ Rs.10 each	10,00,000		
Subscribed :			
45000 Preference Shares @ Rs.10 each	4,50,000		
100000 Equity shares @ Rs.10 each	10,00,000		
Called-up:			
45000 Preference Shares @ Rs.10 each	4,50,000		
100000 Equity shares @ Rs.10 each	10,00,000		
Paid-up:			
45000 Preference Shares @ Rs.10 each	4,50,000		
100000 Equity shares @ Rs.10 each	10,00,000		
	14,50,000		14,50,000

Illustration : 22

Thamarai Co. Ltd. issued 70,000 shares of Rs.10 each payable at a premium of Rs.2 per share.

Rs. 4 on application

Rs. 5 on Allotment

Rs. 2 on First Call

Re. 1 on Final Call

All the shares were duly subscribed. The money's due on the shares were received except the First Call amount on 1,000 shares and the Final Call amount on 1,500 shares.

The company forfeited the shares on which both the call amounts were not received. Of these 800 shares were reissued at Rs.7 per share.

Draft the necessary journal entries.

Solution:

Journal in the Books of Thamarai Co. Limited

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Bank A/c Dr		2,80,000	
	To Share Application A/c			2,80,000
	(Money received as 70,000 shares @ Rs.4 per Share)			
	Share Application A/c Dr		2,80,000	
	To Share Capital A/c			2,80,000
	(Transfer of Application money to Share capital)			
	Share Allotment A/c Dr		3,50,000	
	To Share Capital A/c			2,10,000
	To Securities premium A/c			1,40,000
	(Allotment money due on 70,000 shares including premium)			

	Bank A/c Dr		3,50,000	
	To Share Allotment A/c			3,50,000
	(Allotment money received)			
	Share First call A/c Dr		1,40,000	
	To Share Capital A/c			1,40,000
	(First call money due on 70,000 shares of Rs.2 each)			
	Bank A/c Dr		1,38,000	
	To Share First call A/c			1,38,000
	(First call money received except on 1000 shares)			
	Share Final call A/c Dr		70,000	
	To Share Capital A/c			70,000
	(Final call money due on 70,000 shares of Re. 1 each)			
	Bank A/c Dr		68,500	
	To Share Final call A/c			68,500
	(Final call money received except on 1,500 shares)			
	Share Capital A/c Dr		10,000	
	To Share First call A/c			2,000
	To Share Final call A/c			1,000
	To Forfeited Shares A/c			7,000
	(1,000 shares forfeited on which both the calls were not received)			
	Bank A/c Dr		5,600	
	Forfeited Shares A/c Dr		2,400	
	To Share capital A/c			8,000
	(800 shares reissued)			
	Forfeited Shares A/c Dr		3,200	
	To Capital Reserve A/c			3,200
	(Profit on forfeited and reissued shares transferred to capital reserve A/c)			

Illustration : 23

Surya Ltd. issued 16,000 shares of Rs.20 each at par payable Rs.4 on Application, Rs.6 on Allotment, the First call of Rs.5 and Second and Final Call of Rs.5.

Applications were received for 24,000 shares. The shares were allotted on pro-rata basis to the applicants for 19,200 shares and the remaining were rejected. Money over-paid on Application was used towards the money due on allotment. All the money due were received except from one shareholder holding 800 shares who failed to pay the final call.

Those shares were forfeited and later reissued at Rs.18 as fully paid up.

Pass Journal Entries, prepare Ledger Accounts and the Balance Sheet.

(October, 1997)

Solution:

Journal Entries of Surya Ltd.

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Bank A/c Dr To Share Application A/c (Share application money on 24000 applications received)		96,000 -	- 96,000
	Share Application A/c Dr To Share Capital A/c (The application money on 16,000 applications transferred to share capital account)		64,000	- 64,000
	Share Application A/c Dr To Bank A/c (Excess application money refunded on 4,800 shares @ Rs.4))		19,200 -	- 19,200

	Share application A/c Dr To Share Allotment A/c (Excess application money transferred to share allotment A/c)		12,800 -	- 12,800
	Share allotment A/c Dr To Share capital A/c (Allotment money on 16,000 shares)		96,000 -	- 96,000
	Bank A/c Dr To Share allotment A/c (Allotment money received)		83,200	83,200
	Share first call A/c Dr To Share capital A/c (First call money due)		80,000	80,000
	Bank A/c Dr To Share first call A/c (First call money received)		80,000	80,000
	Share second and final call A/c Dr To Share capital A/c (Second call money due)		80,000	80,000
	Bank A/c Dr To Share second and final call A/c (Second call money received except on 800 shares)		76,000	76,000
	Share capital A/c Dr To Share second & final call A/c To Forfeited Shares A/c (800 shares forfeited on which final call money was not received)		16,000	4,000 12,000
	Bank A/c Dr Forfeited Shares A/c Dr To Share capital A/c (800 shares reissued @ Rs.18)		14,400 1,600	16,000
	Forfeited Shares A/c Dr To Capital reserve A/c (Profit on forfeited and reissued shares transferred to capital reserve A/c)		10,400	10,400

Ledger in the books of Surya Ltd.

Dr. **Bank Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Application A/c	96,000	By Share Application A/c	19,200
To Share Allotment A/c	83,200	By Balance c/d	3,30,400
To Share First Call A/c	80,000		
To Share Second Call A/c	76,000		
To Share Capital A/c	14,400		
	3,49,600		3,49,600
To Balance b/d	3,30,400		

Dr. **Share Application Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	64,000	By Bank A/c	96,000
To Bank A/c	19,200		
To Share Allotment A/c	12,800		
	96,000		96,000

Dr. **Share Allotment Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	96,000	By Bank A/c	83,200
		By Share Application A/c	12,800
	96,000		96,000

Dr. **Share First Call Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	80,000	By Bank A/c	80,000
	80,000		80,000

Dr. **Share Final Call Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	80,000	By Bank A/c	76,000
		By Share Capital A/c	4,000
	80,000		80,000

Dr. **Share Capital Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share second call A/c	4,000	By Share Application A/c	64,000
To Forfeited Shares A/c	12,000	By Share Allotment A/c	96,000
To Balance c/d	3,20,000	By Share First call A/c	80,000
		By Shares Second call A/c	80,000
		By Bank A/c	14,400
		By Shares forfeited A/c	1,600
	3,36,000		3,36,000
		By Balance b/d	3,20,000

Dr. **Shares Forfeited Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	1,600	By Share Capital A/c	12,000
To Capital Reserve A/c	10,400		
	12,000		12,000

Dr. **Capital Reserve Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Balance c/d	10,400	By Share Forfeited A/c	10,400
	10,400		10,400
		By Balance b/d	10,400

Extracts from the Balance Sheet of Surya Ltd.

Liabilities	Rs.	Assets	Rs.
Share Capital		Current Assets:	
Authorised Capital	---	Bank	3,30,400
Issued Capital 16,000 shares @ Rs.20 each	3,20,000		
Subscribed Capital 16,000 shares @ Rs.20 each	3,20,000		
Called-up Capital 16,000 shares @ Rs.20 each	3,20,000		
Paid up Capital 16,000 shares @ Rs.20 each	3,20,000		
Reserves and surplus: Capital reserve	10,400		
	3,30,400		3,30,400

QUESTIONS

I. Objective type:

a) Fill in the Blanks:

1. Companies have been defined in Section ____________ of the Companies Act, ________.
2. ___________ is considered as the official signature of the company.
3. The management of a company is done by ___________.
4. The liability of share holders are ___________ in a company.
5. Audit of accounts are done by practicing chartered accounts who are appointed by ___________ at the ___________.
6. _________ is the maximum amount of capital that can be issued by a company.
7. Nominal capital is the capital mentioned in the ________________ of the company.
8. That part of the authorised capital not offered for subscription to the public in known as __________.
9. Reserve capital can be issued only at the time of ___________.
10. A public issue can not be kept open for more ___________ days.
11. Minimum subscription that should be received by the company is ______% of the issued capital.
12. When excess application money is adjusted towards allotment it is called as ___________ allotment.
13. There should be a time gap of _____________ between two calls.
14. Capital Reserve represents ___________ profit.

15. Forfeited shares have to be reissued at a price __________ than the face value.

16. Securities premium is shown in the __________ side of the Balance Sheet.

(Answers: 1. Sec. 3(1)(i), 1956; 2. Common Seal; 3. Board of Directors; 4. Limited; 5. Shareholders, Annual General Meeting; 6. Authorised/ Nominal / Register; 7. Memorandum of Association; 8. Unissued; 9. Winding up; 10. 10 days; 11. 90; 12. Prorata/Proportional; 13. One month; 14. Capital; 15. Lesser than; 16. Liability)

b) Choose the correct answer:

1. According to Companies (Amendment) Act 2000, a company limited by share can issue _______ kinds of shares.
   a) 1 b) 2 c) 3

2. The public issue must be kept open for atleast
   a) 3 days b) 5 days c) 7 days

3. Minimum amount to be collected by a company as application money according to SEBI is _____% of the issue price.
   a) 10% b) 25% c) 50%

4. When more number of applications are received than that are offered to the public, it is called ____________.
   a) Over subscription b) Under subscription
   c) Full subscription

5. The maximum calls that a company can make is
   a) one b) two c) three

6. According to Table A, interest charged on calls-in-arrears is ______%.
   a) 4% b) 5% c) 6%

7. According to Table A, interest charged on calls in advance is _______%.
   a) 4% b) 5% c) 6%

8. A company can issue shares
   a) at par only b) at par and at premium
   c) at par, at premium & at discount

9. When the company issue shares at a price more than the face value it is called as an issue at ________.
   a) Par b) Premium c) Discount

10. Normally companies can issue shares at ________% of discount
    a) 5 b) 10 c) 20

11. When shares are forfeited the share capital of the company will _______.
    a) remain same b) reduce c) increase

12. Securities premium will appear in the ________ side of the Balance Sheet.
    a) Asset b) Liability c) Assets & Liabilities

13. The balance of forfeited share account is________ in the Balance Sheet.
    a) added to paid up capital b) added to authorised capital
    c) deducted from paid up capital.

14. Calls-in-arrears is shown in the Balance Sheet as
    a) deduction from called up capital
    b) addition to paid up capital
    c) addition to issued capital

15. Capital Reserve is shown on the ________ side of Balance Sheet.

a) Asset b) Liability c) Both

(Answer: 1. (b); 2. (a); 3. (b); 4. (a); 5. (c); 6. b); 7. (c); 8. (c); 9. (b); 10. (b); 11. (b); 12. (b); 13. (a); 14. (a); 15. (b))

II. Other Questions:

1. Define a company.
2. What are the characteristics of a company?
3. Explain the different types of share capital of a company.
4. What is a share?
5. What are the different types of shares that can be issued by company?
6. Explain the different types of preference shares.
7. Explain the procedure for issue of shares.
8. What is allotment?
9. What is prorata allotment?
10. What do you understand by calls-in-arrears?
11. What is meant by calls-in-advance.
12. What are the differences between over subscription & undersubscription?
13. Write a note on equity shares?
14. What do you understand by issue of shares at premium?
15. What is forfeiture of shares?
16. Write notes on reissue of forfeited shares?

III. Problems

1. A company issued 20,000 shares of Rs.10 each payable

   Rs. 3 on Application,

   Rs. 3 on Allotment,

   Rs. 4 on First and Final call

   All shares were subscribed and duly paid for. Pass journal entries.

2. Preeti Ltd. invited applications for 5,000 shares of Rs.10 each payable as follows:

   Rs.3 on Application,
   Rs.2 on Allotment,
   Rs.2 on First call and
   Rs. 3 on Final call.

   All these shares were subscribed and paid for. Pass journal entries.

3. A Joint Stock Company had a Nominal Capital of Rs.5,00,000 divided into 5,000 shares Rs.100 each payable

   Rs.30 per share on application,
   Rs.20 per share on allotment
   Rs.30 on First call and Rs.20 on Final call.

   All the shares were subscribed and fully paid for by the public. Pass Journal entries.

4. Mary Ltd. issued 1,000 shares of Rs.10 each at premium of Rs.2 per share payable as follows:

   Rs.4 on application
   Rs.4 on allotment (including premium)

and the balance when required. All the shares were subscribed for and duly paid. Pass necessary Journal entries.

5. Global Ltd. issued 6000 shares of Rs. 100 each at premium of Rs.20 per share payable as follows:

   Rs. 30 on application

   Rs. 50 on allotment (including premium)

   Rs. 30 on First call and

   Rs. 10 on Final call

   All shares were duly subscribed and money due were fully received.

   Pass journal entries.

6. A Company issued 10,000 shares of Rs.10 each at discount of Re.1 per share payable

   Rs.3 on application

   Rs.4 on allotment (with discount adjustment)

   Rs.2 on first and final call.

   All the shares issued were subscribed for and duly paid. Pass Journal entries.

7. Green Ltd. issued 40,000 shares of Rs.100 each at discount of Rs.10 per share payable as follows:

   Rs. 25 on application.

   Rs. 40 on allotment (including discount) and

   Rs. 25 on final call

   The shares were applied and allotted in full and all moneys were received in time. Pass the Journal entries.

8. Vinod Company Ltd. issued 40,000 Preference shares of Rs.10 each at premium of Rs.3. Give journal entry.

   (October 1997)

9. Sridhar Ltd., issued 20,000 shares of Rs.100 each at discount of 10%. Give journal entry.

   (March 1999)

10. Suresh Ltd. issued 2000 shares of Rs.10 each at premium of Re.1 to the public payable as follows:

    Rs. 3 on application;

    Rs. 4 on allotment (including premium) ;

    Rs. 2 on first call and

    Rs. 2 on final call.

    1800 shares were subscribed by the public. All money due were received. Prepare ledger accounts.

    (Answer: Bank Account Rs. 19,800; Share Capital Account Rs.18,000; Securities Premium Account Rs.1,800)

11. Goodwill Ltd. had an authorised capital of Rs.50,00,000 divided into shares of Rs.100 each. It issued 10,000 shares at discount of 4% payable as follows:

    Rs.20 on application,

    Rs.46 on allotment and

    Rs.30 on first and final call.

    Applications were received for 9,000 shares and all the shares allotted. All money due was received. Pass journal entries and show the extracts from Balance Sheet.

    (Answer: B/s Rs. 9,00,000)

12. On 1.1.98 Alpha Ltd., issued 1,00,000 shares of Rs.10 each payable Rs.2 on application. The company received applications

for 1,20,000 shares. The excess applications were rejected and money refunded. Pass necessary entries.

(October 2000)

13. Good Luck Co. Ltd issued 1,00,000 shares @ Rs.10 each payable

    Rs.3 on application

    Rs.3 on allotment

    and the balance when required. 1,50,000 shares were applied for. The directors rejected the excess applications and refunded the application money. All money due was received. Pass entries to record the transactions.

14. Jackson Ltd. had an authorised capital of Rs.3,00,000 divided into shares of Rs.10 each. It offered 4,000 shares @ Rs.10 each at premium of Rs.2 on the following terms:

    Rs.2 per share on application,

    Rs.5 per share on allotment, (including Rs.2 premium)

    Rs.3 per share on first call and

    Rs.2 per share on final call.

    Applications were received for 6,000 shares. Applicants for 2,000 shares were rejected. All the money due on shares were duly received. Give the necessary journal entries and show the extracts from the Balance Sheet.

    (Answer: B/s. Rs.48,000)

15. Moon Ltd. offered for subscription 20,000 shares of Rs.10 each payable at a premium of Rs.2.50 per share

    Rs.2.50 on application

    Rs.5 on allotment (including premium)

    Rs. 3 on first call and

    Rs.2 on final call

    Application were received for 30,000 shares. Applications for 5,000 shares were rejected. Application money for other 5,000 shares was applied towards the amount due on allotment. The balance money was received in due time. Pass journal entries.

16. A company issued 10,000 shares of Rs.20 each at a premium of Rs.5 per share payable

    Rs. 10 on Application

    Rs. 10 on Allotment (including premium)

    Rs. 5 on First and Final Call

    The company received 11,000 shares. Excess application money was rejected. All money due were received except the Final call money on 500 shares. Pass journal entries.

17. Santhosh Ltd. issued 5,000 Equity shares of Rs.100 each to the public. The shares were payable as follows:

    Rs. 30 on Application;

    Rs. 30 on Allotment;

    Rs. 40 on First and Final call.

    The public subscribed for 4000 shares and the shares were allotted. All money was received except the amount due on call, on 200 shares. Give Journal entries.

18. Shenbagam Ltd. issued 20,000 shares of Rs.100 each payable

    Rs.25 on Application

    Rs.25 on Allotment

    Rs.20 on First call and

    Rs.30 on Final call

18,000 shares were subscribed for and all the shares were allotted. All money due was received except the Final call money on 250 shares. Pass journal entries.

19. Mari Ltd. issued 1,000 shares of Rs.100 each to the public at discount of Rs.5 payable as under:

    Rs.20 on Application;

    Rs. 25 on Allotment; (with discount adjustment)

    Rs. 20 on First call; and

    Rs. 30 on Final call

    All the shares were applied for and allotted. Shanmugam, to whom 100 shares were allotted, paid the final call amount due along with first call. All money were received. Pass journal entries.

20. Bhagavathi Ltd. issued 10,000 shares of Rs.10 each at discount of 10% payable as follows:

On application	Rs. 2.50
On Allotment	Rs. 3.00
On First and Final Call	Rs. 3.50

All money due were received except the final call on 100 shares which were forfeited by the company after giving due notice. Pass the forfeiture entry.

21. Ganthimathi Ltd. was registered with a nominal capital of Rs.1,00,000 in equity shares of Rs.10 each. It offered to the public 6,000 shares for subscription. The applications were, however, received for 8,000 shares. The Directors had to reject the applications for 1,000 shares and to return the money received thereon. The application money received on the other 1,000 shares

was adjusted to allotment account. The amount payable on shares was

    Rs.3 per share on application,

    Rs.3 per share on allotment and

    the balance on first and final call.

    One shareholder holding 100 shares failed to pay the call money and as a result his shares were forfeited. Pass the necessary journal entries.

22. Gani Ltd. forfeited 20 shares of Rs.10 each fully called up, held by Santha for non-payment of final call of Rs.4 per share. These shares were re-issued to Josephin for Rs.8 per share as fully paid up. Give journal entries for the forfeiture and re-issue of shares.

    (Answer: Capital Reserve Rs.80)

23. A Company forfeited 100 equity shares of Rs.100 each issued at premium of 10% (to be paid at the time of allotment) on which first call money of Rs.30 per share and final call of Rs.20 were not received. These shares were forfeited and subsequently re-issued at Rs.90 per share. Give necessary journal entries regarding forfeiture and re-issue of shares.

    (Answer : Capital Reserve Rs.4,000)

24. The Directors of a company forfeited 200 Equity Shares of Rs.10 each fully called up on which the final call of Rs.2 has not been paid. The shares were re-issued upon payment of Rs.1,500. Journalise the above transactions.

    (Answer : Capital Reserve Rs.1,100)

25. The Directors of a company forfeited 100 shares of Rs.10 each fully called up for non-payment of First call of Rs.2 per share and Final call of Rs.3 per share. 60 of these shares were subsequently re-issued at Rs.6 per share fully paid up. Pass necessary Journal entries to record the above.

(Answer : Capital Reserve Rs.60)

26. The directors of Sheela Ltd. forfeited 2000 shares Rs.10 each for non-payment of final call of Rs.2.50. 1,800 of these shares were re-issued for Rs.6 per share fully paid up. Give the necessary Journal entries.

(Answer : Capital Reserve Rs.6,300)

27. Meenakshi Limited forfeited 100 equity shares of face value of Rs.10 each, for non-payment of final call of Rs.2 per share. The forfeited shares were subsequently reissued @ Rs.7 each as fully paid. Give necessary entries in company's Journal.

(Answer : Capital Reserve Rs. 500)

28. Ashok Ltd. forfeited 300 shares of Rs.10 each fully called up held by Ram for non-payment of first call of Rs.3 per share and final call money of Rs.4 per share. Out of these shares 250 were re-issued to Shyam for Rs.2,000. Give Journal entries for forfeiture and re-issue.

(Answer : Capital Reserve Rs.250)

29. A company issued 10,000 shares of the value of Rs.10 each, payable

Rs.3 on application,

Rs.3 on allotment and

Rs. 4 on the first and final call.

All cash is duly received except the call money on 100 shares. These shares ae subsequently forfeited by directors and are reissued as fully paid for Rs.500. Give the necessary Journal entries for the transactions.

(Answer : Capital Reserve Rs. 100)

30. Saraswathi Ltd. having an authorised capital of Rs.20,00,000 in shares of Rs.100 each invited applications for 10,000 shares payable as follows:

On Application	Rs. 30
On Allotment	Rs. 20
On First Call	Rs. 25
On Final Call	Rs. 25

The company received applications for 12,000 shares. Applictions for 10,000 shares were accepted in full and the money on 2000 applications rejected was returned.

All money due as stated above was received with the exception of the final call of 250 shares. Half of these shares were forfeited and re-issued as fully paid at Rs.90 per share. Pass necessary journal entries.

(Answer : Capital Reserve Rs. 8,125)

31. Arun Ltd. offered to the public 20,000 equity shares of Rs.10 each payable

Rs.4 on application,

Rs.2 on allotment,

Rs.2 on first call and

the balance on final call.

Applications received for 35,000 shares. Applications for 10,000 shares were rejected. Excess application money was utilised towards the money due on allotment. Then calls were made. One shareholder Balu holding 500 shares failed to pay the two calls and consequently his shares were forfeited. 200 of these shares were re-issued to as fully paid at Rs.6 per share. Pass journal entries.

(Answer : Capital Reserve Rs. 400)

32. Sriram Ltd. issued 10,000 shares of Rs.100 each at Rs.120 payable as follows:

    Rs. 25 on application;

    Rs. 45 on allotment (including premium);

    Rs. 20 on first Call; and

    Rs. 30 on final Call.

    9,000 shares were applied for and allotted. All money was received with the exception of first and the final calls on 200 shares held by Ram. These shares were forfeited. Give the Journal entries and important ledger Accounts.

    (Answer : Capital Account Rs.8,80,000; Securities Premium Account Rs. 1,80,000; Forfeited Shares Account Rs.10,000; Bank Account Rs. 10,70,000)

33. Narayanan Ltd. has an authorised capital of Rs.4,00,000 divided into shares of Rs.20 each, the whole of which is issued and subscribed at premium of Rs.2 per share. The amount was payable as follows:

    on application Rs. 10

    on allotment Rs.7 (including premium);

    on first call Rs.5 ;

All sums due were received except from Shankar holding 2,000 shares who failed to pay the call money and his shares were forfeited. They were later re-issued at Rs.14 per share as fully paid. Pass journal entries.

(Answer : Capital Reserve Rs. 18,000)

34. A company invited applications for 10,000 shares of Rs.100 each at premium of Rs.20 per share. The shares were payable as under:

On Application	Rs. 30
On Allotment	Rs. 40 (including premium)
On First & Final Call	Rs. 50

The public applied for 9,000 shares. These were allotted. All money due were received with the exception of the call on 200 shares. These shares were forfeited and re-issued at Rs.80 per share fully paid up. Give Journal entries.

(Answer : Capital Reserve Rs. 6,000)

35. Lucy Ltd. issued 50,000 Equity shares of Rs.10 each at premium of 10% payable as under:

On Application	Rs. 2
On Allotment	Rs.5 (including premium)
On First Call	Rs. 2
On Final Call	Rs. 2

All money was duly received except the first and final call money on 500 shares. These shares were, therefore, forfeited and later on re-issued at Rs.9 per share as fully paid. Pass journal entries.

(Answer : Capital Reserve Rs. 2,500)

36. A Company issues 50,000 equity shares of Rs.100 each at a discount of 10% (allowed at the time of allotment). The net amount payable is as follows.

On application	Rs.20
On allotment	Rs.20
On First Call	Rs.25
On Final Call	Rs.25

All the shares were applied and money was duly received except one sharholder, David holding 100 shares did not pay final call money. The shares were forfeited. Out of these, 40 shares were re-issued to Siva at Rs.70 per share as fully paid up. Pass Journal entries.

(Answer : Capital Reserve Rs. 1,800)

37. Tirupur Textiles Company invited applications for 10,000 equity shares of Rs.100 each at a discount of Rs.10 per share (allowed at the time of allotment).

The amount was payable as follows:

On Application	Rs. 30
On Allotment	Rs. 30
On First and Final Call	Rs. 30

The public applied for 9,000 shares and these were allotted. All money due was collected with the exception of first and final call on 400 shares. Subsequently, these shares were forfeited. 200 of these shares were re-issued as fully paid for a payment of Rs.80 per share.

Journalise the above transactions in the books of the Company.

(Answer : Capital Reserve Rs. 10,000)

38. Basha Ltd. invited applications for 30,000 equity shares of Rs.50 each at a discount of 10%. The amount was payable as under:

On application	Rs. 25
On Allotment	Rs. 10 (with discount adjustment)
On Call	Rs. 10

The public applied for 30,000 shares and these were allotted. All money was duly received with the exception of call money on 400 shares. These shares were forfeited. Out of these, 300 shares were re-issued as fully paid up @ Rs.35 per share.

Pass necessary journal entries.

(Answer : Capital Reserve Rs.6,000)