CA – Foundation

Accounting

Question Bank

Index

AMORTISATION

The concept of amortisation in case of intangible assets is similar to the concept of depreciation in case of tangible assets. In other words, 'depreciation of an intangible asset' is called AMORTISATION.

Amortisation can be defined as 'the systematic allocation of the depreciable amount of an intangible asset over its useful life'.

Depreciable amount is the cost of an asset less its residual value.

Useful life is either: the period of time over which an asset is expected to be used by the enterprise; or the number of production or similar units expected to be obtained from the asset by the enterprise.

Residual value is the amount which an enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.

3.

Amortisation of Intangible Asset

Useful life of Intangible Asset

Amortise over its useful life (Assumption Max. life = 10 yrs, if expected useful life cannot be expected.)

Method of Amortisation

Any method which reflects the pattern of Flow of Economic Benefits

If not possible to determine pattern of future economic benefit - Follow Straight Line Method

The depreciable amount of an intangible asset should be allocated on a systematic basis over the best

Given the nature of intangible assets, the residual value of an intangible asset should be assumed to be zero unless:

(a) there is a commitment by a third party to purchase the asset at the end of its useful life; or

(b) there is an active market for the asset and:

(i) residual value can be determined by reference to that market; and

(ii) it is probable that such a market will exist at the end of the asset's useful life.

The amortisation period and the amortisation method should be reviewed at least at each financial year end. If the expected useful life of the asset is significantly different from previous estimates, the amortisation period should be changed accordingly.

If there has been a significant change in the expected pattern of economic benefits from the asset, the amortisation method should be changed to reflect the changed pattern.

Practical Questions

Amortisation

Question No. 21

Kumar R&D Co. registered a patent (the patent meets the criteria of an intangible asset) on 1st July, 2021 developed at a cost of ₹ 28,00,000 and spent ₹ 2,00,000 towards legal fees and registration. The patent is granted for a period of 10 years. The books are closed on 31st December every year.

Question No. 22

Prime Streaming Co. acquired the streaming rights of a movie for ₹ 18,00,000 with the contracted duration of the streaming period being 10 years. At the beginning of the fourth year, based on the decline in viewership, Prime Streaming Co. decided to stream the movie only for the next 5 years.

Preparation of Financial Statements from Incomplete Records

Introduction

- **Very often the small sole proprietorship and partnership business do not maintain books of accounts on double entry systems.**
- The small business concerns, according to their convenience maintain record only of cash transactions and credit transactions; they do not maintain record of many transactions.
- Such incomplete accounting records create special problems while ascertaining business results and financial position at the end of the year.
- **The term 'Single Entry System' is popularly used to describe the finalisation of accounts from incomplete records. In fact there's no such system as single entry system.**

Reasons of Incomplete Records	
1. High cost of record keeping	
2. Lack of knowledge	
3. Time Saving	
4. Lack of awareness for the need of financial records	

Self Notes

Self Notes

Limitations/ Defects of Incomplete Accounting Records

Arithmetical Accuracy cannot be Checked:

- Under this method all ledger accounts related to real, personal and nominal are not maintained as such trial balance cannot be prepared. Hence, arithmetical accuracy cannot be checked.

Figures of Profits cannot be relied Upon

- The profit is based on estimation, hence cannot be relied upon.

True and Fair View of the Business Concern not Shown

- The position of assets and liabilities does not show true and fair view of the business concern as very often recording is made on the basis of memory and sometimes on the basis of information available.

Errors and Frauds not Detectable

- Under this system it is very difficult to detect errors and frauds because various checks which are imposed by double entry system are not available.

Improper Analysis of Profitability and Solvency

- In the absence of complete books of accounts, based on double entry system, proper analysis of profitability and solvency cannot be made. Hence, it may cause a great problem in raising loans from financial institutions.

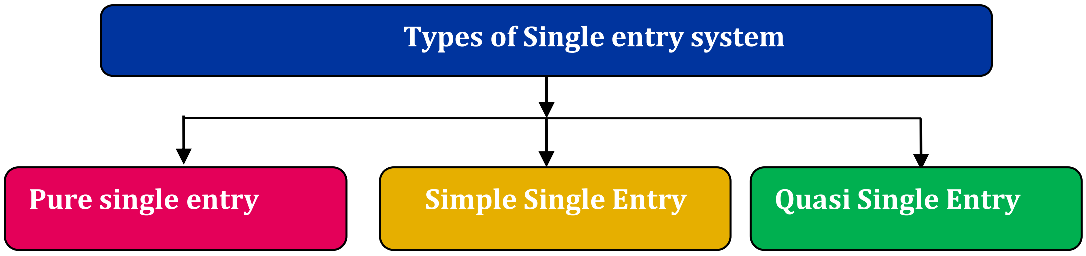
Users' Dissatisfaction:

- Under this system, legal requirements cannot be complied with. Hence, taxation authorities and other governmental agencies do not satisfy with the incomplete information provided by single entry system.

Items	Accounts to be referred
Credit Sale	Account Receivables (Debtors/Bills receivables)
Cash Sale	Cash and Bank Balance
Credit Purchases	Account Payables (Creditors/Bills Payables)
Cash Purchases	Cash and Bank Balance
Other recurring Expenses (Salary, Rent etc..	Cash and Bank Balance , Information collected on Outstanding and Prepaid

Types of single entry system

A scrutiny of many procedures adopted in maintaining records under single entry system brings forth the existence of following three types:



1. Pure single entry

In this, **only personal accounts** are maintained with the result that no information is available in respect of cash and bank balances, sales and purchases, etc. In view of its failure to provide even the basic information regarding cash etc., this method exists only on paper and has no practical application.

2. Simple Single Entry

In this, only:**(a) Personal accounts and (b) cash book** are maintained.

Although these accounts are kept on the basis of double entry system, postings from cash book are made only to personal accounts and no other account is to be found in the ledger. Cash received from debtors or cash paid to creditors is simply noted on the bills issued or received as the case may be.

3. Quasi Single Entry

In this

(a) Personal accounts, (b) cash book, and (c) Some subsidiary books are maintained.

The main subsidiary books kept under this system are Sales book, Purchases book and Bills book. No separate record is maintained for discounts which are entered into the personal accounts. In addition, some scattered information is also available in respect of few important items of expenses like wages, rent, rates, etc.. In fact, this is the method which is generally adopted as a substitute for double entry system.

My Notes

Question No. 1

A Firm sold 20% of the goods on cash basis and the balance on credit basis. Debtors are allowed 1½ month's credit and their balance as on 31.03.2021 is ₹ 1,25,000. Assume that the sale is uniform throughout the year. Calculate the credit sales and total sales of the company for the year ended 31.03.2022.

Question No. 2

Raju does not maintain proper records of his business. However, he provides the following information:

	₹
Opening capital	10,000
Closing capital	12,500
Drawings during the year	3,000
Capital added during the year	3,750

You are required to calculate the profit or loss for the year.

Question No. 3

Rakesh started his business on 1st of April 2021. He invested a capital of ₹ 1,00,000. On 31st March 2022, he has the following information available as per the Single-entry system maintained by him.

	₹
Cash balance (counted)	3,200
Inventory (physically verified)	34,800
Receivable from Ajay against credit sales	31,000
Machine	85,000
Payable to Vinod towards credit purchase	12,000
Loan taken from Bank	10,000
Drawings made during the year	24,000

You are required to calculate the profit or loss earned by Rakesh for the year ended 31st March 2022.

Question No. 4

Assets and Liabilities of Mr. X as on 31-03-2021 and 31-03-2022 are as follows:

	31-03-2021	31-03-2022
Assets		
Building	1,00,000	?
Furniture	50,000	?
Inventory	1,20,000	2,70,000
Sundry debtors	40,000	90,000
Cash at bank	70,000	85,000
Cash in hand	1,200	3,200
Liabilities		
Loans	1,00,000	80,000
Sundry creditors	40,000	70,000

Decided to depreciate building by 2.5% p.a. and furniture by 10% p.a. One Life Insurance Policy of the Proprietor was matured during the period and the amount ₹ 40,000 is retained in the business. Proprietor took @ ₹ 2,000 p.m. for meeting family expenses. Prepare Statement of Affairs as on 31-03-2021 and 31-03-2022.

Question No. 5

The Income Tax Officer, on assessing the income of Shri Moti for the financial years 2020-2021 and 2021-2022 feels that Shri Moti has not disclosed the full income. He gives you the following particulars of assets and liabilities of Shri Moti as on 1st April, 2020 and 1st April, 2022.

				₹
1-4-2020	Assets	:	Cash in hand	25,500
			Inventory	56,000
			Sundry debtors	41,500
			Land and Building	1,90,000
			Wife's Jewellery	75,000
	Liabilities	:	Owing to Moti's Brother	40,000
			Sundry creditors	35,000
1-4-2022	*Assets*	:	Cash in hand	16,000

	Inventory	91,500
	Sundry debtors	52,500
	Land and Building	1,90,000
	Motor Car	1,25,000
	Wife's Jewellery	1,25,000
	Loan to Moti's Brother	20,000
Liabilities:	Sundry creditors	55,000

During the two years the domestic expenditure was ₹ 4,000 p.m. The declared incomes of the financial years were ₹ 1,05,000 for 2020-2021 and ₹ 1,23,000 for 2021-2022 respectively.

State whether the Income-tax Officer's contention is correct. Explain by giving your workings.

Question No. 6

Calculate the bad debts from the below information:

Opening balance of Debtors	₹ 5,00,000
Closing balance of Debtors	₹ 7,00,000
Amount received in Cash	₹ 6,00,000
Discount allowed	₹ 10,000
Credit Sales	₹ 11,40,000
Bills Receivable	₹ 3,00,000
Bad Debts	???

Question No. 7

Calculate the credit purchases from the below information:

Opening balance of creditors	₹ 4,00,000
Closing balance of creditors	₹ 5,00,000
Payments made in Cash	₹ 8,50,000
Discount received	₹ 20,000

Question No. 8

Adamjee keeps his books on single entry basis. The analysis of the cash book for the year ended on 31st March, 2022 is given below:

Receipts	**₹**	**Payments**	**₹**
Bank Balance as on 1st April, 2021	2,800	Payments to Sundry creditors	35,000
Received from Sundry Debtors	48,000	Salaries	6,500
Cash Sales	11,000	General expenses	2,500
Capital brought during the year	6,000	Rent and Taxes	1,500
Interest on Investments	200	Drawings	3,600
		Cash purchases	12,000
		Balance at Bank on 31st March, 2022	6,400
		Cash in hand on 31st March, 2022	500
	68,000		68,000

Particulars of other assets and liabilities are as follows:

	1st April, 2021	31st March, 2022
Sundry debtors	14,500	17,600
Sundry creditors	5,800	7,900
Machinery	7,500	7,500
Furniture	1,200	1,200
Inventory	3,900	5,700
Investments	5,000	5,000

Prepare final accounts for the year ending 31st March, 2022 after providing depreciation at 10 per cent on machinery and furniture and ₹ 800 against doubtful debts.

Question No. 9

Mr. A runs a business of readymade garments. He closes the books of accounts on 31st March. The Balance Sheet as on 31st March, 2021 was as follows:

Liabilities	₹	Assets	₹
A's capital a/c	4,04,000	Furniture	40,000
Creditors	82,000	Stock	2,80,000
		Debtors	1,00,000
		Cash in hand	28,000

		Cash at bank	38,000
	4,86,000		4,86,000

You are furnished with the following information:

(1) His sales, for the year ended 31st March, 2022 were 20% higher than the sales of previous year, out of which 20% sales was cash sales. Total sales during the year 2020-21 were ₹ 5,00,000.

(2) Payments for all the purchases were made by cheques only.

(3) Goods were sold for cash and credit both. Credit customers pay be cheques only.

(4) Depreciation on furniture is to be charged 10% p.a.

(5) Mr. A sent to the bank the collection of the month at the last date of the each month after paying salary of ₹ 2,000 to the clerk, office expenses ₹ 1,200 and personal expenses ₹ 500.

Analysis of bank pass book for the year ending 31st March 2022 disclosed the following:

	₹
Payment to creditors	3,00,000
Payment of rent up to 31st March, 2022	16,000
Cash deposited into the bank during the year	80,000

The following are the balances on 31st March, 2022:

	₹
Stock	1,60,000
Debtors	1,20,000
Creditors for goods	1,46,000

On the evening of 31st March 2022, the cashier absconded with the available cash in the cash book.

You are required to prepare Trading and Profit and Loss A/c for the year ended 31st March, 2022 and Balance Sheet as on that date. All the workings should form part of the answer.

Question No. 10

Ram carried on business as retail merchant. He has not maintained regular account books. However, he always maintained ₹ 10,000 in cash and deposited the balance into the bank account. He informs you that he has sold goods at profit of 25% on sales.

Following information is given to you:

Assets and Liabilities	As on 1.4.2021	As on 31.3.2022
Cash in Hand	10,000	10,000
Sundry Creditors	40,000	90,000
Cash at Bank	50,000 (Cr.)	80,000 (Dr.)
Sundry Debtors	1,00,000	3,50,000
Stock in Trade	2,80,000	?
Ram's capital	3,00,000	?

Analysis of his bank pass book reveals the following information:

a) Payment to creditors ₹ 7,00,000
b) Payment for business expenses ₹ 1,20,000
c) Receipts from debtors ₹ 7,50,000
d) Loan ₹ 1,00,000 taken on 1.10.2021 at 10% per annum
e) Cash deposited in the bank ₹ 1,00,000

He informs you that he paid creditors for goods ₹ 20,000 in cash and salaries ₹ 40,000 in cash. He has drawn ₹ 80,000 in cash for personal expenses. During the year Ram had not introduced any additional capital. Surplus cash if any, to be taken as cash sales. All purchases are on credit basis.

You are required to prepare Trading and Profit and Loss Account for the year ended 31.3.2022 and Balance Sheet as at 31st March, 2022.

Limited Liability Partnership

- A **body corporate** and **legal entity** separate from its partners, have Perpetual succession and any change in the partners of a limited Liability Partnership shall not affect the existence, rights or liabilities of the limited Liability Partnership.

- limited Liability Partnership contains elements of both 'a corporate structure' as well as 'a partnership firm structure' limited Liability Partnership is called a hybrid between a company and a partnership.

- Gives the benefits of limited liability of a company and the flexibility of a partnership.

Advantages of limited Liability Partnership form of Business

1. **Limited liability protects the member's personal assets from the liabilities of the business. limited Liability Partnership's are a separate legal entity to the members.**

2. **Flexibility -** The operation of the partnership and distribution of profits is determined by written agreement between the members. This may allow for greater flexibility in the management of the business.

3. The limited Liability Partnership is deemed to be a **legal person**. It can buy, rent, lease, own property, employ staff, enter into contracts, and be held accountable if necessary.

4. **Corporate ownership -** limited Liability Partnership's can appoint two companies as members of the limited Liability Partnership. In an LTD company at least one director must be a real person.

5. **Designate and non-designate members -** You can operate the limited Liability Partnership with different levels of membership.

Protecting the partnership name - By registering the limited Liability Partnership at Companies House you prevent another partnership or company from registering the same name.

Important Concepts

1. **"Small limited liability partnership [Section 2(ta)]:** It means a limited liability partnership—

- the contribution of which, does not exceed twenty-five lakh rupees or such higher amount, not exceeding five crore rupees, as may be prescribed; and
- the turnover of which, as per the Statement of Accounts and Solvency for the immediately preceding financial year, does not exceed forty lakh rupees or such higher amount, not exceeding fifty crore rupees, as may be prescribed; or
- which meets such other requirements as may be prescribed, and fulfils such terms and conditions as may be prescribed;

2. **Partner [Section 2(q)]:** Partner, in relation to a limited Liability Partnership, means any person who becomes a partner in the limited Liability Partnership in accordance with the limited Liability Partnership agreement.

3. **Non-applicability of the Indian Partnership Act, 1932 (Section 4):** Save as otherwise provided, the provisions of the Indian Partnership Act, 1932 shall not apply to a limited Liability Partnership.

4. **Partners (Section 5):** Any individual or body corporate may be a partner in a limited Liability Partnership. However, an individual shall not be capable of becoming a partner of a limited Liability Partnership, if—
   (a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
   (b) he is an un-discharged insolvent; or
   (c) he has applied to be adjudicated as an insolvent and his application is pending.

5. **Minimum number of partners (Section 6):**
   (i) Every limited Liability Partnership shall have at **least two partners.**
   (ii) If at any time the number of partners of a limited Liability Partnership is reduced below two and the limited Liability Partnership carries on business for more than six months while the number is so reduced, the person, who is the only partner of the limited Liability Partnership during the time that it so carries on business after those six months and has the knowledge of the fact that it is carrying on business with him alone, shall be liable personally for the obligations of the limited Liability Partnership incurred during that period.

6. Designated partners (Section 7):

1. Every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India:

   Provided that in case of a limited liability partnership in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such limited liability partnership or nominees of such bodies corporate shall act as designated partners.

   Explanation - For the purposes of this section, the term resident in India means a person who has stayed in India for a period of not less than one hundred and **twenty days during the financial year.**

2. Subject to the provisions of sub-section (1),

   (i) if the incorporation document

   [a] specifies who are to be designated partners, such persons shall be designated partners on incorporation; or

   [b]states that each of the partners from time to time of limited liability partnership is to be designated partner, every partner shall be a designated partner;

   (ii) any partner may become a designated partner by and in accordance with the limited liability partnership agreement and a partner may cease to be a designated partner in accordance with limited liability partnership agreement.

3. An individual shall not become a designated partner in any limited liability partnership unless he has given his prior consent to act as such to the limited liability partnership in such form and manner as may be prescribed.
4. Every limited liability partnership shall file with the Registrar the particulars of every individual who has given his consent to act as designated partner in such form and manner as may be prescribed within thirty days of his appointment.
5. An individual eligible to be a designated partner shall satisfy such conditions and requirements as may be prescribed.
6. Every designated partner of a limited liability partnership shall obtain a Designated Partners Identification Number (DPIN) from the Central Government and the provisions of sections 153 to 159 (both inclusive) of the Companies Act, 2013 shall apply mutatis mutandis for the said purpose.

Salient Features of Limited Liability Partnership

limited Liability Partnership is a body corporate

According to Section 3 of the Limited Liability Partnership Act 2008 (limited Liability Partnership Act), an limited Liability Partnership is a body corporate, formed and incorporated under the Act. It is a legal entity separate from its partners.

Perpetual Succession

Unlike a general partnership firm, a limited liability partnership can continue its existence even after the retirement, insanity, insolvency or even death of one or more partners. Further, it can enter into contracts and hold property in its name.

Separate Legal Entity

Just like a corporation or a company, it is a separate legal body. Further, it is completely liable for its assets. Also, the liability of the partners has certain limitations in their contribution to the limited Liability Partnership. Hence, the creditors of the limited Liability Partnership are not the creditors of individual partners.

Mutual Agency

Another difference between an limited Liability Partnership and a partnership firm is that independent or unauthorized actions of one partner do not make the other partners liable. All partners are agents of the limited Liability Partnership and the actions of one partner do not bind the others.

limited Liability Partnership Agreement

An agreement between all partners governs the rights and duties of all the partners. Also, the partners can devise the agreement as per their choice. If such an agreement is not made, then the Act governs the mutual rights and duties of all partners.

Common Seal

If the partners decide, the limited Liability Partnership can have a common seal [Section 14(c)]. It is not mandatory though. However, if it decides to have a seal, then it is necessary that the seal remains under the custody of a responsible official. Further, the common seal can be affixed only in the presence of at least two designated partners of the limited Liability Partnership.

Limited Liability

According to Section 26 of the Act, every partner is an agent of the limited Liability Partnership for the purpose of the business of the entity. However, he is not an agent of other partners. Further, the liability of each partner has limitations to his agreed contribution to the limited Liability Partnership. It provides personal liability protection to its partners.

Minimum and Maximum Number of Partners in an limited Liability Partnership

Every Limited Liability Partnerships must have at least two partners and at least two individuals as designated partners. At any time, at least one designated partner should be resident in India. There is no maximum limit on the number of maximum partners in the entity.

Business Management and Business Structure

The partners of the limited Liability Partnership can manage their business. However, only the designated partners are responsible for legal compliances.

Business for Profit Only

Limited Liability Partnerships cannot be formed for charitable or non-profit purposes. It is essential that the entity is formed to carry on a lawful business with a view to earning a profit.

Investigation

The power to investigate the affairs of an limited Liability Partnership resides with the Central Government. Further, they can appoint a competent authority for the same.

Compromise or Arrangement

Any compromise or arrangement like a merger or amalgamation needs to be in accordance with the Act.

Conversion into limited Liability Partnership

A private company, firm, or an unlisted public company or a small business can convert into an limited Liability Partnership in accordance with the provisions of the Act.

E-Filing of Documents

If the entity is required to file any form/application/document, then it needs to be filed in an electronic form on the website www.mca.gov.in. Further, a partner or designated partner has to authenticate the same using an electronic or digital signature.

Maintenance of Books of Account, Other Records and Audit, Etc. Of Limited Liability Partnership

(Section 34)

1. Every limited Liability Partnership shall maintain its proper books of account on double entry system of accounting; and shall be prepared either on
   (i) cash basic; or

   (ii) accrual basic

2. Every limited Liability Partnership shall keep books of account which are sufficient to show and explain the limited Liability Partnership's transaction and are such as to;

- Disclose with reasonable accuracy in the financial position of the limited Liability Partnership
- Designated partner to ensure that any Statement of Account and solvency shall complied with the requirement of limited Liability Partnership act.

3. Every limited liability partnership shall, within a period of six months from the end of each financial year, prepare a Statement of Account and Solvency for the said financial year as at the last day of the said financial year in such form as may be prescribed, and such statement shall be signed by the designated partners of the limited liability partnership.

4. Every limited liability partnership shall file within the prescribed time, the Statement of Account and Solvency prepared pursuant to sub-section (2) with the Registrar every year in such form and manner and accompanied by such fees as may be prescribed.
5. The accounts of limited liability partnerships shall be audited in accordance with such rules as may be prescribed: Provided that the Central Government may, by notification in the Official Gazette, exempt any class or classes of limited liability partnerships from the requirements of this sub-section.

6. fails to comply with the provisions such limited liability partnership shall be punishable with fine which shall not be less than **twenty-five thousand rupees**, but may extend to **five lakh rupees** and every designated partner of such limited liability partnership shall be punishable with fine which shall not be less than ten thousand rupees, but may extend to one lakh rupees.

Section - 34A. Accounting and auditing standards.

The Central Government may, in consultation with the National Financial Reporting Authority constituted under section 132 of the Companies Act, 2013,—

a) Prescribe the standards of accounting;
b) and prescribe the standards of auditing, as recommended by the Institute of Chartered Accountants of India constituted under section 3 of the Chartered Accountants Act, 1949, for a class or classes of limited liability partnerships.

Annual return: (Section 35)

1) Every limited Liability Partnership shall file an annual return duly authenticated with the Registrar within sixty days of closure of its financial year in such form and manner and accompanied by such fee as may be prescribed.

2) Any limited Liability Partnership which fails to comply with the provisions of this section shall be punishable with fine ₹ 100 for each day during such failure continues, subject to the maximum of one **lakh rupees for the limited liability partnership and fifty thousand rupees for designated partners.**

DISTINCTION BETWEEN AN ORDINARY PARTNERSHIP FIRM AND AN LLP

	Basis	LLP	Partnership firm
1.	Applicable Act	The Limited Liability Partnership Act, 2008.	The Indian Partnership Act, 1932.
2.	Body corporate	It is a body corporate.	It is not a body corporate,
3.	Separate legal entity	It is a legal entity separate from its members.	It is a group of persons with no separate legal entity.
4.	Creation	It is created by a legal process called registration under the LLP Act, 2008.	It is created by an agreement between the partners.
5.	Registration	Registration is mandatory. LLP can sue and be sued in its own name.	Registration is voluntary Only the registered partnership firm can sue the third parties.

6.	Perpetual succession	The death, insanity, retirement or insolvency of the partner(s)does not affect its existence of LLP. Members may join or leave but its existence continues forever.	The death, insanity, retirement or insolvency of the partner(s) may Affect its existence. It has no perpetual succession.
7.	Name	Name of the LLP to contain the word limited liability partners (LLP) as suffix.	No guidelines. The partners can have any name as per their choice.
8.	Liability	Liability of each partner limited to the extent to agreed contribution except in case of willful fraud.	Liability of each partner is unlimited. It can be extended upto the personal assets of the partners.
9.	Mutual agency	Each partner can bind the LLP by his own acts but not the other partners.	Each partner can bind the firm as well as other partners by his own acts.
10.	Designated partners	At least two designated partners and at least one of them shall be resident in India.	There is no provision for such partners under the Partnership Act, 1932.
11.	Number of Partners	Minimum 2 but no maximum limit	Minimum 2 and maximum 50.
12.	Legal compliances	Only designated partners are responsible for all the compliances and penalties under this Act.	All partners are responsible for all the compliances and penalties under the Act.
13.	Foreign partnership	Foreign nationals can become a partner in a LLP.	Foreign nationals cannot become a partner in a partnership firm.
14.	Minor as partner	Minor cannot be admitted to the benefits of LLP.	Minor can be admitted to the benefits of the partnership with the prior consent of the existing partners.

Circumstances Leading to Dissolution of Partnership

A partnership is dissolved or comes to an end on

- **On the completion of the venture for which it was entered into;**
- **Death of a partner**
- **Insolvency of a partner**
- **Retirement of a partner**

However, the partners or remaining partners (in case of death, insolvency or retirement) may continue to do the business. In such case there will be a new partnership but the firm will continue When the business comes to an end then only it will be said that the firm has been dissolved.

A firm stands dissolved in the following cases:

The partners agree that the firm should be dissolved

All partners except one become insolvent

The business becomes illegal

In case of partnership at will, a partner gives notice of dissolution

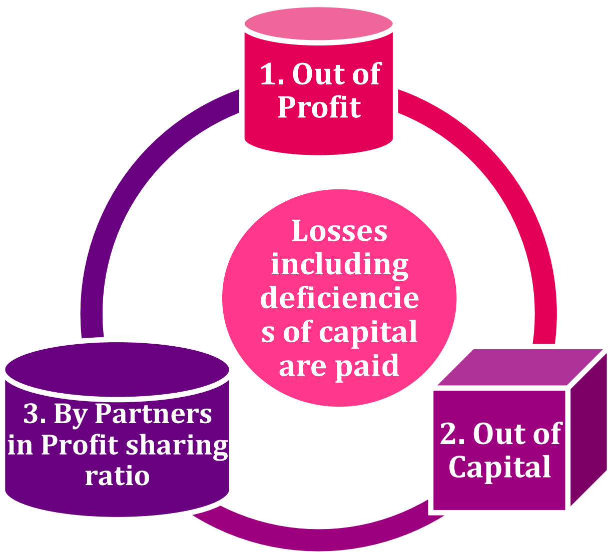
The court orders dissolution.

The court has the option to order dissolution of a firm in the following circumstances :

- Where a partner has become of unsound mind
- Where a partner suffers from permanent incapacity
- Where a partner persistently disregards the partnership agreement
- Where a partner is guilty of misconduct of the business
- Where a partner transfers his interest or share to a third party
- Where the business cannot be carried on except at a loss
- Where it appears to be just and equitable.

Consequences of Dissolution

Upon dissolution of partnership, the mutual rights of the partners, unless otherwise agreed upon, are settled in the following manner



The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital have to be applied in the following manner and order

1. In paying the debts of the firm to third parties

2. In paying to each partner rateably what is due to him from the firm in respect of advances as distinguished from capital

3. In paying to each partner what is due to him on account of capital

4. The residue, if any, to be divided among the partners in the proportion in which they are entitled to share profits

Dissolution before expiry of a fixed term

A partner who, on admission, pays a premium to the other partners with a stipulation that the firm will not be dissolved before the expiry of a certain term, will be entitled to a suitable refund if the firm is dissolved before the term has expired. No claim in this respect will arise if:

The firm is dissolved due to the death of a partner	
The dissolution is mainly due to the partner's (claiming refund) own misconduct	
The dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.	

Closing of Partnership Books on Dissolution

Following steps are necessary to close the books of accounts :

1. Open Realisation a/c and transfer all assets except cash in hand or at Bank at their BOOK VALUES. It is important to note that, Sundry Debtors and R.D.D. are two separate amounts and the gross amount of debtors should be transferred.
2. Transfer all liabilities to outsiders and provisions against assets (e.g. R.D.D.) the credit side of Realisation account.
3. Accounts denoting accumulated losses or profits should not be transferred to realisation A/c; they should be transferred to partners' capital accounts in their profit sharing ratio.
4. Realisation of assets :

   If assets are sold out, cash a/c is debited and realisation a/c is credited

   If assets are taken over by one of the partners, partner's capital a/c is debited and realisation a/c is credited.
5. Payment of Liabilities:

   Realisation a/c is debited with actual amount paid and cash/or partners capital a/c (in case he has taken over the liability) is credited.
6. Payment of realisation expenses is recorded by debited Realisation A/c. and credited cash/bank a/c.
7. At this stage realisation A/c will show profit/loss which is to be transferred to partner's capital A/c in their profit sharing ratio.
8. Partner's loan if any shall be paid.
9. At this stage partner's capital account will show how much amount is due to them and/or from them. The partners having debit balance in their capital accounts will bring in cash to the extent of the debit balance; and partners having credit balance in their capital accounts will receive cash to that extent

Consequences of Insolvancy of one Partner.

1. The partner adjudicated as insolvent ceases to be a partner.

2. He ceases to be a partner on the date on which the order of adjudication is made.

3. The firm is dissolved on the date of the order of adjudication unless there is a contract to the contrary.

4. The estate of the insolvent partner is not liable for any act of the firm after the date of the order of adjudication, and

5. The firm cannot be held liable for any acts of the insolvent partner after the date of the order of adjudication.

Loss Arising from Insolvency of One Partner

When a partner is unable to pay his debt due to the firm, he is said to be insolvent and his share of loss is to be borne by other solvent partners in accordance with the decision is English case of **'GARNER VS MURRAY'.** Following rules were established in this famous case

1. Loss on realisation of assets is to be borne by all partners (including insolvent partner) in the profit sharing ratio.
2. Loss due to insolvency of a partner has to be borne by all partners (including insolvent partners) in the profit sharing ratio.
3. Loss due to insolvency of a partner has to be borne by the solvent partners in their capital ratio. Capital ratio is calculated in the following manner :

Case 1: When Partner's capitals are fixed: The insolvency loss is distributed in the ratio of fixed capital.

Case 2: When partners capital are fluctuation : Capital ratio will be determined after adjusting all the reserves and accumulated profits to the date of dissolution, all drawings to the date of dissolution, all interest on capital and drawings to the date of dissolution but before adjusting profit/loss on realisation Account.

Note: If a partner is having a debit balance in his capital account and is not insolvent, then he cannot be called up to bear loss on account of the insolvency of other partner.

Insolvency Of Partners

When liabilities of the firm cannot be paid in full out of the firm assets as well as personal assets of the partners. Then all the partners of the firm are said to be insolvent.

Following steps are required to be taken to close the books of accounts of the firm.

1. Transfer all assets at their book value to realisation A/c. But do not transfer creditors to realisation A/c.
2. Amount realised by sale of assets shall be credited to realisation a/c; and realisation expenses shall be debited to realisation a/c.
3. At this stage profit/loss realisation a/c shall be ascertained and transferred to all partners in their profit sharing ratio.

4. Available cash is to be paid to creditors.
5. Unpaid balance in creditors account shall be transferred to an account specially opened which may called 'Deficiency a/c's. This account is opened for the purpose of closing the books of accounts of the firm.
6. Debit/Credit balances in partner's capital a/c's will be transferred to Deficiency A/c.
7. At this stage Deficiency A/c. closes with NIL balance

PIECEMEAL PAYMENTS

The assets sold upon dissolution of partnership are realised only in small instalments over a Period of time. In such circumstances, the choice is either to distribute whatever is collected or to wait till the whole amount is collected.

METHODS OF PIECEMEAL PAYMENTS

- **Proportionate capital method**
  - A partner who has contributed more than his proportionate share of capital is paid first in priority to the other partners.
    - For identifying the partner who has to be paid first, the partner's capital, who has contributed the least is taken as the base.
- **Minimum loss method**
  - Realisation loss is ascertained at every stage and distributed among the partners in their profit-sharing ratio.
  - In case capital account of a partner starts showing a debit balance on account of such loss, he is presumed to be insolvent and his deficiency is to be charged to the 'solvent partners in the ratio of their capitals as per Garner Vs Murray rule.

Winding up and Dissolution

Winding up and dissolution (Section 63): The winding up of a limited Liability Partnership may be either voluntary or by the Tribunal and limited Liability Partnership, so wound up may be dissolved.

Circumstances in which limited Liability Partnership may be wound up by Tribunal (Section 64): A limited Liability Partnership may be wound up by the Tribunal:

(a) if the limited Liability Partnership decides that limited Liability Partnership be wound up by the Tribunal;
(b) if, for a period of more than six months, the number of partners of the limited Liability Partnership is reduced below two;
(c) if the limited Liability Partnership is unable to pay its debts;
(d) if the limited Liability Partnership has acted against the interests of the sovereignty and integrity of India, the security of the State or public order;
(e) if the limited Liability Partnership has made a default in filing with the Registrar the Statement of Account and Solvency or annual return for any five consecutive financial years; or
(f) if the Tribunal is of the opinion that it is just and equitable that the limited Liability Partnership be wound up.

Rules for winding up and dissolution (Section 65): The Central Government may make rules for the provisions in relation to winding up and dissolution of limited Liability Partnership.

Question No. 1

X, Y, and Z are partners of the firm XYZ and Co., sharing Profits and Losses in the ratio of 4: 3:2. Following is the Balance Sheet of the firm as on 31st March, 2022:

Balance Sheet as on 31st March, 2022

Liabilities	₹	Assets	₹
Partners' Capitals:		Fixed Assets	5,00,000
X	4,00,000	Stock in trade	3,00,000
Y	3,00,000	Sundry debtors	5,00,000
Z	2,00,000	Cash in hand	10,000
General Reserve	90,000		
Sundry Creditors	3,20,000		
	13,10,000		13,10,000

Partners of the firm decided to dissolve the firm on the above-said date. Fixed assets realized ₹ 5,20,000 and book debts ₹ 4,40,000.

Stocks were valued at ₹ 2,50,000 and it was taken over by partner Y.

Creditors allowed discount of 5% and the expenses of realization amounted to ₹ 6,000.You are required to prepare:

(i) Realization account;
(ii) Partners capital account; and
(iii) Cash account.

Question No. 2

Amit, Sumit, and Kumar are partners sharing profit and losses in the ratio 2:2:1. The partners decided to dissolve the partnership on 31st March 2022 when their Balance Sheet was as under:

Liabilities	Amount	Assets	Amount
Capital Accounts:		Land & Building	1,35,000
Amit	55,200	Plant & Machinery	45,000
Sumit	55,200	Furniture	25,500
General Reserve	61,500	Investments	15,000
Kumar's Loan A/c	15,000	Book Debts 60,000	
Loan from D	1,20,000	Less: Prov. for bad debts (6,000)	54,000
Trade Creditors	30,000	Stock	36,000
Bills Payable	12,000	Bank	13,500
Outstanding Salary	7,500	Capital Withdrawn:	
		Kumar	32,400
	3,56,400		3,56,400

The following information is given to you:

(i) Realization expenses amounted to ₹ 18,000 out of which ₹ 3,000 was borne byAmit.

(ii) A creditor agreed to takeover furniture of book value ₹ 12,000 at ₹ 10,800. Therest of the creditors were paid off at a discount of 6.25%.

(iii) The other assets realized as follows:

Furniture - Remaining taken over by Kumar at 90% of book valueStock

- Realized 120% of book value

Book Debts - ₹ 12,000 of debts proved bad, remaining were fullyrealized

Land & Building - Realized ₹ 1,65,000

Investments -Taken over by Amit at 15% discount

(iv) For half of his loan, D accepted Plant & Machinery and ₹ 7,500 cash. Theremaining amount was paid at a discount of 10%.

(v) Bills payable were due on an average basis of one month after 31st March 2022,but they were paid immediately on 31st March @ 6% discount "per annum".

Prepare the Realization Account, Bank Account and Partners' Capital Accounts in the books of Partnership firm.

Question No. 3

Amal and Bimal are in equal partnership. Their Balance Sheet stood as under on31st March, 2021 when the firm was dissolved:

Liabilities	₹	Assets	₹
Creditors A/c	4,800	Plant & Machinery	2,500
Amal's Capital A/c	750	Furniture	500
		Debtors	1,000
		Stock	800
		Cash	200
		Bimal's drawings	550
	5,550		5,550

The assets realized as under:

Particulars	₹
Plant & Machinery	1,250
Furniture	150
Debtors	400
Stock	500

The expenses of realization amounted to ₹ 175. Amal's private estate is not sufficient even to payhis private debts, whereas Bimal's private estate has a surplus of ₹ 200 only.

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

Question No. 4

M/s X, Y, and Z who were in partnership sharing profits and losses in the ratio of 2:2:1 respectively, had the following Balance Sheet as on December 31, 2022:

Liabilities		₹	₹	Assets	₹	₹
Capital:	X	29,200		Fixed Assets		40,000
	Y	10,800		Stock		25,000
	Z	10,000	50,000	Book Debts	25,000	

Z's Loan	5,000	Less: Provision	(5,000)	20,000
Loan from Mrs. X	10,000	Cash		1,000
Sundry Trade Creditors	25,000	Advance to Y		4,000
	90,000			90,000

The firm was dissolved on the date mentioned above due to continued losses. After drawing up the balance sheet given above, it was discovered that goods amounting to ₹ 4,000 have been purchased in November, 2022 and had been received but the purchase was not recorded inbooks.

Fixed assets realized ₹ 20,000; Stock ₹ 21,000 and Book Debt ₹ 20,500. Similarly, the creditors allowed a discount of 2% on average. The expenses of realization come to ₹ 1,080. X agreed to take over the loan of Mrs. X. Y is insolvent, and his estate is unable to contribute anything.

Give accounts to close the books; work according to the decision in Garner vs. Murray.

Question No. 5

A partnership firm was dissolved on 30th June, 2022. Its Balance Sheet on the date of dissolution was as follows:

Liabilities	₹	₹	Assets	₹
Capitals:			Cash	10,800
A	76,000		Sundry Assets	1,89,200
B	48,000			
C	36,000	1,60,000		
Loan A/c – B		10,000		
Sundry Creditors		30,000		
		2,00,000		2,00,000

The assets were realized in instalments and the payments were made on the proportionate capital basis. Creditors were paid ₹ 29,000 in full settlement of their account. Expenses of realization were estimated to be ₹ 5,400 but actual amount spent was ₹ 4,000. This amount was paid on 15th September. Draw up a statement showing distribution of cash, which was realized as follows:

	₹
On 5th July, 2022	25,200
On 30th August, 2022	60,000
On 15th September, 2022	80,000

The partners shared profits and losses in the ratio of 2 : 2 : 1. Prepare a statement showing distribution of cash amongst the partners by 'Highest Relative Capital' method.

Question No. 6

Winding up of LLP

P and Q were partners sharing profits equally in LLP. Their Balance Sheet as on March 31, 2022was as follows:

Balance Sheet as on 31st March, 2022

Equity and Liabilities		₹	**Assets**	₹
Capitals:			Bank	30,000
P	1,00,000		Debtors	25,000
Q	50,000	1,50,000	Stock	35,000
Creditors		20,000	Furniture	40,000
Q's current account		10,000	Machinery	60,000
Reserves		15,000	P's current account	10,000
Bank overdraft		5,000		
		2,00,000		2,00,000

The firm was dissolved on the above date:

P took over 50% of the stock at 10% less on its book value, and the remaining stock was sold at a gain of 15%. Furniture and Machinery realized for ₹ 30,000 and ₹ 50,000 respectively; There was an unrecorded investment which was sold for ₹ 25,000; Debtors realized 90% only and ₹ 1,245 were recovered for bad debts written off last year. There was an outstanding bill for repairs which had to be paid for ₹ 2,000.

You are required to prepare Realization Account, Partners' capital accounts (including transfer of current account balances) and Bank Account in the books of the firm.

Question No. 7

The following is the Balance Sheet of A, B, C on 31st December, 2022 when they decided to dissolve the partnership:

Liabilities	₹	Assets	₹
Creditors	2,000	Sundry Assets	48,500
A's Loan	5,000	Cash	500
Capital Accounts:			
A	15,000		
B	18,000		
C	9,000		

	49,000		49,000

The assets realized the following sums in installments:

I	1,000
II	3,000
III	3,900
IV	6,000
V	20,100 [includes saving in expenses i.e. 100] (₹ 500 - ₹ 400).
	34,000

The expenses of realization were expected to be ₹ 500 but ultimately amounted to ₹400 only. Show how at each stage the cash received should be distributed between partners. They share profits in the ratio of 2:2:1.

Question No. 8

Thin', 'Short' and 'Fat' were in partnership sharing profits and losses in the ratio of 2:2:1. On 30th September, 2022 their Balance Sheet was as follows:

Liabilities		₹	Assets	₹
Capital Accounts:			Premises	50,000
Thin	80,000		Fixtures	1,25,000
Short	50,000		Plant	32,500
Fat	20,000	1,50,000	Stock	43,200
Current Accounts:			Debtors	54,780
Thin	29,700			
Short	11,300			
Fat (Dr.)	(14,500)	26,500		
Sundry Creditors		84,650		
Bank Overdraft		44,330		
		3,05,480		3,05,480

Thin' decides to retire on 30th September, 2022 and as 'Fat' appears to be short of private assets, 'Short' decides that he does not wish to take over Thin's share of partnership, so all three partners decide to dissolve the partnership with effect from 30th September, 2022. It then transpires that 'Fat' has no private assets whatsoever.

The premises are sold for ₹ 60,000 and the plant for ₹ 1,07,500. The fixtures realize ₹ 20,000 and the stock is acquired by another firm at a book value less 5%. Debtors realize ₹ 45,900. Realization expenses amount to ₹ 4,500.

The bank overdraft is discharged and the creditors are also paid in full.
You are required to write up the following ledger accounts in the partnership books following the rules in Garner vs. Murray:
Realization Account; Partners' Current Accounts; Partners' Capital Accounts showing the closing of the firm's books.

Accounting for Bonus Issue and Right Issue

Accounting for Bonus Issue

PROVISIONS:

1. Bonus Shares are issued to the Existing Equity Share Holder of the company.

2. Bonus Shares are issued to the fully paid up existing equity share holders only.

3. **Partly paid up Equity Shares can be made fully paid up <u>through</u> Bonus.**

4. Bonus Shares are issued **Out of Free Reserves** means the following
- Profits which are available for Dividend - Capital Profits like
- Securities Premium - Capital Reserves
- Other **Capital Profits but they should be realized in Cash.**

5. **Capital Redemption Reserve (CRR):- This is used to issue the Bonus Shares only.**

6. Statutory Reserves: - Reserves required by state regulators, and if maintained than used only for specific purpose for which it created. Like
- Investment Allowance Reserve. - Development Rebate Reserve
- Export Profit Reserve - Foreign Project Reserve

Note: Statutory Reserves cannot be used to issue the Bonus Shares.

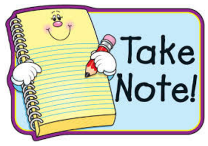
7. **Profit created through Revaluation of Assets Cannot be used to issue the bonus shares.**

8. Bonus Shares Cannot be issued in lieu of Dividend

9. No company shall issue Bonus shares unless similar benefits are hold or extended to the Fully Convertible Debentures and Partly Convertible Debentures.

10. A company cannot Capitalized its profit by way of Bonus unless the Articles of Association (AOA) of the company authorizes it.

Self Notes



My Notes

11. To issue the bonus shares by way of capitalizing the profit, a company should amend (change) it's Articles of Association (AOA) by a resolution in meeting.

12. **Capital Redemption Reserve, Securities Premium, Capital Reserve (Realized in Cash) is used only to issue the New Shares as Bonus** to the existing equity share holders of the company AND To make partly paid up equity shares as fully paid up the company uses it Revenue Reserves like General Reserves and Profit and Loss A/c etc.

13. If the issue of Bonus Shares exceeds the authorized capital, the company should make the proper provisions to increase its Authorized Capital.

14. Bonus Shares always issued as fully paid up.

Journal Entries for Bonus Share

CASE 1: When partly paid up equity shares made Fully Paid Up through Bonus

S.No.	Particulars	Dr.	Cr.
1.	**When Final Call is Made** Equity Share Final Call A/c ....Dr. To Equity Share Capital A/c	xxx	xxx
2.	**When Final Call is Completed through Bonus** General Reserve A/c ....Dr. Profit and Loss A/c ....Dr. To Bonus to Share Holders A/c	xxx xxx	xxx
3.	**When Bonus to Share holder are cancelled** Bonus to Share Holders A/c....................................Dr. To Equity Share Final Call A/c	xxx	xxx

CASE2:

When Bonus Shares are issued to the existing fully paid up equity share holders

S.No.	Particulars	Dr.	Cr.
1.	**For Capitalisation of Profit** Capital Redemption Reserve A/c ....Dr. Securities Premium A/c ....Dr. Capital Reserve A/c ....Dr. General Reserve A/c..Dr. Profit and Loss A/c ....Dr. Other Revenue Reserves A/c ....Dr. To Bonus to Share Holders A/c	xxx xxx xxx xxx xxx xxx	Xxx
2	**When Bonus shares are actually issued** Bonus to Share Holders A/c ....Dr. To Equity Share Capital A/c	xxx	xxx

My Notes

Right Issue

Meaning

Rights offering (issue) is an issue of rights to a company's existing shareholders that entitles them to buy additional shares directly from the company in proportion to their existing holdings, within a fixed time period. In a rights offering, the subscription price at which each share may be purchased is generally at a discount to the current market price. Rights are often transferable, allowing the holder to sell them on the open market.

Conditions required to fulfill for issue of Right Shares

The offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined.

Unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice (referred to in above bullet point) shall contain a statement of this right.

After the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not disadvantageous to the shareholders and the company.

Exceptions to the rights of existing equity shareholders

Section 62 recognises four situations under which the further shares are to be issued by a company, but they need not be offered to the existing shareholders.

1. The company in General Meeting passes a special resolution to this effect; and
2. The price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

The provisions of section 62 are applicable to all types of companies except the Nidhi companies.

Financial effects of a further issue

1. The financial position of a business is contained in the balance sheet.
2. Further issue of shares increase the amount of equity (net worth[2]) as well as the liquid resources (Bank).
3. The amount of equity is the product of further number of shares issued multiplied by issue price.
4. The issue price may be higher than the face value (issue at a premium). Companies Act does not allow issue of shares at a discount, except issue of sweat equity shares under Section 53.

Calculation of Book Value of share

Book value of a share = Net worth (as per books)/ Number of shares

Right of Renunciation

Meaning

- Right of renunciation refers to the right of the shareholder to surrender his right to buy the securities and transfer such right to any other person.

Rights Of Shareholder

- Shareholders that have received right shares have three choices of what to do with the rights. They can act on the rights and buy more shares as per the particulars of the rights issue; they can sell them in the market; or they can pass on taking advantage of their rights (i.e., reject the right offer).

Value of Right

- The renunciation of the right is valuable and can be monetised by the existing shareholders in well-functioning capital market. The monetised value available to the existing shareholders due to right issue is known as 'value of right'. If a shareholder decides to renounce all or any of the right shares in favour of his nominee, the value of right is restricted to the sale price of the re-nouncement of a right in favour of the nominee

Value of right is determined by

- **Value of right = Cum-right value of share - Ex-right value of share**
- **Ex-right value of the shares = [Cum-right value of the existing shares + (Rights shares X Issue Price)] / (Existing Number of shares + Number of right shares)**
- The Ex-right value of the share is also known as the average price.

My Notes

My Notes

ACCOUNTING FOR RIGHT ISSUE

The accounting treatment of rights share is the same as that of issue of ordinary shares and the following journal entry will be made:

S. No.	Particulars	Journal Entries
1.	Issue of Right Shares	Bank A/c………………………….. Dr. To Equity shares capital A/c
2.	Issue of right shares at premium	Bank A/c………………………….. Dr. To Equity Share Capital A/c To Securities Premium A/c

Advantages Of Right Issue

- Right issue enables the existing shareholders to maintain their proportional holding in the company and retain their financial and governance rights.
- In well functioning capital markets, the right issue necessarily leads to dilution in the value of share.
- Right issue is a natural hedge against the issue expenses normally incurred by the company in relation to public issue.
- The chance of success of a right issue is better than that of a general public issue and is logistically much easier to handle

Disadvantages Of Right Issue

- . The right issue invariably leads to dilution in the market value of the share of the company.
- The attractive price of the right issue should be objectively assessed against its true worth to ensure that you get a bargained deal.

Practical Questions

Question 1

Following items appear in the trial balance of Bharat Ltd. (a listed company) as on 31st March, 2022:

40,000 Equity shares of ₹ 10 each	4,00,000
Capital Redemption Reserve	55,000
Securities Premium (collected in cash)	30,000
General Reserve	1,05,000
Surplus i.e. credit balance of Profit and Loss Account	50,000

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 4 shares held and for this purpose, it decided that there should be the minimum reduction in free reserves. Pass necessary journal entries.

Question 2

Pass Journal Entries in the following circumstances:

(i) A Limited company with subscribed capital of ₹ 5,00,000 consisting of 50,000 Equity shares of ₹ 10 each; called up capital ₹ 7.50 per share. A bonus of ₹ 1,25,000 declared out of General Reserve to be applied in making the existing shares fully paid up.

(ii) A Limited company having fully paid up capital of ₹ 50,00,000 consisting of Equity shares of ₹ 10 each, had General Reserve of ₹ 9,00,000. It was resolved to capitalize ₹ 5,00,000 out of General Reserve by issuing 50,000 fully paid bonus shares of ₹ 10 each, each shareholder to get one such share for every ten shares held by him in the company.

Question 3

Following notes pertain to the Balance Sheet of Solid Ltd. as at 31st March, 2022:

Authorised capital :

10,000 12% Preference shares of ₹ 10 each	1,00,000
1,00,000 Equity shares of ₹ 10 each	10,00,000
	11,00,000

Issued and Subscribed capital:

8,000 12% Preference shares of ₹ 10 each fully paid	80,000
90,000 Equity shares of ₹ 10 each, ₹ 8 paid up	7,20,000

Reserves and Surplus :

General reserve	1,60,000
Revaluation reserve	35,000

Securities premium (collected in cash)	20,000
Profit and Loss Account	2,05,000
Secured Loan:	
12% Debentures @ ₹ 100 each	5,00,000

On 1st April, 2022 the Company has made final call @ ₹ 2 each on 90,000 equity shares. The call money was received by 20th April, 2022. Thereafter the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held. Show necessary entries in the books of the company and prepare the extract of the Balance Sheet immediately after bonus issue assuming that the company has passed necessary resolution at its general body meeting for increasing the authorised capital.

Question 4

Following notes pertain to the Balance Sheet of Preet Ltd. as at 31st March, 2022

Share capital:	
Authorised capital:	
15,000 12% Preference shares of ₹ 10 each	1,50,000
1,50,000 Equity shares of ₹ 10 each	15,00,000
	16,50,000
Issued and Subscribed capital:	
12,000 12% Preference shares of ₹ 10 each fully paid	1,20,000
1,35,000 Equity shares of ₹ 10 each, ₹ 8 paid up	10,80,000
Reserves and surplus:	
General Reserve	1,80,000
Capital Redemption Reserve	60,000
Securities premium (collected in cash)	37,500
Profit and Loss Account	3,00,000

On 1st April, 2022, the Company has made final call @ ₹ 2 each on 1,35,000 equity shares. The call money was received by 20th April, 2022. Thereafter, the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held.

Show necessary journal entries in the books of the company and prepare the extract of the balance sheet as on 30th April, 2022 after bonus issue.

Right Issue

Question 5

A Ltd company having share capital of 25,000 equity shares of ₹ 10 each decides to issue rights share at the ratio of 1 for every 4 shares held at par value. Assuming all the share holders accepted the rights issue and all money was duly received, pass journal entries in the books of the company.

Question 6

A company has decided to increase its existing share capital by making rights issue to its existing shareholders. The company is offering one new share for every two shares held by the shareholder. The market value of the share is ₹ 240 and the company is offering one share of ₹ 120 each. Calculate the value of a right. What should be the ex-right market price of a share?

Question 7

A company offers new shares of ` 100 each at 25% premium to existing shareholders on one for four bases. The cum-right market price of a share is ` 150. Calculate the value of a right. What should be the ex-right market price of a share?

Right & Bonus issue

Question 8

Following notes pertain to the Balance Sheet of Mars Company Limited as at 31st March 2022:

Authorised capital:	
50,000 12% Preference shares of ₹ 10 each	*5,00,000*
5,00,000 Equity shares of ₹ 10 each	*50,00,000*
	55,00,000
Issued and Subscribed capital:	
50,000 12% Preference shares of ₹ 10 each fully paid	*5,00,000*
4,00,000 Equity shares of ₹ 10 each, ₹ 8 paid up	*32,00,000*
Reserves and surplus:	
General Reserve	*1,60,000*
Capital Redemption Reserve	*2,40,000*
Securities premium (collected in cash)	*2,75,000*
Revaluation Reserve	*1,00,000*
Profit and Loss Account	*16,00,000*

On 1st April, 2022, the Company has made final call @ R₹ 2 each on 4,00,000 equity shares. The call money was received by 25th April, 2022. Thereafter, on 1st May 2022 the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held, it decided that there should be minimum reduction in free reserves.

On 1st June 2022, the Company issued Rights shares at the rate of two shares for every five shares held on that date at issue price of ₹ 12 per share. All the rights shares were accepted by the existing shareholders and the money was duly received by 20th June 2022.

Show necessary journal entries in the books of the company for bonus issue and rights issue.

Self Notes

Meaning of Preference shares

Preference shares means shares which enjoys the **preferences** in following two rights over equity shares:

(a) **Right to dividend** at a predetermined rate before payment of dividend to equity shareholders.

(b) Right to **receive repayment** of the capital in the event of winding-up before repayment to equity shareholders.

Types of Preference Shares.

- **On the basis of convertability**
  - Convertible Preference Shares.
  - Non Convertible Preference Shares.
- **On the basis of Redemption**
  - Redeemable Preference Shares.
  - Irredeemable Preference Shares
- **On the basis of Right to arrears in dividend**
  - Cumulative Preference Shares
  - Non-Cumulative Preference Shares
- **On the basis of Further Rights with repect to Profits**
  - Participating preference shares
  - Non-participating preference shares

Use of Profit for Redemption of Preference Shares:

- The profit may be used for the redemption of Preference Shares but it should be profit which is available for dividend (means revenue profit)
- But profit which is not available for dividend **(means not of revenue nature)** shall not be used for redemption of Preference Share.

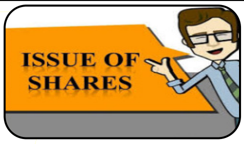
Profit available for dividend	1. General reserve 2. Reserve fund 3. Dividend equalisation fund 4. Insurnace fund 5. Workmen's compensation fund 6. Voluntry debenture redemption A/c. 7. Voluntary debenture sinking fund 8. Profit and loss account
Profits not avaliable for dividend	**1.** Share premium account 2. Forfeited share account 3. Profit prior to incorporation 4. Capital reserve 5. Development rebate reserve

Sources for Redemption of Preference Shares

Following are the conditions applicable for Redemption of Preference Shares:

1. Preference shares can be redeemed only when they are **fully paid up**. If preference shares are partly paid up, Company must see that they are made fully paid up before they are redeemed.

2. Preference shares can be redeemed **out of[a] profit available for dividends. and / or [b] proceeds of fresh issue of shares.**



3. **If preference shares are redeemed out of profits,** an amount equivalent to the nominal value of the preference shares redeemed must be **transferred to Capital Redemption Reserve**. Thus, preference share capital redeemed would be replaced by Capital Redemption Reserve Account. The object is that with the repayment of redeemable preference shares, the security for creditors should not be reduced.

4. Any **premium payable** on redemption of preference shares should be provided either **out of profits or out of the share premium account**. Thus, premium on redemption preference shares can be provided both out of revenue as well as capital profits actually realised.

5. **Capital Redemption Reserve** is available only for declaring fully paid **bonus shares**. This reserve must be maintained intact unless otherwise sanctioned by the court.

For arranging cash required for redemption except investment.No fixed assets should be sold

Self Notes

Accounting Entries

The following are the accounting entries to be passed in the books of a company which wants to redeem its redeemable preference share capital.

Sr. No.	Transactions	Accounting Entry
[1]	**For making partly paid up shares fully paid up**	(a) Redeemable Preference Share Final
		Call A/c…………………………….. Dr. To Redeemable Preference Share Capital A/c. (for final call being made)
		(b) Bank A/c…………………………….. Dr. To Redeemable Preference Share Final Call A/c. (for money realised on final call)
[2]	**For redeeming out of profits**	Profit & Loss / Revenue Reserve A/c……..Dr. To Capital Redemption Reserve A/c
[3]	**For a fresh issue of shares**	Bank A/c. Dr. To Share Capital A/c. (in case of issue of shares at premium/discount, the relevant account should be credited or debited.)
[4]	**Making provision for payment of premium on redemption of preference shares**	Share Premium / Profit & Loss / Revenue Reserve A/c. Dr. To Premium on Redemption of Shares A/c
[5]	**For money due to redeemable Preference Shareholders**	Redeemable Pref.Share Capital A/C ……….……Dr. Premium on Redemption of Pref.Shares A/c....Dr. To Redeemable Preference Shareholders/Preference Shares Redemption A/c.
[6]	**Payment to Preference Share- holders.**	Redeemable Preference Shareholders/ Preference Shares Redemption A/c. ……….……Dr. To Bank A/c.
[7]	**For issue of bonus shares**	Capital Redemption Reserve/Share Premium/Revenue Reserve A/c. ………….....Dr. To Share Capital A/c.

Practical Questions

Question No. 1

Hinduja Company Ltd. had 5,000, 8% Redeemable Preference Shares of ₹ 100 each, fully paid up. The company decided to redeem these preference shares at par by the issue of sufficient number of equity shares of ₹ 10 each fully paid up at par. You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Question No. 2

The Board of Directors of a Company decided to issue minimum number of equity shares of ₹ 9 to redeem ₹ 5,00,000 preference shares. The maximum amount of divisible profits available for redemption is ₹ 3,00,000. Calculate the number of shares to be issued by the company to ensure that the provisions of Section 55 are not violated. Also determine the number of shares if the company decides to issue shares in multiples of ₹ 50 only.

Question No. 3

X Ltd. gives you the following information as at 31st March, 2023

Particulars	₹
EQUITY AND LIABILITIES	
1. Shareholders' funds	
a Share capital	2,90,000
b Reserves and Surplus	48,000
2. Current liabilities	
Trade Payables	56,500
ASSETS	
1. Property, Plant and Equipment	3,45,000
2. Non-current investments	18,500
3. Current Assets	
Cash and cash equivalents (bank)	31,000

The share capital of the company consists of ₹ 50 each equity shares of ₹ 2,25,000 and ₹ 100 each Preference shares of ₹ 65,000(issued on 1.4.2021). Reserves and Surplus comprises Profit and Loss Account only.

In order to facilitate the redemption of preference shares at a premium of 10%, the Company decided:

(a) To sell all the investments for ₹ 15,000.
(b) To finance part of redemption from company funds, subject to, leaving a bank balance of ₹ 12,000.
(c) To issue minimum equity share of ₹ 50 each share to raise the balance of funds required.

You are required to pass the necessary Journal Entries to record the above transactions.

Question No. 4

The following are the extracts from the Balance Sheet of ABC Ltd. as on 31st December, 2022. Share capital: 40,000 Equity shares of ₹ 10 each fully paid – ₹ 4,00,000; 1,000 10% Redeemable preference shares of ₹ 100 each fully paid – ₹ 1,00,000.

Reserve & Surplus: Capital reserve – ₹ 50,000; Securities premium – ₹ 50,000; General reserve – ₹ 75,000; Profit and Loss Account – ₹ 35,000

On 1st January 2023, the Board of Directors decided to redeem the preference shares at par by utilisation of reserve.

You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Question No. 5

C Limited had 3,000, 12% Redeemable Preference Shares of ₹ 100 each, fully paid up. The company had to redeem these shares at a premium of 10%.

It was decided by the company to issue the following:

(i) 25,000 Equity Shares of ₹ 10 each at par,
(ii) 1,000 14% Debentures of ₹ 100 each.

The issue was fully subscribed and all amounts were received in full. The payment was duly made. The company had sufficient profits. Show Journal Entries in the books of the company.

Question No. 6

The Balance Sheet of XYZ Ltd. as at 31st December, 2021 inter alia includes the following information:

	₹
50,000, 8% Preference Shares of ₹ 100 each, ₹ 70 paid up	35,00,000
1,00,000 Equity Shares of ₹ 100 each fully paid up	1,00,00,000
Securities Premium	5,00,000
Capital Redemption Reserve	20,00,000
General Reserve	50,00,000
Bank	15,00,000

Under the terms of their issue, the preference shares are redeemable on 31st March, 2022 at 5% premium. In order to finance the redemption, the company makes a rights issue of 50,000 equity shares of ₹ 100 each at ₹ 110 per share, ₹ 20 being payable on application, ₹ 35 (including premium) on allotment and the balance on 1st January, 2023. The issue was fully subscribed and allotment made on 1st March, 2022. The money due on allotment were duly received by 31st March, 2022. The preference shares were redeemed after fulfilling the necessary conditions of Section 55 of the Companies Act, 2013.

You are asked to pass the necessary Journal Entries. (Ignore date column)

In case of Forfeited Shares

Question No. 7

With the help of the details in Illustration 9 above and further assuming that the Preference Shareholders holding 2,000 shares fail to make the payment for the Final Call made under Section 55, you are asked to pass the necessary Journal Entries and show the relevant extracts from the balance sheet as on 31st March, 2022 with the corresponding figures as on 31st December, 2021 assuming that the shares in default are forfeited after giving proper notices. (Ignore date column)

REDEMPTION OF PREFERENCE SHARES & BONUS ISSUE

Question No. 8

The books of B Ltd. showed the following balance on 31st December, 2023:

30,000 Equity Shares of ₹ 10 each fully paid; 18,000 12% Redeemable Preference Shares of ₹ 10 each fully paid; 4,000 10% Redeemable Preference Shares of ₹ 10 each, ₹ 8 paid up (all shares issued on 1st April, 2022).

Undistributed Reserve and Surplus stood as: Profit and Loss Account ₹ 80,000; General Reserve ₹ 1,20,000; Securities Premium Account ₹ 15,000 and Capital Reserve ₹ 21,000.

For redemption, 3,000 equity shares of ₹ 10 each are issued at 10% premium. At the same time, Preference shares are redeemed on 1st January, 2024 at a premium of ₹ 2 per share. The whereabouts of the holders of 100 shares of ₹ 10 each fully paid are not known.

A bonus issue of equity share was made at par, two shares being issued for every five held on that date out of the Capital Redemption Reserve Account. However, equity shares, issued for redemption are not eligible for bonus.

Show the necessary Journal Entries to record the transactions. (Ignore date column)

Debenture Redemption Reserve:- (D.R.R) (Sinking Fund)

A company issuing debentures shall create D.R.R. from profit available for distribution of dividend & such amount credited to D.R.R shall be utilised only for redemption of debentures.

➢ **At the end of year**

1.	Fixed amount is set aside for redemption from P&L A/c.	P&L A/c ....Dr. To D.R.R. A/c (This entry shall be passed every year)
2.	Amount equivalent to current year transfer to D.R.R. is Invested.	D.R.R. Investment A/c ....Dr. To Bank A/c (Every Year)
3.	Additional entries in 2nd year / subsequent Year other than last year.	
	a) Receipt of interest on debenture redemption investment A/c.	Bank A/c ......Dr. To Interest on D.R.R Investment A/c
	b) Transfer of Interest to P&L A/c.	Interest on D.R.R. Investment A/c To P&L A/c

Note :- Interest received on D.R.R Investment is generally not re-invested but it is used in business. Hence interest credited to P&L A/c.

➢	At the end of last year:-	
a)	Receipt of Interest	Same entry as above. (3rd entry)
b)	Setting aside from P&L A/c to D.R.R. A/c	Same entry as above.
c)	Sale of D.R.R. Investment A/c	Bank A/c .....Dr. To D.R.R. Investment A/c
	- If Profit (Transferred to DRR A/c)	D.R.R. Investment A/c To P&L A/c
	- If Loss	(Reverse Entry)
d)	Amount due to debentures holders.	__% of Debenture A/c.........Dr. Premium on Redemption A/c........Dr. To Debenture holders A/c
e)	Payment to debenture holders.	Debenture holder A/c To Bank A/c
f)	Premium on redemption adjusted against P&L A/c.	P&L A/c............Dr. To Premium On redemption A/c
g)	Balance available in D.R.R. shall be transfer to General Reserve after redemption.	D.R.R. A/c ....Dr. To General Reserve A/c

Methods of Redemption of Debentures

1. Redemption By payment in lump sum– (At maturity or expiry of specific period)
2. Redemption By payment in installment – (At specified Intervals)
3. Redemption by Purchase of debentures in open market (Own debenture)

Let's see "Redemption of debentures by Purchase of debentures in open market".

(Journal Entry)

1. Purchase of own debentures

    Own debenture A/c ……..Dr. (Price excluding interest if price is cum interest)
    Interest A/c…………………Dr. (Last due date of interest to present date)
        To Bank A/c

2. At the time of cancellation.

    Debenture A/c…..Dr.
      To Own debenture A/c
      To profit on cancellation of debentures

(Own debenture price shall be exclusive of interest. If price is cum interest shall Be deducted from price).

If debentures are cancelled (own debentures) the profit or loss on redemption of debentures will be ascertained as

Face value of debenture Cancelled 100	(-)	Price Paid Excluding interest (95 – 5) (Cum-Interest)

In case of Ex-Interest - The interest to the date of transaction will be paid addition to price.

Note:-

1. Minimum requirements which are required to be checked before accounting for redemption of debenture.
   a) D.R.R. A/c must have minimum balance of 10% of total debentures.
   b) If balance is less than 10% transferred amount from P&L A/c to D.R.R. A/c

to make it 10%.

c) D.R.R. investments shall be at least 15% of debentures expected to be reddemed before 31st march of next year. This shall be invested at the beginning of year on or before 30th April.

After redemption, balance available in D.R.R. A/c shall be transferred to General Reserve. But only part of debentures are redeemed - then D.R.R. proportionate amount shall transferred to General reserve.

2 Options for cancellation of own debentures

Option 1	Option 2
1) 1st show the entry of	Directly cancel the debentures
- Purchase of own Debentures.	In other word – Debit to debenture A/c
Own debentures A/c.....Dr. (Ex – Interest)	
Interest A/c..................Dr.	Debenture A/c ....Dr.
To Bank A/c	Interest A/c ....Dr.
	To Bank A/c
2) 2nd Pass Entry for	To profit on cancellation of deb. A/c
- Cancellation of own debentures	
.....% of own debenture A/c ...Dr.	
To own debentures A/c	
To profit on cancellation of deb. A/c	

If in the question, it is specified to Prepare own debenture A/c, then option - 1 shall be adopted but if nothing is specified in the problem then option - 2 shall adopted.

If debentures are cancelled then next due date interest shall be paid on remaining debentures. (Period – last due date to – present date).

Adequacy of D.R.R. – for theory question – Important

Minimum Limits of D.R.R.

	For debentures issued by	Adequacy of Debenture Redemption Reserve (DRR)
1.	All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures.	No D.R.R. is required.
2.	Other Financial Institutions (FIs) within the meaning given in the Companies Act.	D.R.R. will be as applicable to NBFCs registered with RBI.
3.	All NBFCs listed or unlisted with the RBI for both public as well as privately placed debentures.	No D.R.R. is required.
4.	Other unlisted companies.	D.R.R. shall be 10% of the value of the outstanding debentures issued.

Example – If total debentures are of ₹ 16,00,000 then,

minimum D.R.R. = 10 % ₹ 1,60,000

But if debentures only of ₹ 8,00,000 are redeemed then,

Only ₹ 80,000 (10% of 8,00,000) transfer to general reserve.

Questions

Question No. 1

The following balances appeared in the books of a company (unlisted company other than AIFI, Banking company, NBFC and HFC) as on December 31, 2021: 6% Mortgage 10,000 debentures of ₹ 100 each; Debenture Redemption Reserve (for redemption of debentures) ₹ 50,000; Investments in deposits with a scheduled bank, free from any charge or lien ₹ 1,50,000 at interest

4% p.a. receivable on 31st December every year. Bank balance with the company is ₹ 9,00,000.

The Interest on debentures had been paid up to December 31, 2021.

On February 28, 2022, the investments were realised at par and the debentures were paid off at

101, together with accrued interest.

Write up the concerned ledger accounts (excluding bank transactions). Ignore taxation.

Question No. 2

The following balances appeared in the books of Paradise Ltd (unlisted company other than AIFI, Banking company, NBFC and HFC) as on 1-4-2021:

(a) 12 % Debentures ₹ 7,50,000
(b) Balance of DRR ₹ 25,000
(c) DRR Investment 1,12,500 represented by 10% ₹ 1,125 Secured Bonds of the Government of India of ₹ 100 each.

Annual contribution to the DRR was made on 31st March every year. On 31-3-2022, balance at bank was ₹ 7,50,000 before receipt of interest. The investment were realised at par for redemption of debentures at a premium of 10% on the above date.

You are required to prepare the following accounts for the year ended 31st March, 2022:

(1) Debentures Account
(2) DRR Account
(3) DRR Investment Account
(4) Bank Account
(5) Debenture Holders Account.

Question No. 3

XYZ Ltd. has issued 1,000, 12% convertible debentures ₹100 each redeemable after a period of five years. According to the terms & conditions of the issue, these debentures were redeemable at a premium of 5%. The debenture holders also had the option at the time of redemption to convert 20% of their holdings into equity shares of ₹ 10 each at a price of ₹ 20 per share and balance in cash. Debenture holders amounting ₹ 20,000 opted to get their debentures converted into equity shares as per terms of the issue. You are required to calculate the number of shares issued and cash paid for redemption of ₹ 20,000 debenture holders

Question No. 4

A company had issued 20,000, 13% debentures of ₹ 100 each on 1st April, 2021. The debentures are due for redemption on 1st July, 2022. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debenture holders to convert 20% of their holding into equity shares (Nominal value ₹ 10) at a price of ₹ 15 per share. Debenture holders holding 2,500 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the debenture holders exercising the option to the maximum.

Question No. 5

Libra Limited (a listed company) recently made a public issue in respect of which the following information is available:

(a) No. of partly convertible debentures issued- 2,00,000; face value and issue price - ₹ 100 per debenture.
(b) Convertible portion per debenture- 60%, date of conversion- on expiry of 6 months from the date of closing of issue.
(c) Date of closure of subscription lists- 1.5.2021, date of allotment- 1.6.2021, rate of interest on debenture- 15% payable from the date of allotment, value of equity share for the purpose of conversion- ₹ 60 (Face Value ₹ 10).
(d) No. of debentures applied for- 2,00,000.
(e) Interest payable on debentures half-yearly on 30th September and 31st March.

Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 2022 (including cash and bank entries)

Question No. 6

Case Ltd. (unlisted company other than AIFI, Banking company, NBFC and HFC) provides the following information as at 31st March, 2022:

Particulars	₹
Shareholder's Funds	
(a) Share Capital	
Authorized share capital:	
45,000 equity shares of ₹ 10 each fully paid	**4,50,000**
Issued and subscribed share capital:	
30,000 equity shares of ₹ 10 each fully paid	3,00,000
(b) Reserves and Surplus	
Profit & Loss Account	1,62,000
Debenture Redemption Reserve	18,000
Non-current liabilities	
(a) Long term borrowings	
12% Debentures	1,80,000
Current Liabilities	
(a) Trade payables	1,72,500
Non-current assets	
(a) Property, Plant and Equipment (Freehold property)	1,72,500
(b) Non-current Investment: DRR Investment	27,000
Current assets	
(a) Inventories	2,02,500
(b) Trade receivables	1,12,500
(c) Cash and bank balances:	
Cash at bank	2,73,000
Cash in hand	45,000

At the Annual General Meeting on 1.4.2022, it was resolved:

(a) To give existing shareholders the option to purchase one ₹ 10 share at ₹ 15 for every four shares (held prior to the bonus distribution). This option was taken up by all the shareholders.

(b) To issue one bonus share for every five shares held.

(c) To repay the debentures at a premium of 3%.

Give the necessary journal entries for these transactions.