Part A: Accounting For Not-For-Profit Organizations, Partnership Firms and Companies
UNIT 1: FINANCIAL STATEMENTS OF NOT-FOR-PROFIT ORGANIZATIONS

CHAPTER-1
NOT-FOR-PROFIT ORGANIZATIONS

Revision Notes

- **Meaning of Not-for-Profit Organizations:** The main purpose of any business organization is to earn profit. In other words, they work for self-interest. However, there are some organizations whose basic aim is to serve the society *i.e.*, they work for the benefit of the society as a whole. These organizations are called Not-for-Profit Organizations. The accounting information provided by such organisations is meant for the potential contributors and to meet the statutory requirement.
- **Features of Not-for-Profit Organizations:** The basic features of any non-profit organization are as under:
  (i) Service motive, *e.g.*, Indus Trust is an NPO that works for education of under privileged community.
  (ii) Profit is not the objective.
  (iii) Surplus not distributed among its members.
  (iv) Separate entity.
  (v) Unique names connoting their working.
  (vi) Managed by elected persons.
  (vii) Major funds in the form of contributions, donations, etc.
- **The books of accounts generally maintained by every Not-for-Profit Organizations are:**
  (i) Cash book
  (ii) Ledger
  (iii) Member's register
  (iv) Register of assets
  (v) Journal
- **The final accounts of a Not-for-Profit Organization consists of:**
  (i) **Receipts and Payments Account:** It is a real account in nature which records the cash receipts and payments for the business.
  (ii) **Income and Expenditure Account:** It is a nominal account in nature which is like Trading and Profit and Loss Account of profit earning organizations.
  (iii) **Balance Sheet:** It is a financial statement of the organization which shows its liabilities and assets.

Mnemonics

Final Accounts of a Not-for-Profit Organization

Mr Ram Pratap and Isha Experienced a Big Shock

R and P : Receipts and Payments Account
I and E : Income and Expenditure Account
B and S : Balance Sheet

Know the Terms

- **Endowment:** It is a donation with a condition by the donor to use only the income earned from investment of such fund for the specified purpose so that the original donated amount remains intact.
- **Loan fund:** It is set up to grant loans for specific purpose. e.g. to pursue higher studies.
- **Legacy:** It is the amount received as donation by not-for-profit organization under the will of a deceased person.
- **Subscription:** It is the amount paid by the members periodically so that their membership continues.
- **Honorarium:** It is a payment made to a person who has voluntarily undertaken a service which would normally command a fee. It is an expression of gratitude rather than a payment for the services.

UNIT 2: ACCOUNTING FOR PARTNERSHIP FIRMS

CHAPTER-2
RECONSTITUTION OF PARTNERSHIP FIRM: RETIREMENT/ DEATH OF A PARTNER

Revision Notes

Effect of Retirement / Death of a Partner on Profit Sharing Ratio

➢ **Meaning of Retirement**

Retirement of a partner means a partner leaving or separating from a partnership firm due to certain reasons. On retirement, the old partnership agreement comes to an end and a new partnership agreement comes into existence between the remaining partners. According to Section 32 (1) of the Indian Partnership Act, 1932, "A partner may retire from the firm with the consent of all the partners or at his will, by giving written notice to all the other partners of his intention to retire."

➢ **Retirement involves a few preconditions that have been clearly laid down in Section 32(1) of the Indian Partnership Act , 1932. It states that a partner may retire :**

(1) On a dispute with other partners of the firm;
(2) Having no interest in commercial/business activities;
(3) Old age, illness or physical weakness;
(4) To do other work or desire to do some profitable business;
(5) Other reasons.

As against above, a partner can be removed from the partnership firm due to his fraudulent or illegal behaviour against the firm.

➢ **Death of A Partner**

On death of a partner, old partnership among partners comes to an end but the firm may continue its business with new partnership agreement. The legal representative of the deceased partner has the right over the capital balance of deceased partner, profit for the period till he was alive, salary, commission and interest on capital (if permitted in the deed). Apart from the above, he has the right over the goodwill, reserves funds and accumulated profits.

There is no distinction between the death of a partner and retirement of a partner from the accounting point of view. The problem which arises in case of death of a partner is similar to that of retirement of a partner except that the death of a partner may occur at any time, whereas, the date of retirement of a partner is fixed. Generally, adjustments done in case of death of a partner are similar to those done at the time of retirement of a partner. Important difference from the legal point is that a retiring partner settles his account with firm himself, whereas on the event of the death of a partner, the accounts are settled by his legal executor.

➢ **Amount Payable to the Legal Executor of the Deceased Partner**

The legal executor of a deceased partner is entitled to receive the following amounts apart from the deceased partner's capital balance. Therefore, these amounts are credited in the legal executor's account of the deceased partner.

(1) Credit balance of capital and current account.
(2) Salary, commission, interest, etc. up to the date of death.
(3) Proportionate share in profit of firm till the date of death.
(4) Proportionate share in goodwill of the firm.
(5) Proportionate share in undistributed profits and reserves of the firm as shown in the balance sheet.
(6) Proportionate share in the profit on revaluation of assets and reassessment of liabilities.

After crediting the above items in the Executor's Account of the deceased partner, the following items are debited in his account (if any) :

(1) Debit capital/current account balance of deceased partner.
(2) Drawings of deceased partner and interest on drawings.

(3) Share of Goodwill written off.

(4) Share in the loss on revaluation of assets and reassessment of liabilities.

(5) Share in undistributed loss.

After adjusting the above items, the balance of capital account of the deceased partner is paid to his executor as per any one of the following ways : (i) in lump-sum, or (ii) in installments.

➢ Legal Provisions regarding the Payment to the executor of the Deceased Partner

The amount due is paid to the executor as follows :

(1) If procedure of payment is mentioned in the partnership deed, then payment will be made accordingly.

(2) In the absence of clear instructions in partnership deed, payment of due amount will be made in cash, immediately.

(3) If immediate payment is not possible, then as per Section 37 of Indian Partnership Act, 1932, payment can be made by any one of the following two options :

(i) Interest at 6 % p.a. on the amount due from the date of death to the date of payment, **or**

(ii) Share in the amount of profit earned by the firm by using the amount due of the deceased partner from the date of death to the date of payment.

➢ Gaining Ratio

Gaining ratio is the ratio in which continuing partners will receive the share of the retired/deceased partner. *i.e.*, it is the ratio in which the share of the retiring partner is taken over by the other partners. In other words, "Gaining Ratio is the difference between new profit sharing ratio and old profit sharing ratio."

The retiring partner acquires the amount of goodwill from the remaining partners on the basis of this ratio.

➢ Calculation of Gaining Ratio

(1) If new and old profit sharing ratio is given in question : In such case, Gaining Ratio is calculated by subtracting old share of each partner from his new share. Thus,

Gaining Ratio = New Ratio – Old Ratio

(2) If new profit sharing ratio is not given in question : In such case, it is assumed that the remaining partners will continue to share in the old ratio as existed between them prior to the retirement of a partner, which means they gain in the old ratio.

➢ Difference between Sacrificing Ratio and Gaining Ratio

S. No.	Basis	Sacrificing Ratio	Gaining Ratio
1.	Definition	It is the proportion in which the old partners sacrifice their share in favour of a new partner.	It is the proportion in which the old partners acquire the outgoing (retired or deceased) partner's share.
2.	Time of calculation	Generally, it is calculated at the time of admission of a new partner.	Generally, it is calculated at the time of retirement or death of a partner.
3.	Purpose	It is calculated to know, how the old partners shall share the goodwill brought in by the new partner.	It is calculated to know how the remaining partners shall contribute towards the share of goodwill of the retiring/deceased partner.
4.	Formula	Sacrificing Ratio = Old Share – New Share	Gaining Ratio = New Share – Old Share
5.	Effect on Share of Profit of Old/ Remaining Partners	The old partners' share decreases.	The remaining partners' share increases.
6.	Effect on Capital Accounts	Old partners' capital accounts are credited for the share of goodwill in the sacrificing ratio.	Remaining partners' capital accounts are debited for the share of goodwill in the gaining ratio.

Accounting Treatment

➢ Accounting Treatment of Goodwill :

In the case of retirement/death, retiring partner or legal heirs or executors of the deceased partner claim the share of goodwill of the firm because retiring or deceased partner must have worked to earn goodwill for the firm. After retirement or death, remaining partners in addition to their old profit share will also get the share of retiring or deceased partner, so, proper compensation should be given by the remaining partners to the retiring partner or executors of the deceased partner. Based on the golden rule that "gaining partners should compensate the sacrificing partners to the extent of their gain' should be complied with."

The accounting treatment of goodwill depends upon the two broader situations *viz.* whether goodwill already appears in the books of firm or not.

Accounting Treatment

When goodwill is not appearing in the books | When goodwill is already appearing in the books

(1) When goodwill is not appearing in the books :

In this case, retiring or deceased partner's capital account is to be credited with his share of goodwill and gaining partners' capital accounts are to be debited in gaining ratio by way of the following journal entry :

Gaining Partners' Capital/Current A/cs Dr. (In gaining ratio)

To Retiring /Deceased Partner's Capital/Current A/c (Share of outgoing partner)

(Being retiring/deceased partner's share of goodwill debited to gaining partners capital accounts in gaining ratio)

(2) When goodwill is already appearing in the books :

In this case, the old goodwill should always be written off among all partners in their old profit sharing ratio by way of the following journal entries :

(i) All Partners' Capital /Current A/cs Dr. (In old ratio)

To Goodwill A/c (Value of old goodwill)

(Being old goodwill written off among all partners in their old ratio)

(ii) Gaining Partners' Capital/Current A/cs Dr. (In gaining ratio)

To Retiring /Deceased Partner's Capital/Current A/c (Share of outgoing partner)

(Being retiring/deceased partner's share of goodwill adjusted in gaining partners' capital accounts)

Special Note : Goodwill cannot be shown in books unless and until it is purchased by paying some consideration (AS-26).

➢ Hidden Goodwill

If the firm has agreed to settle the account of retiring partner by paying him a lump-sum amount, then amount paid to him in excess of his adjusted capital shall be treated as his share of goodwill. *For example*—A, B and C are partners. A retires and his capital account after making adjustments for reserves and profit on revaluation exists at ₹ 60,000. B and C have agreed to pay him ₹ 90,000 in full settlement of his claim. It implies that ₹ 30,000 (₹ 90,000 – ₹ 60,000) is A's share of goodwill of the firm. This will be treated by debiting ₹ 30,000 in B and C's Capital Accounts in their gaining ratio and crediting A's Capital A/c.

➢ Revaluation of Assets and Reassessment of Liabilities

At the time of retirement or death of a partner, there may be some assets which may not have been shown at their current values. Similarly, there may be certain liabilities which have been shown at a value different from the obligation to be met by the firm. Not only that, there may be some unrecorded assets and liabilities which need to be brought into books. As learnt in case of admission of a partner, a Revaluation Account is prepared in order to ascertain net gain (loss) on revaluation of assets or reassessment of liabilities and bringing unrecorded items into firm's books and the same is transferred to the capital account of all partners including retiring/deceased partner in their old profit sharing ratio.

Note : A Profit & Loss Adjustment A/c can be prepared instead of Revaluation A/c.

➢ Adjustment of Accumulated Profits And Reserves

It is quite certain that some kind of Reserves, Accumulated Profits, Profit & Loss A/c appear in the balance sheet at the time of retirement/death of a partner. Since, these profits were earned with the contribution of the retiring or deceased partner also, so he is also entitled to a share in such profits. In such a case, the following journal entry will be passed :

General Reserve A/c Dr. (old profit sharing ratio)

Reserve Fund A/c Dr.

Profit & Loss A/c Dr.

To All Partners' Capital A/cs

(Being profits and reserves distributed)

All accumulated losses *viz*. Profit and Loss debit balance; Deferred Revenue Expenditure, etc. are also to be written off by passing the following journal entry :

All Partners' Capital A/cs Dr. (old profit sharing ratio)

To Accumulated Losses A/c

(Being loss distributed)

➢ Determination and Payment of Total Payable Amount to Retiring Partner

(1) Determination of payable amount : If a partner retires on the last day of the accounting year or first day of the next accounting year, then amount payable is determined by adjusting his capital and current account with the revaluation of assets and liabilities shown in the balance sheet of last year. But if a partner retires on any date during the accounting year, then the following is included in the determination of amount payable to him :

- Balance of capital and current account as shown on the date of last balance sheet.
- Interest, salary, bonus, commission, etc. payable from the date of last balance sheet till the date of retirement.
- Share in firm's goodwill.
- Share in undistributed profit, loss and reserves.
- Share in the profit or loss on revaluation of assets and liabilities.
- Share of profit or loss from the date of last balance sheet to the date of retirement, which may be calculated according to the instructions given in question or on the basis of time or on the basis of sale.

(2) Payment of payable amount : Amount payable to retiring partner after making all the above adjustments is made according to the provisions of partnership deed. Generally, such payment can be made in lump-sum or in installments or in the form of annuity.

➢ Lump-sum payment system :

Amount payable to the retiring partner can be paid in cash or through bank, if the financial position of the firm is strong. The amount payable to the retiring partner in this method, will be as follows :

The following journal entry will be passed :

Out of firm's own resources :

If all the partners agree and the firm has sufficient cash available, then lump-sum amount may be paid in cash.

Retiring Partner's Capital A/c Dr.

To Cash /Bank A/c

(i) By receiving additional amount from remaining partners : In case, if sufficient cash is not available in the firm, then cash may be received from remaining partners upon mutual consent to pay lump-sum amount to the retiring partner.

The following entries will be passed in this respect :

(a) For cash brought in by the remaining partners :

Cash/Bank A/c Dr.

To Continuing Partners' Capital A/cs

(b) For paying lump-sum amount to the retiring partner :

Retiring Partner's Capital A/c Dr.

To Cash/Bank A/c

(ii) By payment through bank loan : When partners are not able to bring cash then loan from bank or financial institution can be raised by mortgaging firm's assets so as to make lump-sum payment to the retiring partner.

The following entry will be passed :

Retiring Partner's Capital A/c Dr.

To Bank Loan A/c

➢ Share of Profit of the Deceased Partner

Generally, a partner retires on the date of preparation of final accounts but the date of death is not fixed as it can occur on any day. If a partner dies at any time during the year then his successor is entitled to get a share in profit from the beginning of the year till the date of death. It can be determined by either of the two following methods :

(1) On the basis of Time : In this method, proportionate estimated profit of the firm will be determined for the period for which the deceased partner remained in the firm on the basis of profit of previous years and then, share of deceased partner in that profit will be calculated. In this, part of current year's profit will be computed on the basis of profit of the previous year or on the basis of average profits of previous years.

(2) On the basis of Sales/Turnover : In this method, ratio of profit to sales of past year (or average of past few years) is calculated, which is applied to the amount of sales from the beginning of the current year upto the date of death to determine profit of that period and share of deceased partner is calculated.

➢ Interest on Capital of Deceased Partner

As per partnership deed, interest on opening balance of capital of deceased partner may be given till the date of death as per pre-decided rate, which will be credited in the deceased partner's account.

➢ **Amount Payable to a Deceased Partner :** The share of the deceased partner can be ascertained by preparing his capital account.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Undistributed Losses A/c	—	By Balance b/d (Opening Balance)	—
To Revaluation A/c (Loss)	—	By Interest on Capital A/c	—
To Drawings A/c	—	By Salary/Commission A/c	—
To Interest on Drawings A/c	—	By Undistributed Profit and Reserves A/c	—
To Profit & Loss Suspense A/c	—	By Goodwill A/c	—
To Deceased Partner's Executor's A/c	—	By Revaluation A/c (Profit)	—
(Balancing Figure)	—	By Profit & Loss Suspense A/c	—
	—		—

Mnemonics

Amount payable to the legal executor of the deceased partner [Components included]

Ram will get Corn, Sauce, Cream, Perk, Gum, Rice and Roll on A Leave

C : Capital/Current Account Balance
S : Salary [If applicable]
C : Commission [If applicable]
P : Proportionate Profit of Firm
G : Goodwill
R : Reserves
R : Revaluation
A : Assets
L : Liabilities

Know the Terms

- **New Profit Sharing Ratio :** New profit sharing ratio is the ratio in which the remaining partners will share the future profits after the retirement or death of any partner.
  New Share = Old Share + Acquired Share from the Outgoing Partner
- **Profit and Loss Suspense Account :** An account opened to record fictitious profits in case of retirement /death of a partner to settle the share of profits of that partner.
- **Revaluation of Assets and Reassessment of Liabilities :** At the time of retirement/death of a partner, there may be some assets which may not have been shown at their current values. Similarly, there may be certain liabilities which have been shown at a value different from the obligation to be met by the firm.
  Besides this, there may be unrecorded assets and liabilities which have to be recorded. To adjust such items is called Revaluation of Assets and Reassessment of Liabilities
- **Deferred Revenue Expenditure :** Deferred Revenue Expenditures are those expenditures which are incurred in an accounting period but their benefits are derived in future accounting periods.

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CHAPTER-3
DISSOLUTION OF PARTNERSHIP FIRM

Revision Notes

- **Meaning of Dissolution of Partnership :** Dissolution of partnership means reconstitution of the firm due to change in the profit sharing ratio among existing partners, admission of a new partner, retirement of a partner, death of a partner, or insolvency of a partner and the firm continues as before. However, the dissolution of partnership does not lead to the dissolution of firm.
- **Meaning of Dissolution of Partnership Firm :** Dissolution of partnership firm means that the firm closes down its business and comes to an end. On dissolution of partnership firm, assets of the firm are sold out, liabilities are paid off and out of the remaining amount, the accounts of partners are settled.

Distinction Between Dissolution of Partnership and Dissolution of Firm

S. No.	Basis of Difference	Dissolution of Partnership	Dissolution of Firm
(i)	Change in economic relation	The economic relation of partnership among different partners is changed.	The economic relation among all the partners comes to an end.
(ii)	Termination of business	The business of the firm is not terminated.	The business of the firm is closed.
(iii)	Assets and Liabilities	Assets and liabilities are revalued and new balance sheet is drawn.	Assets are sold and realized and liabilities are paid off.
(iv)	Closure of books of accounts	It does not require the closing of books because the business is not terminated.	All books of accounts are closed.
(v)	Implication	It does not imply dissolution of firm.	It implies dissolution of the partnership and the firm.

- **Modes of Dissolution of a Partnership Firm :** Modes of dissolution of a firm have been described in Sections 40 to 44 of Indian Partnership Act, 1932, and they are as under :
  (1) Dissolution by Agreement (Section 40) : When all the partners agree to dissolve the firm or if there is any such agreement in partnership deed or amongst the partners regarding dissolution of firm.
  (2) Compulsory Dissolution or Dissolution by the Operation of Law (Section 41) : In the following circumstances, the firm will be dissolved compulsorily :
  (i) When any such event happens which makes the operation of business of the firm unlawful.
  (ii) When all partners or all partners except one are declared as insolvent by the court.

(3) Dissolution on the Happening of an Unexpected Event (Section 42) : Under this, a firm will be dissolved in the following conditions :

(i) When partnership is formed for a particular period, then on the expiry of that period.

(ii) When formation of partnership was for some objectives, then on the fulfilment of those objectives.

(iii) When any partner is declared as insolvent.

(iv) When any partner dies.

(4) Dissolution by Notice of Partnership at Will (Section 43) : If partnership is at will, then any partner may notify other partners about his will in writing and then the firm may be dissolved.

(5) Dissolution by Court (Section 44) : On filing of a suit by a partner, the court may pass orders for dissolution in the following conditions :

(i) When any partner becomes of unsound mind.

(ii) When any partner becomes permanently incapable of executing his duties as a partner.

(iii) When any partner is found guilty of any such conduct which may bring loss to the business.

(iv) When any partner knowingly violates the terms of agreement again and again.

(v) When any partner transfers or assigns all his interests to a third person.

(vi) When it is not possible to run the business without loss.

(vii) When dissolution of firm is just and equitable in the opinion of the court.

➢ **Settlement of Accounts :** Section 48 of the Indian Partnership Act, 1932, provides the following rules for the settlement of accounts between the partners :

(1) Payment of Losses : Losses shall be paid first out of profits, next out of capital and at last, if necessary, by the partners individually in their profit sharing ratio.

(2) Distribution of Assets : Assets of the firm are first to be applied in paying the debts of the firm to the third parties; next in paying to each partner rateably what is due to him from the firm for advances as distinguished from capital; next in paying to each partner rateably what is due to him on account of capital, and the residue to be divided among the partners in the proportion in which they were entitled to share profits.

(3) Realisation Account : Realisation Account is opened on dissolution of firm to close down the books of accounts of the firm. This account is a nominal account. The purpose of this account is to show the profit or loss on realisation of assets and payment of liabilities.

➢ Format of Realisation Account

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

Particulars	Amount (₹)	Particulars	Amount (₹)
To Land and Building	xxx	By Sundry creditors	xxx
To Plant and Machinery	xxx	By Bills payables	xxx
To Furniture and Fittings	xxx	By Bank overdraft	xxx
To Bills receivables	xxx	By Outstanding expenses	xxx
To Sundry debtors	xxx	By Provision for doubtful debts	xxx
To Cash/Bank A/c (Payment of liabilities)	xxx	By Cash/Bank A/c (sale of assets)	xxx
To Cash/Bank A/c (Payment of unrecorded liabilities)	xxx	By Partner's capital account (assets taken over by the partner)	xxx
To Partner's capital account (liabilities assumed by the partner)	xxx	By Loss (transferred to partners' capital accounts)	xxx
To Profit (transferred to partners' capital accounts in their profit sharing ratio)	xxx		
Total	**xxxxx**	**Total**	**xxxxx**

➢ Accounting Entries

On dissolution of the firm, the accounting entries will be passed as under :

Journal Entries

Accounting of assets (Excluding cash & bank)	Realisation A/c Dr. To All Assets A/c (Individual)
Accounting of goodwill on dissolution If goodwill account exists at the time of dissolution	Realisation A/c Dr. To Goodwill A/c Cash/Bank A/c Dr. To Realisation A/c

Accounting of undisclosed assets : ● On selling in the market ● On taking over by any partner	Cash/Bank A/c Dr. To Realisation A/c Partner's Capital/Current A/c Dr. To Realisation A/c
Provisions relating to assets are opened	Provision for Bad Debts A/c Dr. Provision for Discount on Debtors A/c Dr. Life Insurance Policy Reserve A/c Dr. Investment Fluctuation Reserve A/c Dr. To Realisation A/c
Transfer of debit balance of Profit & Loss A/c	Partners' Capital/Current A/cs Dr. To Profit & Loss A/c
Closing the accounts of various liabilities	Sundry Creditors A/c Dr. Bills Payable A/c Dr. Partner's Wife's Loan A/c Dr. Bank Overdraft A/c Dr. Outstanding Expenses A/c Dr. Employees Provident Fund A/c Dr. Employees Saving A/c Dr. To Realisation A/c
Accounting of undisclosed liabilities : **(1)** If paid by the firm **(2)** Taking over the responsibility regarding payment of liability by any partner	Realisation A/c Dr. To Cash/Bank A/c Realisation A/c Dr. To Partner's Capital/Current A/c
Transfer of various reserve funds and credit balance of Profit & Loss A/c	Contingencies Reserve A/c Dr. Reserve Fund A/c Dr. Profit & Loss A/c Dr. To Partners' Capital/Current A/cs
Realising assets **(1)** On sale of asset in cash (with selling price)	Cash/Bank A/c Dr. To Realisation A/c
(2) Asset taken over by any partner (with agreed price)	Partner's Capital/Current A/c Dr. To Realisation A/c
(3) Asset taken over by any creditor (with agreed price)	Realisation A/c (Claim Price-Agreed Price) Dr. To Bank A/c (Claim Price-Agreed Price)
(i) If the amount due to creditors and value of assets taken by them from firm is equal	No Entry needed
(ii) If the amount due to creditors is more than the value of asset, and the difference amount is paid by the firm	Realisation A/c Dr. To Bank A/c
(iii) If the amount due to creditors is less than the value of asset taken over by creditors and the creditors pay-off the excess amount to the firm.	Bank A/c Dr. To Realisation A/c
Payment of liabilities **(1)** Liabilities paid by firm	Realisation A/c Dr. To Cash/Bank A/c
(2) Liabilities taken over or paid by any partner	Realisation A/c Dr. To Partner's Capital/Current A/c

Payment of realisation expenses : **(1)** If paid by the firm	Realisation A/c Dr. To Cash/Bank A/c
(2) Responsibility regarding payment of expenses taken over by any partner	Realisation A/c Dr. To Partner's Capital/Current A/c
(3) If it is clearly mentioned in partnership deed that dissolution expenses will be borne by any partner, then this amount will not be recorded in Realisation A/c of the firm.	No Entry needed
(4) If it is clearly mentioned in partnership deed that in case of dissolution, the winding up expenses will be borne by any partner but if such expense is incurred by the firm on behalf of that partner then the following entry will be recorded	Partner's Capital/Current A/c Dr. To Cash/Bank A/c
Remuneration of dissolution work is to be paid to any partner	Realisation A/c Dr. To Partner's Capital/Current A/c
For closing realisation account **(1)** If debit balance of Realisation A/c (loss)	Partners' Capital/Current A/cs Dr. To Realisation A/c
(2) If credit balance of Realisation A/c (profit)	Realisation A/c Dr. To Partners' Capital/Current A/cs
For payment of partner's loan	Partner's Loan A/c Dr. To Cash/Bank A/c
For closing of current accounts : **(1)** If debit balance of partners' current A/cs	Partners' Capital A/cs Dr. To Partners' Current A/cs
(2) If credit balance of partners' current A/cs	Partners' Current A/cs Dr. To Partner's Capital A/cs
For closing of partners' capital accounts : **(1)** Debit balance of partners' capital A/c	Cash/Bank A/c Dr. To Partners' Capital A/cs
(2) Credit balance of partner's capital A/c	Partners' Capital A/c Dr. To Cash/Bank A/c

➢ Distinction between Realisation Account and Revaluation Account

S. No.	Basis of Difference	Realisation Account	Revaluation Account
(i)	Time of Preparation	This account is prepared at the time of dissolution of the firm.	This account is prepared when the firm is reconstituted due to change in the profit sharing ratio, admission, retirement or death of a partner.
(ii)	Objective of Preparation	This account is prepared to find out the profit or loss on the sale of assets and repayment of liabilities.	This account is prepared to make necessary adjustment regarding revaluation of assets and re-assessment of liabilities.
(iii)	Values of Assets and Liabilities recorded	Assets and Liabilities are shown in the Realisation Account on book values while the amount of actual payment and actual realisation is recorded in this account.	Only the difference between the book value and revised values of assets and liabilities is recorded in this account.
(iv)	Results	After preparation of Realisation Account, there will be no business afterwards.	After preparing Revaluation Account, firm continues its business.

(v)	Frequency of Preparation	Realisation Account is prepared only once during the life time of a firm.	Revaluation Account may be prepared at a number of occasions during the life time of a firm.
(vi)	Expenses	Usually realisation expenses are shown in the Realisation Account.	No expenses are shown in Revaluation Account.
(vii)	Memorandum	No such memorandum account is prepared.	Sometimes, when it is desired not to change the value of assets and liabilities in the reconstituted firm, Memorandum Revaluation Account is prepared.

- **Treatment of Reserves and Accumulated Profits :**

The undistributed profits and losses and reserves are always transferred to partners' capital accounts in their profit sharing ratio and not to the realisation account.

For distribution of reserves or accumulated profits :

General Reserve Dr.
Reserve Fund Dr.
Profit & Loss A/c Dr.
To Partners' Capital A/cs (in profit sharing ratio)
(Being undistributed profits and reserves transferred to partners' capital accounts)

For distribution of accumulated losses :

Partners' Capital A/cs Dr.
To Profit & Loss A/c
(Being undistributed losses transferred to partners' capital accounts)

- **Partner's Loan Account :** If a partner has given any loan to the firm, first of all, it will be shown on the credit side of partner's loan account. When all the outside liabilities are paid in full, afterwards this loan will be paid. Thus, partner's loan account is prepared separately and paid off by passing the following entry :

Partner's Loan A/c Dr.
To Cash/Bank A/c
(Being partner's loan paid off)

Note : Partner's loan account is prepared before partners' capital accounts because at the time of dissolution, capitals are paid off, only if, any balance is left after payment of partner's loan.

- **Treatment of Goodwill :** In case of dissolution of a firm, goodwill should be treated just like other assets. If nothing is mentioned about the realisation of goodwill, it can be assumed that the goodwill is valueless and as such, nothing is received or realised from it.

- **Cash or Bank Account :** All the receipts are recorded on the debit side and all the payments are recorded on the credit side of cash account. At the time of dissolution, this account is closed at last and total of both the sides (Dr. and Cr.) must be equal. It means all accounts are closed. Thus, this account also helps in the verification of the arithmetical accuracy of all the accounts at the time of dissolution.

If both cash and bank balances are given in the balance sheet, only one account, either cash account or bank account is prepared. If cash account is prepared, an entry is made for withdrawing the bank balance and if a bank account is prepared, an entry is passed for depositing the cash balance into bank which are as follows :

(i) **For cash deposited into bank:**

Bank A/c Dr.
To Cash A/c

(ii) **For cash withdrawn from bank :**

Cash A/c Dr.
To Bank A/c

Know the Terms

- **Compulsory Dissolution :** When the business of the firm becomes unlawful or all the partners (or except one partner) becomes insolvent, court orders to dissolve the partnership firm. Such type of dissolution is called compulsory dissolution.
- **Realisation Expenses :** The expenses which are done to complete the dissolution process of a partnership firm are called Realisation Expenses.
- **Memorandum Revaluation Account :** This account is prepared when new assets and liabilities are recorded in new balance sheet at the older values of assets and liabilities. The effect of revaluation is given through Partners' Capital Accounts.

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UNIT 3: ACCOUNTING FOR COMPANIES

CHAPTER-4
ACCOUNTING FOR DEBENTURES

Revision Notes

Debentures : Concept, Features and Types

- **Meaning of Debenture :**

  The word debenture has been derived from the latin word 'debere' which means to borrow.

  If a company needs funds for extension and development purpose without increasing its share capital, it can borrow from the general public by issuing certificates for a fixed period of time and at a fixed rate of interest. Such a loan certificate is called a debenture.

- **Features of Debentures :**

  (1) Debenture holders are the creditors of the company carrying a fixed rate of interest.
  (2) Debenture is redeemed after a fixed period of time.
  (3) Debentures may either be secured or unsecured.
  (4) Interest payable on a debenture is a charge against profit and hence it is a tax deductible expenditure.
  (5) Debenture holders do not enjoy any voting right.
  (6) Interest on debenture is payable even if there is a loss.
  (7) Debenture holders can apply for winding up of the company to safeguard their interests.

- **Advantages of Debentures :**

  (1) Issue of debenture does not result in dilution of interest of equity shareholders as they do not have right either to vote or to take part in the management of the company.
  (2) Interest on debenture is a tax deductible expenditure and thus, it saves income tax.
  (3) Cost of debenture is relatively lower than the dividend on preference shares.
  (4) Issue of debentures is advantageous during the times of inflation.
  (5) Interest on debenture is payable even if there is a loss, so debenture holders bear no risk.
  (6) The companies can raise money through debentures easily compared to equity and preference shares.

- **Disadvantages of Debentures :**

  (1) Payment of interest on debenture is obligatory and hence, it becomes burden if the company incurs loss.
  (2) Debentures are issued to trade on equity but too much dependence on debentures increases the financial risk of the company.
  (3) Redemption of debenture involves a large amount of cash outflow.
  (4) During depression, the profit of the company goes on declining and it becomes difficult for the company to pay interest.

➢ Different Types of Debentures :

A company can issue different types of debentures for raising funds for long-term purposes. Some of them are as follows :

(1) Ordinary Debentures : Such debentures are issued without mortgaging any asset, *i.e.*, this is unsecured. It is very difficult to raise funds through ordinary debentures.

(2) Mortgage Debentures : This type of debenture is issued by mortgaging an asset and debenture holders can recover their dues by selling that particular asset in case the company fails to repay the claim of debenture holders.

(3) Non-convertible Debentures : A non-convertible debenture is a debenture, where there is no option for its conversion into equity shares. Thus, the debenture holders remain debenture holders till maturity.

(4) Partly Convertible Debentures : The holders of partly convertible debentures are given an option to convert part of their debentures. After conversion they will enjoy the benefit of both debenture holders as well as equity shareholders.

(5) Fully Convertible Debentures : Fully convertible debentures are those debentures which are fully converted into specified number of equity shares after predetermined period at the option of the debenture holders.

(6) Redeemable Debentures : Redeemable debenture is a debenture which is redeemed/repaid on a predetermined date and at a predetermined price.

(7) Registered Debentures : Registered debentures are those debentures, where names, address, etc. of the debenture holders are recorded in the register book of the company. Such debentures cannot be easily transferred to another person.

(8) Unregistered Debentures : Unregistered debentures may be referred to those debentures which are not recorded in the company's register book. Such a type of debenture is also known as bearer debenture and this can be easily transferred to any other person.

➢ Difference Between A Debenture holder and A Shareholder

Following are the important differences between a debenture holder and a shareholder of a company :

S. No.	Basis of Difference	Debenture holder	Shareholder
1.	Status	Debenture holder is not the owner of the company, but only a creditor.	Shareholder is the owner of the company.
2.	Return	Debenture holders do not receive dividend while they receive interest at fixed rate whether the company earns profit or not.	Receives dividend out of the profits of the company.
3.	Repayment	Has a right to receive repayment of the principal amount after definite period.	Capital amount is repaid only in case of redeemable preference shares.
4.	Voting Rights	Except few exceptional situations, debenture holders do not have a right to vote in the meetings of the company.	Being the owner of the company, shareholders have a right to control and vote in the meetings of the company.
5.	Winding-up of the company	In case of winding-up of the company, debenture holders must be paid first, before anything is paid to the equity and preference shareholders.	In such a case, shareholders are paid at last after making payments to external fund suppliers.

➢ Over Subscription

The company invites the investors to subscribe its debenture issue. However, it may happen that the applications received for the debentures may be more than the original number of debentures offered. This scenario is referred to as over-subscription. In case of over-subscription, a company cannot allot more debentures than it had originally planned to issue. So, the company refunds the money to the applicants to whom debentures are not allotted.

However, the excess money received from applicants who are allotted debentures is not refunded. The same money is used towards allotment adjustment and the subsequent calls to be made.

Issue of Debentures

➢ Issue of Debentures :

The procedure of issuing debentures by a company is similar to the one followed while issuing equity stocks. The company starts by releasing a prospectus declaring the debenture issuance. The interested investors, then, apply for the same. The company may need the entire amount while applying for the debentures or may ask for instalments to be paid while submitting the application, on allotment of debentures or on various calls by the company. The company can issue debentures at par, at premium or at discount as explained below:

➢ Different Ways for Issuing of Debenture :

Once the company invites the applications and the investors apply for the debentures, the company can issue debentures in one of the following ways:

(1) Issue of Debenture at Par :

When the issue price of the debenture is equal to its face value, the debenture is said to be issued at par. When a debenture is issued at par, the long-term borrowings in the liabilities section of the balance sheet equals the cash in the assets side of the balance sheet.

(2) Issue of Debenture at Discount :

The debenture is said to be issued at a discount when the issued price is below its nominal value. Let us take an example – A ₹ 100 debenture is issued at ₹ 90, then ₹ 10 is the discount amount. The 'discount on debentures' issuance is noted as a capital loss and is charged to 'Securities Premium Account' and is reflected as an asset. The discount can be written off later.

(3) Issue of Debenture at Premium :

When the price of the debenture is more than its nominal value, it is said to be issued at a premium. For example, a ₹ 100 debenture is issued for ₹ 105 and ₹ 5 is the premium amount. The premium amount is credited to Securities Premium Reserve and is reflected under 'Reserves and Surplus' on the liabilities side of the balance sheet.

➢ Accounting Entries for Issue of Debentures for Cash :

(i) When Debenture Amount is received in Lump-sum :

When Application Money is received	Bank A/c Dr. To Debenture Application and Allotment A/c	With the application money received
On Allotment of Debentures	Debenture Application and Allotment A/c Dr. To Debentures A/c	With the amount of application money on the allotted debentures
On Refund of Excess Application Money	Debenture Application and Allotment A/c Dr. To Bank A/c	With the application money refunded

(ii) When Debenture Amount is received in Instalments :

(a) When Applications are received	Bank A/c Dr. To Debenture Application A/c	With the application money received
(b) When Applications are accepted	Debenture Application A/c Dr. To ....% Debentures A/c	With the amount of application money on the allotted debentures
(c) When allotment money is due	**(i) When issued at Par :** Debenture Allotment A/c Dr. To .....% Debentures A/c **(ii) When issued at Premium :** Debenture Allotment A/c Dr. To ...% Debentures A/c To Securities Premium Reserve A/c **(iii) When issued at Discount :** Debenture Allotment A/c Dr. Discount on Issue of Debentures A/c Dr. To......% Debentures A/c	With the amount due on allotment of debentures

(d) When Excess Debenture Application money is adjusted	Debenture Application A/c Dr. To Debenture Allotment A/c	With the surplus application money adjusted on application
(e) When Excess Debenture Application money is refunded	Debenture Application A/c Dr. To Bank A/c	With the application money refunded on rejected applications
(f) When Allotment money is received	Bank A/c Dr. To Debenture Allotment A/c	With the amount actually received on allotment
(g) (i) When Calls are made	Debenture Call A/c Dr. To ....% Debentures A/c	With the money due on a particular call
(ii) When Call money is received	Bank A/c Dr. To Debenture Call A/c	With the amount received on a particular call

➢ The Issue of Debenture as Collateral Security :

Meaning : The term 'collateral security' implies additional security given for a loan. Where a company obtains a loan from a bank or insurance company and the security offered to the company is not sufficient, the company may issue its own debentures to the lender as collateral security against the loan. In such a case, the lender has the absolute right over the debentures until and unless the loan is repaid.

On repayment of the loan, however, the lender is legally bound to release the debentures forthwith. But in case, the loan is not repaid by the company on the due date or in the event of any other breach of agreement, the lender has the right to retain these debentures and to realize them. The lender is entitled to interest only on the amount of loan, but not on the debentures issued as collateral security.

When debentures are issued as a collateral security, there are options for treatment in the accounting books :

(i) First Option :

In this case, company does not record such issue of debentures. No journal entry is made in the account books for issue of such debentures. A note is appended below the loan on the liabilities side of the balance sheet to the fact that they have been secured by the issue of debentures.

This will be shown in the balance sheet as follows :

Balance Sheet (Extract)

Particulars	Note No.	Current Year	Previous Year
I. EQUITY AND LIABILITIES			
Non-current Liabilities :			
Long-Term Borrowings			
Debentures			
(In addition, debentures for ₹ ... have been issued as collateral security)			
Loan			
(Secured by the issue of debentures of ₹ .... as collateral security)			

(ii) Second Option :

In this case, company records such issue of debentures in the books and following journal entry is passed :

Debenture Suspense A/c Dr.

To Debentures A/c

(With nominal value of debentures)

The Debenture Suspense Account will appear on the assets side of the balance sheet and Debentures on the liabilities side. When the loan is re-paid the entry is reversed in order to cancel it.

➢ Accounting Treatment of Interest on Debentures :

Interest on Debentures :

Interest paid is the reward to the debenture holders for investing in the debentures of the company. Interest is paid periodically at a predetermined fixed rate on the face value of debentures and is treated as a charge against profits.

The Journal Entries are as follows :

For recording interest due :

Interest A/c Dr.
  To Debenture holders' A/c
(Being the entry for interest due)

For making payment to debenture holders :

Debenture holders' A/c Dr.
  To Bank A/c
(Being the entry for payment of interest)

For transferring to Statement of Profit & Loss :

Statement of Profit & Loss Dr.
  To Interest A/c
(Being interest amount transferred to Statement of Profit & Loss)

No interest is payable on debentures issued as collateral securities :

- Interest accrued and due on debentures appear under the head 'Secured Loans'.
- Interest accrued but not due on debentures appear under the head 'Current Liabilities'.

Issue of Debentures with conditions Stipulated to their Redemption :

Journal Entry

1. **Issued at Par, redeemable at Par :**

   (i) On receipt of application money :

   Bank A/c Dr.
     To Debentures Application and Allotment A/c
   (Being application money received on ….. % Debentures at ₹ …. each)

   (ii) On transfer of application money to Debentures Account :

   Debenture Application and Allotment A/c Dr.
     To .... % Debentures A/c
   (Being debentures issued at par, redeemable at par)

2. **Issued at Discount, redeemable at Par :**

   (i) On receipt of application money :

   Bank A/c Dr.
     To Debenture Application and Allotment A/c
   (Being application money received on ….. % Debentures at ₹ …. each)

   (ii) On transfer of application money to Debentures Account :

   Debenture Application and Allotment A/c Dr.
   Discount on Issue of Debentures A/c Dr.
     To ..... % Debentures A/c
   (Being debentures issued at discount, redeemable at par)

3. **Issued at Premium, redeemable at Par :**

   (i) On receipt of application money :

   Bank A/c Dr.
     To Debenture Application and Allotment A/c
   (Being application money received on ….. % Debentures at ₹ …. each)

   (ii) On transfer of application money to Debentures Account :

   Debenture Application and Allotment A/c Dr.
     To ..... % Debentures A/c
     To Securities Premium Reserve A/c
   (Being debentures issued at premium, redeemable at par)

4. Issued at Par, redeemable at Premium :

(i) On receipt of application money :

Bank A/c Dr.

To Debenture Application and Allotment A/c

(Being application money received on ….. % Debentures at ₹ …. each)

(ii) On transfer of application money to Debentures Account :

Debenture Application and Allotment A/c Dr.

Loss on Issue of Debentures A/c Dr.

To ..... % Debentures A/c

To Premium of Redemption of Debentures A/c

(Being debentures issued at par, redeemable at premium)

5. Issued at Discount, redeemable at Premium :

(i) On receipt of Application money :

Bank A/c Dr.

To Debenture Application and Allotment A/c

(Being application money received on ….. % Debentures at ₹ …. each)

(ii) On transfer of Application money to Debentures Account :

Debenture Application and Allotment A/c Dr.

Discount of Issue of Debentures A/c Dr.

Loss on Issue of Debentures A/c Dr.

To ..... % Debentures A/c

To Premium of Redemption of Debentures A/c

(Being debentures issued at discount, redeemable at premium)

6. Issued at Premium, redeemable at Premium :

(i) On receipt of Application money :

Bank A/c Dr.

To Debenture Application and Allotment A/c

(Being application money received on ….. % Debentures at ₹ …. each)

(ii) On transfer of Application money to Debentures Account :

Debenture Application and Allotment A/c Dr.

Loss on Issue of Debentures A/c Dr.

To ..... % Debentures A/c

To Premium of Redemption of Debentures A/c

To Securities Premium Reserve A/c

(Being debentures issued at premium, redeemable at premium)

➢ Issue of Debentures for Consideration other than cash :

When debentures are issued to vendors against purchase of assets or against purchase of business, it is termed as issue of debentures for consideration other than cash. The debentures can be issued at a par, premium or discount and are accounted for in the similar fashion.

(1) Issue of Debentures to the Vendor for Purchase of Assets :

It may so happen that the company acquires some assets from the vendor and instead of paying the vendor in cash, the company may allot debentures in payment of purchase consideration. In such a case, the accounting entries will be as follows :

(i) For acquisition of assets :

Sundry Assets (Individually) A/c Dr. (with the value of assets)

To Vendor's A/c (with the purchase price)

(Being assets given to vendor)

Notes :

(a) If the value of debentures allotted is more than the agreed purchase price, the difference is debited to Goodwill Account.

(b) Similarly, if the value of debentures allotted is less than the agreed purchase price, credited to Capital Reserve Account.

(ii) On Allotment of Debentures :

(a) On allotment of debentures (at par) :

Vendor's A/c	Dr.	(with the value of debentures)
To Debentures A/c		
(Being debenture allotted to the vendor)		

(b) On allotment of debentures (at premium) :

Vendor's A/c	Dr.	(with the purchase price)
To Debentures A/c		(with the nominal value)
To Securities Premium Reserve A/c		(with the amount of premium)
(Being debentures allotted to the vendor at premium)		

(c) On allotment of debentures (at discount) :

Vendor's A/c	Dr.	(with the amount of purchase)
Discount on Issue of Debentures A/c	Dr.	(with the amount of discount)
To Debentures A/c		(with the nominal value)
(Being debentures allotted to the vendor on discount)		

(2) Issue of Debentures to the Vendor for Purchase of Business :

Sometimes a company purchases a running business (its assets and liabilities both) and issues debentures to vendor as purchase consideration.

(i) When Purchase Consideration is equal to Net Assets :

Sundry Assets A/c	Dr.
To Sundry Liabilities A/c	
To Vendor's A/c	
(Being purchase of business from the vendor company)	

(ii) When Purchase Consideration is more than the Net Assets :

In this case, difference between purchase consideration and net assets is treated as Goodwill, which can be calculated as :

(a) Net Assets = Sundry Assets taken – Sundry Liabilities

(b) Goodwill = Purchase Consideration – Net Assets

Journal Entry :

Sundry Assets A/c	Dr.
Goodwill A/c (Amount of difference)	Dr.
To Sundry Liabilities A/c	
To Vendor Company A/c	
(Being purchase of business from vendor company)	

(iii) When Purchase Consideration is less than Net Assets :

If purchase consideration is less than the net assets, the difference is treated as Capital Reserve, which can be calculated as :

(a) Net Assets = Sundry Assets taken – Sundry Liabilities

(b) Capital Reserve = Net Assets – Purchase Consideration

Journal Entry :

Sundry Assets A/c	Dr.
To Sundry Liabilities A/c	
To Capital Reserve A/c (Amount of difference)	
To Vendor Company A/c	
(Being business purchased from vendor company)	

Mnemonics

Types of Debentures	
One Man can Never Pay For Resources and Riches in Urgency.	
O : Ordinary	**F : Fully convertible**
M : Mortgage	**R : Redeemable**
N : Non-convertible	**R : Registered**
P : Partly convertible	**Ur : Unregistered**

Know the Terms

- **Bearer Debentures :** Bearer Debentures are those which are payable to the bearer or holder of the debenture. These are transferable by mere delivery and the company does not keep any record of name and address of debenture holders.
- **Bond:** Bond is also an instrument of acknowledgement of debt. Traditionally, the Government issued bonds, but these days, bonds are also being issued by semi-government and non-government organisations. The terms 'debentures' and 'bonds' are now being used inter-changeably.
- **Debenture Suspense Account :** Debenture Suspense Account is an adjustment account which is prepared when debentures are issued as collateral security. It is a temporary account. When loan is repaid, reverse entry is passed to cancel it.
- **Over-subscription :** When the number of debentures applied for is more than those offered for subscription, it is known as over-subscription.

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Part B: Analysis of Financial Statements
UNIT 4: Financial Statements of a Company

CHAPTER-5
COMPARATIVE AND COMMON SIZE STATEMENTS

Revision Notes

- **Comparative Statements :** Comparative statements compare financial data at two points of time and help in deriving meaningful conclusions regarding the changes in financial position and operating results. Statements showing financial data for two or more years, placed side by side to facilitate comparison are called Comparative Financial Statements.

  (A) Comparative Balance Sheet

  According to ***Faulke***, ''Comparative Balance Sheet analysis is the study of the trend of some items or group of some comprised items in balance sheets of the same business enterprise on different dates.''

  The Comparative Balance Sheet shows increase and decrease in absolute terms as well as in percentage in various assets, liabilities and capital and thus, provides information regarding progress of the business firm.

Format of comparative balance sheet is given below :

Comparative Balance Sheet of .... Ltd.
as at ....

Particulars	Note No.	Previous Year (₹)	Current Year (₹)	Absolute Change (₹)	Percentage Change (%)
1		2	3	4	5
		A	B	(B – A) = C	C/A × 100 = D
I. EQUITY AND LIABILITIES					
1. Shareholders' Funds :					
(a) Share Capital					
(b) Reserves and Surplus					
(c) Money received against share warrants					
2. Non-current Liabilities :					
(a) Long-term Borrowings					
(b) Other Long-term Liabilities					
(c) Long-term Provisions					
(d) Deferred tax liabilities (net)					
3. Current Liabilities :					
(a) Short-term Borrowings					
(b) Trade Payables					
(c) Other Current Liabilities					
(d) Short-term provisions					
Total					
II. ASSETS					
1. Non-current Assets :					
(a) Fixed Assets :					
(i) Tangible Assets					
(ii) Intangible Assets					
(iii) Capital work in progress					
(b) Non-current Investments					
(c) Long-term Loans and Advances					
(d) Other Non-current Assets					
(e) Foreign currency monetary item translation difference account					
2. Current Assets :					
(a) Current Investments					
(b) Inventories					
(c) Trade Receivables					
(d) Cash and Cash Equivalents					
(e) Short-term Loans and Advances					
(f) Other Current Assets					
Total					

(B) Comparative Statement of Profit & Loss or Comparative Income Statement

Comparative Statement of Profit and Loss is the income statement which is prepared in such a form so as to reflect the operating activities of the business for two or more accounting periods. It helps in assessing and reviewing the operational efficiency, deciding future action and formulating effective planning. The generally accepted format of the Comparative Income Statement is given below:

Comparative Statement of Profit and Loss
for the years ended...

Particulars	Note No.	Previous Year (₹)	Current Year (₹)	Absolute change (₹)	Percentage change (%)
		A	B	(B – A) = C	C/A × 100 = D
I. Revenue from Operations					
II. Other Income					
III. Total Revenue (I + II)					
IV. Expenses :					
Cost of material consumed					
Purchases of Stock-in-Trade					
Changes in inventories of Finished Goods, Work-in-Progress and Stock-in-Trade					
Employees Benefit Expenses					
Finance Costs					
Depreciation and Amortization Expenses					
Other Expenses					
Total Expenses					
V. Profit before Tax (III–IV)					
VI. *Less* : Income Tax					
VII. Profit after Tax (V–VI)					

➢ **Common-Size Statements :** According to *Kohler*. ''Common-Size Statements are accounting statements expressed in percentages of same base rather than rupees.''

(A) Common-Size Balance Sheet : In a Common-Size Balance Sheet, each item of assets is converted into the percentage to total assets (*i.e.*, 100) and each item of equity and liabilities is converted into the percentage to total equity and liabilities (*i.e.*, 100). Thus, the Balance Sheet is converted into percentage form and the converted Balance Sheet is called as 'Common Size Balance Sheet'.

Format of Common-Size Balance

Sheet as at ....

Particulars	Note No.	Absolute Amounts		Percentage of Balance Sheet	
		Previous Year (₹)	Current Year (₹)	Previous Year (%)	Current Year (%)
(1)	(2)	(3)	(4)	(5)	(6)
I. EQUITY AND LIABILITIES					
1. Shareholders' Funds :					
(a) Share Capital :					
(i) Equity Share Capital		—	—	—	—
(ii) Preference Share Capital		—	—	—	—
(b) Reserves and Surplus		—	—	—	—
2. Non-current Liabilities :					
(a) Long-term Borrowings		—	—	—	—
(b) Other Long-term Liabilities		—	—	—	—
(c) Long-term Provisions		—	—	—	—
3. Current Liabilities :					
(a) Short-term Borrowings		—	—	—	—
(b) Trade Payables		—	—	—	—
(c) Other Current Liabilities		—	—	—	—
(d) Short-term Provisions		—	—	—	—
Total		—	—	**100**	**100**

2. ASSETS :					
1. Non-Current Assets :					
(a) Fixed Assets :					
(i) Tangible Assets		—	—	—	—
(ii) Intangible Assets		—	—	—	—
(b) Non-current Investments		—	—	—	—
(c) Long-term Loans and Advances		—	—	—	—
2. Current Assets :					
(a) Current Investments		—	—	—	—
(b) Inventories		—	—	—	—
(c) Trade Receivables		—	—	—	—
(d) Cash and Cash Equivalents		—	—	—	—
(e) Short-terms Loans and Advances		—	—	—	—
(f) Other Current Assets		—	—	—	—
Total		—	—	**100**	**100**

➢ **Common-Size Income Statement :** A common-size income statement is a statement in which the figure of net sales is assumed to be equal to 100 and all other figures are expressed as percentage of net sales.

Format of a Common-Size Income Statement
for the years ended ....

Particulars	**Note No.**	**Absolute Amounts**		**Percentage of Revenue from Operations**	
		Previous Year (₹)	**Current Year (₹)**	**Previous Year (%)**	**Current Year (%)**
I. Revenue from Operations					
II. Other Income					
III. Total Revenue (I + II)					
IV. Expenses :					
(a) Cost of Materials Consumed					
(b) Purchase of Stock-in-Trade					
(c) Changes in Inventories of Finished Goods, Work-in-Progress and Stock-in-Trade					
(d) Employees Benefit Expenses					
(e) Finance Costs					
(f) Depreciation and Amortisation Expenses					
(g) Other Expenses					
Total Expenses					
V. Profit before Tax (III–IV)					
VI. *Less* : Income Tax					
VII. Profit (Loss) for the period (V–VI)					

Mnemonics

Tools for Financial Statements Analysis	
HArish, VAnshika and RAdha Came For Study	
HA	**: Horizontal Analysis [Comparative Statements]**
VA	**: Vertical Analysis**
RA	**: Ratio Analysis**
CFS	**: Cash Flow Statement**

Know the Terms

- **Horizontal Analysis :** Financial statements analysis through comparative statements is called horizontal analysis.
- **Vertical Analysis :** Financial statements analysis through common-size statements is called vertical analysis.
- **Revenue from Operations :** The net sale (Total sales—Sales returns) is also called revenue from operation.

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UNIT 4 : ANALYSIS OF FINANCIAL STATEMENTS

CHAPTER-6
CASH FLOW STATEMENT

Revision Notes

- **Cash Flow Statement :** Cash flow statement is a statement that shows the flow of cash and cash equivalents during a given period of time. Cash Flow Statement shows the net increase or net decrease of cash and cash equivalents under each activity, *i.e.*, Operating, Investing, Financing and Collectively as well.
- **Objectives of Preparing Cash Flow Statement :** The basic objective of preparing Cash Flow Statement is to highlight the changes in the cash position including the sources from which cash was obtained by the enterprise and specific uses to which cash was applied. A Cash Flow Statement has the following objectives :

  (1) To depict inflows and outflows of cash, *i.e.*, sources and uses of cash.

  (2) To facilitate formulation of financial policies such as dividend policy, etc.

  (3) To ascertain the liquidity of the enterprise.

  (4) To ascertain the net change in cash and cash equivalents.

  (5) To study the trend of cash receipts and cash payments.

  (6) To know the deviation of cash from earnings.

  (7) To enable a more realistic assessment of the financial condition of an enterprise and to anticipate the cash position.
- **Operating Activities :** Operating Activities are the main revenue generating activities of a business firm. Operating activities are those transactions and events whose cash flows affect the net profit or loss of a business firm.

  Examples of Cash Flow from Operating Activities : AS–3 (Revised) gives the following examples of Cash Flow from Operating Activities :

Operating Activities

Cash Inflows

(i) Cash Sales
(ii) Cash received from Trade Receivables
(iii) Cash received as Commission
(iv) Cash received as Fees
(v) Cash received as Royalty

Cash Outflows

(i) Cash Purchase
(ii) Payment to Trade Payables
(iii) Cash Operating Expenses
(iv) Payment of Wages, Salary, etc.
(v) Income Tax Paid

The major inflows and outflows in case of financial companies : In case of Financial Companies, following will be cash flows from operating activities, as dealing in securities is their main business activity :

Operating Activities

Cash Inflows

(i) Cash received for Interest
(ii) Cash received from Dividends
(iii) Proceeds from Sale of Securities

Cash Outflows

(i) Cash paid for Interest
(ii) Payment for Purchase of Securities

- **Investing Activities :** Investing Activities are those activities which are related to acquisition and disposal of long-term assets and other investments not included in the cash equivalents.

  Examples of Cash Flow from Investing Activities : AS–3 (Revised) gives the following examples of Cash Flow from Investing Activities :

Investing Activities

Cash Inflows

(i) Sale of Fixed Assets
(ii) Sale of Investments (Non-current and current other than marketable securities)
(iii) Interest received on Investments
(iv) Dividend received

Cash Outflows

(i) Purchase of Fixed Assets
(ii) Purchase of Investments (Non-current and current other than marketable securities)

- **Financing Activities :** Financing Activities are those activities that result in the changes in size and composition of the owners' capital (including Preference Share Capital in case of a company and borrowings of the business firm).

  Examples of Cash Flow from Financing Activities : AS–3 (Revised) gives the following examples of Cash Flow from Financing Activities :

Financing Activites

Cash Inflows

(i) Issue of Shares in Cash
(ii) Issue of Debentures in Cash
(iii) Proceeds from Long-term Loans
(iv) Proceeds from Bank Overdraft or Cash Credit

Cash Outflows

(i) Payment of Loans
(ii) Payment of Interest
(iii) Payment of Dividend
(iv) Buy-back of Equity Shares
(v) Redemption of Preference Shares
(vi) Repayment of Long-term Loans
(vii) Repayment of Bank Overdraft or Cash Credit

➢ Format of Cash Flow Statement :

Cash Flow Statement of ....

for the year ended ....

[As per Accounting Standard (AS-3) (Revised) (Indirect Method)]

Particulars	₹	₹
1. Cash Flow From Operating Activities		
(A) Net Profit before Taxation and Extraordinary Items **(WN 1)**		....
Assessment for Non-cash and Non-operating Items		
(B) Items to be added back :		
Depreciation	....	
Interest on Borrowings and Debentures	....	
Goodwill Patents / Trade Marks/Copyrights Amortised	....	
Loss on Sale of Fixed Assets	....	
Increase in Provision for Doubtful Debts	....	....
(C) Items to be Deducted :		
Interest Income	....	
Dividend Income	....	
Rental Income	....	
Profit on Sale of Fixed Assets	....	
Liability / Provisions written back (Decrease in Provision for Doubtful Debts)	....	....
(D) Operating profit before working capital changes (A + B – C)	....	
(E) *Add :* Decrease in Current Assets	....	
Increase in Current Liabilities	....	
(F) *Less :* Increase in Current Assets	....	
Decrease in Current Liabilities	(...........)	
(G) Cash generated from Operations (D + E – F)	(...........)	
(H) *Less :* Income tax paid (Net of Refund of Tax)	(...........)	....
Net Cash Flow from (or used in) Operating Activities **(X)**		....
2. Cash Flow from Investing Activities		
Proceeds from Sale of Tangible Fixed Assets	....	
Proceeds from Sale of Intangible Fixed Assets	....	
Proceeds from Sale of Non-current Investments	....	
Interest and Dividend Received (for Non-financial Companies only)	....	
Rental Income	....	
Purchase of Tangible Fixed Assets	(...........)	
Purchase of Intangible Assets like Goodwill, Patents, etc.	(...........)	
Purchase of Non-Current Investments	(...........)	
Extraordinary Items (*e.g.* Insurance claim on machinery against fire)	(...........)	....
Net Cash Flow (or used in) from Investing Activities **(Y)**		
3. Cash Flow from Financing Activities		
Proceeds from Issue of Share Capital and Debentures	....	
Proceeds from Long-term Borrowings	....	
Increase/Decrease in Bank Overdraft and Cash Credit	....	

	Final Dividend Paid	(..........)	
	Interim Dividend Paid	(..........)	
	Interest on Long-term Borrowings Paid	(..........)	
	Redemption of Debentures/Preference Shares	(..........)	
	Extraordinary items (*eg.* Buy-back of shares)	....	
	Net Cash Flow from (or used in) Financing Activities **(Z)**		....
4.	**Net Increase/Decrease in Cash and Cash Equivalents (X + Y + Z)**		
5.	***Add* : Cash and Cash Equivalents in the beginning of the year (WN 2)**	....	....
6.	**Cash and Cash Equivalents at the end of the year (WN 3)**		....

Working Notes :

1. Calculation of Net Profit before Tax and Extraordinary Items :

Particulars	₹
Net Profit of the current year or Difference between Closing Balance and Opening Balance of Surplus *i.e.,* Balance in Statement of Profit & Loss	....
Add : Transfer to reserves (or transfer to reserves from Surplus *i.e.*, Balances in Statement of Profit & Loss)	....
Dividend Paid **(**Proposed dividend for Previous year)	....
Interim dividend paid during the year	....
Provisions for tax made during the current year	....
Extraordinary items if any debited to Statement of Profit & Loss	....
Less : Refund of tax credited to Statement of Profit & Loss	....
Extraordinary items, if any credited to Statement of Profit & Loss	....
	....

2. Calculation of Cash and Cash Equivalents in the beginning :

Particulars	₹
Cash in hand	....
Cash at Bank	....
Short-term Deposits	....
Marketable Securities	....
Cheques and drafts in hand	....
	....

3. Calculation of Cash and Cash Equivalents at the end :

Particulars	₹
Cash in hand	....
Cash at Bank	....
Short-term Deposits	....
Marketable Securities	....
Cheques and drafts in hand	....
	....

Know the Terms

- **Cash Equivalents :** These are short-term highly liquid investments that are readily convertible into known amounts of cash.
- **Marketable Securities :** These securities are assets that can be liquidated to cash quickly and can be bought or sold on a public stock exchange.
- **Proposed Dividend :** Recommended dividend by Board of Directors in Annual General Meeting on the basis of estimated profit.

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