SECTION- A

UNIT I : PARTNERSHIP ACCOUNTS

Chapter-1 : Retirement of a Partner

Revision Notes

- **Retirement of a partner :**

  When a partner leaves or retires from the firm, it is known as retirement of a partner. On retirement or death of a partner, the existing partnership agreement comes to an end and a new partnership agreement comes into existence. Section 32(1) of the Indian Partnership Act, 1932 states that a partner may retire :

  - With the consent of all partners.
  - In accordance with the express agreement among the partners.
  - By issuing a proper notice to all the partners.

- **New Profit Sharing Ratio :**

  New share of Continuing Partners = Old Share + Acquired Share from outgoing partner/Gaining Ratio.

- **Gaining Ratio :**

  Gaining Ratio refers to the ratio in which the continuing partners gain from the retiring or deceased partner's share of profit. It is calculated as :

  Gaining Ratio = New share of continuing partners – Old share

- **Adjustment with regard to Goodwill :**

  When a partner retires, the continuing partners acquire his share of profit. They have to compensate the retiring partner for his share in the goodwill in their gaining ratio. Following two cases are there for treatment of goodwill :

  (i) When goodwill does not appear in the books of accounts — In this case following entry is passed :

  Continuing Partners' Capital /Current A/cs ... Dr.

  To Retiring/ Deceased Partner's Capital /Current A/cs

  (Goodwill adjusted in gaining ratio)

  (ii) When goodwill appear in the books of accounts :

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

  To Goodwill A/c

  (Existing value of goodwill written off)

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

  To Outgoing Partner's Capital / Current A/c

  (Goodwill adjusted on partner's retirement)

- **Hidden Goodwill :**

  Sometimes, the firm agrees to settle the account of retiring partner by paying him a lump sum amount. The amount paid to him in excess of his adjusted capital shall be treated as Hidden Goodwill.

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Chapter - 2 : Dissolution of a Partnership firm

Revision Notes

- **Meaning of Dissolution of Firm:** Dissolution of Firm means business of the firm comes to an end. It brings an end to the existence of the firm. Assets of the firm are sold and liabilities are paid off.

- **Dissolution of Partnership:** It means the reconstitution of the firm due to change in business relationship among the partners but the firm continues its business.

- **Types of Dissolution of a firm :** A partnership firm can be dissolved in the following ways :
  - Dissolution by Agreement (Section 40)
  - Compulsory Dissolution (Section 41)
  - Dissolution on happening of certain event (Section 42)
  - Dissolution by Notice (Section 43)
  - Dissolution by Order of Court (Section 44)
- **Difference between Dissolution of a Firm and Dissolution of a Partnership :**

S.No.	Dissolution of Firm	Dissolution of Partnership
I.	It refers to the dissolution of partnership between all the partners of the firm.	It refers to a change in the existing agreement between the partners.
II.	In case of dissolution of firm, the firm does not continue its business.	In case of dissolution of partnership, the firm continues its business.
III.	Dissolution of firm necessarily means the dissolution of partnership also.	Dissolution of partnership does not necessarily mean the dissolution of firm.
IV.	In case of dissolution of the firm, books of accounts have to be closed.	In case of dissolution of partnership, books of accounts are prepared on regular basis.

- **Settlement of accounts under Section 48 :**

  Section 48 of the Indian Partnership Act, 1932 deals with the settlement of accounts at the time of dissolution of firm.
- **Treatment of losses : First of all, the amount of loss including the deficiency of capital shall be paid out of profits, next out of capital of partners and lastly if necessary will be paid by partners in their profit sharing ratio.**
- **Application of Assets** : Amount realised from the sale of the assets of the firm shall be applied in the following ways :
  - In paying firm's debt to the third parties.
  - In paying to each partner, the loan advanced by him.
  - Thereafter, the balance of partners' capital accounts will be returned.
  - The remaining amount, if any, it will be distributed among partners in their profit sharing ratio.
- **Payment of Firm's debts and Private debts under Section 49 :** Firms debts are the debts incurred by the firm whereas private debts are incurred by the partners under their individual capacity.

  Firm's assets are first utilized for settlement of firm's debt and the surplus is used towards payment of partner's private debt to the extent of his share in profits of the firm. Private debts of the partners are first paid out of private property of the partners and the surplus, if any, used to pay off the firm's debts.
- **Accounting treatment on Dissolution of the Firm :** When a firm is dissolved, assets are realised, liabilities are paid off and the balance, if any, is distributed among the partners. In case of deficiency, it is borne by the partners. Following accounts are prepared at the time of dissolution of the firm :
  - Realisation Account
  - Partner's Loan Account
  - Partner's Capital Account
  - Bank or Cash Account
- **Realisation Account :** Realisation account is a special kind of account, which is prepared at the time of dissolution of the firm. This account is prepared to find out the profit or loss on the sale of assets and repayment of liabilities and realisation expenses.

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

Particulars	₹	Particulars	₹
To Sundry Assets (Excluding Cash/Bank, Fictitious assets, Debit Balance of Profit & Loss Account A/c and Loan to partner)		By Sundry Liabilities (Excluding Loan from partners, Credit Balance of Profit Loss Account)	
To Bank A/c (Amount paid for discharging liabilities)		By Provision on any Asset (Such as provision for doubtful debts, provision for Depreciation)	

To Bank/Cash A/c (Expenses on realisation)		By Bank/Cash A/c (Amount received on sale of assets)	
To Partner's Capital A/c (Liability taken over by partner)		By Bank/Cash A/c (Amount received from unrecorded assets)	
To Bank Cash A/c (Amount paid for unrecorded Liabilities)		By Partner's Capital A/c (Assets taken over by partner)	
To Partners' Capital A/c (For profit)		By Partners' Capital A/c (Loss)	

➢ **General Entries :**

- **For transfer of Assets :**

  Realisation A/c Dr.
  To Sundry Assets A/c
  (Being assets transferred to Realisation A/c at book value)

- **For transfer of Liabilities :**

  Sundry Liabilities A/c Dr.
  To Realisation A/c
  (Being liabilities transferred to Realisation A/c at book value)

- **For Sale of Assets :**

  Cash/Bank A/c Dr.
  To Realisation A/c
  (Being assets sold)

- **For transfer of Provisions :**

  Provision for Bad Debts A/c Dr.
  Provision for Depreciation A/c Dr.
  Machinery Replacement A/c Dr.
  Investment Fluctuation Fund A/c Dr.
  To Realisation A/c
  (Being various Reserves and Provisions transferred to Realisation A/c)

- **For Undistributed Profits :**

  General Reserve A/c Dr.
  Reserve Fund A/c Dr.
  Contingency Reserve A/c Dr.
  Profit & Loss A/c Dr.
  Workmen Compensation Reserve A/c Dr.
  To Partners' Capital A/cs
  (Being undistributed Profits transferred to Capital Accounts of Partners)

- **For Liabilities paid :**

  Realisation A/c Dr.
  To Cash/Bank A/c
  (Being liabilities paid in cash)

- **For Assets taken over by partner :**

  Partner's Capital A/c Dr.
  To Realisation A/c
  (Being assets taken over by partner)

- **For Liability taken over by partner :**

  Realisation A/c Dr.
  To Partner's Capital A/c
  (Being liability taken over by partner)

- **For Realisation Expenses :**

  Realisation A/c Dr.

  To Cash/Bank A/c

  (Being realisation expenses paid in cash)

- **For Profit on Realisation A/c :**

  Realisation A/c Dr.

  To Partners' Capital A/cs

  (Being profit transferred to Partners' Capital A/c)

- **For Loss on Realisation A/c :**

  Partners' Capital A/cs Dr.

  To Realisation A/c

  (Being loss transferred to Partners' Capital A/c)

➢ **Partner's Loan Account :** If a partner has given loan to the firm, his loan will be paid after the payment of outside liabilities. Therefore, partner's loan account will not be transferred to the Realisation Account and his loan account will be prepared separately and paid off by passing the following entry :

Partner's Loan A/c Dr.

To Bank A/c

(Being amount of partner's loan paid off)

➢ **Partners' Capital Accounts :** After the transfer of profit or loss on realisation, undistributed profits, reserves, etc. to the capital accounts of the partners, the balance of capital accounts are closed in the following manner :

- **On bringing cash by partners for deficiency in capital :**

  Bank/Cash A/c Dr.

  To Partner's Capital A/c

  (Being required cash brought by partner)

- **On payment to Partner :**

  Partner's Capital A/c Dr.

  To Bank/Cash A/c

  (Being excess cash paid to partner)

➢ **Cash or Bank Account :** In the end of the dissolution process, Cash or Bank A/c is prepared. On the debit side of this account entries for opening balance, received from sale of assets and amount brought in by the partners are shown and on credit side, entries for payment of liabilities, expenses and amount paid to partners are shown. After the claims of the partners are settled, no balance should be left in the Bank/Cash Account.

➢ **Realization expenses**

These are paid during the process of dissolution of a firm. It is an expense of the firm. It is also possible that any partner may agree to pay these expenses in exchange of some amount (in ₹) of commission and the following entries are passed.

- **When the realization expenses are paid by the firm.**

  Realization A/c Dr

  To Cash/Bank A/c

- **When the realization expenses are paid by the partners.**

  Realization A/c Dr

  To concerned partner's capital A/c

- **When the firm pays a fixed amount (in ₹) to a partner for dissolving the firm and the dissenter expirees following entries are passed.**

  Paying the Amount (in ₹) to the partner

  Real A/c Dr.

  To Concerned Partner capital A/c

  When the expenses are paid by the firm on behalf of the partner.

  Concerned Partner's Capital A/c Dr.

  To Bank/ Cash A/c

- **When the firm pays a fixed Amount (in ₹) to the partner as remuneration but dissolution expenses are borne by the firm.**
  1. When the remuneration is paid to the partner.
     Realization A/c Dr.
     To Concerned Partner's Capital A/c
  2. When the expenses of dissolution are paid.
     Realization A/c Dr.
     To Bank /Cash A/c
- **When the realization expenses are borne by one partner (A) and paid by another partner (B)**
  A's capital A/c Dr.
  To B's capital A/c

  Note. When nothing is mentioned in the question regarding the payment of realization expenses it is assumed that the firm has to pay for it.
- **When the realization account is closed.**
  The balance of realization account is profit or loss. Profit arises when the total of the credit side is more than the total of debit side. Loss arises when the total of debit side is more than the total of credit side. The profit or loss is transferred to the partners capital account in their profit sharing ratio and the following entry is passed.
  1. **In case of profit (always in old ratio)**
     Realization A/c Dr
     To partners capital A/c
  2. **In case of loss (always in old ratio)**
     Partner's capital A/c Dr
     To realization A/c

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UNIT II : JOINT STOCK COMPANY ACCOUNTS

Chapter-3 : Issue of Debentures

TOPIC-1
Accounting Treatment of Issue of Debentures

Revision Notes

➢ **Meaning of Debenture :**

Debenture is a document acknowledging a company's indebtedness issued under the seal of the company. It contains a contract for the repayment of the principal sum at a specified date with fixed interest rate.

According to section 2(30) of the Companies Act, 2013 "Debenture includes stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not."

Characteristics or Features of Debenture :

- Debenture is a document issued by the company acknowledging a debt.
- It is issued under the common seal of a company.
- It contains a contract for the repayment of principal sum at specified rate.
- Rate of interest on debenture is fixed.

➢ **Bond :**

Bond is an instrument of acknowledgement of debt. It is very much similar to that of debenture but bonds can be issued without predetermined rate of interest. These days, bonds can be issued by non-government and semi government organisations.

➢ **Types or Kinds of Debentures :**

- **Secured or Mortgage Debentures :** These debentures are those debentures on which a charge is created on the assets of the company for the purpose of payment. The charge which is created on a particular asset is called fixed charge. The charge which is created on all assets of the company in general is called a floating charge.
- **Unsecured or Naked Debentures :** These are those debentures on which no security is given. The holders of such debentures are treated as unsecured creditors at the time of liquidation of the company.
- **Registered Debentures :** Registered Debentures are those which are payable only to those holders whose name and addresses are recorded in the register of the company.
- **Bearer Debentures :** Bearer Debentures are those debentures which are payable to the bearer or holder of the debentures. These are transferable by mere delivery and the company does not keep any record of name and addresses of debenture holders.
- **Redeemable Debentures :** Redeemable Debentures are those debentures which will be repaid by the company at the end of a specified period either in lump sum or in installments during the lifetime of the company. Most of the debentures are generally of this type.
- **Irredeemable or Perpetual Debentures :** These are those debentures which are not repayable by the company during its life time. These debentures are payable only at the time of liquidation of the company or on the expiry of a long period.
- **Convertible Debentures :** Holders of these debentures are given an option to convert them into equity or other securities at a stated rate of exchange after a certain period either at the option of the company or the debenture holders.
- **Non Convertible Debentures :** These Debenture holders do not have right or option to convert debentures into equity shares or security at a specified period of time.

➢ **Distinction between Shares/Debentures :**

S. No.	Shares	Debentures
1.	A Share is a part of the capital of the company, therefore, the shareholders are the owners of the company.	A Debenture is a part of the loan and the Debenture holders are the creditors of the company.
2.	Shareholders get dividend from the company.	Debenture holders gets interest from the company.
3.	A Share is always unsecured.	A Debenture may be secured.
4.	Shares cannot be issued at discount.	Debentures can be issued at discount.
5.	Shareholders can vote in the company	Debenture holders cannot vote.
6.	Shares cannot be converted into debentures	Debentures can be converted into shares.

➢ **Issue of Debentures :** The procedure for the issue of debentures is very much similar to that of the issue of shares. Debentures can be issued at par, premium or discount.

➢ **Accounting entries for Issue of Debentures for Cash :**

Following entries will be passed at the time of Issue of Debentures :

(1) On receipt of application money :

Bank A/c Dr.
To Debenture Application A/c
(Being application money received)

(2) On transfer of application money to Debentures A/cs :

Debenture Application A/c Dr.
To Debenture A/c
(Being application money transferred)

(3) On Refund of rejected application

Debenture Application A/c Dr.
To Bank A/c
(Being application money refunded)

(4) On making allotment money due :

Debenture Allotment A/c Dr.

To Debentures A/c

(Being allotment money due)

(5) On receipt of allotment money :

Bank A/c Dr.

To Debenture Allotment A/c

(Being allotment money received)

➢ **Issue of Debentures at Premium :**

When the debentures are issued at a price more than their face value, they are said to have been issued at premium. Premium on Issue of Debenture is shown in the liability side of the Balance Sheet under the head—"Reserves and Surplus".

Debenture Allotment A/c Dr.

To Debenture A/c

To Securities Premium Reserve A/c

(Being debenture issued at premium)

Bank A/c Dr.

To Debenture Allotment A/c

(Being allotment money received including premium)

➢ **Issue of Debentures at Discount :**

When a company issues debentures at a price less than their face value, the debentures are said to have been issued at a discount. Discount allowed on issue of debentures is a capital loss, therefore, it must be shown as deduction from Reserves and Surplus in liabilities side of Balance Sheet.

Debenture Allotment A/c Dr.

Discount on Issue of Debenture A/c Dr.

To Debenture A/c

(Being debentures issued at discount)

Bank A/c Dr.

To Debenture Allotment A/c

(Being allotment money received)

➢ **Issue of Debentures as Collateral Security :**

Sometimes, when a company takes a loan from a bank or some other party, the company may have to issue debentures as subsidiary or secondary security in addition to the principal security. In other words, collateral security means secondary security in addition to the principal security. There are two methods of dealing with such debentures in the books of accounts of the company.

- **First method :** In this method, no entry needs to be passed in the books of the company, as the debentures are not actually issued, but are only given away as collateral security. As such under this method, entry is passed only for taking a loan. If the loan is taken from a bank, the entry will be :

  On taking loan :

  Bank A/c Dr.

  To Bank Loan A/c

  (Being Bank loan taken)

- **Second method :** In this method, the entry for issuing debenture as collateral security is also recorded with the entry for taking the loan.

  (i) On taking a loan :

  Bank A/c Dr.

  To Bank Loan A/c

  (Being bank loan taken)

(ii) On Issuing of Debentures as Collateral Security :

Debenture Suspense A/c Dr.
To Debenture A/c
(Being Debentures issued as collateral security)

- In the Balance Sheet, the Debenture Suspense Account will be shown as a deduction from the Debenture Account on the Equity and Liabilities side.
- **Issue of Debenture for Consideration other than Cash**

Sometimes, when a company purchases some assets from the vendor, the company may decide to issue debentures to vendors in payment of purchase consideration. Such an issue of debentures to vendors is known as Issue of Debentures for consideration other than Cash. Debentures can be issued at par, premium or at a discount.

On Purchase of Assets :

Assets A/c Dr.
To Vendor's A/c
(Being assets purchased from vendor)

For the Issue of Debentures to Vendor at par :

(1) Vendor's A/c Dr.
To Debenture A/c
(Being debentures issued to vendor at par)

For the Issue of Debenture at Premium :

Vendor's A/c Dr.
To Debenture A/c
To Securities Premium Reserve A/c
(Being debentures issued to vendor at premium)

For the Issue of Debentures to Vendor at Discount :

Vendor's A/c Dr.
Discount on Issue of Debenture A/c Dr.
To Debenture A/c
(Being debentures issued to vendor at discount)

- **Accounting for Issue of Debentures considering the Terms and Conditions of Redemption :**

Debentures may be redeemed either at par or at premium, according to the terms laid down at the time of issue. After taking into account the three possibilities of issue (*i.e.*, at par, at discount, at premium) and two possibilities of redemption (*i.e.*, at par or at premium), a company can issue debentures in the following six ways :

- **When debentures are Issued at Par and are Redeemable at Par :** For example, if a debenture of ₹ 100 is issued at ₹ 100 and is redeemable at ₹ 100, the following entries will be passed :

Entries for Issue	₹	₹	Entries for Redemption	₹	₹
Bank A/c Dr. To Debenture Application & Allotment A/c (Being application money received)	100	100	Debentures A/c Dr. To Debenture holders' A/c (Being debenture amount transferred to debenture-holders' account)	100	100
Debenture Application & Allotment A/c Dr. To Debentures A/c (Being application money transferred)	100	100	Debenture holders' A/c Dr. To Bank A/c (Being Debenture holders' paid)	100	100

- **When debentures are Issued at a Discount and are Redeemable at Par :** For example, if a debenture of ₹ 100 is issued at ₹ 95 and is redeemable at ₹ 100, the following entries will be passed :

Entries for Issue	₹	₹	Entries for Redemption	₹	₹
Bank A/c Dr. To Debenture Application & Allotment A/c (Being money received)	95	95	Debenture A/c Dr. To Debenture holders' A/c (Being debenture amount transferred to debenture-holders' account)	100	100

Debenture Application & Allotment A/c Dr. Discount on Issue of Debentures A/c Dr. To Debentures A/c (Being transfer to debenture account)	95 5	 100	Debenture holders' A/c Dr. To Bank A/c (Being Debenture holders' paid)	100	 100

'Discount on Issue' is a Capital Loss and will be written off during the life time of the debentures. It will be written off against Securities Premium Reserve, Capital Profit (if any) or Surplus *i.e.,* Statement of Profit and Loss.

- **When debentures are Issued at Premium and are Redeemable at Par :** For example, if a debenture of ₹ 100 is issued at ₹ 105 and is redeemable at ₹ 100, the following entries will be passed :

Entries for Issue	₹	₹	Entries for Redemption	₹	₹
Bank A/c Dr. To Debenture Application & Allotment A/c (Being money received)	105	 105	Debentures A/c Dr. To Debenture holders' A/c (Being debenture amount transferred to debenture-holders' account)	100	 100
Debenture Application & Allotment A/c Dr. To Debenture A/c To Securities Premium Reserve A/c (Being transfer to debenture account)	 105	 100 5	Debenture holders' A/c Dr. To Bank A/c (Being Debenture holders' paid)	100	 100

Securities Premium Reserve A/c has a credit balance and is a Capital Profit, and therefore, to be shown on the Equity and Liabilities side under the head, "Reserves and Surplus".

- **When debentures are Issued at Par and are Redeemable at Premium :** Sometimes, the debentures are issued with specific condition that the company will pay a premium at the time of their redemption. Although, such premium will be paid at the time of actual redemption, but as it is a known loss, the company records such loss at the time of issue by debiting an account called, "Loss on Issue of Debentures A/c". It is done in keeping with the convention of conservatism.

  For example, if a debenture of ₹ 100 issued at ₹ 100 and is redeemable at ₹ 105, the following entries will be passed :

Entries for Issue	₹	₹	Entries for Redemption		
Bank A/c Dr To Debenture Application & Allotment A/c (Being application money received)	100	 100	Debentures A/c Dr. Premium on Redemption of Debentures A/c Dr. To Debenture holders' A/c (Being debenture amount transferred to debenture-holder's account)	100 5	 105
Debenture Application & Allotment A/c Dr. Loss on Issue Debentures A/c Dr. To Debenture A/c To Premium on Redemption of Debenture A/c (Being transfer to debenture account)	 100 5	 100 5	Debenture holders' A/c Dr. To Bank A/c (Being Debenture holders' paid)	105	 105

Loss on Issue of Debenture A/c is a loss on account of promise to pay debentures at premium at the time of their redemption. This is a Capital Loss and is written off from Security Premium Reserve or from Statement of Profit and Loss gradually every year during the lifetime of the debentures. The entry for writing off will be :

Statement of Profit and Loss Dr.

To Loss on Issue of Debentures A/c

The balance of 'Loss on Issue of Debentures A/c' is shown as 'Unamortized Expenses' on the assets side of the Balance Sheet.

'Premium on Redemption of Debentures A/c' is a Personal Account and shows a credit balance. It is a liability on the part of the Company and appears under the head : 'Non-Current Liabilities' under sub-head 'Other Long

Term Liabilities' on the Equity and Liability side of the balance sheet each year, until the debentures are repaid. At the time of Redemption of Debentures, this account is debited and closed off.

- **When Debentures are Issued at Discount and are Redeemable at Premium :** For example, if a debenture of ₹ 100 is issued at ₹ 98 and is redeemable at ₹ 105 the following entries will be passed :

Entries for Issue	₹	₹	Entries for Redemption	₹	₹
Bank A/c Dr. To Debenture Application & Allotment A/c (Being money received)	98	98	Debenture A/c Dr. Premium on Redemption of Debentures A/c Dr. To Debenture holders' A/c (Being debenture amount transferred to debenture-holders' account)	100 5	105
Debenture Application & Allotment A/c Dr. Discount on Issue of Debentures A/c Dr. Loss on Issue of Debentures A/c Dr. To Debenture A/c To Premium on Redemption A/c (Being transfer to debenture account)	98 2 5	100 5	Debenture holders' A/c Dr. To Bank A/c (Being Debenture holders' paid)	105	105

Both, the amount of discount allowed ₹ 2 and premium on redemption ₹ 5 are Capital Losses and therefore, total amount to be written off during the year is ₹ 7.

- **When Debentures are Issued at Premium and are Redeemable at Premium :** For example, if a debenture of ₹ 100 is issued at ₹ 106 and is redeemable at ₹ 110, the following entries will be passed :

Entries for Issue	₹	₹	Entries for Redemption	₹	₹
Bank A/c Dr. To Debenture Application & Allotment A/c (Being money received)	106	106	Debentures A/c Dr. Premium on Redemption of Debentures A/c Dr. To Debenture holders' A/c (Being debenture amount transferred to Debenture holders' account)	100 10	110
Debenture Application & Allotment A/c Dr. Loss on Issue of Debenture A/c Dr. To Debenture A/c To Securities Premium Reserve A/c To Premium on Redemption of Debentures A/c (Being transfer to debenture account)	106 10	100 6 10	Debenture holders' A/c Dr. To Bank A/c (Being Debenture holders' paid)	110	110

On the Equity and Liabilities side, Securities Premium Reserve will be shown under the head "Reserves and Surplus" and Premium on Redemption will be shown under the head "Non-Current Liabilities" under the sub-head 'Other Long-term Liabilities'.

➢ **Interest on Debentures :**

Interest on Debentures is usually paid half-yearly. Interest on debentures is a charge against the profits of the company. It is to be paid regularly even if the company incurs a loss or does not earn profits. The rate of interest payable on debentures is prefixed. For example, if the rate of interest is 15% p.a., the name given to debentures will be 15% Debentures.'' As per Income Tax Act, a company is required to deduct income tax at the prescribed rate from the gross amount of debenture interest before any amount is paid to the debenture holders. The tax thus deducted is to be deposited with the income tax authorities on behalf of the debenture holders.

Following entries are passed for Interest on Debentures :

1. When interest is due and Tax is Deducted at Source (TDS) :

   Interest on Debentures A/c Dr.

   To Debenture holders' A/c

   To Income Tax Payable A/c

   (Being interest due to debenture holders and tax deducted at source)

2. When interest is paid to the debenture holders :
   Debenture holder A/c Dr.
   To Bank A/c
   (Being interest paid)
3. On payment of Tax Deducted at Source :
   Income Tax Payable A/c Dr.
   To Bank A/c
   (Being depositing the amount of TDS with income tax authorities)
4. On transfer of debenture interest to Statement of Profit and Loss at the end of the year :
   Statement of Profit & Loss Dr.
   To Interest on Debentures A/c
   (Being interest transferred to Statement of P & L)

TOPIC-2
Methods of Writing Off Discount/Loss on Issue of Debentures

Revision Notes

- **Methods to write off discount/loss on issue of debentures :**
  - **(i) Fixed Installment Method :** This method is used when debentures are redeemable in lump-sum at the end of a specified period. Under this method, the total amount of discount allowed on issue of debentures/loss on issue of debentures is spread over the life of the debentures equally and every year a fixed amount is written off against revenue.
  - **(ii) Fluctuating Installment Method :** This method is used when debentures are redeemed in installments. Under this method, the amount of discount or loss on issue of debentures is spread as per the proportion to the debentures outstanding at the beginning of each year. The amount of discount or loss under this method goes on reducing every year. So, this method is also called reducing installment method.
- **Disclosure of discount on issue of debentures in the company's Balance sheet when debentures are redeemed in installments :** Unamortized portion of discount on issue of debentures is shown on the assets side of the balance sheet under the head Current/Non Current Assets depending on whether the amount will be amortized in the next 12 months or thereafter.
- Suppose, if the discount or loss on issue of debentures amounts to ₹ 2,00,000 and it is to be written off in five years then, ₹ 40,000 will be debited to Statement of Profit & Loss of the current year; ₹ 40,000 will be shown under 'Other Current Assets' and the balance ₹ 1,20,000 will be shown under 'Other non current Assets.'

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Chapter - 4 : Redemption of Debentures

TOPIC-1
Redemption of Debentures : Introduction

Revision Notes

- **Redemption of Debentures :**
  Redemption of Debenture means repayment of amount of debentures to the debenture holders.
- **Debenture Redemption Reserve :**
  According to section 71(4) of the Companies Act, 2013, unlisted companies are required to set aside an amount out of profit for Redemption of Debentures to a separate account. This account is known as Debenture Redemption Reserve.

Listed company (a company whose share is freely traded in a stock exchange) is not required to create any Debenture Redemption Reserve.

Unlisted companies are required to create DRR equal to at least 10% of outstanding debentures out of divisible profits. Hence, they can redeem 90% of there debentures out of capital.

Exemption from transferring amount to DRR.

As per rule 18 (7) of Companies Rule, 2013, following companies would not be required to create DRR :

(i) All India Financial Institutions regulated by Reserve Bank of India.

(ii) Other Financial Institutions regulated by Reserve Bank of India (Banking Companies)

(iii) National Housing Bank

(iv) DRR is not required to be created on fully convertible debentures.

- **Debenture Redemption Investment :** As per Companies Rules 18(7) every unlisted company is required to maintain DRR — shall deposit or invest in specified securities on or before 30th April of each year atleast 15% of the nominal value of its debentures redeeming during the year ending 31st March of the next year.

Know the Terms

- **Divisible Profit :** Portion of Profit that can be legally distributed as a dividend to the shareholders.
- **Financial Institution :** Corporation that focuses on dealing with financial institutions.
- **National Housing Bank :** It is a apex regulatory body for overall regulation and licensing of housing finance companies in India.

TOPIC-2
Methods of Redemption of Debentures

Revision Notes

- **Redemption of Debentures out of Profits :**

Redemption out of Profits means that an amount equal to debentures issued (*i.e.*, 100% of the amount of debentures) is transferred from Surplus in Statement of Profit and Loss to a newly opened account named Debenture Redemption Reserve. It is called Redemption out of Profits.

Journal Entries :

(1) For transfer of profits to Debenture Redemption Reserve

Statement of Profit and Loss Dr.
To Debenture Redemption Reserve A/c
(Being profit transferred to DRR)

(2) For making investment in specified securities

Debenture Redemption Investment A/c Dr.
To Bank A/c
(Being investment made in specified securities)

(3) For amount payable on redemption

Debentures A/c Dr.
To Debenture holders' A/c
(Being amount due on redemption)

(4) For encashment of investment

Bank A/c Dr.
To Debenture Redemption Investment A/c
To Interest on DRI A/c
(Being investment encashed)

(5) For amount paid on redemption

Debenture holders' A/c Dr.
To Bank A/c
(Being amount paid on redemption)

(6) When all debentures are redeemed, balance transferred to General Reserve.

Debenture Redemption Reserve A/c Dr.

To General Reserve A/c

(Being DRR transferred to General Reserve)

- **Redemption of Debentures out of Capital :** Listed company can redeem its 100% debentures out of capital while an unlisted company can redeem maximum 90% of its debentures out of capital.

Methods of Redemption of Debentures

- **Redemption of Debentures in Lump-sum :** Under this method, the company redeems whole of its debentures in lump-sum at the expiry of a specified period. Such redemption can be made at par or premium according to terms of issue.

It is necessary for an unlisted company to transfer an amount equal to 10% of the face value of debentures outstanding from Surplus in Statement of Profit & Loss to Debenture Redemption Reserve.

When all debentures are redeemed in lump-sum, the DRR balance is transferred to General Reserve.

The Journal entries in this method are as follow :

(1) On transfer of profits from Surplus in statement of Profit and Loss

Statement of Profit and Loss Dr.

To Debenture Redemption Reserve A/c

(Being profit transferred to DRR)

(2) On Redemption of Debentures

Debentures A/c Dr.

To Debenture holders' A/c

(Being amount of debentures due for redemption)

(3) Debenture holders' A/c Dr.

To Bank A/c

(Being amount of debentures paid)

(4) When all the debentures are redeemed

Debenture Redemption Reserve A/c Dr.

To General Reserve A/c

(Being balance of DRR transferred to General Reserve)

- **Redemption of Debentures in annual instalments by Draw of Lots :**

According to this method, the debentures are redeemed in annual installments. The serial number of debentures which should be redeemed each year are selected by lottery. This procedure is known as 'Drawing of Lots'. In this case, 10% amount of outstanding debentures (for unlisted company) is transferred to DRR before redemption begins.

Proportionate amount of DRR is transferred to General Reserve in case of redemption in installments.

- **Redemption of Debentures by purchase in the open market :**

When a company purchases its own debentures in the open market for immediate cancellation, the purchase and cancellation of such debentures is known as Redemption by Purchase in the Open Market. Company can redeem its debentures by purchase in the open market. This procedure is usually adopted by the company only when its debentures are quoted at a discount on the stock exchange. After purchasing the debentures from the open market, the company may use either of the following two options :

(A) Cancel the debenture **(B)** Kept as investment

(A) When Debentures are Purchased for Cancellation:

(1) On purchasing

Own Debentures A/c Dr.

To Bank A/c

(Being debentures purchased)

(2) On Cancellation

Debentures A/c Dr.

To Own Debentures A/c

(Being debentures cancelled)

(3) Profit on Cancellation

Debentures A/c	Dr.
To Own Debentures A/c	
To Gain on Cancellation of Debentures A/c	
(Being debentures Cancelled at a profit)	

(4) Loss on Cancellation

Debentures A/c	Dr.
Loss on Redemption of Debentures A/c	Dr.
To Own Debentures A/c	
(Being own debentures cancelled at a loss)	

(B) When Debentures are kept as Investments :

When a company purchases its own debentures as investment and not for cancellation, an account named "Investment in Own Debentures Account" is debited instead of Own Debentures.

Entry :

Investment on Own Debentures A/c	Dr.
To Bank A/c	
(Being debentures purchased for investment)	

Know the Terms

- **Redemption of Debentures out of Profit :** It means that amount equal to debentures issued *i.e.*, 100% is transferred to DRR.
- **Redemption of Debentures out of Capital :** When no profits are set aside for Redemption of Debentures, it is called Redemption out of Capital.

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SECTION- B

UNIT III : FINANCIAL STATEMENT ANALYSIS

Chapter-5 : Financial Statement Analysis

TOPIC-1
Comparative Statements

Revision Notes

- **Meaning of Analysis of Financial Statements :** It is the process of critical evaluation of the financial information to understand and make decisions regarding the operations of the business.
- **Comparative Statement :** These statements show the financial position and profitability of an organisation for different period of time in a comparative way so that the position of the organisation can be found out for two or more periods. It is the study of individual items or components of financial statement of two or more years of the enterprise itself.
- **Significance/Objectives of Comparative Statements :**

(i) These statements make the data more simpler and understandable.

(ii) These statements show the trend.

(iii) These statements depict the strong and weak points of the concern.

(iv) These statements help in forecasting.

- Limitations of Comparative Statements :
  - **(i) Historical Records :** It is an analysis of historical records i.e., analysis of post financial statements.
  - **(ii) Qualitative Elements are ignored :** These Statements consider only those items which can be measured in terms of money.
  - **(iii) Change in Price Level are ignored :** These statements ignore the change in price level so it is meaningless.
- **Types of Comparative Statements :**

  (i) Comparative Balance Sheet **(ii)** Comparative Statement of Profit & Loss.
- **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 Sheet of the same business enterprise of different dates."

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

  Format of comparative balance sheet—

Comparative Balance Sheet

as on ....

Particulars	Note No.	Current Year A (₹)	Previous Year B (₹)	Absolute change (increase/ decrease) C = A – B (₹)	Percentage change (increase/ decrease) (%) $D = \frac{C}{B} \times 100$
(1)	(2)	(3)	(4)	(5)	(6)
I. EQUITY AND LIABILITIES					
1. Shareholders' Fund					
(a) Share Capital					
(b) Reserves and Surplus					
2. Non-Current Liabilities					
(a) Long-Term Borrowings					
(b) Long-Term Provisions					
3. Current Liabilities					
(a) Short-Term Borrowings					
(b) Trade Payables					
(c) Short-Term Provisions					
(d) Other Current Liabilities					
Total					
II. 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-Term Loans and Advances					
(f) Other Current Assets					
Total					

- **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 formulation of effective planning. The generally accepted format of the Comparative Income Statement is given ahead :

Comparative Statement of Profit & Loss

For the year ended 31.03.....

Particulars	Note No.	Previous Year (₹)	Current Year (₹)	Absolute change (₹)	Percentage change (%)
		A	B	(B – A) = C	$D = \frac{C}{A} \times 100$
I. Revenue from Operations					
II. Other Income					
III. Total Revenue (I + II)					
IV. Expenses					
Cost of Material Consumed					
Purchases of Stock-in-Trade					
Change in Inventories of Finished Goods shifted to next line Work-in-Progress and Stock- in-Trade					
Employees Benefit Expenses					
Finance Costs					
Depreciation and Amortisation Expenses					
Other Expenses					
Total Expenses					
V. Profit Before Tax (III–IV)					
VI. *Less* : Tax					
VII. Profit After Tax (V –VI)					

Know the Terms

- **Revenue from Operations :** Revenue earned from the operating activities, *i.e.*, activities done by enterprises to earn profit.
- **Other Income :** Income earned from activities other than principal revenue generating activities, *i.e.*, operating activities. Examples of other revenue can be Rent and Interest Receipts.
- **Cost of Material Consumed :** Total value of material used in manufacturing process which includes the value of Opening Inventory as well as Purchase of Material during the year and excludes the Closing Inventory of material.
- **Employee Benefit Expenses :** Expenses made by company for the benefit of employees, e.g., Staff Welfare Expenses, Bonus, etc.
- **Depreciation :** Reduction in value of Tangible (Fixed) Assets over a time.
- **Amortisation :** Reduction in value of Intangible (Fixed) Assets over a time.
- **Horizontal Analysis :** Analysis of each amount of Financial Statement over a horizon of many years.

TOPIC-2
Common Size Statements

Revision Notes

- **Common size statements :** A common size financial statement displays all items as percentages of a common base figure rather than as absolute numerical figures.
- **Objectives of Common Size Statements :** Following are the objectives of Common Size Statements :
  - These Statements provide a common base for comparison.
  - These Statements present the change in various items in relation to Revenue from Operations, Total Assets or Total Liabilities.

- These Statements establish a relationship between various items of the Statement of Profit and Loss to Revenue from Operations and various items of Balance Sheet to Total Assets or Total Equity & Liabilities.

➢ **Limitations of Common Size Statements :**

- Cannot eliminate the effect of window dressing.
- Don't provide real information in case of seasonal fluctuation.
- Ignore qualitative information.
- Liquidity and Solvency position cannot be measured.

➢ **Types of Common Size Statements :**

- Common Size Balance Sheet
- Common Size Profit & Loss or Income Statement

➢ **Common-Size Balance Sheet :** In a Common-Size Balance Sheet each item of Assets is converted into percentages to Total Assets (*i.e.*, 100) and each item of Equity and Liabilities is converted into 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 a Common Size Balance sheet :**

Common Size Balance Sheet

as on ....

Particulars	**Note No.**	**Absolute amount**		**Absolute change**	
		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) Long-Term Provisions					
3. Current Liabilities					
(a) Short-Term Borrowings					
(b) Trade Payables					
(c) Other Current Liabilities					
(d) Short-Term Provisions					
Total				**100**	**100**
II. 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-Term Loans and Advances					
(f) Other Current Assets					
Total				**100**	**100**

Note : It does not include line items of Balance Sheet, accounting treatment of which are not to be evaluated.

➢ **Common Size Statement of Profit & Loss :**

A Common Size Statement of Profit & Loss is a statement in which the figures of Revenue From Operations is assumed to be equal to 100 and other figures are expressed as percentage of Revenue From Operations.

➢ **Format of Common Size Statement of Profit & Loss**

Common Size Statement of Profit & Loss

For the year ended 31st March ....

Particulars	Note No.	Absolute Amount		Percentage Change	
		Current Year (₹)	Previous Year (₹)	Current Year (%)	Previous Year (%)
I. Revenue From Operations **II.** *Add :* Other Income **III.** Total Revenue (I + II)					
IV. *Less* : Expenses Cost of Material Consumed Purchase of Stock-in-Trade Changes in Inventories of Finished Goods Work-in-Progress Stock-in-trade Employee Benefit Expenses Finance Costs Depreciation and Amortisation Expenses Total Expenses **V.** Profit Before Tax (III – IV) **VI.** *Less* : Tax **VII.** Profit After Tax (V -VI)					

Know the Terms

➢ **Vertical Analysis :** Analysis of each amount of Financial Statement as a percentage of other amounts for one accounting year.

➢ **Window Dressing:** Manipulating the financial data by company to improve its appearance of Financial Statements.

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UNIT IV : CASH FLOW STATEMENT

Chapter-6 : Cash Flow Statement

Revision Notes

➢ **Cash Flow :** A Cash Flow Statement is a statement which shows inflow and outflow of cash during a particular period. It is a summary of sources and application of cash during a particular period of time on the basis of Operating, Financing and Investing Activities.

➢ **Objectives of Cash Flow Statement :**

- To ascertain the Sources of Cash (Receipts) and Application of Cash (Payments) from Operating, Investing and Financing Activities of the enterprise.
- To ascertain net change in Cash and Cash Equivalents.
- To highlight the major activities that have provided cash and that have used cash during a particular period of time.

➢ **Importance of Cash Flow Statement :**

Following are the importance of Cash Flow Statement :

- It is useful for short-term financial planning.
- It is useful in preparing cash budget.
- It is helpful in ascertaining cash flow from various activities separately.
- It explains the deviations of cash from earnings.

➢ **Limitations of Cash Flow Statement :**

- It ignores non-cash transactions.
- It is historical in nature.
- There is possibility of window-dressing.
- It is not suitable for judging the liquidity.

Operating Activities

Cash Inflow

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

Cash Outflow

(i) Cash Purchases
(ii) Payment to Creditors
(iii) Cash Operating Expenses
(iv) Payment of Wages
(v) Income Tax

Investing Activities

Cash Inflow

(i) Proceeds from Sale of Fixed Assets
(ii) Proceeds from Sale of Non-current Investments
(iii) Interest received on Debentures
(iv) Dividend received on Shares
(v) Cash receipt from the repayment of advances or loans made to third parties (except in case of financial enterprise).

Cash Outflow

(i) Purchase of Fixed Assets
(ii) Purchase of Non-current Investments
(iii) Cash advances and loans made to third party (other than advances and loans made by a financial enterprise wherein it is operating activity).

Financing Activities

Cash Inflow

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

Cash Outflow

(i) Payment for Buy-back of Equity Shares
(ii) Payment for Redemption of Preference Shares
(iii) Payment for Redemption of Debentures
(iv) Repayment of Loans (Long-term and Short-term)
(v) Payment of Dividend
(vi) Payment of Interest
(vii) Payment of Share Issue Expenses
(viii) Decrease in Balance of Bank Overdraft or Cash Credit

➢ **Procedure of Preparing Cash Flow Statement :** The Institute of Chartered Accountants of India has issued Accounting Standard–3 (Revised), for preparing a Cash Flow Statement. This Accounting standard has been made mandatory in respect of accounting periods commencing on or after 1st April, 2001 for certain enterprises.

These enterprises are :

- Enterprises whose equity and debt securities are listed with a recognized Stock Exchange in India.
- All other commercial, industrial and business enterprises, whose turnover for the accounting period exceeds ₹ 50 crore.

XYZ Ltd.

Cash Flow Statement (Indirect Method)

for the year ended ....

(as per Accounting Standard–3 Revised)

Particulars		₹	₹
A. Cash Flow from Operating Activities :			
Net Profit before Tax (See Note No. 1)		....	
Adjustments for Non-Cash and Non-Operating Items :			
Add : Depreciation	....		
Preliminary Expenses/Discount on Issue of Debentures written off	....		
Goodwill, Patents and Trademarks Amortised	....		
Interest on Long-term Borrowings	....		
Loss on Sale of Fixed Assets	....	....	
Less : Interest Income	(...........)		
Dividend Income	(...........)		
Rental Income	(...........)		
Profit on Sale of Fixed Assets	(...........)	(...........)	
Operating Profit before Working Capital Changes		....	
Add : Decrease in Current Assets	....		
Increase in Current Liabilities	....	....	
Less : Increase in Current Assets	(...........)		
Decrease in Current Liabilities	(...........)	(...........)	
Cash generated from Operations		....	
Less : Income Tax paid (Net of Tax Refund received)		(...........)	
Net Cash Flow from (or used in) from Operating Activities		....	....
B. Cash Flow from Investing Activities :			
Proceeds from Sale of Tangible Fixed Assets		....	
Proceeds from Sale of Intangible Fixed Assets like Goodwill		....	
Proceeds from Sale of Non-Current Investments		....	
Interest and Dividend Received		....	
Rent Received		....	
Purchase of Tangible Fixed Assets		(...............)	
Purchase of Intangible Fixed Assets like Goodwill		(...............)	
Purchase of Non-Current Investments		(...............)	
Net Cash Flow (or used in) Investing Activities			....
C. Cash Flow from Financing Activities :			
Proceeds from Issue of Shares and Debentures		....	
Proceeds from Other Long-term Borrowings		....	
Proceeds from Short-term Borrowings :			
(i) Increase in the Balance of Bank Overdraft and Cash Credit		....	
(ii) Decrease in the Balance of Bank Overdraft and Cash Credit		....	
Final Dividend Paid		(...............)	
Interim Dividend Paid		(...............)	
Interest paid on Long-term Borrowings		(...............)	
Repayment of Loans (Whether Short-term or Long-term)		(...............)	
Redemption of Debentures		(...............)	

Net Cash Flow from (or used in) Financing Activities		....
Net Increase (or Decrease) in Cash & Cash Equivalents (A+B+C)		....
Add : Cash and Cash Equivalents in the beginning of the year		....
Cash and Cash Equivalents at the end of the year		....

Working Note 1 :

Calculation of Net Profit before Tax

Particulars	**₹**
Net Profit of the Current Year (After Appropriations)	....
Add : Transfer to Reserves (all transfers to Reserves from balances of the Statement of Profit & Loss)	....
Dividend Paid (Proposed Dividend of the Previous year)	....
Interim Dividend paid during the year	....
Provision for Tax made during the current year	
Profit before Tax	....

- **Effect of Amendment (Regarding Proposed Dividend in AS-4) in Cash Flow Statement :**
  - **(a)** Dividend proposed for the previous year will be an Outflow of Cash, unless otherwise stated, on the assumption that the proposed amount has been approved by the shareholders in the AGM.
  - **(b)** No effect is given to proposed dividend for the current year as it is not provided for and is a Contingent Liability.
  - **(c)** Any unpaid dividend is transferred to Dividend Payable Account/Unpaid Dividend Account which is shown in the Balance Sheet of the current year as other Current Liabilities under Current Liabilities.

Know the Terms

- **Operating Activities :** These are the main revenue generating activities of an enterprise which ascertain the Net Profit/Loss of the enterprise.
- **Investing Activities :** Investing Activities of an enterprise refer to acquisition (purchase) and disposal (sale) of long-term assets and other investments which are not included in cash equivalents.
- **Financing Activities :** Financing Activities are those activities that result in the changes in size not composition of the owner's capital (including preference share capital in the case of a company) and borrowings of the business firm.
- **Cash Equivalents :** These are short-term highly liquid investments that are readily convertible into known amounts of cash.
- **Proposed Dividend :** Recommended dividend by Board of Directors in AGM on the basis of estimated profit.

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