INDIAN SCHOOL MUSCAT

ACCOUNTANCY CLASS XII

Revision Notes
Chapter-1 Non-for Profit Organization

Learning Objectives:

After studying this chapter, you should be able to:

- State the meaning of Not - for - Profit organization.
- Explain the various items of accounting in Not-for-Profit organization.
- Explain the Financial Statements of Not-for-profit organization.
- Show the Accounting Treatment of various items of accounting in Not-for-profit organization.
- Distinguish between Receipts and Payments Account and Income and Expenditure Account.

Meaning of Not-for-profit Organization

Not-for-Profit organizations are those organisations which are formed for the purpose of promoting commerce, art, science, religion, charity or any other useful object. Not-for-profit organisations intend to spend their income in promoting their objectives. Not-for-Profit organisations prohibit the payment of any dividend to their members. The primary motive of not-for-profit organization is to render services to their members to promote culture, art, education and other religious, social and charitable activities. Main Sources of their Income are **Subscription, Donation, Aid by the Government, etc.**

Examples of not-for-profit organizations:

Hospitals, dispensaries, sports clubs, libraries, religious places, recreation clubs, dharamshalas, orphanage, etc. such organisations may or may not have trading activities. If trading activities are carried on by such entities, then the profit arising therefrom is used for the purposes of promoting the objectives for which such organisations were formed. For example, if a sports club also runs a restaurant, the profit of such a restaurant is used to promote the service objectives. It may be noted that the restriction is on the application of income and not on the earning of income by not-for-profit organisations.

Such organizations prepare following financial statement at the end of accounting period:

1. Receipts and Payments Account
2. Income and Expenditure Account
3. Balance Sheet

Receipts and Payments Account: This account is merely a summary of the transactions appearing in the cash book. All receipts are shown on its debit side and all payments are shown on its credit side.

Features of Receipts and Payments Account

1. It is a real account. Thus Receipts are shown on its debit side and payments on the credit side.
2. Excess of receipts over payments is the closing balance which is shown in Balance sheet on Asset side.
3. This account begins with the opening balance of cash in hand and cash at bank.
4. An item may be repeated many times in a cash book, but it is shown only once in 'Receipts and Payments Account'.
5. All cash payments are shown on its credit side irrespective of the fact whether these are of capital nature or of revenue nature and whether they relate to current year, previous year or next year.
6. Receipts and payments Account records only the actual receipts and payments of cash. Non-Cash expense such as Depreciation, outstanding expenses etc. are not shown in it.

Income and Expenditure Account

Income and Expenditure Account serves the same purpose for a Not-for-profit organization as the Profit and Loss Account for a business enterprise. This is a **nominal account.**

It is also based on accrual concept of accounting according to which every transaction which belongs to current year should be recorded in the books in the current financial year whether payment is made or not and Income is received or not.

Features of Income and Expenditure Account:

1. It is a nominal account.
2. No capital item is entered in this account.
3. Its debit side includes all the expenses pertaining to the particular period and credit side includes all the incomes pertaining to the same period.
4. No opening and closing balance are recorded in it.
5. This account is prepared in the same manner in which a Profit & Loss Account is prepared.
6. Credit balance is "Excess of Income over Expenditure" and debit balance is "Excess of Expenditure over Income".

Important Items of Not for Profit Organizations

1. **Legacy**: Legacy represents the amount of property received by organization under a will on death of the contribution. In other words we can say that legacies are the donations made by a person at his own will, so the donation is called legacy.
2. **Entrance Fees**: Entrance fee is called Admission fee. It is a fee paid by members at the time of joining a not-for-profit organization.
    1. It is an item of **recurring** nature.
    2. Generally Entrance fees is **treated as income.**
3. **Grant**: Grant is an aid issued by a Government agency to any Not-for- profit organization for specific purpose or general purpose. Specific Grant should be capitalized & General grant may be treated as Revenue income and shown on credit side of Income & Expenditure Account.
4. **Donation**: Donation is the amount received by Not-for-profit Organization from **any person or institution without any consideration and not periodically.**

Types of Donation

Category	Explanation	Treatment
General Donation	If donation received is not for a specific purpose and can be utilized for any purpose, it is known as general donation.	Revenue Receipt
Specific Donation	If donation is received for a particular purpose and can be utilised for the same purpose only it is known as specific donation such as Donation for Building.	Capital Receipt

5. **Subscription**: Subscription is the amount payable by members of Not- for-profit Organization for renewal of membership periodically.
    1. It is recurring in nature.
    2. It is treated as Revenue Receipt.
6. **Life Membership Fee:** Life Membership Fee is the fee received from those members who do not pay periodic fee or subscription but pay a lump sum amount to become life time members. It can be shown by **adding to capital fund or separately on the liabilities side of Balance sheet.**
7. **Honorarium:** Honorarium is an amount paid to a person (other than employee) for rendering some special services for Not-for-profit organization. It is treated as an expense of Not-for-profit organization.

Calculation of Subscription to be shown in the Income and Expenditure Account for current year.

(*a*) Statement of Actual amount of subscription for the current year.

Particulars	Details	Amount
Subscription received during the year Add: Outstanding Subscription (at the end of Current Year)	------ ------	------- -------

Prepaid or advance (at the beginning Of previous year) Less: Outstanding Subscription (at the beginning of Current Year) Prepaid or Advance (at the end of current year)	------ ------	--------
Amount of subscription to be shown in Income & Exp. A/c		---------

(*b*) Preparing ledger Account.

Subscription Account

Particulars	Amount	Particulars	Amount
To Bal. b/d ((outstanding Subscription at the Beginning) To Income & Expenditure A/C (Balancing Figure) To Bal. c/d ((Prepaid Subscription at the end)	XXXX XXXX XXXX XXXX	By Bal. b/d (Prepaid Subscription at the Beginning) By Receipts & Payment A/C By Bal. c/d (Outstanding subscription at the end)	XXXX XXXX XXXX

II. Calculation of Stationary (A consumable item) to be shown in income and expenditure Account

Particulars	*Details*	*Amount*
Amount paid to creditors for stationary during current year Add: Opening Stock of stationary Closing Creditors of Stationary	-------- -------- --------	-------- --------
Prepaid or advance (Beginning of previous year) Less: Closing Stock of stationary Opening Creditors of Stationary Prepaid or Advance (End of current year)	-------- --------	-------- --------
Amount of subscription to be shown in Income & Exp. A/C		--------

Note: In both the statements only the amount pertaining to current year is to be shown in the Income & Expenditure Account because it is based on the revenue concept of accounting which states that any expense or expenditure, the full benefit of which is received during one accounting period is to be shown in the current financial year statements whether the amount is received (or paid) or not.

Case: II Income & Expenditure Account

Illustration: If the number of members is given and the amount is always equal to the amount which the members have to pay in any one year i.e. 500 × 200 = 1,00,000

Calculation of Outstanding Subscription as on 31-03-2015 (End)

Total amount to be received during the year	500×200=	1,00,000
Amount received during the year (2014-15)		90,000

Outstanding subscription for the current year (2014-15)		10,000
Outstanding subscription as on 31-03-2014 (Previous Year)	9,500	
Subscription Received during the year	5,000	
Still outstanding subscription as on 31-03-2015	4,500	
Outstanding subscription for the current year (2014-15)		10,000
Still outstanding subscription as on 31-03-2015		4,500
Outstanding subscription as on 31-03-2015		14,500

Important Points:-
Creditors for Stationary are not considered because ‘Stationary purchased during the year’ and ‘Amount paid to Creditors during the year’ are not given.
Interest on Investment is given in the question but value of investment is not shown in ‘Receipts and Payments Account’, it means that investment was purchased before the current year and was mentioned in the Balance Sheet at the beginning of the year. Therefore, the value of the investments calculated is as under:
Value of investment =18000×1009=200000

INDIAN SCHOOL MUSCAT

ACCOUNTANCY CLASS XII

Chapter 1 Part – A
Accounting for partnership firms fundamentals

According to Section -4 of the Indian Partnership Act, 1932:

“Partnership is the relations between two or more persons who have agreed to share the profits of a business carried on by all or any one of them acting for all”

Features of Partnership

1. Two or more persons: There must be at least two persons to form a valid partnership. The maximum number of partners cannot exceed the number of partners prescribed by companies Act, 2013 which is 50 in any business whether banking or non- banking.

2. Agreement : Partnership comes into existence by an agreement (either written or oral among the partners. The written agreement among the partners is called Partnership Deed.

3. Existence of business and profit motive : A partnership can be formed for the purpose of carrying on legal business with the intention of earning profits. A joint ownership of some property by itself cannot be called a partnership.

4. Sharing of Profits : An agreement between the partners must be aimed at sharing the profits. If some persons join hands to run some charitable activity, it will not be called partnership. Further, if a partner is deprived of his right to share the profits of the business, he cannot be called as partner.

5. Business carried on by all or any of them acting for all : It means that each partner can participate in the conduct of business and each partner is bound by the acts of other partners in respect to the business of the firm.

6. Relationship of Principal and Agent : Each partner is an agent ad well as a partner of the firm. An agent, because he can bind the other partners by his acts and principal, because he himself can be bound by the acts of the other partners

Partnership Deed

Since partnership is the outcome of an agreement, it is essential that there must be some terms and conditions agreed upon by all the partners. Such terms and conditions might be either written or oral. The law doesn't make it compulsory to have a written agreement. However, in order to avoid all misunderstandings and disputes, it is always the best course to have a written agreement duly signed and registered under the Act.

The partnership deed is a written agreement among the partners which contains the terms of agreement. It is also called ' ***Articles of Partnership'.*** **A partnership deed should contain the following points:**

1. Name and address of the firm as well as partners.

2. Name and addresses of the partners.

3. Nature and place of the business.

4. Duration, if any of partnership.

5. Capital contribution by each partner.

6. Interest on capital.

7. Drawings and interest on drawings.

8. Profit sharing ratio.

9. Interest on loan.

10. Partner's Salary/commission etc.

11. Method for valuation of goodwill and assets.

12. Accounting period of the firm and duration of partnership

13. Rights and duties of partners how disputes will be settled.

14. Decisions taken if some partner becomes insolvent.

15. Opening of Bank Account – whereas it will be in the name of firm or partners.

16. Rules to be followed in case of admission & Settlement of accounts or retirement or death of partner.

17. Revaluation of assets & liabilities, if any to be done.

18. Method of recording of firm's accounts

19. Auditing

20. Date of commencement of partnership

Benefits of Partnership Deed

(1) It regulates the rights, duties and liabilities of each partner.

(2) It helps to avoid any misunderstanding amongst the partners because all the terms and conditions of partnership have been laid down before hand in the deed.

(3) Any dispute amongst the partners may be settled easily as the partnership deed may be readily referred to.

Hence, it is always best course to have a written partnership deed duly signed by all the partners and registered under the Act.

Rules applicable in the absence of partnership deed

Profit sharing Ratio	Equal, Irrespective of capital contribution.
Interest on Capital	No Interest on Capital is to be allowed to any Partner
Interest on Drawings	No interest on Drawings is to be charged to any partner
Salary or Commission to a Partner	Not allowed to any partner
Interest on loan by a Partner	Interest is allowed @ 6% per annum.

Distribution of Profits among Partners

Transactions of the partnership firm are recorded according to the principles of Double-entry book keeping system, and as in the case of a sole proprietorship concern a partnership firm will also prepare Trading account, Profit & Loss account and Balance Sheet at the end of every year. The only difference between accounting of a sole trader and partnership firm is that the profits of the partnership firm are divided amongst the partners.

A Profit and Loss Appropriation Account is prepared to show the distribution of profits among partners as per the provision of Partnership Deed (or as per the provision of Indian Partnership Act, 1932 in the absence of Partnership Deed). It is an extension of profit and Loss Account. It is nominal account. It records entries for interest on capital, Interest on Drawings, Salary to the partner, and division of profits among the partners.

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

1.For transfer of balance of Profit and Loss Account

Profit and Loss A/c Dr.

To Profit and Loss Appropriation A/c

2.For Interest on Capital

For allowing Interest on capital

1. Interest on Capital A/c

To Partner's Capital/Current A/cs

(Being interest on capital allowed @ % p.a.)

2. For transferring Interest on Capital to P&L appropriation A/c.

Profit and Loss Appropriation A/cDr.

To Interest on Capital A/c.

(Being interest on capital transferred to P&L Appropriation A/c)

3. For Salary or Commission payable to a partner

i. For allowing Salary or Commission to a partner:

Partners Salary/Commission A/c Dr.

To Partner's Capital/Current A/cs

(Being salary/commission payable to a partner)

ii. For transferring Partner's Salary/Commission A/c to Profit and Loss

Appropriation A/s:

Profit and Loss Appropriation A/cDr.

To Partner's Salary/Commission A/c

4. For transfer of Reserves:

Profit and Loss Appropriation A/cDr.

To Reserve A/c

(Being reserve created)

5. For Interest on Drawings:

1.For charging interest on a partner's drawings:

Partner's Capital/Current A/c.Dr.

To Interest on Drawings A/c

(Being interest on drawings charged @ % p.a.)

2. For transferring interest on drawings to Profit and Loss Appropriation A/c

Interest on Drawings A/cDr.

To Profit and Loss Appropriation A/c

(Being interest on drawings transferred to P&L appropriation A/c)

6. For transfer to Profit (i.e. Credit Balance of Profit and Loss Appropriation Account

Profit and Loss Appropriation A/cDr.

To Partners Capital/Current A/cs

(Being profits distributed among partners)

SPECIMEN OF PROFIT AND LOSS APPROPRIATION ACCOUNT

Profit and Loss Appropriation Account

For the year ending on ___________________

Particulars	₹	Particulars	₹
To Interest on Capital: A B To Partner's Salary/Commission To Reserves To Profits transferred to capital A/cs of: A B		By Profit and Loss A/c (Net Profits transferred from P & L A/c) By Interest on drawings: A B	

Partner's Capital Accounts

Partner's Capital Accounts : It is an account which represents the partners interest in the business.

In case of partnership business, a separate capital account is maintained for each partner. The capital accounts of partners may be maintained by any of the following two methods.

1. Fixed Capital Accounts

2. Fluctuating Capital Accounts

1. Fixed Capital Accounts

Under this method the original capitals invested by the partners remain constant, unless additional capital is introduced by an agreement. All entries relating to drawings, interest on capitals, interest on drawings, salary to partner, share of profits/losses are made in separate account which is called as Current Account. Thus the following two accounts are maintained when capitals are fixed.

(i) Capital Account

This account will always show a credit balance: Balance of Capital account remains fixed, it does not change every year that is why it is called fixed capital method and only the following two transactions are recorded in the Fixed Capital Accounts:

Permanent· Additional Capital Introduced

·Permanent Capital Withdrawn or Drawings out of Capital only

Partner's Capital A/Cs

Particulars	X(₹)	Y(₹)	Particulars	X(₹)	Y(₹)
To Cash/Bank A/c (Capital Withdrawn) To Balance c/d (Closing balance)			By Balance b/d (Opening Cr. Balance) By Cash/Bank A/c (Additional Capital Introduced)		

(ii) Current Account

The Current account may show a debit or credit balance. All the usual adjustments such as interest on Capital, partner's salary/commission, drawings (out of profits), interest on drawings and share in profits or losses etc. are recorded in this account. All the Current Year's adjustments are recorded in this account that is why it is called Current account.

Partner's Current A/cs

Particulars	X(₹)	Y(₹)	Particulars	X(₹)	Y(₹)
To Balance b/d (Opening Dr. Balance) To Drawings (out of Profits) To Interest on Drawings To Profit and Loss A/c (Share in losses) To Balance c/d (Closing credit Balance)			By Balance b/d (Opening Cr. Balance) By Interest on Capital By Partner's Salary or Commission By Profit and Loss Appropriation A/c (Share in Profits) By Balance c/d (Closing Dr. Balance)		

Note :

1. Debit balance of Current Account is shown in Assets side of Balance Sheet.

2. Credits balance of Current Account A/c is shown in Liabilities side of balance Sheet.

3. Balance of Fixed Capital Accounts are always shown in Liabilities side of Balance Sheet as it will be always be credit balance.

2. Fluctuating Capital Accounts

In this method only one account i.e., Capital Account of each and every partner is prepared and all the adjustment such as interest on capital interest on drawings etc, are recorded in this account under this method, Capital account may show a debit or credit balance and the balance of this account changes frequently from time to time therefore it is called fluctuating Capital Account. In this method the capitals are not fixed. **In the absence of information, the Capital Accounts should be prepared by this method.**

Partner's Capital

Particulars	X(₹)	Y(₹)	Particulars	X(₹)	Y(₹)

To Balance b/d (Opening Dr. Balance) To Cash/Bank A/c (Capital Withdrawn) To Drawings (out of profits) To Interest on Drawings To Profit and Loss A/c (Share in losses) To Balance c/d (Closing credit Balance)			By Balance b/d (Opening Cr. Balance) By Cash/Bank A/c (Additional Capital Introduced) By Interest on Capital By Partner's Salary or Commission By Profit and Loss Appropriation A/c (Share in Profits) By Balance c/d (Closing Dr. Balance)		

INTEREST ON CAPITAL

Interest on partners' capital will be allowed only when it has been specifically mentioned in the partnership deed. If interest on capital is to be allowed as per the agreement, it should be calculated with respect to the time, rate of interest and the amount of capital. Interest on Capital can be treated as either:

a. An Appropriation of profit; or

b. A charge against profit.

A. Interest on Capital: An Appropriation of Profits:

In case of Losses	Interest on Capital is NOT ALLOWED
In cases of Sufficient Profits	Interest on Capital is ALLOWED IN FULL
In case of Insufficient Profits	Interest will be restricted to the amount of profit. Hence, profit will be distributed in the ratio of interest on capital of each partner.

B. Interest on Capital: As a Charge against Profits:

Interest on Capital is always allowed in full irrespective of amount of profits of losses.

Note:

Interest on Capital is always calculated on the OPENING CAPITAL.

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

Particulars	(₹)
Capital at the End Add: **1.** Drawing **2.** Interest on Drawings **3.** Losses during the year Less: **1.** Additional Capital Introduced **2.** Profits during the year 3. Any salary/commission received	
Opening Capital ……………	……………

INTEREST ON DRAWINGS

Interest on drawing is charged by the firm only when it is clearly mentioned in Partnership Deed. It is calculated with reference to the time period for which the money was withdrawn. There are two cases in which calculation of interest on drawings may arise:

Case 1: When Rate of Interest on Drawings is given in %

Interest on Drawings is calculated on flat rate irrespective of period.

Case 2: When Rate of Interest on Drawings is given in % p.a.

1. When date of Drawing is not given

Interest on Drawing = TotalDrawings×Rate100×6/12 X 12/12

Note: Interest is calculated for a period of 6 months, we assume drawings have been done evenly during the year, that is why we take average six months tenure.

2. When date of Drawings is given

Interest on Drawing = TotalDrawings×Rate100×Time left after drawings (in months) / 12

Case 3: When different amount are withdrawn on different dates:

We have the following two methods to calculate the amount of interest on Drawing:

1. Simple Interest Method

In this method, interest on drawing is calculated for each amount of drawing individually on the basis of periods for which it remained withdrawn till the close of accounting period.

2. Product Method

In this method, the amounts of drawings are multiplied by the period for which it remained withdrawn during the period; thereafter the products are added and interest is calculated on the total of products so arrived at for one month. The advantage of this system is that separate calculations are not required each time.

We can explain the above mentioned two methods with the help of an example.

Month	Date	Drawings Amount
May	1	12000
July	31	6000
September	30	9000
November	30	12000
January	1	8000
March	31	7000

Interest on drawings is to be charged @ 9% p.a

SIMPLE METHOD

DATE	AMOUNT	PERIOD	INTEREST @9%
1 MAY	12000	11	990
31 JULY	6000	8	360
30 SEP	9000	6	405
30 NOV	12000	4	360
1 JAN	8000	3	180
31 MAR	7000	0	00
TOTAL	**54000**		**2295**

PRODUCT METHOD

DATE	AMOUNT	PERIOD	PRODUCTS
1 MAY	12000	11	132000
31 JULY	6000	8	48000
30 SEP	9000	6	54000
30 NOV	12000	4	48000
1 JAN	8000	3	24000
31 MAR	7000	0	00
TOTAL	**54000**		**306000**

Interest = Total of products * 9/100* 1/12= 306000*9/100*1/12 = ₹ 2295/-.

Case 4: When an equal amount is withdrawn regularly

Interest on Drawing can be calculated using either Product Method or Direct Method (i.e. Short Cut Method)

Direct Method will be used only if all the following three conditions are satisfied:

1. Amount should be same (Regular drawings at regular Interval) throughout the period

2. Date of Drawings should be same throughout the period

3. Drawings should be made regularly without any gap.

4. Interest on Drawing = Total Drawings × Rate/100 × T/ 12

T = Time (in months) for which interest is to be charged

T=Timeleftafterfirstdrawing+Timeleftafterlastdrawing2T

Value of T under Different circumstances will be as under:

	Monthly Drawings for 12 Months	Quarterly Drawings for 12 Months	Half yearly Drawings for 12 Months	Monthly Drawings for 06 Months (last 6 months)
	6.5(beginning of the month)	**7.**5 (beginning of every quarter)	9 (beginning of every month for six month in the beginning of 6 months)	**3.**5(beginning of the month for last six month)
	6(middle of very month)	6(middle of every quarter)	6 middle of every month for six month in the beginning of 6 months)	3(middle of the month for last six month)
	5.5(end of every month)	**4.**5(end of every quarter)	3 (end of every month for six month in the beginning of 6 months)	**2.**5(end of the month for last six month)

INTEREST ON PARTNERS LOAN

If a partner has given loan to the firm, he is entitled to receive interest on such loan at an agreed rate.

It is a charge against profits. It is provided irrespective of profits or loss. It will also be provided in the absence of Partnership Deed @ 6% per annum.

The following entries are passed to record the interest on partner's loan

1. For allowing Interest on loan:

Interest on Partner's Loan A/cDr.

To Partner's Loan A/c

(Being interest on loan allowed @ % p.a.)

2. For transferring Interest on Loan to Profit and Loss A/c:

Profit and Loss A/cDr.

To Interest on Loan A/c

(Being Interest on loan transferred to P & L A/c)

It is always DEBITED to Profit and Loss A/c

Rent Paid to Partner.

Rent paid to a partner is also a charge against profits and it will also be

DEBITED to Profit and Loss A/c

Note:

Interest on A's Loan = Loan Amount × Rate/100 × Timeleftafterloantaken / 12

= 2,00,000×6100×05122,00,000×6/100×05/12=₹ 5,000

PAST ADJUSTMENTS

If, after preparation of Final Accounts of firm, it is found that some errors or commission in accounts has occurred than such errors or omissions are rectified in the next year by passing an adjustment entry.

A statement is prepared to ascertain the net effect of such errors or omissions on partner's capital/current accounts in the following manner.

Statement showing adjustment

Particulars	A (₹)	B (₹)	C (₹)
A Amount to be given credited Interest on Capital			

(Not allowed or provided at a lower rate) Partner's Salary or Commission etc. (Omitted to be recorded) Actual Profits (To be distributed in correct ratio)			
Total A			
B. Amount already given to be taken back now debited * Interest on Capital (If given at a higher rate) * Interest on Drawings (If not charged) * Profits already distributed in wrong ratio (debited now)			
Total B			
Net Effect (A-B)	+/-	+/-	+/-

+ Indicates Amount to be credited to Partner's Capital Account – Indicates Amount to be debited to Partners Capital Account

Journal

Date	Particulars	LF.	Debit(₹)	Debit(₹)
	Partners' Capital A/C Dr. (Amount to be Debited) To Partners' Capital A/c (Amount to be Credited) (Being adjustment entry passed)			

During Past Adjustment it is not compulsory that capital accounts of all partners are affected. More than one partners Capital Account may be debited or credited but amount of debit & credit should be equal.

GUARANTEE OF PROFITS TO A PARTNER

Guarantee is an assurance given to the partner of the firm that at least a fixed amount shall be given to him/her irrespective of his/her actual share in profits of the firm. If actual share in profits is less than the guaranteed amount in that case the deficit amount shall be borne either by the firm or by any partner as the case may be or as may have been decided by an agreement.

Note:

Guarantee to a partner is given for minimum share in profits. If the actual share in profits is more than the minimum share in profits, then the actual profits will be allowed to the partner.

Case: 1. When guarantee is given by FIRM (i.e. by all the Partners of the firm)

1. If share in actual profits is less than the guaranteed amount then. Guaranteed amount to a partner is first written off against the profits and then,

2. Remaining profits are distributed among the remaining partners in the remaining ratio.

Case: 2. when guarantee is given by a partner or partners to another partner.

1. Calculate the share in profits for the partner to whom guarantee is given.

2. If share in profits is more than the guaranteed amount, distribute the profit as per the profit and loss sharing ratio in usual manner.

3. If share in profits is less than the guaranteed amount, find the difference between the share in profits and the guaranteed amount and the difference known as deficiency.

Deficiency is contributed by the partner or partners who guaranteed in certain ratio and subtracted from his or their respective shares.

INDIAN SCHOOL MUSCAT

ACCOUNTANCY CLASS XII

Part – A Chapter 2
Goodwill Nature And Valuation

Goodwill is good name or the reputation of the business, which is earned by a firm through the hard work and honesty of its , If a firm renders good service to the customers, the customers who feel satisfied will come again and again and the firm will be able to earn more profits in future.

Thus, goodwill is the value of the reputation of a firm which enables it to earn higher profits in comparison to the normal profits earned by other firms in the same trade.

Features of Goodwill

1. It is an intangible asset : Goodwill cannot be seen or touched, it does not have any physical existence, thus it belongs to the category of intangible assets such as patents, trademarks, copy rights, etc.

2. It is a valuable asset

3. It is helpful in earning excess profits.

4. Its value is liable to constant fluctuations : While goodwill does not depreciate, its value is liable to constant fluctuation, its value is liable to constant fluctuations. It is always present as a silent asset in a business where there are super profits (i.e.more than the normal) but declines in value with the decline in earnings.

5. It is valuable only when entire business is sold : Goodwill cannot be sold in part. It can be sold with the entire business only. The only exception is at the time of admission or retirement of the partner.

6. It is difficult to place an exact value on goodwill : This is because its value may fluctuate from time to time due to changing circumstances which are internet and external to business.

Goodwill is divided into two categories.

I. Purchased Goodwill: Purchased goodwill means goodwill for which a consideration has been paid e.g. when business is purchased the excess of purchase consideration of its net assets i.e. (Assets – Liabilities) is the Purchased Goodwill. It is separately recorded in the books because as it is purchased by paying in form of cash or kind.

Characteristics

(i) It arises on purchase of a business or brand.

(ii) Consideration is paid for it so it is recorded in books.

(iii) Shown in balance sheet as on asset.

(iv) It is amortised (depreciated).

(v) Value is a subjective judgment & ascertained by agreement of seller & purchaser. It is approximate value and cannot be sold separately in the market or in parts.

II. Self-generated Goodwill also called as inherent goodwill. It is an internally generated goodwill which arises from a number of factors that a running business possesses due to which it is able to earn more profits in the future.

Features

(i) It is generated internally over the years.

(ii) A true cost cannot be placed on this type of goodwill.

(iii) Value depends on subjective judgment of the value.

(**iv) As per Accounting Standard 26(Intangible Asset)**, it is not recorded in the books of accounts because consideration in money or money's worth has not be paid for it.

Factors Affecting the Value of Goodwill

1. Efficient management: If the business is run by experienced and efficient management, its profits will go on increasing, which results in increase in the value of goodwill.

2. Quality of products: If the firm is supplying good quality of products, then the customer will come again and again for the same and thus will create the goodwill and brand name for the same.

3. Location of business: If the business is located at a convenient or prominent place, it will attract more customers and therefore will have more goodwill.

4. The Longevity of the business: An older business is better known to its customers, therefore it is likely to have more goodwill. When a business enterprise has built up good reputation over a period of time, the number of customers will be more in comparison to the customers of new entrants. Number of customers is an indicator of profit earning capacity of a business.

5. Monopolistic and other Rights : If a business enjoys monopoly market, it will have assured profits. Similarly, if it holds some special rights such as patents, trademarks, copyrights or concessions, etc., it will have more goodwill.

6. Other factors:
(i) Good industrial relations.
(ii) Favorable Government regulations
(iii) Stable political conditions
(iv) Research and development efforts
(v) Effective advertising to establish brand popularity
(vi) Popularity of product in terms of quality.

Need for Valuing Goodwill: Whenever the mutual rights of the partner's changes the party which makes a sacrifice must be compensated. This basis of compensation is goodwill so we need to calculate goodwill.

Mutual rights change under following circumstances

1. When profit sharing ratio changes

2. on admission of a partner

3. On Retirement or death of a partner

4. When amalgamation of two firms taken place

5. When partnership firm is sold.

Method of valuation of goodwill:

It is very difficult to assess the value of goodwill, as it is an intangible asset. In case of sale of a business, its value depends on the mutual agreement between the seller and the purchaser of the business. Usually, there are three methods of valuing goodwill:

1. Average profit method

2. Super profit method

3. Capitalization method

Average Profit Method

This is a very simple and widely followed method of valuation of goodwill. In this method, goodwill is calculated on the basis of the number of past years years, Average of such profits is multiplied by the agreed number of years (such as two or three) to find out the value of goodwill.

Formula for calculation of goodwill

Goodwill = Average Profits $\times$ Number of years of purchase

Number of years of purchase means for how many years the firm will earn the same amount of profits in future.

Average Profits = Total Profits/Number of years

A buyer always wants to estimate the future profits of a business. Future profits depend upon the average performance of the business in the past. Past profits indicate as to what profits are likely to accrue in the future. Therefore the past profits are averaged. But before calculating the average profits, the profits earned in the past must be adjusted in the light of future expectations and the following factors should be taken into account while calculating the average profits:

(i) Abnormal income of a year should be deducted out of the net profit of that year.

(ii) Abnormal loss of a year should be added back to the net profit of that year.

(iii) Income from investments should be deducted out of the net profits of that year, because this income is received from outside the business.

Weighted Average Profit Method: This method is a modified version of average profit method. In this Method each year's profit is assigned a weight. The highest weight is attached to profit of most recent year.

Eg: 2011-1, 2012-2, 2013-3, 2014-4.

Each year profits are multiplied by assigned weights. Products are added & divided by total number of weights. Weighted average is multiplied by agreed Number of years of Purchase.

Weighted Average Profit:
= TotalproductofprofitsTotalofweightsTotalproductofprofitsTotalofweights

Goodwill = Weighted Average Profit $\times$ No. of years of purchase.

Weighted average profit method is considered better than the simple average profit method because it assigns more weightage to the profits of the latest year which is more likely to be earned in future. This method is preferred when profits over the past years have been continuously rising or falling.

Super profit Method: In this method goodwill is calculated on the basis of surplus (excess) profits earned by a firm in comparison to average profits earned by other firms. If a business has no anticipated excess earnings, it will have no goodwill. Super Profit are the excess of actual profit over normal profits. Where Normal profits are profits earned by similar business.

If a firm earns higher profit in comparison to normal profit (generally earned by other firms of same industry) then the difference is called Super Profit. Goodwill is calculated on the basis of Super profit due to future expectations of earning capacity of the firm.

Goodwill is calculated by the formula

Goodwill = Super Profit × Number of years of purchase

Super Profit = Average profit - Normal profits

Normal Profit = Investment (Capital Employed) × Normal Rate of Return/ 100

Capital Employed = Capital + Free Reserves – fictitious Assets (if any), or

All Assets – (Goodwill, fictitious assets and non-trade Investment) – Outsider's Liabilities

Capitalised Method Under this method, goodwill can be calculated in two ways:

(A) Capitalisation of Average Profit Method: Under this method first of all we calculate the average profits and then we assess the capital needed for earning such average profits on the basis of normal rate of return. Such capital is also called capitalised value of average profits. It is calculated as under.

Capitalised value of the firm =Average profits × 100 /Normal rate of return

Goodwill is calculated by deducting the actual capital employed in business from the capitalised value of average profits.There will be no goodwill if the actual capital employed in the business exceeds or equals the capitalised value of the average profits.

Net Assets or Capital employed = Total assets – Outside liabilities

Goodwill = Capitalized value of average profits – Capital Employed

(B) Capitalisation of Super Profit Method: Under this method first of all we calculate the super profits and then we assess the capital needed for earning such super profits on the basis of normal rate of return. Such capital is actually the amount of goodwill. Super profits are calculated in the same manner as calculated in super profits method.

Goodwill of the firm = Super Profits * 100 / Normal rate of return.

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Chapter 3 Part – A
Reconstitution of Partnership

Meaning of Reconstitution

Any change in agreement of partnership or profit sharing ratio is called reconstitution of partnership firm. In following circumstances a partnership firm may be reconstituted:

1. Change in Profit Sharing Ratio

2. Admission of a partner

3. Retirement/Death of a partner.

CHANGE IN PROFIT SHARING RATIO AMONG THE EXISTING PARTNERS

Meaning : A Change in profit sharing ratio means one or more partners acquires interest form another partner or partners. Here it share of profit of one or more partners increases then share of one or more partner decreases to same extent.

When all the partners of a firm agree to change their profit sharing ratio. The ratio may be changed

New profit sharing ratio : The ratio in which the partners are to share the profits in future on reconstitution is known as New profit sharing ratio.

Gaining Ratio : It is the ratio in which the profit sharing ratio of gaining partners increases. It is calculated by taking difference between new profit sharing ratio and old profit sharing ratio.

Sacrificing Ratio : It is the ratio in which the profit sharing ratio of sacrificing partners decreases. It is calculated by taking difference between old profit sharing ratio and new profit sharing ratio.

Note : If old ratio-new ratio is positive it means sacrifice and if it is negative it means gain.

Accounting Treatment of Goodwill

In case of change in profit sharing ratio, the gaining partner must compensate the sacrificing partner by paying the proportionate amount of goodwill.

Note :

(i) Increase in the value of an Asset and decrease in the value of a liability result in profit.

Assets A/c Dr.

To Revaluation

(ii) Decrease in the value of any asset and increase in the value of a liability gives loss.

Revaluation A/c Dr.

To Assets A/c

(iii) For increase in the value of liabilities.

Revaluation A/c Dr.

To Liabilities A/c

(Increase in value of Liability)

(iv) For decrease in the value of Liabilities

Liabilities A/c Dr.

To Revaluation A/c

(Decrease in the value of Liabilities)

(v) When Revaluation account shows profit

Revaluation A/c Dr.

To Partner's Capital A/c

(Profit credited to Partner's Capital A/c in old ratio)

(vi) In case of Revaluation Loss

Partner's Capital A/c's Dr.

To Revaluation A/c

(Loss debited to Partner's Capital A/cs in old ratio)

SPECIMEN/PROFORMA OF REVALUATION ACCOUNT

Revaluation Account

Particulars	(₹)	Particulars	(₹)
To Assets (individually) Decrease in value To Liabilities increase On revaluation To Unrecorded Liability To profits transferred to Partner's capital A/c (in old ratio)		By Assets (individually) Increase in value of Asset By Liabilities (individually) Decrease on revaluation By Unrecorded asset By Loss transferred to partners Capital A/c (in old ratios)	

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ACCOUNTANCY CLASS XII

Chapter 4 Part – A
Accounting For Partnership Firms : Admission of A Partner

Meaning

When a new partner is admitted in a running business due to the requirement of more capital or may be to take advantage of the experience and competence the newly admitted partner or any other reason, it is called admission of a part in partnership firm.

According to section 31(1) of Indian partnership Act, 1932, “A new partner be admitted only with the consent of all the existing partners”

At the time of admission of new partner, following adjustments are requires

1. Calculation of new profit sharing ratio and sacrificing ratio.
2. Accounting treatment of Goodwill.
3. Accounting treatment of accumulated profit, reserves and accumulated loss.
4. Accounting treatment of revaluation of assets and reassessment of liabilities.
5. Adjustment of capital in new profit sharing ratio.

1. Calculation of new profit sharing ratio
following types of problems may arise for the calculation of new profit share ratio.
Case (i) When old ratio is given and share of new partner is given.

Note : Unless agreed otherwise, it is presumed that the new partner acquires his share in profits from the old partners in their old profit sharing ratio.

Alternative Method :
Old Ratio = A : B
1 : 2

Left the profit of the firm = 1
C’s share (New Partner) = 1/3
Remaining Profit = 1-1/3 = 2/3

Now this profit 2/3 will be divided between the old partners in their future profit sharing ratio (old ratio) i.c., 1:2

A's new Profit = 1/3 of 2/3 = $\frac{1}{3} \times \frac{2}{3}$ = 2/9

B's new Profit = 2/3 of 2/3 = $\frac{2}{3} \times \frac{2}{3}$ = 4/9

C's profit = 1/3 or $\frac{1}{3} \times \frac{3}{3}$ = 3/9

Hence the new ratio = 2:4:3

Note : In this case only New Partners share is given then Sacrificing ratio = Old Ratio = 1 : 2 there is no need to calculate it

Case (ii) when new partner acquires his/her share from old partners in agreed share.

2. Accounting Treatment of Goodwill

At the time of admission of a partner, treatment of Goodwill is necessary to compensate the old partners for their sacrifice. The incoming partner must compensate the existing partners because he is going to acquire the right to share future profits and his share is sacrificed by old partners, If goodwill (Premium) is paid to old partners privately or outside the business by the new partner then on entry is required in the books of the firm.

There may be different situations about the treatment of goodwill at the time of the admission of the new partner.

(i) Goodwill (premium) brought in by the new partner in cash and retained in the business

Note : Sacrificing = Old ratio – New ratio

A = 3/5 – 3/8 = $\frac{24-15}{40} = \frac{9}{40}$

B = 2/5 – 3/8 = $\frac{16-15}{40} = \frac{1}{40}$

This sacrificing ratio between A and B i.e., 9 : 1.

3. Accounting treatment of Accumulated Profits

Accumulated profits and reserves are distributed to partners in their old profit sharing ratio. If old partners are not interested to distribute, these accumulated profits are adjusted in the same manner as goodwill and the following adjusting entry will be passed.

New Partner's capital A/c Dr. (New share)
To old partner's capital A/c (Sacrificing ratio)

4. Accounting treatment for revaluation of assets and re-assessment of liabilities

The assets and liabilities are generally revalued at the time of admission of a new partner. Revaluation Account is prepared for this purpose in the same way was in case of change in profit sharing ratio. This account is debited with all losses and credited with all gains. Balance of Revaluation Account is transferred to old partner in their old ratio.

5. Adjustment of Capital in New Profit Sharing Ratio

Working Notes :

Gauri's share of goodwill = ₹ $45,000 \times \frac{1}{3} = Rs.15,000$

Total adjusted capital of old partner for 2/3 share = ₹ 1,42,433 + ₹ 91,217 = ₹ 2,33,650

Proportionate capital of Gauri 1/3 share = ₹ $2,33,650 \times \frac{3}{2} \times \frac{1}{3} = \frac{Rs.233650}{2}$ = ₹ 1,16,855

Bank A/c

Particulars	(₹)	Particulars	(₹)
To Gauri's Capital	1,16,825	By balance c/d	1,31,825
To Premium for goodwill	15,000		
	1,31,825		1,31,825

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Chapter 5 Part – A
Retirement or Death of a partner

Retirement of a partner means ceasing to be partner of the firm. A partner may retire (i) of there is agreement of this effect (ii) all partners give consent (iii) At will by giving written notice.

Introduction

Like admission and changes in profit sharing ratio in case of retirement or death also the existing partnership deep comes to end and the new once comes into exist-tense among the remaining partner. There is not much difference in the accounting treatment at the time of retirement or in the event of death.

Amount due to Retiring/Deceased Partner (To be credited to his capital account)

1. Credit Blanca of his capital.

2. Credit Balance of his current account (if any).

3. Share of Goodwill. (By gaining partners)

4. Share of Reserves of Undistributed profits.

5. His share in the profit on revaluation of assets and liabilities.

6. Share in profits up to the date of Retirement/Death. (By p & L suspense A/c)

7. Interest on capital if involved.

8. Salary if any

Deduction from the above sum (to be debited to capital account)

1. Debit balance of his current account (if any)

2. Share of existing Goodwill to be written off.

3. Share of accumulated loss.

4. Drawing and interest on drawings (if any)

5. Share of loss on account of Revaluation of assets and liabilities.

6. His share of business loss up to the date of Retirement/Death (To p & L) suspense A/C)

Accounting Treatment

1. Calculation of new profit sharing ratio and gaining ratio

2. Treatment of goodwill.

3. Evaluation a/c preparation with the adjustment in the respect of unrecorded assets /liabilities.

4. Distribution of reserves and accumulated profits/loss.

5. Ascertainment of share of profit/loss till the date of retirement/ death.

6. Adjustment of capital if required.

7. Settlement of the Accounts due to Retired/Deceased partner.

New profit Sharing Ratio & Gaining Ratio

New profit Sharing Ratio: it is the ratio in which the remaining partners share future profits after retirement/death.

Gaining ratio: it is the ratio in which the continuing partners have acquired the share from the outgoing partner. Gaining Ratio = New Ratio -Old Ratio.

Calculation of the two ratios.

Following situations may arise

1. When no information about new ratio or gaining ratio is given in question

In this case it considered that the share of the retraining partner is acquired the remaining partners in the old ratio. Then no need to calculate the new paining ratio as it will be the same as before.

2. Gaining ratio is given which is different than the old ratio in this New share of continuing partner = has old share + gained from outgoing partner.

3. If the new ratio is given the Gaining ratio = New Ratio -Old Ratio

TREATMENT OF GOOD WILL

According to accounting standards – 10, Good will account can't be raised as only purchased goodwill is recorded in books. Therefore only adjustment entry is done for goodwill

Steps to be followed

1. When old good will appears in the books then first of all this is writer in the old ratio**. Remember Old Good will old Ratio**

All Partner's capital A/C   Dr.

To Good Will A/c

2. After written off of goodwill adjustment of retiring partner's share goodwill will be made through the following journal entry.

Remaining Partner's Capital, A/C Dr. (in gaining

To Retiring/Deceased Partner's Capital A/c

Hidden Goodwill

Sometimes goodwill is not given in the question directly, But if a firm agrees to pay a sum which is more than retiring partner's balance in capital also after making all adjustment with respect to resaves, revaluation of assets and liabilities etc. then cases amount is treated as his share of goodwill (known as hidden goodwill).

3. Revaluation of Assets and Reassessment of Liabilities

Revaluation A/c is prepared in the same way as in the case of admission of a new partner. Profit and loss on revaluation is transferred among all the partners in old ratio.

4. Adjustment of Reservation and Surplus (Profits)

(Appearing in the Balance Sheet – Liability Side)

(a) General Reserve A/cDr.

Reserve Fund A/cDr.

Profit & Loss A/c (Credit Balance)Dr.

To all partners Capital/Current A/c (in old ratio)

(b) Specific Funds – If the specific funds such as workmen's compensation funds or investment fluctuation fund are in excess of actual requirement, the excess will be transferred to the Capital A/c in old ratio.

Workmen Compensation Fund A/cDr.

Investment Fluctuation Funds A/cDr.

To All Partner's Capital A/cs

(c) For distributing accumulated losses

(i.e. P & L A/c debit balance shown on the Asset side of Balance Sheet)

All partner's Capital/Current A/cDr. (in old ratio)

To P & L A/c

Disposal of the Amount Due to the Retiring Partner

This outgoing partners A/c is settled as per the terms of partnership deed. Three cases may be there as given below –

1. When the retiring partner is paid full amount either in cash or by cheque.

Retiring Partner's Capital A/cDr.

To Cash Bank A/c

2. When the retiring partner is paid nothing in cash then the whole amount due is transferred to his loan A/c

Retiring Partner's Capital A/cDr.

To retiring partner's Loon A/c

3. When Retiring Partner is partly paid in cash and the remaining amount in treated Loan.

Retiring Partner's Capital A/cDr. (Total Amount due)

To Cash Bank A/c (Amount Paid)

To Retiring Partner's Loan A/c (Amount of Loan)

Settlement of loan of the Retiring Partner

Loan of the retiring partner is disposed off accordingly of the pre decided term and conditions among the partners. Normally the Principal amount is paid in **few equal installments.** In such cases **interest is credited to the Loan A/c on the basic of the amount outstanding at the beginning of each year** and the amount paid it debited to loan A/c. The following Journal entries are done

a. For interest on Loan.

Interest A/cDr.

To Retiring partner's Loan A/c

b. For the payment of installment.

Retiring Partner's Loan A/cDr.

To Cash/Bank A/c (including interest)

Adjustment of Capitals

At the time of retirement/death, the remaining partners may decide to adjust their capitals in their new profit sharing Ratio. Then

· The sum of their capitals will be treated as the total capital of the new firm which will be divided in their New Profit Sharing Ratio.

· Excess of Deficiency of capital in the individual capital A/c is calculated.

· Such excess or shortage is adjusted by withdrawal or contribution in case or transferring to their current A/cs.

Journal Entries

(a) For excess Capital withdrawn by the Partners

Partner's capital A/cDr.

To Cash/Bank A/c

(b) For deficiency, cash will be brought in by the partner

Cash/Bank A/cDr.

To Partner's capital A/c

DEATH OF A PARTNER

Accounting treatment in the case of death is same as in the case of return except the following:

1. The deceased partners claim is transferred to **his executer's account.**

2. Normally the **retirement** takes place at the **end of the Accounting pried** but the **death** may **occur at any time.** Hence the **claim of deceased part** shall also **include his share or profit or loss, interest on capital drawings if any from the date of the last balance sheet to the date his death.**

1. Calculation of profit/Loss for the intervening Period.

It is calculated by any one of the two methods given below:

a. On Time Basis : In this method **proportionally profit** for the time period is calculated either on the **basis of last year's profit or on basis of average profits of last few years** and then deceased profit share is calculated based on his share of profits.

b. On Turnover or Sales Basis : In this method the profits upto the date of death for the current year are calculated on the **basis of current year's sales upto the date of death by using the formula.**

Profits for the current year upto the date of death =

(Sales of the current year upto the date of death/total sales of last year) × Profit for the last year.

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

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Chapter 6 Part – A
Dissolution Of a Partnership Firm

Dissolution of a firm : As per Indian Partnership Act, 1932 : **"Dissolution firm means termination of partnership among all the partners of the firm"**

When a firm is dissolved, the business of the firm terminates. All the assets the firm are disposed off and all outsiders' liabilities and partners' loan and partner capital are paid.

Dissolution of Partnership : Dissolution of Partnership refers to terminal of old partnership agreement (i.e., Partnership Deep) and a reconstruction the firm.

It may take place on

· Change in profit sharing ratio among the existing partner:

· Admission of a partner; and

· Retirement of Death of partner.

It may or may not result into closing down of the business as the remount partners may decide to carry on the business under a new agreement.

Types of dissolution of firms: A Partnership firm can be dissolved in any the following ways:

(A)Without the intervention of the court:

(1) When all partners agree to dissolve the firm (Sec. 40);

(2) Compulsory Dissolution (Sec. 41)

(i) When all or except but one partner of the firm become insolvent

(ii) When business of the firm become unlawful.

(3) On the happening of any of the following events: (Sec. 42)

(i) On the insolvency of a partner.

(ii) On the fulfillment of the objective of the firm for which the for was formed.

(iii) On the expiry of the (period) for which the firm was formed.

(4) By Notice (Sec. 43) : When the duration of the partnership firm is a fixed and it is at will of the partne₹ Any partner by giving notice other partners can dissolve the firm.

(B) Dissolution by order of the court (Sec. 44) : A court on application by a partner may order the dissolution of the firm under the following circumstances:

(1) When a partner has become of unsound mind.

(2) When a partner has become permanently incapable of performing his duties as a partner.

(3) When a partner is found quality of misconduct that may harm the partnership.

(4) When a partner consistently and deliberately commits breach of partnership agreement.

(5) When a partner transfer whole of is interest in the business firm to a third party, without the consent of existing partne₹

(6) When the court is satisfied that the partnership firm cannot be carried on except at a loss.

(7) When the court finds that the dissolution of firm is justified and equitable.

ACCOUNTING TREATMENT OF DISSOLUTION

On dissolution of a firm, the following accounts are opened to close the books of the firm .

· Realisation Account;

· Partner’s Loan Account;

· Partner’s Capital Accounts; and

· Cash or Bank Account.

Realisation Account : It is nominal account opened on the dissolution of a firm **to ascertain the profit or loss on realization of assets and payment of outsiders**

liabilities. This account is closed by transferring the balance (i.e., profit or loss on realization) to partner's capital accounts.

PREPARATION OF REALISATION ACCOUNT

The following Journal Entries are passed :

A. For Closing Assets Accounts:

Realisation A/cDr.

To sundry Assets A/c

(Being assets transferred to Realisation A/c)

Note :

1. Cash and Bank balance are not transferred to Realisation Account.

2. Assets (tangible and intangible) are transferred to Realisation Account to their Gross Value

3. Fictitious Asset such as Debit balance of Profit and Loss Account of Advertisement Suspense's Account etc. are not transferred to Realisation Account. These are directly debited to partners' capital accounts in their profit sharing ratio by passing the following entry.

Partner's capital A/cDr.

To Profit and Loss A/c

To Advertisement Suspense A/c

(Being Balance of losses transferred to capital accounts)

4. Provision against assets such as Provision for Depreciation of Provision for Bad & Doubtful debts etc. are transferred to Realisation Account by passing a Separate entry:

Provision's for Bad Debts A/cDr.

Provision's for Depreciation A/cDr.

Investment Fluctuation Fund A/cDr.

Machinery Replacement Reserve A/cDr.

To Realisation A/c

(Being Provision & Reserves Against Assets transferred to Realisation Account)

B. For Closing Liabilities Accounts:

Sundry Liabilities A/cDr.

To Realisation A/c

(Being sundry liabilities transferred to Realisation A/c)

Note :

1. Only third parties liabilities/outsiders ‘liabilities are transferred to Realisation A/c

2. Balance of Partner’s Loan Accounts are not transferred to Realisation Account Separate accounts are opened to settle such liabilities.

3. Undistributed profits and reserves are also not transferred to Realisation A/c. These are directly credited to partners’ capital accounts in their profit sharing ratio by passing the following entry.

Profit and Loss A/cDr.

General Reserves A/cDr.

Reserve fund A/cDr.

Contingency Reserve A/cDr.

To Partner’s Capital A/cs

(Being balance of undistributed profits transferred to capital accounts)

4. Provident Fund is a liability on the firm towards employees and hence it is transferred to Realisation A/c.

*__5.__ If any liability is expected to arise against any found or reserve e.g., Workmen’s Compensation Fund, then an amount equal to such liability is transferred to Realisation A/c balance, if any, distributed among the partners in their profits-sharing ratio by passing the following entry.

Workmen’s Compensation Fund A/CDr.

To Realisation A/c(Liability)

To Partners’ Capital A/cs(Balance, if any)

(Being liability against workmen’s compensation fund transferred to Realisation A/c and balance Distributed among partne₹

C. For Realisation of Assets (Whether recorded or unrecorded)

a. When assets are sold for cash

Cash/Bank A/cDr.

To Realisation A/c

(Being assets sold for cash)

b. When assets are taken over by any partner.

Partner's Capital A/cDr.

To Realisation A/c

(Being assets taken over by any partner)

c. When assets are taken over by any creditor in part of full payment his dues :

I. In case of Full Settlement:

i. NO ENTRY is passed for the transfer of assets to the creditor.

ii. NO ENTRY is passed for the payment to creditor.

II. In case of Part Settlement:

i. NO ENTRY is passed for the transfer of assets to the creditor.

ii. The agreed amount of asset is deducted from the claims of it creditors and the balance is paid to him.

Note :

1. The realized value of each asset must be given at the time of dissolution.

D. For Payment of Liabilities

a. When liabilities are paid in cash

Realisation A/cDr.

To Cash/Bank A/c

(Being liabilities paid in cash)

b. When liabilities are taken over by any partner

Realisation A/cDr.

To Partner’s Capital A/c

(Being liabilities taken over by a partner)

Note : If nothing is stated regarding the settlement of any outside liability, then it should be assumen that the amount equal to book value is paid.

E. For Realisation Expenses

a. When expenses are paid by firm and borne by firm:

Realisation A/cDr.

To Cash/Bank A/c

(Being realization expenses paid in cash).

b. When expenses are paid by any partner and borne by firm :

Realisation A/cDr.

To Partner’s Capital A/c

(Being realization expenses paid by a partner).

c. When expenses are paid by firm (on behalf of any partner) and born by an partner.

Partner’s Capital A/cDr.

To Cash/Bank A/c

(Being realization expenses paid on behalf of partner).

e. When a partner is paid a fixed amount for bearing realization expenses then: Actual expenses are not be considered;

ii. Realization A/cDr. (With Fixed Amount)

To Partner’s Capital A/c

(Being realization expenses paid by a partner)

f. When expenses are paid by one partner and borne by another partner;

Partner’s Capital A/cDr. (Who borne the expenses)

To Partner's Capital A/c (Who pays the expenses)

(Being realization expenses paid by one partner and borne by another partner).

In case the realization expenses are borne by a partner, clear indication should be given regarding the payment there of.

F. For Closing Realisation Account

a. When Realization A/c Discloses profit (in case total of credit side is more than the total of debit side)

Realisation A/cDr.

To Partner's Capital A/cs

(Being profit on realization transferred to partners' capital A/cs)

b. When Realisation A/c discloses loss (in case total of debit side is more than the total of credit side)

Partners' Capital A/cDr.

To Realisation A/c

(Being loss on realization transferred to partners capital A/cs)

FORMAT OF REALISATION ACCOUNT

Realization A ccount

Particulars	(₹)	Particulars	(₹)
To sundry Assets A/c (Excluding cash or bank balance. Fictitious assets. Dr. balance of P & Lac, Dr. balance of partner's Capital/current A/cs, Loans to partners) To Cash/Bank A/c (Amount paid for discharging Liabilities-recorded and unrecorded)		By Sundry Liabilities A/c (Excluding Cr. Balance of P & L A/c, Reserves, Partners' Capital/Current A/cs, Loan from partner and Bank Overdraft) By provision on any Assets A/c (Such as provision for Depreciation, Provision for Doubtful Debts, Joint Life Policy Reserve etc.)	

To Cash Bank A/c (Expenses on Realisation) **To Partner's Capital A/cs** (Liabilities taken over by a Partner commission payable to him or any expenses payable to him) **To Partner' Capital A/cs** (For transferring profit on Realisation)		**By Cash/Bank A/c** (Amount received on realization of assets-recorded and unrecorded) **By Partners' Capital A/c** (Assets taken over by a partner recorded or unrecorded) **By partners' Capital A/cs** (For transferring loss on Realisation)	

PREPARATION OF PARTNERS' LOAN ACCOUNT

If a partner has given any loan to firm, his loan will be paid

· After payment of all the outside liabilities : but

· Before making any payment to partners on account of capital

Partner's Loan A/cDr.

To Cash/Bank A/c

(Being loan of a partner paid)

Partner's Loan A/c

Particulars	**(₹)**	**Particulars**	**(₹)**
To Cash/Bank A/c		By Balance b/d	

If the firm has given a loan to any partner then such loan account will show a debti balance and will appear on the asset side of Balance Sheet of the firm. Such loan accounts are settled through partner's capital account by passing the following entry:

Partner's Capital A/c Dr.

To Partner's Loan A/c

(Being loan to partner transferred to his Capital A/c)

Preparation of partner capital Accounts

After the Transfer of

· Undistributed profits and reserves

· Profit on Realisation

· Any liability taken over by any partner

And

· Undistributed losses and fictitious assets

· Loss on realization

· Any assets taken over by any partner

The balance of partners’ capital A/cs are closed in the following manner

a. For making final payment to a partner (if total of credit side is more than the total of debit side)

Partner’s Capital A/c Dr.

To Cash/Bank A/c

(Being excess paid to partner in cash)

b. For any amount received form a partner against debit balance in his capital account.

Cash/Bank A/c Dr.

To Partner’s Capital

(Being cash brought in by any partner)

Partner’s Capital A/c

Particulars	(₹)	Particulars	(₹)
To Balance A/c (Dr. Balance)		By balance bid (Cr. Balance)	

To Profit and Loss A/c **To Advertisement Suspense A/c** **To Realisation A/c** (Assets taken) **To Realisation A/c** (Loss on Realisation) **To Cash/Bank A/c** (Excess cash paid)		By General Reserve A/c By Profit and Loss A/c By workmen's Compensation Fund By Realisation A/c (Liabilities taken) **By Realisation A/c** (Profit on Realisation) By Cash/Bank A/c Cash brought in	

Preparation of Cash or Bank Account

This account is prepared at the end closed last of all. This account helps to verification of the arithmetically accuracy of accounts as both sides of this account must be equal.

Note: If cash and bank balance both are given in the Balance Sheet, one A/c to prepared, either a Cash A/c or a Bank A/c If Cash A/c is opened, an entry of with drawing the bank balance is made:

Cash A/c Dr.

To Bank A/c

(Being cash withdrawn from Bank)

If Bank A/c is opened, an entry for depositing the cash into bank is passed.

Bank A/c Dr.

To Cash A/c

(Being cash deposited into Bank)

Cash/Bank A/c

Particulars	(₹)	Particulars	(₹)
To Balance A/c		By balance bid	

(Cash in Hand or Cash at Bank) To Realisation A/c (Assets Realisation) To Partner' Capital A/cs (Cash brought in by partner)		(Bank overdraft) By Realisation A/c (Liabilities Paid) By Realisation A/c (Realisation Expenses Paid) By Partner's Loan A/c (Partner's Loan Paid) By Partner's Capital A/cs (Excess cash paid to partner)	

Distinction between Revaluation Account Realisation Account

Basic of Difference	Revaluation Account	Realisation Account
Purpose	It is prepared to show assets and liabilities in the books at their revised values	It is prepared to ascertain profit or loss on sale of assets and repayment of liabilities
When to be prepared	It is prepared at the time of change in profit sharing ratio among the existing partner, admission, retirement and death of a partner	It is prepared at the time of dissolution of a firm
Preparation of Account	This account may be prepared at a number of times during the life of a firm	This account is prepared once during the life of a firm
Content	This account records only those assets and liabilities whose book values have been changed	This account records all assets (except cash, fic-tious assets etc.) and all outside liabilities
Result	A Firm continues its business even after the preparation of revaluation account.	A firm comes to an end after preparation of realization account

PREPARATION OF MEMORANDUM BALANCE SHEET

If a balance sheet on the date of dissolution is not given in the question, there is always advisable to prepare Memorandum Balance Sheet on the date of dissolution to ascertain the amount of balancing figure.

Note

· In the absence of any other information “Sundry Assets” should be treatment as balancing figure on the **assets side of Balance Sheet.**

· If the balance of Partners’ Capital A/cs are not given as on the date on dissolution, first we will find the balance of partners’ capital accounts as on the date of dissolution by **recasting the capital accounts.**

· When “Sundry Assets” are given in the question and nothing is specified about the difference on the asset side of Balance Sheet, the different should be treated as **Dr. balance of Profit and Loss A/c.**

Some common mistakes committed by students

· Entries for assets or liabilities taken by partners

· Dissolution Expenses

· Realisation of unrecorded assets

· Payment of Unrecorded Liabilities

· Treatment of Fictitious Assets

Due care should be taken while showing the effect of above mentioned items.

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