HAPPY NEW YEAR (2017)
and
BEST WISHES FOR THE BOARD EXAMINATION 2017

Gyan ko prapt karne ke liye,
Dhyan ki ikagarta zaroori,
Aur Dhyan ko vass mein karne ke liye,
Khatre ki majoodgi zaroori hei.

Difficulty is only a state of mind.

If you can smile at life,
Life will also smile at you.
- Mother Teressa

Keep Smiling and Be Happy

Tips on Important Topics

Partnership Accounts

- Partnership is governed by the terms and conditions of the Partnership.
- Capital Accounts are maintained either following Fixed Capital Accounts Method or Fluctuating Capital Accounts Method.
- When Capital Accounts are maintained following Fixed Capital Accounts Method, two accounts, Capital Account Current Account, for each partner is maintained.
- Current Account is credited and debited by the amounts other than those relating Capital.

- When Capital Accounts are maintained following Fluctuating Capital Accounts Method, one account for each partner is maintained. All transactions of the partner with the firm are debited or credited to the Capital Account.
- Unless agreed otherwise by the partners, their Profit-sharing Ratio is equal.
- Unless the Partnership Deed permits, Interest on Capital and remuneration (salary, commission etc.), is not allowed.
- Unless the Partnership Deed permits, Interest on Drawings is not charged.

- Interest on Partner's loan to the firm is allowed @ 6% per annum unless agreed otherwise by the partners.
- Interest on Partner's loan is a charge against profits. It means it is to be allowed whether the firm earns profit or incurs loss.
- Interest on Drawings is calculated on Average Method if the amount and the date of drawings is uniform.
- In drawings of uneven amounts and / or date not being uniform, Interest on Drawings is calculated using Product Method.

- If the rate of interest is given without the words "per annum" (for example 10%), time period is ignored but, if the words "per annum" (say 10% p.a.), time period is considered.
- In calculating the value of goodwill, abnormal gains (profits) are deducted while abnormal losses are added to determine Annual Maintainable Profit.
- Consider whether Interest on Capital is a charge or appropriation.
- In Past Adjustments, verify whether capitals are fixed or fluctuating.

  If Capitals are fixed – Use Current Account,

  If Capitals are fluctuating-Use Capital Account.

- Guaranteed Partner will get guaranteed amount of profit whether the firm earns inadequate profit or incurs loss.
- Attention should be paid to the words **‘of’** and **‘from’** while calculating **sacrificing ratio** of existing partners.
- Share of Goodwill not brought by Incoming (New) partner, the amount not brought by the Incoming (New) partner may be debited to his **Capital** or **Current Account**.
- But Incoming (New) partner does not bring his share of goodwill and Capitals of old partners is adjusted on the basis of Incoming (New) partner’s Capital or Incoming (New) partner brings Capital proportionate to Capital of the firm, it should be debited to his **‘Current Account’.**

- **Realisation Expenses** to the extent borne by the firm is debited to Realisation Account. It is important to understand the adjustment. In a hurry to complete the Question Paper, entry is wrongly passed. (See following Slides on Realisation Expenses)
- In case**, Realised Value** of an asset is not given, it should be considered that the asset has **not** realised any amount.

Journal Entries of Realisation Expenses

Mode of Payment	Journal Entry
1. When Realisation Expenses are paid by firm.	Realisation A/c …Dr. To Cash/Bank A/c
2. When Realisation Expenses are borne by firm and paid by a partner.	Realisation A/c …Dr. To Concerned Partner's Capital A/c
3. When Realisation Expenses are borne and paid by the same partner. *Or* When Expenses are paid by a partner who has to bear such expenses.	No Entry
4. When Realisation Expenses are borne by a partner and paid by the firm.	Concerned Partner's Capital A/c ...Dr. To Cash/Bank A/c
5. When any of the partner agrees to do dissolution work for an agreed remuneration.	Realisation A/c ...Dr. To Concerned Partner's Capital A/c
6. When Realisation Expenses are to be borne by one partner (Say *X*) and paid by other partner (Say *Y*).	*X*'s Capital A/c ...Dr. To *Y*'s Capital A/c

Notes: 1. As per CBSE guidelines, if Realisation Expenses are borne by a partner, then clear indication should be given regarding the payment thereof.

2. If the question is silent about the treatment of Realisation Expenses it is assumed that the firm has met the liability.

Some Cases of Treatment of Realisation Expenses

Realisation or Realisation expenses amounted to Rs. 10,000.

Ans.: It means firm is to bear Realisation Expenses. Therefore, entry is:

Realisation A/c	… Dr.	10,000	
To Cash / Bank A/c			10,000

Realisation expenses amounted to Rs. 5,000 paid by a partner '*X*'.

Ans.: It means firm is to bear Realisation Expenses but, paid by 'X' a partner. Therefore, entry is:

Realisation A/c	… Dr.	5,000	
To X's Capital A/c			5,000

Some Cases of Treatment of Realisation Expenses

'*X*' a partner, agreed to take over the responsibility of completing dissolution at an agreed remuneration of Rs. 5,000 and to bear all Realisation expenses. Realisation expenses amounted to Rs. 4,000 were paid by *X* out of his private funds.

Ans.: X is to be paid remuneration of Rs. 5,000 and it includes Realisation Expenses also. Therefore, firm is to bear Realisation Expenses of Rs. 5,000 and not Rs. 9,000 (Rs. 5,000 + Rs. 4,000). Realisation Expenses are paid by X. Journal entry will be:

Realisation Expenses A/c	.Dr.	5,000	
To X's Capital A/c			5,000

Some Cases of Treatment of Realisation Expenses

'*X*' a partner agreed to take over the responsibility of completing dissolution at an agreed remuneration of Rs. 5,000 and to bear all Realisation expenses. Actual Realisation expenses amounted to Rs. 4,000 were paid by the firm.

Ans.: X is to be paid remuneration of Rs. 5,000 and it includes Realisation Expenses also. Therefore, firm is to bear Realisation Expenses of Rs. 5,000 and not Rs. 9,000 (Rs. 5,000 + Rs. 4,000). Realisation Expenses are paid by the firm and not X i.e., firm has paid expenses on behalf of X. Journal entry will be:

		Dr.	Cr.
Realisation Expenses A/c	...Dr.	5,000	
To X's Capital A/c			5,000
X's Capital A/c	…Dr.	4,000	
To Cash / Bank A/c			4,000

Company Accounts: Share Capital

- Share Capital Account is debited with the amount called-up till the date of forfeiture.
- Forfeited Shares Account is credited with the amount received by the company and forfeited by it.
- Amount not received is credited to respective Call Account, if the arrears amount is not transferred to Calls–in–Arrears Account.
- Calls-in-Arrears Account must be used where the question requires use of the account.
- Maximum Discount allowed on reissue of forfeited shares can be the amount forfeited.

- When forfeited shares are reissued, transfer the gain on reissued shares to Capital Reserve.
- It is important to understand the language in the question. Some examples of language used for reissue of forfeited shares and their meaning are discussed below.

1. Shares issued for Rs. 9 paid–up, means that Share Capital Account is to be credited by Rs. 9 per share. Re. 1 is receivable from the shareholder.
2. Shares issued for Rs. 10, as Rs. 9 paid-up, means that Rs. 9 is the paid-up value of the share and is credited to Share Capital Account and Re. 1 is received towards securities premium.

3. Shares issued for Rs. 8 as fully paid–up. It means that Share Capital Account is to be credited with Rs. 10 per share. Rs. 2 is the discount allowed, which is debited to Forfeited Shares Account.
4. Shares issued for Rs. 9, as Rs. 9 paid-up. It means that Rs. 9 is the paid-up value of the share and credited to Share Capital Account and no discount is allowed on the reissued shares.

Company Accounts: Debentures

Important Points on Debentures

- When debentures amount is received in lump sum, an account titled "Debentures Application and Allotment Account" is used.
- When debentures amount is received in instalments, an account titled "Debentures Application Account" is used.
- When debentures are issued for Consideration Other than Cash, number of debentures to be issued are determined by dividing the Consideration Amount by the Issue Price.
- Debentures are prefixed with the rate of interest (say) 9% Debentures. 9% is the per annum rate of interest of interest.

- Debentures whenever credited (issued) or debited (redeemed), like share capital, will be credited or debited by the nominal (face) value, if amount received in lump sum.
- Interest is paid on the nominal (face) value of the debentures.
- Premium received on debentures is credited to Securities Premium Reserve Account.
- Securities Premium Reserve can be used for the purposes specified in section 52(2) of the Companies Act, 2013.

Section 52(2) of the Companies Act, 2013 prescribes that Securities Premium Reserve can be used for:

- Issue of unissued shares of the company to the members as fully paid bonus shares;
- Writing off preliminary expenses;
- Writing off expenses of, or commission paid or discount allowed on, any issue of shares or debentures of the company;
- Providing premium payable on redemption of any redeemable preference shares or any debentures of the company; or
- Purchase of its own shares or other securities.

- In case, question does not specify when premium is collected, it is presumed to have been collected along with Debentures Allotment Money.
- In case, question does not specify when discount is allowed, it is presumed to have been allowed along with Debentures Allotment Money.
- After redemption of all the debentures, DRR is transferred to General Reserve.
- Debentures issued as Collateral Security can be shown:

  (a) by way of note disclosed under the loan; or

  (b) by passing a journal entry as follows:

  Debenture Suspense A/c …Dr.

  To …% Debentures A/c
- Interest is not paid on Debentures issued as Collateral Security.

Important Points on Issue of Debentures

- Debentures are shown in the Balance Sheet under the main head "**Non – current Liabilities**" and sub – head "**Long Term Borrowings**" if the date of redemption is **not** given.
- Debentures maturing within 12 months from the date of Balance Sheet or within the period of Operating Cycle is shown under the main – head "**Current Liabilities**" and sub – head "**Other Current Liabilities**" as "**Current Maturities of Long – term Debts**".

Important Points on Issue of Debentures

- Discount allowed on issue of debentures and premium payable on redemption of debentures, if any, is debited to “Loss on Issue of Debentures Account”. Discount or Loss on Issue of Debentures is written off over the life of the debentures.
- Loss on Issue of Debentures to be written off after 12 months from the date of Balance Sheet or after the period of Operating Cycle is shown as Other Non-current Assets under Non-current Assets.
- Loss on Issue of Debentures to be written off within 12 months from the date of Balance Sheet or within the period of Operating Cycle is shown as Other Current Assets under Current Assets.

Debenture Redemption Reserve
and
Debenture Redemption Investment

Debenture Redemption Reserve

The Companies Act, 2013 [Section 71(4)] prescribes that:

- a company shall create DRR;
- out of profits available for payment of dividend; and
- the amount credited to DRR will not be used for purposes other than redemption of debentures.

Rule 18(7)(b) of the Companies (Share Capital and Debentures) Rules, 2014 has prescribed:

- that a company shall transfer an amount <u>at least</u> equal to 25% of the nominal (face) value of <u>total outstanding</u> redeemable debentures.

Rule 18(7)(c)

Rule 18(7)(c) of the Companies (Share Capital and Debentures) Rules, 2014 has prescribed:

- that a company shall invest an amount
- **<u>not less than</u>**15% of the nominal (face) value of the debentures
- to be redeemed (maturing) ***<u>during the year ending (i.e.,by)</u>*** 31st March of the next year
- in specified securities
- ***<u>on or before</u>*** 30th April of the year.

Amount to be transferred to DRR

If Question is silent	If Redemption is out of Profit	If DRR amount is given in the question
Create DRR of amount equal to 25% of the Nominal (Face) Value of total Redeemable Debentures	Create DRR of amount equal to 100% of the Nominal (Face) Value of total Redeemable Debentures	Create DRR of amount as stated in the question

Companies not to create DRR

- **When Debentures are Convertible**

  DRR is not created on Convertible Debentures or Convertible part of partly Convertible Debentures.

- **Following class of Companies are exempt from creating DRR**:

  1. All India Financial Institutions, regulated by Reserve Bank of India;
  2. Other Financial Institutions (Like LIC)
  3. Banking Companies; and
  4. National Housing Bank.

Question

Global Bank Ltd. is to redeem 8% Debentures of nominal (face) value Rs. 50,00,000 and has credit balances as on 31st March, 2016 as follows:

General Reserve	Rs. 10,00,000;
Surplus i.e., Balance in Statement of Profit and Loss	Rs. 15,00,000.

Pass the necessary journal entries?

Solution

Entries for DRR and DRI will not be passed, it being a banking company and hence, is exempt from creating DRR. Because it is exempt from creating DRR, it will also not create DRI.

The entries will be passed only for amount due to debenture-holders and thereafter for payment of due amount.

CANCELLATION OF OWN DEBENTURES BY PURCHASE FROM OPEN MARKET

Solution

- In the Compartment Examination, CBSE solution is given whereby journal entries for purchase of Own Debentures for Cancellation and their cancellation were passed as are given in the Second Approach.

Journal Entries for Redemption

By Purchase from Open Market for Immediate cancellation (First Approach)
On Purchase
…% Own Debentures A/c …Dr. To Bank A/c (Being … own debentures purchased @ Rs. …. plus Brokerage of Rs. ….for immediate cancellation)

Second Approach

…% Own Debentures A/c	…Dr.	(At purchase price)
Expense on Purchase of Own Debentures A/c	…Dr.	(Expense say Brokerage)
To Bank A/c		
(Being … own debentures purchased @ Rs. …. and Brokerage of Rs. ….paid)		

On Cancellation of Own Debentures Redeemable at Par

…% Debentures A/c …Dr.

Loss on Cancellation of

Own Debentures A/c …Dr. [Amount of Loss]

To Own Debentures A/c [Amt. of purchase]

To Exp. On Purchase of Own Debentures A/c

To Gain (Profit) on Cancellation

of Own Debentures A/c [Diff. Between Nominal (Face) Value and Purchase Cost]

(Being the Own Debentures purchased now cancelled resulting in loss / gain)

When Debentures are Redeemable at Premium

…% Debentures A/c …Dr.
Premium on Redemption
of Debentures A/c …Dr.
Loss on Cancellation of
Own Debentures A/c …Dr. [Amt. of Loss]
To Own Debentures A/c [Amt. of purchase]
To Exp. on Purchase of Own Debentures A/c
To Gain (Profit) on Cancellation
of Own Debentures A/c
(Being the Own Debentures purchased
now cancelled, gain (profit) of Rs. …. recorded)

Journal Entries on Cancellation

Transfer of Gain (Profit)

Gain (Profit) on Cancellation
of Own Debentures A/c ...Dr.
To Capital Reserve A/c
(Being the gain (profit) on cancellation transferred to Capital Reserve)

Transfer of Loss

Statement of Profit and Loss A/c …Dr.

To Loss on Cancellation of

Own Debentures A/c

(Being the gain (profit) on cancellation transferred to Capital Reserve)

Cash Flow Statement

Operating Activities

These are the principal revenue-producing activities of the enterprise and those activities which are not Investing or Financing Activities.

Investing Activities

These are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Financing Activities

These are activities that result in change in the size and composition of the owners' capital and borrowings of the enterprise.

Extraordinary Activities

These are incomes or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly.

Students are advised to understand the definitions of Operating Activity, Investing Activity, Financing Activity and Extraordinary Items. It will help them classifying items when preparing Cash Flow Statement.

Important Adjustments

- **Proposed Dividend**

  Proposed Dividend of Current Year is added under Operating Activities and Previous Year's Proposed Dividend is deducted under Financing Activities.

- **Interim Dividend**

  Interim Dividend of Current Year is added under Operating Activities and deducted under Financing Activities.

- **Unpaid Dividend**

  Unpaid Dividend is shown as Current Liability in the Balance Sheet. It means that it is unpaid out of Previous Year's Proposed Dividend.

Contd/---

Dividend

- Increase in Unpaid Dividend (as compared to previous year's Unpaid Dividend) is deducted from Previous Year's Proposed Dividend while decrease in Unpaid Dividend is added to payment of dividend during the year under Financing Activity.
- Dividend Paid is shown as Financing Activity.
- Dividend Received by financial companies is shown as **Operating Activity;**
- Dividend Received by companies other than financial companies is shown as **Investing Activity**;
- Dividend Paid is shown as **Financing Activity..**

Important Adjustments

- **Tax Paid and Provision for Tax**

  Tax Paid is added to Net Profit to determine Net Profit Before Tax and Extraordinary Items and shown as outflow under Operating Activity unless it is identified with items of Investing Activity or Financing Activity.

  Tax Paid should be shown at net of refund.

  In case, Opening and Closing Balances of Provision for Tax is given, Provision for Tax for Current Year is added to determine Net Profit before Tax and Extraordinary Items and Provision for Tax of Previous Year is deducted considering it as paid in the Current Year.

  In case Tax provided during the year is given, Provision for Tax Account should be prepared to determine tax paid during the year.

Important Adjustments

- Fixed Assets Sale or Purchase, prepare Fixed Asset Account to determine purchase or sale of fixed assets.

Treatment of Interest in Cash Flow Statement

- Interest Received on Investment is shown as **Investing Activity**;
- Interest Received on Investment by a Financing Company is shown as **Operating Activity**;
- Interest Received on Marketable Securities is shown as **Operating Activities**.
- Interest Paid on loans / debts is shown **Financing Activities**;
- Interest Paid on loans by a financing company is **Operating Activity**.
- Interest Paid on Debentures by a company is **Financing Activity**.

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