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ADVANCED ACCOUNTING

SYNOPSIS

B.Com II Year III Sem

ADVANCED ACCOUNTING

B.Com-II Year III Sem

SUBJECT :

ADVANCED ACCOUNTING

Unit No.	Unit Name	Unit Description
1.	Partnership Accounts-I	Meaning — Partnership Deed - Capital Accounts (Fixed and Fluctuating) — Admission of a Partner — Retirement and Death of a Partner (Excluding Joint Life Policy)(Including problems).
2.	Partnership Accounts — II	Dissolution of Partnership — Insolvency of a Partner (excluding Insolvency of all partners) — Sale to a Company (Including problems).
3.	Issue of Shares, Debentures, Underwriting and Bonus Shares	Issue of Shares at Par, Premium and Discount - Prorata Allotment — Forfeiture and Re-issue of Shares — Issue of Debentures with Conditions of Redemption — Underwriting: Meaning — Conditions - Bonus Shares: Meaning — SEBI Guidelines for Issue of Bonus Shares — Accounting of Bonus Shares(Including problems).

Unit No.	Unit Name	Unit Description

4.	Company Final Accounts and Profit Prior to Incorporation	Companies Act 2013: Structure — General Instructions for preparation of Balance Sheet and Statement of Profit and Loss — Part-I: Form of Balance Sheet -- Part-II: Statement of Profit and Loss — Preparation of Final Accounts of Companies - Profits Prior to Incorporation - Accounting treatment. (Including problems).
5.	Valuation of Goodwill and Shares	Valuation of Goodwill: Need — Methods: Average Profits, Super Profits and Capitalization Methods - Valuation of Shares: Need — Net Assets, Yield and Fair Value Methods. (Including problems).

UNIT –I
PARTNERSHIP ACCOUNTS - I

After studying this unit, one would be able to understand

- Meaning and Features of Partnership.
- Kinds of Partners.
- Rights, Duties and Powers of Partners.
- Meaning and Contents of Partnership Deed.
- Legal Provisions in the absence of Partnership Deed.

PARTNERSHIP ACCOUNTS-I

- Fixed and Fluctuating methods of maintaining Capital Accounts.
- Admission of a Partner and various adjustments at the time of Admission.
- Retirement of a Partner and various adjustments at the time of Retirement.
- Death of a Partner and Adjustments on death of a Partner.

Partnership Deed

When the agreement between the partners is in written form,

it is partnership deed. It should be duly signed by stamped and registered and can be easily

altered with the mutual consent of all the partners.

Cartents of Partnership Deed

- Partnership deed contains the following,
- Name of the firm.
- Nature of the business.
- Names of the Partners. Place of the business.
- Capital contributed by all the partners. Profit-sharing ratio.
- Loans and advances, rate of interest on Loans.

Sacrificing Ratio and Gaining Ratio

The basic differences between Sacrificing Ratio and Gaining Ratio are,

Basis of Differences		**Sacrificing Ratio**	**Gaining Ratio**
1.	Meaning	Sacrificing ratio refers to the ratio in which old partners sacrifices their share in favour of newly admitted partners.	Gaining ratio refers to the ratio in which continuinz 1 partners gain from the retired partner or deceasec partner.
2.	Objective	The objective behind computing sacrificing ratio is to ascertain the compensation to be paid to the sacrificing partners by the new partner.	The objective behind computing gaining ratio is to ascertain the compensation to be paid to the retired or deceased partner by the continuing partners.
3.	Formula	Sacrificing Ratio = Old Ratio — New Ratio	Gaining Ratio = New Ratio — Old Ratio
4.	When it is calculated	Sacrificing ratio is calculated under two situations, + Admission of a Partner.	Gaining ratio is calculated under three situations, + Retirement of a Partner.

Write a brief note on sacrificing ratio and gaining ratio.

Sacrificing Ratio:

- Sacrificing ratio arises when old Partners
- foregoes/sacrifices some part of their share in favour of the newly admitted

Vie- Such share will be

- reduced from the sharing ratio of old partners and then new profit sharing

will be calculated to future

- profits among old and new partners.
- Sacrificing ratio is calculated with the help of the formula:

- Sacrificing ratio = Old ratio — New ratio

Example

X and Y are the partners sharing profit and losses in the ratio of 3 : 2 and later on they admitted Z into their business. After the admission of Z, the new profit sharing ratio of all partner in 5 : 3 : 1. Calculate sacrificing ratio.

Sacrificing Ratio = Old Share — New Share

Sacrificing ratio of X and Y is 2 : 3 IN **Ratio**

Gaining ratio is the ratio calculated at the time of retirement of a partner from a firm. If the new ratio is not calculated

Remaining after partners follow the old ratio for sharing profits Retirement of partner i.e., they gain in old ratio.

le

A. **B & C are partners who share profit and losses in ratio of 4 : 3 : 2. C retires from the firm.**

Ascertain the gaining ratio of A and B, if A and B decided to share profits and losses equally in future.

CAPITAL ACCOUNTS (FIXED AND FLUCTUATING) :

What are the two methods available for maintaining capital accounts of partners?

were are two methods available for maintaining the

capital accounts of partners.

The partnership firm can adopt among them.

They are namely, Fixed capital method and fluctuating capital method,

Methods for maintaining capital accounts .

1. Fixed capital method
2. Fluctuating capital method

Capital Accounts Methods Fixed Capital Method

Under fixed capital method, the Capital brought by each partner
remain fixed Year by year.
A capital account is opened
partner and the amount contributed by respective partner while joining will be shown in this account.
Apart from account, a separate current account is also maintained for each partner.

All the adjustments such as drawings, interest tal, salary, profit, commission etc., are recorded in current account.
The current account will be
balanced at the end and if
there is any credit balance, it w
ill be
shown in the liabilities pmr :
Balance Sheet.
Both the current account and
capital
account appears in the Balance
Sheet at liabilities side.

Proforma

Dr. **Capital Account** Cr.

Particulars	John (Z)	Akhil (Z)	Particulars	John (Z)	Akhil (')
To Cash/Bank a/c (Withdrawal of capital) To Balance c/d	xxx xxx	xxx xxx	By Balance b/d By Cash/Bank a/c (Additional Capital)	*xxx* xxx	*xxx* xxx
	xxx	xxx		xxx	xxx

UNIT -2

Partnership Accounts -II,

LEARNING OBJECTIVES

After studying this unit, one would be able to understand,

- The concept of Dissolution of Firm and Partnership Firm.
- Reasons and Modes of Dissolution of Partnership Firm.
- Differences between Realization Account and Revaluation Account.
- The concept of Insolvency and Insolvency of a Partner. The special case of Garner Vs. Murray of Insolvency.
- The concept of Sale to a Company.

Q . What do you mean by dissolution of firm and partnership?

A:-

In Indian Partnership Act, 1932 determines the variations that exist between the 'dissolution of partnership' and 'dissolution of firm'. The Indian Partnership Act, 1932 defines these two terms under sec. 39 as, "the dissolution of partnership between all the partners of a firm is called the dissolution of the firm". The dissolution of a firm occurs when partnership completely collapse and partners are not willing to continue with the firm. Where dissolution of the partnership refers to restructuring of the firm because of some reasons such as the retirement of a partner or the insolvency of the partner or the death of a partner and willingness of remaining partners to continue with the firm to accomplish the expressed or implied agreement to that effect. At the time of dissolution of a firm, the assets of the firm are realized and the liabilities are discharged and in case of dissolution of partnership, the share of outgoing partner is identified but firm is not closed.

Q :Rama and Shyama are partners sharing profits and losses as to two-thirds and one-third respectively. On 1St January, 2009 they dissolved partnership. Their books at the date shows the following,

Dr. **Cr.**

Particulars	Amount (t)	Particulars	Amount (t)
Book-debts	35,000	Bank overdraft	1,560
Stock	17,000	Sundry creditors	24,440
Investments	9,000	Capitals:	
Goodwill	20,000	Rama	40,000
Trade furniture	4,400	Shyama	20,000

The stock realized 75% of its book value and the book debts 27,800. Trade furniture was sold for 5,000.

Goodwill proved unrealizable. Investments were taken over by Rama for Z 12,000. Prepare realization account

Realisation A/c

Dr. Cr.

Particulars		Amount (')	Particulars		Amount (?)
To Sundry Assets:					
Book-debts	35,000		By Sundry Liabilities:		
Stock	17,000		Bank overdraft	1,560	
Investments	9,000		Sundry creditors	24,440	26,000
Goodwill	20,000		By Bank (Assets Realized):		
Trade furniture	4,400	85,400	Stock	12,750	
			Book debts	27,800	
			Trade furniture	5,000	45,550
To Bank (Liabilities discharged):			By Rama (Investments)		12,000
Bank Overdraft		1,560	By Loss:		
Sundry Creditors		24,440	Rama's capital a/c		18,56ˉ
			Shyama's capital a/c		9,28
		1,11,400			**1,11,400**

Journal Entries

Particulars			Debit Amount (Z)	Credit Amount (Z)
1.	When assets are transferred to realisation account: Realisation a/c To Sundry Assets a/c (Being all assets except cash and bank balance are transferred individually to realisation a/c)	Dr.	xxx —	— xxx
2.	When liabilities and provisions are transferred to realisation account: Sundry liabilities a/c Provisions a/c To Realisation a/c (Being liabilities and provision transferred to realisation account)	Dr. Dr.	xxx	— xxx

Particulars			Debit Amount (Z)	Credit Amount (Z)
3.	When assets are sold: Bank /cash a/c To Realisation a/c (Being assets sold in market)	Dr.	xxx —	— xxxx
4.	When liabilities are paid/discharged: Realisation a/c To Bank/Cash a/c (Being liabilities amount paid)	Dr.	xxx —	— xxx
5.	When assets are purchased by partners: Partner's capital a/c To Realisation a/c (Being assets purchases by a partner)	Dr.	. xxx —	— xxx

6.	When liabilities are paid/discharged by partners: Realisation a/c	**Dr.**	, **xxx**	—
	To Partner's capital a/c		—	xxx
	(Being liabilities amount paid/discharged by partners)		xxx	—
7.	When expenses incurred on realisation:	Dr.	—	xxx
	Realisation a/c		xxx	—
	To Cash/Bank a/c		xxx	—
	(Being expenses on realisation paid)		—	'km(
8.	When expenses incurred on realisation is paid by partners:	Dr.	xxx	-
	Realisation a/c		—	xxx
	To Partners capital a/c		xxx	—
	(Being realisation expenses paid by partners)		xxx	—
9.	When profit on realisation is transferred to partners accounts:	Dr.	xxx	-
	Realisation a/c		xxx	xxx
	To Partners capital a/c		—	—
	(Being profit on realisation transferred to partners accounts)		xxx	xxx
10.	When loss on realisation transferred to partners accounts:	Dr.	—	-
	Partner's capital a/c's To realisation a/c		xxx	xxx
	(Being loss on realisation transferred to partners capital accounts)			xxx
11.	When partners loan is paid:	Dr.		
	Partner's loan a/c			
	To Bank/cash a/c (Being partners loan paid)			
12.	When reserves and accumulated profit and loss a/c credit	Dr.		
	balances are transferred:	Dr.		
	Reserves a/c Profit and loss a/c			
	To Partner's capital a/c's			
	(Being reserves and accumulated balances transferred to partners account)			
13.	When partners accounts are closed:	Dr.		
	Partners capital a/c's			
	To Bank/cash a/c			
	(Being Partners accounts closed)			

14.	When accumulated profit and loss a/c debit balance are transferred: Dr. Partners capital a/c's To Profit and loss a/c (Being credit balance loss of accumulated profit and loss transferred)		
15.	When amount bought by partners from their private estates: Dr. Bank/Cash a/c To Partners capital a/c (Being amount by partners from their private estates to settle down the realisation process)		

UNIT-3

ISSUE OF SHARES, DEBENTURES, UNDERWRITING AND BONUS SHARES

LEARNING OBJECTIVES

After studying this unit, one would be able to understand,

- ❖ Concept of Company and its Features, Merits and Limitations.
- ❖ Meaning of Shares and its types i.e., Equity and Preference Shares.
- ❖ Issue of Shares at Par, Premium and Discount
- ❖ Concept of Prorata Allotment of Shares.
- ❖ Meaning of Forfeiture and Re-issue of Forfeiture Shares.
- ❖ Issue of Debentures with conditions of Redemption.
- ❖ Concept of Underwriting and its Conditions.
- ❖ Meaning of Bonus Shares, Guidelines issued by SEBI and Accounting of Bonus Shares.

Q : Distinguish between Debentures and Shares.

Answer :

The differences between Shares and Debentures are as follows,

Basis		Shares	Debentures
1.	Meaning	Shares are considered as a part of the owned capital.	Debentures are regarded as the acknowledged debt.
2.	Nature	Shares are usually irredeemable in nature.	Debentures are redeemable only after specific period of time.
3.	Method of Financing	Shares are used as a method of long-term financing.	Debentures are used as method of both i.e., long and medium-term financing.
4.	Issuer	Companies with unsound financial position issues shares.	Companies with comparatively low financial position issues debentures.
5.	Mode of payment	Dividends is paid on shares.	Interest is paid on debentures.

Write short notes on equity shares and preference shares.

Answer:

Equity Shares

Equity shares represent ownership position in a company. Equity holders are owners of the company and elect the board of directors and enjoy voting right. Equity share capital is also called as risk capital, because if the company is not performing well, the holders of the equity shares are sufferers and if the company is doing well they will reap the benefits.

Preference Shares

Preference shares holds a preferential right over the equity shares with respect to the dividend. This right is also applicable at the time of payment of capital, repayment of capital or winding up.

Journal Entries in the Books of Harsha Ltd.

S.No.	Particulars		LF No.	Debit (')	Credit (Z)
(i)	Bank a/c (10,000 x 5) To Equity Share Application a/c (Being the share application money received)	Dr.		50,000	50,000
(ii)	Equity Share Application a/c To Equity Share Capital a/c (Being the transfer of share application account)	Dr.		50,000	50,000
(iii)	Equity Share Allotment a/c (10,000 x 5) To Equity Share Capital a/c (Being the share allotment amount due)	Dr.		50,000	50,000
(iv)	Bank a/c To Equity Share Allotment a/c (Being the Share allotment amount received)	Dr.		50,000	50,000

Application for Shares

Firstly, the investors must fill in the application for shares. After receiving the share amount along with the application the following entry is made,

Allotment of Shares

Secondly, after receiving the share applications along with the application amounts the company allots the shares. The company's acceptance of applicants offer to take up the shares is known as allotment of shares. The allotment of shares 'rings into existence a contract between the members and the applicants. The following entries are made under.

Date	Particulars	LF No.	Debit (Z)	Credit (Z)
	Bank a/c Dr. To Share Application a/c (Being amount received on application of shares)		xxx	xxx

Date	Particulars	L/F	Debit	Credit
(a)	**Transferring application money:** Dr. Share Application a/c... To Share Capital a/c (Being application money transferred)		xxx —	— xxx
(b)	**Rejected excess application money refunded:** Dr. Share Application a/c.. To Bank a/c (Being application amount refunded)		xxx	— xxx
(c)	**Allotment amount due:** Dr. Share Allotment a/c.. To Share Capital a/c (Being amount due on share allotment)		xxx —	— xxx
(d)	**Excess application money adjusted:** Dr. Share Application a/c.. To Share Allotment a/c (Being excess application amount adjusted with due allotment amount)		xxx —	— xxx
(e)	**Allotment amount received:** Dr. Bank a/c ... To Share Allotment a/c (Being allotment amount received)		xxx	xxx

Q. Talat Ltd. issued 10,000 equity shares of Z 10 each at a premium of Z 2 per share payable 2 on application, 5 on allotment (inlcuding premium) 3 on first call and balance on final call. The shares were all subscribed and amount received on calls except the first call on 2000 shares and final call on 3000 shares. These shares were forfeited and reissued at a later date at the rate of Z 7 per share. Give journal entries to record the above transactions.

Solution

Journal Entries in the Books of Talat Ltd.

Date	**Particulars**	**LF No.**	**Debit (!)**	Credit **(!)**
1.	Bank a/c (10,000 x 2) Dr.		20,000	—
	To Share Application A/c			20,000
	(Being share application amount received for 10,000 shares @ ! 2 each)			
2.	Share Application A/c Dr.		20,000	
	To Share Capital A/c			20,000
	(Being share application amount transferred for share capital a/c)			
3.	Share Allotment A/c (10,000 x 5) Dr.		50,000	
	To Share Capital A/c (10,000 x 3)			30,000
	To Securities Premium A/c (10,000 x 2)			20,000
	(Being allotment amount due with premium)			
4.	Bank A/c Dr.		50,000	
	To Share Allotment A/c			50,000

	(Being share allotment with premium received)			
5.	Share First Call A/c (10,000 x 3) Dr. To Share Capital A/c (Being first call money due on 10,000 shares @ Z 3)		30.000	 30,000

6.	Bank A/c Dr. To Share First Call A/c (Being first call money received for 8,000 shares @ ? 3)		24,000	 24,000
7.	Share Final Call A/c (10,000 x 2) Dr. To Share Capital A/c (Being final call money due on 10,000 shares @ Z 2)		20,000	 20,000
8.	Bank A/c Dr. To Share Final Call A/c (Being final call money received for 7,000 shares @ Z 2)		14,000	 14,000
9.	Share Capital A/c (5,000 x 10) Dr. To Share First Call A/c (2,000 x 3) To Share final call (3,000 x 2) To Forfeited Shares A/c (2,000 x 7)		50,000	 6,000 6,000 38,000

	(Being 2,000 shares forfeited due to non-payment of first call)			
10.	Bank A/c (5,000 x 7) Dr.		35,000	
	Forfeited Shares A/c (5,000 x 3) Dr.		15,000	
	To Share Capital A/c (5,000 x 10)			50,000
	(Being forfeited shares re-issued)			
11.	Forfeited Shares A/c (38,000 - 15,000) Dr.		23,000	
	To Capital Reserve A/c			23,000
	(Being forfeited shares transferred to capital reserve account)			

Debenture

- Debenture holders do not have 'right to vote'.
- They are always made under the company seal.
- Debenture holders get specified rate of interest at specified time.
- The holders of debenture bear less risk.
- They are not a permanent capital.
- The holders of debenture are creditors of the company.
- Generally, debentures are secured.
- From company's perspective, raising long term finance through debentures is highly risky.

Types of Debentures

There are many types of debentures.

Some of them are,

as unsecured debentures

Secured Debentures

These debentures posses security over assets of the company and have right to sell them off in case of

default in

Unsecured Debentures

These debentures do not avail any security on assets and at the time of winding-up of a company, they

are considered

payment of interest or principle amount.

Redeemable Debentures

These debentures can be redeemed after specific period from their issue.

Irredeemable Debentures

These debentures can be redeemed only at the time of winding up of the company.

Guaranteed Debentures

Generally, third party like government, banks, etc., guarantees the payment of interest and principle

amount of these

Advantages of debentures

- Investors of debentures get definite, secure and uniform income.
- Debentures have a specific maturity period which attract many investors.
- SEBI have issued many guidelines, and debenture trust deed have provided many provisions to protect the interest of debenture-holders.

Disadvantages of Debentures

- Debenture holders do not posses any authority over management, as they do not have any voting rights.
- Debenture holders must pay full tax on interest gained.
- Debenture holders just play the role of creditors, they do not posses any share in surplus profits or assets of the company.

PROBLEM :

Q1. Journalise the following transaction only at the time of issue of debentures

(a) **A company issued 90,000, 13%. Debentures at a discount of 10% redeemable at par.**

(b) **A company issued Z 90.000, 13% debentures at par redeemable at 10% premium.**

(c) **A company issued 90,000, 13% debentures at a discount of 10% and redeemable at 5% premium**

The face value of debenture is Z 100.

Solution :

Journal Entries at the time of Issuing Debenture

Date	Particulars		L/F	Debit (!)	Credit (!)
(a)	Bank a/c	Dr.		81,000	
	Discount on issue of debentures a/c	Dr.		9,000	
	To Debentures a/c				90,000
	(Being the 13% debentures issued for of ! 90,000 at a discount of 10% and redeemable at par)				
(b)	Bank a/c	Dr.		90,000	
	Loss on issue of debenture a/c	Dr.		9,000	
	To 13% debentures a/c			—	90,000
	To Premium on redemption of debenture a/c				9,000
	(Being the 13% debentures issued at par Z 90,000 and redeemable at 10% premium)				
				81,000	

(c)	Bank a/c	Dr.			
	Discount on issue of	Dr.		9,000	
	debentures a/c				
	Loss on issue of debentures a/c	Dr.		4,500	
	To Debentures a/c				90,000
	To Premium on redemption of debenture a/c				4,500
	(Being debenture issued at discount 10% and				
	redeemable at premium of 5%)				

BONUS SHARES — MEANING, SEBI GUIDELINES FOR ISSUE OF BONUS SHARES

Q : What do you understand by bonus shares? State its advantages and limitations.

Answer :

Bonus Shares

Bonus shares are those shares which are given by the company to its shareholders as a bonus or gift. Bonus can be in any form either cash or shares. When company is not in a position to give bonus in cash, it issue bonus shares.

The meaning of bonus shares in dictionary is "an extra dividend paid to shareholders in a joint stock company from surplus profit". Bonus shares are referred as shares allotted by capitalization of the reserves or surplus of a corporate enterprise. Profits of the company are converted into share capital with issue of bonus shares. Capital structure of the company is not influenced by issuing of shares as it is capitalizing shareholders equity.

Bonus shares are useful to both shareholders as well as company in many ways.

Example

The extracts are given from the draft balance sheet of Modi Industries ltd. as on 31st Dec. 2007,

Liabilities	**Amount (Z)**
Authorized capital 15,000 equity shares of Z12 each	**1,80,000**
Issued and Subscribed capital:	
5,000 equity shares of Z12 each fully called up	**60,000**
Reserve fund	**26,000**
Profit and loss accounts	**17,000**

The board of directors have passed a resolution, to capitalize a part of existing reserves and profits by issuing bonus shares. One bonus share is being issued for every 5 equity shares held at present. For this purpose, Z 8,000 are to be provided out of reserve fund and the remaining out of profit and loss account.
Set out the journal entries to give effect to the resolution and show how they would affect the balance sheet of the company.

UNIT-IV

COMPANY FINAL ACCOUNTS AND PROFIT PRIOR TO INCORPORATION

LEARNING OBJECTIVES

After studying this unit, one would be able to understand,

- **Concept of Companies Act, 2013.**
- **General Instructions (Provisions) for preparation of Balance Sheet** and Statement of Profit and Loss.
- Proformas of Company's **Balance Sheet and Profit and Loss Account.**
- **Concept of Profit Prior to Incorporation.**
- Methods and Accounting Treatment of Profit or Loss Prior to Incorporation.

Q: company/Joint Stock Company

A company or joint stock company defined by Justice Marshal in the court as, "A corporation is an artificial being, visible, intangible and existing only in contemplation of the law. As an artificial person created by law, it possesses the laracters of perpetual succession and a separate legal entity"

.

Objectives of Company

The company law has been enforced for integrating and modifying the other laws associated with companies and her associations. This law aims to accomplish certain important objectives which are as follows,

- To increase and promote investments.
- To assure appropriate administration
- To avoid or prohibit malpractices.
- To approve and allow investigate .

Modern (Vertical) Proforma of Balance Sheet
Balance Sheet as on.........

Particulars	**Amount (Z)**	**Amount (')**
Sources of Funds		
I. **Equity and Liabilities**		
1. **Shareholders Funds:**		
(a) Share Capital		xxx
(b) Reserves and surplus:		
(i) General Reserve	xxx	
(ii) Profit and loss a/c surplus	xxx	xxx
2. Share application money pending allotment:		
3. Non-current liabilities:		
4. Current liabilities and provisions:		
(a) Short term borrowings		
(b) Trade Payables:		
(i) Bills payable	xxx	
(ii) Sundry creditors	xxx	xxx
(c) Short Term Provision:		
(i) Provision for taxation		xxx
Total Liabilities		**xxx**

Particulars	Amount (Z)	Amount ()
Applications of Funds		
II. **Assets**		
1. **Non-current Assets:**		
(a) Fixed Assets:		
(i) Tangible Assets:		
Buildings	xxx	
Plant and machinery	xxx	
Furniture xxx	xxx	
Less: Depreciation xxx	xxx	
(ii) Intangible Assets:		
Patents	xxx	xxx
Good will	xxx	
(b) Non-current investments		
(c) Long term loans and advances		
2. Current Assets:		
Cash at Bank	xxx	
Stock	xxx	
Bills receivables	xxx	
Debtors xxx		
Less: Reserve for bad debts xxx	xxx	xxx

Total Assets		**xxx**

Statement of Profit and Loss

Q23. What is a profit and loss account? What are its features? Show the proforma of profit and loss account.

Answer :

Profit and Loss Account

The profit and loss account is one of the financial statements which shows the net profit/loss position of the business during an accounting period. Under profit and loss account, all the indirect revenue expenses and losses (i.e., other than those shown on the debit side of the Trading Account) are shown on the debit side of the Profit and Loss Account, whereas all indirect revenue incomes (i.e., other than those shown on the credit side of the Trading Account) are shown on the credit side of the Profit and Loss Account. This account is closed by transferring its balance i.e., net profit or net loss to the Capital Account of the owner in case of a sole trading firm.

Features of Profit and Loss Account

Following are the features of profit and loss account,

1. It is based on the principle of nominal account.

2. It is a type of financial statement which is prepared at the end of accounting year.

3. It shows profit or loss position of the business.

4. It is prepared by considering all indirect incomes and expenses.

- The balancing figure of profit and loss

- account exhibits net profit or net loss of the

- business which is transferred to capital

- account under balance sheet-liabilities side.

Particulars	**Amount (')**	**Particulars**	**Amount (!)**
To Gross Loss b/d	xxxx	By Gross Profit b/d	xxxx
To Salaries a/c	xxxx	By Interest earned a/c	xxxx
To Rent, Rates and Taxes a/c	xxxx	By Commission received a/c	xxxx
To Fire Insurance Premium a/c	xxxx	By Rent earned a/c	xxxx
To Repairs and Maintenance a/c	xxxx	By Profit on Sale of fixed assets a/c	xxxx
To Depreciation a/c	xxxx	By Income from Investments a/c	xxxx
To Audit Fees a/c	xxxx	By Sale of Scrap a/c	xxxx
To Bank Charges a/c	xxxx	By Miscellaneous Incomes a/c	xxxx

Particulars	Amount (')	Particulars	Amount (!)
To Legal Charges a/c To Miscellaneous Expenses a/c To Discount Allowed a/c To Carriage Outwards a/c To Freight Outwards a/c To Commission to Salesman a/c To Travelling Expenses a/c To Entertainment Expenses a/c To Advertising and Publicity a/c To Bad Debts a/c To Packing Expenses a/c To Interest on Loan a/c To Loss by Theft a/c To Loss by Fire a/c To Loss by Embezzlement a/c To Net Profit (Transferred to Capital a/c)	xxxx xxxx xxxx xxxx xxxx xxxx xxxx xxxx xxxx xxxx xxxx xxxx xxxx xxxx xxxx xxxx	By Net Loss (Transferred to capital account) •	xxxx

	xxxx		xxxx

UNIT-5

VALUATION OF GOODWILL AND SHARES

LEARNING OBJECTIVES

After studying this unit, one would be able to understand,

- ❖ Concept of Goodwill, its Features, Need and Factors affecting the value of Goodwill.
- ❖ Components of Goodwill, Methods available for Valuation of Goodwill.
- ❖ The need for Valuation of Shares.
- ❖ Methods of Shares Valuation.

Q : Capital employed f 2,80,000 ; Average Profit 50,000 ; Normal rate of return is 10%. Calculate goodwill as two years purchases of super profit.

Calculation of Goodwill

Goodwill = Number of years of Purchase x Super Profits

= 2 x 22,000

= Z 44,000.

Working Notes

Normal Profit = Capital employed x Normal rate of return

= 2,80,000 x 10%

= Z 28,000

Super Profit = Average Profit — Normal Profit

= 50,000 — 28,000

Q3. **Capital employed ₹ 1,80,000; Average profit ₹ 20,000; normal rate of return is 10%. Calculate super profit.**

Answer :

Calculation of Super Profit

Super Profit = Average Profit — Normal Profit

= 20,000 — 18,000

= 2,000

Working Notes

Normal Profit = Capital employed x Normal rate of return

= 1,80,000 x 10%

= 7 18,000.

VALUATION OF GOODWILL: NEED, FEATURES, FACTORS AND COMPONENTS

Q. Define Goodwill. Explain its special features, need and factors affecting the valuation of goodwill.

Answer :

Goodwill

In a corporate world, the term "
Goodwill"
is an oftenly used term whose
meaning is
found to be ambigious as it is
complicated to define. However, it is
regarded as an invaluable asset
which is
intangible in nature.

VALUATION OF GOODWILL: NEED, FEATURES, FACTORS AND COMPONENTS

Goodwill is defined as "the ability of
a business to earn profits in future.
Goodwill
refers to the present value of a firm's
anticipated excess earnings".

Features of Goodwill

Goodwill of a business possesses
Some
special features which
differentiates itself
from the other type of assets which
includes the following,

Valuation of Goodwill

Q. In a deal goodwill was agreed to be valued at three years purchase of the weighted average profits of the previous five years, the weights being 1, 2, 3, 4, 5 respectively from first year to fifth year. Profits for these five years were ! **80,000; 86,000; 90,000; 98,000 and 1,04,000s in order. Determine the value of goodwill.**