

B.COM III SEMESTER
ADVANCED ACCOUNTING NOTES

THEORY NOTES

PARTNERSHIP

Meaning of Partnership

Partnership is a voluntary agreement between two or more persons to share profits and losses of a business carried on by all or any of them acting for all.

Explanation:

- Governed by the **Indian Partnership Act, 1932**.
- Partners contribute **capital, skill, labor, or property** to the business.
- Profit or loss is shared as per **mutual agreement**.

Features / Characteristics of Partnership

1. Agreement Between Two or More Persons

- Minimum **two persons** required; maximum **50 persons** (for general partnership under Indian law).
- Must be based on **mutual consent**.

2. Mutual Agency

- Each partner is an **agent of the firm** and can bind the firm in business transactions within the scope of partnership.

3. Sharing of Profits and Losses

- Profits and losses are shared among partners **according to the agreement**.
- If no agreement exists, **equally** among partners.

4. Contribution of Capital or Skill

- Partners contribute **capital, labor, property, or skill** for the business.
- Contribution need not always be financial.

5. Unlimited Liability

- In general partnership, partners have **unlimited liability** for the debts of the firm.
- They may have to use **personal assets** if firm assets are insufficient.

6. Voluntary Association

- Partnership is a **voluntary association**, entered into **by mutual consent**.
- Cannot be imposed by law.

7. Limited Life

- Partnership **ceases on death, insolvency, or retirement** of a partner unless otherwise agreed.

8. No Separate Legal Entity

- The firm is **not a separate legal entity**; partners are personally responsible for obligations.

Partnership Deed

Meaning

A **Partnership Deed** is a **written agreement among partners** that defines the **rights, duties, and obligations** of partners and governs the functioning of the firm.

- Though a partnership can be **oral**, a **written deed is preferred** for clarity and legal enforceability.

Contents / Clauses of Partnership Deed

1. **Name and Address of Firm and Partners** – Legal identity and contact details.
2. **Nature of Business** – Type of business the firm will carry on.
3. **Capital Contribution** – Amount of capital contributed by each partner.
4. **Profit and Loss Sharing Ratio** – Agreed proportion for sharing profits/losses.
5. **Interest on Capital or Drawings** – Rate of interest, if any, on partners' capital or drawings.
6. **Rights and Duties of Partners** – Roles, responsibilities, and authority of each partner.
7. **Admission, Retirement, or Expulsion of Partners** – Rules for adding or removing partners.
8. **Dispute Resolution** – Methods for resolving disagreements among partners.
9. **Duration of Partnership** – Fixed term or indefinite.
10. **Accounting and Audit** – Procedure for maintaining books and auditing accounts.

Importance of Partnership Deed

- Provides **legal protection** to partners.
- Prevents **disputes** by clearly defining roles and profit-sharing.
- Helps in **accounting and taxation** compliance.

DEATH OR INSOLVENCY OF PARTNERS

1. Death of a Partner

Effect on Partnership

1. Partnership is **dissolved automatically** unless otherwise agreed in the deed.
2. The **deceased partner's share of capital and profit** becomes payable to the legal heirs.
3. Continuing partners may **decide to continue the business** by forming a new partnership with the heirs' consent.

Accounting Treatment

1. **Prepare Revaluation Account** (if necessary)
 - Adjust the value of assets and liabilities to **current market value**.
2. **Partner's Capital Account**
 - Credit **capital, share of profits, and revaluation profit/loss**.
3. **Partner's Loan Account / Executor Account**
 - Payable to the **legal heirs** in cash or as per the agreement.
4. **Balance Sheet of Firm** (if required)
 - Shows remaining assets and liabilities after payment to the deceased partner.

2. Insolvency of a Partner

Meaning

A partner is **insolvent** when he is **unable to pay debts** or declared bankrupt by law.

Effect on Partnership

1. Insolvent partner is **removed from the firm**, but the firm may **continue with remaining partners**.
2. The **insolvent partner's capital account** is written off partially or fully depending on available assets.
3. Remaining partners are liable for **future debts** as per the partnership agreement.

Accounting Treatment

1. **Partner's Capital Account**
 - Credit balance reduced according to **share of loss or deficiency**.
2. **Insolvent Partner's Loan Account / Capital Deficiency**
 - Loss may be shared among remaining partners in **profit-sharing ratio**.
3. **Firm Continues**
 - Accounts are adjusted to reflect the **new composition of partners**.

Basis	Death of Partner	Insolvency of Partner
Effect on Firm	Dissolves automatically unless deed allows continuation	Firm continues; insolvent partner removed
Share of Partner	Payable to legal heirs	Paid as per available assets; remaining loss shared
Profit/Loss Sharing	Share of profit up to death calculated	Loss shared among remaining partners
Capital Account	Credited with capital and share of profit	Credited with capital; deficiency written off
Continuity	Can continue with heirs' consent	Can continue with remaining partners

GARNER VS MURRAY CASE –

The **Garner vs Murray case (1920)** is a landmark case in **partnership law**, particularly dealing with the **death or insolvency of a partner** and the distribution of profits and losses. The case arose when two partners, **Garner and Murray**, were carrying on a business with a profit-sharing ratio of **5:3**. During the accounting period, the firm earned a profit of £8,000; however, one of the partners, **Murray**, was **insolvent** and could not contribute his share of losses. The legal question that arose was how the profits should be distributed, given that one partner was unable to pay his share due to insolvency.

The court held that the **solvent partner must bear the insolvent partner's share of loss** in accordance with the agreed profit-sharing ratio. In other words, while profits are distributed based on the agreed ratio, if a partner is **insolvent or unable to contribute to a loss**, the loss cannot be recovered from him. Consequently, the solvent partner, in this case Garner, had to bear the unpaid portion of Murray's share of loss. This established the important principle that when a partner is insolvent, his **share of loss is absorbed by the remaining solvent partners**, and the insolvent partner cannot claim profit or be made liable for losses beyond his available assets.

The **accounting implication** of this case is significant for partnership firms. In practice, the **partners' capital accounts** are adjusted for their share of profits and losses, and the **insolvent partner's capital account** is limited to the assets he can provide. The remaining partners bear the shortfall according to the profit-sharing ratio. This case ensures **fair treatment of solvent partners** while providing a legal framework to handle the death or insolvency of a partner without disrupting the firm's operations.

In conclusion, the **Garner vs Murray case** is a foundational case in partnership law. It clarifies that in situations where a partner is insolvent, the **financial burden of losses is shifted to the solvent partners**, while the insolvent partner's inability to pay is recognized legally. The case also guides the **proper accounting treatment** for partnership firms dealing with death or insolvency, ensuring fairness and clarity in profit and loss distribution.

EQUITY AND PREFERENCE SHARES

Shares are **units of ownership in a company**, representing the capital contributed by shareholders. Companies can issue different types of shares to raise capital, mainly **Equity Shares** and **Preference Shares**.

Equity Shares:

Equity shares, also called **ordinary shares**, represent ownership in the company. Equity shareholders are the **real owners** of the company and have the **right to vote** in general meetings. They earn **dividends** from profits, which are **not fixed** and may vary depending on the company's performance.

Preference Shares:

Preference shares are a type of share that gives the shareholder **preference over equity shareholders** in the payment of **dividends** and **repayment of capital** in case of liquidation. Preference shareholders generally **do not have voting rights**, except in certain cases. Dividends are usually **fixed**, providing a more secure return than equity shares.

Features of Equity Shares

1. Ownership Rights:

Equity shareholders are **owners of the company** and have voting rights in general meetings.

2. Dividend:

Dividend is **variable** and depends on the company's profitability. There is **no guaranteed return**.

3. Risk and Return:

Equity shareholders **bear the highest risk**. In case of liquidation, they are paid **after preference shareholders and creditors**.

4. **Voting Rights:**
Equity shareholders can **vote on company matters**, including appointment of directors and approval of financial statements.
5. **Capital Contribution:**
The amount invested by equity shareholders forms the **equity capital of the company**.
6. **Residual Claim:**
Equity shareholders have a **residual claim on assets** after all debts and preference shares are settled.

Features of Preference Shares

1. **Fixed Dividend:**
Preference shareholders receive a **fixed rate of dividend**, irrespective of company profits.
2. **Preference in Dividend:**
They are paid **before equity shareholders** in terms of dividend distribution.
3. **Preference in Capital Repayment:**
In case of liquidation, preference shareholders are **paid before equity shareholders** but **after creditors**.
4. **Limited Voting Rights:**
Generally, preference shareholders **do not have voting rights**, except when **dividends are in arrears** or in **specific situations** defined by law.
5. **Types of Preference Shares:**
Preference shares can be **cumulative, non-cumulative, redeemable, or convertible**, depending on the company's rules.
6. **Risk and Return:**
Preference shares are **less risky** than equity shares due to **fixed dividends** and preferential treatment in repayment.

ISSUE OF SHARES, DEBENTURES, UNDERWRITING, AND BONUS SHARES

1. Issue of Shares at Par, Premium, and Discount

- **Par Value:** Shares are issued at their **nominal value**. For example, a share of ₹10 issued at ₹10 is **issued at par**.
- **Premium:** Shares issued at a price **higher than nominal value** are said to be issued at a **premium**. Example: Share of ₹10 issued at ₹12, premium ₹2. The extra amount is credited to the **Securities Premium Account**.
- **Discount:** Shares issued at a price **lower than nominal value** are issued at a **discount**. Example: Share of ₹10 issued at ₹8, discount ₹2. The **discount must comply with legal provisions**.

2. Pro-rata Allotment of Shares

When the **number of shares applied exceeds the number of shares offered**, shares are **allotted in proportion to applications received**.

- Excess application money is **refunded or adjusted against future calls**.
- **Example:** If 1,00,000 shares are offered and 1,50,000 applied, each applicant gets **2/3rd of applied shares**.

Accounting:

- Bank Account is debited with application money received.
- Share Capital is credited with allotted shares.
- Refund Account is adjusted for excess applications.

3. Forfeiture and Re-issue of Shares

- **Forfeiture:** If a shareholder **fails to pay calls** on shares, the company may **forfeit the shares**.
 - Forfeited shares are **debited to Share Capital** and any **amount received is credited to Forfeited Shares Account**.
- **Re-issue:** Forfeited shares can be **re-issued to new shareholders at par, premium, or discount**.
 - Any **gain on re-issue** is transferred to **Capital Reserve**.

Accounting Example:

- Share Capital A/C (forfeited shares) debited
- Bank A/C credited for money received on re-issue
- Capital Reserve credited for profit on re-issue

4. Issue of Debentures and Redemption

- **Debentures:** A **debt instrument** issued by a company to raise funds. Debenture holders are **creditors**.
- **Redemption:** Debentures can be redeemed:
 1. **At par** (nominal value)
 2. **At premium** (above nominal value)
 3. **At discount** (below nominal value, rarely)
- Companies may redeem debentures **after a fixed period** or **on due date**.

5. Underwriting of Shares

- **Meaning:** An arrangement where a **person or institution agrees to subscribe to shares not subscribed by the public.**
- **Conditions:**
 1. Underwriting agreement must be **written.**
 2. Underwriter is liable **only for unsubscribed shares.**
 3. Can be **full or partial underwriting.**
- **Accounting:**
 1. Bank A/C debited for application money received.
 2. Share Capital A/C credited.
 3. Underwriting Commission (if any) is **debited to Commission A/C.**

6. Bonus Shares

- **Meaning:** Free shares issued to existing shareholders from **reserves or profits.**
- **Purpose:** To reward shareholders and **capitalization of reserves.**
- **SEBI Guidelines for Bonus Shares:**
 1. Company must have **sufficient free reserves or securities premium.**
 2. Bonus shares issued **proportionately to existing shareholding.**
 3. Allotment requires **Board and shareholder approval.**
 4. Shares must be **fully paid up.**

Accounting Treatment of Bonus Shares:

- **Reserves or Securities Premium A/C debited**
- **Share Capital A/C credited**

Example:

- 10,000 shares of ₹10 each issued as bonus from **General Reserve**
 - General Reserve A/C debit ₹1,00,000
 - Share Capital A/C credit ₹1,00,000

ISSUE OF SHARES AT PREMIUM AND DISCOUNT

1. Issue of Shares at Premium

Meaning:

Shares are said to be issued at a **premium** when the **issue price is higher than their nominal (face) value**. For example, if a share of ₹10 is issued at ₹12, the excess ₹2 is the **share premium**. Companies often issue shares at a premium when the **market value of shares is higher than their nominal value**, or to strengthen the **capital base without diluting ownership excessively**.

Accounting Treatment:

- **Bank Account** is debited with the total amount received.
- **Share Capital Account** is credited with the **nominal value of shares**.
- **Securities Premium Account** is credited with the **excess amount received over nominal value**.

Journal Entry Example:

Bank A/C ₹12,000

— To Share Capital A/C ₹10,000

— To Securities Premium A/C ₹2,000

Uses of Securities Premium:

According to the Companies Act, the premium can be used for:

1. Issuing fully paid bonus shares.
2. Writing off preliminary expenses.
3. Buying back shares.
4. Redemption of debentures.

2. Issue of Shares at Discount**Meaning:**

Shares are issued at a **discount** when the **issue price is lower than their nominal value**. For example, a share of ₹10 issued at ₹8 has a **discount of ₹2**.

- Issue of shares at a discount is **allowed under strict conditions** by law, often requiring **approval from the Registrar of Companies (ROC)**.
- Companies issue shares at a discount to **attract investors** when market conditions are weak.

Accounting Treatment:

- **Bank Account** is debited with the cash received.
- **Share Capital Account** is credited with **full nominal value**.

- **Discount on Issue of Shares Account** is debited with the difference and later **written off against capital or reserves**.

Journal Entry Example:

Bank A/C ₹8,000

Discount on Issue of Shares A/C ₹2,000

— To Share Capital A/C ₹10,000

FORFEITURE AND RE-ISSUE OF SHARES

1. Forfeiture of Shares

Meaning:

Forfeiture of shares occurs when a shareholder **fails to pay calls** (either fully or partially) on the shares allotted to them. The company then has the **right to cancel or forfeit the shares**, as per the provisions of the **Companies Act**. Forfeited shares **cease to be the property of the shareholder**, and the company may re-issue them to new investors.

Reasons for Forfeiture:

1. Non-payment of allotment money.
2. Non-payment of first or subsequent calls.

Accounting Treatment:

1. **Share Capital Account** is debited with the **nominal value of forfeited shares**.
2. **Bank Account** is credited with the **amount received from the shareholder** before forfeiture.
3. Any **premium received** is transferred to **Securities Premium Account**.
4. If the shareholder has **paid less than allotment or call**, the amount is retained in the **Forfeited Shares Account** as capital reserve.

Journal Entry Example:

- Share Capital A/C ₹10,000
- To Forfeited Shares A/C ₹4,000
- To Bank A/C ₹6,000

2. Re-issue of Forfeited Shares

Meaning:

Forfeited shares can be **re-issued to new shareholders** either at **par, premium, or discount**. The company may gain or lose depending on the **re-issue price relative to nominal value**.

Accounting Treatment:

1. Re-issued at Par:

- Debit Bank A/C with cash received.
- Credit Share Capital A/C with nominal value of shares re-issued.
- If the shares were forfeited for **less than full nominal**, the difference in Forfeited Shares A/C is **transferred to Capital Reserve**.

2. Re-issued at Premium:

- Bank A/C debited with total amount received.
- Share Capital A/C credited with nominal value.
- Securities Premium A/C credited with **premium received**.
- Any **gain on forfeited shares** is transferred to Capital Reserve.

3. Re-issued at Discount:

- Re-issue below nominal value requires **capital reserve adjustment** from Forfeited Shares Account or loss recognition.

Journal Entry Example (Re-issue at Premium):

Bank A/C ₹12,000

— To Share Capital A/C ₹10,000

— To Securities Premium A/C ₹2,000

Profit on Re-issue of Forfeited Shares:

- When re-issued at **par or premium**, the **difference between amount received and original amount forfeited** is transferred to **Capital Reserve**.
- Capital Reserve is **not distributable as dividend** but appears under shareholders' equity.

UNDERWRITING OF SHARES

Meaning:

Underwriting of shares is an arrangement in which a **person or institution (called underwriter)** agrees to **subscribe to shares of a company that are not subscribed by the public** during a new issue. Essentially, the underwriter **guarantees that the company will raise the required capital**, and assumes responsibility for the **unsubscribed portion** of shares.

Key Features of Underwriting:

1. **Guarantee of Subscription:** The underwriter ensures that **all shares offered to the public are fully subscribed**.
2. **Consideration:** The underwriter is entitled to a **commission** for assuming the risk of unsubscribed shares.
3. **Contractual Agreement:** The underwriting arrangement is **formalized through a written agreement** specifying the number of shares to be underwritten and the commission rate.
4. **Types of Underwriting:**
 - **Firm Underwriting:** The underwriter subscribes to a **fixed number of shares** whether or not the public subscribes.
 - **Partial or Conditional Underwriting:** The underwriter takes responsibility only for a **portion of unsubscribed shares**.
5. **Risk Assumed:** The underwriter bears the **risk of having to purchase shares himself** if the public does not subscribe fully.

Accounting Treatment:

- **Bank Account:** Debited with application money received from public.
- **Share Capital Account:** Credited with the nominal value of shares allotted.
- **Underwriters' Commission Account:** Debited for the commission payable to underwriters.

Example:

A company issues 1,00,000 shares, and an underwriter agrees to subscribe to **10,000 shares not taken up by the public** at a commission of 5%. The underwriter's commission is calculated on the unsubscribed shares and recorded as an **expense in the books of the company**.

BONUS SHARES – MEANING AND SEBI GUIDELINES

Meaning of Bonus Shares:

Bonus shares are **additional shares issued by a company to its existing shareholders for free**, in proportion to their current shareholding. These shares are issued **out of the company's accumulated reserves, securities premium, or profits**, and **do not involve any cash payment from the shareholders**. Bonus shares are a way for a company to **capitalize its reserves**, reward shareholders, and **increase the liquidity of shares** in the market. For example, a company may

issue **1 bonus share for every 5 shares held**, meaning a shareholder holding 100 shares will receive 20 additional shares.

Purpose of Bonus Shares:

1. To **reward existing shareholders** without paying cash dividends.
2. To **increase paid-up capital** using accumulated profits or reserves.
3. To **improve marketability and liquidity** of shares.
4. To maintain **equity in shareholding structure**.

SEBI Guidelines for Issue of Bonus Shares

The **Securities and Exchange Board of India (SEBI)** regulates the issuance of bonus shares to ensure **transparency and fairness**. The key guidelines are:

1. Source of Bonus Shares:

- Bonus shares can be issued only out of **free reserves, securities premium account, or capital redemption reserve**.
- They **cannot be issued out of revaluation reserves** or unrealized gains.

2. Proportional Issue:

- Bonus shares must be issued **proportionately to existing shareholders**.
- For example, if the bonus ratio is 1:2, each shareholder gets **1 new share for every 2 shares held**.

3. Board and Shareholder Approval:

- The **Board of Directors must approve** the proposal for bonus shares.
- **Shareholders must approve** the issue in a general meeting.

4. Allotment of Fully Paid Shares:

- Bonus shares must be **fully paid-up**, i.e., the shareholder **pays nothing for the shares**.

5. Compliance and Disclosure:

- Companies must **file with stock exchanges** and comply with **SEBI regulations**.
- Necessary disclosures must be made in the **annual accounts** and public announcements.

6. Trading Restrictions:

- The issue of bonus shares must **not affect the market price significantly**, and shares are usually credited to shareholders' accounts **within a specified period**.