CA Foundation I Paper 1

New Syllabus

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ACCOUNTING

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What Our Students have to Say....

Aman Mahajan (CA AIR 19)

I really liked your classes, especially the practical linkages explained with amazing graphics. The full subject test serieshelped a lot in improving my writing speed and presentation skills.

Sundar Sri Renganathan B (AIR 33)

I took Accounting from IndigoLearn and the classes were really good. They emphasized on conceptual clarity over getting things done quickly, which is really vital to score good marks in practical papers. Other resources like Notes, Quizzes and Forum was beneficial too.

Dwarakesh

Thank you IndigoLearn team for the guidance and support throughout the past few months. I had great conceptual clarity in all the subjects and the revision classes by Suraj Sir were very helpful. Study planner and Free resources were very useful. Thank you Team IndigoLearn.

Yug Manoj Kumar Bhattad

I have cleared my CA Foundation examination with the total of 286. And this was not possible without the efforts and support of IndigoLearn. The way of teaching with utmost conceptual clarity is the best thing at Indigolearn.

Prakash Bhatt

Superb, one stop solution for All CA and Accountancy students they serve real Education at very very reasonable price

Naveen Kumar S

Good experience, unlimited views helped a lot in last one month preparation. Looking forward for

Bhagyasree Chougule

It was only because of Indigolearn that my concepts became very clear, and I was able to crack the exam. I wasn't 100% prepared I needed more practice but luckily I got through. I'm definitely choosing IndigoLearn for group 2 preparation. A big thanks!

Mohd Thayyab

Theoretical subjects made easier through story based examples and charts. Concept clarity 100%. Fully exam+practical oriented classes will help not only to retain the concepts during exams but for the longer duration.

Lalit Chetan Sanpal

Indigolearn has been fantastic and brilliant. Helped me alot in my preparations. I cleared both the groups in first attempt with your brilliant classes and notes. Thanks to all the faculties, coordinators, forum admins and everyone at Indigolearn. Really grateful. Will go for CA Finals at Indigolearn For sure. Thank you so much Indigolearn.

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Abishek M

I'd like to thank IndigoLearn for all the support they've provided me with. Modules were great. They were time saving and straight to the point. I extensively used the materials provided before exams, they were so helpful. Also I'd appreciate them for providing unlimited views as I kept looking into the maths modules till the end.

Munnur Nandini Sree

Accounting classes I have taken from IndigoLearn. Now I feel that it's a great choice that I have made (after seeing my result) because only in Accounting I got exemption. Thank you IndigoLearn.

Harshita G

Thank u so much IndigoLearn for your guidance. This is only possible because of u people.... For my finals also my journey will continue with IndigoLearn.

Bharathsha PS

I purchased Economics, IT, FM, EIS and Audit from Indigolearn. All your classes are superb and anyone can easily crack the CA exams. What makes u special is your classes help us to understand the concepts very well.Special thanks to the FM faculty, I studied only 2 chapters in economics,and still managed to score exemption in the 8th paper.

Nayi Mihir kumar

This platform is very helpful in all activity like mcq practise, notes, teaching activities, revisions and the forum interaction with all students which I like the most. If anybody want to clear their exams in first attempt then IndigoLearn is the best platform for them. My all regards to IndigoLearn. Thank you so much.

Rajalaxmi CA Inter

Can't believe I cleared.Sathya Sir, Suraj Sir, Yogita Mam ... thanks to all my faculties. Basically an Eng student with zero accounts knowledge. Thanks IndigoLearn for making me clear in first attempt.

Priyanka Udeshi

All the faculties have excellent knowledge of the subject and deliver it in very crisp & effective manner. Also, quick response at Forums never let any of my doubts go unresolved no matter how small they were. Thank you once again to all the teachers & staff at IndigoLearn!

Naveen Kumar T

It been a great journey with indigo learn team. Thanks to all the facilities and forum friends who support me a lot.

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Edition 1 – Dec 2022
Edition 2 – Dec 2023

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Chapter 1 – Theoretical Framework

OBJECTIVES

The lists of topics which will be covered in this chapter are as follows:

1.1 Meaning and Scope of Accounting:

- Meaning and significance of Accounting.
- Difference between Book-Keeping and Accounting.
- Limitations of Accounting.

1.2 Accounting Concepts, Conventions and Principles:

- Understanding various accounting concepts, conventions, principles and assumptions which govern Accounting.
- Characteristics of Financial Statements.

1.3 Capital and Revenue Expenditure and Receipts:

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Meaning of Accounting:

American Institute of Certified Public Accountant defined Accounting as "Accounting is the art of recording, classifying and summarizing in a significant manner and in term of Money, transactions and events which are, in part at least, of a financial character and interpreting the results thereof."

In simple terms Accounting can be stated as the process of recording and maintaining the Financial Information.

Procedures of Accounting:

Broadly the accounting procedures are divided into two categories:

1. Generating Financial Information

2. Using the Financial Information.

Procedure to Generate Financial Information comprises of the following 6 steps:

1. Recording:

This is the first step of accounting. All the transactions are recorded in the respective account book which is called as a "Journal".

For Eg: All the transactions done by the company during a particular month will be recorded in the Journal on a daily basis.

2. Classifying:

Classifying involves systematically analyzing and segregating the transactions recorded in the Journal.

This is done by transferring the journal entries in the Ledger which clubs all the similar transactions to a particular account.

For Eg: All the journal entries related to sales will be recorded in the Sales Ledger.

3. Summarizing:

Under this step all the ledger balances are summarized and prepared in manner that is useful to the users of the Financial Statements.

A company carries on hundreds and thousands of transactions in a financial year and the journal and ledger balances for all the transactions can run into hundreds of pages which will be lot time consuming and confusing for the users of the Financial Statements.

Therefore, to avoid this problem a summary of all the transactions and ledger balances is presented. The preparation of this summary leads to the creation of the Financial Statements which includes the following:

i) Trial Balance

ii) Profit and Loss Statement

iii) Balance Sheet

iv) Cash Flow Statement

4. Analyzing:

The financial statements need to be presented in a meaningful and usable way for the users whereby they can analyze and draw the relationship among the various items of the Financial Statements.

For Eg: All items relating to a particular type of Asset can be found in the Balance Sheet Asset side such as Fixed Asset, Current Asset, Investments, etc. This classification makes it easier for the users to analyze the information presented in the Financial Statements in a systematical manner and analyze various important ratios and other meaningful information as per their requirement.

5. Interpreting:

This step is stated as the Final Step of Accounting whereby the financial statements are interpreted in a manner that enables the end users of the Financial Statements to derive useful information about the company's Financial Condition and profitability of the Business.

It is important from the point of view of interpretation that the companies provide an in depth explanation the conditions under which the important transactions have happened, the impact of its occurrence, what is the likelihood of its occurrence.

6. Communicating:

This step is not concerned with the generation of the Financial Statements, but it deals with communicating the Financial Statements prepared using the above steps.

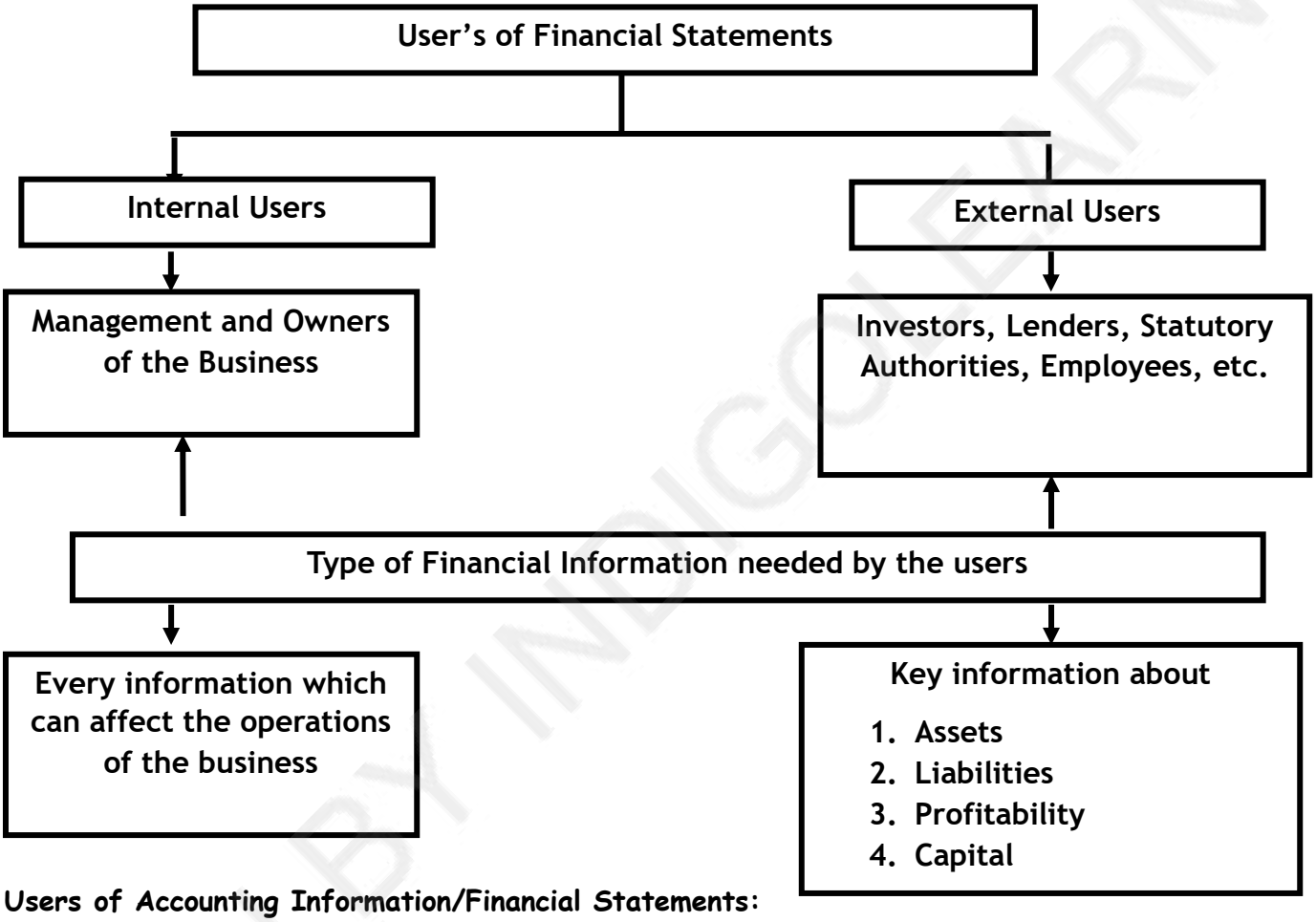
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The Financial Statements are communicated through the distribution of annual accounting reports, mandatory fillings with the various statutory authorities.

Using the Financial Information and Users of Financial Statements (Accounting Information):

With the advancement of the global trade and rising interest of various parties in an organizations business there has been an increase in the number of stakeholder's who are interested in the using the company's Financial Statements to fulfill their various interests.

Broadly speaking the users of financial statement can be classified into 2 categories:



Users of Accounting Information/Financial Statements:

As seen in the previous diagram the users of the Accounting Information are classified into 2 categories Internal Users and External Users.

Let us try to understand the usability of the Financial Statement to the various users:

Internal Users:

1. **Management:**
   The Management of the entity needs to take various decisions with respect to budgeting, forecasting based on the past trends and market analysis for the sake of which they need to evaluate their financial statements to get an understanding of their business has been performing and the details of their financial position which assist them in taking better decisions.

Also, they need the various financial information to identify the shortcomings and weaknesses in their business so that they can design and act on corrective measures to improve the deficiencies.

External Users:

1. **Investors:**
   The investors of the company want to understand how the company has been performing and how is their investment growing.

   Based on that information they can take various investment related decisions such as whether to invest further or disinvest from their existing investment.

2. **Employees:**
   Employees of any company are interested in understanding how the growth of the company is?

   This is because their career growth depends on the growth of the organization at least till the time they are associated with the company.

3. **Lenders:**
   Lenders are interested in knowing how profitably the company is performing.

   This is to ensure that their loans and interest are safe with the company and will be repaid as per the contracts.

4. **Suppliers and Creditors:**
   Suppliers and Creditors are interested in using the financial information of the company with the same intention as the lenders.
   They are keen to know whether the credit balances owed to them by the company will be paid on timely basis.

   Also, they try to estimate that how long they can expect to be in business with the company in future.

5. **Customers:**
   Many of customers of any business are probably their repeat customers and if the business goes into trouble and cannot continue then it also causes hassle to the customer who needs to find a replacement of the product.

   This is especially true if the customer used the company's product as an input for its own business.

   For Eg: If ABC Company was a steel manufacturer and its customer Mr. D had a steel factory. Mr. D used to procure majority of his raw material from ABC Company.
   If for some reason ABC Company shuts down, then it would be a lot of hassle for Mr. D to find a new supplier for the same input especially if it was a customizable product.

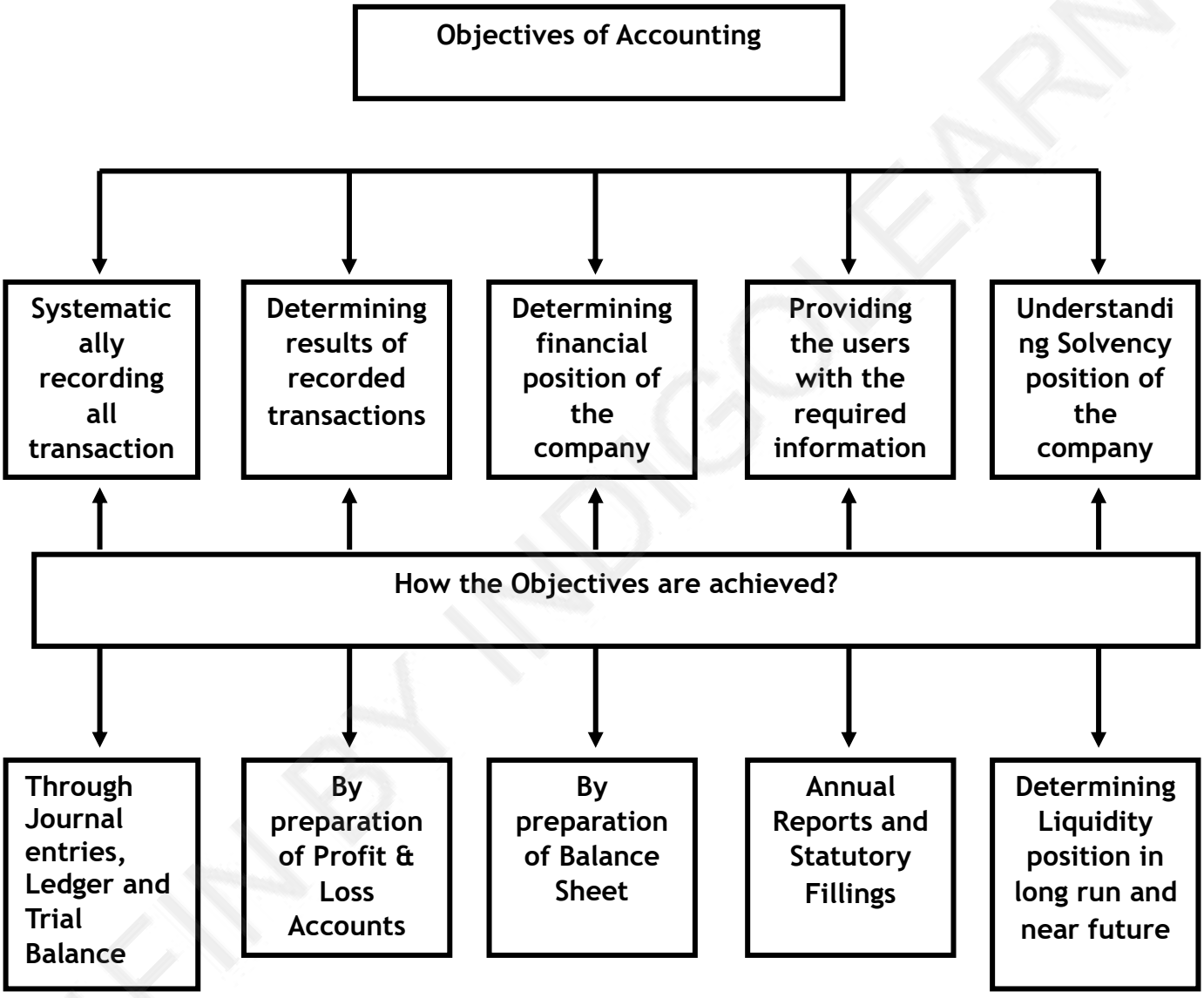
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6. **Statutory Authorities:**

Statutory Authorities make sure that the business is operating within the laws and regulations and defined framework and for accomplishing this objective they need to rely on the Financial Statements submitted by the companies as per the rules and acts.

Objectives of Accounting:

The objectives of Accounting and the method through which they are achieved can be understood with the help of the following diagram:



Book-Keeping:

Book-Keeping can be stated as the process/activity to record the various transactions entered by the entity in a systematic and timely manner.

By properly recording all the transactions in an orderly manner, organizations can prepare the Financial Statements which are true and correct and useful to their users.

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The main objective of Book-Keeping is to provide proper summary of all the financial and non-financial transactions entered by the company which would help the company in systematic preparation of the Financial Statements.

The main objective of Book-Keeping is to maintain a Complete Record of all the Transactions in a systematic manner which is useful in determining the Financial Results on the business.

Often, Book-Keeping is confused with Accounting. It is important to note that Book-Keeping is a part of Accounting. Accounting in itself is a big domain and not restricted to Book-Keeping.

The following table will enable you to understand the important points of Distinction between Book-Keeping and Accounting:

Point of Distinction	Book-Keeping	Accounting
Objective	Systematic Recording of Transactions	Summarizing of Recorded Transactions
Basis for	It is basis for preparation of Financial Statements	It is the basis for communicating the results of operations
Are Financial Statements parts of it?	Financial Statements do not form a part of Book-Keeping	Financial Statements are part of Accounting
Basis for Managerial Decisions	Managerial Decisions cannot be made on the basis of Book-Keeping	Managerial Decisions are made based on the statements prepared under Accounting
Sub-Fields	There is no Sub-Field of Book-Keeping	Accounting has various sub-fields such as Managerial Accounting, Financial Accounting, Cost Accounting, etc.

Sub-Fields of Accounting:

Book-Keeping can be stated as the process/activity to record the various transactions entered

Accounting is not just restricted to the preparation and presentation of the Financial Statements to the users. It has various domains which are designed to serve the various purposes:

1. **Financial Accounting:**
   This field of Accounting deals in preparation and presentation of the financial statements to the users. The Financial Accounting main objective is determining profitability and financial position of the business at a particular point of time.

2. **Management Accounting:**
   This field of Accounting is specifically designed to provide customized and specialized information to the managers of the organization which would assist them in planning and taking appropriate steps in achieving the goals of the organization.

3. **Cost Accounting:**
   This field of Accounting is specifically designed to determine the cost and its allocation which is crucial in determining profitability of the business.

4. **Social Responsibility Accounting:**
   With the increasing awareness about the social issues and involvement of the various business houses in view to work for profit and support a cause along with the advancement in the laws relating the CSR there has been a significant increase in the spending towards social causes.

   The companies who are spending towards CSR are highly interested in knowing whether the amount spent by them is able to fulfill the cause and generate the impact it had expected through the spending.

   The measurement of the social benefits created and the lives impacted is the main objective of the Social Responsibility Accounting.

   For Eg: If Company ABC had spent Rs.1.00 Cr during F.Y.2017-2018 for promoting education among the low income kids. It would like to know the number of kids who got enrolled in the schools via their programs for which they had spent amount of Rs.1.00 Cr.

5. **Human Resource Accounting:**
   Of all the expenditure incurred by the businesses they can be measured by using the standards, measurements and valuation principles provided by various laws, regulations and AS.

   Except for the Human Resource, which is the only expenditure incurred by the company to develop and maintain the human resource which will be able to provide the company benefits across the years. However, it is written off as expense in the year it is incurred.

   Human Resource Accounting attempts to identify measure and report the investment made in the Human Resource of the entity.

Relationship of Accounting with other disciplines:

i. **Accounting and Economics:**

Accounting	Economics
• It is viewed as a system, which provides data to the users to permit informed judgement and decisions. • Non-accounting data are also relevant for decision-making	It is viewed as a science of rational decision-making about the use of scarce resources.
Contributed a lot improving the management decision-making process.	economic theories influenced the development of the decision-making tools used in accounting.

At the macro-level, accounting provides the database over which the economic decision models have been developed; micro-level data arranged by the accounting system is summed up to get macro-level database.

ii. **Accounting and Statistics:**

Accounting	Statistics
Accounting information is very precise; it is exact to the last paisa	For decision-making purposes such precision is not necessary for which this is used.
All values are important individually because they relate to business transactions.	It is concerned with the typical value, behavior or trend over a period of time or

	the degree of variation over a series of observations.
It records generally take a short-term view of events and are confined to a year	It is more useful if a longer view is taken for the purpose
Several accounting and financial calculations are based on statistical formulae.	Statistical methods are helpful in developing accounting data and in their interpretation.

The functional relations showing mathematical relations of one variable with one or more other variables are based on statistical work.

iii. **Accounting and Mathematics:**

- Knowledge of arithmetic and algebra is a pre-requisite for accounting computations and measurements.
- Accounting data are also presented in ratio form.
- The fundamental accounting equation will be discussed in detail under 'Dual Aspect Concept' of this chapter.
- Since accounting is meant for providing information to the users, to be effective, accounting data should feed the information requirements of such statistical, econometric and operations research models.
- Understanding mathematics has become a must to grasp the decision models framed by statisticians, econometricians and the O.R. experts.

iv. **Accounting and Law:**

- An economic entity operates within a legal environment.
- Transactions and events are always guided by laws of the land. Very often the accounting system to be followed has been prescribed by the law.
- The legal prescription about the accounting system is the product of developments in accounting knowledge.
- Accounting influences law and is also influenced by law.

v. **Accounting and Management**

- Management is a broad occupational field, which comprises many functions and encompasses application of many disciplines.
- Accountants are well placed in the management and play a key role in the management team.
- A large portion of accounting information is prepared for management decision-making.
- So the accounting system can be molded to serve the management purpose.

Limitations of Accounting:

Accounting has some limitations which are important to be aware of. Since the Financial statements are the basis of communicating the performance and financial position it is important to be aware of the limitations in the presence of which the Financial Statements have been prepared:

The Limitations of Accounting are as follow:

1. **Non-Monetary items are not considered:**

The most important factor to determine the worth of a business is their employee, their skill and dedication which are nowhere found on the Financial Statements.

2. **Balance Sheet is valid only for a particular point of time:**
   The Balance Sheet which reflects the financial position of the business is valid only for a particular point of time. A single additional transaction can alter the balance sheet drastically.

   However, to overcome this limitation the auditors disclose the events occurring after the balance sheet date.

3. **Time Value of Money:**
   The Monetary factors such as Inflation, Time value of Money, etc. are ignored in preparation of Accounting.

4. **Use of Estimates:**
   Some Accounting Estimates such as provision for doubtful debts, useful life of the Fixed Asset, etc. depends on the estimates and judgments made by the management and accounting personnel.

   Since human judgment is involved it can lead to error in estimation of the same which can have an impact on the Financial Statements.

Questions:

1. Identify whether the following are transactions which would be recorded in the Financial Statement or not?

   i. Mr. A asked for Quotation of goods and received a quotation of Rs.5.00/- Lac from Mr. B. Will this be recorded as purchase in the Books of Mr. A?
      Will not be recorded

   ii. Mr. B received an order for Rs.10.00/- Lac and raised an invoice to Mr. C for the same. Will this be recorded as sales in the books of Mr. B?
      Will be recorded

2. Which of the following is not an internal user of the Company's Financial Statement?

   i. CEO of the company
   ii. Employees of the company – Not an internal user
   iii. CFO of the company
   iv. Directors of the company

3. Limitation of Accounting is that it:

   i. It does not use estimates.
   ii. It accounts only for Monetary Items – Is a Limitation
   iii. Accounts for time value of Money
   iv. Balance Sheet is valid throughout the year.

Unit-2 Accounting for Concepts, Conventions and principles

Need for Accounting Concepts, Conventions and Principles:

Accounting is stated as the Language through which the results of the operations of the company are communicated to the various stakeholders.

How would the Financial Statements of various companies look like when they are prepared by various accountants based on their understanding of the norms and notions of accounting due to absence of any standardized policy? It would literally cause chaos because the result of operations prepared by two different accountants for the same set data would be showing different results rendering it useless.

To avoid this issue and establish uniformity and comparability among the financial statements of various entities and across the period of time for same entity framework of GAAP "Generally Accepted Accounting Principles" have been established.

GAAP provides all the concepts, conventions and principles on the basis of which the Financial Statements of the entity needs to be prepared.

Accounting Concepts:

Accounting Concepts defines the assumptions which form the basis of preparation of Financial Statements.

Accounting Principles:

Accounting principles provide explanation of current practices and a guide for selection of practices where alternative treatments exist.

Accounting Principles need to satisfy the following conditions:

1. They should be based on real assumptions.
2. They must be simple, understandable and explanatory.
3. They must be followed consistently.
4. They should be able to reflect future predictions.
5. They should be informational for the users.

Accounting Conventions:

Accounting Conventions are the conventions which arise in the company Accounting Process due to the application of the principles and practices over a period of time.

Let us look at the Concepts, Conventions and Principles:

1. **Entity Concept:**

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Entity Concepts states that the business enterprise and the owner of the enterprise are two separate entities and have their own identities. The transactions occurring between the two should be clearly recorded as transaction between two different persons.

For Eg: If an amount of Rs.10,000/- is withdrawn by Mr. A from his business, it should be treated as a Drawings from business and not as a Expense of the Business.

2. **Money Measurement Concept:**
As per this Concept only those transactions which can be measured in Monetary Terms are to be recorded.

Any transaction which cannot be measured in monetary terms should not be recorded even though it may be materially significant in value.

For Eg: The Human Resource of any organization is its biggest strength but it will not be recorded anywhere in the Financial Statement because it cannot be measured in Monetary Terms.

3. **Periodicity Concept:**
As per this Concept companies need to prepare their accounts at a regular interval comprising of fixed period of time and not at the end of the life of the business.

Using this concept only the Financial Statements of the company are prepared for every 12 months also known as "Financial Year".

It can be stated that the periodicity concept helps in achieving the following objectives:

- Comparing financial statements of different periods of time.
- Uniform and consistent accounting treatment for ascertaining the profit/loss and assets/liabilities of the business.
- Matching current period revenues with current period expenses for getting correct results of the business operations during a given period of time.

4. **Accrual Concept:**

As per the Accrual Concept of Accounting all transactions and events of business are recognized o a Mercantile Basis.

It means that all expenses and losses are recognized in the period during which they have occurred irrespective of the fact whether they have been paid or not and all income and gains are recognized in the period during which they have been earned irrespective of the fact whether they have been received or not.

5. **Matching Concept:**
As per the Matching Concept all the expenses incurred should be matched to the corresponding revenue earned from those expenses. In Simple words it can be stated that for all the revenue recognized during a period the corresponding expenses should be recorded during that period.

For Eg: ABC Company had purchased 1000 quantity of goods for reselling and had sold 600 of those in the current financial year.

Then at the end of the Financial Year the Cost of Goods Sold will be booked only for 600 units and the balance 400 will be transferred to Ending Inventory which will be transferred to COGS when they are sold.

6. **Going Concern Concept:**
   As per the Going Concern Concept it is assumed that the entity intends to continue its operations for the foreseeable future and has no intentions of drastically reducing its scale of operations.

   If it has any intention to scale down its operations materially or it is intending to close down its operation then it is liable to disclose the same to the users of the Financial Statements.

7. **Cost Concept:**
   As per the Cost Concept the assets are supposed to be measured at their historical cost i.e. their original cost of purchase.

   This concept is mainly applied to long term assets such as Fixed Assets. Because current assets are valued at cost or market value whichever is realizable.

   For Eg: If ABC company had acquired a Machinery worth Rs.10.00 Lacs 10 years back and had spend Rs.2.00 Lac towards its installation. Then the cost of the machine will be carried over across the years at Rs.12.00 Lac Less Accumulated Depreciation.

8. **Realization Concept:**
   As per the Realization Concept any change in the value of the assets is to be recognized only when the asset has been sold and the amount has been realized.

   This means that companies do not need to revalue their assets every year as per the realizable value. However, they need to adjust the cost of the asset when they are sold.

   For Eg: ABC Company had machinery with book value of Rs.5.00 Lac as on August 2018 whose market value was Rs.6.00 Lac which was sold for Rs.5.50 Lac. In Sep 2018.

   Here ABC Co. would not revalue the asset at Rs.6.00 Lac in August 2018 and then record the sale in Sep recognizing a loss of Rs.50 thousand.

   ABC Co. would be directly booking the asset value at Rs.5.00 Lac and a gain of Rs.50 thousand when asset is sold in September.

9. **Dual Aspect Concept:**
   This concept is the basis on which the Double Entry System of Book-Keeping is based on. As per this concept every transaction has 2 effects.

   This can be summarized in the following manner:

Effect of Changes in Asset

In one Asset, in other Asset.
In one Asset, in Liability.

Effect of Changes in Liability

In one Liability, in other Liability.
In one Liability, in Asset.
For Eg: When the business pays of dues to its creditors, it results in reduction of Asset (Cash & Bank) and reduction of liability (Creditors Balance).

10. **Conservatism Concept:**

This Concept states that accountants should not record anticipated income but they need to record the anticipated losses.

As the name itself suggest this concept is based on Conservatism principle which means that all the possible expenses and losses are reported which have not even occurred yet but the income and gains are reported only once they are realized. Resulting in preparation of most conservative Financial Statements.

11. **Consistency Concept:**

This Concept states that the enterprises should follow the accounting policies on a consistent basis from one period to another and should change their accounting policy only when the exceptional circumstances arise.

The intention of this concept is to ensure the comparability of financial statements across a period of time. Financial Statements can be compared across a period of time only when they are prepared using the same accounting policies and principles for the period being compared.

The exceptional circumstances under which the companies can change the accounting policies are as stated below:

i. To prepare the accounts in line with the newly issued Accounting Standards.
ii. To comply with the provisions of Law.
iii. If the circumstances have changed and it is felt that only by the adoption of the New Accounting Standards the company's financial results will be shown in a true and fair manner.

12. **Materiality Concept:**

This Concept allows the accountant to ignore all the other concepts of accounting which have been discussed till now under the condition that the result of ignoring all the other concepts will not make the financial statements materially misstated.

According to the Materiality concept all the items which have significant effect on the financial statements should be disclosed and all the items which are insignificant in value and will only increase the work of the accountant but are not relevant to the users should be ignored.

For Eg; When the business purchases some stationery items such as calculator which are going to be used for a more than a year, they are not classified as Fixed Asset and depreciated accordingly. They are expensed off as a Expense under Printing and Stationery for the year.

This is because the cost of calculator is no material enough to impact the decision of the users of the Financial Statement.

Characteristics of Financial Statements.

The 4 qualitative characteristics of Financial Statement that make them useful to their users are as follow:

1. **Understandability:**

The Financial Statements should be easily understandable by the users.

It is assumed that the users of these Financial Statements have a basic understanding of the Business and Accounting to study the information presented in them.

The Financial Statements contain information about complex matters that are to be supposed to be reported. However, they should not be omitted just because they are complex in nature to understand.

2. **Relevance:**

The information presented in the Financial Statement should be relevant to the users.

It means that the users should be able to use the information presented in making their economic decisions.

3. **Reliable:**

The information presented in the Financial Statements should be reliable.

Quality of reliability is established when the Financial Statements are free from material errors and bias and represents all the information in a faithful manner.

4. **Comparable:**

The information presented should be comparable. It should be comparable with the entities past performance as well as with the different entities across the same and other industries.

Comparability can be established when the financial statements are presented using the consistent principles and policies across the years.

The other characteristics which enhance the value of the Financial Statements are as follow:

5. **Materiality:**

The information is said to be material if its misstatement either by way of omission of wrong presentation can influence the economic decision of the user which is based on the financial statements.

Therefore, it is important the Financial Statements present all the material information.

6. **Substance over Form:**

The information presented should be indicating the true nature or intention of the transactions rather than focusing on the legality of the transaction.

For Eg: if the ABC Co. had purchased a asset of Rs.10.00 Lac by paying an advance amount of Rs.1.00 Lac. However, the official transfer is not made in the name of the ABC Co.

In this situation ABC Co. will record the asset in its balance sheet and create a creditor for the balance amount. Even though the official transfer is not made by considering the substance over the form the asset is recorded in the books of ABC Co.

7. **Neutrality:**

If the financial statement are prepared and presented with a view to influence the decision of the user they are said to be biased and not neural.

A neutral financial statement is the one which presents the information as it is without any intention to influence the decision of the users.

8. **Prudence:**

Quality of Prudence states that the Financial Statements have been prepared using professional judgment needed in determining the estimates needed in the preparation of the financial statements.

However, by using prudence one should not resort to unethical practices such as creation of hidden reserves, overstatement or understatement of assets and liabilities, incomes and expenses, etc.

9. **Faithful Representation:**

Financial Statements should faithfully represent all the transactions and events related to the period for which the financial statements are being presented.

10. **Full, Fair and Adequate Disclosure:**

Full disclosure states that nothing should be omitted from the Financial Statements.

Fair disclose states that all the transactions should be accounted for in manner that presents the financial statement in a true and fair manner.

Adequate disclosure states that all the information which could influence the decision of the user should be presented in adequate detail.

11. **Completeness:**

To establish reliability it is important that the information presented is complete in all material aspects. Information can be false or misleading and thus irrelevant and reliable if it is not complete in all material aspects.

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Questions:

1. Identify the effect on Asset and Liability of the following transactions.

   i. Mr. A paid outstanding creditors balance of Rs.10,000
   Asset decreases, Liability Decreases.

   ii. Mr. B sold goods worth Rs.10,000 for cash?
   Asset decreases (Inventory), Asset Increases (Cash/Bank).

2. Which of the following is not a qualitative characteristic of Financial Statement?

   i. Comparability
   ii. Completeness – Not an qualitative characteristics
   iii. Relevance
   iv. Reliability

3. A company needs to apply same method of depreciation due to which accounting concept:

   i. Consistency – For Consistency
   ii. Money Measurement
   iii. Periodicity
   iv. Accrual

4. What are the situations under which company can change its Accounting Policy?

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Unit-3 Capital and revenue expenditure and receipts

Capital Expenditure:

Capital Expenditure is that expense whose benefits last for more than one accounting period.

For Eg: Purchase of Fixed Assets is a capital expenditure since its benefit is going to be lasting for more than 1 accounting period.

Revenue Expenditure:

Revenue Expenditure is that expense whose benefit is going to expire within a single accounting period or is incurred in relation to the sales made during the accounting period.

For Eg: Cost of Goods Sold in relation to the sales made.

Factors determining whether expenditure is CAPITAL or REVENUE in nature:

1. **Nature of Business:**
   The Nature of business is an important factor in determining whether a expense is capital or revenue in nature.

   For Eg: For a company dealing in sale of computers, purchase of computer will be a part of revenue expenditure. However, for company dealing in groceries purchase of computer will be capital expenditure.

2. **Is the Expenditure Recurring or Not?**
   The expenditure which are recurring on a fixed basis and whose benefit is exhausted within a single accounting period is revenue expenditure. For eg: Salaries paid on monthly basis.

   The Expenses which are incurred once in a while such as purchase of Fixed Asset is a capital expenditure.

3. **Purpose of Expense:**
   If the expense helps in generating income over more than one accounting period it is a capital expenditure.

   If the expense is useful in generating income in the current accounting period, then it is revenue expenditure.

4. **Materiality:**
   The most important factor is the materiality of the amount involved. If the amount of expenditure is not material enough to be classified as a capital expenditure it will be written off as a Revenue Expenditure in the current period itself.

Revenue Receipts:

Revenue Receipts are the receipts which are received in the normal course of the business operations. It is important to note that the revenue receipt is not equal to cash receipts.

Revenue receipts are credited to the profit & loss account.

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For Eg: Collection from Debtors for the sales made.

Capital Receipts:

Capital Receipts are the receipts which are not revenue in nature. Capital receipts realized from sale of asset are first utilized to reduce the outstanding value of the asset in the company's balance sheet and any surplus or deficit is transferred to Profit & Loss Account.

For Eg: An asset whose value is Rs.1.00 Lac in the books of Accounts is sold for Rs1.10 Lac.
Here the Rs.1.00 lac out of the proceeds will be credited to the asset value to make it 0. And the balance Rs.10 thousand will be transferred to credit side of Profit & Loss Account.

Questions:

1. Identify which of the following is Capital/Revenue Expenditure or Capital/Revenue Receipt.

i.Purchase of Computer worth Rs.1.00 lac by company dealing in computers for maintaining its accounts.

Capital Expenditure (Even though it is dealing in computers it is purchased the computer for maintaining its accounts and not for sale).

ii.Payment of Rent in advance for 2 years.

Rent Expense for current year is revenue expense but the rent paid for the next year is capital expense.

iii.Cash Sale of Rs.1.00 Lac

Revenue Receipt

iv.Sale of old Fixed Asset by the company at a loss of Rs. 50 thousand.

Capital Receipt

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Unit-4 Contingent assets and contingent liabilities

A contingent liability is an obligation which may arise in future depending on occurrence of one or more uncertain events in the future. This obligation would be arising due to some past events.

Contingent Liabilities Vs Liabilities:

Point of Distinction	Contingent Liabilities	Liabilities
Status of obligation	Uncertain Obligation. It may or may not arise in future	Fixed present Obligation
Outflow of Resources	Outflow of Resources to settle the obligation is not fixed or probably estimable	Outflow of Resources to settle the obligation is fixed.
Recognition in the Financial Statements.	Not Recognized in the Financial Statements.	Recognized in the Financial Statements.
Example	Ongoing legal dispute, guarantee given in respect of third parties	Amount due to Creditors

Contingent Liabilities Vs Provisions:

Point of Distinction	Contingent Liabilities	Provisions
Status of obligation	Uncertain Obligation. It may or may not arise in future	Obligation is present. However, amount of obligation is measured by estimate since it is not fixed
Recognition in the Financial Statements.	Not Recognized in the Financial Statements.	Outflow of Resources to settle the obligation probable and estimable. Hence, recognized in the Financial Statements.
Example	Ongoing legal dispute, guarantee given in respect of third parties	Provision for Doubtful debts, provision for depreciation.

Contingent Assets:

A contingent Asset is possible asset that may arise in future due past events. The occurrence of Asset is dependent on one or more future uncertain events in Future.

As per the Accounting Standards, A Contingent Asset is not supposed to be recognized in the Financial Statements. This is because recognition of any anticipated gains is not allowed in the Financial Statements.

A Contingent Assets should be disclosed in the Board of Directors Report, if the realization of the assets is probable.

When the future event on the basis of which the Contingent Asset was dependent has occurred and it is certain that the contingent asset is realizable by the entity, then it is no longer a contingent asset and it is supposed to be recognized in the Financial Statement.

Questions:

1. Identify which of the following is Contingent Liability.

i. Ongoing Legal proceeding, the company expects to win the case.
Not a Contingent Liability. (It's a Contingent Asset)

ii. Liability in respect of Bill Discounted by the company.
Contingent Liability.

iii. Company is planning to make an appeal against Income Tax demand of Rs.5.00 Lac and has estimated that it has 70% probability of winning the same.
Not a Contingent Liability. (Since it has not yet made the appeal, as of now it is a liability due against the demand)

iv. Company expects additional bad debts of 5% during the current year as compared to the average of the past 3 years.
Not a Contingent Liability. (It's a provision)

Illustration

State with reasons whether the following statements are 'True' or 'False'.

1. Overhaul expenses of 2nd hand machinery purchased are Revenue Expenditure
2. Money spent to reduce working expenses is Revenue Expenditure
3. Legal fees to acquire property is Capital Expenditure
4. Amount spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the plaintiff 's land is Capital Expenditure
5. Amount spent for replacement of worn out part of machine is Capital Expenditure

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Unit-5 Accounting policies

Accounting Policies:

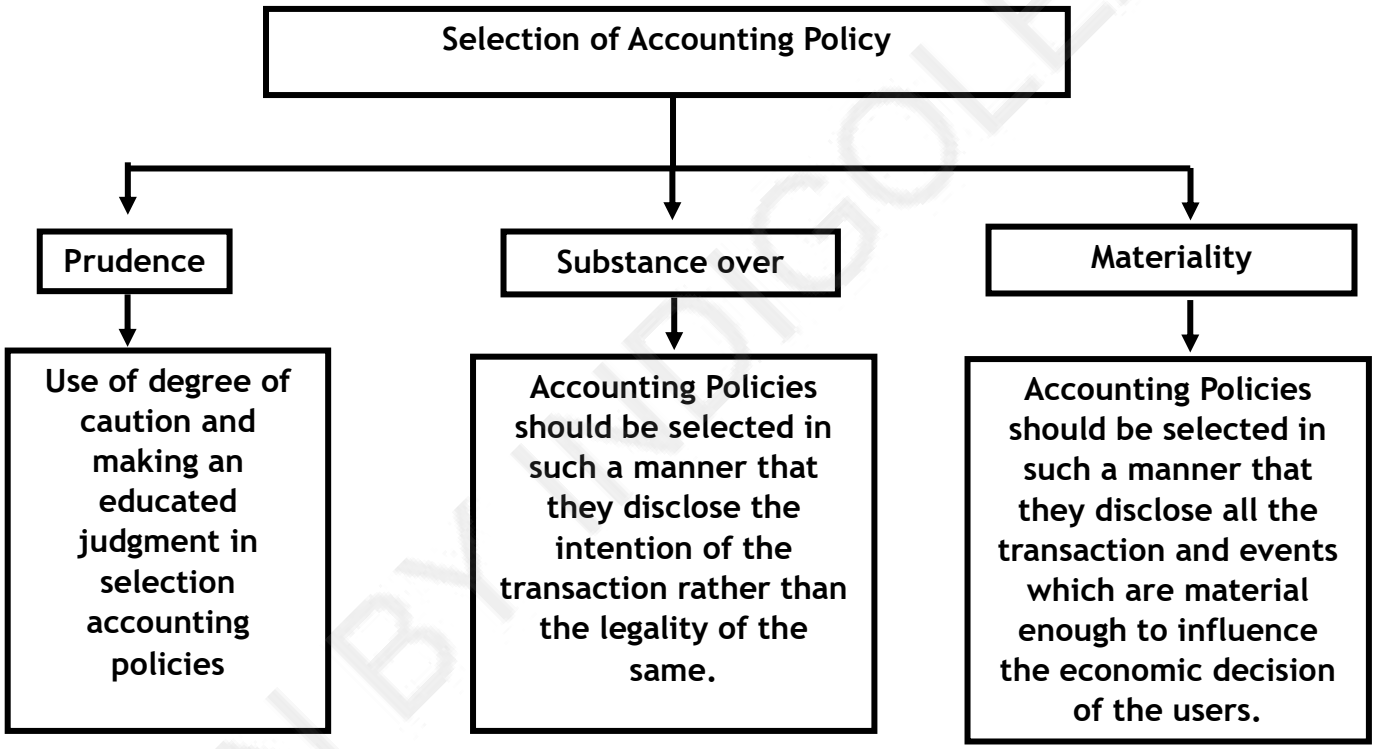
Accounting Policies are the specific accounting principles and the methods of applying those principles adopted by the organization sin preparation of their Financial Statements.

There isn't any single set of accounting policy applicable to all the organizations. Selection of Accounting Policies needs extreme judgment on part of the Key Management personnel of the organization.

Selection of Accounting Policies:

The Accounting Policies which are selected and on the basis of which the Financial Statements will be prepared play a major role in preparing and presenting the Financial Statements in a true and fair manner.

There are 3 main considerations in selection of Accounting Policies which are as presented below:



Examples of Accounting Policy

- Valuation of inventory
- Accounting for Depreciation
- Valuation of Investments

Changes in Accounting Policies:

Although the Accounting policies which are adopted once are supposed to be followed every year as per the principle of consistency to present the financial statements in a comparable manner.

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There are exceptional circumstances under which the companies can change the accounting policies which are as stated below:

i. To prepare the accounts in line with the newly issued Accounting Standards.
ii. To comply with the provisions of Law.
iii. If the circumstances have changed and it is felt that only by the adoption of the New Accounting Standards the company's financial results will be shown in a true and fair manner.

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Unit-6 Valuation principles and contingent assets

Valuation Principles:

There are 4 valuation principles on the basis of which the amounts which are to be presented in the Financial Statements are measured. These 4 principles are:

1. Historical Cost:

Under this principle the Assets Acquired are recorded at the original acquisition price or the original cost at which they were acquired.

For Eg: If ABC Co. had acquired a plant & machinery worth Rs.20.00 Lac in 2000 and had spent Rs.5.00 Lac towards its installation and other charges to bring to its usable condition.

Its value as per Historical cost would be Rs.25.00 Lac.

2. Current Cost:

Under this principle the cost of an asset is measured at the current amount of cash or cash equivalents to be paid to acquire the same.

For Eg: If ABC Co. had acquired a plant & machinery worth Rs.20.00 Lac in 2000 and had spent Rs.5.00 Lac towards its installation and other charges to bring to its usable condition. The Current Cost to acquire the machinery as of August 2018 was Rs. 45.00 Lacs.

Then as per the current cost principle it value would be Rs. 45.00 Lacs.

3. Realizable Value:

Under this principle the cost of an asset is measured at the amount of cash or cash equivalents which could be obtained by selling the asset in its present condition.

For Eg: If ABC Co. had acquired a plant & machinery worth Rs.20.00 Lac in 2000 and had spent Rs.5.00 Lac towards its installation and other charges to bring to its usable condition. It can sell the machinery in the market as on today for Rs.30.00 and it can buy new machine for Rs.45.00 Lacs.

Then as per the Realizable Value principle it value would be Rs. 30.00 Lacs.

4. Present Value:

Under this principle the asset is value at the present value of all the future net cash flows expected to be received from the asset over its course of life.

For Eg: If ABC Co. had acquired a plant & machinery worth Rs.20.00 Lac in 2000 and had spent Rs.5.00 Lac towards its installation and other charges to bring to its usable condition. It had expected that over its useful life of 20 years it will generate an output of Rs.2.00 Lac each year. Its expected rate of return is 10%.

Then as per the Present value Principle, it will be valued at Rs. 17,02,800/-
As per the PV Annuity table PV of Rs.1 received for 20 years at 10% rate of interest is 8.514. Therefore Rs.2.00 lac received for 20 years at 10% is Rs.17,02,800/-.

Accounting Estimate:

Till now we have seen how to value the transaction which have already taken place in past. But in the Financial Statements there are certain items which are based on future events which are uncertain.

The value of these future assets and liabilities is based on estimates. Therefore, it is important to select the estimates with a reasonable prudence and intelligence.

Organizations need to constantly evaluate the circumstances on the basis of which the estimates were made and revise their estimates as needed.

For Eg: When the company buys machinery it has to estimate its useful life. But in the evolving technological world it is highly possible that the circumstances on the basis of which the management had estimated life of 20 years have changed and now the machine has a useful life of only 15 years.

Then the management needs to revise its estimate of life of the machine and depreciation accordingly to bring it to the revised life.

Questions:

1. ABC Co. bought a machine in 2013 for Rs. 50.00 Lacs and spent another Rs. 10Lacs to install the machine and put it to its intended usage.

   After 5 years it found that the machine has Book value of Rs.45 Lacs and can be sold for Rs.48 Lacs in its present condition. The same machine cost Rs. 75 Lacs today.

   When it had bought the machine it had estimated that the machine had useful life of 20 years and its expected rate of return was 10%. The machine was expected to provide an annual cashflow of Rs.10 Lacs.

   Determine the value of Machine as per

   i.Historical Cost
   Rs.60/- Lacs

   ii.Current Cost.
   Rs.75/- Lacs.

   iii.Realizable Value.
   Rs.48/- Lacs

   iv.Present Value.
   Rs.85,14,000/- (10 Lacs X 8.514) [Using present value formula for annuity]

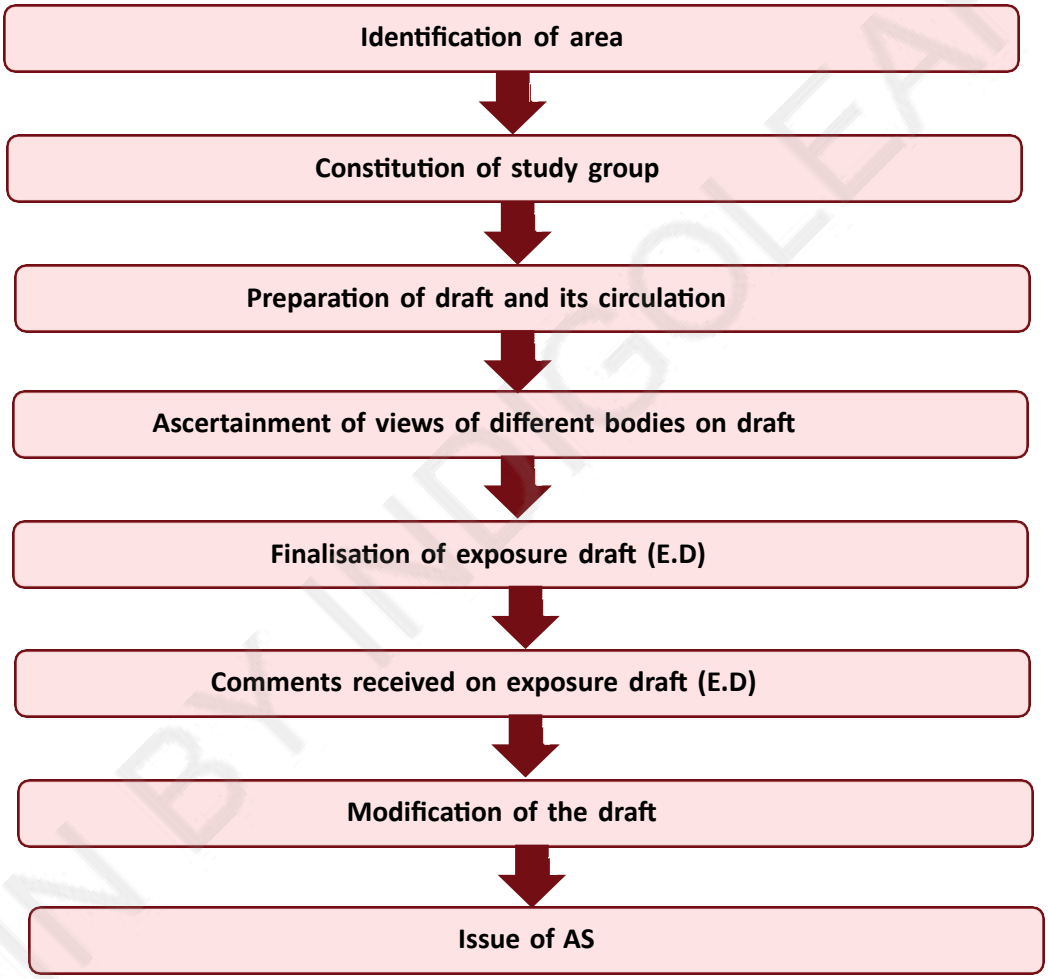
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UNIT 7: ACCOUNTING STANDARDS

Accounting Standards deal with the issues of

1. Recognition of events and transactions
2. Measurement of transactions and events
3. Presentation of transactions and events
4. Disclosure requirements

Formulation of Accounting Standards



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Introduction of Accounting standards

Accounting as a 'language of business' communicates the financial results of an enterprise to various stakeholders by means of financial statements. If the financial accounting process is not properly regulated, there is possibility of financial statements being misleading, tendentious and providing a distorted picture of the business, rather than the true. To ensure transparency, consistency, comparability, adequacy and reliability of financial reporting, it is essential to standardize the accounting principles and policies. Accounting Standards (ASs)

provide framework and standard accounting policies for treatment of transactions and events so that the financial statements of different enterprises become comparable.

Accounting standards are written policy documents issued by the expert accounting body or by the government or other regulatory body covering the aspects of recognition, measurement, presentation and disclosure of accounting transactions and events in the financial statements.

Objectives of Accounting Standards

The whole idea of accounting standards is centered around harmonisation of accounting policies and practices followed by different business entities so that the diverse accounting practices adopted for various aspects of accounting can be standardised. Accounting Standards standardise diverse accounting policies with a view to:

(i) eliminate the non-comparability of financial statements and thereby improving the reliability of financial statements; and

(ii) provide a set of standard accounting policies, valuation norms and disclosure requirements.

Benefits and limitations of accounting standards

Accounting standards seek to describe the accounting principles, the valuation techniques and the methods of applying the accounting principles in the preparation and presentation of financial statements so that they may give a true and fair view. By setting the accounting standards, the accountant has following benefits:

(i) Standards reduce to a reasonable extent or eliminate altogether confusing variations in the accounting treatments used to prepare financial statements.

(ii) There are certain areas where important information are not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.

(iii) The application of accounting standards would, to a limited extent, facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in this respect that differences in the institutions, traditions and legal systemsfrom one country to another give rise to differences in accounting standards adopted in different countries.

However, there are some limitations of accounting standards:

(i) ***Difficulties in making choice between different treatments:*** Alternative solutions to certain accounting problems may each have arguments to recommend them. Therefore, the choice between different alternative accounting treatments may become difficult.

(ii) ***Restricted scope:*** Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.

Process of formulation of accounting standards in India

The Institute of Chartered Accountants of India (ICAI), being a premier accounting body in the country, took upon itself the leadership role by constituting the Accounting Standards Board (ASB) in 1977. The ICAI has taken significant initiatives in the setting and issuing procedure of Accounting Standards to ensure that the standard-setting process is fully consultative and transparent.

The ASB considers International Financial Reporting Standards (IFRSs) while framing Indian Accounting Standards (ASs) in India and try to integrate them, in the light ofthe applicable laws, customs, usages and business environment in the country. The composition of ASB includes, representatives of industries (namely, ASSOCHAM, CII, FICCI), regulators, academicians, government departments etc. Although ASB is a body constituted by the Council of the ICAI, it (ASB) is independent in the formulation of accounting standards and Council of the ICAI is not empowered to make any modifications in the draft accounting standards formulated by ASB without consulting with the ASB.

The standard-setting procedure of Accounting Standards Board (ASB) can be briefly outlined as follows:

- Identification of broad areas by ASB for formulation of AS.
- Constitution of study groups by ASB to consider specific projects and to prepare preliminary drafts of the proposed accounting standards. The draft normally includes objective and scope of the standard, definitions of the terms used in the standard, recognition and measurement principles wherever applicable and presentation and disclosure requirements.
- Consideration of the preliminary draft prepared by the study group of ASB and revision, if any, of the draft on the basis of deliberations.
- Circulation of draft of accounting standard (after revision by ASB) to the Council members of the ICAI and specified outside bodies such as Department of Company Affairs (DCA), Securities and Exchange Board of India (SEBI), Comptroller and Auditor General of India (C&AG), Central Board of Direct Taxes (CBDT), Standing Conference of Public Enterprises (SCOPE), etc. for comments.
- Meeting with the representatives of the specified outside bodies to ascertain their views on the draft of the proposed accounting standard.
- Finalisation of the exposure draft of the proposed accounting standard and its issuance inviting public comments.
- Consideration of comments received on the exposure draft and finalisation of the draft accounting standard by the ASB for submission to the Council of the ICAI for its consideration and approval for issuance.
- Consideration of the final draft of the proposed standard and by the Council of the ICAI, and if found necessary, modification of the draft in consultation with the ASB is done.
- The accounting standard on the relevant subject (for non-corporate entities) is then issued by the ICAI. For corporate entities the accounting standards are issued by The

Central Government of India.

List of Accounting Standards in India

Sl. No.	Number of the Accounting Standard (AS)	Title of the Accounting Standard
1.	AS 1	Disclosure of Accounting Policies
2.	AS 2 (Revised)	Valuation of Inventories
3.	AS 3 (Revised)	Cash Flow Statements
4.	AS 4 (Revised)	Contingencies and Events Occurring after the Balance Sheet Date
5.	AS 5 (Revised)	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
6.	AS 7 (Revised)	Accounting for Construction Contracts
7.	AS 9	Revenue Recognition
8.	AS 10	Property, Plant and Equipment
9.	AS 11 (Revised)	The Effects of Changes in Foreign Exchange Rates
10.	AS 12	Accounting for Government Grants
11.	AS 13	Accounting for Investments
12.	AS 14	Accounting for Amalgamations
13.	AS 15 (Revised)	Employee Benefits
14.	AS 16	Borrowing Costs
15.	AS 17	Segment Reporting
16.	AS 18	Related Party Disclosures
17.	AS 19	Leases
18.	AS 20	Earnings Per Share
19.	AS 21	Consolidated Financial Statements
20.	AS 22	Accounting for Taxes on Income
21.	AS 23	Accounting for Investments in Associates in Consolidated Financial Statements
22.	AS 24	Discontinuing Operations
23.	AS 25	Interim Financial Reporting
24.	AS 26	Intangible Assets
25.	AS 27	Financial Reporting of Interests in Joint Ventures
26.	AS 28	Impairment of Assets
27.	AS 29	Provisions, Contingent Liabilities & Contingent Assets

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Chapter 2 – Accounting Process

Unit-1 Journal Entries

Double Entry System:

The Double Entry System of Accounting is the most commonly used system of Accounting.

According to Double Entry System, Every transaction has two aspects a Debit and a Credit.

For every transaction entered into there will be one or more Debit and one or more Credit and the total of debit will be equal to the total of credit.

Advantages of Double Entry System:

Following are the advantages of Double Entry System due to which it is extensively used in all the countries.

i. The accuracy of the accounting can be established by the preparation of the trial balance.
ii. The result of the operations carried on during a period of time i.e. either profit or loss can be ascertained with details.
iii. The financial position of the organization can be ascertained at the end of each period through the balance sheet.
iv. The accounts can be kept in as much details as required and provides information for the purposes of control etc.
v. Result of one year may be compared with those of previous years and reasons for the change may be easily determined.

Debits and Credits:

Debits and Credits are the 2 sides of same coin. For every debit there will always be an equal and corresponding credit.

The Rules of Debit and Credit can be summarized as follow:

i. Increases in assets = debits & decrease in assets = credits.
ii. Increases in liabilities = credits & decreases in liabilities = debits.
iii. Increases in owner's capital = credits & decreases in owner's capital = debits.
iv. Increases in expenses = debits & decreases in expenses = credits.
v. Increases in revenue or incomes = credits & decreases in revenue or incomes = debits.

There are 2 methods of recording every transaction by under the Double Entry System.

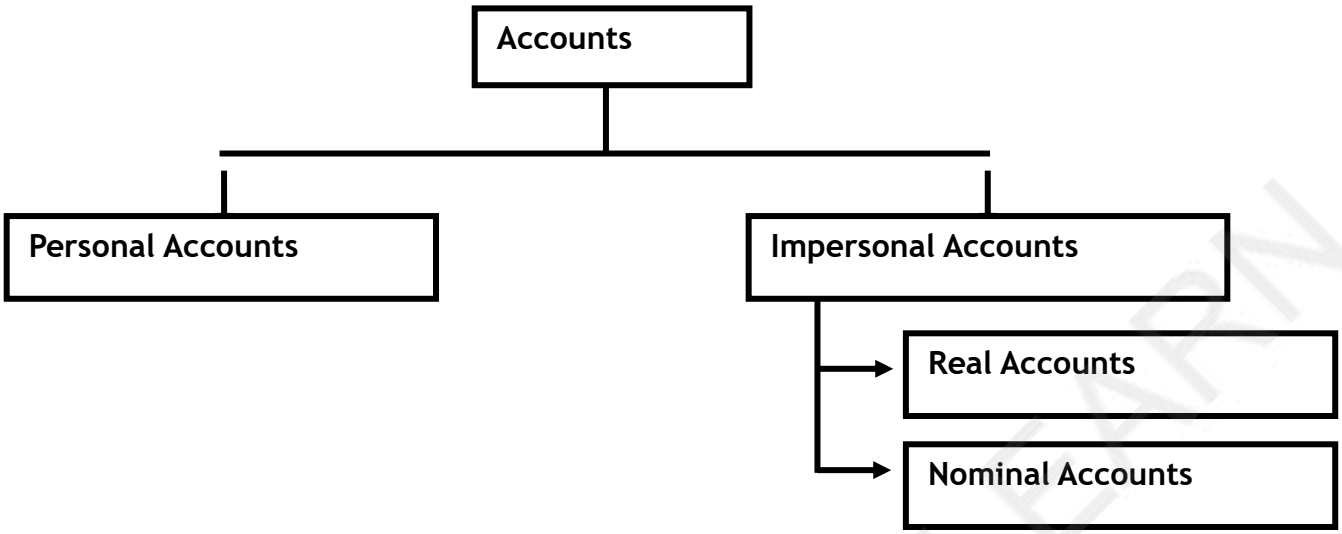
Journal Entry – Traditional Approach:

To understand the traditional approach it is important to understand 2 important factors

i. Classification of Accounts.
ii. Golden Rules of Accounting.

Classification of Accounts:

Classification of Accounts under traditional accounts is based on Personal and Impersonal Accounts.
[GroupDrawing]



Interpretation of the Accounts:

1. **Personal Accounts:**
   These are the accounts which relate to someone who can be identified. All those accounts that have their own identity either as an individual or as a legal establishment such as Mr.A, ABC &Co, etc. are classified as Personal Accounts.

2. **Real Accounts:**
   These are the accounts which represent the assets of the firm either tangible or intangible such as Cash, Bank, Inventory, Trademark, Goodwill, etc.

3. **Nominal Accounts:**
   These are the accounts which are presented in the Profit & Loss account. This includes all the revenues, expenses, gains & Losses. The important feature of the Nominal Accounts is that they are temporary accounts and are written off by the end of the accounting period by transfer to Profit & Loss Account.

Golden Rules of Accounting:

The Golden Rules of Accounting states the rules of debit and credit for every type of accounts. The summary of Golden Rule of Accounting is as follow:

Type of Account	Debit	Credit
Personal Account	When Receiving	When Giving
Real Account	When it comes in	When it Goes out
Nominal Account	All the Expenses and Losses	All Incomes and gains

Example on Journal Entry:

Prepare the Journal entries for the following transactions:

1. Mr. A Introduced capital of Rs.10.00 lac to start his business.
2. Purchased Machinery worth Rs.2.00 Lac by paying the entire amount.
3. Purchased goods on credit from Mr. B worth Rs. 50 Thousand.
4. Sold goods for Rs. 4.00 Lac to Mr.C and of Rs.1.00 Lac in cash.

The Journal entries for the above transaction are as follow:

Date	Particulars		Debit	Credit
	Bank A/c	Dr.	1,000,000	
	To Mr. A Capital A/c			1,000,000
	(Being capital Introduced by Mr.A)			
	Machinery A/c	Dr.	200,000	
	To Cash/Bank A/c			200,000
	(Being Machinery Purchased)			
	Purchase A/c	Dr.	50,000	
	To Mr.B A/c			50,000
	(Being Goods Purchased on Credit)			
	Mr.C A/c	Dr.	400,000	
	To Sales A/c			400,000
	(Being Goods Sold on Credit to Mr.C)			
	Cash/Bank A/c	Dr.	100,000	
	To Sales A/c			400,000
	(Being cash sales made)			

Accounting Equation – Modern Approach:

The other approach to record the transactions is the Modern Approach of accounting which is based on the Accounting Equation. The relationship among the Assets, Liabilities and Owner's equity can be expressed in terms of an Equation which is known as the "Accounting Equation."

Assets = Liabilities + Owner's Equity

The owner's equity is computed as follow:

Contributed Capital
Add: Beginning Retained Earnings (Opening balance in Profit & Loss)
Add: Profit earned during the period (Revenues – Expenses)
Less: Dividends distributed (Drawings made)

The Modern classification of accounts can be summarized in the following table:

Account Type	Account shown a Normal Balance in	Debit when the account is to be	Credit when the account is to be
ASSET	Debit	Increase	Decrease
LIBAILITES	Credit	Decrease	Increase
CAPITAL	Credit	Decrease	Increase
REVENUE	Debit	Decrease	Increase
EXPENSES	Credit	Increase	Decrease
DRAWINGS	Debit	Increase	Decrease

Example on Modern Classification of Accounts:

Prepare the Journal entries for the following transactions:

1. Mr. A Introduced capital of Rs.10.00 lac to start his business.
2. Purchased Machinery worth Rs.2.00 Lac by paying the entire amount.
3. Purchased goods on credit from Mr. B worth Rs. 50 Thousand.
4. Sold goods for Rs. 4.00 Lac to Mr.C and of Rs.1.00 Lac in cash.

Date	Transaction	Accounts Involved	Nature of Accounts	Affected	Debit (Rs.)	Credit (Rs.)
		Bank	Asset	Increased	1,000,000	
	Capital introduced in Business	Capital	Capital	Increased		1,000,000
		Machinery	Asset	Increased	200,000	
	Machinery Purchased	Bank	Asset	Decreased		200,000
		Purchases	Expense	Increased	50,000	
	Goods Purchased on Credit	Creditor	Liability	Increased		50,000
		Debtor	Asset	Increased	400,000	
	Sold Goods on Credit	Sales	Revenue	Increased		400,000
		Bank	Asset	Increased	100,000	
	Sold Goods on Cash	Sales	Revenue	Increased		100,000

Accounting for GST

GST is a comprehensive Indirect Tax which has subsumed multiple Indirect Taxes such as Value added Tax (VAT), Excise Duty, Service Tax etc.

GST is a single tax on the supply of goods and services, right from the manufacturer to consumer.

On introduction of GST, the tax to be levied at all stages right from the manufacture up to final consumption was a single tax-GST, with credit of taxed paid at previous stages available as setoff.

Salient features of GST

a. GST is levied on supply.
b. Tax is levied only the value added at each stage of the supply chain.
c. GST is a destination-based consumption tax.
d. There is no tax on tax or cascading of taxes under GST system.
e. There is a hormonization of laws, procedures and rates of tax across the country.

Types of Taxes under GST

a. Intra-state supply: The location of the supplier and the place of supply of goods or services are in the same state/union territory.

b. Inter-state supply: The location of the supplier and the place of supply of goods or services are in two different states or two different union territories or a state and a union territory.

1. **Central Goods and Service Tax (CGST):** Levied and collected by the centre on the Intra-state supply of goods and services.

2. **State Goods and Service Tax (SGST):** Levied and collected by the state governments on Intra State supply of goods and services.

3. **Union Territory Goods and Service Tax (UTGST):** Levied and collected by Union Territories without legislatures on Intra-state supply of goods and services.

   Union Territories – Andaman and Nicobar Islands, Lakshadweep, Ladakh, Dadra and Nagar Haveli & Daman and Diu and Chandigarh

4. **Integrated Goods and Service Tax (IGST):** Levied on the inter state supply of goods and services and is collected by centre. IGST is equivalent to the sum total of CGST and SGST.

Input and Output GST

Input tax – The tax paid by the recipient on procurement of goods/services.

Entity at each stage is permitted to avail credit of GST paid on the purchase of goods and/or availment of services and can setoff this credit against the GST payable on the goods and/or services supplied by him.

Thus, the final consumer bears the GST charged in the supply chain, with set-off benefits at all the previous stages.

Output tax – The GST charged on supply of goods or services made by the supplier.
Input tax – The credit of Input tax already paid.

Utilisation of Input Tax Credit under GST

Tax credit of CGST, SGST and IGST can be utilized in the following manner:

Utilization of IGST credit:

a. First utilized against IGST liability
b. If any balance is still available – Utilized against CGST or/and SGST in any order and in any proportion

Utilization of CGST credit:

a. First utilized against CGST liability
b. If any balance available – Same can be utilized against IGST.
c. CGST credit cannot be utilized against SGST.

Utilisation of SGST credit

a. First utilized against SGST liability.
b. If any balance available – Same can be utilized against IGST.
c. SGST credit cannot be utilized against CGST.

	Input GST	**Output GST**
Nature	At the time of purchase of goods or services Input GST A/c is debited.	At the time of sale of goods/assets or supply of services Output GST A/c is credited.
Intra-state transaction	CGST paid is debited to Input CGST A/c SGST paid is debited to Input SGST	CGST charged is credited to output CGST A/c SGST charged is credited to Output SGST A/c
Inter-state transaction	IGST paid is debited to Input IGST A/c	IGST charged is credited to Output IGST A/c
Reversal of GST	Input GST paid at the time of purchase are reversed in following situations i. Purchase Return ii. Drawings iii. Free samples distribution iv. Goods distributed as gift v. Goods lost in fire or theft vi. Input tax credit not allowed to be availed by recipient	Reversed when the goods are returned by the purchaser.
Utilization of Input tax credit	Input GST A/c is credited when tax is paid by utilizing input tax.	

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Journal entries

The Double entry book-keeping records need to show the GST values separately so that the purchases, expenses and sales are posted without the addition of GST.

Sale of Goods or Services

Account Receivable/Debtors A/c	Dr	Gross Amount(Include GST)
To sales A/c		Net Amount
To Output GST		Ampunt of GST

Purchase of Goods or Services

Purchases A/c	Dr	Net Amount
Input GST A/c	Dr	Amount of GST
To Account payable/Creditors		Gross Amount

Utilization of Input Tax Credit towards payment of Output Tax

Output CGST A/c	Dr	Amount of GST liability
Output SGST A/c	Dr	Amount of GST liability
Output IGST A/c	Dr	Amount of GST liability
To Input CGST A/c		Amount of output GST liability paid utilizing input CGST
To Input SGST A/c		Amount of output GST liability paid utilizing input SGST
To Input IGST A/c		Amount of output GST liability paid utilizing Input IGST

Questions:

Show the effect of the following transactions using the Traditional approach as well as the Modern Approach.

i. Mr. A Introduced capital of Rs.25.00 lac to start his business.
ii. Purchased Machinery worth Rs.10.00 Lac by paying the Rs.5.00 Lac in cash and balance in credit from XYZ &Co.
iii. Purchased goods on credit from Mr. C worth Rs. 50 Thousand and in cash for Rs.1.50 Lacs
iv. Sold goods for Rs. 2.00 Lac to Mr.D and received amount of Rs.1.00 lac from him after 20 days.
v. Mr. A asked deposited amount of Rs.2.00/- Lac from his savings in Bank.

Illustration 1

Develop the accounting equation from following information available at the beginning of accounting period:

Particulars	**Amount (Rs.)**
Capital	51,000,000
Loan	11,500,000
Trade payables	5,700,000
Fixed Assets	12,800,000

Inventory	22,600,000
Trade receivables	17,500,000
Cash and Bank	15,300,000

At the end of the accounting period the balances appear as follows:

Particulars	**Amount (Rs.)**
Capital	?
Loan	11,500,000
Trade payables	5,800,000
Fixed Assets	12,720,000
Inventory	22,900,000
Trade receivables	17,500,000
Cash and Bank	15,600,000

a. Reset the equation and find out profit.
b. Prepare Balance Sheet at the end of the accounting period.

Illustration 2

Mr. Dravid has provided following details related to his financials. Find out the missing figures-

Particulars	**Amount (Rs.)**
Profits carved during the year	5,000,000
Assets at the beginning of year	A
Liabilities at the beginning of year	12,000,000
Assets at the end of the year	B
Liabilities at the end of the year	C
Closing capital	35,000,000
Total liabilities including capital at the end of the year	50,000,000

Illustration 3

From the following information, state the nature of account and state which account will be Debited and which will be Credited.

- Started business with a capital of Rs. 50,00,00
- Wages and salaries paid Rs. 50,000
- Rent received Rs. 2,00,000
- Purchased goods on credit Rs. 9,00,000
- Sold goods for Rs. 8,16,000 and received payment in cheque.

Illustration 4

Pass journal entries for the following:

Mohan Brought in Capital of Rs. 50,00,000
Out of the above, Rs. 25,000 is withdrawn from the bank.
Furniture is purchased for Rs. 12,00,000.
Purchased goods for cash Rs. 4,00,000.

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Purchased goods for Rs. 10,00,000 on credit from M/s Ram Narain Bros.
Sold goods to Ramesh on credit for Rs. 13,00,000.
Received cheque from Ramesh Rs. 13,00,000.

Illustration 5

Journalise the following transactions. Also state the nature of each account involved in the Journal entry.
Following figures are given in ('000)
Ajith started business with capital Rs. 4,00,000
He withdrew cash for business from the Bank Rs. 2,000
He purchased goods making payment through bank Rs. 15,000
He sold goods Rs. 16,000 and received payment through bank.
He purchased furniture and paid by cheque Rs. 2,500

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Unit-2 Ledgers

What is a Ledger?

Once all the transactions are recorded through Journal Entries, they need to be classified and grouped by preparing the accounts. The book in which all the accounts are prepared is known as "LEDGER".

Format of LEDGER:

DR.	ACCOUNT						CR.
DATE	PARTICULARS	J.F.	AMOUNT (Rs.)	DATE	PARTICULARS	J.F.	AMOUNT (Rs.)

The process of transferring the Journal Entries in the Ledger is known as **"POSTING"**.

Important rules to be noted while posting:

1. All the Accounts which have been entered in the Journal should have Ledger Account.
2. Whenever any account is mentioned in the Debit side of the Ledger it is supposed to use the word "TO" before the name of the account
3. Whenever any account is mentioned in the Credit side of the Ledger it is supposed to use the word "BY" before the name of the account
4. At a fixed interval of time the accounts needs to be balanced. Wherein the accounts are totaled and the balance on either side is carried forward to the next period for assets and liabilities. (Refer example to understand the concept of Balancing a Ledger). The balance in income and expenses ledgers are transferred to final accounts.

Example on Ledger:

Prepare the Purchase Account for the following transactions:

1. 10/08/2018 - Purchased goods of Rs.5.00 lac on credit from Mr. A.
2. 12/08/2018 - Purchased goods of Rs.1.00 lac in cash.
3. 15/08/2018 – Returned goods of Rs.1.00 lac Purchased from Mr. A

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DR.	PURCHASE ACCOUNT						CR.
DATE	PARTICULARS	J.F.	AMOUNT (Rs.)	DATE	PARTICULARS	J.F.	AMOUNT (Rs.)
10-08-18	To Mr.A A/c		500,000	15-08-18	By Mr.A A/c		100,000
12-08-18	To Cash A/c		100,000				
				31-08-18	By Balance c/d		500,000
	TOTAL		600,000		TOTAL		600,000
01-09-18	To Balance c/d		500,000				

Note:

1. Whenever the Purchase account was debited in the Journal the corresponding credit account is mentioned on the debit side of the journal with the word "TO" before it.

2. Whenever the Purchase account was credited in the Journal the corresponding credit account is mentioned on the debit side of the journal with the word "BY" before it.

3. At the end of the month the total of both the sides is done. The deficit amount on the lower side is mentioned as Balance c/d which is known as Balancing of the Account.

Questions:

1. Prepare the Ledgers for the various transactions entered into by the company as follow:
   i. Mr. A Introduced capital of Rs.25.00 lac to start his business.
   ii. Purchased Machinery worth Rs.10.00 Lac by paying the Rs.5.00 Lac in cash and balance in credit from XYZ &Co.
   iii. Purchased goods on credit from Mr. C worth Rs. 50 Thousand and in cash for Rs.1.50 Lacs
   iv. Sold goods for Rs. 2.00 Lac to Mr.D and received amount of Rs.1.00 lac from him after 20 days.
   v. Mr. A asked deposited amount of Rs.2.00/- Lac from his savings in Bank.

(Hint – Use the Journal entries created while solving the exercise for chapter 2.1)

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Unit-3 Trial Balance

What is a Trial Balance?

After the entire ledger accounts for the various transactions which were recorded via Journal Entries is completed. The Next step is the creation of the Trial balance.

Trial Balance contains the debit and credit balance of the various ledgers. It is important to note that the total of debit column and credit column needs to be equal for the trial balance to be complete.

Objectives of Preparing a Trial Balance:

The Objectives of preparing a Trial Balance are as mentioned below:

i. Trial balance helps to establish arithmetical accuracy of the books of Accounts.
ii. Financial statements are normally prepared on the basis of agreed trial balance otherwise the work may be cumbersome. So it can be stated that the preparation of trail balance eases the preparation of Financial Statements.
iii. The trial balance serves as a summary of all the ledger balances.

LIMITATIONS OF TRIAL BALANCE:

The agreement of Trial Balance is not a final evidence of the accuracy of the trial balance. The Arithmetical accuracy shows the fact that all the debit balance equals the credit balances. However, there are certain possibilities whereby even though the trial balance is agreed upon it is still inaccurate.

It is possible that the following types of errors still exist and the trial balance is agreed upon.

i. Transaction has not been entered at all in the journal. Hence, is not entered in Ledger and not accounted for in Trial balance.
ii. A journal recorded with wrong Amount.
iii. A journal recorded with wrong Accounts.
iv. Omitting to record a Journal entry in the Ledger.
v. Posting the same journal entry twice in the ledger.

It is to be noted that the preparation of trial balance still cannot be omitted due to the above mentioned limitations.

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Format of TRIAL BALANCE:

Trial Balance as at _____

Sr.No.	Ledger Account	L.F.	Debit Amount	Credit Amount

Adjusted Trial Balance:

Sometimes it may happen that the trial balance does not agree even after entering all the amounts correctly from the Ledgers. In such situations the entities use suspense account to balance the trial balance. Wherein they transfer the difference in the suspense account and agree the trial balance. This kind of trial balance which has suspense account in it is known as Agreed Trial Balance.

Methods of preparing Trial Balance:

There are 3 different methods of preparing Trial Balance. The only difference in these 3 methods is the manner of presenting the ledger balances.

1. **TOTAL METHOD:**

Under this method, every ledger account is totaled and that total amount of debit side and credit side is transferred to trial balance. In this method, trial balance can be prepared as soon as ledger accounts are totaled. There is no need to balance the ledger Accounts.

2. **BALANCE METHOD:**

Under this method, only the ledger balances of the various ledger accounts are transferred to trial balance. This is the most commonly used method of creating trial balance. Also, it is to be noted that the Financial Statements are prepared on the basis of the Ledger Account Balances.

3. **TOTAL AND BALANCE METHOD:**

This is a combination of the above mentioned 2 methods. Under this method the trial balance shows the total columns as well as the balance columns.

Example on Trial Balance:

The Balances of the various ledgers and the total of the ledger columns are as presented below: Prepare the Trial Balance for the following Ledger Accounts as per the 3 different methods.

Sr.No.	Account Name	Balance Amount (Rs.)	Total Amount (Rs.)
1	Cash A/c	10,000	50,000
2	Furniture A/c	25,000	25,000
3	Salaries A/c	20,000	60,000
4	Mr.A Capital A/c	100,000	370,000
5	Debtors A/c	50,000	150,000
6	Creditors A/c	80,000	100,000
7	Bank A/c	40,000	120,000
8	Sales A/c	130,000	145,000
9	Purchases A/c	155,000	200,000
10	Trade Discounts Given A/c	10,000	10,000

Note:

1. The Total Amount represents the total of the Ledger Accounts.
2. The Balance Amount represents the amounts remaining after the balancing of the respective ledgers which are carried forward.

TRIAL BALANCE AS PER TOTAL METHOD:

Table image

Note: Here we have considered only the amount from the total column.

TOTAL METHOD

Trial Balance as at _____

Sr.No.	Ledger Account	L.F.	Debit Amount	Credit Amount
1	Cash A/c		50000	
2	Furniture A/c		25000	
3	Salaries A/c		60000	
4	Mr.A Capital A/c			370000
5	Debtors A/c		150000	
6	Creditors A/c			100000
7	Bank A/c		120000	
8	Sales A/c			145000
9	Purchases A/c		200000	
10	Trade Discounts Given A/c		10000	
	TOTAL		615000	615000

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TRIAL BALANCE AS PER BALANCE METHOD:

BALANCE METHOD

Trial Balance as at _____

Sr.No.	Ledger Account	L.F.	Debit Amount	Credit Amount
1	Cash A/c		10000	
2	Furniture A/c		25000	
3	Salaries A/c		20000	
4	Mr.A Capital A/c			100000
5	Debtors A/c		50000	
6	Creditors A/c			80000
7	Bank A/c		40000	
8	Sales A/c			130000
9	Purchases A/c		155000	
10	Trade Discounts Given A/c		10000	
	TOTAL		310000	310000

Note: Here we have considered only the amount from the BALANCE column.

TRIAL BALANCE AS PER TOTAL & BALANCE METHOD:

TOTAL & BALANCE METHOD

Trial Balance as at _____

Sr.No.	Ledger Account	L.F.	Debit Total	Credit Total	Debit Balance	Credit Balance
1	Cash A/c		50000		10000	
2	Furniture A/c		25000		25000	
3	Salaries A/c		60000		20000	
4	Mr.A Capital A/c			370000		100000
5	Debtors A/c		150000		50000	
6	Creditors A/c			100000		80000
7	Bank A/c		120000		40000	
8	Sales A/c			145000		130000
9	Purchases A/c		200000		155000	
10	Trade Discounts Given A/c		10000		10000	
	TOTAL		615000	615000	310000	310000

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Unit-4 Subsidiary Books

What is Subsidiary Book?

All the transactions incurred by business on a daily basis can be classified into few major activities which are Receipt and Payment of Cash, Sale of Goods and Purchase of Goods.

To facilitate ease of work a separate register is maintained which records all the transactions for each such class of transactions. For the entries mentioned in such registers there wouldn't be any Journal Entries. The balances from these registers in respect of the particular items will be directly posted in the Ledger.

This separate registers where the entries are first made are known as **"SUBSIDIARY BOOKS"**.

The following Subsidiary Books are commonly prepared and maintained by the businesses:

1. Cash Book:
   Records all transactions related to receipts and payments.

2. Purchase Book
   Records credit purchase of goods which are required by the entity in its daily operations.

3. Purchase Return Book
   Records the return of the goods purchased on credit.

4. Sales Book
   Records Credit sales of goods made by the entity.

5. Sales Return Book
   Records sales return made by the customers.

6. Bills Receivable & Bills Payable
   If the entity deals in promissory notes they record it in a separate subsidiary book for all the Bill Receivable and Bills Payable.

7. Journal Book
   This is the book where if any transaction cannot be recorded in the above 7 books they are recorded in this book.

Advantages of Subsidiary Book:

The following are the advantages of the Subsidiary Books:

1. **Division of Work:**
   Every Subsidiary book deals in a specific area of business. Therefore, it is possible to allocate resources on a specific of work based on the volume

2. **Specialization of Work:**
   Since the work is divided into different areas of business, it can be specialized by allocating and training resources on a particular domain.

3. **Time Saving:**
   Since the need to maintain the Journal is eliminated for the transactions entered into the subsidiary books and there are various accountants involved for different work areas, it leads to Time Savings.

4. **Information Availability:**
   Since all the common areas of work are identified and maintained in separate books it is easy to access information about a specific area of work without going through all the different records.

5. **Easiness in Locating errors:**
   If the Trial Balance does not agree, it is easy to identify the area where there might be an issue due to the maintenance of various subsidiary books.

Difference between Principal Books and Subsidiary Books:

The book in which transactions are recorded first for further processing is called Subsidiary Books. The details entered into subsidiary books are transferred to the Ledgers and from the Ledgers to the trial balance and ultimately to the Financial Statements.

The Ledger and the Cash Book are called the Principal Books. This is because they facilitate the information needed to prepare the trial balance and financial statements.

Example on Subsidiary Book (Purchase Books):

Prepare the Purchase Book from the following transactions and post their balances in Ledger.

Date	Transaction
01-08-18	Purchased from ABC & Co. 10,000 units @ Rs.10 each
	Received Trade Discount of 5% on the above purchases
	Paid Freight Charges for Rs.7000/- on the above purchases
10-08-18	Purchased from XYZ & Co. 5,000 units @ Rs.15 each
	Received Trade Discount of 10% on the above purchases
	Paid Freight Charges for Rs.1000/- on the above purchases

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The purchase book for the above transactions is as follow:

	PURCHASE BOOK					
DATE	PARTICULARS	GROSS AMOUNT	TRADE DISCOUNT	NET PRICE	FREIGHT	TOTAL
01-08-18	ABC & Co.					
	10,000 units @ Rs.10 each, Trade Discount 5%	100,000	5,000	95,000	7,000	102,000
10-08-18	XYZ & Co.					
	5,000 units @ Rs.15 each, Trade Discount 10%	75,000	7,500	67,500	1,000	68,500
	TOTAL	175,000	12,500	162,500	8,000	170,500

The ledger posting for the above transactions recorded in the Purchase Book is as Follow:

DR.	PURCHASE ACCOUNT						CR.
DATE	PARTICULARS	J.F.	AMOUNT (Rs.)	DATE	PARTICULARS	J.F.	AMOUNT (Rs.)
31-08-18	To Amt. as per Purchase Book		162,500				

DR.	FREIGHT ACCOUNT						CR.
DATE	PARTICULARS	J.F.	AMOUNT (Rs.)	DATE	PARTICULARS	J.F.	AMOUNT (Rs.)
31-08-18	To Amt. as per Purchase Book		8,000				

DR.	ABC & Co.						CR.
DATE	PARTICULARS	J.F.	AMOUNT (Rs.)	DATE	PARTICULARS	J.F.	AMOUNT (Rs.)
31-08-18				31-08-18	By Purchase A/c		95,000
				31-08-18	By Freight A/c		7,000

DR.	XYZ & Co.						CR.
DATE	PARTICULARS	J.F.	AMOUNT (Rs.)	DATE	PARTICULARS	J.F.	AMOUNT (Rs.)
31-08-18				31-08-18	By Purchase A/c		67,500
				31-08-18	By Freight A/c		1,000

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Questions:

1. Prepare the Sales Subsidiary Books for the following transactions and prepare the Ledger posting for the same.

Date	Transaction
01-08-18	Sold 20,000 units @ Rs.25 each to ABC & Co.
	Proivded Trade Discount of 2% on the above sales
10-08-18	Sold 15,000 units @ Rs.15 each for cash to XYZ & Co.
	Proivded CAsh Discount of 3% on the above sales
10-08-18	Sold old Computer for Rs.50,000 for Cash

Hint:

1. The sale of Computer is a sale of Fixed Asset and not normal sale made in the course of business.
2. The Cash Sales will be recorded in Cash Book. Only credit sales are recorded in Sales Book.

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Unit-5 Cash Books

What is CASH Book?

As discussed in the Subsidiary Books, Under Cash Book all the transactions wherein cash has been received or paid are recorded.

Cash Book plays a dual role as a Principal as well as a Subsidiary Book also.
This is because all the transactions related to payment and deposit of cash is recorded in the cash book directly. Therefore, it is treated as Subsidiary Book. But cash book also serves as a basis for preparing the trial balance thereby serving as a Ledger also. Hence, it is a principal book.

Different Kinds of Cash Book.
There are mainly 3 kinds of Cash Book.

i. Simple Cash Book
ii. Two Column Cash Book
iii. Three Column Cash Book

Some organizations also maintain another form of cash book known as Petty Cash Book.

1. **Simple Cash Book:**
   This is like a simple Cash Ledger Account. Wherein the deposits are recorded on the debit side and the payments are recorded on the credit side.

   Important points to be noted in this regard are:
   i. Only Cash receipts and payments are recorded.
   ii. The cash receipts total is always greater than cash payments total. Since payments cannot be greater than the amount of cash available.
   iii. Simple cash book is the ordinary cash ledger account.

Example on Simple Cash Book:
Record the following transactions in the simple cash book:

Date	Transaction	Amount Rs.
01-08-18	Cash in Hand	50,000
05-08-18	Received from Mr. A	5,000
07-08-18	Paid for Salaries of July 2018	30,000
08-08-18	Paid for Rent for August 18	5,000
09-08-18	Received amount due from Mr. B	25,000
15-08-18	Received amount due from Mr. D	45,000
20-08-18	Purchased Office Equipments	20,000
29-08-18	Purchased Stationery	15,000

DR.	CASH BOOK						CR.
DATE	Receipts	L.F.	AMOUNT (Rs.)	DATE	Payments	L.F.	AMOUNT (Rs.)
01-08-18	To Balance b/d		50,000	07-08-18	By Salaries		30,000
05-08-18	To Mr.A		5,000	08-08-18	By Rent		5,000
09-08-18	To Mr. B		25,000	20-08-18	By Office Equipments		20,000
15-08-18	To Mr. D		45,000	29-08-18	By Stationery		15,000
				31-08-18	By Balance c/d		55,000
	TOTAL		125,000		TOTAL		125,000

2. **Double Column Cash Book:**

When an additional column is added to the simple cash book which shows either discount allowed or discount received. Alternatively, the new column can also show payments made through the Bank and deposits received in the bank. It is known as a Double Column Cash Book.

Important points to be noted in this regard are:

i. The discount columns if prepared are not balanced. They are just totaled to reflect the total discount received and total discount given.

ii. If the bank Column is prepared then the cash and bank column are recorded in the same manner as the simple cash book. The balancing figure of the bank balance will be the Balance in the Bank.

Example on double Column Cash Book:

Record the following transactions in the Double Column cash book preparing the discount column:

Date	Transaction	Amount Rs.
01-08-18	Cash in Hand	50,000
05-08-18	Cash Sales made to Mr.A	100,000
05-08-18	Cash Discount allowed	5,000
07-08-18	Paid for Salaries of July 2018	30,000
08-08-18	Paid for Rent for August 18	5,000
09-08-18	Received amount due from Mr. B	25,000
09-08-18	Cash Discount allowed	1,000
15-08-18	Amount paid to Mr. D	40,000
15-08-18	Cash Discount Received	2,000
20-08-18	Purchased Office Equipments	20,000
29-08-18	Purchased Stationery	15,000

DR.	CASH BOOK								CR.
DATE	Receipts	L.F.	Discount	AMOUNT (Rs.)	DATE	Payments	L.F.	Discount	AMOUNT (Rs.)
01-08-18	To Balance b/d			50,000	07-08-18	By Salaries			30,000
05-08-18	To Mr.A		5000	100,000	08-08-18	By Rent			5,000
09-08-18	To Mr. B		1000	25,000	15-08-18	By Mr. D		2000	40,000
					20-08-18	By Office Equipments			20,000
					29-08-18	By Stationery			15,000
					31-08-18	By Balance c/d			65,000
	TOTAL		6000	175,000		TOTAL		2000	175,000
01-09-18	To Balance b/d			65,000					

3. **Three Column Cash Book:**

Most of the organizations keep most of their balances in the Bank and the money can be deposited and withdrawn at any point of time as per their requirements.

The only difference between cash in hand and money in bank is the location of the cash amount. But it is important to track the moment in both of them. That purpose is served by the three column cash book.

Another column is added to the Cash and discount column which is the Bank Column. All the deposits and payment made in Bank are entered in the Bank Column.

The most important factor to be noted in the three column cash book is the method of recording contra entries.

For instance when cash is deposited in the bank the Receipt Column on the bank side is debited and the cash column on the credit side is credited. This shows the increase in the bank balance and decrease in the cash balance due to depositing cash in Bank.

Example on Three Column Cash Book:

Record the following transactions in the Three Column cash book:

Date	Transaction	Amount Rs.
01-08-18	Cash deposited in bank for commencing business	50,000
04-08-18	Cash deposited in current account	10,000
05-08-18	Cash Collected from Mr. A	40,000
05-08-18	Cash Discount allowed	2,000
10-08-18	Amount paid to Mr. D	50,000
10-08-18	Cash Discount Received	3,000
25-08-18	Amount withdrawn from Bank	10,000

DR.	CASH BOOK										CR.
DATE	Receipts	L.F.	Discount	Cash	Bank	DATE	Payments	L.F.	Discount	Cash	Bank
01-08-18	To Capital A/c				50,000						
04-08-18	To Cash A/c	C			10,000	04-08-18	By Bank A/c	C		10000	
05-08-18	To Mr. A A/c		2000		40,000	10-08-18	By Mr. D A/c		3000		50,000
25-08-18	To Bank	C		10000		25-08-18	By Cash A/c				10,000
						31-08-18	By Balance c/d				40,000
	TOTAL		2000	10000	100,000		TOTAL		3000	10000	100000
01-09-18	To Balance b/d				40,000						-

IMPEREST SYSTEM OF PETTY CASH BOOK:

Sometimes business have to make a lot of petty payments in cash as a part of their operational and miscellaneous expenses.

It would be highly inconvenient for the main cashier to deal in such transactions on a daily basis. For the sake of convenience companies install the Petty Cash System.

Under the system of petty cash, a small imprest amount of cash is always maintained in the petty cash balance. The petty cashier pays all the petty expenses during the given period and at the beginning of the next period may be a week or month the petty cashier is provided the deficit to bring the petty cash balance to the originally decided amount.

For instance, if the company decides to maintain a petty cash balance of 10,000 on a weekly basis. And the petty cashier incurs an expense of Rs. 5,000 during the given week. Then at the beginning of the next week he will be reimbursed Rs.5,000 of the expenses incurred by him to bring the petty cash balance to the decided amount of Rs.10,000.

Example on Petty Cash Book:
Record the following transactions in the Petty cash book:

Record the following transactions in the Petty cash book:

Date	Transaction	Amount Rs.
01-08-18	Received Rs.1000 for Petty Cash	1,000
04-08-18	Paid to office boy for travel reimbursement	100
05-08-18	Paid for Postage & telegram	150
07-08-18	Paid for Stationery	50

PETY CASH BOOK

Receipts	Date	V.No.	Particulars	Total	Travel	Postage	Stationery
1,000	01-08-18		To Cash				
	04-08-18		By Travel	100	100		
	05-08-18		By Postage	150		150	
	07-08-18		By Stationery	50			50
				300	100	150	50
			By Balance c/d	700			
1,000			**TOTAL**	**1,300**	**200**	**300**	**100**
700			To Balance b/d				
300	08-08-18		To CASh				

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Unit-6 Rectification of Errors

What are ERRORS?

Since Accounting involves a huge amount of recurring and record-keeping task it is highly possible that sometimes unintentional omission or commission of amounts and accounts may happen during the preparation of the accounts while recording them. This is known as ERROR in ACCOUNTING.

It is also possible that there may be due to mathematical mistake due to which the trial balance may not agree.

Whatever kind of error has occurred it is important to rectify the error that have occurred and been detected so that the Financial Statements show a True and Fair view of the various transactions and events.

How the errors can occur?

1. **Wrong Entry of amounts in the books of accounts.**
   For Eg: Sales of Rs. 15650/- recorded as sales of Rs.15065/-

2. **Wrong posting of the Subsidiary Books.**
   For Eg: As per the Purchase Books the total purchases for the month of August 18 was of Rs. 19250/- recorded as purchases of Rs.19520/- while posting it in the Ledger.

3. **Posting the entries in the wrong account:**
   For Eg: Purchases from Mr. A are posted as purchases from Mr.B

STAGES OF ERRORS:

Till now we have been able to see that accounting involves multiple processes from recording a transaction to posting ledger to preparation of the Financial Statements.

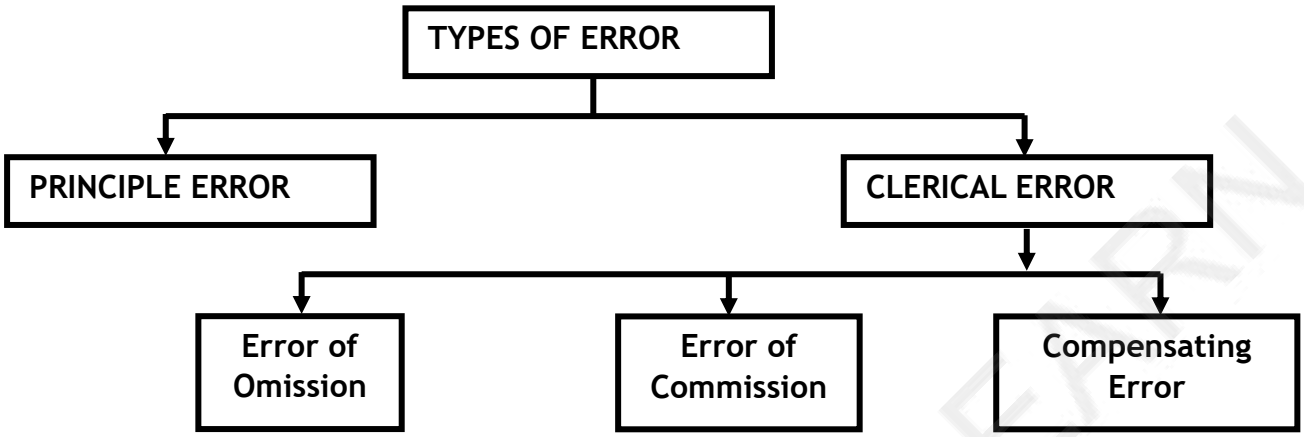
An error can occur at any stage; broadly speaking the error can occur during any of the following stages based on the flow of the process:

1. When recording the transaction in Journal.
2. While posting entries in the Ledger.
3. Balancing the Ledger Accounts.
4. Preparing the Trial Balance.

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TYPES OF ERRORS:

Classification of errors can be understood from the following table:



Error of Principle:

This error occurs when the transactions are recorded in a fundamentally wrong manner ignoring the principles of Accounting.

For Eg: When the purchase of Computer (Fixed Asset) is recorded as office expense.

Clerical errors:

1. **Error of Omission:**

This error occurs when the recording of transactions is omitted from the books of accounts.

For Eg: Omitting to record a purchase entry from the journal or omitting to record the journal entry in the ledger.

2. **Error of Commission:**

This error occurs when the amounts are posted in the wrong account, or a debit amount is written on the credit side, or the amounts are written wrong.

3. **Compensating Errors:**

These are the errors whose combine effect cancels out each other. For Eg: if salaries account is overbooked by Rs. 1000/- and the office expense is under booked by the same amount i.e. Rs.1000/- then the final profit remains unaffected. These types of errors are known as "COMPENSATING ERRORS".

Apart from the above mentioned classification based on principle of error or clerical error there is also another category of error which can occur which is based on whether they affect the trial balance or not.

The errors which affect the trial balance are as stated below:

i. Wrong casting of the subsidiary books.

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ii. Wrong balancing of an account.
iii. Posting an amount on the wrong side.
iv. Posting the wrong amount.
v. Omitting to post an amount from a subsidiary book.
vi. Omitting to post the totals of subsidiary book.
vii. Omitting to write the cash book balances in the trial balance.
viii. Omitting to write the balance of an account in the trial balance.
ix. Writing a balance in wrong column of the trial balance.
x. Totaling the trial balance wrongly.

The errors which do not affect the trial balance are as stated below:

i. Omitting an entry altogether from the subsidiary book.
ii. Making an entry with the wrong amount in the subsidiary book.
iii. Posting an amount in a wrong account but on the correct side, e.g., an amount to be debited to A debited to B, the trial balance will still agree.

Steps to Locate the Error:

If the trial balance does not agree then it is a first indicator that there are errors in the accounts and there can be various reasons the existence of errors which needs to be enquired upon and rectified.

The following steps helps in identifying the errors:

1. The two columns of the Trial Balance should be verified and is there are multiple amounts which are represented by a single amount in the trial Balance then even those amounts should be verified again.
   For eg: if the trial balance shows only a single amount for Trade Payables for the various accounts then the list of the trade payables should also be verified.

2. Verify the Cash and Bank Balances written in the trial balance.

3. The exact difference in the trail balance should be determined. All the ledgers should be scrutinized thoroughly to verify whether any amount of the exact difference has been omitted from recording in the trial balance.

4. The Ledger accounts should be re balanced.

5. Recheck the casting of subsidiary books.

6. Posting of the amount equal to the difference in the trial balance or the half amount of the difference should be checked. If the amounts are posted on the wrong side the difference doubles up.
   For Eg: If the amount of Rs.1000 to be posted in the debit side is posted on the credit side then the trial balance would be showing a difference of Rs. 2000/-. The omission of Debit of Rs.1000/- and additional credit of Rs.1000/-

7. If the difference still exists a complete checking of the entire books of accounts would be necessary.

Rectification of an Error:

Errors always need to be corrected in a systematic way such that the effect of the error is nullified and the correct entry is also shown in the accounts.

The rectification of error depends on which stage the error is detected. The stage at which the rectification needs to happen depends on the following stages:

1. Before Preparation of Trial Balance
2. After the preparation of Trial Balance but before the preparation of the Final Accounts.
3. After preparation of Final Accounts.

Rectification of error before preparation of trial balance:

These categories of errors are identified during or before preparation of the Trial Balance and corrective entries need to be made to rectify the same.

The Rectification has to be done in 2 steps:

i. Pass a reverse entry of the wrong entry. This will nullify the effect of the wrong entry.
ii. Pass the correct Journal entry to ensure that proper effect of transactions is accounted.

Example:

Purchase of Fixed Asset for Rs. 1,00,000/- from ABC & Co. has been booked under Purchases. Rectify the same.

The following states the wrong entries made and the correct entry to be passed for the rectification.

Wrong Entry	Reversal of Wrong entry	Correct Entry
Purchase A/c Dr. 100000 To ABC & Co. A/c 100000	ABC & Co. A/c Dr. 100000 To Purchases 100000	Fixed Assets A/c Dr. 100000 To ABC & Co. A/c 100000

Rectification of error after preparation of trial balance but before preparation of Final Accounts:

Sometimes when the trial balance does not agree it is made to agree artificially by opening a Suspense Account. If the debit total of the trial balance is higher than the suspense account is credited, and it is debited if the total of the credit side of the trial balance is higher.

All those errors which needs to be rectified by a Journal entry but were not able to be rectified due to the absence of complete journal entry will be rectified with the use of Journal Entry by using suspense account as the other part of the Journal.

Example:

Pass the rectification entry for the following errors using a Suspense Account:

1. The Sales book total is under casted by Rs.10,000/-
2. Goods Sold to Mr. B for Rs.2000/- But the accountant credited Mr. B instead of Debiting.
3. Discount received from Mr. C for Rs.500/- has been omitted from the discount column of the cash book. However, the discount is properly accounted in Mr. C Account.

DATE	PARTICULARS		L.F.	DEBIT (Rs.)	CREDIT (Rs.)
	Suspense A/c	Dr.		10,000	
	To Sales A/c				10,000
	(Being Sales increased for the amount undercasted)				
	Mr. B A/c	Dr.		4,000	
	To Suspense A/c				4,000
	(Being Amont wrongly credited to Mr. B rectified)				
	Suspense A/c	Dr.		500	
	To Discount Received A/c				500
	(Being Disocunt Received not recorded previously accounted for)				

DR. SUSPENSE ACCOUNT CR.

DATE	PARTICULARS	J.F.	AMOUNT (Rs.)	DATE	PARTICULARS	J.F.	AMOUNT (Rs.)
	To Sales A/c		10,000		By Difference in Trial Balance		6,500
	To Discount Received A/c		500		By Mr. B A/c		4,000
	TOTAL		10,500		TOTAL		10,500

Rectification of error in the next accounting Period:

All the errors discussed so far were on the assumption that these errors have taken place during the current year. However, sometimes the books of accounts for a particular period are prepared along with the errors itself. These errors however, need to be rectified in the following year.

For instance the purchase for the year 2017 were over stated by Rs.10000/- but the Financials of the year 2017 were finalized along with the errors itself and it was only in 2018 the company realized the presence of error in 2017 financial statements and intended to rectify it.

If the company rectifies the error by reducing the purchases in 2018 by Rs. 10000/- then it would be reducing the purchases for the year 2018 instead of 2017. It is to avoid these situations a special account named "PROFIT & LOSS ADJUSTMENT ACCOUNT" is used to rectify the errors of previous years.

It is to be noted that at the end of the current accounting period the balance of Profit & Loss Adjustment Account will be transferred to the Profit & Loss Account itself.

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It is to be noted that at the end of the current accounting period the balance of Profit & Loss Adjustment Account will be transferred to the Profit & Loss Account itself.

Example:

Mr. A was unable to agree the trial balance for 2017 and directly posted the differences in the Profit and Loss account. In 2018, the Auditors of the company revealed the following errors committed in 2017.

Rectify the mistakes noted above and use the Profit & Loss Adjustment Account wherever necessary:

i. Purchase of a Fixed Asset was debited to Printing & Stationery Account for Rs.5,000. Depreciation on Fixed Assets is levied at 10%.
ii. Sales account was overstated by Rs.20,000.
iii. A credit sale of goods to Mr. A for Rs.5,000 entered as a purchase.
iv. Rs. 1000 due by Mr. C was omitted from recording into the trial balance.
v. Purchase of goods from Mr. R for 5,000 was omitted to be recorded.
vi. Amount of Rs.2525 of purchase was wrongly posted as Rs.5252.

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DATE	PARTICULARS		L.F.	DEBIT (Rs.)	CREDIT (Rs.)
	Fixed Assets A/c	Dr.		4,500	
	To Profit & Loss Adjustment A/c				4,500
	(Being Purchase of Fixed Asset wrongly debited to Printing & Stationery rectified and asset is capitalised at the Depreciated value)				
	Profit & Loss Adjustment A/c	Dr.		20,000	
	To Suspense A/c				20,000
	(Being Sales account overstated in previous year rectified)				
	Mr. A A/c	Dr.		5,000	
	To Profit & Loss Adjustment A/c				5,000
	(Being Credit sales made to Mr.A recorded as Purchases now rectified)				
	Account Receivable A/c	Dr.		1,000	
	To Suspense A/c				1,000
	(Being Accounts receivable not recorded last year now accounted)				
	Profit & Loss Adjustment A/c	Dr.		5,000	
	To Mr.R A/c				5,000
	(Being Purchases made from Mr. R not recorded last year now accounted for)				
	Suspense A/c	Dr.		2,727	
	To Profit & Loss Adjustment A/c				2,727
	(Being excess posting of purchases of Rs.5252 instead of Rs.2525 now rectified)				
	Mr. A Capital A/c	Dr.		12773	
	To Profit & Loss Adjustment A/c				12773
	(Being Balance of Profit & Loss Adjustment Account trnasferred to Capital Account)				
	Suspense A/c	Dr.		18273	
	To Mr. A Capital A/c				18273
	(Being balance of Suspense Account trnasferred to Mr.A Capital A/c)				

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Chapter 3 – Bank Reconciliation System

OBJECTIVES

The lists of topics which will be covered in this chapter are as follows:

3.1 Understand Pass book

3.2 Understand the differences between cash book and bank pass book

3.3 Reconcile the difference between the cash book and bank pass book.

3.4 Intention of preparing the bank reconciliation system and its utility.

SERVICES PROVIDED BY BANK:

In the present time nearly all of the transactions of the organizations are performed through the banks whether it is a receipt or a payment at local, regional, national or international level. In Fact, it is legally necessary to carry out the transactions through bank after a certain limit.

Apart from receiving collections and making payments, the following services are also performed by the bank:

i. Discounting of promissory notes or hundies which enables the entities to receive the cash before the due date in exchange for a small charges.

ii. Allowing overdraft facilities to their credible customer which enables them to make payments even when they do not have sufficient balance in their account. These overdraft balances need to be cleared within a certain period of time.

iii. Providing loans to their customers which provide great financial assistance for their businesses.

iv. Collecting on behalf of the customer the amount of dividends, interest on securities etc.

v. Making Utility payments such as insurance premium, rent etc. on the due dates as instructed by their customers.

vi. Remitting money to another place or persons at a low cost.

vii. Providing security or guarantee for its customers whose credit is good, in return for a consideration,

viii. Issuing letter of credit or traveller's cheque which facilitates commerce as well as travel.

ix. Provides international banking services.

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BANK PASS BOOK AND BANK STATEMENT:

Bank pass book and Bank Statements provides the details of the customer's account in the bank. Through the Bank Pass Book and Bank Statement the bank keeps its customers informed of the entries made in their account. It is the customer's duty to check the entries and immediately inform the bank of any error that he may notice.
The bank balance shown in the passbook or the statement is known as pass book balance for reconciliation purpose. The credit balance as per pass book at a particular point of time is the deposit made by the customer while debit balance as per pass book is the overdraft balance for the customer.

BANK RECONCILIATION STATEMENT:

The Bank Reconciliation Statement reconciles the difference between the Bank Pass Book and Bank Balance as per the organization record eliminating any differences arising between them.
Whenever any deposit or withdraws is made from banks, it is always recorded at two places: -
1. Bank column of the cash book and
2. Bank statement or Bank pass book

The cash book is maintained by the customer having who has the bank account and the bank statement is prepared by the bank.

The balance in both the accounts should be equal and opposite in nature ideally. For e.g. If Mr. Z deposited 1,000 in his bank account, it should be recorded as Debit entry on the cash book of Mr. Z. And the same should be recorded as Credit Entry on the Customer Account maintained by the Bank.

In an Ideal world both the accounts should always match but it does not happen in most of the cases due to several reasons.

There are many reasons for these differences in balances which are explained later. These differences are reconciled by considering the various facts and figures on the two statements.

The process of reconciling the difference and bringing the two accounts in line with each other is known as "Reconciliation", and the statement in which the reconciliation is done is known as "BANK RECONCILIATION STATEMENT".

IMPORTANCE OF BANK RECONCILIATION STATEMENT:

Bank reconciliation statement acts as a tool for internal control of cash flows by detecting if any errors, frauds and irregularities have occurred at the time of passing entries in the cash book or in the passbook, whether intentionally or unintentionally. The important features of bank reconciliation statement can be summarized as follow:

i. The reconciliation identifies any errors that may have been committed either in the cash book or in the pass book.

ii. Any unreasonable delay in the clearance of cheques will be shown up by the reconciliation

iii. A regular reconciliation discourages the accountant of the bank from embezzlement. There have been many cases when the cashiers merely made entries in the cash book but never deposited the cash in the bank they were able to get away with it only because of lack of reconciliation.

iv. It helps in finding out the actual position of the bank balance.

v. It will ensure accounting of all the financial transactions incurred by the company during a particular financial year.

CAUSES OF DIFFERENCES:

The differences between the balance as per the Bank Pass Book and the Bank Balance as per the company's cash book arise mainly due to the following reasons:

1. **Timing of recording the transactions:**
   Due to the difference in the timing of recording the transaction.
   For e.g., If M has issued a cheque on 30th March, it will be recorded in the bank column of cash book on 30th March itself, but it will be recorded by the Bank only when it is presented for clearance giving rise to the difference.

2. **Transactions:**
   Some transactions are carried out by the bank directly and the customer becomes aware of it only when they perform the reconciliation.
   For e.g. crediting the interest in the customer's account directly.

3. **Errors:**
   Any kind of Mistake or error made either by the customers or the bank results in differences.

TRANSACTIONS OR EVENTS THAT FREQUENTLY CAUSE DIFFERENCES:

The following are the transactions and events that frequently cause a difference between the balance as per the bank records and the organization records due to the difference in the timing of recording these transactions.

1. Cheques issued but not presented for payment.
2. Cheques paid into the bank but not cleared.
3. Interest allowed by bank.
4. Interest and expenses charged by the bank.
5. Interest and dividends collected by the bank.
6. Direct payments by the bank.
7. Direct payment into the bank by a customer.
8. Dishonor of a bill discounted with the bank.

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9. Bills collected by the bank on behalf of the customer.

10. Errors (This is not a timing difference)

Following is the table summarizing in brief the timings of different transactions

Sr.No.	Transaction	Time of recording in cash Book	Time of recording in pass book
1	Issue of a cheque by the account holder	When the cheque is issued	When it is presented to the bank for payment.
2	Depositing a cheque in the account	When deposited in the Bank Account	When collected from the issuing party
3	Collection of bills/cheque directly by the bank	When referring the bank pass book	When it is collected by the bank.
4	Direct payment to the account holder	When referring the bank pass book.	When the amount is made in the account
5	Dishonor of cheque/bills Receivable.	When referring the bank pass book	When the cheque is Dishonored.
6	Bank charges levied by the Bank	When referring the bank pass book	When charges are levied by the bank
7	Interest and dividend credited by the bank	When referring the bank pass book	When interest or dividend is collected by the bank.
8	Interest debited by the bank	When referring the bank pass book	When interest is charged by the bank

Example on Reconciliation of Timing Differences:

The following is the bank passbook and bank balance as per the cash book maintained by Mr. A. for the month of September 2018.

Bank Pass Book

Date	Particulars	Deposits	Withdrawls	Balance
01-09-18	By Cash	100,000	-	100,000
03-09-18	To ABC & Co.	-	10,000	90,000
05-09-18	To XYZ & Co.	-	15,000	75,000
08-09-18	By MR. D	50,000	-	125,000
15-09-18	By Cash	10,000	-	135,000
17-09-18	By Cash	5,000	-	140,000
20-09-18	To Bank Charges	-	1,000	139,000
22-09-18	By Interest	500	-	139,500
25-09-18	By Interest on Govt. Securities	750	-	140,250

Dr.	Cash Book (Bank Column)				Cr.
Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
01-09-18	By Cash	100,000	01-09-18	To ABC & Co.	10,000
06-09-18	By Mr.D	50,000	04-09-18	To XYZ & Co.	15,000
15-09-18	By Cash	10,000			
17-09-18	By Cash	5,000	30-09-18	To Balance c/d	140,000
	TOTAL	**165,000**		**TOTAL**	**165,000**

As can be noted above the balance as per the bank pass book is Rs.140250/- However, as per the Bank Column of the cash book it is Rs. 140000/-. The difference between the same is reconciled as follow:

The reconciliation can be done by 2 ways.

i. Arriving at the pass book balance from cash book or
ii. Arriving at the cash book balance from pass book.

We will reconcile the balance by arriving at the cash book balance from the pass book balance.

Particulars	**Amount**	**Amount**
Amount as per Pass Book		**140,250**
Add		
Bank Charges levied by bank	1,000	1,000
Less:		
Bank Interest credited in pass book	(500)	
Interest on Govt Securities credited in pass book	(750)	(1,250)
Amount as per Cash Book		**140,000**

Thus the balances have been reconciled.

PROCEDURE FOR RECONCILING THE CASH BOOK BALANCES WITH THE PASS BANK BALANCE:

Understanding the following debit and credit balances presented in the cash book and bank pass book is important in reconciling the differences:

Debit Balance as per Cash Book – Excess of Deposit over Withdrawals in Bank
Credit Balance as per Cash Book – Excess of Withdrawals over Deposit in Bank

Debit Balance as per Bank Pass Book – Excess of Withdrawals over Deposit in Bank
Credit Balance as per Bank Pass Book – Excess of Deposit over Withdrawals in Bank

The reconciliation can be done by using any of the four balances given in the question.

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There can be 2 different kinds of reconciliation based on the details provided which can be categorized as follow:

i. When the causes of differences are known
ii. When the causes of differences are not known

When causes of differences are known the reconciliation can be done by taking any of the balance stated above and analyzing the causes and accordingly reconciling the transactions to eliminate the effects of the various differences.

If the balance of the other book is more on account of the said causes then add the amount. If the balance of the other book is less on account of the said causes then subtract the amount.
For example, if the reconciliation is initiated with Dr. Balance as per the cash book and there is a cheque deposited in the bank but not cleared, then on account of non-clearance of the cheque, the Cr. balance of the pass book would be less. In this case, the amount of cheque should be subtracted from the cash book balance to arrive at the balance as per the pass book.

When causes of differences are not known then a comparison needs to be done of the debit entries of cash book with the credit entries of the pass-book and vice-versa.

The entries which do not tally are the causes of difference in the balances of both the books. Once the causes are located their effects on both the books are analyzed and then reconciliation statement is prepared to arrive at the actual bank balance. However, one should take care that whether opening balance of both the books tallies or not. If opening balances are not same then the reconciliation items are divided into two categories i.e., one relating to reconciliation of opening balance and other relating to reconciliation of closing balance.

METHODS OF RECONCILIATION:
There are 2 methods of reconciliation:

i. Without preparation of the Adjusted Cash-Book and
ii. With the preparation of the Adjusted Cash-Book

Without preparation of the Adjusted Cash-Book
The reconciliation under this method can be done by taking any of the four balances as the starting point and reconciling the causes of differences. The following table (Extracted from the ICAI Study Material) provides the detailed analysis of how to reconcile the difference by using the various starting point.

Causes of differences	Favorable balance (Dr.) as per cash book	Unfavorable balance (Cr.) as per cash book	Favorable balance (Cr.) as per pass book	Unfavorable balance (Dr.) as per pass book
Cheque deposited but not cleared	Subtract	Add	Add	Subtract
Cheque issued but not presented to bank	Add	Subtract	Subtract	Add

Cheque directly deposited in bank by a customer	Add	Subtract	Subtract	Add
Income (e.g., interest from UTI) directly received by bank	Add	Subtract	Subtract	Add
Expenses (e.g., telephone bills, Insurance charges) directly paid by bank on standing instructions	Subtract	Add	Add	Subtract
Bank charges levied by bank	Subtract	Add	Add	Subtract
Locker rent levied by bank	Subtract	Add	Add	Subtract
Wrong debit in the cash book	Subtract	Add	Add	Subtract
Wrong credit in the cash book	Add	Subtract	Subtract	Add
Wrong debit in the pass book	Subtract	Add	Add	Subtract
Wrong credit in pass book	Add	Subtract	Subtract	Add
Under casting of Dr. side of bank account in the cash book	Add	Subtract	Subtract	Add
Overcastting of Dr. side of bank account in the cash book	Subtract	Add	Add	Subtract
Under casting of Cr. side of bank account in the cash book	Subtract	Add	Add	Subtract
Over casting of Cr. side of bank account the cash book	Add	Subtract	Subtract	Add
Bill receivable collected directly by bank	Add	Subtract	Subtract	Add
Interest on bank overdraft charged	Subtract	Add	Add	Subtract
Final Balance	If answer is positive then it is favorable balance as per pass book i.e. Cr. Balance as per Pass Book, if it is negative then it is Unfavorable balance i.e.. Dr. Balance as per Pass Book	If answer is positive then it is Unfavorable balance as per pass book i.e. Dr. Balance as per Pass Book, if it is negative then it is Favorable balance i.e.. Cr. Balance as per Pass Book	If answer is positive then it is Unfavorable balance as per pass book i.e. Dr. Balance as per Pass Book, if it is negative then it is Favorable balance i.e.. Cr. Balance as per Pass Book	If answer is positive then it is Unfavorable balance as per cash book i.e. Cr. Balance as per Cash Book, if it is negative then it is Favorable balance i.e.. Dr. Balance as per Cash Book

Note: The reconciliation statement can be presented as per the two methods:

i. Balance Presentation
ii. Plus-Minus Presentation

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With preparation of the Adjusted Cash-Book:

Adjusted Cash Book:
When the balance in the cash book is first adjusted for certain adjustments before taking it to the bank reconciliation statement, then it is known as adjusted cash book balance. Adjusting the cash-book before preparing the bank reconciliation statement is completely optional, if reconciliation is done during different months. But if reconciliation is done at the end of the accounting year or financial year, the cash-book must be adjusted so as to reflect the correct bank balance in the balance sheet.

While adjusting the cash-book the following adjustments are considered: -

1. All the errors (like wrong amount recorded in the cash-book, entry posted twice in the cash-book, over/ under casting of the balance etc.) and omissions (like bank charges recorded in the pass-book only, interest debited by the bank, direct receipt or payment by the bank, dishonor of cheques/bills etc.) by the cash-book are taken into care

2. Only these transactions are considered for adjusting cash book, apart from this delay in recording in the pass-book due to difference in timing (like cheque issued but not presented for payment, cheque deposited but not collected) is taken to bank reconciliation statement. This adjusted cash-book balance is taken to bank reconciliation statement.

EXAMPLE 1:
On 30th September, 2018, the bank account of Mr. A, according to the bank column of the Cash-Book, was overdrawn to the extent of Rs 10,000. On the same date the bank statement showed a debit balance of 15,000 in favor of A.
An examination of the Cash Book and Bank Statement reveals the following:

1. A cheque for Rs.50,000 deposited on 28th September, 2018 was credited by the bank only on 2nd October, 2018

2. A payment by cheque for Rs.20,000 has been entered twice in the Cash Book.

3. On 29th September, 2018, the bank credited an amount of Rs.75,000 received from a customer of A, but the advice was not received by A until 2nd October, 2018.

4. Bank charges amounting to Rs. 1500 had not been entered in the Cash Book.

5. On 6th September, 2018, the bank credited Rs.10,000 to A in error.

6. A bill of exchange for Rs.90,000 was discounted by X with his bank. This bill was dishonored on 28th September, 2018 but no entry had been made in the books of A.

7. Cheques issued up to 30th September, 2018 but not presented for payment up to that date totaled Rs.100,000.

Prepare the following details based on the above mentioned transactions:

1. Present appropriate rectifications in the Cash Book of Mr. A to arrive at the correct balance as on 30th September 2018 and
2. Bank Reconciliation Statement

Cash Book (Bank Column) of Mr. A for September 30, 2018

Dr.	Cash Book (Bank Column)				Cr.
Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
Sept 30	To Customer A/c	20,000	Sept 30	By Bank Charges	1,500
	To Customer A/c	75,000		By Customer A/c	
				(Bill Dishonored)	90,000
				By Balance c/d	3,500
	TOTAL	**95,000**		**TOTAL**	**95,000**

Bank Reconciliation Statement for September 30, 2018		
Particulars	**Amount**	**Amount**
Balance as per Cash Book		**3,500**
Add		
Cheques deposited but not collected upto 30 september 2018	50,000	50,000
Less:		
Cheques issue but not presented for payment till september 30 2018	(100,000)	(100,000)
Amount as per Bank Pass Book		**(46,500)**

EXAMPLE 2:
From the following information (as on 31.3.2018), prepare a bank reconciliation statement after making necessary amendments in the cash book

Particulars Amount Bank balances as per the cash book (Dr.) 800,000

Cheques deposited, but not yet credited 45,000

Cheques issued but not yet presented for payment 35,000

Bank charges debited by bank but not recorded in the cash-book 2,500

Dividend directly collected by the bank 20,000

Insurance premium paid by bank as per standing instruction

Not intimated 18,000

Cash sales wrongly recorded in the Bank column of the cash-book 2,00,000

Customer's cheque dishonored by bank not recorded in the cash-book 1,00,000

Wrong credit given by the bank 1,10,000

Also show the bank balance that will appear in the trial balance as on 31.3.2018.

Dr.	Cash Book (Bank Column) - After necessary adjustements				Cr.
Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
31-03-18	To Balance b/d	800,000	31-03-18	By Bank Charges	2,500
	To Dividend	20,000		By Insurance Premium	18,000
				By Acc. Receivable	100,000
				(Cheque Dishonored)	
				By Cash (Wrong recorded cash sales)	200,000
				By Balance c/d	499,500
	TOTAL	**820,000**		**TOTAL**	**820,000**

Bank Reconciliation Statement for March 31, 2018		
Particulars	**Amount**	**Amount**
Balance as per Cash Book		**499,500**
Add		
Cheques issued but not presented for payment	35,000	
Amount wrongly credited by bank	110000	145,000
		644,500
Less:		
Cheques deposited but not yet credited by bank	(45,000)	(45,000)
Amount as per Bank Pass Book		**599,500**

The balance of Rs. 499,500/- will appear on the trial balance of 31st March 2018.

Questions:

From the following information (as on 31.3.2018), prepare a bank reconciliation statement after making necessary amendments in the cash book

Particulars Amount Bank balances as per the cash book (Dr.) 600,000

Cheques deposited, but not yet credited 85,000

Cheques issued but not yet presented for payment 70,000

Bank charges debited by bank but not recorded in the cash-book 1,000

Dividend directly collected by the bank 50,000

Insurance premium paid by bank as per standing instruction
Not intimated 45,000

Cash sales wrongly recorded in the Bank column of the cash-book 1,50,000

Customer's cheque dishonored by bank not recorded in the cash-book 3,00,000

Wrong credit given by the bank 10,000

Also show the bank balance that will appear in the trial balance as on 31.3.2018.

Illustrations

Question: 1

From the following particulars, prepare a Bank Reconciliation Statement for Jindal offset Ltd.

(1) Balance as per cash book is Rs. 2,40,000
(2) Cheques issued but not presented in the bank amounts to Rs. 1,36,000.
(3) Cheques deposited in bank but not yet cleared amounts to Rs. 90,000.
(4) Bank charges amounts to Rs. 300.
(5) Interest credited by bank amounts to Rs. 1,250.
(6) The balance as per passbook is Rs.2,86,950

Question: 2

On 31st March 2017, the Bank Pass Book of Namrata showed a balance of Rs.1,50,000 to her credit while balance as per cash book was Rs.1,12,050. On scrutiny of the two books, she ascertained the following causes of difference:

i.She has issued cheques amounting to Rs. 80,000 out of which only Rs. 32,000 were presented for payment.

ii.She received a cheque of Rs.5,000 which she recorded in her cash book but forgot to deposit in the bank.

iii.A cheque of Rs.22,000 deposited by her has not been cleared yet.

iv.Mr. Gupta deposited an amount of Rs.15,700 in her bank which has not been recorded by her in Cash Book yet.

v.Bank has credited an interest of Rs. 1,500 while charging Rs. 250 as bank charges.

Prepare a bank reconciliation statement.

Question: 3

From the following particulars ascertain the balance that would appear in the Bank Pass Book of A on 31st December 2017.

1. The bank overdraft as per Cash Book on 31st December 2017 Rs. 6,340.

2. Interest on overdraft for 6 months ending 31st December 2017 Rs. 160 is entered in Pass Book.
3. Bank charges of Rs. 400 are debited in the Pass Book only.
4. Cheques issued but not cashed prior to 31st December,2017, amounted to Rs.11,68,000.
5. Cheques paid into bank but not cleared before 31st, December 2017 were for Rs. 22,17,000.
6. Interest on investments collected by the bank and credited in the Pass Book Rs.12,00,000.

Question: 4

On 30th September 2017, the bank account of X, according to the bank column of the Cash- Book, was over drawn to the extent of Rs. 4,062. On the same date the bank statement showed a debit balance of Rs.20,758 in favour of X. An examination of the Cash Book and Bank Statement reveals the following:

1. A cheque for Rs.13,14,000 deposited on 29th September 2017 was credited by the bank only on 3rd October 2017
2. A payment by cheque for Rs.16,000 has been entered twice in the Cash Book.
3. On 29th September 2017, the bank credited an amount of Rs.1,17,400 received from a customer of X, but the advice was not received by X until 1st October 2017.
4. Bank charges amounting to Rs.580 had not been entered in the Cash Book.
5. On 6th September 2017, the bank credited Rs.20,000 to X in error.
6. A bill of exchange for Rs.1,40,000 was discounted by X with his bank. This bill was dishonoured on 28th September 2017, but no entry had been made in the books of X.
7. Cheques issued up to 30th September 2017 but not presented for payment up to that date totalled Rs.13,26,000.

You are required:

a. to show the appropriate rectifications required in the cash Book of X, to arrive at the correct balance on 30th September 2017. And
b. to prepare a bank reconciliation statement as on that date.

Question: 5

On 30th December 2017 the bank column of A. Philip's cash book showed a debit balance of Rs. 4,610. On examination of the cash book and bank statement you find that:

1. Cheques amounting to Rs. 6,30,000 which were issued to trade payables and entered in the cash book before 30th December 2017 were not presented for payment until that date.
2. Cheques amounting to Rs. 2,50,000 had been recorded in the cash book as having been paid into the bank on 30th December 2017 but were entered in the bank statement on1st January 2018.
3. A cheque for Rs. 73,000 had been dishonoured prior to 30th December 2017, but no record of this fact appeared in the cash book.
4. A dividend of Rs. 3,80,000, paid direct to the bank had not been recorded in the cash book.
5. Bank interest and charges amounting to Rs.4,200 had been charged in the bank statement but not entered in the cash book.
6. No entry had been made in the cash book for a trade subscription of Rs. 10,000 paid vide banker's order in November 2017.

7. A cheque for Rs.27,000 drawn by B. Philip had been charged to A. Philip's bank account by mistake in December 2017.

You are required:

a. to make appropriate adjustments in the cash book bringing down the correct balance, and

b. to prepare a statement reconciling the adjusted balance in the cash book with the balance shown in the bank statement.

Question: 6

From the following information, prepare a Bank reconciliation statement as at 31st December 2017 for Messrs New Steel Limited:

(1)	Bank overdraft as per Cash Book on 31st December, 2017	22,45,900
(2)	Interest debited by Bank on 26th December 2017, but no advice received	2,78,700
(3)	Cheque issued before 31st December 2017 but not yet presented to Bank	6,60,000
(4)	Transport subsidy received from the State Government directly by the Bank but not advised to the company	14,25,000
(5)	Draft deposited in the Bank, but not credited till 31st December, 2017	13,50,000
(6)	Bills for collection credited by the Bank till 31st December 2017 but no advice received by the company	8,36,000
(7)	Amount wrongly debited to company account by the Bank, for which no details are available	7,40,000

Question: 7

The Cash Book of Mr. Gadbadwala shows Rs.8,36,400 as the balance at Bank as on 31st December 2017, but you find that it does not agree with the balance as per the Bank Pass Book. On scrutiny, you find the following discrepancies:

1. On 15th December 2017 the payment side of the Cash Book was undercast by Rs.10,000.
2. A cheque for Rs.1,31,000 issued on 25th December 2017 was not taken in the bank column.
3. One deposit of Rs.1,50,000 was recorded in the Cash Book as if there is no bank column therein.
4. On 18th December 2017 the debit balance of Rs.15,260 as on the previous day, was brought forward as credit balance.
5. Of the total cheques amounting to Rs.11,514 drawn in the last week of December 2017, cheques aggregating Rs.7,815 were encashed in December.
6. Dividends of Rs.25,000 collected by the Bank and subscription of Rs.1,000 paid by it were not recorded in the Cash Book.
7. One out-going Cheque of Rs.3,50,000 was recorded twice in the Cash Book.

Prepare a Reconciliation Statement

Question: 8

When Nikki & Co. received a Bank Statement showing a favourable balance of Rs.10,39,200 for the period ended on 30th June 2017, this did not agree with the balance in the cash book.

An examination of the Cash Book and Bank Statement disclosed the following:

1. A deposit of Rs.3,09,200 paid on 29th June 2017 had not been credited by the Bank until 1st July 2017.
2. On 30th March 2017 the company had entered into hire purchase agreement to pay by bank order a sum of Rs.3,00,000 on the 10th of each month, commencing from April 2017. No entries had been made in Cash Book.
3. A customer of the firm, who received a cash discount of 4% on his account of Rs.4,00,000 paid the firm a cheque on 12th June. The cashier erroneously entered the gross amount in the bank column of the Cash Book.
4. Bank charges amounting to Rs.3,000 had not been entered in Cash Book.
5. On 28th June, a customer of the company directly deposited the amount in the bank Rs. 4,00,000, but no entry had been made in the Cash Book.
6. Rs.11,200 paid into the bank had been entered twice in the Cash Book.
7. A debit of Rs. 11,00,000 appeared in the Bank Statement for an unpaid cheque, which had been returned marked 'out of date'. The cheque had been re-dated by the customer and paid into Bank again on 5th July 2017.

Prepare Bank Reconciliation Statement on 30 June 2017.

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Chapter 4 – Inventories

MEANING OF INVENTORY:

Inventory can be defined as an asset which is held for sale in the ordinary course of business, or in the process of production, or for consumption in the production of goods or services for sale, including maintenance supplies and consumables other than machinery spares, servicing equipment and standby equipment.

Different types of businesses have different kinds of inventories. The goods which are inventory for one business can be a fixed asset for other business.

For Example: For a business dealing in computers, the computers will form a part of inventory but for a business providing professional consulting services computers would form a part of the Fixed Assets.

The classification of an item as inventory also depends on how it is intended to be used.

For Example: For a business dealing in computers, the computers will form a part of inventory but the computer which is used by the entity to maintain their accounting and other records will form a part of the Fixed Assets and not inventory.

Every business entity needs to ascertain the closing balance of Inventory which comprise of Inventory of raw material, work-in-progress, finished goods and other consumable items which is reported in the financial statements by crediting the value of closing Inventory to the Trading Account and the other effect is to report it on the asset side of the Balance Sheet.

INVENTORY VALUATION:

Inventories are reported in the balance sheet until the revenue related to them is recognized.

Most of the times inventory forms a significant component of the entities current assets especially in case of trading and manufacturing enterprises. Proper valuation of inventory is important to present the true and fair financial statements. The significance of inventory valuation arises due to various reasons as explained in the following points:

1. **Determination of Income:**
   The gross profit of the entity can be determined with the correct value of the Cost of Goods Sold which is computed as follow:

   Cost of Goods Sold = Beginning Inventory + Purchases + Direct Expenses – Ending Inventory

The effect of overstatement or understatement on the financial Statements of the entity is as stated below:

If closing inventory is overstated, net income for the current accounting period will be overstated and the net income for the next accounting period will be understated.

If closing inventory is understated, net income for the current accounting period will be understated and the net income for the next accounting period will be overstated.

2. **Determination of Financial Positions:**
Since inventories form a part of the current assets. They play an important role in determining the current assets of the entity.

3. **Liquidity Analysis:**
Since inventories form a part of the current assets they are used in the computation of the liquidity position of the entity.

4. **Statutory Compliances:**
Schedule III to the Companies Act, 2013 requires valuation of each class of goods i.e. raw material, work-in-progress and finished goods under broad head to be disclosed in the financial statements.

BASIS OF INVENTORY VALUATION:

As per the conservatism principle of accounting, Inventories are always valued at the **"LOWER OF COST OR NET REALIZABLE VALUE"**.

Cost of Inventory comprises of the following components:

1. All cost of purchase,
2. All Costs of conversion (Converting Raw Materials to Finished Goods) and
3. All other costs incurred in bringing the inventories to their present location and condition.

Amounts Excluded from the cost of inventories:

The following expenses are not included in computing the costs of inventories:
1. Abnormal Losses or Expenses.
2. Storage costs, unless it is necessary in the production process.
3. Administrative overheads that do not contribute to bringing the inventories to their present location and condition.
4. Selling and distribution costs

Net realizable value:

This is the price expected to be realized by selling the inventories in the ordinary course of business less the estimated costs of completion necessary to make the sale.

INVENTORY RECORD SYSTEM:

There are 2 methods of recording inventory:

1. Periodic Inventory System
2. Perpetual Inventory System

PERIODIC INVENTORY SYSTEM:

Under the Periodic inventory system, the inventory is determined by performing an **actual physical count** of the inventory items on hand at a **particular date** on which inventory is valued.

The system is also called physical inventory system because of the method of physically counting the units.

The cost of goods sold is determined as shown below:
Opening inventory (known) + Purchases (known) - closing inventory (physically counted) = Cost of goods sold.

Periodic inventory system is simple and less expensive than the perpetual system. Under this method, inventory account is adjusted at the end of the accounting period to determine cost of goods sold.

There are some limitations in using this system which are as stated below:

i. Inventory values are needed more often and not just at the year end. Thereby making this system more expensive.
ii. Physical count of goods can be conducted properly on by closure of normal operations of business.
iii. It is not possible to identify loss of goods due to pilferage, damage or even fraud.
iv. Inventory control is not possible.
v. Books of accounts does not reflect inventory in hand on real time basis due to which it is difficult to plan operations e.g. how much or when to order/manufacture.

This system is suitable for small enterprises where is easy to control physical inventory. It is not considered suitable for medium or large enterprises.

PERPETUAL INVENTORY SYSTEM:

Under the Perpetual inventory system, the inventory balances are recorded after each transaction involving inventory.

Under perpetual inventory system, closing inventory is determined as follows:
Beginning inventory + Purchases during the period – Cost of Goods Sold (known) = Closing Inventory (balancing figure)

DISTINCTION BETWEEN PERIODIC AND PERPETUAL INVENTORY SYSTEM:

Periodic System	**Perpetual System**
Based on Physical Verification	Based on Book Records
Details about the cost of goods sold and ending inventory is available on a particular date.	Details about cost of goods sold and ending inventory is available on real time and continuous basis.

Cost of Goods Sold is computed as balancing figure after determining the Inventory balance	Ending Inventory is computed as balancing figure after determining the Cost of Goods Sold
Loss of Goods is included in Cost of Goods Sold	Loss of Goods Sold is included in Ending Inventory
Simple and Less Expensive Method	Costly Method
Requires closure of business on a particular day to count the inventories	Can be carried out with the ongoing operations of the business.

FORMULA/METHODS OF DETERMINING COST OF INVENTORY:

HISTORICAL METHODS:

1. **Specific Identification Method:**
   Allocates specific cost to each of the goods identified.
   This method is generally used to determine the cost of items which are not ordinarily interchangeable and are relatively high in value like diamonds and precious stones.

2. **FIFO (First In First Out) Method:**
   This method assumes that the goods which came in first will be sold first. The ending inventory comprises of the latest purchases and the Cost of Goods Sold comprises of the earliest purchases.

Example on First In First out (FIFO):
A trader has the following details of purchases of goods in which he deals

Date	Quantity (In Units)	Price Per Unit
Oct 1	1000	10
Oct 5	500	12
Oct 15	200	15
Oct 25	500	13
	2200 Units	

The ending inventory consists of 650 units. Compute the cost of the ending inventory for October using FIFO Method:

The Closing Inventory of 650 units would consist of 500 units purchased on Oct 25 and 150 units purchased on Oct 15, the value of the same is as computed below:

Particulars	Amount
500 units @ Rs.13 per unit	6500
150 units @ Rs.15 per unit	2250
TOTAL	**8750**

Thus, the value of inventory using the FIFO Method has been computed.

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3. **LIFO (Last In First Out) Method:**
   This method assumes that the goods which came in last will be sold first i.e. the most recent purchased goods are sold first.
   The ending inventory comprises of the earliest purchases and the Cost of Goods Sold comprises of the recent purchases.
   LIFO method is based on the principle of matching current cost with current revenue as cost of recently purchased or produced goods are charged to cost against each sale

Example on Last In First out (FIFO):
trader has the following details of purchases and issue of goods in which he deals

PURCHASES

Date	Quantity (In Units)	Price Per Unit
Oct 1	1000	10
Oct 5	500	12
Oct 15	200	15
Oct 25	500	13
	2200 Units	

ISSUES

Date	Quantity (In Units)
Oct 10	900
Oct 23	700
Oct 28	200
	1800 Units

The ending inventory consists of 400 units. Compute the cost of the ending inventory for October using LIFO Method:
Under the LIFO Method the following will be the stock ledger of the entity:

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Date	Receipts			Issues			Balance Inventory		
	Quantity	Rate	Amount	Quantity	Rate	Amount	Quantity	Rate	Amount
Oct 1	1000	10	10000				1,000	10	10,000
Oct 5	500	12	6000						
Oct 10				500	12	6,000			
				400	10	4,000	600	10	6,000
Oct 15	200	15	3000				600	10	6,000
							200	15	3,000
Oct 23				200	15	3,000			
				500	10	5,000	100	10	1,000
Oct 25	500	13	6500				100	10	1,000
							500	13	6500
Oct 28				200	13	2,600	300	13	3,900
							100	10	1,000
TOTAL							400		4,900

Thus, as can be observed from the above computations that the value of ending inventory using the LIFO Method for 400 units is Rs 4900/-.

4. **Simple Average Method:**
   This method is the easiest method of computing the value of inventory.
   This method is used by entities using periodic inventory system.

   The simple average price per unit of the output is computed by the following formula:

$$\frac{\text{Different Prices of all Purchases}}{\text{Total Number of purchases}}$$

Example on Simple Average Method:
A trader has the following details of purchases and issue of goods in which he deals

PURCHASES

Date	Quantity (In Units)	Price Per Unit
Oct 1	1000	10
Oct 5	500	12
Oct 15	200	15
Oct 25	500	13
	2200 Units	

The trader has 500 units in its ending inventory. Compute the Cost of the inventory using the Simple Average Method:

The simple average price per unit of the product is computed as below:

$\frac{10+12+15+13}{4}$ = Rs.12.5/- Per unit

The ending inventory of 500 units will be computed at Rs.12.5/- per unit. Therefore, the value of the ending inventory is Rs.6250/-

5. **Weighted Average Method:**
   This method is an advanced version of the simple average method.

   The weighted average price per unit of the output is computed by the following formula:

$$\frac{\text{Total Cost of Goods Available for Sale during the period}}{\text{Total Number of units available for sale during the period}}$$

Ending Inventory = No. of units in inventory X Weighted Average price per unit
Cost of Goods Sold = No. of units in sold X Weighted Average price per unit

Example on Weighted Average Method:
A trader has the following details of purchases and issue of goods in which he deals

PURCHASES

Date	Quantity (In Units)	Price Per Unit
Oct 1	1000	10
Oct 5	500	12
Oct 15	200	15
Oct 25	500	13
	2200 Units	

ISSUES

Date	Quantity (In Units)
Oct 10	900
Oct 23	700
Oct 28	200
	1800 Units

The ending inventory consists of 400 units. Compute the cost of the ending inventory for October using LIFO Method:

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WEIGHTED AVERAGE METHOD

Date	Receipts			Issues			Balance Inventory		
	Quantity	Rate	Amount	Quantity	Rate	Amount	Quantity	Rate	Amount
Oct 1	1000	10	10000				1,000	10	10,000
Oct 5	500	12	6000				1,500	11	16,500
Oct 10				900	11	9,900	600	11	6,600
Oct 15	200	15	3000				800	13	10,400
Oct 23				700	13	9,100	100	13	
Oct 25	500	13	6500				600	13	7,800
Oct 28				200	13	2,600	400	13	5,200

NON-HISTORICAL METHODS:

1. **Adjusted Selling Price Method:**

This method is known as retail inventory method. It is mainly used by retail business or in business where the inventory comprises of items whose individual costs are not readily determinable.

The cost of the inventory is determined by reducing the percentage of gross margins from the sales value of the inventory.

Example on adjusted Selling Price Method:

A trader has the following records available for the month of October 2018.
Determine the adjusted selling price of the inventory using the adjusted selling price method.

Goods purchased Rs.2,00,000/-
Packaging and transportation charges Rs.10,000/-
Sales during the year Rs.4,00,000/-
Sales price of closing inventories Rs.75,000/-

Cost of Purchases:

Goods purchased Rs.2,00,000/-

Packaging and transportation charges Rs.10,000/-
Rs.2,10,000/-

Estimated Gross Profit Margin:

Sales during the year	Rs.4,00,000/-
Sales price of closing inventories	Rs.75,000/-
	Rs.4,75,000/-
Less: Purchases	(Rs. 2,10,000/-)
Gross Profit	**Rs.2,65,000/-**

Gross Profit Margin 55.79%	**(265000/475000)**
Inventory Valuation:	
Sales price of closing inventories	Rs.75,000/-
Less: Gross Profit Margin @ 55.79%	(Rs.41843)
	Rs.33157

2. **Standard Cost Method:**
This method is used when the price of the goods which are purchased changes frequently e.g. crude oil.

Based on the past experiences a standard cost is determined and the inventory is valued on that price per unit.

INVENTORIES TAKING:

Ideally inventories need to be counted physically on the last day of the accounting period to determine the correct balance of the closing inventory. However, it is not possible in most of the cases and the same is done near the balance sheet date but not exactly on it.

For the year-end inventory valuation, physical inventory taking is done during the last week of the financial year or during the first week of next financial year. In such a case, the actual value of the inventory needs to be adjusted to relate it to the end of the year concerned. For doing so, the entity needs to consider the goods that have come in either by way of purchases or sales returns and those that have gone out either by way of sales or purchase returns during the time between the close of the year and the date of actual inventory taking. It is important to note that all the adjustment must be on the basis of cost. If inventory taking is finished on 5th April, whereas accounting year ends on 31st March purchases and sales between 31st March and 5th April are then separately adjusted.

Example on Inventories Taking:

Suppose a company that closes its books on 31st March, carried out the inventory taking on the 5th of April and actual inventory was of Rs. 5,00,000 on 5th April, during the period March 31 to April 5 purchases were Rs. 1,00,000 and sales were Rs. 2,00,000, the mark up being 20% on cost. The inventory on 31st of March is computed below:

Inventories ascertained on 5th April		Rs.5,00,000/-
Less: Purchases during the period 31 march to 5 April		Rs.1,00,000/-
		Rs.4,00,000/-
Add: Cost of Goods Sold during the period:		
	2,00,000 X (100/120)	Rs.1,66,667/-
Inventory value on 31st March		Rs.5,66,667/-

Questions:

Question 1:
A trader has the following details of purchases and issue of goods in which he deals

PURCHASES

Date	Quantity (In Units)	Price Per Unit
Oct 1	2000	25
Oct 5	1000	22
Oct 15	700	20
Oct 25	500	30
	4200 Units	

ISSUES

Date	Quantity (In Units)
Oct 10	1500
Oct 23	1300
Oct 28	400
	3200 Units

The ending inventory consists of 1000 units. Compute the cost of the ending inventory for October using the following methods:

1. FIFO
2. LIFO
3. Simple Average
4. Weighted Average

Question 2:
A trader has the following records available for the month of October 2018.
Determine the adjusted selling price of the inventory using the adjusted selling price method.

Goods purchased Rs.5,00,000/-
Packaging and transportation charges Rs.70,000/-
Sales during the year Rs.7,00,000/-
Sales price of closing inventories Rs.1,50,000/-

Question 3:
Suppose a company that closes its books on 31st March, carried out the inventory taking on the 25th of March and actual inventory was of Rs. 15,00,000 on 25th March, during the period March 25 to March 31 purchases were Rs. 4,00,000 and sales were Rs. 9,00,000, the mark up being 25% on cost. Compute the inventory on 31st of March.

Illustrations

Question: 1
A manufacturer has the following record of purchases of a condenser, which he uses while manufacturing radio sets:

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Date December	Quantity (units)	Price Per Unit
4	900	50
10	400	55
11	300	55
19	200	60
28	800	47
	2,600	

1,600 units were issued during the month of December till 18th December

Question: 2

M/s X, Y and Z are in retail business, following information are obtained from their records for the year ended 31st March 2016-

Particulars	Amount (Rs.)
Goods received from suppliers (subject to trade discount and taxes)	15,75,500
Trade discount 3% and sales tax 11%	
Packaging and transportation charges	87,500
Sales during the year	22,45,500
Sales price of closing inventories	2,35,000

Find out the historical cost of inventories using adjusted selling price method

Question: 3

From the following information, calculate the historical cost of inventories using adjusted selling price method:

Particulars	Amount (Rs.)
Sales during the year	2,00,000
Cost of Purchases	2,00,000
Opening Inventory	Nil
Closing Inventory at Selling Price	50,000

Question: 4

From the following ascertain the value of Inventories as on 31st March 2017

Particulars	Amount (Rs.)
Inventory as on 01.04.2016	1,42,500
Purchases	7,62,500
Manufacturing Expenses	1,50,000
Selling Expenses	60,500
Administrative Expenses	30,000
Financial Charges	21,500
Sales	12,45,000

At the time of valuing inventory as on 31st March 2016, a sum of Rs. 17,500 was written off on an item, which was originally purchased for Rs. 50,000 and was sold during the year for Rs. 45,000. Barring the transaction relating to this item, the gross profit earned during the year was 20 % on sales.

Question: 5

A trader prepared his accounts on 31st March, each year. Due to some unavoidable reasons, no inventory taking could be possible till 15th April 2017. On which date the total cost of goods in his go down came to Rs. 5,00,000. The following facts were established between 31st March and 15th April 2017.

(i) Sales Rs. 4,10,000 (including cash sales Rs. 1,00,000)

(ii) Purchases Rs. 50,340 (including cash purchases Rs. 19,900)

(iii) Sales Return Rs. 10,000

Goods are sold by the trader at a profit of 20% on sales

You are required to ascertain the value of inventory as on 31st March 2017.

Question: 6

1. Inventory taking for the year ended 31st March 2016 was completed by 10th April 2016
2. The Valuation of which showed an Inventory figure of Rs. 16,75,000 at cost as on the completion date
3. After the end of the accounting year and till the date of completion of inventory taking
4. Sales for the next year were made for Rs. 68,750, Profit Margin being 33.33 % on Cost
5. Purchases for the next year included in the inventory amounted to Rs. 90,000 at cost less trade discount 10%
6. During this period, goods were added to inventory at the mark up price of Rs. 3,000 in respect of sales returns
7. After inventory taking it was found that there were certain very old slow-moving items costing Rs. 11,250, which should be taken at Rs. 5,250 to ensure disposal to an interested customer
8. Due to heavy flood, certain goods costing Rs. 15,500 were received from the supplier beyond the delivery date of customer
9. As a result, the customer refused to take delivery and net realizable value of the goods was estimated to be Rs. 12,500 on 31st March

Compute the value of inventory for inclusion in the final accounts for the year ended 30th March 2016.

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Chapter 5 – Concept and Accounting of Depreciation

OBJECTIVES

The lists of topics which will be covered in this chapter are as follows:

1. What is Depreciation and Objectives of providing depreciation?

2. Factors affecting depreciation

What is Depreciation?

Concept of Depreciation

Fixed Assets includes Property, plant and equipment that are tangible and which are used in the production or supply of goods or services or for administrative purposes and are expected to be used during more than a period of one accounting year i.e. more than twelve months.

Value of such assets decreases with passage of time due to following reasons.

i. Wear and tear due to its use in business.
ii. Passage of time even when it is not being used.
iii. Obsolescence and outdating due to technological or other changes.
iv. Decrease in market value.
v. Depletion of the assets especially in case of mines and other natural reserves.

To arrive at the correct income for the current accounting period it is important to account for value of portion of property, plant and equipment utilized for generating revenue during that period. The portion of Property, Plant & Equipment allocated to an accounting year is called depreciation.

As per Schedule II under the Companies Act, 2013, Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. The depreciable amount of an asset is the cost of an asset or other amount substituted for cost, less its residual value. The useful life of an asset is the period over which an asset is expected to be available for use by an entity, or the number of production or similar units expected to be obtained from the asset by the entity.

The 3 important factors affecting the amount of depreciation are:

i. Estimated useful life of the asset

ii. Cost of the asset

iii. Residual value of the asset at the end of the of its estimated useful life

Objectives of Providing Depreciation:

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The basic objectives for providing depreciation are as follow:

i. Correct income measurement.

ii. To find True Asset value.

iii. To Ensure Sufficient Funds are available for replacement.

iv. To determine the true cost of production.

Factors affecting Measurement of Depreciation:

Following factors are taken into consideration while computing the depreciation.

i. Cost of the asset

ii. Estimated useful life of the asset.

iii. Estimated scrap value at the end of useful life of the asset.

Example on computing the depreciable amount per annum:

For example, a machinery is purchased for Rs.5,00,000. The residual value is estimated at Rs.50,000. It is estimated that the machinery will work for 10 years. The cost to be allocated as depreciation in the accounting periods will be calculated as:

Acquisition Cost Rs.500000
Less: Residual Value (Rs.50000)
Depreciable Amount Rs. 450000
(÷)Estimated Useful Life 5 years

Depreciation = Depreciable Amount / Estimated Useful Life = Rs450000 / 5 Years = Rs.90000/- Per Year

Cost of the Fixed Asset (i.e. Property, Plant and Equipment) comprises of the following:

i. The purchase price including import duties and taxes and deducting the trade discounts and rebates.

ii. Any cost incurred to bring the asset to its present condition to put it to its intended usage

iii. The costs of preparing the site on which an asset is to be located.

Examples of costs directly attributable costs are:

i. Cost of labor for bringing the asset to its present condition.

ii. Cost to prepare the site.

iii. Delivery and Handling costs

iv. Installation costs
v. Cost of testing
vi. Professional fees e.g. engineers & technicians hired to install the equipment

Thus, all the expenses which are necessary for asset to bring it in condition and location of desired used will become part of cost of the asset.

Methods of Computing Depreciation:

There are several methods of computing depreciation, in this chapter we are going to focus on 3 methods which are as follow:

i. Straight-Line Method
ii. Diminishing Balance Method
iii. Sum of Years of Digits Method
vi. Machine Hour Method
vii. Units of Production Method
viii. Depletion Method

1. Straight-Line Method:

This method is also known as Fixed Installment Method. According to this method, an equal amount of depreciation is written off every year so as to reduce the cost of the asset to nil or its salvage value at the end of its useful life.

The advantage of this method is that it is the easiest methods to apply and gives accurate results in case of leases and also in case of plant and machinery are assumed to have a constant usage across years.

The formula to compute the depreciation and the rate of depreciation under straight line method is as follow:

$$\text{Straight Line Depreciation} = \frac{\text{Cost of Asset – Salvage Value}}{\text{Useful Life of the Asset}}$$

$$\text{Straight Line Depreciation Rate} = \frac{\text{Straight Line Depreciation}}{\text{Cost of the Asset}} \times 100$$

2. Diminishing Balance Method:

This method is also known as Reducing Balance Method. According to this method, a Fixed Percentage of depreciation is computed on the Asset Value every year so as to reduce the asset value to Nil or it's Salvage Value at the end of its useful life.

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Under this method, the depreciation amount decreases from year to year due to which the earlier years suffer incur a higher depreciation expense as compared to the later years.

Under this method, the value of asset can never be completely extinguished, which happens in the earlier explained Straight Line Method. This method assumes that the cost of repairs will increase with the passage of time. Therefore, depreciation is higher in earlier years and lower in the later years when the cost of the asset is expected to be lower in the later years.

The formula to compute the depreciation under the diminishing balance method is as follow:

Diminishing Balance Depreciation = 1 X 100

Here, n = useful life of the asset

Accounting Entries under Straight Line and Diminishing Balance Method:

There are two approaches to account for depreciation. The entity can either opt to have a provision for depreciation account and credit the annual depreciation in that provision account, thereby the asset account remains at the same historical cost or else it can directly credit the depreciation amount to the asset account and reduce the asset balance on an annual basis.

Accounting Entries under the Provision Method:	
For Charging Depreciation	Depreciation Account Dr. To Provision for Depreciation Account
Transferring Depreciation to Profit & Loss Account	Profit & Loss Account Dr. To Depreciation Account
Accounting Entries under the Direct Method:	
For Charging Depreciation	Depreciation Account Dr. To Asset Account
Transferring Depreciation to Profit & Loss Account	Profit & Loss Account Dr. To Depreciation Account

Example:

ABC Co. acquired a equipment on 1st July, 2016 at a cost of Rs.9,00,000 and spent Rs.1,00,000 on its installation. The books are closed on 31st December every year.

Prepare the Machinery Account and Depreciation Account for 2016 & 2017 using:

i. Straight Line Method @ 10% Depreciation per annum
ii. Diminishing Balance Method @ 15% Depreciation per annum

i. Machinery and Depreciation Account under Straight Line Method:

Dr.	Machinery Account				Cr.
Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
2016			2016		
Jul-01	To Bank A/c	900,000	Dec-31	By Depreciation A/C	50,000
	To Bank A/c (Installation)	100,000		10% on 10,00,000 for 6 months	
			Dec-31	By Balance c/d	950,000
	TOTAL	**1,000,000**		**TOTAL**	**1,000,000**
2017			2017		
Jan-01	To Balance b/d	950,000	Dec-31	By Depreciation A/C	100,000
				10% on 10,00,000 for 12 months	
			Dec-31	By Balance c/d	850,000
	TOTAL	**950,000**		**TOTAL**	**950,000**

Dr.	Depreciation Account				Cr.
Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
2016			2016		
Dec-31	To Machinery A/c	50,000	Dec-31	By Profit & Loss A/C	50,000
	TOTAL	**50,000**		**TOTAL**	**50,000**
2017			2017		
Dec-31	To Machinery A/c	100,000	Dec-31	By Profit & Loss A/C	100,000
	TOTAL	**100,000**		**TOTAL**	**100,000**

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Machinery and Depreciation Account under Diminishing Balance Method:

Dr.	Machinery Account				Cr.
Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
2016			2016		
Jul-01	To Bank A/c	900,000	Dec-31	By Depreciation A/C	75,000
	To Bank A/c (Installation)	100,000		15% on 10,00,000 for 6 months	
			Dec-31	By Balance c/d	925,000
	TOTAL	**1,000,000**		**TOTAL**	**1,000,000**
2017			2017		
Jan-01	To Balance b/d	925,000	Dec-31	By Depreciation A/C	142,500
				15% on 9,50,000 for 12 months	
			Dec-31	By Balance c/d	782,500
	TOTAL	**925,000**		**TOTAL**	**925,000**

Dr.	Depreciation Account				Cr.
Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
2016			2016		
Dec-31	To Machinery A/c	75,000	Dec-31	By Profit & Loss A/C	75,000
	TOTAL	**75,000**		**TOTAL**	**75,000**
2017			2017		
Dec-31	To Machinery A/c	142,500	Dec-31	By Profit & Loss A/C	142,500
	TOTAL	**142,500**		**TOTAL**	**142,500**

3. Sum of Years Digit Method:

This method is also known as Reducing Balance Method. According to this method, the depreciation formula is derived based on the number of years of the asset.

The formula to compute the depreciation under the sum of year's method is as follow:

$$\frac{\text{The number of years of remaining life of the asset}}{\text{Total of all digits of the life of the asset}}$$

Example:

ABC Co. acquired a equipment on 1st January, 2010 at a cost of Rs.20,00,000 which had a life of 10 years and scrap value of Rs2,40,000/- . The books are closed on 31st December every year.

Prepare the Machinery Account and Depreciation Account for 2015 using Sum of Digits method of depreciation:

Dr.	Machinery Account				Cr.
Date	Particulars	Amount	Date	Particulars	Amount
2015			2016		
Jan-01	To Balance b/d	720,000	Dec-31	By Depreciation A/C	160,000
	(As per the working note)				
			Dec-31	By Balance c/d	560,000
	TOTAL	**720,000**		**TOTAL**	**720,000**
2016					
Jan-01	To Balance b/d	560,000			

Working Notes for the above computation:

1. Computation of Depreciation for 2010-2014:

   (10+9+8+7+6)X (2000000-240000) = 40/55 X 1760000 = 1280000 10(10+1)/2

2. Computation of WDV as on 1-1-2015:
   2000000 – 1280000 = Rs.720000/-

3. Depreciation for 2015:

   (2000000 – 240000) X 5/55 = Rs160000/-

1. Machine Hours Method:

Under this method, Depreciation is calculated on the basis of hours that the concerned machine worked. The machine hour rate of the depreciation is calculated after estimating the total number of hours that machine would work during its whole life.

Example:

A machine was purchased for Rs. 20,00,000 having an estimated total working of 30,000 hours. The scrap value is expected to be Rs. 4,00,000 and anticipated machine hours usage is as follows :

Year

1 – 2 3,000 hours per year
3 – 5 4,000 hours per year
6 – 7 6,000 hours per year

Compute the Annual Depreciation under Machine Hour Rate Method.

Statement showing the Annual Depreciation under Machine Hours Method

Year	Annual Depreciation
1-2	3000/30000 X (2000000-400000) = Rs.160000/- Per Year
3-5	4000/30000 X (2000000-400000) = Rs.213333/- Per Year
6-7	6000/30000 X (2000000-400000) = Rs.320000/- Per Year

2. **Production of Units Method:**

Under this method depreciation of the asset is determined by comparing the annual production with the estimated total production. The amount of depreciation is computed by the use of following method:

Depreciation for the period = Depreciable Amount X $\frac{\text{Production during the period}}{\text{Estimated total}}$

production The method is applicable to machines producing product of uniform specifications. **Example:**

A machine is purchased for Rs. 10,00,000. Its estimated useful life is 8 years. The machine is expected to produce 10 lakh units during its life time. Expected distribution pattern of production is as follows:

Yearly Production

1-3 100,000 units per year
4-6 150,000 units per year
7-8 125,000 units per year

Required

Determine the value of depreciation for each year using production units method.

Statement showing the Annual Depreciation under Yearly Production Method

Year	Annual Depreciation
1-2	100000/1000000 X 1000000 = Rs.100000/- Per Year
3-5	150000/1000000 X 1000000 = Rs.150000/- Per Year
6-7	125000/1000000 X 1000000 = Rs.125000/- Per Year

3. **Depletion Method:**

This method is used in industries where only a certain quantity of product is available. This is used in case of mines, quarries etc. The depreciation rate is calculated by dividing the cost of the asset by the estimated quantity of product likely to be available. Annual depreciation will be the quantity extracted multiplied by the rate per unit.

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Example:

ABC & Co. took a quarry on 1-1-2015 for Rs. 1,00,00,000. As per technical estimate the total quantity of mineral deposit is 5,000 tonnes. Depreciation was charged on the basis of depletion method.

Extraction pattern is as follows:

Year Quantity of Mineral extracted

2015 1,000 tonnes

2016 2,000 tonnes

2017 2,000 tonnes

Statement showing the Annual Depreciation under Depletion Method

Year	Annual Depreciation
2015	1000/5000 X 10000000 = Rs.2000000/-
2016	2000/5000 X 10000000 = Rs.4000000/-
2017	2000/5000 X 10000000 = Rs.4000000/-

Profit or Loss on the sale or disposal of Property, Plant & Equipment:

Whenever any depreciable asset is sold during the year, depreciation is charged on it for the period it has been used in the sale year. The written down value after charging such depreciation is used for calculating the profit or loss on the sale of that asset. The resulting profit or loss on sale of the asset is ultimately transferred to profit and loss account.

Example:

The book value of the asset as on 1st April, 2017 is Rs.25,00,000. Depreciation is charged on the asset @20%. On 1st October 2017, the asset is sold for Rs.10,00,000. In such a situation, profit or loss on the sale will be calculated as follows:

Particulars	Amount
Book Value as on 1st April 2017	2500000
Less: Depreciation for 6 months @ 15% (1st April to 1st October)	187500
Written Down Value as on 1st October 2017	2312500
Less: Sales Proceeds as on 1st October 2017	1000000
Loss on Sale of the Asset	**1312500**

Change in the Method of Depreciation:

If there has been a significant change in the expected consumption pattern of the asset the method should be changed to reflect the changed pattern.

Whenever any change in depreciation method is made. Such change in method is treated as change in accounting estimate as per Accounting Standards whose effect needs to be quantified and disclosed. A change in an accounting estimate may affect the current period or both the current period and future periods.

Example:

Cost of Machine:
Rs.20,00,000 Residual
Value: NIL
Useful life: 10 years.

The company charges depreciation on straight line method for the first four years and thereafter decides to adopt written down value method by charging depreciation @ 15%. (Calculated based on useful life).

Compute the depreciation for the 5th year. Depreciation already charged for the first 4 years as per straight line method is Rs. 8,00,000. Therefore, WDV for 5th year is Rs. 3,00,000 Therefore in the profit and loss account of the 5th year, the depreciation of Rs. 3,00,000 (25% of Rs. 12,00,000) should be debited.

Revision of the Estimated Useful Life of Property, Plant & Equipment:

The residual value and the useful life of an asset needs to be reviewed every financial year-end and, if the company expects a change in an estimated useful life of the asset in accordance with Accounting Standards then the unamortized depreciable amount needs to be charged over the remaining estimated useful life of the asset.

Example:

A Machine costing Rs. 10,00,000 is depreciated on straight line basis, assuming 10 years working life and Nil residual value, for five years. The estimate of remaining useful life after fifth year was re-evaluated for 8 years only.

Calculate depreciation for the sixth year.

Particulars	Amount
Depreciation per year = Rs. 10,00,000 / 10	Rs.1000000/-
Depreciation on SLM charged for five years = Rs. 100,000 x 5 years = Rs.500000	Rs.500000/-
Book value of the asset at the end of fifth year = Rs. 10,00,000 – Rs. 5,00,000	Rs.500000/-
Remaining useful life as per previous estimate	5 Years
Remaining useful life as per revised estimate	3 Years
Depreciation from the sixth year onwards = Rs.5,00,000 / 3	Rs.166667/-

Re-Evaluation of the Fixed Asset:

As a Result of Re-evaluation of the fixed asset there can either be an increase in the value of the Fixed Asset or a Decrease in the Fixed Asset.

If there is an increase in the fixed asset, in case revaluation is done first time then the increase is credited directly to revaluation surplus. In case of Subsequent Reevaluation, it is recognized in the Statement of Profit and loss to the extent it was initially reduced and it also decreases the asset previously recognized in the Statement of profit and loss.

If there is an increase in the fixed asset, Charged to the Statement of profit and loss and if the subsequent revaluation decreases the asset value when it was increases during the previous revaluation then the Decrease should be debited directly to owners' interests under the heading of Revaluation surplus to the extent of any credit balance existing in the Revaluation surplus in respect of that asset.

Example:

A machine of cost Rs.15,00,000 is depreciated straight-line assuming 10 year working life and zero residual value for three years. At the end of fourth year, the machine was revalued upwards by Rs. 200,000 the remaining useful life was reassessed at 8 years.

Particulars	Amount
Depreciation per year for the 3 years = Rs. 15,00,000 / 10 X 3	Rs.450000/-
Rs. Rs.	Rs.1050000/-
Rs. Rs.	Rs.1250000/-
Remaining useful life as per previous estimate	6 Years
Remaining useful life as per revised estimate	8 Years
Depreciation from the fifth year onwards = Rs.12,50,000 / 8	Rs.156250/-

Provision for Repairs and Renewals:

Expenditure incurred for repairs, renewals and maintenance on Fixed Assets varies over the life of the asset. Therefore, to equalize the charge of repairs and renewals, sometimes a Provision for Repairs and Renewals Account is opened.

Total of such expenses that may be incurred over the working life is estimated beforehand and the Average amount of the expenditure is debited to Profit and Loss Account and credited to Provision for Repairs and Renewals Account irrespective of actual expenses incurred.

Annually the Provision for Repairs and Renewals Account is debited and Repairs Account is credited for actual expenses incurred. The balance in provision for Repairs and Renewals Account is carried forward and in the end or on sale of the asset, the account is closed by transfer to the Asset Account for any balance left.

Example:

The following particulars are available with regard to company's Fixed Assets:
Balance in Prov. for Repairs and Renewals Account as on 31.3.2015 Rs. 10,00,000 Actual repairs charged/incurred during the year ended
31.3.2016 Rs. 5,00,000
31.3.2017 Rs. 3,00,000

The company makes an annual provision of Rs.2,00,000 on repairs and renewals.

Prepare the Provision for Repairs and Renewals Account for the years 2015-2016 and 2016-2017.

Dr.	Provision for Repairs and Renewals Account				Cr.
Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
31.03.2016	To Repairs A/c	500,000	01.04.2015	By Balance b/d	1,000,000
31.03.2016	By Balance c/d/	700,000	31.03.2016	By Profit & Loss A/c	200,000
	TOTAL	**1,200,000**		**TOTAL**	**1,200,000**
31.03.2017	To Repairs A/c	300,000	01.04.2016	By Balance b/d	700,000
31.03.2017	By Balance c/d/	600,000	31.03.2017	By Profit & Loss A/c	200,000
	TOTAL	**900,000**		**TOTAL**	**900,000**
			01.04.2017	By Balance b/d	600,000

Intangible Assets

An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

Examples of intangible assets include:

a) Streaming rights of movies/TV shows
b) Patents
c) Trademarks
d) Copyrights
e) Long-term customer contracts
f) Goodwill (Purchased)
g) Computer software

Intangible assets comprise a major portion of the balance sheet. It may be noted that it can also be the case that intangible assets could make the entities far more valuable than the tangible assets.

Intangible assets can be recognized in the financial statements provided they meet the following conditions:

i. The intangible asset is identifiable. Being identifiable means the entity could rent, sell, exchange or distribute the specific future economic benefits attributable to the asset without disposing of future economic benefits that flow from other assets used in the same revenue earning activity.

ii. The enterprise can **exercise control** over such intangible asset. Control means the power available with the enterprise to obtain economic benefits from the asset and atthe same time, can restrict access of others to those benefits.

iii. It is portable that the future economic benefits attributable to the asset will flow to the enterprise and

iv. The cost of the intangible asset can be measured reliably.

An intangible asset acquired separately usually measured at cost, as cost can be measured reliably in such cases. The cost of the intangible asset would comprise of:

- Purchase price
- Any import duties and taxes (other than those subsequently recoverable by the enterprise from the tax authorities)
- Any directly attributable expenditure on making the asset ready for its intended use

Intangible assets acquired as part of acquisition, government grants, internally generated goodwill/ intangible assets, or on exchange of assets are dealt separately at the intermediate level

An intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.

Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount ofthe asset and should be recognised as income or expense in the statement of profit and loss.

Difference between Tangible and Intangible assets

Tangible Assets	Intangible Assets
These are assets that have a physical substance i.e., they can be seen and touched, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.	These are identifiable assets that do NOT have a physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.
Tangible Assets have a finite life based on expected usage.	Intangible Assets have a finite life based on contractual terms. In some cases, intangible assets could also have an indefinite life e.g. purchased goodwill.

Useful life is based on expected usage, with no presumption laid down for the same.	Useful life of Intangible Assets is presumed not to exceed 10 years unless evidence exists to the contrary.
Tangible Assets are depreciated over the useful life. In other words, writing off the value of tangible assets on an annual basis is known as depreciation.	Intangible Assets are amortised over the useful life. In other words, writing off the value of intangible assets on an annual basis is known as amortisation.
Examples include Property, Machinery, Vehicles etc.	Examples include software, streaming rights, landing rights, trademarks, patents etc.

Amortisation

The concept of amortisation in case of intangible assets is similar to the concept of depreciation in case of tangible assets. In other words, 'depreciation of an intangible asset' is called **AMORTISATION**.

Amortisation can be defined as 'the systematic allocation of the depreciable amount of an intangible asset over its useful life'. Depreciable amount is the cost of an asset less its residual value.

Useful life is either:

(a) the period of time over which an asset is expected to be used by the enterprise; or

(b) the number of production or similar units expected to be obtained from the asset bythe enterprise.

Residual value is the amount which an enterprise expects to obtain for an asset at the end ofits useful life after deducting the expected costs of disposal.

The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. Amortisation should commence when the asset is available for use. It is presumed that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use unless evidence exists to the contrary. For instance, given the rapid changes in technology, computer software and many other intangible assetsare susceptible to technological obsolescence. Therefore, it is likely that their useful life will be short. Similarly, intangible assets with contractual rights for a period exceeding ten years, will be amortised over such extended period rather than the presumed period of ten years.

Given the nature of intangible assets, the residual value of an intangible asset should be assumed to be zero unless:

(a) there is a commitment by a third party to purchase the asset at the end of its usefullife; or

(b) there is an active market for the asset and:

(i) residual value can be determined by reference to that market; and

(ii) it is probable that such a market will exist at the end of the asset's useful life.

The amortisation period and the amortisation method should be reviewed at least at each financial year end. If the expected useful life of the asset is significantly different from previous estimates, the amortisation period should be changed accordingly. If there has been a significant change in the expected pattern of economic benefits from the asset, the amortisation method should be changed to reflect the changed pattern.

Questions:

Question 1:

ABC Co. acquired a equipment on 1st July, 2016 at a cost of Rs.20,00,000 and spent Rs.5,00,000 on its installation. The books are closed on 31st December every year.

Prepare the Machinery Account and Depreciation Account for 2016 & 2017 using:

ii. Straight Line Method @ 20% Depreciation per annum

iii. Diminishing Balance Method @ 25% Depreciation per annum

Illustrations

Question: 1

Jain Bros. acquired a machine on 1st July,2015 at a cost of Rs. 14,00,000 and spent Rs. 1,00,000 on its installation. The firm writes off depreciation at 10% p.a. of the original cost every year. The books are closed on 31st December every year

Show the Machinery Account and Depreciation Account for the year 2015 and 2016.

Question: 2

Jain Bros. acquired a machine on 1st July,2015 at a cost of Rs. 14,00,000 and spent Rs. 1,00,000 on its installation. The firm writes off depreciation at 10% p.a. every year. The books are closed on 31st December every year.

Show the Machinery Account on diminishing balance method for the year 2015 and 2016.

Question: 3

M/s Akash purchased a machine for Rs. 10,00,000. Estimated useful life and scrap value were 10 years and Rs. 1,20,000 respectively. The machine was put to use on 1.1.2010.

Show Machinery Account and Depreciation Account in their books for 2015 by using sum of years digits method.

Question: 4

A machine was purchased for Rs. 30,00,000 having an estimated total working of 24,000 hours. The scrap value is expected to be Rs. 2,00,000 and anticipated pattern of distribution of effective hours is as follows

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Year	Particulars
1 – 3	3,000 hours per year
4 – 6	2,600 hours per year
7 – 10	1,800 hours per year

Determine Annual Depreciation under Machine Hour Rate Method.

Question:5

A machine is purchased for Rs. 20,00,000. Its estimated useful life is 10 years with a residual value of Rs. 2,00,000.

The machine is expected to produce 1.5 lakh units during its lifetime. Expected distribution pattern of production is as follows:

Year	Units of Production per year
1 – 3	20,000 units
4 – 7	15,000 units
8 – 10	10,000 units

Determine the value of depreciation for each year using production units method.

Question: 6

M/s Surya took lease of a quarry on 1-1-2013 for Rs. 1,00,00,000. As per technical estimate the total quantity of mineral deposit is 2,00,000 tonnes

Depreciation was charged on the basis of depletion method. Extraction pattern is given in the following table:

Year	Quantity of Mineral extracted (in Tonnes)
2013	2,000
2014	10,000
2015	15,000

Show the Quarry Lease Account and Depreciation Account for each year from 2013 to 2015.

Question: 7

A firm purchased on 1st January,2015 certain machinery for Rs. 5,82,000 and spent Rs. 18,000 on its erection. On July 1,2015 another machinery for Rs. 2,00,000 was acquired. On 1st July,2016 the machinery purchased on 1st January,2015 having become obsolete was auctioned for Rs. 3,86,000 and on the same date fresh machinery was purchased at a cost of Rs. 4,00,000. Depreciation was provided for annually on 31st December at the rate of 10 per cent p.a. on written down value

Prepare Machinery Account.

Question: 8

M/s Anshul commenced business on 1st January 2011, when they purchased plant and equipment for Rs. 7,00,000. They adopted a policy of charging depreciation at 15% per annum on diminishing balance basis and over the years, their purchases of plant have been:

Date	Amount (Rs.)
01-01-2012	1,50,000

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01-01-2015	2,00,000

On 1-1-2015 it was decided to change the method and rate of depreciation to straight line basis. On this date remaining useful life was assessed as 6 years for all the assets purchased before 1.1.2015 and 10 years for the asset purchased on 1.1.2015 with no scrap value. Calculate the difference in depreciation to be adjusted in the Plant and Equipment Account for the year ending 31st December,2015.

Question: 9

A Machine costing Rs. 6,00,000 is depreciated on straight line basis, assuming 10 years working life and Nil residual value, for three years. The estimate of remaining useful life after third year was reassessed at 5 years.
Calculate depreciation for the fourth year

Question: 10

The following particulars are available from the books of a public company having a large fleet of vehicles:

Particulars	**Amount (Rs.)**
Balance in Provision for Repairs and Renewals Account as on 31.03.2016	
Actual repairs charged/incurred during the year ended 31.03.2016	11,50,000
31.03.2017	7,50,000
	3,20,000

The company makes an annual provision of Rs. 4,00,000 on repairs and renewals.
Draw up the Provision for Repairs and Renewals Account for the years 2015-2016 and 2016-2017.

Question 11

Kumar R&D Co. registered a patent (the patent meets the criteria of an intangible asset) on 1st July, 2021 developed at a cost of ` 28,00,000 and spent ` 2,00,000 towards legal fees and registration. The patent is granted for a period of 10 years. The books are closed on 31st December every year.

Show the Patent Account and Amortisation Account for the year 2021 and 2022.

Question 12

Prime Streaming Co. acquired the streaming rights of a movie for ` 18,00,000 with the contracted duration of the streaming period being 10 years. At the beginning of the fourth year, based on the decline in viewership, Prime Streaming Co. decided to stream the movie only for the next 5 years. Calculate amortisation for the fourth year.

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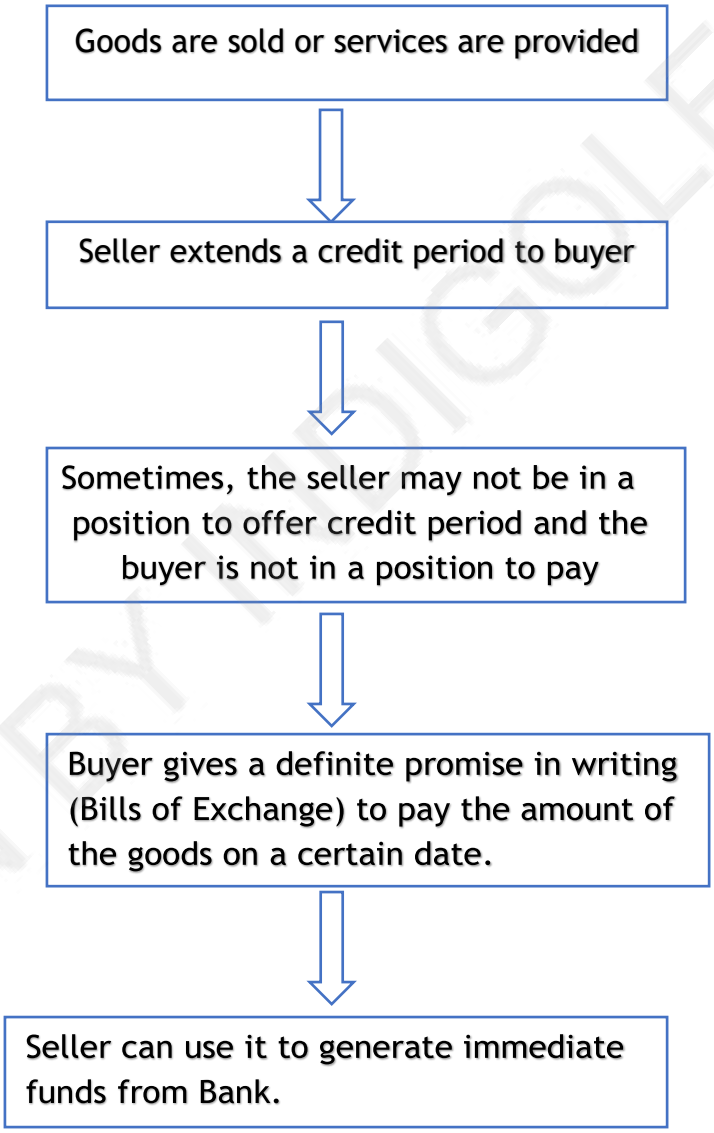
Chapter 6 – Bills of Exchange and Promissory Note

1. BILLS OF EXCHANGE

❖ Definition

- Instrument in **writing**,
- Containing an **unconditional order** signed by the maker,
- **Directing** certain person to pay a certain sum of money
- Only to or to the order of a **certain** person or to the bearer of the instrument.
- When such an order is **accepted** in writing on the face of the order itself,
- It becomes a valid bill of exchange.

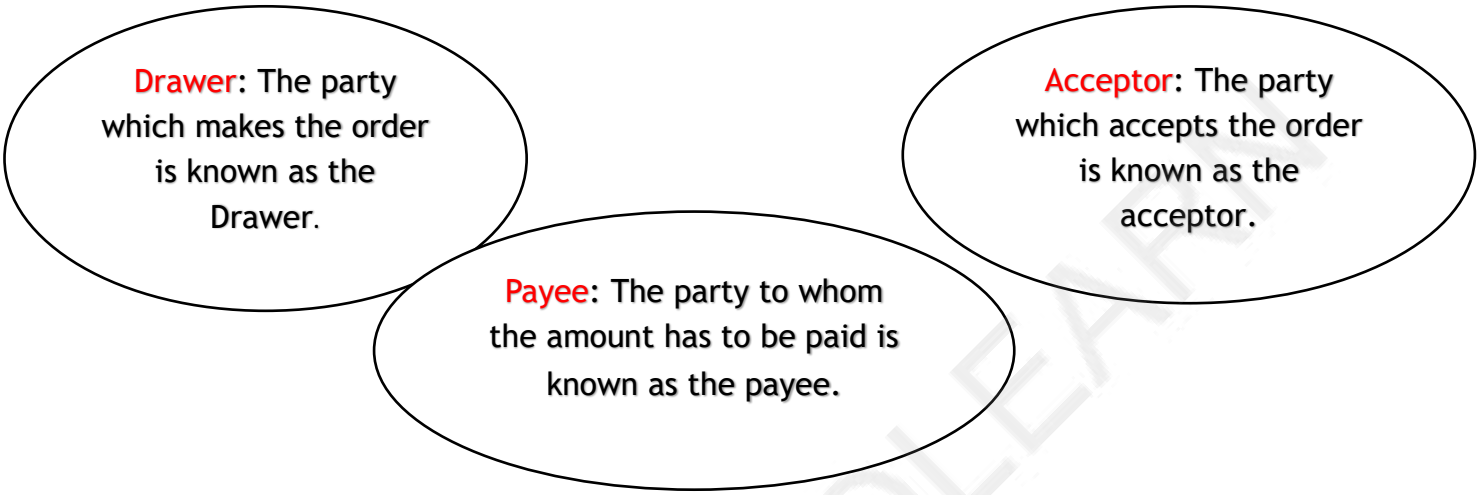
❖ Concept



- Characteristics
  - It must be in **writing**.
  - It must be **dated**.
  - It must contain an **order** to pay a certain sum of money.

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- The promise to pay must be **unconditional**.
- The money must be payable to a **definite person** or to his order to the bearer.
- The draft must be **accepted for payment** by the party to whom the order is made.
- It should be properly **stamped**.
- Payment must be in **legal currency** of the country.
- A Bill of Exchange can be passed on to another person by **endorsement**.



- Foreign Bill of Exchange
  - A bill of exchange drawn for **foreign trade operations** known as Foreign Bill of Exchange.
  - A foreign bill of exchange is one which is drawn in one country and is payable in another.
  - It is generally drawn up in **triplicate** wherein each copy is sent by separate post so that at least one copy reaches the intended party.
  - Payment will be made only on **one of the copies** and when such payment is made the other copies become useless.

Example

1. A bill drawn in India on a person resident outside India and made payable outside India.
2. A bill drawn outside India on a person resident outside India.
3. A bill drawn outside India and made payable in India.
4. A bill drawn outside India and made payable outside India.

2. PROMISSORY NOTES

- Definition
  - A promissory note is an **instrument in writing**,
  - Not being a bank note or currency note
  - Containing an **unconditional undertaking** signed by the maker to pay a certain sum of money
  - Only to or to the order of a **certain person**.

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- Characteristics
  - It must be in **writing**.
  - It must contain a clear **promise to pay**. Mere acknowledgement of a debt is not a promissory note.
  - The promise to pay must be **unconditional** "I promise to pay 50,000 as soon as I can" is not an unconditional promise.
  - The promiser or maker must **sign** the promissory note.
  - The maker must be a **certain person**.
  - The payee (the person to whom the payment is promised) must also be **certain**.
  - The sum payable must be **certain**. "I promise to pay 50,000 plus all fine" is not certain.
  - Payment must be in **legal currency** of the country.
  - It should not be made payable to the **bearer**.
  - It should be properly **stamped**.
  - It does not require any **acceptance**.

3. BILLS OF EXCHANGE V/S PROMISSORY NOTES

BILLS OF EXCHANGE	PROMISSORY NOTE
A bill contains an unconditional order to pay.	A promissory note contains only a promise to pay certain sum of money.
There are generally 3 parties (Drawer, Drawee and Payee) in bill of exchange.	There are 2 parties (Maker and Payee) in promissory note.
A bill is paid by Acceptor.	A promissory note is paid by maker.
A bill is drawn by creditor.	A promissory note is made by debtor.
The drawer and payee may be same person in case of bill of exchange	In promissory note maker and payee cannot be same person.
In a bill of exchange the liability of drawer is secondary and conditional.	In a promissory note the liability of a maker is primary and absolute.
A bill of exchange can be accepted conditionally.	A promissory note cannot be made conditionally.
In a bill of exchange, notice of dishonor must be given.	Notice of dishonor is not required in case of promissory note.
In case of dishonor, a bill of exchange must be noted and protested.	Noting and protest is not required in case of dishonor of a promissory note.

4.TERM OF A BILL

1) When a bill is drawn ***after sight***

Term of the bill: Begins from the date of 'sighting' i.e. when the bill is accepted.

2) When a bill is drawn ***after date***

Term of the bill: Begins from the date of drawing the bill.

5. EXPIRY /DUE DATE OF BILL

- The date on which the term of the bill terminates is called as '**Expiry/Due Date of the bill**'.

6. DAY OF GRACE

- Every instrument payable otherwise than on demand entitled to **three days** of grace.

7. DATE OF MATURITY OF BILL

- The date which comes after adding **three days** to the expiry/due date of a bill, is called the **date of maturity**.
- The maturity of a promissory note or bill of exchange is the date at which it **falls due**.
- Every promissory note or bill of exchange gets matured on the third day after the day on which it is expressed to be payable , except when it is expressed to be payable
  i. on **demand**,
  ii. at **sight**, or
  iii. on **presentment**

8. BILL AT SIGHT

- Bill at Sight means the instruments in which **no time** for payment is mentioned.
- A promissory note or bill of exchange is payable **on demand**-
  - when **no time** for payment is specified, or
  - when it is **expressed** to be payable on demand, or at sight or on presentment.

Point to be remember

- ❖ At sight' and 'presentment' means **on demand.**
- ❖ An instrument payable on demand may be **presented for payment** at any time.
- ❖ **Days of grace** is not to added to calculate maturity for such types of bill.
- ❖ A **cheque** is always payable on demand.

9. BILL AFTER DATE

- ➢ Bill after date means the instrument in which **time for payment** is mentioned.
- ➢ A promissory note or bill of exchange is a time instrument when it is expressed to be payable-
  - After a **specified period**.
  - on a **specific day**
  - after **sight**
  - on the happening of event Which is **certain to happen**.

Point to be remember

*The expression '**after sight**' means-*

- ❖ *In a promissory note, after **presentment for sight**.*
- ❖ *In a bill of exchange, **after acceptance or noting for non-acceptance or protest for non-acceptance**.*

- ➢ A cheque cannot be a time instrument because the cheque is always payable on demand.
- ➢ Though a cheque can be postdated and which can be presented on or after such date.
- ➢ A cheque has validity of 90 days from its date after that it becomes void, normally termed as 'Stale Cheque' as bank will not honour such cheque.

9. BILL AFTER DATE

- Bill after date means the instrument in which **time for payment** is mentioned.
- A promissory note or bill of exchange is a time instrument when it is expressed to be payable-
  - After a **specified period.**
  - on a **specific day**
  - after **sight**
  - on the happening of event

  Which is **certain to happen**.

- A cheque cannot be a time instrument because the cheque is always payable on demand.
- Though a cheque can be postdated and which can be presented on or after such date.
- A cheque has validity of 90 days from its date after that it becomes void, normally termed as 'Stale Cheque' as bank will not honour such cheque.

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10. CALCULATION OF DUE DATE OF A BILL

When the bill is made payable on a specific date.

That specific date will be the due date

When the bill is made payable at a stated number of months(s) after date.

That date on which the term of the bill shall expire will be the due date.

When the bill is made payable at a stated number of days after date.

That date which comes after adding stated number of days to the date of bill, shall be the due date.

Note : the date of bill is excluded

When the due date is a public holiday.

The preceding business day will be the due date.

When the due date is an emergency/due unforeseen holiday.

The next following day will be the date.

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Point to be remember

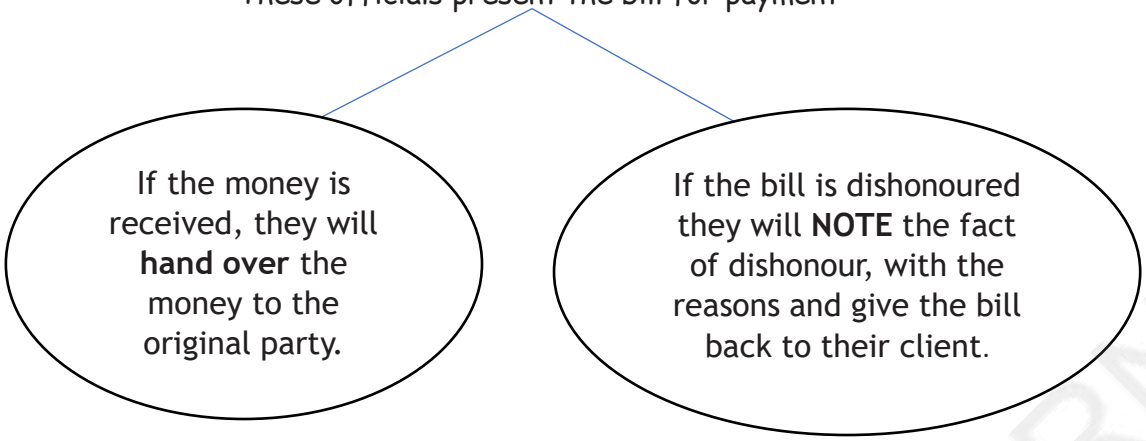
1) When the bill is made payable at a stated number of months(s) after date, the **term** shall expire on that day of the month which corresponds with the day on which the bill is dated. If the month in which the period terminates has no corresponding day, the period shall be deemed to expire on the last day of such a month. For example, a bill signed on January 31st payable after 3 months will be due on April 30th.

2) The term of a **Bill after sight** commences from the date of acceptance of the bill whereas the term of a bill after date commences from the date of drawing of bill.

11. NOTING CHARGES

- When the acceptor denies the payment of bill then it leads to dishonor of bill.
- If there is dishonour, or fear of dishonour, the bill will be given to a public official known as "***Notary Public***".

These officials present the bill for payment
These officials present the bill for payment



- For doing this activity, the officer charges a small fee known as **noting charges**. The amount of noting charges is recoverable from the party which is responsible for dishonour.

12. RENEWAL OF BILL

When Acceptor is unable to pay the amount and he himself moves that he should be given extension.

⇩

In consideration, the acceptor agrees to bear interest for the extended tie period.

(Calculated from the date of renewal till the date of expected settlement).

⇩

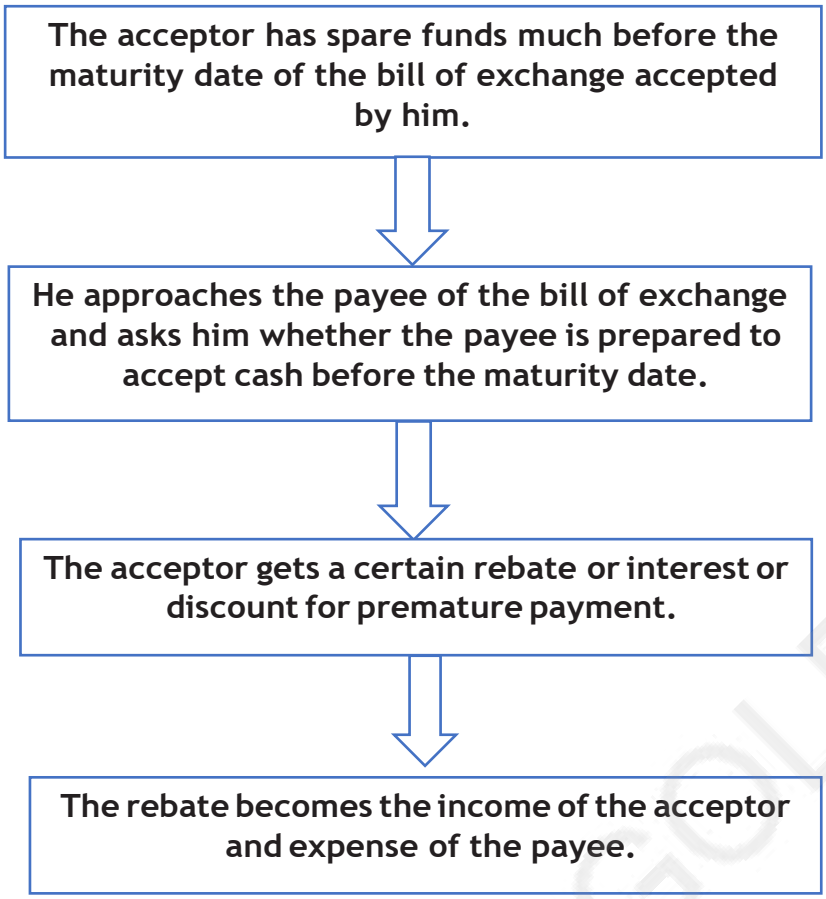
A new bill will be drawn and the old bill will be cancelled.

The amount of the new bill may represent any of the following

1) **Where the drawee pays nothing:** Total of amount of original bill as well as the interest for the extended time period.
2) **Where the drawee pays the interest amount at the time of renewal:** Amount of the Original bill.
3) **Where the drawee makes part payment of the original bill:** that part of total of amount of original bill remain unpaid as well as the interest for the extended time period on unpaid amount.

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13. RETRIEMENT OF BILLS OF EXCHANGE AND REBATE



14. ACCOMODATION BILLS

- The mechanism of bill can be used to raise finance without doing any trading activity.

For example: Sanju and Manju are two friends. Sanju needs fund for three months. . In that case he may persuade his friend Manju to accept his draft. The bill of exchange may then be taken by Sanju to his bank and get it discounted there. Thus, Sanju will be able to make use of funds.

When the three months period expires Sanju will send the requisite amount to Manju and Manju will meet the bill.

- The same mechanism can be use when both the party needs money. In that case the proceeds divided between the drawer and drawee according to mutual concern. The discounting charges must also be borne by the two parties in the same ratio in which the proceeds are divided.
- It may so happen that the drawer is not able to remit the proceeds to drawee on the due date.

In such a case, the drawee may draw a bill on the drawer, and get it discounted with the bank to honour the first bill.

15. BILL RECEIVABLE AND BILL PAYABLE BOOKS

- Bills receivable and bills payable books are **journals** (Day Books) to record in a **chronological order** the details of bills receivable and bills payable.

- When **large number** of bill transactions take place in an organization, it is convenient to maintain these books.
- Wherein any bill transaction takes place, the same is entered in the Day Books in the first instance and then the posting to respective debtor or creditor and to Bills Receivable or Bills Payable account done from the day book.
- Useful for **following up** the status of outstanding bills.

16. JOURNAL ENTRIES IN BOOKS OF DRAWER

Particular	Amount
On receipt of Bill	
Bills Receivable Account Dr.	
To Drawee/Maker of the note	
On Endorsement in favour of another Party(say Z) Z A/c Dr.	
To Bills Receivable Account	
On discounting with bank Bank Account Dr. (with the amount actually received Discount Account Dr. (with the amount of loss or discount) To Bills Receivable Account	
On the date of maturity (Bill is honoured) Cash Account Dr.	
To Bills Receivable Account	
On the date of maturity (Bill is dishonoured)	
1. **If the bill was kept till maturity then**	
Drawee / Maker of the note Dr.	
To Bills Receivable Account	
2. **If the bill was endorsed in favour of a creditor, the entry is** :	
Drawee / Maker of the note Dr.	
To Bill payables	
3. **If the bill was discounted with the bank :**	
Drawee / Maker of the note Dr.	
To Bank A/c	
Entry for Noting charges	

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1. **Suppose X received from Y a bill for 1,000. On Maturity the bill is dishonoured and 10 is paid as noting charges. The entry in this case will be**		
Y A/c	Dr.	1,010
To Bills Receivable Account		1,000
To Bank A/c		10
2. **Suppose X had endorsed this bill in favour of Z**		
Y A/c	Dr.	1,010
To Z		1,010
This is because Z will claim 1,010 from X and X has the right of recovering 1,010 from Y.		
3. **If the bill has been discounted with a bank, entry will be**		
Y	Dr.	1,010
To Bank A/c		1,010
<u>In case of Insolvency</u>		
1. **When drawee become insolvent**		
Drawee A/c	Dr.	
To Bills Receivable A/c		
2. **When something received from estate**		
Cash A/c	Dr.	
To Drawee A/c		
3. **Entry for Irrecoverable Amount**		
Bad debt A/c	Dr.	
To Drawee A/c		
• **<u>In case of Renewal of bill</u>**		
1. **Cancellation of original Bill**		
Entries are same as explained for dishonour of bill.		
2. **Entry for New bill**		
Bills Receivable A/c	Dr.	
To Drawee A/c		

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3. **In case of interest charged for new period**	
Bills Receivable A/c Dr.	
To Drawee A/c To Interest Income A/c	
In case of Retirement of Bill	
Cash/ Bank A/c Dr.	
Rebate on bills account Dr.	
To Bills Receivable A/c	

17. JOURNAL ENTRIES IN BOOKS OF DRAWEE

Particular	Amount
On acceptance of Bill	
Drawer A/c Dr.	
To Bills Payable A/c	
On the date of maturity (Bill is honoured)	
Bills Payable A/c Dr.	
To Cash/Bank A/c	
On the date of maturity (Bill is dishonoured)	
Bills Payable A/c Dr.	
To Drawer A/c	
Entry for Noting charges	
Legal expense A/c Dr.	
To Drawer A/c	
In case of Insolvency	
1. **When drawee become insolvent**	
Bills Payable A/c Dr.	
To Drawer A/c	
2. **When final settlement Made**	
Drawer A/c Dr.	
To Cash/Bank A/c	
3. **Entry for short payment**	
Drawer A/c Dr.	
To Deficiency A/c	
In case of Renewal of bill	

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Cancellation of original Bill		
Bills Payable A/c	Dr.	
To Drawer A/c		
Entry for New bill		
Drawer A/c	Dr.	
To Bills Payable A/c		
In case of interest charged for new period		
Drawer A/c	Dr.	
Interest Charged A/c	Dr.	
To Bills Payable		
In case of Retirement of Bill		
Bills Payable	Dr.	
To Cash / Bank To Rebate on bill discount		

18. BILLS OF COLLECTION

Particular		Amount
Entries for Bills for Collection Process		
Bills for Collection Account	Dr.	
To Bills Receivable Account		
When the amount is realized the entry will be		
Bank Account	Dr.	
To Bills for Collection Account		
When the amount is not honoured, the entry will be		
Party (from whom the bill was received)	Dr.	
To Bills for collection A/c		

Question: 1

Vijay sold goods to Pritam on 1st September 2016 for Rs. 1,06,000. Pritam immediately accepted three months bill. On due date Pritam requested that the bill be renewed for a fresh period of two months. Vijay agrees provided interest at 9% was paid immediately in cash. To this Pritam was agreeable. The second bill was met on due date.

Give Journal entries in the books of Vijay and Pritam.

Question: 2

On 1st January 2016, Ankita sells goods for Rs 5,00,000 to Bhavika and draws a bill at three months for the amount. Bhavika accepts it and returns it to Ankita. On 1st March 2016, Bhavika retires her acceptance under rebate of 12% per annum.

Record these transactions in the journals of Ankita and Bhavika.

Question: 3

	Journalize the following transactions in K. Katrak's books
1	Katrak's acceptance to Basu for Rs 2,500 discharged by a cash payment of Rs 1,000 and a new bill for the balance plus Rs 50 for interest
2	G. Gupta's acceptance for Rs 4,000 which was endorsed by Katrak to M. Mehta was dishonored. Mehta paid Rs 20 noting charges. Bill withdrawn against cheque
3	D. Dalal retires a bill for Rs 2,000 drawn on him by Katrak for Rs 10 discount
4	Katrak's acceptance to Patel for Rs 5,000 discharged by Patel. Mody's acceptance to Katrak for a similar amount

Question: 4

On 1st January,2016, Vilas draws a Bill of Exchange for Rs. 10,000, due for payment after 3 months on Eknath. Eknath accepts to this bill of exchange. On 4th March,2016. Eknath retires the bill of exchange at a discount of 12% p.a.

You are asked to show the journal entries in the books of Vilas.

Question: 5

Mr. David draws two bills of exchange on 1.1.2016 for Rs 6,000 and Rs 10,000. The bills of exchange for Rs 6,000 is for two months while the bill of exchange for Rs 10,000 is for three months. These bills are accepted by Mr. Thomas.

On 4.3.2016, Mr. Thomas requests Mr. David to renew the first bill with interest at 18% p.a. for a period of two months. Mr. David agrees to this proposal. On 20.3.2016, Mr. Thomas retires the acceptance for Rs 10,000, the interest rebate i.e. discount being Rs 100. Before the due date of the renewed bill, Mr. Thomas becomes insolvent and only 50 paisa in a rupee could be recovered from his estate.

You are to give the journal entries in the books of Mr. David.

Question: 6

Rita owed Rs. 1,00,000 to Siriman.

- On 1st October,2016, Rita accepted a bill drawn by Siriman for the amount at 3 months
- Siriman got the bill discounted with his bank for Rs. 99,000 on 3rd October,2016
- Before the due date, Rita approached Siriman for renewal of the bill.
- Siriman agreed on the conditions that Rs. 50,000 be paid immediately together with interest on the remaining amount at 12% per annum for 3 months and for the balance, Rita should accept a new bill at three months
- These arrangements were carried out
- But afterwards, Rita became insolvent and 40% of the amount could be recovered from his estate

Pass journal entries (with narration) in the books of Siriman.

Question: 7

On 1st July,2016 Gorge drew a bill for Rs. 1,80,000 for 3 months on Harry for mutual accommodation.

- Harry accepted the bill of exchange

- Gorge had purchased goods worth Rs. 1,81,000 from Jack
- On the same date Gorge endorsed Harry's acceptance to Jack in full settlement
- On 1st September,2016, Jack purchased goods worth Rs. 1,90,000 from Harry
- Jack endorsed the bill of exchange received from Gorge to Harry and paid Rs. 9,000 in full settlement of the amount due to Harry
- On 1st October,2016, Harry purchased goods worth Rs. 2,00,000 from Gorge
- Harry paid the amount due to Gorge by cheque

Give the necessary Journal Entries in the books of Harry and Gorge.

Question: 8

For the mutual accommodation of 'X' and 'Y' on 1st April,2016, 'X' drew a four month's bill on 'Y' for Rs. 4,000

- 'Y' returned the bill after acceptance of the same date
- 'X' discounts the bill from his bankers @ 6% per annum and remit 50% of the proceeds to 'Y'
- On due date 'X' is unable to send the amount due and therefore 'Y' draws a bill for Rs. 7,000, which is duly accepted by 'X'
- 'Y' discounts the bill for Rs. 6,600 and sends Rs. 1,300 to 'X'
- Before the bill is due for payment 'X' becomes insolvent. Later 25 paise in a rupee received from his estate

Record Journal entries in the books of 'X'.

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Chapter 7 – Preparation of Final Accounts of Sole Proprietors

Financial Accounts of Non-Manufacturing Entities:

What is a Non-Manufacturing Entity?
Non-manufacturing entity is the entity, which is engaged in the purchase and sale of goods at profit without processing of those goods. Non-manufacturing entities sell the goods in its original form.

To ascertain the results of the business the entity prepares the income statement i.e. the Profit & Loss Statement and financial position i.e. Balance Sheet at the end of the accounting year.

Important Principles to be followed in preparation of Final Accounts:

The important principles to be followed in the preparation of the Final Accounts are as follow:

i. Distinction should be made between capital and revenue receipts and payments.

ii. Only the Income earned and Expense incurred in the current accounting period should be accounted for in the current accounting period.

iii. All the different items of income and expenditure should be accumulated under major heads of income and expense to disclose the sources from which capital has been raised and the liabilities, which are outstanding for payment.

iv. Distinction between Personal and Business Income should be maintained.

v. All material information needs to be disclosed which can impact the decision of the users.

Matching Principle:

As per this principle the expenses incurred to earn the revenue should be properly matched in the same accounting period. The following point's needs to be taken care while recording the revenue and expense for the current period:

i. If an item of revenue or income is recorded in the Trading or Profit and Loss Account then all the expenses relating to those revenue or income needs to be recorded in the same period Trading and Profit & Loss Account irrespective of the fact whether or not payment has been actually made.

ii. If some expense has been incurred but the revenue for it will be received in the next year, the expense should be carried forward as an asset and shown in the Balance Sheet.

It will be debited to the Profit and Loss Account only when the relevant income will also be credited. This is the same logic based on which the depreciation on assets is charged.

iii. In the similar manner if some income has been received but the expense for the same will be incurred in the next year, the income should be recorded as liability and shown in the Balance Sheet.
It will be credited to the Profit and Loss Account only when the relevant expense is debited.

iv. Exception to the above rule is that costs which have been incurred or is expected to be incurred should only be debited to Profit and Loss Account. For example, if a fire has occurred and has damaged the firm's property the loss must be debited to the Profit and Loss Account to the extent it is not covered by insurance.

Trading Account:
Trading Account enables to compute the Gross Profit or Gross Loss occurred due to carrying out the business operations during the accounting period.

Gross Profit/Gross Loss is computed as the difference between the selling price and the Cost of Goods Sold. The Cost of Goods sold is computed using the following formula:

Opening Stock
Add: Purchases
Add: Direct Expenses
Less: Closing Stock
Cost of Goods Sold

Dr.	Trading Account for the year ended.....				Cr.
	Amount	Amount		Amount	Amount
To Opening Stock		XXX	By Sales	XXX	
To Purchases	XXX		Less: Sales Return	(XXX)	XXX
Less: Purchase Return	(XXX)	XXX			
			By Closing Stock		XXX
To Direct Expenses			By Gross Loss c/d (Either profit or loss)		
Freight & Carriage	XXX				
Insurance	XXX				
Wages	XXX				
Fuel	XXX				
Factory Expense	XXX				
Depreciation on Factory Equip	XXX	XXX			
By Gross Profit c/d (Either profit or loss)					
TOTAL		XXX	TOTAL		XXX

Accounting Entries related to Trading Account:

1. **Opening Inventory:**
   Trading A/c Dr.
   To Opening Stock

2. **Purchases:**
   Purchase A/c Dr.
   To Vendor/Cash A/c

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Trading A/c Dr.
To Purchases

3. **Purchase Return:**
Purchase Return A/c Dr.
To Purchases

4. **Carriage, Freight Inwards:**
Trading A/c Dr.
To Carriage, Freight Inwards A/c

5. **Wages:**
Trading A/c Dr.
To Wages A/c

6. **Sales:**
Debtors/Cash A/c Dr.
To Trading A/c

Sales A/c Dr.
To Trading A/c

7. **Sales Return:**
Trading A/c Dr.
To Sales Return A/c

8. **Closing Inventory:**
Closing Inventory A/c Dr.
To Trading A/c

Note:
If Closing Stock appears in the Trial balance then the closing inventory is not recorded in the trading account, it is directly presented in the balance sheet.
This is due to the fact that the entry has already been recorded to arrive at Cost of Goods Sold.
As per the valuation principle closing inventory is recorded at cost or net realisable value whichever is less.

Profit & Loss Account:
Trading Account enables to determine the gross profit or loss derived from carrying out the trading activities in which the organization is engaged in.

All the expenses which have not been recorded in the trading account form a part of the Profit & Loss Account. All the income and gains except for sales form a part of the Profit & Loss Account.

Format of Profit & Loss Account:
Format of Profit & Loss Account:

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Dr.	Profit & Loss Account for the year ended.....				Cr.
	Amount	Amount		Amount	Amount
To Gross Loss b/d			**By Gross Profi t b/d**		
Management expenses			**Other Income**		
To Salaries (administrative)			By Discount Received		
To Offi ce rent, rates and taxes			By Commission Received		
To Printing and stationery					
To Telephone charges			**Non-trading Income**		
To Postage and telegrams			By Bank Interest		
To Insurance			By Rent of property let-out		
To Audit Fees			By Dividend from shares		
To Legal Charges					
To Electricity Charges			**Abnormal Gains**		
			By Profi t on sale of machinery		
Maintenance expenses			By Profi t on sale of investment		
To Repairs & renewals					
To Depreciation on:			**By Net Loss (transferred to capital A/c)**		
Office Equipment					
Office Furniture					
Office Buildings					
Selling and Distribution expenses					
To Salaries (selling staff)					
To Advertisement					
To Godown rent					
To Carriage Outward					
To Bad Debts					
To Provision for bad debts					
To Selling commission					
Financial expenses					
To Bank charges					
To Interest on loans					
To Discount on bills					
To discount allowed to customers					
Abnormal Losses					
To Loss on sale of machinery					
To Loss on sale of investment					
To loss by fi re					
To Net Profit (transferred to Capital A/c)					
TOTAL		XXX	**TOTAL**		XXX

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Accounting Entries related to Profit & Loss Account:

1. **Drawings:**
   Capital A/c Dr.
   To Drawings

2. **Income Tax**
   Capital A/c Dr.
   To Income Tax A/c

3. **Discount received**
   Profit/Loss A/c Dr.
   To Discount Allowed A/c

4. **Discount allowed**
   Discount Received A/c Dr.
   To Profit/Loss A/c

5. **Bad Debts**
   Bad Debts Account Dr.
   To Debtor's Account

   Profit/Loss Account Dr.
   To Bad Debts A/c

   In case of Provision for Bad Debts is prepared then the bad debts are first recorded against the provision

   Bad Debts Account Dr.
   To Debtor's Account

   Provision for Bad Debts A/c Dr.
   To Bad Debts A/c

6. **Bad Debts Recovery**

   Bad Debts Recovered Account Dr.
   To Profit/Loss Account

Closing Entries
The journal entries that are made for transferring various account to the trading and Profit & Loss Account are known as Closing Entries.

1. **For expenses to be recorded to Profit & Loss Account.**

   Profit and Loss Account Dr.
   To Salaries Account
   To Rent Account
   To Interest Account
   To Other Expenses Account

2. **For revenues and gains to be recorded to Profit & Loss Account.**

   Discount Received Account Dr.

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Bad debts Recovered Account Dr.
To Profit and Loss Account

3. **Net Profit or Loss transferred to Capital Account**

Net Profit
Profit and Loss Account Dr.
To Capital Account
Net Loss
Capital Account Dr.
To Profit and Loss Account

Other Adjustments and their treatment:

1. **Abnormal loss of Inventory by accident or fire**

Loss by Fire Account Dr.
To Purchases/Trading Account

Claim received from Insurance Company
Profit & Loss A/c Dr.
To Loss by Fire A/c

2. **Goods sent on Approval basis**

Sales A/c Dr.
To Trade receivables A/c

Sale on approval A/c Dr.
To Trading A/c

3. **Goods used other than for sale**

When goods are given away as donation
` Donation A/c Dr.
To Purchases A/c

When goods are used by the proprietor for his personal use
Drawings A/c Dr.
To Purchases A/c

When goods are distributed as free samples:-
Advertisement A/c Dr.
To Purchases A/c

When goods are used in business for construction of Fixed Asset:-
Fixed Asset A/c Dr.
To Purchases A/c

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When goods are used for maintenance of Fixed Asset: -
Repair & Maintenance A/c Dr.
To Purchases A/c

4. **Commission based on profit**
Sometimes organizations offer the Managers and high level authorities a part of profit via commission as a part of their compensation. The computation involved in the computation of these commission and the journal entries to record the same are as stated below.

Commission based on Net Profit before charging such commission:

$$\text{Commission} = \text{Profit before commission} \times \frac{\text{Rate of Commission}}{100}$$

Commission based on Net Profit after charging such commission:

$$\text{Commission} = \text{Profit before commission} \times \frac{\text{Rate of Commission}}{100 + \text{Rate of Commission}}$$

Recording Commission in the Books of Accounts:

Commission A/c Dr.
To Commission Payable A/c

Profit/Loss Account Dr.
To Commission A/c

Example:

The following is the Trial Balance of ABC Co. on 31st Dec. 2018. Prepare the Trading and Profit & Loss Account from the Trial Balance after passing the closing entries.

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Particulars	Debit Rs.	Credit Rs.
Capital		1,500,000
Inventory	357,500	
Cash	55,000	
Machinery	800,000	
Purchases	800,000	
Wages	250,000	
Salaries	175,000	
Discount Received		10,000
Discount Allowed	7,500	
Office Expense	15,000	
Sales		1,000,000
Debtors	500,000	
Creditors		450,000
TOTAL	**2,960,000**	**2,960,000**

Value of Closing Inventory on December 31, 2017 was Rs.625000/-

Date	Particulars		Debit	Credit
Dec-31	Trading A/c	Dr.	1,407,500	
	To Inventory A/c			357,500
	To Purchases A/c			800,000
	To Wages A/c			250,000
	(Being balances appearing in trial balance transferred to trading account)			
Dec-31	Sales A/c	Dr.	1,000,000	
	To Trading A/c			1,000,000
	(Being Sales balance transferred to trading account)			
Dec-31	Closing Inventory A/c	Dr.	625,000	
	To Trading A/c			625,000
	(Being Closing Inventory recorded)			
Dec-31	Trading A/c	Dr.	217,500	
	To Profit & Loss A/c			217,500
	(Being gross profit transferred to Profit & Loss Account)			

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Dec-31	Profit & Loss A/c	Dr.	197,500	
	To Salaries A/c			175,000
	To Discount Allowed A/c			7,500
	To Office Expenses A/c			15,000
	(Being expenses appearing in trial balance transferred to P&L account)			
Dec-31	Discount Received A/c	Dr.	10,000	
	To Profit & Loss A/c			10,000
	(Being expenses appearing in trial balance transferred to P&L account)			
Dec-31	Profit & Loss A/c		30,000	
	To Capital A/c			30,000
	(Being Profit & Loss Account Balance transferred to Capital)			

Dr. **Trading Account for the year ended December 31, 2018** Cr.

	Amount	Amount		Amount	Amount
To Opening Stock		357,500	By Sales		1,000,000
To Purchases		800,000	By Closing Stock		625,000
To Wages		250,000			
To Gross Profit c/d		217,500			
TOTAL		1,625,000	TOTAL		1,625,000

Dr. **Profit & Loss Account for the year ended December 31, 2018** Cr.

	Amount	Amount		Amount	Amount
To Salaries		175,000	By Gross Profit b/d		217,500
To Discount Allowed		7,500	By Discount Received		10,000
To Office Expenses		15,000			
To Net Profit (Transferred to Capital A/c)		30,000			
TOTAL		227,500	TOTAL		227,500

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Balance Sheet:

Balance Sheet is the statement which presents an organization Assets and Liabilities position on a particular date.

Important points with regard to Balance Sheet:

1. It is valid only for a particular date and not later. For Example, if the closing inventory for December 31, 2018 was valued at Rs.1,00,000/- and the entity purchased inventory worth Rs,50,000 on 1st January 2019 the Balance Sheet on 1st January 2019 would be different as compared to 31st December 2018.

2. Balance sheet is prepared only after the preparation of the Profit and Loss Account.

Format of Balance Sheet:

	Balance Sheet as at				
Liabilities	Amount	Amount	Assets	Amount	Amount
Capital A/c			Tangible Fixed Assets		
Opening Balance	XXX		Land and Building	XXX	
Add : Net Profi t/Less: Net Loss	XXX		Plant and Machinery	XXX	
Less : Drawings	(XXX)	XXX	Furniture and Fixture	XXX	
			Vehicles	XXX	XXX
Long Term Loans					
Term Loans	XXX		Intangibles		
Other Loans	XXX	XXX	Goodwill	XXX	
			Patent Rights	XXX	
Short Term Loans			Designs and Brand Names	XXX	XXX
Cash Credit	XXX				
Overdrafts	XXX		Investments		
Other Loans	XXX	XXX	Long term investments	XXX	XXX
Current Liabilities			Current Assets		
Trade payables	XXX		Inventory in Trade	XXX	
Outstanding Expenses	XXX		Trade receivables	XXX	
Advances Taken	XXX	XXX	Short term investments	XXX	
			Prepayments	XXX	
Provision			Advances	XXX	
Provision for Bad debts	XXX		Bank Balances	XXX	XXX
Provision for Retirement Benefits	XXX	XXX			
TOTAL		XXXX	TOTAL		XXXX

CLASSIFICATION OF ASSETS AND LIABILITIES

Assets are classified into the following categories:

1. **Current Assets**
   These are the assets which are meant to be used or converted into cash as within the next operating cycle or one year whichever is longer.
   For Eg: Cash, Bank, Debtors, Closing stock, etc.

2. **Long Term Assets: -**
   These are the assets which are meant for long term usage and are expected to last for more than a year or the accounting cycle whichever is longer.
   Long Term Assets are classified as Intangible Assets or Tangible Assets.

   Intangible Assets are those Assets which have no physical existence i.e. which cannot be touched, felt or seen. For Eg, Patents, Copyrights, etc.

   Tangible Assets are those assets which have their physical existence and can be identified. For Eg, Furniture, Equipments, Machinery, etc.

Liabilities can be classified into the following categories:

1. **Current Liabilities**:
   These are the liabilities which must be settled or paid within in one year or operating cycle whichever is higher. Current Liabilities are also known as Short Term Liabilities. For Eg, Creditors, Bills Payable etc.

2. **Long Term Liabilities**:
   These are the liabilities which are to be paid or settled at least after a year or the operating cycle whichever is longer. For Eg, Long term loans, Borrowings, etc.

Example:
The following is the Trial Balance of ABC Co. on 31st Dec. 2018. Prepare the Balance Sheet.

Particulars	Debit Balance	Credit Balance
Capital A/C		1,235,000
Machinery	100,000	
Long Term Loan		50,000
Creditors		24,000
Debtors	40,000	
Cash	5,000	
Closing Stock	15,000	
Building	1,500,000	
Short Term Borrowings		175,000
Advances to Suppliers	55,000	
Profit for Current year		256,000
Drawings	25,000	
TOTAL	1,740,000	1,740,000

Balance Sheet as at 31st December 2018					
Liabilities	**Amount**	**Amount**	**Assets**	**Amount**	**Amount**
Capital	1,235,000		Machinery		100,000
Add: Profit	256,000		Building		1,500,000
Less: Drawings	(25,000)	1,466,000			
			Debtors		40,000
Long Term Loan		50,000	Cash		5,000
			Closing Stock		15,000
Creditors		24,000	Advance to Suppliers		55,000
Short Term Borrowings		175,000			
TOTAL		**1,715,000**	**TOTAL**		**1,715,000**

Questions:

Question 1:

The following is the Trial Balance of ABC Co. on 31st Dec. 2018. Prepare the Trading and Profit & Loss Account from the Trial Balance after passing the closing entries.

Particulars	**Debit Rs.**	**Credit Rs.**
Capital		1,381,500
Inventory	256,500	
Cash	49,000	
Machinery	550,000	
Purchases	851,000	
Wages	355,000	
Salaries	475,000	
Discount Received		25,000
Discount Allowed	20,000	
Office Expense	150,000	
Sales		1,355,000
Debtors	400,000	
Creditors		345,000
TOTAL	**3,106,500**	**3,106,500**

Value of Closing Inventory on December 31, 2017 was Rs.89500/-

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Question 2:

The following is the Trial Balance of ABC Co. on 31st Dec. 2018. Prepare the Balance Sheet.

Particulars	Debit Rs.	Credit Rs.
Capital A/C	-	2,470,000
Machinery	200,000	-
Long Term Loan	-	100,000
Creditors	-	48,000
Debtors	80,000	-
Cash	10,000	-
Closing Stock	30,000	-
Building	3,000,000	-
Short Term Borrowings	-	350,000
Advances to Suppliers	110,000	-
Profit for Current year	-	512,000
Drawings	50,000	-
TOTAL	**3,480,000**	**3,480,000**

Illustrations

Question: 1

Trial Balance for financial the year (FY) ended 31st March 2017 of M/s Deepakshi shows following details:

Particulars	Debit (Rs.)	Credit (Rs.)
Purchases and sales	10,00,000	12,00,000
Debtors and Creditors	5,00,000	4,00,000
Opening Stock	2,00,000	
Closing Stock	3,00,000	
Other Expenses and Incomes	7,00,000	9,00,000
Fixed Assets and Long-term Liabilities	25,00,000	6,00,000
Capital		21,00,000
Total	**52,00,000**	**52,00,000**

Additional Information:

- Creditors balance as on 1st April 2016 is Rs. 3,00,000.
- You are required to calculate cost of goods sold and amount paid to creditors during the year.

Question: 2

Particulars	Amount (Rs.)
Opening Inventory	1,00,000
Purchases	6,72,000
Carriage Inwards	30,000
Wages	50,000
Sales	11,00,000
Returns inward	1,00,000
Returns outward	72,000
Closing Inventory	2,00,000

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From the above information, prepare a Trading Account of M/s. ABC Traders for the year ended 31st March 2017 and Pass necessary closing entries in the journal proper of M/s. ABC Traders.

Question: 3

Revenue, Expenses and Gross Profit Balances of M/s ABC Traders for the year ended on 31st March 2016 were as follows:

Particulars	**Amount (Rs.)**
Gross Profit	4,20,000
Salaries	1,10,000
Discount (Cr.)	18,000
Discount (Dr.)	19,000
Bad Debts	17,000
Depreciation	65,000
Legal Charges	25,000
Consultancy Fees	32,000
Audit Fees	1,000
Electricity Charges	17,000
Telephone, Postage and Telegrams	12,000
Stationery	27,000
Interest paid on Loans	70,000

Prepare Profit and Loss Account of M/s ABC Traders for the year ended on 31st March. Show necessary closing entries in the Journal Proper of M/s. ABC Traders also.

Question: 4

On 1st Jan. 2017 provision for Doubtful Debts existed at Rs. 40,000. Trade receivables on 31.12.2017 were Rs. 15,00,000. Bad debts totalled Rs. 1,00,000. It is required to write off the bad debts and create a provision equal to 5% of the Trade receivable's balance.

Question: 5

The following is the Trial Balance of C. Wanchoo on 31st Dec. 2017

Trial Balance on 31st December

Particulars	**Amount (Rs.)**	**Amount (Rs.)**
Capital Account		10,00,000
Inventory Account	2,00,000	
Cash in hand	1,44,000	
Machinery A/c	7,36,000	
Purchases A/c	18,20,000	
Wages A/c	10,00,000	
Salaries A/c	10,00,000	
Discount Allowed A/c	50,000	
Discount Received A/c		30,000
Sundry Office Expenses A/c	6,00,000	
Sales A/c		50,00,000
Sums owing by customer (Trade receivables)	8,50,000	
Trade payables (sums owing to suppliers)		3,70,000
Total	64,00,000	64,00,000

Value of Closing Inventory on 31st Dec. 2017 was Rs. 2,70,000

Prepare Trading and Profit and Loss Account.

Question: 6

The balance sheet of Thapar on 1st January 2017 was as follows:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Trade Payables	15,00,000	Plant and Machinery	30,00,000
Expenses Payable	1,50,000	Furniture and Fixture	3,00,000
Capital	50,00,000	Trade receivables	14,00,000
		Cash at Bank	6,50,000
		Inventories	13,00,000
Total	66,50,000	Total	66,50,000

During 2017, his Profit and Loss Account revealed a net profit of Rs. 15,30,000. This was after allowing for the following:

(a) Interest on capital @ 6% p.a.

(b) Depreciation on Plant and Machinery @ 10% and on Furniture and Fixtures @ 5%

(c) A provision for Doubtful Debts @ 5% of the trade receivables as at 31st December 2017

But while preparing the Profit and Loss Account he had forgotten to provide for

(1) Outstanding expenses totalling Rs. 1,80,000

(2) Prepaid insurance to the extent of Rs. 20,000

His current assets and liabilities on 31st December 2017 were:

a. Inventories Rs. 14,50,000
b. Trade receivables Rs. 20,00,000
c. Cash at Bank Rs. 10,35,000
d. Trade payables Rs. 11,40,000

During the year he withdrew Rs. 6,00,000 for domestic use.

Draw up his Balance Sheet at the end of the year.

Question: 7

Balance Sheet as at 31st December 2017

Capital and Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Mahindra & Sons	5,60,000	Cash in Hand	43,000
Capital	20,00,000	Cash at Bank	2,67,500
		Trade Receivables	7,49,500
		Closing Inventory	9,00,000
		Machinery and Equipment	6,00,000
Total	25,60,000	Total	25,60,000

From the above given balance sheet prepare the relevant opening entry.

Question: 8

Shri Mittal gives you the following Trial Balance and some other information

Trial Balances as on 31st March 2017

Particulars	Amount (Rs.) Dr.	Amount (Rs.) Cr.
Capital		8,70,000
Purchases and Sales	6,05,000	12,10,000
Opening Inventory	72,000	

Trade receivables and Trade payables	90,000	1,70,000
14% Bank Loan (loan taken at year end)		2,00,000
Overdrafts (overdraft taken at year end)		1,12,000
Salaries	2,70,000	
Advertisements	1,10,000	
Other expenses	60,000	
Returns	40,000	30,000
Furniture	4,50,000	
Building	8,90,000	
Cash in Hand	5,000	
Total	25,92,000	25,92,000

Closing Inventory on 31st March 2017 was valued at Rs. 1,00,000.
Prepare final accounts of Shri Mittal for the year ended 31st March 2017.

Question: 9
Mr. Mohan gives you the following trial balance and some other information

Particulars	**Amount (Rs.)**	**Amount (Rs.)**
Capital		6,50,000
Sales		9,70,000
Purchases	4,30,000	
Opening Inventory	1,10,000	
Freight Inward	40,000	
Salaries	2,10,000	
Other Administrative Expenses	1,50,000	
Furniture	3,50,000	
Trade receivables and Trade Payables	2,10,000	1,90,000
Returns	20,000	12,000
Discounts	19,000	9,000
Bad debts	5,000	
Investments in Government Securities	1,00,000	
Cash in Hand and cash at Bank	1,87,000	
Total	18,31,000	18,31,000

Other Information:
(i) Closing Inventory was Rs. 1,80,000
(ii) Depreciate Furniture @ 10% p.a

1. Prepare Trading and Profit and Loss Account for the year ended on 31.3.2017. Balance Sheet of Mr. Mohan as on that date.

Question: 10
The Balance Sheet of Mr. Popatlal, a merchant on 31st March,2017 stood as below

Capital and Liabilities	**Amount (Rs.)**	**Assets**	**Amount (Rs.)**	**Amount (Rs.)**
Capital	2,40,000	Fixed Assets		1,25,600
Trade payables	1,64,000	Inventories		2,06,400
Bank Overdraft		Trade Receivables		
	1,46,000	**Less**	1,88,000	
		Provision		

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			6,200	
		Cash		1,81,800
				36,200
Total	5,50,000	Total		5,50,000

Show opening journal entry on 1st April,2017 in the books of Mr. Popatlal.

Question: 11

The following is the schedule of balances as on 31.3.17 extracted from the books of Shri Gavaskar, who carries on business under the same name and style of Messrs Gavaskar Viswanath & Co., at Bombay

Particulars	**Amount (Rs.) Dr.**	**Amount (Rs.) Cr.**
Cash in Hand	14,000	
Cash at Bank	26,000	
Sundry Debtors	8,60,000	
Stock on 01.04.2016	6,20,000	
Furniture & fixtures	2,14,000	
Office equipment	1,60,000	
Buildings	6,00,000	
Motor Car	2,00,000	
Sundry Creditors		4,30,000
Loan from Viswanath		3,00,000
Provision for bad debts		30,000
Purchases	14,00,000	
Purchase Returns		26,000
Sales		23,00,000
Sales Returns	42,000	
Salaries	1,10,000	
Rent for Go down	55,000	
Interest on loan from Vishwanath	27,000	
Rates & Taxes	21,000	
Discount allowed to Debtors	24,000	
Discount Received from creditors		16,000
Freight on purchases	12,000	
Carriage Outwards	20,000	
Drawings	1,20,000	
Printing and Stationery	18,000	
Electricity Charges	22,000	
Insurance Premium	55,000	
General office expenses	30,000	
Bad debts	20,000	
Bank Charges	16,000	
Motor car expenses	36,000	
Capital a/c		16,20,000
Total	47,22,000	47,22,000

Prepare Trading and Profit and Loss Account for the year ended 31st March 2017 and the Balance Sheet as at that date after making provision for the following:

I.Depreciate:

(a) Building used for business by 5 %

(b) Furniture and fixtures by 10 %:

One steel table purchased during the year for Rs. 14,000 was sold for same price but the sale proceeds were wrongly credited to Sales Account

(c) Office equipment by 15 %:

Purchase of a typewriter during the year for Rs. 40,000 has been wrongly debited to purchase

(d) Motor car by 20%

II. Value of stock at the close of the year was Rs. 4,40,000

III. Two month's rent for Go down is outstanding

IV. Interest on loan from Viswanath is payable at 12 % per annum, this loan was taken on 01.05.2016

V. Reserve for bad debts is to be maintained at 5 % of Sundry Debtors

VI. Insurance premium includes Rs. 40,000 paid towards proprietor's life insurance policy and the balance of the insurance charges cover the period from 01.04.2016 to 30.06.2017.

Question: 12

Crimpson Ltd.'s profit and loss account for the year ended 31st March 2016 includes the following information

Particulars	**Amt (Rs.)**
(i) Depreciation	57,500
(ii) Bad debts written off	21,000
(iii) Increase in provision for doubtful debts	18,000
(iv) Proposed dividend	15,000
(v) Retained profit for the year	20,000
(vi) Liability for tax	4,000

Required:

State which one of the items (i) to (vi) above are –

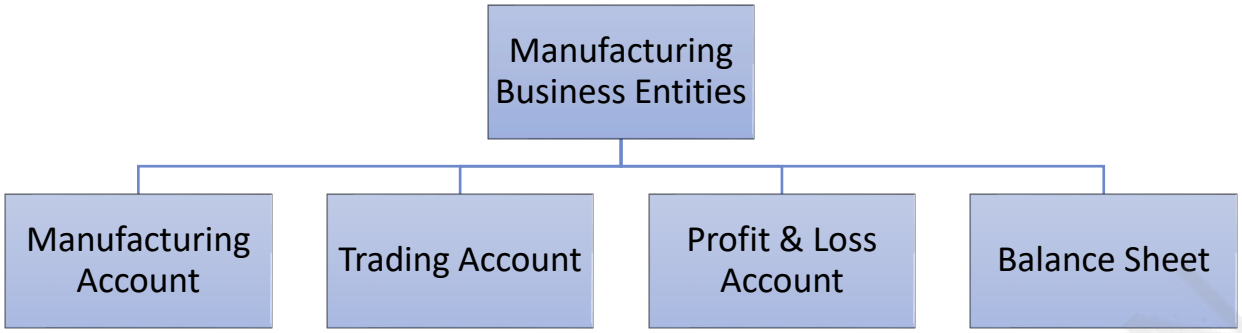
(a) transfer to provisions;

(b) transfer to reserves; and

(c) neither related to provisions nor reserves.

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UNIT 2: Final accounts of Manufacturing entities



Introduction

The manufacturing entities generally prepare a separate Manufacturing Account as a part of Final accounts in addition to Trading Account, Profit and Loss Account and Balance Sheet. The objective of preparing Manufacturing Account is to determine manufacturing costs of finished goods for assessing the cost effectiveness of manufacturing activities. Manufacturing costs of finished goods are then transferred from the Manufacturing Account to Trading Account.

Purpose

A manufacturing account serves the following functions:

1. It shows the total cost of manufacturing the finished products and sets out in detail, with appropriate classifications, the constituent elements of such cost. It is, therefore, debited with the cost of materials, manufacturing wages and expenses incurred directly or indirectly on manufacture.
2. It provides details of factory cost and facilitates reconciliation of financial books with cost records and also serves as a basis of comparison of manufacturing operations from year to year.
3. The Manufacturing Account may also be used for various other purposes. For example, if the output is carried to the Trading Account at market prices, it discloses the profit or loss on manufacture. Similarly, it may also be used to fix the amount of production of profit sharing bonus when such schemes are in force.

Manufacturing costs are classified into :

+ Raw Material Consumed	…….
+ Direct Manufacturing Wages	……
+ Direct Manufacturing Expenses	……
+ Direct Manufacturing Cost	……
+ Indirect Manufacturing expenses or	
+ Manufacturing Overhead	……
Total Manufacturing Cost	

Direct Manufacturing Expenses

Direct manufacturing expenses are costs, other than material or wages, which are incurred for a specific product or saleable service.

Examples of direct manufacturing expenses are (i) Royalties for using license or technology if based on units produced, (ii) Hire charge of the plant and machinery used on hire, if based on units produced, etc.
When royalty or hire charges are based on units produced, these expenses directly vary with production.

INDIRECT MANUFACTURING EXPENSES OR OVERHEAD EXPENSES

These are also called Manufacturing overhead, Production overhead, Works overhead, etc.
Overhead is defined as total cost of indirect material, indirect wages and indirect expenses.
Overhead = Indirect Material + Indirect Wages + Indirect Expenses
Indirect material means materials which cannot be linked directly with the units produced, for example, stores consumed for repair and maintenance work, small tools, fuel and lubricating oil, etc.
Indirect wages are those which cannot be directly linked to the units produced, for example, wages for maintenance works, holding pay, etc.
Indirect expenses are those which cannot be directly linked to the units produced, for example, training expenses, depreciation of plant and machinery, depreciation of factory shed, insurance premium for plant and machinery, factory shed, etc.
Accordingly, indirect manufacturing expenses comprise indirect material, indirect wages and indirect expenses of the manufacturing division.

BY-PRODUCTS

In most manufacturing operations, the production of the main product is accompanied by the production of a subsidiary product which has a value on sale. For example, the production of hydrogenated vegetable oil is accompanied by the production of oxygen gas and the production of steel yields scrap. The subsidiary product is termed as a by-product because its production is not consciously undertaken but results out of the production of the main product. It is usually very diflcult to ascertain the cost of the product. Moreover, its value usually forms a very small percentage of the main product.
By-product is a secondary product. This is produced from the same raw materials, which are used for producing the main product and without incurring any additional expenses from the same production process in which the main product is produced. Some examples of by-product are given below:

i. Molasses is the by-product in sugar manufacturing;
ii. Butter milk is the by-product of a dairy which produces butter and cheese, etc.

By-products generally have insignificant value as compared to the value of main product. They are **generally valued at net realizable value,** if their costs cannot be separately identified. It is often treated, as "Miscellaneous income" but the correct treatment would be to credit the sale value of the by-product to Manufacturing Account so as to reduce to that extent, the cost of manufacture of main product

Question: 1
1,00,000 units were produced in a factory Per unit material cost was Rs.10 and per unit labour cost was Rs.5. That apart it was agreed to pay royalty @ Rs.3 per unit to the Japanese collaborator who supplied technology.
Required: Calculate Manufacturing Cost.

Question: 2

Mr. Vimal runs a factory which produces soaps. Following details were available in respect of his manufacturing activities for year ended on 31.03.2016.

Particulars	**Amt. (Rs.)**
Opening Work-in-Process (10,000 units)	16,000
Closing Work-in-Process (12,000 units)	20,000
Opening inventory of Raw Materials	1,70,000
Closing inventory of Raw Materials	1,90,000
Purchases	8,20,000
Hire charges of machine @ Rs. 0.60 per unit manufactured	
Hire charges of factory	2,20,000
Direct wages-Contracted @ Rs.0.80 per unit manufactured and @ Rs.0.40 per unit of	
Closing W.I.P.	
Repairs and Maintenance	1,80,000
Units produced – 5,00,000 units	

Prepare a Manufacturing Account of Mr. Vimal for the year ended 31.3.2016.

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Chapter 8 – Financial Statements of Not-For-Profit Organizations

What is a Not-for-Profit Organization?

A Not-for-Profit Organization is an entity which is not being operated for the purpose of earning profit but for the benefit for the society. It is brought into existence with a view to serve a social cause, not to earn profits for its owners.

Following are some of the forms of Not-For-Profit Organization:

1. Public Hospitals
2. Public Educational Institutions
3. Government Clubs
4. Temples, etc.

Receipt and Payment Account:

A Receipt and Payment Account is similar to cash book except it does not include the date column. The key features of the Receipt and Payment account are as stated below:

1. It presents the summary of cash and bank transactions.
2. All the receipts and payments irrespective of the fact whether they are capital or revenue in nature are accounted for.
3. This account is not maintained as part of the double entry system of accounting.
4. Surplus for the period i.e. Excess of Income over expenditure or Deficit i.e. Excess of Expenditure over income for the period cannot be determined from this account since it excludes all non-cash transactions. This is the limitation of the Receipt and Payment Account.

Example on Receipt and Payment Account:

The receipts and payments for the ABC, NPO for the year ended March 31, 2018 were:

Particulars	**Amount (INR)**
Entrance fees	1000
Membership Fees	5000
Donation for Club Building 1	5000
Food sales	3500
Salaries and Wages	5500
Purchase of Food	2000
Construction of Club Pavilion	13000
General Expenses	1000
Rent and Taxes	500
Bank Charges	250
Opening Cash in hand Balance	5000
Closing Cash in hand Balance	1500
Opening Cash in Bank Balance	2000
Closing Cash in Bank Balance	3500

Prepare the Receipts and Payment Account.

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Receipt and Payment Account for the year ended 31st March 2018

Receipts	Amount	Payments	Amount
To Balance b/d (Op. Bal)		By Salaries and Wages	5,500
- Cash	5,000	By Purchase of Food	2,000
- Bank	2,000	By Construction of Club Building	13,000
		By General Expenses	1,000
To Entrance fees	1,000	By Rent and Taxes	500
To Membership Fees	5,000	By Bank Charges	250
To Donation for Club Building	15,000		
To Food sales	3,500	By Balance c/d	
		- Cash	3,500
		- Bank	5,750
TOTAL	**31,500**	**TOTAL**	**31,500**

Income and Expenditure Account:

Income and Expenditure account can be considered as the PROFIT AND LOSS ACCOUNT for the NPO. The key features of the Receipt and Payment account are as stated below:

1. It is the revenue account for the NPO which is prepared at the end of the accounting period of the NPO.

2. It is prepared using the Matching Principle i.e. current year revenue and expenses are recorded in the current accounting period only irrespective of the status of their payment.

3. Cash as well as Non-Cash items are taken into consideration.

4. Income and Expenses which are capital in nature are excluded.

Preparing the Income and Expenditure Account from the Receipt and Payment Account:

Income and Expenditure account and the Balance Sheet for the NPO can be prepared from the Receipt and Payment Account by making necessary adjustment with respect to the income earned and expense incurred during the current period.
The following steps needs to be followed to prepare the income and expenditure and balance sheet using the Receipt and Payment Account.

1. Prepare the Opening Balance Sheet to arrive at the opening balance of the accumulated fund.

2. Prepare Ledger Accounts for the various income and expenses through which the accruals and outstanding at the beginning and end of the period needs to be adjusted to arrive at the income and expense for the current period.
3. Post the debit and credit of the Receipt and Payment to the Credit of the Income and Expenditure Account for adjusting the accrual and outstanding.

4. Transfer the balance of the income and expenditure to the Accumulated/Capital Fund Account.

5. Transfer the amounts which are capital in nature from the Receipt and Payment to the Balance Sheet of the NPO.

6. Prepare the Closing Balance Sheet.

Example on Computing and Preparing a particular Income Account from the Receipt and Payment information:

During 2018, Subscription received in cash is Rs. 70000.
It includes Rs.15000 for 2017 and Rs.10000 for 2019.
Also Rs.20000 has still to be received for 2018.
Prepare the Subscription Outstanding, Subscription and Advance Subscription Account for the year ended March 31, 2018.

Dr. Subscription Outstanding Account for the year ended 31st March 2018 Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2018					
Apr - 1	To Balance b/d	15,000	Mar - 31	By Subscription A/c	15,000
Mar - 31	To Subscription A/c	20,000	Mar - 31	By Balance c/d	20,000
	TOTAL	**35,000**		**TOTAL**	**35,000**
2019					
Apr - 1	To Balance b/d	20,000			

Dr. Subscription Account for the year ended 31st March 2018 Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2018					
Mar - 31	To Subscription Outstanding A/c	15,000	Mar - 31	By Cash/Bank A/c	70,000
Mar - 31	To Advance Subscription A/c	10,000	Mar - 31	By Subscriptions Outstanding A/c	20,000
Mar - 31	To Income & Expenditure A/c	65,000			
-	**TOTAL**	**90,000**		**TOTAL**	**90,000**

Dr. Advance Subscription Account for the year ended 31st March 2018 Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2018			2018		
Apr - 1	To Balance b/d	10,000	Mar - 31	By Subscription A/c	10,000
	TOTAL	**10,000**		**TOTAL**	**10,000**
			2019		
			Apr - 1	By Balance c/d	10,000

The balance in Advance Subscription Account of Rs.10000/- will appear on the liabilities side and in Outstanding subscription Account of Rs.20000/- will appear on the Asset Side.

Balance Sheet:

A Balance Sheet is the statement which presents the balance of the assets and liabilities of an accounting period at a given date. Normally it is prepared at the end of an accounting period after the Income and Expenditure Account has been prepared. In NPO Accounting, the excess of total

assets over total outside liabilities is known as Capital Fund which presents the amount contributed by the Members, receipt of special donations and surplus accumulated over the years.

Example on preparing the Income and Expenditure account and Balance Sheet from the receipt and Payment Account.

Following is the Receipt and Payment Account of Club XYZ, an NPO for the year ended March 31, 2018 along with the details of the opening and closing balance of Assets and Liabilities for the year ended.

Prepare the Income and Expenditure and Balance Sheet for the year ended March 31, 2018.

Receipt and Payment Account for the year ended 31st March 2018

Receipts	Amount	Payments	Amount
To Balance b/d (Op. Bal)	10,000	By Salaries and Wages	13,000
		By Rent	5,000
To Membership fees	25,000	By Utilities	7,000
To Miscellaneous Income	5,000	By Magazines and Periodicals	2,500
To Interest on Secured Deposit	2,500	By Miscellaneous Expenses	3,000
		By Balance c/d (Cl. Bal)	12,000
TOTAL	**42,500**	**TOTAL**	**42,500**

Particulars	31-Mar-17	31-Mar-18
Salaries outstanding	5,000	8,000
Outstanding Rent	5,000	10,000
Outstanding Utilities	500	1,000
Outstanding Magazines and Periodicals	250	500
Fixed Deposit	50,000	50,000
Accrued Interest	1,000	1,000
Fees Receivable	1,250	1,500
Prepaid Expenses (Miscellaneous)	450	600
Computers	7,000	
Equipment	4,000	
TOTAL		

Depreciation on the Computers is charged at 15% and on Equipment is charged at 10%.
The Opening Balance Sheet is as presented below:

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Balance Sheet as on 31st March 2017

Liabilities	Amount	Amount	Assets	Amount	Amount
Outstanding Expenses:			Fixed Deposits		50,000
- Salaries		5,000	Accrued Interest		1,000
- Rent		5,000	Fees Receivable		1,250
- Utilites		500	Prepaid Expenses		450
- Magazines & Periodicals		250	Computers		7,000
			Equipments		4,000
Capital Fund (Bal. Fig)		52,950			
TOTAL		**63,700**	**TOTAL**		**63,700**

The Income and Expenditure Account is as presented below:

Dr. Income and Expenditure Account for the year ended March 31, 2018 Cr.

Particulars	Amount	Amount	Particulars	Amount	Amount
To Salaries and Wages		16,000	By Membership Fees		25,250
To Rent		10,000	By Miscellaneous Income		5,000
To Utilites		7,500	By Interest on Seurity Deposit		2,500
To Magazines & Periodicals		2,750			
To Misc. Expenses		2,850			
			By Excess of Expenditure over Income		7,800
To Depreciation:					
- Computers (@ 15%)	1050				
- Equipments (@ 10%)	400	1,450			
TOTAL		**40,550**	**TOTAL**		**40,550**

The computations done in arriving at the amounts mentioned in the above income and expenditure account are as follow:

Particulars	Salaries	Rent	Utilities	Mag & Periodicals	Misc. Exp
1. Expense Computation					
Paid during the year	13,000	5,000	7,000	2,500	3,000
Add: O/s as on 31.03.2018	8,000	10,000	1,000	500	
Add: Prepaid on 31.03.2017					450
	21,000	**15,000**	**8,000**	**3,000**	**3,450**
Less: O/s as on 31.03.2017	(5,000)	(5,000)	(500)	(250)	
Less: Prepaid on 31.03.2018					(600)
Expenditure for the Year	**16,000**	**10,000**	**7,500**	**2,750**	**2,850**

Particulars	
2. Membership Income Computation	
Received in Cash/Bank	25,000
Add: Receivable in 2018	1,500
Less: Receivable in 2017	(1,250)
Membership Income	**25,250**

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The Balance Sheet is as presented below:

Club XYZ Balance Sheet as on 31st March 2018

Liabilities	Amount	Amount	Assets	Amount	Amount
Outstanding Expenses:			Fixed Deposits		50,000
- Salaries		8,000	Accrued Interest		1,000
- Rent		10,000	Fees Receivable		1,500
- Utilites		1,000	Prepaid Expenses		600
- Magazines & Periodicals		500	Computers	7,000	
			Less: Depreciation (@ 15%)	(1,050)	5,950
Capital Fund					
Opening Balance	62,950		Equipments	4,000	
Less: Excess of Expenditure over Income	(7,800)	55,150	Less: Depreciation (@ 10%)	(400)	3,600
			Cash in Hand/Bank		12,000
TOTAL		74,650	TOTAL		74,650

Accounting treatment of some special items

Donations: These may have been raised either for meeting some revenue or capital expenditure; those intended for the first mentioned purpose are credited directly to the Income and Expenditure Account but others, if the donors have declared their specific intention, then they are credited to special fund account and in the absence thereof, to the Capital Fund Account.

If any investments are purchased out of a special fund or an asset is acquired therefrom, these are disclosed separately. Any income received from such investments or any donations collected for a special purpose are credited to an account indicating the purpose and correspondingly the expenditure incurred in carrying out the purpose of the fund is debited to this account. On no account any such expense is charged to the Income and Expenditure Account. **The term "Fund" is strictly applicable to the amounts collected for a special purpose when these are invested, e.g. Scholarship Fund, Prize Fund etc.**

Entrance and admission fees: Such fees which are payable by a member on admission to club or society are normally considered capital receipts and credited to Capital Fund. This is because these do not give rise to any special obligation towards the member who is entitled to the same privileges as others who have paid only their annual subscription. Nevertheless, where the amount is small, meant to cover expenses concerning admission, or the rules of the society provided that such fees could be treated as income of the society, these amounts may be included in the Income and Expenditure Account. The treatment depends upon the requirement of question. If the question is silent then always take it to be capital receipt.

Subscription: Subscriptions being an income should be allocated over the period of their accrual. For testing the knowledge of candidates of this important accounting principle, questions are often set in examinations wherein figures of subscription collected by a society during the year as well as those outstanding at the beginning of the year and at its close are given. If some subscriptions have been received in advance, their amount is also indicated. In such cases, it is

always desirable to set up a Subscription Account for determining the amount of subscription pertaining for the period for which accounts are being prepared

Life membership fee: Fees received for life membership is a **capital receipt** as it is of non-recurring nature. It is **directly added to capital fund** or general fund.

For adjusting lump sum subscription collected from the life members, one of the following methods can be adopted:

(1) The entire amount may be carried forward in a special account until the member dies, after which the same may be transferred to the credit of the Accumulated Fund.

(2) An amount equal to the normal annual subscription may be transferred every year to the Income and Expenditure Account and balance carried forward till it is exhausted. If, however, the life member dies before the whole of the amount paid by him has been transferred in this way, the balance should be transferred to the Accumulated Fund on the date of his death.

(3) An amount, calculated according to the age and average life of the member, may annually be transferred to the credit of Income and Expenditure Account.

Other Concepts:

1. **Donation:** it is **gift** in **cash** or **kind** from some person. It may be of two types:
   (a) **Specific Donation:** It is received for certain specific purpose like Building Donation, Library Books donation etc. It should be capitalized and shown on the liabilities side of the balance sheet.
   (b) **General Donation:** It is not received for any specific purpose and shown on the credit side of Income and Expenditure Account.
2. **Entrance Fees:** It may also be known as admission fees. **Entrance Fees should be capitalized** and added to the capital fund for all organization. If the question gives any specific treatment of Entrance fees, then it should be followed accordingly.
3. **Legacy:** It is an amount received by an organization as per the **will** of the person after the death of the person. It should be capitalised and shown on the liabilities side of the balance sheet by adding to the Capital Fund.
4. **Life Membership Fees:** It should **be capitalized** and shown on the liabilities side of the balance sheet. If the question gives any specific treatment of Life membership Fees, then it should be followed accordingly.
5. **Endowment Fund Donation:** It is a donation received and **only income from that donation is to be used for certain specific purpose**. In such cases income relating to special funds should be added to these funds on the liabilities side of the Balance sheet. All the expenses should be deducted from that fund on the liabilities side of the Balance sheet.
6. **Treatment of Sale of Old Newspaper and Periodicals:** The amount received on such sale is shown as Income on the credit side of income and expenditure account.

7. **Sale of old Fixed Assets:** The Sale proceeds of old Fixed Assets are treated as **capital receipts**. The profit or loss on sale of fixed asset is shown in the Income and Expenditure A/c

8. **Honorarium:** It is paid to someone for receiving any services from person who are **not the employees** of the Not for Profit Organisation.

Questions:

Question 1:

Following is the Receipt and Payment Account of Club ABC, an NPO for the year ended March 31, 2018 along with the details of the opening and closing balance of Assets and Liabilities for the year ended.

Prepare the Income and Expenditure and Balance Sheet for the year ended March 31, 2018.

Receipt and Payment Account for the year ended 31st March 2018

Receipts	Amount		Payments	Amount
To Balance b/d (Op. Bal)	15,000		By Salaries and Wages	17,000
			By Rent	12,000
To Membership fees	35,000		By Utilities	7,500
To Miscellaneous Income	7,000		By Magazines and Periodicals	2,500
To Interest on Secured Deposit	4,000		By Miscellaneous Expenses	3,500
			By Balance c/d (Cl. Bal)	18,500
TOTAL	**61,000**		**TOTAL**	**61,000**

Particulars	31-Mar-17	31-Mar-18
Salaries outstanding	7,000	9,500
Outstanding Rent	5,500	7,500
Outstanding Utilities	750	500
Outstanding Magazines and Periodicals	450	150
Fixed Deposit	75,000	75,000
Accrued Interest	1,500	1,250
Fees Receivable	850	1,400
Prepaid Expenses	950	1,200
Computers	15,000	
Equipment	9,000	
TOTAL		

Depreciation on the Computers is charged at 25% and on Equipment is charged at 15%.

Illustrations

Question: 1

The receipts and payments for the Swaraj Club for the year ended March 31, 2016 were:

- Entrance fees Rs.300;
- Membership Fees Rs.3,000;
- Donation for Club Pavilion Rs.10,000,
- Foodstuff sales Rs.1,200;
- Salaries and Wages Rs.1,200
- Purchase of Foodstuff Rs.800;
- Construction of Club Pavilion Rs.11,000;
- General Expenses Rs.600;
- Rent and Taxes Rs.400;
- Bank Charges Rs.160.
- Cash in hand–April. 1st Rs.200, March. 31st Rs.350
- Cash in Bank–April. 1st Rs.400; March. 31st Rs.590

You are required to prepare Receipts and Payment Account.

Question: 2

During 2016, subscription received in cash is Rs.42,000. It includes Rs.1,600 for 2015 and Rs.600 for 2017. Also, Rs.3,000 has still to be received for 2016.

Calculate the amount to be credited to Income and Expenditure Account in respect of subscription.

Question: 3

Suppose salaries paid during 2016 were Rs 23,000. The following further information is available:

Salaries unpaid on 31st March,2015	1,400
Salaries pre-paid on 31st March,2015	400
Salaries un-paid on 31st March,2016	1,800
Salaries pre-paid 31st March,2016	600

Required: Calculate the amount to be debited to Income and expenditure account in respect of salaries and also, show necessary ledger accounts.

Question: 4

The following was the Receipts and Payments Account of Exe Club for the year ended March. 31, 2016 (All the figures in thousands)

Receipts	**Rs**	**Payments**	**Rs**
Cash in hand	100	Groundsman's Fee	750
Balance at Bank as per Pass Book:		Moving Machine	1,500
Deposit Account	2,230	Rent of Ground	250
Current Account	600	Cost of Teas	250
Bank Interest	30	Fares	400
Donations and Subscriptions	2,600	Printing & Office Expenses	280
Receipts from teas	300	Repairs to Equipment	500
Contribution to fares	100	Honorarium to Secretary and	
Sale of Equipment	80	Treasurer of 2015	400
Net proceeds of Variety		Balance at Bank as per Pass Book:	

Entertainment	780	Deposit Account	3,090
Donation for forth coming		Current Account	150
Tournament	1,000	Cash in hand	250
	7,820		**7,820**

You are given the following additional information:

Particulars	**April.1.2015 (Rs.)**	**March.31.2016 (Rs.)**
Subscription due	150	100
Amount due for printing etc.	100	80
Cheques unpresented being payment for repairs	300	260
Estimated value of machinery and equipment	800	1,750
Interest not yet entered in the Pass book		20
Bonus to Groundsman o/s.		300

For the year ended March. 31, 2016, the honorarium to the Secretary and Treasurer are to be increased by a total of Rs 200.

Required: Prepare Income & Expenditure Account for period ending 31-03-2016 and the relevant Balance Sheet.

Question: 5

The Income and Expenditure Account of the Youth Club for the Year 2016 is as follows:

Expenditure	Rs.	**Income**	Rs.
To Salaries	4,750	By Subscription	7,500
To General Expenses	500	By Entrance Fees	250
To Audit Fee	250	By Contribution for annual dinner	1,000
To Secretary's Honorarium	1,000	By Annual Sport meet receipts	750
To Stationery & Printing	450		
To Annual Dinner Expenses	1,500		
To Interest & Bank Charges	150		
To Depreciation	300		
To Surplus	600		
	9,500		9,500

This account had been prepared after the following adjustments:

Particulars	**Amount (Rs.)**
Subscription outstanding at the end of 2015	600
Subscription received in Advance on 31st December,2015	450
Subscription received in advance on 31st December,2016	270
Subscription outstanding on 31st December,2016	750

Salaries Outstanding at the beginning and the end of 2016 were respectively Rs.400 and Rs.450. General Expenses include insurance prepaid to the extent of Rs.60. Audit fee for 2016 is yet unpaid. During 2016 audit fee for 2015 was paid amounting to Rs.200.

The Club owned a freehold lease of ground valued at Rs.10,000. The club had sports equipment on 1st January 2016 valued at Rs.2,600. At the end of the year, after depreciation, this equipment

amounted to Rs.2,700. In 2015, the Club has raised a bank loan of Rs.2,000. This was outstanding throughout 2016. On 31st December 2016 cash in hand amounted to Rs.1,600.
Required: Prepare the Receipts and Payments Account for 2016 and Balance Sheet as at the end of the year.

Question: 6
From the following Income and Expenditure Account and the Balance Sheet of a club, prepare its Receipts and Payments Account and Subscription Account for the year ended 31st March 2016:

Income & Expenditure Account for the year 2015-16

Expenditure	Rs.	Income	Rs.
Upkeep of Ground	10,000	By Subscriptions	17,320
Printing	1,000	By Sale of Newspapers (Old)	260
Salaries	11,000	By Lectures	1,500
Depreciation on Furniture	1,000	By Entrance Fee	1,300
Rent	600	By Misc. Income	400
		By Deficit	2,820
	23,600		23,600

Balance Sheet as at 31st March 2016

Liabilities		Rs.	Assets	Rs.
Subscription in Advance (2016-17)		100	Furniture	9,000
Prize Fund: Opening Balance			Ground and Building	47,000
Add: Interest	25,000		Prize Fund Investment	
	1,000		Cash in Hand	20,000
	26,000		Subscription	2,300
Less: Prizes	(2,000)	24,000	(outstanding) (2015-16)	
General Fund: Opening Balance				
Less: Deficit	56,420			700
	(2,820)			
Add: Entrance Fee	53,600			
	1,300	54,900		
		79,000		79,000

The following adjustments have been made in the above accounts:

1. Upkeep of ground Rs.600 and Printing Rs. 240 relating to 2014-2015 were paid in 2015-16.
2. One-half of entrance fee has been capitalised by transfer to General Fund.
3. Subscription outstanding in 2014-15 was Rs.800 and for 2015-16 Rs.700.
4. Subscription received in advance in 2014-15 was Rs.200 and in 2015-16 for 2016-17 Rs. 100.

Question: 7

The Sportswriters Club gives the following Receipts and Payments Account for the year ended March 31, 2016:

Receipts and Payments Account

Receipts	Rs.	Payments	Rs.
To Balance b/d	4,820	By Salaries	12,000
To Subscriptions	28,600	By Rent and electricity	7,220
To Miscellaneous income	700	By Library books	1,000
To Interest on Fixed deposit	2,000	By Magazines and newspapers	2,172
		By Sundry expenses	10,278
		By Sports equipment's	1,000
		By Balance c/d	2,450
	36,120		36,120

Figures of other assets and liabilities are furnished as follows:

Particulars	As at March 31	
	Rs.	Rs.
	2015	2016
Salaries outstanding	710	170
Outstanding rent & electricity	864	973
Outstanding for magazines and newspapers	226	340
Fixed Deposit (10%) with bank	20,000	20,000
Interest accrued thereon	500	500
Subscription receivable	1,263	1,575
Prepaid expenses	417	620
Furniture	9,600	
Sports equipment's	7,200	
Library books	5,000	

The closing values of furniture and sports equipment's are to be determined after charging depreciation at 10% and 20% p.a. respectively inclusive of the additions, if any, during the year. The Club's library books are revalued at the end of every year and the value at the end of March 31, 2016 was Rs. 5,250.

Required: From the above information you are required to prepare:

(a) The Club's Balance Sheet as at March 31, 2015;

(b) The Club's Income and Expenditure Account for the year ended March 31, 2016.

(c) The Club's Closing Balance Sheet as at March 31, 2016.

Question: 8

From the following balances and particulars of Republic College, prepare Income & Expenditure Account for the year ended March 2016 and a Balance Sheet as on the date:

	Rs.	Rs.
Seminars & Conference Receipts		4,80,000
Consultancy Receipts		1,28,000
Security Deposit – Students		1,50,000
Capital Fund		16,06,000
Research Fund		8,00,000
Building Fund		25,00,000

Provident Fund		5,10,000
Tuition Fee Received		8,00,000
Government Grants		5,00,000
Donations		50,000
Interest & Dividends on Investments		1,85,000
Hostel Room Rent		1,75,000
Mess Receipts (Net)		2,00,000
College Stores-Sales		7,50,000
Outstanding expenses		2,25,000
Stock of-stores and Supplies (opening)	3,00,000	
Purchases - Stores & Supplies	8,00,000	
Salaries – Teaching	8,50,000	
Research	1,20,000	
Scholarships	80,000	
Students Welfare expenses	38,000	
Repairs & Maintenance	1,12,000	
Games & Sports Expenses	50,000	
Misc. Expenses	65,000	
Research Fund Investments	8,00,000	
Other Investments	18,50,000	
Provident Fund Investment	5,10,000	
Seminar & Conference Expenses	4,50,000	
Consultancy Expenses	28,000	
Land	1,00,000	
Building	16,00,000	
Plant and Machinery	8,50,000	
Furniture and Fittings	6,00,000	
Motor Vehicle	1,80,000	
Provision for Depreciation:		
Building		4,80,000
Plant & Equipment		5,10,000
Furniture & Fittings		3,36,000
Cash at Bank	6,42,000	
Library	3,60,000	
	1,03,85,000	**1,03,85,000**

Adjustments:

	Particulars	**Rs.**
(1)	*Materials & Supplies consumed: (From college stores)*	
	Teaching	*50,000*
	Research	*1,50,000*
	Students Welfare	*75,000*
	Games or Sports	*25,000*
(2)	Tuition fee receivable from Government for backward class Scholars	80,000

(3)	Stores selling prices are fixed to give a net profit of 10% on selling price	
(4)	Depreciation is provided on straight line basis at the following rates:	
	(1) Building	5%
	(2) Plant & Equipment	10%
	(3) Furniture & Fixtures	10%
	(4) Motor Vehicle	20%

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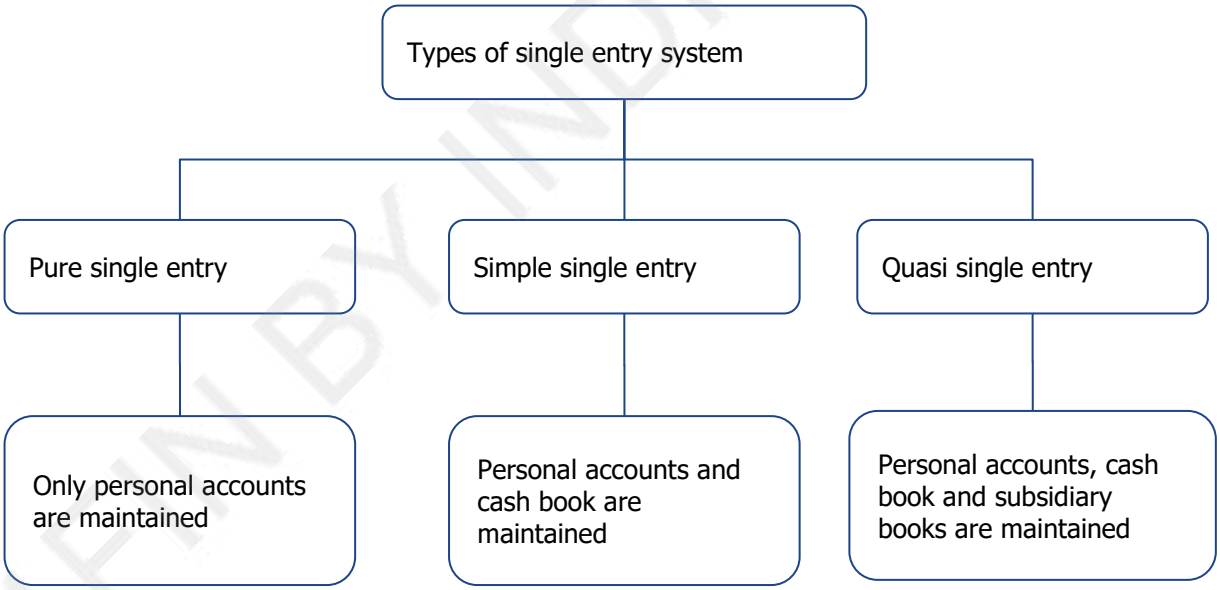
CHAPTER 9: ACCOUNTS FROM INCOMPLETE RECORDS

Introduction

Very often small sole proprietorship and partnership businesses do not maintain a double entry bookkeeping system. Sometimes they keep records of the cash transactions and credit transactions only. But at the end of the accounting period they want to know the performance and financial position of their businesses. So, it becomes imperative to complete the accounts from available incomplete records.

Accounts from incomplete records is also popularly known as 'Single entry system'. Under this system the task of the accountant is to establish linkage among the available information and to finalize the accounts.

Types Of Single-Entry System



Features Of Single-Entry System

- It is an inaccurate, unscientific and unsystematic method of recording business transactions.
- There is generally no record of real and personal accounts and, in most of the cases; a record is kept for cash transactions and personal accounts.
- Cash books mix up business and personal transactions of the owners.

- There is no uniformity in maintaining the records and the system may differ from firm to firm depending on the requirements and convenience of each firm.
- Profit under this system is only an estimate based on available information and therefore true and correct profits cannot be determined. The same is the case with the financial position in the absence of a proper balance sheet.

Financial Performance And Financial Position

ASCERTAINMENT OF PROFIT THROUGH STATEMENT OF AFFAIRS

If detailed information regarding revenue and expenses is not known, it becomes difficult to prepare a profit and loss account. Instead by collecting information about assets and liabilities, it is easier to prepare a balance sheet at two different points of time. So, while preparing accounts from incomplete records, if sufficient information is not available, it is better to follow the **method of capital comparison** to arrive at the profit figure.

This method is also known as **Net Worth method** or **Statement of Affairs Method**.

The above formula can also be expanded as below:

Particulars	Amount
A.Capital at the end	XXX
Add: drawings	XXX
Less: Fresh capital introduced	XXX
B. Capital at the beginning	XXX
Profit **(A-B)**	XXX

Opening and closing capital can be determined by preparing a statement of affairs at the two respective points of time.
Statement of affairs is prepared in the following format. The opening and the closing balance is a balancing figure.

Statement of affairs as on…….

LIABILITIES	AMOUNT 20X0	AMOUNT 20X1	ASSETS	AMOUNT 20X0	AMOUNT 20X1
capital(balancing figure)	xxx	xxx	Building	xxx	xxx
Loans, Bank overdraft	xxx	xxx	Machinery	xxx	xxx
Sundry creditors	xxx	xxx	Furniture	xxx	xxx

Bills payable	xxx	xxx	Inventory	xxx	xxx
Outstanding Expenses	xxx	xxx	Sundry debtors	xxx	xxx
			Cash at bank	xxx	xxx
			Prepaid expenses	xxx	xxx
Total	xxx	xxx	Total	xxx	xxx

Sources of assets and liabilities: -

Item	Source of information
Cash and bank	Cash book and bank pass book
Debtors and Creditors	Personal ledger
Inventory	Actual counting and valuation
Fixed assets	The proprietor would disclose the original cost and date of purchase. Reasonable amount of depreciation can be deducted from the same.
Loans, Bank Overdraft	Corresponding bank documents

Difference Between Statement Of Affairs And Balance Sheet

Basis	Statement of affairs	Balance sheet
Reliability	It is prepared based on transactions partly recorded based on double entry book keeping and partly based on single entry. Most of the assets are recorded based on estimates, assumptions, information gathered from memory rather than records.	It is based on transactions recorded strictly based on double entry book keeping; Each item in the balance sheet can be verified from the relevant subsidiary books and ledger. Hence the balance sheet is not only reliable, but also dependable.
Capital	In this statement, capital is merely a balancing figure being excess of assets over capital. Hence assets need not be equal to liabilities.	Capital is derived from the capital account in the ledger and therefore the total of assets side will always be equal to the total of liabilities side.
Omission	Since this statement is prepared based on incomplete records, it is very difficult to locate the assets and liabilities, if they are omitted from the books.	There is no possibility of omission of any item of asset and liability since all items are properly recorded. Moreover, it is easy to locate the missing items since the balance sheet will not agree.
Basis of Valuation	The valuation of assets is generally done in an arbitrary manner; therefore, no method of valuation is disclosed.	The valuation of assets is done on a scientific basis, that is the original cost in the case of new assets and the

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		depreciated amount based on cost minus depreciation to date for used assets. Any change in the method of valuation is properly disclosed.
Objects	The object of preparing this statement in the calculation of capital figures in the beginning and at the end of the accounting period respectively.	The object of preparing the balance sheet is to ascertain the financial position on a particular date.

Ascertainment Of Profit By Completing Books Of Accounts

- Where the accounts of a business are incomplete, it is advisable to convert them first to the double entry system and then to draw up the Profit and Loss Account and the Balance Sheet.
- As books of accounts of different firms being incomplete in varying degrees, it is not possible to suggest a formula which could uniformly be applied for preparing final accounts there from.
- However, the following general rule can be followed:
  1. It is essential first to start the ledger accounts with the opening balances of assets, liabilities and the capital.
  2. Afterwards, each book of original entry should be separately dealt with, so as to complete the double entry by posting into the ledger such entries as have not been posted. For example, if only personal accounts have been posted from the Cash Book, debits and credits pertaining to nominal accounts and real accounts that are not posted, should be posted into the ledger.
  3. Afterwards, the other subsidiary books, i.e., Purchases Day Book, Sales Day Book, Return Book and Bills Receivable and Payable, etc. should be totaled up and their totals posted into the ledger to the debit or credit of the appropriate nominal or real accounts, the personal aspect of the transactions having been posted already.
  4. Once all the ledgers have been updated, prepare a trial balance to confirm the arithmetical accuracy.
  5. From the trial balance, prepare the financial statements.

When an Accountant is engaged in posting the unposted items from the Cash Book and other subsidiary books, he may be confronted with a number of problems. The manner in which some of them may be dealt with is described below:

Problems encountered by Accountants	Solutions
In the Cash Book, there might be several receipts and payments which have no connection with the business but which belong to the proprietor, e.g.,	All the personal receipts should be credited to his capital account. And his personal expenses should be debited to his capital account.

interest collected on his private investment, legacies received by him, purchase of car as gift for his son, expenses of his pleasure trip etc.	
Amounts belonging to the business after collection may have been directly utilized for acquiring business assets or for meeting certain expenses instead of being deposited into the Cash Book.	The appropriate asset or expense account should be debited and the source which had provided funds credited
The proprietor may have met some of the business expenses from his private resources.	The appropriate asset or expense account should be debited, and the capital account should be credited
Any excess or shortage in cash book for unidentified reasons	Should be adjusted with Proprietor's capital account.
Where the benefit of an item of an expense is received both by the proprietor and business	It should be allocated between them on some equitable basis e.g. rent of premises when the proprietor lives in the same premises, should be allocated based on the area occupied by him for residence.
Analysis of cash and bank receipts and payments in detail.	Should be done in an extensive manner. Prepare Cash and Bank Summary (if not available in proper form with both sides tallied). The cash and bank balance at the end should be reconciled with the cash and bank books. Having done so, the various items detailed on the Summary Statements, should be posted into the ledger. The balancing figure in the summary can be the opening balance of cash, cash sales or cash purchases. This is based on other available information.
Analysis of sales and purchases ledger.	This should be done by considering all the information regarding credit sales, purchases, discount allowed/received, bad debts, return inwards/outwards, bills received/ dishonored, etc.
Analysis of nominal accounts	This should be done by considering the outstanding and prepaid expenses during the period.

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Analysis of Sales Ledger

It would disclose information pertaining to the opening balance of the debtors, the goods sold to them on credit during the year, bills receivable dishonored, if any; cash received from them in the accounting period, discount, rebate or any other concession allowed to them, receipts of bills receivable, returns inwards, bad debts written off and transfers which can be shown in the following format.

OP Customer Balance	Sales	Bills Dishonored	Total Debits	Cash Recd.	Discounts Allowed	Bills Recd.	Bad debts	Sales Returns	Total credit	Balance (CL)

Journal entries must be made by debiting or crediting the impersonal accounts concerned with contra credit or debit given to the total debtors account.

From the aforementioned, it will be possible to build up information about sales and other accounts which can then be posted in totals, if so desired. It would also be possible to prepare Total Debtors.

Analysis of Purchases Ledger

A Purchases Ledger is not as commonly in existence as the Debtors Ledger for it being convenient to make entries in respect of outstanding liabilities at the time they are paid rather than when they are incurred.

The information is available in respect of opening balance of the creditors, goods purchased on credit, bills payable dishonored; cash paid to the creditors during the year, discount and other concessions obtained, returns outwards and transfers. It is made in the similar format as the sales ledger.

Journal entries must be made by debiting or crediting the respective impersonal accounts. Contra credit or debit being given to the total creditor's account.

If a proper record of return to creditors, discount allowed by them etc., has not been kept, it will not be possible to write up the Total Creditors A/c.

In such a case, net credit purchase will be ascertained as follows:

Cash paid to Creditors including on account of bills payable during the period	xxx
Closing balance of Creditors and Bills Payable	xxx
Total	xxx
Less: Opening balance of Creditors and Bills Payable	xxx
Net credit purchase during the period	xxx

Alternatively

Cash paid to Creditors during the period	xxx
Add: Bills Payable issued to them	xxx

Total	xxx
Closing balance of Creditor	xxx
Less: Opening balance of creditors	xxx
Credit Purchases during the period	xxx

Analysis of Nominal accounts

It is quite likely that the total expenditure shown by the balance of the nominal account may contain items of expenditure which do not relate to the year for which accounts are being prepared and, also, there may exist certain items of expenditure incurred but not paid, which have not been included therein. On that account, each and every account should be adjusted in the following manner:

Particulars (1)	Cash payment (2)	Bank payment (3)	Outstanding payment (4)	Total paid/payable (5) = 2 +3 + 4	Prepaid amount (6)	Expenses for the period (7) = 5 – 6
Office rent						
Salaries						

Only the amount entered as "expenses for the period" should be posted to the respective nominal accounts.

A similar adjustment of nominal accounts in respect of revenue receipt should be made.

Scan the business transactions carefully to identify the nature of payment/ receipt and classify them as drawings / fresh investments.

The following are some examples of drawings and fresh investment made by the proprietor/partner.

Drawings	**Fresh investment**
Rent of premises commonly used for residential as well as business purposes	Money collected and put in the business on maturity of Life Insurance Policy of the proprietors
Common electricity and telephone bills	Interest and dividend of personal investment of the proprietors collected and put in the business.
Life insurance premiums of proprietor/partners paid from business cash.	Income from non-business property collected and put in the business
Household expenses met from business cash	Business expenses met by the proprietor from his personal bank account.
Private loan paid to friends and relatives out of business cash	Payment made to any creditor out of the proprietor's personal account.
Personal gifts made to any friends and relatives out of business cash	
Goods or services taken from the business for personal consumption	
Cash withdrawals to meet family expenses	

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Illustrations

Illustration – 1

Assets and Liabilities of Mr. X as on 31-12-2015 and 31-12-2016 are as follows:

Particulars	31-12-2015 (Rs.)	31-12-2016 (Rs.)
Assets		
Building	1,00,000	?
Furniture	50,000	?
Inventory	1,20,000	2,70,000
Sundry debtors	40,000	90,000
Cash at bank	70,000	85,000
Cash in hand	1,200	3,200
Liabilities		
Loans	1,00,000	80,000
Sundry creditors	40,000	70,000

Decided to depreciate building by 2.5% and furniture by 10%.
One Life Insurance Policy of the Proprietor was matured during the period and the amount Rs. 40,000 is retained in the business.
Proprietor took @ Rs. 2,000 p.m. for meeting family expenses.
Prepare a Statement of Affairs 31-12-2015 and 31-12-2016.
Find out profit for the year ended ended 31-12-2016

Solution

(i).Statement of affairs

Liabilities	**31-12-2015**	**31-12-2016**	**Assets**	**31-12-2015**	**31-12-2016**
	Rs.	**Rs.**		**Rs.**	**Rs.**
Capital	**2,41,200**	**4,40,000**	Building	1,00,000	97,500

Loans	1,00,000	80,000	Furniture	50,000	45,000
Sundry creditors	40,000	70,000	Inventory	1,20,000	2,70,000
			Sundry debtors	40,000	90,000
			Cash at bank	70,000	85,000
			Cash in hand	1200	3200
	3,81,200	5,90,000		3,81,200	5,90,000

Working notes

(i) Depreciation and closing balances

	Building (Rs.)	furniture(Rs.)
Balance as on 31-12-2015	1,00,000	50,000
Less : depreciation	2500	5000
Balance as on 31-12-2016	97,500	45,000

(ii) Determination of profit by applying the method of capital comparison

Particulars	Amount (₹)
Capital balance as on 31-12-2016	4,40,700
Less : fresh capital introduced	(40,000)
	4,00,700
Add : drawings(₹2000 × 12)	24,000
	4,24,700
Less: capital balance as on 31-12-2015	(2,41,200)
Profit	1,83,500

Note :

- Closing balance is increased due to fresh capital introduction , so its deducted
- Closing capital was reduced due to withdrawal by proprietor ;so its deducted

Alternative method

Capital account can be prepared as follows

Particulars	(₹)	Particulars	(₹)
To drawings	24,000	By balance b/d	2,41,200
To balance c/d	4,40,700	By additional capital	40,000
		By net profit (bal fig)	**1,83,500**
	4,64,700		4,64,700

Illustration - 2

The Income Tax Officer, on assessing the income of Shri Moti for the financial year 1 and year 2 feels that Shri Moti has not disclosed the full income. He gives you the following particulars of assets and liabilities of Shri Moti as on 1st Jan Yr. 1 and 1st Jan Yr. 2.

			Amount (₹)
1st Jan Yr. 1	Assets	Cash in hand	25,500
		Inventory	56,000
		Sundry debtors	41,500
		Land and Building	1,90,000
		Wife's Jewelry	75,000
	Liabilities	Owing to Moti's Brother	40,000
		Sundry creditors	35,000
1st Jan Yr. 2	Assets	Cash in hand	16,000
		Inventory	91,500
		Sundry debtors	52,500
		Land and Building	1,90,000
		Motor Car	1,25,000
		Wife's Jewellery	1,25,000
		Loan to Moti's Brother	20,000
	Liabilities	Sundry creditors	55,000

During the two years the domestic expenditure was Rs. 4,000 p.m. The declared income of the financial years were Rs. 1,05,000 for Yr. 1 and Rs. 1,23,000 for Yr. 2 respectively.

State whether the Income-tax Officer's contention is correct. Explain by giving your workings.

Solution

Statement of affairs

Particulars	01.01.year 1		01.01.year 2	
	liabilities(₹)	Assets (₹)	liabilities(₹)	Assets (₹)
Assets				
Cash in hand		25,500		16,000
Inventory		56,000		91,500
Sundry creditors		41,500		52,500

Land and building		1,90,000		1,90,000
Wife's jewellery		75,000		1,25,000
Motor car		_		1,25,000
Loan to Moti's brother		_		20,000
		3,88,000		6,20,000
Liabilities				
Owing to Moti's brother	(40,000)		_	
Sundry creditors	(35,000)	_	(55,000)	_
Capital		**3,13,000**		**5,60,000**

Income during the 2 years

Particulars	**Amount (₹)**	**Amount (₹)**
Closing Capital (1st jan year 1)	5,65,000	
Add : Drawings - domestic expenses for two years (Rs.4000 × 24 months)	96,000	
Less : opening capital	(3,13,000)	3,48,000
Profit for the year 1 and year 2)		
Profit disclosed Year 1 Year 2	1,05,000 1,23,000	(2,28,000)
		1,20,000

Income is disclosed less than Rs. 1,20,000
Hence, the contention of the Income tax Officer is correct.

Illustration – 3
A and B are in Partnership having Profit sharing ratio 2:1. The following information is available about their assets and liabilities:

Particulars	**31-3-2016 (₹)**	**31-3-2017 (₹)**
Furniture	1,20,000	?
Advances	70,000	50,000
Creditors	32,000	30,000
Debtors	40,000	45,000
Inventory	60,000	74,750
Loan	80,000	—
Cash at Bank	50,000	1,40,000

The partners are entitled to salary @ Rs. 2,000 p.m. They contributed proportionate capital.
Interest is paid @ 6% on capital and charged @ 10% on drawings.
Drawings of A and B

Particulars	A	B
April 30	2,000	—
May 31	—	2,000
June 30	4,000	—
Sept. 30	—	6,000
Dec. 31	2,000	—
Feb. 28	—	8,000

- On 30th June, they took C as 1/3rd partner who contributed Rs. 75,000.
- C is entitled to share of 9 months' profit.
- The new profit ratio becomes 1:1:1.
- A withdrew his proportionate share.
- Depreciate furniture @ 10% p.a., new purchases Rs. 10,000 may be depreciated for 1/4th of a year
- Current account as on 31-3-2016: A Rs. 5,000 (Cr.), B Rs. 2,000 (Dr)

Prepare Statement of Profit, Current Accounts of partners and Statement of Affairs as on 31-3-2017.

Solution

Statement of affairs as on 31-03-2016 and 31-03-2017

Liabilities	31-12-2016	31-12-2017	Assets	31-12-2016	31-12-2017
	Rs.	Rs.		Rs.	Rs.
Capital a/cs			Furniture	1,20,000	1,17,500
A	1,50,000	75000	Advances	70,000	50,000
B	75,000	75000	Inventory	60,000	74,750
C		75000	Sundry debtors	40,000	45,000
Loan	_	_	Cash at bank	50,000	1,40,000
Sundry creditors	32000	30,000	Current a/c B	2,000	_
Current a/cs					
A	5,000	74,036*			
B		48,322*			
C		50,142*			
	3,42,000	**4,27,500**		**3,42,000**	**4,27,500**

***refer current A/Cs**

CURRENT ACCOUNTS

Particulars	A	B	C	Particulars	A	B	C
	₹	₹	₹		₹	₹	₹
To balance b/d	_	2,000	_	By balance b./d	5,000	_	_
To drawings	8,,000	16,000	_	By salary	24,000	24,000	18,000

To interest on drawings	533	534	-	By interest on capital	5635	4,500	3375
To balance b/d(b.f)	74,036	48,322	50,142	By share of profit	47,944	38,356	28,767
	82,567	48,322	50,142		82,567	48,322	50,142

STATEMENT OF PROFIT

₹

Current account balances as on 31-3-20X2			1,72,500
Less: Salary			
A Rs.2000 × 12 = 24,000			
B Rs.2000 × 12 = 24,000			
C Rs.2000 × 12 = 18,000			(66,000)
Less : interest on capital			
	A	5,625	
	B	4,500	
	C	3,375	(13,500)
Add: drawings			
	A	8,000	
	B	16,000	24,000
Add: interest on drawings			
	A	533	
	B	534	1067
			1,18,067
Less: current a/c balances as on 31-3-20X1 (5000-2000)			(3000)
Net profit for the year			1,15,067

Notes :

₹

(i) Depreciation on furniture	
10 % on Rs.1,20,0000	12000
10 % on Rs. 10,000 for 1/4th year	250
	12,250
(ii) furniture as on 31-3-20X1	1,20,000
Balance as on 31-3-20X1	10,000
Add: new purchase	1,30,000
	(12,250)
	1,17,750

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(iii) total of current accounts as on 31-3-20X2	
Total of assets (1,17,750 + 50,000 + 74,750 + 45,000 + 1,40,000)	4,27,500
Less: fixed capital (75,000 + 75,000+ 75000)	(2,55,000)
	1,72,500
(iv) interest on capital	
A: 1,50,000 @ 6% for 3 months	2250
75,000 @ 6 % for 9 months	3375
	5625
B: 75,000 @ 6 % for 1 year	4500
C: 75,000 @ 6 % for 9 months	3375
(v) interest on drawings	
A: 2000 @ 10% for 11 months	183
4000 @ 10% for 9 months	300
6000 @ 10% for 3 months	50
	533
B: 2000 @ 10% for 10 months	167
6000 @ 10% for 6 months	300
8000 @ 10 % for 1 month	67
	534
(vi) Allocation of profit	
3 months profit Rs. 1,15,067	
9 months profit Rs. 28,767	
A: 2/3 * 28,767 + 1/3 * 86,300	47,944
B: 1/3* 1,15,067	38,356
C: 1/3 * 86,300	28,767
	1,15,067

Illustration - 4

The following information relates to the business of Mr. Shiv Kumar, who requests you to prepare a Trading and Profit & Loss Account for the year ended 31st March, 20X2 and a Balance Sheet as on that date:

(a)

Particulars	31-3-20X0 ₹	31-3-20X1 ₹
Building	3,20,000	3,60,000
Furniture	60,000	68,000
Motorcar	80,000	80,000
Inventory	?	40,000
Bills payable	28,000	16,000

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Cash and bank balances	1,80,000	1,04,000
Sundry debtors	1,60,000	?
Bills receivable	32,000	28,000
Sundry creditors	1,20,000	?

(b) Cash transactions during the year included the following besides certain other items:

Particulars	Amount (₹)	Particulars	Amount (₹)
Sale of old papers and miscellaneous income	20,000	Cash purchases	48,000
Miscellaneous Trade expenses (including salaries etc.)	80,000	Payment to creditors	1,84,000
Collection from debtors	2,00,000	Cash sales	80,000

(c) **Other information:**

1. Bills receivable drawn during the year amount to Rs.20,000 and Bills payable accepted Rs.16,000.
2. Some items of old furniture, whose written down value on 31st March, 20X1 was Rs.20,000 was sold on 30th September, 20X1 for Rs.8,000. Depreciation is to be provided on Building and Furniture @ 10% p.a. and on Motorcar @ 20% p.a. Depreciation on sale of furniture to be provided for 6 months and for additions to Building for the whole year.
3. Of the Debtors, a sum of Rs.8,000 should be written off as Bad Debt and a reserve for doubtful debts is to be provided @ 2%.
4. Mr. Shivkumar has been maintaining a steady gross profit rate of 30% on turnover.
5. Outstanding salary on 31st March, Year1 was Rs.8,000 and on 31st March, Year2 was Rs.10,000. On 31st March, Year1, Profit and Loss Account had a credit balance of Rs.40,000.
6. 20% of total sales and total purchases are to be treated as for cash.
7. Additions in the Furniture Account took place in the beginning of the year and there was no opening provision for doubtful debts.

Solution

Mr. Shiv Kumar

Trading and profit and loss account of for the year ended 31st March,20X2

Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)	Amount (₹)
To opening inventory (bal.fig)		80,000	By sales (3,20,000×100/80)		4,00,000
To purchases (1,92,000 × 100/80)		2,40,000	By closing stock		40,000
To gross profit c/d @ 30%on sales		120,000			

		4,40,000			4,40,000
To miscellaneous expenses (w.n.10)		82,000	By gross profit b/d		1,20,000
To depreciation			By miscellaneous receipts		20,000
building	36,000		By net loss transferred to capital a/c (bal.fig)		25,840
Furniture (6800 + 1000)	7800				
Motor car	16000	59,800			
To loss on sale of furniture		11,000			
To bad debts		8,000			
To provision for doubtful debts		5040			
		1,65,840			**1,65,840**

Balance sheet as on 31st March,20X2

Liabilities	**Amount (₹)**	**Amount (₹)**	**Assets**	**Amount (₹)**	**Amount (₹)**
Capital as on 1st April,20X1		7,16,000	Building (w.n.8)		3,24,000
Profit and loss a/c	40,000		Furniture (w.n.5)		61,200
Less: loss for the year	(25,840)		Motor car(w.n.9)		80,000
		14,160	Inventory in trade		40,000
Sundry creditors		1,12,000	Sundry debtors	2,52,000	
Bills payable		16,000	Less: provision for doubtful debts @ 2%	(5040)	2,46,960
Outstanding salary		10,000	Bills receivable		28,000
			Cash in hand and at bank		1,04,000
		8,68,160			**8,68,160**

Working notes:

1.Debtors account

Particulars	**Amount (₹)**	**Particulars**	**Amount (₹)**
To balance b/d	1,60,000	By cash/bank a/c	2,00,000
To sales a/c	3,20,000	By bills receivable a/c	20,000
		By bad debts	8,000
		By balance c/d (bal.fig)	2,52,000
	4,80,000		4,80,000

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2.Creditors account

Particulars	Amount (₹)	Particulars	Amount (₹)
To cash/bank a/c	1,84,000	By balance b/d	1,20,000
To bills payable a/c	16,000	By purchases a/c	1,92,000
To balance c/d (bal.fig)	1,12,000		
	3,12,000		3,12,000

3.Bills payable account

Particulars	Amount (₹)	Particulars	Amount (₹)
To cash/bank a/c (bal.fig)	28,000	By balance b/d	28,000
To balance c/d	16,000	By sundry creditors a/c	16,000
	44,000		44,000

4.Bills receivable account

Particulars	Amount (₹)	Particulars	Amount (₹)
	32,000	By cash/bank a/c (b.f)	24,000
	20,000	By balance c/d	28,000
	52,00o		52,000

5. Furniture account

Particulars	Amount (₹)	Particulars	Amount (₹)
To balance b/d	60,000	By bank/cash a/c	8,000
To bank a/c (b.f)	28,000	By depreciation	1,000
		By profit and loss a/c (loss on sale) (20,000-1000-8000)	11,000
		By depreciation a/c (68,000 ×10%)	6,800
			61,200
	88,000		88,000

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6. Cash /Bank account

Particulars	Amount (₹)	Particulars	Amount (₹)
To balance b/d	1,80,000	By miscell. Trade expensesa/c	80,000
To miscellaneous receipts a/c	20,000	By purchases a/c	48,000
To sundry debtors a/c	2,00,000	By furniture a/c	28,000
To sales a/c	80,000	By sundry creditors a/c	1,84,000
To furniture a/c (sale)	8000	By bills payable a/c	28,000
To bills receivable a/c	24,000	By building a/c (3,60,000-3,20,000)	40,000
		By balance c/d	1,04,000
	5,12,000		5,12,000

7. Opening balance sheet as on 31.3.20X1

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital (bal.fig)	7,16,000	Building	3,20,000
Profit and loss a/c	40,000	Furniture	60,000
Sundry creditors	1,20,000	Motor car	80,000
Bills payable	28,000	Inventory in trade	80,000
Outstanding salary	8,000	Sundry debtors	1,60,000
		Bills receivable	32,000
		Cash in hand and at bank	1,80,000
	5,12,000		5,12,000

8. Building account

Particulars	Amount (₹)	Particulars	Amount (₹)
To balance b/d	3,20,000	By depreciation a/c	36000
To cash/bank a/c	40,000	By balance c/d	3,24,000
	3,60,000		3,60,000

9. Motor car account

Particulars	Amount (₹)	Particulars	Amount (₹)
To balance b/d	80,000	By depreciation a/c	16,000
		By balance c/d	64,000
	80,000		80,000

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10.miscellaneous expenses

Miscellaneous expenses (including salaries)	80,000
Less:outstanding salary as on 31.3.20X1	(8000)
Add: oustanding salary as on 31.3.20X2	10,000

Illustration - 5

From the following data furyou are required to prepare a Trading and Profit and Loss Account for the year ended 31st March, 20X2 and a Balance Sheet as at that date. All workings should form part of your answer.

Particulars	**As on 01-04-x1 (Rs.)**	**As on 31-03-x2 (Rs.)**
Creditors	15,770	12,400
Sundry expenses outstanding	600	330
Sundry Assets	11,610	12,040
Inventory in trade	8,040	11,120
Cash in hand and at bank	6,960	8,080
Trade debtors	?	17,870
Details relating to transactions in the year:		
Cash and discount credited to debtors		64,000
Sales return		1,450
Bad debts		420
Sales (cash and credit)		71,810
Discount allowed by trade creditors		700
Purchase returns		400
Additional capital-paid into Bank		8,500
Realizations from debtors-paid into Bank		62,500
Cash purchases		1,030
Cash expenses		9,570
Paid by cheque for machinery purchased		430
Household expenses drawn from Bank		3,180
Cash paid into Bank		5,000
Cash drawn from Bank		9,240
Cash in hand on 31-3-x2		1,200
Cheques issued to trade creditors		60,270

Solution

Trading and profit and loss account of for the year ended 31st March,20X2

Particulars	**Amount (₹)**	**Amount (₹)**	**Particulars**	**Amount (₹)**	**Amount (₹)**
To opening inventory		8,040	By sales		

To purchases (58000 + 1030)	59,030		cash	4,600	
Less: returns	(400)	58,630	credit	67,210	
To gross profit c/d		14,810	Less: returns	(1450)	70,360
			By closing inventory		11,120
		81,480			81,480
To sundry expenses (w.n.5)		9300	By gross profit b/d		14,810
To discount		1500	By discount		700
To bad debts		420			
To net profit		4290			
		15,510			**15,510**

Balance sheet as on 31st March,20X2

Liabilities	**Amount (₹)**	**Amount (₹)**	**Assets**	**Amount (₹)**
Capital			Sundry assets	12,040
Opening balance	26,770		Inventory in trade	11,120
Add: addition	8500		Sundry debtors	17,870
Add: net profit	4,290		Cash in hand & at bank	8,080
	39,560			
Less: drawings	(3,180)	36,380		
Sundry creditors		12,400		
Outstanding expenses		330		
		49,110		**49,110**

Working notes:

1.Cash sales

Cash and bank account

Particulars	**Amount (₹)**	**Particulars**	**Amount (₹)**
To balance b/d	6,960	By sundry creditors	60,270
To sundries (contra)	5000	By sundries (contra)	5,000
To sundries (contra)	9240	By sundries (contra)	9,240
To sundry debtors	62,500	By drawings	3,180
To capital a/c	8,500	By machinery	430
To sales (balancing figure)	4,600	By sundry expenses	9,570
		By purchases	1,030
		By balance c/d	8,080
	96,800		96,800

2. Debtors account

Particulars	Amount (₹)	Particulars	Amount (₹)
To balance b/d	16,530	By bank	62,500
To sales (71,810-4600)	67,210	By discount (64,000-62,500)	1500
		By return inward	1450
		By bad debts	420
		By balance c/d	17,870
	83,740		83,740

3. Total creditors account

Particulars	Amount (₹)	Particulars	Amount (₹)
To bank	60,270	By balance b/d	15,770
To discount	700	By purchases	58,000
To return outward	400		
To balance c/d	12,400		
	73,770		73,770

4.Balance sheet as on 1st April,20X1

Liabilities	Amount (₹)	Particulars	Amount (₹)
Capital	26,770	Sundry assets	11,610
Sundry creditors	15,770	Inventory in trade	8,040
Outstanding expenses	600	Sundry debtors	16,530
		Cash in hand and at bank	6,960
	43,140		43,140

5.Calculation of sundry expenses

	₹
Expenses paid in cash	9570
Add: outstanding on 31-2-20X2	330
	9900
Less: outstanding on 1-4-20X1	(600)
	9300

6.Due to lack of information, depreciation has not been provided on fixed assets.

Illustration – 6

Adamjee keeps his books on a single entry basis. The analysis of the cash book for the year ended on 31st December, 20X1 is given below:

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Receipts	Amount (₹)	Payments	Amount (₹)
Bank Balance as on 1st January, 20X1	2,800	Payment to Sundry Creditors	35,000
Received from Sundry Debtors	48,000	Salaries	6,500
Cash Sales	11,000	General Expenses	2,500
Capital brought during the year	6,000	Rent and Taxes	1,500
Interest on Investments	200	Drawings	3,600
		Cash Purchases	12,000
		Balance at Bank on 31st Dec, 20X1	6,400
		Cash in hand on 31st Dec., 20X1	500
	68,000		**68,000**

Particulars of other assets and liabilities are as follows:

Particulars	1st January 20X1 (₹)	31st December 20X1 (₹)
Sundry Debtors	14,500	17,600
Sundry Creditors	5,800	7,900
Machinery	7,500	7,500
Furniture	1,200	1,200
Inventory	3,900	5,700
Investments	5,000	5,000

Prepare final accounts for the year ending 31st December, 20X1 after providing depreciation at 10 percent on machinery and furniture and Rs. 800 against doubtful debts.

Solution

In the books of A.Adamji

Trading and profit and loss account of for the year ended 31st December,20X1

Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)
To opening inventory		3900	By sales	62,100
To purchases		49,100	By closing inventory	5700
To gross profit c/d (bal.fig)		14,800		
		67,800		67,800
To salaries		6,500	By gross profit c/d	14,800

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To rent and taxes		1,500	By interest on investment	200
To general expenses		2,500		
To depreciation				
Machinery @ 10 %	750			
Furniture @ 10 %	120	870		
To provision for doubtful debts		800		
To net profit (carried to capital a/c)		2,830		
		15,000		**15,000**

Balance sheet as on 31st December,20X1

Liabilities	**Amount (₹)**	**Amount (₹)**	**Assets**	**Amount (₹)**	**Amount (₹)**
Capital as on 1st April,20X1	29,100		Machinery	7,500	
Add: fresh capital	6000		Less: depreciation	(750)	6,750
Add: net profit	2830		furniture	12000	
Less: drawings	(3600)	34,330	Less: depreciation	(120)	1,080
Sundry creditors		7,900	Inventory in trade		5,700
			Sundry debtors	17,600	
			Less: provision for doubtful debts	(800)	16,800
			investment		5,000
			Cash at bank		6,400
			Cash in hand		500
		42,230			**42,230**

Working notes;

1. **Balance sheet of Mr.Adamjee as on 1st January, 20X1**

Liabilities	**Amount (₹)**	**Assets**	**Amount (₹)**
Adamjee's capital	29,100	Machinery	7500
Sundry creditors	5800	furniture	1200
		inventory	3900
		Sundry debtors	14,500
		investments	5,000
		Bank balance (from cash statement)	2,800
	34,900		34,900

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2. Ledger accounts

Adamjee's capital account

Particulars	Amount (₹)	Particulars	Amount (₹)
To drawings	3,600	By balance b/d	29,100
To balance c/d (b.f)	34,330	By net profit	2,830
		By cash	6,000
	37,930		37,930

Sales account

Particulars	Amount (₹)	Particulars	Amount (₹)
To trading a/c (b.f)	62,100	By cash a/c	11,000
		By debtors a/c	51,100
	62,100		62,100

Debtors account

Particulars	Amount (₹)	Particulars	Amount (₹)
To balance b/d	14,500	By cash	48,000
To credit sales (b.f)	51,100	By balance c/d	17,600
	65,800		65,800

Purchase account

Particulars	Amount (₹)	Particulars	Amount (₹)
To cash a/c	12,000	By trading account (b.f)	49,100
To balance b/d	37,100		
	49,100		49,100

Creditors account

Particulars	Amount (₹)	Particulars	Amount (₹)
To cash	35,000	By balance b/d	5,800
To balance b/d	7,900	By credit purchases	37,100
	42,900		42,900

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Illustration – 7

Mr. Anup runs a wholesale business where all purchases and sales are made on credit. He furnishes the following closing balances:

Particulars	1-1-20X1 (₹)	31-12-20X1(₹)
Sundry Debtors	70,000	92,000
Bills Receivable	15,000	6,000
Bills Payable	12,000	14,000
Sundry Creditors	40,000	56,000
Inventory	1,10,000	1,90,000
Bank	90,000	87,000
Cash	5,200	5,300

Summary of cash transactions during the year 20X1:

i. Deposited to bank after payment of shop expenses
   @ Rs. 600 p.m., wages
   @ Rs. 9,200 p.m. and personal expenses
   @ Rs. 1,400 p.m. Rs. 7,62,750.

ii. Withdrawals Rs. 1,21,000.

iii. Cash payment to suppliers Rs. 77,200 for supplies and Rs. 25,000 for furniture.

iv. Cheques collected from customers but dishonored Rs. 5,700.

v. Bills accepted by customers Rs. 40,000.

vi. Bills endorsed Rs. 10,000.

vii. Bills discounted Rs. 20,000, discount Rs. 750 Bills matured and duly collected Rs. 16,000.

viii.Bills accepted Rs. 24,000.

ix. Paid suppliers by cheque Rs. 3,20,000.

x. Received Rs. 20,000 on maturity of one LIC policy of the proprietor by cheque.

xi.Received Rs. 14,000 by cheque for the premises owned by the proprietor.

xii.The building was purchased on 30-11-20X1 for opening a branch for Rs. 3,50,000 and some expenses were incurred on this building, details of which are not maintained.

xiii.and telephone bills paid by cash Rs. 18,700, due Rs. 2,200.

Other transactions:

i. Claim against the firm for damage Rs. 1,55,000 is under legal dispute. Legal expenses Rs. 17,000. The firm anticipates defeat in the suit.

ii. Goods returned to suppliers Rs. 4,200.

iii. Goods returned by customers Rs. 1,200.

iv.Discount offered by suppliers Rs. 2,700.

v. Discount offered to the customers Rs. 2,400.

vi.The business is carried on at the rented premises for an annual rent of Rs. 20,000 which is outstanding at the year end.

Prepare Trading and Profit & Loss Account of Mr. Anup for the year ended 31-12-20X1 and Balance Sheet as on that date.

Solution

Trading and profit and loss account of Mr.Anup for the year ended 31st March,20X2

Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)	Amount (₹)
To opening inventory		1,10,000	By sales	9,59,750	
To purchases (w.n2)	4,54,100		Less : sales return	(1,200)	9,58,550
Less:purchase return	(4,200)	4,49,900	By closing inventory		1,90,000
To gross profit c/d (bal.fig)		5,88,650			
		11,48,550			11,48,550
To salary (9200 × 12)		1,10,400	By gross profit b/d		5,88,650
To electricity & Tel. charges	18,700		By discount received		2,700
	2,200	20,900			
To legal expenses		17,00			
To discount allowed :					
Debtors	2,400				
Bills	750	3150			
To shop expenses (600 × 12)		7200			
To provision for claims for damages		1,55,000			
To shop rent		20,000			
To net profit(b.f)		2,57,700			
		5,91,350			**5,91,350**

Balance sheet as on 31st March,20X2

Liabilities	Amount (₹)	Amount (₹)	Assets	Amount (₹)
Capital a/c (wn.6)	2,38,200		Building (from cash and bank a/c)	3,72,000
Add: fresh capital introduced			Furniture	25,000
Maturity value from LIC	20,000		Inventory	1,90,000
rent	14,000		Sundry debtors	92,000
Add: net profit	2,57,700		Bills receivable	6,000
	5,29,900		Cash at hand	87,000
Less : drawing (1400×12)	(16,800)	5,13,100	Cash in hand	5,300
Rent outstanding		20,000		
Sundry creditors		56,000		

Bills payable		14,000		
Outstanding expenses :				
Legal expenses	17,000			
Electricity & telephone charges	2,200	19,200		
Provision for claims for damages		1,55,000		
		7,77,300		7,77,300

Working notes :

1. **Sundry debtors A/C**

Particulars	**Amount (₹)**	**Particulars**	**Amount (₹)**
To balance b/d	70,000	By bills receivable a/c - bills accepted by customers	40,000
To bills receivable a/c - bills dishonoured	3,000	By bank a/c - cheque received	5,700
To bank a/c - cheque dishonoured	5,700	By cash a/c (from summary cash and bank account)	8,97,150
To credit sales (bal.fig.)	9,59,750	By return inward a/c	1,200
		By discount a/c	2,400
		By balance c/d	92,000
	10,38,450		10,38,450

2. **Bills receivable account**

Particulars	**Amount (₹)**	**Particulars**	**Amount (₹)**
To balance b/d	15,000	By sundry creditors a/c (bills endorsed)	10,000
To sundary creditors a/c (bills accepted)	40,000	By bank a/c (20,000-750)	19,250
		By discount a/c (bills discounted)	750
		By bank a/c (bills collected on maturity)	16,000
		By sundry debtors Bills dishonoured (bal.fig)	3,000
		By balance c/d	6,000
	55,000		55,000

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3. Sundry creditors account

Particulars	Amount (₹)	Particulars	Amount (₹)
To bank	3,20,000	By balance c/d	40,000
To cash	77,200	By credit purchase (bal.fig.)	4,54,100
To bills payable a/c	24,000		
To bills receivable a/c	10,000		
To return outward a/c	4,200		
To discount received a/c	2,700		
To balance b/d	56,000		
	4,94,100		4,94,100

4. Bills payable account

Particulars	Amount (₹)	Particulars	Amount (₹)
To bank a/c (bal.fig)	22,000	By balance b/d	12,000
To balance c/d	14,000		24,000
	36,000		36,000

5. Summary cash and bank a/c

Particulars	Cash (₹)	bank(₹)	Particulars	Cash (₹)	Bank (₹)
To balance b/d	5200		By bank	7,62,750	1,21,000
To sundry debtors (bal.fig)	8,97,150	90,000	By cash	7200	
To cash			By shop exp.(600 × 12)	1,10,400	
To bank	121,000	7,62,750	By salary	16,800	
To sundry debtors					22,000
To bills receivable				77,200	3,20,000
To bills receivable				25,000	
To capital(maturity value of LIC policy)		20,000			5700
To capital (rent received)		14,000		18,700	
					3,72,000
				5300	87000
	10,23,350	9,27,700		10,23,350	9,27,700

6. Statement of affairs as on 31st March 20X1

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital (bal.fig.)	**40,000**	Inventory	1,10,000

Creditors	12,000	Debtors	70,000
Bills payable	2,38,200	Bills receivable	15,000
		Cash at bank	90,000
		Cash in hand	5,200
	2,90,200		2,90,200

Illustration - 8

Ms. Rashmi furnishes you with the following information relating to her business:

a. Assets and liabilities as on

Particulars	**1.4.20X1**	**31.3.20X2**
	Amount (Rs.)	**Amount (Rs.)**
Furniture (w.d.v)	12,000	12,700
Inventory at cost	16,000	14,000
Sundry Debtors	32,000	?
Sundry Creditors	22,000	30,000
Prepaid expenses	1,200	1,400
Unpaid expenses	4,000	3,600
Cash in hand and at bank	2,400	1,250

b.Receipts and payments during 20X2:

- Collections from debtors, after allowing a discount of Rs. 3,000 amounted to Rs. 1,17,000.
- Collections on discounting of bills of exchange, after deduction of discount of Rs. 250 by the bank, totaled to Rs. 12,250.
- Creditors of Rs. 80,000 were paid Rs. 78,400 in full settlement of their dues.
- Payment for freight inwards Rs. 6,000.
- Amount withdrawn for personal use Rs. 14,000.
- Payment for office furniture Rs. 2,000.
- Investments carrying annual interest of 4% were purchased at Rs. 192 (face value Rs. 200) on 1st July,2016 and payment made there for.
- Expenses including salaries paid Rs. 29,000.
- Miscellaneous receipts Rs. 1,000

c.Bills of exchange drawn on and accepted by customers during the year amounted to Rs. 20,000. Of these, bills of exchange of Rs. 4,000 were endorsed in favor of creditors. An endorsed bill of exchange of Rs. 800 was dishonored.

d.Goods costing Rs. 1,800 were used as advertising materials.

e. Goods are invariably sold to show a gross profit of 33-1/3% on sales.

f. Difference in cash books, if any, is to be treated as further drawing or introduction of capital by Ms. Rashmi.
g.Provide at 2.5% for doubtful debts on closing debtors.
Prepare trading and profit and loss accounts for the year ended 31st March,20X2 and the balance sheet as on that date.

Solution

Trading and profit and loss account of Ms.Rashmi for the year ended 31st March,20X2

Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)
To opening inventory		16000	By sales	1,46,100
To purchases (w.n2)	91,200		By closing inventory	14,000
Less: for advertising	(1800)	89,400		
To freight inwards		6,000		
To gross profit c/d @ 33-⅓%		48,700		
		1,60,100		1,60,100
To sundry expenses (w.n.6)		28,400	By gross profit b/d	48,700
To advertisement		1800	By interest accrued on investment (200×4/100×1/2)	4
To discount allowed			By discount received	1600
Debtors	3000		By miscellaneous income	1,000
Bills receivable	250	3250		
To depreciation on furniture (12,000+2000-12,700)		1300		
To provision for doubtful debts		972		
To net profit(b.f)		15,582		
		51,304		**51,304**

Balance sheet as on 31st March,20X2

Liabilities	Amount (₹)	Amount (₹)	Assets	Amount (₹)	Amount (₹)
Capital as on 1.4.20X1	37,600		Furniture	12,000	
Less: drawings	(15,808)		Additions during the year	2,000	
	21,792		Less: depreciation (b.f)	(1300)	12,700
Add: net profit	15,582	37,374	Investments		192
Sundry creditors		30,000	Interest accrued (200×4/100×1/2)		4

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Outstanding expenses		3,600	Closing inventory		14,000
			Sundry debtors	38,900	
			Less: provision for doubtful debts @ 2.5 %	972	37,928
			Bills receivable		3,500
			Cash in hand and at bank		1250
			Prepaid expenses		1400
		70,972			**70,974**

Working notes:

1.Capital on 1st april, 20X1

Balance sheet as on 1.4.20X1

Liabilities	**Amount (₹)**	**Assets**	**Amount (₹)**
Capital (bal.fig.)	37,600	Furniture	12,00
Creditors	22,000	Inventory at cost	16,00
Outstanding expenses	4,000	Sundry creditors	32,00
		Cash in hand and at bank	2,400
		Prepaid expenses	1,200
	63,600		63,600

2. Purchases made during the year

Sundry creditors

Particulars	**Amount (₹)**	**Particulars**	**Amount (₹)**
To cash and bank a/c	78,400	By balance b/d	22,000
To discount received a/c	1,600	By sundry debtors a/c	800
To bills receivable a/c	4,000	By purchases a/c (bal.fig)	91,200
To balance b/d	30,000		
	1,14,000		1,14,000

3. Sales made during the year

Particulars	**Amount (₹)**	**Amount (₹)**
Opening inventory		16,000
Purchases (w.n2)	91,200	
Less: for advertising	(1800)	89,400
Freight inwards		6,000
Less: closing inventory		(14,000)
Cost of goods sold		97,400

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Add: gross profit (@ 50 % on cost)		48,700
		1,46,100

4. Debtors on 31.3.20X2

Sundry debtors account

Particulars	Amount (₹)	Particulars	Amount (₹)
To balance b/d	32000	By cash and bank a/c	1,17,000
To sales a/c (w.n.3)	1,46,100	By discount allowed a/c	3,000
To sundry creditors a/c (bills dishonoured)	800	By bills receivable a/c	20,000
		By balance c/d (bal.fig.)	38,900
	1,78,900		1,78,900

5. Additional drawings by Ms.Rashmi

Cash and bank a/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To balance b/d	2,400	By freight inwards a/c	6,000
To sundry debtors a/c	1,17,000	By furniture a/c	2,000
To bills receivable a/c	12,250	By investment a/c	192
To miscellaneous income a/c	1,000	By expenses a/c	29,000
		By drawings a/c (14,000+1808(b.f)(additional drawings)]	78,400
		By balance c/d	1250
	1,31,650		1,31,650

6. Amount of expenses debited to profit and loss a/c

Sundry expenses a/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To prepaid expenses a/c (on 1.4.20X1)	1200	By outstanding expenses a/c (on 1.4.20X1)	4,000
To bank a/c	29,000	By profit and loss a/c (bal.fig)	28,400
To outstanding expenses a/c (on 31.3.20X2)	3,600	By prepaid expenses a/c	1400
	33,800		33,800

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7. Bills receivable on 31st March,20X2

Bills receivable account

Particulars	Amount (₹)	Particulars	Amount (₹)
To debtors a/c	20,000	By creditors a/c	4,000
		By bank a/c	12,250
		By discount on bills receivable a/c	250
		By balance c/d (bal.fig.)	3,500
	20,000		20,000

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Chapter – 10 Partnership

Unit-1 Introduction

Business carried on by all or any one of them acting for all.

If the person carrying on the business acts not only for himself but for others also so that they stand in the positions of principals and agents, they are

Sharing of profits and losses of the business.

The persons concerned must agree to **share the profits of the business.**

A provision for sharing of loss is not necessary.

Existence of a business.

A partnership comes into existence only when partners begin to carry on business in accordance with their agreement.

An agreement entered into by all persons concerned.

A formal or written agreement is not necessary to create a partnership.

An association of two or more persons.

Unlimited liability of all partners

Why Partnership?

Due to the financial and managerial demands of the present day business world. In Partnership, two or more individuals may decide to pool their financial and non-financial resources to carry on a business

2. LIMITED LIABILITY PARTNERSHIP

The Limited Liability Partnership (LLP)

Ø Viewed as an alternative corporate business proposal that provides the benefits of limited liability.

Ø Allows its members, the flexibility of organizing their internal structure as a partnership, which is based on a mutually arrived agreement.

Law Definition

Section 2 of the Limited Liability Partnership (LLPs) Act, 2008 defines LLP

As a partnership formed and registered under this Act

AND

"limited liability partnership agreement" means any written agreement

1) between the partners of the limited liability partnership

2) between the limited liability partnership and its partners

Which determines the mutual rights and duties of the partners and their rights and duties in relation to that limited liability partnership.

Advantages

1.LLP is organized and operates on the basis of an agreement.

2.Enables professional/technical expertise and initiative to combine with financial risk taking capacity in an innovative and efficient manner.

3.Limited liability of partners as in case of corporate entities along with flexibility of a partnership without imposing detailed legal and procedural requirements.

4.Lower registration costs as compared to corporate entities.

5.Audit not mandatory

Challenges

1.Public disclosure of financial statements.

2.No opinion for Equity investments.

3.Extensive penal provisions for non-compliance.

v Features

Ø The LLP will be a separate legal entity

§ Liable to the full extent of its assets.

§ The liability of the partners being limited to their agreed contribution in the LLP which may be of tangible or intangible nature.

§ No partner would be liable on account of the independent or un- authorized actions of other partners or their misconduct.

The liabilities of the LLP and partners who are found to have acted with intent to defraud Creditors or for any fraudulent purpose shall be unlimited for all or any of the debts or other liabilities of the LLP.

Ø It is taxed as a partnership, but has the benefits of being a corporate, or more significantly, a juristic entity with limited liability.

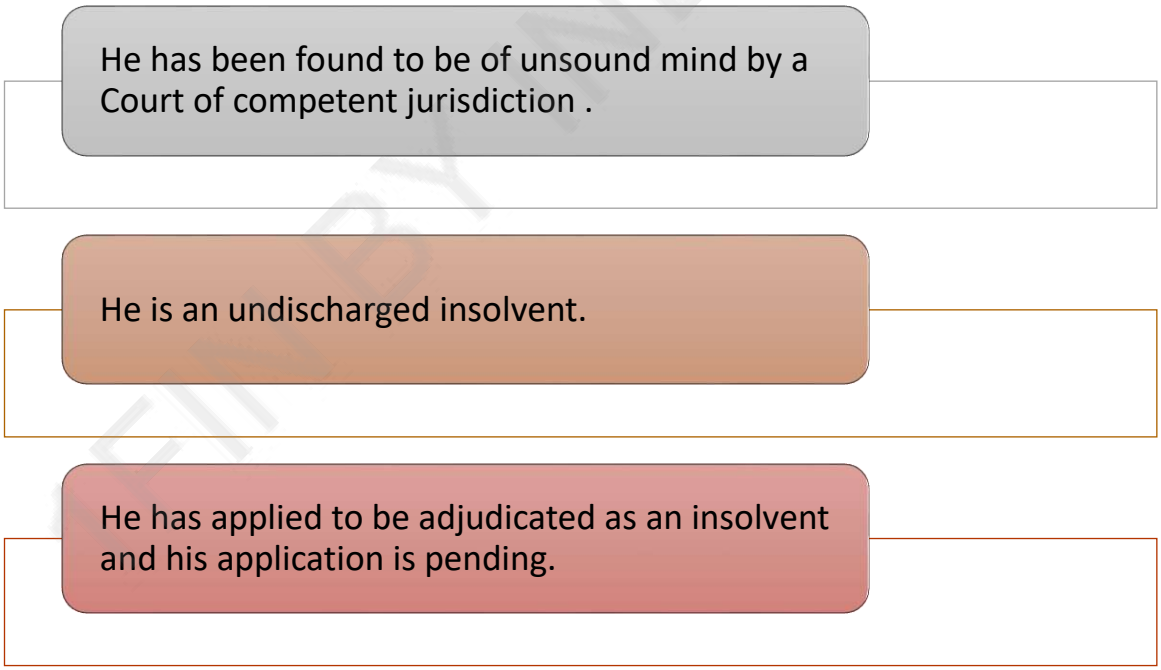
Ø The provisions of the Indian Partnership Act, 1932 shall not apply to LLP unless stated.

Ø Every limited liability partnership shall have at least two partners.

v Who can become a partner in LLP?

Any individual or body corporate may be a partner in a LLP.

Provided that an individual shall not be capable of becoming a partner of a limited liability partnership if



❖ What happen if the number of partner reduced to one and the LLP carried business for more than 6 month.
The only partner of LLP who carries the business after 6 month and has the knowledge of the fact he is carrying the business alone, shall be liable personally for the

obligations of the LLP incurred during that period.

Designated Partners

Every LLP should have atleast two designated partners who are individuals and atleast one of them should be a resident in India.

Provisions:

1. If the incorporation document-
    a. Specifies who are to be designated partners, such persons should be designated partners on incorporation
    b. States that each of the partners from time to time of LLP is to be designated partner, every such partner will be a designated partner
2. Any partner may become or cease to be a designated partner in accordance with the LLP agreement.
3. Individual partner will not become a designated partner in any LLP unless he has given his prior consent.
4. Every LLP should file with the registrar the particulars of every individual who has given his consent to act as a designated partner within 30 days of his appointment.

Liabilities

a. Responsible for the doing of all acts, matters, and things as are required to be done by the LLP in respect of compliance of the provisions of the Act
b. Liable for all penalties imposed on the LLP.

3. DISTINCTION BETWEEN ORDINARY PARTNERSHIP FIRM AND AN LLP

	Key Elements	Partnerships	LLPs
1	Applicable Law	Indian Partnership Act 1932	**The Limited Liability Partnerships Act, 2008**
2	Registration	Optional	**Compulsory with ROC**
3	Creation	Created by an Agreement	**Created by Law**
4	Body Corporate	No	**Yes**
5	Separate Legal Entity	No	**Yes**
6	Perpetual Succession	Partnerships do not have perpetual succession	**It has perpetual succession and individual partners may come and go**
7	Number of Partners	Minimum 2 and Maximum 50	**Minimum 2 but no maximum limit**
8	Ownership of Assets	Firm cannot own any assets. The partners own the assets of the firm	**The LLP as an independent entity can own assets**

9	Liability of Partners / Members	Unlimited: Partners are severally and jointly liable for actions of other partners and the firm and their liability extends to personal assets	**Limited to the extent of their contribution towards LLP except in case of intentional fraud or wrongful act of omission or commission by a partner.**
10	Principal Agent Relationship	Partners are the agents of the firm and of each other	**Partners are agents of the firm only and not of other partners**
11	Mutual agency	Each partner can bind the firm as well as other partners by his own acts.	**Each partner can bind the LLP by his own acts but not the other partners.**
12	**Designated partners**	**There is no provision for such partners under the Partnership Act 1932.**	**At least two designated partners and atleast one of them shall be a resident in India.**
13	Legal compliances	All partners are responsible for all the compliances and penalities under the Act	**Only designated partners are responsible for all the compliances and penalities under the Act.**
14	**Foreign partnership**	**Foreign nationals cannot become a partner in a partnership firm**	**Foreign nationals can become a partner in a LLP**
15	**Minor as partner**	**Minor can be admitted to the benefits of the partnership with the prior consent of the existing partners.**	**Minor cannot be admitted to the benefits of LLP.**

4. MAIN CLAUSES IN A PARTNERSHIP DEED

- Name of the firm and the partners
- Rate of interest to be allowed to each partner on his capital and on his loan to the firm, and to be charged on his drawings
- Commencement and duration of business
- Amount of capital to be contributed by each partner
- Whether a partner will be allowed to draw any salary
- The ratio in which profits or losses are to be shared
- Treatment of losses arising out of the insolvency of a partner

- Any variations in the mutual rights and duties of partners
- Amount to be allowed to each partner as drawings and the timings of such drawings
- Method of valuing goodwill on the occasions of changes in the constitution of the firm.
- Procedure by which a partner may retire and the method of payment of his dues
- Basis of the determination of the executors of a deceased partner and the method of payment
- Procedure to be allowed for settlement of disputes among partners
- Preparation of accounts and their audit

❖ Special Points

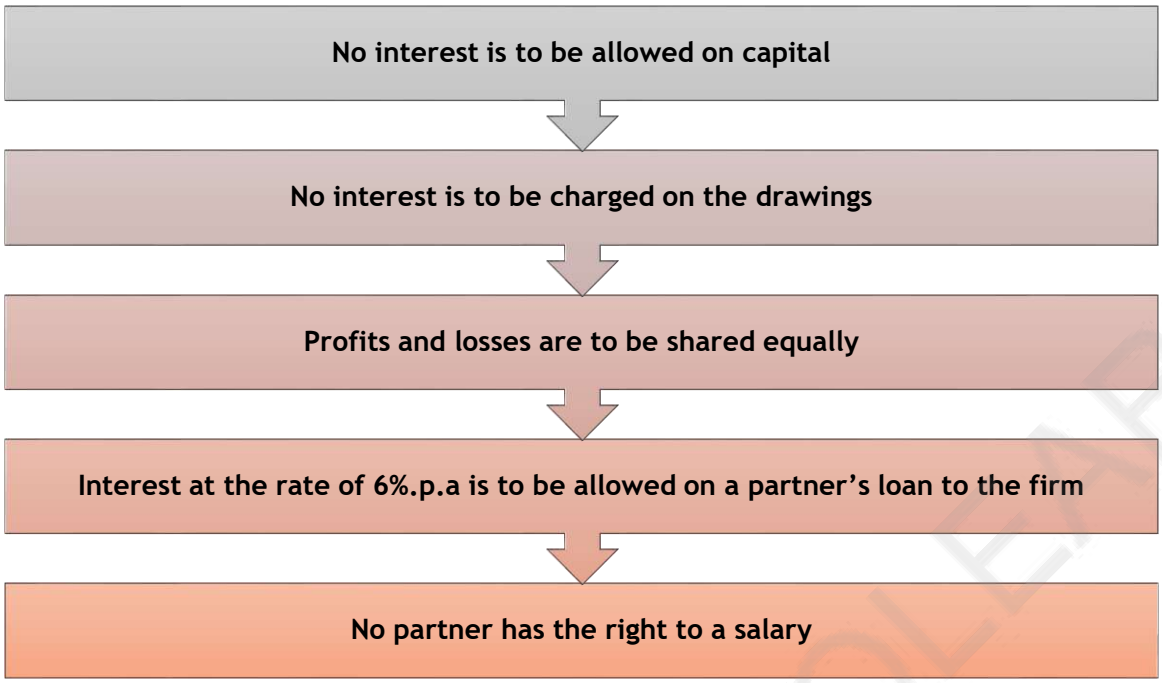
Registration of a deed is not compulsory.

Non registration restricts the partners or firm from taking any **legal action.**

Partnership act will apply in case of no partnership deed or the deed is silent on any point.

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Rules in the absence of Partnership Deed



In the absence of an agreement to the contrary, the interest and salary payable to a partner will be paid only if there is profit.

5. MAIN CLAUSES IN A PARTNERSHIP DEED

- In case of a trading firm, the implied power of partners are the following

Buying and selling of goods

Receiving payments on behalf of the firm and giving valid receipt.

Engaging servants for the business of the firm.

Drawing cheques and drawing, accepting and endorsing bills of exchange and promissory notes in the name of the firm.

Borrowing money on behalf of the firm with or without pledging the inventories-in-trade.

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❖ **In following cases** , third parties cannot bind the firm unless all the partners have agreed

- Submitting a dispute relating to the firm arbitration
- Withdrawal of a suit or proceeding filed on behalf of the firm
- Admission of any liability in a suit or proceedings against the firm
- Opening a bank account on behalf of the firm in the name of a partner
- Compromise or relinquishment of any claim or portion of claim by the firm
- Acquisition of immovable property belonging to the firm
- Entering into partnership on behalf of the firm

6. ACCOUNTS

❖ Partnership Act doesn't specify any **format** for preparation of accounts of Partnership Firm

❖ **Capital Account**

- ➢ May be, there are multiple capital account.
- ➢ Partner withdraw money which either can be debited to capital account or separately debited to Drawing account.

❖ In a Trial Balance of a partnership firm, one may find Capital Accounts of partners as well as Drawings Accounts.

7. PROFIT AND LOSS APPROPRIATION

Profit has to be divided between the partners in a certain profit sharing ratio after making necessary adjustments stated in the partnership deed such as

1) **Interest on capitals**
2) **Interest on Drawings and loans**
3) **Salaries or/and commission to partners**

For above adjustments, there is an additional account is prepared known as Profit and Loss Appropriation Account.

Credit Side	Debit Side
1. Net profit of the company	1 .Salary to the partners
2. Interest on Drawings	2. Interest on capital

8. FIXED AND FLUCTUATING CAPITAL

There are two methods of accounting

1) **Fixed capital method**
2) **Fluctuating capital method**

❖ Fixed Capital Method

There are two accounts under this method

1) **Capital account**: Initial capital contributions by the partners are credited.
2) **Current Account**: subsequent transactions and events are dealt with through current accounts.

Unless a decision is taken to change it, initial capital account balance is not changed.

❖ Fluctuating Capital method

- No current account is maintained. Only one account is maintained.
- All such transactions and events are passed through capital accounts.
- Capital account balance fluctuates all the time.

9. INTEREST ON CAPITAL

- A partner get interest on capital only if there is an **agreement** for it.
- Normally, interest on capital for full year on the balance of capital at the **beginning** of the year.
- If any fresh capital introduced, then the interest for the **relevant period** of utilization is calculated.
- If any permanent withdraw of capital then the interest for the **relevant period** of utilization is calculated.
- In case of fixed capital accounts, interest is calculated on the balance of capital accounts only and **no interest** is payable / chargeable on the balance of **current accounts**.
- Subject to contract between the partners, interest on capitals is to be provided out of profits only.
- *In case of insufficient profits,* the amount of profit is distributed in the ratio of capital as partners get profit by way of interest on capital only.

❖ What is insufficient profit?

When the interest on capital is more than the net profit.

10. INTEREST ON DRAWINGS

- Interest will be charged according to the time that elapses between the **taking out of the money** and the **end of the year** or till the time it was **repaid** whichever is earlier.
- If the dates on which amounts are drawn are not given, then interest for **six months** on the whole of the amount will be charged

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Withdrawals are made evenly in the beginning of each Month	Interest can be calculated on whole amount for 6.5 months
Withdrawals are made at the end of each month	Interest can be calculated on whole amount for 5.5 months
Withdrawals are mode at the beginning of each quarter	Interest can be calculated on whole amount for 7.5 months
Withdrawals are mode at the beginning of each quarter	Interest can be calculated on whole amount for 4.5 months

11. GUARANTEE OF MINIMUM PROFIT

- One partner can enjoy the right to have **minimum amount of profit** in a year as per the terms of the partnership agreement.

- If share of partner (who has been guaranteed minimum profit) is more than the amount of guarantee profit



Allocation of profit is done in a normal way

- If share of partner (who has been guaranteed minimum profit) is less than the amount of guarantee profit



He takes minimum profit and the excess of guaranteed share of profit over the actual share is borne by the remaining partners as per the agreement.

- Deficiency can be share in following ways
  - Excess is payable by one of the **remaining partners**.
  - Excess is payable by **at least two or all the partners** in an agreed ratio.
  - Excess is payable by **remaining partners** in their mutual profit sharing ratio.

- If question silent about the nature of guarantee

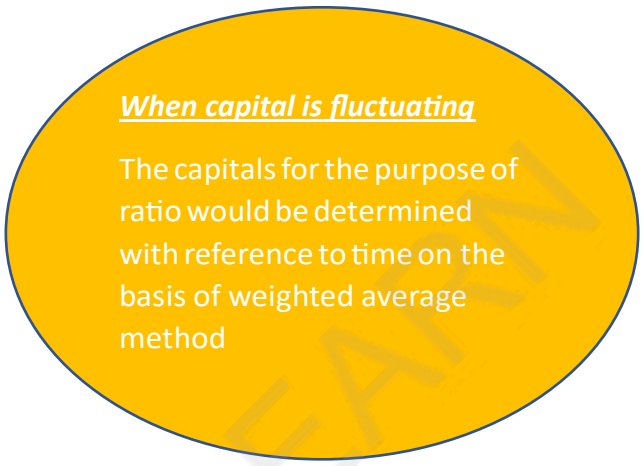
  The burden of guarantee is borne by the remaining partners in their mutual profit sharing ratio

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12. CAPITAL RATIO – For sharing profits

- When capital is fixed: **Profits will be shared in the ratio of given capitals**
- Partners may agree to share profits and losses in the capital ratio.





13. JOURNAL ENTRIES

PARTICULAR	AMOUNT
1. Introduction of capital	
Bank A/c Dr.	
To Partner's Capital A/c	
2. *Withdrawal of capital*	
Drawings A/c Dr.	
To Bank A/c	
3. *Interest on Capital*	
Interest on capital A/c Dr.	
To (Individual) Capital (or Current) Accounts of Partners	
4. Interest on Drawings	
(Individual) Capital (or Current) Accounts of Partners A/c Dr.	
To Interest on Drawings A/c	
5. Salary to partners	
Salary A/c Dr.	
To (Individual) Capital (or Current) Accounts of Partners	
6. Sharing of profit	

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Profit& Loss Appropriation A/c Dr.	
To (Individual) Capital (or Current) Accounts of Partners	
7. In case of Loss	
(Individual) Capital (or Current) Accounts of Partners Dr.	
To Profit& Loss Appropriation A/c	

Illustration 1 & 2

A and B start business on 1st January 2016, with capitals of Rs. 30,000 and Rs.20,000. According to the Partnership Deed, B is entitled to salary of Rs.500 per month and interest is to be allowed on capitals at 6% per annum. The remaining profits are to be distributed amongst the partners in the ratio of 5:3. During 2016 the firm earned a profit, before charging salary to B and interest on capital amounting to Rs.25,000. During the year A withdraw Rs.8,000 and B withdrew Rs.10,000 for domestic purposes.

Give Journal entries relating to division of profit.

Illustration – 3

Ram, Rahim and Karim are partners in a firm. They have no agreement in respect of profit-sharing ratio, interest on capital, interest on loan advanced by partners and remuneration payable to partners. In a matter of Distribution of profits, they have put forward the following claims:

i) Ram, who has contributed maximum capital demands interest on capital at 10% p.a. and share of profit in the capital ratio. But Rahim and Karim do not agree

ii) Rahim has devoted full time for running the business and demands salary at the rate of Rs.500 p.a. But Ram and Karim do not agree.

Karim demands interest on loan of Rs.2,000 advanced by him at the market rate of interest which is 12% p.a.

How shall you settle the dispute and prepare Profit and Loss Appropriation after transferring 10% of the divisible profits to Reserve? Net profit before taking into account any of the above claims amounted Rs.45,000 at the end of the first year of their business.

Illustration – 4

A and B start business on 1st January,2016 with capitals of Rs.30,000 and Rs.20,000. According to the Partnership Deed, B is entitled to a salary of Rs. 500 per month and interest is to be allowed on opening capitals at 6% per annum. The remaining profits are to be distributed amongst the partners in the ratio of 5:3. During 2016, the firm earned a profit, before charging salary to B and interest on capital amounting to Rs.25,000.

During the year A withdrew Rs.8,000 and B withdrew Rs.10,000 for domestic purposes. Prepare Profit and Loss Appropriation Account.

Illustration 5

Prepare Partner's capital account for Illustration – 4

Illustration – 6

A and B are partners sharing profits and losses in the ratio of their effective capital.
They had Rs.1,00,000 and Rs. 60,000 respectively in their Capital Accounts as on 1st January 2016. A introduced a further capital of Rs.10,000 on 1st April 2016 and another Rs.5,000on 1st July 2016. On 30th September 2016 A withdrew Rs.40,000.
On 1st July 2016, B introduced further capital of Rs.30,000. The partners drew the following amounts in anticipation of profit.
A drew Rs.1,000 per month at the end of each month beginning from January 2016.
B drew Rs.1,000 on 30th June and Rs.500 on 30th September 2016. 12% p.a. interest on capital is allowed and 10% p.a. interest on drawings is chargeable.
Date of closing 31.12.2016.
Calculate:

- profit sharing ratio
- interest on capital and
- interest on drawings

Illustration 7

A and B were partners in a firm sharing profits and losses in the ratio of 3:2. They admit C for 1/6th share in profits and guaranteed that his share of profits will not be less than Rs.2,50,00,000. Total profits of the firm for the year ended 31st March 2017 were Rs.9,00,000.
Calculate share of profits for each partner when:

1. Guarantee is given by firm
2. Guarantee is given by A
3. Guarantee is given by A and B equally

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Unit-2 Treatment of Goodwill

Necessity for valuation of goodwill	**Change in profit sharing ratio**
	Admission of partner
	When business is dissolved or sold
	Retirement or death of partner

Methods of valuation of goodwill	**Annuity basis**
	Super profit
	Average Profit
	Capitalization Basis

Goodwill

Goodwill is nothing more than the probability that old customer will resort to old place again and again.

The capacity of a business to earn super profits in the future.

It is necessary that goodwill has some monetary or saleable vlaue

Goodwill is an intangible asset ; it cannot be seen; it cannot be felt; it cannot be transported physically

❖ Why does Goodwill arise?

Due to

- Locational advantage
- Better customer service
- Possession of a unique patent right
- Personal reputation of the partner
- Quality of the goods sold.
- possession of near monopoly right
- Possession of trademarks and patents
- Presence of managerial skill.
- Cost of research and development.
- Possession of special contracts

❖ <u>Recommendation of Accounting Standard</u>

Accounting Standards require an enterprise to recognize an intangible asset, if

An intangible asset must have the **characteristics of an asset**	• It means that it must have some **value** and must be clearly **identifiable.** • It can be sold without **disposing** other assets or future benefits flowing from other assets.
An intangible asset should be recognized only if **future probable economic benefits will flow to the business enterprise**	• Future **probable economic benefits** means it has a capacity to increased revenue from sales. • It means that management can make **reasonable estimates** of future benefits.
The cost of the intangible asset can **be measured reliably**	• The cost is objectively **verifiable.** • If the cost cannot be measured **reliably**, then it cannot be recognized as an asset.

** Internally generated goodwill or inherent goodwill will not be recognise*

Goodwill should be recorded in the books only when some consideration in money or money' worth has been paid for it. Only purchased goodwill should be recorded in the books of account.

In the event of **reconstitution of the firm due to admission, or retirement or death of a partner or even a change in the profit sharing ratio** without reconstitution

- Goodwill of the firm is evaluated.
- The value of goodwill should not be brought into books of account because it is **inherent or self-generated goodwill** since no money or money' worth has been paid for it.
- The goodwill should be adjusted through **capital accounts** of the partner(s) of the firm.
- Goodwill account **cannot be raised** in the books of account, either on the reconstitution of the firm or change in the profit sharing ratio.
- If goodwill account exists at the time of reconstitution of firm, It should be **written off** immediately whether it is internally generated or goodwill has been bought for some consideration.

2. METHOD FOR GOODWILL VALUATION

Three Methods

- Average profit basis,-Simple and Weighted.
- Super profit basis-Number of Year Purchase, Annuity basis, and Capitalization of Super Profit.
- Capitalization basis- Average Profits.

❖ ***Average Profits Basis – Simple and weighted***

- Average profit of past years can be calculated by using Simple average or weighted average method.
- The no. of years for average profit and no. of years of purchase profit are decided on the basis of **judgment and negotiation**.
- For averaging the past profit, either simple average or weighted average may be employed depending upon the circumstances.

Weighted average profit : If there exists clear increasing or decreasing trend of profits.
Simple average profit : If there is no clear trend of profit.

❖ ***Super Profit Basis***

- Goodwill is valued on the basis of super profits earned by the firm.

- Super profit can be calculated as follows:

Super Profit=Actual Profit-Normal Profit

Super Profit: Excess profit that can be earned by a firm over and above the normal profit usually earned by similar firms under similar circumstances.

Actual Profit: Actual Profit is average profit

Normal Profit: Normal rate of Return (NRR) x Capital Employed

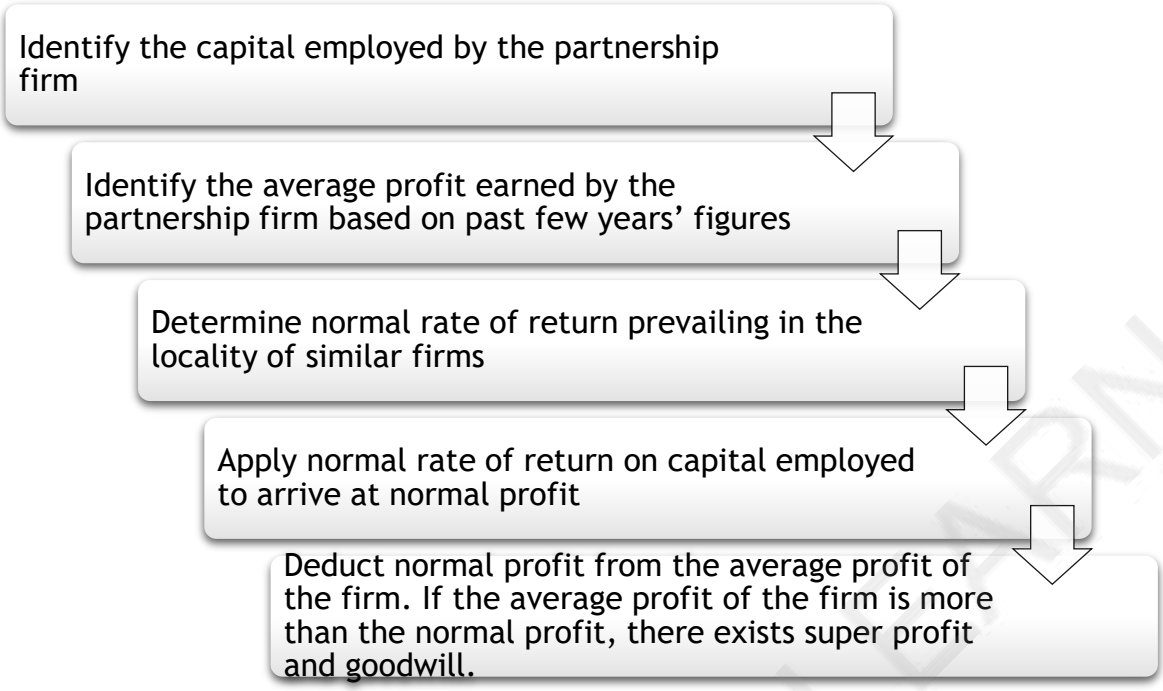
Why super profit can be use?

1) The partner who gains **excess earning** owing to reconstitution of firm should compensate to partners sacrificing their share in the reconstitution.

2) The partner who gains in terms of profit sharing ratio has to contribute only for excess profit because normal profit he can earn by joining any partnership firm.

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Steps in calculation of Super profit



How Goodwill calculate using Super Profit?

(a) **Number of Years Purchase Method:**

(i) Goodwill is generally valued by **multiplying the amount of super profit**

(ii) By **certain number of years** depending upon the expectation about the maintenance of such profit in future.

(b) **Annuity Method:**

(i) Goodwill is valued by **multiplying the amount of super profit** of every year by the **discounting factor** of every year and then adding them.

(ii) The major drawback of number of number of years purchase method is that **time value of money** is not considered and in annuity method the time of value money considered.

(c) Capitalization Basis:

(i) Value of whole business is determined applying **normal rate of return**.

(ii) Value (**arrived at by applying normal rate of return**) is higher than the capital employed in the business, then the difference is goodwill.

Steps :

1) Determine the **normal rate of return**.
2) Find out the **average profit** of the partnership firm for which goodwill is to be determined.
3) Determine the **capital employed** by the partnership firm for which goodwill is to

be determined.

4) Find out **normal value of the business** by dividing average profit by normal rate of return.
5) Deduct average capital employed from the normal value of the business to arrive at **goodwill**.

Goodwill = Normal Capital-Actual Capital

Normal capital = Average Profit/NRR

3. NEED FOR VALUATION OF GOODWILL

Whenever there is any change in the existing relationship of the partners

↓

Those who are sacrificing future profit should be compensated by the others who are gaining.

↓

Some partners have to sacrifice their future profit and some others would gain.

↓

The partners, who gain in terms of profit sharing ratio, have to pay for such gain as a proportion to the value of goodwill.

↓

The partners, who lose in terms of profit sharing ratio, receive payments for the sacrifice as a proportion to the value of goodwill.

4. VALUATION OF GOODWILL IN CASE OF ADMISSION OF A PARTNER

When a new partner is admitted into a partnership

↓

Certain adjustments in accounts become necessary

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Because the new partner will acquire a share in the profits of the firm and because of this, the old partners will stand to lose.

For Example: A and B are partners sharing profits in the ratio of 3:2. C is admitted and given one fourth share in profits.

1) If their profits are 20,000, A will get 12,000 and B will get 8,000.
2) C got 5000 and remaining 15000 will be divided between A and B.
3) A got 9000 and B got 6000.
4) Due to C's admission, A loses 3,000 per year and B loses 2,000 per year.
5) C will have to compensate A and B for this loss.

- The above compensation is tackled through **Goodwill**. Compensation of goodwill is done in **profit sacrificing ratio**.
- Kindly note that it is not necessary that the profit of the firm will remain 20000 after C's admission. Extra profits will arise and therefore, A and B will both get more than what they previously got.
- The additional profits will be earned by the combined efforts of all the partners A, B and C and hence no need that c compensate to A and B for extra profit in future.

As per the Accounting Standards, it is not recommended to raise goodwill account but to show the adjustment of goodwill through partners' capital accounts

5. ACCOUNTING TREATMENT OF GOODWILL

❖ Accounting Treatment of Goodwill in Case of Change in Profit Sharing Ratio

In case of change in profit sharing ratio, the value of goodwill should be determined and preferably adjusted through **capital accounts** of the partners on the basis of profit sacrificing ratio.

❖ Accounting Treatment of Goodwill in Case of Retirement or Death of a partner

- When a partner retired, the continuing partners will gain in terms of **profit sharing ratio**.
- They have to pay to retiring partner for his share of goodwill in the firm in the **gaining ratio**.
- Similarly, in case of **death of the partner**, the continuing partners should bear the **share of goodwill** due to the heirs of the deceased partner.

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❖ Accounting treatment of Goodwill in case of Admission of a new partner

The goodwill should be recorded in the books only when some consideration in money or money's worth as been paid for it.

only purchased goodwill should be recorded in the books of the firm.

In case of admission of a partner, goodwill cannot be raised in the books of the firm because no consideration in money or money's worth is paid for it.

The adjustment of goodwill is done in Profit Sacrificing ratio.

The profit sacrificing ratio is computed by deducting the new profit sharing ratio from the old profit sharing ratio. If differnece is positive then it is a profit sacrifice and if it is negative then it is profit gain.

Premium for goodwill brought in cash by new partner	The premium for goodwill shall be given in Profit sacrificing ratio by crediting their respective partner capital or current account .
When no cash brought by new partner for goodwill	The goodwill adjusted through debiting the new partner capital account and crediting those partner's capital account who is going to sacrifice
When new partner pays premium privately.	No entry required.
	the amount to be paid to each partner should be calculated as per the profit sacrificing ratio.

13. JOURNAL ENTRIES

PARTICULAR	AMOUNT
Accounting treatment of Goodwill at the time of Admission	
1. Premium for goodwill brought in cash by new partner	
Bank A/c Dr.	
To A Partner's Capital A/c	
To B Partner's Capital A/c	
(Goodwill adjustment in the profit sacrificing ratio)	
2. When no cash brought by new partner for goodwill	
C Partner's Capital A/c Dr.(New partner)	
To A Partner's Capital A/c (old Partner)	
To B Partner's Capital A/c (old Partner)	
(Adjustment for goodwill)	
3. When new partner pays premium privately	
No entry Required	
Accounting treatment of Goodwill at the time of change in profit sharing ratio	
C Partner's Capital A/c Dr. (gaining partner)	
To A Partner's Capital A/c (Sacrificing Partner)	
To B Partner's Capital A/c (Sacrificing Partner)	
(Adjustment for goodwill)	
Accounting Treatment of Goodwill in Case of Retirement or Death of a partner	
A Partner's Capital A/c	
B Partner's Capital A/c	
To C's Partner Capital A/c	
(C is going to retire and his share of goodwill adjusted to existing partners' capital accounts in profit gaining ratio)	

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Illustration – 1

Lee and Lawson are equal partnership. They agreed to take Hicks as one- fourth partner. For this it was decided to find out the value of goodwill. M/s. Lee and Lawson earned profits during 2013-2016 as follows:

Year	Profits
2013	1,20,000
2014	1,25,000
2015	1,30,000
2016	1,50,000

On 31.12.2016 capital employed by M/s. Lee and Lawson was Rs.5,00,000. Rate of normal profit id 20%. Find out the value of goodwill following various methods.

Illustration – 2

The following particulars are available in respect of the business carried on by Rathore

S.No.	Particulars		Rs.
1)	Capital invested		1,50,000
2)	Trading Results		
	2013	profit	40,000
	2014	profit	36,000
	2015	loss	6,000
	2016	profit	50,000
3)	Market Rate of interest on investment	10%	
4)	Rate of risk return on capital invested in business 2%		
5)	Remuneration from alternative Employment of the proprietor Rs.6,000 per annum (if not engaged in business)		

You are required to compute the value of goodwill on the basis of 5 years purchase of super profit of the business calculated on the average profits of the last four years.

Illustration – 3

The following is the balance Sheet of Yellow and Green as at 31st December 2016:

Liabilities	Rs.	Assets	Rs.
Trade payables	20,000	Cash at Bank	10,000
Capital:		Sundry Assets	55,000
Yellow	25,000		
Green			

	20,000 65,000		65,000

The partners shared profits and losses in the ratio 3:2. On the above date, Black was admitted as partner on the condition that he would pay Rs.20,000 as capital.
Goodwill was to be valued at 3 years purchase of the average of four years profits which were:

	Rs.		Rs.
2012	9,000	2014	12,000
2013	14,000	2105	13,000

The new profit-sharing ratio is 6:5:5.
Give journal entries and Balance Sheet if goodwill is adjusted through partner's capital accounts.

Illustration – 4

With the information given in illustration 3, give Journal Entries assuming that goodwill is brought in cash.

Illustration – 5

With the information given in illustration 3, assuming that goodwill is paid privately.

Illustration – 6

A, B and C are equal partners. They wanted to change the profit-sharing ratio into 4:3:2. Make the necessary journal entries. Goodwill of the firm is valued at Rs.90,000.

Illustration – 7

A, B and C are partners sharing profits and losses in the ratio of 4:3:3.
They decided to change the profit-sharing ratio to 7:7:6. Goodwill of the firm is valued at Rs.20,000. Calculate the sacrifice/gain by the partners and make necessary journal entry.

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Unit -3 Admission of Partner

Revaluation Account or Profit and

Loss Adjustment Account for revaluation of assets and liabilities

Adjustment of goodwill amongst the old partners in their sacrificing ratio

Reserves lying in the balance sheet transferred to the capital accounts of old partners in their old profit sharing ratio.

Profit/loss on revaluation account is ts/f to old partners in their old profit sharing ratio

INTRODUCTION

- **Reason for admitting New Partner**
  - For increasing the **partnership capital**.
  - For strengthening the **management** of the firm.

- **Effects for admitting New partner**
  - Desirable to bring all **appreciation or reduction** in the value of assets into accounts as on the date of admission.
  - **Liabilities recorded**, if not recorded.
  - **Liabilities written off**, if not required to be paid.
  - All profits which have **accrued but not yet brought** into books should be record.
  - All losses which have **occurred but not recorded** should be recorded.
  - The **value of goodwill** is to be assessed and proper accounting treatment is required to bring the value of goodwill into books of accounts.

The purpose of such entries is to make an updated Balance Sheet on the date of admission.

REVLAUATION ACCOUNT OR PROFIT AND LOSS ADJUSTMENT ACCOUNT

- **Revaluation Account**
  - Revaluation account is debited with all **reduction** in the value of **assets** and **increase** in **liabilities**.
  - Credited with **increase** in the value of **assets** and **decrease** in the value of **liabilities**.
  - The difference in two sides of the account will show **profit or loss**.
  - This is transferred to the Capital Accounts of **old partners** in the **old profit sharing ratio**.

- **Why Revaluation?**

  When a new partner is admitted into the partnership, assets are revalued and liabilities are reassessed.

- **Memorandum Revaluation Account**

  Memorandum Revaluation Account prepared when all the partners including the new partner may agree to keep the assets and liabilities at the old values even when they agree to revalue them.

  Memorandum Revaluation Account has two parts

First Part

1. Entries for the revaluation of assets and liabilities are made in the **usual way** as made in case of **revaluation account.**

2. No record for the revaluation of assets and liabilities is made through the respective **ledger accounts.**

3. The resultant profit or loss on revaluation in the first part of this account is transferred to the **capital accounts of old partners** only in the **old profit and loss sharing ratio.**

Second Part

1.Entries made in the first part of Memorandum Revaluation Account are reversed in the second part so that the values of the assets and liabilities **remain unchanged.**

2.The balance of the second part is transferred to the capital accounts of all the partners including new partner in their **new profit and loss sharing ratio.**

Special Points

1. If there is a **profit** in the **first part** there will be a **loss** of the same amount in the **second part** and vice versa.

2. The result of the **first part** of Memorandum Revaluation Account is shared by **old partners** in the **old profit sharing ratio**, while the result of the **second part** is shared by all partners including the **new one** in the **new profit sharing ratio**.

Difference between Revaluation Account and Memorandum Revaluation Account

Basis	Revaluation Account	Memorandum Revaluation Account
Asset and Liabilities	Assets and liabilities appear in the new balance sheet at the new or revalued figures.	Assets and liabilities appear in the new balance sheet at the old figures.
No. of parts	Revaluation account is not divided into two parts.	Memorandum revaluation account has two parts: first part for old partners and second part for all partners including the new partner.

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Sharing of Net results	transferred to old partners' capital accounts in the old profit sharing ratio	The balance of the first part is transferred to old partner's capital accounts in the old profit sharing ratio while the balance of the second part is transferred to all partners including the new partner in the new profit sharing ratio.

COMPUTATION OF NEW PROFIT SHARING RATIO

When new partner's share is given but the question is silent about the sacrifice made by the old partners	It is assumed that the old partner will share the remaining share in their old profit sharing ratio.
When new partner purchases his share from old partner's in a particular ratio	The new ratio of the old partners will be calculated by deducted the proportion given to the new partner from the shares of old partner.
When the old partners surrender a particular fraction of their share in favour of new partner	Determine the share surrendered by the old partners. Find the new share of the old partners by deducting share surrendered from their old share. Calculate share of the new partner by taking the sum of surrendered share of old partners. Calculate the new ratio.
When the new partner acquires his share entirely from any one of partner only	The sacrificing partner share is calculated by deducting his sacrifice from his old share.
When the new partner acquires his share from the old partners in the certain ratio	The sacrifice of each partner is deducted from their old shares.

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Some Useful terms

1. **Sacrificing Partner** : The partners whose shares have decreased as a result of change are known as sacrificing partners.

2. **Sacrificing Ratio** : Ratio in which the old partners sacrifice their share in favor of new Partner is called sacrificing ratio.

Sacrificing ratio = Old Profit sharing ratio - New Profit sharing ratio

3. **Gaining Partners** : The partners whose shares have increased as a result of change are known as gaining partners.

4. **Gaining Ratio**: The ratio in which the partners have agreed to gain their shares in profit from the other partner or partners, is known as gaining ratio.

Gaining Ratio = New Profit sharing ratio - Old Profit sharing ratio

HIDDEN GOODWILL

When the value of the goodwill of the firm is not specifically given, the value of goodwill has to be inferred

Particulars	`
Incoming partner's capital x Reciprocal of share of incoming partner	**xxx**
***Less*: Total capital after taking into consideration the capital brought in by incoming partner**	**xxx**
Value of Goodwill	**xxx**

JOURNAL ENTRIES

PARTICULAR	Amt	Remarks
Accounting treatment of Revaluation of assets and liabilities through Revaluation Account		
a. Revaluation A/c Dr.		**With the reduction in the value of the assets**
To Assets A/c		
(individually which show a decrease)		
b. Revaluation A/c Dr.		**With the increase in the liabilities.**
To Liabilities A/c		
(Individually which have to be increased)		
c. Assets A/c Dr.		**With the increase in the value of the of assets.**
To Revaluation A/c		

(Individually which have to be increased)			
d. Liabilities A/c Dr.			**With the reduction in the amount liabilities.**
To Revaluation A/c			
(individually which show a decrease)			
e. Revaluation A/c Dr.			**With the profit in the old profit sharing ratio.**
To Capital A/c of the old partners			
(Sharing of Revaluation Profit)			
Capital A/c of the old partners Dr.			**with the loss in old profit sharing ratio**
To Revaluation A/c			
(Sharing of Revaluation Loss)			
Accounting treatment of Revaluation of assets and liabilities through Memorandum Revaluation Account(Part – 1)			
A) Assets A/c Dr.			**with increase in the value of individual assets**
Liabilities A/c Dr.			**With decrease in the value of individual liabilities**
To Memorandum Revaluation A/c			
B) Memorandum Revaluation A/c Dr.			
To Assets A/c			**with increase in the value of individual assets**
To Liabilities A/c			**with decrease in the value of individual liabilities**
Memorandum Revaluation A/c Dr			**If there is profit on revaluation.**
To Old Partners' Capital A/c			
Old Partners' Capital A/C Dr.			**If there is loss on revaluation.**
To Memorandum Revaluation A/c			

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Accounting treatment of Revaluation of assets and liabilities through Memorandum Revaluation Account(Part – 2)		
REVERSE ENTRIES OF PART 1 (A &B)		
Memorandum Revolution A/c Dr.		**(New profit and loss sharing ratio)**
To All Partners' Capital A/c		
(If there is Profit)		
All Partners' Capital A/c Dr.		**(New profit and loss sharing ratio)**
To Memorandum Revaluation A/c		
(If there is loss)		
Reserves or Profit & Loss A/c Dr.		**In the old profit sharing ratio**
To Old Partners' Capital A/c		
(Any reserve etc. lying in the Balance Sheet transferred to the Capital Accounts of the old partners)		
C's Capital A/c (Gaining Partner)		**In case of Hidden Goodwill**
To A's Capital A/c (Sacrificing Partner)		
To B's Capital A/c (Sacrificing Partner)		
(Being the share of C in the hidden goodwill adjusted through capital accounts by crediting sacrificing partners in their sacrificing ratio)		

Illustration 1

The following is the Balance Sheet of Ram and Mohan, who share Profit in the ratio of 3:2 as on 1st January 2016:

Liabilities	**Rs.**	**Assets**	**Rs.**
Trade Payables	15,000	Buildings	18,000
Ram's Capital	20,000	Plant and Machinery	15,000
Mohan's Capital	25,000	Inventories	12,000
		Trade Receivables	10,000
		Bank	5,000
	60,000		**60,000**

On this date Shyam was Admitted on the following:

1. He is to pay Rs.25,000as his capital and Rs.10,000as his share of goodwill for one fifth share in profits.
2. The new profits sharing ratio will be 5:3:2
3. The assets are to be revalued as under:

	Rs.
Building	25,000
Machinery	12,000
Inventories	12,000
Trade receivables (Because of Doubtful debts)	9,500

4. It was found that there was a Lability for Rs.1,500 for goods received but not recorded in books.

Give journal entries to record the above. Also, give the Balance Sheet of the partnership firm after Shyam's admission.

Illustration 2

A and B are partners sharing profits and losses in the ratio of 3:2. The Balance Sheet as on 31.3.2016 is given below:

Liabilities	**Rs.**	**Assets**	**Rs.**
Trade Payables	50,000	Freehold premises	2,00,000
Capital A/c		Plant	40,000
A	2,00,000	Furniture	20,000
B	1,00,000	Office equipment	25,000
		Inventories	30,000
		Trade Receivables	25,000
		Bank	10,000
	3,50,000		**3,50,000**

On 1.4.2016 they admit C on the following terms:

1. C will bring Rs.50,000 as a capital and Rs.10,000 for goodwill for 1/5 share;
2. Provision for doubtful debts is to be made on trade receivables @2%
3. Inventory to written down by 10%
4. Freehold premises are to be revalued at Rs.2,40,000, plant at Rs.35,000 furniture Rs.25,000 and office equipment Rs.27,500.
5. Partners agreed that the values of the assets and liabilities remain the same and as such, there should not be any change in the book values as a result of the above-mentioned adjustments.

You are required to make necessary adjustments in the capital Accounts of the partners and show the Balance Sheet of the New Firm.

Illustration 3

Dalal, Banerji and Mallick are partners in a firm sharing profits and losses in the ratio 2:2:1. Their Balance Sheet as on 31st March 2016 is as below:

Liabilities	Rs.	Assets	Rs.
Trade payables	12,850	Land and Buildings	25,000
Outstanding Liabilities	1,500	Furniture	6,500
General Reserves	6,500	Inventory of goods	11,750
Capital Account:		Trade receivables	5,500
Mr. Dalal – 12,000		Cash in Hand	140
Mr. Banerji – 12,000		Cash at Bank	960
Mr. Mallick - 5,000	29,000		
	49850		**49850**

The partners have agreed to take Mr. Mistri as a partner with effect from 1st April 2016 on the following terms:

1. Mr. Mistri shall bring Rs.5,000 towards his capital.
2. The value of Inventory should be increased by Rs.2,500 and furniture should be depreciated by 10%.
3. Reserves for bad and doubtful debts should be provided at 10% of the Trade receivables.
4. The value of land and buildings should be enhanced by 20% and the value of the goodwill be fixed at Rs.15,000.
5. The value of the goodwill be fixed at Rs.15,000.
6. General Reserve will be transferred to the partner's Capital Accounts.
7. The new profit- sharing ratio shall be: Mr. Dalal 5/15, Mr. Banerji 3/15, and Mr. Mistri 2/15.

The outstanding liabilities include Rs.1,000 due to Mr. Sen which has been paid by Mr. Dalal. Necessary entries were not made in the books.

Prepare i) Revaluation Account, ii) The Capital Accounts of the partners, iii) Balance Sheet of the firm after admission of Mr. Mistri

Illustration 4

A and B are in a partnership sharing profits and losses in the proportion of three- fourth respectively. Their Balance Sheet as on 31st March 2016 was as follows:

Cash Rs.1,000: trade receivable Rs.25,000; inventory Rs.22,000; plant and machinery Rs.4,000; trade payables Rs.12,000; bank overdraft Rs.15,000; A's Capital Rs.15,000; B's Capital Rs.10,000.

1. C to purchase one-third of the goodwill for Rs.20,000 and provide Rs.10,000 as capital. Goodwill not to appear in books.
2. Further profits and losses are to share by A B and C equally.
3. Plant and machinery is to be reduced by 10% and Rs.500 is to provide for estimated bad debts. Inventory is to be taken at a valuation of Rs.24,940.
4. By brining in or withdrawing cash and capitals of A and B are to be made proportionate to that of C on their profit-sharing basis.

Set out entries to the above arrangement in the firm's journal and give the partners'capital accounts in tabular from.

Illustration 5

A and B are partners of X & Co. sharing profits and losses in 3:2 ratio between themselves. On 31st March 2016, the Balance Sheet of the firm was as follows:

Liabilities	Rs.	Assets	Rs.
Capital A/cs:		Plant and Machinery	20,000
A:37,000		Furniture and Fittings	5,000
B:28,000	65,000	Inventories	15,000
		Trade Receivables	20,000
Trade Payables	5,000	Cash in Hand	10,000
	70,000		**70,000**

X agrees to join the business on the following conditions as and from 1.4.2016:

a. He will introduce Rs.25,000 as his capital and pay Rs.15,000 to the partners as premium for goodwill for 1/3rd share of the future profits of the firm.

b. A revaluation of assets of the firm will be made by reducing the value of plant and machinery to Rs.15,000, inventory by 10%, furniture and fittings by Rs.1,000 and by making a provision of bad and doubtful debts at Rs.750 on trade receivables.

Prepare profit and losses adjustment account, capital accounts of partners including partner X assuming that the relative ratios of the old partners will be in equal proportion after admission.

Illustration 6

A and B are in partnership sharing profits and losses equally. The Balance Sheet M/s. A and B as on 31.12.2016, was as follows:

Liabilities	Rs.	Assets	Rs.
Capital A/cs:		Sundry fixed assets	60,000
A	45,000	Inventories	30,000
B	45,000	Bank	20,000
Trade Payables	20,000		
	1,10,000		**1,10,000**

On 1.1.2017 they agreed to take C as 1/3rd partner to increase the capital base to Rs.1,35,000. C agrees to pay Rs.60,000. Show the necessary journal entries and prepare partner's capital accounts.

Unit-4 Retirement of Partner

When a partner retires from a firm, the treatment of various items like revaluation of assets, goodwill treatment, sacrifice/gain ratio, reserves etc., are similar to that of admission of a partner into a partnership firm. The only additional treatment which is required is to settle the amount due to outgoing partner.

Important Points:

1. The revaluation gain/loss belongs to all the partners (before retirement) and is distributed in existing profit sharing ratio.
2. The reserves are distributed to all partners in existing profit sharing ratio.
3. The goodwill is adjusted on the basis of gain ratio or sacrifice ratio. (Can be done using table adjustment)
4. The settlement to partner is done based on agreement between partners as discussed below.

Settlement

1. The final amount standing to the credit of capital account may be paid in full to the retiring partner.

Retiring Partner Capital A/c … Dr.
To Bank A/c

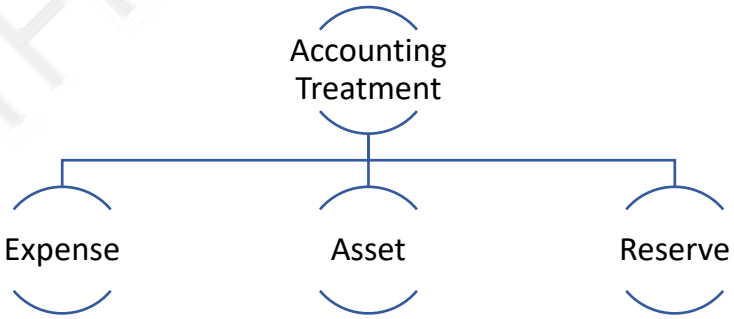
2. If the amount is not settled in full, the balance amount is transferred to loan account.

Retiring Partner Capital A/c … Dr.
To Bank A/c
To Retiring Partner's Loan A/c

The loan is repaid as per the terms of retirement and entries will be passed accordingly.

Joint Life Policy

- A partnership firm may decide to take a Joint Life Insurance Policy on the lives of all partners.
- The firm pays the premium and the amount of policy is payable to the firm on the death of any partner or on the maturity of policy whichever is earlier.
- The objective of taking such a policy is to minimize the financial hardships to the event of payment of a large sum to the legal representatives of a deceased partner or to the retiring partner.



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1. When JLP is treated as expense

Payment of JLP premium	JLP Premium A/c Dr. To Bank A/c
Transfer of JLP to P&L	Profit & Loss A/c Dr. To JLP Premium A/c
On Maturity of Policy	Bank A/c Dr. To Partners Capital A/c (in PSR)

2. When JLP is treated as Asset

Payment of JLP premium	Joint Life Policy A/c Dr. To Bank A/c
Year End – Check with Surrender Value Loss = JLP Balance – Surrender Value	Profit & Loss A/c Dr. To Joint Life Policy A/c
On Maturity of Policy	Bank A/c Dr. To Joint Life Policy A/c To Partner's Capital A/c (In case of gain)

3. Creation of JLP Reserve

Payment of JLP premium	Joint Life Policy A/c Dr. To Bank A/c
Year End Creation of Reserve	Profit & Loss Appropriation A/c Dr. To JLP Reserve A/c
Year End – Check with Surrender Value Loss = JLP Balance – Surrender Value	JLP Reserve Dr. To Joint Life Policy A/c
On Maturity of Policy	JLP Reserve A/c To Joint Life Policy A/c
Balance in JLP A/c	Transferred to Partners

Joint Life Policy – Individual

- All the partners may take individual life policies for each of them by paying the premium from the firm.
- In the event of retirement, the retired partner is entitled for the surrender value of the life policies of all the partners.

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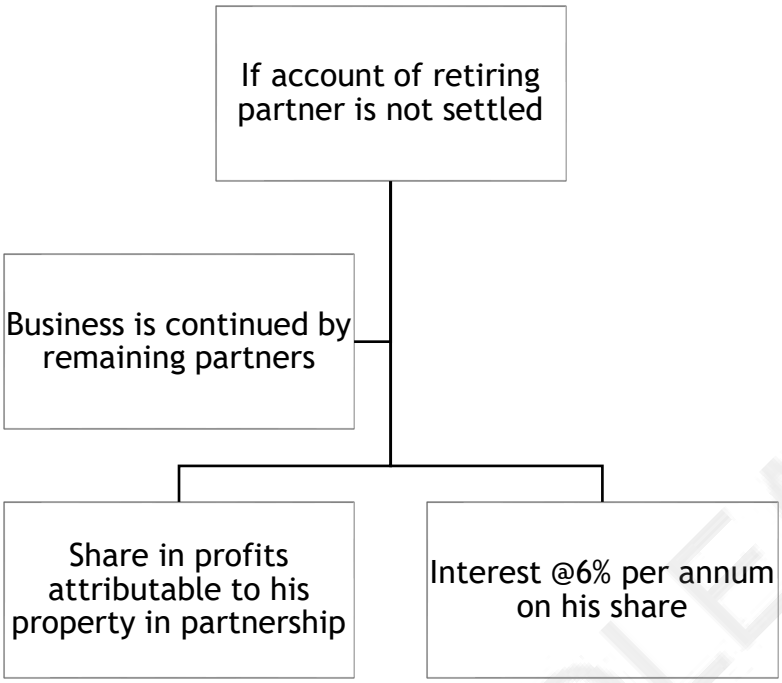


Illustration 1

F, G and K were partners sharing profits and losses at the 2:2:1. K wants to retire on 31.12.2015. given below is the Balance Sheet of the Partnership as well as other information:

Balance Sheet as on 31.12.2015

Liabilities	Rs.	Assets	Rs.
Capital A/cs:		Sundry Fixed Assets	1,50,000
F	1,20,000	Inventories	50,000
K	80,000	Trade Receivables	70,000
G	60,000	(including Bills Receivables Rs.20,000)	
Reserves	10,000	Bank	50,000
Trade Payables	50,000		
	3,20,000		**3,20,000**

F and G agrees to share profits and losses at the ratio of 3:2 in future. Value of Goodwill is taken to be Rs.50,000. Sundry fixed Assets are revalued upward by Rs.30,000 and inventories by Rs.10,000. Bills Receivable dishonoured Rs.5,000 on 31.12.2015 but not recorded in the books. Dishonour of bill was due to insolvency of the customer. F and G agree to bring sufficient cash to discharge claim of K and to make their capital proportionate. Also, they wanted to maintain Rs. 75,000 bank balance for working capital.

Required:

Pass necessary journal entries and draft the balance Sheet of M/s F & G. Also prepare capital accounts of partners and the Balance Sheet of M/s F& G after K's retirement.

Illustration 2

K, L & M are partners- sharing profits and losses in the ratio 5:3:2. Due to illness, L wanted to retire from the firm on 31.12.2015 and admit his son N in his place.

Balance Sheet of K, L and M as on 31.3.2015

Liabilities	Rs.	Assets	Rs.
Capital A/cs:		Goodwill	30,000
F: 40,000		Furniture	20,000
K: 60,000		Trade receivables	50,000
G: 30,000	1,30,000	Inventory in trade	50,000
		Cash and bank balance	50,000
Reserves	50,000		
Trade Payables	20,000		
	2,00,000		**2,00,000**

On the retirement of L assets were revalued: Goodwill Rs.50,000, furniture Rs.10,000 and inventory in trade Rs.30,000. 50% of the amount due to L was paid off in cash and the balance was retained in the firm as capital of N. On admission of the new partner, goodwill has been written off. M is paid off his extra balance to make capital proportionate.

You are required to give:

i. Necessary journal entries
ii. Balance Sheet of M/s K, M and N

Capital Accounts of partners

Illustration 3

Dowell & Co. is a partnership firm with partners Mr. A, Mr. B and Mr. C, sharing profits and losses in the ratio of 10:6:4. The Balance Sheet of the firm as at 31st March 2015 is as under:

Liabilities	Rs.	Assets	Rs.
Capital A/cs:		Land	10,000
Mr. A:80,000		Buildings	2,00,000
Mr. B:20,000		Plant and Machinery	1,30,000
Mr. C: 30,000	1,30,000	Furniture	43,000
Reserves		Investment	12,000
(inappropriate profit)	50,000	Inventories	1,30,000
Long term Debt	3,00,000	Trade Receivables	1,39,000
Bank O/D	44,000		
Trade Payables	1,70,000		
	6,64,000		**6,64,000**

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It was mutually agreed that Mr. B will retire from the partnership and in his place Mr. D will be admitted as a partner with effect from 1st April 2015. For this purpose, the following adjustments are to be made:

a. Goodwill is to be valued at 1 lakh but the same will not appear as an asset in the books of the reconstituted firm.

b. Building and plant and machinery are to be depreciated by 5% and 20% respectively. Investments are to be taken over by the retiring partner at Rs.15,000. Provision of 20% is to be made on trade receivables to cover doubtful debts.

c. In the reconstituted firm, the total capital will be Rs.2 lakhs which will be contributed by Mr. A, Mr.C and Mr. D in their new profit- sharing ratio, which is 2:2:1.

1. The surplus funds, if any will be used for repaying bank O/D.
2. The amount due to retiring partner shall be transferred to his loan account.

Required:

Prepare i) Revaluation account

ii) Partners capital accounts:

iii)Bank account and

iv)Balance Sheet of the reconstituted firm as on 1st April 2015.

Illustration 4

Red, White and Black shared profits and losses in the ratio of 5:3:2. They took out a joint life policy in 2011 for Rs.50,000, a premium of Rs.3,000 being paid annually on the 10th June.

The surrender value of the policy on 31st December of various years was as follows: 2011 nil;

2012 Rs.900;

2013 Rs.2,000;

2014 Rs.3,600.

Black retires on 15th April 2015.

Required

Prepare ledger accounts assuming no Joint Life Policy Account is Maintained.

Illustration 5

A, B and C are in partnership sharing profits and losses at the ratio of 5:3:2. The balance sheet of the firm on 31.12.2015 was as follows:

Balance Sheet

Liabilities	**Rs.**	**Assets**	**Rs.**
Capital A/cs :		Sundry Fixed Assets	80,000
A	50,000	Inventories	50,000
B	40,000	Trade receivables	30,000
C	30,000	Joint Life Policy	20,000
Bank loan	40,000	Bank	10,000
Trade payables	30,000		
	1,90,000		**1,90,000**

On 1.1.2016 A wants to retire B and C agreed to continue at 2:1. Joint Life Policy was taken on 1.1.2010 for Rs.1,00,000 and its surrender value as on 31.12.2015 was Rs.25,000.

For the purpose of A's retirement goodwill was raised for Rs.1,00,000.

Sundry Fixed Assets was revalued for Rs.1,10,000. But B and C did not prefer to show such increase in assets in the Balance Sheet.

Also, they agreed to bring necessary cash to discharge 50% of the A's claim, to make the bank balance Rs25,000and to make their capital proportionate.

Required:
Prepare necessary journal entries.

Illustration 6

A, B & C were in partnership sharing profits in the proportions of 5:4:3. The balance sheet of the firm as on 31st March 2015 was as under:

Liabilities	Amount (Rs)	Assets	Amount (Rs)
Capital accounts:		Goodwill	40,000
A	1,35,930	Fixtures	8,200
B	95,120	Inventories	1,57,300
C	61,170	Trade receivables	93,500
Trade payables	41,690	Cash	34,910
	3,33,910		**3,33,910**

A had been suffering from ill-health and gave notice that he wished to retire. An agreement was, therefore, entered as on 31st March 2015, the terms of which were as follows:

1. The profit and loss account for the year ended 31st March 2015 which showed a net profit of Rs 48,000 was to be re-opened. B was to be credited with Rs 4,000 as bonus, in consideration of the extra work which had devolved upon him during the year. The profit sharing was to be revised as from 1st April 2014 as 3:4:4
2. Goodwill was to be valued at two years' purchase of the average profits of the preceding five years. The fixtures were to be valued by an independent valuer. A provision of 2% was to be made for doubtful debts and the remaining assets were to be taken at their book values.

The valuations arising out of the above agreement were goodwill Rs 56,800 and fixtures Rs 10,980.
B and C agreed, as between themselves, to continue the business, sharing profits in the ratio of 3:2 and decided to eliminate goodwill from the balance sheet, to retain the fixtures on the books at the revised value, and to increase the provision for doubtful debts to 6%.
You are required to submit the journal entries necessary to give effect to the above arrangements and to draw up the capital account of the partners after carrying out all adjusting entries as stated above.

Illustration 7
K, L & M are partners sharing profits and losses in the ratio 5:3:2

- Due to illness, L wanted to retire from the firm on 31.03.2015 and admit his son N in his place

Balance Sheet of K, L and M as on 31.3.2015

Liabilities	**Amount (Rs.)**	**Amount (Rs.)**	**Assets**	**Amount (Rs.)**
Capital			Goodwill	30,000
K	40,000		Furniture	20,000
L	60,000			
M	30,000		Trade Receivables	50,000
		1,30,000		

Reserve		50,000	Inventory in Trade	50,000
Trade Payable		20,000		
			Cash and Bank Balances	50,000
		2,00,000		**2,00,000**

On Retirement of L assets were revalued –

- Goodwill Rs. 50,000
- Furniture Rs. 10,000
- Inventory in Trade Rs. 30,000
- 50% of the amount due to L was paid off in cash and the balance was retained in the firm as capital of N

On admission of the new partner, goodwill has been written off

M is paid off his extra balance to make capital proportionate

Required

i. Necessary journal entries

ii. Balance sheet of M/s K, M and N as on 01.04.2015

Capital accounts of partners.

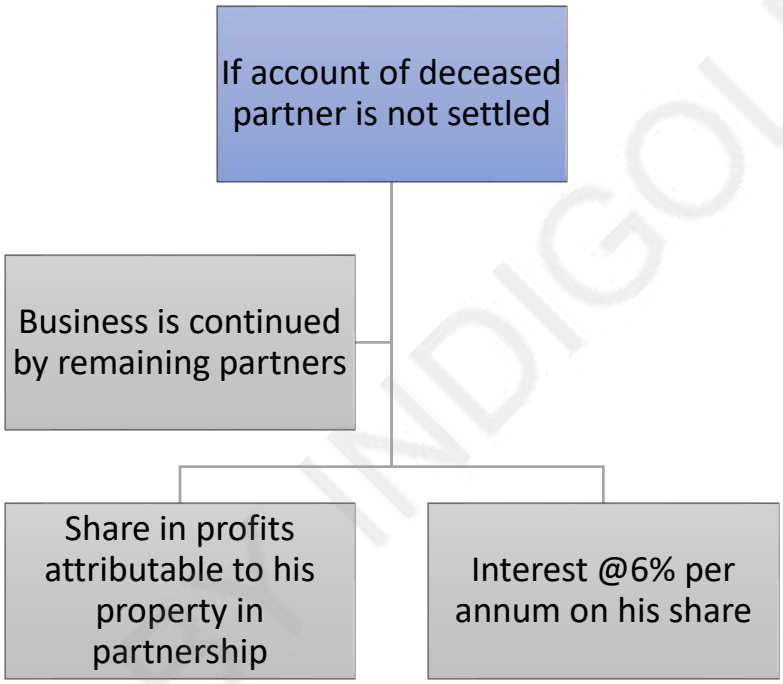
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Unit-5 Death of a Partner

The problems arising on the death of a partner are similar to those arising on retirement
Important Points:

- The revaluation gain/loss belongs to all the partners and is distributed in existing profit sharing ratio.
- The reserves are distributed to all partners in existing profit sharing ratio.
- The goodwill is adjusted on the basis of gain ratio or sacrifice ratio. (Can be done using table adjustment)
- The treatment of Joint Life Policy would be different as the firm would receive the sum assured on the policy.
- The amount due to the deceased partner would be paid to the legal heirs.
- Business may be continued by other partners (also known as reconstitution of partnership)

Right in subsequent profits



Amount payable to legal representatives

1. The amount standing to the credit to the capital account of the deceased partner
2. Interest on capital, if provided in the partnership deed up to the date of death
3. Share of goodwill of the firm;
4. Share of undistributed profit or reserves;
5. Share of profit on the revaluation of assets and liabilities;
6. Share of profit up to the date of death;
7. Share of Joint Life Policy.
8. Share in profits after death if account is not settled

The following amounts will be deducted

1. Drawings
2. Interest on drawings

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3. Share of loss on revaluation of assets and liabilities
4. Share of loss up to the date of death

Settlement

3. The final amount standing to the credit of capital account may be paid in full to the retiring partner.

Retiring Partner Capital A/c … Dr.
To Bank A/c

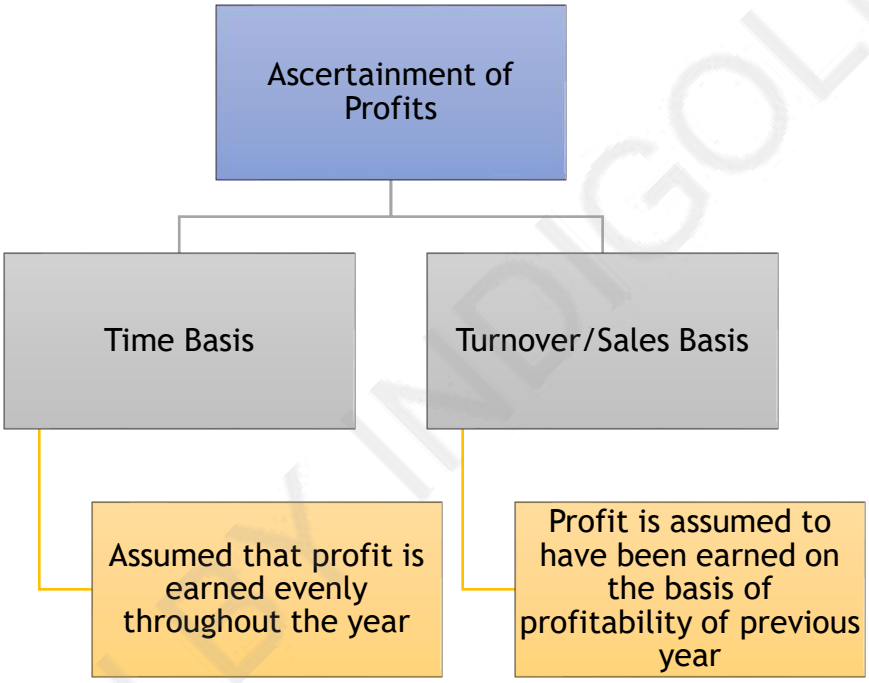
4. If the amount is not settled in full, the balance amount is transferred to loan account.

Retiring Partner Capital A/c … Dr.
To Bank A/c
To Retiring Partner's Loan A/c

The loan is repaid as per the terms of retirement and entries will be passed accordingly.

Calculation of profits up to the death of a partner

- Profit is calculated through P&L Suspense account.
- Amount due to the deceased partner, it should be credited to his Executor's Account.
- The representatives of the deceased partner are entitled to his/her share of profits earned till the date of his/her death



Joint Life Policy

- The firm will receive the sum assured on joint life policy
- The gain on joint life policy will be credited to the partners in profit sharing ratio
- The joint life policy reserve will be credited to the partners in profit sharing ratio

Entry at time of receipt of amount from Joint Life Policy

Bank A/c Dr.
To Joint Life Policy A/c

Entry to transfer gain on Joint Life Policy (balance in JLP)

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Joint Life Policy A/c Dr. (Balance Figure)
To Partner's capital A/c (PSR)

Entry to transfer Joint Life Policy (JLP) reserve

Joint Life Policy Reserve A/c
To Partner's Capital A/c (PSR)

Joint Life Policy – Separate Policy

If the firm has taken separate policy for each partner, then at the time of death of partner,

- The firm will receive sum assured on the policy of deceased partner
- The policy of other partners will be valued at surrender value.

Any gain on account of above will be credited to the continuing partners and executor (legal representative)

Bank A/c Dr.
To Separate Life Policy of Deceased partner A/c

(Policy value received on death of a partner)

Separate Life Policy of Deceased Partner A/c Dr. (Sum Assured)
Separate Life Policy of Remaining Partners A/c Dr. (Surrender Value)
To Executor's A/c
To Remaining partners A/c
(Distribution of balances)

Illustration 1

The following was the Balance Sheet of Om & Co. in which X, Y, Z were partners sharing profits and losses in the ratio of 1:2:2 as on 31.3.2016. Mr. Z died on 31st December 2016. His account has to be settled under the following terms.

Balance Sheet of Om & Co. as on 31.3.2016

Liabilities	Rs.	Assets	Rs.
Trade payables	20,000	Goodwill	30,000
Bank Loan	50,000	Building	1,20,000
General reserve	30,000	Computers	80,000
Capital accounts:		Inventories	20,000
X: 40,000		Trade receivables	20,000
Y: 80,000		Cash at bank	20,000
Z:80,000	2,00,000	Investments	10,000
	3,00,000		3,00,000

Goodwill is to be calculated at the rate of two years purchase on the basis of average of three years profits and losses. The profits and losses for three years were detailed as below:

Year ending on	Profits/loss
31.3.2016	30,000
31.3.2015	20,000
31.3.2014	(10,000) loss

Profit for the period from 1.4.2016 to 31.12.2016 shall be ascertained proportionately on the basis of average profits and losses of the preceding three years. During the year ending on 31.3.2016 a

car costing Rs.40,000 was purchased on 1.4.2015 and debited to traveling expenses account on which depreciation is to be calculated at 20% p.a. this asset is to be brought into account at the depreciated value.
Other values of assets were agreed as follows:
Inventory at Rs.16,000, Building at Rs.1,40,000, Computers at Rs. 50,00; investments at Rs.6,000. Trade receivables were considered good.

Required

i. Calculate goodwill and Z's share in the profits of the firm for the period 1.4.2016 to 31.12.2016
ii. Prepare revaluation account assuming that other items of assets and liabilities remained the same

Prepare partners' capital accounts and balance sheet of the firm Om & Co. as on 31.12.2016.

Illustration 2

The partnership agreement of a firm consisting of three partners- A, B and C (who share profits in proportion of $\frac{1}{2}$ $\frac{1}{4}$ and $\frac{1}{4}$ and whose fixed capitals are Rs.10,000; Rs.6,000 and Rs.4,000 respectively) provides as follows:

a. That partners be allowed interest at 10 per cent per annum on their fixed capitals, but no interest be allowed on undrawn profits or charged drawings.
b. That upon the death of a partner, the goodwill of the firm be valued at two years' purchase of the average net profits (after charging interest on capital) for the three years to 31st December preceding the death of a partner.

That an insurance policy of Rs.10,000 each to be taken in individual names of each partner, the premium is to be charged against the profit of the firm.

a. Upon the death of a partner, he is to be credited with his share of the profits, interest on capitals etc. calculated upon 31st December following his death.
b. That the share of the partnership policy and goodwill be credited to a deceased partner as on 31st December following his death.
c. That the partnership books be closed annually on 31st December.

A died-on 30th September 2016, the amount standing to the credit of his current account on 31st December 2015 was Rs.450 and from that date to the date of death he had withdrawn Rs.3,000 from the business.
An unrecorded liability of Rs.2,000 was discovered on 30th September 2016. It was decided to record it and be immediately paid off.
The trading result of the firm (before charging interest on capital) had been as follows: 2013 profit Rs.9,640; 2014 profit Rs.6,720; Loss Rs.640; 2016 Profit Rs.3,670
Assuming the surrender value of the policy to be 20 percent of the sum assured.

Required

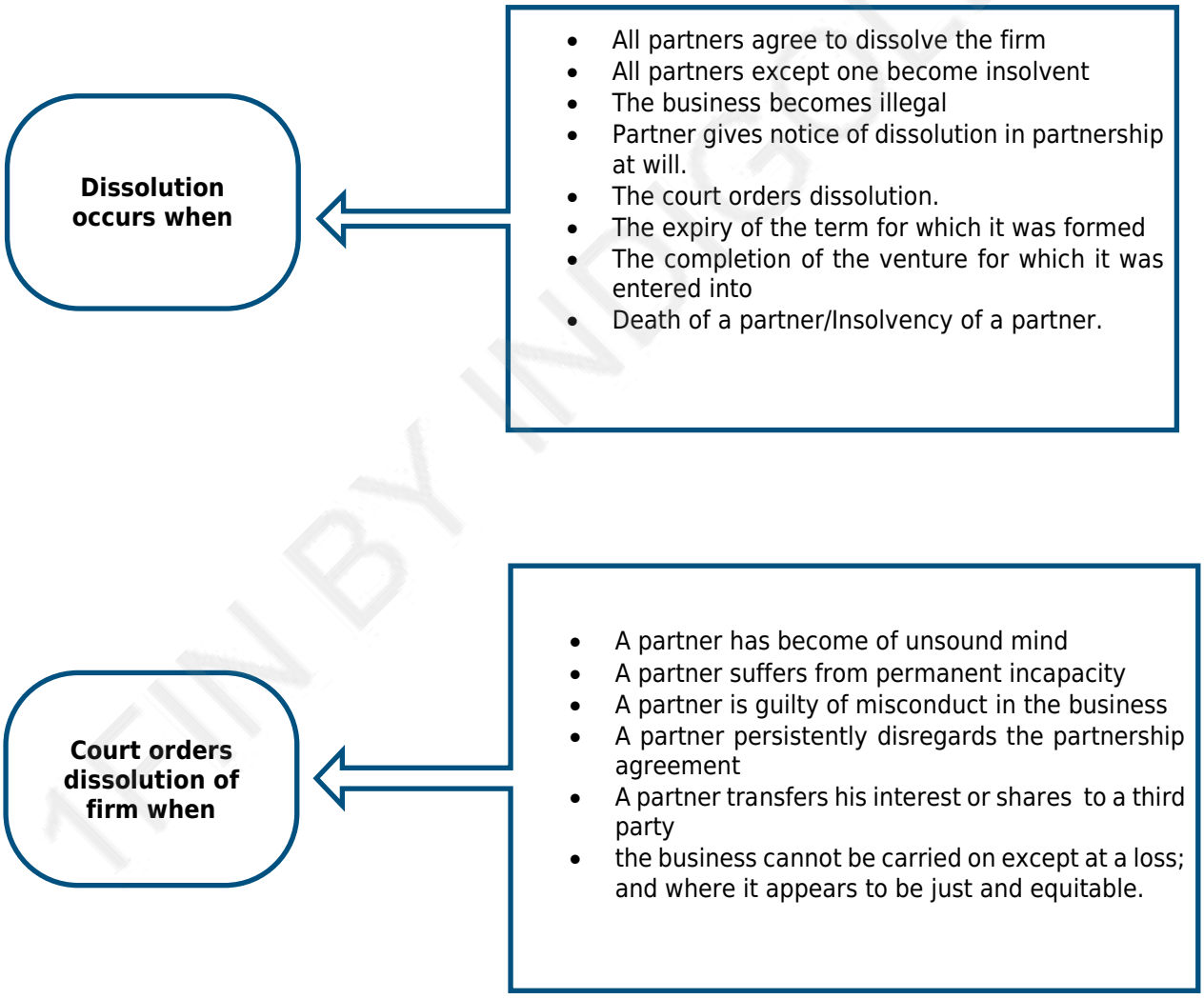
Prepare an account showing the amount due to A's legal representative as on 31st December 2016.

DISSOLUTION OF PARTNERSHIP FIRMS

1. Introduction

One of the important aspects of partnership accounts is to close books of accounts in case of dissolution.
Dissolution of partnership means the ending of the relationship between partners as in the case of admission of a partner.
Dissolution of a Partnership firm means when the business ceases to exist, and also includes dissolution of the partnership as the relation between the partners also comes to an end.
This chapter deals with the accounting for Dissolution.

2. Circumstances of Dissolution



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3. Dissolution of Partnership Vs Partnership Firm

Basis	Dissolution Of Partnership	Dissolution Of Firm
Meaning	Discontinue the relationship between partners or reconstitution of partnership. Eg: Change in profit sharing ratio, admission of partner etc.	The entire firm and the relation between partners cease. Eg: Business becomes illegal
Continuation of Business	Partnership is reconstituted and business continues.	Business comes to an end
Power of Court	No intervention by the court	Court has the power to order the dissolution of a firm.
Economic Relationship	Economic relationship among partners may change or remain the same.	Economic relationship among partners comes to an end.
Revaluation v/s Realization	Assets and liabilities are revalued after the winding up of the existing partnership. Revaluation account is prepared	Assets and liabilities are realized and settled on winding up. Realization account is prepared.
Books of Accounts	Books of accounts are not closed	Books of accounts are closed

4. Consequences of Dissolution

4.1 Section 48 of the Partnership Act

- The assets of the firm including the goodwill are realized initially.
- The assets realized are utilized in the following manner:
  - to pay the debts of third parties
  - to settle loans and advances from partners
  - To repay partners' capital
  - Surplus if any, to be divided in the profit sharing ratio
- Losses including deficiencies of capital are paid;
  - First out of profits
  - Next out of capital
  - If necessary, by partners in their profit sharing ratio

4.2 Dissolution Before the Expiry of a Fixed Period

- Some partners enter the partnership on the condition that the firm will not be dissolved before the expiry of a certain period and pays a premium. This premium or its part is refundable if the firm dissolves earlier. This is borne by other partners in their profit sharing ratio.

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- Exceptions:
  - Dissolution due to the death of a partner
  - Dissolution due to the misconduct of the partner claiming the refund
  - In pursuing an agreement with no provision of refund of premium

5. Closing of Books of the Partnership Firm

Accounts To Be Created

- Realisation A/c ;
- Partner's Loan A/c;
- Partner's capital A/c;
- Cash A/c

Realization a/c

- All assets except cash in hand or at bank are transferred to this account at book values.
- Sundry Debtors and Provisions for Bad Debts Accounts are two separate accounts and the gross amount of debtors should be separately transferred.
- Outsider's liabilities and Reserves or Provisions against Assets are also transferred to Realization A/c, which will also include Partner's spouse loan account.

- If the question is silent about the realization of an asset, it is assumed that the asset has not realized any amount. All liabilities have to be settled in full whether or not mentioned in the question
- If goodwill is already appearing in the balance sheet, it is treated like any other asset and is transferred to the realization account.

JOURNAL ENTRIES

Date	Particulars		Debit (₹)	Credit (₹)
1	**Realization A/c**			
	Transfer of assets			
	Realization A/c	Dr.		
	To Asset A/c			
	Transfer of outside liabilities			
	Liabilities A/c	Dr.		
	To Realization A/c			
	Amount realized from sale of an asset			
	Cash A/c	Dr.		
	To Realization A/c			

	Payment of outside liabilities Realization A/c Dr. To Cash A/c **Asset taken over by the partner at agreed value** Partner's Capital A/c Dr. To Realization A/c **Liability taken over by the partner at agreed value** Realization A/c Dr. To Partner's Capital A/c **Payment of Dissolution Expenses or Realization expenses** Realization A/c Dr. To Cash A/c **Dissolution Expenses borne by Partner** Realization A/c Dr. To Partner's Capital A/c **In case of profit, Closing Realization A/c and transferring profit** Realization A/c Dr. To Partner's Capital A/c **In case of loss, Closing Realization A/c and transferring loss** Partner's Capital A/c Dr. To Realization A/c		

- Investment fluctuation fund is transferred to the credit side of the realization account only if investments are appearing on the asset side. Otherwise, it is credited to the partner's capital account.
- Bank Overdraft is not transferred to Realization A/c, since it should be shown as a negative balance in Bank A/C.

Partner's loan a/c

- Loan taken from a partner will be passed through cash or bank account.
- Loan given to a partner will be transferred (debited) to his capital account.

- If the current account of the partner from whom loan has been taken by the firm, shows a debit balance after all adjustments, his loan account will be transferred to the credit of his capital account to the extent of the debit balance of the capital account.

JOURNAL ENTRIES

Date	Particulars	Debit (₹)	Credit (₹)
2	**Partner's loan A/c** **Payment of Partner's Loan Account** Partner's Loan A/c Dr. To Cash A/c **In case of debit balance of partner's current accounts** Partner's Loan A/c Dr. To Partner's Current Account		

Partner's Capital A/c

- Apart from the realization profit or loss, undistributed profits such as General reserve, P&L account etc are transferred to the partners' capital account.
- Fictitious assets like Debit balance of the P&L account, deferred revenue expenditure etc. should not be transferred to the realization account. Such accounts are transferred to the partner's capital account

JOURNAL ENTRIES

Date	Particulars	Debit (₹)	Credit (₹)
	Transfer of reserves, undistributed profits or fictitious assets **Distribution of Undistributed Profits/ Reserves** Reserves A/c Dr. Profit and Loss A/c (Credit Balance) Dr. To Partner's Capital A/c **Transfer of fictitious assets** Partner's Capital A/c Dr. To Profit and Loss A/c (Debit Balance) To Deferred Expenditure		

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Cash A/c

- The balance of the cash account at the end will be exactly equal to the balance of the capital accounts, provided they are in credit; credit cash and debit the partners' capital account with the amount payable to them to close their accounts.

JOURNAL ENTRIES

Date	Particulars	Debit (₹)	Credit(₹)
4	**BALANCE** **In case of surplus cash balance, paid toward capital** Partner's Capital A/c Dr. To Cash A/c **In case of deficit cash balance, brought in by partners** Cash A/c Dr. To Partner's Capital A/c		

6. Insolvency of a Partner

Any partner who is unable to pay its debts in the usual course of business and has been declared to be insolvent by the appropriate court is an insolvent. The following are the consequences of the insolvency of a partner;

- The partner adjudicated as insolvent ceases to be a partner on the date on which the order of adjudication is made.
- The firm is dissolved on the date of the order of adjudication unless there is a contract to the contrary.
- The estate of the insolvent partner is not liable for any act of the firm after the date of the order of adjudication and,
- The firm cannot be held liable for any acts of the insolvent partner after the date of the order of adjudication.

6.1 Loss arising from Insolvency of a Partner

The share of loss of an insolvent partner is to be borne by other solvent partners following the decision in the English case of **Garner vs. Murray**.

Garner v/s murray

- normal loss on realization of assets to be borne by all partners (including insolvent partner) in the profit-sharing ratio.
- loss due to insolvency of a partner must be borne by the solvent partners in the capital ratio.

Calculation of capital ratio in different scenarios

Scenarios	Consequence
When Capitals are fixed (Fixed Capital Method)	Loss on insolvency is borne by the solvent partners in the ratio of their fixed capitals. All other adjustments are done through their current accounts, which may have a debit or credit balance
When Capitals are not fixed (Fluctuating Capital Method)	The Capital ratio will be determined after adjusting • all the reserves and accumulated profits to the date of dissolution, • all drawings to the date of dissolution, • all interest on capitals and on drawings to the date of dissolution • but before adjusting profit or loss on Realization Account.
A partner has a Debit Balance in his Capital Account (Partner other than the insolvent partner)	Although he is not insolvent, he cannot be called up to bear the loss on insolvency.
When outside liabilities cannot be paid in full • out of firm's assets • out of partners' personal assets	• It is advised not to transfer creditors to Realization A/c • Creditors may be paid the amount available including the amount contributed by the partners. • The remaining portion of the creditor account is transferred to the Capital Accounts of the partners in the profit sharing ratio, then Capital Accounts are closed. • In doing so first close the Partners' Capital Account which is having the worst position. The last account will be automatically closed.

7. Piecemeal payment

Generally, the assets sold upon dissolution of the partnership are realized only in small instalments over a period of time. In such cases, liabilities are settled gradually as cash is received rather than waiting to collect the entire sum. This is the system of Piecemeal Payments. In this system,

- Outside liabilities are settled initially, which includes creditors and thereafter loan from spouse of the partner
- In the next stage, inside liabilities which includes loans from partners are settled.
- Finally, Partners' Capitals are settled by;
    1) Maximum Loss Method OR
    2) Highest Relative Capital Method

Maximum Loss Method

Each instalment realized is considered to be the final payment i.e., outstanding assets and claims are considered worthless, and partners' accounts are adjusted on that basis each time when a distribution is made, following either Garner vs. Murray Rule or the profit-sharing ratio rule.

Highest Relative Capital Method (OR) Proportionate capital method

The partner who has the higher relative capital, that is, whose capital is greater in proportion to his profit-sharing ratio, is first paid off.

Methods - Stepwise

Steps	Maximum possible loss method	Highest relative capital method
Step 1	Adjust the money available with the total amount due to the partners	Ascertain capital per profit sharing unit for each partner (capital balance/ profit sharing ratio)
Step 2	Determine the maximum possible loss assuming there is no more money going to be realized	Determine the capital balance to be maintained by each partner considering the lowest per unit capital as base
Step 3	Distribute the maximum possible loss amongst the partners in their profit-sharing ratio	Determine partners with capital greater in proportion to their profit-sharing ratio and ascertain excess for each such partner

Step 4	If any partner has deficiency (negative balance), distribute the deficiency to the other partners in their capital ratio by applying Garner vs Murray Rule	Compare the excess per unit of profit for all such partners. Ascertain the partner with the largest excess capital following the above procedure
Step 5	The amount left is the value of money to be distributed to the partners from the installment	Pay the partner with the largest excess capital the value of money equivalent to excess capital
Step 6	Subtract the amount from the opening balance and arrive at the revised capital balances. Repeat the above procedure	Pay other partners who have excess capital (amounting to excess capital) until the capital of partners is reduced to their profit-sharing ratio. Distribute the balance money amongst all the partners in profit sharing ratio

NOTE: Total payment made to each partner will be the same under both methods.

8. Limited Liability Partnerships

A limited liability partnership is a body corporate formed and incorporated under the **Limited Liability Partnership Act, 2008**. It has a **separate legal entity** with **perpetual succession** and the change in the partners of a limited liability partnership does not affect the existence, rights, or liabilities of the limited liability partnership.

8.1 Incorporation of LLP

- **Two or more persons** associated
- to carry on a **lawful** business to **earn profits** may
- subscribe their names to an **incorporation document** and
- file the same with the **Registrar of the state** in which the Registered Office of the LLP is to be situated,
- in such manner with such fees as may be prescribed
- along with a **statement** in the prescribed form made
- either by an **advocate, a company secretary or a chartered accountant, or a cost accountant,**
- who is engaged in the formation of LLP
- and by anyone who subscribed his name to the incorporation document,
- that all the requirements of the **LLP Act 2008** and the rules made thereunder have been complied with.

8.2 Important Sections

Section	Title	Law
Section 5	Members	any individual or body corporate may be a partner in an LLP provided he is not; • of unsound mind • undischarged insolvent • applied to be adjudicated insolvent
Section 6	Number Of Members	every LLP should have at least 2 partners if at any time the number of partners is reduced below 2 and the LLP carries on business for more than six months, • the person, who is the only partner during such six months and has the knowledge of the fact • will be liable personally for the obligations of the LLP incurred during that period.
Section 7	Designated Partners	every LLP should have at least two designated partners who are ; • individuals and • at least one should be a resident of India "resident in India" means a person who has stayed in India for **not less than 182** days during the immediately preceding year. where all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at **least two individuals who are partners** of such LLP or **nominees of such body corporate** will act as designated partners.
Section 8	Liabilities of Designated Partners	responsible for the doing of all acts, matters, and things as are required to be done by the LLP, complying with the provisions of the act Eg: filing of any document, return etc. liable to all penalties imposed on the LLP for any contravention of those provisions.

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Section 27	Limitation of liability of an LLP and its Partners	**27 (1)** A LLP is not bound by anything done by a partner in dealing with a person, if: • The partner does **not** have the **authority** to act on behalf of the LLP in doing a particular act; and • The **other person knows** that the partner has no authority or does not know or believe him to be a partner in the LLP **27(2)** The LLP is liable if a partner of the LLP is **liable** to any person due to wrongful or omission on his part in the course of business of the LLP or **with his authority**. **27(3)** An obligation of an LLP arising out of a contract or otherwise, will be **solely** the obligation of the LLP and liabilities met out of the properties of the LLP
Section 28		A partner is not personally liable, directly or indirectly, for an obligation referred to in Section 27 (3) above
Section 30		The liability of the LLP and the partners from **fraud** will be **unlimited** for all or any of the debts or other liabilities of the LLP.
Section 34	Financial disclosures and Returns	**34(1)** Every LLP should maintain such proper books of accounts as may be prescribed relating to its affairs • for each year of its existence • on cash basis or accrual basis and • according to the double entry system of accounting and • maintain at its registered office for the prescribed period **34(2)** within **six months** of the end of each financial year prepare a **Statement of Account and Solvency** as of the last day of the said financial year, in the prescribed form and should be **signed by the designated partners** of the LLP **34(3)** should file within the prescribed time, the Statement of Account and Solvency with the **Registrar every year** in such form and manner and with such fee as may be prescribed **34(4)** accounts of an LLP must be audited in following such rules.

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Section 35		Every LLP is required to file an Annual Return which is • duly authenticated with the registrar • within **sixty days** of the closure of its financial year • in such form and manner and with such fees as may be prescribed.
Section 55	Conversion of Firm into Limited Liability Partnership	A **firm** may convert into an LLP in accordance with the provisions of the Act and the **Second Schedule** to the Act.
Section 56		A **private limited company** may convert into an LLP in accordance with the provisions of the Act and the **Third Schedule** to the Act.
Section 57		An **unlisted public limited company** may convert into an LLP in accordance with the provisions of the Act and the **Fourth Schedule** to the Act.
Section 63	Winding up and Dissolution	an LLP may be wound up • voluntarily or • by the Tribunal • and such LLP so wound up may be dissolved
Section 64		LLP may be wound up by the Tribunal if • the LLP decides • number of partners remain less than two for more than six months • unable to pay its debts; • acted against the interests of the integrity and sovereignty of India, the security of the state or public order; • defaulted in the filing of the Statement of Account and Solvency with the Registrar for **five consecutive financial years**; • the Tribunal believes that it is just and equitable that the LLP be wound up.

9. Summary

- Dissolution of partnership occurs when the relationship between the partners comes to an end
- Dissolution of partnership firm occurs when the business ceases to exist.

- Realization account is prepared and profit or loss is transferred to the Partners' Capitals.
- In case of Insolvency of a partner Garner vs Murray rule is followed.

Garner v/s murray

- normal loss on realization of assets to be borne by all partners (including insolvent partner) in the profit sharing ratio
- loss due to insolvency of a partner has to be borne by the solvent partners in the capital ratio.

10. Illustrations

1. Illustration

X, Y and Z are partners of the firm XYZ and Co., sharing Profits and Losses in the ratio of 4 : 3 : 2. Following is the Balance Sheet of the firm as at 31st March, 20X1:

Balance Sheet as at 31st March, 20X1

Liabilities	Rs.	Assets	Rs.
Partners' Capitals:		Fixed Assets	5,00,000
X	4,00,000	Stock in trade	3,00,000
Y	3,00,000	Sundry debtors	5,00,000
Z	2,00,000	Cash in hand	10,000
General Reserve	90,000		
Sundry Creditors	3,20,000		
	13,10,000		**13,10,000**

1. Partners of the firm decided to dissolve the firm on the above said date.
2. Fixed assets realised Rs. 5,20,000 and book debts Rs. 4,40,000.
3. Stocks were valued at Rs. 2,50,000 and it was taken over by partner Y.
4. Creditors allowed discount of 5% and the expenses of realisation amounted to Rs. 6,000.

You are required to prepare:

(i) Realisation account;

(ii) Partners capital account; and

(iii) Cash account

Solution 1

Realisation A/c

Particulars	₹	Particulars	₹
To Fixed Assets	5,00,000	By Creditors	3,20,000
To Stock in trade	3,00,000	By Cash	5,20,000
To Sundry debtors	5,00,000	By cash	4,40,000
To Cash A/c	3,04,000	By Partner's capital A/c	2,50,000
To Cash A/c	60,000	By loss (transferred to Partner's capital A/c in 4:3:2)	80,000
	16,10,000		16,10,000

Particulars	X	Y	Z	Particulars	X	Y	Z
To Realisation A/c	35,555	25,000 26,667	17,778	By Balance B/d	4,00,000 40,000	3,00,000 30,000	2,00,000 20,000
To Realisation A/c [80,000 loss in 4:3:2]	4,04,445	53,333	2,02,222	By General reserve [90,000 in 4:3:2]			
To Cash A/c	4,40,000	3,30,000	2,20,000		4,40,000	3,30,000	2,20,000

Partners Capital Account

Cash A/c

Particulars	₹	Particulars	₹
To Balance B/d	10,000	By Realisation A/c	3,04,000
To Realisation A/c	5,20,000	[95% of 3,20,000]	6,000
To Realisation A/c	4,40,000	By Realisation A/c	4,04,445
		By X's Capital A/c	53,333
		By Y's Capital A/c	2,02,222
		By Z's Capital A/c	
	9,70,000		9,70,000

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2. Illustration

P, Q and R were partners sharing profits and losses in the ratio of 3 : 2 : 1, no partnership salary or interest on capital
being allowed. Their balance sheet on 30th June, 20X1 is as follows:

Liabilities		Rs.	Assets	Rs.
Fixed Capital			Fixed assets:	
P	20,000		Goodwill	40,000
Q	20,000		FreeholdProperty	8,000
R	10,000	50,000	Plant and Equipment	12,800
Current Accounts:			Motor Vehicle	700
P	500		Current Assets	
Q	9,000	9,500	Stock	3,900
Loan from P		8,000	TradeDebtors 2,000	
Trade Creditors		12,400	Less: Provision (100)	1,900
			Cash at Bank	200
			Miscellaneouslosses	
			R's CurrentAccount	400
			Profit and LossAccount	12,000
		79,900		**79,900**

On 1st July, 20X1 the partnership was dissolved. Motor Vehicle was taken over by Q at a value of Rs. 500 but no cash passed specifically in respect of this transaction.
Sale of other assets realised the following amounts:

	Rs.
Goodwill	nil
Freehold Property	7,000
Plant and Equipment	5,000
Stock	3,000
Trade Debtors	1,600

Trade Creditors were paid Rs. 11,700 in full settlement of their debts. The costs of dissolution amounted to Rs. 1,500.
The loan from P was repaid, P and Q were both fully solvent and able to bring in any cash required but R was forced into bankruptcy and was only able to bring 1/3 of the amount due.
You are required to show:
(a) Cash and Bank Account,
(b) Realisation Account, and
(c) Partners Fixed Capital Accounts (after transferring Current Accounts' balances).

Solution 2

Realisation A/c

Particulars	₹	Particulars	₹
To Goodwill	40,000	By Loan from P	8,000
To Freehold property	8,000	By Trade Creditors	12,400
To Plant & Equipment	12,800	By Provisions	100
To Motor vehicle	700	By Q's Capital A/c	500
To Stock	3,900	By Cash/Bank A/c (Asset sale)	16,600
To Trade Debtors	2,000	By Loss (B.F)	51,000
To Cash/Bank A/c (Creditors)	11,700	(Transferred to Partner's	
To Cash/Bank A/c (Expenses)	1,500	Capitals)	
To Cash/Bank A/c (P's Loan)	8,000		
	88,600		**88,600**

Garner vs Murray Rule

- **Realisation Loss**: Divide in Profit sharing ratio as given in the Deed. Solvent Partners to get their share in cash.
- **Deficiency**: Divide amongst other partners in ratio of Capitals after few adjustments.

Cash A/c

Particulars	₹	Particulars	₹
To Balance B/d	200	By Realisation A/c (Creditors Paid)	11,700
To Realisation A/c (Asset sale) [7,000 + 5,000 + 3,000 + 1,600]	25,500	By Realisation A/c (Expenses)	1,500
		By Realisation A/c (P's Loan)	8,000
To P's Capital A/c	17,000	By P's Capital A/c	14,200
To Q's Capital A/c	300	By Q's Capital A/c	24,200
To R's Capital A/c			
	9,70,000		9,70,000

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		Partner's Capital Account					
Particulars	**P**	**Q**	**R**	**Particulars**	**P**	**Q**	**R**
To Current A/c			400	By Balance B/d	20,000	20,000	10,000
To Profit and loss A/c	6,000	4,000	2,000	By Current A/c	500	9,000	
[12,000 in 3:2:1]	25,500	17,000	8,500	By Cash/Bank A/c	25,500	17,000	
To Realisation A/c		500		By Cash/Bank A/c			300
To Realisation Loss [3:2:1]	300	300		By P's Capital A/c (W.N:1)			300
To R's Capital A/c	14,200	24,200		By Q's Capital A/c (W.N:1)			300
To Cash A/c (B.F)	46,000	46,000	10,900		46,000	46,000	10,900

Working Note: 1

Bal. Fig in R's Capital -> 900		
1/3	2/3	
Cash = 300	Deficiency = 600	
	In the Ratio of Fixed Capital A/c (20,000:20,000) = (1:1)	
	P	Q
	₹300	₹300

3. Illustration

Amal and Bimal are in equal partnership. Their Balance Sheet stood as under on 31st March, 20X1 when the firm was dissolved:

Liabilities	Rs.	Assets	Rs.
Creditors A/c	4,800	Plant & Machinery	2,500
Amal's Capital A/c	750	Furniture	500
		Debtors	1,000
		Stock	800
		Cash	200
		Bimal's drawings	550
	5,550		**5,550**

The assets realised as under:

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Asset	Rs.
Plant & Machinery	1,250
Furniture	150
Debtors	400
Stock	500

The expenses of realisation amounted to Rs. 175. Amal's private estate is not sufficient even to pay his private debts, whereas Bimal's private estate has a surplus of Rs. 200 only.
Show necessary ledger accounts to close the books of the firm.

Solution 3

Realisation A/c

Particulars	₹	Particulars	₹
To Plant & Machinery	2,500	By Cash (1,250+150+400+500)	2,300
To Furniture	500	By Partner's Capital (Bal.Fig)	2,675
To Debtors	1,000	[Realisation loss]	
To Stock	800		
To Cash (Expenses)	175		
	4,975		4,975

Cash A/c

Particulars	₹	Particulars	₹
To Balance B/d	200	By Realisation A/c	175
To Realisation A/c	2,300	By Creditors A/c (Bal.Fig)	2,525
To Bimal's Capital A/c	200		
	2,700		2,700

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Partner's Capital Account

Particulars	Amal	Bimal	Particulars	Amal	Bimal
To Balance B/d		550	By Balance B/d	750	
To Realisation A/c [2,675 in 1:1]	1,337	1,338	By cash A/c		200
			By Deficiency A/c (Bal.Fig)	587	1.688
	1,337	1,888		1,337	1,888

Sundry Creditors A/c

Particulars	₹	Particulars	₹
To Cash A/c	2,525	By Balance B/d	4,800
To Deficiency A/c (Bal.Fig)	2,275		
	4,800		4,800

Deficiency A/c

Particulars	₹	Particulars	₹
To Amal's Capital A/c	587	By Sundry creditors A/c	2,275
TO Bimal's Capital A/c	1,688		
	2,275		2,275

4. Illustration

M/s X, Y and Z who were in partnership sharing profits and losses in the ratio of 2:2:1 respectively, had the following Balance Sheet as at December 31, 20X1:

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital :X	29,200		Fixed Assets		40,000
Y	10,800		Stock		25,000
Z	10,000	50,000	Book Debts	25,000	
Z's Loan		5,000	Less : Provision	(5,000)	20,000
Loan from Mrs. X		10,000	Cash		1,000
Sundry Trade Creditors		25,000	Advance to Y		4,000
		90,000			**90,000**

The firm was dissolved on the date mentioned above due to continued losses

- After drawing up the balance sheet given above, it was discovered that goods amounting to Rs. 4,000 have been purchased in November, 20X1 and had been received but the purchase was not recorded in books.
- Fixed assets realised Rs. 20,000; Stock Rs. 21,000 and Book Debt Rs. 20,500.
- Similarly, the creditors allowed a discount of 2% on the average.
- The expenses of realisation come to Rs. 1,080.
- X agreed to take over the loan of Mrs. X.
- Y is insolvent, and his estate is unable to contribute anything.

Give accounts to close the books; work according to the decision in Garnervs. Murray.

Solution 4

Realisation A/c

Particulars	₹	Particulars	₹
To Fixed Assets	40,000	By Z's Loan	5,000
To Stock	25,000	By Sundry Creditors	25,000
To Book Debts	25,000	By Provision	5,000
To Cash	28,420	By Sundry Creditors –	4,000
To Cash	1,080	(Unrecorded liability)	
To Cash (Z's Loan)	5,000	By Cash (20,000 + 21,000 + 20,500	61,500
		By Loss – Transferred to	24,000
	1,24,500	Partners Capital (Bal. Fig)	1,24,500

Cash A/c

Particulars	₹	Particulars	₹
To Balance B/d	1,000	By Realisation A/c	28,420
To Realisation A/c	61,500	By Realisation A/c	1,080
To X's Capital A/c [Cash	9,600	By Realisation A/c	5,000
for loss]	4,800	By X's Capital A/c	34,300
To Y's Capital A/c [Cash		BY Z's Capital A/c	8,100
for loss]	76,900		76,900

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		Partner's Capital Account					
Particulars	**X**	**Y**	**Z**	**Particulars**	**X**	**Y**	**Z**
To Y's Advance	-	- 4,000		By balance	29,200	10,800	10,000
To Creditors	1,600	1,600	800	B/d	10,000		-
Unrecorded [4,000 in 2 : 2 : 1]	9,600	9,600	4,800	By Mrs X's loan	9,600	- 3,300	4,800
To Realisation Loss {2:2:1)	3,300	-	1,100	By Cash		1,100	
To Y's Capital	34,300		8,100	By X's Capital			
To Cash	48,800	15,200	14,800	BY Z's Capital	48,800	15,200	14,800

Working Note: 1

Purchases – Unrecorded

Trading ,Profit and loss A/c To Creditors A/c	Dr	4,000	 4,000

- ₹ 4,000 will reduce profits, it should be debited to Partner's Capital A/c => 4,000 (in 2 : 2 :1 ratio).
- Creditors increased by ₹ 4,000.

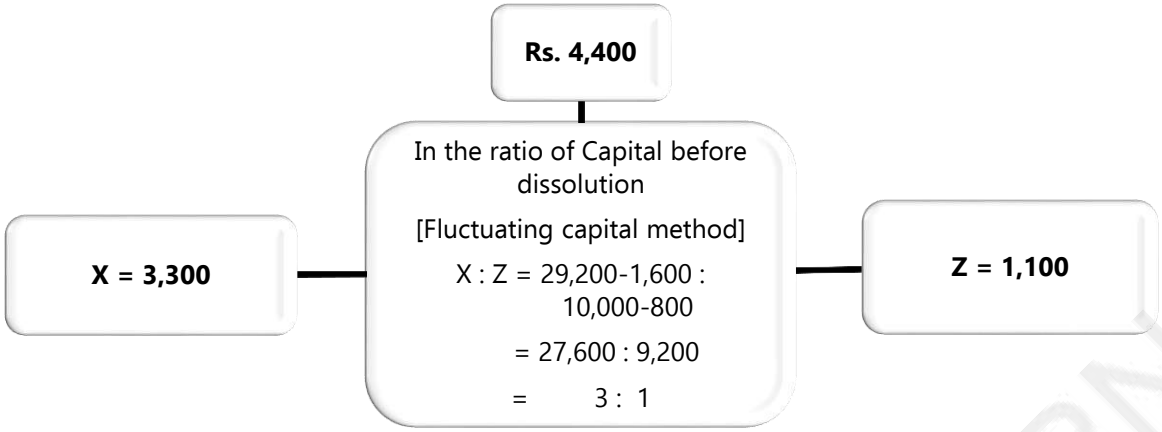
Working Note: 2

Creditors

Creditors	25,000
(+) Unrecorded Creditors	4,000
	29,000
(98% of 29,000) – Cash paid	28,420

Working note: 3

⇨ Y's Deficiency [after all adjustment] => 16,000 + 4,000 + 9,600 = ₹4,400



5. Illustration (5&6)

The following is the Balance Sheet of A, B, C on 31st December, 20X1 when they decided to dissolve the partnership:

Liabilities	Rs.	Assets	Rs.
Creditors	2,000	Sundry Assets	48,500
A's Loan	5,000	Cash	500
Capital Accounts:			
A	15,000		
B	18,000		
	49,000		**49,000**

The assets realised the following sums in instalments:

I	1,000
II	3,000
III	3,900
IV	6,000
V	20,100
	34,000

The expenses of realisation were expected to be Rs.500 but ultimately amounted to Rs.400 only. Show how at each stage the cash received should be distributed between partners. They share profits in the ratio of 2:2:

Solution 5

Maximum Loss Method

- **Statement showing Realisation and Distribution**

Particulars	Amount Realised	Creditors	Partner's (A's) Loan	Partner's Capital
Balance payable (Due)	-	2,000	5,000	42,000

1st Instalment	1,000	(1,000)	-	-
		1,000	**5,000**	**42,000**
2nd Instalment	3,000	(1,000)	(2,000)	-
		0	**3,000**	**42,000**
3rd Instalment	3,900	-	(3,000)	(900)
		-	**0**	**41,100**
4th Instalment	6,000	-	-	(6,000)
		-	**-**	**35,100**
5th Instalment	20,100	-	-	(20,100)
Deficiency / Loss	**-**	**-**	**-**	**15,000**

** Includes savings in expenses i.e. Rs.100 (Rs.500-Rs.400)*

- **Statements showing Realisation and Distribution of cash to Partners**

❖ **Distribution of ₹900 (3rd Instalment)**

Particulars	**Amount**	**A**	**B**	**C**
Balance payable (Due)	42,000	15,000	18,000	9,000
Balance from 3rd instalment	(900)			
Maximum possible loss (Divided into 2 :2 :1)	**41,100**	(16,440)	(16,440)	(8,220)
		(1,440)	**+ 1,560**	**+780**
A's Deficiency split between B&C in their capital ratio of 18 : 9 as per Garner vs Murray		+ 1,440	(960)	(480)
Actual pay out (Balance available and to be distributed)		0	600	300
Closing Capital after 3rd Instalment	**41,100**	**15,000**	[18,000-600] **17,400**	[9,000-300] **8,700**

❖ **Distribution of ₹6,000 (4th Instalment)**

Particulars	**Amount**	**A**	**B**	**C**
Capital balance	41,100	15,000	17,400	8,700

4th instalment	(6,000)			
Maximum possible loss (Divided into 2 :2 :1)	**35,100**	(14,040)	(14,040)	(7,020)
Actual pay out (Balance available and to be distributed)		**960**	**3,360**	**1,680**
Closing Capital after 4th Instalment	**35,100**	=15,000-900 =**14,040**	=17,400-3,360 =**14,040**	=8,700-1,680 =**7,020**

❖ **Distribution of ₹20,000 (5th Instalment)**

Particulars	**Amount**	**A**	**B**	**C**
Capital balance	35,100	14,040	14.040	7,020
5th instalment	(20,100)			
Maximum possible loss (Divided into 2 :2 :1)	**15,000**	(6,000)	(6,000)	(3,000)
Actual pay out (Balance available and to be distributed)		**8,040**	**8,040**	**4,020**
Closing Capital after 4th Instalment	**15,000**	**=14,040-8,040 =6,000**	**=14,040-8,040 =6,000**	**=7,020-4,020 =3,000**

Summary

Particulars	**Amount Realised**	**Creditors**	**Partner's (A's) Loan**	**A**	**B**	**C**
Opening balance	-	2,000	5,000	15,000	18,000	9,000
• 1st Instalment	1,000	(1,000)	-	-	-	-
• 2nd Instalment	3,000	(1,000)	(2,000)	-	-	-
• 3rd Instalment	3,900	-	(3,000)		(600)	(300)
• 4th Instalment	6,000	-	-	**(960)**	**(3,360)**	**(1,680)**
• 5th Instalment	20,100	-	-	**(8,040)**	**(8,040)**	**(4,020)**

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Deficiency / Loss	**-**	**-**	**-**	**6,000**	**6,000**	**3,000**

6. Illustration (Same as 5th)

Solution 6

Highest Relative Capital Mthod

Statement showing Realisation and Distribution

Particulars	Amount Realised	Creditors	Partner's (A's) Loan	Partner's Capital
Balance payable (Due)	-	2,000	5,000	42,000
1st Instalment	1,000	(1,000)	-	-
		1,000	**5,000**	**42,000**
2nd Instalment	3,000	(1,000)	(2,000)	-
		0	**3,000**	**42,000**
3rd Instalment	3,900	-	(3,000)	(900)
		-	**0**	**41,100**
4th Instalment	6,000	-	-	(6,000)
		-	**-**	**35,100**
5th Instalment	20,100	-	-	(20,100)
Deficiency / Loss	**-**	**-**	**-**	**15,000**

Statement showing basis for calculation of distribution of cash

Particulars	A	B	C
a) Capital	15,000	18,000	9,000
b) PSR	2	2	1
c) Capital per unit of profit (a) ÷ (b)	7,500*	9,000	9,000
d) Taking A's Capital as base [7,500 x (b)] (i.e. Lowest capital)*	15,000	15,000	7,500
e) Excess (a) – (d)	**0**	**3,000**	**1,500**
f) PSR	2	2	1

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g) Excess per unit of profit (e) ÷ (f)	-	**1,500**	**1,500**

Conclusion

1) 3,000 + 1,500 = 4,500. => 1st 4,500 towards Partner's capital will be divided among B:C in 2:1 ratio.
2) Subsequent amount will be divided among A : B : C in 2 : 2 : 1 ratio.

Statement showing distribution of cash to partners

Particulars	Amount	A	B	C
3rd Instalment B : C => 2 : 1	900	-	600	300
4th Instalment • 4,500 - 900 = 3,600 (B:C=>2:1) • 6,000 - 3,600 = 2,400 (2 :2 :1)	6,000	- 960	2,400 960	1,200 480
5th instalment (2 : 2 : 1)	20,100	8,040	8,040	4,020
Total Pay out	**27,000**	**9,000**	**12,000**	**6,000**

7. Illustration

Ajay Enterprises, a Partnership firm in which A,B and C are three partners sharing profits and losses in the ratio of 4 : 3 : 3. the balance sheet of the firm as on 31st December, 20X1 is as below:

Liabilities	Rs.	Assets	Rs.
A' s Capital	15,000	Factory Building	24,160
B' s Capital	7,500	Plant & Machinery	16,275
C' s Capital	15,000	Debtors	5,400
B' s Loan	4,500	Stock	12,390
Sundry Creditors	16,500	Cash at Bank	275
	58,500		**58,500**

On balance sheet date all the three partners have decided to dissolve their partnership. Since the realisation of assets was protracted, they decided to distribute amounts as and when feasible and for this purpose they appoint C who was to get as his remunerations 1% of the value of the assets realised other than cash at Bank and 10% of the amount distributed to the partners.
Assets were realised piecemeal as under:

First instalment	Rs. 18,650
Second instalment	Rs. 17,320
Third instalment	Rs. 10,000
Last instilment	Rs. 7,000
Dissolution expenses were provided for estimatedamount of	Rs. 3,000
The creditors were settled finally for	Rs. 15,900

Prepare a statement showing distribution of cash amongst the partners by 'Higher Relative Capital Method'

Solution 7

- **Statement showing Distribution of Cash**

Particulars	Amount Realised	Expenses	Commission on sale of assets	Creditors
Balance payable (Due)	-	N/A	N/A	16,500
1st Instalment **(WN: 1)**	18,925	3,000	187	(15,738)
2nd Instalment **(WN: 2 & 5)**	17,320	-	173	**(162)**
3rd Instalment **(WN : 3 & 6)**	10,000	-	100	-
4th Instalment **(WN: 4)**	7,000	-	70	-
Closing balance	-	N/A	N/A	600*

⇨ *600 is a gain transferred to P & L A/c

Partner's Loan	Commission from Payment to Partners	A	B	C
4,500	N/A	15,000	7,500	15,000
-	-	-	-	-
(4,500)	1,135	(4,343)	-	**(7,007)**

				[3,750 + 3,257]
-	900	(3,797) [657 + 3,140]	(2355)	(2,848) [493 + 2,355]
-	630	(2,520)	(1,890)	(1,890)
0	N/A	4,340	3,255	3,255

➔ Loss suffered by Partners : A = 4,340
B = 3,255
C = 3,255

Highest Relative Capital method

Statement showing basis for calculation of distribution of cash to Partners

Particulars	A	B	C
a) Capital	15,000	7,500	15,000
b) PSR	4	3	3
c) Capital per unit of profit (a) – (b)	3,750	2,500	5,000
d) Revised capital taking B's capital as base [2,500 x (b)]	10,000	7,500	7,500
e) Excess (a) – (d)	**5,000**	**-**	**7,500**
f) Excess per unit of profit (e) ÷ (b)	1,250	-	2,500
g) Excess consideration taking A's excess as base	1,250 x 4 = 5,000	-	1,250 x 3 =3,750
h) C's excess over A (e) – (g)	**-**	**-**	**3,750**

Conclusions:

1) 1st 3,750 to C only
2) Next 5,000 + (7,500 – 3,750) = 8,750 to A & C in 4 : 3
3) Balance will be paid to A : B : C in 4 : 3 : 3

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Working note: 1

1st installment

Sale amount = 18,650

(+) cash balance = 275

= 18,925

- 3,000 expenses
- 18,650 x 1% = 187 [Remuneration or Commision on sale of asset]
- Balance = 18,925 - 3,000 - 187 = 15,738
  (-) Creditors = (15,738) = 0
  Balance payable to Creditors (15,900 - 15,738) is Rs. 162

Working note: 2

2nd Instalment : 17,320

- 17,320 x 1% = 173 [Remuneration or Commision on sale of asset]
- Sundry Creditors = 162 **(WN: 1)**
- Balance = 17,320 - 173 - 162 = 16,985
  (-) Partners Loan = (4,500)
  =12,485
  - a) 12,485 x (10/110) = 1,135 (commission)
  - b) 12,485 x (100/110) = 11,350 (Partners payment)

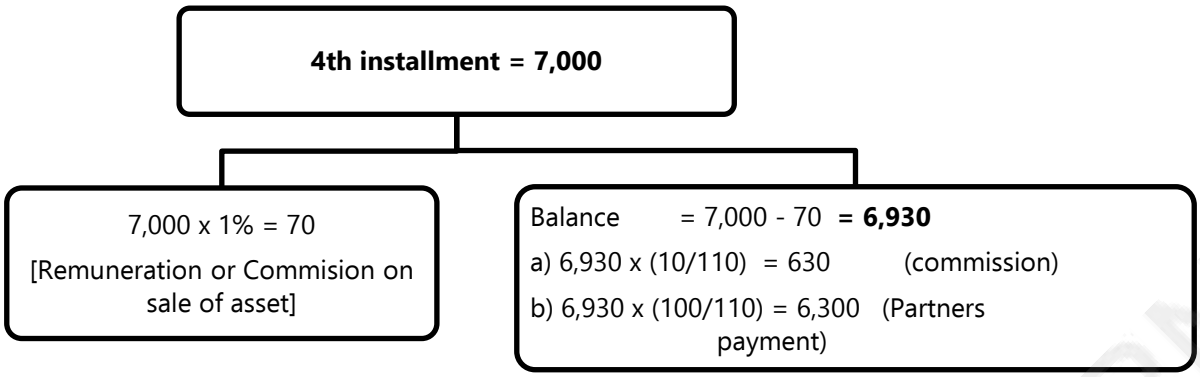
Working note: 3

3rd installment = 10,000

- 10,000 x 1% = 100 [Remuneration or Commision on sale of asset]
- Balance = 10,000 - 100 **= 9,900**
  a) 9,900 x (10/110) = 900 (commission)
  b) 9,900 x (100/110) = 9,000 (Partners payment)

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Working note: 4



Working Note: 5

Particulars	₹
Total 2nd Instalment	17,320
Less : Commission and B's Loan	(5,970)
Balance after Commission and B's loan	**11,350**
Less : First payment from balance to C (as per conclusion 1)	(3,750)
Balance available after payment to C	**7,600**

- This 7,600 will be split in 4 : 3 ration to A & C as per conclusion (2)
- A = 7,600 x 4/7 = 4,343
- C = 7,600 x 3/7 = 3,257

Working Note: 6

Particulars	₹
3rd Instalment	10,000
Less: Remuneration	**(1,000)**
Balance available	9,000
Less: Balance of ₹1,150 [(8,750 – 7,600) as per conclusion (2)] split among A & C in 4 : 3	(1,150)
Balance available	7,850

- The balance ₹7,850 will be split among A & B & C on 4 : 3 : 3 [3,140 : 2,355 : 2,355]

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8. Illustration

The partners A, B and C have called you to assist them in winding up the affairs of their partnership on 30th June 20X1. Their Balance Sheet as on that date is given below:

Liabilities	Amount (₹)	Assets	Amount (₹)
Sundry Creditors	17,000	Cash at Bank	6,000
Capital Accounts		Sundry Debtors	22,000
A	67,000	Stock in trade	14,000
B	45,000	Plant and Equipment	99,000
C	31,500	Loan-A	12,000
		Loan-B	7,500
	1,60,500		**1,60,500**

(1) The partners share profit and losses in the ratio of 5:3:2
(2) Cash is distributed to the partners at the end of each month
(3) A summary of liquidation transactions are as follows:

- **July 20X1**
  - ₹ 16,500 collected from Debtors, balance is uncollectable.
  - ₹ 10,000 received from sale of entire stock.
  - ₹ 1,000 liquidation expenses paid.
  - ₹ 8,000 cash retained in the business at the end of the month.
- **August 20X1**
  - ₹ 1,500 liquidation expenses paid.
  - As part payment of his Capital, C accepted a piece of equipment for ₹ 10,000 (book value ₹ 4,000).
  - ₹ 2,500 cash retained in the business at the end of the month.
- **September 20X1**
  - ₹ 75,000 received on sale of remaining plant and equipment.
  - ₹ 1,000 liquidation expenses paid. No cash retained in the business.

Required : Prepare a schedule of cash payments as of September 30, showing how the cash was distributed under 'Highest Relative Capital Method'

Solution 8

Statement of Distribution of Cash

Particulars	Creditors	Partner's Capital		
		A	B	C
Balance Due	17,000	67,000	45,000	31,500
(-) Loan to Partners		(12,000)	(7,500)	-

		17,000	**55,000**	**37,500**	**31,500**
Opening Cash + Sale of Stock + Debtors Collection (-) Liquidation expenses (-) Closing cash	6,000 10,000 16,500 (1,000) (8,000)				
Distribution **(WN:1)**	**23,500**	(17,000)	-	-	(6,500)
Revised balance		**0**	**55,000**	**37,500**	**25,000**
August Opening Cash (-) Liquidation expenses (-) Closing Cash	8,000 (1,500) (2,500)	-	-	(4,000)	(10,000) assets
Cash	**4,000**				
Revised balance		**0**	**55,000**	**33,500**	**15,000**
September Opening Cash (+) Inflows (-)Liquidation expenses		2,500 75,000 (1,000)			
Distribution **(WN: 2)** • 1st 500 to B • Next 28,000 => A:B in 5:3 • Next 48,000 => A:B:C in 5:3:2		76,500	- (17,500) (24,000)	(500) (10,500) (14.400)	- - (9,600)
Loss			**13,500**	**8,100**	**5,400**
Total Payment			**41,500**	**25,400**	**9,600**

Working note: 1

Particulars	**A**	**B**	**C**
1) Bal. Net of Loan	55,000	37,500	31,500
2) PSR	5	3	2
3) Capital / Unit of Profit **(1)** ÷ **(2)**	11,000 (Lowest)	12,500	15,750
4) Revised Capitals - taking 'A' as Base **[11,000* x (2)]**	55,000	33,000	22,000
5) Excess **(1) – (4)**	0	4,500	9,500

6) PSR	-	3	2
7) Excess / Unit of Profit **(5) ÷ (6)**	-	1,500	4,750
8) Revised Excess –taking B's excess as base	-	4,500 (1,500 x 3)	3,000 (1,500 x 2)
9) Excess of C's capital over B [(5) –(9)]	-	-	6,500

Conclusions:

1) Till ₹6,500*, only 'C' will take
2) Combining excess of B & C = 4,500 + 9,500
   = 14,000
   14,000 – 6,500* = 7,500 will be split between B & C in 3 : 2
3) Thereafter, A : B : C in 5 : 3 : 2

Working Note: 2

Revised Calculation for September

Particulars	A	B	C
1) Opening Capitals	55,000	33,500	15,000
2) PSR	5	3	2
3) Capital / Share of Profit **(1)÷(2)**	11,000	11,167	7,500* (Lowest)
4) Revised Capitals - taking 'C' as Base **[7,500* x (2)]**	37,500	22,500	15,000
5) Excess **(1) – (4)**	17,500	11,000	-
6) PSR	5	3	-
7) Excess / Share of Profit **(5)÷(6)**	3,500	3,667	-
8) Revised Excess –taking A's excess as base	17,500	10,500 (3,500 x 3)	-
9) Excess of B's capital over A [(5) –(9)]	-	500	-

Conclusions

1) 500 => only B
2) Next (17,500 + 11,000 – 500) = 22,000 => A : B in 5 : 3
3) Thereafter, A : B : C in 5 : 3 : 2

Chapter – 11 Company Accounts

Unit-1 INTRODUCTION

TYPES OF COMPANIES



Ownership	• Government • Foreign • Private • Public
Size	• One Person • Small
Listing (on Stock Exchange)	• Listed • Unlisted
Liability	• Limited by Guarantee • Limited by Shares • Unlimited
Holding	• Holding • Subsidiary

Prepraration of Financial Statements	Balance Sheet
	Statement of Profit & Loss
	Cash Flow Statement
	Notes to Accounts

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COMPANY

A Company is a separate legal entity registered under Companies Act, 2013

Company consists of individuals, called shareholders by virtue of holding the shares of a company,

Shareholders are authorised by law to elect a board of directors

Through Board of Directors , the Companyt performs its activities as an artificial person.

2. SALIENT FEATURES

Incorporated Association - Invisible/ Intangible / Existing only in the eyes of law

A company comes into existence only through registration under Companies Act. It is regarded as an **artificial legal person.**

Separate Legal Entity

A company **can contract, sue and be sued in its incorporated name** and capacity.

Perpetual Existence

Existence independent of its members. It continues to be in existence despite the death, insolvency or change of members

Common Seal

Company is not a natural person. In order to enable the company to sign its documents, it is provided with a legal tool called 'Common Seal'..

Limited Liability

The liability of every shareholder is limited to the amount he has agreed to pay (fully paid up value of shares) to the company on the shares allotted to him.

Distinction between ownership and management

Ownership – Shareholders;

Management: Board of Directors, appointed by the shareholders

- Why 'Company' form of organisation?

Large amount of money, modern technology, large human contribution etc. is required to increase the scale of operations so as to provide goods and services to the ever-increasing needs of the growing population of consumers, which is not possible to arrange under partnership or proprietorship. This led to the inception of the concept of 'Company' or 'Corporation'.

3. TYPES OF COMPANIES

1. **Government Company** - Section 2(45) of the Companies Act, 2013
   - Any Company in which **not less than fifty-one per cent of the paid-up share capital** is held by
     - the Central Government, or
     - any State Government or Governments, or
     - partly by the Central Government and partly by one or more State Governments,
   - and **includes** a company which is a **subsidiary company of such a Government company**.

2. **Foreign Company -** Section 2 (42) of the Companies Act, 2013,
   Any company or body corporate **incorporated outside India** which –
   - Has a **place of business in India** whether by itself or through an agent physically or through electronic mode; and
   - Conducts any business activity in India in any other manner.

3. Private Company - Section 2(68) of the Companies Act, 2013
   A company which by its articles,
   - **restricts the right to transfer its shares**;
   - **Prohibits any invitation to the public to subscribe for any securities** of the company.
   - Shares of a Private Company are not listed on Stock Exchange.
   - Exception
     - One Person Company limits the number of its members to two hundred. Joint membership will be considered as single member
     - Employees – Present & past holding shares are not considered as members

4. **Public Company -** Section 2(71) of the Companies Act, 2013
   - A company which is not a private company;
   - Subsidiary of company which is not a private company shall also be considered as public company even where such subsidiary company continues to be a private company in its articles.
   - A unlisted public company.
   - No Minimum Paid-up Share Capital

   Note:The minimum paid-up share capital requirement of INR 1,00,000 (in case of a private company) and INR 5,00,000 (in case of a public company) has been done away with under Companies Act, 2013.

5. **One Person Company -** Section 2 (62) of the Companies Act, 2013

A company which has **only one person as a member.**

6. **Small Company -** Section 2(85) of the Companies Act, 2013

- A company, **other than a public company**
  - **paid-up share capital**
    - does not exceed **Rs.50 lakhs** or
    - such higher amount as may be prescribed which shall not be more than **Rs.5 Crores**; or
  - **turnover** (as per its last profit and loss account)
    - does not exceed **Rs.2 Crores** or
    - such higher amount as may be prescribed which shall not be more than **Rs.20 crores**

Note: The status of a company as a Small Company may change from year to year.

7. **Listed Company -** Section 2 (52) of the Companies Act, 2013

A company which has any of its **securities listed on any recognised stock exchange**.

8. **Unlisted Company**

The company, whose shares are **not listed on any recognised stock exchange.** An unlisted company can be a public company or a private company.

9. **Company limited by Shares -** Section 2(22) of the Companies Act, 2013

Liability of its members is **limited by the memorandum to the amount, if any, unpaid** on the shares respectively held by them.

10. **Company limited by Guarantee -** Section 2(21) of the Companies Act, 2013

Liability of its members **limited by the memorandum to such amount as the members may respectively undertake to contribute** to the assets of the company in the event of its being wound up.

11. **Unlimited Company -** Section 2 (92) of the Companies Act, 2013

A company **not having any limit on the liability of its members**.

12. **Holding Company -** Section 2 (46) of the Companies Act, 2103

A company of which one or more other companies companies are subsidiary companies.

13. **Subsidiary Company** - Section 2(87) of the Companies Act, 2013
    - A company in which the holding company:
      - **Controls** the **composition of the Board of Directors** (i.e. power to appoint or remove all or a majority of the directors); or
      - **Exercises or controls > ½** of the **total share capital** either on its
        - own or
        - together with one or more of its subsidiary companies.
    - **Deemed Subsidiary Company** - indirect control through the subsidiary company (ies).

4. MAINTENANCE OF BOOKS OF ACCOUNTS – Section 128

- **Who should maintan** : Every company

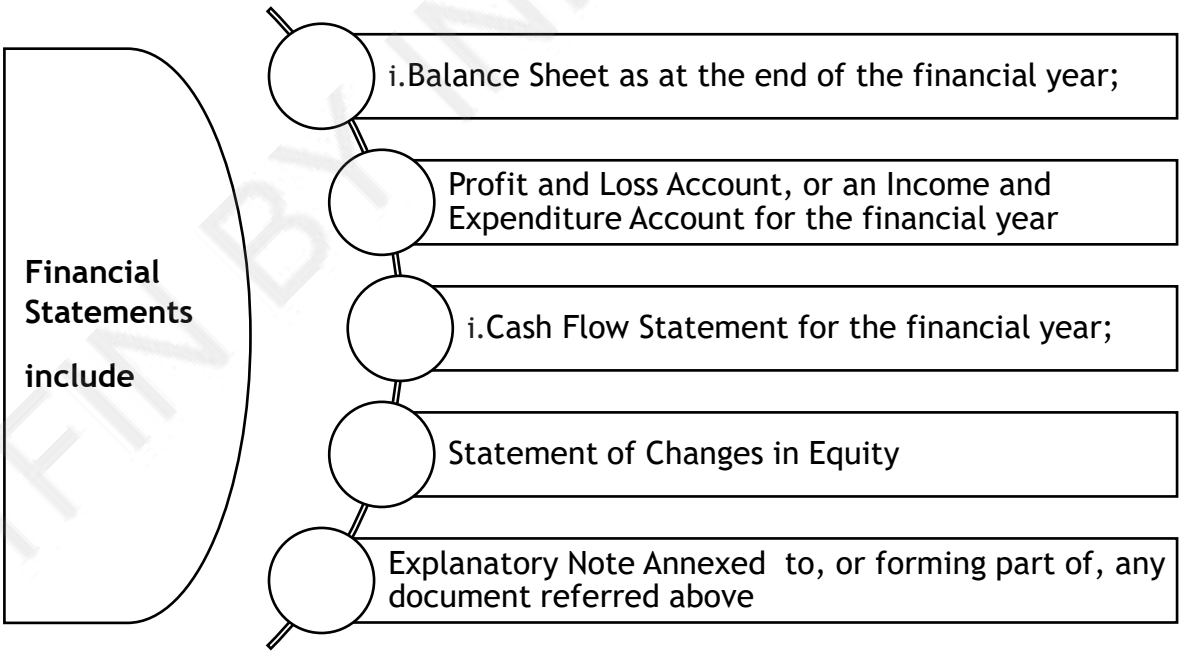
- **Where to maintain** : Registered office
    - **What to maintain** : Books of accounts and other relevant books and papers and financial statement for every financial year **which g**ive a true and fair view of the state of the affairs of the company
- **Whose books** : Company's, Branch office's or Company's other offices, explaining the transactions effected both at the registered office and its branches
- **How to maintain** :
    - **Method of Accounting**- Accrual basis and according to the double entry system of accounting
    - **Mode** – Physical or electronic

5. PREPARATION OF FINANCIAL STATEMENTS

Requisites of Financial Statements (Section 129)

- Give a **true and fair view of the state of affairs** of the company or companies
- **Comply** with the **notified accounting standards**
- Format
    i. If specific Act is applicable (Eg: Insurance Company, Banking company, etc.) – as given in the respective statute
    ii. **Schedule III of the Companies Act, 2013**
        - Part I: Balance Sheet
        - Part II: Profit & Loss Account
- Board of Directors of the company shall **lay financial statements at every annual general meeting of a company**

- **What are Financial Statements?** (Section 2(40) of the Companies Act, 2013)



Part I – Form of Balance Sheet

Name of the Company……

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Balance Sheet as at……

(Rs. in…)

	Particulars	Notes No.	Current Year	Previous Year
	EQUITY AND LIABILITIES			
1.	**Shareholders' funds**			
	a. Share capital (A)			
	b. Reserves and Surplus (B)			
	c. Money received against share warrants			
2.	**Share application money pending allotment**			
3.	**Non-current liabilities**			
	a. Long-term borrowings (C)			
	b. Deferred tax liabilities (Net)			
	c. Other long-term liabilities			
	d. Long-term provisions (D)			
4.	**Current liabilities**			
	a. Short-term borrowings (E)			
	b. Trade Payables			
	▪ Total outstanding dues to micro enterprises and small enterprises			
	▪ Total outstanding dues to creditors other than micro enterprises and small enterprises			
	c. Other current liabilities (F)			
	d. Short-term provisions			
	Total			
1	**ASSESTS**			
	Non-current assets			
	a. Property, Plant and Equipment			
	i. Tangible assets (G)			
	ii. Intangible assets (H)			
	iii. Capital Work-in-progress			
	iv. Intangible assets under development			
	b. Non-current investments (I)			
	c. Deferred tax assets (Net)			
	d. Long-term loans and advances (J)			
	e. Other non-current assets			
2	**Current assets**			
	a. Current investments (K)			
	b. Inventories (L)			
	c. Trade receivables			
	d. Cash and cash equivalents (M)			
	e. Short-term loans and advances			
	f. Other current assets			
	Total			

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Balance Sheet items to be explained in the Explanatory Note:

A. **SHARE CAPITAL** – for each class

- Authorised share capital - Number and amount.
- Issued; Subscribed & Fully paid; and Issued subscribed but not fully paid.
- The par value per share.
- Reconciliation of Shares outstanding
  - at the beginning &
  - at the end of the reporting period
- Calls unpaid
- Forfeited shares

B. **RESERVES AND SURPLUS** – subheads (Additions and deductions since last balance sheet to be shown under each of the specified heads)

- Capital Reserves
- Capital Redemption Reserve (CRR)
- Securities Premium
- Debenture Redemption Reserve.
- Revaluation Reserve
- Surplus (the balance as per Profit and Loss statement)
- Other Reserves (specify the nature and purpose)

C. **LONG TERM BORROWINGS** - subheads

- Bonds/Debentures
- Term loans
  - From Banks
  - From Other parties
- Deferred payment liabilities
- Deposits
- Long term maturities of finance lease obligations
- Loans and advances from related parties
- Other loans and advances (specify nature)

D. **OTHER LONG-TERM LIABILITIES**

(a) Trade payables;
(b) Others.

E. **LONG TERM PROVISIONS**

- Provision for Employee Benefits (eg: gratuity, provident fund etc.)
- Other provisions (specify the nature)

F. **SHORT TERM BORROWINGS**

- Loans repayable on demand
  - From banks
  - From other parties
- Loans and advances from related parties
- Deposits
- Other loans and advances (specify the nature)

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FA. **TRADE PAYABLES -** Outstanding dues to Micro, Small and Medium Enterprises

- Principal amount and interest due thereon remaining
- Amount of interest paid
- Amount of interest due and payable for period of delay
- Amount of interest accrued and remaining unpaid

G. **OTHER CURRENT LIABILITIES**

- Current maturities of long-term debt
- Current maturities of finance lease obligations
- Interest accrued but not/and due on borrowings
- Income received in advance
- Unpaid dividends
- Application money received for allotment of securities and due for refund and interest accrued thereon
- Unpaid matured deposits and interest accrued thereon
- Unpaid matured debentures and interest accrued thereon
- Other current liabilities (specify the nature)

H. **SHORT TERM PROVISIONS**

- Provision for Employee Benefits
- Other provisions (specify the nature)
-

I **TANGIBLE ASSETS -** Classification

- Land
- Buildings
- Plant and Equipment
- Furniture and Fixtures
- Vehicles
- Office equipment
- Others (specify nature)

J. **INTANGIBLE ASSETS**

- Goodwill
- Brands /trademarks
- Computer software
- Mastheads and publishing titles
- Mining rights
- Copyrights, and patents and other intellectual property rights, services and operating rights
- Recipes, formulae, models, designs and prototypes
- Licenses and franchise
- Others (specify nature)

K. **NON-CURRENT INVESTMENTS** (Classify as Trade & Other Investments)

- Investment property;
- Investments in Equity Instruments;

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- Investments in preference shares;
- Investments in Government or trust securities;
- Investments in debentures or bonds;
- Investments in Mutual Funds;
- Investments in partnership firms;
- Other non-current investments (specify nature)

L. **LONG TERM LOANS AND ADVANCES**

- Long-term loans and advances shall be classified as:
  - Capital Advances;
  - Security Deposits;
  - Loans and advances to related parties (giving details thereof);
  - Other loans and advances (specify nature).
- The above shall also be separately sub-classified as:
  - Secured, considered good;
  - Unsecured, considered good;
  - Doubtful.

M. **OTHER NON-CURRENT ASSETS**

- Long-term Trade Receivables (including trade receivables on deferred credit terms);
- Others (specify nature);

Long term Trade Receivables, shall be sub-classified as:

- Secured, considered good;
- Unsecured, considered good;
- Doubtful.

N. **CURRENT INVESTMENTS**

- Investments in Equity Instruments
- Investment in Preference Shares
- Investments in Government or Trust Securities
- Investments in Debentures or Bonds
- Investments in Mutual Funds
- Investments in Partnership Firms
- Other investments (specify nature)

O. **INVENTORIES**

- Raw materials
- Work-in-progress
- Finished goods
- Stock-in-trade (in respect of goods acquired for trading)
- Stores and spares
- Loose tools
- Goods in transit
- Others (specify nature)

P. **TRADE RECEIVABLES**

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- Secured, considered good
- Unsecured, considered good
- Doubtful

Aggregate amount of Trade Receivables outstanding for a period exceeding six months from the date they are due for payment should be separately stated.

Q. CASH AND CASH EQUIVALENTS

- Balances with banks
- Cheques, drafts on hand
- Cash on hand
- Others (specify nature)

R. **SHORT TERM LOANS AND ADVANCES**

- Loans and advances to related parties (giving details thereof);
- Others (specify nature).

The above shall also be sub-classified as:
(a) Secured, considered good;
(b) Unsecured, considered good;
(c) Doubtful.

S. **OTHER CURRENT ASSETS** – Specify nature

T. **CONTINGENT LIABILITIES AND COMMITMENTS**

- **Contingent liabilities**
  - Claims against the company not acknowledged as debt;
  - Guarantees;
  - Other money for which the company is contingently liable.
- **Commitments**
  - Estimated amounts of contracts remaining to be executed on capital account and not provided for;
  - Uncalled liability on shares and other investments partly paid;
  - Other commitments (specify nature).

PART II – Form of STATEMENT OF PROFIT AND LOSS

Name of the Company……
Profit and Loss Statement for the year ended ……

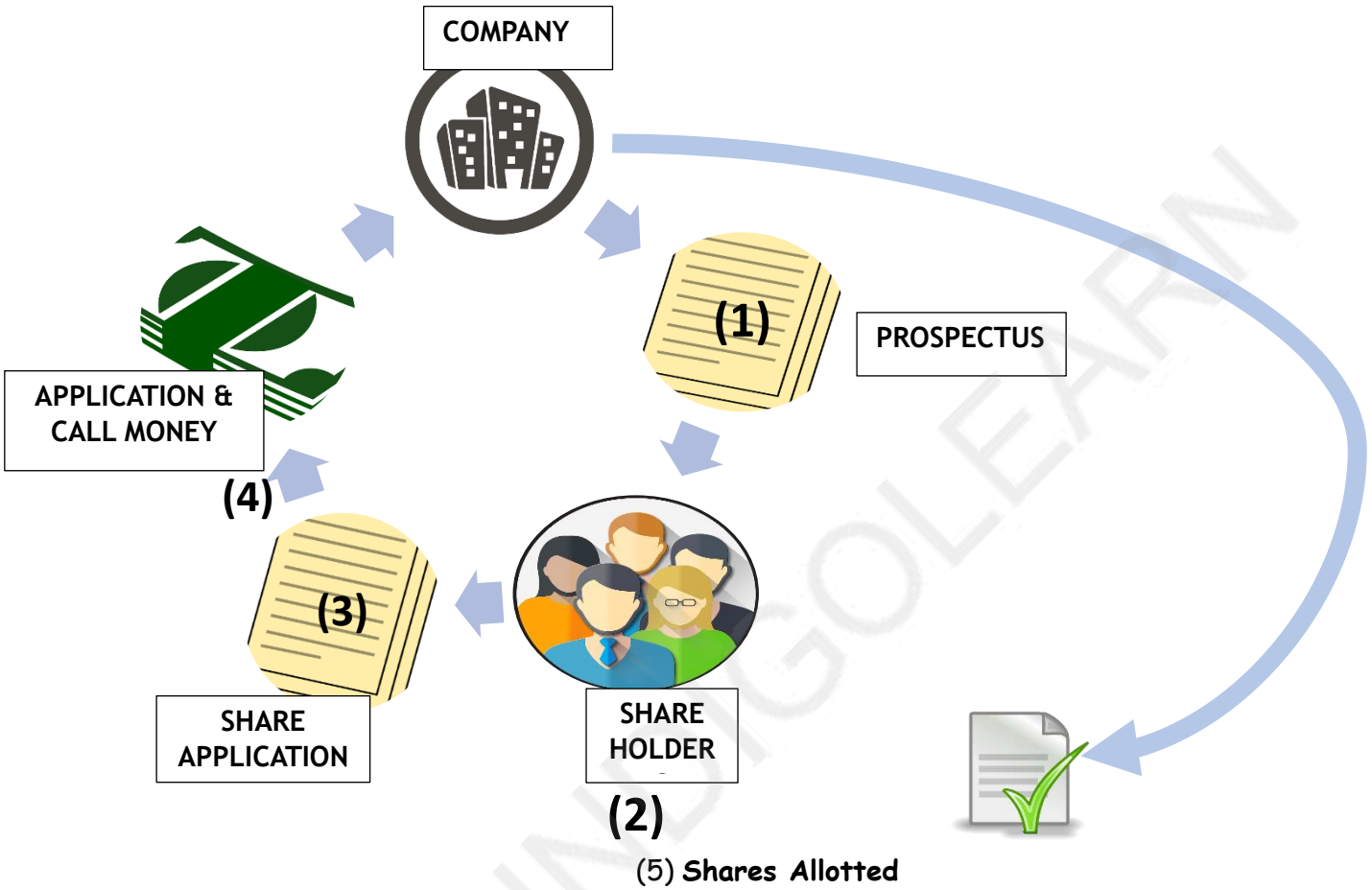
(Rs.in……)

Particulars	Note No.	Figures for the current reporting period	Figures for the previous reporting period

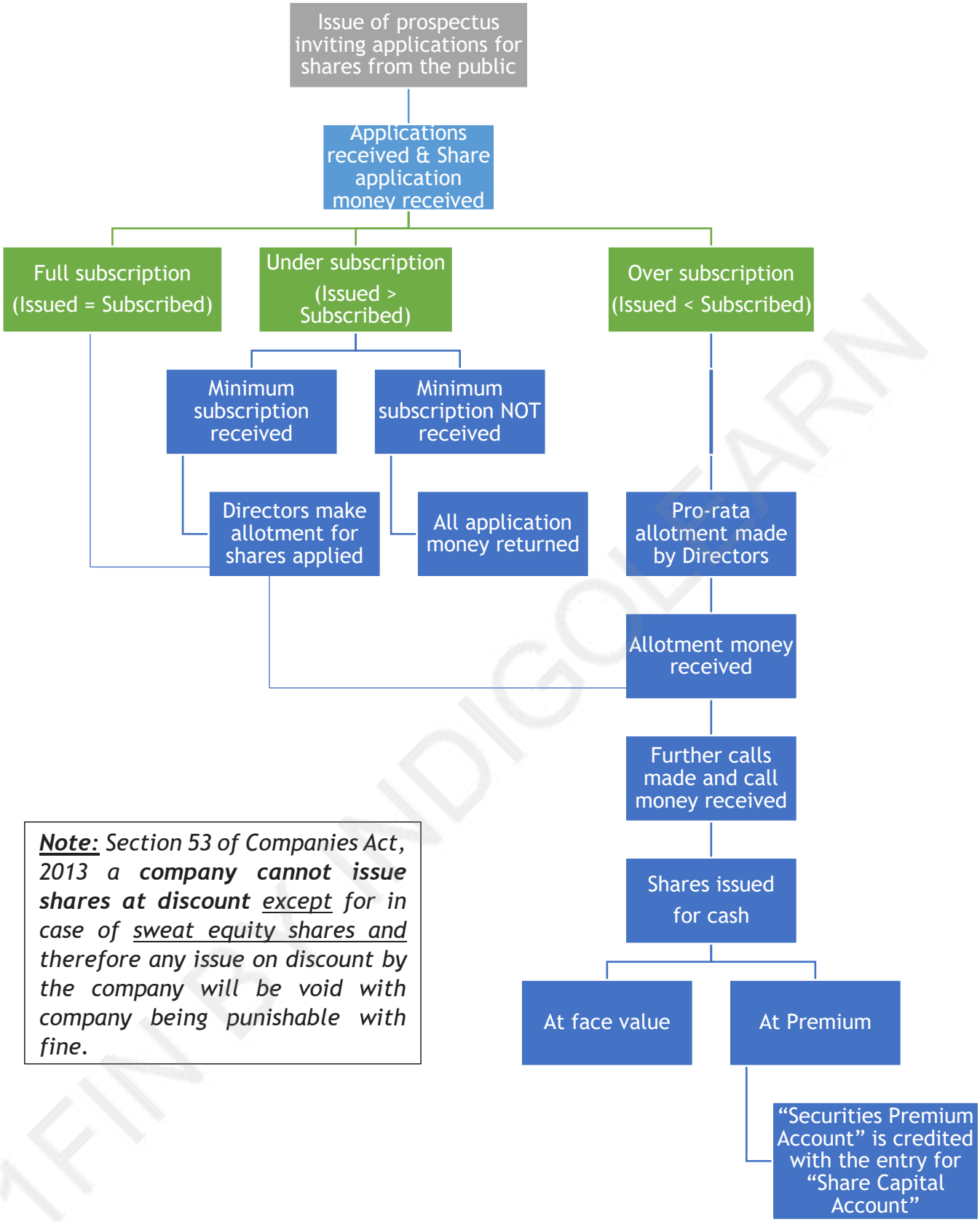
I.	Revenue from operations			xxx		xxx
II.	Other income			xxx		xxx
III.	Total Revenue (I + II)			xxx		xxx
IV.	Expenses:			xxx		xxx
	Cost of materials consumed			xxx		xxx
	Purchases of Stock-in-Trade			xxx		xxx
	Changes in inventories of finished goods Work-in- Progress and Stock-in-Trade			xxx		xxx
	Employee benefits expense			xxx		xxx
	Finance costs			xxx		xxx
	Depreciation and amortization expense			xxx		xxx
	Other expenses			xxx		xxx
Total expenses				xxx		xxx
V. Profit before exceptional and extraordinary items and tax (III-IV)				xxx		xxx
VI. Exceptional items				xxx		xxx
VII. Profit before extraordinary items and tax (V-VI)				xxx		xxx
VIII. Extraordinary Items				xxx		xxx
IX. Profit before tax (VII-VIII)				xxx		xxx
X. Tax expense:						
(1) Current tax			xxx		xxx	
(2) Deferred tax			xxx	xxx	xxx	xxx
XI. Profit (Loss) for the period from continuing operations (VII-VIII)				xxx		xxx
XII. Profit/(Loss) from discontinuing operations				xxx		xxx
XIII. Tax expense of discontinuing operations				xxx		Xxx
XIV.	Profit/(Loss) from discontinuing operations (after tax) (XII-XIII)			xxx		xxx
XV.	Profit (Loss) for the period (XI + XIV)			xxx		xxx
XVI.	Earnings per equity share:					
	(1) Basic			xxx		xxx
	(2) Diluted			xxx		xxx

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Procedure for raising funds through equity



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Note: *Section 53 of Companies Act, 2013 a* ***company cannot issue shares at discount*** *except for in case of sweat equity shares and therefore any issue on discount by the company will be void with company being punishable with fine.*

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INTRODUCTION

Capital

Funds provided by the owners.

Business Organization	Ownership	Type of Capital	Liability of Owners
Sole - Proprietorship	Proprietor	Capital	Unlimited
Partnership	Partners	Partners' Capital	Unlimited
Company	Shareholders	Share Capital	Limited to issue price of shares held

SHARE CAPITAL

- **Share**

  Total capital of the company is divided into a number of small indivisible units of a fixed amount called shares. The capital of the company is called 'Share Capital'

- **Face / Nominal Value of Share**

  The fixed value of a share printed on the share certificate.

- **Share Price**

  Issue price *– The value at which the share is issued [Face (+) Premium, if any (–) Discount, if any]*

  Book building *- Process through which company determines it's share prices. Under this method company determines a price band of its shares and on the basis of bids received from potential investors at various prices within the price band finally fixes its issue price*

  Market Price *– The value at which the share is traded on the stock exchange*

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Authorised Share Capital or Nominal Capital	*Issued Share Capital*	*Subscribed Share Capital*
•It is the maximum limit of capital which a company is authorised to raise during its lifetime •It is mentioned in 'Capital Clause' of the "Memorandum of Association" •It is disclosed on the face of the Balance Sheet at face value	•It is the portion of the authorised capital issued by the company •It includes the nominal value of shares issued for •Cash •Consideration other than Cash to • Promoters • Others •The remaining portion of the Authorised Share capital which is not issued either in cash or consideration may be termed as **'Un-issued Capital'**	•It is part of Issued Share Capital •subscribed by the public •allotted by the company •It also includes face value of shares issued by company for consideration other than cash.

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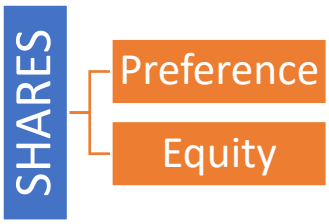
SHARE CAPITAL - Categories

Called-up Share Capital	Paid-up Share Capital	Subscribed Share Capital	Reserve Share capital
•It is the portion of the issue price of shares which a company has demanded or called from shareholders •The balance, which the company has decided to demand in future may be referred to as Uncalled Capital."	•It is the portion of called up capital which is paid by the shareholders. • A particular amount called by the company and not paid by the shareholder(s), fully or partially, is known as **'unpaid calls'** or **'installments (or Calls) in Arrears'** • Paid up Capital = Called up Capital - Installments in Arrears •In balance sheet, Called -up and Paid-up share capital are showin together	•It is part of Issued Share Capital •subscribed by the public •allotted by the company •It also includes face value of shares issued by company for consideration other than cash.	•It is the portion of the uncalled capital which a company has decided to call only in case of liquidation of the company •As per Section 65 of the Companies Act, 2013, a Company may decide by passing a resolution

1. Authorised Capital = Issued Capital + Unissued Capital.
2. Subscribed Capital differs based on subscription type
   - **Fully Subscribed:** Subscribed Capital = Issued Capital
   - **Over Subscribed:** Subscribed Capital > Issued Capital
   - **Under Subscribed:** Subscribed Capital < Issued Capital
3. Called up Capital = Paid up Capital + Calls in arrears if any - Calls in advance if any
4. Uncalled capital = Issued Share Capital - Called up Share Capital

- **Calls in advance**

been paid by shareholder. It is shown separately, in the Balance Sheet as liability of the company under the heading 'Current Liabilities' until the calls are made and the amount actually becomes payable by the shareholder.

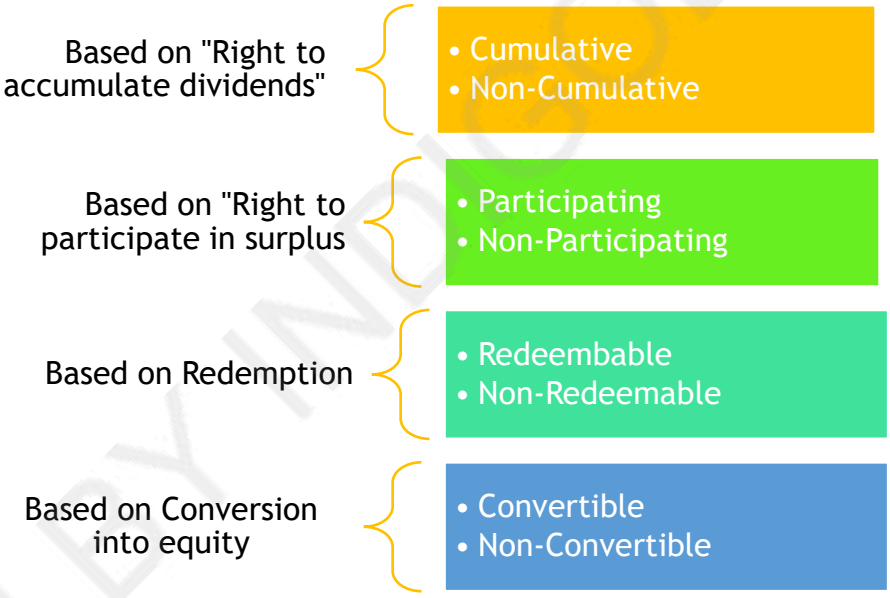


- **Preference Shares**

As per Section 43 of the Companies Act, 2013, Preference shareholders

- are assured of a **preferential dividend at a fixed rate** during the life of the company.
- carry a preferential **right over other shareholders to be paid first in case of winding up** of the company.

- **Type of Preference Shares**



a. **Cumulative Preference Shares**

- It carries the right to a fixed amount of dividend or dividend at a fixed rate.
- Dividend on these shares accumulates unless it is paid in full
- The arrears of dividend are then shown in the balance sheet as a contingent liability.
- In India, a preference share is considered cumulative unless otherwise stated.
- If arrears of dividend are outstanding for a period more than two years, holders of such shares can vote on every resolution on every matter in the general body meeting of the shareholders.

b. **Non-cumulative Preference Shares:**

- It carries with it the right to a fixed amount of dividend.

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- Dividend on these shares does not accumulate in the year with no profits
- The right to dividend expires every year.

c. **Participating Preference Shares**
- These shares give the right to participate in the surplus profits, if any, after the equity shareholders
  - Every year for dividend at a stipulated rate
  - At the time of winding up for distribution of profits (a pre-determined proportion)

d. **Non-participating Preference Shares**
- No additional rights in profits and in the surplus on winding-up,
- Unless otherwise specified, the preference shares are generally non-participating.

e. **Redeemable Preference Shares**
- The company will repay after the fixed period or even earlier at company's discretion.
- The repayment on these shares is called redemption and is governed by Section 55 of the Companies Act, 2013.

f. **Non-redeemable Preference Shares**
- No redemption arrangement agreed upon.
- According to Section 55, no company limited by shares shall issue irredeemable preference shares or preference shares redeemable after the expiry of 20 years from the date of issue.
- A Company may issue preference shares redeemable after 20 years for such infrastructure projects as may be specified, under the Companies Act, 2013.

g. **Convertible Preference Shares**
- These shares give the right to get converted into equity shares at the shareholder's option.

h. **Non-convertible Preference Shares**
- No right to get his holding converted into equity share
- Preference shares are non-convertible unless otherwise stated.

Special Points related to Preference Shares:
- They enjoy preferential rights in the matter of :
  - Payment of dividend, and
  - Repayment of capital
- Generally, holders of these shares do not get voting rights
- The cost of raising preference share capital is cheaper than raising debt
- The Companies Act, 2013 prohibits the issue of any preference share which is irredeemable.
- Preference shares are cumulative and non-participating unless expressly stated otherwise.
- Unless mentioned otherwise Preference Shares are Non-Cumulative, Non Participating, Non- Convertible and Redeemable in nature.

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- Dividend is generally cumulative.

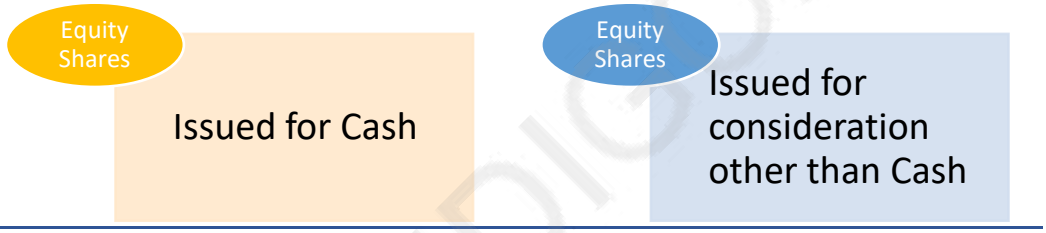
- **Equity Shares**

Those shares, which are not preference shares are called Equity Shares.

Special Points for Equity Shares

- These shares **carry voting rights**.
- **No preferential rights** in the matter of payment of dividend or repayment of capital
- **Dividend on equity shares is recommended by the Board** of Directors and may vary from year to year.
- Rate of dividend depends upon the dividend policy and the availability of profits after satisfying the rights of preference shareholders.
- Companies Act, 2013 permits issue of **equity share capital with differential rights** as to dividend.

Types of Equity Shares



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Private Companies

- Private Placement

Public Companies

- Issue Prospectus
- Invite General Public to subscribe for Shares
- Receive Share applications and Application money (Section 39 Application money ≥ 5% of nominal value)
- Allot Shares to subscribers as per SEBI guidelines (*A company cannot proceed to allot shares unless **minimum subscription** is received by the company*

❖ Minimum Subscription

A public limited company cannot make any allotment of shares unless

- minimum subscription stated in the prospectus has been subscribed and
- application money for such shares has been paid to and received by the company.

The **amount of minimum subscription** to be disclosed in prospectus by the Board of Directors should consider the following

(a) **Preliminary expenses**,
(b) **Commission payable on issue of shares**,
(c) Cost of **fixed assets** purchased or to be purchased,
(d) **Working capital requirements**, and
(e) Any other expenditure for the day to day operation of the business.

Guidelines of the Securities Exchange Board of India (SEBI)

- **Minimum subscription** to be received in an issue shall **not be less than 90%** of the offer through offer document.
- **Non receipt of the minimum subscription of 90%** of the issue, all application moneys received shall be refunded:
  - Non-underwritten Issue – within 15 days of the closure of the issue; and
  - Underwritten Issue – within 7 days of the closure of the issue
  - Underwritten issue where minimum subscription including devolvement obligations paid by the underwriters is not received – within 60 days of the closure of the issue.
- The company has the **right to reject or accept an application** fully or partially.
  - **Accepted applications** – Shareholders have to pay "Allotment Money"
  - **Rejected applications** – Application money is refunded by the Company (delayed

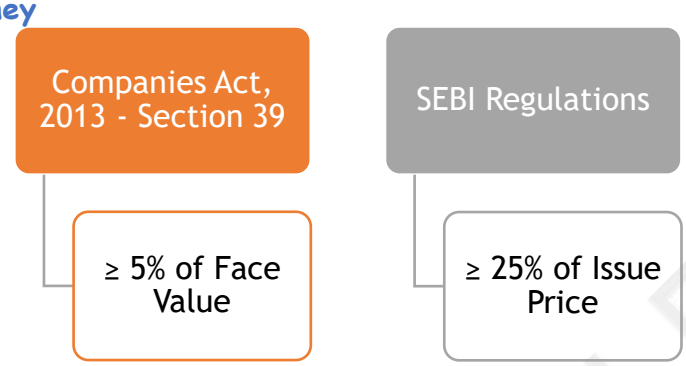
refunds shall be paid with interest)

- **'Calls'** (subsequent instalments of the issue price) made by company as given in prospectus.

Note: The issue price of shares is generally received by the company in instalments:

First instalment	**Application Money**
Second Instalment	**Allotment Money**
Third Instalment	**First Call Money**
Fourth Instalment	**Second Call Money and so on.**
Last Instalment	**Final Call Money**

Application money



Section 24 of the Companies Act, 2013 - Matters related to issue and transfer of securities will be administered by the SEBI and not by the Company Law Board. Thus the application money has to be minimum of 25% of Issue price.

SUBSCRIPTION OF SHARES

❖ Full Subscription

Number of shares offered for subscription = Number of shares actually subscribed by the public

❖ Under Subscription

Number of shares offered for subscription > Number of shares actually subscribed by the public.

Important Note: shares can be allotted, in this case, only when the minimum subscription is received.

- *Minimum subscription received è Proceed for allotment*
- *Minimum subscription not received è Refund the amount received on application, as per guidelines*

❖ Over Subscription

Number of shares offered (Public issue) < Number of shares actually subscribed by the public.

- Applications rejected è application money refunded
- Applications accepted
  - All shares applied are allotted è No refund
  - Part of the shares applied are allotted è excess amount received can be used for allotment or call money

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JOURNAL ENTRIES – ISSUE OF SHARES

Event	Entry	Debit (Rs.)	Credit (Rs.)	Remarks
(1) Receipt of Application Money	Bank A/c Dr.	xxxx		Actual amount received.
	To Share Application Money A/c		xxxxx	Actual amount received.
	(Being application money received)			
(1a) Refund of Application money to applicants)	Share Application A/c Dr.	xx		Actual amount refunded
	To Bank A/c		xx	
	(Being application money refunded)			
(2) Allotment of Share	Share Allotment A/c Dr.	xxxx		Amount due on allotment
	Share Application A/c Dr.	xxxx		Application amount received on allotted shares
	To Share Capital A/c		xxxxxx	Amount due on allotment and application
	(Being the sum due on allotment and application money transferred to capital account)			
(2a) A part of shares applied for are allotted	Share Application A/c Dr.	xxxx		
	To Share Allotment A/c **		xxxx	Application money accepted for allotment
	To Shares Calls in advance A/c		xxx	Amount from application money adjusted for future calls
	To Bank A/c		xx	Excess amount to be refunded
	(Being application money adjusted) ** Credited to Share Capital A/c subsequently			
(3) Receipt of allotment money	Bank A/c Dr.	xxxx		Amount actually received on allotment.
	To Share Allotment A/c		xxxx	
	(Being money received on allotment)			
(4) Call being made	Share Call A/c Dr.	xxx		Amount due on the call
	To Share Capital A/c		xxx	
	(Being share call made due at Rs……)			
(5) Receipt of Call Money	Bank A/c Dr.	xxxx		Amount called actually received

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	To Share Call A/c		xxxx	
	(Being share call money received)			

Note: *Sometimes separate Application and Allotment Accounts are not prepared and entries relating to application and allotment monies are passed through a combined account "Share Application & Allotment Account".*

SHARES ISSUED AT DISCOUNT

Shares are issued at DISCOUNT, if Issue Price < Nominal or Par Value

Discount = Nominal Value – Issue Price

Example:

Nominal Value (a)	Issue Price (b)	Discount (Rs.) (c) = (a-b)	Discount % (d)= [(c) ÷ (a)]100
100	100	0	N.A
100	98	2	2%
100	110	N.A	N.A
250	200	50	20%

Important Note: As per Section 53 of the Companies Act, 2013, a Company **cannot issue shares at a discount except in the case of issue of sweat equity shares** (issued to employees and directors). Thus, any issue of shares at discount shall be void (if issued to general public).

SHARES ISSUED AT PREMIUM

Shares are issued at PREMIUM, if Issue Price > Nominal or Par Value

Premium = Issue Price -Nominal Value

Example:

Nominal Value (a)	Issue Price (b)	Premium (Rs.) (c) = (b-a)	Premium % (d)= [(c) ÷ (a)]100
100	100	0	N.A
100	120	20	20%
100	90	N.A	N.A
250	350	100	40%

Premium is generally called with the amount due on allotment, sometimes with the application of money and rarely with the call money

- ***Securities Premium Account***
  - Premium amount is credited to a separate account called Securities Premium Account.
  - It is not a part of share capital. Rather, it represents a gain of a capital nature to the company.
  - It is shown under the heading, "Reserves and Surplus", which is further shown as "Shareholders' Funds" in the Balance Sheet as per Schedule III.

❖ Utilisation of Securities Premium Account

It may be used by the company as given under **Section 52** of the Companies Act, 2013:

(a) Towards issue of un-issued shares of the company to be issued to members of the company as fully paid **bonus securities.**

(b) To **write off preliminary expenses** of the company.

(c) To **write off the expenses of, or commission paid, or discount allowed on any of the securities** or debentures of the company.

(d) To provide for premium on the redemption of redeemable preference shares or debentures of the company.

(e) For the purchase of own shares or other securities i.e. **Buy back of shares.**

Note Companies whose financial statements comply with the accounting standards prescribed for them under Section 133 of the Companies Act, 2013.

JOURNAL ENTRIES – ISSUE OF SHARES AT PREMIUM

(1) Premium amount called with Application Money

Event	Entry	Debit (Rs.)	Credit (Rs.)	Remarks
(1) Receipt of Application Money	Bank A/c Dr.	xxxx		Total application money + Premium amount
	To Share Application Money A/c		xxxxx	Actual amount received.
	(Being application money received for _____ shares @ Rs._____ per share including premium)			
(2) Allotment of Share	Share Application A/c Dr.	xxxx		No. of shares x Application money per share
	To Share Premium A/c Dr.		xxxx	No. of shares allotted x Premium per share
	To Share Capital A/c		xxxxxx	No. of shares allotted x Nominal Value per share
	(Being the application money transferred to capital account)			

(2) Premium amount called with Allotment Money

Event	Entry	Debit (Rs.)	Credit (Rs.)	Remarks
(1) Receipt of Application Money	Bank A/c Dr.	xxxx		Total application money + Premium amount
	To Share Application A/c		xxxxx	Actual amount received.

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	(Being application money received for _____ shares @ Rs._____ per share including premium)			
(2) Allotment of Share	Share Application A/c Dr.	xxxx		No. of shares x Application money per share
	Share Allotment A/c Dr.	xxxx		No. of shares allotted x Allotment & Premium amount per share
	To Share Capital A/c		xxxxxx	No. of shares allotted x Application & allotment amount per share
	To Share Premium A/c Dr.		xxxx	No. of shares allotted x Premium per share
	(Being Amount due on allotment of shares @ Rs.____per share including premium)			
(3) Allotment money received	Bank A/c Dr.	xxxx		Actual amt received
	To Share Allotment Money A/c		xxxxx	Total allotment money + Premium amount
	(Being money received including premium consequent upon allotment)			

OVER SUBSCRIPTION AND PRO-RATA ALLOTMENT

Number of shares offered (Public Issue) < Number of shares actually subscribed by the public.

Reasons for oversubscription

- *investors' confidence in the company,*
- *previous performance of the company*
- *general economic conditions,*
- *pricing of the issue etc*

Allotment for oversubscription

- ✓ Shares can be allotted to the applicants by a company in any manner it thinks proper.
  - ➢ Some Applicants rejected in full and remaining accepted in fullè application money refunded to such applicants
  - ➢ Multiple applications by the same person not considered è application money refunded for applications
  - ➢ All Applications accepted è allotment done on pro-rata basis i.e. 'Pro-rata allotment' means allotment in proportion of shares applied for.

Example

Shares offered to public	10,000
Applications received	12,000
Ratio	12,000:10,000 i.e. 6:5
For every 6 shares applied, 5 shares are allotted	

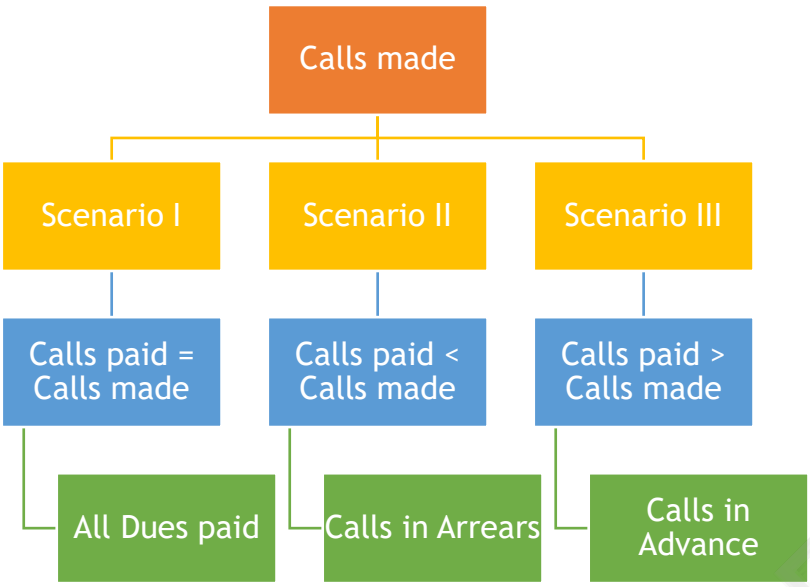
- ✓ Excess amount received is treated as an advance against allotment and calls and thereby adjusted against the amount due on allotment or calls.
- ✓ Surplus money after making adjustment against future calls is returned to the applicants.
- ✓ The applicants are informed about the allotment procedure through an advertisement in leading newspapers.

JOURNAL ENTRIES – OVER SUBSCRIPTION (PRO-RATA ALLOTMENT)

Event	Entry	Debit (Rs.)	Credit (Rs.)	Remarks
(1) Rejected applications	Share Application A/c Dr.	xxxx		Application money x no. of shares rejected
	To Bank A/c		xxxxx	Actual amount received.
	(Being application money refunded for rejected applications as per Board's Resolution No….dated….)			
(2) Pro-rata Allotment	Share Application A/c Dr.	xxxx		Total money received – (No. of shares allotted x Application money per share)
	To Share Allotment A/c		xxxxxx	No. of shares allotted x Allotment money per share
	(Being excess application money adjusted against allotment money as per Board's Resolution No….dated….)			

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CALLS IN ADVANCE & CALLS IN ARREARS



❖ Calls in Arrears

- The total unpaid amount on one or more instalments called but shareholder failed to pay is known as *Calls-in-Arrears* or *Unpaid Calls*.
- It is the uncollected amount of capital from the shareholders;
- It is shown by way of deduction from 'called-up capital' to arrive at paid-up value of the share capital.

❖ Calls in Advance

- Amount not yet called up but paid by shareholders is known as Calls-in-advance.
- Interest at a rate not exceeding 12 % p.a. is to be paid on such advance call money.
- This amount is credited in Calls-in-Advance Account and shown separately under Current Liabilities

❖ Interest on Calls in Arrears & Calls in Advance

Interest on Calls in Arrears	Interest on Calls in Advance
Receivable by the Compay from the Shareholders	Payable by the Company to Shareholders
Maximum Rate (Table F prescribed) is 10%	Maximum Rate (Table F prescribed) is 12%
Interest period = Call due date to actual money receipt date	Inerest period = Actual money receipt date to Call due date
Directors have right to waive off such interest on their discretion	Shareholders are not entitled to dividend on calls in advance
Income - credited to P&L A/c as a nominal account	Expense - debited to P&L A/c

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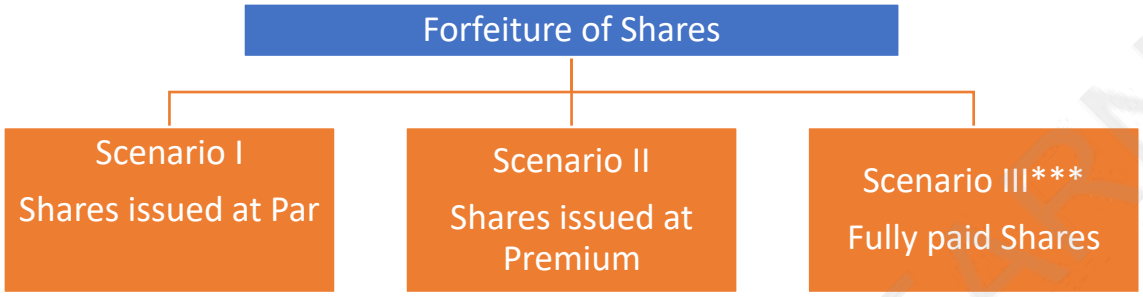
JOURNAL ENTRIES – CALLS IN ADVANCE & CALLS IN ARREARS

Event	Entry	Debit (Rs.)	Credit (Rs.)	Remarks
(1a) Calls in Arrears after call made	Calls in arrears A/c Dr.	xx		Amount of Unpaid Calls
	Bank A/c Dr.	xxxx		Amount received
	To Share Allotment A/c		xxx	Total allotment money due
	To Share Calls A/c		xxxx	Total allotment money due
	(Being call money/ allotment money received on .... shares at ` per share.)			
(1b) Calls in Arrears received	Bank A/c Dr.	xx		Amount of Unpaid calls received
	To Calls in Arrears A/c		xx	
	(Being unpaid calls received)			
(2a) Calls in Advance received	Bank A/c Dr.	xxx		Call amount received in advance
	To Calls in Advance A/c		xxx	
	(Being excess application money received)			
(2b) Call made	Calls in Advance A/c Dr.	xxx		Call amount received in advance
	Bank A/c Dr.	xx		Remaining call money received, if any
	To Particulars Call A/c		xxxx	Call money due
	(Being call in advance adjusted and call money due received)			
(3a)For interest receivable on Calls-in-Arrears	Shareholder's A/c Dr.	xxx		
	To Interest on Calls in arrears A/c		xxx	
	(Being interest on calls in arrears at the rate of _____% due)			
(3b) For receipt of interest	Bank A/c Dr.	xxx		
	To Shareholder's A/c		Xxx	
	(Being interest money received)			
(4a) For interest payable on Calls-in-Advance due	Interest on Calls-in-AdvanceA/c Dr.	xxx		Amount of interest due for payment
	To Shareholder's A/c		xxx	
	(Being interest on calls in advance due)			
(4b) For payment of interest	Shareholder's A/c Dr.	xxx		Amount of interest paid
	To Bank A/c		xxx	
	(Being interest money received)			

FORFEITURE OF SHARES

- Forfeiture of shares is the action taken by a company to cancel the shares, WHEN shareholders fail to pay their allotment and/or calls on the due dates

- The directors are usually empowered by the Articles of Association to forfeit those shares by strictly following the rules and regulations in the Articles of Association
- Proper notice to the defaulting shareholder(s) should be served.
- Directors also have the right to cancel such forfeiture before the forfeited shares are re-allotted.
- When shares are forfeited, the title of such shareholder is extinguished but the amount paid to date is not refunded to him.
- The shareholder then has no further claim on the company.



*** *Forfeiture for non-payment of calls, premium, or the unpaid portion of the face value of the shares is one of the many causes for which a share may be forfeited. But fully paid-up shares may be forfeited for realization of debts of the shareholder if the Articles specifically provide it.*

JOURNAL ENTRIES – FORFEITURE OF SHARES

Important Amounts to consider:

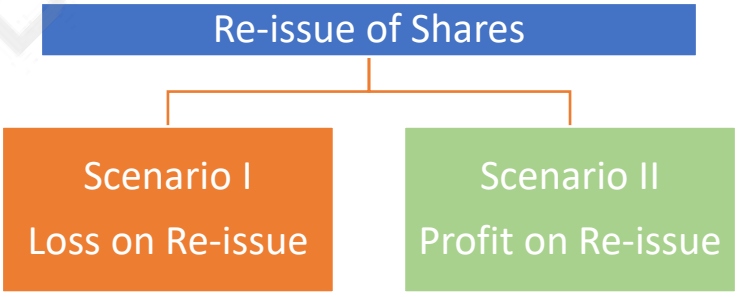
(i) Amount **called-up (i.e., amount credited to capital)** in respect of forfeited shares.
(ii) Amount already **received** in respect of those shares.
(iii) Amount **due but has not been received** in respect of those shares.

Event	Entry	Debit (Rs.)	Credit (Rs.)	Remarks
***(1a) Forfeiture of shares issued at Par** – No Calls-in-Arrears*	Share Capital A/c Dr.	xxxx		No. of forfeited shares x called-up value per share
	To Forfeited Shares A/c		xxx	Amount already received on forfeited shares
	To Share Allotment A/c		xxx	IF amount due but not paid
	To Share Call A/c		xx	IF amount due but not paid
***(1b) Forfeiture of shares issued at Par** – With Calls-in-Arrears*	Share Capital A/c Dr.	xxxx		No. of forfeited shares x called-up value per share
	To Calls in Arrears A/c		xx	Total Amount due but not paid
	To Forfeited Shares A/c		xxx	Amount already received on forfeited shares

(2a) Forfeiture of shares issued at Premium *– IF Premium NOT received*	Share Capital A/c Dr.	xxx		Call amount received in advance
	Securities Premium A/c Dr.			Amount of Security premium not received
	To Forfeited Shares A/c		xxx	Amount already received on forfeited shares
	To Share Allotment A/c		xxx	IF amount due but not paid
	To Share Call A/c		xx	IF amount due but not paid
(2a) Forfeiture of shares issued at Premium *– IF Premium received*	Share Capital A/c Dr.	xxx		Call amount received in advance
	To Forfeited Shares A/c		xxx	Amount already received on forfeited shares
	To Share Allotment A/c		xxx	IF amount due but not paid
	To Share Call A/c		xx	IF amount due but not paid
Note: *If the premium has already received by the company, it cannot be cancelled even if the shares are forfeited in the future:*				

RE-ISSUE OF FORFEITURE OF SHARES

- ✓ A forfeited share is merely a share available to the company for sale and remains vested in the company as an obligation to dispose it off.
- ✓ Reissue of forfeited shares is not allotment of shares but only a sale. In practice, forfeited shares are disposed off, by auction.
- ✓ These shares can be re-issued at any price so long as the total amount received (from the original allottee and the second purchaser) for those shares is not less than the amount in "Calls-in-arrears" on those shares.



❖ Important Points

- ➢ Loss on re-issue should not exceed the forfeited amount.
- ➢ When the shares are re-issued at a loss, such loss is to be debited to "Forfeited Shares Account".
- ➢ If the loss on re-issue is less than the total amount forfeited, the surplus should be transferred to Capital Reserve.

- When only a portion of the forfeited shares are re-issued, then the profit made on re-issue of such portion of shares only must be transferred to Capital Reserve.
- If the shares are re-issued at a price which is more than the face value of the shares, the excess amount will be credited to Securities Premium Account.
- The forfeited amount on shares (amount originally paid-up) not yet reissued should be shown under the heading 'share capital.'
- If the re-issued amount and forfeited amount (taken together) exceeds the face value of the shares re-issued, it is not necessary to transfer such amount to Securities Premium Account.
- The credit balance of forfeited shares account cannot be considered a surplus until the shares forfeited have been re-issued, because the company may, on re-issue, allow the discount to the new purchaser equivalent to the amount held in credit in this regard in the forfeited shares Account

❖ Calculation of Profit on Re-issue of Forfeited Shares

Example

No.of shares forfeited	120
Nominal value of each share	Rs.10
Paid up amount on each forfeited share	Rs.5

First Re-Issue 50 shares (Rs.6 per share collected to make it fully paid up)

Amount received	[50x 6]	Rs.300
Amount transferred from Shares forfeited A/c to Share Capital A/c	No. of shares x (Nominal Value – Amount received on re-issue) i.e. [50 (10 – 6)]	Rs.200
Surplus on Re-issue: Amount transferred to Capital Reserve	Amount in Shares Forfeited A/c for shares re-issued – Amount transferred to Share Capital A/c i.e. [(50x5)-Rs.200]	Rs.50
Amount carried forward in Shares Forfeited A/c	Total Value of Shares Forfeited – Amount transferred to Share Capital on re-issue – Surplus transferred to Capital Reserve [(120x5) – Rs.200 – Rs.50]	Rs.350

JOURNAL ENTRIES – FORFEITURE OF SHARES

Event	Entry		Debit (Rs.)	Credit (Rs.)	Remarks
(1) Re-issue of shares	Bank A/c	Dr.	xx		Actual amount received
	Forfeited Shares A/c	Dr.	xxx		Profit on re-issue
	To Share Capital A/c			xxx	

	(Being the re-issue of….shares @ Rs….. each as per Board's Resolution No…. dated.)			
(2) Surplus transferred to Capital Reserve A/c	Forfeited Shares A/c Dr.	xxxx		
	To Capital Reserve A/c		xx	
	(Being the profit on re-issue, transferred to capital reserve).			

ISSUE OF SHARES FOR CONSIDERATION OTHER THAN CASH

- A public limited company generally, issue their shares for cash but it may issue shares
  - in a **direct exchange** for land, buildings or other **assets**.
  - **in payment for services rendered** by promoters, lawyers in the formation of the company.
- These shares should be **shown separately under 'Share Capital'**.
- Within specified time of allotment, the **company must produce before the Registrar** a **written contract of sale of service** in respect of which shares have been allotted.

When assets are purchased in exchange of shares

Assets Account Dr.
To Share Capital Account

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Illustrations

Question: 1

JHP Limited is a company with an authorised share capital of Rs.10,00,000 in equity shares of Rs.10 each, of which 6,00,000 shares had been issued and fully paid on 30th June 2016. The company proposed to make a further issue of 1,00,000 of these Rs.10 shares at a price of Rs.14 each, the arrangements for payment being:

a. Rs.2 per share payable on application, to be received by 1st July 2016;
b. Allotment to be made on 10th July 2016 and a further Rs.5 per share (including the premium) to be payable;
c. The final call for the balance to be made, and the money received by 30th April 2017.

Applications were received for 3,55,000 shares and were dealt with as follows:

i. Applicants for 5,000 shares received allotment in full;
ii. Applicants for 30,000 shares received an allotment of one share for every two applied for; no money was returned to these applicants, the surplus on application being used to reduce the amount due on allotment;
iii. Applicants for 3,20,000 shares received an allotment of one share for every four applied for; the money due on allotment was retained by the company, the excess being returned to the applicants; and
iv. the money due on final call was received on the due date.

You are required these transaction (including cash items) in the Journal of JHP Ltd.

Question: 2

A company had an authorised capital of Rs.10,00,000 divided into 1,00,000 equity shares of Rs.10 each. It decided to issue 60,000 shares for subscription and received applications for 70,000 shares. It allotted 60,000 shares and rejected remaining applications. Up to 31-3 -2017, it has demanded or called Rs.9 per share. All shareholders have duly paid the amount called, except one shareholder, holding 5,000 shares who has paid only Rs.7 per share.

Prepare a balance sheet assuming there are no other details.

Question: 3

A company invited applications for 10,000 equity shares of Rs.50 each payable on:

1. Application Rs.15;
2. Allotment Rs.20,
3. on first and final call Rs.15.

Applications are received for 10,000 shares and all the applicants are allotted the number of shares they have applied for and instalment money was duly received by the company.

Show Journal entries in the books of the company.

Question: 4

On 1st April 2017, A Ltd. issued 43,000 shares of Rs. 100 each payable as follows:

- Rs.20 on application;
- Rs.30 on allotment;
- Rs.25 on 1st October 2017; and
- Rs. 25 on 1st February 2018

By 20th May, 40,000 shares were applied for and all applications were accepted. Allotment was made on 1st June. All sums due on allotment were received on 15th July; those on 1st call was received on 20th October.
Journalise the transactions when accounts were closed on 31st March 2018.

Question: 5
Pant Ltd. invited applications for 50,000 equity shares at Rs.50 each, which are payable as on application Rs.20, on allotment Rs.10 and on first and final call Rs.20. The company received applications for 60,000 shares. The directors accepted application for 50,000 shares and rejected the rest.
Show Journal entries if company refunded the application money to rejected applicants and allotment money was received for 45,000 shares.

Question: 6
The Delhi Artware Ltd. issued 50,000 equity shares of Rs 100 each and 1,00,000 preference shares of Rs.100 each. The Share Capital was to be collected as under:

Particulars	Equity Shares Rs.	Preference Shares Rs.
On Application	25	20
On Allotment	20	30
First Call	30	20
Final Call	25	30

All these shares were subscribed. Final call was received on 42,000 equity shares and 88,000 preference shares.
Prepare the cash book and journalise the remaining transactions in the books of the company.

Question: 7
On 1st October 2017 Pioneer Equipment Limited received applications for 2,50,000 Equity Shares of Rs. 100 each to be issued at a premium of 25 per cent payable as:
On Application Rs.25
On Allotment Rs.75 (including premium)
Balance Amount on Shares As and when required
The shares were allotted by the Company on October 20, 2017 and the allotment money was duly received on October 31, 2017.
Record journal entries in the books of the company to record the transactions in connection with the issue of shares

Question: 8
JHP Limited is a company with an authorised share capital of Rs.10,00,000 in equity shares of Rs.10 each, of which 6,00,000 shares had been issued and fully paid on 30thJune, 2016. The company proposed to make a further issue of 1,00,000 of these Rs.10 shares at a price of Rs.14 each, the arrangements for payment being:

- Rs.2 per share payable on application, to be received by 1st July 2016.
- Allotment to be made on 10th July 2016 and a further Rs.5 per share (including the premium) to be payable.
- The final call for the balance to be made, and the money received by 30th April 2017.

Applications were received for 3,55,000 shares and were dealt with as follows:

i. Applicants for 5,000 shares received allotment in full
ii. Applicants for 30,000 shares received an allotment of one share for every two applied for, no money was returned to these applicants, the surplus on application being used to reduce the amount due on allotment.
iii. Applicants for 3,20,000 shares received an allotment of one share for every four applied for, the money due on allotment was retained by the company, the excess being returned to the applicants.
iv. the money due on final call was received on the due date.

You are required to record these transactions (including cash items) in the Journal of JHP Limited.

Question: 9

Shreyas Ltd. did not receive the first call on 10,000 equity shares @ Rs. 3 per share which was due on 1.7.2016. This amount was received on 1.4.2017.
Open Calls in arrears account and journalise the entries in the books of the company on 1.7.2016 and 1.4.2017. Also show an extract of Balance Sheet on 31.3.2017.

Question: 10

Rashmi Limited issued at par 1,00,000 Equity shares of Rs.10 each payable:

- Rs.2.50 on application;
- Rs.3 on allotment;
- Rs. 2 on first call and balance on the final call.

All the shares were fully subscribed. Mr. Nair who held 10,000 shares paid full remaining amount on first call itself. The final call which was made after 3 months from first call was fully paid except a shareholder having 1000 shares who paid his dues amount after 2 months along with interest on calls in arrears. Company also paid interest on calls in advance to Mr. Nair.
Give journal entries to record these transactions

Question: 11

A Ltd forfeited 30,000 equity shares of Rs.10 fully called-up, held by Mr. X for non-payment of final call @ Rs.4 each. However, he paid application money @ Rs.2 per share and allotment money @ Rs.4 per share. These shares were originally issued at par.
Give Journal Entry for the forfeiture

Question: 12

X Ltd forfeited 20,000 equity shares of Rs.10 each, Rs. 8 called-up, for non-payment of first call money @ Rs. 2 each. Application money @ Rs. 2 per share and allotment money @ Rs.4 per share have already been received by the company.
Give Journal Entry for the forfeiture (assume that all money due is transferred to Calls-in-Arrears Account).

Question: 13

X Ltd. forfeited 5,000 equity shares of Rs.100 each fully called-up which were issued at a premium of 20%.
Amount payable on shares were:- on application Rs.20; on allotment Rs.50 (including premium); on First and Final call Rs.50. Only application money was paid by the shareholders in respect of these shares.
Pass Journal Entries for the forfeiture.

Question: 14
Mr. Shami has applied for 1,000 shares of Company XYZ Ltd. paying application money @ Rs. 2 per share but has been allotted only 600 shares. The shares have a face value of Rs.10 and a premium of Rs. 2 per share, which are payable as: on Allotment- Rs.5 (including premium) and on final call Rs. 5. Now in case Mr. Shami doesn't pay allotment money and final call and his shares are forfeited, then following entry will be passed on forfeiture:

Question: 15
Mr. Long who was the holder of 2,000 preference shares of Rs.100 each, on which Rs. 75 per share has been called up could not pay his dues on Allotment and First call each at Rs.25 per share. The Directors forfeited the above shares and reissued 1500 of such shares to Mr. Short at Rs. 65 per share paid-up as Rs.75 per share.
Give Journal Entries to record the above forfeiture and re-issue in the books of the company.

Question: 16
Beautiful Co. Ltd issued 30,000 equity shares of Rs.10 each payable as

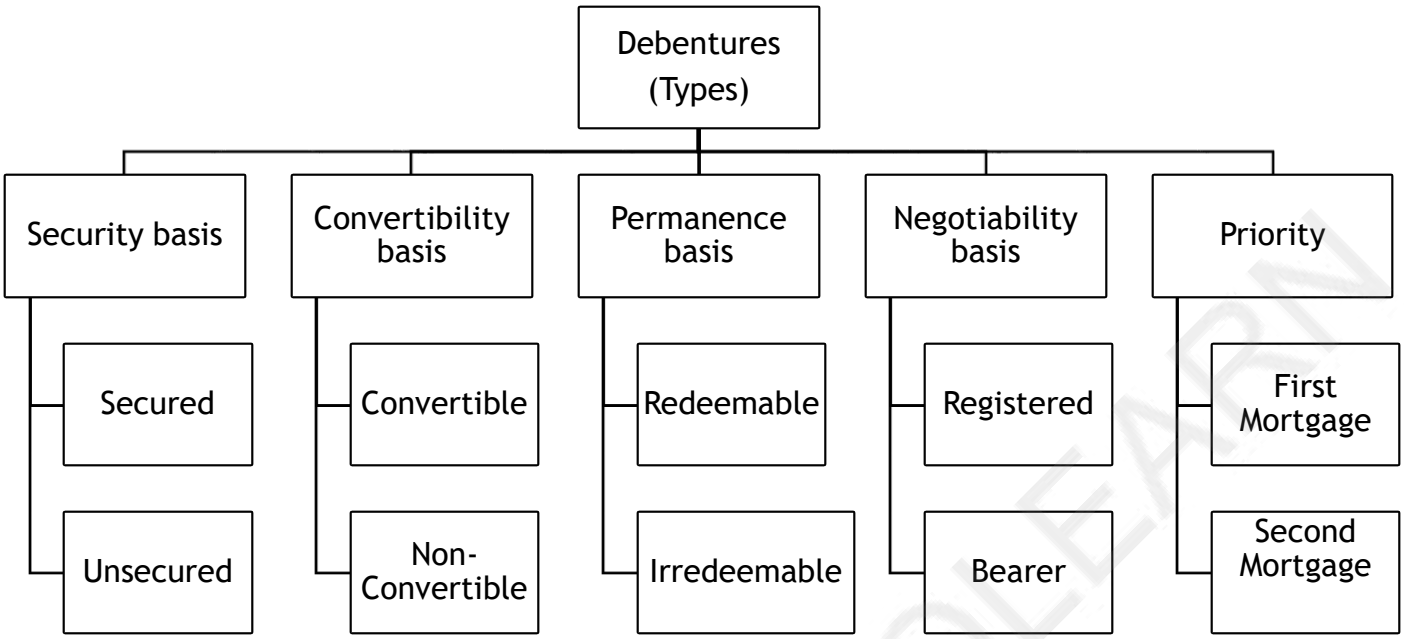
- Rs.3 per share on Application,
- Rs.5 per share (including Rs.2 as premium) on Allotment and
- Rs.4 per share on Call.

All the shares were subscribed. Money due on all shares was fully received except from Ram, holding 500 shares, who failed to pay the Allotment and Call money and Shyam, holding 1,000 shares, who failed to pay the Call Money. All those 1,500 shares were forfeited. Of the shares forfeited, 1,250 shares (including whole of Ram's shares) were subsequently re-issued to Jadu as fully paid up at a discount of Rs.2 per share.
Pass the necessary entries in the Journal of the company to record the forfeiture and re-issue of the share. Also prepare the Balance Sheet of the company.

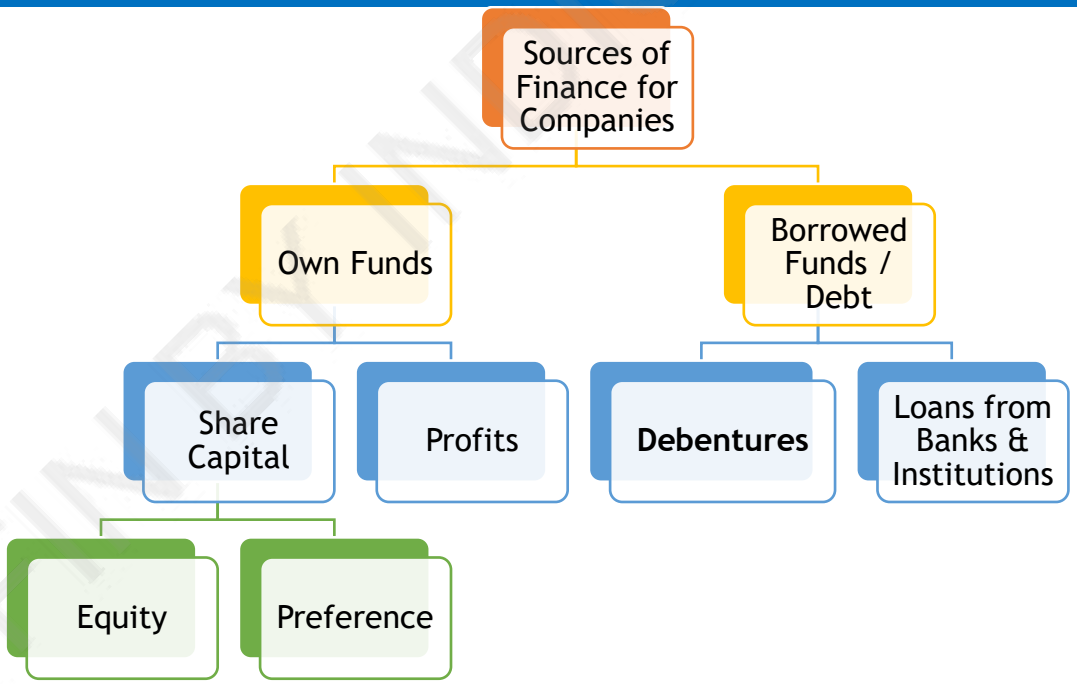
Question: 17
X Co. Ltd. was incorporated with an authorized share capital of 90,000 equity shares of Rs.10 each. The company purchased land and buildings from Y Co. Ltd for Rs.4,00,000 payable in fully paid-up shares of the company. The balance of the shares was issued to the public, which were fully subscribed and paid for.
You are required to pass Journal Entries and to prepare the Balance Sheet.

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Unit-3 Issue of Debentures



Introduction

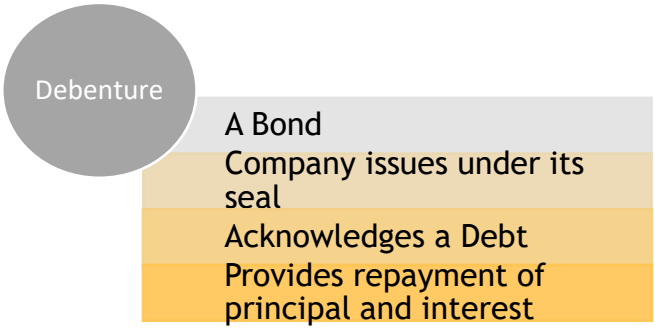


❖ Debenture

It is one of the most commonly used debt instrument issued by the company to raise funds for the business. Reason for opting Debentures: Benefits of Debt financing

- ✓ reduces the cost of the capital
- ✓ helps in designing appropriate capital structure of the company.

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Section 2 (30) of the Companies Act, 2013 - "Debenture" includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not.

Thus, debenture may be Secured Debenture or Unsecured Debenture. Those debentures that have charge on the assets of the company are called "Secured Debentures"

❖ Charge on Assets

- It is a right of a lender (debenture holder, in this case) to be paid from a borrower's (Company's) **assets** if the debt is not paid on time as promised.
- The nature of the charge and the assets charged are described in the Bond.
- The charge is not valid unless registered with the Registrar, and the certificate registering the charge is printed on the bond.
- It is also customary to create a trusteeship in favour of one or more persons in the case of mortgage debentures.
- The trustees of debenture holders have all powers of a mortgage of a property and can act in whatever way they think necessary to safeguard the interest of debenture holders.

Note: No company shall issue any debentures carrying any voting rights.

❖ Features of Debentures

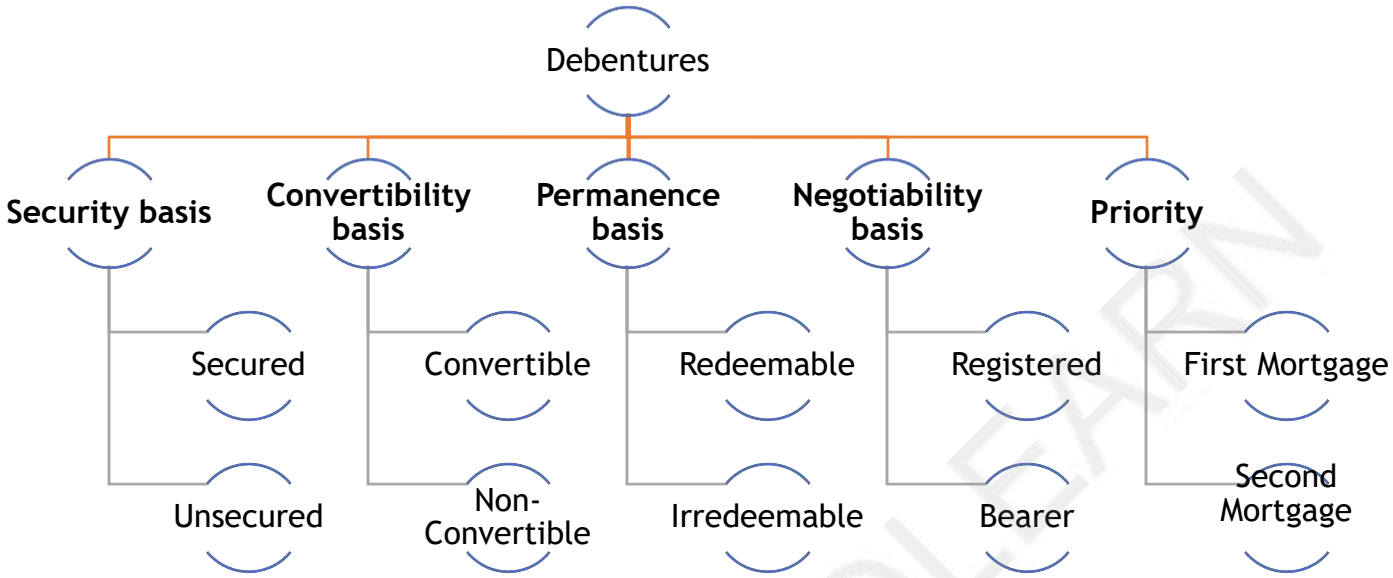
- It is a fixed interest-bearing **security** where interest falls due on specific dates.
- **Interest** is payable at a **predetermined fixed rate**, regardless of the level of profit.
- The original sum is
  - repaid at a specified future date or
  - converted into
    - shares or
    - other debentures.
- It may or may not create a charge on the assets of a company as security.
- It is a document which evidences a loan made to a company.
- It can generally, be bought or sold through the stock exchange at a price above or below its face value.

DISTINCTION BETWEEN DEBENTURES AND SHARES

Difference	Debentures	Shares
Holders - status	Creditors of the company.	Owners of the company.
Voting Rights	No voting rights Thus, no threat to the existing control of the company.	Holders have voting rights and thus issue will dilute the existing control
Return on Investment for the holder	Interest is paid at a pre- determined fixed rate.	Dividend is paid at (i) a variable rate for equity shares (ii) fixed rate for preference shares
Payment of Interest	Payable whether there is any profit or not. Interest on debentures has to be paid	Payable only if profits are there.
Deductible expense	Interest is charge against profits and they are deductible as an expense in determining taxable profit of the company.	Dividends are appropriation of profits and these are not deductible.
Types	Secured/Unsecured; Redeemable/ Irredeemable; Registered/Bearer; Convertible / Non-convertible, etc.	Equity Shares; Preference Shares.
Presentation in financial statements	"Long Term Borrowings" in the Company's Balance Sheet	"Shareholder's Fund" in the Company's Balance Sheet. Shares are shown under detailed in 'Share Capital' of Notes to Accounts.
Convertibility	Debentures can be converted into other debentures or shares as per the terms of issue of debentures.	Shares cannot be converted into other shares in any circumstances.
Forfeiture	Debentures cannot be forfeited for non-payment of call moneys.	Shares can be forfeited for non-payment of allotment and call moneys.
Redemption	At maturity, debenture holders get back their money as per the terms and conditions of redemption.	(i) Equity shareholders: cannot get back their money before the liquidation of the company (ii) Preference shareholders: can get back their money before liquidation .
Winding up	At the time of liquidation, debenture holders are paid-out before the shareholders.	At the time of liquidation shareholders are paid at last, after paying debenture holders, Trade payable, etc.

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TYPES OF DEBENTURES



1. Based on Security
   (a) ***Secured Debentures:*** These are **secured by a charge** upon some or all assets of the company. There are two types of charges:
      (i) ***Fixed charge***: It is a **mortgage on specific assets**. These assets cannot be sold without the consent of the debenture holders. The sale proceeds of these assets are utilized first for repaying debenture holders; and
      (ii) **Floating charge**: It generally covers **all the assets of the company** including future one.
   (b) ***Unsecured or "Naked" Debentures:*** These are not secured by any charge upon any assets. A company merely promises to pay interest on due dates and to repay the amount due on maturity date.
2. Based on Convertibility
   (a) ***Convertible Debentures***: These will be **converted into equity shares** (either at par or premium or discount) after a certain period of time from the date of its issue. These debentures may be fully or partly convertible.
   (b) ***Non-Convertible Debentures***: These cannot be converted into shares in future. As per the terms of issue, these debentures are repaid.
3. Based on Permanence
   (a) ***Redeemable Debentures:*** These are **repayable** as per the terms of issue.
   (b) ***Irredeemable Debentures***: These are **not repayable** during the lifetime of the company i.e. they are repaid at the time of liquidation. These are also called perpetual debentures.
4. Based on Negotiability
   (a) ***Registered Debentures:*** These are payable to a registered holder whose name, address and particulars of holding is recorded in the Register of Debenture holders. They are not easily transferable. Debenture interest is paid either to the

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order of registered holder as expressed in the warrant issued by the company or the bearer of the interest coupons.

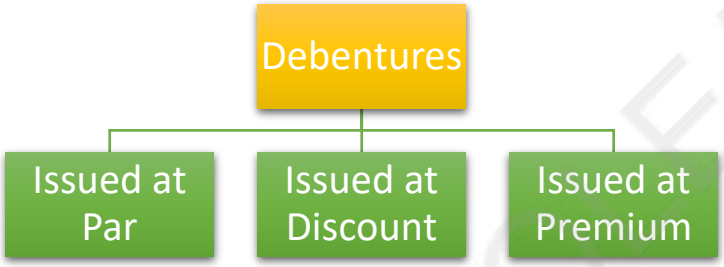
(b) ***Bearer Debentures:*** These are transferable by delivery. These are **negotiable instruments payable to the bearer**. No kind of record is kept by the company in respect of the holders of such debentures. Therefore, the interest on it is paid to the holder irrespective of any identity. No transfer deed is required for transfer of such debentures.

5. Based on Priority

(a) ***First Mortgage Debentures:*** These are payable first, out of the property charged.

(b) ***Second Mortgage Debentures:*** These are payable after satisfying the first mortgage debentures.

ISSUE OF DEBENTURES



ISSUE OF DEBENTURES – JOURNAL ENTRIES

Debentures issued at Par

The debentures which are issued at par are issued at the same price as their nominal value

Event	Entry	Debit (Rs.)	Credit (Rs.)	Remarks
(1) *Cash received on application*	Bank A/c Dr.	xxxx		
	To Debentures Application A/c		xxxx	
	(Being money received on __% debentures @ Rs.____ each)			
(2) *Excess money refunded or adjusted for future calls*	Debenture Application A/c Dr.	xxx		
	To Bank A/c		xx	Amount refunded
	To Debenture Allotment A/c		xxx	Amount adjusted for allotment
	(Being excess money adjusted as per Board's resolution No…… dated……			
(3) Debentures Allotted	Debenture Application A/c Dr.	xxxx		
	To …… % Debenture A/c		xxxx	
	(Being the allotment of ….% Debentures of Rs….. each as per Board's resolution No….. dated……)			
	Debenture Allotment A/c Dr.	xxxx		

(4) Allotment money being called	To ….% Debentures A/c		xxxx	
	(Being allotment money being called)			
(5) Allotment money being received	Bank A/c Dr.	xxxx		
	To Debenture Allotment A/c		xxxx	
	(Being allotment money received)			
(6) Debenture Call money being called	Debenture Calls A/c Dr.	xxxx		
	To ….. % Debentures A/c		xxxx	
	(Being call money made due)			
(7) Call money received	Bank A/c Dr.	xxxx		
	To Debenture Calls A/c		xxxx	
	(Being call money received)			

Debentures issued at Premium

- The debentures, which are issued at a premium, are issued at a higher price than their nominal value.
- Debentures are issued at a premium by a company when the market rate of interest is lower than the debentures interest rate.
- *The premium on debentures is credited to 'Securities Premium Account' as 'Debentures' are covered in the definition of 'securities' u/s 2(h) of the Securities Contracts (Regulation) Act.*
- *Utilisation of such Debenture Premium is restricted as it is governed by Section 52 of the Companies Act, 2013.*

Event	Entry	Debit (Rs.)	Credit (Rs.)	Remarks
(1) Cash received on application	Bank A/c Dr.	xxxx		
	To Debentures Application A/c		xxxx	
	(Being money received on __% debentures @ Rs.____ each)			
(2) Excess money refunded or adjusted for future calls	Debenture Application A/c Dr.	xxx		
	To Bank A/c		xx	Amount refunded
	To Debenture Allotment A/c		xxx	Amount adjusted for allotment
	(Being excess money adjusted as per Board's resolution No…… dated……			
(3) Debentures Allotted	Debenture Application A/c Dr.	xxxx		
	To …… % Debenture A/c		xxxx	
	To Securities Premium A/c		xx	Difference between issue and nominal value
	(Being the allotment of ….% Debentures of Rs….. each and Premium amount transferred to Securities Premium A/c as per Board's resolution No….. dated……)			

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(4) Allotment money being called	Debenture Allotment A/c Dr.	xxxx		
	To ….% Debentures A/c		xxxx	
	(Being allotment money being called)			
(5) Allotment money being received	Bank A/c Dr.	xxxx		
	To Debenture Allotment A/c		xxxx	
	(Being allotment money received)			
(6) Debenture Call money being called	Debenture Calls A/c Dr.	xxxx		
	To ….. % Debentures A/c		xxxx	
	(Being call money made due)			
(7) Call money received	Bank A/c Dr.	xxxx		
	To Debenture Calls A/c		xxxx	
	(Being call money received)			

Debentures issued at Discount

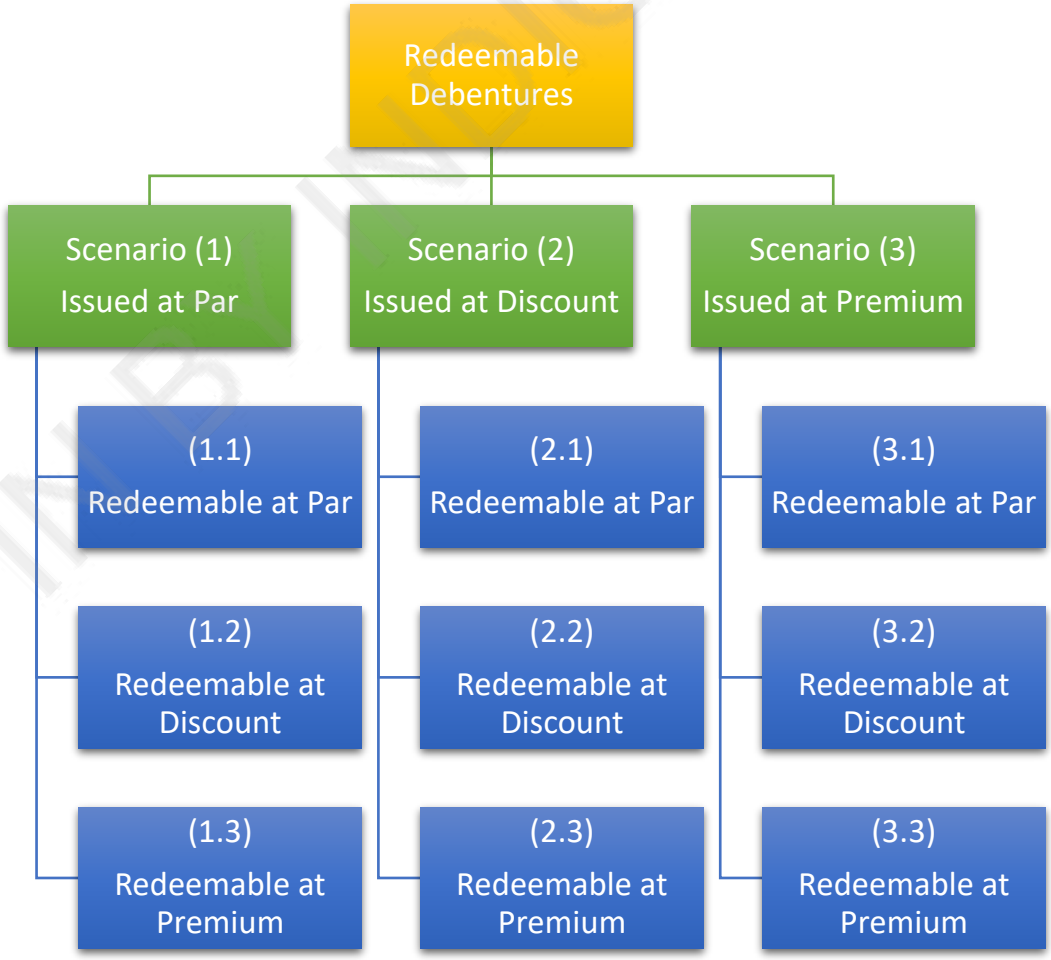
- The debentures which are issued at a discount are issued at a lower price than nominal value
- The Companies Act does not impose any restriction on the price at which debentures can be issued. Unlike shares, there is no limit for discount on issue of debentures.
- The company issues debentures at a discount when the market rate of interest is higher than the debenture interest rate.
- The difference between the nominal value of debentures and cash received is transferred to "Discount on Issue of Debentures Account".
- Such "Discount on Issue of Debentures" is written-off proportionately in subsequent years by charging to the Statement of Profit and Loss. It is considered a normal practice to amortize discount on issue of debentures over the period of benefit, i.e., normally 3 to 5 years.
- The Discount on issue of debentures is considered as incremental interest expense. The true expense (net borrowing cost) for a particular accounting period is, therefore, the total interest payment plus the discount written off.

Event	Entry	Debit (Rs.)	Credit (Rs.)	Remarks
(1) Cash received on application	Bank A/c Dr.	xxxx		
	To Debentures Application A/c		xxxx	
	(Being money received on __% debentures @ Rs.___ each)			
(2) Excess money refunded or adjusted for future calls	Debenture Application A/c Dr.	xxx		
	To Bank A/c		xx	Amount refunded
	To Debenture Allotment A/c		xxx	Amount adjusted for allotment
	(Being excess money adjusted as per Board's resolution No…… dated……			
(3) Debentures Allotted	Debenture Application A/c Dr.	xxxx		
	Discount on Issue of Debentures A/c Dr.	xx		Difference between issue

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				price and nominal value
	To …… % Debenture A/c		xxxx	
	(Being the allotment of ….% Debentures of Rs….. each and Discount amount transferred to Discount on Issue of Debentures A/c as per Board's resolution No….. dated……)			
(4) Allotment money being called	Debenture Allotment A/c Dr.	xxxx		
	To ….% Debentures A/c		xxxx	
	(Being allotment money being called)			
(5) Allotment money being received	Bank A/c Dr.	xxxx		
	To Debenture Allotment A/c		xxxx	
	(Being allotment money received)			
(6) Debenture Call money being called	Debenture Calls A/c Dr.	xxxx		
	To ….. % Debentures A/c		xxxx	
	(Being call money made due)			
(7) Call money received	Bank A/c Dr.	xxxx		
	To Debenture Calls A/c		xxxx	
	(Being call money received)			

ISSUE OF REDEEMABLE DEBENTURES – JOURNAL ENTRIES



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Scenario	Entry	Debit (Rs.)	Credit (Rs.)	Remarks
(1.1) Issued at Par Redeemed at Par	Bank A/c Dr.	xxxxx		
	To Debenture Application A/c		xxxxx	Application money
	(Being application money received)			
	Debenture Application A/c Dr.	xxxxx		Application money
	To ____% Debenture A/c		Xxxxx	
	(Being application money transferred to Debenture A/c)			
(2.1 & 2.2) Issued @ Discount Redeemed @ Par/ Discount	Bank A/c Dr.	xxxxx		The difference between the amount received and amount payable in future is considered as loss on issue on debentures and is to be written-off over the life of debentures.
	To Debenture Application A/c		xxxxx	
	(Being application money received)			
	Debenture Application A/c Dr.	xxxxx		
	Discount on issue of debentures A/c Dr.	xx		
	To ____% Debenture A/c		xxxxx	
	(Being application money transferred to Debenture A/c on allotment)			
(3.1 & 3.2) Issued @ Premium Redeemed @ Par/Discount	Bank A/c Dr.	xxxxx		The gain on paying less than what is received in this scenario will not be recognised in the books at the time of issue of debentures as per the conservatism concept.
	To Debenture Application A/c		xxxxx	
	(Being application money received)			
	Debenture Application A/c Dr.	xxxxx		
	To ____% Debenture A/c		xxxxx	
	To Securities Premium A/c		xx	
	(Being application money transferred to Debenture A/c on allotment)			
(1.3) Issued @ Par Redeemed @ premium	Bank A/c Dr.	xxxxx		The redemption premium is recorded as a loss on issue of debentures allotment time. Debenture Redemption Premium A/c is a personal account
	To Debenture Application A/c		xxxxx	
	(Being application money received)			
	Debenture Application A/c Dr.	xxxxx		
	To ____% Debenture A/c		xxxxx	
	(Being application money transferred to Debenture A/c)			
	Bank A/c Dr.	xxxx		
	Loss on issue of debenture A/c Dr. (Amount equal to redemption premium)	xxxx		
	To __% Debenture A/c		xxxxx	

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	To __% Debenture Redemption Premium A/c		xxxxx	representing company's liability.
	(Being call made subsequent to allotment)			
(2.3) Issued @ Discount Redeemed @ premium	Bank A/c Dr.	xxxxx		The difference between the redemption price and par value plus difference between the issue price and par value is treated as discount/loss on issue of debentures
	To Debenture Application A/c		xxxxx	
	(Being application money received)			
	Debenture Application A/c Dr.	xxxxx		
	To _____% Debenture A/c		xxxxx	
	(Being application money transferred to Debenture A/c)			
	Bank A/c Dr.	xxxx		
	Discount/Loss on issue of debenture A/c Dr. (Amount equal to discount on issue + premium on redemption)	xxxx		
	To __% Debenture A/c		xxxxx	
	To _% Debenture Redemption Premium A/c (Amount equal to premium payable on redemption)		xxxxx	
	(Being call made subsequent to allotment)			
(3.3) Issued @ premium Redeemed @ premium	Bank A/c Dr.	xxxxx		The premium received at the time of issue of debentures is credited to Securities premium account and premium paid at the time of redemption is a loss to be provided at the time of issue of debentures
	To Debenture Application A/c		xxxxx	
	(Being application money received)			
	Debenture Application A/c Dr.	xxxxx		
	To _____% Debenture A/c		xxxxx	
	(Being application money transferred to Debenture A/c)			
	Bank A/c Dr.	xxxx		
	Discount/Loss on issue of debenture A/c Dr. (Amount equal to premium on redemption)	xx		
	To __% Debenture A/c		xxxxx	
	To Securities Premium A/c (Amount equal to premium on issue)		xx	
	To _% Debenture Redemption Premium A/c (Amount equal to premium payable on redemption)		xx	
	(Being call made subsequent to allotment)			

DEBENTURES AS COLLATERAL SOCIETY

Collateral security = Secondary or Supporting security for a loan

- Under this arrangement, the borrower agrees that a particular asset or a group of assets of the company, will be realized and the proceeds there from will be applied to repay the loan in the event that the amount due, cannot be paid.
- Sometimes companies issue their own debentures as collateral security for a loan or a fluctuating overdraft.
    - When the loan is repaid on the due date, these debentures are at once released with the main security.

- In case, the company cannot repay its loan and the interest thereon on the due date, the lender becomes the debenture holder who can exercise all the rights of a debenture holder.

➢ ***The holder of such debentures is entitled to interest only on the amount of loan, but not on the debentures.***

Accounting Entries

There are two methods of showing these types of debentures in the accounts of a company.

➢ **Method 1**

No entry is made in the books of account of the company at the time of making issue of such debentures.

In the 'Notes to Accounts' of Balance Sheet, the fact of the debentures being issued and outstanding is **shown by a note under the liability secured**.

➢ **Method 2**

Under this method, the following accounting **entry is made to record the issue** of such debentures:

Debentures Suspense A/c	Dr.	
To …..% Debentures A/c		
(Being the issue of…debentures collaterally as per Board's Resolution No…..dated)		

The Debentures Suspense Account will appear on the assets side of the Balance Sheet under Other Non- Current Assets and Debentures on the liabilities side of the Balance Sheet. When the loan is repaid, the entry is reversed in order to cancel it.

Students should note that the Method 1 is much more logical from the accounting point of view. Therefore, it is advised to follow Method 1 .

DEBENTURES IN CONSIDERATION OTHER THAN FOR CASH

Debentures, just like shares, can also be issued for consideration other than for cash, such as for purchase of land, machinery, etc.

In this case, the following entries are passed:

(a) Sundry Assets A/c	Dr.	[Assets taken over]
To Sundry Liabilities A/c		[Liabilities assumed]
To Vendors Account		[Purchase consideration]
(Being the assets and liabilities taken over)		
(b) Vendors A/c	Dr.	
To Debentures A/c		
(Being the issue of….% debentures to satisfy purchase consideration)		

Further it should be noted that these debentures can be issued at par, premium and at discount. In each case the second entry for issue of debentures would be done accordingly

i.e. "Securities Premium A/c" will be created in case of 'issued at premium' or "Discount on Issue of Debentures A/c" will be created in case of 'issued at discount'.

Number of debentures to be issued is calculated as follows:-

1. When debentures are issued at par

$$\text{No. of Debentures} = \frac{\text{Purchase Consideration}}{\text{Par Value}}$$

2. When debentures are issued at premium

$$\text{No. of Debentures} = \frac{\text{Purchase Consideration}}{\text{Par Value + Premium}}$$

3. When debentures are issued at discount

$$\text{No. of Debentures} = \frac{\text{Purchase Consideration}}{\text{Par Value - Discount}}$$

TREATMENT OF DISCOUNT / LOSS ON ISSUE OF DEBENTURES

The discount on issue of debentures is amortised over a period between the issuance date and redemption date.

It should be written-off in the following manner depending upon the terms of redemption:

(a) If the debentures are **redeemable after a certain period of time**, the total amount of discount should be written-off equally throughout the life of the debentures **(applying the straight-line method)**. The main advantage of this method is that it spreads the burden of discount equally over the years.

(b) If the debentures are **redeemable at different dates**, the total amount of discount should be written-off in the ratio of benefit derived from debenture loan in any particular year **(applying the sum of the year's digit method)**. This method is suitable when debentures are redeemed by unequal instalments.

The accounting entries would be as follows :

Profit and Loss A/c		Dr.
	To Discount on Issue of Debentures A/c	

(Being the amount of discount on issue of debentures written-off)

Loss on issue of debentures is also a capital loss and should be written off in a similar manner as discount on debentures issued.

In the balance sheet both the items (Discount and Loss) are shown as Non-current/ current assets depending upon the period for which it has to be written off.

INTEREST ON DEBENTURES

- Interest payable on Debentures is treated as a charge against the profits of the company.

- Interest on debenture is paid periodically and is calculated at coupon rate on the nominal value of debentures.
- The company will pay interest net of tax to the debenture holders because the company is under obligation to deduct tax at source at the rates applicable under tax rules from time to time.
- The companies will deposit the tax so deducted with income tax authorities.

Following accounting entries are to be recorded in this regard:

Event	Entry	Debit (Rs.)	Credit (Rs.)	Remarks
(1) For making interest due	Interest A/c Dr.	xxx		
	To ….% Debentures holders' A/c		xxx	
	(Being interest due on debentures)			
(2) Payment of interest and deduction of tax at source (TDS)	…% Debentures holders' A/c Dr.	xxx		
	To TDS Payable A/c		xxx	
	To Bank A/c		x	
	(Being interest paid to the debenture holders after deducting tax at source)			
(3) Payment of TDS	TDS Payable A/c Dr.	x		
	To Bank A/c		x	
	(Being TDS deducted from interest on debentures paid)			
(4) Interest charged to P&L A/c	Profit & Loss A/c Dr.	xxx		
	To Interest A/c		xxx	
	(Being interest charged as expense to P&LA/c)			

Illustrations

Question: 1

Amol Ltd. issued 40,00,000, 9% debentures of Rs.50 each, payable on application as per term mentioned in the prospectus and redeemable at par any time after 3 years from the date of issue.

Record necessary entries for issue of debentures in the books of Amol Ltd.

Question: 2

Atul Ltd. issued 1,00,00,000, 8% debenture of Rs.100 each at a discount of 10% redeemable at par at the end of 10th year.

Money was payable as follows:

- Rs.30 on application
- Rs. 60 on allotment

Record necessary journal entries regarding issue of debenture.

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Question: 3
Koinal Chemicals Ltd. issued 15,00,000, 10% debenture of Rs.50 each at premium of 10%, payable as Rs.20 on application and balance on allotment. Debentures are redeemable at par after 6 years. All the money due on allotment was called up and received.
Record necessary entries when premium money is included in application money.

Question: 4
Modern Equipment's Ltd. issued 4,00,000, 12% debentures of Rs. 100 payables as follows:

- On application Rs.30
- On allotment Rs. 70

The debenture was fully subscribed, and all the money was duly received. As per the terms of issue, debentures are redeemable at Rs.110 per debenture. Record necessary entries regarding issue of debentures.
Record necessary entries regarding issue of debentures.

Question: 5
Agrotech Ltd. issued 150 lakh 9% debentures of Rs.100 each at a discount of 6%, redeemable at a premium of 5% after 3 years payable as:

- Rs.50 on application and
- Rs. 44 on allotment.

Record necessary journal entries for issue of debentures.

Question: 6
Simmons Ltd. issued 1,00,000, 12% Debentures of Rs.100 each at par payable in full on application by 1st April, Application were received for 1,10,000 Debentures. Debentures were allotted on 7th April. Excess money refunded on the same date.
You are required to pass necessary Journal Entries (including cash transactions) in the books of the company.

Question: 7
X Ltd. issued 1,00,000 12% Debentures of Rs.100 each at a discount of 10% payable in full on application by 31st May 2017. Applications were received for 1,20,000 debentures. Debentures were allotted on 9th June 2017. Excess monies were refunded on the same date.
Pass necessary Journal Entries. Also show necessary ledger accounts

Question: 8
X Ltd. obtains a loan from IDBI of Rs.1,00,00,000, giving as collateral security of Rs.1,50,00,000 (of Rs.10 each), 14%, First Mortgage Debentures.

Question: 9
X Company Limited issued 10,000 14% Debentures of the nominal value of Rs.50,00,000 as follows:
(a) To sundry persons for cash at 90% of nominal value of Rs.25,00,000.
(b) To a vendor for purchase of fixed assets worth Rs.10,00,000 – Rs.12,50,000 nominal value.
(c) To the banker as collateral security for a loan of Rs.10,00,000 – Rs.12,50,000 nominal value.
Pass necessary Journal Entries.

Question: 10
HDC Ltd issues 1,00,000, 12% Debentures of Rs.100 each at Rs.94 on 1st January 2017. Under the terms of issue, the debentures are redeemable at the end of 5 years from the date of the issue. Calculate the amount of discount to be written-off in each of the 5 years.

Question: 11
A company issued 12% debentures of the face value of Rs.10,00,000 at 10% discount on 1-1-2017. Debenture interest after deducting tax at source @ 10% was payable on 30th June and 31st of December every year. All the debentures were to be redeemed after the expiry of five-year period at 5% premium.
Pass journal entries for the accounting year 2017.

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ACCOUNTING FOR BONUS ISSUE AND RIGHT ISSUE

1.BONUS ISSUE

1.1 Introduction

- Issue of additional shares to existing shareholders, free of cost in proportion to existing holding
- It is also known as 'capitalization of profit' or ' scrip issue' or ' capitalization of profits'.

EXAMPLE:

Alpha company announced bonus issue to its shareholders in the ratio of 2:3 (2 shares for 3 shares held)

Shareholder X has 6000 shares before announcement.

He will be entitled to 4000 bonus shares (6000 shares *2/3)

1.2 Provisions of Companies Act 2013

As per section 63 (1) a company can issue fully paid up bonus issue to members, in any manner out of

- Free reserves
- Securities premium account
- Capital redemption reserve account

Provided that no issue shall be made out of

- Capital reserve
- Revaluation reserve

1.2.1 Conditions for bonus issue – Sec 63(2)

a) authorised by **articles of association**
b) on the recommendation of the board, must be authorised in the **general meeting**
c) not defaulted in the **payment of interest or principal** in respect of fixed assets, deposits or debt securities
d) not defaulted in the payment of **statutory dues of employees** (gratuity, provident fund, bonus)
e) outstanding partly paid-up shares made **fully paid-up**

SEBI Regulation 293

Includes above points +

Any of its promoters or directors is not an economic fugitive offender

Note: While converting partly paid up shares into fully paid up,

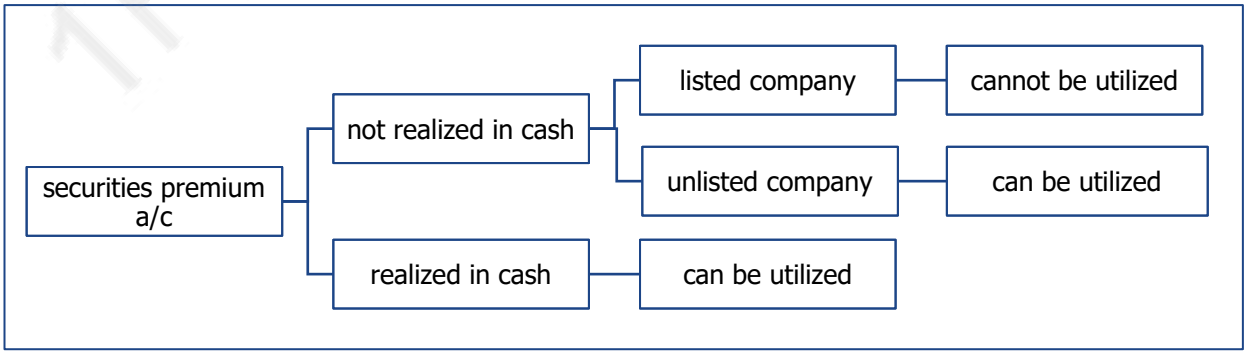
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Free reserve	Can be used
Securities premium a/c	Cannot be used
Capital redemption reserve a/c	Cannot be used

1.3. Journal entries

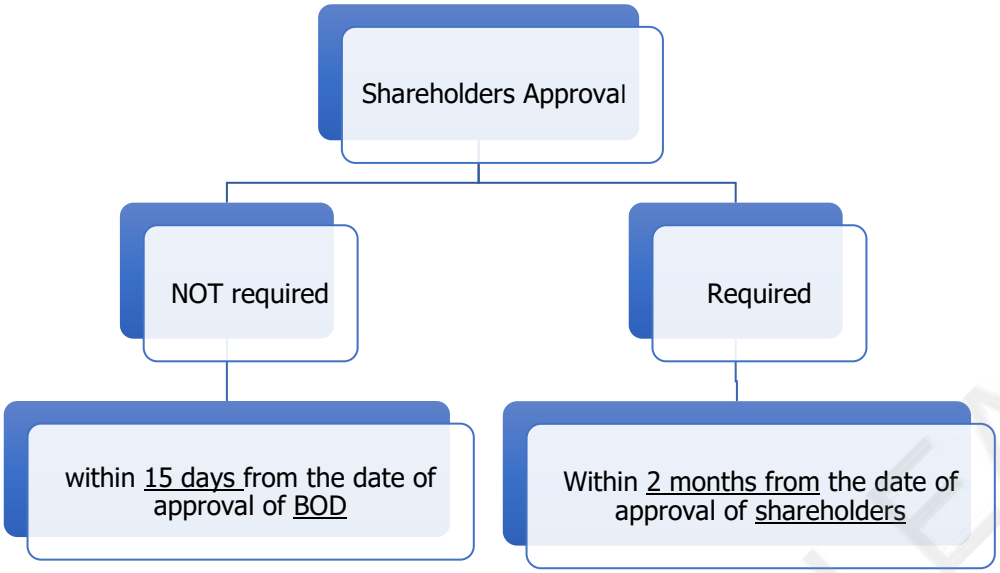
s. n	Particulars		Debit	Credit
(A)1.	**Sanction of an issue of bonus shares**			
	Capital redemption reserve a/c	Dr		
	General reserve a/c	Dr		
	Profit and loss a/c	Dr		
	To bonus to shareholders a/c			
2.	**Issue of bonus shares**			
	Bonus to shareholders a/c	Dr		
	To share capital a/c			
(B) 1.	**Sanction of bonus by converting partly paid up shares into fully paid up shares**			
	General reserve a/c	Dr		
	Profit and loss a/c	Dr		
	To bonus to shareholders a/c			
2.	**On making final call due**			
	Share final call a/c	Dr		
	To share capital a/c			
3.	**On adjustment of final call**			
	Bonus to shareholders a/c	Dr		
	To share final call a/c			

Note: Balance in the securities premium for issue of bonus shares, utilized in the following manner



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Regulation 295 – Completion of a bonus issue



1.5. EFFECTS OF BONUS ISSUE

Bonus issue has following major effects:

- **Increase in share capital**
- **Reduction in earnings per share (EPS) and other per share values**
- **Favourable act considered by the market**
- **Adjustment in market price**
- **Reduction in accumulated profit**

2.RIGHT ISSUE

2.1 Introduction

The companies act, 2013 provides existing shareholders a right to subscribe to any fresh issue of shares by the company in proportion to their existing holding for shares.

If the shareholders are not willing to exercise the rights, they are given right to renounce it in favour of someone else (unless the Articles of the company prohibits)

2.2. Conditions for Rights Issue of Shares

As per section 62(1)(a) of Companies Act 2013, the shares to existing equity shareholders through a letter of offer subject to the following conditions, namely:

A. The offer made by notice,
   - Specifying the number of shares offered,
   - Limiting a time not being less than 15 days and not exceeding 30 days from the date of offer

B. The offer shall include a right exercisable by the person concerned to renounce his shares offered; and the notice shall contain a statement of this right

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C. Board of directors shall dispose the notice, after the expiry of specified time

2.3. Exceptions to the rights of existing equity shareholders

As per section 62, rights shares can be offered, without being offered to existing shareholders under following situations, provided company has passed special resolution.

To employees under employees stock option

↓

To any persons, either for cash or consideration, (Price of the shares is determined by registered valuer)

↓

To creditors or debenture holders, as an option to buy equity shares

↓

To government for converting the debentures or loan into equity shares

2.4. Right of renunciation

It refers to the right of the shareholder to surrender his right to buy the securities and transfer such rights to any other person

The monetized value available to equity shareholders due to right issue is known as 'value of right'

$$\text{Ex right value of shares} = \frac{\text{Cum}-\text{right value of existing shares} + (\text{Rights shares} * \text{Issue price})}{\text{Existing number of shares} + \text{number of rights shares}}$$

Value of right = cum right value of share - ex right value of the shares

2.5. Journal Entries

S.N	PARTICULARS	DEBIT	CREDIT
1	**Issue of right shares at par**		
	Bank a/c Dr		
	To equity share capital a/c		
	(Being issue of right shares at par)		
2	**Issue of right shares at premium**		
	In case rights shares are being offered at a premium,		
	the premium amount credited to securities premium a/c		
	Bank a/c Dr		

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	To equity share capital a/c		
	To securities premium a/c		
	(being issue of right shares at premium)		

2.6. EFFECTS OF RIGHT ISSUE

- Maintenance of existing shareholders' proportional holding in company and retain their financial governance rights
- Dilution in the value of share
- Image enhancement
- Convenience in handling issue.

Summary

- Bonus issue means an issue of additional shares free of cost to existing shareholders
- Bonus shares can be issued from following:
    1. Free Reserves
    2. Securities Premium
    3. Capital Redemption Reserve
- Bonus issue cannot be made out of revaluation reserve created by revaluation of assets
- A Right issue is an offer of equity shares in a further issue of shares by a company to its existing shareholders, for maintaining their financial and governance interest in the company.
- The right shares are offered at a price less than cum - right value of shares, causing dilution in its post - right issue.
- The value of share offered after right is termed as ex- right value of shares (average price)
- The right issue is cost effectiveness as compared to a full-blown public issue.
- However, the dilution in the value of the share is a dampener and a major limitation in case of right issue.

Illustrations

Illustration – 1

Following items appear in the trial balance of Bharat Ltd. (listed company) as on 31st March, 20X1:

Particulars	Amount (Rs.)
40,000 Equity shares of Rs. 10 each	4,00,000
Capital Redemption Reserve	55,000
Securities Premium (collected in cash)	30,000
General Reserve	1,05,000
Surplus i.e. credit balance of Profit and Loss Account	50,000

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 4 shares held and for this purpose, it decided that there should be the minimum reduction in free reserves. Pass necessary journal entries.

Solution: Illustration 1

Journal Entries

Particulars		Dr. (₹)	Cr. (₹)
Capital **Redemption** Reserve A/c	Dr.	55,000	
Securities Premium A/c	Dr.	30,000	
General Reserve A/c (b.f.)	Dr.	15,000	
To Bonus to Shareholders A/c			1,00,000
(Being Bonus issue of one share for every four shares held)			
Bonus to Shareholders A/c	Dr.	1,00,000	
To Equity Share Capital A/c			1,00,000
(Being Bonus shares allotted or Capitalisation of profit)			

Working Note:

Number of Bonus shares to be issued- (40,000 shares / 4) X 1 = 10,000 shares

Value of Bonus shares = 10,000 shares of ₹10 each = ₹1,00,000

Illustration – 2

Following is the extract of the Balance Sheet of Solid Ltd. as at 31st March, 20X1:

Particulars	**Amount (Rs.)**
Authorised capital:	
10,000 12% Preference shares of Rs. 10 each	**1,00,000**
1,00,000 Equity shares of Rs. 10 each	**10,00,000**
	11,00,000
Issued and Subscribed capital:	
8,000 12% Preference shares of Rs. 10 each fully paid	**80,000**
90,000 Equity shares of Rs. 10 each, Rs. 8 paid up	**7,20,000**
Reserves and Surplus:	
General reserve	**1,60,000**
Revaluation reserve	**35,000**
Securities premium (collected in cash)	**20,000**
Profit and Loss Account	**2,05,000**
Secured Loan:	
12% Debentures @ Rs. 100 each	**5,00,000**

On 1st April, 20X1 the Company has made final call @ Rs. 2 each on 90,000 equity shares. The call money was received by 20th April, 20X1.

Thereafter the company decided to capitalize its reserves by way of bonus at the rate of one share for every four shares held. Show necessary entries in the books of the company and

prepare the extract of the Balance Sheet immediately after bonus issue if the company has passed necessary resolution at its general body meeting for increasing the authorized capital.

Solution: Illustration 2

Journal Entries in books of Solid Ltd.

Particulars			**Dr. (₹)**	**Cr. (₹)**
20X1				
April 1	Equity Share Final Call A/c	Dr.	1,80,000	
	To Equity Share Capital A/c			1,80,000
	(Final call of ₹2 per share on 90,000 equity shares due as per Board's Resolution dated ...)			
April 20	Bank A/c	Dr.	1,80,000	
	To Equity Share Final Call A/c			1,80,000
	(Being Final Call Amount Received)			
April 20	Securities Premium A/c	Dr.	20,000	
	General Reserve A/c	Dr.	1,60,000	
	Profit and Loss A/c (b.f.)	Dr.	45,000	
	To Bonus to Shareholders A/c (Bonus issue @ 1 share for every 4 shares held by utilising various reserves as per Board's Resolution dated...)			2,25,000
April 20	Bonus to Shareholders A/c	Dr.	2,25,000	
	To Equity Share Capital A/c			2,25,000
	(Capitalisation of profit)			

Balance Sheet (Extract) as at 30th April, 20X1 (after bonus issue)

Particulars	**Notes**	**Amount (₹)**
I. Equity and Liabilities		
(1) **Shareholders' funds**		
(a) Share capital	1	12,05,000
(b) Reserves and Surplus	2	1,95,000
(2) **Non-current liabilities**		
(a) Long-term borrowings	3	5,00,000
		19,00,000

Notes to Accounts

No		₹	₹
1	**Share Capital**		
	Authorised share capital		

	1,12,500 Equity shares of ₹10 each	11,25,000	
	10,000 12% Preference shares of ₹10 each	1,00,000	12,25,000
	Issued, subscribed and fully paid share capital		
	1,12,500 Equity shares of ₹10 each, fully paid (Out of above, 22,500 equity shares @ ₹10 each were issued by way of bonus)	11,25,000	
	8,000 12% Preference shares of ₹10 each	80,000	**12,05,000**
2	**Reserves and Surplus**		
	General Reserve	1,60,000	
	Less : Used for Bonus	(1,60,000)	Nil
	Revaluation Reserve		35,000
	Securities Premium	20,000	
	Less: Utilised for bonus	(20,000)	Nil
	Profit & Loss Account	2,05,000	
	Less: Utilised for bonus issue	(45,000)	1,60,000
	Total		**1,95,000**
3	**Long-term borrowings**		
	Secured		
	12% Debentures @ ₹100 each		**5,00,000**

Illustration – 3

A company offers new shares of Rs. 100 each at 25% premium to existing shareholders on one for four bases. The cum-right market price of a share is Rs. 150. Calculate the value of a right. What should be the ex-right market price of a share?

Solution: Illustration 3

Cum Right (Market) Price =₹150

Issue Price = 100 + 25% of 100

= 100 + 25 = ₹125

Ratio = 1:4

Theoretical Ex – Right Price = $\frac{4\times₹150+1\times₹125}{4+1}$

= $\frac{₹725}{5}$ = ₹145

Value of Right = Market Price - Theoretical Ex – Right Price

= ₹150 – ₹145 = ₹5

*This Method is Recommended for Exams

OR

Value of Right = $\frac{\text{Theoretical Ex – Right Price} - \text{Issue Price}}{\text{No.of Shares Held}}$

$= \frac{₹145 - ₹125}{4} = ₹5$

OR

$\text{Value of Right} = \frac{\text{Market Price} - \text{Issue Price}}{\text{No.of Shares Held (After Rights)}}$

$= \frac{₹150 - ₹125}{5} = ₹5$

Illustration 4

Following is the extract of the Balance Sheet of Manoj Ltd. as at 31st March, 20X1

	Rs.
Authorised capital:	
30,000 12% Preference shares of Rs. 10 each	**3,00,000**
4,00,000 Equity shares of Rs. 10 each	**40,00,000**
	43,00,000
Issued and Subscribed capital:	
24,000 12% Preference shares of Rs. 10 each fully paid	**2,40,000**
2,70,000 Equity shares of Rs. 10 each, Rs. 8 paid up	**21,60,000**
Reserves and surplus:	
General Reserve	**3,60,000**
Capital Redemption Reserve	**1,20,000**
Securities premium (collected in cash)	**75,000**
Profit and Loss Account	**6,00,000**

On 1st April, 20X1, the Company has made final call @ Rs. 2 each on 2,70,000 equity shares. The call money was received by 20th April, 20X1. Thereafter, the company decided to capitalize its reserves by way of bonus at the rate of one share for every four shares held.

Show necessary journal entries in the books of the company and prepare the relevant extract of the balance sheet as on 30th April, 20X1 after bonus issue.

Solution: Illustration 4

Journal Entries in the books of Manoj Ltd.

Particulars			**Dr. (₹)**	**Cr. (₹)**
20X1				
April 1	Equity Share Final Call A/c	Dr.	5,40,000	
	To Equity Share Capital A/c			5,40,000
	(Final call of ₹2 per share on 2,70,000 equity shares due as per Board's Resolution dated ...)			
April 20	Bank A/c	Dr.	1,80,000	
	To Equity Share Final Call A/c			1,80,000
	(Being Final Call Amount Received)			

April 20	Securities Premium A/c	Dr.	75,000	
	Capital Redemption Reserve A/c	Dr.	1,20,000	
	General Reserve A/c	Dr.	3,60,000	
	Profit and Loss A/c (b.f.)	Dr.	1,20,000	
	To Bonus to Shareholders A/c (Bonus issue @ 1 share for every 4 shares held by utilising various reserves as per Board's Resolution dated...)			6,75,000
April 20	Bonus to Shareholders A/c	Dr.	6,75,000	
	To Equity Share Capital A/c			6,75,000
	(Capitalisation of profit)			

Extract of Balance Sheet as at 30th April, 20X1 (after bonus issue)

Particulars	Amount (₹)
Authorized Capital	
30,000 12% Preference shares of ₹10 each	3,00,000
4,00,000 Equity shares of ₹10 each	40,00,000
Issued and subscribed capital	
24,000 12% Preference shares of ₹10 each, fully paid	2,40,000
3,37,500 Equity shares of ₹10 each, fully paid	33,75,000
(Out of the above, 67,500 equity shares @ ₹10 each were issued by way of bonus shares)	
Reserves and surplus Profit and Loss Account	4,80,000

Value of right share = Cum-right value of the share – Ex-right value of the share (working Note)

= ₹190 – ₹176 = ₹14 per share

Working Note:

= (Cum-right value of the existing shares + Rights shares x Issue Price) / (Existing No. of shares + No. of right shares) = (₹190 X 4 Shares + ₹120 X 1 Share) / (4 + 1) Shares

= ₹880 / 5 shares = ₹176 per share

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REDEMPTION OF PREFERENCE SHARES

Introduction

- Redemption is the process of repaying an obligation, at prearranged amounts and timings.
- These shares are issued on the terms that shareholders will be repaid the invested amount at a future date

Purpose Of Issuing Redeemable Preference Shares

- Raising finance in a dull primary market
- Encouraging potential investors to make investment , inorder to raise share capital of the company whose shares are traded on the stock exchange
- Utilizing surplus funds in redeeming capital when it cannot be used in the business for profitable purpose.

Provisions Of The Companies Act (Section 55)

1) Issue of Preference Shares should be authorized by **Articles**
2) Shares should be redeemable within a period **not exceeding 20 years** from the date of issue (**30 years** for the company undertaking infrastructure projects)
3) Only **fully paid up shares** can be redeemed.
4) Shares can be redeemed out of the **profits** of the company which would otherwise available for dividend or out proceeds of **fresh issue** of shares made for the purpose of redemption
5) A sum equal to the nominal amount of the shares redeemed should be transferred to **Capital Redemption Reserve account** .
6) If the premium payable on redemption , the same shall be provided for out of the **profits of the company or out of securities premium account**.



Note -
In case of companies ,which are prescribed and whose financial statements comply with section 133,
the premium, payable on redemption shall be provided for out of profits of the company ,
before redemption .

Section 52 of the Companies Act,2013 provides that the securities premium account may be

applied by the company;

(a) Towards issue of bonus shares
(b) To write off preliminary expenses
(c) To write off the expenses of, commission paid, or discount allowed on securities
(d) To provide for premium on the redemption of redeemable preference shares or debentures
(e) For purchase of its own shares or other securities



Note -
Companies whose financial statements comply with Accounting Standards as prescribed under Section 133 of the Companies Act, 2013, can't apply the securities premium account for the purposes (b) and (d) mentioned above.

Methods Of Redemption Of Fully Paid Up Shares

The preference shares can be redeemed under any of these following methods

- By fresh issue of Equity shares
- By capitalization of undistributed divisible profits
- By combination of A and B

Redemption Of Preference Shares By Fresh Issue Of Equity Shares

Reasons :

- For having permanent capital, it makes sense to issue to equity shares in place of preference shares
- When the balance of profit , which would otherwise be available for dividend,is insufficient.
- When the liquidity position of the company is not good enough

Advantages	Disadvantages
No cash outflow of money	There will be dilution of future earnings
Shares may be valued at a premium	Share - holding in the company is changed
Shareholders can retain their equity interest	

Accounting Entries

S.N	PARTICULARS	DEBIT	CREDIT
1.	**When shares are issued at par**		

	Bank a/c Dr.		
	To Share capital a/c		
	(being issue of…… shares of….each for purpose of redemption)		
2.	**When shares are issued at a premium**		
	Bank a/c Dr.		
	To Share capital a/c		
	To Securities Premium a/c		
	(being the issue of ……shares of ….each at a premium of…..each for the purpose of redemption)		
3.	**When preference shares are redeemed at par**		
	Redeemable Preference Share Capital a/c Dr.		
	To Preference Shareholders a/c		
	(being amount payable on redemption of preference shares)		
4.	**When preference shares are redeemed at a premium**		
	Redeemable Preference Share Capital a/c Dr.		
	Premium on Redemption of Preference Shares a/c Dr.		
	To Preference Shareholders a/c		
	(being amount payable on redemption of preference shares at premium)		
5.	**When payment is made to preference shareholders**		
	Preference Shareholders a/c		

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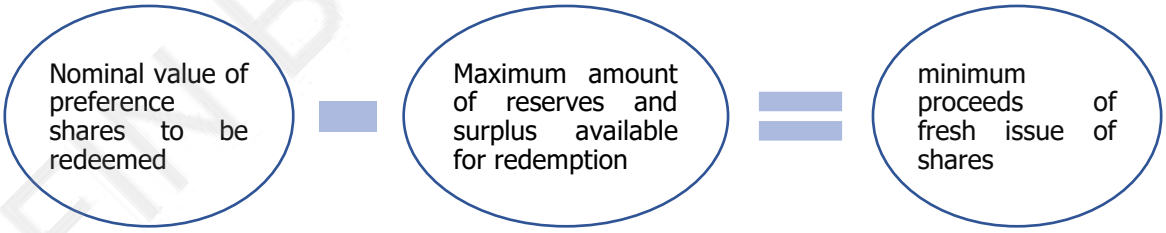
	Dr.		
	To Bank a/c		
	(being the amount paid on redemption on preference shares)		
6.	**For adjustment of premium on redemption**		
	Profit and loss a/c Dr.		
	To Premium on redemption of preference shareholders a/c		
	(being premium on redemption written off out of profits)		

Calculating of Minimum Fresh Issue of Shares

The minimum number of shares should be issued to ensure that provisions of Section 55 of the Companies Act,2013,are not violated. This is done in following four steps.

(1) The maximum amount of reserves and surplus available for redemption is ascertained taking into account the balances appearing in the balance sheet before redemption and the additional information given in problem.

(2) Minimum proceeds of fresh issue of shares:



(3) Minimum number of shares to be issued :

$$\text{Minimum number of shares} = \frac{\text{Minimum proceeds to comply with Sec 55}}{\text{Face value of one share}}$$

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(4) Shares cannot be issued in fractions , it must be approximated to the next highest figure to ensure that provisions of Section 55 are not violated, number of shares should be multiple of 10 or 50 or 100.

Redemption Of Preference Shares By Capitalisation Of Undistributed Divisible Profits

- The profit or a portion that can be otherwise legally distributed as dividend to shareholders is known as Divisible or distributable profit. (profit and loss a/c , General Reserve and other free reserves)
- When shares are redeemed by utilizing distributable profit, an amount equal to the face value is transferred to Capital Redemption Reserve account.



Note :

Securities Premium and Capital Reserve cannot be utilised for or transfer to Capital Redemption Reserve

ADVANTAGES	DISADVANTAGES
• No change in the percentage of equity shareholding pattern • Surplus funds can be used	• Reduction in liquidity

Accounting entries

S.n	Particulars	Debit	Credit
1.	**For transferring nominal amount of shares redeemed**		
	General reserve a/c Dr.		
	Profit and loss a/c Dr.		
	Or any divisible profits a/c Dr.		
	To Capital Redemption Reserve a/c		
	(being the amount transferred to Capital Redemption Reserve a/c)		

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2.	**When shares are redeemed at par**		
	Redeemable preference share capital a/c Dr.		
	To preference shareholders a/c		
	(being the amount payable on redemption of preference shares)		
3.	**When shares are redeemed at a premium**		
	Redeemable preference share capital a/c Dr.		
	Premium on Redemption of Preference Shares a/c Dr.		
	To Preference Shareholders a/c		
	(being amount payable on redemption of preference shares at premium)		
4.	**When payment is made to preference shareholders**		
	Preference Shareholders a/c Dr.		
	To Bank a/c		
	(being the amount paid on redemption on preference shares)		
5.	**For adjustment of premium on redemption**		
	Profit and loss a/c Dr.		
	To Premium on redemption of preference shareholders a/c		
	(being premium on redemption written off out of profits)		

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Redemption Of Preference Shares By Combination Of Fresh Issue And Capitalization Of Undistributed Divisible Profits

A company can redeem the preference shares partly from the proceeds from issue and partly out of profits. In order to fill the ' gap' between the face value of shares redeemed and the proceeds of new issue, a transfer should be made from distributable profits to Capital Redemption Reserve a/c.

Formula

1) **Amount to be transferred to Capital Redeption Reserve**

	Amount
Face value of shares redeemed	******
Less : Proceeds from new issue	******
	—--------
	******
	—---------

2) **Proceeds to be collected from New Issue**

	Amount
Face value of shares redeemed	******
Less: Profits available for distribution of dividend	******
	—----------
	*******
	—----------

The term proceeds from fresh/new issue shall be interpreted as:

a) Amount credited to share capital, in case of issue at par.
b) Amount credited to share capital, in case of issue at premium. Premium is received which is credited to the Securities Premium A/c, the same shall not be regarded as 'proceeds', because if it were treated as such, the transfer of distributable profits to the Capital Redemption Reserve would be lower by the amount of the premium received.
c) Amount received,in case of issue at discount.

Sale Of Investments To Provide Sufficient Funds For Redemption

Companies sell investments in the market to arrange funds for redemption of preference shares

Accounting entry:		DEBIT	CREDIT
Bank a/c	Dr.	*****	

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Profit and loss a/c (loss on sale)	Dr.	*****	
To Investments a/c			*****
To profit and loss a/c (profit on sale)			*****

Redemption Of Partly Called- Up Preference Shares

- The final call on shares are **demanded and received** before proceeding with redemption of preference share
- Only **fully paid up shares are redeemed** and partly paid up shares are left are intact.
- The company can **forfeit the shares**, if the call money is not received by the company in spite of giving opportunity to pay via reminders.

Redemption Of Fully Called But Partly Paid-Up Preference Shares

When The Amount Of Calls -In-Arrears Is Received By The Company

If the amount of unpaid calls is received by the company before redemption,

Bank a/c	Dr.	****	
To calls in arrears a/c			****

The company can proceed with redemption, as the shares become fully paid up.

In Case Of Forfeited Shares

When the amount of **calls in arrears not received** by the company, inspite of receiving **proper notice** by the shareholder, Board may decide to **forfeit the shares** instead of re-issuing, as redemption is due immediated or near future.

Following entry is passed

Preference Share Capital a/c	Dr.	****	
To calls in arrears a/c			****
To Shares Forfeited a/c			****

In this case, the number of shares to be redeemed will be reduced by the number of share forfeited.

Summary

- A company limited by shares , authorized by its Articles , may issue redeemable preference shares.
- Only fully paid up shares can be redeemed
- These are redeemed out of divisible profits.
- Methods of redemption of fully paidup shares;
  - (a) By Fresh issue of equity
  - (b) By Capitalization of undistributed profits
  - (c) By Combination of both

Illustrations

Illustration – 1

Hinduja Company Ltd. had 5,000, 8% Redeemable Preference Shares of Rs. 100 each, fully paid up. The company decided to redeem these preference shares at par by the issue of sufficient number of equity shares of Rs. 10 each fully paid up at par.

You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Solution: Illustration 1

Date	Particulars		Dr. (₹)	Cr. (₹)
	Bank A/c To Equity Share Capital A/c (Being the issue of 50,000 Equity Shares of ₹10 each)	Dr.	5,00,000	5,00,000
	8% Redeemable Preference Share Capital A/c To Preference Shareholders A/c (Being the amount payable on redemption of Preference shares)	Dr.	5,00,000	5,00,000
	Preference Shareholders A/c To Bank A/c (Being amount paid to preference Shareholders)	Dr.	5,00,000	5,00,000

Workings:

No. of Preference Shares = 5,000

Face Value = 100

Premium on Redemption = 0

Total amount Payable = 5,000 × ₹100

= ₹5,00,000 (Towards Face Value)

Face Value of Equity Shares = ₹10
No. of equity shares to be issued = 5,00,000/10 = 50,000

Illustration – 2

C Ltd. had 10,000, 10% Redeemable Preference Shares of Rs. 100 each, fully paid up. The company decided to redeem these preference shares at par, by issue of sufficient number of equity shares of Rs. 10 each at a premium of Rs. 2 per share as fully paid up.

You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Solution: Illustration 2

Date	Particulars		Dr. (₹)	Cr. (₹)
	Bank A/c To Equity Share Capital A/c To securities premium A/c (Being the issue of 1,00,000 Equity Shares of ₹10 each at a premium of ₹2)	Dr.	12,00,000	 10,00,000 2,00,000
	10% Redeemable Preference Share Capital A/c To Preference Shareholders A/c (Being the amount payable on redemption of Preference shares)	Dr.	10,00,000	 10,00,000
	Preference Shareholders A/c To Bank A/c (Being amount paid to preference Shareholders)	Dr.	10,00,000	 10,00,000

Working Notes:

1. Amount payable to Preference shareholders:
= 10,000 × ₹100
= ₹10,000
No premium on redemption.
2. Number of equity shares to be issued:

$$= \frac{\text{(Face value of Redemption of Preference Shares)}}{\text{(Face value of Equity Shares)}}$$

$$= \frac{(₹10,00,000)}{(₹10)} = 1,00,000$$

- 1Lakh equity shares to be issued with a face value of ₹10 at a premium of ₹2

Illustration – 3

The Board of Directors of a Company decide to issue minimum number of equity shares of Rs. 9 to redeem Rs. 5,00,000 preference shares. The maximum amount of divisible profits available for redemption is Rs. 3,00,000. Calculate the number of shares to be issued by the company to ensure that provisions of Section 55 are not violated. Also determine the number of shares if the company decides to issue shares in multiples of Rs. 50 only.

Solution: Illustration 3

Nominal value of preference shares = ₹ 5,00,000
Maximum possible redemption out of profits = ₹3,00,000
Minimum proceeds of fresh issue = ₹5,00,000 – ₹3,00,000
Proceed of one share = ₹9
Minimum number of shares = ₹2,00,000/9 = 22,222.22shares

As fractional shares are not permitted, the minimum number of shares to be issued is 22,223 shares. If shares are to be issued in multiples of 50, then the next higher figure which is a multiple of 50 is 22,250. Hence, minimum number of shares to be issued in such a case is 22,250 shares.

Illustration 4

The Balance Sheet of X Ltd. as on 31st March, 20X3 is as follows:

Particulars	Amount (Rs.)
EQUITY AND LIABILITIES	
1. Shareholders' funds	
a Share capital	2,90,000
b Reserves and Surplus	48,000
2. Current liabilities	
Trade Payables	56,500
Total	**3,94,500**
ASSETS	
1. Fixed Assets	
Tangible asset	3,45,000
Non-current investments	18,500
2. Current Assets	
Cash and cash equivalents (bank)	31,000
Total	**3,94,500**

The share capital of the company consists of Rs. 50 each equity shares of Rs. 2,25,000 and Rs. 100 each Preference shares of Rs. 65,000 (issued on 1.4.20X1

The necessary Journal Entries to record the above transactions and prepare the balance sheet as on completion of the above transactions.

Solution: Illustration 4

Journal Entries

Date	Particulars		Dr. (₹)	Cr. (₹)
	Bank A/c (625 × ₹60) To Equity Share Capital A/c To Securities Premium [Being 625 equity shares issued at ₹60 (50 towards Face Value + ₹10 Premium)]	Dr.	37,500	 31,250 6,250
	Bank A/c Profit and Loss A/c (loss on sale) A/c To Investments (Being Investment sold)	Dr. Dr.	15,000 3,500	 18,500
	Profit and Loss A/c To Loss on sale of Investment (Being loss on Sale of Investment Transferred to P/L)	Dr.	3,500	 3,500
	Profit and Loss A/c To Premium on Redemption of Preference Shares A/c (Being Premium on Redemption transferred to P/L)	Dr.	6,500	 6,500
	Profit and Loss A/c To Capital Redemption Reserve A/c (65,000 – 31,250)[Being Creation of CRR to the extent of excess of nominal value of Preference share over fresh issue]	Dr.	33,750	 33,750
	Preference Shareholders A/c To Bank A/c (Being amount paid to preference Shareholders)	Dr.	71,500	 71,500

Balance Sheet (after redemption)

Particulars	**Note**	**Amount**
I. EQUITY AND LIABILITIES		
(1) Shareholder's Funds		
(a) Share capital	**1**	2,56,250
(b) Reserves and Surplus	**2**	44,250
(2) Current liabilities		
(a) Trade Payables		56,500
Total		**3,57,000**
II. Assets		
(1) PPE		

(a) Tangible asset		3,45,000
(b) Current Assets	**3**	12,000
Total		**3,57,000**

Notes to accounts

		₹	₹
1	**Share Capital**		
	Authorised, Issued, and Paid - up Shares of ₹50	2,56,250	2,56,250
2	**Reserves and Surplus**		
	Capital Redemption Reserve	33,750	
	Profit and Loss Account (48,000 – 6,500 – 3,500 – 33,750)	4,250	
	Securities Premium	6,250	44,250
3	**Cash and cash equivalents**		
	Balances with banks (31,000 + 37,500 +15,000 – 71,500)		12,000

Working Notes:

1. Amount Payable to Preference Share holders

Nominal value of Preference Shares = ₹65,000

Add: Premium (10%) = ₹6,500

= ₹71,500

2. No. of Equity shares to be issued

Current Bank Balance = ₹31,000

Add: Amount Realised on sale = ₹15,000

Total Available = ₹46,000

Less: Minimum Balance of = ₹12,000

Amount available for redemption = ₹71,500 – ₹34,000

= 37,500

Issue Price of equity shares = ₹50 (Issue Price) + ₹10 (Premium)

= ₹60

No. of Shares to be issued = $\frac{₹37,500}{₹60}$ = 625 Shares

Equity Share Capital = 625 × ₹50 = 31,250

Securities Premium = 625 × ₹10 = 6,250

Illustration 5

The following are the extracts from the Balance Sheet of ABC Ltd. as on 31st December, 20X1.

Particulars	**Amount (Rs.)**
Share capital:	

40,000 Equity shares of Rs. 10 each **fully paid**	Rs. 4,00,000
1,000,10% Redeemable preference share s of Rs. 100 each **fully paid**	Rs. 1,00,00
Reserve & Surplus:	
Capital reserve	Rs. 50,000
Securities premium	Rs. 50,000
General reserve	Rs. 75,000
Profit and Loss Account	Rs. 35,000

On 1st January 20X2, the Board of Directors decided to redeem the preference shares **at par** by utilization of reserve.

You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Solution: Illustration 5

Date	Particulars		Dr. (₹)	Cr. (₹)
20X2 Jan 1	10% Redeemable Preference Share Capital A/c To Preference Shareholders A/c (Being the amount payable on redemption transferred to Preference Shareholders Account)	Dr.	1,00,000	 1,00,000
	Preference Shareholders A/c To Bank A/c (Being the amount paid on redemption of preference shares)	Dr.	1,00,000	 1,00,000
	General Reserve A/c Profit & Loss A/c To Capital Redemption Reserve A/c (Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)	Dr. Dr.	75,000 25,000	 1,00,000

Illustration 6

C Limited had:

3,000, 12% Redeemable Preference Shares of Rs. 100 each, fully paid up
The company had to redeem these shares at a premium of 10%
It was decided by the company to issue the following: • 25,000 Equity Shares of Rs. 10 each at par • 1,000 14% Debentures of Rs. 100 each

The issue was fully subscribed, and all amounts were received in full. The payment was duly made. The company had sufficient profits.

Show Journal Entries in the books of the company.

Solution: Illustration 6

Date	Particulars		Dr. (₹)	Cr. (₹)
	Bank A/c To Equity Share Capital A/c (Being the issue of 25,000 equity shares of ₹10 each at par as per Board's resolution No……dated…..)	Dr.	2,50,000	2,50,000
	Bank A/c To 14% Debenture A/c (Being the issue of 1,000 Debentures of ₹100 each at par)	Dr.	1,00,000	1,00,000
	12% Redeemable Preference Share Capital Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c (Being the amount payable on redemption to Preference Shareholders at 10% premium)	Dr. Dr.	3,00,000 30,000	 3,30,000
	Preference Shareholders A/c To Bank A/c (Being the amount paid on redemption of preference shares)	Dr.	3,30,000	3,30,000
	Profit & Loss A/c To Premium on Redemption of Preference Shares/c (Being Premium on redemption transferred to P/L)	Dr.	30,000	30,000
	Profit & Loss A/c To Capital Redemption Reserve A/c (Being the amount transferred to Capital Redemption Reserve Account on redemption to the extent not covered by fresh issue)	Dr.	50,000	50,000

Working Note:

Amount to be transferred to Capital Redemption Reserve Account

Face value of shares to be redeemed (3,000 × ₹100)	3,00,000
Add: 10% Premium	30,000
Amount Payable to Preference Share Holders	3,30,000
Proceeds from fresh issue (25,000 shares @ ₹10)	2,50,000
Amount of CRR requirement (3,00,000 – 2,50,000)	50,000

Illustration 7

The capital structure of a company consists of:

Particulars	**Amount (Rs.)**
20,000 Equity Shares of Rs. 10 each **fully paid up**	
1,000 8% Redeemable Preference Shares of Rs. 100 each **fully paid up** (issued on 1.4.20X1).	
Undistributed reserve and surplus stood as:	
General Reserve	Rs. 80,000
Profit and Loss Account	Rs. 20,000
Investment Allowance Reserve (out of which Rs. 5,000, not free for distribution as dividend)	Rs. 10,000
Securities Premium	Rs. 2,000
Cash at bank	Rs. 98,000

Preference shares are to be redeemed at a Premium of 10% and for the purpose of redemption, the directors are empowered to make fresh issue of Equity Shares at par after utilizing the undistributed reserve and surplus, subjected to the conditions that a sum of Rs. 20,000 shall be retained in general reserve and which should not be utilized.

Pass Journal Entries to give effect to the above arrangements and show how the relevant items will appear in the Balance Sheet of the company after the redemption carried out.

Solution: Illustration 7

Working Note:

1

	₹
Face Value of Preference Shares (1,000 × 100)	1,00,000
Premium on Redemption (10% of 1,00,000)	10,000
Amount Payable to Preference Share Holders	1,10,000

2. Maximum CRR Possible

	Total	**Restricted**	**Available**
General Reserve	80,000	20,000	60,000
Profit & Loss	20,000	10,000 (Premium)	10,000
Investment Allowance Reserve	10,000	5,000	5,000
Securities Premium*	--	--	--
Maximum CRR			25,000
Face Value of Preference Shares Redeemed			1,00,000
Shortfall (Required to Fresh issue)			75,000

*Securities Premium not considered as a free reserve for the purpose of Redemption of Preference shares

Journal Entries

Date	Particulars		Dr. (₹)	Cr. (₹)
	Bank A/c To Equity Share Capital A/c (Being the issue of 2,500 equity shares of ₹10)	Dr.	25,000	 25,000
	8% Redeemable Preference Share Capital A/c Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c (Being amount payable to Preference Share Holders)	Dr. Dr.	1,00,000 10,000	 1,10,000
	Preference Shareholders A/c To Bank A/c (Being the amount paid to Preference Share Holders)	Dr.	1,10,000	 1,10,000
	Profit & Loss A/c To Premium on Redemption of Preference Shares a/c (Being Premium Transferred to P/L)	Dr.	10,000	 10,000
	General Reserve A/c Profit & Loss A/c Investment Allowance Reserve A/c To Capital Redemption Reserve A/c (Being CRR created to the extent not covered by Fresh issue)	Dr. Dr. Dr.	60,000 10,000 5,000	 75,000

Balance Sheet as on ……[Extracts]

Particulars	**Note**	**Amount**
I. EQUITY AND LIABILITIES		
(1) Shareholder's Funds		
(a) Share capital	**1**	2,25,000
(b) Reserves and Surplus	**2**	1,02,000
Total		
II. Assets		
(1) PPE		
(a) Current Assets	**3**	13,000
Total		

Notes to accounts

		₹	₹
1	**Share Capital**		

	Authorised, Issued, and Paid - up 22,500 equity Shares of ₹10	2,25,000	2,25,000
2	**Reserves and Surplus**		
	General Reserve (80,000 – 60,000)	20,000	
	Investment Allowance Reserve	5,000	
	Capital Redemption Reserve	75,000	
	Securities Premium	2,000	1,02,000
3	**Cash and cash equivalents**		
	Balances with banks (98,000 + 25,000 – 1,10,000)	13,000	13,000

Illustration 8

The Balance Sheet of XYZ as at 31st December, 20X1 inter alia includes the following:

Particulars	**Amount (Rs.)**
50,000, 8% Preference Shares of Rs. 100 each, **Rs. 70 paid up**	35,00,000
1,00,000 Equity Shares of Rs. 100 each **fully paid up**	1,00,00,000
Securities Premium	5,00,000
Capital Redemption Reserve	20,00,000
General Reserve	50,00,000

Under the terms of their issue, the preference shares are redeemable on 31st March, 20X2 at 5% premium.

In order to finance the redemption, the company makes,Rights issue of 50,000 equity shares of Rs. 100 each at Rs. 110 per share

Rs. 20 being payable on application
Rs. 35 (including premium) on allotment
Balance on 1st January, 20X3

1. The issue was fully subscribed, and allotment made on 1st March, 20X2. The money due on allotment were received by 31st March, 20X2.
2. The preference shares were redeemed after fulfilling the necessary conditions of Section 55 of the Companies Act, 2013.

You are asked to pass the necessary Journal Entries and show the relevant extracts from the balance sheet as on 31st March, 20X2 with the corresponding figures as on 31st December, 20X1

Solution: Illustration 8

Journal Entries

Date	Particulars		Dr. (₹)	Cr. (₹)

	8% Preference Share Final Call A/c To 8% Preference Share Capital A/c (For final call made on preference shares @ ₹30 each to make them fully paid up)	Dr.	15,00,000	15,00,000
	Bank A/c To 8% Preference Share Final Call A/c (Being amount received from preference shareholders for final call)	Dr.	15,00,000	15,00,000
	Bank A/c To Equity Share Application A/c (Being application money on 50,000 equity shares @₹20 per share)	Dr.	10,00,000	10,00,000
	Equity Share Allotment A/c To Equity Share Capital A/c To Securities Premium A/c (Being amount due on 50,000 equity shares @ ₹35 per share including a premium)	Dr.	17,50,000	 12,50,000 5,00,000
	Bank A/c To Equity Share Allotment A/c (Being amount received from equity shareholders towards allotment)	Dr.	17,50,000	17,50,000
	8% Preference Share Capital A/c Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c (Being amount payable to preference shareholders on redemption at 5% premium)	Dr. Dr.	50,00,000 2,50,000	 52,50,000
	Preference Shareholders A/c To Bank A/c (Being amount paid to preference shareholders)	Dr.	52,50,000	52,50,000
	General Reserve A/c To Premium on Redemption (Being premium on redemption of preference shares transferred to General Reserve)	Dr.	2,50,000	2,50,000
	General Reserve A/c To Capital Redemption Reserve A/c (Being CRR created as per the requirement of companies Act i.e, 50,00,000 – 10,00,000 - 12,50,000)	Dr.	27,50,000	27,50,000

Balance Sheet (extracts)

Particulars	Note	As at 31.3.20X2 (₹)	As at 31.12.20X1(₹)

EQUITY AND LIABILITIES			
I. Shareholders' funds			
(a) Share capital	1	1,22,50,000	1,35,00,000
(b) Reserves and Surplus	2	77,60,000	75,00,000

Notes to accounts

		As at 31.3.20X2 (₹)	**As at 31.12.20X1(₹)**
1	**Share Capital**		
	Authorised 1,00,000 equity Shares of ₹100 1,50,000 equity Shares of ₹100 50,000 preference shares of ₹100	 1,50,00,000 50,00,000	 1,00,00,000 50,00,000
		200,00,000	**1,50,00,000**
	Issued, and Paid-up: 1,00,000 Equity shares of ₹100 each fully paid up 50,000 Equity shares of ₹100 each ₹45 paid up	 1,00,00,000 22,50,000	 1,00,00,000 -
	50,000, 8% Preference shares of ₹100 each, ₹70 paid up	-	35,00,000
		1,22,50,000	**1,35,00,000**
2	**Reserves and Surplus**		
	Securities Premium	10,00,000	5,00,000
	Capital Redemption Reserve	47,50,000	20,00,000
	General Reserve (50 – 2.5 -27.5)	20,00,000	50,00,000
		77,50,000	**75,00,000**

Note: Amount collected towards face value on issue of Equity Shares can be used for redemption of preference shares.

Workings:

Amount payable to preference shareholders:

= ₹50,00,000 + ₹2,50,000

= ₹52,50,000

Illustration 9

The following are the extracts from the Balance Sheet of ABC Ltd. as on 31st December, 20X1:

Share capital:

- 50,000 Equity shares of Rs.10 each fully paid – Rs.5,00,000;
- 2,000 10% Redeemable preference shares of Rs.100 each fully paid – Rs. 2,00,000.

Reserve & Surplus:

- Capital reserve – Rs.2,00,000;

- General reserve –Rs. 2,00,000;
- Profit and Loss Account – Rs.75,000.

On 1st January 20X2, the Board of Directors decided to redeem the preference shares at premium of 5% by utilization of reserves.

You are required to prepare necessary Journal Entries including cash transactions in the books of the company.

Solution: Illustration 9

Journal Entries

Date	Particulars		Dr. (₹)	Cr. (₹)
20X2 Jan 1	10% Redeemable Preference Share Capital A/c Premium on Redemption of Preference Shares To Preference Shareholders A/c (Being the amount payable on redemption transferred to Preference Shareholders Account)	Dr.	2,00,000 10,000	 2,10,000
	Preference Shareholders A/c To Bank A/c (Being the amount paid on redemption of preference shares)	Dr.	2,10,000	2,10,000
	General Reserve A/c To Capital Redemption Reserve A/c (Being the amount transferred to Capital Redemption Reserve Account)	Dr.	2,00,000	2,00,000
	Profit & Loss A/c To Premium on Redemption of Preference Shares A/c (Being premium on redemption charged to Profit and Loss A/c)	Dr.	10,000	10,000

Note: Capital reserve cannot be utilized for transfer to Capital Redemption Reserve.

Illustration 10

The Balance Sheet of XYZ Ltd. as at 31st December, 20X1 inter alia includes the following information:

Particulars	**Rs.**
50,000, 8% Preference Shares of Rs.100 each, Rs.70 paid up	35,00,000
1,00,000 Equity Shares of Rs.100 each fully paid up	1,00,00,000
Securities Premium	5,00,000
Capital Redemption Reserve	20,00,000

General Reserve	50,00,000
Bank	15,00,000

Under the terms of their issue, the preference shares are redeemable on 31st March, 20X2 at 5% premium. In order to finance the redemption, the company makes a rights issue of 50,000 equity shares of Rs. 100 each at Rs. 110 per share, Rs. 20 being payable on application, Rs. 35 (including premium) on allotment and the balance on 1st January, 20X3.

The issue was fully subscribed and allotment made on 1st March, 20X2. The money due on allotment were duly received by 31st March, 20X2. The preference shares were redeemed after fulfilling the necessary conditions of Section 55 of the Companies Act, 2013.

Assume that the Preference Shareholders holding 2,000 shares fail to make the payment for the Final Call made under Section 55,

You are asked to pass the necessary Journal Entries and show the relevant extracts from the balance sheet as on 31st March, 20X2 with the corresponding figures as on 31st December, 20X1 assuming that the shares in default are forfeited after giving proper notices.

Solution: Illustration 10

Journal Entries

Date	Particulars		Dr. (₹)	Cr. (₹)
	8% Preference Share Final Call A/c To 8% Preference Share Capital A/c (Being Final call of ₹30 made on 50,000 pref. shares)	Dr.	15,00,000	 15,00,000
	Bank A/c Calls – in – arrear A/c To 8% Preference Share Final Call A/c	Dr. Dr.	14,40,000 60,000	 15,00,000
	8% Preference Share Capital A/c To Calls – in – arrear A/c To Shares Forfeited A/c (Being Forfeiture of 2000 pref. shares ₹70 paid up)	Dr.	2,00,000	 60,000 1,40,000
	Bank A/c To Equity Share Application A/c (Being receipt of share application money on 50,000 equity shares @ 20 each)	Dr.	10,00,000	 10,00,000
	Equity Share Application A/c To Equity Share Capital A/c (Being Capitalization of share application money)	Dr.	10,00,000	 10,00,000

	Equity Share Allotment A/c To Equity Share Capital A/c (50,000 × ₹25) To Securities Premium A/c (50,000 ×₹10)	Dr.	17,50,000	 12,50,000 5,00,000
	Bank A/c To Equity Share Allotment A/c (Amount received on allotment)	Dr.	17,50,000	 17,50,000
	8% Preference Share Capital A/c Premium on Redemption of Preference Shares A/c (48,00,000 × 5%) To Preference Shareholders A/c (Being amount payable on redemption of 48,000 preference shares at a premium of 5%)	Dr. Dr.	48,00,000 2,40,000	 50,40,000
	Preference Shareholders A/c To Bank A/c (For amount paid to preference shareholders)	Dr.	50,40,000	 50,40,000
	General Reserve A/c To Capital Redemption Reserve A/c [48,00,000 – 10,00,000 – 12,50,000] (Being creation of CRR not covered by the proceeds of fresh issue)	Dr.	25,50,000	 25,50,000
	General Reserve A/c To Premium on Redemption A/c (Being Premium on Redemption Written – off)	Dr.	2,40,000	 2,40,000

Balance Sheet (extracts)

Particulars	**Note**	**As at 31.3.20X2 (₹)**	**As at 31.12.20X1(₹)**
EQUITY AND LIABILITIES			
I. Shareholders' funds			
(a) Share capital	1	1,23,90,000	1,35,00,000
(b) Reserves and Surplus	2	77,60,000	75,00,000
ASSETS			
2. Current Assets			
Cash and cash equivalents	3	6,50,000	15,00,000

Notes to accounts

		As at 31.3.20X2 (₹)	**As at 31.12.20X1(₹)**
1	**Share Capital**		
	Issued, and Paid-up:	1,00,00,000	1,00,00,000

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	1,00,000 Equity shares of ₹100 each fully paid up 50,000 Equity shares of ₹100 each ₹45 paid up	22,50,000	-
	50,000, 8% Preference shares of ₹100 each, ₹70 paid up	-	35,00,000
	Shares Forfeited	1,40,000	
		1,23,90,000	**1,35,00,000**
2	**Reserves and Surplus**		
	Securities Premium	10,00,000	5,00,000
	Capital Redemption Reserve	45,50,000	20,00,000
	General Reserve (50 – 25.5 -2.4)	22,10,000	50,00,000
		77,60,000	**75,00,000**
3	Cash and Cash Equivalents		
	Bank	6,50,000	15,00,000

Working Note:

Bank Balance

Opening Balance	15,00,000
Add: Preference share final call	14,40,000
Add: Equity Share Application	10,00,000
Add: Equity Share Allotment	10,00,000
	56,90,000
Less: Preference Shares Redeemed	50,40,000
Closing Balance	**6,50,000**

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REDEMPTION OF DEBENTURES

1. Introduction

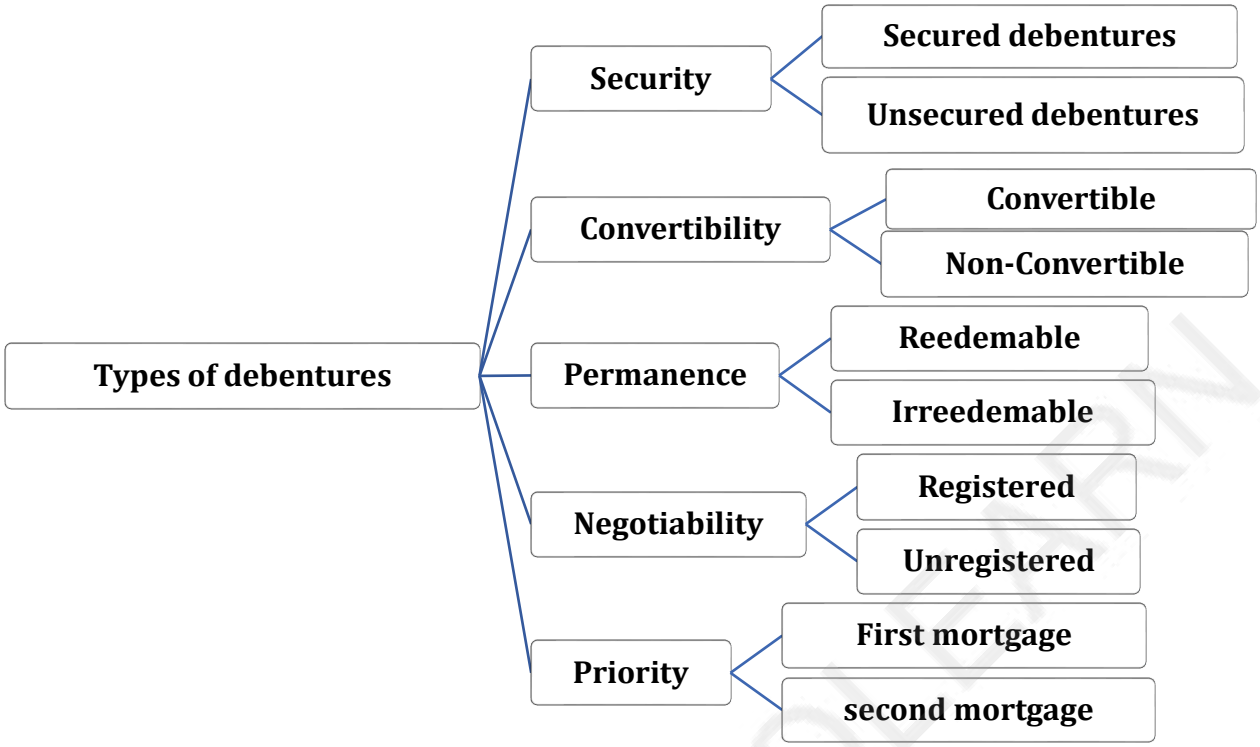
- A debenture is an instrument issued by a company under its seal, acknowledging a debt and containing provisions as regards repayment of the principal and interest
- It's a long-term debt for the company. They are commonly secured by charge. Thus, they appear under "Secured Liabilities".
- If a charge has been created on any or the entire asset of the company, the nature of the charge and the asset charged therein are described in the bond. The certificate registering the charge with the registrar is also printed on the bond.
- A trusteeship in favor of one or more persons in the case of mortgage debentures is created. The trustees of debenture holders can take any action necessary to safeguard the interest of debenture holders.
- It earns a fixed income in form of interest. Interest is payable by the company whether it earns profit or not.
- The procedure for issue of debentures is similar to that of issue of shares. Thus, the amount can be collected in lumpsum along with application or in instalments.
- In case of oversubscription, the excess applications must be rejected, and the amount should be refunded. The excess money cannot be adjusted as in case of shares.
- They can be issued for
    - Cash
    - Consideration other than cash.
    - As collateral security.
- They can be issued at
    - Par
    - Premium
    - At discount
- The terms of redemption should also be accounted at the time of issue. Redemption of debentures at a premium is a known loss at the time of issue of debentures as the terms of issue generally contain such provisions for redemption.

2. Provision Of Companies Act 2013

- **Sec.71(1)** - A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. Provided the issue of convertible debentures is approved by a special resolution passed at a duly convened general meeting.
- **Sec.71 (2)** -No company can issue any debentures which carry any voting rights.
- **Sec.71(4)-**The company should create a debenture redemption reserve account (DRR) out of free reserves and the amount credited to such account should not be utilized by the company for any purpose other than the redemption of debentures.

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3. Types Of Debentures



Redeemable debentures - Debentures, which can be redeemed or for which payment is made after a specified time are called Redeemable debentures.

These are redeemable-

(i) At the expiry of a specified period either at par or at a premium;
(ii) By purchasing in the open market at any time at the price prevailing in the market; and
(iii) By annual drawings.

Irredeemable debentures - When the issuing company does not fix any date by which debentures can be redeemed, and the holders of such debentures cannot demand payment from the company so long as it is a going concern it is called irredeemable debentures. Usually such debentures are repayable after a long period of time or when the company decides to wind up.

First debentures: - Those debentures, which are repaid before other debentures are paid out, are called First debentures.

Second debentures: - Those debentures, which are paid after the payment towards the First debenture, are called Second debentures.

Convertible debentures: - Those debentures, which are given the option to convert the debentures fully or partly into equity shares after a specified time, are called Convertible Debentures. If the debentures are fully converted, then it is called as 'Fully Convertible debentures. those which are partly convertible are called 'Partly Convertible debentures.

Non-convertible Debentures: - The debentures that cannot be converted into equity shares such are non-convertible debentures.

Mortgage Debentures: - Debentures, which are secured either on a particular asset [called fixed charge], or on the general assets of the company [called floating charge], are called Mortgage debentures.

Unsecured / Naked Debentures: - Those debentures which are not secured, are called naked debentures. Companies with very good standing can issue such debentures.

Registered Debentures – Those which are registered with the Registrar

Unregistered Debentures – Those which are not registered with the registrar.

4. Debenture Redemption Reserve – Sec 71 Of Companies Act 2013

(1) Where a company issues debenture under this section, it should **create a Debenture Redemption Reserve (DRR) account** out of its profits which are available for distribution of dividend **every year** until such debentures are redeemed.

(2) If Debentures are **redeemed at a premium**, DRR is created for an amount including redemption amount.

(3) The amounts credited to the debenture redemption reserve **should not be utilized** by the company except for the purpose aforesaid.

(4) The company should **pay interest and redeem the debentures** in accordance with the terms and conditions of their issue.

(5) In **case of failure** by the company, the **Tribunal** may, on the application of any or all the holders of debentures or debenture trustee and, after hearing the parties concerned, direct, by **order**, the company to redeem the debentures forthwith by the payment of principal and interest due thereon.

(6) The company can create an investment out of the amount set aside for the reserve. It will be called **Debenture Redemption Reserve Investment**.

(7) Interest earned on DRR investments will be credited to profit and loss account.

(8) In **last year**, the Debenture Redemption Reserve Investments are **encashed** and the amount so obtained is used for the redemption of debentures.

(9) Any **profit or loss** made on the encashment of Debenture Redemption investments is also transferred to **Profit & Loss account**.

(10) The **balance** of Debenture Redemption Reserve is subsequently transferred to General Reserve.

5. Investment Of Debenture Redemption Reserve (Drr) Amount

Rule 18(7) of Companies (Share Capital and Debentures) Rules, 2014 prescribes the following conditions:

- Every company required to create DRR should before the 30th day of April of each year, deposit or invest, as the case may be, a sum which should not be less than 15% of the amount of its debentures maturing during the year ending on the 31st day of March next following in any one or more of the following methods, namely:
    - in deposits with any scheduled bank, free from charge or lien;
    - in unencumbered securities of the Central Government or of any State Government;
    - in unencumbered securities mentioned in clauses (a) to (d) and (ee) of Section 20 of the Indian Trusts Act, 1882;

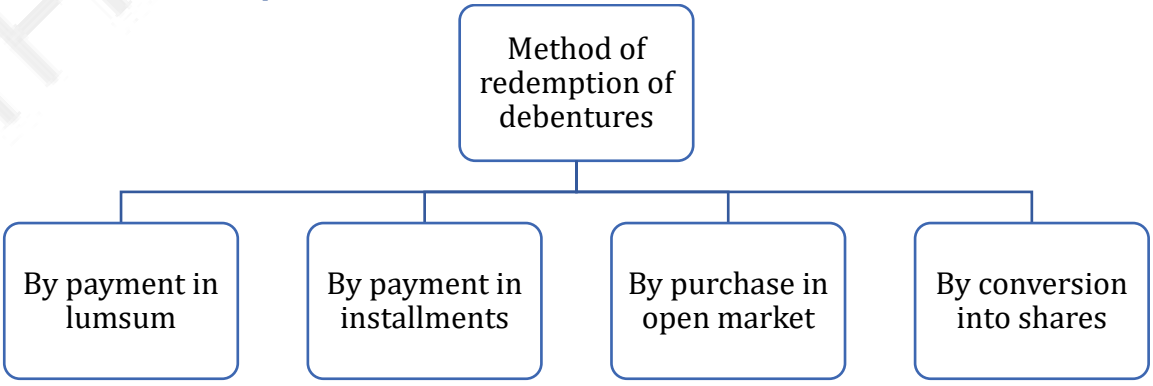
- in unencumbered bonds issued by any other company which is notified under clause (f) of Section 20 of the Indian Trusts Act, 1882;

- The amount deposited or invested, as the case may be, above should not be utilized for any purpose other than for the repayment of debentures maturing during the year referred to above, provided that the amount remaining deposited or invested, as the case may be, should not at any time fall below 15% of the amount of debentures maturing during the 31st day of March of that year.

- Ministry of Corporate Affairs has made the following clarification on adequacy of Debenture Redemption Reserve (DRR):

		Pre August 16, 2019	Post August 16, 2019
1	For debentures issued by All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures	No DRR is required	No DRR is required
2	For other Financial Institutions (FIs) and NBFCs registered with RBI and for housing finance companies registered with National Housing Bank	25% of the value of outstanding debentures issued through public issue. No DRR is required in the case of privately placed debentures.	No DRR is required
3	For debentures issued by listed companies including manufacturing and infrastructure companies.	25% of the value of outstanding debentures issued through public issue. Also 25% DRR is required in the case of privately placed debentures by listed companies	No DRR is required (irrespective of public or Private Issue)
4	For unlisted companies issuing debentures on private placement basis,	DRR will be 25% of the value of outstanding debentures.	DRR will be 10% of the value of outstanding debentures

6. Methods Of Redemption



By payment in lumpsum

Under payment in lumpsum method, at maturity or at the expiry of a specified period of debenture the payment of entire debenture is made in one lot or even before the expiry of the specified period

By payment in Instalments

Under payment in installments method, the payment of specified portion of debenture is made in installments at specified intervals

ACCOUNTING FOR DEBENTURE REDEMPTION FUND AND INVESTMENT

Journal entries	
1. At the end of First Year	
For setting aside the fixed amount of profit for redemption Profit and Loss A/c To Debenture Redemption Reserve A/c (Being transfer of profits to Debenture redemption reserve A/c)	Dr.
For investing the amount set aside for redemption Debenture Redemption Reserve Investment A/c To Bank A/c (Being amount invested in DRR investment A/c)	Dr.
2. At the end of second year and subsequent years other than last year	
For receipt of interest on Debenture Redemption Reserve Investments Bank A/c To Interest on Debenture Redemption Reserve Investment A/c (Being interest on investment received)	Dr.
For transfer of Interest on Debenture Redemption Reserve Investment (DRRI) to profit and loss account. Interest on Debenture Redemption Reserve Investment A/c To Profit & Loss A/c (Being interest on investment transferred to P&L A/c)	Dr.
For setting aside the fixed amount of profit for redemption Profit and Loss A/c To Debenture Redemption Reserve A/c (Being transfer of profits to Debenture redemption reserve A/c)	Dr.
For investments of the amount set aside for redemption and the interest earned on DRRI Debenture Redemption Reserve Investment A/c To Bank A/c (Being amount invested in DRR investment A/c)	Dr.
3. At the end of last year	
For receipt of interest Bank A/c To Interest on Debenture Redemption Reserve Investment A/c (Being interest on investment received)	Dr.

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For transfer of interest on Debenture Redemption Reserve Investment to Profit and loss account. Interest on Debenture Redemption Reserve Investment A/c Dr. To Profit and loss A/c
For setting aside the fixed amount of profit for redemption Profit and Loss A/c Dr. To Debenture Redemption Reserve A/c
For encashment of Debenture Redemption Reserve Investments Bank A/c Dr. To Debenture Redemption Reserve Investment, A/c
For the transfer of profit/loss on realization of Debenture Redemption Reserve Investments **(i)** In case of Profit Debenture Redemption Reserve Investment A/c Dr. To profit and loss A/c Or
(ii) In case of Loss Profit and loss A/c Dr To Debenture Redemption Reserve Investment, A/c
For amount due to debenture holders on redemption Debenture A/c Dr To Debenture holder's A/c
For payment to debenture holders Debenture holder's A/c Dr To Bank A/c
For transfer of balance in DRR to General Reserve Debenture Redemption Reserve A/c Dr. To General reserve A/c

ACCOUNTING FOR PURCHASE OF DEBENTURES IN THE OPEN MARKET

A company, if authorized by its Articles of Association, can buy its own debentures in the open market.

This can be categorized as follows:

For immediate cancellation

When the company cancels the debentures so purchased, it amounts to redemption of debentures. It means after cancellation; redemption is automatic, and these debentures cannot be reissued.

For investment in the form of own debentures

If the company purchases its debentures from open market and holds them for some time before cancellation, such debentures are known as own debentures. Own debentures are held by company as investment and may be resold till cancellation. After cancellation, the debentures are said to be redeemed and cannot be resold.

Accounting treatment for purchase of own debentures for immediate cancellation.

Journal entries	
On purchase and cancellation of debentures Debentures A/c (with the amount paid) To Bank A/c (Being debentures purchased in the open market and cancelled immediately)	Dr.
If there is any difference between the nominal value of the debentures cancelled and the price paid for them, In case of profit Debenture A/c To Bank A/c To Profit on redemption of debentures A/c (Being debentures purchased in the open market for immediate cancellation and profit made on the same)	Dr.
Transferring the above profit to Capital reserve A/c Profit on redemption of debentures A/c To Capital Reserve A/c	Dr.
In case of loss Debenture A/c Loss on redemption A/c To Bank A/c (Being debentures purchased in the open market for immediate cancellation and Incurred loss on the same)	Dr. Dr.
Transferring the above loss to Capital reserve A/c or P&L A/c or Securities premium A/c Profit and Loss A/c Or Securities Premium A/c Or Capital Reserve A/c To Loss on redemption A/c	Dr. Dr. Dr.

ACCOUNTING FOR REDEMPTION BY CONVERSION

Journal entries	
When shares are issued at Par Debentures A/c To Share Capital A/c (Being debentures converted in ..... (no. of) Equity shares of Rs.... each)	Dr.
When shares are issued at premium Debenture A/c To Share capital A/c To Securities premium A/c (Being debentures converted in ..... (no. of) Equity shares of Rs.... Each issued at a premium of Rs.....each)	Dr.

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Illustration – 1

X Ltd. issued 1,00,000; 9% Debentures of Rs.50 each at a premium of 10% on 30th June, 2019 redeemable on 31st March 2021.The issue was fully subscribed. The Company decided to create DRR on 31st March,2020 and invest in Fixed Deposit Earnings interest @ 10% p.a. on 1st April 2020 to meet the legal requirement. Tax was deducted at source (TDS) by bank @ 10%.

Pass journal entries for issue and redemption of debentures along with interest on investment.

Solution: Illustration 1

Date	Particulars		Dr. (₹)	Cr. (₹)
30-6-x1	Bank A/c To Debenture Application A/c	Dr.	55,00,000	 55,00,000
30-6-20x1	Debenture Application A/c To 9% Debenture A/c To Securities Premium A/c (Being Allotment of Debentures)	Dr.	55,00,000	 50,00,000 5,00,000
31-3-x2	Profit & Loss A/c To Debenture Redemption Reserve A/c (Being Creation of DRR as per the statute)	Dr.	5,00,000	 5,00,000
31-3-x2	Interest on Debenture A/c To Bank A/c (1,00,000 × 50% × 9% × 9/12) (Being Interest on Debentures paid)	Dr.	3,37,500	 3,37,500
31-3-x2	Profit & Loss A/c To Interest on Debenture A/c	Dr.	3,37,500	 3,37,500
1-4-x2	DRR Investment A/c To Bank (Being Creation of DRR Investment)	Dr.	7,50,000	 7,50,000
31-3-x3	Bank A/c To DRR Investment A/c To Interest on DRR investment A/c (Being Redemption of DRR investment)	Dr.	8,25,000	 7,50,000 75,000
31-3-x3	Interest on DRR Investment A/c To Profit & Loss A/c (Interest Received on DRR Investment Transferred to P&L)	Dr.	75,000	 75,000
31-3-x3	9% Debentures A/c To Debenture Holder A/c	Dr.	50,00,000	 50,00,000
31-3-x3	Debenture Holder A/c To Bank	Dr.	50,00,000	 50,00,000
31-3-x3	DRR A/c To General Reserve (Being Balance on DRR transferred to General Reserve)	Dr.	5,00,000	 5,00,000

Illustration – 2

On January 1, Rama Ltd., had 500 Debentures of Rs.100 each outstanding in its books carrying interest at 6% per annum. DRR balance is standing in books at

12,500/-. In accordance with the powers in the deed, the directors acquired debentures from the open market for immediate cancellation as follows:

March 1 Rs.5,000 at 98.00/- (cum interest)

Aug. 1 Rs. 10,000 at 100.25/- (cum interest)

Dec. 15 Rs. 2,500 at 98.50/- (ex-interest)

Debenture interest is payable half-yearly, on 30th June and 31st Dec.

Show ledger accounts of Debenture and Debenture interest for the first year, ignoring income-tax.

Solution: Illustration 2

Working Note:

Date	Face Value	Purchase Price (₹)	Amount Paid (₹)	Interest	Ex-Interest
Mar -1	5,000	98	4,900 (Cum)	50 (5,000 × 6% × 2/12)	4,850
Aug - 1	10,000	100.25	10,025 (Cum)	50 (10,000 × 6% × 1/12)	9,975
Dec - 15	2,500	98.5	2531.25	68.75 (2,500 × 6% × 5.5/12)	2,462.5

6% Debentures (1st Half)

Date	**Particulars**	**Debit ₹**	**Date**	**Particulars**	**Credit ₹**
1st March	To Bank	4,850	Jan. 1	By Balance b/d	50,000
1st March	To Profit on Cancellation	150			
30th June	To Balance c/d	45,000			
		50,000			50,000

Interest on Debentures (1st Half)

Date	**Particulars**	**Debit ₹**	**Date**	**Particulars**	**Credit ₹**
1st March	To Bank	50	30th June	By Profit and Loss	1,400
30 June	To Bank A/c	1,350			
		1,400			**1,400**

6% Debentures (2nd Half)

Date	**Particulars**	**Debit ₹**	**Date**	**Particulars**	**Credit ₹**
1st Aug	To Bank	9,975	Aug. 1	By Balance b/d	45,000

1st Aug	To Profit on Cancellation	25			
15th Dec	To Bank	2,462.5			
15th Dec	To Profit on Cancellation	37.5			
31st Dec	To Balance c/d	32,500			
		45,000			**45,000**

Interest on Debentures (2nd Half)

Date	**Particulars**	**Debit ₹**	**Date**	**Particulars**	**Credit ₹**
1st Aug	To Bank A/c	50	30th June	By Profit and Loss	1093.75
15th Dec	To Bank A/c	68.75			
31st Dec	To Bank A/c	975			
		1093.75			**1093.75**

Illustration – 3

The following balances appeared in the books of Paradise Ltd as on 1-4-20X1:

1. 12 % Debentures Rs. 7,50,000
2. Balance of DRR Rs. 1,00,000
3. DRR Investment 1,12,500 represented by 10% 1,125 Secured Bonds of the Government of India of Rs. 100 each.

Annual contribution to the DRR was made on 31st March every year. On 31-3-20X2, balance at bank was Rs. 7,50,000 before receipt of interest. The investment was realised at par for redemption of debentures at a premium of 10% on the above date.

You are required to prepare the following accounts for the year ended 31st March, 20X2:

1. Debentures Account
2. DRR Account
3. DRR Investment Account
4. Bank Account

Debenture Holders Account.

Solution: Illustration 3

12% Debenture Account

Date	**Particulars**	**₹**	**Date**	**Particulars**	**₹**
31-03-X2	To Debenture Holders A/c	7,50,000	1-4-X1	By Balance b/d	7,50,000
		7,50,000			**7,50,000**

DRR Account

Date	**Particulars**	**₹**	**Date**	**Particulars**	**₹**
			1-4-X1	By Balance b/d	25,000

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31-03-X2	To General reserve A/c	75,000	1-4-X1	By Profit & Loss A/c (75,000 -25,000) WN1	50,000
		75,000			**75,000**

DRR Investment Account (10% GOI Bonds)

Date	Particulars	₹	Date	Particulars	₹
1-4-X1	To Balance b/d	1,12,500	31-03-X2	By Bank	1,12,500
		1,12,500			**1,12,500**

Bank Account

Date	Particulars	₹	Date	Particulars	₹
31-03-X2	To Balance b/d	7,50,000	31-03-X2	By Debenture holders A/c	8,25,000
31-03-X2	To Interest on DRR Investment (10% × ₹100 × 1,125)	11,250		By Interest on Debentures	90,000
	To DRR Investment A/c	1,12,500			
31-03-X2	To balance c/d	41,250			
		9,15,000			**9,15,000**

Debenture Holders Account

Date	Particulars	₹	Date	Particulars	₹
			31-03-X2	By 12% Debentures	7,50,000
31-03-X2	To Bank A/c	8,25,000		By Premium on redemption of debentures (7,50,000 × 10%)	75,000
		8,25,000			**8,25,000**

Working Note:

1. Closing balance required in DRR (10% of 7,50,000) = 75,000

Illustration – 4

Sencom Limited issued Rs.1,50,000 5% Debentures on 30th September Year 0 on which interest is payable half yearly on 31st March and 30th September. The Company has power to purchase debentures in open market for cancellation thereof.

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The following purchases were made during the year ended 31st December Year 2 and the cancellation were made on the same date. On 31st December Year 1, balance in the DRR of the Company was Rs.25,000 and investments made for the purpose of redemption were Rs.20,000.

The purchase details are:

- 1st March Year 2 – Rs.25,000 nominal value purchased for Rs.24,725 ex-interest.
- 1st September Year 2– Rs.20,000 nominal value purchased for Rs.20,125 cum-interest.

You are required to draw up the following accounts up to the date of cancellation:

(i) Debentures Account and
(ii) Own Debenture (Investment) Account.

Ignore Taxation.

Solution: Illustration 4

5% Debentures A/c (20X2)

Date	Particulars	Amount	Date	Particulars	Amount
Mar 1	To Own Debenture Investment	24,725	Jan 1	By Balance b/d	1,50,000
	To Gain on Cancellation (25,000 – 24,725)	275			
Sep 1	To Own Debenture Investment	19,708			
	To Gain on Cancellation (WN)	292			
Sep 1	To Balance c/d	1,05,000			
		1,50,000			**1,50,000**

Own Debenture Investment A/c (20X2)

Date	Particulars	Face Value	Interest	Cost	Date	Particulars	Face Value	Interest	Cost
1/3	To Bank	25,000	521	24,725	1/3	By 5% Debentures A/c	25,000	-	24,725
1/9	To Bank (WN)	20,000	417	19,708	1/9	By 5% Debenture A/c	20,000	-	19,708
					1/9	By P&L		938	
		45,000	**938**	**44,433**			**45,000**	**938**	**44,433**

Working Note

Date	Face Value (Nominal Value)	Amount Paid	Interest	Ex- Interest
1/03/21	25,000	25,246	521 (25,000 × 5% × 5/12)	24,725
Gain on Cancellation				**275**
1/9/X2	20,000	20,125	417 (20,000 × 5% × 5/12)	19,708
Gain on Cancellation				**292**

Illustration – 5 : Deleted

Illustration – 6

The Summarized Balance Sheet of BEE Co. Ltd. as on 31st March, 20X1 is as under:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Share Capital:		Freehold property	1,15,000
Authorized:			
30,000 Equity Shares of Rs. 10 each	3,00,000		
		Stock	1,35,000
		Trade receivables	75,000
Issued and Subscribed:		Cash	30,000
20,000 Equity Shares of Rs. 10 each fully paid	2,00,000		
		Balance at Bank	2,00,000
Profit and Loss Account	1,20,000		
12% Debentures	1,20,000		
Trade payables	1,15,000		
	5,55,000		**5,55,000**

At the Annual General Meeting, it was resolved:

1. To give existing shareholders the option to purchase one Rs. 10 shares at Rs. 15 for every four shares (held prior to the bonus distribution), this option being taken up by all shareholders.
2. To issue one bonus share for every five shares held.
3. To repay the debentures at a premium of 3%.

Give the necessary journal entries and the company's Balance Sheet after these transactions are completed.

Solution: Illustration 6

Working Notes:

1) Rights Issue

Number of Rights shares to be issued- (20,000 shares / 4) X 1 = 5,000 shares @ ₹15 (Face Value @₹10 + ₹5 towards premium)

2) No. of Bonus Shares

Number of Bonus shares to be issued- (25,000 shares / 5) X 1 = 5,000 bonus shares

Journal of BEE Co. Ltd

Particulars		Dr. (₹)	Cr. (₹)
Bank A/c	Dr.	75,000	
To Equity Shareholders A/c			75,000
(Being amount collected from equity shareholders @₹15 per share for 5,000 right shares)			
Equity Shareholders A/c	Dr.	75,000	
To Equity Share Capital A/c			50,000
To Securities Premium A/c			25,000
(Being right shares issued to the shareholders @₹15. ₹10 accounted as Share Capital and ₹5 accounted as securities Premium)			
Securities Premium A/c	Dr.	25,000	
Profit & Loss A/c	Dr.	25,000	
To Bonus to Shareholder's A/c			50,000

(Being amount transferred for issue of Bonus Share)			
Bonus to Shareholders A/c To Equity Share Capital A/c (Being 5000 Bonus Shares issued @1 share for every 5 shares held)	Dr.	50,000	 50,000
Profit and Loss A/c To Debenture Redemption Reserve (Being DRR created at 10% of debentures redeemed)	Dr.	12,000	 12,000
Debenture Redemption Reserve Investment A/c To Bank A/c (Being DRR Investment created 15% x 1,20,000 as per the provisions)	Dr.	18,000	 18,000
12% Debentures A/c Premium on Redemption of Debentures A/c To Debenture Holders a/c (Being amount payable to Debenture holders)	Dr. Dr.	1,20,000 3,600	 1,23,600
Debenture holders a/c To Bank A/c (Being Amount repaid to debenture holders)	Dr.	1,23,600	 1,23,600
DRR A/c To General Reserve A/c (Being DRR balance transferred to General Reserve after redemption of debentures)	Dr.	12,000	 12,000
Bank A/c To DRR Investment (Being DRR investment Realised at par)	Dr.	18,000	 18,000

Balance Sheet of BEE Co. Ltd. As on ..... (after completion of transactions)

Particulars	**Note No**	**₹**
I. Equity and liabilities		
(1) Shareholder's Funds		
(a) Share Capital	**1**	3,00,000
(b) Reserves and Surplus	**2**	91,400
(2) Current Liabilities		
(a) Trade payables		1,15,000
Total		**5,06,400**
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment		
(i) Tangible Assets	**3**	1,15,000
(2) Current assets		
(a) Inventories		1,35,000
(b) Trade receivables		75,000
(c) Cash and bank balances	**4**	1,81,400
Total		**5,06,400**

Notes to Accounts

1	**Share Capital**		**3,00,000**

	30,000 shares of ₹10 each fully paid (5,000 shares of ₹10 each, fully paid issued as bonus shares out of securities premium and P&L Account)		
2	**Reserve and Surplus**		
	Profit & Loss Account	1,20,000	
	Less: Utilisation for issue of bonus shares	(25,000)	
	Less: DRR created	(12,000)	
	Less: Premium on Redemption	(3,600)	
		79,400	
	General Reserve	12,000	91,400
3	**Tangible assets**		
	Freehold property		1,15,000
4	**Cash and bank balances**		
	Cash at bank (2,00,000 + 75,000 – 1,23,600)	1,51,400	
	Cash in hand	30,000	1,81,400

Notes:

Closing Balances after Transaction

Account	Opening	Additions	Deletions	Closing Balance
Cash& Bank	2,00,000	75,000 18,000	18,000 1,23,600	1,51,400
Equity Share Capital	1,20,000	50,000 + 50,000		3,00,000
Securities Premium	0	25,000	25,000	0
Profit & Loss	1,20,000		25,000 12,000 3,600	79,400
DRR	30,000	12,000	12,000	0
DRR Investment		18,000	18,000	0
12% Debentures	1,20,000		1,20,000	0
General Reserve	-	12,000	-	12,000

Illustration – 7

The summarised Balance Sheet of Convertible Limited, as on 30th June, 20X1, stood as follows:

Particulars	Amount (Rs.)
Liabilities:	
Share Capital: 5,00,000 equity shares of Rs. 10 each fully paid	50,00,000
General Reserve	75,00,000
Profit And loss A/c	10,00,000
Debenture Redemption Reserve	25,00,000
13.5% Convertible Debentures, 1,00,000 Debentures of Rs. 100 each	1,00,00,000
Other loans	65,00,000
Current Liabilities and Provisions	1,25,00,000
	4,50,00,000

The Debentures are due for redemption on 1st July, 20X1. The terms of issue of debentures provided that they were redeemable at a premium of 5% and conferred option to the debenture holders to convert 20% of their holdings into equity shares at a predetermined price of Rs.15.75 per share and the payment in cash.

Assuming that:

1. except for 100 debenture holders holding totally 25,000 debentures, the rest of them exercised the option for maximum conversion.
2. the investments were realised at par on sale; and
3. all the transactions are put through, without any lag, on 1st July, 20X1.

Redraft the balance sheet of the company as on 1st July, 20X1 after giving effect to the redemption. Show your calculations in respect of the number of equity shares to be allotted and the necessary cash payment.

Solution: Illustration 7

Working Notes :

1) Calculation of number of shares to be allotted:

Total number of debentures	1,00,000
Less: Number of debentures for which debenture holders did not opt for conversion	(25,000)
	75,000
20% of 75,000 opt for conversion as in the form equity shares (Redemption)	15,000
Redemption value of 15,000 debentures (15,000x105)	₹15,75,000
Therefore No. of equity shares to be issued (15,75,000/15.75)	1,00,000 equity shares

2) Computation of cash to be Paid

Total number of debentures	1,00,000
Less: Converted to Equity	15,000
To be Paid (Cash/Bank) in Number of Deb. holders	85,000
Total amount to be Paid (85,000 × 105)	₹89,25,000

Convertible Limited Balance Sheet as on July 1,20X1

Particulars	**Note No**	**₹ in Lakhs**
I. Equity and liabilities		
(1) Shareholder's Funds		
(a) Share Capital	**1**	60
(b) Reserves and Surplus	**2**	110.75
(2) Non - Current Liabilities		
(a) Long-term borrowings	**3**	65
(3) Current Liabilities		
(a) Short-term provisions		125
Total		**360.75**
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment		
(i) Tangible Assets		160
(2) Current assets		
(a) Cash and bank balances	**4**	0.75
(b) Other current assets		200
Total		**360.75**

[Text Wrapping Break]**Notes to Accounts**

(In Lakhs)

1	**Share Capital** Authorised, issued and Subscribed (5,00,000 + 1,00,000) 6,00,000 @₹10 (Refer WN (1))		60
2	**Reserve and Surplus**		
	General Reserve	75	
	Add: Transfer from DRR	25	100
	Profit & Loss	10	
	Less: Premium on Redemption	(5)	5
	Securities Premium		5.75
			110.75
3	**Long Term Borrowings**		
	Secured Loans		65
4	Cash and bank balances	75	
	Add: DRR Investment	15	
		90	
	Less: Debenture Holder Payment	(89.25)	0.75

Illustration 8

The following balances appeared in the books of a company, which is an unlisted company other than All India Financial Institution , Banking Company, NBFC and HFC, as on 31st December of Year 1:

- 6% Mortgage 10,000 debentures of Rs.100 each;
- Debenture Redemption Reserve (for redemption of debentures) Rs.2,00,000;
- Investments in deposits with a scheduled bank free from any charge or lien Rs.1,50,000 at interest of 4% p.a. receivable on 31st December every year.
- Bank Balance with the company is Rs.9,00,000.
- The Interest on debentures has been paid up to 31st December of Year 1.

On 28th February of Year 2, the investments were realised at par and the debentures were paid off at Rs.101, together with accrued interest.

Write up the concerned ledger accounts (excluding bank transactions). Ignore taxation.

Solution: Illustration 8

6% Debentures Account

Particulars	**Debit ₹**	**Particulars**	**Credit ₹**
To Debenture Holders	10,00,000	By Balance b/d	10,00,000
	10,00,000		**10,00,000**

Debenture Investment Account

Particulars	**Debit ₹**	**Particulars**	**Credit ₹**
To Balance b/d	1,50,000	By Bank	1,50,00
	1,50,000		**1,50,000**

Bank A/c

Particulars	**Debit ₹**	**Particulars**	**Credit ₹**
To Balance b/d	9,00,000	By Deb. Interest A/c	10,000
To Interest on Debentures Redemption Investment	1,50,000	By Debenture holders (10,000 x 101)	10,10,000
To interest on DRR Investment	1,000	By Balance c/d	31,000

	10,51,000		**10,51,000**

Debenture Redemption Reserve A/c

Particulars	**Debit ₹**	**Particulars**	**Credit ₹**
To General Reserve	1,00,000	By Balance b/d	50,000
		By P&L	50,000
	1,00,000		**1,00,000**

Debenture Holders A/c

Particulars	**Debit ₹**	**Particulars**	**Credit ₹**
To Bank A/c	10,10,000	By 6% Debentures A/c	10,00,000
		By Premium on Redemption of Debentures	10,000
	10,10,000		**10,10,000**

Illustration 9

A Company has issued 20,000 13% debentures of Rs.100 each on 1st April 20X1. The debentures are due for redemption on 1st July 20X2.

The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to debenture holders to convert 20% of their holding into equity shares (Nominal value Rs.10) at a price of Rs.15 per share. Debenture holders holding 2,500 debentures did not exercise the option.

Calculate the number of equity shares to be allotted to the debenture holders exercising the option to the maximum

Solution: Illustration 9

Calculation of number of equity shares to be allotted

	Number
Total number of debentures	20,000
Less: Debenture holders not opted for conversion	(2,500)
Balance eligible for conversion	17,500
Conversion Ratio (Maximum – 20%)	20%
Number of debentures to be converted (20% of 17,500)	3,500
Redemption value (105% of ₹100)	105
Number of debentures to be converted (20% of 17,500)	₹3,67,500
Agreed price of each share	15
No. of shares to be issued (₹ 3,67,500/ ₹ 15)	24,500 shares

Illustration 10

Libra Limited (a listed company) recently made a public issue in respect of which the following information is available:

(a) No. of partly convertible debentures issued- 2,00,000; face value and issue price - Rs. 100 per debenture.

(b) Convertible portion per debenture- 60%, date of conversion- on expiry of 6 months from the date of closing of issue.

(c) Date of closure of subscription lists- 1.5.20X1, date of allotment- 1.6.20X1, rate of interest on debenture- 15% payable from the date of allotment, value of equity share for the purpose of conversion- Rs. 60 (Face Value Rs. 10).

(d) Underwriting Commission- 2%.

(e) No. of debentures applied for- 1,50,000.

(f) Interest payable on debentures half-yearly on 30th September and 31st March.

Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 20X2 (including cash and bank entries).

Solution: Illustration 10

Journal Entries in the books of Libra Ltd.

Date	Particulars		Dr. (₹)	Cr. (₹)
01/05/X1	Bank A/c To Debenture Application A/c (Being 1,50,000 Application received for ₹100 each)	Dr.	1,50,00,000	 1,50,00,000
1/6/20X1	Debenture Application A/c Underwriters A/c Dr. To 15% Debentures A/c (Being 2,00,000 Debentures allotted and shortfall undertaken)	Dr. Dr.	1,50,00,000 50,00,000	 2,00,00,000
	Underwriting Commission To Underwriters A/c (Commission payable to underwriters @ 2% on ₹ 2,00,00,000)	Dr.	4,00,000	 4,00,000
	Bank A/c To Underwriters A/c (Amount receivable from underwriter received)	Dr.	46,00,000	 46,00,000
01/06/20X1	Debenture Redemption Investment A/c To Bank A/c (200,000 X 100 x 15% X 40%) (Being Investment in specified securities made for redeemable value as per Rule 18)		12,00,000	 12,00,000
30/09/20X1	Debenture Interest A/c To Bank A/c (Being interest due 15% debenture paid on due date)	Dr.	10,00,000	 10,00,000
31/10/20X1	15% Debentures A/c To Equity Share Capital To Securities equity premium (Being 60% of 15% debentures converted into 2,00,000 equity shares of ₹60 each)	Dr.	1,20,00,000	 20,00,000 1,00,00,000

Working Note:

Calculation of Debenture Interest for the half year ended 31st March, 20X2

On ₹ 80,00,000 for 6 months @ 15%	₹6,00,000
On ₹ 1,20,00,000 for 1 months @ 15%	₹ 1,50,000
	₹7,50,000

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