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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.
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## Unit-1 Theoretical Framework

## 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.

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.

## 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.

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 BookKeeping.

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 BookKeeping | Managerial Decisions are made based on the statements prepared under Accounting |
| Sub-Fields | There is no Sub-Field of BookKeeping | Accounting has various subfields 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. | It is viewed as a science of rational <br> decision-making about the use of <br> Non-accounting data are also relevant <br> for decision-making |

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 <br> exact to the last paisa | For decision-making purposes such <br> precision is not necessary for which this <br> is used. |
| All values are important individually because <br> they relate to business transactions. | It is concerned with the typical value, <br> behavior or trend over a period of time <br> or the degree of variation over a series <br> of observations. |
| It records generally take a short-term view of <br> events and are confined to a year | It is more useful if a longer view is <br> taken for the purpose |
| Several accounting and financial calculations <br> are based on statistical formulae. | Statistical methods are helpful in <br> developing accounting data and in their <br> 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 decisionmaking.
- 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:

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

i) $\boldsymbol{\uparrow}$ In one Asset, $\downarrow$ in other Asset.
ii) $\boldsymbol{\uparrow}$ In one Asset, $\boldsymbol{\uparrow}$ in Liability.
iii) $\downarrow$ In one Asset, $\boldsymbol{\uparrow}$ in other Asset.
iv) $\downarrow$ In one Asset, $\downarrow$ in Liability.

## Effect of Changes in Liability

v) $\uparrow$ In one Liability, $\downarrow$ in other Liability.
vi) $\boldsymbol{\uparrow}$ In one Liability, $\boldsymbol{\uparrow}$ in Asset.
vii) $\downarrow$ In one Liability, $\boldsymbol{\uparrow}$ in other Liability.
viii) $\downarrow$ In one Liability, $\downarrow$ 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 $A B C$ 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 $A B C$ 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.

## 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?

## 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.
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 $\mathcal{\&}$ 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

## Unit-4 Contingent liabilities and contingent assets

## 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 <br> may not arise in future | Fixed present Obligation |
| Outflow of <br> Resources | Outflow of Resources to settle <br> the obligation is not fixed or <br> probably estimable | Outflow of Resources to settle <br> the obligation is fixed. |
| Recognition in the <br> Financial <br> Statements. <br> Example | Not Recognized in the Financial <br> Statements. | Recognized in the Financial <br> Statements. |
| Ongoing legal dispute, <br> guarantee given in respect of <br> third parties | Amount due to Creditors |  |

Contingent Liabilities Vs Provisions:

| Point of Distinction | Contingent Liabilities | Provisions |
| :--- | :--- | :--- |
| Status of obligation | Uncertain Obligation. It may or <br> may not arise in future | Obligation is present. However, <br> amount of obligation is <br> measured by estimate since it <br> is not fixed |
| Recognition in the <br> Financial <br> Statements. | Not Recognized in the Financial <br> Statements. | Outflow of Resources to settle <br> the obligation probable and <br> estimable. Hence, recognized <br> in the Financial Statements. |
| Example | Ongoing legal dispute, <br> guarantee given in respect of <br> third parties | Provision for Doubtful debts, <br> 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 $2^{\text {nd }}$ 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

## 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:


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.

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.

## 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 $A B C$ 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. $A B C$ Co. bought a machine in 2013 for Rs. 50.00 Lacs and spent another Rs. 10 Lacs 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 output 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)

## Chapter 2 - Accounting Process

## OBJECTIVES

The lists of topics which will be covered in this chapter are as follows:
2.1 Journal Entries
2.2 Ledgers
2.3 Trial Balance
2.4Subsidiary Book:
2.5Cash Book:
2.6Rectification of Errors

## 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.
13. 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.


## 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 <br> Real Account | When Receiving | When Giving |
| Nominal Account | When it comes in | When it Goes out |

## 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 |  |  |  |
|  | To Mr.B A/c |  |  | 50,000 |
|  | (Being Goods Purchased on Credit) |  |  | 50,000 |
|  | Mr.C A/c |  |  |  |
|  | To Sales A/c |  |  | 400,000 |
|  | (Being Goods Sold on Credit to Mr.C) |  |  |  |
|  |  |  |  | 400,000 |
|  | Cash/Bank A/c | Dr. | 100,000 |  |
|  | To Sales A/c |  |  | 4000 |
|  | (Being cash sales made) |  |  |  |

14. 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
Add: Profit earned during the period (Revenues - Expenses)
Less: Dividends distributed

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

| Account Type | Account shown a <br> Normal Balance in | Debit when the <br> account is to be | Credit when the <br> account is to be |
| :--- | :--- | :--- | :--- | :--- |
| ASSET | Lebit | Increase | Decrease |
| CIBAILITES | Credit | Decrease | Increase |
| REVENUE | Credit | Decrease | Increase |
| EXPENSES | Debit | Decrease | Increase |
| DRAWINGS | Credit | 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.) |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Capital introduced in Business | Bank | Asset | Increased | 1,000,000 |  |
|  |  | Capital | Capital | Increased |  | 1,000,000 |
|  |  |  |  |  |  |  |
|  | Machinery Purchased | Machinery | Asset | Increased | 200,000 |  |
|  |  | Bank | Asset | Decreased |  | 200,000 |
|  |  |  |  |  |  |  |
|  | Goods Purchased on Credit | Purchases | Expense | Increased | 50,000 |  |
|  |  | Creditor | Liability | Increased |  | 50,000 |
|  |  |  |  |  |  |  |
|  | Sold Goods on Credit | Debtor | Asset | Increased | 400,000 |  |
|  |  | Sales | Revenue | Increased |  | 400,000 |
|  |  |  |  |  |  |  |
|  | Sold Goods on Cash | Bank | Asset | Increased | 100,000 |  |
|  |  | Sales | Revenue | Increased |  | 100,000 |

## Questions:

4. 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.

## 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. |  |  |  |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| 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. (Refer example to understand the concept of Balancing a Ledger).

## 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

| 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 $\mathrm{c} / \mathrm{d}$ 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)

## 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.

## 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:

## 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 |

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

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 |  |

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 $\qquad$

| 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 |

## Questions:

1. Prepare the Trial Balance as per the 3 different methods from the following details:

| Sr.No. | Account Name | Balance Amount (Rs.) | Total Amount (Rs.) |
| ---: | :--- | ---: | ---: |
| 1 | Cash A/c | 20,000 | 100,000 |
| 2 | Furniture A/c | 50,000 | 50,000 |
| 3 | Salaries A/c | 40,000 | 120,000 |
| 4 | Mr.A Capital A/c | 100,000 | 740,000 |
| 5 | Debtors A/c | 100,000 | 300,000 |
| 6 | Creditors A/c | 160,000 | 200,000 |
| 7 | Bank A/c | 80,000 | 240,000 |
| 8 | Sales A/c | 260,000 | 290,000 |
| 9 | Purchases A/c | 310,000 | 400,000 |
| 10 | Trade Discounts Given A/c | 20,000 | 20,000 |

## 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 |

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 A 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 ACC | COUNT |  |  | 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 a 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 \& |  |  |  | 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 |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |

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.

## 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 |  | $\mathbf{1 2 5 , 0 0 0}$ |  | TOTAL |  | $\mathbf{1 2 5 , 0 0 0}$ |
|  |  |  |  |  |  |  |  |

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 |


| 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 |  | 200 |  | 40,000 | 10-08-18 | By Mr. DA/c |  | 300 |  | 50,000 |
| 25.08-18 | To Bank | C |  | 1000 |  | 25-08-18 | By Cash A/c |  |  |  | 10,000 |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  | 31-08-18 | By Balance c/d |  |  |  | 40,000 |
|  | TOTAL |  | 2000 | 10000 | 100,000 |  | TOTAL |  | 300 | 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:

| 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 |
| $\mathbf{1 , 0 0 0}$ |  |  | By Balance c/d | 700 |  |  |  |
| 700 |  |  | TOTAL | $\mathbf{1 , 3 0 0}$ | $\mathbf{2 0 0}$ | $\mathbf{3 0 0}$ | $\mathbf{1 0 0}$ |
| 300 | $08-08-18$ |  | To Balance b/d |  |  |  |  |

## 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.

## 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.
(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 | ABC \& Co. A/c Dr. 100000 | Fixed Assets A/c Dr. |
| To ABC \& Co. A/c 100000 | To Purchases 100000 | 10000 |
|  |  | 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 |  | 10,000 |  |
|  | To Sales A/c |  |  | 10,000 |
|  | (Being Sales increased for the amount <br> undercasted) |  |  |  |
|  | Dr. |  | 4,000 |  |
|  | Mr. B A/c |  |  | 4,000 |
|  | To Suspense A/c <br> (Being Ament wrongly credited to Mr. B <br> rectified) <br> Suspense A/c <br> To Discount Received A/c <br> (Being Disocunt Received not recorded <br> previously accounted for) |  |  |  |

DR.

| DATE | PARTICULARS | J.F. | AMOUNT (Rs.) | DATE | PARTICULARS | CR. |  |
| :--- | :--- | ---: | ---: | ---: | :--- | ---: | ---: |
|  | 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 Financial 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.

## 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.

| 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) |  |  |  |



## Questions:

1. The following errors have occurred in the Books of Accounts of Mr. A and have been identified before the preparation of the trial Balance. Pass the wrong entries and the correct entries for the same.
i) Purchase of Fixed Asset for Rs. 10,000/- from $A B C \& C$. has been booked under Purchases.
ii) Sales of Rs. 5000/- to Mr. B were recorded as Sales to Mr. D.
iii) Omitted to record cash sales of Rs. 1000/-.
2. The Following errors have been identified after the preparation of the trial balance but before the preparation of Final Accounts. Correct the errors using suspense account wherever necessary:
i) Goods of the value of Rs. 1000 returned by Mr. A were not recorded as sales return.
ii) Discount received for Rs.500/- for making early payment was not recorded in the discount received ledger. But the same was recorded in the cash book.
iii) Goods Purchased from Mr. B for Rs.4500/-were recorded in Purchases but the same was recorded in Mr. B A/c
3. The Following errors have been identified in the next year and the entity wants to rectify the same using Profit $\&$ Loss Adjustment Account.
i) Purchase of a Fixed Asset was debited to Purchase Account for Rs.10,000. Depreciation on Fixed Assets is levied at 20\%.
ii) Sales account was understated by Rs.5,000.
iii) A credit purchase of goods from Mr. B for Rs.2,000 entered as a sales to Mr. B.

## Illustrations

## UNIT 1: Basic Accounting Procedures - Journal Entries

## Question: 1

Following are the transactions entered by 'R' after he started his business. Show how various accounts will be affected by these transactions:

| April $\mathbf{2 0 1 7}$ | Particulars | Amount (Rs.) |
| :--- | :--- | ---: |
| 1 $^{\text {st }}$ | R started business with | $5,000,000$ |
| $2^{\text {nd }}$ | He purchased furniture for | $1,200,000$ |
| $3^{\text {rd }}$ | Paid salary to his clerk | $1,100,000$ |
| $4^{\text {th }}$ | Paid rent | $1,150,000$ |
| $5^{\text {th }}$ | Received interest | $2,000,000$ |

## Question: 2

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

## Question: 3

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 | $50,000,000$ |

## Question: 4

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

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

Question: 5
Journalise the following transactions. Also state the nature of each account involved in the Journal entry:
Following figures are given in ('000)

1. December 1,2016, Ajith started business with capital Rs. 4,00,000
2. December 3,2016, He withdrew cash for business from the Bank Rs. 2,000
3. December 5,2016, He purchased goods making payment through bank Rs. 15,000
4. December 8,2016 , He sold goods Rs. 16,000 and received payment through bank
5. December 10,2016, He purchased furniture and paid by cheque Rs. 2,500
6. December 12,2016, He sold goods to Arvind Rs. 2,400
7. December 14,2016, He purchased goods from Amrit Rs. 10,000
8. December 15,2016, He returned goods to Amrit Rs. 500
9. December 16,2016, He received from Arvind Rs. 2,300 in full settlement
10. December 18,2016, He withdrew goods for personal use Rs. 1,000
11. December 20,2016, He withdrew cash from business for personal use Rs. 2,000
12. December 26,2016, Amount paid to Amrit in full settlement Rs. 9,450
13. December 31,2016, Paid for Stationery Rs. 200, Rent Rs. 5,000 and Salaries to staff

Rs. 2,000
14. December 31,2016, Goods distributed by way of free samples Rs. 2,000

Question: 6
Transactions of Ramesh for April are given below. Journalise them

| Apr 1,2107 | Ramesh started business with Rs. 10,00,000 |
| :--- | :--- |
| Apr 1,2107 | Bought goods for cash Rs. 50,000 |
| Apr 1,2107 | Drew cash from bank Rs. 10,000 |
| Apr 1,2107 | Sold to Krishna- goods on credit Rs. 1,50,000 |
| Apr 1,2107 | Bought from Shyam goods on credit Rs. 2,25,000 |
| Apr 1,2107 | Received from Krishna Rs. 1,45,000 <br> Allowed him discount Rs. 5,000 |
| Apr 1,2107 | Paid Shyam cash Rs. 2,15,000 <br> Discount allowed Rs. 10,000 |
| Apr 1,2107 | Cash sales for the month Rs. 8,00,000 <br> Paid Rent Rs. 50,000 <br> Paid Salary Rs. 1,00,000 |

## UNIT 2: Ledgers

Question: 1
Prepare the Stationery Account of a firm for the year ended 31.12.2015 duly balanced off, from the following details:

| Date | Particulars | Amount (Rs.) |
| :--- | :--- | ---: |
| 01.01 .2015 | Inventory of stationery | 480 |
| 15.04 .2015 | Purchase of stationery by cheque | 800 |
| 15.11 .2015 | Purchase of stationery on credit from Five Star <br> Stationery Mart | 1,280 |
| 31.12 .2015 | Inventory of stationery | $\mathbf{2 4 0}$ |

Question: 2
Prepare the ledger accounts on the basis of following transactions in the books of a trader

- Debit Balances on January 1, 2015
- Cash in Hand Rs. 8,000,
- Cash at Bank Rs. 25,000,
- Inventory of Goods Rs. 20,000,
- Building Rs. 10,000
- Trade receivables: Vijay Rs. 2,000 and Madhu Rs. 2,000

Following were further transactions in the month of January 2015:

| Jan 1 | Purchased goods worth Rs. 5,000 for cash less 20\% trade discount and 5\% <br> cash discount |
| :--- | :--- |
| Jan 4 | Received Rs. 1,980 from Vijay and allowed him Rs. 20 as discount |
| Jan 8 | Purchased plant from Mukesh for Rs. 5,000; Paid Rs. 100 as cartage for <br> bringing the plant to the factory and Paid Rs. 200 as installation charges |
| Jan 12 | Sold goods to Rahim on credit Rs. 600 |
| Jan 15 | Rahim became insolvent and could pay only 50 paise in a rupee |
| Jan 18 | Sold goods to Ram for cash Rs. 1,000 |

## Question: 3

The following data is given by Mr. S, the owner, with a request to compile only the two personal accounts of Mr. H and Mr. R, in his ledger, for the month of April,2015:
1 Mr. S owes Mr. R Rs. 15,000; Mr. H owes Mr. S Rs.20,000
4 Mr. R sold goods worth Rs. 60,000 @ 10\% trade discount to Mr. S
5 Mr. S sold to Mr. H goods prices at Rs.30,000
17 Record a purchase of Rs. 25,000 net from R , which were sold to H at a profit of Rs.15,000
18 Mr. S rejected 10\% of Mr. R’s goods of 4th April
19 Mr. S issued a cash memo for Rs.10,000 to Mr. H who came personally for this consignment of goods, urgently needed by him
22 Mr. H cleared half his total dues to Mr. S, enjoying a $1 / 2 \%$ cash discount (of the payment received, Rs.20,000 was by cheque)
26 R's total dues (less Rs.10,000 held back) were cleared by cheque, enjoying a cash discount of Rs.1,000 on the payment made
29 Close H's Account to record the fact that all but Rs.5,000 was cleared by him, by a cheque, because he was declared bankrupt

## UNIT 3: Trial Balance

Question: 1
Given below is a ledger extract relating to the business of $X$ and Co. as on March, 31,2016. You are required to prepare the Trial Balance by:

1. Total Method.
2. Balance Method
3. Total and Balance Method

| Cr. |  |  |  | Cash Account |
| :--- | :--- | :--- | ---: | ---: |
| Particulars | Amount (Rs.) | Particulars | Amount (Rs.) |  |
| To Capital A/c | 10,000 | By Furniture A/c | 3,000 |  |
| To Ram's A/c | 25,000 | By Salaries A/c | 2,500 |  |
| To Cash Sales | 500 | By Shyam's A/c | 21,000 |  |
|  |  |  | By Cash Purchases | 1,000 |
|  |  | By Capital A/c | 500 |  |
|  |  | By Balance c/d | 7,500 |  |
| Total | 35,500 | Total | 35,500 |  |

Dr.

| Particulars | Amount (Rs.) |  | Particulars |
| :--- | :--- | :--- | :--- |
| To Cash A/c | 3,000 | By Balance c/d | Amount (Rs.) |
| Total |  |  | 3,000 |

Dr.

| Particulars | Amount (Rs.) | Particulars | Amount (Rs.) |
| :--- | :--- | :--- | :--- | :--- |
| To Cash A/c | 2,500 | By Balance c/d | 2,500 |
| Total |  |  |  |


| Dr. | Shyam's A/c |  | Cr |
| :---: | :---: | :---: | :---: |
| Particulars | Amount (Rs.) | Particulars | Amount (Rs.) |
| To Cash A/c | 21,000 | By Purchases A/c | 25,000 |
| To Purchase Returns A/c | 500 | (Credit Purchases) |  |
| To Balance c/d | 3,500 |  |  |
| Total | 25,000 | Total | 25,000 |
| Dr. | Purchases A/c |  | Cr |
| Particulars | Amount (Rs.) | Particulars | Amount (Rs.) |
| To Cash A/c (Cash Purchases) | 1,000 | By Balance c/d | 26,000 |
| To Sundries as per | 25,000 |  |  |
| Purchases Book (Credit Purchases) |  |  |  |
| Total | 26,000 | Total | 26,000 |

Dr.

| Particulars | Amount (Rs.) | Particulars | Amount (Rs.) |
| :--- | :--- | :--- | :--- | :--- |
| To Balance c/d | 500 | By Sundries as per <br> Purchases Return <br> Book | 500 |
| Total | 500 | Total | 500 |


| Dr. |
| :--- |
| Particulars Amount (Rs.) Particulars Amount (Rs.) <br> To Sales A/c (Credit 30,000 By Sales Returns A/c 100 <br> Sales)  By Cash A/c  <br>    By Balance c/d |
| Total |

Dr.

| Particulars | Amount (Rs.) | Particulars | Amount (Rs.) |
| :--- | :--- | :--- | ---: |
| To Balance c/d | $\mathbf{3 0 , 5 0 0}$ | By Cash A/c (Cash <br> Sales) <br> By Sundries as per <br> Sales Book (Credit <br> sales) | 500 |
| Total | 30,500 | Total | 30,000 |

Dr.

| Particulars | Amount (Rs.) | Particulars | Amount (Rs.) |
| :--- | :--- | :--- | ---: | ---: |
| To Balance c/d | 30,500 | By Cash A/c (Cash <br> Sales) <br> By Sundries as per <br> Sales Book (Credit <br> sales) | 500 |
| Total | 30,500 | Total | 30,000 |

Dr.

| Particulars | Amount (Rs.) | Particulars | Amount (Rs.) |
| :--- | ---: | ---: | ---: |
| To Cash A/c | 500 | By Cash | 10,000 |
| To Balance | 9,500 |  |  |
| c/d |  |  |  |
| Total | 10,000 | Total | 10,000 |

Question: 2
From the following ledger balances, prepare a trial balance of Anuradha Traders as on 31st March 2016

| Account Head | Amount (Rs.) |
| :--- | :--- |
| Capital | $1,00,000$ |
| Sales | $1,66,000$ |
| Purchases | $1,50,000$ |
| Sales Returns | 1,000 |
| Discount allowed | 2,000 |
| Expenses | 10,000 |
| Trade receivables | 75,000 |
| Trade Payables | 25,000 |
| Investments | 15,000 |
| Cash at bank and in hand | 37,000 |
| Interest received on investments | 1,500 |
| Insurance paid | 2,500 |

Question: 3
One of your clients, Mr. Singhania has asked you to finalise his accounts for the year ended 31st March 2016.
Till date, he himself has recorded the transactions in books of accounts. As a basis for audit, Mr. Singhania furnished you with the following statement.

| Particulars | Debit Balance (Rs.) | Credit Balance (Rs.) |
| :--- | ---: | ---: |
| Singhania's Capital | 564 | 1,556 |
| Singhana's Drawings | 750 |  |
| Leasehold premises |  | 2,750 |
| Sales | 1,259 | 530 |
| Due from customers | 264 |  |
| Purchases |  |  |
| Purchases return | 528 |  |
| Loan from bank | 700 |  |
| Trade payables | 226 |  |
| Trade expenses | 100 |  |
| Cash at bank | 600 |  |
| Bills payable |  |  |
| Salaries and wages | 463 | 264 |
| Inventories (1.4.2015) |  |  |
| Rent and rates | 5,454 | 98 |
| Sales return |  | 5,454 |
| Total |  |  |

The closing inventory on $31^{\text {st }}$ March' 16 was valued at Rs. 574 . Mr. Singhania claims that he has recorded every transaction correctly as the trial balance is tallied. Check the accuracy of the above trial balance.

## UNIT 4: Subsidiary books

## Question: 1

The Rough Book of M/s. Narain \& Co. contains the following in Feb'16:

1. Purchased from Brown \& Co. on credit:

- 5 gross pencils @ Rs. 100 per gross
- 12 gross registers @ Rs. 240 per doz
- Less: Trade Discount @ 10\%

2. Purchased for cash from the Stationery Mart: 10 gross exercise books @ Rs. 300 per doz.
3. Purchased computer for office use from M/s. office Goods Co. on credit for Rs.

30,000
4. Purchased on credit from The Paper Co.

- 5 reams of White paper @ Rs. 100 per ream.
- 10 reams of Ruled paper @ Rs. 150 per ream.
- Less Trade Discount @ 10\%

5. Purchased one Dozen Gel Pens @ Rs. 15 each from M/s. Verma Bros. on credit Make out the Purchase Book of M/s Narain \& Co.

## Question: 2

Enter the following transactions in Purchase Book and post them into ledger.
April 4 ${ }^{\text {th }}, 2017$

- Purchased from Ajay Enterprises, Delhi
- 100 Doz. Rexona Hawai Chappal @ Rs. 120 per doz.
- 200 Doz. Palki Leather Chappal @ Rs. 300 per Doz.
- Less: Trade discount @ 10\%
- Freight charged Rs. 150

April $15^{\text {th }}$

- Purchased from Balaji Traders, Delhi
- 50 doz. Max Shoes @ Rs. 400 per doz.
- 100 pair Sports Shoes @ Rs. 140 per paid.
- Less Trade discount @ 10\%.
- Freight charged Rs. 200

April $28^{\text {th }}$

- Purchased from Trupti Industries, Bahadurgarh
- 40 pair leather shoes @ Rs. 400 per pair
- 100 doz. Rosy Hawai Chappal @ Rs. 180 per doz
- Less Trade discount @ 10\%.
- Freight charged Rs. 100

Question: 3
The following are some of the transaction of M/s Kishore \& Sons of the year 2017 as per their Waste Book. Make out their Sales Book
Sold to M/s. Gupta \& Verma on credit:

- 30 shirts @ Rs. 800 per shirt.
- 20 trousers @ Rs. 1,000 per trouser.
- Less Trade Discount @ 10\%

Sold furniture to $\mathrm{M} / \mathrm{s}$. Sehgal \& Co. on credit Rs. 8,000
Sold 50 shirts of M/s. Jain \& Sons @ Rs. 800 per shirt
Sold 13 shirts to Cheap Stores @ Rs. 750 each for cash
Sold on credit to M/s. Mathur \& Jain.

- 100 Shirts @ Rs. 750 per shirt
- 10 overcoats @ Rs. 5,000 per overcoat
- Less Trade Discount @ $10 \%$

Question: 4
Post the following into the ledger
Sold Goods to M/s. Ram \& Co of Rs. 100

- Less Trade Discount 10\%
- Goods Returned by M/s Ram \& Co on $5^{\text {th }}$ June 2020

Purchased Goods from M/s. Ram \& Co of Rs. 100

- Less Trade Discount 10\%
- Goods Returned to M/s Ram \& Co on $5^{\text {th }}$ June 2020

Question: 5

| Date 2017 | Particulars | Details (Rs.) | Amount (Rs.) |
| :---: | :---: | :---: | :---: |
| $20^{\text {th }} \mathrm{Nov}$ | Rajindra Prakash \& Sons |  |  |
|  | One 36" Usha Ceiling Fan | 200 |  |
|  | Less Trade Discount @ 10\% | (20) | 180 |
| $30^{\text {th }} \mathrm{Nov}$ | Modern Electric Company |  | 100 |
|  | Total |  | $\underline{280}$ |

Question: 6
From the following transactions, prepare the Purchases Returns Book of Alpha \& Co., a saree dealer and post them to ledger

| Date | Debit Note <br> No. | Particulars |
| :--- | :--- | :--- |
| 04.01 .2016 | 101 | Returned to Goyal Mills, Surat - 5 polyester sarees @ Rs. <br> 1,000 |
| 09.01.2016 | Garg Mills, Kota - accepted the return of goods (which were <br> purchased for cash) from us - 5 Kota sarees @ Rs. 400 |  |
| 16.01 .2016 | 102 | Returned to Mittal Mills, Bangalore - 5 silk sarees @ Rs. <br> 2,600 |
| 30.01 .2016 |  | Returned one computer (being defective) @ Rs. 35,000 to B <br> d Co |

## UNIT 5: Cash books

Question: 1
Enter the following transactions in a Simple Cash Book:

| 2016 | Particulars | Amount (Rs.) |
| :--- | :--- | ---: |
| Jan 1 | Cash in hand | 1,200 |
| Jan 5 | Received from Ram | 300 |
| Jan 7 | Paid Rent | 30 |
| Jan 8 | Sold goods for cash | 300 |
| Jan 10 | Paid to Shyam | 700 |
| Jan 27 | Purchased Furniture | 200 |
| Jan 31 | Paid Salaries | 100 |
| Jan 31 | Rent due, not yet paid, for January | 100 |

Question: 2
Ganesh commenced business on 1st April 2017 with Rs 2,000 as capital. He had the following cash transaction in the month of April 2017

| Date | Particulars | Amount <br> in Rs | Date | Particulars | Amount <br> in Rs |
| :--- | :--- | ---: | :--- | :--- | ---: |
| April 1 | Purchased furniture <br> and paid cash | 250 | April 7 | Paid for petty <br> Expenses | 15 |
| April 2 | Purchased goods | 500 | April 8 | Cash purchases | 150 |
| April 4 | Sold goods for cash | 950 | April 13 | Paid for labour | 1000 |
| April 5 | Paid cash to Ram <br> Mohan | 560 | April 13 | Paid Ali \& Sons | 400 |
| April 6 | He allowed discount | 10 | April 13 | They allowed <br> discount | 8 |
| April 6 | Received cash from <br> Krishna \& Co | 600 |  |  |  |
| April 6 | Allowed Discount | 20 |  |  |  |

Make out the two-column Cash Book (Cash and discount column) for the month of April,2017.

## Question: 3

Enter the following transactions in Cash Book with Discount and Bank Columns. Cheques are first treated as cash receipt:

| $\mathbf{2 0 1 6}$ | Particulars | Amount in <br> Rs |
| :--- | :--- | :--- |
| Jan 1 | Chandrika commences business with Cash | 20000 |
| Jan 3 | He paid into Current A/c | 19000 |
| Jan 4 | He received cheque from Kirti \& Co. on account | 600 |
| Jan 7 | He pays in bank Kirti \& Co.'s cheque | 600 |
| Jan 10 | He pays Rattan \& Co. by cheque and is allowed discount Rs 20 | 330 |
| Jan 12 | Tripathi \& Co. pays into his Bank A/c | 475 |
| Jan 15 | He receives cheque from Varshi and allows him discount Rs 35 | 450 |
| Jan 20 | He receives cash Rs 75 and cheque Rs 100 for cash sale |  |
| Jan 25 | He pays into Bank, including cheques received on 15th and 20th | 1000 |
| Jan 27 | He pays by cheque for cash purchase | 275 |
| Jan 30 | He pays sundry expenses in cash | 50 |

Question: 4
Prepare a Petty Cash Book on the Imprest system from the following:

| 2016 <br> Jan | Particulars | Rs. |
| :---: | :--- | ---: |
| 1 | Received Rs.100 for petty cash |  |
| 2 | Paid bus fare | .50 |
| 2 | Paid cartage | 2.50 |
| 3 | Paid for Postage \& Telegrams | 5.00 |
| 3 | Paid wages for casual labor | 6.00 |
| 4 | Paid for stationery | 4.00 |
| 4 | Paid Tonga charges | 2.00 |
| 5 | Paid for the repairs to chairs | 15.00 |
| 5 | Bus fare | 1.00 |
| 5 | Cartage | 4.00 |
| 6 | Postage and Telegrams | 7.00 |
| 6 | Tonga charges | 3.00 |
| 6 | Cartage | 3.00 |
| 6 | Stationery | 2.00 |
| 6 | Refreshments to customers | 5.00 |

Question: 5
Enter the following transaction in Cash Bank with Discount and Bank columns. Cheques are first treated as cash receipts

| 2016 <br> March | Particulars | Rs. |
| :---: | :--- | ---: |
| 1 | Cash in Hand | 15,000 |
|  | Overdraft in Bank | 500 |
| 2 | Cash Sales | 3,000 |
| 3 | Paid to Sushil Bros. by cheque | 3,400 |
|  | Discount received | 100 |
| 5 | Sales through credit card | 2,800 |
| 6 | Received cheque from Srijan | 6,200 |
| 7 | Endorsed Srijan's cheque in favour of Adit | 6,800 |
| 9 | Deposit into Bank | 3,600 |
| 10 | Received cheque from Aviral and deposited the <br> same into Bank by allowing discount of Rs. 50 |  |
| 12 | Adit informed that Srijan's cheque is dishonored. <br> Now cash is received from Srijan and amount is paid <br> to Adit through own cheque | 3,200 |
| 15 | Sales through Debit Card | 1,800 |
| 24 | Withdrawn from Bank | 3,000 |
| 28 | Paid to Sanchit by cheque |  |
| 30 | Bank charged 1\% commission on sales through <br> Debit/Credit Cards |  |

## UNIT 6: Subsidiary books

## Question: 1

The following errors, affecting the account for the year 2015 were detected in the books of Jain Brothers, Delhi:
(1) Sale of old Furniture Rs 150 treated as sale of goods
(2) Receipt of Rs 500 from Ram Mohan credited to Shyam Sunder
(3) Goods worth Rs 100 brought from Mohan Narain have remained unrecorded so far
(4) A return of Rs 120 from Mukesh posted to his debit
(5) A return of Rs 90 to Shyam Sunder posted as Rs 9 in his account
(6) Rent of proprietor's residence, Rs 600 debited to rent A/c
(7) A payment of Rs 215 to Mohammad Sadiq posted to his credit as Rs125
(8) Sales Book added Rs 900 short
(9) The total of Bills Receivable Book Rs 1,500 left unposted

You are required to pass the necessary rectifying entries and show how the trails balance would be affected by the error.

## Question: 2

Write out the Journal Entries to rectify the following errors, using a Suspense Account.
i.Goods of the value of Rs. 100 returned by Mr. Sharma were entered in the Sales Day Book and posted therefrom to the credit of his account
ii.An amount of Rs. 150 entered in the Sales Returns Book, has been posted to the debit of Mr. Philip, who returned the goods
iii.A sale of Rs. 200 made to Mr. Ghanshyam was correctly entered in the Sales Day Book but wrongly posted to the debit of Mr. Radheshyam as Rs. 20
iv.Bad Debts aggregating Rs. 450 were written off during the year in the Sales ledger but were not adjusted in the General Ledger
v.The total of "Discount Allowed" column in the Cash Book for the month of September, 2015 amounting to Rs. 250 was not posted

## Question: 3

Mr. Roy was unable to agree the Trial Balance last year and wrote off the difference to the Profit and Loss Account of that year. Next Year, he appointed a Chartered Accountant who examined the old books and found the following mistakes:

1. Purchase of a scooter was debited to conveyance account Rs.3,000.
2. Purchase account was over-cast by Rs.10,000.
3. A credit purchase of goods from Mr. P for Rs. 2,000 entered as a sale.
4. Receipt of cash from Mr. A was posted to the account of Mr. B Rs. 1,000
5. Receipt of cash from Mr. C was posted to the debit if his account Rs.500.
6. Rs. 500 due by Mr. Q was omitted to be taken to the trial balance.
7. Sale of goods to Mr. R for Rs.2,000 was omitted to be recorded.
8. Amount of Rs. 2,395 of purchase was wrongly posted as Rs.2,593.

Mr. Roy used 10\% depreciation on vehicles. Suggest the necessary rectification entries

## 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.

## 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.

## 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 $30^{\text {th }}$ March, it will be recorded in the bank column of cash book on $30^{\text {th }}$ 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.
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 <br> cash Book | Time of recording in pass <br> book |
| :--- | :--- | :--- | :--- |
| 1 | Issue of a cheque by the <br> account holder | When the cheque is <br> issued | When it is presented to <br> the bank for payment. |
| 2 | Depositing a cheque in <br> the account | When deposited in the <br> Bank Account | When collected from the <br> 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 | $\mathbf{1 6 5 , 0 0 0}$ |  | TOTAL | $\mathbf{1 6 5 , 0 0 0}$ |

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 |  | $\mathbf{1 4 0 , 2 5 0}$ |
| 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 |  | $\mathbf{1 4 0 , 0 0 0}$ |

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.
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.

|  | Favorable <br> balance (Dr.) <br> as per cash <br> book | Unfavorable <br> balance (Cr.) as <br> per cash book | Favorable <br> balance (Cr.) as <br> per pass book | Unfavorable <br> balance (Dr.) as <br> per pass book |
| :--- | :--- | :--- | :--- | :--- |
| Cheque deposited but <br> not cleared | Subtract | Add | Add | Subtract |
| Cheque issued but not <br> presented to bank | Add | Subtract | Subtract | Add |
| Cheque directly <br> deposited in bank by a <br> 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

## 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 $28^{\text {th }}$ 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 $30^{\text {th }}$ September 2018 and
2. Bank Reconciliation Statement

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

|  | 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 |
|  |  |  |  |  |  |
|  |  | $\mathbf{9 5 , 0 0 0}$ |  | TOTAL | $\mathbf{9 5 , 0 0 0}$ |

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 <br> 2018 | $(100,000)$ | $(100,000)$ |
|  |  |  |
| Amount as per Bank Pass Book |  | $\mathbf{( 4 6 , 5 0 0 )}$ |

## 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

| 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 <br> cash sales) | 200,000 |
|  |  |  |  | By Balance c/d | 499,500 |
|  |  | $\mathbf{8 2 0 , 0 0 0}$ |  | TOTAL | $\mathbf{8 2 0 , 0 0 0}$ |

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 |  | $\mathbf{5 9 9}, \mathbf{5 0 0}$ |

The balance of Rs. 499,500/- will appear on the trial balance of $31^{\text {st }}$ 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 | 1,000 |  |
| Bank charges debited by bank but not recorded in the cash-book | 50,000 |  |
| Dividend directly collected by the bank | 45,000 |  |
| Insurance premium paid by bank as per standing instruction | $1,50,000$ |  |
| Not intimated | $3,00,000$ |  |
| Cash sales wrongly recorded in the Bank column of the cash-book | 10,000 |  |
| Customer's cheque dishonored by bank not recorded in the cash-book |  |  |
| Wrong credit given by the bank |  |  |
| 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 $31^{\text {st }}$, 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 CashBook, 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 $31^{\text {st }}$ December, 2017 | $22,45,900$ |
| :--- | :--- | ---: |
| (2) | Interest debited by Bank on $26^{\text {th }}$ December 2017, but no advice <br> received | $2,78,700$ |
| (3) | Cheque issued before $31^{\text {st }}$ December 2017 but not yet presented to <br> Bank | $6,60,000$ |
| (4) | Transport subsidy received from the State Government directly by <br> the Bank but not advised to the company | $14,25,000$ |
| (5) | Draft deposited in the Bank, but not credited till <br> $31^{\text {st }}$ December, 2017 | $13,50,000$ |

(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.

## Chapter 4 - Inventories

## OBJECTIVES

The lists of topics which will be covered in this chapter are as follows:
4.1 Understanding what is Inventory?
4.2 Methods of Inventory Valuation which are:

- FIFO
- LIFO
- Average Price
- Weighted Average Price
- Specific Identification
- Adjusted Selling price
4.3 Methods of Inventory Record Keeping.


## 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:

$$
\begin{aligned}
& \text { Cost of Goods Sold = Beginning Inventory + Purchases + Direct Expenses - Ending } \\
& \text { Inventory }
\end{aligned}
$$

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 <br> ending inventory is available on a <br> particular date. | Details about cost of goods sold and <br> ending inventory is available on real <br> time and continuous basis. |


| Cost of Goods Sold is computed as <br> balancing figure after determining the <br> Inventory balance | Ending Inventory is computed as <br> balancing figure after determining the <br> Cost of Goods Sold |
| :--- | :--- |
| Loss of Goods is included in Cost of <br> Goods Sold | Loss of Goods Sold is included in Ending <br> Inventory |
| Simple and Less Expensive Method | Costly Method |
| Requires closure of business on a <br> particular day to count the inventories | Can be carried out with the ongoing <br> 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 | $\mathbf{8 7 5 0}$ |

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

| 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:

Total Cost of Goods Available for Sale during the period
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:

## 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
Packaging and transportation charges
Sales during the year
Sales price of closing inventories

Rs.2,00,000/-
Rs.10,000/-
Rs.4,00,000/-
Rs.75,000/-

## Cost of Purchases:

Goods purchased
Rs.2,00,000/-
Packaging and transportation charges
Rs. 10,000/-
Rs.2,10,000/-

Rs.4,00,000/-
Rs.75,000/-
Rs.4,75,000/-
(Rs. 2,10,000/-) Rs.2,65,000/-

Gross Profit Margin Inventory Valuation:
Sales price of closing inventories
Less: Gross Profit Margin @ 55.79\%
55.79\%

Rs.75,000/-
(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 $5^{\text {th }}$ April, whereas accounting year ends on $31^{\text {st }}$ March purchases and sales between $31^{\text {st }}$ March and $5^{\text {th }}$ April are then separately adjusted.

## Example on Inventories Taking:

Suppose a company that closes its books on $31^{\text {st }}$ March, carried out the inventory taking on the $5^{\text {th }}$ of April and actual inventory was of Rs. 5,00,000 on $5^{\text {th }}$ 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 $31^{\text {st }}$ of March is computed below:

Inventories ascertained on $5^{\text {th }}$ April
Less: Purchases during the period 31 march to 5 April

Add: Cost of Goods Sold during the period:
2,00,000 X (100/120)
Inventory value on $31^{\text {st }}$ March

Rs.5,00,000/-
Rs.1,00,000/-Rs.4,00,000/-
$\frac{\text { Rs. 1,66,667/- }}{\text { Rs. 5,66,667/- }}$

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
Packaging and transportation charges
Sales during the year
Sales price of closing inventories

Rs.5,00,000/-
Rs.70,000/-
Rs.7,00,000/-
Rs.1,50,000/-

## Question 3:

Suppose a company that closes its books on $31^{\text {st }}$ March, carried out the inventory taking on the $25^{\text {th }}$ of March and actual inventory was of Rs. $15,00,000$ on $25^{\text {th }}$ 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 $31^{\text {st }}$ of March.

## Illustrations

## Question: 1

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

| Date <br> 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
$\mathrm{M} / \mathrm{s} \mathrm{X}, \mathrm{Y}$ and Z are in retail business, following information are obtained from their records for the year ended 31st March 2016-

| Particulars |  |
| :--- | ---: |
| Goods received from suppliers | Amount (Rs.) |
| (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.

## Chapter 5 - Concept and Accounting of Depreciation

## OBJECTIVES

The lists of topics which will be covered in this chapter are as follows:
5.1 What is Depreciation and Objectives of providing depreciation?
5.2 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 morethan 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:

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
( $\div$ ) Estimated Useful Life 5 years
$\begin{array}{llll}\text { Depreciation }= & \text { Depreciable Amount } & \text { Rs450000 } & \begin{array}{l}=\text { Rs.90000/- Per } \\ \\ \\ \text { Estimated Useful Life }\end{array} \\ & 5 \text { Years } & \text { Year }\end{array}$
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 $\mathbb{\&}$ 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.

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
iv. Annuity Method
v. Sinking Fund 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:

Straight Line Depreciation $=\frac{\text { Cost of Asset }- \text { Salvage Value }}{\text { Useful Life of the Asset }}$
Straight Line Depreciation Rate $=\quad$ Straight Line Depreciation $\quad X \quad 100$
Cost of the Asset
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.

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 $=1$


Here, $\mathrm{n}=$ 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. <br> 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  <br> 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.

| Date | Particulars | Amount | Date | Particulars | Cr. |
| :--- | :--- | ---: | :--- | :--- | :--- | ---: |
| 2016 |  |  | 2016 |  | Amount |
| Dec-31 | To Machinery A/c | 50,000 | Dec-31 | By Profit \& Loss A/C | 50,000 |
|  |  |  |  |  |  |
|  | TOTAL | $\mathbf{5 0 , 0 0 0}$ |  | TOTAL | $\mathbf{5 0 , 0 0 0}$ |
| 2017 |  |  | 2017 |  |  |
| Dec-31 | To Machinery A/c | 100,000 | Dec-31 | By Profit \& Loss A/C | 100,000 |
|  |  |  |  |  |  |
|  | TOTAL | $\mathbf{1 0 0 , 0 0 0}$ |  | TOTAL | 100,000 |

i. 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.

| Date | Particulars | Amount | Date | Particulars | Cr. |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| 2016 |  |  | 2016 |  | Amount |
| Dec-31 | To Machinery A/c | 75,000 | Dec-31 | By Profit \& Loss A/C | 75,000 |
|  |  |  |  |  |  |
|  | TOTAL | $\mathbf{7 5 , 0 0 0}$ |  | TOTAL | $\mathbf{7 5 , 0 0 0}$ |
| 2017 |  |  | 2017 |  |  |
| Dec-31 | To Machinery A/c | 142,500 | Dec-31 | By Profit \& Loss A/C | 142,500 |
|  |  |  |  |  |  |
|  | TOTAL | $\mathbf{1 4 2 , 5 0 0}$ |  | TOTAL | $\mathbf{1 4 2 , 5 0 0}$ |

## 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:
The number of years of remaining life of the asset
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.

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

Working Notes for the above computation:

1. Computation of Depreciation for 2010-2014:

$$
\frac{(10+9+8+7+6)}{10(10+1) / 2} X(2000000-240000)=40 / 55 \times 1760000=1280000
$$

2. Computation of WDV as on 1-1-2015:

$$
\text { 2000000-1280000 = Rs. } 720000 /-
$$

3. Depreciation for 2015 :
(2000000-240000) X 5/55 = Rs $160000 /-$

## 4. Annuity Method:

Under this method of depreciation, the interest which is lost on capital invested on the asset and is written off. It is based on the assumption that the amount invested in acquiring the asset, if would have been invested elsewhere, would have earned interest which must be recorded as part of the cost of asset.

This method is suitable for writing off the amounts paid for long leases which involve a considerable capital outlay. It is not practicable to adopt this method for writing off depreciation of plant and machinery on account of frequent changes in the value of such assets which would necessitate the recalculation of the amount of depreciation to be written off annually.

The relevant Journal Entries involved in this method are as follow:

| Accounting Entries under the Annuity Method: |  |
| :--- | :--- |
| For charging interest on <br> asset account | Asset Account $\quad$ To Interest Account |
| For charging depreciation <br> on asset | Depreciation Account D. <br> To Depreciation Provision for depreciation <br> Account |
| For transferring <br> depreciation to Profit <br> and <br> Loss Account | Profit \& Loss Account account <br> To Depreciation Accout |
| For transferring interest <br> to Profit and Loss <br> Account | Interest Account Dr. <br> To Profit \& Loss Account |

## Example:

ABC Co. acquired a lease is purchased on 1st April, 2013 for 4 years at a cost of Rs. $4,00,000$. It is proposed to depreciate the lease by the annuity method charging 5 percent interest. A reference to the annuity table shows that to depreciate Rs. 1 by annuity method over 4 years charging $5 \%$ interest, one must write off a sum of Rs.0.282012 [To write off Rs.2,00,000 one has to write off every year Rs. 112,804.80 i.e. $0.282012 \times 4,00,000]$.

Prepare the Lease Account for four years and also the relevant entries in the profit and loss account.
Dr.

| Date | Particulars | Amount | Date | Particulars | Cr. |  |
| ---: | :--- | ---: | :--- | :--- | :--- | :--- |
| 2013-2014 |  |  |  |  | Amount |  |
| Apr-01 | To Bank A/c | 400,000 | Mar-31 | By Depreciation A/C | 112,804 |  |
| Mar-31 | To Interest A/c | 20,000 | Mar-31 | By Balance b/d | 307,196 |  |
|  | (5\% on Rs.400000) |  |  |  |  |  |
|  | TOTAL | $\mathbf{4 2 0 , 0 0 0}$ |  | TOTAL | $\mathbf{4 2 0 , 0 0 0}$ |  |
| $2014-2015$ |  |  |  |  |  |  |
| Apr-01 | To Balance b/d | 307,196 | Mar-31 | By Depreciation A/C | 112,804 |  |
| Mar-31 | To Interest A/c | 15,360 | Mar-31 | By Balance b/d | 209,752 |  |
|  | (5\% on Rs.307196) |  |  |  |  |  |
|  | TOTAL | $\mathbf{3 2 2 , 5 5 6}$ |  | TOTAL | $\mathbf{3 2 2 , 5 5 6}$ |  |
| $2015-2016$ |  |  |  |  | 112,804 |  |
| Apr-01 | To Balance b/d | 209,752 | Mar-31 | By Depreciation A/C | 107,435 |  |
| Mar-31 | To Interest A/c | 10,488 | Mar-31 | By Balance b/d |  |  |
|  | (5\% on Rs.209752) |  |  |  | $\mathbf{2 2 0 , 2 3 9}$ |  |
|  | TOTAL | $\mathbf{2 2 0 , 2 3 9}$ |  | TOTAL |  |  |
| $2016-2017$ |  |  |  |  | 112,804 |  |
| Apr-01 | To Balance b/d | 107,435 | Mar-31 | By Depreciation A/C |  |  |
| Mar-31 | To Interest A/c | 5,369 |  |  | $\mathbf{1 1 2 , 8 0 4}$ |  |
|  |  |  |  |  | TOTAL |  |

Dr.
Profit a Loss Account
Cr.

| Date | Particulars | Amount | Date | Particulars | Amount |
| ---: | :--- | :--- | :--- | :--- | :--- |
| $2013-2014$ |  |  | $2013-2014$ |  |  |
| Mar-31 | To Depreciation A/c | 112,804 | Mar-31 | By Interest A/C | 20,000 |
|  |  |  |  |  |  |
| $2014-2015$ |  |  | $2014-2015$ |  | 15,360 |
| Mar-31 | To Depreciation A/c | 112,804 | Mar-31 | By Interest A/C |  |
|  |  |  |  |  |  |
| 2015-2016 |  |  |  |  | 10,488 |
| Mar-31 | To Depreciation A/c | 112,804 | Mar-31 | By Interest A/C |  |
|  |  |  |  |  |  |
| 2016-2017 |  |  |  |  | 5,369 |
| Mar-31 | To Depreciation A/c | 112,804 | Mar-31 | By Interest A/C |  |

## 5. Sinking Fund Method:

When a large sum of money is required for replacement of the fixed asset at the end of its effective life, organizations invest the amount equal to depreciation and the amount earned on that investment is re-invested. The account in which the amount is kept aside is referred to as Sinking Fund Account.

When the asset is due for replacement, the securities are sold and the new asset is purchased with the proceeds of their sale. The book value of the old asset, at the time, is transferred to the Sinking Fund Account. Any amount realized on sale of the old asset, as well as the profit or loss on sale of securities is transferred to the Sinking Fund Account and it is closed off by transfer of the balance of the Profit and Loss Account or General Reserve.

| Accounting Entries under the Sinking Fund Method in First |  |
| :--- | :---: |
| Year |  |$\quad$ Dr.


| For charging depreciation <br> to profit and loss account | Profit \& Loss Account Dr. <br> To Depreciation Account |  |
| :--- | :--- | :--- |
| For investment of <br> amount <br> of depreciation | Sinking Fund Investment <br> Account | Dr. |


| investment at the end of useful life of the asset | Dr. Bank Account To Sinking Fund Investment Account |
| :---: | :---: |
| If Sale is Profit | Sinking Fund Investment Account Dr. To sinking Fund Account |
| If Sale is Loss | Sinking Fund Account Dr. To Sinking Fund Investment Account |
| For transfer of the amount to the extent of book value of the asset from asset account to Sinking Fund | Sinking Fund Account To Asset Account |
| Any surplus in Sinking fund account to be transferred to General Reserve Account | Sinking Fund Account Dr. To General Reserve Account |
| Any deficit, may be transferred to Profit and Loss Account | Profit $\&$ Loss Account Dr. To Sinking Fund Account |

Example:

On 1st April, 2013, ABC \& Co. purchased the Equipment for Rs.20,00,000. The life of the asset was only 3 years and would expire on 31st March, 2016.
$A B C \& C o$. decided to set up a sinking fund.
During the three years following transactions took place:
2014 31st March: A contribution from profits of Rs. $6,40,000$ was made and this sum was invested.

2014 5th Oct.: Investments which originally costed Rs. 2,20,000 were sold for Rs. $2,40,000$ and the proceeds of sale were re-invested.

2015 31st March: A contribution from profits of Rs. 6,40,000 was made; interest on investments of Rs. 32,000 was received and these amountswere reinvested.

2015 15th September: Investments which originally costed Rs. 4,20,000 were sold at a profit of Rs. 40,000 and proceeds of sale were re-invested.

2016 31st March: Interest on investments Rs. 96,000 was received which was not invested. All existing investments were sold for Rs. 13,20,000. A contribution from profit of an amount required to make up the sinking fund to Rs. 20,00,000 was made and this amount was not invested.

Prepare Sinking Fund and Sinking Fund Investment Account for the years 2013-14, 2014-15, 2015-16.

Dr.
Sinking Fund Account
Cr .

| Date | Particulars | Amount | Date | Particulars | Amount |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 2014 |  |  | 2014 |  |  |
| Mar-31 | To Balance c/d | 640,000 | Mar-31 | By Depreciation A/c | 640,000 |
|  |  |  |  |  |  |
|  | TOTAL | 640,000 |  | TOTAL | 640,000 |
| 2015 |  |  | 2015 |  |  |
| Mar-31 | To Balance c/d | 1,332,000 | Apr-01 | By Balance b/d | 640,000 |
|  |  |  | Oct-05 | By Sinking Fund Investment A/c | 20,000 |
|  |  |  | Mar-31 | By Interest on Sinking Fund InvestmentA/c | 32,000 |
|  |  |  | Mar-31 | By Depreciation A/c | 640,000 |
|  |  |  |  |  |  |
|  | TOTAL | 1,332,000 |  | TOTAL | 1,332,000 |
| 2016 |  |  | 2016 |  |  |
| Mar-31 | To Sinking Fund Investment A/c | 52,000 | Apr-01 | By Balance b/d | 1,332,000 |
| Mar-31 | To Asset A/c | 2,000,000 | Sep-15 | By Sinking Fund Investment A/c | 40,000 |
|  |  |  | Mar-31 | By Interest on Sinking Fund InvestmentA/c | 96,000 |
|  |  |  | Mar-31 | By Depreciation A/C | 584,000 |
|  |  |  |  | (Balancing Figure) |  |
|  |  |  |  |  |  |
|  | TOTAL | 2,052,000 |  | TOTAL | 2,052,000 |

Dr.
Sinking Fund Investment Account
Cr.

| Date | Particulars | Amount | Date | Particulars | Amount |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 2014 |  |  | 2014 |  |  |
| Mar-31 | To Bank A/c | 640,000 | Mar-31 | By Balance c/d | 640,000 |
|  |  |  |  |  |  |
|  | TOTAL | 640,000 |  | TOTAL | 640,000 |
| 2015 |  |  | 2015 |  |  |
| Apr-01 | To Balance c/d | 640,000 | 0ct-05 | By Bank A/c (Sales) | 240,000 |
| Oct-05 | To Sinking Fund A/c (Profit on Sale) | 20,000 | Mar-31 | By Balance c/d | 1,332,000 |
| 0ct-05 | To Bank A/c (Investment of Sales Proceeds) | 240,000 |  |  |  |
|  |  |  |  |  |  |
| 2016 |  |  |  |  |  |
| Mar-31 | To Bank A/c (Investment of Depreciation amount and interest) | 672,000 |  |  |  |
|  |  |  |  |  |  |
|  | TOTAL | 1,572,000 |  | TOTAL | 1,572,000 |
| 2016 |  |  | 2016 |  |  |
| Apr-01 | To Balance b/d | 1,332,000 | Sep-15 | By Bank A/c | 460,000 |
| Sep-15 | To Sinking Fund A/c (Profit on Sale) | 40,000 | Mar-31 | By Bank A/c | 1,320,000 |
| Sep-15 | To Bank A/c (Investment of Sales Proceeds) | 460,000 | Mar-31 | By Sinking Fund A/c (Loss on Sale) | 52,000 |
|  |  |  |  |  |  |
|  | TOTAL | 1,832,000 |  | TOTAL | 1,832,000 |

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 |
| :--- | :--- |
| $1-2$ | $3000 / 30000 \times(2000000-400000)=$ Rs.160000/- Per Year |
| $3-5$ | $4000 / 30000 \times(2000000-400000)=$ Rs.213333/- Per Year |
| $6-7$ | $6000 / 30000 \times(2000000-400000)=$ 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 Production during the period 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 <br> Depreciation |
| :--- | :--- |
| $1-2$ | $100000 / 1000000 \times 100000=$ Rs. $100000 /-$ Per Year |
| $3-5$ | $150000 / 1000000 \times 1000000=$ Rs. $150000 /-$ Per Year |
| $6-7$ | $125000 / 1000000 \times 1000000=$ 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.

## 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 <br> Depreciation |
| :--- | :--- | :--- |
| 2015 | $1000 / 5000 \times 10000000=$ Rs. $2000000 /-$ |
| 2016 | $2000 / 5000 \times 10000000=$ Rs. $4000000 /-$ |
| 2017 | $2000 / 5000 \times 10000000=$ 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 $1^{\text {st }}$ April 2017 | $\mathbf{2 5 0 0 0 0 0}$ |
| Less: Depreciation for 6 months @ 15\% (1 ${ }^{\text {st }}$ April to 1 ${ }^{\text {st }}$ October) | 187500 |
| Written Down Value as on $1^{\text {st }}$ October 2017 | 2312500 |
| Less: Sales Proceeds as on $1^{\text {st }}$ October 2017 | 1000000 |
| Loss on Sale of the Asset | $\mathbf{1 3 1 2 5 0 0}$ |

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 $5^{\text {th }}$ 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.

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.

| Particular <br> s | Amount |
| :--- | :--- |
| Depreciation per year = Rs. 10,00,000 / 10 | Rs.1000000/- |
| Depreciation on SLM charged for five years = Rs. $100,000 \times 5$ years $=$ <br> Rs.500000 | Rs.500000/- |
| Book value of the asset at the end of fifth year $=$ Rs. 10,00,000 - Rs. <br> $5,00,000$ | 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.

| $\begin{gathered} \text { Particular } \\ \mathrm{s} \end{gathered}$ | Amount |
| :---: | :---: |
| Depreciation per year for the 3 years = Rs. 15,00,000 / $10 \times 3$ | Rs.450000/- |
| Rs. Rs. 4,50,000 | Rs.1050000/- |
| Rs. Rs. 200,000 | 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 | $\mathbf{1 , 2 0 0 , 0 0 0}$ |  | 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 |
|  |  |  |  |  |  |

## 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

## Question 2:

On 1st April, 2013, ABC \& Co. purchased the Equipment for Rs.10,00,000. The life of the asset was only 3 years and would expire on 31st March, 2016. $A B C \& C o$. decided to set up a sinking fund.

During the three years following transactions took place:
2014 31st March: A contribution from profits of Rs. 5,00,000 was made and this sum was invested.

2014 5th Oct.: Investments which originally costed Rs. 1,00,000 were sold for Rs. 1,50,000 and the proceeds of sale were re-invested.

2015 31st March: A contribution from profits of Rs. 7,00,000 was made; interest on investments of Rs. 50,000 was received and these amounts were reinvested.

2015 15th September: Investments which originally costed Rs. 6,00,000 were sold at a profit of Rs. 50,000 and proceeds of sale were re-invested.

2016 31st March: Interest on investments Rs. 100,000 was received which was not invested. All existing investments were sold for Rs. 15,40,000. A contribution from profit of an amount required to make up the sinking fund to Rs. 25,00,000 was made and this amount was not invested.

Prepare Sinking Fund and Sinking Fund Investment Account for the years 201314, 2014-15, 2015-16.

## 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

| 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

$\mathrm{M} / \mathrm{s}$ 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 $1^{\text {st }}$ 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.) |
| :--- | ---: |
| $01-01-2012$ | $1,50,000$ |
| $01-01-2015$ | $2,00,000$ |

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 | $11,50,000$ |
| 31.03 .2016 <br> Actual repairs charged/incurred during the year ended <br> 31.03.2016 | $7,50,000$ |

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

On 1st April,2013, Z Limited purchased the lease of property for Rs. 10,00,000. The lease would expire on 31st March, 2016. Z Ltd. decided to set up a sinking fund. The Sinking Fund was to be credited (or debited) with an annual contribution from profit, the interest on the investments and any profits (or losses) made on the realisation of the sinking fund investments. The sinking fund was to be represented by specific investment, and any sums made available to the sinking fund were to be immediately invested, except at the termination of the fund.
During the three years following transactions took place:

- 31st March,2014 A contribution from profits of Rs. 3,20,000 was made and this sum was invested
- 13th Oct,2014 Investments which originally costed Rs. 1,10,000 were sold for Rs. 1,20,000 and the proceeds of sale were re-invested
- 31st March,2015 A contribution from profits of Rs. 3,20,000 was made; interest on investments of Rs. 16,000 was received and these amounts were reinvested
- 9th August,2015 Investments which originally costed Rs. 2,10,000 were sold at a profit of

Rs. 20,000 and proceeds of sale were re-invested

- 31st March,2016 Interest on investments Rs. 48,000 was received which was not invested
- All existing investments were sold for Rs. 6,60,000
- A contribution from profit of an amount required to make up the sinking fund to Rs.
$10,00,000$ was made and this amount was not invested
Prepare Sinking Fund and Sinking Fund Investment Account for the years 2013-14, 2014-15, 201516.


## Question: 12

On 1st April,2013, Z Limited purchased the lease of property for Rs. 10,00,000. The lease would expire on 31st March, 2016. Z Ltd. decided to set up a sinking fund. The Sinking Fund was to be credited (or debited) with an annual contribution from profit, the interest on the investments and any profits (or losses) made on the realisation of the sinking fund investments. The sinking fund was to be represented by specific investment, and any sums made available to the sinking fund were to be immediately invested, except at the termination of the fund.
During the three years following transactions took place:

- 31st March,2014 A contribution from profits of Rs. 3,20,000 was made and this sum was invested
- 13th Oct,2014 Investments which originally costed Rs. 1,10,000 were sold for Rs. 1,20,000 and the proceeds of sale were re-invested
- 31st March, 2015 A contribution from profits of Rs. 3,20,000 was made; interest on investments of Rs. 16,000 was received and these amounts were reinvested
- 9th August, 2015 Investments which originally costed Rs. $2,10,000$ were sold at a profit of

Rs. 20,000 and proceeds of sale were re-invested

- 31st March,2016 Interest on investments Rs. 48,000 was received which was not invested. All existing investments were sold for Rs. 6,60,000
- A contribution from profit of an amount required to make up the sinking fund to Rs.

10,00,000 was made and this amount was not invested
Prepare Lease A/c and Depreciation A/c for the years 2013-2014, 2014-2015, 2015-2016.

## Chapter-6 Accounting for Special Transactions

## Unit-1 Bills of Exchange



## 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

Goods are sold or services are provided


Seller extends a credit period to buyer


Sometimes, the seller may not be in a position to offer credit period and the buyer is not in a position to pay


Buyer gives a definite promise in writing (Bills of Exchange) to pay the amount of the goods on a certain date.


Seller can use it to generate immediate funds from Bank.

* Characteristics
$>$ It must be in writing.
> It must be dated.
> It must contain an order to pay a certain sum of money.
> 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.


## * 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.

There are generally 3 parties (Drawer, Drawee and Payee) in bill of exchange.

A bill is paid by Acceptor.
A bill is drawn by creditor.
The drawer and payee may be same person in case of bill of exchange

A promissory note contains only a promise to pay certain sum of money.

There are 2 parties (Maker and Payee) in promissory note.

A promissory note is paid by maker.
A promissory note is made by debtor.
In promissory note maker and payee cannot be same person.

In a bill of exchange the liability of drawer is secondary and conditional.

## A bill of exchange can be accepted conditionally.

In a bill of exchange, notice of dishonor must be given.

In case of dishonor, a bill of exchange must be noted and protested.

In a promissory note the liability of a maker is primary and absolute.

A promissory note cannot be made conditionally.

Notice of dishonor is not required in case of promissory note.

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 nonacceptance.

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.

## 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 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 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 due date is a public holiday.

The preceding business day will be the due date.

## 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 $30^{\text {th }}$.
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

> 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.

## 13. RETRIEMENT OF BILLS OF EXCHANGE AND REBATE

The acceptor has spare funds much before the maturity date of the bill of exchange accepted by him.


He approaches the payee of the bill of exchange and asks him whether the payee is prepared to accept cash before the maturity date.


The acceptor gets a certain rebate or interest or discount for premature payment.


The rebate becomes the income of the acceptor and expense of the payee.

## 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 $\quad$ Dr. |  |
| To Drawee/Maker of the note |  |
| Z A/c |  |
| To Bills Receivable Account |  |
| On discounting with bank | Dank Account |


| 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 |  |
| 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 <br> To Bank A/c <br> 2) Suppose $X$ had endorsed this bill in favour of $Z$ | $\begin{aligned} & 1,000 \\ & 10 \end{aligned}$ |
| Y A/C Dr. | 1,010 |


| To Z |  |
| :---: | :--- |
| This is because Z will claim 1,010 from X and X has the right of |  |
| recovering 1,010 from Y. | 1,010 |
| 3) If the bill has been discounted with a bank, entry will be |  |
| Y Dr. |  |
| To Bank A/c | 1,010 |
| In case of Insolvency | 1,010 |
| 1) When drawee become insolvent |  |
| Drawee A/c |  |
| To Bills Receivable A/c |  |
| 2) When something received from estate |  |
| Cash A/c |  |
| To Drawee A/c |  |
| Bad debt A/c | Dr. |


| To Drawee A/c |  |
| :---: | :---: |
| 3) In case of interest charged for new period | Dr. |
| Bills Receivable A/c |  |
| To Drawee A/c |  |
| To Interest Income A/c |  |
| In case of Retirement of Bill | Dr. |

## 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 |  |
| 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 |  |
| 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 |  |
| 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. |  |
| When the amount is realized the entry will be |  |
| Bank Account |  |
| 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 |  |

## Unit -2 Sale of Goods on Approval or Return Basis



## 1. INTRODUCTION

## In Normal Course of Business

| Goods sold to <br> Customer |
| :---: | :---: | :---: | :---: |
| Treated as Sale | | Revenue being |
| :---: |
| recognized |

## Sale on return or approval basis



## * Features of sale of goods on approval or return basis

$>$ There is a change in the possession of goods from one person to another.
$>$ It does not involve transfer of ownership of goods. Ownership transfer when buyer gives his approval or goods not returned in specific period.
$>$ The customer does not incur any liability when the goods are merely sent to him.

Normally sales of good on return basis take place between a manufacture and a retailer. In online sales, this practice is prevalent.

## 2. ACCOUNTING RECORDS



* Business send goods Casually on sale or return basis



## Special cases

If at year end, goods are still lying with the customers and the specified time limit is yet to expire
$>$ Effect on Profit \& loss A/c: The entry made for sales earlier reversed.
$>$ Effect on Balance Sheet : Goods lying with the customer treated as ordinary inventory (Calculated on Cost Price)

* Business sends Goods Frequently on sale or return basis


Ques. If no sale recorded then how is the transaction recorded?
Ans. Records of goods sent is maintained in a specially ruled Sale or Return Journal / Day Book instead of passing entry for sale of goods.

This Day Book is divided into 4 main columns
(1) Goods sent on Approval
(2) Goods Returned
(3) Goods Approved
(4) Balance.

| Goods Sent on Approval |  |  | Goods returned |  |  | Goods approved |  |  | Balance |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Date | Particulars | Folio | Amt | Particulars | Folio | Amt | Particulars | Folio | Amt | Amt |
| $\mathbf{1}$ | $\mathbf{2}$ | $\mathbf{3}$ | $\mathbf{4}$ | $\mathbf{5}$ | $\mathbf{6}$ | $\mathbf{7}$ | $\mathbf{8}$ | $\mathbf{9}$ | $\mathbf{1 0}$ | $\mathbf{1 1}$ |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |

Procedure for recording transaction in sales or return journal/Day book

| Goods sent to customer on approval basis | Entries made only in column 1 to 4, the sale <br> price of goods entered in column 4. |
| :--- | :--- |
| If goods returned | Entries are made in column 5 to 7, the price <br> of goods returned being entered to column <br> 7. |
| If goods are retained by customer | Entries are made in columns 8 to 10. The <br> individual amounts are then posted to the <br> debit of customer's accounts in the Sales <br> Ledger and their total is credited to Sales <br> Account in the General Ledger. |
| Neither returned nor retained till end of the <br> year. | Shown as balance in column. The total of <br> this column, afterwards, will show the value <br> of goods with customers at the sale price. |

## * When Business Sends Goods Numerously on Sale or Return Basis



## Procedure for recording transaction

At the time when goods send to customer on a sale or return basis

1. First recorded in sale or return day book.
2. In sale or return ledger, all the customers are individually debited and the Sale or Return Account is credited with the periodical total of the Sale or Return Day Book.

When the goods are returned by the customer

1. They are recorded initially in the Sale or Return Day Book.
2. in the Sale or Return Ledger, the Sale or Return Account is debited with the periodical total of the Sale or Return Day Book and the individual customers are credited

When the goods are retained by the customer or no intimation received within a specified time

1. In general ledger, Sales are recorded in the Sales Day Book and thereafter, the total of the Sales Day Book is credited to Sales Account and debited to the Individual Customers Account.
2. In Memorandum Sales or return ledger, To cancel the earlier entries, individual customers are credited and the Sale or Return Account is debited.

It is important to remember that Sale or return day book and sale or return ledger are Memorandum Books, i.e., these records are not a part of regular books of accounts.

## 3. JOURNAL ENTRIES

* WHEN THE BUSINESS SENDS GOODS CASUALLY ON SALE OR RETURN BASIS

| PARTICULAR | AMOUNT |
| :---: | :--- |
| When goods are sent on sale or return basis |  |
| Trade receivable/ customer Account $\quad$ Dr. | Invoice price |
| To Sales Account |  |
| 1. When goods are rejected or returned within the specified time |  |
| Sales/Return Inwards Account | Dr. |
| To Customers/Trade receivables Account |  |
| Tnvoice price |  |



* WHEN THE BUSINESS SENDS GOODS FREQUENTLY ON SALE OR RETURN BASIS

| PARTICULAR | AMOUNT |
| :---: | :--- |
| 1. At the time of approval |  |
| Customer A/c |  |
| To Sales Account |  |
| 2. At the time of preparing of Final Accounts | Cost or net <br> realizable value |
| Goods with Customers on Sale or Return Account Dr. | whichever is less |
| To Trading Account |  |

* WHEN THE BUSINESS SENDS GOODS NUMEROUSLY ON SALE OR RETURN

| PARTICULAR | AMOUNT |
| :---: | :---: |
| IN THE MEMORANDUM SALE OR RETURN LEDGER | Dr. |
| 1) When goods are sent to the customer |  |
| Customer Account |  |
| To Sale or Return Account |  |
| 2) When goods are returned | Dr. |
| Sales or Return Account |  |
| To Customer Account |  |
| 3) When goods are retained by the customer | Dr. |
| Sales or Return Account |  |
| To Customer Account |  |
| 2 |  |
| 2 |  |


| IN THE REGULAR BOOKS |  |
| :---: | :---: |
| 1) When goods are sent to the customer <br> No Entry |  |
| 2) When goods are returned <br> No Entry | Dr. |
| 3) When goods are retained by the customer |  |
| Customer Account | Dr. |

## Unit - 3 Consignment




Agent
(Mr. Shyam)

Ownership: Remains with the consignor or the principal.

Invoicing : Consignor does not send an invoice. He only sends a proforma invoice.

## What is Proforma Invoice?

It is a statement conveying information to the consignee regarding particulars of the good sent. It looks like an invoice.

## * Features

$>$ The consignee recovers from the consignor all expenses incurred by him on the consignment. This however can be changed by agreement between the two parties
$>$ It is also usual for the consignee to give an advance to the consignor in the form of cash or a bill of exchange.
> The consignee receives a commission calculated on the basis of gross sale. It is calculated on total sale and not merely on credit sale.

> Periodically, the consignees sends to the consignor a statement called Account Sales.

## What is Account Sales?

> It sets out the sales made by the consignee
$>$ The expenses incurred on behalf of the consignor
$>$ The commission earned by the consignee and
$>$ The balance due to the consignor.

Firms usually like to ascertain the profit or loss on each consignment or consignments to each consignee.

## 3. DISTINCTIONS

## Consignment And Sale

| S.No. | Consignment | Sale | Basis |
| :--- | :--- | :--- | :--- |
| 1. | Ownership of the goods rests with <br> the consignor till the time they are <br> sold by the consignee, no matter the <br> goods are transferred to the <br> consignee. | The ownership of the <br> goods transfers with the <br> transfer of goods from <br> the seller to the buyer. | Ownership |
| 2. | The consignee can return the <br> unsold goods to the consignor. | Goods sold are the <br> property of the buyer <br> and can be returned only | Return |


|  |  | if the seller agrees |  |
| :--- | :--- | :--- | :--- |
| 3. | Consignor bears the loss of goods <br> held with the consignee. | It is the buyer who will <br> bear the loss if any, after <br> the transfer of goods. | Onus of loss |
| 4. | The relationship between the <br> consignor and the consignee is <br> that of a principal and agent. | The relationship between <br> the seller and the buyer <br> is that of a creditor and a <br> debtor. | Relationship |
| 5. | Expenses done by the consignee to <br> receive the goods and to keep it <br> safely are borne by the consignor <br> unless there is any other agreement. | Expenses incurred by the <br> buyer are to be borne by <br> the buyer itself after the <br> transfer of goods. | Expenses |

## Commission and Discount


#### Abstract

Commission Commission may be defined as remuneration of an employee or agent relating to services performed in connection with sales, purchases, collections or other types of business transactions and is usually based on a percentage of the amounts involved. Commission earned is accounted for as an income in the books of accounts, and commission allowed or paid is accounted for as an expense in the books of the party availing such facility or service.


## Discount

The term discount refers to any reduction or rebate allowed and is used to express one of the following situations:

An allowance given for the settlement of a debt before it is due i.e. cash discount.

An allowance given to the whole sellers or bulk buyers on the list price or retail price, known as trade discount. A trade discount is not shown in the books of account separately and it is shown by way of deduction from cost of purchases.

## 4. ACCOUNTING IN BOOKS OF CONSIGNOR

$>$ A separate consignment account has to be prepared for each consignment.
$>$ Each consignment account is a nominal-cum-personal account.
$>$ Each consignment account constitutes a profit and loss account in respect of the transactions to which it relates.

| PARTICULAR | AMOUNT | COMMENTS |
| :---: | :---: | :---: |
| 1. When goods are consigned or dispatched |  | The personal account of consignee is not debited and also sales account is not credited. |
| Consignment Account Dr. |  |  |
| To Goods Sent on Consignment Account |  |  |
| 2. Expenses incurred by consignor |  | Unlike normal practice to debiting expense accounts first and then transferring to profit and loss account, expenses are directly debited to consignment account |
| Consignment Account Dr. |  |  |
| To Supplier Account/Bank/Cash |  |  |
| 3. When advance is received from the consignee |  | The consignee may remit some advance to consignor. |
| Dr. Bank/Cash Account |  |  |
| To Consignee's Personal Account |  |  |
| 4. On receipt of account sales from the consignee |  |  |
| For sales proceeds |  |  |
| Consignee's Personal Account Dr. |  | Account sales contains details of sales made by consignee. |
| To Consignment Account |  |  |
|  |  |  |


| For expenses incurred by consignee |  | expenses <br> incurred by <br> consignee |
| :---: | :--- | :--- |
| Consignment Account <br> Dr. |  |  |
| 5. Co Consignee's Personal Account <br> exchange/promissory note received from the consignee <br> as settlement |  |  |
| Cash/Bank/Bills Receivable Account <br> Dr. |  |  |
| To Consignee's Personal Account |  |  |


| 9. For commission payable to consignee |  |  |
| :--- | :--- | :--- |
| Consignment Account <br> Dr. |  |  |
| To Consignee's Personal Account |  |  |
|  |  |  |

## 5. VALUATION OF INVENTORIES

Principle: Inventories should be valued at cost or net realizable value whichever is lower.

## In the case of consignment

Cost means cost of the goods to the consignor + all expenses incurred till the goods reach the premises of the consignee

## Examples of expense

1) Packaging
2) Freight
3) Cartage
4) Insurance in transit
5) Octroi
6) Import duty

What is not include?
Expenses incurred after the goods have reached the consignee's godown.

Examples: Godown rent
Insurance of godown
Delivery charges
Salesman salaries.

If the expected selling price of inventories on hand is lower than the cost, the inventories should be valued at expected net selling price only, i.e. expected selling price less delivery expenses, etc.

## 6. GOODS INVOICED ABOVE COST

Scenario: The proforma invoice is made out at a value higher than the cost.

Entries in the books of the consignor are made out on that basis.

Additional entries (before ascertaining profit) to remove the effect of loading:

| PARTICULAR | AMOUNT | COMMENT |
| :---: | :--- | :--- |
| Dr. Goods sent on Consignment Account |  | reversed to the <br> extent of loading <br> in order to debit <br> the Consignment <br> A/c on cost basis |
| To Consignment Account |  | Dr. |
| To Inventory Reserve Account |  | The amount of <br> loading included in <br> the value of the <br> closing Inventories <br> is unrealized profit <br> hence reserve is <br> created by debit <br> to the |
| Consignment |  |  |

## 7. NORMAL LOSS

> Normal loss would be spread over the entire consignment while valuing inventories.
$>$ No entry is recorded for normal loss.
> Normal loss considered as an expense for valuation of remaining inventory.

Cost per unit: (total cost + normal loss)/total quantity.

## 8. ABNORMAL LOSS

$>$ Abnormal loss is any accidental or unnecessary loss occurs.
> This amount should be credited to the Consignment Account and debited to the P\&L A/c.
$>$ Abnormal loss cannot be considered in valuing the stock.
$>$ Abnormal loss is valued just like inventories in hand.
$>$ For the purpose of valuation of inventory in hand, it should be noted that while normal loss is considered as part of cost of remaining goods, whereas abnormal loss is ignored.

## Special case

Valuing goods lost in transit
Valuing goods lost in consignee's godown
: Consignee's non-recurring expenses are not included.
: Consignee's non-recurring expenses are included.

* Distinction between Normal loss and abnormal loss

| Basis | Normal loss | Abnormal loss |
| :--- | :--- | :--- |
| Occurrence | Normal loss occurs due to inherent nature <br> of the goods being shipped e.g. leakage, <br> evaporation, loss of perishable goods etc. | Abnormal loss occurs mainly <br> because of unforeseen <br> events e.g. accident or <br> natural calamity etc. |
| Time of <br> Accounting | Normal loss is not accounted for <br> immediately and is loaded on the <br> remaining goods. It gets accounted for as <br> cost of remaining goods as and when they <br> are sold. | Abnormal loss is accounted <br> for immediately in profit <br> and loss account. |
| Impact on <br> gross profit | As normal loss is added to cost of <br> remaining goods, it impact gross profit. | Abnormal loss does not <br> impact gross profit. |
| Coverage by <br> Insurance <br> Co. | Insurance companies generally do not <br> cover normal loss as it is expected to be <br> incurred on each consignment or storage <br> of goods. | Insurance is generally <br> available for abnormal losses. |
| Certainty | Normal loss is almost certain however it <br> may vary from time to time. | Abnormal loss is because of <br> unforeseen events and is not <br> certain. |

* Journal Entries

| PARTICULAR | AMOUNT | COMMENT |
| :---: | :---: | :---: |
| Abnormal Loss Account |  |  |
| To Consignment Account |  |  |
| Dr. |  | If abnormal loss is <br> recoverable from <br> the insurance <br> company. |
| Tnsurance Company's Account | Dr. |  |
| To Abnormal Loss Account |  |  |
| Consignee's Personal Account |  | If abnormal loss is <br> recoverable from <br> the consignee. |
| To Abnormal Loss Account |  |  |
| Profit \& Loss Account |  |  |
| To Abnormal Loss Account |  |  |
| Dr. |  |  |
| If abnormal loss is |  |  |
| not recoverable |  |  |

## 9. COMMISSION

* Definition: Commission is the remuneration paid by the consignor to the consignee for the services rendered to the former for selling the consigned goods.

- It is based on fixed percentage of the gross sales proceeds made by the consignee.
- . It is given by the consignor regardless of whether the consignee is making credit sales or not.
- This type of commission does not give any protection to the consignor from bad debts and is provided on total sales.


Del-credere Commission

- To increase the sale and to encourage the consignee to make credit sales, the consignor provides an additional commission generally known as delcredere commission.
- This additional commission when provided to the consignee gives a protection to the consignor against bad debts.
- It is calculated on total sales unless there is any agreement between the consignor and the consignee to provide it on credit sales only.


## Over-riding

 Commission- It is an extra commission allowed by the consignor to the consignee to promote sales at higher price then specified.
- Depending on the agreement it is calculated on total sales or on the difference between actual sales and sales at invoice price or any specified price.
- In order to encourage the consignee to earn higher margins, it can also be in the form of share of additional profits made by consignee on sale of goods.


## 10. RETURN OF GOODS FROM THE CONSIGNEE

Consigned goods can be returned by the consignee because of many reasons like

- poor quality
- not upto the specimen
- Destroyed in transit etc.


## What is the value of returned goods?

Valued at the price at which it was consigned to the consignee.

## Special Point

Expenses incurred by the consignee to send those goods back to the consignor are not taken into consideration. This is generally called secondary freight in accounting terms.

## 11. ACCOUNT SALES

* Definition: An account sale is the periodical summary statement sent by the consignee to the consignor


## It contains details regarding:

1) sales made
2) Expenses incurred on behalf of the consignor.
3) Commission earned.
4) Unsold inventories left with the consignee.
5) Advance payment or security deposited with the consignor and the extent to which it has been adjusted.
6) Balance payment due or remitted.

It is a summary statement and is different from Sales Account



| Commission Account | Dr. |
| :---: | :---: |
| To Bad Debts Account |  |
|  |  |

## 13. ADVANCE BY THE CONSIGNEE VS SECURITY AGAINST CONSIGNMENT

> The consignor insist the consignee for some advance payment for the goods consigned at the time of delivery of goods.
$>$ This advance payment is adjusted in full against the amount due by the consignee on account of the goods sold.

## Special case

If the advance money deposited by the consignee is in the form of security against the goods consigned.

- Then the full amount is not adjusted against the amount due by the consignee to the consignor on account of goods sold if, there is any unsold inventory left with the consignee.
In that case proportionate security in respect of unsold goods is carried forward till the time the respective goods held with the consignee are sold.


## Unit - 4 Average Due-Date

## USES OF AVERAGE DUE DATE



## CALCULATION OF DUE DATE



What is Average Due date
Average Due Date is weighted average of due dates of various transactions where amount of each transaction is used as weight.

Why Average due date is important
Why the concept of Average due date developed

Unique Feature

Mathematical Definition of Average due date

Formula

To simplify the calculation of interest.
Where a person owing several amounts due on different dates, desires to pay the total amount payable by him/her on a particular date, so that neither the debtor nor the creditor stands to lose or gain anything by way of interest.
the party making payment neither suffers any loss nor gains anything by this arrangement of making a single payment

It is the mean or equated date on which a single total payment may be made in lieu of different payments on different dates without any loss to either party.

Average Due Date $=$ Base date $+\frac{\text { Total of products }}{\text { Total of amount }}$

## * Uses of Average Due date

> For calculating interest on drawings of partners;
> For settling accounts between principle and agent;
> For settling contra accounts e.g. where parties sell goods to each other;
> For making lump sum payment against various bills drawn on different dates with different due dates

## Points to be Remember

Selection of base date/ zero date: Such a date may be the due date of the first transaction or the due date of the last transaction or any other due date between the first and the last but preferably earlier due date may be taken.

While ascertaining the number of intervening days (plus or minus) between the base date and the due date of each transaction ignore the first date and include the last day.


If amount is paid before due date, rebate is given.

If amount is paid after due date, then interest is charged.

Whenever there is a sale of goods by two persons to each other on different dates, the formula for calculating average due date becomes.
$=$ Base date $+\frac{\text { Difference in Products }}{\text { Difference in Amounts }}$

## 2. CONCEPT OF DUE DATE (DATE OF MATURITY)



Calculation of Due Date
after Taking into

- A Bill of exchange or promissory note matures on the date on which it falls due.
- Every promissory note or bill of exchange (other than those payable on demand or at sight or on presentment) falls due on the third day after on which it is expressed to be payable.
- The bill is made payable at a stated number of months after date or after sight or after certain events.
- the period stated shall be held to terminate on the date of the month which corresponds with the day on which the instrument is dated.
- If the month in which the period would terminate has no corresponding day, the period shall be held to terminate on the last day of such month.

Calculating Due Date of Bill or Note Payable Few Months after Date or Sight

- The instrument shall be deemed to be due on the preceding business day.
- If the preceding day is also a public holiday, it will fall on the day preceding the previous day.
Calculation of Due Date when the Maturity Day is a Holiday
(i) Calculation of average due date where one party is involved.

Take the earliest due date as starting day or base date or " O " day for convenience. Any date whatsoever, may also be taken as " $O$ " day.

Consider the number of days from base date up to each due date. Calculations may also be made in month.

Multiply the number of days by the corresponding amounts.

Add up the amount and products.

Divide the "Product total" by "Amount total" and get result approximately upto a whole number.

This number is added in the base date to find the average due date.
Thus the formula is
Average Due date $=$ Base date $+/-$ Total of products
Total of Amounts

Note: For calculation of no. of days, no. of days in each respective month involved are to be considered individually
(ii) Calculation of average due date Where inter transactions between 2 Parties are involved
> The steps are same as of previous case
$>$ Only instead of paying gross amount they may go for new amount i.e. Purchase amount and sales amount will be set off and thus here we take difference of amount and produce as Net Amount.

Note: Earliest date of both parties is taken as the base date.
(iii) Calculation of average due date where amount is repaid in Instalments

## Step 1

Calculate number of days/monthly/years from the date of lending money to the date of each repayment.

Step 2

Find the total of such days/months/years.

## Step 3

Quotient will be the number of days/months/years by which average due date falls away from date of commencement of loan.

If instalment are same, we can use Simple mean concept i.e. Divide days by number of items and no need for product.

Thus, the formula for average due date is as follows :

Average due date $=$ Date of loan + Sum of days $/$ months/year from the date of lending to the date of repayment of each installment

Number of Instalments
(iv) Calculation of average due date for determining interest on drawings
> Amount is drawn by the owners of business on various dates but it may settled on one day.
> When different amounts are due on different dates, but they are ultimately settled on one day the interest may be calculated by means of Average Due Date.
$>$ When interest is chargeable on drawings, and drawings are on different dates, interest may be calculated on the basis of Average Due Date of drawings.

## Illustrations

## UNIT 1: Bill of Exchange and Promissory notes

## 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
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 D. Dalal retires a bill for Rs 2,000 drawn on him by Katrak for Rs 10 discount

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 ' $X$ '.


## UNIT 2: Sale of goods on Approval or Return basis

Question: 1
CE sends goods to his customers on Sale or Return basis. The following transactions took place during 2016:

| Sept. 15 | Sent goods to customers on sale or return basis at cost plus <br> $331 / 3 \%$ | Rs.1,00,000 |
| :--- | :--- | :--- |
| Oct. 20 | Goods returned by customers | Rs. 40,000 |
| Nov. 25 | Goods with customers awaiting approval | Rs. 20,000 |

CE records sale or return transactions as ordinary sales. You are required to pass the necessary Journal Entries in the books of CE assuming that accounting year closes on 31st December,2016.

## Question: 2

S. Ltd. sends out its goods to dealers on Sale or Return basis. All such transactions are, however, treated as actual sales and are passed through the Day Book. Just before the end of the accounting year on 31.03.2016, 200 such goods have been sent to a dealer at Rs. 250 each (cost Rs. 200 each) on sale or return basis and debited to his account. Of these goods, on 31.03.2016, 50 were returned and 70 were sold while for the other goods, date of return has not yet expired.
Pass necessary adjustment entries on 31.03.2016.

## Question: 3

Caly Company sends out its gas containers to dealers on Sale or Return basis. All such transactions are, however, treated as actual sales and are passed through the Day Book. Just before the end of the financial year, 100 gas containers, which cost them Rs. 900 each have been sent to the dealer on 'sale or return basis' and have been debited to his account at Rs.1,200 each. Out of this only 20 gas containers are sold at Rs. 1,500 each.
You are required to pass necessary adjustment entries for the purpose of Profit and Loss Account and Balance Sheet.

## Question: 4

E Ltd. sends out its accounting machines costing Rs. 200 each to their customers on Sales or Return basis. All such transactions are, however, treated like actual sales and are passed through the Day Book. Just before the end of the financial year, i.e., on March 24, 2016, 300 such accounting machines were sent out at an invoice price of Rs. 280 each, out of which only 90 accounting machines are accepted by the customers Rs. 250 each and as to the rest no report is forthcoming. Show the Journal Entries in the books of the company for the purpose of preparing Final Accounts for the year ended March 31, 2016.

## Question: 5

A sends out goods on approval to few customers and includes the same in the Sales Account. On 31.3.2016, the Trade receivables balance stood at Rs. 1,00,000 which included Rs. 7,000 goods sent on approval against which no intimation was received during the year. These goods were sent out at $25 \%$ over and above cost price and were sent to-

- Mr. X - Rs. 4,000 and Mr. Y - Rs.3,000.

Mr. X sent intimation of acceptance on 30th April and Mr. Y returned the goods on 10th April,2016.

Make the adjustment entries and show how these items will appear in the Balance Sheet on 31st March,2016. Show also the entries to be made during April,2016. Value of closing Inventories as on 31st March, 2016 was Rs.60,000.

Question: 6
On 31st December, 2016 goods sold at a sale price of Rs. 3,000 were lying with customer, Ritu to whom these goods were sold on 'sale or return basis' were recorded as actual sales.
Since no consent has been received from Ritu, you are required to pass adjustment entries presuming goods were sent on approval at a profit of cost plus $20 \%$. Present market price is $10 \%$ less than the cost price.

Question: 7

- On $1^{\text {st }}$ June 2019, Goods sent by Mr. A to Mr. B = 100 Units worth Rs 1000
- On $15^{\text {th }}$ June 2019, Mr. B Accepted 50 units
- On 20th June 2019 Mr. B Returned 20 units


## Question: 8

A firm sends goods on sale or return basis. Customers having the choice of returning the goods within a month. During May 2016, the following are the details of goods sent

| Date (May) | Customers | Value (Rs) |
| :---: | :---: | :---: |
| 2 | P | 15000 |
| 8 | B | 20000 |
| 12 | Q | 28000 |
| 18 | D | 3000 |
| 20 | E | 1000 |
| 27 | R | 26000 |

Within the stipulated time, $P$ and $Q$ returned the goods and $B, D$, and $E$ signified that they have accepted the goods.
Show in the books of the firm, the Sale or Return Account and Customer- P for Sale or Return Account on 15th June,2016.

Question: 9
X supplied goods on sale or return basis to customers, the particulars of which are as under:

| Date of Dispatch | Party's Name | Amount (Rs) | Remarks |
| :--- | :--- | :--- | :--- |
| 10.12 .2016 | $\mathrm{M} / \mathrm{s} . \mathrm{ABC}$ | 10,000 | No information till 31.12.2016 |
| 12.12 .2016 | $\mathrm{M} / \mathrm{s} . \mathrm{DEF}$ | 15,000 | Returned on 16.12.2016 |
| 15.12 .2016 | $\mathrm{M} / \mathrm{s} . \mathrm{GHI}$ | 12,000 | Goods worth Rs 2,000 returned on <br> 20.12 .2016 |
| 20.12 .2016 | $\mathrm{M} / \mathrm{s}$. DEF | 16,000 | Goods Retained on 24.12.2016 |
| 25.12 .2016 | $\mathrm{M} / \mathrm{s} . \mathrm{ABC}$ | 11,000 | Good Retained on 28.12.2016 |
| 30.12 .2016 | $\mathrm{M} / \mathrm{s} . \mathrm{GHI}$ | 13,000 | No information till 31.12.2016 |

Goods are to be returned within 15 days from the dispatch, failing which it will be treated as sales. The books of ' $X$ ' are closed on the 31st December 2016.
Prepare the following accounts in the books of ' $X$ '.
(a) Goods on "sales or return, sold and returned day books".
(b) Goods on sales or return total account.

## UNIT 3: Consignment

## Question: 1

Exe sent on 1st July,2019 to Wye goods costing Rs 50,000 and spent Rs1,000 on packing etc. On 3rd July,2019, Wye received the goods and sent his acceptance to Exe for Rs. 30,000, payable at 3 months. Wye spent Rs 2,000 on freight and cartage, Rs 500 on godown rent and Rs 300 on insurance. On 31st December, 2019 he sent his Account Sales (along with the amount due to Exe). Showing that 4/5 of the goods had been sold for Rs55,000. Wye is entitled to a commission of $10 \%$. One of the customers turned insolvent and could not pay Rs600 due from him.
Show the necessary journal entries in the books of consignor. Also prepare ledger accounts.
Question: 2
Miss Rakhi consigned 1,000 radio sets costing Rs. 900 each to Miss Geeta, her agent on $1^{\text {st }}$ July,2016. Miss Rakhi incurred the following expenditure on sending the consignment.
Freight
Rs.7,650
Insurance
Rs.3,250
Miss Geeta received the delivery of 950 sets. An Account sale dated $26^{\text {th }}$ November 2016 showed that 750 sets were sold for Rs.9,00,000 and Miss Geeta incurred Rs.10,500 for carriage.
Miss Geeta was entitled to commission of $6 \%$ on the sales effected by her. She incurred expenses amounting to Rs.2,500 for repairing the damaged radio sets remaining in the inventory. Miss Rakhi lodged a claim with the insurance company which was admitted at Rs.35,000. Show the Consignment A/c and Miss Geeta's Account in the books of Miss Rakhi.

Question: 3
Vikram Milk Foods Co. Ltd. of Vikrampur sent to Sunder Stores, Sonepuri 5,000 kgs of baby food packed in 2,000 tins of net weight 1 kg and 6,000 packets of net weight $1 / 2 \mathrm{~kg}$ for sale on consignment basis. The consignee's commission was fixed at $5 \%$ of sale proceeds. The cost price and selling price of the product were as under

| Particulars | 1 Kg. tin | $1 / 2 \mathrm{Kg}$. packet |
| :--- | ---: | ---: |
| Cost Price | 10 | 6 |
| Selling Price | 15 | 7 |

The consignment was booked on freight "To Pay" basis, and freight charges came to $2 \%$ of selling value. One case containing 50 ( 1 kg . tins) was lost in transit and the transport carrier admitted a claim of Rs. 450.
At the end of the first half-year, the following information is gathered from the "Account Sales" sent by the consignee:

1. Sale proceeds:
a. $1,5001 \mathrm{Kg}$. tins
b. $4,0001 / 2 \mathrm{Kg}$. packets
2. Store rent and insurance charges Rs. 600

Find out the value of closing inventory on consignment.
Show the Consignment A/c and the Consignee's A/c in the books of Vikram Milk Food Co. Ltd. assuming that, the consignee had paid the amount due from him.

## Question: 4

Shri Mehta of Mumbai consigns 1,000 cases of goods costing Rs. 1,000 each to Shri Sundaram of Chennai. Shri Mehta pays the following expenses in connection with consignment:

| Particulars | Amount (Rs.) |
| :--- | ---: |
| Carriage | 10,000 |
| Freight Charges | 30,000 |
| Loading Charges | 10,000 |

Shri Sundaram sells 700 cases at Rs. 1,400 per case and incurs the following expenses:

| Particulars | Amount (Rs.) |
| :--- | ---: |
| Clearing Charges | 8,500 |
| Warehousing and Storage | 17,000 |
| Packing and Selling Expenses | 6,000 |

It is found that 50 cases have been lost in transit and 100 cases are still in transit.
Shri Sundaram is entitled to a commission of $10 \%$ on gross sales. Draw up the Consignment Account and Sundaram's Account in the books of Shri Mehta.

Question: 5
Ajay of Mumbai consigned to Vijay of Delhi, goods to be sold at invoice price which represents $125 \%$ of cost. Vijay is entitled to a commission of $10 \%$ on sales at invoice price and $25 \%$ of any excess realised over invoice price.

1. The expenses on freight and insurance incurred by Ajay were Rs. 10,000.
2. The account sales received by Ajay shows that Vijay has affected sales amounting to Rs. $1,00,000$ in respect of $75 \%$ of the consignment.
3. His selling expenses to be reimbursed were Rs. 8,000 .
4. $10 \%$ of consignment goods of the value of Rs. 12,500 were destroyed in fire at the Delhi godown and the insurance company paid Rs. 12,000 net of salvage.
5. Vijay remitted the balance in favour of Ajay.

Prepare consignment account and the account of Vijay in the books of Ajay along with the necessary calculations.

## Question: 6

Exe sent on 1st July, 2019 to Wye goods costing Rs 50,000 and spent Rs1,000 on packing etc. On 3rd July,2019, Wye received the goods and sent his acceptance to Exe for Rs. 30,000, payable at 3 months. Wye spent Rs 2,000 on freight and cartage, Rs 500 on godown rent and Rs 300 on insurance. On 31st December, 2019 he sent his Account Sales (along with the amount due to Exe). Showing that $4 / 5$ of the goods had been sold for Rs55,000. Wye is entitled to a commission of $10 \%$. One of the customers turned insolvent and could not pay Rs. 600 due from him.
Show the necessary journal entries in the books of consignor. Also prepare ledger accounts.

Unit- 4 Average Due- Date
Illustration - 1
The following are the amounts due on different dates in between the same parties

| Amount <br> (Rs.) | Due Date |
| :---: | :---: |
| 500 | $3^{\text {rd }}$ July |
| 800 | $2^{\text {nd }}$ August |
| 1,000 | $11^{\text {th }}$ September |

Suggest a date on which all the bills may be paid out without any loss of interest to either party.

## Illustration-2

The following are the amounts due on different dates in between the same parties

| Amount <br> (Rs.) | Due Date |
| :---: | :---: |
| 500 | $3^{\text {rd }}$ July |
| 800 | $2^{\text {nd }}$ August |
| 1,000 | $11^{\text {th }}$ September |

Suggest a date on which all the bills may be paid out without any loss of interest to either party.
Illustration-3
Calculate Average Due date from the following information:

| Date of Bill | Term | Amount (Rs) |
| :---: | :---: | :---: |
| August 10, 2015 | 3 months | 6000 |
| October 23, 2015 | 60 days | 5000 |
| December 4, 2015 | 2 months | 4000 |
| January 14, 2016 | 60 days | 2000 |
| March 08, 2016 | 2 months | 3000 |

## Illustration-4

A owes B Rs 890 on 1st January 2015. From January to March, the following further transactions took place between $A$ and $B$ :

| January 16 | A buys goods | Rs 910 |
| :--- | :--- | :--- |
| February 2 | A receives Cash <br> loan | Rs 750 |
| March 6 | A buys goods | Rs 810 |

A pays the whole amount on 31st March 2015 together with interest at 5\% per annum. Calculate the interest by the average due date method.

## Illustration 5

Two traders X and Y buy goods from one another, each allowing the other one month's credit. At the end of 3 months the accounts rendered are as follows:

| Date | Goods Sold by X to Y |
| :---: | :---: |
| April 18 | 60.00 |
| May 15 | 70.00 |
| June 16 | 80.00 |
| Date | Goods Sold by Y to X |
| April 23 | 52.00 |
| May 24 | 50.00 |

Calculate the date upon which the balance should be paid so that no interest is due either to $X$ or Y

## Illustration 6

Manoj had the following bills receivables and bills payable against Sohan. Calculate the average due date, when the payment can be received or made without any loss of interest

| Date | Bills Receivables | Tenure |
| :--- | :--- | :--- |
| $01 / 06 / 2016$ | 3,000 | 3 months |
| $05 / 06 / 2016$ | 2,500 | 3 months |
| $09 / 06 / 2016$ | 6,000 | 1 month |
| $12 / 06 / 2016$ | 1,000 | 2 months |
| $20 / 06 / 2016$ | 1,500 | 3 months |


| Date | Bills Payable | Tenure |
| :--- | :--- | :--- |
| $29 / 05 / 2016$ | 2,000 | 2 months |
| $03 / 06 / 2016$ | 3,000 | 3 months |
| $9 / 06 / 2016$ | 6,000 | 1 month |

15 August 2016 was a Public holiday. However, 6 September 2016 was also declared as sudden holiday

## Illustration 7

Rs 10,000 lent by Dass Bros. to Kumar \& Sons on 1st January 2011 is repayable in 5 equal annual instalments commencing on 1st January 2012. Find the average due date and calculate interest at 5\% per annum, which Dass Bros. will recover from Kumar \& Sons.

## Illustration 8

A and B, two partners of a fi rm, have drawn the following amounts from the firm in the year ending 31st March 2015:

| Date | A | Date | B |
| :---: | :---: | :---: | :---: |
|  | Amount (Rs) |  | Amount (Rs) |
| $1^{\text {st }}$ July | 500 | $12^{\text {th }}$ June | 1000 |
| $30^{\text {th }}$ <br> September | 800 | $11^{\text {th }}$ August | 500 |
| $1^{\text {st }}$ November | 1000 | $9^{\text {th }}$ February | 400 |
| $28^{\text {th }}$ February | 400 | $7^{\text {th }}$ March | 900 |

Interest at 6\% p.a. is charged on all drawings. Calculate interest chargeable by using

1. Ordinary system

Average due date system. (assume 1 year = 365 days)

## Unit - 5 Account Current

## - Definition

An Account Current

- is a running statement of transactions
- between parties for a given period of time
- Includes interest allowed or charged on various items.
- It takes the form of a ledger account.
* Some of the situations when account current is prepared are:

It is prepared when frequent transactions regularly take place between two parties. An example is of a manufacturer who sells goods frequently to a merchant on credit and receives payments from him in instalments at different intervals and charges interest on the amount which

An Account Current also is frequently prepared to set out the transactions taking place between a banker and his customer.

A consignee of goods can also prepare an Account Current, if the latter is to settle the account at the end of the consignment \& interest is chargeable on outstanding balance.

It is prepared when two or more persons are in joint venture and each co-venture is entitled to interest on their investment. Also, no separate set of book is maintained forit.

## An Account current has two parties



## 2. PREPARATION OF ACCOUNT CURRENT

## There are three ways of preparing an Account Current



## Preparation of Account Current with the help of Interest Tables-Individual Method

All the transactions are arranged in the form of an account
There are two additional columns on both the sides of such an account.
$>$ One column is meant to indicate the number of days counted from the due date of each transaction to the date of rendering the account

If no specific date is mentioned as the date on which payment is due, the date of the transactions is presumed to be the due date.
> The other column is meant for writing interest.

The interest columns of both the sides are totalled up and the balance is drawn.


## Template

| Date <br> 2015 | Particulars | Due <br> date | Amt | Days | Int | Date <br> 2015 | Particulars | Due <br> date | Amt | Days | In |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
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## Point to be remember

> While counting the number of days, the date of due date is ignored and the date up to which the account is prepared, is included.
> While counting the number of days, for opening balances, the opening date as well as date up to which the account is prepared, is counted.

## Preparation of Account Current by means of Products; Product Method

> The way of preparing the Account Current remains the same.
$>$ In this method only the method of calculating interest is different.
$>$ Interest columns are replaced by "product" columns.
$>$ Product means the amount multiplied by the number of days for which it has been outstanding.

The remaining steps are as follows:
Find out the balance of the products on the two sides.

Calculate interest at the given rate on the balance of the products for a single day.

Enter interest on the appropriate side in the amount column. This entry is made on the side other than that on which the balance of products appears.

Template

| $\begin{aligned} & \text { Date } \\ & 2015 \end{aligned}$ | Particulars | Due date | Amt | Days | Prod | $\begin{aligned} & \text { Date } \\ & 2015 \end{aligned}$ | Particu lars | Due date | Amt | Days | Pr |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
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* Method of computing the numbers of Days

> Forward Method

- Under this method the number of days are calculated from the due date of the transaction to the date of closing the account.


## Backward Method

- Under this method, the number of the days are calculated from the opening date of statement to the due date of transaction.


## RED INK INTEREST

Due date of a bill falls after the date of closing the account


Interest from the date of closing to such due date is written in "Red-Ink" in the appropriate side of the 'Account current. This interest is called Red-Ink interest


Red Ink interest is treated as negative interest

## * Preparation of Account Current by Means of Product of Balances in case of Banks.

> Usually adopted in Banks.
$>$ Under this method, the balance of account is taken out after every transaction.
$>$ In this case, the number of days written against each transaction are the days counted from its date or due date to the date of the following transaction.
> In the case of the last transaction, the number of days is counted to the close of the period.
> Each amount is multiplied with the number of days.


The Dr. Product and Cr. Product columns are then totalled up.
Interest is calculated on each total at the given rate of interest; and the net interest is ascertained.
If net interest is payable to the customer
If it is due from the customer

## Illustrations

Illustration-1
Prepare Account Current for Nath Brothers in respect of the following transactions with Shyam:

| 2015 | Particulars | Amount <br> (Rs.) | Due Date |
| :--- | :--- | ---: | :--- |
| September 16 | Goods sold to Shyam | 200 | due 1 ${ }^{\text {st }}$ Oct. |
| October 1 | Cash received from Shyam | 90 |  |
| October 21 | Good purchased from Shyam | 500 | due 1 ${ }^{\text {st }}$ Dec. |
| November 1 | Paid to Shyam | 330 |  |
| December 1 | Paid to Shyam | 330 |  |
| December 5 | Goods purchased from Shyam | 500 | due 1 ${ }^{\text {st }}$ Jan. |
| December 10 | Goods purchased from Shyam | 200 | due 1 ${ }^{\text {st }}$ Jan. |
| 2016 |  |  |  |
| January 1 | Paid to Shyam | 600 |  |
| January 9 | Goods sold to Shyam | 20 | due 1 ${ }^{\text {st }}$ Feb. |

## Illustration-2

From the following particulars, make up an Account Current to be rendered by Mr. X to Mr. Y on 31st December, 2016 taking interest into account at the rate of $18 \%$ p.a. ( 1 year $=365$ days)

| 01.07. 2016 | Balance owing by Mr. Y | Rs. 600 |
| :--- | :--- | :---: |
| 30.07. 2016 | Goods sold to Mr. Y (Credit Period allowed 1 <br> month) | Rs. 300 |
| 01.08. 2016 | Good purchased from Mr. Y (Credit Period <br> received 1 month) | Rs. 200 |
| 01.09. 2016 | Cash received from Mr. Y | Rs. 100 |
| 01.09 .2016 | Mr. Y accepted Mr. X's Draft at 3 Months date | Rs. 400 |

You are required to prepare the Account Current according to interest on individual transaction under the Forward and Backward methods

## Illustration-3

From the following particulars make up an Account Current to be rendered by S. Dasgupta to A. Halder at 31st Dec. reckoning interest at 5\% p.a. (assume 1 year $=365$ days)

| Particulars | Rs. |  |
| :--- | :--- | ---: |
| June 30 | Balance owing by A. Halder | 520 |
| July 17 | Goods sold to A. Halder | 40 |
| Aug. 1 | Cash received from A. Halder | 500 |
| Aug. 19 | Goods sold to A. Halder | 720 |
| Aug. 30 | Goods sold to A. Halder | 50 |
| Sept. 1 | Cash received from A. Halder | 400 |
| Sept. 1 | A. Halder accepted Dasgupta's Bill at 3 month date for | 300 |
| Oct. 22 | Goods bought from A. Halder | 20 |
| Nov. 12 | Goods sold to A. Halder | 14 |
| Dec. 14 | Cash received from A. Halder | 50 |

## Illustration-4

Following transaction took place between $X$ and $Y$ during the month of April, 2016

| April | Particulars | Rs. |
| :--- | :--- | ---: |
| 1 | Amount payable by X to Y | 10,000 |
| 7 | Received acceptance of X to Y for 2 months | 5,000 |
| $\mathbf{1 0}$ | Bills receivable (accepted by Y)on7.2.2016 is honoured |  |
|  | on this due date | 15,000 |
| 10 | X sold goods to Y (invoice dated 10.5.2016) | 7,500 |
| 12 | X received cheque form Y dated 15.5.2016 | 6,000 |
| 15 | Y sold goods to X (invoice dated 15.5.2016) | 1,000 |
| 20 | X returned goods sold by Y on 15.4.2016 | 5,000 |
| 20 | Bill accepted by Y is dis-honoured on this due date |  |

You are required to make out an account current by products method to be rendered by $X$ to $Y$ as on 30.4.2016, taking interest into account @ 10\% p.a. (assume 1 year = 365 days)

## Illustration-5

On 2nd January, 2016 Vinod opened a current account with the Allahabad Bank Limited; and deposited a sum of Rs.30,000.

| Deposits | Rs. | Withdrawals | Rs. |
| :--- | ---: | :--- | :---: |
| $15^{\text {th }}$ January | 12,000 | $15^{\text {th }}$ <br> February | 26,000 |
| $12^{\text {th }}$ March | 8,000 | $10^{\text {th }}$ April | 30,000 |
| $10^{\text {th }}$ May | 16,000 | $15^{\text {th }}$ June | 14,000 |

Show Vinod's a/c in the ledger of the Allahabad Bank. Interest is to be calculated at 5\% on the debit balance and 2\% on credit balance. The account to be prepared as on 30th June, 2016. Calculation may be made correct to the nearest rupee.

## Chapter 7 - Preparation of Final Accounts of Sole Proprietors

## OBJECTIVES

The lists of topics which will be covered in this chapter are as follows:
7.1 Financial Accounting of Non-Manufacturing Entities and Manufacturing Entities.
7.2 Preparation of Trading Account, Profit \& Loss Account and Balance Sheet.
7.3 Understanding various adjustments which need to be presented in the Financial Statements and their treatment.
7.4 Accounting for depreciation.

## 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

## Format of Trading Account:



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
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: <br> Trading A/c <br> 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 $\mathbb{\&}$ Loss Account. All the income and gains except for sales form a part of the Profit $\&$ Loss Account.

## Format of Profit \& Loss Account:

Dr.
Profit \& Loss Account for the year ended................
Cr .

|  | Amount | Amount |  | Amount | Amount |
| :---: | :---: | :---: | :---: | :---: | :---: |
| To Gross Loss b/d |  |  | By Gross Profit 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 fire |  |  |  |  |  |
| To Net Profit (transferred to Capital A/c) |  |  |  |  |  |
|  |  |  |  |  |  |
| TOTAL |  | XXX | TOTAL |  | XXX |

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 $\mathbb{\&}$ 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.
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
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:
Commission $=$ Profit before commission $\times \frac{\text { Rate of Commission }}{100}$

## Commission based on Net Profit after charging such commission:

Commission $=$ Profit before commission $X \frac{\text { Rate of Commission }}{100+\text { Rate of Commission }}$
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 $\mathbb{C}$ Loss Account from the Trial Balance after passing the closing entries.

| 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 | $\mathbf{2 , 9 6 0 , 0 0 0}$ | $\mathbf{2 , 9 6 0 , 0 0 0}$ |
| TOTAL |  |  |

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) |  |  |  |

$\left.\begin{array}{|l|l|l|r|r|}\hline \text { Dec-31 } & \text { Profit \& Loss A/c } & \text { Dr. } & 197,500 & \\ \hline & \text { To Salaries A/c } & & & 175,000 \\ \hline & \text { To Discount Allowed A/c } & & & 7,500 \\ \hline & \text { To Office Expenses A/c } & & & 15,000 \\ \hline & \begin{array}{l}\text { (Being expenses appearing in trial balance } \\ \text { transferred to PaL account) }\end{array} & & & \\ \hline & & & & 10,000\end{array}\right]$
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 |  |  |

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 <br> Capital A/c) |  | 30,000 |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| TOTAL |  | 227,500 | TOTAL |  | 227,500 |  |  |

## 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 $1^{\text {st }}$ January 2019 the Balance Sheet on $1^{\text {st }}$ January 2019 would be different as compared to 31 ${ }^{\text {st }}$ 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 |  |  |
| Long Term Loan |  | 50,000 | Cash |  | 40,000 |
|  |  |  | Closing Stock | 5,000 |  |
| Creditors |  | 24,000 | Advance to Suppliers |  | 15,000 |
| Short Term Borrowings |  | 175,000 |  | 55,000 |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
| TOTAL |  | $\mathbf{1 , 7 1 5 , 0 0 0}$ | TOTAL |  |  |

## 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 | 150,000 |  |
| Office Expense | 400,000 |  |
| Sales |  | $3,355,000$ |
| Debtors | $\mathbf{3 , 1 0 6 , 5 0 0}$ | $\mathbf{3 , 1 0 6 , 5 0 0}$ |
| Creditors |  |  |

Value of Closing Inventory on December 31, 2017 was Rs.89500/-

## 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 | $\mathbf{5 2 , 0 0 , 0 0 0}$ | $\mathbf{5 2 , 0 0 , 0 0 0}$ |

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 | $2,00,000$ |

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 $\mathrm{M} / \mathrm{s}$. ABC Traders.

## Question: 3

Revenue, Expenses and Gross Profit Balances of $\mathrm{M} / \mathrm{s}$ 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 $\mathrm{M} / \mathrm{s}$ ABC Traders for the year ended on 31st March. Show necessary closing entries in the Journal Proper of $\mathrm{M} / \mathrm{s}$. 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 | $6,00,000$ | 30,000 |
| Sundry Office Expenses A/c | $8,50,000$ | $50,00,000$ |
| Sales A/c |  | $3,70,000$ |
| Sums owing by customer (Trade receivables) | $64,00,000$ | $64,00,000$ |
| Trade payables (sums owing to suppliers) |  |  |
| Total |  |  |

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 | Amount (Rs.) | Assets | Amount (Rs.) |
| :--- | ---: | :--- | ---: |
| Liabilities | $5,60,000$ | Cash in Hand | 43,000 |
| Mahindra \& Sons | $20,00,000$ | Cash at Bank | $2,67,500$ |
| Capital |  | 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
Freight Inward
Salaries
Other Administrative Expenses
Furniture
Trade receivables and Trade Payables
Returns
Discounts
Bad debts
Investments in Government Securities Cash in Hand and cash at Bank
Total

| $1,10,000$ |  |
| ---: | ---: |
| 40,000 |  |
| $2,10,000$ |  |
| $1,50,000$ |  |
| $3,50,000$ |  |
| $2,10,000$ | $1,90,000$ |
| 20,000 | 12,000 |
| 19,000 | 9,000 |
| 5,000 |  |
| $1,00,000$ |  |
| $1,87,000$ |  |
| $18,31,000$ | $18,31,000$ |

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 <br> Provision | 1,88,000 |  |
|  |  |  | 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
Purchases
Purchase Returns
Sales
Sales Returns
Salaries
Rent for Go down
Interest on loan from Vishwanath
Rates \& Taxes
Discount allowed to Debtors
Discount Received from creditors
Freight on purchases
Carriage Outwards
Drawings
Printing and Stationery
Electricity Charges
Insurance Premium
General office expenses
Bad debts
Bank Charges
Motor car expenses
Capital a/c
Total

|  | 30,000 |
| ---: | ---: |
| $14,00,000$ | 26,000 |
|  | $23,00,000$ |
| 42,000 |  |
| $1,10,000$ |  |
| 55,000 |  |
| 27,000 |  |
| 21,000 |  |
| 24,000 | 16,000 |
|  |  |
| 12,000 |  |
| 20,000 |  |
| $1,20,000$ |  |
| 18,000 |  |
| 22,000 |  |
| 55,000 |  |
| 30,000 |  |
| 20,000 |  |
| 16,000 |  |
| 36,000 |  |
| $47,22,000$ |  |

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.

## 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

Raw Material Consumed = Opening inventory of Raw Materials + Purchases - Closing inventory of Raw Materials

## 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 oxygengas andthe production of steel yields scrap. Thesubsidiary product is termed as aby-product because its production is
not consciously undertaken but resultsout 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 byproduct 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 | $2,20,000$ |
| Hire charges of factory |  |
| Direct wages-Contracted @ Rs.0.80 per unit manufactured and @ Rs.0.40 <br> per unit of |  |
| Closing W.I.P. | $1,80,000$ |
| Repairs and Maintenance |  |
| Units produced $-5,00,000$ units |  |

Prepare a Manufacturing Account of Mr. Vimal for the year ended 31.3.2016.

## Chapter - 8 Partnership

## Unit-1 Introduction



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 partners.


## Existence of a business.

A partnership comes into existence only when partners begin to carry on business in accordance with their agreement.

An association of two or more persons.


Sharing of profits and losses of the business.
The persons concerned must agree to share the fits of the business.

A provision for sharing of loss is not necessary.

An agreement entered into by all persons concerned.

A formal or written agreement is not necessary to create a partnership.


## * 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)
> Viewed as an alternative corporate business proposal that provides the benefits of limited liability.
$>$ 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.

## * Features

> 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.
$>$ It is taxed as a partnership, but has the benefits of being a corporate, or more significantly, a juristic entity with limited liability.
> The provisions of the Indian Partnership Act, 1932 shall not apply to LLP unless stated.
> Every limited liability partnership shall have at least two partners.

* 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

He has been found to be of unsound mind by a Court of competent jurisdiction.

He is an undischarged insolvent.

He has applied to be adjudicated as an insolvent and his application is pending.

* 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.

## 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 |


| $\mathbf{5}$ | Separate <br> Legal Entity | No | Yes |
| :--- | :--- | :--- | :--- |
| $\mathbf{6}$ | Perpetual <br> Succession | Partnerships do not have <br> perpetual succession | It has perpetual <br> succession and individual <br> partners may come and go |
| $\mathbf{7}$ | Number of <br> Partners | Minimum 2 and Maximum 50 | Minimum 2 but no <br> maximum limit |
| $\mathbf{8}$ | Ownership of <br> Assets | Firm cannot own any assets. <br> The partners own the assets of <br> the firm | The LLP as an <br> independent entity can <br> own assets |
| $\mathbf{9}$ | Liability of <br> Partners / <br> Members | Unlimited: Partners are <br> severally and jointly liable <br> for actions of other partners <br> and the firm and their <br> liability extends to personal <br> assets | Limited to the extent of <br> their contribution <br> towards LLP except in <br> case of intentional fraud <br> or wrongful act of <br> omission or commission <br> by a partner. |
| $\mathbf{1 0}$ | Principal <br> Agent <br> Relationship | Partners are the agents of <br> the firm and of each other | Partners are agents of the <br> firm only and not of other <br> partners |

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

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.

## 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

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-intrade.

* In following cases, third parties cannot bind the firm unless all the partners have agreed



## 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.


## 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

| Withdrawals are made evenly in the <br> beginning of each Month | Interest can be calculated on whole <br> amount for 6.5 months |
| :--- | :--- |
| Withdrawals are made at the end of <br> each month | Interest can be calculated on whole <br> amount for 5.5 months |
| Withdrawals are mode at the <br> beginning of each quarter | Interest can be calculated on whole <br> amount for 7.5 months |
| Withdrawals are mode at the <br> beginning of each quarter | Interest can be calculated on whole <br> 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.

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 |  |
| 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 |  |
|  |  |

## Unit-2 Treatment of Goodwill




* Why 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

## * Recommendation of Accounting Standard

Accounting Standards require an enterprise to recognize an intangible asset, if

- It means that it must have some value and must be

An intangible asset must have the characteristics of an asset 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 is objectively verifiable.

The cost of the intangible asset can be measured reliably

- 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.

## 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.

## Steps in calculation of Super profit



Identify the average profit earned by the partnership firm based on past few years' figures

Determine normal rate of return prevailing in the locality of similar firms

Apply normal rate of return on capital employed to arrive at normal profit

Deduct normal profit from the average profit of the firm. If the average profit of the firm is more than the normal profit, there exists super profit and goodwill.

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.

When a new partner is admitted into a partnership


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.

[^0]> 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.

* 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.


## 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 |  |
| To A Partner's Capital A/c |  |
| To B Partner's Capital A/c |  |
| (Goodwill adjustment in the profit sacrificing ratio) |  |



## Unit -3 Admission of Partner

Revaluation Account or Profit and

## Loss

Adjustment Account for revaluation of assets and liabilities

Profit/loss on revaluation account is ts/f to old partners in their old profit sharing ratio

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.

## 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



## 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.
[^1]| Basis | Revaluation Account | Memorandum Revaluation <br> 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. |
| 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. |
|  |  |  |

When new partner's share is given but the question is sitent 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.
* Some useful Definition

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
ParticularsIncoming partner's capital x Reciprocal of share of incoming partner xxx
Less: Total capital after taking into consideration the ..... xxxcapital brought in by incoming partner
Value of Goodwill ..... xxx

## JOURNAL ENTRIES

| PARTICULAR | AMOUNT | 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) |  |  |
|  |  |  |


$\left.\begin{array}{|c|l|l|}\hline \text { To Memorandum Revaluation A/c } & & \\ \hline \text { B) Memorandum Revaluation A/c Dr. } & & \begin{array}{l}\text { (To Assets A/c } \\ \text { in the value } \\ \text { of individual } \\ \text { assets }\end{array} \\ \hline \text { To Liabilities A/c } & & \begin{array}{l}\text { with } \\ \text { decrease in } \\ \text { the value of } \\ \text { individual }\end{array} \\ \hline \text { Tiabilities }\end{array}\right\}$

|  |  |  |
| :---: | :--- | :--- |
| All Partners' Capital A/c |  | (New profit <br> and loss <br> sharing ratio) |
| To Memorandum Revaluation A/c |  |  |
| (If there is loss) |  | In the old <br> profit sharing <br> ratio |
| Reserves or Profit \& Loss A/c |  |  |
| To Old Partners' Capital A/c |  |  |
| Cr. |  | In case of <br> Hidden <br> Goodwill |
| (Any reserve etc. lying in the Balance Sheet transferred to <br> the Capital Accounts of the old partners) |  |  |
| Tapital A/c ( Gaining Partner) |  |  |
| To A's Capital A/c ( Sacrificing Partner) |  |  |
| To B's Capital A/c ( Sacrificing Partner) |  |  |

## 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.


1. When JLP is treated as expense

| Payment of JLP premium | JLP Premium A/c Dr. <br> To Bank A/c |
| :--- | :---: |
| Transfer of JLP to P\&L | Profit \& Loss A/c Dr. <br> To JLP Premium A/c |
| On Maturity of Policy | Bank A/c Dr. <br>  <br> To Partners Capital A/c (in PSR) |

2. When JLP is treated as Asset

| Payment of JLP premium | Joint Life Policy A/c Dr. <br> To Bank A/c |
| :--- | :---: |
| Year End - Check with Surrender Value <br> Loss = JLP Balance - Surrender Value | Profit \& Loss A/c Dr. <br> To Joint Life Policy A/c |
| On Maturity of Policy | Bank A/c Dr. <br> To Joint Life Policy A/c <br> To Partner's Capital A/c (In case of <br> gain) |

## 3. Creation of JLP Reserve

| Payment of JLP premium | Joint Life Policy A/c Dr. <br> To Bank A/c |
| :--- | :---: |
| Year End <br> Creation of Reserve | Profit \& Loss Appropriation A/c Dr. <br> To JLP Reserve A/c |
| Year End - Check with Surrender Value <br> Loss = JLP Balance - Surrender Value | JLP Reserve Dr. <br> To Joint Life Policy A/c |
| On Maturity of Policy | TLP Reserve A/c |
| To Joint Life Policy A/c |  |

## 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.

Right in subsequent profits

If account of retiring partner is not settled

Business is continued by remaining partners

Share in profits attributable to his property in partnership

Interest @6\% per annum on his share

## Unit-5 Death of a Partner

The problems arising on the death of a partner are similar to those arising on retirement Important Points:
5. The revaluation gain/loss belongs to all the partners and is distributed in existing profit sharing ratio.
6. The reserves are distributed to all partners in existing profit sharing ratio.
7. The goodwill is adjusted on the basis of gain ratio or sacrifice ratio. (Can be done using table adjustment)
8. The treatment of Joint Life Policy would be different as the firm would receive the sum assured on the policy.
9. The amount due to the deceased partner would be paid to the legal heirs.
10. 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
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)
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)

## Illustrations

Introduction to Partnership Accounting

## 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 profitsharing 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 $1^{\text {st }}$ 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 $1^{\text {st }}$ January 2016. A introduced a further capital of Rs.10,000 on $1^{\text {st }}$ April 2016 and another Rs.5,000on $1^{\text {st }}$ July 2016. On $30^{\text {th }}$ September 2016 A withdrew Rs.40,000.
On $1^{\text {st }}$ 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 $30^{\text {th }}$ June and Rs. 500 on $30^{\text {th }}$ 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 $1 / 6^{\text {th }}$ 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 $31^{\text {st }}$ 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

## Goodwill

## 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  <br> 2013 profit <br> 2014 profit <br> 2015 loss <br> 2016 profit | $\begin{array}{r} 40,000 \\ 36,000 \\ 6,000 \\ 50,000 \end{array}$ |
| 3) | Market Rate of interest on investment $10 \%$ |  |
| 4) | Rate of risk return on capital invested in business 2\% |  |
| 5) | Remuneration from alternative <br> 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 $31^{\text {st }}$ December 2016:

| Liabilities | Rs. | Assets | Rs. |
| :--- | ---: | :--- | ---: |
| Trade payables | 20,000 | Cash at Bank | 10,000 |
| Capital: |  | Sundry Assets | 55,000 |
| $\quad$ Yellow | 25,000 |  |  |
| Green |  |  |  |


|  | $\underline{20,000}$ |  | $\underline{65,000}$ |
| :--- | :--- | :--- | :--- |
|  | $\underline{65,000}$ |  |  |

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.

## Admission of a Partner Illustration 1

The following is the Balance Sheet of Ram and Mohan, who share Profit in the ratio of 3:2 as on $1^{\text {st }}$ 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 |
|  |  |  |  |
|  | $\underline{\mathbf{6 0 , 0 0 0}}$ |  | $\underline{\mathbf{6 0 , 0 0 0}}$ |

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 |
|  |  |  |  |
|  |  |  | $3,50,000$ |

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 $31^{\text {st }}$ 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 | 29,000 |  | 960 |
| Mr. Mallick - 5,000 |  |  |  |
|  |  |  | 49850 |
|  |  |  |  |

The partners have agreed to take Mr. Mistri as a partner with effect from $1^{\text {st }}$ 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 31 ${ }^{\text {st }}$ 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 $X \& C o$. sharing profits and losses in 3:2 ratio between themselves. On $31^{\text {st }}$ 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 | 5,000 |
| B:28,000 | 65,000 | Fittings | 15,000 |
| Trade Payables |  | Inventories | 20,000 |
|  | 5,000 | Trade Receivables | 10,000 |
|  |  | Cash in Hand |  |
|  |  |  | $\mathbf{7 0 , 0 0 0}$ |

$X$ 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 $1 / 3^{\text {rd }}$ 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 $1 / 3^{\text {rd }}$ 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.

## Retirement of Partner

## 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 |
|  | 60,000 | (including Bills |  |
| Reserves | 10,000 | Receivables | Rs.20,000) |
| Trade Payables | 50,000 | Bank | 50,000 |
|  |  |  |  |
|  |  |  | $3,20,000$ |

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 |
| Reserves  Cash and bank <br> Trade Payables 50,000 balance | 50,000 |  |  |
|  | 20,000 |  |  |
|  |  |  |  |
|  |  |  | $\mathbf{2 , 0 0 , 0 0 0}$ |

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 $\mathrm{M} / \mathrm{s} \mathrm{K}, \mathrm{M}$ 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 $31^{\text {st }}$ 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 | $1,70,000$ |  |  |
|  |  |  | $\mathbf{6 , 6 4 , 0 0 0}$ |

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 $1^{\text {st }}$ 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 $1^{\text {st }}$ 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 $10^{\text {th }}$ June.
The surrender value of the policy on $31^{\text {st }}$ December of various years was as follows: 2011 nil; 2012 Rs.900;
2013 Rs.2,000;
2014 Rs.3,600.
Black retires on $15^{\text {th }}$ 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 |  |  |
|  | $\mathbf{1 , 9 0 , 0 0 0}$ |  | $\mathbf{1 , 9 0 , 0 0 0}$ |

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 <br> (Rs) | Assets | Amount <br> (Rs) |
| :--- | :--- | :--- | :--- |
| Capital <br> accounts: | $1,35,930$ | Fixtures | 8,200 |
| A | 95,120 | Inventories | $1,57,300$ |
| B | 61,170 | Trade <br> receivables | 93,500 |
| C | 41,690 | Cash | 34,910 |
| Trade payables | $\mathbf{3 , 3 3 , 9 1 0}$ |  | $\mathbf{3 , 3 3 , 9 1 0}$ |
|  |  |  |  |

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 <br> (Rs.) | Amount <br> (Rs.) | Assets | Amount <br> (Rs.) |
| :--- | ---: | ---: | :--- | ---: |
| Capital | 40,000 |  | Goodwill | 30,000 |
| K | 60,000 |  | Furniture | 20,000 |
| L | 30,000 | $1,30,000$ | Trade Receivables | 50,000 |
| M |  | 50,000 | Inventory in Trade | 50,000 |
| Reserve |  | 20,000 | Cash and Bank | 50,000 |
| Trade Payable |  |  | Balances |  |
|  |  | $\mathbf{2 , 0 0 , 0 0 0}$ |  | $\mathbf{2 , 0 0 , 0 0 0}$ |
|  |  |  |  |  |

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 $\mathrm{M} / \mathrm{s} \mathrm{K}, \mathrm{M}$ and N as on 01.04.2015

Capital accounts of partners.

## Death of Partner

## Illustration 1

The following was the Balance Sheet of $\mathrm{Om} \& \mathrm{Co}$. in which $\mathrm{X}, \mathrm{Y}, \mathrm{Z}$ were partners sharing profits and losses in the ratio of 1:2:2 as on 31.3.2016. Mr. Z died on $31^{\text {st }}$ 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 $1 / 21 / 4$ and $1 / 4$ 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 $31^{\text {st }}$ 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 $31^{\text {st }}$ December following his death.
b) That the share of the partnership policy and goodwill be credited to a deceased partner as on $31^{\text {st }}$ December following his death.
c) That the partnership books be closed annually on $31^{\text {st }}$ December.

A died-on $30^{\text {th }}$ September 2016, the amount standing to the credit of his current account on $31^{\text {st }}$ 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 $30^{\text {th }}$ 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 $31^{\text {st }}$ December 2016.

## Chapter 9 - Financial Statements of Not-For-Profit Organizations

## OBJECTIVES

The lists of topics which will be covered in this chapter are as follows:
9.1 Receipts and Payments Account (Which is Equivalent to Cash Book).
9.2 Income and Expenditure Account (Which is Equivalent to Profit and Loss Account).
9.3 Balance Sheet for NPO.
9.4 Understanding various sources of Income for NPO and the separate kind of treatments applicable to them.

## 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
Entrance fees
Amount (INR)
Membership Fees
1000
Denation for Club Building
Donation for Club Building 15000
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.

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 |
|  | $\mathbf{3 1 , 5 0 0}$ | TOTAL | $\mathbf{3 1 , 5 0 0}$ |
| TOTAL |  |  |  |

## 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

| 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 | $\mathbf{3 5 , 0 0 0}$ |  | TOTAL |  |
| 2019 |  |  |  |  | $\mathbf{3 5 , 0 0 0}$ |
| Apr - 1 | To Balance b/d | 20,000 |  |  |  |

Dr. Subscription Account for the year ended 31st March 2018

| Date | Particulars | Amount | Date | Particulars |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| 2018 |  |  |  |  | Amount |
| 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

| Date | Particulars | Amount | Date | Particulars | Amount |
| :--- | :--- | :--- | :--- | :--- | :--- |
| 2018 |  |  | 2018 |  |  |
| Apr -1 | To Balance b/d | 10,000 | Mar -31 | By Subscription A/c |  |
|  |  |  |  |  | 10,000 |
|  |  | 10,000 |  | TOTAL |  |
|  | TOTAL |  |  |  | 10,000 |
|  |  |  | 2019 |  |  |
|  |  |  | Apr -1 | By Balance c/d |  |

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 |
|  |  |  |  |
|  | $\mathbf{4 2 , 5 0 0}$ | TOTAL | $\mathbf{4 2 , 5 0 0}$ |


| 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 Exproliseellaneous) | 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:

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 |  |  |

The Income and Expenditure Account is as presented below:
Dr.

| Cr. |  |  |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Particulars | Amount | Amount | Particulars | Amount | Amount |  |
| To Salaries and Wages |  | 16,000 | By Membership Fees |  | And |  |
| To Rent |  | 10,000 | By Miscellaneous Income |  |  | 5,000 |
| To Utilites |  | 7,500 | By Interest on Seurity Deposit |  |  |  |
| To Magazines \& Periodicals |  | 2,750 |  |  |  |  |
| To Misc. Expenses |  | 2,850 |  |  |  |  |
|  |  |  | By Excess of Expenditure over Income |  |  |  |
| To Depreciation: |  |  |  |  | 7,800 |  |
| - Computers (@ 15\%) |  |  |  |  |  |  |
| - Equipments (@ 10\%) | 4000 | 1,450 |  |  |  |  |
|  |  |  |  |  |  |  |
| TOTAL |  | 40,550 | TOTAL |  |  |  |

The computations done in arriving at the amounts mentioned in the above income and expenditure account are as follow:

| Particulars | Salaries | Rent | Utilities | Mag a <br> Periodicals | Misc. Exp |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 1. Expense Computation |  |  |  |  |  |
| Paid during the year | 13,000 | 5,000 | 7,000 | 2,500 | 3,000 |
| Add: $\mathrm{O} / \mathrm{s}$ 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: 0/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 | $\mathbf{2 5 , 2 5 0}$ |

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 \& Periodical |  | 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 |  |  |

## 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 31 ${ }^{\text {st }}$ March,2015 | 400 |
| Salaries un-paid on 31st March,2016 | 1,800 |
| Salaries pre-paid 31 ${ }^{\text {st }}$ 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 <br> 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 <br> Book: |  |
| :--- | ---: | :--- | ---: |
| Entertainment | 780 | Deposit Account | 3,090 |
| Donation for forth coming |  | Current Account | 150 |
| Tournament | 1,000 | Cash in hand | 250 |
|  | $\mathbf{7 , 8 2 0}$ |  | $\mathbf{7 , 8 2 0}$ |

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 <br> repairs | 300 | 260 |
| Estimated value of machinery and <br> 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 <br> 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 |  | 9,500 |
| To Surplus | 600 |  |  |
|  | 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 <br> Newspapers (Old) | 260 |
| Salaries | 11,000 | By Lectures | 1,500 |
| Depreciation on <br> 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 |  |  | Furniture | 9,000 |
| (2016-17) |  | 100 | Ground and Building | 47,000 |
| Prize Fund: Opening Balance |  |  | Prize Fund |  |
| Add: Interest | 25,000 |  | Investment |  |
|  | 1,000 |  | Cash in Hand | 20,000 |
| Less: Prizes | 26,000 |  | Subscription | 2,300 |
| General Fund: | $(2,000)$ | 24,000 | (outstanding) (2015- |  |
| Opening Balance |  |  |  |  |
| Less: Deficit | $\begin{aligned} & 56,420 \\ & (2,820) \end{aligned}$ |  |  | 700 |
| 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 |  | 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 |  | 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 | $\mathbf{2 0 1 6}$ |
| 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.

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 |  | $5,00,000$ |
| Provident Fund |  | $8,00,000$ |
| Tuition Fee Received |  | $5,00,000$ |
| Government Grants |  | 50,000 |
| Donations |  | $1,85,000$ |
| Interest \& Dividends on Investments |  | $1,75,000$ |
| Hostel Room Rent |  | $2,00,000$ |
| Mess Receipts (Net) | $3,00,000$ | $2,00,000$ |
| College Stores-Sales | $8,50,000$ |  |
| Outstanding expenses | $1,20,000$ |  |
| Stock of-stores and Supplies (opening) | 80,000 |  |
| Purchases - Stores \& Supplies | 38,000 |  |
| Salaries - Teaching | $1,12,000$ |  |
| Research | 50,000 |  |
| Scholarships | 65,000 |  |
| Students Welfare expenses | $8,00,000$ |  |
| Repairs \& Maintenance | $18,50,000$ |  |
| Games \& Sports Expenses | $5,10,000$ |  |
| Misc. Expenses | $4,50,000$ |  |
| Research Fund Investments | 28,000 |  |
| Other Investments | $1,00,000$ |  |
| Provident Fund Investment | $16,00,000$ |  |
| Seminar \& Conference Expenses | $8,50,000$ |  |
| Consultancy Expenses | $6,00,000$ |  |
| Land | $1,80,000$ |  |
| Building |  |  |
| Plant and Machinery |  |  |
| Furniture and Fittings |  | $4,60,000$ |
| Motor Vehicle |  |  |
| Provision for Depreciation: |  | $5,80,000$ |
| Building |  | $5,10,000$ |
| Plant \& Equipment |  |  |
| Furniture \& Fittings |  |  |
| Cash at Bank |  |  |
| Library |  |  |
|  |  |  |
|  |  |  |

## Adjustments:

|  | Particulars | Rs. |
| :--- | :--- | ---: |
| (1) | Materials \& Supplies consumed: (From college stores) | 50,000 |
|  | Teaching | $1,50,000$ |
|  | Research | 75,000 |
|  | Students Welfare | 25,000 |
|  | Games or Sports | 80,000 |
| (2) | Tuition fee receivable from Government for backward class Scholars |  |
| $(3)$ | Stores selling prices are fixed to give a net profit of 10\% on selling <br> 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 | $20 \%$ |

## Chapter - 10 Company Accounts

TYPES OF COMPANIES
Ownership $\left\{\begin{array}{l}- \text { Government } \\ \bullet \text { Foreign } \\ - \text { Private } \\ - \text { Public }\end{array}\right.$


Balance
Sheet

Cash
Flow
Stateme
nt

## Unit-1 INTRODUCTION

## 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



```
* 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 -
$\checkmark$ Has a place of business in India whether by itself or through an agent physically or through electronic mode; and
$\checkmark$ 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 $>1 / 2$ 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).
> 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 give 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)


Name of the Company
Balance Sheet as at.
$\qquad$ ...
Balance Sheet as at............................
(Rs.in...)


| Notes |
| :---: |
| No. |
|  |

## 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
3.
allotment 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

ASSETS
Non-current assets
a. Property, Plant and Equipment
i. Tangible assets (G)
$\begin{array}{ll} & \begin{array}{l}\text { ii. } \\ \\ \text { iii. } \\ \\ \text { iv. Capital Work-in-progres } \\ \text { ivtangible assets under } \\ \text { b. }\end{array} \\ \text { c. Non-current investments (I) } \\ \text { c. } & \text { Deferred tax assets (Net) }\end{array}$
$\begin{array}{lll} & \text { ii. } & \text { Intangible assets (H) } \\ & \text { iii. Capital Work-in-progress } \\ & \text { iv. Intangible assets under de } \\ \text { b. } & \text { Non-current investments (I) } \\ \text { c. } & \text { Deferred tax assets (Net) }\end{array}$
iv. Intangible assets under development
$\begin{array}{ll} & \begin{array}{l}\text { ii. } \\ \\ \text { iii. } \\ \\ \text { iv. Capital Work-in-progres } \\ \text { ivtangible assets under } \\ \text { b. }\end{array} \\ \text { c. Non-current investments (I) } \\ \text { c. } & \text { Deferred tax assets (Net) }\end{array}$
$\begin{array}{ll} & \begin{array}{l}\text { ii. } \\ \\ \text { iii. } \\ \\ \\ \text { iv. } \\ \text { ivangible assets (H) } \\ \text { Intangible assets under } \\ \text { b. }\end{array} \\ \text { c. Non-current investments (I) } \\ \text { c. } & \text { Deferred tax assets (Net) }\end{array}$
d. Long-term loans and advances (J)
e. Other non-current assets

## Current assets

a. Current investments $(\mathrm{K})$
b. Inventories (L)
c. Trade receivables
d. Cash and cash equivalents (M)
e. Short-term loans and advances
f. Other current assets

Total
Figures as at end of the previous reporting period


| XXX | xxx |
| :---: | :---: |
| xxx | xxx |
| xxx | xxx |
| xxx | xxx |
| xxx | xxx |
| xxx | xxx |
| xxx | xxx |
| xxx | xxx |
| xxx | xxx |
| xxx | xxx |
| xxx | xxx |
| xxx | xxx |
| xxx | xxx |
| xxx | xxx |
| xxx | Xxx |

## Balance Sheet items to be explained in the Explanatory Note:

A. SHARE CAPITAL - for each class
$\checkmark$ Authorised share capital - Number and amount.
$\checkmark$ Issued; Subscribed \& Fully paid; and Issued subscribed but not fully paid.
$\checkmark$ The par value per share.
$\checkmark$ Reconciliation of Shares outstanding

- at the beginning \&
- at the end of the reporting period
$\checkmark$ Calls unpaid
$\checkmark$ Forfeited shares
B. RESERVES AND SURPLUS - subheads (Additions and deductions since last balance sheet to be shown under each of the specified heads)
$\checkmark$ Capital Reserves
$\checkmark$ Capital Redemption Reserve (CRR)
$\checkmark$ Securities Premium
$\checkmark$ Debenture Redemption Reserve.
$\checkmark$ Revaluation Reserve
$\checkmark$ Surplus (the balance as per Profit and Loss statement)
$\checkmark$ Other Reserves (specify the nature and purpose)
C. LONG TERM BORROWINGS - subheads
$\checkmark$ Bonds/Debentures
$\checkmark$ Term loans
- From Banks
- From Other parties
$\checkmark$ Deferred payment liabilities
$\checkmark$ Deposits
$\checkmark$ Long term maturities of finance lease obligations
$\checkmark$ Loans and advances from related parties
$\checkmark$ Other loans and advances (specify nature)
D. OTHER LONG-TERM LIABILITIES
(a) Trade payables;
(b) Others.
E. LONG TERM PROVISIONS
$\checkmark$ Provision for Employee Benefits (eg: gratuity, provident fund etc.)
$\checkmark$ Other provisions (specify the nature)


## F. SHORT TERM BORROWINGS

$\checkmark$ Loans repayable on demand

- From banks
- From other parties
$\checkmark$ Loans and advances from related parties
$\checkmark$ Deposits
$\checkmark$ Other loans and advances (specify the nature)
FA. TRADE PAYABLES - Outstanding dues to Micro, Small and Medium Enterprises
$\checkmark$ Principal amount and interest due thereon remaining
$\checkmark$ Amount of interest paid
$\checkmark$ Amount of interest due and payable for period of delay
$\checkmark$ Amount of interest accrued and remaining unpaid
G. OTHER CURRENT LIABILITIES
$\checkmark$ Current maturities of long-term debt
$\checkmark$ Current maturities of finance lease obligations
$\checkmark$ Interest accrued but not/and due on borrowings
$\checkmark$ Income received in advance
$\checkmark$ Unpaid dividends
$\checkmark$ Application money received for allotment of securities and due for refund and interest accrued thereon
$\checkmark$ Unpaid matured deposits and interest accrued thereon
$\checkmark$ Unpaid matured debentures and interest accrued thereon
$\checkmark$ Other current liabilities (specify the nature)
H. SHORT TERM PROVISIONS
$\checkmark$ Provision for Employee Benefits
$\checkmark$ Other provisions (specify the nature)
$\checkmark$

I TANGIBLE ASSETS - Classification
$\checkmark$ Land
$\checkmark$ Buildings
$\checkmark$ Plant and Equipment
$\checkmark$ Furniture and Fixtures
$\checkmark$ Vehicles
$\checkmark$ Office equipment
$\checkmark$ Others (specify nature)
J. INTANGIBLE ASSETS
$\checkmark$ Goodwill
$\checkmark$ Brands /trademarks
$\checkmark$ Computer software
$\checkmark$ Mastheads and publishing titles
$\checkmark$ Mining rights
$\checkmark$ Copyrights, and patents and other intellectual property rights, services and operating rights
$\checkmark$ Recipes, formulae, models, designs and prototypes
$\checkmark$ Licenses and franchise
$\checkmark$ Others (specify nature)
K. NON-CURRENT INVESTMENTS (Classify as Trade \& Other Investments)
$\checkmark$ Investment property;
$\checkmark$ Investments in Equity Instruments;
$\checkmark$ Investments in preference shares;
$\checkmark$ Investments in Government or trust securities;
$\checkmark$ Investments in debentures or bonds;
$\checkmark$ Investments in Mutual Funds;
$\checkmark$ Investments in partnership firms;
$\checkmark$ Other non-current investments (specify nature)
L. LONG TERM LOANS AND ADVANCES
$\checkmark$ 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).
$\checkmark$ The above shall also be separately sub-classified as:
- Secured, considered good;
- Unsecured, considered good;
- Doubtful.
M. OTHER NON-CURRENT ASSETS
$\checkmark$ Long-term Trade Receivables (including trade receivables on deferred credit terms);
$\checkmark$ Others (specify nature);
Long term Trade Receivables, shall be sub-classified as:
- Secured, considered good;
- Unsecured, considered good;
- Doubtful.
N. CURRENT INVESTMENTS
$\checkmark$ Investments in Equity Instruments
$\checkmark$ Investment in Preference Shares
$\checkmark$ Investments in Government or Trust Securities
$\checkmark$ Investments in Debentures or Bonds
$\checkmark$ Investments in Mutual Funds
$\checkmark$ Investments in Partnership Firms
$\checkmark$ Other investments (specify nature)


## O. INVENTORIES

$\checkmark$ Raw materials
$\checkmark$ Work-in-progress
$\checkmark$ Finished goods
$\checkmark$ Stock-in-trade (in respect of goods acquired for trading)
$\checkmark$ Stores and spares
$\checkmark$ Loose tools
$\checkmark$ Goods in transit
$\checkmark$ Others (specify nature)
P. TRADE RECEIVABLES
$\checkmark$ Secured, considered good
$\checkmark$ Unsecured, considered good
$\checkmark$ 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

$\checkmark$ Balances with banks
$\checkmark$ Cheques, drafts on hand
$\checkmark$ Cash on hand
$\checkmark$ Others (specify nature)

## R. SHORT TERM LOANS AND ADVANCES

$\checkmark$ Loans and advances to related parties (giving details thereof);
$\checkmark$ 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

$\checkmark$ Contingent liabilities

- Claims against the company not acknowledged as debt;
- Guarantees;
- Other money for which the company is contingently liable.
$\checkmark$ 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 $\qquad$
(Rs.in $\qquad$

XIV. $\operatorname{Profit/(Loss)~from~discontinuing~operations~(after~}$ tax) (XII-XIII)
XV. Profit (Loss) for the period (XI + XIV)
XVI. Earnings per equity share:
(1) Basic
(2) Diluted

# Unit-2 Issue, Forfeiture and Re-issue of Shares 

## Procedure for raising funds through equity


(2)

(5) Shares Allotted


INTRODUCTION

## Capital

Funds provided by the owners.

| Business Organization | Ownership | Type of Capital | Liability of Owners |
| :--- | :--- | :--- | :--- |
| Sole - Proprietorship | Proprietor | Capital | Unlimited |
| Partnership <br> Company | Partners <br> Shareholders | Partners' Capital <br> Share Capital | Unlimited <br> Limited to issue price of <br> 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

## SHARE CAPITAL - Categories




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
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

Based on "Right to accumulate dividends"

Based on "Right to participate in surplus


Based on Conversion into equity

Cumulative
Non-Cumulative

Participating

- Non-Participating

Redeembable

- Non-Redeemable


## Convertible

- Non-Convertible
(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.
$>$ 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 nonparticipating.
(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.
$>$ 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


[^2]
## 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 $\geq 5 \%$ 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 $\mathbf{9 0 \%}$ 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.

## * 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 $\rightarrow$ Proceed for allotment
$>$ Minimum subscription not received $\rightarrow$ 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 $\rightarrow$ application money refunded
> Applications accepted

- All shares applied are allotted $\rightarrow$ No refund
- Part of the shares applied are allotted $\rightarrow$ excess amount received can be used for allotment or call money

| Event | Entry | Debit (Rs.) | Credit <br> (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) <br> ** 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 |
|  | 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 <br> (a) | Issue Price <br> (b) | Discount (Rs.) <br> $(c)=(a-b)$ | Discount \% <br> $(d)=[(c) \div(a)] 100$ |
| :---: | :---: | :---: | :---: |
| 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

## Example:

| Nominal Value <br> (a) | Issue Price <br> (b) | Premium (Rs.) <br> (c) $=(b-a)$ | Premium \% <br> $(d)=[(c) \div(a)] 100$ |
| :---: | :---: | :---: | :---: |
| 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 <br> (Rs.) | Remarks |  |  |
| (1) Receipt of <br> Application <br> Money | Bank A/c Dr. | xxxx |  | Total application <br> money + Premium <br> amount |


|  | To Share Application Money A/c |  | xxxxx | Actual amount received. |
| :---: | :---: | :---: | :---: | :---: |
|  | (Being application money received for $\qquad$ shares @ Rs. $\qquad$ 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 <br> (Rs.) | Credit <br> (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. |
|  | (Being application money received for $\qquad$ shares @ Rs. $\qquad$ 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. $\qquad$ 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

$\checkmark$ 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 full $\rightarrow$ application money refunded to such applicants
$>$ Multiple applications by the same person not considered $\rightarrow$ application money refunded for applications
$>$ All Applications accepted $\rightarrow$ 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 |  |

$\checkmark$ Excess amount received is treated as an advance against allotment and calls and thereby adjusted against the amount due on allotment or calls.
$\checkmark$ Surplus money after making adjustment against future calls is returned to the applicants.
$\checkmark$ The applicants are informed about the allotment procedure through an advertisement in leading newspapers.

| 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....) |  |  |  |

## 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

Receivable by the Compay from the Shareholders

Maximum Rate (Table F prescribed) is $10 \%$
Interest period = Call due date to actual money receipt date
Directors have right to waive off such interest on their discretion
Income - credited to P\&L A/c as a nominal account

## Interest on Calls in Advance

Payable by the Company to Shareholders

Maximum Rate (Table F prescribed) is $12 \%$
Inerest period = Actual money receipt date to Call due date
Shareholders are not entitled to dividend on calls in advance Expense - debited to P\&L A/c

## JOURNAL ENTRIES - CALLS IN ADVANCE \& CALLS IN ARREARS

\left.| Event | Entry | Debit | Credit |
| :--- | :--- | :--- | :--- | :--- | :--- |
| (Rs.) |  |  |  |$\right)$


| (1b) Calls in Arrears received | To Calls in Arrears A/c |  | XX | Amount of Unpaid calls received |
| :---: | :---: | :---: | :---: | :---: |
|  | (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 $\qquad$ \% 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 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 | Credit |  |
| :--- | :--- | :--- | :--- | :--- |
| (Rs.) | (Rs.) | Remarks |  |  |
| (1a) Forfeiture of <br> shares issued at <br> Par - No Calls-in- <br> Arrears | Share Capital A/c | Dr. | xxxx |  |


| (2a) Forfeiture of <br> shares issued at <br> Premium - IF <br> Premium received | Share Capital A/c Dr. | xxx |  | Call amount received in <br> advance |
| :--- | :--- | :--- | :--- | :--- |
|  | To Forfeited Shares A/c |  | $x x x$ | Amount already <br> received on forfeited <br> shares |
|  | To Share Allotment A/c |  | $x x x$ | IF amount due but not <br> paid |
|  | To Share Call A/c |  | $x x$ | IF amount due but not <br> paid |
| Note: If the premium has already received by the company, it cannot be cancelled even if the <br> shares are forfeited in the future: |  |  |  |  |

$\checkmark$ 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.
$\checkmark$ Reissue of forfeited shares is not allotment of shares but only a sale. In practice, forfeited shares are disposed off, by auction.
$\checkmark$ 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.

## Re-issue of Shares

## Scenario I

Loss on Re-issue

## Scenario II

Profit on Re-issue

## * 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 reissue 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

$$
\text { Nominal value of each share Rs. } 10
$$

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 <br> Shares forfeited A/c to <br> Share Capital A/c | No. of shares x (Nominal Value - Amount <br> received on re-issue) i.e. [50 (10-6)] | Rs. 200 |
| Surplus on Re-issue: <br> Amount transferred to <br> Capital Reserve | Amount in Shares Forfeited A/c for shares <br> re-issued - Amount transferred to Share <br> Capital A/c i.e. <br> [(50x5)-Rs.200] | Rs. 50 |
| Amount carried forward in <br> Shares Forfeited A/c | Total Value of Shares Forfeited - Amount <br> transferred to Share Capital on re-issue - <br> Surplus transferred to Capital Reserve | Rs. 350 |
| $[(120 x 5)$ - Rs.200 - Rs.50] |  |  |

## JOURNAL ENTRIES - FORFEITURE OF SHARES

| Event | Entry | Debit <br> (Rs.) | Credit <br> (Rs.) | Remarks |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| (1) Re-issue of <br> shares | Bank A/c | Dr. | xx |  | Actual amount received |
|  | Forfeited Shares A/c | Dr. | xxx |  | Profit on re-issue |
|  | To Share Capital A/c |  |  |  |  |


| Capital Reserve | (Being the profit on re-issue, <br> A/c |
| :--- | :--- |
| 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

## 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 <br> Rs. | Preference <br> 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-inArrears 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.

## 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
$\checkmark$ reduces the cost of the capital
$\checkmark$ helps in designing appropriate capital structure of the company.

| Debenture |  |
| :--- | :--- |
|  | A Bond <br> Company issues under its <br> seal |
| Acknowledges a Debt <br> Provides repayment of <br> principal and interest |  |

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.

| Difference | Debentures | Shares |
| :---: | :---: | :---: |
| Holders status | Creditors of the company. | Owners of the company. |
| Voting | No voting rights | Holders have voting rights |
| Rights | Thus, no threat to the existing control of the company. | 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 <br> (i) a variable rate for equity shares <br> (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; <br> Redeemable/ Irredeemable; <br> Registered/Bearer; <br> Convertible / Non-convertible, etc. | Equity Shares; <br> Preference Shares. |
| Presentation in financial statements | "Long Term Borrowings" in the Company's Balance Sheet | "Shareholder's Fund" in the Company's Balance Sheet. <br> Shares are shown under detailed in 'Share Capital' of Notes to Accounts. |
| Convertibili ty | 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 nonpayment of call moneys. | Shares can be forfeited for non-payment of |



## TYPES OF DEBENTURES

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 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.

## Debentures

## Issued at <br> Par

Issued at Discount

## Issued at Premium

## 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 | (Rs.) | Credit <br> (Rs.) | Remarks |
| :---: | :---: | :---: | :---: | :---: |
| (1) Cash received on application | Bank A/c Dr. | xxxx |  |  |
|  | To Debentures Application A/c |  | xxxx |  |
|  | (Being money received on __\% debentures @ Rs. $\qquad$ 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......) |  |  |  |


| (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 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 <br> (Rs.) | Credit <br> (Rs.) | Remarks |
| :---: | :---: | :---: | :---: | :---: |
| (1) Cash | Bank A/c | Dr. | xxxx |  |


| received on application | To Debentures Application A/c |  | xxxx |  |
| :---: | :---: | :---: | :---: | :---: |
|  | (Being money received on __\% debentures @ Rs. $\qquad$ 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 ....\% <br> Debentures of Rs..... each and Premium amount transferred to Securities Premium 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) |  |  |  |
|  | Bank A/c Dr. | xxxx |  |  |


| (7) Call money <br> received | 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 <br> (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) $\qquad$ |  |  |  |
| (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 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



| Scenario | Entry | Debit (Rs.) | Credit (Rs.) | Remarks |
| :---: | :---: | :---: | :---: | :---: |
| (1.1) <br> 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 |
|  | To ___\% Debenture A/c |  | Xxxxx |  |
|  | (Being application money transferred to Debenture A/c) |  |  |  |


|  |  |  |  | The difference between the amount received and amount |
| :---: | :---: | :---: | :---: | :---: |
| Issued @ <br> Discount <br> Redeemed @ <br> Parl Discount | To Debenture Application A/c |  | XXXXX |  |
|  | (Being application money received) |  |  |  |
|  | Debenture Application A/c Dr. | xxxxx |  | future is |
|  | Discount on issue of debentures A/c Dr. | xx |  | loss on issue on |
|  | To ___\% Debenture A/c |  | xxxxx | debentures and is to be written- |
|  | (Being application money transferred to Debenture A/C on allotment) |  |  | off over the life of debentures. |
| (3.1\& 3.2) <br> Issued @ Premium <br> Redeemed @ Par/Discount | Bank A/c Dr. | xxxxx |  | The gain on paying less |
|  | To Debenture Application A/c |  | XXXXX |  |
|  | (Being application money received) |  |  | received in this scenario |
|  | Debenture Application A/c Dr. | xxxxx |  | will not be recognised in |
|  | To ___\% Debenture A/c |  | XXXXX | the books at the time of |
|  | To Securities Premium A/c |  | XX | issue of debentures as |
|  | (Being application money transferred to Debenture A/c on allotment) |  |  | per the conservatism concept. |
| (1.3) <br> Issued @ Par <br> 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 representing company's liability. |
|  | 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. <br> (Amount equal to redemption premium) | xxxx |  |  |
|  | To __\% Debenture A/c |  | xxxxx |  |


|  | To __\% Debenture Redemption Premium A/C <br> (Being call made subsequent to allotment) |  | xxxxx |  |
| :---: | :---: | :---: | :---: | :---: |
| (2.3) <br> Issued @ <br> Discount <br> 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 <br> (Amount equal to premium payable on redemption) |  | xxxxx |  |
|  | (Being call made subsequent to allotment) |  |  |  |
| (3.3) <br> Issued @ premium <br> 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 |
|  | To Debenture Application A/c |  | xxxxx |  |
|  | (Being application money received) |  |  |  |
|  | Debenture Application A/c Dr. | xxxxx |  |  |
|  | To $\qquad$ \% Debenture A/C <br> (Being application money transferred to Debent | (Being application money transferred to Debenture A/c) | xxxxx |  |
|  | Bank A/c Dr. | Xxxx |  |  |
|  | Discount/Loss on issue of debenture A/c Dr. <br> (Amount equal to premium on redemption) | xx |  |  |


|  | To __\% Debenture A/c | xxxxx | time of issue of |
| :---: | :---: | :---: | :---: |
|  | To Securities Premium A/c <br> (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.
$\Rightarrow$ 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] <br> To Sundry Liabilities A/c |
| :--- | :--- | :--- |
| [Liabilities assumed] |  |  |

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

No. of Debentures $=\underline{\text { Purchase Consideration }}$

Par Value

2. When debentures are issued at premium

$$
\text { No. of Debentures }=\frac{\text { Purchase Consideration }}{\text { Par Value }+ \text { Premium }}
$$

3. When debentures are issued at discount

$$
\text { No. of Debentures }=\frac{\text { Purchase Consideration }}{\text { Par Value }- \text { Discount }}
$$

## 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 <br> (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.
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 1-12017.

Debenture interest after deducting tax at source @ $10 \%$ was payable on 30th June and 31 st 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.


[^0]:    * 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.

[^1]:    * Difference between Revaluation Account and Memorandum Revaluation Account

[^2]:    ISSUE OF SHARES FOR CASH

