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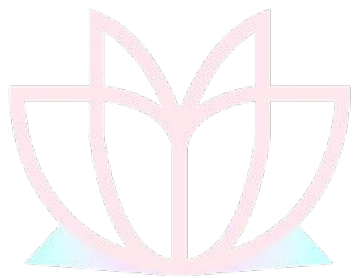
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Theoretical Framework

Chapter 1.1 Meaning And Scope of Accounting

True and False

Question 1

There is no difference between book keeping and accounting, both are same.

Answer 1

False: Book-keeping and accounting are different from each other. Accounting is a broad subject. It calls for a greater understanding of records obtained from book-keeping and an ability to analyse and interpret the information provided by book-keeping records.

Book-keeping is the recording phase while accounting is concerned with the summarizing phase of an accounting system.

Question 2

Management Accounting covers the preparation and interpretation of financial statements and communication to the users of accounts.

Answer 2

False: Financial accounting covers the preparation and interpretation of financial statements and communication to the users of accounts.

Question 3

Financial accounting is concerned with internal reporting to the managers of a business unit.

Answer 3

False: Management accounting is concerned with internal reporting to the managers of a business unit.

Question 4

Customers of business should not be considered as users of accounts prepared by business. They are not interested to know performance of the business

Answer 4

False: Customers are also concerned with the stability and profitability of the enterprise because their functioning is more or less dependent on the supply of goods.

Question 5

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Summarising is the basic function of accounting. All business transactions of a financial characters evidenced by some documents such as sales bill, pass book, salary slip etc. are recorded in the books of account.

Answer 5

False: Recording is the basic function of accounting. Summarising is concerned with the preparation and presentation of the classified data in a manner useful to the internal as well as the external users of financial statements.

Question 6

Balance sheet shows the position of the business on the day of its preparation and not on the future date.

Answer 6

True: Balance Sheet is a statement of the financial position of an enterprise at a given date.

Question 7

Objectives of book-keeping are complete recording of transactions & ascertainment of financial effect on the business.

Answer 7

True: Book-keeping is concerned with complete recording and combined effect of transactions made during the accounting period.

Multiple Choice Questions

1. Which of the following is not a subfield of accounting?

- (a) Management accounting.
- (b) Cost accounting.
- (c) Book-keeping

Answer 1 : (c)

2. Purposes of an accounting system include all the following except

- (a) Interpret and record the effects of business transaction.
- (b) Classify the effects of transactions to facilitate the preparation of reports.
- (c) Dictate the specific types of business enterprise transactions that the enterprises may engage in.

Answer 2 : (c)

3. Book-keeping is mainly concerned with

- (a) Recording of financial data
- (b) Designing the systems in recording, classifying and summarising the recorded data.
- (c) Interpreting the data for internal and external users.

Answer 3 : (a)

4. All of the following are functions of Accounting except

- (a) Decision making.
- (b) Ledger posting.

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- (c) Forecasting.

Answer 4 : (b)

5. Financial statements are part of
- (a) Accounting.
 - (b) Book-keeping.
 - (c) Management Accounting.

Answer 5 : (a)

6. Financial position of the business is ascertained on the basis of
- (a) Records prepared under book-keeping process.
 - (b) Trial balance.
 - (c) Balance Sheet.

Answer 6 : (c)

7. Users of accounting information include
- (a) Creditors/Suppliers
 - (b) Lenders/ Customers
 - (c) Both (a) and (b)

Answer 7 : (c)

8. Financial statements do not consider
- (a) Assets expressed in monetary terms.
 - (b) Liabilities expressed in monetary terms.
 - (c) Assets and liabilities expressed in non-monetary terms

Answer 8 : (c)

9. On January 1, Sohan paid rent of ₹ 5,000. This can be classified as
- (a) An event.
 - (b) A transaction.
 - (c) A transaction as well as an event.

Answer 9 : (b)

10. On March 31, 2022 after sale of goods worth ₹ 2,000, he is left with the closing inventory of ₹ 10,000. This is
- (a) An event.
 - (b) A transaction.
 - (c) A transaction as well as an event.

Answer 10 : (a)

11. Which of the following is not a business transaction?
- (a) Bought a machine of ₹10,000 for business
 - (b) Paid towards salaries of employees ₹ 5,000
 - (c) Paid son's fees from her personal bank account ₹ 8,000

Answer 11 : (c)

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12. Which qualitative characteristics of accounting information is reflected when accounting information is clearly presented?

- (a) Understandability
- (b) Relevance
- (c) Comparability

Answer 12 : (a)

Theoretical Questions & Answers

Question 1

Define accounting. What are the sub-fields of accounting?

Answer 1

Accounting is the art of recording, classifying, and summarising in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the result thereof. Various subfields of accounting are listed as: Financial Accounting; Management Accounting; Cost Accounting; Social Responsibility Accounting and Human Resource Accounting.

Question 2

Who are the users of accounting information?

Answer 2

Users of accounts can be listed as Investors, Employees, Lenders, Suppliers and Creditors, Customers, Govt. and their agencies, public and Management.

Question 3

Discuss briefly the relationship of accounting with

- (i) Economics
- (ii) Statistics
- (iii) Law

Answer 3

Refer para 1.10 for understanding the relationship of Accounting with Economics, Statistics and Law.

Question 4

Discuss the limitations which must be kept in mind while evaluating the Financial Statements.

Answer 4

Limitations which must be kept in mind while evaluating the Financial Statements are as follows:

- ◆ The factors which may be relevant in assessing the worth of the enterprise don't find place in the accounts as they cannot be measured in terms of money.
- ◆ Balance Sheet shows the position of the business on the day of its preparation and not on the future date while the users of the accounts are interested in knowing the position of the business in the near future and also in long run and not for the past date.
- ◆ Accounting ignores changes in some money factors like inflation etc.
- ◆ There are occasions when accounting principles conflict with each other.
- ◆ Certain accounting estimates depend on the sheer personal judgement of the accountant.
- ◆ Different accounting policies for the treatment of same item adds to the probability of manipulations.

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Question 5

What services can a Chartered Accountant provide to the society?

Answer 5

The practice of accountancy has crossed its usual domain of preparation of financial statements, interpretation of such statements and audit thereof. Accountants are presently taking active role in company laws and other corporate legislation matters, in taxation laws matters (both direct and indirect) and in general management problems. For details, refer Para 1.12.

Example 1

An individual invests ₹ 2,00,000 for running a stationery business. On 1st January, he purchases goods for ₹ 1,15,000 and sells for ₹ 1,47,000 during the month of January. He pays shop rent for the month ₹ 5,000 and finds that still he has goods worth ₹ 15,000 in hand. The individual performs an economic activity. He carries on a few transactions and encounters with some events. Is it not logical that he will want to know the result of his activity?

We see that the individual, who runs the stationery business, earns a surplus of ₹ 42,000.

		₹
Goods sold		1,47,000
Goods in hand		15,000
		1,62,000
Less : Goods purchased	1,15,000	
Shop rent paid	5,000	(1,20,000)
Surplus		42,000

Earning of ₹ 42,000 surplus is an event; also having the inventories in hand is another event, while purchase and sale of goods, investment of money and payment of rent are transactions.

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Chapter 1.2

Accounting Concepts, Principles And Conventions

9

True and False

Question 1

The concept helps in keeping business affairs free from the influence of the personal affairs of the owner is known as the matching concept.

Answer 1

False: Under matching concept all expenses matched with the revenue of that period should only be taken into consideration. In the financial statements of the organization if any revenue is recognized then expenses related to earn that revenue should also be recognized.

Question 2

Entity concept means that the enterprise is liable to the owner for capital investment made by the owner.

Answer 2

True: Since the owner invested capital, he has claim on the profits of the enterprise.

Question 3

Accrual means recognition as money is received or paid and not of revenue and costs as they are earned or incurred.

Answer 3

False: Under accrual concept, the effects of transactions and other events are recognised on mercantile basis i.e., when they occur (and not as cash or a cash equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate.

Question 4

The Conservatism Concept states that no change should be counted unless it has materialized.

Answer 4

False: The Realisation Concept states that no change should be counted unless it has materialised.

Question 5

The concept of consistency implies non-flexibility as not to allow the introduction of improved method of accounting.

Answer 5

False: The concept of consistency does not imply non-flexibility as not to allow the introduction of improved method of accounting.

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Question 6

The materiality depends only upon the amount of the item and not upon the size of the business, nature and level of information, level of the person making the decision etc.

Answer 6

False: As per materiality principle, all the items having significant economic effect on the business of the enterprise should be disclosed in the financial statements.

Question 7

Accrual basis of accounting is the method of recording transactions by which revenues and costs and assets and liabilities are reflected in the accounts in the period in which actual receipts or actual payments are made.

Answer 7

False: Cash Basis of Accounting is the method of recording transactions by which revenues and costs and assets and liabilities are reflected in the accounts in the period in which actual receipts or actual payments are made.

Multiple Choice Questions

1. All the following items are classified as fundamental accounting assumptions except

- (a) Consistency.
- (b) Business entity.
- (c) Going concern.

Answer 1 : (b)

2. Two primary qualitative characteristics of financial statements are

- (a) Understandability and materiality.
- (b) Relevance and reliability.
- (c) Neutrality and understandability.

Answer 2 : (b)

3. Kanika Enterprises follows the written down value method of depreciating machinery year after year due to

- (a) Comparability.
- (b) Convenience.
- (c) Consistency.

Answer 3 : (c)

4. A purchased a car for ₹ 5,00,000, making a down payment of ₹ 1,00,000 and signing a ₹ 4,00,000 bill payable due in 60 days. As a result of this transaction

- (a) Total assets increased by ₹ 5,00,000.
- (b) Total liabilities increased by ₹ 4,00,000.
- (c) Total assets increased by ₹ 4,00,000 with corresponding increase in liabilities by ₹ 4,00,000.

Answer 4 : (c)

5. Mohan purchased goods for ₹15,00,000 and sold 4/5th of the goods amounting ₹18,00,000 and met expenses amounting ₹ 2,50,000 during the year, 2022. He counted net profit as ₹ 3,50,000.

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Which of the accounting concept was followed by him?

- (a) Entity.
- (b) Periodicity.
- (c) Matching.

Answer 5 : (c)

6. A businessman purchased goods for ₹ 25,00,000 and sold 80% of such goods during the accounting year ended 31st March, 2022. The market value of the remaining goods was ₹ 4,00,000. He valued the closing Inventory at cost. He violated the concept of

- (a) Money measurement.
- (b) Conservatism.
- (c) Cost.

Answer 6 : (b)

7. Capital brought in by the proprietor is

- (a) Increase in asset and increase in liability
- (b) Increase in liability and decrease in asset
- (c) Increase in asset and decrease in liability

Answer 7 : (a)

8. During the life-time of an entity, accounting provides financial statements in accordance with which basic accounting concept:

- (a) Conservatism
- (b) Matching
- (c) Accounting period

Answer 8 : (c)

9. A concept that a business enterprise will not be liquidated in the near future is known as :

- (a) Going concern
- (b) Economic entity
- (c) Monetary unit

Answer 9 : (a)

10. Assets are held in the business for the

- (a) Resale.
- (b) Conversion into cash
- (c) Earning revenue.

Answer 10 : (c)

11. Revenue from sale of products, is generally, realised in the period in which

- (a) Cash is collected.
- (b) Sale is made
- (c) Products are manufactured.

Answer 11 : (b)

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12. The concept of conservatism when applied to the balance sheet results in

- (a) Understatement of assets.
- (b) Overstatement of assets.
- (c) Overstatement of capital.

Answer 12 : (a)

13. Decrease in the amount of trade payables results in

- (a) Increase in cash.
- (b) Decrease in bank over draft account.
- (c) Decrease in assets.

Answer 13 : (c)

14. The determination of expenses for an accounting period is based on the principle of

- (a) Objectivity.
- (b) Materiality.
- (c) Matching.

Answer 14 : (c)

15. Economic life of an enterprise is split into the periodic interval to measure its performance is as per

- (a) Entity.
- (b) Matching.
- (c) Periodicity.

Answer 15 : (c)

16. If an individual asset is increased, there will be a corresponding

- (a) Increase of another asset or increase of capital.
- (b) Decrease of another asset or increase of liability.
- (c) Decrease of specific liability or decrease of capital.

Answer 16 : (b)

17. Purchase of machinery for cash

- (a) Decreases total assets.
- (b) Increases total assets.
- (c) Retains total assets unchanged.

Answer 17 : (c)

18. Consider the following data pertaining to Alpha Ltd.:

Particulars	₹
Cost of machinery purchased on 1st April, 2021	10,00,000
Installation charges	1,00,000
Market value as on 31st March, 2022	12,00,000

While finalizing the annual accounts, if the company values the machinery at ₹ 12,00,000. Which of the following concepts is violated by the Alpha Ltd.?

- (a) Cost.

- (b) Matching.
- (c) Accrual.

Answer 18 : (a)

Theoretical Questions & Answers

Question 1

Write short notes on:

- (i) Fundamental accounting assumptions.
- (ii) Periodicity concept.
- (iii) Accounting conventions.

Answer 1

- (i) Fundamental accounting assumptions: There are three fundamental accounting assumptions: Going Concern; Consistency and Accrual. If nothing has been written about the fundamental accounting assumption in the financial statements then it is assumed that they have already been followed in their preparation of financial statements.
- (ii) Periodicity concept: According to this concept accounts should be prepared after every period & not at the end of the life of the entity. For details, refer para 2.5.
- (iii) Accounting conventions: Accounting conventions emerge out of accounting practices, commonly known as accounting principles, adopted by various organizations over a period of time. For details, refer para 2.4.

Question 2

Distinguish between:

- (i) Money measurement concept and matching concept
- (ii) Going concern and cost concept

Answer 2

- (i) Distinction between Money measurement concepts and matching concept
 As per Money Measurement concept, only those transactions, which can be measured in terms of money are recorded. Since money is the medium of exchange and the standard of economic value, this concept requires that those transactions alone that are capable of being measured in terms of money be only to be recorded in the books of accounts. Transactions and events that cannot be expressed in terms of money are not recorded in the business books.
 In Matching concept all expenses matched with the revenue of that period should only be taken into consideration. In the financial statements of the organization if any revenue is recognized then expenses related to earn that revenue should also be recognized.
- (ii) Distinction between Going concern and cost concept
Going Concern Concept
 The financial statements are normally prepared on the assumption that an enterprise is a going concern and will continue in operation for the foreseeable future.

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Cost concept

By this concept, the value of an asset is to be determined on the basis of historical cost, in other words, acquisition cost. For details refer para 2.5.

Question 3

Briefly explain the qualitative characteristics of the financial statements.

Answer 3

Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. For details, refer para 2.7.1.

Example 1:

Mr. X started business investing ₹ 7,00,000 with which he purchased machinery for ₹ 5,00,000 and maintained the balance in hand. The financial position of the will be as follows:

	₹
Capital	7,00,000
Machinery	5,00,000
Cash	2,00,000

This means that the enterprise owes to Mr. X ₹ 7,00,000. Now if Mr. X spends ₹ 5,000 to meet his family expenses from the business fund, then it should not be taken as business expenses and would be charged to his capital account (i.e., his investment would be reduced by ₹ 5,000). Following the entity concept the revised financial position would be

Liability	₹	₹
Capital	7,00,000	
Less : Drawings	(5,000)	6,95,000
Machinery		5,00,000
Cash		1,95,000

Example 2:

Mr. X purchased a piece of land on 1.1.1995 paying ₹ 2,000. Its current market value is ₹ 1,02,000 on 31.12.2022. Should the accountant show the land at ₹ 2,000 following cost concept and ignoring ₹1,00,000 value increase since it is not realised? If he does so, the financial position would be:

BALANCE SHEET

Liabilities	₹	Asset	₹
Capital	2,000	Land	2,000
	2,000		2,000

Is it not proper to show it in the following manner?

BALANCE SHEET

Liabilities	₹	Asset	₹
Capital	2,000	Land	1,02,000
Unrealised Gain	1,00,000		
	1,02,000		1,02,000

Now-a-days the revaluation of assets has become a widely accepted practice when the change in value is of permanent nature. Accountants adjust such value change through creation of revaluation (capital) reserve.

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Thus, the going concern, cost concept and realization concept gives the valuation criteria.

Example 3:

BALANCE SHEET

Liabilities	₹	Asset	₹
Capital	1,50,000	Machinery	2,00,000
Bank Loan	75,000	Cash	1,00,000
Other Loan	75,000		
	3,00,000		3,00,000

Transactions:

- A new machine is purchased paying ₹ 50,000 in cash.
- A new machine is purchased for ₹ 50,000 on credit, cash is to be paid later on.
- Cash paid to repay bank loan to the extent of ₹ 50,000.
- Raised bank loan of ₹ 50,000 to pay off other loan.

Effect of the Transactions:

- Increase in machine value and decrease in cash balance by ₹ 50,000.

BALANCE SHEET (1 & 3)

Liabilities	₹	Asset	₹
Capital	1,50,000	Machinery	2,50,000
Bank Loan	75,000	Cash	50,000
Other Loan	75,000		
	3,00,000		3,00,000

- Increase in machine value and increase in Creditors by ₹ 50,000.

BALANCE SHEET (1 & 3)

Liabilities	₹	Asset	₹
Capital	1,50,000	Machinery	2,50,000
Creditors for machinery	50,000	Cash	1,00,000
Bank Loan	75,000		
Other Loan	75,000		
	3,50,000		3,50,000

- Decrease in bank loan and decrease in cash by ₹ 50,000.

BALANCE SHEET (4 & 8)

Liabilities	₹	Asset	₹
Capital	1,50,000	Machinery	2,00,000
Bank Loan	25,000	Cash	50,000
Other Loan	75,000		
	2,50,000		2,50,000

- Increase in bank loan and decrease in other loan by ₹ 50,000

BALANCE SHEET (5 & 7)

Liabilities	₹	Asset	₹
Capital	1,50,000	Machinery	2,00,000
Bank Loan	1,25,000	Cash	1,00,000
Other Loan	25,000		
	3,00,000		3,00,000

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We may conclude that every transaction and event has two aspects.

This gives basic accounting equation :

Equity (E) + Liabilities (L) = Assets (A)

Or

Equity (E) = Assets (A) – Liabilities (L)

Or, Equity + Long Term Liabilities + Current Liabilities = Fixed Assets + Current Assets

Or, Equity + Long Term Liabilities = Fixed Assets + (Current Assets – Current Liabilities)

Or, Equity = Fixed Assets + Working Capital – Long Term Liabilities

ILLUSTRATION 1

Develop the accounting equation from the following information:

Particulars	March 31, 2021 ₹	March 31, 2022 ₹
Capital	1,00,000	?
12% Bank Loan	1,00,000	1,00,000
Trade Payables	75,000	70,000
Fixed Assets	1,25,000	1,10,000
Trade Receivables	75,000	80,000
Inventory	70,000	80,000
Cash & Bank	5,000	6,000

Required

Find the profit for the year & the Balance sheet as on 31/3/2022.

SOLUTION

For the year ended March 31, 2021:

Equity = Capital ₹ 1,00,000

Liabilities = Bank Loan + Trade Payables
 ₹ 1,00,000 + ₹ 75,000 = ₹ 1,75,000

Assets = Fixed Assets + Trade Receivables + Inventory + Cash & Bank

₹ 1,25,000 + ₹ 75,000 + ₹ 70,000 + ₹ 5,000 = ₹ 2,75,000

Equity + Liabilities = Assets

₹ 1,00,000 + ₹ 1,75,000 = ₹ 2,75,000

For the year ended March 31, 2022:

Assets = ₹ 1,10,000 + ₹ 80,000 + ₹ 80,000 + ₹ 6,000 = ₹ 2,76,000

Liabilities = ₹ 1,00,000 + ₹ 70,000 = ₹ 1,70,000

Equity = Assets – Liabilities = ₹ 2,76,000 – ₹ 1,70,000 = ₹ 1,06,000 Profits = New Equity

– Old Equity = ₹ 1,06,000 – ₹ 1,00,000 = ₹ 6,000

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Chapter 1.3

Capital And Revenue Expenditures And Receipts

17

TRUE OR FALSE

Question 1

The nature of business is not an important criteria in separating an expenditure between capital and revenue.

Answer 1

False: The nature of business is a very important criteria in separating an expenditure between capital and revenue. For example- For a trader dealing in furniture, purchase of furniture is revenue expenditure but for any other trade, the purchase of furniture should be treated as capital expenditure and shown in the balance sheet as asset.

Question 2

Expenditure incurred for major repair of the asset so as to increase its productive capacity is Revenue in nature.

Answer 2

False: Expenditure incurred for major repair of the asset so as to increase its productive capacity is capital in nature.

Question 3

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.

Answer 3

False: Legal expenses incurred to defend a suit claiming that the firm's factory site belongs to the plaintiff is maintenance expenditure of the asset. By this expense, neither any enduring benefit can be obtained in future in addition to that what is presently available nor the capacity of the asset will be increased. Maintenance expenditure in relation to an asset is revenue expenditure.

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Question 4

Amount spent for replacement of worn-out part of machine is Capital Expenditure.

Answer 4

False: Amount spent for replacement of any worn out part of a machine is revenue expense since it is part of its maintenance cost.

Question 5

Legal fees to acquire property is Capital Expenditure.

Answer 5

True: Legal fee paid to acquire any property is a part of cost of that property. It is incurred to possess the ownership right of the property and hence a capital expenditure.

Question 6

Amount spent for the construction of temporary huts, which were necessary for construction of the cinema house and were demolished when the cinema house was ready, is Capital Expenditure.

Answer 6

True: Since temporary huts were necessary for the construction, their cost should be added to the cost of the cinema hall and thus capitalised.

MULTIPLE CHOICE QUESTIONS:

1. Money spent ₹ 10,000 as traveling expenses of the directors on trips abroad for purchase of capital assets is
 - (a) Capital expenditures
 - (b) Revenue expenditures
 - (c) Prepaid revenue expenditures

Answer 1 : (a)

2. Amount of ₹ 5,000 spent as lawyers' fee to defend a suit claiming that the firm's factory site belonged to the plaintiff's land is
 - (a) Capital expenditures
 - (b) Revenue expenditures
 - (c) Prepaid revenue expenditures

Answer 2 : (b)

3. Entrance fee of ₹ 2,000 received by Ram and Shyam Social Club is
 - (a) Capital receipt
 - (b) Revenue receipt
 - (c) Capital expenditures

Answer 3 : (a)

4. Subsidy of ₹ 40,000 received from the government for working capital by a manufacturing concern is
 - (a) Capital receipt
 - (b) Revenue receipt
 - (c) Capital expenditures

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Answer 4 : (b)

5. Insurance claim received on account of

- (a) Capital receipt
- (b) Revenue receipt
- (c) Capital expenditures

Answer 5 : (a)

6. Interest on investments received from

- (a) Capital receipt
- (b) Revenue receipt
- (c) Capital expenditures

Answer 6 : (b)

7. Amount received from IDBI as a medium term loan for augmenting working capital is

- (a) Capital expenditures
- (b) Revenue expenditures
- (c) Capital receipt

Answer 7 : (c)

8. Revenue from sale of products, ordinarily, is reported as part of the earning in the period in which

- (a) The sale is made.
- (b) The cash is collected.
- (c) The products are manufactured.

Answer 8 : (a)

9. If repair cost is ₹ 25,000, whitewash expenses are ₹ 5,000, (both these expenses relate to presently used building) cost of extension of building is ₹ 2,50,000 and cost of improvement in electrical wiring system is ₹19,000; the amount to be expensed is

- (a) ₹ 2,99,000.
- (b) ₹ 44,000.
- (c) ₹ 30,000.

Answer 9 : (c)

THEORETICAL QUESTIONS:

Question 1

What are the basic considerations in distinguishing between capital and revenue expenditures?

Answer 1

The basic considerations in distinction between capital and revenue expenditures are:

- (a) Nature of business.
- (b) Recurring nature of expenditure.
- (c) Purpose of expenses.
- (d) Effect on revenue generating capacity of business.
- (e) Materiality of the amount involved.

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Question 2

Define revenue receipts and give examples. How are these receipts treated?

Answer 2

Receipts which are obtained in course of normal business activities are revenue receipts (e.g., receipts from sale of goods or services, interest income etc.).

Revenue receipts should not be equated with the actual cash receipts. Revenue receipts are credited to the Profit and Loss Account.

ILLUSTRATION 1

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

Question 1

Overhaul expenses of second-hand machinery purchased are Revenue Expenditure.

Answer 1

False: Overhaul expenses are incurred to put second-hand machinery in working condition to derive enduring long-term advantage. So it should be capitalised.

Question 2

Money spent to reduce working expenses is Revenue Expenditure.

Answer 2

False: It may be reasonably presumed that money spent for reducing revenue expenditure would have generated long-term benefits to the entity. So this is capital expenditure.

Question 3

Legal fees to acquire property is Capital Expenditure.

Answer 3

True: Legal fee paid to acquire any property is part of the cost of that property. It is incurred to possess the ownership right of the property and hence a capital expenditure.

Question 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.

Answer 4

False: Legal expenses incurred to defend a suit claiming that the firm's factory site belongs to the plaintiff is maintenance expenditure of the asset. By this expense, neither any enduring benefit can be obtained in future in addition to that what is presently available nor the capacity of the asset will be increased. Maintenance expenditure in relation to an asset is revenue expenditure.

Question 5

Amount spent for replacement of worn out part of machine is Capital Expenditure.

Answer 5

False: Amount spent for replacement of any worn out part of a machine is revenue expense since it is part of its maintenance cost.

Question 6
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Expense incurred on the repairs and white washing for the first time on purchase of an old building are Revenue Expenses.

Answer 6

False: Repairing and white washing expenses for the first time of an old building are incurred to put the building in usable condition. These are the part of the cost of building. Accordingly, these are capital expenditure.

Question 7

Expenses in connection with obtaining a license for running the cinema is Capital Expenditure.

Answer 7

True: The Cinema Hall could not be started without license. Expenditure incurred to obtain the license is pre-operative expense which is capitalised. Such expenses are amortised over a period of time.

Question 8

Amount spent for the construction of temporary huts, which were necessary for construction of the Cinema House and were demolished when the cinema house was ready, is Capital Expenditure.

Answer 8

True: Cost of temporary huts constructed which were necessary for the construction of the cinema house is part of the construction cost of the cinema house. Therefore such costs are to be capitalised.

ILLUSTRATION 2

State with reasons whether the following are Capital or Revenue Expenditure:

Question 1

Expenses incurred in connection with obtaining a license for starting the factory for ₹ 10,000.

Answer 1

Money paid ₹ 10,000 for obtaining license to start a factory is a capital expenditure. This is an item of expenditure incurred to acquire the right to carry on business.

Question 2

₹ 1,000 paid for removal of Inventory to a new site.

Answer 2

₹ 1,000 paid for removal of Inventory to a new site is revenue expenditure. This is neither bringing enduring benefit nor enhancing the value of the asset.

Question 3

Rings and Pistons of an engine were changed at a cost of ₹ 5,000 to get fuel efficiency.

Answer 3

₹ 5,000 spent in changing Rings and Pistons of an engine to get fuel efficiency is capital expenditure. This is an expenditure on improvement of a fixed asset. It results in increasing profit-earning capacity of the business by cost reduction.

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Question 4

Money paid to Mahanagar Telephone Nigam Ltd. (MTNL) ₹ 8,000 for installing telephone in the office.

Answer 4

Money deposited with MTNL for installation of telephone in office is not expenditure. This is treated as an asset and the same is adjusted over a period of time against actual telephone bills.

Question 5

A factory shed was constructed at a cost of ₹ 1,00,000. A sum of ₹ 5,000 had been incurred in the construction of temporary huts for storing building material.

Answer 5

Cost of construction of building including cost of temporary huts is capital expenditure. Building is fixed asset which will generate enduring benefit to the business over more than one accounting period. Construction of temporary huts is incidental to the main construction. Such cost is also capitalised with the cost of building.

ILLUSTRATION 3

Best Tech Solutions buys and sells computers as a part of its business. It purchased 20 computers for resale to its customers. Cost of each computer is ₹ 20,000. It also purchased a computer costing ₹ 24,000 for its accountant to be able to maintain the accounting records and printing of invoices. Suggest whether above transactions qualify as capital expenditure or revenue expenditure transactions?

Answer

Best Tech Solutions is in the business of buying and selling of computers. Any computers purchased for resale to its customers will qualify as revenue expenditure. Hence, a purchase of $20,000 \times 20 = ₹ 4,00,000$ will be a part of revenue expenditure.

At the same time, the computer purchased for maintaining the records and invoicing is to be able to operate the business for a longer period of time. Therefore, the purchase of ₹ 24,000 qualifies as a capital expenditure. This amount will be a part of assets in the Balance Sheet.

ILLUSTRATION 4

State with reasons whether the below items relating to the business of AB td are capital or revenue receipts?

- A machine with a book value of ₹ 10 lakh is sold for ₹ 12 lakh.
- Premium amounting to ₹ 1 Lakh received on issue of shares
- An amount of ₹ 20,000 received from goods sold in cash.
- An amount of ₹ 5 lac received on the maturity of fixed deposit from bank. Also, an interest of ₹ 40,000 was received in addition to the maturity amount of the fixed deposits.

Answer

- The amount of ₹ 12 lac is a capital receipt. There is a profit on sale of the machine to the extent of ₹ 2 lac ($12 - 10$)
- Premium received on issue of shares is an example of capital receipt.
- Amount received from cash sale is a revenue receipt.
- Amount received on the maturity of fixed deposit is the recovery of the deposit amount, and is a capital receipt. Interest income is an example of revenue receipt.

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ILLUSTRATION 5

Good Pictures Ltd., constructs a cinema house and incurs the following expenditure during the first year ending 31st March, 2022.

- (1) Second-hand furniture worth ₹ 9,000 was purchased; repainting of the furniture costs ₹ 1,000. The furniture was installed by own workmen, wages for this being ₹ 200.
- (2) Expenses in connection with obtaining a license for running the cinema worth ₹ 20,000. During the course of the year the cinema company was fined ₹ 1,000, for contravening rules. Renewal fee ₹2,000 for next year also paid.
- (3) Fire insurance, ₹ 1,000 was paid on 1st October, 2021 for one year.
- (4) Temporary huts were constructed costing ₹ 1,200. They were necessary for the construction of the cinema. They were demolished when the cinema was ready.

Point out how you would classify the above items.

Answer

- (1) The total cost of the furniture should be treated as ₹ 10,200 i.e., all the amounts mentioned should be capitalised since without such expenditure the furniture would not be available for use. If ₹ 1,000 and ₹ 200 have been respectively debited to the Repairs Account and the Wages Account, these accounts will be credited to the Furniture Account.
- (2) License for running the cinema house is necessary, hence its cost should be capitalised. But the fine of ₹ 1,000 is revenue expenditure. The renewal fee for the next year is also revenue expenditure but pertains to the next year; hence, it is a prepaid expense.
- (3) Half of the insurance premium pertains to the year beginning on 1st April, 2021. Hence such amount should be treated as prepaid expense. The remaining amount is revenue expense for the current year.
- (4) Since the temporary huts were necessary for the construction, their cost should be added to the cost of the cinema hall and thus capitalised.

ILLUSTRATION 6

State with reasons, how you would classify the following items of expenditure:

- (1) Overhauling expenses of ₹ 25,000 for the engine of a motor car to get better fuel efficiency.
- (2) Inauguration expenses of ₹ 25 lacs incurred on the opening of a new manufacturing unit in an existing business.
- (3) Compensation of ₹ 2.5 crores paid to workers, who opted for voluntary retirement.

Answer

- (1) Overhauling expenses are incurred for the engine of a motor car to derive better fuel efficiency. These expenses will reduce the running cost in future and thus the benefit is in form of enduring long-term advantage. So this expenditure should be capitalised.
- (2) Inauguration expenses incurred on the opening of a new unit may help to explore more customers. This expenditure is in the nature of revenue expenditure, as the expenditure may not generate any enduring benefit to the business over more than one accounting period.
- (3) The amount paid to workers on voluntary retirement is in the nature of revenue expenditure. Since the magnitude of the amount of expenditure is very significant, it may be better to defer it over future years.

ILLUSTRATION 7
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Classify the following expenditures and receipts as capital or revenue:

- (i) ₹ 10,000 spent as travelling expenses of the directors on trips abroad for purchase of capital assets.
- (ii) Amount received from Trade receivables during the year.
- (iii) Amount spent on demolition of building to construct a bigger building on the same site.
- (iv) Insurance claim received on account of a machinery damaged by fire.

Answer

- (i) Capital expenditure.
- (ii) Revenue receipt.
- (iii) Capital expenditure.
- (iv) Capital receipt.

ILLUSTRATION 8

Are the following expenditures capital in nature?

- (i) M/s ABC & Co. run a restaurant. They renovate some of the old cabins. Because of this renovation some space was made free and number of cabins was increased from 10 to 13. The total expenditure was ₹ 20,000.
- (ii) M/s New Delhi Financing Co. sold certain goods on installment payment basis. Five customers did not pay installments. To recover such outstanding installments, the firm spent ₹ 10,000 on account of legal expenses.
- (iii) M/s Ballav & Co. of Delhi purchased a machinery from M/s Shah & Co. of Ahmedabad. M/s Ballav & Co. spent ₹ 40,000 for transportation of such machinery. The year ending is 31st Dec, 2022.

Answer

- (i) Renovation of cabins increased the number of cabins. This has an effect on the future revenue generating capability of the business. Thus, the renovation expense is capital expenditure in nature.
- (ii) Expense incurred to recover installments due from customer do not increase the revenue generating capability in future. It is a normal recurring expense of the business. Thus, the legal expenses incurred in this case is revenue expenditure in nature.
- (iii) Expenses incurred on account of transportation of fixed asset is capital expenditure in nature.

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Chapter 1.4

Contingent Assets And Contingent Liabilities

25

TRUE OR FALSE

Question 1

A contingent liability need not be disclosed in the financial statements.

Answer 1

False: A Contingent liability is required to be disclosed unless possibility of outflow of a resource embodying economic benefits is remote.

Question 2

A Provision fails to meet the recognition criteria.

Answer 2

False: A contingent liability fails to meet the recognition criteria.

Question 3

A claim that an enterprise is pursuing through legal process, where the outcome is uncertain, is a contingent liability.

Answer 3

False: A claim that an enterprise is pursuing through legal process, where the outcome is uncertain, is a contingent asset

Question 4

When it is probable that the firm will need to pay off the obligation, this gives rise to Contingent liability.

Answer 4

False: When it is probable that the firm will need to pay off the obligation, this gives rise to provision.

Question 5

Present financial obligation of an enterprise, which arises from past event is termed as contingent liability.

Answer 5

False: Present Financial obligation of an enterprise, which arises from past events is termed as liability.

MULTIPLE CHOICE QUESTIONS:

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1. Contingent asset usually arises from unplanned or unexpected events that give rise to
 - (d) The possibility of an inflow of economic benefits to the business entity.
 - (e) The possibility of an outflow of economic benefits to the business entity.
 - (f) Either (a) or (b).

Answer 1 : (a)

2. If an inflow of economic benefits is probable then a contingent asset is disclosed
 - (a) In the financial statements.
 - (b) In the report of the approving authority (Board of Directors in the case of a company, and the corresponding approving authority in the case of any other enterprise).
 - (c) In the cash flow statement.

Answer 2 : (b)

3. In the case of __, either outflow of resources to settle the obligation is not probable or the amount expected to be paid to settle the liability cannot be measured with sufficient reliability.
 - (a) Liability
 - (b) Provision
 - (c) Contingent liabilities

Answer 3 : (c)

4. Present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation is termed as _____.
 - (a) Provision.
 - (b) Liability.
 - (c) Contingent liability.

Answer 4 : (a)

5. In the financial statements, contingent liability is
 - (a) Recognised.
 - (b) Not recognised.
 - (c) Adjusted.

Answer 5 : (b)

THEORETICAL QUESTIONS:

Question 1

Differentiate between:

- (i) Provision and Contingent Liability.
- (ii) Liability and Contingent liability.

Answer 1

- (i) Provision is a present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation. On the other hand, a Contingent liability is a possible obligation that may or may not crystallize depending on the occurrence or non-occurrence of one or more uncertain future events.
- (ii) A liability is defined as the present financial obligation of an enterprise, which arises from past events. On the other hand, in the case of contingent liability, either outflow of resources to

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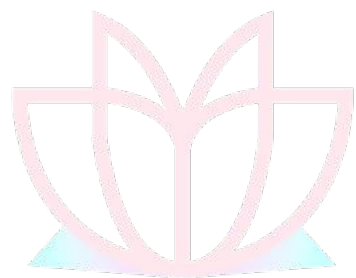
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settle the obligation is not probable or the amount expected to be paid to settle the liability cannot be measured with sufficient reliability.



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Chapter 1.5

Accounting Policies

TRUE OR FALSE

Question 1

There is a single list of accounting policies, which are applicable to all enterprises in all circumstances.

Answer 1

False: There cannot be single list of accounting policies, which are applicable to all enterprises in all circumstances. There would always be different policies chosen by different industries under different circumstances.

Question 2

Selection of accounting policy doesn't impact financial performance and financial position of the business

Answer 2

False: Accounting policy has big impact on value of items goes under financial statements, hence it impacts financial performance and financial position of the business.

Question 3

A change in accounting policies should be made as and when business like to show result as per their choice.

Answer 3

False: A change in accounting policies should be made in the following conditions:

- (a) It is required by some statute or for compliance with an Accounting Standard.
- (b) Change would result in more appropriate presentation of financial statement.

Question 4

Choosing FIFO or weighted average method for inventory valuation is selection of accounting policy.

Answer 4

True: An enterprise may adopt FIFO or weighted average method for inventory valuation and the method selected for valuation is called an accounting policy.

Question 5

Selection of an inappropriate accounting policy decision will overstate the performance and financial position of a business entity every time.

Answer 5

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False: It could understate/overstate the performance and financial position of a business entity.

MULTIPLE CHOICE QUESTIONS:

1. A change in accounting policy is justified

- (a) To comply with accounting standard and law.
- (b) To ensure more appropriate presentation of the financial statement of the enterprise.
- (c) Both (a) and (b).

Answer 1 : (c)

2. Accounting policy for inventories of Xeta Enterprises states that inventories are valued at the lower of cost determined on weighted average basis or net realizable value. Which accounting principle is followed in adopting the above policy?

- (a) Materiality.
- (b) Prudence.
- (c) Substance over form.

Answer 2 : (b)

3. The areas wherein different accounting policies can be adopted are

- (a) Providing depreciation.
- (b) Valuation of inventories.
- (c) Both the option.

Answer 3 : (b)

4. Selection of an inappropriate accounting policy decision may

- (a) Overstate the performance and financial position of a business entity.
- (b) Understate/overstate the performance and financial position of a business entity.
- (c) Overstate the performance of a business entity.

Answer 4 : (b)

5. Accounting policies refer to specific accounting

- (a) Principles.
- (b) Methods of applying those principles.
- (c) Both (a) and (b).

Answer 5 : (c)

THEORETICAL QUESTIONS:

Question 1

Define Accounting Policies in brief. Identify few areas wherein different accounting policies are frequently encountered.

Answer 1

Accounting Policies refer to specific accounting principles and methods of applying these principles adopted by the enterprise in the preparation and presentation of financial statements. For details,

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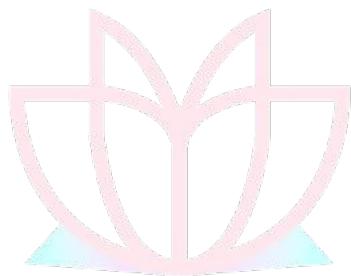
refer para 5.1.

Question 2

“Change in accounting policy may have a material effect on the items of financial statements.”
 Explain the statement with the help of an example.

Answer 2

Change in accounting policy may have a material effect on the items of financial statements. For example, if cost formula used for inventory valuation is changed from weighted average to FIFO. Unless the effect of such change in accounting policy is quantified, the financial statements may not help the users of accounts.



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Chapter 1.6

Accounting As A

Management

Discipline – Valuation

Principles, Accounting

Estimates

31

TRUE OR FALSE

Question 1

There are four generally accepted measurement bases.

- (i) Historical Cost;
- (ii) Current Cost;
- (iii) Realizable Value;
- (iv) Future Value.

Answer 1

False: There are four generally accepted measurement bases .

- (i) Historical Cost;
- (ii) Current Cost;
- (iii) Realizable Value;
- (iv) Present Value.

Question 2

Historical Cost means price paid at time acquisition.

Answer 2

True: Historical cost means the acquisition price.

Question 3

As per future value, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in an orderly disposal.

Answer 3

False: At Realisable value, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in an orderly disposal.

Question 4

At Present value, liabilities are carried at the value of future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

Answer 4

False: Liabilities are carried at the present discounted value of future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

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Question 5

ABC purchased a machinery amounting ₹ 10,00,000 on 1st April, 2001. On 31st March, 2022, similar machinery could be purchased for ₹ 20,00,000. Historical cost of machine is 20,00,000

Answer 5

False: Historical cost is ₹10,00,000.

Question 6

ABC purchased a machinery amounting ₹ 10,00,000 on 1st April, 2001. On 31st March, 2022, similar machinery could be purchased for ₹ 20,00,000. Current cost of machine is ₹ 20,00,000

Answer 6

True: Since similar machine is purchased at 20,00,000, the current cost of machine is ₹ 20,00,000.

Question 7

Change in accounting estimate has to be given retrospective effect.

Answer 7

False: Change in accounting estimate has not to be given retrospective effect.

MULTIPLE CHOICE QUESTIONS:
Question 1

- (i) Measurement discipline deals with
 (d) Identification of objects and events.
 (e) Selection of scale.
 (f) Both (a) and (b)

Answer : (c)

- (ii) All of the following are valuation principles except
 (a) Historical cost.
 (b) Present value.
 (c) Future value.

Answer : (c)

- (iii) Book value of machinery on 31st March, 2022 ₹ 10,00,000
 Market value as on 31st March, 2022 if sold ₹ 11,00,000
 As on 31st March, 2022, if the company values the machinery at ₹ 11,00,000, which of the following valuation principle is being followed?
 (a) Historical Cost.
 (b) Present Value.
 (c) Realisable Value.

Answer : (c)
Question 2

Mohan purchased a machinery amounting ₹ 10,00,000 on 1st April, 2001. On 31st March, 2022, similar machinery could be purchased for ₹ 20,00,000 but the realizable value of the machinery (purchased on 1.4.2001) was estimated at ₹ 15,00,000. The present discounted

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value of the future net cash inflows that the machinery was expected to generate in the normal course of business, was calculated as ₹ 12,00,000.

- (i) The current cost of the machinery is
- (a) ₹ 10,00,000.
 - (b) ₹ 20,00,000.
 - (c) ₹ 15,00,000.

Answer : (b)

- (ii) The present value of machinery is
- (a) ₹ 10,00,000.
 - (b) ₹ 20,00,000.
 - (c) ₹ 12,00,000.

Answer : (c)

- (iii) The historical cost of machinery is
- (a) ₹ 10,00,000.
 - (b) ₹ 20,00,000.
 - (c) ₹ 15,00,000.

Answer : (a)

- (iv) The realizable value of machinery is
- (a) ₹ 10,00,000.
 - (b) ₹ 20,00,000.
 - (c) ₹ 15,00,000.

Answer : (c)

THEORETICAL QUESTIONS:

Question 1

Define Measurement in brief. Explain the significant elements of measurement.

Answer 1

Measurement is vital aspect of accounting. Primarily transactions and events are measured in terms of money. Three elements of measurement are: (1) Identification of objects and events to be measured; (2) Selection of standard or scale to be used; (3) Evaluation of dimension of measurement standard or scale.

Question 2

Describe in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the balance sheet or statement of profit and loss.

Answer 2

Alternative measurement bases are: (i) Historical Cost; (ii) Current cost (iii) Realisable (Settlement) Value and (iv) Present Value. Refer para 6.6 for details.

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Chapter 1.7

Accounting Standards

Chapter 1.7 Accounting Standards

TRUE OR FALSE

Question 1

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

Answer 1

True: Accounting standards are documents covering recognition, measurement, presentation and disclosure of accounting transactions and events in the financial statements.

Question 2

Accounting standards can override the statute.

Answer 2

False: Accounting standards can never override the statute. The standards are required to be framed within the ambit of prevailing statutes.

Question 3

Difficulties in making choice between different treatments is one of the benefits of accounting standards.

Answer 3

False: Difficulties in making choice between different treatments is one of the limitation of accounting standard.

Question 4

Requirements for additional disclosures is limitation of accounting standards.

Answer 4

False: Benefits of accounting standards are:

- Standardisation of alternative accounting treatments
- Comparability of financial statements
- Requirements for additional disclosures.

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Question 5

ASB stands for Accounting standardisation benchmarking.

Answer 5

False: ASB stands for Accounting Standard Board.

Question 6

There are no limitation to accounting standards.

Answer 6

False: limitations of accounting standards

- Difficulties in making choice between different treatments
- Restricted scope

MULTIPLE CHOICE QUESTIONS:
Question 1

Accounting Standards for Non-Corporate entities in India are issued by

- (d) Central Govt.
- (e) State Govt.
- (f) Institute of Chartered Accountants of India.

Answer 1 : (c)
Question 2

Accounting Standards

- (a) Harmonise accounting policies.
- (b) Eliminate the non-comparability of financial statements.
- (c) Both the above.

Answer 2 : (c)
Question 3

It is essential to standardize the accounting principles and policies in order to ensure

- (a) Transparency.
- (b) Consistency.
- (c) Both the above.

Answer 3 : (c)
THEORETICAL QUESTIONS:
Question 1

Explain the objective of "Accounting Standards" in brief.

Answer 1

Accounting Standards are selected set of accounting policies or broad guidelines regarding the principles and methods to be chosen out of several alternatives. The main objective of Accounting Standards is to establish standards which have to be complied with, to ensure that financial statements are prepared in accordance with generally accepted accounting principles. Accounting Standards seek to suggest rules and criteria of accounting measurements. These standards harmonize the diverse accounting policies and practices at present in use in India.

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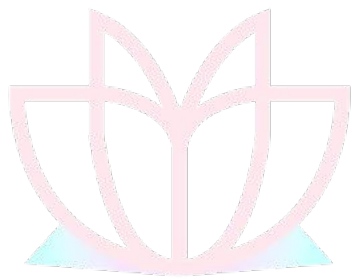
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Question 2

State the advantages of setting Accounting Standards.

Answer 2

The main advantage of setting accounting standards is that the adoption and application of accounting standards ensure uniformity, comparability and qualitative improvement in the preparation and presentation of financial statements. The other advantages are: Reduction in variations; Disclosures beyond that required by law and Facilitates comparison.



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Chapter 2.1 Accounting Process

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Chapter 2.1 Accounting Process

True and False

Question 1

In accounting equation approach, $\text{equity} + \text{Long-term liabilities} = \text{fixed asset} + \text{current assets} - \text{current liabilities}$.

Answer 1

True: As per the modern accounting equation approach- it is the basic formula in the accounting process

Question 2

In the traditional approach, for an entity a debtor will be receiver after sale of goods.

Answer 2

False: In the traditional approach, a debtor will be giver since he will be paying money for the sale of goods by the entity.

Question 3

The rule of nominal account states that all expenses & losses are recorded on credit side.

Answer 3

False: The rule of nominal account states that all expenses & losses are recorded on debit side.

Question 4

Journal proper is also called a subsidiary book.

Answer 4

True: It is one of the book where in the transactions not entered in the other books are entered in this book.

Question 5

Capital account has a debit balance.

Answer 5

False: Capital account has a credit balance.

Question 6

Purchase account is a nominal account.

Answer 6

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True: As it is considered as an expense.

Question 7

All the personal & real account are recorded in P&L A/c.

Answer 7

False: All the personal & real account are recorded in balance sheet.

Question 8

Asset side of balance sheet contains all the personal & nominal accounts.

Answer 8

False: Asset side of balance sheet contains all the personal & real accounts.

Question 9

Capital account is a personal account.

Answer 9

True: As it is in the name of the proprietor who is bringing in the capital to the business.

Question 10

Journal is also known as the book of original entry.

Answer 10

True: As the transactions are entered first in this book as a first hand record.

Multiple Choice Questions

1. The rent paid to landlord is credited to
- (d) Landlord's account.
 - (e) Rent account.
 - (f) Cash account.

Answer 1 : (c)

2. In case of a debt becoming bad, the amount should be credited to
- (a) Trade receivables account.
 - (b) Bad debts account.
 - (c) Cash account.

Answer 2 : (a)

3. A Ltd. has a ₹ 35,000 account receivable from Mohan. On January, 22, Mohan makes a partial payment of ₹ 21,000 to A Ltd. The journal entry made on January, 22 by A Ltd. to record this transaction includes:
- (a) A credit to the cash received account of ₹ 21,000.
 - (b) A credit to the Accounts receivable account of ₹ 21,000.
 - (c) A debit to the cash account of ₹ 14,000.

Answer 3 : (b)

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4. Which financial statement represents the accounting equation –
Assets = Liabilities + Owner's equity:

- (a) Income Statement
- (b) Statement of Cash flows
- (c) Balance Sheet.

Answer 4 : (c)

5. Which account is the odd one out?

- (a) Office furniture & Equipment.
- (b) Freehold land and Buildings.
- (c) Inventory of materials.

Answer 5 : (c)

6. The debts written off as bad, if recovered subsequently are

- (a) Credited to Bad Debts Recovered Account
- (b) Credited to Trade Receivables Account.
- (c) Debited to Profit and Loss Account.

Answer 6 : (a)

7. In Double Entry System of Book-keeping every business transaction affects:

- (a) Two accounts
- (b) Two sides of the same account.
- (c) The same account on two different dates.

Answer 7 : (a)

8. A sale of goods to Ram for cash should be debited to:

- (a) Ram
- (b) Cash
- (c) Sales

Answer 8 : (b)

Theoretical Questions & Answers

Question 1

Write short note on classification of accounts.

Answer 1

Accounts are broadly classified into assets, liabilities and capital. The basic accounting equation specifies broad categories, which are as follows:

- (i) **Assets:** These are resources controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise, namely cash, stock of goods, land, buildings, machinery etc.

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- (ii) **Liabilities:** These are financial obligations of an enterprise other than owner's equity namely long term loans, creditors, outstanding expenses etc.
- (iii) **Capital:** It generally refers to the amounts invested in an enterprise by its owner(s), the accretion to it or a reduction in it. Since capital is affected by expenses and incomes of revenue nature, there are two more categories of accounts, namely expenses and incomes. The difference between incomes and expenses are taken into capital account.
- **Expenses:** These represent those accounts which show the amount spent or even lost in carrying on operations.
 - **Incomes:** These represent those accounts which show the revenue amounts earned by the enterprise.

However, traditionally accounts are classified as follows:

- (i) **Personal Accounts:** These accounts relate to persons, institutions, debtors or creditors.
- (ii) **Impersonal Accounts:** These represent accounts which are not personal. These can be further sub-divided as follows:
- **Real Accounts:** These accounts relate to assets of the firm but not debt e.g. accounts relating to land, buildings, cash in hand etc.
 - **Nominal accounts:** These accounts relate to expenses, losses, gains, revenues etc.

Question 2

Distinguish between Real account and nominal account.

Answer 2

A real account is an account relating to properties and assets, other than personal accounts of the firm. Examples are land, buildings, machinery, cash, investments etc. Nominal accounts relate to expenses or losses, incomes and gains. Examples are: wages, salaries, rent, depreciation etc. The net result of all the nominal accounts is reflected as profit or loss which is transferred to the capital account. Nominal accounts are therefore, temporary. The real accounts are shown in the balance sheet along with personal accounts.

Practical Questions & Answers

Question 1

Show the classification of the following Accounts under traditional and accounting equation approach:

a	Rent outstanding	g	Capital
b	Closing Inventory	h	Sales Tax Payable
c	Sales	i	Trade receivables
d	Bank Fixed Deposit	j	Depreciation
e	Cash	k	Drawings
f	Bad Debts		

Answer 1

Nature of Account

Sr. No.	Title of Account	Traditional Approach	Accounting Equation Approach
a	Rent Outstanding	Personal	Liability
b	Closing Inventory	Real	Asset
c	Sales	Nominal	Revenue

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d	Bank Fixed Deposit	Personal	Asset
e	Cash	Real	Asset
f	Bad Debts	Nominal	Expense
g	Capital	Personal	Capital
h	Sales Tax Payable	Personal	Liability
i	Trade receivables	Personal	Asset
j	Depreciation	Nominal	Expense
k	Drawings	Personal	Capital -Drawings

Question 2

Pass Journal Entries for the following transactions in the books of Gamma Bros.

- Employees had taken inventory worth ₹ 1,00,000 (Cost price ₹ 75,000) on the eve of Deepawali and the same was deducted from their salaries in the subsequent month.
- Wages paid for erect on of Machinery ₹ 18,000.
- Income tax liability of proprietor ₹ 17000 was paid out of petty cash.
- Purchase of goods from Naveen of the list price of ₹ 2,00,000. He allowed 10% trade discount, ₹ 5,000 cash discount was also allowed for quick payment.

Answer 2
Journal Entries in the books of Gamma Bros.

	Particulars		Dr. Amount ₹	Cr. Amount ₹
(i)	Salaries A/c	Dr.	75,000	
	To Purchase A/c			75,000
	(Being entry made for inventory taken by employees)			
(ii)	Machinery A/c	Dr.	18,000	
	To Bank A/c			18,000
	(Being wages paid for erect on of machinery)			
(iii)	Drawings A/c		17,000	
	To Petty Cash A/c			17,000
	(Being the income tax of proprietor paid out of business money)			
(iv)	Purchase A/c	Dr.	1,80,000	
	To Naveen A/c			1,80,000
	(Being goods purchased from Naveen)			
	Naveen A/c	Dr.	1,80,000	
	To Bank			1,75,000
	To Discount Received A/c			5,000
	(Being amount paid for the goods purchased from Naveen for ₹ 2,00,000. 10% trade discount and cash discount of ₹ 5,000 allowed by him)			

Note:

- Here wages paid on erect on of machinery have been capitalised therefore machinery account has been debited directly instead of wages being recorded as an expenditure.
- The students may also note that trade discount is allowed on the list price of goods. It is

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deducted to compute the invoice amount of the goods to be recorded in the books. Cash discount is a discount allowed in case of early payments to the seller. The entry is made in the books of accounts for cash discount.

Question 3

Calculate the missing amount for the following.

	Assets	Liabilities	Capital
(a)	15,00,000	2,50,000	?
(b)	?	1,50,000	75,000
(c)	14,50,000	?	13,75,000
(d)	57,00,000	- 2,80,000	?

Answer 3

- (b) 12,50,000
- (c) 2,25,000
- (d) 75,000
- (e) 59,80,000

These have been solved using the Accounting Equation: Assets = Capital + Liabilities

Question 4

Show the effect of increase = (+), decrease = (-) and no change=(0) on the assets of the following transactions:

- a. Purchased office furniture, payment to be made next month.
- b. Collected cash for repair services
- c. Goods sold on credit.
- d. Withdrawal of cash by the owner for personal use.
- e. Hired an employee as sales manager of the north wing.
- f. Returned goods worth ₹ 50,000.
- g. One of our debtor agreed to pay his dues to Mr. C who is a creditor of the company with the same amount being due to him.
- h. Entered into an agreement with Mehta & Co. to purchase all raw materials from their company from next year.

Also give reasons for your answers.

Answer 4

Sr. No.	Increase (+) / Decrease (-) / No Change (0) in Assets	Reasons
(a)	+	Furniture has been purchased making it an increase in assets and also it being purchased on credit it increases liability and there is no out low of assets like cash or bank.
(b)	+	Cash has f owed in for services provided making it an increase in assets.

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(c)	+	For goods sold, it is a decrease in inventory (assets) but correspondingly there is an increase in debtors. However, there will be a net increase in assets because goods sold on profit. Though if goods are sold at cost; it will result in no change whereas if sold at below cost; it will result in decrease in assets.
(d)	-	Here cash has been withdrawn from business resulting in decrease in assets and capital.
(e)	0	Only hiring of employee has been done resulting in no change in assets.
(f)	-	Outflow of goods has resulted in decrease in assets while money owed to creditors reduce on the liability side.
(g)	-	Both assets and liabilities reduced by same amounts meaning a decrease in assets.
(h)	0	Only a purchase agreement has been entered into with no transaction taking place yet.

Question 5

Following is the information provided by Mr. Gopi pertaining to year ended 31st March 2022. Find the unknowns, showing computation to support your answer:

Particulars	₹	Particulars	₹
Machinery	12,00,000	Trade Receivables	B
Accounts Payable	1,00,000	Loans	C
Inventory	60,000	Closing Capital	D
Total Liabilities including capital	14,15,000	Opening Capital	10,00,000
Cash	A	Loss incurred during the year	35,000
Bank	80,000	Capital Introduced during the year	1,00,000

Additional Information: During the year sales of ₹ 15,55,000 was made of which ₹ 15,00,000 have been received.

Answer 5

$$\begin{aligned}
 \text{Trade Receivable Balance (B)} &= \text{Sales} - \text{Amount received during the year} \\
 &= ₹ (15,55,000 - 15,00,000) \\
 &= ₹ 55,000.
 \end{aligned}$$

Since, we know Assets = Capital + Liabilities

Therefore, balance of assets is also ₹ 14,15,000

So, total assets:

Particulars	₹
Total Assets	14,15,000
Less: Machinery	(12,00,000)
Less: Inventory	(60,000)
Less: Bank	(80,000)
Less: Receivables	(55,000)
Cash (A)	20,000

Computation of Closing Capital (D):

Particulars	₹

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Opening Capital	10,00,000
Add: Introduced during the year	1,00,000
Less: Loss incurred during the year	(35,000)
Closing Capital	10,65,000

So, Loan amount (C) = Total Liabilities and capital - Closing Capital - Trade Payables
 = ₹ (14,15,000 - 10,65,000 - 1,00,000) = ₹ 2,50,000

Question 6

Pass journal entries for the following transactions in the books of Mr. Manish:

- Purchased goods from Sonu for ₹ 3,00,000 at a trade discount of 10% plus CGST and SGST @ 6% each.
- Sold goods to Mohit for ₹ 1,00,000 and charged CGST and SGST @ 5% each. Out of the amount due 40% is received by cheque immediately.
- Goods costing ₹ 25,000 withdrawn for personal use. Such Goods were purchased by paying CGST and SGST @ 6% each.
- Machinery purchased from M/s Bright Industries for ₹ 2,00,000 plus CGST and SGST @ 9% each. Paid ₹ 1,00,000 immediately by cheque and balance to be paid after two months.

Answer 6

Journal entries in the books of Mr. Manish

S No.	Particulars	L.F.	Amount Dr. (₹)	Amount Cr. (₹)
(i)	Purchases A/c Dr.		2,70,000	
	Input CGST A/c Dr.		16,200	
	Input SGST A/c Dr.		16,200	
	To Sonu's A/c			3,02,400
	(Being goods purchased from Sonu, CGST and SGST payable @ 6% each)			
(ii)	Bank A/c Dr.		44,000	
	Mohit's A/c Dr.		66,000	
	To Sales A/c			1,00,000
	To Output CGST A/c To			5,000
	Output SGST A/c			5,000
	(Being goods sold to Mohit, charged CGST and SGST @ 5% each and received 40% in cash)			
(iii)	Drawings A/c Dr.		28,000	
	To Purchase A/c			25,000
	To Input CGST A/c			1,500
	To Input SGST A/c			1,500
	(Being goods withdrawn for personal use and input CGST and input SGST debited at the time of purchase reversed)			
(iv)	Machinery A/c Dr.		2,00,000	
	Input CGST A/c Dr.		18,000	
	Input SGST A/c Dr.		18,000	
	To Bank A/c			1,00,000

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	To Bright Industries			1,36,000
	(Being machinery purchased and paid ₹ 1,00,000 immediately, CGST and SGST @ 9% each)			

ILLUSTRATION 1

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

2022 April		(₹ in 000)
1.	R started business with	5,000
2.	He purchased furniture for	1,200
3.	Paid salary to his clerk	1,100
4.	Paid rent	1,150
5.	Received interest	2,000

Answer

2022 April	Explanation	Accounts Involved	Nature of Accounts	How affected	Debit (₹ in 000)	Credit (₹ in 000)
1.	₹ 5,000 cash invested in business	Bank and R's Capital	Asset Capital	Increased Increased	5,000	5,000
2.	Purchased furniture for ₹ 1,200	Furniture and Bank	Asset Asset	Increased Decreased	1,200	1,200
3.	Paid ₹ 1,100 to employee for salary	Salary & Bank	Expense Asset	Increased Decreased	1,100	1,100
4.	Paid Rent ₹ 1,150	Rent & Bank	Expense Asset	Increased Decreased	1,150	1,150
5.	Received interest ₹ 2,000	Cash & Interest	Asset Income	Increased Increased	2,000	2,000

ILLUSTRATION 2

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

Particulars	(₹ in '000)
Capital	51,000
Loan	11,500
Trade payables	5,700
Fixed Assets	12,800
Inventory	22,600
Trade receivables	17,500

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Cash and Bank	15,300

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

	₹
Capital	?
Loan	11,500
Trade payables	5,800
Fixed Assets	12,720
Inventory	22,900
Trade receivables	17,500
Cash at Bank	15,600

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

Answer

- (a) Accounting equation is given by

Equity + Liabilities = Assets

Let us use, E_0 , L_0 and A_0 to mean equity, liabilities and assets respectively at the beginning of the accounting period.

$$E_0 = ₹ 51,000$$

$$L_0 = \text{Loan} + \text{Trade payables} \\ = ₹ 11,500 + ₹ 5,700 = ₹ 17,200$$

$$A_0 = \text{Fixed Assets} + \text{Inventories} + \text{Trade receivables} + \text{Cash at Bank} \\ = ₹ 12,800 + ₹ 22,600 + ₹ 17,500 + ₹ 15,300 = ₹ 68,200$$

So, at the beginning of accounting period

$$E_0 + L_0 = A_0$$

$$\text{i.e., } ₹ 51,000 + ₹ 17,200 = ₹ 68,200$$

Let us use E_1 , L_1 , A_1 to mean equity, liabilities and assets respectively at the end of the accounting period.

$$L_1 = \text{Loan} + \text{Trade payables} \\ = ₹ 11,500 + ₹ 5,800 = ₹ 17,300$$

$$A_1 = \text{Fixed Assets} + \text{Inventories} + \text{Trade receivables} + \text{Cash at Bank} \\ = ₹ 12,720 + ₹ 22,900 + ₹ 17,500 + ₹ 15,600 = ₹ 68,720$$

$$E_1 = A_1 - L_1 = ₹ 68,720 - ₹ 17,300 = ₹ 51,420$$

$$\text{Profit} = E_1 - E_0 = ₹ 51,420 - ₹ 51,000 = ₹ 420$$

- (b) **Balance Sheet**

Liabilities	₹	₹	Assets	₹
Capital			Fixed Assets	12,720
Balance	51,000		Inventories	22,900
Add: Profit	420	51,420	Trade receivables	17,500
Loan		11,500	Cash at Bank	15,600
Trade payables		5,800		
		68,720		68,720

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ILLUSTRATION 3

Mr. David. has provided following details related to his financials. Find out the missing figures:

Particulars	(₹ in '000)
Profits earned during the year	5,000
Assets at the beginning of year	A
Liabilities at the beginning of year	12,000
Assets at the end of the year	B
Liabilities at the end of the year	C
Closing capital	35,000
Total liabilities including capital at the end of the year	50,000

Answer

Computing opening capital: (All figure in ₹ '000)

Closing capital - profits earned during the year $(35,000 - 5,000) = 30,000$

We also know:

Assets = liabilities + capital

Therefore, opening assets (A) $(12,000 + 30,000) = 42,000$

Computation of liabilities at the end of the year:

Total liabilities including capital - closing capital (C) $(50,000 - 35,000) = 15,000$

Also assets at the end of the year (B) = closing capital + liabilities at the end of the year
 $= 35,000 + 15,000 = 50,000$

ILLUSTRATION 4

Analyse transactions of M/s Sahil & Co. for the month of March, 2022 on the basis of double entry system by adopting the following approaches:

(A) Accounting Equation Approach.

(B) Traditional Approach.

Transactions for the month of March, 2022 were as follows (figures are in '000):

1. Sahil introduced capital through bank of ₹ 4,000.
2. Cash withdrawn from the City Bank ₹ 200.
3. Loan of ₹ 500 taken from Mr. Y.
4. Salaries paid for the month of March, 2022, ₹ 300 and ₹ 100 is still payable for the month of March, 2022.
5. Furniture purchased ₹ 500.

Required

What conclusions one can draw from the above analysis?

Answer

(A) Analysis of Business Transaction: Accounting Equation Approach

The accounting equation is

Assets = Liabilities + Capital

							(₹ in '000)		
ASSETS						=	CAPITAL	+	LIABILITIES
	CASH	+	BANK	+	FURNITURE	=	CAPITAL	+	LIABILITIES
(a)	-	+	4,000	+	-	=	4,000	+	

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(b)	+200	+	-200	+	-	=	-	+	-
(c)	-	+	500	+	-	=	-	+	500
(d)	-	+	-300	+	-	=	-400	+	100
(e)	-	+	-500	+	500	=	-	+	-
Balance	200	+	3,500	+	500	=	3,600	+	600
			4,200				4,200		

(B) Analysis of Business Transactions: Traditional Approach

Transaction	Analysis	Account Affected and Nature of Account	Rule	Entry
Introduction of ₹ 4,000 through bank by the proprietor	Bank has received the money; Owner has given Bank balance	Bank–Personal Capital–Personal	Debit the receiver Credit the giver	Debit Bank Credit Capital
Cash Withdrawn from Bank ₹ 200	Cash comes into business; Bank gives out cash	Cash–Real Bank–Personal	Debit what comes in Credit the giver	Debit Cash Credit Bank
Loan from Y ₹ 500	Bank receives the amount : Y pays through bank	Bank–Personal Y's Loan– Personal	Debit the receiver Credit the giver	Debit Bank Credit Y's Loan
Salary paid ₹ 300 and SII payable ₹ 100	Cost of services used ₹ 400; Bank gives out ₹300; SII payable or outstanding for services received ₹ 100	Salary Nominal Bank–Personal Salary Outstanding–Personal	Debit all expenses Credit the giver Credit the giver	Debit Salary (₹ 400) Credit Bank (₹ 300) Credit Salary outstanding (₹ 100)
Furniture purchased ₹ 500	Furniture is purchased; Bank gives out money	Furniture Real Bank–Personal	Debit what comes in Credit the giver	Debit Furniture Credit Bank

Conclusion:

It is evident from above analysis that procedure for analysis of transactions, classification of accounts and rules for recording business transactions under accounting equation approach and traditional approach are different. But the accounts affected and entries entered/passed remains the same under both approaches. Thus, the recording of transactions in affected accounts on the basis of double entry system is independent of the method of analysis followed by a business enterprise. In other words, accounts to be debited and credited to record the dual aspect remains the same under both the approaches.

ILLUSTRATION 5

Journalise the following transactions. Also state the nature of each account involved in the Journal entry.

Following figures are given in (‘00)

- December 1, 2022, Ajit started business with capital ₹ 4,00,000
- December 3, he withdrew cash for business from the Bank ₹ 2,000.

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3. December 5, he purchased goods by making payment through bank ₹ 15,000.
4. December 8, he sold goods for ₹ 16,000 and received payment through bank.
5. December 10, he purchased furniture and paid by cheque ₹ 2,500.
6. December 12, he sold goods to Arvind ₹ 2,400.
7. December 14, he purchased goods from Amrit ₹ 10,000.
8. December 15, he returned goods to Amrit ₹ 500.
9. December 16, he received from Arvind ₹ 2,300 in full settlement.
10. December 18, he withdrew goods for personal use ₹ 1,000.
11. December 20, he withdrew cash from business for personal use ₹ 2,000.
12. December 24, he paid telephone charges ₹ 110.
13. December 26, amount paid to Amrit in full settlement ₹ 9,450.
14. December 31, paid for stationary ₹ 200, rent ₹5,000 and salaries to staff ₹ 2,000 from bank.
15. December 31, goods distributed by way of free samples ₹ 2,000.

Answer

JOURNAL

(₹ in '00)

Dr.

Cr.

Sr. No.	Date	Particulars		Nature of Account	L.F.	Debit (₹)	Credit (₹)
1.	Dec. 1	Bank Account	Dr.	Personal A/c		4,00,000	
		To Capital Account		Personal A/c			4,00,000
		(Being commencement of business with capital)					
2.	Dec. 3	Cash Account	Dr.	Real A/c		2,000	
		To Bank Account		Personal A/c			2,000
		(Being cash withdrawn from the Bank)					
3.	Dec. 5	Purchases Account	Dr.	Nominal A/c		15,000	
		To Bank Account		Personal A/c			15,000
		(Being purchase of goods for cash)					
4.	Dec. 8	Bank Account	Dr.	Personal A/c		16,000	
		To Sales Account		Nominal A/c			16,000
		(Being goods sold for cash)					
5.	Dec. 10	Furniture Account	Dr.	Real A/c		2,500	
		To Bank Account		Personal A/c			2,500
		(Being purchase of furniture, paid by cheque)					
6.	Dec. 12	Arvind	Dr.	Personal A/c		2,400	
		To Sales Account		Nominal A/c			2,400
		(Being sale of goods on credit)					
7.	Dec. 14	Purchases Account	Dr.	Nominal A/c		10,000	
		To Amrit		Personal A/c			10,000

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		(Being purchase of goods from Amrit)					
8.	Dec. 15	Amrit	Dr.	Personal A/c		500	
		To Purchases Returns Account		Nominal A/c			500
		(Being goods returned to Amrit)					
9.	Dec. 16	Bank Account	Dr.	Personal A/c		2,300	
		Discount Account	Dr.	Nominal A/c		100	
		To Arvind		Personal A/c			2,400
		(Being amount received from Arvind in full settlement and allowed him ₹ 100 as discount)					
10.	Dec. 18	Drawings Account	Dr.	Personal A/c		1,000	
		To Purchases Account		Nominal A/c			1,000
		(Being withdrawal of goods for personal use)					
11.	Dec. 20	Drawings Account	Dr.	Personal A/c		2,000	
		To Cash Account		Real A/c			2,000
		(Being cash withdrawal from the business for personal use)					
12.	Dec. 24	Telephone Expenses Account	Dr.	Nominal A/c		110	
		To Bank Account		Personal A/c			110
		(Being telephone expenses paid)					
13.	Dec 26	Amrit	Dr.	Personal A/c		9,500	
		To Bank Account		Personal A/c			9,450
		To Discount Account		Nominal A/c			50
		(Being cash paid to Amrit and he allowed ₹ 50 as discount)					
14.	Dec. 31	Stationery Expenses	Dr.	Nominal A/c		200	
		Rent Account	Dr.	Nominal A/c		5,000	
		Salaries Account	Dr.	Nominal A/c		2,000	
		To Bank Account		Personal A/c			7,200
		(Being expenses paid)					
15.	Dec. 31	Advertisement Expenses Account	Dr.	Nominal A/c		2,000	
		To Purchases Account		Real A/c			2,000
		(Being distribution of goods by way of free samples)					

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ILLUSTRATION 6

Show the classification of the following Accounts under traditional and accounting equation approach:

(a) Building; (b) Purchases; (c) Sales; (d) Bank Fixed Deposit; (e) Rent; (f) Rent Outstanding; (g) Cash; (h) Adjusted Purchases; (i) Closing Inventory; (j) Investments; (k) Trade receivables; (l) Sales Tax Payable; (m) Discount Allowed; (n) Bad Debts; (o) Capital; (p) Drawings; (q) Interest Receivable account; (r) Rent received in advance account; (s) Prepaid salary account; (t) Bad debts recovered account; (u) Depreciation account; (v) Personal income-tax account.

Answer

Nature of Account			
Sr. No.	Title of Account	Traditional Approach	Accounting Equation Approach
(a)	Building	Real	Asset
(b)	Purchases	Nominal	Expense
(c)	Sales	Nominal	Revenue
(d)	Bank Fixed Deposit	Personal	Asset
(e)	Rent	Nominal	Expense
(f)	Rent Outstanding	Personal	Liability
(g)	Cash	Real	Asset
(h)	Adjusted Purchases	Nominal	Expense
(i)	Closing Inventory	Real	Asset
(j)	Investment	Real	Asset
(k)	Trade receivables	Personal	Asset
(l)	Sales Tax Payable	Personal	Liability
(m)	Discount Allowed	Nominal	Expense
(n)	Bad Debts	Nominal	Expense
(o)	Capital	Personal	Capital
(p)	Drawings	Personal	Capital - Drawings
(q)	Interest receivable	Personal	Asset
(r)	Rent received in advance	Personal	Liability
(s)	Prepaid salary	Personal	Asset
(t)	Bad debts recovered	Nominal	Gain
(u)	Depreciation	Nominal	Expense
(v)	Personal Income Tax	Personal (Drawing)	Capital - Drawings

ILLUSTRATION 7

Transactions of Ramesh for April are given below. Journalise them.

2022			₹
April	1	Ramesh started business with	10,00,000
"	3	Bought goods for cash	50,000
"	5	Drew cash from bank	10,000
"	13	Sold to Krishna- goods on credit	1,50,000
"	20	Bought from Shyam goods on credit	2,25,000
"	24	Received from Krishna	1,45,000

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"		Allowed him discount	5,000
"	28	Paid Shyam cash	2,15,000
"		Discount allowed	10,000
"	30	Cash sales for the month	8,00,000
		Paid Rent	50,000
		Paid Salary	1,00,000

Answer
JOURNAL

Date 2022	Particulars		L.F.*	Amount (Dr.)	Amount (Cr.)
April 1	Bank Account	Dr.	1	10,00,000	
	To Capital Account		4		10,00,000
	(Being the amount invested by Ramesh in the business as capital)				
" 3	Purchases Account	Dr.	7	50,000	
	To Bank Account		1		50,000
	(Being goods purchased for cash)				
" 5	Cash Account	Dr.	5	10,000	
	To Bank Account		1		10,000
	(Being cash withdrawn from bank)				
" 13	Krishna	Dr.	9	1,50,000	
	To Sales Account		11		1,50,000
	(Being goods sold to Krishna on credit)				
" 20	Purchases Account	Dr.	7	2,25,000	
	To Shyam		10		2,25,000
	(Being goods bought from Shyam on credit)				
" 24	Bank Account	Dr.	1	1,45,000	
	Discount Account	Dr.	12	5,000	
	To Krishna		9		1,50,000
	(Being cash received from Krishna and discount allowed to him)				
" 28	Shyam	Dr.	10	2,25,000	
	To Bank Account		1		2,15,000
	To Discount Account		12		10,000
	(Being cash paid to Shyam and discount allowed by him)				
" 30	Bank Account	Dr.	1	8,00,000	
	To Sales Account		11		8,00,000
	(Being sales for the month of April 2022)				

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" 30	Rent Account	Dr.	15	50,000	
	Salaries Account	Dr.	14	1,00,000	
	To Bank Account		1		1,50,000
	(Being the amount paid for rent and salary)				
	Total			27,60,000	27,60,000

ILLUSTRATION 8

Journalise the following transactions in the books of Mr. Rohit:

- Purchased goods from Sahil for ₹ 50,000 plus CGST and SGST @ 9% each.
- Purchased goods from Sam for ₹ 40,000 at a trade discount of 10% plus CGST and SGST @ 9% each. ₹ 20,000 was paid immediately and balance payable after 3 months.
- Goods costing ₹ 20,000 withdrawn for personal use. Such goods were purchased by paying CGST and SGST @ 9% each.
- Paid rent to Gagandeep for ₹ 30,000 plus CGST and SGST @ 6% each.
- Goods costing ₹ 5,000 (before trade discount of 10%) returned to Sam. Such goods were purchased by paying CGST and SGST @ 9% each.
- Purchased furniture for ₹ 44,800 including IGST @ 12%.
- Purchased machinery from M/s Symphony industries for ₹ 1,40,000 plus CGST and SGST @ 9% each. Paid ₹ 1,00,000 immediately and balance to be paid after two months.

Answer

In the books of Mr. Rohit

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	Purchases A/c	Dr.	50,000	
	Input CGST A/c (50,000 x 9%)	Dr.	4,500	
	Input SGST A/c (50,000 x 9%)	Dr.	4,500	
	To Sahil's A/c			59,000
	(Being goods purchased from Sahil, CGST and SGST paid @ 9% each)			
(ii)	Purchases A/c (40,000 x 90%)	Dr.	36,000	
	Input CGST A/c (36,000 x 9%)	Dr.	3,240	
	Input SGST A/c (36,000 x 9%)	Dr.	3,240	
	To Sam's A/c			22,480
	To Bank A/c			20,000
	(Being goods purchased from Sam, CGST and SGST payable @ 9% each)			
(iii)	Drawings A/c*	Dr.	23,600	
	To Purchase A/c			20,000

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	To Input CGST A/c (20,000 x 9%)			1,800
	To Input SGST A/c (20,000 x 9%)			1,800
	(Being goods withdrawn for personal use and input GST and input SGST debited at the time of purchase reversed)			
(iv)	Rent A/c Dr.	30,000		
	Input CGST A/c (30,000 x 6%) Dr.	1,800		
	Input SGST A/c (30,000 x 6%) Dr.	1,800		
	To Gagandeep A/c			33,600
	(Being rent paid to Gagandeep)			
(v)	Sam's A/c Dr.	5,310		
	To Purchases Return A/c ** (5,000 – 10% trade Discount)			4,500
	To Input CGST A/c (4,500 x 9%)			405
	To Input SGST A/c (4,500 x 9%)			405
	(Being goods returned to Sam and input IGST debited at the time of purchases reversed)			
(vi)	Furniture A/c (WN 1) Dr.	40,000		
	Input IGST A/c Dr.	4,800		
	To Bank A/c			44,800
	(Being furniture purchased paid IGST @ 12%)			
(vii)	Machinery A/c Dr.	1,40,000		
	Input CGST A/c (1,40,000 x 9%) Dr.	12,600		
	Input SGST A/c (1,40,000 x 9%) Dr.	12,600		
	To Bank A/c			1,00,000
	To Symphony Industries			65,200
	(Being machinery purchased and paid ₹ 1,00,000 immediately, CGST and SGST @ 9% each)			

* The input tax availed earlier is reversed, because these goods are 'consumed' by Mr. Rohit himself. Since he cannot 'sell' goods to himself and charged output tax, the input tax thereon is reversed, since in this case Mr. Rohit himself is the ultimate consumer of those goods.

** Since goods are returned to the supplier, the input tax credit availed earlier on those goods is to be reversed, since these goods are no longer available to be sold.

Working Note.

- Furniture purchased is including IGST @ 12%. So, value of furniture excluding IGST = ₹ 44,800 × 100/112 = ₹ 40,000. IGST = ₹ 40,000 × 12% = ₹ 4,800.

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ILLUSTRATION 9

Journalise the following transactions in the books of Ms. Nidhi traders July, 2022

- 3 Sold Goods for ₹ 50,000, charged CGST and SGST @ 6% each.
- 4 Sold goods to Surjeet for ₹ 28,000 including CGST and SGST @ 6% each.
- 5 Received ₹ 25,200 from Surjeet in full settlement of his account of ₹ 28,000.
- 6 Sold goods to Kapil for ₹ 30,000 charged IGST @ 12%. Received ₹ 12,000 immediately and balance to be received after one month.
- 10 Kapil was allowed rebate of ₹ 5,000 as goods supplied to him were defective. These goods were sold by charging IGST @ 12%.
- 12 Sold goods to Manpreet for ₹ 1,00,000 at trade discount of 20% and charged IGST @ 12%
- 13 Goods of list price ₹ 20,000 returned by Manpreet.
- 17 Received commission of ₹ 15,000, charged CGST and SGST @ 6% each.

Answer

In the Books of Ms. Nidhi

Journal

Date July, 2022	Particulars	L.F.	Dr. (₹)	Cr. (₹)
3	Bank A/c Dr.		56,000	
	To Sales A/c			50,000
	To Output CGST A/c			3,000
	To Output SGST A/c			3,000
	(Being goods sold for cash, charged CGST and SGST @ 6% each)			
4	Surjeet's A/c Dr.		28,000	
	To Sales A/c			25,000
	To Output CGST A/c			1,500
	To Output SGST A/c			1,500
	(Being goods sold to Surjeet, charged CGST and SGST @ 6% each) (refer W.N.)			
5	Bank A/c Dr.		25,200	
	Discount Allowed A/c Dr.		2,800	
	To Surjeet A/c			28,000
	(Being amount received from Surjeet in full settlement of ₹ 28,000 after allowing him discount of ₹ 2,800)			
6	Bank A/c Dr.		12,000	
	Kapil's A/c Dr.		21,600	
	To Sales A/c			30,000
	To Output IGST A/c			3,600
	(Being goods sold to Kapil, charged IGST @ 12% and			

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	received ₹ 12,000 in cash and balance receivable after one month)			
10	Rebate A/c * Dr.		5,000	
	Output IGST A/c Dr.		600	
	To Kapil's A/c			5,600
	(Being rebate allowed on goods sold to Kapil, Output IGST charged at the time of sales, now reversed)			
12	Manpreet's A/c Dr.		89,600	
	To Sales A/c (1,00,000 x 80%)			80,000
	To Output IGST A/c (80,000 x 12%)			9,600
	(Being goods sold to Manpreet at trade discount of 20% and charged IGST @ 12%)			
13	Sales Return A/c Dr.		16,000	
	Output IGST A/c Dr.		1,920	
	To Manpreet A/c			17,920
	(Being goods returned by Manpreet and Output IGST charged at the time of sales now reversed)			
17	Cash A/c Dr.		16,800	
	To Commission A/c			15,000
	To Output CGST A/c (15,000 x 6%)			900
	To Output SGST A/c (15,000 x 6%)			900
	(Being commission received charged CGST and SGST @ 6% each)			

*Since rebate is on account of defective goods which cannot be sold/ utilized further by Kapil, the output GST charged thereon is also reversed. This treatment is like that of Sales Return. If rebate was on account of other reasons (such as prompt payment), Output IGST would not be reversed.

Working Note:

Goods sold to Surjeet is including CGST and SGST @ 6% each. So, sales excluding CGST and SGST = ₹ 28,000 × 100/112 = ₹ 25,000. CGST and SGST = ₹ 25,000 × 6% = ₹ 1,500 each.

ILLUSTRATION 10

Record the following transactions in a Journal, assuming CGST and SGST @ 6% each.

- Sold goods to Mukesh at the list price of ₹ 50,000 less 20% trade discount.
- Sold goods to Mukesh at the list price of ₹ 1,00,000 less 20% trade discount and 5% cash discount.
- Sold goods to Mukesh at the list price of ₹ 1,50,000 less 20% trade discount. Out of the amount due 60% is received out of which three-fourth is received by cheque.

Answer

Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	Mukesh A/c Dr.		44,800	
	To Sales A/c			40,000

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	To Output CGST A/c			2,400
	To Output SGST A/c			2,400
	(Being goods sold to Mukesh at a trade discount of 20% charged CGST and SGST @ 6% each)			
(ii)	Discount Allowed A/c Dr.		4,000	
	Bank A/c		85,600	
	To Sales A/c			80,000
	To Output SGST A/c			4,800
	To Output SGST A/c			4,800
	(Being goods sold to Mukesh at a trade discount of 20% and 5% cash discount, charged CGST and SGST @ 6% each)*			
(iii)	Bank A/c Dr.		60,480	
	Cash A/c Dr.		20,160	
	Mukesh's A/c (refer W. N.) Dr.		53,760	
	To Sales A/c (1,50,000 × 80%)			1,20,000
	To Output CGST A/c (1,20,000 × 6%)			7,200
	To Output SGST A/c (1,20,000 × 6%)			7,200
	(Being goods sold to Mukesh at a trade discount of 20% and received 60%, charged CGST and SGST @ 6% each)			

***Note :** Af er allowing cash discount of ₹ 4,000 (₹ 80,000 × 5%), the balance of ₹ 85,600 is received. Since discount is on account of prompt payment, output CGST and SGST is computed on value determine af er deduct ng trade discount.

Working Note: Af er allowing trade discount of ₹ 30,000 on ₹ 1,50,000 = ₹ 1,20,000, 60% of the balance amount i.e. ₹ 1,34,400 (₹ 1,20,000 + 12% GST ₹ 14,400) is paid in cash and by cheque.

Hence, the amount paid in cash and cheque = ₹ 1,34,400 × 60% = ₹ 80,640.

Amount paid by cheque = ₹ 80,640 × 3/4 = ₹ 60,480

Amount paid in cash = ₹ 80,640 × 1/4 = ₹ 20,160

Mukesh's A/c = (₹ 1,20,000 + ₹ 14,400 – ₹ 60,480 – ₹ 20,160) = ₹ 53,760

Example:-

From the following informat on, state the nature of account and state which account will be debited and which will be credited.

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

Answer

Transact on	ACCOUNTS INVOLVED	NATURE	DEBIT CREDIT	OR	Journal Entry

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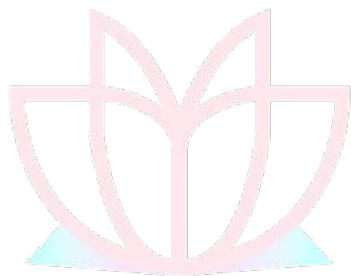
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Started business with capital of ₹ 50,00,000	Bank account Capital account	Personal Personal	Debit (Receiver) Credit (giver)	Bank A/c Dr. To Capital A/c
Wages and salaries paid	Wages/salaries Bank	Nominal Personal	Debit (expense) Credit (giver)	Wages/ Salaries Dr. To Bank A/c
Rent received	Bank Rent	Personal Nominal	Debit (Receiver) Credit (income)	Bank A/c Dr. To Rent A/c
Purchases made on credit	Purchases Creditor	Nominal Personal	Debit (expense) Credit (giver)	Purchases A/c Dr. To Creditor A/c
Goods sold and payment received in cheque	Bank Sales	Personal Nominal	Debit (Receiver) Credit (gains)	Bank A/c Dr. To Sales A/c



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Chapter 2.2

Ledgers

True and False

Question 1

A ledger is also known as the principal book of accounts.

Answer 1

True: Since it classifies all the amounts related to a particular account and then it is used as the base for preparing the Trial balance, a ledger is also known as principal books of accounts.

Question 2

Cash account has a debit balance.

Answer 2

True: Being an asset under the modern equation approach, cash account has a debit balance.

Question 3

Posting is the process of transferring the accounts from ledger to journal.

Answer 3

False: Posting is the process of transferring the balances from journal to ledger.

Question 4

At the end of the accounting year, all the nominal accounts of the ledger book are balanced.

Answer 4

False: At the end of the accounting year, all the nominal accounts of the ledger book are totaled and transferred to P&L A/c.

Question 5

Ledger records the transactions in a chronological order.

Answer 5

False: Ledger records the transactions in analytical order. But journal records the transactions in a chronological order.

Question 6

If the total debit side is greater than the total of credit side, we get a credit balance as opening balance.

Answer 6

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False: If the total of debit side is greater than the total of credit side, we get a debit balance as the opening balance.

Question 7

Ledger accounts of assets will always be debited when they are increased.

Answer 7

True: The increase to an asset shall be debited since the original balance is also debit.

Multiple Choice Questions

1. The process of transferring the debit and credit items from a Journal to their respective accounts in the ledger is termed as
 - (d) Posting
 - (e) Purchase
 - (f) Balancing of an account

Answer 1 : (a)

2. The technique of finding the net balance of an account after considering the totals of both debits and credits appearing in the account is known as
 - (a) Posting
 - (b) Purchase
 - (c) Balancing of an account

Answer 2 : (c)

3. Journal and ledger records transactions in
 - (a) A chronological order and analytical order respectively.
 - (b) An analytical order and chronological order respectively.
 - (c) A chronological order only

Answer 3 : (a)

4. Ledger book is popularly known as
 - (a) Secondary book of accounts
 - (b) Principal book of accounts
 - (c) Subsidiary book of accounts

Answer 4 : (b)

5. At the end of the accounting year all the nominal accounts of the ledger book are
 - (a) Balanced but not transferred to profit and loss account
 - (b) Not balanced and also the balance is not transferred to the profit and loss account
 - (c) Not balanced and their balance is transferred to the profit and loss account.

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Answer 5 : (c)

Theoretical Questions & Answers

Question 1

What do you mean by principal books of accounts?

Answer 1

Ledger is known as principal books of accounts and it provides full information regarding all the transactions pertaining to any individual account. Ledger contains all set of accounts (viz. personal, real and nominal accounts).

Question 2

What are the rules of posting of journal entries into the Ledger?

Answer 2

Rules regarding posting of entries in the ledger:

- Separate account is opened in ledger book for each account and entries from the Journal are posted to respective accounts accordingly.
- It is a practice to use words 'To' and 'By' while posting transactions in the ledger. The word 'To' is used in the particular column with the accounts written on the debit side while 'By' is used with the accounts written in the particular column of the credit side. These 'To' and 'By' do not have any meanings but are used to the account debited and credited.
- The concerned account debited in the journal should also be debited in the ledger but reference should be of the respective credit account.

Practical Questions & Answers

Question 1

Journalize the following transactions, post them in the Ledger and balance the accounts on 31st December.

- X started business with a capital of ₹ 20,000
- He purchased goods from Y on credit ₹ 4,000
- He paid cash to Y ₹ 2,000
- He sold goods to Z ₹ 4,000
- He received cash from Z ₹ 6,000
- He further purchased goods from Y ₹ 4,000
- He paid cash to Y ₹ 2,000
- He further sold goods to Z ₹ 4,000
- He received cash from Z ₹ 2,000

Answer 1

Journal

Particulars	L.F.	Debit ₹	Credit ₹
Cash A/c To Capital A/c (Being commencement of business)	Dr.	20,000	20,000
Purchase A/c To Y	Dr.	4,000	4,000

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(Being purchase of goods on credit)				
Y To Cash (Being amount paid to Y)	Dr.		2,000	2,000
Z To Sales A/c (Being goods sold to Z)	Dr.		4,000	4,000
Bank A/c To Z (Being amount received from Z)	Dr.		6,000	6,000
Purchase A/c To Y (Being purchase of goods on credit from Y)	Dr.		4,000	4,000
Y To Cash A/c (Being amount paid to Y)	Dr.		2,000	2,000
Z To Sales A/c (Being goods sold to Z)	Dr.		4,000	4,000
Cash A/c To Z (Being cash received from Z)	Dr.		2,000	2,000
TOTAL			48,000	48,000

Dr.		Cash Account		Cr.	
Date	Particulars	₹	Date	Particulars	₹
Feb. 1	To Capital A/c	20,000		By Y	2,000
	To Z	6,000		By Y	2,000
	To Z	2,000		By Balance c/d	24,000
		28,000			28,000
	To Balance b/d	24,000			

Dr.		Capital Account		Cr.	
Date	Particulars	₹	Date	Particulars	₹
Jan. 31	To Balance c/d	20,000		By Cash A/c	20,000
		20,000			20,000
			Feb. 1	By Balance b/d	20,000

Dr.		Purchase Account		Cr.	
Date	Particulars	₹	Date	Particulars	₹
Feb. 1	To Y	4,000	Jan 31.	By Balance c/d	8,000
	To Y	4,000			
		8,000			8,000
	To Balance b/d	8,000			

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Dr.			Y's Account			Cr.		
Date	Part culars	₹	Date	Part culars	₹			
	To Cash	2,000		By Purchases	4,000			
	To Cash	2,000		By Purchases	4,000			
Jan. 31	To Balance c/d	4,000						
		8,000			8,000			
				By Balance b/d	4,000			

Dr.			Z's Account			Cr.		
Date	Part culars	₹	Date	Part culars	₹			
	To Sales	4,000		By Cash A/c	6,000			
	To Sales	4,000		By Cash A/c	2,000			
		8,000			8,000			

Dr.			Sales Account			Cr.		
Date	Part culars	₹	Date	Part culars	₹			
Jan. 31	To Balance c/d	8,000		By Z	4,000			
				By Z	4,000			
		8,000			8,000			
			Feb. 1	By Balance b/d	8,000			

ILLUSTRATION 1

Prepare the Stationery Account of a firm for the month of Jan. 2022 duly balanced off, from the following details:

2022		₹
Jan. 1	Inventory of stationery	480
Jan. 5	Purchase of stationery by cheque	800
Jan. 15	Purchase of stationery on credit from Five Star Stationery Mart	1,280

Answer

Dr.				Stat onery Account				Cr.			
Date		Particulars	₹	Date		Particulars	₹			Particulars	₹
1.1.2022	To	Balance b/d	480	31.1.2022	By	Balance c/d	2,560				
5.1.2022	To	Bank A/c	800								
15.1.2022	To	Five Star Stationery Mart A/c	1,280								
			2,560								
1.2.2022	To	Balance b/d	2,560								

ILLUSTRATION 2

Prepare the ledger accounts on the basis of following transactions in the books of a trader. Debit Balances on January 1, 2022:

Cash in Hand ₹ 8,000, Cash at Bank ₹ 25,000, inventory of Goods ₹ 20,000, Building ₹ 10,000. Trade

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receivables: Vijay ₹ 2,000 and Madhu ₹ 2,000.

Credit Balances on January 1, 2022:

Trade payables: Anand ₹ 5,000 and Kapil ₹7,000, Capital ₹ 55,000

Following were further transactions in the month of January, 2022:

Jan. 1	Purchased goods worth ₹ 5,000 (payable at later date) for cash less 20% trade discount and 5% cash discount.
Jan. 4	Received ₹ 1,980 from Vijay and allowed him ₹ 20 as discount.
Jan. 8	Purchased plant from Mukesh for ₹5,000 and paid ₹100 as cartage for bringing the plant to the factory and another ₹200 as installat on charges.
Jan. 12	Sold goods to Rahim on credit ₹600.
Jan. 15	Rahim became insolvent and could pay only 50 paise in a rupee.
Jan. 18	Sold goods to Ram for cash ₹1,000.

Answer

Dr. Cash Account				Cr.			
Date 2022	Particulars	J.F.	₹	Date 2022	Particulars	J.F.	₹
Jan. 1	To Balance b/d		8,000	Jan. 1	By Purchases A/c		3,800
Jan. 4	To Vijay		1,980	Jan. 8	By Plant A/c		300
Jan. 15	To Rahim		300	Jan. 31	By Balance c/d		7,180
Jan. 18	To Sales A/c		1,000				
			11,280				11,280
Feb. 1	To Balance b/d		7,180				

Dr. Bank Account				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
Jan. 1	To Balance b/d		25,000	Jan. 31	By Balance c/d		25,000
			25,000				25,000
Feb. 1	To Balance b/d		25,000				

Dr. Inventory Account				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
Jan. 1	To Balance b/d		20,000	Jan. 31	By Balance c/d		20,000
			20,000				20,000
Feb. 1	To Balance b/d		20,000				

Dr. Building Account				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
Jan. 1	To Balance b/d		10,000	Jan. 31	By Balance c/d		10,000
			10,000				10,000
Feb. 1	To Balance b/d		10,000				

Dr. Vijay				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹

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Jan. 1	To Balance b/d		2,000	Jan. 4	By Cash A/c		1,980
					By Discount A/c		20
			2,000				2,000

Dr. Madhu				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
Jan. 1	To Balance b/d		2,000	Jan. 31	By Balance c/d		2,000
			2,000				2,000
Feb. 1	To Balance b/d		2,000				

Dr. Anand				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
Jan. 31	To Balance c/d		5,000	Jan. 1	By Balance b/d		5,000
			5,000				5,000
				Feb. 1	By Balance b/d		5,000

Dr. Kapil				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
Jan. 31	To Balance c/d		7,000	Jan. 1	By Balance b/d		7,000
			7,000				7,000
				Feb. 1	By Balance b/d		7,000

Dr. Capital Account				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
Jan. 31	To Balance c/d		55,000	Jan. 1	By Balance b/d		55,000
			55,000				55,000
				Feb. 1	By Balance b/d		55,000

Dr. Purchase Account				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
Jan. 1	To Cash		3,800	Jan. 31	By Balance c/d		4,000
Jan. 1	To Cash Discount		200				4,000
			4,000				
Feb. 1	To Balance b/d		4,000				

Dr.	Discount Account	Cr.

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Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
Jan. 4	To Vijay		20	Jan. 1	By Purchases A/c		200
Jan.31	To Balance c/d		180				
			200				200
				Feb. 1	By Balance b/d		180

Dr. Plant Account				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
Jan. 8	To Mukesh		5,000	Jan. 31	By Balance c/d		5,300
Jan. 8	To Cash A/c		300				
			5,300				5,300
Feb. 1	To Balance b/d		5,300				

Dr. Mukesh				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
Jan. 31	To Balance c/d		5,000	Jan. 8	By Plant A/c		5,000
			5,000				5,000
				Feb. 1	By Balance b/d		5,000

Dr. Sales Account				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
Jan. 31	To Balance c/d		1,600	Jan. 12	By Rahim		600
				Jan. 18	By Cash A/c		1,000
			1,600				1,600
				Feb. 1	By Balance b/d		1,600

Dr. Rahim				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
Jan. 12	To Sales A/c		600	Jan. 15	By Cash A/c		300
				Jan. 15	By Bad Debts A/c		300
			600				600

Dr. Bad Debts Account				Cr.			
Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
Jan. 15	To Rahim		300	Jan. 31	By Balance c/d		300
			300				300
Feb. 1	To Balance b/d		300				

ILLUSTRATION 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, 2022.

1	Mr. S owes Mr. R ₹ 15,000; Mr. H owes Mr. S ₹ 20,000.
4	Mr. R sold goods worth ₹ 60,000 @ 10% trade discount to Mr. S.
5	Mr. S sold to Mr. H goods prices at ₹ 30,000.

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17	Record a purchase of ₹ 25,000 net from R, which were sold to H at a profit of ₹15,000.
18	Mr. S rejected 10% of Mr. R's goods of 4th April.
19	Mr. S issued a cash memo for ₹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 ½% cash discount (of the payment received, ₹ 20,000 was by cheque).
26	R's total dues (less ₹10,000 held back) were cleared by cheque, enjoying a cash discount of ₹1,000 on the payment made.
29	Close H's Account to record the fact that all but ₹ 5,000 was cleared by him, by a cheque, because he was declared bankrupt.
30	Balance R's Account.

Answer

In the books of Mr. S

Dr.			Mr. H Account			Cr.		
Date	Particulars	₹	Date	Particulars	₹			
1.4.2022	To Balance b/d	20,000	22.4.2022	By Bank A/c	20,000			
5.4.2022	To Sales A/c	30,000	22.4.2022	By Cash A/c (Note 2)	24,775			
17.4.2022	To Sales A/c	40,000	29.4.2022	By Discount Allowed A/c	225			
			29.4.2022	By Bank A/c	40,000			
			29.4.2022	By Bad Debts A/c	5,000			
		90,000			90,000			

Dr.			Mr. R Account		Cr.
Date	Particulars	₹	Date	Particulars	₹
18.4.2022	To Purchase Returns A/c	5,400	1.4.2022	By Balance b/d	15,000
			4.4.2022	By Purchases A/c	54,000
26.4.2022	To Bank A/c	77,600	17.4.2022	By Purchases A/c	25,000
26.4.2022	To Discount Received A/c	1,000			
30.4.2022	To Balance c/d	10,000			
		94,000			94,000
			1.5.2022	By Balance b/d	10,000

Working Notes:

- (1) Sale of ₹ 10,000 on 19th April is a cash sales, therefore, it will not be recorded in the Personal Account of Mr. H; and
- (2) On 22nd April, Mr. H owes Mr. S ₹ 90,000, amount paid by Mr. H ½ of ₹ 90,000 less ½% discount i.e., ₹ 45,000 – ₹ 225 = ₹ 44,775. Out of this amount, ₹ 20,000 paid by cheque and the balance of ₹ 24,775 in cash.

Note: The balance of all nominal accounts is transferred to Profit and Loss account at the time of preparation of financial statements as the nominal Accounts are in the nature of revenue/incomes/gains or expenses/losses. Thus, the net result of all nominal accounts is reflected in profit and loss Account for an accounting period which is transferred to Capital Account. The balance of all the accounts relating to assets and liabilities (personal and real) are reflected in the Balance Sheet at the end of accounting period.

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True and False

Question 1

Preparing trial balance is the third phase of accounting process.

Answer 1

True: Preparing trial balance is the third phase of accounting process which forms the base for the preparation of the final accounts.

Question 2

Trial balance forms a base for the preparation of Financial statement.

Answer 2

True: Based on trial balance only, we can prepare financial statement.

Question 3

Agreement of trial balance is a conclusive proof of accuracy.

Answer 3

False: Agreement of trial balance gives only arithmetical accuracy, there can still be errors in preparing the trial balance.

Question 4

A trial balance will tally in case of compensating errors.

Answer 4

True: Since compensating errors cancel out due to their compensating nature of the amounts, hence the Trial balance tallies.

Question 5

A trial balance can find the missing entry from the journal.

Answer 5

False: A trial balance cannot find the missing entry from the journal.

Question 6

Suspense account opened in a trial balance is a permanent account.

Answer 6

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False: Suspense account opened in a trial balance is a temporary account

Question 7

The balance of purchase returns account has a credit balance.

Answer 7

True: As purchases is debited, any returns shall be credited (treated in opposite way).

Multiple Choice Questions

Question 1

A trial balance will not balance if _____

- (d) Correct journal entry is posted twice.
- (e) The purchase on credit basis is debited to purchases and credited to cash.
- (f) ₹ 500 cash payment to creditor is debited to Trade payables for ₹ 50 and credited to cash as ₹ 500.

Answer 1 : (c)

Question 2

₹ 1, 500 received from sub-tenant for rent and entered correctly in the cash book is posted to the debit of the rent account. In the trial balance _____

- (d) The debit total will be greater by ₹ 3,000 than the credit total.
- (e) The debit total will be greater by ₹ 1,500 than the credit total.
- (f) Subject to other entries being correct the total will agree.

Answer 2 : (a)

Question 3

After the preparation of ledgers, the next step is the preparation of _____

- (a) Trading accounts
- (b) Trial balance
- (c) Profit and loss account

Answer 3 : (b)

Question 4

After preparing the trial balance the accountant finds that the total of debit side is short by ₹ 1,500. This difference will be _____

- (a) Credited to suspense account
- (b) Debited to suspense account
- (c) Adjusted to any of the debit balance account

Answer 4 : (b)

Question 5

S.No.	Account heads	Debit (₹)	Credit (₹)
1.	Sales		15,000
2.	Purchases	10,000	
3.	Miscellaneous expenses	2,500	

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4.	Salaries		2,500
	Total	12,500	17,500

The difference in trial balance is due to _____

- (a) Wrong placing of sales account
- (b) Wrong placing of salaries account
- (c) Wrong placing of miscellaneous expenses account

Answer 5 : (b)

Theoretical Questions & Answers

Question 1

What is the trial balance? And how it is prepared?

Answer 1

Preparation of trial balance is the third phase in the accounting process. After posting the accounts in the ledger, a statement is prepared to show separately the debit and credit balances. Such a statement is known as the trial balance.

Trial balance contains various ledger balances on a particular date. It forms the basis for preparing the financial statements i.e. profit and loss account and balance sheet. If it tallies, it means that the accounts are arithmetically accurate but certain errors may still remain undetected. Therefore, it is very important to carefully journalise and post the entries, following are rules of accounting.

Question 2

Explain objectives of preparation of trial balance.

Answer 2

The preparation of trial balance has the following objectives:

- d. Trial balance enables one to establish whether the posting and other accounting processes have been carried out without committing arithmetical errors. In other words, the trial balance helps to establish arithmetical accuracy of the books of accounts.
- e. Financial statements are normally prepared on the basis of agreed trial balance.
- f. The trial balance serves as a summary of what is contained in the ledgers.

Question 3

Even if the trial balance agrees, some errors may remain. Do you agree? Explain.

Answer 3

In spite of the agreement of the trial balance some errors may remain. These may be of the following types:

- (i) Transaction has not been entered at all in the journal.
- (ii) A wrong amount has been written in both columns of the journal.
- (iii) A wrong account has been mentioned in the journal.
- (iv) An entry has not at all been posted in the ledger.
- (v) Entry is posted twice in the ledger.

Practical Questions & Answers

Question 1

An inexperienced bookkeeper has drawn up a Trial Balance for the year ended 30th June, 2022.

	Debit (₹)	Credit (₹)

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Provision for Doubtful Debts	200	–
Bank Overdraft	1,654	–
Capital	–	4,591
Trade payables	–	1,637
Trade receivables	2,983	–
Discount Received	252	–
Discount Allowed	–	733
Drawings	1,200	–
Office Furniture	2,155	–
General Expenses	–	829
Purchases	10,923	–
Returns Inward	–	330
Rent & Rates	314	–
Salaries	2,520	–
Sales	–	16,882
Inventory	2,418	–
Provision for Depreciation on Furniture	364	–
Total	24,983	25,002

Required:

Draw up a 'Corrected' Trial Balance, debiting or crediting any residual errors to a Suspense Account.

Answer 1

Trial Balance as on 30th June, 2022

Heads of Accounts	Debit ₹	Credit ₹
Provision for Doubtful Debts	–	200
Bank overdraft	–	1,654
Capital	–	4,591
Trade payables	–	1,637
Trade receivables	2,983	–
Discount Received	–	252
Discount allowed	733	–
Drawings	1,200	–
Office furniture	2,155	–
General Expenses	829	–
Purchases	10,923	–
Returns Inward	330	–
Rent & Rates	314	–
Salaries	2,520	–
Sales	–	16,882
Inventory	2,418	–
Provision for Depreciation on Furniture	–	364
Suspense Account (Balancing figure)	1,175	–
Total	25,580	25,580

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ILLUSTRATION 1

Given below is a ledger extract relating to the business of X and Co. as on March, 31, 2022. You are required to prepare the Trial Balance by the Total Amount Method.

Dr. **Cash Account**

Cr.

Particulars	₹	Particulars	₹
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
	35,500		35,500

Dr. **Furniture Account**

Cr.

Particulars	₹	Particulars	₹
To Cash A/c	3,000	By Balance c/d	3,000
	3,000		3,000

Dr. **Salaries Account**

Cr.

Particulars	₹	Particulars	₹
To Cash A/c	2,500	By Balance c/d	2,500
	2,500		2,500

Dr. **Shyam's Account**

Cr.

Particulars	₹	Particulars	₹
To Cash A/c	21,000	By Purchases A/c	25,000
To Purchase Returns A/c	500	(Credit Purchase)	
To Balance c/d	3,500		—
	25,000		25,000

Dr. **Purchases Account**

Cr.

Particulars	₹	Particulars	₹
To Cash A/c (Cash Purchases)	1,000	By Balance c/d	26,000
To Sundries as per Purchases Book (Credit Purchases)	25,000		—
	26,000		26,000

Dr. **Purchases Return Account**

Cr.

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Particulars	₹	Particulars	₹
To Balance c/d	500	By Sundries as per Purchases Return Book	500
	500		500

 Dr. **Ram's Account**

Cr.

Particulars	₹	Particulars	₹
To Sales A/c (Credit Sales)	30,000	By Sales Returns A/c	100
		By Cash A/c	25,000
		By Balance c/d	4,900
	30,000		30,000

 Dr. **Sales Account**

Cr.

Particulars	₹	Particulars	₹
To Balance c/d	30,500	By Cash A/c (Cash Sales)	500
		By Sundries as per Sales Book (Credit Sales)	30,000
	30,500		30,500

 Dr. **Sales Returns Account**

Cr.

Particulars	₹	Particulars	₹
To Sundries as per Sales Returns Book	100	By Balance c/d	100
	100		100

 Dr. **Capital Account**

Cr.

Particulars	₹	Particulars	₹
To Cash A/c To Balance c/d	500 9,500	By Cash A/c	10,000
	10,000		10,000

Answer

Trial Balance of X and Co. as at 31.03.2022

Sr. No.	Name of Account	Total Debit ₹	Total Credit ₹
1.	Cash A/c	35,500	28,000
2.	Furniture A/c	3,000	
3.	Salaries A/c	2,500	
4.	Shyam's A/c	21,500	25,000

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5.	Purchases A/c	26,000	
6.	Purchases Returns A/c		500
7.	Ram's A/c	30,000	25,100
8.	Sales A/c		30,500
9.	Sales Returns A/c	100	
10.	Capital A/c	500	10,000
		1,19,100	1,19,100

ILLUSTRATION 2

Taking the same information as given in Illustration 1, prepare the Trial Balance by Balance Method.

Answer

Trial Balance of X and Co. as at 31.03.2022

Sr. No.	Name of Account	Total Debit ₹	Total Credit ₹
1.	Cash A/c	7,500	
2.	Furniture A/c	3,000	
3.	Salaries A/c	2,500	
4.	Shyam's A/c		3,500
5.	Purchases A/c	26,000	
6.	Purchases Returns A/c		500
7.	Ram's A/c	4,900	
8.	Sales A/c		30,500
9.	Sales Returns A/c	100	
10.	Capital A/c		9,500
		44,000	44,000

ILLUSTRATION 3

From the following ledger balances, prepare a trial balance of Anuradha Traders as on 31st March, 2022:

Account Head	₹
Capital	1,00,000
Sales	1,66,000
Purchases	1,50,000
Sales return	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

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Insurance paid	2,500

Answer

Trial Balance of Anuradha Traders as on 31.03.2022

Particulars	Dr balance ₹	Particulars	Cr balance ₹
Purchases	1,50,000	Capital	1,00,000
Sales return	1,000	Sales	1,66,000
Discount allowed	2,000	Trade payables	25,000
Expenses	10,000	Interest received on investments	1,500
Trade receivables	75,000		
Investments	15,000		
Cash at bank and in hand	37,000		
Insurance paid	2,500		
Total	2,92,500		2,92,500

ILLUSTRATION 4

One of your clients, Mr. Singhania has asked you to finalise his accounts for the year ended 31st March, 2022. 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.

	Dr. Balance (₹)	Cr. Balance (₹)
Singhania's Capital		1,556
Singhania's Drawings	564	
Leasehold premises	750	
Sales		2,750
Dues from customers		530
Purchases	1,259	
Purchases return	264	
Loan from bank		256
Trade payables	528	
Trade expenses	700	
Cash at bank	226	
Bills payable	100	
Salaries and wages	600	
Inventories (1.4.2021)		264
Rent and rates	463	
Sales return		98
	5,454	5,454

The closing inventory on 31st March, 2022 was valued at ₹ 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.

Answer

Corrected Trial Balance of Mr. Singhania as on 31st March, 2022

Particulars	Dr. Balance (₹)	Cr. Balance (₹)

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Singhanian's Capital		1,556
Singhanian's Drawings	564	
Leasehold premises	750	
Sales		2,750
Dues from customers (refer note 1 below)	530	
Purchases	1,259	
Purchases returns (refer note 2 below)		264
Loan from Bank		256
Trade payables (refer note 3 below)		528
Trade expenses	700	
Cash at Bank	226	
Bills payable (refer note 4 below)		100
Salaries and Wages	600	
Inventory (1.4.2021) (refer note 5 below)	264	
Rent and rates	463	
Sales return (refer note 6 below)	98	
	5,454	5,454

Notes:

1. Dues from customers is an asset, so its balance will be a debit balance.
2. Purchases return account always shows a credit balance because assets go out.
3. Balance in Trade payables is a liability, so its balance will be a credit balance.
4. Bills payable is a liability, so its balance will be a credit balance.
5. Inventory (opening) represents assets, so it will have a debit balance.
6. Sales return account always shows a debit balance because assets come.

ILLUSTRATION 5

The following trail balance as on 31st March, 2022 was drawn from the books of fintech traders:

	L.F.	Dr. Balance (₹)	Cr. Balance (₹)
Building		60,000	-
Machinery		17,000	-
Return Outward		2,600	-
Bad Debts		2,800	-
Cash		400	-
Discount Received		3,000	-
Bank Overdraft		10,000	-
Creditors		50,000	-
Purchases		1,00,000	-
Capital		-	73,600
Fixtures		-	5,600
Sales		-	1,04,000
Debtors		--	60,000
Interest Received		-	2,600
Input CGST A/c		-	3,000
Input SGST A/c		-	3,000

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Input IGST A/c		-	4,800
Output CGST A/c		5,400	-
Output SGST A/c		5,400	-
Total		2,56,600	2,56,600

Even though the debit and credit sides agree, the trial Balance contains certain errors. Check the accuracy of trial balance.

Answer

Corrected Trial Balance of Fintech traders as on 31st March, 2022

	L.F.	Dr. Balance (₹)	Cr. Balance (₹)
Building		60,000	-
Machinery		17,000	-
Return Outward		-	2,600
Bad Debts		2,800	-
Cash		400	-
Discount Received		-	3,000
Bank Overdraft		-	10,000
Creditors		-	50,000
Purchases		1,00,000	-
Capital		-	73,600
Fixtures		5,600	-
Sales		-	1,04,000
Debtors		60,000	-
Interest Received		-	2,600
Input CGST A/c		3,000	-
Input SGST A/c		3,000	-
Input IGST A/c		4,800	-
Output CGST A/c		-	5,400
Output SGST A/c		-	5,400
		2,56,600	2,56,600

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True and False

Question 1

Transactions recorded in the purchase book include only purchases of goods on credit transactions.

Answer 1

True: Since cash purchases are taken to the cash book, it is only credit transactions that are recorded in the purchases book.

Question 2

Transactions regarding the purchase of fixed asset are recorded in the purchase book.

Answer 2

False: Transactions regarding the purchase of fixed asset are not recorded in the purchase book, only the credit purchases of goods are recorded in it.

Question 3

Cash sales are recorded in the sales book.

Answer 3

False: Credit sales are recorded in the sales book.

Question 4

Subsidiary books are also known as the books of original entry.

Answer 4

True: Subsidiary books are maintained as an alternate to the journal.

Question 5

Bills receivable book is a subsidiary book.

Answer 5

True: Bills receivable is one of the subsidiary book.

Question 6

Return inward book is also known as purchase return book.

Answer 6

False: Return inward book is also known as sales return book.

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Question 7

Purchase of a second hand machinery will be recorded in purchase book.

Answer 7

False: Purchase of a second hand machinery will not be recorded in purchase book.

Question 8

Total of sales return book may be posted to the debit side of sales account.

Answer 8

True: Since sales return is reduction from the total sales value, it is debited in the sales account.

Question 9

If the sales are on a frequent basis, the transactions are recorded in the sales book.

Answer 9

True: When there are numerous transactions then there are subsidiary books like the sales book where there are recorded instead of regular journal entries.

Multiple Choice Questions

1. In Purchases Book, the record is in respect of _____
- (g) Cash purchase of goods.
 - (h) Credit purchase of goods dealt in.
 - (i) All purchases of goods.

Answer 1 : (b)

2. The Sales Returns Book records _____
- (a) The return of goods purchased.
 - (b) Return of anything purchased.
 - (c) Return of goods sold.

Answer 2 : (c)

3. The Sales Book _____
- (a) Is a part of journal.
 - (b) Is a part of the ledger.
 - (c) Is a part of the balance sheet.

Answer 3 : (a)

4. The weekly or monthly total of the Purchase Book is _____
- (a) Posted to the debit of the Purchases Account.
 - (b) Posted to the debit of the Sales Account.
 - (c) Posted to the credit of the Purchases Account.

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Answer 4 : (a)

5. The total of the Sales Book is posted to _____
- Credit of the Sales Account.
 - Credit of the Purchases Account.
 - Credit of the Capital Account.

Answer 5 : (a)

6. In which book of original entry, will you record an allowance of ₹50 which was offered for an early payment of cash of ₹1,050 _____.
- Sales Book
 - Cash Book
 - Journal Proper (General Journal)

Answer 6 : (b)

7. A second hand motor car was purchased on credit from B Brothers for ₹10,000 will be recorded in _____.
- Journal Proper (General Journal)
 - Sales Book
 - Cash Book
 - Purchase Book

Answer 7 : (a)

8. In which book of original entry, will you record a bills receivable of ₹1,000, which was received from a debtor in full settlement for a claim of ₹1,100, is dishonoured _____.
- Purchases Return Book
 - Bills Receivable Book
 - Journal Proper (General Journal)

Answer 8 : (c)

Theoretical Questions & Answers

Question 1

Which subsidiary books are normally used in a business?

Answer 1

Refer para 4.1 of this unit for subsidiary books normally maintained in a business.

Question 2

What are the advantages of subsidiary books?

Answer 2

For advantages of Subsidiary Books, refer para 4.1 of this unit.

Practical Questions & Answers

Question 1

- (i) Enter the following transactions in Sales Book of M/s. Pranat Engineers Ltd., Delhi. 2022

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Jan.2	Sold to M/s. Ajanta Electricals, Delhi 5 pieces of Ovens @ ₹6,000/- each less Trade discount @ 10%.
8	Sold to M/s. Electronics Plaza, 10 pieces of Tablets @ ₹ 8,000/- each less trade discount 5%.
15	Sold to M/s. Haryana Traders, 5 pieces of Juicers @ ₹3,500/- each less trade discount @ 10%.

(ii) Post into the ledger , the entries of Sales Book Prepared in question 1.

Answer 1

(i) Sales Book

Date	Particulars	Gross Amount (₹)	Trade Discount (₹)	Net Price (₹)
2022 Jan. 2	M/s. Ajanta Electricals 5 pieces of Ovens @ ₹ 6,000 each Less: 10% discount	30,000	3,000	27,000
8	M/s. Electronics Plaza 10 pieces of Tablets @ ₹ 8,000 each, less 5% trade discount	80,000	4,000	76,000
15	M/s. Haryana Traders 5 pieces of Juicers @ ₹ 3,500 each, less 10% trade discount	17,500	1,750	15,750
		1,27,500	8,750	1,18,750

(ii) Ledger

M/s. Ajanta Electricals

Date 2022	Particulars	L.F.	Amount (₹)	Date 2022	Particulars	L.F.	Amount (₹)
Jan. 2	To Sales A/c (From Sales Book)		27,000				

M/s. Electronics Plaza

Date 2022	Particulars	L.F.	Amount (₹)	Date 2022	Particulars	L.F.	Amount (₹)
Jan. 8	To Sales A/c (From Sales Book)		76,000				

M/s. Haryana Traders

Date 2022	Particulars	L.F.	Amount (₹)	Date 2022	Particulars	L.F.	Amount (₹)
Jan. 15	To Sales A/c (From Sales Book)		15,750				

Sales Account

Date 2022	Particulars	L.F.	Amount (₹)	Date	Particulars	L.F.	Amount (₹)

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				2022			
				Jan. 31	By Sundries (As per Sales Book)		1,18,750

ILLUSTRATION 1

The Rough Book of M/s. Narain & Co. contains the following :

2022 Feb.

Feb 1	Purchased from Brown & Co. on credit : 5 gross pencils @ ₹100 per gross, 1 gross register @ ₹ 240 per doz. Less : Trade Discount @ 10%
2	Purchased for cash from the Stat onery Mart; 10 gross exercise books @ ₹ 300 per doz.
3	Purchased computer for of ce use from M/s. of ce Goods Co. on credit for ₹ 30,000.
4	Purchased on credit from The Paper Co. 5 reams of white paper @ ₹100 per ream. 10 reams of ruled paper @ ₹150 per ream. Less : Trade Discount @ 10%
5	Purchased one dozen gel pens @ ₹15 each from M/s. Verma Bros. on credit.

Make out the Purchase Book of M/s. Narain & Co.

Answer

Purchases Book

Date	Part culars	Details	Amount
2022		₹	₹
Feb. 1	M/s. Brown & Co.		
	5 gross pencils @ ₹ 100 per gross	500.00	
	1 gross register @ ₹ 240 per doz.	<u>2880.00</u>	
		3380.00	
	Less : 10% trade discount	<u>(338)</u>	3,042
"4	The Paper Co.		
	5 reams white paper @ ₹ 100 per ream	500.00	
	10 reams ruled paper @ ₹ 150 per ream	<u>1500.00</u>	
		2,000.00	
	Less : 10% trade discount	<u>(200.00)</u>	1,800
5	M/s. Verma Bros.		
	1 doz. gel pens @ ₹ 15 each	180	<u>180</u>
		Total	5022

Note : Purchases of cash and purchase of computer are not recorded in the Purchase Book.

ILLUSTRATION 2

Enter the following transactions in Purchase Book and post them into ledger.

2022

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April 4	Purchased from Ajay Enterprises, Delhi 100 Doz. Rexona Hawai Chappal @ ₹ 120 per doz. 200 Doz. Palki Leather Chappal @ ₹ 300 per Doz. Less : Trade discount @ 10% Freight charged ₹ 150.
April 15	Purchased from Balaji Traders, Delhi 50 doz. Max Shoes @ ₹ 400 per doz. 100 pair Sports Shoes @ ₹ 140 per pair. Less : Trade discount @ 10%. Freight charged ₹ 200.
April 28	Purchased from Tript Industries, Bahadurgarh 40 pair leather shoes @ ₹ 400 per pair 100 doz. Rosy Hawai Chappal @ ₹ 180 per doz. Less : Trade discount @ 10%. Freight charged ₹ 100.

Answer

Purchase Book

Date 2022	Part culars	Details	Gross Amount	Trade Discount	Net Price	Freight	Total Amount
April 4	Ajay Enterprises						
	100 doz Rexona Hawai chappal @ ₹ 120 per doz - ₹ 12,000	12,000					
	200 doz Palki Leather Chappal @ ₹ 300 per doz - ₹ 60,000	60,000					
	Less: trade discount @ 10%		72,000	7,200	64,800	150	64,950
April 15	Balaji Traders, Delhi						
	50 doz max Shoes @ ₹ 400 per doz - ₹ 20,000	20,000					
	100 pair Sports shoes @ ₹ 140 per pair - ₹ 14,000	14,000					
	Less: Trade discount @ 10%		34,000	3,400	30,600	200	30,800
April 28	Tript Industries, Bahadurgarh						
	40 pair Leather shoes @ ₹ 400 per pair - ₹ 16,000	16,000					
	100 doz Rosy Hawai Chappal: @ ₹ 180 per doz - ₹ 18,000	18,000					
	Less: Trade discount @ 10%		34,000	3,400	30,600	100	30,700

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			1,40,000	14,000	1,26,000	450	1,26,450

Ledgers

Dr. **Purchase Account**
Cr.

2022		₹	2022		₹
April 30	To amount as per purchase book	1,26,000			

Dr. **Freight Account** Cr.

2022		₹	2022		₹
April 30	To amount as per purchase book	450			

Dr. **Ajay Enterprise** Cr.

2022		₹	2022		₹
			April 4	By Purchase A/c	64,800
				(From Purchase Book)	
				By Freight A/c	150
				(From Purchase Book)	

Dr. **Balaji Traders** Cr.

2022		₹	2022		₹
			April 15	By Purchase A/c	30,600
				(From Purchase Book)	
				By Freight A/c	200
				(From Purchase Book)	

Dr. **Tripat Capital** Cr.

2022		₹	2022		₹
			April 28	By Purchase A/c	30,600
				(From Purchase Book)	
				By Freight A/c	100
				(From Purchase Book)	

ILLUSTRATION 3

The following are some of the transaction of M/s Kishore & Sons of the year 2022 as per their Waste Book. Make out their Sales Book.

Sold to M/s. Gupta & Verma on credit:

30 shirts @ ₹ 800 per shirt.

20 trousers @ ₹1,000 per trouser.

Less : Trade Discount @ 10%

Sold furniture to M/s. Sehgal & Co. on credit ₹8,000.

Sold 50 shirts to M/s. Jain & Sons @ ₹800 per shirt.

Sold 13 shirts to Cheap Stores @ ₹750 each for cash.

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Sold on credit to M/s. Mathur & Jain.
 100 shirts @ ₹750 per shirt
 10 overcoats @ ₹5,000 per overcoat.
 Less: Trade Discount @ 10%

Answer

Sales Book

Date	Particulars	Details ₹	Amount ₹
2022	M/s. Gupta & Verma		
	30 shirts @ ₹800	24,000	
	20 Trousers @ ₹1,000	20,000	
		44,000	
	Less : 10%	(4,400)	
	Sales as per invoice no. dated		39,600
	M/s. Jain & Sons 50 shirts @ ₹800		
	Sale as per invoice no. dated		40,000
	M/s Mathur & Jain		
	100 shirts @ ₹750	75,000	
	10 overcoats @ ₹5,000	50,000	
		1,25,000	
	Less : 10%	(12,500)	
	Sales as per invoice no. dated.....		1,12,500
		Total	1,92,100

Note : Cash sale and sale of furniture are not entered in Sales Book.

ILLUSTRATION 4

Post the following into the ledger

Returns Outward Book

Date 2022	Particulars	Details ₹	Amount ₹
Nov. 20	Rajindra Prakash & Sons One 36" Usha Ceiling Fan	200.00	
	Less : Trade Discount @ 10%	(20.00)	180.00
" 30	Modern Electric Company		100.00
	Total		280.00

Answer

Ledger

Dr. Rajindra Parkash & Sons				Cr.			
Date 2022	Particulars	Folio	Amount	Date	Particulars	Folio	Amount
Nov. 20	To Returns Outward A/c (From Returns Outward Book)		180.00				

Dr. Modern Electric Co. Cr.

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Date 2022	Particulars	Folio	Amount	Date	Particulars	Folio	Amount
Nov . 30	To Returns Outward A/c (From Returns Outward Book)		100.00				

Dr.				Returns Outward Account				Cr.	
Date 2022	Particulars	Folio	Amount	Date	Particulars	Folio	Amount		
				Nov. 30	By Sundries as per Returns Outward Book		280.00		

ILLUSTRATION 5

From the following transactions, prepare the Purchases Returns Book of Alpha & Co., a saree dealer :

Date	Debit Note No.	Particulars
04.01.2022	101	Returned to Goyal Mills, Surat - 5 polyester sarees @ ₹ 1,000.
09.01.2022		Garg Mills, Kota - accepted the return of goods (which were purchased for cash) from us - 5 Kota sarees @ ₹ 400.
16.01.2022	102	Returned to Mittal Mills, Bangalore - 5 silk sarees @ ₹ 2,600.
30.01.2022		Returned one computer (being defective) @ ₹ 35,000 to B & Co.

Answer

Purchase Returns Book				
Date 2022	Debit Note No.	Name of supplier	L.F.	Amount
Jan. 4	101	Goyal Mills, Surat		5,000
Jan. 16	102	Mittal Mills, Bangalore		13,000
Jan. 31		Purchases Returns Account (Cr.)		18,000

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True and False

Question 1

Cash book is a subsidiary book as well as a principal book.

Answer 1

True: Since the balance is directly taken to the Trial balance from cash book. Hence, it is a subsidiary book as well as principal book.

Question 2

Two column cash book consists of two columns cash column & bank column.

Answer 2

False: Two column cash book consists of two columns either cash column & discount column or cash column & bank column.

Question 3

Discount column of cash book is never balanced.

Answer 3

True: Discount column is totalled and transferred to the discount allowed or received account.

Question 4

Contra entry is passed in a two column cash book.

Answer 4

True: Contra entry can be passed in a two column cash book which includes bank and cash columns.

Question 5

If the bank column is showing the opening balance on credit side, it is an overdraft.

Answer 5

True: The debit side of opening balance shows a favourable balance, whereas the credit balance is an unfavourable balance and treated as overdraft.

Question 6

A cash book records cash transactions as well as credit transactions.

Answer 6

False: A cash book records only cash transactions.

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Question 7

Discount column of cash book records the trade discount.

Answer 7

False: Discount column of cash book records the cash discount. Trade discount is not shown in the books of accounts.

Multiple Choice Questions

1. The total of discounts column on the debit side of the cash book, recording cash discount deducted by customers when paying their accounts, is posted to the _____.
- (d) Credit of the discount allowed account.
 - (e) Debit of the discount allowed account
 - (f) Credit of the discount received account.

Answer 1 : (b)

2. Cash book is a type of _____ but treated as a _____ of accounts.
- (a) Subsidiary book, principal book
 - (b) Principal book, subsidiary book
 - (c) Subsidiary book, subsidiary book

Answer 2 : (a)

3. Which of the following is not a column of a three-column cash book?
- (a) Cash column
 - (b) Bank column
 - (c) Petty cash column

Answer 3 : (c)

4. Contra entries are passed only when _____
- (a) Double-column cash book is prepared
 - (b) Three-column cash book is prepared
 - (c) Simple cash book is prepared

Answer 4 : (b)

5. The Cash Book records _____
- (a) All cash receipts
 - (b) All cash payments
 - (c) All cash receipts and payments

Answer 5 : (c)

6. The balance in the petty cash book is _____
- (a) An expense
 - (b) A profit
 - (c) An asset

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Answer 6 : (c)

7. If Ram has sold goods for cash, the entry will be recorded _____

- (a) In the Cash Book
- (b) In the Sales Book
- (c) In the Journal

Answer 7 : (a)

Theoretical Questions & Answers

Question 1

Is cash book a subsidiary book or a principal book? Explain.

Answer 1

Cash transactions are straightaway recorded in the Cash Book and on the basis of such a record, ledger accounts are prepared. Therefore, the Cash Book is a subsidiary book. But the Cash Book itself serves as the cash account and the bank account, if bank column is also included; the balances are entered in the trial balance directly. The Cash Book, therefore, is part of the ledger also. Hence, it is also treated as the principal book. The Cash Book is thus both a subsidiary book and a principal book.

Question 2

What are the various kinds of cash book?

Answer 2

The main Cash Book may be of the three types:

- (i) Simple Cash Book;
- (ii) Two-column Cash Book;
- (iii) Three-column Cash Book.

In addition to the main Cash Book, firms also generally maintain a petty cash book but that is purely a subsidiary book.

Question 3

What are the advantages of a three column cash book?

Answer 3

The advantages of three column Cash Book are that -

- (a) the Cash Account and the Bank Account are prepared simultaneously, therefore the double entry is completed in the Cash Book itself. Thus the contra entries can be easily cross-checked in Cash column in one side and the Bank column in the other side of the Cash Book. The chances of error are also reduced.
- (b) the information regarding Cash in Hand and the Bank Balance can be obtained very easily and quickly as there is no need to prepare Ledger of the Cash and Bank Account.

Practical Questions & Answers

Question 1

Shri Ramaswamy maintains a Columnar Petty Cash Book on the Imprest System. The imprest amount is ₹ 500. From the following information, show how his Petty Cash Book would appear for the week ended 12th September, 2022:

7-9-2022	Balance in hand	134.90

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	Received Cash reimbursement to make up the imprest	365.10
	Stat onery	49.80
8-9-2022	Miscellaneous Expenses	20.90
9-9-2022	Repairs	156.70
10-9-2022	Travelling	68.50
11-9-2022	Stat onery	71.40
12-9-2022	Miscellaneous Expenses	6.30
13-9-2022	Repairs	48.30

Answer

Petty Cash Book

Date 2022	Receipts	Amount ₹	Date 2022	Payments	Total Amount ₹	Stat onery ₹	Travelling ₹	Misc Exps. ₹	Repairs ₹
Sept. 7	To Balance b/d	134.90	7	By Stat onery	49.80	49.80			
	To Reimbursement	365.10	8	By Misc. Expenses	20.90			20.90	
			9	By Repairs	156.70				156.70
			10	By Travelling	68.50		68.50		
			11	By Stat onery	71.40	71.40			
			12	By Misc. Expenses	6.30			6.30	48.30
			13	By Repairs	48.30				
					421.90	121.20	68.50	27.20	205.00
				By Balance c/d	78.10				
		500.00			500.00				
	To Balance b/d	78.10							

ILLUSTRATION 1

Enter the following transactions in a Simple Cash Book:

2022		₹
Jan.1	Cash in hand	1,200
"5	Received from Ram	300
"7	Paid Rent	30
"8	Sold goods for cash	300
"10	Paid to Shyam	700
"27	Purchased Furniture	200
"31	Paid Salaries	100
"31	Rent due, not yet paid, for January	30

Answer

Dr.		Cash Book				Cr.	
Date 2022	Receipts	L.F.	Amount ₹	Date 2022	Payments	L.F.	Amount ₹

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Jan. 1	To Balance b/d		1,200	Jan. 07	By Rent A/c		30
" 5	To Ram A/c		300	" 10	By Shyam A/c		700
" 8	To Sales A/c		300	" 27	By Furniture A/c		200
				" 31	By Salaries A/c		100
				" 31	By Balance c/d		770
			1,800				1,800
2022							
Feb. 1	To Balance b/d		770				

Note :

- In the simple cash book only the cash receipts and cash payments are recorded.
- The total of debit side is always greater than the total of credit side since the payment cannot exceed the available cash.
- The simple cash book is like an ordinary account.
- Rent due not yet paid for January has not been recorded in the cash book because no cash has been paid, hence it will be recorded through normal Journal entry.

ILLUSTRATION 2

Ganesh commenced business on 1st April, 2022 with ₹ 2,000 as capital. He had the following cash transactions in the month of April 2022:

		₹			₹
April 1	Purchased furniture and paid cash	250	April 7	Paid for petty expenses	15
" 2	Purchased goods	500	" 8	Cash purchases	150
" 4	Sold goods for cash	950			
			13	Paid for labour	1,000
" 5	Paid cash to Ram Mohan	560			
" 6	He allowed discount	10	" "	Paid Ali & Sons	400
" 6	Received cash from Krishna & Co.	600	" "	They allowed discount	8
	Allowed discount	20			

Make out the two-column Cash Book (Cash and discount column) for the month of April, 2022.

Answer

Cash Book

Dr. Date 2022	Receipts	L.F.	Discount ₹	Amount ₹	Date 2022	Payments	L.F.	Discount ₹	Cr. Amount ₹
April 1	To Capital A/c			2,000	April 1	By Furniture A/c			250
" 4	To Sales A/c			950	" 2	By Purchases A/c			500
" 6	To Krishna A/c		20	600					
					" 5	By Ram Mohan		10	560
					" 7	By Petty Expenses A/c			15

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					" 8	By Purchases A/c			150
					" 13	By wages A/c			1,000
					" 13	By Ali & Sons		8	3,550
					" 30	By Balance c/d			675
			20	3,550				18	3,550
May 1	To Balance b/d			675					

To summarise:

- (i) the discount columns in the cash book are totalled;
- (ii) they are not balanced; and
- (iii) their totals are entered in the discount received/paid account in the ledger.

Note: The person who pays, is credited by both the cash paid by him and the discount allowed to him. Similarly, the person to whom payment is made, is debited with both the amount paid and the discount allowed by him.

ILLUSTRATION 3

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

2022		₹
Jan.1	Chandrika commences business with Cash	20,000
" 3	He paid into Current A/c	19,000
" 4	He received cheque from Kirti & Co. on account	600
" 7	He pays in bank Kirti & Co.'s cheque	600
" 10	He pays Rattan & Co. by cheque and is allowed discount ₹ 20	330
" 12	Tripathi & Co. pays into his Bank A/c	475
" 15	He receives cheque from Warshi and allows him discount ₹ 35	450
" 20	He receives cash ₹ 75 and cheque ₹ 100 for cash sale	
" 25	He pays into Bank, including cheques received on 15th and 20th	1,000
" 27	He pays for cash purchase	275
" 30	He pays sundry expenses in cash	50

Answer

Dr.

Cash Book

Cr.

Date	Receipts	L.F.	Discount ₹	Cash ₹	Bank ₹	Date	Payments	L.F.	Discount ₹	Cash ₹	Bank ₹
2022						2022					
Jan. 1	To Capital A/c			20,000		Jan. 3	By Bank A/c	C		19,000	
3	To Cash	C			19,000	7	By Bank A/c	C		600	
4	To Kirti & Co.			600		10	By Ratan & Co.		20		330
7	To Cash	C			600	25	By Bank A/c	C		1,000	
12	To Tripathi & Co.				475	27	By Purchases A/c			275	
15	To Warshi		35	450		30	By S. Exp. A/c			50	

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20	To Sales A/c			175							
25	To Cash	C			1,000						
						31	By Balance c/d			300	20,745
			35	21,225	21,075				20	21,225	21,075
Feb. 1	To Balance b/d			300	20,745						

ILLUSTRATION 4

Prepare a Petty Cash Book on the imprest System from the following:

2022			₹
Jan.	1	Received ₹100 for petty cash	
"	2	Paid bus fare	.50
"	2	Paid cartage	2.50
"	3	Paid for Postage	5.00
"	3	Paid wages for casual labourers	6.00
"	4	Paid for stationery	4.00
"	4	Paid Bus charges	2.00
"	5	Paid for the repairs to chairs	15.00
"	5	Bus fare	1.00
"	5	Cartage	4.00
"	6	Postage	7.00
"	6	Bus charges	3.00
"	6	Cartage	3.00
"	6	Stationery	2.00
"	6	Refreshments to customers	5.00

Answer

Petty Cash Book

Receipts ₹	Date 2022	V. No.*	Particulars	Total ₹	Conveyn ce ₹	Cartage ₹	Stationery ₹	Postage ₹	Wages ₹	Sundries ₹
100	Jan. 1		To Cash							
	2	1	By Conveyance	.50	.50					
		2	By Cartage	2.50		2.50				
	3	3	By Postage	5.00				5.00		
		4	By Wages	6.00					6.00	
	4	5	By Stationery	4.00			4.00			
		6	By Conveyance	2.00	2.00					
	5	7	By Repairs to Furniture	15.00						15.00
		8	By Conveyance	1.00	1.00					
		9	By Cartage	4.00		4.00				

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	6	10	By Postage	7.00				7.00		
	"	11	By Conveyance	3.00	3.00					
	"	12	By Cartage	3.00		3.00				
	"	13	By Stationery	2.00			2.00			
	"	14	By General Expenses	5.00						5.00
				60.00	6.50	9.50	6.00	12.00	6.00	20.00
			By Balance c/d	40.00						
100				100.00						
40.00			To Balance b/d							
60.00	8		To Cash							

ILLUSTRATION 5

Enter the following transaction in Cash Book with Discount and Bank columns. Cheques are first treated as cash receipts –

2022		₹
March 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	
9	Deposit into Bank	6,800
10	Received cheque from Aviral and deposited the same into Bank by allowing discount of ₹ 50	3,600
12	Adit informed that Srijan's cheque is dishonoured. Now cash is received from Srijan and amount is paid to Adit through own cheque	
15	Sales through Debit Card	3,200
24	Withdrawn from Bank	1,800
28	Paid to Sanchit by cheque	3,000
30	Bank charged 1% commission on sales through Debit/Credit Cards	

Answer

Dr.

Cash Book

Cr.

Date	Particulars	L.F.	Discount ₹	Cash ₹	Bank ₹	Date	Particulars	L.F.	Discount ₹	Cash ₹	Bank ₹
2022						2022					
March 1	To Balance b/d			15,000		March 1	By Balance b/d				500
2	To Sales			3,000		3	By Sushil		100		3,400

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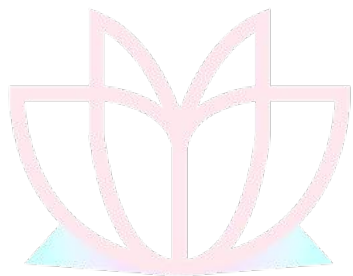
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							Bros.				
5	To Sales				2,800	7	By Adit			6,200	
6	To Srijan			6,200		9	By Bank	C		6,800	
9	To Cash A/c	C			6,800	12	By Adit				6,200
10	To Aviral		50		3,600	24	By Cash A/c	C			1,800
12	To Srijan			6,200		28	By Sanchit				3,000
15	To Sales A/c				3,200	30	By Commission				60
24	To Bank A/c	C		1,800		31	By Balance c/d			19,200	1,440
			50	32,200	16,400				100	32,200	16,400

Note: If the received cheque is endorsed to the other party on the same day, then no entry is required. However, in the above case posting has been done through cash column as the endorsement is done on next day.



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Chapter 2.6

Rectification of Errors

96

True and False

Question 1

The method of rectification of errors depends on the stage at which the errors are detected.

Answer 1

True: There are 3 different stages when the mistakes are identified and then the rectification depends on the stage of identification of errors.

Question 2

In case of error of complete omission, the trial balance does not tally.

Answer 2

False: In case of error of complete omission, the trial balance tallies.

Question 3

When errors are detected after preparation of trial balance, suspense account is opened.

Answer 3

True: In order to balance the difference of balances in the trial balance suspense account is opened.

Question 4

When purchase of an asset is treated as an expense, it is known as error of principle.

Answer 4

True: Where the accounts being debited is principally incorrect it is termed as error of principle.

Question 5

Trial balance agrees in case of compensating errors.

Answer 5

True: Compensating errors cancel out each other when Trial balance is prepared as the mistake pertains to the same amount being credited and later debited on account of two different mistakes.

Question 6

When amount is written on wrong side, it is known as an error of principle.

Answer 6

False: When amount is written on wrong side, it is known as an error of commission.

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Question 7

On purchase of old furniture, the amount spent on repairs should be debited to repairs account.

Answer 7

False: On purchase of furniture, the amount spent on repairs should be debited to furniture account as it is a capital expense.

Question 8

'Profit & Loss adjustment account' is opened to rectify the errors detected in the current accounting period.

Answer 8

False: 'Profit & Loss adjustment account' is opened to rectify the errors detected in the next accounting period.

Question 9

Rent paid to landlord of the proprietors house, must be debited to 'Rent account'.

Answer 9

False: Rent paid to land lord of the proprietors house, must be debited to 'Drawings account'.

Question 10

If the errors are detected after preparing trial balance, then all the errors are rectified through suspense account.

Answer 10

False: If the errors are detected after preparing trial balance, then all the errors are not rectified through suspense account. There may be principal errors, which can be rectified without opening a suspense account.

Multiple Choice Questions

1. Goods purchased from A for ₹10,000 passed through the sales book. The error will result in
 - (d) Increase in gross profit.
 - (e) Decrease in gross profit.
 - (f) No effect on gross profit.

Answer 1 : (a)

2. If a purchase return of ₹1,000 has been wrongly posted to the debit of the sales returns account, but has been correctly entered in the suppliers' account, the total of the
 - (a) Trial balance would show the debit side to be ₹1,000 more than the credit.
 - (b) Trial balance would show the credit side to be ₹ 1,000 more than the debit.
 - (c) The debit side of the trial balance will be ₹ 2,000 more than the credit side.

Answer 2 : (c)

3. If the amount is posted in the wrong account or it is written on the wrong side of the account, it is called
 - (a) Error of omission.

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- (b) Error of commission.
- (c) Error of principle.

Answer 3 : (b)

4. ₹ 200 paid as wages for erecting a machine should be debited to
- (a) Repair account.
 - (b) Machine account.
 - (c) Capital account.

Answer 4 : (b)

5. On purchase of old furniture, the amount of ₹1,000 spent on its repair should be debited to
- (a) Repair account.
 - (b) Furniture account.
 - (c) Cash account.

Answer 5 : (b)

6. Goods worth ₹50 given as charity should be credited to
- (a) Charity account.
 - (b) Sales account.
 - (c) Purchase account.

Answer 6 : (c)

7. Goods worth ₹100 taken by proprietor for domestic use should be credited to
- (a) Sales account.
 - (b) Proprietor's personal expenses.
 - (c) Purchases account.

Answer 7 : (c)

8. Sales of office furniture should be credited to
- (a) Sales Account.
 - (b) Furniture Account.
 - (c) Purchase Account.

Answer 8 : (b)

9. The preparation of a trial balance is for:
- (a) Locating errors of commission.
 - (b) Locating errors of principle.
 - (c) Locating clerical errors.

Answer 9 : (c)

10. ₹ 200 received from Smith whose account, was written off as a bad debt should be credited to:
- (a) Bad Debts Recovered account.
 - (b) Smith's account.
 - (c) Cash account.

Answer 10 : (a)

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11. Purchase of office furniture ₹1,200 has been debited to General Expense Account. It is:
- A clerical error.
 - An error of principle.
 - An error of omission.

Answer 11 : (b)

Theoretical Questions & Answers

Question 1

How does errors of omission differ from errors of commission?

Answer 1

- Errors of Omission:** If a transaction is completely or partially omitted from the books of account, it will be a case of omission. Examples would be: not recording a credit purchase of furniture or not posting an entry into the ledger.
- Errors of Commission:** If an amount is posted in the wrong account or it is written on the wrong side or the totals are wrong or a wrong balance is struck, it will be a case of "errors of commission."

Question 2

What is error of principle and how does it affect Trial Balance?

Answer 2

Errors of principle: When a transaction is recorded in contravention of accounting principles, like treating the purchase of an asset as an expense, it is an error of principle. In this case there is no effect on the trial balance since the amounts are placed on the correct side, though in a wrong account. Suppose on the purchase of a typewriter, the office expenses account is debited; the trial balance will still agree.

The method of correction of error indicated so far is appropriate when the errors have been located before the end of the accounting period. After the corrections, the trial balance will agree. Sometimes the trial balance is artificially made to agree in spite of errors by **opening a suspense account** and putting the difference in the trial balance to the account - the suspense account will be debited if the total of the credit column in the trial balance exceeds the total of the debit column; it will be credited in the other case. Each and every error detected after preparation of trial balance can only be corrected by a complete journal entry. Those errors for which journal entries were not possible at the earlier stage will now be rectified by a journal entry(s), the difference or the unknown side is being taken care of by suspense account. Those errors for which entries were possible even at the first stage will now be rectified in the same way.

Practical Questions & Answers

Question 1

The trial balance of Mr. W & H failed to agree and the difference ₹20,570 was put into suspense account pending the investigation which disclosed that:

- Purchase returns day book had been correctly entered and totalled at ₹6,160, but had not

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- been posted to the ledger.
- (ii) Discounts received ₹1,320 had been debited to discounts allowed.
 - (iii) The Sales account had been under added by ₹10,000.
 - (iv) A credit sale of ₹1,470 had been debited to a customer account at ₹1,740.
 - (v) A vehicle bought originally for ₹7,000 four years ago and depreciated to ₹1,200 had been sold for ₹1,500 in the beginning of the year but no entries, other than in the bank account had been passed through the books.
 - (vi) An accrual of ₹560 for telephone charges had been completely omitted.
 - (vii) A bad debt of ₹1,560 had not been written off and provision for doubtful debts should have been maintained at 10% of Trade receivables which are shown in the trial balance at ₹23,390 with a credit provision for bad debts at ₹2,320.
 - (viii) Tools bought for ₹1,200 had been inadvertently debited to purchases.
 - (ix) The proprietor had withdrawn, for personal use, goods worth ₹1,960. No entries had been made in the books.

You are required to give rectification entries without narration to correct the above errors before preparing annual accounts.

Answer 1

	Particulars	Dr.	Cr.
(i)	Suspense Account	6,160	
	To Return Outward A/c		6,160
(ii)	Suspense Account	2,640	
	To Discount Allowed Account		1,320
	To Discount Received Account		1,320
(iii)	Suspense Account	10,000	
	To Sales Account		10,000
(iv)	Suspense Account	270	
	To Trade Receivable Account		270
(v)	Suspense Account	1,500	
	To Vehicle Account		1,200
	To Profit on Sale of Vehicle Account		300
(vi)	Telephone Charges Account	560	
	To Outstanding Expenses Account		560
(vii)	Bad Debts Account (refer W.N 1)	1,560	
	To Trade receivables Account		1,560
	Provision for Doubtful Debts Account (refer W.N. 2)	164	
	To Profit and Loss Account		164
(viii)	Loose Tools Account	1,200	
	To Purchases Account		1,200
(ix)	Drawings Account	1,960	
	To Purchases Account		1,960

Suspense Account

	₹		₹
To Return outward Account	6,160	By balance b/d	20,570
To Discount allowed Account	1,320		

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To Discount Received Account	1,320		
To Sales Account	10,000		
To Customers Account	270		
To Vehicles Account	1,200		
To Profit on Sale of Vehicle	300		
	20,570		20,570

Working Notes :

(i)	Trade receivables as per books		23,390
	Deduct on vide item (iv) 270	270	
	Bad Debts	<u>1,560</u>	<u>1,830</u>
			21,560
(ii)	Amount Charge to Profit & Loss on Account of Provision for Doubtful Debts		
	Opening of Provision for Doubtful Debts		2,320
	Less: Bad debts		1,560
			760
	Closing Balance of Provision for Doubtful Debts		2,156
	Charge to Profit and Loss A/c		1,396+

Question 2

On going through the Trial balance of Ball Bearings Co. Ltd. you find that the debit is in excess by ₹150. This was credited to "Suspense Account". On a close scrutiny of the books, the following mistakes were noticed:

- (1) The totals of debit side of "Expenses Account" have been casted in excess by ₹ 50.
- (2) The "Sales Account" has been totalled in short by ₹100.
- (3) Supplier account has been over casted by 225.
- (4) The sale return of ₹100 from a party has not been posted to that account though the Party's account has been credited.
- (5) A cheque of ₹500 issued to the Suppliers' account (shown under Trade payables) towards his dues has been wrongly debited to the purchases.
- (6) A credit sale of ₹50 has been credited to the Sales and also to the Trade receivables Account.

You are required to

- (i) Pass necessary journal entries for correcting the above;
- (ii) Show how they affect the Profits; and
- (iii) Prepare the "Suspense Account" as it would appear in the ledger.

Answer 2
Journal Entries

Particulars		L.F.	Dr. ₹	Cr. ₹
Suspense Account	Dr.		50	
To Expenses Account				50
(Being the mistake in totalling of Expenses Account, rectified)				
Suspense Account	Dr.		100	
To Sales Account				100
(Being the mistake in totalling of Sales Accounts)				

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rect f ed)				
Supplier	Dr.		225	
To Suspense Account				225
(Being the mistake in post ng from Day Book to Ledger rect f ed)				
Sales Returns Account	Dr.		100	
To Suspense Account				100
(Being the sales return from a party not posted to "Sales Returns" now rect f ed)				
Trade payables Account	Dr.		500	
To Purchases Account				500
(Being the payments made to supplier wrongly posted to purchases now rect f ed)				
Trade receivables Account	Dr.		100	
To Suspense Account				100
(Being the sales wrongly credited to Customer's Account now rect f ed)				

Suspense Account

	Dr. ₹		Cr. ₹
To Expenses Account	50	By Dif erence in Trial Balance	150
To Sales Account	100	By Trade payables	225
To Balance c/d	425	By Sales Returns Account	100
		By Trade receivables	100
	575		575
		By Balance b/d	425

Since the Suspense Account does not balance, it is clear that all the errors have not been traced. As a result of the above correct ons the Net Prof t will be:

	Increased by ₹	Decreased by ₹
Mistake in totalling in "Expenses"	50	
Mistake in totalling in "Sales"	100	
Mistake in post ng from day book to Ledger under "Purchases"	500	
Omission in post ng under "Sales Returns"		100
	650	100
Net Increase	550	

As a result of these adjustments, the Profits will be increased by ₹550.

Question 3

Mr. A closed his books of account on September 30, 2021 in spite of a difference in the trial balance. The difference was ₹830 the credits being short; it was carried forward in a Suspense Account. In 2022 following errors were located:

- A sale of ₹2,300 to Mr. Lala was posted to the credit of Mrs. Mala.
- The total of the Returns Inward Book for July, 2021 ₹1,240 was not posted in the ledger.
- Freight paid on a machine ₹5,600 was posted to the Freight Account as ₹6,500. 10% Depreciat on is charge on this machines.

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- (iv) While carrying forward the total in the Purchases Account to the next page, ₹65,590 was written instead of ₹56,950.
- (v) A sale of machine on credit to Mr. Mehta for ₹9,000 on 30th sept. 2021 was not entered in the books at all. The book value of the machine was ₹6,750.
- Pass journal entries to rectify the errors. Have you any comments to make?

Answer 3
Journal of Mr. A

Date	Particulars	Dr.	Cr.
		₹	₹
2022 (i)	Mrs. Mala	2,300	
	Mr. Lala	2,300	
	To Suspense A/c (Correct on of error by which a sale of ₹ 2,300 to Mr. Lala was posted to the Credit of Mrs. Mala)		4,600
(ii)	Profit and Loss Adjustment A/c	1,240	
	To Suspense A/c (Rectification of omission to post the total of Returns Inward Book for July, 2021)		1,240
(iii)	(a) Machinery A/c	5,600	
	Suspense A/c	900	
	To Profit & Loss Adjustment A/c (Correct on of error by which freight paid for a machine ₹ 5,600 was posted to Freight Account at ₹ 6,500 instead of capitalising it)		6,500
	(b) Profit & Loss Adjustment A/c	560	
	To Plant and Machinery A/c (Depreciation @ 10% charged on freight paid on a machine capitalised)		560
(iv)	Suspense A/c	8,640	
	To Profit & Loss Adjustment A/c (Correct on of wrong carry forward of total in the purchase Account to the next page ₹ 65,590 instead of ₹ 56,950)		8,640
(v)	Mr. Mehta	9,000	
	To Plant & Machinery A/c		6,750
	To Profit & Loss Adjustment A/c (Correct on of omission of a sale of machine on credit to Mr. Mehta for ₹ 9,000)		2,250

Comments

The Suspense Account will now appear as shown below:

Suspense Account

Date	Particulars	Dr. Amount	Date	Particulars	Cr. Amount

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		₹			₹
2022	To Profit and Loss		2022	By Balance b/d	830
	Adjustment A/c	900	Oct. 1	By Sundries	
	To Profit and Loss			Mrs. Mala	2,300
	Adjustment A/c	8,640		Mr. Lala	2,300
				By Profit and Loss	
				Adjustment A/c	1,240
				By balance c/d	2,870
		9,540			9,540

Since the Suspense Account still shows a balance, it is obvious that there are still some errors left in the books.

**Profit & Loss Adjustment A/c
(For Prior Period Items)**

Date 2022	Particulars	Dr. Amount ₹	Date 2022	Particulars	Cr. Amount ₹
	To Suspense A/c	1,240		By Machinery A/c	5,600
	To Plant and Machinery A/c	560		By Suspense A/c	900
	To Balance c/d	15,590		By Suspense A/c	8,640
				By Mr. Mehta	2,250
		17,390			17,390

Question 4

A merchant's trial balance as on June 30, 2022 did not agree. The difference was put to a Suspense Account. During the next trading period, the following errors were discovered:

- (i) The total of the Purchases Book of one page, ₹4,539 was carried forward to the next page as ₹4,593.
- (ii) A sale of ₹573 was entered in the Sales Book as ₹753 and posted to the credit of the customer.
- (iii) A return to a creditor, ₹510 was entered in the Returns Inward Book; however, the creditor's account was correctly posted.
- (iv) Cash received from C. Dass, ₹620 was posted to the debit of G. Dass.
- (v) Goods worth ₹840 were despatched to a customer before the close of the year but no invoice was made out.
- (vi) Goods worth ₹1,000 were sent on sale or return basis to a customer and entered in the Sales Book. At the close of the year, the customer still had the option to return the goods. The sale price was 25% above cost.

You are required to give journal entries to rectify the errors in a way so as to show the current year's profit or loss correctly.

Answer 4

Journal Entries

	Particulars		Dr. ₹	Cr. ₹
(i)	Suspense Account	Dr.	54	
	To Profit and Loss Adjustment A/c (Correct on of error by which Purchase Account was over debited last			54

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	year- ₹4,593 carried forward instead of ₹4,539)			
(ii)	Prof t & Loss Adjustment A/c	Dr.	180	
	Customer's Account	Dr.	1,326	
	To Suspense Account (Correct on of the entry by which (a) Sales A/c was over credited by ₹180 (b) customer was credited by ₹753 instead of being debited by ₹573)			1,506
(iii)	Suspense Account	Dr.	1,020	
	To Prof t & Loss Adjustment A/c (Correct on of error by which Returns Inward Account was debited by ₹510 instead of Returns Outwards Account being credited by ₹ 510)			1,020
(iv)	Suspense Account	Dr.	1,240	
	To C. Dass			620
	To G. Dass (Removal or wrong debit to G. Dass and giving credit to C. Dass from whom cash was received).			620
(v)	Customer's Account	Dr.	840	
	To Prof t & Loss Adjustment A/c (Rect f cat on of the error arising from non- preparat on of invoice for goods delivered)			840
(vi)	Prof t & Loss Adjustment A/c	Dr.	200	
	Inventory Account	Dr.	800	
	To Customer's Account (The Customer's A/c credited with ₹ 1,000 for goods not yet purchased by him; cost of the goods debited to inventory and "Prof t" debited to Prof t & Loss Adjustment Account)			1,000
(vii)	Prof t & Loss Adjustment A/c	Dr.	1,534	
	To Capital Account (Transfer of Prof t & Loss Adjustment A/c balance to the Capital Account)			1,534

Question 5

The following errors were committed by the Accountant of Geete Dye-Chem.

- Credit sale of ₹ 400 to Trivedi & Co. was posted to the credit of their account.
- Purchase of ₹ 420 from Mantri & Co. passed through Sales Day Book as ₹ 240

How would you rectify the errors assuming that :

- they were detected before preparation of Trial Balance.
- they were detected after preparation of Trial Balance but before preparing Final Accounts, the difference was taken to Suspense A/c.
- they were detected after preparing Final Accounts

Answer 5

- (b) (i) This is one sided error. Trivedi & Co. account is credited instead of debit. Amount posted to the wrong side and therefore while rectifying the account, double the amount (₹ 800) will be taken.

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Before Trial Balance	After Trial Balance	After Final Accounts
No Entry Debit Trivedi A/c with ₹ 800	Trivedi & Co. A/c Dr. 800 To Suspense A/c 800	Trivedi & Co. A/c Dr. 800 To Suspense A/c 800

(iii) Purchase of ₹ 420 is wrongly recorded through sales day book as ₹ 240.

Correct Entry	Entry Made Wrongly
Purchase A/c Dr. 420 To Mantri & Co. 420	Mantri & Co. Dr. 240 To Sales 240

Before Trial Balance	After Trial Balance	After Final Accounts
Sales A/c Dr. 240 Purchase A/c Dr. 420 To Mantri & Co. 660	Sales A/c Dr. 240 Purchase A/c Dr. 420 To Mantri & Co. 660	Profit & Loss Adj. A/c Dr. 660 To Mantri & Co. 660

Rectification Entry

ILLUSTRATION 1

How would you rectify the following errors in the book of Rama & Co.?

- The total to the Purchases Book has been undercast by ₹ 100.
- The Returns Inward Book has been undercast by ₹ 50.
- A sum of ₹ 250 written off as depreciation on Machinery has not been debited to Depreciation Account.
- A payment of ₹ 75 for salaries (to Mohan) has been posted twice to Salaries Account.
- The total of Bills Receivable Book ₹ 1,500 has been posted to the credit of Bills Receivable Account.
- An amount of ₹ 151 for a credit sale to Hari, although correctly entered in the Sales Book, has been posted as ₹ 115.
- Discount allowed to Satish ₹ 25 has not been entered in the Discount Column of the Cash Book. the amount has been posted correctly to the credit of his personal account.

Answer

- The Purchases Account should receive another debit of ₹ 100 since it was debited short previously:
"To Undercasting of Purchases Book for the month of --- ₹ 100."
- Due to this error the Returns Inward Account has been posted short by ₹ 50 : the correct entry will be:
"To Undercasting of Returns Inward Book for the month of --- ₹ 50."
- The omission of the debit to the Depreciation Account will be rectified by the entry:
"To Omission of posting on ₹ 250".
- The excess debit will be removed by a credit in the Salaries Account by the entry:
"By double posting on ₹ 75".
- ₹ 1,500 should have been debited to the Bills Receivable Account and not credited. To correct the mistake, the Bills Receivable Account should be debited by ₹ 3,000 by the entry:
"To Wrong posting of B/R received on ₹ 3,000"
- Hari's personal A/c is debited ₹ 36 short. The rectification entry will be:
"To Wrong posting ₹ 36".
- Due to this error, the discount account has been debited short by ₹ 25. The required entry is :

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“To Omission of discount allowed to Satish on ₹ 25.”

So far we have discussed the correction of errors which affected only one Account or more than one account but for which rectifying entries were not complete journal entries. We shall now take up the correction of errors which affect more than one account in such a way that complete journal entries are possible for their rectification. Read the following illustrations:

- (i) The purchase of machinery for ₹ 2,000 has been entered in the purchases book. The effect of the entry is that the account of the supplier Ram & Co. has been credited by ₹ 2,000 which is quite correct. But the debit to the Purchases Account is wrong : the debit should be to Machinery Account. To rectify the error, the debit in the purchases Account has to be transferred to the Machinery Account. The correcting entry will be to Credit Purchases Account and debit the Machinery Account. Please see the three entries made below: the last entry rectifies the error:

Particulars	Debits ₹	Credits ₹
Wrong Entry:		
Purchases Account	2,000	
To Ram & Co.		2,000
Correct Entry:		
Machinery Account	2,000	
To Ram & Co.		2,000
Rectifying Entry:		
Machinery Account	2,000	
To Purchases Account		2,000

- (ii) ₹100 received from Kamal Kishore has been credited in the account of Krishan Kishore. The error is that there is a wrong credit in the account of Krishan Kishore and omission of credit in the account of Kamal Kishore; Krishan Kishore should be debited and Kamal Kishore be credited. The following three entries make this clear:

Particulars	Debits ₹	Credits ₹
Wrong Entry:		
Cash Account	100	
To Krishan Kishore		100
Correct Entry:		
Cash Account	100	
To Kamal Kishore		100
Rectifying Entry:		
Krishan Kishore	100	
To Kamal Kishore		100

- (iii) The sale of old machinery, ₹1,000 has been entered in the sales book. By this entry the account of the buyer has been correctly debited by ₹1,000. But instead of crediting the Machinery Account. Sales Account has been credited. To rectify the error this account should be debited and the Machinery Account credited. See the three entries given below:

Particulars	Debits ₹	Credits ₹

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Wrong Entry:		
Buyer's Account	1,000	
To Sales Account		1,000
Correct Entry:		
Buyer's Account	1,000	
To Machinery Account		1,000
Rectifying Entry:		
Sales Account	1,000	
To Machinery Account		1,000

ILLUSTRATION 2

The following errors were found in the book of Ram Prasad & Sons. Give the necessary entries to correct them.

- (1) ₹ 500 paid for furniture purchased has been charged to ordinary Purchases Account.
- (2) Repairs made were debited to Building Account for ₹ 50.
- (3) An amount of ₹100 withdrawn by the proprietor for his personal use has been debited to Trade Expenses Account.
- (4) ₹100 paid for rent debited to Landlord's Account.
- (5) Salary ₹ 125 paid to a clerk due to him has been debited to his personal account.
- (6) ₹ 100 received from Shah & Co. has been wrongly entered as from Shaw & Co.
- (7) ₹ 700 paid in cash for a typewriter was charged to Office Expenses Account.

Answer

Journal

Sr. No.	Particulars	Dr. ₹	Cr. ₹
(1)	Furniture A/c	500	
	To Purchases A/c (Correct on of wrong debit to Purchases A/c for furniture purchased)		500
(2)	Repairs A/c	50	
	To Building A/c (Correct on of wrong debit to building A/c for repairs made)		50
(3)	Drawings A/c.	100	
	To Trade Expenses A/c (Correct on of wrong debit to Trade Expenses A/c for cash withdrawn by the proprietor for his personal use)		100
(4)	Rent A/c	100	
	To Landlord's Personal A/c (Correct on of wrong debit to landlord's A/c for rent paid)		100
(5)	Salaries A/c	125	
	To Clerk's (Personal) A/c (Correct on of wrong debit to Clerk's personal A/c for salaries paid)		125
(6)	Shaw & Co.	100	
	To Shah & Co. (Correct on of wrong credit to Shaw & Co. Instead of Shah & Co.)		100
(7)	Typewriter A/c	700	

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	To Office Expenses A/c (Correct on of wrong debit to Office Expenses A/c for purchase of typewriter)		700

ILLUSTRATION 3

Give journal entries to rectify the following:

- (1) A purchase of goods from Ram amounting to ₹150 has been wrongly entered through the Sales Book.
- (2) A Credit sale of goods amounting to ₹120 to Ramesh has been wrongly passed through the Purchase Book.
- (3) On 31st December, 2022 goods of the value of ₹ 300 were returned by Hari Saran and were taken into inventory on the same date but no entry was passed in the books.
- (4) An amount of ₹ 200 due from Mahesh Chand, which had been written off as a Bad Debt in a previous year, was unexpectedly recovered, and had been posted to the personal account of Mahesh Chand.
- (5) A Cheque for ₹ 100 received from Man Mohan was dishonoured and had been posted to the debit of Sales Returns Account.

Answer

Journal			
Sr. No.	Particulars	Dr. ₹	Cr. ₹
(1)	Purchases A/c	150	
	Sales A/c	150	
	To Ram (Correct on of wrong entry in the sales Book for a purchases of goods from Ram)		300
(2)	Ramesh	240	
	To Purchases A/c		120
	To Sales A/c (Correct on of wrong entry in the Purchases Book of a credit sale of goods to Ram)		120
(3)	Returns Inwards A/c	300	
	To Hari Saran (Entry of goods returned by him and taken in inventory omitted from records)		300
(4)	Mahesh Chand	200	
	To Bad Debts Recovered A/c (Correct on of wrong credit to Personal A/c in respect of recovery of previously written off bad debts)		200
(5)	Man Mohan	100	
	To Sales Return A/c (Correct on of wrong debit to Sales Returns A/c for dishonour of cheque received from Man Mohan)		100

Thus, it can be said that errors detected before the preparation of trial balance can be rectified either through rectification statements (not entries) or through rectification entries.

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ILLUSTRATION 4

Correct the following errors (i) without opening a Suspense Account and (ii) opening a Suspense Account:

- The Sales Book has been totalled ₹100 short.
- Goods worth ₹150 returned by Green & Co. have not been recorded anywhere.
- Goods purchased ₹250 have been posted to the debit of the supplier Gupta & Co.
- Furniture purchased from Gulab & Bros, ₹1,000 has been entered in Purchases Day Book.
- Discount received from Red & Black ₹15 has not been entered in the Discount Column of the Cash Book.
- Discount allowed to G. Mohan & Co. ₹18 has not been entered in the Discount Column of the Cash Book. The account of G. Mohan & Co. has, however, been correctly posted.

Answer

If a Suspense Account is not opened.

- Since sales book has been totalled ₹100 short, the Sales Account has been similarly credited ₹100 short. The correcting entry is to credit the Sales Account by ₹100 as "By wrong totalling of the Sales Book ₹100".
- To rectify the omission, the Returns Inwards Account has to be debited and the account of Green & Co. credited. The entry:

Returns Inward Account	Dr.	₹ 150	
To Green & Co. (Goods returned by the firm, previously omitted from the Returns Inward Book)			₹ 150

- Gupta & Co. have been debited ₹250 instead of being credited. This account should now be credited by 500 to remove the wrong debit and to give the correct credit. The entry will be on the credit side... "By errors in posting ₹500".
- By this error Purchases Account has to be debited by ₹1,000 whereas the debit should have been to the Furniture Account. The correcting entry will be:

Furniture Account	Dr.	₹ 1000	
To Purchases Account (Correction of the mistake by which of the Furniture Account)			₹ 1000

- The discount of ₹15 received from Red & Black should have been entered on the credit side of the cash book. Had this been done, the Discount Account would have been credited (through the total of the discount column) and Red & Black would have been debited. This entry should not be made:

Red & Black	Dr.	₹ 15	
To Discount Account (Rectification of the error by which the discount allowed by the firm was not entered in Cash Book)			₹ 15

- In this case the account of the customer has been correctly posted; the Discount Account has been debited ₹18 short since it has been omitted from the discount column on the debit side of the cash book. The discount account should now be debited by the entry; "To Omission of entry in the Cash Book ₹18."

If a Suspense Account is opened.

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	Particulars	Dr. ₹	Cr. ₹
(a)	Suspense Account	100	
	To Sales Account (Being the correction arising from understating of Sales Day Book)		100
(b)	Return Inward Account	150	
	To Green & Co (Being the recording of unrecorded returns)		150
(c)	Suspense Account	500	
	To Gupta & Co. (Being the correction of the error by which Gupta & Co. was debited instead of being credited by ₹ 250).		500
(d)	Furniture Account	1,000	
	To Purchases Account (Being the correction of recording purchase of furniture as ordinary purchases)		1,000
(e)	Red & black	15	
	To Discount Account (Being the recording of discount omitted to be recorded)		15
(f)	Discount Account	18	
	To Suspense Account (Being the correction of omission of the discount allowed from Cash Book customer's account already posted correctly)		18

Suspense Account

Date	Particulars	Dr. Amount ₹	Date	Particulars	Cr. Amount ₹
	To Sales A/c	100		By Difference in Trial Balance	582
	To Gupta & Co.	500		By Discount A/c	18
		600			600

Notes:

- One should note that the opening balance in the Suspense Account will be equal to the difference in the trial balance.
- If the question is silent as to whether a Suspense Account has been opened, the student should make his assumption, state it clearly and then proceed.

ILLUSTRATION 5

Correct the following errors found in the books of Mr. Dutt. The Trial Balance was out by ₹ 493 excess credit. The difference thus has been posted to a Suspense Account.

- An amount of ₹100 was received from D. Das on 31st December, 2022 but has been omitted to enter in the Cash Book.

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- (b) The total of Returns Inward Book for December has been casted short by ₹100.
- (c) The purchase of an office table costing ₹ 300 has been passed through the Purchases Day Book.
- (d) ₹ 375 paid for Wages to workmen for making show-cases had been charged to "Wages Account".
- (e) A purchase of ₹ 67 had been posted to the trade payables' account as ₹ 60.
- (f) A cheque for ₹ 200 received from P. C. Joshi had been dishonoured and was passed to the debit of "Allowances Account".
- (g) ₹ 1,000 paid for the purchase of a motor cycle for Mr. Dut for his personal use had been charged to "Miscellaneous Expenses Account".
- (h) Goods amounting to ₹100 had been returned by customer and were taken into inventory, but no entry in respect thereof, was made into the books.
- (i) A sale of ₹ 200 to Singh & Co. was wrongly credited to their account. Entry was correctly made in sales book.

Answer

Journal Entries

	Particulars	LF	Dr. ₹	Cr. ₹
(a)	Cash Account	Dr.	100	
	To D. Das (Being the amount received)			100
(b)	Returns Inward Account	Dr.	100	
	To Suspense Account (Being the mistake in totalling the Returns Inward Book corrected)			100
(c)	Furniture Account	Dr.	300	
	To Purchases Account (Being the rectification of mistake by which purchase of furniture was entered in Purchases book and hence now corrected by crediting the Purchases Account)			300
(d)	Furniture Account	Dr.	375	
	To Wages Account (Being the wages paid to workmen for making show-cases which should have been capitalised and not to be charged to Wages Account)			375
(e)	Suspense Account	Dr.	7	
	To Creditors (personal) Account (Being the mistake in crediting the Trade payables Account less by ₹ 7, now corrected)			7
(f)	P.C. Joshi	Dr.	200	
	To Allowances Account (Being the cheque of P.C. Joshi dishonoured, previously debited to Allowances Account)			200
(g)	Drawings Account	Dr.	1,000	
	To Miscellaneous Expenses (Being the motor cycle purchased for Mr. Dut debited to his)			1,000

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	Drawings Account instead of Miscellaneous Expenses Account as previously done by mistake)				
(h)	Returns Inward Account	Dr.		100	
	To Debtors (Personal) Account (Correct on of the omission to record return of goods by customers)				100
(i)	Singh & Co.	Dr.		400	
	To Suspense Account (Being the correct on of mistake by which the account of Singh & Co. was credited by ₹ 200 instead of being debited)				400

Suspense Account

Date	Particulars	Dr. Amount ₹	Date	Particulars	Cr. Amount ₹
2022 Dec.31	To Difference in Trial Balance	493	2022 Dec. 31	By Returns Inwards A/c	100
" "	To Trade Payables A/c	7		By Singh & Co.	400
		500			500

ILLUSTRATION 6

The following errors, affecting the account for the year 2022 were detected in the books of Jain Brothers, Delhi:

- (1) Sale of old Furniture ₹ 150 treated as sale of goods.
- (2) Receipt of ₹ 500 from Ram Mohan credited to Shyam Sunder.
- (3) Goods worth ₹ 100 brought from Mohan Narain have remained unrecorded so far.
- (4) A return of ₹ 120 from Mukesh posted to his debit.
- (5) A return of ₹ 90 to Shyam Sunder posted as ₹ 9 in his account.
- (6) Rent of proprietor's residence, ₹ 600 debited to rent A/c.
- (7) A payment of ₹ 215 to Mohammad Sadiq posted to his credit as ₹125.
- (8) Sales Book casted short by ₹ 900 .
- (9) The total of Bills Receivable Book ₹ 1,500 left unposted.

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

Answer

Journal

	Particulars		LF	Dr. ₹	Cr. ₹
(1)	Sales Account	Dr.		150	
	To Furniture Account (Rectification of sales of furniture treated as sales of goods)				150
(2)	Shyam Sunder	Dr.		500	
	To Rama Mohan (Rectification of a receipt from Ram Mohan credited to Shyam Sunder)				500
(3)	Purchases Account	Dr.		100	

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	To Mohan Narain (Purchases of goods from Mohan Narain unrecorded, now corrected)				100
(6)	Drawing Account	Dr.		600	
	To Rent Account (Rectification of Payment of rent of proprietor's residence treated as payment of office rent)				600

N.B. : For 4, 5, 7, 8, 9 no journal entry can be passed as they affect a single account. The correction will be as under:

- (4) Credit Mukesh's Account with ₹ 240.
- (5) Debit the account of Shyam Sunder by ₹ 81.
- (7) Debit the account of Mohammad Sadiq by ₹ 340.
- (8) Credit Sales Account by ₹ 900.
- (9) Debit Bills Receivable Account with ₹ 1,500.

Effect of the Errors on Trial Balance

1	No effect		
2	No effect		
3	No effect		
4	Trial Balance credit total short by	₹	240
5	Trial Balance debit total short by	₹	81
6	No effect		
7	Trial Balance debit total short by	₹	340
8	Trial Balance credit total short by	₹	900
9	Trial Balance debit total short by	₹	1,500

ILLUSTRATION 7

Write out the Journal Entries to rectify the following errors, using a Suspense Account.

- (1) Goods of the value of ₹ 100 returned by Mr. Sharma were entered in the Sales Day Book and posted therefrom to the credit of his account;
- (2) An amount of ₹150 entered in the Sales Returns Book, has been posted to the debit of Mr. Philip, who returned the goods;
- (3) A sale of ₹ 200 made to Mr. Ghanshyam was correctly entered in the Sales Day Book but wrongly posted to the debit of Mr. Radheshyam as ₹ 20; and
- (4) The total of "Discount Allowed" column in the Cash Book for the month of September, 2022 amounting to ₹ 250 was not posted.

Answer

Journal

	Particulars		LF	Dr. ₹	Cr. ₹
(1)	Sales Account	Dr.		100	
	Sales Returns Account	Dr.		100	
	To Suspense Account (The value of goods returned by Mr. Sharma wrongly posted to Sales and omission of debit to Sales Returns Account, now				200

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	rect f ed)				
(2)	Suspense Account	Dr.		300	
	To Mr. Philip (Wrong debit to Mr. Philip for goods returned by him, now rect f ed)				300
(3)	Mr. Ghanshyam	Dr.		200	
	To Mr. Radheshyam				20
	To Suspense Account (Omission of debit to Mr. Ghanshyam and wrong credit to Mr. Radhesham for sale of ₹ 200, now rect f ed)				180
(4)	Discount Account	Dr.		250	
	To Suspense Account (The total of Discount allowed during September, 2022 not posted from the Cash Book; error now rect f ed)				250

ILLUSTRATION 8

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

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

Answer

Journal Entries in the books of Mr. Roy

	Part ulars	LF	Dr. ₹	Cr. ₹
(1)	Motor Vehicles Account		2,700	
	To Prof t and Loss Adjustment A/c (Purchase of scooter wrongly debited to conveyance account now rect f ed-capitalisat on of ₹ 2,700, i.e., ₹ 3,000 less 10% depreciat on)			2,700
(2)	Suspense Account		10,000	
	To Prof t & Loss Adjustment A/c (Purchase Account overcast in the previous year; error now rect f ed)			10,000
(3)	Prof t & Loss Adjustment A/c		4,000	
	To P's Account (Credit purchase from P ₹ 2,000, entered as sales last year; now rect f ed)			4,000
(4)	B's Account		1,000	

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	To A's Account (Amount received from A wrongly posted to the account of B; now rectified)			1,000
(5)	Suspense Account		1,000	
	To C's Account (₹ 500 received from C wrongly debited to his account; now rectified)			1,000
(6)	Trade receivables		500	
	To Suspense Account (₹ 500 due by Q not taken into trial balance; now rectified)			500
(7)	R's Account		2,000	
	To Profit & Loss Adjustment A/c (Sales to R omitted last year; now recorded)			2,000
(8)	Suspense Account		198	
	To Profit & Loss Adjustment A/c (Excess posting to purchase account last year, ₹ 2,593, instead of ₹ 2,395, now adjusted)			198
(9)	Profit & Loss Adjustment A/c		10,898	
	To Roy's Capital Account (Balance of Profit & Loss Adjustment A/c transferred to Capital Account)			10,898
(10)	Roy's Capital Account		10,698	
	To Suspense Account (Balance of Suspense Account transferred to the Capital Account)			10,698

Note : Entries No. (2) and (8) may even be omitted; but this is not advocated.

Profit and Loss Adjustment Account

(Prior Period Items)

	Dr. ₹		Cr. ₹
To P	4,000	By Motor Vehicles A/c	2,700
To Roy's Capital (transfer)	10,898	By Suspense A/c	10,000
		By R	2,000
		By Suspense Account	198
	14,898		14,898

Suspense Account

	Dr. ₹		Cr. ₹
To Profit & Loss Adjustment A/c	10,000	By Trade Receivables (Q)	500
To C	1,000	By Roy's Capital A/c (Transfer)	10,698
To Profit & Loss Adjustment A/c	198		
	11,198		11,198

Example 1:

Credit purchases ₹17,270 are entered in the Purchases Day Book as ₹17,720. Credit sales of ₹15,000 gross less 1% trade discount are wrongly entered in Sales Day Book at ₹15,000. Cheque issued

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₹19,920 are wrongly entered in the credit of bank column in the Cash Book as ₹19,290.

Example 2:

For the month of January, 2022 total of credit sales are ₹1,75,700, this is wrongly totalled as ₹1,76,700 and posted to sales account as ₹1,76,700.

Example 3:

The following cash transactions of M/s. Tularam & Co. occurred: 2023

Jan. 1	Balance - cash ₹1,200 bank ₹16,000;
Jan. 2	Cheque issued to M/s. Bholaram & Co., a supplier, for ₹22,500;
Jan. 6	Cheque collected from M/s. Scindia & Bros. ₹42,240 and deposited for clearance;
Jan. 7	Cash sales ₹27,200 and paid wages ₹12,400;
Jan. 8	Cash sales ₹ 37,730 and cash deposited to bank ₹ 35,000.

The following Cash Book entries are passed:

Dr.				Cash Book				Cr.			
Date	Particulars	Cash	Bank	Date	Particulars	Cash	Bank				
2023		₹	₹	2023		₹	₹				
Jan. 1	To Balance b/d	1,200	16,000	Jan. 2	By M/s Bholaram & Co. A/c		22,500				
Jan. 6	To M/s. Scindia & Bros. A/c		42,420		By Wages A/c	12,200					
Jan. 7	To Sales A/c	27,200			By Bank A/c	34,500					
Jan. 8	To Sales A/c	37,370			By Balance c/d	19,070	71,420				
Jan. 8	To Cash A/c		34,500								
		65,770	93,920			65,770	93,920				

Wrong entries and wrong casting are shown in **bold prints**. However, errors of cash entries generally are not carried. Usually cash balances are tallied daily. So errors are identified at an early stage. But bank balance cannot be checked daily and thus errors may be carried until bank reconciliation is done. In the above example, there are four wrong entries and one wrong casting. Bank and cash balances are affected by these errors.

Example 4:

The following cash transactions of M/s. Tularam & Co. occurred: 2023

Jan. 1 Purchases from M/s. Saurabh & Co.- gross ₹1,00,000 less 1% trade discount.

Jan. 3 Purchases from M/s. Netai & Co.- gross ₹ 70,000 less 1% trade discount.

Jan. 6 Purchases from M/s. Saurabh & Co.- gross ₹ 60,000 less 1% trade discount

Let us cast M/s. Saurabh & Co.'s Account:

Dr.				M/s Saurabh & Co. Account			Cr.	
Date	Particulars	Amount ₹	Date	Particulars	Amount ₹			
2023			2023					
Jan. 1	To Balance c/d	1,55,400	Jan. 1	By Purchases A/c	99,000			

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			Jan. 6	By Purchases A/c	59,400
		1,55,400			*1,55,400

*While casting the credit side, an error has been committed and so the account is wrongly balanced.

Example 5:

Goods are purchased on credit from M/s. Saurabh & Co. for ₹ 27,030 and from M/s. Karnataka Suppliers for ₹ 28,050. The following Purchase Day Book is prepared:

Purchases Day Book

Date	Particulars	Amount ₹
	M/s. Saurabh & Co.	27,050
	M/s. Karnataka Suppliers	28,030
		55,080

In the above Purchase Day Book, both the transactions are entered wrongly but the first error has been compensated by the second. Even if these errors are not rectified Trial Balance would tally.

Trial Balance

Particulars	Dr. ₹	Cr. ₹
M/s. Saurabh & Co.		27,050
M/s. Karnataka Suppliers		28,030
Purchases Account	55,080	
	55,080	55,080

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Chapter 3

Bank Reconciliation Statement

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True or False

Question 1

Bank Reconciliation is the process of reconciling cash column of the cash book and bank column of the cash book.

Answer 1

False: Bank Reconciliation Statement reconciles bank column of cash book with the balance in the passbook i.e. customer account in the books of bank.

Question 2

There are 3 types of differences between cash book and pass book namely Timing, Transactions & Errors.

Answer 2

True: These are the three broad categories.

Question 3

Adjusting the cash book for any errors and/or omissions before preparing bank reconciliation is optional when the reconciliation is done at the end of the financial year.

Answer 3

False: Adjusting the cash book is mandatory when bank reconciliation is done at the end of the financial year.

Question 4

Debit balance in cash book is same as overdraft as per pass book.

Answer 4

False: Debit balance as per cash book should be represented by credit or favourable balance in pass book.

Question 5

Bank charges debited by the bank is an example of timing difference for the purposes of bank reconciliation.

Answer 5

False: Bank charges are example of the transactions that bank carries out by itself and the same has not been recorded in the cashbook until statement is obtained from the bank.

Question 6

Overcasting of the debit side of the cash book is an example of a difference that is due to error.

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Answer 6

True: Overcasting is an example of an error.

Question 7

When we start bank reconciliation with a debit balance in cash book, then cheques issued but not yet presented should be added back to arrive at the balance as per pass book.

Answer 7

True: Since the cheques issued would have been recorded as payments and bank balance was credited in cash book, we need to add it back as the same is not yet deducted from our bank balance.

Question 8

The bank charges charged by the bank should be deducted when bank reconciliation statement is being prepared starting from a credit balance of pass book.

Answer 8

False: Bank charges should be added when we start with credit or favourable balance in pass book as bank would have debited the charges.

Question 9

When the causes of differences between pass book balance and cash book is not known, then the bank reconciliation statement can be prepared by matching the two books and identifying any unticked items in both sets.

Answer 9

True: Since, we don't know the causes of difference, matching the two statements is only efficient way to identify the difference.

Question 10

While preparing the bank reconciliation statement starting with debit balance as per pass book or bank statement, the deposited cheques that are not yet cleared need not be adjusted.

Answer 10

False: Cheques deposited but not yet cleared should be subtracted from debit or unfavourable balance in passbook.

Question 11

Cash book shows a debit balance of ₹ 50,000 and the only difference from the balance as shown in pass book relates to cheques issued for ₹ 60,000 but not yet presented for payment. The balance as per pass book should be ₹ 1,10,000.

Answer 11

True: Cheques issued but not yet presented should be added back to a debit balance in cash book to arrive at pass book balance i.e. ₹ 50,000 + ₹ 60,000 = ₹ 1,10,000.

Question 12

Overcasting of credit side of the cash book shall result in a higher bank balance in cash book when compared with pass book balance.

Answer 12

False: Overcasting of credit side means excessive payments are recorded and hence would lower the bank balance.

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Question 13

A cheque for ₹ 25,000 that was issued and was also presented for payment in same month but erroneously recorded on debit side of the cash book would cause a difference of ₹ 50,000 from the balance in pass book.

Answer 13

True: ₹ 25,000 payment is recorded as a receipt and hence it will have to be adjusted twice (once to nullify and then once to record actual payment) hence causing the difference of double amount.

Question 14

A direct debit by bank on account of any payment as may be instructed by customer should be recorded on credit side of cash book.

Answer 14

True: It is an example of a payment instructed by customer to be directly debited by bank, and hence credited in the cash book.

Question 15

Bank Reconciliation Statement can be prepared in two formats – “Balance” presentation and “Plus & Minus” presentation.

Answer 15

True: Reconciliation statement can be prepared in either of the two formats.

Question 16

The difference between cash book & pass book that relates to errors are those mostly made by Bank.

Answer 16

False: Bank rarely makes mistakes, and hence differences that relate to errors are generally made in cash book.

Question 17

A cheque for ₹ 80,000 that was discounted from bank was dishonoured and the bank charged ₹ 1,600 as the charges on account of same. While starting with debit balance in cash book for preparing bank reconciliation statement, we need to deduct ₹ 78,400 to reconcile with pass book.

Answer 17

False: We need to deduct ₹ 81,600 (i.e. both cheque returned & charges) from debit balance in cash book to arrive at balance as per pass book.

Question 18

Interest on savings bank that is allowed or credited by bank is generally recorded in cash book prior to it being recorded by bank.

Answer 18

False: Interest allowed by bank is mostly recorded in cash book after the entry has been made in the pass book or bank statement.

Question 19

A regular bank reconciliation discourages the accountants to be involved in any kind of funds

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embezzlement.

Answer 19

True: In absence of any reconciliation, the accountants can mis-utilize the funds temporarily by recording the entry without actual depositing the cash.

Question 20

Timing difference relates the transactions that are recorded in the same period in both cash book and also the bank pass book.

Answer 20

False: Timing differences relate to the transactions that are recorded in cash book and pass book in two different periods.

Multiple Choice Questions

1. When the balance as per Cash Book is the starting point, direct deposits by customers are:

- (a) Added
- (b) Subtracted
- (c) Not required to be adjusted.

Answer 1: (a)

2. A debit balance in the depositor's Cash Book will be shown as:

- (a) A debit balance in the Bank Statement.
- (b) A credit balance in the Bank Statement.
- (c) An overdrawn balance in the Bank Statement.

Answer 2: (b)

3. When balance as per Pass Book is the starting point, interest allowed by Bank is

- (a) Added
- (b) Subtracted
- (c) Not required to be adjusted

Answer 3: (b)

4. A Bank Reconciliation Statement is prepared with the help of:

- (a) Bank statement and bank column of the Cash Book.
- (b) Bank statement and cash column of the Cash Book
- (c) Bank column of the Cash Book and cash column of the Cash Book.

Answer 4: (a)

5. The cash book showed an overdraft of ₹ 1,50,000, but the pass book made up to the same date showed that cheques of ₹ 10,000, ₹ 5,000 and ₹ 12,500 respectively had not been presented for payments; and the cheque of ₹ 4,000 paid into account had not been cleared. The balance as per the pass book will be:

- (a) ₹ 1,10,000
- (b) ₹ 2,17,500
- (c) ₹ 1,26,500

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Answer 5: (c)

6. When drawing up a Bank Reconciliation Statement, if you start with a debit balance as per the Bank Statement, the unpresented cheques should be:
- Added;
 - Deducted;
 - Not required to be adjusted.

Answer 6: (a)

7. When drawing up a BRS if you start with a Dr. Balance as per Bank Statement, the following are added:
- Cheque issued but not presented to bank
 - B/R collected directly by bank
 - Overcasting of the Dr. Side of bank A/c in the cash book.
- only 1
 - only 1 & 2
 - all of the above

Answer 7: (b)

8. A bank reconciliation statement is mainly prepared to:
- Reconcile the cash balance of the cash book
 - Reconcile the difference between the bank balance shown by the cash book and bank passbook
 - both a & b

Answer 8: (b)

Theory Questions

Question 1

Write short note on Bank reconciliation statement.

Answer 1

Bank reconciliation statement is prepared as on a particular date to reconcile and explain the causes of difference between the bank balance as per cash book and the same as per savings bank pass book or current account statement. At the end of each month, the bank balance as per cash book and that as per pass book /bank statement should be compared and, if there is disagreement, these balances should be reconciled stating exact reasons of disagreement. The reconciliation is made in a statement called the bank reconciliation statement.

Question 2

State the causes of difference between the balance shown by the pass book and the cash book.

Answer 2

The difference between the balance shown by the passbook and the cashbook may arise on account of the following:

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- (i) Cheques issued but not yet presented for payment.
- (ii) Cheques deposited into the bank but not yet cleared.
- (iii) Interest allowed by the bank.
- (iv) Interest and expenses charged by the bank.
- (v) Interest and dividends collected by the bank.
- (vi) Direct payments by the bank.
- (vii) Direct deposits into the bank by a customer.
- (viii) Dishonour of a bill discounted with the bank.
- (ix) Bills collected by the bank on behalf of the customer.
- (x) An error committed in cash book or by the bank etc.
- (xi) Under casting or Overcasting in cashbook.

Practical Questions

Question 1

From the following particulars prepare a bank reconciliation statement as on 31st December 2022:

- (i) On 31st December, 2022 the cash-book of a firm showed a bank balance of ₹ 60,000 (debit balance).
- (ii) Cheques had been issued for ₹ 15,00,000, out of which cheques worth ₹ 4,00,000 only were presented for payment.
- (iii) Cheques worth ₹ 11,40,000 were deposited in the bank on 28th December, 2022 but had not been credited by the bank. In addition to this, one cheque for ₹ 5,00,000 was entered in the cash book on 30th December, 2022 but was banked on 3rd January, 2023.
- (iv) A cheque from Susan for ₹ 4,00,000 was deposited in the bank on 26th December 2022 but was dishonoured and the advice was received on 2nd January, 2023.
- (v) Pass-book showed bank charges of ₹ 2000 debited by the bank.
- (vi) One of the debtors deposited a sum of ₹ 5,00,000 in the bank account of the firm on 20th December, 2022 but the intimation in this respect was received from the bank on 2nd January, 2023.
- (vii) Bank pass-book showed a debit balance of ₹ 3,82,000 on 31st December, 2022.

Answer 1

Bank Reconciliation Statement as on 31st December, 2022

	₹	₹
Bank balance (Dr.) as per cash book		60,000
Add: Cheques issued but not yet presented for payment	11,00,000	
Cheques directly deposited by a customer not yet recorded in cash book	5,00,000	16,00,000
		16,60,000
Less: Cheques deposited but not yet credited by bank	11,40,000	
Cheque received and recorded in cash book but not yet banked	5,00,000	
Cheque dishonoured by the bank; the dishonour entry not yet passed in cash book	4,00,000	
Bank charges not recorded in cash book	2,000	(20,42,000)
Bank balance (Dr.) as per pass book		(3,82,000)

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Question 2

According to the cash-book of Gopi, there was a balance of ₹ 44,50,000 in his bank on 30th June, 2022. On investigation you find that:

- (i) Cheques amounting to ₹ 6,00,000 issued to creditors have not been presented for payment till the date.
- (ii) Cheques paid into bank amounting to ₹ 11,05,000 out of which cheques amounting to ₹ 5,50,000 only collected by the bank up to 30th June 2022.
- (iii) A dividend of ₹ 40,000 and rent amounting to ₹ 6,00,000 received by the bank and entered in the pass-book but not recorded in the cash book.
- (iv) Insurance premium (up to 31st December, 2022) paid by the bank ₹ 27,000 not entered in the cash book.
- (v) The payment side of the cash book had been under casted by ₹ 5,000.
- (vi) Bank charges ₹ 1,500 shown in the pass book had not been entered in the cash book.
- (vii) A bill payable of ₹ 2,00,000 had been paid by the bank but was not entered in the cash book and bill receivable for ₹ 60,000 had been discounted with the bank at a cost of ₹ 1,000 which had also not been recorded in cash book.

Required:

- (a) to make the appropriate adjustments in the cash book, and
- (b) to prepare a statement reconciling it with the bank pass book.

Answer 2

Cash Book (Bank Column)

Receipts	₹	Payments	₹
To Balance b/d	44,50,000	By Insurance premium A/c	27,000
To Dividend A/c	40,000	By Correct on of errors	5,000
To Rent A/c	6,00,000	By Bank charges	1,500
To Bill receivable A/c	59,000	By Bill payable	2,00,000
		By Balance c/d	49,15,500
	51,49,000		51,49,000

Bank Reconciliat on Statement as on 30th June, 2022

	₹
Adjusted balance as per cash book (Dr.)	49,15,500
Add: Cheques issued but not presented for payment t ll 30th June, 2022	6,00,000
Less: Cheques paid into bank for collect on but not collected t ll 30th June, 2022	(5,55,000)
Balance as per pass book	49,60,500

Question 3

Prepare a bank reconciliation statement as on 30th September, 2022 from the following particulars:

Part culars	₹
Bank balance as per pass-book	10,00,000
Cheque deposited in the bank, but no entry was passed in the Cash-Book	5,00,000

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Cheque received, but not sent to bank	11,20,000
Credit side of the bank column cast short	2,000
Insurance premium paid directly by the bank under the standing advice	60,000
Bank charges entered twice in the cash book	2,000
Cheque issued, but not presented to the bank for payment	5,00,000
Cheque received entered twice in the cash book	10,000
Bills discounted dishonoured not recorded in the cash book.	5,00,000

Answer 3

Bank Reconciliation Statement as on 30th September, 2022

	₹	₹
Bank balance as per pass book		10,00,000
Add: Cheque received but not sent to the bank	11,20,000	
Credit side of the bank column cast short	2,000	
Insurance premium paid directly not recorded in the cash book	60,000	
Cheque received entered twice in the cash book	10,000	
Bills dishonoured not recorded in the cash book	5,00,000	16,92,000
		26,92,000
Less: Cheque deposited into the bank but no entry was passed in the cash book	5,00,000	
Bank charges recorded twice in the cash book	2,000	
Cheque issued but not presented to the bank	5,00,000	(10,02,000)
Bank balance as per cash book		16,90,000

Question 4

Prepare a bank reconciliation statement from the following particulars on 31st March, 2022:

Particulars	₹
Debit balance as per bank column of the cash book	37,20,000
Cheque issued to creditors but not yet presented to the bank for payment	7,20,000
Dividend received by the bank but not yet entered in the cash book	5,00,000
Interest allowed by the bank	12,500
Cheques deposited into bank for collect on but not collected by bank up to this date.	15,40,000
Bank charges	2,000
A cheque deposited into bank was dishonoured, but no int mat on received	3,20,000
Bank paid house tax on our behalf, but no informat on received from bank in this connect on.	3,50,000

Answer 4

Bank Reconciliation Statement as on 31st March, 2022

	₹	₹
Debit balance as per cash book		37,20,000

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Add: Cheque issued but not yet presented to bank for payment	7,20,000	
Dividend received by bank not entered in cash book	5,00,000	
Interest allowed by bank	12,500	12,32,500
		49,52,500
Less: Cheques deposited into bank but not yet collected	15,40,000	
Bank charges	2,000	
A cheque deposited into bank was dishonoured	3,20,000	
House tax paid by bank	3,50,000	(22,12,000)
Credit balance as per pass book		27,40,500

Question 5

Prepare a bank reconciliation statement from the following particulars on 31st March, 2022 and show the balance as per cash book:

- Overdraft as per passbook on March 31, 2022, is ₹ 3,00,000.
- Interest on bank overdraft not entered in the cash book Rs. 36,500
- Insurance premium of Rs. 17,950 was due and paid by the bank but same has not been accounted in the books.
- Cheques drawn in the last week of March, 2022, but not cleared till date for ₹ 13,000 and Rs. 23,500.
- Cheques deposited into bank on February, 2022, but yet to be credited on dated March 31, 2022 Rs. 56,000.
- Amount of Rs. 20,500 is wrongly debited by the bank
- Interest on Investment Rs. 83,800 collected and credited by bank but the same has not been entered in the Cash Book.

Answer 5
Bank Reconciliation Statement as on 31st March, 2022

	₹	₹
Balance as per bank statement (Overdraft)		3,00,000
Add: Cheques drawn but not cleared	36,500	
Interest collected on investments directly credited by bank	83,800	1,20,300
		4,20,300
Less: Interest on bank overdraft not entered in the cash book	36,500	
Cheques deposited but not yet cleared	56,000	
Insurance premium paid by bank	17,950	
Amount wrongly debited by bank	20,500	1,30,950
Overdraft as per cash book		289,350

Question 6

The Cash-book of M/s ABC shows ₹ 27,570 as the balance at Bank as on 31st March, 2022. But this does not agree with balance as per the Bank Statement. On scrutiny following discrepancies were found:

- Subsidy ₹ 10,250 received from the government directly by the bank, but not advised to

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- the company.
- (ii) On 15th March, 2022 the payments side of the Cash-book was under cast by ₹ 350.
 - (iii) On 20th March, 2022 the debit balance of ₹ 2,156 as on the previous day, was brought forward as credit balance in Cash-book.
 - (iv) A customer of the M/s ABC, who received a cash discount of 5% on his account of ₹ 2,000, paid to M/s ABC a cheque on 24th March, 2022. The cashier erroneously entered the gross amount in the Cash-Book.
 - (v) On 10th March, 2022 a bill for ₹ 5,700 was discounted from the bank, entered in Cash-book, but proceeds credited in Bank Statement amounted to ₹ 5,500 only.
 - (vi) A cheque issued amounting to ₹ 1,725 returned marked 'out of date'. No entry made in Cash-book.
 - (vii) Insurance premium ₹ 756 paid directly by bank under a standing order. No entry made in cash-book.
 - (viii) A bill receivable for ₹ 1,530 discounted for ₹ 1,500 with the bank had been dishonoured on 30th March, 2022, but advice was received on 1st April, 2022.
 - (ix) Bank recorded a Cash deposit of ₹ 1,550 as ₹ 1,505.
- Prepare Bank Reconciliation Statement on 31st March, 2022

Answer 6
Bank Reconciliation Statement on 31st March, 2022

			₹	
Bank Balance as per Cash Book				27,570
Add:	(i)	Subsidy from government received directly by the bank not recorded in the Cash Book	10,250	
	(iii)	Debit balance of ₹2,156 brought forward as credit balance on 20 th March, 2022 in the Cash Book	4,312	
	(vi)	Cheque issued returned marked 'out of date'	1,725	16,287
				43,857
Less:	(ii)	Cash Book under cast on 15 th March, 2022	350	
	(iv)	Discount allowed to a customer, however entry made at gross amount in the Cash Book	100	
	(v)	Commission charged by bank on discounting of bill, not considered in Cash Book	200	
	(vii)	Insurance Premium paid directly by bank under standing instructions	756	
	(viii)	Discounted B/R dishonoured; not entered in Cash Book	1,530	
	(ix)	Bank recorded short cash deposit	45	2,981
Balance as per Bank Statement				40,876

ILLUSTRATION 1

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 in account with Punjab National Bank, Daryaganj, New Delhi-110002

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PASS-BOOK

Date		Particulars	Withdrawals ₹	Deposits ₹	Dr. or Cr.	Balance ₹
2022						
Jan.	2	By Cash		4,00,000	Cr.	4,00,000
"	4	To Furniture Dealers Ltd.	60,000		Cr.	3,40,000
"	4	To Das & Co.	1,25,000		Cr.	2,15,000
"	10	By J. Johnson & Co.'s cheque		35,000	Cr.	2,50,000
"	12	To Roy & James	1,00,000		Cr.	1,50,000
"	15	By B. Babu & Co's cheque		76,000	Cr.	2,26,000
"	16	By Cash		30,000	Cr.	2,56,000
"	20	To Cash	50,000		Cr.	2,06,000
"	26	By J. Rai & Bros cheque		43,000	Cr.	2,49,000
"	31	To Premium paid as per standing instructions	25,000		Cr.	2,24,000
	31	To Bank Charges	1,000		Cr.	2,23,000
	31	By Interest collected on Government Securities		20,000	Cr.	2,43,000

CASH-BOOK (Bank column only)

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2022			2022		
Jan. 1	To Cash	4,00,000	Jan. 2	By Furniture Dealers Ltd.	60,000
Jan. 2	To J. Johnson & Co.	35,000	Jan. 2	By Roy & James	1,00,000
Jan. 8	To B. Babu & Co.	76,000	Jan. 2	By Das & Co.	1,25,000
Jan. 10	To Cash	30,000	Jan. 4	By K. Nagpal & Co.	73,000
Jan. 16	To J. Rai & Bros.	43,000	Jan. 17	By Cash	50,000
Jan. 20	To M. Mohan & Co.	1,05,000	Jan. 20	By B. Babu & Co.	78,000
Jan. 22	To N. Nandy & Sons	34,000	Jan. 31	By Balance c/d	2,37,000
		7,23,000			7,23,000
Feb. 1	To Balance b/d	2,37,000			

It will be seen that whereas the pass book shows a credit balance of ₹ 2,43,000, the cash-book shows a debit balance of ₹ 2,37,000. We shall compare the two to establish the reasons for the difference.

The reconciliation of the two statements can be done in two ways:-

1. Arrive at pass book balance from cash book.
2. Arrive at cash book balance from pass book.

Let us start with the pass book balance and arrive at the balance as per cash book.

Step: 1. Compare the debit side of cash book with the deposits column of pass book:-

We find that the following cheques are recorded in the cash book but not in the pass book. Therefore if we enter these two cheques in the deposit side of the pass book the balance becomes:-

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Exist ng balance	2, 43,000
Add:- M Mohan & Co.	1,05,000
N. Nandy & Sons	34,000
Total	3,82,000

Step: 2. Compare the credit side of the cash book with the withdrawal column of the pass book
 We find that the following cheques are not recorded. Therefore, if we enter these two cheques on the withdrawal side of the pass book the balance becomes: -

Exist ng balance	3,82,000
Less:- K Nagpal & Co.	(73,000)
B Babu & Co.	(78,000)
Total	2,31,000

There is an item 'Interest on Government Securities' which appears on the deposit side of the pass book but not in the debit side of the cash book, so this item should be deducted from pass book balance:-

Exist ng balance	2,31,000
Less:- Interest on govt. securit es	(20,000)
Total	2,11,000

Further, there are two items which appear on the withdrawal side of the pass book i.e. they have been deducted from the bank balance but not on the credit side of the cash book, so these items should be added in order to reconcile the balance:-

Exist ng balance	2,11,000
Add: Insurance premium	25,000
Add: Bank charges	1,000
Total	2,37,000

Therefore, we have arrived at the balance as per the cash book from the pass book.

This process shows that the difference between the two balance arise only because there are some entries made in the cash-book but not in the pass book and some entries which are made in the pass book but not in the cash book. A comparison of the two shows up such entries and then, on that basis, the reconciliation is prepared. To illustrate it again, let us proceed from the cash book balance of ₹ 2,37,000. Since cheques totalling ₹ 1,39,000 have not been entered in the pass book, let us assume that they are also omitted from the cash book, this will reduce the cash book balance to ₹ 98,000. Cheques totalling ₹ 1,51,000 have been entered on the credit side of the cash book but not in the pass book their omission from the cash book will increase the cash book balance to ₹ 2,49,000. Amounts totalling ₹ 26,000 have been entered in the withdrawals column of the pass book but not in the cash book; an entry on the credit side of the cash book for these amounts will reduce the balance to ₹ 2,23,000. The deposits column shows an entry of ₹ 20,000 not found on the debit side of the cash book; the entry made in the cash book will increase balance to ₹ 2,43,000 as shown in the pass book.

ILLUSTRATION 2

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

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

SOLUTION
Bank Reconciliation Statement

Particulars	Amount ₹
Balance as per Cash Book	2,40,000
Add: Cheque issued but not presented	1,36,000
Interest credited by bank	1,250
	3,77,250
Less: Cheque deposited but not yet cleared	(90,000)
Bank charges debited by bank	(300)
Balance as per Pass Book	2,86,950

ILLUSTRATION 3

On 31st March 2022, the Bank Pass Book of Namrata showed a balance of ₹ 1,50,000 to her credit while balance as per cash book was ₹ 1,12,050. On scrutiny of the two books, she ascertained the following causes of difference:

- i) She has issued cheques amounting to ₹ 80,000 out of which only ₹ 32,000 were presented for payment.
- ii) She received a cheque of ₹ 5,000 which she recorded in her cash book but forgot to deposit in the bank.
- iii) A cheque of ₹ 22,000 deposited by her has not been cleared yet.
- iv) Mr. Gupta deposited an amount of ₹ 15,700 in her bank which has not been recorded by her in Cash Book yet.
- v) Bank has credited an interest of ₹ 1,500 while charging ₹ 250 as bank charges.

Prepare a bank reconciliation statement.

SOLUTION
Bank Reconciliation Statement as on 31st March, 2022

Particulars	Details (₹)	Amount (₹)
Balance as per Pass Book (Cr.)		1,50,000
Add: Cheque deposited but not yet cleared	22,000	
Add: Cheque recorded in Cash Book but not yet deposited	5,000	
Add: Bank Charges debited by bank	250	27,250
Less: Cheque issued but not yet presented	48,000	
Less: Amount deposited but not recorded in Cash Book	15,700	
Less: Interest allowed by bank	1,500	65,200
Balance as per Cash Book		1,12,050

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ILLUSTRATION 4

From the following particulars ascertain the balance that would appear in the Bank Pass Book of A on 31st December, 2022.

- (1) The bank overdraft as per Cash Book on 31st December, 2022 ₹ 6,340.
- (2) Interest on overdraft for 6 months ending 31st December, 2022 ₹ 160 is entered in Pass Book.
- (3) Bank charges of ₹ 400 are debited in the Pass Book only.
- (4) Cheques issued but not cashed prior to 31st December, 2022, amounted to ₹ 11,68,000.
- (5) Cheques paid into bank but not cleared before 31st December, 2022 were for ₹ 22,17,000.
- (6) Interest on investments collected by the bank and credited in the Pass Book ₹ 12,00,000.

SOLUTION

Bank Reconciliation Statement As on 31st December, 2022

Particulars	Amount ₹
Overdraft as per Cash Book	6,340
Add: Interest debited in the Pass Book but not yet entered in the Cash Book	160
Add: Bank charges debited in the Pass Book but not entered in the Cash Book	400
Add: Cheques deposited but not yet credited in the Pass Book	22,17,000
	22,23,900
Less: Cheques issued but not yet presented	(11,68,000)
Less: Interest collected and credited by bank but not yet entered in Cash Book	(12,00,000)
Balance as per Pass Book (Credit/Favourable balance)	(1,44,100)

The above illustration can also be presented with the column for "Plus" and "Minus."

Particulars	Plus Amount ₹	Minus Amount ₹
Overdraft as per Cash Book		6,340
Interest debited in Pass Book but not yet in Cash Book		160
Cheque issued but not yet presented	11,68,000	
Cheques paid in but not yet credited by the Bank		22,17,000
Bank charges		400
Interest collected and credited by the Bank in the Pass Book but not yet entered in Cash Book	12,00,000	
Balance as per Pass Book		1,44,100
Total	23,68,000	23,68,000

ILLUSTRATION 5

On 30th September, 2022, the bank account of X, according to the bank column of the Cash-Book, was overdrawn to the extent of ₹ 4,062. On the same date the bank statement showed a credit

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balance of ₹ 20,758 in favour of X. An examination of the Cash Book and Bank Statement reveals the following:

1. A cheque for ₹ 13,14,000 deposited on 29th September, 2022 was credited by the bank only on 3rd October, 2022.
2. A payment by cheque for ₹ 16,000 has been entered twice in the Cash Book.
3. On 29th September, 2022, the bank credited an amount of ₹ 1,17,400 received from a customer of X, but the advice was not received by X until 1st October, 2022.
4. Bank charges amounting to ₹ 580 had not been entered in the Cash Book.
5. On 6th September, 2022, the bank credited ₹ 20,000 to X in error.
6. A bill of exchange for ₹ 1,40,000 was discounted by X with his bank. This bill was dishonoured on 28th September, 2022 but no entry had been made in the books of X.
7. Cheques issued upto 30th September, 2022 but not presented for payment upto that date totalled ₹ 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, 2022 and
- (b) to prepare a bank reconciliation statement as on that date.

SOLUTION

(a)

Cash Book (Bank Column)

Date 2022	Particulars	Amount ₹	Date 2022	Particulars	Amount ₹
Sept. 30	To Party A/c To To Customer A/c (Direct deposit) To Balance c/d	16,000 1,17,400 11,242 1,44,642	Sept. 30	By Balance b/d By Bank charges By Customer A/c (B/R dishonoured)	4,062 580 1,40,000 1,44,642

(b) Bank Reconciliation Statement as on 30th September, 2022

Particulars	Amount ₹
Overdraft as per Cash Book	11,242
Add: Cheque deposited but not collected upto 30th September, 2022	13,14,000
	13,25,242
Less: Cheques issued but not presented for payment upto 30th September, 2022	(13,26,000)
Credit by Bank erroneously on 6th September	(20,000)
Credit balance as per bank statement	20,758

Note: Bank has credited X by 20,000 in error on 6th September, 2022. If this mistake is rectified in the bank statement, then this will not be deducted in the above statement along with ₹ 13,26,000 resulting in credit balance of ₹ 758 as per pass-book.

ILLUSTRATION 6

On 30th December, 2022 the bank column of A. Philip's cash book showed a debit balance of ₹ 4,610. On examination of the cash book and bank statement you find that:

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1. Cheques amounting to ₹ 6,30,000 which were issued to trade payables and entered in the cash book before 30th December, 2022 were not presented for payment until that date.
2. Cheques amounting to ₹ 2,50,000 had been recorded in the cash book as having been paid into the bank on 30th December, 2022, but were entered in the bank statement on 1st January, 2023.
3. A cheque received for ₹ 73,000 had been dishonoured prior to 30th December, 2022, but no record of this fact appeared in the cash book.
4. A dividend of ₹ 3,80,000, paid direct to the bank had not been recorded in the cash book.
5. Bank interest and charges amounting to ₹ 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 ₹ 10,000 paid vide banker's order in November, 2022.
7. A cheque for ₹ 27,000 drawn by B. Philip had been charged to A. Philip's bank account by mistake in December, 2022.

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.

SOLUTION

(a) **A. Philip**

Dr.			Cash Book (Bank column)		Cr.
Date 2022	Part culars	Amount ₹	Date 2022	Part culars	Amount ₹
Dec. 30	To Balance b/d	4,610	Dec. 30	By Trade receivables-	73,000
				Cheque dishonoured	
	To Dividend received	3,80,000		By Bank interest and charges	
					4,200
				By Trade Subscript on	10,000
			Dec. 31	By Balance c/d	2,97,410
		3,84,610			3,84,610
2023					
Jan. 1	To Balance b/d	2,97,410			

(b) **Bank Reconciliation Statement as at 30th December, 2022**

Particulars	Amount ₹
Balance per cash book	2,97,410
Add: Cheques not yet presented	6,30,000
	9,27,410
Less: Lodgement not yet recorded by bank	(2,50,000)

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	6,77,410
Less: Cheque wrongly charged	(27,000)
Balance as per the bank statement	6,50,410

ILLUSTRATION 7

From the following information, prepare a Bank reconciliation statement as at 31st December, 2022 for Messrs New Steel Limited :

	₹
(1) Bank overdraft as per Cash Book on 31st December, 2022	22,45,900
(2) Interest debited by Bank on 26th December, 2022 but no advice received	2,78,700
(3) Cheque issued before 31st December, 2022 but not yet presented to Bank	6,60,000
(4) Transport subsidy received from the State Government directly by the Bank but not advised to the company	14,25,000
(5) Draft deposited in the Bank, but not credited till 31st December, 2022	13,50,000
(6) Bills for collection credited by the Bank till 31st December, 2022 but no advice received by the company	8,36,000
(7) Amount wrongly debited to company account by the Bank, for which no details are available	7,40,000

SOLUTION

M/s. New Steel Ltd. Bank Reconciliation Statement as on 31st Dec, 2022			
Particulars	Details ₹	Amount ₹	
Overdraft as per Cash Book		22,45,900	
Add : Interest charged by the bank	2,78,700		
Draft deposited in bank but not yet credited	13,50,000		
Wrong debit by the bank, under verification	7,40,000	23,68,700	
		46,14,600	
Less: Cheque issued but not yet presented	(6,60,000)		
Transport subsidy not yet recorded in the Cash Book	(14,25,000)		
Bills for collection credited in the bank not yet entered in the cash book	(8,36,000)	(29,21,000)	
Overdraft as per bank statement		16,93,600	

ILLUSTRATION 8

The Cash Book of Mr. Gadbadwala shows ₹ 8,36,400 as the balance at Bank as on 31st December, 2022, 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, 2022 the payment side of the Cash Book was undercast by ₹ 10,000.
- (2) A cheque for ₹ 1,31,000 issued on 25th December, 2022 was not taken in the bank column.
- (3) One deposit of ₹ 1,50,000 was recorded in the Cash Book as if there is no bank column therein.
- (4) On 18th December, 2022 the debit balance of ₹ 15,260 as on the previous day, was brought forward as credit balance in the Cash book.
- (5) Of the total cheques amounting to ₹ 11,514 drawn in the last week of December, 2022,

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cheques aggregating ₹ 7,815 were encashed in December.

- (6) Dividends of ₹ 25,000 collected by the Bank and subscription of ₹ 1,000 paid by it were not recorded in the Cash Book.
- (7) One out-going Cheque of ₹ 3,50,000 was recorded twice in the Cash Book. Prepare a Reconciliation Statement.

Prepare bank reconciliation statement:

(i) If the books are not closed on 31st December, 2022

(ii) If the books are closed on 31st December, 2022

SOLUTION

(If the books are not closed on 31st December, 2022)

Bank Reconciliation Statement of Mr. Gadbadwala as on 31st Dec., 2022

Particulars		Details ₹	Amount ₹
Balance as per the Cash Book			8,36,400
Add : Mistake in bringing forward ₹ 15,260 debit balance as credit balance on 18th Dec., 2022		30,520	
Cheques issued but not presented :			
Issued	11,514		
Cashed	7,815	3,699	
Dividends directly collected by bank but not yet entered in the Cash Book		25,000	
Cheque recorded twice in the Cash Book		3,50,000	
Deposit not recorded in the Bank column		1,50,000	5,59,219
			13,95,619
Less : Wrong casting in the Cash Book on 15th Dec.		10,000	
Cheques issued but not entered in the Bank column		1,31,000	
Subscription paid by the bank directly not yet recorded in the Cash Book		1,000	(1,42,000)
Balance as per the Pass Book			12,53,619

If the books are to be closed on 31st December, then adjusted cash book will be prepared as given below:

Cash Book (Bank Column)

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	8,36,400	By wrong casting	10,000
To error for wrong posting	30,520	By cheques not entered	1,31,000
To dividends collected by bank	25,000	By subscription	1,000
To cheques recorded twice	3,50,000	By balance c/d	12,49,920
To deposit not recorded	1,50,000		
	13,91,920		13,91,920

Bank Reconciliation Statement

Particulars	₹
Balance as per the Cash Book (corrected)	12,49,920
Add: Cheques issued but not yet presented	3,699

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Balance as per the Pass Book	12,53,619

ILLUSTRATION 9

The following are the Cash Book (bank column) and Pass Book of Jain for the months of March, 2022 and April, 2022:

Cash Book (Bank Column only)

Date	Particulars	Amount Dr. ₹	Date	Particulars	Amount Cr. ₹
01/3/2022	To Balance b/d	60,000	03/3/2022	By Cash A/c	2,00,000
06/3/2022	To Sales A/c	3,00,000	07/3/2022	By Modi	60,000
10/3/2022	To Ram	65,000	12/3/2022	By Pat I	30,000
18/3/2022	To Singhal	2,70,000	18/3/2022	By Suresh	40,000
25/3/2022	To Goyal	33,000	24/3/2022	By Ramesh	1,50,000
31/3/2022	To Patel	65,000	30/3/2022	By Balance c/d	3,13,000
		7,93,000			7,93,000

Pass Book

Date	Particulars	Amount Dr. ₹	Amount Cr. ₹	Dr. or Cr.	Balance ₹
1/4/2022	By Balance b/d		3,65,000	Cr.	3,65,000
3/4/2022	By Goyal		33,000	Cr.	3,98,000
5/4/2022	By Patel		65,000	Cr.	4,63,000
7/4/2022	To Naresh	2,80,000		Cr.	1,83,000
12/4/2022	To Ramesh	1,50,000		Cr.	33,000
15/4/2022	To Bank Charges	200		Cr.	32,800
20/4/2022	By Usha		17,000	Cr.	49,800
25/4/2022	By Kalpana		38,000	Cr.	87,800
30/4/2022	To Sunil	6,200		Cr.	81,600

Reconcile the balance of cash book on 31/3/2022.

SOLUTION

- On scrutiny of the debit side of the Cash Book of March 2022 and receipt side of the Pass Book of April, 2022 reveals that two cheques deposited in Bank (Goyal ₹ 33,000 and Patel ₹ 65,000) in March were not credited by the Bank till 31/3/2022.
- On scrutiny of the credit side of the cash book and payment side of the Pass Book reveals that a cheque issued to Ramesh for ₹ 1,50,000 in March 2022, had not been presented for payment in Bank till 31/3/2022. Therefore the Bank Reconciliation statement on 31/3/2022 will appear as follows :

Bank Reconciliation Statement as on 31st March, 2022

Particulars	Amount (₹)
Balance as per the Cash Book	3,13,000
Add : Cheque issued but not presented for payment	1,50,000
	4,63,000
Less : Cheque deposited but not credited by Bank	(98,000)

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Balance as per the Pass Book	3,65,000

ILLUSTRATION 10

When Nikki & Co. received a Bank Statement showing a favourable balance of ₹ 10,39,200 for the period ended on 30th June, 2022, 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 ₹ 3,09,200 paid on 29th June, 2022 had not been credited by the Bank until 1st July, 2022.
2. On 30th March, 2022 the company had entered into hire purchase agreement to pay by bank order a sum of ₹ 3,00,000 on the 10th of each month, commencing from April, 2022. 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 ₹ 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 ₹ 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 ₹ 4,00,000, but no entry had been made in the Cash Book.
6. ₹ 11,200 paid into the bank had been entered twice in the Cash Book.
7. A debit of ₹ 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, 2022.

Prepare Bank Reconciliation Statement on 30 June, 2022.

SOLUTION

Bank Reconciliation Statement on 30th June, 2022

Particulars	Details (₹)	Amount (₹)
Balance as per the Pass Book		10,39,200
Add: Deposited with bank but not credited	3,09,200	
Payment of Hire Purchase installments not entered in the Cash Book (₹ 3,00,000 x 3)	9,00,000	
Discount allowed wrongly entered in bank column	16,000	
Bank charges not entered in the Cash Book	3,000	
Deposit entered in the Cash Book twice	11,200	
Cheque returned 'out of date' entered in the Cash Book	11,00,000	23,39,400
		33,78,600
Less: Direct deposit by customer not entered in the Cash Book		(4,00,000)
Balance as per the Cash Book		29,78,600

ILLUSTRATION 11

Mr. Manoj is employed by Century Rayon and Carpets Pvt Ltd. as their cashier. The main responsibility of Mr. Manoj is to maintain the company's cash book and prepare a bank

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reconciliation statement at the end of each month. The cash book (only bank column) is set out below together with a copy of the bank statement for the month of February 2022.

You are required to :

- Reconcile the cash book with the bank statement.
- Make necessary entries to update the cash book.
- Start with the balance as per cash book, list any unpresented cheques and sub-total on the reconciliation statement.

Century Rayon and Carpets Pvt Ltd
Cash Book (Bank Column only)

Date	Particulars	Amount Dr. ₹	Date	Particulars	Amount Cr. ₹
01/02/2022	To Balance b/d	1,42,500	03/02/2022	By Bhagwandas	1,980
01/02/2022	To Blue and Co	1,570	07/02/2022	By Marut Ltd (400460)	1,500
04/02/2022	To GM Ltd	2,430	12/02/2022	By Jackson Ltd (400461)	54,000
08/02/2022	To Robinson Ltd	910	18/02/2022	By PC computers (400462)	1,420
13/02/2022	To Donald	750	24/02/2022	By Shiv garage (400463)	49,000
20/02/2022	To Avenue Super mart	4,200	30/02/2022	By Pet y cash (400465)	1,500
28/02/2022	To Sleep Well Ltd	940		By Shweta & Co (400464)	2,100
				By AV Partners (400466)	5,200
				By Balance c/d	36,600
		1,53,300			1,53,300

Customer: Century Rayon and Carpets Pvt Ltd Account No – xxxxx0439
Account Statement for the month of February 2022

Date	Particulars	Amount Dr.	Amount Cr.	Dr. or Cr.	Balance ₹
1/02/2022	Balance b/d				1,42,500
3/02/2022	Cheques		1,570	Cr.	1,44,070
5/02/2022	Marut Ltd	1,500		Dr.	1,42,570
7/02/2022	Bhagwandas	1,980		Dr.	1,40,590
12/02/2022	GM Ltd		2,430	Cr.	1,43,020
15/02/2022	Robinson Ltd		910	Cr.	1,43,930
20/02/2022	Premium of New India Insurance Ltd	3,800		Dr.	1,40,130
14/02/2022	Donald		750	Cr.	1,40,880
14/02/2022	400463	49,000		Dr.	91,880
23/02/2022	cheques		4,200	Cr.	96,080
26/02/2022	Savita 400465	1,030		Dr.	95,050
26/02/2022	Shreya	1,500		Dr.	93,550
27/02/2022			2,200	Cr.	95,750
28/02/2022	Bank charges	2,538		Dr.	93,212

SOLUTION

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Journal entries to be posted:

Bank A/c	Dr 2200	
To Shreya A/c		2200
Bank Charges A/c	Dr 2538	
Insurance premium A/c	Dr 3800	
Savita A/c	Dr 1030	
To Bank A/c		7368

After posting above entries, following will be the updated book of the company.

Cash Book (Bank Column)

Particulars	Amount (₹)	Particulars	Amount (₹)
To balance b/d	36,600	By bank charges	2,538
To direct receipt in bank	2,200	By insurance premium	3,800
		By direct payment to Savita	1,030
		By balance c/d	31,432
	38,800		38,800

Bank Reconciliation Statement as on February 28, 2022

Particulars	Details	Amount ₹
Updated Balance as per Cash book		31,432
Add: Cheques issued but not yet presented for payment Jackson Ltd	54000	
P C Computers	1,420	
Shweta & Co	2,100	
A.V. Partners	5,200	62,720
		94,152
Less: Cheques deposited but not yet credited Sleep Well Ltd	940	940
Balance as per the bank statement		93,212

Example 1

The balance as per Cash Book and Pass Book are ₹10,000. Cheque of ₹ 2,000 is issued but not presented for payment. Then the balances as per cash book and pass book will be as follows:

Cash book (bank column only)

Particulars	₹	Particulars	₹
To balance b/f	10,000	By Vendor A/c (to whom cheque is issued)	2,000
		By balance c/f	8,000
	10,000		10,000

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Bank statement (pass book)

Date	Particulars	Dr. (withdrawn)	Cr. (deposited)	Balance
	Balance b/f			

On the issue of aforesaid cheque, the bank account in Cash Book is credited by ₹2,000 and so balance is reduced to ₹ 8,000. Whereas balance in the Pass Book remains ₹10,000 until the cheque is presented for payment.

Example 2

The balance as per Cash book and Pass Book are ₹ 12,000. Cheque of ₹ 3,000 is deposited but not cleared.

Cash book

Particulars	₹	Particulars	₹
To balance b/f	12,000	By balance c/f	15,000
To Vendor A/c	3,000		
	15,000		15,000

Bank statement (Pass Book)

Date	Particulars	Dr. (withdrawn)	Cr. (deposited)	Balance
	Balance b/f			12,000 (cr.)

When cheque is deposited into bank, the bank account in Cash Book is increased to ₹ 15,000, but the balance in the Pass Book remains ₹ 12,000 until the cheque is cleared.

Example 3

The balance as per Cash Book and Pass Book are ₹ 10,000. The bank has allowed ₹ 1,000 interest on saving account to customer.

Cash book

Particulars	₹	Particulars	₹
To balance b/f	10,000	By balance c/f	10,000
	10,000		10,000

Bank statement (Pass Book)

Date	Particulars	Dr. (withdrawn)	Cr. (deposited)	Balance
	Balance b/f			10,000 (cr.)
	Interest		1,000	11,000 (cr.)

Because of such interest, balance of Pass Book is increased to ₹11,000. Whereas balance in the Cash Book remains ₹10,000 until information reaches to the customer and he records such transaction.

Example 4
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The balance as per Cash Book and Pass Book are ₹15,000. The bank has collected dividend of ₹ 2,000.

Cash book

Particulars	₹	Particulars	₹
To balance b/f	15,000	By balance c/f	15,000
	15,000		15,000

Bank statement (Pass Book)

Date	Particulars	Dr. (withdrawn)	Cr. (deposited)	Balance
	Balance b/f			15,000(cr.)
	Dividend		2,000(Cr.)	17,000(cr.)

On collection of dividend bank credits the amount to customer's account, so balance in Pass Book is increased to ₹ 17,000. Whereas balance in the Cash Book remains ₹ 15,000 until the information of such dividend collection reaches to the customer and he records such transaction.

Example 5

The balance as per Cash Book and Pass Book of Mr. X are ₹ 20,000. The bank has instruction to pay insurance premium of ₹ 1,500 directly to insurance company at the end of each month.

Particulars	₹	Particulars	₹
To balance b/f	20,000	By balance c/f	20,000
	20,000		20,000

Bank statement (pass book)

Date	Particulars	Dr. (withdrawn)	Cr. (deposited)	Balance
	Balance b/f			20,000 (cr.)
	Insurance premium	1,500		18,500 (cr.)

On payment of insurance premium bank debits the customer's account by ₹ 1,500 so balance in Pass Book is decreased to ₹ 18,500. Whereas balance in the Cash Book remains ₹ 20,000 until the information of such payment reaches to the customer and he records such transaction.

Example 6

The balances as per Cash Book and Pass Book of Mr. X are ₹ 20,000. Mr. X deposited a cheque of ₹ 3,000 and debited to his bank account ₹ 3,000 immediately. But bank will credit X's account on realization of amount. Now the cheque is dishonoured for non-payment. Bank charges ₹ 100 in this connection.

Cash book

Particulars	₹	Particulars	₹
To balance b/f	20,000	By balance c/f	23,000
To bank a/c	3,000		
	23,000		23,000

Bank statement (Pass Book)

Date	Particulars	Dr. (withdrawn)	Cr. (deposited)	Balance

	Balance b/f Bank charges	100		20,000 (cr.) 19,900 (cr.)

Thus, balance of Mr. X's account in Pass Book stands ₹ 19,900 after this transaction while balance as per Cash Book stand ₹ 23,000. So Mr. X should deduct ₹ 3,000 the amount of dishonoured cheque, plus ₹ 100 the amount of bank charges for reconciliation.

Example 7

Mr. A's cash book shows following transactions:

CASH-BOOK (Bank column only)

Date	Particulars	Amount ₹	Date 2022	Particulars	Amount ₹
			Mar 31	By balance c/d	1,00,000
April 7	To Wayne Ltd.	60,000	Apr 1	By balance b/d	10,000
April 11	To Cash A/c	80,000	April 29	By Cash A/c	2,000
				By Balance c/d	1,28,000
		1,40,000			1,40,000

PASS-BOOK

Date	Particulars	Withdrawals ₹	Deposit ₹	Balance ₹ (cr.)
2022 April 1	Balance b/d			1,00,000
April 7	By Wayne Ltd. By Cash		60,000	1,60,000
April 11	To Vandy Ltd.		80,000	2,40,000
April 13	To Cash A/c	90,000		3,30,000
April 29		2,000		3,28,000

Here there are several errors made by accountant:

April 1: Balance should be have bought down in debit side as ₹ 1,00,000

April 13: Also a cheque issued to Vandy Ltd. has been omitted in the books of ₹ 90,000 So, on correcting these entries balance as per Cash Book will be:

Exist ng Balance	₹ 1,28,000
Add: Correct Opening Balance	₹ 1,00,000
Add: Incorrect Opening Balance	₹ 10,000
(Since it was bought down on credit side it will be added back)	
Less: Cheque issued not recorded	₹ 90,000
Closing Balance as per Cash Book	₹ 1,48,000
Balance as per Pass Book	3,28,000
Less: Cheque to Vandy Ltd wrongly added to exist ng balance	
instead of being subtracted	1,80,000
Dif erence in balances between cash book and pass book	Nil

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True and False

Question 1

Inventories are stocks of goods and materials that are maintained for mainly the purpose of revenue generation.

Answer 1

True: Inventories refers to stocks of goods and materials that are maintained in business for revenue generation.

Question 2

A building is considered inventory in a construction business.

Answer 2

True: For a construction business, a building under construction will be inventory. The building is being built in the normal course of business and will eventually be sold as inventory.

Question 3

Inventory is valued as carrying cost less percentage decreases.

Answer 3

False: Inventory is valued at lower of cost or net realizable value.

Question 4

Management has daily information about the quantity and valuation of closing stock under physical Inventory System.

Answer 4

False: Under Perpetual Inventory System management have daily information of closing stock.

Question 5

Periodic Inventory System is more suitable for small enterprises.

Answer 5

True: A periodic inventory system is suitable to small and micro enterprises, where physical counting of inventory is not a tedious process.

Question 6

When closing inventory is overstated, net income for the accounting period will be understated.

Answer 6

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False: When closing inventory is overstated, net income for the accounting period will be overstated.

Question 7

Closing inventory = Opening inventory + Purchases + Direct expenses + Cost of goods sold.

Answer 7

False: Closing stock = Cost of goods sold - (Opening inventory + Purchases + Direct expenses).

Question 8

Cost of inventories should comprise all cost of purchase.

Answer 8

False: Cost of inventories should comprise all cost of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Question 9

Inventory by-products, should be valued at net realisable value where cost of by products can be separately determined.

Answer 9

False: Inventory by-products, should be valued at net realisable value where cost of by products cannot be separately determined.

Question 10

Abnormal amounts of wasted materials, labour or other production overheads expenses are included in the costs of inventories.

Answer 10

False: Abnormal amounts of wasted materials, labour or other production overheads expenses are generally not included in the costs of inventories.

Question 11

Perpetual system requires closure of business for counting of inventory.

Answer 11

False: Periodic system requires closure of business for counting of inventory.

Question 12

Periodic inventory system is a method of ascertaining inventory by taking an actual physical count.

Answer 12

True: Under Periodic inventory system actual physical count of inventory is taken of all the inventory on hand at a particular date.

Question 13

The value of closing inventory under simple average price method is realistic as compare to LIFO.

Answer 13

True: Value of Closing stock as per average method is more realistic then LIFO.

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Question 14

The value of stock is shown on the assets side of the balance-sheet as fixed assets.

Answer 14

False: The value of stock is shown on the assets side of the balance-sheet as current assets. As it is realisable within 12 months.

Question 15

Under inflationary conditions, FIFO will not show lowest value of cost of goods sold.

Answer 15

False: Under inflationary conditions, LIFO and weighted average will not show lowest value of cost of goods sold.

Question 16

Under LIFO, valuation of inventory is based on the assumption that costs are charged against revenue in the order in which they occur.

Answer 16

False: Under FIFO, valuation of inventory is based on the assumption that costs are charged against revenue in the order in which they occur.

Question 17

Valuation of inventory, at cost or net realisable value, whichever less, is based on the principle of Conservatism.

Answer 17

True: The conservatism concept states that one shall not account for anticipated profits but shall provide all prospective losses. Valuing inventory at cost or net realisable value whichever is less, therefore is based on principle of Conservatism.

Question 18

Finished goods are normally valued at cost or market price whichever is higher.

Answer 18

False: Finished goods are normally valued at cost or market price whichever is lower.

Multiple Choice Questions

1. The amount of purchase if
 Cost of goods sold is ₹ 80,700
 Opening Inventory ₹ 5,800
 Closing Inventory ₹ 6,000
 (g) ₹ 80500
 (h) ₹ 74900
 (i) ₹ 80900

Answer 1 : (c)

2. Average Inventory = ₹ 12,000. Closing Inventory is ₹ 3,000 more than opening Inventory. The value of closing Inventory = _____.

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- (a) ₹ 12,000
- (b) ₹ 24,000
- (c) ₹ 13,500.

Answer 2 : (c)

3. While finalizing the current year's profit, the company realized that there was an error in the valuation of closing Inventory of the previous year. In the previous year, closing Inventory was valued more by ₹ 50,000. As a result
- (d) Previous year's profit is overstated and current year's profit is also overstated
 - (e) Previous year's profit is overstated and current year's profit is understated
 - (f) Previous year's profit is understated and current year's profit is also understated

Answer 3 : (b)

4. Consider the following for Q Co. for the year 2021-22:

Cost of goods available for sale	₹ 1,00,000
Total sales	₹ 80,000
Opening inventory of goods	₹ 20,000
Gross profit margin on sales	25%
Closing inventory of goods for the year 2021-22 as	

- (a) ₹ 80,000
- (b) ₹ 60,000
- (c) ₹ 40,000

Answer 4 : (c)

5. If the profit is 25% of the cost price then it is

- (a) 25% of the sales price
- (b) 33% of the sales price
- (c) 20% of the sales price

Answer 5 : (c)

6. Goods purchased ₹ 1,00,000. Sales ₹ 90,000. Margin 20% on cost. Closing Inventory =?

- (a) ₹ 20,000
- (b) ₹ 10,000
- (c) ₹ 25,000

Answer 6 : (c)

7. A company is following weighted average cost method for valuing its inventory. The details of its purchase and issue of raw-materials during the week are as follows:

1.12.2022 opening Inventory 50 units value ₹ 2,200.

2.12.2022 purchased 100 units @ ₹47.

4.12.2022 issued 50 units.

5.12.2022 purchased 200 units @ ₹ 48

The value of inventory at the end of the week and the unit weighted average costs is

- (a) ₹ 14,200 – ₹ 47.33
- (b) ₹ 14,300 – ₹ 47.67

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(c) ₹ 14,000 – ₹ 46.66

Answer 7 : (a)

8. The cost of sales is equal to

- (a) Opening stock plus purchases
- (b) Purchases minus Closing stock
- (c) Opening stock plus purchases minus closing stock

Answer 8 : (c)

9. Inventory is disclosed in financial statements under:

- (a) Fixed Assets
- (b) Current Assets
- (c) Current Liabilities

Answer 9 : (b)

10. Accounting Standards do not permit following method of inventory valuation

- (a) FIFO
- (b) Average cost
- (c) LIFO

Answer 10 : (c)

11. Which inventory costing formula calculates value of closing inventory considering that inventory most recently purchased has not been sold?

- (a) FIFO
- (b) LIFO
- (c) Weighted average cost

Answer 11 : (a)

12. Valuing inventory at cost or net releasable value is based on which principle

- (a) Consistency
- (b) Conservatism
- (c) Going concern

Answer 12 : (b)

13. Under inflationary trend, which of the methods will show highest value of inventory?

- (a) FIFO
- (b) Weighted average
- (c) LIFO

Answer 13 : (a)

14. Which of the following methods does not consider historical cost of inventory?

- (a) Weighted average
- (b) FIFO

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(c) **Retail price method**

Answer 14 : (c)

Theoretical Questions & Answers

Question 1

Write short notes on:

- (i) **Adjusted Selling Price method of determining cost of stock.**
- (ii) **Principal methods of ascertainment of cost of inventory.**

Answer 1

- (i) Adjusted selling method is also called retail inventory method. It is used widely in retail business or in business where the inventory comprises of items, the individual costs of which are not readily ascertainable. The historical cost of inventory is estimated by calculating it in the first instance at selling price and then deducting an amount equal to the estimated gross margin of profit on such stocks.
- (ii) The specific identification method, First-In–First-Out (FIFO) and weighted average cost formulae are the principal methods of ascertaining the cost of inventory. The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by specific identification of their individual costs under the specific identification method.

Question 2

Distinguish between:

- (i) **LIFO and FIFO basis of costing of stock.**
- (ii) **FIFO and weighted average price method of stock costing.**

Answer 2

- (i) Under FIFO method of inventory valuation, inventories purchased first are issued first. The closing inventories are valued at latest purchase prices and inventory issues are valued at corresponding old purchase prices. In other words, under FIFO method, costs are assigned to the units issued in the same order as the costs entered in the inventory. During periods of rising prices, cost of goods sold are valued at older and lower prices if FIFO is followed and consequently reported profit rise due to lower cost of goods sold.
On the other hand, under LIFO method of inventory valuation, units of inventories issued should be valued at the prices paid for the latest purchases and closing inventories should be valued at the prices paid for earlier purchases. In other words, closing inventories are valued at old purchase prices and issues are valued at corresponding latest purchase prices.
- (ii) Under the First-In-First-Out (FIFO) method of valuation of stock, the actual issue of goods is usually the earliest lot on hand. Hence, the stock in hand will therefore consist of the latest consignments. The closing stock is valued at the price paid for such consignments.
The weighted average price method is not a simple average price method. Under this method of valuation of stock, a stock ledger is maintained, recording receipts and issues on daily basis. A new average would be calculated on receiving fresh consignment. The average price thus calculated after considering arrival of new consignment with the previous value of stock and dividing the preceding stock value and the cost of new arrival with the total units of preceding and new arrival will give the weighted average price.

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Question 3

Define inventory. Explain the importance of proper valuation of inventory in the preparation of statements of the business entity.

Answer 3

Inventory can be defined as assets held

- ♦ for sale in the ordinary course of business, or
- ♦ in the process of production for such sale, or
- ♦ for consumption in the production of goods or services for sale, including maintenance supplies and consumables other than machinery spares.

The significance of inventory valuation arises due to the following reasons:

- (i) Determination of Income
- (ii) Ascertainment of Financial Position
- (iii) Liquidity Analysis
- (iv) Statutory Compliance

Practical Questions & Answers
Question 1

X who was closing his books on 31.3.2022 failed to take the actual stock which he did only on 9th April, 2022, when it was ascertained by him to be worth ₹ 2,50,000.

It was found that sales are entered in the sales book on the same day of dispatch and return inwards in the returns book as and when the goods are received back. Purchases are entered in the purchases day book once the invoices are received.

It was found that sales between 31.3.2022 and 9.4.2022 as per the sales day book are ₹ 17,200. Purchases between 31.3.2022 and 9.4.2022 as per purchases day book are ₹ 1,200, out of these goods amounting to ₹ 500 were not received until after the stock was taken.

Goods invoiced during the month of March, 2022 but goods received only on 4th April, 2022 amounted to ₹ 1,000. Rate of gross profit is 33-1/3% on cost.

Ascertain the value of physical stock as on 31.3.2022.

Answer 1
Statement of Valuation of Physical Stock as on 31st March, 2022

		₹
Value of stock as on 9th April, 2022		2,50,000
Add: Cost of sales during the intervening period		
Sales made between 31.3.2022 and 9.4.2022	17,200	
Less: Gross profit @25% on sales	(4,300)	12,900
		2,62,900
Less: Purchases actually received during the intervening period:		
Purchases from 1.4.2022 to 9.4.2022	1,200	
Less: Goods not received upto 9.4.2022	(500)	700
		2,62,200
Less: Purchases during March, 2022 received on 4.4.2022		1,000
Value of physical stock as on 31.3.2022		2,61,200

Question 2

From the following information, ascertain the value of stock as on 31.3.2022:

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	₹
Value of stock on 1.4.2021	7,00,000
Purchases during the period from 1.4.2021 to 31.3.2022	34,60,000
Manufacturing expenses during the above period	7,00,000
Sales during the same period	52,20,000

At the time of valuing stock on 31.3.2021 a sum of ₹ 60,000 was written off a particular item which was originally purchased for ₹ 2,00,000 and was sold for ₹ 1,60,000. But for the above transaction the gross profit earned during the year was 25% on cost.

Answer 2

Statement of Valuation of Stock as on 31st March, 2022

		₹
Value of stock as on 1st April, 2021		7,00,000
Add: Purchases during the period from 1.4.2021 to 31.3.2022		34,60,000
Add: Manufacturing expenses during the above period		7,00,000
		48,60,000
Less: Cost of sales during the period:		
Sales	52,20,000	
Less: Gross profit	10,32,000	41,88,000
Value of stock as on 31.3.2022		6,72,000

Working Note:

	₹
Calculation of gross profit:	
Gross profit on normal sales $20/100 \times (52,20,000 - 1,60,000)$	10,12,000
Gross profit on the particular (abnormal) item $1,60,000 - (2,00,000 - 60,000)$	20,000
	10,32,000

Note: The value of closing stock on 31st March, 2022 may, alternatively, be found out by preparing Trading Account for the year ended 31st March, 2022.

Question 3

The Profit and loss account of Hanuman showed a net profit of ₹ 6,00,000, after considering the closing stock of ₹ 3,75,000 on 31st March, 2022. Subsequently the following information was obtained from scrutiny of the books:

- Purchases for the year included ₹ 15,000 paid for new electric fittings for the shop.
- Hanuman gave away goods valued at ₹ 40,000 as free samples for which no entry was made in the books of accounts.
- Invoices for goods amounting to ₹ 2,50,000 have been entered on 27th March, 2022, but the goods were not included in stock.
- In March, 2022 goods of ₹ 2,00,000 sold and delivered were taken in the sales for April, 2022.
- Goods costing ₹ 75,000 were sent on sale or return in March, 2022 at a margin of profit of 33-1/3% on cost. Though approval was given in April, 2022 these were taken as sales for March, 2022.

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Calculate the value of stock on 31st March, 2022 and the adjusted net profit for the year ended on that date.

Answer 3

Profit and Loss Adjustment Account

Particulars	₹	Particulars	₹
To Advertisement (samples)	40,000	By Net profit	6,00,000
To Sales (goods approved in April to be taken as April sales: (75,000 + 25,000))	1,00,000	By Electric fittings	15,000
To Adjusted net profit	10,40,000	By Samples	40,000
		By Stock (purchases of March not included in stock)	2,50,000
		By Sales (goods sold in March wrongly taken as April sales)	2,00,000
		By Stock (goods sent on approval basis not included in stock)	75,000
	11,80,000		11,80,000

Calculation of value of inventory on 31st March, 2022

	₹
Stock on 31st March, 2022 (given)	3,75,000
Add: Purchases of March, 2022 not included in the stock	2,50,000
Goods lying with customers on approval basis	75,000
	7,00,000

Question 4

Physical verification of stock in a business was done on 23rd June, 2022. The value of the stock was ₹ 48,00,000. The following transactions took place between 23rd June to 30th June, 2022:

- Out of the goods sent on consignment, goods at cost worth ₹ 2,40,000 were unsold.
- Purchases of ₹ 4,00,000 were made out of which goods worth ₹ 1,60,000 were delivered on 5th July, 2022.
- Sales were ₹ 13,60,000, which include goods worth ₹ 3,20,000 sent on approval. Half of these goods were returned before 30th June, 2022.
- Goods are sold at cost plus 25%. However, goods costing ₹ 2,40,000 had been sold for ₹ 1,20,000.

Determine the value of stock on 30th June, 2022.

Answer 4

Statement of Valuation of Stock on 30th June, 2022

		₹
Value of stock as on 23rd June, 2022		48,00,000
Add: Unsold stock out of the goods sent on consignment	2,40,000	
Purchases during the period from 23rd June, 2022 to 30th June, 2022	2,40,000	
Goods in transit on 30th June, 2022	1,60,000	
Cost of goods sent on approval basis (80% of ₹ 1,60,000)	1,28,000	7,68,000
		55,68,000

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Less: Cost of sales during the period from 23rd June, 2022 to 30th June, 2022		
Sales (₹ 13,60,000 - ₹ 1,60,000)	12,00,000	
Less: Gross profit	96,000	
		11,04,000
Value of stock as on 30th June, 2022		44,64,000

Working Notes:

1. Calculation of normal sales:		₹
Actual sales		13,60,000
Less: Abnormal sales	1,20,000	
Return of goods sent on approval	1,60,000	2,80,000
		10,80,000
2. Calculation of gross profit:		
Gross profit on normal sales $20/100 \times ₹ 10,80,000$		2,16,000
Less: Loss on sale of particular (abnormal) goods (₹ 2,40,000 - ₹ 1,20,000)		1,20,000
Gross profit		96,000

ILLUSTRATION 1

Surekha Ltd deals in 3 products P, Q & R, which are neither similar nor interchangeable. At the end of a financial year, the Historical Cost and NRV of items of Closing Stock are given below. Determine the value of Closing Stock.

Items	Historical Cost (in ₹ Lakhs)	Net Realisable Value (in ₹ Lakhs)
P	38	42
Q	29	29
R	17	14

Answer

Inventories are to be valued at the lower of cost and Net Realisable Value (NRV). Inventories are usually written down to NRV on an item-by-item basis. The Value of Closing Stocks is determined as under:

Items	Historical Cost (in ₹ Lakhs)	Net Realisable Value (in ₹ Lakhs)	Valuation = Least of Cost or NRV
P	38	42	38
Q	29	29	29
R	17	14	14
Total			81

ILLUSTRATION 2

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

Date	Quantity (units)	Price per unit
Dec. 4	900	50
Dec. 10	400	55
Dec. 11	300	55

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Dec. 19	200	60
Dec. 28	800	47
	2,600	

1,600 units were issued during the month of December till 18th December. Calculate the value of closing inventory.

Answer

The closing inventory is 1,000 units and would consist of:
 800 units received on 28th December; and
 200 units received on 19th December as per FIFO

	₹
The value of 800 units @ ₹ 47	37,600
The value of 200 units @ ₹ 60	12,000
Total	49,600

ILLUSTRATION 3

In the previous example assume that following issues were made during the month of December:

Record of issues

Date	Quant ty (units)
Dec. 5	500
Dec. 20	600
Dec. 29	500
Total	1,600

Answer

Computation of closing stock under perpetual inventory system

Using LIFO method, following will be stock ledger:

Date	Receipts			Issues			Balance inventory		
Dec.	Qty.	Rate	Amount	Qty	Rate	Amount	Qty.	Rate	Amount
4	900	50	45,000	-	-	-	900	50	45,000
5	-	-	-	500	50	25,000	400	50	20,000
10	400	55	22,000	-	-	-	400	50	20,000
							400	55	22,000
11	300	55	16,500	-	-	-	400	50	20,000
							400	55	22,000
							300	55	16,500
19	200	60	12,000	-	-	-	400	50	20,000
							400	55	22,000
							300	55	16,500
							200	60	12,000
20	-	-	-	200	60	12,000			
	-	-	-	300	55	16,500			
	-	-	-	100	55	5,500	400	50	20,000
							300	55	16,500
28	800	47	37,600	-	-	-	400	50	20,000

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							300	55	16,500
28							800	47	37,600
29	-	-	-	500	47	23,500	400	50	20,000
							300	55	16,500
							300	47	14,100

Therefore, cost of closing inventory of 1,000 pcs will be ₹ 50,600.

Computation under periodic inventory system

In the above example, if the entity followed periodic inventory valuation, closing inventory of 1,000 pcs. will be valued as follows:

800 pcs. @ ₹ 47 each (purchased on Dec. 28th) = ₹ 37,600

200 pcs. @ ₹ 60 each (purchased on Dec. 19th) = ₹ 12,000

Total 1,000 pcs. = ₹ 49,600

We can see that cost of closing inventory has changed following LIFO method based on perpetual inventory method and periodic inventory method.

"LIFO method is based on an irrational assumption that inventories entering last in the stores are issued or consumed first. However, the flow of goods which is generally observed in business entities is contradictory to this assumption. It should be noted that while applying LIFO, there will be difference in cost of goods sold and value of closing inventory, if the entity follows periodic as against perpetual method of inventory valuation. (Periodic and Perpetual methods have been explained later in this chapter). Therefore, LIFO method is no longer adopted for valuing inventories. Accounting Standards also does not permit the usage of LIFO Method. Generally, in practice, FIFO and Weighted Average Price Method are popular among the business entities and both these methods are also permitted by Accounting Standards."

ILLUSTRATION 4

In the same example of a manufacturer of radio sets given earlier, let us calculate the value of closing inventory using Average Price Method:

Answer

The simple average in this question is:

$[(50 + 55 + 55 + 60 + 47)/5] = 267/5 = ₹ 53.4$

1,000 units valued at ₹ 53.4 would be ₹ 53,400

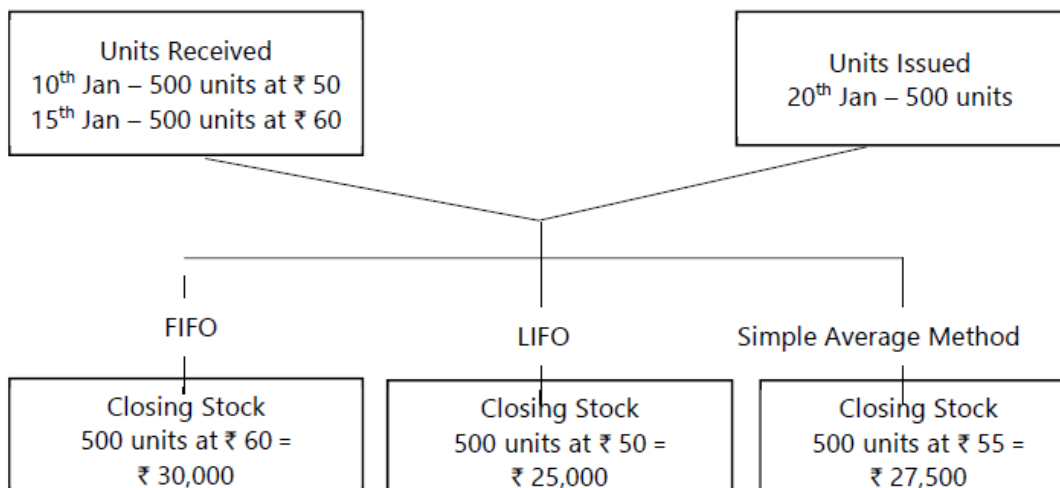
Let us try to analyse the impact of FIFO, LIFO and Simple Average Price Method with the help of the following chart:

Thus, we See that value of inventories Changes based on different cost formula used.

ILLUSTRATION 5

On the basis of the data given in illustration 2 and 3, calculate the weighted average price and also the value of closing inventory by weighted average price method.

Answer



The computation of weighted average price in the referred example is shown below:
 A new average rate would be calculated on receiving a fresh consignment. Answer on that basis would be as under:

Date	Receipts			Issues			Balance inventory		
	Qty	Rate	Amount	Qty	Rate	Amount	Qty	Rate	Amount
Dec. 4	900	50	45,000	-	-	-	900	50	45,000
Dec. 5	-	-	-	500	50	25,000	400	50	20,000
Dec. 10	400	55	22,000	-	-	-	800	52.5	42,000
Dec. 11	300	55	16,500	-	-	-	1,100	53.18	58,500
Dec. 19	200	60	12,000	-	-	-	1,300	54.23	70,500
Dec. 20	-	-	-	600	54.23	32,538	700	54.23	37,962
Dec. 28	800	47	37,600	-	-	-	1,500	50.37	75,562
Dec. 29	-	-	-	500	50.37	25,185	1,000	50.37	50,377

ILLUSTRATION 6

M/s X, Y and Z are in retail business, following information are obtained from their records for the year ended 31st March, 2022:

Goods received from suppliers

(subject to trade discount and taxes)	₹	15,75,500
Trade discount 3% and GST 11%		
Packaging and transportat on charges	₹	87,500
Sales during the year	₹	22,45,500
Sales price of closing inventories	₹	2,35,000

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

Answer

Determination of cost of purchases:

Goods received from suppliers	15,75,500
Less: Trade discount 3%	(47,265)
	15,28,235
Add: GST 11%	₹ 1,68,106
	₹ 16,96,341
Add: Packaging and transportat on charges	₹ 87,500
	₹ 17,83,841

Determination of estimated gross profit margin:

Sales during the year	22,45,500
Closing inventory at the selling price	₹ 2,35,000
	24,80,500
Less: Purchases	₹(17,83,841)
Gross prof t	₹ 6,96,659
Gross prof t margin	28.09%
Inventory valuat on:	
Selling price of closing inventories	₹ 2,35,000
Less: Gross prof t margin 28.09%	₹ (66,012)

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	₹ 1,68,988

ILLUSTRATION 7

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

	₹
Sales during the year	2,00,000
Cost of purchases	2,00,000
Opening inventory	Nil
Closing inventory at selling price	50,000

Answer

Calculation of gross margin of profit:

	₹
Sales	2,00,000
Add: Closing inventory (at selling price)	50,000
Selling price of goods available for sale:	2,50,000
Less: Cost of goods available for sale	2,00,000
Gross margin	50,000

$$\text{Rate of gross margin} = \frac{50,000}{2,50,000} \times 100 = 20\%$$

$$\text{Cost of closing inventory} = 50,000 \text{ less } 20\% \text{ on } ₹ 50,000 = ₹ 40,000$$

(ii) Standard cost method

This method is used when there is frequent change in the price per unit of the goods and goods are purchased frequently by the business e.g. crude oil. Based on the experience a standard cost is determined on the basis of frequent changes in prices and inventory is valued on that price per unit.

ILLUSTRATION 8

From the following particulars ascertain the value of Inventories as on 31st March, 2022:

	₹
Inventory as on 1.4.2021	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, 2021, a sum of ₹ 17,500 was written off on a particular item, which was originally purchased for ₹ 50,000 and was sold during the year for ₹ 45,000. Barring the transaction relating to this item, the gross profit earned during the year was 20 % on sales.

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Answer
Statement of Inventory in trade as on 31st March, 2022

	₹	₹
Inventory as on 1st April, 2021	1,42,500	
Less: Book value of abnormal inventory (₹ 50,000 - ₹ 17,500)	32,500	1,10,000
Add: Purchases		7,62,500
Manufacturing Expenses		1,50,000
		10,22,500
Less: Cost of goods sold:		
Sales as per books	12,45,000	
Less: Sales of abnormal item	45,000	
	12,00,000	
Less: Gross Profit @ 20%	2,40,000	9,60,000
Inventory in trade as on 31st March, 2022		62,500

ILLUSTRATION 9

A trader prepared his accounts on 31st March, each year. Due to some unavoidable reasons, no stock taking could be possible till 15th April, 2022 on which date total cost of goods in his godown came to ₹ 50,000. The following facts were established between 31st March and 15th April, 2022.

- Sales ₹ 41,000 (including cash sales ₹ 10,000).
- Purchases ₹ 5,034 (including cash purchases ₹ 1,990).
- Sales return ₹ 1,000.
- On 15th March, goods of the sale value of ₹ 10,000 were sent on sale or return basis to a customer, the period of approval being four weeks. He returned 40% of the goods on 10th April, approving the rest; the customer was billed on 16th April.
- The trader had also received goods costing ₹ 8,000 in March, for sale on consignment basis. 20% of the goods had been sold by 31st March, and another 50% by the 15th April. These sales are not included in above sales.

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, 2022.

Answer
Statement of Valuation of Stock on 31st March, 2022

	₹	₹
Value of stock as on 15th April, 2022		50,000
Add: Cost of sales during the period from 31st March, 2022 to 15 th April, 2022:		
Sales (₹ 41,000 - ₹ 1,000)	40,000	
Less: Gross profit (20% of ₹ 40,000)	8,000	32,000
Cost of goods sent on approval basis (80% of ₹ 6,000)		4,800
		86,800
Less: Purchases during the period from 31st March, 2022 to 15th April, 2022	5,034	
Unsold stock out of goods received on consignment basis (30% of ₹ 8,000)	2,400	7,434

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		79,366

ILLUSTRATION 10

Inventory taking for the year ended 31st March, 2022 was completed by 10th April 2022, the valuation of which showed a inventory figure of ₹ 16,75,000 at cost as on the completion date. After the end of the accounting year and till the date of completion of inventory taking, sales for the next year were made for ₹ 68,750, profit margin being 33.33 % on cost. Purchases for the next year included in the inventory amounted to ₹ 90,000 at cost less trade discount 10 %. During this period, goods were added to inventory at the mark up price of ₹ 3,000 in respect of sales returns. After inventory taking it was found that there were certain very old slow-moving items costing ₹ 11,250, which should be taken at ₹ 5,250 to ensure disposal to an interested customer. Due to heavy flood, certain goods costing ₹ 15,500 were received from the supplier beyond the delivery date of customer. As a result, the customer refused to take delivery and net realizable value of the goods was estimated to be ₹ 12,500 on 31st March. Compute the value of inventory for inclusion in the final accounts for the year ended 31st March, 2022.

Answer

Statement showing the valuation of Inventory as on 31st March, 2022

	₹
Value of Inventory as on 10th April	16,75,000
Add: Cost of goods sold after 31st March till Inventory taking (₹ 68,750 – ₹ 17,190)	51,560
Less: Purchases for the next period (net)	(81,000)
Less: Cost of Sales Returns	(2,250)
Less: Loss on revaluation of slow-moving inventories	(6,000)
Less: Reduction in value on account of default	(3,000)
Value of Inventory on 31st March	16,34,310

Note: Profit margin of 33.33 % on cost means 25 % on sales price.

ILLUSTRATION 11

The following are the details of a spare part of Sriram mills:

1-1-2022	Opening Inventory	Nil
1-1-2022	Purchases	100 units @ ₹ 30 per unit
15-1-2022	Issued for consumpt on	50 units
1-2-2022	Purchases	200 units @ ₹ 40 per unit
15-2-2022	Issued for consumpt on	100 units
20-2-2022	Issued for consumpt on	100 units

Find out the value of Inventory as on 31-3-2022 if the company follows First in first out basis.

Answer

First-in-First out basis

Sriram Mills

Calculation of the value of Inventory as on 31-3-2022

	Receipts			Issues			Balance		
Date	Units	Rate	Amount	Units	Rate	Amount	Units	Rate	Amount
		₹	₹		₹	₹		₹	₹

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1-1-2022	Balance							Nil	
1-1-2022	100	30	3,000				100	30	3,000
15-1-2022				50	30	1,500	50	30	1,500
1-2-2022	200	40	8,000				50	30	1,500
							200	40	8,000
15-2-2022				50	30	1,500			
				50	40	2,000	150	40	6,000
20-2-2022				100	40	4,000	50	40	2,000

Therefore, the value of Inventory as on 31-3-2022: 50 units @ ₹ 40 = ₹ 2,000

ILLUSTRATION 12

Continuing with the information given in illustration 11, find out the value of Inventory as on 31-3-2022 if the company follows Weighted Average basis.

Answer

Weighted Average basis

Sriram Mills

Calculation of the value of Inventory as on 31-3-2022

Date	Receipts			Issues			Balance		
	Units	Rate	Amount	Units	Rate	Amount	Units	Rate	Amount
		₹	₹		₹	₹		₹	₹
1-1-2022	Balance							Nil	
1-1-2022	100	30	3,000				100	30	3,000
15-1-2022				50	30	1,500	50	30	1,500
1-2-2022	200	40	8,000				250	38	9,500
15-2-2022				100	38	3,800	150	38	5,700
20-2-2022				100	38	3,800	50	38	1,900

Therefore, the value of Inventory as on 31-3-2022 = 50 units @ ₹ 38 = ₹ 1,900

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Chapter 5 Depreciation and Amortisation

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True and False

Question 1

Increase in market value of a fixed asset is one of the reasons for depreciation being charged.

Answer 1

False : It is the decrease in market value as one of the reasons for depreciation. Increase in market value may result in Revaluation.

Question 2

Depreciation is a cash expenditure like other normal expenses.

Answer 2

False: Depreciation is not a cash expenditure like other normal expenses as it does not result in any cash outflow.

Question 3

Cost of property, plant and equipment includes purchase price, refundable taxes & import duties after deducting any discount or rebate.

Answer 3

False : Non refundable taxes & duties form part of the cost.

Question 4

Cost of fixed asset should also include cost of opening a new facility such as inauguration costs.

Answer 4

False : Inauguration costs shouldn't be part of cost.

Question 5

Depreciation is charged with a constant amount under straight line method and charged with a constant percentage under diminishing balance method.

Answer 5

True : SLM method results in same amount and diminishing method involves same rate of depreciation.

Question 6

In case an item of Property, Plant & Equipment is revalued, whole class of assets to which that asset being revalued belongs should be revalued.

Answer 6

True : Revaluation should be done for the whole class of the asset.

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Question 7

In case the carrying amount of an asset is decreased due to revaluation, such decrease should always be recognized in the Profit and Loss account.

Answer 7

False : Any decrease in value of asset on account of revaluation should be first debited to Revaluation Reserve, if any, and then to Profit & Loss account.

Question 8

Akash purchased a machine for ₹ 12,00,000. Estimated useful life is 10 years and scrap value is ₹ 1,00,000. Depreciation for the first year using sum of the years digit method shall be ₹ 2,00,000.

Answer 8

True : Sum of years digit method depreciation is calculated as $10/55 \times (12,00,000 - 1,00,000) = 2,00,000$

Question 9

Depreciation cannot be provided in case of loss, in a financial year.

Answer 9

False: Depreciation is a charge against profit and not an appropriation of profit. Therefore, depreciation has to be provided for, even in case of loss in a financial year.

Question 10

Providing for depreciation also helps in providing for accumulation of funds to facilitate the replacement at the end of its useful life.

Answer 10

True : Depreciation being non cash expense reduces the distributable profits and hence facilitates replacement of asset when required.

Question 11

If the equipment account has a balance of ₹ 12,50,000 and the accumulated depreciation account has a balance of ₹ 4,00,000, the written down value of same shall be ₹ 16,50,000.

Answer 11

False : $WDV = ₹ 12,50,000 - ₹ 4,00,000 = ₹ 8,50,000$

Question 12

Sum of the years digit method is an example of accelerated method of charging depreciation.

Answer 12

True : Higher depreciation is charged in earlier years under sum of the years digit method.

Question 13

Over the life of an asset subject to depreciation, the accelerated method will result in less Depreciation Expense in early years and more depreciation in later years of its life.

Answer 13

False : It is vice versa as under diminishing balance method; higher depreciation is charged in beginning.

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Question 14

While depreciating land cost, Straight line method shall give more depreciation than the written down value.

Answer 14

False : Land is not depreciated.

Question 15

Provision for depreciation account is debited at the time of recording the depreciation on an asset.

Answer 15

False : Provision for Depreciation account is credited while charging the depreciation.

Question 16

If adequate maintenance expenditure is incurred with relation to running repairs of an asset, we need not charge any depreciation.

Answer 16

False : Depreciation is allocation of the cost of an asset over its useful life. Regular repairs may be required during its life are expensed and depreciation has to be charged anyways.

Question 17

When a property, plant or equipment is sold then provision for depreciation account is debited, asset account is credited and any gain or loss is recorded to profit and loss account.

Answer 17

True : At the time of sale of an asset, respective asset account is credited with provision for depreciation account being debited and any resulting gain or loss being charged to profit & loss account.

Question 18

While calculating the depreciation as per diminishing balance method, the salvage value of the asset at the end of its life is reduced from its cost.

Answer 18

False: Under diminishing balance method, salvage value is not considered initially as it assumes that at the end of the asset's life the remaining value shall be its salvage value.

Question 19

Any change in the estimated useful life of an asset should be accounted for as a change in an accounting estimate in accordance with Accounting Standards.

Answer 19

True : Any change in useful life of an asset is accounted for as a change in estimate.

Question 20

An intangible asset is a non identifiable, non monetary asset.

Answer 20
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False : An intangible asset is an identifiable non-monetary asset, held for use in production and supply of goods and services.

Multiple Choice Questions

1. Original cost = ₹ 12,60,000; Salvage value = Nil; Useful life = 6 years. Depreciation for the first year under sum of years digits method will be
- (d) ₹ 3,60,000
 (e) ₹ 1,20,000
 (f) ₹ 1,80,000

Answer 1 : (a)

2. Obsolescence of a depreciable asset may be caused by:
- I. Technological changes.
 II. Improvement in production method.
 III. Change in market demand for the product or service output.
 IV. Legal or other restrictions.
- (a) Only (I) above
 (b) Both (I) and (II) above
 (c) All (I), (II), (III) and (IV) above

Answer 2 : (c)

3. The number of production of similar units expected to be obtained from the use of an asset by an enterprise is called as
- (a) Unit life
 (b) Useful life
 (c) Production life

Answer 3 : (b)

4. If a concern proposes to discontinue its business from March 2018 and decides to dispose of all its plants within a period of 4 months, the Balance Sheet as on March 31, 2018 should indicate the plants at their
- (a) Historical cost
 (b) Net realizable value
 (c) Cost less depreciation

Answer 4 : (b)

5. In the case of downward revaluation of a plant which is for the first time revalued, the account to be debited is
- (a) Plant account
 (b) Revaluation Reserve
 (c) Profit & Loss account

Answer 5 : (c)

6. The portion of the acquisition cost of the tangible asset, yet to be allocated is known as

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- (a) Written down value
- (b) Accumulated value
- (c) Realisable value

Answer 6 : (a)

7. The main objective of providing depreciation is to
- (a) Create secret reserve
 - (b) Reduce the book value of assets
 - (c) Allocate cost of the assets

Answer 7 : (c)

8. Original cost of a machine was ₹ 25,20,000 salvage value was ₹ 1,20,000, useful life was 6 years. Annual depreciation under Straight Line Method
- (a) ₹ 4,20,000
 - (b) ₹ 4,00,000
 - (c) ₹ 3,00,000

Answer 8 : (b)

9. The cost of a machine is ₹ 20,00,000. Two years later the book value is ₹ 10,00,000. The Straight-line percentage depreciation is
- (a) 50%
 - (b) 33-1/3%
 - (c) 25%

Answer 9 : (c)

10. A machinery with original cost of ₹ 10,00,000 and Nil Salvage value acquired on 1st April 2019 with 4 years useful life was depreciated using Straight Line Method. It was decided to sell the machinery on 1st October 2022 for ₹ 1,20,000. What shall be the gain or (loss) on the sale of Machinery?
- (a) Loss of ₹ 1,30,000
 - (b) Gain of ₹ 1,20,000
 - (c) Loss of ₹ 5,000

Answer 10 : (c)

11. Which of the following assets does not depreciate?
- (a) Machinery and equipment
 - (b) Patents
 - (c) Land

Answer 11 : (c)

12. A company purchased a machinery on April 01, 2017, for ₹ 15,00,000. It is estimated that the machinery will have a useful life of 5 years after which it will have no salvage value. The depreciation charged during the year 2021-22 was
- (a) ₹ 5,00,000
 - (b) ₹ 4,00,000

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(c) ₹ 3,00,000

Answer 12 : (c)

13. If the equipment account has a balance of ₹ 22,50,000 and the accumulated depreciation account has a balance of ₹ 14,00,000, the book value of the equipment is

(a) ₹ 36,50,000

(b) ₹ 8,50,000

(c) ₹ 14,00,000

Answer 13 : (b)

14. A plant with original cost of ₹ 50,00,000 was revalued after 2 years resulting in credit to Revaluation Surplus account of ₹ 4,00,000. Towards the year end of 2019-20, due to COVID-19 the plan value had gone down by ₹ 5,00,000 and accordingly management decided to revalue the same. What shall be the impact of this downwards revaluation on the Profit & Loss Account ?

(a) Debit of ₹ 5,00,000

(b) Debit of ₹ 1,00,000

(c) Credit of ₹ 5,00,000

Answer 14 : (b)

15. In respect of intangible assets, there is a presumption that the useful life of an intangible asset will not exceed

(a) 2 years

(b) 3 years

(c) 10 years

Answer 15 : (c)

16. A company developed a technology to enhance the battery life of mobile phones. The cost of development have been capitalized as an intangible asset at ₹ 5,00,000. The company estimates the life of the technology developed to be 3 years. The company has forecasted that 50% of sales will be in year 1, 35% in year 2 and 15% in year 3. What should be the amortisation charge in third year?

(a) ₹ 2,50,000

(b) ₹ 75,000

(c) ₹ 1,75,000

Answer 16 : (b)

17. An intangible asset is an asset

(a) with no physical existence

(b) generated internally by the business

(c) cannot be sold

Answer 17 : (a)

Theoretical Questions & Answers

Question 1

Distinguish between Straight line method of depreciation and Written down value method of

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depreciation.

Answer 1

Under straight line method an equal amount is written off each year throughout the working life of the depreciable tangible asset so as to reduce the cost of the asset to nil or to its scrap value at the end. Under reducing balance method, a fixed percentage is charged on the diminishing balance of the asset each year so as to reduce the value of the asset to its scrap value at the end of useful life. The basic distinction between these two methods are as follows:

Under straight line method, annual depreciation charge is equal throughout the life of the asset; but under reducing balance method, depreciation charge is reduced over the years as the asset grows old. Under straight-line method, the asset can be fully depreciated but under reducing balance method asset can never be fully depreciated.

Under straight line method the charge for depreciation is constant while repair charges increase with the life of the asset, so the total charge throughout the life of the asset will not be uniform. To the contrary, under reducing balance method, depreciation charges become high in the initial years but generally repair remains low. As the asset grows old depreciation charge reduces but repair expenses increase. Thus under reducing balance method depreciation and repairs are more or less evenly distributed throughout the life of the asset.

Question 2

Write short note on Depletion method of depreciation.

Answer 2

Natural resources include physical assets like mineral deposits, oil and gas resources and timber. These natural resources exhaust by exploitation.

Depletion per unit is calculated as
$$\frac{\text{Acquisition cost} - \text{Residual Value}}{\text{Estimate life in terms of production units}}$$

Question 3

What factors are considered for calculation of depreciation of a plant?

Answer 3

The factors considered for calculation of depreciation are as: (i) Cost of asset including expenses for installation, commissioning, trial run etc. (ii) Estimated useful life of the asset and (iii) Estimated scrap value (if any) at the end of useful life of the asset.

Question 4

What are intangible assets. Explain with the help of examples.

Answer 4

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

- Streaming rights of movies / TV shows / web series on platforms like Netflix, Disney Hot Star, Amazon Prime / Sony LIV etc.
- Broadcasting rights of events such as the Cricket World Cup, the Indian Premier League, the Pro Kabaddi League etc.
- Landing rights / time slots at airports which permit aircrafts to land or take-off during a particular time frame

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- (d) Patents
- (e) Trademarks
- (f) Copyrights
- (g) Distribution rights for motion pictures in theatres
- (h) Long-term customer contracts
- (i) Customer data collected by the entities such as customer contact numbers / email IDs and spending data at stores like Pantaloons, Westside etc. could be a major intangible asset for these entities.
- (j) Goodwill (purchased)
- (k) Computer Software

Practical Questions & Answers

Question 1

A firm's plant and machinery account at 31st December, 2021 and the corresponding depreciation provision account, broken down by year of purchase are as follows:

Year of Purchase	Plant and Machinery at cost ₹	Depreciat on Provision ₹
2005	2,00,000	2,00,000
2011	3,00,000	3,00,000
2012	10,00,000	9,50,000
2013	7,00,000	5,95,000
2020	5,00,000	75,000
2021	3,00,000	15,000
	30,00,000	21,35,000

Depreciat on is at the rate of 10% per annum on cost. It is the Company's policy to assume that all purchases, sales or disposal of plant occurred on 30th June in the relevant year for the purpose of calculat ng depreciat on, irrespect ve of the precise date on which these events occurred.

During 2022 the following transact ons took place:

1. Purchase of plant and machinery amounted to ₹ 15,00,000
2. Plant that had been bought in 2011 for ₹ 170,000 was scrapped.
3. Plant that had been bought in 2012 for ₹ 90,000 was sold for ₹ 5,000.
4. Plant that had been bought in 2013 for ₹ 2,40,000 was sold for ₹ 15,000.

You are required to:

Calculate the provision for depreciat on of plant and machinery for the year ended 31st December, 2022. In calculat ng this provision you should bear in mind that it is the company's policy to show any prof t or loss on the sale or disposal of plant as a completely separate item in the Prof t and Loss Account. You are also required to prepare the following ledger accounts during 2022.

- (i) Plant and machinery at cost;
- (ii) Depreciat on provision;
- (iii) Sales or disposal of plant and machinery.

Answer 1

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Calculation of provision for depreciation of plant and machinery for the yearended 31st December, 2022.

Plant purchased in:		₹	₹
2005		nil	
2011		nil	
2012			50,000
2013	1/2 year at 10% on ₹ 2,40,000	12,000	
	1 year at 10% on ₹ 4,60,000	46,000	58,000
2020	10% on ₹ 5,00,000		50,000
2021	10% on ₹ 3,00,000		30,000
2022	1/2 year at 10% on ₹ 15,00,000		75,000
			2,63,000

Plant and Machinery Account (for 2022) at Cost

	₹		₹
To Balance b/d	30,00,000	By Disposals account:	
To Bank A/c	15,00,000	Scrapped	1,70,000
		Sold	3,30,000
		By Balance c/d	40,00,000
	45,00,000		45,00,000

Depreciation Provision Account (for 2022)

	₹		₹
To Disposal Account :		By Balance b/d	21,35,000
Scrapped - 2011 assets	1,70,000	By Profit and Loss Account	2,63,000
Sold - 2012 assets	90,000		
Sold - 2013 assets	2,16,000	4,76,000	
To Balance c/d		19,22,000	
		23,98,000	23,98,000

Sale or disposal of Plant and Machinery Account (for 2022)

	₹		₹
To Plant and Machinery :		By Provision for Depreciat on	4,76,000
Scrapped	1,70,000	By Cash-Sales Proceeds	20,000
Sold	3,30,000	By Loss on sales	4,000
	5,00,000		5,00,000

Question 2

The Machinery Account of a Factory showed a balance of ₹ 19,00,000 on 1st January, 2022. Its accounts were made up on 31st December each year and depreciat on is writ en of at 10% p.a. under the Diminishing Balance Method.

On 1st June 2022, a new machinery was acquired at a cost of ₹ 2,80,000 and installat on charges incurred in erect ng the machine works out to ₹ 8,920 on the same date. On 1st June, 2022 a machine which had cost ₹ 4,37,400 on 1st January 2020 was sold for ₹ 75,000. Another machine

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which had cost ₹ 4,37,000 on 1st January, 2021 was scrapped on the same date and it realised nothing.

Write a machinery account for the year 2022, allowing the same rate of depreciat on as in the past, calculat ng depreciat on to the nearest mult ple of a Rupee.

Answer 2

Plant and Machinery Account

		₹			₹
2022			2022		
Jan. 1	To Balance b/d	19,00,000	June 1	By Bank (Sales)	75,000
June. 1	To Bank (2,80,000 + 8,920)	2,88,920		By Depreciat on (on sold machine)	14,762
				By Loss on sale	2,64,532
				By Loss on scrapping the machine	3,76,912
				By Depreciat on (on scrapped machinery)	16,388
				By Depreciat on (Note iii)	1,32,094
				By Balance c/d	13,09,232
		21,88,920			21,88,920

Working Note :

(i)	Calculat on of loss on sale of machine on 1-6-2022		₹
	Cost on 1-1-2020		4,37,400
	Less : Depreciat on @ 10% on ₹ 4,37,400		(43,740)
	W.D.V. on 31-12-2020		3,93,660
	Less : Depreciat on @ 10% on ₹ 3,93,660		(39,366)
	W.D.V. on 31-12-2021		3,54,294
	Less : Depreciat on @ 10% on ₹ 3,54,294 for 5 months		(14,762)
			3,39,532
	Less : Sale proceeds on 1-6-2022		(75,000)
	Loss		2,64,532
(ii)	Calculat on of loss on scrapped machine		₹
	Cost on 1-1-2021		4,37,000
	Less : Depreciat on @ 10% on ₹ 4,37,000		(43,700)
	W.D.V. on 1-1-2022		3,93,300
	Less : Depreciat on @ 10% on ₹ 3,93,300 for 5 months		(16,388)
	Loss		3,76,912
(iii)	Depreciat on		₹
	Balance of machinery account on 1-1-2022		19,00,000
	Less : W.D.V of machinery sold	3,54,294	
	W.D.V. of machinery scrapped	3,93,300	(7,47,594)
	W.D.V. of other machinery on 1-1-2022		11,52,406
	Depreciat on @ 10% on ₹ 11,52,406 for 12 months		1,15,240
	Depreciat on @ 10% on ₹ 2,88,920 for 7 months		16,854
			1,32,094

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Question 3

The LG Transport company purchased 10 trucks at ₹ 45,00,000 each on 1st April 2019. On October 1st, 2021, one of the trucks is involved in an accident and is completely destroyed and ₹ 27,00,000 is received from the insurance in full settlement. On the same date another truck is purchased by the company for the sum of ₹ 50,00,000. The company writes off 20% on the original cost per annum. The company observes the calendar year as its financial year. Give the motor truck account for two years ending 31 Dec, 2022.

Answer 3

Date	Particulars	Amount	Date	Particulars	Amount
2021			2021		
Jan-01	To balance b/d	2,92,50,000	Oct-01	By bank A/c	27,00,000
Oct-01	To Profit & Loss A/c		Oct-01	By Depreciation on lost assets	6,75,000
	(Profit on settlement of Truck)	4,50,000	Dec-31	By Depreciation A/c	83,50,000
Oct-01	To Bank A/c	50,00,000	Dec-31	By balance c/d	2,29,75,000
		3,47,00,000			3,47,00,000
2022			2022		
Jan-01	To balance b/d	2,29,75,000	Dec-31	By Depreciation A/c	91,00,000
			Dec-31	By balance c/d	1,38,75,000
		2,29,75,000			2,29,75,000

Working Note:
1. Profit on settlement of truck

	₹
Original cost as on 1.4.2019	45,00,000
Less: Depreciation for 2019	(6,75,000)
	38,25,000
Less: Depreciation for 2020	(9,00,000)
	29,25,000
Less: Depreciation for 2021 (9 months)	(6,75,000)
	22,50,000
Less: Amount received from Insurance company	(27,00,000)
	4,50,000

Question 4

A Machinery costing ₹ 20,00,000 is depreciated on straight line assuming 10 years working life and nil salvage value for four years. At the end of the fourth year, the machinery was revalued upwards by ₹ 80,000. The remaining useful life of the machinery was also reassessed as 8 years at the end of the fourth year. Calculate the depreciation for 5th Year.

Answer 4

Depreciation per year for first 4 years = ₹ 20,00,000 / 10 = ₹ 2,00,000

Thus, WDV of the Machinery at end of the 4th year = ₹ 20,00,000 – (₹ 2,00,000 × 4) = ₹ 12,00,000

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Revalued Amount i.e. New Depreciable Amount shall be = ₹ 12,00,000 + ₹ 80,000 = ₹ 12,80,000
 Original remaining useful life is (10-4) = 6 Years whereas it is reassessed as 8 Years.
 Hence, depreciate on for 5th Year = ₹ 12,80,000 / 8 = ₹ 1,60,000

Question 5

Amazing group had Property, Plant & Equipment (PP&E) with a book value of ₹ 35,00,000 on 31st December, 2022. The balance in Revaluation Surplus on that date was ₹ 3,00,000. As part of their practice of revaluing the assets on yearly basis, another revaluation was carried out on 31st December, 2022. Evaluate the impact of Revaluation if the Fair Value as a result of Revaluation done on 31st December, 2022 was (a) ₹ 37,00,000 (b) ₹ 33,00,000 and (c) ₹ 31,00,000. Also, give the journal entries.

Answer 5

(a) Fair Value: ₹ 37,00,000

Since this is an upward revaluation and the group had a balance in revaluation surplus (i.e. there was an upward movement earlier), hence this will result in an additional credit of ₹ 2,00,000 to Revaluation Surplus and hence the total Revaluation Surplus balance (part of other comprehensive income in Equity) shall increase to ₹ 5,00,000. The Accounting journal entry shall be:

Property, Plant & Equipment A/c	Dr	2,00,000	
To Revaluation Surplus A/c			2,00,000

(b) Fair Value : ₹ 33,00,000

Since this is a downward revaluation and the group had a balance in revaluation surplus (i.e. there was an upward movement earlier), hence this will result in a reduction or a debit to Revaluation Surplus to the extent of balance therein and any excess shall be debited to Profit & Loss A/c. In this case, there is a reduction in fair value of ₹ 2,00,000 (35,00,000 – 33,00,000) and hence the entire amount shall be debited to Revaluation Surplus. Hence, the total Revaluation Surplus balance (part of other comprehensive income in Equity) shall decrease to ₹ 1,00,000. The Accounting journal entry shall be:

Revaluation Surplus A/c	Dr	2,00,000	
To Property, Plant & Equipment A/c			2,00,000

(c) Fair Value : ₹ 31,00,000

Since this is also a downward revaluation and the group had a balance in revaluation surplus (i.e. there was an upward movement earlier), hence this will result in a reduction or a debit to Revaluation Surplus to the extent of balance therein and any excess shall be debited to Profit & Loss A/c. In this case, there is a reduction in fair value of ₹ 4,00,000 (35,00,000 – 31,00,000) and hence the Revaluation Surplus A/c shall be debited by ₹ 3,00,000 and the balance ₹ 1,00,000 shall be debited to Profit & Loss A/c. Hence, the total Revaluation Surplus balance (part of other comprehensive income in Equity) shall become Nil. The Accounting journal entry shall be:

Revaluation Surplus A/c	Dr	3,00,000	
Profit & Loss A/c	Dr	1,00,000	
To Property, Plant & Equipment A/c			4,00,000

Question 6

On April 1, 2019 a firm purchased a machinery for ₹ 2,00,000. On 1st October in the same accounting

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year, additional machinery costing ₹ 1,00,000 was purchased. On 1st October, 2020, the machinery purchased on 1st April 2019, having become obsolete was sold off for ₹ 90,000. On October 1, 2021, new machinery was purchased for ₹ 2,50,000 while the machinery purchased on 1st October 2019 was sold for ₹ 85,000 on the same day. The firm provides depreciation on its machinery @ 10% per annum on original cost on 31st March every year. Show Machinery Account, Provision for Depreciation Account and Depreciation Account for the period of three accounting years ending March 31, 2022.

Answer 6

Dr.

Machinery Account

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2019	To Bank A/c	2,00,000	31.03.2020	By Balance c/d	3,00,000
01.10.2019	To Bank A/c	1,00,000			
		3,00,000			3,00,000
01.04.2020	To Balance b/d	3,00,000	01.10.2020	By Bank A/c	90,000
				By Provision for Depreciation A/c	30,000
				By Profit and Loss A/c	80,000
			31.3.2021	By Balance c/d	1,00,000
		3,00,000			3,00,000
01.04.2021	To Balance b/d	1,00,000	01.10.2021	By Bank A/c	85,000
01.10.2021	To Bank A/c	2,50,000		By Provision for Depreciation A/c	20,000
	To Profit and Loss A/c	5,000	31.3.2022	By Balance c/d	2,50,000
		3,55,000			3,55,000

Depreciation Account

Date	Particulars	₹	Date	Particulars	₹
31.03.2020	To provision for Depreciation A/c	25,000	31.03.2020	By Profit and Loss A/c	25,000
		25,000			25,000
01.10.2020	To Provision for Depreciation A/c	10,000	31.03.2021	By Profit and Loss A/c	20,000
31.03.2021	To Provision for Depreciation A/c	10,000			
		20,000			20,000
01.10.2021	To Provision for Depreciation A/c	5,000	31.03.2022	By Profit and Loss A/c	17,500
31.03.2022	To Provision for Depreciation A/c	12,500			
		17,500			17,500

Dr.

Provision for Depreciation Account

Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2020	To Balance c/d	25,000	31.03.2020	By Depreciation A/c (₹ 20,000 + ₹ 5,000)	25,000
		25,000			25,000
01.12.2020	To Machinery A/c (₹ 20,000 + ₹ 10,000)	30,000	01.04.2020	By Balance b/d	25,000

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31.03.2021	To Balance c/d	15,000	01.10.2020	By Depreciat on A/c	10,000
			31.03.2021	By Depreciat on A/c	10,000
		45,000			45,000
01.10.2021	To Machinery A/c (₹ 5,000 + ₹ 10,000+ ₹ 5,000)		01.04.2021	By Balance b/d	15,000
31.03.2022	To Balance c/d	12,500	01.10.2021	By Depreciat on A/c	5,000
				By Depreciat on A/c	12,500
		32,500			32,500

ILLUSTRATION 1

Jain Bros. acquired a machine on 1st July, 2021 at a cost of ₹ 14,00,000 and spent ₹ 1,00,000 on its installat on. The f rm writes of depreciat on at 10% p.a. of the original cost every year. The books are closed on 31st December every year.

Required

Show the Machinery Account and Depreciat on Account for the year 2021 and 2022.

Answer

Machinery Account

Date	Part culars	₹	Date	Part culars	₹
2021			2021		
July 1	To Bank A/c	14,00,000	Dec. 31	By Depreciat on A/c	
July 1	To Bank A/c - Installat on Expenses	1,00,000		10% on ₹ 15,00,000 for 6 months	75,000
			Dec. 31	By Balance c/d	14,25,000
		15,00,000			15,00,000
2022			2022		
Jan. 1	To Balance b/d	14,25,000	Dec. 31	By Depreciat on A/c	
				10% on ₹ 15,00,000	1,50,000
			Dec. 31	By Balance c/d	12,75,000
		14,25,000			14,25,000

Depreciat on Account

Date	Part culars	₹	Date	Part culars	₹
2021			2021		
Dec. 31	To Machinery A/c	75,000	Dec. 31	By Prof t & Loss A/c	75,000
2022			2022		
Dec. 31	To Machinery A/c	1,50,000	Dec. 31	By Prof t & Loss A/c	1,50,000

ILLUSTRATION 2

Jain Bros. acquired a machine on 1st July, 2021 at a cost of ₹ 14,00,000 and spent ₹ 1,00,000 on its installat on. The f rm writes of depreciat on at 10% p.a. every year. The books are closed on 31st December every year.

Required

Show the Machinery Account on diminishing balance method for the year 2021 and 2022.

Answer

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As per Reducing Balance Method

Machinery Account

Date	Particulars	₹	Date	Particulars	₹
2021			2021		
July 1	To Bank A/c	14,00,000	Dec. 31	By Depreciation A/c	75,000
July 1	To Bank A/c -	1,00,000		(₹ 15,00,000 x 10% x 6/12) for 6 months	
			Dec. 31	By Balance c/d	14,25,000
		15,00,000			15,00,000
2022			2022		
Jan. 1	To Balance b/d	14,25,000	Dec. 31	By Depreciation A/c	1,42,500
				(₹ 14,25,000 x 10%)	
			Dec. 31	By Balance c/d	12,82,500
		14,25,000			14,25,000

ILLUSTRATION 3

M/s Akash & Co. purchased a machine for ₹ 10,00,000. Estimated useful life and scrap value were 10 years and ₹ 1,20,000 respectively. The machine was put to use on 1.1.2017.

Required

Show Machinery Account and Depreciation Account in their books for 2022 by using sum of years digits method.

Answer

In the books of M/s Raj & Co.
Machinery Account

Date	Particulars	₹	Date	Particulars	₹
2022			2022		
Jan. 1	To Balance b/d (w.n.2)	3,60,000	Dec. 31	By Depreciation A/c (w.n.3)	80,000
			Dec. 31	By Balance c/d	2,80,000
		3,60,000			3,60,000
2023					
Jan.1	To Balance b/d	2,80,000			

Depreciation Account

		₹			₹
2022			2022		
Dec. 31	To Machinery A/c	80,000	Dec. 31	By Profit and Loss A/c	80,000
		80,000			80,000

Working Notes:

(1) Total of sum of digit of depreciation for 2017-21

$$= (\text{₹ } 10,00,000 - \text{₹ } 1,20,000) \times \frac{10+9+8+7+6}{\frac{10(10+1)}{2}} = \text{₹ } 8,80,000 \times \frac{40}{55} = \text{₹ } 6,40,000$$

(2) Written down value as on 1-1-2022

$$\text{₹ } 10,00,000 - \text{₹ } 6,40,000 = \text{₹ } 3,60,000$$

(3) Depreciation for 2022

$$(\text{₹ } 10,00,000 - \text{₹ } 1,20,000) \times \frac{5}{55} = \text{₹ } 80,000$$

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ILLUSTRATION 4

A machine was purchased for ₹ 30,00,000 having an estimated total working of 24,000 hours. The scrap value is expected to be ₹ 2,00,000 and anticipated pattern of distribution of effective hours is as follows:

Year

1 – 3 3,000 hours per year

4 - 6 2,600 hours per year

7 - 10 1,800 hours per year

Required

Determine Annual Depreciation under Machine Hour Rate Method.

Answer

Statement of Annual Depreciation under Machine Hours Rate Method

Year	Annual Depreciation
1 - 3	$\frac{3,000}{24,000} \times (\text{₹ } 30,00,000 - \text{₹ } 2,00,000) = \text{₹ } 3,50,000$
4 - 6	$\frac{2,600}{24,000} \times (\text{₹ } 30,00,000 - \text{₹ } 2,00,000) = \text{₹ } 3,03,333$
7 - 10	$\frac{1,800}{24,000} \times (\text{₹ } 30,00,000 - \text{₹ } 2,00,000) = \text{₹ } 2,10,000$

ILLUSTRATION 5

A machine is purchased for ₹ 20,00,000. Its estimated useful life is 10 years with a residual value of ₹ 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 Production

1-3 20,000 units per year

4-7 15,000 units per year

8-10 10,000 units per year

Required

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

Answer

Statement showing Depreciation under Production Units Method

Year	Annual Depreciation
1 - 3	$\frac{20,000}{1,50,000} \times (\text{₹ } 20,00,000 - \text{₹ } 2,00,000) = \text{₹ } 2,40,000$
4 - 7	$\frac{15,000}{1,50,000} \times (\text{₹ } 20,00,000 - \text{₹ } 2,00,000) = \text{₹ } 1,80,000$
8 - 10	$\frac{10,000}{1,50,000} \times (\text{₹ } 20,00,000 - \text{₹ } 2,00,000) = \text{₹ } 1,20,000$

ILLUSTRATION 6

M/s Surya & Co. took lease of a quarry on 1-1-2019 for ₹ 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

2019 2,000 tonnes

2020 10,000 tonnes

2021 15,000 tonnes

Required

Show the Quarry Lease Account and Depreciat on Account for each year from 2019 to 2021.

Answer
Quarry Lease Account

		₹			₹
2019			2019		
Jan.	To Bank A/c	1,00,00,000	Dec. 31	By Depreciat on A/c	1,00,000
				[(2,000/2,00,000)×₹1,00,00,000]	
			Dec. 31	By Balance c/d	99,00,000
		1,00,00,000			1,00,00,000
2020			2020		
Jan. 1	To Balance b/d	99,00,000	Dec. 31	By Depreciat on A/c	5,00,000
			Dec. 31	By Balance c/d	94,00,000
		99,00,000			99,00,000
2021			2021		
Jan. 1	To Balance b/d	94,00,000	Dec. 31	By Depreciat on A/c	7,50,000
			Dec. 31	By Balance c/d	86,50,000
		94,00,000			94,00,000

Depreciation Account

		₹			₹
2019			2019		
Dec. 31	To Quarry lease A/c	1,00,000	Dec. 31	By Prof t & Loss A/c	1,00,000
		1,00,000			1,00,000
2020			2020		
Dec. 31	To Quarry lease A/c	5,00,000	Dec. 31	By Prof t & Loss A/c	5,00,000
		5,00,000			5,00,000
2021			2021		
Dec. 31	To Quarry lease A/c	7,50,000	Dec. 31	By Prof t & Loss A/c	7,50,000
		7,50,000			7,50,000

ILLUSTRATION 7

A firm purchased on 1st January, 2020 certain machinery for ₹ 5,82,000 and spent ₹ 18,000 on its erect on. On July 1, 2020 another machinery for ₹ 2,00,000 was acquired. On 1st July, 2021 the machinery purchased on 1st January, 2020 having become obsolete was auct oned for ₹ 3,86,000 and on the same date fresh machinery was purchased at a cost of ₹ 4,00,000.

Depreciat on was provided for annually on 31st December at the rate of 10 per cent p.a. on writ en down value.

Required

Prepare machinery account.

Answer
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Machinery Account

Date	Particulars	₹	Date	Particulars	₹
2020			2020		
Jan. 1	To Bank A/c	5,82,000	Dec. 31	By Depreciation A/c	70,000
Jan. 1	To Bank A/c – erect on charges	18,000		By Balance c/d	7,30,000
July 1	To Bank A/c	2,00,000			
		8,00,000			8,00,000
2021			2021		
Jan. 1	To Balance b/d	7,30,000	July 1	By Depreciation on sold machine	27,000
July 1	To Bank A/c	4,00,000		By Bank A/c	3,86,000
				By Profit and Loss A/c	1,27,000
			Dec. 31	By Depreciation A/c	39,000
				By Balance c/d	5,51,000
		11,30,000			11,30,000

Working Note:
Book Value of Machines

	Machine I ₹	Machine II ₹	Machine III ₹
Cost	6,00,000	2,00,000	4,00,000
Depreciation for 2020	(60,000)	(10,000)	
Written down value	5,40,000	1,90,000	
Depreciation for 2021	(27,000)	(19,000)	(20,000)
Written down value	5,13,000	1,71,000	3,80,000
Sale Proceeds	(3,86,000)		
Loss on Sale	1,27,000		

ILLUSTRATION 8

On April 1, 2019 Shubra Ltd. purchased a machinery for ₹ 12,00,000. On Oct 1, 2021, a part of the machinery purchased on April 1, 2019 for ₹ 80,000 was sold for ₹ 45,000 and a new machinery at a cost of ₹ 1,58,000 was purchased and installed on the same date. The company has adopted the method of providing 10% p.a. depreciation on the written down value of the machinery.

Required :

Show the necessary ledger accounts for the years ended 31st March, 2020 to 2022 assuming that

(a) 'Provision for Depreciation Account' is not maintained (b) Provision for Depreciation Account is maintained.

Answer

(a) When 'Provision for Depreciation Account' is not maintained.

Dr. **Machinery Account**
Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2019	To Bank A/c	12,00,000	31.03.2020	By Depreciation A/c	1,20,000

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				By Balance c/d	10,80,000
		12,00,000			12,00,000
01.04.2020	To Balance b/d	10,80,000	31.03.2021	By Depreciat on A/c	1,08,000
				By Balance c/d	9,72,000
		10,80,000			10,80,000
01.04.2021	To Balance b/d	9,72,000	01.10.2021	By bank A/c	45,000
01.10.2021	To Bank A/c	1,58,000		By Prof t & Loss A/c	16,560
				By Depreciat on A/c	3,240
			31.3.2021	By Depreciat on A/c (7,900+ 90,720)	98,620
				By Balance c/d (8,16,480 + 1,50,100)	9,66,580
		11,30,000			11,30,000

(b) When 'Provision for Depreciat on Account' is maintained

Dr. Machinery Account (at original cost)

Cr.

Date	Part culars	₹	Date	Part culars	₹
01.04.2019	To Bank A/c	12,00,000	31.03.2020	By Balance c/d	12,00,000
01.04.2020	To Balance b/d	12,00,000	31.03.2021	By Balance c/d	12,00,000
01.04.2021	To Balance b/d	12,00,000	01.10.2021	By Machinery Disposal A/c	80,000
01.10.2021	To Bank A/c	1,58,000	31.03.2022	By Balance c/d	12,78,000
		13,58,000			13,58,000

Dr. Provision for Depreciat on Account

Cr.

Date	Part culars	₹	Date	Part culars	₹
31.03.2020	To Balance c/d	1,20,000	31.03.2020	By Depreciat on A/c	1,20,000
31.03.2021	To Balance c/d	2,28,000	1.04.2020	By Balance b/d	1,20,000
			31.03.2021	By Depreciat on A/c	1,08,000
		2,28,000			2,28,000
01.10.2021	To Machinery Disposal A/c	18,440	01.04.2021	By Balance b/d	2,28,000
31.03.2022	To Balance c/d	3,11,420	01.10.2021	By Depreciat on A/c	3,240
			31.03.2022	By Depreciat on A/c	98,620
		3,29,860			3,29,860

Dr. Machinery Disposal Account

Cr.

Date	Part culars	₹	Date	Part culars	₹
01.10.2021	To Machinery Disposal A/c	80,000	01.10.2021	By Provision for Depreciat on A/c	18,440
				By Bank A/c	45,000
				By Prof t and Loss A/c	16,560
		80,000			80,000

Working Notes:

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(1) Calculation of Profit/Loss on Sale of Machinery

Particulars	₹
A. Original Cost	80,000
B. Less : Depreciation @ 10% WDV p.a. for 2 ½ years	18,440
C. Book Value as on date of Sale (A – B)	61,560
D. Less : Sale proceeds	45,000
E. Loss on Sale (C – D)	16,560

(2) Calculation of Depreciation for Current Year on Machines (other than sold)

Particulars	₹
A. On Old Machines of ₹ 9,07,200 for 1 year (10% WDV)	90,720
B. On New Machine of ₹ 1,58,000 for ½ year	7,900
	98,620

ILLUSTRATION 9

A firm purchased second hand machinery on 1st January, 2019 for ₹ 3,00,000, subsequent to which ₹ 60,000 and ₹ 40,000 were spent on its repairs and installation, respectively. On 1st July, 2020 another machinery was purchased for ₹ 2,60,000. On 1st July, 2021, the first machinery having become outdated was auctioned for ₹ 3,20,000 and on the same date, another machinery was purchased for ₹ 2,50,000.

On 1st July, 2022, the second machinery was also sold off and it fetched ₹ 2,30,000.

Depreciation was provided on machinery @ 10% on the original cost annually on 31st December, under the straight line method.

Required

Prepare the following accounts in the books of the company: (i) Machinery Account for the years ending Dec. 31, 2019 to 2022 and (ii) Machinery Disposal Account.

Answer

Dr.			Machinery Account			Cr.		
Date	Particulars	₹	Date	Particulars	₹			
01.01.2019	To Bank A/c (A) – Cost	3,00,000	31.12.2019	By Depreciation (A)	40,000			
	- Repairs	60,000		By Balance c/d (A)	3,60,000			
	- Installation	40,000						
		4,00,000			4,00,000			
01.01.2020	To Balance b/d	3,60,000	31.12.2020	By Depreciation				
				(A) 40,000				
				(B) 13,000	53,000			
01.07.2020	To Bank A/c (B)	2,60,000		By Balance c/d				
				(A) 3,20,000				
				(B) 2,47,000	5,67,000			
		6,20,000			6,20,000			
01.01.2021	To Balance b/d	5,67,000	01.07.2021	By Machinery Disposal A/c (A)	3,00,000			
01.07.2021	To Bank A/c (C)	2,50,000		By Depreciation A/c				
				(A) 20,000				

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				(B) 26,000	
				(C) 12,500	58,500
				By Balance c/d	
				(B) 2,21,000	
				(C) 2,37,500	4,58,500
		8,17,000			8,17,000
01.01.2022	To Balance b/d	4,58,500	01.07.2022	By Machinery Disposal A/c (B)	2,08,000
				By Depreciat on A/c	
				(B) 13,000	
				(C) 25,000	38,000
				By Balance c/d	2,12,500
		4,58,500			4,58,500

Machinery Disposal Account

Date	Part culars	₹	Date	Part culars	₹
01.07.2021	To Machinery A/c (A)	3,00,000	01.07.2021	By Bank A/c	3,20,000
	To Prof t Loss A/c (Prof t)	20,000			
		3,20,000			3,20,000
01.07.2022	To Machinery A/c (B)	2,08,000	01.07.2022	By Bank A/c	2,30,000
	To P & L A/c (Prof t)	22,000			
		2,30,000			2,30,000

ILLUSTRATION 10

M/s Anshul & Co. commenced business on 1st January 2017, when they purchased plant and equipment for ₹ 7,00,000. They adopted a policy of charging depreciat on at 15% per annum on diminishing balance basis and over the years, their purchases of plant have been:

Date	Amount ₹
01.01.2018	1,50,000
01.01.2021	2,00,000

On 1-1-2021 it was decided to change the method and rate of depreciat on to straight line basis. On this date remaining useful life was assessed as 6 years for all the assets purchased before 1.1.2021 with no scrap value and 10 years for the asset purchased on 1.1.2021.

Required

Calculate the difference in depreciation to be adjusted in the Plant and Equipment Account for the year ending 31st December, 2021.

Answer

Depreciation on written down value basis

		Purchased on Jan. 1, 2017	Purchased on Jan. 1, 2018	Total Depreciat on
		₹	₹	₹
2017	Cost	7,00,000		
	Depreciat on	(1,05,000)		1,05,000
	Writ en Down Value (WDV)	5,95,000		

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2018	Cost	-	1,50,000	
	Depreciat on	(89,250)	(22,500)	1,11,750
	W.D.V.	5,05,750	1,27,500	
2019				
	Depreciation	(75,863)	(19,125)	94,988
	W.D.V.	4,29,887	1,08,375	
2020				
	Depreciation	(64,483)	(16,256)	80,739
	W.D.V.	3,65,404	92,119	
2021				
	Depreciation	(60,900)	(15,353)	76,253
		3,04,504	76,766	

Plant and Equipment Account

		₹			₹
2021			2021		
Jan. 1	To Balance b/d	4,57,523	Dec. 31	By Depreciat on	96,253
	To Bank	2,00,000		(60,900+15,353+20,000)	
				By Balance c/d	5,61,270
		6,57,523			6,57,523
2022					
Jan. 1	To Balance b/d	5,61,270			

ILLUSTRATION 11

A Machine costing ₹ 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.

Required

Calculate depreciation for the fourth year.

Answer

Depreciation per year = ₹ 6,00,000 / 10 = ₹ 60,000

Depreciation on SLM charged for three years = ₹ 60,000 x 3 years = ₹ 1,80,000

Book value of the computer at the end of third year = ₹ 6,00,000 – ₹ 1,80,000 = ₹ 4,20,000.

Remaining useful life as per previous estimate = 7 years

Remaining useful life as per revised estimate = 5 years

Depreciation from the fourth year onwards = ₹ 4,20,000 / 5 = ₹ 84,000 per annum

ILLUSTRATION 12

A machine of cost ₹ 12,00,000 is depreciated straight-line assuming 10 year working life and zero residual value for three years. At the end of third year, the machine was revalued upwards by ₹ 60,000 the remaining useful life was reassessed at 9 years.

Required

Calculate depreciation for the fourth year.

Answer

Depreciation per year charged for three years = ₹ 12,00,000 / 10 = ₹ 1,20,000

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WDV of the machine at the end of third year = ₹12,00,000 – ₹1,20,000 × 3 = ₹8,40,000

Depreciable amount after revaluation = ₹8,40,000 + ₹60,000 = ₹9,00,000

Remaining useful life as per previous estimate = 7 years

Remaining useful life as per revised estimate = 9 years

Depreciation for the fourth year onwards = ₹9,00,000 / 9 = ₹1,00,000.

ILLUSTRATION 13

Kumar R&D Co. registered a patent (the patent meets the criteria of an intangible asset) on 1st July, 2021 developed at a cost of ₹ 28,00,000 and spent ₹ 2,00,000 towards legal fees and registration. The patent is granted for a period of 10 years. The books are closed on 31st December every year. Required

Show the Patent Account and Amortisation Account for the year 2021 and 2022.

Answer

Useful Life: 10 years from 1 July, 2021

Residual Value: NIL

Value of patent = ₹ 30,00,000 (₹ 28,00,000 cost + ₹ 2,00,000 legal expenses and registration fees)

Therefore, annual depreciation: ₹30,00,000 ÷ 10 years = ₹ 3,00,000

Patent Account

		₹			₹
2021			2021		
July 1	To Bank A/c	28,00,000	Dec. 31	By Amort sat on A/c:	
July 1	To Bank A/c - Legal & Reg. Exp.	2,00,000		₹ 3,00,000 x 6/12	1,50,000
			Dec. 31	By Balance c/d	28,50,000
		30,00,000			30,00,000
2022			2022		
Jan. 1	To Balance b/d	28,50,000	Dec. 31	By Amort sat on A/c	3,00,000
			Dec. 31	By Balance c/d	25,50,000
		28,50,000			28,50,000

Amortisation Account

		₹			₹
2021			2021		
Dec. 31	To Patent A/c	1,50,000	Dec. 31	By Prof t & Loss A/c	1,50,000
2022			2022		
Dec. 31	To Patent A/c	3,00,000	Dec. 31	By Prof t & Loss A/c	3,00,000

ILLUSTRATION 14

Prime Streaming Co. acquired the streaming rights of a movie for ₹ 18,00,000 with the contracted duration of the streaming period being 10 years. At the beginning of the fourth year, based on the decline in viewership, Prime Streaming Co. decided to stream the movie only for the next 5 years.

Required

Calculate amortisation for the fourth year.

Answer

Amortisation per year = ₹18,00,000 / 10 = ₹1,80,000

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Amortisation on SLM charged for three years = ₹1,80,000 x 3 years = ₹5,40,000

Carrying Amount of the Streaming Rights at the end of third year = ₹18,00,000 – ₹5,40,000 = ₹12,60,000.

Remaining useful life as per previous estimate = 7 years

Remaining useful life as per revised estimate = 5 years

Amortisation from the fourth year onwards = ₹12,60,000 / 5 = ₹2,52,000 per annum

Example:

Cost of Machine	₹10,50,000
Residual Value	₹50,000
Useful life	10 years

The company charges depreciation on straight line method for the first two years and thereafter decides to adopt written down value method by charging depreciation @ 25%. (calculated based on useful life). You are required to calculate depreciation for the 3rd year.

Depreciation already charged for the first 2 years as per straight line method is ₹2,00,000. Therefore, WDV for 2nd year is ₹8,50,000

Therefore, in the profit and loss account of the 3rd year, the depreciation of ₹2,12,500 (25% of ₹8,50,000) should be debited. In case the entity would have continued with Straight Line Method, depreciation for 3rd year would have been ₹1,00,000.



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Chapter 6

Bills of Exchange and Promissory Notes

185

True and False

Question 1

Bills payable account is a nominal account.

Answer 1

False: The bills payable account is a personal account that represents a liability.

Question 2

Promise to pay is included in a bill of exchange.

Answer 2

False: Bill of exchange contains an order to pay the required amount and not a mere promise to pay.

Question 3

Days of rebate are added to the due date to arrive at the maturity date.

Answer 3

False: 3 Days of grace are added to the due date to arrive at the maturity date.

Question 4

Discount at the time of retirement of a bill is a gain for the drawee.

Answer 4

True: Discount at the time of retirement of a bill is a gain for the drawee and loss for the drawer.

Question 5

Foreign bill is drawn in the country and payable outside the country.

Answer 5

True: When a bill is drawn in the country and is payable outside the country it is termed as a foreign bill.

Question 6

Promissory note is different from bill of exchange because the amount is paid by the maker in case of former and by the acceptor in the later.

Answer 6

True: In case of the promissory note, it is generally the maker who makes the payment, but in case of the bill of exchange, the person accepting the bill shall be liable to make the payment to the holder of the bill.

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Question 7

A has drawn a bill on B. B accepts the same and endorses the bill to C.

Answer 7

False: B cannot endorse the bill to C as he is a drawee. Only A, the drawer can do so.

Question 8

A bill given to a creditor is called bills payable.

Answer 8

True: A bill given to a creditor is called Bills Payable as the debtor commits to pay by giving a bill to creditor.

Multiple Choice Questions

1. On 1.1.2022, A draws a bill on B for ₹1,20,000 for 3 months' maturity date of the bill will be:

- (d) 1.4.2022
- (e) 3.4.2022
- (f) 4.4.2022

Answer 1 : (c)

2. On 16.6.2022 P draws a bill on Q for ₹1,25,000 for 30 days. 19th July is a public holiday, maturity date of the bill will be:

- (a) 19th July
- (b) 18th July
- (c) 17th July

Answer 2 : (b)

3. PQ draws a bill on XY for ₹130,000 on 1.1.2022. XY accepts the same on 4.1.2022 for period of 3 months after date. What will be the maturity date of the bill:

- (a) 4.4.2022
- (b) 3.4.2022
- (c) 7.4.2022

Answer 3 : (a)

4. A draws a bill on B. A endorsed the bill to C. The payee of the bill will be

- (a) A
- (b) B
- (c) C

Answer 4 : (c)

5. A bill of ₹ 120,000 was discounted by Saras with the banker for ₹1,18,800. At maturity, the bill returned dishonoured, noting charges ₹ 200. How much amount will the bank deduct from Saras's bank balance at the time of such dishonour?

- (a) ₹1,20,000
- (b) ₹1,18,800
- (c) ₹1,20,200

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Answer 5 : (c)

6. X draws a bill on Y for ₹300,000 on 1.1.2022 for 3 months after sight, date of acceptance is 6.1.2022. Maturity date of the bill will be:
- (a) 8.4.2022
 - (b) 9.4.2022
 - (c) 10.4.2022

Answer 6 : (b)

7. X sold goods to Y for ₹ 5,00,000. Y paid cash ₹4,30,000. X will grant 2% discount on balance, and Y request X to draw a bill for balance, the amount of bill will be:
- (a) ₹ 98,000
 - (b) ₹ 68,000
 - (c) ₹ 68,600

Answer 7 : (c)

8. On 1.1.2022, X draws a bill on Y for ₹ 5,00,000 for 3 months. X got the bill discounted 4.1.2022 at 12% rate. The amount of discount on bill will be:
- (a) ₹ 15,000
 - (b) ₹ 16,000
 - (c) ₹ 18,000

Answer 8 : (a)

9. Mr. Jay draws a bill on Mr. John for ₹ 3,00,000 on 1.1.2022 for 3 months. On 4.2.2022, John got the bill discounted at 12% rate. The amount of discount will be:
- (a) ₹ 9,000
 - (b) ₹ 6,000
 - (c) ₹ 3,000

Answer 9 : (b)

10. XZ draws a bill on YZ for ₹ 2,00,000 for 3 months on 1.1.2022. The bill is discounted with banker at a charge of ₹1,000. At maturity the bill return dishonoured. In the books of XZ, for dishonour, the bank account will be credited by:
- (a) ₹199,000
 - (b) ₹ 200,000
 - (c) ₹ 201,000

Answer 10 : (b)

11. On 1.1.2022, XA draws a bill on YB for ₹ 1,00,000. At maturity YB request XA to renew the bill for 2 months at 12% p.a. interest. Amount of interest will be:
- (a) ₹ 2,000
 - (b) ₹ 1,500
 - (c) ₹ 1,800

Answer 11 : (a)

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12. A bill of exchange is drawn by a

- (a) Creditor
- (b) Debtor
- (c) Debenture holder

Answer 12 : (a)

13. At the time of drawing a bill, the drawer credits

- (a) Bills Receivables A/c
- (b) Bills Payable A/c
- (c) Debtor's A/c

Answer 13 : (c)

14. A promissory note is made by a

- (a) Seller
- (b) Purchaser
- (c) Endorsee

Answer 14 : (b)

15. A bill of exchange contains

- (a) An unconditional order
- (b) A promise
- (c) A request to deliver the goods

Answer 15 : (a)

16. A promissory note contains

- (a) An unconditional order
- (b) A promise
- (c) A request to deliver the goods

Answer 16 : (b)

17. The rebate on the bill shows that

- (a) It has been endorsed
- (b) It has been paid after the date of maturity
- (c) It has been paid before the date of maturity

Answer 17 : (c)

18. Notary Public may charge his fee from the

- (a) Holder of bill of exchange
- (b) Drawer
- (c) None

Answer 18 : (a)

Theoretical Questions & Answers

Question 1

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Write short notes on:

- (a) **Accommodation bill.**
- (b) **Renewal of bill.**
- (c) **Noting charges.**

Answer 1

- (a) Bills of Exchange are usually drawn to facilitate trade transmission, that is, bills are meant to finance actual purchase and sale of goods. But the mechanism of bill can be utilised to raise finance also. When bills are used for such a purpose, they are known as accommodation bills.
- (b) When the acceptor of a bill finds himself in financial straits to honour the bill on the due date, then he may request the drawer to cancel the original bill and draw on him a fresh bill for another period. And if the drawer agrees, a new bill in place of the original bill may be accepted by the drawee for another period. This is called the renewal of bill.
- (c) The charges paid to Notary public for notify the dishonour are noting charges. Refer para 1.12 for details.

Question 2

What is bill of exchange? How does it differ from Promissory Note?

Answer 2

A bill of exchange has been defined as “an instrument in writing containing an unconditional order signed by the maker directing a certain person to pay a certain sum of money only to or to the order of certain person or to the bearer of the instrument”. When such an order is accepted by the drawee, it becomes a valid bill of exchange. A promissory note is an instrument in writing (not being a bank note or a government 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, or to the bearer of the instrument.

A promissory note needs no acceptance, as the debtor himself writes the document promising to pay the stated amount. Like bills of exchange, promissory notes are also negotiable instruments, and can be transferred by endorsement. In case of bill of exchange, the drawer and the payee may be the same person but in case of a promissory note, the maker and the payee cannot be the same person.

Practical Questions & Answers

Question 1

On 1st January, 2022, A sells goods for ₹10,000 to B and draws a bill at three months for the amount. B accepts it and returns it to A. On 1st March, 2022, B retires his acceptance under rebate of 12% per annum. Record these transactions in the journals of B.

Answer 1

Journal Entries in the books of B

Date	Particulars		Debit	Credit
2022			₹	₹
Jan. 1	Purchases account	Dr.	10,000	
	To A's account (Being the goods purchased from A on credit)			10,000
	A's account	Dr.	10,000	
	To Bills payable account (Being the acceptance of bill given to A)			10,000

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1-Mar	Bills payable account	Dr.	10,000	
	To Bank account			9,900
	To Rebate on bills account (Being the bill discharged under rebate @ 12% p.a.)			100

Working Note :

Calculat on of rebate:

$$₹10,000 \times 12/100 \times 1/12 = ₹100$$

Question 2

A draws upon B three Bills of Exchange of ₹ 3,000, ₹ 2,000 and ₹ 1,000 respectively. A week later his first bill was mutually cancelled, B agreeing to pay 50% of the amount in cash immediately and for the balance plus interest ₹100, he accepted a fresh Bill drawn by A. This new bill was endorsed to C who discounted the same with his bankers for ₹1,500. The second bill was discounted by A at 5%. This bill on maturity was returned dishonoured (nothing charge being ₹30). The third bill was retained till maturity when it was duly met.

Give the necessary journal entries recording the above transactions in the books of A.

Answer 2
Journal of A

		₹	₹
Bills Receivable A/c	Dr.	6,000	
To B (Three bills for ₹3,000, ₹2,000 and ₹1,000 drawn on B and duly accepted by him received)			6,000
B	Dr.	3,000	
To Bills Receivable A/c (Bill received from B cancelled for renewal)			3,000
Cash Account	Dr.	1,500	
Bill Receivable Account	Dr.	1,600	
To B			3,000
To Interest Account (Amount received on cancellat on of the f rst bill, 50% along with a new bill for 50% of the amount plus interest ₹100)			100
C	Dr.	1,600	
To Bills Receivable A/c (A's acceptance endorsed in favour of C)			1,600
Bank A/c	Dr.	1,900	
Discount A/c	Dr.	100	
To Bills Receivable A/c (Second Bill for ₹ 2,000 discounted with the bank @ 5%)			2000
B	Dr.	2,030	
To Bank A/c (Second Bill for ₹2,000 discounted with the Bank dishonoured, not ng charges ₹30 paid by the Bank)			2,030

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Bank A/c	Dr.	1,000	
To Bills Receivable A/c (Amount received on maturity of the third bill)			1,000

Note: It is assumed that the bill for ₹1,600 has not yet fallen due for payment.

Question 3

Journalize the following in the books of Don:

- Bob informs Don that Ray's acceptance for ₹ 3,000 has been dishonoured and nothing charges are ₹ 40. Bob accepts ₹ 1,000 cash and the balance as bill at three months at interest of 10%. Don accepts from Ray his acceptance at two months plus interest @ 12% p.a.
- James owes Don ₹ 3,200; he sends Don's own acceptance in favour of Ralph for ₹ 3,160; in full settlement.
- Don meets his acceptance in favour of Singh for ₹ 4,500 by endorsing John's acceptance for ₹ 4,450 in full settlement.
- Ray's acceptance in favour of Don returned one month before due date, interest is taken at the rate of 6% p.a.

Answer 3

Books of Don

			₹	₹
(i)(a)	Ray	Dr.	3,040	
	To Bob (Ray's acceptance endorsed to Bob dishonoured on due date nothing charges paid by Bob ₹40)			3,040
(b)	Bob	Dr.	3,040	
	Interest	Dr.	51	
	To Cash			1,000
	To Bills Payable A/c (Amount payable to Bob ₹3,040 settled by cash payment ₹1,000 and issue of new bill for ₹2,091 including interest ₹ 51 for three months on ₹2,040 @ 10% p.a.)			2,091
(c)	Bills Receivable A/c	Dr.	3,100.80	
	To Ray			3,040.00
	To Interest (Bill received from Ray for ₹3,040 due against earlier acceptance dishonoured plus ₹ 60.80 interest for two months @ 12% p.a.)			60.8
(ii)	Bills Payable A/c	Dr.	3,160	
	Discount A/c	Dr.	40	
	To James (Cancellation of bills payable to Ralph for ₹3,160 in settlement of ₹3,200 due from James)			3,200
(iii)	Bills payable A/c	Dr.	4,500	
	To Bills Receivable A/c			4,450
	To Discount A/c			50

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	(Settlement of acceptance issued to Mr. Singh by endorsement of John's Acceptance for ₹4,450)			
(iv)	Bank A/c	Dr.	3,085.30	
	Discount A/c	Dr.	15.5	
	Total Bills Receivable A/c (Amount received from Ray in settlement of Bills Payable, retained one month before due date)			3,100.80

ILLUSTRATION 1

Ms. Sujata receives two bills from Ms. Aruna dated 1st January 2022 for 2 months. The first bill is for 10,200 and the second bill is for ₹ 15,000. The First bill is discounted immediately with the bank for ₹ 10,000 and the second bill was endorsed in favour of Mr. Sree on 3rd January 2022. Pass the necessary journal entries in the books of Ms. Sujata.

Answer

**In the books of Sujata
Journal Entries**

Date	Particulars		L.F.	DR. (₹)	CR. (₹)
01/01/2022	Bills receivables A/c	Dr.		25,200	
	To Aruna A/c (Being 2 bills receivable from Aruna)				25,200
01/01/2022	Bank A/c	Dr.		10,000	
	Discount charges A/c	Dr.		200	
	To Bills receivable A/c (Being the bills receivable discounted with the bank at a charge of ₹ 200)				10,200
03/01/2022	Sree A/c	Dr.		15,000	
	To Bills receivable A/c (Being bill endorsed in favour of Mr. Sree)				15,000

ILLUSTRATION 2

Vijay sold goods to Pritam on 1st September, 2022 for ₹1,06,000. Pritam immediately accepted a 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% p.a. 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.

Answer

**Books of Vijay
Journal**

2022	Particulars		L.F.	DR. (₹)	CR. (₹)
1 Sept.	Pritam	Dr.		1,06,000	
	To Sales Account (Sales of goods to Pritam as per Invoice No...)				1,06,000
	Bills Receivable Account	Dr.		1,06,000	
	To Pritam				1,06,000

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	(3 months acceptance received from Pritam for the amount due from him)				
Dec. 4	Pritam	Dr.		1,06,000	
	To Bills Receivable Account (Pritam acceptance cancelled because of renewal)				1,06,000
	Pritam	Dr.		1,590	
	To interest (Interest @ 9% on ₹1,06,000 due from Pritam for 2 months because of renewal)				1,590
	Bills Receivable Account	Dr.		1,06,000	
	Cash Account	Dr.		1,590	
	To Pritam [New acceptance for 2 months for ₹106,000 and Cash (for interest) received from Pritam]				1,07,590
2023 Feb. 7	Cash Account	Dr.		1,06,000	
	To Bills Receivable Account (Cash received against Pritam's second acceptance)				1,06,000

Books of Pritam Journal

2022			₹	₹
1 Sept.	Purchase Account	Dr.	1,06,000	
	To Vijay A/c (Purchase of goods from Vijay as per Invoice No...)			1,06,000
	Vijay A/c	Dr.	1,06,000	
	To Bills Payables Account (3 months acceptance given to Vijay for the amount)			1,06,000
Dec. 4	Bills Payable Account	Dr.	1,06,000	
	To Vijay A/c (Cancellation of bill because of renewal)			1,06,000
	Interest Account	Dr.	1,590	
	To Vijay (Interest @ 9% on ₹1,06,000 due to Vijay for 2 months because of renewal)			1,590
	Vijay Account	Dr.	1,07,590	
	To Cash Account To Bills Payable Account [New acceptance for 2 months for ₹106,000 and Cash (for interest) paid to Vijay]			1,590 1,06,000
2023 Feb. 7	Bills Payable Account	Dr.	1,06,000	
	To Cash Account			1,06,000

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	(Cash paid against second bill)		

ILLUSTRATION 3

On 1st January, 2022, Ankita sells goods for ₹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, 2022, Bhavika retires her acceptance under rebate of 12% per annum. Record these transactions in the journals of Ankita and Bhavika.

Answer

Journal Entries in the books of Ankita

Date 2022	Particulars		(₹)	(₹)
Jan. 1	Bhavika's account	Dr.	5,00,000	
	To Sales account (Being the goods sold to Bhavika on credit)			5,00,000
	Bills receivable account	Dr.	5,00,000	
	To Bhavika's account (Being the acceptance of bill received)			5,00,000
Mar.1	Bank account	Dr.	4,95,000	
	Rebate on bills account	Dr.	5,000	
	To Bills receivable account (Being retirement of bill by Bhavika one month before maturity, the rebate being given to her at 12% p.a.)			5,00,000

Journal Entries in the books of Bhavika

Date 2022	Particulars		(₹)	(₹)
Jan. 1	Purchases account	Dr.	5,00,000	
	To Ankita Account (Being the goods purchased from Ankita on credit)			5,00,000
	Ankita Account	Dr.	5,00,000	
	To Bills Payable Account (Being the acceptance of bill)			5,00,000
Mar.1	Bills Payable Account	Dr.	5,00,000	
	To Rebate Income Account			5,000
	To Bills receivable account (Being retirement of bill one month before maturity, the rebate being received at 12% p.a.)			4,95,000

ILLUSTRATION 4

Journalise the following transactions in K. Katrak's books.

- Katrak's acceptance to Basu for ₹ 2,500 discharged by a cash payment of ₹ 1,000 and a new bill for the balance plus ₹ 50 for interest.
- G. Gupta's acceptance for ₹ 4,000 which was endorsed by Katrak to M. Mehta was dishonoured. Mehta paid ₹ 20 not ng charges. Bill withdrawn against cheque.
- D. Dalal ret res a bill for ₹ 2,000 drawn on him by Katrak for ₹10 discount.

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- (iv) Katrak's acceptance to Patel for ₹ 5,000 and Mody's acceptance to Katrak for a similar amount were duly discharged.

Answer

Books of K. Katrak
Journal Entries

	Particulars		(₹)	(₹)
(i)	Bills Payable Account	Dr.	2,500	
	Interest Account	Dr.	50	
	To Cash A/c			1,000
	To Bills Payable Account (Bills Payable to Basu discharged by cash payment of ₹1,000 and a new bill for ₹1,550 including ₹50 as interest)			1,550
(ii)	(a) G. Gupta	Dr.	4,020	
	To M. Mehta (G. Gupta's acceptance for ₹4,000 endorsed to M. Mehta dishonoured, ₹20 paid by M. Mehta as not ng charges)			4,020
	(b) M. Mehta	Dr.	4,020	
	To Bank Account (Payment to M. Mehta on withdrawal of bill earlier received from Mr. G. Gupta)			4,020
(iii)	Bank Account	Dr.	1,990	
	Discount Account	Dr.	10	
	To Bills Receivable Account (Payment received from D. Dalal against his acceptance for ₹2,000. Allowed him a discount of ₹10)			2,000
(iv)	Bills Payable Account	Dr.	5,000	
	To Bills Receivable Account (Bills Receivable from Mody endorsed to settlement of bills payable issued to him earlier)			5,000

ILLUSTRATION 5

On 1st January, 2022, Vilas draws a bill of exchange for ₹10,000 due for payment after 3 months on Eknath. Eknath accepts to this bill of exchange. On 4th March, 2022 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 Eknath.

Answer

Journal entries in the books of Eknath

Date 2022	Particulars		Dr. (₹)	Cr. (₹)
Jan. 1	Vilas A/c	Dr.	10,000	
	To Bills Payable A/c (Being the bill drawn by him accepted)			10,000
Mar. 4	Bills Payable A/c	Dr.	10,000	
	To Bank A/c			9,900
	To Interest A/c (Discount A/c) (Being retirement of acceptance 1 month before)			100

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	maturity, interest allowed at 12% p.a.)			

ILLUSTRATION 6

On 1st January, 2022, Vilas draws a Bill of Exchange for ₹10,000 due for payment after 3 months on Eknath. Eknath accepts to this bill of exchange. On 4th March, 2022. 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.

Answer

Journal entries in the books of Vilas

Date 2022	Particulars		Dr. (₹)	Cr. (₹)
Jan. 1	Bills Receivable A/c	Dr.	10,000	
	To Eknath A/c (Being bill of exchange drawn on Eknath due for payment on 4th April 2022)			10,000
Mar. 4	Bank A/c	Dr.	9,900	
	Interest A/c (Discount) A/c	Dr.	100	
	To Bills Receivable A/c (Being retirement of bill of exchange due for maturity on 4th April, 2022 by Eknath 1 month before maturity, the rebate being given to him at 12% p.a.)			10,000

ILLUSTRATION 7

Mr. David draws two bills of exchange on 1.1.2022 for ₹6,000 and ₹10,000. The bills of exchange for ₹6,000 is for two months while the bill of exchange for ₹10,000 is for three months. These bills are accepted by Mr. Thomas. On 4.3.2022, 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 20.3.2022, Mr. Thomas retires the acceptance for ₹10,000, the interest rebate i.e. discount being ₹100. Before the due date of the renewed bill, Mr. Thomas becomes insolvent and only 50 paise in a rupee could be recovered from his estate.

You are to give the journal entries in the books of Mr. David.

Answer

Journal Entries in the books of Mr. David

2022	Particulars		Dr. (₹)	Cr. (₹)
Jan. 1	Bills receivable (No. 1) A/c	Dr.	6,000	
	Bills receivable (No. 2) A/c	Dr.	10,000	
	To Mr. Thomas's A/c (Being drawing of bills receivable No. 1 due for maturity on 4.3.2022 and bills receivable No. 2 due for maturity on 4.4.2022)			16,000
4-Mar	Mr. Thomas's A/c	Dr.	6,000	
	To Bills receivable (No.1) A/c (Being the reversal entry for bill No.1 on agreed renewal)			6,000
4-Mar	Bills receivable (No. 3) A/c	Dr.	6,180	
	To Interest A/c			180
	To Mr. Thomas's A/c			6,000

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	(Being the drawing of bill of exchange no. 3 due for maturity on 7.5.2022 together with interest at 18%p.a. in lieu of the original acceptance of Mr. Thomas)			
20-Mar	Bank A/c	Dr.	9,900	
	Discount A/c	Dr.	100	
	To Bills receivable (No. 2) A/c (Being the amount received on retirement of bills No.2 before the due date)			10,000
7-May	Mr. Thomas's A/c		6,180	
	To Bills receivable (No. 3) A/c (Being the amount due from Mr. Thomas on dishonour of his acceptance on presentation on the due date)			6,180
7-May	Bank A/c	Dr.	3,090	
	To Mr. Thomas's A/c (Being the amount received from official assignee of Mr. Thomas at 50 paise per rupee against dishonoured bill)			3,090
May 7	Bad debts A/c	Dr.	3,090	
	To Mr. Thomas's A/c (Being the balance 50% debt in Mr. Thomas's Account arising out of dishonoured bill written as bad)			3,090

ILLUSTRATION 8

Rita owed ₹1,00,000 to Siriman. On 1st October, 2021, Rita accepted a bill drawn by Siriman for the amount at 3 months. Siriman got the bill discounted with his bank for ₹99,000 on 3rd October, 2021. Before the due date, Rita approached Siriman for renewal of the bill. Siriman agreed on the conditions that ₹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.

Answer

In the books of Siriman Journal Entries

Particulars		₹	₹
Bills Receivable A/c	Dr.	1,00,000	
To Rita (Being a 3 month's bill drawn on Rita for the amount due)			1,00,000
Bank A/c	Dr.	99,000	
Discount A/c	Dr.	1,000	
To Bills Receivable A/c (Being the bill discounted)			1,00,000
Rita	Dr.	1,00,000	

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To Bank A/c (Being the bill cancelled up due to Rita's inability to pay it)			1,00,000
Rita	Dr.	1,500	
To Interest A/c (Being the interest due on ₹ 50,000 @ 12% for 3 months)			1,500
Bank A/c	Dr.	51,500	
To Rita (Being the receipt of a part of the amount due on the bill together with interest)			51,500
Bills Receivable A/c	Dr.	50,000	
To Rita (Being the new bill drawn for the balance)			50,000
Rita	Dr.	50,000	
To Bills Receivable A/c (Being the dishonour of the bill due to Rita's insolvency)			50,000
Bank A/c	Dr.	20,000	
Bad Debts A/c	Dr.	30,000	
To Rita (Being the receipt of 40% of the amount due on the bill from Rita's estate)			50,000

ILLUSTRATION 9

On 1st July, 2022 Gorge drew a bill for ₹1,80,000 for 3 months on Harry for mutual accommodation. Harry accepted the bill of exchange. Gorge had purchased goods worth ₹1,81,000 from Jack on the same date. Gorge endorsed Harry's acceptance to Jack in full settlement. On 1st September, 2022, Jack purchased goods worth ₹1,90,000 from Harry. Jack endorsed the bill of exchange received from Gorge to Harry and paid ₹ 9,000 in full settlement of the amount due to Harry. On 1st October, 2022, Harry purchased goods worth ₹2,00,000 from Gorge. Harry paid the amount due to Gorge by cheque. Give the necessary Journal Entries in the books of Harry, Gorge and Jack.

Answer

**In the books of Harry
Journal Entries**

Date	Particulars		(₹)	(₹)
1.7.2022	Gorge's account	Dr.	1,80,000	
	To Bills payable account (Acceptance of bill drawn by Gorge)			1,80,000
1.9.2022	Jack's account	Dr.	1,90,000	
	To Sales account (Sales made to Jack)			1,90,000
1.9.2022	Bills receivable account	Dr.	1,80,000	
	Bank account	Dr.	9,000	
	Discount account	Dr.	1,000	
	To Jack's account (Acceptance received from Jack's endorsement of bill received)			1,90,000

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	from Gorge for ₹ 1,80,000 and ₹ 9,000 received in full settlement of the amount due)			
1.9.2022	Bills payable account	Dr.	1,80,000	
	To Bills receivable account (Own acceptance received from Jack's endorsement, cancelled)			1,80,000
1.10.2022	Purchase account	Dr.	2,00,000	
	To Gorge's account (Purchases made from Gorge)			2,00,000
	Gorge's account	Dr.	20,000	
	To Bank account (Amount paid to Gorge after adjusting ₹180,000 for accommodation extended to him)			20,000

**In the books of Gorge
Journal Entries**

Date	Particulars		(₹)	(₹)
1.7.2022	Purchases Account	Dr.	1,81,000	
	To Jack Account (Purchase of goods from Jack)			1,81,000
1.7.2022	Bills Receivable Account	Dr.	1,80,000	
	To Harry Account (Acceptance by Harry of bill drawn on him)			1,80,000
1.7.2022	Jack's account	Dr.	1,81,000	
	To Rebate Account			1,000
	To Bills Receivable Account (Harry's bill endorsed to Jack)			1,80,000
1.10.2022	Harry Account	Dr.	2,00,000	
	To Sales account (Sales to Harry)			2,00,000
1.10.2022	Bank Account	Dr.	20,000	
	To Harry account (Amount received from Gorge after adjusting ₹180,000 for accommodation extended by him)			20,000

**In the books of Jack
Journal Entries**

Date	Particulars		(₹)	(₹)
1.7.2022	Gorge Account	Dr.	1,81,000	
	To Sales Account (Sold goods to Gorge)			1,81,000
1.7.2022	Bills Receivable Account	Dr.	1,80,000	
	Rebate Account	Dr.	1,000	
	To Gorge Account (Being Harry's acceptance received from Gorge)			1,81,000
1.9.2022	Purchase Account	Dr.	1,90,000	
	To Harry Account			1,90,000

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	(Purchase of goods from Harry)			
1.9.2022	Harry Account	Dr.	1,90,000	
	To Bills Receivable Account			1,80,000
	To Bank Account			9,000
	To Discount Account (Endorsement of bill received from Gorge for Rs. 1,80,000 to Harry and Rs. 9,000 paid in full settlement of the amount due)			1000

ILLUSTRATION 10

X draws on Y a bill of exchange for ₹ 30,000 on 1st April, 2022 for 3 months. Y accepts the bill and sends it to X who gets it discounted for ₹ 28,800. X immediately remits ₹ 9,600 to Y. On the due date, X, being unable to remit the amount due, accepts a bill for ₹ 42,000 for three months which is discounted by Y for ₹ 40,110. Y sends ₹ 6,740 to X. Before the maturity of the bill X becomes bankrupt, his estate paying fifty paise in the rupee. Give the journal entries in the books of X and Y.

Answer

**In the books of X
Journal Entries**

Date	Particulars		(₹)	(₹)
1/4/2022	Bills receivables A/c	Dr.	30,000	
	To Y A/c (Being bill of exchange drawn on Mr. Y)			30,000
1/4/2022	Bank A/c	Dr.	28,800	
	Discount charges A/c	Dr.	1,200	
	To Bills receivable A/c (Being the bills receivable discounted with the bank at a charge of ₹ 1,200)			30,000
1/4/2022	Y A/c	Dr.	10,000	
	To Bank A/c			9,600
	To Discount charges (Being the amount remitted to Y along with his share of the bank charges)			400
4/7/2022	Y A/c	Dr.	42,000	
	To Bills payable A/c (Being the bills drawn by Y, due to non-payment of earlier bill)			42,000
4/7/2022	Bank A/c	Dr.	6,740	
	Discount charges A/c $\left[\frac{20,000+6,740}{40,110} \times 1,890 \right]$	Dr.	1,260	
	To Y A/c (Being the amount discounted and sent it by Y to X)			8,000
	Bills payable A/c	Dr.	42,000	
	To Y's A/c (Being the bill due dishonoured due to bankruptcy)			42,000
	Y A/c	Dr.	28,000	

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	To Bank A/c			14,000
	To Deficiency account (Being the amount due to Y discharged by payment of 50 paise in a rupee)			14,000

In the books of Y
Journal Entries

Date	Particulars		Dr. in (₹)	Cr. In (₹)
1/4/2022	X A/c	Dr.	30,000	
	To Bills payable A/c (Being bill of exchange accepted and sent to Mr. X)			30,000
1/4/2022	Bank A/c	Dr.	9,600	
	Discount charges A/c	Dr.	400	
	To X A/c (Being the amount received from X on account of the bills receivable)			10,000
4/7/2022	Bills receivable A/c	Dr.	42,000	
	To X A/c (Being the bills accepted by X)			42,000
4/7/2022	Bank A/c	Dr.	40,110	
	Discount charges A/c	Dr.	1,890	
	To Bills receivable A/c (Being X acceptance discounted with bank)			42,000
	Bills payable A/c	Dr.	30,000	
	To Bank A/c (Being the amount met on the due date)			30,000
	X A/c	Dr.	8,000	
	To Bank A/c			6,740
	To Discount account (Being the amount received and the discount debited to X)			1,260
	X A/c	Dr.	42,000	
	To Bank A/c (Being X's acceptance which was discounted dishonoured due to X's bankruptcy)			42,000
	Bank A/c	Dr.	14,000	
	Bad debts A/c	Dr.	14,000	
	To X A/c (The amount received from X and the balance being written off as debt)			28,000

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Preparation of Final Accounts of Sole Proprietors

Chapter 7.1 Final Accounts of Non-Manufacturing Entities

True and False

Question 1

The income statement shows either net profit or net loss for a particular period.

Answer 1

True: Profit and loss account shows either net profit or net loss for a particular period.

Question 2

Gains from the sale or exchange of assets are not considered as the revenue of the business.

Answer 2

False: Gains from the sale or exchange of assets are considered as the revenue of the business. But this revenue not in the ordinary course of business so it is capital receipts.

Question 3

The salary paid in advance is not an expense because it neither reduces assets or nor increase liabilities.

Answer 3

True: The salary paid in advance is an asset it is not an expense because it neither reduces assets or nor increase liabilities.

Question 4

A loss is an expenditure which does not bring any benefit to the concern.

Answer 4

True: A loss is an expenditure of the business which does not bring any gain to the business.

Question 5

All liabilities which become due for payment within the year are classified as long-term liabilities.

Answer 5

False: All liabilities which become due for payment within one year are classified as current liabilities.

Question 6

The term current asset is used to designate cash and other assets or resources which are

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reasonably expected to be realized or sold or consumed within one year.

Answer 6

True: Current assets are all the assets which are expected to be realized or sold or consumed within one year.

Question 7

An asset gives rise to expenditure when it is acquired and to an expense when it is consumed.

Answer 7

True: When an asset is purchase capital expenditure is incurred and when the asset is put to use expenses are incurred in consumption.

Question 8

If the balance of an account on the debit side of the trial balance where the benefit has already expired then it is treated as an expense.

Answer 8

True: Debit balance of accounts are treated as expenses whose benefit is already received or expired.

Question 9

Sales less cost of goods sold = gross profit.

Answer 9

True: Gross profit is obtained by deducting cost of goods sold from sales.

Question 10

If the debit side of the trading account exceeds its credit side then the balance is termed as gross profit.

Answer 10

False: If the debit side of the trading account exceeds its credit side then the balance is termed as gross loss.

Question 11

The provision for bad debts is debited to Sundry Debtors Account.

Answer 11

False: The provision for bad debts is debited to debited to Profit and loss Account, in Balance Sheet it is shown either on liability side or deducted from the head Debtors.

Question 12

The provision for discount on creditors is often not provided in keeping with the principle of conservatism.

Answer 12

True: According to the provision of conservatism provision is maintained for the losses to be incurred in future. Discount on creditors is an income so provision is not maintained.

Question 13

The debts written off as bad, if recovered subsequently are credited to Debtors Account.

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Answer 13

False: The debts written off as bad, if recovered subsequently are credited to Bad Debts Recovered Account and becomes an income.

Question 14

The adjustment entry in respect of income received in advance is debit Income received in advance account and credit income account.

Answer 14

False: Income received in advance is reduces it from the concerned income in profit and loss account. And, it is shows it as a liability in the current balance sheet under the head Current Liabilities.

Question 15

Premium paid on the life policy of a proprietor is debited to profit and loss account.

Answer 15

False: Premium paid on the life policy of a proprietor is to be debited to capital account, as it is personal expense.

Question 16

Depreciation account appear in the trial balance is taken only to profit and loss account.

Answer 16

True: Depreciation is charge on each of the asset on a certain percentage. Depreciation is a charge to profit and loss account and should be debited to profit & loss account by crediting the respective assets. If it appears in trial balance then it is taken only to profit and loss account.

Question 17

Personal purchases included in the purchases day book are added to the sales account in the Trading account.

Answer 17

False: Personal purchases included in the purchases day book are deducted from the purchases account in the Trading account.

Question 18

Medicines given to the office staff by a manufacturer of medicines will be debited to salaries account.

Answer 18

True: Any benefit given to the staff is debited to the salary account.

Question 19

Goods worth ₹ 600 taken by the proprietor for personal use should be credited to Capital Account.

Answer 19

False: Goods taken by the proprietor for personal use should be credited to Purchase Account as less goods are left in the business for sale.

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Question 20

If Closing Stock appears in the Trial Balance, the Closing inventory is then not entered in Trading Account. It is only shown in the Balance Sheet.

Answer 20

True: The closing Stock appears in the trial balance only when it is adjusted against purchases by passing the entry. In this case, closing stock is not entered in Trading Account and is shown only in Balance Sheet.

Multiple Choice Questions

1. A debit to an account may
- (d) increase expense
 - (e) decrease an asset.
 - (f) increase a liability.

Answer 1 : (a)

2. Prepayment of insurance premium will appear in the Balance Sheet and in the Insurance Account respectively as:
- (a) a liability and a debit balance.
 - (b) an asset and a debit balance.
 - (c) an asset and a credit balance.

Answer 2 : (c)

3. Gross profit is the difference between:
- (a) sales and purchases
 - (b) sales and cost of sales.
 - (c) sales and total expenses.

Answer 3 : (b)

4. Payment made to a creditor subject to cash discount will :
- (a) reduce a liability, reduce an asset and add to expenses.
 - (b) reduce a liability, add to an asset, and add to revenue.
 - (c) reduce an asset, reduce a liability, and add to revenue.

Answer 4 : (c)

5. A customer returns goods already charged to him. We should:
- (a) debit his account.
 - (b) credit his account.
 - (c) make no entry on his account.

Answer 5 : (b)

6. Capital is the difference between
- (a) Income and expenses
 - (b) Sales and Cost of goods sold
 - (c) Assets and liabilities

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Answer 6 : (c)

7. The capital of a sole trader would change as a result of:
- (a) A creditor being paid his account by cheque.
 - (b) Raw materials being purchased on credit.
 - (c) Wages being paid in cash.

Answer 7 : (c)

8. A decrease in the provision for doubtful debts would result in:
- (a) An increase in liabilities.
 - (b) A decrease in working capital.
 - (c) An increase in net profit.

Answer 8 : (c)

9. A Company wishes to earn a 20% profit margin on selling price. Which of the following is the profit mark up on cost, which will achieve the required profit margin?
- (a) 33%
 - (b) 25%
 - (c) 20%

Answer 9 : (b)

10. If sales is ₹ 2,000 and the rate of gross profit on cost of goods sold is 25%, then the cost of goods sold will be
- (a) ₹ 2,000.
 - (b) ₹ 1,500.
 - (c) ₹ 1,600.

Answer 10 : (c)

11. Sales for the year ended 31st March, 2022 amounted to ₹ 10,00,000. Sales included goods sold to Mr. A for ₹ 50,000 at a profit of 20% on cost. Such goods are still lying in the godown at the buyer's risk. Therefore, such goods should be treated as part of
- (a) Sales.
 - (b) Closing Inventory.
 - (c) Goods in transit.

Answer 11 : (a)

12. If sales revenues are ₹ 4,00,000; cost of goods sold is ₹ 3,10,000 and expenses are ₹ 60,000, the gross profit is
- (a) ₹ 30,000.
 - (b) ₹ 90,000.
 - (c) ₹ 3,40,000.

Answer 12 : (b)

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Theoretical Questions & Answers

Question 1

Write short notes on:

- Balance sheet.
- Trading account
- Closing entries

Answer 1

- The balance sheet may be defined as “a statement which sets out the assets and liabilities of a firm or an institution as at a certain date.” Since even a single transaction will make a difference to some of the assets or liabilities, the balance sheet is true only at a particular point of time. That is the significance of the word “as at.”
- At the end of the year, it is necessary to ascertain the net profit or the net loss. For this purpose, it is first necessary to know the gross profit or gross loss with the help of Trading A/c. Gross Profit is the difference between the selling price and the cost of the goods sold.
- Closing entries: The entries that have to be made in the journal for preparing the Trading and the Profit and Loss Account that is for transferring the various accounts to these two accounts are known as closing entries.

Question 2

Distinguish between Provision and reserve fund.

Answer 2

Provision means “any amount written off or retained by way of providing for depreciation, renewal or diminution in the value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy”.

Reserve Fund: It signifies the amount standing to the credit of the reserve that is invested outside the business in securities which are readily realisable e.g., when the amounts set apart for replacement of an asset are invested periodically, in government securities or shares. The account to which these amounts are annually credited is described as the Reserve Fund.

Practical Questions & Answers

Question 1

From the following particulars extracted from the books of Ganguli, prepare trading and profit and loss account and balance sheet as at 31st March, 2022 after making the necessary adjustments:

	₹		₹
Ganguli's capital account (Cr.) as on 1.4.2021	5,40,500	Interest received	7,250
Stock on 1.4.2021	2,34,000	Cash with Traders Bank Ltd.	40,000
Sales	14,48,000	Discounts received	14,950
Sales return	43,000	Investments (at 5%) as on 1.4.2021	25,000
Purchases	12,15,500	Furniture as on 1-4-2021	9,000
Purchases return	29,000	Discounts allowed	37,700
Carriage inwards	93,000	General expenses	19,600
Rent	28,500	Audit fees	3,500
Salaries	46,500	Fire insurance premium	3,000

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Sundry debtors	1,20,000	Travelling expenses	11,650
Sundry creditors	74,000	Postage and telegrams	4,350
Loan from Dena Bank Ltd. (at 12%)	1,00,000	Cash in hand	1,900
Interest paid	4,500	Deposits at 10% as on 1-4-2021 (Dr.)	1,50,000
Printing and stationery	17,000	Drawings	50,000
Advertisement	56,000		

Adjustments:

- (1) Value of stock as on 31st March, 2022 is ₹ 3,93,000. This includes goods returned by customers on 31st March, 2022 to the value of ₹ 15,000 for which no entry has been passed in the books.
- (2) Purchases include furniture purchased on 1st January, 2022 for ₹10,000.
- (3) Depreciation should be provided on furniture at 10% per annum.
- (4) The loan account from Dena bank in the books of Ganguli appears as follows:

		₹			₹
31.3.2022	To Balance c/d	1,00,000	1.4.2021	By Balance b/d	50,000
			31.3.2022	By Bank	50,000
		1,00,000			1,00,000

- (5) Sundry debtors include ₹ 20,000 due from Robert and sundry creditors include ₹ 10,000 due to him.
- (6) Interest paid include ₹ 3,000 paid to Dena bank.
- (7) Interest received represents ₹ 1,000 from the sundry debtors (due to delay on their part) and the balance on investments and deposits.
- (8) Provide for interest payable to Dena bank and for interest receivable on investments and deposits.
- (9) Make provision for doubtful debts at 5% on the balance under sundry debtors. No such provision need to be made for the deposits.

Answer 1
In the books of Ganguli
Trading and Profit & Loss Account for the year ended 31st March, 2022

	₹	₹		₹	₹
To Opening stock		2,34,000	By Sales	14,48,000	
To Purchases	12,15,500		Less: Returns	(58,000)	13,90,000
Less: Transfer to furniture A/c	(10,000)		By Closing stock		3,93,000
	12,05,500				
Less: Returns	(29,000)	11,76,500			
To Carriage inwards		93,000			
To Gross profit c/d		2,79,500			
		17,83,000			17,83,000
To Salaries		46,500	By Gross profit b/d		2,79,500
To Rent		28,500	By Interest		17,250
To Advertisement		56,000	By Discount received		14,950
To Printing & stationery		17,000			

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To Interest		7,500			
To Discount allowed		37,700			
To General expenses		19,600			
To Travelling expenses		11,650			
To Fire insurance premium		3,000			
To Postage & telegrams		4,350			
To Provision for doubtful debts (W.N.1)		4,750			
To Depreciation on furniture		1,150			
To Audit fees		3,500			
To Capital A/c (Net profit transferred)		70,500			
		3,11,700			3,11,700

Balance Sheet as at 31st March, 2022

Liabilities	₹	₹	Assets	₹	₹
Capital account:			Furniture	9,000	
Balance on 1st April, 2021	5,40,500		Additions during the year	10,000	
Add: Net profit	70,500			19,000	
	6,11,000		Less: Depreciation	(1,150)	17,850
Less: Drawings	(50,000)	5,61,000	Investments		25,000
Loan from Dena Bank Ltd.		1,00,000	Deposits		1,50,000
Insurance accrued on bank loan (W.N.2)		3,000	Interest accrued on investment & deposits (W.N.3)		10,000
Sundry creditors		64,000	Stock in trade		3,93,000
			Sundry debtors	95,000	
			Less: Provision	(4,750)	90,250
			Cash with Traders Bank Ltd.		40,000
			Cash in hand		1,900
		7,28,000			7,28,000

Working Notes:
1. Calculation of provision for doubtful debts:

Sundry debtors as per trial balance	1,20,000
Less: Sales returns not recorded	(15,000)
	1,05,000
Less: Cancellation against sundry creditors	(10,000)
Adjusted balance of sundry debtors	95,000
Provision for doubtful debts @ 5%	4,750

2. Accrued interest on bank loan:

Annual interest @12%	6,000

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Less: Interest paid to Dena bank	(3,000)
Accrued interest	<u>3,000</u>

3. Interest accrued on investments and deposits:

Annual interest on investments @ 5%	1,250
Annual interest on deposits @ 10%	<u>15,000</u>
	16,250
Less: Interest received on investments and deposits	(6,250)
Accrued interest	<u>10,000</u>

Question 2

Sengupta & Co. employs a team of eight workers who were paid ₹30,000 per month each in the year ending 31st March, 2021. At the start of financial year 2021-2022, the company raised salaries by 10% to ₹33,000 per month each.

On October 1, 2021 the company hired two trainees at salary of ₹21,000 per month each. The work force are paid salary on the first working day of every month, one month in arrears, so that the employees receive their salary for January on the first working day of February etc.

You are required to calculate:

- Amount of salaries which would be charged to the profit and loss for the year ended 31st March, 2022.
- Amount actually paid as salaries during 2021-22
- Outstanding Salaries as on 31st March, 2022.

Answer 2

(i) Salaries to be charged to profit and loss account for the year

ended 31st March, 2022:	
Salaries of 8 employees for full year @ ₹ 33,000 per month each	31,68,000
Salaries of 2 trainees for 6 months @ ₹ 21,000 p.m.	2,52,000
	<u>34,20,000</u>

(ii) Salaries actually paid in 2021-22

March, 2021 salaries paid in April, 2021 (8 x 30,000)	2,40,000
Salaries of 8 employees for April 2021 to March, 2022 paid in May 2021 to March 2022 @ ₹ 33,000 for 11 months	29,04,000
Salaries of 2 trainees for October 2021 to February 2022 paid in November 2021 to March 2022 @ ₹ 21,000 for 5 months	2,10,000
	<u>33,54,000</u>

(iii) Outstanding salaries as at 31st March, 2022

8 employees @ ₹ 33,000 each for 1 month	2,64,000
2 trainees @ ₹ 21,000 each for 1 month	42,000
	<u>3,06,000</u>

Question 3

You are required, prepare a Trading and Profit and Loss Account for the year ending 31st March, 2022 and a Balance Sheet as on that date from the Trial Balance given below:

Particulars	₹	Particulars	₹

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Debit Balance:			
Trade receivables	3,50,000	Salaries	2,20,000
Inventory 1st April, 2021	5,00,000	Purchases	12,50,00
Cash in Hand	5,60,000	Plant and Machinery	15,70,000
Wages	3,00,000	Credit Balance:	
Bad Debts	50,000	Capital	25,00,000
Furniture and Fixtures	1,50,000	Trade payables	9,00,000
Depreciat on	1,50,000	Sales	17,00,000

On 31st March, 2022 the Inventory was valued at ₹10,00,000.

Answer 3

Trading and Profit and Loss Account for the year ending 31st March, 2022

Part culars	₹	Part culars	₹
To Opening Inventory	5,00,000	By Sales	17,00,000
To Purchases	12,50,000	By Closing Inventory	10,00,000
To Wages	3,00,000		
To Gross Prof t	6,50,000		
	27,00,000		27,00,000
To Bad Debts	50,000	By Gross Prof t	6,50,000
To Depreciat on	1,50,000		
To Salaries	2,20,000		
To Net Prof t transferred. to Capital A/c	2,30,000		
	6,50,000		6,50,000

Balance Sheet as at 31st March, 2022

Liabilit es	₹	₹	Assets	₹	₹
Trade payables		9,00,000	Cash in Hand	5,60,000	
Capital:			Trade receivables	3,50,000	
Previous Balance	25,00,000		Closing Inventory	10,00,000	19,10,000
Add : Net Prof t	2,30,000	27,30,000			
			Furniture & Fixtures	1,50,000	
			Plant & Machinery	15,70,000	17,20,000
		36,30,000			36,30,000

Question 4

Mr. Kotriwal is engaged in business of selling magazines. Several of his customers pay money in advance for subscribing his magazines. Information related to year ended 31st March 2022 has been given below:

On 1.4.2021 he had a balance of ₹ 2,00,000 advance from customers of which ₹ 1,50,000 is related to year 2021-22 while remaining pertains to year 2022-23. During the year 2021-22 he made cash sales of ₹ 5,00,000. You are required to compute:

- Total income for the year 2021-22.
- Total money received during the year if the closing balance in advance from customers account is ₹ 1,70,000.

Answer 4

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(i) Computat on of Income for the year 2021-22:

	₹
Money received during the year related to 2021-22	5,00,000
Add: Money received in advance during previous years	1,50,000
Total income of the year 2021-22	6,50,000

(ii) Advance from Customers A/c

Date	Part culars	₹	Date	Part culars	₹
	To Sales A/c (Advance related to current year transferred to sales)	1,50,000	1.4.2021	By Balance b/d	2,00,000
				By Bank A/c (Balancing Figure)	1,20,000
31.3.22	To Balance c/d	1,70,000			
		3,20,000			3,20,000

So, total money received during the year is:

	₹
Cash Sales during the year	5,00,000
Add: Advance received during the year	1,20,000
Total money received during the year	6,20,000

Question 5

Mr. Birla is a proprietor engaged in business of trading electronics. An excerpt from his Trading & P&L account is as follows:

Trading and P&L A/c for the year ended 31st March, 2022

Part culars	₹	Part culars	₹
To Cost of Goods Sold	45,00,000	By Sales	C
To Gross Prof t c/d	<u>D</u>		
	<u>F</u>		<u>F</u>
To Rent A/c	26,00,000	By Gross Prof t b/d	<u>D</u>
To Of ce Expenses	13,00,000	By Miscellaneous Income	E
To Selling Expenses	B		
To Commission to Manager (on Net Prof t before charging such commission)	2,00,000		
To Net Prof t	<u>A</u>		
	G		60,00,000

Commission is charged at the rate of 10%.

Selling Expenses amount to 1% of total sales.

You are required to compute the missing figures.

Answer 5

(A) Computat on of Net Prof t:

Commission Manager = Rate of Commission X Net Profit before charging such commission
 So, Commission to manager = $10/100 \times \text{Net Profit before charging such commission}$
 $= ₹2,00,000 = 10/100 \times \text{Net Profit before charging such commission}$
 $= \text{Net Profit before charging such commission} = ₹20,00,000$
 $\Rightarrow \text{Net Profit (A)} = ₹(20,00,000 - 2,00,000) = ₹18,00,000$

(B) Computat on of Selling Expenses:

Total income appearing in P&L A/c = ₹ 60,00,000
 Total expenses other than selling expenses = ₹(26,00,000 + 13,00,000 + 2,00,000) = ₹ 41,00,000
 So, Selling Expenses + Remaining Expenses + Net Prof t = Total Income
 $= \text{Selling Expenses} = ₹ 60,00,000 - ₹ 41,00,000 - ₹ 18,00,000$
 $= \text{Selling Expenses} = ₹ 1,00,000$

(C) Computat on of Sales:

We have been given selling expenses amount to 1% of Sales
 So, Sales = $\frac{\text{Selling Expenses}}{1} \times 100 = \frac{1,00,000}{1} \times 100 = ₹ 1,00,00,000$

(D) Computat on of Gross Prof t:

In Trading A/c			
Part culars	₹	Part culars	₹
To COGS	45,00,000	By Sales (from C above)	100,00,000
To Gross Prof t (Balancing Figure)	55,00,000		
Total (F)	100,00,000	Total (F)	100,00,000

So, Gross Profit (D) = ₹ 55,00,000

(E) Miscellaneous Income = Total Income in P&L - Gross Prof t
 $= ₹ (60,00,000 - 55,00,000) = ₹ 5,00,000$

(F) = ₹ 100,00,000 (As computed in D above)

(G) = ₹ 60,00,000 (Total of both sides of P&L is equal af er balancing has been done)

ILLUSTRATION 1

Trial Balance for the financial year (FY) ended 31st March 2022 of M/s Deepakshi shows following details:

Part culars	Debit (₹)	Credit (₹)
Purchase & Sales	10,00,000	12,00,000
Debtors & Creditors	5,00,000	4,00,000
Opening Stock	2,00,000	
Closing Stock	3,00,000	
Other Expenses & Incomes	7,00,000	9,00,000
Fixed Assets & Long Term Liabilit es	25,00,000	6,00,000
Capital		21,00,000

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	52,00,000	52,00,000

Additional Information: Creditors balance as on 1st April, 2021 is ₹ 3,00,000.

You are required to calculate cost of goods sold and amount paid to creditors during the year.

Answer

(i) Calculation of Cost of Goods sold:

Particulars	₹
Opening Stock	2,00,000
Add: Purchases (Closing stock already adjusted)*	10,00,000
Cost of Goods Sold	12,00,000

*Since, closing stock appears in Trial Balance, it means following entry has already been passed in books:

Closing Stock A/c	Dr.	3,00,000	
To Purchases A/c			3,00,000

So, we can see purchases have already been reduced by the amount of unsold stock, therefore no more adjustment needs to be made on account of closing stock for computing Cost of goods sold (COGS).

(ii) Calculation of amount paid to creditors:

Date	Particulars	₹	Date	Particulars	₹
31.3.22	To Bank A/c (Balancing Figure)	12,00,000	1.4.21	By Balance b/d	3,00,000
31.3.22	To Balance c/d	4,00,000		By Purchases A/c (Note:1)	13,00,000
		16,00,000			16,00,000

Note: 1) Purchases made during the year can be computed as:

Particulars	₹
Purchases as per Trial Balance	10,00,000
Add: Closing Stock already adjusted	3,00,000
Purchases made during the year	13,00,000

Students may note that in case Closing Stock is not mentioned in Trial Balance, then it means Opening Stock and Purchases appearing in Trial Balance include the value of unsold stock. Since, we prepare our financial statements using matching concept such unsold stock should not form part of cost and therefore is deducted. Therefore, in this case to compute Cost of goods sold (COGS) we will have to use:

$$\text{COGS} = \text{Opening Stock} + \text{Purchases} - \text{Closing Stock} - \text{Purchase Returns}$$

ILLUSTRATION 2

	₹
Opening Inventory	1,00,000
Purchases	6,72,000
Carriage Inwards	30,000
Wages	50,000
Sales	11,00,000
Returns inward	1,00,000
Returns outward	72,000
Closing Inventory	2,00,000

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Required

From the above information, prepare a Trading Account of M/s. ABC Traders for the year ended 31st March, 2022 and Pass necessary closing entries in the journal proper of M/s. ABC Traders

Answer

In the books of M/s. ABC Traders
Trading Account for the year ended 31st March, 2022

Particulars		Amount	Particulars		Amount
	₹	₹		₹	₹
To Opening Inventory		1,00,000	By Sales	11,00,000	
To Purchases	6,72,000		Less : Returns Inward	(1,00,000)	10,00,000
Less : Returns Outward	(72,000)	6,00,000	By Closing Inventory		2,00,000
To Carriage Inwards		30,000			
To Wages		50,000			
To Gross profit (Balancing Figure)		4,20,000			
		12,00,000			12,00,000

Journal Proper in the Books of M/s. ABC Traders (Closing entries)

Date 2022	Particulars		(₹)	(₹)
Mar. 31	Returns outward A/c	Dr.	72,000	
	To Purchases A/c (Being the transfer of returns to purchases account)			72,000
	Sales A/c	Dr.	1,00,000	
	To Returns Inward A/c			1,00,000
	Sales A/c	Dr.	10,00,000	
	To Trading A/c (Being the transfer of balance of sales account to trading account)			10,00,000
	Trading A/c	Dr.	7,80,000	
	To Opening Inventory A/c			1,00,000
	To Purchases A/c			6,00,000
	To Wages A/c			50,000
	To Carriage Inwards A/c (Being the transfer of balances of opening Inventory, purchases and wages accounts)			30,000
	Closing Inventory A/c	Dr.	2,00,000	
	To Trading A/c (Being the incorporation of value of closing Inventory)			2,00,000
	Trading A/c	Dr.	4,20,000	
	To Gross Profit (Being the amount of gross profit)			4,20,000
	Gross profit	Dr.	4,20,000	
	To Profit and Loss A/c (Being the transfer of gross profit to Profit and Loss)			4,20,000

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	Account)			

ILLUSTRATION 3

Revenue, Expenses and Gross Profit Balances of M/s ABC Traders for the year ended on 31st March 2022 were as follows:

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.

Required

Prepare Profit and Loss Account of M/s ABC Traders for the year ended on 31st March, 2022. Show necessary closing entries in the Journal Proper of M/s. ABC Traders also.

Answer

In the Books of M/s. ABC Traders
Profit and Loss Account for the year ended 31st March, 2022

Particulars	Amount ₹	Particulars	Amount ₹
To Salaries	1,10,000	By Gross Profit	4,20,000
To Legal Charges	25,000	By Discount received	18,000
To Consultancy Fees	32,000		
To Audit Fees	1,000		
To Electricity Charges	17,000		
To Telephone, Postage & Telegrams	12,000		
To Stationery	27,000		
To Depreciation	65,000		
To Discount Allowed	19,000		
To Bad Debts	17,000		
To Interest	70,000		
To Net Profit (b/f)	43,000		
	4,38,000		4,38,000

Journal Proper in the Books of M/s. ABC Traders (Closing Entries)

Date 2022	Particulars		Amount ₹	Amount ₹
March 31	Profit & Loss Account	Dr.	3,95,000	
	To Salaries A/c			1,10,000
	To Legal Charges A/c			25,000
	To Consultancy Fees A/c			32,000
	To Audit Fees A/c			1,000
	To Electricity Charges A/c			17,000
	To Telephone, Postage & Telegrams A/c			12,000
	To Stationery A/c			27,000
	To Depreciation A/c			65,000
	To Discount Allowed A/c			19,000

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	To Bad Debts A/c			17,000
	To Interest A/c (Being the transfer of balances of various expenses accounts)			70,000
	Discount Received A/c	Dr.	18,000	
	To Prof t & Loss A/c (Being the transfer of discount received account balance)			18,000
	Gross Prof t A/c	Dr.	4,20,000	
	To Prof t & Loss A/c (Being the transfer of gross prof t from Trading Account)			4,20,000
	Prof t & Loss A/c		43,000	
	To Net Prof t A/c (Being the ascertainment of net prof t)			43,000
	Net Prof t A/c		43,000	
	To Capital A/c (Being the transfer of net prof t to Capital A/c)			43,000

ILLUSTRATION 4

On 1st April 2021 provision for Doubtful Debts existed at ₹ 40,000. Trade receivables on 31.03.2021 were ₹ 15,00,000; bad debts totaled ₹ 1,00,000. It is required to write off the bad debts and create a provision equal to 5% of the Trade receivables' balances.

Show how you would compute the amount debited to the Prof t and Loss Account.

Answer

Part culars	₹
Opening Provision (Cr.)	40,000
Bad Debts writ en of (Dr.)	1,00,000
Short Provision	60,000
Provision required (Dr.) (5% of ₹14,00,000)	70,000
Addit onal amount required for debit to the Prof t and Loss Account (Dr.)	1,30,000

The account will appear as follows:

Provision for Doubtful Debts Account

		₹			₹
March 31, 2022	To Bad Debts	1,00,000	April 1, 2021	By Balance b/d	40,000
	To Balance c/d (required)	70,000	March 31, 2022	By Prof t and Loss A/c (Balancing Figure)	1,30,000
		1,70,000			1,70,000
			April 1, 2022	By Balance b/d	70,000

ILLUSTRATION 5

The following is the Trial Balance of C. Wanchoo on 31st March, 2022.

Trial Balance on 31st March , 2022

Part culars	₹	₹
Capital Account		10,00,000
Inventories as on 1st April,2021	2,00,000	

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Cash in hand	1,44,000	
Machinery Account	7,36,000	
Purchases Account	18,20,000	
Wages Account	10,00,000	
Salaries Account	10,00,000	
Discount Allowed A/c	50,000	
Discount Received A/c		30,000
Sundry Office Expenses Account	6,00,000	
Sales Account		50,00,000
Sums owing by customer (Trade receivables)	8,50,000	
Trade payables (sums owing to suppliers)		3,70,000
Total	64,00,000	64,00,000

Value of Closing Inventory on 31st March, 2022 was ₹ 2,70,000

Prepare closing entries for the above items and Prepare Trading and Profit and Loss Account.

Answer

Date	Particulars		₹	₹
2022				
March 31	Trading Account	Dr.	30,20,000	
	To Inventory Account			2,00,000
	To Purchase A/c			18,20,000
	To Wages A/c			10,00,000
	(Being the accounts in the Trial Balance which have to be transferred to the Trading Account debit side)			
March 31	Sales Account	Dr.	50,00,000	
	To Trading A/c			50,00,000
	(Being the amount of Sales transferred to the credit of Trading Account)			
March 31	Inventory (Closing) A/c	Dr.	2,70,000	
	To Trading A/c			2,70,000
	(Being the value of Inventory on hand on 31st March, 2022)			
March 31	Trading A/c	Dr.	22,50,000	
	To Profit and Loss A/c			22,50,000
	(Being the transfer of gross profit.)			
March 31	Profit and Loss A/c	Dr.	16,50,000	
	To Discount Allowed Account			50,000
	To Salaries A/c			10,00,000
	To Sundry Office Expenses A/c			6,00,000
	(Being the various expense accounts transferred to the P & L Account)			
March 31	Discount Received A/c	Dr.	30,000	
	To P & L Account			30,000
	(Being the credit balance of discount received transferred to Profit and Loss A/c)			

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March 31	Profit and Loss A/c	Dr.	6,30,000	
	To Capital A/c (Being the transfer to Net Profit to the Capital Account)			6,30,000

C. WANCHOO
Trading Account of the year ended March 31, 2022

Particulars	₹	Particulars	₹
To Inventory A/c	2,00,000	By Sales A/c	50,00,000
To Purchases	18,20,000	By Inventory (Closing)	2,70,000
To Wages	10,00,000		
To Gross profit transferred to P & L A/c	22,50,000		
	52,70,000		52,70,000

Profit and Loss Account for the year ended March 31, 2022

Particulars	₹	Particulars	₹
To Salaries	10,00,000	By Gross profit transferred from the Trading Account	22,50,000
To Discount Allowed	50,000	By Discount Received	30,000
To Sundry Office Expenses	6,00,000		
To Net Profit transferred to Capital A/c	6,30,000		
	22,80,000		22,80,000

ILLUSTRATION 6

Given below Trial Balance of M/s Dayal Bros. as on 31st March, 2022 :

Particulars	Debit Balances	Credit Balances
	₹	₹
Capital A/c		7,00,000
Land and Building	3,00,000	
14% Term Loan		4,00,000
Loan from M/s. D & Co.		4,60,000
Trade receivables	4,20,000	
Cash in hand	20,000	
Inventories in Trade	6,00,000	
Furniture	2,00,000	
Trade payables		40,000
Advances to Suppliers	1,00,000	
Net Profit		1,00,000
Drawings	60,000	
	17,00,000	17,00,000

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Required

Prepare Balance Sheet as on 31st March, 2022.

Answer

Liabilities	Amount	Assets	Amount
	₹		₹
Capital: Balances	7,00,000	Land & Building	3,00,000
Add: Net Profit	1,00,000	Furniture	2,00,000
	8,00,000	Inventories in Trade	6,00,000
Less: Drawings	(60,000)	Trade receivables	4,20,000
14% Term Loan (loan taken at year end)		Advances to Suppliers	1,00,000
Loan from M/s D & Co.		Cash in Hand	20,000
Trade payables			
	16,40,000		16,40,000

ILLUSTRATION 7

The balance sheet of Thapar on 1st April, 2021 was as follows:

Liabilities	Amount	Assets	Amount
	₹		₹
Trade payables	15,00,000	Plant & Machinery	30,00,000
Expenses Payable	1,50,000	Furniture & Fixture	3,00,000
Capital	50,00,000	Trade receivables	14,00,000
		Cash at Bank	6,50,000
		Inventories	13,00,000
	66,50,000		66,50,000

During 2021-22, his Profit and Loss Account revealed a net profit of ₹ 18,30,000. This was after allowing for the following :

- (a) Rent received from property let out ₹ 3,00,000.
 - (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 March, 2022
- But while preparing the Profit and Loss Account he had forgotten to provide for (1) outstanding expenses totaling ₹ 1,80,000 and (2) prepaid insurance to the extent of ₹ 20,000.
- His current assets and liabilities on 31st March, 2022 were: Inventories ₹ 14,50,000; Trade receivables ₹ 20,00,000; Cash at Bank ₹ 10,35,000 and Trade payables ₹ 11,40,000.
- During the year he withdrew ₹ 6,00,000 for domestic use.

Required

Draw up his Balance Sheet at the end of the year.

Answer

Profit and Loss Account (Revised)

Particulars	₹	Particulars	₹
To Outstanding expenses	1,80,000	By Balance b/d	18,30,000
To Net profit	16,70,000	By Prepaid insurance	20,000
	18,50,000		18,50,000

Balance Sheet of Thapar as at 31st March, 2022

Liabilities	₹	₹	Assets	₹	₹
Capital	50,00,000		Cash at Bank		10,35,000
Add: Net Profit	16,70,000		Trade receivables	20,00,000	
	66,70,000		Less: Provision for doubtful debts	(1,00,000)	19,00,000
Less: Drawings	(6,00,000)	60,70,000	Plant and Machinery	30,00,000	
Outstanding expenses		1,80,000	Less: Depreciation	(3,00,000)	27,00,000
Trade payables		11,40,000	Furniture & Fixtures	3,00,000	
			Less: Depreciation	(15,000)	2,85,000
			Inventories		14,50,000
			Prepaid insurance		20,000
		73,90,000			73,90,000

ILLUSTRATION 8

Balance Sheet as at 31st March, 2022

Liabilities	₹	Assets	₹
Mahendra & Sons	5,60,000	Cash in hand	43,000
Capital	20,00,000	Cash at Bank	2,67,500
		Trade receivables	7,49,500
		Closing Inventory	9,00,000
		Machinery and Equipment	6,00,000
	25,60,000		25,60,000

From the above given balance sheet prepare the relevant opening entry.

Answer

The Opening Entry :01-04-2022

	Dr. ₹	Cr. ₹
Cash A/c	Dr. 43,000	
Bank A/c	Dr. 2,67,500	
Trade receivables	Dr. 7,49,500	
Inventory A/c	Dr. 9,00,000	
Machinery and Equipment A/c	Dr. 6,00,000	
To Mahendra & Sons A/c		5,60,000
To Capital A/c		20,00,000
(Being the balances brought forward)	25,60,000	25,60,000

ILLUSTRATION 9

Shri Mit al gives you the following Trial Balance and some other informat on:

Trial Balances as on 31st March, 2022

Particulars	Dr. ₹	Cr. ₹
Capital		8,70,000

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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	2,000	
Input CGST	9,000	
Input SGST	9,000	
Output IGST		15,000
	26,07,000	26,07,000

Closing Inventory on 31st March, 2022 was valued at ₹ 1,00,000.

Required

Prepare final accounts of Shri Mittal for the year ended 31st March, 2022.

Answer

In the books of Shri Mittal
Trading Account for the year ended 31st March, 2022

Particulars		Amount	Particulars		Amount
		₹			₹
To Opening inventory		72,000	By Sales	12,10,000	
To Purchases	6,05,000		Less: Returns	(40,000)	11,70,000
Less: Returns	(30,000)	5,75,000	By Closing inventory		1,00,000
To Gross Profit		6,23,000			
		12,70,000			12,70,000

Profit and Loss Account for the year ended 31st March, 2022

Particulars	Amount (₹)	Particulars	Amount (₹)
To Salaries	2,70,000	By Gross profit	6,23,000
To Advertisement	1,10,000		
To Other expenses	60,000		
To Net profit	1,83,000		
	6,23,000		6,23,000

Balance Sheet as at 31st March, 2022

Liabilities		Amount (₹)	Assets	Amount (₹)
Capital	8,70,000		Building	8,90,000
Add: Net profit	1,83,000	10,53,000	Furniture	4,50,000
14% Bank Loan		2,00,000	Trade receivables	90,000
Trade payables		1,70,000	Closing inventory	1,00,000
Overdrafts		1,12,000	Cash in hand	2,000
			Input SGST (W.N.)	3,000

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		15,35,000		15,35,000

Note: As loan and overdraft taken at year end so no interest shown.

Working Note:

Output IGST liability is paid by utilizing Input CGST of ₹ 9,000 and Input SGST of ₹ 6,000. Thereafter, closing balance of Input SGST of ₹ 3,000 is reported in Balance Sheet.

ILLUSTRATION 10

Mr. Mohan gives you the following trial balance and some other information:

Trial Balance as on 31st March, 2022

Particulars	₹	₹
Capital		6,50,000
Sales		9,70,000
Purchases	4,30,000	
Opening Inventory	1,10,000	
Freights Inward	40,000	
Salaries	2,10,000	
Other Administration Expenses	1,50,000	
Furniture	3,50,000	
Trade receivables and Trade payables	2,10,000	1,90,000
Returns	20,000	12,000
Discounts	19,000	9,000
Bad Debts	5,000	
Investments in Government Securities	1,00,000	
Cash in Hand and Cash at Bank	1,89,000	
Input CGST	10,000	
Input SGST	10,000	
Output CGST		8,000
Output SGST		8,000
Output IGST		6,000
	18,53,000	18,53,000

Other Information:

(i) Closing Inventory was ₹ 1,80,000;

(ii) Depreciate Furniture @ 10% p.a.

Required

Prepare Trading and Profit and Loss Account for the year ended on 31.3.2022 and Balance Sheet of Mr. Mohan as on that date.

Answer

In the books of Mr. Mohan

Trading Account for the year ended 31st March, 2022

Particulars	Amount	Particulars	Amount
	₹		₹
To Opening Inventory	1,10,000	By Sales	9,70,000
To Purchases	4,30,000	Less: Returns	(20,000)
Less: Returns	(12,000)	By Closing Inventory	1,80,000
	4,18,000		

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To Freight Inwards		40,000			
To Gross profit		5,62,000			
		11,30,000			11,30,000

Profit and Loss Account for the year ended 31st March, 2022

Particulars	₹	Particulars	₹
To Depreciation	35,000	By Gross profit	5,62,000
To Salaries	2,10,000	By Discount received	9,000
To Administrative expenses	1,50,000		
To Discount allowed	19,000		
To Bad debts	5,000		
To Net profit	1,52,000		
	5,71,000		5,71,000

Balance Sheet as at 31st March, 2022

Liabilities		Amount ₹	Assets		Amount ₹
Capital	6,50,000		Furniture	3,50,000	
Add: Net profit	1,52,000	8,02,000	Less: Depreciation	(35,000)	3,15,000
Trade payables		1,90,000	Closing Inventory		1,80,000
Output IGST		2,000	Trade receivables		2,10,000
			Investment in Govt		
			Securities		1,00,000
			Cash in Hand and Cash at Bank		1,89,000
		9,94,000			9,94,000

Working Note:
Summary of Output and Input GST liability (as per Trial Balance)

	OUTPUT GST (₹)	INPUT GST (₹)
IGST	6,000	
CGST	8,000	10,000
SGST	8,000	10,000

Output liability (Tax head)	Tax Payable	Paid through ITC			Tax paid in cash
		IGST	CGST	SGST	
IGST	6,000		2,000	2,000	2,000
CGST	8,000		8,000		
SGST	8,000			8,000	

In the above solution, it is assumed that balance IGST liability of ₹ 2,000 (after utilising CGST and SGST) is not paid off in cash.

Alternatively, students may assume that the balance liability of ₹ 2,000 is paid off in cash. Accordingly, Output IGST liability of ₹ 2,000 shall not appear under liability side of the balance sheet and amount of cash at bank is reported as ₹1,87,000

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The Balance Sheet of Mr. Popatlal, a merchant on 31st March, 2022 stood as below:

Liabilities	Amount	Assets		Amount
	₹			₹
Capital	2,40,000	Fixed Assets		1,25,600
Trade payables	1,64,000	Inventories		2,06,400
Bank Overdraft	1,46,000	Trade receivables	1,88,000	
		Less: Provision	(6,200)	1,81,800
		Cash		36,200
	5,50,000			5,50,000

Required

Show opening journal entry on 1st April, 2022 in the books of Mr. Popatlal.

Answer

Opening entry

			(Dr.) ₹	(Cr.) ₹
1.4.2022	Fixed Assets A/c	Dr.	1,25,600	
	Inventories A/c	Dr.	2,06,400	
	Trade receivables A/c	Dr.	1,88,000	
	Cash A/c	Dr.	36,200	
	To Trade payables A/c			1,64,000
	To Bank Overdraft A/c			1,46,000
	To Provision for Doubtful Debts A/c			6,200
	To Capital A/c			2,40,000

ILLUSTRATION 12

The following is the schedule of balances as on 31.3.22 extracted from the books of Shri Gavaskar, who carries on business under the same name and style of Messrs Gavaskar Viswanath & Co., at Mumbai:

Particulars	Dr.	Cr.
	₹	₹
Cash in hand	14,000	
Cash at bank	26,000	
Sundry Debtors	8,60,000	
Stock on 1.4.2021	6,20,000	
Furniture & fixtures	2,14,000	
Office equipment	1,60,000	
Buildings	6,00,000	
Motor Car	2,00,000	
Sundry Creditors		4,30,000
Loan from Viswanath		3,00,000
Provision for bad debts		30,000
Purchases	14,00,000	
Purchase Returns		26,000
Sales		23,00,000
Sales Returns	42,000	

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Salaries	1,10,000	
Rent for Godown	55,000	
Interest on loan from Viswanath	27,000	
Rates & Taxes	21,000	
Discount allowed to Debtors	24,000	
Discount received from Creditors		16,000
Freight on purchases	12,000	
Carriage Outwards	20,000	
Drawings	1,20,000	
Printing and Stationery	18,000	
Electricity Charges	22,000	
Insurance Premium	55,000	
General office expenses	30,000	
Bad Debts	20,000	
Bank charges	16,000	
Motor car expenses	36,000	
Capital A/c		16,20,000
TOTAL	47,22,000	47,22,000

Prepare Trading and Profit and Loss Account for the year ended 31st March, 2022 and the Balance Sheet as at that date after making provision for the following:

- Depreciate: (a) Building used for business by 5 percent; (b) Furniture and fixtures by 10 percent; One steel table purchased during the year for ₹ 14,000 was sold for same price but the sale proceeds were wrongly credited to Sales Account; (c) Office equipment by 15 percent; Purchase of a typewriter during the year for ₹ 40,000 has been wrongly debited to purchase; and (d) Motor car by 20%.
- Value of stock at the close of the year was ₹ 4,40,000.
- Two month's rent for godown is outstanding.
- Interest on loan from Viswanath is payable at 12 percent per annum, this loan was taken on 1.5.2021.
- Provision for bad debts is to be maintained at 5 percent of Sundry Debtors.
- Insurance premium includes ₹ 40,000 paid towards proprietor's life insurance policy and the balance of the insurance charges cover the period from 1.4.2021 to 30.6.2022.

Answer

M/s Gavaskar Viswanath & Co.
Trading for the year ended 31st March, 2022

Particulars	Details	Amount ₹	Particulars	Details	Amount ₹
To opening Stock		6,20,000	By Sales	23,00,000	
To Purchases	14,00,000		Less: Sale of furniture included in sale	14,000	
Less: Typewriter included in purchases	40,000		Less: Sales Returns	42,000	22,44,000
Less: Purchase Returns	26,000	13,34,000	By Closing Stock		4,40,000
To Freight on purchase		12,000			

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To Gross Profit c/d		7,18,000			
		26,84,000			26,84,000

M/s Gavaskar Viswanath & Co.
Profit/Loss Account for the year ended 31st March, 2022

Particulars	Details	Amount ₹	Particulars	Details	Amount ₹
To Salaries		1,10,000	By Gross profit b/d		7,18,000
To Rent for Godown	55,000				
Add: Outstanding	11,000	66,000	By Discount received		16,000
To provision for doubtful debts (4)		33,000			
To Rent and Taxes		21,000			
To Discount Allowed		24,000			
To Carriage outwards		20,000			
To printing and stationery		18,000			
To Electricity charges		22,000			
To Insurance premium (1)		12,000			
To Depreciation (2)		1,20,000			
To general office expenses		30,000			
To Bank Charges		16,000			
To interest on loan	27,000				
Add: Outstanding (3)	6,000	33,000			
To Motor car expenses		36,000			
To Net Profit transferred to Capital a/c		1,73,000			
		7,34,000			7,34,000

**Balance Sheet of M/s Gavaskar Vishwanath & Co.
as at 31st March, 2022**

Liabilities	Details	Amount ₹	Assets	Details	Amount ₹
Capital	16,20,000		Building	6,00,000	
Add: Net Profit	1,73,000		Less: Dep.	(30,000)	5,70,000
Less: Drawings	(1,20,000)				
Less: Insurance Premium	(40,000)	16,33,000	Motor Car	2,00,000	
			Less: Dep.	(40,000)	1,60,000
Loan from Vishwanath	3,00,000				
Add: Outstanding	6,000	3,06,000	Office equipment	2,00,000	
			Less: Dep.	(30,000)	1,70,000
Sundry Creditors		4,30,000			
Outstanding rent		11,000	Furniture & Fixture	2,00,000	
			Less: Dep.	(20,000)	1,80,000
			Stock in Trade		4,40,000
			Sundry Debtors	8,60,000	
			Less: Provision for	(43,000)	8,17,000

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			doubt ul debts		
			Cash at hand		26,000
			Cash in bank		14,000
			Prepaid insurance (1)		3,000
		23,80,000			23,80,000

Working Notes:
(1) Insurance premium

	₹
Insurance premium as given in trial balance	55,000
Less: Personal premium	(40,000)
Less: Prepaid for 3 months $\left(\frac{15,000}{15} \times 3\right)$	(3,000)
Transfer to Profit & Loss a/c	12,000

(2) Depreciat on

Building @ 5% on 6,00,000	30,000
Motor Car @ 20% on 2,00,000	40,000
Furniture & Fit ngs @ 10% on 2,00,000 (2,14,000-14,000)	20,000
Of ce Equipment @ 15% on 2,00,000 (1,60,000 + 40,000)	30,000
Total	1,20,000

(3) Interest on Loan

Interest on Loan (3,00,000 x 12% x 11/12)	33,000
Less : Interest as per Trial Balance	(27,000)
Profit & Loss account (Outstanding)	6,000

(4) Provision for bad debts a/c

Part culars	Amount	Part culars	Amount
	₹		₹
To bad debts a/c	20,000	By balance b/d	30,000
To balance c/d	43,000	By P&L a/c	33,000
	63,000		63,000

- (5) Purchase of a typewriter during the year for ₹ 40,000 which was wrongly debited to purchase added to of ce equipment.

ILLUSTRATION 13

The following are the balances as at 31st March, 2022 extracted from the books of M/s Mapple States.

	₹		₹
Plant and Machinery	19,550	Bad debts recovered	450
Furniture and Fittings	10,250	Salaries	22,550
Bank Overdraft	80,000	Salaries payable	2,450
Capital Account	65,000	Prepaid rent	300

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Drawings	8,000	Rent	4,300
Purchases	1,60,000	Carriage inward	1,125
Opening Stock	32,250	Carriage outward	1,350
Wages	12,165	Sales	2,15,300
Provision for doubtful debts	3,200	Advertisement Expenses	3,350
Provision for Discount on debtors	1,375	Printing and Stationery	1,250
Sundry Debtors	1,20,000	Cash in hand	1,450
Sundry Creditors	47,500	Cash at bank	3,125
Bad debts	1,100	Office Expenses	10,160
		Interest paid on loan	3,000

Additional Information:

1. Purchases include sales return of ₹ 2,575 and sales include purchases return of ₹ 1,725.
 2. Goods withdrawn by Mr. XYZ for own consumption ₹ 3,500 included in purchases.
 3. Wages paid in the month of April for installation of plant and machinery amounting to ₹ 450 were included in wages account.
 4. Free samples distributed for publicity costing ₹ 825.
 5. Create a provision for doubtful debts @ 5% and provision for discount on debtors @ 2.5%.
 6. Depreciation is to be provided on plant and machinery @ 15% p.a. and on furniture and fittings @ 10% p.a.
 7. Bank overdraft is secured against hypothecation of stock. Bank overdraft outstanding as on 31.3.2022 has been considered as 80% of real value of stock (deducting 20% as margin) and after adjusting the marginal value 80% of the same has been allowed to draw as an overdraft.
- Prepare a Trading and Profit and Loss Account for the year ended 31st March, 2022, and a Balance Sheet as on that date. Also show the rectification entries

Solution

Rectification Entries

Particulars		Dr.	Cr.
		Amount (₹)	Amount (₹)
(i)	Returns inward A/c Dr.	2,575	
	Sales A/c Dr.	1,725	
	To Purchases A/c		2,575
	To Returns outward A/c		1,725
	(Being sales return and purchases return wrongly included in purchases and sales respectively, now rectified)		
(ii)	Drawings A/c Dr.	3,500	
	To Purchases A/c		3,500

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	(Being goods withdrawn for own consumption included in purchases, now rectified)		
(iii)	Plant and machinery A/c Dr.	450	
	To Wages A/c		450
	(Being wages paid for installation of plant and machinery wrongly debited to wages, now rectified)		
(iv)	Advertisement expenses A/c Dr.	825	
	To Purchases A/c		825
	(Being free samples distributed for publicity out of purchases, now rectified)		

M/s Mapple States.
Trading for the year ended 31st March, 2022

Dr.			Cr.		
	₹	Amount		₹	Amount ₹
To Opening stock		32,250	By Sales	2,13,575	
To Purchases	1,53,100		Less: Sales return	<u>2,575</u>	2,11,000
Less: Purchases return	<u>1,725</u>	1,51,375	By Closing stock		
To Carriage inward		1,125	(₹80,000 × $\frac{100}{80}$ × $\frac{100}{100}$)		1,25,000
To Wages		11,715			
To Gross profit c/d		1,39,535			
		3,36,000			3,36,000

M/s Mapple States.
Profit and Loss for the year ended 31st March, 2022

Dr.		Cr.	
	Amount		Amount
₹	₹	₹	₹
To Salaries	22,550	By Gross profit b/d	1,39,535
To Rent	4,300	By Bad debts recovered	450
To Advertisement expenses	4,175		
To Printing and stationery	1,250		
To Bad debts	1,100		
To Carriage outward	1,350		
To Provision for doubtful debts			
5% of ₹ 1,20,000	6,000		
Less: Existing provision	<u>3,200</u>		
To Provision for discount on debtors			

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2.5% of ₹ 1,14,000	2,850		
Less: Existing provision	<u>1,375</u>	1,475	
To Depreciate on:			
Plant and machinery	3,000		
Furniture and fittings	<u>1,025</u>	4,025	
To Office expenses		10,160	
To Interest on loan		3,000	
To Net profit (Transferred to capital account)		83,800	
		1,39,985	1,39,985

M/s Mapple States
Balance Sheet as on 31st March, 2022

		Amount			Amount
Liabilities	₹	₹	Assets	₹	₹
Capital account	65,000		Payable salaries	20,000	
Add: Net profit	<u>83,800</u>		Less: Depreciate on	<u>3,000</u>	17,000
	1,48,800		Furniture and fittings	10,250	
Less: Drawings	<u>11,500</u>	1,37,300	Less: Depreciate on	<u>1,025</u>	9,225
Bank overdraft		80,000	Closing stock		1,25,000
Sundry creditors		47,500	Sundry debtors	1,20,000	
Payable salaries		2,450	Less: Provision for doubtful debts	6,000	
			Provision for bad debts	<u>2,850</u>	1,11,150
			Prepaid rent		300
			Cash in hand		1,450
			Cash at bank		3,125
		2,67,250			2,67,250

ILLUSTRATION 14

Crimson traders profit and loss account for the year ended 31st March, 2022 includes the following information:

	₹
(i) Depreciate on	57,500
(ii) Bad debts written off	21,000
(iii) Increase in provision for doubtful debts	18,000
(iv) Retained profit for the year	20,000
(v) Liability for tax	4,000

Required

State which one of the items (i) to (v) above are – (a) transfer to provisions; (b) transfer to reserves; and (c) neither related to provisions nor reserves.

Answer

(a) Transfer to provisions - (i), (iii) (v)

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- (b) Transfer to reserves - (iv)
 (c) Neither related to provisions nor reserves - (ii),.

A summary of all adjustments are as follows:

Adjustment	If Given in Trial Balance				If Not Given in Trial Balance
1. Closing stock	Balance Side	Sheet	–	Asset	(a) Trading A/c – Credit Side (b) Balance Sheet – Asset Side
2. Outstanding Expenses	Balance Sheet – Liability Side				(a) Trading/Prof t & Loss A/c Debit Side. Add to the concerned expenses. (b) Balance Sheet – Liability Side
3. Prepaid Expenses	Balance Side	Sheet	–	Asset	(a) Trading/Prof t & Loss A/c Debit Side. Deduct from the concerned expense. (b) Balance Sheet - Asset
4. Income Outstanding	Balance Side	Sheet	–	Asset	(a) Prof t & Loss A/c – Credit Side. Add to the concerned income. (b) Balance Sheet – Asset Side.
5. Incomes Received in Advance	Balance Sheet – Liability Side				(a) Prof t & Loss A/c – Credit Side. Deduct from concerned income. (b) Balance Sheet – Liability Side
6. Bad Debts	Prof t & Loss A/c – Debit Side				(a) Prof t & Loss A/c – Debit Side. (b) Balance Sheet – Asset Deduct from debtors . Side.
7. Provision for Bad or Doubt ul debts	Prof t & Loss A/c – Debit Side				(a) Prof t & Loss A/c – Debit Side. (b) Balance Sheet – Asset Deduct from Debtors add it onal bad debts, if any. Side. af er
8. Provision for Discount on Debtors	Balance Side Debtors.	Sheet Deduct	–	Asset from	(a) Prof t & Loss A/c – Debit Side. (b) Balance Sheet – Asset Side. Deduct from debtors af er providing for provision for bad debts
9. Depreciat on	Prof t & Loss A/c – Debit Side				(a) Prof t & Loss A/c – Debit Side. (b) Balance Sheet – Asset Side. Deduct from Respect ve Asset.
10. Interest on Capital	Prof t & Loss A/c – Debit Side				(a) Prof t & Loss A/c – Debit Side. (b) Balance Sheet – Liability Side. Add to Capital.
11. Interest on Drawings	Prof t & Loss A/c – Credit Side				(a) Prof t & Loss A/c – Credit Side. (b) Balance Sheet – Liability Side. Deduct from Capital.
12. Loss by Fire	Prof t & Loss A/c – Debit Side				(a) Trading A/c – Credit Side (with full amount of loss)

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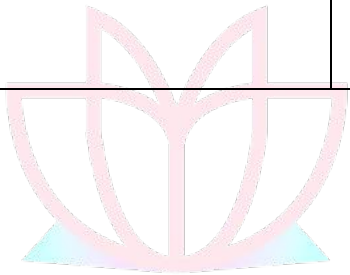
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		(b) Profit & Loss A/c – Debit Side (Actual loss, if any) [adjusted with insurance claim if any]
		(c) Balance Sheet – Asset Side (with insurance claim admitted by Insurance Co.)
13. Goods withdrawn for personal use	Trading A/c - Credit Side	(a) Trading A/c – Credit Side or Deduct from Purchases.
		(b) Balance Sheet – Liability Side (Deduct from Capital as Drawings)
14. Goods Distributed as free Samples	Profit & Loss A/c – Debit Side	(a) Trading A/c – Credit Side or Deduct from Purchases
		(b) Profit & Loss A/c – Debit Side
15. Sale of Goods on Approval Basis, approval not yet received	Usually it is not given in Trial Balance	(a) Trading A/c – Credit Side. Deduct from Sales the selling price of goods sold and add to stock at cost price.
		(b) Balance Sheet – Asset Side. Deduct from Debtors the selling price of such sales and show the cost price of such sales along with closing stock.


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Chapter 7.2

Final Accounts of Manufacturing Entities

234

True and False

Question 1

By-products valued at cost or net realisable value whichever is lower.

Answer 1

False: By-products generally have insignificant value as compared to the value of main product. Therefore, they are generally valued at net realizable value.

Question 2

The manufacturing account is prepared to ascertain the profit or loss on the goods produced.

Answer 2

False: The objective of preparing Manufacturing Account is to determine manufacturing costs of finished goods for assessing the cost effectiveness of manufacturing activities.

Question 3

If there remain unfinished goods at the beginning and at the end of the accounting period, cost of such unfinished goods is shown in the Manufacturing Account.

Answer 3

True: Manufacturing account deals with the raw material and work in progress.

Question 4

Raw Material Consumed = Opening inventory of Raw Materials + Purchases – Closing inventory of Raw Materials.

Answer 4

True: Raw Material consumed is arrived at after adjustment of opening and closing inventory of raw materials and purchases.

Question 5

The Trading Account will show the quantities of finished goods, raw materials and work-in-progress.

Answer 5

False: The Trading Account will show the quantities of finished goods manufactured and sold and the opening and closing inventory. It will not show the quantity of raw materials or work-in-progress.

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Question 6

Overhead is defined as total cost of direct material, direct wages and direct expenses.

Answer 6

False: Overhead is defined as total cost of indirect material, indirect wages and indirect expenses.

Question 7

Manufacturing A/c is prepared by an enterprise engaged in trading activities.

Answer 7

False: Manufacturing A/c is prepared by the entities engaged in manufacturing activities.

Multiple Choice Questions

1. Under-statement of closing work in progress in the period will
- Understate cost of goods manufactured in that period.
 - Overstate current assets.
 - Understate net income in that period.
 - None of the three.

Answer 1 : (c)

2. Sales is equal to
- Cost of goods sold – Gross profit.
 - Cost of goods sold + Gross profit.
 - Gross profit – Cost of goods sold.
 - Net profit + cost of goods sold.

Answer 2 : (b)

3. Indirect Manufacturing expenses are also called
- Manufacturing overhead.
 - Production overhead.
 - Works overhead.
 - All the three.

Answer 3 : (d)

4. Sale value of the by-product is credited to
- Manufacturing account.
 - Capital account.
 - Overheads account.
 - Trading account.

Answer 4 : (a)

5. Manufacturing account shows
- Total cost of manufacturing the finished products.
 - It provides details of factory cost.
 - It facilitates reconciliation of financial books with cost records.

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(d) All the three.

Answer 5 : (d)

Theoretical Questions & Answers

Question 1

Write short note on by-products.

Answer 1

By-products generally have insignificant value as compared to the value of main product. They are **generally valued at net realisable value**, if their costs cannot be separately identified. It is often treated, as "Miscellaneous income" but the correct treatment would be to credit the sale value of the by-product to Manufacturing Account so as to reduce to that extent, the cost of manufacture of main product.

Question 2

Differentiate between Direct Manufacturing Expenses and Indirect Manufacturing expenses.

Answer 2

Direct manufacturing expenses are costs, other than material or wages, which are incurred for a specific product or saleable service.

Indirect Manufacturing expenses are also called Manufacturing overhead, Production overhead, Works overhead, etc. Overhead is defined as total cost of indirect material, indirect wages and indirect expenses.

Practical Questions & Answers

Question 1

Mr. Pankaj runs a factory which produces motor spares of export quality. The following details were obtained about his manufacturing expenses for the year ended on 31.3.2022.

			₹
W.I.P.	- Opening		3,90,000
	- Closing		5,07,000
Raw Materials	- Purchases		12,10,000
	- Opening		3,02,000
	- Closing		3,10,000
	- Returned		18,000
	- Indirect material		16,000
Wages	- direct		2,10,000
	- indirect		48,000
Direct expenses	- Royalty on product on		1,30,000
		Repairs and maintenance	2,30,000
		Depreciat on on factory shed	40,000
		Depreciat on on plant & machinery	60,000
By-product at			

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selling price			20,000

You are required to prepare Manufacturing Account of Mr. Pankaj for the year ended on 31.3.2022.

Answer 1

In the Books of Mr. Pankaj
Manufacturing Account for the year ended on March 31,2022

Particulars		Amount	Particulars	Amount
	₹	₹		₹
To Opening W.I.P.		3,90,000	By Closing W-I-P	5,07,000
To Raw Material Consumed:			By by products	20,000
Opening inventory	3,02,000		By Trading A/c-	17,81,000
Purchases	12,10,000		Cost of f nished	
	15,12,000		goods transferred	
Less: Return	(18,000)			
	14,94,000			
Less: Closing inventory	(3,10,000)	11,84,000		
To Direct Wages		2,10,000		
To Direct expenses:				
Royalty		1,30,000		
To Manufacturing Overhead:				
Indirect Material	16,000			
Indirect Wages	48,000			
Repairs & Maintenance	2,30,000			
Depreciat on on Factory Shed	40,000			
Depreciat on on Plant & Machinery	60,000	3,94,000		
		23,08,000		23,08,000

Question 2

Following are the Manufacturing A/c, Creditors A/c and Trading A/c provided by Ms. Shivi related to 2021-22. There are certain figures missing from these accounts.

Raw Material A/c

Date	Part culars	Amount ₹	Date	Part culars	Amount ₹
	To Opening Stock A/c	1,00,000		By Raw Material Consumed	
	To Creditors A/c			By Closing Stock A/c	

Creditors A/c

Date	Part culars	Amount ₹	Date	Part culars	Amount ₹
	To Bank A/c	22,00,000		By Balance b/d	15,00,000
	To Balance c/d	6,00,000			

Manufacturing A/c

Part culars	Amount ₹	Part culars	Amount ₹
To Raw Material Consumed		By Trading A/c	17,94,000
To Wages	3,50,000		

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To Depreciat on	2,00,000		
To Direct Expenses	2,44,000		

Additional Information:

- 1) Purchase of machinery worth ₹ 10,00,000 has been omit ed. Machinery are chargeable at a depreciat on rate of 10%.
- 2) Wages include the following
 Paid to Factory Workers - ₹ 3,00,000
 Paid to labour at of ce - ₹ 50,000
- 3) Direct Expenses include following:
 - ♦ Electricity charges of ₹ 80,000 of which 30% pertained to of ce.
 - ♦ Fuel Charges of ₹ 20,000
 - ♦ Freight Inwards of ₹ 35,000
 - ♦ Delivery charges to customers - ₹ 20,000.

You are required to prepare revised Manufacturing A/c, and Raw Material A/c.

Answer 2
Manufacturing A/c

Part culars	Amount ₹	Part culars	Amount ₹
To Raw Material Consumed		By Trading A/c (W.N. 4)	18,00,000
(Balancing Figure)	10,00,000		
To Wages (W.N. 2)	3,00,000		
To Depreciat on (W.N. 1)	3,00,000		
To Direct Expenses (W.N. 3)	2,00,000		
	18,00,000		18,00,000

Raw Material A/c

Date	Part culars	Amount ₹	Date	Part culars	Amount ₹
	To Opening Stock A/c	1,00,000		By Raw Material Consumed (from Trading A/c above)	10,00,000
	To Creditors A/c (W.N. 5)	13,00,000		By Closing Stock A/c	4,00,000
				(Balancing Figure)	
		14,00,000			14,00,000

Working Notes:

- (1) Since purchase of Machinery worth ₹ 10,00,000 has been omit ed.
 So, depreciat on omit ed from being charged = ₹ 10,00,000 X 10%
 = ₹1,00,000
 Correct total depreciat on expense = ₹ (2,00,000 + 1,00,000)
 = ₹ 3,00,000
- (2) Wages worth ₹ 50,000 will be excluded from manufacturing account as they pertain to of ce and hence will be charged P&L A/c.
- (3) Expenses to be excluded from direct expenses:

Of ce Electricity Charges (80,000 X 30%)	24,000
Delivery Charges to Customers	20,000
Total expenses not part of Direct Expenses	44,000

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=> Revised Direct Expenses	= ₹ (2,44,000 - 44,000) = ₹ 2,00,000

Fuel charges are related to factory expenses and also freight inwards are incurred for bringing goods to factory/ godown so they are part of direct expenses.

(4) **Revised Balance to be transferred to Trading A/c:**

Particulars	Amount ₹
Current Balance transferred	17,94,000
Add: Depreciation charges not recorded earlier	1,00,000
Less: Wages related to Office	(50,000)
Less: Office Expenses	(44,000)
Revised balance to be transferred	18,00,000

(5) **Creditors A/c**

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
	To Bank A/c	22,00,000		By Balance b/d	15,00,000
	To Balance c/d	6,00,000		By Raw Materials A/c (Balance figure)	13,00,000
		28,00,000			28,00,000

Question 3

The following is the trial balance of Mr. Pandit for the year ended 31st March, 2022:

Trial Balance as on 31st March 2022

Particulars	Dr. ₹	Particulars	Cr. ₹
Opening Stock:			
Raw Materials	1,50,000	Sundry Creditors	50,000
Finished goods	75,000	Purchase Returns	5,000
Purchase of Raw Materials	5,00,000	Capital	1,00,000
Land & Building	1,00,000	Bills Payable	24,000
Loose tools	30,000	Long-Term Loan	2,00,000
Plant & Machinery	30,000	Provision for Bad and Doubtful Debts	2,000
Investments	25,000	Sales	8,50,000
Cash in Hand	20,000	Bank Overdraft	23,000
Cash at Bank	5,000		
Furniture & Fixtures	15,000		
Bills Receivable	15,000		
Sundry Debtors	40,000		
Drawings	20,000		
Salaries	20,000		
Coal and Fuel	15,000		
Factory rent & rates	20,000		
General Expenses	4,000		
Advertisement	5,000		
Sales Return	10,000		
Bad Debts	4,000		

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Direct Wages (Factory)	80,000		
Power	30,000		
Interest Paid	7,000		
Discount Allowed	3,000		
Carriage Inwards	15,000		
Carriage Outwards	7,000		
Commission Paid	9,000		
	12,54,000		12,54,000

Additional Information

Stock of finished goods at the end of the year ₹1,00,000.

A provision for doubtful debts is to be created. at 5% on Sundry Debtors. Depreciation on building ₹ 1,000 and ₹ 3,000 on Plant & Machinery to be provided.

Accrued commission of ₹ 12,500 is to be received for the year. Interest has accrued on investment ₹ 15,000.

Salary Outstanding ₹ 2,000 and Prepaid Interest ₹ 1,500.

You are required to prepare Manufacturing, Trading and Profit and Loss Account for the year ended 31st March, 2022.

Answer 3

In the books of Mr. Pandit
Manufacturing Account for the year ended 31st March, 2022

Particulars		₹	Particulars	₹
To Opening Stock of Raw Materials		1,50,000	By Cost of Manufactured goods transferred to Trading A/c	8,08,000
To Purchase	5,00,000			
Less: Purchase Return	5,000	4,95,000		
To Carriage Inwards		15,000		
To Direct Wages		80,000		
To Power		30,000		
To Coal and fuel		15,000		
To Factory Rent and Rates		20,000		
To Depreciation on Machinery		3,000		
		8,08,000		8,08,000

Trading Account for the year ended 31st March, 2022

Particulars	₹	Particulars	₹
To Opening Stock of finished goods	75,000	By Sales	8,50,000
To Cost of goods transferred from Manufacturing A/c	8,08,000	Less: Sales Return	<u>10,000</u>
		By Closing Stock	1,00,000
To Gross Profit c/d	57,000		
	9,40,000		9,40,000

Profit and Loss Account for the year ended 31st March 2022

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Particulars		₹	Particulars	₹
To Carriage Outward		7,000	By Gross Profit b/d	57,000
To Discount Allowed		3,000	By Accrued Commission	12,500
To Commission Paid		9,000	By Accrued Interest	15,000
To General Expenses		4,000		
To Advertisement		5,000		
To Salaries	20,000			
Add: Outstanding	2,000	22,000		
To Interest Paid	7,000			
Less: Prepaid	1,500	5,500		
To Provision for Bad & Doubtful Debts	2,000			
Add: Bad Debts	4,000			
Less: Old Provision for Doubtful Debts	2,000	4,000		
To Depreciation on Building		1,000		
To Net Profit c/d		24,000		
		84,500		84,500

Balance Sheet as at 31st March, 2022

Capital and Liabilities		₹	Assets		₹
Capital	1,00,000		Plant & Machinery	30,000	
Add: Net Profit	24,000		Less: Depreciation	3,000	27,000
	1,24,000		Land & Building	1,00,000	
Less: Drawings	20,000	1,04,000	Less: Depreciation	1,000	99,000
Bills Payable		24,000	Furniture & Fixtures		15,000
Sundry Creditors		50,000	Investments		25,000
Salary Outstanding		2,000	Closing Stock		1,00,000
Long-Term Loans		2,00,000	Loose Tools		30,000
Bank Overdraft		23,000	Sundry Debtors	40,000	
			Less: Provision for Bad & Doubtful Debts	2,000	38,000
			Bills Receivable		15,000
			Accrued Commission		12,500
			Accrued Interest		15,000
			Prepaid Interest		1,500
			Cash in Hand		20,000
			Cash at Bank		5,000
		4,03,000			4,03,000

ILLUSTRATION 1

1,00,000 units were produced in a factory. Per unit material cost was ₹ 10 and per unit labour cost was ₹ 5. That apart it was agreed to pay royalty @ ₹ 3 per unit to the Japanese collaborator who supplied technology.

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Required
Calculate Manufacturing Cost.

Answer

In this case Manufacturing Cost comprises of –

Raw Material consumed	(1,00,000 × ₹ 10)	₹ 10,00,000
Direct Wages	(1,00,000 × ₹ 5)	₹ 5,00,000
Direct Expenses	(1,00,000 × ₹ 3)	₹ 3,00,000
		₹ 18,00,000

ILLUSTRATION 2

Mr. Vimal runs a factory which produces soaps. Following details were available in respect of his manufacturing activities for the year ended on 31.3.2022:

	₹
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 @ ₹ 0.60 per unit manufactured	
Hire charges of factory	2,20,000
Direct wages-Contracted @ ₹ 0.80 per unit manufactured and @ ₹ 0.40 per unit of Closing W.I.P.	
Repairs and Maintenance	1,80,000
Units produced – 5,00,000 units	

Required

Prepare a Manufacturing Account of Mr. Vimal for the year ended 31.3.2022.

Answer

In the Books of Mr. Vimal Manufacturing Account for the Year ended 31.3.2022

Particulars		Units	Amount	Particulars	Units	Amount
			₹			₹
To Opening Work- in- Process		10,000	16,000	By Closing Work- in- Process	12,000	20,000
To Raw Materials Consumed:				By Trading A/c –	5,00,000	19,00,800
Opening inventory	1,70,000			Cost of finished Goods transferred		
Add: Purchases	8,20,000					
	9,90,000					
Closing Inventory	(1,90,000)		8,00,000			
To Direct Wages – W.N. (1)			4,04,800			

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To Direct expenses:						
Hire charges on Machinery – W.N. (2)			3,00,000			
To Indirect expenses:						
Hire charges of Factory Shed			2,20,000			
Repairs Maintenance			1,80,000			
			19,20,800			19,20,800

Working Notes:

(1)

Direct Wages – 5,00,000 units @ ₹ 0.80 =	₹ 4,00,000
12,000 units @ ₹ 0.40 =	₹ 4,800
	₹ 4,04,800

(2) Hire charges on Machinery (5,00,000 units @ ₹0.60) ₹ 3,00,000

ILLUSTRATION 3

On 31st March, 2022 the Trial Balance of Mr. White were as follows:

Trial Balance as on 31st March, 2022

Particulars	Dr. ₹	Particulars	Cr. ₹
Stock on 1st April 2021			
Raw Materials	21,000	Sundry Creditors	15,000
Work in Progress	9,500	Bills Payable	7,500
Finished goods	15,500	Sale of Scrap	2,500
Sundry Debtors	24,000	Commission Received	450
Carriage on Purchases	1,500	Provision for doubtful debts	1,650
Bills Receivable	15,000	Capital Account	1,00,000
Wages	13,000	Sales	1,67,200
Salaries	10,000	Bank Overdraft	8,500
Telephone, Postage etc.	1,000		
Repairs to Office Furniture	350		
Cash at Bank	17,000		
Office Furniture	10,000		
Repairs to Plant	1,100		
Purchases	85,000		
Plant and Machinery	70,000		
Rent	6,000		
Lighting	1,350		
General Expenses	1,500		
	3,02,800		3,02,800

The following additional information is available:

 Stocks on 31st March, 2022 were:

Raw Materials ₹ 16,200

Finished goods ₹ 18,100

Semi-finished goods ₹ 7,800

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Salaries and wages unpaid for March 2022 were respectively, ₹ 900 and ₹ 2,000

Machinery is to be depreciated by 10% and office furniture by 7 1/2 %

Provision for doubtful debts is to be maintained @ 1% of sales

Office premises occupy 1/4 of total area.

Lighting is to be charged as to 2/3 to factory and 1/3 to office.

Prepare the Manufacturing Account Trading Account, Profit and Loss Account and the Balance Sheet relating to 31st March 2022.

Answer

In the books of Mr. White

Manufacturing Account for the year ended 31st March, 2022

Particulars		₹	Particulars	₹
Raw material consumed:			By Closing Stock of Work in Progress	7,800
To Opening Stock of Raw Materials	21,000		By Sale of Scrap	2,500
Add: Purchases	85,000		By Cost of goods Manufactured (Transferred to Trading Account)	1,19,000
Less: Closing Stock	16,200	89,800		
To Opening Stock of WIP		9,500		
To Wages	13,000			
Add: Outstanding Wages	2,000	15,000		
To Carriage on Purchases		1,500		
To Repairs to Plant		1,100		
To Rent (3/4)		4,500		
To Lighting (2/3)		900		
To Depreciation of Plant		7,000		
		1,29,300		1,29,300

Trading Account for the year ended 31st March, 2022

Particulars	₹	Particulars	₹
To Opening Stock of finished goods	15,500	By Sales	1,67,200
To Cost of goods transferred from Manufacturing A/c	1,19,000	By Closing Stock of finished goods	18,100
To Gross Profit c/d	50,800		
	1,85,300		1,85,300

Profit and Loss Account for the year ended 31st March, 2022

Particulars		₹	Particulars	₹
To Salaries	10,000		By Gross Profit b/d	50,800
Add: Outstanding	900	10,900	By Commission	450
To Telephone & Postage		1,000		
To Repairs to Furniture		350		
To Depreciation of furniture		750		

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To Rent (1/4)		1,500		
To Light ng (1/3)		450		
To General Expenses		1,500		
To Provision for doubtful Debts: Required (1% of ₹1,67,200)	1,672			
Less: Existing Provision	1,650	22		
To Net Profit		34,778		
		51,250		51,250

Balance Sheet as at 31st March, 2022

Capital and Liabilities		₹	Assets		₹
Capital Account	1,00,000		Plant & Machinery	70,000	
Add: Net Profit	34,778	1,34,778	Less: Depreciation	7,000	63,000
Bank Loan		8,500	Office Furniture	10,000	
Sundry Creditors		15,000	Less: Depreciation	750	9,250
Bills Payable		7,500	Closing Stock		
Salary Payable		900	Raw Materials		16,200
Wages Payable		2,000	Work in Progress		7,800
			Finished Goods		18,100
			Sundry Debtors	24,000	
			Less: Provision for Bad & Doubtful Debts	1,672	22,328
			Bills Receivable		
			Cash at Bank		
		1,68,678			1,68,678

NOTE: The ICAI has, through technical guide (issued in June, 2022) provided guidance on the formats of financial statements for non-corporate entities. This would enable these entities to communicate their financial performance and financial position in standardised formats thereby enhancing their consistency and comparability. The said format of financial statements has been given as **Annexure – I** at the end of the chapter for awareness of students. It may be noted that this format does not form part of syllabus and has been given here for the knowledge of students only.

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Chapter 8

Financial Statements of Not-For-Profit Organisations

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True and False

Question 1

The Receipts and payment account for a non-profit organization follows the accrual concept of accounting.

Answer 1

False: It depicts the cash system of accounting rather than the accrual system, as the cash receipts and payments pertaining to any year are entered in the Receipts and payments account. The principle of accrual is not followed with regard to the receipts and payments account of a non-profit organization.

Question 2

Both the revenue and capital nature transactions are recorded in the Income and expenditure account.

Answer 2

False: The income and expenditure account records only the revenue income and expenditure. The capital transactions are being recorded in the Balance sheet.

Question 3

Sale of grass by a sports club is to be treated as sale of an asset.

Answer 3

False: The grass for a sports club is not a capital item, hence the sale of such grass shall be treated as a revenue receipt.

Question 4

Subscriptions outstanding for the current year are disclosed under the Fixed assets side of the Balance sheet.

Answer 4

False: They are disclosed under the current assets of the Balance sheet as they will be paid within the next year and not to be treated as non-current assets.

Question 5

Receipts and payments account gives the details about the expenses outstanding for the year.

Answer 5

False: Receipts and payments account gives information about the expenses paid in cash for the current year, previous or the next year. It is only from the additional information we identify the

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outstanding expenses.

Question 6

Adjustments in the form of additional information shall be adjusted in the final accounts of a Non-profit organisation only in one place.

Answer 6

False: Additional information means that information which has been identified just before the preparation of the final accounts. As NPO follows the double entry system of book keeping, there shall be 2 effects for each of the additional information.

Question 7

Tournament expenses incurred are more than the Tournament fund, then the excess to be shown as an asset in the closing Balance sheet.

Answer 7

False: The excess of expenditure over the tournament fund shall be debited to the income and expenditure account and not taken to the closing balance sheet.

Question 8

For Non-profit organisation, Excess of income over expenditure in the Income and Expenditure account is termed as profit.

Answer 8

False: The excess of the income over the expenditure is called as Surplus and not profit for an Non-profit organisation.

Question 9

Surplus of non-profit organizations is distributed among its members.

Answer 9

False: The Non-profit organisation credits the surplus earned in a year to the general fund maintained by it.

Question 10

Tournament fund, building fund, library fund is based on the fund based accounting.

Answer 10

True: It is Fund based accounting that records the fund balances in the balance sheet.

Question 11

Subscription fees refers to the one-time fees paid by the members to get admission for the benefits of the club.

Answer 11

False: Subscription is a regular fees paid by the members to keep the membership alive.

Question 12

Token payment made to a person, who voluntarily undertakes a service which would normally be paid in case of profitable organization is termed as Honorarium.

Answer 12

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True: Honorarium refers to the nominal amount paid for the services with a non- commercial intent.

Question 13

An Insurance company is an example of non-profit organization.

Answer 13

False: Insurance Company has a profit motive, hence it is not a non-profit organization.

Question 14

Part amount of entrance fees which is to be capitalized shall be disclosed in the income and expenditure account.

Answer 14

False: It shall be shown in the Balance sheet- where it is to be capitalized.

Question 15

Both the income and expenditure of the current and the previous year are recorded in the Income and Expenditure account.

Answer 15

False: It is only the current year income and expenditure which is recorded in the Income and Expenditure account as per the accrual concept.

Question 16

Amount received as donation by an Non-profit organisation under the will of a deceased person is termed as legacy.

Answer 16

True: While on the death bed, if there is any will written that the assets of a person shall be donated to any NPO- then such a donation to the NPO, is termed as Legacy.

Question 17

Where a Non-profit organisation has a separate trading activity, the profit/loss from the trading account shall be transferred to Income and Expenditure Account at the time of consolidation.

Answer 17

True: Where in case of the trading activities, the profit /loss from such activity to be transferred to the Income and expenditure account in case of consolidated accounts.

Question 18

Not for profit concerns concentrate their efforts to maximize the profit earning avenues.

Answer 18

False: The Non-profit organisation has its very existence to serve the members and the society. Profit earning shall never be its motive.

Question 19

All the receipts are of revenue nature in case of Non-profit organisation.

Answer 19

False: Receipts can be both of revenue as well as capital nature. Receipts of both the nature are recorded in the receipts and payments account.

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Question 20

There is opening balance of Income and expenditure account.

Answer 20

False: It represents a nominal account and is prepared in accordance with the accrual concept, hence there can be no opening balances.

Multiple Choice Questions

1. Scholarship granted to students out of specific funds provided by Government will be debited to
 - (d) Income and Expenditure Account.
 - (e) Receipts and payments Account.
 - (f) Funds granted for Scholarship account.

Answer 1 : (c)

2. In case of NPO, excess of total assets over liabilities is known as
 - (a) Profits.
 - (b) Surplus.
 - (c) Capital Fund.

Answer 2 : (c)

3. General donations and legacies are credited to
 - (a) Receipts and Payments Account.
 - (b) Income and Expenditure Account.
 - (c) Capital Fund.

Answer 3 : (b)

4. Interest on prize funds is
 - (a) Credited to Income and Expenditure Account.
 - (b) Credited to Receipts and Payments Account.
 - (c) Added to prize fund.

Answer 4 : (c)

5. Special aids are
 - (a) Treated as capital receipts.
 - (b) Treated as revenue receipts.
 - (c) Both (a) and (c).

Answer 5 : (c)

6. If there exist a specific sports fund, the expenses incurred in relation to sports activities will be taken to
 - (a) Income and Expenditure Account
 - (b) Receipt and Payment Account
 - (c) Sports fund

Answer 6 : (c)

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Theoretical Questions & Answers

Question 1

Distinguish between Receipt and Payment and Income and Expenditure Account.

Answer 1

Non-profit making organizations such as public hospitals, public educational institutions, clubs etc., conventionally prepare Receipt and Payment Account and Income and Expenditure Account to show periodic performance for a particular accounting period. For distinguishing features of both the accounts, Refer para 3.2.

Practical Questions & Answers

Question 1

The following is the Receipts and Payments Account of Lion Club for the year ended 31st March, 2022.

Receipts	₹	Payments	₹
Opening balance:		Salaries	1,20,000
Cash	10,000	Creditors	15,20,000
Bank	3,850	Printing and stationary	70,000
Subscription received	2,02,750	Postage	40,000
Entrance donation	1,00,000	Telephones and telex	52,000
Interest received	58,000	Repairs and maintenance	48,000
Sale of assets	8,000	Glass and table linen	12,000
Miscellaneous income	9,000	Crockery and cutlery	14,000
Receipts at		Garden upkeep	8,000
Coffee room	10,70,000	Membership fees	4,000
Sofa drinks	5,10,000	Insurance	5,000
Swimming pool	80,000	Electricity	28,000
Tennis court	1,02,000	Closing balance:	
		Cash	8,000
		Bank	2,24,600
	21,53,600		21,53,600

The assets and liabilities as on 1.4.2021 were as follows:

	₹
Fixed assets (net)	5,00,000
Stock	3,80,000
Investment in 12% Government securities	5,00,000
Outstanding subscription	12,000
Prepaid insurance	1,000
Sundry creditors	1,12,000
Subscription received in advance	15,000
Entrance donation received pending membership	1,00,000
Gratuity fund	1,50,000

The following adjustments are to be made while drawing up the accounts:

- Subscription received in advance as on 31st March, 2022 was ₹ 18,000.
- Outstanding subscription as on 31st March, 2022 was ₹ 7,000.

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- (iii) Outstanding expenses are salaries ₹ 8,000 and electricity ₹ 15,000.
- (iv) 50% of the entrance donation was to be capitalized. There was no pending membership as on 31st March, 2022.
- (v) The cost of assets sold net as on 1.4.2021 was ₹ 10,000.
- (vi) Depreciation is to be provided at the rate of 10% on assets.
- (vii) A sum of ₹ 20,000 received in October 2021 as entrance donation from an applicant was to be refunded as he has not fulfilled the requisite membership qualifications. The refund was made on 3.6.2022.
- (viii) Purchases made during the year amounted ₹ 15,00,000.
- (ix) The value of closing stock was ₹ 2,10,000.
- (x) The club as a matter of policy, charges off to income and expenditure account all purchases made on account of crockery, cutlery, glass and linen in the year of purchase.

You are required to prepare an Income and Expenditure Account for the year ended 31st March, 2022 and the Balance Sheet as on 31st March, 2022 along with necessary workings.

Answer 1

**Income and Expenditure Account of Lion Club
for the year ended 31st March, 2022**

Expenditure	₹	Income	₹
To Salaries	1,28,000	By Subscript on	1,94,750
To Printing and stationary	70,000	By Entrance donation	90,000
To Postage	40,000	By Interest	60,000
To Telephone and telex	52,000	By Miscellaneous income	9,000
To Repairs and maintenance	48,000	By Profit from operations	92,000
To Glass and table linen	12,000	By Excess of expenditure over income	
To Crockery and cutlery	14,000	(deficit) transferred to capital fund	30,250
To Garden upkeep	8,000		
To Membership fees	4,000		
To Insurance	6,000		
To Electricity charges	43,000		
To Loss on sale of assets	2,000		
To Depreciation	49,000		
	4,76,000		4,76,000

Balance Sheet of Lion Club as on 31st March, 2022

Liabilities	₹	Assets	₹
Capital fund	10,89,600	Fixed assets	4,41,000
Gratuity fund	1,50,000	Stock	2,10,000
Sundry creditors	92,000	Investments	5,00,000
Subscription received in advance	18,000	Subscription outstanding	7,000
Entrance donation refundable	20,000	Interest accrued	2,000
Outstanding expenses	23,000	Bank	2,24,600
		Cash	8,000
	13,92,600		13,92,600

Working Notes:

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1. Opening Balance Sheet
Balance Sheet of Lion Club as on 1st April, 2021

Liabilities	₹	Assets	₹
Sundry creditors	1,12,000	Fixed assets	5,00,000
Subscription received in advance	15,000	Stock	3,80,000
Entrance donation received in advance	1,00,000	Investments Subscription outstanding	5,00,000
Gratuity fund	1,50,000	Prepaid expenses	12,000
Capital fund (balance figure)	10,29,850	Cash	1,000
		Bank	10,000
			3,850
	14,06,850		14,06,850

2. Subscription

	₹
Subscription received during the year	2,02,750
Add: Outstanding subscription on 31.3.2022	7,000
	2,09,750
Add: Received in advance as on 1.4.2021	15,000
	2,24,750
Less: Outstanding subscription as on 1.4.2021	(12,000)
	2,12,750
Less: Received in advance as on 31.3.2022	(18,000)
	1,94,750

3. Entrance donation

	₹
Entrance donation received during the year	1,00,000
Add: Received in advance as on 1.4.2021	1,00,000
	2,00,000
Less: Entrance donation in respect of ineligible member	(20,000)
	1,80,000
Less: 50% capitalized	(90,000)
Taken to income and expenditure account	90,000

4. Loss on sale of asset

	₹
Cost of asset sold	10,000
Less: Sale proceeds	(8,000)
Loss on sale of asset	2,000

5. Depreciation

	₹
Fixed asset as per trial balance	5,00,000
Less: Cost of asset sold	(10,000)
	4,90,000
Depreciation on ₹ 4,90,000 @ 10%	49,000

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6. Salaries

	₹
Salary paid during the year	1,20,000
Add: Outstanding as on 31.3.2022	8,000
	1,28,000

7. Electricity charges

	₹
Electricity charges paid during the year	28,000
Add: Outstanding as on 31.3.2022	15,000
	43,000

8. Interest

	₹
Interest on 12% Government securities investment (₹ 5,00,000 @ 12% p.a.)	60,000
Less: Interest received during the year	(58,000)
Interest accrued	2,000
Interest credited to Income and Expenditure Account	60,000
	60,000

9. Profit from operations

	₹
Cost of goods sold:	
Opening stock	3,80,000
Add: Purchases	15,00,000
	18,80,000
Less: Closing stock	(2,10,000)
Cost of goods sold (A)	16,70,000
Receipts from operations:	
Receipts from canteen room	10,70,000
Receipts from soft drinks	5,10,000
Receipts from swimming pool	80,000
Receipts from tennis court	1,02,000
Total receipts (B)	17,62,000
Profits from operations (B-A)	92,000

10. Insurance

	₹
Insurance paid during the year	5,000
Add: Prepaid insurance as on 1.4.2021	1,000
	6,000

11. Sundry creditors

	₹
Opening balance as on 1.4.2021	1,12,000
Add: Purchases made during the year	15,00,000

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	16,12,000
Less: Payments made during the year	(15,20,000)
Closing balance as on 31.3.2022	92,000

12. Outstanding expenses

	₹
Outstanding salaries	8,000
Outstanding electricity charges	15,000
Outstanding expenses	23,000

13. Fixed assets

	₹
Fixed assets as on 1.4.2021	5,00,000
Less: Cost of assets sold	(10,000)
	4,90,000
Less: Depreciat on	(49,000)
Fixed assets as on 31.3.2022	4,41,000

14. Capital fund

	₹
Capital fund as on 1.4.2021	10,29,850
Add: Entrance donat on capitalised	90,000
	11,19,850
Less: Excess of expenditure over income	(30,250)
Balance as on 31.3.2022	10,89,600

Question 2

During the year ended 31st March, 2022, Sachin Cricket Club received subscriptions as follows:

	₹
For year ending 31st March, 2021	12,000
For year ending 31st March, 2022	6,15,000
For year ending 31st March, 2023	18,000
Total	6,45,000

There are 500 members and annual subscription is ₹ 1,500 per member.

On 31st March, 2022, a sum of ₹ 15,000 was still in arrears for subscriptions for the year ended 31st March, 2021.

Ascertain the amount of subscriptions that will appear on the credit side of Income and Expenditure Account for the year ended 31st March, 2022. Also show how the items would appear in the Balance Sheet as on 31st March, 2021 and the Balance Sheet as on 31st March, 2022.

Answer 2

**Income & Expenditure Account (An extract) of Sachin Cricket Club
for the year ended 31st March, 2022**

	₹		₹
		By Subscript on (500 members × ₹ 1,500 per member)	7,50,000

Balance Sheet of Sachin Cricket Club as on 31st March, 2021 (An extract)

Liabilit es	₹	Assets	₹

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		Subscript on Receivable (₹15,000 + ₹12,000)	27,000

Balance Sheet of Sachin Cricket Club as on 31st March, 2022 (An extract)

Liabilities	₹	Assets	₹	₹
Unearned Subscript on	18,000	Outstanding Subscript on of 2020-21	15,000	
		of 2021-22	1,35,000	1,50,000
		₹ (7,50,000 – 6,15,000)		

Question 3

Summary of receipts and payments of Bombay Medical Aid society for the year ended 31.12.2022 are as follows:

Opening cash balance in hand ₹ 8,000, subscription ₹ 50,000, donation ₹ 15,000 (raised for meeting revenue expenditure), interest on investments @ 9% p.a. ₹ 9000, payments for medicine supply ₹ 30,000 Honorarium to doctor ₹ 10,000, salaries ₹ 28,000, sundry expenses ₹ 1,000, equipment purchase ₹ 15,000, charity show expenses ₹ 1,500, charity show collections ₹ 12,500.

Additional information:

	1.1.2022	31.12.2022
Subscript on due	1,500	2,200
Subscript on received in advance	1,200	700
Stock of medicine	10,000	15,000
Amount due for medicine supply	9,000	13,000
Value of equipment	21,000	30,000
Value of building	50,000	48,000

You are required to prepare receipts and payments account and income and expenditure account for the year ended 31.12.2022 and balance sheet as on 31.12.2022.

Answer 3

**Receipts and Payments Account of Bombay Medical Aid Society
for the year ended 31st December, 2022**

Receipts	₹	Payments	₹
To Cash in hand (opening)	8,000	By Medicine supply	30,000
To Subscript on	50,000	By Honorarium to doctors	10,000
To Donat on	15,000	By Salaries	28,000
To Interest on investment	9,000	By Sundry expenses	1,000
To Charity show collect ons	12,500	By Purchase of equipment	15,000
		By Charity show expenses	1,500
		By Cash in hand (closing)	9,000
	94,500		94,500

**Income and Expenditure Account of Bombay Medical Aid Society
for the year ended 31st December, 2022**

Expenditure	₹	Income	₹
To Medicine consumed	29,000	By Subscript on	51,200
To Honorarium to doctors	10,000	By Donat on	15,000

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To Salaries		28,000	By Interest on investments		9,000
To Sundry expenses		1,000	By Profit on charity show:		
To Depreciation on					
To Depreciation on			Show collections	12,500	
Equipment	6,000		Less: Show expenses	(1,500)	11,000
Building	2,000	8,000			
To Surplus-excess of income over expenditure		10,200			
		86,200			86,200

**Balance Sheet of Bombay Medical Aid Society
as on 31st December, 2022**

Liabilities	₹	₹	Assets	₹	₹
Capital fund:			Building	50,000	
Opening balance	1,80,300		Less: Depreciation	(2,000)	48,000
Add: Surplus	10,200	1,90,500	Equipment	21,000	
Subscription received in advance		700	Add: Purchase	15,000	
Amount due for medicine supply		13,000		36,000	
			Less: Depreciation	(6,000)	30,000
			Stock of medicine		15,000
			Investments		1,00,000
			Subscription receivable		2,200
			Cash in hand		9,000
		2,04,200			2,04,200

Working Notes:

Subscription for the year ended 31st December, 2022:		₹
Subscription received during the year		50,000
Less: Subscription receivable on 1.1.2022	1,500	
Less: Subscription received in advance on 31.12.2022	700	(2,200)
		47,800
Add: Subscription receivable on 31.12.2022	2,200	
Add: Subscription received in advance on 1.1.2022	1,200	3,400
		51,200
Purchase of medicine:		
Payment for medicine supply		30,000
Less: Amounts due for medicine supply on 1.1.2022		(9,000)
		21,000
Add: Amounts due for medicine supply on 31.12.2022		13,000
		34,000
Medicine consumed:		
Stock of medicine on 1.1.2022		10,000
Add: Purchase of medicine during the year		34,000
		44,000
Less: Stock of medicine on 31.12.2022		(15,000)

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		29,000
Depreciat on on equipment:		
Value of equipment on 1.1.2022		21,000
Add: Purchase of equipment during the year		15,000
		36,000
Less: Value of equipment on 31.12.2022		(30,000)
Depreciat on on equipment for the year		6,000

**Balance Sheet of Medical Aid Society
as on 1st January, 2022**

Liabilit es	₹	Assets	₹
Capital fund (balancing f gure)	1,80,300	Building	50,000
Subscript on received in advance	1,200	Equipment	21,000
Amount due for medicine supply	9,000	Stock of medicine	10,000
		Investments (₹ 9,000 x 100/9)	1,00,000
		Subscript on receivable	1,500
		Cash in hand	8,000
	1,90,500		1,90,500

ILLUSTRATION 1

The receipts and payments for the Swaraj Club for the year ended March 31, 2022 were: Entrance fees ₹ 300; Membership Fees ₹ 3,000; Donation for Club Pavilion ₹ 10,000, Foodstuff sales ₹ 1,200; Salaries and Wages ₹ 1,200 Purchase of Foodstuff ₹ 800; Construction of Club Pavilion ₹11,000; General Expenses ₹ 600; Rent and Taxes ₹ 400; Bank Charges ₹ 160.

Cash in hand–April. 1st ₹ 200, March. 31st ₹ 350

Cash in Bank–April. 1st ₹ 400; March. 31st ₹ 590

You are required to prepare Receipts and Payment Account.

Answer

**Swaraj Club
Receipts and Payments Accounts
for the year ended 31st March, 2022**

Receipts	₹	Payments	₹
To Balance b/d(opening bal.) Cash in hand	200	By Salaries and Wages	1,200
To Cash with bank	400	By Purchase of Foodstuff	800
To Entrance Fees	300	By Club Pavilion (Expenditure on its construct on)	11,000
To Membership Fees	3,000	By General Expenses	600
To Donat on of Account of Club Pavilion	10,000	By Rent and Taxes	400
To Sales of foodstuf	1,200	By Bank Charges	160
		By Balance c/d (closing bal) Cash in hand	350
		Cash in bank	590
	15,100		15,100

ILLUSTRATION 2

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During 2022, subscription received in cash is ₹ 42,000. It includes ₹ 1,600 for 2021 and ₹ 600 for 2023. Also ₹ 3,000 has still to be received for 2022.

Required

Calculate the amount to be credited to Income and Expenditure Account in respect of subscription.

Answer

		₹
Amount received		42,000
Add : Outstanding on 31st Dec., 2022		3,000
		45,000
Less : Received on account of 2021	1,600	
2023	600	(2,200)
		42,800

The various accounts will appear as under:

Subscription Outstanding Account

2022		₹	2022		₹
Jan. 1	To Balance b/d	1,600	Dec. 31	By Subscript on A/c	1,600
	(transfer)				
Dec. 31	To Subscript on A/c	3,000	Dec. 31	By Balance c/d	3,000
		4,600			4,600
2023					
Jan. 1	To Balance b/d	3,000			

Subscription Account

2022		₹	2022		₹
Dec. 31	To Subscript on Outstanding A/c (transfer)	1,600	Dec. 31	By Cash A/c	42,000
Dec. 31	To Subscript on received in advance A/c	600	Dec. 31	By Subscript on Outstanding A/c	3,000
Dec. 31	To Income and Expenditure A/c	42,800			
		45,000			45,000

Subscription received in Advance Account

2022		₹	2022		₹
Dec. 31	To Balance c/d	600	Dec. 31	By Subscript on A/c	600
			2023		
			Jan. 1	By Balance b/d	600

Subscript on outstanding ₹ 3,000 and Subscript on received in advance ₹ 600 will be shown in the balance sheet on the assets and liabilities side respectively.

ILLUSTRATION 3

Suppose salaries paid during 2022 were ₹ 23,000. The following further information is available:

		₹
Salaries unpaid on 31st March,	2021	1,400
Salaries pre-paid on 31st March,	2021	400
Salaries unpaid on 31st March,	2022	1,800
Salaries pre-paid on 31st March,	2022	600

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Required

Calculate the amount to be debited to Income and expenditure account in respect of salaries and also show necessary ledger accounts.

Answer
Salaries Account

Date	Particulars	₹	Date	Particulars	₹
April, 1, 2021	To Prepaid Salaries A/c	400	April, 1, 2021	By Salaries Outstanding A/c	1,400
March, 31, 2022	To Cash	23,000	March, 31, 2022	By Salaries Prepaid A/c	600
	To Salaries Outstanding A/c	1,800		By Transfer to Income & Expenditure A/c	23,200
		25,200			25,200

Salaries Outstanding Account

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
April, 1, 2021	To Salaries A/c	1,400	April, 1, 2021	By Balance b/d	1,400
March, 31, 2022	To Balance c/d	1,800	March, 31, 2022	By Salaries A/c	1,800
		3,200			3,200
			April, 1, 2022	By Balance b/d	1,800

Salaries Prepaid Account

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
April, 2021	To Balance b/d	400	April, 1, 2021	By Salaries A/c (transfer)	400
March, 31, 2022	To Salaries A/c	600	March, 31, 2022	By Balance c/d	600
		1,000			1,000
April, 1, 2022	To Balance b/d	600			

ILLUSTRATION 4

Following is the Receipts and Payments Account of New bird Forty Club for the year ended 31st March, 2022:

Dr. Receipts and payments A/c for the year ended on 31 st March 2022			Cr.	
Receipts	Amount ₹	Payments	Amount ₹	
To balance b/d	2,50,000	By Salaries and wages	1,65,000	
To Subscript on- 2020-2021	65,000	By Office expenses	35,000	
2021-2022	3,55,000	By Sports equipment	3,42,000	
To Donations	55,000	By Telephone Charges	28,000	
To Entrance fees	85,000	By Electricity charges	32,000	
		By Travelling and conveyance	65,000	
		By balance c/d	1,43,000	
	8,10,000		8,10,000	

Additional information :

- Outstanding subscriptions for the year ended 31st March, 2022 – ₹ 55,000.
- Outstanding salaries and wages – ₹ 40,000 for the year ended on 31st March 2022.
- Depreciate sports equipment by 25% for the year ended on 31st March 2022.

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(d) Capitalize 50% of the entrance fees.

Prepare Income and Expenditure Account of the club from the above particulars for the year ended on 31st March 2022.

Answer

In the books of New bird forty Club

Dr. Income and expenditure Account for the year ended on 31 st March 2022 Cr.			
Expenditure	Amount ₹	Income	Amount ₹
Salaries and wages 1,65,000		By Subscript ons 4,20,000	
Add: Outstanding Salaries for 2022 40,000	2,05,000	Add: Outstanding Subscript ons for 2022 55,000	
To Of ce expenses	35,000	Less: Outstanding	
To Depreciat on (25% × 3,42,000)	85,500	Subscript ons for 2021 65,000	4,10,000
To Telephone Charges	28,000	By Donat ons	55,000
To Electricity charges	32,000	By Entrance fees (50% × 85,000)	42,500
To Travelling and conveyance	65,000		
Excess of income over expenditure	57,000		
	5,07,500		5,07,500

ILLUSTRATION 5

From the following information of a club show the amounts of match expenses and match fund in the appropriate Financial Statements of the club for the year ended on 31st March, 2022:

Details	Amount ₹
Match expenses paid during the year ended 31st March 2022	1,10,000
Match fund as on 01.04.2021	30,000
Donat ons for Match fund (received during the year)	55,000
Proceeds from the sale of the match t ckets (during the year)	20,000

Answer

Balance sheet as at March 31st 2022 (extract)

Liabilit es	Amount ₹	Assets	Amount ₹
Match fund	30,000		
Add: Donat on for match fund	55,000		
Add: Proceeds from sale of t ckets	20,000		
Less: Match expenses (Note)	(1,05,000)		
	NIL		

Note: Since the expenses incurred are more than the Match fund available ₹ 1,05,000 we are limiting the expenses to ₹ 1,05,000. The remaining expenses of ₹ 5000 (1,10,000-1,05,000) will be debited to the Income and expenditure account.

ILLUSTRATION 6

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During the year ended 31st March, 2022, the subscriptions received by the Jaipur Literary Society were ₹ 4,50,000. These subscriptions include ₹ 20,000 received for the year ended 31st March, 2021. On 31st March, 2022, subscriptions due but not received were ₹ 15,000. Advance subscription on received for the year ending 31st March 2022 but pertaining to year 2023 amounted to ₹ 26,000. The Subscriptions received in advance for the year ending 31st March, 2021 includes ₹ 18,000 pertaining to year 2021-22. Show the subscription account in book of the society?

Answer

In the books of Jaipur literary society			
Dr.	Subscription A/c (for the year ended on 31st March 2022)		Cr.
Particulars	Amount ₹	Particulars	Amount ₹
To outstanding subscriptions (2021)	20,000	By Advance subscriptions (2021)	18,000
To Income from Subscriptions A/c	4,37,000	By Bank A/c	4,50,000
To Advance subscriptions (2023)	26,000	By Outstanding subscriptions (2022)	15,000
	4,83,000		4,83,000

ILLUSTRATION 7

From the following information, calculate amount of subscriptions outstanding for the year ended 31st March, 2022.

A club has 350 members each paying an annual subscription of ₹ 1,050. The Receipts and Payments Account for the year showed a sum of ₹ 4,10,000 received as subscriptions. The following additional information is provided:

Subscriptions Outstanding on 31st March, 2021 – ₹45,000

Subscriptions Received in Advance on 31st March, 2022 – ₹ 62,000

Subscriptions Received in Advance on 31st March, 2021 – ₹ 30,000

Answer

Subscription Account			
Particulars	Amount ₹	Particulars	Amount ₹
To Outstanding subscriptions (2021)	45,000	By Advance subscriptions (2021)	30,000
To Income from subscriptions A/c (350*1050)	3,67,500	By Bank A/c	4,10,000
To Advance subscriptions (2023)	62,000	By Outstanding subscriptions (2021)	34,500
	4,74,500		4,74,500

ILLUSTRATION 8

The following was the Receipts and Payments Account of Exe Club for the year ended March. 31, 2022

All the figures in thousands

Receipts	₹	Payments	₹
Cash in hand	100	Groundsman's Fee	750
Balance at Bank as per Pass Book:		Moving Machine	1,500
Deposit Account	2,230	Rent of Ground	250
Current Account	600	Cost of Teas	250
Bank Interest	30	Fares	400
Donations and Subscriptions	2,600	Printing & Office Expenses	280
Receipts from teas	300	Repairs to Equipment	500

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Contribution to fares	100	Honorarium to Secretary and Treasurer of 2021	400
Sale of Equipment	80	Balance at Bank as per Pass Book:	
Net proceeds of Variety Entertainment	780	Deposit Account	3,090
Donation for forthcoming Tournament	1,000	Current Account	150
	7,820	Cash in hand	250
			7,820

You are given the following additional information on:

	April, 1, 2021	March, 31, 2022
	₹	₹
Subscription due	150	100
Amount due for printing etc.	100	80
Cheques unpresented being payment for repairs	300	260
Estimated value of machinery and equipment	800	1,750
Interest not yet entered in the Pass book		20
Bonus to Groundsman outstanding		300

For the year ended March 31, 2022, the honorarium to the Secretary and Treasurer are to be increased by a total of ₹ 200. Prepare the Income and Expenditure Account and Balance Sheet for period ending 31st March, 2022.

Answer

**Income and Expenditure Account of Exe Club
for the year ending 31st March, 2022**

All the figures in thousands

Expenditure		₹	Income	₹
To Groundsman's fee		750	By Donations and Subscription	2,550
To Rent of Ground		250	By Receipts from teas (Fares) less expenses (₹ 300 - ₹ 250)	50
To Fares' Expenses	400		By Proceeds of Variety Entertainment	780
Less: Contribution	(100)	300	By Interest (₹ 30 + ₹ 20)	50
To Printing & Office Expenses		260		
To Repairs		460		
To Depreciation on Machinery				
Opening balance and Purchases	2,300			
Less: Closing Balance	(1,750)			
	550			
Less: Sale	(80)	470		
To Honorarium to Sect. & Treasurer		600		
To Bonus to Groundsman		300		
To Excess of Income over Expenditure		40		
		3,430		3,430

Balance Sheet of Exe Club as on 31st March, 2022

Liabilities		₹	Assets	₹
Outstanding Expenses:				

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Groundsman Bonus		300	Cash in hand	250
Printing		80	Cash in Deposit A/c	3,090
Honorarium		600	Subscription Due	100
Bank Overdraft (₹260 – ₹150)		110	Interest Due	20
Capital Fund: Opening	3,080		Machinery & Equipments	1,750
Add: Surplus for the year	40	3,120		
Tournament Fund (Donation)		1,000		
		5,210		5,210

Balance Sheet as on 1st April, 2021

Liabilities	₹	Assets	₹
Outstanding Expenses and		Cash in hand	100
Honorarium (₹100 + ₹400)	500	Cash in Deposit A/c	2,230
Capital Fund (Balancing Figure)	3,080	Cash in Current A/c	300
		Subscription Due	150
		Machinery	800
	3,580		3,580

ILLUSTRATION 9

The Sportwriters Club gives the following Receipts and Payments Account for the year ended March 31, 2022:

Receipts and Payments Account

Receipts		₹	Payments		₹
To	Balance b/d	4,820	By	Salaries	12,000
To	Subscriptions	28,600	By	Rent and electricity	7,220
To	Miscellaneous income	700	By	Library books	1,000
To	Interest on Fixed deposit	2,000	By	Magazines and newspapers	2,172
			By	Sundry expenses	10,278
			By	Sports equipments	1,000
			By	Balance c/d	2,450
		36,120			36,120

Figures of other assets and liabilities are furnished as follows:

	As at March 31	
	₹	₹
	2021	2022
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	

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Sports equipments	7,200	
Library books	5,000	

The closing values of furniture and sports equipments 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, 2022 was ₹ 5,250.

Required

From the above information you are required to prepare:

- The Club's Balance Sheet as at March 31, 2021;
- The Club's Income and Expenditure Account for the year ended March 31, 2022.
- The Club's Closing Balance Sheet as at March 31, 2022.

Answer

(a)

Sportswriters Club
Balance Sheet as on 31st March, 2021

Liabilities	₹	₹	Assets	₹
Outstanding expenses:			Furniture	9,600
Salaries	710		Library Books	5,000
Rent & Electricity	864		Sports Equipment	7,200
Magazines & Newspapers	226	1,800	Fixed Deposit	20,000
Capital Fund (Balancing figure)		47,000	Cash in hand & at Bank	4,820
			Prepaid Expenses	417
			Subscription receivable	1,263
			Interest accrued	500
		48,800		48,800

(b) **Income and Expenditure Account for the year ending 31st March, 2022**

Receipts		₹	Payments	₹
To Salaries		11,460	By Subscription	28,912
To Rent & Electricity		7,329	By Interest on Fixed Deposit	2,000
To Magazines & Newspapers		2,286	By Misc. Income	700
To Sundry Expenses		10,075	By Excess of expenditure over income	2,888
To Depreciation:				
Furniture	960			
Sports Equipment	1,640			
Library Books	750	3,350		
		34,500		34,500

(c) **Balance Sheet of Sports Writers Club**
as on 31st March, 2022

Liabilities	₹	₹	Assets	₹	₹
Outstanding Expenses:			Furniture		
Salaries	170		Cost	9,600	
Rent & Electricity	973		Less : Depreciation on Magazines & Sport Equipment:	(960)	8,640
Newspapers	340	1,483	Opening balance	7,200	
Capital Fund:			Addition	1,000	

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Opening balance	47,000			8,200	
Less : Excess of exp. over income	(2,888)	44,112	Less : Depreciat on	(1,640)	6,560
			Library Books :		
			Opening Balance	5,000	
			Addit on	1,000	
				6,000	
			Less : Depreciat on	(750)	5,250
			Fixed Deposit		20,000
			Cash in hand & at bank		2,450
			Prepaid Expenses		620
			Subscript on Receivable		1,575
			Interest accrued		500
		45,595			45,595

Working Notes:

(i)	Expenses	Salaries ₹	Rent & Electricity ₹	Magazines & News- Papers ₹	Sundry Expenses ₹
	Paid during the year	12,000	7,220	2,172	10,278
	Add : Outstanding on 31.3.2022	170	973	340	—
	Add : Prepaid on 31.3.2021	—	—	—	417
		12,170	8,193	2,512	10,695
	Less : Outstanding on 31.3.2021	(710)	(864)	(226)	—
	Less : Prepaid on 31.3.2022	—	—	—	(620)
	<u>Expenditure for the year</u>	<u>11,460</u>	<u>7,329</u>	<u>2,286</u>	<u>10,075</u>
					₹
(ii)	Depreciat on				
	(a) Furniture @10% on ₹ 9,600				960
	(b) Sports Equipment @ 20% on ₹ 8,200				1,640
	(c) Library books - book value			6,000	
	Revalued at			<u>(5,250)</u>	750
(iii)	Subscript on				
	Received in cash				28,600
	Add : Receivable on 31.3.2022				1,575
					30,175
	Less: Receivable on 31.3.2021				(1,263)
					28,912

ILLUSTRATION 10

The Income and Expenditure Account of the Youth Club for the Year 2022 is as follows:

Expenditure		₹	Income		₹
To	Salaries	4,750	By	Subscript on	7,500
To	General Expenses	500	By	Entrance Fees	250
To	Audit Fee	250	By	Contribut on for annual	1,000

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				dinner	
To	Secretary’s Honorarium	1,000	By	Annual Sport meet receipts	750
To	Stat onery & Print ng	450			
To	Annual Dinner Expenses	1,500			
To	Interest & Bank Charges	150			
To	Depreciat on	300			
To	Surplus	600			
		9,500			9,500

This account had been prepared after the following adjustments:

	₹
Subscription outstanding at the end of 2021	600
Subscription received in advance on 31st December, 2021	450
Subscription received in advance on 31st December, 2022	270
Subscription outstanding on 31st December, 2022	750

Salaries Outstanding at the beginning and the end of 2022 were respectively ₹ 400 and ₹ 450. General Expenses include insurance prepaid to the extent of ₹ 60. Audit fee for 2022 is as yet unpaid. During 2022 audit fee for 2021 was paid amounting to ₹ 200. The Club owned a freehold lease of ground valued at ₹ 10,000. The club had sports equipment on 1st January, 2022 valued at ₹ 2,600. At the end of the year, after depreciation, this equipment amounted to ₹ 2,700. In 2021, the Club has raised a bank loan of ₹ 2,000. This was outstanding throughout 2022. On 31st December, 2022 cash in hand amounted to ₹ 1,600.

Required

Prepare the Receipts and Payments Account for 2022 and Balance Sheet as at the end of the year.

Answer

The Youth Club
Receipts and Payments Account for the year ended 31st December, 2022

Receipts		₹	₹	Payments		₹	₹
To	Balance b/d (balancing figure)		1,390	By	Salaries	4,750	
To	Subscriptions as per Income & Expenditure Account	7,500			Add: Paid for 2021	400	
	Add: 2021's Received	600				5,150	
	2023's Received	270			Less: Unpaid for 2022	(450)	4,700
		8,370		By	General Expenses	500	
	Less: 2022's Received in 2021	(450)			Add : Paid for 2023	60	560
		7920					
	Less: 2022's Outstanding	(750)	7,170	By	Audit fee (2022)		200
To	Entrance Fees		250	By	Secy. Honorarium		1,000
To	Contribution for annual		1,000	By	Stationery & Printing		450

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	dinner					
To	Annual sport meet receipt		750	By	Annual Dinner Expenses	1,500
				By	Interest & Bank Charges	150
				By	Sports Equipments [2700 - (2600 - 300)]	400
				By	Balance c/d	1,600
			10,560			10,560
To	Balance b/d		1,600			

Balance Sheet of Youth Club as on December 31, 2022

Liabilities	₹	₹	Assets	₹	₹
Subscriptions received in advance		270	Freehold Ground		10,000
Audit Fee Outstanding		250	Sport Equipment: As per last Balance Sheet	2,600	
Salaries Outstanding		450	Additions	400	
Bank Loan		2,000		3,000	
Capital Fund :			Less : Depreciation	(300)	2,700
Balance as per previous Balance Sheet	11,540		Subscriptions Outstanding		750
Add : Surplus for 2022	600	12,140	Insurance Prepaid		60
			Cash in hand		1,600
		15,110			15,110

Balance Sheet of Youth Club as on 31st December, 2021

Liabilities	₹	₹	Assets	₹
Subscriptions received in advance	450		Freehold Ground	10,000
Salaries outstanding	400		Sports Equipment	2,600
Audit fees unpaid	200		Subscriptions Outstanding	600
Bank Loan	2,000		Cash in hand	1,390
Capital Fund (balancing figure)	11,540			
	14,590			14,590

ILLUSTRATION 11

Smith Library Society showed the following position on 31st March, 2021:

Balance Sheet as on 31st March, 2021

Liabilities	₹	Assets	₹
Capital fund	7,93,000	Electrical fittings	1,50,000
Expenses payable	7,000	Furniture	50,000
		Books	4,00,000
		Investment in securities	1,50,000
		Cash at bank	25,000
		Cash in hand	25,000
	8,00,000		8,00,000

The receipts and payment account for the year ended on 31st March, 2022 is given below:

	₹	₹

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To Balance b/d		By Electric charges	7,200
Cash at bank 25,000		By Postage and stationery	5,000
Cash in hand <u>25,000</u>	50,000	By Telephone charges	5,000
To Entrance fee	30,000	By Books purchased	60,000
To Membership subscription	2,00,000	By Outstanding expenses paid	7,000
To Sale proceeds of old papers	1,500	By Rent	88,000
To Hire of lecture hall	20,000	By Investment in securities	40,000
To Interest on securities	8,000	By Salaries	66,000
		By Balance c/d	
		Cash at bank	20,000
		Cash in hand	11,300
	3,09,500		3,09,500

You are required to prepare income and expenditure account for the year ended 31st March, 2022 and a balance sheet as at 31st, March, 2022 after making the following adjustments: Membership subscription included ₹ 10,000 received in advance and 75% of the entrance fees is to be capitalized.

Rent for ₹ 4,000 and salaries for ₹ 3,000 are outstanding.

Books are to be depreciated @ 10% including additions. Electrical fittings and furniture are also to be depreciated at the same rate.

Interest on securities is to be calculated @ 5% p.a. including purchases made on 1.10.2021 for ₹ 40,000.

Answer

Smith Library Society
Income and Expenditure Account
for the year ended 31st March, 2022

Dr.					Cr.
Expenditure	₹	₹	Income		₹
To Electric charges		7,200	By Entrance fee (25% of ₹ 30,000)		7,500
To Postage and stationery		5,000	By Membership subscription	2,00,000	
To Telephone charges		5,000	Less: Received in advance	<u>10,000</u>	1,90,000
To Rent	88,000		By Sale proceeds of old papers		1,500
Add: Outstanding	<u>4,000</u>	92,000	By Hire of lecture hall		20,000
To Salaries	66,000		By Interest on securities (W.N.2)	8,000	
	<u>3,000</u>	69,000	Add: Receivable	<u>500</u>	8,500
To Depreciation (W.N.1)			By Deficit - excess of expenditure over income		16,700
Electrical fittings	15,000				
Furniture	5,000				
Books	<u>46,000</u>	66,000			
		<u>2,44,200</u>			<u>2,44,200</u>

Balance Sheet of Smith Library Society

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as on 31st March, 2022

Liabilities	₹	₹	Assets	₹	₹
Capital fund	7,93,000		Electrical fittings	1,50,000	
Add: Entrance fees	<u>22,500</u>		Less: Depreciation	<u>(15,000)</u>	1,35,000
	8,15,500		Furniture	50,000	
Less: Excess of expenditure over income	<u>(16,700)</u>	7,98,800	Less: Depreciation	<u>(5000)</u>	45,000
Outstanding expenses:			Books	4,60,000	
Rent	4,000		Less: Depreciation	<u>(46,000)</u>	4,14,000
Salaries	<u>3,000</u>	7,000	Investment:		
Membership subscription in advance		<u>10,000</u>	Securities	1,90,000	
			Accrued interest	<u>500</u>	1,90,500
			Cash at bank		20,000
			Cash in hand		<u>11,300</u>
		<u>8,15,800</u>			<u>8,15,800</u>

Working Notes:

1.	Depreciation		₹
	Electrical fittings 10% of ₹1,50,000		15,000
	Furniture 10% of ₹50,000		5,000
	Books 10% of ₹4,60,000		46,000
2.	Interest on Securities		
	Interest @ 5% p.a. on ₹1,50,000 for full year	7,500	
	Interest @ 5% p.a. on ₹40,000 for half year	<u>1,000</u>	8,500
	Less: Received		<u>(8,000)</u>
	Receivable		500

ILLUSTRATION 12

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, 2022:

Income & Expenditure Account for the year 2021-22

To	₹	By	₹
Upkeep of Ground	10,000	Subscriptions	17,320
Printing	1,000	Sale of Newspapers (Old)	260
Salaries	11,000	Lectures	1,500
Depreciation on Furniture	1,000	Entrance Fee	1,300
Rent	600	Miscellaneous Income	400
		Deficit	2,820
	23,600		23,600

Balance Sheet as at 31st March, 2022

Liabilities	₹	Assets	₹

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Subscript on in Advance (2022-23)		100	Furniture	9,000
Prize Fund :			Ground and Building	47,000
Opening Balance	25,000		Prize Fund Investment	20,000
Add : Interest	1,000		Cash in Hand	2,300
	26,000		Subscript on(outstanding) (2021-22)	700
Less : Prizes	(2,000)	24,000		
General Fund :				
Opening Balance	56,420			
Less : Def cit	(2,820)			
	53,600			
Add : Entrance Fee	1,300	54,900		
		79,000		79,000

The following adjustments have been made in the above accounts:

- (1) Upkeep of ground ₹ 600 and Printing ₹ 240 relating to 2020-2021 were paid in 2021-22.
- (2) One-half of entrance fee has been capitalised by transfer to General Fund.
- (3) Subscription outstanding in 2020-21 was ₹ 800 and for 2021-22 ₹ 700.
- (4) Subscription received in advance in 2020-21 was ₹ 200 and in 2021-22 for 2022-23 ₹ 100.

Solution

Receipts and Payments Account for the year ending 31st March, 2022

Receipts	₹	Payments	₹
To Balance b/d (Balancing figure)	4,660	By Upkeep of Ground (10,000 + 600)	10,600
To Subscription	17,320	By Printing (1,000 + 240)	1,240
To Interest on Prize Fund	1,000	By Salaries	11,000
To Lecture (fee)	1,500	By Rent	600
To Entrance Fee	2,600	By Prizes	2,000
To Sale of Newspapers (old)	260	By Balance c/d	2,300
To Misc. Income	400		
	27,740		27,740

Note: In order to arrive at the payments under Upkeep of ground and printing, even the payment for 2020-21 has been considered, as receipts and payments A/c shows all the period payments

Subscription Account

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2021		₹	2021		₹
April	To Subscript on Outstanding(2020-2021)	800	April 1	By Cash(Balancing Figure)	17,320
	To Subscript on In Advance	100		By Subscript on Outstanding	700
2022 March	To Income & Expenditure A/C	17,320		By Subscript on In Advance	200
		18,220			18,220

ILLUSTRATION 13

From the following balances and particulars of Republic College, prepare Income & Expenditure Account for the year ended March, 2022 and a Balance Sheet as on the date :

	₹	₹
Seminars & Conference Receipts		4,80,000
Consultancy Receipts		1,28,000
Security Deposit - Students		1,50,000
Capital Fund		16,06,000
Research Fund		8,00,000
Building Fund		25,00,000
Provident Fund		5,10,000
Tuition Fee Received		8,00,000
Government Grants		5,00,000
Donations		50,000
Interest & Dividends on Investments		1,85,000
Hostel Room Rent		1,75,000
Mess Receipts (Net)		2,00,000
College Stores-Sales		7,50,000
Outstanding expenses		2,25,000
Stock of-stores and Supplies (opening)	3,00,000	
Purchases - Stores & Supplies	8,00,000	
Salaries - Teaching	8,50,000	
Research	1,20,000	
Scholarships	80,000	
Students Welfare expenses	38,000	
Repairs & Maintenance	1,12,000	
Games & Sports Expenses	50,000	
Misc. Expenses	65,000	
Research Fund Investments	8,00,000	
Other Investments	18,50,000	
Provident Fund Investment	5,10,000	
Seminar & Conference Expenses	4,50,000	

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Consultancy Expenses	28,000	
Land	1,00,000	
Building	16,00,000	
Plant and Machinery	8,50,000	
Furniture and Fittings	6,00,000	
Motor Vehicle	1,80,000	
Provision for Depreciation:		
Building		4,80,000
Plant & Equipment		5,10,000
Furniture & Fittings		3,36,000
Cash at Bank	6,42,000	
Library	3,60,000	
	1,03,85,000	1,03,85,000

Adjustments:

	₹
(1) Materials & Supplies consumed: (From college stores)	
Teaching Staff	2,00,000
Students Welfare	75,000
Games or Sports	25,000
(2) Tuition fee receivable from Government for backward class Scholars	80,000
(3) Stores selling prices are fixed to give a net profit of 10% on selling price	
(4) Depreciation is provided on straight line basis at the following rates:	
(1) Building	5%
(2) Plant & Equipment	10%
(3) Furniture & Fixtures	10%
(4) Motor Vehicle	20%

Answer
Republic College
Income and Expenditure Account for the year ending 31st March, 2022

Expenditure	₹	₹	Income	₹	₹
To Salaries: Teaching staf		9,70,000	By Tuit ons & other fee		8,80,000
To Material & Supplies Consumed: Teaching staf		2,00,000	By Govt. Grants		5,00,000
To Repairs & Maintenance		1,12,000	By Income from Investments		1,85,000
To Sports & Games Expenses:			By Hostel room rent		1,75,000
Cash	50,000		By Mess Receipts		2,00,000
Materials	25,000	75,000	By Prof t-Stores Sales		75,000

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To Students Welfare Expenses:			By Seminar and Conferences:		
Cash	38,000		Income	4,80,000	
Materials	75,000	1,13,000	By Less: Expenses	(4,50,000)	30,000
To Misc. Expenses		65,000	By Consultancy charges:Income	1,28,000	
To Scholarships		80,000	Less : Expenses	28,000	1,00,000
To Depreciat on:			By Donat ons		50,000
Building		80,000			
Plant & Equipment		85,000			
Furniture		60,000			
Motor Vehicle		36,000			
To Excess of Income over Expenditure		3,19,000			
		21,95,000			1,95,000

Republic College
Balance Sheet as on 31st March, 2022

Liabilit es	₹	₹	Assets	₹	₹
			Fixed Assets:		
Capital Fund			Land		1,00,000
Opening balance	16,06,000		Building Cost	16,00,000	
Add: Excess of Income over Expenditure	3,19,000	19,25,000	Less: Depreciat on	(5,60,000)	10,40,000
Other Funds			Equipment Cost	8,50,000	
Research Fund		8,00,000	Less: Depreciat on	(5,95,000)	2,55,000
Building Fund		25,00,000	Furniture & Fit ngs:		
Current Liabilit es :			Cost	6,00,000	
Outstanding Expenses		2,25,000	Less: Depreciat on Motor Vehicles	(3,96,000)	2,04,000
Provident Fund		5,10,000	Cost	1,80,000	
Security Deposit		1,50,000	Less: Depreciat on	(36,000)	1,44,000
			Library		3,60,000
			Investments:		
			Capital Fund Investments		18,50,000
			Research Fund Investment		8,00,000
			P.F. Investment Stock (stores)		5,10,000
			Material & Supplies		1,25,000
			Tuit on fees receivable		80,000
			Cash in hand & at Bank		6,42,000
		61,10,000			61,10,000

Working Notes:
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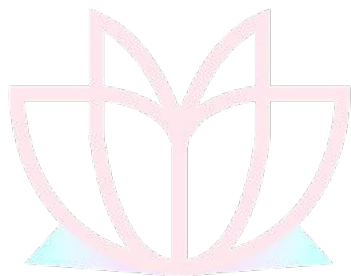
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			₹	₹
(1)	Material & Supplies - Closing Stock			
	Opening Stock			3,00,000
	Purchases			8,00,000
				11,00,000
	Less: Cost of Material & Supplies [7,50,000*90% (100-10)]		6,75,000	
	Consumed		3,00,000	(9,75,000)
	Balance			1,25,000
(2)	Provisions for Depreciat on	Building	Plant & Equipment	Furniture & Fit ng
		₹	₹	₹
	Opening Balance	4,80,000	5,10,000	3,36,000
	Addit on	80,000	85,000	60,000
	Closing Balance	5,60,000	5,95,000	3,96,000
	Note: Expense related to income earned like consultancy charges, conference expenses are shown as net of income.			



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Chapter 9

Accounts From Incomplete Records

275

True and false

Question 1

A Trial Balance cannot be drawn up from books kept under Single Entry.

Answer 1

True: Since incomplete records are maintained, trial balance cannot be prepared

Question 2

Nominal Accounts are kept under Single Entry System.

Answer 2

False: Under the single entry system of bookkeeping, generally cash book and personal accounts of creditors and debtors are maintained, and no other ledger is maintained.

Question 3

Single Entry System can be adopted by small firms.

Answer 3

True: A single entry system is the one where financial transactions are recorded as a single entry in a log and is usually used by new small businesses.

Question 4

Profit under single entry system is always correct and accurate.

Answer 4

False: Profit under single entry system is only an estimate based on available information and correct profits cannot be determined.

Question 5

Profits computed under single entry system by different business entities are not comparable.

Answer 5

True: Since entry system has no fixed set of principles for recording the financial transaction, different organisations maintain records as per their needs. Hence their accounts are not comparable.

Multiple Choice Questions

1. **In case of net worth method, profit is determined by**
 - (a) Preparing a trading and profit and loss account.
 - (b) Comparing the capital in the beginning with the capital at the end of the accounting period.
 - (c) Comparing the net assets in the beginning with the net assets at the end of the accounting

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period.

Answer 1 (b)

2. Single entry system can be followed by

- (a) Small firms.
- (b) Joint stock companies.
- (c) Co-operative societies.

Answer 2 (a)

3. Closing capital is calculated as

- (a) Opening capital + Additional capital - Drawings.
- (b) Opening capital + Additional capital - Drawings + Profit.
- (c) Opening capital + Additional capital + Drawings - Profit.

Answer 3 (b)

4. Under single entry system, only personal accounts are kept and, in some cases,

- (a) Cash book is maintained
- (b) Fixed assets' accounts are maintained
- (c) Liabilities' accounts are maintained.

Answer 4 (a)

5. The closing capital of Mr. B as on 31.3.2022 was ₹4,00,000. On 1.4.2021 his capital was ₹ 3,50,000. His net profit for the year ended 31.3.2022 was ₹ 1,00,000. He introduced ₹30,000 as additional capital in February, 2022 Find out the amount drawn by Mr. B for his domestic expenses.

- (a) ₹ 1,00,000;
- (b) ₹ 80,000;
- (c) ₹1,20,000;

Answer 5 (b)

6. Giving Information

Opening capital:	60,000
Drawings:	5,000
Capital introduced during the period:	10,000
Closing capital:	90,000

Profit earned during the period ?

- (a) ₹ 20,000
- (b) ₹ 25,000
- (c) ₹ 30,000.

Answer 6 (b)

Theoretical Questions

Question 1

What is meant by Single entry System? What are the types of procedures adopted for this system?

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Answer 1

Single entry system is an inaccurate and unsystematic method of recording business transactions. The procedures adopted are: Pure single entry; Simple entry and Queasy single entry. For details, Refer Para 1 and 2 of the chapter.

Question 2

Differentiate between Statement of Affairs and Balance Sheet.

Answer 2

To understand the difference between Statement of Affairs and Balance Sheet, refer para 3.2 of the chapter.

Practical Question
Question 1

A Firm sold 20% of the goods on cash basis and the balance on credit basis. Debtors are allowed 1½ month's credit and their balance as on 31.03.2021 is ₹ 1,25,000. Assume that the sale is uniform throughout the year. Calculate the credit sales and total sales of the company for the year ended 31.03.2022.

Answer 1

Calculation of Credit Sales and Total sales

$$\text{Credit Sales for the year ended 2021-22} = \text{Debtors} \times \frac{12 \text{ Months}}{1.5 \text{ Months}}$$

$$= ₹ 1,25,000 \times \frac{12 \text{ Months}}{1.5 \text{ Months}} = ₹ 10,00,000$$

$$\text{Total sales for the year ended 2021-22} = \text{Credit Sales} \times \frac{100\%}{80\%}$$

$$= ₹ 10,00,000 \times \frac{100\%}{80\%} = ₹ 12,50,000$$

Question 2

Mr. A runs a business of readymade garments. He closes the books of accounts on 31st March. The Balance Sheet as on 31st March, 2021 was as follows:

Liabilities	₹	Assets	₹
A's capital a/c	4,04,000	Furniture	40,000
Creditors	82,000	Stock	2,80,000
		Debtors	1,00,000
		Cash in hand	28,000
		Cash at bank	38,000
	4,86,000		4,86,000

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- (1) His sales, for the year ended 31st March, 2022 were 20% higher than the sales of previous year, out of which 20% sales was cash sales.
Total sales during the year 2020-21 were ₹ 5,00,000.
- (2) Payments for all the purchases were made by cheques only.
- (3) Goods were sold for cash and credit both. Credit customers pay by cheques only.
- (4) Depreciation on furniture is to be charged 10% p.a.
- (5) Mr. A sent to the bank the collection of the month at the last date of the each month after paying salary of ₹ 2,000 to the clerk, office expenses ₹ 1,200 and personal expenses ₹ 500.

Analysis of bank pass book for the year ending 31st March 2022 disclosed the following:

	₹
Payment to creditors	3,00,000
Payment of rent up to 31st March, 2022	16,000
Cash deposited into the bank during the year	80,000

The following are the balances on 31st March, 2022:

	₹
Stock	1,60,000
Debtors	1,20,000
Creditors for goods	1,46,000

On the evening of 31st March 2022, the cashier absconded with the available cash in the cash book. You are required to prepare Trading and Profit and Loss A/c for the year ended 31st March, 2022 and Balance Sheet as on that date. All the workings should form part of the answer.

Answer 2

In the books of Mr. A

Trading Account for the year ending 31st March, 2022

Particulars	₹	Particulars	₹
To Opening stock	2,80,000	By Sales (W.N. 3)	
To Purchases (W.N. 1)	3,64,000	Credit	4,80,000
To Gross profit (b.f.)	1,16,000	Cash	1,20,000
		By Closing stock	1,60,000
	7,60,000		7,60,000

Profit and Loss Account for the year ending 31st March, 2022

Particulars	₹	Particulars	₹
To Salary (2,000 x 12)	24,000	By Gross profit	1,16,000
To Rent	16,000		
To Office expenses (1,200 x 12)	14,400		
To Loss of cash (W.N. 6)	23,600		
To Depreciation on furniture	4,000		
To Net Profit (b.f.)	34,000		

	1,16,000		1,16,000

Balance Sheet as on 31st March, 2022

Liabilities		₹	Assets		₹
A's Capital	4,04,000		Furniture	40,000	
Add: Net Profit	34,000		Less: Depreciation	(4,000)	36,000
Less: Drawings			Stock		1,60,000
(500 x 12)	(6,000)	4,32,000	Debtors		1,20,000
Creditors		1,46,000	Cash at bank		2,62,000
		5,78,000			5,78,000

Working Notes:
(1) Calculation of purchases
Creditors Account

Particulars	₹	Particulars	₹
To Bank A/c To Balance c/d	3,00,000 1,46,000	By Balance b/d By Purchases (Bal. f.g.)	82,000 3,64,000
	4,46,000		4,46,000

(2) Calculation of total sales

	₹
Sales for the year 2020-21	5,00,000
Add: 20% increase	1,00,000
Total sales for the year 2021-22	6,00,000

(3) Calculation of credit sales

	₹
Total sales	6,00,000
Less: Cash sales (20% of total sales)	(1,20,000)
	4,80,000

(4) Calculation of cash collected from debtors
Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d To Sales A/c	1,00,000 4,80,000	By Bank A/c (Bal. f.g.) By Balance c/d	4,60,000 1,20,000

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	5,80,000		5,80,000

(5) **Calculation of closing balance of cash at bank**

Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	38,000	By Creditors A/c	3,00,000
To Debtors A/c	4,60,000	By Rent A/c	16,000
To Cash A/c	80,000	By Balance c/d (b.f.)	2,62,000
	5,78,000		5,78,000

(6) **Calculation of the amount of cash defalcated by the cashier**

		₹
Cash balance as on 1st April 2021		28,000
Add: Cash sales during the year		1,20,000
		1,48,000
Less: Salary (₹2,000x12)	24,000	
Office expenses (₹1,200 x 12)	14,400	
Drawings of A (₹500x12)	6,000	
Cash deposited into bank during the year	80,000	(1,24,400)
Cash balance as on 31st March 2022 (defalcated by the cashier)		23,600

Question 3

Ram carried on business as retail merchant. He has not maintained regular account books. However, he always maintained ₹ 10,000 in cash and deposited the balance into the bank account. He informs you that he has sold goods at profit of 25% on sales.

Following information is given to you:

Assets and Liabilities	As on 1.4.2021	As on 31.3.2022
Cash in Hand	10,000	10,000
Sundry Creditors	40,000	90,000
Cash at Bank	50,000 (Cr.)	80,000 (Dr.)
Sundry Debtors	1,00,000	3,50,000
Stock in Trade	2,80,000	?
Ram's capital	3,00,000	?

Analysis of his bank pass book reveals the following information:

- Payment to creditors ₹ 7,00,000
- Payment for business expenses ₹ 1,20,000
- Receipts from debtors ₹ 7,50,000
- Loan ₹ 1,00,000 taken on 1.10.2021 at 10% per annum
- Cash deposited in the bank ₹ 1,00,000

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He informs you that he paid creditors for goods ₹ 20,000 in cash and salaries ₹ 40,000 in cash. He has drawn ₹ 80,000 in cash for personal expenses. During the year Ram had not introduced any additional capital. Surplus cash if any, to be taken as cash sales. All purchases are on credit basis. You are required to prepare Trading and Profit and Loss Account for the year ended 31.3.2022 and Balance Sheet as at 31st March, 2022.

Answer 3

**Trading Account of Ram
for the year ended 31st March, 2022**

		₹			₹
To	Opening stock	2,80,000	By	Sales	
To	Purchases	7,70,000		Cash	2,40,000
To	Gross Profit @ 25%	3,10,000		Credit	<u>10,00,000</u>
			By	Closing Stock (bal. fig.)	1,20,000
		13,60,000			13,60,000

Profit and Loss Account of Ram for the year ended 31st March, 2022

		₹			₹
To	Salaries	40,000	By	Gross Profit	3,10,000
To	Business expenses	1,20,000			
To	Interest on loan (10% of 1,00,000 x 6/12)	5,000			
To	Net Profit	1,45,000			
		3,10,000			3,10,000

Balance Sheet of Ram as at 31st March, 2022

Liabilities	₹	₹	Assets	₹
Ram's capital:			Cash in hand	10,000
Opening	3,00,000		Cash at Bank	80,000
Add: Net Profit	1,45,000		Sundry Debtors	3,50,000
	4,45,000		Stock in trade	1,20,000
Less: Drawings	(80,000)	3,65,000		
Loan (including interest due)		1,05,000		
Sundry Creditors		90,000		
		5,60,000		5,60,000

Working Notes:

1. Sundry Debtors Account

		₹			₹
To	Balance b/d	1,00,000	By	Bank A/c By	7,50,000
To	Credit sales (Bal. fig)	10,00,000		Balance c/d	3,50,000
		11,00,000			11,00,000

2. Sundry Creditors Account

		₹			₹
To	Bank A/c	7,00,000	By	Balance b/d	40,000
To	Cash A/c	20,000	By	Purchases (Bal. fig.)	7,70,000

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To	Balance c/d	90,000			
		8,10,000			8,10,000

3. Cash and Bank Account

	Cash ₹	Bank ₹		Cash ₹	Bank ₹
To Balance b/d	10,000		By Balance b/d		50,000
To Sales (bal. fig)	2,40,000		Bank A/c (C) By	1,00,000	
To Cash (C)		1,00,000	Salaries	40,000	
To Debtors		7,50,000	By Creditors	20,000	7,00,000
To Loan		1,00,000	By Drawings	80,000	
			By Business expenses		1,20,000
				10,000	80,000
	2,50,000	9,50,000	By Balance c/d	2,50,000	9,50,000

Question : 4

Lucky does not maintain proper books of accounts. However, he maintains a record of his bank transactions and also is able to give the following information from which you are required to prepare his final accounts for the year 2022:

Particulars	1.1.2022 ₹	31.12.2022 ₹
Debtors	1,02,500	-
Creditors	-	46,000
Stock	50,000	62,500
Bank Balance	-	50,000
Fixed Assets	7,500	9,000

Details of his bank transactions were as follows:

	₹
Received from debtors	3,40,000
Additional capital brought in	5,000
Sale of fixed assets (book value ₹ 2,500)	1,750
Paid to creditors	2,80,000
Expenses paid	49,250
Personal drawings	25,000
Purchase of fixed assets	5,000

No cash transactions took place during the year. Goods are sold at cost plus 25%.

Cost of goods sold was ₹ 2,60,000

Answer : 4

Trading and Profit and Loss Account for the year ended 31st December, 2022

	Amount		Amount
	₹		₹
To Opening stock	50,000	By Sales (₹ 2,60,000 × 125/100)	3,25,000
To Purchases (balancing figure)	2,72,500	By Closing stock	62,500

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To Gross profit c/d (₹ 2,60,000 × 25/ 100)	65,000		
	3,87,500		3,87,500
To Expenses	9,250	By Gross profit b/d	65,000
To Loss on sale of fixed assets	750		
To Depreciation on fixed assets (W.N.1)	1,000		
To Net profit	14,000		
	65,000		65,000

		Amount		Amount
Liabilities		₹	Assets	₹
Capital (W.N. 5)	1,69,000		Fixed assets	9,000
Add: Additional capital	5,000		Debtors (W.N. 3)	87,500
Net profit	<u>14,000</u>		Stock	62,500
	1,88,000		Bank balance	50,000
Less: Drawings	<u>(25,000)</u>	1,63,000		
Creditors		<u>46,000</u>		
		<u>2,09,000</u>		<u>2,09,000</u>

Balance Sheet as at 31st December, 2022

Working Notes:
1. Fixed assets Account

		₹			₹
To	Balance b/d	7,500	By	Bank (sale)	1,750
To	Bank	5,000	By	Loss on sale of fixed asset (2,500-1,750)	750
			By	Depreciation (balancing figure)	1,000
			By	Balance c/d	<u>9,000</u>
		<u>12,500</u>			<u>12,500</u>

2. Bank Account

	₹		₹

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To	Balance b/d (balancing figure)	62,500	By	Creditors	2,80,000
To	Debtors	3,40,000	By	Expenses	49,250
To	Capital	5,000	By	Drawings	25,000
To	Sale of fixed assets	1,750	By	Fixed assets	5,000
			By	Balance c/d	<u>50,000</u>
		<u>4,09,250</u>			<u>4,09,250</u>

3. Debtors account

	₹		₹
To Balance b/d	1,02,500	By Bank	3,40,000
To Sales $\left(₹2,60,000 \times \frac{125}{100} \right)$	3,25,000	By Balance c/d (balancing figure)	87,500
	<u>4,27,500</u>		<u>4,27,500</u>

4. Creditors account

	₹		₹
To Bank	2,80,000	By Balance b/d (balancing figure)	53,500
To Balance c/d	46,000	By Purchases (from trading account)	2,72,500
	<u>3,26,000</u>		<u>3,26,000</u>

5. Balance Sheet as on 1st January, 2022

Liabilities	₹	Assets	₹
Creditors (W.N. 4)	53,500	Fixed assets	7,500
Capital (balancing figure)	1,69,000	Debtors	1,02,500
		Stock	50,000
		Bank balance (W.N. 2)	62,500
	<u>2,22,500</u>		<u>2,22,500</u>

ILLUSTRATION 1

Raju does not maintain proper records of his business. However, he provides the following information:

Opening capital	10,000
Closing capital	12,500
Drawings during the year	3,000
Capital added during the year	3,750

You are required to calculate the profit or loss for the year.

SOLUTION

Computation of Profit or Loss during the year	₹
Closing Capital	12,500
Add: Drawings during the year	<u>3,000</u>
	15,500
Less: Additional capital during the year	(3,750)
Less: opening capital	<u>(10,000)</u>
Net Profit for the year	<u>1,750</u>

ALTERNATIVELY

Profit/Loss can also be ascertained as balancing figure by preparing capital account as follows:

Particulars	₹	Particulars	₹
To drawings	3,000	By Balance b/d	10,000
To Balance c/d	12,500	By additional capital	3,750
		By Net Profit (Bal Fig)	1,750
	15,500		15,500

It is clear from the above discussion that to follow the capital comparison method, one should know the opening capital and closing capital. This should be determined by preparing statement of affairs at the two respective points of time.

Capital = Assets (-) liabilities.

Thus, the preparation of statement of affairs will require listing of assets and liabilities and their amount. The accountant utilizes the following sources for the purpose of finding out the assets and liabilities of a business enterprise:

- Cash book for cash balance
- Bank pass book for bank balance
- Personal ledger for debtors and creditors
- Inventory by actual counting and valuation.
- As regards fixed assets, he prepares a list of them. The proprietor would help him by disclosing the original cost and date of purchase. After deducting reasonable amount of depreciation, the written down value would be included in the Statement of Affairs.

After obtaining all necessary information about assets and liabilities, the next task of the accountant is to prepare statement of affairs at two different points in time.

The design of the statement of affairs is just like balance sheet as given below:

Statement of affairs as on.....

Liabilities	₹	Assets	₹
Capital (Bal. Fig.)	xx	Building	xx
Loans, Bank overdraft	xx	Machinery	xx
Sundry creditors	xx	Furniture	xx

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Bills payable	xx	Inventory	xx
Outstanding expenses		Sundry debtors	xx
		Bills receivable	xx
		Loans and advances	xx
		Cash and bank	xx
		Prepaid expenses	xx
	xx		xx

Now from the statement of affairs prepared at two different dates, the opening and closing capital balances can be obtained

ILLUSTRATION 2

Rakesh started his business on 1st of April 2021. He invested a capital of Rs 1,00,000. On 31st March 2022, he has the following information available as per the Single-entry system maintained by him.

	₹
Cash balance (counted)	3,200
Inventory (physically verified)	34,800
Receivable from Ajay against credit sales	31,000
Machine	85,000
Payable to Vinod towards credit purchase	12,000
Loan taken from Bank	10,000
Drawings made during the year	24,000

You are required to calculate the profit or loss earned by Rakesh for the year ended 31st March 2022.

SOLUTION

Statement of Affairs as on 31st March, 2022

Liabilities	Amount	Assets	Amount
Sundry Creditors	12,000	Cash balance	3,200
Loan from bank	10,000	Inventory	34,800
Capital (Bal fig)	1,32,000	Sundry Debtors	31,000
		Machine	85,000
	1,54,000		1,54,000

Statement of profit or loss for the year ended 31st March, 2022

Capital as at 31st March 2022	1,32,000
Add: Drawings made during the year	24,000
Total	1,56,000
Less: Opening Capital as at 1st April 2021	(1,00,000)
Profit for the year ended 31st March 2022	56,000

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ILLUSTRATION 3

Assets and Liabilities of Mr. X as on 31-03-2021 and 31-03-2022 are as follows:

	31-03-2021	31-03-2022
	₹	₹
Assets		
Building	1,00,000	?
Furniture	50,000	?
Inventory	1,20,000	2,70,000
Sundry debtors	40,000	90,000
Cash at bank	70,000	85,000
Cash in hand	1,200	3,200
Liabilities		
Loans	1,00,000	80,000
Sundry creditors	40,000	70,000

Decided to depreciate building by 2.5%p.a. and furniture by 10% p.a. One Life Insurance Policy of the Proprietor was matured during the period and the amount ₹ 40,000 is retained in the business. Proprietor took @ ₹ 2,000 p.m. for meeting family expenses. Prepare Statement of Affairs as on 31-03-2021 and 31-03-2022.

SOLUTION


Mr. X
Statement of Affairs
 as on 31-03-2021 & 31-03-2022

Liabilities	31-03-2021	31-03-2022	Assets	31-03-2021	31-03-2022
	₹	₹		₹	₹
Capital	2,41,200	4,40,700	Building	1,00,000	97,500
Loans	1,00,000	80,000	Furniture	50,000	45,000
Sundry creditors	40,000	70,000	Inventory	1,20,000	2,70,000
			Sundry debtors	40,000	90,000
			Cash at bank	70,000	85,000
			Cash in hand	1,200	3,200
	3,81,200	5,90,700		3,81,200	5,90,700

ILLUSTRATION 4

Take figures given in Illustration 4. Find out profit of Mr. X for the year ended 31-03-2022.

SOLUTION

Determination of Profit by applying the method of the capital comparison

	₹
Capital Balance as on 31-03-2022	4,40,700
Less: Fresh capital introduced	(40,000)

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	4,00,700
Add: Drawings (₹2000 × 12)	24,000
Less: Capital Balance as on 31-03-2021	4,24,700
Profit	(2,41,200)
	1,83,500

Note:

- Closing capital is increased due to fresh capital introduction, so it is deducted.
- Closing capital was reduced due to withdrawal by proprietor; so it is added back.

ALTERNATIVELY

Capital account can be prepared as follows:

Particulars	₹	Particulars	₹
To drawings	24,000	By Balance b/d	2,41,200
To Balance c/d	4,40,700	By additional capital	40,000
		By Net Profit (Bal Fig)	1,83,500
	4,64,700		4,64,700

ILLUSTRATION 5

The Income Tax Officer, on assessing the income of Shri Moti for the financial years 2020-2021 and 2021-2022 feels that Shri Moti has not disclosed the full income. He gives you the following particulars of assets and liabilities of Shri Moti as on 1st April, 2020 and 1st April, 2022.

				₹
1-4-2020	Assets	:	Cash in hand	25,500
			Inventory	56,000
			Sundry debtors	41,500
			Land and Building	1,90,000
			Wife's Jewellery	75,000
	Liabilities	:	Owing to Moti's Brother	40,000
			Sundry creditors	35,000
1-4-2022	Assets	:	Cash in hand	16,000
			Inventory	91,500
			Sundry debtors	52,500
			Land and Building	1,90,000
			Motor Car	1,25,000
			Wife's Jewellery	1,25,000
			Loan to Moti's Brother	20,000
	Liabilities	:	Sundry creditors	55,000

During the two years the domestic expenditure was ₹ 4,000 p.m. The declared incomes of the financial years were ₹ 1,05,000 for 2020-2021 and ₹ 1,23,000 for 2021-2022 respectively.

State whether the Income-tax Officer's contention is correct. Explain by giving your workings.

SOLUTION

Calculation of Capital of Shri Moti

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	₹	1-4-2020₹	₹	1-4-2022₹
Assets				
Cash in hand		25,500		16,000
Inventory		56,000		91,500
Sundry debtors		41,500		52,500
Land & Building		1,90,000		1,90,000
Wife's Jewellery		75,000		1,25,000
Motor Car		—		1,25,000
Loan to Moti's Brother		—		20,000
		3,88,000		6,20,000
Liabilities:				
Owing to Moti's Brother	40,000		—	
Sundry creditors	35,000	75,000	55,000	55,000
Capital		3,13,000		5,65,000
Income during the two years:				
Capital as on 1-4-2022				5,65,000
Add: Drawings – Domestic Expenses for the two years (₹ 4,000 × 24 months)				96,000
				6,61,000
Less: Capital as on 1-4-2020				(3,13,000)
Income earned in 2020-2021 and 2021-2022				3,48,000
Income declared (₹ 1,05,000 + ₹ 1,23,000)				2,28,000
Suppressed Income				1,20,000

The Income-tax officer's contention that Shri Moti has not declared his true income is correct. Shri Moti's true income is in excess of the disclosed income by ₹ 1,20,000 based on the information available

ILLUSTRATION 6

Calculate the bad debts from the below information:

Opening balance of Debtors	₹5,00,000
Closing balance of Debtors	₹7,00,000
Amount received in Cash	₹6,00,000
Discount allowed	₹10,000
Credit Sales	₹ 11,40,000
Bills Receivable	₹ 3,00,000
Bad Debts	???

SOLUTION

Debtors Account

Particulars	Amount	Particulars	Amount
Balance b/f	5,00,000	Cash A/c	6,00,000
Credit Sales	11,40,000	Discount allowed	10,000

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		Bills Receivable	3,00,000
		Bad Debts(Bal fig)	30,000
		Balance c/f	7,00,000
	16,40,000		16,40,000

ILLUSTRATION 7

Calculate the credit purchases from the below information:

Opening balance of creditors	₹4,00,000
Closing balance of creditors	₹ 5,00,000
Payments made in Cash	₹ 8,50,000
Discount received	₹ 20,000

SOLUTION
Total Creditors Account

Particulars	Amount	Particulars	Amount
Cash paid	8,50,000	Balance b/d	4,00,000
Discount received	20,000	Credit Purchases (Bal. fig)	
Balance c/d	<u>5,00,000</u>		<u>9,70,000</u>
	<u>13,70,000</u>		<u>13,70,000</u>

ILLUSTRATION 8

A. Adamjee keeps his books on single entry basis. The analysis of the cash book for the year ended on 31st March, 2022 is given below:

Receipts	₹	Payments	₹
Bank Balance as on 1st April, 2021	2,800	Payments to Sundry creditors	35,000
Received from Sundry Debtors	48,000	Salaries	6,500
Cash Sales	11,000	General expenses	2,500
Capital brought during the year	6,000	Rent and Taxes	1,500
Interest on Investments	200	Drawings	3,600
		Cash purchases	12,000
		Balance at Bank on 31st March, 2022	6,400
		Cash in hand on 31st March, 2022	<u>500</u>
	<u>68,000</u>		<u>68,000</u>

Particulars of other assets and liabilities are as follows:

	1 st April, 2021	31st March, 2022
Sundry debtors	14,500	17,600
Sundry creditors	5,800	7,900
Machinery	7,500	7,500
Furniture	1,200	1,200
Inventory	3,900	5,700

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Investments	5,000	5,000

Prepare final accounts for the year ending 31st March, 2022 after providing depreciation at 10 per cent on machinery and furniture and ₹ 800 against doubtful debts.

SOLUTION
A. Adamjee
Trading Account for the year ended 31st March 2022

	₹	₹		₹
To Opening Inventory		3,900	By Sales	62,100
To Purchases		49,100	By Closing Inventory	5,700
To Gross profit c/d (b.f.)		14,800		
		67,800		67,800

Profit & Loss Account for the year ended 31st March 2022

	₹	₹		₹
To Salaries		6,500	By Gross Profit b/d	14,800
To Rent and Taxes		1,500	By Interest on investment	200
To General expenses		2,500		
To Dep:				
Machinery @ 10%	750			
Furniture @ 10%	120	870		
To Provision for doubtful debts		800		
To Net profit carried to				
Capital A/c (b.f.)		2,830		
		15,000		15,000

Balance Sheet as on 31st March 2022

Liabilities	₹	₹	Assets	₹	₹
A. Adamjee's Capital			Machinery	7,500	
on 1 st April, 2021	29,100		Less : Depreciation	(750)	6,750
Add: Fresh Capital	6,000		Furniture	1,200	
Add: Profit for the year	2,830		Less : Depreciation	(120)	1,080
	37,930				
Less: Drawings	(3,600)	34,330	Inventory-in-trade		5,700
			Sundry debtors	17,600	
Sundry creditors		7,900	Less : Provision for		
			Doubtful debts	(800)	16,800
			Investment		5,000
			Cash at bank		6,400
			Cash in hand		500
		42,230			42,230

Working Notes:
1. Balance sheet of A. Adamjee as on 1st April 2021

Liabilities	₹	Assets	₹
Sundry creditors	5,800	Machinery	7,500

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A. Adamjee's capital	29,100	Furniture	1,200
(balancing figure)		Inventory	3,900
		Sundry debtors	14,500
		Investments	5,000
		Bank balance (from Cash statement)	2,800
	34,900		34,900

2. Ledger Accounts

A. Adamjee's Capital Account

		₹			₹
31.03.22	To Drawings	3,600	01.04. 21	By Balance b/d	29,100
			31.03.22	By Net Profit	2,830
31.03.22	To Balance c/d (b.f.)	34,330	31.03.22	By Cash	6,000
		37,930			37,930

Sales Account

		₹			₹
31.03.22	To Trading A/c(b.f.)	62,100	31.03.22	By Cash	11,000
			31.03.22	By Total Debtors Account (Credit Sales)	51,100
		62,100			62,100

Total Debtors Account

		₹			₹
01.04.21	To Balance b/d	14,500	31.03.22	By Cash	48,000
31.03.22	To Credit sales (Balancing figure)	51,100	31.03.22	By Balance c/d	17,600
		65,600			65,600

Purchases Account

		₹			₹
31.03.22	To Cash A/c	12,000	31.03.22	By Trading Account (b.f.)	49,100
	To total Creditors A/c (credit Purchases)	37,100			
		49,100			49,100

Total Creditors Account

		₹			₹
31.03.22	To Cash	35,000	01.04.21	By Balance b/d	5,800
31.03.22	To Balance b/d	7,900	31.03.22	By Credit Purchases (Balancing figure)	37,100
		42,900			42,900

ILLUSTRATION 9

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From the following data furnished by Mr. Manoj, you are required to prepare a Trading and Profit and Loss Account for the year ended 31st March, 2022 and Balance Sheet as at that date. All workings should form part of your answer.

Assets and Liabilities	As on 1st April 2021	As on 31st March 2022
	₹	₹
Creditors	15,770	12,400
Sundry expenses outstanding	600	330
Sundry Assets	11,610	12,040
Inventory in trade	8,040	11,120
Cash in hand and at bank	6,960	8,080
Trade debtors	?	17,870
Details relating to transactions in the year:		
Cash and discount credited to debtors		64,000
Sales return		1,450
Bad debts		420
Sales (cash and credit)		71,810
Discount allowed by trade creditors		700
Purchase returns		400
Additional capital-paid into Bank		8,500
Realisations from debtors-paid into Bank		62,500
Cash purchases		1,030
Cash expenses		9,570
Paid by cheque for machinery purchased		430
Household expenses drawn from Bank		3,180
Cash paid into Bank		5,000
Cash drawn from Bank		9,240
Cash in hand on 31-3-2022		1,200
Cheques issued to trade creditors		60,270

SOLUTION

In the books of Mr. Manoj Trading Account for the year ending 31st March, 2022

	₹	₹		₹	₹
To Opening Inventory		8,040	By Sales		
To Purchases (58,000 + 1,030)	59,030		Cash	4,600	
Less: Returns	(400)	58,630	Credit	67,210	
To Gross profit c/d		14,810		71,810	
			Less: Returns	(1,450)	70,360
			By Closing inventory		11,120
		81,480			81,480

Profit & Loss Account for the year ending 31st March, 2022

	₹		₹

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To Sundry expenses (W.N.(v))	9,300	By Gross profit b/d	14,810
To Discount	1,500	By Discount	700
To Bad Debts	420		
To Net Profit transfer to Capital	4,290		
	15,510		15,510

Balance Sheet of Mr. Manoj as on 31st March, 2022

Liabilities	₹	₹	Assets	₹
Capital			Sundry assets	12,040
Opening balance	26,770		Inventory in trade	11,120
Add: Addition	8,500		Sundry debtors	17,870
Net Profit	4,290		Cash in hand & at bank	8,080
	39,560			
Less: Drawings	(3,180)	36,380		
Sundry creditors		12,400		
Outstanding expenses		330		
		49,110		49,110

Working Notes:

(i) Cash sales

Combined Cash & Bank Account

	₹		₹
To Balance b/d	6,960	By Sundry creditors	60,270
To Sundries (Contra)	5,000	By Sundries (Contra)	5,000
To Sundries (Contra)	9,240	By Sundries (Contra)	9,240
To Sundry debtors	62,500	By Drawings	3,180
To Capital A/c	8,500	By Machinery	430
To Sales (Cash Sales-Balancing Figure)	4,600	By Sundry expenses	9,570
		By Purchases	1,030
		By Balance c/d	8,080
	96,800		96,800

(ii) Total Debtors Account

	₹		₹
To Balance b/d (bal. fig.)	16,530	By Bank	62,500
To Sales (71,810–4,600 ¹)	67,210	By Discount(64,000 – 62,500)	1,500
		By Return Inward	1,450
		By Bad Debts	420
		By Balance c/d	17,870
	83,740		83,740

(iii) Total Creditors Account

	₹		₹
To Bank	60,270	By Balance b/d (bal. fig.)	15,770

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To Discount	700	By Purchases	58,000
To Return Outward	400		
To Balance c/d	12,400		
	73,770		73,770

¹ From combined cash and bank account

(iv) Balance Sheet as on 1st April, 2021

Liabilities	₹	Assets	₹
Capital (bal. fig.)	26,770	Sundry Assets	11,610
Sundry Creditors	15,770	Inventory in Trade	8,040
Outstanding Expenses	600	Sundry Debtors (from total debtors A/c)	16,530
		Cash in hand & at bank	6,960
	43,140		43,140

(v)

Expenses paid in Cash	9,570
Add: Outstanding on 31-3-2022	330
	9,900
Less: Outstanding on 1-4-2021	(600)
	9,300

(vi) Due to lack of information, depreciation has not been provided on fixed assets.

ILLUSTRATION 10

Mr. Anup runs a wholesale business where in all purchases and sales are made on credit. He furnishes the following closing balances

	31st March 2021	31st March 2022
Sundry debtors	70,000	92,000
Bills receivable	15,000	6,000
Bills payable	12,000	14,000
Sundry creditors	40,000	56,000
Inventory	1,10,000	1,90,000
Bank	90,000	87,000
Cash	5,200	5,300

Summary of cash transactions during the year 2021- 2022:

- (i) Deposited to bank after payment of shop expenses @ ₹ 600 p.m., salary @ ₹ 9,200 p.m. and personal expenses @ ₹ 1,400 p.m. ₹ 7,62,750.
- (ii) Cash Withdrawn from bank ₹ 1,21,000.
- (iii) Cash payment to suppliers ₹ 77,200 for supplies and ₹ 25,000 for furniture.
- (iv) Cheques collected from customers but dishonoured ₹ 5,700.
- (v) Bills accepted by customers ₹ 40,000.
- (vi) Bills endorsed ₹ 10,000.
- (vii) Bills discounted ₹ 20,000, discount ₹ 750.
- (viii) Bills matured and duly collected ₹ 16,000.

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- (ix) Bills accepted ₹ 24,000.
- (x) Paid suppliers by cheque ₹ 3,20,000.
- (xi) Received ₹ 20,000 on maturity of one LIC policy of the proprietor by cheque.
- (xii) Rent received ₹ 14,000 by cheque for the premises owned by proprietor.
- (xiii) A building was purchased on 30-11-2021 for opening a branch for ₹ 3,50,000 and some expenses were incurred on this building, details of which are not maintained.
- (xiv) Electricity and telephone bills paid by cash ₹ 18,700, due ₹ 2,200.

Other transactions:

- (i) Claim against the firm for damage ₹ 1,55,000 is under legal dispute. Legal expenses ₹ 17,000. The firm anticipates defeat in the suit.
- (ii) Goods returned to suppliers ₹ 4,200.
- (iii) Goods returned by customers ₹ 1,200.
- (iv) Discount offered by suppliers ₹ 2,700.
- (v) Discount offered to the customers ₹ 2,400.
- (vi) The business is carried on at the rented premises for an annual rent of ₹ 20,000 which is outstanding at the year end.

Prepare Trading and Profit & Loss Account of Mr. Anup for the year ended 31st March 2022 and Balance Sheet as on that date.

SOLUTION

Trading Account of Mr. Anup for the year ended 31st March 2022

	₹	₹		₹	₹
To Opening Inventory		1,10,000	By Sales	9,59,750	
To Purchases	4,54,100		Less: Sales Return	(1,200)	9,58,550
Less: Purchases Return	(4,200)	4,49,900	By Closing Inventory		1,90,000
To Gross Profit (b.f.)		5,88,650			
		11,48,550			11,48,550

Profit & Loss Account of Mr. Anup for the year ended 31st March 2022

	₹		₹
To salary (9,200 x 12)	1,10,400	By Gross Profit	5,88,650
To Electricity & Tel. Charges (18,700 + 2,200)	20,900	By Discount	2,700
To Legal expenses	17,000		
To Discount (2,400 + 750)	3,150		
To Shop exp. (600 x 12)	7,200		
To Provision for claims for damages	1,55,000		
To Shop Rent	20,000		
To Net Profit (b.f.)	2,57,700		
	5,91,350		5,91,350

Balance Sheet as on 31st March 2022

Liabilities	₹	Assets	₹
Capital A/c (W.N.vi)	2,38,200	Building (from summary cash and bank A/c)	3,72,000
Add: Fresh capital introduced		Furniture	25,000
Maturity value from LIC	20,000		

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Rent	14,000		Inventory	1,90,000
Add : Net Profit	2,57,700		Sundry debtors	92,000
	5,29,900		Bills receivable	6,000
Less : Drawing(14,00 x12)	(16,800)	5,13,100	Cash at Bank	87,000
Rent outstanding		20,000	Cash in Hand	5,300
Sundry creditors		56,000		
Bills Payable		14,000		
Outstanding expenses				
Legal Exp.	17,000			
Electricity & Telephone charges	2,200	19,200		
Provision for claims for damages		1,55,000		
		7,77,300		
				7,77,300

Working Notes :
(i) Sundry Debtors Account

	₹		₹
To Balance b/d	70,000	By Bill Receivable A/c	
To Bill receivable A/c-Bills dishonoured	3,000	Bills accepted by customers	40,000
To Bank A/c-Cheque dishonoured	5,700	By Bank A/c- Chequereceived	5,700
To Credit sales(Balancing Figure)	9,59,750	By Cash (from summary cash and bank account)	8,97,150
		By Return inward A/c	1,200
		By Discount A/c	2,400
		By Balance c/d	92,000
	10,38,450		10,38,450

(ii) Bills Receivable Account

	₹		₹
To Balance b/d	15,000	By Sundry creditors A/c	
To Sundry Debtors A/c	40,000	(Bills endorsed)	10,000
(Bills accepted)		By Bank A/c (20,000 – 750)	19,250
		By Discount A/c	750
		(Bills discounted)	
		By Bank	
		Bills collected on maturity	16,000
		By Sundry debtors	
		Bills dishonoured (Bal. Fig)	3,000
		By Balance c/d	6,000

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	55,000		55,000

(iii) Sundry Creditors Account

	₹		₹
To Bank	3,20,000	By Balance c/d	40,000
To Cash	77,200	By Credit purchase (Balancing figure)	
To Bill Payable A/c	24,000		4,54,100
To Bill Receivable A/c	10,000		
To Return Outward A/c	4,200		
To Discount Received A/c	2,700		
To Balance b/d	56,000		
	4,94,100		4,94,100

(iv) Bills Payable A/c

	₹		₹
To Bank A/c (Balance figure)	22,000	By Balance b/d	12,000
To Balance c/d	14,000	By Sundry creditors A/c Bills accepted	24,000
	36,000		36,000

(v) Summary Cash and Bank A/c

	Cash ₹	Bank ₹		Cash ₹	Bank ₹
To Balance b/d	5,200	90,000	By Bank	7,62,750	
To Sundry debtors (Bal. Fig)	8,97,150		By Cash		1,21,000
To Cash		7,62,750	By Shop exp. (600 x 12)	7,200	
To Bank	1,21,000		By Salary (9,200 x 12)	1,10,400	
To Sundry Debtors		5,700	By Drawing A/c (1,400 x 12)	16,800	
To Bills receivable		19,250			
To Bills receivable		16,000	By Bills Payable		22,000
To Capital (maturity value of LIC policy)		20,000	By Furniture	77,200	3,20,000
To Capital (Rent received)		14,000	By Sundry creditors	25,000	
			By Sundry Debtors		5,700
			By Electricity & Tel.Charges	18,700	
			By Building (Bal. fig)		3,72,000
			By Balance c/d	5,300	87,000
	10,23,350	9,27,700		10,23,350	9,27,700

(vi) Statement of Affairs as on 31st March 2021

Liabilities	₹	Assets	₹
Sundry Creditors	40,000	Inventory	1,10,000

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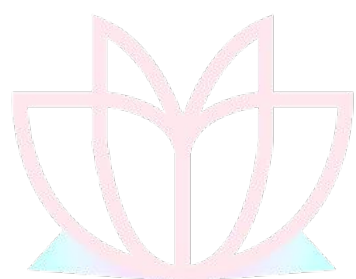
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Bills Payable	12,000	Debtors	70,000
Capital (Balancing figure)	2,38,200	Bills receivable	15,000
		Cash at Bank	90,000
		Cash in Hand	5,200
	2,90,200		2,90,200



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Partnership and LLP Accounts

Chapter 10.1 Introduction to Partnership Accounts

True and False

Question 1

In absence of any agreement partners share profits of the business in the ratio of their capital contribution.

Answer 1

False: In absence of any agreement partners share profits equally and not in capital contribution ratio.

Question 2

Profit sharing ratio and capital contribution ratio need not be same.

Answer 2

True: Profit sharing can be different from the that of the capital introduced by each of the partner. Not necessary that partner contributing more capital should have a higher profit sharing ratio and vice versa.

Question 3

Every partnership firm must register itself with Registrar of firms.

Answer 3

False: Registration of firms is not compulsory under Indian Partnership Act, 1932.

Question 4

A partner can advance loan to the partnership firm in addition to capital contributed by him.

Answer 4

True: Where the partnership deed is absent, then the interest shall be paid at 6% per annum. So the interest on the loan to be paid to the partner.

Question 5

A partner can demand interest on capital even if it is not provided in the partnership deed.

Answer 5

False: Interest on capital can be paid only if it is provided in the partnership deed.

Question 6

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If a partner does not take part in day to day business activities of the firm then he is not entitled to any share of profit.

Answer 6

False: Every partner need not take part in the business. Even if a partner does not take part in the business he is entitled for his share of profit.

Question 7

Interest should be paid @ 6% p.a. on partners' loan even if it is not provided in the partnership deed.

Answer 7

True: In absence of Partnership deed, Interest at the rate of 6%.p.a is to be allowed on a partner's loan to the firm.

Question 8

Husband and wife cannot be partners in the same firm.

Answer 8

False: Husband and wife can be partners in the same firm.

Question 9

One senior partner is Principal and other partners are his agents.

Answer 9

False: There is no senior or junior partner. Every partner is agent/principal of other partners.

Question 10

Partners are the agents of the firm and each other.

Answer 10

True: Concept of agency applies to every partner and the firm as well. So each partner is a principal to and agent of every other partner and to the firm.

Multiple Choice Questions

1. If a firm prefers Partners' Capital Accounts to be shown at the amount introduced by the partners as capital in firm then entries for salary, interest, drawings, interest on capital and drawings and profits are made in
 - (a) Trading Account
 - (b) Profit and Loss Account
 - (c) Partners' Current Account

Answer 1 : (c)

2. In the absence of any agreement, partners are liable to receive interest on their Loans @
 - (a) 12% p.a.
 - (b) 10% p.a.
 - (c) 6% p.a.

Answer 2 : (c)

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3. The relationship between persons who have agreed to share the profit of a business carried on by all or any of them acting for all is known as
- Partnership.
 - Joint Venture.
 - Association of Persons.

Answer 3 : (a)

4. Firm has earned exceptionally high profits from a contract which will not be renewed. In such a case the profit from this contract will not be included in
- Profit sharing of the partners.
 - Calculation of the goodwill.
 - Both

Answer 4 : (b)

5. In the absence of an agreement, partners are entitled to
- Interest on Loan and Advances.
 - Commission.
 - Salary.

Answer 5 : (a)

6. Partners are supposed to pay interest on drawings only when by the
- Provided, Agreement.
 - Agreed, Partners.
 - Both (A) and (B) above.

Answer 6 : (c)

7. When a partner is given a guarantee by the other partner, loss on such guarantee will be borne by
- Partner who gave the guarantee
 - All the other partners.
 - Partnership firm.

Answer 7 : (a)

8. A, B and C had capitals of ₹ 50,000; ₹ 40,000 and ₹ 30,000 respectively for carrying on business in partnership. The firm's reported profit for the year was ₹ 80,000. As per provisions of the Indian Partnership Act, 1932, find out the share of each partner in the above amount after taking into account that no interest has been provided on an advance by A of ₹ 20,000, in addition to his capital contribution.
- ₹ 26,267 for Partner B and C & ₹ 27,466 for partner A.
 - ₹ 26,667 each partner.
 - ₹ 33,333 for A, ₹ 26,667 for B and ₹ 20,000 for C.

Answer 8 : (a)

9. X, Y and Z are partners in a firm. At the time of division of profit for the year there was dispute between the partners. Profits before interest on partner's capital was ₹ 6,000 and X wanted interest on capital @ 20% as his capital contributions was ₹ 1,00,000 as compared to that of Y and Z which

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was ₹ 75,000 and ₹ 50,000 respectively.

- (a) Profits of ₹ 6,000 will be distributed equally with no interest on either Capital.
- (b) X will get the interest of ₹ 20,000 and the loss of ₹ 14,000 will be shared equally.
- (c) All the partners will get interest on capital and the loss of ₹ 39,000 will be shared equally.

Answer 9 : (a)

10. X, Y and Z are partners in a firm. At the time of division of profit for the year there was dispute between the partners. Profits before interest on partner's capital was ₹ 6,000 and Y determined interest @ 24% p.a. on his loan of ₹ 80,000. There was no agreement on this point. Calculate the amount payable to X, Y and Z respectively.

- (a) ₹ 2,000 to each partner.
- (b) Loss of ₹ 4,400 for X and Z & Y will take home ₹ 14,800.
- (c) ₹ 400 for X, ₹ 5,200 for Y and ₹ 400 for Z.

Answer 10 : (c)

11. X, Y and Z are partners in a firm. At the time of division of profit for the year there was dispute between the partners. Profits before interest on partner's capital was ₹ 6,000 and Z demanded minimum profit of ₹ 5,000 as his financial position was not good. However, there was no written agreement. Profits to be distributed to X, Y and Z will be

- (a) Other partners will pay Z the minimum profit and will suffer loss equally.
- (b) Other partners will pay Z the minimum profit and will suffer loss in capital ratio.
- (c) ₹ 2,000 to each of the partners.

Answer 11 : (c)

Theoretical Questions & Answers

Question 1

Write short notes on:

- (a) Features of Partnership
- (b) Powers of Partners

Answer 1

- (a) The following four essential features of a partnership, namely:
 - (i) Partnership is the result of an agreement: It means that the relation of partnership arises from contract and not from status.
 - (ii) Business: A partnership can exist only in business.
 - (iii) Sharing of profit: The persons concerned must agree to share the profits of the business.
 - (iv) Mutual agency: It means that the business is to be carried on by all or any of them acting for all. Thus, 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.
- (b) Powers of partners are the following:
 - (i) Buying and selling of goods;
 - (ii) Receiving payments on behalf of the firm and giving valid receipt;
 - (iii) Drawing cheques and drawing, accepting and endorsing bills of exchange and promissory notes in the name of the firm;
 - (iv) Borrowing money on behalf of the firm with or without pledging the inventories-in-trade;
 - (v) Engaging servants for the business of the firm.

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Question 2

Distinguish between fixed capital and fluctuating capital.

Answer 2

In **fixed capital** method, generally initial capital contributions by the partners are credited to partners' capital accounts and all 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.

In **fluctuating capital** method, no current account is maintained. All such transactions and events are passed through capital accounts. Naturally, capital account balance of the partners fluctuates every time. So in fixed capital method a fixed capital balance is maintained over a period of time while in fluctuating capital method capital account balances fluctuate all the time.

Question 3

What are the liabilities of designated partners in case of LLP.

Answer 3

As per LLP Act, unless expressly provided otherwise in this Act, a designated partner should be-

- (a) responsible for the doing of all acts, matters, and things as are required to be done by the limited liability partnership in respect of compliance of the provisions of this Act including filing of any document, return, statement, and the like report pursuant to the provisions of this Act and as may be specified in the limited liability partnership agreement; and.
- (b) liable to all penalties imposed on the limited liability partnership for any contravention of those provisions.

Practical Questions & Answers

STRIVING TOWARDS KNOWLEDGE

Question 1

A, B and C entered into partnership on 01.04.2021 to share profits and losses in the ratio of 5 : 3 : 2. A personally guaranteed that C's share of profit after charging interest on capitals at 5% p.a. would not be less than ₹ 30,000 in any year. Capitals of A, B and C were ₹ 3,20,000, ₹ 2,00,000 and ₹ 1,60,000 respectively.

Profits for the year ending 31.03.2022 before providing for interest on partners capital was ₹ 1,59,000.

You are required to prepare the Profit and Loss Appropriation Account.

Answer : 1

Profit and Loss Appropriation Account for the year ended 31st March, 2022

Dr.				Cr.		
		₹	₹			₹
To	Interest on capital			By	Net profit b/d	1,59,000
	A (5% of ₹ 3,20,000)	16,000				
	B (5% of ₹ 2,00,000)	10,000				
	C (5% of ₹ 1,60,000)	<u>8,000</u>	34,000			
To	Partners' capital					

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accounts:					
[profit (₹ 1,59,000 – ₹ 34,000) transferred]					
A $\left(\frac{5}{10}\right)$ of ₹ 1,25,000	62,500				
Less: Transferred to C	<u>5,000</u>	57,500			
B $\left(\frac{3}{10}\right)$ of ₹ 1,25,000		37,500			
C $\left(\frac{2}{10}\right)$ of ₹ 1,25,000	25,000				
Add: Transferred from A	<u>5,000</u>	<u>30,000</u>			
		<u>1,59,000</u>			<u>1,59,000</u>

Question 2

Weak, Able and Lazy are in partnership sharing profits and losses in the ratio of 2:1:1. It is agreed that interest on capital will be allowed @ 10% per annum and interest on drawings will be charged @ 8 % per annum. (No interest will be charged/allowed on Current Accounts).

The following are the particulars of the Capital and Drawings Accounts of the partners:

	Weak	Able	Lazy
	₹	₹	₹
Capital (1.1.2022)	75,000	40,000	30,000
Current Account (1.1.2022)	10,000	5,000	(Dr.) 5,000
Drawings	15,000	10,000	10,000

The draft accounts for 2022 showed a net profit of ₹ 60,000 before taking into account interest on capitals and drawings and subject to following rectification of errors:

- Life Insurance premium of Weak amounting to ₹ 750 paid by the firm on 30th June, 2022 has been charged to Miscellaneous Expenditure A/c.
- Repairs of Machinery amounting to ₹ 10,000 has been debited to Plant Account and depreciation thereon charged @ 20%.
- Travelling expenses of ₹ 3,000 of Able for a pleasure trip to U.K. paid by the firm on 30th June, 2022 has been debited to Travelling Expenses Account.

You are required to prepare the Profit and Loss Appropriation Account, Current Accounts of partners Weak, Able and Lazy for the year ended 31st December, 2022.

Answer 2

Weak, Able & Lazy
Profit and Loss Appropriation Account for the year ended
31st December, 2022

	₹	₹		₹	₹
To interest on Capital:			By Net Profit (Adjusted)		55,750
Weak	7,500		By Interest on Drawings:		
Able	4,000		Weak	630	
Lazy	<u>3,000</u>	14,500	Able	520	
			Lazy	<u>400</u>	1,550
To Partner's Current A/cs-					
Share of profit:					
Weak	21,400				
Able	<u>10,700</u>				

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Lazy	<u>10,700</u>	<u>42,800</u>			
		<u>57,300</u>			<u>57,300</u>

Working Notes:

(i) Adjusted Profit

	₹	₹
Net Profit as per Profit & Loss A/c	60,000	
Add : Drawings by Weak : Life Insurance Premium of Weak charged to Miscellaneous Expenditure A/c of the Firm	750	
Drawings by Able : Travelling expenses of Able in connection with pleasure trip to U.K. charged to travelling expenses A/c of the firm	<u>3,000</u>	63,750
Less : Repairs to Machinery wrongly capitalised	10,000	
Less : Depreciation charged @ 20%	<u>(2,000)</u>	<u>(8,000)</u>
		<u>55,750</u>

(ii) Interest on Drawings :

	Weak	Able	Lazy
	₹	₹	₹
Drawings	15,000	10,000	10,000
Add : Rectification adjustments	<u>750</u>	<u>3,000</u>	-
	15,750	13,000	10,000
Interest @ 8% p.a. for 6 months	630	520	400

Partners' Current Accounts

	Weak	Able	Lazy		Weak	Able	Lazy
	₹	₹	₹		₹	₹	₹
To Balance b/d	-	-	5,000	By Balance b/d	10,000	5,000	-
To Drawings	15,000	10,000	10,000	By Profit & Loss App. A/c (Int. on Capital)	7,500	4,000	3,000
To Life Insurance Premium	750	-	-	By Profit & Loss App. A/c. (Share of Profit)	21,400	10,700	10,700
To Travelling Expenses	-	3,000	-				
To Profit & Loss App. A/c. (Int. on drawings)	630	520	400				
To Balance c/d	<u>22,520</u>	<u>6,180</u>	-	By Balance c/d	-	-	<u>1,700</u>
	<u>38,900</u>	<u>19,700</u>	<u>15,400</u>		<u>38,900</u>	<u>19,700</u>	<u>15,400</u>

Question 3

Ram and Rahim are in partnership sharing profits and losses in the ratio of 3:2. As Ram, on account of his advancing years, feels he cannot work as hard as before, the chief clerk of the firm, Ratan, is admitted as a partner with effect from 1st January, 2022, and becomes entitled to 1/10th of the net profits and nothing else, the mutual ratio between Ram and Rahim remaining unaltered.

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Before becoming a partner, Ratan was getting a salary of ₹ 500 p.m. together with a commission of 4% on the net profits after deducting his salary and commission.

It is provided in the partnership deed that the share of Ratan's profits as a partner in excess of the amount to which he would have been entitled if he had continued as the chief clerk, should be taken out of Ram's share of profits.

The net profit for the year ended December 31, 2022 is ₹ 1,10,000. Show the distribution of net profit amongst the partners.

Answer 3

Amount due to Ratan as a Chief Clerk

	₹
Salary	6,000
Add: Commission 4/104 (₹ 1,10,000 - ₹ 6,000)	4,000
	10,000
Less: Share of Profit as a partner (1/10th of 1,10,000)	(11,000)
Excess chargeable to Ram	(1,000)

Profit and Loss Appropriation Account for the year ended December 31, 2022

	Particulars	₹	Particulars	₹
To	Share of Profit A/c Ram [3/5 of (₹ 1,10,000 - ₹ 10,000) - ₹ 1,000]	59,000	By Profit and Loss A/c (Net profit)	1,10,000
	Rahim [2/5 of (₹ 1,10,000 - ₹ 10,000)]	40,000		
	Ratan [1/10 of ₹ 1,10,000]	11,000		
		<u>1,10,000</u>		<u>1,10,000</u>

Question 4

X and Y are partners. As per terms of agreement interest is allowed on capital at 8% p.a. and charged on drawings at 10% p.a. X withdrew ₹ 40,000 pm at the end of each month and Y withdrew ₹ 120,000 at the end of each quarter. You are required to fill the missing figures in following accounts:

Profit and Loss Appropriation Account for the year ended March 31, 2022

Particulars	₹	Particulars	₹
To ...?		By Profit and Loss A/c (Net profit)	?
To Interest on Capital A/c		By Interest on Drawings A/c	
X 160,000		X ?	
Y ?		Y ?	?
	288,000		
To profit transferred to Capital A/c			
X (2/3) ?			
Y (1/3) 280,000	?		
	?		?

Partner's Capital Accounts

Particulars	X	Y	Particulars	X	Y
To ...?	?	?	By ...?	?	?
To ...?	?	?	By Salary A/c	3,60,000	?

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To ...?	?	?	By ...?	?	
			By ...?	?	?
	?	?		?	?

Answer 4

Profit and Loss Appropriation Account for the year ended March 31, 2022

Particulars	₹	Particulars	₹
To Salary to X	3,60,000	By Profit and Loss A/c (Net profit)	14,48,000
To Interest on Capital A/c		By Interest on Drawings A/c	
X 1,60,000		X 22,000	
Y 1,28,000	2,88,000	Y 18,000	
To profit transferred to Capital A/c			
X (2/3) 5,60,000			
Y (1/3) 2,80,000	8,40,000		
	14,88,000		14,88,000

Partner's Capital Accounts

Particulars	X	Y	Particulars	X	Y
To Drawing A/c	4,80,000	4,80,000	By Balance b/d	20,00,000	16,00,000
To Interest on Drawings A/c	22,000	18,000	By Salary A/c	3,60,000	1,28,000
To Balance c/d	25,78,000	15,10,000	By Interest on Capital A/c	1,60,000	
			By Profit and Loss App A/c	5,60,000	2,80,000
	30,80,000	20,08,000		30,80,000	2,008,000

Working Notes:

1. X's Share of Profit $2,80,000 \times \frac{3}{1} \times \frac{2}{3} = 5,60,000$
2. Interest on Drawings
 $X = 4,80,000 \times \frac{11}{2} \times \frac{1}{12} \times \frac{10}{100} = 22,000$
 $Y = 4,80,000 \times \frac{9}{2} \times \frac{1}{12} \times \frac{10}{100} = 18,000$
3. Y's Interest on Capital $2,88,000 - 1,60,000 = 128,000$

Illustration 1

A and B start business on 1st January, 2022, with capitals of ₹ 30,000 and ₹ 20,000. According to the Partnership Deed, B is entitled to a salary of ₹ 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 2022 the firm earned a profit, before charging salary to B and interest on capital amounting to

₹ 25,000. During the year A withdrew ₹ 8,000 and B withdrew ₹ 10,000 for domestic purposes.

Give journal entries relating to division of profit.

Answer

Journal Entries

2022	Particulars	Dr. (₹)	Cr. (₹)
Dec. 31	Profit and Loss Appropriation Account	Dr.	6,000

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	To B's Capital Account (Salary due to B @ ₹ 500 per month)		6,000
	Profit and Loss Appropriation Account	Dr.	3,000
	To A's Capital Account		1,800
	To B's Capital Account (Interest due on Capital @ 6% per month)		1,200
	Profit and Loss Appropriation Account	Dr.	16,000
	To A's Capital Account		10,000
	To B's Capital Account (Remaining profit of ₹ 16,000 divide between A and B in the ratio of 5:3)		6,000

Now, let us learn the preparation of profit and loss appropriation account with the help of same illustration of partnership firm consisting of partners A and B.

Illustration 2

Ram, Rahim and Karim are partners in a firm. They have no agreement in respect of profit- sharing ratio, interest on capital, interest on loan advanced by partners and remuneration payable to partners. In the matter of distribution of profits they have put forward the following claims:

- 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.
- Rahim has devoted full time for running the business and demands salary at the rate of ₹ 500 p.m. But Ram and Karim do not agree.
- Karim demands interest on loan of ₹ 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 Account after transferring 10% of the divisible profit to Reserve. Net profit before taking into account any of the above claims amounted to ₹ 45,000 at the end of the first year of their business

Answer

There is no partnership deed. Therefore, the following provisions of the Indian Partnership Act are to be applied for settling the dispute.

- No interest on capital is payable to any partner. Therefore, Ram is not entitled to interest on capital.
- No remuneration is payable to any partner. Therefore, Rahim is not entitled to any salary.
- Since interest on loan payable to partner is not an appropriation of profit. It will be charged to Profit and Loss Account.
- The profits should be distributed equally.

Profit and Loss Appropriation Account for the year ended...

	Particulars		₹	Particulars	₹
To	Reserve A/c – 10% of ₹ 44,880		4,488	By Profit and Loss A/c – ₹ (45,000-120) (Net profit)	44,880
To	Share of Profit A/c:				
	Ram capital A/c	₹ 13,464			
	Rahim capital A/c	₹ 13,464			
	Karim capital A/c	₹ 13,464	40,404		

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			44,880		44,880

Illustration 3

A and B start business on 1st January, 2022, with capitals of ₹ 30,000 and ₹ 20,000. According to the Partnership Deed, B is entitled to a salary of ₹ 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 2022 the firm earned a profit, before charging salary to B and interest on capital amounting to ₹ 25,000. During the year A withdrew ₹ 8,000 and B withdrew ₹ 10,000 for domestic purposes.

Prepare Profit and Loss Appropriation Account.

Answer

Profit and Loss Appropriation Account for the year ended 31-Dec-22

Particulars	₹	Particulars	₹
To B's Capital Account-Salary	6,000	By Net Profit	25,000
To A's Capital Account-interest	1,800		
To B's Capital Account-interest	1,200		
To Profit transferred to:			
A's Capital Account (5/8)	10,000		
B's Capital Account (3/8)	6,000		
	<u>25,000</u>		<u>25,000</u>

NOTE: Since date of drawing & rate of interest on drawing is not given, it is assumed drawings are made on last day of year.

Let us also learn the preparation of capital accounts of partners with the help of same illustration of partnership firm consisting of partners A and B.

Illustration 4

A and B start business on 1st January, 2022, with capitals of ₹ 30,000 and ₹ 20,000. According to the Partnership Deed, B is entitled to a salary of ₹ 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 2022, the firm earned a profit, before charging salary to B and interest on capital amounting to ₹ 25,000. During the year A withdrew ₹ 8,000 and B withdrew ₹ 10,000 for domestic purposes.

Prepare Capital Accounts of Partners A and B.

Answer

A's Capital Account

2022	Particulars	₹	2022	Particulars	₹
Dec. 31	To Bank A/c- (Drawings)	8,000	Jan. 1	By Bank A/c	30,000
	To Balance c/d	33,800	Dec. 31	By Profit and Loss appropriation A/c Interest	1,800
				By Profit and Loss appropriation A/c – (5/8 Profit)	10,000
		<u>41,800</u>			<u>41,800</u>
			2021 Jan. 1	By Balance b/d	33,800

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B's Capital Account

2022	Particulars	₹	2022	Particulars	₹
Dec. 31	To Bank A/c (Drawings)	10,000	Jan. 1	By Bank A/c	20,000
Dec. 31	To Balance c/d	23,200	Dec. 31	By Profit and Loss appropriation A/c	
				- Salary	6,000
				- Interest	1,200
				By Profit and Loss appropriation A/c - (3/8 Profit)	6,000
		33,200			33,200
			2023 Jan. 1	By Balance b/d	23,200

Illustration 5

A and B are partners sharing profits and losses in the ratio of their effective capital. They had ₹ 1,00,000 and ₹ 60,000 respectively in their Capital Accounts as on 1st January, 2022.

A introduced a further capital of ₹ 10,000 on 1st April, 2022 and another ₹ 5,000 on 1st July, 2022.

On 30th September, 2022 A withdrew ₹ 40,000.

On 1st July, 2022, B introduced further capital of ₹ 30,000.

The partners drew the following amounts in anticipation of profit.

A drew ₹ 1,000 per month at the end of each month beginning from January, 2022. B drew ₹ 1,000 on 30th June, and ₹ 5,000 on 30th September, 2022.

12% p.a. interest on capital is allowable and 10% p.a. interest on drawings is chargeable. Date of closing 31.12.2022. Calculate: (a) Profit-sharing ratio; (b) Interest on capital; and (c) Interest on drawings.

Answer
(a) Calculation of Effective Capital

A		B	
₹ 1,00,000 invested for 3 months i.e., ₹ 3,00,000 invested for 1 month	3,00,000	₹ 60,000 invested for 6 months i.e., ₹ 3,60,000 invested for 1 month	3,60,000
₹ 1,10,000 invested for 3 months i.e., ₹ 3,30,000 invested for 1 month.	3,30,000	₹ 90,000 invested for 6 months, i.e., ₹ 5,40,000 invested for 1 month	<u>5,40,000</u>
			<u>9,00,000</u>
₹ 1,15,000 invested for 3 months i.e., ₹ 3,45,000 invested for 1 month.	3,45,000		
₹ 75,000 invested for 3 months, i.e., ₹ 2,25,000 invested for 1 month.	<u>2,25,000</u>		
	<u>12,00,000</u>		

(b) Calculation of Interest on Capital

$$A = ₹ 12,00,000 \times 12/100 \times 1/12 = ₹ 12,000$$

$$B = ₹ 9,00,000 \times 12/100 \times 1/12 = ₹ 9,000$$

(c) Calculation of Interest on Drawings

$$A = ₹ 12,000 \times 10/100 \times 5.5/12 = ₹ 550$$

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$$B = ₹ 1,000 \times 10/100 \times 6/12 = ₹ 50$$

$$₹ 5,000 \times 10/100 \times 3/12 = ₹ 125$$

Effective capital is in the ratio 12 : 9 therefore profit sharing ratio is 12 : 9 i.e. 4 : 3.

Illustration 6

Ram and Rahim start business with capital of ₹ 50,000 and ₹ 30,000 on 1st January, 2022. Rahim is entitled to a salary of ₹ 400 per month. Interest is allowed on capitals and is charged on drawings at 6% per annum. Profits are to be distributed equally after the above noted adjustments. During the year, Ram withdrew ₹ 8,000 and Rahim withdrew ₹ 10,000. The profit for the year before allowing for the terms of the Partnership Deed came to ₹ 30,000. Assuming the capitals to be fixed, prepare the Profit and Loss Appropriation Account and the Capital and Current Accounts relating to the partners.

Answer

Profit & Loss (Appropriation) Account

2022	Particulars	₹	2022	Particulars	₹
Dec. 31	To Rahim's Current A/c		Dec. 31	By Net Profit	30,000
	Salary	4,800		By Sundries-Interest on Drawings:	
	To Sundries-Interest on			Ram's Current A/c (6% on ₹ 8,000 for 6 months)	240
	Capitals :			Rahim's Current A/c (6% on ₹ 10,000 for 6 months)	300
	Ram's Current A/c	3,000			
	Rahim's Current A/c	1,800			
	To Profit transferred to				
	Ram's Current A/c (1/2)	10,470			
	Rahim's Current A/c (1/2)	10,470			
		<u>30,540</u>			<u>30,540</u>

Illustration 7

With the help of same information given in illustration 6, let us prepare the Capital and Current Accounts of Ram and Rahim.

Answer

Ram's Capital Account

2022	Particulars	₹	2022	Particulars	₹
Dec. 31	To Balance c/d	50,000	Jan. 1	By Bank A/c	50,000
			2023		
			Jan. 1	By Balance b/d	<u>50,000</u>

Rahim's Capital Account

2022	Particulars	₹	2022	Particulars	₹
Dec. 31	To Balance c/d	30,000	Jan. 1	By Bank A/c	30,000
			2023		
			Jan. 1	By Balance b/d	<u>30,000</u>

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Ram's Current Account

2022	Particulars	₹	2022	Particulars	₹
Dec. 31	To Cash Bank A/c (Drawings)	8,000	Dec. 31	By Profit and Loss appropriation A/c - Interest	3,000
	To Profit and Loss appropriation A/c - Interest on Drawings	240		By Profit and Loss appropriation A/c – ½ profit	10,470
	To Balance c/d	<u>5,230</u>			
		<u>13,470</u>			<u>13,470</u>
			2023 Jan. 1	By Balance b/d	5,230

Rahim's Current Account

2022	Particulars	₹	2022	Particulars	₹
	To Cash Bank A/c (Drawings)	10,000	Dec. 31	By Profit and Loss appropriation A/c Salary	4,800
Dec. 31	Interest on Drawings	300		By Interest	1,800
	To Balance c/d	<u>6,770</u>		By Profit and Loss appropriation A/c Profit	10,470
		<u>17,070</u>			<u>17,070</u>
			2023 Jan. 1	By Balance b/d	6,770

Illustration 8

A and B were partners in a firm sharing profits and losses in the ratio of 3:2. They admit C for 1/6th share in profits and guaranteed that his share of profits will not be less than ₹ 25,00,000. Total profits of the firm for the year ended 31st March, 2022 were ₹ 90,00,000. 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.

Answer

Case1. When Guarantee is given by firm.

Profit and Loss Appropriation Account
For the year ending on 31st March, 2022

Particulars	₹	Particulars	₹
To A's Capital A/c (3/5 of ₹ 65,00,000)	3,90,00,000	By Profit and Loss, A/c	9,00,00,000
To B's Capital A/c (2/5 of ₹ 65,00,000)	2,60,00,000		
To C's Capital A/c (1/6 of ₹ 9,00,00,000 or ₹ 25,00,000 which ever is more)	<u>2,50,00,000</u>		
	<u>9,00,00,000</u>		<u>9,00,00,000</u>

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Case2. When Guarantee is given by A

Profit and Loss Appropriation Account
For the year ending on 31st March, 2022

Particulars	₹	Particulars	₹
To A's Capital A/c (3/6 of ₹ 9,00,00,000) 4,50,00,000		By Profit and Loss, A/c (net profits) 9,00,00,000	
Less: Deficiency borne for C (1,00,00,000) 3,50,00,000			
To B's Capital A/c (2/6 of ₹ 9,00,00,000) 3,00,00,000			
To C's Capital A/c (1/6 of ₹ 9,00,00,000) 1,50,00,000			
Add: Deficiency Recovery from A 1,00,00,000 2,50,00,000			
	9,00,00,000		9,00,00,000

Case3. When Guarantee is given by A and B equally.

Profit and Loss Appropriation Account
For the year ending on 31st March, 2022

Particulars	₹	Particulars	₹
To A's Capital A/c (3/6 of ₹ 9,00,00,000) 4,50,00,000		By Profit and Loss, A/c (net profits) 9,00,00,000	
Less: Deficiency borne for C (1/2 of 1,00,00,000) (50,00,000) 4,00,00,000			
To B's Capital A/c (2/6 of ₹ 9,00,00,000) 3,00,00,000			
Less: Deficiency borne for C (1/2 of 1,00,00,000) (50,00,000) 2,50,00,000			
To C's Capital A/c (1/6 of ₹ 9,00,00,000) 1,50,00,000			
Add: Deficiency Recovery from A (50,00,000)			
Add: Deficiency Recovery from B (50,00,000) 2,50,00,000			
	9,00,00,000		9,00,00,000

Example 1

A and B commenced business in partnership on 1 January 2022. No partnership agreement was made either oral or written. They contributed ₹ 40,000 and ₹ 10,000 respectively as capital. In addition, A also advanced ₹ 20,000 on 1 July 2022. A met with an accident on 1 April 2022 and could not attend to the partnership business upto 30 June 2022. The profits for the year ended on 31 December 2022 amounted to ₹ 50,600. Disputes having been arisen between them for sharing the profits.

A claims: (i) He should be given interest at 10% p.a. on capital and loan (ii) Profit should be distributed in proportion of capital.

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B claims: (i) Net profit should be shared equally. (ii) He should be allowed remuneration of ₹ 1,000 p.m. during the period of A's illness. (iii) Interest on capital and loan should be given @ 6% p.a. You are required to settle the dispute between them and distribute the profits according to law. State reasons for your answer.

Answer

Since there is no written or oral partnership agreement, allowing rules are applicable as per Indian partnership act 1932

- (a) No interest is allowed on capital.
- (b) 6% p.a. interest is allowed on the loan advanced.
- (c) Prof ts and losses shall be shared equally.
- (d) No remunerat on is allowed to any partner for taking part in the conduct of the business.

Thus

- (a) neither of A nor B will be allowed interest on capital
- (b) 6% interest will be allowed to both A and B
- (c) Prof t and losses shall be shared equally between A and B
- (d) No remunerat on shall be allowed to B.

Net prof t for the year	=	50,600
Less: Int. on A's loan $20,000 \times 6\% \times 6/12$	=	<u>600</u>
Net Prof t	=	<u>50,000</u>

A's 50% = 25,000

B's 50% = 25,000

Example 2

A, B and C are partners in a firm sharing profits and losses in the ratio of 2:3:5. Their fixed capitals were

₹ 15,00,000, ₹ 30,00,000 and ₹ 60,00,000 respectively. For the year 2022 interest on capital was credited to them @ 12% instead of 10%. Pass the necessary adjustment entry.

Part culars	A	B	C	Firm
Interest that should have been credited @ 10%	1,50,000	3,00,000	6,00,000	10,50,000
Interest already credited @ 12%	<u>1,80,000</u>	<u>3,60,000</u>	<u>7,20,000</u>	<u>12,60,000</u>
Excess credit in partners account	(30,000)	(60,000)	(1,20,000)	(2,10,000)
By recovering the extra amount paid, the share of prof ts will increase and it will be credited in the rat o of 2:3:5	<u>42,000</u>	<u>63,000</u>	<u>105,000</u>	<u>2,10,000</u>
	<u>12,000</u>	<u>3,000</u>	<u>(15,000)</u>	<u>-</u>

The necessary journal entry will be:

Part culars	Debit (₹)	Credit (₹)
C's Current A/c	15,000	
To A's Current A/c		12,000
To B's Current A/c		3,000
(Interest less charged now rect f ed)		

Example 3

Shilpa and Sanju are partners with a capital of ₹1,00,000 and ₹1,60,000 on January 1,2022 respectively. Shilpa introduced additional capital of ₹30,000 on July 1, 2022 and another ₹20,000 on

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October 31, 2022. Calculate interest on capital for the year ending 2022. The rate of interest is 9% p.a.

Answer

Interest on Capital (Shilpa):

On ₹1,00,000 for 12 month @ 9%	=	$1,00,000 \times 9/100 \times 12/12$
	=	₹ 9,000
On ₹30,000 for 6 month @ 9%	=	$30,000 \times 9/100 \times 6/12$
	=	₹ 1,350
On ₹20,000 for 2 month @ 9%	=	$20,000 \times 9/100 \times 2/12$
	=	₹ 300
Total interest on shilpa capital	=	₹ 9,000 + ₹ 1,350 + ₹ 300
	=	₹ 10,650

By product method

Amount (₹)	Months	Product
1,00,000	12	12,00,000
30,000	6	1,80,000
20,000	2	40,000
Total product		14,20,000

Interest on capital $14,20,000 \times 9/100 \times 1/12 = ₹ 10,650$

Interest on Capital (Sanju):

On ₹1,60,000 for 12 month @ 9% = $1,60,000 \times 9/100 \times 12/12 = ₹ 14,400$

By product method: = $1,60,000 \times 12 = 19,20,000 = 19,20,000 \times \frac{9}{100} \times \frac{1}{12} = 14,400$

Example 4

A and B formed a partnership with a capital contribution of ₹50,000 and ₹30,000 respectively on 1st January 2022. The profits were to be shared in the capital ratio. Calculate the capital ratio on the basis of following details:

	Capital Introduced		Capital Withdrawn	
	A (₹)	B (₹)	A (₹)	B (₹)
31 March	5,000	—	—	2,000
1 July	—	9,000	3,000	—
1 September	5,500	—	—	1,000
1 November	—	4,000	4,500	—

Answer

Total Capital Employed by A for one Month

Capital (₹)	Months for which capital has been used in the business	Product (₹)
50,000	3	1,50,000
55,000	3	1,65,000
52,000	2	1,04,000
57,500	2	1,15,000
53,000	2	1,06,000
Total		6,40,000

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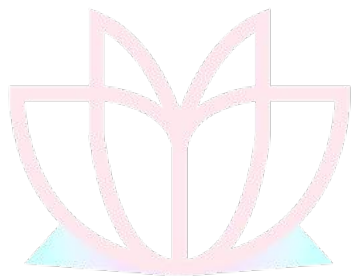
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Total Capital Employed by B for one Month

Capital	Months for which capital has been used in the business	Product
(₹)		(₹)
30,000	3	90,000
28,000	3	84,000
37,000	2	74,000
36,000	2	72,000
40,000	2	80,000
Total		4,00,000

On the basis of products of both the partners, the capital ratio between A and B is 64: 40 or 8 : 5.



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Chapter 10.2 Treatment Of Goodwill In Partnership Accounts

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True and False

Question 1

Goodwill is intangible asset therefore it cannot be valued.

Answer 1

False: Even though Goodwill is intangible asset it can be valued in terms of money.

Question 2

Goodwill is valued whenever there is change in the profit sharing ratio among the partners.

Answer 2

True: Goodwill has to be valued every time whenever there is a reconstitution.

Question 3

Goodwill is the value of reputation of a firm in respect of profits expected in future over and above the normal rate of profits.

Answer 3

True: Goodwill is the brand image the firm has in the market due to which it enjoys an advantageous position over the other players in the market.

Question 4

At the time of admission or retirement of a partner, goodwill can be raised in the books of accounts and shown as an asset.

Answer 4

False: At the time of admission or retirement of a partner, goodwill should not be raised in the books of account of partnership firm because no consideration in money or money worth has been paid for it.

Question 5

Only simple average method can be used for valuation of goodwill.

Answer 5

False: Weighted average profit method, capitalisation method, super profits methods also can be used for valuation of Goodwill.

Question 6

Super profit means excess of actual average profit over normal profit.

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Answer 6

True: Super profit means excess profit that can be earned by the firm over and above the normal profit usually earned by similar firms under similar circumstances.

Question 7

Normal profit means profit earned by similar companies in the same industry.

Answer 7

True: The rate of return is considered as an average for the industry, which is applied to the capital employed in the concerned firm.

Question 8

Normal profit depends upon Normal Rate of Return and past profits.

Answer 8

False: Normal profit depends upon Normal rate of return only and not on past profits.

Question 9

At the time of admission/retirement of a partner, since goodwill can not be raised in the books of accounts is recorded through capital accounts of the partners.

Answer 9

True: Generally, the goodwill at the time of admission is adjusted through the capital accounts and not shown in the books of the firm.

Question 10

At the time of admission of a partner, goodwill brought in by the new partner is shared equally by old partners.

Answer 10

False: Goodwill brought in by new partner is shared by old partners in sacrificing ratio and not equally.

Multiple Choice Questions

1. Goodwill brought in by incoming partner in cash for joining in a partnership firm is taken away by the old partners in their.....ratio.
 - (d) Capital.
 - (e) New Profit Sharing.
 - (f) Sacrificing.

Answer 1 : (c)

2. A & B are partners sharing profits and losses in the ratio 5:3. On admission, C brings ₹ 70,000 cash and ₹ 48,000 against goodwill. New profit sharing ratio between A, B and C are 7:5:4. Find the sacrificing ratio of A:B.
 - (a) 3:1.
 - (b) 4:7.
 - (c) 5:4.

Answer 2 : (a)

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3. Following are the factors affecting goodwill except:

- (a) Nature of business.
- (b) Efficiency of management.
- (c) Location of the customers.

Answer 3 : (c)

4. Weighted average method of calculating goodwill should be followed when:

- (a) Profits has increasing trend.
- (b) Profits has decreasing trend.
- (c) Either 'a' or 'b'.

Answer 4 : (c)

5. In the absence of any provision in the partnership agreement, profits and losses are shared

- (a) In the ratio of capitals.
- (b) Equally.
- (c) In the ratio of loans given by them to the partnership firm.

Answer 5 : (b)

6. The profits and losses for the last 4 years are 2018-19 Losses ₹ 10,000; 2019-20 Losses ₹ 2,500; 2020-21 Profits ₹ 98,000 & 2021-22 Profits ₹ 76,000. The average capital employed in the business is ₹ 2,00,000. The rate of interest expected from capital invested is 12%.

The remuneration of partners is estimated to be ₹ 1,000 per month not charged in the above losses/profits. Calculate the value of goodwill on the basis of two years purchase of super profits based on the average of four years.

- (a) ₹ 9,000.
- (b) ₹ 8,750.
- (c) ₹ 8,250.

Answer 6 : (b)

7. A, B and C are partners sharing profits and losses in the ratio 3:2:1. They decide to change their profit sharing ratio to 2:2:1. To give effect to this new profit sharing ratio they decide to value the goodwill at ₹ 30,000. Pass the necessary journal entry if Goodwill not appearing in the old balance sheet and should not appear in the new balance sheet.

- (d) B's Capital Account Dr. ₹ 2,000
C's Capital Account Dr. ₹ 1,000
To A's Capital Account ₹ 3,000
- (e) Goodwill Account Dr. ₹ 30,000
To A's Capital Account ₹ 15,000
To B's Capital Account ₹ 10,000
To C's Capital Account ₹ 5,000
- (f) A's Capital Account Dr. ₹ 12,000
B's Capital Account Dr. ₹ 12,000
C's Capital Account Dr. ₹ 6,000
To Goodwill Account ₹ 30,000

Answer 7 : (a)

Theoretical Questions & Answers

Question 1

Write short note on methods for valuation of goodwill.

Answer 1

There are three methods for valuation of goodwill

- (i) Average profit basis - Simple and Weighted
- (ii) Super profit basis - Number of Year Purchase, Annuity basis, and Capitalization of Super Profit
- (iii) Capitalization basis

Question 2

Explain Accounting treatment of goodwill in case of change in profit sharing ratio. Distinguish between Super profit basis and Capitalisation Basis.

Answer 2

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.

Super Profit Basis: In case of average profit basis, goodwill is calculated on the basis of average profit multiplied by certain number of years.

Super Profit = Actual Profit - Normal Profit

Actual Profit is average profit and Normal Profit = Normal rate of Return (NRR)

Capitalization Basis: Under this basis, value of whole business is determined applying normal rate of return. If such value (arrived at by applying normal rate of return) is higher than the capital employed in the business, then the difference is goodwill.

Practical Questions & Answers

Question 1

Wise, Clever and Dull were trading in partnership sharing profits and losses 4:3:3 respectively. The accounts of the firm are made upto 31st December every year.

The partnership provided, inter alia, that:

On the death of a partner the goodwill was to be valued at three years' purchase of average profits of the three years upto the date of the death after deducting interest @8 percent on capital employed and a fair remuneration of each partner. The profits are assumed to be earned evenly throughout the year.

On 30th June, 2022, Wise died and it was agreed on his death to adjust goodwill in the capital accounts without showing any amount of goodwill in the Balance Sheet.

It was agreed for the purpose of valuation of goodwill that the fair remuneration for work done by each partner would be ₹ 15,000 per annum and that the capital employed would be ₹ 1,56,000. Clever and Dull were to continue the partnership, sharing profits and losses equally after the death of Wise.

The following were the amounts of profits of earlier years before charging interest on capital employed.

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	₹
2019	67,200
2020	75,600
2021	72,000
2022	62,400

You are required to compute the value of goodwill and show the adjustment there of in the books of the firm.

Answer 1

Computat on of the value of goodwill:

(i)	Average Prof t for three years, ending 30th June; before death:		
	Year ending 30th June, 2020:	₹	₹
	1/2 of 2019 prof ts	33,600	
	1/2 of 2020 Prof ts	37,800	71,400
	Year ending 30th June, 2021:		
	1/2 of 2020	37,800	
	1/2 of 2021 Prof ts	36,000	73,800
	Year ending 30th June, 2022:		
	1/2 of 2021	36,000	
	1/2 of 2022 Prof ts	31,200	67,200
	Total		2,12,400
	Average Prof ts		
	Alternat vely it can be calculated as below :		
	1/2 prof t of 2019 + prof t of 2020 + prof t of 2021 + prof t of 2022 = $\frac{33,600+75,600+72,000+31,200}{3} = 70,800$		
(ii)	Average future maintainable prof t :		
	Average prof ts earned		70,800
	Less : Partner's remunerat on	45,000	
	Less: 8% on capital employed	12,480	(57,480)
			13,320
(iii)	Goodwill of the f rm @ three years' purchase		39,960
(iv)	Wise's share of Goodwill = 4/10 of 39,960 = 15,984		

Adjustment entry for Goodwill

Journal Entry

	Dr. ₹	Cr. ₹
Clever's Capital Account	Dr. 7,992	
Dull's Capital Account	Dr. 7,992	
To Wise's Capital Account (Adjust ng entry passed for share of goodwill of Wise through remaining partners' capital accounts in gaining rat o)		15,984

Working Note:

Partner	New Share	Old Share	Dif erence
Wise	-	4/10	4/10
Clever	1/2	3/10	2/10

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Dull	1/2	3/10	2/10

There is no change in profit sharing ratio of containing partners therefore gain ratio will be same as profit sharing ratio.

Illustration 1

Lee and Lawson are in 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 2019-2022 as follows:

Year	Prof ts (₹)
2019	1,20,000
2020	1,25,000
2021	1,30,000
2022	1,50,000

On 31.12.2022 capital employed by M/s. Lee and Lawson was ₹ 5,00,000. Rate of normal profit is 20%.

Required

Find out the value of goodwill following various methods.

Answer

Average Profit:

Year	Prof t	Weight	Weighted Prof t ₹
2019	1,20,000	1	1,20,000
2020	1,25,000	2	2,50,000
2021	1,30,000	3	3,90,000
2022	1,50,000	4	6,00,000
		10	13,60,000

Weighted Average Profit = ₹ 13,60,000 divided by 10 = ₹ 1,36,000

Method (1): Average Profit Basis

Assumption: Goodwill is valued at 3 year's purchase

Valuation of Goodwill: ₹ 1,36,000 × 3 = ₹ 4,08,000

Method (2): Super Profit Basis

	₹
Average Prof t	1,36,000
Less: Normal Prof t	
20% on ₹ 5,00,000	(1,00,000)
	₹ 36,000

Assumption: Goodwill is valued at 3 years' purchase.

Value of Goodwill = ₹ 36,000 × 3 = ₹ 1,08,000

Method (3): Annuity Basis

Assumptions:

(a) Interest rate is equivalent to normal profit rate i.e. 20%p.a.

(b) Goodwill is valued at 3 years' purchases

Valuation of Goodwill: ₹ 36,000 × 2.1065 = ₹ 75,834

Method (4): Capitalisation Basis

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Normal Value of business: $\frac{₹ 1,36,000}{20} \times 100$	=	₹ 6,80,000
Less: Capital Employed in M/s. Lee and Lawson	=	(₹ 5,00,000)
Goodwill	=	₹ 1,80,000

Illustration 2

The following particulars are available in respect of the business carried on by Rathore

		₹
(1) Capital Invested		1,50,000
(2) Trading Results:		
2019	Prof t	40,000
2020	Prof t	36,000
2021	Loss	6,000
2022	Prof t	50,000
(3) Market Rate of interest on investment	10%	
(4) Rate of risk return on capital invested in business	2%	
(5) Remunerat on from alternat ve employment of the proprietor (if not engaged in business).	₹ 6,000 per annum	

You are required to compute the value of goodwill on the basis of 5years' purchase of super profit of the business calculated on the average profits of the last four years.

Answer

Average maintainable prof ts:		₹
Trading prof t during	2019	40,000
	2020	36,000
	2021	50,000
		1,26,000
Less: Loss during	2022	(6,000)
Total		1,20,000
Average Prof ts		30,000
Less: Remunerat on for the proprietor		(6,000)
Average maintainable Prof t		24,000
Less: Normal Prof t (12% on capital employed of ₹ 1,50,000)		(18,000)
Super Prof t		6,000
Goodwill at 5 year's purchase of super Prof t		30,000

Illustration 3

The following is the Balance Sheet of Yellow and Green as at 31st December, 2022:

Liabilit es	₹	Assets	₹
Trade payables	20,000	Cash at Bank	10,000
Capital:		Sundry Assets	55,000
Yellow	25,000		
Green	20,000		
	65,000		65,000

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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 ₹ 20,000 as Capital. Goodwill was to be valued at 3 years' purchase of the average of four years' profits which were:

	₹		₹
2019	9,000	2021	12,000
2020	14,000	2022	13,000

The new profit sharing ratio is 6:5:5.

Give journal entries and Balance Sheet if goodwill is adjusted through partners' capital accounts.

Answer

			₹	₹
(i)	Bank Account	Dr.	20,000	
	To Black's Capital Account (Amount brought in by Black as capital)			20,000
(ii)	Black's Capital Account	Dr.	11,250	
	To Yellow's Capital Account			8,100
	To Green's Capital Account (Black's share of goodwill adjusted through old partners' capital accounts in the profit sacrificing ratio 18:7)			3,150

Balance Sheet as on 31st December, 2022

Liabilities	₹	₹	Assets	₹
Trade payables		20,000	Cash at Bank	30,000
Capital:			Sundry Assets	55,000
Yellow	33,100			
Green	23,150			
Black	8,750	65,000		
		85,000		85,000

Note: Calculation of Profit Sacrificing Ratio

Old Share – New Share = Share Sacrificed

$$\text{Yellow } \frac{3}{5} - \frac{6}{16} = \frac{18}{80}$$

$$\text{Green } \frac{2}{5} - \frac{5}{16} = \frac{7}{80}$$

Calculation of Goodwill

$$\text{Average profit} = \frac{9,000 + 14,000 + 12,000 + 13,000}{4} = 12,000$$

$$\text{Goodwill of the firm} = 3 \times 12,000 = 36,000$$

$$\text{Black share} = \left(\frac{36,000}{16} \right) \times 5 = 11,250$$

Illustration 4

With the information given in illustration 3, let us give journal entries and prepare balance sheet assuming that goodwill is brought in cash.

Answer

Goodwill brought in cash

Bank Account	Dr.	31,250	
To Black's Capital Account			20,000

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To Yellow's Capital Account			8,100
To Green's Capital Account (Amount brought in by Black as capital and as goodwill; goodwill credited to Yellow and Green's Capital accounts in the profit sacrificing ratio)			3,150

Balance Sheet as on 31st December, 2022

Liabilities	₹	₹	Assets	₹
Trade payables		20,000	Cash at Bank	41,250
Capital:			Sundry Assets	55,000
Yellow	33,100			
Green	23,150			
Black	20,000	76,250		
		96,250		96,250

Illustration 5

Continuing with the same illustration 3, let us give journal entries and prepare balance sheet assuming that goodwill is brought in cash, but withdrawn.

Answer

Goodwill brought in cash, but withdrawn

In addition to the treatment under Illustration 3 the following additional entry will be made:

Yellow's Capital Account	Dr.	8,100	
Green's Capital Account	Dr.	3,150	
To Bank Account (Amount withdrawn by Yellow and Green in respect of goodwill credited to them)			11,250

Balance Sheet as on 31st December, 2022

Liabilities	₹	₹	Assets	₹
Trade payables		20,000	Cash at Bank	30,000
Capital:			Sundry Assets	55,000
Yellow	25,000			
Green	20,000			
Black	20,000	65,000		
		85,000		85,000

Illustration 6

On the basis of information given in illustration 3, let us give journal entries and prepare balance sheet assuming that goodwill is paid privately.

Answer

There will be no entry for goodwill but Black will pay ₹ 8,100 to Yellow and ₹ 3,150 to Green. For capital brought in by Black, the entry is:

Bank Account	Dr.	20,000	
To Black's Capital Account			20,000

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(Amount brought in by Black as capital)				
Balance Sheet as on.....				
Liabilities	₹	₹	Assets	₹
Trade payables		20,000	Cash at Bank	30,000
Capital:			Sundry Assets	55,000
Yellow	25,000			
Green	20,000			
Black	<u>20,000</u>	<u>65,000</u>		
		<u>85,000</u>		<u>85,000</u>

Illustration 7

A, B & 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 ₹ 90,000.

Answer

Journal Entry

A's Capital	Dr.	10,000	
To C's Capital A/c			10,000

In this case due to change in profit sharing ratio

A's gain is = $\frac{4}{9}$ less $\frac{1}{3} = \frac{1}{9}$

B's gain is = $\frac{1}{3}$ less $\frac{1}{3} = 0$

C's loss is = $\frac{1}{3}$ less $\frac{2}{9} = \frac{1}{9}$

So, A should compensate C to the extent of $\frac{1}{9}$ th of goodwill i.e. ₹ $90,000 \times \frac{1}{9} = ₹ 10,000$

Illustration 8

A, B and C are in partnership 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 ₹ 20,000. Calculate the sacrifice / gain by the partners and make the necessary journal entry.

Answer

Partner	New Share	Old Share	Difference
A	$\frac{7}{20}$	$\frac{4}{10}$	$= \left(\frac{1}{20}\right)$
B	$\frac{7}{20}$	$\frac{3}{10}$	$= \frac{1}{20}$
C	$\frac{6}{20}$	$\frac{3}{10}$	$= 0$

Thus, B gained $\frac{1}{20}$ th share while A sacrificed $\frac{1}{20}$ th share i.e. ₹ $20,000 \times \frac{1}{20} = ₹ 1,000$. For C there was no loss no gain.

Journal Entry

B's Capital A/c	Dr.	1,000	
To A's Capital A/c			1,000
(Being goodwill adjusted through partners' capital accounts in sacrificing/gaining ratio)			

Illustration 9
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A, B, C and D are in partnership sharing profits and losses equally. They mutually agreed to change the profit sharing ratio to 3:3:2:2. Goodwill of the firm is valued at ₹ 20,000. Give necessary journal entry.

Answer

$$\text{A gains by } \frac{3}{10} - \frac{1}{4} = \frac{1}{20}$$

$$\text{B gains by } \frac{3}{10} - \frac{1}{4} = \frac{1}{20}$$

$$\text{C gains by } \frac{1}{4} - \frac{2}{10} = \frac{1}{20}$$

$$\text{D gains by } \frac{1}{4} - \frac{2}{10} = \frac{1}{20}$$

A and B should pay @₹ 1,000 each (i.e., ₹ 20,000 × 1/20) as compensation to C and D respectively for their sacrifice.

Journal Entry

A's Capital Account	Dr.	1,000	
B's Capital Account	Dr.	1,000	
To C's Capital Account			1,000
To D's Capital Account			1,000
(Being goodwill adjusted through partners' capital accounts at sacrificing/gaining ratio)			

Illustration 10

Antoo, Bantoo and Chintoo were in partnership sharing profits and losses 3:4:3 respectively. The accounts of the firm are made up to 31st March every year. The partnership provided, inter alia, that: On the retirement of a partner the goodwill was to be valued at three years' purchase of average profits of the past four years up to the date of the retirement after deducting interest @12%p.a. on capital employed and remuneration of ₹ 2,000 p.m. to each partner. On 1st April 2022, Antoo retired and it was agreed on his retirement to adjust goodwill in the capital accounts without showing any amount of goodwill in the Balance Sheet. It was agreed that the capital employed would be ₹ 6,50,000. Bantoo and Chintoo were to continue the partnership, sharing profits and losses equally after the retirement of Antoo. The following were the amounts of profits of earlier years before charging salary to partners and interest on capital employed.

Year	Profit
2018-19	2,60,000
2019-20	2,75,000
2020-21	2,65,000
2021-22	2,80,000

You are required to compute the value of goodwill and show the adjustment there of in the books of the firm.

Answer

Valuation of Goodwill

Calculation of Average Profit

2018-19	2,60,000

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2019-20	2,75,000
2020-21	2,65,000
2021-22	2,80,000
Total	<u>10,80,000</u>

Average Profit (10,80,000/4)	2,70,000
Less: Interest on capital @ 12%p.a.	78,000
Less: Salaries of partners' (3 x 12 x 2,000)	<u>72,000</u>
Adjusted Average profit	1,20,000
Goodwill (3 years purchase = 3 x 1,20,000)	3,60,000
Antoo's Share of Goodwill (3/10) i.e.	1,08,000

Adjustment Journal entry for Goodwill

Bantoo's Capital Account	Dr.	36,000	
Chintoo's Capital Account	Dr.	72,000	
To Antoo's Capital Account (Adjusting entry passed for share of goodwill of Antoo through remaining partners' capital accounts in gaining ratio)			1,08,000

Working Note:

Partner	New Share	Old Share	Difference
Antoo	0	3/10	-3/10
Bantoo	1/2	4/10	1/10
Chintoo	1/2	3/10	2/10

Illustration 11

Cu and Au were in partnership sharing profits and losses in the ratio 5:3. On 1st April 2022, they decided to admit Ag the partnership on the following terms:

- Ag will bring ₹ 2,00,000/- as capital for $\frac{1}{4}$ share.
- New profit sharing ratio shall be 2:1:1 among Cu, Au and Ag.
- Cu was entitled to salary of ₹ 2,000/- p.m., it was revised to ₹ 3,000 p.m. from 1st October 2020.
- Interest on capital was paid at 8% p.a.
- Capitals as on 31st March 2022 were Cu ₹ 4,00,000 Au ₹ 3,00,000, which had remained unchanged since last four years.
- Goodwill was to be valued on the basis of 3 years purchase of average adjusted weighted average profits of past 4 years. The profits of previous four years, before charging interest on capital and salary to Cu were as follows:

Year	Profit
2018-19	2,10,000
2019-20	2,60,000
2020-21	2,10,000
2021-22	3,05,000

These profits were subject to following rectification

- (a) A machine costing ₹ 40,000 purchased on 1st October, 2020 was wrongly charged to revenue. The machinery was depreciated at 20% p.a. on written down value method

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- (b) Stock on 31st March 2020 was over valued by ₹ 20,000/-
- (c) There was a loss by fire amounting to ₹ 10,000/- in the year 2018-19 which was not considered in trading account but correctly debited in the Profit & Loss a/c for that year.
- (d) Debtors as on 31st March 2022 included bad debts of ₹ 5,800/-
7. Ag shall bring his share of goodwill in cash.
 You are required to calculate amount of goodwill Ag is supposed to bring and journal entry for the same.

Answer

Valuation of goodwill

Particulars	2018-19	2019-20	2020-21	2021-22
Profits	2,10,000	2,60,000	2,10,000	3,05,000
Less: Salary to Cu	(24,000)	(24,000)	(30,000)	(36,000)
Less: Interest on Capital of Partners	(56,000)	(56,000)	(56,000)	(56,000)
Add: Machine to be capitalised			40,000	
Less: Depreciation on above			(4,000)	(7,200)
Less: Overvaluation of closing stock		(20,000)		
Add: Overvaluation of opening stock			20,000	
Add: Loss by fire	10,000			
Less: Bad debts to be written off				(5,800)
Adjusted profits	1,40,000	1,60,000	1,80,000	2,00,000
Weights	1	2	3	4
Product	1,40,000	3,20,000	5,40,000	8,00,000

Weighted Average profit = total product / total weights

= 18,00,000 / 10 = 1,80,000

Goodwill (3 years purchase) = 3 × 1,80,000 = 5,40,000

Ag's share $\frac{1}{4}$ th = 5,40,000 / 4 = 1,35,000

Adjustment Journal entry for Goodwill

Bank A/c	Dr.	1,35,000	
To Cu's Capital Account			67,500
To Au's Capital Account			67,500
(Adjusting amount brought in by Ag towards goodwill credited to remaining partners' capital accounts in sacrifice ratio)			

Working Note:

Partner	New Share	Old Share	Difference
Cu	$\frac{2}{4}$	$\frac{5}{8}$	$= \frac{1}{8}$
Au	$\frac{1}{4}$	$\frac{3}{8}$	$= \frac{1}{8}$
Ag	$\frac{1}{4}$		$= \frac{1}{4}$

Example 1

The past profits of five years of a partnership firm are: ₹ 50,000; ₹ 40,000; ₹ 52,000; ₹ 48,000 and ₹ 56,000 respectively. Calculate the value of goodwill on the basis of 4 years' purchase of the average profits of the last five years.

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Answer

Total profits for five years = ₹ (50,000 + 40,000 + 52,000 + 48,000 + 56,000) = ₹ 2,46,000

Average profit = Sum of profits/No. of years

Average Profit = ₹ 2,46,000 ÷ 5 = ₹ 49,200

Value of goodwill (being four years' purchase of the average profit of five years) = 4 × ₹ 49,200 = ₹ 1,96,800.

Example 2

A firm of A, B and C has a total capital investment of ₹ 4,50,000. The firm earned net profits during the last four years as: I-₹ 70,000; II-₹ 80,000; III-₹ 1,20,000 and IV-₹ 1,00,000. The reasonable expected return is 15 per cent having regard to the risk involved. The value of goodwill of the business, if it is based on 3 years' purchase of the average super profits of the past four years is as follows:

Answer

Average Profit = Sum of profits/no. of years Normal

Profit = NRR x Capital Employed

Super Profit = Average maintainable profit- Normal Profit

Total profits earned during four years : 3,70,000

Average annual profit ₹ 3,70,000 ÷ 4 92,500

Normal Profit (15% of ₹ 4,50,000) 67,500

Super Profit ₹ 92,500-₹ 67,500 25,000

Value of goodwill (being 3 years' purchase of the average super profit:

₹ 25,000 x 3 = 75,000

Example 3

Calculate the goodwill by annuity method of super profit from the following facts:

(a) Annual maintainable profit after tax is ₹ 65,000.

(b) Capital employed is ₹ 4,00,000.

(c) Normal rate of return is expected at 12% p.a.

(d) Present value of an annuity of ₹ 1 for five years @ 12% interest is 3.604776.

Answer

	₹
Annual maintainable profit	65,000
Less: Normal profit based on capital employed and normal rate of return i.e., 12% of ₹ 4,00,000	(48,000)
Super profit	17,000
The present value of an annuity of ₹ 1 for five years at 12% compound interest is	3.604776

The present value of annuity of ₹ 17,000 for five years at 12% compound interest = 17,000 x

3.604776 = ₹ 61,281 (Approx.)

Capitalization of Super Profit:

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$$\text{Goodwill} = \frac{\text{Super Profit}}{\text{Normal Rate of Return (NRR)}} = \frac{17,000}{12\%} = ₹ 14,1667$$

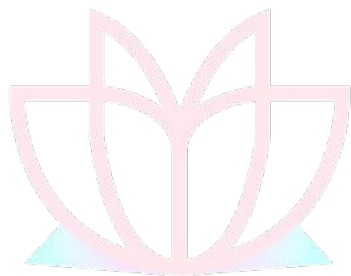
Example 4

The net tangible assets of a firm are worth ₹ 4,10,000 and the average profit of last four years amounts to ₹ 60,000. Find out the value of goodwill under capitalization method if the reasonable return on capital invested is 12%.

Answer

	₹
Capital invested in the business	4,10,000
Normal rate of return	12%
Average profit earned by the firm	60,000
Value of the firm (Capitalization of average profit): $60,000/12\% =$	5,00,000
Goodwill = Value of the firm – Net Assets = ₹ 5,00,000 – ₹ 4,10,000	90,000

Above methods are explained below with the help of following illustrations:



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Chapter 10.3 Dissolution of Partnership Firms And LLP

333

True and false

Question 1

A newly admitted partner does not have same rights as old partners.

Answer 1

False: All the partners have same rights at all times, unless contrary is provided in the partnership deed/or agreed by the partners.

Question 2

When a new partner is admitted, old partners have to forego certain share in profits of the firm, this is called as sacrifice ratio.

Answer 2

True: With every new partner, remaining old partners have to foregone a proportion in their share which is called as sacrificing ratio.

Question 3

Revaluation account is also called as Profit and Loss Adjustment Account.

Answer 3

True: Revaluation is also called as profit and loss adjustment account.

Question 4

Any appreciation in the value of an asset is credited to Revaluation account.

Answer 4

True: Increase in asset is an income hence credited to revaluation account.

Question 5

All the partners may decide not to change the values of assets and liabilities in the books of accounts.

Answer 5

True: This can be done by opening Memorandum Revaluation Account.

Question 6

New partner is entitled to have share in reserves appearing in the balance sheet prior to his admission.

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Answer 6

False: New partner is not entitled to have any share in the reserves of the firm prior to his admission. Such reserves are distributed to old partners in their old profit sharing ratio.

Question 7

If revaluation account shows credit balance then it represents profit and therefore it is credited to all partners equally.

Answer 7

False: If revaluation account shows credit balance then it represents profit and therefore it is credited to all partners in their profit sharing ratio and not equally.

Question 8

New partner brings necessary amount as his capital.

Answer 8

True: Every incoming partner shall bring in some amount of capital for the firm.

Question 9

New partner is entitled to share in revaluation profit.

Answer 9

False: New partner is not entitled to profit on revaluation, it belongs to old partners in their old profit sharing ratio.

Multiple Choice Questions

1. A and B are partners sharing profits and losses in the ratio 5:3. They admitted C and agreed to give him $\frac{3}{10}$ th of the profit. What is the new ratio after C's admission?

- a) 35:42:17.
- b) 35:21:24.
- c) 49:22:29.

Answer 1 (b)

2. A and B are partners sharing profits in the ratio 5:3, they admitted C giving him $\frac{3}{10}$ th share of profit. If C acquires $\frac{1}{5}$ from A and $\frac{1}{10}$ from B, new profit sharing ratio will be:

- a) 5:6:3.
- b) 2:4:6.
- c) 17:11:12

Answer 2 (c)

3. C was admitted in a firm with $\frac{1}{4}$ th share of the profits of the firm. C contributes ₹ 15,000 as his capital, A and B are other partners with the profit sharing ratio as 3:2. Find the required capital of A and B, if capital should be in profit sharing ratio taking C's as base capital:

- a) ₹ 27,000 and ₹ 16,000 for A and B respectively.
- b) ₹ 27,000 and ₹ 18,000 for A and B respectively.
- c) ₹ 32,000 and ₹ 21,000 for A and B respectively.

Answer 3 (b)

4. A, B and C are partners sharing profits and losses in the ratio 6:3:3, they agreed to take D into partnership for $\frac{1}{8}$ th share of profits. Find the new profit sharing ratio.

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- a) 2:27:36:42.
- b) 14:7:7:4.
- c) 1:2:3:4.

Answer 4 (b)

5. A and B are partners sharing profits and losses in the ratio of 3:2 (A's Capital is ₹ 30,000 and B's Capital is ₹ 15,000). They admitted C and agreed to give 1/5th share of profits to him. How much C should bring in towards his capital?
- (a) ₹ 9,000
 - (b) ₹ 12,000
 - (c) ₹ 11,250

Answer 5 (c)

6. A and B are partners sharing the profit in the ratio of 3:2. They take C as the new partner, who brings in ₹ 25,000 against capital and ₹ 10,000 against goodwill. New profit sharing ratio is 1:1:1. In what ratio will this amount will be shared among the old partners A & B.
- (a) ₹ 8,000: ₹ 2,000.
 - (b) ₹ 5,000: ₹ 5,000.
 - (c) Old partners will not get any share in the goodwill brought in by C.

Answer 6 (a)

7. A and B are partners sharing the profit in the ratio of 3:2. They take C as the new partner, who is supposed to bring ₹ 25,000 against capital and ₹ 10,000 against goodwill. New profit sharing ratio is 1:1:1. C brought cash for his share of Capital and agreed to compensate to A and B outside the firm. How this will be treated in the books of the firm.
- (a) Cash brought in by C will only be credited to his capital account.
 - (b) Goodwill will be raised to full value in old ratio.
 - (c) Goodwill will be raised to full value in new ratio.

Answer 7 (a)

8. X and Y are partners sharing profits in the ratio of 3: 1. They admit Z as a partner who pays ₹ 4,000 as Goodwill the new profit sharing ratio being 2:1: 1 among X, Y and Z respectively. The amount of goodwill will be credited to:
- (a) X and Y as ₹ 3,000 and ₹ 1,000 respectively.
 - (b) X only
 - (c) Y only.

Answer 8 (b)

9. P and Q are partners sharing Profits in the ratio of 2:1. R is admitted to the partnership with effect from 1st April on the term that he will bring ₹ 20,000 as his capital for 1/4th share and pays ₹ 9,000 for goodwill, half of which is to be withdrawn by P and Q. If profit on revaluation is ₹ 6,000 and opening capital of P is ₹ 40,000 and of Q is ₹ 30,000, find the closing balance of each capital.
- (a) ₹ 47,000: ₹ 33,500: ₹ 20,000
 - (b) ₹ 50,000: ₹ 35,000: ₹ 20,000.
 - (c) ₹ 40,000: ₹ 30,000: ₹ 20,000

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Answer 9 (a)

10. Adam, Brain and Chris were equal partners of a firm with goodwill ₹ 1,20,000 shown in the balance sheet and they agreed to take Daniel as an equal partner on the term that he should bring ₹ 1,60,000 as his capital and goodwill, his share of goodwill was evaluated at ₹ 60,000 and the goodwill account is to be written off before admission. What will be the treatment for goodwill?

- Write off the goodwill of ₹ 1,20,000 in old ratio.
- Cash brought in by Daniel for goodwill will be distributed among old partners in sacrificing ratio.
- Both (a) & (b)

Answer 10 (c)
Theoretical Questions & Answers
Question 1

Write short note on Revaluation account

Answer 1

When a new partner is admitted into the partnership, assets are revalued and liabilities are reassessed. A Revaluation Account (or Profit and Loss Adjustment Account) is opened for the purpose. This account is debited with all reduction in the value of assets and increase in liabilities and 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.

Question 2

What is the difference between revaluation account and memorandum revaluation account?

Answer 2

Difference between revaluation account and memorandum revaluation account

- Revaluation account is prepared to find out the profit or loss on revaluation of assets and liabilities which appear in the new balance sheet at the new or revalued figures. Memorandum revaluation account is also prepared to record the effect of revaluation of assets and liabilities which of course are recorded at their old figures in the new balance sheet.
- Revaluation account is not divided into two parts. But the memorandum revaluation account has two parts: first part for old partners and second part for all partners including the new partner.

Question 3

The following was the balance sheet of A, B and C who were equal partners on January 1, 2022

Liabilities	₹	Assets	₹
Bills Payable	3,000	Cash	1,000
Creditors	6,000	Debtors	10,000
Capital Accounts :		Stock	12,000
A	20,000	Furniture	5,000
B	15,000	Buildings	25,000

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C	10,000	Bills Receivable	1,000
	54,000		54,000

They agree to take D into partnership and give him a 1/4 share in the profits on the following terms:

- (1) D should bring in ₹ 6,000 for goodwill and ₹ 10,000 as capital;
- (2) one-half of the goodwill shall be withdrawn by old partners;
- (3) stock and furniture be depreciated by 10%.
- (4) a liability of ₹ 1,300 be created against bills discounted;
- (5) the building be valued at ₹ 40,000;
- (6) the values of liabilities and assets other than cash are not to be altered.

Give the necessary entries to give effect to the above arrangement; prepare revaluation account and opening balance sheet of the firm as newly constituted.

Answer 3

		₹	₹
Cash Account	Dr.	16,000	
To D's Capital Account (Amount of goodwill and capital brought in by D)			16,000
D's Capital Account	Dr.	6,000	
To A's Capital Account			2,000
To B's Capital Account			2,000
To C's Capital Account (Goodwill brought in by D credited to old partners in sacrifice ratio)			2,000
A's Capital Account	Dr.	1,000	
B's Capital Account	Dr.	1,000	
C's Capital Account	Dr.	1,000	
To Cash Account			3,000
(Half the amount of goodwill withdrawn by existing partners)			
Memorandum Revaluation Account	Dr.	12,000	
To A's Capital Account			4,000
To B's Capital Account			4,000
To C's Capital Account (Profit on revaluation credited to old partners)			4,000
A's Capital Account	Dr.	3,000	
B's Capital Account	Dr.	3,000	
C's Capital Account	Dr.	3,000	

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D's Capital Account	Dr.	3,000	
To Memorandum Revaluation Account			12,000
(The profit credited previously to old partners written off to all partners including D in the new profit-sharing ratio)			

Memorandum Revaluation Account

Stock	1,200	Buildings	15,000
Furniture	500		
Liability for bills discounted	1,300		
Profit transferred to capital accounts:			
A	4,000		
B	4,000		
C	4,000		
	15,000		15,000
Buildings	15,000	Stock	1,200
		Furniture	500
		Liability for bills discounted	1,300
		Loss transferred to capital accounts:	
		A	3,000
		B	3,000
		C	3,000
		D	3,000
	15,000		15,000

Balance Sheet of M/s. A, B, C and D As on 1st January, 2022

Liabilities		₹	Assets	₹
Bills Payable		3,000	Cash	14,000
Creditors		6,000	Debtors	10,000
Capital Accounts:			Stock	12,000
A	22,000		Furniture	5,000
B	17,000		Buildings	25,000
C	12,000		Bills Receivable	1,000
D	7,000	58,000		
		67,000		67,000

Question 2

Gopal and Govind are partners sharing profits and losses in the ratio 60:40. The firms' balance sheet as on 31.03.2022 was as follows:

Liabilities	₹	Assets	₹
Capital accounts:		Fixed assets	3,00,000

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Gopal	1,20,000	Investments	50,000
Govind	80,000	Current assets	2,00,000
Long term loan	2,00,000	Loans and advances	1,00,000
Current liabilities	2,50,000		
	6,50,000		6,50,000

Due to financial difficulties, they have decided to admit Guru as partner in the firm from 01.04.2022 on the following terms:

Guru will be paid 40% of the profits.

Guru will bring in cash ₹ 1,00,000 as capital. It is agreed that goodwill of the firm will be valued at 2 years' purchase of 3 years' normal average profits of the firm and Guru will bring in cash his share of goodwill. It was also decided that the partners will not withdraw their share of goodwill nor will the goodwill appear in the books of account.

The profits of the previous three years were as follows:

For the year ended 31.3.2020: profit ₹ 20,000 (includes insurance claim received of ₹ 40,000).

For the year ended 31.3.2021: loss ₹ 80,000 (includes voluntary retirement compensation paid ₹ 1,10,000).

For the year ended 31.3.2022: profit of ₹ 1,05,000 (includes a profit of ₹ 25,000 on the sale of assets).

It was decided to revalue the assets on 31.03.2022 as follows:

	₹
Fixed assets (net)	4,00,000
Investments	Nil
Current assets	1,80,000
Loans and advances	1,00,000

The new profit sharing ratio after the admission of Guru was 35:25:40.

Pass journal entries on admission, show goodwill calculation and prepare revaluation account, partners' capital accounts and balance sheet as on 01.04.2022 after the admission of Guru.

Answer 2

i. Calculation of Profit/ Loss for the year ended

	31.3.2020	31.3.2021	31.3.2022
Profit/(loss) for the year	20,000	(80,000)	1,05,000
Add/(less): Abnormal items	(40,000)	1,10,000	(25,000)
Net Profit/(loss)	(20,000)	30,000	80,000

$$\frac{(20,000) + 30,000 + 80,000}{3} = ₹ 30,000$$

Average Profit = ₹ 30,000
 Two years' purchase of average profits = $30,000 \times 2 = ₹ 60,000$ Goodwill to be brought in by Guru = ₹ 60,000 x 40% = ₹ 24,000 Goodwill brought in by Guru shared (at the profit sacrificing ratio) by:

	₹
Gopal (₹ 24,000 x 5/8)	15,000

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Govind (₹ 24,000 x 3/8)	9,000
	24,000

ii. Journal Entries

Date	Particulars		Dr. ₹	Cr. ₹
1.4.2022	Bank A/c	Dr.	1,24,000	
	To Guru's capital A/c (Amount of capital and goodwill brought in by Guru)			1,24,000
1.4.2022	Guru's capital A/c	Dr.	24,000	
	To Gopal's capital A/c			15,000
	To Govind's capital A/c (Amount of goodwill brought in by Guru credited to capital accounts of the old partners in the profit sacrificing ratio 5:3)			9,000
1.4.2022	Revaluation A/c	Dr.	70,000	
	To Investment A/c			50,000
	To Current assets A/c (Writing down the value of investments to nil and current assets from ₹ 2,00,000 to ₹ 1,80,000 on the occasion of admission of Guru)			20,000
1.4.2022	Fixed assets A/c	Dr.	1,00,000	
	To Revaluation A/c (Writing up the value of fixed assets from ₹ 3,00,000 to ₹ 4,00,000 on the occasion of admission of Guru)			1,00,000
1.4.2022	Revaluation A/c	Dr.	30,000	
	To Guru's capital A/c			18,000
	To Govind's capital A/c (Net revaluation profit credited to the capital accounts of the old partner in the old profit sharing ratio of 60:40)			12,000

iii. Revaluation Account

Particulars	₹	Particulars	₹
To Investments A/c	50,000	By Fixed assets A/c	1,00,000
To Current assets A/c	20,000		
To Partner's capital A/c: (Profit on revaluation)			
Gopal (60%)	18,000		
Govind (40%)	12,000		
	1,00,000		1,00,000

iv. Partner's Capital Accounts:
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Particulars	Gopal ₹	Govind ₹	Guru ₹	Particulars	Gopal ₹	Gopal ₹	Guru ₹
				By Balance b/d	1,20,000	80,000	1,00,000
To Balance c/d	1,53,000	1,01,000	1,00,000	By Bank A/c	15,000	9,000	-
				By Profit on revaluation A/c	18,000	12,000	-
	1,53,000	1,01,000	1,00,000		1,53,000	1,01,000	1,00,000

Balance Sheet (after admission of Guru) as on 1st April, 2022

Liabilities		₹	Assets	₹
Capital accounts:			Fixed assets	4,00,000
Gopal	1,53,000		Current assets	3,04,000
Govind	1,01,000		(including bank balance of ₹	
Guru	<u>1,00,000</u>	3,54,000	1,24,000)	
Long term loan		2,00,000	Loans & advances	1,00,000
Current liabilities		2,50,000		
		8,04,000		8,04,000

Working Notes:

- Calculation of profit sacrificing ratio
 Profit sacrificed by Gopal = $60\% - 35\% = 25\%$
 Profit sacrificed by Govind = $40\% - 25\% = 15\%$
 Sacrificing ratio = $25\% : 15\%$ or $5:3$
- Bank balance after admission of Guru:

Bank Account

Particulars	₹	Particulars	₹
To Guru's capital A/c	1,24,000	By Balance c/d	1,24,000
	1,24,000		1,24,000

ILLUSTRATION 1

The following is the Balance Sheet of Ram and Mohan, who share profits in the ratio of 3:2 as on 1st January, 2022:

Liabilities	₹	Assets	₹
Trade payables	15,000	Buildings	18,000
Ram's Capital	20,000	Plant and Machinery	15,000
Mohan's Capital	25,000	Inventories	12,000
		Trade receivables	10,000
		Bank	5,000
	60,000		60,000

On this date Shyam was admitted on the following:

- He is to pay ₹25,000 as his capital and ₹10,000 as his share of goodwill for one fifth share in profits.
- The new profits sharing ratio will be 5:3:2.

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3. The assets are to be revalued as under:

	₹
Building	25,000
Plant and Machinery	12,000
Inventories	12,000
Trade receivables (because of doubtful debts)	9,500

4. It was found that there was a liability for ₹ 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.

SOLUTION

Journal Entries

2022		Dr. (₹)	Cr. (₹)
Jan. 1	Bank Account	Dr.	35,000
	To Shyam's Capital Account (Being amount brought in by Shyam for capital and goodwill)		35,000
	Shyam's Capital Account	Dr.	10,000
	To Ram's Capital Account		5,000
	To Mohan's Capital Account (Being Shyam's share of goodwill adjusted to existing partners' capital accounts in the profit sacrificing ratio 1:1)		5,000
	Revaluation Account	Dr.	5,000
	To Plant and Machinery Account		3,000
	To Provisions for Doubtful Debts Account		500
	To Trade payables Account (Being recording of the reduction in the value of assets and the liability which had been previously omitted)		1,500
	Building Account	Dr.	7,000
	To Revaluation Account (Being increase in the value of building brought into account)		7,000
	Revaluation Account	Dr.	2,000
	To Ram's Capital Account		1,200
	To Mohan's Capital Account (Being profit on revaluation credited to Ram and Mohan in the old profit sharing ratio)		800

Working Note:

Profit sacrificing ratio:

$$\begin{aligned} \text{Ram} &= 3/5 - 1/2 \\ &= 1/10 \\ \text{Mohan} &= 2/5 - 1/2 \\ &= 1/5 \end{aligned}$$

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$$3/10 = 1/10$$

Balance Sheet of Ram, Mohan and Shyam as at January 1, 2022

Liabilities	₹	₹	Assets	₹	₹
Trade payables		16,500	Buildings		25,000
Capital Accounts :			Plant and Machinery		12,000
Ram	26,200		Inventories		12,000
Mohan	30,800		Trade receivables	10,000	
Shyam	25,000	82,000	Less : Provision for		
			Doubtful Debts	(500)	9,500
			Bank		40,000
		98,500			98,500

ILLUSTRATION 2

A and B are partners sharing profits and losses in the ratio of 3:2. Their Balance Sheet as on 31.3.2022 is given below:

Liabilities	₹	Assets	₹
Trade payables	50,000	Freehold premises	2,00,000
Capital Accounts:		Plant	40,000
A	2,00,000	Furniture	20,000
B	1,00,000	Office equipment	25,000
		Inventories	30,000
		Trade receivables	25,000
		Bank	10,000
	3,50,000		3,50,000

On 1.4.2022 they admit C on the following terms:

- (1) C will bring ₹ 50,000 as a capital and ₹ 10,000 for goodwill for 1/5 share;
- (2) Provision for doubtful debts is to be made on Trade receivables @ 2%
- (3) Inventory to be written down by 10%.
- (4) Freehold premises is to be revalued at ₹ 2,40,000, plant at ₹ 35,000, furniture ₹ 25,000 and office equipment ₹ 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 their book values as a result of the above mentioned adjustments. You are required to make necessary adjustment in the Capital Accounts of the partners and show the Balance Sheet of the New Firm.

SOLUTION

Memorandum Revaluation Account

Particulars	₹	Particulars	₹
To Provision for Bad Debts A/c	500	By Freehold premises A/c	40,000
To Inventory A/c	3,000	By Furniture A/c	5,000

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To Plant A/c	5,000	By Office equipment A/c	2,500
To Profit on Revaluation A/c			
A's Capital-3/5	23,400		
B's Capital-2/5	15,600		
	47,500		47,500
To Freehold premises A/c	40,000	By Provision for Bad Debts A/c	500
To Furniture A/c	5,000	By Inventory A/c	3,000
To Office equipment A/c	2,500	By Plant A/c	5,000
		Loss on Revaluation A/c	
		A's Capital -12/25	18,720
		B's Capital-8/25	12,480
		C's Capital-5/25	7,800
	47,500		47,500

Partners' Capital Accounts

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To A's Capital A/c			6,000	By Balance b/d	2,00,000	1,00,000	-
To B's Capital A/c			4,000	By Bank A/c			60,000
To Loss on revaluation A/c	18,720	12,480	7,800	By C's Capital A/c	6,000	4,000	-
To Balance c/d	2,10,680	1,07,120	42,200	By Profit on revaluation A/c	23,400	15,600	-
	2,29,400	1,19,600	60,000		2,29,400	1,19,600	60,000

Note: Amount brought in by new partner shall be distributed among the old partner's in their profit sacrificing ratio, which is same as old profit sharing ratio in this case.

Balance Sheet as at April 1, 2022

Liabilities	₹	Assets	₹
Trade payables	50,000	Freehold premises	2,00,000
		Plant	40,000
Capital A/c:		Furniture	20,000
A	2,10,680	Office equipment	25,000
B	1,07,120	Inventories	30,000
C	42,200	Trade receivables	25,000
		Bank	70,000
	4,10,000		4,10,000

ILLUSTRATION 3

A and B are partners in a firm, sharing profits and losses in the ratio of 3:2. The Balance Sheet of A and B as on 1.1.2022 was as follows:

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Liabilities	₹	Amount ₹	Assets	₹	Amount ₹
Trade payables		17,000	Building		26,000
			Furniture		5,800
Bank overdraft		9,000	Inventories		21,400
Capital accounts:			Trade receivables	35,000	
A	44,000		Less: Provision	(200)	34,800
B	36,000	80,000	Investment		2,500
			Cash		15,500
		1,06,000			1,06,000

'C' was admitted to the firm on the above date on the following terms:

- C is admitted for 1/6 share in the future profits and to introduce a capital of ₹ 25,000.
- The new profit sharing ratio of A, B and C will be 3:2:1 respectively.
- 'C' is unable to bring in cash for his share of goodwill, they decide to calculate goodwill on the basis of C's share in the profits and the capital contribution made by him to the firm.
- Furniture is to be written down by ₹ 870 and Inventory to be depreciated by 5%. A provision is required for trade receivables @ 5% for bad debts. A provision would also be made for outstanding wages for ₹ 1,560. The value of buildings having appreciated be brought upto ₹ 29,200. The value of investments is increased by ₹ 450.
- It is found that the trade payables included a sum of ₹ 1,400, which is not to be paid off.

Prepare the following:

- Revaluation account.
- Partners' capital accounts.

SOLUTION

Revaluation Account

	₹		₹
To Furniture	870	By Building	3,200
To Inventory	1,070	By Trade payables	1,400
To Provision for doubtful debts (₹1,750 – ₹200)	1,550	By Investment	450
To Outstanding wages	1,560		
	5,050		5,050

Partners' Capital Accounts

	A	B	C		A	B	C
	₹	₹	₹		₹	₹	₹
To A			4,500	By Balance b/d	44,000	36,000	–
To B			3,000	By Cash A/c	–	–	25,000
To Balance c/d	48,500	39,000	17,500	By C (working note 2)	4,500	3,000	–
	48,500	39,000	25,000		48,500	39,000	25,000

Working Notes:

- Calculation of goodwill:
 C's contribution of ₹25,000 consists of only 1/6th of capital.
 Therefore, total capital of firm should be ₹25,000 x 6 = ₹1,50,000

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But combined capital of A, B and C amounts ₹44,000 + 36,000 + 25,000 = ₹1,05,000

Thus, the hidden goodwill of the firm is ₹45,000 (₹1,50,000- ₹1,05,000).

C's share $\frac{1}{6}$ th = 7,500

Goodwill will be shared by A & B in their sacrificing ratio.

2. Calculation of sacrificing ratio

Partners	New share	Old share	Sacrifice	Gain
A	$\frac{3}{6}$	$\frac{3}{5}$	$\frac{-3}{30}$	-
B	$\frac{2}{6}$	$\frac{2}{5}$	$\frac{-2}{30}$	-
C	$\frac{1}{6}$	-	-	$\frac{1}{6}$

Therefore, A will get = ₹ 45,000 $\times \frac{3}{30}$ = ₹ 4,500;

B will get = ₹ 45,000 $\times \frac{2}{30}$ = ₹ 3,000; and

C will be debited on account of goodwill = ₹ 45,000 $\times 1$ = ₹ 7,500

ILLUSTRATION 4

Dalal, Banerji and Mallick are partners in a firm sharing profits and losses in the ratio 2:2:1. Their Balance Sheet as on 31st March, 2022 is as below:

Liabilities	₹	Assets	₹
Trade payables	12,850	Land and Buildings	25,000
Outstanding Liabilities	1,500	Furniture	6,500
General Reserve	6,500	Inventory of goods	11,750
Capital Account :		Trade receivables	5,500
Mr. Dalal	12,000	Cash in hand	140
Mr. Banerji	12,000	Cash at Bank	960
Mr. Mallick	5,000		
	49,850		49,850

The partners have agreed to take Mr. Mistri as a partner with effect from 1st April, 2022 on the following terms:

- (1) Mr. Mistri shall bring ₹ 5,000 towards his capital.
- (2) The value of Inventory should be increased by ₹ 2,500 and Furniture should be depreciated by 10%.
- (3) Reserve 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%.
- (5) The value of the goodwill be fixed at ₹ 15,000.
- (6) General Reserve will be transferred to the Partners' Capital Accounts.
- (7) The new profit sharing ratio shall be: Mr. Dalal 5/15, Mr. Banerji 5/15, Mr. Mallick 3/15 and Mr. Mistri 2/15.

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The outstanding liabilities include ₹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.

SOLUTION

Revaluation Account

2022		₹	2022		₹
April 1	To Provision for bad and doubtful debts	550	April 1	By Inventory in trade	2,500
	To Furniture and fittings	650		By Land and Building	5,000
	To Capital A/cs: (Profit on revaluation transferred)				
	Dalal	2,520			
	Banerji	2,520			
	Mallick	1,260			
		7,500			7,500

Partners' Capital Accounts

Particulars	Dalal	Banerji	Mallick	Mistri	Particulars	Dalal	Banerji	Mallick	Mistri
	₹	₹	₹	₹		₹	₹	₹	₹
To Dalal				1,000	By Balance b/d	12,000	12,000	5,000	—
To Banerji				1,000	By General Reserve	2,600	2,600	1,300	
To Balance c/d	19,120	18,120	7,560	3,000	By Cash	—	—	—	5,000
					By Mistri	1,000	1,000	—	—
					By Outstanding Liabilities	1,000	—	—	—
					By Revaluation A/c	2,520	2,520	1,260	—
	19,120	18,120	7,560	5,000		19,120	18,120	7,560	5,000

Working Note:

Calculation of sacrificing ratio

Partners	New share	Old share	Sacrifice	Gain
Dalal	$\frac{5}{15}$	$\frac{2}{5}$	$\frac{1}{15}$	
Banerji	$\frac{5}{15}$	$\frac{2}{5}$	$\frac{1}{15}$	
Mallick	$\frac{3}{15}$	$\frac{1}{5}$	No gain No loss	—
Mistri	$\frac{2}{15}$			$\frac{2}{15}^s$

Sacrifice by Mr. Dalal and Mr. Banerji = $\frac{1}{15} \times ₹15,000 = ₹1,000$ each

Balance Sheet of M/s. Dalal, Banerji, Mallick and Mistri as on April 1, 2022

Liabilities	₹	Assets	₹
Trade payables	12,850	Land and Buildings	30,000

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Outstanding Liabilities		500	Furniture		5,850
Capital Accounts of Partners :			Inventory of goods		14,250
Mr. Dalal	19,120		Trade receivables	5,500	
Mr. Banerji	18,120		Less : Provisions	(550)	4,950
Mr. Mallick	7,560		Cash in hand		140
Mr. Mistri	3,000	47,800	Cash at Bank		5,960
		61,150			61,150

Illustration 5

A and B are in partnership sharing profits and losses at the ratio 3:2. They take C as a new partner. Calculate the new profit sharing ratio if -

- C purchases $\frac{1}{10}$ share from A
- A and B agree to sacrifice $\frac{1}{10}$ th share to C in the ratio of 2: 3
- Simply gets $\frac{1}{10}$ th share of profit.

SOLUTION

- New profit sharing ratio: $A = \frac{3}{5} - \frac{1}{10} = \frac{5}{10}$
 $B = \frac{2}{5}$ i.e. $\frac{4}{10}$
 $C = \frac{1}{10}$
 i.e. 5:4: 1
- A's sacrifice $\frac{1}{10} \times \frac{2}{5} = \frac{2}{50}$ B's sacrifice $\frac{1}{10} \times \frac{3}{5} = \frac{3}{50}$ New profit sharing ratio
 $A = \frac{3}{5} - \frac{2}{50} = \frac{28}{50}$ B = $\frac{2}{5} - \frac{3}{50} = \frac{17}{50}$ C = $\frac{1}{10}$ i.e. $\frac{5}{50}$
 i.e. 28:17: 5
- Let total share be 1 C's share= $\frac{1}{10}$
 Remaining share= $1 - \frac{1}{10} = \frac{9}{10}$ Distribution:
 $A = \frac{9}{10} \times \frac{3}{5} = \frac{27}{50}$ B = $\frac{9}{10} \times \frac{2}{5} = \frac{18}{50}$ C = $\frac{1}{10}$ i.e. $\frac{5}{50}$
 i.e. 27:18: 5

ILLUSTRATION 6

A and B are in the partnership sharing profits and losses in the proportion of three-fourth and one-fourth respectively. Their balance sheet as on 31st March, 2022 was as follows:

Cash ₹ 1,000; trade receivables ₹ 25,000; Inventory ₹ 22,000; plant and machinery ₹ 4,000; trade payables ₹ 12,000; bank overdraft ₹ 15,000; A's capital ₹ 15,000; B's capital ₹ 10,000.

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On 1st April, 2022, they admitted C into partnership on the following terms:

- (i) C to purchase one-third of the goodwill for ₹ 2,000 and provide ₹ 10,000 as capital. Goodwill not to appear in books.
- (ii) Further profits and losses are to be shared by A, B and C equally.
- (iii) Plant and machinery is to be reduced by 10% and ₹ 500 is to be provided for estimated bad debts. Inventory is to be taken at a valuation of ₹ 24,940.
- (iv) By bringing in or withdrawing cash, the 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 form.

SOLUTION

Journal Entries as on 1st April, 2022

		Dr. (₹)	Cr. (₹)
Revaluation Account	Dr.	900	
To Plant and machinery Account			400
To Provision for bad debts Account			500
(Plant & machinery reduced by 10% and ₹500 provided for bad debts)			
Inventory Account	Dr.	2,940	
To Revaluation Account			2,940
(Value of inventory increased by ₹2,940)			
Revaluation Account	Dr.	2,040	
To A's capital Account			1,530
To B's capital Account			510
(Profit on revaluation transferred)			
Cash Account	Dr.	12,000	
To C's capital Account			12,000
(Cash brought in by C as his capital)			
C's Capital Account	Dr.	2,000	
B's capital Account	Dr.	500	
To A's capital Account			2,500
(Entry for goodwill purchased by B and C)			
A's capital Account	Dr.	9,030	
B's capital Account	Dr.	10	
To Cash Account			9,040
(Excess amount of capital withdrawn)			

Partners' Capital Accounts

	A	B	C		A	B	C
	₹	₹	₹		₹	₹	₹
To A's capital A/c	-	500	2,000	By Balance b/d	15,000	10,000	-
To Cash	9,030	10		By Revaluation A/c	1,530	510	-
To Balance c/d	10,000	10,000	10,000	By Cash		-	12,000

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				By C's Capital A/c	2,000		
				By B's Capital A/c	500		
	19,030	10,510	12,000		19,030	10,510	12,000

Working Note:

Calculation of goodwill

 C pays ₹2,000 on account of goodwill for 1/3rd share of profit/loss. Total goodwill is ₹2,000
 $\times 3 = ₹6,000$.

 Gaining ratio: B: $1/3 - 1/4 = 1/12$ C: $1/3$

Goodwill to be paid to A:

 By B ₹ 6,000 $\times 1/12 =$ ₹ 500

 By C ₹ 6,000 $\times 1/3 =$ ₹ 2,000

Total ₹ 2,500

ILLUSTRATION 7

A and B are partners of X llp. sharing profits and losses in 3:2 ratio between themselves. On 31st March, 2022, the balance sheet of the firm was as follows:

Balance Sheet of X llp as at 31.3.2022

Liabilities	₹	₹	Assets	₹
Capital accounts:			Plant and machinery	20,000
A	37,000		Furniture and fittings	5,000
B	28,000		Inventories	15,000
		65,000	Trade receivables	20,000
Trade payables		5,000	Cash in hand	10,000
		70,000		70,000

X agrees to join the business on the following conditions as and from 1.4.2022:

- He will introduce ₹ 25,000 as his capital and pay ₹ 15,000 to the partners as premium for goodwill for 1/3rd share of the future profits of the firm.
- A revaluation of assets of the firm will be made by reducing the value of plant and machinery to ₹ 15,000, Inventory by 10%, furniture and fitting by ₹ 1,000 and by making a provision of bad and doubtful debts at ₹ 750 on trade receivables.

Prepare profit and loss adjustment account, capital accounts of partners including the incoming partner X assuming that the relative ratios of the old partners will be in equal proportion after admission.

SOLUTION

Profit and Loss Adjustment Account

2022, April 1	₹	2022, April 1	₹
To Plant and machinery A/c	5,000	By Partners' capital accounts	
To Inventory A/c	1,500	- Loss on revaluation	8,250
To Furniture and fitting A/c	1,000		

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To	Provision for bad and doubtful debts	750		(3/5) A	4,950	
				(2/5) B	<u>3,300</u>	
		8,250				8,250

Partners' Capital Accounts

	A	B	X		A	B	X
	₹	₹	₹		₹	₹	₹
To Profit & loss adjustment A/c	4,950	3,300	—	By Balance b/d	37,000	28,000	—
				By Cash A/c	—	—	40,000
To A's & B's capital A/cs	—	—	15,000	By X's capital A/c [W. N. (ii)]	12,000	3,000	—
To Balance c/d	44,050	27,700	25,000				
	49,000	31,000	40,000		49,000	31,000	40,000

Working Notes:

- (i) New profit sharing ratio:
 On admission of X who will be entitled to 1/3rd share of the future profits of the firm. A and B would share the remaining 2/3rd share in equal proportion i.e. 1:1.
 A: $\frac{2}{3} \times \frac{1}{2} = \frac{1}{3}$
 B: $\frac{2}{3} \times \frac{1}{2} = \frac{1}{3}$
 X: $\frac{1}{3}$
 A, B and X would share profits and losses in equal ratio.
- (ii) Adjustment of goodwill:
 X pays ₹15,000 as premium for goodwill for 1/3rd share of the future profits.
 Thus, total value of goodwill is ₹15,000 x 3 i.e. ₹45,000
 Sacrificing ratio:
 A: $\frac{3}{5} - \frac{1}{3} = \frac{4}{15}$
 B: $\frac{2}{5} - \frac{1}{3} = \frac{1}{15}$
 Hence, sacrificing ratio is 4:1
 Adjustment of X's share of goodwill through existing partners' capital accounts in the profit sacrificing ratio:

	₹
A: $15,000 \times \frac{4}{5} =$	12,000
B: $15,000 \times \frac{1}{5} =$	3,000
	15,000

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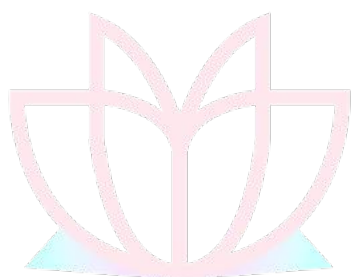
ILLUSTRATION 8

A and B are partners with capitals of ₹ 7,000 each. They admit C as a partner with 1/4th share in the profits of the firm. C brings ₹ 8,000 as his share of capital. Give the necessary journal entry to record goodwill.

SOLUTION
Journal Entry

Particulars	Dr. (₹)	Cr. (₹)
C's Capital A/c [₹10,000 x 1/4] Dr.	2,500	
To A's Capital A/c		1,250
To B's Capital A/c		1,250
(Being the share of C in the hidden goodwill adjusted through capital accounts by crediting sacrificing partners in their sacrificing ratio)		

Note: Hidden Goodwill = $8,000 \times \frac{4}{1} - (\text{₹}7,000 + \text{₹}7,000 + \text{₹}8,000) = \text{₹}10,000$



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ILLUSTRATION 9

A and B are in partnership sharing profits and losses equally. The Balance Sheet M/s. A and B as on 31.12.2022, was as follows:

Liabilities	₹	Assets	₹
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 1.1.2023 they agreed to take C as 1/3rd partner to increase the capital base to ₹ 1,35,000. C agrees to pay ₹ 60,000. Show the necessary journal entries and prepare partners' capital accounts.

SOLUTION

**In the Books of M/s. A, B
and C Journal
Entries**

		₹	₹
Bank A/c To C's Capital A/c (Cash brought in by C for 1/3rd share)	Dr.	60,000	60,000
C's Capital A/c To A's Capital A/c To B's Capital A/c	Dr.	15,000	7,500 7,500
A's Capital A/c To Bank A/c (Amount of goodwill due to A and B withdrawn)	Dr. Dr.	7,500 7,500	15,000

Workings:

- (1) Old Profit Sharing Ratio: 1: 1
 - (2) New Profit Sharing Ratio: 1:1:1
 - (3) C's share of capital ₹1,35,000 × 1/3 = ₹ 45,000
 - (4) Goodwill ₹60,000 – ₹ 45,000 = ₹15,000 for 1/3rd share.
- Total Goodwill: ₹15,000 × 3 = ₹ 45,000

Partners' Capital A/cs

Particulars	A	B	C	Particulars	A	B	C
	₹	₹	₹		₹	₹	₹
To A			7,500	By Balance b/d	45,000	45,000	–
To B			7,500	By Bank	–	–	60,000
To Bank	7,500	7,500	–	By C	7,500	7,500	–
To Balance c/d	45,000	45,000	45,000				
	52,500	52,500	60,000		52,500	52,500	60,000

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Note : In this problem it is mentioned that total capital should be at ₹ 1,35,000 hence excess capital is to be withdrawn by partners hence third entry is passed.

ILLUSTRATION 10

Leena and Meena were in business sharing profits and losses in the ratio of 2:3 Their Balance Sheet as on 31st March, 2022 was as follows:

Liabilities	₹	Assets	₹
Capital Accounts:		Building	60,000
Leena	60,000	Plant	45,000
Meena	1,40,000	Furniture	23,500
General Reserve	40,000	Debtors	38,400
Creditors	42,600	Bills Receivable	12,500
Bills Payable	17,400	Stock	42,600
		Bank	78,000
	3,00,000		3,00,000

On 1st April, 2022, they decided to admit Neena into the partnership giving her a 1/5th share in future profits. She brings in ₹ 80,000 as her share of capital. Goodwill was valued at ₹ 1,00,000 at the time of admission of Neena. The partners decided to revalue the Assets as follows:

Plant ₹ 40,000, Debtors ₹ 38,000, Stock ₹ 42,000, Building ₹ 90,000, Furniture ₹ 20,000, Bills Receivable ₹ 12,000.

You are required to show the following accounts in the books of the firm:-

- Profit & Loss Adjustment Account
- Partners' Capital Accounts
- The Balance Sheet of the new firm.

SOLUTION

In the books of Leena, Meena and Neena Profit & Loss Adjustment Account

(a)

Particulars	₹	Particulars	₹
To Plant	5,000	By Building	30,000
To Debtors	400		
To Stock	600		
To Furniture	3,500		
To Bills receivable	500		
To Profit on revaluation			
Leena	8,000		
Meena	12,000		
	30,000		30,000

Partners' Capital A/c

Particulars	Leena	Meena	Neena	Particulars	Leena	Meena	Neena
To Leena, Meena			20,000	By Balance b/d	60,000	1,40,000	
Goodwill adjustment							

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entry							
To Balance c/d	92,000	1,88,000	60,000	By Bank			80,000
				By Neena	8,000	12,000	
				By General	16,000	24,000	
				Reserve			
				By Revaluation	8,000	12,000	
	92,000	1,88,000	80,000		92,000	1,88,000	80,000

Balance Sheet as on 1st April, 2022 (after admission)

Liabilities	₹	Assets	₹
Capital Accounts:		Building	90,000
Leena	92,000	Plant	40,000
Meena	188,000	Furniture	20,000
Neena	60,000	Debtors	38,000
Creditors	42,600	Bills Receivable	12,000
Bills Payable	17,400	Stock	42,000
		Bank	1,58,000
	4,00,000		4,00,000

ILLUSTRATION 11

Alpha and Beeta were partners in a LLP namely Meta-Chem LLP sharing profits and losses equally.

Balance Sheet of Meta-Chem LLP as on 31st March, 2022

Liabilities	₹	Assets	₹
Capital :		Factory Building	4,78,000
Alpha 3,00,000		Plant & Machinery	3,41,000
Beeta 2,00,000	5,00,000	Office Furniture	55,850
General Reserve	1,80,000	Inventory	77,740
Workmen compensation fund	60,000	Trade Receivables	1,43,210
Term loan from IDFC bank	2,78,000	Bank	44,200
Trade payables	1,22,000		
	11,40,000		11,40,000

They agreed to admit Gyama as partner from 1st April 2022 on the following terms:

1. He shall have one-sixth share in future profits.
2. New profit sharing ratio would be 3:2:1
3. He shall bring ₹ 2,50,000 as his capital.
4. Goodwill of the firm is valued at ₹ 3,00,000
5. Factory Building is to be appreciated by 20% and inventory is revalued at ₹ 70,000.
6. Machinery to be appreciated by 20% and Office furniture to be revalued at ₹ 50,000
7. Of the trade receivables ₹ 3,210 are bad and 5% be provided for bad & doubtful debts.

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8. There is no actual liability towards workman. You are required to prepare:

1. Revaluation account
2. Partners' capital accounts.
3. Bank account.
4. Balance Sheet after admission.

SOLUTION

In the books of Meta-Chem LLP Revaluation A/c

Liabilities	₹	Assets	₹
To Bad debts	3,210	By Factory Building	95,600
To Provision for Doubtful Debts	7,000	By Plant and Machinery	68,200
To Office Furniture	5,850		
To Inventory	7,740		
To Profit on revaluation			
Alpha 70,000			
Beeta <u>70,000</u>	1,40,000		
	1,63,800		1,63,800

Partners' Capital A/c

Particulars	Alpha	Beeta	Gyama	Particulars	Alpha	Beeta	Gyama
To Beeta			50,000	By balance b/d	3,00,000	2,00,000	
To Balance c/d	4,90,000	4,40,000	2,00,000	By Bank			2,50,000
				By Gyama		50,000	
				By General Reserve	90,000	90,000	
				By Workman comp. fund	30,000	30,000	
				By Revaluation A/c	70,000	70,000	
	4,90,000	4,40,000	2,50,000		4,90,000	4,40,000	2,50,000

Bank A/c

Particulars	₹	Particulars	₹
To balance b/d	44,200	By Balance c/d	2,94,200
To Gyama's capital	2,50,000		
	2,94,200		2,94,200

Balance Sheet of Meta-Chem LLP as on 1st April 2022 (after admission)

Liabilities	₹	Assets	₹
Capital Accounts:		Factory Building	5,73,600
Alpha 4,90,000		Plant & Machinery	4,09,200

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Beeta	4,40,000		Office Furniture		50,000
Gyama	<u>2,00,000</u>	11,30,000	Inventory		70,000
Term Loan from IDFC bank		2,78,000	Trade Receivables	1,40,000	
Trade Payables		1,22,000	Less: Provision for Doubtful Debts	<u>7,000</u>	1,33,000
			Bank		2,94,200
		15,30,000			15,30,000

Working Note:

Partner	New Share		Old Share		Difference
Alpha	1/2	–	3/6	=	0
Beeta	1/2	–	2/6	=	1/6
Gyama		–	1/6 (gain)	=	1/6 (gain)

Example: A and B are partners sharing profits in the ratio 3:2. They admit C for 1/3 share in future profits. Calculate the new ratio.

Solution

Share in Firm = 1

C's Share = 1/3

Remaining Profit = $1 - 1/3 = 2/3$

This remaining share of 2/3 is divided between A and B in the ratio 3:2 So

A's share = $2/3 \times 3/5 = 6/15$

B's share = $2/3 \times 2/5 = 4/15$

C's share = $1/3 \times 5/5 = 5/15$

New ratio = 6/15: 4/15: 5/15 = 6:4:5

Example: A and B are partners sharing in the ratio 3:2. They admit C as a new partner for 1/3rd share in future profits which he gets 1/9 from A and 2/9 from B. Calculate the new ratio.

Solution

A's old share = 3/5; A sacrifice in favour of C = 1/9 So

A's new share = $3/5 - 1/9 = 22/45$

B's old share = 2/5; B sacrifice in favour of C = 2/9 So

B's new share = $2/5 - 2/9 = 8/45$

C's new share = $3/9 \times 5/15 = 15/45$

New ratio = 22: 8: 15

Example

A and B are partners sharing in the ratio 3:2. They admit C as the new partner. A surrenders 1/3rd of his share and B surrenders 2/3rd of his share in favour of C. calculate the new ratio.

Solution

A's old share = 3/5; A surrender in favour of C = $3/5 \times 1/3 = 3/15$ A's

new share = $3/5 - 3/15 = 6/15$

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B's old share = $\frac{2}{5}$; B surrender in favour of C = $\frac{2}{5} \times \frac{2}{3} = \frac{4}{15}$ B's
 new share = $\frac{2}{5} - \frac{4}{15} = \frac{2}{15}$
 C's share = $\frac{3}{15} + \frac{4}{15} = \frac{7}{15}$
 New ratio = 6:2:7

Example: A and B are partners sharing in the ratio 3:2. They admit C for $\frac{1}{5}$ th share in profits which he acquires entirely from A. Calculate the new ratio.

Solution

A's old share = $\frac{3}{5}$; Sacrifice in favour of C = $\frac{1}{5}$ A's
 new share = $\frac{3}{5} - \frac{1}{5} = \frac{2}{5}$
 B's share =
 $\frac{2}{5}$ C's share
 = $\frac{1}{5}$
 New ratio = 2:2:1

Example: A and B are partners sharing profits in the ratio 3:2. C is admitted for $\frac{1}{5}$ th share which he acquires from A and B in the ratio of 2:1. Calculate the new ratio.

Solution

A's old share = $\frac{3}{5}$, A's sacrifice = $\frac{1}{5} \times \frac{2}{3} = \frac{2}{15}$ A's
 new share = $\frac{3}{5} - \frac{2}{15} = \frac{7}{15}$
 B's old share = $\frac{2}{5}$, B's sacrifice = $\frac{1}{5} \times \frac{1}{3} = \frac{1}{15}$
 B's new share = $\frac{2}{5} - \frac{1}{15} = \frac{5}{15}$
 C's share = $\frac{1}{5} \times \frac{3}{3} = \frac{3}{15}$
 New ratio = 7:5:3

Example: X and Y are partners in a firm sharing profits and losses in the ratio 5:3. They admit Z into partnership. The new ratio 3:2:1. Calculate the Sacrificing Ratio.

Solution

X's sacrifice = X's old share - X's new ratio = $\frac{5}{8} - \frac{3}{6} = \frac{6}{48}$ Y's
 sacrifice = Y's old share - Y's new ratio = $\frac{3}{8} - \frac{2}{6} = \frac{2}{48}$ Thus,
 sacrificing ratio = 6:2 or 3:1

Example: A, B and C are sharing profits and losses in the ratio of 5:3:2. Calculate the new profit sharing ratio and the sacrificing ratio in each of the following alternative cases:

Case (a) If C acquires $\frac{1}{10}$ th share from B

Case (b) If C acquired $\frac{1}{10}$ th share equally from A and B

Case (c) If C's share is increased by $\frac{1}{10}$ th share by acquiring from A. Case

(d) If C's share is increased to $\frac{3}{10}$ th by acquiring from B.

Case (e) if A, B and C decide to share future profits and losses in the ratio of 5:2:3. Case

(f) if A, B and C decide to share future profits and losses in the ratio of 2:3:5. Case (g) if

A, B and C decide to share future profits and losses in the ratio of 2:1:2. Case (h) if A, B and C decide to share future profits and losses equally.

Case(i) If A, B and C decide that the future profit sharing ratio between B and C shall be the same as existing between A and B

Solution

Case (a)	A	B	C

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Their existing shares	5/10	3/10	2/10
Share acquired by C from B	-	-1/10	+1/10
Their new shares	5/10	2/10	3/10

New Profit sharing ratio of A, B and C = 5 : 2 : 3 Share sacrificed by B = 1/10

Case (b)	A	B	C
Their existing shares	5/10	3/10	2/10
Share acquired by C from A and B	-1/20	-1/20	+1/10
Their new shares	9/20	5/20	3/10

New Profit sharing ratio of A, B and C = 9 : 5 : 6

Sacrificing ratio of A and B = 1 : 1

Case (c)	A	B	C
Their existing shares	5/10	3/10	2/10
Share acquired by C from B	-1/10	-	+1/10
Their new shares	4/10	3/10	3/10

New Profit sharing ratio of A, B and C = 4 : 3 : 3

Share sacrificed by A = 1/10

Share acquired by C = New Share – Old share = 3/10 - 2/10 = 1/10

Case (d)	A	B	C
Their existing shares	5/10	3/10	2/10
Share acquired by C from B	-	-1/10	+1/10
Their new shares	5/10	2/10	3/10

New Profit sharing ratio of A, B and C = 5 : 2 : 3

Share sacrificed by B = 1/10

Case (e)	A	B	C
Their existing shares	5/10	3/10	2/10
Their new shares	5/10	2/10	3/10
	-	1/10	-1/10

C gains by 1/10th share and B sacrifice 1/10th Share

Case (f)	A	B	C
Their existing shares	5/10	3/10	2/10
Their new shares	2/10	3/10	5/10
	3/10	-	-3/10

C gains by 3/10th share and A sacrifice 3/10th Share

Case (g)	A	B	C

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Their existing shares	$\frac{5}{10}$	$\frac{3}{10}$	$\frac{2}{10}$
Their new shares	$\frac{2}{5}$	$\frac{1}{5}$	$\frac{2}{5}$
	$\frac{1}{10}$	$\frac{1}{10}$	$-\frac{2}{10}$

C gains by $\frac{2}{10}$ th share and A sacrifices $\frac{1}{10}$ th Share & B sacrifices $\frac{1}{10}$ th share.

Case (h)	A	B	C
Their existing shares	$\frac{5}{10}$	$\frac{3}{10}$	$\frac{2}{10}$
Their new shares	$\frac{1}{3}$	$\frac{1}{3}$	$\frac{1}{3}$
	$\frac{5}{30}$	$-\frac{1}{30}$	$-\frac{4}{30}$

B gains by $\frac{1}{30}$ th share, C gains by $\frac{4}{30}$ th share and A sacrifices by $\frac{5}{30}$ th Share

Case (i)

Ratio of A and B = 5 : 3

Ratio of B and C should be 5 : 3

Since B's share in relation to A is $\frac{3}{5}$ or 60% of A's share, C's share should also be 60% of B's share

Thus C's share (60% of 3) = 1.8

New ratio of A, B and C = 5 : 3 : 1.8 or 25 : 15 : 9

	A	B	C
Their existing shares	$\frac{5}{10}$	$\frac{3}{10}$	$\frac{2}{10}$
Their new shares	$\frac{25}{49}$	$\frac{15}{49}$	$\frac{9}{49}$
	$-\frac{5}{490}$	$-\frac{3}{490}$	$\frac{8}{490}$

C sacrifices by $\frac{8}{490}$ and A gains by $\frac{5}{490}$ and B gains by $\frac{3}{490}$

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Chapter 10.4

Retirement Of A Partner

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True and False

Question 1

Business of a partnership has to be closed if any one of the partners retires.

Answer 1

False: Business of a partnership is not closed if any one of the partners retires, remaining partners continue to carry on the business.

Question 2

At the time of retirement of a partner no special treatment is required for any reserves appearing in the Balance Sheet.

Answer 2

False: At the time of retirement of a partner all the reserves appearing in the balance sheet are transferred to all the partners in their old profit-sharing ratio.

Question 3

After retirement of a partner, profit sharing ratio of continuing partners remains the same.

Answer 3

False: After retirement of a partner, profit sharing ratio of continuing partners does not remain the same.

Question 4

If any partner wants to retire from the business, he must retire on 1st day of the accounting year.

Answer 4

False: A partner can retire on any day as per his own wish.

Question 5

Retiring partner has to forego his share of goodwill in the firm.

Answer 5

False: Retiring partner is entitled to his share of goodwill in the firm.

Question 6

If a partner retires in between the accounting year then he is not entitled to any profit from the date of beginning of the year till his date of retirement.

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Answer 6

False: If a partner retires in between the accounting year then he is certainly entitled to the profit from the date of beginning of the year till his date of retirement.

Question 7

If the firm has taken any joint life policy then it is to be surrendered at the time of retirement of a partner.

Answer 7

True: The firm is eligible for the surrender value on the Joint Life Policy taken on the partners at the time of their retirement.

Question 8

Any joint life policy reserve appearing in the Balance Sheet is credited to all the partners in their old profit-sharing ratio.

Answer 8

True: As per the surrender policy method, the JLP reserve is distributed to the partners in their profit sharing ratio through capital account.

Question 9

Revaluation of assets and liabilities is not necessary on retirement of a partner.

Answer 9

False: Revaluation of assets and liabilities is necessary at the time of retirement of a partner.

Question 10

Profit on revaluation is credited to continuing partners, retiring partner is not entitled to any profit on revaluation.

Answer 10

False: Profit on revaluation is credited to all the partners in their profit-sharing ratio.

Multiple Choice Questions

1. C, D and E are partners sharing profits and losses in the proportion of $\frac{1}{2}$, $\frac{1}{3}$ and $\frac{1}{6}$. D retired and the new profit sharing ratio between C and E is 3:2 and the Reserve of ₹ 12,000 is divided among the partners in the ratio:
 - (a) ₹ 2,000: ₹ 4,000: ₹ 6,000.
 - (b) ₹ 5,000: ₹ 5,000: ₹ 2,000.
 - (c) ₹ 6,000: ₹ 4,000: ₹ 2,000.

Answer 1: (c)

2. A, B and C takes a Joint Life Policy, after five years B retires from the firm. Old profit sharing ratio is 2:2:1. After retirement, A and C decides to share profits equally. They had taken a Joint Life Policy of ₹ 2,50,000 with the surrender value ₹ 50,000. What will be the treatment in the partner's capital account on receiving the JLP amount if joint life policy premium is fully charged to revenue as and when paid?
 - (a) ₹ 50,000 credited to all the partners in old ratio.
 - (b) ₹ 2,50,000 credited to all the partners in old ratio.

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- (c) ₹ 2,00,000 credited to all the partners in old ratio.

Answer 2: (a)

3. A, B and C take a Joint Life Policy, after five years, B retires from the firm. Old profit sharing ratio is 2:2:1. After retirement A and C decides to share profits equally. They had taken a Joint Life Policy of ₹ 2,50,000 with the surrender value ₹ 50,000. What will be the treatment in the partner's capital account on receiving the JLP amount if joint life policy is maintained at the surrender value?
- (a) ₹ 50,000 credited to all the partners in old ratio.
 (b) ₹ 2,50,000 credited to all the partners in old ratio.
 (c) No treatment is required.

Answer 3: (c)

4. A, B and C are partners sharing profits in the ratio 2:2:1. On retirement of B, goodwill was valued as ₹ 30,000. Find the contribution of A and C to compensate B.
- (a) ₹ 20,000 and ₹ 10,000.
 (b) ₹ 8,000 and ₹ 4,000.
 (c) They will not contribute anything.

Answer 4: (b)

5. A, B and C were partners in a firm sharing profits and losses in the ratio of 2:2:1 respectively with the capital balance of ₹ 50,000 for A and B, for C ₹ 25,000. B declared to retire from the firm and balance in reserve on the date was ₹ 15,000. If goodwill of the firm was valued as ₹ 30,000 and profit on revaluation was ₹ 7,050 then what amount will be transferred to the loan account of B.
- (a) ₹ 70,820.
 (b) ₹ 50,820.
 (c) ₹ 25,820.

Answer 5: (a)

6. A, B and C are partners sharing profits and losses in the ratio of 3:2:1. C retires on a decided date and Goodwill of the firm is to be valued at ₹ 60,000. Find the amount payable to retiring partner on account of goodwill.
- (a) ₹ 30,000.
 (b) ₹ 20,000.
 (c) ₹ 10,000.

Answer 6: (c)

7. A, B and C were partners sharing profits and losses in the ratio of 3:2:1. A retired and Goodwill of the firm is to be valued at ₹ 24,000. What will be the treatment for goodwill?
- (a) Credited to Revaluation Account at ₹ 24,000.
 (b) Adjusted through partners' capital accounts in gaining/sacrificing ratio.
 (c) Only A's capital account credited with ₹ 12,000.

Answer 7: (b)

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8. Balances of A, B and C sharing profits and losses in proportionate to their capitals, stood as A - ₹ 2,00,000; B - ₹ 3,00,000 and C - ₹ 2,00,000. A desired to retire from the firm, B and C share the future profits equally, Goodwill of the entire firm be valued at ₹ 1,40,000 and no Goodwill account being raised.
- Credit Partner's Capital Account with old profit sharing ratio for ₹ 1,40,000.
 - Credit Partner's Capital Account with new profit sharing ratio for ₹ 1,40,000.
 - Credit A's Account with ₹ 40,000 and debit B's Capital Account with ₹ 10,000 and C's Capital Account with ₹ 30,000.

Answer 8: (c)

Theoretical Questions & Answers

Question 1

Write short notes on:

- Calculation of gaining ratio.
- Final payment of a retiring partner.

Answer 1

- On retirement of a partner, the continuing partners will gain in terms of profit sharing ratio. For example, if A, B and C were sharing profits and losses in the ratio of 5:3:2 and B retires, then A and C have to decide at which ratio they will share profits and losses in future. If it is decided that the continuing partners will share profits and losses in future at the ratio of 3:2, then A gains $\frac{1}{10}$ th $[(\frac{3}{5}) - (\frac{2}{10})]$ and C gains $\frac{2}{10}$ $[(\frac{2}{5}) - (\frac{2}{10})]$. So the gaining ratio between A and C is 1:2. If A and C decide to continue at the ratio 5:2, this indicates that they are dividing the gained share in the previous profit sharing ratio.
- The following adjustments are necessary in the Capital A/c: (i) Transfer of reserve, (ii) Transfer of goodwill, (iii) Transfer of profit/loss on revaluation. After adjustment of these items, the Capital Account balance standing to the credit of the retiring partner represents amount to be paid to him. The continuing partners may discharge the whole claim at the time of retirement.

Question 2

What is joint life policy? What is the objective of taking such a policy?

Answer 2

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.

Practical Questions & Answers

Question 1

On 31st March, 2022, the balance sheet of M/s Ram, Rahul and Rohit sharing profits and losses in proportion to their capital, stood as follows:

Liabilities	₹	₹	Asset	₹
Capital accounts:			Land & building	2,00,000
Ram	3,00,000		Machinery	2,00,000
Rahul	2,00,000		Closing stock	1,00,000

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Rohit	<u>1,00,000</u>	6,00,000	Sundry debtors	<u>2,00,000</u>
Sundry creditors		<u>2,00,000</u>	Cash and bank balances	<u>1,00,000</u>
		<u>8,00,000</u>		<u>8,00,000</u>

On 31st March, 2022, Ram desired to retire from the firm and the remaining partners decided to carry on. It was agreed to revalue the assets and liabilities on that date on the following basis:-

1. Land and buildings be appreciated by 30%.
 2. Machinery be depreciated by 20%.
 3. Closing stock to be valued at ₹ 80,000.
 4. Provision for bad debts be made at 5%.
 5. Old credit balances of sundry creditors ₹ 10,000 be writ en of .
 6. Joint life policy of the partners surrendered and cash obtained ₹ 60,000.
 7. Goodwill of the ent re f rm be valued at ₹ 1,80,000 and Ram's share of the goodwill be adjusted in the accounts of Rahul and Rohit who share the future prof ts equally. No goodwill account being raised.
 8. The total capital of the f rm is to be the same as before ret rement. Individual capital be in their prof t sharing rat o.
 9. Amount due to Ram is to be set led as 50% on ret rement and the balance 50% within one year.
- Prepare revaluation account, capital account of partners: Rahul & Rohit, loan account of Ram, cash account and balance sheet as on 1.4.2022 of M/s Rahul and Rohit.

Answer 1

Revaluation Account

	₹		₹
To Machinery A/c	40,000	By Land and Buildings A/c	60,000
To Closing Stock A/c	20,000	By Sundry Creditors A/c	10,000
To Provision for Bad Debts A/c	10,000	By Cash and Bank A/c – Joint Life policy surrendered	60,000
To Partners' Capital A/cs:			
Ram	30,000		
Rahul	20,000		
Rohit	<u>10,000</u>		
	<u>1,30,000</u>		<u>1,30,000</u>

Partners' Capital Accounts

			Rahul	Rohit				Rahul	Rohit
			₹	₹				₹	₹
31.3.2022	To	Ram's Capital A/c	30,000	60,000	31-3-2022	By	Balance b/d	2,00,000	1,00,000
	To	Balance c/d	3,00,000	3,00,000		By	Revaluat on A/c	20,000	10,000
						By	Cash & bank A/c – cash brought in by Rahul and Rohit	1,10,000	2,50,000
			<u>3,30,000</u>	<u>3,60,000</u>				<u>3,30,000</u>	<u>3,60,000</u>

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				1-4-2022	By	Balance b/d	3,00,000	3,00,000

Ram's Loan Account

		₹			₹
31-3-2022	To Balance c/d	2,10,000	31-3-2022	By Ram's Capital A/c	2,10,000
		2,10,000			2,10,000
			1-4-2022	By Balance b/d	2,10,000

Cash and Bank Account

		₹			₹
31-3-2022	To Balance b/d	1,00,000	31-3-2022	By Ram's capital A/c	2,10,000
	To Revaluat on A/c- joint life policy surrendered	60,000		By Balance c/d	3,10,000
	To Rahul's Capital A/c	1,10,000			
	To Rohit's Capital A/c	2,50,000			
		5,20,000			5,20,000
1-4-2022	To Balance b/d	3,10,000			

M/s Rahul & Rohit
Balance Sheet as on 1st April, 2022

Liabilities	₹	₹	Assets	₹	₹
Capital accounts:			Land and buildings		2,60,000
Rahul	3,00,000		Machinery		1,60,000
Rohit	3,00,000	6,00,000	Closing stock		80,000
Ram's loan account		2,10,000	Sundry debtors	2,00,000	
Sundry creditors		1,90,000	Less: Provision for bad debts	(10,000)	1,90,000
			Cash and bank balances		3,10,000
		10,00,000			10,00,000

Working Notes:
1. Gaining ratio of existing partners:

 Rahul $1/2 - 1/3 = 1/6$

 Rohit $1/2 - 1/6 = 2/6$
2. Total goodwill of firm is ₹ 1,80,000

 Ram's share $(1/2 \times ₹ 1,80,000) = ₹ 90,000$

Ram's share of goodwill is to be borne by Rahul and Rohit in their gaining ratios i.e.

 Rahul $= 1/3 \times ₹ 90,000 = ₹ 30,000$

 Rohit $= 2/3 \times ₹ 90,000 = ₹ 60,000$
3. Ram's Capital Account

		₹			₹
31-3-2022	To Cash and Bank A/c	2,10,000	31-3-2022	By Balance b/d	3,00,000
	To Ram's Loan A/c - Transfer	2,10,000		By Revaluat on A/c	30,000

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				By Rahul's Capital A/c - Goodwill	30,000
				By Rohit's Capital A/c - Goodwill	60,000
		<u>4,20,000</u>			<u>4,20,000</u>

Question 2

A, B, C were in partnership sharing profits and losses in the ratio of 3:2:1. The balance sheet of the firm as on 31.2.2022 was as under:

Liabilities	₹	Assets	₹
Capital accounts:			
A	1,50,000	Fixtures	30,000
B	1,00,000	Stock	1,70,000
C	<u>50,000</u>	Sundry debtors	90,000
Sundry creditors	<u>40,000</u>	Cash	<u>50,000</u>
	<u>3,40,000</u>		<u>3,40,000</u>

A, on account of ill-health, gave notice that he wished to retire from the firm. A retirement agreement was, therefore, entered as on 31.3.2022, the terms of which were as follows:

- The profit and loss account for the year ended 31.3.2022, which showed a net profit of ₹ 42,000 was to be re-opened. B was to be credited with ₹ 6,000 as bonus, in consideration of the extra work, which had devolved upon him during the year. The profit sharing basis was to be revised and the revised ratio is to be 2:3:1 as and from 1st April 2021.
- Goodwill was to be valued at two years' purchase of the simple average profits of five years. Profits for these five years ending on 31st March were as under:

	₹
31.3.2018	15,000
31.3.2019	23,000
31.3.2020	25,000
31.3.2021	35,000
31.3.2022	42,000

- Fixtures are to be valued at ₹ 39,800 and a provision of 2% was to be made for doubtful debts and the remaining assets were to be taken at their book value.
- That the amount payable to A shall be paid by B.

B and C agreed, as between themselves, to continue the business, sharing profits and losses in the ratio of 3:1 and decided to retain fixtures in the books at the revised value and increase the provision for doubtful debts to 6%. Total capital of the firm will be ₹ 3 lakhs as before to be maintained in the new ratio as between B and C.

You are required to give the necessary entries to give effect to the above arrangements. Prepare capital accounts of partners, cash account and balance sheet of B and C after giving effect to the above arrangements on the retirement of A.

Answer 2

Journal Entries

1.	A's Capital Account	Dr.	21,000	
	B's Capital Account	Dr.	14,000	

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	C's Capital Account	Dr.	7,000	
	To Profit and loss adjustment account (Profit written back for making adjustments)			42,000
2.	Profit and loss adjustment account	Dr.	6,000	
	To B's Capital account (Bonus credited to B's capital account)			6,000
3.	Profit and loss adjustment account	Dr.	36,000	
	To A's Capital Account			12,000
	To B's Capital Account			18,000
	To C's Capital Account (Distribution of profits in the new ratio)			6,000
4.	Fixtures account	Dr.	9,800	
	To Provision for bad debts account			1,800
	To A's Capital Account			2,667
	To B's Capital Account			4,000
	To C's Capital Account (Revaluation of assets on A's retirement)			1,333
5.	B's capital account	Dr.	2,700	
	C's capital account	Dr.	900	
	To Provision for bad debts account (Raising provision for bad debts)			3,600
6.	A's capital account	Dr.	1,62,334	
	To B's Capital account (Amount payable to A paid by B)			1,62,334
7.	B's capital account	Dr.	14,000	
	C's capital account	Dr.	4,667	
	To A's Capital account (Adjusting entry of goodwill passed through partners' capital accounts in gaining/sacrificing ratio)			18,667

Partners' Capital Accounts

	A ₹	B ₹	C ₹		A ₹	B ₹	C ₹
To P & L adjustment A/c	21,000	14,000	7,000	By Balance b/d	1,50,000	1,00,000	50,000
To Provision for bad debts A/c	-	2,700	900	By P & L adjustment account	-	6,000	-
To B's Capital A/c	1,62,334	-	-	By P & L adjustment account	12,000	18,000	6,000
To Cash A/c	-	34,634	-	By Fixtures A/c	2,667	4,000	1,333
To A's Capital A/c		14,000	4,667	By A's capital A/c	-	1,62,334	-
				By B and C's capital A/c	18,667		
To Balance c/d	-	2,25,000	75,000	By Cash A/c			30,234
	<u>1,83,334</u>	<u>2,90,334</u>	<u>87,567</u>		<u>1,83,334</u>	<u>2,90,334</u>	<u>87,567</u>

Cash Account

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	₹		₹
To Balance b/d	50,000	By B's capital A/c	34,634
To C's capital A/c	<u>30,234</u>	By Balance b/d	<u>45,600</u>
	<u>80,234</u>		<u>80,234</u>

Balance Sheet of B and C
as on 31st March, 2022 (after retirement of A)

Liabilities		₹	Assets	₹	₹
Capital accounts:			Fixtures		39,800
B	2,25,000		Stock		1,70,000
C	<u>75,000</u>	3,00,000	Sundry debtors	90,000	
Sundry creditors		40,000	Less: Provision for bad debts	<u>5,400</u>	84,600
			Cash		<u>45,600</u>
		<u>3,40,000</u>			<u>3,40,000</u>

Working Notes:

Calculation of goodwill:

1. Average of last five year's profit

Year ended on	Profit ₹
31.3.2018	15,000
31.3.2019	23,000
31.3.2020	25,000
31.3.2021	35,000
31.3.2022	<u>42,000</u>
	<u>1,40,000</u>

2. Goodwill at two years' purchase

$$₹ 28,000 \times 2 = ₹ 56,000$$

3. Calculation for adjustment of Amount of Goodwill

Partner	Old Share	New Share	Gain	Sacrifice
A	$\frac{2}{6}$	—	—	$\frac{2}{6}$
B	$\frac{3}{6}$	$\frac{3}{4}$	$\frac{3}{12}$	—
C	$\frac{1}{6}$	$\frac{1}{4}$	$\frac{1}{12}$	—

Illustration 1

A and B are partners in a business sharing profit and losses as A-3/5th and B-2/5th. Their balance sheet as on 1st January, 2022 is given below:

Liabilities		₹	Assets	₹
Capital Accounts			Plant and Machinery	20,000
A	20,000		Inventories	16,000
B	<u>15,000</u>	35,000	Trade receivables	15,000

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Reserve Account		15,000	Balance at Bank	6,000
Trade payables		7,500	Cash in hand	500
		57,500		57,500

B retires from the business owing to illness and A takes it over. The following revaluation was made:

- (1) The goodwill of the firm is valued at ₹ 25,000.
- (2) Depreciate Plant & Machinery by 7.5% and Inventories by 15%.
- (3) Doubtful debts provision is raised against trade receivables at 5% and a discount reserve against trade payables at 2%.

Required:

Journalize the above transactions in the books of the firm and close the Partners' Accounts as on 1st January 2022. Give also the opening Balance Sheet of A.

Answer

Journal Entries

2022		Dr. (₹)	Cr. (₹)
Jan 1.	A's Capital Account Dr.	10,000	
	To B's Capital Account (The amount of share of goodwill adjusted on B's retirement)		10,000
	Reserve Account Dr.	15,000	
	To A's Capital Account		9,000
	To B's Capital Account (Transfer of reserve to A's Capital Account and B's Capital Account in the profit sharing ratio)		6,000
	Profit and Loss Adjustment Account Dr.	4,650	
	To Plant and Machinery Account		1,500
	To Inventory Account		2,400
	To Provision for Doubtful Debts Account (Reduction in the values, assets and creation of provision for doubtful debts as per agreement with B)		750
	Reserve for Discount on Trade payables A/c Dr.	150	
	To Profit and Loss Adjustment Account (Creation of reserve for discount on trade payables at 2%)		150
	A's Capital Account Dr.	2,700	
	B's Capital Account Dr.	1,800	
	To Profit and Loss Adjustment Account (Transfer of loss on revaluation of assets and liabilities to Capital Accounts of A and B in the profit sharing ratio)		4,500
	B's Capital Account Dr.	29,200	
	To B's Loan Account (Transfer of B's Capital Account to his Loan A/c)		29,200

Note: Here it is assumed that amount payable to B is transferred to his loan a/c.

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Balance Sheet of A as on 1st January, 2022

Liabilities	₹	₹	Assets	₹	₹
A's Capital Account		16,300	Plant and Machinery		18,500
B's Loan Account		29,200	Inventories		13,600
Trade payables	7,500		Trade receivables	15,000	
Less: Reserve for Discount	(150)	7,350	Less: Prov. for Bad Debts	(750)	14,250
			Balance at Bank		6,000
			Cash		500
		<u>52,850</u>			<u>52,850</u>

Illustration 2

F, G and K were partners in LLP sharing profits and losses at the 2:2:1. K wants to retire on 31.12.2022. Given below is the Balance Sheet of the partnership as well as other information:

Balance Sheet as on 31.12.2022

Liabilities	₹	Assets	₹
Capital A/cs		Sundry Fixed Assets	1,50,000
F	1,20,000	Inventories	50,000
G	80,000	Trade receivables (Including Bills Receivable 20,000)	70,000
K	60,000	Bank	50,000
Reserve	10,000		
Trade payables	50,000		
	<u>3,20,000</u>		<u>3,20,000</u>

F and G agree to share profits and losses at the ratio of 3:2 in future. Value of Goodwill is taken to be ₹ 50,000. Sundry Fixed Assets are revalued upward by ₹ 30,000 and Inventories by ₹ 10,000. Bills Receivable dishonoured ₹ 5,000 on 31.12.2022 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 ₹ 75,000 bank balance for working capital.

Required:

Pass necessary journal entries and draft the Balance Sheet of M/s F & G LLP. Also prepare capital accounts of partners and draft the Balance Sheet of M/s F & G after K's retirement.

Answer

Journal Entries

		₹	₹
(1)	F's Capital A/c Dr.	10,000	
	To K's Capital A/c (Being the adjustment for goodwill on K's retirement) - Refer W.N.		10,000
(2)	Reserve A/c Dr.	10,000	
	To F's Capital A/c		4,000
	To G's Capital A/c		4,000
	To K's Capital A/c		2,000

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	(Transfer of Reserve to Partners' Capital A/cs on K's retirement)		
(3)	Sundry Fixed Assets A/c Dr.	30,000	
	Inventory A/c Dr.	10,000	
	To Profit and Loss Adjustment A/c (Increase in the value of Sundry Fixed Assets and inventory recorded)		40,000
(4)	Profit and Loss Adjustment A/c Dr.	5,000	
	To Trade Receivable A/c (Loss arising out of dishonoured bill recorded)		5,000
(5)	Profit and Loss Adjustment A/c Dr.	35,000	
	To F's Capital A/c		14,000
	To G's Capital A/c		14,000
	To K's Capital A/c (Profit on revaluation transferred to Partners' Capital A/cs on K's retirement)		7,000
(6)	Bank A/c Dr.	1,04,000	
	To F's Capital A/c		70,000
	To G's Capital A/c (Cash brought in by F and G as per agreement)		34,000
(7)	K's Capital A/c Dr.	79,000	
	To Bank A/c (Payment made to K on retirement)		79,000

Working Note:

Adjusting entry for goodwill

Partner	Old Share	New Share	Gain	Sacrifice
F	$\frac{2}{5}$	$\frac{3}{5}$	$\frac{1}{5}$	$\frac{2}{6}$
G	$\frac{2}{5}$	$\frac{2}{5}$	$\frac{3}{12}$	-
K	$\frac{1}{5}$	-	$\frac{1}{12}$	-

Adjusting entry:

		₹	₹
F's Capital A/c (50,000 x 1/5)	Dr.	10,000	
To K's Capital A/c			10,000

Balance Sheet (after K's retirement)

Liabilities	₹	Assets	₹
Capital A/cs:		Sundry Fixed Assets	1,80,000
F	1,98,000	Inventories	60,000
G	1,32,000	Trade receivables	65,000

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Trade payables	<u>50,000</u>	Bank	<u>75,000</u>
	<u>3,80,000</u>		<u>3,80,000</u>

Partners' Capital Accounts

	F	G	K		F	G	K
	₹	₹	₹		₹	₹	₹
To K's Capital A/c	10,000	—	—	By Balance b/d	1,20,000	80,000	60,000
To Balance c/d	1,28,000	98,000	79,000	By F's Capital A/c			10,000
				By P & L Adj. A/c	14,000	14,000	7,000
				By Reserve	<u>4,000</u>	<u>4,000</u>	<u>2,000</u>
	<u>1,38,000</u>	<u>98,000</u>	<u>79,000</u>		<u>1,38,000</u>	<u>98,000</u>	<u>79,000</u>
To Bank	—	—	79,000	By Balance b/d	1,28,000	98,000	79,000
To Balance c/d	<u>1,98,000</u>	<u>1,32,000</u>	—	By Bank	<u>70,000</u>	<u>34,000</u>	—
	<u>1,98,000</u>	<u>1,32,000</u>	<u>79,000</u>		<u>1,98,000</u>	<u>1,32,000</u>	<u>79,000</u>

Working Notes:

1. Total Capital	₹
Sundry Fixed Assets (₹ 1,50,000 + ₹ 30,000)	1,80,000
Inventory (₹ 50,000 + ₹ 10,000)	60,000
Trade receivables (Including Bill Receivable of ₹ 15,000)	65,000
Bank	<u>75,000</u>
	<u>3,80,000</u>
Less: Sundry Creditors	<u>(50,000)</u>
	<u>3,30,000</u>
F's share ($3,30,000 \times 3/5$)	1,98,000
G's share ($3,30,000 \times 2/5$)	<u>1,32,000</u>

2. Bank Account

	₹		₹
To Balance b/d	50,000	By K's Capital A/c	79,000
To F's Capital A/c	70,000	By Balance c/d	75,000
To G's Capital A/c	<u>34,000</u>		
	<u>1,54,000</u>		<u>1,54,000</u>

Illustration 3

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, 2022 was as under:

Liabilities	₹	Assets	₹
Capital accounts:		Fixtures	8,200
A	1,35,930	Inventories	1,57,300

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B	95,120	Trade receivables	93,500
C	61,170	Cash	74,910
Trade payables	<u>41,690</u>		
	3,33,910		3,33,910

A had been suffering from ill-health and gave notice that he wished to retire. An agreement was, therefore, entered into as on 31st March, 2022, the terms of which were as follows:

- A had been suffering from ill-health and gave notice that he wished to retire. An agreement was, therefore, entered into as on 31st March, 2022, the terms of which were as follows:
- 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. The valuations arising out of the above agreement were goodwill ₹ 56,800 and fixtures ₹ 10,980. A provision of 2% was to be made for doubtful debts and the remaining assets were to be taken at their book values.

B and C agreed, as between themselves, to continue the business, sharing profits in the ratio of 3:2 and decided to retain the fixtures on the books at the revised value, and to increase the provision for doubtful debts to 6%.

Required:

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.

Answer

Journal Entries

Particulars		Dr. (₹)	Cr. (₹)
A's Capital Account	Dr.	20,000	
B's Capital Account	Dr.	16,000	
C's Capital Account	Dr.	12,000	
To Profit and Loss Adjustment Account (Profit written back for making adjustments)			48,000
Profit and Loss Adjustment Account	Dr.	4,000	
To B's Capital account (Bonus Credited to B's Capital Account)			4,000
Profit and Loss Adjustment Account	Dr.	44,000	
To A's Capital Account			12,000
To B's Capital Account			16,000
To C's Capital Account (Distribution of profits in the new ratio)			16,000
Fixtures Account	Dr.	2,780	
To Provision for Doubtful debts Account @ 2%			1,870
To A's Capital Account			248
To B's Capital Account			331
To C's Capital Account (Revaluation of assets on A's retirement)			331
A's Capital Account	Dr.	1,43,669	
To A's Loan Account (Transfer of A's Capital Account to his Loan Account)			1,43,669

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B's Capital Account	Dr.	13,425	
C's Capital Account	Dr.	2,066	
To Provision for Doubtful Debts Account (Raising provision for bad debts)			15,491

Partners' Capital Accounts

	A	B	C		A	B	C
	₹	₹	₹		₹	₹	₹
To Profit and Loss Adjustment A/c	20,000	16,000	12,000	By Balance b/d	1,35,930	95,120	61,170
To A's Loan A/c	1,43,669	—	—	By Profit and Loss Adjustment A/c	—	4,000	—
To Provision for Doubtful Debts A/c	—	—	—	By Profit and Loss Adjustment A/c	12,000	16,000	16,000
	—	2,244	1,496	By Fixtures Less provision for Doubtful Debts A/c	248	331	331
To A	—	13,425	2,066	By B	13,425		
To Balance c/d	—	83,782	61,939	By C	2,066		
	<u>1,63,669</u>	<u>1,15,451</u>	<u>77,501</u>		<u>1,63,669</u>	<u>1,15,451</u>	<u>77,501</u>

Note: The balance of A's Capital Account has been transferred to A's Loan Account.

Working Note:

Calculation for adjustment of Amount of Goodwill

Partner	Old Share	New Share	Gain	Sacrifice
A	$\frac{3}{11}$	—	—	$\frac{3}{11}$
B	$\frac{4}{11}$	$\frac{3}{5}$	$\frac{13}{55}$	—
C	$\frac{4}{11}$	$\frac{2}{5}$	$\frac{2}{55}$	—

Illustration 4

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 31.3.2022 and admit his son N in his place.

Balance Sheet of K, L and M as on 31.3.2022

Liabilities	₹	₹	Assets	₹
Capital:			Furniture	20,000
K	40,000		Trade receivables	50,000
L	60,000		Inventory in Trade	50,000
M	<u>30,000</u>	1,30,000	Cash and Bank balances	80,000
Reserve		50,000		
Trade payables		<u>20,000</u>		
		<u>2,00,000</u>		<u>2,00,000</u>

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On retirement of L assets were revalued: Furniture ₹ 10,000 and Inventory in trade ₹ 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 was valued at ₹ 50,000. Partners are being paid off their extra balances to make capital proportionate by keeping N's capital as base.

You are required to give:

(i) Necessary journal entries; (ii) balance sheet of M/s K, M and N as on 1.4.2022; (iii) capital accounts of partners.

Answer

Journal Entries

Date		Dr. (₹)	Cr. (₹)
31.3.2022	Profit and Loss Adjustment A/c Dr.	30,000	
	To Furniture A/c		10,000
	To Inventory in Trade A/c (Being revaluation of Furniture and inventory in trade recorded)		20,000
	K's Capital A/c Dr.	15,000	
	L's Capital A/c Dr.	9,000	
	M's Capital A/c Dr.	6,000	
	To Profit and Loss Adjustment A/c (Being net revaluation loss debited to capital accounts of K, L and M in the ratio 5 : 3 : 2)		30,000
	Reserve A/c Dr.	50,000	
	To K's Capital A/c		25,000
	To L's Capital A/c		15,000
	To M's Capital A/c (Being reserve transferred to capital accounts, K, L and M)		10,000
	N's Capital A/c Dr.	15,000	
	To L's Capital A/c (Being adjusting entry for goodwill passed in gaining/sacrificing ratio)		15,000
	L's Capital A/c Dr.	81,000	
	To Cash and Bank A/c		40,500
	To N's Capital A/c (Being 50% of the amount due to L was paid off in cash and balance was retained in the firm as capital of N)		40,500
	K's Capital A/c Dr.	7,500	
	M's Capital A/c Dr.	17,000	
	To Cash and Bank A/c (Being amount paid to K and M to make their capital proportionate)		24,500

Working Note:

1. Calculation for adjustment of Amount of Goodwill

Partner	Old Share	New Share	Gain	Sacrifice

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K	$\frac{5}{10}$	$\frac{5}{10}$	-	-
L	$\frac{3}{10}$	-	-	$\frac{3}{10}$
M	$\frac{2}{10}$	$\frac{2}{10}$	-	-
N	-	$\frac{3}{10}$	$\frac{3}{10}$	-

2. Calculation of excess capital paid off to M to make capital proportionate.

Partner	Capital Balance	P/L Ratio	Excess Capital Paid Off
K	50,000	5	7,500
N	25,500	3	-
M	34,000	2	17,000

Partners' Capital Accounts

	K ₹	L ₹	M ₹	N ₹		K ₹	L ₹	M ₹	N ₹
To Profit and Loss Adjustment A/c	15,000	9,000	6,000		By Balance b/d By Reserve	40,000 25,000	60,000 15,000	30,000 10,000	
To Cash & Bank A/c	-	40,500	-	-	By L's Capital A/c	-	-	-	40,500
To N's Capital A/c	-	40,500	-	-	By N's Capital A/c	-	15,000	-	-
To L's Capital A/c	-	-	-	15,000					
To Cash & Bank A/c									
(Balancing figure)	7,500	-	17,000	-					
To Balance c/d	<u>42,500</u>	<u>-</u>	<u>17,000</u>	<u>25,500</u>		<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>65,000</u>	<u>90,000</u>	<u>40,000</u>	<u>40,500</u>		<u>65,000</u>	<u>90,000</u>	<u>40,000</u>	<u>40,500</u>
					By Balance b/d	35,000	-	14,000	25,500

Balance Sheet of M/s K, M & N

Liabilities	₹	₹	Assets	₹
Capital Accounts:			Furniture	10,000
K	42,500		Trade receivables	50,000
M	17,000		Inventory in Trade	30,000
N	<u>25,500</u>	85,000	Cash and Bank balance	15,000
Trade payables		<u>20,000</u>		
		<u>1,05,000</u>		<u>1,05,000</u>

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Illustration 5

Dowell llp. with partners Mr. A, Mr. B and Mr., C, are sharing profits and losses in the ratio of 10:6:4. The balance sheet of the firm as at 31st March, 2022 is as under:

Liabilities		₹	Assets	₹
Capitals :			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			Investments	12,000
(un-appropriated profit)		20,000	Inventories	1,30,000
Long Term Debt		3,00,000	Trade receivables	1,39,000
Bank Overdraft		44,000		
Trade payables		1,70,000		
		6,64,000		6,64,000

It was mutually agreed that Mr. B will retire from partnership and in his place Mr. D will be admitted as a partner with effect from 1st April, 2022. For this purpose, the following adjustments are to be made:

- Goodwill is to be valued at ₹ 1 lakh but the same will not appear as an asset in the books of the reconstituted firm.
- Buildings and plant and machinery are to be depreciated by 5% and 20% respectively. Investments are to be taken over by the retiring partner at ₹ 15,000. Provision of 20% is to be made on Trade receivables to cover doubtful debts.
- In the reconstituted firm, the total capital will be ₹ 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.
 - The surplus funds, if any, will be used for repaying bank overdraft.
 - The amount due to retiring partner shall be transferred to his loan account.

Required:

Prepare

- Revaluation account;
- Partners' capital accounts;
- Bank account; and
- Balance sheet of the reconstituted firm as on 1st April, 2022.

Answer

Revaluation Account

	₹		₹
To Buildings A/c	10,000	By Investments A/c	3,000
To Plant and Machinery A/c	26,000	By Loss to Partners:	
To Provision for Doubtful Debts A/c	27,800	A	30,400
		B	18,240
		C	12,160
			60,800

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	63,800		63,800

A's Capital Account

	₹		₹
To Revaluation A/c	30,400	By Balance b/d	80,000
To Balance c/d	80,000	By Reserves A/c	10,000
		By C and D's Capital A/c	10,000
		By Bank A/c (balancing figure)	10,400
	<u>1,10,400</u>		<u>1,10,400</u>

B's Capital Account

	₹		₹
To Revaluation A/c	18,240	By Balance b/d	20,000
To Investments A/c	15,000	By Reserves A/c	6,000
To B's Loan A/c	22,760	By C and D's Capital A/c	30,000
	<u>56,000</u>		<u>56,000</u>

C's Capital Account

	₹		₹
To Revaluation A/c	12,160	By Balance b/d	30,000
To A and B's Capital A/c	20,000	By Reserves A/c	4,000
To Balance c/d	80,000	By Bank A/c (balancing figure)	78,160
	<u>1,12,160</u>		<u>1,12,160</u>

D's Capital Account

	₹		₹
To A and B's Capital A/cs	20,000	By Bank A/c	60,000
To Balance c/d	40,000		
	<u>60,000</u>		<u>60,000</u>

Bank Account

	₹		₹
To A's Capital A/c	10,400	By Bank Overdraft A/c	44,000
To C's Capital A/c	78,160	By Balance c/d	1,04,560
To D's Capital A/c	60,000		
	<u>1,48,560</u>		<u>1,48,560</u>

Balance Sheet of Dowell llp.

as at 1st April, 2022

Liabilities		₹	Assets		₹
Capital Accounts:			Land		10,000
A	80,000		Buildings		1,90,000
C	80,000		Plant and Machinery		1,04,000
D	40,000	2,00,000	Furniture		43,000
Long Term Debts		3,00,000	Inventories		1,30,000
Trade payables		1,70,000	Trade receivables	1,39,000	
B's Loan Account		22,760	Less: Provision for Doubtful Debts)	(27,800)	1,11,200
			Balance at Bank		<u>1,04,560</u>

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		6,92,760			6,92,760

Note: Even though the problem says goodwill ₹ 1,00,000 to appear in new Balance Sheet, it is written off so as to company with Accounting Standard. Net entry for goodwill is:

C's capital	Dr.	20,000	
D's capital	Dr.	20,000	
To A's capital			10,000
To B's capital			30,000

Illustration 6

M/s X is a partnership firm with the partners A, B and C sharing profits and losses in the ratio of 3:2:5. The balance sheet of the firm as on 30th June 2022, was as under:

Balance Sheet of M/s. X as on 30.06.2022

Liabilities	₹	Assets	₹
A's Capital A/c	1,04,000	Land	1,00,000
B's Capital A/c	76,000	Building	2,00,000
C's Capital A/c	1,40,000	Plant and Machinery	3,80,000
Long Term Loan	4,00,000	Investments	22,000
Bank Overdraft	44,000	Inventories	1,16,000
Trade payables	1,93,000	Trade receivables	1,39,000
	<u>9,57,000</u>		<u>9,57,000</u>

It was mutually agreed that B will retire from partnership and in his place D will be admitted as a partner with effect from 1st July, 2022. For this purpose, the following adjustments are to be made:

- Goodwill of the firm is to be valued at ₹ 2 lakhs due to the firm's locational advantage but the same will not appear as an asset in the books of the reconstituted firm.
- Buildings and plant and machinery are to be valued at 90% and 85% of the respective balance sheet values. Investments are to be taken over by the retiring partner at ₹ 25,000. Trade receivables are considered good only upto 90% of balance sheet figure. Balance be considered bad.
- In the reconstituted firm, the total capital will be ₹ 3 lakhs, which will be contributed by A, C and D in their new profit sharing ratio, which is 3:4:3.
- The amount due to retiring partner shall be transferred to his loan account.

Required:

Prepare Revaluation Account and Partners' Capital Accounts.

Answer

Revaluation Account

2022		₹	2022		₹
July 1	To Building	20,000	July 1	By Investments (25,000 - 22,000)	3,000
	To Plant and Machinery	57,000		By Partners' Capital A/cs	
	To Bad Debts	13,900		(Loss on revaluation)	
				A (3/10)	26,370
				B (2/10)	17,580
				C (5/10)	43,950
		<u>90,900</u>			<u>87,900</u>
					<u>90,900</u>

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Partners' Capital Accounts

	A	B	C	D		A	B	C	D
	₹	₹	₹	₹		₹	₹	₹	₹
To Revaluation A/c	26,370	17,580	43,950	–	By Balance b/d	1,04,000	76,000	1,40,000	–
To B's and C's Capital A/cs	–	–	–	60,000	By D's Capital A/c (W.N.1)	–	40,000	20,000	–
To Investments A/c	–	25,000	–	–	By Bank A/c	12,370	–	3,950	1,50,000
To B's Loan A/c	–	73,420	–	–					
To Balance c/d (W.N. 2)	90,000	–	1,20,000	90,000					
	<u>1,16,370</u>	<u>1,16,000</u>	<u>1,63,950</u>	<u>1,50,000</u>		<u>1,16,370</u>	<u>1,16,000</u>	<u>1,63,950</u>	<u>1,50,000</u>

Working Notes:
1. Adjustment of goodwill

Goodwill of the firm is valued at ₹ 2 lakhs

Sacrificing ratio:

$$A \quad 3/10-3/10 = 0$$

$$B \quad 2/10-0 = 2/10$$

$$C \quad 5/10-4/10 = 1/10$$

Hence, sacrificing ratio of B and C is 2:1. A has not sacrificed any share in profits after retirement of B and admission of D in his place.

Adjustment of D's share of goodwill through existing partners' capital accounts in the profit sacrificing ratio:

$$B : ₹ 60,000 \times \frac{2}{3} = 40,000$$

$$C : ₹ 60,000 \times \frac{1}{3} = 20,000 \quad 60,000$$

2. Capital of partners in the reconstituted firm :

	₹
Total capital of the reconstituted firm (given)	3,00,000
A (3/10)	90,000
B (4/10)	1,20,000
C (3/10)	90,000

ILLUSTRATION 7

Red, White and Black shared profits and losses in the ratio of 5:3:2. They took out a joint life Policy in 2018 for ₹ 50,000, a premium of ₹ 3,000 being paid annually on 10th June. The surrender value of the policy on 31st December of various years was as follows: 2018 nil; 2019 ₹ 900; 2020 ₹ 2,000; 2021 ₹ 3,600. Black retires on 15th April, 2022.

Required

Prepare ledger accounts assuming no Joint Life Policy Account is maintained.

Answer

Joint Life Policy Premium Account
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		₹			₹
10th June, 2018	To Bank A/c	3,000	31st Dec., 2018	By Profit and Loss A/c	3,000
10th June, 2019	To Bank A/c	3,000	31st Dec., 2019	By Profit and Loss A/c	3,000
10th June, 2020	To Bank A/c	3,000	31st Dec., 2020	By Profit and Loss A/c	3,000
10th June, 2021	To Bank A/c	3,000	31st Dec., 2021	By Profit and Loss A/c	3,000

Profit and Loss Account

		₹		₹
31st Dec., 2018	To Joint Life Policy Premium A/c	3,000		
31st Dec., 2019	To Joint Life Policy Premium A/c	3,000		
31st Dec., 2020	To Joint Life Policy Premium A/c	3,000		
31st Dec., 2021	To Joint Life Policy Premium A/c	3,000		

Joint Life Policy Account

		₹			₹
15th April, 2022	To Capital A/cs:		15th April, 2022	By Bank A/c	3,600
	(Transfer)				
	Red 5/10	1,800			
	White 3/10	1,080			
	Black 2/10	720			
		3,600			3,600

ILLUSTRATION 8

Red, White and Black shared profits and losses in the ratio of 5: 3: 2. They took out a Joint Life Policy in 2018 for ₹ 50,000, a premium of ₹ 3,000 being paid annually on 10th June. The surrender value of the policy on 31st December of various years was as follows: 2018 nil;

2019: ₹ 900;

2020: ₹ 2,000;

2021: ₹ 3,600.

Black retires on 15th April, 2022.

Required:

Prepare ledger accounts assuming Joint Life Policy Account is maintained on surrender value basis.

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Answer
Joint Life Policy Account

		₹			₹
10th June, 2018	To Bank A/c	3,000	31st Dec., 2018	By Profit and Loss A/c	3,000
10th June, 2019	To Bank A/c	3,000	31st Dec., 2019	By Profit and Loss A/c	2,100
				By Balance c/d	900
		3,000			3,000
1st January, 2020	To Balance b/d	900	31st Dec., 2020	By Profit and Loss A/c	1,900
10th June, 2020	To Bank A/c	3,000		By Balance c/d	2,000
		3,900			3,900
1st January, 2021	To Balance b/d	2,000	31st Dec., 2021	By Profit and Loss A/c	1,400
10th June, 2021	To Bank A/c	3,000		By Balance c/d	3,600
		5,000			5,000
1st January, 2022	To Balance b/d	3,600	15th April, 2022	By Bank	3,600
		3,600			3,600

Profit and Loss Account

		₹
31st Dec., 2018	To Joint Life	
	Policy A/c	3,000
31st Dec., 2019	To Joint Life	
	Policy A/c	2,100
	To Joint Life	
	Policy A/c	1,900
	To Joint Life	
	Policy A/c	1,400

ILLUSTRATION 9

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 31.12.2021 was as follows:

Balance Sheet

Liabilities	₹	Assets	₹
Capital A/cs:		Sundry Fixed Assets	80,000
A	50,000	Inventories	50,000
B	40,000	Trade receivables	30,000
C	30,000	Joint Life Policy	20,000
Bank Loan	40,000	Bank	10,000
Trade payables	30,000		
	1,90,000		1,90,000

On 1.1.2022, A wants to retire, B and C agreed to continue at 2:1. Joint Life Policy was taken on 1.1.2017 for ₹ 1,00,000 and its surrender value as on 31.12.2021 was ₹ 25,000. For the purpose of A's retirement goodwill was raised for ₹ 1,00,000. Sundry Fixed Assets was revalued for

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₹ 1,10,000. But B and C did not prefer to show such an 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 ₹ 25,000 and to make their capital proportionate.

Required:

Prepare necessary journal entries to give the effect in capital accounts of partners.

Answer

Journal Entries

			₹	₹
1.	B's Capital A/c	Dr.	49,500	
	C's Capital A/c	Dr.	18,000	
	To A's Capital A/c (Share of memorandum revaluation profit ₹ 67,500 including goodwill due to A borne by B and C at the gaining ratio 11 : 4)			67,500
2.	A's Capital A/c	Dr.	1,17,500	
	To A's Loan A/c			58,750
	To Bank A/c (Settlement of A's claim on his retirement by payment of 50% in cash and transferring the balance to his Loan A/c).			58,750
3.	Bank A/c	Dr.	73,750	
	To B's Capital A/c			60,333
	To C's Capital A/c (Cash brought in by the continuing partners).			13,417

Working Notes:

1.	Memorandum Revaluation Profit	₹
	Goodwill	1,00,000
	Sundry Fixed Assets	30,000
	Joint Life Policy	5,000
		1,35,000
	A's Share ₹ 1,35,000 × 5/10 = ₹ 67,500.	

2. **Gaining Ratio**

$$B : \quad 2/3 - 3/10 = 11/30$$

$$C : \quad 1/3 - 2/10 = 4/30$$

Gaining Ratio :

$$\begin{array}{ccc} B & : & C \\ 11 & : & 4 \end{array}$$

3. **Total Capital**

		₹
Assets as per Balance Sheet		1,90,000
Additional Bank Balance		15,000
		2,05,000
Less : Bank Loan	40,000	
Sundry Creditors	30,000	
A's Loan	58,750	(1,28,750)

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		76,250
B's Share		50,833
C's Share		25,417

4. Partners' Capital Accounts

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To A's Capital		49,500	18,000	By Balance b/d	50,000	40,000	30,000
To Bank A/c	58,750			By B & C's Capital	67,500		
To A's Loan	58,750			a/c By Bank A/c		60,333	13,417
To Balance c/d		50,833	25,417				
	1,17,500	1,00,333	43,417		1,17,500	1,00,333	43,417

ILLUSTRATION 10

Aarav, Nirav and Purav are partners in LLP sharing profits and losses in the ratio of 3:2:1. Their Balance Sheet as on 31st March, 2022 was as follows:

Balance Sheet as on 31st March, 2022

Liabilities	₹	Assets	₹
Capital : Aarav	80,000	Building	50,000
Nirav	50,000	Machinery	67,500
Purav	35,000	Debtors	65,000
General Reserve	60,000	Stock	80,000
Trade Creditors	50,000	Bank	12,500
	2,75,000		2,75,000

Purav retired from the business on 1st April 2022 on the following terms:

- Goodwill was to be valued at 2 years purchase of average profit of past 3 years.
 31st March, 2020 ₹ 41,000
 31st March, 2021 ₹ 50,000
 31st March, 2022 ₹ 55,000
- Goodwill was not to be raised in the books of accounts.
- Provision for Doubtful Debts was to be created on debtors at 5%. Machinery is to be depreciated by 10% and stock is revalued at ₹ 71,000.
- Building to be appreciated by 20%.
- Aarav and Nirav to bring in additional capital of ₹ 35,000 and ₹ 25,000 respectively.
- Balance payable to Purav must be paid immediately.

You are required to prepare:

- Revaluation account
- Partners capital accounts.

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- Bank account.
- Balance Sheet after revaluation.

Answer

In The Books of Aarav Nirav and Purav Revaluation A/c

Particulars	₹	Particulars	₹
To Provision for Doubtful Debts	3,250	By Building	10,000
To Machinery	6,750	By Loss on revaluation	
To Stock	9,000	Aarav	4,500
		Nirav	3,000
		Purav	<u>1,500</u>
	<u>19,000</u>		<u>9,000</u>
			<u>19,000</u>

Partners Capital A/c

Particulars	Aarav	Nirav	Purav	Particulars	Aarav	Nirav	Purav
To Loss on Revaluation	4,500	3,000	1,500	By Balance b/d	80,000	50,000	35,000
To Bank			60,500	By General Reserve	30,000	20,000	10,000
To Purav capital	10,200	6,800		By Aarav, Nirav capital			17,000
To Balance c/d	1,30,300	85,200		By Bank	35,000	25,000	
	<u>1,45,000</u>	<u>95,000</u>	<u>62,000</u>		<u>1,45,000</u>	<u>95,000</u>	<u>62,000</u>

Bank A/c

Particulars	₹	Particulars	₹
To Balance b/d	12,500	By Purav's Capital	60,500
To Aarav's Capital	35,000	By Balance c/d	12,000
To Nirav's Capital	25,000		
	<u>72,500</u>		<u>72,500</u>

Balance Sheet as on April 1st, 2022

Liabilities		₹	Assets		₹
Capital :	Aarav	1,30,300	Building		60,000
	Nirav	85,200	Machinery		60,750
Trade Creditors		50,000	Debtors	65,000	
			Less: Provision for doubtful Debts	3,250	61,750
			Stock		71,000
			Bank		12,000
		<u>2,65,500</u>			<u>2,65,500</u>

Working note :

Valuation of Goodwill (as per weight average method)

31st March 2020	₹ 41,000 X 1	= 41,000
31st March 2021	₹ 50,000 X 2	= 1,00,000
31st March 2022	₹ 55,000 X 3	= <u>1,65,000</u>
Total		<u>₹ 3,06,000</u>

Weighted average profit (3,06,000/6) = 51,000 Goodwill (2)

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years purchase) = $2 \times 51,000 = ₹ 1,02,000$

Purav's share = $1/6\text{th} = 1,02,000/6 = 17,000$

Journal entry for adjustment of goodwill

Aarav capital A/c	Dr.	10,200	
Nirav capital	Dr.	6,800	
To Purav capital			17,000

ILLUSTRATION 11

Satyam, Shivam & Sundaram are partners of M/s. Great Stationers sharing profits and losses in the ratio of 1:1:2.

On 31st March, 2022 their Balance Sheet was as under :

Liabilities	₹	Assets	₹
Capitals :		Building	2,50,000
Satyam 1,95,000		Plant	1,60,000
Shivam 1,48,000		Investments	85,000
Sunderam <u>1,12,000</u>	4,55,000	Stock	45,280
General Reserve	80,000	Trade Receivable	68,000
Loan from Satyam	94,000	Bank	95,720
Sundry Creditors	75,000		
	7,04,000		7,04,000

On 1st April 2022 Shivam retired on the following terms:

- Goodwill is to be valued at ₹ 1,20,000 but the same will not appear as an asset in the books of the reconstituted firm.
- Buildings is to be appreciated by 20% and Plant is to be depreciated by 10 %.
- Investments are to be taken over by the Satyam in full settlement of his loan.
- Provision of 5% is to be made on trade receivables to cover doubtful debts.
- In the reconstituted firm, the total capital will be ₹ 3,00,000/- which will be contributed by Satyam and Sunderam in their new profit sharing ratio, which is 2:3.
- The amount due to retiring partner shall be transferred to his loan account.

You are required to give journal entries to record above adjustments and also prepare Balance Sheet thereafter.

Answer

In the books of Satyam Shivam & Sundaram Journal entries

Sr No	Particulars	Dr. ₹	Cr. ₹
1	General Reserve A/c Dr.	80,000	
	To Satyam Capital A/c		20,000
	To Shivam Capital A/c		20,000
	To Sunderam Capital A/c (Being General reserve distributed among old partners)		40,000
2.	Satyam Capital A/c Dr.	18,000	
	Sunderam Capital A/c Dr.	12,000	
	To Shivam Capital A/c		30,000

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	(Being adjustment entry for goodwill passed)		
3.	Building A/c Dr.	50,000	
	To Revaluation A/c (Being Building appreciated)		50,000
4.	Satyam loan A/c Dr.	94,000	
	To Revaluation A/c		9,000
	To Investments A/c (Being investments taken over by Satyam)		85,000
5.	Revaluation A/c Dr.	19,400	
	To Plant		16,000
	To Provision for Doubtful Debts (Being Assets revalued)		3,400
6.	Revaluation A/c Dr.	39,600	
	To Satyam Capital A/c		9,900
	To Shivam capital A/c		9,900
	To Sundaram Capital A/c (Being profit on Revaluation distributed)		19,800
7	Shivam Capital A/c Dr.	2,07,900	
	To Shivam loan a/c (Being amount payable to Shivam transferred to his Loan A/c)		2,07,900
8.	Satyam Capital A/c Dr.	86,900	
	To Bank A/c (Being Capital accounts adjusted in Profit sharing ratio)		86,900
9.	Bank A/c	20,200	
	To Sunderam Capital A/c (Being Capital accounts adjusted in Profit sharing ratio)		20,200

Balance Sheet as on April 1st, 2022

Liabilities	₹	Assets	₹
Capitals :		Building	3,00,000
Satyam 1,20,000		Plant	1,44,000
Sunderam 1,80,000	3,00,000	Stock	45,280
Shivam loan A/c	2,07,900	Trade Receivable 68,000	
Sundry Creditors	75,000	Less: Provision for Doubtful Debts 3,400	64,600
		Bank	29,020
	5,82,900		5,82,900

Working Note:
Revaluation A/c

Particulars	₹	Particulars	₹
To Provision for Doubtful Debts	3,400	By building	50,000
To Plant	16,000	By Investments	9,000

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To Revaluation profit			
Satyam	9,900		
Shivam	9,900		
Sunderam	<u>19,800</u>	39,600	
		59,000	59,000

Bank A/c

Particulars	₹	Particulars	₹
To Balance b/d	95,720	By Satyam Capital	86,900
To Sundaram Capital	20,200	By Balance c/d	29,020
	1,15,920		1,15,920

Partners Capital A/c

Particulars	Satyam	Shivam	Sundaram	Particulars	Satyam	Shivam	Sundaram
To Shivam	18,000		12,000	By Balance b/d	1,95,000	1,48,000	1,12,000
To Shivam Loan A/c		2,07,900		By Satyam and Sundaram		30,000	
To bank	86,900			By General Reserve	20,000	20,000	40,000
To balance c/d	1,20,000		1,80,000	By Revaluation	9,900	9,900	19,800
				By Bank			20,200
	2,24,900	2,07,900	1,92,000		2,24,900	2,07,900	1,92,000

Partner	Old Share		New share		Gain Share
Satyam	1/4	-	2/5	=	3/20
Shivam	1/4	-	-	=	(5/20)
Sunderam	2/4	-	3/5	=	2/20

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Chapter 10.5

Death of a Partner

390

True and false

Question 1

Business of partnership comes to an end on death of a partner.

Answer 1

False: Surviving partners continue to carry on the business.

Question 2

Legal heir of a deceased partner automatically becomes partner in the firm.

Answer 2

False: Legal heirs of deceased partners are entitled to dues of the deceased partner.

Question 3

A revaluation account is opened in the books of accounts on death of a partner.

Answer 3

True: To find out the actual values of the assets and liabilities, revaluation account is prepared.

Question 4

Any reserve appearing in the balance sheet on the date of death of a partner is transferred to all partners capital account in their profit sharing ratio.

Answer 4

True: reserves belong to the partners in the same manner the capital contributed by them. Hence it is distributed to them through the capital account.

Question 5

Legal heirs of a deceased partner are entitled to his capital account balance only.

Answer 5

False: Legal heirs of a deceased partner are entitled to all the dues of deceased partner.

Question 6

It is not necessary to adjust goodwill on death of a partner.

Answer 6

False: It is very much necessary to adjust goodwill on death of a partner.

Question 7

On death of a partner continuing partners can agree to change their capital contribution and profit sharing ratio.

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Answer 7

True: Yes, it can be continued in the earlier share or in new share- in either case it leads to computing a new profit sharing ratio.

Question 8

On death of a partner, the firm gets surrender value of the joint life policy.

Answer 8

False: On death of a partner the firm gets full value of sum assured of the joint life policy.

Question 9

Only legal heirs of deceased partner are entitled to amount received from joint life policy.

Answer 9

False: All the partners are entitled to amount received from joint life policy.

Multiple Choice Questions

1. **In the absence of proper agreement, representative of the deceased partner is entitled to the Dead partner's share in**

- (a) Profits till date, goodwill, joint life policy, share in revalued assets and liabilities.
- (b) Capital, goodwill, joint life policy, interest on capital, share in revalued assets and liabilities.
- (c) Capital, profits till date, goodwill, joint life policy, share in revalued assets and liabilities.

Answer 1 (c)

2. **A, B and C are the partners sharing profits and losses in the ratio 2:1:1. Firm has a joint life policy of ₹ 1,20,000 and in the balance sheet it is appearing at the surrender value i.e. ₹20,000. On the death of A, how this JLP will be shared among the partners.**

- (a) ₹ 50,000: ₹ 25,000: ₹ 25,000.
- (b) ₹ 60,000: ₹ 30,000: ₹ 30,000.
- (c) ₹ 40,000: ₹ 35,000: ₹ 25,000.

Answer 2 (a)

3. **R, J and D are the partners sharing profits in the ratio 7:5:4. D died on 30th June 2022. It was decided to value the goodwill on the basis of three year's purchase of last five years average profits. If the profits are ₹ 29,600; ₹ 28,700; ₹ 28,900; ₹ 24,000 and ₹ 26,800. What will be D's share of goodwill?**

- (a) ₹ 20,700.
- (b) ₹ 27,600.
- (c) ₹ 82,800.

Answer 3 (a)

4. **R, J and D are the partners sharing profits in the ratio 7:5:4. D died on 30th June 2022 and profits for the accounting year 2021-2022 were ₹ 24,000. How much share in profits for the period 1st April 2022 to 30th June 2022 will be credited to D's Account.**

- (a) ₹ 6,000.
- (b) ₹ 1,500.

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(c) ₹ 2,000.

Answer 4 (b)

5. Revaluation account is prepared at the time of

- (a) Admission and retirement of a partner
- (b) Death of a partner
- (c) All of the above

Answer 5 (c)

6. If three partners A, B & C are sharing profits as 5:3:2, then on the death of a partner A, how much B & C will pay to A's executor on account of goodwill. Goodwill is to be calculated on the basis of 2 years purchase of last 3 years average profits. Profits for last three years are: ₹ 3,29,000; ₹ 3,46,000 and ₹ 4,05,000.

- (a) ₹ 2,16,000 & ₹ 1,42,000.
- (b) ₹ 2,44,000 & ₹ 2,16,000.
- (c) ₹ 2,16,000 & ₹ 1,44,000.

Answer 6 (c)

Theoretical Questions & Answers

Question 1

Explain the difference between retirement and death of a partner as relating to finalisation of amount payable.

Answer 1

The basic difference between retirement and death of a partner relates to finalisation of amount payable to the Executor of the deceased partner. Although, revaluation of goodwill is done in the same way as it has been done in case of retirement, in addition, the executor of the deceased partner is entitled to share of profit upto the date of death.

Question 2

What amount is payable to legal representatives of dead partner?

Answer 2

When the partner dies the amount payable to him/her is paid to his/her legal representatives. The representatives are entitled to the followings :

- (a) The amount standing to the credit to the capital account of the deceased partner;
- (b) Interest on capital, if provided in the partnership deed upto the date of death;
- (c) Share of goodwill of the firm;
- (d) Share of undistributed profit or reserves;
- (e) Share of profit on the revaluation of assets and liabilities;
- (f) Share of profit upto the date of death;
- (g) Share of Joint Life Policy.

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Practical Questions

Question 1

The Balance Sheet of Seed, Plant and Flower as at 31st December, 2021 was as under :

Liabilities		₹	Assets	₹
Trade payables		20,000	Fixed Assets	40,000
General Reserve		5,000	Debtors	10,000
Capital:			Bills Receivable	4,000
Seed	25,000		Inventories	16,000
Plant	15,000		Cash at Bank	10,000
Flower	15,000	55,000		
		80,000		80,000

The profit sharing ratio was: Seed 5/10, Plant 3/10 and Flower 2/10. On 1st May, 2022 Plant died. It was agreed that:

- (a) Goodwill should be valued at 3 years purchase of the average profits for 4 years. The profits were:

2018	₹10,000	2020	₹12,000
2019	₹13,000	2021	₹15,000

- (b) The deceased partner to be given share of profits upto the date of death on the basis of the previous year.
- (c) Fixed Assets were to be depreciated by 10%. A bill for ₹ 1,000 was found to be worthless. These are not to affect goodwill.
- (d) A sum of ₹ 7,750 was to be paid immediately, the balance was to remain as a loan with the firm at 9% p.a. as interest.
- Seed and Flower agreed to share profits and losses in future in the ratio of 3:2. Give necessary journal entries.

Answer 1

Journal Entries

2022			₹	₹
May 1	General Reserve Account	Dr.	5,000	
	To Seed's Capital Account			2,500
	To Plant's Capital Account			1,500
	To Flower's Capital Account (General reserve transferred to Capital account on the death of Plant)			1,000
	Seed's Capital Account	Dr.	3,750	
	Flower's Capital Account	Dr.	7,500	
	To Plant's Capital Account (adjustment for goodwill on the death of plant on the basis			11,250

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	of gaining ratio) (Value = $3 \times (10,000 + 13,000 + 12,000 + 15,000)/4$)			
	Revaluation Account			
	To Fixed Assets Account			
	To Bills Receivable Account (depreciation of fixed assets @10% and writing off one bill for ₹1,000 on Plant's Death)			
	Seed's Capital Account	Dr.	2,500	
	Plant's Capital Account	Dr.	1,500	
	Flower's Capital Account	Dr.	1,000	
	To Revaluation Account (loss on Revaluation transferred to Capital Accounts)			5,000
	Profit and loss suspense account	Dr.	1,500	
	To Plant's Capital Account (Plant's share of four month's profit based on the previous year)			1,500
	Plant's Capital Account	Dr.	27,750	
	To Plant's Executor's Account (amount standing to the credit of Plant's Capital Account transferred to the credit of his Executor's Account)			27,750
	Plant's Executor's Account	Dr.	7,750	
	To Bank Account (amount paid to Plant's Executor's)			7,750

Question 2

Peter, Paul and Prince were partners sharing profits and losses in the ratio 2:1:1. It was provided in the partnership deed that in the event of retirement /death of a partner he/his legal representatives would be paid:

- The balance in the capital Account
- His share of goodwill of the firm valued at two years purchase of normal average profits (after charging interest on fixed capital) for the last three years to 31st December preceding the retirement or death.
- His share of profits from the beginning of the accounting year to the date of retirement or death, which shall be taken on proportionate basis of profits of the previous year as increased by 25%
- Interest on fixed capital at 10% p.a. though payable to the partners will not be payable in the year of death or retirement.
- All the assets are to be revalued on the date of retirement or death and the profit and loss be debited/credited to the Capital Accounts in the profit sharing ratio.

Peter died on 30th September, 2022. The books of Account are closed on calendar year basis from 1st January to 31st December.

The balance in the Fixed Capital Accounts as on 1st January, 2022 were Peter ₹ 10,000, Paul ₹ 5,000 and Prince ₹ 5,000. The balance in the Current Account as on 1st January, 2022 were Peter

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₹ 20,000, Paul ₹ 10,000 and Prince ₹ 7,000. Drawings of Peter till 30th September, 2022 were ₹ 10,000. The profits of the firm before charging interest on capital for the calendar years 2019, 2020 and 2021 were ₹ 1,00,000, ₹ 1,20,000 and ₹ 1,50,000 respectively. The profits include the following abnormal items of credit:

	2019	2020	2021
	₹	₹	₹
Profit on sale of Assets	5,000	7,000	10,000
Insurance claim received	3,000	-	12,000

The firm has taken out a Joint Life Policy for ₹ 1,00,000. Besides the partners had severally insured their lives for ₹ 50,000 each, the premium in respect thereof being charged to the Profit and Loss account. The surrender value of the Policies were 30% of the face value. On 30th June, 2022 the firm received notice from the insurance company that the insurance premium in respect of fire policy had been undercharged to the extent of ₹ 6,000 in the year 2021 and the firm has to pay immediately. The revaluation of the assets indicates an upward revision in value of assets to the extent of ₹ 20,000. Prepare an account showing the amount due to Peter's Legal representatives as on 30th September, 2022 along with necessary workings.

Answer 2

In the books of M/s Paul and Prince Executors of Peter Account

	₹		₹
To Balance c/d	2,91,125	By Peter's capital A/c (W.N.6)	20,000
		By Peter's Current A/c (W.N.7)	2,71,125
	2,91,125		2,91,125

Working Notes:

		2019	2020	2021
		₹	₹	₹
1. Valuation of Goodwill:				
	Profit as per Profit and loss A/c	1,00,000	1,20,000	1,50,000
	Less: Interest on capital @ 10%	2,000	2,000	2,000
	Abnormal Items:			
	Profit on sale of asset	5,000	7,000	10,000
	Insurance claim received	3,000	-	12,000
	Insurance premium undercharged	-	-	6,000
		90,000	1,11,000	1,20,000
	Total profit of three years		3,21,000	
	Average Profit		1,07,000	

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	Goodwill (2 x Average Profit)		2,14,000	
	Peter's share of goodwill (2/4)		1,07,000	

2. Peter's share of profit	₹
Profit for the year 2021	1,50,000
Less: Insurance premium undercharged	6,000
	1,44,000
Add: 25% increase thereof	36,000
Estimated profit for 2022	1,80,000
Less: Interest on capital*	1,000
Estimated profit for 2022	1,79,000
Estimated profit upto 30.09.2022	1,34,250
Peter's Share (2/4)	67,125

*Since Peter was not entitled to interest on capital in the year of death, interest is payable only to the remaining two partners.

3. **Profit on revaluation of assets:**

	₹
Upward revision in the value of assets	20,000
Peter's share (2/4)	10,000

4. **Peter's share in insurance premium undercharged:**

	₹
Insurance Premium undercharged in 2021	6,000
Peter's share	3,000

5. **Share of Life Policy**

Joint life policy	1,00,000
Maturity value of Peter's individual life policy	50,000
Surrender value of individual life policies of Paul & Prince (30% of face value)	30,000
	1,80,000
Peter's share (2/4)	90,000

6. **Peter's Capital Account**

		₹			₹
30.9.22	To Executors of Peter A/c (Transfer)	20,000	1.1.22	By Balance b/d	10,000

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			30.9.22	By Profit on revaluation of assets	10,000*
		20,000			20,000

* This is generally transferred to Peter's current account. But as per the requirement of adjustment No. (v) of question, it is transferred to capital account.

7. Peter's Current Account

		₹			₹
30.9.22	To Drawings	10,000	1.1.22	By Balance b/d	20,000
	To Insurance premium undercharged	3,000	30.9.22	By Share of goodwill	1,07,000
	To Executor's of Peter's Account (balance transferred)	2,71,125		By share of profit	67,125
				By Share of life policy	75,000
				By Paul & Prince	15,000
		2,84,125			2,84,125

Note: The share of goodwill given to peter would be borne by remaining partners in their gaining ratio, so that goodwill account does not appear in the balance sheet.

Illustrations

ILLUSTRATION 1

The following was the Balance Sheet of Om & Co. in which X, Y, Z were partners sharing profits and losses in the ratio of 1:2:2 as on 31.3.2022. Mr. Z died on 31st December, 2022. His account has to be settled under the following terms.

Balance Sheet of Om & Co. as on 31.3.2022

Liabilities	₹	₹	Assets	₹
Trade payables		20,000	Building	1,20,000
Bank loan		50,000	Computers	80,000
General reserve		30,000	Inventories	20,000
Capital accounts:			Trade receivables	20,000
X	40,000		Cash at bank	50,000
Y	80,000		Investments	10,000
Z	80,000	2,00,000		
		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 the three years were detailed as below:

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Year ending on	profit/loss
31.3.2022	30,000
31.3.2021	20,000
31.3.2020	(10,000) Loss

Profit for the period from 1.4.2022 to 31.12.2022 shall be ascertained proportionately on the basis of average profits and losses of the preceding three years.

During the year ending on 31.3.2022 a car costing ₹ 40,000 was purchased on 1.4.2021 and debited to traveling expenses account on which depreciation is to be calculated at 20% p.a. at written down value method. This asset is to be brought into account at the depreciated value. Other values of assets were agreed as follows:

Inventory at ₹ 16,000, building at ₹ 1,40,000, computers at ₹ 50,000; investments at ₹ 6,000. Trade receivables were considered good.

Required:

- Calculate goodwill and Z's share in the profits of the firm for the period 1.4.2022 to 31.12.2022.
- 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 31.12.2022.

SOLUTION

(i) Calculation of goodwill and Z's share of profit

(a)	Adjusted profit for the year ended 31.3.2022:	₹	₹
	Profit (Given)		30,000
	Add: Cost of car wrongly written off	40,000	
	Less: Depreciation for the year 2021-22 (20% on 40,000)	(8,000)	32,000
			62,000
(b)	Average of last three year's profits and losses	Profit/(loss)	
	Year ended on	₹	
	31.3.2020	(10,000)	
	31.3.2021	20,000	
	31.3.2022	62,000	
		72,000	
	Average profit (72,000/3)	24,000	
(c)	Goodwill at 2 years' purchase		
	₹ 24,000 x 2 = ₹ 48,000		
(d)	Z's share of profits from the period 1.4.22 to 31.12.22		
	₹ 24,000 x 9/12 x 2/5 = ₹ 7,200		

(i) Revaluation Account

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	₹			₹
To Inventory account	4,000	By Building account		20,000
To Computers account	30,000	By Car(32,000-4,800)		27,200
To Investments account	4,000			
To Profit transferred to				
X 1,840				
Y 3,680				
Z 3,680				
	<u>9,200</u>			
	47,200			47,200

Partners' Capital Accounts

	X ₹	Y ₹	Z ₹		X ₹	Y ₹	Z ₹
To Z's Executor's A/c			1,22,080	By balance b/d	40,000	80,000	80,000
To Z	6,400	12,800	–	By General Reserve	6,000	12,000	12,000
To Balance c/d	41,440	82,880		By X and Y	–	–	19,200
				By Revaluation A/c	1,840	3,680	3,680
				By Profit and Loss Suspense A/c	–	–	7,200
	47,840	95,680	1,22,080		47,840	95,680	1,22,080

Balance Sheet of Om & Co. as on 31st December, 2022

Liabilities	₹	Assets	₹
Trade payables	20,000	Building	1,40,000
Bank loan	50,000	Car	27,200
Capital accounts:		Inventories	16,000
X	41,440	Computers	50,000
Y	82,880	Investments	6,000
Z's Executor's account	1,22,080	Trade receivables	20,000
		Cash at bank	50,000
		Profit and Loss suspense Account	7,200
	3,16,400		3,16,400

Working Note:

Goodwill calculated at the time of death of partner Z ₹ 48,000

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Partner	Old Share	New Share	Gain	Sacrifice
X	$\frac{1}{5}$	$\frac{1}{3}$	$\frac{2}{15}$	–
Y	$\frac{2}{5}$	$\frac{2}{3}$	$\frac{4}{15}$	–
Z	$\frac{2}{5}$	–	–	$\frac{1}{5}$

Adjusting entry:			
X's Capital Account	Dr.	6,400	
Y's Capital Account	Dr.	12,800	
To Z's Capital Account (adjustment for goodwill on the death of Z on the basis of gaining ratio)			19,200

ILLUSTRATION 2

The partnership agreement of a firm consisting of three partners - A, B and C (who share profits in proportion of $\frac{1}{2}$, $\frac{1}{4}$ and $\frac{1}{4}$ and whose fixed capitals are ₹ 10,000; ₹ 6,000 and ₹ 4,000 respectively) provides as follows:

- 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 on drawings.
- That upon the death of a partner, the goodwill of the firm be valued at two years' purchase of the average net profits (after charging interest on capital) for the three years to 31st December preceding the death of a partner.
- That an insurance policy of ₹ 10,000 each to be taken in individual names of each partner, the premium is to be charged against the profit of the firm.
- Upon the death of a partner, he is to be credited with his share of the profits, interest on capitals etc. calculated upon 31st December following his death.
- That the share of the partnership policy and goodwill be credited to the deceased partner as on 31st December following his death.
- That the partnership books be closed annually on 31st December.

A died on 30th September 2022, the amount standing to the credit of his current account on 31st December, 2021 was ₹ 450 and from that date to the date of death he had withdrawn ₹ 3,000 from the business.

An unrecorded liability of ₹ 2,000 was discovered on 30th September, 2022. 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: 2019 Profit ₹ 9,640; 2020 Profit ₹ 6,720; 2021 Profit ₹ 7,640; 2022 Profit ₹ 3,670.

Assuming the surrender value of the policy to be 20 percent of the sum assured.

Required

Prepare an account showing the amount due to A's legal representative as on 31st December, 2022.

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SOLUTION
A's Capital Account

2022		₹	2022		₹
Sep. 30	To Current A/c (3,000 - 450)	2,550	Jan. 1	By Balance b/d	10,000
			Dec. 31	By Prof t and Loss A/c :	
Dec. 31	To Prof t and Loss Adj. (Unrecorded Liability)	1,000		Interest on Capital	1,000
				Share of Prof t	835
	To Balance Transferred to A's Executor's A/c	21,285		B & C (Goodwill)	6,000
				Insurance Policies A/c	7,000
		24,835			24,835

Working Notes:
(i) Valuat on of Goodwill

Year	Prof t before Interest on f xed capital	Interest	Prof t af er interest
	₹	₹	₹
2019	9,640	2,000	7,640
2020	6,720	2,000	4,720
2021	7,640	2,000	5,640
	24,000	6,000	18,000
Average			₹ 6,000
Goodwill at two years purchase of average net prof ts			12,000
Share of A in the goodwill			6,000
(ii) Prof t on Separate Life Policy			
A's policy			10,000
B and C's policy @ 20%			4,000
			14,000
Share of A (1/2)			7,000
(iii) Share in prof t for 2022			
Prof t for the year			3,670
Less : Interest on capitals			(2,000)
			1,670
A's share in prof t (1/2)			835

(iv) As unrecorded liability of ₹ 2,000 has been charged to Capital Accounts through Prof t and Loss Adjustment Account, no further adjustment in current year's prof t is required.

(v) Prof ts for 2019, 2020 and 2021 have not been adjusted (for valuing goodwill) for unrecorded liability for want of precise informat on.

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ILLUSTRATION 3

The following is the Balance Sheet of M/s. ABC LLP as at 31st December, 2021.

Balance Sheet as at 31st December, 2021

Liabilities	₹	Assets		₹
Capital		Machinery		5,000
A	4,100	Furniture		2,800
B	4,100	Fixture		2,100
C	4,500	Cash		1,500
General Reserve	1,500	Inventories		950
Trade payables	2,350	Trade receivables	4,500	
		Less: Provision for Doubtful debts	300	4,200
	16,550			16,550

C died on 3rd January, 2022 and the following agreement was to be put into effect.

- Assets were to be revalued: Machinery to ₹ 5,850; Furniture to ₹ 2,300; Inventory to ₹ 750.
- Goodwill was valued at ₹ 3,000 and was to be credited with his share, without using a Goodwill Account
- ₹ 1,000 was to be paid away to the executors of the dead partner on 5th January, 2022.

Required

- The Journal Entry for Goodwill adjustment.
- The Revaluation Account and Capital Accounts of the partners.
- Which account would be debited and which account credited if the provision for doubtful debts in the Balance Sheet was to be found unnecessary to maintain at the death of C.

SOLUTION

- Journal Entry in the books of the firm

Date	Particulars		₹	₹
Jan 3, 2022	A's Capital A/c	Dr.	500	
	B's Capital A/c	Dr.	500	
	To C's Capital A/c (Being the required adjustment for goodwill through the partner's capital accounts)			1,000

-

Revaluation Account

Particulars	₹	Particulars	₹
To Furniture A/c (₹ 2,800 – 2,300)	500	By Machinery A/c (₹ 5,850 – 5,000)	850
To Inventory A/c (₹ 950 – 750)	200		
To Partners' Capital A/cs (A – ₹ 50, B – ₹ 50, C – ₹ 50)	150		
	850		850

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Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To C (Goodwill)	500	500	–	By Balance b/d	4,100	4,100	4,500
To Cash A/c	–	–	1,000	By General Reserve A/c	500	500	500
To Executors A/c	–	–	5,050	By Revaluation A/c	50	50	50
To Balance C/d	4,150	4,150	–	(Profit)			
				By A (Goodwill)	–	–	500
				By B (Goodwill)	–	–	500
	4,650	4,650	6,050		4,650	4,650	6,050

- (iii) Provision for Doubtful Debts Account is a credit balance. To close, this account is to be debited. It becomes a gain for the partners. Therefore, either Partners' Capital Accounts (including C) or Revaluation Account is to be credited.

Working Note:

Statement showing the Required Adjustment for Goodwill

Particulars	A	B	C
Right of goodwill before death	1/3	1/3	1/3
Right of goodwill after death	1/2	1/2	–
Gain/(Sacrifice)	(+) 1/6	(+) 1/6	(-) 1/3

Profit sharing ratio is equal before or after the death of C because nothing has been mentioned in respect of profit-sharing ratio.

ILLUSTRATION 4

B and N were partners. The partnership deed provides inter alia:

- That the accounts be balanced on 31st December each year.
- That the profits be divided as follows:
B: One-half; N: One-third; and carried to Reserve Account: One-sixth
- That in the event of death of a partner, his executor will be entitled to the following:
 - the capital to his credit at the date of death; (b) his proportion of profit to date of death based on the average profits of the last three completed years; (c) his share of goodwill based on three years' purchases of the average profits for the three preceding completed years.

Trial Balance on 31st December, 2021

Particulars	Dr. (₹)	Cr. (₹)
B's Capital		90,000
N's Capital		60,000
Reserve		30,000
Bills receivable	50,000	

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Investments	40,000	
Cash	1,10,000	
Trade payables		20,000
Total	2,00,000	2,00,000

The profits for the three years were 2019: ₹ 42,000; 2020: ₹ 39,000 and 2021: ₹ 45,000. N died on 1st May, 2022. Show the calculation of N (i) Share of Profits; (ii) Share of Goodwill; (iii) Draw up N's Executors Account as would appear in the firms' ledger transferring the amount to the Loan Account.

SOLUTION

(i)	Ascertainment of N's Share of Profit		(ii)	Ascertainment of Value of Goodwill	
	2019	42,000		2019	42,000
	2020	39,000		2020	39,000
	2021	45,000		2021	45,000
	Total Profit	1,26,000		Total Profit for 3 years	1,26,000
	Average Profit	42,000		Average Profit	42,000
	4 months' Profit	14,000		Goodwill - 3 years	
				Purchase of Average Profit	1,26,000
	N's Share in Profit (2/5th* of ₹ 14,000)	5,600			
				N's Share of goodwill (2/5 of ₹ 1,26,000)	50,400

* Profit sharing ratio between B and N = $1/2; 1/3; = 3:2$, Therefore N's share of Profit = $2/5$

N's Executors Account

Date	Particulars	₹	Date	Particulars	₹
2022			2022		
May 1,	To N's Loan A/c	1,28,000	Jan. 1	By Capital A/c	60,000
			May 1	By Reserves (2/5th of ₹ 30,000)	12,000
				By B's Capital A/c (Share of goodwill)	50,400
			May 1	By P/L Suspense A/c (Share of Profit)	5,600
		1,28,000			1,28,000

ILLUSTRATION 5

Diya, Riya & Kiya are partners of M/s. DRK Fabrics sharing profits and losses in the ratio of 2:1:2. On 31st March 2022 their Balance Sheet was as under:

Liabilities	₹	Assets	₹
Capitals :		Land & Building	1,65,000
Diya	1,50,000	Furniture	75,000

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Riya	1,80,000	Joint life Policy	60,000
Kiya	70,000	Inventory	88,740
General Reserve	1,40,000	Trade Receivable	96,750
Trade payables	60,000	Bank	1,14,510
	6,00,000		6,00,000

Kiya died on 30th September, 2022.

The partnership deed provides as follows:

- That partners be allowed interest at 12% p.a. on their capitals, but no interest be charged on drawings.
- Upon the death of a partner, the goodwill of the firm be valued at one years' purchase of the average net profits (after charging interest on capital) for the four years to 31st March preceding the death of a partner. The profits of the firm before charging interest on capitals were

2018-19	1,62,000
2019-20	1,99,000
2020-21	1,87,000
2021-22	1,96,000

Average capital during preceding four years may be assumed as ₹ 3,00,000

- Profits till the date of death to be ascertained on the basis of average profit of previous four years
- Upon the death of a partner, she is to be credited with her share of the profits, interest on capitals etc. calculated till the date of death

After the death of Kiya

- ₹ 2,00,000 was received from insurance company against Joint life Policy.
- Land & Building was appreciated by 20%, Furniture to be depreciated by 10%, inventory to be revalued at ₹ 80,000. Bad debts amounted ₹ 1760.
- Amount payable to Kiya was paid in cash. You are required to prepare
 - Revaluation A/c
 - Partners' Capital A/c
 - Balance Sheet as on 30th September 2022, assuming other Assets and liabilities remaining the same.

SOLUTION

Revaluation A/c

Particulars	₹	Particulars	₹
To Furniture	7,500	By Land & Building	33,000
To Inventory	8,740		
To Bad Debts	1,760		
To Profit on Revaluation			
Diya	6,000		
Riya	3,000		
Kiya	6,000		
	15,000		
	33,000		33,000

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Partners Capital A/c

Part ulars	Diya ₹	Riya ₹	Kiya ₹	Part ulars	Diya ₹	Riya ₹	Kiya ₹
To Kiya capital	40,000	20,000		By balance b/d	1,50,000	1,80,000	70,000
To Bank			2,79,800	By general reserve	56,000	28,000	56,000
To Balance c/d	2,28,000	2,19,000		By joint life policy	56,000	28,000	56,000
				By interest on capital			4,200
				By revaluation	6,000	3,000	6,000
				By diya and riya capital			60,000
				By profit and loss suspense account			27,600
	2,68,000	2,39,000	2,79,800		2,68,000	2,39,000	2,79,800

Bank A/c

Part ulars	₹	Part ulars	₹
To Balance B/d To	1,14,510	By Kiya's Capital	2,79,800
Bank	2,00,000	By Balance c/d	34,710
	3,14,510		3,14,510

Balance Sheet as on 30th September, 2022

Liabilit es	₹	Assets	₹
Capitals :		Land & Building	1,98,000
Diya	2,28,000	Furniture	67,500
Riya	2,19,000	Inventory	80,000
		Trade Receivable	94,990
Trade payables	60,000	Bank	34,710
		Prof t and loss Suspense (27,600+4,200)	31,800
	5,07,000		5,07,000

Working Notes:
1. Goodwill valuat on

2018-19	1,62,000
2019-20	1,99,000
2020-21	1,87,000
2021-22	1,96,000
Total	7,44,000

Average	= 7,44,000/4	= 1,86,000
Less: Interest on Capital	3,00,000 X 12%	= 36,000
Adjusted Average Prof t		= 1,50,000
Goodwill (1 year's purchase)		= 1,50,000
Kiya's share (2/5)		= 60,000

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2. Journal entry for adjustment of goodwill

Particulars		₹	₹
Diya's Capital A/c	Dr.	40,000	
Riya's Capital A/c	Dr.	20,000	
To Kiya's Capital A/c			60,000
(Share of goodwill adjusted)			

3. Kiya's share of profit till the date of death
- | | | |
|---|---|----------|
| Average profit for full year before interest on capital | = | 1,86,000 |
| 6 month's profit | = | 93,000 |
| Less: interest on capital 4,00,000 X 12% X 6/12 | = | 24,000 |
| Adjusted profit till the date of death | = | 69,000 |
| Kiya's share 2/5th | = | 27,600 |

4. The Joint life policy in this question is based on the surrender value method- where in the amount shown in the balance sheet shall be deducted from the JLP proceeds received from insurance co, on the death of a partner.
- ₹ 2,00,000 - 60,000 (Balance Sheet value) = ₹ 1,40,000 (divided in profit sharing ratio between the partners.)

NOTE: The ICAI through technical guide (issued in June, 2022) has recommended the formats of financial statements for Limited Liability Partnerships (LLPs). This would enable these entities to communicate their financial performance and financial position in standardised formats thereby enhancing their consistency and comparability. The said format of financial statements is being given as Annexure – II at the end of the chapter for awareness of students. It may be noted that this format does not form part of syllabus and has been given here for the knowledge of students only.

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Chapter 10.6

Dissolution of Partnership Firms And LLP

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True and false

Question 1

Books of accounts are closed in dissolution of partnership.

Answer 1

False. Books of accounts are not closed in dissolution of partnership but are closed in case of dissolution of partnership firm.

Question 2

On the dissolution of a partnership, firstly, the assets of the firm are realized. Then the amount realized, is applied first towards repayment of liabilities to outsiders.

Answer 2

True. On the dissolution of a partnership, firstly, the assets of the firm, are realized. Then the amount realized, is applied first towards repayment of liabilities to outsiders and loans taken from partners; afterwards, the capital contributed by partners is repaid.

Question 3

In event of the dissolution of the firm, the business ceases to end. In event of dissolution of the partnership, the partnership is reconstituted and the business discontinues.

Answer 3

True. In event of the dissolution of the firm, the business ceases to end. However, in event of dissolution of the partnership, the business continues as usual, but the partnership is reconstituted.

Question 4

Expenses of dissolution on realization of assets are credited to the Realization Account.

Answer 4

False. Expenses of dissolution on realization of assets are debited to the Realization Account.

Question 5

Revaluation Account is prepared at the time of dissolution of partnership but Realization Account is prepared at the time of dissolution of partnership firm.

Answer 5

True. Revaluation Account is prepared at the time of dissolution of partnership but Realization Account is prepared at the time of dissolution of partnership firm.

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Multiple Choice Questions

1. Partnership could be dissolved because of

- (a) Death of a partner.
- (b) Insolvency of a partner.
- (c) Either (a) or (b).

Answer 1 (c)

2. On the dissolution of partnership, profit or loss on realization of assets and liabilities should be divided among partners

- (a) In the ratio of their capitals.
- (b) In the same ratio in which they share profits.
- (c) Equally.

Answer 2 (b)

3. An unrecorded asset realized at the time of dissolution is credited to

- (a) Realization account.
- (b) Revaluation account.
- (c) Capital accounts.

Answer 3 (a)

4. A liability taken over by a partner at the time of dissolution is credited to

- (a) Profit and loss account.
- (b) Partners' capital accounts.
- (c) Realization account.

Answer 4 (b)

5. Realization account is a

- (a) Nominal account.
- (b) Real account.
- (c) Personal account.

Answer 5 (a)

6. Which of the following method/methods is adopted to ensure that distribution of cash among partners is in proportion to their interest in partnership?

- (a) Maximum loss method.
- (b) Highest relative capital method.
- (c) Either (a) or (b).

Answer 6 (c)

Theoretical Questions & Answers

Question 1

State the circumstances when Garner V/S Murray rule not applicable.

Answer 1

Non-Applicability of Garner vs Murray rule:

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- (i) When the solvent partner has a debit balance in the capital account.
Only solvent partners will bear the loss of capital deficiency of insolvent partner in their capital ratio. If incidentally, a solvent partner has a debit balance in his capital account, he will escape the liability to bear the loss due to insolvency of another partner.
- (ii) When the firm has only two partners.
- (iii) When there is an agreement between the partners to share the deficiency in capital account of the insolvent partner.
- (iv) When all the partners of the firm are insolvent.

Question 2

W paid a premium to other partners of the firm at the time of his admission to the firm, with a condition that they will not be dissolved before the expiry of five years. The firm is dissolved after three years. W claims refund of premium.

- (i) List the criteria for the calculation of the amount of refund.
- (ii) Also list any two conditions when no claim in this respect will arise.

Answer 2

If the firm is dissolved before the term expires, as is the case, W being a partner who has paid a premium on admission will have to be repaid/refunded

The criteria for calculation of refund amount are:

- (i) Terms upon which admission was made,
- (ii) The time period for which it was agreed that the firm will not be dissolved,
- (iii) The time period for which the firm has already been in existence.

No claim for refund will arise if:

- (i) The firm is dissolved due to the death of a partner,
- (ii) If the dissolution of the firm is basically because of misconduct of W,
- (iii) If the dissolution is through an agreement and such an agreement does not have a stipulation for a refund of premium.

Question 1

P, Q, and R are partners sharing profits and losses as to 2:2:1. Their Balance Sheet as on 31st March, 2022 is as follows:

Liabilities		₹	Assets	₹
Capital accounts			Plant and Machinery	1,08,000
P	1,20,000		Fixtures	24,000
Q	48,000		Stock	60,000
R	24,000	1,92,000	Sundry debtors	48,000
Reserve Fund		60,000	Cash	60,000
Creditors		48,000		
		3,00,000		3,00,000

They decided to dissolve the business. The following are the amounts realized:

Particulars	₹

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Plant and Machinery	1,02,000
Fixtures	18,000
Stock	84,000
Sundry debtors	44,400

Creditors allowed a discount of 5% and realization expenses amounted to ₹ 1,500. There was an unrecorded asset of ₹ 6,000 which was taken over by Q at ₹ 4,800. An amount of ₹ 4,200 due for GST had come to notice during the course of realization and this was also paid.

You are required to prepare:

- Realization account.
- Partners' capital accounts.
- Cash account.

Answer 1

Realization Account

Particulars	₹	Particulars	₹
To Debtors	48,000	By Creditors	48,000
To Stock	60,000	By Cash A/c (Assets realized):	
To Fixtures	24,000	Plant and Machinery 1,02,000	
To Plant and machinery	1,08,000	Fixtures 18,000	
To Cash A/c (Creditors)	45,600	Stock 84,000	
To Cash A/c (GST)	4,200	Sundry Debtors 44,400	2,48,400
To Cash A/c (Realization expenses)	1,500	By Q (Unrecorded asset)*	4,800
To Profit on Realization			
P 3,960			
Q 3,960			
R 1,980	9,900		
	3,01,200		3,01,200

Partners' Capital Accounts

Particulars	P	Q	R	Particulars	P	Q	R
	₹	₹	₹		₹	₹	₹
To Realization A/c (unrecorded asset)		4,800		By Balance b/d	1,20,000	48,000	24,000
To Cash (Bal. Fig.)	1,47,960	71,160	37,980	By Reserve fund	24,000	24,000	12,000
				By Realization A/c (Profit)	3,960	3,960	1,980
	1,47,960	75,960	37,980		1,47,960	75,960	37,980

Cash Account

Particulars	₹	Particulars	₹
To Balance b/d	60,000	By Realization A/c (Creditors)	45,600
To Realization A/c (Assets)	2,48,400	By Realization A/c (Expenses)	1,500

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		By Realization A/c (GST)	4,200
		By P's Capital A/c	1,47,960
		By Q's Capital A/c	71,160
		By R's Capital A/c	37,980
	3,08,400		3,08,400

Question 2

'Thin', 'Short' and 'Fat' were in partnership sharing profits and losses in the ratio of 2:2:1. On 30th September, 2022 their Balance Sheet was as follows:

Liabilities		₹	Assets	₹
Capital Accounts:			Premises	50,000
Thin	80,000		Fixtures	1,25,000
Short	50,000		Plant	32,500
Fat	20,000	1,50,000	Stock	43,200
Current Accounts:			Debtors	54,780
Thin	29,700			
Short	11,300			
Fat (Dr.)	(14,500)	26,500		
Sundry Creditors		84,650		
Bank Overdraft		44,330		
		3,05,480		3,05,480

'Thin' decides to retire on 30th September, 2022 and as 'Fat' appears to be short of private assets, 'Short' decides that he does not wish to take over Thin's share of partnership, so all three partners decide to dissolve the partnership with effect from 30th September, 2022. It then transpires that 'Fat' has no private assets whatsoever.

The premises are sold for ₹ 60,000 and the plant for ₹ 1,07,500. The fixtures realize ₹ 20,000 and the stock is acquired by another firm at a book value less 5%. Debtors realize ₹ 45,900. Realization expenses amount to ₹ 4,500.

The bank overdraft is discharged and the creditors are also paid in full.

You are required to write up the following ledger accounts in the partnership books following the rules in Garner vs. Murray:

- Realization Account;
- Partners' Current Accounts;
- Partners' Capital Accounts showing the closing of the firm's books.

Answer 2

Realization Account

Particulars	₹	Particulars		₹
To Premises	50,000	By Sundry Creditors By Bank:		84,650
To Plant	1,25,000	Premises		
To Fixtures	32,500	Plant	60,000	
To Stock	43,200	Fixtures	1,07,500	

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To Debtors	54,780	Stock	20,000	
To Bank (Creditors)	84,650	Debtors	41,040	
To Bank (Expenses)	4,500	By Loss on Realization transferred to Partners' Current A/cs	45,900	2,74,440
		Thin	14,216	
		Short	14,216	
		Fat	7,108	35,540
	3,94,630			3,94,630

Partners' Current Accounts

Particulars	Thin	Short	Fat	Particulars	Thin	Short	Fat
	₹	₹	₹		₹	₹	₹
To Balance b/d	–	–	14,500	By Balance b/d	29,700	11,300	–
To Realization	14,216	14,216	7,108	By Capital A/c			
To Capital A/c				Transfer	–	2,916	21,608
transfer	15,484	–	–				
	29,700	14,216	21,608		29,700	14,216	21,608

Partners' Capital Accounts

Particulars	Thin	Short	Fat	Particulars	Thin	Short	Fat
	₹	₹	₹		₹	₹	₹
To Current A/c	–	2,916	21,608	By Balance b/d	80,000	50,000	20,000
To Fat's Capital A/c				By Current A/c (transfer)	15,484	–	–
Deficiency in the ratio of 8:5	990	618	–	By Bank (Realization loss)	14,216	14,216	
To Bank	1,08,710	60,682	–	By Thin & Short Capital A/cs			1,608
	1,09,700	64,216	21,608		1,09,700	64,216	21,608

Working Notes:

(i)

Bank Account

Particulars	₹	Particulars	₹
To Realization A/c	2,74,440	By Balance b/d	44,330
To Thin's Capital A/c	14,216	By Realization A/c (Creditors)	84,650
To Short's Capital A/c	14,216	By Realization A/c (Expenses)	4,500
		By Thin's Capital A/c	1,08,710
		By Short's Capital A/c	60,682

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	3,02,872		3,02,872

- (ii) Fat's deficiency has been by borne Thin & Short in the ratio of their fixed capitals i.e., 8:5 following the rule in Garner vs. Murray.

Question 3

Amit, Sumit, and Kumar are partners sharing profit and losses in the ratio 2:2:1. The partners decided to dissolve the partnership on 31st March 2022 when their Balance Sheet was as under:

Liabilities	Amount	Assets	Amount
Capital Accounts:		Land & Building	1,35,000
Amit	55,200	Plant & Machinery	45,000
Sumit	55,200	Furniture	25,500
General Reserve	61,500	Investments	15,000
Kumar's Loan A/c	15,000	Book Debts	60,000
Loan from D	1,20,000	Less: Prov. for bad debts	(6,000)
Trade Creditors	30,000	Stock	36,000
Bills Payable	12,000	Bank	13,500
Outstanding Salary	7,500	Capital Withdrawn:	
		Kumar	32,400
	3,56,400		3,56,400

The following information is given to you:

- Realization expenses amounted to ₹ 18,000 out of which ₹ 3,000 was borne by Amit.
- A creditor agreed to takeover furniture of book value ₹ 12,000 at ₹ 10,800. The rest of the creditors were paid off at a discount of 6.25%.
- The other assets realized as follows:
 - Furniture - Remaining taken over by Kumar at 90% of book value
 - Stock - Realized 120% of book value
 - Book Debts - ₹ 12,000 of debts proved bad, remaining were fully realized
 - Land & Building - Realized ₹ 1,65,000
 - Investments - Taken over by Amit at 15% discount
- For half of his loan, D accepted Plant & Machinery and ₹ 7,500 cash. The remaining amount was paid at a discount of 10%.
- Bills payable were due on an average basis of one month after 31st March 2022, but they were paid immediately on 31st March @ 6% discount "per annum".

Prepare the Realization Account, Bank Account and Partners' Capital Accounts in the books of Partnership firm.

Answer 3

Realization Account

Particulars	₹	Particulars	₹

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To	Land and Building	1,35,000	By	Provision for bad debts	6,000
To	Plant and Machinery	45,000	By	Loan from D	1,20,000
To	Furniture	25,500	By	Trade creditors	30,000
To	Investments	15,000	By	Bills payable	12,000
To	Book debts	60,000	By	Outstanding salary	7,500
To	Stock	36,000	By	Kumar - Furniture taken over (13,500 x .9)	12,150
To	Bank (Realization expenses)	15,000	By	Bank A/c -	
				Stock Realized	43,200
To	Amit- Realization expenses	3,000		Land & Building	1,65,000
				Debtors	<u>48,000</u>
					2,56,200
To	Bank A/c -				
	Bill payable	11,940	By	Amit (Investment taken over)	12,750
	D's Loan	61,500			
	Creditors	18,000			
	Salary	7,500			
To	Profit transferred to partners' capital Accounts				
	Amit	9,264			
	Sumit	9,264			
	Kumar	<u>4,632</u>			
		23,160			
		4,56,600			4,56,600

Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	13,500	By Realization A/c (payment of liabilities: 11,940+ 7,500 + 54,000 + 15,000 + 18,000 + 7,500)	1,13,940
To Realization A/c (assets realized)	2,56,200	By Amit	79,314
To Kumar	12,618	By Sumit	89,064
	<u>2,82,318</u>		<u>2,82,318</u>

Partners' Capital Accounts

Particulars	Amit ₹	Sumit ₹	Kumar ₹	Particulars	Amit ₹	Sumit ₹	Kumar ₹

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To Balance b/d			32,400	By Balance b/d	55,200	55,200	
				By Kumar's Loan			15,000
To RealizationA/c (Investment taken over)	12,750			By General Reserve	24,600	24,600	12,300
To RealizationA/c (Furniture taken over)			12,150	By Realization A/c (expense)	3,000		
To Bank A/c	79,314	89,064		By Realization A/c (profit)	9,264	9,264	4,632
				By Bank A/c			12,618
	92,064	89,064	44,550		92,064	89,064	44,550

Working Notes:
1. Payment for Bills Payable

Particulars	Amount (₹)
Bills Payable as per Balance Sheet	12,000
Less: Discount for early payment {12,000 x 6% x (1/12)}	60
Amount Paid in Cash	11,940

2. Payment to D's Loan

Particulars	Amount (₹)
D's Loan as per Balance Sheet	120,000.00
50% of Loan adjusted as below:	
Plant & Machinery accepted at Book Value (₹ 45,000) and ₹ 7,500 in cash.	7,500
Balance 50% of Loan adjusted as below:	
In cash after allowing discount of 10% i.e. ₹ 60,000 – ₹ 6,000 = ₹ 54,000.	54,000

3. Payment to Trade Creditors

Particulars	Amount (₹)
Trade Creditors as per Balance Sheet	30,000
Less: Furniture of Book Value ₹ 12,000 accepted at value ₹ 10,800	10,800
	19,200
Less: Discount @ 6.25%	1,200
Amount paid in Cash	18,000

4. Furniture taken over by Kumar

Particulars	Amount (₹)
Furniture as per Balance Sheet	25,500
Less: Furniture of Book Value ₹ 12,000 accepted by trade creditors	12,000
	13,500
Less: 10% of Book Value	1,350
Value of Furniture taken over by Kumar	12,150

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ILLUSTRATION 1

X, Y, and Z are partners of the firm XYZ and Co., sharing Profits and Losses in the ratio of 4: 3: 2. Following is the Balance Sheet of the firm as on 31st March, 2022:

Balance Sheet as on 31st March, 2022

Liabilities	₹	Assets	₹
Partners' Capitals:		Fixed Assets	5,00,000
X	4,00,000	Stock in trade	3,00,000
Y	3,00,000	Sundry debtors	5,00,000
Z	2,00,000	Cash in hand	10,000
General Reserve	90,000		
Sundry Creditors	3,20,000		
	13,10,000		13,10,000

Partners of the firm decided to dissolve the firm on the above-said date.

Fixed assets realized ₹ 5,20,000 and book debts ₹ 4,40,000.

Stocks were valued at ₹ 2,50,000 and it was taken over by partner Y. Creditors allowed discount of 5% and the expenses of realization amounted to ₹ 6,000. You are required to prepare:

- Realization account;
- Partners capital account; and
- Cash account.

SOLUTION

(i) **Realization Account**

Particulars	₹	Particulars	₹
To Fixed assets	5,00,000	By Creditors	3,20,000
To Stock in trade	3,00,000	By Cash (5,20,000+4,40,000)	9,60,000
To Debtors	5,00,000	By Y (Stock taken over)	2,50,000
To Cash – Expenses	6,000	By Loss transferred to partners' capital accounts	
To Cash -Creditors (3,20,000 x 95%)	3,04,000	X	35,555
		Y	26,667
		Z	17,778
	16,10,000		16,10,000

(ii) **Partners' Capital Accounts**

Particulars	X	Y	Z	Particulars	X	Y	Z
	₹	₹	₹		₹	₹	₹
To Realization Account	35,555	26,667	17,778	By Balance b/d	4,00,000	3,00,000	2,00,000
To Realization Account	-	2,50,000	-	By General reserve	40,000	30,000	20,000
To Cash	4,04,445	53,333	2,02,222				

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	4,40,000	3,30,000	2,20,000		4,40,000	3,30,000	2,20,000

 (iii) **Cash Account**

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Realization A/c (Expenses)	6,000
To Realization A/c	9,60,000	By Realization A/c (Creditors)	3,04,000
(Fixed assets and book debts realized)		By X	4,04,445
		By Y	53,333
		By Z	<u>2,02,222</u>
	9,70,000		9,70,000

ILLUSTRATION 2

P, Q, and R were partners sharing profits and losses in the ratio of 3: 2: 1, no partnership salary or interest on capital being allowed. Their balance sheet on 30th June, 2022 is as follows:

Liabilities	₹	Assets	₹
Fixed Capital		Fixed Assets:	
P	20,000	Trademark Freehold	40,000
Q	20,000	Property	8,000
R	10,000	Plant and Equipment	12,800
Current Accounts:		Motor Vehicle	700
P	500	Current Assets Stock	3,900
Q	9,000	Trade Debtors	2,000
Loan from P	8,000	Less: Provision (100)	1,900
Trade Creditors	12,400	Cash at Bank	200
		Miscellaneous losses	
		R's Current Account	400
		Profit and Loss Account	12,000
	79,900		79,900

On 1st July, 2022 the partnership was dissolved. Motor Vehicle was taken over by Q at a value of ₹ 500 but no cash passed specifically in respect of this transaction. Sale of other assets realized the following amounts:

	₹
Trademark	Nil
Freehold Property	7,000
Plant and Equipment	5,000
Stock	3,000
Trade Debtors	1,600

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Trade Creditors were paid ₹ 11,700 in full settlement of their debts. The costs of dissolution amounted to ₹ 1,500. The loan from P was repaid, P and Q were both fully solvent and able to bring in any cash required but R was forced into bankruptcy and was only able to bring 1/3 of the amount due.

Required

- Cash and Bank Account,
- Realization Account, and
- Partners Fixed Capital Accounts (after transferring Current Accounts' balances).

SOLUTION

Cash / Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	200	By Realization A/c- Creditors	11,700
To Realization A/c-		By Realization A/c- Expenses	1,500
Freehold property	7,000	By P's Loan A/c	8,000
Plant and Equipment	5,000	By P's Capital A/c	14,200
Stock	3,000	By Q's Capital A/c	24,200
Trade Debtors	1,600		
To Capital Accounts:			
P 25,500			
Q 17,000			
R 300	42,800		
	59,600		59,600

Realization Account

Particulars	₹	Particulars	₹
To Trademark	40,000	By Trade Creditors	12,400
To Freehold Property	8,000	By Provision for Bad Debts	100
To Plant and Equipment	12,800	By Bank:	
To Motor Vehicle	700	Freehold Property	7,000
To Stock	3,900	Plant and Equip.	5,000
To Sundry Debtors	2,000	Stock	3,000
To Bank (Creditors)	11,700	Debtors	1,600
To Bank (Expenses)	1,500	By Q (Car)	500
		By Capital Accounts: (Loss)	
		P 25,500	
		Q 17,000	
		R 8,500	51,000
	80,600		80,600

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Partners' Capital Accounts

Particulars	P ₹	Q ₹	R ₹	Particulars	P ₹	Q ₹	R ₹
To Current A/c (Transfer) (WN)	5,500	—	2,400	By Balance b/d	20,000	20,000	10,000
To Realization A/c (Loss)	25,500	17,000	8,500	By Current A/c (Transfer) (WN)	—	5,000	—
To Realization A/c (Car)	—	500	—	By Bank	—	—	300
To R's Capital A/c	300	300	—	By Bank	25,500	17,000	—
To (Deficiency) Bank	14,200	24,200	—	(realization loss)			
	45,500	42,000	10,900	By P & Q (Deficiency)	—	—	600
					45,500	42,000	10,900

Working Note

Particulars	P	Q	R
Current Account Balance	500 (Cr)	9000 (Cr)	400 (Dr)
Less: share of Profit & Loss A/c (debit balance)	6000 (Dr)	4000 (Dr)	2000 (Dr)
Adjusted Current Account Balance	5500 (Dr)	5000 (Cr)	2400 (Dr)

Note:

1. P, Q, and R will bring cash to make good their share of the loss on realization. In actual practice they will not be bringing any cash; only a notional entry will be made.
2. On following Garner Vs. Murray rule, solvent partners P and Q have to bear the loss due to insolvency of a partner R in their fixed capital ratio.

ILLUSTRATION 3

Amal and Bimal are in equal partnership. Their Balance Sheet stood as under on 31st March, 2021 when the firm was dissolved:

Liabilities	₹	Assets	₹
Creditors A/c	4,800	Plant & Machinery	2,500
Amal's Capital A/c	750	Furniture	500
		Debtors	1,000
		Stock	800
		Cash	200
		Bimal's drawings	550
	5,550		5,550

The assets realized as under:

Particulars	₹
Plant & Machinery	1,250

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Furniture	150
Debtors	400
Stock	500

The expenses of realization amounted to ₹ 175. Amal's private estate is not sufficient even to pay his private debts, whereas Bimal's private estate has a surplus of ₹ 200 only.

Show necessary ledger accounts to close the books of the firm.

SOLUTION

In the books of M/s Amal and Bimal

Realization Account

Particulars	₹	Particulars		₹
To Sundry Assets:		By Cash A/c:		
Plant & Machinery	2,500	Plant & Machinery	1,250	
Furniture	500	Furniture	150	
Debtors	1,000	Debtors	400	
Stock	800	Stock	500	2,300
Cash A/c-expenses	175	By Partners' Capital A/c		
		Loss on realization (Bal. fig.)		
		Amal	1,337	
		Bimal	1,338	2,675
	4,975			4,975

Cash Account

Particulars	₹	Particulars	₹
To Balance b/d	200	By Realization A/c- expenses	175
To Realization A/c		By Sundry Creditors A/c (Bal. fig.)	2,525
- Sale of sundry assets	2,300		
To Bimal's Capital A/c	200		
	2,700		2,700

Sundry Creditors Account

Particulars	₹	Particulars	₹
To Cash A/c	2,525	By Balance b/d	4,800
To Deficiency A/c-transfer (bal. fig.)	2,275		

Partners' Capital Accounts

Particulars	Amal(₹)	Bimal (₹)	Particulars	Amal (₹)	Bimal (₹)
To Balance b/f	—	550	By Balance b/f	750	—
To Realization A/c			By Cash A/c	—	200
- loss	1,337	1,338	By Deficiency		
			A/c- transfer (bal. fig.)	587	1,688
	1,337	1,888		1,337	1,888

Deficiency Account

Particulars	₹	Particulars	₹

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To Partners' Capital A/c		By Sundry Creditors A/c	2,275
Amal	587		
Bimal	<u>1,688</u>		
	2,275		<u>2,275</u>

ILLUSTRATION 4

A, B, C, and D sharing profits in the ratio of 4:3:2:1 decided to dissolve their partnership on 31st March 2022 when their balance sheet was as under:

Liabilities	₹	Assets	₹
Creditors	15,700	Bank	535
Employees Provident Fund	6,300	Debtors	15,850
Capital Accounts:		Stock	25,200
A 40,000		Prepaid Expenses	800
B <u>20,000</u>	60,000	Plant & Machinery	20,000
		Patents	8,000
		C's Capital A/c	3,200
		D's Capital A/c	8,415
	<u>82,000</u>		<u>82,000</u>

Following information is given to you: -

- One of the creditors took some of the patents whose book value was ₹ 5,000 at a valuation of ₹ 3,200. Balance of the creditors were paid at a discount of ₹ 400.
- There was a joint life policy of ₹ 20,000 (not mentioned in the balance sheet) and this was surrendered for ₹ 4,500.
- The remaining assets were realized at the following values: - Debtors ₹ 10,800; Stock ₹ 15,600; Plant and Machinery ₹ 12,000; and Patents at 60% of their book-values. Expenses of realization amounted to ₹ 1,500.

D became insolvent and a dividend of 25 paise in a rupee was received in respect of the firm's claim against his estate. Prepare necessary ledger accounts.

SOLUTION
Realization Account

Particulars	₹	Particulars	₹
To Sundry Assets: -		By Creditors	15,700
Debtors	15,850	By Employee's Provident Fund	6,300
Stock	25,200		
Prepaid Expenses	800	By Bank A/c:	
Plant & Machinery	20,000	Joint Life Policy	4,500
Patents	8,000	Debtors	10,800
To Bank-Creditors: (₹ 15,700 - ₹ 3,200 - ₹ 400)	12,100	Stock	15,600
		Plant and Machinery	12,000
To Bank A/c Employee's (P.F)	6,300		

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			Patents 60% of (₹ 8,000 – ₹ 5,000)	1,800	44,700
To Bank A/c (expenses)		1,500	By Loss transferred to:		
			A's Capital A/c	9,220	
			B's Capital A/c	6,915	
			C's Capital A/c	4,610	
			D's Capital A/c	2,305	23,050
		89,750			89,750

Capital Accounts

Particulars	A (₹)	B (₹)	C (₹)	D (₹)	Particulars	A (₹)	B (₹)	C (₹)	D (₹)
To Bal. b/d	—	—	3,200	8,415	By Bal. b/d	40,000	20,000	—	—
To Realization A/c	9,220	6,915	4,610	2,305	By Bank (Realization loss)	9,220	6,915	4,610	—
To D's Capital (Deficiency)	5,360	2,680	—	—	By Bank (Recovery)	—	—	—	2,680
To Bank	34,640	17,320	—	—	By A's Capital (2/3)	—	—	—	5,360
					By B's Capital (1/3)	—	—	—	2,680
					By Bank A/c		—	3,200	—
	49,220	26,915	7,810	10,720		49,220	26,915	7,810	10,720

Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	535	By Realization A/c	12,100
To Realization A/c	44,700	By Realization A/c	6,300
To A's Capital A/c	9,220	By Realization A/c	1,500
To B's Capital A/c	6,915	By A's Capital A/c	34,640
To D's Capital A/c	2,680	By B's Capital A/c	17,320
To C's Capital A/c (4,610 + 3,200)	7,810		
	71,860		71,860

Working Note

D's loss will be borne by A and B only because only solvent partners having credit balance has to bear the loss on account of insolvency. C will bring his share of loss in cash.

ILLUSTRATION 5

M/s X, Y, and Z who were in partnership sharing profits and losses in the ratio of 2:2:1 respectively, had the following Balance Sheet as on December 31, 2022:

Liabilities	₹	₹	Assets	₹	₹
Capital: X	29,200		Fixed Assets		40,000
Y	10,800		Stock		25,000
Z	10,000	50,000	Book Debts	25,000	
Z's Loan		5,000	Less: Provision	(5,000)	20,000
Loan from Mrs. X		10,000	Cash		1,000
Sundry Trade Creditors		25,000	Advance to Y		4,000

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		90,000			90,000

The firm was dissolved on the date mentioned above due to continued losses. After drawing up the balance sheet given above, it was discovered that goods amounting to ₹ 4,000 have been purchased in November, 2022 and had been received but the purchase was not recorded in books.

Fixed assets realized ₹ 20,000; Stock ₹ 21,000 and Book Debt ₹ 20,500. Similarly, the creditors allowed a discount of 2% on average. The expenses of realization come to ₹ 1,080. X agreed to take over the loan of Mrs. X. Y is insolvent, and his estate is unable to contribute anything. Give accounts to close the books; work according to the decision in Garner vs. Murray.

SOLUTION

Realization Account

Particulars	₹	Particulars		₹
To Sundry		By Provision for Doubtful Debts		5,000
Fixed Assets (transfer)	40,000	By Cash (20,000+21,000+20,500)		61,500
Stock	25,000	By Sundry Trade Creditors (Discount)		29,000
Book Debts	25,000	By Loss: X (2/5)	9,600	
To Cash—Expenses	1,080	Y (2/5)	9,600	
- Creditors	28,420	Z (1/5)	4,800	24,000
	1,19,500			1,19,500

Sundry Trade Creditors

Particulars	₹	Particulars	₹
To Realization A/c	29,000	By Balance b/d	25,000
		By Partners Capital Accounts (Purchase omitted)	4,000
	29,000		29,000

Z's Loan Account

Particulars	₹	Particulars	₹
To Cash Account	5,000	By Balance b/d	5,000

Mrs. X's Loan Account

Particulars	₹	Particulars	₹
To X's Capital A/c – transfer	10,000	By Balance b/d	10,000

Cash Account

Particulars	₹	Particulars	₹
To Balance b/d	1,000	By Sundry Trade Creditors (after deducting discount of 2%)	28,420
To Realization A/c- assets realized	61,500	By Realization A/c – expenses	1,080
To X's Capital A/c*	9,600	By Z's Loan	5,000
To Z's Capital A/c*	4,800	By X's Capital A/c	34,300
		By Z's Capital A/c	8,100

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	76,900		76,900

*X and Z bring these amounts to make good their share of the loss on realization. In actual practice they will not be bringing any cash; only a notional entry will be made.

Capital Accounts

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Sundry Trade				By Balance b/d	29,200	10,800	10,000
Creditors- omission	1,600	1,600	800				
To Balance c/d	27,600	9,200	9,200				
	29,200	10,800	10,000		29,200	10,800	10,000
To Advance	-	4,000	-	By Balance b/d	27,600	9,200	9,200
To Realization A/c- loss	9,600	9,600	4,800	By Mrs. X's Loan	10,000	-	-
To Y's Capital A/c	3,300	-	1,100	By Cash (Realization loss)	9,600	-	4,800
				By X's Capital A/c		3,300	
To Cash	34,300	-	8,100	By Z's Capital A/c	-	1,100	-
	47,200	13,600	14,000		47,200	13,600	14,000

Note: Y's deficiency comes to ₹ 4,400 (difference in the two sides of his Capital Account); this has been debited to X and Z in the ratio of 27,600: 9,200 i.e., capital standing up just before dissolution but after correction of error committed while drawing up the accounts for 2022.

ILLUSTRATION 6

A, B, and C are partners sharing profits and losses in the ratio of 5:3:2. Their capitals were ₹ 9,600, ₹ 6,000 and ₹ 8,400 respectively.

After paying creditors, the liabilities and assets of the firm were:

Liabilities	₹	Assets	₹
Liability for interest on loans from:		Investments	1,000
Spouses of partners	2,000	Furniture	2,000
Partners	1,000	Machinery	1,200
		Stock	4,000

The assets realized in full in the order in which they are listed above. B is insolvent.

You are required to prepare a statement showing the distribution of cash as and when available, applying the maximum possible loss procedure.

SOLUTION

Statement of Distribution of Cash

Realization		Interest on loans from partner's spouses	Interest on loans from partners	Partners Capitals			Total
				A	B	C	
₹		₹	₹	₹	₹	₹	₹

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Balances due (1)		2,000	1,000	9,600	6,000	8,400	24,000
(i) Sale of Investments	1,000	(1,000)					
		1,000	1,000				
(ii) Sale of furniture	2,000	(1,000)	(1,000)				
(iii) Sale of machinery	1,200						
Maximum possible loss ₹ 22,800 (total of capitals ₹ 24,000 less Cash available ₹ 1,200) allocated to partners in the profit sharing ratio i.e. 5:3: 2				(11,400)	(6,840)	(4,560)	(22,800)
Amounts at credit				(1,800)	(840)	3,840	1,200
Deficiency of A and B written off against C				1,800	840	(2,640)	
Amount paid (2)				-	-	1,200	1,200
Balances in capital accounts (1-2) = (3)				9,600	6,000	7,200	22,800
(iv) Sale of stock 4,000							
Max. possible loss 22,800-4,000= 18,800							
allocated to partner's in the ratio 5:3:2				(9,400)	(5,640)	(3,760)	(18,800)
Amounts at credit and cash paid (4)				200	360	3,440	4,000
Balances in capital accounts left unpaid - Loss (3-4) = (5)				9,400	5,640	3,760	18,800

ILLUSTRATION 7

The following is the Balance Sheet of A, B, C on 31st December, 2022 when they decided to dissolve the partnership:

Liabilities	₹	Assets	₹
Creditors	2,000	Sundry Assets	48,500
A's Loan	5,000	Cash	500
Capital Accounts:			
A	15,000		
B	18,000		
C	9,000		
	49,000		49,000

The assets realized the following sums in instalments:

I	1,000
II	3,000
III	3,900

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IV	6000
V	20,100
	34,000

The expenses of realization were expected to be ₹ 500 but ultimately amounted to ₹ 400 only. Show how at each stage the cash received should be distributed between partners. They share profits in the ratio of 2:2:1.

SOLUTION

First of all, the following table will be constructed to show the amounts available for distribution among the various interests:

Statement showing Realization and Distribution of Cash Payments

	Particulars	Realization ₹	Creditors ₹	Partners' Loan ₹	Partners' Capitals ₹
1.	After taking into account cash balance and amount set aside for expenses	1,000	1,000	-	-
2.		3,000	1,000	2,000	-
3.		3,900	-	3,000	900
4.		6,000	-	-	6,000
	Including saving in expenses	20,100	-	-	20,100
		34,000	2,000	5,000	27,000

To ascertain the amount distributable out of each installment realized among the partners, the following table will be constructed:

Statement of Distribution on Capital Accounts

(1) Calculation to determine the mode of distribution of ₹ 900

Particulars	Total (₹)	A(₹)	B(₹)	C(₹)
Balance	42,000	15,000	18,000	9,000
Less: Possible loss, should remaining assets prove to be worthless (in their profit-sharing ratio)	(41,100)	(16,440)	(16,440)	(8,220)
	+ 900	- 1,440	+ 1,560	+ 780
Deficiency of A's capital written off against those of B and C in the ratio of their capital, 18,000:9,000 (Garner vs. Murray)			(960)	(480)
Manner in which the first ₹ 900 should be distributed			+ 600	+ 300

(2) Distribution of ₹ 6,000

Balance after making payment of amount shown in step (1)	41,100	15,000	17,400	8,700
Less: Possible Loss assuming remaining asset to	(35,100)	(14,040)	(14,040)	(7,020)

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be valueless (in their profit sharing ratio)				
Balance available and to be distributed	6,000	960	3,360	1,680

(3) Distribution of ₹ 20,100

Balance after making payment of amount shown in step (2)	35,100	14,040	14,040	7,020
Less: Possible loss, assuming remaining assets to be valueless (in their profit sharing ratio)	(15,000)	(6,000)	(6,000)	(3,000)
Manner of distribution of ₹ 20,100	20,100	8,040	8,040	4,020
Summary:				
Balance	42,000	15,000	18,000	9,000
Total amounts paid	27,000	9,000	12,000	6,000
Loss	15,000	6,000	6,000	3,000

ILLUSTRATION 8

A partnership firm was dissolved on 30th June, 2022. Its Balance Sheet on the date of dissolution was as follows:

Liabilities	₹	₹	Assets	₹
Capitals:			Cash	10,800
A	76,000		Sundry Assets	1,89,200
B	48,000			
C	36,000	1,60,000		
Loan A/c – B		10,000		
Sundry Creditors		30,000		
		2,00,000		2,00,000

The assets were realized in instalments and the payments were made on the proportionate capital basis. Creditors were paid ₹ 29,000 in full settlement of their account. Expenses of realization were estimated to be ₹ 5,400 but actual amount spent was ₹ 4,000. This amount was paid on 15th September. Draw up a statement showing distribution of cash, which was realized as follows:

	₹
On 5 th July, 2022	25,200
On 30 th August, 2022	60,000
On 15 th September, 2022	80,000

The partners shared profits and losses in the ratio of 2 : 2 : 1. Prepare a statement showing distribution of cash amongst the partners by 'Highest Relative Capital' method.

SOLUTION
Statement showing distribution of cash amongst the partners

	Creditors	B's Loan	A	B	C
2022	₹	₹	₹	₹	₹
June 30	30,000	10,000	76,000	48,000	36,000
Balance b/d	5,400	-	-	-	-
Cash balance less Provision for expenses (₹ 10,800 – ₹ 5,400)					

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Balances unpaid July 5	24,600	10,000	76,000	48,000	36,000
1 st Instalment of ₹ 25,200	23,600	1,600	-	-	-
Discount received on full settlement	1,000	8,400	76,000	48,000	36,000
Less: Transferred to Realisation A/c	1,000				
	Nil				
August 30 2 nd instalment of ₹ 60,000 (W.N. 2)		8,400	32,640	4,640	14,320
Balance unpaid September 15		Nil	43,360	43,360	21,680
Amount realised ₹ 80,000					
Add: Balance out of the Provision for Expenses A/c 1,400					
	81,400		32,560	32,560	16,280
Amount unpaid being loss on Realisation in the ratio of 2 : 2 : 1			10,800	10,800	5,400

Working Notes:
1. Highest relative capital basis

		A ₹	B ₹	C ₹
1.	Present Capitals	76,000	48,000	36,000
2.	Profit-sharing ratio	<u>2</u>	<u>2</u>	<u>1</u>
3.	Capital per unit of Profit share (1 ÷ 2)	38,000	24,000	36,000
4.	Proportionate capitals taking B, whose capital is the least, as the basis	48,000	48,000	24,000
5.	Excess capital (1-4)	28,000	Nil	12,000
6.	Profit-sharing ratio	<u>2</u>	<u>-</u>	<u>1</u>
7.	Excess capital per unit of Profit share (5 ÷ 6)	14,000		12,000
8.	Proportionate capitals as between A and C taking C capital as the basis	24,000	-	12,000
9.	Excess of A's Capital over C's Excess capital (5- 8)	4,000	-	-
10.	Balance of Excess capital (5-9)	24,000		12,000
11.	Distribution sequence:			
	First ₹ 4,000 (2 : 0 : 0)	4,000	-	-
	Next ₹ 36,000 (2 : 0 : 1)	24,000	-	12,000
	Over ₹ 40,000 (2 : 2 : 1)			

2. Distribution of Second instalment
3.

		Creditors	A	B	C
First	₹ 8,400	8,400	-	-	-
Next	₹ 4,000 (2 : 0 : 0)		4,000	-	-
Next	₹ 36,000 (2 : 0 : 1)		24,000	-	12,000
Balance	₹ 11,600 (2 : 2 : 1)		4,640	4,640	2,320
	60,000	8,400	32,640	4,640	14,320

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ILLUSTRATION 9

P and Q were partners sharing profits equally in LLP. Their Balance Sheet as on March 31, 2022 was as follows:

Balance Sheet as on 31st March, 2022

Equity and Liabilities		₹	Assets		₹
Capitals:			Bank		30,000
P	1,00,000		Debtors		25,000
Q	50,000	1,50,000	Stock		35,000
Creditors		20,000	Furniture		40,000
Q's current account		10,000	Machinery		60,000
Reserves		15,000	P's current account		10,000
Bank overdraft		5,000			
		2,00,000			2,00,000

The firm was dissolved on the above date:

P took over 50% of the stock at 10% less on its book value, and the remaining stock was sold at a gain of 15%. Furniture and Machinery realized for ₹ 30,000 and ₹ 50,000 respectively; There

was an unrecorded investment which was sold for ₹ 25,000; Debtors realized 90% only and ₹ 1,245 were recovered for bad debts written off last year. There was an outstanding bill for repairs which had to be paid for ₹ 2,000. You are required to prepare Realization Account, Partners' capital accounts (including transfer of current account balances) and Bank Account in the books of the firm.

SOLUTION

Books of P & Q LLP.

Realization Account

Particulars			₹	Particulars			₹
To	Debtors	25,000		By	Creditors		20,000
To	Stock	35,000		By	Bank overdraft		5,000
To	Furniture	40,000		By	Bank:		
To	Machinery	60,000	1,60,000		Investment	25,000	
To	Bank:				Furniture	30,000	
	Creditors	20,000			Machinery	50,000	
	Bank overdraft	5,000			Debtors (90%)	22,500	
	Outstanding bill	2,000	27,000		Stock	20,125	
To	Profit transferred to:				Bad debts Recovered	1,245	1,48,870
	P's capital	1,310			By P's capital (stock taken over)		15,750
	Q's capital	1,310	2,620				
			1,89,620				1,89,620

Partners' Capital Accounts

	P	Q		P	Q
To	P's current	16,940	By	Balance b/d	1,00,000
	Account				
To	Bank	83,060	By	Q's current Account	18,810
		68,810			

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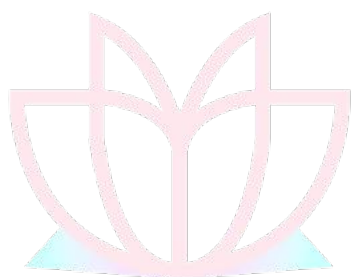
	1,00,000	68,810		1,00,000	68,810

Bank Account

	₹		₹
To Balance b/d	30,000	By Realization	27,000
To Realization	1,48,870	By P's capital	83,060
		By Q's capital	68,810
	1,78,870		1,78,870

Working
Note:
Partners' Current Accounts

	P	Q		P	Q
To Balance b/d	10,000		By Balance b/d		10,000
To Realization	15,750		By Reserves	7,500	7,500
To Q's capital		18,810	By Realization (profit)	1,310	1,310
			By P's Capital	16,940	
	25,750	18,810		25,750	18,810



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Chapter 11.1 Introduction to Company Accounts

True and False

Quest on 1

Every public company is a listed company.

Answer 1

False: Listed companies are those which are listed on the stock exchange. Shares of listed companies are open to general public. Every listed company is a public company but every public company is not a listed company.

Quest on 2

Shares of a private company are not listed on stock exchange.

Answer 2

True: Only the shares of public company are listed on stock exchange. Every listed company is a public company.

Quest on 3

It is not mandatory to incorporate a company under the companies act.

Answer 3

False: It is mandatory to incorporate a company under the Companies Act. Without such incorporation, a company cannot come into existence.

Quest on 4

Company is an artificial, legal person created by law.

Answer 4

True: Company comes into existence through the operation of law. It is a separate entity distinct from its members.

Quest on 5

Death, insolvency or change of members affects the existence of a company.

Answer 5

False: Company is a separate legal entity created by law. Death, insolvency or change of member does not affect its existence.

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Quest on 6

If the shares are fully paid-up by the shareholder, he is subject to no further liability.

Answer 6

True: Liability of shareholders is limited to the extent of the unpaid share capital. So, if shares are fully paid-up, he is subject to no further liability.

Quest on 7

Public limited company has restrictions on transferability of shares.

Answer 7

False: Shares of public company are freely transferable. Transferability of shares is restricted in a private limited company.

Quest on 8

Financial statements of company show the financial position of the business.

Answer 8

True: Financial statements give a true & fair view of the state of affairs of the company. Financial statements include profit and loss account, balance sheet, etc.

Quest on 9

Schedule I gives proforma of Balance Sheet.

Answer 9

False: Schedule III Part I explains proforma of Balance Sheet.

Quest on 10

Schedule III prescribes the format of Directors' Report

Answer 10

False: Schedule III Part I explains proforma of Balance Sheet and Profit and Loss.

Quest on 11

Financial statements need to be true and correct as per Companies Act.

Answer 11

False: As per Section 128, every company shall prepare financial statement for every financial year which give a true and fair view of the state of the affairs of the company.

Multiple Choice Questions
1. Which of the following statement is not a feature of a Company?

- (a) Separate legal entity
- (b) Perpetual Existence
- (c) Members have unlimited liability

Answer: (c)

2. In a Government Company, the holding of the Central Government in paid-up capital should not be

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less than

- (a) 25%
- (b) 50 %
- (c) 51%

Answer: (c)

3. Which of the following statement is true in case of a Foreign Company?

- (a) A Company incorporated in India and has place of business outside India.
- (b) A Company incorporated outside India and has a place of business in India.
- (c) A Company incorporated in India and has a place of business in India.

Answer: (b)

4. Which of the following statements is not a feature of a private company?

- (a) Restricts the rights of members to transfer its shares.
- (b) Does not restrict on the number of its members to any limit.
- (c) Does not involve participation of public in general.

Answer: (b)

5. Under Schedule III of the Companies Act, assets and liabilities are to be disclosed based on:

- (a) Current/ non-current.
- (b) Financial /non-financial.
- (c) Owned /not-owned.

Answer: (a)

6. Schedule III of the Companies Act prescribes the format and content of

- (a) Balance sheet and statement of profit and loss
- (b) Auditors' report.
- (c) Directors' report.

Answer: (a)

7. A company is required to maintain its books of accounts at

- (a) its registered office.
- (b) its largest branch office.
- (c) Managing Director's residence.

Answer: (a)

8. Cash flow statements are not required for

- (a) Private company.
- (b) One person company.
- (c) Public company.

Answer: (b)

9. The presentation and disclosure requirements of a company are prescribed by

- (a) Schedule III.
- (b) Schedule II.

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(c) Schedule I.

Answer: (a)

10. Following is an example of current assets

- (a) Inventories.
- (b) Property, Plant & Equipment.
- (c) Intangible Assets.

Answer: (a)

11. Earnings per share (EPS) is to be disclosed in which of the following section of the financial statements

- (a) Balance Sheet.
- (b) Statement of Profit and Loss.
- (c) Cash Flow Statements.

Answer: (b)

12. Following is NOT an example of a company under Companies Act, 2013

- (a) Small company.
- (b) Private company.
- (c) Large company.

Answer: (c)

Theory Questions

Question 1:

Explain salient features of a company in brief.

Answer 1:

Following are the salient features of a company:

1. Incorporated Association: A company comes into existence through the operation of law. Therefore, incorporation of company under the Companies Act is must. Without such registration, no company can come into existence. Being created by law, it is regarded as an artificial legal person.
2. Separate Legal Entity: A company has a separate legal entity and is not affected by changes in its membership. Therefore, being a separate business entity, a company can contract, sue and be sued in its incorporated name and capacity.
3. Perpetual Existence: Since company has existence independent of its members, it continues to be in existence despite the death, insolvency or change of members.
4. Common Seal: Company is not a natural person; therefore, it cannot sign the documents in the manner as a natural person would do. In order to enable the company to sign its documents, it is provided with a legal tool called 'Common Seal'. The common seal is affixed on all documents by the person authorised to do so who in turn puts his signature for and on behalf of the company. Companies Act, 2013 required common seal to be affixed on certain documents (such as bill of exchange, share certificates, etc.) Now, the use of common seal has been made optional. All such documents which required affixing the common seal may now instead be signed by two directors or one director and a company secretary of the company.

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Further, every company registered in India are required to obtain unique Corporate Identification Number (CIN) that is assigned by Registrar of Companies.

5. **Limited Liability:** The liability of every shareholder of a company is limited to the amount he has agreed to pay to the company on the shares allotted to him. If such shares are fully paid-up, he is subject to no further liability.
6. **Distinction between Ownership and Management:** Since the number of shareholders is very large and may be distributed at different geographical locations, it becomes difficult for them to carry on the operational management of the company on a day- to-day basis. This gives rise to the need of separation of the management and ownership.
7. **Not a citizen:** A company is not a citizen in the same sense as a natural person is, though it is created by the process of law. It has a legal existence but does not enjoy the citizenship rights and duties as are enjoyed by the natural citizens.
8. **Transferability of Shares:** The capital is contributed by the shareholders through the subscription of shares. Such shares are transferable by its members except in case of a private limited company, which may have certain restrictions on such transferability.
9. **Maintenance of Books:** A limited company is required by law to keep a prescribed set of account books and any failure in this regard attracts penalties.
10. **Periodic Audit:** A company has to get its accounts periodically audited through the chartered accountants appointed for the purpose by the shareholders on the recommendation of board of directors.
11. **Right of Access to Information:** The right of the shareholders of a company to inspect its books of account, with the exception of books open for inspection under the Statute, is governed by the Articles of Association. The shareholders have a right to seek information from the directors by participating in the meetings of the company and through the periodic reports.

Question 2:

Write short note on:

- (a) **Foreign company.**
- (b) **Small company.**
- (c) **Company limited by guarantee.**

Answer 2:

- (i) **Foreign Company**

According to Section 2 (42) of the Companies Act, 2013, "Foreign company" means any company or body corporate incorporated outside India which –

- (a) Has a place of business in India whether by itself or through an agent physically or through electronic mode; and
- (b) Conducts any business activity in India in any other manner.

- (ii) **Small Company**

Section 2(85) of the Companies Act, 2013 defines "Small company" means a company, other than a public company.

- (a) paid-up share capital of which does not exceed four crores rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; or
- (b) turnover of which as per its last profit and loss account for the immediately preceding financial year does not exceed forty crores rupees or such higher amount as may be prescribed which shall not be more than hundred crore rupees.

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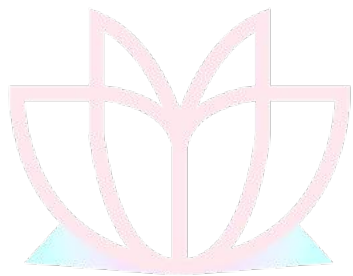
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Provided that nothing in this clause should apply to:

1. a holding company or a subsidiary company
2. a company registered under section 8
3. a company or body corporate governed by any special Act

(iii) Company limited by Guarantee

As per Section 2(21) of the Companies Act, 2013, “company limited by guarantee” means a company having the 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.



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Chapter 11.2

Issue, Forfeiture and Re-Issue of Shares

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True and False

Quest on 1:

Liability of a holder of shares is limited to the face value of shares acquired by them.

Answer 1:

False: Liability of the holder of shares is limited to the issue price of shares acquired by them.

Quest on 2:

Authorised capital appears in the balance sheet at face value.

Answer 2:

True: Authorised capital is the amount of capital mentioned in 'capital clause' of the 'Memorandum of Association'. Authorised capital is considered only as presentation and not considered in total of balance sheet.

Quest on 3:

The rate of dividend on preference shares may vary From year to year.

Answer 3:

False: Rate of preference dividend is always fixed.

Quest on 4:

A company may issue shares at a discount to the public in general.

Answer 4:

False: According to 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.

Quest on 5:

Sweat equity shares are those which are issued to employees & directors at a discount.

Answer 5:

True: According to 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).

Quest on 6:

As per table F, rate of interest on calls in arrears is 12%.

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Answer 6:

False: As per table F, rate of interest on calls in arrears is 10%.

Quest on 7:

As per Table F, rate of interest on calls in advance is 10%.

Answer 7:

False: As per Table F, rate of interest on calls in advance is 12%.

Quest on 8:

Non-participating preference shareholders enjoy voting rights.

Answer 8:

False: A share on which only a fixed rate of dividend is paid every year, without any accompanying additional rights in profits and in the surplus on winding-up, is called 'Non-participating Preference Shares. Non-participating preference shareholders do not enjoy voting rights.

Quest on 9:

Forfeited shares are available to the company for the purpose of resale.

Answer 9:

True: Reissue of forfeited shares is not allotment of shares but only a sale.

Quest on 10:

Loss on reissue should exceed the forfeited amount.

Answer 10:

False: Loss on re-issue should not exceed the forfeited amount.

Multiple Choice Questions

1. The excess price received over the par value of shares, should be credited to _____.
 (a) Calls-in-advance account
 (b) Share capital account
 (c) Securities premium account

Answer 1: (c)

2. The Securities Premium amount may be utilized by a company for _____.
 (a) Writing off any loss on sale of fixed asset
 (b) Writing off any loss of revenue nature
 (c) Writing off the expenses/discount on the issue of debentures

Answer 2: (c)

3. When shares are forfeited, the share capital account is debited with _____ and the share forfeiture account is credited with _____.
 (a) Paid-up capital of shares forfeited; Called up capital of shares forfeited
 (b) Called up capital of shares forfeited; Calls in arrear of shares forfeited
 (c) Called up capital of shares forfeited; Amount received on shares forfeited

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Answer 3: (c)

4. T Ltd. proposed to issue 6,000 equity shares of ₹ 100 each at a premium of 40%. The minimum amount of application money to be collected per share as per the Companies Act, 2013
- (a) ₹ 5.00
 - (b) ₹ 6.00
 - (c) ₹ 7.00

Answer 4: (a)

5. Dividends are usually paid as a percentage of _____.
- (a) Authorized share capital
 - (b) Net profit
 - (c) Paid-up capital

Answer 5: (c)

6. As per the SEBI guidelines, on issue of shares, the application money should not be less than
- (a) 2.5% of the nominal value of shares
 - (b) 2.5% of the issue price of shares
 - (c) 25.0% of the issue price of shares

Answer 6: (c)

7. G Ltd. acquired assets worth ₹ 7,50,000 from H Ltd. by issue of shares of ₹ 100 at a premium of 25%. The number of shares to be issued by G Ltd. to settle the purchase consideration = ?
- (a) 6,000 shares
 - (b) 7,500 shares
 - (c) 9,375 shares

Answer 7: (a)

8. Securities Premium is presented as a part of
- (a) Reserves & Surplus
 - (b) Share Capital
 - (c) Liabilities

Answer 8: (a)

9. Schedule III of Companies Act 2013 prescribes the format for
- (a) Financial statements
 - (b) Directors' Report
 - (c) Auditors' Report

Answer 9: (a)

10. Dividend on _____ shares have to be paid before dividend on _____ shares.
- (a) Equity, Preference
 - (b) Preference, Equity
 - (c) Convertible, Non-Cumulative

Answer 10: (b)

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11. Preference shares are _____ unless expressly stated otherwise.

- (a) Non-participating
- (b) Convertible
- (c) Interest-bearing

Answer 11: (a)

Theory Questions

Question 1:

Write short notes on:

- (i) Utilization of securities premium account
- (ii) Re-issue of forfeited shares

Answer 1:

(i)

When shares are issued at a premium, the premium amount is credited to a separate account called "Securities Premium Account" because it is not a part of share capital. Rather, it represents a gain of a capital nature to the company.

Being a credit balance, Securities premium Account is shown under the heading, "Reserves and Surplus". However, 'Reserves and Surplus' is shown as 'shareholders' funds in the Balance Sheet as per Schedule III. According to Section 52 of the Companies Act, 2013, Securities Premium Account may be used by the company:

- (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.

Note : It may be noted that certain class of Companies as prescribed under Section 133 of the Companies Act, 2013, whose financial statements comply with the accounting standards prescribed for them (i.e. those companies to whom Indian Accounting Standards are applicable), can't apply the securities premium account for the purposes (b) and (d) mentioned above.

(ii)

A forfeited share is merely a share available to the company for sale and remains vested in the company for that purpose only. Reissue of forfeited shares is not allotment of shares but only a sale. The share, after forfeiture, in the hands of the company is subject to an obligation to dispose it off. In practice, forfeited shares are disposed off by auction. These shares can be re- issued at any price so long as the total amount received (from the original allottee and the second purchaser) for those shares is not less than the amount in arrears on those shares.

Question 2:

Distinguish between:

- (i) Calls-in-Arrears and Calls-in-advance

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(ii) Issue of shares for cash and Issue of Shares for Consideration other than Cash

Answer 2:

- (i) **Calls-in-Arrears:** Sometimes shareholders fail to pay the amount due on allotment or calls. The total unpaid amount on one or more instalments is known as Calls-in-Arrears or Unpaid Calls. Such amount represents the uncollected amount of capital from the shareholders; hence, it is shown by way of deduction from 'called-up capital' to arrive at paid-up value of the share capital.
Calls-in-advance: Some shareholders may sometimes pay a part, or whole, of the amount not yet called up, such amount is known as Calls-in-advance.
- (ii) The shares can be issued by a company either for cash or for consideration other than cash. Public limited companies, generally, issue their shares for cash and use such cash to buy the various types of assets needed in the business. Sometimes, however, a company may issue shares in a direct exchange for land, buildings or other assets.

Question 3:

Can a company issue shares at discount?

Answer 3:

According to 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.

Practical Questions

Question 1:

X Ltd. invited applications for 10 lakhs shares of ₹ 100 each payable as follows :

	₹
On Application	20
On Allotment (on 1st May, 2022)	30
On First Call (on 1st Oct., 2022)	30
On Final Call (on 1st Feb., 2023)	20

All the shares were applied for and allotted. A shareholder holding 20,000 shares paid the whole of the amount due along with allotment. Journalise the transactions, assuming all sums due were received. Interest was paid to the shareholder concerned on 1st February, 2023.

Answer 1:

Journal of X Ltd.

2022			₹ in lakhs	₹ in lakhs
May 1	Bank A/c	Dr.	200	
	To Share Application A/c (Receipt of applications for 10 lakh shares alongwith application money of ₹20 per share.)			200
May 1	Share Application A/c	Dr.	200	
	Share Allotment A/c	Dr.	300	

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	To Share Capital A/c (The allotment of 10 lakh shares: payable on application ₹ 20 share and ₹ 30 on allotment as per Directors' resolution no... dated...)		500
May 1	Bank A/c Dr.	310	
	To Shares Allotment A/c To Calls in Advance A/c [Receipt of money due on allotment @ ₹30, also the two calls (₹ 30 and ₹20) on 20,000 shares.]		300 10
Oct. 1	Share First Call A/c Dr.	300	
	To Share Capital A/c (The amount due on 10 lakh shares @ ₹30 on first call, as per Directors, resolution no... dated...)		300
	Bank A/c Dr.	294	
	Calls in Advance A/c Dr.	6	
	To Share First Call A/c (Receipt of the first call on 9.80 lakh shares, the balance having been previously received and now debited to call in advance account.)		300
2023			
Feb. 1	Share Final Call A/c Dr.	200	
	To Share Capital A/c (The amount due on Final Call on 10 lakh shares @ ₹ 20 per share, as per Directors' resolution no... dated...)		200
Feb. 1	Bank A/c Dr.	196	
	Calls in Advance A/c Dr.	4	
	To Share Final Call A/c (Receipt of the moneys due on final call on 9.80 lakhs shares, the balance having been previously received.)		200
Feb. 1	Interest on calls in Advance A/c Dr.	0.66	
	To Shareholder A/c (Being interest on call in advance made due)		0.66
Feb 1	Shareholder A/c Dr.	0.66	
	To Bank A/c (Being interest paid)		0.66

Working Note:

The interest on calls in advance paid @ 12% on :	₹
₹ 6,00,000 (first call) from 1st May to 1st Oct., 2022–5 months	30,000
₹ 4,00,000 (final call) from 1st May to 1st Feb., 2023–9 months	36,000
Total Interest Amount Due	66,000

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Question 2:

A limited Company, with an authorized capital of ₹ 20,00,000 divided into shares of ₹ 100 each, issued for subscription 10,000 shares payable at ₹ 25 per share on application, ₹ 30 per share on allotment, ₹ 20 per share on first call three months after allotment and the balance as and when required. The subscription list closed on January 31, 2022 when application money on 10,000 shares was duly received and allotment was made on March 1, 2022. All amounts due were received within one month of the date they were called. The allotment amount was received in full but, when the first call was made, one shareholder failed to pay the amount on 1,000 shares held by him and another shareholder with 500 shares paid the entire amount on his shares.

Give journal entries in the books of the Company to record these share capital transactions.

Answer 2:
Journal Entries in the Books of the Company

Date	Particulars	L.F.	Debit	Credit
2022			Amount	Amount
			(₹)	(₹)
Jan. 31	Bank A/c Dr.		2,50,000	
	To Equity Share Application A/c			2,50,000
	(Money received on applications for 10,000 shares @ ₹ 25 per share)			
March 1	Equity Share Application A/c Dr.		2,50,000	
	To Equity Share Capital A/c			2,50,000
	(Transfer of application money on 10,000 shares to share capital)			
March 1	Equity Share Allotment A/c Dr.		3,00,000	
	To Equity Share Capital A/c			3,00,000
	(Amount due on the allotment of 10,000 shares @ ₹ 30 per share)			
April 1	Bank A/c Dr.		3,00,000	
	To Equity Share Allotment A/c (Allotment money received)			3,00,000
June 1	Equity Share First Call A/c Dr.		2,00,000	
	To Equity Share Capital A/c (First call money due on 10,000 shares @ ₹ 20 per share)			2,00,000
July 1	Bank A/c Dr.		1,92,500	
	Calls-in-Arrears A/c Dr.		20,000	
	To Equity Share First Call A/c			2,00,000
	To Calls-in-Advance A/c			12,500
	(First call money received on 9000 shares and calls-in-advance on 500 shares @ ₹ 25 per share)			

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Question 3:

A Ltd. forfeits 100 shares of Rs.10 each fully called upon. The shareholder failed to pay the first call money of Rs. 4 per share and the second and final Call Money of Rs. 4 per share. Give journal entry to show the effect of this transaction.

Answer 3:

**In the Books of A Ltd.
Journal Entries**

Date	Particulars	₹	₹
	Equity Share Capital A/c (100X10) Dr.	1,000	
	To Share First Call A/c (100X4)		400
	To Second and Final Call A/c (100X4)		400
	To Share Forfeiture A/c (100X2)		200
	(Being share forfeiture of 100 shares as per Board's Resolution No.....dated...)		

Question 4:

B Ltd. issued 20,000 equity shares of ₹ 100 each at a premium of ₹ 20 per share payable as follows: on application ₹ 50; on allotment ₹ 50 (including premium); on final call ₹ 20. Applications were received for 24,000 shares. Letters of regret were issued to applicants for 4,000 shares and shares were allotted to all the other applicants. Mr. A, the holder of 150 shares, failed to pay the allotment and call money, the shares were forfeited. Show the Journal Entries and Cash Book in the books of B Ltd.

Answer 4:

**In the Books of B Ltd.
Cash Book (Bank column only)**

Date	Particulars	₹	Date	Particulars	₹
	To Equity Share Application A/c (Being application money received on 24,000 shares @ ₹ 50 each)	12,00,000		By Equity Share Application A/c (Being excess money refunded on 4,000 shares @ ₹ 50 each as per Board's Resolution No...dated....)	2,00,000
	To Equity Share Allotment A/c (Being allotment money received on 19,850 shares @ ₹ 50 each)	9,92,500		By Balance c/d	23,89,500
	To Equity Share Final Call A/c (Being final call money received on 19,850 shares @ ₹ 20 each)	3,97,000			

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		25,89,500			25,89,500

Journal Entries

Date	Particulars		₹	₹
	Equity Share Application A/c Dr.		10,00,000	
	To Equity Share Capital A/c (Being application money on 20,000 shares @ ₹ 50 each transferred to Equity Share Capital Account as per Board's Resolution No.....dated...)			10,00,000
	Equity Share Allotment A/c Dr.		10,00,000	
	To Equity Share Capital A/c			6,00,000
	To Securities Premium A/c (Being allotment money @ ₹ 50 per share including premium of ₹ 20 per share being made due as per Board's Resolution No.....dated....)			4,00,000
	Equity Share Capital A/c (150 x ₹100) Dr.		15,000	
	Securities Premium A/c (150 x ₹ 20) Dr.		3,000	
	To Equity Share Allotment A/c			7,500
	To Equity Share Final Call A/c			3,000
	To Forfeited Shares A/c (Being forfeiture of 150 shares for non-payment of allotment money and final call money as per Board's Resolution No.....dated...)			7,500
	Equity Share Final Call A/c (19,850 x ₹20) Dr.		3,97,000	3,97,000
	To Equity Share Capital A/c (Being final call money received for ₹ 20 per share being made as per Board's resolution No.... dated)			

Note:

Here, securities premium on forfeited shares has not been realised, so Securities Premium Account will be debited at the time of forfeiture of these shares.

Also, alternatively Calls in arrears A/c could have been used in which case following entries would have been passed in place of the entry (given above) for forfeiture:

On non- receipt of allotment money:			
Calls in Arrears A/c	Dr.	7,500	
To Equity Share Allotment A/c			7,500
(Being allotment money on 150 shares @ ₹ 50 not received transferred to calls in arrears.)			
On non - receipt of Call money:			
Calls in Arrears A/c	Dr.	3,000	

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To Equity Share Final Call A/c			3,000
(Being final call on 150 shares @ ₹20 not received transferred to calls in arrears)			
On Forfeiture:			
Share Capital A/c (150 x ₹ 100)		15,000	
Securities Premium A/c (150 x ₹20)		3,000	
To Calls in Arrears A/c			10,500
To Share Forfeiture A/c			7,500
(Being forfeiture of 150 shares for non-payment of allotment money and final call money as per Board's Resolution No....dated...)			

ILLUSTRATIONS:

Question 1 (ILLUSTRATION)

A company had an authorised capital of ₹ 10,00,000 divided into 1,00,000 equity shares of ₹ 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. Upto 31-3-2022, it has demanded or called ₹ 9 per share. All shareholders have duly paid the amount called, except one shareholder, holding 5,000 shares who has paid only ₹ 7 per share.

Prepare a balance sheet assuming there are no other details.

Answer:

Balance Sheet as at 31st March, 2022

Particulars	Notes No.	₹
EQUITY AND LIABILITIES		
Shareholders' funds		
Share capital	1	5,30,000
Total		5,30,000
ASSETS		
Current assets		
Cash and cash equivalents	2	5,30,000
Total		5,30,000

Notes to accounts

		₹	₹
1.	Share Capital		
	Equity share capital Authorized share capital 1,00,000 Equity shares of ₹ 10 each	10,00,000	
	Issued share capital 60,000 Equity shares of ₹ 10 each	6,00,000	

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	Subscribed share capital 60,000 Equity shares of ₹ 10 each	6,00,000	
	Called up and Paid up share capital 60,000 Equity shares of ₹ 10 each ₹ 9 called up Less: Calls unpaid on 5,000 shares @ ₹ 2 per share	5,40,000 (10,000)	5,30,000
2.	Cash and cash equivalents		
	Balances with banks		5,30,000

It is clear from above, that details of authorised, issued and subscribed capital are given in the Notes to Accounts but are not counted. It is only the paid-up capital i.e., the portion of the issued capital subscribed by shareholders which is taken into account while totalling the liabilities side of the balance sheet.

Question 2 (ILLUSTRATION)

A company invited applications for 10,000 equity shares of ₹ 50 each payable on application ₹ 15, on Allotment ₹ 20, on first and final call ₹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.

Answer

Journal entries in the books of a company

For application money received: Amount received along with application is accounted as follows:

Bank A/c	Dr.	(Applicat on money on allot ed share i.e., 10,000 × ₹15 = ₹1,50,000)
To Equity Share Applicat on A/c		

At the time of allotment: Application money received from successful applicants become part of share capital and is transferred to share capital as under:

Equity Share Applicat on A/c	Dr.	(Applicat on money on allot ed share i.e., 10,000 × ₹ 15 = ₹ 1,50,000)
To Equity Share Capital A/c		

To record amount due on allotment: When the decision is taken to allot shares, allotment money on allotted shares falls due and is recorded as follows:

Equity Share Allotment A/c	Dr.	(Allotment money due at the allot ed share i.e., 10,000 × ₹ 20 = ₹ 2,00,000)
To Equity Share Capital A/c		

For allotment money received: Allotment money received from shareholders is recorded as follows:

Bank A/c	Dr.	(Allotment money received from shareholders i.e. 10,000 × ₹ 20 = ₹ 2,00,000)
To Equity Share Allotment A/c		

When decision to demand first call is made: After allotment of share, when the Board of Directors decide to demand the next instalment from shareholders, first call money falls due and is accounted

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for, as under:

Equity Share First Call A/c	Dr.	(No. of shares × first call money per share i.e., 10,000 × ₹ 15 = ₹ 1,50,000)
To Equity Share Capital A/c		

On receiving first and final call money: The journal entry passed to record the money received on account of first call is as under:

Bank A/c	Dr.	(Amount actually received on account of first call i.e., ₹ 10,000 × ₹ 15 = ₹ 1,50,000)
To Equity First Call A/c		

Question 3 (ILLUSTRATION)

On 1st April, 2021, A Ltd. issued 43,000 shares of ₹ 100 each payable as follows:

₹ 20 on application;

₹ 30 on allotment;

₹ 25 on 1st October, 2021; and

₹ 25 on 1st February, 2022.

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 were received on 20th October. Journalise the transactions when accounts were closed on 31st March, 2022.

Answer

A Ltd. Journal

2021			₹	₹
May 20	Bank Account	Dr.	8,00,000	
	To Share Application A/c (Application money on 40,000 shares at ₹ 20 per share received.)			8,00,000
June 1	Share Application A/c	Dr.	8,00,000	
	To Share Capital A/c (The amount transferred to Capital Account on 40,000 shares at ₹ 20 on application. Directors' resolution no..... dated)			8,00,000
	Share Allotment A/c	Dr.	12,00,000	
	To Share Capital A/c (Being share allotment made due at ₹ 30 per share. Directors' resolution no..... dated.....)			12,00,000

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July 15	Bank Account	Dr.	12,00,000	
	To Share Allotment A/c (The sums due on allotment received.)			12,00,000
Oct. 1	Share First Call Account	Dr.	10,00,000	
	To Share Capital Account (Amount due from members in respect of first call-on 40,000 shares at ₹ 25 as per Directors, resolution no... dated...)			10,00,000
Oct. 20	Bank Account	Dr.	10,00,000	
	To Share First Call Account (Receipt of the amounts due on first call.)			10,00,000
2022 Feb. 1	Share Second and Final Call A/c	Dr.	10,00,000	
	To Share Capital A/c (Amount due on 40,000 share at ₹ 25 per share on second and final call, as per Directors resolution no... dated...)			10,00,000
Mar. 31	Bank Account	Dr.	10,00,000	
	To Share Second & Final Call A/c (Amount received against the final call on 40,000 shares at ₹ 25 per share.)			10,00,000

Question 4 (ILLUSTRATION)

Pant Ltd. invited applications for 50,000 equity shares at ₹50 each, which are payable as on application ₹20, on allotment ₹10 and on first and final call ₹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.

Answer
**Pant Ltd.
Journal**

		₹	₹
Bank A/c	Dr.	12,00,000	
To Equity Share Application A/c (Being the application money received for 60,000 shares at ₹ 20 per share)			12,00,000
Equity Share Application A/c	Dr.	12,00,000	
To Equity Share Capital A/c			10,00,000
To Bank A/c			2,00,000
(Being share allotment made for 50,000 shares and excess refunded.)			

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Equity Share Allotment A/c To Equity Share Capital A/c (Being allotment amount due on 50,000 equity shares at ₹ 10 per share as per Directors' resolution no... dated...)	Dr.	5,00,000	5,00,000
Bank A/c Calls in Arrears A/c To Equity Share Allotment A/c (Being allotment money received for 45,000 shares at ₹ 10 per share.)	Dr. Dr.	4,50,000 50,000	5,00,000

Question 5 (ILLUSTRATION)

The Delhi Artware Ltd. issued 50,000 equity shares of ₹ 100 each and 1,00,000 preference shares of ₹ 100 each. The Share Capital was to be collected as under:

	Equity Shares (₹)	Preference Shares (₹)
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.

Answer

Delhi Artware Ltd.
Cash Book

	₹		₹
To Equity Shares Applications Account (application money on 50,000 shares at ₹ 25)	12,50,000	By Balance c/d	14,440,000
To Preference Share Application A/c (Application money on 1,00,000 shares at ₹ 20)	20,00,000		
To Equity Share Allotment A/c (allotment money on 50,000 shares at ₹ 20)	10,00,000		
To Preference Share Allotment A/c (allotment money on 1,00,000 shares at ₹ 30)	30,00,000		
To Equity Shares First Call A/c (₹ 30 on 50,000 shares)	15,00,000		
To Preference Share First Call A/c (₹ 20 on 1,00,000 shares)	20,00,000		
To Equity Shares Final Call A/c (₹ 25 on 42,000 shares)	10,50,000		
To Preference Share Final A/c (₹ 30 on 88,000 shares)	26,40,000		
	14,440,000		14,440,000
To Balance b/d	14,440,000		

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Journal

		₹	₹
Equity Share Application A/c Dr.		12,50,000	
Equity Share Allotment A/c Dr.		10,00,000	
To Equity Share Capital A/c			22,50,000
[The Credit to share capital on allotment of 50,000 equity shares at ₹ 45 per share (₹ 25 on application and ₹ 20 on allotment) allotted as per Directors resolution no.... dated.]			
Preference Share Application A/c Dr.		20,00,000	
Preference Share Allotment A/c Dr.		30,00,000	
To Preference Share Capital A/c			50,00,000
[The credit to Preference Share Capital on allotment of 1,00,000 preference shares at ₹ 50 per share (₹ 20 on application and ₹30 on allotment), allotted as per Directors' resolution no... dated...]			
Equity Share First Call A/c Dr.		15,00,000	
To Equity Share Capital A/c			15,00,000
(Amount due on 50,000 equity shares at ₹ 30 per share as per Directors' resolution no... dated...)			
Preference Share First Call A/c Dr.		20,00,000	
To Preference Share Capital A/c			20,00,000
(Amount due on 1,00,000 preference shares at ₹ 20 per share, as per Directors' resolution no...dated...)			
Equity Share Final Call A/c Dr.		12,50,000	
To Equity Share Capital A/c			12,50,000
(Amount due on final call on 50,000 equity shares at ₹ 25 per share, as per Directors' resolution no... dated...)			
Preference Share Final Call A/c Dr.		30,00,000	
To Preference Share Capital A/c			30,00,000
(Amount due on final call on 1,00,000 preference shares at ₹ 30 per share, as per Directors' resolution no... dated...)			

Note:

Students may note that cash transactions have not been journalised as these have been entered in the Cash Book

Question 6 (ILLUSTRATION)

On 1st October, 2022 Pioneer Equipment Limited received applications for 2,50,000 Equity Shares of ₹ 100 each to be issued at a premium of 25 per cent payable as :

On Application ₹ 25

On Allotment ₹ 75 (including premium)

Balance Amount on Shares As and when required.

The shares were allotted by the Company on October 20, 2022 and the allotment money was duly received on October 31, 2022.

Record journal entries in the books of the company to record the transactions in connection with the issue of shares.

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Answer
**Pioneer Equipment Limited
Journal**

Date	Particulars	L.F.	Debit Amount	Credit Amount
2022			(₹ 000)	(₹ 000)
Oct. 1	Bank A/c Dr.		6,250	
	To Equity Share Application A/c (Money received on applications for 2,50,000 shares @ ₹ 25 per share)			6,250
Oct. 20	Equity Share Application A/c Dr.		6,250	
	To Equity Share Capital A/c (Transfer of application money on allotment to share capital)			6,250
Oct. 20	Equity Share Allotment A/c Dr.		18,750	
	To Equity Share Capital A/c			12,500
	To Securities Premium A/c			6,250
	(Amount due on allotment of 2,50,000 shares @ ₹ 75 per share including premium)			
Oct. 31	Bank A/c Dr.		18,750	
	To Equity Share Allotment A/c			18,750
	(Money received including premium consequent upon allotment)			

Note:

Bifurcation of Allotment amount

 Security premium per share = $25\% \times ₹100$
 = ₹ 25

Money received on allotment per share = ₹ 75

Question 7 (ILLUSTRATION)

JHP Limited is a company with an authorised share capital of ₹10,00,000 in equity shares of ₹10 each, of which 6,00,000 shares had been issued and fully paid on 30th June, 2021. The company proposed to make a further issue of 1,00,000 of these ₹10 shares at a price of ₹14 each, the arrangements for payment being:

- ₹ 2 per share payable on application, to be received by 1st July, 2021;
 - Allotment to be made on 10th July, 2021 and a further ₹ 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, 2022.
- Applications were received for 3,55,000 shares and were dealt with as follows:
- Applicants for 5,000 shares received allotment in full;
 - 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;
 - Applicants for 3,20,000 shares received an allotment of one share for every four applied for;

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the money due on allotment was retained by the company, the excess being returned to the applicants; and 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.

Answer

Journal of JHP Limited

Date	Particulars	₹	₹
2021			
	Bank A/c (Note 1 – Column 3) Dr.	7,10,000	
July 1	To Equity Share Application A/c (Being application money received on 3,55,000 shares @ ₹ 2 per share)		7,10,000
July 10	Equity Share Application A/c Dr.	7,10,000	
	To Equity Share Capital A/c		2,00,000
	To Equity Share Allotment A/c (Note 1 Column 5)		4,30,000
	To Bank A/c (Note 1 – Column 6)		80,000
	(Being application money on 1,00,000 shares transferred to Equity Share Capital Account; on 2,15,000 shares adjusted with allotment and on 40,000 shares refunded as per Board's Resolution No.....dated...)		
	Equity Share Allotment A/c Dr.	5,00,000	
	To Equity Share Capital A/c		1,00,000
	To Securities Premium A/c (Being allotment money due on 1,00,000 shares @ ₹ 5 each including premium at ₹4 each as per Board's Resolution No.... dated....)		4,00,000
	Bank A/c (Note 1 – Column 8) Dr.	70,000	
	To Equity Share Allotment A/c (Being balance allotment money received)		70,000
2022	Equity Share Final Call A/c Dr.	7,00,000	
	To Equity Share Capital A/c		7,00,000
	(Being final call money due on 1,00,000 shares @ ₹ 7 per share as per Board's Resolution No.....dated....)		
April 30	Bank A/c Dr.	7,00,000	
	To Equity Share Final Call A/c (Being final call money on 1,00,000 shares @ ₹ 7 each received)		7,00,000

Working Notes:

Calculation for Adjustment and Refund

Category	No. of Shares Applied for	No. of Shares Allotted	Amount Received on Application	Amount Required on Application	Amount adjusted on Allotment	Refund [3 - 4 + 5]	Amount due on Allotment	Amount received on Allotment
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)

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(i)	5,000	5,000	10,000	10,000	Nil	Nil	25,000	25,000
(ii)	30,000	15,000	60,000	30,000	30,000	Nil	75,000	45,000
(iii)	3,20,000	80,000	6,40,000	1,60,000	4,00,000	80,000	4,00,000	Nil
TOTAL	3,55,000	1,00,000	7,10,000	2,00,000	4,30,000	80,000	5,00,000	70,000

Also,

- (i) Amount Received on Application (3) = No. of shares applied for (1) × ₹ 2
- (ii) Amount Required on Application (4) = No. of shares allotted (2) × ₹ 2

Question 8 (ILLUSTRATION)

Shreyas Ltd. did not receive the first call on 10,000 equity shares @ ₹ 3 per share which was due on 1.7.2021. This amount was received on 1.4.2022.

Open Calls in arrears account and journalise the entries in the books of the company on 1.7.2021 and 1.4.2022.

Answer

Shreyas Ltd Journal

Date	Particulars	L.F.	Amount Dr.	Amount Cr.
1.7.2021	Calls in Arrears A/c Dr. To Equity Share First Call A/c (Being amount due on first call on 10,000 shares at ₹3 per share transferred to calls in arrears account)		30,000	30,000
1.4.2022	Bank A/c Dr. To Calls in Arrears A/c (Being calls in arrears received)		30,000	30,000

Question 9 (ILLUSTRATION)

Rashmi Limited issued at par 1,00,000 Equity shares of ₹10 each payable ₹2.50 on application; ₹3 on allotment; ₹ 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 due 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.

Answer

Date	Particulars	L.F.	Debit Amount (₹)	Credit Amount (₹)
	Bank A/c Dr.		2,50,000	
	To Equity Share Application A/c (Money received on applications for 1,00,000 shares @ ₹ 2.50 per share)			2,50,000
	Equity Share Application A/c Dr.		2,50,000	
	To Equity Share Capital A/c (Transfer of application money on 1,00,000 shares to share capital)			2,50,000

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	Equity Share Allotment A/c Dr.		3,00,000	
	To Equity Share Capital A/c (Amount due on the allotment of 1,00,000 shares @ ₹ 3 per share)			3,00,000
	Bank A/c Dr.		3,00,000	
	To Equity Share Allotment A/c (Allotment money received)			3,00,000
	Equity Share First Call A/c Dr		2,00,000	
	To Equity Share Capital A/c (Being first call made due on 1,00,000 shares at ₹ 2 per share)			2,00,000
	Bank A/c Dr		2,25,000	
	To Equity Share First Call A/c			2,00,000
	To Calls in Advance A/c (Being first call money received along with calls in advance on 10,000 shares at ₹ 2.50 per share)			25,000
	Equity Share Final Call A/c Dr		2,50,000	
	To Equity Share Capital A/c (Being final call made due on 1,00,000 shares at ₹ 2.50 each)			2,50,000
	Bank A/c Dr		2,25,000	
	Calls in Advance A/c Dr		25,000	
	Calls in Arrears A/c Dr		2,500	
	To Equity Share Final Call A/c (Being final call received for 89,000 shares and calls in advance for 10,000 shares adjusted)			2,50,000
	Interest on Calls in Advance A/c Dr.		750	
	To Shareholders A/c (Being interest made due on calls in advance of ₹25,000 at the rate of 12% p.a.)			750
	Shareholders A/c		750	
	To Bank A/c (Being payment of interest made to shareholder)			750
	Shareholders A/c Dr.		41.67	
	To Interest on Calls in Arrears A/c (Being interest on calls in arrears made due at the rate of 10%)			41.67
	Bank A/c		2,541.67	
	To Calls in Arrears A/c			2,500
	To Shareholders A/c (Being money received from shareholder for calls in arrears and interest thereupon)			41.67

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Question 10 (ILLUSTRATION)

A Ltd forfeited 30,000 equity shares of ₹ 10 fully called-up, held by Mr. X for non-payment of final call @ ₹ 4 each. However, he paid application money @ ₹ 2 per share and allotment money @ ₹ 4 per share. These shares were originally issued at par. Give Journal Entry for the forfeiture.

Answer

In the books of A Ltd.

Journal

Date	Particulars	₹	₹
	Equity Share Capital A/c (30,000 x ₹ 10) Dr.	3,00,000	
	To Equity Share Final Call A/c (30,000 x ₹ 4)		1,20,000
	To Forfeited Shares A/c (30,000 x ₹ 6) (Being the forfeiture of 30,000 equity shares of ₹ 10 each fully called-up for non-payment of final call money @ ₹ 4 each as per Board's Resolution No.... dated....)		1,80,000

Question 11 (ILLUSTRATION)

X Ltd forfeited 20,000 equity shares of ₹ 10 each, ₹ 8 called-up, for non-payment of first call money @ ₹ 2 each. Application money @ ₹ 2 per share and allotment money @ ₹ 4 per share have already been received by the company. Give Journal Entry for the forfeiture (assume that all money due is transferred to Calls-in-Arrears Account).

Answer

In the books of X Ltd Journal

Date	Particulars	₹	₹
	Equity Share Capital A/c (20,000 x ₹ 8) Dr.	1,60,000	
	To Calls-in-Arrears A/c (20,000 x ₹ 2)		40,000
	To Forfeited Shares A/c (20,000 x ₹ 6) (Being the forfeiture of 20,000 equity shares of ₹ 10 each, ₹ 8 called-up for non-payment of first call money @ ₹ 2 each as per Board's Resolution No.....dated.....)		1,20,000

Question 12 (ILLUSTRATION)

X Ltd. forfeited 5,000 equity shares of ₹100 each fully called-up which were issued at a premium of 20%. Amount payable on shares were: on application ₹ 20; on allotment ₹ 50 (including premium); on First and Final call ₹ 50. Only application money was paid by the shareholders in respect of these shares. Pass Journal Entries for the forfeiture.

Answer

In the books of X Ltd.

Journal

Date	Particulars	₹	₹
	Equity Share Capital A/c (5,000 x ₹ 100) Dr.	5,00,000	
	Securities Premium A/c (See Note) Dr.	1,00,000	
	To Equity Share Allotment A/c (5,000 x ₹ 50)		2,50,000
	To Equity Share First and Final Call A/c (5000 x ₹ 50)		2,50,000
	To Forfeited Shares A/c (5000 x ₹ 20)		1,00,000

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Share premium @ ₹ 20 on 5,000 shares has not been received by the company. Therefore, at the time of forfeiture, Securities Premium Account will be debited to cancel it (because Securities Premium Account was credited at the time of allotment).

Also, in case of pro-rata allotment where shares are issued at premium, the excess money received on application will be first adjusted to capital account and then for securities premium.

Question 13 (ILLUSTRATION)

Mr. Shami has applied for 1,000 shares of Company XYZ Ltd. paying application money @ ₹ 2 per share but has been allotted only 600 shares. The shares have a face value of ₹ 10 and a premium of ₹ 2 per share, which are payable as: on Allotment- ₹ 5 (including premium) and on final call ₹ 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:

Answer

Share Capital A/c (600 x ₹ 10)	Dr.	6,000	
Securities Premium A/c (600 x ₹ 2)	Dr.	1,200	
To Share Forfeiture A/c			2,000
To Share Allotment A/c			2,200
To Share Final Call A/c (600 x 5)			3,000
(Being 600 shares forfeited due to non-payment of allotment money and call money as per Board Resolution no..... dated.....)			

Note

Total Amount Received on application (1,000 x 2)	2,000
Less: Amount used for application money (600 x 2)	(1,200)
Excess money received on application	800
Amount due on Allotment (600 x 5)	3,000
For premium (600 x 2)	1,200
For Capital A/c (600 x 3)	1,800
Thus amount not received on allotment (3,000 - 800)	2,200

	For Premium A/c	For Capital A/c
Amount not received on allotment (2,200)	₹ 1,200	₹ 1,000

Question 14 (ILLUSTRATION)

Mr. Long who was the holder of 2,000 preference shares of ₹ 100 each, on which ₹ 75 per share has been called up could not pay his dues on Allotment and First call each at ₹ 25 per share. The Directors forfeited the above shares and reissued 1500 of such shares to Mr. Short at ₹ 65 per share paid-up as ₹ 75 per share.

Give Journal Entries to record the above forfeiture and re-issue in the books of the company.

Answer

	Particulars	₹	₹
	Preference Share Capital A/c (2,000 x ₹ 75)	Dr.	1,50,000

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	To Preference Share Allotment A/c To Preference Share First Call A/c To Forfeited Share A/c (Being the forfeiture of 2,000 preference shares ₹ 75 each being called up for non-payment of allotment and first call money as per Board's Resolution No.... dated)		50,000 50,000 50,000
	Bank A/c (1,500 x ₹ 65) Forfeited Shares A/c (1,500 x ₹ 10)	Dr. Dr.	97,500 15,000
	To Preference Share Capital A/c (Being re-issue of 1500 shares at ₹ 65 per share paid-up as ₹ 75 as per Board's Resolution No....dated....)		1,12,500
	Forfeited Shares A/c	Dr.	22,500
	To Capital Reserve A/c (Note 1) (Being profit on re-issue transferred to Capital/Reserve)		22,500

Working Note:
Calculation of amount to be transferred to Capital Reserve

Forfeited amount per share = ₹ 50,000/2000	=	₹ 25
Loss on re-issue = ₹ 75 – ₹ 65	=	₹ 10
Surplus per share re-issued	=	₹ 15
Transferred to capital Reserve ₹ 15 x 1500	=	₹ 22,500

Question 15 (ILLUSTRATION)

Beautiful Co. Ltd issued 30,000 equity shares of ₹ 10 each payable as ₹ 3 per share on application, ₹ 5 per share (including ₹ 2 as premium) on allotment and ₹ 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 ₹ 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.

Answer

In the books of Beautiful Co. Ltd.
Journal

Date	Particulars		₹	₹
	Equity Share Capital A/c (1,500 x ₹ 10) Securities Premium A/c (500 x ₹ 2)	Dr. Dr.	15,000 1,000	
	To Equity Share Allotment A/c (500 x ₹ 5) To Equity Share Call A/c (1,500 x ₹ 4) To Forfeited Shares A/c (Being forfeiture of 1,500 equity shares for non payment of allotment and call money on 500 shares and for non-payment			2,500 6,000 7,500

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	of call money on 1,000 shares as per Board's Resolution No.....dated)			
	Bank A/c	Dr.	10,000	
	Forfeited Shares A/c	Dr.	2,500	
	To Equity Share Capital A/c			12,500
	(Being re-issue of 1250 shares @ ₹ 8 each as per Board's Resolution No.....dated.....)			
	Forfeited Shares A/c	Dr.	3,500	
	To Capital Reserve A/c			3,500
	(Being profit on re-issue transferred to Capital Reserve)			

Balance Sheet of Beautiful Limited as at.....

Particulars	Notes No.	₹
EQUITY AND LIABILITIES		
Shareholders' funds		
Share capital	1	2,99,000
Reserves and Surplus	2	62,500
Total		3,61,500
ASSETS		
Current assets		
Cash and cash equivalents (bank)		3,61,500
Total		3,61,500

Notes to accounts

		₹	₹
1. Share Capital			
Equity share capital			
Issued share capital			
30,000 Equity shares of ₹ 10 each	3,00,000		
Subscribed, called up and paid up share capital	2,97,500		
29,750 Equity shares of ₹ 10 each			
Add: Forfeited shares	1,500	2,99,000	
2. Reserves and Surplus			
Securities Premium	59,000		
Capital Reserve	3,500	62,500	

Working Note:
(1) Calculat on of Amount to be Transferred to Capital Reserve

Amount forfeited per share of Ram	₹ 3	Amount forfeited per share of Shyam	₹ 6
		Less: Loss on re-issue per share	
		Surplus	
Less: Loss on re-issue per share	(₹ 2)		(₹ 2)

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Surplus	₹ 1		₹ 4
Transferred to Capital Reserve: Ram share (500 x ₹ 1)		₹ 500	
Shyam's Share (750 x ₹ 4)		₹ 3,000	
Total		₹ 3,500	

(2) Balance of Security Premium

Total Premium amount receivable on allotment =	60,000
Less: Amount reversed on forfeiture =	(1,000)
Balance remaining =	59,000

Question 16 (ILLUSTRATION)

A holds 2,000 shares of ₹ 10 each on which he has paid ₹ 2 as application money. B holds 4,000 shares of ₹ 10 each on which he has paid ₹ 2 per share as application money and ₹ 3 per share as allotment money. C holds 3,000 shares of ₹ 10 each and has paid ₹ 2 on application, ₹ 3 on allotment and ₹ 3 for the first call. They all fail to pay their arrears on the second and final call and the directors, therefore, forfeited their shares. The shares are re-issued subsequently for ₹ 12 per share fully paid-up. Journalise the transactions relating to the forfeiture and re-issue.

Answer

Journal

Date	Particulars	₹	₹
	Share Capital A/c (9,000 x ₹ 10) Dr.	90,000	
	To Share Allotment A/c (2,000 x ₹ 3)		6,000
	To Share First Call A/c (6,000 x ₹ 3)		18,000
	To Share Final Call A/c (9,000 x ₹ 2)		18,000
	To Forfeited Shares A/c (Being forfeiture of 9,000 shares of ₹ 10 each for non-payment of allotment, first and final call money as per Board's Resolution No.....dated....)		48,000
	Bank A/c (9,000 x ₹ 12) Dr.	1,08,000	
	To Share Capital A/c		
	To Securities Premium A/c		90,000
	(Being the re-issue of 9,000 shares of ₹ 10 each @ ₹ 12 as per Board's Resolution No.....dated....)		18,000
	Forfeited Shares A/c Dr.	48,000	
	To Capital Reserve A/c		48,000
	(Being profit on re-issue transferred to Capital Reserve).		

Working Note:

Shareholders	Money Received				Money Not Received On		
	Application	Allotment	First Call	Final Call	Allotment	First Call	Final Call
A	2,000	-	-	-	2,000	2,000	2,000
B	4,000	4,000	-	-	-	4,000	4,000

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C	3,000	3,000	3,000	-	-	-	3,000
TOTAL	9,000	7,000	3,000	-	2,000	6,000	9,000
Money	₹ 2	₹ 3	₹ 3	₹ 2	₹ 3	₹ 3	₹ 2
Receivable	₹ 18,000	₹ 21,000	₹ 9,000	-	₹ 6,000	₹ 18,000	₹ 18,000

Question 17 (ILLUSTRATION)

X Limited invited applications for issuing 75,000 equity shares of ₹ 10 each at a premium of ₹ 5 per share. The total amount was payable as follows:

- ₹ 9 per share (including premium) on application and allotment
- Balance on the First and Final Call

Applications for 3,00,000 equity shares were received. Applications for 2,00,000 equity shares were rejected and money refunded. Shares were allotted on pro-rata basis to the remaining applicants. The first and final call was made. The amount was duly received except on 1,500 shares applied by Mr. Raj. His shares were forfeited. The forfeited shares were re-issued at a discount of ₹ 4/- per share.

Pass necessary journal entries for the above transactions in the books of X Limited.

Answer
Journal

			Dr. ₹	Cr. ₹
1	Bank Account	Dr.	27,00,000	
	To Share Application & Allotment A/c (Being Application money on 3,00,000 shares at ₹ 9 per share received.)			27,00,000
2	Share Application & Allotment A/c	Dr.	27,00,000	
	To Share Capital A/c (75,000 x ₹ 4)			3,00,000
	To Securities premium A/c (75,000 x ₹ 5)			3,75,000
	To Bank A/c (2,00,000 x ₹ 9)			18,00,000
	To Share First & Final Call A/c (Being application money transferred)			2,25,000
3	Share First & Final Call A/c (75,000 x 6)	Dr.	4,50,000	
	To Share Capital Account (Amount First & Final Call A/c due from members as per Directors, resolution no..... dated)			4,50,000
4	Bank Account A/c	Dr.	2,21,625	
	Calls in arrear A/c	Dr.	3,375	
	To Share First & Final Call Account (Being Receipt of the amounts due on first call.)			2,25,000
5	Equity share capital A/c	Dr.	11,250	
	To Share forfeiture A/c To Calls in arrear A/c (Being 1,125 shares forfeited for non payment of final call.)			7,875 3,375

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6	Bank Account A/c (1,125 x ₹ 6) Share forfeiture A/c (1,125 x ₹ 4) To Share Capital Account (1,125 x ₹ 10) (Being forfeited shares reissued at ₹ 4 discount)	Dr.	6,750 4,500	11,250
7	Share forfeiture A/c To Capital reserve A/c (Being share forfeiture transferred to capital reserve*)		3,375	3,375

Working notes:

1.

Shares Applied	Shares Allotted	Money Received on Application @ ₹ 9/-	Money Transferred to Share Capital @ ₹ 4/-	Money Transferred to Security Premium @ ₹ 5/-	Excess Application Money	Share First and Final Call @ ₹ 6/-	Amount received from Share First and Final Call after adjusting excess appl. money	Money Refunded
2,00,000	-	18,00,000	-	-	-	-	-	18,00,000
1,00,000	75,000	9,00,000	3,00,000	3,75,000	2,25,000	4,50,000	2,25,000*	-
3,00,000	75,000	27,00,000	3,00,000	3,75,000	2,25,000	4,50,000	4,46,625*	18,00,000

*4,50,000 less 2,25,000

** ₹ 4,50,000 less ₹ 3,375.

- Number of shares allotted to Mr. Raj = $1,500 \times 75,000 / 1,00,000 = 1,125$ shares
- Calculation of calls in arrear

Application money received from Raj	(1,500 x 9)	13,500
Less: actual application money	1,125 x 9	<u>10,125</u>
Excess Application & Allotment Money Adjusted with first and final call		<u>3,375</u>
Final call due from Raj		6,750
Less: Adjusted with final call		<u>(3,375)</u>
Calls in arrear		<u>3,375</u>

Question 18 (ILLUSTRATION)

X Co. Ltd. was incorporated with an authorized share capital of 90,000 equity shares of ₹ 10 each. The company purchased land and buildings from Y Co. Ltd for ₹ 4,00,000 payable in fully paid-up shares of the company. The balance of the shares were issued to the public, which were fully subscribed and paid for.

You are required to pass Journal Entries and to prepare the Balance Sheet.

Answer
Journal
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Date	Particulars	₹	₹
	Land and Buildings A/c Dr. To Y Co. Ltd A/c (Being the land and buildings purchased from Y Co. Ltd as per agreement dated...).	4,00,000	4,00,000
	Y.Co. Ltd A/c Dr. To Equity Share Capital A/c (Being 40,000 shares of ₹ 10 each issued to Y Co. Ltd. on purchase of land and building)	4,00,000	4,00,000
	Bank A/c Dr. To Equity Share Application and Allotment A/c (Being the issue of 50,000 shares of ₹ 10 each as per Board's Resolution No.....dated...)		5,00,000
	Equity Share Application and Allotment A/c Dr. To Equity Share Capital A/c (Being shares allotted for application money received.)	5,00,000	5,00,000

Balance Sheet of X Company Limited as at....

	Particulars	Notes No.	₹
	EQUITY AND LIABILITIES		
	Shareholders' funds		
	Share capital	1	9,00,000
	Total		9,00,000
	ASSETS		
	1. Non-current assets		
	a Fixed assets		
	i. Plant Property and Equipment	2	4,00,000
	2. Current assets		
	Cash and cash equivalents	3	5,00,000
	Total		9,00,000

Notes to accounts

		₹
1. Share Capital		
	Equity share capital	
	Authorised share capital 90,000 Equity shares of ₹ 10 each	9,00,000
	Issued share capital 90,000 Equity shares of ₹ 10 each	9,00,000
	Subscribed Share Capital 90,000 Equity Shares of ₹ 10 each	9,00,000

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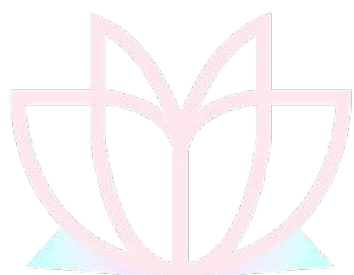
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	Called up and Paid up Capital 90,000 Equity Shares of ₹ 10 each	9,00,000
	(Out of the above 40,000 shares have been allotted as fully paid up pursuant to contract(s) without payment being received in cash)	
2.	Plant Property and Equipment	
	Land and Building	4,00,000
3.	Cash and cash equivalents	
	Balances with banks	5,00,000



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Chapter 11.3

ISSUE OF DEBENTURES

True and False

Question 1:

Debenture holder are the owners of the company.

Answer 1:

False: Debenture holder are the creditors of the company.

Question 2:

Perpetual debentures are payable at the time of liquidation of the company.

Answer 2:

True: Perpetual debentures, also known as irredeemable debentures are not repayable during the life time of the company.

Question 3:

Registered debentures are transferable by delivery.

Answer 3:

False: Registered debentures are not easily transferable by delivery. Bearer debentures are transferrable by delivery.

Question 4:

When companies issue their own debentures as collateral security for a loan, the holder of such debenture is entitled to interest only on the amount of loan and not on the debentures

Answer 4:

True: In case the company cannot repay its loan & the interest thereon on the due date, the lender becomes debenture holder & then only he is entitled to interest on debentures.

Question 5:

Debentures suspense account appears on liability side of balance sheet.

Answer 5:

False: Debentures suspense account appears on asset side of balance sheet under non- current asset.

Question 6

If a company incurs loss, then it does not pay interest to the debenture holders.

Answer 6:

False: Even if the company incurs loss or earns profit, it has to pay the interest on debentures.

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Question 7

At the time of liquidation, debenture holders are paid off after the shareholders.

Answer 7:

False: At the time of liquidation, debenture holders are paid off before shareholders on priority basis.

Question 8:

Convertible debentures can be converted into equity shares.

Answer 8:

True: Convertible debentures can be converted into equity share after a certain period of time from the date of its issue.

Question 9:

Redeemable debentures are not payable during the life time of the company.

Answer 9:

False: These debentures are repayable as per the terms of issue, for example, after 8 years from the date of issue.

Question 10:

Debentures can be issued for a consideration other than for cash, such as for purchasing land, machinery etc.

Answer 10:

True: Debentures can be issued for a consideration other than for cash, such as for purchasing land, machinery etc.

Multiple Choice Questions

1. **Premium on redemption of debentures account appearing in the balance sheet is ____.**

- (a) A nominal account – expenditure
- (b) A nominal account - income
- (c) A personal account _____.

Answer 1: (c)

2. **Debenture interest**

- (a) Is payable before the payment of any dividend on shares
- (b) Accumulates in case of losses or inadequate profits
- (c) Is payable after the payment of preference dividend but before the payment of equity dividend _.

Answer 2: (a)

3. **F Ltd. purchased Machinery from G Company for a book value of ₹ 4,00,000. The consideration was paid by issue of 10% debentures of ₹ 100 each at a premium of 25%. The debenture account was credited with _.**

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- (a) ₹ 4,00,000
- (b) ₹ 5,00,000
- (c) ₹ 3,20,000

Answer 3: (c)

4. Which of the following is not a characteristic of Bearer Debentures?

- (a) They are treated as negotiable instruments
- (b) Their transfer requires a deed of transfer
- (c) They are transferable by mere delivery

Answer 4: (b)

5. When debentures are issued as collateral security, the final entry for recording the collateral debentures in the books is ____.

- (a) Credit Debentures A/c and debit Cash A/c.
- (b) Debit Debenture suspense A/c and credit Cash A/c.
- (c) Debit Debenture suspense A/c and credit Debentures A/c.

Answer 5: (c)

6. When debentures are redeemable at different dates, the total amount of discount on issue of debentures should be written off

- (a) Every year by applying the sum of the year's digit method
- (b) Every year by applying the straight line method
- (c) To profit and loss account in full in the year of final or last redemption

Answer 6: (a)

7. Debentures are issued at discount when

- (a) Market interest rate is higher than debenture interest rate
- (b) Market interest rate is lower than debenture interest rate
- (c) Market interest rate is equal debenture interest rate

Answer 7: (a)

Ques

8. Interest payable on Debentures attract

- (a) Tax deducted at source
- (b) Goods and Service tax
- (c) Fringe benefit tax

Answer 8: (a)

Theoretical questions

Question 1:

Distinguish between debentures and shares.

Answer 1:

Debentures	Shares
1. Debenture holders are the creditors of the	1. Shareholders are the owners of the company.

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company.	
2. Debenture holders have no voting rights and consequently do not pose any threat to the existing control of the company.	2. Shareholders have voting rights and consequently control the total affairs of the company.
3. Debenture interest is generally paid at a pre-determined fixed rate. It is payable, whether there is any profit or not. Debentures rank ahead of all types of shares for payment of the interest due on them.	3. Dividend on equity shares is paid at a variable rate which is vastly affected by the profits of the company (however, dividend on preference shares is paid at a fixed rate).
4. Interest on debentures are the charges against profits and they are deductible as an expense in determining taxable profit of the company.	4. Dividends are appropriation of profit and these are not deductible in determining taxable profit of the company.
5. There are different kinds of debentures, such as Secured/ Unsecured; Redeemable/ Irredeemable; Registered / Bearer; Convertible/ Non-convertible, etc.	5. There are only two kinds of shares– Equity Shares and Preference Shares.
6. In the Company's Balance Sheet Debentures are shown under "long Term Borrowings".	6. In the Company's Balance Sheet, shares are shown under "Shareholder's Fund" detailed in 'Share Capital' of Notes to Accounts.
7. Debentures can be converted into other debentures or shares as per the terms of issue of debentures.	7. Shares cannot be converted into other shares in any circumstances.
8. Debentures cannot be forfeited for non-payment of call moneys.	8. Shares can be forfeited for non-payment of allotment and call moneys.
9. At maturity, debenture holders get back their money as per the terms and conditions of redemption.	9. Equity shareholders cannot get back their money before the liquidation of the company (however, preference shareholders can get back their money before liquidation).
10. At the time of liquidation, debenture holders are paid-off before the shareholders.	10. At the time of liquidation shareholders are paid at last, after paying debenture holders, Trade payable, etc.

Question 2:

Explain the purpose for raising of debenture by the company. Also give the main features of debentures.

Answer 2:

Debenture is one of the most commonly used debt instrument issued by the company to raise funds for the business. The most common method of supplementing the capital available to a company is to issue debentures which may either be simple or naked carrying no charge on assets, or mortgage debentures carrying either a fixed or a floating charge on some or all of the assets of the company.

1. It is a document which evidences a loan made to a company.
2. It is a fixed interest-bearing security where interest falls due on specific dates.
3. Interest is payable at a predetermined fixed rate, regardless of the level of profit.
4. The original sum is repaid at a specified future date or it is converted into shares or other

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debentures.

5. It may or may not create a charge on the assets of a company as security.
6. It can generally be bought or sold through the stock exchange at a price above or below its face value.

Practical questions

Question 1:

Country Crafts Ltd. issued 1,00,000, 8% debentures of ₹ 100 each at premium of 5% payable fully on application and redeemable at premium of ₹ 10 Pass necessary journal entries at the time of issue.

Answer 1:

Journal Entries in the Books of Country Crafts Ltd

Date	Particulars	L.F.	Debit Amount (₹'000)	Credit Amount (₹'000)
(a)	Bank A/c To Debenture Application A/c (Debenture application money received)	Dr.	10,500	10,500
(b)	Debenture Application A/c Loss on Issue of Debenture A/c	Dr. Dr.	10,500 1,000	
	To Securities Premium A/c			500
	To 8% Debentures A/c			10,000
	To Premium on Redemption A/c (Debenture application money transferred to debenture account)			1,000

Question 2:

Koinal Chemicals Ltd. issued 20,00,000, 10% debentures of ₹50 each at premium of 10%, payable as ₹ 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 allotment money.

Answer 2:

Journal Entries in the Books of Koinal Chemicals Ltd.

Particulars		Debit Amount (₹ lakhs)	Credit Amount (₹ lakhs)
Bank A/c	Dr.	400	
To Debenture Application A/c (Debenture application money received)			400
Debentures Application A/c	Dr.	400	

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To 10% Debentures A/c			400
(Debenture application money transferred debenture to account consequent upon allotment)	10%		
Debenture allotment A/c	Dr.	700	
To 10% Debentures A/c			600
To Securities Premium A/c			100
(Call made on allotment of debenture including premium)			
Bank A/c	Dr.	700	
To Debenture Allotment A/c			700
(Money received consequent upon allotment)			

Question 3:

Kapil Ltd. issued 50,000, 12% Debentures of ₹100 each at a premium of 10% payable in full on application by 1st March, 2022. The issue was fully subscribed and debentures were allotted on 9th March, 2022.

Pass necessary Journal Entries (including cash transactions).

Answer 3:
Journal Entries in the books of Kapil Limited

Date	Particulars	₹	₹
2022 March 1	Bank A/c Dr.	55,00,000	
	To Debentures Application A/c (Being the money received on 50,000 debentures @ ₹ 110 each including premium of ₹ 10 each)		55,00,000
March 9	Debentures Application A/c Dr.	55,00,000	
	To 12% Debentures A/c To Securities Premium A/c (Being the allotment of 50,000 debentures of ₹ 100 each, premium @ ₹ 10 each transferred to Securities Premium Account as per Board's Resolution No.... dated....)		50,00,000 5,00,000

Question 4:

On 1st April 2022 Sheru Ltd. issued 1,00,000 12% debentures of ₹100 each at a discount of 5%, redeemable on 31st March, 2027. Issue was oversubscribed by 20,000 debentures, who were refunded their money. Interest is paid annually on 31st March. You are required to prepare:

- Journal Entries at the time of issue of debentures.
- Discount on issue of Debenture Account
- Interest account and Debenture holder Account assuming TDS is deducted @ 10%.

Answer 4:
Journal in the Books of Sheru Ltd.

Date	Particulars	LF	(₹ 00)	(₹ 00)
2022				

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Apr 1	Bank A/c		1,14,000	
	To Debenture Application A/c (Being debenture application money received for 1,20,000 debentures)			1,14,000
	Debenture Application A/c	Dr.	1,14,000	
	Discount on Issue of Debenture A/c	Dr.	5,000	
	To 12% Debenture A/c			1,00,000
	To Bank A/c (Being application money transferred to debenture account and excess refunded)			19,000

Discount on Issue of Debenture A/c

Date	Particulars	₹'00	Date	Particulars	₹'00
1.4.22	To 12% Debentures A/c	5,000	31.3.23	By Profit & Loss A/c	1,000
			31.3.23	By Balance c/d	4,000
		5,000			5,000
1.4.23	To Balance b/d	4,000	31.3.24	By Profit & Loss A/c	1,000
			31.3.24	By Balance c/d	3,000
		4,000			4,000
1.4.24	To Balance b/d	3,000	31.3.25	By Profit & Loss A/c	1,000
			31.3.25	By Balance c/d	2,000
		3,000			3,000
1.4.25	To Balance b/d	2,000	31.3.26	By Profit & Loss A/c	1,000
			31.3.26	By Balance c/d	1,000
		2,000			2,000
1.4.26	To Balance b/d	1,000	31.3.27	By Profit & Loss A/c	1,000
		1,000			1,000

Interest A/c

Date	Particulars	₹'00	Date	Particulars	₹'00
31.3.23	To Debentureholder A/c	12,000	31.3.23	By Profit & Loss A/c	12,000
		12,000			12,000
31.3.24	To Debentureholder A/c	12,000	31.3.24	By Profit & Loss A/c	12,000
		12,000			12,000
31.3.25	To Debentureholder A/c	12,000	31.3.25	By Profit & Loss A/c	12,000
		12,000			12,000
31.3.26	To Debentureholder A/c	12,000	31.3.26	By Profit & Loss A/c	12,000
		12,000			12,000
31.3.27	To Debentureholder A/c	12,000	31.3.27	By Profit & Loss A/c	12,000
		12,000			12,000

Debentureholder A/c

Date	Particulars	₹'00	Date	Particulars	₹'00
31.3.23	To Bank A/c	10,800	31.3.23	By Interest A/c	12,000

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31.3.23	To TDS A/c	1,200			
		12,000			12,000
31.3.24	To Bank A/c	10,800	31.3.24	By Interest A/c	12,000
31.3.24	To TDS A/c	1,200			
		12,000			12,000
31.3.25	To Bank A/c	10,800	31.3.25	By Interest A/c	12,000
31.3.25	To TDS A/c	1,200			
		12,000			12,000
31.3.26	To Bank A/c	10,800	31.3.26	By Interest A/c	12,000
31.3.26	To TDS A/c	1,200			
		12,000			12,000
31.3.27	To Bank A/c	10,800	31.3.27	By Interest A/c	12,000
31.3.27	To TDS A/c	1,200			
		12,000			12,000

Question 5:

A Limited issued 14% Debentures of the nominal value of ₹ 10 each as follows:

- To sundry persons 1,00,000 Debentures for cash at 10% discount.
- To a vendor for purchase of Inventory worth ₹ 1,00,000, 8,000 debentures at 25% premium.
- To the banker as collateral security for a loan of ₹ 1,00,000 – ₹ 1,50,000 nominal value.

Pass necessary Journal Entries.

Answer 5:

In the books of X Company Ltd.

Journal Entries

Date	Particulars	₹	₹
(a)	Bank A/c Dr.	9,00,000	
	To Debentures Application A/c (Being the application money received on 100,000 debentures @ ₹ 9 each)		9,00,000
	Debentures Application A/c Dr.	9,00,000	
	Discount on issue of Debentures A/c Dr.	1,00,000	
	To 14% Debentures A/c (Being the issue of 100,000 14% Debentures @ 90% as per Board's Resolution No.... dated....)		10,00,000
(b)	Inventories A/c Dr.	1,00,000	
	To Vendor A/c (Being the purchase of inventories from vendor)		1,00,000
	Vendor A/c Dr.	1,00,000	
	To 14% Debentures A/c To Securities Premium (Being the issue of 8,000 debentures of to vendor to satisfy his claim at premium of 25%)		80,000 20,000
(c)	Bank A/c Dr.	1,00,000	

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	To Bank Loan A/c (See Note) (Being a loan of ₹1,00,000 taken from bank by issuing debentures of ₹1,50,000 as collateral security)		1,00,000

Note:

No entry is made in the books of account of the company at the time of making issue of such debentures. In the Balance Sheet due to the fact that the debentures being issued as collateral security and outstanding are shown under the respective liability.

ILLUSTRATIONS

ILLUSTRATION 1

Amol Ltd. issued 40,00,000, 9% debentures of ₹ 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.

SOLUTION

**Books of Amol Ltd.
Journal**

Date	Particulars	L.F.	Debit Amount (₹)	Credit Amount (₹)
	Bank A/c Dr. To Debenture Application A/c (Debenture application money received)		20,00,00,000	20,00,00,000
	Debenture Application A/c Dr.		20,00,00,000	
	To 9% Debentures A/c (Application money transferred to 9% debentures account consequent upon allotment)			20,00,00,000

ILLUSTRATION 2

Atul Ltd. issued 1,00,00,000, 8% debenture of ₹100 each at a discount of 10% redeemable at par at the end of 10th year. Money was payable as follows:

₹ 30 on application

₹ 60 on allotment

Record necessary journal entries regarding issue of debenture.

SOLUTION

**Books of Atul Ltd.
Journal**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr.		30,00,00,000	
	To Debenture Application A/c (Debenture application money received)			30,00,00,000
	Debenture Application A/c Dr.		30,00,00,000	

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	To 8% Debentures A/c (Application money transferred to 8% debentures account consequent upon allotment)			30,00,00,000
	Debenture allotment A/c	Dr.	60,00,00,000	
	Discount on issue of debentures A/c	Dr.	10,00,00,000	
	To 8% Debentures A/c (Amount due on allotment)			70,00,00,000
	Bank A/c	Dr.	60,00,00,000	
	To Debenture Allotment A/c (Money received consequent upon allotment)			60,00,00,000

ILLUSTRATION 3

Koinal Chemicals Ltd. issued 15,00,000, 10% debenture of ₹ 50 each at premium of 10%, payable as ₹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.

SOLUTION

Books of Koinal Chemicals Ltd.

Journal

When premium money is received along with application money:

Date	Particulars	L.F.	Debit Amount (₹)	Credit Amount (₹)
	Bank A/c	Dr.	3,00,00,000	
	To Debenture Application A/c (Debenture application money received)			3,00,00,000
	Debentures Application A/c	Dr.	3,00,00,000	
	To 10% Debentures A/c To Securities Premium A/c (Application money transferred to 10% debentures account and securities premium account consequent upon allotment)			2,25,00,000 75,00,000
	Debenture Allotment A/c	Dr.	5,25,00,000	
	To 10% Debentures A/c (Call made consequent upon allotment)			5,25,00,000
	Bank A/c	Dr.	5,25,00,000	
	To Debenture Allotment A/c (Call made consequent upon allotment money received)			5,25,00,000

ILLUSTRATION 4

Modern Equipments Ltd. issued 4,00,000, 12% debentures of ₹ 100 payable as follows:

On application ₹ 30

On allotment ₹ 70

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The debenture were fully subscribed and all the money was duly received. As per the terms of issue, debentures are redeemable at ₹110 per debenture. Record necessary entries regarding issue of debentures.

SOLUTION

Books of Modern Equipments Ltd.
Journal

Date	Particulars		Debit Amount (₹ Lakhs)	Credit Amount (₹ Lakhs)
	Bank A/c	Dr.	120	
	To Debentures application A/c (Debenture application money received)			120
	Debentures Application A/c	Dr.	120	
	To 12% Debentures A/c (Application money transferred to 12% debentures account consequent to allotment)			120
	Debentures Allotment A/c	Dr.	280	
	Loss on issue of Debentures A/c	Dr.	40	
	To 12% Debentures A/c			280
	To Debenture redemption premium A/c (Call made on allotment of debentures at par and entry for debentures redeemable at premium)			40
	Bank A/c	Dr.	280	
	To Debentures allotment A/c (Call made consequent upon allotment money received)			280

ILLUSTRATION 5

Agrotech Ltd. issued 150 lakh 9% debentures of ₹ 100 each at a discount of 6%, redeemable at a premium of 5% after 3 years payable as: ₹ 50 on application and ₹ 44 on allotment. Record necessary journal entries for issue of debentures.

SOLUTION

Books of Agrotech Ltd.
Journal

Date	Particulars L.F.		Debit Amount (₹ Lakhs)	Credit Amount (₹ Lakhs)
	Bank A/c	Dr.	7,500	
	To Debenture Application A/c (Debentures application money received)			7,500
	Debenture Application A/c	Dr.	7,500	
	To 9% Debentures A/c			7,500

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	(Applicat on money transferred to 9% debentures account)		
	Debenture Allotment A/c Dr.	6,600	
	Discount on issue of debentures Dr.	900	
	Loss on issue of debenture A/c Dr.	750	
	To 9% Debentures A/c		7,500
	To Debenture redempt on premium A/c (Call made consequent upon allotment of debentures issued at discount and redeemable at premium)		750
	Bank A/c Dr.	6,600	
	To Debenture Allotment A/c (Allotment amount received)		6,600

Working Notes:

Amount of discount on issue = 150 Lakhs X ₹100 X 6% = ₹900 lakhs

Loss on issue of debentures = 150 Lakhs X ₹100 X 5% = ₹750 Lakhs

Alternatively, the discount on issue of debentures can be combined with loss on issue of debentures A/c as both discount and premium on redemption represent loss to the company. In that case, the journal entries will be

Books of Agrotech Ltd.
Journal

Date	Particulars	L.F.	Debit Amount (₹ Lakhs)	Credit Amount (₹ Lakhs)
	Bank A/c	Dr.	7,500	
	To Debenture Application A/c (Debentures application money received)			7,500
	Debenture Application A/c To 9% Debentures A/c (Application money transferred to 9% debentures account)	Dr.	7,500	7,500
	Debenture Allotment A/c Loss on issue of debenture A/c	Dr. Dr.	6,600 1,650	
	To 9% Debentures A/c To Debenture redemption premium A/c (Call made consequent upon allotment of debentures issued at discount and redeemable at premium)			7,500 7,50
	Bank A/c To Debenture Allotment A/c	Dr.	6,600	6,600

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	(Allotment amount received)			

Working Notes:

Loss on issue of debentures =
 (Amount of discount on issue + Premium payable on redemption) x No. of Debentures
 = (6% of ₹100 + 5% of ₹100) x 150 lakh
 = (₹ 6 + ₹ 5) x 150 lakh
 = ₹ 1,650 lakh

ILLUSTRATION 6

Simmons Ltd. issued 1,00,000, 12% Debentures of ₹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.

SOLUTION
In the books of Simmons Limited

Date	Particulars		₹ 000	₹ 000
April 1	Bank A/c	Dr.	11,000	
	To Debentures Application A/c (Being money received on 1,10,000 debentures)			11,000
April 7	Debentures Application A/c	Dr.	1,000	
	To Bank A/c (Being money on 10,000 debentures refunded as per Board's Resolution No.....dated...)			1,000
April 7	Debentures Application A/c	Dr.	10,000	
	To Debentures A/c (Being the allotment of 1,00,000 debentures of ₹ 100 each at par, as per Board's Resolution No.... dated...)			10,000

ILLUSTRATION 7

X Ltd. issued 1,00,000 12% Debentures of ₹100 each at a discount of 10% payable in full on application by 31st May, 2022. Applications were received for 1,20,000 debentures. Debentures were allotted on 9th June, 2022. Excess money was refunded on the same date. Pass necessary Journal Entries. Also show necessary ledger accounts.

SOLUTION
**In the books of X
Limited Journal
Entries**

Date	Particulars		₹ '000	₹ '000
2022				
May 31	Bank A/c	Dr.	10,800	
	To Debentures Application A/c (Being money received for 1,20,000 debentures @ ₹ 90 each)			10,800

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June 9	Debentures Application A/c	Dr.	1,800	
	To Bank A/c (Being excess money on 20,000 debentures @ ₹ 90 refunded as per Board's Resolution No.... dated....)			1,800
June 9	Debentures Application A/c	Dr.	9,000	
	Discount on Issue of Debentures A/c	Dr.	1,000	
	To 12% Debentures A/c (Being the allotment of 1,00,000 debentures of ₹ 100 each at a discount of ₹ 10 per debenture as per Board's Resolution No.....dated...)			10,000

Bank Account

Date	Particulars	₹	Date	Particulars	₹
31.5.2022	To 12% Debentures Application A/c	10,800	9.6.2022	By 12% Debentures Application A/c	1,800
			9.6.2022	By Balance c/d	9,000
		10,800			10,800

12% Debentures Account

Date	Particulars	₹	Date	Particulars	₹
30.6.2022	To Balance c/d	10,000	9.6.2022	By 12% Debentures Application A/c	9,000
			9.6.2022	By Discount on Issue of Debentures A/c	1,000
		10,000			10,000

Debentures Application Account

Date	Particulars	₹	Date	Particulars	₹
9.6.2022	To Bank A/c	1,800	31.5.2022	By Bank A/c	10,800
9.6.2022	To 12% Debentures A/c	9,000			
		10,800			10,800

Discount on Issue of Debentures Account

Date	Particulars	₹	Date	Particulars	₹
9.6.2022	To 12% Debentures A/c	1,000	30.6.2022	By Balance c/d	1,000
		1,000			1,000

ILLUSTRATION 8

X Ltd. obtains a loan from IDBI of ₹1,00,00,000, giving as collateral security of ₹1,50,00,000 (of ₹ 10 each), 14%, First Mortgage Debentures.

SOLUTION

In the Notes to Accounts of Balance Sheet of X Ltd., it is shown as follows:

Notes to Accounts of X Limited as at...(includes)

Long Term Borrowings	₹
Secured Loan	

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IDBI Loan	1,00,00,000

(Collaterally secured by issue of ₹ 1,50,00,000 14% First Mortgage Debentures)

ILLUSTRATION 9

Taking the same information of the illustration 8, the entry on issue will be as follows :

In the Books of X Ltd.

Journal

Date	Particulars	₹	₹
	Debentures Suspense A/c Dr. To 14% First Mortgage Debentures A/c (Being the issue of ₹ 15,00,000 debentures @ ₹10 collaterally as per Board's Resolution No...dated...)	1,50,00,000	1,50,00,000

Balance Sheet of X Limited as at....(Extracts)

Particulars	Notes No.	₹	₹
EQUITY AND LIABILITIES			
1. Non-Current Liabilities			
Long Term Borrowings	1	1,00,00,000	
Total		1,00,00,000	
ASSETS			
2. Non-current Assets			
Other non-current asset			
3. Current Assets			
Cash and cash equivalent		1,00,00,000	
Total		1,00,00,000	
Notes to accounts			
		₹	₹
1. Long Term Borrowings			
Secured Loan			
IDBI Loan			1,00,00,000
14% First Mortgage Debentures		1,50,00,000	
Debenture Suspense Account (issue of ₹ 15,00,000 14% First Debentures as collateral security as per contra)		1,50,00,000	

ILLUSTRATION 10

X Company Limited issued 10,000 14% Debentures of the nominal value of ₹50,00,000 as follows:

- To sundry persons for cash at 90% of nominal value of ₹ 25,00,000.
- To a vendor for purchase of fixed assets worth ₹10,00,000 – ₹ 12,50,000 nominal value.
- To the banker as collateral security for a loan of ₹ 10,00,000 – ₹ 12,50,000 nominal value.

Pass necessary Journal Entries.

SOLUTION

In the books of X Company Ltd.

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Journal Entries

Date	Particulars	₹	₹
(a)	Bank A/c Dr.	22,50,000	
	To Debentures Application A/c (Being the application money received on 5,000 debentures @ ₹ 450 each)		22,50,000
	Debentures Application A/c Dr.	22,50,000	
	Discount on issue of Debentures A/c Dr.	2,50,000	
	To 14% Debentures A/c (Being the issue of 5,000 14% Debentures @ 90% as per Board's Resolution No.... dated....)		25,00,000
(b)	Fixed Assets A/c Dr.	10,00,000	
	To Vendor A/c (Being the purchase of fixed assets from vendor)		10,00,000
	Vendor A/c Dr.	10,00,000	
	Discount on Issue of Debentures A/c Dr.	2,50,000	
	To 14% Debentures A/c (Being the issue of debentures of ₹ 12,50,000 to vendor to satisfy his claim)		12,50,000
(c)	Bank A/c Dr.	10,00,000	
	To Bank Loan A/c (See Note) (Being a loan of ₹10,00,000 taken from bank by issuing debentures of ₹12,50,000 as collateral security)		10,00,000

Note :

No entry is made in the books of account of the company at the time of making issue of such debentures. In the Balance sheet due to the fact the debentures being issued as collateral security and outstanding are shown under the respective liability.

ILLUSTRATION 11

HDC Ltd issues 1,00,000, 12% Debentures of ₹100 each at ₹94 on 1st January, 2022. 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.

SOLUTION

Total amount of discount comes to ₹ 6,00,000 (₹ 6 X 1,00,000). The amount of discount to be written-off in each year is calculated as under:

Year end	Debentures outstanding	Ratio in which discount to be written-off	Amount of discount to be written-off
1st	₹ 1,00,00,000	1/5	1/5th of ₹ 6,00,000 = ₹ 1,20,000
2nd	₹ 1,00,00,000	1/5	1/5th of ₹ 6,00,000 = ₹ 1,20,000
3rd	₹ 1,00,00,000	1/5	1/5th of ₹ 6,00,000 = ₹ 1,20,000
4th	₹ 1,00,00,000	1/5	1/5th of ₹ 6,00,000 = ₹ 1,20,000
5th	₹ 1,00,00,000	1/5	1/5th of ₹ 6,00,000 = ₹ 1,20,000

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ILLUSTRATION 12

HDC Ltd. issues 2,00,000, 12% Debentures of ₹ 10 each at ₹ 9.40 on 1st January, 2022. Under the terms of issue, 1/5th of the debentures are annually redeemable by drawings, the first redemption occurring on 31st December, 2022. Calculate the amount of discount to be written-off from 2022 to 2026.

SOLUTION
Calculation of amount of discount to be written-off

At the Year end	Debentures Outstanding before redemption	Ratio of benefit Derived	Amount of discount to be written-off
2022	₹ 20,00,000	5	5/15th of ₹ 1,20,000 = ₹ 40,000
2023	₹ 16,00,000	4	4/15th of ₹ 1,20,000 = ₹ 32,000
2024	₹ 12,00,000	3	3/15th of ₹ 1,20,000 = ₹ 24,000
2025	₹ 8,00,000	2	2/15th of ₹ 1,20,000 = ₹ 16,000
2026	₹ 4,00,000	1	1/15th of ₹ 1,20,000 = ₹ 8,000
	TOTAL	15	₹1,20,000

ILLUSTRATION 13

A company issued 12% debentures of the face value of ₹10,00,000 at 10% discount on 1-1-2019. Debenture interest after deducting tax at source @ 10% was payable on 30th June and 31st of December every year. All the debentures were to be redeemed after the expiry of five year period at 5% premium.

Pass journal entries for the accounting year 2022.

SOLUTION
Journal Entries

			(₹)	(₹)
1-1-2022	Bank A/c	Dr.	9,00,000	
	Discount/Loss on Issue of Debentures A/c	Dr.	1,50,000	
	To 12% Debentures A/c	Dr.		10,00,000
	To Premium on Redemption of Debentures A/c			50,000
	(For issue of debentures at discount redeemable at premium)			
30-6-2022	Debenture Interest A/c	Dr.	60,000	
	To Debenture holders A/c			54,000
	To Tax Deducted at Source A/c (For interest payable)			6,000
	Debenture holders A/c	Dr.	54,000	
	Tax Deducted at Source A/c	Dr.	6,000	
	To Bank A/c			60,000
	(For payment of interest and TDS)			
31-12-2022	Debenture Interest A/c	Dr.	60,000	
	To Debenture holders A/c			54,000
	To Tax Deducted at Source A/c			6,000

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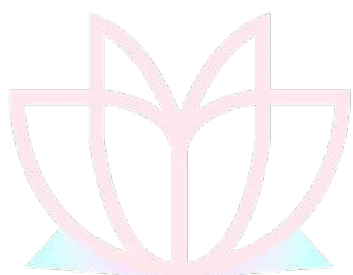
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	(For interest payable)			
	Debenture holders A/c Tax Deducted at Source A/c	Dr. Dr.	54,000 6,000	
	To Bank A/c (For payment of interest and tax)			60,000
	Profit and Loss A/c	Dr.	1,20,000	
	To Debenture Interest A/c (For transfer of debenture interest to profit and loss account at the end of the year)			1,20,000
	Profit and Loss A/c	Dr.	30,000	
	To Discount/Loss on issue of debenture A/c (For proportionate debenture discount and premium on redemption written off, i.e., 1,50,000 x 1/5)			30,000



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Chapter 11.4

Accounting For Bonus Issue And Right Issue

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True and false

Question 1:

Earning per share gets increased after bonus issue.

Answer 1:

False. Earnings per share gets decreased after bonus issue.

Question 2:

Issued share capital including issue of rights shares and bonus shares may be more than the Authorised capital.

Answer 2:

False. Issued share capital including issue of rights shares and bonus shares is always less than or equal to Authorised capital.

Question 3:

Rights issue of shares results in decrease of market value of per share in comparison to market price

Answer 3:

True. Rights issue of shares results in decrease of market value of per share in comparison to market price before rights issue.

Question 4:

Right shares are normally offered at a price more than the cum-right value of the share, causing dilution in its value post-right issue.

Answer 4:

False. Right shares are normally offered at a price less than the cum-right value of the share, causing dilution in its value post-right issue.

Multiple Choice Questions

1. Which of the following cannot be used for issue of bonus shares as per the Companies Act?

- (a) Securities premium account
- (b) Revaluation reserve
- (c) Capital redemption reserve

Answer 1: (b)

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2. Which of the following statements is true with regard to declaring and issuing of Bonus Shares?
- (a) Assets are transferred from the company to the shareholders.
 - (b) A Bonus issue results in decrease in reserves and surplus.
 - (c) A Bonus issue is same as declaration of dividends.

Answer 2: (b)

3. Which of the following statement is true in case of bonus issue?
- (a) Convertible debenture holders will get bonus shares in same proportion as to the existing shareholders.
 - (b) Bonus shares may be issued to convertible debenture holders at the time of conversion of such debentures into shares.
 - (c) Both (a) and (b).

Answer 3: (c)

4. Bonus issue is also known as
- (a) Scrip issue.
 - (b) Capitalisation issue.
 - (c) Both (a) and (b).

Answer 4: (c)

5. The bonus issue is not made unless
- (a) Partly paid shares are made fully paid up.
 - (b) It is provided in its articles of association
 - (c) Both (a) and (b).

Answer 5: (c)

6. Bonus issue has the following effect
- (a) Market price gets adjusted on issue of bonus shares.
 - (b) Effective Earnings per share, Book Value and other per share values stand increased.
 - (c) Markets generally take the action as an unfavorable act.

Answer 6: (a)

7. ABC Co. Ltd resolved to issue bonus shares. Which of the following is not a pre-requisite for issuance of bonus shares?
- (a) Authorization in Articles of Association.
 - (b) Timely Payment of statutory dues of employees such as PF, Gratuity etc.
 - (c) Sufficient balance in bank account of company.

Answer 7: (c)

8. In case of further issue of shares, the right to renounce the shares in favour of a third party
- (a) Must include a right exercisable by the person concerned to renounce the shares;
 - (b) Should include a right exercisable by the person concerned to renounce the shares;
 - (c) Is deemed to include a right exercisable by the person concerned to renounce the shares (subject to the provisions under the articles of the company).

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Answer 8: (c)

9. A company's share's face value is ₹ 10, book value is ₹ 20, Right issue price is ₹ 30 and Market price is ₹ 40, while recording the issue of right share, the securities premium will be credited with
- (a) ₹ 10
 - (b) ₹ 20
 - (c) ₹ 30

Answer 9: (b)

10. A. Right shares enable existing shareholders to maintain their proportional holding in the company.
 B. Right share issue does not cause dilution in the market value of the share.
 Which of the option is correct?
- (a) A-Correct; B Correct
 - (b) A – Incorrect; B Correct
 - (c) A - Correct; B – Incorrect

Answer 10: (c)

11. Ex-Rights price can be calculated by which of these formulas?
- (a) $(\text{Cum rights value of the existing shares} + \text{Rights share issue proceeds}) / (\text{existing number of shares} + \text{No. of right shares})$.
 - (b) $(\text{Cum rights value of the existing shares} + \text{Rights share issue proceeds}) \times (\text{existing number of shares} + \text{No. of right shares})$.
 - (c) $(\text{Cum rights value of the existing shares} - \text{Rights share issue proceeds}) / (\text{existing number of shares} - \text{No. of right shares})$.

Answer 11: (a)

Theoretical Questions

Question 1:

What is meant by Bonus issue? Explain its related provisions as per the Companies Act, 2013.

Answer 1:

Bonus Issue means an offer of free additional shares to existing shareholders. A company may decide to distribute further shares as an alternative to increase the dividend pay-out.

Question 2:

Explain the financial effects of a further issue of equity shares on the market value of the share.

Answer 2:

The financial position of a business is contained in the balance sheet. Further issue of shares increases the amount of share capital as well as the liquid resources (Bank). The amount of share capital issued is the product of further number of shares issued multiplied by issue price. The issue price may be higher than the face value (issue at a premium).

Question 3:

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What are the advantages and disadvantages of a rights issue?

Answer 3:

Rights issue is an issue of rights to a company's existing shareholders that entitles them to buy additional shares directly from the company in proportion to their existing holdings, within a fixed time period. For advantages and disadvantages of right issue,

Question 4:

What is meant by renunciation of rights shares by existing shareholder?

Answer 4:

In a situation where existing shareholder does not intend to subscribe to the rights issue of a company, he may give up his right in favour of another person for a consideration. Such giving up of rights is called renunciation of rights.

Practical Questions

Question 1:

Following items appear in the Trial Balance of Saral Ltd. as on 31st March, 2022:

Particulars	Amount
4,500 Equity Shares of ₹ 100 each	4,50,000
Securities Premium (collected in cash)	40,000
Capital Redemption Reserve	70,000
General Reserve	1,05,000
Profit and Loss Account (Cr. Balance)	65,000

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 3 shares held. Company decided that there should be the minimum reduction in free reserves.

Pass necessary Journal Entries in the books Saral Ltd.

Answer 1:

Journal Entries in the books of Saral Ltd.

2022		Dr.	Cr.
	Capital Redemption Reserve A/c	Dr. 70,000	
	Securities Premium A/c	Dr. 40,000	
	General Reserve A/c (b.f.)	Dr. 40,000	
	To Bonus to Shareholders A/c (Bonus issue of one shares for every three shares held, by utilising various reserves as per Board's resolution dated.....)		1,50,000
	Bonus to Shareholders A/c	Dr. 1,50,000	
	To Equity Share Capital A/c (Capitalisation of profit)		1,50,000

Working Note- Number of bonus shares to be issued- $4500 / 3 \times 1 = 1500$ shares

Question 2:

The following notes pertain to Brite Ltd.'s Balance Sheet as at 31st March, 2022:

Notes	₹ in Lakhs

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(1) Share Capital Authorised : 20 crore shares of ₹ 10 each	20,000
Issued and Subscribed : 10 crore Equity Shares of ₹ 10 each	10,000
2 crore 11% Cumulative Preference Shares of ₹ 10 each	2,000
Total	12,000
Called and paid up: 10 crore Equity Shares of ₹ 10 each, ₹ 8 per share called and paid up	8,000
2 crore 11% Cumulative Preference Shares of ₹ 10 each, fully called and paid up	2,000
Total	10,000
(2) Reserves and Surplus :	
Capital Redemption Reserve	1,485
Securities Premium (collected in cash)	2,000
General Reserve	1,040
Surplus i.e. credit balance of Profit & Loss Account	273
Total	4,798

On 2nd April 2022, the company made the final call on equity shares @ ₹ 2 per share. The entire money was received in the month of April, 2022.

On 1st June 2022, the company decided to issue to equity shareholders bonus shares at the rate of 2 shares for every 5 shares held. Pass journal entries for all the above mentioned transactions. Also prepare the notes on Share Capital and Reserves and Surplus relevant to the Balance Sheet of the company immediately after the issue of bonus shares.

Answer 2:

Journal Entries in the books of Brite Ltd.

2022		Dr. ₹ in lakhs	Cr. ₹ in lakhs
April 2	Equity Share Final Call A/c Dr.	2,000	
	To Equity Share Capital A/c (Final call of ₹ 2 per share on 10 crore equity shares made due)		2,000
	Bank A/c Dr.	2,000	
	To Equity Share Final Call A/c (Final call money on 10 crore equity shares received)		2,000
June 1	Capital Redemption Reserve A/c Dr.	1,485	
	Securities Premium A/c Dr.	2,000	
	General Reserve A/c (b.f.) Dr.	515	
	To Bonus to Shareholders A/c (Bonus issue of two shares for every five shares held, by utilising various reserves as per Board's resolution dated.....)		4,000
	Bonus to Shareholders A/c Dr.	4,000	
	To Equity Share Capital A/c (Capitalisation of profit)		4,000

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Notes to Accounts

			₹ in lakhs
1.	Share Capital		
	Authorized share capital: 20 crore shares of ₹ 10 each		20,000
	Issued, subscribed and fully paid up share capital: 14 crore Equity shares of ₹ 10 each, fully paid up (Out of the above, 4 crore equity shares @ ₹ 10 each were issued by way of bonus)		14,000
	2 crore, 11% Cumulative Preference share capital of ₹ 10 each, fully paid up		2,000
			16,000
2.	Reserves and Surplus:		
	Capital Redemption reserve	1,485	
	Less: Utilised for bonus issue	(1,485)	-
	Securities Premium	2,000	
	Less: Utilised for bonus issue	(2,000)	-
	General Reserve	1,040	
	Less: Utilised for bonus issue	(515)	525
	Surplus (Profit and Loss Account)		273
	Total		798

question 3:

Following notes pertain to the Balance Sheet of Manoj Ltd. as at 31st March, 2022

Authorised capital:	₹
30,000 12% Preference shares of ₹ 10 each	3,00,000
3,00,000 Equity shares of ₹ 10 each	30,00,000
	33,00,000
Issued and Subscribed capital:	
24,000 12% Preference shares of ₹ 10 each fully paid	2,40,000
2,70,000 Equity shares of ₹ 10 each, ₹ 8 paid up	21,60,000
Reserves and surplus:	
General Reserve	3,60,000
Capital Redemption Reserve	1,20,000
Securities premium (collected in cash)	75,000
Profit and Loss Account	6,00,000

On 1st April, 2022, the Company has made final call @ ₹ 2 each on 2,70,000 equity shares. The call money was received by 20th April, 2022. Thereafter, the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held.

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Show necessary journal entries in the books of the company and prepare the extract of the balance sheet as on 30th April, 2022 after bonus issue.

Answer 3:

Journal Entries in the books of Manoj Ltd

		₹	₹
1-4-2022	Equity share final call A/c Dr.	5,40,000	
	To Equity share capital A/c (For final calls of ₹ 2 per share on 2,70,000 equity shares due as per Board's Resolution dated....)		5,40,000
20-4-2022	Bank A/c Dr.	5,40,000	
	To Equity share final call A/c (For final call money on 2,70,000 equity shares received)		5,40,000
	Securities Premium A/c Dr.	75,000	
	Capital redemption Reserve A/c Dr.	1,20,000	
	General Reserve A/c Dr.	3,60,000	
	Profit and Loss A/c (b.f.) Dr.	1,20,000	
	To Bonus to shareholders A/c (For making provision for bonus issue of one share for every four shares held)		6,75,000
	Bonus to shareholders A/c Dr.	6,75,000	
	To Equity share capital A/c (For issue of bonus shares)		6,75,000

Extract of Balance Sheet as at 30th April, 2022 (after bonus issue)

	₹	₹
Authorised Capital		
30,000 12% Preference shares of ₹10 each		3,00,000
3,37,500 Equity shares of ₹10 each (refer W.N.)		33,75,000
Issued and subscribed capital		
24,000 12% Preference shares of ₹10 each, fully paid		2,40,000
3,37,500 Equity shares of ₹10 each, fully paid		33,75,000
(Out of the above, 67,500 equity shares @ ₹10 each were issued by way of bonus shares)		
Reserves and surplus		
Capital Redemption Reserve	1,20,000	
Less: Utilised for bonus issue	(1,20,000)	NIL
Securities premium	75,000	
Less: Utilised for bonus issue	(75,000)	NIL
General Reserve	3,60,000	
Less: Utilised for bonus issue	(3,60,000)	NIL
Profit and Loss Account	6,00,000	
Less: Utilised for bonus issue	(1,20,000)	4,80,000

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Working Note:

1. Number of bonus shares to be issued- $2,70,000/4 \times 1 = 67,500$ shares	
2. The authorised capital should be increased as per details given below:	₹
Existing issued Equity share capital	27,00,000
Add: Issue of bonus shares to equity shareholders	<u>6,75,000</u>
	<u>33,75,000</u>

Question 4:

A company has decided to increase its existing share capital by making rights issue to its existing shareholders. The company is offering one new share for every two shares held by the shareholder. The market value of the share is ₹ 240 and the company is offering one share of ₹ 120 each. Calculate the value of a right. What should be the ex-right market price of a share?

Answer 4:

Ex-right value of the shares	=	(Cum-right value of the existing shares + Rights shares x Issue Price) / (Existing Number of shares + No. of right shares)
	=	(₹ 240 x 2 Shares + ₹ 120 x 1 Share) / (2 + 1) Shares
	=	₹ 600 / 3 shares = ₹ 200 per share.
Value of right share	=	Cum-right value of the share – Ex-right value of the share
	=	₹ 240 – ₹ 200 = ₹ 40 per share.

Hence, any one desirous of having a confirmed allotment of one share from the company at ₹ 120 will have to pay ₹ 80 (2 shares x ₹ 40) to an existing shareholder holding 2 shares and willing to renounce his right of buying one share in favour of that person.

Question 5:

A Ltd company having share capital of 25,000 equity shares of ₹10 each decides to issue rights share at the ratio of 1 for every 4 shares held at par value. Assuming all the share holders accepted the rights issue and all money was duly received, pass journal entries in the books of the company.

Answer 5:
Journal Entry in the books of A Ltd.

		₹	₹
Bank A/c	Dr.	62,500	
To Equity share capital A/c			62,500
(For rights share issued at par value in the ratio of 1:4 equity shares due as per Board's Resolution dated....)			

Working Note:

Number of Rights shares to be issued- $25,000/4 \times 1 = 6,250$ shares

Question 6:

Following notes pertain to the Balance Sheet of Mars Company Limited as at 31st March 2022:

	₹

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Authorised capital:	
50,000 12% Preference shares of ₹ 10 each	5,00,000
5,00,000 Equity shares of ₹ 10 each	50,00,000
	55,00,000
Issued and Subscribed capital:	
50,000 12% Preference shares of ₹ 10 each fully paid	5,00,000
4,00,000 Equity shares of ₹ 10 each, ₹ 8 paid up	32,00,000
Reserves and surplus:	
General Reserve	1,60,000
Capital Redemption Reserve	2,40,000
Securities premium (collected in cash)	2,75,000
Revaluation Reserve	1,00,000
Profit and Loss Account	16,00,000

On 1st April, 2022, the Company has made final call @ ₹ 2 each on 4,00,000 equity shares. The call money was received by 25th April, 2022. Thereafter, on 1st May 2022 the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held, it decided that there should be minimum reduction in free reserves.

On 1st June 2022, the Company issued Rights shares at the rate of two shares for every five shares held on that date at issue price of ₹ 12 per share. All the rights shares were accepted by the existing shareholders and the money was duly received by 20th June 2022.

Show necessary journal entries in the books of the company for bonus issue and rights issue.

Answer 6:

Journal Entries in the books of Mars Ltd.

2022		Dr. ₹	Cr. ₹
April 1	Equity Share Final Call A/c Dr.	8,00,000	
	To Equity Share Capital A/c (Final call of ₹ 2 per share on 4,00,000 equity shares made due)		8,00,000
April 25	Bank A/c Dr.	8,00,000	
	To Equity Share Final Call A/c (Final call money on equity shares received)		8,00,000
May 1	Capital Redemption Reserve A/c Dr.	2,40,000	
	Securities Premium A/c Dr.	2,75,000	
	General Reserve A/c Dr.	1,60,000	
	Profit and Loss A/c (b.f.) Dr.	3,25,000	
	To Bonus to Shareholders A/c (Bonus issue of one shares for every four shares held, by utilising various reserves as per Board's resolution dated.....)		10,00,000
	Bonus to Shareholders A/c Dr.	10,00,000	
	To Equity Share Capital A/c		10,00,000

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	(Capitalisation of profit)			
June 20	Bank A/c	Dr.		
	To Securities Premium A/c			4,00,000
	To Equity Share Capital A/c (Being Rights issue of 2 shares for every 5 shares held as per board resolution dated)			20,00,000

Illustrations

Illustrations 1

Following items appear in the trial balance of Bharat Ltd. (a listed company) as on 31st March, 2022:

	₹
40,000 Equity shares of ₹ 10 each	4,00,000
Capital Redemption Reserve	55,000
Securities Premium (collected in cash)	30,000
General Reserve	1,05,000
Surplus i.e. credit balance of Profit and Loss Account	50,000

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 4 shares held and for this purpose, it decided that there should be the minimum reduction in free reserves. Pass necessary journal entries.

Answer 1

Journal Entries in the books of Bharat Ltd.

	Dr.	Cr.
	₹	₹
Capital Redemption Reserve A/c	Dr. 55,000	
Securities Premium A/c	Dr. 30,000	
General Reserve A/c (b.f.)	Dr. 15,000	
To Bonus to Shareholders A/c		1,00,000
(Bonus issue of one share for every four shares held, by utilising various reserves as per Board's resolution dated.....)		
Bonus to Shareholders A/c	Dr. 1,00,000	
To Equity Share Capital A/c		1,00,000
(Capitalisation of profit)		

Working Note-

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Number of Bonus shares to be issued- $(40,000 \text{ shares} / 4) \times 1 = 10,000 \text{ shares}$
 Value of Bonus shares- 10,000 shares of ₹ 10 each = ₹ 1,00,000

Illustrations 2

Pass Journal Entries in the following circumstances:

- (i) A Limited company with subscribed capital of ₹ 5,00,000 consisting of 50,000 Equity shares of ₹ 10 each; called up capital ₹ 7.50 per share. A bonus of ₹ 1,25,000 declared out of General Reserve to be applied in making the existing shares fully paid up.
- (ii) A Limited company having fully paid up capital of ₹ 50,00,000 consisting of Equity shares of ₹ 10 each, had General Reserve of ₹ 9,00,000. It was resolved to capitalize ₹ 5,00,000 out of General Reserve by issuing 50,000 fully paid bonus shares of ₹ 10 each, each shareholder to get one such share for every ten shares held by him in the company.

Answer 2

Journal Entries

			₹	₹
(i)	General Reserve A/c	Dr.	1,25,000	
	To Bonus to shareholders A/c (For making provision of bonus issue)			1,25,000
	Share Final Call A/c		1,25,000	
	To Equity share capital A/c (For final calls of ₹ 2.5 per share on 50,000 equity shares due as per Board's Resolution dated....)			1,25,000
	Bonus to shareholders A/c	Dr.	1,25,000	
	To Share Final Call A/c (For bonus money applied for call)			1,25,000
(ii)	General Reserve A/c	Dr.	5,00,000	
	To Bonus to shareholders A/c (For making provision of bonus issue)			5,00,000
	Bonus to shareholders A/c	Dr.	5,00,000	
	To Equity share capital A/c (For issue of 50,000 bonus shares at ₹ 10)			5,00,000

Illustrations 3

Following notes pertain to the Balance Sheet of Solid Ltd. as at 31st March, 2022:

	₹
Authorised capital :	
10,000 12% Preference shares of ₹ 10 each	1,00,000
1,00,000 Equity shares of ₹ 10 each	10,00,000
	11,00,000
Issued and Subscribed capital:	
8,000 12% Preference shares of ₹ 10 each fully paid	80,000
90,000 Equity shares of ₹ 10 each, ₹ 8 paid up	7,20,000
Reserves and Surplus :	
General reserve	1,60,000

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Revaluation reserve	35,000
Securities premium (collected in cash)	20,000
Profit and Loss Account	2,05,000
Secured Loan:	
12% Debentures @ ₹ 100 each	5,00,000

On 1st April, 2022 the Company has made final call @ ₹ 2 each on 90,000 equity shares. The call money was received by 20th April, 2022. Thereafter the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held. Show necessary entries in the books of the company and prepare the extract of the Balance Sheet immediately after bonus issue assuming that the company has passed necessary resolution at its general body meeting for increasing the authorised capital.

Answer 3

Journal Entries in books of Solid Ltd.

			Dr.	Cr.
			₹	₹
2022 April 1	Equity Share Final Call A/c To Equity Share Capital A/c (Final call of ₹ 2 per share on 90,000 equity shares due as per Board's Resolution dated)	Dr.	1,80,000	1,80,000
April 20	Bank A/c To Equity Share Final Call A/c (Final Call money on 90,000 equity shares received)	Dr.	1,80,000	1,80,000
	Securities Premium A/c General Reserve A/c Profit and Loss A/c (b.f.) To Bonus to Shareholders A/c (Bonus issue @ one share for every four shares held by utilising various reserves as per Board's Resolution dated...)	Dr. Dr. Dr.	20,000 1,60,000 45,000	2,25,000
April 20	Bonus to Shareholders A/c To Equity Share Capital A/c (Capitalization of profit)	Dr.	2,25,000	2,25,000

Balance Sheet (Extract) as at 30th April, 2022 (after bonus issue)

	Particulars	Notes	Amount (₹)
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital	1	12,05,000
b	Reserves and Surplus	2	1,95,000
2	Non-current liabilities		
a	Long-term borrowings	3	5,00,000
	Total		19,00,000

Notes to Accounts

1	Share Capital	
	Equity share capital	

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	Authorised share capital		
	10,000 12% Preference shares of ₹ 10 each		1,00,000
	1,12,500 Equity shares of ₹ 10 each		11,25,000
	Issued, subscribed and fully paid share capital 8,000 12% Preference shares of ₹ 10 each		80,000
	1,12,500 Equity shares of ₹ 10 each, fully paid (Out of above, 22,500 equity shares @ ₹ 10 each were issued by way of bonus)	(A)	11,25,000
		Total	12,05,000
2	Reserves and Surplus		
	Revaluation Reserve		35,000
	Securities Premium	20,000	
	Less: Utilised for bonus issue	(20,000)	Nil
	General reserve	1,60,000	
	Less: Utilised for bonus issue	(1,60,000)	
	Profit & Loss Account	2,05,000	
	Less: Utilised for bonus issue	(45,000)	1,60,000
		Total	1,95,000
3	Long-term borrowings		
	Secured 12% Debentures @ ₹ 100 each		5,00,000

The authorised capital has been increased by sufficient number of shares. (11,25,000 – 10,00,000)

Working Note-

Number of Bonus shares to be issued $(90,000 \text{ shares} / 4) \times 1 = 22,500 \text{ shares}$

Note: It has to be ensured that the authorized capital after bonus issue should not be less than the issued share capital (including bonus issue) in all the practical problems. The authorized capital may either be increased by the amount of bonus issue or the value of additional shares [value of bonus shares issued less unused authorized capital (excess of authorized capital in comparison to the issued shares before bonus issue)].

Illustrations 4

Following notes pertain to the Balance Sheet of Preet Ltd. as at 31st March, 2022

	₹
Share capital:	
Authorised capital:	
15,000 12% Preference shares of ₹ 10 each	1,50,000
1,50,000 Equity shares of ₹ 10 each	15,00,000
	16,50,000
Issued and Subscribed capital:	
12,000 12% Preference shares of ₹ 10 each fully paid	1,20,000
1,35,000 Equity shares of ₹ 10 each, ₹ 8 paid up	10,80,000
Reserves and surplus:	

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General Reserve	1,80,000
Capital Redemption Reserve	60,000
Securities premium (collected in cash)	37,500
Profit and Loss Account	3,00,000

On 1st April, 2022, the Company has made final call @ ₹ 2 each on 1,35,000 equity shares. The call money was received by 20th April, 2022. Thereafter, the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held.

Show necessary journal entries in the books of the company and prepare the extract of the balance sheet as on 30th April, 2022 after bonus issue.

Answer 4

Journal Entries in the books of Preet Ltd.

			₹	₹
1-4-2022	Equity share final call A/c	Dr.	2,70,000	
	To Equity share capital A/c (For final calls of ₹ 2 per share on 1,35,000 equity shares due as per Board's Resolution dated....)			2,70,000
20-4-2022	Bank A/c	Dr.	2,70,000	
	To Equity share final call A/c (For final call money on 1,35,000 equity shares received)			2,70,000
	Securities Premium A/c	Dr.	37,500	
	Capital Redemption Reserve A/c	Dr.	60,000	
	General Reserve A/c	Dr.	1,80,000	
	Profit and Loss A/c (b.f.)	Dr.	60,000	
	To Bonus to shareholders A/c (For making provision for bonus issue of one share for every four shares held)			3,37,500
	Bonus to shareholders A/c	Dr.	3,37,500	
	To Equity share capital A/c (For issue of bonus shares)			3,37,500

Extract of Balance Sheet as at 30th April, 2022 (after bonus issue)

	Particulars	Notes	Amount (₹)
	Equity and Liabilities		
1	Shareholders' funds		
A	Share capital	1	18,07,500
B	Reserves and Surplus	2	2,40,000
	Total		20,47,500

Notes to Accounts

		₹
Share Capital		
Authorised Capital		
15,000 12% Preference shares of ₹10 each		1,50,000
1,68,750 Equity shares of ₹10 each (refer working note below)		16,87,500

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Issued and subscribed capital		
12,000 12% Preference shares of ₹10 each, fully paid		1,20,000
1,68,750 Equity shares of ₹10 each, fully paid		16,87,500
(Out of above, 33,750 equity shares @ ₹10 each were issued by way of bonus)		
Reserves and surplus		
Securities Premium	37,500	
Less: Utilised for bonus issue	(37,500)	NIL
Capital Redemption Reserve	60,000	
Less: Utilised for bonus issue	(60,000)	NIL
General Reserve	1,80,000	
Less: Utilised for bonus issue	(1,80,000)	NIL
Profit and Loss Account	3,00,000	
Less: Utilised for bonus issue	(60,000)	2,40,000

Working Notes:

- Number of Bonus shares to be issued-
₹

$$(1,35,000 \text{ shares} / 4) \times 1 = 33,750 \text{ shares}$$

- The authorised capital should be increased as per details given below:

Existing issued Equity share capital	13,50,000
Add: Issue of bonus shares to equity shareholders	<u>3,37,500</u>
	<u>16,87,500</u>

STRIVING TOWARDS KNOWLEDGE

Illustrations 5

A company offers new shares of ₹ 100 each at 25% premium to existing shareholders on one for four bases. The cum-right market price of a share is ₹ 150. Calculate the value of a right. What should be the ex-right market price of a share?

Answer 5

Ex-right value of the shares = (Cum-right value of the existing shares + Rights shares Issue Price) / (Existing Number of shares + No. of right shares)

$$= (\text{₹ } 150 \times 4 \text{ Shares} + \text{₹ } 125 \times 1 \text{ Share}) / (4 + 1) \text{ Shares}$$

$$= \text{₹ } 725 / 5 \text{ shares} = \text{₹ } 145 \text{ per share.}$$

Value of right = Cum-right value of the share – Ex-right value of the share
 = ₹ 150 – ₹ 145 = ₹ 5 per share.

Hence, any one desirous of having a confirmed allotment of one share from the company at ₹ 125 will have to pay ₹ 20 (4 shares X ₹ 5) to an existing shareholder holding 4 shares and willing to renounce his right of buying one share in favour of that person.

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Chapter 11.5

REDEMPTION OF PREFERENCE SHARES

499

Test Your Knowledge

True and False

1. When shares are redeemed by utilising distributable profit, an amount equal to the face value of shares redeemed is transferred to Capital Reserve account by debiting the distributable profit.

Ans: False: When shares are redeemed by utilising distributable profit, an amount equal to the face value of shares redeemed is transferred to Capital Redemption Reserve account by debiting the distributable profit.

2. A company who prepares financial statements in compliance with Accounting Standards under Section 133 of the Companies Act, 2013, it cannot utilize securities premium for the purpose of providing for premium on the redemption of Redeemable Preference shares of the Company.

Ans: True: A company who prepares financial statements in compliance with Accounting Standards under Section 133 of the Companies Act, 2013, it cannot utilize securities premium for the purpose of providing the premium on the redemption of redeemable preference shares.

3. The balance in forfeited shares account can be used for transfer to capital redemption reserve account.

Ans: False: The balance in Forfeited shares account cannot be used for transfer to capital redemption reserve account.

4. Capital redemption reserve cannot be used for writing off miscellaneous expenses and losses

Ans: True: Capital redemption reserve cannot be used for writing off miscellaneous expenses and losses.

Multiple Choice Questions

1. Securities premium cannot be used to _____.

- (a) Issue bonus shares
- (b) Redeem preference shares
- (c) Write-off preliminary expenses

Answer:(b)

2. S Ltd. issued 2,000, 10% Preference shares of ₹ 100 each at par on 1.4.2021, which are redeemable at a premium of 10%. For the purpose of redemption, the company issued 1,500 Equity Shares of ₹ 100 each at a premium of 20% per share. At the time of redemption of

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Preference Shares, the amount to be transferred by the company to the Capital Redemption Reserve Account = ?

- (a) ₹ 50,000
- (b) ₹ 40,000
- (c) ₹ 2,00,000

Answer:(a¹)

¹ 2,00,000 – 1,50,000

3. Which of the following cannot be used for the purpose of creation of capital redemption reserve account?

- (a) Profit and loss account (credit balance)
- (b) General reserve account
- (c) Unclaimed dividend account

Answer:(c)

4. According to Section 52 of the Companies Act, 2013, the amount in the Securities Premium A/c cannot be used for the purpose of

- (a) Issue of fully paid bonus shares
- (b) Writing off losses of the company
- (c) For purchase of own securities

Answer:(b)

5. Which of the following can be utilized for redemption of preference shares?

- (a) The proceeds of fresh issue of equity shares
- (b) The proceeds of issue of debentures
- (c) The proceeds of issue of fixed deposit

Answer:(a)

6. Preference shares amounting to ₹ 2,00,000 (already issued on 1.4.2021) are redeemed at a premium of 5%, by issue of shares amounting to ₹ 1,00,000 at a premium of 10%. The amount to be transferred to capital redemption reserve =?

- (a) ₹ 1,05,000
- (b) ₹ 1,00,000
- (c) ₹ 2,00,000

Answer:(b²)

² 2,00,000 – 1,00,000

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Theoretical Questions

1. What is the purpose of issuing redeemable preference shares?

Ans: A company may issue redeemable preference shares to raise finance in a dull primary market. Preference shares may be redeemed when there is a surplus of capital and the surplus funds cannot be utilised in the business for profitable use.

A company may issue redeemable preference shares because of the following:

1. It is a proper way of raising finance in a dull primary market.
2. A company may face difficulty in raising share capital, as its shares are not traded on the stock exchange. Potential investors who may, hesitate in putting money into shares that cannot easily be sold may be encouraged to invest if the shares are redeemable by the company.
3. The preference shares may be redeemed when there is a surplus of capital and the surplus funds cannot be utilised in the business for profitable use.
4. No dividend is required to be paid, if there is loss or no profit, whereas interest is payable on debentures or loans even in case of loss. In other words, preference dividend declared / paid continues to be regarded as an appropriation of profits (similar treatment is given for equity shares), as against interest on debentures, which is a charge against profits.

In India, the issue and redemption of preference shares is governed by Section 55 of the Companies Act, 2013.

2. What are the provisions of the Companies Act, 2013 related with redemption of preference shares? Explain in brief.

Ans: Section 55 of the Companies Act, 2013, deals with provisions relating to redemption of preference shares. It ensures that there is no reduction in shareholders' funds due to redemption and, thus, the interest of outsiders is not affected.

A company limited by shares if so authorised by its Articles, may issue preference shares which at the option of the company, are liable to be redeemed within a period, normally not exceeding 20 years from the date of their issue. It should be noted that:

- (a) no shares can be redeemed except out of divisible or distributable profit, (i.e. out of the profit of the company which would otherwise be available for dividend) or out of proceeds of fresh issue of shares made for the purpose of redemption;
- (b) no such shares can be redeemed unless they are fully paid;
- (c) (i) in case of such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under Section 133, the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed:
Provided also that premium, if any, payable on redemption of any preference shares issued on or before the commencement of this Act by any such company shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

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- (ii) in case of other companies (not falling under (i) above), the premium, if any payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.
 (Refer to the Note given in para 5.4.1 for the basis applied in the Illustrations in this Chapter.)
- (d) where any such shares are proposed to be redeemed out of the profits of the company, there shall, out of the divisible profits, i.e. the profits which would otherwise have been available for dividends, be transferred to a reserve account to be called Capital Redemption Reserve Account, a sum equal to the nominal amount of the shares redeemed; and the provisions of the Act relating to the reduction of the share capital of a company shall, except as provided in the Section, apply as if the Capital Redemption Reserve (CRR) Account were the paid-up share capital of the company. The utilisation of CRR Account is further restricted to issuance of fully paid-up bonus shares only.

Practical Questions

Question 1

The books of B Ltd. showed the following balance on 31st December, 2023:

30,000 Equity Shares of ₹10 each fully paid; 18,000 12% Redeemable Preference Shares of ₹10 each fully paid; 4,000 10% Redeemable Preference Shares of ₹ 10 each, ₹ 8 paid up (all shares issued on 1st April, 2022).

Undistributed Reserve and Surplus stood as: Profit and Loss Account ₹ 80,000; General Reserve ₹ 1,20,000; Securities Premium Account ₹ 15,000 and Capital Reserve ₹ 21,000.

For redemption, 3,000 equity shares of ₹10 each are issued at 10% premium. At the same time, Preference shares are redeemed on 1st January, 2024 at a premium of ₹2 per share. The whereabouts of the holders of 100 shares of ₹10 each fully paid are not known.

A bonus issue of equity share was made at par, two shares being issued for every five held on that date out of the Capital Redemption Reserve Account. However, equity shares, issued for redemption are not eligible for bonus.

Show the necessary Journal Entries to record the transactions. (Ignore date column)

Answer

In the books of B Limited Journal Entries

Particulars		Dr. (₹)	Cr. (₹)
12% Redeemable Preference Share Capital A/c Premium on Redemption of Preference Shares A/c	Dr. Dr.	1,80,000 36,000	
To Preference Shareholders A/c (Being the amount payable on redemption of 18,000 12% Redeemable Preference Shares transferred to Shareholders Account)			2,16,000
Preference Shareholders A/c	Dr.	2,14,800	
To Bank A/c (Being the amount paid on redemption of 17,900 preference shares)			2,14,800

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Bank A/c	Dr.	33,000	
To Equity Shares Capital A/c			30,000
To Securities Premium A/c (Being the issue of 3,000 Equity Shares of ₹10 each at a premium of 10% as per Board's Resolution No..... Dated.....)			3,000
General Reserve A/c	Dr.	1,20,000	
Profit & Loss A/c	Dr.	30,000	
To Capital Redemption Reserve A/c (Being the amount transferred to Capital Redemption Reserve A/c as per the requirement of the Act.)			1,50,000
Capital Redemption Reserve A/c	Dr.	1,20,000	
To Bonus to Shareholders A/c (Being the amount appropriated for issue of bonus share in the ratio of 5:2 as per shareholders Resolution No..... dated...)			1,20,000
Bonus to Shareholders A/c	Dr.	1,20,000	
To Equity Share Capital A/c (Being the utilisation of bonus dividend for issue of 12,000 equity shares of ₹10 each fully paid)			1,20,000
Profit & Loss A/c	Dr.	36,000	
To Premium on Redemption of Preference Shares A/c (Being premium on redemption of preference shares adjusted against to Profit & Loss Account)			36,000

Working Note:

- Partly paid-up preference shares cannot be redeemed.
- Amount to be Transferred to Capital Redemption Reserve Account Face value of share to be redeemed

₹1,80,000

Less: Proceeds from fresh issue (excluding premium)

(₹30,000)

₹1,50,000

- No bonus shares on 3,000 equity shares issued for redemption.

Note: Bonus shares does not result in receipt of cash, and hence the increase in share capital on account of bonus issue cannot be considered in determination of amount to be transferred to Capital Redemption Reserve.

Illustration 1

Hinduja Company Ltd. had 5,000, 8% Redeemable Preference Shares of ₹ 100 each, fully paid up. The company decided to redeem these preference shares at par by the issue of sufficient number of equity shares of ₹ 10 each fully paid up at par. You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Solution

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In the books of Hinduja
Company Ltd.
Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
	Bank A/c Dr.	5,00,000	
	To Equity Share Capital A/c (Being the issue of 50,000 Equity Shares of ₹10 each at par for the purpose of redemption of preference shares, as per Board Resolution No. dated...)		5,00,000
	8% Redeemable Preference Share Capital A/c Dr.	5,00,000	
	To Preference Shareholders A/c		5,00,000
	(Being the amount payable on redemption of preference shares transferred to Preference Shareholders Account)		
	Preference Shareholders A/c Dr.	5,00,000	
	To Bank A/c (Being the amount paid on redemption preference of shares)		5,00,000

Illustration 2

C Ltd. had 10,000, 10% Redeemable Preference Shares of ₹ 100 each, fully paid up. The company decided to redeem these preference shares at par, by issue of sufficient number of equity shares of ₹ 10 each at a premium of ₹ 2 per share as fully paid up. You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Solution

In the books of C Ltd.
Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
	Bank A/c Dr.	12,00,000	
	To Equity Share Capital A/c To Securities Premium A/c (Being the issue of 1,00,000 Equity Shares of ₹10 each at a premium of ₹2 per share as per Board's Resolution No..... dated)		10,00,000 2,00,000
	10% Redeemable Preference Share Capital A/c Dr.	10,00,000	
	To Preference Shareholders A/c (Being the amount payable on redemption of preference shares transferred to Preference Shareholders A/c)		10,00,000
	Preference Shareholders A/c Dr.	10,00,000	
	To Bank A/c (Being the amount paid on redemption of preference shares)		10,00,000

Note: Amount required for redemption is ₹10,00,000. Therefore, face value of equity shares to

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be issued for this purpose must be equal to ₹ 10,00,000. Premium received on new issue cannot be used to finance the redemption.

Illustration 3

G India Ltd. had 9,000 10% redeemable Preference Shares of ₹ 10 each, fully paid up. The company decided to redeem these preference shares at par by the issue of sufficient number of equity shares of ₹ 9 each fully paid up.

You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Solution

In the books of G India Limited Journal

Date	Particulars		Dr. (₹)	Cr. (₹)
	Bank A/c To Equity Share Capital A/c (Being the issue of 10,000 Equity Shares of ₹9 each at par, as per Board's Resolution No.....Dated.....)	Dr.	90,000	90,000
	10% Redeemable Preference Shares Capital A/c To Preference Shareholders A/c (Being the amount payable on redemption of preference shares transferred to Preference Shareholders A/c)	Dr.	90,000	90,000
	Preference Shareholders A/c To Bank A/c (Being the amount paid on redemption of preference shares)	Dr.	90,000	90,000

Illustration 4

The Board of Directors of a Company decided to issue minimum number of equity shares of ₹ 9 to redeem ₹ 5,00,000 preference shares. The maximum amount of divisible profits available for redemption is ₹ 3,00,000. Calculate the number of shares to be issued by the company to ensure that the provisions of Section 55 are not violated. Also determine the number of shares if the company decides to issue shares in multiples of ₹ 50 only.

Solution

Nominal value of preference shares	₹
5,00,000	
Maximum possible redemption out of profits	₹
3,00,000	
Minimum proceeds of fresh issue	₹ 5,00,000 – 3,00,000 = ₹
2,00,000	Proceed of one share = ₹9
Minimum number of shares	$\frac{2,00,000}{9} = 22,222.22 \text{ shares}$

As fractional shares are not permitted, the minimum number of shares to be issued is 22,223 shares. If shares are to be issued in multiples of 50, then the next higher figure which is a multiple of 50 is 22,250. Hence, minimum number of shares to be issued in such a case is 22,250 shares.

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Illustration 5

X Ltd. gives you the following information as at 31st March, 2023:

	Particulars	₹
1.	EQUITY AND LIABILITIES	
	Shareholders' funds	
	a Share capital	
	b Reserves and Surplus	2,90,000
	Current liabilities	48,000
	Trade Payables	
2.	ASSETS	
	Property, Plant and EquipmentNon-current investments Current Assets	56,500
1.	Cash and cash equivalents (bank)	3,45,000
2.		18,500
3.		
		31,000

The share capital of the company consists of ₹ 50 each equity shares of ₹ 2,25,000 and ₹ 100 each Preference shares of ₹ 65,000(issued on 1.4.2021). Reserves and Surplus comprises Profit and Loss Account only.

In order to facilitate the redemption of preference shares at a premium of 10%, the Company decided:

- to sell all the investments for ₹ 15,000.
- to finance part of redemption from company funds, subject to, leaving a bank balance of ₹ 12,000.
- to issue minimum equity share of ₹ 50 each share to raise the balance of funds required.You are required to pass the necessary Journal Entries to record the above transactions.

Solution
Journal

Date	Particulars	Dr. (₹)	Cr. (₹)
	Bank A/c Dr. To Share Application A/c (For application money received on 750 shares @ ₹50 per share)	37,500	37,500
	Share Application A/c Dr. To Equity Share Capital A/c (For disposition of application money received)	37,500	37,500

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Preference Share Capital A/c	Dr.		
Premium on Redemption of Preference Shares A/c	Dr.	65,000	
To Preference Shareholders A/c			
(For amount payable on redemption of preference shares)		6,500	71,500
Bank A/c	Dr.		
Profit and Loss A/c (loss on sale) A/c	Dr.	15,000	
To Investment A/c		3,500	
(For sale of investments at a loss of ₹3,500)			18,500
Profit and Loss A/c	Dr.		
To Capital Redemption Reserve A/c		27,500	
(For transfer to CRR out of divisible profits an amount equivalent to excess of nominal value of preference shares over proceeds (face value of equity shares) i.e., ₹65,000 - ₹37,500)			27,500
Preference Shareholders A/c	Dr.		
To Bank A/c		71,500	
(For payment of preference shareholders)			71,500
Profit and Loss A/c	Dr.		
To Premium on Redemption of Preference Shares A/c		6,500	
(For writing off premium on redemption out of profits)			6,500

Working Note:
Calculation of Number of Shares:

₹

Amount payable on redemption (₹65,000 + 10% of ₹65,000)	71,500
Less: Sale price of investment	(15,000)
	56,500
Less: Available bank balance (31,000 - 12,000)	(19,000)
Funds from fresh issue	37,500

☐ No. of shares = 37,500/50 = 750 shares

Illustration 6

The following are the extracts from the Balance Sheet of ABC Ltd. as on 31st December, 2022.

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Share capital: 40,000 Equity shares of ₹ 10 each fully paid – ₹ 4,00,000; 1,000 10% Redeemable preference shares of ₹ 100 each fully paid – ₹ 1,00,000.

Reserve & Surplus: Capital reserve – ₹ 50,000; Securities premium – ₹ 50,000; General reserve – ₹ 75,000; Profit and Loss Account – ₹ 35,000

On 1st January 2023, the Board of Directors decided to redeem the preference shares at par by utilisation of reserve.

You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Solution

In the books of ABC Limited Journal Entries

Date	Particulars		Dr. (₹)	Cr. (₹)
2023 Jan 1	10% Redeemable Preference Share Capital A/c To Preference Shareholders A/c	Dr.	1,00,000	
	(Being the amount payable on redemption transferred to Preference Shareholders Account)			1,00,000
	Preference Shareholders A/c To Bank A/c	Dr.	1,00,000	
	(Being the amount paid on redemption of preference shares)			1,00,000
	General Reserve A/c Profit & Loss A/c	Dr.	75,000	
	To Capital Redemption Reserve A/c	Dr.	25,000	
	(Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)			1,00,000

Note: Securities premium and capital reserve (not being distributable profits) cannot be utilised for transfer to Capital Redemption Reserve.

Illustration 7

C Limited had 3,000, 12% Redeemable Preference Shares of ₹ 100 each, fully paid up. The company had to redeem these shares at a premium of 10%.

It was decided by the company to issue the following:

- (i) 25,000 Equity Shares of ₹ 10 each at par,
- (ii) 1,000 14% Debentures of ₹ 100 each.
- (iii) The issue was fully subscribed and all amounts were received in full. The payment was duly made. The company had sufficient profits. Show Journal Entries in the books of the company.

Solution

In the books of C Limited Journal Entries

Date	Particulars		Dr. (₹)	Cr. (₹)
	Bank A/c	Dr.	2,50,000	

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To Equity Share Capital A/c (Being the issue of 25,000 equity shares of ₹ 10 each at par as per Board's resolution No.....dated.....)		2,50,000
Bank A/c Dr.	1,00,000	
To 14% Debenture A/c (Being the issue of 1,000 Debentures of ₹ 100 each as per Board's Resolution No.....dated.....)		1,00,000
Profit & Loss A/c Dr.	50,000	
To Capital Redemption Reserve A/c (Being the amount transferred to Capital Redemption Reserve Account as per requirement of the Act)		50,000
12% Redeemable Preference Share Capital A/c Dr.	3,00,000	
Premium on Redemption of Preference Shares A/c Dr.	30,000	
To Preference Shareholders A/c (Being the amount payable on redemption transferred to Preference Shareholders Account)		3,30,000
Preference Shareholders A/c Dr.	3,30,000	
To Bank A/c (Being the amount paid on redemption of preference shares)		3,30,000
Profit & Loss A/c Dr.	30,000	
To Premium on Redemption of Preference Shares A/c (Being the adjustment of premium on redemption against Profits & Loss Account)		30,000

Working Note:

Amount to be transferred to Capital Redemption Reserve Account

Face value of shares to be redeemed	3,00,000
Less: Proceeds from new issue	(2,50,000)
Total Balance	<u>50,000</u>

Illustration 8

The capital structure of a company consists of 20,000 Equity Shares of ₹ 10 each fully paid up and 1,000 8% Redeemable Preference Shares of ₹ 100 each fully paid up (issued on 1.4.2021).

Undistributed reserve and surplus stood as: General Reserve ₹ 80,000; Profit and Loss Account ₹ 20,000; Investment Allowance Reserve out of which ₹ 5,000, (not free for distribution as dividend) ₹ 10,000; Securities Premium ₹ 2,000, Cash at bank amounted to ₹ 98,000. Preference shares are to be redeemed at a Premium of 10% and for the purpose of redemption, the directors are empowered to make fresh issue of Equity Shares at par after utilising the undistributed reserve and surplus, subject to the conditions that a sum of ₹ 20,000 shall be retained in general reserve and which should not be utilised.

Pass Journal Entries to give effect to the above arrangements.

Solution

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In the books of
Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
	Bank A/c Dr. To Equity Share Capital A/c (Being the issue of 2,500 Equity Shares of ₹ 10 each at a premium of Re. 1 per share as per Board's Resolution No.....dated.....)	25,000	25,000
	General Reserve A/c Dr. Profit & Loss A/c Dr. Investment Allowance Reserve A/c Dr. To Capital Redemption Reserve A/c (Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)	60,000 10,000 5,000	75,000
	8% Redeemable Preference Share Capital A/c Dr.	1,00,000	
	Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c (Being the amount paid on redemption transferred to Preference Shareholders Account)	Dr. 10,000	1,10,000
	Preference Shareholders A/c To Bank A/c (Being the amount paid on redemption of preference shares)	Dr. 1,10,000	1,10,000
	Profit & Loss A/c Dr. To Premium on Redemption of Preference Shares A/c (Being the premium payable on redemption is adjusted against Profit & Loss Account)	Dr. 10,000	10,000

Working Note:

No of Shares to be issued for redemption of Preference Shares:	
Face value of shares redeemed	₹ 1,00,000
Less: Profit available for distribution as dividend:	
General Reserve: ₹ (80,000-20,000)	₹ 60,000
Profit and Loss (20,000 – 10,000 set aside for adjusting premium payable on redemption of preference shares)	₹ 10,000
Investment Allowance Reserve: (₹ 10,000-5,000)	₹ 5,000
	(₹ 75,000)
	<u>₹ 25,000</u>

Therefore, No. of shares to be issued = ₹ 25,000/₹10 = 2,500 shares.

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Illustration 9

The Balance Sheet of XYZ Ltd. as at 31st December, 2021 information:

inter alia includes the following

	₹
50,000, 8% Preference Shares of ₹100 each, ₹70 paid up	35,00,000
1,00,000 Equity Shares of ₹100 each fully paid up	1,00,00,000
Securities Premium	5,00,000
Capital Redemption Reserve	20,00,000
General Reserve	50,00,000
Bank	15,00,000

Under the terms of their issue, the preference shares are redeemable on 31st March, 2022 at 5% premium. In order to finance the redemption, the company makes a rights issue of 50,000 equity shares of ₹ 100 each at ₹ 110 per share, ₹ 20 being payable on application, ₹ 35 (including premium) on allotment and the balance on 1st January, 2023. The issue was fully subscribed and allotment made on 1st March, 2022. The money due on allotment were duly received by 31st March, 2022. The preference shares were redeemed after fulfilling the necessary conditions of Section 55 of the Companies Act, 2013.

You are asked to pass the necessary Journal Entries. (Ignore date column)

Solution
Journal Entries

		₹	₹
8% Preference Share Final Call A/c To 8% Preference Share Capital A/c (For final call made on preference shares @ ₹ 30 each to make them fully paid up)	Dr.	15,00,000	15,00,000
Bank A/c To 8% Preference Share Final Call A/c (For receipt of final call money on preference shares)	Dr.	15,00,000	15,00,000
Bank A/c To Equity Share Application A/c (For receipt of application money on 50,000 equity shares @ ₹ 20 per share)	Dr.	10,00,000	10,00,000
Equity Share Application A/c To Equity Share Capital A/c (For capitalisation of application money received)	Dr.	10,00,000	10,00,000
Equity Share Allotment A/c To Equity Share Capital A/c To Securities Premium A/c (For allotment money due on 50,000 equity shares @ ₹ 35 per share including a premium of ₹ 10 per share)	Dr.	17,50,000	12,50,000 5,00,000
Bank A/c To Equity Share Allotment A/c	Dr.	17,50,000	17,50,000

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(For receipt of allotment money on equity shares)			
General Reserve A/c To Capital Redemption Reserve A/c (For transfer of CRR the amount not covered by the proceeds of fresh issue of equity shares i.e., 50,00,000 - 10,00,000 - 12,50,000)	Dr.	27,50,000	27,50,000
8% Preference Share Capital A/c	Dr.	50,00,000	
Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c	Dr.	2,50,000	52,50,000
(For amount payable to preference shareholders on redemption at 5% premium)			
Preference Shareholders A/c To Bank A/c	Dr.	52,50,000	52,50,000
(For amount paid to preference shareholders)			
General Reserve A/c To Premium on Redemption A/c	Dr.	2,50,000	2,50,000
(For writing off premium on redemption of preference shares)			

Note: Amount received (excluding premium) on fresh issue of shares till the date of redemption should be considered for calculation of proceeds of fresh issue of shares. Thus, proceeds of fresh issue of shares ₹ 22,50,000 (₹ 10,00,000 application money plus ₹ 12,50,000 received on allotment towards share capital) will be considered.

Illustration 10

With the help of the details in Illustration 9 above and further assuming that the Preference Shareholders holding 2,000 shares fail to make the payment for the Final Call made under Section 55, you are asked to pass the necessary Journal Entries and show the relevant extracts from the balance sheet as on 31st March, 2022 with the corresponding figures as on 31st December, 2021 assuming that the shares in default are forfeited after giving proper notices. (Ignore date column)

Solution

Journal Entries

		₹	₹
8% Preference Share Final Call A/c To 8% Preference Share Capital A/c (For final call made on preference shares @ ₹ 30 each to make them fully paid up)	Dr.	15,00,000	15,00,000
Bank A/c (48,000 x ₹30) Calls in arrears A/c (2,000x ₹30) To 8% Preference Share Final Call A/c (For receipt of final call money on preference shares)	Dr.	14,40,000 60,000	15,00,000

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Preference Share Capital A/c (2000 X ₹100) To Calls in Arrears A/c (2000 X ₹30) To Shares Forefeited A/c (2000 X ₹70) (For Shares Forefeited after shareholders fail to pay the Final Call)	Dr.	2,00,000	60,000 1,40,000
Bank A/c To Equity Share Application A/c (For receipt of application money on 50,000 equity shares @ ₹ 20 per share)	Dr.	10,00,000	10,00,000
Equity Share Application A/c To Equity Share Capital A/c (For capitalisation of application money received)	Dr.	10,00,000	10,00,000
Equity Share Allotment A/c To Equity Share Capital A/c To Securities Premium A/c (For allotment money due on 50,000 equity shares @ ₹ 35 per share including a premium of ₹ 10 per share)	Dr.	17,50,000	12,50,000 5,00,000
Bank A/c To Equity Share Allotment A/c (For receipt of allotment money on equity shares)	Dr.	17,50,000	17,50,000
General Reserve A/c To Capital Redemption Reserve A/c (For transfer of CRR the amount not covered by the proceeds of fresh issue of equity shares i.e., 48,00,000 – 10,00,000 – 12,50,000)	Dr.	25,50,000	25,50,000
8% Preference Share Capital A/c Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c (For amount payable to preference shareholders on redemption at 5% premium)	Dr. Dr.	48,00,000 2,40,000	50,40,000
Preference Shareholders A/c To Bank A/c (For amount paid to preference shareholders)	Dr.	50,40,000	50,40,000
General Reserve A/c To Premium on Redemption A/c (For writing off premium on redemption of preference shares)	Dr.	2,40,000	2,40,000
Shares Forfeited A/c To Capital Reserve A/c (For transferring balance to Capital Reserve A/c after redemption of preference shares)	Dr.	1,40,000	1,40,000

Note: Amount received (excluding premium) on fresh issue of shares till the date of redemption should be considered for calculation of proceeds of fresh issue of shares. Thus, proceeds of fresh issue of shares ₹ 22,50,000 (₹10,00,000 application money plus ₹ 12,50,000 received on allotment towards share capital) will be considered.

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Chapter 11.6 REDEMPTION OF DEBENTURES

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True and False

Quest on 1

Amounts credited to the debenture redemption reserve may be utilised by the company for any purpose.

Answer 1

False: Amounts credited to the debenture redemption reserve should not be utilised by the company for any purpose except for the purpose other than for redemption of debentures.

Quest on 2

All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures need not create any Debenture Redemption Reserve (DRR).

Answer 2

True: All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures need not create any DRR.

Quest on 3

Under payment in instalments method, the payment of entire debenture is made in one lot.

Answer 3

False: under payment in instalments method, the payment of specified portion of debentures are made in instalments at specified intervals.

Quest on 4

At redemption of debentures, DRR should be transferred to general reserve.

Answer 4

True: DRR is transferred to general reserve at the time of redemption of debentures.

Multiple Choice Questions

Quest on 1

Which of the following statements is true?

- (a) A debenture holder is an owner of the company.
- (b) A debenture holder can get his money back only on the liquidation of the company.
- (c) A debenture issued at a discount can be redeemed at a premium.

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Answer: (C)

Quest on 2

Which of the following statements is false?

- (a) Debentures can be redeemed by payment in lump sum at the end of a specified period.
- (b) Debentures cannot be redeemed during the life time of the company.
- (c) Debentures can be redeemed by payments in annual instalments.

Answer: (B)

Quest on 3

For debentures issued by unlisted companies (other than AIFs, Banking companies, NBFCs and HFCs), Debentures Redemption reserve will be considered adequate if it is:

- (a) 25% of the value of debentures issued through public issue.
- (b) 10% of the value of debentures issued through public issue.
- (c) 5% of the value of debentures issued through public issue.

Answer: (B)

Quest on 4

A company has issued 6% debentures for ₹ 10,00,000, interest being payable on 31st March and 30th September. The company redeems ₹ 10,000 debentures at ₹ 96 (ex- interest) on 1st August 2021. The amount of Profit/loss on cancellation of debentures will be

- (a) Profit of ₹ 600.
- (b) Profit of ₹ 400.
- (c) Loss of ₹ 400

Answer: (B)

Theory Questions

Quest on 1

What is meant by redemption of debentures? Explain.

Answer 1

Debentures are usually redeemable i.e. either redeemed in cash or convertible after a time period. Redeemable debentures may be redeemed:

- after a fixed number of years; or
- any time after a certain number of years has elapsed since their issue; or
- on giving a specified notice; or
- by annual drawing.

A company may also purchase its debentures, as and when convenient, in the open market. When the debentures are quoted at a discount on the Stock Exchange, it may be profitable for the company to purchase and cancel them.

Quest on 2

Write short note on Debenture Redemption Reserve.

Answer 2

A company issuing debentures may be required to create a debenture redemption reserve account out of the profits available for distribution of dividend and amounts credited to such account cannot

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be utilised by the company except for redemption of debentures. Such an arrangement would ensure that the company will have sufficient liquid funds for the redemption of debentures at the time they fall due for payment.

An appropriate amount is transferred from profits every year to Debenture Redemption Reserve and its investment is termed as Debenture Redemption Reserve Investment (or Debenture Redemption Fund). In the last year or at the time of redemption of debentures, Debenture Redemption Reserve Investments are encashed and the amount so obtained is used for the redemption of debentures.

Practical Questions

Quest on 1

A company had issued 20,000, 13% debentures of ₹ 100 each on 1st April, 2021. The debentures are due for redemption on 1st July, 2022. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debenture holders to convert 20% of their holding into equity shares (Nominal value ₹ 10) at a price of ₹ 15 per share. Debenture holders holding 2,500 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the debenture holders exercising the option to the maximum.

Answer 1

Calculation of number of equity shares to be allotted

	Number of debentures
Total number of debentures	20,000
Less: Debenture holders not opted for conversion	(2,500)
Debenture holders opted for conversion	17,500
Option for conversion	20%
Number of debentures to be converted (20% of 17,500)	3,500
Redemption value of 3,500 debentures at a premium of	
5% [$3,500 \times (100+5)$]	₹ 3,67,500
Equity shares of ₹ 10 each issued on conversion	
[$₹ 3,67,500 / ₹ 15$]	24,500 shares

Quest on 2

Libra Limited (a listed company) recently made a public issue in respect of which the following information is available:

- No. of partly convertible debentures issued- 2,00,000; face value and issue price- ₹ 100 per debenture.
- Convertible portion per debenture- 60%, date of conversion- on expiry of 6 months from the date of closing of issue.
- Date of closure of subscription lists- 1.5.2021, date of allotment- 1.6.2021, rate of interest on debenture- 15% payable from the date of allotment, value of equity share for the purpose of conversion- ₹ 60 (Face Value ₹ 10).

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(d) No. of debentures applied for- 2,00,000.

(e) Interest payable on debentures half-yearly on 30th September and 31st March.

Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 2022 (including cash and bank entries).

Answer 2

**Journal Entries in the books
of Libra Ltd. Journal Entries**

Date	Particulars	Amount ₹ Dr.	Amount ₹ Cr.
1.5.2021	Bank A/c Dr. To Debenture Application A/c (Application money received on 1,50,000 debentures @ ₹100 each)	2,00,00,000	2,00,00,000
1.6.2021	Debenture Application A/c To 15% Debentures A/c (Allotment of 1,50,000 debentures to applicants and 50,000 debentures to underwriters)	2,00,00,000	2,00,00,000
1.6.2021	Debenture Redemption Investment A/c To Bank A/c (2,00,000 X 100 x 15% X 40%) (Being Investments made for redemption purpose) Dr.	12,00,000	12,00,000
30.9.2021	Debenture Interest A/c To Bank A/c (Interest paid on debentures for 4 months @ 15% on ₹ 2,00,00,000) Dr.	10,00,000	10,00,000
31.10.2021	15% Debentures A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Conversion of 60% of debentures into shares of ₹60 each with a face value of ₹10)	1,20,00,000	20,00,000 1,00,00,000
31.3.2022	Debenture Interest A/c Dr. To Bank A/c (Interest paid on debentures for the half year) (Refer working note)	7,50,000	7,50,000

Working Note:

Calculation of Debenture Interest for the half year ended 31st March, 2022

On ₹ 80,00,000 for 6 months @ 15% = ₹6,00,000

On ₹1,20,00,000 for 1 months @ 15% = ₹1,50,000

₹7,50,000

Quest on 3

Case Ltd. (unlisted company other than AIFI, Banking company, NBFC and HFC) provides the

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following information as at 31st March, 2022:

Particulars	₹
Shareholder's Funds	
(a) Share Capital Authorized share capital: 45,000 equity shares of ₹ 10 each fully paid Issued and subscribed share capital: 30,000 equity shares of ₹ 10 each fully paid	4,50,000
(b) Reserves and Surplus Profit & Loss Account	3,00,000
	1,62,000
Debenture Redemption Reserve	18,000
Non-current liabilities	
(a) Long term borrowings	
12% Debentures	1,80,000
Current Liabilities	
(a) Trade payables	1,72,500
Non-current assets	
(a) Property, Plant and Equipment (Freehold property)	1,72,500
(b) Non-current Investment: DRR Investment	27,000
Current assets	
(a) Inventories	2,02,500
(b) Trade receivables	1,12,500
(c) Cash and bank balances:	
Cash at bank	2,73,000
Cash in hand	45,000

At the Annual General Meeting on 1.4.2022, it was resolved:

- (a) To give existing shareholders the option to purchase one ₹ 10 share at ₹ 15 for every four shares (held prior to the bonus distribution). This option was taken up by all the shareholders.
- (b) To issue one bonus share for every five shares held.
- (c) To repay the debentures at a premium of 3%.

Give the necessary journal entries for these transactions.

Answer 3

Journal Entries in the Books of Case Ltd.

	Dr. ₹	Cr. ₹
Bank A/c To Equity Shareholders A/c (Application money received on 7,500 shares @ ₹15 per share to be issued as rights shares in the ratio of 1:4)	Dr. 1,12,500	1,12,500
Equity Shareholders A/c To Equity Share Capital A/c To Securities Premium A/c (Share application money on 7,500 shares @ ₹ 10 per share transferred to)	Dr. 1,12,500	75,000 37,500

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Share Capital Account, and ₹5 per share to Securities Premium Account vide Board's Resolution dated...)			
Securities Premium A/c	Dr.	37,500	
Profit & Loss A/c	Dr.	37,500	
To Bonus to Shareholders A/c (Amount transferred for issue of bonus shares to existing shareholders in the ratio of 1:5 vide General Body's resolution dated...)			75,000
Bonus to Shareholders A/c	Dr.	75,000	
To Equity Share Capital A/c (Issue of bonus shares in the ratio of 1 for 5 vide Board's resolution dated.....)			75,000
12% Debentures A/c	Dr.	1,80,000	
Premium Payable on Redemption A/c (@ 3%)	Dr.	5,400	
To Debenture holders A/c			1,85,400
(Amount payable to debentures holders)			
Profit and loss A/c	Dr.	5,400*	
To Premium Payable on Redemption A/c			5,400
(Premium payable on redemption of debentures charged to Profit & Loss A/c)			
Debenture Redemption Reserve A/c	Dr.	18,000	
To General Reserve			18,000
(For DRR transferred to general reserve)			
Bank A/c	Dr.	27,000	
To Debenture Redemption Reserve Investment			27,000
(for DRR Investment realised)			
Debenture holders A/c	Dr.	1,85,400	
To Bank A/c			1,85,400
(Amount paid to debenture holders on redemption)			

* In the absence of details of the term of debentures (redemption period), the entire redemption premium was charged to profit & loss A/c of the year.

ILLUSTRATION 1

The following balances appeared in the books of a company (unlisted company other than AIFI, Banking company, NBFC and HFC) as on December 31, 2021: 6% Mortgage 10,000 debentures of ₹ 100 each; Debenture Redemption Reserve (for redemption of debentures) ₹ 50,000; Investments in deposits with a scheduled bank, free from any charge or lien ₹ 1,50,000 at interest 4% p.a. receivable on 31st December every year. Bank balance with the company is ₹ 9,00,000.

The Interest on debentures had been paid up to December 31, 2021.

On February 28, 2022, the investments were realised at par and the debentures were paid off at 101, together with accrued interest.

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Write up the concerned ledger accounts (excluding bank transactions). Ignore taxation.

SOLUTION

6% Mortgage Debentures Account

2022			₹	2022			₹
Feb. 28	To	Debenture-holders A/c	10,00,000	Jan. 1	By	Balance b/d	10,00,000

Premium on Redempt on of Debentures Account

2022			₹	2022			₹
Feb. 28	To	Debenture-holders A/c	10,000	Feb. 28	By	Profit and loss A/c	10,000

Debentures Redemption Reserve Investment Account

2022			₹	2022			₹
Jan. 1	To	Balance b/d	1,50,000	Feb. 28	By	Bank	1,50,000

Debenture Interest Account

2022			₹	2022			₹
Feb. 28	To	Bank (10,000 x 100 x 6% x 2/12)	10,000	Feb. 28	By	Profit & Loss A/c	10,000

Bank A/c

2022			₹	2022			₹
Jan 01	To	Balance b/d	9,00,000	Feb. 28	By	Debenture-holders (10,000 x 101)	10,10,000
Feb 28	To	Interest on Debentures Redemption Investments (1,50,000 x 4% x 2/12)	1,000				
	To	Debentures Redemption Reserve investment A/c	1,50,000		By	Debenture Interest A/c	10,000
					By	Balance c/d	31,000
			10,51,000				10,51,000

Debenture Redempt on Reserve Account

2022			₹	2022			₹

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Feb 28	To	General Reserve-note	1,00,000	Jan.1 Jan.1	By	Balance b/d	50,000
			<u>1,00,000</u>		By	Profit & Loss (b/f)	<u>50,000</u> 1,00,000

Note

Amount to be transferred to DRR before the redemption = ₹ 1,00,000 [i.e. 10% of (10,000 X 100)].

ILLUSTRATION 2

The following balances appeared in the books of Paradise Ltd (unlisted company other than AIFI, Banking company, NBFC and HFC) as on 1-4-2021:

- (i) 12 % Debentures ₹ 7,50,000
- (ii) Balance of DRR ₹ 25,000
- (iii) DRR Investment 1,12,500 represented by 10% ₹ 1,125 Secured Bonds of the Government of India of ₹ 100 each.

Annual contribution to the DRR was made on 31st March every year. On 31-3-2022, balance at bank was ₹ 7,50,000 before receipt of interest. The investment were realised at par for redemption of debentures at a premium of 10% on the above date.

You are required to prepare the following accounts for the year ended 31st March, 2022:

- (1) Debentures Account
- (2) DRR Account
- (3) DRR Investment Account
- (4) Bank Account
- (5) Debenture Holders Account.

SOLUTION
1. 12% Debentures Account

Date	Particulars	₹	Date	Particulars	₹
31 st March, 2022	To Debenture holders A/c	7,50,000	1 st April, 2021	By Balance b/d	7,50,000
		<u>7,50,000</u>			<u>7,50,000</u>

2. DRR Account

Date	Particulars	₹	Date	Particulars	₹
31 st March, 2022	To General reserve A/c (Refer Note)	75,000	1 st April, 2021	By Balance b/d	25,000
			1 st April, 2021	By Profit and loss A/c (Refer Note)	50,000

3. 10% Secured Bonds of Govt. (DRR Investment) A/c

		₹			₹
1 st April, 2021	To Balance b/d	1,12,500	31 st March, 2022	By Bank A/c	1,12,500
		<u>1,12,500</u>			<u>1,12,500</u>

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4. Bank A/c

		₹			₹
31 st March, 2022	To Balance b/d	7,50,000	31 st March, 2022	By Debenture holders A/c	8,25,000
	To Interest on DRR Investment (1,12,500 x 10%)	11,250		By Balance c/d	48,750
	To DRR Investment A/c	1,12,500			
		8,73,750			8,73,750

5. Debenture holders A/c

		₹			₹
31 st March, 2022	To Bank A/c	8,25,000	31 st March, 2022	By 12% Debentures	7,50,000
				By Premium on redemption of debentures (7,50,000 X 10%)	75,000
		8,25,000			8,25,000

Note—

Calculation of DRR before redemption = 10% of ₹7,50,000 = 75,000

Available balance = ₹25,000

DRR required = 75,000 – 25,000 = ₹50,000.

ILLUSTRATION 3

XYZ Ltd. has issued 1,000, 12% convertible debentures ₹100 each redeemable after a period of five years. According to the terms & conditions of the issue, these debentures were redeemable at a premium of 5%. The debenture holders also had the option at the time of redemption to convert 20% of their holdings into equity shares of ₹ 10 each at a price of ₹ 20 per share and balance in cash. Debenture holders amounting ₹ 20,000 opted to get their debentures converted into equity shares as per terms of the issue. You are required to calculate the number of shares issued and cash paid for redemption of ₹ 20,000 debenture holders.

SOLUTION

	Number of debentures
Debenture holders opted for conversion (20,000 /100)	200
Option for conversion	20%
Number of debentures to be converted (20% of 200)	40
Redemption value of 40 debentures at a premium of 5% [40 x (100+5)]	₹ 4,200
Equity shares of ₹10 each issued on conversion [₹4,200/ ₹20]	210 shares

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Calculation of cash to be paid :

	₹
Number of debentures	200
Less: number of debentures to be converted into equity shares	(40)
	<u>160</u>

Redemption value of 160 debentures (160 × ₹105) ie. ₹16,800.

ILLUSTRATION 4

The Balance Sheet of BEE Co. Ltd. (unlisted company other than AIFI, Banking company, NBFC and HFC) as at 31st March, 2021 is as under:

Particulars	Note No	₹
I. Equity and liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	2,00,000
(b) Reserves and Surplus	2	1,20,000
(2) Non-current liabilities		
(a) Long term borrowings	3	1,20,000
(3) Current Liabilities		
(a) Trade payables		1,15,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	4	1,15,000
(2) Current assets		
(a) Inventories		1,35,000
(b) Trade receivables		75,000
(c) Cash and bank balances	5	2,30,000
Total		<u>5,55,000</u>

Notes to Accounts

	₹
1. Share Capital	
Authorised share capital	
30,000 shares of ₹10 each fully paid	<u>3,00,000</u>
Issued and subscribed share capital	
20,000 shares of ₹10 each fully paid	<u>2,00,000</u>
2. Reserve and Surplus	
Profit & Loss Account	1,20,000
3. Long term borrowings	
12% Debentures	1,20,000
4. Property, Plant and Equipment	
Freehold property	1,15,000

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5.	Cash and bank balances		
	Cash at bank	2,00,000	
	Cash in hand	<u>30,000</u>	2,30,000

At the Annual General Meeting, it was resolved:

- To give existing shareholders the option to purchase one ₹ 10 share at ₹ 15 for every four shares (held prior to the bonus distribution). This option was taken up by all the shareholders.
- To issue one bonus share for every five shares held.
- To repay the debentures at a premium of 3%.

Give the necessary journal entries for these transactions.

SOLUTION

Journal of BEE Co. Ltd.

		Dr. ₹	Cr. ₹
Bank A/c	Dr.	75,000	
To Equity Shareholders A/c			75,000
(Application money received on 5,000 shares @ ₹15 per share to be issued as rights shares in the ratio of 1:4)			
Equity Shareholders A/c	Dr.	75,000	
To Equity Share Capital A/c			50,000
To Securities Premium A/c			25,000
(Share application money on 5,000 shares @ ₹ 10 per share transferred to Share Capital Account, and ₹ 5 per share to Securities Premium Account vide Board's Resolution dated...)			
Securities Premium A/c	Dr.	25,000	
Profit & Loss A/c	Dr.	25,000	
To Bonus to Shareholders A/c			50,000
(Amount transferred for issue of bonus shares to existing shareholders in the ratio of 1:5 vide General Body's resolution dated...)			
Bonus to Shareholders A/c	Dr.	50,000	
To Equity Share Capital A/c			50,000
(Issue of bonus shares in the ratio of 1 for 5 vide Board's resolution dated.....)			
Profit and Loss A/c	Dr.	12,000	
To Debenture Redemption Reserve			12,000
(for DRR created 10% x 1,20,000)			
Debenture Redemption Reserve Investment A/c	Dr.	18,000	
To Bank A/c			18,000
(for DRR Investment created 15% x 1,20,000)			
12% Debentures A/c	Dr.	1,20,000	
Premium Payable on Redemption A/c @ 3%	Dr.	3,600	
To Debenture holders A/c			1,23,600

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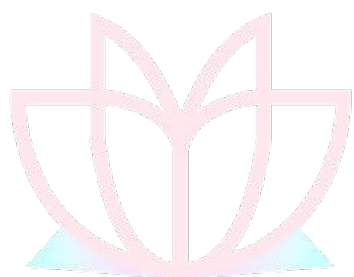
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(Amount payable to debentures holders)			
Profit and loss A/c	Dr.	3,600*	
To Premium Payable on Redemption A/c			3,600
(Premium payable on redemption of debentures charged to Profit & Loss A/c)			
Debenture Redemption Reserve A/c	Dr.	12,000	
To General Reserve			12,000
(for DRR transferred to general reserve)			
Bank A/c	Dr.	18,000	
To Debenture Redemption Reserve Investment			18,000
(for DRR Investment realised)			
Debenture holders A/c	Dr.	1,23,600	
To Bank A/c			1,23,600
(Amount paid to debenture holders on redemption)			

*In the absence of details of the term of debentures (redemption period), the entire redemption premium was charged to profit & loss A/c of the year.



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