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FUNDAMENTALS OF ACCOUNTING

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संदेश

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Welcome to YES Family!!

To begin with, we endorse our heartfelt thank you for showing your trust and confidence in YES Academy. We take pride to welcome you to this prestigious Academy, foundations of which are based on commitment, quality education and integrity. It has been our constant endear our to deliver better and better. In our attempt to achieve mark of excellence and beyond, we would be even more grateful to have received your continued faith and love. We assure you, your trust will not go in vain and as reflected by our Vision Statement, we would continue to produce Best Company Secretaries as we have been doing for almost a decade now.

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On behalf of TEAM YES

CS VIKAS VOHRA
(Founder)

CA CS HARISH A. MATHARIYA
(Founder)

FROM THE AUTHOR

- *This book is for all the students aspiring to make the grade in the Professional Examination.*
- ***FUNDAMENTALS OF ACCOUNTING** subject is both interesting & easy to understand.*
- *This subject has utility value in day-to-day commercial activities.*
- *Trends shows that, there is a scope for securing high-score in this subject.*
- *This book is not a substitute for the Study Material prescribed by the Institute, as I believe,*
- ***"There is no short cut to success"***

DEDICATED TO

- ***To my Family:** "Who are Divine Source of Power to me, who always stood beside me in every phase of my Life"*
- ***To My Love:** Manisha Soni*
- ***Most special regards:** Parents gave me birth, you gave me the identity. I am, who I am is because of all of you, my most lovable STUDENTS.*
- ***To My Competitors:** who gave me the ability to sharpen my skills and improve each day*

"The only person you are destined to become is the person you decide to be"

I believe these words shall motivate you throughout this journey

HOW TO STUDY?

Step 1

- *Develop a liking for the subject, for this you need to be; **Regular in class** & Write down all notes neatly.*

Step 2

- *For each topic spend proper time in reading the theory part (concept)*
- *Before solving problems read question very slowly then decide approach to solve it.*
  - *Read problem with high concentration giving importance to every punctuation*
  - *Remembering contents of question until the solution is competed; for each step you should be able to immediately pick up data without a second reading.*
  - *Visualizing steps for the solution, the layout, tabulation format, number of columns, etc.*
  - *Maintain good speed so that solution is completed within time (5 marks = 8 minutes.)*
- *Write down your solutions in a note book. Do not jump to see the solution.*

Step 3

- *After you finish a topic, prepare summary notes (covering all important points)*
- *"Revise" your hand-made summary notes periodically then "Try to Recall"*
- *Solve Topic-wise Test*

Step 4

- *Before your exams revisit summary notes & all-important problems as many times as possible.*
- *Solve two or three past exam question papers and solve them under simulated exam conditions so that you get smooth, flow of thoughts, hand – mind coordination and most importantly confidence*

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INDEX

Topic 1 BASIC CONCEPTS & PRINCIPLES OF ACCOUNTING

UNIT 1 – INTRODUCTION TO ACCOUNTING

A. INTRODUCTION

- Accounting is used by business entities for keeping records of their money or financial transactions.
- A businessman would like to know whether his business is making profit or not.
- The position of his assets and liabilities and whether his capital in the business has increased or decreased during a particular period.
- Every person in his day-to-day life performs some sort of Economic Activity, such economic activities are performed through 'transactions and events'.
- Transaction is used to mean an exchange in money or money's worth, while event is used to mean 'a happening, as a consequence of transaction(s), a result.'

THUS, Accounting involves:

- **Identifying** – Spotting transactions that have a financial effect.
- **Measuring** – Expressing them in monetary terms.
- **Recording** – Entering them systematically in the books.
- **Communicating** – Presenting them in financial statements so that users can make decisions.

SIGNIFICANCE OF ACCOUNTING

1. **Decision-Making Tool for Management**

   Accounting provides **accurate financial data**, to plan, budget, and control resources effectively & **management can decide** whether to launch new products, cut costs, expand operations, or enter new markets.

2. **Ensures Accountability to Shareholders and Society**

   Accounting ensures that they are informed about how their invested funds are being used (Via Annual Reports)

3. **Compliance with Laws & Regulations**

   Accounting ensures that books are maintained as per prescribed standards and that reports are filed on time, avoiding legal penalties.

4. **Facilitates Taxation and Government Planning**

   Governments rely on accounting records to assess taxes like GST, income tax, and corporate tax. Additionally, aggregated business data helps in policy formulation and economic planning.

5. **Performance Evaluation of Business**

By comparing current results with past data or industry benchmarks, accounting helps evaluate efficiency, profitability, and financial health.

6. **Historical Record for Future References**

Accounting creates a permanent record of all business transactions, which is useful for audits, resolving disputes, applying for loans, or strategic planning.

B. SOME BASIC TERMS OF ACCOUNTING

Business:

- It is the set of activities for earning profit (Profit Motive).
- Regularly carried on by a person or an organization for the Purpose of earning profits from such activities

  Example – A Mango shop owner regularly purchase mango & sells it to his customers.

  Business may be:

  - Manufacturing – Purchasing Raw Materials, Converting them into finished Goods and selling the goods.
  - Trading – Buying finished Goods and selling them as such without any conversion.
  - Service – Rendering services to clients E.g. Doctors, Chartered Accountants etc.

Goods

- Products / Articles / Items which are regularly traded by the businessman are called "Goods".
- Eg. For a Computer Shop owner, computers are "goods", as he regularly purchases and sells them.
- However, for the same Computer shop owner, if he purchases one Tempo for carrying the laptops, then the tempo is not considered as goods for him.

Finished goods

For Manufacturer: Products manufactured by the manufacturer.

For a trader: Goods purchased and sold by him are called finished goods.

Purchase (from purchaser's point of view)

It refers to Buying of finished goods / raw materials by one person from another person for consideration. Sale for one person is the purchase for another person.

Sales (from seller's point of view)

"sales" refers to Transfer of ownership in goods from one person to another for a consideration"

Thus, following 3 Conditions for sale are –

(a) Transfer of ownership (refer below)
(b) Ownership must be in goods (refer above)
(c) Consideration: some money or money's worth must be given by one person to another.

Transfer of ownership: ownership in goods is transferred when the risks of loss and rewards relating to such goods are transferred.

Assets

- **In Technical Language:** An Asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.
- **In General Language:** Properties of the business / Amounts receivable from others by the business Eg. Stock, Land, Building, Debtors, Receivables, etc

Debtors

- Persons from whom the business has to receive money

Liabilities

- Amounts Payable by the business to outsiders and includes capital. For eg. Bank loans, Expenses not yet paid

Creditors

- Persons to whom the business has to pay money

Capital

- Amount Invested by the owner into the business

Drawings

- Cash / Goods / Assets drawn by the owner for his personal purpose is called as Drawing. It decreases the capital.

Profits

- Profit =Incomes – Expenses

Income / revenue

- Amount received or receivable due to sales made OR
- Any other amount receivable arising out of the regular operations of the business. For eg. Interest, commission due or received, etc.

Expenses

- Amount spent for benefits for an accounting period. For eg. Rent paid

Losses

- Amount spent but no benefits is derived / amount not recoverable from debtors. For eg. Bad Debt, Stocks lost due to earthquake

Bank overdraft

- First of all, Bank O/D is bank Account.
- Example: However, in this account, holder is allowed to withdraw over and above the existing balance. For eg. Assume that Mr. Ritesh has a balance of Rs. 20,000 in his Bank Account. If he draws a cheque for Rs. 25,000, normally it will be rejected by the bank. However, if the account has overdraft (O/D) facility, then the bank will pay 25,000 on the cheque, instead of insufficient balance.
- Bank O/D is current Liability

Current assets

- Are the assets which are easily convertible into cash or cash equivalents within a single accounting period.
- Eg. Bank Balance, debtors, Bills receivables, etc.

Current liabilities

- Are the liabilities which are payable within the single accounting period.
- Eg. Creditors, Bank Overdraft, Bills Payable, etc.
- Working Capital= Current Assets – Current Liability

Fixed assets

- Are Long Term Assets which are expected to be used in the business for a longer period of time (Generally more than one Accounting period).
- Fixed Assets are meant for usage in business for production/rendering of service etc.
- Eg. Machinery, Building, Land, Car, etc

Inventory

- Inventory is technical term for "stock" (Unsold Goods/ Unused raw material).
- It includes Raw Material stock, work in progress and finished goods stock

Depreciation

- Decrease in the value of fixed Assets gradually due to wear and tear, use, passage of time, obsolescence (due to innovations & Technology) and other related factors.

Solvency

- Solvency is ability of the to meets its Total Liabilities i.e. Assets are > Liabilities

Window dressing

- Manipulating the financial statements to attract investments
- Inflating incomes, suppressing the expenses, treating revenue expenses as capital

Holding gains

- Holding gains are the notional gains arising due to increase in prices of inventory held in the business.
- Example: Mr. X has 1,000 kgs of onion in stock. They are bought at Rs. 25/ kg. they are sold for 15 days month. Then, market price is Rs. 80/kg. In this case, if the stocks are sold at the end of one month, then X can earn a profit of Rs.55/kg. Since this profit is not realized as sale is not actually made and they are just kept in stock.

Notional

- It is not realized and may be earned if some event happens.
- In the above example, if sale happened then Rs. 25 per kg is earned. Till the actual sale, it is only a Notional Profits.

Cost / Historical cost

- It represents the amount actually spent or the liability actually incurred.
- Example: Assume that a plot of land is purchased for Rs. 50,000, but its market value is Rs. 150,000. In this case, the Historical cost is Rs. 50,000 only.

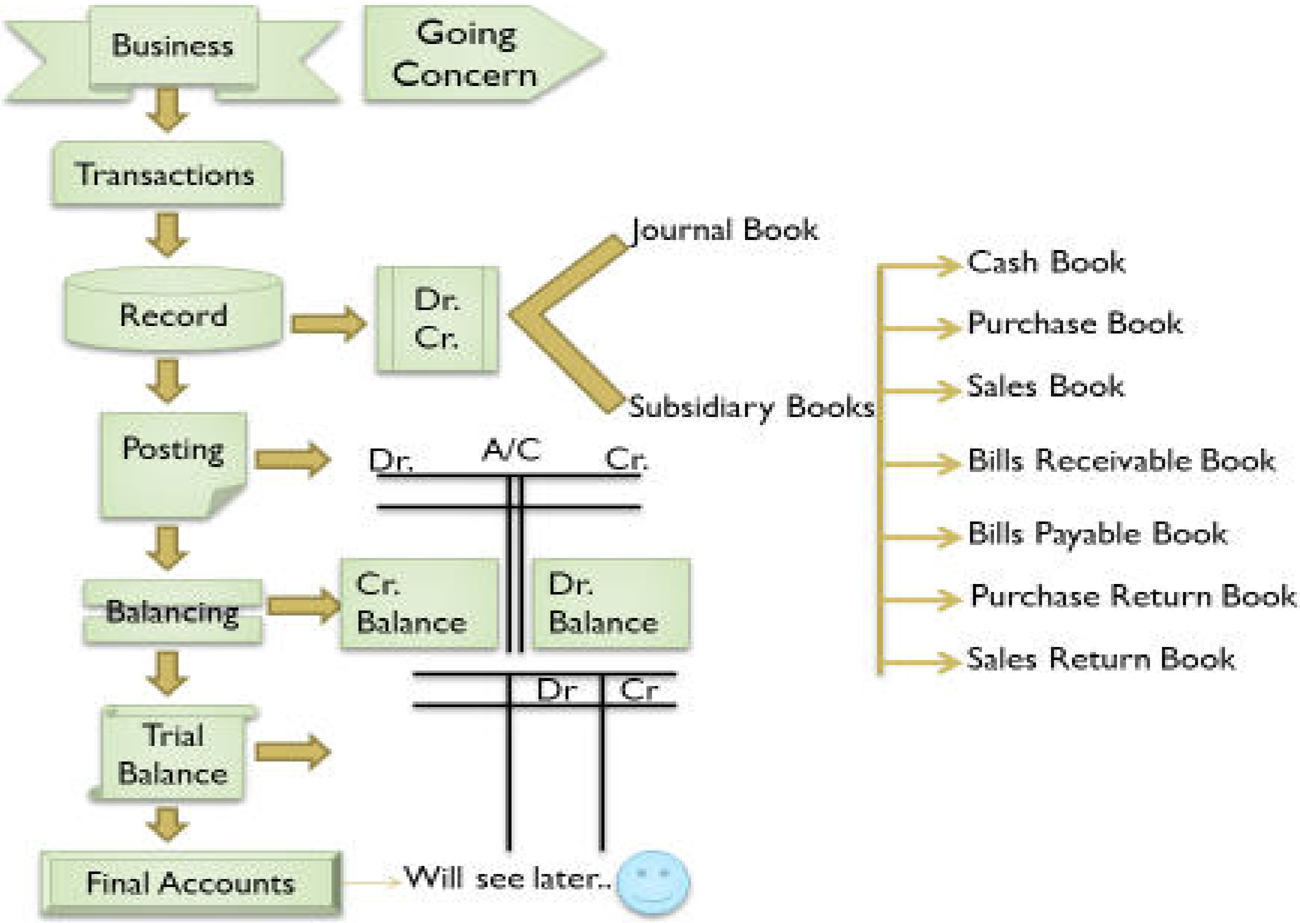
Raw Materials

- It refers to the base material from which finished goods are manufactured.
- Example –(RM) Wood used in pencil & here pencils are finished goods
- For a trader, there is no raw material as he does not produce anything.
- It Applies only for manufacturing business

Stock

- Stock is unsold finished goods / Raw materials at the beginning or end of a period.
- Closing stock – stock at the end of a specified period.
- Opening stock – Stock at the beginning of the period.
- Example – Ritu purchased 500 kgs of sugar in 2014. He sold 300 kgs throughout in 2014. In this case, the stock on 31.12. 2014 is 200 kgs, is opening stock on 01.01.2015.

C. ACCOUNTING PROCEDURE



D. MEANING OF ACCOUNTING

- "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."
- Thus, accounting may be defined as the process of recording, classifying, summarising, analysing and interpreting the financial transactions and communicating the results thereof to the persons interested in such information.

Accounting involves:

- **Art**: It involves judgment, skill, and creativity in presenting financial information.
- **Recording**: Chronological documentation of financial transactions.
- **Classifying**: Systematic arrangement of transactions in ledgers.
- **Summarizing**: Preparing trial balances, profit & loss accounts, and balance sheets.
- **Interpreting**: Analysing the data to aid decision-making.

E. SCOPE OF ACCOUNTING (ACCOUNTING INVOLVES)

1. **Recording of Transactions** — The systematic process of capturing all financial transactions in the books of original entry, such as journals or cash books, to ensure a complete and chronological record.
2. **Classification and Summarization** — Organising recorded transactions into relevant categories by posting them to appropriate ledger accounts and then preparing summaries like the trial balance.
3. **Financial Reporting** — Preparing and presenting periodic financial statements, including the profit and loss account, balance sheet, and cash flow statement, to communicate the financial position and performance of the entity.
4. **Compliance with Laws and Standards** — Ensuring that the accounting process adheres to applicable legal requirements, such as the Companies Act and the Income Tax Act, as well as prescribed accounting standards (AS/Ind AS).
5. **Decision Support** — Supplying accurate and relevant financial data to assist management in planning, budgeting, performance evaluation, and strategic control.
6. **Safeguarding Assets** — Implementing proper record-keeping and internal control systems to prevent misuse, loss, or theft of the organisation's resources.
7. **Facilitating Auditing** — Maintaining clear and complete accounting records that enable auditors to verify the accuracy, completeness, and fairness of the financial statements.
8. **Assisting in Taxation** — Providing precise financial information to calculate taxable income and meet various tax obligations accurately and on time.

F. EVOLUTION OF ACCOUNTING AS A SOCIAL SCIENCE:

Understanding Accounting as a Social Science

Accounting falls into this category because accounting:

- **Shapes human decisions** — Investors decide whether to invest, governments decide how much tax to collect, and creditors decide whether to lend— all based on accounting reports.
- **Reflects society's economic activities** — The way we record and report financial transactions depends on the culture, laws, and economic systems we live in.
- **Promotes transparency and trust** — Just like rules in a game keep it fair, accounting rules ensure businesses play fair with money.

Key points:

- It's **normative** (guided by rules & standards such as IFRS, Ind AS).
- It's **empirical** (based on actual financial transactions).
- It impacts **resource allocation** in society.

HISTORICAL DEVELOPMENTOF ACCOUNTING

Ancient Civilizations:

- **Mesopotamia (circa 3500 BCE)** — Clay tablets recorded trade and taxes.
- **Egypt** — Used papyrus for recording grain storage and state revenues.
- **India** — The "Bahi-Khata" (traditional ledger) used in kingdoms.
- **Greece & Rome** — Public funds and treasury records maintained for accountability.

Middle Ages:

- **Double Entry System (1494)** formalized by *Luca Pacioli*, known as the "Father of Accounting."

Industrial Revolution (18th–19th century):

- Increased scale of business ⟶ Need for cost accounting, managerial reporting, and auditing.

20th Century:

- Rise of corporate accounting, auditing standards, stock market regulation.
- GAAP, IFRS, and accounting bodies established.

21st Century:

- Accounting integrated with **technology** (ERP, AI, blockchain).
- Focus on sustainability (Integrated Reporting, ESG reporting).
- Greater role in governance and social responsibility.

G. OBJECTIVES OF ACCOUNTING

- **Systematic recording of transactions** — Basic objective of accounting is to systematically record the financial aspects of business transactions i.e. book-keeping.
- **Ascertainment of results of above recorded transactions** —If revenue exceed expenses then it is said that business is running profitably otherwise loss. The profit and loss account helps the management and different stakeholders in taking rational decisions.
- **Ascertainment of the financial position of the business** —Financial position statement popularly known as Balance Sheet. The balance sheet is a statement of assets and liabilities of the business at a particular point of time and helps in ascertaining the financial health of the business.
- **Providing information** to the users for rational decision-making — Accounting as a 'language of business' communicates the financial results of an enterprise to various stakeholders by means of financial statements.
- **To know the solvency position** —B/S gives the information regarding concern's ability to meet its liabilities in the short run (liquidity position) and also in the long-run (solvency position) as and when they fall due.
- **Compliance with Laws** — Ensuring adherence to statutory requirements like the

Companies Act, SEBI rules, and tax laws.

- **Assisting in Decision-Making** – Helping management plan, control, and strategise using accounting reports.
- **Safeguarding Assets** – Preventing misuse or loss of resources through proper records and internal controls.

H. FUNCTIONS OF ACCOUNTING

- Measurement: Accounting measures past performance of the business entity and depicts its current financial position.
- Forecasting: Accounting helps in forecasting future performance and financial position of the enterprise using past data.
- Decision-making: Accounting provides relevant information to the users of accounts to aid rational decision-making.
- Comparison & Evaluation: Accounting assesses performance achieved in relation to targets and discloses information regarding accounting policies and contingent liabilities which play an important role in predicting, comparing and evaluating the financial results.
- Control: Accounting also identifies weaknesses of the operational system and provides feedbacks regarding effectiveness of measures adopted to check such weaknesses.
- Government Regulation and Taxation: Accounting provides necessary information to the government to exercise control on entity as well as in collection of tax revenues.

I. BOOK-KEEPING

- Book-keeping is concerned with the recording of financial data relating to business operations in a significant and orderly manner.
- It covers procedural aspects of accounting work & embraces record keeping function
- Book-keeping procedures are governed by the end product, the financial statements.
- Book-keeping also requires suitable classification of transactions and events.
- A book-keeper may be responsible for keeping all the records of a business
- Accounting is based on a careful and efficient book-keeping system.
- Therefore, in book-keeping, is indispensable for any business.

J. OBJECTIVES OF BOOK-KEEPING

- Complete Recording of Transactions – It is concerned with complete and permanent record of all transactions in a systematic and logical manner to show its financial effect on the business.

- **Ascertainment of Financial Effect on the Business** – It is concerned with the combined effect of all the transactions made during the accounting period upon the financial position of the business as a whole.

  - Relationship between & Accounting can be explained with help of following diagram:

Difference between Book-Keeping and Accounting can be explained as follows:

Book Keeping	Accounting
Recording transactions	Summarizing of the recorded transactions.
Work mainly routine and clerical in nature	Reqd. higher level of knowledge
Book-keeping constitute the base for accounting.	Language of business.
To follow Basic accounting concepts and conventions.	The methods and procedures for accounting may vary from firm to firm.
Financial statements not form part of book-keeping	Financial statements are prepared from the bookkeeping records.
Financial position of the business cannot be ascertained	To ascertained Financial position of the business

K. SUB-FIELDS OF ACCOUNTING

1. **Financial Accounting** – Preparation of financial statements for external users.
2. **Cost Accounting** – Recording, classification, and analysis of production costs.
3. **Management Accounting** – Providing internal reports to assist managerial decisions.
4. **Tax Accounting** – Preparing returns and tax planning.
5. **Auditing** – Independent examination of accounts.
6. **Forensic Accounting** – Investigating financial frauds.

7. **Environmental & Social Accounting** — Reporting on sustainability and social impact.
8. **Government Accounting** — Public sector revenue and expenditure recording.

L. USERS OF ACCOUNTING INFORMATION

- Owners/Shareholders: The primary aim of accounting is to provide necessary information to the owners related to their business.
- Managers: In large business organizations and in corporations, there is a separation of ownership and management functions. The managers of such business houses are more concerned with the accounting information because they are answerable to the owners.
- Prospective Investors: The persons who are contemplating an investment in a business will like to know about its profitability and financial position.
- Creditors, Bankers and other Lending Institutions: Trade creditors, bankers and other lending institutions would like to be satisfied that they will be paid on time.
- Government: The Government is interested in the financial statements of business enterprise on account of taxation, labour and corporate laws.
- Employees: Employees are interested in financial statements because increase in their salaries & wages and payment of bonus depends on the size of the profit earned.
- Regulatory Agencies: Various Government departments and agencies use accounting reports not only as a basis for tax assessment but also in evaluating how well various businesses are operating under regulatory legislation.
- Researchers: Accounting data are also used by the research scholars in their research in accounting theory as well as business affairs and practices.
- Customers: Customers may also have interest in the business entity to know the profitability, liquidity and solvency position of the company.

M. RELATIONSHIP OF ACCOUNTING WITH OTHER DISCIPLINES

Accounting & Mathematics

- Basic arithmetic and algebra used in calculations (totals, ratios, depreciation).
- No higher-level pure math needed, but accuracy is essential.

Accounting & Statistics

- Statistical tools used for trend analysis, forecasting, sampling in audits.

Accounting & Management

- Provides quantitative data for managerial planning, organizing, controlling.

Accounting & Law

- Must comply with Company Law, Tax Laws, SEBI regulations, etc.
- Legal framework dictates accounting disclosures.

Accounting & Economics

- Reflects and influences economic activities.
- Helps in economic policy formulation.

N. LIMITATIONS OF ACCOUNTING

- Accounting information is expressed in terms of money only: Non-monetary items or events which cannot be measured are not recorded in accounting.
- Accounting information is based on estimates
- Accounting information may be biased: Accounting information is not without personal influence or bias of the accountant. Hence, income arrived at may not be correct in certain cases.
- Fixed assets are recorded at the original cost: The values of fixed assets change over time and so there may be a great difference between the original cost and current replacement cost.
- Accounting can be manipulated: Accounting information may not be used as the only test of managerial performance as profits can be manipulated or misrepresented.
- Money as a measurement unit changes in value
- Financial statements consider only those assets which can measure in money. Human resources although the very important asset of the enterprise are not shown in the balance sheet.
- There are occasions when accounting principles conflict with each other.
- Balance Sheet shows the position of the business on the day of its preparation and not on the future date
- **Inadequate for Inflation:** Accounting follows historical cost principle and does not automatically adjust for changes in purchasing power due to inflation. This can understate asset values and overstate profits.
- **Static in Nature:** Traditional accounting systems may not keep pace with rapidly changing business environments, technological advancements, or emerging financial practices.

SUMMARY:

1. **Historical Nature**
2. **Subjectivity in Estimates**
3. **Ignores Non-Monetary Factor**
4. **Possibility of Manipulation**
5. **Inadequate for Inflation**
6. **Static in Nature**

O. ROLE OF COMPANY SECRETARY IN ACCUNTING AREA

CS plays a vital role in ensuring that the accounting function operates within the framework of law, governance, and ethical business practices.

CS ensures that accounting information complies with statutory requirements, supports decision-making, and is communicated effectively to stakeholders.

In **financial accounting**, the CS verifies that financial statements are prepared in accordance with the Companies Act, SEBI Listing Obligations and Disclosure Requirements (LODR), and applicable accounting standards like Ind AS or IFRS.

For **cost accounting**, the CS works with cost accountants to ensure accurate cost reporting and, where required, facilitates statutory cost audits.

In **management accounting**, the CS presents key financial information at board meetings, enabling directors to make informed strategic decisions.

In the area of **tax accounting**, the CS oversees that tax returns are prepared and filed on time, ensuring compliance with Income Tax and GST laws.

Similarly, during **auditing**, the CS liaises (bridge / link) between statutory and internal auditors, addressing queries, and ensuring audit reports are submitted to the Registrar of Companies and other regulators.

CS is deeply involved in **integrated reporting**, ESG disclosures, CSR reporting, and online compliance filing such as XBRL submissions.

They ensure that both financial and non-financial data presented in annual reports meet statutory and stakeholder expectations.

For example, if a manufacturing company is preparing its annual integrated report, the CS will coordinate with the finance team to ensure the profit figures match audited accounts, verify that environmental performance data meets ESG standards, and ensure the report is filed with the stock exchange in the correct format.

CS also ensures that accounting output is useful to both **external users** and **internal users** such as management and employees. They act as the bridge between the numbers and the people who rely on them. For instance, before a company issues new shares, the CS will ensure that the latest financial statements are accurate, approved by the board, and disclosed to the stock exchange, so potential investors can make informed decisions.

In relation to other disciplines, the CS plays a key role in integrating accounting with **law** by ensuring that disclosures comply various laws; with **management** by providing clear and concise financial summaries for planning and control; and with **economics** by interpreting financial results in the light of broader economic trends.

A well-informed CS can even address some **limitations of accounting**, such as reducing manipulation risk by enforcing transparent disclosures, promoting fair value reporting to reflect inflation-adjusted values, and encouraging the inclusion of qualitative data like CSR impact to complement the purely monetary focus of traditional accounts.

P. QUESTIONS

A. True and False

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

2. Management Accounting covers the preparation and interpretation of financial statements and communication to the users of accounts.
3. Financial accounting is concerned with internal reporting to the managers of a business unit.
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
5. 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.
6. Balance sheet shows the position of the business on the day of its preparation and not on the future date.
7. Objectives of book-keeping are complete recording of transactions & ascertainment of financial effect on the business.

Ans:

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 bookkeeping 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.
2. **False:** Financial accounting covers the preparation and interpretation of financial statements and communication to the users of accounts.
3. **False:** Management accounting is concerned with internal reporting to the managers of a business unit.
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
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
6. **True:** Balance Sheet is a statement of the financial position of an enterprise at a given date.
7. **True:** Book-keeping is concerned with complete recording and combined effect of transactions made during the accounting period.

UNIT 2: ACCOUNTING CONCEPTS, PRINCIPLES & CONVENTIONS

A. ACCOUNTING ASSUMPTIONS, PRINCIPLES AND CONCEPTS

S.N.	Item	Description
1	**Accounting Assumptions**	(a) "Assumption" refers to the fundamental **Premise / Condition** based on which the entire accounting process is carried out. (b) In Accounting, there are 3 Fundamental Accounting Assumptions. (c) **Example:** When a person started a particular business, we assume that the person started the business for continuing it to earn profits and not for closing it.
2	**Accounting Concepts**	(a) "Concept" means any idea or notion, which has a universal application (b) **Accounting Concepts** are the basic conditions which lay down the foundation for formulating the accounting principles. (c) They are clearly defined and supported by reasoning.
3	**Accounting Principles**	(a) **Accounting Principles** refer to the set of doctrines associated with the theory and procedures of accounting. **(b)** They serve as an explanation of current practices and as a **guide** for **selection of conventions** or **procedures where alternatives exist.** (c) Accounting Policies should be – (i) based on real assumptions, (ii) simple and easily understandable, (iii) consistently followed, (iv) informational to the Users, and (v) able to reflect future predictions.
4	**Accounting Conventions**	(a) **Accounting Conventions** are the general procedures emerging out of **usage and practice** of accounting principles. (b) Conventions may **not** have universal application (c) They may contradict the basic accounting principles. (d) Further, certain conventions may be **changed** over a period of time, by Accounting Bodies like ICAI, for improving the quality of Financial Statements. (e) **Example:** In India, pedestrians walk on the left side and the vehicles go on the right side of the road. This is traditionally accepted practice and everybody follows it

Concepts vs Conventions:

(a) Concepts are clearly defined and supported by reasoning while conventions may be clearly defined.

(b) Concepts support the principles whereas Conventions may contradict the principles.

Note: The above terms Concepts, Principles and Conventions, are sometimes used interchangeably. In the Exam questions, the students have to give a liberal meaning to the above words.

B. ACCOUNTING ASSUMPTION / CONCEPTS / CONVENTIONS

- **Fundamental Accounting Assumptions: Only 3 –** (a) Going Concern, (b) Consistency and (c) Accrual. (They are also considered as part of Accounting Concepts)
- **Accounting Concepts:**

(a) Business Entity	(g) Consistency
(b) Money Measurement	(h) Cost
(c) Accounting Period/ Periodicity	(i) Realization
(d) Accrual	(j) Dual Aspect
(e) Matching	(k) Full Disclosure
(f) Going Concern	(l) Substance Over Legal form

- **Accounting Conventions:** (a) Conservatism (b) Materiality.

C. ACCOUNTING CONCEPTS, PRINCIPLES, AND CONVENTIONS

Accounting is based on certain **concepts, principles, and conventions** that act like the "rules of the game." They ensure that financial statements are prepared consistently, comparably, and truthfully. Without these rules, every business could report in its own way, making it impossible to compare or rely on results.

Accounting Concepts (Basic Assumptions of Recording Transactions)

Accounting concepts are basic assumptions that guide how transactions are recorded and reported. They provide consistency and uniformity in financial reporting.

1. **Business Entity Concept**
   - The business is regarded as separate and distinct from its owner(s).
   - The owner's personal income, expenses, or property should not be mixed with the business accounts
   - This helps in knowing the true financial performance of the business itself.

   Example: If the owner uses Rs. 50,000 from business funds for personal needs, it is recorded as "Drawings" (reduction in owner's capital), not as a business expense.
2. **Money Measurement Concept**
   - Only transactions that can be measured in money terms are recorded in books of

accounts.

- Non-financial factors like employee skills, brand reputation, or work environment are not recorded, even though they may impact the business.

Example: The company records Rs. 2,00,000 spent on staff training, but the actual knowledge/skills gained by employees are not recorded.

3. **Going Concern Concept**
   - Assumes that the business will continue its operations indefinitely unless evidence suggests otherwise.
   - Because of this assumption, assets are valued at cost less depreciation instead of liquidation (selling) value.

   Example: A company buys machinery for Rs. 10 lakh and depreciates it over 10 years, assuming it will keep operating during that time.

4. **Accounting Period Concept**
   - The life of a business is continuous, but for reporting, it is divided into specific time periods (usually 1 year).
   - This helps in comparing performance year by year.

   Example: A company prepares financial statements for 1st April 2024 to 31st March 2025, even though the business continues after that.

5. **Dual Aspect Concept**
   - Every transaction has two aspects: one debit and one credit.
   - This is the basis of the double-entry system, which ensures that the **Accounting Equation (Assets = Liabilities + Capital)** always balances.

   Example: Purchase of furniture worth Rs. 10,000 increases Assets (Furniture) and decreases Cash/ Bank by the same amount

6. **Cost Concept**
   - Assets are recorded in the books at the price paid to acquire them, not at their current market value.
   - This ensures objectivity and reliability.

   Example: A plot of land purchased in 2010 for Rs. 5 lakh is still shown at Rs. 5 lakh (minus depreciation, if applicable) even if its current market price is Rs. 50 lakh

7. **Realisation (Revenue Recognition) Concept**
   - Revenue should be recorded only when it is earned, not just when cash is received.
   - Ensures profits are not overstated.

   Example: If a company sells goods on credit worth Rs. 1,00,000, the sale is recorded immediately even if the cash will be received after 2 months

8. **Matching Concept**
   - Expenses should be matched with the revenue of the same accounting period.
   - Helps in calculating the true profit or loss.

   Example: If a company sells goods worth Rs. 10,00,000 in 2024, the cost of producing those goods (say Rs. 7,00,000) must also be recorded in 2024, not later.

9. **Accrual Concept**
   - Income and expenses are recorded when they are earned or incurred, not when cash is received or paid.
   - This gives a true picture of financial performance

   Example: Rent for March payable in April is recorded as an expense in March itself

Accounting Principles (Rules Derived from Concepts)

1. **Consistency Principle**
   - Once a business adopts an accounting method (e.g., for depreciation or stock valuation), it should use the same method every year.
   - This ensures comparability across years.

     Note: A change in method is allowed only if it makes financial statements more accurate or relevant, but it must be disclosed.
2. **Conservatism (Prudence) Principle**
   - "Anticipate no profits, but provide for all possible losses."
   - Assets and income should not be overstated, and liabilities or expenses should not be understated.

   Example: Closing stock is valued at *Cost or Market Price, whichever is lower*. If stock costs Rs. 1,00,000 but market value Rs. 80,000, it will be shown at Rs. 80,000.
3. **Full Disclosure Principle**
   - All material and relevant information must be disclosed in financial statements.
   - Ensures transparency and prevents misleading of stakeholders.

     Note: Disclosures are usually made in the "Notes to Accounts." For example, contingent liabilities like pending court cases must be disclosed.
4. **Materiality Principle**
   - Only information that is significant and influences decision-making needs detailed recording and disclosure.
   - Insignificant items can be grouped or written off to simplify records.

     Example: Stationery worth Rs. 500 used in a year is expensed immediately instead of being shown as an asset.
5. **Objectivity Principle**

   The **Objectivity Principle** states that all accounting transactions should be recorded **based on verifiable and reliable evidence**, rather than personal opinion or bias of the accountant or management.

   This ensures that the financial statements are:
   - **Reliable** – Users can trust the information.
   - **Free from personal judgment** – Minimises manipulation.

- **Comparable** – Since evidence is the same for all.

> ***Example***
>
> 1. If a company purchases machinery worth Rs. 10,00,000, the accountant records it in the books **based on the supplier's invoice and payment receipt**.
>   - Evidence-based ⟶ Objective
>   - Not just management's word "we bought machinery worth Rs. 10,00,000."
> 2. If an employee claims to have spent Rs. 5,000 for office supplies but provides **no bill**, the expense cannot be recorded. Only when the bill is submitted does the expense become valid in accounting.

Accounting Conventions

- **Conservatism** – Anticipate no profits but provide for all possible losses.
- **Consistency** – Maintain uniformity in accounting methods over time.
- **Disclosure** – Important information must be clearly stated in reports.
- **Materiality** – Ignore trivial items but disclose significant facts.

Fundamental Accounting Assumptions

As per Indian Accounting Standards (Ind AS) and Generally Accepted Accounting Principles (GAAP), there are three **fundamental accounting assumptions**:

1. **Going Concern**
   - Assumes the business will continue in the foreseeable future.
   - *Example:* Assets like plant and machinery are depreciated over several years, not valued at liquidation price.
2. **Consistency**
   - Same accounting methods are applied from one period to another to enable comparison.
   - *Example:* If a company uses straight-line depreciation, it should continue unless a change is justified.
3. **Accrual**
   - Transactions are recorded when they occur, not when cash is received or paid.
   - *Example:* Salaries payable at year-end are shown as expense even if payment is made later.

D. FINANCIAL STATEMENTS

- Through financial statements management of an entity makes public communication of the financial information.
- To determine operating results for the period & Financial position

THUS, COMPONENTS OF FINANCIAL STATEMENTS:

1. **Profit and Loss Account (Income Statement)** – Shows revenue, expenses, and

profit/loss for a period.

2. **Balance Sheet (Statement of Financial Position)** – Shows assets, liabilities, and owner's equity at a given date.
3. **Cash Flow Statement** – Shows inflows and outflows of cash under operating, investing, and financing activities.
4. **Notes to Accounts** – Provide additional disclosures, policies, and explanations.

QUALITATIVE CHARACTERISTICS OF FINANCIAL STATEMENTS

- **Understandability:** It must be readily understandable by users. For this purpose, it is assumed that users have a reasonable knowledge of business and economic activities and accounting and study the information with reasonable diligence.
- **Relevance:** To be useful, information must be relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.
- **Reliability:** To be useful, information must also be reliable, Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.
- **Comparability:** Users must be able to compare the financial statements of an enterprise through time in order to identify trends in its financial position, performance and cash flows. Users must also be able to compare the financial statements of different enterprises in order to evaluate their relative financial position, performance and cash flows.

  Note: The four principal qualitative characteristics are Understandability, relevance, reliability and comparability.
- **Materiality:** The relevance of information is affected by its materiality. Information is material if its misstatement (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information. Materiality depends on the size and nature of the item or error, judged in the particular circumstances of its misstatement.
- **Faithful Representation:** To be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent. Thus, for example, a balance sheet should represent faithfully the transactions and other events that result in assets, liabilities and equity of the enterprise at the reporting date which meet the recognition criteria.
- **Substance Over Form:** If information is to present in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form.

- **Neutrality:** To be reliable, the information contained in financial statements must be neutral, that is, free from bias.
- **Prudence**
- **Full, fair and adequate disclosure:** The financial statement must disclose all the reliable and relevant information about the business enterprise to the management and also to their external users for which they are meant, which in turn will help them to take a reasonable and rational decision. **The principle of full disclosure implies that nothing should be omitted while principle of fair disclosure implies that all the transactions recorded should be accounted in a manner that financial statement purports true and fair view of the results of the business.**
- **Completeness:** To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

E. QUESTIONS

True and False

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.
2. Entity concept means that the enterprise is liable to the owner for capital investment made by the owner.
3. Accrual means recognition as money is received or paid and not of revenue and costs as they are earned or incurred.
4. The Conservatism Concept states that no change should be counted unless it has materialized.
5. The concept of consistency implies non-flexibility as not to allow the introduction of improved method of accounting.
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.
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.

Ans:

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.

2. **True:** Since the owner invested capital, he has claim on the profits of the enterprise.
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.
4. **False:** The Realisation Concept states that no change should be counted unless it has materialised.
5. **False:** The concept of consistency does not imply non-flexibility as not to allow the introduction of improved method of accounting.
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.
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

UNIT 3: CAPITAL & REVENUE EXPENDITURES & RECEIPTS

CAPITAL
- EXPENDITURE
- RECEIPTS

REVENUE
- EXPENDITURE
- RECEIPTS

A. CONSIDERATIONS IN DETERMINING CAPITAL & REVENUE EXPENDITURES

(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

CAPITAL EXPENDITURE VS. REVENUE EXPENDITURE

Particulars	Capital Expenditure	Revenue Expenditure
1. Meaning	It is an expenditure incurred for the purpose of – (a)Purchase / Creation / Improvement of Fixed Assets or (b)Expenses necessary for the above purchase / Creation	It is an expenditure, the benefit of which is immediately (normally within one year) exhausted in the process of earning revenue.

	(c)Increasing the earning capacity of the business.	
2. Purpose	(a) Acquiring Fixed Assets, which are held not for resale, but for use with a view to earn profits. (b) Making additions to the existing Fixed Assets. (c) Increasing earning capacity of the business by improved facilities and equipment. (d) Reducing the cost of production. (e) Acquiring benefit of enduring nature or valuable right.	(a)Actual day – to – day running of the business, (b)Maintaining the capital assets in an efficient manner. (c)Cost of Materials & Stores (d)Salary and Wages of employees, (e)Administrative Exp. Like Stationery, Rent, Telephone and Insurance.
3. Treatment in Financial Statement	• Capital Expenditure is displayed as asset in Balance Sheet. Only depreciation portion is debited to P & L A/c. • It is NOT directly reduced from Incomes.	• Expenditure is charged fully in the Profit and Loss Account. • It is fully REDUCED from income
4. Wrong treatment	If wrongly treated as revenue, profits will be understated or reduced.	If wrongly capitalized, profits will be inflated or overstated.
5. Matching	Capital Expenditure is not matched with Capital Receipts.	Revenue Expenditure is matched with Revenue Receipts.
6. Time of incurrence	Capital Expenditure may be incurred before or after the commencement of the business.	It is incurred after the commencement of the business.
7. Recurring Nature	Normally Capital Expenditure is generally non-recurring in nature. However, certain Capital Expenditure is required once in 2-5 years, e.g. modernization of Machinery, etc.	Revenue Expenditure is of recurring / repetitive nature. It is incurred every year by the business.
8. Interest on borrowing	If Interest on Borrowings is payable for the period prior to the commencement of the Business / Production	If interest on borrowings is payable for the period on or

		after commencement of business / production
Note: Amount involved in a transaction is not always relevant for Capital vs Revenue distinction. Hence, even a transaction involving a huge amount say Rs. 5 Crores, may be considered as Revenue Expenditure.		

DEFERRED REVENUE EXPENDITURE

Particulars	Deferred Revenue Expenditure
1. Meaning	It is an expenditure primarily of revenue nature, but the benefit where of extends to periods more than the year of incurrence.
2. Inclusion	It also includes expenditure which gives benefits for 2/3 years, but does not result in creation or improvement of Fixed Assets. Example: Shifting of business from one location to a convenient location. This results in increase in benefits for many years, but do not result in creation of any Fixed Asset.
3. Examples	(a) Expenditure on an Advertisement Campaign to introduced a product in the market, (b) Discount allowed on issue of Debentures, (c) Development Expenses in the case of Mines and Plantations. (d) Cost of construction/ extension to a leased building (Since the building has to be returned after the lease period is over, it s benefits are for only a limited period.)
4. Time	Benefit of such expenditure relates to many years, i.e. relating to the future period.
5. Treatment	Even if the benefits from these Expenditures arise over a period of 2 or 3 years, in accordance with applicable Accounting Standards, these Expenditures are fully written off in P & L in the year of incurrence. They are not "Assets" and hence should not be carried forward. [Note: Hence the concept of "Deferral" of Revenue Expenditure is no longer relevant.]

Notes:

- DRE ≠ Losses or Exceptional Items: Exceptional losses suffered due to natural calamity, political or other social disturbances, etc. are not Deferred Revenue Expenditures. They constitute "Losses" / "Exceptional Item", since there is no corresponding benefit, either current or future.
- DRE ≠ Prepaid Expenses: The benefits available from Prepaid Expenses can be precisely estimated (e.g. Prepaid Insurance), but such precise estimation is not possible in the case of Deferred Revenue Expenditure (e.g. substantial Advertisement Campaign).

CRITERIA / CONSIDERATIONS FOR CAPITAL VS REVENUE

Whether an expenditure is Capital or Revenue in nature, depends upon following factors:

Factor	Capital Expenditure if....	Revenue Expenditure if ....
1. Nature of Business	Expenditure relates to purchase of a Fixed Asset (e.g. Land purchased by a Manufacturing Firm).	Expenditure relates to purchase of a Current Asset (e.g. Land purchased by a Construction Company).
2. Recurring Nature	Expenditure is incurred infrequently, or once in 2-5 years (e.g. purchase of assets).	Expenditure is incurred frequently/ regularly, in the normal course of business (e.g. Salary, Rent, etc.)
3. Purpose of Expenses	Expenditure is for acquiring / creating capital assets or increasing their productive capacity.	Expenditure is for maintaining the capital assets in an efficient manner.
4. Period of Benefit	Expenditure helps to generate revenue over more than one accounting period	Expenditure helps to generate income / revenue in the current period only.
5. Materiality	Expenditure is material/ significant.	Expenditure is not material, i.e. insignificant.

EXAMPLES FOR CAPITAL AND REVENUE EXPENDITURES

Capital Expenditure	Revenue Expenditure
1. Purchase of Fixed Asset (Land, Building, etc.) 2. Purchase of Second-hand Asset (e.g. Vehicle, Furniture, etc.) 3. Overhaul Expenses to put second-hand machinery in working condition. 4. Repairing & Painting of Old Building purchased recently by the Firm. 5. Expenditure incurred to reduced working expenses / operating expenses. 6. Legal Fee paid to acquire new property. 7. Licence Fee paid by Cinema Theatre to commence its business. 8. Cost of constructing Temporary Huts which are necessary for Factory Building Construction, which were demolished when the Factory was ready.	1. Expenditure for replacement of worn-out part of an existing assets. 2. Regular Advertisement Expenses in respect of products and services. 3. Expenditure on removal of stock to new site. 4. Legal Fees incurred to file suit against a

	Customer from whom money is due.

CAPITAL VS REVENUE RECEIPTS

Particulars	Capital Receipt	Revenue Receipt
1. Meaning	Capital Receipts refer to receipts other than Revenue Receipts.	Revenue Receipts are moneys received in the course of normal business activities, and are recurring in nature.
2. Example	Capital contribution by Owner, Issue of Shares / Debentures, Sale Proceeds of Fixed Assets, etc.	Sales, Interest and Other Income Received, Bad Debts Recovered, etc.
3. Purpose	Capital Receipts relate to specific purpose, e.g. Capital Contribution for commencing business or expanding business, Loans taken for acquiring Fixed Assets, etc.	Revenue Receipts relate to general business purpose, and are not specifically identifiable to any purpose as such.
4. Effect on Profit	Capital Receipts do not affect profit.	Revenue Receipts have a direct impact on the profits.
5. Disclosure	They are shown as Liability or Reduction from the Asset in the Balance Sheet.	They are shown on the Credit Side of the Profit and Loss Account.
6. Matching	Capital Receipts are not matched with Capital Expenditure, in all cases.	Revenue Receipts is generally matched with Revenue Expenditure.

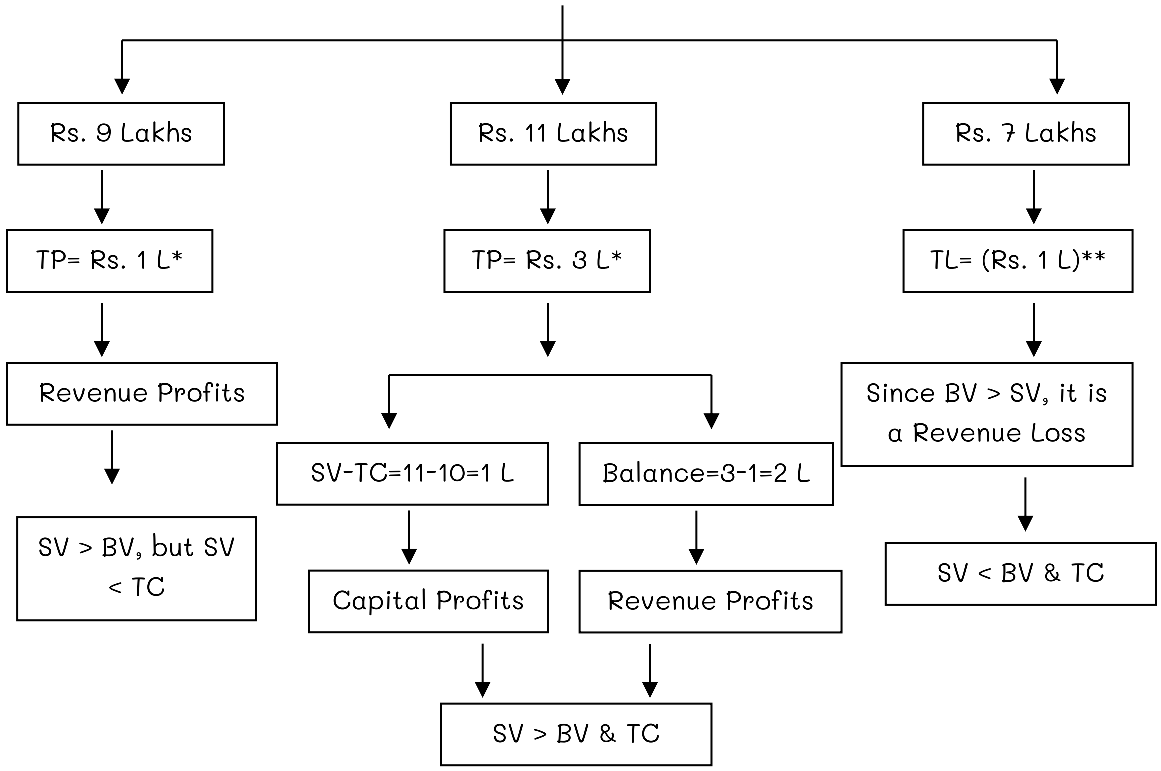
1. Revenue Receipts ≠ Cash Receipts: "Revenue Receipts" refers to Total Income in the period (e.g. Total Sales on Cash & Credit) while "Cash Receipts" refers to Cash Collections (i.e. Cash Sales + Collection from Debtors) in the period.
2. Deposit of Money with other persons ≠Expenditure:

- Deposit of money is not considered as an expenditure as the money is just kept with another person and it is to be recovered from that person.
- Expenditure refers to the amount spent to earn benefit. Deposit is not considered as amount spent

PROFITS / LOSSES ON SALE OF A FIXED ASSET – CAPITAL VS REVENUE PROFITS:

Cost of Fixed Asset – Purchase Value	Rs. 10,00,000
Book Value of Fixed Asset	Rs. 8,00,000

If the above Fixed Asset is sold for (Sale Value is)



Notes:

1. SV = Sale Value; TC = Total Cost; BV = Book Value (TC less depreciation), TP = Total Profits.
2. Profit/ Losses = SV – BV; If SV > BV = Profits; If SV < BV = Losses
3. If SV > TC, then Capital Profits = SV – TC and Revenue Profits = Balance amount
4. If SV < TC, but SV > BV, then Revenue Profits alone = SV – BV (No Capital Profits)
5. If SV < TC and SV < BV, then Revenue losses = BV – SV (No Capital Losses)

B. QUESTIONS

True and False

1. The nature of business is not an important criteria in separating an expenditure between capital and revenue.
2. Expenditure incurred for major repair of the asset so as to increase its productive capacity is Revenue in nature.
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.
4. Amount spent for replacement of worn-out part of machine is Capital Expenditure.
5. Legal fees to acquire property is Capital Expenditure.
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.*

Ans:

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

C. EXTRA PRACTICE QUESTION

Question 1:

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

1. Overhaul expenses of second-hand machinery purchased are Revenue Expenditure.
2. Money spent to reduce working expenses is Revenue Expenditure.
3. Legal fees to acquire property is Capital Expenditure.

4. Amount spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the plaintiff's land is Capital Expenditure.
5. Amount spent for replacement of worn out part of machine is Capital Expenditure.
6. Expense incurred on the repairs and white washing for the first time on purchase of an old building are Revenue Expenses.
7. Expenses in connection with obtaining a license for running the cinema is Capital Expenditure.
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.

Question 2:

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

1. Expenses incurred in connection with obtaining a license for starting the factory for ₹ 10,000.
2. ₹ 1,000 paid for removal of Inventory to a new site.
3. Rings and Pistons of an engine were changed at a cost of ₹ 5,000 to get fuel efficiency.
4. Money paid to Mahanagar Telephone Nigam Ltd. (MTNL) ₹ 8,000 for installing telephone in the office.
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.

Question 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?

Question 4:

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

(a) A machine with a book value of ₹ 10 lakh is sold for ₹ 12 lakh.
(b) Premium amounting to ₹ 1 Lakh received on issue of shares
(c) An amount of ₹ 20,000 received from goods sold in cash.
(d) 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.

Question 5

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

(a) 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.

(b) 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.

(c) Fire insurance, ₹ 1,000 was paid on 1st October, 2021 for one year.

(d) 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.

Question 6

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

(a) Overhauling expenses of ₹ 25,000 for the engine of a motor car to get better fuel efficiency.

(b) Inauguration expenses of ₹ 25 lacs incurred on the opening of a new manufacturing unit in an existing business.

(c) Compensation of ₹ 2.5 crores paid to workers, who opted for voluntary retirement.

Question 7

Classify the following expenditures and receipts as capital or revenue:

(a) ₹ 10,000 spent as travelling expenses of the directors on trips abroad for purchase of capital assets.

(b) Amount received from Trade receivables during the year.

(c) Amount spent on demolition of building to construct a bigger building on same site.

(d) Insurance claim received on account of a machinery damaged by fire.

Question 8

Are the following expenditures capital in nature?

(a) 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.

(b) 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.

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.

UNIT 4: CONTINGENT ASSETS & LIABILITIES

A. CONTINGENT ASSET

- Defined as a possible asset that arises from past events and
- whose existence will be confirmed only after occurrence or non-occurrence of one or more uncertain future events
- not wholly within the control of the enterprise.
- It usually arises from unplanned or unexpected events that give rise to the possibility of an inflow of economic benefits to the business entity.
- For example, a claim that an enterprise is pursuing through legal process, where the outcome is uncertain, is a contingent asset.
- As per the concept of prudence as well as the present accounting standards, an enterprise should not recognise a contingent asset.
- There is uncertainty in realisation of claim.
- It is possible that recognition of contingent assets may result in recognition of income that may never be realised.
- However, when the realisation of income is virtually certain, then the related asset no longer remains as contingent asset.
- A contingent asset need not be disclosed in the financial statements.
- A contingent asset is usually disclosed in the report of the approving authority (BOD if co. or corresponding approving authority in other case)

B. CONTINGENT LIABILITIES: DEFINED AS -

- **A possible obligation** - that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise;

or

- **A present obligation** - that arises from past events but is not recognised because:
  (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
  (ii) a reliable estimate of the amount of the obligation cannot be made

A contingent liability is a possible obligation arising from past events and may arise in future depending on the occurrence or non-occurrence of one or more uncertain future events [part (a) of the definition].

A contingent liability may also be a present obligation that arises from past events [(part (b) of the definition)

- An enterprise should not recognise a contingent liability.
- A Contingent liability is required to be disclosed unless possibility of outflow of a resource embodying economic benefits is remote.
- These liabilities are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable.
- If it becomes probable that an outflow or future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in financial statements of the period in which the change in probability occurs except in the extremely rare circumstances where no reliable estimate can be made.

C. DISTINCTION BETWEEN CONTINGENT LIABILITIES AND PROVISIONS

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.

It is important to know the difference between provisions and contingent liabilities. The distinction between both of them can be explained as follows:

	Provision	Contingent liability
(1)	Provision is a present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation.	A Contingent liability is a possible obligation that may or may not crystallise depending on the occurrence or non-occurrence of one or more uncertain future events.
(2)	A provision meets the recognition criteria.	A contingent liability fails to meet the same.
(3)	Provision is recognised when (a) an enterprise has a present obligation arising from past events; an outflow of resources embodying economic benefits is probable, and (b) a reliable estimate can be made of the amount of the obligation.	Contingent liability includes present obligations that do not meet the recognition criteria because either it is not probable that settlement of those obligations will require outflow of economic benefits, or the amount cannot be reliably estimated.
(4)	If the management estimates that it is probable that the settlement of an obligation will result in outflow of	If the management estimates, that it is less likely that any economic benefit will outflow the firm to settle the obligation,

	economic benefits, it recognises a provision in the balance sheet.	it discloses the obligation as a contingent liability.

Let us take an example to understand the distinction between provisions and contingent liabilities. The Central Excise Officer imposes a penalty on Alpha Ltd. for violation of a provision in the Central Excise Act. The company goes on an appeal. If the management of the company estimates that it is probable that the company will have to pay the penalty, it recognises a provision for the liability. On the other hand, if the management anticipates that the judgement of the appellate authority will be in its favour and it is less likely that the company will have to pay the penalty, it will disclose the obligation as a contingent liability instead of recognising a provision for the same.

D. QUESTIONS

True and False

1. A contingent liability need not be disclosed in the financial statements.
2. A Provision fails to meet the recognition criteria.
3. A claim that an enterprise is pursuing through legal process, where the outcome is uncertain, is a contingent liability.
4. When it is probable that the firm will need to pay off the obligation, this gives rise to Contingent liability.
5. Present financial obligation of an enterprise, which arises from past event is termed as contingent liability.

Ans:

1. **False:** A Contingent liability is required to be disclosed unless possibility of outflow of a resource embodying economic benefits is remote.
2. **False:** A contingent liability fails to meet the recognition criteria.
3. **False:** A claim that an enterprise is pursuing through legal process, where the outcome is uncertain, is a contingent asset
4. **False:** When it is probable that the firm will need to pay off the obligation, this gives rise to provision.
5. False: Present Financial obligation of an enterprise, which arises from past events is termed as liability,

UNIT 5: ACCOUNTING POLICIES

A. MEANING OF ACCOUNTING POLICIES

Accounting Policies are the **set of specific principles, bases, conventions, rules, and practices** a business adopts in preparing and presenting its financial statements.

These policies guide how transactions are recognized, measured, recorded, and disclosed.

They bring **uniformity and comparability** to financial reporting, but companies may adopt **different policies**

based on their size, industry, management preferences, and legal requirements.

Example:

- Suppose both **Company A** and **Company B** purchase machinery for Rs. 10 lakh.
- Company A uses the **Straight-Line Method (SLM)** for depreciation, charging equal depreciation every year.
- Company B uses the **Written Down Value (WDV)** method, charging higher depreciation in earlier years and lower in later years.
- Both follow valid accounting methods, but the reported profits differ because of their **accounting policy choice**.

This shows that **accounting policies affect how profits, assets, and liabilities are presented**.

Selection of Accounting Policies

When management selects accounting policies, they should ensure the policies present the company's accounts in a manner that is **fair, true, and useful** to stakeholders.

1. **Reflect a True and Fair View**
   - The selected policy should present a correct picture of the company's financial health and performance without manipulation or bias.
   - This helps stakeholders (investors, creditors, government, employees) make correct decisions.
   - If land purchased in 2005 for Rs. 10 lakh is now worth Rs. 2 crore, showing it at historical cost may not reflect a true and fair view. In such cases, companies may adopt **revaluation**.

   Example:

   A company must decide whether to value fixed assets at **historical cost** (original purchase price) or **fair value** (current market price).

2. **Follow Prudence (Conservatism)**
   - The policy should avoid overstating income or assets and must make provisions for possible losses
   - This protects users from being misled by inflated figures.

   Example:

   When valuing closing stock:

   - If cost = Rs. 1,00,000 but market value = Rs. 80,000, the stock should be recorded at Rs.**80,000**.
   - This ensures that future losses are considered in advance, but future profits are

not recorded until they are actually realized.

3. Ensure Materiality

- Materiality means giving importance only to items that are significant enough to influence decisions.
- Small, insignificant items can be recorded in a simplified manner.

Example:

- A calculator worth Rs. 500 or office pen worth Rs. 50 need not be capitalized as assets. They are treated as **expenses immediately**
- This saves time and makes records more practical, without losing accuracy for big-ticket items

4. Promote Consistency

- Once a policy is selected, it should be followed consistently from year to year.
- Consistency ensures comparability across different accounting periods.
- A change in policy should be made only when it leads to more reliable or relevant information.

Example:

If a company adopts the **WDV method** of depreciation, it should continue in subsequent years.

- If the company switches to SLM without reason, it would distort year-to-year comparisons.
- However, if industry standards or new accounting laws require the change, it can be done but must be **fully disclosed in notes to accounts**

5. Comply with Laws and Standards

- The accounting policy must align with statutory requirements like the **Companies Act, Income Tax Act, SEBI guidelines**, and Accounting Standards (AS / Ind AS / IFRS).
- Compliance ensures that the company is legally sound and trusted by regulators and investors.

Example:

Ind AS 16 (Property, Plant, and Equipment) provides guidelines for depreciation and asset valuation.

- If a company deviates from this, its accounts may not be legally accepted.
- Thus, policies must comply with **Ind AS / IFRS**, ensuring transparency and uniformity.

Changes in Accounting Policies

Accounting policies should generally remain consistent. However, they may be changed under the following conditions:

1. **Required by Law or Standards:** When a new law or accounting standard mandates a change.
   Example: Adoption of **Ind AS** (Indian Accounting Standards) required companies to shift from Indian GAAP.
2. **Better Presentation of Financial Statements:** When the change results in more accurate or relevant information.
   Example: A company earlier using historical cost method for investments shifts to fair value method for better reflection of market conditions.
3. **For Compliance with Industry Practice:** To align with industry norms and ensure comparability with peers.
   Example: A company in the IT sector may adopt revenue recognition policies similar to its competitors to provide better comparability for investors.

Impact of Change in Accounting Policies

- A change can affect **profit, asset values, and liabilities**.
- Companies must **disclose the nature, reason, and financial impact** of the change in the financial statements (as per AS 1 / Ind AS 8).

Example:

If a company shifts from SLM to WDV method of depreciation:

- Depreciation expense will increase in early years (lower profits).
- This must be clearly disclosed in Notes to Accounts.

B. QUESTIONS

True and False

1. There is a single list of accounting policies, which are applicable to all enterprises in all circumstances.
2. Selection of accounting policy doesn't impact financial performance and financial position of the business
3. A change in accounting policies should be made as and when business like to show result as per their choice.
4. Choosing FIFO or weighted average method for inventory valuation is selection of accounting policy.
5. Selection of an inappropriate accounting policy decision will overstate the performance and financial position of a business entity every time.

Ans:

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

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

UNIT 6: ACCOUNTING AS A MEASUREMENT DISCIPLINE - VALUATION PRINCIPLES, ACCOUNTING ESTIMATES

A. MEANING OF MEASUREMENT

Measurement means **assigning numbers to objects, events, or attributes according to rules**, so that they can be compared, recorded, and communicated. In accounting,

Example:

- Buying machinery for Rs. 10, 00,000 ⟶ measured in terms of
- Providing employee training (value of knowledge gained) ⟶ cannot be measured in money, hence not recorded.

Measurement involves quantifying economic events and resources in monetary terms.

Objects and Events to be measured in Accounting

Accounting is essentially a system of **measurement** — it measures and records the **financial position** and

performance of a business. For this purpose, two things need to be measured:

1. **Objects (Resources/Assets)**
2. **Events (Transactions/Activities)**

1. Objects (Resources / Assets to be measured)

- Objects are the **things owned or controlled by the business**, which have economic value and can be expressed in monetary terms.
- These are usually resources that will bring **future economic benefits**.
- They are listed in the **Balance Sheet** under assets.

Examples of Objects:

✓ **Land & Building** ⟶ Land for factory premises, office buildings.
✓ **Machinery & Equipment** ⟶ Machines used in production.
✓ **Furniture & Fixtures** ⟶ Office tables, chairs, shelves.
✓ **Patents, Trademarks, Copyrights** ⟶ Intangible assets providing competitive advantage.
✓ **Stock/Inventory** ⟶ Raw materials, work-in-progress, and finished goods.

✓ **Cash & Bank Balances** → most liquid form of asset.

Illustration:

- A company owns a **factory building worth Rs. 2 crore and machinery worth Rs. 1 crore.**
- Both are measured in monetary terms and appear in the Balance Sheet as **objects of measurement**.

2. Events (Transactions / Activities to be measured)

- Events are the **economic activities or financial transactions** that affect the financial position of a business.
- These are actions/events that bring a **change in the value of assets, liabilities, or income/expenses**.
- They are reflected in the **Profit & Loss Account (income statement)** or in adjustments to assets and liabilities.

Examples of Events:

- **Sales** → Selling products worth Rs. 50,000 generates revenue.
- **Purchases** → Buying raw materials worth Rs. 30,000 creates an expense or stock.
- **Rent Paid** → Monthly rent of Rs. 10,000 reduces cash and creates an expense.
- **Salaries/Wages Paid** → Rs. 1,00,000 salary expense decreases profits.
- **Depreciation** → A non-cash expense that reduces the value of machinery.
- **Tax Liability** → Income tax payable to the government.

Illustration:

- A company sells goods worth **Rs. 50,000.** This is an **event** that increases revenue.
- Paying **electricity bill of Rs. 5,000------** This is an **event** that reduces profit.

Key Difference Between Objects and Events

Basis	**Objects (Assets/Resources)**	**Events (Transactions/Activities)**
Meaning	Things the business owns/controls	Actions that affect business finances
Examples	Land, building, machinery, patents, stock	Sales, purchases, salaries, rent, depreciation
Nature	Static — they exist over time	Dynamic — they occur frequently
Shown in	Balance Sheet (Assets)	Profit & Loss A/c or adjustments

Standards and Scale of Measurement

- To measure consistently, we need a **standard unit**.
- In accounting, the standard is **money** (, $, €).
- **Scale of measurement** ensures uniformity (e.g., rupees in India, dollars in USA).

Example: If a company owns land in India (Rs. 50 lakh) and the USA ($200,000), both are first recorded in their local currency but later converted to the reporting currency (say, INR) for financial reporting.

Dimensions of Measurement Scale

Accounting measurement is not just about money, but also about **time** and **value changes**.

Time Dimension: Transactions are recorded for a particular period (e.g., monthly, yearly).

Example: Rent for April is accounted in April, not in March.

Value Dimension: Assets & liabilities can be valued differently based on chosen principles.

Accounting as a Measurement Discipline

Accounting is often called a **measurement discipline** because it measures business resources, obligations, and performance in monetary terms. It provides numerical

Example:

- Assets = Rs. 50 crore, Liabilities = Rs. 30 crore → Net Worth = Rs. 20 crore.
- Profit for the year = Rs. 5 crore → This measurement helps investors assess performance.

information that helps in decision-making, planning, and control.

B. VALUATION PRINCIPLES

There are four generally accepted measurement bases or valuation principles. These are:

- **Historical Cost:**

  It means acquisition price.

  For example, the businessman paid 7,00,000 to purchase the machine and spend 1,00,000 on its installation, its acquisition price including installation charges is 8,00,000. The historical cost of machine would be 8,00,000.

  According to this, assets are recorded at its acquisition cost.

  Liabilities are recorded at the amount of proceeds received in exchange for the obligation. In some circumstances a liability is recorded at the amount of cash or cash equivalent expected to be paid to satisfy it in the normal course of business.

  When one Mr. X a businessman, takes 5,00,000 loan from a bank @ 10% interest p.a., it is to be recorded at the amount of proceeds received in exchange for the obligation. Here the obligation is the repayment of loan as well as payment of interest at an agreed rate i.e. 10%. Proceeds received are 5,00,000 - it is historical cost of the transactions.

- **Current Cost:** Take that Mr. X purchased a machine on 1st January, 2000 at 7,00,000. As per historical cost base he has to record it at 7,00,000 i.e. the acquisition price. As on 1.1 .2011, Mr. X found that it would cost 25,00,000 to purchase that machine.

Take also that Mr. X took loan from a bank as on 1.1.2000 5,00,000 @ 18% p.a repayable at the end of 15th year together with interest. As on 1.1.2011 the bank announces 1% prepayment penalty on the loan amount if it is paid within 15 days starting from that day. As per historical cost the liability is recorded at 5,00,000 at the amount or proceeds received in exchange for obligation and asset is recorded at 7,00,000.

Current cost gives an alternative measurement base. Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

So as per current cost base, the machine value is 25,00,000 while the value of bank loan is 5,05,000.

- **Realisable Value**: Suppose Mr. X found that he can get Rs.20,00,000 if hewould sell the machine purchased, on 1.1.2000 paying 7,00,000 and which would cost 25,00,000 in case he would buy it currently. Take also that Mr. X found that he had no money to pay off the bank loan of 5,00,000 currently.

  As per 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. Haphazard disposal may yield something less. Liabilities are carried at their settlement values; i.e.the undiscounted amount of cash or cash equivalents expressed to be paid to satisfy the liabilities in the normal course of business.

  So the machine should be recorded at 20,00,000 the realisable value in an orderly sale while the bank loan should be recorded at Rs. 5,00,000 the settlement value in the normal course of business.

- **Present Value**: Suppose we are talking as on 1.1.2011 - take it as time for reference. Now think the machine purchased by Mr. X can work for another 10 years and is supposed to generate cash @ Rs. 1,00,000 p.a. Also take that bank loan of 5,00,000 taken by Mr. X is to be repaid as on 31.12.2015. Annual interest is 90,000.

  As per present value, an asset is carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. 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.

C. MEASUREMENT AND VALUATION

1. **Measurement**
   - Measurement means **assigning numerical values (in money terms)** to resources

(assets, liabilities) and events (transactions).

- It answers the question: "**How much?**"
- Without measurement, accounts cannot be recorded or compared.

Example:

- A company buys **machinery worth Rs. 5,00,000**. Recording "Machinery = Rs. 5,00,000" is the **measurement** process.
- Similarly, if a company pays **Rs.50,000 salary**, that transaction is measured and recorded as **salary expense = Rs. 50,000**.

2. **Valuation**
   - Valuation means **deciding the basis on which the measurement is made**.
   - Since values change over time, accountants need to decide whether to record at **historical cost, fair value, market value, or net realizable value (NRV)**.
   - It answers the question: "**On what basis is the amount measured?**"

Example (Stock/Inventory):

- Closing stock worth Rs. 1,00,000 (cost).
- Market price = Rs. 90,000.

As per **prudence principle**, stock is valued at **lower of cost or NRV** = Rs. 90,000.

Example (Machinery):

- Machinery purchased for **Rs. 5,00,000** in 2018.
- In 2024, its market value is **Rs.7,00,000**.
  - If recorded at **purchase price (historical cost)** 5,00,000.
  - If recorded at **revalued amount (market price)**

The difference lies in **valuation basis**.

D. ACCOUNTING ESTIMATES

- Not everything in accounting can be measured with **100% accuracy**.
- Some figures are uncertain and depend on **judgment, assumptions, and experience**.
- Such approximations are called **Accounting Estimates**.

Common Items Requiring Estimates:

1. **Depreciation of Assets** –
   - Useful life of machinery (10 years or 12 years) is an estimate.
   - Example: Machinery cost Rs. 5,00,000, estimated life = 10 years → Depreciation = Rs. 50,000 per year.
   - If later life is reassessed as 12 years, depreciation = Rs. 41,667 per year.
2. **Provision for Bad Debts** — Out of Rs. 10,00,000 receivables, the company estimates 5% may not be recovered → Provision = Rs. 50,000.
3. **Warranty Liabilities** –

- A company selling electronics estimates 2% of sales may require warranty service.
- If sales = Rs. 5,00,000 ⟶ Provision = Rs. 10,000.

4. **Obsolescence of Inventory** – Fashion retailer estimates 10% of stock may go unsold.
5. **Fair Value Estimates** – Investments in shares are shown at market value, which fluctuates daily and must be estimated at reporting date.

Common accounting estimates

1. **Depreciation of assets** – estimated useful life of machinery.
2. **Provision for doubtful debts** – estimation of how many customers may default.
3. **Warranty expenses** – estimated future cost of servicing products sold.
4. **Provisions for taxation** — estimated tax liability before final assessment.

Example:

- A company has debtors of Rs. 10,00,000. Based on past experience, it estimates that 2% may not be recoverable.
- It creates a provision of Rs. 20,000 as **bad debt expense** — this is an accounting estimate.

E. QUESTIONS

True and False

1. There are four generally accepted measurement bases.
   (i) Historical Cost;
   (ii) Current Cost;
   (iii) Realizable Value;
   (iv) Future Value.
2. Historical Cost means price paid at time acquisition.
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.
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.
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
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
7. Change in accounting estimate has to be given retrospective effect.

Ans:

1. **False:** There are four generally accepted measurement bases . (i) Historical Cost; (ii) Current Cost; (iv) Realizable Value; (iv) Present Value.
2. **True:** Historical cost means the acquisition price.
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.
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.
5. **False:** Historical cost is ₹ 10,00,000.
6. **True:** Since similar machine is purchased at ₹ 20,00,000, the current cost of machine is ₹ 20,00,000.
7. **False:** Change in accounting estimate has not to be given retrospective effect.

UNIT 7: ACCOUNTING STANDARDS

A. INTRODUCTION OF ACCOUNTING STANDARDS

- Accounting Standards (AS) are **written policy documents** issued by regulatory bodies that provide guidelines on how financial statements should be prepared and presented.
- They bring **uniformity, transparency, and comparability** in financial reporting.
- In India, Accounting Standards were initially issued by the **Institute of Chartered Accountants of India (ICAI)** and later notified by the **Ministry of Corporate Affairs (MCA)** under the Companies Act.
- For companies following IFRS-converged standards, **Indian Accounting Standards (Ind AS)** are applicable.

Example:

If two companies buy the same type of machinery, one may record it at historical cost and another at revalued price. Without standards, their financial statements would not be comparable. Accounting Standards remove such inconsistencies

Objectives of Accounting Standards

1. **Uniformity in Accounting Practices:** Ensure consistency across industries and companies. Example: AS-2 prescribes how to value inventories, so all companies follow the same rule (Cost or NRV, whichever is lower).
2. **Transparency and Comparability:** Financial statements should be easily compared across years and with other companies.
3. **Reliability of Financial Statements:** Users can trust that figures are prepared without manipulation.
4. **Protection of Stakeholders:** Safeguards the interests of investors, creditors, and

regulators.

5. **True and Fair View**: Ensure that statements reflect the actual performance and position of the business.

Benefits of Accounting Standards

- Brings **uniformity** in preparation of accounts.
- Increases **comparability** across industries and time.
- Provides **reliability** to investors, creditors, and other users.
- Ensures **compliance with law** and global practices.
- Facilitates **better decision-making** by management.
- Helps in **global integration** of financial reporting (especially with Ind AS/IFRS).

Limitations of Accounting Standards

- Cannot cover all possible situations — business complexities may need judgment.
- Sometimes **rigid** — reduces flexibility for unique industries.
- Implementation may involve **high cost** (system upgrades, training).
- Differences between **local laws and global standards** may create confusion.
- Too much reliance may reduce management's **professional judgment**.

Process of Formulation of Accounting Standards in India

1. **Identification of the area** — ICAI identifies an area where a standard is needed.
2. **Constitution of Study Group** — Experts study the issue and draft a proposal.
3. **Preparation of Exposure Draft** — Draft standard prepared and circulated for comments.
4. **Public Feedback** — Stakeholders, industry bodies, and regulators provide input.
5. **Finalization by ASB (Accounting Standards Board of ICAI)** — Incorporates suggestions.
6. **Approval by Council of ICAI** — Sent to **National Financial Reporting Authority (NFRA)/MCA** for notification.
7. **Implementation** — Once notified, it becomes mandatory.

List of Accounting Standards (AS) in India

(As per ICAI, for non-Ind AS entities)

1. AS 1: Disclosure of Accounting Policies
2. AS 2: Valuation of Inventories
3. AS 3: Cash Flow Statements
4. AS 4: Contingencies & Events Occurring After Balance Sheet Dt.
5. AS 5: Net Profit or Loss for the Period, Prior Period Items, and Changes in Accounting Policies
6. AS 6: Depreciation Accounting (withdrawn, now covered under AS

10)
7. AS 7: Construction Contracts
8. AS 9: Revenue Recognition
9. AS 10: Property, Plant, and Equipment
10. AS 11: The Effects of Changes in Foreign Exchange Rates
11. AS 12: Accounting for Government Grants
12. AS 13: Accounting for Investments
13. AS 14: Accounting for Amalgamations
14. AS 15: Employee Benefits
15. AS 16: Borrowing Costs
16. AS 17: Segment Reporting
17. AS 18: Related Party Disclosures
18. AS 19: Leases
19. AS 20: Earnings Per Share
20. AS 21: Consolidated Financial Statements
21. AS 22: Accounting for Taxes on Income
22. AS 23: Accounting for Investments in Associates
23. AS 24: Discontinuing Operations
24. AS 25: Interim Financial Reporting
25. AS 26: Intangible Assets
26. AS 27: Financial Reporting of Interests in Joint Ventures
27. AS 28: Impairment of Assets
28. AS 29: Provisions, Contingent Liabilities and Contingent Assets

List of Ind AS (Indian Accounting Standards – IFRS Converged)

- Ind AS 1: Presentation of Financial Statements
- Ind AS 2: Inventories
- Ind AS 7: Statement of Cash Flows
- Ind AS 8: Accounting Policies, Changes in Accounting Estimates and Errors
- Ind AS 10: Events after the Reporting Period
- Ind AS 12: Income Taxes
- Ind AS 16: Property, Plant, and Equipment
- Ind AS 19: Employee Benefits
- Ind AS 20: Accounting for Government Grants and Disclosure of Government Assistance
- Ind AS 21: The Effects of Changes in Foreign Exchange Rates
- Ind AS 23: Borrowing Costs
- Ind AS 24: Related Party Disclosures
- Ind AS 27: Separate Financial Statements
- Ind AS 28: Investments in Associates and Joint Ventures
- Ind AS 29: Financial Reporting in Hyper inflationary Economies
- Ind AS 32: Financial Instruments – Presentation
- Ind AS 33: Earnings per Share
- Ind AS 34: Interim Financial Reporting
- Ind AS 36: Impairment of Assets
- Ind AS 37: Provisions, Contingent Liabilities, and Contingent Assets
- Ind AS 38: Intangible Assets
- Ind AS 40: Investment Property
- Ind AS 41: Agriculture
- Ind AS 101: First time adoption of Ind AS
- Ind AS 102: Share Based Payment
- Ind AS 103: Business Combination
- Ind AS 104: Insurance Contracts

- Ind AS 105: Non-Current Assets Held for Sales and Discontinued Operations
- Ind AS 106: Exploration for and Evaluation of Mineral Resources
- Ind AS 107: Financial Instruments: Disclosures
- Ind AS 108: Operating Segments
- Ind AS 109: Financial Instruments
- Ind AS 110: Consolidated Financial Statements
- Ind AS 111: Joint Arrangements
- Ind AS 112: Disclosure of Interests in Other Entities
- Ind AS 113: Fair Value Measurement
- Ind AS 114: Regulatory Deferral Accounts
- Ind AS 115: Revenue from Contracts with Customers
- Ind AS 116: Leases

True/False Questions

1. Accounting assumes that business and owner are the same entity. (False)
2. Depreciation is an example of accounting estimate. (True)
3. Prudence principle requires recognition of all profits as soon as they are expected. (False)
4. Valuation and measurement in accounting are identical. (False)
5. Going concern assumption means business will continue in foreseeable future. (True)
6. Accounting Standards in India are issued by ICAI. (True)
7. Inventory is valued at market price only. (False – lower of cost or NRV).

Multiple Choice Questions (MCQs)

1. Which of the following is NOT a fundamental accounting assumption?
   (a) Going Concern
   (b) Consistency
   (c) **Matching Concept**
   (d) Accrual

2. "Stock is valued at cost or NRV, whichever is lower" is based on:
   (a) Consistency principle
   (b) Prudence principle
   (c) Accrual concept
   (d) Dual Aspect Concept

3. If the owner withdraws cash for personal use, it is recorded as:
   (a) Expense
   (b) Drawings
   (c) Liability
   (d) Asset

4. Which of the following is an accounting estimate?
   (a) Cash in hand
   (b) **Provision for doubtful debts**
   (c) Purchase of land
   (d) Issued capital

5. Which body issues Ind AS in India?
   (a) **MCA (Ministry of Corporate Affairs)**
   (b) RBI

(c) ICAI (d) SEBI

Practical / Application-Based Questions

1. A machine is purchased for Rs. 10,00,000 with an expected life of 10 years and no residual value. Calculate depreciation under SLM. If life is later revised to 12 years, recalculate. (Ans: Rs. 1,00,000 p.a. originally; revised = Rs. 83,333 p.a.)

2. A firm has debtors of Rs. 5,00,000. It estimates 5% will be irrecoverable. Create provision for doubtful debts.
   Ans: Rs. 25,000 provision.

3. Closing stock = Cost Rs. 2,00,000; NRV Rs. 1,80,000. Show valuation in balance sheet.
   Ans: Valued at Rs. 1,80,000 (lower of cost/NRV).

4. Distinguish between historical cost and fair value measurement by taking the case of land purchased in 2015 for Rs. 10 lakh, with a market value of Rs. 25 lakh in 2024.

Ans: Historical cost = Rs. 10 lakh; Fair value = Rs. 25 lakh.

5. Identify the accounting concept or principle violated in each case:
   (a) Recording owner's personal expenses as business expenses.
   (b) Changing depreciation method frequently.
   (c) Not disclosing contingent liability in financial statements. Ans: (a) Business Entity, (b) Consistency, (c) Full Disclosure.

6. **Historical Cost vs Current Cost**
   ABC Ltd. purchased a machine on **1st April, 2012** for Rs. 8,00,000 and spent Rs. 1,00,000 on its installation. On **31st March, 2022**, the current market price of the same machine is Rs. 22,00,000.
   (a) What is the **historical cost** of the machine?
   (b) What is the **current cost** of the machine?

7. **Realisable Value**
   A company purchased a machine for Rs. 7,00,000 on 1st January, 2015. On 31st March, 2022, a similar machine costs Rs. 20,00,000. However, if the company sells the machine today, it can realize only Rs. 14,00,000.
   (a) At what value will the machine be shown under the **historical cost principle**?
   (b) At what value will the machine be shown under the **realisable value principle**?

8. **Present Value (Discounting Future Cash Flows)**

A machine is expected to generate **cash inflows of Rs. 1,00,000 each year for 5 years**. The discount rate is **10% p.a.** Calculate **present value** of the machine.

9. **Accounting Estimates – Change in Useful Life**

   XYZ Ltd. purchased a machine for Rs. 10,00,000 in 2019 with an expected useful life of **10 years** and no residual value. The company uses **Straight Line Method (SLM)**. After 3 years, due to technological changes, the machine is now expected to last only **3 more years**.

   Calculate **annual depreciation**:

   (a) As per original estimate.

   (b) As per revised estimate (from 2022 onwards).

10. **Provision for Doubtful Debts**

   A company has **debtors of Rs.5,00,000** at year-end. Based on past experience, 5% of debtors are likely to turn into bad debts.

   - Pass the **adjusting entry** for provision.
   - Show how **net debtors** will be presented in the Balance Sheet.

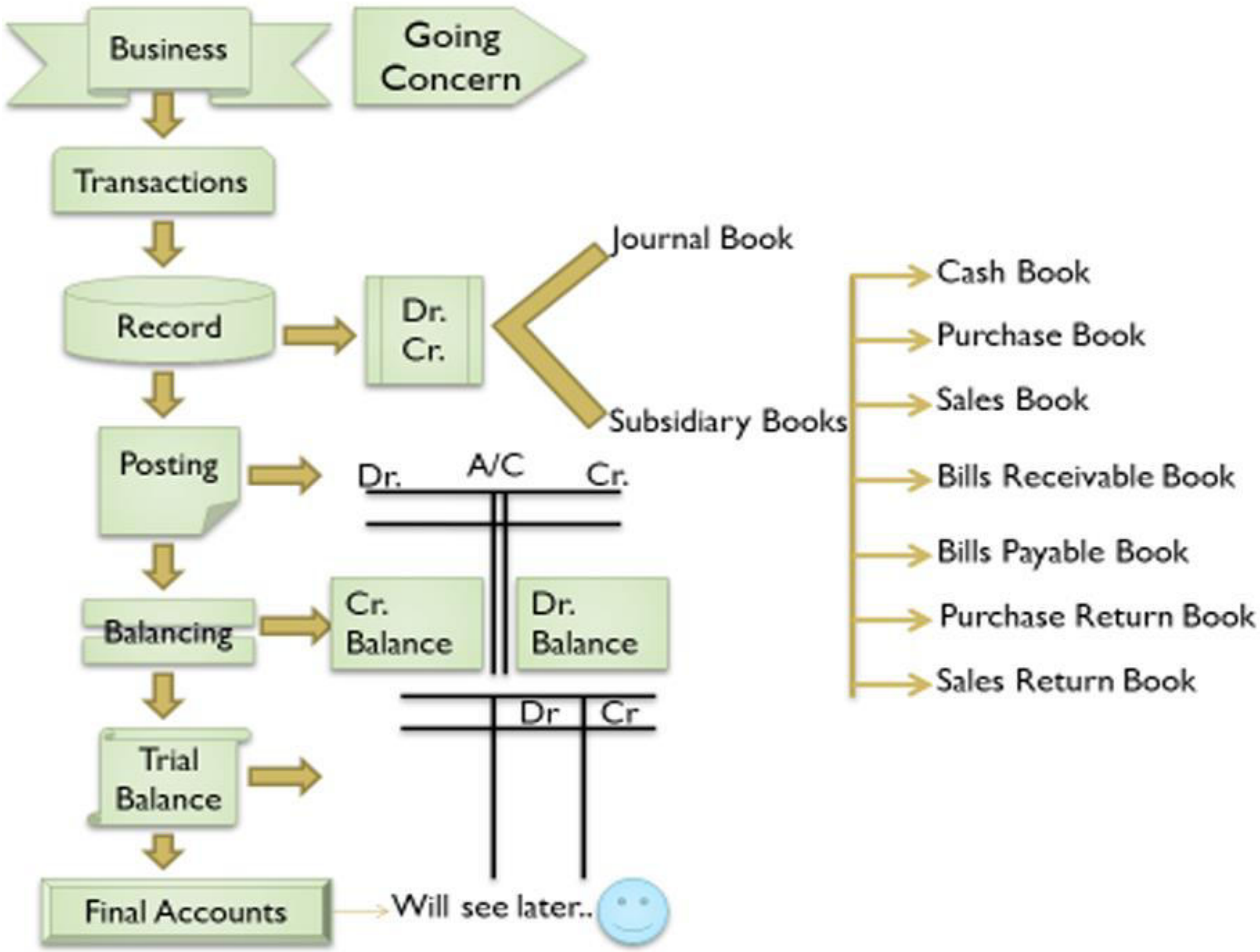
Topic 2 ACCOUNTING PROCESS

A. INTRODUCTION

After studying basic concepts, this chapter emphasizes the **practical application of accounting tools** such as **journals, subsidiary books, ledgers, cash books, and trial balances**.

These instruments **serve as checkpoints to ensure accuracy** and act as the backbone of the financial system of an organization.

THUS, Accounting Process involves:



AND IF SOME ERRORS WE HAVE TO RECTIFY THE ERRORS:

RECTIFICATION OF ERRORS		
BEFORE TRIAL BALANCE	AFTER TRIAL BALANCE	NEXT PERIOD

(Will see later in this chapter)

B. DOUBLE ENTRY SYSTEM

- The **Double Entry System** of accounting is the **most scientific & widely used method** of recording business transactions.
- It is based on the principle: "Every transaction has two aspects (Debit Aspect & Credit Aspect) & both should be recorded." **(लेन-देन)**

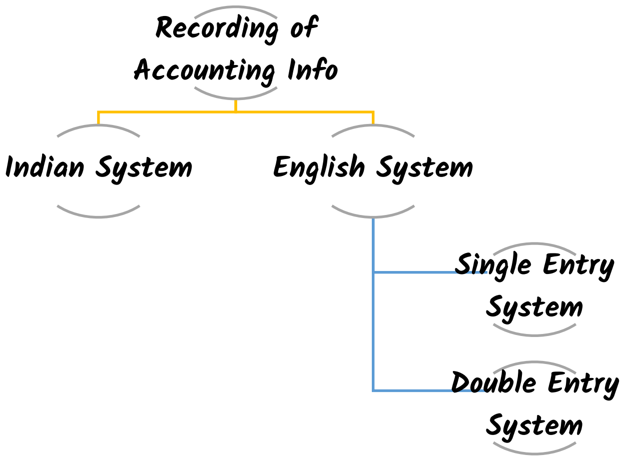
For example: If a business purchases goods worth 10,000 in cash,

- Goods are received (one aspect)
- Cash is paid (other aspect)

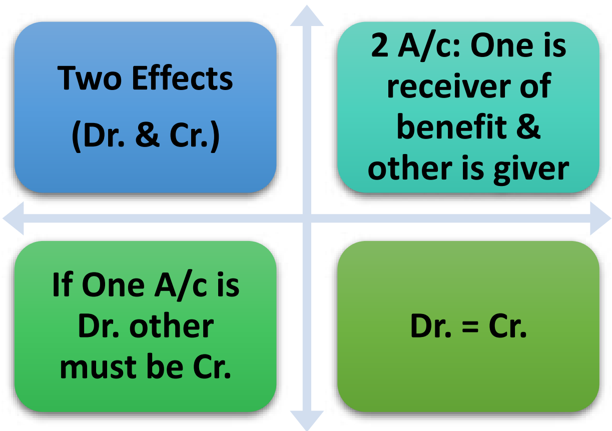
Thus, every transaction affects **at least two accounts**.

In short-

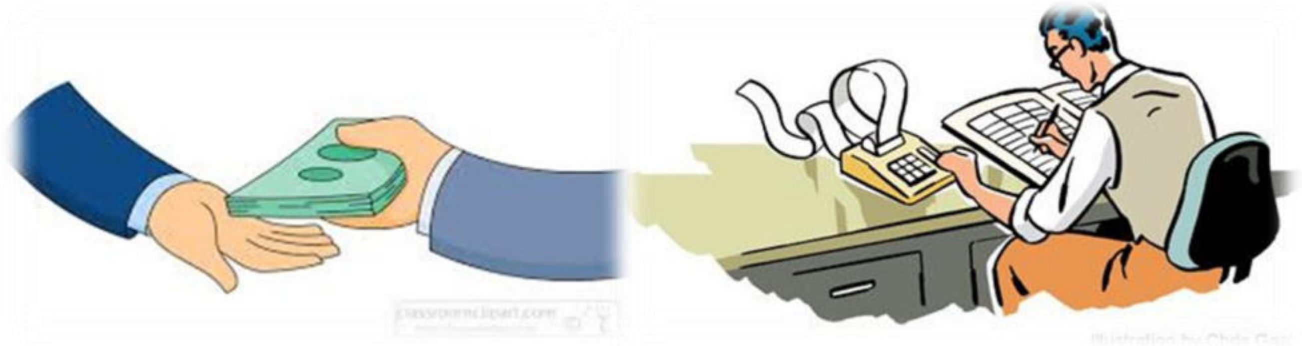
- 'Double Entry System is most scientific method of recording all monetary transactions.
- Owes its origin to **Italian Merchant "LUCA D. BARGO PACIOLI" on 10th November 1494** and this day is celebrated as International Accounting Day
- There are **two aspects** of every business transactions.
- Recording of two aspects of monetary transactions in Books of Account in terms of Debit (Dr.) & Credit (Cr.) is called as "Double Entry" System of Book-keeping.



PRINCIPLES OF DOUBLE ENTRY BOOK-KEEPING SYSTEM:



In layman's language Accounting means to record business transactions



(लेन-देन)

"Aaasaan bhasha me, Accounting ka matalb hai Hisab-Kitab rakhna"

Significance

- Ensures mathematical accuracy of accounts.
- Provides complete information about financial position.
- Facilitates preparation of Trial Balance, Profit & Loss A/c, and Balance Sheet.
- Universally accepted and reliable for auditing.

C. MEANING OF ACCOUNT

An **Account** is a systematic record of all transactions relating to a person, asset, liability, expense, or income in summarized form.

Types of Accounts (Traditional Approach):

Personal Accounts
- Debtors / Creditors
- Representative
- All Natural & Artificial Persons

Real Accounts
- Cash
- Car
- Computer
- Furniture
- Goodwill

Nominal Accounts
- Expenses
- Losses
- Income
- Gains

GOLDEN RULES OF DEBIT AND CREDIT (TRADITIONAL APPROACH):

Personal A/c	Real A/c	Nominal A/c
Debit the Receiver Credit the Giver	Debit what comes in Credit what goes out	Debit Exp. & Losses Credit Income & Gains

Utility of Classification & Sub-classification

- Helps in **easy identification** of accounts.
- Simplifies the **application of debit-credit rules**.
- Facilitates preparation of financial statements.
- Avoids confusion and errors in recording transactions.
- Sub-classification (Tangible/Intangible, Natural/Artificial/Representative) further improves clarity.

Advantages of Double Entry System

- Complete Records (Both Effects)
- Arithmetical Accuracy
- Business Results
- Common Acceptance
- Minimize Frauds
- Receivable & Payable Balances can determined easily
- Decision Making
- Easy Tax Calculation

Limitations of Double Entry System

- Not Disclose all errors
- Trial Balance does not disclose all the errors
- It costly (Required to maintain no. of a/c)

ACCOUNTING EQUATION

Assets = Liabilities + Capital

CLASSIFICATION OF ACCOUNTS (MODERN APPROACH)

Dr. Balance (Dr. ↑ Cr. ↓)	Cr. Balance (Cr. ↑ Dr ↓)
Assets	Liabilities
Drawing	Capital
Debtors	Creditors
Expenses	Incomes
Losses	Gains

D. LEDGER

- In accounting, business transactions are first recorded in the Journal in chronological order.
- However, **to know the position of each account** (e.g., how much is owed by debtors, how much cash is left, total expenses incurred), it is **necessary to collect and classify all transactions account-wise**.
- This classification is done in the **Ledger**, which is the **principal book of accounts**.
- From the ledger, the **Trial Balance**, **Profit & Loss Account**, and **Balance Sheet** are prepared.
- Thus, the Ledger is called the **final-destination of all transactions**.

Concept of Ledger

- The Ledger is a **book of accounts** where transactions relating to a particular account are recorded under one head.
- It contains accounts of **assets, liabilities, capital, expenses, and incomes**.
- Ledger helps in determining the **net balance of each account** and the overall financial position.

Specimen of a Ledger Account

Ledger accounts are generally drawn in the **'T' format**:

Account Title

Debit Side (Dr.) **Credit Side (Cr.)**

Date	Particulars	Amount	Date	Particulars	Amount

Posting in the Ledger

Posting is the process of transferring entries from the **Journal** to their respective **Ledger Accounts**.

Steps in Posting:

- Identify the two accounts from the Journal entry.
- Post the **debited account** to the **debit side** of the ledger, writing the credit account's name in the particulars column.
- Post the **credited account** to the **credit side** of the ledger, writing the debit account's name in the particulars column.
- Use the same date and amount as in the journal.
- Continue for all entries until all ledger accounts are completed.

Rules Regarding Posting of Entries in the Ledger

1. The account debited in the journal ⟶ Debit side of that account in the ledger with the words **"To (other account)"**.
2. The account credited in the journal ⟶ Credit side of that account in the ledger with the words **"By (other account)"**.
3. The amount entered in the journal must be the **same in ledger posting**.
4. The date of transaction should be recorded on both sides of the ledger account.
5. Each journal entry affects **two ledger accounts** (at least).

Balancing an Account

Balancing means finding the net difference between **total debits and total credits** in a ledger account.

Steps to Balance an Account:

1. Total both sides of the account.
2. Find the difference (Debit – Credit or Credit – Debit).
3. Enter the difference on the **shorter side** as **"Balance c/d"** (carried down).
4. Bring this balance forward on the **opposite side** in the next accounting period as **"Balance b/d"** (brought down).
   - If Debit > Credit ⟶ Debit Balance (Assets, Expenses).

- If Credit > Debit → Credit Balance (Liabilities, Incomes).

Opening Accounts in the Next Year

At the beginning of a new accounting year:

- **Real Accounts (Assets)** and **Personal Accounts (Debtors, Creditors, Capital)** balances are carried forward.
- These are shown as **Balance b/d** in the next year's ledger.
- **Nominal Accounts (Incomes & Expenses)** are not carried forward; they are closed to the Profit & Loss Account at year-end.

Balance c/d and Balance b/d

- **Balance c/d (Carried Down):** The closing balance of an account at the end of the current period, entered on the **shorter side** to make both sides equal.
- **Balance b/d (Brought Down):** The same balance brought forward to the next accounting period, written on the **opposite side** of the account.

Example: If Cash A/c debit side = Rs. 70,000 and credit side = Rs. 50,000

- On closing: write **Balance c/d = Rs.20,000** on Credit side.
- On reopening: write **Balance b/d = Rs. 20,000** on Debit side (next year).

Question 1: Posting and Balancing Transactions:

1. Commenced business with cash Rs. 1,00,000.
2. Purchased goods for cash Rs. 30,000.
3. Paid rent Rs. 5,000.
4. Sold goods to Mohan (credit) Rs. 20,000.
5. Received cash from Mohan Rs. 12,000.

Question 2: Post the following into ledger accounts and balance them:

1. Started business with Rs. 80,000.
2. Deposited Rs. 20,000 into bank.
3. Bought goods from Sohan Rs. 25,000 on credit.
4. Sold goods for cash Rs. 15,000.
5. Paid Rs. 10,000 to Sohan.
6. Paid wages Rs. 3,000.

COMPARISON CHART: JOURNAL VS LEDGER

Basis	Journal (Book of Original Entry)	Ledger (Book of Final Entry)
Meaning	Records transactions in chronological order	Classifies transactions into accounts
Nature	Daily record of all transactions	Permanent record account-wise

Purpose	Provides raw transaction details	Provides summarized balances
Structure	Date, Particulars, Debit, Credit	Separate accounts (Dr. & Cr.)
Recording	First stage of entry	Second stage (posting from journal)
Helps in	Checking correctness of debit/credit	Preparing Trial Balance & Final Accounts
Example	Cash A/c Dr. To Capital A/c	Cash A/c and CapitalA/c shown separately

E. SUBSIDIARY BOOKS

- In large-scale businesses, recording **every transaction directly in the Journal becomes cumbersome**.
- To overcome this, **transactions of similar nature are grouped** and recorded in separate books known as **Subsidiary Books**.
- These are also called **special journals**.

They help in:

- Systematic classification of transactions.
- Easy posting to the Ledger.
- Division of work among staff.

Advantages of Subsidiary Books

1. **Division of Work** – Different clerks can maintain different books (purchases clerk, sales clerk).
2. **Time Saving** – Similar transactions are grouped together.
3. **Specialization** – Improves efficiency by allocating responsibility.
4. **Error Detection** – Easier to locate mistakes.
5. **Ledger Efficiency** – Ledger remains neat and simple.
6. **Fraud Prevention** – Division of work ensures better internal check.

Difference between Subsidiary Books and Cash Book

Basis	Subsidiary Books	Cash Book
Nature	Record of transactions of similar type (credit purchases, sales, returns, etc.)	Records only cash and bank transactions.
Types	Purchases Book, Sales Book, Returns Book, Bills Books, etc.	Cash Book only (with single, double or triple columns).

Transactions	Mostly credit transactions (except bills).	Only cash/bank receipts and payments.
Utility	Helps to divide work in large firms.	Acts as both journal and ledger for cash/bank.

TYPES OF SUBSIDIARY BOOKS

Purchases Book

- Records **credit purchases of goods** only.
- Cash purchases are recorded in the **Cash Book**.
- Non-goods purchases (e.g., machinery, furniture) are recorded in the **Journal Proper**.

Specimen: Purchases Book

Date	Invoice No.	Name of Supplier	L.F.	Amount

Posting Rule:

- Debit **Purchases A/c** in Ledger.
- Credit individual **Supplier's A/c** in Ledger.

Question 3:

Purchased goods on credit from Ram & Co. Rs.20,000. Entry in Purchases Book.

Solution: Purchases A/c (Dr.) Rs. 20,000; Ram & Co. A/c (Cr.) Rs. 20,000.

Sales Book

- Records **credit sales of goods** only.
- Cash sales ⟶ Cash Book.
- Sale of assets ⟶ Journal Proper.

Specimen: Sales Book

Date	Invoice No.	Name of Customer	L.F.	Amount (Rs.)

Posting Rule:

- Debit individual **Customer's A/c**.
- Credit **Sales A/c**.

Illustration 5:

Returned goods worth Rs. 5,000 to Ram & Co. Purchases Return Book entry.

Solution: Ram & Co. A/c (Dr.) Rs. 5,000; To Purchases Return A/c Rs. 5,000.

Sales Return (Return Inward) Book

Records return of goods by customers.

Specimen: Sales Return Book

Date	Credit Note No.	Customer	L.F.	Amount (Rs.)

Posting Rule:

- Debit Sales Return A/c.
- Credit Customer's A/c.

Illustration 6:

Shyam & Co. returned goods worth Rs. 2,000. Sales Return Book entry.

Solution: Sales Return A/c (Dr.) Rs. 2,000; To Shyam & Co. Rs. 2,000.

Bills Receivable Book

Records all **Bills Receivable** accepted by debtors.

Posting Rule:

- Debit Bills Receivable A/c with total.
- Credit individual Debtors' A/c.

Illustration 7:

Received an acceptance from Shyam for Rs. 10,000. Bills Receivable Book entry.

Solution: Bills Receivable A/c (Dr.) Rs. 10,000; To Shyam A/c Rs. 10,000.

Bills Payable Book

Records all **Bills Payable** accepted in favor of creditors.

Posting Rule:

- Debit individual Creditor's A/c.
- Credit Bills Payable A/c.

Illustration 8:

Accepted a bill in favor of Ram for Rs. 8,000. Bills Payable Book entry.

Solution: Ram A/c (Dr.) Rs. 8,000; To Bills Payable A/c Rs. 8,000.

Journal Proper (General Journal)

Transactions not covered under subsidiary books are recorded here.

Types of Entries in Journal Proper:

1. **Opening Entries** – Bringing forward balances of assets & liabilities.
   Example: Assets A/c Dr.
   To Liabilities A/c,
   To Capital A/c.
2. **Closing Entries** – Transfer of expenses and revenues to Trading & P&L A/c.
   Example: Trading A/c Dr.
   To Purchases A/c.
3. **Rectification Entries** – Correcting errors.
   Example: If Wages wrongly debited to Machinery, then
   Machinery A/c Dr.
   To Wages A/c.
4. **Transfer Entries** – Transfer between accounts.
   Example: Drawings A/c Dr.
   To Cash A/c.
5. **Adjusting Entries** – Outstanding, prepaid, depreciation.
   Example: Salary Outstanding A/c Dr.
   To Salary A/c.
6. **Entries for Dishonor of Bills** – Debtor A/c Dr.
   To Bills Receivable A/c.

Illustration 9:

Record the following in proper Subsidiary Books and post into Ledger:

1. Purchased goods on credit from Ram & Co. Rs. 30,000.
2. Sold goods on credit to Shyam & Co. Rs. 20,000.
3. Returned goods to Ram & Co. Rs. 5,000.
4. Shyam returned goods worth Rs. 3,000.
5. Received a bill from Shyam Rs. 17,000.
6. Accepted a bill in Favor of Ram Rs. 25,000.

Solution:

- Purchases Book Rs. 30,000 (Ram & Co.)
- Sales Book Rs. 20,000 (Shyam & Co.)
- Purchases Return Book Rs. 5,000 (Ram & Co.)
- Sales Return Book Rs. 3,000 (Shyam & Co.)
- Bills Receivable Book Rs. 17,000 (Shyam & Co.)
- Bills Payable Book Rs. 25,000 (Ram & Co.)

Ledger Posting (Summarized):

- Purchases A/c Dr. Rs. 30,000
  To Ram A/c Rs. 30,000
- Shyam A/c Dr. Rs. 20,000
  To Sales A/c Rs. 20,000
- Ram A/c Dr. Rs. 5,000
  To Purchases Return A/c Rs. 5,000
- Sales Return A/c Dr. Rs. 3,000
  To Shyam A/c Rs. 3,000
- Bills Receivable A/c Dr. Rs. 17,000
  To Shyam A/c Rs. 17,000
- Ram A/c Dr. Rs. 25,000
  To Bills Payable A/c Rs. 25,000

Cash Book – A Subsidiary and Principal Book

The **Cash Book** is a special journal maintained for recording all cash and bank transactions of a business. Unlike other subsidiary books, the Cash Book serves both as:

- **Subsidiary Book** ⟶ because it records transactions like a journal.
- **Principal Book (Ledger)** ⟶ because it also works as a Cash Account and Bank Account (hence, no need to open separate Cash A/c or Bank A/c in the ledger).

  Thus, it has a **dual nature**.

  Kinds of Cash Book

  The cash book can be divided into the following types:

Single Column Cash Book

- Contains only one column (Cash).
- Records cash receipts on the debit side and cash payments on the credit side.
- Cash balance is always **debit** (never negative).

  Specimen Format

Date	Particulars	L.F	Debit (Receipts)	Date	Particulars	L.F	Credit (Payments)

Double Column Cash Book (Cash + Bank)

- Contains **two columns**: Cash and Bank.
- Records both **cash and bank transactions**.
- Helps avoid duplication of posting.

Specimen Format

Date	Particulars	L.F	Cash (Dr)	Bank (Dr)	Date	Particulars	L.F	Cash (Cr)	Bank (Cr)

Triple Column Cash Book (Cash + Bank + Discount)

- Has **three columns** on each side: Cash, Bank, and Discount.
- Discount column is a **memorandum column** (not balanced, only totalled).

Specimen Format

Date	Particulars	L.F	Discount (Dr)	Cash (Dr)	Bank (Dr)	Date	Particulars	L.F	Discount (Cr)	Cash (Cr)	Bank (Cr)

Petty Cash Book

- Maintained for **small, routine expenses** (postage, stationery, traveling, etc.).
- Operates under **Imprest-System**: a fixed sum is given to the petty cashier, and after spending, he is reimbursed.

Advantages of Petty Cash Book

1. Saves time of chief cashier.
2. Reduces clerical work.
3. Improves accuracy.
4. Provides better internal control.

Posting of Cash Book Entries

- **Single Column Cash Book** ⟶ posted to relevant accounts except Cash A/c.
- **Double Column Cash Book** ⟶ both cash and bank entries are self-contained, only contra entries (Cash ⟶ Bank, Bank ⟶ Cash) marked as "C" are not posted.
- **Discount Columns** ⟶ totals transferred to Discount Allowed A/c (Dr) and Discount Received A/c (Cr).
- **Petty Cash Book** ⟶ totals posted to respective nominal accounts.

Balancing the Cash Book

- **Cash Column** ⟶ always shows a **debit balance** (cannot be negative).
- **Bank Column** ⟶ can show debit balance (favourable balance) or credit balance (bank overdraft).
- Balancing is done like ledger accounts ⟶ "Balance c/d" at the end of the period, brought down as "Balance b/d" in the next period.

Entries for Debit and Credit Card Sales

- **Debit Card Sales** ⟶ treated like **cash sales** because money is received immediately.

Entry:

Bank A/c Dr
  To Sales A/c

- **Credit Card Sales** ⟶ treated like **credit sales**, but to bank/credit card company.

Entry:

Bank/Credit Card Co. A/c Dr
  To Sales A/c

Charges deducted by Card Company:
Discount/Commission A/c Dr
  To Bank/Credit Card Co. A/c

Illustration 10: Single Column Cash Book

Prepare a Cash Book from the following:
1 April: Cash in hand Rs. 10,000
2 April: Purchased goods for cash Rs. 3,000 5 April: Cash sales Rs. 4,000
10 April: Paid rent Rs. 2,000

Solution:

Cash book single column

Date	Particulars	Receipts (Rs.)	Date	Particulars	Payments (Rs.)
Apr 1	Balance b/d	10,000	Apr 2	Purchases	3,000
Apr 5	Sales	4,000	Apr 10	Rent	2,000
			Apr 30	Balance c/d	9,000
		14,000			**14,000**
May 1	Balance b/d	9,000			

Illustration 11: **Enter the following transactions in Double Column Cash Book:**

1 May: Cash in hand Rs. 5,000, Bank balance Rs. 10,000
2 May: Deposited Rs. 2,000 into bank
4 May: Received cheque from Ram 3,000 & deposited 6 May: Issued cheque to Shyam Rs. 4,000

Solution:

Double Column Cash Book

Date	Particulars	Cash Dr (Rs.)	Bank Dr (Rs.)	Date	Particulars	Cash Cr (Rs.)	Bank Cr (Rs.)
May 1	Balance b/d	5,000	10,000				
May 2	Bank (C)	2,000		May 2	Cash (C)		2,000
May 4	Ram		3,000				
May 6	Shyam			May 6	Bank		4,000
	Balance c/d	3,000	9,000				
		10,000	**13,000**			**2,000**	**13,000**
Jun 1	Balance b/d	3,000	9,000				

Illustration 12: Triple Column Cash Book Transactions:

1 June: Cash in hand Rs. 8,000, Bank balance Rs. 12,000

2 June: Cash sales Rs. 6,000, allowed discount Rs. 200

5 June: Paid to Ramesh by cheque Rs. 5,000, received discount Rs. 100

Solution:

Triple **Column Cash Book**

Date	Particulars	Disc Dr (Rs.)	Cash Dr (Rs.)	Bank Dr (Rs.)	Date	Particulars	Disc (Rs.)	Cash Cr (Rs.)	Bank Cr (Rs.)
Jun 1	Balance b/d		8,000	12,000					
Jun 2	Sales	200	6,000						
Jun 5					Jun 5	Ramesh	100		5,000
						Balance c/d	100	14,000	7,000
		200	**14,000**	**12,000**			**200**	**14,000**	**12,000**
Jul 1	Balance b/d	100	14,000	7,000					

***Illustration 13*: Petty Cash Book (Imprest System)**

Petty cashier receives Rs. 5,000 on 1 July. Expenses during July: Postage Rs. 600, Stationery Rs. 800, Conveyance Rs. 1,000, Refreshments Rs. 700.

Solution: **Pretty cash book**

Date	Particulars	V. No	Total (Rs.)	Postage (Rs.)	Stationery (Rs.)	Conveyance (Rs.)	Refreshments (Rs.)
Jul 1	Cash Received		5,000				
Jul	Expenses		3,100	600	800	1,000	700
	Balance c/d		1,900				

F. TRIAL BALANCE:

- In the accounting cycle, after all transactions are recorded in the **Journal** and subsequently posted into the **Ledger accounts**, the next step is **to check the arithmetical accuracy** of these accounts. This is done by preparing a **Trial Balance**.
- A **Trial Balance** is a statement prepared at a particular date, containing debit and credit balances of all ledger accounts. The main purpose is to ascertain whether the total of debits equals the total of credits.

Definition:
"A trial balance is a statement of debit and credit totals or balances extracted from ledger accounts to check the arithmetical accuracy of the books."

Objectives of Preparing a Trial Balance

1. **Check arithmetical accuracy** – Ensures total debits = total credits.
2. **Summarize ledger balances** – Provides a consolidated list of all account balances.
3. **Facilitates preparation of financial statements** — Serves as the basis for preparing Trading A/c, P&L A/c, and Balance Sheet.
4. **Helps in locating errors** – Certain types of errors can be detected when totals do not tally.
5. **Provides a snapshot** – Reflects the financial position at a glance.

Limitations of Trial Balance

- **Does not ensure complete accuracy** – Certain errors remain undetected (like compensating errors, omission, principle errors).
- **Not a final proof** – Even if debits = credits, accounts may still contain mistakes.
- **Cannot show fraud** – Manipulation may go unnoticed.
- **Only arithmetical check** – Does not check correctness of posting to correct accounts.

Methods of Preparing Trial Balance

There are **three main methods** and one **special adjusted method**:

Total Method

- Debit and credit totals of each ledger account are taken to the trial balance.
- Rarely used in practice.

Balance Method (Most widely used)

- Only balances (debit or credit) of accounts are carried to the trial balance.

Total and Balance Method

- Both debit/credit totals and balances are shown.
- Not commonly used due to redundancy.

Adjusted Trial Balance (Suspense Account)

- When the trial balance does not tally, the difference is temporarily placed in a **Suspense Account** to proceed with final accounts.
- Later adjustments are made once errors are identified.

Rules of Preparing a Trial Balance

1. List all ledger accounts in order (assets, liabilities, incomes, expenses).
2. Enter debit balances in the debit column, credit balances in the credit column.
3. Ensure the totals of both sides are equal.
4. If totals do not match, investigate errors or use suspense account temporarily.

***Illustration 14:* Balance Method**

From the following balances of M/s Raghav Traders, prepare a Trial Balance as on 31st March, 20XX:

- Cash in Hand Rs. 12,000
- Furniture Rs. 8,000
- Creditors Rs. 6,000
- Sales Rs. 50,000
- Purchases Rs. 32,000
- Capital Rs. 20,000
- Wages Rs. 4,000

Solution:

Particulars	Debit (Rs.)	Credit (Rs.)
Cash in Hand	12,000	
Furniture	8,000	
Purchases	32,000	
Wages	4,000	
Creditors		6,000
Sales		50,000
Capital		20,000
Total	56,000	76,000

Since totals do not match, the difference (Rs. 20,000) will be placed in **Suspense A/c**.

***Illustration 15:* Adjusted Trial Balance through Suspense Account**

A trial balance shows a difference of Rs. 2,000 carried to Suspense A/c. On rechecking:

- Sales return of Rs. 1,000 omitted from books.
- Rent received Rs. 500 posted twice.
- Machinery purchased for Rs. 500 wrongly debited to Purchases A/c.

Solution:

Adjusting errors:

- Sales return not recorded — Debit Returns A/c Rs. 1,000, Credit Debtors A/c Rs. 1,000.
- Rent received double — Debit Rent A/c Rs. 500, Credit Suspense A/c Rs. 500.

- Machinery misposted — Debit Machinery A/c Rs. 500, Credit Purchases A/c Rs. 500.

Suspense A/c will be closed after rectification.

G. RECTIFICATION OF ERRORS

WHAT IS AN ERROR?

Error is an accounting mistake. When a business transaction is not recorded in accordance with well accepted accounting principles and practices, it is said there is an error.

EXAMPLES OF ERRORS:

Goods Purchased from Gopi for Rs. 68,000. This transaction may be recorded in the books of accounts wrongly by one of the following ways-

1. Omitted to be recorded in Purchase Day Book.
2. Recorded in Purchase Day Book twice.
3. Recorded in Purchase Day book as Rs. 86,000.
4. Recorded in sales Returns Day book.
5. Posted to the Gopi's Account as Rs. 86,000.
6. Posted to the account of Gopika.
7. Posted to the Debit side of Gopi's Account.

STAGES OF ERRORS

While recording the transactions in journal	While posting the entries in the Ledger	While balancing the Ledger Accounts	While preparing the Trial Balance
Errors of Principle Errors of Omission Errors of Commission	Errors of Omission (a) Partial Omission (b) Complete Omission Errors of Commission (a) Posting to wrong A/c (b) Posting on wrong A/c (c) Posting wrong amount	Wrong Totalling of A/c Wrong Balancing of A/c	Errors of omission Errors of commission (a) Taking wrong A/c (b) Taking wrong Amt. (c) Taking to wrong side

TYPES OF ERRORS:

Errors

- **Errors of Principle**
  - **(A)**
- **Clerical Errors**
  - Errors of Omission
    - **(a)** Complete Omission **(A)**
    - **(b)** Partial Omission **(B)**
  - Errors of Commission
    - **(A and B)**
  - Compensating Errors
    - **(A)**

Imp Note: **Type A** Error = Trial Balance will still agree.
Type B Error = Trial Balance will not agree.

ERRORS OF PRINCIPLE

Meaning	It arises when a financial transaction is recorded in the books in an **incorrect manner.** i.e. Journal Entry is **not as per Accounting Principles.**
Example	Capital Expenditure is treated as revenue expenditure or vice versa, E.g. Repairs to machinery wrongly treated as capital expenditure and debited to Machinery Account instead of Machinery Repairs A/c.
Types	They may be analysed into – • **Errors which affect profits:** e.g. Treating Rent Paid as a Debtor instead of as Expenses, or when Capital Expenditure is treated as revenue and debited to P & L Account. • **Errors which do not affect profits:** e.g. Manufacturing Wages posted to Trade Expenses Account or wrong classification of assets or liabilities.
Stage	Such errors are normally **committed while recording in the Journal.**
Effect on T.B.	Such errors **WILL NOT** affect the Trial Balance.
Effect on profits	Errors of principle, which **involve income and expenditure accounts,** e.g. wrong distinction between capital & revenue expenditure, **will affect profit.**

ERRORS OF OMISSION

Meaning	Error of Omission means that a transaction **is not recorded / Posted / transferred** either wholly or partially, in the books of accounts.	
Types	They may be further analysed into –	
	Partial Omission	**Complete Omission**

	(a) One aspect of the transaction, either debit or credit, is omitted to be recorded / posted	Both aspects of the transaction, debited and credited, are omitted to be recorded / posted.
	(b) Trial Balance will not agree.	Trial Balance will still agree.
	(c) Arises from posting errors – one-sided posting and omission of other side entry.	Arises from omission – either in the book of original entry or in the ledger.
Stage	(a)**Complete Omission:** (i) while recording in Journal (ii) Posting to Ledger (b)**Partial Omission:** (i) While posting to ledger	
Effect on T.B.	(a) **Complete Omission – will NOT affect** the Trial Balance (As both aspects of equal amounts omitted) (b) **Partial Omission in posting – will affect** the Trial Balance (as one of the aspects are recorded)	
Effect on profit	Effect of errors of omission on Profit cannot be generalized. If errors involve Nominal Account, i.e. income and expenditure items, profits are affected.	

ERRORS OF COMMISSION

Meaning	A transaction is recorded **wrongly** or **incorrectly** in the books. It also includes all clerical errors during the Accounting Process.
Types and Effect on T.B.	These may be categorized into – **(a) Posting Errors:** wrong account, wrong amount, wrong side, etc. This **affects** Trial Balance. **(b) Casting Errors:** wrong totalling or balancing. This **affects** Trial Balance. **(c) Carry Forward Errors:** carrying forward a wrong amount, wrong side, etc. This **affects** Trial Balance. **(d) Duplication Errors:** recording the same transaction twice in the original book of entry and also posting it to the Ledger. This **does not affect TB.**
Effect on T.B.	**One-Sided Errors** will cause difference in Trial Balance, E.g. Wrong Posting, Wrong amount, Account etc. **Two-Sided errors** will not affect the Trial Balance.
Effect on profit	Effect of errors of commission on Profit cannot be generalized. If errors involve Nominal Accounts i.e. income and expenditure items, profits are affected.

COMPENSATING ERRORS

Meaning	One set of errors on the debit side for a specified amount is counter—balanced by another set of errors for the same amount on the credit side. Due to this, the Trial Balance is not affected.
Nature	• It is difficult to detect as such. It may or may not affect the profit. • If the Original Error and the Compensating Error both arise in Incomes / Expense Accounts, the profit will **not** be affect, but if one arises in a Revenue Account and the other in an Asset or Liability Account, although the Trial Balance will agree, profit will be incorrectly stated. • Such errors arises in various ways, but most frequently casting (totaling), e.g. the cast of expenditure account may be Rs. 9,600 less, and the cost of asset account Rs. 9,600 extra, the profit and the asset being thereby increase improperly.
Effect on T.B.	Such errors **will not affect the Trial Balance.**
Effect on profits	Compensating Errors, which involve Income and Expenditure Accounts, will affect profit. However if the error occurs in Asset and Liability Accounts only, profits may not be affected.

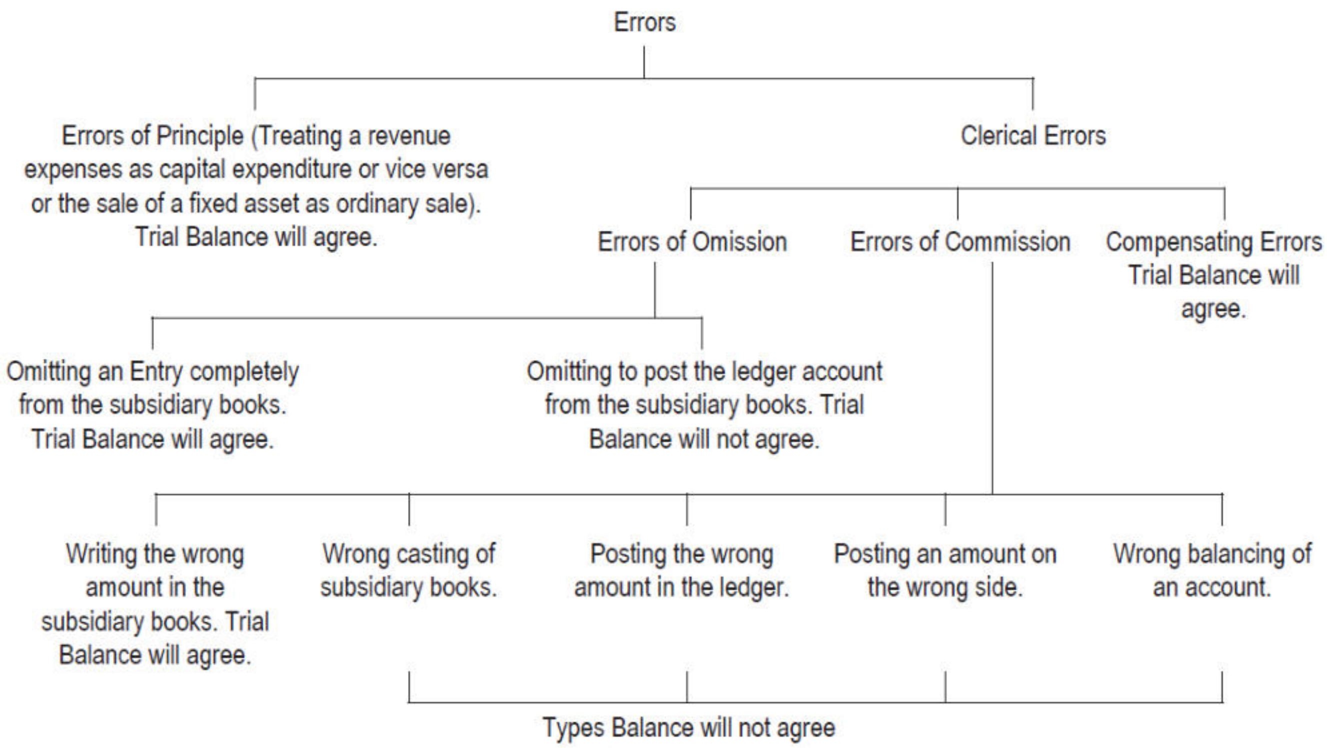
ANOTHER POINT OF VIEW, ERROR MAY BE DIVIDED INTO TWO CATEGORIES:

(a) Those that affect the trial balance - because of these errors ,trial balance does not agree; these are the following:

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

(b) The errors that do not affect the trial balance are the following:

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



TOOLS FOR IDENTIFYING ERRORS

Particulars	Errors identifiable	Errors not identifiable
1. Trial Balance	Totals of Debit Column & Credit Column do not match.	Totals of Dr. & Cr. Columns may match even if some errors exist.
2. Bank Reconciliation Statement	Identifies errors in Cash Book / Pass Book / Omission to record	Names of debtors and Creditors may not be verifiable from Bank Statement
3. Stock Reconciliation Statement	Identifies errors in Stock as per books, omission of stock losses etc.	When the same error is committed while physical verification of stock and computation as per books.
4. Debtors & Creditors Reconciliation	Identifies errors in recording the entries involving debtors / creditors.	When collusion is involved with the relevant debtors / creditors
5. Ratio Analysis	Indicates the possibility of errors on an overall basis.	Not possible to identify the exact error. It is not only an indication and not a confirmation of errors.

SUSPENSE ACCOUNT

1. **Meaning:** When the Trial Balance does not tally, then it is essential to create an account named "Suspense Account" on the **column whose total is lower.**
2. **Purpose:**

(a) The Suspense Account is opened for the **differential amount on the column** which is lower to make the trial balance **artificially tally. (i.e. Trial Balance is temporarily tallied by opening the suspense account).**

(b) It is kept till the errors are identified and rectified. After the rectification, **Suspense A/c balance will become zero.**

3. **Type:** Suspense A/c is a **combination of Real, Personal and Nominal Accounts.** It is a **temporary Account.**

4. **Nature of balance in Suspense Account:**

Situation	Suspense A/c will appear on	Nature of Balance
If **Debit** Column Total **<** **Credit** Column Total	Debit Column	Debit Balance
If **Credit** Column Total < **Debit** Column Total	Credit Column	Credit Balance
IMP Note: Suspense account will appear on the Column whose total is lower		

5. Hence, Suspense Account will appear only when an error affects the Trial Balance.

6. **Disclosure in Balance Sheet:**

Nature of Suspense A/c Balance	Show in	Side
Debit Balance in Suspense A/c	Balance Sheet	Assets
Credit Balance in Suspense A/c	Balance Sheet	Liabilities

STAGE OF RECTIFICATION OF ERRORS

Error in the accounts can be detected and rectified in any of the following stages —

Stage	Treatment
1. Before preparation of Trial Balance	• Errors of Complete Omission are rectified by recording the same fully and properly • Errors of Partial Omission are rectified by making relevant posting. • Errors of Principle rectified by making rectification Journal Entry. • ***Suspense Account shall not be opened. Direct rectification is done.***
2. After Trial Balance but before Final Accounts are prepared	• Errors of Complete Omission are rectified by recording the same fully and properly. • Errors of Partial Omission are rectified by rectification Journal Entry, by **using the Suspense Account.** • Errors of Principle are rectified by making the rectification Journal Entry. • Errors of Commission are rectified based on the nature of error.

3. After Final Accounts i.e. in the next a/cing period	• Errors of Partial Omission are rectified by way of rectification Journal Entry, by using the **Suspense Account.** • **Errors which have an impact on Profit (Nominal Accounts) are rectified by using the P & L Adjustment Account. Instead of Nominal Accounts, P & L Adjustments A/c is debited or credited.**

ERRORS:

(a) Error of Principle

Treating Capital Expenditure as Revenue	Treating Revenue Expenditure as Capital	Payments for expenses as loans given	Receipts for incomes as loans recd.

(b) Error of Omission

Not recorded in Journal	Not recorded in Subsidiary Books	Both aspects not posted to ledger	One aspect not posted to ledger

(c) Error of Commission

Recording in Journal	Recording in Subsidiary Book	Posting entries in the Ledger	Balancing Ledger A/cs / Subsidiary Books	Preparing the Trial Balance
↓	↓	↓	↓	↓
(a) Wrong Amt.	(a) Wrong Book	(a) Wrong Amount (Correct A/c)	Overcasting – Dr. Side	Taking wrong A/c
(b) Wrong A/c	(b) Wrong Amt.	(b) Wrong Account (Correct Side)	Overcasting – Cr. Side	Taking wrong Amt.
	(c) Wrong Casting	(c) Wrong Side of a Correct A/c	Under casting – Dr. Side	Taking to wrong side
		(d) Wrong Amt. to a Wrong A/c	Under casting – Cr. Side	
		(e) Wrong Side of a Wrong A/c	Wrong Balancing of Dr. balance A/c	
		(f) Wrong Amt. to Wrong Side of a Correct A/c		
		(g) Wrong Amt. to Wrong Side of a Wrong A/c	Wrong Balancing of Cr. balance A/c	

H. PRACTICAL QUESTIONS

1. Comprehensive Illustration for Rectification of Errors

1. Total of Purchases Book undercast by ₹90,000
2. Returns Inward Book has been overcast by ₹1,00,000
3. ₹25,000 paid towards Salary has been credited in Cash Book, but has not been posted in the Salary a/c.
4. Electricity Charges ₹15,000 has been debited to Electrical Fittings (Asset) Account.
5. Total of Discount Received from Suppliers as per Cash Book ₹3,000 has not been posted in the Nominal Ledger. But, the Parties Ledger has been properly recorded.
6. Credit Sales ₹1,80,000 made to Ram is correctly recorded in Sales Book, but posted as ₹1,00,000 in Ram's Account.
7. Sale of Old Machinery ^45,000 has been recorded in the Sales Book.
8. ₹30,000 received from Ashwin (a Customer), has been credited to Balram's Account.
9. Rent paid ₹15,000 to Arun (Landlord) has been debited to his personal A/c.
10. Given that the debit balance in Suspense Account is ₹92,000

Solution:

Stage I: Rectification before preparation of Trial Balance

1.	Entry in the Purchase Account will be	"To undercasting of Purchases Book ₹ 90,000".
2.	Entry in the Sales Returns Account will be	"By overcasting of Sales Returns Book ₹ 1,00,000".
3.	Entry in the Salary Account will be	"To omission of posting on ₹ 25,000".
4.	This will be rectified by the Journal Entry	Electricity Charges A/c Dr. 15,000 To Electrical Fittings (Asset) A/c 15,000
5.	Entry in the Discount Received Account will be -	"By omission of posting on ₹ 3,000".
6.	Entry in Ram A/c will be -	"To wrong posting of Invoice No ₹ 80,000"
7.	This will be rectified by the Journal Entry	Sales A/c Dr. 45,000 To Machinery A/c 45,000
8.	This will be rectified by the Journal Entry	Balram A/c Dr. 30,000 To Ashwin A/c 30,000
9.	This will be rectified by the Journal Entry	Rent A/c Dr. 15,000 To Arun (Landlord) A/c 15,000

Stage II: Rectification after preparation of Trial Balance but before Final Accounts

	Particulars	Dr. (₹)	Cr. (₹)

1.	Purchases A/c Dr. To Suspense A/c (Being wrong undercasting of Purchases Book, now rectified)	90,000	90,000
2.	Suspense A/c Dr. To Sales Returns A/c (Being wrong overcasting of Sales Returns Book, now rectified)	1,00,000	1,00,000
3.	Salary A/c Dr. To Suspense A/c (Being omission of posting of Salary A/c, now rectified)	25,000	25,000
4.	Electricity Charges A/c Dr. To Electrical Fittings (Asset) A/c (Beinq Electricity Charges wrongly capitalized, now rectified)	15,000	15,000
5.	Suspense A/c Dr. To Discount Received A/c (Beinq omission of posting of Discount Received, now rectified)	3,000	3,000
6.	Ram (Sundry Debtors)A/c Dr. To Suspense A/c (Being wrong posting of Ram's A/c as 1,00,000 instead of 1,80,000, rectified)	80,000	80,000
7.	Sales A/c Dr. To Machinery A/c (Being sale of old m/c, wrongly recorded in Sales Book, now rectified)	45,000	45,000
8.	Balram (Sundry Debtors) A/c Dr. To Ashwin (Sundry Debtors) A/c (Being collection from Ashwin wrongly credited to Balram, now rectified)	30,000	30,000
9.	Rent A/c Dr. To Arun (Landlord)A/c (Rent wrongly debited to Personal A/c, now rectified)	15,000	15,000

Suspense A/c

Particulars	₹	**Particulars**	₹
To balance b/d	**92,000**	By Purchases A/c (1)	90,000
To Sales Returns A/c (2)	1,00,000	By Salary A/c (3)	25,000
To Discount Received A/c (5)	3,000	By Ram (Sundry Debtors)A/c (6)	80,000
Total	**1,95,000**	**Total**	**1,95,000**

Note: Before rectification of the above errors, the Trial Balance will be showing a Balance (short debit) of ₹92,000. That difference will be rectified by the above rectification of errors. Hence, there will be no balance in Suspense A/c.

Stage III: Rectification of errors in next accounting period

	Particulars	Dr. (₹)	Cr. (₹)
1.	Profit and Loss Adjustment A/c Dr. To Suspense A/c (Being wrong under casting of Purchases Book, now rectified)	90,000	90,000
2.	Suspense A/c Dr. To Profit and Loss Adjustment A/c (Being wrong overcasting of Sales Returns Book, now rectified)	1,00,000	1,00,000
3.	Profit and Loss Adjustment A/c Dr, To Suspense A/c (Being omission of posting of Salary A/c, now rectified)	25,000	25,000
4.	Profit and Loss Adjustment A/c Dr. To Electrical Fittings (Asset) A/c (Being Electricity Charges wrongly capitalized, now rectified)	15,000	15,000
5.	Suspense A/c Dr. To Profit and Loss Adjustment A/c (Being omission of posting of Discount Received, now rectified)	3,000	3,000
6.	Ram (Sundry Debtors)A/c Dr. To Suspense A/c (Being wrong posting of Ram's A/c as 1,00,000 instead of 1,80,000, rectified)	80,000	80,000
7.	Profit and Loss Adjustment A/c Dr. To Machinery A/c (Old m/c sold, wrongly recorded in Sales Book, now rectified)	45,000	45,000
8.	Balram (Sundry Debtors) A/c Dr. To Ashwin (Sundry Debtors) A/c (Collection from Ashwin wrongly credited to Balram, now rectified)	30,000	30,000
9.	Profit and Loss Adjustment A/c Dr. To Arun (Landlord)A/c (Being Rent Expense wrongly debited to Personal A/c, now rectified)	15,000	15,000

Suspense A/c

Particulars	₹	Particulars	₹
To balance b/d	92,000	By Profit & Loss Adjustment A/c (1)	90,000
To P&L Adjustment A/c (2)	1,00,000	By P&L Adjustment A/c (3)	25,000
To P&L Adjustment A/c (5)	3,000	By Ram (Sundry Debtors) A/c (6)	80,000
Total	**1,95,000**	**Total**	**1,95,000**

Profit and Loss Adjustment A/c (for Prior Period Items)

Particulars	₹	Particulars	₹
To Suspense A/c (1)	90,000	By Suspense A/c (2)	1,00,000
To Suspense A/c (3)	25,000	By Suspense A/c (5)	3,000
To Electrical Fittings (Asset) A/c (4)	15,000		
To Machinery A/c (7)	45,000		
To Arun (Landlord)A/c (9)	15,000	By balance c/d	87,000
Total	**1,90,000**	**Total**	**1,90,000**

Note: Depreciation on Furniture purchased, and Loss on Sale of Old Machinery is ignored.

2. A book-keeper finds the difference in the Trial Balance amounting to ₹1,000 and puts it in the Suspense A/c. Later on the detects the following errors. From the following, Give Journal Entries with full narration and prepare Suspense A/c.
   (a) Purchased Goods from Ravi 5,000 but entered into Sales Book.
   (b) Received one Bill for ₹25,000 from Arun but recorded in Bills Payable Book.
   (c) An item of ₹3,500 relating to Prepaid Rent Account was omitted to be brought forward.
   (d) An item of ₹2,000 in respect of Purchases Return had been wrongly entered in the Purchase Book.
   (e) ₹25,000 paid to Hari against our acceptance were debited to Harish's Account.
   (f) Bills received from Janaki for Repairs done to Radio ₹2,500 and Radio supplied for ₹45,000 were entered in the Purchase Book as ₹46,000.

Solution:

Rectification Entries

	Particulars		Dr.	Cr.
1.	Purchases	Dr.	15,000	
	A/c Sales A/c	Dr.	15,000	
	To Ravi A/c			30,000
	(Being the rectification of error by which Purchases were wrongly entered into Sales Book)			
2.	Bills Receivable A/c	Dr.	25,000	
	Bills Payable A/c	Dr.	25,000	
	To Arun A/c			50,000

	(Being the rectification of recording in Bills Payable Book instead of Bills Receivable Book)			
3.	Prepaid Rent A/c	Dr.	35,000	
	To Suspense A/c			35,000
	(Being the error by which Prepaid Rent A/c was omitted to be brought forward, rectified)			
4.	Suspense A/c	Dr.	4,000	
	To Purchases A/c			2,000
	To Purchases Returns A/c			2,000
	(Being the rectification of error by which Purchase Returns had been wrongly entered in the Purchase Book)			
5.	Bills Payable A/c	Dr.	25,000	
	To Harish A/c			25,000
	(Being the rectification of wrong debit to Harish Account instead of Bills Payable Account)			
6.	Repairs A/c	Dr.	2,500	
	Radio A/c	Dr.	45,000	
	To Purchases A/c			46,000
	To Suspense A/c			1,500
	(Being the rectification of wrong recording of amount of Repairs and cost of Radio purchased in the Purchases Book)			

Dr. **Suspense Account** **Cr.**

Particulars	**₹**	**Particulars**	**₹**
To Balance b/d	1,000	By Prepaid Rent A/c	3,500
To Purchases A/c	2,000	By Repairs and Radio A/c	1,500
To Purchase Returns A/c	2,000		
Total	**5,000**	**Total**	**5,000**

3. The Accountant of X prepared the Trial Balance for the year ended 31stMarch. But there was a difference and the Accountant put the difference in Suspense Account. Rectify the following errors found and prepare the Suspense Account:
   (a) The total of the Returns Outward Book, ₹420 has not been posted in the Ledger.
   (b) A Purchase of ₹350 from Y has been entered in the Sales Book. However, Y's Account has been correctly entered.
   (c) A Sale of ₹390 to Z has been credited to his account as ₹290.
   (d) Old Furniture sold for ₹5,400 had been entered as ₹4,500 in Sales Account.
   (e) Goods taken by Proprietor, ₹500 have not been entered in the books a tall.

Solution:

Rectification Entries

	Particulars		**Dr.**	**Cr.**
1.	Suspense A/c	Dr.	420	
	To Return Outward A/c	Dr.		420
	(Being the rectification of error of Return Outward A/c not posted)			
2.	Sales A/c	Dr.	350	
	Purchases A/c	Dr.	350	
	To Suspense A/c			700
	(Being the Rectification of the wrong Credit to Sales A/c and placing the correct Debit to Purchases Account)			
3.	Z A/c	Dr.	680	
	To Suspense A/c			680
	(Being the conversion of credit of ₹290 into a debit of ₹390 in the account of Z)			
4.	Sales A/c	Dr.	4,500	
	Suspense A/c	Dr.	900	
	To Furniture A/c			5,400
	(Being the rectification of error by which Sales A/c was credited by ₹4,500 instead of ₹5,400 in Furniture A/c)			
5.	Drawings A/c	Dr.	500	
	To Purchases A/c			500
	(Being the error relating to omission of entry of ₹500 worth of goods taken by the Proprietor rectified)			

Dr. **Suspense Account** **Cr.**

Particulars	**₹**	**Particulars**	**₹**
To Difference in Trial Balance **(B.F)**	60	By Sales Account	350
To Return Outward Account	420	By Purchases Account	350
To Furniture Account	900	By Z Account	680
Total	**1,380**	**Total**	**1,380**

Topic 3 BANK RECONCILIATION STATEMENT

A. INTRODUCTION - BANK

- A bank is an institution which deals in money.
- Its main business is **to accept deposits and to lend money**.
- It also **collects money and makes payments** on behalf of its clients.
- Bank account is a **personal** account
- The account-holders record their transaction with the bank in a similar manner as they do with any other person.

B. ACTIVITIES OF A BANK

- **Acceptance of Deposits:** Banks accept various deposits like Term Deposits, Fixed Deposits, Current Deposit, Recurring Deposit, etc.
- **Loans:** Lending of money is the major revenue earning activity for a Bank, e.g. Machinery Loan, Building Loan, Vehicle Loan, Personal Loan, etc.
- **Discounting:** Discounting is a process by which the Bank enables its customer to receive the cash before the due date, in consideration of a small charge called Discount, e.g. Bills / Hundi / Pro-Note Discounting.
- **Overdraft:** Bank allows overdrafts to its good customers so that they can make payment even when they do not have sufficient balance in their account at the Bank.
- **Guarantee:** The Bank furnishes securities or guarantee for its customers whose credit is good. The Bank charges commission for this service.
- **Letter of Credit:** Banks can issue Letter of Credit to facilitate commerce. LC Facility is used by businessmen to make payments to Suppliers, etc.
- **Standing Instructions:** As per the instructions of the customer and on his behalf, a Bank makes payment to various parties on the due date, e.g. Telephone Bills, Insurance Premium, Credit Card Dues, etc.
- **Demand Draft:** Banks issue Demand Draft based on its customer's request. Demand Draft is also called as Banker's Cheque, Pay Order, etc. in some cases.
- **Travellers' Cheque:** For frequent travellers, to avoid the risk of carrying cash, the Bank can issue Travellers Cheque, which can be encashed by the traveller in a Bank at the destination.

Role of Banks:

- Banks help people and businesses **keep their money safe**.
- They allow easy **deposits and withdrawals** of money.
- Banks offer **different types of accounts** to suit different needs:
  - **Savings Account** – for individuals to save money and earn interest.
  - **Current Account** – for businesses to handle frequent and high-value transactions.
  - **Fixed Deposit Account** – to keep money for a fixed period and earn higher

interest.

- **Recurring Deposit Account** – to save a fixed amount at regular intervals and earn interest.

- Banks give **loans** for personal, educational, business, and housing needs.
- They help in **paying bills, receiving salaries**, and **transferring money** easily.
- Bank accounts help people and businesses keep **track of their income and spending**.
- Banks reduce the need to carry cash, making transactions **safer and more convenient**.
- They are an important part of the financial system and **support the growth of the economy**.

C. BANK PASS-BOOK OR STATEMENT

- Bank Pass-Book (also known as Bank Statement), is an extract of the Ledger Account of the customer, as per the Bank's Books of Accounts.
- It is a periodical statement of account in which all transactions, i.e. deposits and withdrawals made by the customer during the particular period is recorded.
- A comparative analysis of the Bank Pass Book and Cash Book (Bank Column) is given below.

PASS BOOK FORMAT

Messers ....

in account with

State Bank of India

Navi Peth, Pune-411030

Date	Particulars	Withdrawals Dr. (Rs.)	Deposits Cr. (Rs.)	Dr. or Cr. (Rs.)	Balance (Rs.)

IMP POINTS:

Point	In Bank Pass Book	In Cash Book of the Customer / Business Entity
Debit Entries in Bank Pass Book	• Withdrawal of Cash, • Payment of Cheques to Creditors, Expenses, etc. • Bank Interest, Commission and Charges for various services rendered by the Bank.	These are recorded as **"Payments"** in the Cash Book, i.e. on the **credit side** of the Cash Book (Bank Column).

	• Payment by Bank under Standing Instructions.	
Credit Entries in Bank Pass Book	• Deposit of Cash into Bank, • Receipt / Collection of cheques from Debtors, • Other Incomes / Receipts, e.g. Interest, Dividend, Capital introduced, Loans taken, etc. • Direct collection of Bills Receivable (B/R), Income on Investments, etc. by the Bank.	These are recorded as **"Receipts"** in the Cash Book, i.e. on the **debit side** of the Cash Book (Bank Column).
Favourable Bank Balance	**Credit Balance** in the Bank Pass Book represents a favourable balance, i.e. Normal Balance.	Such favourable balance will normally appear in the **Debit Side** of Cash Book (Bank Column).
Overdraft Balance	**Debit Balance** in the Pass Book represents an unfavourable balance, i.e. Overdraft Balance.	Such overdraft balance will normally appear in the **Credit Side** of Cash Book (Bank Column).

D. BANK RECONCILIATION STATEMENT (BRS):

BRS is a Statement (not Account), which help us to know the causes of difference between balance as per bank column of cash book and pass book.

WHY BRS IS PREPARED?

Transaction	Entry in Bank's Books	Entry in our Books
1. Opened a Bank Account with ₹ 5,000/-	Cash A/c Dr. 5000 To Customers A/c 5000 **(PB Bal.: 5000)**	Bank A/c Dr. 5000 To cash A/c 5000 **(CB Bal.: 5000)**
2. Goods sold & Cheque received ₹ 2,000/-	No Entry in Bank Books at time of receipt of cheque **(PB Bal.: 5000)**	Bank A/c Dr. 2000 To Sales A/c 2000 **(CB Bal.: 7000)**
3. Cash receipt of ₹ 500 at time of sales wrongly recorded in bank column	No Entry in Bank Books since its an error in CB **(PB Bal.: 5000)**	Bank A/c Dr. 500 To Sales A/c 500 **(CB Bal.: 7500)**

CASH BOOK INCREASE	CASH BOOK DECREASE
• Cash Deposited in to bank • Cheque received (& or deposited) • Bill Receivable discounted with bank • Due to Errors or Omission	• Cash withdrawal from bank • Cheque issued • Due to Errors or Omission

RULE 1: DIRECT ENTRY IN PB EFFECT IN CASH BOOK IS PENDING

- **RULE 2: IF THERE IS AN ERROR/ OMISSION IN CB RELATED TO CHEQUE, THEN EFFECT OF SUCH CHEQUE HAS BEEN CLEARED IN PB**

PASS BOOK INCREASE

- Cash Deposited in to bank
- Cheque received & cleared
- Bill Receivable discounted with bank
- Any payment collected by bank
- Direct deposit by our customer into our bank
- Interest allowed by Bank
- Due to Errors or Omission

PASS BOOK DECREASE

- Cash withdrawal from bank
- Cheque issued & cleared
- Any payment made by bank on behalf of customer
- Any charges charged by Bank
- Due to Errors or Omission

BANK RECONCILIATION STATEMENT

- **The** bank pass book and bank columns of the cash book record the **same transactions**
- Of course, in the pass book the transactions are recorded from the **point of view** of the **bank** whereas in cash book they are recorded from the point of view of the **client**. The bank balance as per pass book can therefore, be expected to be equal to the bank balance as revealed by the cash book.
- However, in **actual practice the two balances rarely agree** because of the **time lag** of a few days between the entries made by the firm in cash book and by the bank in the pass book.
- Thus a comparison is necessary to find out the items on account of which differences have arisen and a need to reconcile the two balances.
- Thus a bank reconciliation statement **is a statement which is prepared as on a particular date to reconcile the bank balance as per cash book with balance as per pass book by showing all causes of difference between the two**.

IMP STEPS IN BRS:

1st ⇨ CB = PB

2nd ⇨ Read the transaction analyse it go to the new positions of CB & PB

3rd ⇨ Adjust the starting point

CAUSES OF DIFFERENCE BETWEEN BANK BALANCE SHOWN BY CASH BOOK & BANK PASS BOOK:

- Timing difference
- Differences arises due to errors in recording entries

CAUSES OF DIFFERENCES:

(i) Cheques issued but not presented for payment

(ii) Cheques deposited for collection but not yet collected

(iii) Bank charges not entered in the cash book

(iv) Interest credited or debited by bank not entered in the cash book:

(v) Direct collections on behalf of customers:

(vi) Direct payment by bank

(vii) Dishonour of cheques/bills

(viii) Cheques received and entered in the cash book but omitted to be deposited into the bank.

(ix) Errors

(x) Direct Payment in to bank by a customer

(xi) Bill collected by bank on behalf of customer

(xii) Bill Discounted with bank

IMPORTANCE OR SIGNIFICANCE OF BANK RECONCILIATION STATEMENT:

- It highlights the **causes of difference** between the bank balance as per cash book and the balance as per pass book. Necessary adjustments can, therefore, be carried out at an early date.
- It reduces the **chance of fraud** by the staff dealing in cash.
- It acts as a **moral check** on the staff of the organization to keep the cash records always up to date.
- Bank balance as per cash book cannot be accepted as final unless it is supported by statement of passbook. When these two balances do not tally, reconciliation becomes **essential to determine the correct bank balance** that can be used while finalizing the accounts.
- It helps in finding out **actual position of the bank balance**.

#FOLLOWING IS THE TABLE SUMMARISING IN BRIEF THE TIMINGS OF DIFFERENT TRANSACTIONS:

1	Payment done by the account holder through issuing a cheque	At the time of issuing the Cheque	At the time presenting the cheque to the bank for payment.
2	Receipt by the account holder through a cheque	At the time of depositing the cheque into the bank	At the time of collection of amount from the account of the issuing party.
3	Collection of bills/cheque directly on behalf of the account holder	When the entry is posted in the pass book.	When the amount is collected by the bank.
4	Direct payment to the third party on behalf of the account holder	When the entry is posted in the pass book	When the amount is paid by the bank
5	Dishonour of cheque/bills receivable.	When the entry is posted in the pass book	When the cheque is dishonoured.
6	Bank charges levied by the Bank	When the entry is posted in the pass book	When charges are levied by the bank
7	Interest and dividend credited by the bank	When the entry is posted in the pass book	When interest or dividend is allowed or collected by the bank.
8	Interest debited by the bank	When the entry is posted in the pass book	When interest is charged by the bank

METHOD OF BANK RECONCILIATION STATEMENT:

- Without preparing adjusted cash book
- After preparing adjusted cash book

#BANK RECONCILIATION STATEMENT AFTER THE PREPARATION OF ADJUSTED CASH-BOOK

Meaning of adjusted cash book

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

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

1. all the errors (like wrong amount recorded in the cash-book, entry posted twice in the cash-book, over/ under casting of the balance etc.) and
2. omissions (like bank charges recorded in the pass-book only, interest debited by the bank, direct receipt or payment by the bank, dishonour of cheques/bills etc.) by the cash-book are taken into care Only these transactions are considered for adjusting cash book, apart from this delay in recording in the pass-book due to difference in timing (like cheque issued but not presented for payment, cheque deposited but not collected) is taken to bank reconciliation statement. This adjusted cash-book balance is taken to bank reconciliation statement.

Note: Errors occurring in the pass-book are not to be adjusted in the cash book. All the adjustments considered in the adjusted cash-book are not carried again to the bank reconciliation statement.

E. STATE WITH REASON TRUE OR FALSE

Question	T/F	Reasoning
1. BRS is prepared to arrive at the Bank Balance.	False	BRS is prepared to reconcile and explain the causes of differences between Bank Balance as per Cash Book and the same as per Bank Statement as on a particular date.
2. Interest charged by the Bank will be deducted, when the Overdraft as per the Cash Book is the starting point for making BRS.	False	Here Interest charged by the Bank will be added, since this charge when accounted for, will increase the Overdraft (credit balance) as shown by the Cash Book.
3. If the balance as per Cash Book and Pass Book are the same, there is no need to prepare a Reconciliation Statement.	False	BRS is prepared to find out the cause of difference in individual items of Cash Book and Pass Book, even though the balance as per Cash Book and Pass Book is same.
4. BRS is the process of reconciling cash column of the cash book and bank column of the cash book.	False	BRS reconciles bank column of cash book with the balance in the pass book i.e. customer A/c in the books of bank.
5. There are 3 types of differences between cash book and pass book namely Timing, Transactions & Errors.	True	These are the three broad categories.
6. Adjusting the cash book for any errors and/or omissions before preparing BRS	False	Adjusting the cash book is mandatory when BRS is done at the end of the financial year.

is optional when the reconciliation is done at the end of the financial year.		
7. Debit balance in cash book is same as overdraft as per pass book.	False	Dr balance as per cash book should be represented by credit or favourable balance in pass book.
8. Bank charges debited by the bank is an example of timing difference for the purposes of bank reconciliation.	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.
9. Overcasting of the debit side of the cash book is an example of a difference that is due to error.	True	Overcasting is an example of an error.
10. When we start BRS 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.	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.
11. The bank charges charged by the bank should be deducted when BRS is being prepared starting from a credit balance of pass book.	False	Bank charges should be added when we start with credit or favourable balance in pass book as bank would have debited the charges.
12. When the causes of differences between pass book balance and cash book is not known, then the BRS can be prepared by matching the two books and identifying any unticked items in both sets.	True	Since, we don't know the causes of difference, matching the two statements is only efficient way to identify the difference.
13. While preparing the BRS starting with debit balance as per pass book or bank statement, the deposited cheques that are not yet cleared need not be adjusted.	False	Cheques deposited but not yet cleared should be subtracted from debit or unfavourable balance in pass book.
14. 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. Balance as per pass book should be 1,10,000.	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.
15. Overcasting of credit side of the cash book shall result in a higher bank	False	Overcasting of credit; side means excessive payments are recorded and hence would lower the bank balance.

balance in cash book when compared with pass book balance.		
16. 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.	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.
17. 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.	True	It is an example of a payment instructed by customer to be directly debited by bank, and hence credited in the cash book.
18. BRS can be prepared in two formats - "Balance" presentation and "Plus & Minus" presentation.	True	Reconciliation statement can be prepared in either of the two formats.
19. The difference between cash book 8t pass book that relates to errors are those mostly made by Bank.	False	Bank rarely makes mistakes, and hence differences that relate to errors are generally made in cash book.
20. 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 BRS, we need to deduct 78,400 to reconcile with pass book.	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.
21. Interest on savings bank that is allowed or credited by bank is generally recorded in cash book prior to it being recorded by bank.	False	Interest allowed by bank is mostly recorded in cash book after the entry has been made in the pass book or bank statement.
22. A regular BRS discourages the accountants to be involved in any kind of funds embezzlement.	True	In absence of any reconciliation, the accountants can mis-utilize the funds temporarily by recording the entry without actual depositing the cash.
23. Timing difference relates the transactions that are recorded in the same period in both cash book and also the bank pass book.	False	Timing differences relate to the transactions that are recorded in cash book and pass book in two different periods.

F. METHODS OF PRESENTATION OF BRS

1. Balance Presentation
2. Plus & Minus Presentation **Example**

From the following particulars, prepare Bank Reconciliation Statement through

(a) Balance Presentation

(b) Plus & Minus Presentation

(i)	Overdraft as per cash book	1,80,000
(ii)	Overdraft as per pass book	2,13,900
(iii)	Cheque deposited into bank but no entry in cash book	3,000
(iv)	Cheque received and entered into cash book but not sent to bank	1,000
(v)	Credit side of bank column casted short	5,000
(Vi)	Insurance premium paid directly by bank under standing order	10,000
(vii)	Bank charges entered twice in cash book	100
(viii)	Cheque received, returned by bank but no entry passed	40,000
(ix)	Cheque issued, returned on technical grounds	3,000
(x)	Bills discounted, dishonoured	4,000
(xi)	Bills receivable directly collected by bank	20,000

Answer:

(a) Balance Presentation

Bank Reconciliation Statement

Particulars	Amount	Amount
Overdraft as per cashbook (Cr.)		1,80.000
Add: Cheque received & entered in cashbook but not sent to bank	1,000	
Credit side of bank column casted short	5,000	
Insurance premium paid directly by bank	10,000	
Cheque received returned by bank	40,000	
Bills discounted, dishonoured	4,000	60,000
		2,40,000
Less: Bank charges entered twice in cashbook	100	
Cheques issued and returned on technical grounds	3,000	
Bills directly collected by bank	20,000	
Cheques deposited into bank but no entry passed in cashbook	3,000	(26,100)
Overdraft as Passbook (Dr.)		2,13,900

(b) Plus - minus Presentation

Particulars	Plus Items (₹)	Minus Items (₹)
Overdraft as per cash book		1,80,000
Cheque deposited into bank but no entry the cashbook	3,000	
Cheque received & entered into cashbook but not sent to bank		1,000
Credit side of bank column casted short		5,000
Insurance premium paid directly by bank under standing order		10,000
Bank charges entered in cash book twice	100	

Cheques received, returned by bank but no entry passed		40,000
Cheques issued, returned on technical grounds	3,000	
Bills discounted, dishonoured		4,000
Bills receivable directly collected by bank	20,000	
	26,100	
Overdraft as per pass book	2,13,900	
[2,40,000 - 3,000 - 100 - 3,000 - 20,000]	2,40,000	2,40,000

G. PRACTICAL QUESTIONS

1. On March 31, 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.

Bank Reconciliation Statement as on March 31

Particulars	Action	₹
Balance as per Pass Book (Cr.)	Start	1,50,000
Cheque deposited but not yet cleared	Add	+22,000
Cheque recorded in Cash Book but not yet deposited	Add	+ 5,000
Bank Charges debited by bank	Add	+ 250
Cheque issued but not yet presented	Less	- 48,000
Amount deposited but not recorded in Cash Book	Less	-15,700
Interest allowed by bank	Less	- 1,500
Balance as per Pass Book (Favourable Balance)	Result	1,12,050

2. From the following, prepare a Bank reconciliation statement as at December 31 for Messrs New Steel Limited: (₹)

Bank overdraft as per Cash Book on December 31	22,45,900
Interest debited by Bank on December 26 but no advice received	2,78,700
Cheque issued before December 31 but not yet presented to Bank	6,60,000
Transport subsidy received from the State Government directly by the Bank but not advised to the company	14,25,000
Draft deposited in the Bank, but not credited till December 31	13,50,000

Bills for collection credited by the Bank till December 31 but no advice received by the Company	8,36,000
Amount wrongly debited to company account by the Bank, for which no details are available	7,40,000

Bank Reconciliation Statement as on Dec 31

Particulars	Action	₹
Overdraft as per cash Book	**Start**	22,45,900
Interest charged by the bank	**Add**	+2,78,700
Draft deposited in bank but not yet credited	**Add**	+13,50,000
Wrong debit by the bank, under verification	**Add**	+7,40,000
Cheque issued but not yet presented	**Less**	-6,60,000
Transport subsidy not yet recorded in the Cash Book	**Less**	-14,25,000
Bills for collection credited in the bank not yet entered in the cash book	**Less**	-8,36,000
Overdraft as per bank statement (Favourable Balance)	**Result**	**16,93,600**

3. The Cash Book of Mr. Gadbadwala shows ₹ 8,36,400 as the balance at Bank as on 31st December, but you find that it does not agree with the balance as per the Bank Pass Book. On scrutiny, you find the following discrepancies:
   (i) On 15th December, the payment side of the Cash Book was undercast by ₹ 10,000.
   (ii) A cheque for ₹ 1,31,000 issued on 25th December, was not taken in the bank column.
   (iii) One deposit of ₹ 1,50,000 was recorded in the Cash Book as if there is no bank column therein.
   (iv) On 18th December, 2019 the debit balance of ₹ 15,260 as on the previous day, was brought forward as credit balance.
   (v) Of the total cheques amounting to ₹ 11,514 drawn in the last week of December, cheques aggregating ₹ 7,815 were encashed in December.
   (vi) Dividends of ₹ 25,000 collected by the Bank and subscription of ₹ 1,000 paid by it were not recorded in the Cash Book.
   (vii) One out-going Cheque of ₹ 3,50,000 was recorded twice in the Cash Book.

   Prepare a Reconciliation Statement.

Particulars	Action	₹
Balance as per the Cash Book	**Start**	8,36,400
Mistake in bringing forward ₹ 15,260 debit balance as credit balance	**Add**	+30,520
Cheques issued but not presented Issued	**Add**	+11,514
Cheques issued but not presented Cashed	**Add**	+7,815
Dividends directly collected by bank but not yet	**Add**	+25,000
Cheque recorded twice in the Cash Book	**Add**	+3,50,000
Deposit not recorded in the Bank column	**Add**	+1,50,000
Wrong casting in the Cash Book on 15th Dec	**Less**	-10,000
Cheques issued but not entered in the Bank column	**Less**	-1,31,000

Subscription paid by the bank directly not yet recorded in the Cash Book	**Less**	-1,000
Balance as per the Pass Book (Favourable Balance)	**Result**	**12,53,619**

4. When Nikki & Co. received a Bank Statement showing a favourable balance of ₹ 10,39,200 for the period ended on 30th June, this did not agree with the balance in the cash book. An examination of Cash and Bank book disclosed the following
   (i) A deposit of ₹ 3,09,200 paid on 29th June, had not been credited by the Bank until 1st July.
   (ii) On 30th March, 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. No entries had been made in Cash Book.
   (iii) 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.
   (iv) Bank charges amounting to ₹ 3,000 had not been entered in Cash-Book.
   (v) 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.
   (vi) ₹ 11,200 paid into the bank had been entered twice in the Cash Book.
   (vii) 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.

   Prepare Bank Reconciliation Statement on 30 June.

Bank Reconciliation Statement on 30th June

Particulars	Action	₹
Balance as per the Pass Book	**Start**	10,39,200
Deposited with bank but not credited	**Add**	+3,09,200
Payment of Hire Purchase installments not entered in the Cash Book (₹ 3,00,000 x 3)	**Add**	+9,00,000
Discount allowed wrongly entered in bank column	**Add**	+ 16,000
Bank charges not entered in the Cash Book	**Add**	+3,000
Deposit entered in the Cash Book twice	**Add**	-11,200
Cheque returned 'out of date' entered in the Cash Book	**Add**	+ 11,00,000
Direct deposit by customer not entered in the Cash Book	**Less**	^1,00,000
Balance as per the Cash Book (Favourable Balance)	**Result**	**29,78,600**

5. Prepare a Bank Reconciliation Statement as on Sep. 30 from the following particulars: (₹)

Bank balance as per pass book	10,00,000
Cheque deposited into the bank, but no entry was passed in the cash book	5,00,000
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

Bank Reconciliation Statement as on September 30 (₹)

Particulars	Action	₹
Bank balance as per pass book	Start	10,00,000
Cheque received but not sent to the bank	Add	+ 11,20,000
Credit side of the bank column cast short	Add	+2,000
Insurance premium paid directly not recorded in the cash book	Add	+60,000
Cheque received entered twice in the cash book	Add	+ 10,000
Bills dishonoured not recorded in the cash book	Add	+5,00,000
Cheque deposited into the bank but no entry was passed in the cash book	Less	-5,00,000
Bank charges recorded twice in the cash book	Less	-2,000
Cheque issued but not presented to the bank	Less	-5,00,000
Balance as per cash book (Favourable Balance)	Result	16,90,000

6. On 31st March, Mahesh's Cash Book showed a Bank Overdraft of ₹ 98,700. On comparison, he finds the following:
   - (i) Out of the Total Cheques of ₹ 8,900 issued on 27th March, one Cheque of ₹ 7,400 was presented for payment on 4th April and the other Cheque of ₹ 1,500 handed over to the Customer, was returned by him and in lieu of that a New Cheque of the same amount was issued to him on 1st April. No entry for the return was made.
   - (ii) Out of the Total Cash and Cheques of ₹ 6,800 deposited in Bank on 24th March, one Cheque of ₹ 2,600 was cleared on 3rd April and the other Cheque of ₹ 500 was returned dishonoured by the Bank on 4th April.
   - (iii) Bank Charges ₹ 35 & interest ₹ 2,860 charged by the Bank appearing in the Passbook are not yet recorded in Cash Book.
   - (iv) A Cheque deposited in his another account of ₹ 1,550 wrongly credited to this account by Bank.
   - (v) A Cheque of ₹ 800, drawn on this account, was wrongly debited in another account by the Bank.
   - (vi) A debit of ₹ 3,500 appearing in the Bank Statement for an unpaid Cheque returned for being 'out of date' had been re-dated and deposited in the Bank Account again on 5th April.
   - (vii) The Bank allowed interest on Deposit ₹ 1,000.

(viii) A Customer who received a Cash Discount of 4% on his account of ₹ 1,00,000 paid a Cheque on 20th March. The Cashier erroneously entered the gross amount in the bank column of the Cash Book.

Prepare Bank Reconciliation Statement as on 31st March.

Solution:

Bank Reconciliation Statement as on 31st March

Particulars	Action	₹
Balance as per Cash Book (Overdraft Balance)	Start	98,700
Cheques deposited into Bank but collected only on3rd April	Add	2,600
Cheques issued, but not presented till 31st March	Less	(8,900)
Cheques deposited but returned dishonoured	Add	500
Bank charges and interest not entered in Cash Book (₹2,860+₹35)	Add	2,895
Interest allowed by Bank	Less	(1,000)
Cheque wrongly debited by Bank in another account	Less	(800)
Cheque deposited in another account wrongly credited by bank in this account	Less	(1,550)
Cheques deposited and returned as out of date	Add	3,500
Wrong amount entered in cash book by cashier	Add	4,000
Overdraft as per Pass Book	Result	99,945

7. On comparing the Cash Book of Ganesh, with his Bank Pass Book, the following discrepancies were noted:
   (i) Out of ₹ 20,500 paid into Bank on 27th March through cash and cheque, Cheques amounting to ₹ 7,500 were collected on 7th April.
   (ii) Cheque and Cash amounting to ₹ 4,800 were deposited in Bank on 26th March but credit was given for ₹ 3,800 only.
   (iii) Out of Cheques amounting to ₹ 7,800 drawn on 26th March, a Cheque for ₹ 2,500 was encashed on 3rd April.
   (iv) Cheques issued to Creditor amounting to ₹ 20,000 on 25th March of which cheques worth ₹ 3,000 were only presented to Bank upto 31st March.
   (v) A Cheque for ₹ 1,000 entered in Cash Book was omitted to be banked before 31st March.
   (vi) Cheque for ₹ 600 deposited into Bank but omitted to be recorded in Cash Book and was collected by Bank on 30th March.
   (vii) A Bill Receivable for ₹ 520 previously discounted (Discount t 20) with the Bank had been dishonoured but advice was received on 1st April.
   (viii) A Bill Payable for ₹ 10,000 was retired /paid by the Bank at ₹ 9,850 but the full amount of the Bill was credited in the Bank Column of the Cash Book.
   (ix) A Cheque of ₹ 1,080 credited in the Pass Book on 25th March being dishonoured is debited again in the Pass Book on 1st April. There was no entry in the Cash Book about the dishonour of the cheque until 15th April.
   (x) A cheque of ₹ 200 drawn on this Bank A/c has been shown as drawn on another Bank A/c, in the Cash Book.

Prepare a BRS as at 31st March, if the Balance as per Cash Book on 31st March was ₹ 39,570.

Solution:

Bank Reconciliation Statement as on 31st March

Particulars	Action	₹
Balance as per Cash Book (Normal Balance) (Given)	**Start**	39,570
Cheques deposited into Bank but collected on 7th April (i.e. subsequently)	**Less**	- 7,500
Cheques deposited but not cleared till 31st March (4,800 - 3,800)	**Less**	- 1,000
Cheques issued / drawn, but presented / encashed on 3rd April	**Add**	+ 2,500
Cheques issued, but not presented / encashed till 31st March (20,000 - 3,000)	**Add**	+ 17,000
Cheque received as per Cash Book, but omitted to be deposited in Bank	**Less**	- 1,000
Cheque received and banked, but omitted in Cash Book	**Add**	+ 600
Bills Receivable dishonoured and debited by Bank	**Less**	- 520
Rebate on Bills Payable not considered in Cash Book (10,000 - 9,850)	**Add**	+ 150
Wrong Entry in Cash Book, relating to Cheque issued	**Less**	-200
Balance as per Pass Book (Favourable Balance)	**Result**	**49,600**

Note: Cheque dishonoured is reversed by the Bank only on 1st April (i.e. after BRS date). Hence, it will not affect the BRS.

8. Prepare a Bank Reconciliation Statement from the following particulars as on 31st March - (₹)

(i)	Debit Balance as per Bank Column of the Cash Book	18,60,000
(ii)	Cheque issued to Creditors but not yet presented to the Bank for Payment	3,60,000
(iii)	Dividend received by the Bank but not entered in the Cash Book	2,50,000
(iv)	Interest allowed by the Bank	6,250
(v)	Cheques deposited into Bank for collection but not collected by Bank upto this date	7,70,000
(vi)	Bank Charges not entered in Cash Book	1,000
(vii)	A Cheque deposited into Bank was dishonored, but no intimation received	1,60,000
(viii)	Bank paid House Tax on our behalf, but no intimation received from Bank in this connection	1,75,000

Bank Reconciliation Statement as on 31st March

Particulars	Action	₹
Balance as per Cash Book (Normal Balance)	**Start**	18,60,000
Cheque issued to Creditors but not yet presented to the Bank for Payment	**Add**	3,60,000
Dividend received by the Bank but not entered in the Cash Book	**Add**	2,50,000
Interest allowed by the Bank	**Add**	6,250

Cheques deposited into Bank for collection but not collected by Bank up to this date	**Less**	-7,70,000
Bank Charges not entered in Cash Book	**Less**	- 1,000
Cheque deposited into Bank was dishonoured, but no intimation received	**Less**	-1,60,000
Payment of House Tax by Bank on our behalf, but no intimation received	**Less**	-1,75,000
Balance as per Pass Book (Normal Balance)		**13,70,250**

9. From the following particulars, prepare a Bank Reconciliation Statement as on 31st December
   (i) On 31st December, the Cash Book of a Firm showed a bank balance of ₹6,000 (Debit balance).
   (ii) Cheques had been issued for f 5,000, out of which Cheques worth ₹ 4,000 only were presented for payment.
   (iii) Cheques worth ₹ 1,400 were deposited in the Bank on 28th December but had not been credited by the bank, In addition to this, one Cheque for ₹ 500 was entered in the Cash Book 30th December but was banked on 3rd January.
   (iv) A Cheque from Susan for ₹ 400 was deposited in the bank on 26th December but was dishonored and the advice was received on 2nd January.
   (v) Pass Book showed Bank Charges of ₹ 20 debited by the Bank.
   (vi) One of the Debtors deposited a sum of ₹ 500 in the Bank Account of the Firm on 20th December but the intimation in this respect was received from the Bank on 2nd January.
   (vii) Bank Pass Book showed a Credit balance of ₹ 5,180 on 31st December.

Solution:

Bank Reconciliation Statement as on 31st December

Particulars	Action	₹
Balance as per Cash Book (Normal Balance) (Dr. Balance)	Start	6,000
Cheques issued, but not presented / encashed till 31st Dec (5,000 - 4,000)	Add	+ 1,000
Cheques deposited but not yet credited by Bank	Less	- 1,400
Cheque received and recorded in Cash Book	Less	-500
Cheque dishonoured by Bank	Less	-400
Bank Charges not recorded in Cash Book	Less	-20
Cheques directly deposited by a Customer not yet recorded in Cash Books	Add	+ 500
Balance as per Pass Book (Cr.)	Result	5,180

10. From the following data, ascertain the balance that would appear in Bank Pass Book of Gajapathy on 31st Dec -
    - Bank Overdraft as per Cash Book on 31st December ₹ 6,34,000
    - Interest on Overdraft for the month of December ₹ 16,000 is entered in Pass Book.
    - Bank Charges of ₹ 300 for the above period are debited in the Pass Book.
    - Cheques issued but not cashed prior to 31st December amounted to ₹ 1,16,800
    - Cheques deposited into the Bank but not cleared before 31st December were for ₹ 2,17,000.

- Interest on investment collected by the Bank and credited in the Pass Book ₹ 1,20,000.

Solution:

Bank Reconciliation Statement as on 31st December

Particulars	Action	₹
Overdraft Balance as per Cash Book (Given)	Start	6,34,000
Interest on Overdraft for Dec month entered in Pass Book	Add	+ 16,000
Bank Charges for the above period debited in the Pass Book	Add	+ 300
Cheques issued but not cashed prior to 31st December	Less	- 1,16,800
Cheques deposited into the Bank but not cleared before 31st Dec.	Add	+ 2,17,000
Interest on investment collected by the Bank & credited in the Pass Book	Less	- 1,20,000
Overdraft as per Pass Book	Result	6,30,500

11. The Bank Account of Mukesh was balanced on 31st March. It showed an Overdraft of ₹ 5,000. The Bank Statement of Mukesh showed a credit balance of ₹ 76,750. Prepare a Bank Reconciliation Statement taking the following into account:
    (i) Cheques issued but not presented for payment till 31st March -₹ 12,000.
    (ii) Cheques deposited but not collected by Bank till 31st March - ₹20,000.
    (iii) Interest on Term Loan ₹ 10,000 debited by Bank on 31st March but not accounted in Mukesh's book.
    (iv) Bank Charges ₹ 250 was debited by Bank during March but accounted in the books of Mukesh on4th April.
    (v) An amount of ₹ 1,00,000 representing collection of Murukesh's Cheque was wrongly credited to the Account of Mukesh by the Bank in their Bank Statement.

Solution:

Bank Reconciliation Statement as on 31st March

Particulars	Action	₹
Balance as per Cash Book (Normal Balance) (Credit Balance)	Start	- 5,000
Cheques issued, but not presented / encashed till 31st March	Add	+ 12,000
Cheques deposited into Bank but not collected in March	Less	- 20,000
Interest on Long Term Loan debited by Bank	Less	- 10,000
Bank Charges debited by Bank	Less	-250
Cheque wrongly credited by Bank	Add	1,00,000
Balance as per Pass Book (Favourable Balance)	Result	76,750

12. From the following information given by Ganapathy, prepare a BRS as on 31st December-

Transaction	₹
Bank Overdraft as per Pass Book	16,500
Cheques issued but not presented for payment	8,750
Cheques deposited with the Bank but not collected	10,500
Cheques recorded in the Cash Book but not sent to the Bank for collection	2,000

Payments received from customers directly by the Bank	3,500
Bank Charges debited in the Pass Book	200
Premium on Life Policy of Ganapathy paid by the Bank on standing advice	1,980
A Bill for ₹ 3,000 (discounted with the Bank in November) dishonoured on 31st December and Noting Charges paid by the Bank.	100

Solution:

Bank Reconciliation Statement as on 31st December

Particulars	Action	₹
Overdraft Balance as per Pass Book (Given)	Start	16,500
Cheques issued but not presented for payment	Add	+ 8,750
Cheques deposited with the Bank but not collected	Less	- 10,500
Cheques recorded in the Cash Book but not sent to the Bank for collection	Less	- 2,000
Payments received from customers directly by the Bank	Add	+ 3,500
Bank Charges debited in the Pass Book	Less	-200
Premium on Life Policy of Ganapathy paid by the Bank on standing advice	Less	- 1,980
Bill discounted dishonoured and Noting Charges paid by Bank (3,000 + 100)	Less	-3,100
Overdraft as per Cash Book	Result	10,970

13. Prepare the Bank Reconciliation Statement of M/s. R.K. Brothers on 30th June from the particulars given below:
    (i) The Bank Pass Book had a debit balance of ₹ 25,000 on 30th June.
    (ii) A cheque worth ₹ 400 directly deposited into Bank by a customer but no entry was made in the Cash Book.
    (iii) Out of cheques issued worth ₹ 34,000, cheques amounting to ₹ 20,000 only were presented for payment till 30th June.
    (iv) A cheque for ₹ 4,000 received & entered in the Cash Book but it was not sent to the Bank.
    (v) Cheques worth ₹ 20,000 had been sent to Bank for collection but the collection was reported by the Bank as under.
        (a) Cheques collected before 30th June ₹ 14,000
        (b) Cheques collected on 10th July ₹ 4,000
        (c) Cheques collected on 12th July ₹ 2,000
    (vi) The Bank made a direct payment of ₹ 600 which was not recorded in the Cash Book.
    (vii) Interest on Overdraft charged by the bank ₹ 1,600 was not recorded in the Cash Book.
    (viii) Bank charges worth ₹ 80 have been entered twice in the cash book whereas Insurance charges for ₹ 70 directly paid by Bank was not at all entered in the Cash Book.
    (ix) The credit side of bank column of Cash Book was undercast by ₹ 2,000.

Bank Reconciliation Statement as on 30th June 2018

Particulars	Action	₹
Overdraft Balance as per Pass Book (Given)	Start	25,000
Payments received from customers directly by the Bank	Add	+ 400

Cheques issued but not presented for payment ('34,000 - '20,000)	Add	+ 14,000
Cheques recorded in the Cash Book but not sent to the Bank for collection	Less	- 4,000
Cheques deposited into Bank but collected on 10th July 2018 and 12th July 2018 (i.e. subsequently)	Less	- 6,000
Direct Payment by Bank not recorded in Cash Book	Less	-600
Interest on Overdraft charged by Bank	Less	-1,600
Bank Charges Entered Twice in Cash Book	Add	80
Insurance Charges Directly paid by Bank not entered in Cash Book	Less	- 70
Under casting of Credit side of Cash Book	Less	- 2,000
Overdraft as per Cash Book	Result	25,210

14. On 30th September, the Pass Book of Vignesh showed a balance of ₹ 3,750. An examination of the Cash Book and the Bank Statement reveals the following -
- Cheques of to ₹ 500 issued to Creditors before 30th Sep, were not presented for payment until that date.
- A Cheque for ₹ 8,200 deposited on 29th Sep. was credited by the Bank only on 3rd Oct.
- A Cheque issued for ₹ 750 has been dishonoured before 30th Sep, but not recorded in Cash Book till 30th Sep.
- Cheques deposited before 30th September but not cleared amounting to ₹ 250
- A payment by cheque for ₹ 150 has been entered twice in the Cash Book.
- A Dividend of ₹ 350, received by the Bank directly has not been recorded in the Cash Book.
- On 29th September, the Bank credited an amount of ₹ 1,750 received from a customer of Vignesh, but was not intimated to Vignesh until 1st October.
- Bank Charges amounting to ₹ 50 not entered in the Cash Book.
- On 6th September, the Bank credited ₹ 2,000 to Vignesh's account erroneously.
- A Bill Receivable for ₹ 1,000 was discounted by Vignesh with his Bank. This bill was dishonoured on 28th September, but no entry was made in the books of Vignesh.
- Cheques issued upto 30th September but not presented for payment upto that date totaled ₹ 3750

You are required to prepare a Bank Reconciliation Statement as on 30th September.

Solution:

Bank Reconciliation Statement as on 30th September

Particulars	Action	₹
Balance as per Pass Book (Given)	Start	3,750
Cheques issued but not presented for payment	Less	- 500
Cheques deposited with the Bank but not credited	Add	+ 8,200
Cheque dishonoured not recorded in Cash Book	Less	- 750
Cheques deposited with the Bank but not cleared	Add	+ 250
Wrong Entry in Cash Book (Chq issued recorded twice)	Less	- 150
Dividends received in Bank, not recorded in Cash Book	Less	- 350
Direct collection from Customer by Bank, not recorded in Cash Book	Less	- 1,750

Bank Charges not considered in Cash Book	Add	+ 50
Wrong Credit in Pass Book by Bank	Less	- 2,000
Bill discounted dishonoured not recorded in Cash Book	Add	+ 1,000
Cheques issued but not presented for payment	Less	- 3,750
Balance as per Cash Book (Favourable Balance)	Result	4,000

15. The following are the Cash Book & Pass Book of Vinayaka Bros. -

Date	Receipts	₹	Date	Payments	₹
1	To balance b/d	6,000	3	By Cash a/c	2,000
6	To Sales ale	3,000	7	By Modi	6,000
10	To Ram	6,500	12	By Patill	3,000
18	To Singhal	2,700	18	By Suresh	4,000
25	To Goyal	3,300	24	By Ramesh	1,500
31	To Patel	6,500	31	By Balance c/d	11,500
	Total	**28,000**		**Total**	**28,000**

Pass Book for the month of April 2008

Date	Particulars	Withdrawal ₹	Deposit ₹	Dr. or Cr.	Balance ₹
1	By Balance b/d		3,200	Cr.	3,200
3	By Goyal		3,300	Cr.	6,500
5	By Patel		6,500	Cr.	13,000
7	To Naresh	2,800		Cr.	10,200
12	To Ramesh	1,500		Cr.	8,700
15	To Bank Charges	200		Cr.	8,500
20	By Usha		1,700	Cr.	10,200
25	By Kalpana		3,800	Cr.	14,000
30	To Sunil	6,200		Cr.	7,800

Reconcile the balance of Cash Book on 31st March.

Solution:

- In this question, Cash Book is given for the March month, but Pass Book is given for April month. Hence, the Closing Balance of the Cash Book (₹ 11,500) should be reconciled with the opening balance of the Pass Book (₹ 3,200).
- On comparing / reconciling the above items / balances, the following reasons can be observed -
  (a) Cheques deposited into the Bank (Goyal ₹ 3,300 and Patel ₹ 6,800) in March were not credited by the Bank till 31st March (i.e. credited only in April)
  (b) Cheque issued to Ramesh for ₹ 1,500 in March has been presented for payment only on 12th April.

Bank Reconciliation Statement as on 31st March

Particulars	Action	₹

Balance as per Cash Book (Normal Balance) (Given)	Start	11,500
Cheques deposited into Bank but collected only in April (3,300 + 6,800)	Less	- 9,800
Cheques issued, but not presented / encashed till 31st March	Add	+ 1,500
Balance as per Pass Book (Favourable Balance)	Result	3,200

16. The Cash Book of Kapila showed a Bank Balance of ₹ 1,200 (Dr.) on 30th June. However, according to his Bank Statement the account was overdrawn. On investigation it was found that -
- Receipts Column of the Cash Book had been overcast by ₹ 1,100
- Cheques drawn and entered in the Cash Book in June amounting to ₹ 1,670 were not presented until July.
- Discount received from a Supplier ₹ 100 had been included with the cheque entered in the Bank Column of the Cash Book in April.
- An amount of ₹ 750 paid directly into Kapila's Account by a customer was not entered in the Cash Book.
- A cheque payment of ₹ 1,230 in April had been entered in the Cash Book as ₹ 1,320.
- The Bank had charged Kapila's Business Account with a cheque for ₹ 2,200 in February, which should have been passed through Kapila's Private Account.
- Bank Charges of ₹ 80 on 31st March and ₹ 100 on 30th June had not yet been entered in the Cash Book.
- Cheque to the value of ₹ 3,780 received from customers was recorded in the Cash Book on 28th June but not entered by the Bank until 2nd July.

Rectify the errors / omissions in the Cash Book and prepare Bank Reconciliation Statement as on 30th June.

1. Adjusted Cash Book (for rectification of errors / omissions)

Receipts	₹	Payments	₹
To balance b/d (given)	1,200	By Overcast of Receipts Side, now rectified	1,100
To Discount Recd wrongly recorded as payment to Supplier, now rectified	100	By Bank Charges omitted in Cash Book, now rectified (80 + 100)	180
To Sundry Debtors A/c (Direct Collection by Bank)	750		
To Rectification of Error in Cheque issued (1,230 recorded as 1,320, now rectified)	90	By balance c/d (Favourable balance as per Cash Book)	**860**
Total	**2,140**	**Total**	**2,140**

2. Bank Reconciliation Statement as on 31st March

Particulars	Action	₹
Balance as per Cash Book (Normal Balance) (Adjusted Cash Balance)	Start	860
Cheques deposited into Bank but collected only in July	Less	- 3, 780

Cheques issued, but not presented / encashed till 30th June	Add	+ 1,670
Error by Bank (Private A/c Cheque paid through Business Bank A/c)	Less	- 2,200
Overdraft Balance as per Pass Book	Result	- 3,450

17. According to the Cash Book of Gopi, there was a balance of 44,500 standing to his credit in Bank on 30th June. On investigation, you find that -
    (i) Cheques amounting to ₹ 60,000 issued to Creditors have not been presented for payment till the date.
    (ii) Cheques paid into Bank amounting to ₹ 1,05,000 out of which Cheques amounting to ₹ 55,000 only collected by the Bank upto 30th June.
    (iii) A Dividend of ₹ 4,000 and Rent amounting to ₹ 6,000 received by the Bank and entered in the Pass Book but not recorded in the Cash Book.
    (iv) Insurance Premium (upto 31st December) paid by the Bank ₹2,700 not entered in the Cash Book.
    (v) The payment side of the Cash Book had been undercasted by ₹ 50.
    (vi) Bank Charges ₹ 50 shown in the Pass Book had not been entered in the Cash Book.
    (vii) A Bill Payable of ₹ 2,000 has been paid by the Bank but is not entered in the Cash Book and Bill Receivable for ₹ 6,000 has been discounted with the Bank at a cost of ₹ 100 which has also not been recorded in Cash Book,

    Make the appropriate adjustments in the Cash Book, and Prepare a Statement reconciling it with the Bank Pass Book.

Solution:

1. Cash Book (Bank Column)

Receipts	₹	Payments	₹
To Balance b/d	44,500	By Insurance Premium A/c	2,700
To Dividend A/c	4,000	By Correction of Error	50
To Rent A/c	6,000	By Bank Charges	50
To Bill Receivable A/c	5,900	By Bill Payable A/c	2,000
		By Balance c/d	55,600
Total	**60,400**	**Total**	**60,400**

2. Bank Reconciliation Statement as on 30th June

Particulars	₹
Adjusted Balance as per Cash Book (Dr.)	55,600
Add: Cheques issued but not presented for payment till 30th June	60,000
Less: Cheques paid into bank for collection but not collected till 30th June	(50,000)
Balance as per Pass Book	**65,600**

18. On 30th September, the bank account of XYZ, according to the bank column of the cash book, was overdrawn to the extent of ₹ 8,062. An examination of the Cash book and Bank Statement reveals the following:

(i) A cheque for ₹ 11,14,000 deposited on 29th September, 2018 was credited by the bank only on 3rd October.

(ii) A payment by cheque for ₹ 18,000 has been entered twice in the Cash book.

(iii) On 29th September, the bank credited an amount of ₹ 1,15,400 received from a customer of XYZ, but the advice was not received by XYZ until 1st October.

(iv) Bank charges amounting to ₹ 280 had not been entered in the cash book.

(v) On 6th September, the bank credited ₹ 30,000 to XYZ in error.

(vi) A bill of exchange for ₹ 1,60,000 was discounted by XYZ with his bank. The bill was dishonoured on 28th September, but no entry had been made in the books of XYZ.

(vii) Cheque issued upto 30th September, but not presented for payment upto that date totalled ₹ 13,46,000.

(viii) 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.

You are required: To show the appropriate rectifications required in the cash book of XYZ to arrive at the correct balance on 30th September and to prepare a Bank Reconciliation Statement as on that date.

1. Adjusted Cash Book (for rectification of errors / omissions)

Receipts	₹	Payments	₹
To Cheque Payment recorded twice, now rectified	18,000	By balance b/d (given)	8,062
To Sundry Debtors A/c (Direct Collection by Bank)	1,15,400	By Bank Charges omitted in Cash Book, now rectified	280
To Bill Receivable (Bill Discounted Rs.60,000 Less: Discounting Charges ₹1,000)	59,000	By Sundry Debtors A/c (Bill Discounted, dishonored, omitted in Cash Book, now rectified)	1,60,000
To balance c/d (Overdraft balance as per Cash Book)	1,75,942	By Bills Payable (Being Bills Honoured, omitted in Cash Book, now rectified)	2,00,000
Total	**3,68,342**	**Total**	**3,68,342**

2. Bank Reconciliation Statement as on 30th September 2018

Particulars	Action	₹
Balance as per Cash Book (Overdraft Balance) (Adjusted Cash Bal.)	Start	1,75,942
Cheques deposited into Bank but collected only on 3rd October	Add	11,14,000
Cheques issued, but not presented / encashed till 30th June	Less	(13,46,000)
Error by Bank (Wrong Credit to XYZ)	Less	(30,000)
Favourable Balance as per Pass Book	Result	86,058

Topic 4 DEPRECIATION & AMORTIZATION

A. INTRODUCTION

Concept of Depreciation

- Tangible Assets are assets that have a physical substance i.e., they can be seen and touched, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.
- Useful life of tangible asset is based on expected usage.

Property, plant and equipment are tangible items that:

- are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- are expected to be used during more than a period of twelve months.
- These are also called fixed assets in common parlance.

Recording:

- When a fixed asset is purchased, it is recorded in books of account at its original or acquisition/purchase cost.
- However fixed assets are used to earn revenues or save costs for several accounting periods in future with the same acquisition cost until the concerned fixed asset is sold or discarded.
- *Since*, the life of such assets exceeds one year, it is therefore necessary that a part of the acquisition cost of such fixed assets be treated or allocated as an expense in each of the accounting period in which the asset is utilized.
- The amount or value of fixed assets allocated in such manner to respective accounting period is called depreciation.

Value of such assets decreases mainly due to following reasons:

1. Wear and tear due to its use in business
2. Efflux of time (even when it is not being used)
3. Obsolescence due to technological or other changes
4. Decrease in market value
5. Depletion mainly in case of mines and other natural reserves
6. Physical Deterioration Resulting from Atmospheric Exposure: Number of assets deteriorates for being continually exposed nature.

It is important to account for value of portion of property, plant and equipment utilized for generating revenue during an accounting year to ascertain true income.

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

3 important factors for computing depreciation:

- Estimated useful life of the asset
- Cost of the asset
- Residual value of the asset at the end of the of its estimated useful life

Few important points:

- ✓ Depreciation of an asset begins when it is available (Ready) for use. Thus, it is not necessary that an asset must be used to be depreciated.
- ✓ There is decrease in value of assets due to normal wear and tear or obsolescence even when these are not physically used.
- ✓ Accordingly, value of such wear & tear should be estimated and accounted for.

Characteristics of Depreciation

1. Depreciation refers to a permanent, continuous & gradual decrease in the utility value of a fixed asset & it continues till the end of the useful life of asset.
2. It is a charge against profit (i.e. revenue earned) for a particular period.
3. It is always computed in a systematic & rational manner (it is not a sudden loss)
4. It is a process of allocation of expired cost & not of valuation of fixed assets.
5. By any method, the exact amount of depreciation can never be calculated, & it can only be estimated.
6. Depreciation is caused due to physical factors and functional factors.
7. The fundamental objectives of depreciation are - (a) to maintain the nominal capital invested in fixed assets, and (b) to allocate the expired portion of the cost of fixed assets over a number of accounting periods.
8. Depreciation is must (Compulsory)
9. Market value of a fixed asset does not affect the amount of depreciation
10. It is calculated in respect of fixed assets (depreciable) only (Not current assets)
11. Total depreciation cannot exceed its depreciable value or original cost where the scrap value is nil.

Depreciation on components of an assets

- It may be noted that Accounting Standards as well as the Companies Act, 2013 requires depreciation to be charged on a component basis.

- Each part of an item of Property, Plant and Equipment with a cost that is significant in relation to the total cost of the item & an estimated useful life or depreciation method different from rest should be depreciated separately.
- For Example- Aircraft is a classic example of such an asset. The airframe (i.e. the body of the aircraft), the engines and the interiors have different individual useful lives. Other components (usually small and low value) which will require replacement very frequently may be depreciated over the useful life of airframe and their frequent replacement cost may be charged to expense as and when it is incurred.

Objectives of Providing Depreciation:

1. To ascertain the correct profit: When a particular asset is used for earning business income, the depreciation in the value of assets should be deducted from the income in order to calculate the correct and real profit of the business.
2. To present true financial position: It is necessary that assets must be shown at their true values after deducting reasonable depreciation. (Else assets will be overstated)
3. To make provision for replacement of assets: Since depreciation is a non-cash expense, the amount charged can be kept separately and utilised for the replacement of the fixed asset after the expiry of the useful life of the asset.
4. To ascertain the proper cost of the product
5. To maintain the capital invested in the cost of the asset intact in the business so that it can be reinvested in profit earning process.
6. To derive maximum tax benefit as it is allowed expense.
7. To meet the legal requirements: In the case of companies, it is necessary to charge depreciation on fixed assets before declaring dividends.

Factors in Measurement of Depreciation

1. The original cost of asset: i.e. purchase price including transportation and installation costs, if any.
2. The additions, if any, made to the assets during the year taking into consideration the date on which these additions were made.
3. The estimated useful life of the asset.
4. The scrap or the residual value of the asset.
5. Obsolescence, i.e., the chance of the asset going out of fashion.
6. The working hours of the asset concerned.
7. The repairs and renewals.
8. The skill of the operators who handle the asset.
9. The legal provisions or other restrictions relating to depreciation.

In short:

- Depreciation accounting is the process of allocating the cost of the tangible fixed asset less its salvage value over its serviceable life.
- Depreciation is an expense that is to be charged against the revenue whether the business makes profit or incurs loss;
- Depreciation provides funds for replacing the asset when its useful life ends. Depreciation is not a process of valuation but it is an allocation.
- Even if the market value of an asset increases, depreciation has to be recorded because of allocation process

B. METHODS OF ACCOUNTING FOR DEPRECIATION

ACCOUNTING METHODS
- CHARGED TO ASSETS
- MAKE A PROVISION FOR DEPRECIATION

WHEN THE DEPRECIATION IS DIRECTLY CHARGED TO ASSET ACCOUNT:

Depreciation charged to asset:

Depreciation A/C	*Dr.*	*XXX*	
To Asset A/C			*XXX*

Note: Asset account in this case appears at its reduced value in the balance sheet

Cost or book value	*XXX*
Less: Depreciation for the accounting period.	*XXX*
[=] Net Value of Asset	*XXX*

Depreciation expense is transferred to the debit of profit and loss account:

Profit and Loss Account	*Dr.*	*XXX*	
To Depreciation Account			*XXX*

WHEN PROVISION FOR DEPRECIATION ACCOUNT IS OPENED:

For charging depreciation:

Depreciation Account	*Dr.*		*XXX*
To Provision for Depreciation Account		*XXX*	

For transferring depreciation expense to Profit and Loss Account:

Profit and Loss Account	*Dr.*	*XXX*	
To Depreciation Account			*XXX*

Important Points:

- ✓ In this method, the asset account is not affected by the amount of depreciation and the value of asset appears in the ledger and the balance sheet at its original cost.

- ✓ Amount of depreciation written off is accumulated in provision for depreciation A/C
- ✓ When the asset is sold or discarded or exchanged for a new asset, the total accumulated depreciation for that asset in the provision for depreciation account is transferred to that asset account by the following *journal entry:*

  Provision for Depreciation A/c Dr. XXX
  To Relevant Asset A/c XXX

- ✓ Thus, the balance in the provision for depreciation account always shows the accumulated depreciation on the assets which are in use or not sold out.
- ✓ In the balance sheet, the asset account is shown at its original cost less balance in the provision for depreciation account.
- ✓ *On the assets side of the balance sheet*

  Relevant Asset A/c XXX
  Less: Provision for Depreciation XXX

  Note: Alternatively, the asset account can be shown at its original cost on the assets side and provision for depreciation account can be shown on the liabilities side. But the former method is better and recommended.

C. METHODS OF CALCULATING AMOUNT OF DEPRECIATION

METHODS TO CALCULATE ₹ OF DEPRECIATION

- **UNIFORM CHARGE METHOD**
  - SLM
  - ANNUITY
  - DEPRECIATION FUND
  - INSURANCE POLICY METHOD
- **DECLINING CHARGE METHODS**
  - DIMINISHING BALANCE METHOD
  - SUM OF YEARS DIGITS OF METHOD GROUP
- **OTHER METHODS**
  - DEPRECIATION METHOD INVENTORY
  - SYSTEM (VALUATION) DEPLETION

Commonly used methods of Depreciation

- **Straight-line Method**
  - Results in a constant charge over the useful life if the residual value of the asset does not change
- **Diminishing Balance Method**
  - Results in a decreasing charge over the useful life

UNIFORM CHARGE METHODS:

Depreciation is charged uniformly every year for those assets which are uniformly productive.

Fixed Instalment Method or Straight-Line Method (SLM) or Original Cost Method or Equal Instalment Method or Historical Cost Method:

- Here, fixed proportion of the original cost of the asset (less residual value) is written off each year so that asset account may be reduced to its residual value at the end of its estimated economic useful life.
- It is assumed that depreciation is a function of time.
- Depreciation is charged on a uniform basis every year till asset is written off.

$$\textbf{Depreciation} = \frac{\text{Original Cost of Fixed Assets (Including all capital exp)} \;-\; \text{Estimated Scrap Value}}{\text{Life of the Assets in Number of Year}}$$

$$(\%)\textbf{Percentage of Depreciation} = \frac{\text{Depreciation}}{\text{Original Cost of the Fixed Assets}} \times 100$$

Note:

- Additional asset purchased during the year must be depreciated only from the date of purchase to the close of the accounting period.
- When NO date of addition is mentioned, depreciation may be charged for half of the year on the assumption that addition was made in the middle of the year.
- Assets sold during the year should be depreciated from the beginning of the year till the date of sale.

ADVANTAGES	DISADVANTAGES
➢ It is a simple and easy method. ➢ The value of the asset can be completely written off, i.e. the value can be reduced to zero its estimated scrap value. ➢ This method can be applied where asset gets depreciated because of effluxion of time like furniture, equipments, patents, leasehold etc. ➢ There is no change either in the rate or amount of depreciation over the useful life of the asset. ➢ The value of the asset each year in the balance sheet is reasonably fair.	➢ The assumption that the asset shall be equally useful throughout its life seems to be illogical. ➢ It does not take into account the effective utilization of the asset. ➢ Even though the asset is used uniformly from period to period, the total charge for the use of the asset keeps on increasing every year. This is because cost of repairs in each subsequent year rises though equal amount of depreciation is written off every year.

DECLINING CHARGE METHODS

Amount of depreciation charged decreases for each subsequent year of the asset's life.

This method can be applied:

(a) When the asset becomes old and receipts decline or

(b) When it is necessary to charge depreciation according to the asset's expected earnings.

Diminishing Balance Method or Reducing Balance Method or WDV Method:

- Here, depreciation is calculated at a certain percentage each year on the balance of the asset which is brought forward from the previous year.
- The amount of depreciation charged for each period is not fixed
- It goes on decreasing as the opening balance of asset in each year will reduce.
- Thus, amount of depreciation becomes higher at in the earlier periods and becomes gradually lower in subsequent periods,
- while repairs and maintenance charges increase gradually.

$$\text{Rate of Depreciation} = 1 - \sqrt[n]{\frac{\text{Net Residual Value}}{\text{Cost of Acquisition}}}$$

Where, n = life of the asset in years.

Distinction between straight line method and diminishing balance method of depreciation

Straight Line Method	Diminishing Balance Method
➢ Depreciation is charged at a fixed rate on the original cost of the asset.	➢ Depreciation is charged at a fixed rate on the original cost in the first year and on the written down value (cost-minus total depreciation) in the subsequent years.
➢ The amount of depreciation remains the same in all the years.	➢ The amount of depreciation goes on decreasing year after year.
➢ The total burden on the profit and loss account is more in the later years because the repair charges increase while the amount of depreciation remains the same.	➢ The total burden on the profit and loss account is almost same in the early years as well as is the later years because of more depreciation plus repairs cost in the beginning and less depreciation plus more repairs cost in the later years.
➢ Book value of the asset becomes zero or equal to scrap value.	➢ The book value never becomes zero.
➢ Easy to calculate rate of depn.	➢ Use of mathematical tables requires.

➢ It is suitable where repair charges are less and obsolescence is not frequent.	➢ It is suited where repair charges are more in later years and also where there is obsolescence.

D. CHANGE IN METHOD OF DEPRECIATION

- Consistency principle of accounting requires that same accounting practices and methods should be observed and followed from year to year as otherwise the reported profit or loss will not be comparable.
- However, sometimes, a change in the method becomes inevitable.
- According to "Accounting Standard-6 (AS-6) Depreciation Accounting", issued by the Institute of Chartered Accountants of India, when a change in the method of depreciation is made, depreciation is re-calculated in accordance with the new method from the date of asset coming into use.
- In brief, change in method is permitted retrospectively, that is, from the date of purchase of existing assets

Steps for change in method of depreciation

➢ Calculate the amount of depreciation on the assets existed at the end of previous year till the end of previous year as per OLD Method.

➢ Calculate the amount of depreciation on the assets existed at the end of previous year till the end of previous year as per NEW Method.

➢ Find the difference between the both.

➢ Then the difference has to be adjusted in the current year's asset account by giving debit or credit to profit and loss account.

E. CALCULATION OF PROFIT OR LOSS ON ASSETS SOLD

PROFIT OR LOSS ON SALE OF ASSETS		
A	Sale price of asset	XXX
B	(-) Book value of asset on the date of sale (Original Cost-Depreciation till date)	XXX
C	(-) Selling Expenses (if any)	XXX
D	(=) +Profit / -Loss on Sale of Assets	XXX

The following journal entries are passed to record the above transactions

- When the depreciation is directly credited to the asset account:

i. On sale of assets:

Bank Dr.

To Assets Account (with the sale price)

ii. For profit on sale of asset:

Asset Account Dr.
To Profit and Loss Account
(In case of loss the above entry is reversed.)

- When Provision for Depreciation Account is maintained then the asset account appears at its cost price and the following accounting procedure is followed:
  i. <u>Transfer of accumulated depreciation including the depreciation created at the time of sale:</u>
  Provision for Depreciation Account Dr.
  To Asset Account

  ii. <u>On sale of the asset:</u>
  Bank Account Dr.
  To Asset Account

  iii. <u>If the amount of accumulated depreciation and sale price put together is less than the original cost of the asset, the difference is loss on sale and transferred to profit and loss account:</u>
  Profit and Loss Account Dr.
  To Asset Account

  iv. <u>In case the accumulated depreciation and sale price put together is more than the original cost of the asset, the difference is treated as profit on sale and is credited to profit and loss account:</u>
  Asset Account Dr.
  To Profit and Loss Account

- When Provision for Depreciation Account is maintained on sale of asset, alternatively, it is suggested to open an 'Asset Disposal Account' in such case the following accounting entries may be passed:
  i. <u>On transfer of original cost of asset to Asset Disposal Account:</u>
  Asset Disposal Account Dr.
  To Asset Account

  ii. <u>On sale of the asset:</u>
  Bank Account Dr.
  To Asset Disposal Account

  iii. <u>On transfer of Provision for Depreciation Account to Asset Disposal Account:</u>
  Provision for Depreciation Account Dr.

To Asset Disposal Account

iv. For profit on disposal of asset:

Asset Disposal Account Dr.

To Profit and Loss Account

(In case of loss the above entry is reversed.)

F. DEPRECIATION AND REPLACEMENT OF ASSETS

Due inflationary conditions, it will be appropriate to provide for depreciation on the replacement cost instead of on the historical cost.

This is because of the fact that depreciation is provided for replacing the asset. Sufficient funds will not be available for replacing an asset at the end of its serviceable life.

But following difficulties may crop up when replacement cost system is used:

(a) Estimating replacement cost in advance is difficult.

(b) The method of charging depreciation on the basis of replacement cost is not recognized by income tax authorities.

(c) The method of charging depreciation on replacement cost during inflationary conditions is preferred but not during period of falling prices.

(d) According to the Companies Act, depreciation should be charged on the original cost of the asset and any deficiency or surplus arising due to sale of such asset should be transferred to the profit and loss account.

(e) Any new asset purchased, with few exceptions, is always of a better quality than the asset replaced.

Hence, it is difficult to calculate the cost of the asset replaced. These difficulties can be obviated by taking the following steps:

(a) The additional amount required for replacing the asset over and above the original cost of the asset may be estimated. Every year, an appropriate amount may be transferred from profit and loss account besides usual depreciation on asset to provide for additional amount required for replacement of the asset over and above the original cost of the asset. It may be debited to Profit and Loss Appropriation Account and credited to Replacement Reserve account.

(b) The Replacement Reserve Account may be credited every year with interest at the current rate on the accumulated balance standing to the credit of the account.

G. AMORTIZATION

Amortization is the accounting practice of spreading the cost of an intangible asset over its useful life. Intangible assets are not physical but they are still assets of value. They can include patents, trademarks, franchise agreements, copyrights, costs of issuing bonds to raise capital, and organizational costs.
Amortization is typically expensed on a straight-line basis. The same amount is expensed in each period over the asset's useful life. Assets that are expensed using the amortization method typically do not have any resale or salvage value.

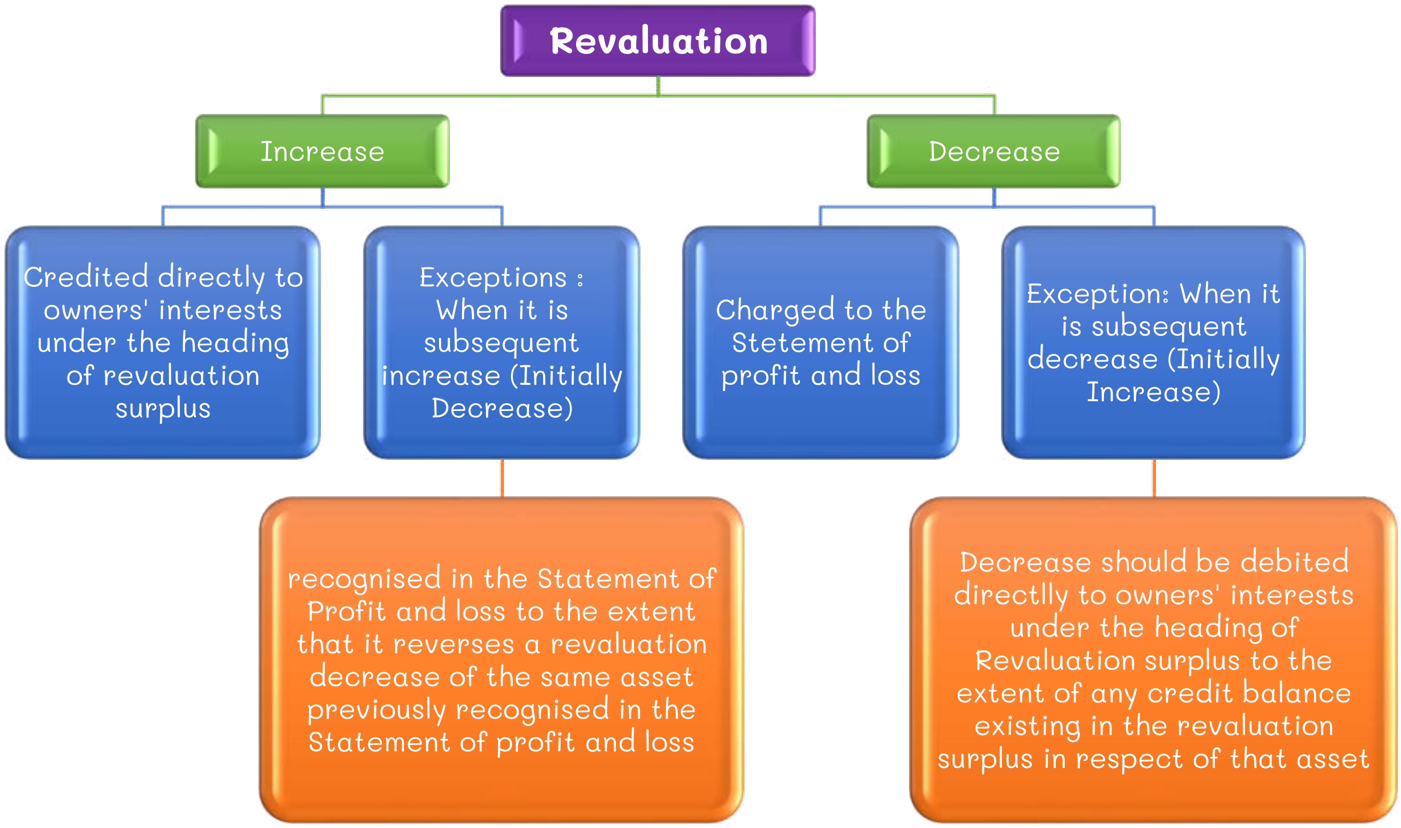
Amortization of Intangible Assets

- Purpose: To gradually reduce the value of non-physical assets over their useful life, reflecting the cost- to-benefit spread as the asset generates revenue.
- Examples of Intangible Assets: Patents, trademarks, copyrights, goodwill, and software.
- Method: Similar to depreciation for tangible assets, the total cost of the intangible asset is divided and recorded as an expense over several years

Amortization vs Depreciation: Key Differences

1. Applicability: Depreciation is only applicable to physical, tangible assets that are subject to having their costs allocated over their useful lives. Amortization is only applicable to intangible assets.
2. General Philosophy: The term depreciate means to diminish in value over time. Amortize means to gradually write off a cost over a period.
3. Options of Methods: Almost all intangible assets are amortized over their useful life using the straight- line method. The same amount of amortization expense is recognized each year. A company can choose from several depreciation methods. These options differentiate the amount of depreciation expense a company may recognize in a given year, yielding different net income calculations based on the option chosen.
4. Acceleration: A company often has the option of accelerating depreciation. More depreciation expense is recognized earlier in an asset's useful life when a company accelerates it. That asset may be used more heavily when it's newest. Amortization doesn't often use this practice. The same amount of expense is recognized whether the intangible asset is older or newer.
5. Use of Salvage Value: The formulas for depreciation and amortization are different because of the use of salvage value. The depreciable base of a tangible asset is reduced by its salvage value. The amortization base of an intangible asset is not. This is often because intangible assets don't have a salvage value. Use of Contra Account

Add some 'EXTRA KNOWLEDGE':



H. ICSI MODULE QUESTIONS:

Illustration 1:

A firm acquired a machinery on 1st July 2022 at a cost of Rs. 45,000 and spent Rs. 5,000 for its installation. The firm writes off depreciation at 10% per annum on the original cost every year. The books are closed on 31st March every year. Show Machinery Account and Depreciation Account for three years.

Illustration 2:

A firm acquired machinery on 1st July 2022 at a cost of Rs. 45,000 and spent Rs. 5,000 for its installation. The firm writes off depreciation at 10% per annum on diminishing balance method. The books are closed on 31st March every year. Show Machinery Account and Depreciation Account for three years.

Illustration 3:

M Ltd. which depreciates its machinery @ 10% per annum according to diminishing balance method, had on 1st April, 2024 Rs. 4,86,000 balance in its machinery account. During the year ended 31st March, 2025, the machinery purchased on 1st April, 2022 for Rs. 60,000 was sold for Rs. 40,000 on 1st October, 2024 and a new machinery costing Rs. 70,000 was purchased and installed on the same date; installation charges being Rs. 5,000.

The company wants to change its method of depreciation from diminishing balance method to straight line method w.e.f. 1st April, 2022 and adjust the difference before 31st March, 2025, the rate of depreciation remaining the same as before.
Show the machinery account for the year ended 31st March, 2025.

Illustration 4:
On 1st April, 2022, a firm purchased a machinery for Rs. 2,00,000. On 1st October in the same accounting year, additional machinery costing Rs. 1,00,000 was purchased. On 1st October, 2023, the machinery purchased on
1st April, 2022, having become obsolete, was sold off for Rs. 90,000. On 1st October, 2024, new machinery was purchased for Rs. 2,50,000 while the machinery purchased on 1st October, 2023 was sold for Rs. 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 31st March, 2025.

Illustration 5:
ABC & Co. registered a patent (intangible assets) on 1st April, 2024 developed at a cost of Rs. 12,00,000 and spent Rs. 1,00,000 towards legal and registration fees. The patent is granted for 10 years. The book are closed on 31st March every year.
Show the patent accounts and amortization accounts for the year ended 31.03.2025 & 31.03.2026.
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Topic 5 PREPARATION OF FINAL ACCOUNTS FOR SOLE PROPRIETORS

FINAL ACCOUNTS OF NON- MANUFACTURING ENTITIES

A. INTRODUCTION

To ascertain the final outcome of the business i.e., the income and financial position, they prepare financial statements at the end of the accounting year.

- Financial Statements
  - Income Statement
    - Trading Account
      - Gross Profit or Gross Loss
    - Profit & Loss Account
      - Net Profit or Net Loss
  - Position Statement
    - Balance Sheet
      - Position of Assets & Liabilities

Comparison between Income Statement and Position Statement

Income Statement	Position statement
Profit or loss is presented in the Income Statement prepared at the close of the financial year	It exhibits assets and liabilities of the business as at the close of the financial year.
Income Statement is sub-divided into following two parts for a non-manufacturing concern: (i) Trading account; and (ii) Profit and Loss account	Apart from balance sheet, to assess the financial position of the business, sometimes additional statements are also prepared like cash flow statement, statement of changes in equity etc. which is not mandatory for non-corporate entities.
Income Statement discloses net profit or net loss of the business after adjusting from the income earned during the year, all the expenditures of the business incurred in that year.	Position statement discloses the assets and liabilities position as on a particular date.

B. PREPARATION OF FINAL ACCOUNTS

The BASIC PRINCIPLES in regard to accumulation of accounting period data are:

(i) a distinction should be made between capital and revenue receipts and payments.

(ii) income and expenses relating to a period of account should be separated from those of another period.

(iii) different items of income and expenditure should be accumulated under significant heads so as to disclose the sources from which capital has been procured and the nature of liabilities, which are outstanding for payment.

Various matters to which attention should be paid for determining the different aspects of transactions, a record of which should be kept, and the different heads of account under which various items of income and expenditure should be accumulated, are stated below:

(a) Distinction between personal and business income:- Since the final statements of account are intended to show the profitability of the business and not that of its proprietors, it is essential that all personal income and expenditure should be separated from business income and expenditure.

(b) Distinction between capital and revenue expenditure:- A distinction should be made between capital and revenue, both receipts and expenditure. Different types of income and expenditure should be classified under separate heads. Assets should be included in the Balance Sheet by following accounting principles and accounting standards. Likewise, a provision for expenses which have accrued but not paid, should be made by estimation or otherwise on the same basis as in the previous year.

(c) All material information to be disclosed:- Every information, considered material for evaluating the performance of the business or its financial position, should be disclosed. For example, when the labour charges have increased substantially on account of bonus having been paid to workmen, the amount of bonus paid should be disclosed. Similarly, If there are substantial write-offs in inventory due to any reason, it should be shown separately.

(d) Record only current period transactions:- Though the record of transactions should be maintained continuously, at the end of each accounting period, the transactions of the closing accounting period should be cut off from those of the succeeding period.

Only transactions completed before close of accounts should be given effect:- It should be seen that only the effect of transactions, which were concluded before the close of period of account, has been adjusted in the accounts of the year. For example, when a sale of goods is to take place only after the goods have been inspected by the purchaser and the inspection had not been made before the close of the year, it would be incorrect to treat the goods as a sale in the accounts of the year.

Matching Principle

This principle demands that expenses incurred to earn the revenue should be properly matched. This means the following:

(a) If a certain revenue and income is entered in the Trading / Profit and Loss Account all the expenses relating to it, whether or not payment has been actually made, should be debited to the Trading / Profit and Loss Account. This is why at the end of the year an entry is recorded to bring into account the outstanding expenses. That is also the reason why the opening inventory of goods is debited to the Trading Account since the relevant sale is credited in the same account.

(b) If some expense has been incurred but against it sale will take place in the next year or income will be received next year, the expense should not be debited to the current year's Profit and Loss Account but should be carried forward as an asset and shown in the Balance Sheet. It will be debited to the Profit and Loss Account only when the relevant income will also be credited. The same reason applies to depreciation of assets also. The part of the cost which is used to earn current year revenue is debited in same year.

(c) If an income or revenue is received in the current year but the work against it has to be done and the cost in respect of it has to be incurred next year, i.e. income received in advance, such income or the revenue is considered to be of next year. It should be shown in the Balance Sheet on the liabilities side as "income received in advance" and should be credited to the Profit and Loss Account of the next year. E.g. Newspapers or magazines usually receive subscriptions in advance for a year. The part of subscription that covers copies to be supplied in the next year is treated as income received in advance.

C. TRADING ACCOUNT

At the end of the year, as has been seen above, 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.

Gross Profit is the difference between the selling price and the cost of the goods sold. For a trading firm, the cost of goods sold can be ascertained by adjusting the cost of goods still on hand at the end of the year against the purchases.

Trading Account of..... for the year ended.....

		₹			₹
To Opening Stock		XXX	By Sales	XXX	
To Purchases	XXX		Less: Returns Inwards	XXX	XXX
Less: Returns outwards	XXX	XXX	By Closing Stock		
To Direct expenses:		XXX	By Gross Loss c/d* (If Balance)		
Freight & Carriage		XXX			
Customs & Insurance		XXX			

Wages Gas, Water & Fuel Factory Expenses Royalty on production To Gross Profit c/d* (If balance)		XXX XXX XXX XXX			
		XXX			XXX

Point to Remember:-

- The opening inventory and purchases are written on the debt side.
- Sales and the closing inventory are entered on the credit side.
- If there are any direct expenses then they should also be written on the debit side of the Trading account.
- If the balances of credit side is more, the difference is written on the debit side as gross profit. This amount will also be carried forward to the Profit and Loss Account on the credit side.
- In case of gross loss, i.e., when the debit side of the Trading Account exceeds the credit side, the amount will be written on the credit side of the Trading Account and transferred to the debit side of the Profit and Loss Account

Trading Account Items

(Refer class notes)

If Closing Stock appears in the Trial balance:- The closing inventory is then not entered in the trading account, it is shown only in the balance sheet. This is because it has already been adjusted to arrive at Cost of Goods Sold.

Note: To ascertain value of the closing inventory, it is necessary to make a complete inventory or list of all the items in the godown together with quantities. Of course, damaged or obsolete items are separately listed. To the list of finished goods, one should also add the goods lying with agents sent to them on consignment basis and also the goods sent on approval to customer.

Note: The valuation principle is cost or net realisable value whichever is lower.

D. PROFIT AND LOSS ACCOUNT

- The Profit and Loss Account starts with gross profit on the credit side. If there is gross loss, it will be written on the debit side.
- All other expenses and losses, which have not been entered in the Trading Account, will be written on the debit side of Profit and Loss Account.
- Incomes and gains, other than sales, will be written on the credit side.

Format f profit/loss A/c appears as follows:

Dr. Profit and Loss Account for the year ended Cr.

Particulars	₹	Particulars	₹
To Gross Loss b/d		By Gross Profit b/d	
Management expenses		Other Income	
To Salaries (administrative)		By Discount Received	
To Office rent, rates and taxes		By Commission Received	
To Printing and stationery		Non-trading Income	
To Telephone charges		By Bank Interest	
To Postage		By Rent of property let-out	
To Insurance		By Dividend from investment in shares	
To Audit Fees			
To Legal Charges		Abnormal Gains	
To Electricity Charges		By Profit on sale of machinery	
Maintenance expenses		By Profit on sale of investment	
To Repairs & renewals		By Net Loss	
To Depreciation on:		(transferred to capital A/c)	
Office Equipment			
Office Furniture			
Office Buildings			
Selling & Distribution expenses			
To Salaries (selling staff)			
To Advertisement			
To Godown rent			
To Carriage Outward			
To Bad Debts			
To Provision for bad debts			
To Selling commission			
Financial expenses			
To Bank charges			
To Interest on loans			
To Discount on bills			
To Discount allowed to customers			
Abnormal Losses			
To Loss on sale of machinery			
To Loss on sale of investment			
To Loss by fire			
To Net Profit (transferred to Capital A/c)			

E. CLOSING ENTRIES

Refer Class Notes

F. CERTAIN ADJUSTMENTS AND THEIR TREATMENTS

Adjustment	If Given in Trial Balance	If Not Given in Trial Balance
1. Closing stock	Balance Sheet – Asset Side	(a) Trading A/c – Credit Side (b) Balance Sheet – Asset Side
2. Outstanding Expenses	Balance Sheet – Liability Side	(a) Trading/Profit & Loss A/c Debit Side. Add to the concerned expenses. (b) Balance Sheet – Liability Side
3. Prepaid Expenses	Balance Sheet – Asset Side	(a) Trading/Profit & Loss A/c Debit Side. Deduct from the concerned expense. (b) Balance Sheet - Asset
4. Income Outstanding	Balance Sheet – Asset Side	(a) Profit & 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) Profit & Loss A/c – Credit Side. Deduct from concerned income. (b) Balance Sheet – Liability Side
6. Bad Debts	Profit & Loss A/c – Debit Side	(a) Profit & Loss A/c – Debit Side. (b) Balance Sheet – Asset Side. Deduct from debtors .
7. Provision for Bad or Doubtful debts	Profit & Loss A/c – Debit Side	(a) Profit & Loss A/c – Debit Side. (b) Balance Sheet – Asset Side. Deduct from Debtors after additional bad debts, if any.
8. Provision for Discount on Debtors	Balance Sheet – Asset Side. Deduct from debtors	(a) Profit & Loss A/c – Debit Side. (b) Balance Sheet – Asset Side. Deduct from debtors after providing for provision for bad debts
9. Depreciation	Profit & Loss A/c – Debit Side	(a) Profit & Loss A/c – Debit Side. (b) Balance Sheet – Asset Side. Deduct from Respective Asset.
10. Interest on Capital	Profit & Loss A/c – Debit Side	(a) Profit & Loss A/c – Debit Side. (b) Balance Sheet – Liability Side. Add to Capital.
11. Interest on Drawings	Profit & Loss A/c – Credit Side	(a) Profit & Loss A/c – Credit Side. (b) Balance Sheet – Liability Side. Deduct from Capital.
12. Loss by Fire	Profit & Loss A/c – Debit Side	(a) Trading A/c – Credit Side (with full amount of loss) (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.

G. BALANCE SHEET

- 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."
- The assets are shown on the right hand side and liabilities and capital on the left hand side

CHARACTERISTICS

(i) It is prepared at a particular date, rather the close of a day and not for a period. It is true only on that date and not later. Suppose, in the example given above, a part of the goods were sold on 1st April, 2021. This will mean that the value of the Inventory will be reduced, the cash in hand will increase and the capital account will be reduced or increased depending upon loss or profit on sale.

(ii) The balance sheet is prepared only after the preparation of the Profit and Loss Account. This is the reason why the Profit and Loss Account (including the Trading Account) and the Balance Sheet are together called Final Accounts (of course, the Balance Sheet is not an account, the two sides are not the debit and the credit sides.) Without being accompanied by the Profit and Loss Account, the Balance Sheet will not be able to throw adequate light on the financial position of the firm. For that purpose an appreciation of the profits of the firm is necessary.

(iii) Since capital always equals the difference between assets and liabilities and since the capital account will independently arrive at this figure, the two sides of the Balance Sheet must have the same totals. If it is not so, there is certainly an error somewhere.

ARRANGEMENTS OF ASSETS AND LIABILITIES

1. Assets: Assets may be grouped in one of the following two ways:

   (i) Liquidity: Under this approach, the asset, which can be converted into cash first, is presented first. Those assets, which are most difficult in this respect, are presented at the bottom. As per Liquidity balance sheet can be prepared as follows:

Balance Sheet as at...

Liabilities	Amt. (₹)	Assets	Amt. (₹)
Bills Payable		Cash in Hand	
Trade Creditors		Cash at Bank	
Loans		Government Securities	
Outstanding Expenses		Other Investments	
Reserves & Surplus		Bills Receivable	
Capital		Sundry Debtors	
		Stock	
		Furniture & Fixtures	
		Plant & Machinery	
		Land and Building	

   (ii) Permanence: Assets, which are to be used, for long term in the business and are not meant to be sold are presented first. Assets, which are most liquid, such as cash in hand, are presented at the bottom.

Balance Sheet as at...

Liabilities	Amt. (₹)	Assets	Amt. (₹)
Capital		Land and Building	
Reserves & Surplus		Plant & Machinery	
Outstanding Expenses		Furniture & Fixtures	
Loans		Stock	
Trade Creditors		Sundry Debtors	
Bills Payable		Bills Receivable	
		Other Investments	
		Government Securities	
		Cash at Bank	
		Cash in Hand	

   Note:- Some of the assets may be capable of being sold easily like investment in government securities or shares of some companies. They should be treated as liquid or permanent according to the intention of the firm.

2. Liabilities: Liabilities may also be shown according to the urgency with which payment has to be made. One way is to first show the capital, then long-term liabilities and last of all short term liabilities like amounts due to suppliers of goods

or bills payable. The other way is to start with short-term liabilities and then show long term liabilities and last of all capital.

THUS;

Marshalling of Balance Sheet

The arrangement of assets and liabilities in accordance with a particular order is known as marshalling of balance sheet. The items in the balance sheet are generally marshalled in two ways-

(i). Liquidity order or according to time: In liquidity order, the assets are stated in the order in which they can be easily converted into cash and the liabilities in the order in which they have to be paid off.

(ii). Permanence order or according to purpose: In permanence order, assets which are to be used permanently in the business and are not meant for sale are shown first and the assets that are liquid are shown last in order. Similarly, liabilities may also be shown according to the permanence arrangement.

CLASSIFICATION OF ASSETS AND LIABILITIES

- Current Assets: - these assets are meant to be converted into cash as quickly as possible. Generally, within one year. For example:- Cash in hand, Cash at Bank, Trade receivables, Inventories.
- Long Term Assets: - Those that are meant to be used by the firm over a long period and not sold the former type of assets is also called fixed assets. For example:- Machinery, Building, Long term Investment.
- Intangible Assets: - the assets which have no physical existence and cannot be seen or touched are called as Intangible Assets. For example :- Patents, Copyrights etc.
  It is desirable that in the balance sheet the two types of assets should be shown separately and prominently. This would give meaningful and logical information.
  Liabilities to outsider will be of two types:
- Current Liabilities: - this liability must be settled in one year or less. It is also called as short- term liability. For example: - Creditors, Bills Payable etc.
- Long Term Liability: - those liabilities which exists for more than one year are Long term liabilities. For example long term loans from banks. Of course, it will include undistributed profits also.

H. SEQUENCE OF ACCOUNTING PROCEDURE OR THE ACCOUNTING CYCLE

What has been done so far shows that the accounting process in the following order

- recording the transactions in the journal or journalising;
- preparing ledger accounts on the basis of the journal or posting into the ledger;
- taking out the trial balance to check arithmetical accuracy;

- preparing the trading and profit and loss account or the income statement for the period concerned; and
- preparing the balance sheet to show the financial position at the end of the period.

I. OPENING ENTRY

Refer Class Notes

J. PROVISIONS AND RESERVES

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". A provision is a liability which can be measured only by using a substantial degree of estimation.

Thus, a provision may be either in respect of loss in the value of an asset provided or written off on the basis of an estimate or the one in respect of a liability for expenses incurred in respect of a claim which is disputed i.e. when it is a contingent liability. On the occurrence of a diminution in asset values due to some of them having become irrecoverable or Inventory items are lost as a result of some natural calamity, amounts contributed or transferred from profit to make good the diminution also are described as provision.

The following are instances of amount retained in the business out of earning for different purposes that are described as provisions.

1. Amount provided for meeting claims which are admissible in principle, but the amount whereof has not been ascertained.
2. An appropriation made for payment of taxes still to be assessed.
3. Amount set aside for writing off bad debts or payment of discounts.

The portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability is known as reserves. The reserves are primarily of two types: capital reserves and revenue reserves. Also provisions in excess of the amount considered necessary for the purposes these were originally made, are to be considered as reserves. It is thus evident that provisions are a charge against profits, while reserve is an appropriation of profits. Also provisions that ultimately prove to be in excess of amounts required or have been made too liberally are reserves. Such a distinction is essential for disclosing truly in the Balance Sheet the amount by which the equity of shareholders has increased with the accumulation of undistributed profits.

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.

K. LIMITATIONS OF FINANCIAL STATEMENTS

The principal limitations affecting financial statements are the following:

(a) Historical Cost: Accounting records and, on that account, the financial statements are prepared only on the basis of the money value prevailing at the time the transaction were entered into. Thus, the effect of subsequent changes in the value of money is not taken into account. At times this has the effect of making the statements of account quite misleading. Take the obvious example of a house built in 1980, say at the cost of ₹15,000, in 2022 the benefit receivable from its occupation will be as much as that of a house created in 2022, say at a cost of ₹30,00,000. If the house were included in the financial statements at its original cost, as normally it would not convey a true picture except to a knowledgeable person.

The limitations can be serious in the case of other fixed assets that have been working over a long period over which prices have changed radically. It is, however, not easy to get over this difficulty, since revaluation of fixed assets, apart from being costly is not practicable when the value of money is continuously falling. On this account, historical cost continues to be the accepted basis for the preparation of financial statements. Though it may not be possible to do much to remove the limitation mentioned above, one must always remember to read the balance sheet and the profit and loss accountin the light of what they cannot reveal as well as what they do.

(b) Intangible strengths and weaknesses: A company may have a number of strengths and weaknesses which cannot be shown in the balance sheet e.g., the loyalty and calibre of its staff. These must be kept in mind while judging the financial position of the company.

(c) Perpetual continuity and periodical account: Financial statements ordinarily are drawn up at the end of each year but the accounting record is maintained on the assumption that the business undertaking shall continue to exist forever on the basis of going concern assumption. In consequence, much of the expenditure other than revenue expenditure has to be distributed arbitrarily over a number of years during which benefit of the expenditure is expected to arise. As a result, financial statements of account are not absolutely correct.

(d) Different accounting policies: It is permissible for a company within certain limits to adopt different policies for the preparation of accounts, valuation of various assets and distribution of expenditure over different periods of account. For example, a company may decide to provide annually for payment of pensions and gratuities to staff and thus build up a 'fund' out of which payments will be made ultimately whereas another company may deal with these only when actual payments are made. Similarly, a company may decide whether or not to include intangible assets amongst its assets or manner in which the amounts thereof should be written off.

(e) Management policies: Management can have different accounting policies for welfare of the staff and public at large.

FINAL ACCOUNTS OF MANUFACTURING ENTITIES

A. INTRODUCTION

The manufacturing entities generally prepare a separate Manufacturing Account as a part of Final accounts in addition to Trading Account, Profit and Loss Account and Balance Sheet. The objective of preparing Manufacturing Account is to determine manufacturing costs of finished goods for assessing the cost effectiveness of manufacturing activities. Manufacturing costs of finished goods are then transferred from the Manufacturing Account to Trading Account.

(a) Trading account shows Gross Profit while Manufacturing Account shows cost of goods sold which includes direct expenses.

(b) Manufacturing account also deals with the raw materials, and work in progress while the trading account would deal with finished goods only.

B. PURPOSE

A manufacturing account serves the following functions:

1. It shows the total cost of manufacturing the finished products and sets out in detail, with appropriate classifications, the constituent elements of such cost. It is, therefore, debited with the cost of materials, manufacturing wages and expenses incurred directly or indirectly to manufacture.
2. It provides details of factory cost and facilitates reconciliation of financial books with cost records. It also serves as a basis of comparison of manufacturing operations from period to period.
3. The Manufacturing Account may also be used for various other purposes. For example, if the output is carried to the Trading Account at market prices, it shows the profit or loss on manufacture. Similarly, it may also be used to fix the amount of production linked bonus when such schemes are in force.

C. MANUFACTURING COSTS

Manufacturing costs are classified into:

+ Raw Material Consumed	....
+ Direct Manufacturing Wages	....
+ Direct Manufacturing Expenses	....
+ Direct Manufacturing Cost	....
+ Indirect Manufacturing expenses or	
+ Manufacturing Overhead	....
Total Manufacturing Cost	______

Raw Material consumed is arrived at after adjustment of opening and closing Inventory of raw materials:

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

If there remain unfinished goods at the beginning and at the end of the accounting period, cost of such unfinished goods (also termed as Work-In-Process) is shown in the Manufacturing Account.

Opening inventory of Work-in-Process is posted to the debit of the Manufacturing Account and closing inventory of Work-in-Process is posted to the credit of the Manufacturing Account.

DIRECT MANUFACTURING EXPENSES

Direct manufacturing expenses are costs, other than material or wages, which are incurred for a specific product or saleable service.

Examples of direct manufacturing expenses are (i) Royalties for using license or technology if based on units produced, (ii) Hire charge of the plant and machinery used on hire, if based on units produced, etc.

When royalty or hire charges are based on units produced, these expenses directly vary with production.

D. INDIRECT MANUFACTURING EXP. OR OVERHEAD EXPENSES

These are also called Manufacturing overhead, Production overhead, Works overhead, etc. Overhead is defined as total cost of indirect material, indirect wages and indirect expenses.

Overhead = Indirect Material + Indirect Wages + Indirect Expenses

- Indirect material means materials which cannot be linked directly with the units produced, for example, stores consumed for repair and maintenance work, small tools, fuel and lubricating oil, etc.
- Indirect wages are those which cannot be directly linked to the units produced, for example, wages for maintenance works, holding pay, etc.
- Indirect expenses are those which cannot be directly linked to the units produced, for example, training expenses, depreciation of plant and machinery, depreciation of factory shed, insurance premium for plant and machinery, factory shed, etc.

Accordingly, indirect manufacturing expenses comprise indirect material, indirect wages and indirect expenses of the manufacturing division.

BY-PRODUCTS

In most manufacturing operations, the production of the main product is accompanied by the production of a subsidiary product which has a value on sale. For example, the production of hydrogenated vegetable oil is accompanied by the production of oxygen gas and the production of steel yields scrap. The subsidiary product is termed as a by-product because its production is not consciously undertaken but results out of the production of the main product. It is usually very difficult to ascertain the cost of the product. Moreover, its value usually forms a very small percentage of the main product.

By-product is a secondary product. This is produced from the same raw materials, which are used for producing the main product and without incurring any additional expenses from the same production process in which the main product is produced. Some examples of by- product are given below:

(i) Molasses is the by-product in sugar manufacturing;

(ii) Butter milk is the by-product of a dairy which produces butter and cheese, etc.

By-products generally have insignificant value as compared to the value of main product. They are generally valued at net realizable value, if their costs cannot be separately identified. It is often treated, as Other Operating 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.

E. DESIGN OF A MANUFACTURING ACCOUNT

There is no standardized design for the presentation of a Manufacturing Account. Given below is a format covering various elements:

Manufacturing Account

Particulars	Units	Amt. (₹)	Particulars	Units	Amt. (₹)

To Raw Material Consumed: Opening inventory Add: Purchases Less: Closing inventory To Direct Wages			By By-products at net realizable value By Closing Work-in-Process By Trading A/c Cost of production		
To Direct expenses: Prime cost	...... 				
To Factory overheads: Royalty Hire charges					
To Indirect expenses: Repairs & Maintenance Depreciation Factory cost	....				
To Opening Work-in-process	.....	....			

F. ICSI MODULE QUESTIONS

Illustration 1:

A business house maintains provision of 5% against bad debts and 3% for discount on debtors and a reserve for discount on creditors at 2%. On 1st April, 2023 it had the following balances:

Provision for Bad and Doubtful Debts ... ₹ 5,000
Provision for Discount on Debtors... ₹ 2,850
Provision for Discount on Creditors ... ₹ 4,800

During the year 2023-24, bad debts, discount allowed to debtors and discount received from creditors amounted to ₹ 3,950, ₹ 8,800 and ₹ 9,840 respectively while for 2024-25 they amounted to ₹ 1,800, ₹ 7,000 and ₹ 6,800 respectively. Sundry Debtors were ₹ 1,20,000 on March 31, 2024 and ₹ 80,000 on March 31, 2025. Sundry Creditors on these two dates were ₹ 2,10,000 and ₹ 1,95,000 respectively.

Show provision for bad debts account, provision for discount on debtors account and reserve for discount on creditors account along with relevant portions of profit and loss account.

Illustration 2:		
Trial balance of Amar as on 31st March, 2025:		
	₹	₹
Capital Account		8,00,000
Drawing Account	60,000	
Stock (1.4.2024)	4,50,000	

Purchases	26,00,000	
Sales		31,00,000
Furniture	1,00,000	
Sundry Debtors	4,00,000	
Freight and Octroi	4,6,000	
Trade Expenses	5,000	
Salaries	55,000	
Rent	24,000	
Advertising Expenses	50,000	
Insurance Premium	4,000	
Commission		13,000
Discount	2,000	
Bad Debts	16,000	
Provision for Bad Debts		9,000
Creditors		2,00,000
Cash in hand	52,000	
Bank	58,000	
Goodwill (at cost)	2,00,000	
	41,22,000	41,22,000

Adjustments:

(a). Stock on 31st March, 2025 was valued at ₹ 5,30,000

(b). Salaries have been paid only for 11 months.

(c). Unexpired insurance included in the figure of ₹ 4,000 appearing in trial balance is ₹ 1,000.

(d). Commission earned but not yet received amounting to ₹ 1,220 is to be recorded in books of account.

(e). Provision for bad debts is to be brought upto 3% of sundry debtors.

(f). Manager is to be allowed a commission of 10% of net profits after charging such commission.

(g). Furniture is depreciated @10% per annum.

(h). Only 1/4th of advertising expenses is to be written off.

Prepare trading and profit and loss account for the year ended 31st March, 2025 and balance sheet as on that date. Also show adjustments entries and closing entries.

Illustration 3:	

Following are the balances in the ledger of Mr. Patel for the year ended 31st March, 2025:	
	₹
Stock (1.4.2024):	
Raw materials	1,00,000
Semi-finished goods	50,000
Finished goods Purchases:	2,60,000
Raw materials	8,00,000
Finished goods	1,70,000
Carriage inwards on raw materials	30,000
Manufacturing wages	1,00,000
Salary of the supervisor	36,000
Rent of the factory	70,000
Gas and water	30,000
Return of raw materials	13,000
Fuel and coal	33,000
Factory power	1,25,000
Fire insurance	13,000
Sales returns	1,20,000
Depreciation on factory building	12,000
Stock on 31.3.2025:	
Raw materials	80,000
Semi-finished goods	1,30,000
Finished goods	2,20,000
Sales	22,00,000
Carriage outwards	35,000
Office salaries	1,50,000

Prepare manufacturing account and trading and profit and loss accounts for the year ended March, 2016

MULTIPLE CHOICE QUESTIONS (MCQ)

1. The main purpose of a manufacturing account is to:
   (a) Ascertain gross profit
   (b) Ascertain cost of goods manufactured
   (c) Show financial position
   (d) Calculate net profit

Answer: Ascertain cost of goods manufactured

2. Which of the following is a direct manufacturing expense?
   (a) Depreciation on Plant
   (b) Salary of Factory Manager
   (c) Royalty based on production
   (d) General Administration Expenses
   Answer: Royalty based on production

3. Manufacturing Account does NOT deal with:
   (a) Raw Materials
   (b) Work in Progress
   (c) Finished Goods Sales
   (d) Factory Overheads

   Answer: Finished Goods Sales

4. Work-in-progress at year end is:
   (a) Credited to Manufacturing Account
   (b) Debited to Trading Account
   (c) Debited to Manufacturing Account
   (d) Credited to Trading Account

   Answer: Credited to Manufacturing Account

5. The formula for Raw Material Consumed is:
   (a) Purchases – Opening Inventory
   (b) Opening Inventory + Purchases – Closing Inventory
   (c) Purchases + Closing Inventory – Opening Inventory
   (d) Opening Inventory — Purchases — Closing Inventory Answer: Opening Inventory + Purchases – Closing Inventory

6. Which of the following is NOT an indirect manufacturing expense?
   (a) Depreciation on Plant
   (b) Factory Rent
   (c) Royalty based on units produced
   (d) Factory Lighting

   Answer: Royalty based on units produced

7. In manufacturing account, by-products are generally:
   (a) Ignored
   (b) Credited at cost price
   (c) Credited at net realisable value
   (d) Credited at selling price
   Answer: Credited at net realisable value

8. If closing work-in-progress is understated, the effect is:

(a) Net income is understated
(b) Net income is overstated
(c) No effect on income
(d) Assets are overstated
Answer: Net income is understated

9. Manufacturing account is prepared only by:
(a) Trading entities
(b) Manufacturing entities
(c) Service entities
(d) Non-trading entities
Answer: Manufacturing entities

10. Overheads in a manufacturing account generally include:
(a) Direct materials
(b) Indirect materials, indirect wages and indirect expenses
(c) Finished goods costs only
(d) Direct expenses only
Answer: Indirect materials, indirect wages and indirect expenses

11. The main objective of preparing final accounts is to:
(a) Record transactions
(b) Ascertain profit or loss and financial position
(c) Calculate depreciation
(d) Maintain cash flow statement
Answer: Ascertain profit or loss and financial position

12. The Trading Account is prepared to ascertain:
(a) Net Profit
(b) Net Loss
(c) Gross Profit or Gross Loss
(d) Financial Position
Answer: Gross Profit or Gross Loss

13. In which account are outstanding expenses shown at the year end?
(a) Income Statement
(b) Liabilities side of Balance Sheet
(c) Assets Side of Balance Sheet
(d) Trading Account
Answer: Liabilities side of Balance Sheet

14. Expenses related to the proprietor personally are:
(a) Debited to Profit & Loss Account

(b) Debited to Trading Account
(c) Debited to Drawings/Capital Account
(d) Credited to Profit & Loss Account

Answer: Debited to Drawings/Capital Account

15. Which of the following is NOT a direct expense in Trading Account?

(a) Wages
(b) Carriage Inwards
(c) Advertisement Expenses
(d) Freight on Purchases

Answer: Advertisement Expenses

16. When Closing Inventory appears in the trial balance, it is shown:

(a) Only in Trading Account
(b) Only in Balance Sheet
(c) Both in Trading Account and Balance Sheet
(d) Not shown anywhere

Answer: Only in Balance Sheet

17. Discount received is:

(a) Debited to Profit & Loss Account
(b) Credited to Profit & Loss Account
(c) Debited to Trading Account
(d) Credited to Capital Account

Answer: Credited to Profit & Loss Account

18. Income tax paid by sole proprietor is treated as:

(a) Business expense
(b) Personal expense debited to Capital Account
(c) Profit & Loss Account expense
(d) Current Liability

Answer: Personal expense debited to Capital Account

19. Provision for bad debts is:

(a) Debited to Debtors' Account
(b) Debited to Capital Account
(c) Debited to Profit & Loss Account
(d) Credited to Trading Account

Answer: Debited to Profit & Loss Account

20. The order of liquidity in Balance Sheet means:

(a) Current assets first, fixed assets last

(b) Fixed assets first, current assets last

(c) Liabilities first, assets last

(d) Capital first, assets last

Answer: Current assets first, fixed assets last

TRUE / FALSE QUESTIONS WITH ANSWERS

1. The Trading Account shows only indirect expenses of a business for the year.
   False – Trading Account shows direct expenses related to purchases and bringing goods to sale.

2. Closing Stock appearing in the Trial Balance is shown only in the Balance Sheet.
   True – It is already adjusted in the books.

3. Outstanding expenses at year-end are added to the related expenses in the P&L and shown as liabilities in the Balance Sheet.
   True

4. Prepaid expenses are deducted from the related expense and shown as an asset in the Balance Sheet.
   True

5. Provision for doubtful debts is created to meet possible future bad debts.
   True

6. Drawings by the proprietor are debited to the Profit & Loss Account.
   False – They are debited to the Capital Account.

7. Goods given as free samples are treated as a selling expense.
   True – They are debited to Advertisement/Sales promotion expenses.

8. Manager's commission on net profit after charging such commission is calculated as: Commission = Profit before commission × Rate ÷ (100 — Rate)
   True

9. Loss from fire is always adjusted in the Trading Account.
   False – Only abnormal loss cost portion is transferred to P&L; total loss is reduced from Purchases in Trading.

10. Accrued income is an asset in the Balance Sheet.
    True

11. Income received in advance is deducted from the related income in P&L and shown as liability in the Balance Sheet.
    True

12. Depreciation appearing in Trial Balance is debited to P&L and reduced from the asset in the Balance Sheet.
    True

13. When goods are sold on approval basis and approval is not received before year-end,

the sale is reversed for that amount.

True

14. Provision for discount on debtors is created on the gross amount of debtors (before bad debts provision).
False – Created on good debtors after bad debts provision.
15. Cash discount allowed is recorded in Trading Account.
False – It is recorded in P&L as an expense.
16. Capital = Assets – Liabilities.
True
17. The Matching Principle states that expenses should be recorded in the period in which they are paid.
False – Expenses are recorded in the period in which the related revenue is earned, whether paid or not.
18. Purchase Returns reduce the Purchases in Trading Account.
True
19. If the debit side of Trading A/c exceeds the credit side, it results in a Gross Loss.
True
20. Interest on proprietor's drawings is treated as business income and credited to the P&L Account.
True

PRACTICAL QUESTIONS

1. The following are the balances taken from the books of Mr. Atma Ram: Balances on 31st March, 2025

	₹' in 000
Atma Ram's capital	300
Atma Ram's drawings	50
Furniture and fittings	26
Bank overdraft	42
Creditors	133
Business premises	200
Stock on 1st April, 2024	220
Debtors	186
Rent from tenants	10
Purchases	1,100
Sales	1,500
Sales returns	20
Discount-debit	16
Discount-credit	20

Taxes and insurance	20
General expenses	40
Salaries	90
Commission-debit	22
Carriage on purchases	18
Provision for bad and doubtful debts	6
Bad debts written off	8

Stock on hand on 31st March, 2025 was estimated at 200 thousand. Rent 3 thousand, is still due from the tenant. Salaries, ₹ 7.5 thousand are as yet unpaid. Write off bad debts ₹ 6 thousand and depreciate business premises by ₹ 300 and furniture and fittings by ₹ 266. Make a provision of 5% on debtors for bad and doubtful debts and provision of 2% for discounts.

Allow interest on capital at 5 per cent and carry forward ₹ 7 for unexpired insurance. The manager is entitled to a commission of 10% on profits remaining after charging his commission.

Prepare Trading Account, Profit and Loss Account and Balance Sheet on 31st March, 2025. Hints: Suspense Account (difference in trial balance) = 500.

[Ans : G.P = 342 thousand, N.P. = 132.2 thousand, B/s Total = 597.92 thousand]

2. Below is the trial balance of Suresh as at 31st March, 2025.

Debit Balance	₹'000	Credit Balance	₹'000
Suresh's Current Account	150	Capital Account	5,000
Adjusted purchases	69,920	Loan from Mohan @ 9%	
Salaries	420	(taken on 1st October, 2024)	2,000
Carriage on purchases	40	Sales	72,000
Carriage on sale	50	Discount	50
Lighting	30	Sundry creditors	2,000
Rates and insurance	40		
Buildings	2,700		
Sundry debtors	800		
Furniture	600		
Cash in hand	25		
Cash at bank	150		
Stock (31st March, 2014)	6125		
	81,050		81,050

Rates have been prepaid to the extent of ₹1,75,000. Bad debts totaling ₹ 50,000 have to be written off. A provision for doubtful debts @ 5% on debtors is necessary.

Buildings have to be depreciated at
2% and furniture @ 10%. The manager is entitled to a commission of 5% of net profits before charging such commission.

You are required to prepare the profit and loss account for the year ended 31st March, 2025 and the balance sheet as on that date.

[Hints: (a) The trial balance gives "Adjusted Purchases". It means that the opening stock has already been transferred to the Purchases Account and has thus been closed. Further, entry for closing stock has already been passed by debiting the Closing Account and crediting Purchases Account. That is why closing stock appears in the trial balance. It will now be shown in the Balance Sheet and not in the Trading Account since Purchases already stand reduced.

(b) There is a loan of Mohan @ 9% taken in October, 2024. The trial balance makes no mention of any interest being paid to him. Hence, interest @ 9% must be provided for six months i.e. from October 2024 to March 2025.]

[Ans.: G.P. = 2,040 thousand, N.P. =1212.2 thousand, Total B/S =10,216 thousand].

3. Mr. T.P.'s trial balance as on 31st March, 2025 is as under:

Debit Balance	₹'000	Credit Balance	₹'000
Land and building	2,000	Capital	8,000
Machinery	5,000	Sundry creditors	800
Furniture and fixtures	400	Discounts received	40
Opening stock	1,630	Outstanding expenses	155
Purchases	8,000	Sales	15,050
Salaries	600	Repairs and renewals	
Carriage on sales	150	provision	200
Freight on purchase	800		
Advertising	540		
Wages	1,500		
Rent	300		
Postage and stationery	150		
General expenses	320		
Loan to Santhanam @ 9% (given on 1st Oct., 2024)	500		
Prepaid insurance	20		
Sundry debtors	2,000		
Cash in hand	25		
Cash in bank	310		

	24,245		24,245

The following further information is given:

(a) Stock on 31st March, 2025 was ₹ 14,90,000.

(b) Machinery was purchased on 31st October, 2024 for ₹ 10,00,000 and was installed by own workmen. The wages for this purpose amounted to ₹ 50,000. This amount is included in wages account.

(c) Depreciation is to be written off @
 3% on land and buildings;
 10% on machinery; and
 5% on furniture and fixtures.

(d) Provision for repairs and renewals is credited with ₹ 1,50,000 every year.

(e) A reserve of 2% is to be made on creditors for discount.

From the information given above, prepare trading account and profit and loss account for the year ended 31st March, 2025 and balance sheet as at that date.

[Hints:

(a) Prepaid insurance and outstanding expenses are given in trial balance. This means double entry in respect of these of items has been completed. Therefore, they will appear in balance sheet only.

(b) There is a provision for repairs and renewals. Actual repairs will, therefore, be debited to this account and not to the profit and loss account, the provision for repairs and renewals account will be credited with ₹ 1,50,000 by debiting profit and loss account.]

4. On 31st March 2025, following Trial Balance was extracted from books of Ghosh:

	Dr.(₹'000)	Cr. (₹'000)
Capital Account		9,000
Plant and Machinery	8,000	
Sales		40,700
Purchases	26,000	
Returns	600	575
Opening Stock	3,000	
Discount	35	80
Bank Charges	7.5	
Sundry debtors	4,500	
Sundry Creditors		25,00
Salaries	2,680	
Manufacturing wages	4,000	

Carriage Inwards	75	
Carriage Outwards	120	
Bad Debts Provision		5.05
Rent, Rates and Taxes	1,000	
Advertisements	200	
Cash in Hand	90	
Cash in Bank	600	
Furniture & Fittings	2,000	
	52,907.5	52,907.5

Prepare the final accounts for the year ended 31st March, 2025 and the Balance Sheet as on that date. The following adjustments are required:

i. Clocking Stock ₹ 3,500 thousand.

ii. Depreciation on Plant and Machinery @ 15% p.a. and on furniture & Fittings @ 10% p.a. to be provided.

iii. Bad Debts Provision to be adjusted to ₹ 50 thousand.

iv. Interest on Capital to be allowed at 10% per annum.

v. 15% of the profits remaining after providing interest on capital is to be carried to General Reserve.

[Ans.: G.P. = ₹ 1,1,100 thousand; N.P. = ₹ 4,114 thousand; Total of B/S =₹ 1,7,240 thousand].

5. From the following, prepare the Trading and Profit and Loss Accounts for the year ended 31st March 2025 and Balance Sheet of Niyati as at 31st March, 2025:

	'000
Capital	3,000
Trade Creditors	600
Bills Payable	200
General Reserve	500
Provision for Bad and Doubtful Debts	20
Profit and Loss Account, 1st April, 2024	109
Sales	11,500
Discount Allowed	95
Stocks at 1st April, 2024	1,100
Purchases	8,960
Discount Received	88
Buildings	1,000
Machinery, Plant and Furniture (Cost ₹ 2,500 thousand)	1,500

Book Debts	728
Bank Balance (Dr.)	488
Investment, 9% Government Loan at par	200
Bills Receivable	450
Salaries a Wages	660
Audit Fees	100
Office Expenses	440
Repairs and Renewals	236
Interest Paid	14
Bad Debts Recovered	5

The value of stocks on hand as at 31st March, 2025 was ₹1,360 thousand including goods costing 18 thousand received on 30th March, 2025 in respect of which supplier's bill had not yet been received. Goods of the cost of ₹ 30 thousand were sent to a customer on sale or approval basis. The invoice for ₹ 40 thousand was entered in the Sales Book. Provision is to be made for bad debts to the extent of ₹ 8 thousand, and for depreciation of buildings at 2% per annum: Machinery, Plant and Furniture have been depreciated at 20% of the diminishing value; Niyati, however, considers that the proper method is 8% of the original cost and wishes to adopt it with effect from 1st April, 2021.

[Ans.: G.P. = ₹ 1,386 thousand; N.P. = ₹ 652.5 thousand; Total of B/S =₹ 2,866 thousand]

Topic 6 PARTNERSHIP & LLP ACCOUNTS

A. INTRODUCTION

- Partnership: Partnership is the relationship between persons who have agreed to share the profit or loss of a business carried on by all or any one of them acting for all.
- Partners: Persons who have entered into Partnership are individually called Partners.
- Firm: Persons who have entered into Partnership are collectively called Firm.
- Firm Name: The name under which their business is carried on is called the Firm Name.

FEATURES OF PARTNERSHIP

1. Persons: At least two persons to form a Partnership. Includes natural persons and artificial persons having legal entity
2. Agreement: An agreement is entered by all the persons concerned, setting out the terms and conditions under which the Partnership is based. (If in writing, it is "Partnership Deed")
3. Minor as a partner: A minor can be added in partnership firm. But the condition is that he can be admitted to share profit only. He cannot be made to share losses of the firm. If the partnership firm suffers loss than it will be borne by other major partners is their profit sharing ratio.
4. 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.
5. Sharing of Profit / Loss: Partners share profits and losses of business in the agreed ratio.
6. Number of Partners: Minimum Partners: Two Maximum Partners: As per Section 464 of the Companies Act, 2013, no association or partnership consisting of more than 100 number of persons as may be prescribed shall be formed for the purpose of carrying on any business. Rule 10 of Companies (incorporation) Rules 2014 specifies the limit as 50 .Thus, maximum number of members in a partnership firm are 50.

B. PARTNERSHIP DEED AND ITS CONTENTS

1. Meaning: Partnership Deed is the written agreement containing the terms and conditions under which the Partnership will sustain or exist. It not mandatory to

have a written agreement in all cases also it is not compulsory to have it registered.

2. Contents of Partnership Deed:
   (a) Name of the Firm and the nature of the Partnership Business.
   (b) Commencement and Tenure of the Business (e.g. Partnership at Will, etc.).
   (c) Amount of Capital to be contributed by each Partner.
   (d) Ratio for sharing the Profit / Loss
   (e) Arrangement in respect of Drawings by Partners and limits thereon.
   (f) Interest on the Capital Account of Partners.
   (g) Interest on Drawings of Partners.
   (h) Remuneration to Partners and the basis of determining such remuneration
   (i) Process of settling disputes that may arise among the Partners.
   (j) Procedure for maintenance of Books of Accounts.
   (k) Audit of Books of Accounts.
   (l) Manner of valuation of Goodwill in case of admission, retirement and death of a Partner.
   (m) Procedure for settlement of Partners' claims in case of retirement / death.
   (n) Procedure for dissolution of Partnership.
   (o) Such other conditions which the Partners' may decide.

REMUNERATION, INTEREST ON CAPITAL PROFIT SHARING RATIO – IF DEED SILENT

1. Governing Statute: The law governing Partnership in India is the Partnership Act, 1932.
2. Conditions not covered by Partnership Deed: Where any situation or circumstance is not covered by the Partnership Deed or is not adequately provided for in the Partnership Deed, the provisions of the Partnership Act, 1932 will apply.

If the Deed is silent on -	Provisions of the Partnership Act
Remuneration / Salary / Commission to P'	No Remuneration will be allowed to any Partner.
Interest on Partners' Capital	No Interest on Capital will be allowed
Interest on Loan given by Partner to firm	Maximum 6% p.a. can be allowed on Loan.
Interest on Partners' Drawings	No interest will be charged on Drawings.
Profit Sharing Ratio	Profits and Losses will be shared equally.

Difference between Partnership and Joint Venture

Partnership	Joint Venture

It is not limited to a specific venture	It is limited to a specific venture
It is a continuing profit seeking enterprise	It is a terminable profit-seeking venture
It is carried on under firm's name.	There is no common firm's name in joint venture.
Persons carrying on partnership business are called partners.	Parties are called co-venturers
Profit or loss is ascertained on an annual basis.	Profit or loss is ascertained only after the end of the specific venture
Partnership firms are governed by Indian Partnership Act, 1932.	There is no specific act for joint ventures
The doctrine of implied authority is applicable to partners.	The doctrine of implied authority is not applicable to co-venturers.

TRANSACTIONS THAT AFFECT THE CAPITAL ACCOUNTS OF PARTNERS

(a) Capital Contribution in the form of Cash / other Asset introduced into business
(b) Interest on Capital at the rate agreed in the Partnership Deed,
(c) Amounts withdrawn by Partners during the period,
(d) Interest, if any, chargeable on Drawings of Partners,
(e) Salary / Remuneration to Partners for managing the affairs of the business,
(f) Share of Profit / Loss of the business as per agreed Profit Sharing Ratio (PSR),
(g) Share of Goodwill / Revaluation Profit, etc.

C. METHODS FOR PARTNERS' CAPITAL ACCOUNTS

Aspect	Fluctuating Capital Method	Fixed Capital Method
Accounts prepared	Partner's Capital Account.	1. Partner's Capital Account, and 2. Partner's Current Account.
Initial Capital Contribution	Amount brought in or contributed is credited to the Partner's Capital A/c.	Amount contributed is credited to the Partner's Capital A/c.
Subsequent transactions	Subsequent transactions are also routed through Partner's Capital Account.	Subsequent transactions are accounted in Partner's Current Account.

Balance	capital account will always have a plus or credit balance while the current account may have a debit (negative) balance	Fluctuating capital account may sometimes show a debit (negative) balance.

D. GOODWILL

Goodwill - Meaning

- Is value of reputation of a Firm in respect of profits expected in future over and above the normal rate of profits earned by similar Firms in the same locality.
- Goodwill is the benefit and advantage of the good name, reputation and connections of a business Firm.

FEATURES OF GOODWILL

1. Goodwill is an Intangible Asset, i.e. cannot be seen and felt. (it is not a Fictitious Asset, like Discount on Issue of Debentures, Misc. Expenditure not written off or adjusted, etc
2. Goodwill helps a Firm to earn more profits than other Firms in same line of business. Strictly, there is no Goodwill, if the Firm is able to earn same profits as any other Firm.
3. Goodwill cannot have an existence separate from that of the Business Firm. Hence, Goodwill as such cannot be sold, it can be sold when the entire Business Firm is sold.
4. It's value is subjective. It depends upon purpose of valuation, and judgement of the Valuer.
5. Value of Goodwill is not constant throughout the life of the business. It fluctuates with the changes in the fortunes of the Firm.

FACTORS THAT CREATE / AFFECT THE VALUE OF GOODWILL

Goodwill is subject to a variety of factors, a few are as below -

- Efficient Management,
- Quality of Firm's Products and Services,
- Locational and other advantages,
- Patents, Copyrights, Intellectual Property Rights, and similar advantages,
- Favourable Contracts and bargaining power with Suppliers, Customers, etc.

SITUATIONS, INVOLVE A VALUATION OF GOODWILL IN CASE OF PARTNERSHIP FIRMS

- Change in Profit Sharing Ratio amongst the Partners,
- Admission of a new Partner,

- Retirement of a Partner,
- Death of a Partner,
- Dissolution of the Partnership,
- Amalgamation of two or more Firms, and
- Sale of the Firm (to a Company).

VARIOUS METHODS OF VALUATION OF GOODWILL

Average Profits Method

Step	Procedure
1	Compute the Profits of the previous financial years, say, past 5 years. [Note: Such profits should be adjusted for items like Salary to Partners & IOC not provided, Abnormal Losses & Gains, etc.]
2	Compute Average Profits = Total Profits for the past period ÷ Number of years. [Note: If there is a noticeable trend increase in the amount of profits, Weighted Average Profits may be used, instead of Simple Average as specified above. In such case, more weightage is given to the profits of the recent years than that of the earlier years.]
3	Compute Goodwill = Average Profits X Number of years purchase.

Super Profits Method

Step	Procedure
1	Compute the Profits of the previous financial years, say, past 5 years. [Note: Such profits should be adjusted for items like Salary to Partners & IOC not provided, Abnormal Losses & Gains, etc.]
2	Compute Average Profits = Total Profits for the past period ÷ Number of years.
3	Compute Normal Profits = Firm's Capital Employed X Normal Rate of Return [Note: Capital Employed = Tangible Fixed Assets + Current Assets – Current Liabilities.]
4	Compute Super Profits = Average Profit Less Normal Profit = Step 2 – Step 3.
5	Compute Goodwill = Super Profits X Number of years purchase.

Discontinuing or Annuity Method

Step	Procedure
1	Compute Super Profits of the Firm. (as per Super Profits Method given above).
2	Ascertain the number of years for which such Super Profits are maintainable, and obtain the Present Value (PV) of Re. 1 for each such year. [Note: PV can be obtained from the Annuity Tables, or by using the formula $[1 \div (1+R)]^N$, where R = Rate of Interest, and N = N^{th} year.]

3	Compute Goodwill = Total of (Super Profits X PV for each year).

Capitalization Method

Step	Procedure
1	Compute the Profits of the previous financial years, say, past 5 years. [Note: Such profits should be adjusted for items like Salary to Partners & IOC not provided, Abnormal Losses & Gains, etc.]
2	Compute Average Profits = Total Profits for the past period ÷ Number of years.
3	Compute Expected or Normal Capital Employed = Average Profits ÷ Normal Rate of Return.
4	Compute Actual Capital Employed in the Firm. [Note: Capital Employed = Tangible Fixed Assets + Current Assets — Current Liabilities.]
5	Compute Goodwill = Normal Capital Employed Less Actual Capital Employed = Step 3 — Step 4,

PROFIT AND LOSS APPROPRIATION ACCOUNT

1. Purpose: The Profit and Loss A/c of the Firm will show the profit earned or loss suffered by the Firm. To distribute the above Profit properly to the Partners, the Profit and Loss Appropriation A/c is used.
2. Features:
   (a) It is an extension of P&L Account.
   (b) It is applicable only for Partnership Firms, and not Sole Proprietary Concerns.
   (c) It provides details of how the Net Profit for the period has been distributed to the Partners.
   (d) Entries in P&L Appropriation A/c are governed by the Partnership Deed or Partnership Act.

Journal Entries:

Item	Journal Entry
(a) Profit brought forward from P&L A/c to Profit and Loss Appropriation A/c	Profit & Loss A/c Dr. To Profit & Loss Appropriation A/c
(b) Remuneration / Salary / Commission to Partners, as per Partnership Deed (c) Interest on Partners' Capital, if any. (d) Profit distributed to Partners in agreed ratio.	Profit & Loss Appropriation A/c Dr. To Partners' Capital (individually)

(e) Transfer to Reserves, if any.	Profit & Loss Appropriation A/c Dr. To Specific Reserve A/c
(f) Interest on Partners' Drawings, if any. (g) Loss distributed to Partners in agreed ratio.	Partners' Capital A/c (individually) Dr. To Profit & Loss Appropriation A/c

E. INTEREST ON CAPITAL IN CASE OF INSUFFICIENT PROFITS OR LOSS

Interest on Partners' Capital is provided out of profits only

Situation		Treatment of Interest on Capital (IOC)		
1.	If Partnership Deed is silent, or when there is no Deed	IOC is not allowed.		
2.	When Partnership Deed provides for Interest on Capital		Profit Situation	IOC
		(a)	In case of Loss	IOC is not allowed.
		(b)	In case of Insufficient Profits	IOC is restricted to the amount of Net Profit. Each Partner's IOC is proportionately reduced.
		(c)	In case of sufficient Profits	IOC is fully allowed to each Partner.

INTEREST ON CAPITAL WITH ADDITIONAL CAPITAL

A and B started business on 1st January with a Capital of Rs. 60,000 and Rs. 40,000 respectively. During the year, A introduced Rs. 10,000 to the Firm as Additional Capital on 1st July. They withdrew Rs. 5,000 per month for household expenses in lieu of profits. Interest on capital is to be allowed at 10%. Calculate the interest payable to A and B for the year ended 31st December.

INTEREST ON PARTNERS' DRAWINGS

Drawings refer to the amount withdrawn by the Partners, in cash or in kind, for their personal use. If the Partnership Deed so provides, Interest on Drawings shall be calculated as below

Situation		Interest on Drawings =
1.	Fixed Amount drawn at the beginning of every month, throughout the year	Total Drawings × Rate of Interest× $\frac{6.5}{12}$

2.	Fixed Amount drawn at the middle of every month, throughout the year	Total Drawings × Rate of Interest× $\frac{6}{12}$
3.	Fixed Amount drawn at the end of every month, throughout the year	Total Drawings × Rate of Interest× $\frac{5.5}{12}$
4.	Fixed Amount drawn at the beginning of every quarter, throughout the year	Total Drawings × Rate of Interest× $\frac{7.5}{12}$
5.	Fixed Amount drawn at the middle of every quarter, throughout the year	Total Drawings × Rate of Interest× $\frac{6}{12}$
6.	Fixed Amount drawn at the end of every quarter, throughout the year	Total Drawings × Rate of Interest× $\frac{4.5}{12}$
7.	Fixed Amount drawn at the beginning of every month, for a 6- months period	Total Drawings × Rate of Interest× $\frac{3.5}{12}$
8.	Fixed Amount drawn at the middle of every month, for a 6- months period	Total Drawings × Rate of Interest× $\frac{3}{12}$
9.	Fixed Amount drawn at the end of every month, for a six months period	Total Drawings × Rate of Interest× $\frac{2.5}{12}$
10.	Annual Amount of Drawings is given, but date of withdrawal is not given.	Total Drawings × Rate of Interest× $\frac{6}{12}$
11.	Annual Drawings is given, but Interest is to be calculated without reference to Time Factor, i.e. without "p.a."	Total Drawings × Rate of Interest
12.	Unequal Amounts withdrawn on different dates	Use - (a) Direct Method, or (b) Product Method, to calculate Interest.

INTEREST ON DRAWINGS IN VARIOUS SITUATIONS

Compute Interest on Partners' Drawings in the following situations, if interest rate is 10% p.a.

1. Rs. 10,000 withdrawn per month, throughout the year, at - (a) beginning of each month, (b) middle of each month, and (c) end of each month.
2. Rs. 24,000 withdrawn per quarter, throughout the year, at - (a) beginning of each quarter, (b) middle of each quarter, and (c) end of each quarter.
3. Rs. 15,000 withdrawn per month, for a six months period, at - (a) beginning of each month, (b) middle of each month, and (c) end of each month.
4. Drawings during the entire year Rs. 2,50,000 (details of withdrawal not available)

5. Drawings during the entire year Rs. 2,51,000 (details of withdrawal not available), and interest is to be calculated without reference to time factor, (i.e. Interest on Drawings at 10%, and not 10% p.a.)

Interest on Drawings using Direct Method and Product Method

Compute Interest on Partners' Drawings, at 15% p.a. (Year ends on 31st December)

Date of withdrawal	Feb 1	May 1	June 30	Oct 31	Dec 31
Amount withdrawn	20,000	50,000	20,000	60,000	20,000

F. GUARANTEE OF MINIMUM PROFIT TO A PARTNER

1. **Meaning:** Sometimes, Partners may mutually agree that certain Partner(s) has right to have minimum amount of profit. Such profit is Guaranteed Profit or Guaranteed Minimum Profit.
2. **Treatment:**

Situation	Steps in Computation / Treatment
(a) If Profit Share > Guaranteed Profit	Distribute the Total Available Profit in the agreed profit sharing ratio, in the usual manner.
(b) If Profit Share < Guaranteed Profit	• Distribute the Total Available Profit in the agreed profit sharing ratio, in the usual manner. • Compute the shortfall in Guaranteed Profit, and add that to the share of the Partner entitled to the same. • Deduct the shortfall from the Profit Shares of the Other Partners, as described below.

3. **Burden of Shortfall:** The shortfall in respect of Guaranteed Profit has to be reduced from the Profit Shares of the Other Partners, in the following manner -

Guarantee given by	Shortfall to be reduced from
(a) One of the remaining Partners	That Remaining Partners Share of Profit.
(b) Remaining two or all Partners in an agreed ratio	Two or all Partners, in agreed ratio.
(c) Remaining Partners in their mutual PSR	All Remaining Partners in mutual PSR.

Note: If the question is silent about nature of guarantee, situation (c) is assumed.

G. ADMISSION OF NEW PARTNER

Accounting issues in case of Admission of New Partner

The, accounting issues in case of admission of New Partner are -

1. Change in Profit Sharing Ratio,
2. Treatment of Goodwill on Admission,
3. Capital and Goodwill Contribution by New Partner,
4. Revaluation of Assets and Liabilities, and distribution of such profit / loss,
5. Transfer of Reserves and Accumulated Losses, if any, as per Balance Sheet,
6. Adjustment of Capitals, if any.

New Profit Sharing Ratio in case of admission of New Partner

The New Partner may acquire his share of profit from the Old Partner(s), in any of the following manner -

1. From the Old Partners in their Old Profit Sharing Ratio,
2. From the Old Partners in a specified Ratio, (i.e. Sacrifice Ratio),
3. From the Old Partners, by surrender of particular fraction of their shares by Old Partner(s).

Journal Entries for treatment of Goodwill on Admission

Transaction / Issue involved		Journal Entry
1.	Goodwill (Premium) paid privately by New Partner, to the Old Partners	No entry in the Firm's books of account.
2.	Goodwill (Premium) brought in cash / kind by New Partner, and retained in the business	
	(a) For Capital and Goodwill (Premium) brought in by New Partner	Cash / Bank / Asset A/c Dr. (Total Amt) To New Partner's Capital A/c (Capital + G/w)
	(b) Goodwill (Premium) distributed to Old Partners in Sacrificing Ratio	New Partners' Capital A/c (G/w Share) Dr. To Old Partner's Capital (in Sacrifice Ratio)
3.	Goodwill (Premium) brought in cash by New Partner, and withdrawn by Old Partners	In addition to Entries 2(a) and (b), the following entry will also be passed for withdrawal of G/w amount - Old Partner's Capital A/c Dr. To Cash / Bank A/c (amount withdrawn)
4.	Only part of Goodwill (Premium) brought in by New Partner	In addition to Entry 2(a), the following entry will also be passed - New Partners' Capital A/c Dr. (Full G/w)

		To Old Partner's Capital (in Sacrifice Ratio)
5.	New Partner is unable to bring in any amount towards Goodwill (Premium)	(a) Capital Contribution: Cash / Bank / Asset A/c Dr. (Capital Amt) To New Partner's Capital A/c (Capital Amt) (b) G/w Adjustment: New Partners' Capital A/c Dr. (Share of G/w) To Old Partner's Capital (in Sacrifice Ratio)
6.	Old Goodwill, if any, appearing in B/Sheet (See Note 2)	Old Partner's Capital (Old PSR) Dr. To Goodwill A/c

Notes:

1. Instead of crediting the entire amount of Capital + Goodwill to the New Partners' Capital A/c, the amount of Goodwill can be routed through Premium (Goodwill) A/c also.
2. In all cases, the Goodwill appearing in Balance Sheet (if any), should be written off) by debiting Old Partners' Capital A/c in Old Profit Sharing Ratio.

Journal Entries in connection with Admission of a New Partner

Transaction / Issue involved		Journal Entry	
1.	Recording - (a) increase in value of Assets, and (b) reduction in amount of Liabilities	Assets (Individually) A/c Liabilities (Individually) A/c To Revaluation A/c	Dr. Dr.
2.	Recording - (a) decrease in value of Assets, and (b) increase in amount of Liabilities	Revaluation A/c To Assets (Individually) A/c To Liabilities (Individually) A/c	Dr.
3.	Recording Unrecorded Assets	Assets (Individually) A/c To Revaluation A/c	Dr.
4.	Recording Unrecorded Liabilities	Revaluation A/c To Liabilities (Individually) A/c	Dr.
5.	Transfer of Revaluation Gain	Revaluation A/c To Old Partner's Capital (in Old PSR)	Dr.
6.	Transfer of Revaluation Loss, if any	Old Partner's Capital (Old PSR) To Revaluation A/c	Dr.
7.	Distribution of Reserves and Surplus as per Balance Sheet	Reserves A/c (Individually) To Old Partner's Capital (Old PSR)	Dr.
		Old Partner's Capital (Old PSR)	Dr.

8.	Distribution of Accumulated Losses, Deferred Revenue Expenditure(B/S)	To Accumulated Losses / Deferred Rev.Exp.
10.	Capital Contribution by New Partner	Cash /Bank A/c Dr. To New Partner's Capital A/c

Note: In Entries 1 to 6 above, the Account can also be called as "Profit and Loss Adjustment A/c", instead of the head "Revaluation A/c".

Revaluation of assets and liabilities on admission

Revaluation of Assets and Liabilities on Admission of Partner	
↓	↓
Assets and Liabilities to be shown in the B/Sheet at revised amounts	If the Revalued Amounts are not to be shown in the Books of the Firm on admission
↓	↓
1. Prepare Revaluation A/c and ascertain the Profit / Loss on Revaluation. 2. Distribute Profit / Loss on Revaluation, to Old Partners, in Old Profit Sharing Ratio.	1. Prepare Memorandum Revaluation A/c and ascertain the Profit / Loss on Revaluation. 2. Distribute Profit / Loss on Revaluation, to Old Partners, in Old Profit Sharing Ratio. 3. Reverse the Profit / Loss on Revaluation, to all (i.e. Old & New) Partners, in New Profit Sharing Ratio.

ADJUSTMENT OF CAPITALS, ON ADMISSION OF A NEW PARTNER

Sometimes, the Partners may agree to adjust their Capital in the new Firm, to be in their profit-sharing ratio. The steps involved in the Adjustment of Capitals are -

1. Compute the Capital Balance of all Partners (Old and New), after all adjustments relating to Goodwill, Revaluation of Assets & Liabilities, Transfer of Reserves & Accumulated Losses, etc.
2. Compute Total Capital of New Firm (if it is not given specifically in the question), as the aggregate of Capital Balances of all Partners.
3. Distribute the above Total Capital in the new Profit Sharing Ratio, to all the Partners. This is called as the Required Capital Balance.
4. Compute the amount to be withdrawn / brought in by each Partner, by comparing his old Capital Balance with Required Capital Balance.

H. RETIREMENT / DEATH OF A PARTNER

Amounts due to a Retiring / Deceased Partner

Retirement from Partnership means ceasing to be a Partner in a Firm. The Firm continues as such, and the Retiring Partner is entitled to the following amounts -

1. Balance in his Capital / Current Accounts
2. Share of Goodwill,
3. Share in Gain / Loss of Revaluation of Assets and Liabilities,
4. Share of Accumulated Profits / Reserves and Losses, if any,
5. Share in Profits of the current year (till the date of retirement / death), and
6. Interest on Capital, Salary, etc. if any, due to him till the date of his retirement / death.

Note: As per Section 37 of the Partnership Act, 1932, the representatives of a Deceased Partner are entitled to receive, at their option - (a) interest at the rate of 6% p.a, or (b) share of profits earned, for the amount due to the Deceased Partner, till the amount is settled in full.

Accounting issues in case of Retirement of a Partner

The accounting issues in case of retirement of Partner are -

1. Change in Profit Sharing Ratio,
2. Treatment of Goodwill on Retirement,
3. Revaluation of Assets and Liabilities, and distribution of such profit / loss,
4. Transfer of Reserves and Accumulated Losses, if any, as per Balance Sheet,
5. Adjustment of Capitals, if any.
6. Joint Life Policy, if any.

Compute of the New PSR of Continuing Partners in case of Retirement of Partner

New Share = Old Share + Acquired Share. So, the Continuing Partners may acquire the share of the Retiring Partner, in any of the following manner -

1. In a specified / agreed ratio.
2. In the Old Profit Sharing Ratio itself.

Journal Entries in connection with Retirement / Death of a Partner.

	Transaction / Issue involved	Journal Entry
1.	Old Goodwill, if any, appearing in B/Sheet	All Partner's Capital (Old PSR) Dr. To Goodwill A/c
2.	Goodwill credited to Retiring Partner / Sacrificing Partners, and borne by Gaining Partners in Gain Ratio	Gaining Partners' A/c(Gain Ratio) Dr. To Retiring / Deceased Partners'A/c To Sacrificing Partners' A/c (if any

3.	Recording - (a) increase in Assets, and (b) reduction in Liabilities	Assets (Individually) A/c Dr. Liabilities (Individually) A/c Dr. To Revaluation A/c
4.	Recording - (a) decrease in Assets, and (b) increase Liabilities	Revaluation A/c Dr. To Assets (Individually) A/c To Liabilities (Individually) A/c
5.	Recording Unrecorded Assets	Assets (Individually) A/c Dr. To Revaluation A/c
6.	Recording Unrecorded Liabilities	Revaluation A/c Dr. To Liabilities (Individually) A/c
7.	Transfer of Revaluation Gain	Revaluation A/c Dr. To All Partner's Capital (Old PSR)
8.	Transfer of Revaluation Loss, if any	All Partner's Capital (Old PSR) Dr. To Revaluation A/c
9.	Distribution of Reserves and Surplus as per Balance Sheet	Reserves A/c (Individually) Dr. To All Partner's Capital (Old PSR)
10.	Transfer of Reserves, if Continuing Partners want to show the Reserves in the B/Sheet	Gaining Partners' A/c(Gain Ratio) Dr. To Retiring / Deceased Partners' A/c To Sacrificing Partners' A/c (if any)
11.	Distribute Accumulated Losses, Deferred Revenue Expenditure	Old Partner's Capital (in Old PSR) Dr. To Accumulated Losses / Deferred Rev. Exp.
12.	Share of Profit of Deceased Partner	Profit and Loss Suspense A/c Dr. To Deceased Partners' Capital A/c
13.	Settlement of Amount due to Retiring Partner / Transfer to Loan A/c, etc.	Retiring Partners' Capital A/c Dr. To Cash / Bank (to the extent settled) To Bills Payable (if B/E accepted) To Loan A/c (unpaid amt tfr to Loan a/c) To Deceased Partners' Executors' A/c

I. JOINT LIFE POLICY - RETIREMENT / DEATH

1. Purpose: A Partnership Firm may take a Joint Life Insurance Policy (JLP) on the lives of all its Partners. The objective of taking out a JLP is to provide sufficient

funds in case of settlement due to Retiring Partner or Legal Representatives of a Deceased Partner.

2. **Operation:** The Firm pays the Premium Amount on the JLP. The amount of policy is payable to the Firm upon death of any Partner, or maturity of the policy, whichever falls earlier.
3. **Accounting Treatment: Refer class Notes**

J. DISSOLUTION OF PARTNERSHIP FIRMS AND LLP

CIRCUMSTANCES LEADING TO DISSOLUTION OF PARTNERSHIP

A partnership is dissolved or comes to an end on:

- (a) the expiry of the term for which it was formed;
- (b) completion of the venture for which it was entered into;
- (c) death of a partner;
- (d) insolvency of a partner.

However, the partners or remaining partners (in case of death or insolvency) may continue to do the business. In such a case there will be a new partnership but the firm will continue. When the business comes to an end then only it will be said that the firm has been dissolved.

A firm stands dissolved in the following cases:

A firm stands dissolved in the following cases:				
The partners agree that the firm should be dissolved;	All partners except one become insolvent;	The business becomes illegal;	In case of partnership a will, a partner gives notice of dissolution; and	The court orders dissolution.

The court has the option to order dissolution of a firm in the following circumstances:

(a) Where a partner has become of unsound mind;
(b) Where a partner suffers from permanent incapacity;
(c) Where a partner is guilty of misconduct of the business;
(d) Where a partner persistently disregards the partnership agreement;
(e) Where a partner transfers his interest or share to a third party;
(f) Where the business cannot be carried on except at a loss; and
(g) Where it appears to be just and equitable.

K. CONSEQUENCES OF DISSOLUTION

On the dissolution of a partnership, firstly, the assets of the firm, including goodwill, 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

And, if there is still a surplus, it is distributed among the partners in their profit-sharing ratio.

After payment of liabilities of the firm and repayment of loans from partners, if the assets of the firm leftover are insufficient to repay in full the capital contributed by each partner, the deficiency is borne by the partners in their PSR.

According to the provisions contained in section 48 of the Partnership Act, upon dissolution of the partnership, the mutual rights of the partners, unless otherwise agreed upon, are settled in the following manner:

(a) Losses including deficiencies of capital are paid, first out of profits, next out of capital, and, lastly, if necessary, by the partners individually in the proportion in which they are entitled to share profits.

(b) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital have to be applied in the following manner and order:
   (i) in paying the debts of the firm to third parties;
   (ii) in paying to each partner rateably what is due to him from the firm in respect of advances as distinguished from capital;
   (iii) in paying to each partner what is due to him on account of capital; and
   (iv) the residue, if any, to be divided among the partners in the proportion in which they are entitled to share profits.

L. DISTINCTION BETWEEN DISSOLUTION OF PARTNERSHIP AND DISSOLUTION OF PARTNERSHIP FIRM

Dissolution of Partnership	Dissolution of Partnership Firm
Refers to the discontinuance of the relation between the partners of the firm.	The entire firm ceases to exist, including the relation among all the partners.
There can be change in profit sharing ratio or admission/ death/ retirement of a partner.	Dissolution of partnership firm occurs.
In event of dissolution of the partnership, the business continues as usual, but the partnership is reconstituted.	In event of the dissolution of the firm, the business ceases to end.

There is no intervention by the court.	Court has the inherent power to intervene. By its order, a firm can be dissolved.
Economic relationships among partners may remain same or change.	Economic relationship among partners comes to an end.
Assets and liabilities are revalued. New balance sheet is prepared.	Assets are sold and realized. Liabilities are paid off.
Revaluation account is prepared.	Realization account is prepared.
Assets and liabilities are revalued after winding up of the existing partnership.	Assets and liabilities are settled on winding up of a firm.
Books of accounts are not closed.	Books of accounts are closed.

Dissolution before the expiry of a fixed term

A partner who, on admission, pays a premium to the other partners with a stipulation that the firm will not be dissolved before the expiry of a certain term, will be entitled to a suitable refund of premium or of such part as may be reasonable, if the firm is dissolved before the term has expired.

No claim in this respect will arise if:	the firm is dissolved due to the death of a partner;
	the dissolution is mainly due to the partner's (claiming refund) own misconduct; and
	the dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.

The amount to be repaid will be such as is reasonable having regard to the terms upon which the admission was made and to the length of the period agreed upon and that already expired. Any amount that becomes due will be borne by other partners in their profit- sharing ratio.

M. CLOSING OF PARTNERSHIP BOOKS ON DISSOLUTION

To close books of accounts of Partnership Firm. We need to transfer all the assets and liabilities to Realization Account.

Specimen of Realization Account

Particulars	₹	Particulars	₹
To Sundry Assets		By Sundry Liabilities	

(Excluding Cash/Bank, Debit Balance of P&L A/c, Partners' Current, Capital, & Loan A/cs)		(Excluding Credit Balance of P&L A/c, Partners' Current, Capital, and Loan A/c)	
To Bank/Cash (expenses for realization)		By Provision on Assets	
To Bank/Cash A/c (Amount paid for liabilities and unrecorded liabilities)		By Bank/Cash A/c (Amount realized from assets and unrecorded assets)	
To Partners' Capital A/cs (Expenses or Liabilities paid by partners)		By Partners' Capital A/cs (Assets taken over by partners)	
To Partners' Capital A/cs (Profit on realization distributed among partners in profit sharing ratio)		By Partners' Capital A/cs (Loss on realization distributed among partners in profit sharing ratio)	

Treatment of Goodwill at the time of dissolution of Firm

Treatment of Goodwill

- If Goodwill appears in the Balance Sheet, it is considered as purchased Goodwill and is treated like any other asset and is transferred to realization account.
- If Goodwill does not appear in the balance sheet, no entry is required for this.
- If something is realized or Goodwill is purchased by any one of the partners, then either Cash Account is debited or Partner's Capital A/c is debited and Realization Account is credited.

N. CONSEQUENCES OF INSOLVENCY OF A PARTNER

If a partner goes insolvent then the following are the consequences:

1. The partner adjudicated as insolvent ceases to be a partner on the date on which the order of adjudication is made.	2. The firm is dissolved on the date of the order of adjudication unless there is a contract to the contrary.	3. The estate of the insolvent partner is not liable for any act of the firm after the date of the order of adjudication, and	4. The firm cannot be held liable for any acts of the insolvent partner after the date of the order of adjudication.

O. LOSS ARISING FROM INSOLVENCY OF A PARTNER

When a partner is unable to pay his debt due to the firm, he is said to be insolvent and the share of loss is to be borne by other solvent partners following the decision in the English case of Garner vs. Murray.

According to this decision, solvent partners have to bear the loss due to insolvency of a partner and have to categorically put that the normal loss on realization of assets to be borne by all partners (including insolvent partner) in the profit-sharing ratio but a loss due to insolvency of a partner has to be borne by the solvent partners in the capital ratio.

The determination of capital ratio for this has been explained below. The provisions of the Indian Partnership Act are not contrary to Garner vs. Murray rule. However, if the partnership deed provides for a specific method to be followed in case of insolvency of a partner, the provisions as per the deed should be applied.

Capital Ratio on Insolvency

- The partners are free to have either fixed or fluctuating capitals in the firm.
- If they are maintaining capitals at fixed amounts then all adjustments regarding their share of profits, interest on capitals, drawings, interest on drawings, salary, etc. are done through Current Accounts, which may have debit or credit balances, and insolvency loss is distributed in the ratio of fixed capitals.
- But if capitals are not fixed and all transactions relating to drawings, profits, interest, etc., are passed through Capital Accounts then Balance Sheet of the business should not exhibit Current Accounts of the partners and capital ratio will be determined after adjusting all the reserves and accumulated profits to the date of dissolution, all drawings to the date of dissolution, all interest on capitals and drawings to the date of dissolution but before adjusting profit or loss on Realization Account.
- If some partner is having a debit balance in his Capital Account and is not insolvent then he cannot be called upon to bear the loss on account of the insolvency of other partner.

Insolvency of all Partners

- When the liabilities of the firm cannot be paid in full out of the firm's assets as well as personal assets of the partners, then all the partners of the firm are said to be insolvent. Under such circumstances, it is better not to transfer the amount of creditors to Realization Account. The balance of the creditors' accounts is transferred to Deficiency Account.
- Creditors may be paid the amount available including the amount contributed by the partners.

- The unsatisfied portion of the creditor account is transferred to the Capital Accounts of the partners in the profit-sharing ratio. Then Capital Accounts are closed. In doing so first close the Partners' Capital Account which is having the worst position. The last account will be automatically closed.

P. LIMITED LIABILITY PARTNERSHIP (LLP)

- The Limited Liability Partnership Act, 2008 was published in the Official Gazette of India on January 9, 2009 and has been notified with effect from 31st March 2009.
- However, the Act, has been notified with limited sections only.
- The rules have been notified in the Official Gazette on April 1, 2009.
- The first LLP was incorporated in the first week of April 2009.
- It extends to the whole of India.

MEANING AND FEATURES OF LIMITED LIABILITY PARTNERSHIP

Meaning	Means a partnership formed and registered under this Act.
Features	• Body Corporate: Is a body corporate formed and incorporated under this Act. • Separate Legal Entity: It is a legal entity separate from that of its partners. • Perpetual Succession: Any change in the partners of a Limited Liability Partnership shall not affect the existence, rights or liabilities of LLP • Non-Applicability: The provisions Indian Partnership Act, 1932 not apply to LLP

Q. COMPARISON BETWEEN EXISTING PARTNERSHIP AND LLP

Basis of Distinction	Partnership	LLP
Regulating Law	Indian Partnership Act, 1932	LLP Act, 2008
Registration	Registration is optional.	Registration is compulsory.
Creation	It is created by agreement.	It is created by Law.
Sept. Legal Entity	It has no separate legal entity.	It has separate legal entity.
Name of Entity	Can have any name	Suffix: LLP / Limited Liab. Partnership

Perpetual Succession	It does not have perpetual succession. Death, insolvency or unsoundness of its members may affect its existence.	It has perpetual succession. Death, insolvency or unsoundness of its members does not affect its existence.
Charter Document	Partnership Deed is a charter of the firm	LLP Agreement is charter of LLP which denote scope of operation & right
Common Seal	There is no concept of common seal in partnership.	It may have its own common seal i.e. Official Signature
Incorporation Formalities	1. Partnership Deed 2. Form / Affidavit 3. Prescribed Fee. To file with Registrar of Firms	1. LLP Agreement 2. Various e Forms 3. Prescribed Fee. Required to file with Registrar of LLP.
Time to incorporate	It takes 12-14 days (approx.)	It takes 10 days (approx.) to incorporate
Can it sue third party?	Only registered partnership can sue third party.	A LLP being a legal entity can sue third party.
Can Foreign National become partner?	Foreign National can not become a partner	Foreign National can become a Partner in a LLP.
Number of Members	Minimum 2 and Maximum 10 for Banking business & 20 for non- Banking business.	Minimum 2 but their is no limit on maximum number of partners.
Ownership of Assets	Partners have joint ownership of all the assets offirm.	The LLP is a legal entity independent of the partners has ownership of assets
Right / Duty of Partners	Rights/Duties/Obligation of the partners are governed by Partnership Deed.	Rights / Duties / Obligation of the partners are governed by LLP Agreement.
Liability of Partners	Liability of Partner is unlimited.	Liability of Partner is limited, to the extent their contribution towards LLP
Mutual Agency	Partners are agents of the firm and other partners.	Partners act as agents of LLP and not of other partners.

Designated Partner	It need not have Designated Partners.	Must have at least 2 individuals as Designated Partners, least one must be resident in India. DPIN is compulsory
Digital Signature	There is no requirement of obtaining Digital Signature	At least one Designated Partner must have Digital Signatures since e forms are filled electronically.
Dissolution	Take place By Mutual Agreement, Insolvency, Court Order	Its Dissolution may take place Voluntarily or by order of National Company Law Tribunal.
Maintenance of Minutes	No concept of any minutes.	A LLP by agreement may decide to record the proceedings of meetings of the partners/Designated Partners.
Annual Filing with Registrar	No Return is required to be filed with Registrar of Firms	1. Annual Statement of Accounts 2. Statement of Solvency 3. Annual Return With Registrar of LLP every year
Audit of Accounts	Partnership Firms are only required to have Tax Audit as per the provisions of the Income Tax Act.	To be Audited annually as per the provisions of LLP Act 2008 if its turnover exceeds Rs. 40 Lacs or its capital contribution exceeds Rs. 25 Lacs in any financial year.
Compromise/Arrangements/Merger/Amalgamation	Partnership cannot merge with other firm	LLP's can enter into Compromise /Arrangements/ Merger/Amalgamation.
Whistle Blowing	No such provision is provided under The Indian Partnership Act, 1932	Provision has been made to provide protection to employees & partners, providing useful information during an investigation or convicting any partner
Admission of Minor	Minor can be admitted to benefits	Minor can-not be admitted to the benefits of LLP.

Liability of Partners for Legal Compliance	All Partners are liable for Legal Compliance.	Only Designated Partners are liable for Legal Compliance.

WHO CAN BECOME A PARTNER IN LLP? [SEC 5]

Any individual or body corporate may be a partner in a limited liability partnership:

DISQUALIFICATIONS OF AN INDIVIDUAL TO BECOME A PARTNER[SEC 5]

An individual shall not be capable of becoming a partner of a limited liability partnership, if -

- Found, unsound mind by a Court of competent jurisdiction and the finding is in force;
- he is an undercharged insolvent; or
- he has applied to be adjudicated as an insolvent and his application is pending.

EFFECT OF REDUCTION IN MINIMUM NO OF PARTNERS

If at any time the number of partners of a LLP is reduced below 2 and the LLP carries on business for more than 6 months while the number is so reduced, the person, who is the only partner of the LLP during the time that it so carries on business after those 6 months and has the knowledge of the fact that it is carrying on business with him alone, shall be personally liable for the obligations of the LLP incurred during that period.

R. WINDING UP OF A LIMITED LIABILITY PARTNERSHIP (LLP)

The winding up of a LLP may be either voluntary or by the Tribunal and LLP, so wound up may be dissolved.

Winding up of a LLP may be initiated by Tribunal if:

- The LLP wishes to wind up;
- The LLP has less than 2 partners for more than 6 months;
- The LLP is unable to pay its debts;
- The LLP has not acted in the interest of the sovereignty and the integrity of India;
- The LLP has failed to submit with the statements of accounts and solvency or the LLP annual returns for more than five consecutive financial years with the Registrar;
- The Tribunal thinks that it is Just and Equitable that the LLP should be wound up.

The Central Government may make rules for the provisions in relation to winding up and dissolution of LLP.

PRACTICALS

Illustration 1:

On 1st April, 2024 P and Q started business in partnership agreeing to share profits and losses equally. P contributed Rs. 3,00,000 while Q contributed Rs. 2,00,000 by way of capital. It was agreed that interest be allowed on capital @ 6% per annum and charged on drawing @ 8% per annum. P withdrew Rs. 2,000 at the end of every month whereas Q withdrew Rs. 4,500 in the middle of every month.

Profits before the above noted adjustments for the year ended 31st March, 2025 amounted to Rs. 89,700. Show the necessary ledger accounts assuming:

(a). capital accounts are fluctuating

(b). capital accounts are fixed.

Illustration 2:

On 1st April, 2024 the capital accounts of A, B and C stood at Rs. 30,000, Rs. 20,000 and Rs. 10,000 respectively. They shared profits and losses equally. Profit and Loss account for the year ended 31 March, 2025 revealed a net profit of Rs.12, 000 which was transferred to capital accounts of the partners equally.

It was decided in April 2025 that profits should be distributed equally after allowing interests on capital @ 6% per annum with effect from 1st April, 2024. While going through the books of account for 2024-25 it was discovered that repair charges for A's personal scooter amounting to Rs. 90 had been charged to Repairs Account.

Show the journal entries necessary to adjust the current account of the partners.

Illustration 3:

C and D were sharing profits in the ratio of 3:1. Profits as per books for 2024-25 amounted to Rs. 40,000. In April 2025, they agreed to change the profit sharing ratio to 5:3 with retrospective effect from 1st April, 2024. It was found that outstanding expenses of Rs. 4,000 as on 31st March, 2024 and outstanding expenses of Rs. 3,000 as on 31st March, 2025 had not been taken into account while drawing up the final accounts for 2023-24 and 2024-25. Also by mistake interest on drawings had been ignored while preparing the accounts for 2024-25 such as interest being Rs. 600 on C's drawings and Rs. 300 on D's drawings. Pass the necessary journal entries to adjust the capitals of partners.

Illustration 4:

With effect from 1st April, 2024, D, the manager in the firm of A,B, and C who were sharing profits and losses in the ratio of 5:3:2 respectively was admitted as a partner in the firm with 1/11th share of profit. It was agreed that should D' share of profits exceed his remuneration as the manager, A will bear the burden of such an excess.

The manager D was entitled to a salary of Rs. 10,000 p.m. plus a commission of 2% of net profit remaining after charging his salary but before charging his commission.

Profit and Loss Account for the year ended 31st March, 2025 showed a profit of Rs. 22,00,000. Show how the profit will be distributed among the four partners.

Illustration 5:

P and S were in partnership sharing profits and losses in the ratio of 7:3 respectively. As a mark of appreciation of the services of their manager Z, they admitted him into partnership on 1st April, 2024 giving him 1/10th share of the future profits; the mutual ratio between P and S remaining unchanged. Before becoming a partner, Z was getting a salary of Rs. 4,000 per month and a commission of 5% on the net profits remaining after charging his salary and commission. It was agreed that any excess over his former remuneration to which Z as a partner becomes entitled will be provided out of P's share of profit.

The net profit for the year ended 31st March, 2025 amounted to Rs. 19,80,000. Prepare the profit and loss appropriation account for the year ended 31st March, 2025 showing the distribution of the profits of the net profits amongst the partners. Show your working notes clearly.

Illustration 6:

On 1st April, 2024 A, B and C who were sharing profits and losses in the ratio of 5:3:2 respectively decided to become equal partners. Goodwill of the firm was valued at Rs. 4,50,000. It was also decided to appreciate the book value of land and buildings by Rs. 1,40,000. No goodwill account appeared in the books of the firm and none was opened on change in profit sharing ratio. Pass journal entries to make the necessary adjustments.

Illustration 7:

On 31st March, 2025 the following was the Balance Sheet of A and B who were equal partners:

Liabilities	Rs.	Assets		Rs.
Sundry Creditors	8,940	Cash in hand		950
General Reserve	10,000	Stock		32,710
A's Capital Account	35,000	Debtors	11,000	
B's Capital Account	20,000	Less: Provision for Bad Debts	220	10,780
		Furniture and Fittings		9,500
		Land and Buildings		20,000
	73,940			73,940

On 1st April 2025, C was admitted as a new partner on the following conditions:

i. A, B and C share profits and losses in the ratio 4:3:2 respectively.

ii. Prior to C's admission appreciation of Rs. 15,000 in the value of land and buildings would be recorded and provision for bad debts would be brought upto Rs. 820.

iii. C would bring Rs. 20,000 in cash as his capital.

Pass journal entries to record the abovementioned transactions and show the balance sheet of firm immediately after C's admission.

Illustration 8:

On 31st March, 2025 the following was the balance sheet of P and Q who were carrying on business in partnership sharing profits and losses in the ratio of 5:3 respectively.

Liabilities		Assets	
Sundry Creditors	10,900	Furniture and Fittings	15,000
Capital Accounts		Stock	48,000
P	45,000	Sundry Debtors	16,500
Q	27,000	Cash	3,400
	82,900		82,900

On 1st April, 2025 R is admitted to the firm as a new partner, the new profit sharing ratio among P, Q and R is agreed upon as 7:5:4 respectively. R brings in Rs. 24,000 as his capital. R's share of goodwill is fixed at Rs. 5,000.

Show journal entries and balance sheet immediately after R's admission in each of the following cases:

(a) R brings cash for his shares of goodwill and the old partners withdraw half of the amounts credited to their accounts for goodwill brought by R.

(b) R does not bring anything by way of his share of goodwill.

(c) R brings Rs. 3,000 as his share of goodwill and an adjustment in capital accounts is made for the balance sheet.

Illustration 9:

A and B sharing profits in proportion of three-fourth and one-fourth showed the following as their Balance shett as on 31 march 2025

Liabilities	Rs.	Assets	Rs.
Creditors	375,000	Cash at Bank	2,25,000
General Reserve	40,000	Bills Receivable	30,000
Capital Account:		Debtors	1,60,000
A Rs.3,00,000	4,60,000	Stock	2,00,000
B Rs.1,60,000		Office Furniture	10,000
		Land and Buildings	2,50,000
	8,75,000		8,75,000

They admit C into partnership on 1st April, 2025 on the following terms

1) That C pays Rs. 1,00,000 as his capital for a fifth share in the future profits.
2) That goodwill of the new firm is valued at Rs. 2,00,000 and C brings his share of goodwill in cash.
3) That a stock and furniture be reduced by 10% and a 5% provision for doubtful debts is created on debtors.
4) That the value of land and buildings be appreciated by 20%.
5) That the capital accounts of all the partners be re-adjusted on the basis of their profits-sharing arrangement and any additional amount be immediately withdrawn by them.

Pass the journal entries; prepare the Profit and Loss Adjustment Account (Revaluation Account), Partners' capital accounts and the opening Balance Sheet of the new firm.

illustration 10:

Ajay and Binoy are partners in a firm sharing profits and losses in the ratio of 2:1 respectively. On 31st March, 2025 their balance sheet stood as follows:

Liabilities	(Rs.)	Assets	(Rs.)
Bills payable	6,000	Cash at bank	90,000
Sundry creditors	90,000	Bills receivable	20,000
General reserve	42,000	Sundry debtors	1,00,000
Ajay's capital	2,82,000	Stock	1,60,000
Binoy's capital	2,40,000	Furniture	40,000
		Machinery	2,50,000
	6,60,000		6,60,000

On 1st April 2025, a new partner Harry is admitted into partnership on the following terms:

1) That Harry brings in cash Rs. 60,000 as goodwill for his one-third share in future profits.
2) That Harry brings such an amount that his capital will be one-third of total capital of the new firm.
3) That the value of stock be raised to Rs. 1,68,000.
4) That furniture and machinery be depreciated by 5% and 10% respectively.
5) That a provision for doubtful debts be created at 5% on sundry debtors.
6) That the capital accounts of the partners be re-adjusted on the basis of their profit sharing ratio through their current accounts.

Prepare the necessary ledger accounts and the opening balance sheet of the new firm.

Illustration 11:

Bansal and Chandar were partners in a firm sharing profits and losses equally. Their balance sheet as on 31st March, 2025 was as follows:

Liabilities	Rs.	Rs.	Assets	Rs.
Sundry Creditors		1,26,000	Cash at Bank	14,000
General Reserve		70,000	Debtors	1,40,000
Capital Accounts:			Stock	1,68,000
Bansal	2,10,000		Furniture	28,000
Chander	1,68,000	3,78,000	Buildings	2,24,000
		5,74,000		5,74,000

Sagar was admitted as a partner and was given one-fourth share of profits on the following terms:

- He would bring Rs. 2,10,000 in cash as his capital.
- His share of goodwill was valued at Rs.70,000 but he was unable to bring it in cash.
- Stock and furniture be depreciation by 10%.
- A provision of 5% on debtors be created for doubtful debts.
- An amount of Rs.14,000 included in creditors not to be treated as a liability.
- A provision of Rs.7,000 be created against bills discounted
- The buildings be treated as worth Rs.2,80,000.

It was agreed that except cash, the other assets and liabilities were to be shown at old figures in the balance sheet. Give journal entries to record the transactions and prepare Memorandum Revaluation Account and capital accounts of the partners. Also prepare the balance sheet after admission of Sagar

Illustration 12:

A, B and C are partners sharing profits and losses in the ratio of 3:2:1 and on the retirement of C, the various assets and liabilities are revalued as under:

	Book Value	Revalued Value
	Rs.	Rs.
Plant and machinery	35,000	43,000
Sundry creditors	10,000	9,000
Stock	15,000	13,000

Pass journal entries on revaluation of these assets and liabilities

Illustration 13:

On 31st March, 2024 the following was the balance sheet of A, B and C who were equal partners:

Liabilities	Rs.	Assets		Rs.
Sundry Creditors	89,400	Cash in hand		1,800

General Reserves	1,50,000	Cash at Bank		39,700
A's Capital Account	2,40,000	Investments		50,000
B's Capital Account	1,90,000	Debtors	2,10,000	
C's Capital Account	1,75,000	Less:		
		Provision for Bad debts	(2,200)	2,07,800
		Stock		3,70,100
		Furniture and Fittings		1,75,000
	8,44,400			8,44,400

On that date, A decided to retire due to ill health and the following adjustments were agreed upon by the partners:

- Investments be appreciated by Rs. 15,000
- Provision for bad debts be brought upto 5% of debtors.
- Furniture be depreciated by 10%
- Stock be depreciated by Rs. 7,200

A was paid the amount due to him by means of cheque, the bank agreed to allow the necessary overdraft. Pass journal entries to record the above mentioned transactions and show the balance sheet of the firm immediately after A's retirement.

Illustration 14:

Following is the balance sheet of A, B and C who share profits and losses in the ratio of 7:5:3 respectively.

Balance sheet on A, B and C as on 31st March 2024

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	15,400	Furniture and Fittings	12,000
Capital Accounts:		Sundry Debtors	16,000
A	40,000	Stock	44,000
B	25,000	Cash at Bank	18,400
C	10,000		
	90,400		90,400

On 31st March, 2024 C retires on the condition that he be immediately paid the amount due to him after making adjustment for goodwill which is valued at Rs.22,500. A and B agree to share profits and losses in the ratio of 8:7 respectively in future.

Show journal entries and balance sheet in each of the following cases:

(a) Goodwill Account is raised only with C's share of goodwill.

(b) No Goodwill account is raised but adjustments are made in the capital accounts with retiring partner's share of goodwill.

(c) A and B pay privately to C for goodwill.

Illustration 15:

The balance sheet of Anil, Bashin and Chaman who were sharing profits in proportion to their capitals stood as follows on 31st March, 2024.

Liabilities	Rs.	Assets	Rs.	Rs.
Sundry Creditors	69,000	Cash in Bank		55,000
General Reserve	1,80,000	Sundry Debtors	50,000	
Capital Accounts:		Less : Provision for Bad Debts	(1,000)	49,000
Anil	2,00,000	Stock		2,60,000
Bashin	1,50,000	Plant and Machinery		1,35,000
Chaman	1,00,000	Land and Buildings		2,00,000
	6,99,000			6,99,000

Bashin retired on the above date and the following was agreed upon:

- That the provision for bad debts be brought upto 5% on debtors.
- That land and buildings be appreciated by 25%.
- That a provision of Rs. 3,500 be made in respect of outstanding legal charges.
- That the goodwill of the entire firm be fixed at Rs. 1,08,000 and Bashin's share of it be adjusted into the accounts of Anil and Chaman who are going to share future profits in the ratio of 5:3 respectively.
- That the entire capital of the new firm be fixed at Rs. 4,80,000 and the capital accounts of the partners be made in their new profit sharing ratio; actual cash to be brought in or paid off as the need be.

Pass journal entries, show profit and loss adjustment account and capital accounts and prepare balance sheet of Anil and Chaman.

Illustration 16:

On 31st March, 2024 the balance sheet of M/s. Ashok, Basu, and Chauhan, who were sharing profits and losses in proportion to their capitals, stood as follows:

Liabilities		Rs.	Assets	Rs.
Capital Accounts:			Land and Buildings	2,00,000
Ashok	3,00,000		Machinery	2,00,000
Basu	2,00,000		Closing Stock	1,00,000
Chauhan	1,00,000	6,00,000	Sundry Debtors	2,00,000
Sundry Creditors		2,00,000	Cash and Bank Balances	1,00,000
		8,00,000		8,00,000

On 31st March, 2024, Ashok desired to retire from the firm and the remaining partners decided to carry on. They agreed on the following terms and conditions:

(a) Land and buildings be appreciated by 30%

(b) Machinery be depreciated by 20%

(c) Closing stock to be valued at Rs. 80,000.

(d) Provision for bad debts be made at 5%.

(e) Old credit balances of sundry creditors amounting to Rs. 10,000 be written back.

(f) Joint Life Policy of the partners be surrendered. Cash received was Rs. 60,000.

(g) Goodwill of the entire firm be valued at Rs. 1,80,000 and Ashok's share of the goodwill be adjusted in the accounts Basu and Chauhan who would share the future profits equally.

(h) The total capital of the firm was to be the same as before retirement. Individual capitals of partners were to be in their profit sharing ratio.

(i) Amount due to Ashok was to be settled on the following basis: 50% on retirement and balance 50% within one year.

Prepare Revaluation Account, Capital Accounts of the Partners, Loan Account of Ashok, Cash Book and Balance Sheet as on 1st April 2024 of M/s. Basu and Chauhan.

Illustration 17:

A, B and C are partners in a firm sharing profits and losses in the ratio of 5:4:3 respectively. The firm had insured the partners' lives severally, A's life for Rs. 20,000, B's life for Rs. 16,000 and C's life for Rs. 14,000. The premiums were charged to the firm's profit and loss account. B died on 1.4.2024. The surrender values of these policies were 20% of the policy amount. Calculate B's share in policies.

Illustration 18:

A, B and C are partners sharing profits in the ratio of 2:1:1 respectively. On 30th June, 2024 their balance sheet was as follows:

Liabilities	Rs.	Assets	Rs.
Creditors	40,000	Goodwill	30,000
Bills Payable	20,000	Freehold Property	1,00,000
Capitals:		Joint Life Policy	20,000
A	1,00,000	Stock	55,000
B	60,000	Debtors	45,000
C	40,000	Cash	10,000
	2,60,000		2,60,000

A died on July 1, 2024. The firm had taken a joint life policy for Rs. 1,50,000, the payment for which was received on July 31, 2024. According to the partnership agreement, on retirement or death of a partner, the goodwill was to be valued at 1-1/2 times the average profit of the last four years. The profits for the last four years were Rs.60,000, Rs. 75,000, Rs. 90,000 and Rs. 95,000 respectively. For paying the amount due to A's legal representative, B and C brought as much cash as would bring their capitals in profit-sharing ratio and the firm would have cash in hand Rs. 30,000. Calculate goodwill, prepare partners' capital accounts and the balance sheet.

Illustration 19:

On 31st March, 2024 the balance sheet of Sen, Sil and Som who shared profits and losses in the ratio of 4:3:2 respectively stood as follows:

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	20,600	Furniture and Fittings	12,000
Joint Life Policy Reserve	6,000	Joint Life Policy (Policy for Rs. 18,500)	10,000
Capital Accounts:		Sundry Debtors	17,500
Sen	10,000	Stock	30,500
Sil	30,000	Cash at Bank	7,100
Som	10,500		
	77,100		77,100

On 30th June, 2024 Sen died. According to partnership deed, at the time of death, goodwill of the firm was to be valued at 2 years' purchase of average profits of the last three years and deceased partner's capital account was to be credited with the share of profits for the period he lived in the year of death on the basis of profit of immediately previous year.

Find out the amount due to Sen's executors on 30th June, 2024. Profits for the past three years have been as follows:

For the year ended 31st March, 2024 36,000
For the year ended 31st March, 2023 30,000
For the year ended 31st March, 2022 25,800

Illustration 20:

Following is the balance sheet of A, B and C as at 1st April, 2024:

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	20,000	Goodwill	40,000
Reserve fund	32,000	Plant and Machinery	60,000
Capital Accounts:		Stock	40,000
A	1,00,000	Sundry Debtors	60,000
B	50,000	Cash at Bank	50,000

C	50,000	Cash in Hand	2,000
	2,52,000		2,52,000

C died on 30th June, 2024. Under the terms of partnership deed, the executors of a deceased partner were entitled to —

(a) Amount standing to the credit of partner's capital account;

(b) Interest on capital balance at 15% per annum;

(c) Share or goodwill on the basis of twice the average of the past three years' profit; and

(d) Share of profit from the closing of the last financial year to the date of death on the basis of the average of three completed year profits before the death.

Profits for the years ended 31st March, 2022, 2023 and 2024 were Rs. 60,000, Rs. 70,000 and Rs. 80,000 respectively. Profits were shared in the ratio of capitals.

Pass the necessary journal entries and draw up C's Capital Account to be rendered to his executors

Illustration 21:

On 31st March, 2024 the following was the balance sheet of A, B and C when the firm was dissolved:

Liabilities	Rs.	Assets	Rs.	Rs.
Capital Accounts:		Goodwill		10,000
A	30,000	Plant and machinery		20,000
B	30,000	Furniture		8,000
C	30,000	Investments		10,000
General Reserve	9,000	Stock		51,060
B's Loan	5,000	Debtors	23,600	
Mrs. A's Loan	5,000	Less: Provision for Bad Debts	(1,020)	22,580
Current Accounts		Bill Receivable		5,000
A	2,860	Cash at Bank		2,760
C	1,240	Unexpired Insurance		125
Bill Payable	10,000			
Sundry Creditors	6,530	B's Current Account		105
	1,29,630			1,29,630

Investments were taken over by A for Rs. 13,000 whereas bills receivable were taken over by B for Rs. 4,800, fixed assets fetched Rs. 17,000 whereas stock realised Rs. 60,000. All the debtors paid the amounts due from them. Total rebate of Rs. 110 was received on retiring all bills payable immediately. Expenses of realisation came to

Rs. 1,441. Pass Journal entries to close the books of the firm and show Realisation Account, Bank Account, and the Capital Accounts of all the partners.

Illustration 22:

A, B and C commenced business on 1st April, 2024. They agreed to share the profits and losses in the ratio of 2: 2: 1. Their capitals were Rs. 30,000, Rs. 22,500 and Rs. 15,000 respectively. The partnership deed provided for interest on capital at 6% per annum. During 2016-17 the firm earned a profit of Rs. 20,050 (before providing for interest on capital). During the year the partners' drawings were A – Rs.7,000; B – Rs. 6,250; and C – 4,000.

The relations between partners were not good. They decided to dissolve the firm on 31st March, 2025. The assets were sold which realised Rs. 75,000. There were creditors to the extent of Rs. 12,000 which were paid off at a discount of 5%. Expenses of realisation amounted to Rs. 1,200.

Prepare the necessary accounts to close the books of the firm.

Illustration 23:

On 31st March, 2024 the following was the balance sheet of A, B and C who shared profits and losses in the ratio of 2:1:1 respectively

Liabilities	Rs.	Assets	Rs.
Creditors	16,000	Cash in hand	200
General Reserve	5,000	Stock	18,800
Capital Accounts:		Debtors	11,300
A	30,000	Furniture	12,500
B	20,000	Plant & Machinery	20,000
C	1,000	Goodwill	9,200
	72,000		72,000

The firm was dissolved on this date due to C's insolvency. Assets realised Rs.32,000. Expenses of dissolution came to Rs. 200. C's estate paid 50% of what was due to C. Close the books of the firm assuming that the loss due to C's insolvency has been divided:

i. in the ratio of fixed capitals.
ii. in the ratio of fluctuating capitals.

Illustration 24:

A, B, C and D are partners in a firm sharing profits and losses in the ratio of 4 : 1 : 2 : 3. The following is the balance sheet as at March 31st 2024

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry creditors		30,000	Cash in hand		14,000

Capital accounts:			Sundry debtors	35,000	
A	70,000		Less: Provision for bad debt	(5,000)	30,000
D	30,000	1,00,000	Other assets		51,000
			Capital accounts: B	20,000	
			C	15,000	35,000
		1,30,000			1,30,000

On March 31st, 2024, the firm is dissolved. The partnership agreement provides that the deficiency of an insolvent partner will be borne by the solvent partners in the ratio of capitals as they stand just before dissolution.

The following arrangements are agreed upon:

(a) A is to take over 60% of book debts at 70% and D is to take over the balance at 75%. Further, they are to be allowed Rs. 2,100 and 1,100 respectively to cover future losses.

(b) D is to realise other assets and to pay off the creditors. He is to receive 5% gross commission on the amounts finally payable to other partners but to bear expenses of realisation. He reports the results of realisation as follows:

Other assets realize at a loss of 2% on net collection and pays of the creditors at a discount of 30%. Realisation expenses amount to Rs. 3,000 but the same is paid by the firm. B is declared insolvent and a dividend of 20% in a rupee is realised from his estate. Prepare Cash Account, Realisation Account and Capital Accounts.

Illustration 25:

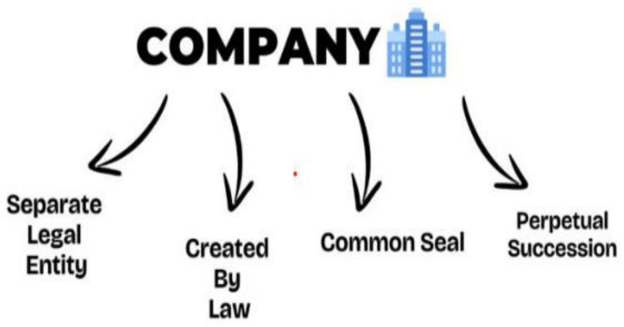
Below is the Balance Sheet of C, D and E as on 31st March, 2025

Liabilities	Rs.		Assets	Rs.
Sundry Creditors	2,00,000		Cash	31,200
Loan	1,00,000	3,00,000	Stock	1,56,300
Capital Accounts:			Debtors	47,200
C	80,000		Furniture	95,300
D	60,000		Profit & Loss Account	1,20,000
E	10,000	1,50,000		
		4,50,000		4,50,000

The firm was dissolved due to insolvency of all the partners. Stock was sold for Rs. 1,09,000 while furniture fetched Rs. 40,000. Rs. 41,000 were received from Debtors. Expenses were Rs. 2,200. Nothing could be recovered from D and E but C's private estate showed a surplus of Rs. 6,000. Close the books of the firm.

Topic 7 INTRODUCTION TO COMPANY ACCOUNTS

A. BASIC CONCEPTS OF COMPANY ACCOUNTS



- ✓ The company form of business organization
- ✓ It is a voluntary association of persons to carry on a business.
- ✓ It is an association of persons who generally contribute money for some common purpose. (Called as Capital)
- ✓ Persons who contribute capital are its members.
- ✓ Proportion of capital to which each member is entitled is called his share,
- ✓ Therefore, members of a joint stock company are known as shareholders and the capital of the company is known as share capital.
- ✓ Total share capital is divided into a number of units known as 'shares'
- ✓ The companies are governed by the Indian Companies Act, 2013

COMPANY DEFINITIONS AS PER COMPANIES ACT, 2013

Sec. 2(20)	A Company means a Company incorporated UNDER THIS Act or any previous Company Law.

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A Company is an Incorporated Association, which is an Artificial Person created by law, having a Separate Entity, with a Perpetual Succession and a Common Seal.

FEATURES OF COMPANY:

Features	Details
1. Artificial Person	(a) A Company comes into existence by the operation of law. (b) Thus, Company is an artificial person, incorporated under law.
2. Separate Legal Entity	(a) Company is separate legal entity known by its own name. members cannot in any way, claim to be the same as that of Company
3. Person, not Citizen	(a) A Company is not a citizen either under — (a) the Constitution of India or (b) the Citizenship Act, 1955. (b) Company can claim those fundamental rights which available to all persons, whether citizens or not, e.g. Right to own property, etc.
4. Perpetual Succession	(a) Since Company is an artificial person Hence, death, insolvency, retirement of Members not-affect Company. (b) Members may change but status of the Company will not. (c) Company goes on forever and continues to exist, till it is wound up

5. Separate Property	(a) Company entitled to hold property or contract in its own name (b) Members of Company cannot claim ownership of Company's property.
6. Common Seal	(a) Common Seal (engraved on the Seal) is official signature of co. (b) AOA may provide for documents that require the signature of the Company, i.e. the Common Seal. [Presently, Common Seal is optional.]
7. Capacity to Sue	(a) In any suit, the Company shall sue or be sued in its own name. (b) When the Creditors remain unpaid, They cannot proceed against SH
8. Owner-ship vs Management	(a) Board of Directors are elected representative of the Company (b) Every Shareholder does not participate in the day– to–day affairs of working and administration of the Company. Ownership of Company is different from that of its Management (BOD).
9. Right of Access	Shareholders are entitled to have access to information, and inspect Records in the manner specified in the Companies Act.
10. Limited Liability	(a) The liability of a Member of a Company may be limited by Shares or Guarantee. (Rarely, the liability may be unlimited by its Memorandum). (b) In case of Company limited by Shares, the Member's liability is limited to the amount unpaid on Shares. (If fully paid:- no further liability) (c) In case of company limited by Guarantee, the Member's liability is limited to the amount guaranteed by him in the Memorandum.
11. Transferability of Shares	(a) Shares of a Company are always transferable, although the right to transfer them is sometimes restricted, e.g. in the case of Pvt Company.
12. Accounts and Audit	(a) Accounts: Company has to maintain the prescribed books of accounts under accrual system, and double – entry system (b) Audit: Accounts are subject to annual audit. Appointment of Auditors shall be in accordance with the provisions of the Companies Act.

B. SHARES

SHARE

Meaning	"Share" is the basic unit into which the Capital of a Company is divided. It is an interest measured by a sum of money. Example: A Company with a Total Capital of Rs.1Crore is divided into 1Lakh Units of Rs.100 each. Each unit of Rs.100 is called a Share of the Company
Sec. 2(84)	A Share is a Share in the Share Capital of the Company, and includes Stock.

KINDS OF SHARE CAPITAL (Of a company limited by shares)

(a) Equity share capital: Means all share capital which is not preference share capital. Equity share capital can be

i. with voting rights; or
ii. with differential rights as to dividend or voting or any other right.

(b) Preference share capital: Means that part of the issued share capital of the company which carries or would carry a preferential right with respect to —

- payment of dividend, either as a fixed amount or an amount calculated at a fixed rate; and
- repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up

Deemed preference share capital:

The capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:

- that in respect of dividends, in addition to the preferential rights to the payment of dividend, it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;
- that in respect of capital, in addition to the preferential right to the repayment, on a winding up, it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

PREFERENCE SHARES VS EQUITY SHARES

	Basis	Preference Shares	Equity Shares
1	Definition	Carry Preferential Right as payment of — (a) Dividend, and (b) Repayment of Capital.	Shares that are not Preference Shares are called Equity Shares.
2	Return	Fixed Rate or Fixed Amount.	Based on profits available
3	Dividend	Priority over Equity Dividend	After payment of Pref. Dividend
4	Repayment of Capital	Paid before repayment of Equity Capital.	Paid after entire Preference Capital is repaid.
5	Arrears of Dividend	Generally accumulates unless otherwise given	No accumulation of Unpaid Dividend. No Profits means no Dividend.
6	Redemption	Redeemable as per terms of issue and provisions of Act.	Not Redeemable. Even in winding up, will be repaid after Pref. Shares.
7	Voting Rights	Generally restricted. Carries right to vote on all matters if	Unrestricted, i.e. Holder can vote at any matter at any Meeting, or the

		dividend remains unpaid for the prescribed period.	Shares may be issued with varying voting rights.
8	Further Issue of Shares	Principles relating to Rights or Bonus Issue is Not Applicable.	Fresh Issue offered first to existing holders, i.e. Rights Issue & Bonus Shares offered to all members.
9	Control / Management	No right to take part in Management.	Equity Shareholders are real owners, hence have a right to control the Management of Company.

TYPES OF SHARE CAPITAL:

Nominal/Authorised or Registered Capital	Authorised by MOA to be the maximum amount of share capital of the company
Issued Capital	Part of the authorised or nominal capital which the company issues for the time being for public subscription and allotment. Computed at the FV or NV.
Unissued Capital	•Portion of the authorized capital which has not yet been issued.
Subscribed Capital	Portion of the issued capital at face value which has been subscribed for or taken up by the subscribers of shares in the company. Entire issued capital may or may not be subscribed.
Called Up Capital	Portion of Subscribed capital which has been called up or demanded on shares.
Paid Up capital	Aggregate amount of money credited as paid-up as is equivalent to the amount received as paid-up in respect of shares issued and also includes any amount credited as paid up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called.
Uncalled Capital	Portion of the issued capital which has not yet been called up by the company
Reserve Capital	Portion of uncalled share capital which shall not be capable of being called up except in the event and for the purpose of being wound up. (Sec.65)

TYPES OF SHARE CAPITAL

Type	Meaning
Authorized Capital	Also known as nominal or registered capital which means the maximum amount of capital a company can issue. It is disclosed in the memorandum of association
Issued Capital	Issued capital is a part of authorized capital which is offered to the public for subscription
Called up Capital	Called up capital is the amount of nominal value of shares that has been called up by the company for payment from the shareholder.
Paid up Capital	Is that part of called up capital which the members of company or shareholders have paid for
Unpaid Capital	It is that part of called up capital which is yet to be paid by the share holders
Subscribed capital	Called up share capital that is been taken up by Share Holders
Reserved capital	it is that part of subscribed capital which is yet to be called

(Refer class-room chart for types of share capital)

ISSUE OF SHARES:

At Par

- when the issue price is equal to the face value or nominal value of the shares
- Payment may be either lumpsum or in instalment

At Premium

- Issue at higher than face value = Premium
- Where issue is at an amount more than the nominal or par value of shares.
- The premium amount is credited to a separate account called 'Securities Premium Account'

At Discount

- When the issue price of a share is less than its face value
- a company shall not issue shares at a discount except as provided in Section 54 for issue of sweat equity shares

GENERAL ACCOUNTING TREATMENTS (Refer Class room notes)

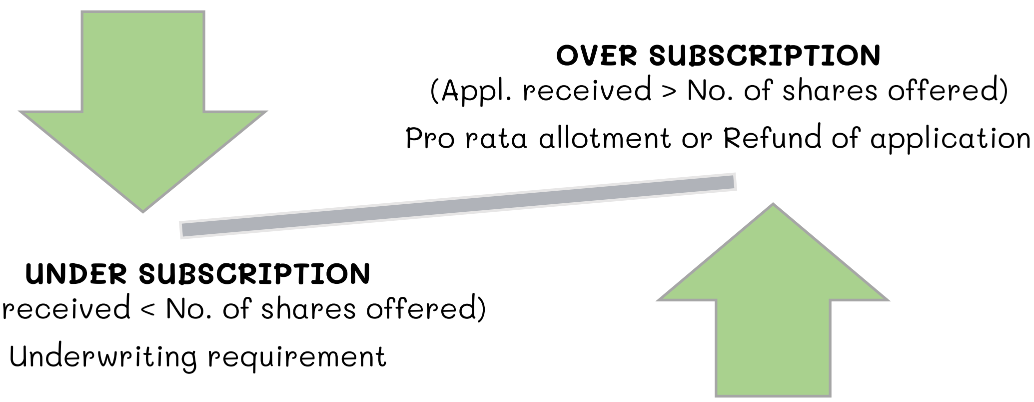
SHARE ISSUE AT PREMIUM

<table>
<tr><th colspan="3">Issue of Shares at Premium [Section 52(2)]</th></tr>
<tr><td>Meaning and nature</td><td colspan="2">• Share issue price > Face value then Share issue at premium
• Premium on issue of share treated as "Capital receipt".
• Sum equal amount of premium credited to "Securities Premium Account"</td></tr>
<tr><td>Restriction Note:</td><td colspan="2">• No restrictions in the Companies Act on the issue of shares at a premium, but there are restrictions on its disposal</td></tr>
<tr><td>Section 52(2) of the Companies Act 2013, the Securities Premium Account may be applied by the company</td><td colspan="2">I. towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
II. writing off the preliminary expenses of the company;
III. writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
IV. providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
V. For the purchase of its own shares or other securities under section 68.(Buy back)</td></tr>
<tr><td>Shown under head</td><td colspan="2">Liabilities side under the head "Reserves and Surplus"</td></tr>
<tr><td>Applicable section</td><td colspan="2">Section 52(2) of the Companies Act 2013</td></tr>
<tr><td rowspan="2">Security Premium vs Share premium</td><td>Security Premium</td><td>• It's a broader than Share Premium
• It includes premium on issue of shares, debentures, bonds & financial instruments.</td></tr>
<tr><td>Share Premium</td><td>• It includes premium on issue of equity share and preference shares.</td></tr>
<tr><td colspan="3">Journal Entry:
<u>When allotment money becomes due:</u>
Share Allotment A/c Dr. (with the money due on allotment including premium)
To Securities Premium A/c (with the premium amount)
To Share Capital A/c (with the share allotment amount)</td></tr>
</table>

SHARE ISSUE AT DISCOUNT

Issue of Shares at Discount (Section-53)	
Meaning and nature	• Share issue price < Face value then Share issue at Discount.
A company shall not issue shares at a discount	• As per companies Act 2013, a company shall not issue shares at a discount except as provided in section 54 for issue of sweat equity shares.
Legal consequences (Prohibition on issue of shares at discount- section 53)	• Any share issued at a discounted price shall be void. • The company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.
RBI Act,1934 Banking Regulation Act, 1949	• However, company can issue shares at discount to its creditors when its debt is converted in to shares in pursuance of any statutory resolution plan or debt restructuring scheme.

C. SUBSCRIPTION



OPTIONS AVAILABLE IN CASE OVER SUBSCRIPTION

1. Rejection of Excess Applications and Money Returned
2. Excess application money adjusted towards sums due on allotment
3. Partial acceptance of Applications (Pro-rata acceptance)

CALL IN ADVANCE

1. Money Received (Before Due Date)
2. If Permitted By Its Articles, May Accept
3. Not Be Entitled To Any Voting Rights On Calls In Advance
4. Always Have A Credit Balance
5. At The Rate Of 12% P.A. Interest As Per Table F
6. No Dividend
7. Not Become Part Of Capital (Shown Under Current Liabilities)

CALLS IN ARREARS

1. Money remaining unpaid
2. Debit balance
3. Deduction from share capital in the liabilities side
4. Interest received at the rate of 10% p.a. As per table F

Summary Points- Calls-In-Advance And Interest On Calls-In-Advance	
Section 50 of Companies Act, 2013	• Company to accept unpaid share capital, although not called up
Section 51 of Companies Act, 2013	• Payment of dividend in proportion to amount paid-up • A company may, if so authorized by its articles, pay dividends in proportion to amount paid-up on each share
Calls in advance	• Authorized by articles of association. • Debt of company until calls are made an amount already paid is adjusted. • Arises when No. of share allotted < shares applied for • When calls are made, calls in advance account is ultimately closed by transfer to relevant call a/c.
Shown as	• "Calls in Advance " on liabilities side
Important note	• Does not become part of share capital • No dividend is paid on Calls in Advance.
Interest on calls in advance Regulation-18 of Table F of Companies Act, 2013	• Period- from date of receipt of amount till date when call is due for payment • Rate of Interest- (a) As per AOA or (b) Subject to Max. 12% per annum as per Companies Act, 2013. [Table-A if AOA silent] • Charge against- Profit of the company and must be paid When profit is earned by company.

<table>
<tr><th colspan="2">Summary Points - Calls In Arrears</th></tr>
<tr><td>Meaning</td><td>• Default in sending call money within appointed date by shareholder.
• It is an asset account which represent the called-up amount not received from some shareholders.
• It is disclosed "Notes to account" — Share Capital</td></tr>
<tr><td>Interest on call in arrears</td><td>• Interest is recoverable as per AOA.
• Period- Form day appointed for payment
• Rate- not exceeding 10% p.a. [Table-A if AOA silent] (Regulation 16 of Table F of Companies Act, 2013)</td></tr>
<tr><td>Important note</td><td>• Directors have right to waive payment of interest
• Interest is transferred to Profit and loss a/c at the end year</td></tr>
<tr><td colspan="2">Journal Entry:
(1) When call money is in arrear:
Calls-in-Arrear A/c Dr. (with the amount-failed by the shareholders)
To Relevant Call A/c
(2) n receipt of amount of Calls-in-Arrear on a subsequent date:
Bank Dr. (with the amount received)
To Calls-in-Arrears A/c
(3) Making due the interest on calls in arrears (with Interest due)
Sundry Members A/c Dr.
To Interest
(4) On receipt of Interest on calls in arrears (With Interest received)
Bank A/c Dr.
To Sundry Members A/c
(5) Transfer to P&L
Interest on calls in arrears A/c Dr.
To P&L A/c</td></tr>
</table>

CALLS IN ARREARS VS CALLS IN A DVANCE

Points	Call in Arrears	Calls In Advance
Meaning	Called up amount not received yet from some shareholders till the last day fixed for payment	Uncalled up amount received in advance from shareholders

Authority under AOA	No	Company may accept if AOA permits
Interest	Charged	Allowed (Charged against the profit)
Max. ROI	10% p.a.	12% p.a.
Disclosure	Share Capital Balance sheet	Current Liabilities – Other CL

ISSUE FOR CONSIDERATION OTHER THAN CASH

1. to vendors
2. to the promoters
3. same must be clearly stated in the balance sheet & must be distinguished from the issue made for cash

ACCOUNTING TREATMENT FOR CONSIDERATION OTHER THAN CASH

Date	Particulars	Dr. (₹)	Cr.(₹)
	When fair value of assets is equal to shares are issued: Sundry Assets A/c Dr. To Share Capital A/c	-	-
	When fair value of assets is more than value of shares are issued: Sundry Assets A/c Dr. To Share Capital A/c To Securities Premium A/c	-	-
	When fair value of assets is less than value of shares are issued: Sundry Assets A/c Dr. Discount on Issue of Shares A/c To Share Capital A/c (Companies Act, 2013 totally prohibits the issue of shares at discount)	-	-
-	Issue of shares to promoters for their services: Goodwill A/c Dr. To Share Capital A/c	-	-

FORFEITURE OF SHARES

1. Shareholders fail to pay allotment or call money due
2. directors may forfeit
3. Proper notice (14 days)

4. amount will not refunded (Trf. to share forfeiture account)
5. shown as an addition to share capital, on the liabilities side

PROCESS OF FORFEITURE OF SHARES

- **1st:** Cancellation of membership of the shareholder (Reduce share capital a/c by called up face value of forfeited shares)
- **2nd:** Forfeit, amount received except premium (By transferring such amt to share forfeiture A/c)
- **3rd:** Allotment or call money (as the case may be) not received is required to be reversed

Effects of Forfeiture of shares

- Defaulting shareholder losses all his rights in the forfeited shares
- Ceases to be a member of company
- Name of shareholder is removed from the register of members
- Amount already paid by him is forfeited
- Not entitled in future to dividends & rights of membership

ACCOUNTING TREATMENT OF FORFEITURE

Share Capital A/c	Dr	XX		(By called up Face value)
Securities Premium A/c	Dr	XX		(if Sec. prem. Not received=Reversed)
To Share Forfeiture A/c			XX	(Amount received except premium)
To Share Allotment A/c			XX	
To Share 1^{st} Call A/c			XX	(Amount Not received=Reversed)
To Share Final Call A/c			XX	
To calls in arrears (if any) A/c			XX	

PROCEDURE OF FORFEITURE

- The Board has to give at least 14 days' notice to the defaulting members calling upon them to pay outstanding amount, with or without interest as the case may be, before the specified date.
- The notice must also state that if the shareholders fail to remit the amount mentioned therein within the stipulated period, their shares will be forfeited.

- If th ey still fail to pay the amount within the specified period of time, the Board of Directors of the company may decide to forfeit such shares by passing a resolution.
- The decision regarding the forfeiture of shares should be communicated to the concerned allottees.
- Forfeited shares account is to be shown in the balance sheet by way of addition to the paid- up share capital on the 'liabilities' side, until the concerned shares are reissued.

RE-ISSUE OF FORFEITED SHARES

PAR	PREMIUM	DISCOUNT
The entire amount standing to the credit of Shares Forfeited Account for those shares would be treated as net gain and transferred to Capital Reserve Account.	The amount of such premium should be credited to Securities Premium Account. Also, in such a case, the entire amount standing to the credit of Shares Forfeited Account would be treated as net gain and transferred to Capital Reserve Account.	The amount in the forfeiture account is used to overcome the loss on discount on reissue of forfeited shares .standing amount in the account is being transferred to Capital Reserve Account

1. BOD can sell / re-issue / dispose off as they think fit
2. Sales, not Allotment (NOT a Fresh issue or Further issue)
3. Auction Sale
4. Loss on re—issue of forfeited shares should not exceed the forfeited Amount
5. Loss on re—issue: debited to "forfeited shares" A/c
6. surplus arising on the reissue to capital reserve A/c
7. excess amount should be credited to securities premium A/c

Forfeiture and Re-issue of Shares Allotted on Pro-rata Basis in Case of Over-subscription

- If pro-rata allotted shares are subsequently forfeited for non-payment of money, the entries shall remain the same, but it may involve some difficulty in the calculation.
- If there is any excess amount received along with the application and it is adjusted against the allotment money which is failed by the shareholder, such amount should be deducted from the amount due on allotment.

DEBENTURES:

Derived from a Latin word 'DEBERE' which means to BORROW

- Is an acknowledgement of a debt taken by the company
- Issued under the common seal of the company and
- On or after a specified maturity period and
- To pay the interest on the debt at a fixed rate whichever is decided at regular intervals
- Generally half yearly until the debt is repaid fully
- Debenture certificate contains an undertaking to pay back principal sum

KINDS OF DEBENTURES

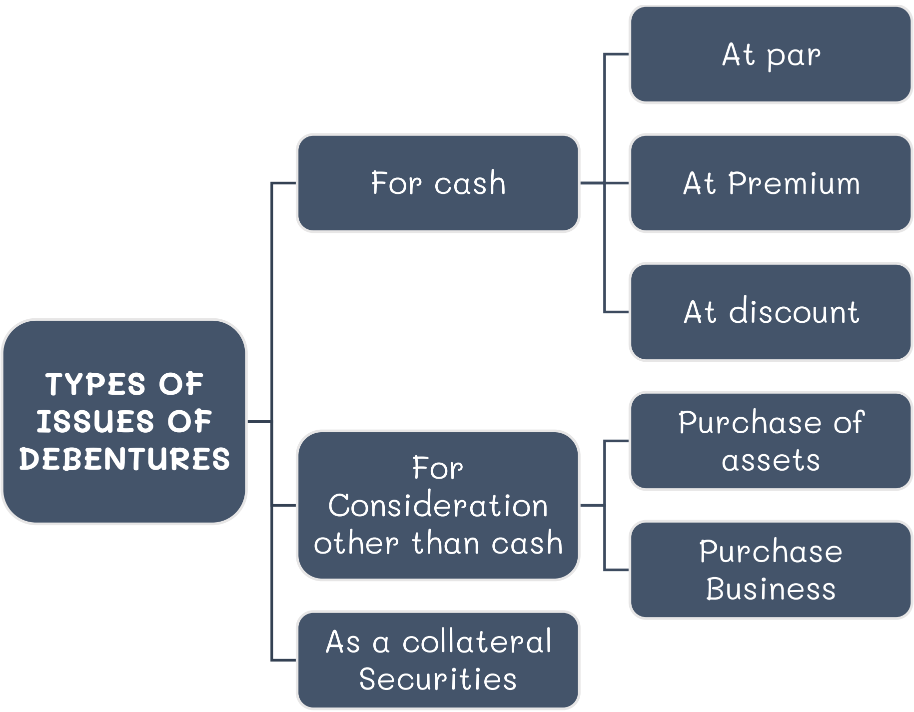
Secured or mortgage debentures are secured by a mortgage on the property of the company	**Unsecured Or Naked debenture debentures are issued without any security**	**Bearer debenture payable to bearer and are transferable by mere delivery upon presentation &delivery of coupons and debentures.**
Registered debenture Repaid only to the person whose name is registered in the debenture ledger.	**Convertible debenture Debentures may be convertible into preference or equity shares of the company on certain specified dates**	**Non - convertible debenture Such debentures are paid into cash**
Redeemable debenture Such debentures are paid either at par or at a premium after the expiry of a particular period	**Irredeemable debenture debentures are payable either on a happening of the contingency, -or when the company winds its business up**	**First mortgage: Such debentures are paid on the basis of priority as compared to other debentures.**
	Second mortgage Such Debentures are paid after redemption of first mortgage debentures	

Share vs Debentures

Basis	Share	Debenture
1. Meaning	Is the Share in the Share Capital	Is the acknowledgment of Debt.
2. Nature	Is part of the Capital of the Company	Is Loan of the Company.
3. Holders	Shareholders are the Owners	Debenture holders are Creditors
4. Kinds	Equity, and Preference Shares.	(See later in same topic)

5. Voting	Enjoy voting rights.	Do not have any voting rights.
6. Return	Dividend (out of the profits)	Interest (Charge against profit)
7. Variation in return	Dividend on ESC may vary [However, on PSC is paid at a fixed rate.]	Rate of Interest on Debentures is fixed.
8. Nature of Payment	Dividend is an appropriation of Profits of the Company. (Not Deductible)	Interest on Debentures is "charge" on the profits
9. Disclosure	Under "Share Capital" (Liabilities)	Under "Secured Loans" (Liab.)
10. Conversion	Shares cannot be converted into Debentures under any circumstances.	Debentures may be converted into Shares (partly or fully) as per the terms of issue.
11. Forfeiture	Shares can be forfeited for non – payment of Allotment or Call Moneys, as per AOA.	Debentures cannot be forfeited for non – payment of Call Money.
12. Charge on Assets	Shares do not carry any charge on Assets.	Generally have a charge on the Assets of the Company.
13. Priority of repayment	Upon winding – up, they are paid after Debenture holders are settled.	Paid before Shareholders, since they are the Creditors
14. Risk	Higher Risk than Debenture holders.	Lower Risk than ESC
15. Control	Higher degree of control over Co.	Minimum / No control.

ISSUE OF DEBENTURES (Entries like shares)



Conditions for issue of debentures as per Companies Act, 2013

- Issue of Debentures by Special Resolution
- No voting rights
- Terms for the issue of secured debentures
- Creation and utilization of debenture redemption reserve
- Debenture Trustee(s) to protect the interest of debenture holder

ISSUE OF DEBENTURES FOR CASH

Debentures may be issued for cash on a PAR, A PREMIUM OR DISCOUNT. When the debentures are issued for cash, the entire issue price may be received on application itself or the amount may be payable in installments, such as on application, on allotment and balance in calls. Any premium or discount on the issue of debentures is generally recorded at the time of making allotment.

Issue of Debentures as Collateral Security

1. Meaning:
   (a) Collateral Security means secondary or supporting security for a loan, which can be realized by the Lender, when the original loan is not paid on due date.
   (b) Companies may issue their Own Debentures as Collateral Security for a Loan or Overdraft facility taken from Bank / other Lenders.
2. Effect:
   (a) If the Company repays the loan on the due dates, the Debentures will be released, along with the main security.
   (b) If the Company is not able to repay the loan or the interest thereon, the Lender will become the Debenture holders of the Company. However, such Debenture holders will receive interest only to the extent of Loan Amount, and not on the amount of debentures.
3. Accounting Treatment: Two methods of showing Debentures issued as Collateral Security –

Situation	Method I	Method II
Journal Entry for issue as Collateral Security	No Entry. It is only a Memorandum Method.	Debenture Suspense A/c Dr. To .... % Debentures A/c
Disclosure in the Balance Sheet till Loan is settled	The issue of Debentures and Loan Outstanding is shown as a Note under "Secured Loans".	• Debenture Suspense A/c appear on Assets Side. • Debentures A/c will appear on the Liabilities Side under Secured Loans.

Treatment after settlement of Loan	The Note given as above will be discontinued.	The Journal Entry given above will be reversed in order to cancel Debentures.

Accounting Treatment for Payment of Interest on Debentures

1. **Interest:** Interest on Debentures is a charge against the profits of the Company. Interest is paid at specified dates on the Nominal Value of Debentures.
2. **Tax Deducted at Source:** Company will pay interest to the Debenture holders after deducting the amount of tax, as specified in the Income Tax Rules.
3. **Journal Entries:**

	Transaction	Journal Entry
(a)	Interest due on Debentures	Interest on Debentures A/c Dr. To Debenture holders A/c
(b)	Payment of Interest after deduction of tax at source (TDS)	Debenture holders A/c Dr. To TDS Payable A/c To Bank A/c
(c)	Remittance Tax Deducted at Source with Government	TDS Payable A/c Dr. To Bank A/c
(d)	Transfer of Interest on Debentures to P & L A/c	Profit and Loss A/c Dr. To Interest on Debentures A/c

REDEMPTION OF DEBENTURES

- Debentures shall be redeemed out of divisible profits of the company through the creation of debenture redemption reserve.
- Redemption shall be out of Debenture redemption reserve [DRR] Section 71(4)

CONDITIONS FOR CREATION OF DRR

- DRR is created out of profit of company.
- A sum shall not be less than 15% of the amount of its debentures maturing during the year ending on 31st march
- Same amount shall be invested in Govt./secured securities /plans
- [e.g. treasury bill, Govt. bonds]
- This amount can only be used for redemption purpose
- The invested amount cant fall below 15% of the debenture
- that are going to redeem in the year ending on 31st march
- In case of partly convertible debentures, DRR shall be created in respect of non-convertible portion
- No DRR required for All India Financial Institutions (AIFIs)
- For other FI= same as NBFC in india
- NBFC are required to make DRR for 25 % of deb outstanding to mature during FY

- Other companies other than FI and NBFC required to make DRR for 25 % of value of DEB. Outstanding

Adequacy of Debenture Redemption Reserve (DRR)

The Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend; the limits with respect to adequacy of DRR and investment or deposits, as the case may be, shall be as under:

Sr. No.	Debentures issued by	Adequacy of Debenture Redemption Reserve (DRR)
1	All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures	No DRR is required
2	Other Financial Institutions (FIs) within the meaning of clause (72) of section 2 of the Companies Act, 2013	DRR will be as applicable to NBFCs registered with RBI (as per (3) below)
3	For listed companies (other than AlFIs and Banking Companies as specified in Sr. No. 1 above):	
a.	All listed NBFCs (registered with RBI under section 45-IA of the RBI Act,) and listed HFCs (Housing Finance Companies registered with National Housing Bank) for both public as well as privately placed debentures	No DRR is required
b.	Other listed companies for both public as well as privately placed debentures	No DRR is required
4	For unlisted companies (other than AlFIs and Banking Companies as specified in Sr. No. 1 above	
a.	All unlisted NBFCs (registered with RBI under section 45-IA of the RBI (Amendment) Act, 1997) and unlisted HFCs (Housing Finance Companies registered with National Housing Bank) for privately placed debentures	No DRR is required
b.	Other unlisted companies	DRR shall be 10% of the value of the outstanding debentures issued

Investment of Debenture Redemption Reserve (DRR) Amount

As per Rule 18 (7) of the Companies (Share Capital and Debentures) Amendment Rules, 2019, following companies:

(a) All listed NBFCs

(b) All listed HFCs

(c) All other listed companies (other than AIFIs, Banking Companies & Other FIs); &

(d) All unlisted companies which are not NBFCs and HFCs

shall on or before the 30th day of April in each year, in respect of debentures issued, deposit or invest, as the case may be, a sum which should not be less than 15% of the amount of its debentures maturing during the year ending on the 31st day of March of next year, in any one or more of the following methods, namely:

(a) in depos its with any scheduled bank, free from charge or lien;

(b) in unencumbered securities of the Central Government or of any State Government;

(c) in unencumbered securities mentioned in clauses (a) to (d) and (ee) of Section 20 of the Indian Trusts Act, 1882;

(d) in unencumbered bonds issued by any other company which is notified under clause (f) of Section 20 of the Indian Trusts Act, 1882.

Important Point:

- The amount deposited or invested, as the case may be, above should not be utilised for any purpose other than for the redemption of debentures maturing during the year referred to above.

  Provided that the amount remaining deposited or invested, as the case may be, shall not at any time fall below 15% of the amount of debentures maturing during the 31st day of March of that year.

- In case of partly convertible debentures, DRR shall be created in respect of non-convertible portion of debenture issue.

- The amount credited to DRR shall not be utilised by the company except for the purpose of redemption of debentures.

- It should be noted that appropriation to DRR can be made any time before redemption and Investments in specified securities as mentioned above can be done before 30th April for the debentures maturing that year, however, for the sake of simplicity and ease, it is advisable to make the appropriation and investment immediately after the debentures are allotted assuming that the company has sufficient amount of profits (issued if allotment date is not given in the question). Also, in some cases, the date of allotment could be missing, in such cases the appropriation and investments should be done on the first day of that year for which ledgers accounts are to be drafted.

Journal Entries				
Date	Particular	L.F.	₹ (Dr.)	₹ (Cr.)
	(a) For setting aside the fixed amount of profit for redemption Profit and Loss A/c Dr. To Debenture Redemption Reserve A/c (b) For investing the amount set aside for redemption Debenture Redemption Reserve Investment A/c Dr. To Bank A/c (c) For receipt of interest on Debenture Redemption Reserve Investments Bank A/c Dr. To Interest on DRR Investment A/c			
	(d) For transfer of interest on Debenture Redemption Reserve Investments (DRRI) Interest on DRR Investment A/c Dr. To Profit and loss A/c* At the time of redemption of debentures (e) For encashment of Debenture Redemption Reserve Investments Bank A/c Dr. To DRR Investment, A/c			

	(b) For amount due to debenture holders on redemption Debentures A/c Dr. To Debenture holders A/c (c) For payment to debenture holders Debenture holders A/c Dr. To Bank A/c After redemption of debentures, DRR should be transferred to general reserve			

	DRR A/c Dr. To General Reserve			

METHODS OF REDEMPTION

LUMPSUM:

- The redemption is made in one lumpsum at the expiry of a specified period promised as the redemption date when the debentures were issued.

ANNUAL INSTALMENTS OR DRAW BY LOTS:

- Under this method, a certain amount of debentures is redeemed at regular intervals, say yearly, during the life of debentures. The amount of annual drawings may or may not be equal.

CONVERSION INTO SHARES:

- A company may issue convertible debentures, giving options to the debenture holders to exchange their debentures for equity shares or preference shares in the company.

PURCHASE OF ITS OWN DEBENTURES IN OPEN MARKET:

- A company is entitled to purchase its own debentures in open market, i.e., through the stock exchange.
- When the company purchases its own debentures for immediate cancellation, it leads to automatic redemption.
- Can purchase deb for investment purpose.

SOURCES OF REDEMPTION

- Out of capital
- Out of profit
- Through conversion

REDEMPTION OF PREFERENCE SHARE CAPITAL

The preference shares can be redeemed only when they are fully paid up

Amount req. for Redemption of Pref. Share

Nominal Value Redeemable
- Out of Fresh Issue
- Out of FR and PROFIT

Premium Payable
- Out of FR / SP

The same nominal amount which is paid out of FR shall be transferred to CRR {Capital Redemption Reserve} guaranteeing creditors of the company

The capital redemption reserve account may be used by the company, in paying up of unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Redeemable Preference Shares

Point	Description
Max. 20 Years Period for Redemption	Companies cannot issue the following types of Preference Shares— (a) Irredeemable Preference Shares, or (b) Redeemable after 20 years from the date of its issue
Extended Time Limit of 30 years for Infrastructure Facilities	The maximum limit is extended to 30 years in the following situation (a) Such issue can be made only by a Company engaged in the setting up and dealing with of Infrastructural Projects [See Note below]. (b) Such Preference Shares may for a period exceeding 20 years but not exceeding 30 years. (c) Minimum 10% of such Preference Shares should be redeemed every year from the 21^{st} year onwards or earlier, on proportionate basis, at the option of the Preference Shareholders.

Purpose of transfer to CRR

- Transfer: Amount to be transferred to CRR = Face Value of Preference Shares to be redeemed Less Proceeds of Fresh Issue of Share Capital.
- Utilization of CRR: CRR can be utilized only for the purpose of issuing Bonus Shares. It shall be used for any other purpose, e.g. distribution of dividend, etc.
- Retention of Capital: So, when Preference Shares are redeemed out of Profits, replacement / retention of Capital is ensured in an indirect manner, by transfer of profit to CRR. Amount, which would otherwise have been distributed as dividend, is now retained in business, in form of CRR, and this is subsequently converted into ESC, by issuing Bonus Shares.

- Non – Distributable Profits: Transfer to CRR ensures replacement of Capital and Tangible Assets of the Company. Transfer to CRR creates non – distributable profits, and maintains the Capital Base of the Company.
- Protection of Outsiders Interests: The purpose of transfer to CRR is ensure Capital Maintenance, and to protect the interest of Outsiders / Creditors of the Company. Transfer to CRR ensures that there is no reduction in "Shareholders' Funds" or Capital Base due to the redemption, and hence the interests of outsiders are not affected.

Accounting entries for Redemption of Preference Shares

Transaction	Journal Entry
1. Calling unpaid portion of Preference Share Capital, if any	Redeemable Pref. Share Final Call A/c Dr. To Redeemable Preference Share Capital A/c
2. Receipt of Final Call Amount [Also see Note below]	Bank A/c Dr. To Redeemable Preference Share Final Call A/c
3. Fresh issue of Share Capital for the purpose of redemption	Bank A/c Dr. To Share Capital A/c (at Face Value) To Securities Premium A/c (if issued at a Premium)
4. Sale of Investments or Current Assets for raising funds for redemption	Bank A/c Dr. Profit and Loss A/c (if sold at a Loss) Dr. To Investments / Current Asset A/c To Profit and Loss A/c (if sold at a Profit)
5. Transfer of Preference Share Capital and Premium on Redemption of Pref. Share Capital (if any), to PSH A/c	Redeemable Pref. Share Capital A/c Dr. Prem. on Redempn of Pref. Shares A/c (if any) Dr. To Preference Shareholders A/c
6. Transferring Divisible Profit to Capital Redemption Reserve Account	Profit and Loss A/c Dr. General Reserve A/c Dr. Other Divisible Profits A/c Dr. To Capital Redemption Reserve A/c (Amt trfd to CRR = Nominal Value of PSC to be redeemed (Less) Nominal Value of Fresh Issue Sh Cap
7. Sourcing Premium payable on Redemption of Preference Shares	Securities Premium A/c Dr. General Reserve A/c Dr. Profit and Loss A/c Dr. Other Reserves A/c Dr.

	To Premium on Redemption of Preference Shares A/c
8. Making payment to Preference Shareholders	Preference Shareholders A/c Dr. To Bank A/c

Summary Points - Capital Redemption Reserve Account (CRR)	
When to transfer?	If preference shares are to be redeemed out of the profits
Amt. transfer to CRR	1. A sum equal to nominal amount of shares that are to be redeemed
Transfer to capital redemption reserve account is allowed from these profits	2. General reserve 3. Reserve fund 4. Dividend equalization fund 5. Insurance fund 6. Workmen's compensation fund 7. Workmen's accident fund 8. Voluntary debenture redemption account 9. Voluntary debenture sinking fund 10. Profit and loss account.
Transfer to capital redemption reserve account is not allowed from these profits.	1. Securities premium account 2. Forfeited shares account 3. Profit prior to incorporation 4. Capital reserve 5. Development rebate reserve

SUMMARY OF ALL JOURNAL ENTRIES:

	Transaction	Journal Entry
1.	Receipts of application money on shares issued	Bank A/c (amount actually received) Dr. To shares Application A/c (amount actually received)
2.	Allotment of shares to applicants, and transfer of application money	Share Application A/c Dr. To shares capital A/c [shares allotted x Appln money] To Securities Premium A/c [share allotted x premium ps] (if premium amount is collected at time of appln itself)
3.	Adjustment of excess money received for allotment stage	Share Application A/c Dr. To Share Allotment A/c [Amount adjusted for allotment]
4.	Refund of excess money received / refund to	Share Allotment A/c Dr. To Bank A/c

	unsuccessful applicants	[Amount refund money paid]
5.	Allotment money due	Share allotment A/c Dr. Discount on Issue of shares A/c (if any) Dr. To Share Capital A/c [shares allotted x Allotment ₹] To securities premium A/c [shares allotted x Premium ps] (if premium amount is collected at time of Allotment only)
6.	Receipt of share Allotment Money	Bank A/c (Amount actually received on allotment) Dr. To share Allotment A/c (Amount received on Allotment)
7.	Making calls, i.e. call money due	Share (first or second or final)......Call A/c Dr. To share capital A/c [shares allotment x call money due]
8.	Receipts of share .....call money	Bank A/c Dr. (amount actually received on calls) To Share Call A/c (Amount actually received on calls)
	Oversubscription	
9.	Part Allotment and carry forward of application money to allotment & call stage	Share Application A/c Dr (amount received in advance) To share Allotment A/c (Allotment amount due) To share calls in advance A/c (calls amount due) To Bank A/c (Balance excess refunded)
	Calls In Arrears	
10.	Transfer of non – receipts of share ... call money to calls in arrears A/c	Calls in Arrears A/c Dr. To share Allotment / Share ....Call A/c (This journal entry is optional. The amount may also be left in the share......Call A/c itself)
11.	Interest Receivable on calls – in - arrears	Sundry Members / shareholder's A/c Dr. To interest on calls – in – Arrears A/c
12.	Receipts of interest on calls – in - arrears	Bank A/c Dr. To Sundry Member / Shareholder's A/c
	Calls In – Advance	
13.	Receipts of calls – in - advance	Bank A/c Dr. To Calls – in – Advance A/c
14.	Adjusting Calls in Advance against call moneys due	Calls – in – advance A/c Dr. To particular call A/c
15.	Interest on call in Adv. (max 6% p.a.)	Interest on calls – in – advance A/c Dr. To sundry Member / Shareholder's A/c

16.	Interest on calls in adv paid by company	Sundry member's / shareholder's A/c Dr. To Bank A/c
	Shares Forfeiture	
17.	Forfeiture of shares issued at par	Share Capital A/c (to the extent called) Dr. To share forfeited A/c (to the extent amount received) To Calls in Arrears (to extent amount called up & unpaid) (or alternatively share allotment A/c or share...... call A/c)
18.	Forfeiture of shares issued at premium – premium fully collected	Share capital A/c (called excluding premium) Dr. To Shares forfeited A/c (to extent amount received) To calls in Arrears (to extent amount called & unpaid) (or alternatively share.......call A/c)
19.	Forfeited of shares issued at premium – premium not fully collected	Share Capital A/c (to extent called UP CAPITAL) Dr. Share Premium A/c (Premium ₹ on shares forfeited) Dr. To Shares forfeited A/c (to the extent amount received) To Calls in Arrears (to extent amount called up & unpaid) (or alternatively share.....Call A/c)
20.	Forfeiture of shares issued at discount	Share Capital A/c (to the extent called) Dr. To Shares forfeited A/c (to the extent amount received) To Discount on issue of shares (Discount offered on original issue) To Calls in Arrears (to extent amount called up and unpaid) (Or alternatively share allotment A/c or Share....Call A/c)
	Re – Issue of shares forfeited earlier	
21.	Re – issue of forfeitures shares at par	Bank A/c (shares re- issued x re – issue price) Dr. Shares forfeited A/c (to the extent re - issued) Dr. To share capital A/c (shares re–issued x paid up value) To calls in arrears (to the extent amt called up & unpaid) (Or alternatively share allotment A/c or Share .....call A/c)
22.	Re – issue of forfeited shares at premium	Bank A/c (shares Re–issued x re – issue price) Dr. Shares forfeited A/c (to the extent re – issued) Dr. To shares forfeited A/c (re-issued x paid up value) To securities Premium A/c (shares re issued x prem ps) To capital Reserve A/c (Balancing Figure)
23.	Re – issue of forfeited shares at discount	Bank A/c (Shares re – issued x re – issue price) Dr. Share Forfeited A/c (to the extent re - issued) Dr.

		Discount on Issue of Shares A/c Dr. To share capital A/c (shares re - issued x paid up value) To capital Reserve A/c (Balancing Figure)
	Issued: non-cash	
24.	Eg. Purchase of Machinery, Formation expenses, etc.	Machinery/Assets A/c (in case of assets purchased) Dr Preliminary Expenses A/c (formation exp. by promoters) Dr Underwriting commission, A/c Dr. To vendor's / Parties Account
25.	Allotment of Shares to the vendor / promoter / Underwriter	Vendor's / parties Account Dr. Discount on issue of shares (if issued at discount) Dr To share capital (Nominal value of shares issued) To Securities premium (is issued at premium)

ICSI MODULE QUESTIONS:

Illustration 1:

P Ltd. was registered with an authorised capital of Rs. 10,00,000 divided into 1,00,000 equity shares of ₹ 10 each out of which 50,000 equity shares were offered to the public for subscription. The shares were payable

as under:

₹ 3 per share on application

₹ 2 per share on allotment

₹ 2 per share on 1st call

₹ 3 per share on 2nd and final call

The shares were fully subscribed for and the money was duly received. Show the journal and cash book entries

Illustration 2:

Wonder Ltd. issued 10,000, 12% Preference Shares of ₹ 100 each at a premium of ₹ 10 per share payable as follows:

On Application ₹ 30

On Allotment ₹ 30 (including premium) On First Call ₹ 25 On Final Call ₹ 25

Applications were received for 12,000 shares and the directors allotted 10,000 shares and rejected applications for 2,000 shares and the money received thereon was refunded.

The allotment money was duly received while the first call money was received on 9,000 shares and the final call money on 8,000 shares.

Show the cash book and journal entries.

Illustration 3:

Newlook Ltd. issued, 1,00,000 Equity Shares of ₹ 10 each payable as follows:0

On Application (On 1st March, 2025) ₹ 4

On Allotment (On 1st April, 2025) ₹ 1

On First Call (On 1st August, 2025) ₹ 3

On Final Call (On 1st October, 2025) ₹ 2

Application were received for 2,60,000 shares. Of these 10,000 shares were in disorder; 40,000 shares in lots of 100 shares; 1,20,000 shares in lots of exceeding 100 but less than 500 shares; 60,000 shares in lots of exceeding 500 but less than 1,000 shares and the balance in lots of exceeding 1,000 shares.

Allotment was made as follows:

Application for the 10,000 shares in disorder were rejected. Application for 100 shares in full, i.e. 100% 40,000

Application over 100 shares but not exceeding 500 shares - 40% 48,000

Application over 500 shares but not exceeding 1,000 shares - 15% 9,000

Applications over 1,000 shares - 10% 3,000

Money received in excess on shares partially allotted was retained to the extent possible. Show the cash book and journal entries assuming that all the installments were duly received and interest was paid by the directors on calls-in-advance @ 12% per annum on 1st October, 2025.

Illustration 4:

On 1st January, 2025, New Ventures Ltd. issued 1,00,000 equity shares of ₹10 each payable as follows: On application ₹ 3

On allotment ₹ 2

On 1st Call ₹ 2 (Payable after 2 months, from the date of allotment) On Final Call ₹ 3 (Payable after 2 months from the date of 1st call)

Applications were received on 15th January, 2025 for 1,20,000 shares and allotment was made on 1st February, 2025. Applicants for 50,000 shares were allotted in full, those for 60,000 shares were allotted 50,000 shares and applications for 10,000 shares were rejected.

Balance of amount due on allotment was received on 15th February. The calls were duly made on 1st March, 2025 and 1st April, 2025 respectively. One shareholder did not pay the 1st call money on 3,000 shares which he paid with the final call together with interest at 10% p.a. Another shareholder holding 2,000 share did not pay the final call money till end of the accounting year which ended on 31st March, 2025. Show the Cash Book and Journal Entries.

Illustration 5:

Rocket Ltd. purchased the business of Comet Ltd. for ₹ 2,70,000 payable in fully paid shares. Rocket Ltd. allotted equity shares of ₹ 10 each fully paid in satisfaction of the claim by Comet Ltd. Show the necessary journal entries in the books of Rocket Ltd. assuming that:

(a) Such shares are issued at par,

(b) Such shares are issued at premium of 20% and

Illustration 6:

Bright Ltd. was registered with a share capital of ₹ 10,00,000 in equity shares of ₹ 10 each. The company acquired factory building worth ₹ 1,00,000 and plant and machinery worth ₹ 80,000 from Delite Ltd. and issued 18,000 equity shares of ₹ 10 each to the vendors as fully paid-up. The directors also decided to allot 2,000 equity shares credited as full paid to the promoters for their services. Further capital was issued to the public for cash to the extent of ₹ 3,00,000 payable in full with the application. All the shares were taken up by the public and fully paid for. Show the necessary journal entries and the balance sheet.

Illustration 7:

(i) X Ltd. forfeited 1,000 equity shares of ₹ 10 each issued at par for non-payment of the first call of ₹ 2 per share and the final call of ₹ 3 per share. Give journal entry for the forfeiture.

(ii) XD Ltd. forfeited 500 equity shares of Rs.10 each fully called up which were issued at a premium 20%. Amount payable on shares were: on application Rs.2; on allotment Rs.5; on first and final call Rs.5. Only application money was paid by the shareholders in respect of these shares. 300 shares out of the above were reissued at Rs.9 per share fully paid. Pass journal entries for the forfeiture and re-issue.

Que on IOSFCOTC:

(iii) B Ltd purchase the assets of Rs. 10,80,000 from C Ltd. The consideration was payable in fully paid equity shares of Rs. 100 each.

Required: Show the necessary journal entries in books of B Ltd. assuming that —

- Such shares are issued at par
- Such shares are issued at premium of 20%

(iv) D Ltd. issued 2,000 shares of Rs.100 each credited as fully paid to the promoters for their services and issued 1,000 shares of Rs.100 each credited as fully paid to the underwriters for their underwriting services. Journalise these transactions.

Illustration 8

X Ltd. forfeited 1,500 equity shares of ₹ 10 each, issued at a premium of ₹ 5 per share for non-payment of allotment money of ₹ 8 per share (including share premium ₹ 5 per share) the first call @ ₹ 2 per share and the final call @ ₹ 3 per share. Give the journal entry for the forfeiture.

Illustration 9:

X Ltd. forfeited 1,500 equity shares of ₹ 10 each issued at a premium of ₹ 5 per share payable with the allotment money, for non-payment of the first call money of ₹ 2 per share and the final call money of ₹ 3 per share. Give journal entries.

Illustration 10:

Give journal entries for the forfeiture and re-issue of shares in the following cases:

(a) P Ltd. forfeited 300 shares of ₹ 10 each, fully called up for non-payment of final call @ ₹ 4 per share. These shares were subsequently re-issued by the company @ ₹ 10 per share as fully paid-up.

(b) Q Ltd. forfeited 300 shares of ₹ 10 each, fully called up for non-payment of final call @ ₹ 4 per share. These shares were subsequently re-issued by the company @ ₹ 12 per share as fully paid-up.

(c) R Ltd. forfeited 200 shares of ₹ 10 each, ₹ 8 per share being called up on which a shareholder paid application and allotment money @ ₹ 5 per share but did not pay the first call money @ ₹ 3 per share. Of these forfeited shares, 150 shares were subsequently re-issued by the company as fully paid-up @ ₹ 8 per share.

Illustration-11(a)

Give journal entries for the following:

1. P Ltd. forfeited 10,000 equity shares of Rs.10 each for non-payment of first call of Rs.2 and final call of Rs.3 per share. These shares were reissued at a discount of Rs.3.50 per share.
2. K Ltd. forfeited 20,000 equity shares of Rs.15 each (including Rs.5 per share as premium), for non- payment of final call of Rs.3 per share. Out of these 10,000 shares were reissued at a discount of Rs.4 per share.
3. KP Ltd. forfeited 15,000 equity shares of Rs.15 each (including Rs.5 per share as premium), for non- payment of allotment money Rs.8 (including premium money) and first & final call of Rs.5 per share. Out of these 10,000 shares were reissued at Rs.14 per share.

Illustration 11 (b):

A limited company issued a prospectus inviting applications for 2,000 shares of ₹ 10 each at a premium of ₹ 2 per share payable as follows:

On Application	--	₹ 2
On Allotment	--	₹ 5 (including premium)
On First Call	--	₹ 3
On Second and Final Call	--	₹ 2

Applications were received for 3,000 shares and allotment was made pro-rata to the applicants of 2,400 shares. Money overpaid on applications was employed on account of sum due on allotment.

Ramesh, to whom 40 shares were allotted, failed to pay the allotment money and on his subsequent failure to pay the first call, his shares were forfeited. Mohan, the holder of 60 shares failed to pay the two calls and his shares were forfeited after the second and final call.

Of the shares forfeited, 80 shares were sold to Krishna credited as fully paid for ₹ 9 per share, the whole of Ramesh's share being included. Show journal and cash book entries and the Balance Sheet.

Illustration 12:

X Ltd. made an issue of 10,000 12% Debentures of ₹ 100 each, payable as follows:

₹ 25 on Application

₹ 25 on Allotment

₹ 50 on First and Final Call.

Applications were received for 12,000 debentures and the directors allotted 10,000 debentures rejecting applications for 2,000 debentures. The money received on applications for 2,000 debentures rejected was duly refunded. The call was made and the moneys were duly received.

Show the necessary cash book and journal entries to record the above transactions and above the relevant items in the balance sheet of the company.

Illustration 13:

B Ltd. issued 2,000, 13% Debentures of ₹ 100 each at ₹ 110 payable as follows: On Application ₹ 25

On Allotment ₹ 35 (including premium) On First and Final Call ₹ 50

The debentures were fully subscribed and the moneys were duly received. Prepare cash book, pass the necessary journal entries and about the relevant portions of the balance sheet of the company.

Illustration 14:

W Ltd. issued 2,000, 14% Debentures of ₹ 100 each at discount of 5%, the discount being adjustable on allotment. The debentures were payable as follows:

On Application - ₹ 25

On Allotment - ₹ 20 On First and Final Call - ₹ 50

The debentures were fully subscribed and the moneys were duly received. Show the cash book and journal entries and prepare the balance sheet of the company.

Illustration 15:

(1) Optimist Ltd. purchased building worth Rs.1,20,000 and plant and machinery worth Rs. 1,00,000 from Depressed Ltd. for an agreed purchase consideration of Rs. 2,00,000 to be satisfied by the issue of 2,000, 12% Debentures of Rs. 100 each. Show the necessary journal entries in the books of Optimist Ltd.

(2) The XYZ Company Ltd. took over assets of Rs. 230 Lakh and liabilities of Rs. 30 Lakh of PQR Company Ltd. for the purchase consideration of Rs. 220 Lakh. The XYZ Company Ltd. paid the purchase consideration issuing debentures of Rs. 100 each at 10% premium. Give journal entries in the books of the XYZ Company Ltd.

(3) Z Ltd. took over the assets of Rs.6,00,000 and liabilities of Rs.80,000 of C Ltd. for an agreed purchase consideration of Rs.5,40,000 to be satisfied by the issue of 10% Debentures of Rs.1,000 each.

Required: Show the necessary journal entries in the books of Z Ltd, assuming that—

Case (a) Such Debentures are issued at par;

Case (b) Such Debentures are issued at 20% premium; and

Case (c) Such Debentures are issued at 10% discount;

Illustration 16:

Z Ltd. secured an a long-term loan of Rs. 50,000 from the bank by issuing 600, 12% Debentures of Rs. 100 each as collateral security. Show relevant items in the Balance Sheet of the Company under both the methods.

Illustration 17:

Vanities Ltd. had an issue 1,000, 12% redeemable preference shares of ₹ 100 each, repayable at a premium of 10%. These shares are to be redeemed now out of the accumulated reserves, which are more than the

necessary sum required for redemption. Show the necessary entries in the books of the company, assuming that the premium on redemption of shares has to be written off against the company's Securities Premium Account.

Illustration 18:

Sure and Fast Ltd. has part of its share capital in 12% redeemable preference shares of ₹ 100 each, repayable at a premium of 5%. The shares have now become due for redemption. It is decided that the whole amount will be redeemed out of a fresh issue of 20,000 equity shares of ₹ 10 each at ₹ 11 each. The whole amount is received in cash and the 12% preference shares are redeemed. Show the necessary journal entries in the books of the company.

Illustration 19:

The following is the balance sheet of Oscar India Ltd. as on 31st March 2024:

Particulars	Note No.	Amt (₹)
I Equity and Liabilities Shareholders' Funds		
Share Capital	1	5,48000
Reserves and Surplus	2	1,65,000

Current Liabilities			
Trade Payable		3	1,27,000
	Total		8,40,000
II Assets			
Non-Current Assets			
Fixed Assets			6,00,000
Current Assets			
Investment			50,000
Inventories			1,10,000
Cash and Cash Equivalents		4	80,000
	Total		8,40,000
Notes to the Accounts:			

1. Share Capital Authorised	₹	₹
Issued, subscribed and paid-up:		....
30,000 Equity Shares of ₹ 10 each fully paid-up 2,500 Preference share of ₹ 100 each fully called-up	2,50,000	3,00,000
Less: Final Call on 100 pref. shares @ ₹ 20 per sh. unpaid	2,000	2,48,000
		5,48,000

2. Reserves and Surplus	
Securities Premium	15,000
Surplus	1,50,000
	1,65,000
3. Trade Payable	
Trade Creditors	1,10,000
Outstanding Expenses	17,000
	1,27,000
4. Cash and Cash Equivalent	
Balance with Bank	80,000

On 30th June, 2024, the Board of Directors decided to redeem the preference shares at a premium of 10% and to sell the investments at its market price of ₹ 40,000. They also decided to issue sufficient number of equity shares of ₹ 10 each at a premium of Re. 1 per share, required after utilizing the profit and loss account leaving

a balance of ₹ 50,000. Premium on redemption is required to be set off against securities premium account.

Repayments on redemption were made in full except to one shareholder holding 50 shares only due to his leaving India for good.

You are required to show the journal entries and the balance sheet of the company after redemption. Assumption made should be shown in the working.

Illustration 22

The Balance Sheet of Producers Ltd. as at 31st March, 2025 is as follows:

	PARTICULAR	NOTE NO.	AMOUNT
I	Equity and Liabilities		
	Shareholders' Funds		
	Share Capital	1	3,50,000
	Reserves and Surplus	2	64,000
	Current Liabilities		
	Trade Payable	3	72,500
	Short-term provision	4	39,500
	Total		5,26,000
II	Assets		
	Non-Current Assets		
	Fixed Assets	5	2,80,000
	Current Assets		
	Short-term Investment		60,000
	Inventories		1,30,500
	Trade Receivables		50,550
	Cash and Cash Equivalents	6	4,950
	Total		5 26,000

Notes:

.	Share Capital	₹
	Authorised	
	Issued, subscribed and paid-up:	....
	40,000 Equity Shares of ₹ 10 each fully paid-up	4,00,000
	10,000 10% Preference share of ₹ 100 each	1,00,000

		5,00,000
	Issued, subscribed and paid-up:	....
	25,000 Equity Shares of ₹ 10 each, fully paid-up	2,50,000
	10,000 10% Preference share of ₹ 100 each, fully paid-up	1,00,000
		3,50,000
2.	Reserves and Surplus	
	Securities Premium	10,000
	Surplus	54,000
		64,000
3.	Trade Payable	
	Supplies of Goods	66,000
	Outstanding Expenses	6,500
		72,500
4.	Short-term Provision	
	Provision for Income Tax	18,000
	Staff Provision Fund	21,500
		39,500
5.	Tangible Assets	
	Plant and Machinery	2,40,000
	Staff Provision Fund	40,000
		2,80,000
6.	Cash and Cash Equivalent	
	Balance with Bank	4,900
	Cash on hand	50
		4,950

In order to redeem its preference shares, the company issued 5,000 equity shares of ₹ 10 each at a premium of 10% and sold all of its investment for ₹ 70,800. Preference shares were redeemed at a premium of 10%. Show the necessary journal entries in the books of the company and prepare the balance sheet of the company immediately after redemption of preference shares.

PRACTICE QUESTION

Q1.

SOS Limited issued a prospectus inviting applications for 6,000 shares of Rs.10 each at a premium of Rs.2 per share, payable as follows;

- On application Rs.2 per share;
- On allotment Rs.5 per share (including premium):
- On 1st call Rs.3 per share;
- On Second and Final Call Rs.2 per share.,

Applications were receiving for 9,000 shares and allotment was made prorate to the applicants of 7,500 shares, the remaining applicants were refused allotment. Money overpaid on applications were applied towards sums due on allotment. D to whom 100 shares were allotted, failed to pay the allotment money and on his subsequent failure to pay the first call, his shares were forfeited. Z, the holder of 200 shares, failed to pay both the calls, and his shares were forfeited after the second and final call. Of the shares forfeited 200 shares were sold to C credited as fully paid up for Rs.8.50 per share, the whole of D's shares being included.

Q2

Alpha Ltd issued a prospectus inviting applications for 2,000 shares of Rs.10 each at a premium of Rs.2 per share, payable as follows: On Application Rs. 2, On Allotment Rs. 5 (including premium) On First Call Rs. 3, On Second & Final Call Rs. 2 Applications were received for 3,000 shares and pro rata allotment was made on the applications for 2,400 shares. It was decided to utilise excess application money towards the amount due on allotment. Mohit, to whom 40 shares allotted, failed to pay the allotment money and on his subsequent failure to pay the first call, his shares were forfeited. Jagat, the holder of 60 shares failed to pay the two calls and on his such failure, his shares were forfeited. Of the shares forfeited, 80 shares were sold to Rishav credited as fully paid for Rs. 9 per share, the whole of Mohit's shares being included. Required: Give Journal Entries to record the above transactions (including cash transactions)

Q3

(1) JK Ltd is a company with an authorized capital of Rs.10 lacs in equity shares of Rs.10 each, of which 600000 shares had been issued and fully paid on 30th June,

2024. The company proposed to make a further issue of 100000 of these Rs. 10 shares at a price of Rs.14 each the arrangements for payment being:

- Rs 2 per share payable on application, to be received by 1st July 2024.
- Allotment to be made on 10th July and a further Rs.5 per shares (including the premium) to be payable.
- The final call for the balance to be made, and the money received by 31st January 2025. Applications were received for 355000 shares and were dealt with as follows:

- Applicants for 5000 shares received allotment in full.
- Applicants for 30000 shares received an allotment of one share for every 2 applied for, No money was returned to the applicant, the surplus on application being used to reduce the amount due on allotment.
- Applicants for 320000 shares received an allotment of one share for every four applied for, the money due on allotment was retained by the company, the excess being returned to the applicant.
- The money due on final call was received on the due date.

You are required to record these transactions in the journal of JK Limited.

Q4

Practical Problems on Redemption of Preference Shares

HAHA Ltd. had an issue of 2,000, 10% Redeemable Preference Shares of Rs. 100 each, repayable at a premium of 10%. These shares are to be redeemed out of the accumulated reserves, which are more than the necessary sum required for redemption. Show the necessary entries in the books of the company, assuming that the premium on redemption of shares has to be written off against the company's Securities Premium Reserves.

Q5

Diamond Ltd. has part of its share capital consisting of 20000, 12% Redeemable Preference Shares of Rs. 100 each, repayable at a premium of 10%. The shares have now become ready for redemption. It is decided that the whole amount will be redeemed out of a fresh issue of 20,000 equity shares of Rs. 10 each at Rs. 15 each. The whole amount is received in cash and the 12% preference shares are redeemed for the relevant portion. Show the necessary journal entries in the books of the company.

Q6

X Ltd. furnishes you with the following Balance Sheet as at 31st March, 2025:(₹ in Lakhs)

Equity shares of ₹10 each fully paid	400
12% redeemable preference shares of ₹ 100 each fully paid	200
Reserves and surplus:	
- Capital reserve	15
- Share Premium	25
- Revenue reserves	260
Funds Employed in:	
Fixed assets less depreciation	560
Current assets	540
Less: Current liabilities	(200)

The company redeemed preference shares on 1st April 2025 at a premium of 10%. You are required to pass journal entries to record the above.

Q7

In order to redeem its preference shares, the company issued 5,000 equity shares of Rs. 10 each at a Premium of 10% and sold its investment of' 70,800. Preference shares were redeemed at a premium of 10%. Show the necessary journal entries in the books of the company.

PRACTICAL ON REDEMPTION OF DEBENTURES

Question 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, 2022: 6% Mortgage 10,000 debentures of Rs. 10 each; Debenture Redemption Reserve (for redemption of debentures) Rs. 5,000; Investments in deposits with a scheduled bank free from any charge or lien Rs. 15,000 at interest 4% p.a. receivable on 31st December every year. Bank balance with the company is Rs. 90,000.

The Interest on debentures had been paid up to December 31, 2022.

On February 28, 2023, the investments were realised at par and the debentures were paid off at 10.1, together with accrued interest.

Write up the concerned ledger accounts (excluding bank transactions).

Question: 2

The following balances appeared in the books of Apple Ltd (unlisted company other than AIFI, Banking company, NBFC and HFC) as on 1-4-2022:

(i) 12 % Debentures Rs. 75,000

(ii) Balance of DRR Rs. 25,000

(iii) DRR Investment Rs. 11,250 represented by 10%₹ 1,125 Secured Bonds of the Government of India of Rs. 10 each.

Annual contribution to the DRR was made on 31st March every year. On 31-3-2023, balance at bank was Rs. 75,000 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, 2023:

1. Debentures Account
2. DRR Account
3. DRR Investment Account
4. Bank Account
5. Debenture Holders Account.

Question: 3

ABC Ltd. has issued 1,0000, 12% convertible debentures Rs. 100 each redeemable after a period of five years at a premium of 5%. The debenture holders also had the option at the time of redemption to convert 30% of their holdings into equity shares of Rs. 10 each at a price of Rs. 20 per share and balance in cash. Debenture holders amounting Rs. 2,00,000 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 Rs. 20,000 debenture holders.

Question 4

The Balance Sheet of Shyam Co. Ltd. (unlisted company other than AIFI, Banking company, NBFC and HFC) as at 31st March, 2023 shown Long term borrowings with respect to 12% Debentures of Rs. 100000

At the Annual General Meeting, it was resolved that to repay the debentures at a premium of 5%. Give the necessary journal entries for these transactions.

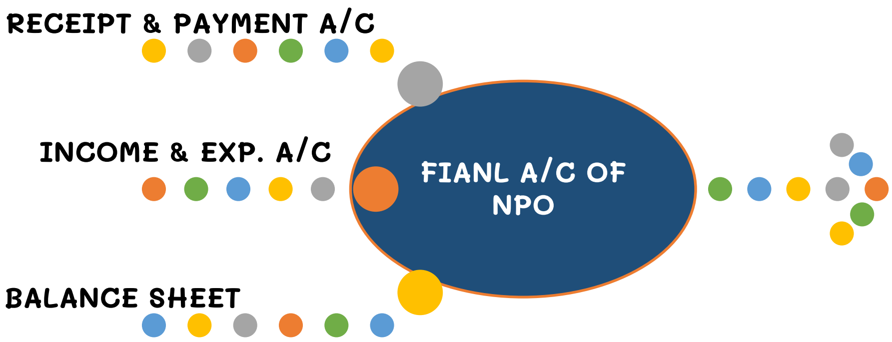
Topic 8 ACCOUNTING FOR NOT-FOR-PROFIT ORGANISATIONS

A. INTRODUCTION

- Certain organisations are established not for the purpose of earning profits
- but to provide services to their members or to the community at large.
- Beneficiaries of these services are generally members who contribute through periodic subscriptions or other forms of support.
- Such organisations are commonly referred to as Non-Trading Entities.
- Examples include gymkhanas and sports clubs, educational institutions, public hospitals, libraries, cultural associations such as the Rotary Club; Charitable Institutions, Schools, Colleges, Chambers of Commerce, Trusts, Trade Unions, etc

B. NOT FOR PROFIT ORGANIZATIONS

1. Meaning: Organizations which are managed and run without the motive of making profits are called as Not-For-Profit Organizations (NPOs). [BUT; It may be noted that such Organizations may incidentally have a Surplus from their activities, but their objective / motive is not to earn such Surplus.]
2. Final Statements: Final Statements of NPOs consist of –
   (a) Receipts & Payments A/c: To highlight the Total Receipts and Total Payments
   (b) Income & Expenditure A/c: To show expenditure incurred & income generated during period. (If Income>Expenditure Surplus, otherwise Deficit).
   (c) Balance Sheet: To show the financial position at the end of the period, in terms of Assets and Liabilities.



Key Features of Non-Profit Organisations

Points	Explanation
Governing Body	Managed by an elected committee or trustees responsible for policy-making and administration
No Profit Distribution	Prohibited from paying dividends or distributing profits to members.

Purpose	Operate without a profit motive, focusing on social, cultural, educational, or community welfare activities
Sources of Funds	Primarily funded through Donations, Grants, and Membership subscriptions.
Use of Funds	All funds are applied solely towards activities that benefit society or the target community
Membership	Membership rights are Personal, Non-Transferable, and cannot be sold or assigned
Accounting Principle	Follow the Entity Concept, treating the organisation as distinct from its members

Books of Accounts

- Cash Book (with or without an analysis column) to record all cash and bank transactions,
- Members' Register to keep detailed records of membership and subscriptions, and
- Register of Assets to track the acquisition, disposal, and current status of the organisation's assets

Profit Seeking Organization Vs. Not for Profit Organization

Points	Profit Seeking Organization	Not for Profit organization
Objective	To earn profit	Interest of members is known as "Capital Fund"
Fund	Interest of owner is known as "Owner's Fund"	Surplus/Deficit
Result	Profit/Loss	Receipts and Payments Account
Accounting Statements	Manufacturing Account Trading Account P&L Account Balance sheet	Receipts and Payments Account Income and Expenditure Account (I&E Account) Balance sheet

C. RECEIPTS AND PAYMENTS ACCOUNT

1. Meaning: Receipts & Payments A/c is a classified summary of Cash Receipts and Payments for a certain period, together with the Cash Balances at the beginning and close of the period.
2. Features:
   (a) Receipts are entered on the Left Hand Side and Payments on the Right Hand Side, i.e. same sides as those on which they appear in Cash Book.
   (b) All Receipts and Payments, irrespective of whether they are Revenue or Capital in nature, are recorded.

(c) It includes all Receipts and Payments during the period, irrespective of whether it is related to current, past or future periods under accrual concept.

(d) The Account starts with the Opening Cash and Bank Balances, and also ends with their Closing Balances.

(e) This Account is usually not recorded as part of the Double Entry System.

(f) Surplus or Deficit cannot be ascertained from this Account, since it shows only cash position, and excludes all non – cash items, accrual items, etc.

3. Use: The Receipts and Payments Account is useful for analysis, only if the activities of the NPO are simple and modest, and involve no carry over from one period to the next and it has no asset, apart from Cash Balance and no Liabilities.

4. Limitations:

(a) Increase in Cash and Bank Balances at the end of the year, as compared to those in beginning, does not truly represent the Surplus for the year. It does not recognize items such as Outstanding Incomes / Expenses, Income / Expenditure in Advance, etc.

(b) No Matching / Accrual: To ascertain whether a year's Current Income is sufficient to meet the Current Expenses, the Receipts & Payments Account is not useful, since it indicates items relating to all periods.

D. INCOME AND EXPENDITURE ACCOUNT

1. Meaning: Income and Expenditure A/c is similar to P&L A/c of trading / business entities. Report the Surplus or Deficit from their activities / operations during the period.
2. Principles: Is prepared by following accounting principles relating to–(a) Accrual, (b) Matching, (c) Periodicity, (d) Capital Revenue distinction, etc.
3. Features:

(a) Is a Revenue A/C prepared, to find out Surplus or Deficit for period

(b) It is prepared by matching Expenses for that period, against the Revenue of that period.

(c) Both Cash and Non–Cash Items (Depreciation, Amortization, etc.) and considered.

(d) Only Revenue nature items are considered, and Capital items are not considered.

(e) Only Current Period Income and Expenses are considered, after adjusting for Prepaid and Unpaid Expenses, Income Receivable and Received in Advance.

(f) Surplus need not be reflected as an Increase in Cash and Bank Balances, it could be represented by Increase in Other Assets or Decrease in Liabilities, if any.

4. Income Items:

(a) Subscriptions (subject to adjustments for Subscriptions Receivable and Subscriptions received in Advance, at the beginning and at the end of the accounting year),

(b) Revenue donations (for revenue purposes, for meeting revenue expenditure, etc.),

(c) Membership Fees or Entrance Fees,

(d) Recurring Revenue Grants from Local Authorities, Other External Agencies,

(e) Income from Investments,

(f) Net Incomes from special activities, e.g. Special Shows, Sale of Match Tickets, Annual Day or Founders' Day, etc.

Note: Expenditures are deducted from the Collections of that activity and Net Amount is shown in the Income and Expenditure A/c (However, if such Income is to be credited to a Special Purpose Fund, e.g. "Building Fund", it shall be credited to that Fund itself.)

5. Expenses Items: Incomes generated by the NPO are spent for meeting its expenses, e.g. to promote its objectives, serving the members, and regular administrative expenses. Some expenses are peculiar to the nature of the institution concerned. Examples are –
   (a) Hospitals – Medicines, Cost of Tests and Investigations, Specialist Fees, etc.
   (b) Sports Club – Sports Materials, Tournament Expenses, etc.
   (c) Drama Club – Expenses of Staging Plays, Rent of Hall, Payment to Artists, etc.
   (d) Educational Societies – Award of Scholarships, Seminar / Event Management Expenses, etc.
   (e) Library Societies – Newspapers and Magazines, Books purchased, etc.

E. RECEIPTS & PAYMENTS A/C VS INCOME & EXPENDITURE A/C

Basis	Receipts & Payments A/c	Income & Expenditure A/c
1. Similarity	Summary of Cash Book.	Similar to Profit and Loss Account.
2. Balances	Shows both Opening and Closing Balance of Cash in Hand and Balance at Bank.	There is no Opening Balance in this account. This account discloses only either Surplus or Deficit for the period.
3. Revenue/Capital difference	Both Revenue and Capital items are shown.	Here, only revenue items are shown.
4. Period covered	All Receipts and Payments which have taken place during the period are shown. Accruals & Outstanding are not considered here.	All Revenue Expenses and Incomes related to the current year, are shown whether expense has been paid or is outstanding or income is received or accrued.
5. Accrual Adjustments	Accrual Adjustments are not shown in this account.	All adjustments for Prepaid and Unpaid Expenses, Income Receivable and Received in Advance, are show.

6. Debit / Credit items	Debit Side: Receipts Credit Side: Payments	Debit Side: Expenditure Credit Side: Incomes
7. Independence	Receipts and Payments can be analysed on a standalone basis.	Income & Expenditure A/c is accompanies by the Balance Sheet.
8. Cash / Accrual	Only cash transactions are recorded in this Account.	Both Cash and Credit / Accrual transactions are recorded in this A/C
9. Reserves and Provisions	Any Reserve or Provision is not created in this account.	All Reserves & Provisions created during the year show in this Account, e.g. Provision for Deprecation.
10. Carry Forward of balance	Closing Balance of this Account becomes Opening Balance of Cash and Bank in the next year.	Closing Balance of this Account is added to or deducted from the Capital Fund.
11. Carry Over to B/s	Closing Balances of Cash and Bank are shown in B/S.	Surplus / Deficit from Income & Expenditure Account is carried to B/S.

F. IMPORTANT ITEMS

1. Entrance fees: This may be treated either as Capital Receipt or as Revenue Income, as discussed under –

   (a) Capital: Entrance Fees/ Admission Fees payable by a Member on admission to a Club or Society are normally considered as Capital Receipts creditable to Capital Fund. This is because these do not give rise to any special obligation towards the Member who is entitled to the same privileges as other Members, who have paid only their annual subscription.

   (b) Revenue: However, where the amount is small, and is meant to cover expenses concerning admission, or the Rules of the Society provided that such Fees could be treated as Income, these amounts may be credited to the Income and Expenditure Account.

2. Donations: Donations are treated either as Capital or Revenue, as discussed below

Purpose of Donation	Treatment
For meeting Revenue Expenditure, e.g. Sports Day, Annual Day.	Credit to Income & Expenditure A/c
For meeting Capital Expenditure, e.g. purchase of Library Books.	Credit to Capital Fund
For meeting specific purpose as declared by Donors, e.g. Prizes.	Credit to Special Fund, e.g. Prize Fund

Note: In case of Donations – in – Kind, i.e. Gift / Transfer of a Security or other Asset / Equipment, the value of such asset should be credited to the Fund for which it has been donated. Sometimes, legal requirements may stipulate that such amounts should be simultaneously transferred to the Special Fund by raising a debit of an equivalent amount in the Income and Expenditure Account. Sometimes, such assets may be recorded at a Nominal Value say Rs.1, for control purpose.

3. Life Membership Fees: In case of lumpsum Subscription collected from Life Members, one of the following methods can be adopted –
   (a) Retained in Special Account: The entire amount may be carried forward in a Special Account until the Member dies, same may be transferred to the credit of the Accumulated Fund / Capital Fund.
   (b) Accrued Income Trf. to I&E: An amount equal to the normal Annual Subscription may be transferred every year to the Income and Expenditure Account and the balance carried forward in the Special Account, till it is exhausted. If the Life Member dies before the whole of the amount paid by him has been transferred in this way, the balance shall be transferred to the Accumulated Fund / Capital Fund, on the date of his death.
   (c) Life Based Transfer: An amount, calculated according to the age and average life expectancy of the Member, may be annually transferred to the credit of Income and Expenditure Account.

4. Income from Investments: Income by way of Interest on Investments, Rents from Properties, etc. should be recognized on accrual basis. Hence, Income to be credited to Income & Expenditure should be computed in the same manner as stipulated for Subscription Income, in Item 1 above.

5. Activity Related Receipts/Collections: Where there are receipts relating to some special activities / events, e.g. Sale of Drama Tickets, Sale of Match Tickets, etc. and Expenses are incurred thereon, the Net Income (i.e. Collections less Expenses) may be shown on the Credit Side of Income and Expenditure Account. (Note: If there is a Net Expenditure (i.e. Expenses > Collections, it will be shown on the Debit Side.)

6. Surplus from Sale to Members: In case of Sale of Items like Provisions, Medicines (in Hospitals), etc. at a profit to Members, the Net Surplus, (i.e. excess of Sale Collections over Cost of Goods Sold) shall be credited to the Income and Expenditure A/c. [Note: Alternatively, the Revenues and COGS may be shown separately on the Credit and Debit Side respectively.

7. Receipt: based Items: Items of Income which are accounted on receipts basis (e.g. Sale of Old Newspaper) and for which no adjustments are necessary, are directly posted to the credit of Income and Expenditure A/c.

8. Gain on Sale of Assets / Investments: Gain, if any, on Sale of Fixed Assets, Investments, etc. is also credited to the Income and Expenditure A/c.

9. Payment: based items: Items of Expense which are accounted on payment basis, and for which no adjustments are necessary, are directly posted to the debit of Income and Expenditure A/c.

G. BALANCE SHEET OF NON – PROFIT ORGANIZATIONS

- The Balance Sheet includes Fixed and Current Assets, External Liabilities and the Capital Fund or / Accumulated Fund.
- Capital Fund: The Capital Fund represents the amount contributed by Members. If Members have not contributed any amount, it is preferable to use the term "Accumulated Fund". The balance of Income and Expenditure Account, i.e. Surplus or Deficit, is transferred to the Accumulated /Capital Fund Account.

H. BALANCE SHEET PROCEDURE

- Opening Balance Sheet: Opening Balance of Accumulated Fund or Capital Fund of the NPO, can be obtained by preparing the Opening Balance Sheet, and computing the Net Assets, i.e. Assets Less External Liabilities. All accruals during the preceding year such as Income received in Advance, Prepaid Expenses, Income Accrued, etc. are taken into account while preparing the Opening Balance Sheet.
- Fixed Assets:
  - (a) Assets appearing in previous Balance Sheet should be adjusted for – (i) Addition, (ii) Sale and Wearing Out / disposals, and (iii) Depreciation during the year.
  - (b) New Assets acquired (for which payments are recorded in the Receipts and Payments A/c) will be included in the Balance Sheet. Depreciation should be properly provided, including for those Assets newly acquired.
  - (c) If a part or whole of an asset has been sold, the Capital Profit / Loss if any, is credited / debited in the Income and Expenditure A/c.
- Current Assets:
  - (a) Outstanding and Prepaid Expenses and Income Received in Advance, Subscriptions, etc. pertaining to the current year will be shown in the Balance Sheet.
  - (b) Closing Balance of Cash in Hand and at Bank (as per Receipts & Payments A/c) should be properly recorded in the Assets side of the Balance Sheet.
- Liabilities: Previous year's Liabilities should be adjusted for payments made, and extra liabilities, i.e. new Loans taken, etc. should be recorded in the Closing Balance Sheet.

- Fund Accounts: Special Capital Receipts as shown by Receipts and Payments Account will be shown in the Balance Sheet. [Refer separate Paragraph for details on Fund Accounting].
- Capital Fund: Capital Fund (as disclosed by the previous Balance Sheet) should be adjusted for Surplus or Deficit that has been determined through the Income and Expenditure Account and then shown in the Balance Sheet. Capital Fund at any date can be ascertained by deducting Liabilities from Assets.

Accounting Records of Non-Profit Organisations

Non-Profit Organisations are generally not engaged in trading or commercial activities. Their primary sources of income include member subscriptions, donations, government grants or financial assistance, and income generated from investments. As most of their transactions are conducted in cash or through banks, these organisations are legally required to maintain proper accounting records to ensure transparency and effective control over the utilisation of funds. Typically, they maintain a Cash Book to systematically record all receipts and payments, along with a Ledger that contains accounts for all incomes, expenses, assets, and liabilities. This systematic record-keeping facilitates the preparation of accurate financial statements at the end of the accounting period.

I. QUESTIONS

Illustration 1: (ICSI)

From the following Cash Book entries of Shiva Entertainment Club, prepare Receipts and Payments Account:

Shiva Entertainment Club

Cash Book (Columnar)

Date	Receipts	Bank ₹	Cash ₹	Date	Payments	Bank ₹	Cash ₹
2025 April 1	Balance b/d	35,000	20,000	2025 April 15	Insurance premium	15,000	
April 10	Subscriptions	1,20,000		May 10	Printing and stationery	10,750	
April 15	Entrance fees	13,000		May 20	Postage and courier fees		1,430
May 20	Life membership fees	12,000		June 10	Telephone expenses		2,810
June 15	Hall rent		42,000	July 15	Wages and salaries		32,000
July 23	Life	8,000		July 15	Rates and	17,000	

	membership fees				Taxes		
Aug. 12	Donation for building	60,000		July 31	Fixed Deposit	1,00,000	
Sept. 10	Subscriptions (2024-25)	30,000		Aug. 10	Printing and stationery	15,000	
Sept. 13	Subscription	1,45,000		Aug. 15	Postage and courier service		1,480
Oct. 14	Entrance fees	40,000		Sept. 8	Lighting	12,250	
Nov. 9	Subscription	35,000		Sept. 13	Telephone exp.		2,830
2026 Jan.10	Subscription (2026 -2027)	10,000		Oct. 1	Wages and salaries	20,000	12,000
Feb. 07	Subscription	25,000		Oct. 18	Printing and stationary	13,000	
Mar. 28	Interest on Fixed Deposit	18,000		Nov. 30	Fixed Deposit	1,00,000	
				Dec. 31	Wages and Salaries	32,000	
				2026 Jan. 10	Postage charges		240
				Feb. 2	Telephone expenses		2,960
				Feb. 10	Postage and Courier fees		850
				Mar. 15	Lighting	14,000	
				Mar. 27	Wages and Salaries	32,000	
				Mar. 31	Balance c/d	1,70,000	5,400
		5,51,000	62,000			5,51,000	62,000

Illustration 2: (ICSI)

From the following particulars relating to Sports Point, prepare a Receipt and Payment account for the year ending March 31, 2026.

Particulars	Amt. ₹	Particulars	Amt. ₹
Opening cash balance		Sale of old sports materials	22,000
Opening bank balance		Donation received for pavilion	1,46,000
Subscriptions collected for:		Rent paid	30,000
2024-25 5,000	90,000	Sports materials purchases	48,000

2025-26 76,000 2026-27 9,000		Purchase of refreshments	16,000
		Expenses - maintenance of ground	20,000
Sale of refreshments	20,000	Salary paid	55,000
Entrance fees received	10,000	Tournament expenses	24,000
		Furniture purchased	15,000
		Office expenses	12,000
		Closing cash in hand	4,000

Illustration 3 (ICSI)

From the following Receipts and Payments Account for the year ending March 31, 2026 of Senior Citizen Club, prepare Income and Expenditure Account for the same period

Receipt and Payment Account for the year ending March 31, 2026

Expenditure	Amount ₹	Income	Amount ₹
Balance c/d (Cash & Bank)	2,61,500	Purchase of furniture (1.7.25)	50,000
Subscriptions		Salaries	1,20,000
2024-25 25,000		Telephone expenses	3,000
2025-26 2,00,000		Electricity charges	16,000
2026-27 15,000	2,40,000	Postage and Stationery	11,500
Donation	20,000	Purchase of books	25,000
Hall rent	33,000	Entertainment expenses	9,000
Interest on bank deposits	14,500	Purchase of 8% government papers (1.7.25)	80,000
Entrance fees	10,000	Miscellaneous expenses	16,000
		Balance c/d:	
		Cash	3,000
		Bank	2,45,500
	5,79,000		5,79,000

The following additional information is available:

(i) Salaries outstanding — Rs. 15000;
(ii) Entertainment expenses outstanding — Rs. 5000;
(iii) Bank interest receivable — Rs. 4500;
(iv) Subscriptions accrued — Rs. 14000;
(v) 50 per cent of entrance fees is to be capitalised;
(vi) Furniture is to be depreciated at 10 per cent per annum

Extra Practice Questions:

Question 1:

The following information of M/s. Rose Club is related for year ended 31st March, 2020:

1.

Balances	As on 01-04-2019 (₹)	As on 31-3-2020 (₹)
Stock of Sports Material	2,25,000	3,37,500
Amount due for Sports Material	2,02,500	2,92,500
Subscription due	33,750	49,500
Subscription received in advance	27,000	15,750

2. Subscription received during the year ₹ 11,25,000
3. Payments for Sports Material during the year ₹ 6,75,000

You are required to ascertain the amount of Subscription and Sports Material that will appear in Income & Expenditure Account for the year ended 31.03.2020.

Question 2:

From the following data, prepare an Income and Expenditure Account for the year ended 31st December 2020, and Balance Sheet as at that date of New Max Hospital:

Receipts and Payments Account

For the year ended 31 December, 2020

RECEIPTS	Rs.	PAYMENTS	Rs.
To Balance b/d Cash 400 Bank 2,600	3,000	By Salaries: (Rs. 3,600 for 2019)	15,600
To Subscriptions:		By Hospital Equipment	8,500
For 2019	2,550	By Furniture purchased	3,000
For 2020	12,250	By Additions to Building	25,000
For 2021	1,200	By Printing and Stationery	1,200
To Government Grant:		By Diet expenses	7,800
For building	40,000	By Rent & rates (Rs. 150 for 2021)	1,000
For maintenance	10,000	By Electricity & water charges	1,200
Fees from sundry Patients	2,400	By Office expenses	1,000
To Donations (not to be capitalized)	4,000	By Investments	10,000
Net collections from Benefit shows	3,000	By Balances: Cash 700 Bank 3,400	4,100
	78,400		78,400

Additional information :

Value of building under construction as on 31.12.2020	Rs.
Value of hospital equipment on 31.12.2020	70,000
Building Fund as on 1.1. 2020	25,500
Subscriptions in arrears as on 31.12.2019	40,000
Investments in 8% Govt. securities were made on 1st July, 2020.	3,250

Ans.:

New Max Hospital
Income & Expenditure Account
For the year ended 31 December, 2020

Expenditure	(Rs.)	Income	(Rs.)
To Salaries	12,000	By Subscriptions	12,250
To Diet expenses	7,800	By Govt. Grants-Maintenance	10,000
To Rent & Rates	850	By Fees Sundry Patients	2,400
To Printing & Stationery	1,200	By Donations	4,000
To Electricity & Water-charges	1,200	By Benefit shows (net collections)	3,000
To Office expenses	1,000	By Interest on Investments	400
To Excess of Income over expenditure transferred to Capital Fund	8,000		
	32,050		32,050

Balance Sheet as at 31st Dec., 2020

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital Fund:			Building:		
Opening bal. Excess of	24,650		Opening balance	45,000	
Income Over Expenditure	8,000	32,650	Addition	25,000	70,000
Building Fund:			Hospital Equipment:		
Opening balance	40,000		Opening balance	17,000	
Add : Govt. Grant	40,000	80,000	Addition	8,500	25,500
Subscriptions received in advance		1,200	Furniture		3,000
			Investments		
			8% Govt. Securities		10,000
			Subscriptions receivable		700
			Accrued interest		400
			Prepaid expenses -Rent		150
			Cash at Bank		3,400
			Cash in hand		700
		1,13,850			1,13,850

Working Notes:

(1) Balance sheet as at 31st Dec., 2019

Liabilities	Rs.	Assets	Rs.
Capital Fund (Balancing Figure)	24,650	Building	45,000
Building Fund	40,000	Equipment	17,000
Creditors for Expenses :		Subscription Receivable	3,250
Salaries payable	3,600	Cash at Bank	2,600

		Cash in hand	400
	68,250		68,250

(2) Value of Building

Balance on 31st Dec. 2020	70,000
Paid during the year	(25,000)
Balance on 31st Dec. 2019	45,000

(3) Value of Equipment

Balance on 31st Dec. 2020	25,500
Paid during the year	(8,500)
Balance on 31st Dec. 2019	17,000

(4) Subscription due for 2019

Receivable on 31st Dec. 2019	3,250
Received in 2020	2,550
Still Receivable for 2019	700

Question 3:

From the following information supplied by New Punjabi Bagh Club, prepare Receipts and Payments account and Income and Expenditure Account for the year ended 31st March 2021.

	01.04.2020 (₹)	31.03.2021 (₹)
Outstanding subscription	70,000	1,00,000
Advance subscription	12,500	15,000
Outstanding salaries	7,500	9,000
Cash in Hand and at Bank	55,000	?
10% Investment	70,000	35,000
Furniture	14,000	7,000
Machinery	5,000	10,000
Sports goods	7,500	12,500

Subscription for the year amount to Rs. 1,50,000/-. Salaries paid Rs. 30,000. Face value of the Investment was Rs. 87,500, 50% of the Investment was sold at 80% of Face Value. Interest on investments was received Rs. 7,000. Furniture was sold for Rs. 4000 at the beginning of the year. Machinery and Sports Goods purchased and put to use at the last date of the year. Charge depreciation @ 15% p.a. on Machinery and Sports goods and @10% p.a. on Furniture.

Following Expenses were made during the year:

Sports Expenses: Rs. 25,000

Rent: Rs. 12,000 out of which Rs. 1,000 outstanding

Misc. Expenses: Rs. 2,500

Ans.:

Receipts and Payments Account for the year ended 31-03-2021

Receipts	Rs.	Payments	Rs.
To balance b/d Cash and bank	55,000	By Salaries	30,000
To Subscription received (W.N.1)	1,22,500	By Purchase of sports goods Rs. (12,500-7,500)	5,000
To Sale of investments (W.N.2)	35,000	By Purchase of machinery Rs. (10,000-5,000)	5,000
To Interest received on investment	7,000	By Sports expenses	25,000
To Sale of furniture	4,000	By Rent paid Rs. (12,000 -1,000)	11,000
		By Miscellaneous expenses	2,500
		By Balance c/d Cash and bank	1,45,000
	2,23,500		2,23,500

Income and Expenditure account for the year ended 31-03-2021

Expenditure	Rs.	Rs.	Income	Rs.	Rs.
To Salaries	30,000		By Subscription		1,50,000
Add: Outstanding for 2021	9,000		By Interest on Invest.		
	39,000		Received	7,000	
Less: Outstanding for 2020	(7,500)	31,500	Accrued (W.N.5)	1,750	8,750
To Sports expenses		25,000			
To Rent		12,000			
To Miscellaneous exp.		2,500			
To Loss on sale of furniture (W.N.3)		3,000			
To Depreciation (W.N.4)					
Furniture	700				
Machinery	750				
Sports goods	1,125	2,575			
To Surplus		82,175			
		1,58,750			1,58,750

Working Notes:

1. Calculation of Subscription received during the year 2020-21

	Rs.
Subscription due for 2020-21	1,50,000
Add: Outstanding of 2020	70,000
Less: Outstanding of 2021	(1,00,000)
Add: Subscription of 2021 received in advance	15,000

Less: Subscription of 2020 received in advance	(12,500)
	1,22,500

2. Calculation of Sale price and profit on sale of investment

   Face value of investment sold: Rs. 87,500 × 50% = Rs. 43,750

   Sales price: Rs. 43,750 × 80% = Rs. 35,000

   Cost price of investment sold: Rs. 70,000 × 50% = Rs. 35,000

   Profit/loss on sale of investment: Rs. 35,000 - Rs. 35,000 = NIL

3. Loss on sale of furniture

	Rs.
Value of furniture as on 01-04-2020	14,000
Value of furniture as on 31-03-2021	7,000
Value of furniture sold at the beginning of the year	7,000
Less: Sales price of furniture	(4,000)
Loss on sale of furniture	3,000

4. Depreciation

Furniture - Rs.7,000 × 10% =	700
Machinery - Rs.5,000 × 15% =	750
Sports goods - Rs.7,500 × 15% =	1,125

5. Interest accrued on investment

Face value of investment on 01-04-2020	87,500
Interest @ 10%	8,750
Less: Interest received during the year	(7,000)
Interest accrued during the year	1,750

Note: It is assumed that the sale of investment has taken place at the end of the year.

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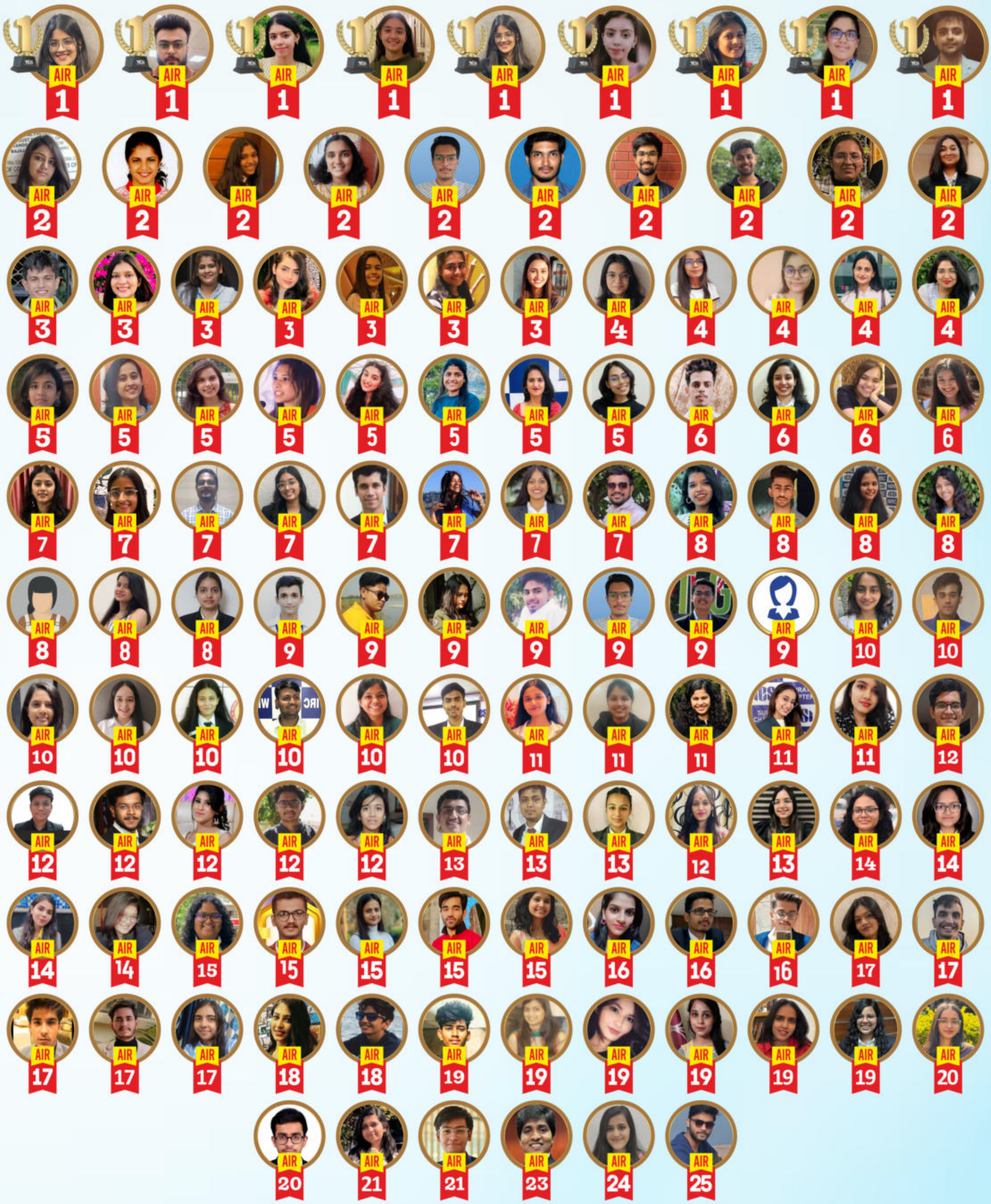

& many more

CA CS Harish A. Mathariya

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Harish Mathariya is a Chartered Accountant as well as a Company Secretary by profession. He specializes in extending services in the areas of Finance & Auditing. He is also a visiting faculty to the most reputed Management Institutes in & around Pune.

His core lies in routing accounts through the very basics, for which, he has been the most loved face for Accounts.

Having taught students for over 10 years, he is well known for taking Accounts in a very conceptual way.

To his credit, he as 100+ All India Rankers, which also includes AIR 1 twice.

His students acknowledge his simplification in Accounts as "Don't worry Bol Hari". He is a Founder of http://www.onlylectures.com and is also a Co-Founder of YES Academy, most loved academy for CS.