

Tulsian's

PRINCIPLES AND PRACTICE OF ACCOUNTING

WITH QUICK REVISION BOOK

for
CA Foundation Course
Third Edition

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CA Foundation Course

Third Edition

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Preface

We are thankful to the Readers and Teachers for their response and encouragement given to the Previous Editions. This edition is thoroughly revised and substantially expanded; all chapters have been updated and expanded.

Salient Features

The book adopts a fresh and novel approach to the study of Accountancy for the students of CA Foundation Course. It has been written in a teach yourself style strictly following a student-friendly approach, and is essentially meant to serve as a tutor at home. Among the important features of this book include:

PEDAGOGICAL FEATURES

Simple Language	The Text is presented in the simplest language "meant to serve beginners".
Heading for each Paragraph	Each paragraph has been arranged under a suitable heading for easy retention of concepts.
Tabular form	Wherever possible the text matter relating to a particular topic/sub-topic has been presented in a Tabular Form.
Eye-catching Screens	All important equations, formulae, figures and practical steps have been presented in screen format to catch the eye.
Uniform Format of Chapter	Each chapter has been uniformly organised under suitable headings, viz., Text Supported by Suitable Illustrations, Solved Problems.

DISTINCTIVE FEATURES

Important Distinctions	Over 50 distinctions have been provided for a better comparative study.
Exhibits	Over 75 exhibits to acquaint students with various accounting treatment and formats.
Illustrations	Over 500 Illustrations have been provided for a better understanding of the text.
Solved Problems	Over 250 solved problems along with necessary working notes and alternative solution have been provided throughout the text.

Tulsian's Quick Revision for Accountancy for CA-FOUNDATION COURSE

Section 1	Tulsian's Fully Solved Scanner for Theoretical Questions
Section 2	Tulsian's Fully Solved Scanner for Practical Questions
Section 3	Tulsian's Revision Test Paper
Section 4	Tulsian's Model Test Papers
Section 5	CA Foundation Examination Papers

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Any criticisms or suggestions for further improvement of the book will be gratefully acknowledged and appreciated.

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Syllabus

CA FOUNDATION COURSE SYLLABUS Paper 1: Principles and Practice of Accounting

Time 3 Hours

Marks-100

Objective:

To develop an understanding of the basic concepts and principles of Accounting and acquire the ability to apply the same in preparing financial statements, computing accounting ratios and simple problem solving.

S.No.	Contents	Relevant Chapter of the Book
1.	Theoretical Framework	
	(i) Meaning and Scope of accounting	1
	(ii) Accounting Concepts, Principles and Conventions	4
	(iii) Accounting terminology - Glossary	2
	(iv) Capital and revenue expenditure, Capital and revenue receipts, Contingent assets and contingent liabilities	3
	(v) Accounting Policies	5
	(vi) Accounting as a Measurement Discipline – Valuation Principles, Accounting Estimates.	6
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	(viii) Indian Accounting Standards – Concepts and Objectives.	7
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	Meaning of goods sent on approval or return basis and accounting treatment.	
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	Elements of financial statements, Closing, Adjustment Entries, Trading Account, Profit and Loss Account and Balance Sheet of Manufacturing and Non-manufacturing entities.	
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Tulsian's Quick Revision for PRINCIPLES AND PRACTICE OF ACCOUNTING for CA-FOUNDATION COURSE

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CA FOUNDATION Examination Papers

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1

MEANING AND SCOPE OF ACCOUNTING

INTRODUCTION

In all activities (whether business activities or non-business activities) and in all organisations (whether business organisations like a manufacturing entity or trading entity or non-business organisations like schools, colleges, hospitals, libraries, clubs, temples, political parties) which require money and other economic resources, accounting is required to account for these resources. In other words, wherever money/economic resource is involved, accounting is required to account for it. Accounting is often called the language of business. The basic function of any language is to serve as a means of communication. Accounting also serves this function.

1.0 MEANING OF ACCOUNTING

TRADITIONAL DEFINITION

"Accounting is an art of recording, classifying and summarising in a signified manner and in terms of money, transactions and events which are, in part at least of financial character, and interpreting the results thereof."

[American Institute of Certified Public Accountants (AICPA) (1941)]

MODERN DEFINITION

"Accounting is the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of information."

[American Accounting Association (AAA) (1966)]

ACTIVITIES COVERED UNDER ACCOUNTING

Accounting covers the following activities:

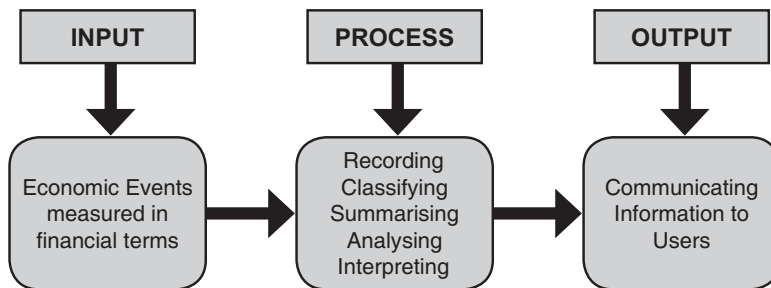
1. Identifying	2. Measuring
3. Recording	4. Classifying
5. Summarising	6. Analysing
7. Interpreting	8. Communicating

Let us discuss these activities one by one:

- 1. Identifying the Transactions and Events** — Accounting identifies transactions and events of a specific entity. A transaction is an exchange in which each participant receives or sacrifices value (e.g., purchase of raw material). An event (whether internal or external) is a happening of consequence to an entity (e.g., use of raw material for production). An entity means an economic unit that performs economic activities (e.g., TATA Steels, Birla Industries Ltd., Reliance Industries Ltd., Infosys, Bharti Airtel).
- 2. Measuring the Identified Transactions** — Accounting measures the transactions in terms of a common measurement unit, (that is the ruling currency of a country.)
- 3. Recording** — It is concerned with the recording of identified and measured financial transactions in an orderly manner, soon after their occurrence in the proper books of account.

4. **Classifying** — It is concerned with the classification of the recorded transactions so as to group the transactions of similar type at one place. This function is performed by maintaining the ledger in which different accounts are opened to which related transactions are brought to one place by posting. For example, all purchases of goods made for cash *or* on credit on different dates are brought to purchases account.
5. **Summarising** — It is concerned with the summarization of the classified transactions in a manner useful to the users. This function involves the preparation of Financial Statements such as Income Statement, Balance Sheet, Cash Flow Statement.
6. **Analysing** — It is concerned with the establishment of relationship between the various items *or* group of items taken from Income Statement *or* Balance Sheet *or* both. Its purpose is to identify the financial strengths and weaknesses of the enterprise. It provides the basis for interpretation.
7. **Interpreting** — It is concerned with explaining the meaning and significance of the relationship so established by the analysis. Nowadays, the first six functions are performed by electronic data processing devices and the accountant has to concentrate mainly on the interpretation aspects of accounting. The accountants should interpret the statements in a manner useful to the users, so as to enable the users to make reasoned decisions out of alternative courses of action. The accountant should explain not only what has happened but also (a) why it happened, and (b) what is likely to happen under specified conditions.
8. **Communicating** — It is concerned with the transmission of summarised, analysed and interpreted information to the users to enable them to make reasoned decisions.

Communication is preceded by an accounting cycle through which the identified and measured transactions and events pass. Accounting performs a basic function of a language, that is, to serve as a means of communication. It is an information system which communicates the accounting information to the users (whether internal *or* external) to enable them to make reasoned decisions. As an information system, accounting may be viewed as under:



Note: *Economic Event refers to the occurrence of economic consequence of an activity related to an accounting entity.*

2.0 MEANING OF ACCOUNTANCY

Accountancy refers to a systematic knowledge of accounting. It explains 'why to do' and 'how to do' of various aspects of accounting. It tells us why and how to prepare the books of accounts and how to summarize the accounting information and communicate it to the interested parties.

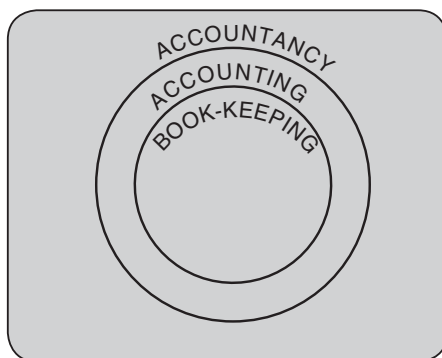
3.0 MEANING OF BOOK-KEEPING

Book-keeping is a part of accounting and is concerned with record keeping *or* maintenance of books of accounting which is often routine and clerical in nature. It only covers the following four activities:

1. Identifying the transactions and events
2. Measuring the identified transactions and events in a common measuring unit
3. Recording the identified and measured transactions and events in Proper Books of Accounts
4. Classifying the recorded transactions and events in the ledger

4.0 RELATIONSHIP BETWEEN ACCOUNTANCY, ACCOUNTING AND BOOK-KEEPING

Book-keeping is a part of Accounting. Accounting is a part of Accountancy. Diagrammatically, the relationship can be viewed as follows:



5.0 DISTINCTION BETWEEN BOOK-KEEPING AND ACCOUNTING

Book-keeping differs from accounting in the following respects:

Basis of Distinction	Book-keeping	Accounting
1. Scope	Book-keeping involves — (a) identifying the transactions, (b) measuring the identified transactions, (c) recording the measured transactions and (d) classifying the recorded transactions.	Accounting in addition to Book-keeping involves — summarizing the classified transactions, analysing the summarized results, interpreting the analysed results and communicating the interpreted information to the interested parties.
2. Stage	Book-keeping is primary stage.	Accounting is the secondary stage. It starts where book-keeping ends.
3. Basic Objective	The basic objective of book-keeping is to maintain systematic records of financial transactions.	The basic objective of accounting is to ascertain Financial Performance and Financial Position and to communicate information to the interested parties.
4. Who Performs	Book-keeping work is performed by junior staff .	Accounting work is performed by senior staff .
5. Knowledge Level	The book-keeper is not required to have higher level of knowledge than that of an accountant.	The accountant is required to have higher level of knowledge than that of book-keeper.

6. Analytical Skill	The book-keeper may or may not possess analytical skill.	An accountant is required to possess analytical skill.
7. Nature of Job	The job of a book-keeper is often routine and clerical in nature.	The job of an accountant is analytical in nature.
8. Designing of Accounting System	It does not cover designing of accounts system.	It covers designing of accounting system.
9. Supervision & Checking	The book-keeper does not supervise and check the work of an accountant.	An accountant supervises and checks the work of a book-keeper.

6.0 MEANING OF AN ACCOUNTING CYCLE

After identifying and measuring the financial transactions, the accounting cycle begins. An accounting cycle is a complete sequence beginning with the recording of the transactions and ending with the preparation of the final accounts. The sequential steps involved in an accounting cycle are given below:

SEQUENTIAL STEPS INVOLVED IN AN ACCOUNTING CYCLE

Step 1: JOURNALISING

Record the transactions in the Journal.

Step 2: POSTING

Transfer the transactions (recorded in the Journal), in the respective accounts opened in the Ledger.

Step 3: BALANCING

Ascertain the difference between the total of debit amount column and the total of credit amount column of a ledger account.

Step 4: TRIAL BALANCE

Prepare a list showing the balances of each and every account to verify whether the sum of the debit balances is equal to the sum of the credit balances.

Step 5: INCOME STATEMENT

Prepare Trading and Profit & Loss Account to ascertain the profit or loss for the accounting period.

Step 6: POSITION STATEMENT (i.e. Balance Sheet)

Prepare the Balance Sheet to ascertain the financial position as at the end of accounting period.

7.0 USERS OF ACCOUNTING INFORMATION AND THEIR NEEDS

The users of accounting information include present and potential investors, management, employees, lenders, suppliers and other trade creditors, customers, government and their agencies and the public. These users use accounting information in order to satisfy some of their varied needs for information.

Some of the users and their needs for information are shown below.

Users	Need for information
1. Short-term creditors [For example, Suppliers of Raw materials/Goods, Suppliers of Short-term Loans]	Short-term creditors need information to determine whether their dues will be paid when due and whether they should extend, maintain or restrict the flow of credit to an individual enterprise.

2. Long-term creditors [For example, Suppliers of Long-term Loans]	Long-term creditors need information to determine whether their principals and the interest thereof will be paid when due and whether they should extend, maintain <i>or</i> restrict the flow of credit to an enterprise.
3. Present investors [For Example, Shareholders]	Present investors need information to judge prospects for their investment and to determine whether they should buy, hold <i>or</i> sell the shares.
4. Potential Investors [For Example, those who want to invest]	Potential investors need information to judge prospects of an enterprise and to determine whether they should buy the shares.
5. Management	Management need information to review the firm's (a) Short-term Solvency, (b) Long-term Solvency, (c) Activity (viz., Effective Utilisation of its Resources), (d) Profitability in relation to turnover, (e) profitability in relation to Investments and to decide upon the course of action to be taken in future.
6. Employees	Employees and their representative groups are interested in information about the stability and profitability of the employers. They are also interested in information which enables them to assess the ability of the enterprise to pay remuneration, retirement benefits and to provide promotion opportunities.
7. Tax Authorities	Tax authorities need information to assess the tax liabilities of an enterprise.
8. Customers	Customers have an interest in information about the continuation of an enterprise, especially when they have established a long term involvement with, <i>or</i> are dependent on, the enterprise.
9. Government and their Agencies	Government and their agencies are interested in the allocation of resources and, therefore, the activities of enterprise. They also require information in order to regulate the activities of enterprise, determine taxation policies and as the basis the national income and similar statistics.
10. Public	Enterprises affect members of the public in a variety of ways. For example, enterprises may make a substantial contribution to the local economy in many ways including the number of people, they employ and their patronage of local suppliers. Financial Statements may assist the public by providing information about trends and recent developments in the prosperity of the enterprise and the range of its activities.

While all the information needs of these users cannot be met by financial statements, there are some needs which are common to all users. The information contents of the financial statements which met information needs of the investors *or* providers of risk capital will also meet most of the needs of other users.

8.0 PRIMARY OBJECTIVES OF ACCOUNTING

The main objectives of accounting are as follows:

- 1. To maintain Systematic Accounting Records** — Written records are always better than oral records, since written records can be used by different persons for different decision-making purposes and serve as evidence of transactions. Nowadays, the volume of transactions is so large, a human memory cannot absorb each and every transaction. Accounting is done to keep a systematic record of (i) Financial Transactions, (ii) Assets and (iii) Liabilities.

2. **To ascertain the Financial Performance** — To measure the financial performance of an enterprise, the results of operations are ascertained by preparing an Income Statement (also called Profit & Loss Account) which shows the matching of current costs with current revenues during a particular accounting period. A systematic record of Incomes and Expenses facilitates the preparation of the Income Statement.
3. **To ascertain the Financial Position** — To evaluate the financial strengths and weakness of an enterprise, the financial position is ascertained by preparing a Position Statement (also called Balance Sheet) which shows resources (assets) owned by an enterprise and the sources of financing those resources. A businessman wants to know what the business owes to others and what it owns, and what happened to his capital whether the capital has increased, decreased or remained constant. A systematic record of various assets and liabilities facilitates the preparation of a Position Statement (also known as Balance Sheet) which answers all these questions.
4. **To communicate the information to the users** — Accounting communicates information to internal users and external users. The internal users include all the organizational participants at all levels of management (i.e. top, middle and lower). Top level management requires information for planning, middle level management requires information for controlling the operations. For internal use, the information is usually provided in the form of reports, for instance Cash Budget Reports, Production Reports, Idle Time Reports, Feedback Reports, Whether to Retain or Replace an Equipment Decision Reports, Project Appraisal Reports, and the like.

Since the external users (e.g. Banks, Creditors) do not have direct access to all the records of an enterprise, they have to rely on financial statements as the source of information. External users are basically interested in the solvency and profitability of an enterprise.

9.0 ADVANTAGES OF ACCOUNTING

1. **Facilitates to Replace Memory** — Accounting facilitates to replace human memory by maintaining complete record of financial transactions. Human memory is limited by its very nature. Accounting helps to overcome this limitation.
2. **Facilitates to comply with Legal Requirements** — Accounting facilitates to comply with legal requirements which require an enterprise to maintain books of accounts. For example, Sec 209 of The Companies Act, 1956, requires a company to maintain proper books of accounts on accrual basis, Sec 44AA of The Income Tax Act 1961 requires certain persons to maintain specified books of accounts.
3. **Facilitates to ascertain Financial Performance** — Accounting facilitates to ascertain Financial Performance by preparing Income Statement.
4. **Facilitates to ascertain Financial Position** — Accounting facilitates to ascertain financial position by preparing Position Statement.
5. **Facilitates the users to take Decisions** — Accounting facilitates the users (i.e. Short-term Creditors, Long-term Creditors, Present Investors, Potential Investors, Employee Groups, Management, General Public, Tax Authorities) to take decisions by communicating accounting information to them.
6. **Facilitates a Comparative Study** — Accounting facilitates a comparative study in the following four ways:
 - (i) Comparison of actual figures with standard or budgeted figures for the same period and the same firm;
 - (ii) Comparison of actual figures of one period with those of another period for the same firm (i.e., Intra-firm Comparison);

- (iii) Comparison of actual figures of one firm with those of another standard firm belonging to the same industry (i.e., Inter-firm Comparison); and
 - (iv) Comparison of actual figures of one firm with those of industry to which the firm belong (i.e., Pattern Comparison)
7. **Assists the Management** — Accounting assists the management in planning and controlling business activities and in taking decisions. For example, Projected Cash Flow Statement facilitates the management to know future receipts and payments and to take decision regarding anticipated surplus or shortage of funds.
 8. **Facilitates Control over Assets** — Accounting facilitates control over assets by providing information regarding Cash Balance, Bank Balance, Debtors, Fixed Assets, Stock etc.
 9. **Facilitates the Settlement of Tax Liability** — Accounting facilitates the settlement of tax liability with the authorities by maintaining proper books of accounts in systematic manner.
 10. **Facilitates the Ascertainment of Value of Business** — Accounting facilitates the ascertainment of value of business in case of transfer of business to another entity.
 11. **Facilitates Raising Loans** — Accounting facilitates raising loans from lenders by providing them historical and projected financial statements.
 12. **Acts as Legal Evidence** — Proper books of accounts maintained in systematic manner act as legal evidence in case of disputes.

10.0 LIMITATIONS OF ACCOUNTING

1. **Ignores the Qualitative Elements** — Since the accounting is confined to the monetary matters only, the qualitative elements like quality of management, quality of labour force, public relations are ignored.
2. **Not Free from Bias** — In many situations, the accountant has to make a choice out of various alternatives available, eg., choice in the method of depreciation (e.g., Straight Line or Written down), choice in the method of inventory valuation (e.g., FIFO, LIFO etc.). Since the subjectivity is inherent in personal judgement, the financial statements are therefore not free from bias. As a result, the analysis of financial statements also cannot be said to be free from bias.
3. **Ignores the Price Level Changes in case of Financial Statements Prepared on Historical Costs** — In case of financial statements prepared on historical costs, the Fixed Assets are shown in the Balance Sheet at historical costs less depreciation and not at the replacement value which is often far higher than the value stated in the Balance Sheet. The analysis of such financial statements will not yield strictly comparable results unless the price-level changes are taken into account.
4. **Estimated Position and not Real Position** — Since the financial statements are prepared on a going concern basis as against liquidation basis, they report only the estimated periodic results and not the true results since the true results can be ascertained only on the liquidation of an enterprise.
5. **Danger of Window Dressing** — When the management decides to enter wrong figures to artificially inflate or deflate the figure of Profits, Assets and Liabilities, the Income Statement fails to provide true and fair view of the Financial Performance and Balance Sheet fails to provide true and fair view of the Financial Position of the enterprise.

11.0 BRANCHES OF ACCOUNTING

Financial Accounting	Financial Accounting is the process of identifying, measuring and communicating accounting information to permit informed judgements and decisions by the users of accounting

Cost Accounting	It is the process of accounting and controlling the cost of a product, operation or function.
Management Accounting	It is the application of accounting techniques for providing information for the purpose of planning, controlling and decision making.
Social Responsibility Accounting	It is the process of identifying, measuring and communicating the social effects of business decisions to permit informed judgements and decisions by the users of information.
Human Resource Accounting	It is the process of identifying, measuring and communicating the investments made in human resources of an enterprise to permit informed judgements and decisions by the users of accounting.

12.0 QUALITATIVE CHARACTERISTICS

The qualitative characteristics are attributes that improve the usefulness of information provided in financial statements. The framework suggests that the financial statements should observe and maintain the following four qualitative characteristics as far as possible within limits of reasonable cost/benefit.

1. Understandability	The financial statements should present information in a manner as to be readily understandable by the users with reasonable knowledge of business and economic activities. It is not right to think that more one discloses better it is. A mass of irrelevant information creates confusion and can be even more harmful than non-disclosure. No relevant information can be however withheld on the grounds of complexity.
2. Relevance	The financial statements should contain relevant information only. Information, which is likely to influence the economic decisions by the users, is said to be relevant. Such information may help the users to evaluate past, present or future events or may help in confirming or correcting past evaluations. The relevance of a piece of information should be judged by its materiality. A piece of information is said to be material if its omission or misstatement can influence economic decisions of a user.
3. Reliability	To be useful, the information must be reliable; that is to say, they must be free from material error and bias. The information provided are not likely to be reliable unless: (a) Transactions and events reported are faithfully represented. (b) Transactions and events are reported in terms of their substance and economic reality not merely on the basis of their legal form. This principle is called the principle of 'substance over form'. (c) The reporting of transactions and events are neutral, i.e. free from bias. (d) Prudence is exercised in reporting uncertain outcome of transactions or events.
4. Comparability	Comparison of financial statements is one of the most frequently used and most effective tools of financial analysis. The financial statements should permit both inter-firm and intra-firm comparison. One essential requirement of comparability is disclosure of financial effect of change in accounting policies.
5. True and Fair View	Financial statements are required to show a true and fair view of the performance, financial position and cash flows of an enterprise. The conceptual framework does not deal directly with this concept of true and fair view, yet the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements portraying true and fair view of information about an enterprise.

2

ACCOUNTING TERMINOLOGY

1.0 ENTITY

An entity means an economic unit that performs economic activities (**For example**, TATA Steel, Birla Industries, Reliance Industries, Infosys, Bharti Airtel).

2.0 EVENT

An event is a happening of consequence to an entity (**For example**, Use of Raw Materials for Production).

3.0 BUSINESS TRANSACTION

A Business transaction is an exchange in which each participant receives *or* sacrifices value (**For example**, Purchase of Raw Material for cash *or* on credit). It involves exchange of goods *or* services on cash *or* credit basis. It is an economic event that relates to a business entity involving transfer of money *or* money's worth.

4.0 ACCOUNT

An account is a summary of relevant transactions at one place relating to a particular head. It records not only the amount of transaction but also their effect and direction.

5.0 ASSETS

Assets refer to tangible objects *or* intangible rights of an enterprise which carry probable future benefits. In other words, 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. These assets may broadly be classified as follows:

1. **Current Assets** — Current assets are those assets which are held:—

- (i) in the form of cash, *or*
- (ii) for their conversion into cash, *either* within the Operating Cycle Period *or* within the 12 Months Period from the date of Balance Sheet, *or*
- (iii) for their consumption in the production of goods *or* rendering of services in the normal course of business.

For example, 1. Current Investments, 2. Inventories, 3. Trade Receivables, 4. Cash and Cash Equivalents, 5. Short-term Loans and Advances, 6. Other Current Assets

Liquid Assets (or Quick Assets) – Liquid Assets represent the Current Assets other than Stock and Prepaid Expenses.

Liquid Assets = Current Assets – Inventories & Prepaid Expenses

2. **Non-Current Assets** — Non-Current Assets refer to those assets which are held for the purposes of producing *or* providing goods *or* services and those that are not held for resale in the normal course of business. **For example**, 1. Fixed Assets, 2. Non-Current Investments 3. Long-Term Loans and Advances, 4. Other Non-Current Assets

Fixed assets may be classified as follows:

- (i) **Tangible Fixed Assets** — Refer to those fixed assets which have physical existence. **For example**, Land and Building, Plant and Machinery and Furniture and Fixtures.
- (ii) **Intangible Fixed Assets** — Refer to those fixed assets which do not have physical existence. **For example**, Goodwill, Patent, Trademarks, Copyrights and the like.
3. **Fictitious Assets:** Fictitious Assets *either* represent Accumulated Losses *or* Deferred Revenue Expenses not yet written off till the date of Balance Sheet.

HOW TO DETERMINE WHETHER AN ASSET IS A CURRENT ASSET OR FIXED ASSET?

An asset is classified either as a Current Asset *or* as a Fixed Asset on the basis of the purpose for which an asset is held in the hands of user.

EXAMPLE

The following table summarises the circumstances when a particular asset is treated as Current in one case and Fixed in another case:

Asset	When treated as Current Asset	When treated as Fixed Asset
1. Land	In case of Land Developers & Property Dealers.	In case of other persons.
2. Buildings	In case of Builders & Property Dealers.	In case of other persons.
3. Furniture	In case of Furniture Manufacturers and Furniture Dealers.	In case of other persons.
4. Motor Vehicles	In case of Motor Vehicles Manufacturers and Dealers.	In case of other persons.
5. Shares & Debentures	In case of Dealer in Securities.	In case of other persons.
6. Plant & Machinery	In case of Plant & Machinery Manufacturers and Dealers.	In case of other persons.

6.0 LIABILITIES

Liabilities refer to the financial obligations of an enterprise other than owner's funds. Liabilities may be broadly classified as follows:

I. LIABILITIES ON THE BASIS OF PERIOD

1. **Current Liabilities** — Current liabilities refer to those liabilities which are expected to be settled either within the Operating Cycle Period *or* within the 12 Months Period from the date of the Balance Sheet.
For example, 1. Short-Term Borrowings, 2. Trade Payables, 3. Other Current Liabilities, 4. Short-Term Provisions.
2. **Non-Current Liabilities** — Non-Current Liabilities refer to those liabilities which are expected to be settled after 12 months from the date of Balance Sheet *or* after Operating Cycle which ever is latter. **For example**, 1. Long-term Borrowings, 2. Other Long term Liabilities, 3. Long-term Provisions.

II. LIABILITIES ON THE BASIS OF SOURCE

1. **Internal Liabilities:** Internal Liabilities refers to the financial obligations of an enterprise towards owners.
2. **External Liabilities:** External Liabilities refer to the financial obligations of an enterprise towards outsiders.

7.0 CAPITAL

Capital refers to the amount invested in an enterprise by the proprietor (*in case of proprietorship*) or partners (*in case of a partnership concern*). This amount is increased by the amount of profits earned and amount of additional capital introduced and is decreased by the amount of losses incurred and the amount withdrawn (*whether in the form of cash or kind*). It represents the owner's claim on the assets of the enterprise. It is also known as Owner's Equity or Net Assets or Net Worth.

Since the liability holders have a definite and prior claim against the assets, the capital is also called a residual of assets over liabilities and may be expressed as follows:

$$\text{Capital} = \text{Assets} - \text{Liabilities}$$

Thus, Capital is the excess of Assets over External Liabilities.

8.0 DRAWINGS

The term 'Drawings' refer to the total amount of cash or goods or any other asset withdrawn by the proprietor (in case of a proprietorship enterprise) or partner (in case of a partnership enterprise) for personal use. **For example**, If Cash of ₹ 10,000 and Goods costing ₹ 5,000 are withdrawn by a proprietor, ₹ 15,000 is called as the amount of drawings.

9.0 GOODS

Goods refer to the items in which the enterprise deals in. **For example**, Cars purchased by a Car Dealer, Tables & Chairs purchased by a Furniture Dealer.

10.0 PURCHASES

The term 'Purchases' refers to the total amount of goods obtained by an enterprise for resale or for use in the production of goods or rendering of services in the normal course of business. The purchases may be for cash or on credit.

For example, in case 100 units are purchased @ ₹ 2 per unit for cash, ₹ 200 is called as the amount of cash purchase. In case 200 units are purchased @ ₹ 3 per unit from Ram on credit, ₹ 600 is called as the amount of credit purchase.

11.0 PURCHASES RETURNS

The term 'Purchase Returns' refers to the total amount of goods returned by an enterprise to the Supplier. **For example**, in case 50 units (Purchased @ ₹ 3 per unit) are returned to Ram, ₹ 150 is called as the amount of purchase returns.

12.0 SALES

The term 'Sales' refers to the amount for which the goods are sold or services are rendered. The sales may be for cash or on credit. **For example**, in case 60 units are sold @ ₹ 5 per unit for cash, ₹ 300 is called as the amount of cash sales in case 120 units are sold @ ₹ 6 per unit to Shyam on credit, ₹ 720 is called as the amount of credit sales.

13.0 SALES RETURNS

The term 'Sales Returns' refers to the total amount of goods returned by a customer to the enterprise. **For example**, in case 50 units (Sold @ ₹ 6 per unit) are returned by Shyam (customer), ₹ 300 is called as the amount of sales returns.

14.0 STOCK (OR INVENTORY OR MERCHANDISE)

The term 'Stock' refers to tangible property held for sale in the ordinary course of business *or* for consumption in the production of goods *or* services for sale. It includes Stock of Raw Materials, Semi-Finished goods and Finished Goods. **For example**, in case 40 units out of 100 units (purchased @ ₹ 2 per unit) remained unsold, ₹ 80 is called as the **Cost of Stock**. The stock may be Opening Stock *or* **Closing Stock**. Opening Stock means the unsold goods at the beginning of the Current Accounting Period. Closing Stock means the Unsold Goods at the end of the Current Accounting Period.

15.0 TRADE RECEIVABLES

The term 'Trade Receivables' include Trade Debtors and Bills Receivables.

1. TRADE DEBTORS

The term 'Trade Debtor' refers to the person from whom the amounts are due for goods sold *or* services rendered on credit basis. **For example**, in case 60 units are sold to Mr X @ ₹ 5 per unit on credit, Mr X is a Trade Debtor of the business.

2. BILLS RECEIVABLES

A bill of exchange is an unconditional order in writing given by the creditor to the debtor to pay on demand *or* at a fixed *or* determinable future time, a certain sum of money to *or* to the order of a specified person *or* to the bearer. This bill of exchange is known as Bills Receivable for the creditor.

16.0 TRADE PAYABLES

The term 'Trade Payables' include Trade Creditors and Bills Payables.

1. TRADE CREDITORS

The term 'Trade Creditor' refers to the person to whom the amounts are due for goods purchased *or* services rendered on credit basis. **For example**, in case 100 units are purchased @ ₹ 2 per unit from Mr Y on credit, Mr Y is a Trade Creditor of the business.

2. BILLS PAYABLES

The Bill of Exchange is known as Bills Payable for the Debtors.

17.0 CAPITAL EXPENDITURE

1. Meaning	It is an expenditure which is incurred: (a) to acquire <i>or</i> bring into existence an asset, <i>or</i> (b) to acquire <i>or</i> bring into existence an advantage <i>or</i> benefit of an enduring nature, <i>or</i> (c) to increase the productivity <i>or</i> earning capacity.
2. Benefits	It normally yields benefits beyond current accounting period.
3. Accounting Treatment	It is debited to the Respective Asset Account which appears on the Assets side of the Balance Sheet.
4. Examples	(a) Cost of Land and Building (b) Cost of Plant and Machinery (c) Cost of Furniture and Fixtures

18.0 REVENUE EXPENDITURE

1. Meaning	It is an expenditure which is incurred: (a) to maintain the productivity <i>or</i> earning capacity of a business. (b) to carry out operating activities in the normal course of business.
2. Benefits	It normally does not yield benefits beyond current accounting period.
3. Accounting Treatment	It is debited to Respective Expense Account which appears on the debit side of Trading A/c (If Direct Expense) <i>or</i> P&L A/c (If Indirect Expense).
4. Examples	(a) Depreciation on Land & Building (b) Rent of Machines (c) Repairs of Building (d) Insurance of Building

19.0 DEFERRED REVENUE EXPENDITURE

1. Meaning	According to the Guidance note on 'Terms used in Financial Statements', issued by ICAI 'Deferred revenue expenditure is the expenditure for which payment has been made <i>or</i> a liability has been incurred but which is carried forward on the presumption that it will be of benefit over a subsequent period <i>or</i> periods'. In short, it refers to that expenditure which is, for the time being, deferred from being charged to income. Such suspension of 'charging off' operation may be due to the nature of expenses and the benefit expected therefrom.
2. Example	Heavy advertising to launch a new product is a deferred revenue expenditure since the benefit from it will be availed over the next 3 to 5 years.
3. Accounting Treatment	Normally such expenditure should be written off over a period of 3 to 5 years. The written off portion is debited to P&L Account and unwritten off portion is shown on the Assets Side of Balance Sheet.

20.0 CAPITAL RECEIPTS

1. Meaning	Capital receipts refer to those receipts which are not revenue in nature.
2. Accounting Treatment	These are credited to the respective account of capital nature.
3. Examples	(a) Sale of Land and Building by a person other than a dealer in real estate. (b) Raising of Loan by a person other than one engaged in the business of finance/banking. (c) Raising of Capital.

21.0 REVENUE RECEIPTS

1. Meaning	Revenue receipts refer to those receipts which arise in the normal course of business.
2. Accounting Treatment	These are credited to Respective Revenue Account which appears in the Income Statement.
3. Examples	(a) Sale of Land and Building by a dealer in real estate. (b) Sale of Securities by a dealer in securities

22.0 EXPENSES

Expenses are decrease in economic benefits during an accounting period in the form of (a) Outflow or Depletion of Assets or (b) Incurrence of Liabilities, that result in decrease in internal equity other than those relating to distribution to Equity Participants.

Example I: Purchase of Goods for Cash involves outflow of Cash.

Example II: Purchase of Goods on Credit involves increase in Creditors.

Example III: Discount Allowed to Customers involves decrease in Assets.

23.0 INCOME

Income is increase in economic benefits during an accounting period in the form of (a) Inflow of Assets, or (b) Decrease of Liabilities, that result in increase in internal equity other than those relating to Investment by Equity Participants.

Note: Equity Participants means —

- (a) Proprietor in case of sole proprietorship
- (b) Partners in case of a partnership firm
- (c) Shareholders in case of a company

Example I: Trading Commission received involves inflow of Cash.

Example II: Discount Received from Creditors involves decrease in Creditors.

24.0 NET PROFIT

Net Profit means the excess of Revenue & Gains Over its related Expenses & Losses during an accounting period. It increases Owners' Equity.

$$\text{Net Profit} = (\text{Revenue \& Gain}) - (\text{Expenses \& Loss})$$

25.0 GAINS

Gains are increases in equity (i.e., Net Assets) from incidental transaction of an entity and from all other transactions and other events and circumstances affecting the entity during the accounting period except those that result from revenues or investment by equity participants. These gains may be operating or non-operating.

Example I: Profit on sale of marketable securities is usually considered as operating gain.

Example II: Profit on sale of a fixed asset is usually considered as non-operating gain.

Example III: Increase in Equity due to Profit on sale of goods is not considered as Gain because it is due to Revenue.

Example IV: Increase in Equity due to increase in Capital is not gain because it is due to increase in Capital.

26.0 LOSSES

Losses are decreases in equity (i.e., Net Assets) from incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity during the accounting period except those result from expenses or distribution to equity participants. These losses may be operating or non-operating.

Example I: Loss or Sale of marketable securities, losses on writing down inventory from Cost to Market Value, writing off Bad Debts are considered as operating losses.

Example II: Loss on Sale of a Fixed Asset, Losses from disposal of segments of enterprises, Losses on Foreign Currency Devaluations are usually considered as Non-Operating Losses.

27.0 DISCOUNT

Discount is an incentive to promote Sales (i.e. Trade Discount) or prompt payment by the debtors (i.e. Cash Discount).

1. TRADE DISCOUNT

Trade Discount is a reduction granted by a supplier from the list price of goods or services on business considerations (such as quantity bought, trade practices, etc.,) other than for prompt payment.

Example — If 10 Gold Rings are sold at the list price of ₹ 50,000 each subject to trade discount of 10%. In this case trade discount will be calculated as given on below:

10 Gold Rings @ ₹ 50,000	₹ 5,00,000
Less: Trade Discount @ 10%	₹ 50,000
Amount Payable as per Invoice	₹ 4,50,000

2. CASH DISCOUNT

Cash Discount is a reduction granted by a supplier from the invoice price in consideration of immediate payment or payment within a stipulated period.

Example — If in the above example, terms of payable are 2%, 30 Days, it means buyer will get 2% cash discount if he makes payment within 30 days. In case the purchaser makes the payment within 30 days, the cash discount will be calculated as under:

Amount Payable as per Invoice	₹ 4,50,000
Cash Discount @ 2%	₹ 9,000
Cash paid within 30 days	₹ 4,41,000

28.0 COST

The term 'Cost' may be defined as noun or as a verb as follows:

- (a) **As a noun** — The amount of expenditure (actual or notional) incurred on a specified thing or activity.
- (b) **As a verb** — To ascertain the cost of specified thing or activity.

ICA, India defines Cost as "*measurement, in monetary terms, of the amount of resource used for the purpose of production of goods or rendering services*"

The work 'Cost' can rarely stand on its own and should be qualified as to its limitation (e.g., historical, variable, fixed etc.) and should be related to a particular thing or activity (e.g., a given quantity or unit of produced or services performed).

29.0 VOUCHER

Voucher is a documentary evidence in support of a business transaction. **For example**, in case of Cash Purchases, Cash memos and in case of Credit Purchases, Purchase Invoices are Vouchers. The vouchers act as source documents on the basis of which transactions are recorded in the books of accounts.

30.0 REVENUE

The term 'revenue' refers to the amount charged for the goods sold or services rendered, or permitting others to use enterprise's resources yielding Interest, Royalty, and Dividend. **For example**, Sales, Commission earned, Interest earned, Royalty earned, Dividend earned.

31.0 ACCRUAL BASIS OF ACCOUNTING

1. Accrual Basis of Accounting is a method of recording transactions by which Revenue, Costs, Assets and Liabilities are recognised during the accounting period in which they accrue.
2. This basis includes consideration relating to deferrals, allocations, depreciation and amortisation.
3. This basis is also known as **Mercantile** basis of accounting.
4. Under the Companies Act 2013, all companies are required to maintain the books of accounts according to accrual basis of accounting.

32.0 CASH BASIS OF ACCOUNTING

Cash Basis of Accounting is a method of recording transactions by which Revenues, Costs, Assets and Liabilities are recognised during the accounting period in which Actual Receipts and Actual Payments take place.

33.0 HYBRID BASIS OF ACCOUNTING

It is a combination of both Cash Basis of Accounting and Accrual Basis of Accounting. Under the hybrid basis of accounting, Incomes are recorded on Cash basis (i.e., during the accounting period in which they are received irrespective of when they accrue) and Expenses are recorded on Accrual Basis, (i.e., during the accounting period in which they arise irrespective of when they are paid).

34.0 DISTINCTION BETWEEN ACCRUAL BASIS OF ACCOUNTING AND CASH BASIS OF ACCOUNTING

Accrual basis of accounting differs from Cash basis of accounting in the following respects:

Basis of Distinction	Accrual Basis of Accounting	Cash Basis of Accounting
1. Prepaid/Outstanding Expenses/accrued/unaccrued Income in Balance Sheet	Under this, there may be Prepaid/Outstanding Expenses and Accrued/Unaccrued Incomes in the Balance Sheet.	Under this, there is no Prepaid/Outstanding Expenses or Accrued/Unaccrued Incomes.
2. Higher/lower Income in case of Prepaid Expenses and Accrued Income	Income Statement will show a relatively higher income.	Income Statement will show lower income.
3. Higher/Lower Income in case of outstanding expenses and Unaccrued Income	Income Statement will show a relatively lower income.	Income Statement will show higher Income.
4. Recognition under the Companies Act, 2013	This basis is recognised under the Companies Act, 2013.	This basis is not recognised under the Companies Act, 2013.
5. Availability of options to an accountant to manipulate the accounts by way of choosing the most suitable method out of several alternative methods of accounting e.g. FIFO/LIFO/SLM/WDV	Under this, an accountant has options .	Under this an accountant has no option to make a choice as such.

ILLUSTRATION 1

PRARTHANA PESTISIDES supplies you the following information about his incomes and expenses for the financial year 2017–2018:

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Expenses paid	75,000	Income received	2,03,000
Expenses paid in advance	38,000	Income received in advance	25,000
Expenses not yet paid	23,000	Income earned but not received	22,000
Loans taken	1,00,000	Loans given	20,000

Compute the Net Income on: (i) Cash basis, (ii) Accrual basis, (iii) Hybrid basis.

SOLUTION**COMPUTATION OF INCOME**

<i>Particulars</i>	<i>On Cash basis ₹</i>	<i>On Accrual basis ₹</i>	<i>On Hybrid basis ₹</i>
A. Total Revenue:			
(a) Income received	2,03,000	2,03,000	2,03,000
(b) Income received in advance	—	(25,000)	—
(c) Income not yet received	—	22,000	—
	2,03,000	2,00,000	2,03,000
B. Total Expenditure:			
(a) Expenses paid	75,000	75,000	75,000
(b) Expenses paid in advance	—	(38,000)	(38,000)
(c) Expenses not yet paid	—	23,000	23,000
	75,000	60,000	60,000
C. Income for the year	1,28,000	1,40,000	1,43,000

Note: Loans taken and Loan given are not considered while calculating Income because these represent Capital Receipts and Capital Payments respectively.

ILLUSTRATION 2

TULSIAN Cloth Agency provides you the following information for the year 2017–2018:

Cash sales	₹ 1,00,000	
Credit sales	₹ 9,00,000	(out of which ₹ 8,00,000 collected)
Cash purchases	₹ 80,000	
Credit purchases	₹ 6,50,000	(out of which ₹ 6,00,000 paid)
Expenses paid	₹ 75,000	
Expenses paid in advance	₹ 38,000	
Outstanding expenses	₹ 23,000	
Closing stock at end	Nil	

Compute the Net Income on: (i) Cash basis, (ii) Accrual basis, (iii) Hybrid basis.

SOLUTION

COMPUTATION OF INCOME FOR THE YEAR 2017-2018

<i>Particulars</i>	<i>On Cash basis ₹</i>	<i>On Accrual basis ₹</i>	<i>On Hybrid basis ₹</i>
A. Total Revenue:			
(a) Cash sales	1,00,000	1,00,000	1,00,000
(b) Credit sales			
(i) Collected	8,00,000	8,00,000	8,00,000
(ii) Outstanding	—	1,00,000	—
Total Revenue	9,00,000	10,00,000	9,00,000
B. Total Expenditure:			
(a) Cash purchases	80,000	80,000	80,000
(b) Credit purchases			
(i) Paid	6,00,000	6,00,000	6,00,000
(ii) Outstanding	—	50,000	50,000
(c) Expenses			
(i) Paid	75,000	75,000	75,000
(ii) Paid in advance	—	(38,000)	(38,000)
(iii) Outstanding	—	23,000	23,000
	7,55,000	7,90,000	7,90,000
C. Income	1,45,000	2,10,000	1,10,000

3

CAPITAL AND REVENUE EXPENDITURE AND RECEIPTS

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning, Accounting Treatment and Disclosure of Capital Expenditure
- ◇ Meaning, Accounting Treatment and Disclosure of Revenue Expenditure
- ◇ Distinction between Capital Expenditure and Revenue Expenditure
- ◇ Meaning, Accounting Treatment and Disclosure of Deferred Revenue Expenditure
- ◇ Meaning, Accounting Treatment and Disclosure of Capital Receipts
- ◇ Meaning, Accounting Treatment and Disclosure of Revenue Receipts
- ◇ Distinction between Capital Receipts and Revenue Receipts

1.0 CLASSIFICATION OF CAPITAL AND REVENUE

The Going Concern Assumption allows the accountant to classify the expenditure and receipts as Capital expenditure, Revenue expenditure, Deferred Revenue expenditure, Capital Receipts, Revenue Receipts.

2.0 CLASSIFICATION OF EXPENDITURE

An expenditure may be classified as follows:

CAPITAL EXPENDITURE

1. Meaning	It is an expenditure which is incurred: (a) to acquire <i>or</i> bring into existence an asset, or (b) to acquire <i>or</i> bring into existence an advantage <i>or</i> benefit of an enduring nature, or (c) to increase the productivity <i>or</i> earning capacity.			
2. Benefits	It normally yields benefits beyond current accounting period.			
3. Accounting Treatment	It is debited to the Respective Asset Account which appears on the Assets side of the Balance Sheet.			
4. Examples	(a) Cost of Land and Building (b) Cost of Plant and Machinery (c) Cost of Furniture and Fixtures			
5. Disclosure in Financial Statements	BALANCE SHEET AS AT			
	<i>Liabilities</i>	₹	<i>Assets</i>	₹
			Capital Expenditure	

REVENUE EXPENDITURE

1. Meaning	It is an expenditure which is incurred: (a) to maintain the productivity or earning capacity of a business. (b) to carry out operating activities in the normal course of business.		
2. Benefits	It normally does not yield benefits beyond current accounting period.		
3. Accounting Treatment	It is debited to Respective Expense Account which appears on the debit side of Trading A/c (If Direct Expense) or P&L A/c (If Indirect Expense).		
4. Examples	(a) Depreciation on Land & Building (b) Rent of Machines (c) Repairs of Building (d) Insurance of Building		
5. Disclosure in Financial Statements			
Dr. INCOME STATEMENT FOR THE PERIOD ENDED ON.... Cr.			
<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Revenue Expenditure	....		

3.0 DISTINCTION BETWEEN CAPITAL EXPENDITURE AND REVENUE EXPENDITURE

Basis of Distinction	Capital Expenditure	Revenue Expenditure
1. Meaning	It is an expenditure which is incurred: (a) to acquire <i>or</i> bring into existence an asset, <i>or</i> (b) to acquire <i>or</i> bring into existence an advantage <i>or</i> benefit of an enduring nature, <i>or</i> (c) to increase the productivity <i>or</i> earning capacity.	It is an expenditure which is incurred: (a) to maintain the productivity <i>or</i> earning capacity of a business, <i>or</i> (b) to carry out operating activities in the normal course of business.
2. Benefits	It normally yields benefits during current accounting period.	It normally does not yield benefits during current accounting period.
3. Accounting Treatment	It is debited to the Respective Asset Account.	It is debited to Respective Expense Account.
4. Examples	(a) Cost of Land and Building (b) Cost of Plant and Machinery (c) Cost of Furniture & Fixtures	(a) Depreciation on Land and Building (b) Rent of Machines (c) Repairs of Building (d) Insurance of Building

DEFERRED REVENUE EXPENDITURE

1. Meaning	According to the Guidance note on 'Terms used in Financial Statements', issued by ICAI 'Deferred revenue expenditure is the expenditure for which payment has been made <i>or</i> a liability has been incurred but which is carried forward on the presumption that it will be of benefit over a subsequent period <i>or</i> periods'. In short, it refers to that expenditure which is, for the time being, deferred from being charged to income. Such suspension of 'charging off' operation may be due to the nature of expenses and the benefit expected therefrom.
2. Examples	Heavy advertising to launch a new product is a deferred revenue expenditure since the benefit from it will be availed over the next 3 to 5 years.
3. Accounting Treatment	Normally such expenditure should be written off over a period of 3 to 5 years. The written off portion is debited to P&L Account and unwritten off portion is shown on the Assets Side of Balance Sheet.

5. Disclosure in Financial Statements

<i>Dr.</i> INCOME STATEMENT FOR THE PERIOD ENDED ON.... <i>Cr.</i>			
Particulars	₹	Particulars	₹
To Deferred Revenue Expenditure w/o	....		
BALANCE SHEET AS AT			
Liabilities	₹	Assets	₹
		Deferred Revenue Expenditure (Unwritten off portion)	....

4.0 CLASSIFICATION OF SOME EXPENDITURES WITH REASONS

S.N.	Item of Expenditure	Nature of Expenditure	Reason for Classification
1.	Expenses on a Foreign Tour to purchase a machinery	Capital	These are incurred to acquire a capital asset.
2.	Cost of Machinery Purchased	Capital	These are incurred to acquire a capital asset
3.	Insurance & Freight on Machinery purchased	Capital	These are incurred to acquire a capital asset
4.	Custom Duty on Imported Machinery	Capital	These are incurred to acquire a capital asset
5.	Wages for erection of Machinery	Capital	These are incurred to put the Capital Asset to use.
6.	Installation Charges of a Machinery Purchased	Capital	These are incurred to put the capital asset to use.
7.	Expenses incurred on Trial Run before the asset is put to use	Capital	These are incurred before the commencement of commercial production.
8.	Cost of a Second hand Machinery Purchased	Capital	These are incurred to acquire a capital asset

3.4 Principles and Practice of Accounting for CA Foundation Course

9.	Repair of a second hand machinery before put to use	Capital	These are incurred to put the capital asset to use.
10.	Interest on a term loan for the purchase of machinery. The commercial production has not begun till the last day of the accounting year.	Capital	These are incurred to acquire capital asset & the commercial production has not yet begun.
11.	Interest on a term-loan for the purchase of machinery. The commercial production has already begun.	Revenue	The commercial production has already begun.
12.	Repairs of Machine after the machine is put to use	Revenue	These are incurred to maintain the capital asset.
13.	Amount spent for replacement of worn out part of machine	Revenue	These are incurred to maintain the capital asset.
14.	Annual Maintenance fee of a machine	Revenue	These are incurred to maintain the capital asset.
15.	Money spent to reduce working expenses	Capital	These are incurred to acquire long term benefits.
16.	Amount spent for replacement of a petrol driven engine by CNG Kits	Capital	These are incurred to reduce the operating costs and thereby increasing the profit.
17.	Cost of Rings & Pistons of an engine changed to get fuel efficiency	Capital	These are incurred to reduce the operating costs and thereby increasing the profit.
18.	Overhauling expenses for the engine of a motor car to get better fuel efficiency	Capital	These are incurred to reduce the operating costs and thereby increasing the profit.
19.	Legal expenses to acquire a building	Capital	These are incurred to acquire ownership right of the capital asset.
20.	Legal Expenses to defend a suit claiming that firm's factory site belongs to plaintiff	Revenue	These are incurred to maintain the capital asset.
21.	Amount spent on repainting an old building for the first time on purchase	Capital	These are incurred to put the capital asset to use.
22.	Amount spent on annual repainting of building	Revenue	These are incurred to maintain the capital asset.
23.	Expenses to obtain a license for starting a factory	Capital	These are incurred to acquire the right to carry on business.
24.	Annual Renewal fee of licence for next year	Revenue Prepaid Expenses	These are incurred to maintain the capital asset. (i.e. right to carry on business).
25.	Amount spent for the construction of temporary huts for storing building material while constructing a building	Capital	These are incurred for the construction of building and hence to be capitalised with the cost of building.

26.	Deposit with Mahanagar Telephone Nigam Ltd. for installing telephone	Capital	The amount is adjusted over a period of time against telephone bills.
27.	Expenses for removal of stock to a new site	Revenue	Such expenditure is <i>neither</i> bringing enduring benefit <i>nor</i> enhancing the value of capital asset.
28.	Fines Imposed	Revenue	Such expenditure is <i>neither</i> bringing enduring benefit <i>nor</i> enhancing the value of capital asset.
29.	Annual Fire Insurance ₹ 12,000 paid on 1st January 2006 during accounting year ending on 31.3.2006	Revenue	₹ 3,000 as current year's revenue expenses ₹ 9,000 as prepaid expenses for next year.
30.	Inauguration Expenses on opening of a new branch of an existing business Free gift to customers Or Tournament Sponsoring Exp. Or Advertisement compaign to lunch a new product.	Revenue	Such expenditure is not enhancing value of capital asset. Since it has an enduring effect on the future revenue generating capability of business, it may be treated as deferred revenue expenses
31.	Compensation for breach of contract	Revenue	Such expenditure is <i>neither</i> bringing enduring benefit <i>nor</i> enhancing the value of capital asset.
32.	Compensation paid to workers under Voluntary Retirement Scheme (VRS)	Revenue	Such expenditure is not enhancing value of capital asset. Having regared to the large amount, it may be better to treat it as deferred revenue expenditure which may be w/o over future years.
33.	Amount spent on demolition of Building to construct a bigger building on the same site.	Capital	These are incurred for the construction of a new building.
34.	Loss on Sale of Machine	Revenue Loss	Such expenditure is <i>neither</i> bringing enduring benefit <i>nor</i> enhancing the value of capital asset.
35.	Legal Expenses to recover dues from customers	Revenue	These are incurred to maintain present revenue generating capability
36.	Festival Advance to employees	Not on Exp.	It is an item of loan & advances
37.	Advance to Suppliers of Goods	Not an exp.	It is an item of loan & advances.
38.	Cost of Improvement in Electric Wiring System	Capital	This is incurred to acquire capital asset.
39.	Purchase of a Patent Right	Capital	This is incurred to acquire capital asset.
40.	Purchase of a Goodwill	Capital	This is incurred to acquire capital asset.
41.	Purchase of a Technical Know how	Capital	This is incurred to acquire capital asset.

42.	Purchase of a Live Stock by a Farmer	Capital	This is incurred to acquire capital asset.
43.	Amount spent on Neon Sign Board at airport	Capital	This is incurred to acquire capital asset.
44.	Import Duty on purchase of Materials	Revenue	This is incurred on operating activities in the normal course of business.
45.	Compensation paid to employees who were retrenched	Revenue	Such expenditure is <i>neither</i> bringing enduring benefit <i>nor</i> enhancing the value of capital asset.
46.	Imported Goods confiscated by custom authorities	Revenue Loss	Such expenditure is <i>neither</i> bringing enduring benefit <i>nor</i> enhancing the value of capital asset.

ILLUSTRATION

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

- Expenses on a foreign tour for purchasing a new machinery.
- Freight & insurance on the new machinery.
- Customs duty paid on import of a machinery.
- Cartage paid to bring the new machines to factory.
- Wages paid in connection with the erection of new machinery.
- ₹ 1,000 spent on repairing a second hand machine before put to use.
- ₹ 2,000 spent to remove a worn out part and replace it with a new engine.
- A petrol driven engine of a passenger bus was replaced by a diesel engine.
- ₹ 8,00,000 spent on advertising the introduction of a new product in the market, the benefit of which will be effective for 3 to 5 years.
- ₹ 5,000 spent on repainting the factory.
- Heavy amount spent on research for a particular product which ultimately did not result in success.
- Repair ₹ 2,000 necessitated by negligence of an operator of machine.
- ₹ 10,000 paid as compensation to employees who were retrenched.
- Interest on a term loan for the purchase of machinery. The commercial production has not begun till the last day of the accounting year.
- Interest on a term loan for the purchase of machinery. The commercial production has already begun.
- Compensation paid for breach of contract to acquire stock-in-trade.
- ₹ 30,000 spent as lawyer's fee to defend a suit that firm's factory belonged to the plaintiff. The suit was not successful.

SOLUTION

- Items referred to in (a) to (f) represent capital expenditure since these expenditures are incurred up to the point the machine is ready for use.
- It should be treated as revenue expenditure since it is incurred to keep the asset in working order. Such expenditure has *neither* resulted in increasing the life *or* efficiency of an existing asset *nor* in bringing into existence a new asset and as such cannot be treated as capital expenditure.

- (h) Such expenditure should be treated as capital expenditure since it will increase the profit capacity of the business through lowering of costs.
- (i) Such expenses should be treated as a deferred revenue expenditure and should be written-off each year over a period of 3 to 5 years.
- (j) Such expenses should be treated as a revenue expenditure since it is incurred to maintain the factory in good condition.
- (k) Such expenses should be treated as revenue expenditure as per AS 26.
- (l) Such expenses should be treated as revenue expenditure since it is incurred to keep the asset in working order.
- (m) Such expenses should be treated as revenue expenditure since it is *neither* bringing the benefit of enduring nature *nor* enhancing the value of any asset.
- (n) Such expenditure should be treated as capital expenditure since the commercial production has not begun till the last day of the accounting year.,
- (o) Such expenditure should be treated as revenue expenditure since the commercial production has already begun.
- (p) Such expenditure should be treated as revenue since it is *neither* bringing the benefit of enduring nature *nor* enhancing the value of any asset.
- (q) Such expenditure should be treated as revenue expenditure since it is incurred for the upkeep of fixed asset.

5.0 CLASSIFICATION OF RECEIPTS

The receipts may be classified as follows:

CAPITAL RECEIPTS

1. Meaning	Capital receipts refer to those receipts which are not revenue in nature.
2. Accounting Treatment	These are credited to the respective account of capital nature.
3. Examples	(a) Sale of Land and Building by a person other than a dealer in real estate. (b) Raising of Loan by a person other than one engaged in the business of finance/banking. (c) Raising of Capital.

REVENUE RECEIPTS

1. Meaning	Revenue receipts refer to those receipts which arise in the normal course of business.
2. Accounting Treatment	These are credited to Respective Revenue Account which appears in the Income Statement.
3. Examples	(a) Sale of Land and Building by a dealer in real estate. (b) Sale of Securities by a dealer in securities

6.0 DISTINCTION BETWEEN CAPITAL RECEIPTS AND REVENUE RECEIPTS

Basis of Distinction	Capital Receipts	Revenue Receipts
1. Meaning	Capital receipts refer to those receipts which are not revenue in nature.	Revenue receipts refer to those receipts which arise in the normal course of business.
2. Accounting Treatment	These are credited to the respective account of capital nature.	These are credited to Respective Revenue Account which appears in the Income Statement.
3. Examples	(a) Sale of Land and Building by a person other than a dealer in real estate. (b) Raising of Loan by a person other than one engaged in the business of finance/banking. (c) Raising of Capital.	(a) Sale of Land and Building by a dealer in real estate. (b) Sale of Securities by a dealer in securities

7.0 CLASSIFICATION OF SOME RECEIPTS WITH REASONS

S.N.	Item of Receipt	Nature of Receipt	Reason for Classification
1.	Sale of Plant & Machinery	Capital	It is arising from investing activities and not from operating activities in the normal course of business.
2.	Sale of Investments	Capital	It is arising from investing activities and not from operating activities in the normal course of business.
3.	Capital introduced	Capital	It is arising from financing activities and not from operating activities in the normal course of business.
4.	Loans raised	Capital	It is arising from financing activities and not from operating activities in the normal course of business.
5.	Interest received on Investment	Revenue	It is arising from operating activities in the normal course of business.
6.	Interest accrued on Investment	Revenue	It is arising from operating activities in the normal course of business.
7.	Cash received from Debtors	Revenue	It is arising from operating activities in the normal course of business.
8.	B/R collected	Revenue	It is arising from operating activities in the normal course of business.
9.	Sale of Goods for cash	Revenue	It is arising from operating activities in the normal course of business.
10.	Sale of Goods on Credit	Revenue	It is arising from operating activities in the normal course of business.
11.	Insurance claim for stock damaged by fire	Revenue	It is arising from operating activities in the normal course of business.

12.	Insurance claim for machinery damaged by fire	Capital	It is arising from investing activities and not from operating activities in the normal course of business.
13.	Subsidy received from Govt. for plot of land	Capital	It is arising from investing activities and not from operating activities in the normal course of business.
14.	General subsidy received	Revenue	It is not for the purchase of from Govt. any capital asset.
15.	Bad Debt Recovered	Revenue	It is arising from operating activities in the normal course of business.
16.	Scrap Value of Machinery	Capital	It is arising from investing activities and not from operating activities in the normal course of business.
17.	Premium received on issue of Shares	Capital	It is arising from financing activities and not from operating activities in the normal course of business.

8.0 CONTINGENT ASSET

MEANING OF CONTINGENT ASSET

According to Accounting Standard 29, "a contingent asset is a possible asset that arises from past events 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. It usually arises from unplanned or unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise."

EXAMPLE OF CONTINGENT LIABILITY

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

NO RECOGNITION IN FINANCIAL STATEMENTS

As per the concept of prudence as well as the present accounting standards, an enterprise should not recognize a contingent asset. It is possible that recognition of contingent assets may result in recognition of income that may never be realized. However, when the realisation of income is virtually certain, then the related asset no longer remains as contingent asset.

NO DISCLOSURE OF 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 (i.e., Board of Directors in the case of a company, and the corresponding approving authority in the case of any other enterprise), if an inflow of economic benefits is probable.

WHEN RECOGNISED

Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

9.0 CONTINGENT LIABILITIES

MEANING OF CONTINGENT LIABILITY

According to Accounting Standard 29, 'Contingent liability' is

- (a) a possible obligation that arises from past events 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
- (b) 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.

Where

- **Possible Obligation** - An obligation is a possible obligation if, based on the evidence available, its existence at the balance sheet date is considered not probable.
- **Present Obligation** - An obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

NO RECOGNITION OF CONTINGENT LIABILITY

An enterprise should not recognise a contingent liability.

DISCLOSURE OF CONTINGENT LIABILITY BY WAY OF NOTE TO THE BALANCE SHEET

A Contingent liability is required to be disclosed by way of Note to the Balance Sheet unless possibility of outflow of a resource embodying economic benefits is remote.

WHEN RECOGNISED

Contingent 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.

10.0 DISTINCTION BETWEEN CONTINGENT LIABILITY AND OTHER LIABILITIES

Basis of Distinction	Contingent Liability	Other Liabilities
1. Meaning	It is an obligation which may or may not arise depending on the happening or non-happening of an uncertain future event.	These are financial obligations of an enterprise other than owners' equity.
2. Disclosure	It is disclosed by way of foot note to the Balance Sheet.	These are disclosed on the liabilities side of the Balance Sheet.
3. Example	1. Bills discounted but not yet matured 2. Arrears of dividend on Cum-Pref-Shares	1. Creditors for Goods 2. Outstanding Expenses

11.0 PROVISION**MEANING OF PROVISION**

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.”

As per AS 29, A provision is a liability which can be measured only by using a substantial degree of estimation.

CONDITIONS FOR RECOGNITION OF PROVISION

A provision should be recognised when:

- (a) An enterprise has a present obligation as a result of a past event.
- (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and
- (c) a reliable estimate can be made of the amount of the obligation.

11.0 DISTINCTION BETWEEN PROVISION AND CONTINGENT LIABILITY

Basis of Distinction	Provision	Contingent Liability
1. Meaning	Provision is a present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation..	It is an obligation which may or may not arise depending on the happening or non-happening of an uncertain future event.
2. Recognition criteria	A provision meets the recognition criteria.	A contingent liability fails to meet the same.
3. Conditions for Recognition	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.

EXAMPLE TO UNDERSTAND THE DISTINCTION BETWEEN PROVISIONS AND CONTINGENT LIABILITIES.

The GST officer imposes a penalty on X Ltd. for violation of a provision in the GST Act. The company files 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.

12.0 TABLE SHOWING THE TREATMENT OF PRESENT/POSSIBLE OBLIGATION UNDER VARIOUS SITUATIONS

Situation	Present Obligation	Possible Obligation
1. Probable outflow and Reliable estimate	Recognise as 'Provision'	Disclose as 'Contingent Liability'
2. Probable outflow and No Reliable estimate	Disclose as 'Contingent Liability'	Disclose as 'Contingent Liability'
3. No Probable outflow and No Reliable estimate	Disclose as 'Contingent Liability'	Do Nothing

4

ACCOUNTING PRINCIPLES

1.0 FUNDAMENTAL ACCOUNTING ASSUMPTIONS

As per Accounting Standard (AS-1) 'Disclosure of Accounting Policies' issued by Institute of Chartered Accountants of India (ICAI), there are three Fundamental Accounting Assumptions:

1. **Going Concern** 2. **Consistency** 3. **Accrual**

DISCLOSURE REQUIREMENTS

1. If all the Fundamental Accounting Assumptions are followed in financial statements, specific disclosure is not required.
2. If any fundamental accounting assumption is not followed, the fact should be disclosed.

2.0 GOING CONCERN ASSUMPTION

MEANING OF GOING CONCERN ASSUMPTION

1. The enterprise is normally viewed as a going concern, i.e. as continuing operations for the foreseeable future.
2. It is assumed that the enterprise has *neither* the intention *nor* the necessity of liquidation *or* curtailing materially its scale of operations.
3. If an enterprise is not a going concern, valuation of its assets and liabilities on historical cost becomes irrelevant and as a consequence its profit/loss may not give reliable information.

IMPLICATIONS OF GOING CONCERN ASSUMPTION

It is because of the Going Concern Assumption:

1. that the assets are classified as Current Assets and Fixed Assets.
2. that the liabilities are classified as Short-term Liabilities and Long-term liabilities.
3. that the unused resources are shown as unutilised costs (or unexpired costs) as against the break-up values as in case of liquidating enterprise. Accordingly, the earning power and not the break-up value evaluates the continuing enterprise.

DISCLOSURE OF GOING CONCERN ASSUMPTION

According to Accounting Standard (1) issued by the Institute of Chartered Accountants of India, if this fundamental assumption is followed, this fact need not be disclosed in the financial statements since its acceptance and use are assumed. In case this concept is not followed, the fact should be disclosed in the financial statement together with reasons.

3.0 CONSISTENCY ASSUMPTION

MEANING OF CONSISTENCY ASSUMPTION

1. It is assumed that accounting policies are consistent from one period to another.
2. This adds the virtue of comparability to accounting data.

3. If comparability is lost, the relevance of accounting data for users' judgement and decision making is gone.
4. According to Consistency Assumption, whatever accounting practices (whether logical or not) are selected for a given category of transactions, they should be followed on a horizontal basis from one accounting period to another to achieve comparability.

NEED FOR CONSISTENCY ASSUMPTION

The consistency principle is applied when alternative methods of accounting are equally acceptable.

EXAMPLES OF CONSISTENCY ASSUMPTION

1. If the inventory is valued on LIFO basis, this basis should be followed year after year.
2. If a particular asset is depreciated according to WDV method, this method should be followed year after year.

EFFECT OF NOT OBSERVING CONSISTENCY

If Consistency Assumption is not followed, the intra-firm comparison (i.e., comparison of actual figures of one period with those of another period for the same firm), Inter-firm comparison (i.e. comparison of actual figures of one firm with those of another firm belonging to the same industry) and Pattern comparison (i.e., comparison of actual figures of one firm with those of industry to which the firm belongs) cannot be made.

CONSISTENCY DIFFERS FROM UNIFORMITY

The consistency should not be confused with mere uniformity or inflexibility and should not be allowed to become an impediment to the introduction of improved accounting standards. It is not appropriate for an enterprise to leave its accounting policies unchanged when more relevant and reliable alternatives exist.

4.0 ACCRUAL ASSUMPTION

MEANING OF ACCRUAL ASSUMPTION

1. Revenues and Costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate.
2. This assumption is the core of accrual accounting system.
3. For companies it is mandatory to keep accounts on accrual basis under the Companies Act, 2013.

MEANING OF REVENUE

Revenue is the gross inflow of cash, receivables or other considerations arising in the course of ordinary activities of an enterprise from the sale of goods, rendering of services and use of enterprise resources by others yielding interests, royalties and dividends. It excludes the amount collected on behalf of third parties such as certain taxes. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other considerations.

5.0 ACCOUNTING PRINCIPLES

1. Basic Principles of Accounting are essentially, the general decision rules which govern the development of accounting techniques. These principles guide how transactions should be recorded and reported.
2. Generally Accepted Accounting Principles may be defined as those rules of action or conduct which are derived from experience and practice and when they prove useful, they become accepted as principles of accounting.
3. According to the American Institute of Certified Public Accountants (AICPA), the principles which have substantial authoritative support become the part of the Generally Accepted Accounting Principles (GAAP).

6.0 ACCOUNTING ENTITY (OR BUSINESS ENTITY PRINCIPLE)**MEANING OF ACCOUNTING ENTITY PRINCIPLE**

According to Accounting Entity Principle, a business is treated as a separate entity that is distinct from its owner(s), and all other accounting entities and hence a distinction should be made between (i) personal transactions and business transactions, and (ii) transactions of one business entity and those of another business entity. For example, in case of a proprietary concern, though the legal entity of the business and its proprietor is the same, for the purpose of accounting, they are to be treated as separate from each other.

EFFECT OF ACCOUNTING ENTITY PRINCIPLE

If this Principle is not followed, true financial position and true financial performance of a business entity cannot be ascertained. For example, if the household expenses (₹ 10,000) of a proprietor are shown as business expenses, the profits of a business will be understated to the extent of ₹ 10,000.

7.0 MONEY MEASUREMENT PRINCIPLE**MEANING OF MONEY MEASUREMENT PRINCIPLE**

According to Money Measurement Principle, only those transactions which are capable of being expressed in terms of money are included in the accounting records.

WHAT IS NOT RECORDED?

The information which cannot be expressed in terms of money is not included in accounting records. For example, if the Sales Director is not on speaking terms with the Production Director, the enterprise is bound to suffer. Since, monetary measurement of this information is not possible, this fact is not recorded in accounting records.

ADVANTAGE OF MONEY MEASUREMENT PRINCIPLE

By expressing all transactions in terms of money, the different transactions expressed in different units are brought to a common unit of measurement (i.e., Money).

LIMITATIONS OF MONEY MEASUREMENT PRINCIPLE

Besides ignoring the non-monetary facts or attributes, this assumption also ignores the changes in the purchasing power of the monetary unit. In other words, this assumption treats all rupees alike, whether it is a rupee of 1950 or 2013. Hence, nowadays, it is considered to provide additional data showing the effect of price level changes on the reported Income, Assets and Liabilities of the business.

8.0 ACCOUNTING PERIOD PRINCIPLE (PERIODICITY PRINCIPLE)**MEANING OF ACCOUNTING PERIOD PRINCIPLE**

It is also known as Periodicity Principle or Time Period Principle. According to this principle, the economic life of an enterprise is artificially split into periodic intervals which are known as accounting periods, at the end of which an Income Statement and Position Statement are prepared to ascertain the Financial Performance and position respectively.

IMPLICATION OF ACCOUNTING PERIOD PRINCIPLE

The use of this assumption further requires the allocation of expenses between capital and revenue. That portion of capital expenditure which is consumed during the current period is charged as an expense to Income Statement and the unconsumed portion is shown in the Balance Sheet as an asset for future consumption.

ESTIMATE AND NOT ACTUAL INCOME

Truly speaking, measuring the income following the concept of accounting period is more an estimate than factual since, actual income can be determined only on the liquidation of the enterprise.

REPORTING PERIOD

It may be noted that the custom of using twelve month period is applied only for external reporting. For internal reporting, accounts can be prepared even for shorter periods, say monthly, quarterly or half yearly.

9.0 FULL DISCLOSURE PRINCIPLE

MEANING OF FULL DISCLOSURE PRINCIPLE

1. According to Full Disclosure Principle, the Financial Statements should act as means of conveying and not concealing.
2. The financial statements must disclose all the relevant and reliable information which they purport to represent, so that the information may be useful for the users.
3. For this, it is necessary that the information is accounted for and presented in accordance with its substance and economic reality and not merely with its legal form.

EXAMPLE OF FULL DISCLOSURE PRINCIPLE

The practice of appending Notes to the Financial Statements has developed as a result of the Full Disclosure Principle.

QUALITY OF FULL DISCLOSURE PRINCIPLE

The disclosure should be full, fair and adequate so that the users of the Financial Statements can make correct assessment about the financial performance and position of the enterprise.

10.0 MATERIALITY PRINCIPLE

MEANING OF MATERIALITY PRINCIPLE

1. According to the Materiality Principle, all relatively relevant items, the knowledge of which might influence the decision of the users of the financial statements, should be disclosed in the financial statements.
2. Which information is more relevant than others is largely a matter of judgement. For instance, accounting and recording of a small calculator as an asset in the balance sheet may not be justified due to the excess of cost of recording over the benefits in terms of usefulness of recording and the accounting of calculators as assets.

WHAT IS MATERIALITY?

1. The materiality depends not only upon the amount of item but also upon the size of business, level and nature of information, level of the person/department who makes the judgement about materiality, for instance a worker reporting to his foreman about the production in grams (e.g. part of kilogram), a foreman to his supervisor in kilograms, a supervisor to his production manager in quintals and the production manager to the top management in tonnes, may be justified with regard to the circumstances. It hardly makes any difference if the production manager reports to the top management that the production is 1,99,000.90 kilograms or simply 200 tonnes (nearly).
2. It is desirable to establish and follow uniform policies governing material or non-material items so that while measuring income for an accounting period, the non-material items can be ignored on uniform basis.

EXCEPTION TO THE FULL DISCLOSURE PRINCIPLE

1. This Principle is basically an exception to the Full Disclosure Principle.
2. The full disclosure principle requires that all facts necessary to ensure that the financial statements are not misleading, must be disclosed, whereas the materiality principle requires that the items *or* events having an insignificant economic effect *or* not being relevant to the user's need not be disclosed.

11.0 PRUDENCE PRINCIPLE (OR CONSERVATISM PRINCIPLE)

MEANING OF PRUDENCE PRINCIPLE

1. According to Prudence Principle, the principle of '**Anticipate no profit but provide for all probable losses**' should be applied.
2. In other words, the Prudence Principle requires that in the situation of uncertainty and doubt, the business transactions should be recorded in such a manner that the Profits and Assets are not overstated and the Losses and Liabilities are not understated.

Note: *Prudence Principle should be applied rationally only in circumstances in which great uncertainty and doubt exists as the over-conservatism may result in misrepresentation.*

EXAMPLES OF APPLICATIONS OF PRUDENCE PRINCIPLE

1. Valuation of Stock-in-trade at a lower of Cost or Net Realisable Value.
2. Making the Provisions for Doubtful Debts and Discount on Debtors.

CONFLICTS WITH CONSISTENCY

When the Stock is valued at Cost in one accounting period and at a lower of Cost or Net Realisable Value in another accounting period, this Principle conflicts with the Principle of Consistency.

CONFLICTS WITH FULL DISCLOSURE

When excessive Provisions for Doubtful Debts and Depreciation are charged, it leads to the creation of Secret Reserves, and thus, this Principle conflicts with the Full Disclosure Principle.

CONFLICTS WITH OBJECTIVITY

1. The estimation of probable losses is a subjective judgment and thus, this principle conflicts with the Principle of Objectivity.
2. The practice of making provisions for doubtful debts and the like implies lesser charges in the following accounting periods.
3. It reduces the current income and raises the future income and thus it conflicts with the matching principle.

12.0 HISTORICAL COST PRINCIPLE

MEANING OF HISTORICAL COST PRINCIPLE

According to Historical Cost Principle, an asset is ordinarily recorded in the accounting records at the price paid to acquire it at the time of its acquisition and the cost becomes the basis for the accounts during the period of acquisition and subsequent accounting periods.

Accordingly, if nothing is paid to acquire an asset; the same will not be usually recorded as an asset, e.g. a favourable location and increasing reputation of the concern will remain unrecorded though these are valuable assets.

ADVANTAGE OF HISTORICAL COST PRINCIPLE

1. The justification for the use of the cost concept lies in the fact that it is objectively verifiable.
2. This does not mean that the asset will always be shown at cost.
3. The cost of an asset is systematically reduced from year to year by charging depreciation and the asset is shown in the Balance Sheet at Book Value (i.e. Cost less Depreciation).
4. It may be noted that the purpose of depreciation is to allocate the cost of an asset over its useful life and not to adjust its cost so as to bring it close to the market value.

13.0 MATCHING PRINCIPLE

MEANING OF MATCHING PRINCIPLE

1. According to Matching Principle, the expenses incurred in an accounting period should be matched with the revenues recognised in that period. It means that, if revenue is recognised on all goods sold during a period, cost of those goods sold should also be charged to that period. It is wrong to recognise revenue on all sales, but charge expenses only on such sales as are collected in cash till that period.
2. This concept is basically an accrual concept since, it disregards the timing and the amount of actual cash inflow or cash outflow and concentrates on the occurrence (i.e. accrual) of revenue and expenses. This concept calls for adjustment to be made in respect of Prepaid Expenses, Outstanding Expenses, Accrued Revenue and Unaccrued Revenues.
3. Matching does not mean that expenses must be identifiable with revenues. Expenses charged to a period may or may not be related to the revenue recognised in that period, for example, cost of goods sold and commission to salesmen are directly related to sales whereas rent, interest, depreciation accruing with the passage of time and stock lost by fire are not directly related to sales revenue, yet they are charged to the accounting period to which they relate. Thus, appropriate costs have to be matched against the appropriate revenues for the accounting period.

14.0 DUALITY PRINCIPLE

MEANING OF DUALITY PRINCIPLE

1. Two fold aspect of a transaction is called dual aspect or duality of a transaction. This duality is the basis of double entry records.
2. As the name implies, the entry made for each transaction is composed of two parts—one for debit and another for credit.
3. The double entry system may be compared with the Newton's law of motion, viz, to every action there is always an equal and contrary reaction. Every debit has equal amount of credit. So the total of all debits must be equal to the total of all credits.

EXAMPLES OF DUALITY PRINCIPLE

EXAMPLE 1

Mr X sold Goods for Cash ₹ 1,000 to Mr Y. In this case the dual aspects of this transaction for Mr X and Mr Y are as follows:

Dual Aspects for Mr X	Dual Aspects for Mr Y
1. Receipt of Cash ₹ 1,000	1. Payment of Cash ₹ 1,000
2. Foregoing of Goods of ₹ 1,000	2. Receipt of Goods of ₹ 1,000

EXAMPLE 2

Mr X sold Goods for ₹ 1,000 to Mr Y on credit. In this case the dual aspects of this transaction for Mr X and Mr Y are as follows:

Dual Aspects for Mr X	Dual Aspects for Mr Y
1. Acquisition of Right to recover ₹ 1,000	1. Assumption of Obligation to pay ₹ 1,000
2. Foregoing of Goods of ₹ 1,000	2. Receipt of Goods of ₹ 1,000

15.0 DOUBLE ENTRY SYSTEM OF BOOK-KEEPING**MEANING OF DOUBLE ENTRY SYSTEM OF BOOK-KEEPING**

1. Double Entry System of Book-keeping refers to a system of accounting under which both the aspects (i.e., Debit or Credit) of every transaction are recorded in the accounts involved.
2. **Dual Aspect** — Two fold aspect of a transaction is called dual aspect *or* duality of a transaction. This duality is the basis of double entry records.
3. **As the name implies, the entry made for each transaction is composed of two parts** — one for debit and another for credit. The double entry system may be compared with the Newton's law of motion, viz to every action there is always an equal and contrary reaction.
4. Every debit has equal amount of credit. So the total of all debits must be equal to the total of all credits.
5. **The terms debit and credit used today have their origin from the terms** — Debito and Credito as used by Luca fra Pacioli in his book.
6. **Account** — The individual record of a person *or* thing *or* an item of income *or* an expense is called an account.

ADVANTAGES OF DOUBLE ENTRY SYSTEM

1. It facilitates the accuracy of ledger accounts through the device of trial balance.
2. It facilitates the ascertainment of Financial Performance.
3. It facilitates the ascertainment of Financial Position.
4. It facilitates the comparability of Financial Statements.

5

ACCOUNTING POLICIES

1.0 MEANING OF ACCOUNTING POLICIES

Accounting policies refer to the specific accounting principles and methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements. There is no single list of accounting policies which are applicable to all enterprises in all circumstances. The management of each enterprise has to select appropriate accounting policies having regard to the nature and circumstances of the enterprise.

2.0 EXAMPLES OF ACCOUNTING POLICIES

Following are the examples of some of the areas in which different accounting policies may be adopted by different enterprises:

- (i) Methods of depreciation, depletion and amortisations;
- (ii) Treatment of expenditure during construction;
- (iii) Conversion or translation of foreign currency items;
- (iv) Valuation of inventories;
- (v) Treatment of goodwill;
- (vi) Valuation of investments;
- (vii) Treatment of retirement benefits;
- (viii) Recognition of profit on long-term contracts;
- (ix) Valuation of fixed assets;
- (x) Treatment of contingent liabilities.

This list should not be taken as exhaustive, it is only illustrative.

3.0 MAJOR CONSIDERATIONS IN THE SELECTION OF ACCOUNTING POLICIES

The primary considerations in the selection of accounting policies should be to prepare and present financial statements in a way that they represent a true and fair view of the state of affairs of the enterprise as at the Balance Sheet date and of the Profit & Loss Account for the period ended on that date. The major considerations governing the selection and application of accounting policies are as under:

1. **Prudence:** Uncertainties inevitably surround many transactions. This should be recognized by exercising prudence in preparing financial statements. Prudence does not, however, justify the creation of secret or hidden reserves.
2. **Substance over form:** Transactions and other events should be accounted for and presented in accordance with their substance and financial reality and not merely with their legal form.
3. **Materiality:** Financial Statements should disclose all material items, that is, items, the knowledge of which might influence the decision of the users of the financial statements.

4.0 DISCLOSURE OF ACCOUNTING POLICIES

According to AS-1 issued by the Institute of Chartered Accountants of India—

- (a) All significant accounting policies adopted in the preparation and presentations of financial statements should be disclosed.
- (b) The disclosure of the significant accounting policies as such should form a part of the financial statements and the significant accounting policies should normally be disclosed in one place.

5.0 CHANGE IN ACCOUNTING POLICY**WHEN THE CHANGE IN ACCOUNTING POLICY IS RECOMMENDED**

The change in Accounting Policy is recommended only in the following circumstances:

- If it is required by statute for compliance with an accounting standard.
- If it is considered that the change would result in a more appropriate presentation of the financial statements of an enterprise.

DISCLOSURE REQUIREMENTS IN CASE OF CHANGE IN ACCOUNTING POLICY

The disclosure requirements are as follows:

Case	Disclosure Requirements
1 If change has a material effect in current period and the effect of change is ascertainable.	The amount of change should be disclosed.
2. If change has a material effect in current period and the effect of change is not ascertainable, wholly or in part.	The fact should be disclosed.
3 .If change has no material effect in current period but which is reasonably expected to have a material effect in later periods	The fact of such change should be appropriately disclosed.

EXAMPLE OF CHANGE IN ACCOUNTING POLICY

X Ltd. changed the method of depreciation from WDV to SLM, with effect from 1.4.2017. The depreciation has been recomputed from the date of commissioning of these assets at SLM rates applicable to those years. Consequent to this there has been an additional charge for depreciation during the year of ₹ 100 crore due to said change which relates to the previous years and an equal amount has been withdrawn from the General Reserve and credited to Profit & Loss Account. Had there been no change in the method of depreciation, the charge for the year would have been lower by ₹ 10 crore excluding the charge relating to the previous years. Consequently, the Net Block of Fixed Assets and Reserves and Surplus are lower by ₹ 110 Crore.

6.0 DISTINCTION BETWEEN FUNDAMENTAL ACCOUNTING ASSUMPTIONS AND ACCOUNTING POLICIES

The Fundamental accounting assumptions differ from Accounting policies in the following respects:

Basis of Distinction	Fundamental Accounting Assumptions	Accounting Policies
1. Number	There are only three fundamental accounting assumptions viz. Going Concern, Consistency and Accrual.	There is no single list of accounting policies which are applied in all circumstances. As a result, there may be different accounting policies adopted by different enterprises.
2. Disclosure if followed	No disclosure is required if all the fundamental assumptions have been followed.	Disclosure is required if a particular accounting policy has been followed
3. Disclosure if not followed	In case the fundamental assumptions are not followed; the fact has to be disclosed in the financial statements together with the reasons.	In case, the policy is changed in subsequent year, the reasons for such change and the resulting financial consequences have to be disclosed.
4. Choice	There is no choice.	The firm has a choice to select a particular policy

6

ACCOUNTING AS A MEASUREMENT DISCIPLINE

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of Measurement
- ◇ Objects or Events to be Measured
- ◇ Standard or Scale of Measurement
- ◇ Dimension of Measurement Scale
- ◇ Accounting as a Measurement Discipline
- ◇ Valuation Principles or Measurement Bases
- ◇ Measurement and Valuation
- ◇ Accounting Estimates

1.0 MEANING OF MEASUREMENT

Prof. R.J. Chambers defined measurement as “assignment of number to objects and events according to rules specifying the property to be measured, the scale to be used and the dimension of the unit.”

Thus, the three elements of measurements are:

1. Identification of objects and events to be measured
2. Selection of standard or scale to be used
3. Evaluation of dimension of measurement standard or scale.

2.0 OBJECTS OR EVENTS TO BE MEASURED

1. Past and present objects or events can be measured with some degree of accuracy.
2. Future objects or events are only predicted but not measured.
3. Although decision makers need past, present and future information but generally the past information is communicated to the external users.

3.0 STANDARD OR SCALE OF MEASUREMENT

1. In accounting, money is the scale of measurement.
2. Money as a measurement scale has no universal application because it takes the shape of currency ruling in a country which differs from one reporting country to another reporting country. For example, the scale of measurement in India is Rupee, in the U.K., Pound sterling, in USA, dollar.

4.0 DIMENSION OF MEASUREMENT SCALE

1. An ideal measurement scale should be stable overtime.

2. Money as a scale of measurement is not stable in the dimension for comparison over time because the same quantity of money may not have the ability to buy same quantity of identical goods at different dates.

5.0 ACCOUNTING AS A MEASUREMENT DISCIPLINE

1. Accounting is not an exact measurement discipline because accounting measures information mostly in money terms which is —
 - (a) not a stable scale
 - (b) not having universal applicability
 - (c) not stable in dimension for comparison over the time.
2. Though measurement is an important part of accounting discipline but a set of theorems which govern the measurement system (such as Going Concern, Consistency and Accrual) should be carefully understood to know how the cogs of the accounting - wheel work.
3. Although quantitative information is also required in many cases but such information is only supplementary to monetary information.

6.0 VALUATION PRINCIPLES OR MEASUREMENT BASES

There are **four** generally accepted valuation principles or measurement bases.

HISTORICAL COST BASE

As per Historical Cost base —

- (a) the assets are recorded at the amount of cash or cash equivalent paid *or* incurred *or* fair value of the asset at the time of acquisition.
- (b) Liabilities are recorded at the amount of proceeds received in exchange for the obligation.

CURRENT COST BASE

As per Current Cost base —

- (a) the assets are recorded at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently.
- (b) Liabilities are recorded at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

REALIZABLE VALUE BASE

As per realizable value base —

- (a) The assets are recorded at the amount of cash or cash equivalent that could currently be obtained by selling the assets in an orderly disposal.
- (b) Liabilities are recorded at the undiscounted amount of cash or cash equivalents expressed to be paid to satisfy the liabilities in the normal course of business.

PRESENT VALUE BASE

As per Present Value Base—

- (a) An asset is recorded at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business.
- (b) Liabilities are recorded 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.

ILLUSTRATION

X Ltd. purchased a machine for ₹ 1,00,000 on 1.4.2014 on 31st March 2018—

- (a) The similar machine could be purchased for ₹ 1,20,000.
- (b) The same machine could be disposed off for ₹ 80,000.
- (c) The present discounted value of the future net cash inflows that the machinery was expected to generate in the normal course of business is calculated at ₹ 1,50,000.

In the above case —

- (a) Historical Cost is ₹ 1,00,000
- (b) Current Cost is ₹ 1,20,000
- (c) Realizable Value is ₹ 80,000
- (d) Present Value is ₹ 1,50,000

7.0 MEASUREMENT AND VALUATION

1. In economics, the value of an object, ability or idea is the utility (i.e. satisfaction) of an economic resource to the person contemplating or enjoying its use. Economists use ordinal scale to indicate the level of satisfaction.
2. In accounting, the value of an object, ability or idea is always measured in terms of money. Accountants use only cardinal scales.

8.0 ACCOUNTING ESTIMATES**WHEN REQUIRED**

Accounting estimates are required when many items of financial statements can not be measured with precision due to uncertainties inherent in business activities. The estimation process involves judgement based on the latest information available.

EXAMPLES OF ACCOUNTING ESTIMATES

Accounting estimates are required in respect of:

- (a) Doubtful debts
- (b) Useful lives of Depreciable Assets
- (c) Residual Value
- (d) Inventory Obsolescence
- (e) Employees Retirement Benefit Obligations
- (f) Provision for Unseen Contingencies while using percentage of Completion Method is long term contract.

MEANING OF CHANGE IN ACCOUNTING ESTIMATES

Change in Accounting Estimate means differences arising between certain parameters estimated earlier and

- (a) re-estimated during the current period, or
- (b) actual results achieved during the current period.

WHEN AN ACCOUNTING ESTIMATE REQUIRES REVISION

An accounting estimate may require revision —

- (a) if changes occur regarding circumstances on which the estimate was based, or
- (b) as a result of new information, more experience or subsequent developments

EXAMPLES OF CHANGE IN ACCOUNTING ESTIMATE INCLUDE

- (a) Change in the amount of doubtful debts
- (b) Change in the estimated useful life of the depreciable asset
- (c) Change in the estimated residual value of the depreciable asset.

NO RETROSPECTIVE EFFECT

Change in accounting estimates can not be given a retrospective effect.

REQUIREMENTS OF AS 5

1. The effect of change in an accounting estimate should be included in the determination of net profit or loss —
 - (a) in the period of the change if the change affects the period only (e.g. change in the estimated amount of doubtful debts)
 - (b) in the period of change and future periods if the change affects both (e.g. change in the estimated useful life of a depreciable asset)
2. The effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. (For example, previously included as an extraordinary item should be reported as an extraordinary item)
3. The nature and the amount of change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods should be disclosed. If it is impracticable to quantify the amount, this fact should be disclosed.

7

ACCOUNTING STANDARDS

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of Accounting Standard
- ◇ Objective of Accounting Standard
- ◇ Significance of Accounting Standards
- ◇ Advantages of Setting Accounting Standards
- ◇ Arguments against setting Accounting Standards
- ◇ Development of Accounting Standards
- ◇ Accounting Standards Board of India [ASB]
- ◇ International Financial Reporting Standards (IFRS)
- ◇ Historical Background of IFRS
- ◇ International Accounting Standard Board [IASB]
- ◇ Steps Taken By IASB For Global Convergence
- ◇ Arguments In Favour of IFRS
- ◇ Arguments Against IFRS
- ◇ Suggestion For More Effective Adoption of IFRS

1.0 MEANING OF ACCOUNTING STANDARD

An accounting standard is a selected set of accounting policies or broad guidelines regarding the principles and methods to be chosen out of several alternatives. Standards conform to applicable laws, customs, usage and business environment. So there is no universally acceptable set of standards.

2.0 OBJECTIVE OF ACCOUNTING STANDARD

The main objective of accounting standards is to harmonise the diverse accounting policies and practices at present in use in India. However, harmonisation does not mean that accounting standards should become very rigid. In fact, harmonisation of accounting standards do permit flexibility to make the necessary adjustments to suit their purpose.

3.0 SIGNIFICANCE OF ACCOUNTING STANDARDS

1. The adoption and application of accounting standards ensures uniformity, comparability and qualitative improvement in the preparation and presentation of financial statements.
2. The accounting standards seek to describe the accounting principles, the valuation techniques and the methods of applying the accounting principles in the preparation and presentation of financial statements so that they may give a true and fair view.

3. The ostensible purpose of the standard setting bodies is to promote the dissemination of timely and useful financial information to investors and certain other parties having an interest in companies' economic performance.

4.0 ADVANTAGES OF SETTING ACCOUNTING STANDARDS

1. Reduction in Variations	Standards reduce to a reasonable extent <i>or</i> eliminate altogether confusing variations in the accounting treatments used to prepare financial statements.
2. Disclosure Beyond that Required by Law	There are certain areas where important information is not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.
3. Facilitates Comparison	The application of accounting standards would, to a limited extent, facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in accounting standards practised in different countries.

5.0 ARGUMENTS AGAINST SETTING ACCOUNTING STANDARDS

1. Restriction on Choice of Alternative Treatments	Alternative solutions to certain accounting problems may each have arguments to recommend them. A standard which insists on one particular solution may be unduly restrictive. This can sometimes be avoided either by allowing a permitted choice between different accounting treatments, <i>or</i> by defining closely the circumstances where different treatments may be appropriate.
2. Rigidity	There may be a trend towards rigidity in applying the accounting standards. Michael Alexander, Director of Research and Technical Activities at the Financial Accounting Standards Board (FASB) said, 'the demand for standards comes largely from an insatiable appetite for rules. The reliance on judgment in technical accounting matters seems to have gone'.
3. Cannot Override the Statute	Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.

6.0 DEVELOPMENT OF ACCOUNTING STANDARDS

1. Prior to the 1970s, few academics paid much attention to the standard-setting process in accounting. Beginning in the 1970s, however, it became clear that standard setting was a fascinating process that had become intertwined with the economic self-interests of affected parties. Currently, standard-setting boards *or* committees are active in a number of countries, including the United States, United Kingdom, Australia, Canada, New Zealand, the Netherlands, Japan and India.
2. **At International level** — In 1972 International Accounting Standards Committee (IASC), was formed for developing International Accounting Standards (IASs). The IASC comprises the professional accountancy bodies of over 75 countries (including The Institute of Chartered

Accountants of India). During these three decades the IASC has issued 40 IASs through a due process involving the worldwide accountancy profession, the preparers and users of financial statements and the national standard-setting bodies. However the IASs are not accepted worldwide.

3. In 1978, another professional body, the International Federation of Accountants (IFAC) was established.

7.0 ACCOUNTING STANDARDS BOARD OF INDIA [ASB]

1. **Formation of the Accounting Standards Board** — The Institute of Chartered Accountants of India, recognising the need to harmonise the diverse accounting policies and practices at present in use in India, constituted an Accounting Standards Board (ASB) on April 21, 1977.

2. **Scope and Function of Accounting Standards Board**

- (a) The main function of ASB is to formulate accounting standards so that such standards may be established by the Council of the Institute in India.
- (b) While formulating the accounting standards, ASB will take into consideration the applicable law, customs, usages and business environment.
- (c) The Institute is one of the members of the International Accounting Standards Committee (IASC) and has agreed to support the objectives of IASC.
- (d) While formulating the accounting standards, ASB will give due consideration to International Accounting Standards issued by IASC and try to integrate them, to the extent possible, in the light of the conditions and practices prevailing in India.
- (e) The accounting standards will be issued under the authority of the Council. ASB has also been entrusted with the responsibility of propagating the accounting standards and of persuading the concerned parties to adopt them in the preparation and presentation of financial statements.
- (f) ASB will issue guidance notes on the accounting standards and give clarifications on issues arising therefrom.
- (g) ASB will also review the accounting standards at periodical intervals.

3. **Procedure for Issuing Accounting Standards**

Broadly, the following procedure will be adopted for formulating Accounting Standards:

Step 1: Determine the broad areas in which accounting standards need to be formulated and the priority in regard to the selection thereof.

Step 2: To hold a dialogue with the representatives of the government, public sector undertakings, industry and other organizations for ascertaining their views.

Step 3: On the basis of the work of the study groups and the dialogue with the representatives, to prepare and issue the exposure of draft of the proposed standard for comments by members of the Institute and the public at large.

Step 4: To finalise the draft of the proposed standard after taking into consideration the comments received.

Step 5: To submit the final draft of the proposed standard to the Council of the Institute.

The Council of the Institute will consider the final draft of the proposed standard, and if found necessary, modify the same in consultation with ASB. The accounting standard on the relevant subject will then be issued under the authority of the Council.

4. **Accounting Standards issued so far**

- (a) In India, The Council of the Institute of Chartered Accountants of India has so far issued 32 Accounting Standards but effectively there are 31 as at present since AS-8 has been withdrawn consequent to the issuance of AS 26 on 'Intangible Assets'.

- (b) Some of these standards are mandatory.
- (c) These accounting standards are mandatory in the sense that these are binding on the members of the Institute.
- (d) These standards are as follows:

S. No.	Title	Recommendatory or Mandatory	Mandatory from accounting period beginning on or after
AS - 1	Disclosure of Accounting Policies	Mandatory	1.4.93
AS - 2	Valuation of Inventories (Revised)	Mandatory	1.4.99
AS - 3	Cash Flow Statement (Revised)	Mandatory	1.4.2001
AS - 4	Contingencies and Events Occurring After the Balance Sheet Date (Revised)	Mandatory	1.4.95
AS - 5	Net Profit or Loss for the period, Prior Period and Extra-ordinary items and Changes in Accounting Policies (Revised)	Mandatory	1.1.96
AS - 6	Depreciation Accounting (Revised)	Mandatory	1.4.95
AS - 7	Accounting for Construction Contracts (Revised)	Mandatory	1.4.03
AS - 8	Accounting for Research and Development	Withdrawn and included in AS-26	
AS - 9	Revenue Recognition	Mandatory	1.4.93
AS - 10	Accounting for Fixed Assets	Mandatory	1.4.93
AS - 11	Accounting for the Effects of Foreign Changes in Exchange Rates (Revised)	Mandatory	1.4.04
AS - 12	Accounting for Government Grants	Mandatory	1.4.94
AS - 13	Accounting for Investments	Mandatory	1.4.95
AS - 14	Accounting for Amalgamations	Mandatory	1.4.95
AS - 15	Accounting for Retirement Benefits in the Financial Statements of Employers	Mandatory	1.4.95
AS - 16	Borrowing Costs	Mandatory	1.4.2000
AS - 17	Segment Reporting	Mandatory	1.4.2001
AS - 18	Related Parties Disclosures	Mandatory	1.4.2001
AS - 19	Leases	Mandatory	1.4.2001
AS - 20	Earning Per Share	Mandatory	1.4.2001
AS - 21	Consolidated Financial Statements	Mandatory	1.4.2001
AS - 22	Accounting for Taxes on Income	Mandatory	1.4.2001
AS - 23	Accounting for Investments in Associates in Consolidated Financial Statements	Mandatory	1.4.2002
AS - 24	Discontinuing Operations	Mandatory	1.4.2004
AS - 25	Interim Financial Reporting	Mandatory	1.4.2002
AS - 26	Intangible Assets	Mandatory	1.4.2003

AS - 27	Financial Reporting of Interests in Joint Venture	Mandatory	1.4.2004
AS - 28	Impairment of Assets	Mandatory	1.4.2004
AS - 29	Provision, Contingent Liabilities and Contingent Assets	Mandatory	1.4.2004
AS - 30	Financial Instrument Recognition & Measurement:	Recommendation 1.4.2009 to 31.3.2011	1.4.2011
AS - 31	Financial Instrument: Presentation	Recommendation 1.4.2009 to 31.3.2011	1.4.2011
AS - 32	Financial Instrument: Disclosure	Recommendation 1.4.2009 to 31.3.2011	1.4.2011

5. Compliance with Accounting Standards

- (a) During the period an accounting standard is recommendatory in nature, the members of the Institute should, while discharging their attest function, examine whether the standard has been followed or not. If the same has not been followed, the members should consider whether, keeping in view the circumstances of the case, a disclosure in their audit reports is necessary.
- (b) Once the standard becomes mandatory, it will be the duty of the members of the Institute to examine, while discharging their attest function, whether this accounting standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from the accounting standard, it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviations.

8.0 INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

WHY THERE IS NEED OF HARMONISATION?

Harmonisation implies having conformity in accounting and reporting practices. Variations should be minimised. It should be at minimum level.

When originally accounting evolved, there is greater variation in accounting principles and practices.

Many bodies like FASB, OECD took many steps to reduce these variations.

Now many countries try to achieve harmonisation but since all of the countries were following their own accounting standards so harmonisation was never achieved. Hence harmonisation was retaliated again and again but never achieved.

WHAT IS CONVERGENCE?

Convergence implies that all standards setter around the world should agree on a single, high quality accounting standard.

Convergence can be achieved in two ways:

- (i) Either adopting International Financial Reporting Standards (IFRS) or
- (ii) Adopt IFRS to formulate the country's own accounting standards.

9.0 HISTORICAL BACKGROUND OF IFRS

INTERNATIONAL ACCOUNTING STANDARD COMMITTEE (IASC)

Few years back in 1973, a body was established i.e., International Accounting Standard Committee (IASC) to push up harmonisation. It composed of members of the developed nations. Its main objectives were:

1. To formulate and publish in the public interest accounting standards to be observed in the presentation of the financial statements and to promote their worldwide acceptance and observance.
2. To work generally for the improvement and harmonisation of the accounting standard.

INTERNATIONAL FINANCIAL REPORTING STANDARD FOUNDATION

However, nothing happened from 1973 – 2000. As a consequence IASC itself approved constitutional changes necessary for its own restructuring.

A new IFRS foundation was incorporated and its trustees were appointed.

The IFRS Foundation is an independent, not-for-profit private sector organisation working in the public interest. Its principal objectives are:

1. to develop a single set of high quality, understandable, enforceable and globally accepted international financial reporting standards (IFRSs) through its standard-setting body, the IASB;
2. to promote the use and rigorous application of those standards;
3. to take account of the financial reporting needs of emerging economies and small and medium-sized entities (SMEs); and
4. to bring about convergence of national accounting standards and IFRSs to high quality solutions.

The governance and oversight of the activities undertaken by the IFRS Foundation and its standard-setting body rests with its Trustees, who are also responsible for safeguarding the independence of the IASB and ensuring the financing of the organisation. The Trustees are publicly accountable to a Monitoring Board of public authorities.

10.0 INTERNATIONAL ACCOUNTING STANDARD BOARD (IASB)

WHAT IS IASB?

The IASB is the independent standard-setting body of the IFRS Foundation. Its members are responsible for the development and publication of IFRSs, including the IFRS for SMEs and for approving Interpretations of IFRSs as developed by the IFRS Interpretations Committee (formerly called the IFRIC). All meetings of the IASB are held in public and webcast. In fulfilling its standard-setting duties the IASB follows a thorough, open and transparent due process of which the publication of consultative documents, such as discussion papers and exposure drafts, for public comment is an important component. The IASB engages closely with stakeholders around the world, including investors, analysts, regulators, business leaders, accounting standard-setters and the accountancy profession.

Formulation of IASB is necessary since:

1. There is recognized and growing need for common international accounting standard.
2. No individual setter has a monopoly over a best solution to accounting problem.
3. No national standard setter is in position to set accounting standard that can gain acceptance around the world.

WHAT ARE THE OBJECTIVES OF IASB?

1. To develop in the public interest, a single set of high quality, understandable and enforceable accounting standard that requires high quality, transparent and comparable financial information.
2. To promote the use and rigorous application of these accounting standard.
3. To bring about convergence.

The methodology is that board will formulate their own accounting standards and the countries would follow it.

11.0 STEPS TAKEN BY IASB FOR GLOBAL CONVERGENCE

1. **Issued a Conceptual Framework:** It had adopted the framework issued by IASC in 1989. This framework serves as guide to IASB for developing Accounting Standard.
2. **Issue of IAS:** Till now IASC had issued 41 International Accounting Standards.
 - **IAS 1** — Presentation of Financial Statements
 - **IAS 2** — Inventories
 - **IAS 7** — Statement of Cash Flows
 - **IAS 8** — Accounting Policies, Changes in Accounting Estimates and Errors
 - **IAS 10** — Events After the Balance Sheet Date
 - **IAS 11** — Construction Contracts
 - **IAS 12** — Income Taxes
 - **IAS 16** — Property, Plant and Equipment
 - **IAS 17** — Leases
 - **IAS 18** — Revenue
 - **IAS 19** — Employee Benefits
 - **IAS 20** — Accounting for Government Grants and Disclosure of Government Assistance
 - **IAS 21** — The Effects of Changes in Foreign Exchange Rates
 - **IAS 23** — Borrowing Costs
 - **IAS 24** — Related Party Disclosures
 - **IAS 26** — Accounting and Reporting by Retirement Benefit Plans
 - **IAS 27** — Consolidated and Separate Financial Statements
 - **IAS 28** — Investments in Associates
 - **IAS 29** — Financial Reporting in Hyperinflationary Economies
 - **IAS 31** — Interests in Joint Ventures
 - **IAS 32** — Financial Instruments: Presentation
 - **IAS 33** — Earnings per Share
 - **IAS 34** — Interim Financial Reporting
 - **IAS 36** — Impairment of Assets
 - **IAS 37** — Provisions, Contingent Liabilities and Contingent Assets
 - **IAS 38** — Intangible Assets
 - **IAS 39** — Financial Instruments: Recognition and Measurement
 - **IAS 40** — Investment Property
 - **IAS 41** — Agriculture

3. **Issue of International Financial Reporting Standards (IFRS):** Till now IASB has issued 9 IFRS. The difference between IFRS and IAS is that IAS was issued by IASB up to year 2000. Thereafter standards are issued by IASB by the name of IFRS. However IASB adopted all IAS issued previously by IASB and which will remain there till replaced or covered by new IFRS. Till now 9 IFRS has been issued. These are as follows:
- **IFRS 1** — First-time Adoption of International Financial Reporting Standards
 - **IFRS 2** — Share-based Payment
 - **IFRS 3** — Business Combinations
 - **IFRS 4** — Insurance Contracts
 - **IFRS 4** — Non-current Assets Held for Sale and Discontinued Operations
 - **IFRS 6** — Exploration for and evaluation of Mineral Resources
 - **IFRS 7** — Financial Instruments: Disclosures
 - **IFRS 8** — Operating Segments
 - **IFRS 9** — Financial instruments
4. **Setting up the IFRS Interpretations Committee:** The IFRS Interpretations Committee (formerly called the IFRIC) is the interpretative body of the IASB. The role of this committee is to review on timely basis within the context of IAS, IFRS and Framework, accounting issues that are debatable and issue clarification on that.
5. **Working closely with Intergovernmental organisations** such as OECD, EU, ISAR, etc. so as to enforce member bodies to converge with the standards.
6. **Acceptance of IFRS by the International Organization of Securities Commissions (IOSCO):** IOSCO is an association of organisations that regulate the world's securities and futures markets. Members are typically the Securities Commission or the main financial regulator from each country. IOSCO has members from over 100 different countries, who regulate more than 90 per cent of the world's securities markets. The organisations role is to assist its members to promote high standards of regulation and act as a forum for national regulators to cooperate with each other and other international organisations. Therefore the acceptance of IFRS by IOSCO is major landmark since IOSCO can enforce its member to converge with such IFRS.
7. **First time adoption of IFRS (i.e. IFRS 1):** It prescribes the accounting and disclosures required by the first time adopters of IFRS.
8. Issued a draft of Memorandum of Understanding (MOU) on the role of National Accounting Standard Setter and IASB. This document is intended to set out the shared vision. Through this 'MOU' it has become important for National Accounting Standard Setters to converge with IFRS. The draft 'MOU' lays out the large number of responsibilities on national accounting standard setters.
9. Convergence with US GAAP.

12.0 MEANING OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

IFRSs refers to the entire body of IASB pronouncements, including standards and interpretations approved by the International Accounting Standard Board (IASB) & IASs and SIC interpretations approved by the predecessor International Accounting Standards Committee (IASC)

Broadly, IFRS consist of,

1. International Financial Reporting Standard (IFRS)
2. International Accounting Standard (IAS)
3. International Financial Reporting Interpretation committee (IFRIC) Interpretations
4. Standard Interpretation Committee (SIC) Interpretation

Simply be put, IFRS are AS of the World.

13.0 DIFFERENCE BETWEEN IFRS AND AS

The Accounting Standards (AS) issued by ICAI are prepared on the basis of the Indian environment, while International Financial Reporting Standards (IFRS) are prepared by considering the global environment as a whole.

14.0 NEED FOR IND AS

The Indian environment and Global environment are different which leads to a huge gap between AS issued by ICAI & IFRS issued by IASB. So as to bridge the gap between AS & IFRS, ICAI issued Indian Accounting Standard converged with IFRS (formally known as Ind AS)

15.0 MEANING OF INDIAN ACCOUNTING STANDARDS CONVERGED WITH IFRS (IND AS)

Convergence means alignment of the standards of different standard setters with a certain rate of compromise, by adopting the requirements of the standards either fully or partially.

Ind AS are set of accounting standards notified by Ministry of Corporate Affairs (MCA), converged with International Financial Reporting Standards (IFRS), these accounting standards are formulated by Accounting Standard Board (ASB) of Institute of Chartered Accountants of India (ICAI).

Indian Accounting Standards are almost similar to IFRS but with few carve outs so as to make them suitable for Indian Environment.

In a nut shell, Ind AS can be referred as “International Dish with Indian Flavour” or “Desi version of IFRS”

16.0 NEED FOR CHANGE

The Need for Change is to have common set of accounting standards. The benefits of having the common standards for financial reporting are the reasons which attract such change.

1. **Better Comparability:** By following a common set of standards, will help the stakeholders to compare the organisations globally, i.e. to create an apple to apple comparison.
2. **Better Transparency:** The users of accounts will be benefited by this as, same accounting standards will help to them understand the fundamentals of the organisation which will generate better transparency.
3. **Saving time & cost on the finance department:** Many companies having subsidiary or Holding company in different countries are required to follow dual set of accounting standards, local standards on one hand & global standards on the other hand. The transition will be helpful in saving time & cost on the finance department. For example, Swiss pharmaceutical giant ROCHE group, which operates in more than 100 countries, likely to save more than \$100 million through Convergence.
4. **Attract Foreign Investment:** Since the investors can compare with other organisations globally, it will help them to take investment decision, at the same time it will help the organisation to present their financial position in more efficient way to the world, in a language that all can understand.

17.0 ARGUMENTS IN FAVOUR OF IFRS

1. **Growth in International Business:** As international business and investment multiplies, accounting international dimension broadens and it becomes more important as the tool of communication among businessman, entrepreneurs, financiers and investors. If accounting wants to serve as universal means of communication then there must be uniformity in accounting practices and that can be achieved through IFRS.

2. **Globalisation of Capital Markets:** Today companies are going globally to acquire the funds. Like companies acquiring funds through ADRs, GDRs, etc. Now if there is accounting difference then the investor could not analyse the accounts of other countries. So IFRS helps in reducing these accounting differences.
3. **Investors:** Nowadays investors want to invest outside their country. Investors include both type of investors' i.e. transnational company investing directly into other country or individual investors. Now if accounts are comparable then they can make sound decision. If accounts are different then they cannot make sound decision. Now if there is no harmonisation then it is difficult to assess the relative merit of investment opportunities.
4. **Multinational Companies:** A major force in the movement towards adoption of IFRS has been the economic self interest of multinational companies. With diversity in Accounting Standards from country to country, these firm faces lot of accounting requirements from the countries in which they operate. Now due to adoption of IFRS there would be fewer burdens on their financial reporting structure. Due to IFRS they can easily consolidate their subsidiaries and as they are taking funds from many countries so investors across different countries can understand their financial statements.
5. **International Auditing Firms:** Another major force in the movement towards IFRS was the economic self interest of international auditing firms like PWC, Deloitte, KPMG, Ernst & Young, etc., so they can sell their service as expert in different countries.
6. **Developing Countries:** Countries that do not have any domestic Accounting Standards would benefit from international standards since it will enable them to adopt readymade system.
7. **Other interest Group:** Such as tax authorities or government will find it easier to tax foreign concern if their accounts are prepared by following IFRS.

18.0 ARGUMENTS AGAINST IFRS

DIFFICULTIES IN FORMULATION OF IFRS

1. **Nationalism:** Many countries believe that their views are superior to those of others. Due to this behaviour there is great difficulty in achieving a common solution.
2. **Difference in Economic and Social Environment:** Standard setting on international level is adversely affected by the difference in economic and social environment in which accounting has the role to play. In some countries information need of government may dominate accounting structure and in some countries need of investor may dominate accounting structure.
3. **Diverse Accounting Practices:** There is wide divergence in worldwide accounting practices. Each practice has its own justification. But this creates difficulty in arriving at commonality.
4. **Gaps between Developed and Developing Countries:** In many areas, developing countries differ from those of developed. In fact most developing countries have little chance to evolve accounting systems which truly reflect the needs and circumstances of their countries. Now copying the model of developed countries will not fill their needs.

DIFFICULTIES IN ENFORCEMENT OF IFRS

1. Difference in Tax Laws of Nations.
2. Difference in Corporate Laws.
3. Disclosure requirements under any other statute.
4. Existence of Local Standards.
5. Competition among International Standard setting agencies like OECD.
6. Unethical conduct by Corporate houses like Satyam, Enron, etc.

14.0 SUGGESTION FOR MORE EFFECTIVE ADOPTION OF IFRS

1. Enlarge representation on IASB.
2. Avoid political pressure.
3. IASB should publicise its standard world widely and try to get support of accounting profession, member countries and corporate all over the world and investors all over the world.
4. Every country should pass legislation to enforce IFRS.
5. UN should recognise IASB as the body qualified to set up international standard give it authority to force universal acceptance of IFRS.
6. In each country, securities exchange should take an appropriate action that company registering with them is required to comply with IFRS.
7. Continuous research is needed.

8

ACCOUNTING EQUATION

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of Accounting Equation
- ◇ Effect of Transaction on Assets, Liabilities and Capital
- ◇ Analysis of Transactions using Accounting Equation

1.0 MEANING OF ACCOUNTING EQUATION

1. An accounting equation is a statement of equality between the resources and the sources which finance the resources and is expressed as follows:

$$\text{Resources} = \text{Sources of Finances}$$

2. **Resources mean the Assets.** The Assets refer to the tangible objects (e.g. Land & Building, Plant & Machinery, Furniture, Investments, Stock, Debtors, Bank Balance, Cash Balance) or intangible rights (e.g., Patents, Trademark, Copyright) owned by an enterprise and carrying probable future benefits.
3. **Sources of finance mean Equities** and includes (Internal Equity) (i.e., Capital) and External Equity (i.e., Liabilities).
4. Capital refers to the amount invested in an enterprise by its owners.
5. Liabilities are the financial obligations of an enterprise other than owners' funds.
6. Thus, the aforesaid accounting equation may be expressed as follows:

$$\text{Total Assets} = \text{Total Equities}$$

or

$$\text{Assets} = \text{Internal Equity} + \text{External Equity}$$

or

$$\text{Assets} = \text{Capital} + \text{Liabilities}$$

7. Since the liability holders have a definite and prior claim against the assets, the capital is also called a residual of assets over liabilities and may be expressed as follows:

$$\text{Capital} = \text{Assets} - \text{Liabilities}$$

8. This equation is fundamental in the sense that it gives foundation to the double entry book keeping. This equation holds good for all transactions and events and at all periods of time since every transaction and event has two aspects.

2.0 EFFECT OF TRANSACTION ON ASSETS, LIABILITIES AND CAPITAL

<i>Transaction</i>	<i>Effect on</i>		
	<i>Assets</i>	<i>Liabilities</i>	<i>Capital</i>
1. Capital brought in Cash/Kind	Increase	—	Increase
2. Loan taken	Increase in Cash	Increase in Lenders	—
3. Purchased Fixed Asset/Goods for Cash	Increase in Fixed Asset / Goods & Decrease in Cash	—	—
4. Purchased Fixed Asset/Goods on Credit	Increase	Increase in Creditors	—
5. Sold Goods for Cash at Profit	Increase in Cash & Decrease in Goods	—	Increase due to Profit
6. Sold Goods on Credit at Profit	Increase in Debtors & Decrease in Goods	—	Increase due to Profit
7. Return of Goods by a Customer	Decrease in Debtors & Increase in Goods	—	Decrease due to Decrease in Profit
8. Return of Goods to a Supplier	Decrease in Goods	Decrease in Creditors	—
9. Payments received from a Customer to whom Cash Discount was allowed	Decrease in Debtors & Increase in Cash	—	Decrease due to Decrease in Profit
10. Payment made to a Supplier who allowed Cash Discount	Increase in Cash	Decrease in Creditors	Increase due to Cash Discount received
11. Payment of Expenses like Salary	Decrease in Cash	—	Decrease due to Expenses
12. Expenses Due but not paid	—	Increase in Creditors	Decrease due to Expenses
13. Receipt of an Income	Increase in Cash	—	Increase due to Income
14. Income due but not received	Increase in Accrued Income	—	
15. Income received in advance	Increase in Cash	Increase	Increase due to Income
16. Depreciation of Fixed Assets	Decrease in Fixed Assets	—	Decrease due to Expenses

17. Cash/Goods withdrawn for Personal use	Decrease in Cash/Goods	—	Decrease due to Drawings
18. Goods destroyed by Fire	Decrease in Goods	—	Decrease due to Loss
19. Bad Debts on Insolvency of a Debtor	Decrease in Debtors	—	Decrease due to Loss
20. Repayment of Loan	Decrease in Cash	Decrease in Lenders	

Tutorial Notes

1. Capital is increased by capital brought in and Profit & Income.
2. Capital is decreased by Cash/Goods withdrawn for personal use and Loss & Expenses.

ILLUSTRATION 1

Prove that the accounting equation is satisfied in all the following transactions of Earth:

- (a) Commenced business with Cash ₹ 60,000.
- (b) Paid rent in advance ₹ 500.
- (c) Purchased goods for Cash ₹ 30,000 and credit ₹ 20,000.
- (d) Sold goods for Cash ₹ 30,000 costing ₹ 20,000.
- (e) Paid salary ₹ 500 and Salary Outstanding ₹ 100.
- (f) Bought motorcycle for personal use ₹ 5,000.

SOLUTION**ACCOUNTING EQUATION: ASSETS = LIABILITIES + CAPITAL**

S. No.	Transactions	Assets ₹	= Liabilities ₹	+ Capital ₹
(a)	Commenced business with Cash ₹ 60,000	60,000	= 0	+ 60,000
(b)	Rent paid in advance ₹ 500	(-)500		
		(+)500	= 0	+ 0
	New Equation	60,000	= 0	+ 60,000
(c)	Purchased Goods for Cash ₹ 30,000 and credit ₹ 20,000	(+)50,000	= (+)20,000	+ 0
		(-) 30,000		
	New Equation	80,000	= 20,000	+ 60,000
(d)	Sold Goods for Cash ₹ 30,000 costing ₹ 20,000	(+)30,000	= 0	+ 10,000
		(-)20,000		
	New Equation	90,000	= 20,000	+ 70,000
(e)	Paid Salary ₹ 500 and Salary outstanding ₹ 100	(-) 500	= +	+ (-)500
		0	= +100	+ (-)100
	New Equation	89,500	= 20,100	+ (+)69,400
(f)	Bought Motorcycle for Personal use ₹ 5,000	(-)5,000	= 0	+ (-)5,000
	New Equation	84,500	= 20,100	+ 64,400

ILLUSTRATION 2

Mr Water had the following transactions:

- (a) Commenced business with cash ₹ 50,000.
- (b) Purchased goods for cash ₹ 20,000 and credit ₹ 30,000.
- (c) Sold goods for cash ₹ 40,000, costing ₹ 30,000.
- (d) Rent paid ₹ 500.
- (e) Rent outstanding ₹ 100.
- (f) Bought furniture ₹ 5,000 on credit.
- (g) Bought refrigerator for personal use ₹ 5,000.
- (h) Purchased building for cash ₹ 20,000.

Use accounting equation to show the effect of the above transactions on his assets, liabilities and capital and also show his balance sheet.

SOLUTION
ACCOUNTING EQUATION: ASSETS = LIABILITIES + CAPITAL

S. No.	Transactions	Assets ₹	= Liabilities ₹	+ Capital ₹
(a)	Commenced business with cash ₹ 50,000	50,000	= 0	+ 50,000
(b)	Purchased goods for cash ₹ 20,000 and credit ₹ 30,000	(+)50,000 (-)20,000	= 30,000	+ 0
	New Equation	80,000	= 30,000	+ 50,000
(c)	Sold goods for cash ₹ 40,000 costing ₹ 30,000	(+)40,000 (-)30,000	= 0	+ 10,000
	New Equation	90,000	= 30,000	+ 60,000
(d)	Rent paid ₹ 500	(-)500	= 0	+ (-)500
	New Equation	89,500	= 30,000	+ 59,500
(e)	Rent outstanding for ₹ 100	0	= (+)100	+ (-)100
	New Equation	89,500	= 30,100	+ 59,400
(f)	Bought furniture for ₹ 5,000 on credit	+5,000	= (+)5,000	+ 0
	New Equation	94,500	= 35,100	+ 59,400
(g)	Bought refrigerator for personal use ₹ 5,000	(-)5,000	= 0	+ 5,000
	New Equation	89,500	= 35,100	+ 54,400
(h)	Purchased building for cash ₹ 20,000	(+)20,000 (-)20,000	= 0	+ 0
	New Equation	89,500	= 35,100	+ 54,400

BALANCE SHEET AS AT.....

Liabilities + Capital	₹	Assets	₹
Creditors	35,000	Cash in hand	44,500
Rent Outstanding	100	Stock	20,000
Capital	54,400	Furniture	5,000
		Building	20,000
	89,500		89,500

ILLUSTRATION 3

Fill in the blanks:

Case	Total Assets ₹	Equities		
		Internal ₹	External ₹	Total ₹
I	50,000	—	—	?
II	?	25,000	30,000	?
III	60,000	25,000	?	?
IV	70,000	?	25,000	?
V	?	?	35,000	50,000

SOLUTION

Case	Total Assets ₹	Equities		
		Internal ₹	External ₹	Total ₹
I	50,000	—	—	50,000
II	55,000	25,000	30,000	55,000
III	60,000	25,000	35,000	60,000
IV	70,000	45,000	25,000	70,000
V	50,000	15,000	35,000	50,000

ILLUSTRATION 4

Fill in the blanks:

Case	Capital as on 31.12.2013 ₹	Capital as on 1.1.2013 ₹	Profit-Loss during 2013 ₹	Drawings during 2013 ₹	Fresh Capital introduced during 2013 ₹
I	?	10,000	5,000	2,000	1,000
II	20,000	?	(1,000)	3,000	4,000
III	21,000	10,000	?	2,000	10,000
IV	10,000	20,000	5,000	?	1,000
V	15,000	30,000	(8,000)	7,000	?

SOLUTION

Case	Capital as on 1.1.2013 (₹) A	Profit-Loss during 2013 (₹) B	Fresh Capital introduced during 2013 (₹) C	Drawings during 2013 (₹) D	Capital as on 31.12.2013 (₹) $E = A + B + C - D$
I	10,000	5,000	1,000	2,000	14,000
II	20,000	(1,000)	4,000	3,000	20,000
III	10,000	3,000	10,000	2,000	21,000
IV	20,000	5,000	1,000	16,000	10,000
V	30,000	(8,000)	Nil	7,000	15,000

COMPREHENSIVE PROBLEM FOR REVISION

Objective: The following Problems have been given Only to Revise the Chapter. In Examination only some of the parts and not all the parts of such lengthy problems may be asked.

PROBLEM 1

Show the Accounting Equation on the basis of the following transactions and prepare the Balance Sheet at last.

- (a) Shri Ganesh commenced business with Cash ₹ 35,000, Goods ₹ 8,000, Furniture ₹ 7,000.
- (b) Bought furniture from M/s Mohan Furnitures on credit for ₹ 3,000.
- (c) Purchased goods from Sohan for cash ₹ 35,000.
- (d) Sold goods to Shyam for cash ₹ 40,000 (costing ₹ 30,000).
- (e) Bought goods from Ramesh for ₹ 30,000.
- (f) Sold goods to Shyam costing ₹ 30,000 for ₹ 50,000.
- (g) Received ₹ 49,500 from Shyam in full settlement.
- (h) Paid ₹ 29,700 to Ramesh in full settlement.
- (i) Paid half the amount owed to M/s Mohan.
- (j) Withdrew ₹ 1,000 for personal use.
- (k) Withdrew goods for personal use (Cost ₹ 500, Sale Price ₹ 600).
- (l) Purchased household goods for ₹ 15,000 giving ₹ 5,000 in cash and the balance through a loan.
- (m) Paid cash ₹ 500 for loan and ₹ 300 for Interest.
- (n) Goods destroyed by fire (Cost ₹ 500, Sale Price ₹ 600).
- (o) Paid salary ₹ 500 and salary outstanding ₹ 100.
- (p) Paid rent in advance ₹ 2,000.
- (q) Accrued Interest ₹ 500.
- (r) Commission received in advance ₹ 1,000.
- (s) Charged depreciation of ₹ 400 on furniture.

SOLUTION

(See Solution on page 8.7 and 8.8).

BALANCE SHEET OF SHRI GANESH AS AT....

<i>Liabilities + Capital</i>	₹	<i>Assets</i>	₹
Creditor for furniture	1,500	Cash	50,000
Creditor for household goods	9,500	Stock	12,000
Outstanding salary	100	Prepaid Rent	2,000
Commission received in advance	1,000	Accrued Interest	500
Capital	62,000	Furniture	9,600
	74,100		74,100

Solution to Problem 1:

ACCOUNTING EQUATION: ASSETS = LIABILITIES + CAPITAL

Trans.	Assets					Liabilities + Capital				
	Cash	+ Stock	+ Debtors	+ Furniture	+ Prepaid Expenses	+ Accrued Income	Creditors	+ Lenders	+ Income Received in advance + O/s Exp.	+ Capital
(a)	35,000	+ 8,000	+ 0	+ 7,000	+ 0	+ 0	0	+ 0	+ 0 + 0	+ 50,000
New Equation	35,000	+ 8,000	+ 0	+ 7,000	+ 0	+ 0	0	+ 0	+ 0 + 0	+ 50,000
(b)	0	+ 0	+ 0	+ 3,000	+ 0	+ 0	3,000	+ 0	+ 0 + 0	+ 0
New Equation	35,000	+ 8,000	+ 0	+ 10,000	+ 0	+ 0	3,000	+ 0	+ 0 + 0	+ 50,000
(c)	-35,000	+ 35,000	+ 0	+ 0	+ 0	+ 0	0	+ 0	+ 0 + 0	+ 0
New Equation	0	+ 43,000	+ 0	+ 10,000	+ 0	+ 0	3,000	+ 0	+ 0 + 0	+ 50,000
(d)	40,000	- 30,000	+ 0	+ 0	+ 0	+ 0	0	+ 0	+ 0 + 0	+ 10,000
New Equation	40,000	+ 13,000	+ 0	+ 10,000	+ 0	+ 0	3,000	+ 0	+ 0 + 0	+ 60,000
(e)	0	+ 30,000	+ 0	+ 0	+ 0	+ 0	30,000	+ 0	+ 0 + 0	+ 0
New Equation	40,000	+ 43,000	+ 0	+ 10,000	+ 0	+ 0	33,000	+ 0	+ 0 + 0	+ 60,000
(f)	0	- 30,000	+ 50,000	+ 0	+ 0	+ 0	0	+ 0	+ 0 + 0	+ 20,000
New Equation	40,000	+ 13,000	+ 50,000	+ 10,000	+ 0	+ 0	33,000	+ 0	+ 0 + 0	+ 80,000
(g)	49,500	+ 0	- 50,000	+ 0	+ 0	+ 0	0	+ 0	+ 0 + 0	- 500
New Equation	89,500	+ 13,000	+ 0	+ 10,000	+ 0	+ 0	33,000	+ 0	+ 0 + 0	+ 79,500
(h)	- 29,700	+ 0	+ 0	+ 0	+ 0	+ 0	-30,000	+ 0	+ 0 + 0	+ 300
New Equation	59,800	+ 13,000	+ 0	+ 10,000	+ 0	+ 0	3,000	+ 0	+ 0 + 0	+ 79,800
(i)	-1,500	+ 0	+ 0	+ 0	+ 0	+ 0	-1,500	+ 0	+ 0 + 0	+ 0
New Equation	58,300	+ 13,000	+ 0	+ 10,000	+ 0	+ 0	1,500	+ 0	+ 0 + 0	+ 79,800
(j)	-1,000	+ 0	+ 0	+ 0	+ 0	+ 0	0	+ 0	+ 0 + 0	- 1,000

Contd... Solution to Problem 1

Trans.	Assets					Liabilities + Capital				
	Cash	+ Stock	+ Debtors	+ Furniture	+ Prepaid Expenses	+ Accrued Income	Creditors	+ Lenders	+ Income Received in advance + O/s Exp.	+ Capital
New Equation	57,300	+ 13,000	+ 0	+ 10,000	+ 0	+ 0	1,500	+ 0	+ 0 + 0	+ 78,800
(k)	0	- 500	+ 0	+ 0	+ 0	+ 0	0	+ 0	+ 0 + 0	- 500
New Equation	57,300	+ 12,500	+ 0	+ 10,000	+ 0	+ 0	1,500	+ 0	+ 0 + 0	+ 78,300
(l)	-5,000	+ 0	+ 0	+ 0	+ 0	+ 0	0	+ 10,000	+ 0 + 0	- 15,000
New Equation	52,300	+ 12,500	+ 0	+ 10,000	+ 0	+ 0	1,500	+ 10,000	+ 0 + 0	+ 63,300
(m)	-800	+ 0	+ 0	+ 0	+ 0	+ 0	0	- 500	+ 0 + 0	- 300
New Equation	51,500	+ 12,500	+ 0	+ 10,000	+ 0	+ 0	1,500	+ 9,500	+ 0 + 0	+ 63,000
(n)	0	- 500	+ 0	+ 0	+ 0	+ 0	0	+ 0	+ 0 + 0	- 500
New Equation	51,500	+ 12,000	+ 0	+ 10,000	+ 0	+ 0	1,500	+ 9,500	+ 0 + 0	+ 62,500
(o)	-500	+ 0	+ 0	+ 0	+ 0	+ 0	0	+ 0	+ 100	+ 600
New Equation	51,000	+ 12,000	+ 0	+ 10,000	+ 0	+ 0	1,500	+ 9,500	+ 100	+ 61,900
(p)	-2,000	+ 0	+ 0	+ 0	+ 2,000	+ 0	0	+ 0	+ 0	+ 0
New Equation	49,000	+ 12,000	+ 0	+ 10,000	+ 2,000	+ 0	1,500	+ 9,500	+ 100	+ 61,900
(q)	0	+ 0	+ 0	+ 0	+ 0	+ 500	0	+ 0	+ 0 + 0	+ 500
New Equation	49,000	+ 12,000	+ 0	+ 10,000	+ 2,000	+ 500	1,500	+ 9,500	+ 100	+ 62,400
(r)	1,000	+ 0	+ 0	+ 0	+ 0	+ 0	0	+ 0	+ 1,000	+ 0
New Equation	50,000	+ 12,000	+ 0	+ 10,000	+ 2,000	+ 500	1,500	+ 9,500	+ 1,000+100	+ 62,400
(s)	0	+ 0	+ 0	- 400	+ 0	+ 0	0	+ 0	+ 0	- 400
New Equation	50,000	+ 12,000	+ 0	+ 9,600	+ 2,000	+ 500	1,500	+ 9,500	+ 1,000+100	+ 62,000

9

JOURNALISING, POSTING AND BALANCING

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of an Account
- ◇ Traditional Classification of Accounts
- ◇ Accounting Equation Based Classification of Accounts
- ◇ Comparison of Traditional Classification and Accounting Equation Based Classification of Accounts
- ◇ Meaning and Rules of Debit and Credit
- ◇ Meaning and Format of Journal
- ◇ Ledger – Meaning, Form, Utility, Format of a Ledger Account
- ◇ Distinction between Journal and Ledger
- ◇ Distinction between Books of Original Entry and Ledger
- ◇ Posting – Meaning, Necessity, Procedure
- ◇ Compound Entry
- ◇ Meaning, Recording and Posting of Opening Entry
- ◇ Balancing of Accounts – Meaning, Significance, Procedure

1.0 MEANING OF AN ACCOUNT

An Account is a summary of relevant transactions at one place relating to a particular head. It records not only the amount of transaction but also their effect and direction.

2.0 TRADITIONAL CLASSIFICATION OF ACCOUNTS

The classification of accounts according to the Traditional Approach is given below:

CLASSIFICATION OF ACCOUNTS AS PER TRADITIONAL APPROACH

Types of Accounts	Meaning	Examples
(a) Personal Accounts	These accounts relate to natural persons, artificial persons and representative persons.	Natural –Ram's A/c Artificial –Ram & Co.'s etc Representative –Outstanding Salary A/c, Prepaid Insurance
(b) Real Accounts	These accounts relate to the tangible or intangible real assets.	Tangible –Land A/c Intangible –Goodwill A/c

(c) Nominal Accounts	These accounts relate to losses, profit & gains.	Expenses —Purchases A/c Loss —Loss by fire A/c Profits & Gains —Sales A/c, Discount Received A/c

3.0 ACCOUNTING EQUATION BASED CLASSIFICATION OF ACCOUNTS

The classification of accounts according to Accounting Equation Approach is given below:

CLASSIFICATION OF ACCOUNTS AS PER ACCOUNTING EQUATION APPROACH

Types of Accounts	Meaning	Examples
(a) Assets Accounts	These accounts relate to Tangible or Intangible real assets.	Land A/c, Building A/c, Cash A/c, Goodwill, Patents.
(b) Liabilities Accounts	These accounts relate to the financial obligations of an enterprise towards outsiders.	Trade Creditors, Bank overdraft, Short-term loans, Long-term loans.
(c) Capital Accounts	These accounts relate to owners of an enterprise.	Capital A/c, Drawings A/c.
(d) Revenue Accounts	These accounts relate of the amount charged for goods sold or services rendered or permitting others to use enterprise's resources yielding Interest, Royalty or Dividend.	Sales A/c, Discount Received A/c, Dividend Received A/c, Royalty Received A/c, Interest Received A/c.
(e) Expenses Accounts	These accounts relate to the amount incurred or lost in the process of earning revenue.	Purchases A/c, Discount Allowed A/c, Salaries A/c, Interest Allowed A/c, Loss by Fire A/c.

4.0 COMPARISON OF TRADITIONAL CLASSIFICATION & ACCOUNTING EQUATION BASED CLASSIFICATION OF ACCOUNTS

Traditional Classification of Accounts	Accounting Equation Based Classification of Accounts
1. Personal Accounts having debit balances (other than those relating to Owner)	Assets Accounts
2. Personal Accounts having credit balances (other than those relating to Owner)	Liabilities Accounts
3. Personal Account relating to Owner	Capital Account
4. Real Accounts	Assets Account
5. Nominal Accounts relating to Revenue	Revenue Account
6. Nominal Accounts relating to Expenses	Expenses Account

EXAMPLE 1

Classify the following Accounts:

1. Capital brought in	2. Drawings A/c	3. Building Purchased
4. Purchases A/c	5. Sales A/c	6. Carriage inward paid

7. Carriage outward paid	8. Cash received	9. Cash paid
10. Interest paid	11. Interest received	12. Commission paid
13. Commission received	14. Discount allowed	15. Conveyance charges
16. Sales promotion expenses	17. Entertainment expenses	18. Subscription paid
19. Subscription received	20. Light, Power & Electricity	21. Telephone, Postage Electricity and Telegram
22. Repairs incurred	23. Insurance premium paid	24. Bad Debts written off
25. Bad Debts recovered	26. Discount received	27. Printing & Stationery bought
28. Furniture and fixtures	29. Bank A/c	30. Wages and Salaries paid
31. Travelling charges	32. Current A/c of a partner	33. Loan Account of a partner
34. Sales Returns	35. Bank Overdraft	36. Purchases Returns A/c
37. Outstanding Salary A/c	38. Prepaid Rent A/c	39. Interest accrued A/c
40. Interest received in advance A/c		

SOLUTION**(a) According to Traditional Approach**

- (i) Personal Accounts – 1, 2, 29, 32, 33, 35, 37, 38, 39, and 40
- (ii) Real Accounts – 3, 8, 9, 27, 28
- (iii) Nominal Accounts – 4, 5, 6, 7, 10 to 26, 30, 31, 34, 36

(b) According to Accounting Equation Approach or Modern Approach

- (i) Assets Accounts – 3, 8, 9, 27, 28, 29, 38, 39
- (ii) Liabilities Accounts – 33, 35, 37, 40
- (iii) Capital Accounts – 1, 2, 32
- (iv) Revenue Accounts – 5, 11, 13, 19, 25, 26, 34
- (v) Expenses Accounts – 4, 6, 7, 10, 12, 14 to 18, 20 to 24, 30, 31, 36

5.0 MEANING AND RULES OF DEBIT AND CREDIT

- Basically debit means to enter an amount of transaction on the left side of an account and credit means to enter an amount of transaction on the right side on an account.
- In Accounting the abbreviated form Dr. stands for debit and Cr. stands for credit.
- Both debit and credit may represent either increase or decrease depending upon the nature of an account.
- Debit in relation to Assets Accounts and Expenses Accounts represents an increase but in relation to Liabilities Accounts, Capital Accounts and Revenue Accounts represents a decrease.
- Credit in relation to Assets Accounts and Expenses Accounts represents a decrease but in relation to Liabilities Accounts, Capital Accounts and Revenue Accounts represents an increase.
- The Rules for Debit and Credit are given below:

RULES FOR DEBIT AND CREDIT WHEN THE ACCOUNTS ARE CLASSIFIED AS PERSONAL, REAL AND NOMINAL

Types of Accounts	Rules for Debit	Rules for Credit
(a) For Personal Accounts	Debit the Receiver	Credit the Giver
(b) For Real Accounts	Debit What Comes in	Credit What Goes out
(c) For Nominal Accounts	Debit All Expenses & Losses	Credit all Gains and Profits

RULES FOR DEBIT AND CREDIT WHEN THE ACCOUNTS ARE CLASSIFIED ON ACCOUNTING EQUATION BASIS

Types of Accounts	Rules for Debit	Rules for Credit
(a) For Assets Accounts	Debit the Increase	Credit the Decrease
(b) For Liabilities Accounts	Debit the Decrease	Credit the Increase
(c) For Capital Accounts	Debit the Decrease	Credit the Increase
(d) For Revenue Accounts	Debit the Decrease	Credit the Increase
(e) For Expenses Accounts	Debit the Increase	Credit the Decrease

EXAMPLE 2

Which rule of Debit and Credit is applicable for each of the accounts referred to in Example 1?

SOLUTION

RULES OF DEBIT & CREDIT AS PER TRADITIONAL CLASSIFICATION

— Rule No. 1	Debit the receiver and credit the giver for 1, 2, 29, 32, 33, 35, 37, 38, 39 & 40.
— Rule No. 2	Debit what comes in and credit what goes out for 3, 8, 9, 27, 28.
— Rule No. 3	Debit all expenses and losses and credit all gains and profits for 4, 5, 6, 7, 10 to 26, 30, 31, 34 and 36.

RULES OF DEBIT AND CREDIT AS PER MODERN CLASSIFICATION

(a) For Assets Accounts	Debit the Increase and credit the Decrease for 3, 8, 9, 27, 28, 29, 38, 39.
(b) For Liabilities Accounts	Debit the decrease and credit the increase for 33, 35, 37, 40.
(c) For Capital Accounts	Debit the decrease and credit the increase for 1, 2, 32.
(d) For Revenue Accounts	Debit the decrease and credit the increase for 5, 11, 13, 19, 25, 26, 34.
(e) For Expenses Accounts	Debit the increase and credit the decrease for 4, 6, 7, 10, 12, 14 to 18, 20 to 24, 30, 31, 36.

6.0 MEANING AND FORMAT OF JOURNAL

MEANING OF JOURNAL, JOURNALISING AND JOURNAL ENTRY

Journal	A Journal is a book in which transactions are recorded in the order in which they occur i.e., in chronological order. A Journal is called a book of prime entry (also called of original entry) because all business transactions are entered first in this book.
Journalising	The process of recording a transaction in a journal is called Journalising .
Journal Entry	An entry made in the journal is called a Journal Entry .

FORMAT OF A JOURNAL**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr.(₹)</i>	<i>Cr.(₹)</i>

Date Column	Under this column, the date on which the transaction is entered is recorded. The year and month is written once, till they change.
Particulars Column	Under this column, first the names of the accounts to be debited, then the names of the accounts to be credited and lastly the narration (i.e., a brief explanation of the transaction) are entered.
L.F., Ledger Folio Column	Under this column, the ledger page number to containing the relevant account is entered at the time of posting.
Debit Amount Column	Under this column, the amount to be debited is entered.
Credit Amount Column	Under this column, the amount to be credited is entered.

Note: Except the L.F. column, all other columns are recorded at the time of journalising. The L.F. column is recorded at the time of posting.

MEANING OF JOURNALISING

The process of recording a transaction in the journal is called journalising. The various steps to be followed in journalising business transactions are given below:

STEPS IN JOURNALISING

- Step 1:** Ascertain What accounts are involved in a transaction.
- Step 2:** Ascertain What is the nature of the accounts involved.
- Step 3:** Ascertain Which Rule of debit and credit is applicable for each of the accounts involved.
- Step 4:** Ascertain Which Account is to be debited and which is to be credited.
- Step 5:** Record the date of transaction in the 'Date column'.
- Step 6:** Write the Name of the Account to be debited very close to the left hand side (i.e., the line demarcating the 'Date column' and the 'Particulars column') alongwith the abbreviation 'Dr.' on the same line against the name of the account in the 'Particulars column' and the amount to be debited in the 'Debit Amount column' against the name of the account.
- Step 7:** Write the name of the account to be credited in the next line preceded by the word 'To' at a few spaces towards right in the 'Particulars column' and the amount to be credited in the 'Credit Amount column' against the name of the account.
- Step 8:** Write 'Narration' (i.e., a brief description of the transaction) within brackets in the next line in the 'Particulars column'.
- Step 9:** Draw a line across the entire 'Particulars column' to separate one Journal Entry from the other.

Note: The 'Ledger Folio column' is filled in at the time of posting into the ledger and not at the time of journalising.

EXAMPLE 3

Analyse the following transactions according to the Traditional Approach:

- (a) Ganesh started his business with cash.
- (b) Borrowed from Mahesh.
- (c) Purchased furniture.
- (d) Purchased furniture from Mohan on credit.
- (e) Purchased goods for cash.
- (f) Purchased goods from Ram on credit.
- (g) Sold goods for cash.
- (h) Sold goods to Shyam on credit.
- (i) Received cash from Shyam.
- (j) Paid cash to Ram.
- (k) Deposited into bank.
- (l) Withdrew cash for personal use.
- (m) Withdrew from bank for office use.
- (n) Withdrew from bank for personal use.
- (o) Received a crossed cheque from a customer, Shyam at 3 p.m.
- (p) Deposited Shyam's cheque next day.
- (q) Bank intimated that Shyam's cheque was dishonoured.
- (r) Paid Ram by cheque.
- (s) Paid salary.
- (t) Paid rent by cheque.
- (u) Goods withdrawn for personal use.
- (v) Paid an advance to suppliers of goods.
- (w) Received an advance from customers.
- (x) Paid interest on loan.
- (y) Paid instalment of loan.
- (z) Interest allowed by bank.

SOLUTION**ANALYSIS OF TRANSACTIONS AS PER TRADITIONAL APPROACH**

<i>Transaction</i>	<i>What are the Accounts involved?</i>	<i>What is the nature of accounts involved?</i>	<i>How affected</i>	<i>Whether to be Debited or Credited</i>
(a)	Cash A/c	Real	Cash is coming in.	Debit
	Capital A/c	Personal	Ganesh is the giver.	Credit
(b)	Cash A/c	Real	Cash is coming in.	Debit
	Loan from Mahesh A/c	Personal	Mahesh is the giver.	Credit
(c)	Furniture A/c	Real	Furniture is coming in.	Debit

	Cash A/c	Real	Cash is going out.	Credit
(d)	Furniture A/c	Real	Furniture is coming in.	Debit
	Mohan's A/c	Personal	Mohan is the giver.	Credit
(e)	Purchases A/c	Nominal	Purchase is an expense.	Debit
	Cash A/c	Real	Cash is going out.	Credit
(f)	Purchases A/c	Nominal	Purchase is an expense.	Debit
	Ram's A/c	Personal	Ram is the giver.	Credit
(g)	Cash A/c	Real	Cash is coming in.	Debit
	Sales A/c	Nominal	Sales is a revenue.	Credit
(h)	Shyam's A/c	Personal	Shyam is the receiver.	Debit
	Sales A/c	Nominal	Sales is a revenue.	Credit
(i)	Cash A/c	Real	Cash is coming in.	Debit
	Shyam's A/c	Personal	Shyam is the giver.	Credit
(j)	Ram's A/c	Personal	Ram is the receiver.	Debit
	Cash A/c	Real	Cash is going out.	Credit
(k)	Bank A/c	Personal	Bank is the receiver.	Debit
	Cash A/c	Real	Cash is going out.	Credit
(l)	Drawings A/c	Personal	Ganesh is the receiver.	Debit
	Cash A/c	Real	Cash is going out.	Credit
(m)	Cash A/c	Real	Cash is coming in.	Debit
	Bank A/c	Personal	Bank is the giver.	Credit
(n)	Drawings A/c	Personal	Ganesh is the receiver.	Debit
	Bank A/c	Personal	Bank is the giver.	Credit
(o)	Cheques on hands A/c	Real	Cheque is coming in.	Debit
	Shyam's A/c	Personal	Shyam is the giver.	Credit
(p)	Bank A/c	Personal	Bank is the receiver.	Debit
	Cheques on hands A/c	Real	Cheque is going out.	Credit
(q)	Shyam's A/c	Personal	Shyam is the receiver.	Debit
	Bank A/c	Personal	Bank is the giver.	Credit
(r)	Ram's A/c	Personal	Ram is the receiver.	Debit
	Bank A/c	Personal	Bank is the giver.	Credit
(s)	Salary A/c	Nominal	Salary is an expense.	Debit
	Cash A/c	Real	Cash is going out.	Credit
(t)	Rent A/c	Nominal	Rent is an expense.	Debit
	Bank A/c	Personal	Bank is the giver.	Credit
(u)	Drawings A/c	Personal	Ganesh is the receiver.	Debit
	Purchases A/c	Nominal	It is a decrease in expense.	Credit
(v)	Adv. to Suppliers A/c	Personal	Suppliers are the receivers.	Debit
	Cash A/c	Real	Cash is going out.	Credit
(w)	Cash A/c	Real	Cash is coming in.	Debit

	Adv. from Customers A/c	Personal	Customers are the givers.	Credit
(x)	Interest on Loan A/c	Nominal	Interest on loan is an expense.	Debit
	Cash A/c	Real	Cash is going out.	Credit
(y)	Loan A/c	Personal	Lender is the receiver.	Debit
	Cash A/c	Real	Cash is going out.	Credit
(z)	Bank A/c	Personal	Bank is the receiver.	Debit
	Bank Interest A/c	Nominal	Bank Interest is a gain.	Credit

EXAMPLE 4

Analyse the transactions given in Example 3 according to the Accounting Equation Approach.

SOLUTION**ANALYSIS OF TRANSACTIONS AS PER ACCOUNTING EQUATION APPROACH**

<i>Transaction</i>	<i>What are the Accounts involved?</i>	<i>What is the nature of accounts involved?</i>	<i>How affected</i>	<i>Whether to be Debited or Credited</i>
(a)	Cash A/c	Asset	Increased	Debit
	Capital A/c	Capital	Increased	Credit
(b)	Cash A/c	Asset	Increased	Debit
	Loan from Mahesh A/c	Liability	Increased	Credit
(c)	Furniture A/c	Asset	Increased	Debit
	Cash A/c	Asset	Decreased	Credit
(d)	Furniture A/c	Asset	Increased	Debit
	Mohan's A/c	Liability	Increased	Credit
(e)	Purchases A/c	Expense	Increased	Debit
	Cash A/c	Asset	Decreased	Credit
(f)	Purchases A/c	Expense	Increased	Debit
	Ram's A/c	Liability	Increased	Credit
(g)	Cash A/c	Asset	Increased	Debit
	Sales A/c	Revenue	Increased	Credit
(h)	Shyam's A/c	Asset	Increased	Debit
	Sales A/c	Revenue	Increased	Credit
(i)	Cash A/c	Asset	Increased	Debit
	Shyam's A/c	Asset	Decreased	Credit
(j)	Ram's A/c	Liability	Decreased	Debit
	Cash A/c	Asset	Decreased	Credit
(k)	Bank A/c	Asset	Increased	Debit
	Cash A/c	Asset	Decreased	Credit
(l)	Drawings A/c	Capital	Decreased	Debit

	Cash A/c	Asset	Decreased	Credit
(m)	Cash A/c	Asset	Increased	Debit
	Bank A/c	Asset	Decreased	Credit
(n)	Drawings A/c	Capital	Decreased	Debit
	Bank A/c	Asset	Decreased	Credit
(o)	Cheques on hand A/c	Asset	Increased	Debit
	Shyam's A/c	Asset	Decreased	Credit
(p)	Bank A/c	Asset	Increased	Debit
	Cheques on hand A/c	Asset	Decreased	Credit
(q)	Shyam's A/c	Asset	Increased	Debit
	Bank A/c	Asset	Decreased	Credit
(r)	Ram's A/c	Liability	Decreased	Debit
	Bank A/c	Asset	Decreased	Credit
(s)	Salary A/c	Expense	Increased	Debit
	Cash A/c	Asset	Decreased	Credit
(t)	Rent A/c	Expense	Increased	Debit
	Bank A/c	Asset	Decreased	Credit
(u)	Drawings A/c	Capital	Decreased	Debit
	Purchases A/c	Expense	Decreased	Credit
(v)	Advance to Suppliers A/c	Asset	Increased	Debit
	Cash A/c	Asset	Decreased	Credit
(w)	Cash A/c	Asset	Increased	Debit
	Adv. from Customers A/c	Liability	Increased	Credit
(x)	Interest on Loan A/c	Expense	Increased	Debit
	Cash A/c	Asset	Decreased	Credit
(y)	Loan A/c	Liability	Decreased	Debit
	Cash A/c	Asset	Decreased	Credit
(z)	Bank A/c	Asset	Increased	Debit
	Bank Interest A/c	Revenue	Increased	Credit

ADVANTAGES OF JOURNAL

1. Chronological Record	Journal is a chronological record in the sense that it records the transactions in the order in which they occur.
2. Explanation of Transaction	Each journal entry in the journal carries narration which gives a brief explanation of the transaction.
3. Recording of both aspects	Both the aspects (i.e., debit and credit) of a transaction are recorded in the journal. Since the amounts recorded in both debit amount column and credit amount column must be equal, the possibility of committing error is reduced and the detection of errors, if any, committed becomes easy.

LIMITATIONS OF JOURNAL

When the number of transactions is large, it is practically impossible to record all the transactions through one journal because of the following reasons:

1. Time and Cost Consuming	The system of recording all the transactions in a journal requires (i) the writing down of the name of the account involved as many times as the transactions occur; and (ii) an individual posting of each account debited and credited and hence involves the repetitive journalising and posting labour.
2. Delay	Such a system does not provide the information on prompt basis.
3. No Internal Check	Such a system does not facilitate the installation of an internal check system since the journal can be handled by only one person.
4. Bulky and Voluminous	The journal becomes bulky and voluminous.

To overcome the shortcomings of the use of the journal only as a book of original entry, the journal is sub-divided into special journals.

The journal is sub-divided in such a way that a separate book is used for each category of transactions which are repetitive in nature and are sufficiently large in number.

7.0 TRADE DISCOUNT

It is a reduction granted by a supplier from the List Price of goods or services on business considerations (such as quantity bought, trade practices, etc.,) other than for prompt payment.

Example — If 10 Gold Rings are sold at the list price of ₹ 50,000 each subject to trade discount of 10%. In this case trade discount will be calculated as given on below:

10 Gold Rings @ ₹ 50,000	₹ 5,00,000
Less: Trade Discount @ 10%	₹ 50,000
Amount Payable as per Invoice	₹ 4,50,000

8.0 CASH DISCOUNT

A reduction granted by a supplier from the Invoice Price in consideration of immediate payment or payment within a stipulated period.

Example — If in the above example, terms of payable are 2%, 30 Days, it means buyer will get 2% cash discount if he makes payment within 30 days. In case the purchaser makes the payment within 30 days, the cash discount will be calculated as under:

Amount Payable as per Invoice	₹ 4,50,000
Cash Discount @ 2%	₹ 9,000
Cash paid within 30 days	₹ 4,41,000

9.0 DISTINCTION BETWEEN TRADE DISCOUNT AND CASH DISCOUNT

Trade Discount differs from Cash Discount in the following respects:

Basis of Distinction	Trade Discount	Cash Discount
1. Meaning	It is a reduction granted by a supplier from the List Price of goods or services on business considerations (such as quantity bought, trade practices, etc.,) other than for prompt payment.	A reduction granted by a supplier from the Invoice Price in consideration of immediate payment or payment within a credit period allowed.
2. Purpose	It is allowed to promote the sales or as a trade practices.	It is allowed to encourage the prompt payment.

3. Time when allowed	It is allowed on purchase of goods.	It is allowed on immediate payment or payment within a specified period.
4. Disclosure in the Invoice	It is shown by way of deduction in the invoice itself.	It is not shown in the invoice.
5. Ledger Account	Trade Discount Account is not opened in the ledger.	Cash Discount Account is opened in the ledger.
6. Variation	It may vary with the quantity purchased.	It may vary with the period within which the payment is made.

ILLUSTRATION 1

Journalise the following transactions in the books of Shri Ganesh.

2018	Particulars	₹
April 1	Shri Ganesh started his business with Cash	50,000
2	Purchased goods	5,000
3	Purchased goods for Cash	10,000
4	Purchased goods from Mr Sun for Cash	15,000
5	Sold goods	6,000
6	Sold goods for Cash	12,000
8	Sold goods to Mr Sky for Cash	18,000
9	Purchased goods from Mr Moon	10,000
10	Purchased goods from Mr Star on Credit	20,000
11	Sold goods to Mr Sea	12,500
12	Sold goods to Mr Ocean on Credit	25,000
13	Mr Sea returned goods	2,500
15	Returned goods to Mr Moon	2,000
16	Received from Mr Sea	9,900
	Allowed him discount	100
17	Paid Mr Moon	7,880
	Discount allowed by him	120
29	Withdrew for personal use	1,000
30	Withdrew goods for private use (Cost ₹ 500, Selling Price ₹ 600)	
31	Paid Salary to Mr Sevakram, an employee	500
31	Paid Rent to Mr Estate, landlord	500

SOLUTION**JOURNAL OF SHRI GANESH**

Date	Particulars	L.F.	Dr.(₹)	Cr.(₹)
2018 April 1	Cash A/c Dr. To Capital A/c (Being the capital brought in by Shri Ganesh)		50,000	50,000

2	Purchases A/c To Cash A/c (Being the goods purchased for cash)	Dr.		5,000	5,000
3	Purchases A/c To Cash A/c (Being the goods purchased for cash)	Dr.		10,000	10,000
4	Purchases A/c To Cash A/c (Being the goods purchased for cash)	Dr.		15,000	15,000
5	Cash A/c To Sales A/c (Being the goods sold for cash)	Dr.		6,000	6,000
6	Cash A/c To Sales A/c (Being the goods sold for cash)	Dr.		12,000	12,000
8	Cash A/c To Sales A/c (Being the goods sold for cash)	Dr.		18,000	18,000
9	Purchases A/c To Mr Moon (Being the goods purchased on credit from Mr Moon)	Dr.		10,000	10,000
10	Purchases A/c To Mr Star A/c (Being the goods purchased on credit from Mr Star)	Dr.		20,000	20,000
11	Mr Sea A/c To Sales A/c (Being goods sold on credit to Mr Sea)	Dr.		12,500	12,500
12	Mr Ocean A/c To Sales A/c (Being goods sold on credit to Mr Ocean)	Dr.		25,000	25,000
13	Sales Returns A/c To Mr Sea A/c (Being the goods returned by Mr Sea)	Dr.		2,500	2,500
15	Mr Moon A/c To Purchase Returns A/c (Being the goods returned to Mr Moon)	Dr.		2,000	2,000
16	Cash A/c Discount Allowed A/c To Mr Sea (Being Cash received from Mr Sea & allowed him discount ₹ 100)	Dr. Dr.		9,900 100	10,000

17	Mr Moon Dr. To Cash A/c To Discount Received A/c (Being Cash paid to Mr Moon & received discount of ₹ 120)		8,000	7,880 120
29	Drawings A/c Dr. To Cash A/c (Being the cash withdrawn for personal use)		1,000	1,000
30	Drawings A/c Dr. To Purchases A/c (Being the goods costing ₹ 500 withdrawn for personal use)		500	500
31	Salary A/c Dr. To Cash A/c (Being the salary paid to Sevakram)		500	500
31	Rent A/c Dr. To Cash A/c (Being rent paid to landlord)		500	500
	Total		2,08,500	2,08,500

ILLUSTRATION 2

Journalise the following Transactions of Ramesh:

2018	Particulars	₹
April 1	Ramesh started business with cash	10,000
2	Paid into Bank	7,000
3	Bought goods for cash	500
4	Drew Cash from bank for office	100
13	Sold goods to Krishna on credit	150
20	Bought goods from shyam on credit	225
24	Received from Krishna	145
	Allowed him discount	5
28	Paid Shyam Cash	215
	Discount allowed	10
30	Cash Sales for the month	800
	Paid Rent	50
	Paid salary	100

SOLUTION

JOURNAL OF RAMESH

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018 April 1	Cash A/c Dr. To Capital A/c (Being the amount invested by Ramesh in the business as capital)			10,000 10,000
2	Bank A/c Dr. To Cash A/c (Being the amount paid into bank)		7,000	7,000
3	Purchases A/c Dr. To Cash A/c (Being the goods purchased for cash)		500	500
4	Cash A/c Dr. To Bank A/c (Being the cash withdrawn from bank)		100	100
13	Krishna Dr. To Sales A/c (Being the goods sold to Krishna on credit)		150	150
20	Purchases A/c Dr. To Shyam (Being the goods bought from Shyam on credit)		225	225
24	Cash A/c Dr. Discount Allowed A/c Dr. To Krishna (Being the cash received from Krishna and allowed him discount)		145 5	150
28	Shyam Dr. To Cash A/c To Discount Received A/c (Being the cash paid to Shyam and Discount received)		225	215 10
30	Cash A/c Dr. To Sales A/c (Being the goods sold for cash)		800	800
30	Rent A/c Dr. Salaries A/c Dr. To Cash A/c (Being the amount paid for rent and salary)		50 100	150
	Total		19,300	19,300

ILLUSTRATION 3

Record the following transactions in the journal of the Delhi Furniture Marts:

2018	
Jan 1	Started business with cash ₹ 10,000.
2	Deposited into bank ₹ 9,000.
3	Purchased machinery for ₹ 5,000 from Jawahar and gave him a cheque for amount.
5	Paid installation charges of machinery ₹ 100.
20	Purchased timber from Naveen of the list price of ₹ 2,000. He allowed 10% Trade Discount.
23	Furniture costing ₹ 500 was used in furnishing the office.
25	Sold furniture to Naresh of the list price of ₹ 1,000 and allowed him 5% Trade Discount.
28	Received a crossed cheque from Naresh for ₹ 930 in full settlement and sent the cheque to bank.
29	Sent to Naveen in full settlement a cheque for ₹ 1,750.
31	Paid wages ₹ 350 and rent ₹ 200.

SOLUTION**JOURNAL OF THE DELHI FURNITURE MARTS**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
2018 Jan. 1	Cash A/c Dr. To Capital A/c (Being the business started with cash)		10,000	10,000
2	Bank A/c Dr. To Cash A/c (Being the cash deposited into Bank)		9,000	9,000
3	Machinery A/c Dr. To Bank A/c (Being the machinery purchased and paid by cheque)		5,000	5,000
15	Machinery A/c Dr. To Cash A/c (Being the installation charges of machinery capitalised)		100	100
20	Purchases A/c Dr. To Naveen (Being the timber purchased from Naveen ₹ 2,000 at a discount of 10%)		1,800	1,800
23	Office Furniture A/c Dr. To Purchases A/c (Being the furniture costing ₹ 500 use in furnishing the office)		500	500
25	Naresh Dr. To Sales A/c (Being the furniture sold to Naresh for ₹ 1,000 and allowed him 5% trade discount)		950	950

28	Bank A/c Dr. Discount Allowed A/c Dr. To Naresh (Being a cheque received from Naresh in full settlement sent to bank)		930 20	950
29	Naveen Dr. To Bank A/c To Discount Received A/c (Being a cheque for ₹ 1,750 sent to Naveen in full settlement of his account)		1,800	1,750 50
31	Wages A/c Dr. Rent A/c Dr. To Cash A/c (Being the amount paid for wages and rent)		350 200	550
	Total		30,650	30,650

RECORDING OF SPECIAL TRANSACTIONS RELATING TO GOODS

ILLUSTRATION 4

Journalise the following transactions in the books of Tushar:

- 1 Withdrawn goods for personal use (Sale Price ₹ 600, Cost ₹ 500).
- 2 Goods costing ₹ 500 given as charity (Sale Price ₹ 600)
- 3 Goods costing ₹ 1,000 distributed as free samples (Sale Price ₹ 1,200)
- 4 Goods stolen in transit (Sale Price ₹ 1,000, Cost ₹ 800)
- 5 Goods destroyed by fire (Sale Price ₹ 1,000, Cost ₹ 800)
- 6 Goods stolen by an employee (Sale Price ₹ 1,000, Cost ₹ 600)
- 7 Goods used in making of Furniture (Sale Price ₹ 2000, Cost ₹ 1,500)

SOLUTION

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Drawings A/c Dr. To Purchases A/c (Being the goods costing ₹ 500 withdrawn for personal use)		500	500
2.	Charity A/c Dr. To Purchases A/c (Being the goods distributed as charity)		500	500
3.	Free Sample A/c/Sales Promotion A/c Dr. To Purchases A/c (Being the goods costing ₹ 1,000 distributed as free samples)		1,000	1,000
4.	Loss in Transit A/c Dr. To Purchases A/c (Being the goods costing ₹ 800 stolen in transit)		800	800

5.	Loss due to fire A/c To Purchases A/c (Being the goods costing ₹ 800 destroyed by fire)	Dr.		800	800
6.	Loss by Embezzlement A/c To Purchases A/c (Being the goods costing ₹ 600 stolen by an employee)	Dr.		600	600
7.	Furniture A/c To Purchases A/c (Being the goods costing ₹ 1,500 used in making furniture)	Dr.		1,500	1,500
	Total			5,700	5,700

BANKING TRANSACTIONS

ILLUSTRATION 5

Journalise the following transactions:

1. Paid into bank ₹ 11,000 for opening a current account
2. Withdrew for private expenses ₹ 1,000
3. Withdrew from bank ₹ 3,000
4. Withdrew from bank for private use ₹ 1,500
5. Placed on Fixed Deposit A/c at Bank by transfer from current account ₹ 5,000.

SOLUTION

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Bank A/c To Cash A/c (Being the cash deposited into the bank)	Dr.	11,000	11,000
2.	Drawings A/c To Cash A/c (Being the cash withdrawn for personal use)	Dr.	1,000	1,000
3.	Cash A/c To Bank A/c (Being the cash withdrawn for office use)	Dr.	3,000	3,000
4.	Drawing A/c To Bank A/c (Being the cash withdrawn from bank for personal use)	Dr.	1,500	1,500
5.	Fixed Deposit A/c To Bank A/c (Being the transfer from current A/c to fixed deposit A/c)	Dr.	5,000	5,000
	Total		21,500	21,500

ILLUSTRATION 6

Journalise the following transactions:

2018	
March 1	Received a crossed cheque from Ramesh & Co. to whom goods were sold for ₹ 2,000 last year. Allowed him 1% discount.
2	Ramesh & Co.'s Cheque deposited into bank
5	Ramesh & Co.'s Cheque dishonoured (bank charged ₹ 10)
20	Ramesh & Co. settled his account by means of a Cheque for ₹ 2,025, ₹ 15 being for interest charged.
31	Bank charges (half yearly) ₹ 100

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
2018				
March 01	Cheques-on-hand A/c Dr. Discount Allowed A/c Dr. To Ramesh & Co. (Being a cheque received not yet deposited and discount allowed 1%)		1,980 20	2,000
March 02	Bank A/c Dr. To Cheques-on-hand A/c (Being the cheque deposited into the bank)		1,980	1,980
March 05	Ramesh & Co. Dr. To Discount allowed A/c To Bank A/c (Being the cheque of Ramesh & Co. dishonoured bank charges charged & discount already allowed disallowed)		2,010	20 1,990
March 20	Ramesh & Co. Dr. To Interest Received A/c (Being the interest due from Ramesh & Co.)		15	15
March 20	Bank A/c Dr. To Ramesh & Co. (Being Ramesh & Co. settled his account by means of a cheque)		2,025	2,025
March 31	Bank Charges A/c Dr. To Bank A/c (Being the bank charged it half-yearly charges)		100	100
	Total		8,130	8,130

10.0 LEDGER

After recording the transaction in the Journal, the next stage is the transfer of transactions in the respective accounts opened in the ledger.

MEANING OF LEDGER

1. A Ledger is a principal book which contains all the accounts (Assets Accounts, Liabilities Accounts, Capital Accounts, Revenue Accounts, Expenses Accounts) to which the transactions recorded in the books of original entry are transferred.
2. As the ledger is the ultimate destination of all transactions, the ledger is called the **Book of Final Entry**.
3. It is considered a permanent record and is more frequently referred to.
4. It may be noted that an account is a formal record of all transactions relating to change in a particular item.

FORM OF THE LEDGER

A ledger may be kept in the form of bound books, loose leaf sheets *or* CDs *or* RCDs *or* DVDs *or* PAN Drive (in case computer is used) *or* any other like device.

UTILITY OF THE LEDGER

The main utilities of a ledger are summarised as follows:

1. It provides complete information about all accounts in one book.
2. It enables to ascertain what the main items of revenues are.
3. It enables to ascertain what the main items of expenses are.
4. It enables to ascertain what the assets are and of what values.
5. It enables to ascertain what the liabilities are and of what amounts.
6. It facilitates the preparation of Final Accounts.

FORMAT OF A LEDGER ACCOUNT

A ledger account can be prepared in any one of the following two forms:

Form 1

Dr.(NAME OF THE ACCOUNT). LEDGER FOLIO NO. Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)

Form 2

.....(NAME OF THE ACCOUNT). LEDGER FOLIO NO.

Date	Particulars	Folio	Cr. (₹)	Cr. (₹)	Balance (₹)	Dr./Cr.

11.0 DISTINCTION BETWEEN JOURNAL AND LEDGER

Journal differs from the Ledger in the following respects:

Basis of Distinction	Journal	Ledger
1. Nature of Book	It is book of original <i>or</i> prime entry .	It is book of final <i>or</i> secondary entry .
2. Basis for Preparation	It is prepared on the basis of source documents of transactions.	It is prepared on the basis of journal .
3. Stage of Recording	Recording in the journal is the first stage.	Recording in the ledger is the second stage.
4. Object	It is prepared to record all transactions in chronological order .	It is prepared to know the net effect of various transactions affecting a particular account.
5. Format	In Journal, there are five column — 1. Date 2. Particulars 3. Ledger Folio 4. Debit Amount 5. Credit Amount	In ledger, there are identical four column on debit side and credit side. 1. Date 2. Particulars 3. Folio 4. Amount
6. Balancing	Journal is not balanced .	All ledger accounts (except nominal account) are balanced in the ledger.
7. Narration	Narration is written for each entry.	No narration is given.
8. Name of the Process of recording entries	The process of recording in journal is called Journalising .	The process of recording in the ledger is called Posting .
9. Basis for Preparation of Final Accounts	Journal directly does not serve as basis for the preparation of final accounts.	Ledger serves the basis for the preparations of final accounts.

12.0 DISTINCTION BETWEEN BOOKS OF ORIGINAL ENTRY AND LEDGER

Books of Original Entry and Ledger can be distinguished as follows:

Basis of Distinction	Books of Original Entry	Ledger
1. Nature of Book	There are books of original <i>or</i> prime entry .	This is a book of final <i>or</i> secondary entry .
2. Basis for Preparation	These books are prepared on the basis of source documents .	This book is prepared on the basis of books of original entry .
3. Stage of Recording	Recording of entries in these books is the first stage.	Recording of entries in the ledger is the second stage.
4. Net effect of various transactions	These books do not help to know the net effect of the various transactions affecting a particular account.	A ledger helps to know the net effect of the various transactions affecting a particular account.

5. Format	In the Journal, there is one column for particulars and two columns for amounts – one for debit and another for credit. Special journals (except Cash Book) have only one column of amount.	In the ledger, there are two divided sides having identical columns. The left side is known as debit and the right side is known as credit.
6. Balancing	In the books of original entry (except Cash Book) balancing is not done.	In the ledger, all the accounts (except nominal accounts) are balanced.
7. Next stage of accounting process	From the books of original entry, entries are transferred to the ledger.	From the ledger, first the trial balance is drawn and then financial statements are prepared.
8. Name of the process of recording entries	The process of recording entries in these books is called 'journalising'.	The process of recording entries in the ledger is called 'posting'.

13.0 POSTING

MEANING OF POSTING

1. Posting is the process of transferring the transactions recorded in the books of original entry in the concerned accounts opened in the ledger.
2. It may be done daily, weekly, fortnightly or monthly according to the convenience and requirements of the business.

NECESSITY OF POSTING

It is necessary to post all journal entries into various accounts in the ledger because posting helps us to know the net effect of various transactions during a given period on a particular account.

PROCEDURE OF POSTING FROM JOURNAL

The procedure of posting is given as follows:

PROCEDURE OF POSTING FOR AN A/C WHICH HAS BEEN DEBITED IN A TRANSACTION

Step 1: *With the help of an Index, open that page on which the concerned account appears.*

Step 2: *Enter the date of the transaction, in the 'Date column' on the debit side.*

Step 3: *Record the name of the account credited in the Journal, in the 'Particulars column' on the debit side as "To ... (name of the account credited)..."*

Step 4: *Record the page number of the Journal in the 'Folio column' on the debit side and in the journal, write the page number of the ledger on which a particular account appears in the 'Ledger Folio column'.*

Step 5: *Enter the relevant amount in the 'Amount column' on the debit side.*

PROCEDURE OF POSTING FOR AN ACCOUNT WHICH HAS BEEN CREDITED IN A TRANSACTION

Step 1: *With the help of an Index, open that page on which the concerned account appears.*

Step 2: *Enter the date of the transaction, in the 'Date column' on the credit side.*

Step 3: *Record the name of the account debited in the Journal in the 'Particulars column' on the credit side as "By.....(name of the account debited)....."*

Step 4: Record the page number of the Journal in the 'Folio column' on the credit side and in the journal, write the page number of the ledger on which a particular account appears in the 'Ledger Folio column'.

Step 5: Enter the relevant amount in the 'Amount column' on the credit side.

ILLUSTRATION 7

On 1.4.2018 Mohan, a customer, paid Cash ₹ 950 on account of ₹ 1,000. Journalise and post it into the ledger.

SOLUTION

JOURNAL

Folio 2

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018 April 1	Cash A/c To Mohan (Being cash received from Mohan on account)	Dr. 5 9	950	950

LEDGER CASH ACCOUNT

Folio 5

Dr.

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2018 April 1	To Mohan	2	950				

Folio 9

MOHAN'S ACCOUNT

Dr.

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
				2018 April 1	By Cash A/c	2	950

14.0 COMPOUND ENTRY

MEANING OF COMPOUND ENTRY

When more than two accounts are involved in a transaction and the transaction is recorded by means of a single journal entry instead of passing several journal entries, such single journal entry is termed as 'Compound Journal Entry'.

Note: A compound entry may also be passed if there are more transactions of the same nature taking place on the same date.

HOW TO PASS A COMPOUND ENTRY

Compound Entry may be recorded in the following three ways:

- by debiting one account and crediting two or more accounts; or
- by debiting two or more accounts and crediting one account; or
- by debiting several accounts and crediting several accounts.

EXAMPLES OF COMPOUND ENTRY

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	Paid ₹ 490 to Ram in full settlement of his account of ₹ 500. Ram' A/c Dr. 500 To Cash A/c 490 To Discount Received A/c 10 (Being cash paid to Ram in full settlement of his A/c)			
2.	Received ₹ 490 from Shyam in full settlement of his account of ₹ 500. Cash A/c Dr. 490 Discount Allowed A/c Dr. 10 To Shyam's A/c 500 (Being cash received from Shyam in full settlement of his account)			

ILLUSTRATION 18

On 2.4.2018 Mohan, a customer, paid cash ₹ 950 in full settlement of his account of ₹ 1,000. Journalise and post it into the ledger.

SOLUTION**JOURNAL****Folio 5**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
2018 April 2	Cash A/c Dr. 5 Discount Allowed A/c Dr. 4 To Mohan's A/c 8 (Being the cash received from Mohan in full settlement)		950 50	1,000

**LEDGER
CASH ACCOUNT****Folio 5***Dr.**Cr.*

<i>Date</i>	<i>Particulars</i>	<i>Folio</i>	<i>(₹)</i>	<i>Date</i>	<i>Particulars</i>	<i>Folio</i>	<i>(₹)</i>
2018 April 2	To Mohan's A/c	5	950				

DISCOUNT ALLOWED ACCOUNT**Folio 4***Dr.**Cr.*

<i>Date</i>	<i>Particulars</i>	<i>Folio</i>	<i>(₹)</i>	<i>Date</i>	<i>Particulars</i>	<i>Folio</i>	<i>(₹)</i>
2018 April 2	To Mohan's A/c	5	50				

Dr.

MOHAN'S ACCOUNT

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
				2018 April 2	By Cash A/c	5	950
					By Discount		
					Allowed A/c	5	50

15.0 MEANING, RECORDING AND POSTING OF OPENING ENTRY**MEANING OF AN 'OPENING ENTRY'**

'Opening Entry' is a journal entry by means of which previous accounting period's balances of various Assets, Liabilities and Capital are brought forward in the books of Current Accounting Period.

METHOD OF RECORDING AN 'OPENING ENTRY'

While passing an opening entry, all Assets Accounts (individually) are debited and all Liabilities Accounts (individually) are credited and the Net worth (i.e., Excess of Assets over Liabilities) is credited to Proprietor's Capital Account (in case of a Proprietary concern) or Partners' Capital Accounts (in case of a Partnership Concern).

PROCEDURE OF POSTING AN OPENING ENTRY

The procedure of posting an opening entry is same as in case of an ordinary journal entry except that in case of an account which has been debited, the words **To balance b/f** are recorded in the 'Particulars column' on the debit side and in case of an account which has been credited, the words **By balance b/f** are recorded in the 'Particulars column' on the credit side.

ILLUSTRATION 9

Pass the opening entry in the journal of Ram (as on 1st April 2018) and post the same into the ledger:
Cash-in-hand ₹ 1,000, Cash at Bank ₹ 5,000, Stock of ₹ 20,000, Land and Building ₹ 1,00,000, Plant and Machinery ₹ 50,000, Furniture and Fixtures ₹ 25,000, Owings from X Ltd. ₹ 12,500, Prepaid Insurance ₹ 500, Interest received in advance ₹ 250, Loan from Y Ltd. 10,000, Owing to Z Ltd. ₹ 3,750.

SOLUTION**JOURNAL**

Folio 1

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018 April 1	Cash in hand	Dr. 1	1,000	
	Bank	Dr. 2	5,000	
	Stock	Dr. 3	20,000	
	Land and Building	Dr. 4	1,00,000	
	Plant and Machinery	Dr. 5	50,000	
	Furniture and Fixtures	Dr. 6	25,000	
	X Ltd.	Dr. 7	12,500	
	Prepaid Insurance	Dr. 8	500	

To Interest received in advance	9	250
To Loan from Y Ltd.	10	10,000
To Z Ltd.	11	3,750
To Ram's Capital A/c (balancing figure)	12	2,00,000
(Being the balances brought forward from the last year)		

Dr. **LEDGER OF RAM CASH ACCOUNT** **Folio 1**
Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2018 April 1	To Balance b/f	1	1,000				

Dr. **BANK ACCOUNT** **Folio 2**
Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2018 April 1	To Balance b/f	1	5,000				

Dr. **STOCK ACCOUNT** **Folio 3**
Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2018 April 1	To Balance b/f	1	20,000				

Dr. **LAND AND BUILDING ACCOUNT** **Folio 4**
Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2018 April 1	To Balance b/f	1	1,00,000				

Dr. **PLANT & MACHINERY ACCOUNT** **Folio 5**
Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2018 April 1	To Balance b/f	1	50,000				

Dr. **FURNITURE & FIXTURES ACCOUNT** **Folio 6**
Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2018 April 1	To Balance b/f	1	25,000				

Dr. **X LTD.** Folio 7
Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2018 April 1	To Balance b/f	1	12,500				

Dr. **PREPAID INSURANCE** Folio 8
Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2018 April 1	To Balance b/f	1	500				

Dr. **INTEREST RECEIVED IN ADVANCE** Folio 9
Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
				2018 April 1	By Balance b/f	1	250

Dr. **LOAN FROM Y LTD.** Folio 10
Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
				2018 April 1	By Balance b/f	1	10,000

Dr. **Z LTD.** Folio 11
Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
				2018 April 1	By Balance b/f	1	3,750

Dr. **RAM'S CAPITAL ACCOUNT** Folio 12
Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
				2018 April 1	By Balance b/f	1	2,00,000

16.0 BALANCING OF ACCOUNTS

MEANING OF BALANCING OF ACCOUNTS

After posting into the ledger, the next stage is to ascertain the net effect of all transactions posted to an account. The process of ascertaining the difference between the total of debits and total of credits appearing in an account, is known as Balancing of an account.

BALANCE OF AN ACCOUNT

1. Balance of an account is the difference between the total of debits and total of credits appearing in an account.
2. It signifies the net effect of all transactions posted to that account during a given period.
3. It may be a debit balance or a credit balance or a nil balance depending upon whether the debit or the credit side total is higher.

TYPES OF ACCOUNTS THAT ARE BALANCED

Normally, Personal Accounts and Real Accounts are balanced. Nominal Accounts are not usually balanced but are closed by transfer to Trading and Profit & Loss Account.

SIGNIFICANCE OF BALANCING

Balancing an account is necessary to ascertain the net effect of all transactions posted to that account during a given period.

PROCEDURE FOR BALANCING A LEDGER ACCOUNT

Step 1: Total both the 'Debit Amount column' and 'Credit Amount column' separately and ascertain the difference in two totals.

Step 2: If the debit side total exceeds the credit side total, put such difference (called debit balance) on the credit side in 'Credit Amount column', write the date on which balancing is being done in the 'Date column' and the words 'By Balance c/d' in 'Particulars column'.

OR

If the credit side total exceeds the debit side total, put such difference (called credit balance) on the debit side in 'Debit Amount column', write the date on which balancing is being done in the 'Date column' and the words 'To Balance c/d' in 'Particulars column'.

Step 3: Total both the 'Debit Amount column' and 'Credit Amount column' and put the total on both the sides and draw a double line immediately beneath the totals.

Step 4: Enter the date of the beginning of next period in 'Date column' and bring down the debit balance on the debit side along with the words 'To Balance b/d' in Particulars column and the credit balance on the, credit side along with the words 'By Balance b/d' in 'Particulars column'.

ILLUSTRATION 10

Balance the following ledger accounts on 31st Jan. 2018.

Dr. **RAM'S ACCOUNT** Folio 8
Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2018				2018			
Jan 02	To Sales A/c		1,00,000	Jan 05	By Sales Returns		10,000
				Jan 25	By Cash A/c		20,000
				Jan 31	By Bank A/c		30,000
				Jan 31	By Discount A/c		1,000

Folio 8

Dr.

SHYAM'S ACCOUNT

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
6.1.2018	To Purchase Returns A/c		8,000	1.1.2018	By Purchases A/c		1,00,000
26.1.2018	To Cash A/c		20,000				
31.1.2018	To Bank A/c		30,000				
31.1.2018	To Discount A/c		1,000				

SOLUTION

STEPS INVOLVED IN BALANCING RAM'S ACCOUNT

- Step 1:** Total of Debit Amount Column ₹ 1,00,000
 Total of Credit Amount Column ₹ 61,000
 Difference or Balance ₹ 39,000
 Since the total of debit amount column exceeds the total of credit amount column, the difference in the both these totals is called Debit Balance. Credit side is called shorter side.
- Step 2:** Enter the date of balancing (i.e., 31.01.2018), in Date Column 'By Balance c/d' in Particulars column, and the difference in the Amount Column on the shorter side i.e., credit side.
- Step 3:** Total both the amounts columns and draw a double line immediately beneath the totals.
- Step 4:** Enter the date of the beginning of the next period (i.e., 1st Feb.) in the 'Date Column', 'To Balance b/d' in 'Particulars Column' and debit balance in 'Amount Column' on the debit side.

After taking the aforesaid steps, Ram's Account will appear as follows:

Folio 8

Dr.

RAM'S ACCOUNT

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2.1.2018	To Sales A/c		1,00,000	5.1.2018	By Sales Returns		10,000
				25.1.2018	By Cash A/c		20,000
				31.1.2018	By Bank A/c		30,000
				31.1.2018	By Discount A/c		1,000
				31.1.2018	By Balance c/d		39,000
			1,00,000				1,00,000
1.2.2018	To Balance b/d		39,000				

STEPS INVOLVED IN BALANCING SHYAM'S ACCOUNT

- Step 1:** Total of Debit Amount Column ₹ 59,000
 Total of Credit Amount Column ₹ 1,00,000
 Difference Balance ₹ 41,000
 Since the total of credit amount column exceeds the total of debit amount column, the difference in both these totals is called 'Credit Balance'. Debit side is called shorter side.

Step 2: Enter the date of Balancing (i.e., 31.01.2018) in the 'Date Column', 'To Balance c/d' on 'Particulars Column' and the difference in the Account Column on the shorter side i.e., debit side.

Step 3: Total both the amounts column and draw a double line immediately beneath the totals.

Step 4: Enter the date of the beginning of the next period (i.e., 1st Feb.) in the 'Date Column', 'By Balance c/d' in 'Particulars Column' & credit balance in 'Amount Column' on the credit side.

After taking the aforesaid steps, Shyam's Account will appear as follows:

Folio 8

Dr. **SHYAM'S ACCOUNT** Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
6.1.2018	To Purchase			1.1.2018	By Purchase A/c		1,00,000
	Return A/c		8,000				
26.1.2018	To Cash A/c		20,000				
31.1.2018	To Bank A/c		30,000				
31.1.2018	To Discount A/c		1,000				
31.1.2018	To Balance c/d		41,000				
			1,00,000				1,00,000
				1.2.2018	By Balance b/d		41,000

COMPREHENSIVE PROBLEMS FOR REVISION

Objective: The following Problems have been given Only to Revise the Chapter. In Examination only some of the parts and not all the parts of such lengthy problems may be asked.

PROBLEM 1

Journalise the following transactions in the Journal of Mr Tulsian:

01 Jan 2018	Started business with Cash ₹ 2,00,000, Goods ₹ 1,00,000, Furniture ₹ 50,000.
01 Jan 2018	Opened Current Account with ₹ 1,00,000.
02 Jan 2018	Placed an order with Ritik Roshan for the supply of goods of the list price of ₹ 1,00,000. In this connection, we paid 9% of the list price as an advance by cheque.
03 Jan 2018	Ritik Roshan supplied goods of the list price of ₹ 1,00,000 less 12% trade discount. Packing and Delivery charges ₹ 1,000.
04 Jan 2018	Purchased goods from Murlu of the list price of ₹ 1,00,000 less 12% trade discount and paid him by cheque under a cash discount of 5%.
05 Jan 2018	Received an order from Shyam for supply of goods of the list price of ₹ 1,00,000 with an advance of 10% of list price.
06 Jan 2018	Supplied the above goods at 10% trade discount. Packing and delivery charges ₹ 1,000.
07 Jan 2018	Goods costing ₹ 80,000 sold to Mr X at a profit of 20% on sales less 10% trade discount and received a cheque under 2% Cash discount.
08 Jan 2018	Goods (Cost ₹ 3,000, Sale Price ₹ 4,000) taken away by the proprietor for his personal use.

09 Jan 2018	Shyam became insolvent and paid 80 paise in a rupee in full & final settlement.
10 Jan 2018	Paid Ritik 80% on account.
11 Jan 2018	Goods (Cost ₹ 3,000, Sale Price ₹ 4,000) stolen.
12 Jan 2018	Paid Life Insurance Premium ₹ 1,000.
13 Jan 2018	Cash embezzled by an employee ₹ 1,000.

SOLUTION**JOURNAL OF MR TULSIAN**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr.(₹)</i>	<i>Cr.(₹)</i>
2018				
Jan 01	Cash A/c Dr. Purchases A/c Dr. Furniture A/c Dr. To Capital A/c (Being the cash, goods & furniture brought in as Capital)		2,00,000 1,00,000 50,000	3,50,000
Jan 01	Bank A/c Dr. To Cash A/c (Being the current account opened with ₹ 1,00,000)		1,00,000	1,00,000
Jan 02	Ritik Roshan Dr. To Bank A/c (Being advance paid to Ritik)		9,000	9,000
Jan 03	Purchases A/c Dr. To Ritik Roshan (Being the goods purchased on credit) List Price ₹ 1,00,000 Less: Trade Discount @ 12% ₹ 12,000 ₹ 88,000 Add: Packing & Delivery Charges ₹ 1,000 ₹ 89,000		89,000	89,000
Jan 04	Purchases A/c Dr. To Bank A/c To Discount Received A/c (Being the goods purchased against cheque) List Price ₹ 1,00,000 Less: Trade Discount 12% ₹ 12,000 ₹ 88,000 Less: Cash Discount 5% ₹ 4,400 ₹ 83,600		88,000	83,600 4,400
Jan 05	Cash A/c Dr. To Shyam (Being an advance received from Shyam)		10,000	10,000

Jan 06	Shyam To Sales A/c (Being the goods sold on credit) List Price ₹ 1,00,000 Less: Trade Discount @ 10% ₹ 10,000 ₹ 90,000 Add: Packing & Delivery charges ₹ 1,000 ₹ 91,000	Dr.		91,000	91,000
Jan 07	Bank A/c Discount Allowed A/c To Sales A/c (Being the goods sold against cheque) Cost ₹ 80,000 Add: Profit @ 25% ₹ 20,000 List Price ₹ 1,00,000 Less: Trade Discount @ 10% ₹ 10,000 ₹ 90,000 Less: Cash Discount @ 2% ₹ 1,800 ₹ 88,200	Dr. Dr.		88,200 1,800	90,000
Jan 08	Drawings A/c To Purchases A/c (Being the goods taken away by the proprietor for personal use)	Dr.		3,000	3,000
Jan 09	Cash A/c Bad Debts A/c To Shyam (Being 80 paise in a rupee received from Shyam in full and final settlement)	Dr. Dr.		64,800 16,200	81,000
Jan 10	Ritik To Cash A/c (Being 80% of the bal. i.e. (₹ 89,000 – ₹ 9,000) paid)	Dr.		64,000	64,000
Jan 11	Loss by Theft A/c To Purchases A/c (Being the goods stolen)	Dr.		3,000	3,000
Jan 12	Drawings A/c To Cash A/c (Being life insurance premium paid)	Dr.		1,000	1,000
Jan 13	Loss by Embezzlement A/c To Cash A/c (Being cash embezzled by an employee)	Dr.		1,000	1,000
	Total			9,80,000	9,80,000

PROBLEM 2

Journalise the following transactions in the books of Bharat Tulsian:

1. Received ₹ 9,000 from Hari Krishan in full settlement of his account for ₹ 10,000.
2. Received ₹ 9,000 from Shyam on his account for ₹ 10,000.
3. Received a first and final dividend of 90 paise in the rupee from the Official Receiver of Mr Rajan who owed us ₹ 10,000.
4. Paid ₹ 9,000 to Mohan in full settlement of his account for ₹ 10,000.
5. Paid ₹ 9,000 to Sohan on his account for ₹ 10,000.
6. Withdrawn for personal use: Goods (Sale Price ₹ 8,000, Cost ₹ 6,000), Cash ₹ 1,000
7. Goods costing ₹ 9,000 given as charity. (Sale Price ₹ 12,000)
8. Goods costing ₹ 3,000 distributed as free samples. (Sale Price ₹ 4,000)
9. Goods stolen in transit: (Sale Price ₹ 8,000, Cost ₹ 6,000)
10. Goods destroyed by fire (Sale Price ₹ 4,000, Cost ₹ 3,000)
11. Goods stolen by an employee (Sale Price ₹ 8,000, Cost ₹ 6,000), Cash embezzled by an employee ₹ 1,000.
12. Goods used in making of Furniture (Sale Price ₹ 12,000, Cost ₹ 9,000)
13. Paid Rent of building ₹ 50,000 half of the building is used by the proprietor for residential use.
14. Paid Fire Insurance of the above building in advance ₹ 20,000.
15. Paid Life Insurance Premium ₹ 20,000.
16. Paid Income tax ₹ 50,000.
17. Salary due to clerk ₹ 30,000.
18. Received commission ₹ 1,00,000 half of which is in advance.
19. Brokerage due to us ₹ 50,000.
20. Purchased Secondhand Machinery from Jawahar for ₹ 30,000 against a cheque.
21. Goods used in repairs of Machinery. (Sale Price ₹ 12,000, Cost ₹ 9,000)
22. Paid Installation Charges of Machinery ₹ 1,000.
23. Provide Depreciation for one month on above Machinery @ 15% p.a.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr.(₹)</i>	<i>Cr.(₹)</i>
1.	Cash A/c Dr. Discount allowed A/c Dr. To Hari Krishan (Being the cash received from Hari Krishan after allowing him discount of ₹ 1,000)		9,000 1,000	10,000
2.	Cash A/c Dr. To Shyam (Being the Cash received from Shyam on account)		9,000	9,000
3.	Cash A/c Dr. Bad Debts A/c Dr. To Rajan (Being the 90 paise in the rupee received from Rajan in full settlement)		9,000 1,000	10,000

4.	Mohan Dr. To Cash A/c To Discount received A/c (Being the Cash paid to Mohan after receiving discount of ₹ 1,000)		10,000	9,000 1,000
5.	Sohan Dr. To Cash A/c (Being the Cash paid to Sohan on account)		9,000	9,000
6.	Drawings A/c Dr. To Purchases A/c To Cash A/c (Being the Goods & Cash withdrawn for personal use)		7,000	6,000 1,000
7.	Charity A/c Dr. To Purchases A/c (Being the Goods distributed as charity)		9,000	9,000
8.	Free Sample A/c/Sales Promotion A/c Dr. To Purchases A/c (Being the Goods distributed as free samples)		3,000	3,000
9.	Loss in Transit A/c Dr. To Purchases A/c (Being the Goods stolen in transit)		6,000	6,000
10.	Loss due to fire A/c Dr. To Purchases A/c (Being the Goods destroyed by fire)		3,000	3,000
11.	Loss by Embezzlement A/c Dr. To Purchases A/c To Cash A/c (Being the Goods & Cash stolen by an employee)		7,000	6,000 1,000
12.	Furniture A/c Dr. To Purchases A/c (Being the Goods used in making furniture)		9,000	9,000
13. (i)	Rent A/c Dr. To Cash A/c (Being the rent paid for building)		50,000	50,000
13. (ii)	Drawings A/c Dr. To Rent A/c (Being the rent for half building charged to proprietor)		25,000	25,000
14. (i)	Fire Insurance premium A/c Dr. To Cash A/c (Being the fire insurance premium paid for building)		20,000	20,000

14. (ii)	Drawing A/c Dr. Prepaid Insurance Premium A/c Dr. To Fire Insurance Premium A/c (Being the fire insurance premium for half building charged to proprietor and remaining paid in advance)		10,000 10,000	20,000
15.	Drawings A/c Dr. To Cash Ac (Being the life insurance premium paid)		20,000	20,000
16.	Drawings A/c Dr. To Cash A/c (Being the Income Tax paid)		50,000	50,000
17.	Salary A/c Dr. To Outstanding Salary A/c (Being salary due to clerk)		30,000	30,000
18. (i)	Cash A/c Dr. To Commission A/c (Being the commission received)		1,00,000	1,00,000
18. (ii)	Commission A/c Dr. To Commission received in advance A/c (Being the commission received in advance adjusted)		50,000	50,000
19.	Accrued Brokerage A/c Dr. To Brokerage A/c (Being the brokerage due to us adjusted)		50,000	50,000
20.	Machinery A/c Dr. To Bank A/c (Being the machinery purchased and paid by cheque)		30,000	30,000
21.	Machinery A/c Dr. To Purchases A/c (Being the Goods used in repairs of Machinery)		9,000	9,000
22.	Machinery A/c Dr. To Cash A/c (Being the installation charges of machinery capitalised)		1,000	1,000
23.	Depreciation A/c [₹ 40,000 × 15/100 × 1/12] Dr. To Machinery A/c (Being the depreciation on Machinery provided)		500	500

10

SUBSIDIARY BOOKS I — CASH BOOK

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Need for Sub-division of the Journal
- ◇ Meaning of Special Journals (or Subsidiary Books)
- ◇ Advantages of Special Journals (or Subsidiary Books)
- ◇ Meaning and Types of Cash Books
- ◇ Single Column Cash Book – Meaning, Format
- ◇ Cash Book with Discount Column – Meaning, Format
- ◇ Three Column Cash Book – Meaning, Format, Posting
- ◇ Petty Cash Book – Meaning, Format, Posting

1.0 NEED FOR SUB-DIVISION OF THE JOURNAL

1. When the number of transactions is large, it is practically impossible to record all the transactions through one journal **because of the following limitations of Journal:**
 - (a) The system of recording all the transactions in a journal requires (i) the writing down of the name of the account involved as many times as the transactions occur; and (ii) an individual posting of each account debited and credited and hence involves the repetitive journalising and posting labour.
 - (b) Such a system does not provide the information on prompt basis.
 - (c) Such a system does not facilitate the installation of an internal check system since the journal can be handled by only one person.
 - (d) The journal becomes bulky and voluminous.
2. To overcome the shortcomings of the use of the journal only as a book of original entry, the journal is sub-divided into special journals.
3. The journal is sub-divided in such a way that a separate book is used for each category of transactions which are repetitive in nature and are sufficiently large in number.

2.0 MEANING OF SPECIAL JOURNALS (OR SUBSIDIARY BOOKS)

MEANING OF SPECIAL JOURNALS (OR SUBSIDIARY BOOKS)

Special Journals refer to the journals meant for specific transactions of similar nature. Special Journals are also known as subsidiary books or day books.

TYPES OF SPECIAL JOURNALS (OR SUBSIDIARY BOOKS)

The proforma and number of special journals vary according to the requirements of each enterprise. In any large business, the following special journals are generally used:

SPECIFIC TRANSACTIONS TO BE RECORDED IN SPECIAL JOURNALS

Name of Special Journal	Specific transactions to be recorded
I. Cash Journals: (a) Simple Cash Book (b) Cash Book with Discount Column (c) Cash Book with Bank & Discount Column (d) Petty Cash Book	Cash Transactions Cash and Discount transactions Cash, Bank and Discount transactions Petty Cash transactions
II. Goods Journals: (a) Purchases Book (b) Sales Book (c) Sales Returns Book (or Returns Inward book) (d) Purchase Returns Book (or Returns Outward Book)	Credit Purchases of Goods Credit Sales of Goods Goods returned by those customers to whom goods were sold on credit Goods returned to those suppliers from whom goods were purchased on credit
III. Bills Journal: (a) Bills Receivable Book (b) Bills Payable Book	Bills Receivable drawn Bills Payable accepted
IV. Journal Proper	Transactions not covered elsewhere

3.0 ADVANTAGES OF SPECIAL JOURNALS (OR SUBSIDIARY BOOKS)

The advantages of using Special Journals are as follows:

- Facilitates division of work** — The accounting work can be divided among many persons.
- Permits the installation of Internal Check System** — The accounting work can be divided in such a manner that the work of one person is automatically checked by another person. With the use of internal check, the possibility of occurrence of error/fraud may be avoided.
- Permits the use of specialized skill** — The accounting work requiring specialised skill may be assigned to a person possessing the required skill. With the use of a specialised skill, prompt, economical and more accurate supply of accounting information may be obtained.
- Time and labour saving in journalizing and posting** — For instance, when Sales Book is kept, the name of Sales Account will not be required to be written down in the Journal as many times as the sales transactions and at the same time, Sales Account will not be required to be posted again and again since only a periodic total of Sales Book is posted to the Sales Account.

4.0 MEANING AND TYPES OF CASH BOOKS

MEANING OF CASH BOOK

A Cash Book is a special journal which is used for recording all Cash Receipts and Cash Payments.

CASH BOOK — BOTH A JOURNAL AND A LEDGER

The Cash Book is a book of original entry (or Prime Entry) since transactions are recorded for the first time from the source documents. The Cash Book is a ledger in the sense that it is designed in the form of a Cash Account and records Cash receipts on the debit side and cash payments on the credit side. Thus, the Cash Book is both a journal and a ledger.

TYPES OF CASH BOOKS

The various types of Cash Book from the point of view of uses may be as follows:

1. Single Column Book
2. Cash Book with Discount Column
3. Cash Book with Bank & Discount Column
4. Petty Cash Book

5.0 SINGLE COLUMN CASH BOOK**MEANING OF SINGLE COLUMN CASH BOOK**

Single Column Cash Book has one amount column on each side. All cash receipts are recorded on the debit side and all cash payments on the credit side. In fact, this book is nothing but a Cash Account. Hence, there is no need to open Cash Account in the ledger.

FORMAT OF SINGLE COLUMN CASH BOOK*Debit Side***SINGLE COLUMN CASH BOOK***Credit Side*

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>(₹)</i>	<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>(₹)</i>

ILLUSTRATION 1

Enter the following transactions in Single Column Cash Book:

<i>Date</i>	<i>Particulars</i>	<i>₹</i>
2018		
Jan. 1	Cash in hand	1,700
5	Paid to R. Bansal	300
	Discount allowed by him	10
8	Purchased goods from Goyal & Co. for cash	400
10	Received from R. Kansal	980
	Discount allowed	20
16	Sold goods to Garg & Co. for cash	400
21	Paid to S. Ansel	295
	Discount received	5
25	Paid wages	50
31	Paid to X & Co. in full settlement of his account which shows a credit balance of ₹ 400	390
31	Purchased furniture	200

SOLUTION
Dr.
CASH BOOK
Cr.

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>(₹)</i>	<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>(₹)</i>
2018				2018			
Jan. 1	To Balance b/d		1,700	Jan. 5	By R. Bansal		300
10	To R. Kansal		980	8	By Purchases		400
15	To Sales A/c		400	21	By S. Ansel		295
				25	By Wages A/c		50
				31	By X & Co.		390
					By Furniture		200
					By Balance c/d		1,445
			3,080				3,080
2018							
Feb. 1	To Balance b/d		1,445				

ILLUSTRATION 2

Prepare a Simple Cash Book from the following transactions of Mr Ram Gopal of Delhi.

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
April 1	Mr Ram Gopal Commenced	8,000	April 17	Paid for stationery	15
April 3	business with cash		April 21	Paid for office furniture	185
April 5	He bought goods for cash	5,000	April 22	Received from	
April 6	Sold goods for cash	100	April 25	Mr Kailash Chand	680
April 9	Received cash from		April 28	Paid for advertising	90
April 13	Mr Manohar Lal	360	April 30	Purchased Postage	8
April 16	Paid into bank	3,000		stamps	
	Paid cash to Hari Krishan	215		Paid rent	100
	Sold goods for cash	1,500		Paid electricity charges	15

SOLUTION
Dr.
CASH BOOK
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<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>(₹)</i>	<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>(₹)</i>
2018				2018			
April 1	To Capital A/c		8,000	April 3	By Purchases A/c		5,000
5	To Sales A/c		100	9	By Bank A/c		3,000
6	To Manohar Lal		360	13	By Hari Krishan		215
16	To Sales A/c		1,500	17	By Stationery A/c		15
21	To Kailash Chand		680	18	By Furniture A/c		185
				22	By Advertising A/c		90
				25	By Postage A/c		8
				28	By Rent A/c		100
				30	By Electricity		15
				30	Charges A/c		2,012
			10,640		By Balance c/d		
							10,640
May 1	To Balance b/d		2,012				

6.0 TRADE DISCOUNT AND CASH DISCOUNT**MEANING OF TRADE DISCOUNT**

It is a reduction granted by a supplier from the list price of goods *or* services on business considerations (such as quantity bought, trade practices, etc.,) other than for prompt payment. List Price is the selling price as printed on the product *or* in the List/Catalogue of products.

Example — If 10 Gold Rings are sold at the list price of ₹ 50,000 each subject to trade discount of 10%. In this case trade discount will be calculated as under:

10 Gold Rings @ ₹ 50,000	₹ 5,00,000
Less: Trade Discount @ 10%	₹ 50,000
Amount Payable as per Invoice	₹ 4,50,000

MEANING OF CASH DISCOUNT

A reduction granted by a supplier from the invoice price in consideration of immediate payment *or* payment within a credit period allowed.

Example — If in the above example, terms of payable are 2%, 30 Days, it means buyer will get 2% Cash Discount if he makes payment within 30 days. In case the purchaser makes the payment within 30 days, the Cash Discount will be calculated as under:

Amount Payable as per Invoice	₹ 4,50,000
Less: Cash Discount @ 2%	₹ 9,000
Cash paid within 30 days	₹ 4,41,000

DISTINCTION BETWEEN TRADE DISCOUNT AND CASH DISCOUNT

Trade Discount differs from Cash Discount in the following respects:

Basis of Distinction	Trade Discount	Cash Discount
1. Meaning	It is a reduction granted by a supplier from the List Price of goods <i>or</i> services on business considerations (such as quantity bought, trade practices, etc.,) other than for prompt payment.	A reduction granted by a supplier from the Invoice Price in consideration of immediate payment <i>or</i> payment within a credit period allowed.
2. Purpose	It is allowed to promote the sales or as a trade practices.	It is allowed to encourage the prompt payment .
3. Time when allowed	It is allowed on purchase of goods.	It is allowed on immediate payment or payment within a specified period.
4. Disclosure in the Invoice	It is shown by way of deduction in the invoice itself.	It is not shown in the invoice.
5. Ledger Account	Trade Discount Account is not opened in the ledger.	Cash Discount Account is opened in the ledger.
6. Variation	It may vary with the quantity purchased.	It may vary with the period within which the payment is made.

Example: Ram sold Goods of the list price of ₹ 1,00,000 to Shyam subject to Trade Discount of 10% and Cash Discount of 5% if payment is made immediately. Shyam made the payment immediately.

In this case, discount will be calculated as under:

A. List Price	₹ 1,00,000
B. Less: Trade Discount @ 10%	₹ 10,000
C. Amount of Invoice	₹ 90,000
D. Less: Cash Discount @ 5%	₹ 4,500
E. Net Amount Paid	₹ 85,500

7.0 CASH BOOK WITH DISCOUNT COLUMN

MEANING OF CASH BOOK WITH DISCOUNT COLUMN

Cash Book with Discount Column has two amount columns (one for Cash and another for Discount) on each side. All Cash Receipts and Cash Discount allowed are recorded on the debit side and all Cash Payments and Cash Discount received are recorded on the credit side.

FORMAT OF CASH BOOK WITH DISCOUNT COLUMN

Debit Side

CASH BOOK WITH DISCOUNT COLUMN

Credit Side

Date	Particulars	L.F.	Discount ₹	Cash ₹	Date	Particulars	L.F.	Discount ₹	Cash ₹

ILLUSTRATION 3

Prepare a Two Column Cash Book from the following transactions of Shri R. K. Gupta:

Date	Particulars	₹
2018 Jan. 1	Cash in hand	4,000
6	Cash Purchases	2,000
10	Wages paid	40
11	Cash Sales	6,000
12	Cash received from Suresh and allowed him discount	1,980 20
19	Cash paid to Munna and discount received	2,470 30
27	Cash paid to Radhey	400
28	Purchased goods for cash	2,070

SOLUTION

Dr.

TWO COLUMN CASH BOOK OF SHRI R.K. GUPTA

Cr.

Date	Particulars	L.F.	Discount ₹	Cash ₹	Date	Particulars	L.F.	Discount ₹	Cash ₹
2018 Jan. 1	To Balance b/d			4,000	2018 Jan. 6	By Purchases A/c			2,000
11	To Sales A/c			6,000	10	By Wages A/c			40
	To Suresh		20	1,980	19	By Munna			2,470
					27	By Radhey		30	400
					28	By Purchases A/c			2,070
					31	By Balance c/d			5,000
			20	11,980				30	11,980
2018 Feb. 1	To Balance b/d			5,000					

8.0 THREE COLUMN CASH BOOK**MEANING OF THREE COLUMN CASH BOOK**

Three Column Cash Book has three amount columns (one for Cash, one for Bank and one for Discount) on each side. All Cash Receipts, Deposits into Bank and Discount Allowed are recorded on debit side and all Cash Payments, Withdrawals from bank and Discount Received are recorded on the credit side. In fact, a three column cash book serves the purpose of Cash Account and Bank Account. Hence, there is no need to open these two accounts in the ledger.

FORMAT OF THREE COLUMN CASH BOOK*Debit side***THREE-COLUMN CASH BOOK***Credit Side*

Date	Particulars	L.F.	Dis- count (₹)	Cash (₹)	Bank (₹)	Date	Particulars	L.F.	Dis- count (₹)	Cash (₹)	Bank (₹)

POSTING FROM MAIN CASH BOOK

The various items appearing on the debit side and credit side of the Cash Book are posted as follows:

Posting of items appearing on debit side	Posting of items appearing on credit side
(a) All the receipts appearing on the debit side are posted to the credit of the respective ledger accounts in the ledger by writing 'By Cash/Bank A/c' in the particulars column since cash/cheque has been received in respect of them.	All the payments appearing on the credit side are posted to the debit of the respective ledger accounts in the ledger by writing 'To Cash/Bank A/c' in the particulars column since cash/cheque has been paid in respect of them.
(b) An individual entry in the discount allowed column is posted to the credit of the respective personal accounts in the ledger by writing 'By Discount Allowed A/c' in the particulars column.	An individual entry in the discount received column is posted to the debit of the respective personal accounts in the ledger by writing 'To Discount Received A/c' in the particulars column.
(c) The total of discount allowed column on the debit side is posted to the debit of the 'Discount Allowed A/c' in the ledger by writing 'To Sundries as per Cash Book' in the particulars column.	The total of discount received column on the credit side is posted to the credit of the 'Discount Received A/c' in the ledger by writing 'By Sundries as per Cash book' in the particulars column.

TUTORIAL NOTES

1. Cash account is not opened in the ledger since the 'Cash column' in the Cash Book serves the purpose of a Cash Account.
2. In case of a Cash Book with Bank Column, Bank Account is not opened in the ledger since the 'Bank column' in the Cash Book serves the purpose of a Bank Account.
3. In case of Cash Book with Discount column, 'Discount Allowed Account' and 'Discount Received Account' are opened in the ledger since the Cash Book does not serve the purpose of Discount Account.
4. In case of Cash Book with Discount Column, 'Discount Columns' are totalled and never balanced.
5. Posting in the 'Discount Allowed Account' and 'Discount Received Account' are made only for the totals and not for the individual transactions.
6. All Contra entries (i.e., entries of which debit and credit aspects are simultaneously recorded in the Cash Book. e.g. cash deposited into the Bank or Cash withdrawn from the Bank) are ignored while

posting from Cash Book to the Ledger since both the aspects (Debit and Credit) are recorded in the Cash Book itself. These entries are marked with letter 'C' in Ledger Folio Column.

7. Whenever cheques/drafts received are not deposited immediately into the bank, then all such receipts should be first recorded as 'Cheques-on-hand' in the Journal Proper and subsequently, when these are deposited into the bank, the same should be recorded on debit side in 'Bank Column' by writing 'To Cheques-on-hand A/c' in the particulars column.
8. Unless otherwise indicated it is presumed that the cheque received has been deposited on the very same day.

ILLUSTRATION 4

Prepare a Three Column Cash Book of M/s Tulsian & Co. from the following particulars.

Date	Particulars
2018	
Jan. 1	Cash in hand ₹ 50,000, Bank Overdraft ₹ 20,000.
2	Paid into bank ₹ 10,000.
3	Bought goods from Hari for ₹ 200 for cash.
4	Bought goods for ₹ 2,000 paid cheque for them, discount allowed 1%.
5	Sold goods to Mohan for cash ₹ 1,175.
6	Received a crossed cheque from Shyam to whom goods were sold for ₹ 800. Discount allowed 12.5%.
7	Shyam's cheque deposited into bank.
8	Purchased an old typewriter for ₹ 200. Spent ₹ 50 on its repairs.
9	Bank notified that Shyam's cheque has been returned dishonoured and debited the account in respect of charges ₹ 10.
10	Received a money order for ₹ 25 from Hari.
11	Shyam settled his account by means of a crossed cheque for ₹ 820, ₹ 20 being for interest charged.
12	Withdrew from bank ₹ 10,000.
18	Discounted a B/E for ₹ 1,000 at 1% through bank.
20	Honoured our own acceptance by cheque ₹ 5,000.
22	Withdrew for personal use ₹ 1,000.
24	Paid trade expenses ₹ 2,000.
25	Withdrew from bank for private expenses ₹ 1,500.
26	Purchased machinery from Rajiv for ₹ 5,000 and paid him by means of a bank draft purchased for ₹ 5,005.
27	Issued cheque to Ram Saran for cash purchase of furniture ₹ 1,575.
28	Received a crossed cheque for commission ₹ 500 from R. & Co. and deposited into bank.
29	Ramesh who owed us ₹ 500 became bankrupt and paid us 50 paise in the rupee.
30	Received payment of a loan of ₹ 5,000 and deposited ₹ 3,000 out of its into bank.
31	Paid rent to landlord 'Mohan' by a cheque of ₹ 220.
31	Interest allowed by bank ₹ 30.
31	Half yearly bank charges ₹ 50.

SOLUTION: [See Solution on page 10.10]

Solution to Illustration 4:**Dr. THREE COLUMN CASH BOOK OF M/S TULSIAN & CO.****Cr.**

Date	Particulars	L.F.	Discount (₹)	Cash (₹)	Bank (₹)	Date	Particulars	L.F.	Discount (₹)	Cash (₹)	Bank (₹)
2018						2018					
Jan. 1	To Balance b/d					Jan. 1	By Balance b/d				20,000
2	" Cash			50,000		Jan. 2	By Bank A/c			10,000	
5	" Sales	C		1,175	10,000	3	" Purchases A/c			200	
7	" Cheque-on-hand					4	" Purchases A/c		20		1,980
10	" Hari				700	8	" Typewriter			200	
11	" Shyam			25			" Typewriter		100	50	
					820	9	" Shyam				700
12	" Bank						" Bank charges				10
18	" B/E	C	10	10,000		12	" Cash				10,000
28	" Commission				990	20	" B/P				5,000
29	" Ramesh			250	500	22	" Drawings			1,000	
30	" Loans			5,000		24	" Trade expenses			2,000	
	" Cash	C			3,000	25	" Drawings				1,500
31	" Interest				30	26	" Machinery				5,000
31	" Balance c/d (Bank overdraft)				30,000		" Draft Commission				5
						27	" Furniture				1,575
						30	" Bank	C		3,000	
						31	" Rent				220
							" Bank charges				50
							" Balance c/d				50,000
			10	66,450	46,040				120	66,450	66,450
2018						2018					
Feb. 1	To Balance b/d			50,000		Feb. 1	By Balance b/d				30,000

9.0 PETTY CASH BOOK

MEANING OF PETTY CASH BOOK

Petty Cash Book is the book which is used to record the payments of Petty Cash Expenses.

MEANING OF PETTY CASHIER

Petty Cashier is the person who is authorised to make payments of Petty Cash Expenses and to record them in Petty Cash Book.

FEATURES OF PETTY CASH BOOK

The main features of petty cash book are as follows:

1. The amount of cash received from the main cashier is recorded on the left hand side column.
2. The payments of petty cash expenses are recorded on the right hand side in the respective columns.
3. It can never show a credit balance because the cash payments can never exceed the cash receipts.
4. Its balance represents unspent petty cash in hand.
5. Recording is done on the basis of internal as well as external vouchers. Whenever external vouchers are not received, (e.g. in case of autorickshaw charges, coolie charges, postage stamps etc.), internal vouchers are prepared and got verified by an authorised person.
6. All the columns of expenses are totalled periodically and such periodic totals are individually posted to the debit side of the respective expenses accounts in the ledgers by writing 'To Sundries as per Petty Cash Book' in the particulars column.
7. Petty Cash Book is both a book of original entry as well as a book of final entry. In other words, it serves the purpose of both journal and ledger. It is a journal in the sense that all petty cash payments are recorded in it for the first time from the source documents. It is a ledger in the sense that it serves the purpose of 'Petty Cash Account' in which cash receipts from main cashier are recorded on the debit side and cash payments are recorded on the credit side. Hence, there is no need to open Petty Cash Account in the ledger.

SIMILARITIES BETWEEN MAIN CASH BOOK & PETTY CASH BOOK

1. Both are books of original entry. In other words, both serve the purpose of journal. Both are journal in the sense that the transactions are recorded in it for the first time from the source documents.
2. Both are books of final entry. In other words, both serve the purpose of ledger. Both are ledger in the sense that main cash book serves the purpose of 'Main Cash A/c' & 'Bank Account' (only in case of three column cash book) and Petty Cash Book serves the purpose of 'Petty Cash A/c'.

DIFFERENCES BETWEEN MAIN CASH BOOK & PETTY CASH BOOK

1. In the Main Cash Book **all Cash Receipts** are recorded whereas in the Petty Cash Book only **Cash Receipts from Main Cashier** are recorded.
2. In the Main Cash Book **all Cash Payments except payments of Petty Cash Expenses**, are recorded whereas in the Petty Cash Book **only Payments of Petty Cash Expenses** are recorded.

IMPREST VS. NON-IMPREST SYSTEM OF PETTY CASH BOOK

- (a) **Meaning of Imprest or Float** — The amount which the main cashier hands over to the petty cashier in order to meet the petty cash expenses of a given period is known as 'Imprest' or 'Float'.

1. Control over Mistakes	The choices of mistakes are reduced since the chief cashier regularly examines the petty cash book.
2. Control over Petty Expenses	Petty expenses are kept within the limits imprest since the petty cashier can never of spend more than the available petty cash.
3. Control over Fraud	Misappropriation if any, is always kept within the limits of imprest.

The format of Petty Cash Book may be designed according to the requirements of the business. However, the simplest form is given below:

[illegible]

ADVANTAGES OF PETTY CASH BOOK

- 1. Saving of Chief Cashier's Time** — The time of chief cashier is saved when petty expenses are recorded in petty cash book.
- 2. Saving of Labour in Posting** — There is saving in labour in posting because of the following two reasons:
 - (a) limited number of accounts are opened for heads of petty expenses only,
 - (b) periodical totals (say monthly) of each column of expenses are posted to the debit of the respective ledger accounts.
- 3. Control over Mistakes** — The chances of mistakes are reduced since the chief cashier regularly examines the petty cash book.
- 4. Control over Petty Expenses** — Petty expenses are kept within the limits of imprest since the petty cashier can never spend more than the available petty cash.
- 5. Control over Fraud** — Misappropriation if any, is always kept within the limits of imprest.
- 6. Benefits of Specialisation** — The benefits of specialisation are available since recording of cash transactions is divided between main cash book and petty cash book.

POSTING FROM PETTY CASH BOOK

All the heads of expenses (including miscellaneous) are totalled periodically (usually monthly) and such periodic totals are individually posted to the debit side of the concerned ledger accounts in the ledger by writing 'To Sundries as per Petty Cash Book' in the particulars column. The ledger folio number is written under every total amount of expense to indicate that the entry has been posted in the ledger. In the folio column of the ledger account, the page number of the petty cash book is written.

ILLUSTRATION 6

From the following particulars, prepare Petty Cash Book on imprest system of Shri Lakshman & Co:

Date	Particulars	₹
2018		
Jan. 1	Opening balance (on imprest system)	100
2	Paid for stamps	12
3	Paid cleaners wages	15
4	Paid for fare	16
5	Paid for office tea etc.	15
6	Paid for repairs of cycle	10
7	Paid for advertisement	30
8	Drew imprest from head cashier	
9	Paid for cartage	10
10	Paid for travelling expenses	25
11	Paid for telegram sent	15
12	Paid for entertainment to travelling salesmen	20
13	Paid for Repairs of Cycle	10
14	Paid for printing bill	5
15	Paid for stationery	3
16	Drew imprest from head cashier	

SOLUTION

[See Solution on page 10.15 and 10.16]

ILLUSTRATION 7

Insert the following transactions in Tabular Petty Cash Book. On 1st Feb. 2018 ₹ 40 were given to Petty Cash Clerk.

Date	Particulars	₹
2018		
Feb. 1	Chowkidar Wages	15.00
2	Pencils	5.25
8	Railways freight on account of books	2.31
12	Postage Stamps	1.25
14	Telegrams	2.44
15	Sundry Expenses	0.56

SOLUTION**PETTY CASH BOOK**

Cash Receipts (₹)	Date	Particulars	V. No	Total Amount paid (₹)	Printing & Stationery (₹)	Wages (₹)	Postage & Stamps (₹)	Carriage (₹)	Misc. Exp. (₹)
40.00	2018 Feb. 1	To Cash							
	1	By Chowkidar Wages	1	15.00		15.00			
	2	By Pencils	2	5.25	5.25				
	8	By Railway freight	3	2.31				2.31	
	12	By Postage & Stamps	4	1.25			1.25		
	14	By Telegram	5	2.44			2.44		
	15	By Sundry Expenses	6	0.56					0.56
		Total Payment		26.81	5.25	15.00	3.69	2.31	0.56
	28	By Balance c/d		13.19					
40.00		Grand Total		40.00					
	March								
13.19	1	To Balance b/d							
26.81	1	To Cash							

Solution to Illustration 6:

PETTY CASH BOOK

Receipts				Payments									
Date	Particulars	Cash Book Folio	Total (₹)	Date	Particulars	Voucher No.	Postage Telegram (₹)	Conveyance Travelling (₹)	Staff Welfare Entertainment (₹)	Cartage (₹)	Printing & Stationery (₹)	Misc. Items (₹)	Total (₹)
2018 Jan. 1	To balance b/d		100	2018	Stamps	101	12						12
				Jan. 2	Cleaners' Wages	102						15	15
				3	Fare	103		16					16
				4	Office Tea	104				15			15
				5	Repairs	105						10	10
				6	Advertisement	106						30	30
				7	Balance c/d								
			100				12	16	15	—	—	55	100

PETTY CASH BOOK

Receipts				Payments									
Date	Particulars	Cash Book Folio	Total (₹)	Date	Particulars	Voucher No.	Postage Telegram (₹)	Conveyance Travelling (₹)	Staff Welfare Entertainment (₹)	Cartage (₹)	Printing & Stationery (₹)	Misc. Items (₹)	Total (₹)
2018 Jan. 8	To balance b/d		2	Jan. 9	Cartage	107				10			10
	To Cash from Head Cashier		98	10	Travelling	108		25					25
				11	Telegram	109	15						15
				12	Entertain ment	110			20				20
				13	Repairs	111						10	10
				14	Printing	112					5		5
				15	Stationery	113					3		3
				15	Balance c/d								12
			100				15	25	20	10	8	10	100
Jan. 16	To balance b/d		12										
	To Cash from Head Cashier		88										

Note: The numbers assigned to vouchers are imaginary.

11

SUBSIDIARY BOOKS II — BOOKS OTHER THAN CASH BOOK

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Purchases Book – Purpose, Source Document, Contents, Format, Posting
- ◇ Sales Book – Purpose, Source Document, Contents, Format, Posting
- ◇ Purchases Returns Book – Purpose, Source Document, Contents, Format, Posting
- ◇ Sales Returns Book – Purpose, Source Document, Contents, Format, Posting
- ◇ Journal Proper – Purpose

1.0 PURCHASES BOOK (OR PURCHASES JOURNAL)

MEANING OF PURCHASES BOOK

Purchases book (also known as Invoice book/Bought book) is one of the subsidiary books which is used to record the **credit purchases of merchandise** (i.e., the goods in which the enterprise deals in). *Neither* the Cash Purchases of the merchandise *nor* the purchases of any asset other than the merchandise are recorded in Purchases Book. Thus,

Type of Purchases	Where Recorded?
I. Cash Purchases	
(a) of Merchandise (i.e., Goods)	Cash Book
(b) of any other asset (like Furnitures etc.)	Cash Book
II. Credit Purchases	
(a) of Merchandise (i.e., Goods)	Purchases Book
(b) of any other asset (like Furnitures etc.)	Journal Proper

SOURCE DOCUMENT USED FOR RECORDING

The entries in the Purchases Book are made on the basis of **Purchase Invoices received from the Suppliers** with the amounts net of trade discount/quantity discount. Trade discount is a reduction the purchase granted by a supplier from the list price of goods or services on business considerations (such as quantity bought, trade practice etc.) other than for prompt payment.

CONTENTS OF PURCHASES BOOK

Usually, the following information is provided in this book:

1. Date of Purchase,
2. Purchase Invoice Number,
3. Name of Supplier,

4. Page No. of the Ledger on which Supplier's Account appears, and
5. Amount of Invoice net of Trade Discount (if any).

Note: Recording of the particulars of items purchased is considered unnecessary because the details are available in the Purchase Invoices the serial number of which are given in the Purchases Book.

FORMAT OF PURCHASES BOOK

PURCHASES BOOK

Date	Purchase Invoice No.	Name of Supplier (Account to be credited)	L.F.	Details	Amount
				₹ P.	₹ P.

POSTING OF PURCHASES BOOK

The individual entries and the total of the Purchases Book are posted into the ledger as follows:

Posting of Individual Amount	Posting of Periodic Total
Individual amounts are daily posted to the credit of Suppliers' Accounts by writing 'By Purchases A/c' in the particulars column.	Periodic total is posted to the debit of Purchases Account by writing 'To Sundries as per Purchases Book' in the particulars column.

ILLUSTRATION 1

From the following transactions, prepare the Purchases Book of Jindal & Co., a saree dealer and post the transactions recorded in the Purchases Book to the Ledger:

Date	Invoice No.	Particulars
3.1.2018	401	Purchased on credit from Goyal Mills, Surat–55 Polyester Sarees @ ₹ 100. Less: Trade Discount @ 10%
8.1.2018	800	Purchased for Cash from Garg Mills, Kota–50 Kota Sarees @ ₹ 40.
15.1.2018	355	Purchased on credit from Mittal Mills, Bengaluru–10 Silk Sarees @ ₹ 260. Less: Trade Discount @ 10%
30.1.2018	420	Purchased on credit from Bansal & Co.–2 typewriters @ ₹ 3,500.

SOLUTION

PURCHASES BOOK

Date	Purchase Invoice No.	Name of Supplier	L.F.	Details	Amount
				₹ P.	₹ P.
2018					
Jan. 3	401	Goyal Mills, Surat			4,950
Jan. 15	355	Mittal Mills, Bengaluru			2,340
Jan. 31		Purchases Account (Debit)			7,290

Note: Cash purchase of Kota sarees will be recorded in the Cash Book and credit purchase of typewriters will be recorded in the General Journal (or Journal Proper) since in the Purchases Book, only the credit purchases of merchandise (i.e., the goods in which the firm deals in) are recorded.

**LEDGER OF JINDAL & CO.
GOYAL MILLS, SURAT**

Dr.

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
				2018 Jan. 3	By Purchases A/c		4,950

Dr.

MITTAL MILLS, BENGALURU

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
				2018 Jan. 15	By Purchases A/c		2,340

Dr.

PURCHASES ACCOUNT

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2018 Jan. 8	To Cash A/c		2,000				
31	To Sundries as per Purchases Book		7,290				

2.0 SALES BOOK (OR SALES JOURNAL)

MEANING OF SALES BOOK

Sales Book (also known as Day Book/Sales Journal) is one of the subsidiary books which is used to record the **Credit Sales of merchandise**. *Neither* the Cash Sales of the merchandise *nor* the Sales of any asset other than merchandise are recorded in Sales Book. Thus,

Type of Sales	Where Recorded?
I. Cash Sales	
(a) of Merchandise (<i>i.e.</i> , <i>Goods</i>)	Cash Book
(b) of any other asset (<i>like Furnitures etc.</i>)	Cash Book
II. Credit Sales	
(a) of Merchandise (<i>i.e.</i> , <i>Goods</i>)	Sales Book
(b) of any other asset (<i>like Furnitures etc.</i>)	Journal Proper

SOURCE DOCUMENT USED FOR RECORDING

The entries in the Sales Book are on the basis of **Sales Invoices issued to the Customers** with the amounts net of trade discount/quantity discount.

CONTENTS OF SALES BOOK

Usually, the following information is provided in the book:

1. Date of Sale
2. Sales Invoice Number
3. Name of Customer,
4. Page Number of the Ledger on which the Customer's A/c appears, and
5. Amount of Invoice net of Trade Discount (if any).

Notes:

1. In case the firm deals in taxable goods, one additional column may be added to record the Value Added Tax (VAT) recovered from the Customer.
2. Recording of the particulars items sold is considered unnecessary because the details are available in the Sales Invoices the serial number of which are given in the Sales Book.

FORMAT OF SALES BOOK
SALES BOOK

Date	Sales Invoice No.	Name of Supplier (Account to be Debited)	L.F.	Details ₹ P.	Amount ₹ P.

POSTING OF SALES BOOK

The individual entries and the total of the Sales Book are posted into the ledger as follows:

Posting of Individual Amount	Posting of Periodic Total
Individual amounts are daily posted to the debit of Customers' Accounts by writing 'To Sales A/c' in the particulars column.	Periodic total is posted to the credit of Sales Account by writing 'By Sundries as per Sales Book' in the particulars column.

ILLUSTRATION 2

From the following transactions, prepare the Sales Book of Jindal & Co., a saree dealer, and post them to the Ledger:

Date	Invoice No.	Particulars
04.1.2018	101	Sold on credit to Goyal & Co., Rohtak 20 polyester sarees @ ₹ 125. Less: Trade Discount @ 10%.
09.1.2018	102	Sold for cash to Garg & Co., Bhiwani 20 Kota sarees @ ₹ 50.
16.1.2018	103	Sold on credit to Mittal & Co., Hissar 5 silk sarees @ ₹ 325. Less: Trade Discount @ 20%.
30.1.2018		Sold on credit to Mohan 2 old typewriters @ ₹ 500.

SOLUTION
SALES BOOK

Date	Sales Invoice No.	Name of Supplier (Account to be Debited)	L.F.	Details ₹ P.	Amount ₹ P.
2018					
Jan. 4	101	Goyal & Co., Rohtak			2,250
Jan. 16	103	Mittal & Co., Hissar			1,300
Jan. 31		Sales Account (Credit)			3,550

Note: Cash Sale of Kota sarees will be recorded in the Cash Book and Credit Sale of typewriters will be recorded in the General Journal (or Journal Proper) since in the Sales Book, only the credit sales of merchandise (i.e., the goods in which the firm deals in) are recorded.

**LEDGER OF JINDAL & CO.
GOYAL & CO., ROHTAK**

Dr.

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2018 Jan. 4	To Sales A/c		2,250				

Dr.

MITTAL & CO., HISSAR

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2018 Jan. 16	To Sales A/c		2,250				

Dr.

SALES ACCOUNT

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
				2018 Jan. 9	By Cash A/c		1,000
				31	By Sundries as per Sales Book		3,550

3.0 PURCHASES RETURNS BOOK (OR PURCHASES RETURNS JOURNAL)

MEANING OF PURCHASES RETURNS BOOK

Purchases Returns Book (also known as Return Outwards Book/Journal) is one of the subsidiary books which is used to record the **Returns of merchandise purchased on credit**. *Neither* the returns of goods purchased on cash basis *nor* the returns of any asset other than the merchandise are recorded in the Purchases Returns Book.

SOURCE DOCUMENT USED FOR RECORDING

The entries in the Purchases Returns Book are usually made on the basis of **Debit Notes issued to the Suppliers or Credit Notes received from the Suppliers**.

Note: A debit note is a document prepared by the purchaser to inform the supplier that his account has been debited with the amount mentioned and for the reasons stated therein. Debit Note contains the date of return, name of the supplier to whom the goods have been returned, details of the goods returned, reasons for returning the goods. Each debit note is serially numbered.

CONTENTS OF PURCHASES RETURNS BOOK

Usually, the following information is provided in this book:

1. Date of Return
2. Debit Note number
3. Name of the Supplier
4. Page number of the Ledger on which Supplier's A/c appears, and
5. Amount of Goods returned to the Supplier.

Note: If some trade discount had been received at the time of original purchase and some expenses on purchase (e.g. cartage) had been charged by the supplier, the appropriate adjustment should be made so as to arrive at the correct value of goods returned.

FORMAT OF PURCHASES RETURNS BOOK**PURCHASES RETURNS BOOK**

Date	Debit Note No.	Name of Supplier (Account to be Debited)	L.F.	Details	Amount
				₹ P.	₹ P.

POSTING OF PURCHASES RETURNS BOOK

The individual entries and the periodic total of the book are posted into the ledger as follows:

Posting of Individual Amount	Posting of Periodic Total
Individual amounts are daily posted to the debit of Suppliers' Accounts by writing 'To Purchases Returns A/c' in the particulars column.	Periodic total is posted to the credit of Purchases Returns Account by writing 'By Sundries as per Purchases Returns Book' in the particulars column.

ILLUSTRATION 3

From the following transactions, prepare the Purchases Returns Book of Jindal & Co., a saree dealer and post them to the Ledger:

Date	Invoice No.	Particulars
04.1.2018	101	Returned to Goyal Mills, Surat-5 polyester sarees @ ₹ 100. Less: Trade Discount @ 10%
09.1.2018	102	Garg Mills, Kota accepted the returns of goods (which were purchased for cash) from us-5 Kota Sarees @ ₹ 40.
16.1.2018	103	Returned to Mittal Mills, Bengaluru-5 Silk Sarees @ ₹ 260. Less: Trade Discount @ 10%
30.1.2018		Returned one typewriter (being defective) @ ₹ 3,500 to Bansal & Co.

SOLUTION**PURCHASE RETURNS BOOK**

Date	Debit Note No.	Name of Supplier (Account to be Debited)	L.F.	Details	Amount
				₹ P.	₹ P.
2018					
Jan. 4	101	Goyal Mills, Surat			450
Jan. 16	103	Mittal Mills, Bengaluru			1,170
Jan. 31		Purchases Returns Account (Cr.)			1,620

Note: Return of Kota sarees will be recorded in the Cash Book and return of typewriter will be recorded in the General Journal (or Journal Proper) since in the Purchases Returns Book, only the return of merchandise purchased on credit are recorded.

**LEDGER OF JINDAL & CO.
GOYAL MILLS, SURAT**

Dr.

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2018 Jan. 4	To Purchases Returns A/c		450				

Dr.

MITTAL MILLS, BENGALURU

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2018 Jan. 16	To Purchases Returns A/c		1,170				

Dr.

PURCHASES RETURNS ACCOUNT

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
				2018 Jan. 9	By Cash A/c		200
				31	By Sundries as per Purchases Returns Book		1,620

4.0 SALES RETURNS BOOK (OR SALES RETURNS JOURNAL)

MEANING OF SALES RETURNS BOOK

Sales Returns Book (also known as Returns Inward Book/Journal) is one of the subsidiary books which is used to record the **Returns of merchandise sold on credit**. *Neither* the returns of merchandise sold on cash basis *nor* the return of any asset other than the merchandise are recorded in the Sales Returns Book.

SOURCE DOCUMENT USED FOR RECORDING

The entries in the Sales Returns Book are usually on the basis of **Credit Notes issued to the customers or Debit Notes issued by the customers**.

Note: A credit note is a document prepared by the seller to inform the buyer that his account has been credited with the amount mentioned and for the reasons stated therein. Credit Note contains the date of return of goods, the name of the customer who has returned the goods, details of goods received back and the amount of such goods. Each credit note is serially numbered.

CONTENTS OF SALES RETURNS BOOK

Usually, the following information is provided in this book:

1. Date of Return
2. Credit Note Number
3. Name of Customers
4. Page number of ledger on which Customer's A/c appears, and
5. Amount of Goods returned by customer.

Note: If some trade discount had been allowed under/or some expenses on sales (e.g. cartage) had been charged from the customer, the appropriate adjustment should be made so as to arrive at the correct value of goods returned.

FORMAT OF SALES RETURNS BOOK

SALES RETURNS BOOK

Date	Credit Note No.	Name of Supplier (Account to be Debited)	L.F.	Details ₹ P.	Amount ₹ P.

POSTING OF SALES RETURNS BOOK

The individual entries and the periodic total are posted into the ledger as follows:

Posting of Individual Amount	Posting of Periodic Total
Individual amounts are daily posted to the Credit of customers' Accounts by writing ' By Sales Returns A/c ' in the particulars column.	Periodic total is posted to the debit of Sales Returns Account by writing ' To Sundries as per Sales Returns Book ' in particulars column.

ILLUSTRATION 4

From the following transactions, prepare the Sales Returns Account of Jindal & Co., a saree dealer and post them to the Ledger.

Date	Credit Note No.	Particulars
05.1.2018	201	Goyal & Co., Rohtak, returned to us-2 polyester Sarees @ ₹ 125. Less: Trade Discount @ 10%
10.1.2018	202	Accepted return of goods (which were sold for cash) from Garg & Co. Bhiwani, 2 Kota Sarees @ ₹ 50.
17.1.2018	203	Mittal & Co., Hissar returned to us-2 silk sarees @ ₹ 325. Less: Trade Discount @ 20%.
31.1.2018		Mohan returned to us-1 old typewriter @ ₹ 500.

SOLUTION

SALES RETURNS BOOK

Date	Credit Note No.	Name of Supplier (Account to be Debited)	L.F.	Details ₹ P.	Amount ₹ P.
2018					
Jan. 5	201	Goyal & Co., Rohtak			225
Jan. 17	203	Mittal & Co., Hissar			520
Jan. 31		Sales Returns Account (Debit)			745

Note: Return of Kota sarees will be recorded in the Cash Book and return of typewriter will be recorded in the General Journal (or Journal Proper) since in the Sales Returns Book, only the returns of merchandise purchased on credit are recorded.

**LEDGER OF JINDAL & CO.
GOYAL & CO. ROHTAK**

Dr.

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
				2018 Jan. 5	By Sales Returns A/c		225

Dr.

MITTAL & CO. HISSAR

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
				2018 Jan. 17	By Sales Returns A/c		520

Dr.

SALES RETURNS ACCOUNT

Cr.

Date	Particulars	Folio	(₹)	Date	Particulars	Folio	(₹)
2018 Jan. 10	To Cash A/c		100				
31	To Sundries as per Sales Returns Book		745				

5.0 DISTINCTION BETWEEN DEBIT NOTE AND CREDIT NOTE

MEANING OF DEBIT NOTE

A debit note is prepared by the purchaser and contains the date of return, name of the supplier to whom the goods have been returned, details of the goods returned, reasons for returning the goods. Each debit note is serially numbered.

MEANING OF CREDIT NOTE

A credit note is prepared by the seller and contains the date of return of goods, the name of the customer who has returned the goods, details of goods received back and the amount of such goods. Each credit note is serially numbered.

Basis of Distinction	Debit Note	Credit Note
1. Who prepares?	It is prepared by Purchaser .	It is prepared by Seller .
2. Contents	(a) Date of return (b) Name of supplier to who returned (c) Details of goods returned (d) Reasons for returning goods	(a) Date of return (b) Name of Customer who returned (c) Details of goods returned (d) Reason for returning goods
3. Source Document	It is used as source document for recording in Purchase Return Book .	It is used as source document for recording in Sales Return Book .
4. Why Prepared?	It is prepared to debit supplier's account.	It is prepared to give credit to customer.

6.0 BILLS RECEIVABLE BOOK

MEANING OF BILLS RECEIVABLE BOOK

Bills Receivable Book is one of the subsidiary books which is used to record the details of Bills Receivable in favour of a person who is maintaining the Bills Receivable Book.

POSTING OF BILLS RECEIVABLE BOOK

Individual amounts are daily posted to the credit of the accounts of individual debtors from whom the bills are received. Periodic total (normally monthly total) is posted to the debit of 'Bills Receivable Account' in the ledger by writing 'To Sundries as per B/R Book'.

FORMAT OF BILLS RECEIVABLE BOOK

The simplest format of a Bills Receivable Book is given on next page.

7.0 BILLS PAYABLE BOOK

MEANING OF BILLS PAYABLE BOOK

Bills Payable Book is one of the subsidiary books which is used to record the details of bills payable accepted by the person who is maintaining the Bills Payable Book.

POSTING OF BILLS PAYABLE BOOK

Individual amounts are daily posted to the debit of the accounts of individual creditors to whom acceptances have been given. The periodic total (normally monthly total) is posted to the credit of Bills Payable Account in the ledger by writing 'By Sundries as per B/P Book'.

FORMAT OF BILLS PAYABLE BOOK

The simplest format of a Bills Payable Book is given on next page.

BILLS RECEIVABLE BOOK

[illegible]

FORMAT OF A BILLS PAYABLE BOOK

BILLS PAYABLE BOOK

[illegible]

8.0 JOURNAL PROPER**MEANING OF JOURNAL PROPER**

Journal Proper is one of the subsidiary books, which is used to record those transactions which cannot be recorded in any other subsidiary book such as (a) Cash Book, (b) Purchases Book, (c) Sales Book, (d) Purchases Returns Book, (e) Sales Returns Book, (f) Bills Receivable Book, and (g) Bills Payable Book.

EXAMPLES OF TRANSACTIONS RECORDED IN JOURNAL PROPER

The various examples of transactions entered in a Journal Proper are given below:

1. **Opening Entry** — An Opening Entry is passed in the journal to bring the previous accounting period's balances of various assets, liabilities and capital in the books of current accounting period.
2. **Closing Entries** — Closing Entries are passed in the journal to close the nominal accounts by transferring them to the Trading and Profit and Loss Account. These are needed at the end of the accounting period, when the final accounts are prepared.
3. **Transfer Entries** — Transfer Entries are passed in the journal to transfer an amount from one account to another account, i.e., Transfer of Total Drawings from Drawings A/c to Capital A/c.
4. **Adjusting Entries** — Adjusting Entries are passed in the journal to bring into the books of accounts certain unrecorded items like closing stock, depreciation on fixed assets, outstanding and prepaid items. These are needed at the time of preparing the final accounts.
5. **Rectifying Entries** — Rectifying Entries are passed in the journal to rectify the various errors committed while posting, totalling, balancing, etc.
6. **Miscellaneous Entries** — include the following:
 - (a) **Capital brought in kind** — If the proprietor of the business brings in his capital contribution in kind and not in cash, such transaction can be recorded only in the Journal Proper and not in the Cash Book since this transaction does not involve any cash inflow.
 - (b) **Purchases of Assets (other than Stock-in-trade) on credit (e.g., land, building, plant and machinery, furniture and fixture)** — Such transactions can *neither* be recorded in the Purchases Book (since no goods have been purchased) *nor* can be recorded in the Cash Book (since this transaction does not involve any cash outflow).
 - (c) **Sales of Assets (other than Stock-in-trade) which were sold on credit** — Such transaction can *neither* be recorded in the Sales Book (since no goods have been sold) *nor* can be recorded in the Cash Book (since this transaction does not involve any cash inflow).
 - (d) **Return of Assets (other than Stock-in-trade) which were sold on credit** — Such transactions cannot be recorded in the Returns Inward Book since no goods have been returned.
 - (e) **Return of Assets (other than Stock-in-trade) which were bought on credit** — Such transactions cannot be recorded in the Returns Outward book since no goods have been returned.
 - (f) **Endorsement of Bills Receivable to a creditor.**
 - (g) **Dishonour of Bills Receivables (not discounted with bank).**
 - (h) **Cancellation of Bills Payable.**
 - (i) **Abnormal Loss of Stock-in-trade/other assets by theft, accident, fire, etc.**
 - (j) **Writing-off Bad Debts.**
 - (k) **Goods withdrawn by the proprietor partner for personal use.**

- (l) **Goods distributed as free samples for sales.**
- (m) **Cancellation of Discount Allowed or Discount Received at the time of dishonour of a cheque.**

ILLUSTRATION 5

From the following transactions of the month of April 2018, prepare the Journal Proper of Jindal & Co., a saree dealer, who also maintains Purchases Book, Sales Book, Returns Books and Cash Book:

<i>Date</i>	<i>Transaction</i>
1	Purchased on credit from Goyal Mills, Surat 25 polyester sarees @ ₹ 100.
3	Purchased on credit from Bansal & Co., 2 typewriters @ ₹ 3,500.
5	Sold on credit to Goyal & Co., 5 polyester sarees @ ₹ 125.
6	Returned one typewriter (being defective) @ ₹ 3,500 to Bansal & Co.
8	Sold on credit two old typewriters to Murli @ ₹ 500.
10	Sold for cash to Garg & Co., 20 Kota sarees @ ₹ 50.
12	Returned to Goyal Mills, Surat 5 polyester sarees @ ₹ 100.
14	Murli returned one old typewriter @ ₹ 500.
16	Purchased for cash from Kansal & Co., 2 chairs @ ₹ 3,700.
18	Returned one chair (being defective) @ ₹ 3,700.
20	Sold two old chairs for cash to Manohar @ ₹ 500.
21	Manohar returned one old chair @ ₹ 500.
22	Goyal & Co. became insolvent and paid only 80 paise in a rupee in full & final settlement.
24	Mr B.K. Jindal (Proprietor of Jindal & Co.) took away 2 silk sarees (costing ₹ 350 each sale price ₹ 700 each) from the shop and presented to his wife on her 25th birthday.
25	A cheque of ₹ 3,500 received from Mittal & Co., a customer, endorsed in favour of Bansal & Co., a creditor. On 30.4.2018, the bank informed that this cheque was dishonoured.
30	Rent due to landlord, Ram ₹ 1,000.
30	Salaries due to employee Shyam ₹ 1,000.

SOLUTION**JOURNAL PROPER OF M/S JINDAL & CO.**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr.(₹)</i>	<i>Cr.(₹)</i>
2018 April 3	Typewriters A/c To Bansal & Co. (Being 2 typewriters purchased on credit from Bansal & Co.)	Dr.	7,000	7,000
6	Bansal & Co. To Typewriters A/c (Being 1 typewriter returned to Bansal & Co.)	Dr.	3,500	3,500

8	Murli To Typewriters A/c (Being 2 typewriters sold on credit to Murli)	Dr.	1,000	1,000
14	Typewriters A/c To Murli (Being 1 typewriter returned by Murli)	Dr.	500	500
22	Bad Debts A/c To Goyal & Co. (Being 20% of the dues from Goyal & Co. written-off as bad on their insolvency)	Dr.	125	125
24	Drawings A/c To Purchases A/c (Being 2 silk sarees costing ₹ 350 each, taken away by the proprietor for personal use)	Dr.	700	700
25	Bansal & Co. To Mittal & Co. (Being a cheque received from Mittal & Co. endorsed in favour of Bansal & Co.)	Dr.	3,500	3,500
30	Mittal & Co. To Bansal & Co. (Being a cheque (endorsed) dishonoured)	Dr.	3,500	3,500
30	Rent A/c To Outstanding Rent A/c (Being rent due to landlord)	Dr.	1,000	1,000
30	Salaries A/c To Outstanding Salaries A/c (Being Salaries due to employee)	Dr.	1,000	1,000
	Total		21,825	21,825

Note: The other transactions have not been recorded in the Journal Proper due to reasons mentioned below:

Transaction	Reason
Purchases of polyester Sarees	To be recorded in Purchases Book
Sales of polyester sarees	To be recorded in Sales Book
Cash sale of Kota sarees	To be recorded in Cash Book
Return of polyester sarees	To be recorded in Purchases Returns Book
Purchases of chairs	To be recorded in Cash Book
Returns of chairs to Kansal & Co.	To be recorded in Cash Book
Sale of old chairs	To be recorded in Cash Book
Return of old chair	To be recorded in Cash Book
Receipts of Cash from Goyal & Co.	To be recorded in Cash Book

COMPREHENSIVE ILLUSTRATION**ILLUSTRATION 6**

On Jan. 1, 2018 Moti's Assets were:

Cash ₹ 2,000; Due from Jeevan ₹ 1,000; Stores ₹ 3,000; Furniture ₹ 500 and he had to pay to Kishore ₹ 2,000.

The following transactions took place:

Jan. 2	Purchased furniture from Hanuman for ₹ 200.
5	Received payment from Jeevan, discount allowed being 2%.
8	Sold to Mahendra 10 watches. Sent invoice at ₹ 30 per watch; allowed 10% trade discount.
12	Sent to Mahendra a credit note because price per watch was ₹ 25 and not ₹ 30.
20	Settled Kishore's Account to the extent of ₹ 1,000 only, he allowed with 2½% discount.
25	Purchased from Kishore goods of the list price of ₹ 1,500. He allowed 20% trade discount.
28	Paid the amount due to Hanuman.
31	Paid salaries ₹ 200 and rent ₹ 100.

Required: Prepare Moti's Subsidiary Books.

SOLUTION

Dr.

CASH BOOK

Cr.

Date	Particulars	L.F.	Dis. ₹	Cash ₹	Date	Particulars	L.F.	Dis. ₹	Cash
2018					2018				
Jan. 1	To Balance b/d			2,000	Jan. 20	By Kishore		25	975
5	To Jeevan		20	980	28	By Hanuman			200
					31	By Salaries			200
					31	By Rent			100
					31	By Balance c/d			1,505
			20	2,980				25	2,980
Feb. 1	To Balance b/d			1,505					

PURCHASES BOOK

Date	Purchase Invoice No.	Name of Supplier (Account to be Debited)	L.F.	Details ₹ P.	Amount ₹ P.
2018					
Jan. 25		Kishore			1,200
		Purchases A/c	Dr.		1,200

SALES BOOK

<i>Date</i>	<i>Sales Invoice No.</i>	<i>Name of Supplier (Account to be Debited)</i>	<i>L.F.</i>	<i>Details</i> ₹ <i>P.</i>	<i>Amount</i> ₹ <i>P.</i>
2018					
Jan. 8		Mahendra			
		10 watches @ ₹ 30 per watch			270
		Sales A/c	Cr.		270

SALES RETURNS BOOK

<i>Date</i>	<i>Credit Note No.</i>	<i>Name of Supplier (Account to be Debited)</i>	<i>L.F.</i>	<i>Details</i> ₹ <i>P.</i>	<i>Amount</i> ₹ <i>P.</i>
2018					
Jan. 12	101	Mahendra			
		Sent a Credit Note because price per watch was ₹ 25 and not ₹ 30 Invoice date Jan. 8, 2018			45
		Sales Returns A/c	Dr.		45

GENERAL JOURNAL OR JOURNAL PROPER

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr.(₹)</i>	<i>Cr.(₹)</i>
2018				
Jan. 1	Cash A/c	Dr.	2,000	
	Jeevan A/c	Dr.	1,000	
	Store A/c	Dr.	3,000	
	Furniture A/c	Dr.	500	
	To Kishore			2,000
	To Capital A/c			4,500
	(Being the opening balances brought forward from previous year's books)			
2	Furniture A/c	Dr.	200	
	To Hanuman			200
	(Being the furniture purchased from Hanuman)			

12

TRIAL BALANCE

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of a Trial Balance
- ◇ Objectives of a Trial Balance
- ◇ Limitations of a Trial Balance
- ◇ Preparation of a Trial Balance
- ◇ Difference between a Trial Balance by Balance Method and a Trial Balance by Total Amount Method

1.0 MEANING OF A TRIAL BALANCE

1. Trial Balance is a statement which shows *either* the Balances *or* Total Amounts of Debit Items and Credit Items of all the accounts in the Ledger and the Cash and bank balances.
2. A trial balance is a statement and not an account.
3. A Trial Balance is prepared on a particular date and not for a particular period.

2.0 OBJECTIVES OF A TRIAL BALANCE

The main objectives of preparing the trial balance are as follows:

1. **To ascertain the Arithmetical Accuracy of Ledger Accounts** — A tallied trial balance indicates that equal debits and credits have been recorded in the ledger accounts.
2. **To help in Locating Errors** — An untallied trial balance indicates that some error(s) has (have) been committed.
3. **To facilitate the Preparation of Financial Statements** — A trial balance can directly be used for preparing the financial statements and there is no need to refer to the ledger. All revenue and expense accounts appearing in the trial balance are transferred to the Trading and Profit & Loss Account and all liabilities, capital and assets are carried over to the Balance Sheet.

3.0 LIMITATIONS OF A TRIAL BALANCE

1. A tallied trial balance merely indicates that equal debits and credits have been recorded in the books of accounts.
2. A tallied trial balance does not necessarily ensure that —
 - (a) all transactions have been correctly recorded (i.e., correct book, correct a/c, correct amount)
 - (b) all entries/total (e.g. total of purchases book etc.) have been correctly posted in the ledger, (i.e., posting to correct account on correct side with correct amount).

3. A tallied Trial Balance is not a conclusive proof of the accuracy of the books of accounts since certain types of errors remain even when the Trial Balance tallies. The following errors do not affect the Trial balance at all.
- Error of Principle,
 - Compensating error,
 - Error of complete omission,
 - Error of Recording in the books of original entry, and
 - Posting a correct amount in the wrong account but on the correct side.
- These Errors have been discussed in detail in the Next Chapter.

4.0 PREPARATION OF A TRIAL BALANCE

- To verify the correctness of the posting of ledger accounts in terms of the debit and credit amounts periodically, a periodic trial balance may be prepared (say) at the end of a month or quarter or half-year.
 - Though a trial balance may be prepared at any time, but it should at least be prepared at the close of the accounting period so as to verify the arithmetical accuracy of the ledger accounts before the preparation of the financial statements.
 - A Trial Balance may be prepared by following *either* the Balance Method *or* Total Amount Method.
- (a) **Balance Method** — Under this method, the balances of all the accounts (including Cash and Bank Account) are incorporated in the trial balance. It may be noted that a trial balance by this method can be prepared only when all the ledger accounts have been balanced. A format of a Trial Balance by 'Balance Method' is shown below:

FORMAT OF A TRIAL BALANCE BY BALANCE METHOD

TRIAL BALANCE ... (NAME OF THE ENTERPRISE) ...
AS AT ... (DATE ON WHICH THE TRIAL BALANCE IS BEING PREPARED)...

S.No.	Name of Account	L.F.	Debit Bal.		Credit Bal.	
			₹	P.	₹	P.
1.	Purchases A/c	P-1	xxx	—	—	—
2.	Sales A/c	S-1			xxx	—
3.	Purchases Returns A/c	P-2			xxx	—
4.	Sales Returns A/c	S-2	xxx	—		
5.	Cash A/c	C-1	xxx	—		
6.	Bank A/c	B-1	xxx	—		
7.	Capital A/c	C-2			xxx	—
8.	Salaries A/c	S-3	xxx	—		
9.	Furniture A/c	F-1	xxx	—		
10.	Ram's A/c	R-1	xxx	—		
11.	Shyam's A/c	S-4		—	xxx	—
	Total		xxx	—	xxx	—

Note: The 'Ledger Folios' (LF) are totally imaginary.

ILLUSTRATION 1

Given below is a ledger extract relating to the business of X and Co. as on March 31, 2018. You are required to prepare the Trial Balance by the Balance Method.

Dr. **CASH ACCOUNT** **Ledger Folio C-1** Cr.

Particulars	₹	Particulars	₹
To Capital A/c	1,00,000	By Furniture A/c	30,000
To Ram's A/c	2,50,000	By Salaries A/c	25,000
To Cash Sales	5,000	By Shyam's A/c	2,10,000
		By Cash Purchases	10,000
		By Capital A/c	5,000
		By Balance c/d	75,000
	3,55,000		3,55,000

Dr. **FURNITURE ACCOUNT** **Ledger Folio F-1** Cr.

Particulars	₹	Particulars	₹
To Cash A/c	30,000	By Balance c/d	30,000

Dr. **SALARIES ACCOUNT** **Ledger Folio S-3** Cr.

Particulars	₹	Particulars	₹
To Cash A/c	25,000	By Balance c/d	25,000

Dr. **SHYAM'S ACCOUNT** **Ledger Folio S-4** Cr.

Particulars	₹	Particulars	₹
To Cash A/c	2,10,000	By Purchases A/c	2,50,000
To Purchase Returns A/c	5,000	(Credit Purchases)	
To Balance c/d	35,000		
	2,50,000		2,50,000

Dr. **PURCHASES ACCOUNT** **Ledger Folio P-1** Cr.

Particulars	₹	Particulars	₹
To Cash A/c (Cash Purchases)	10,000	By Balance c/d	2,60,000
To Sundries as per Purchase Book (Credit Purchases)	2,50,000		
	2,60,000		2,60,000

Dr. **PURCHASES RETURNS ACCOUNT** **Ledger Folio P-2** Cr.

Particulars	₹	Particulars	₹
To Balance c/d	5,000	By Sundries as per Purchases Returns Book	5,000
	5,000		5,000

Dr. **RAM'S ACCOUNT** Ledger Folio R-1 Cr.

Particulars	₹	Particulars	₹
To Sales A/c (Credit Sales)	3,00,000	By Sales Returns A/c	1,000
		By Cash A/c	2,50,000
		By Balance c/d	49,000
	3,00,000		3,00,000

Dr. **SALES ACCOUNT** Ledger Folio S-1 Cr.

Particulars	₹	Particulars	₹
To Balance c/d	3,05,000	By Cash A/c (Cash Sales)	5,000
		By Sundries as per Sales Book (Credit Sales)	3,00,000
	3,05,000		3,05,000

Dr. **SALES RETURNS ACCOUNT** Ledger Folio S-2 Cr.

Particulars	₹	Particulars	₹
To Sundries as per Sales Returns Book	1,000	By Balance c/d	1,000
	1,000		1,000

Dr. **CAPITAL ACCOUNT** Ledger Folio C-2 Cr.

Particulars	₹	Particulars	₹
To Cash A/c	5,000	By Cash A/c	1,00,000
To Balance c/d	95,000		
	1,00,000		1,00,000

SOLUTION

TRIAL BALANCE OF X AND CO. AS AT 31.3.2018

S.No.	Name of Account	L.F.	Debit Bal. ₹	Credit Bal. ₹
1.	Cash A/c	C-1	75,000	
2.	Furniture A/c	F-1	30,000	
3.	Salaries A/c	S-3	25,000	
4.	Shyam's A/c	S-4		35,000
5.	Purchases A/c	P-1	2,60,000	
6.	Purchase Returns A/c	P-2		5,000
7.	Ram's A/c	R-1	49,000	
8.	Sales A/c	S-1		3,05,000
9.	Sales Returns A/c	S-2	1,000	
10.	Capital A/c	C-1		95,000
	Total		4,40,000	4,40,000

- (b) **Total Amount Method** — Under this method, the total amount of debit items and credit items in each ledger account are incorporated in the trial balance. It may be noted that a trial balance by this method can be prepared immediately after the completion of posting from the books of original entry to the ledger.

A format of a Trial Balance by 'Total Amount Method' is shown below:

FORMAT OF A TRIAL BALANCE BY TOTAL AMOUNT METHOD

TRIAL BALANCE...(NAME OF THE ENTERPRISE)...
AS AT...(DATE ON WHICH THE TRIAL BALANCE IS BEING PREPARED)...

S.No.	Name of Account	L.F.	Debit Bal.		Credit Bal.	
			₹	P.	₹	P.
1.	Purchases A/c	P-1	xxx	—	—	—
2.	Sales A/c	S-1			xxx	—
3.	Purchases Returns A/c	P-2			xxx	—
4.	Sales Returns A/c	S-2	xxx	—		
5.	Cash A/c	C-1	xxx	—	xxx	—
6.	Bank A/c	B-1	xxx	—	xxx	—
7.	Capital A/c	C-2	xxx	—	xxx	—
8.	Salaries A/c	S-3	xxx	—		
9.	Furniture A/c	F-1	xxx	—		
10.	Ram's A/c	R-1	xxx	—	xxx	—
11.	Shyam's A/c	S-4	xxx	—	xxx	—
	Total		xxx	—	xxx	—

Note: The 'Ledger Folios' (LF) are totally imaginary.

5.0 DIFFERENCE BETWEEN A TRIAL BALANCE BY BALANCE METHOD AND A TRIAL BALANCE BY TOTAL AMOUNT METHOD

The following are the main points of difference between the Trial Balance by balance method and the Trial Balance by total amount method:

Trial Balance by Balance Method	Trial Balance by Total Amount Method
(a) It can be prepared only when all the ledger accounts have been balanced.	(a) It can be prepared immediately after the completion of posting from books of original entry to the ledger.
(b) It shows the balances of all the accounts in the ledger.	(b) It shows the total amounts of debit items and credit items in each ledger account.

ILLUSTRATION 2

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

SOLUTION

TRIAL BALANCE OF X AND CO. AS AT 31.3.2018

S.No.	Name of Account	L.F.	Debit Bal. ₹	Credit Bal. ₹
1.	Cash A/c	C-1	3,55,000	2,80,000
2.	Furniture A/c	F-1	30,000	
3.	Salaries A/c	S-3	25,000	
4.	Shyam's A/c	S-4	2,15,000	2,50,000
5.	Purchases A/c	P-1	2,60,000	
6.	Purchases Returns A/c	P-2		5,000
7.	Ram's A/c	R-1	3,00,000	2,51,000
8.	Sales A/c	S-1		3,05,000
9.	Sales Returns A/c	S-2	1,000	
10.	Capital A/c	C-1	5,000	1,00,000
	Total		11,91,000	11,91,000

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ERRORS AND THEIR RECTIFICATION

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Steps to Locate the Errors
- ◇ Types of Errors
- ◇ Error of Omission
- ◇ Error of Commission
- ◇ Compensating Errors
- ◇ Error of Principle
- ◇ Suspense Account — Meaning, Preparation, Utility, Treatment
- ◇ Rectification of Errors Not Affecting the Trial Balance
- ◇ Rectification of Errors Affecting the Trial Balance
- ◇ Effect of Rectification of Errors on Profit or Loss
- ◇ Rectification of Errors after the Preparation of Final Accounts

1.0 STEPS TO LOCATE THE ERRORS

If the Trial Balance does not tally, it means there are some errors in the books of account. The various steps which may be taken to locate the errors include the following:

Step 1: *Check the totals of both the debit and the credit amount columns of Trial Balance.*

Step 2: *Apply trial and error techniques such as scanning all the entries of amount equivalent to the amount of difference or 50% of the amount of difference (if the difference is divisible by 2). On scrutiny of the books, errors such as transposition of the figures, positing of an amount on wrong side of ledger account, etc., may be discovered.*

Example I. *If the total of credit side of the Trial Balance exceeds by ₹ 1,800, it is possible that positing of ₹ 1,800 on the debit side has been omitted. To detect such type of errors, the accountant should scan all the entries of an amount of ₹ 1,800.*

Example II. *If the total of credit side of the Trial Balance exceeds by ₹ 1,800, it is possible that a debit item of ₹ 900 has been posted in the ledger as a credit item. It may be noted that if the amount of difference is ₹ 1300.51, it is not possible that an item of ₹ 650.255 has been posted on the wrong side of ledger account. To detect such type of errors, the accountant should scan all the entries of an amount equal to 50% of the amount of difference (if divisible by 2).*

Example III. *If the debit item of ₹ 3,195 has been posted as ₹ 1,395, the credit side of the Trial Balance will exceed by ₹ 1,800 which is divisible by 9. Thus, a difference in the trial balance divisible by 9 helps in detecting the error involving the transposition of figures.*

Example IV. If the debit item of ₹ 12,000 has been posted as ₹ 1,200, the credit side of the trial balance will exceed by ₹ 10,800 which is divisible by 9. If this difference is divided by 9, a quotient of ₹ 1,200 will be obtained and all amounts of ₹ 1,200 should be scanned to detect such type of error.

Step 3: Check with the help of ledger to ensure whether the balance of each and every account including Main Cash and Bank account and Petty Cash Account has been included in the correct amount column with the correct amount in the Trial Balance.

Step 4: Check whether totals of the Sundry Debtors and Sundry Creditors are correct.

Step 5: Check whether the Cash and Bank balances have been correctly ascertained.

Step 6: Check whether all the opening balances appearing in the previous year's Balance Sheet have been correctly brought forward.

Step 7: Check whether the balancing of all the accounts is correct.

Step 8: Check whether the posting to ledger accounts has been done correctly.

Step 9: Check whether the casting and carrying forward of books of original entry are correct.

EXAMPLE

Mr X started his small business on 1.4.2017 and since he is weak in accountancy, he requests you to tell him whether the following trial balance prepared by him is correct or not. He provides you the following information:

- (i) There is no credit sale/purchase.
- (ii) There is no returns inwards/outwards.
- (iii) Only Cash Book and Ledger are maintained.

Dr.

CASH BOOK FOR THE PERIOD FROM 1.4.2017 TO 31.3.2018

Cr.

Particulars	Discount (₹)	Cash (₹)	Bank (₹)	Particulars	Discount (₹)	Cash (₹)	Bank (₹)
To Capital A/c		10,000	3,400	By Bank A/c (C)		2,000	
To Sales A/c	100	5,000		By Cash A/c (C)			1,000
To Ram			1,000	By Ram		600	
To Cash (C)			2,000	By Purchases A/c (goods)		8,000	
To Bank (C)		1,000		By Purchases A/c (furniture)			8,000
To Sales A/c	200		10,000	By Drawings A/c			3,000
To Shyam			500	By Salaries A/c		500	
To Balance c/d			5,100	By Purchases A/c (goods)			9,000
				By Shyam		2,000	
				By Drawings A/c		2,000	
				By Balance c/d		900	
	300	16,000	22,000		—	16,000	21,000

TRIAL BALANCE OF MR X AS AT 31.3.2018

S.N.	Name of the Account	Debit (₹)	Credit (₹)
1.	Capital Account	—	13,400
2.	Sales	—	15,300
3.	Shyam	—	400
4.	Discount Account	—	300
5.	Purchases	27,000	
6.	Drawings	5,000	
7.	Salaries	500	
8.	Ram	1,500	
9.	Difference in Trial Balance		5,600
		34,000	35,000

SOLUTION

In such a case, the following steps should be taken to find out the errors:

Step 1: Check the total of each side of the trial balance

Total of Dr. side – ₹ 34,000, Total of Cr. side – ₹ 35,000. It means the debit side of the trial balance was overcast by ₹ 1,000. Now, the difference is reduced to ₹ 4,600 (i.e., 5,600 – 1,000)

Step 2: Check whether the balance of each and every account opened in the ledger has been included in the trial balance.

By observation one may find that the balances of Cash and Bank have not been included.

Thus, enter the cash balance of ₹ 900 as a debit balance and bank overdraft of ₹ 5,100 as a credit balance in the trial balance.

Now, the difference is reduced to ₹ 400 (i.e., ₹ 4,600 – 5,100 + 900).

Step 3: Check whether the balances of various accounts have been included on the correct side (Debit/Credit) in the trial balance.

By observation, one may find that the balance of Discount A/c has been entered on credit side instead of debit side.

Thus, enter the balance of Discount A/c on the debit side.

Now the difference is increased to ₹ 1,000 (i.e. 400 + 300 + 300).

Step 4: Check whether the balance of various accounts have been included with the correct amounts in the trial balance.

By observation, one may find that the balance of Purchase A/c has been entered as ₹ 27,000 instead of ₹ 25,000. Thus, reduce the balance of Purchases A/c by ₹ 2,000.

Now, the credit side exceeds the debit side by ₹ 1,000 (i.e., ₹ 2,000 – ₹ 1,000)

Step 5: Check whether the balancing of all accounts is correct

During the process of balancing the various accounts one will find that the balance of bank column has been taken as ₹ 5,100 instead of ₹ 4,100 thus, reduce the balance of bank.

Now, the difference is reduced to Nil. Though the agreement of two sides of the trial balance is a prima facie test of arithmetical accuracy, yet, it is not a conclusive proof of the accuracy of records since the trial balance may agree without disclosing some errors, the examples of such errors are as under:

- (1) Error of omission i.e., omission of recording the transactions in the books of original entry.
- (2) Error of recording in the books of original entry.
- (3) Error of posting to wrong account but on correct side with correct amount.
- (4) Error of principle.
- (5) Compensatory error.

By observation one may find that (a) the Purchase A/c has been debited with the Purchase of furniture (b) Shyam's A/c has been balanced as ₹ 400 instead of being ₹ 1,500 as a debit balance. (c) Ram's A/c have been balanced as ₹ 1,500 instead of being ₹ 400 as a credit balance.

The error (a) is termed as an error of principle since the purchase of furniture should have been debited to Furniture A/c and not to Purchases A/c.

The errors (b) and (c) together constitute compensatory errors since Shyam's A/c, has been cast ₹ 1,900 short and Ram's A/c has been cast ₹ 1,900 excess.

By correcting the aforesaid errors the corrected trial balance will appear as under:

CORRECTED TRIAL BALANCE AS AT 31.3.2018

S.N.	Name of the Account	L.F.	Debit (₹)	Credit (₹)
1.	Capital Account		—	13,400
2.	Sales Account		—	15,300
3.	Shyam's Account		1,500	
4.	Discount Account		300	
5.	Purchases Account		17,000	
6.	Salaries Account		500	
7.	Drawings Account		5,000	
8.	Ram's Account		—	400
9.	Cash in hand		900	
10.	Bank Overdraft		—	4,100
11.	Furniture A/c		8,000	
			33,200	33,200

2.0 TYPES OF ERRORS

All accounting errors may be classified as follows:

1. On the basis of their effect on Trial Balance

- (a) Errors affecting the agreement of Trial Balance
- (b) Errors not affecting the agreement of Trial Balance

Note: Such errors have been shown in a chart given on next page.

2. On the basis of Clerical/Principle Errors

(a) Clerical Errors

(i.e., those errors which arise because of mistakes committed in the ordinary course of the accounting work)

- (i) Error of Omission
- (ii) Error of Commission
- (iii) Compensating Errors

[**Note:** Truly speaking, the Compensating Errors do not represent separate type of errors but only represent a group of errors. Only for the purpose of discussion, these errors have been shown separately.]

(b) Error of Principle

3.0 ERROR OF OMISSION

This error arises when a transaction is completely or partially omitted to be

- (i) Recorded in the books of accounts, or
- (ii) Posted to the ledger

Error of omission may be classified as Error of Complete Omission and Error of Partial Omission.

MEANING OF ERROR OF COMPLETE OMISSION

This error arises when any transaction is not recorded in the books of original entry at all or, the transaction is recorded in General Journal (or Journal Proper) but is not posted in the ledger at all. This error does not affect the trial balance.

EXAMPLES OF ERROR OF COMPLETE OMISSION

Example 1 Goods purchased on credit from Ram not recorded in the Purchases Book.

Example 2 Goods sold on credit to Shyam not recorded in the Sales Book.

Example 3 Furniture sold on credit to Mohan recorded in Journal Proper but omitted to be posted.

MEANING OF ERROR OF PARTIAL OMISSION

An Error of Omission other than an Error of Complete Omission is called an Error of Partial Omission. This error **affects the trial balance**.

EXAMPLES OF ERRORS OF PARTIAL OMISSION

Example 1 Transaction correctly recorded in the books of original entry (other than Journal Proper) but not posted in the ledger at all;

[e.g. A Credit Sale of Goods to Shyam recorded in Sales Book but omitted to be posted in Shyam's Account].

Example 2 Omission in Carrying Forward the total from one page to the other;

Example 3 Omission to Balance an Account.

4.0 ERROR OF COMMISSION

This error arises due to wrong recording, wrong casting, wrong carry forward, wrong posting, wrong balancing etc., Errors of commission may be classified as follows.

1. Error of Recording	2. Error of Casting
3. Error of Carrying Forward	4. Error of Posting

MEANING OF ERROR OF RECORDING

This error arises when any transaction is incorrectly recorded in the books of original entry. This error **does not affect the Trial Balance**.

TYPES OF ERROR OF RECORDING

S.N.	Books of original entry in which the transaction was recorded	Name of the account used in recording	Amount with which the transaction was recorded	Whether affects the Trial Balance
1.	Correct	Correct	Wrong	No
2.	Correct	Wrong	Correct	No
3.	Correct	Wrong	Wrong	No
4.	Wrong	Correct	Correct	No
5.	Wrong	Correct	Wrong	No
6.	Wrong	Wrong	Correct	No
7.	Wrong	Wrong	Wrong	No

EXAMPLES OF ERROR OF RECORDING

Example 1 Goods of ₹ 500 purchased on credit from Ram are recorded in the Purchases Book for ₹ 5,500.

Example 2 Goods of ₹ 5,000 purchased on credit from Ram are recorded in the Sales Book.

MEANING OF ERROR OF CASTING

This error arises when a mistake is committed in totalling. This error **affects the trial balance**.

EXAMPLES OF ERROR OF CASTING

Example 1 Purchases Book is totalled as ₹ 1,000 instead of ₹ 100.

Example 2 Sales Book is totalled as ₹ 500 instead of ₹ 5,000.

MEANING OF ERROR IN CARRYING FORWARD

This error arises when a mistake is committed in carrying forward a total of one page on the next page. This error **affects the trial balance**.

EXAMPLES OF ERROR IN CARRYING FORWARD

Example 1 Total of Purchases Book is carried forward as ₹ 1,000 instead of ₹ 100.

Example 2 Total of Sales Book is carried forward as ₹ 100 instead of ₹ 1000.

MEANING OF ERROR OF POSTING

This error arises when information recorded in the books of original entry is incorrectly entered in the ledger. This error **may or may not affect the trial balance**.

TYPES OF ERROR OF POSTING

S.N.	Account to which the posting was made	Side (debit/credit) on which posting was made	Amount with which posting was made	Whether affects the Trial Balance
1.	Correct	Correct	Wrong	Yes
2.	Correct	Wrong	Correct	Yes
3.	Correct	Wrong	Wrong	Yes
4.	Wrong	Correct	Correct	No
5.	Wrong	Correct	Wrong	Yes
6.	Wrong	Wrong	Correct	Yes
7.	Wrong	Wrong	Wrong	Yes

5.0 COMPENSATING ERRORS**MEANING OF COMPENSATING ERRORS**

These errors arise when two *or* more errors are committed in such a way that the net effect of these errors on the debits and credits of accounts involved is nil. In other words, compensating errors refer to such a group of errors wherein the effect of one error is compensated by the effect of other error *or* errors.

EFFECTS OF COMPENSATING ERRORS

These errors **do not affect the agreement of the trial balance but may *or* may not affect the figure of net profit.**

EXAMPLES OF COMPENSATING ERRORS

Example 1. If the total of Purchases Book is posted in the ledger as ₹ 1,000 instead of ₹ 100 and at the same time Ram's A/c is credited in the ledger as ₹ 1,000 instead of ₹ 100, as a result of these errors, there is an excess credit of ₹ 900 in Ram's Account and an excess debit of ₹ 900 in Purchases Account. Thus, these two errors nullify the effects of each other. The first error will increase the figure of Purchases and consequently will reduce the figure of Profit.

Example 2. If the total of Bills Receivable Book is posted in the ledger as ₹ 1,000 instead of ₹ 100 and at the same time total of Bills Payable Book is posted as ₹ 1,000 instead of ₹ 100, as a result of these errors, there is excess credit of ₹ 900 in Bills Payable Account and an excess debit of ₹ 900 in Bills Receivable Account. These two errors will nullify the effect of each other. These errors will not affect the figure of profit in anyway.

6.0 ERROR OF PRINCIPLE**MEANING OF ERROR OF PRINCIPLE**

This error arises when the transaction is recorded ignoring the distinction between the capital item and revenue item. In other words, this error involves an incorrect allocation of expenditure *or* receipt between Capital and Revenue. The correct allocation between Capital and Revenue is of paramount importance because any incorrect allocation would disturb the final results as disclosed by the Financial Statements.

EFFECT OF ERROR OF PRINCIPLE

It may lead to under/over stating of Incomes *or* Expenses of Assets *or* Liabilities. This error **does not affect the trial balance.**

EXAMPLE OF ERROR OF PRINCIPLE

Error: Freight paid for bringing a new machinery is debited to Freight A/c

Effects:

1. On Revenue Expenditure (i.e., Freight) – Overstated
2. On Capital Expenditure (i.e., Cost of Machinery) – Understated
3. On Depreciation on Machinery – Undercharged
4. On Net Profit – Understated by the Net Effect (i.e., the difference between the amount of Freight and amount of Depreciation).

Note: *The costs incurred on the acquisition, installation and commissioning of a fixed asset up to the point the fixed asset is ready for use represent capital expenditures.*

7.0 SUSPENSE ACCOUNT**MEANING OF SUSPENSE ACCOUNT**

A Suspense Account is an account in which the amount of difference in the trial balance is put till such time that errors are located and rectified.

PREPARATION OF SUSPENSE ACCOUNT

The difference in the trial balance is transferred on the credit side of the Suspense Account (if the debit side of the trial balance exceeds the credit side) or on the debit side of the Suspense Account (if the credit side of the trial balance exceeds the debit side). Thus, the difference is put on the shorter side.

UTILITY OF SUSPENSE ACCOUNT

The rationale behind the opening of a Suspense Account is to avoid delay in the preparation of financial statements.

DISPOSAL OF BALANCE OF SUSPENSE ACCOUNT

When the errors affecting the Suspense Account are located, they are rectified with the help of the Suspense Account. When all the errors affecting the trial balance are located and rectified, the Suspense Account automatically stands balanced.

TREATMENT OF BALANCE OF SUSPENSE ACCOUNT

1. The balance of Suspense Account represents the net effect of errors affecting the trial balance which are still to be located and rectified.
2. Its Debit Balance will be shown on the assets side of the Balance Sheet.
3. Its Credit Balance will be shown on the liabilities side of the Balance Sheet.

8.0 RECTIFICATION OF ERRORS NOT AFFECTING THE TRIAL BALANCE**EXAMPLES OF ERRORS NOT AFFECTING THE TRIAL BALANCE
(OR TWO-SIDED ERRORS)**

The various errors which do not affect the Trial Balance include the following:

1. Two sided Errors of Omission	Error of Complete Omission
2. Two sided Errors of Commission	(a) Error of Recording in the books of original entry (b) Error of Posting involving the posting to Wrong Account on Correct Side with Correct Amount (c) Error of Principle (d) Compensating errors

HOW TO RECTIFY TWO SIDED ERRORS OF OMISSION

Two sided errors of omission in the books of original entry are rectified simply by the passing the journal entry which was to be passed at the time of transaction but was omitted to be passed.

ILLUSTRATION 1 [RECTIFICATION OF ERRORS OF COMPLETE OMISSION]

Pass the necessary journal entries to rectify the following errors:

- A credit sale of ₹ 170 to Ram omitted to be recorded in the books.
- Goods (Cost ₹ 1,000, Sale Price ₹ 1,200) taken away by the proprietor were not recorded anywhere.
- Goods (Cost ₹ 2,000, Sale Price ₹ 2,400) distributed as free samples among prospective customers were not recorded anywhere.
- Goods (Cost ₹ 3,000, Sale Price ₹ 3,600) were returned by Ram, a customer and were taken into stock on the same date but no entry was passed in the books.
- Materials from store of ₹ 1,000 and Wages ₹ 400 had been used in making tools and implements for use in own factory, but no adjustments were made in the books.
- Outstanding Telephone Charges of ₹ 660, had been completely omitted.
- A credit sale of old furniture to Rohan for ₹ 170 omitted to be posted.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
(a)	Ram Dr. To Sales A/c (Being a credit sale omitted to be recorded, now recorded)		170	170
(b)	Drawings A/c Dr. To Purchases A/c (Being goods taken away by the proprietor omitted to be recorded, now recorded)		1,000	1,000
(c)	Free Samples A/c Dr. To Purchases A/c (Being goods distributed as free samples omitted to be recorded, now recorded)		2,000	2,000
(d)	Sales Returns A/c Dr. To Ram's A/c (Being sales returns omitted to be recorded, now recorded)		3,600	3,600
(e)	Tools & Implements A/c Dr. To Purchases A/c To Wages A/c (Being materials and wages used in making tools, omitted to be adjusted, now adjusted)		1,400	1,000 400
(f)	Telephone Charges A/c Dr. To Outstanding Telephone Charges A/c (Being outstanding Telephone charges omitted to be recorded, now recorded)		660	660
(g)	No Journal Entry is to be passed as it has already been correctly passed in the Journal. Merely posting in both the accounts in the ledger is required.			

HOW TO RECTIFY TWO SIDED ERRORS OF COMMISSION

Such errors are committed in two or more accounts. These errors are rectified by passing a journal entry giving the appropriate debit and credit to the Respective Accounts which were affected by the error.

The following procedure may also be adopted to ascertain the rectifying entry:

PRACTICAL STEPS INVOLVED IN RECTIFICATION OF TWO SIDED ERRORS

- Step 1:** Write the Wrong Entry (i.e., entry which has already been passed in the books)
Step 2: Write the Reverse of Wrong Entry to nullify the effect of Wrong Entry.
Step 3: Write the Correct Entry (i.e., entry which should have been passed in the books)
Step 4: Write the Net Effect of Reverse Entry (as per Step 2) and Correct Entry (as per Step 3)

Example A Machine costing ₹ 1,100 purchased on credit from Mohan had been entered in Purchase Book. Rectify.

Step 1	Wrong Entry	Purchases A/c Dr. To Mohan	₹ 1,100	₹ 1,100
Step 2	Reverse of Wrong Entry	Mohan A/c Dr. To Purchases A/c	₹ 1,100	₹ 1,100
Step 3	Correct Entry	Machinery A/c Dr. To Mohan	₹ 1,100	₹ 1,100
Step 4	Rectifying Entry (Net Effect of 2 & 3)	Machinery A/c Dr. To Purchases A/c	₹ 1,100	₹ 1,100

ILLUSTRATION 2 [RECTIFICATION OF ERRORS OF RECORDING]

Pass the necessary journal entries to rectify the following errors in the books of a trader who deals in Cloths:

- A credit sale of ₹ 170 to Ram was recorded as ₹ 710.
- A credit sale of ₹ 170 to Kishan was recorded as sale to Krishan.
- A credit sale of ₹ 170 to Meenu was recorded as sale to Meena as ₹ 710.
- A credit sale of ₹ 170 to Mohan was recorded in the Purchases Book.
- A credit sale of old machinery to Sohan for ₹ 170 was entered in the Sales Book for ₹ 710.
- A cash sale of ₹ 170 to Tushar was recorded as ₹ 710.
- A Bills Receivable of ₹ 170 received from V. P. Singh was entered in Bills Payable Book.
- A cash purchase of ₹ 170 from Bharat was recorded as ₹ 710.

SOLUTION

[See Solution on page 13.12]

ILLUSTRATION 3 [RECTIFICATION OF TWO SIDED ERRORS OF POSTING]

Pass the necessary journal entries to rectify the following errors:

- A credit sale of ₹ 170 to Kishan was posted to Krishan's Account.
- A cash sale of ₹ 170 to Meenu was posted to the credit of Meena.
- A credit sale of old Furniture to Babu Ram for ₹ 170 was credited to Sales Account.

- (d) A cheque for ₹ 128 received from Farid was dishonoured and has been posted to the debit of Sales Returns Account.
- (e) An amount of ₹ 572 due from Lalta Prasad, written off as bad in a previous year, was recovered and credited to the personal account of Lalta Prasad.
- (f) A discounted Bill of Exchange receivable for ₹ 1,600 returned by the firm's bank had been credited to the Bank Account and debited to Bills Receivable Account. A cheque was received later from the customer for ₹ 1,600 and duly paid.
- (g) ₹ 4,000 paid for the telephone bill of the telephone at the proprietor's residence was debited to Postage Account.
- (h) An amount of ₹ 1,500 withdrawn from bank by the proprietor for his personal use has been charged to Trade Expenses Account.
- (i) An amount of ₹ 3,000 withdrawn from Bank by the proprietor for office use has been debited to Drawings Account.
- (j) ₹ 1,600 paid as salary to Hari, an employee, debited to Hira.
- (k) A credit sale of old furniture to Rohan for ₹ 170 posted as ₹ 710.

SOLUTION

[See Solution on page 13.13]

ILLUSTRATION 4 [RECTIFICATION OF ERRORS OF PRINCIPLE]

Pass the necessary journal entries to rectify the following errors:

- (a) ₹ 3,000 paid as wages for the construction of office building debited to Salaries Account.
- (b) ₹ 4,000 spent on the purchases of materials for the construction of Office Building debited to Purchases Account.
- (c) ₹ 10,000 spent on the extension of building was debited to Building Repairs Account.
- (d) ₹ 5,000 spent on white washing of building was charged to Building Account.
- (e) ₹ 200 paid as Installation Charges for newly purchased second hand Machinery posted to Cartage Account.
- (f) ₹ 2,000 paid as repairing charges on the reconditioning of a newly purchased second hand machinery debited to General Expenses Account.
- (g) ₹ 1,000 paid as repairing charges of an existing machine in use charged to Machinery Account
- (h) ₹ 2,000 paid by cheque for a typewriter was charged to the Office Expenses Account.

SOLUTION

[See Solution on page 13.14]

Solution to Illustration 2:

A Error	B Wrong Entry		C Reverse of Wrong Entry		D Correct Entry		E = C + D Rectifying Entry	
(a)	Ram	Dr. ₹ 710	Sales A/c To Ram	Dr. ₹ 710	Ram	Dr. ₹ 170	Sales A/c To Ram	Dr. ₹ 540
(b)	Krishan	Dr. ₹ 170	Sales A/c To Krishan	Dr. ₹ 170	Kishan	Dr. ₹ 170	Kishan	Dr. ₹ 170
(c)	Meena	Dr. ₹ 710	Sales A/c To Meena	Dr. ₹ 710	Meenu	Dr. ₹ 170	Sales A/c Meenu	Dr. ₹ 540
(d)	Purchases A/c To Mohan	Dr. ₹ 170	Mohan To Purchases A/c	Dr. ₹ 170	Mohan	Dr. ₹ 170	Mohan To Purchases A/c To Sales A/c	Dr. ₹ 340 ₹ 170 ₹ 170
(e)	Sohan	Dr. ₹ 710	Sales A/c To Sohan	Dr. ₹ 710	Sohan	Dr. ₹ 170	Sales A/c To Sohan To Machinery A/c	Dr. ₹ 710 ₹ 540 ₹ 170
(f)	Cash A/c To Sales A/c	Dr. ₹ 710	Sales A/c To Cash A/c	Dr. ₹ 710	Cash A/c	Dr. ₹ 170	Sales A/c To Cash A/c	Dr. ₹ 540 ₹ 540
(g)	V.P. Singh	Dr. ₹ 170	Bills Payable A/c To V.P. Singh	Dr. ₹ 170	Bills Receivable A/cDr. To V.P. Singh	Dr. ₹ 170	Bills Payable A/c Bills Receivable A/cDr. To V.P. Singh	Dr. ₹ 170 ₹ 170 ₹ 340
(h)	Purchases A/c To Cash A/c	Dr. ₹ 710	Cash A/c To Purchases A/c	Dr. ₹ 710	Purchases A/c To Cash A/c	Dr. ₹ 170	Cash A/c To Purchases A/c	Dr. ₹ 540 ₹ 540

Solution to Illustration 3:

A Error	B Wrong Entry		C Reverse of Wrong Entry		D Correct Entry		E = C + D Rectifying Entry	
(a)	Krishan	Dr. ₹ 170	Sales A/c To Krishan	Dr. ₹ 170	Kishan To Sales A/c	Dr. ₹ 170	Kishan To Krishan	Dr. ₹ 170
(b)	Cash A/c To Meena	Dr. ₹ 170	Meena To Cash A/c	Dr. ₹ 170	Cash A/c To Sales A/c	Dr. ₹ 170	Meena To Sales A/c	Dr. ₹ 170
(c)	Baburam To Sales A/c	Dr. ₹ 170	Sales A/c To Baburam	Dr. ₹ 170	Baburam To Furniture A/c	Dr. ₹ 170	Sales A/c To Furniture A/c	Dr. ₹ 170
(d)	Sales Returns A/c To Bank A/c	Dr. ₹ 128	Bank A/c To Sales Returns A/c	Dr. ₹ 128	Farid To Bank A/c	Dr. ₹ 128	Farid To Sales Returns A/c	Dr. ₹ 128
(e)	Bank A/c To Lalita Prasad	Dr. ₹ 572	Lalita Prasad To Bank A/c	Dr. ₹ 572	Bank A/c To Bad Debt Recovered A/c	Dr. ₹ 572	Lalita Prasad To Bad Debt Recovered A/c	Dr. ₹ 572
(f)	Bills Receivable A/c To Bank A/c	Dr. ₹ 1,600	Bank A/c To Bills Receivable A/c	Dr. ₹ 1,600	Customer's A/c To Bank A/c	Dr. ₹ 1,600	Customer's A/c To Bills Receivable A/c	Dr. ₹ 1,600
(g)	Postage A/c To Cash A/c	Dr. ₹ 4,000	Cash A/c To Postage A/c	Dr. ₹ 4,000	Drawings A/c To Cash A/c	Dr. ₹ 4,000	Drawings A/c To Postage A/c	Dr. ₹ 4,000
(h)	Trade Exp A/c To Bank A/c	Dr. ₹ 1,500	Bank A/c To Trade Exp. A/c	Dr. ₹ 1,500	Drawings A/c To Bank A/c	Dr. ₹ 1,500	Drawings A/c To Trade Exp. A/c	Dr. ₹ 1,500
(i)	Drawings A/c To Bank A/c	Dr. ₹ 3,000	Bank A/c To Drawings A/c	Dr. ₹ 3,000	Cash A/c To Bank A/c	Dr. ₹ 3,000	Cash A/c To Drawings A/c	Dr. ₹ 3,000
(j)	Hira To Cash A/c	Dr. ₹ 1,600	Cash A/c To Hira	Dr. ₹ 1,600	Salary A/c To Cash A/c	Dr. ₹ 1,600	Salary A/c To Hira	Dr. ₹ 1,600
(k)	Rohan To Furniture A/c	Dr. ₹ 710	Furniture A/c To Rohan	Dr. ₹ 710	Rohan A/c To Furniture A/c	Dr. ₹ 170	Furniture A/c To Rohan	Dr. ₹ 540

Solution to Illustration 4:

A Error	B Wrong Entry	C Reverse of Wrong Entry		D Correct Entry		E = C + D Rectifying Entry	
(a)	Salaries A/c Dr. To Cash A/c	₹ 3,000 ₹ 3,000	Cash A/c Dr. To Salaries A/c	Office Building A/c Dr. To Cash A/c	₹ 3,000 ₹ 3,000	Office Building A/c Dr. To Salaries A/c	₹ 3,000 ₹ 3,000
(b)	Purchases A/c Dr. To Cash A/c	₹ 4,000 ₹ 4,000	Cash A/c Dr. To Purchases A/c	Office Building A/c Dr. To Cash A/c	₹ 4,000 ₹ 4,000	Office Building A/c Dr. To Purchases A/c	₹ 4,000 ₹ 4,000
(c)	Building Repairs A/c Dr. To Cash A/c	₹ 10,000 ₹ 10,000	Cash A/c Dr. To Building Repairs A/c	Building A/c Dr. To Cash A/c	₹ 10,000 ₹ 10,000	Building A/c Dr. To Building Repairs A/c	₹ 10,000 ₹ 10,000
(d)	Building A/c Dr. To Cash A/c	₹ 5,000 ₹ 5,000	Cash A/c Dr. To Building A/c	Building Maintenance A/c Dr. To Cash A/c	₹ 5,000 ₹ 5,000	Building Maintenance A/c Dr. To Building A/c	₹ 5,000 ₹ 5,000
(e)	Cartage A/c Dr. To Cash A/c	₹ 200 ₹ 200	Cash A/c Dr. To Cartage A/c	Machinery A/c Dr. To Cash A/c	₹ 200 ₹ 200	Machinery A/c Dr. To Cartage A/c	₹ 200 ₹ 200
(f)	General Expenses A/c Dr. To Cash A/c	₹ 2,000 ₹ 2,000	Cash A/c Dr. To General Expenses A/c	Machinery A/c Dr. To Cash A/c	₹ 2,000 ₹ 2,000	Machinery A/c Dr. To General Expenses A/c	₹ 2,000 ₹ 2,000
(g)	Machinery A/c Dr. To Cash A/c	₹ 1,000 ₹ 1,000	Cash A/c Dr. To Machinery A/c	Machinery Repairs A/c Dr. To Cash A/c	₹ 1,000 ₹ 1,000	Machinery Repairs A/c Dr. To Machinery A/c	₹ 1,000 ₹ 1,000
(h)	Office Expenses A/c Dr. To Bank A/c	₹ 2,000 ₹ 2,000	Bank A/c Dr. To Office Expenses A/c	Typewriter A/c Dr. To Bank A/c	₹ 2,000 ₹ 2,000	Typewriter A/c Dr. To Office Expenses A/c	₹ 2,000 ₹ 2,000

9.0 RECTIFICATION OF ERRORS AFFECTING THE TRIAL BALANCE**EXAMPLES OF ERRORS AFFECTING THE TRIAL BALANCE
(OR ONE-SIDED ERRORS)**

The various errors which affect the trial balance include the following:

1. Error due to Partial Omission
2. Error of Casting
3. Error in Carrying Forward
4. Error in Totalling or Balancing of an account
5. Errors of Posting (other than an error of posting a correct amount in the wrong account but on the correct side)
6. Omission of Posting the total of a subsidiary book
7. Omission of an Account from Trial Balance
8. Entering the balance of an account in the Wrong Amount column of the Trial Balance
9. Wrong Totalling of the Trial Balance

HOW TO RECTIFY ONE-SIDED ERRORS

Such errors are rectified in the following manner:

RECTIFICATION OF ONE-SIDED ERRORS

Stage at which one-sided errors are rectified	How to Rectify one-sided Errors
(a) When the Errors are rectified before transferring the difference in the Trial Balance to the Suspense Account.	Debit/Credit the "Respective Account" with the required amount alongwith an explanatory note in the "Particulars column".
(b) When the Errors are rectified after transferring the difference in the Trial Balance to the Suspense Account but before the preparation of the Financial Statements.	Pass a journal entry with the help of Respective Account(s) (affected by the error) & Suspense Account .

10.0 THEORETICAL ASSUMPTIONS WHILE RECTIFYING ERRORS

Situation	Theoretical Assumption while rectifying errors
1. If it is not stated that the difference in the Trial Balance has been transferred to the Suspense Account.	1. Assume that the difference has been transferred to the Suspense Account and thus rectify the one sided errors with the help of Suspense Account.
2. If it is not stated that the errors are rectified after the preparation of the financial statements.	2. Assume that the errors are rectified before the preparation of the financial statements.
3. If Error is committed in the books of original entry. <i>[For example, Goods sold on credit to Bharat for ₹ 1,000 recorded as ₹ 100]</i>	3. Assume that all posting have been done accordingly. <i>[It means that Bharat's Account has been debited and Sales Account has been credited with ₹ 100]</i>

4. If Error is committed in Posting. <i>[For example, Goods sold on credit to Bharat for ₹ 1,000 posted as ₹ 100]</i>	4. Assume that recording in the subsidiary books has been done correctly. <i>[It means that goods sold on credit to Bharat for ₹ 1,000 have been correctly recorded in the Sales Book but while posting Bharat's Account has been debited with ₹ 100]</i>
5. If the Error involves posting to a wrong account (without stating side and amount of posting) <i>[For example, Goods sold on credit to Bharat ₹ 1,000 posted to Charat's Account]</i>	5. Assume that posting has been done on correct side with correct amount. <i>[It means that Charat's Account has been debited with ₹ 1,000]</i>
6. If the Error involves posting with wrong amount (without stating side & account) <i>[For example, Goods sold on credit to Bharat for ₹ 1,000 posted as ₹ 100]</i>	6. Assume that posting has been done to a correct account on correct side. <i>[It means that Bharat's account has been debited with ₹ 100].</i>
7. If the Error involves posting on a wrong side (without stating amount & account) <i>[For example, Goods sold on credit to Bharat for ₹ 1000 credited]</i>	7. Assume that posting has been done to a correct account with correct amount as per original recording. <i>[It means that Bharat's account has been credited with ₹ 1,000]</i>
8. If the Error involves omission of posting of a transaction recorded in a Journal Proper <i>[For example, Furniture purchased on credit from Charat for ₹ 1,000 was not posted]</i>	8. Assume that posting has not been done to any of the accounts involved. <i>[It means that neither Furniture Account nor Charat's Account has been posted]</i>

11.0 POINTS TO REMEMBER WHILE RECTIFYING ERRORS

Situation	Points to Remember
1. If Error involves in posting of an individual transaction recorded in Cash Book <i>[For example, Goods sold to Bharat for Cash for ₹ 1,000 posted as ₹ 100]</i>	It affects the Individual Account which was to be posted and not Cash Account/Bank Account. <i>[It means that Sales Account has been credited with ₹ 100 and cash account was not affected]</i>
2. If Error involves in posting of an individual transaction recorded in Other Subsidiary Books <i>[For example, Goods sold on credit to Bharat for ₹ 1,000 posted as ₹ 100]</i>	It affects the Individual Personal Account only and not that account to which total of a particular subsidiary book is posted. <i>[It means that Bharat's Account has been debited with ₹ 100 and Sales Account was not affected]</i>
3. If Error involves in casting of Subsidiary books. <i>[For Example, Sales Book was Overcast by ₹ 100]</i>	It affects only that Account to which Total of the particular subsidiary book is posted and does not affect the Individual Personal Account. <i>[It means that there is excess credit of ₹ 100 in Sales Account.]</i>

TUTORIAL NOTES

1. Unless otherwise stated, it is usually presumed that the errors are rectified after transferring the difference in the Trial Balance to the Suspense Account, but before the preparation of the Financial Statements.
2. When the word "Posted" is used in relation to an Individual Transaction, unless otherwise stated, it is assumed that—
 - (a) posting has been done on the correct side,
 - (b) posting has been done to the account(s) to which the individual item and not the total of the book is posted,
 - (c) posting has been done with the correct amount,
3. When the word 'Debited' is used in relation to an Individual Transaction, it implies the posting on debit side of an account to which an individual item is posted.
4. When the word 'Credited' is used in relation to an Individual Transaction, it implies the posting on credit side of an account to which an individual item is posted.

The Table given below summarizes the interpretation of the word "posted":

Error	Interpretation of the word 'Posted'
(a) Goods purchased from Charat for ₹ 1,000 posted to Bharat's Account.	Instead of Charat's Account, Bharat's Account has been credited by ₹ 1,000.
(b) Goods purchased on credit for ₹ 1,000 from Charat posted as ₹ 100.	Charat's Account has been credited by ₹ 100 instead of ₹ 1,000. Note: Purchase Account can not be debited by ₹ 100 since the Purchase Account is posted with the periodic total of the Purchase Book and not with the amount of individual item.
(c) Cash Purchases of goods from Charat for ₹ 1,000 posted as ₹ 100.	Purchases Account has been debited by ₹ 100 instead of ₹ 1,000. Note: Cash Account can not be credited by ₹ 100 since there is no posting from the Cash Book to the Cash Account.
(d) Furniture purchased on credit from Bharat for ₹ 1,000 posted as ₹ 100.	Furniture Account has been debited by ₹ 100 instead of ₹ 1,000 and Bharat's Account has been credited by ₹ 100 instead of ₹ 1,000. Note: Here the error was committed while posting both the sides of the entry since in case of a transaction recorded in General Journal, both the sides of the entry are posted with the individual amounts.

ILLUSTRATION 5

An accountant of a trading concern (dealing in cloth) provides you the details of various errors discovered as follows:

- (a) The Purchases Book was undercast by ₹ 71.
- (b) The debit side of 'W' a debtor, is overcast by ₹ 7,000.
- (c) The total of Sales Book carried forward ₹ 13,000 less on page 5 & ₹ 14,000 more on page 7.
- (d) Total of Sales Book ₹ 2,000 omitted to be posted.
- (e) A Credit Sale to W ₹ 17 omitted to be posted.

- (f) A Credit Sale to X ₹ 17 posted as ₹ 71.
- (g) A Credit Sale to Y ₹ 17 debited as ₹ 71.
- (h) A Credit Sale to Z ₹ 17 credited as ₹ 71.
- (i) A Cash Sale to W ₹ 17 omitted to be posted.
- (j) A Cash Sale to X ₹ 17 posted as ₹ 71.
- (k) A Cash Sale to Y ₹ 17 debited as ₹ 71.
- (l) A Cash Sale to Z ₹ 17 credited as ₹ 71.
- (m) A Credit Sale of furniture to Y for ₹ 61, debited as ₹ 16.
- (n) A Credit Sale of furniture to Z for ₹ 61 credited as ₹ 16.

Required: How you will rectify the aforesaid errors in each of following alternative cases:

Case 1: If the errors are rectified before transferring the difference in the Trial Balance to the Suspense Account.

Case 2: If the errors are rectified after transferring the difference in the Trial Balance to the Suspense Account but before the preparation of the Financial Statements.

SOLUTION

Case 1: If the Errors are rectified without Suspense Account.

Dr. (A) PURCHASES ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Mistake in totalling on page..	71		

Dr. (B) W'S ACCOUNT Cr.

Particulars	₹	Particulars	₹
		By Mistake in totalling on page	7,000

Dr. (C) SALES ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Mistake in carrying forward on page 5 & 7.....	1,000		

Dr. (D) SALES ACCOUNT Cr.

Particulars	₹	Particulars	₹
		By Omission in posting on . . .	2,000

Dr. (E) W'S ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Omission in Posting on	17		

Dr. (F) X'S ACCOUNT Cr.

Particulars	₹	Particulars	₹
		By Mistake in posting on	54

Dr. **(G) Y'S ACCOUNT** Cr.

Particulars	₹	Particulars	₹
		By Mistake in posting on	54

Dr. **(H) Z'S ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Mistake in posting on . . .	88		

Dr. **(I) SALES ACCOUNT** Cr.

Particulars	₹	Particulars	₹
		By Omission posting on . . .	17

Dr. **(J) SALES ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Mistake in posting on . . .	54		

Dr. **(K) SALES ACCOUNT** Cr.

Particulars	₹	Particulars	₹
		By Mistake in posting on . . .	88

Dr. **(L) SALES ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Mistake in posting on . . .	54		

Dr. **(M) Y'S ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Mistake in posting on . . .	45		

Dr. **(N) FURNITURE ACCOUNT** Cr.

Particulars	₹	Particulars	₹
		By Omission posting on . . .	45

Case 2: If the Errors are rectified after transferring the difference in the Trial Balance to the Suspense Account but before the preparation of the Financial Statements.

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Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(a)	Purchases A/c Dr. To Suspense A/c (Being the mistake in totalling, now rectified)		71	71
(b)	Suspense A/c Dr. To W's A/c (Being the mistake in totalling, now rectified)		7,000	7,000

(c)	Sales A/c To Suspense A/c (Being the mistake in totalling on page 5 and page 7, now rectified with the net effect)	Dr.		1,000 1,000
(d)	Suspense A/c To Sales A/c (Being omission in posting, now rectified)	Dr.	2,000	2,000
(e)	W's A/c To Suspense A/c (Being omission in posting, now rectified)	Dr.	17	17
(f)	Suspense A/c To X's A/c (Being the posting to X's A/c, now rectified)	Dr.	54	54
(g)	Suspense A/c To Y's A/c (Being the posting to Y's A/c, now rectified)	Dr.	54	54
(h)	Z's A/c To Suspense A/c (Being the posting to Z's A/c, now rectified)	Dr.	88	88
(i)	Suspense A/c To Sales A/c (Being omission in posting, now rectified)	Dr.	17	17
(j)	Sales A/c To Suspense A/c (Being Posting to Sales A/c, now rectified)	Dr.	54	54
(k)	Suspense A/c To Sales A/c (Being the posting to Sales A/c, now rectified)	Dr.	88	88
(l)	Sales A/c To Suspense A/c (Being the posting to Sales A/c, now rectified)	Dr.	54	54
(m)	Y's A/c To Suspense A/c (Being the posting to Y's A/c, now rectified)	Dr.	45	45
(n)	Suspense A/c To Furniture A/c (Being the posting to Furniture A/c, now rectified)	Dr.	45	45

ILLUSTRATION 6

A book keeper while preparing trial balance finds that the debit exceeds by ₹ 500. He places the difference to a Suspense Account. Pass the necessary journal entries to rectify the following errors discovered by the auditor and prepare Suspense Account.

- (a) A cheque from A for ₹ 150 had been posted to the credit of A as ₹ 100.
- (b) Goods worth ₹ 100 purchased from Chandra were entered in the Sales Book. The account of Chandra was correctly credited.
- (c) A credit balance of ₹ 755 of Rent Received Account was shown as ₹ 570.
- (d) Goods worth ₹ 130 returned by Green were entered in the Sales Book and were posted therefrom to the Credit of Green's personal account.
- (e) Bills Receivable from Henry of ₹ 1,600 posted to the credit of Bills Payable Account and also credited to Henry.
- (f) An amount of ₹ 800 owing by a customer had been omitted from the list of Sundry Debtors.
- (g) A credit item of ₹ 349 has been debited to a Personal Account of customer as ₹ 439.
- (h) A discount allowed to a customer has been credited to him as ₹ 145 in place of ₹ 154.
- (i) Total Sales of ₹ 594 had been posted as ₹ 495 in the Sales Account.
- (j) Discounts received of ₹ 1,420 had been debited to discount allowed.
- (k) Cash received from Meenu ₹ 720 was posted to the debit of Meena as ₹ 270.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
(a)	Suspense A/c Dr. To A's A/c (Being A's Account credited short for ₹ 50, now rectified)		50	50
(b)	Purchases A/c Dr. Sales A/c Dr. To Suspense A/c (Being purchase wrongly treated as sales, now rectified)		100 100	200
(c)	Suspense A/c Dr. To Rent Received A/c (Being a credit balance of ₹ 755 of Rent Received A/c written as ₹ 570, now rectified)		185	185
(d)	Sales A/c Dr. Returns Inward A/c Dr. To Suspense A/c (Being the return inwards wrongly entered in Sales Book, now rectified)		130 130	260
(e)	Bills Payable A/c Dr. Bills Receivable A/c Dr. To Suspense A/c (Being a B/R received from Henry wrongly posted to the credit of B/P, now rectified)		1,600 1,600	3,200
(f)	Sundry Debtors Dr. To Suspense A/c (Being a debtor omitted from the list now included) [Note: Debtor's A/c need not be posted again in the ledger in this case since it is already correctly balanced.]		800	800

(g)	Suspense A/c To Customer's A/c (Being the wrong posting to Customer's A/c, now rectified)	Dr.	788	788
(h)	Suspense A/c To Customer's A/c (Being the under credit given to Customer's A/c, now rectified)	Dr.	9	9
(i)	Suspense A/c To Sales A/c (Being wrong posting in Sales A/c, now rectified)	Dr.	99	99
(j)	Suspense A/c To Discount Allowed A/c To Discount Received A/c (Being Discount Received wrongly posted to Discount Allowed A/c, now rectified)	Dr.	2,840	1,420 1,420
(k)	Suspense A/c To Meena To Meenu (Being cash received from Meenu wrongly posted to Meena, now rectified)	Dr.	990	270 720

Dr.
SUSPENSE ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To A's A/c	50	By Difference in Trial Balance	500
To Rent Received A/c	185	By Purchases A/c	100
To Customer's A/c	788	By Sales A/c	100
To Customer's A/c	9	By Sales A/c	130
To Sales A/c	99	By Return Inwards A/c	130
To Discount Allowed A/c	1,420	By Bills Payable A/c	1,600
To Discount Received A/c	1,420	By Bills Receivable A/c	1,600
To Meena	270	By Sundry Debtors A/c	800
To Meenu	720	By Balance c/d	1
	4,961		4,961

12.0 EFFECT OF RECTIFICATION OF ERRORS ON PROFIT or LOSS

The effect of rectification of error on profit/loss is summarised as follows:

EFFECT OF RECTIFICATION OF ERRORS ON PROFIT or LOSS

I. If a Nominal Account is debited in a Rectifying Entry	Profit will be decreased or loss will be increased
II. If a Nominal Account is credited in a Rectifying Entry	Profit will be increased or loss will be decreased.

ILLUSTRATION 7

Show the effect of rectifying entries passed in Illustration 5 on profit or loss.

SOLUTION**EFFECT OF RECTIFICATION OF ERRORS ON CURRENT YEAR'S PROFITS**

<i>Rectifying Entry</i>	<i>Effect</i>	<i>Increase in Profit (₹)</i>	<i>Decrease in Profit (₹)</i>
(a)	Profit will be decreased by ₹ 71	—	71
(b)	No effect		—
(c)	Profit will be decreased by ₹ 1,000	—	1,000
(d)	Profit will be increased by ₹ 2,000	2,000	
(e)	No effect		—
(f)	No effect		—
(g)	No effect		
(h)	No effect		—
(i)	Profit will be increased by ₹ 17	17	—
(j)	Profit will be decreased by ₹ 54	—	54
(k)	Profit will be increased by ₹ 88	88	
(l)	Profit will be decreased by ₹ 54	—	54
(m)	No effect		—
(n)	No effect		
		2,105	1,179

Thus, Net Increase in Profit = ₹ 2,105 – ₹ 1,179 = ₹ 926.

MISCELLANEOUS ILLUSTRATIONS**ILLUSTRATION 8**

On going through the Trial Balance of X Ltd., you find that the debit is in excess by ₹ 250. This was credited to the Suspense Account. On a close scrutiny of the books, the following mistakes were noticed:

- The total of debit side of Expenses Account have been cast in excess by ₹ 150.
- The Sales Account has been totalled in short by ₹ 200.
- One item of purchase of ₹ 25 has been posted from the Purchase Book to Ledger as ₹ 350.
- The sale return of ₹ 200 from a party has not been posted to that account, though the Party's account has been credited,
- A cheque of ₹ 600 issued to the Suppliers' Account (shown under Sundry Creditors) towards his dues had been wrongly debited to the Purchases.
- A credit sale of ₹ 100 has been credited to the Sales and also to the Sundry Debtors account.

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

SOLUTION
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<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
(a)	Suspense A/c Dr. To Expenses A/c (Being the mistake in totalling of Expenses A/c rectified)		150	150
(b)	Suspense A/c Dr. To Sales A/c (Being the mistake in totalling of Sales A/c rectified)		200	200
(c)	Supplier's A/c Dr. To Suspense A/c (Being the mistake in posting from Purchases Book to Ledger, rectified)		325	325
(d)	Sales Returns A/c Dr. To Suspense A/c (Being the Sales return from a party, not posted to Sales returns, now rectified)		200	200
(e)	Sundry Creditors' A/c Dr. To Purchases A/c (Being the payments made to supplier wrongly posted to purchases, now rectified)		600	600
(f)	Sundry Debtors' A/c Dr. To Suspense A/c (Being the sales wrongly credited to customer's account, now rectified)		200	200

EFFECT OF RECTIFICATION ON PROFITS

<i>Rectifying Entry</i>	<i>Increase in Profit (₹)</i>	<i>Decrease in Profit (₹)</i>
(a)	150	—
(b)	200	—
(d)	—	200
(e)	600	—
	950	200

As a result of these entries, the profit will be increased by ₹ 750.

Dr.

SUSPENSE ACCOUNT

Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Expenses A/c	150	By Difference in Trial Balance	250
To Sales A/c	200	By Supplier's A/c	325
To Balance c/d	625	By Sales Returns A/c	200
		By Sundry Debtors A/c	200
	975		975
		By Balance b/d	625

Since the Suspense Account has some balance, it means that some of the errors have not been traced.

ILLUSTRATION 9

Pass the necessary journal entries to rectify the following errors:

- (a) A builder's bill for ₹ 4,600 for erection of a small shed was debited to repairs account.
- (b) Repairs to plant amounting to ₹ 900 had been charged to Plant and Machinery Account.
- (c) Wages paid to the firm's workmen for making certain additions to machinery amounting to ₹ 340 were debited to Wages account.
- (d) A cheque for ₹ 750 received from S. Desai was credited to the account of R Ram.
- (e) Goods to the value of ₹ 700 returned by X were included in the closing stock but no entry was made in the books.
- (f) Goods costing ₹ 2,000 were purchased for various members of the staff and the cost was included in "Purchases". A similar amount was deducted from the salaries of the staff members concerned and the net payments to them debited to Salaries account.
- (g) A bill of exchange (received from Hari) for ₹ 3,000 had been returned by the Bank, with whom it had been discounted, as dishonoured and had been credited to Bank Account and debited to Bills receivable Account.
- (h) Goods sold to Z for ₹ 475 have been wrongly entered in the Sales Book as ₹ 745.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
(a)	Building A/c Dr. To Repairs A/c (Being the erection charges wrongly shown as revenue expenditure, now rectified by capitalising the same)		4,600	4,600
(b)	Repairs A/c Dr. To Plant & Machinery A/c (Being the repairs wrongly capitalised instead of being treated as revenue expenditure, now rectified)		900	900
(c)	Plant & Machinery A/c Dr. To Wages A/c (Being the wages for additions to Machinery wrongly treated as Revenue expenditure, now rectified by capitalising the same)		340	340
(d)	R. Ram A/c Dr. To S. Desai A/c (Being the wrong posting of cheque received rectified)		750	750
(e)	Returns Inward A/c Dr. To X A/c (Being the returns inward not recorded by mistake, now rectified)		700	700
(f)	Salaries A/c Dr. To Purchases A/c (Being the goods purchased for staff members wrongly recorded as purchases, now rectified)		2,000	2,000

(g)	Hari A/c To Bills Receivable A/c (Being the dishonour of discounted Bill recorded in the books as Bills Receivable by mistake, now rectified)	Dr.	3,000	3,000
(h)	Sales A/c To Z A/c (Being the excess recording of Sales in Sales Day Book rectified)	Dr.	270	270

ILLUSTRATION 10

There was difference in the trial balance of Shri Arihant which was put to newly opened Suspense Account. Subsequently the following mistakes were discovered. Pass Journal entries to rectify them and ascertain the difference in the Trial Balance:

- Materials costing ₹ 700 in the erection of machinery and the wages paid for it amounting to ₹ 400 were included in the Purchases Account and the Wages Account respectively.
- Goods sold under credit terms ₹ 16,900 to Mohan were recorded properly in the Sales Book but were debited to his account as ₹ 19,600 and carriage outward and freight paid ₹ 700 chargeable from him were posted to Sales Expenses Account.
- Sales Returns to Yogesh ₹ 2,300 were correctly recorded in the Sales Returns Book from where they were debited to Yogesh Account by ₹ 3,200.
- Old furniture originally purchased for ₹ 1,800 written down to ₹ 1,100 was sold for cash ₹ 1,700 and was credited to Furniture Account.
- Machinery purchased on credit ₹ 17,000 was recorded in Purchases book and transport charges for the machine ₹ 1,200 were debited to Trade Expenses Account.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(a)	Machinery A/c To Purchases A/c To Wages A/c (Being the material & wages paid for the erection of machinery wrongly shown as revenue expenditure now rectified by capitalising the same)	Dr.	1,100	700 400
(b)(i)	Suspense A/c To Mohan A/c (Being the excess debit to Mohan A/c rectified by cancellation of the same)	Dr.	2,700	2,700
(b)(ii)	Mohan A/c To Sales Expenses A/c (Being the carriage outward, Freight etc. chargeable from Mohan posted to Sales Expenses A/c by mistake, now rectified)	Dr.	700	700
(c)	Suspense A/c To Yogesh A/c. (Being the Yogesh A/c credited for wrong debit ₹ 3,200 & correct credit ₹ 2,300)	Dr.	5,500	5,500

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Mohan A/c	2,700	By Difference in Trial Balance	8,200
To Yogesh A/c	5,500		
	8,200		8,200

The Trial Balance of Mr X failed to agree and the difference was put into Suspense Account pending investigation which discovered the following:

- (a) Discount received ₹ 1,320 had been debited to Discount allowed as ₹ 132.
- (b) Goods of the value of ₹ 200 returned by Kishan were entered in the Sales Day Book and posted therefrom to the credit of Krishan as ₹ 20.
- (c) A credit purchase of ₹ 500 from N. Kumar was recorded as sale to M. Kumar for ₹ 50.
- (d) A credit sale of machine to P. Dass for ₹ 600 recorded through Sales Day Book as sale to C. Dass for ₹ 60.

Required: Pass the necessary rectifying entries and prepare the Suspense Account assuming that there are no more errors.

SOLUTION:

JOURNAL

Date	Particulars	Dr. (₹)	Cr. (₹)
(a)	Suspense A/c Dr.	1,452	
	To Discount Allowed A/c		132
	To Discount Received A/c		1,320
	(Being wrong posting, now rectified)		
(b)	Sales Returns A/c Dr.	200	
	Sales A/c Dr.	200	
	Krishan Dr.	20	
	To Kishan A/c		200
	To Suspense A/c		220
	(Being wrong recording & posting, now rectified)		

(c)	Sales A/c	Dr.	50	
	Purchases A/c	Dr.	500	
	To M. Kumar			50
	To N. Kumar			500
	(Being recording & posting, now rectified)			
(d)	Sales A/c	Dr.	60	
	P. Dass	Dr.	600	
	To C. Dass			60
	To Machinery A/c			600
	(Being wrong recording & posting, now rectified)			

Dr.
SUSPENSE ACCOUNT
Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Discount Allowed A/c	132	By Difference in Trial Balance	1,232
To Discount Received A/c	1,320	By Sales A/c	200
		By Krishan A/c	20
	1,452		1,452

ILLUSTRATION 12

The Trial Balance of Mr Y failed to agree and the difference was put into Suspense Account pending investigation which disclosed the following.

- Discount allowed ₹ 1,320 had been debited to Discount received as ₹ 132.
- Goods of the value of ₹ 200 returned to Meenu were entered in the Purchases Day Book posted therefrom to the debit to Meena as ₹ 20.
- A credit sale of ₹ 500 to G. Das recorded as purchases from B. Dass as ₹ 50.
- A credit purchase of machine from P. Kumar for ₹ 600 recorded in Purchases Day Book as purchases from C. Kumar for ₹ 60.

Required: Pass the necessary rectifying entries and prepare the Suspense Account assuming that there are no more errors.

SOLUTION:
JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
(a)	Discount Allowed A/c	Dr.	1,320
	To Discount Received A/c		132
	To Suspense A/c		1,188
	(Being wrong posting, now rectified)		
(b)	Meenu A/c	Dr.	200
	Suspense A/c	Dr.	220
	To Purchases Returns A/c		200
	To Purchases A/c		200
	To Meena A/c		20
	(Being wrong recording & posting, now rectified)		

(c)	G. Dass A/c	Dr.	500	
	B. Dass A/c	Dr.	50	
	To Sales A/c			500
	To Purchases A/c			50
	(Being wrong recording & posting, now rectified)			
(d)	Machinery A/c	Dr.	600	
	C. Kumar	Dr.	60	
	To P. Kumar			600
	To Purchases A/c			60
	(Being wrong recording & posting, now rectified)			

Dr.

SUSPENSE ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Difference in Trial Balance	968	By Discount Allowed A/c	1,320
To Discount Received A/c	132		
To Purchases A/c	200		
To Meena A/c	20		
	1,320		1,320

ILLUSTRATION 13

Rectify the following errors:

- (i) A Credit Sale of goods to X ₹ 3,000 posted as ₹ 30,00.
- (ii) A Cash Sale of goods to Y ₹ 3,000 posted as ₹ 30,000
- (iii) A Credit Sale of Furniture to Z ₹ 3,000 posted as ₹ 30,000.
- (iv) A Credit Sale of goods of ₹ 3,000 to Krishan entered in the purchases book as ₹ 30,000 and posted therefrom to the credit of Krishan as ₹ 3,000.
- (v) A Cash Sale of goods of ₹ 3,000 to Krishan posted to the credit of Krishan as ₹ 30,000.
- (vi) A Credit Purchase of old machinery from Sohan for ₹ 17,000 was entered in the Purchases Book as purchase from Mohan for ₹ 71,000. ₹ 3,000 paid as Repair Charges of this Machinery debited to General Expenses Account..
- (vii) A Bill drawn on Meenu for ₹ 30,000. was passed through Bills Payable Book with ₹ 3,000 and posted therefrom to the credit of Meena as ₹ 300.
- (viii) Sales included a sale of furniture having a book of value of ₹ 900 for ₹ 850 on 31st March, 2018.

SOLUTION:**JOURNAL**

Date	Particulars	Dr. (₹)	Cr. (₹)
(i)	Suspense A/c To X (Being wrong positing, now rectified)	27,000	27,000
(ii)	Sales A/c To Suspense A/c (Being wrong positing, now rectified)	27,000	27,000

(iii)	Furniture A/c To Z A/c (Being wrong posting, now rectified)	Dr.	27,000	27,000
(iv)	Krishan Kishan Suspense A/c To Sales A/c To Purchases A/c (Being sale recorded as purchase with wrong amount and wrong posting therefrom, now rectified)	Dr. Dr. Dr.	3,000 3,000 27,000	3,000 30,000
(v)	Kishan To Sales A/c To Suspense A/c (Being wrong positing, now rectified)	Dr.	30,000	3,000 27,000
(vi)	Mohan Machinery A/c To Sohan To Purchases A/c To General Expenses A/c (Being purchase of old machinery recorded the Purchases Book and repairing charges debited to General Expenses A/c, now rectified)	Dr. Dr.	71,000 20,000	17,000 71,000 3,000
(vii)	Bills Receivable A/c Bills Payable A/c Meena To Meenu To Suspense A/c (Being B/R drawn recorded in B/P Book, now rectified)	Dr. Dr. Dr.	30,000 3,000 300	30,000 3,300
(viii)	Sales A/c Loss on Sale of Furniture A/c To Furniture A/c (Being the sale of furniture recorded as sales, now rectified)	Dr. Dr.	850 50	900

ILLUSTRATION 14

Rectify the following errors:

- Goods (Cost ₹ 423, Sale Price ₹ 432) taken by Ganesh, the proprietor for his personal use recorded in the sales book.
- Goods (Cost ₹ 423, Sale Price ₹ 432) given away as free samples to Mahesh, a customer recorded in the sales book
- An amount of ₹ 5,720 due from Ramesh, written off as bad in a previous year, was recovered and credited to the personal account of Mahesh.
- A discounted Bill of Exchange receivable for ₹ 16,000 returned by the firm's bank had been credited to the Bank Account and debited to Bills Receivable Account. A cheque was received later from the Customer for ₹ 16,000 and duly paid.
- An amount of ₹ 8,000 owing by a customer had been omitted from the list of Sundry Debtors.
- A credit sale of old furniture to Rohan for ₹ 17,000 omitted to be posted.
- On 26th March, goods of the sale value of ₹ 2,00,000 were sent on sale or return basis to Gopal, a customer, the period of approval being two weeks. He returned 20% of the goods and approved 80% of the remaining on 31st March. These goods were sent at a profit of 25% on cost.

- (viii) Discount allowed ₹ 1,320 had been debited to Discount received as ₹ 132.
- (ix) Materials from store of ₹ 10,000 and Wages ₹ 4,000 had been used in making tools and implements for use in own factory, but no adjustments were made in the books.

SOLUTION:**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
(i)	Sales A/c Dr. Drawings A/c Dr. To Ganesh's Capital A/c To Purchases A/c (Being the goods taken by proprietor for his personal use recorded in sales book, now rectified)		432 423	432 423
(ii)	Sales A/c Dr. Sales Promotion A/c Dr. To Mahesh To Purchases A/c (Being the goods given away as free samples recorded in sales book, now rectified)		432 423	432 423
(iii)	Mahesh Dr. To Bad Debts Recovered A/c (Being Bad Debts Recovered wrongly credited to Mahesh now rectified)		5,720	5,720
(iv)	Customer's A/c Dr. To Bills Receivable A/c (Being dishonour of a B/R wrongly debited to Bills Receivable A/c now rectified)		16,000	16,000
(v)	Sundry Debtors Dr. To Suspense A/c (Being a debtor omitted from the list now included) [Note: Debtor's A/c need not be posted again in the ledger in this case since it is already correctly balanced].		8,000	8,000
(vi)	No Journal Entry is to be passed as it has already been correctly passed in the Journal. Merely posting in both the accounts in the ledger is required.			
(vii)	(i) Sales Returns Dr. To Gopal (Being 20% of ₹ 2,00,000, returned) (ii) (a) Sales A/c Dr. To Gopal (Being 20% of 1,60,000, not yet approved, now adjusted) (b) Closing Stock Dr. To Trading A/c (Being 80% of ₹ 32,000, treated as parts of stock)		40,000 32,000 25,600	40,000 32,000 25,600

(viii)	Discount Allowed A/c	Dr.	1,320	
	To Discount Received A/c			132
	To Suspense A/c			1,188
	(Being wrong posting, now rectified)			
(ix)	Tools & Implements A/c	Dr	14,000	
	To Materials			10,000
	To Wages			4,000
	(Being materials & wages used in tools, now adjusted)			

9.0 RECTIFICATION OF ERRORS AFTER THE PREPARATION OF FINAL ACCOUNTS

HOW TO RECTIFY ERRORS AFTER THE PREPARATION OF FINAL ACCOUNTS

After the preparation of final accounts, the errors affecting the nominal accounts (e.g., Sales A/c, Purchases A/c, Expense A/c) are rectified with the help of Profit and Loss Adjustment Account so that current year's profit/loss may not be affected as a result of rectification of such errors.

While passing a rectifying entry after the preparation of the Final Accounts, Profit & Loss Adjustment Account is used in place of nominal account(s).

BALANCE OF PROFIT & LOSS ADJUSTMENT ACCOUNT

The balance of profit and loss Adjustment Account is transferred to the Capital Account in case of proprietorship/partnership concerns.

ILLUSTRATION 15

A proprietor of a concern while balancing his book finds some differences in the trial balance. To avoid delay in the preparation of Financial Statements, he places the difference to "Suspense Account" which he carries forward to the next year. In the next year the following mistakes were discovered:

- Sales book was undercast by ₹ 100.
- Purchase book was carried forward as ₹ 250 instead of ₹ 450.
- Credit sales to X ₹ 400 posted as ₹ 4,000.
- Sales to X ₹ 400 recorded in the Sales Book as ₹ 4,000.
- Purchase of a Furniture of ₹ 10,000 passed through the Invoice Book.
- Sales of a Furniture of ₹ 1,000 to Y not entered any where.

You are required to:

- find out the difference in the trial balance,
- rectify the errors,
- prepare Suspense Account,
- show the effect of errors on last year's profits,
- show the effect of rectification of errors on profits,

SOLUTION**(I) DIFFERENCE IN TRIAL BALANCE**

<i>Transaction</i>	<i>Excess Debit</i>	<i>Excess Credit</i>	<i>Net</i>
(a)	(100)	—	(100)
(b)	—	200	200
(c)	No effect	No effect	
(d)	(3,600)	—	(3,600)
(e)	No effect	No effect	
(f)	No effect	No effect	
	(3,700)	200	(3,500)

Thus, debit side of Trial Balance will exceed by ₹ 3,500.

**(II) RECTIFICATION OF ERRORS
JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
(a)	Suspense A/c Dr. To Profit and Loss Adjustment A/c (Being Sales Book undercast, now rectified)		100	100
(b)	Profit and Loss Adjustment A/c Dr. To Suspense A/c (Being wrong carrying forward, now rectified)		200	200
(c)	Suspense A/c Dr. To X (Being wrong posting to X, now rectified)		3,600	3,600
(d)	Profit and Loss Adjustment A/c Dr. To X (Being wrong recording, now rectified)		3,600	3,600
(e)	Furniture A/c Dr. To Profit and Loss Adjustment A/c (Being wrong recording, now rectified)		10,000	10,000
(f)	Ys A/c Dr. To Furniture A/c (Being wrong recording, now rectified)		1,000	1,000
(g)	Profit & Loss Adjustment A/c Dr. To Capital A/c (Being the transfer of Balance of P & L Adjustment A/c)		6,300	6,300

Dr.

(III) SUSPENSE ACCOUNT

Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Profit & Loss Adjustment A/c	100	By Balance b/d	3,500
To X's A/c	3,600	By Profit & Loss Adjustment A/c	200
	3,700		3,700

**(IV) EFFECT OF ERRORS
ON LAST YEAR'S NET PROFITS**

<i>Rectifying Entry</i>		<i>Increase in Profit (₹)</i>	<i>Decrease in Profit (₹)</i>
(a)		—	100
(b)		200	—
(c)		No effect	No effect
(d)		3,600	
(e)		—	10,000
(f)		No effect	No effect
		3,800	10,100

Net Decrease in Profit = ₹ 10,100 – ₹ 3,800 = ₹ 6,300.

**(V) EFFECT OF RECTIFICATION OF
ERRORS ON PROFITS**

<i>Rectifying Entry</i>		<i>Decrease in Profit (₹)</i>	<i>Increase in Profit (₹)</i>
(a)		—	100
(b)		200	
(c)		No effect	No effect
(d)		3,600	
(e)		—	10,000
(f)		No effect	No effect
		3,800	10,100

Net Increase in Profit = ₹ 10,100 – ₹ 3,800 = ₹ 6,300.

COMPREHENSIVE PROBLEMS FOR REVISION

Objective: The following Problems have been given Only to Revise the Chapter. In Examination only some of the parts and not all the parts of such lengthy problems may be asked.

PROBLEM 1

Rectify the following errors:

- (a) A credit sale of goods of ₹ 423 to Krishan omitted to be recorded.
- (b) A credit sale of goods of ₹ 423 to Krishan entered as ₹ 432.
- (c) A credit sale of goods of ₹ 423 to Krishan entered as sale to Kishan.
- (d) A credit sale of goods of ₹ 423 to Krishan entered as sale to Kishan ₹ 432.
- (e) A credit sale of goods of ₹ 423 to Krishan passed through the Purchases Book.
- (f) A credit sale of goods of ₹ 423 to Krishan entered in Purchases Book as ₹ 32.
- (g) A credit sale of goods of ₹ 423 to Krishan entered as purchase from Kishan.
- (h) A credit sale of goods of ₹ 423 to Krishan entered as purchase from Kishan ₹ 432.
- (i) Sales Book overcast by ₹ 9.
- (j) Total of Sales Book ₹ 423 on page 5 is brought forward on page 6 as ₹ 432.

- (k) Total of Sales Book ₹ 423 omitted to be posted.
- (l) A credit sale of goods of ₹ 423 to Krishan omitted to be posted.
- (m) A credit sale of goods of ₹ 423 to Krishan posted as ₹ 432.
- (n) A credit sale of goods of ₹ 423 to Krishan credited to his account.
- (o) A credit sale of goods of rs 423 to Krishan credited to his account as ₹ 432.
- (p) A credit sale of goods of ₹ 423 to Krishan posted to the debit of Krishan.
- (q) A credit sale of goods of ₹ 423 to Krishan posted to be debit of Krishan as ₹ 432.
- (r) A credit sale of goods of ₹ 423 to Krishan posted to the credit of Krishan.
- (s) A credit sale of goods of ₹ 423 to Krishan posted to the credit of Krishan as ₹ 432.
- (t) A credit sale of an old machine of ₹ 423 to Krishan recorded as sale of goods.
- (u) A credit sale of goods of ₹ 423 to Krishan passed through the purchases book and posted therefrom to the debit of Krishan.
- (v) A credit sale of goods of ₹ 423 to Krishan entered in the purchases book as ₹ 432 and posted therefrom to the credit of Krishan as ₹ 423.
- (w) Goods (Cost ₹ 423, Sale Price ₹ 432) taken by Ganesh, the proprietor for his personal use recorded in the sales book.
- (x) Goods (Cost ₹ 423, Sale Price ₹ 432) given away as free samples to Mahesh, a customer recorded in the sales book.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
(a)	Krishan A/c Dr. To Sales A/c (Being credit sale omitted to be recorded, now recorded)		423	423
(b)	Sales A/c Dr. To Krishan A/c (Being sale of 423 recorded as ₹ 432, now rectified)		9	9
(c)	Krishan A/c Dr. To Krishan A/c (Being sale to Krishan recorded as sale to Krishan, now rectified)		423	423
(d)	Krishan Dr. Sales A/c Dr. To Krishan (Being sale to Krishan ₹ 423 recorded as sale to Krishan ₹ 432, now rectified)		423 9	432
(e)	Krishan Dr. To Sales A/c To Purchases A/c (Being sale recorded as purchase, now rectified)		846	423 423

(f)	Krishan Dr. To Sales A/c To Purchases A/c (Being sale of ₹ 423 recorded as purchase of ₹ 432, now rectified)		855	423 423
(g)	Krishan Dr. Kishan Dr. To Sales A/c To Purchases A/c (Being sale to Krishan recorded as purchase from Kishan, now rectified)		423 423	423 423
(h)	Krishan Dr. Kishan Dr. To Sales A/c To Purchases A/c (Being sale to Krishan ₹ 423 recorded as purchase from Kishan ₹ 432, now rectified)		423 432	423 432
(i)	Sales A/c Dr. To Suspense A/c (Being the sale book overcast, now rectified)		9	9
(j)	Sales A/c Dr. To Suspense A/c (Being total of ₹ 423 b/f as ₹ 432, now rectified)		9	9
(k)	Suspense A/c Dr. To Sales A/c (Being total of Sales Book omitted to be posted, now rectified)		423	423
(l)	Krishan Dr. To Suspense A/c (Being omission of posting to Krishan, now rectified)		423	423
(m)	Suspense A/c Dr. To Krishan (Being excess debit to Krishan, now rectified)		9	9
(n)	Krishan Dr. To Suspense A/c (Being wrong side posting, now rectified)		846	846
(o)	Krishan Dr. To Suspense A/c (Being posting on wrong side with wrong amount, now rectified)		855	855
(p)	Krishan Dr. To Kishan (Being posting to wrong a/c, now rectified)		423	423

(q)	Krishan Suspense A/c To Kishan (Being posting to wrong a/c with wrong amount, now rectified)	Dr. Dr.	423 9	432
(r)	Krishan Kishan To Suspense A/c (Being posting to wrong a/c on wrong side, now rectified)	Dr. Dr.	423 423	846
(s)	Krishan Kishan To Suspense A/c (Being posting to wrong a/c on wrong side with wrong amount, now rectified)	Dr. Dr.	423 432	855
(t)	Sales A/c To Machine A/c (Being sale of machine recorded as sale of goods, now rectified)	Dr.	423	423
(u)	Suspense A/c To Sales A/c To Purchases A/c (Being a sale recorded as purchases, now rectified)	Dr.	846	423 423
(v)	Krishan Kishan Suspense A/c To Sales A/c To Purchases A/c (Being sale recorded as purchase with wrong amount and wrong posting therefrom, now rectified)	Dr. Dr. Dr.	423 423 9	423 432
(w)	Sales A/c Drawings A/c To Ganesh's Capital A/c To Purchases A/c (Being the goods taken by proprietor for his personal use recorded in sales book, now rectified)	Dr. Dr.	432 423	432 423
(x)	Sales A/c Sales Promotion A/c To Mahesh To Purchases A/c (Being the goods given away as free samples recorded in sales book, now rectified)	Dr. Dr.	432 423	432 423

PROBLEM 2

Rectify the following errors.

- (a) A Bills receivable of ₹ 102 received from V.P. Singh was entered in Bills Payable Books.
- (b) A discounted Bill of Exchange receivable for ₹ 960 returned by the firm's bank had been credited to the Bank Account and debited to Bills Receivable Account. A cheque was received later from the customer for ₹ 960 and duly paid.
- (c) Bills payables for ₹ 500 to Mr. Y entered in Bills Receivable Book.
- (d) A promissory note for ₹ 1,000 received from Rakesh for which entry of ₹ 10,000 was made in Bills Receivable book.
- (e) Bills receivable from X ₹ 1,600 posted to the credit of Bills Payable A/c.
- (f) The total of Bills Receivable Book ₹ 9,000 left unposted.
- (g) Bills drawn on Murli for ₹ 6,000 was passed through bills payable book.
- (h) Bills payable worth ₹ 3,000 accepted in favour of Murari, was passed through bills receivable book with ₹ 300 and Murali's account was correctly debited.
- (i) A Bill for ₹ 10,000 drawn by Ganesh was not entered in the Bills Receivable Book.
- (j) Bills Receivable from Henry of ₹ 1,600 posted to the credit of Bills Payable Account and credited to Henry.
- (k) A bill of exchange (received from Hari) for ₹ 3,000 had been returned by the bank with whom it had been discounted, as dishonoured and had been credited to Bank Account and debited to Bills Receivable Account.

SOLUTION:

JOURNAL

Date	Particulars	Dr. (₹)	Cr. (₹)
(a)	Bills receivable A/c Dr. Bills Payable A/c Dr. To V P Singh (Being B/R recorded in B/P book, now rectified)	102 102	204
(b)	Customer's A/c Dr. To Bills Receivable A/c (Being wrong recording in B/R book, now rectified)	960	960
(c)	Mr. Y A/c Dr. To Bills receivable A/c To Bills Payable A/c (Being B/P recorded in B/R book, now rectified)	1,000	500 500
(d)	Mr. Rakesh A/c Dr. To Bills Receivable A/c (Being wrong recording in B/R book, now rectified)	9,000	9,000
(e)	B/P A/c Dr. To X's & Co. (Being B/P for X wrongly or, to B/P A/c, now rectified)	1,600	1,600

(f)	Bill Receivable A/c	Dr.	9,000	
	To Suspense A/c			9,000
	(Being total of B/P Book unposted, now rectified)			
(g)	Bills Receivable A/c	Dr.	6,000	
	Bills Payable A/c	Dr.	6,000	
	To Murlu			12,000
	(Being B/R drawn recorded in B/P Book, now rectified)			
(h)	Suspense A/c	Dr.	6,000	
	To B/R A/c			3,000
	To B/P A/c			3,000
	(Being B/P recorded in B/R in B/R Book but Morari's A/c correctly posted, now rectified)			
(i)	Bills receivable A/c	Dr.	10,000	
	To Drawee's A/c			10,000
	(Being bills receivable drawn by Ganesh omitted. not recorded)			
(j)	B/P A/c	Dr.	1,600	
	To Suspense A/c			1,600
	(Being wrong posting, now rectified)			
(k)	Hari A/c	Dr.	3,000	
	To B/R A/c			3,000
	(Being the wrong posting, now rectified)			

PROBLEM 3

Pass the necessary journal entries to rectify the following errors:

- Goods (Cost ₹ 10,000, Sale Price ₹ 12,000) taken away by the proprietor were not recorded anywhere.
- Goods (Cost ₹ 20,000, Sale Price ₹ 24,000) distributed as free samples among prospective customers were not recorded anywhere.
- Goods (Cost ₹ 30,000, Sale Price ₹ 36,000) were returned by Ram, a customer and were taken into stock on the same date but no entry was passed in the books.
- Materials from store of ₹ 10,000 and Wages ₹ 4,000 had been used in making tools and implements for use in own factory, but no adjustments were made in the books.
- A credit purchase of old machinery from Sohan for ₹ 17,000 was entered in the Purchases Book as purchase from Mohan for ₹ 71,000. ₹ 3,000 paid as repairing charges on the reconditioning of a newly purchased second hand Machinery debited to General Expenses Account.
- A cheque for ₹ 12,800 received from Farid was dishonoured and has been posted to the debit of Sales Returns Account.
- An amount of ₹ 5,720 due from Lalta Prasad, written off as bad in a previous year, was recovered and credited to the personal account of Lalta Prasad.
- A discounted Bill of Exchange receivable for ₹ 16,000 returned by the firm's bank had been credited to the Bank Account and debited to Bills Receivable Account. A cheque was received later from the Customer for ₹ 16,000 and duly paid.

SOLUTION

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(a)	Drawings A/c Dr. To Purchases A/c (Being goods taken away by the proprietor omitted to be recorded, now recorded)		10,000	10,000
(b)	Free Samples A/c Dr. To Purchases A/c (Being goods distributed as free samples omitted to be recorded, now recorded)		20,000	20,000
(c)	Sales Returns A/c Dr. To Ram's A/c (Being sales returns omitted to be recorded, now recorded)		36,000	36,000
(d)	Tools & Implements A/c Dr. To Purchases A/c To Wages A/c (Being materials and wages used in making tools, omitted to be adjusted, now adjusted)		14,000	10,000 4,000
(e)	Mohan Dr. Machinery A/c Dr. To Sohan To Purchases A/c To General Expenses A/c (Being purchase of old machinery recorded the Purchases Book and repairing charges debited to General Expenses A/c, now rectified)		71,000 20,000	17,000 71,000 3,000
(f)	Farid Dr. To Sales Returns A/c (Being dishonour of a cheque wrongly debited to Sales Returns A/c now rectified)		12,800	12,800
(g)	Lalta Prasad Dr. To Bad Debts Recovered A/c (Being Bad Debts Recovered wrongly debited to Lalta Prasad now rectified)		5,720	5,720
(h)	Customer Dr. To Bills Receivable A/c (Being dishonour of a B/R wrongly debited to Bills Receivable A/c now rectified)		16,000	16,000

PROBLEM 4

Pass the necessary journal entries to rectify the following errors:

- (a) A cash sale of Goods to X ₹17,000 posted as ₹ 71,000

- (b) A credit sale of Goods to Y ₹17,000 posted as ₹ 71,000.
- (c) A credit sale of Furniture to Z for ₹17,000 posted as ₹ 71,000.
- (d) Bills Receivable from Henry of ₹ 16,000 posted to the credit of Bills Payable Account and also credited to Henry.
- (e) Discounts received of ₹ 14,200 had been debited to discount allowed.
- (f) A credit sale of Goods of ₹ 4,230 to Krishan passed through the Purchase Book as ₹ 4,320 and posted therefrom to the credit of Kishan as ₹ 4,230.
- (g) Goods (Cost ₹ 4,230, Sale Price ₹ 4,320) taken by Ganesh, the proprietor for his personal use recorded in the Sales Book.
- (h) An amount of ₹ 8,000 owing by a customer had been omitted from the list of Sundry Debtors.
- (i) A credit sale of old furniture to Rohan for ₹ 17,000 omitted to be posted.
- (j) Bills payable worth ₹ 3,000 accepted in favour of Murari, was passed through bills receivable book with ₹ 300 and Murari's account was debited with ₹ 3,000. Pass the Rectifying Entry.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(a)	Sales A/c Dr. To Suspense A/c (Being posting to Sales A/c, now rectified)		5,400	5,400
(b)	Suspense A/c Dr. To X (Being the posting to X's A/c, now rectified)		5,400	5,400
(c)	Furniture A/c Dr. To Z (Being error in posting, now rectified)		5,400	5,400
(d)	Bills Payable A/c Dr. Bills Receivable A/c Dr. To Suspense A/c (Being a B/R received from Henry wrongly posted to the credit of B/P, now rectified)		16,000 16,000	32,000
(e)	Suspense A/c Dr. To Discount Allowed A/c To Discount Received A/c (Being Discount Received wrongly posted to Discount Allowed A/c, now rectified)		28,400	14,200 14,200
(f)	Krishan Dr. Kishan Dr. Suspense A/c Dr. To Sales A/c To Purchases A/c (Being sale recorded as purchase with wrong amount and wrong posting therefrom, now rectified)		4,230 4,230 90	4,230 4,320

(g)	Sales A/c	Dr.		4,320	
	Drawings A/c	Dr.		4,230	
	To Ganesh A/c				4,320
	To Purchases A/c				4,230
	(Being the goods taken by proprietor for his personal use reco. in sales book, now rectified)				
(h)	Sundry Debtors	Dr.		8,000	
	To Suspense A/c				8,000
	(Being a debtor omitted from the list now included) [Note: Debtor's A/c need not be posted again in the ledger in this case since it is already correctly balanced].				
(i)	No Journal Entry is to be passed as it has already been correctly passed in the Journal. Merely posting in both the accounts in the ledger is required.				
(j)	Suspense A/c	Dr.		3,300	
	To B/R A/c				300
	To B/P A/c				3000
	(Being B/P recorded in B/R Book but Murari's A/c correctly posted, now rectified)				

PROBLEM 5

Rectify the following errors in the books of SB Ltd.

- Goods sold to Mohan for ₹ 30,000 was wrongly passed through the purchases book.
- Goods sold to Sohan for ₹ 40,000 was wrongly passed through purchases book but correctly posted on the debit side of Sohan's account.
- Goods purchased from Rohan for ₹ 3,000 passed through sales book.
- Goods purchased from Shyam for ₹ 3,000 was passed through sales book but correctly credited to Shyam's account.
- Goods returned by Ram for ₹ 4,000 were passed through returns outward book.
- Bills drawn on Murli for ₹ 6,000 was passed through bills payable book.
- Bills payable worth ₹ 3,000 accepted in favour of Murari, was passed through bills receivable book with ₹ 300 and Murari's account was correctly debited.
- Goods returned to Bankey for ₹ 1,000 was passed through sales Book.
- Goods purchased from Bihari for ₹ 1,000 was passed through return inward book.

SOLUTION
JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(a)	Mohan	Dr.	60,000	
	To Sales A/c			30,000
	To Purchases A/c			30,000
	(Being sales passed through purchases book, now recorded)			

(b)	Suspense A/c To Sales A/c To Purchases A/c (Being the sales passed through purchases book but Sohan's A/c correctly posted, now rectified)	Dr.	80,000	40,000 40,000
(c)	Sales A/c Purchases A/c To Rohan's A/c (Being purchases passed through sales book, now rectified)	Dr. Dr.	3,000 3,000	6,000
(d)	Sales A/c Purchases A/c To Suspense A/c (Being purchases passed through sales book but Shyam's A/c correctly posted, now rectified)	Dr. Dr.	3,000 3,000	6,000
(e)	Sales Returns A/c Purchase Returns A/c To Ram (Being sales returned passed through returns outward book, now rectified)	Dr. Dr.	4,000 4,000	8,000
(f)	Bills Receivable A/c Bills Payable A/c To Murli (Being B/R drawn recorded in B/P Book, now rectified)	Dr. Dr.	6,000 6,000	12,000
(g)	Suspense A/c To B/R A/c To B/P A/c (Being B/P recorded in B/R Book but Murari's A/c correctly posted, now rectified)	Dr.	3,300	300 3,000
(h)	Sales A/c To Purchase Returns A/c (Being purchase returns recorded in sales book, now rectified)	Dr.	1,000	1,000
(i)	Purchase A/c To Return Inward A/c (Being purchase recorded in return inward book, now rectified)	Dr.	1,000	1,000

PROBLEM 6

Rectify the following errors:

- The proprietor has taken goods costing ₹ 1,000 for his personal use without making entry in the books.
- The proprietor has given away goods costing ₹ 1,000 as free samples for which no entry was made in the books of accounts.
- Purchases for the year include a purchase of furniture costing ₹ 200 on 31st March 2018.
- Sales included a sale of furniture having a book of value of ₹ 900 for ₹ 850 on 31st March, 2018.

- (e) Invoices for goods costing ₹ 1,700 have been entered on 26th March 2018 but the goods have not yet been received till 31st March, 2018.
- (f) Goods costing ₹ 4,000 have been purchased and received on 27th March, 2018 but the invoices have not yet been recorded till 31st March, 2018.
- (g) Invoices of goods of ₹ 1,000 (Cost ₹ 800) were entered in 28th March, 2018 but the goods not delivered till 31st March, 2018.
- (h) Goods of ₹ 4,000 (Cost ₹ 3,200) sold and delivered on 29th March, 2018 but the invoice were not entered till 31st March, 2018.
- (i) Goods (Cost ₹ 2,800, selling price ₹ 3,600) were returned by Ram, a customer on 30th March and were taken onto stock on the same date no entry was passed in the books.
- (j) Stock at the end does not include the goods (Cost ₹ 6,000, Selling Price ₹ 7,500) returned by Shyam, a customer for which the entry has already been passed.
- (k) On 26th March, goods of the sale value of ₹ 2,00,000 were sent on sale or return basis to Gopal, a customer, the period of approval being two weeks. He returned 20% of the goods and approved 80% of the remaining on 31st March. These goods were sent at a profit of 25% on cost.
- (l) Goods purchased for proprietor's use for ₹ 1,000 were debited to purchases Account.
- (m) Goods costing ₹ 1000 used by proprietor for personal used were credited to sales Account.

SOLUTION:
JOURNAL

Date	Particulars	Dr. (₹)	Cr. (₹)
(a)	Drawings A/c To Purchases A/c (Being the goods for pvt. use, now recorded)	Dr. 1,000	1,000
(b)	Free Samples A/c To Purchases A/c (Being goods as free samples, now rectified)	Dr. 1,000	1,000
(c)	Furniture A/c To Purchases A/c (Being purchase of furniture treated as of goods, now rectified)	Dr. 200	200
(d)	Sales A/c Loss on Sale of Furniture A/c To Furniture A/c (Being the sale of furniture recorded as sales, now rectified)	Dr. 850 Dr. 50	900
(e)	Goods-in-transit A/c To Trading A/c (Being goods-in-transit, now recorded)	Dr. 1,700	1,700
(f)	Purchases A/c To Supplier's A/c (Being purchases invoices, now recorded)	Dr. 4,000	4,000

(g)	No entry			
(h)	Customer's A/c	Dr.	4,000	
	To Sales A/c			4,000
	(Being sales involves, now recorded)			
(i)	Sales Returns A/c	Dr.	3,600	
	To Ram			3,600
	(Being sales returns, now recorded)			
(j)	Closing Stock A/c	Dr.	6,000	
	To Trading A/c			6,000
	(Being goods returned included in Stock)			
(k)	(i) Sales Returns	Dr.	40,000	
	To Gopal			40,000
	(Being 20% of ₹ 2,00,000, returned)			
	(ii) (a) Sales A/c	Dr.	32,000	
	To Gopal			32,000
	(Being 20% of 1,60,000, not yet approved, now adjusted)			
	(b) Closing Stock	Dr.	25,600	
	To Trading A/c			25,600
	(Being 80% of ₹ 32,000, treated as parts of stock)			
(l)	Drawings A/c	Dr.	1,000	
	To Purchases A/c			1,000
	(Being the goods for pvt. use Dr. to purchases A/c, now rectified)			
(m)	Sales A/c	Dr.	1,000	
	To Purchases A/c			1,000
	(Being the goods taken for pvt. use Cr. to sales A/c, now rectified)			

PROBLEM 7

Rectify the following errors:

- A credit Sale to Vinod ₹ 143 credited to his account as ₹ 134.
- A credit Sale of goods of ₹ 120 to Ramesh has been wrongly passed through the Purchases Book.
- A credit purchase of furniture from Ram ₹ 300 posted as ₹ 30.
- Furniture purchased on credit from Mohan Singh for ₹ 1,000 was entered in the Purchases Book.
- Materials from store of ₹ 1,000 and wages ₹ 400 has been used in making tools and implements for use in own factory but no adjustments were made in the book.
- D's bill for the erection of godown at a cost of ₹ 1,200 had been charged to Repairs Account.
- A cash sale of ₹ 150 to Brown, correctly entered in the Cash Book was posted to the credit of Brown's Personal Account as ₹ 15.
- Goods worth ₹ 130 returned by Green were entered in the Sales Book and were posted there from to the credit of Green's Personal Account.

- (i) Bills Receivable from Henry of ₹ 1,600 posted to the credit of Bills Payable Account and credited to Henry.
- (j) A dishonoured Bill of Exchange receivable for ₹ 1,600 returned by the firm's bank had been credited to the Bank Account and debited to Bills Receivable Account. A cheque was received later from the customers for ₹ 1,600 and duly paid.
- (k) An amount of ₹ 236 due from Lalta Prasad which had been written off as bad in the previous year, was unexpectedly recovered and had been posted to the personal account of Lalta Prasad.
- (l) A cheque for ₹ 128 received from Farid Alam was dishonoured and has been posted to the debit of Sales Returns Account.
- (m) A credit item of ₹ 349 has been debited to a Customer's Account as ₹ 439.
- (n) A discount allowed to a customer has been credited to him as ₹ 145 in place of ₹ 154.
- (o) ₹ 1,000 paid as rent to landlord was debited to Landlord's Account.

SOLUTION:
JOURNAL

Date	Particulars	Dr. (₹)	Cr. (₹)
(a)	Vinod A/c Dr. To Suspense A/c (Being wrong positing, now rectified)	277	277
(b)	Ramesh A/c Dr. To Sales A/c To Purchases A/c (Being sale recorded as purchases, now rectified)	240	120 120
(c)	Furniture A/c Dr. To Ram A/c (Being wrong posting, now rectified)	270	270
(d)	Furniture A/c Dr. To Purchase A/c (Being purchases of furniture recorded in purchase book, now rectified)	1,000	1,000
(e)	Tools & Implements A/c Dr. To Materials To wages (Being materials & wages used in tools, now adjusted)	1,400	1,000 400
(f)	Building A/c Dr. To Repairs A/c (Being erection of godown changed to Repairs)	1,200	1,200
(g)	Brown Dr. Suspense A/c Dr. To sales (Being wrong posting, now rectified)	15 135	150

(h)	Sales A/c	Dr.	130	
	Sales return A/c	Dr.	130	
	To Suspense A/c			260
	(Being the sale return entered in Sales Book, now rectified)			
(i)	B/P A/c	Dr.	1,600	
	To Suspense A/c			1,600
	(Being wrong posting, now rectified)			
(j)	Customer's A/c	Dr.	1,600	
	To Bills Receivable A/c			1,600
	(Being a dishonoured B/E dr. to B/R A/c, now rectified)			
(k)	Lalta Prashad A/c	Dr.	236	
	To Bad Debt Recovered A/c			236
	(Being B/P recovered cr. To personal a/c, now rectified)			
(l)	Farid Alam	Dr.	128	
	To Sales Returns A/c			128
	(Being wrong posting, now rectified)			
(m)	Suspense A/c	Dr.	788	
	To Customer's A/c			788
	(Being wrong posting, now rectified)			
(n)	Suspense A/c	Dr.	9	
	To Customer's A/c			9
	(Being wrong posting, now rectified)			
(o)	Rent A/c	Dr.	1,000	
	To Landlord's A/c			1,000
	(Being rent paid dr. to landlord's A/c, now rectified)			

PROBLEM 8

Rectify the following errors:

- Received interest ₹ 150 posted to loan account.
- A cheque received from Amar, a debtor for ₹ 2,000 was directly received by the proprietor who deposited it into his personal bank account.
- Discount column on the receipt side of the cash book was added as ₹ 2,230 instead of ₹ 2,130.
- Commission of ₹ 25 paid was posted twice: once to discount account and again to commission account.
- An item of ₹ 450 appearing in the discount column on the credit side of Cash Book has been posted to the credit side of the correspond personal account as ₹ 540.
- A purchase amounting to ₹ 1,000 made for a staff member was recorded in the purchases book.
- A bill of exchange (received from Hari) for ₹ 3,000 had been returned by the bank with whom it had been discounted, as dishonoured and had been credited to Bank Account and debited to Bills Receivable Account.

- (h) Several employees took their salary in advance in the month of March which was payable to them in April amounting to ₹ 2,500.
- (i) Advance of ₹ 1,001 given to one of the suppliers Mr X on 20th Feb. was entered correctly in the Cash Book but was posted in his account on the credit side.
- (j) Cash received from Shri Govind was debited to his account ₹ 150.

SOLUTION:
JOURNAL

Date	Particulars	Dr. (₹)	Cr. (₹)
(a)	Loan A/c Dr. To Interest Received A/c (Being wrong posting, now rectified)	150	150
(b)	Drawings A/c Dr. To Amar A/c (Being debtor's cheque deposited into personal a/c, now rectified)	2,000	2,000
(c)	Suspense A/c Dr. To Discount Allowed A/c (Being undercast of discount allowed column, now rectified)	100	100
(d)	Suspense A/c Dr. To Discount A/c (Being wrong posting, now rectified)	25	25
(e)	Personal A/c Dr. To Suspense A/c (Being wrong posting, now rectified)	990	990
(f)	Salaries A/c Dr. To Purchases A/c (Being purchase for staff recorded in Purchases Book, now rectified)	1,000	1,000
(g)	Hari A/c Dr. To B/R A/c (Being the wrong posting, now rectified)	3,000	3,000
(h)	Prepaid Salary A/c Dr. To Salary A/c (Being prepaid salary, now adjusted)	2,500	2,500
(i)	Mr X Dr. To Suspense A/c (Being wrong posting, now rectified)	2,002	2,002
(j)	Suspense A/c Dr. To Govind A/c (Being wrong posting, now recorded)	300	300

PROBLEM 9

Pass the necessary journal entries to rectify the following errors:

- (a) A debit balance of ₹ 2,500 in the account of Shyam, a creditor is included in the list of sundry debtors.
- (b) A deposit of ₹ 5,000 received from Mohan one of the debtors was credited to his personal account.
- (c) Trade Creditors include ₹ 4,000 to the credit of L.M. Corporation in respect of which it has been decided and settled with the party to pay only ₹ 1,000.
- (d) Out of Bills Receivable in hand, one Bill for ₹ 1,200 matured for payment in the last week of March. However, the Banker informed that they could not collect the said bill on the date of maturity. This information was not recorded in the books.
- (e) A dishonour of a bill for ₹ 5,000 stands debited to the Debtors Account. 60% thereof is considered doubtful and has to be provided for accordingly.
- (f) A debtor for ₹ 1,000 was declared insolvent and it is expected that nothing would be recovered from his estate.
- (g) A discount of ₹ 2,995 allowed by a supplier omitted to be recorded.
- (h) ₹ 6,000 paid to Mr. Red against Bills Payable were debited by mistake to Mr. Green's Account and included in the list of Sundry debtors.
- (i) Bills Payable include a Bill of ₹ 1,000 which fell due on 31st March and was paid by the Bank as per Standing instruction. The Bank charges in this connection amounted to ₹ 100. No accounting effect has yet been given in this regard.

SOLUTION:**JOURNAL**

Date	Particulars	Dr. (₹)	Cr. (₹)
(a)	Advance to Shyam A/c Dr. To Sundry Debtors' A/c (Being advance to Shyam included in list of debtors, now excluded)	2,500	2,500
(b)	Mohan Dr. To Deposit from Mohan A/c (Being deposit from Mohan included in the list of creditors, now excluded)	5,000	5,000
(c)	Trade Creditors' A/c Dr. To Misc. Income A/c (Being the reduction in liability, now recorded)	3,000	3,000
(d)	Sundry Debtors' A/c Dr. To Bills Receivable A/c (Being dishonour of B/R, now recorded)	1,200	1,200
(e)	Profit & Loss A/c Dr. To Provision for Doubtful Debts A/c (Being 60% of ₹ 5,000 provided for doubtful debts)	3,000	3,000

(f)	Profit & Loss A/c	Dr.	1,000	
	To Provision for Doubtful Debts A/c			1,000
	(Being 100% of ₹ 1,000 provided for doubtful debts)			
(g)	Creditors' A/c	Dr.	2,995	
	To Discount Received A/c			2,995
	(Being discount received from a supplier, now recorded)			
(h)	Bills Payable A/c	Dr.	6,000	
	To Green A/c			6,000
	(Being wrong debit to Green's A/c, now rectified)			
(i)	Bills Payable A/c	Dr.	1,000	
	Bank Charges A/c	Dr.	100	
	To Bank A/c			1,100
	(Being direct payment of B/P by bank and bank charges, now recorded)			

PROBLEM 10

Pass the necessary journal entries to rectify the following errors:

- Stock at the end does not include the goods (Cost ₹ 2,320, Invoice ₹ 2,900) returned by customer for which the entry has already been passed.
- During the year, some goods (invoiced at ₹ 48,000) were sent to sundry customers on 'sale on approval' basis. On 31st March, 20% of those goods remained with customers as the period of approval did not expire as yet. Goods are invoiced at cost *plus* 25%.
- Advertisement includes ₹ 3,000 spent on neon-signs board
- Legal charges include ₹ 1,000 for cost of stamps and registration of new plot of land acquired during the year.
- Factory Building was constructed on land purchased for ₹ 10,000 but this purchase was wrongly posted to Purchases Account.
- One machine whose value in books as on 1st April stood at ₹ 12,000 was disposed off on 31st Dec. for ₹ 8,750 in part exchange for a new machine costing ₹ 19,000 and an invoice for the net amount of ₹ 10,250 was entered in books. No depreciation need be provided on machinery disposed off during the year.
- During the year, there was a fire as a result of which stock costing ₹ 50,000 was damaged. The damaged goods were sold for ₹ 20,000. This sum is included in Sales. The insurance company paid ₹ 5,000 *less* towards the loss of stock. The godown containing the stock was also damaged during the fire, the extent of damage being ₹ 15,000 which also the insurance company paid. The total amount received from the insurance company was credited to the Building Account.

SOLUTION:**JOURNAL**

Date	Particulars	Dr. (₹)	Cr. (₹)
(a)	Closing Stock A/c	Dr.	2,320
	To Trading A/c		2,320
	(Being closing stock to the extent of ₹ 2,320 not included earlier, now included)		

(b)	(i) Sales A/c Dr.	9,600	
	To Sundry Debtors A/c (Being the cancellation of original entry of sale in respect of goods not yet returned or retained) [i.e. 20% of ₹ 48,000]		9,600
	(ii) Closing Stock A/c Dr.	7,680	
	To Trading A/c (Being the cost of goods lying with the customers not yet returned or retained brought into final accounts) [i.e. 80% of ₹ 9,600]		7,680
(c)	Furniture & Fittings A/c Dr.	3,000	
	To Advertisement A/c (Being the cost of neon-signs transferred to Furniture & Fittings A/c)		3,000
(d)	Land A/c Dr.	1,000	
	To Legal Charges A/c (Being cost of stamps & registration of plot of land treated as capital expenditure)		1,000
(e)	Factory Land & Building A/c Dr.	10,000	
	To Purchases A/c (Being the capital expenditure wrongly treated as revenue expenditure, now rectified)		10,000
(f)	Loss on Sale of Machinery A/c Dr.	3,250	
	To Machinery A/c (Being loss on sale of Machinery recorded)		3,250
(g)	Building A/c Dr.	25,000	
	Loss of Stock due to Fire A/c Dr.	5,000	
	To Trading A/c (Being Loss of Stock recorded and insurance claim received wrongly credited to Building A/c, now rectified)		30,000

BANK RECONCILIATION STATEMENT

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ After studying this chapter, you should be able to understand:
- ◇ Meaning of Bank Pass Book (or Bank Statement)
- ◇ Method of Recording Banking Transactions
- ◇ Timings of Recording Banking Transactions in Cash Book
- ◇ Meaning and Purpose of Bank Reconciliation Statement
- ◇ Distinction between Bank Statement and Bank Reconciliation Statement
- ◇ Causes of disagreement between the Balance shown by the Cash Book and the Balance shown by the Pass Book
- ◇ Practical Steps for preparing the Bank Reconciliation Statement
- ◇ Format of Bank Reconciliation Statement
- ◇ Preparation of Bank Reconciliation Statement with adjusted/amended Cash Book Balance

1.0 MEANING OF BANK PASS BOOK (OR BANK STATEMENT)

1. Bank Pass Book (also known as Bank Statement) is merely a copy of the Customer's Account in the books of a bank.
2. The bank usually supplies this statement periodically (e.g., fortnightly/monthly) or when the ledger page is completed (in case where a duplicate copy of the ledger sheet is sent) or on demand.
3. The proforma of a Bank Pass Book or Bank Statement is shown below:

PROFORMA OF A BANK PASS BOOK/BANK STATEMENT

Date	Particulars	Dr. Withdrawals	Cr. Deposits	Dr. or Cr.	Balance	Initials
					₹	

2.0 METHOD OF RECORDING BANKING TRANSACTIONS**RECORDING OF DEPOSITS**

In case of deposits into the bank, the customer debits the Bank Account because bank is the receiver and the bank credits the Customer's Account because customer is the giver.

RECORDING OF WITHDRAWALS

In case of withdrawals from the bank, the customer credits the Bank Account because bank is the giver and the bank debits the Customer's Account because customer is the receiver.

ITEMS TO BE SHOWN ON THE DEBIT SIDE AND CREDIT SIDE

1. What is shown on the debit side of the Customer's Cash Book (Bank Column) appears on the credit side of the Customer's Account in the bank ledger.
2. What is shown on the credit side of the customer's Cash Book (Bank Column) appears on the debit side of the Customer's Account in the bank ledger.

Nature of Balance in Cash Book and Pass Book

1. When the Cash Book (Bank Column) shows debit balance, the Pass Book shows credit balance.
2. When the Cash Book (Bank Column) shows credit balance (i.e., Overdraft), the Pass Book shows debit balance (i.e., Overdraft.).

TUTORIAL NOTES

1. Debit Bank Balance as per Cash Book = Credit Bank Balance as per Pass Book
2. Credit Bank Balance (i.e., Overdraft) as per Cash Book = Debit Bank Balance (i.e., Overdraft) as per Pass Book.

3.0 TIMINGS OF RECORDING BANKING TRANSACTIONS IN CASH BOOK

Timings of recording Banking transactions in Cash Book and Pass Book need not necessarily be same. These may differ due to various reasons. Timings of recording some of the banking transactions in Cash Book and Pass Book are summarised as follows:

<i>Transactions</i>	<i>Timings of Recording in Cash Book</i>	<i>Timings of Recording in Pass Book</i>
1. Cash Deposits	when Cash is deposited	when Cash is deposited
2. Cash Withdrawn	when Cash is withdrawn	when Cash is withdrawn
*3. Cheque issued	when Cheque is issued	when Cheque is presented for payment
*4. Cheque Deposited	when Cheque is deposited	when Cheque is collected
*5. Bank Charges	when Pass Book is received	when charges are levied
*6. Interest Charged by Bank	when Pass Book is received	when interest is charged by the Bank
*7. Interest Allowed by Bank	when Pass Book is received	when interest is allowed by Bank
*8. Direct Payment by Bank	when Pass Book is received	when payment is made by Bank on behalf of customer
*9. Direct Collection by Bank	when Pass Book is received	when amount is collected by Bank on behalf of customer
*10. Dishonour of Cheque/Bills receivable	when Pass Book is received	when Cheque/B/R is dishonoured

* Because of Difference in the timings of recording of these transactions the Bank Balance as per Cash Book differs from Pass Book.

4.0 MEANING AND PURPOSE OF BANK RECONCILIATION STATEMENT**WHAT A PRUDENT CUSTOMER SHOULD DO?**

When the customer receives the Bank Pass Book (or Bank Statement), he should compare its entries with those in the Cash Book. Normally, entries in the Bank Column of Cash Book should tally with those in the Pass Book and the balances shown by both the books should also be the same. But in practice, these balances generally differ due to difference in the timings of recording of some transactions. In case of disagreement in the balances of the Cash Book and the Pass Book, the need for preparing Bank Reconciliation Statement arises. Now the question arises, What is Bank Reconciliation Statement?

MEANING OF BANK RECONCILIATION STATEMENT

Bank Reconciliation Statement is a statement which reconciles the Bank Balance as per Cash Book with the Balance as per Bank Pass Book (or Statement), by showing all causes of differences between the two.

PURPOSE OF BANK RECONCILIATION STATEMENT

Bank Reconciliation Statement is prepared to reconcile the Bank Balance as per Cash Book with the Balance as per Bank Pass Book (or Bank Statement) by showing all causes of differences between the two and to take necessary follow-up action.

5.0 DISTINCTION BETWEEN BANK STATEMENT AND BANK RECONCILIATION STATEMENT

Bank Statement differs from the Bank Reconciliation Statement in the following respects:

Basis of Distinction	Bank Statement/Pass Book	Bank Reconciliation Statement
1. Who prepares	It is prepared by the Bank .	It is prepared by the bank Customer i.e., account holder.
2. Object	It is prepared to inform the customer about all transactions which have taken place during the period covered by the Statement.	It is prepared to reconcile the bank balance as per cash book with the bank balance shown by the Bank Statement.
3. Timing When Prepared	It is prepared for a particular period .	It is prepared on a particular date .
4. Necessity	It is compulsory for the bank to prepare it.	It is not compulsory .
5. Contents	It shows — (a) Dates of Transactions (b) Particulars of Transactions (c) Withdrawals (d) Deposits (e) Balances	It shows — (a) Causes of disagreement & (b) Amount thereof
6. Starting Amount	It starts with the balance as per customer's account in bank ledger.	It may start with bank balance as per cash book or Bank Statement.
7. Final Result	It shows the balance in customer's account as per bank ledger at the end of the period.	It may show the bank balance as per cash book or Bank Statement at the end of period.

6.0 CAUSES OF DISAGREEMENT BETWEEN THE BALANCE SHOWN BY THE CASH BOOK AND THE BALANCE SHOWN BY THE PASS BOOK

Basically the differences between the Book Balance as per Cash Book and Bank Balance as per Pass Book are caused by:

- (a) Timing Difference of recording of the transactions
- (b) Errors in Cash Book committed by the account holder
- (c) Errors in Pass Book committed by the Bank.

The causes of disagreement between the balance shown by the Cash Book and the balance shown by the Pass book can be classified as follows:

- 1. Transactions that usually appear in the Cash Book but not in the Pass Book:**
 - (a) Cheques issued but not yet presented for payment,
 - (b) Cheques deposited but not yet collected by Bank.
- 2. Transactions that usually appear in the Pass Book but not in the Cash Book:**
 - (a) Bank charges and interest on overdraft debited in Pass Book only,
 - (b) Interest allowed in Pass Book only,
 - (c) Direct Payment by a customer into the bank but not yet recorded in Cash Book,
 - (d) Direct Payment made by a Bank under the standing instructions of the customer but not yet recorded in Cash Book,
 - (e) Bills Receivable directly collected by Bank,
 - (f) Cheque deposited for collection, returned dishonoured and recorded in Pass Book only,
 - (g) Discounted Bills dishonoured but not yet recorded in Cash Book.
- 3. Errors in Cash Book (e.g. Cheques/Cash Deposited but not recorded)**
- 4. Errors in Pass Book (e.g. Cheques/Cash Deposited recorded in another Customer's account).**

7.0 PRACTICAL STEPS FOR PREPARING THE BANK RECONCILIATION STATEMENT

Step 1 → Compare the items appearing on the debit side of the Cash Book with those appearing on the credit side of the Pass Book (deposit column), and place a tick mark against items appearing in both the books and note down the unticked off entries which are considered as causes of difference.

Step 2 → Compare the items appearing on the credit side of the Cash Book with those appearing on the debit side of the Pass Book (withdrawal column), and place a tick mark against items appearing in both the books and note down the unticked off entries which are considered as causes of difference.

Step 3 → Take the Balance as per Cash Book as the starting point and add items which have the effect of higher balance in the Pass Book and deduct those which have the effect of lower balance in the Pass Book [Refer to Table 1]

OR

Take the Balance as per Pass Book as the starting point and add items which have the effect of higher balance in the Cash Book and deduct those which have the effect of lower balance in the Cash Book [Refer to Table 2].

TABLE 1. FORMAT OF BANK RECONCILIATION STATEMENT WHEN THE BANK BALANCE AS PER CASH BOOK IS TAKEN AS A STARTING POINT

Bank Reconciliation Statement
As at . . . (here enter the date on which the statement is being prepared) . . .

<i>Particulars</i>	Plus Items ₹	Minus Items ₹
A. Bank Balance as per Cash Book (Favourable i.e., Debit Balance)	xxx	
<i>or</i>		
Overdraft as per Cash Book (Unfavourable i.e., Credit Balance)		xxx
B. Add: Transactions having the effect of higher balance in Pass Book		
(a) Cheques deposited into the bank but not recorded in Cash Book	xxx	
(b) Cheques issued but not yet presented for payment	xxx	
(c) Interest allowed in Pass Book only	xxx	
(d) Bills Receivable directly collected by bank	xxx	
(e) Direct payment by a customer into bank but not recorded in Cash Book	xxx	
(f) 'Cheques issued' returned on technical grounds	xxx	
(g) A wrong credit given by bank in Pass Book	xxx	
C. Less: Transactions having the effect of lower balance in Pass Book.		
(a) Cheques received and recorded in Bank Column but not yet sent to bank for collection		xxx
(b) Cheques deposited but not yet collected by bank		xxx
(c) Bank charges, Interest on overdraft debited in Pass Book only		xxx
(d) Insurance Premium paid directly by bank under standing advice		xxx
(e) Cheques deposited for collection, returned dishonoured and recorded in Pass Book only		xxx
(f) Discounted Bills Dishonoured but not recorded in Cash Book		xxx
(g) A wrong debit given by bank in Pass Book		xxx
	xxx	xxx
D. Balance as per Pass Book		
(If Total of Plus Items > Total of Minus Items)	xxx	
<i>or</i>		
Overdraft as per Pass Book		xxx
(If Total of Plus Items < Total of Minus Items)		

TABLE 2. FORMAT OF BANK RECONCILIATION STATEMENT WHEN THE BANK BALANCE AS PER PASS BOOK IS TAKEN AS A STARTING POINT

Bank Reconciliation Statement
As at... (here enter the date on which the statement is being prepared)...

<i>Particulars</i>	Plus Items ₹	Minus Items ₹
A. Bank Balance as per Pass Book (Favourable i.e., Credit Balance)	xxx	
<i>Or</i>		

Overdraft as per Pass Book (Unfavourable i.e., Debit Balance)		xxx
B. Less: Transactions having the effect of lower balance in Cash Book		
(a) Cheques deposited into the bank but not recorded in Cash Book		xxx
(b) Cheques issued but not yet presented for payment		xxx
(c) Interest allowed in Pass Book only		xxx
(d) Bills Receivable directly collected by bank		xxx
(e) Direct payment by a customer into bank but not recorded in Cash Book		xxx
(f) 'Cheques issued' returned on technical grounds		xxx
(g) A wrong credit given by bank in Pass Book		xxx
C. Add: Transactions having the effect of higher balance in Cash Book.		
(a) Cheques received and recorded in Bank Column but not yet sent to bank for collection	xxx	
(b) Cheques deposited but not yet collected by bank	xxx	
(c) Bank charges, Interest on overdraft debited in Pass Book only	xxx	
(d) Insurance Premium paid directly by bank under standing advice	xxx	
(e) Cheques deposited for collection, returned dishonoured and recorded in Pass Book only	xxx	
(f) Discounted Bills Dishonoured but not recorded in Cash Book	xxx	
(g) A wrong debit given by bank in Pass Book	xxx	
	xxx	xxx
D. Balance as per Cash Book		
(If Total of Plus Items > Total of Minus Items)	xxx	
or		
Overdraft as per Cash Book		xxx
(If Total of Plus Items < Total of Minus Items)		

TUTORIAL NOTES

An overdraft (i.e., Credit Balance in Cash Book or Debit Balance in Pass Book appears as a 'Minus Items'. The treatment with regard to items causing difference between the balances of the two books remains the same.

8.0 PREPARATION OF BANK RECONCILIATION STATEMENT

Preparation of Bank Reconciliation Statement has been explained below with respect to each cause of disagreement between the balance as shown by Cash Book (Bank Column) and the balance as shown by the Bank Pass Book:

CHEQUES ISSUED BUT NOT YET PRESENTED FOR PAYMENT

Due to the time gap between the issue of cheques and their presentment for payment at bank, the bank balance as per Pass Book will be higher than the Bank balance as per Cash Book since the customer credits the bank's account as soon as a cheque is issued but the bank debits the customer's account only when the cheque is actually presented for payment.

Example X Ltd. issued a cheque in favour of a creditor on 28th March, for a sum of ₹ 5,000. The cheque is presented for payment at bank on 4th April. In case, the bank sends a statement of account upto 31st March, there will be a difference of ₹ 5,000 between the balance as shown by the Cash Book and the balance as shown by the Pass Book. If the bank balance as per Cash Book as on 31st March, is ₹ 50,000, the Bank Reconciliation Statement may be prepared as under:—

BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...

<i>Particulars</i>	₹
A. Balance as per Cash Book	50,000
B. <i>Add:</i> Cheques issued but not yet presented for payment till 31st March	5,000
C. Balance as per Pass Book (A + B)	55,000

CHEQUES DEPOSITED BUT NOT YET COLLECTED

Due to the time gap between the deposits of cheques and their collection, the Bank Balance as per Pass Book will be lower than the Bank balance as per Cash Book since the customer debits the Bank's account as soon as a cheque is deposited but the bank credits the customer account only when the cheque is actually collected.

Example X Ltd. deposited a cheque on 28th March, for a sum of ₹ 5,000. The cheque is collected on 4th April. In case the bank sends a statement of account upto 31st March, there will be a difference of ₹ 5,000 between the balance as shown by the Cash Book and the balance as shown by the Pass Book. If the Bank Balance as per Cash Book as on 31st March is ₹ 50,000, the Bank Reconciliation Statement may be prepared as under:

BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...

Particulars	₹
A. Balance as per Cash Book	50,000
B. <i>Less:</i> Cheques deposited but not yet collected till 31st March	5,000
C. Balance as per Pass Book (A – B)	45,000

BANK CHARGES AND INTEREST CHARGES

Bank Charges includes the Draft Commission, charges for collecting the outstation cheques or B/R, Half years' charges. Due to the charges levied by the Bank for its services, the Bank balance as per Pass Book will be lower than the Bank balance as per Cash Book since the Bank debits the customer's account as soon as the service is rendered but the customer credits the bank's account only when he comes to know of such charges on the receipt of the statement of account.

Example A bank debited X Ltd's account for its charges amounting to ₹ 500 on 31st March. In case the bank sends a statement of account up to 31st March, there will a difference of ₹ 500 between the balance as shown by the Cash Book and the balance as shown by Pass Book. If the Bank Balance as per Cash Book as on 31st March is ₹ 50,000, the Bank Reconciliation Statement may be prepared as follows:

BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...

<i>Particulars</i>	₹
A. Balance as per Cash Book	50,000
B. <i>Less:</i> Bank Charges levied by the bank but not yet recorded in Cash Book	500
C. Balance as per Pass Book (A – B)	49,500

INTEREST ALLOWED BY BANK

Due to Interest (if any) allowed by the bank, the bank balance as per Pass Book will be higher than the bank balance as per Cash Book since the bank credits the customer's account when interest is allowed but the customer debits the bank's account only when he comes to know of such interest on the receipt of Bank Pass Book.

Example A bank credited X Ltd's account for interest amounting to ₹ 500 on 31st March. In case the bank sends a statement of account upto 31st March, there will be a difference of ₹ 500 between the balance as shown by the Cash Book and the balance as shown by the Pass Book. If the Bank Balance as per Cash Book as on 31st March, is ₹ 50,000, the Bank Reconciliation Statement may be prepared as under:

BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...

<i>Particulars</i>	₹
A. Balance as per Cash Book	50,000
B. <i>Add:</i> Interest allowed by bank but not yet recorded in Cash Book	500
C. Balance as per Pass Book [A + B]	50,500

DIRECT PAYMENTS ON BEHALF OF CUSTOMERS

Due to the direct payments on behalf of customers under standing instructions of the customers (e.g. payment of Insurance premium, payment of a Bills Payable), the Bank balance as per Pass Book will be lower than the Bank balance as per Cash Book since the bank debits the customer's account as soon as it makes the payments but the customer credits the Bank's account only when it comes to know of such payments on the receipt of Bank Pass Book or Statement of Account.

Example The Bank made a payment of an Insurance Premium under the standing instructions of X Ltd. amounting to ₹ 5,000 on 28th March. In case, the bank sends a statement of account upto 31st March, there will be a difference of ₹ 5,000 between the balance as shown by the Cash Book and the balance as shown by the Pass Book. If the Bank balance as per Cash Book as on 31st March is ₹ 50,000, the Bank Reconciliation Statement may be prepared as follows:

BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...

<i>Particulars</i>	₹
A. Balance as per Cash Book	50,000
B. <i>Less:</i> Direct Payment by Bank but not yet recorded in Cash Book	5,000
C. Balance as per Pass Book (A – B)	45,000

DIRECT COLLECTIONS ON BEHALF OF CUSTOMERS

Due to direct collections on behalf of customers under the standing instructions of the customers (e.g. collection of B/R, Rent, Interest, Dividend etc.) the Bank balance as per pass book will be higher than the Bank balance as per Cash Book since the Bank credits the customers account as soon as it gets the payment but the customer debits the Bank's account only when it comes to know of such collections on the receipt of Bank Pass Book or Statement of Account.

Example The Bank collected a Bill Receivable of ₹ 5,000 under standing instructions of X Ltd. on 28th March. In case the Bank sends a Statement of account upto 31st March, there will be a difference of ₹ 5,000 between the balance as shown by the Cash Book and the balance shown by the Pass Book. If the Bank Balance as per Cash Book as on 31st March is ₹ 50,000, the Bank Reconciliation Statement may be prepared as under:

BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...

<i>Particulars</i>	₹
A. Balance as per Cash Book	50,000
B. <i>Add:</i> Direct Payments collected by the bank but not yet recorded in Cash Book	5,000
C. Balance as per Pass Book (A + B)	55,000

**DISHONOUR OF A CHEQUE DEPOSITED
AND DISCOUNTED BILLS RECEIVABLE**

Due to dishonour of a cheque (already credited in the Customer's Account) and Discounted Bills Receivable, the Bank balance as per Pass Book will be lower than the Bank balance as per Cash Book since the Bank debits the customer's account as soon as the cheque/B/R is dishonoured but the customer credits the Bank's account only when it comes to know of such dishonour on the receipt of statement of account.

Example A discounted Bill dishonoured for ₹ 5,000 on 28th March. In case the Bank sends a Statement of Account upto 31st March there will be a difference of ₹ 5,000 between the balance as shown by the Cash Book and the balance as shown by the Pass Book. If the Bank balance as per Cash Book on 31st March, is ₹ 50,000 the Bank Reconciliation Statement may be prepared as under:

BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...

<i>Particulars</i>	₹
A. Balance as per Cash Book	50,000
B. <i>Less:</i> Discounted B/R dishonoured but not yet recorded in Cash Book	5,000
C. Balance as per Pass Book (A – B)	45,000

ERRORS IN CASH BOOK

Due to errors in Cash Book, there may be difference between the Bank balance as shown by the Pass Book and the Bank balance as shown by the Cash Book. The examples of the errors in Cash Book may include the items given below:

- Errors of Omission** e.g. cheques/cash deposited but not recorded in the Cash Book, Cheques issued but not recorded in the Cash Book, Cash withdrawn from the Bank but not recorded in the Cash Book.
- Errors of Recording** e.g. cheques deposited into the bank but recorded in the Cash Column/ Discount Column, cheque deposited into the bank but recorded in the Bank column on the payments side of the Cash Book, a cheque of ₹ 1,552 deposited into the bank but recorded as ₹ 1,525, a discount allowed ₹ 100 recorded in Bank Column, Cash received ₹ 1,000 recorded in Bank Column.
- Errors of Casting** e.g. Under/Over casting of Bank Column of the Cash Book.
- Errors of Carrying Forward** e.g. the debit balance on the previous day brought forward as a credit balance, the Bank balance carried forward as ₹ 15,889 instead of ₹ 15,898.
- Other Errors** e.g. cheque received from a debtor recorded in the Cash Book but not deposited into the Bank for collection.

Example A cash deposit of ₹ 1,589 was recorded as ₹ 1,598 in Cash Book on 28th March. In case the bank sends a statement of account upto 31st March there will be difference of ₹ 9 between both the balances. If the Bank balance as per Cash Book on 31st March is ₹ 50,000, the Bank Reconciliation Statement may be prepared as under:

BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...

<i>Particulars</i>	₹
A. Balance as per Cash Book	50,000
B. Less: Excess Debit for Cash Deposited in Cash Book	9
C. Balance as per Pass Book [A – B]	49,991

ERRORS IN PASS BOOK

Due to error in the Pass Book, there may be difference between the balance as shown by the Bank Pass Book and the balance as shown by the Cash Book. The examples of errors in Pass Book may include the following:

1. Errors of Omission e.g. cheque collected by bank but not recorded in pass book due to wrong posting in another customer's account.
2. Errors of Recording e.g. deposit recorded on withdrawal side and vice versa; deposit of ₹ 1,589 recorded as ₹ 1,598.
3. Errors of Casting e.g. Deposit Column/withdrawal columns under/over cast.
4. Errors of Carrying Forward e.g. debit balance on the previous page brought forward as a credit balance on the next page, the balance of ₹ 15,889 carried forward as ₹ 15,898.

Example A Cash deposit of ₹ 1,589 was recorded as ₹ 1,598 in Pass Book on 31st March. In case the bank sends a statement of account upto 31st March, there will be a difference of ₹ 9 between both the balances. If the Bank Balance as per Cash Book as on 31st March is ₹ 50,000, the Bank Reconciliation Statement may be prepared as under:

BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...

<i>Particulars</i>	₹
A. Balance as per Cash Book	50,000
B. Add: Excess Credit for Cash Deposited in Pass Book	9
C. Balance as per Pass Book [A + B]	50,009

ILLUSTRATION 1

Tulsian Ltd. provides you the following information as at 31st March:

	₹
1. Cheque deposited but not yet collected by bank	1,500
2. Cheques issued but not yet presented for payment	2,500
3. Bank charges debited in Pass Book only	200
4. Interest allowed in Pass Book only	100
5. Insurance Premium paid directly by bank under standing advice	500
6. Bills receivables directly collected by bank	2,000
7. A wrong debit given by bank in Pass Book	3,800
8. A wrong credit given by bank in Pass Book	400\
9. Direct payment by a customer into the bank but not recorded in Cash Book	700

Required: Prepare a Bank Reconciliation Statement as at 31st March in each of the following alternative cases:

Case I If the debit balance as per Cash Book was ₹ 200

Case II If the credit balance as per Pass Book was ₹ 200

Case III If an overdraft as per Cash Book was ₹ 200

Case IV If an overdraft as per Pass Book was ₹ 200

SOLUTION

Case I

BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...

<i>Particulars</i>	<i>Plus Items</i> ₹	<i>Minus Items</i> ₹
A. Debit Balance as per Cash Book	200	
B. <i>Add:</i> Transactions having the effect of higher balance as per Pass Book		
1. Cheque issued but not yet presented for payment	2,500	
2. Interest allowed in pass book only	100	
3. Bills receivable directly collected by bank	2,000	
4. A wrong credit given by bank in Pass Book	400	
5. Direct payment by a customer into bank but not recorded in Cash Book	700	
C. <i>Less:</i> Transactions having the effect of lower balance as per Pass Book		
1. Cheque deposited but not yet collected by bank		1,500
2. Bank charges debited in pass book only		200
3. Insurance premium paid directly by bank under standing advice		500
4. A wrong debit given by Bank in Pass Book		3,800
	5,900	6,000
D. Overdraft as per Pass Book		100

Case II

BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...

<i>Particulars</i>	<i>Plus Items</i> ₹	<i>Minus Items</i> ₹
A. Credit Balance as per Pass Book	200	
B. <i>Less:</i> Transactions having the effect of lower balance as per Cash Book		
1. Cheque issued but not yet present for payment		2,500
2. Interest allowed in pass book only		100
3. Bills receivables directly collected by bank		2,000
4. A wrong credit given by bank in pass book		400
5. Direct payment by a customer into bank but not recorded in Cash Book		700

C. Add: Transactions having the effect of higher balance as per Cash Book		
1. Cheque deposited but not yet collected by bank	1,500	
2. Bank charges debited in pass book only	200	
3. Insurance premium paid directly by bank under standing advice	500	
4. A wrong debit given by Bank in Pass Book	3,800	
	6,200	5,700
D. Debit Balance as per Cash Book	500	

Case III
BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...

Particulars	Plus Items ₹	Minus Items ₹
A. Overdraft as per Cash Book		200
B. Add: Transactions having the effect of higher balance as per Pass Book		
1. Cheque issued but not yet presented for payment	2,500	
2. Interest allowed in pass book only	100	
3. Bills receivables directly collected by bank	2,000	
4. A wrong credit given by bank in Pass Book	400	
5. Direct payment by a customer into bank but not recorded in Cash Book	700	
C. Less: Transactions having the effect of lower balance as per Pass Book		
1. Cheque deposited but not yet collected by bank		1,500
2. Bank charges debited in pass book only		200
3. Insurance premium paid directly by bank under standing advice		500
4. A wrong debit given by bank in Pass Book		3,800
	5,700	6,200
D. Overdraft as per Pass Book		500

Case IV
BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...

Particulars	Plus Items ₹	Minus Items ₹
A. Overdraft as per Pass Book		200
B. Less: Transactions having the effect of lower balance as per Cash Book		
1. Cheque issued but not yet presented for payment		2,500
2. Interest allowed in Pass Book only		100
3. Bills receivables directly collected by bank		2,000
4. A wrong credit given by bank in Pass Book		400
5. Direct payment by a customer into bank but not recorded in Cash Book		700

C. Add: Transactions having the effect of higher balance as per Cash Book		
1. Cheque deposited but not yet collected by bank	1,500	
2. Bank charges debited in pass book only	200	
3. Insurance premium paid directly by bank under standing advice	500	
4. A wrong debit given by bank in Pass Book	3,800	
	6,000	5,900
D. Debit Balance as per Cash Book	100	

ILLUSTRATION 2

On comparing the Cash Book of Mr Tulsian with the Bank Pass Book, the following discrepancies were noted:

- Out of ₹ 20,500 paid in cash and by cheques into the bank on 27th March, cheque amounting to ₹ 7,500 were collected on 7th April.
- Cheque and cash amounting to ₹ 4,800 were deposited in bank on 26th March but credit was given for ₹ 3,800 only.
- Out of cheques amounting to ₹ 7,800 drawn on 26th March a cheque for ₹ 2,500 was encashed on 3rd April.
- Cheques issued to creditor amounting to ₹ 20,000 on 25th March of which cheques worth ₹ 3,000 were presented to bank up to 31st March.
- A cheque for ₹ 1,000 entered in Cash Book but omitted to be banked on 31st March.
- A cheque for ₹ 600 deposited into bank but omitted to be recorded in Cash Book and was collected by the bank on 30th March.
- A bill receivable for ₹ 520 previously discounted (Discount ₹ 20) with the bank had been dishonoured but advice was received on 1st April.
- A bill for ₹ 10,000 was retired/paid by the bank under a rebate of ₹ 150 but the full amount of the bill was credited in the bank column of the Cash Book.
- A cheque of ₹ 1,080 credited in the Pass Book on March 28 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.
- A cheque of ₹ 200 drawn on his Saving Deposit Account has been shown as drawn on Current Account in Cash Book.

Required: Prepare a Bank Reconciliation Statement as at 31st March if the Balance as per Cash Book on 31st March was ₹ 39,570.

SOLUTION**BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...**

<i>Particulars</i>	<i>Plus Items ₹</i>	<i>Minus Items ₹</i>
Debit Balance as per Cash Book	39,570	
(a) Cheque deposited on 27th March but not yet collected till 31st March		7,500
(b) Cheques deposited on 26th March but not yet collected till 31st March		1,000
(c) Cheques issued on 26th March but not yet presented for payment till 31st March	2,500	
(d) Cheque issued on 25th March but not yet presented for payment till 31st March	17,000	

(e) A Cheque entered in Cash Book but not yet banked		1,000
(f) A Cheque deposited into bank but not yet entered in Cash Book	600	
(g) Discounted B/R dishonoured, not yet entered in Cash Book		520
(h) Rebate on bill not entered in Cash book	150	
(i) Cheque drawn on Saving Bank A/c but recorded in Current A/c	200	
	60,020	10,020
Credit Balance as per Pass Book	50,000	

Note: A cheque of ₹ 1,080 credited in Pass book on March 28, later debited in Pass Book on 1st April has no effect on Bank Reconciliation Statement as at 31st March.

ILLUSTRATION 3 [EFFECT OF ERRORS IN THE CASH BOOK]

From the following particulars, prepare a Bank Reconciliation Statement as on 31st March.

- Bank Balance as per Cash Book is ₹ 10,000
- A Cheque for ₹ 1,000 deposited but not recorded in the Cash Book. (Note: Bank has collected and credited this cheque.)
- A Cash deposit of ₹ 200 was recorded in the Cash Book as if there is no Bank Column therein.
- A Cheque issued for ₹ 250 was recorded as ₹ 205 in the Cash Column. (Note: Bank has made the payment of this cheque.)
- The debit balance of ₹ 1,500 as on the previous day was brought forward as a credit balance.
- The payment side of the Cash Book (Bank column) was under cast by ₹ 100.
- A cash discount allowed of ₹ 112 was recorded as ₹ 121 in the Bank Column.
- A cheque of ₹ 500 received from a debtor was recorded in the Cash Book but not deposited in the Bank for collection.
- One outgoing cheque of ₹ 300 was recorded twice in the Cash Book.

SOLUTION

BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...

<i>Particulars</i>	<i>Plus Items ₹</i>	<i>Minus Items ₹</i>
A. Debit Balance as per Cash Book	10,000	
B. Add: (a) Error in carrying forward	3,000	
(b) Cheque recorded twice in Cash Book	300	
(c) Cash deposit but not recorded in Bank Column	200	
(d) Cheque deposited but not recorded	1,000	
C. Less: (a) Under Casting of Payment Side		100
(b) Cheque issued but not entered		250
(c) A cash discount wrongly recorded in Bank Column		121
(d) Cheque recorded but not deposited		500
	14,500	971
D. Credit Balance as per Pass Book	13,529	

ILLUSTRATION 4

The Cash book of Mr Avinash shows ₹ 8,364 as the balance at bank as on 31st March, but you find that this does not agree with the balance as per the Bank Pass Book. On scrutiny, you find the following discrepancies.

- On 15th March, the payments side of the Cash Book was undercast by ₹ 100.
 - A cheque for ₹ 131 issued on 25th March, was recorded in the Cash column.
 - One deposit of ₹ 150 was recorded in the Cash Book as if there is not Bank Column therein.
 - On 18th March, the debit balance of ₹ 1,526 as on the previous day, was brought forward as a credit balance.
 - Of the total cheques amounting to ₹ 11,514 drawn in the last week of March, cheques aggregating ₹ 7,815 were encashed in March.
 - Dividends of ₹ 250 collected by the Bank and subscription of ₹ 100 paid by it, were not recorded in the Cash Book.
 - One outgoing cheque of ₹ 350 was recorded twice in the Cash Book.
- Required: Prepare a Bank Reconciliation Statement as on 31st March.

SOLUTION**BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...**

<i>Particulars</i>	<i>Plus Items ₹</i>	<i>Minus Items ₹</i>
A. Debit Balance as per Cash book	8,364	
B. Add: Error in bringing forward ₹ 1,526 debit balance as a credit balance on 18th December,	3,052	
C. Add: Cheques issued but not presented (₹ 11,514 – ₹ 7,815)	3,699	
D. Add: Dividends directly credited by the bank but not entered in the Cash Book	250	
E. Add: Outgoing cheque recorded twice in Cash Book	350	
F. Add: Deposit not recorded in the Bank Column	150	
G. Less: Payment side undercast		100
H. Less: Cheques issued but not entered in Bank Column		131
Less: Subscription paid by the bank directly not yet recorded in the Cash Book		100
	15,865	331
I. Credit Balance as per Pass Book	15,534	

ILLUSTRATION 5 [EFFECT OF ERRORS IN PASS BOOK]

From the following particulars, prepare the Bank Reconciliation Statement of Shri Krishan as on 31st March.

- Balance as per Pass Book is ₹ 10,000.
- Bank collected a cheque of ₹ 500 on behalf of Shri Krishan but wrongly credited it to Shri Kishan's A/c (another customer).
- Bank recorded a Cash deposit of ₹ 1,589 as ₹ 1,598.
- Withdrawal column of the Pass Book undercast by ₹ 100.

- (e) The credit balance of ₹ 1,500 as on page 5 of the Pass Book was recorded on page 6 as the debit balance.
- (f) The payment of a cheque of ₹ 350 was recorded twice in the Pass Book.
- (g) The Pass Book showed a credit for a cheque of ₹ 1,000 deposited by Shri Kishan (another customer of the Bank).

SOLUTION**BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...**

<i>Particulars</i>	<i>Plus Items ₹</i>	<i>Minus Items ₹</i>
A. Credit Balance as per Pass Book	10,000	
B. Add: (a) Cheque wrongly credited to another customers A/c	500	
(b) Error in carrying forward	3,000	
(c) Cheque recorded twice	350	
C. Less: (a) Excess credit for Cash Deposit		9
(b) Undercasting of withdrawal column		100
(c) Wrong credit		1,000
	13,850	1,109
D. Debit Balance as per Cash Book	12,741	

9.0 PREPARATION OF BANK RECONCILIATION STATEMENT WITH ADJUSTED/AMENDED CASH BOOK BALANCE

- In case the Bank Reconciliation Statement is required to be prepared at the end of an accounting period, it is recommended that first, the Cash Book (with amended Bank column) should be prepared in order to ascertain the correct Bank Balance as per Cash Book and then the Bank Reconciliation Statement should be prepared to reconcile this correct Bank Balance as per Cash Book with the balance as per Bank Pass Book.
- It may be noted that it is the adjusted Cash Book Balance which is taken to the Balance Sheet. Now the question arises, **“How to calculate the adjusted Cash Book Balance?”**
- The adjusted Cash Book Balance can be ascertained:
 - By Passing Adjusting entries in respect of correct items which appear only in Pass Book** (e.g. Bank Charges, Interest charged on overdraft, Interest allowed by Bank, Dividend/Interest/Bills Receivable directly collected by Bank, Direct Payment by Bank under standing instructions of customers). and
 - By Passing Rectifying entries in respect of errors committed in the Cash Book** (e.g. cheque issued but recorded in Cash Column/Discount Column, Cheques issued recorded in Bank Column with wrong amount, over/under cast of Bank Column, error in Balancing the Bank Column, error in carry forward/brought forward of bank balance).
- Format of Bank Reconciliation Statement when Adjusted Balance as per Cash Book is taken as starting point

BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...
[With Adjusted Bank Balance as per Cash Book]

<i>Particulars</i>	<i>Plus Items ₹</i>	<i>Minus Items ₹</i>
A. Adjusted Bank Balance as per Amended Cash Book	xxx	
B. Add: Cheques issued but not yet presented for payment A wrong credit given by Bank in Pass Book	xxx	
C. Less: Cheques received and recorded in Bank column but not yet sent to Bank for collection Cheques deposited but not yet collected by the Bank A wrong debit given by Bank in Pass Book	xxx	xxx xxx xxx
D. Balance as per Pass Book	xxx	xxx

ILLUSTRATION 6

From the following particulars, prepare Bank Reconciliation Statement as on 31st March, (a) without amended Cash Book (b) with amended Cash Book.

	₹
1. Balance as per Cash Book	400
2. Cheques received and recorded in Bank Column but not yet sent to Bank for collection	1,000
3. Cheques deposited into the bank but not recorded in the Cash Book	2,000
4. Cheques deposited but not yet collected by the Bank	1,500
5. Cheques issued but not yet presented for payment	2,500
6. Bank Charges debited in Pass Book only	200
7. Interest allowed in Pass Book only	100
8. Insurance Premium paid directly by Bank under standing advice	500
9. Bills receivables directly collected by the Bank	2,000
10. Cheques deposited for collection, returned dishonoured and recorded in Pass Book only	1,000
11. 'Cheques Issued' returned on technical grounds	300
12. A wrong debit given by bank in pass book	800
13. A wrong credit given by bank in pass book	400
14. Bills discounted dishonoured but not recorded in Cash Book	4,000
15. Direct payment by a customer into the bank but not recorded in Cash Book	700
16. A Cash receipt recorded in Bank Column	1,000
17. A Cash payment recorded in Bank Column	600

SOLUTION

(a) Without Amended Cash Book

BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...

Particulars	Plus Items ₹	Minus Items ₹
A. Debit Balance as per Cash Book	400	
B. Add: Cheques deposited into the bank but not recorded in Cash Book	2,000	
Cheques issued but not yet presented for payment	2,500	
Interest allowed in pass book only	100	
Bills receivables directly collected by Bank	2,000	
'Cheques Issued' returned on technical grounds	300	
A wrong credit given by bank in Pass Book	400	
Direct payment by a customer into the bank but not recorded in Cash Book	700	
A Cash payment wrongly recorded in Bank Column	600	
C. Less: Cheques received and recorded in Bank column but not yet sent to Bank for collection		1,000
Cheques deposited but not yet collected by the Bank		1,500
Bank Charges debited in pass book only		200
Insurance a premium paid directly by bank under standing advice		500
Cheques deposited for collection, returned dishonoured and recorded in Pass Book only		1,000
A wrong debit given by Bank in Pass Book		800
Bills dis. dishonoured but not recorded in Cash Book		4,000
A Cash receipt wrongly recorded in Bank Column		1,000
	9,000	10,000
D. Overdraft as per Pass Book		1,000

(b) With Amended Cash Book

DR. CASH BOOK (AMENDED BANK COLUMN) CR.

Particulars	₹	Particulars	₹
To Balance b/d	400	By Bank charges	200
To Cheque deposited but not recor.	2,000	By Insurance premium	500
To Bills Receivables	2,000	By Cheques dishonoured	1,000
To Interest allowed	100	By Bill discounted	4,000
To Cheques issued returned	300	By Cash receipt wrongly recor.	1,000
To Direct Payment by Customers	700		
To Cash Payment wrongly recor.	600		
To Balance c/d	600		
	6,700		6,700

BANK RECONCILIATION STATEMENT AS AT 31ST MARCH ...

<i>Particulars</i>	<i>Plus Items ₹</i>	<i>Minus Items ₹</i>
A. Adjusted Bank Overdraft as per Amended Cash Book		600
B. Add: Cheques issued but not yet presented for payment	2,500	
A wrong credit given by bank in Pass Book	400	
C. Less: Cheques received and recorded in Bank column but not yet sent to Bank for collection		1,000
Cheques deposited but not yet collected by the Bank		1,500
A wrong debit given by Bank in Pass Book		800
	2,900	3,900
D. Overdraft as per Pass Book		1,000

ILLUSTRATION 7

On 31st March, 2018, the bank account of Miss Meenu, according to the Bank Column of the Cash Book, was over drawn to the extent of ₹ 2,315. On scrutiny, you find that:

- (a) On 27th March, Cheques of ₹ 21,500 were collected from customers and recorded in the Cash Book of which:
 - (i) A cheque for ₹ 1,000 was omitted to be banked in March and the rest were sent to bank on 28th March.
 - (ii) A Cheque of ₹ 5,100 was recorded as ₹ 1,500 on the credit side of the Cash Book as if there is no Bank Column therein and
 - (iii) Cheques of ₹ 13,000 collected by the bank in March.
- (b) On 28th March, Cheques of ₹ 20,000 were drawn of which:
 - (i) A Cheque issued for ₹ 250 was recorded as ₹ 205 on the debit side of the Cash Book as if there is no Bank Column therein
 - (ii) One outgoing cheque of ₹ 300 was recorded twice in the Cash Book
 - (iii) Cheques of ₹ 3,000 were presented to the bank in March.
- (c) A bill for ₹ 10,000 was retired by the bank under a rebate of ₹ 150 but the full amount of the bill was credited in the Bank Column of the Cash Book.
- (d) A bill receivable for ₹ 520 previously discounted for ₹ 500 with bank had been dishonoured and recorded in the Pass Book but not in the Cash Book
- (e) The Bank has charged Interest of ₹ 521 instead of ₹ 512 but not recorded in the Cash Book
- (f) The debit balance of ₹ 1,500 as on the previous day was brought forward as a credit balance of ₹ 5,100 in Cash Book.
- (g) A deposit of ₹ 5,432 was recorded in withdrawal column as ₹ 5,342 in pass book.
- (h) A cheque of ₹ 2,345 issued by Mrs Meena was recorded in deposit column as ₹ 2,435 in pass book.

Required: Prepare Bank Reconciliation Statement with amended Cash Book Balance.

SOLUTION:

DR.

CASH BOOK (WITH AMENDED BANK COLUMN)

CR.

Date	Particulars	₹	Date	Particulars	₹
31.03.2018	To Customer A/cs	6,600	31.03.2018	By Balance b/d	2,315
	To Creditors A/c	300		By Creditors A/cs	455
	To Rebate A/c	150		By Drawee's A/c	520
	To Error in carry forward	6,600		By Bank Interest	512
				By Balance c/d	9,848
		13,650			13,650

(B) BANK RECONCILIATION STATEMENT AS AT 31.3.2018

Particulars	Plus items ₹	Minus items ₹
A. Balance as per Cash Book (amended)	9,848	
B. Less: Cheque deposited but not collected upto 31st Mar. [₹ 21,500 – ₹ 13,000]		8,500
C. Add: Cheques issued but not presented for payment up to 31st Mar. [₹ 20,000 – ₹ 3,000]	17,000	
D. Less: Wrong Debit of Interest by Bank [₹ 321 – ₹ 312]		9
E. Less: Wrong Debit by Bank in withdrawal column [₹ 5,432 + ₹ 5,342]		10,774
F. Add: Wrong Credit by Bank in deposit column	2,435	
	29,283	19,283
G. Balance as per Bank Statement	10,000	

15

VALUATION OF INVENTORY

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ What is meant by Inventories?
- ◇ What is included in the Cost of Inventories?
- ◇ What is excluded from the Cost of Inventories?
- ◇ Which Cost formulae is to be used to ascertain the cost of Inventories as per as-2?
- ◇ First in First Out (FIFO) Method
- ◇ Last in First Out (LIFO) Method
- ◇ Weighted Average Price Method
- ◇ Inventory Systems
- ◇ Distinction between periodic inventory system and Perpetual Inventory System
- ◇ What is Lower of Cost or Net Realizable Value Rule?
- ◇ How are Materials and Other Supplies to be valued?
- ◇ What are the Two Methods of Comparison of Cost with NRV?
- ◇ What are the Disclosure Requirements as per AS-2?
- ◇ Adjusted Selling Price [or Retail Inventory Method]
- ◇ Base Stock Method
- ◇ Specific Identification Method
- ◇ Standard Cost Method
- ◇ Valuation of Inventory as on Balance Sheet Date if the physical inventory has been taken on a date prior to Balance Sheet Date
- ◇ Valuation of Inventory as on Balance Sheet Date if the physical inventory has been taken on a date after the Balance Sheet Date.
- ◇ Stock As Per Books and Stock As per Physical Verification

1.0. WHAT IS MEANT BY INVENTORIES?

Inventories are assets that are -

- (a) held for sale in ordinary business; e.g. Finished Goods
- (b) in the process of production for such sale; e.g. WIP or
- (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services. e.g. Raw Materials

$$\text{Inventory} = \text{Finished Goods} + \text{WIP} + \text{Raw Materials}$$

Note: Machinery spares which are specific to a particular item of fixed asset should be capitalized in accordance with AS - 10 and should not be treated as inventories for the purpose of AS - 2.

2.0. WHAT IS INCLUDED IN THE COST OF INVENTORIES?

As per AS-2, Cost of Inventories include:

1. **Cost of Purchase.** [INCLUDES Purchase Price+ Duties & Taxes (which are NOT subsequently recoverable) + other expenditure directly attributable to acquisition (Like Freight Inward) **BUT EXCLUDES** Trade Discount, Rebates, Duty Drawbacks Subsidies and Taxes (which are subsequently recoverable)]
2. **Cost of Conversion.** [INCLUDES Direct Labour, Direct Expenses, Sub Contracted Work and Production Overheads absorbed on the basis of Normal Capacity]
3. **Other Costs** incurred in bringing the inventories to their present location and condition. e.g. costs incurred in designing products for specific customers

3.0. WHAT IS EXCLUDED FROM THE COST OF INVENTORIES?

Items that are to be excluded in determination of the cost of inventories as per para 13 of AS 2 on 'Valuation of Inventories' are:

1. Abnormal Amounts of wasted materials, labour or other production costs.
2. Storage Costs unless those costs are necessary in the production process prior to a further production stage.
3. Administrative Overheads that do not contribute to bringing the inventories to their present location and condition; and
4. Selling and Distribution Costs.

4.0. WHICH COST FORMULAE IS TO BE USED TO ASCERTAIN THE COST OF INVENTORIES AS PER AS-2?

Item of Inventory	Cost Formulae to be used
1. For items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects	Specific Identification of Cost Method
2. For Other Items	First-In-First-Out Method (FIFO) or Weighted Average Method

5.0 FIRST IN FIRST OUT (FIFO) METHOD

Meaning	(a) It is based on the assumption that the goods which are received first are issued first. This assumption is made for the purposes of assigning costs and not for the purposes of the physical flow of goods. The physical flow of goods therefore, need not necessarily coincide with the pattern of cost flow assumption. (b) It uses the price of the first lot received for all the issues untill all units from this lot have been issued after which the price of next lot received is used for pricing and so on. (c) Cost of Materials issued represents the cost of earlier purchases. (d) Cost of Closing Stock represents the cost of latest purchases.

Implications	Period	Implications of fifo Method
	1. In periods of Rising Prices	Higher income is reported since old costs (which are lower than the current costs) are matched with current revenues. As result, income tax liability is increased.
	2. In periods of Falling Prices	Lower income is reported since old costs (which are higher than the current costs) are matched with current revenue. As a result income tax liability is reduced.
Advantages	1. It is simple to understand and easy to operate if prices of materials do not fluctuate very frequently. 2. No unrealised inventory profits/losses are made by using this method because it is based on cost. 3. This method conforms to the physical flow of goods. 4. The value of closing stock tends to be nearer current market prices because it represents the cost of recent purchases. 5. In periods of falling prices, lower income is reported since old costs (which are higher than the current costs) are matched with current revenue. As a result, income tax liability is reduced.	
Disadvantages	1. This method involves a lot of calculation work in case there are violent fluctuations in the prices of materials. 2. Comparison among similar jobs is very difficult if materials of different batches carrying different prices are used in these jobs. 3. In a period of fluctuating prices, the cost of issues do not represent the current market prices. 4. In periods of rising prices, higher income is reported since old costs (which are lower than the current costs) are matched with current revenues. As a result, income tax liability is increased.	

ILLUSTRATION 1

X Ltd. furnishes the following stores transactions for July, 2018:

1	Opening Balance	200 Units value ₹ 2,000
4	Receipts from B & Co. GRN No. 11	300 Units @ ₹ 12 per unit
7	Issues Req. No. 101	400 Units
10	Receipts from M & Co. Grn No. 12	400 Units @ ₹ 14 per unit
19	Issues Req. No. 102	300 Units
22	Receipts from N Co. Grn No. 13	200 Units @ ₹ 16 per unit
28	Issues Req. No. 103	300 Units.
30	Shortage in stock taking	20 Units

Required: Prepare the Stores Ledger using FIFO method.

SOLUTION

STORES LEDGER OF X LTD. (FIFO METHOD)

Date 2018 July	Receipts				Issues				Balance		
	GRN No.	Qty. Units	Rate ₹	Amt. ₹	Requisition No.	Qty. Units	Rate ₹	Amt. ₹	Qty. Units	Rate ₹	Amt. ₹
1	Op. Bal.								200	10	2,000
4	11	300	12	3,600					200	10	2,000
									300	12	3,600
7					101	200	10	2,000			
						200	12	2,400	100	12	1,200
10	12	400	14	5,600					100	12	1,200
									400	14	5,600
19					102	100	12	1,200			
						200	14	2,800	200	14	2,800
22	13	200	16	3,200					200	14	2,800
									200	16	3,200
28					103	200	14	2,800			
						100	16	1,600	100	16	1,600
30					Shortage	20	16	320	80	16	1,280

6.0 LAST IN FIRST OUT (LIFO) METHOD

Meaning	(a) It is based on the assumption that the goods which are received last are issued first. This assumption is made for the purposes of assigning costs and not for the purposes of the physical flow of goods. The physical flow of goods therefore, need not necessarily coincide with the pattern of cost flow assumption.	
	(b) It uses the price of the last lot received for all the issues untill all units from this lot have been issued after which the price of previous lot received is used for pricing and so on. In case a new lot is received, new lot becomes the last lot and its price is used for pricing the issues in the manner explained above.	
	(c) Cost of Materials Issued represents the cost of latest purchases.	
	(d) Cost of Closing Stock represents the cost of earlier purchases.	
Implications	Period	Implications of LIFO Method
	1. In periods of Rising Prices	Lower income is reported since current costs (which are higher than the old costs) are matched with current revenues. As a result, income tax liability is reduced.
	2. In Periods of Falling Prices	Higher income is reported since current costs (which are lower than the old costs) are matched with current revenues. As a result, income tax liability is increased.

Advantages	1. The cost of issues tend to be nearer current market price because it represents cost of recent purchases. 2. In periods of rising prices, lower income is reported since current costs (which are higher than the old costs) are matched with current revenue. As a result, income tax liability is reduced. 3. No unrealised inventory profits/losses are made by using this method because it is based on cost.
Disadvantages	1. It involves a lot of calculation work in case there are violent fluctuations in the prices of materials. 2. Comparison among similar jobs is very difficult if materials of different batches carrying different prices are used in these jobs. 3. This method does not conform to the physical flow of goods. 4. The value of closing stock does not tend to be nearer current market prices because it represents the cost of earlier purchases. 5. In periods of falling price, higher income is reported since current costs (which are lower than the old costs) are matched with current revenues. As a result, income tax liability is increased.

DISTINCTION BETWEEN FIFO AND LIFO METHOD OF VALUATION OF INVENTORY

Fifo Method of Valuation of inventory differs from LIFO Method in the following respects:

Basis of Distinction	FIFO	LIFO
1. Basic Assumption	Goods received first are issued first.	Goods received last are issued first.
2. Cost of Goods Sold	Cost of goods sold represents cost of earlier purchases .	Cost of goods sold represents cost of recent purchases .
3. Ending Inventory	Ending inventory represents cost of recent purchases .	Ending inventory represents cost of earlier purchases .
4. In case of Rising prices	Higher income is reported since old costs (which are lower than current costs) are matched with current revenue. As a result, income tax liability is increased.	Lower income is reported since current costs (which are higher than the old costs) are matched with current revenue. As result, income tax liability is reduced.
5. Distortion in Balance Sheet	Balance Sheet shows the ending inventory at a value nearer the current market price .	Balance Sheet is distorted because ending inventory is understated at old costs .

ILLUSTRATION 2

Taking the same information as given in Illustration 1, Prepare the Stores Ledger using lifo method.

SOLUTION

STORES LEDGER OF X LTD. (LIFO METHOD)

Date 2018 July	Receipts				Issues				Balance		
	GRN No.	Qty. Units	Rate ₹	Amt. ₹	Requisition No.	Qty. Units	Rate ₹	Amt. ₹	Qty. Units	Rate ₹	Amt. ₹
1	Op. Bal.								200	10	2,000
4	11	300	12	3,600					200	10	2,000

									300	12	3,600
7					101	300	12	3,600			
						100	10	1,000	100	10	1,000
10	12	400	14	5,600					100	10	1,000
									400	14	5,600
19					102	300	14	4,200	100	10	1,000
									100	14	1,400
22	13	200	16	3,200					100	10	1,000
									100	14	1,400
									200	16	3,200
28					103	200	16	3,200			
						100	14	1,400	100	10	1,000
30					Shortage	20	10	200	80	10	800

7.0 WEIGHTED AVERAGE PRICE METHOD

Meaning	(a) It is based on the assumption that each issue of goods consists of a due proportion of the earlier lots. (b) It uses a weighted average price for pricing the issue of materials until a new lot is purchased when a new weighted average price will be calculated. (c) Weighted Average Price is calculated as follows: $\text{Weighted Average Price} = \frac{\text{Total Cost of Materials in stock}}{\text{Total Quantity of Materials in stock}}$ (d) It is useful when the quantity of materials in each lot purchased is not uniform.
Advantage	1. It averages out the effect of price fluctuations. 2. It can be advantageously used in process industries.
Disadvantages	1. There may be unrealised profit/loss because it is based as weighted average price and not on actual cost. 2. It increases the clerical work because a new weighted average price is required to be calculated on the receipt of a new lot. 3. It cannot be used in job order industry where each individual order must be priced at each stage upto completion. 4. The closing stock does not correspond to the conventional accounting of valuation of stock.

ILLUSTRATION 3

Taking the same information as given in Illustration 1, Prepare the Stores Ledger using Weighted Average Method.

SOLUTION**STORES LEDGER OF X LTD. (WEIGHTED AVERAGE METHOD)**

Date 2018 July	Receipts				Issues				Balance		
	GRN No.	Qty. Units	Rate ₹	Amt. ₹	Requisition No.	Qty. Units	Rate ₹	Amt. ₹	Qty. Units	Rate ₹	Amt. ₹
1									200	10	2,000
4	11	300	12	3,600					500	11.2	5,600
7					101	400	11.2	4,480	100	11.2	1,120
10	12	400	14	5,600					500	13.44	6,720
19					102	300	13.44	4,032	200	13.44	2,688
22	13	200	16	3,200					400	14.72	5,888
28					103	300	14.72	4,416	100	14.72	1,472
30					Shortage	20	14.72	294.4	80	14.72	1,177.60

8.0 INVENTORY SYSTEMS

There are two inventory systems, viz. Periodic Inventory System and Perpetual Inventory System.

MEANING OF PERIODIC INVENTORY SYSTEM

Periodic Inventory System is a method of ascertaining inventory by taking an actual physical count (or measure or weight) of all the inventory items on hand at a particular date on which information about inventory is required. The cost of goods sold is calculated as a residual figure (which includes lost goods also) as under:

$$\text{Cost of Goods Sold} = \text{Opening Inventory} + \text{Purchases} - \text{Closing Inventory}$$

MEANING OF PERPETUAL INVENTORY SYSTEM

Perpetual Inventory System is a method of recording inventory balances after each receipt and issue in order to ensure accuracy of perpetual inventory records, physical stocks should be checked and compared with recorded balances. The discrepancies, if any, should be investigated and adjusted in the accounts properly. The closing inventory is calculated as a residual figure (which includes lost goods also) as under:

$$\text{Closing Inventory} = \text{Opening Inventory} + \text{Purchases} - \text{Cost of Goods Sold}$$

9.0. DISTINCTION BETWEEN PERIODIC INVENTORY SYSTEM AND PERPETUAL INVENTORY SYSTEM

Periodic Inventory System differs from Perpetual Inventory System in the following respects:

Basis of Distinction	Periodic Inventory System	Perpetual Inventory System
1. Basis of Ascertaining Inventory	Inventory is ascertained by taking an actual physical count	Inventory is ascertained on the basis of records.
2. Calculation of Inventory	Inventory is directly calculated by applying the method of valuation of inventories.	Inventory is calculated as a residual figure as under: Closing Inventory = Opening Inventory + Purchases - Cost of Goods Sold

3. Calculation of cost of goods sold	Cost of Goods Sold is calculated as a residual figure as under:	Cost of Goods Sold is directly calculated by applying the method of valuation of inventories. Cost of Goods Sold = Opening Inventory + Purchases - Closing Inventory
4. Lost Goods lost goods (if any).	Cost of Goods sold includes (if any).	Inventory includes lost goods
5. Closing Down of work for Stock taking	It requires closing down of work for stock taking.	It does not require closing down of work for Stock taking.
6. Continuous Stock stock checking.	It does not facilitate the Checking	It facilitates the continuous continuous stock checking.
7. Simplicity and cost	It is simple and inexpensive.	It is elaborate and expensive.

ILLUSTRATION 4

Purchases and Sales of a certain product during March, 2018 are set out below:

Purchases: on 1st March 100 units @ ₹ 10.00, on 12th March: 100 units @ ₹ 9.80, on 15th March: 50 units @ ₹ 9.60, on 20th March: 100 units @ ₹ 9.40

Sales: on 10th March 80 units, on 14th March: 100 units, 31st March: 90 units.

There was no opening inventories. Determine the cost of goods sold for March as per, FIFO, LIFO and Weighted Average Cost Method using:

- (i) Perpetual Inventory System & (ii) Periodic Inventory System.

SOLUTION**(A) STOCK LEDGER (ON FIFO BASIS)**

Date	Purchases			Sales			Balance		
	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹
01.03.2018	100	10	1,000	—	—	—	100	10.00	1,000
10.03.2018	—	—	—	80	10	800	20	10.00	200
12.03.2018	100	9.80	980	—	—	—	20	10.00	200
							100	9.80	980
14.03.2018	—	—	—	20	10	200			
				80	9.80	784	20	9.80	196
15.03.2018	50	9.60	480	—	—	—	20	9.80	196
							50	9.60	480
20.03.2018	100	9.40	940	—	—	—	20	9.80	196
							50	9.60	480
							100	9.40	940
31.03.2018	—	—	—	20	9.80	196			
				50	9.60	480			
				20	9.40	188	80	9.40	752

Cost of Goods sold (under Perpetual System) = ₹ 800 + ₹ 984 + ₹ 864 = ₹ 2,648

Cost of Goods sold (under Periodic System) = Opening Inventory + Purchases – Ending Inventory
= 0 + ₹ 3,400 – ₹ 752 = ₹ 2,648

(B) STOCK LEDGER (ON LIFO BASIS)

Date	Purchases			Sales			Balance		
	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹
01.03.2018	100	10	1,000	—	—	—	100	10.00	1,000
10.03.2018	—	—	—	80	10	800	20	10.00	200
12.03.2018	100	9.80	980	—	—	—	100	9.80	980
							20	10.00	200
14.03.2018	—	—	—	100	9.80	980	20	10.00	200
15.03.2018	50	9.60	480	—	—	—	20	10.00	200
							50	9.60	480
20.03.2018	100	9.40	940	—	—	—	20	10.00	200
							50	9.60	480
							100	9.40	940
31.03.2018	—	—	—	90	9.40	846	20	10.00	200
							50	9.60	480
							10	9.40	94

Cost of Goods Sold (Under Perpetual System) = ₹ 800 + ₹ 980 + ₹ 846 = ₹ 2,626

Cost of Goods Sold (Under Periodic System) = Opening Inventory + Purchases – Ending Inventory
 = 0 + ₹ 3,400 – ₹ 800 = ₹ 2,600

(C) STOCK LEDGER (ON WEIGHTED AVERAGE BASIS)

Date	Purchases			Sales			Balance		
	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹
01.03.2018	100	10	1,000	—	—	—	100	10.00	1,000
10.03.2018	—	—	—	80	10	800	20	10.00	200
12.03.2018	100	9.80	980	—	—	—	120	9.83	1,180
14.03.2018	—	—	—	100	9.83	983	20	9.85	197
15.03.2018	50	9.60	480	—	—	—	70	9.67	677
20.03.2018	100	9.40	940	—	—	—	170	9.51	1,617
31.03.2018	—	—	—	90	9.51	856	80	9.51	761

Cost of Goods sold (under Perpetual System) = ₹ 800 + ₹ 983 + ₹ 856 = ₹ 2,639

Cost of Goods sold under Periodic System is arrived at as under:

Weighted Average Unit Cost = Total Amount of Purchases/ Total Units Purchased
 = ₹ 3,400/350 = ₹ 9.7142

Weighted Average Cost of 270 Units Sold = (₹ 3,400/350) × 270 = ₹ 2,622.86

ILLUSTRATION 5

From the following data, calculate the value of closing inventory according to FIFO and LIFO on March 31, 2018 using:

- (i) Periodic inventory system, and (ii) Perpetual inventory system.

March 1 Stock in hand 400 units @ ₹ 7.50 each

	Purchases:		Issues:
March 5	600 units @ ₹ 8 each	March 3	300 units
March 15	500 units @ ₹ 9 each	March 10	500 units
March 25	400 units @ ₹ 8.50 each	March 17	400 units
March 30	300 units @ ₹ 9.50 each	March 26	500 units
March 31	200 units		

SOLUTION

PERIODIC INVENTORY SYSTEM

A. Units in opening stock	400
B. Purchases (600 + 500 + 400 + 300)	1,800
C. Issues (300 + 500 + 400 + 500 + 200)	1,900
D. Units in Closing Stock [A + B – C]	300
E. Value of Closing Inventory FIFO = 300 @ ₹ 9.50 = ₹ 2,850; Lifo = 300 @ ₹ 7.50 = ₹ 2,250	

PERPETUAL INVENTORY SYSTEM STOCK LEDGER ON (FIFO BASIS)

Date	Receipts			Sales			Balance	
	Quantity	Rate	Amount	Quantity	Rate	Amount	Quantity	Amount
2018								
March 1	—	—	—	—	—	—	400	3,000
March 3	—	—	—	300	7.50	2,250	100	750
March 5	600	8	4,800	—	—	—	100	750
							600	4,800
March 10	—	—	—	100	7.50	750		
				400	8.00	3,200	200	1,600
March 15	500	9	4,500	—	—	—	200	1,600
							500	4,500
March 17	—	—	—	200	8	1,600		
				200	9	1,800	300	2,700
March 25	400	8.50	3,400	—	—	—	300	2,700
							400	3,400
March 26	—	—	—	300	9	2,700		
				200	8.50	1,700	200	1,700
March 30	300	9.50	2,850	—	—	—	200	1,700
							300	2,850
March 31	—	—	—	200	8.50	1,700	300	2,850

Closing Inventory = 300 units costing ₹ 2,850.

STOCK LEDGER (ON LIFO BASIS)

Date	Receipts			Sales			Balance	
	Quantity	Rate	Amount	Quantity	Rate	Amount	Quantity	Amount
2018								
March 1	—	—	—	—	—	—	400	3,000
March 3	—	—	—	300	7.50	2,250	100	750
March 5	600	8	4,800	—	—	—	100	750
							600	4,800
March 10	—	—	—	500	8	4,000	100	750
							100	800
March 15	500	9	4,500	—	—	—	100	750
							100	800
							500	4500
March 17	—	—	—	400	9	3,600	100	750
							100	800
							100	900
March 25	400	8.50	3,400	—	—	—	100	750
							100	800
							100	900
							400	3400
March 26	—	—	—	400	8.50	3,400	100	750
				100	9	900	100	800
March 30	300	9.50	2,850	—	—	—	100	750
							100	800
							300	2850
March 31	—	—	—	200	9.50	1,900	100	750
							100	800
							100	950

Closing Inventory = 300 units costing ₹ 2,500.

10.0 WHAT IS LOWER OF COST OR NET REALIZABLE VALUE RULE?

The inventories should be valued at the lower of cost and net realizable value at each Balance Sheet date.

Note: *Net Realizable Value = Estimated Selling Price – Estimated Costs of Completion – Estimated Costs necessary to make the sale.*

11.0 HOW ARE MATERIALS AND OTHER SUPPLIES TO BE VALUED AS PER AS 2?

Case	Valuation of Materials
1. If Finished Product are expected to be sold at or above the cost	Materials and other supplies should be valued at cost even if there is decline in the price of materials.
2. If Finished Product are expected to be sold below cost	Materials and other supplies should be valued at NRV if there is decline in the price of materials. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value.

12.0 WHAT ARE THE TWO METHODS OF COMPARISON OF COST WITH NRV?

1. Item by Item Method	Under this method, the cost of each time of inventory is compared with the net realisable value thereof and each item is valued at lower of the cost or net realisable value.
2. Group Method	Under this method, first, the groups of similar (or interchangeable) items are formed. Then the cost of each such group is compared with the net realisable value thereof and each group is valued at lower of the cost or net realisable value.

ILLUSTRATION 6

From the following data, calculate the value of stock, to be shown (i) by the Group by Group Method, and (ii) by the Item by Item Method.

Article	Group	No. of Units Per Unit	Cost (₹) Per Unit	Realisable Value (₹)	Realisation Expenses
1	A	100	100	120	
2	B	200	200	200	10%
3	A	300	150	156	
4	B	400	250	290	10%

SOLUTION**(I) VALUATION OF STOCK ACCORDING TO GROUP METHOD****Group 'A'**

Article	Cost (₹)	NRV (₹)	Lower of Cost/NRV (₹)
1	10,000	11,000	
3	45,000	42,900	
	55,000	53,900	53,900

Group 'B'

Article	Cost (₹)	NRV (₹)	Lower of Cost/NRV (₹)
2	40,000	36,000	
4	1,00,000	1,04,400	
	1,40,000	1,40,400	1,40,000

(II) VALUATION OF STOCK ACCORDING TO ITEM BY ITEM METHOD

Article	Cost (₹)	NRV (₹)	Lower of Cost/NRV (₹)
1	10,000	11,000	10,000
2	40,000	36,000	36,000
3	45,000	42,900	42,900
4	1,00,000	1,04,400	1,00,000
			1,88,900

13.0 WHAT ARE THE DISCLOSURE REQUIREMENTS AS PER AS-2?

1. Accounting Policies
2. Cost Formula Used
3. Total Carrying Amount of Inventories
4. Classification of Amount of Inventories.

14.0 ADJUSTED SELLING PRICE [OR RETAIL INVENTORY METHOD]

1. According to Accounting Standard 2 'this method may be used in retail businesses or in business where the inventory comprises items the individual costs of which are not readily ascertainable'.
2. The cost of the inventory is determined by reducing the estimated percentage of gross margin from the sales value of the inventory.
3. The calculation of the estimated gross margin of profit may be made for individual items or groups of items or by departments, as may be appropriate to the circumstances. This method is also used by some manufacturing organisations for valuing the inventory of finished products held against forward sale contracts.

ILLUSTRATION 7

From the following particulars, calculate the Value of Retail Inventory as on March 31.

<i>Particulars</i>	<i>Cost</i> ₹	<i>Retail Price</i> ₹
Opening Inventory	30,000	40,000
Purchases	3,08,000	3,82,500
Sales	—	3,60,000

SOLUTION

- A Cost to Retail Price Ratio = (Cost of Goods available for Sale/Retail Price of Goods available for sale) × 100
 $= (3,38,000/4,22,500) \times 100 = 80\%$
- B Estimated Ending Inventory at Retail Price = Opening Inventory + Purchases – Sales
 $= ₹ 40,000 + ₹ 3,82,500 - ₹ 3,60,000 = ₹ 62,500$
- C Cost of Estimated Ending Inventory = ₹ 62,500 × 80/100
 $= ₹ 50,000.$

ILLUSTRATION 8

X Ltd uses the adjusted selling price method for estimating monthly inventory balances. It makes a gross profit of 30% on net sales. The following figures for the year are available:

	₹		₹
Opening Inventory	40,000	Freight Inwards	10,000
Purchases	2,30,000	Gross Sales	3,40,000
Purchase Returns	20,000	Sales Returns	40,000
		Carriage Inwards	6,000

Required: Compute the estimated cost of the closing inventory.

SOLUTION**TRADING ACCOUNT****DR.***for the year ending...***CR.**

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Opening Stock	40,000	By Sales	3,40,000
To Purchases	2,30,000	Less: Returns	40,000
Less: Return	20,000	By Closing Stock	
To Freight Inwards	10,000	(Balancing figure)	56,000
To Carriage Inwards	6,000		
To Gross Profit @ 30%	90,000		
	3,56,000		3,56,000

15.0 BASE STOCK METHOD**MEANING OF BASE STOCK METHOD**

The Base Stock Method proceeds on the assumption that a minimum quantity of inventory (base stock) must be held at all times in order to carry on business. Inventories up to this quantity are stated at the cost at which the base stock was acquired. Inventories in excess of the base stock are dealt with on some other basis, e.g., by using any one of the above mentioned methods. The Base Stock Method requires a minimum level of inventory to be held at all times and therefore, has a limited application. Most enterprises customarily maintain certain minimum stock level at all times but that is not by itself a justification for use of Base Stock Method because there must exist clear circumstances to permit use of base stock method.

ADVANTAGES OF BASE STOCK METHOD

The advantages of Base Stock Method are as follows:

1. It involves less clerical work in valuing the closing inventory because the value of base stock is fixed.
2. The figure of net income is reliable from long-run viewpoint.
3. Inventories are consistently shown in balance sheet at conservative value.
4. Unrealised profits are eliminated.

DISADVANTAGES OF BASE STOCK METHOD

The disadvantages of Base Stock Method are as follows:

1. The value of Base stock in the Balance Sheet does not tend to be nearer the current market price.
2. Base Stock is treated as a fixed asset whereas it is not so. There is no similarity in investment in plant and investment in inventory. The former is fixed and for use (i.e. not for resale) while the latter is frequently changing and is for sale.
3. Income statement does not give true results of operation because it fails to recognise gain and losses on inventories.
4. This method is not recognised by Income Tax Authorities.

16.0 SPECIFIC IDENTIFICATION METHOD

The Specific Identification Method attributes specific costs to identified goods that have been bought or manufactured and are Segregated for a specific purpose. According to Accounting Standard 2, this method should be used for inventories of items that are not ordinarily interchangeable or for goods produced and segregated for specific projects.

17.0 STANDARD COST METHOD**MEANING OF STANDARD COST METHOD**

Under this method, a standard cost is set for each material and this cost is used as a basis for pricing the material issues. While determining standard costs, the management takes into account the specified efficiency in efforts relating to purchase of material, issue of material, storing of materials and use of materials, normal levels of consumption of materials and supplies, labour efficiency, and capacity utilization.

Standard Cost Method is often used to arrive at historical cost for the purpose of inventory valuation. The use of standard cost for determining the cost of inventories requires that standards are realistic, are reviewed regularly and, where necessary, revised in the light of current conditions and that there exists a proper system of pro rating significant variances between the cost of sales and the inventories.

REQUIREMENT OF STANDARD COST METHOD

According to Accounting Standard 2, this method may be used if the results approximate consistently the results that could be obtained if the historical cost of inventories is determined by using FIFO or Weighted Average Cost Method.

ADVANTAGES OF STANDARD COST METHOD

The advantages of Standard Cost Method are as follows:

1. This method is easy to operate.
2. This method results in reduction of clerical work because repeated cost calculations are not required to be made on the receipt of each new lot of materials.
3. This method helps to prepare Material Price Variance Accounts and Material Usage Variance Account. These accounts help to determine the efficiency of activities related to purchase and use of materials.
4. This method helps in quick determination of selling prices and placing tenders etc.

DISADVANTAGES OF STANDARD COST METHOD

The disadvantages of Standard Cost Method are as follows:

1. This method does not conform to accepted accounting principles.
2. This method can be used only when standard costing system is used.
3. The cost of issues of materials and closing stock do not reflect the current market prices.
4. The determination of standard cost is very difficult particularly when prices fluctuate frequently.

18.0 VALUATION OF INVENTORY AS ON BALANCE SHEET DATE IF THE PHYSICAL INVENTORY HAS BEEN TAKEN ON A DATE PRIOR TO BALANCE SHEET DATE

To ascertain the value of inventory as on Balance Sheet date, the cost of items which are having the effect of higher closing stock as on Balance Sheet date (*for example*, purchases made, Sales Returns after stock taking till Balance Sheet date) should be *added to* and the cost of items which are having the effect of lower closing stock as on Balance Sheet date (*for example*, Purchases Returns, Sales after stock taking till Balance Sheet date) should be *subtracted from* the value of physical inventory.

ILLUSTRATION 9

Determine the value of stock to be taken to the Balance Sheet of Bharat Tulsian Ltd. as at 31st March from the following information:

The stock was physically verified on 24th March and was valued at ₹ 4,00,000. After stock taking, the following transactions had taken place till 31st March:

- (a) Purchases ₹ 2,00,000 out of which 20% goods were returned.
- (b) Sales of ₹ 2,00,000 out of which 20% goods were returned by the customers.

Note: Goods are sold by the trader at a profit of 25% on Cost.

SOLUTION

STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH

Particulars	₹
A. Stock as per physical verification as at 24th March	4,00,000
B. Add: Cost of Net Goods purchased after stock taking till 31st March [₹ 2,00,000 – 20% of ₹ 2,00,000]	1,60,000
C. Less: Cost of Net goods sold after stock taking till 31st March [80% of (₹ 2,00,000 – 20% of ₹ 2,00,000)]	(1,28,000)
D. Stock as per Books as at 31st March	4,32,000

ILLUSTRATION 10 [ADJUSTMENT OF ABNORMAL SALES]

The stock was physically verified on 24th March and was valued at ₹ 2,00,000. Goods are normally sold by the trader at a profit of 25% on cost. After stock taking the following transactions have taken place till 31st March.

Sales of ₹ 2,21,600 which includes:

- (i) Sales of ₹ 10,800 at 20% more than the normal selling price.
- (ii) Sales of ₹ 10,800 at 10% less than the normal selling price.

Required: Determine the value of stock to be taken to the Balance Sheet of PCT Ltd. as at 31st March.

SOLUTION

STATEMENT SHOWING THE VALUATION OF STOCK as at 31st March

Particulars	₹
A. Value of Stock as at 24th March	2,00,000
B. Less: Cost of Goods sold	
Normal Sales [80% of (₹ 2,21,600 – 10,800 – 10,800)]	(1,60,000)
Abnormal Sales [80% of (10,800 × 100/120)]	(7,200)
[80% of (10,800 × 100/90)]	(9,600)
C. Value of Stock as at 31st March	23,200

In addition the cost of unsold goods lying with others on our behalf, which were sent before the date of stock taking (*for example*, goods sent to customers before date of stock taking on approval basis but not yet approved till Balance Sheet date) is *added to* the value of physical inventory. Similarly, the cost of unsold goods lying with us on behalf of others, which were received before the date of stock taking (*for example*, Goods received from Consignor before the date of stock taking on consignment basis but not yet sold till Balance Sheet date) is *subtracted from* the value of physical inventory.

ILLUSTRATION 11 [ADJUSTMENT OF GOODS SENT OF APPROVAL BASIS]

The stock was physically verified on 24th March and was valued at ₹ 2,00,000. Goods are normally sold by the trader at a profit of 25% on cost.

Determine the value of stock to be taken to the Balance Sheet of PCT Ltd. as at 31st March in each the following alternative cases:

- Case (a)** On 21st March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks.
- Case (b)** On 21st March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks. He return 20% of the goods on 31st March.
- Case (c)** On 21st March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks. He approved 80% of the goods on 31st March.
- Case (d)** On 21st March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks. He returned 20% of the goods and approved the remaining on 31st March.
- Case (e)** On 21st March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks. He returned 20% of the goods and approved 80% of the remaining on 31st March.
- Case (f)** On 21st March goods of the value of ₹ 1,00,000 were sent on sale or return basis to customer, the period of approval being 2 weeks but it was known that he had pledged 80% of goods with bank on 31st March.

SOLUTION

Case (a)

STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH

<i>Particulars</i>	₹
A. Value of Stock as at 24th March	2,00,000
B. <i>Add:</i> Cost of Goods sent on approval and still with the Customer [Sales – Gross Profit] [₹ 1,00,000, – 20% of ₹ 1,00,000]	80,000
C. Value of Stock on 31st March	2,80,000

Case (b)

STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH

<i>Particulars</i>	₹
A. Value of Stock as at 24th March	2,00,000
B. <i>Add:</i> Cost of Goods sent on approval Received back [20% of ₹ 1,00,000 – 20% of ₹ 20,000] Still with the Customer [80% of ₹ 1,00,000 – 20% of ₹ 80,000]	16,000 64,000
C. Value of Stock as at 31st March	2,80,000

Case (c)

STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH

<i>Particulars</i>	₹
A. Value of Stock as at 24th March	2,00,000
B. <i>Add:</i> Cost of Goods sent on approval and still with customer [20% of ₹ 1,00,000 – 20% of ₹ 20,000]	16,000
C. Value of Stock as at 31st March	2,16,000

Case (d)

STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH

<i>Particulars</i>	₹
A. Value of Stock as at 24th March	2,00,000
B. <i>Add:</i> Cost of Goods sent on approval and received back [20% of ₹ 1,00,000 – 20% of ₹ 20,000]	16,000
C. Value of Stock as at 31st March	2,16,000

Case (e)

STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH

<i>Particulars</i>	₹
A. Value of Stock as at 24th March	2,00,000
B. <i>Add:</i> Cost of Goods sent on approval and received back [20% of ₹ 1,00,000 – 20% of ₹ 20,000] Cost of Goods sent on approval and still with customer [20% of 80% of ₹ 1,00,000 – 20% of ₹ 16,000]	16,000 12,800
C. Value of Stock as at 31st March	2,28,800

Case (f) Same solution as in Case (c)

ILLUSTRATION 12 [ADJUSTMENT OF GOODS SENT OF APPROVAL BASIS]

The stock was physically verified on 24th March and was valued at ₹ 2,00,000. Goods are normally sold by the trader at a profit of 25% on cost.

Determine the value of stock to be taken to the Balance Sheet of PCT Ltd. as at 31st March in each the following alternative cases:

Case (a) On 27th March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks.

Case (b) On 27th March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks. He returned 20% of the goods on 31st March.

Case (c) On 27th March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks. He approved 80% of the goods on 31st March.

Case (d) On 27th March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks. He returned 20% of the goods and approved the remaining on 31st March.

Case (e) On 27th March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks. He returned 20% of the goods and approved 80% of the remaining on 31st March.

Case (f) On 27th March goods of the value of ₹ 1,00,000 were sent on sale or return basis to customer, the period of approval being 2 weeks but it was known that he had pledged 80% of goods with bank on 31st March.

SOLUTION

Case (a) Value of Stock ₹ 2,00,000. No adjustment is required in respect of goods sent on approval since the cost of these goods is already included in the value of Stock as at 24th March.

Case (b) Value of Stock ₹ 2,00,000. No adjustment is required in respect of goods sent on approval since the cost of these goods is already included in the value of Stock as at 24th March.

Case (c)

STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH

Particulars	₹
A Value of Stock as at 24th March	2,00,000
B Less: Cost of those goods sent on approval which have been approved [80% of ₹ 1,00,000 – 20% of ₹ 80,000]	(64,000)
C Value of Stock as on 31st March	1,36,000

Case (d)

STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH

Particulars	₹
A Value of Stock as at 24th March	2,00,000
B Less: Cost of those goods sent on approval which have been approved [80% of ₹ 1,00,000 – 20% of ₹ 80,000]	(64,000)
C Value of Stock as on 31st March	1,36,000

Case (e)

STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH

Particulars	₹
A Value of Stock as at 24th March	2,00,000
B Less: Cost of those goods sent on approval which have been approved [80% of ₹ 1,00,000 – 20% of ₹ 64,000]	(51,200)
C Value of Stock as on 31st March	1,48,800

Case (f) Same solution as in Case (c)

Note: Pledging the goods amounts to approval of goods. [See 24 of the Sale of Goods Act, 1930]

Thus, the necessary adjustments are required to be made in order to restore the position as it would have been as on Balance Sheet Date. A format of the statement showing the computation of value of inventory if physical inventory is taken on a date prior to Balance Sheet Date is given on next page:

STATEMENT SHOWING THE COMPUTATION OF VALUE OF INVENTORY
as on 31st March ...

Particulars		₹
A	Value of Inventory as per books as on (say 24 March)	xxx
B	Less: Cost of Goods Sold and Purchase Returns after stock taking till March 31	(xxx)
C	Add: Cost of unsold goods lying with others on our behalf (which were sent before stock taking)	
	(e.g.) (a) Cost of goods sent on Consignment basis	xxx
	(b) Cost of goods sent on Joint Venture basis	xxx
	(c) Cost of goods sent on Approval basis	xxx
	(d) Cost of Goods set on Hire Purchase basis	xxx
	(e) Cost of goods sent to Branch	xxx
D	Add: Cost of Sales Returns and Purchases made after stock taking till 31st March	
E	Less: Cost of unsold goods lying with us on behalf of others (which were received upto date of stock taking)	
	(e.g.) (a) Cost of goods received on Consignment basis	(xxx)
	(b) Cost of goods received on Joint Venture basis	(xxx)
	(c) Cost of goods received on Approval basis	(xxx)
	(d) Cost of goods received on Hire Purchases basis	(xxx)
F	Value of Inventory as per books as on 31st March	xxx

ILLUSTRATION 13

Determine the value of stock to be taken to the Balance Sheet of Bharat Tulsian Ltd. as at 31st March from the following information:

The stock was physically verified on 24th March and was valued at ₹ 4,00,000. After stock taking, the following transactions had taken place till 31st March:

- (a) Purchases ₹ 2,00,000 out of which 20% goods were returned.
- (b) Sales of Good Units ₹ 2,00,000 out of which 20% goods were returned by the customers.
- (c) Sales of Defective units ₹ 1,80,000 at 10% less than the normal selling price.
- (d) On 26th March goods of the sale value of ₹ 2,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks. He returned 20% of the goods and approved 80% of the remaining on 31st March.
- (e) On 27th March goods of the sale value of ₹ 2,00,000 were sent on consignment basis. 80% of these goods had been sold till 31st March.
- (f) On 28th March goods costing ₹ 2,00,000 were received for sale on consignment basis, 80% of these goods had been sold till 31st March.

Notes:

- (i) Goods are sold by the trader at a profit of 25% on Cost.
- (ii) The sales referred to in (d), (e) and (f) are not included in (b) above.

SOLUTION**STATEMENT SHOWING THE VALUATION OF STOCK AS ON 31ST MARCH**

Particulars		₹
A.	Stock as per physical verification as at 24th March	4,00,000
B.	Add: Cost of Net Goods purchased after stock taking till 31st March [₹ 2,00,000 – 20% of ₹ 2,00,000]	1,60,000
C.	Less: Cost of Net goods sold after stock taking till 31st March	
	Good Units: [80% of (₹ 2,00,000 – 20% of ₹ 2,00,000)]	(1,28,000)
	Defective Units: [80% of (₹ 1,80,000 + 1/9th of ₹ 1,80,000)]	(1,60,000)
	Goods sent on approval {80% of (80% of (₹ 2,00,000 – 20% of ₹ 2,00,000))}	(1,02,400)
	Goods sent on Consignment [80% of (80% of ₹ 2,00,000)]	(1,28,000)
D.	Stock as per books as at 31st March	41,600

Notes:

- (i) As the option period is two weeks, the remaining goods [₹ 32,000 i.e. 20% of (₹ 2,00,000 – 20% of ₹ 2,00,000)] lying with the customers can not be treated as having been sold.
- (ii) No adjustment has been made in respect of goods returned by customer to whom goods were sent on approval basis, goods lying with the customers and the consignee since these goods are already included in stock given as on 24th March.
- (iii) No adjustment has been made in respect of goods received for sale on consignment basis since these goods are not included in stock given as on 24th March.

ILLUSTRATION 14

Determine the value of stock to be taken to the Balance Sheet of Tushar Tulsian Ltd. as at March 31, from the following information:

The stock was physically verified on 24th March and was valued at ₹ 4,00,000. After stock taking, the following transactions had taken place till 31st March.

- (a) Purchases ₹ 2,00,000 out of which 20% of goods were returned.
- (b) Sale of good units ₹ 2,00,000 out of which 20% goods were returned by the customer.
- (c) Sale of defective units ₹ 1,80,000 at 10% less than the normal selling price.
- (d) On 21st March goods of the sale value of ₹ 2,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks. He returned 20% of the goods and approved 80% of the remaining on 31st March.
- (e) On 23rd March goods of the sale value of ₹ 2,00,000 were sent on consignment basis. 80% of these goods had been sold on 31st March.
- (f) On 23rd March goods costing ₹ 2,00,000 were received for sale on consignment basis. 80% of these goods had been sold on 31st March.

Notes:

- (i) Goods are sold by the trader at a profit of 25% on cost.
- (ii) The sales referred to in (d), (e) and (f) are not included in (b) above.

SOLUTION**STATEMENT SHOWING THE VALUATION OF STOCK AS ON 31ST MARCH**

Particulars		₹
A	Stock as per physical verification as at 24th March	4,00,000
B	Add: Cost of Net Goods purchased after stock taking till 31st March [₹ 2,00,000 – 20% of ₹ 2,00,000]	1,60,000
C	Less: Cost of Net Goods sold after stock taking till 31st March Good Units: [80% of (₹ 2,00,000 – 20% of ₹ 2,00,000)] Defective Units: [80% of (₹ 1,80,000 + 1/9th of ₹ 1,80,000)]	(1,28,000) (1,60,000)
D	Add: Cost of goods returned by Customer to whom goods were sent on approval [80% of (20% of ₹ 2,00,000)]	32,000
E	Add: Cost of unsold goods lying with other on our behalf: Goods sent on approval {80% of [20% of (₹ 2,00,000 – 20% of ₹ 2,00,000)] Goods sent on Consignment [80% of (20% of ₹ 2,00,000)]	25,600 32,000
F	Less: Cost of goods received for sale on Consignment basis included in stock given as on 24th March	(2,00,000)
G	Stock as per books as at 31st March	1,61,600

19.0 VALUATION OF INVENTORY AS ON BALANCE SHEET DATE IF THE PHYSICAL INVENTORY HAS BEEN TAKEN ON A DATE AFTER THE BALANCE SHEET DATE.

To ascertain the value of inventory as on Balance Sheet date, the cost of items which are having the effect of higher closing stock as on Balance Sheet Date (*for example*, Purchase Return, Sales after Balance Sheet Date till stock taking) should be *added to* and the cost of items which are having the effect of lower closing stock as on Balance Sheet date (*for example*, Purchases made, Sales Returns after Balance Sheet Date till stock taking) should be *subtracted from* the value of physical inventory.

ILLUSTRATION 15

Determine the value of stock to be taken to the Balance Sheet of BT Ltd. as at March 31st, from the following information:

The stock was physically verified on 7th April and was valued at ₹ 4,00,000. After 31st March the following transactions had taken place till the date of stock-taking:

- Purchases ₹ 2,00,000 out of which 20% goods were returned.
- Sales of ₹ 2,00,000 out of which 20% goods were returned by the customers.

Note: Goods are sold by the trader at a profit of 25% of Cost.

SOLUTION**STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH**

Particulars		₹
A.	Stock as per physical verification as at 7th April	4,00,000
B.	Less: Cost of Net Goods purchased after 31st March till stock taking [₹ 2,00,000 – 20% of ₹ 2,00,000]	(1,60,000)
C.	Add: Cost of Net goods sold after 31st March till stock taking [80% of (₹ 2,00,000 – 20% of ₹ 2,00,000)]	1,28,000
D.	Stock as per books as at 31st March	3,68,000

In addition, the cost of unsold goods lying with others on our behalf which were sent before the Balance Sheet Date (*for example*, Goods sent to Customers before Balance Sheet date on approval basis but not yet approved till Balance Sheet Date) is *added* to the value of physical inventory. Similarly, the cost of goods lying with us on behalf of others which were received before the Balance Sheet date but not yet sold till Balance Sheet date (*for example*, Goods received from consignor before the Balance Sheet date but not yet sold till balance Sheet date) is *subtracted* from the value of physical inventory.

ILLUSTRATION 16 [Adjustment of Goods sent on Approval Basis]

The Stock was physically verified on 7th April and was valued at ₹ 2,00,000. Goods are normally sold by the trader at a profit of 25% on cost.

Determine the value of stock to be taken to the Balance Sheet of PCT Ltd. as at 31st March in each the following alternative cases:

- Case (a) On 27th March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks.
- Case (b) On 27th March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks. He returned 20% of the goods on 6th April.
- Case (c) On 27th March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks. He approved 80% of the goods on 6th April.
- Case (d) On 27th March goods of the sale value of ₹ 1,00,000 were sent on sale of return basis to a customer, the period of approval being two weeks. He returned 20% of the goods and approved the remaining on 6th April.
- Case (e) On 27th March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks. He returned 20% of the goods and approved 80% of the remaining on 6th April.
- Case (f) On 27th March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks. He returned 20% of the goods and approved 80% of the remaining on 8th April.
- Case (g) On 27th March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being 2 weeks but it was known that he has pledged goods worth ₹ 20,000 on 6th April.

SOLUTION

Case (a)

STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH

Particulars		₹
A.	Value of Stock as at 7th April	2,00,000
B.	Add: Cost of goods sent on approval and still with the customers [₹ 1,00,000 – 20% of ₹ 1,00,000]	80,000
C.	Value of Stock as at 31st March	2,80,000

Case (b)

STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH

Particulars	₹
A. Value of Stock as at 7th April	2,00,000
B. Add: Cost of Goods Sent on approval and still with the customer [80% of ₹ 1,00,000 – 20% of ₹ 80,000]	64,000
C. Value of Stock as at 31st March	2,64,000

Note: 20% of the goods is already included in given stock of 7th April.

Case (c) Same solution as given in Case (a).

Case (d) Same solution as given in Case (b).

Case (e) Same solution as given in Case (b).

Case (f) Same solution as given in Case (a).

Case (g) Same solution as given in Case (a).

Thus, the necessary adjustments are required to be made in order to restore the same position as it would have been as on Balance Sheet Date. A format of the statement showing the computation of value of inventory if physical inventory is taken on a date after the Balance Sheet date, is given below:

STATEMENT SHOWING THE COMPUTATION OF VALUE OF INVENTORY AS ON MARCH 31

Particulars	₹
A Value of Inventory as per books as on 7th April	xxx
B Add: Cost of Goods Sold and Purchases Returns after 31st March till stock taking	xxx
C Add: Cost of goods lying with others on our behalf as on 31st March (e.g.) (a) Cost of goods sent on Consignment basis (b) Cost of goods sent on Joint Venture basis (c) Cost of goods sent on Approval basis (d) Cost of goods sent on Hire Purchase basis (e) Cost of goods sent to Branch	xxx xxx xxx xxx xxx
D Less: Cost of Sales Returns and Purchases made after 31st March till stock taking	(xxx)
E Less: Cost of goods lying with us on behalf of others as on 31st March (e.g.) (a) Cost of goods received on Consignment basis (b) Cost of goods received on Joint Venture basis (c) Cost of goods received on Approval basis (d) Cost of goods received on Hire Purchase basis	(xxx) (xxx) (xxx) (xxx)
F Value of Inventory as per books as on 31st March	xxx

ILLUSTRATION 17

Determine the value of stock to be taken to the Balance Sheet of PCT Ltd. as at 31st March from the following information:

The stock was physically verified on 7th April and was valued at ₹ 4,00,000. After 31st March the following transactions had taken place till the date of stock taking.

- (a) Purchases ₹ 2,00,000 out of which 20% goods were returned.

- (b) Sales of good units ₹ 2,00,000 out of which 20% goods were returned by the customers
- (c) Sales of defective units ₹ 1,80,000 at 10% less than the normal selling price.
- (d) On 26th March goods of the sale value of ₹ 2,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks. He returned 20% of the goods and approved 80% of the remaining on 6th April.
- (e) On 27th March goods of the sales value of ₹ 2,00,000 were sent on consignment basis. 80% of these goods had been sold on 6th April.
- (f) On 28th March goods costing ₹ 2,00,000 were received for sale on consignment basis. 80% of these goods had been sold on 6th April.

Notes:

- (i) Goods are sold by the trader at a profit of 25% on cost.
- (ii) The sales referred to in (d), (e) & (f) are not included in (b) above.

SOLUTION**STATEMENT SHOWING THE VALUATION OF STOCK AS ON 31ST MARCH**

Particulars		₹
A	Stock as per physical verification as at 7th April	4,00,000
B	Less: Cost of Net goods purchased after 31st March till stock taking [₹ 2,00,000 – 20% of ₹ 2,00,000]	(1,60,000)
C	Add: Cost of Net goods sold after 31st March till Stock taking Good Units: [80% of (₹ 2,00,000 – 20% of ₹ 2,00,000)] Defective units: [80% of (₹ 1,80,000 + 1/9th of ₹ 1,80,000)]	1,28,000 1,60,000
D	Add: Cost of goods lying with others on our behalf as on 31st March Goods sent as approval [80% of (₹ 2,00,000 – 20% of ₹ 2,00,000)] Goods sent on consignment [80% of ₹ 2,00,000]	1,28,000 1,60,000
E	Less: Cost of goods lying with as on behalf of others Goods received for sale on consignment basis [20% of ₹ 2,00,000]	(40,000)
F	Stock as per books as at 31st March	7,76,000

Notes:

- (i) No adjustment has been made in respect of goods returned by customers to whom goods were sent on approval basis since these goods are already included in the stock given as on 7th April.
- (ii) No adjustment has been made in respect of goods sold out of those received for sale on consignment basis since these goods are not included in the stock given as on 7th April.

ILLUSTRATION 18

Determine the value of stock to be taken to the Balance Sheet of BT Ltd. as at March 31, from the following information:

The stock was physically verified on 7th April and was valued at ₹ 4,00,000. After 31st March the following transactions had taken place till the date of stock-taking:

- (a) Purchases ₹ 2,00,000 out of which 20% goods were returned.
- (b) Sales of good units ₹ 2,00,000 out of which 20% goods were returned by the customers.
- (c) Sales of defective limits ₹ 1,80,000 at 10% less than the normal selling price.

- (d) On 1st April, goods of the sale value of ₹ 2,00,000 were sent a sale or return basis to a customer, the period of approval being two weeks. He returned 20% of the goods and approved 80% of the remaining on 6th April.
- (e) On 2nd April, goods of the sale value of ₹ 2,00,000 were sent on consignment basis. 80% of these goods had been sold by 6th April.
- (f) On 3rd April, goods costing ₹ 2,00,000 were received for sale on consignment basis. 80% of there goods had been sold by 6th April.

Notes:

- (i) Goods are sold by the trader at a profit of 25% or Cost.
- (ii) The sales referred to in (d), (e) & (f) are not included in (b) above.

SOLUTION**STATEMENT SHOWING THE VALUATION OF STOCK AS ON 31ST MARCH**

Particulars		₹
A	Stock as per physical verification as at 7th April	4,00,000
B	Less: Cost of Net goods purchased after 31st March till stock taking [₹ 2,00,000 – 20% of ₹ 2,00,000]	(1,60,000)
C	Add: Cost of Net goods sold after 31st March till stock taking Goods Units: [80% of (₹ 2,00,000 – 20% of ₹ 2,00,000)] Defective Units: [80% of (₹ 1,80,000 + 1/9th of ₹ 1,80,000)]	1,28,000 1,60,000
D	Add: Cost of Net goods sent to others after 31st March till stock taking: Goods sent on approval: [80% of (₹ 2,00,000 – 20% of ₹ 2,00,000)] Goods sent on Consignment [80% of ₹ 2,00,000]	1,28,000 1,60,000
E	Less: Goods received for sale on Consignment basis & still remaining unsold [20% of ₹ 2,00,000]	(40,000)
F	Stock as per books as at 31st March	7,76,000

Notes:

- (i) No adjustment has been made in respect of goods returned by customers to whom goods were sent on approval basis since these goods are already included in the stock given as on 7th April.
- (ii) No adjustment has been made in respect of goods sold out of those received for sale on consignment basis since there goods are not included in the stock given as on 7th April.

ILLUSTRATION 19

The draft Profit & Loss Account of Bharat Tulsian showed a net profit of ₹ 1,02,800 after considering the closing stock of ₹ 67,500 on 31st March. Subsequently the following information was obtained from the scrutiny of the books.

- (a) The proprietor has taken goods costing ₹ 1,000 for his personal use without making entry in the books.
- (b) The proprietor has given away goods costing ₹ 1,000 as free samples for which no entry was made in the books of accounts.
- (c) Purchases for the year included a purchase of furniture costing ₹ 200 on 31st March.

- (d) Sales included a sale of furniture having a book value of ₹ 900 for ₹ 850 on 31st March .
- (e) Invoices for goods costing ₹ 1,700 have been entered on 26th March but the goods have not yet been received till 31st March .
- (f) Goods costing ₹ 4,000 have been purchased and received on 27th March but the invoices have not yet been recorded till 31st March .
- (g) Invoices of goods of ₹ 1,000 (Cost ₹ 800) were entered on 28th March but the goods were not delivered till 31st March.
- (h) Goods of ₹ 4,000 (Cost ₹ 3,200) sold and delivered on 29th March but the invoices were not entered till 31st March.
- (i) Goods (Cost ₹ 2,880, selling price ₹ 3,600) were returned by Ram, a customer on 30th March and were taken into stock on the same date but no entry was passed in the books.
- (j) Stock at the end does not include the goods (cost ₹ 6,000, Selling Price ₹ 7,500) returned by Shayam a customer for which the entry has already been passed.
- (k) On 26th March goods of the sale value of ₹ 2,00,000 were sent on sale or return basis to Gopal, a customer, the period of approval being two weeks. He returned 20% of the goods and approved 80% of the remaining on 31st March. These goods were sent at a profit of 25% on cost.

Required: Calculate the value of stock on 31st March and the adjusted net profit for the year ended on that date.

SOLUTION

STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH

Particulars		₹
A	Stock as already stated	67,500
B	Add: Cost of Goods purchased but not yet received	1,700
C	Less: Cost of Goods sold but not yet delivered	(800)
D	Add: Cost of Goods returned by a customer now included	6,000
E	Add: Cost of Goods sent on approval (neither returned nor retained)	25,600
F	Stock as on 31st March	1,00,000

DR.

PROFIT & LOSS ADJUSTMENT ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Furniture A/c (Sale of Furniture)	850	By Profit as per P & L A/c	1,02,800
To Furniture A/c (Loss on Sale of Furniture)	50	By Drawings (Goods for Personal Use)	1,000
To Creditors for Goods A/c (Omitted purchases)	4,000	By Furniture A/c (Purchase of furniture)	200
To Closing Stock A/c	800	By Closing Stock (in transit) A/c	1700
To Ram (Omitted Sales Return)	3,600	By Debtors A/c (Omitted Sales)	4,000
To Gopal (Cancellation of Sales) (Goods sold but not delivered)	32,000	By Closing Stock A/c (Good returned, included)	6,000
To Adjusted Net Profit for the year	1,00,000	By Closing Stock A/c (Cost of Goods neither returned nor retained)	25,600
	1,41,300		1,41,300

20.0 STOCK AS PER BOOKS AND STOCK AS PER PHYSICAL VERIFICATION**REASONS FOR DIFFERENCE**

Stock as per books may be different from the stock found as per physical verification because of any or more of the following reasons:

- Goods sold and recorded in the books but not delivered or vice versa,
- Goods purchased and recorded in the books but not received or vice versa,
- Returns inwards received but not recorded in the books or vice versa,
- Return outwards despatched but not recorded in the books or vice versa.

**STATEMENT SHOWING THE COMPUTATION OF VALUE OF INVENTORY IF THE
PHYSICAL INVENTORY IS TAKEN ON A DATE (SAY 7TH APRIL) AFTER THE
BALANCE SHEET DATE (SAY 31ST MARCH)**

<i>Particulars</i>		₹
A	Value of Physical Inventory as on 7th April	xxx
B	Add: Cost of goods delivered in respect of Sales and Returns outwards after 31st March till stock taking	xxx
C	Less: Cost of goods received in respect of Sales Returns and Purchases made after 31st March till Stock taking.	(xxx)
D	Value of Inventory as on 31st March	xxx

**STATEMENT SHOWING THE COMPUTATION OF VALUE OF INVENTORY IF THE
PHYSICAL INVENTORY IS TAKEN ON A DATE (SAY 24TH MARCH) PRIOR TO
THE BALANCE SHEET DATE (SAY 31 ST MARCH)**

<i>Particulars</i>		₹
A	Value of Physical Inventory as on 24th March	xxx
B	Add: Cost of goods purchased after stock taking till 31st March [whether or not received]	xxx
C	Add: Cost of Sales Returns after stock taking till 31st March [whether or not received]	xxx
D	Less: Cost of goods sold after stock taking till 31st March [whether or not delivered]	(xxx)
E	Less: Cost of Purchase Returns after stock taking till 31st March [whether or not delivered]	(xxx)
F	Value of Inventory as on 31st March	xxx

Note: In examination problems, either the stock as per books or as per physical verification is given. To determine the value of stock as on a given date, the necessary adjustments should be made accordingly keeping in mind whether the stock as per books or as per physical verification is given.

ILLUSTRATION 20

Determine the value of stock as per books of BT Ltd at 31st March from the following information:

- The cost of stock as per physical verification as on 24th March amounted to ₹ 2,00,000.
- Purchases as per Purchase Book after stock taking till 31st March amounted to ₹ 2,00,000 and included the following:

- (i) ₹ 10,000 for goods received till 23rd March
- (ii) ₹ 20,000 for goods received on 1st April.
- (c) Sales as per Sales Book after stock taking, till 31st March amounted to ₹ 2,00,000 and included the following:
 - (i) ₹ 10,000 for goods delivered till 23rd March
 - (ii) ₹ 20,000 for goods delivered on 1st April.
- (d) Goods are sold by the trader at a profit of 25% on Cost.

SOLUTION**STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH**

<i>Particulars</i>	₹
A. Stock as per physical verification as at 24th March	2,00,000
B. <i>Add:</i> Cost of goods purchased after stock taking till 31st March (whether or not received) [₹ 2,00,000 – ₹ 10,000 (being already received)]	1,90,000
C. <i>Less:</i> Cost of goods sold after stock taking till 31st March (whether or not delivered) [80% of (₹ 2,00,000 – ₹ 10,000) (being already delivered)]	(1,52,000)
D Stock as per Books as at 31st March	2,38,000

ILLUSTRATION 21

Determine the cost of physical stock as at 31st March in Illustration 20.

SOLUTION**STATEMENT SHOWING THE COST OF PHYSICAL STOCK AS AT 31ST MARCH**

<i>Particulars</i>	₹
A. Stock as per physical verification as at 24th March	2,00,000
B. <i>Add:</i> Cost of Goods purchased and received after stock taking till 31st March [₹ 2,00,000 – ₹ 10,000 (being already received) – ₹ 20,000 (being not yet received)]	1,70,000
C. <i>Less:</i> Cost of goods sold and delivered after stock taking till 31st March [80% of ₹ 2,00,000 – ₹ 10,000 being already delivered – ₹ 20,000 (being not yet delivered)]	(1,36,000)
D Cost of Physical Stock in hand as at 31st March	2,34,000

ILLUSTRATION 22

Determine the value of stock as per books of BT Ltd. as at 31st March 2018 from the following information.

- (a) The Cost of Stock as per physical verification as on 7th April amounted to ₹ 2,00,000
- (b) Purchases as per Purchases Book per the period from 1st April to 7th April amounted to ₹ 2,00,000 and included the following:
 - (i) ₹ 10,000 for goods received till 31st March.
 - (ii) ₹ 20,000 for goods received on 8th April.

- (c) Sales as per Sales Book for the period from 1st April to 7th April amounted to ₹ 2,00,000 and included the following:
- (i) ₹ 10,000 for goods delivered on 31st March.
 - (ii) ₹ 20,000 for goods delivered on 8th April
- (d) Goods are sold by the trader at a profit of 25% on cost.

SOLUTION:**STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH, 2018**

<i>Particulars</i>		₹
A.	Stock as per physical verification as at 7th April	2,00,000
B.	Less: Cost of goods received in respect of purchases between 1st April and 7th April [₹ 2,00,000 – ₹ 20,000]	1,80,000
C.	Add: Cost of goods delivered in respect of sales between 1st April and 7th April [80% of (₹ 2,00,000 – ₹ 20,000)]	1,44,000
D.	Stock as per books as at 31st March [A – B + C]	1,64,000

ILLUSTRATION 23

The accounting year of Mr X ends on March 31, 2018 but the stock on hand was physically verified only on 15th April. You are required to determine the value of closing stock (at cost) as on 31st March from the following information:

- (a) The physical stock (value at cost) was ₹ 50,000.
- (b) The purchases from 1st April to 15th April amounted to ₹ 8,000 of which goods costing ₹ 1,000 were received on 16th April.
- (c) The sales from 1st April to 15th April amounted to ₹ 21,500 including the following:
 - (i) Goods sent on consignment ₹ 12,500 at invoice price which is made up of cost *plus* 25%.
 - (ii) Goods sent to own branch at invoice price ₹ 4,200. Invoice is made at profit of 20% on cost.
 - (iii) Goods sold for ₹ 800 at a loss of 20% on cost due to damage on 31st March.
 - (iv) Other sales are at a profit of 1/3rd of cost.
 - (v) Goods (sold for ₹ 2,500) were delivered to the customers on 16th April.
- (d) On 15th March, goods of the value of ₹ 10,000 were sent on sale or return basis to a customer, the period of approval being 4 weeks. He returned 40% of the goods on 10th April, approving the rest, the customer was invoiced on 16th April. Mr X makes a profit of 20% on such sales.
- (e) On 15th March, Mr X had received goods costing ₹ 8,000 for sale on consignment basis; 20% of the goods had been sold by 31st March, and another 50% by 15th April.

The sales referred to in (d) and (e) are not included in (c) above.

SOLUTION:**COMPUTATION OF VALUE OF STOCK AS ON 31ST MARCH, 2018**

<i>Particulars</i>		₹
A	Physical Stock as at 15th April	50,000
B	Add: Cost of Goods sold and delivered after 31st March till stock taking	
	(i) Goods sent on consignment (80% of ₹ 12,500)	10,000
	(ii) Goods sent to branch (5/6th of ₹ 4,200)	3,500
	(iii) Damaged Goods (Valued at realizable value)	800
	(iv) Other goods 75% of (₹ 4,000 – 2,500)	1,125

C	Add: Cost of goods sent on approval basis ($6,000 \times 80\%$)	4,800
D	Less: Cost of goods received on consignment basis (30% of ₹ 8,000)	2,400
E	Less: Cost of goods purchased and received after 31st March till stock taking	7,000
F	Stock as at 31st March	60,825

ILLUSTRATION 24

A company closed its accounts on 31st March each year. It could not complete the physical verification of stock on 31st March, 2018; which continued upto 7th April. The stock as disclosed by the books was ₹ 2,00,000. The following facts came to notice during physical verification:

- (a) Goods received on consignment amounting to ₹ 10,000 was included in stock;
- (b) Sales from 1st April to 7th April, amounted to ₹ 21,500 and included the following:
 - (i) Goods sent on consignment: ₹ 12,500 at invoice price, which is made up of cost plus 25%.
 - (ii) Goods sent to branch at invoice price ₹ 4,200. Invoice price is calculated at a profit of 1/6th of the sale.
 - (iii) Other sales are at a profit for 1/3rd of cost.
 - (iv) Damaged Goods were sold for ₹ 800 at a loss of 20% of cost.
- (c) Goods amounting to ₹ 18,000 have been received in the stores before 31st March but passed through the books on 6th April
- (d) Invoices were issued for ₹ 2,800 on 1st April. but goods had not been delivered till 7th April. These sales are not included in (b) above.

Determine the value of stock to be taken for the purpose of preparing the final accounts of the company for the year ended on 31st March, 2018.

SOLUTION:**STATEMENT SHOWING THE COMPUTATION OF VALUE OF STOCK ON 31ST MARCH, 2018**

Particulars		₹
A	Stock disclosed as per books as on 7th April	2,00,000
B	Less: Goods received on consignment included in stock	10,000
	Less: Goods received but not recorded	18,000
C	Add: Cost of Sales from 1st April. to 7th April	
	Goods sent on consignment ($₹ 12,500 \times 100/25$)	10,000
	Goods sent to Branch ($₹ 4,200 - ₹ 700$)	3,500
	Goods sold at loss (damaged stock is to be valued not at cost but at possible realisable value, on the date of balance sheet, which may be taken as ₹ 800)	800
	Other Goods ($4,000 \times 3/4$)	3,000
	Cost of Goods sold but not delivered ($₹ 2,800 \times 3/4$)	2,100
D	Stock for Balance Sheet purpose as on 31st March 7 (A – B + C)	1,91,400

Note: Here Stock as per books is given, and not as per physical verification.

ILLUSTRATION 25

From the following information ascertain the value of stock as on 31st March, 2018 and also the profit for the year:

Stock as on 1.4.2017	₹ 20,750	Administrative Expenses	₹ 3,000
Purchases	₹ 76,250	Financial Charges	₹ 2,150
Manufacturing Expenses	₹ 15,000	Sales	₹ 1,24,500
Selling Expenses	₹ 6,050		

At the time of valuing stock as on 31st March, 2017, a sum of ₹ 5,250 was written off on a particular item, which was originally purchased for ₹ 15,000 and One-third of these goods were sold during the year for ₹ 4,500. Manufacturing Expenses are attributable to current year 's purchases only. Barring the transaction relating to this item, the gross profit earned during the year was 20 percent on sales.

SOLUTION:**STATEMENT SHOWING THE VALUE OF STOCK AS ON 31ST MARCH 2018**

<i>Particulars</i>	<i>Normal Item</i> ₹	<i>Abnormal Item</i> ₹	<i>Total</i> ₹
A Opening Stock	11,000	9,750	20,750
B Add: Purchases	76,250	—	76,250
C Add: Manufacturing Expenses	15,000		15,000
D Less: Cost of goods sold:			
Normal [80% (₹1,24,500 - ₹ 4,500)]	(96,000)		(96,000)
Abnormal [1/3 of (₹15,000 - ₹ 5,250)]		(₹3,250)	(₹3,250)
E Value of Closing Stock	6,250	6,500	12,750

Thus, Book value of Closing Stock ₹ 12,750.

STATEMENT SHOWING NET PROFIT FOR THE YEAR

<i>Particulars</i>	₹	₹
A. Gross Profit on Normal Sales		24,000
B. Add: Profit on abnormal item [₹4,500 - ₹ 3,250]		1,250
C. Less: Overhead Expenses:		
Selling Expenses	6,050	
Administrative Expenses	3,000	
Financial Charges	2,150	11,200
D. Net Profit		14,050

ILLUSTRATION 26

The Profit and Loss Account of Hanuman showed a net profit of ₹ 60,000, after considering the closing stock of ₹ 37,500 on 31st March, 2018. Subsequently the following information was obtained from scrutiny of the books:

- Purchases for the year included ₹ 1,500 paid for new electric fittings for the shop.
- Hanuman gave away goods of sale value of ₹ 4,000, as free samples and took away goods of sale value of ₹ 2,000 for his personal use for which no entries were made in the books of accounts.

- (iii) Invoices for goods amounting to ₹ 25,000 have been entered on 27th March, but the goods were not included in stock.
- (iv) In March, goods of ₹ 20,000 sold and delivered were taken in the Sales for April, 2018.
- (v) ₹ 500 have been included in closing stock in respect of goods purchased and invoiced on 28th March, but included in purchase for April 2018.
- (vi) Goods of the value of ₹ 14,000 were sent on sale or return on 9th March, 2018 at a margin of profit of $33\frac{1}{3}\%$ on cost. The customers had the right of returning the goods within four weeks but it was known that one customer who had goods worth ₹ 4,000 had pledged them with a bank on 30th March, 2018.

Required: Calculate the value of stock on 31st March, 2018 and the Adjusted Net Profit for the year ended on that date.

SOLUTION:

STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH, 2018

Particulars		₹
A	Stock as already stated	37,500
B	Add: Purchases not included	25,000
C	Add: Cost of Goods sent on approval [75% of (₹ 14,000 - ₹ 4,000)]	7,500
D	Stock as on 31st March 2018	70,000

DR.

PROFIT & LOSS ADJUSTMENT ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Suppliers A/c	500	By Profit as per P & L A/c	60,000
To Customer's A/c (Sale value of Goods sent on approval)	10,000	By Fixtures & Fittings A/c	1,500
To Net Profit for the year	1,05,000	By Drawings A/c (Goods taken) [75% of ₹ 2,000]	1,500
		By Closing Stock (in transit) A/c	25,000
		By Customer's A/c	20,000
		By Closing Stock with customer (on approval)	7,500
	1,15,500		1,15,500

Notes:

- Since the rectifying entry in case of free samples involves both the revenue accounts (i.e. Advertisement A/c and Purchases A/c). Profit & Loss Adjustment A/c is to be debited as well as credited and hence not shown in the above account.
- Pledge of goods amounts to acceptance of goods.

SOLVED PROBLEMS

PROBLEM 1

A company, started on April 1, 2017 purchased raw material during 2017-2018 as stated below:

April 2	800 kg	@ ₹ 62 per kg
May 26	1,200 kg	@ ₹ 57 per kg
July 13	2,500 kg	@ ₹ 59 per kg
Oct. 10	3,000 kg	@ ₹ 56 per kg
Dec. 18	1,500 kg	@ ₹ 60 per kg
Feb. 29	1,000 kg	@ ₹ 65 per kg

While preparing its final accounts on March 31, 2018 the company had 1,300 kg of raw material in its godown.

Calculate the values of closing stock of raw materials according to—

- (i) 'First in First Out' basis,
- (ii) 'Last in First Out' basis, and
- (iii) 'Weighted Average' basis.

SOLUTION

VALUATION OF CLOSING STOCK

Particulars	₹
I. On FIFO basis	
1,000 kg @ ₹ 65 per kg	65,000
300 kg @ ₹ 60 per kg	18,000
Value of Closing Stock	83,000
II. On LIFO basis	
800 kg @ ₹ 62 per kg	49,600
500 kg @ ₹ 57 per kg	28,500
Value of Closing Stock	78,100

III. On Weighted Average basis

Weighted Average Cost is computed as under:

Date of Purchase	Price ₹	Quantity	Price × Quantity ₹
Apr. 2, 2017	62	800	49,600
May 26, 2017	57	1,200	68,400
July 13, 2017	59	2,500	1,47,500
Oct. 10, 2017	56	3,000	1,68,000
Dec. 18, 2017	60	1,500	90,000
Feb. 29, 2018	65	1,000	65,000
		10,000	5,88,500

Weighted Average Price = $5,88,500 / 10,000 = ₹ 58.85$ Kg

Value of Closing Stock, viz., 1,300 Kg = $1,300 \times ₹ 58.85 = ₹ 76,505$

PROBLEM 2

The following are the details of a spare part of Sriram Mills:

01.01.2018	Opening stock	Nil
01.01.2018	Purchases	100 units @ ₹ 30 per unit
15.01.2018	Issued for consumption	50 units
01.02.2018	Purchases	200 units @ ₹ 40 per unit
15.02.2018	Issued for consumption	100 units
20.02.2018	Issued for consumption	100 units
01.03.2018	Purchases	150 units @ ₹ 50 per unit
15.03.2018	Issued for consumption	100 units

Required: Find out the Value of Stock as on 31.03.2018 if the company follows:

(a) First in First Out basis; (b) Last in First Out basis; (c) Weighted Average basis.

SOLUTION**(A) STOCK LEDGER (ON FIFO BASIS)**

Date	Receipts			Sales			Balance		
	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹
01.01.2018	Balance								Nil
01.01.2018	100	30	3,000				100	30	3,000
15.01.2018				50	30	1,500	50	30	1,500
01.02.2018	200	40	8,000				50	30	1,500
							200	40	8,000
15.02.2018				50	30	1,500			
				50	40	2,000	150	40	6,000
20.02.2018				100	40	4,000	50	40	2,000
01.03.2018	150	50	7,500				50	40	2,000
							150	50	7,500
15.03.2018				50	40	2,000			
				50	50	2,500	100	50	5,000

Therefore, the Value of Stock as on 31.3.2018: 100 units @ ₹ 50 = ₹ 5,000.

(B) STOCK LEDGER (ON LIFO BASIS)

Date	Receipts			Sales			Balance		
	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹
01.01.2018	Balance								Nil
01.01.2018	100	30	3,000				100	30	3,000
15.01.2018				50	30	1,500	50	30	1,500
01.02.2018	200	40	8,000				50	30	1,500
							200	40	8,000

15.02.2018				100	40	4,000	50	30	1,500
							100	40	4,000
20.02.2018				100	40	4,000	50	30	1,500
01.03.2018	150	50	7,500				50	30	1,500
							150	50	7,500
15.03.2018				100	50	5,000	50	30	1,500
							50	50	2,500

Therefore, the Value of Stock as on 31.3.2018

$$= [50 \text{ units @ ₹ 30} + 50 \text{ units @ ₹ 50}] = ₹ 4,000$$

(C) STOCK LEDGER (ON WEIGHTED AVERAGE BASIS)

Date	Receipts			Sales			Balance		
	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹
01.01.2018	Balance								Nil
01.01.2018	100	30	3,000				100	30	3,000
15.01.2018				50	30	1,500	50	30	1,500
01.02.2018	200	40	8,000				250	38	9,500
15.02.2018				100	38	3,800	150	38	5,700
20.02.2018				100	38	3,800	50	38	1,900
01.03.2018	150	50	7,500				200	47	9,400
15.03.2018				100	47	4,700	100	47	4,700

Therefore, the Value of Stock as on 31.3.2018

$$= 100 \text{ units @ ₹ 47} = ₹ 4,700.$$

PROBLEM 3

In pricing the petrol sold, service station X follows FIFO while service station Y follows LIFO. On April 1st 2018 both had the same quantity of petrol in stock, viz. 8,000 litres at ₹ 25 per litre. During April each station purchased additional supplies of 3,000 litres at ₹ 26 per litre. Sales for each of these stations during the month were 10,000 litres at ₹ 27 per litre. Calculate for each service station the profit earned during the month and the value of petrol in stock at the end of the month.

SOLUTION

SERVICE STATION X (USING FIFO METHOD)

Particulars	₹
A. Opening Stock 8,000 litres @ ₹ 25	2,00,000
B. Purchases 3,000 litres @ ₹ 26	78,000
C. Less: Value of Closing Stock: [1,000 litres @ ₹ 26]	(26,000)
D. Cost of Sales [A + B – C]	2,52,000
E. Sales 10,000 litres @ ₹ 27	2,70,000
F. Profit during April [E – D]	18,000

SERVICE STATION Y (USING LIFO METHOD)

<i>Particulars</i>	<i>₹</i>
A. Opening Stock 8,000 litres @ ₹ 25	2,00,000
B. Purchases 3,000 litres @ ₹ 26	78,000
C. Less: Value of Closing Stock: [1,000 litres @ ₹ 25]	(25,000)
D. Cost of Sales [A + B – C]	2,53,000
E. Sales: 10,000 litres @ ₹ 27	2,70,000
F. Profit during April [E – D]	17,000

PROBLEM 4

Oil India is a bulk distribution of high octane petrol. A periodic inventory of period on hand is taken when the books are closed at the end of each month. The following summary of information is available for the month.

Sales (between 2nd and 29th June)	₹ 9,45,000	Purchases (including freight in-ward):
General administration cost	₹ 25,000	June 1 2,00,000 litres @ ₹ 2.85 per litre
Opening stock: 1,00,000 litres		June 30 1,00,000 litres @ ₹ 3.03 per litre
@ ₹ 3 per litre	₹ 3,00,000	June 30 Closing stock 1,30,000 litres

Compute the following data by FIFO, LIFO and Weighted Average Method of inventory costing:

- Value of inventory on June 30
- Amount of the cost of goods sold for June (c) Profit or loss for June.

SOLUTION**VALUE OF CLOSING STOCK, COST OF GOODS SOLD AND PROFIT**

<i>Particulars</i>	<i>FIFO ₹</i>	<i>LIFO ₹</i>	<i>Weighted Average ₹</i>
(a) Value of Closing Stock:			
1,00,000 litres @ ₹ 3.03	3,03,000		
30,000 litres @ ₹ 2.85	85,500		
30,000 litres @ ₹ 3.00		90,000	
1,00,000 litres @ ₹ 3.03		3,03,000	
1,30,000 litres @ ₹ 3			3,90,000
	3,88,500	3,93,000	3,90,000
(b) Cost of Goods Sold:			
Opening Stock	3,00,000	3,00,000	3,00,000
Add: Purchases (5,70,000 + 3,03,000)	8,73,000	8,73,000	8,73,000
Less: Closing Stock	3,88,500	3,93,000	3,90,000
	7,84,500	7,80,000	7,83,000
(c) Profit:			
Cost of goods sold	7,84,500	7,80,000	7,83,000
Add: General Adm. cost	25,000	25,000	25,000
Total Cost	8,09,500	8,05,000	8,08,000
Sales	9,45,000	9,45,000	9,45,000
Profit	1,35,500	1,40,000	1,37,000

Working Notes:

- (i) Weighted Average Price on First Purchase = $\frac{(1,00,000 \times 3) + (2,00,000 \times 2.85)}{1,00,000 + 2,00,000}$
 $= 8,70,000/3,00,000 = ₹ 2.90$ per litre
- (ii) Balance after issue = $1,00,000 + 2,00,000 - 2,70,000 = 30,000$ litres
- (iii) Weighted Average Price on last Purchase = $\frac{(30,000 \times 2.90) + (1,00,000 \times 3.03)}{30,000 + 1,00,000}$
 $= 3,90,000/1,30,000 = ₹ 3$ per litre

Note: No sale has taken place out of Purchases on 30th June since sales are given between 2nd and 29th June.

PROBLEM 5

Unsold units with Agent	1,000
Cost per unit	₹ 10
Estimated Selling Price per unit as at Balance Sheet Date	₹ 8
Agent's Commission on Sales 5%	
What should be the Value of Closing Stock?	

SOLUTION

I. Cost of Closing Stock (1,000 × ₹ 10)	₹ 10,000
II. Net Realizable Value	
A. Total Realizable Value (1,000 × ₹ 8)	₹ 8,000
B. Less: Realizable Expenses (here agent's commission is realizable expense) (₹ 8,000 × 5/100)	₹ 400
C. Net Realizable Value (A – B)	₹ 7,600
III. Valuation since out of cost (which is ₹ 10,000 as calculated above) and NRV (which is ₹ 7,600), NRV is lower, the said unsold stock should be valued at ₹ 7,600.	

PROBLEM 6

Best Ltd. deals in five products, P, Q, R, S, and T which are neither similar nor interchangeable. At the time of closing of its accounts for the year ending 31st March 2018, the historical cost and net realizable value of the items of the closing stock are determined as follows:

Items	Historical Cost ₹	Net Realizable Value ₹
P	5,70,000	4,75,000
Q	9,80,000	10,32,000
R	3,16,000	2,89,000
S	4,25,000	4,25,000
T	1,60,000	2,15,000

What will be the value of closing stock as at 31st March 2018 as per AS 2 "Valuation of Inventories"?

SOLUTION

As per para 5 of AS 2 "Valuation of Inventories, inventories should be valued at the lower of cost and net realizable value. Inventories should be written down to net realizable value on an item-by-item basis.

VALUATION OF INVENTORY (ITEM WISE) AS AT 31ST MARCH 2018

Item	Historical Cost ₹	Net realizable value ₹	Valuation of closing stock ₹
P	5,70,000	4,75,000	4,75,000
Q	9,80,000	10,32,000	9,80,000
R	3,16,000	2,89,000	2,89,000
S	4,25,000	4,25,000	4,25,000
T	1,60,000	2,15,000	1,60,000
			23,29,000

The value of inventory as at 31st March 2018 = ₹ 23,29,000.

PROBLEM 7

On account of unavoidable circumstances M/s. Mahesh Electricals could not do stock taking on 31.03.2018. However, the stock was taken on April 10th. The following are details of transactions from April 1st to 10th on which day Inventory was taken:

Purchases in April upto 10 April ₹ 45,000; Goods received after 10th April ₹ 5,000; Purchases returns ₹ 3,000; Purchases include special items for ₹ 11,000; Sales ₹ 80,000; Sales Returns ₹ 2,000; Sales of Goods invoiced but delivered after 10th April ₹ 8,000; Sales include half the quantity of special items for ₹ 6,600; balance left in stock; Gross Profit Ratio 25%; Inventory taken on 10th April ₹ 1,75,000. Find out the value of stock as on 31.03.2018.

SOLUTION:**STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH 2018**

Particulars	₹
A. Physical Stock as at 10th April	1,75,000
B. Less: Cost of Net Goods Purchased & received from 1st to 10th April [₹ 45,000 – ₹ 5,000 – ₹ 3,000]	(37,000)
C. Add: Cost of Net Sales of normal items not despatched from 1st to 10th April	
Total Sales	₹ 80,000
Less: Sale of Special item	₹ 6600
Less: Sales Return	₹ 2000
Less: Not yet Delivered	₹ 8020
Net Sales Delivered	63,400
Less: Gross Profit @25%	15,850
D. Add: Cost of Special Items	5,500
E. Value of Stock as per Books as at 31st March	1,91,050

PROBLEM 8

Alpha Limited prepared accounts up to 31st March each year. On 31st March 2018, its stock-taking could not be undertaken until 3rd April, 2018 on which date the stock at cost amounted to ₹ 2,40,000.

An examination of inventories and related financial records disclosed that between 1st and 3rd April:

- Sales totalled ₹ 40,000 including (i) ₹ 2,000 in respect of goods which left the warehouse on 29th March, and (ii) ₹ 4,000 in respect of goods not delivered until 12th April. The rate of gross profit to sales was 30%.

- (b) Returns from customers totalled ₹ 6,000.
- (c) Purchases totalled ₹ 18,000 which included: (i) ₹ 6,000 for goods received in March, and (ii) ₹ 3,000 for goods received on 10th April.
- (d) Returns to suppliers totalled ₹ 4,000.
- (e) There were arithmetical errors in the stock on 3rd April, resulting in an overvaluation of ₹ 4,600.

Required: Statement of Company's stock at cost on March 31, 2018.

SOLUTION:

STATEMENT SHOWING THE VALUATION OF STOCK AS ON 31ST MARCH, 2018

<i>Particulars</i>		₹
A	Stock as on 3rd April	2,40,000
B	Less: Errors of over valuation	4,600
C	Add: Cost of Goods sold & delivered after 31st March till stock taking [70% of (₹ 40,000 – ₹ 4,000)]	25,200
D	Add: Purchases Returns	4,000
E	Less: Cost of goods Purchased and received after 31st March (₹ 18,000 – ₹ 3,000)	15,000
F	Less: Cost of Sales Returns (₹ 6,000 – ₹ 1,800)	4,200
G	Stock as on 31st March	2,45,400

PROBLEM 9

The financial year of Shri X ends on 31st March, 2018, but the stock in hand was physically verified only on 7th April. You are required to determine the value of closing stock (at cost) as on 31st March from the following information:

- (a) The stock (valued at cost) as verified on 7th April, was ₹ 15,000.
- (b) Sales have been entered in the sales day book only after the despatch of goods and sales returns only on receipt of goods.
- (c) Purchases have been entered in the purchases day book on receipt of the purchases invoice irrespective of the date of receipt of goods.
- (d) Sales as per the sales day book for the period 1st April to 7th April (before the actual verification) amounted to ₹ 6,000, of which goods of the sale value of ₹ 1,000 had not been delivered at the time of verification.
- (e) Purchases as per the purchases day book for the period 1st April to 7th April (before the actual verification) amounted to ₹ 6,000 of which goods for purchases of ₹ 1,500 had not been received at the date of verification and goods for purchases of ₹ 2,000 had been received prior to 31st March.
- (f) In respect of goods costing ₹ 5,000 received prior to 31st March, invoices had not been received up to the date of verification of stocks.
- (g) The gross profits is 20% on sales.

SOLUTION:**STATEMENT SHOWING THE VALUATION OF STOCK AS ON 31ST MARCH, 2018**

Particulars		₹
A	Stock on 7th April	15,000
B	Add: Cost of Goods sold & delivered after 31st March till stock taking [80% of (₹ 6,000 – ₹ 1,000)]	4,000
C	Less: Cost of Goods purchased & received after 31st March till stock taking [₹ 6,000 – ₹ 1,500]	4,500
D	Less: Goods received prior to 31st March for which no invoices have been received to the date of verification	5,000
E	Stock as on 31st March	9,500

Notes:

- (i) Separate adjustment for item (e) is not required as the amount is included in the purchases for the period from 1st April to 7th April.
- (ii) As it is the policy of X to record only after the receipt of invoice, ₹ 5,000 worth of goods received before 31st March for which invoices have been deducted from the stock figure.

PROBLEM 10

A trader prepared his accounts on 31st March, each year. Due to some unavoidable reasons, no stock taking could be possible till April 15, 2018 on which date the total cost of goods in his godown came to ₹ 50,000. The following facts were established between 31st March and April 15, 2018.

- (a) Sales ₹ 41,000 (including cash sales ₹ 10,000)
- (b) Purchases ₹ 5,034 (including cash purchases ₹ 1,990)
- (c) Sales Returns ₹ 1,000
- (d) On 15th March, goods of the sale value of ₹ 10,000 were sent on sale or return basis to a customer, the period of approval being four weeks. He returned 40% of the goods on 10th April, approving the rest; the customer was billed on 16th April.
- (e) The trader had received goods costing ₹ 8,000 in March, for sale on consignment basis; 20% of the goods had been sold by 31st March, and another 50% by the 15th April. These sales are not included in (a) above.

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

You are required to ascertain the value of stock on hand on 31st March, 2018.

SOLUTION:**STATEMENT SHOWING THE VALUATION OF STOCK AS ON 31ST MARCH, 2018**

Particulars		₹
A	Stock in godown (Physical inventory) as on 15th April	50,000
B	Add: Cost of goods sold after 31st March till stock taking [80% of (₹ 41,000 – ₹ 1,000)]	32,000
	Add: Cost of Stock with customers on Approval: [80% of (₹ 10,000 – ₹ 4,000)]	4,800
C	Less: Cost of Goods purchased after 31st March till stock taking	5,034
	Less: Stock belonging to consignors (30% of ₹ 8,000)	2,400
D	Stock as on March 31 (at cost)	79,366

PROBLEM 11

Krishna Udyog Limited makes up its accounts upto 31st March, each year. The company was unable to take stock by physical inventory till 14th April on which date the stock at cost was valued at ₹ 1,85,000. It was, therefore necessary to estimate the value of stock in hand as on 31st March, 2018.

You ascertain the following facts regarding the period from 1st January to 14th April :

- Purchases totalled ₹ 48,000 and included (i) ₹ 5,000 in respect of goods received in March, (ii) ₹ 6,000 in respect of goods received on 19th April, (iii) ₹ 2,000 in respect of goods received being returned to suppliers on April 7, for which no credit note has been received or passed through the books.
- Sales totalled ₹ 60,000 and included (i) ₹ 1,500 in respect of goods which left the warehouse on 28th March, (ii) ₹ 2,800 in respect of goods which were not despatched until 15th April, (iii) ₹ 750 in respect of goods invoiced and despatched on 10th April but returned by the customers on 12th April, for which no credit note had been passed but which were in fact included in the stock taken on 14th April.
- Other returns to suppliers totalled ₹ 1,400 and other returns by customers were ₹ 450.
- The rate of gross profit was 25% on the selling prices with the exception of an isolated purchase on 7th April of 100 similar articles which had cost ₹ 11,000. Of these articles, 50 were sold on 7th April, for ₹ 6,500 and the remainder had been included in the cost taken on 14th April.

Assume Delivery Basis.

SOLUTION:**STATEMENT SHOWING THE VALUATION OF STOCK AS ON 31ST MARCH, 2018**

Particulars		₹
A	Stock as on 14th January	1,85,000
B	Less: Purchases pertaining to the period 1st January to 14th April	(48,000)
C	Add: Goods received in December	5,000
D	Add: Goods received on 19th April	6,000
E	Add: Returns	2,000
F	Add: Goods returned to Suppliers	1,400
G	Add: Cost of Goods sold (See working below)	36,000
H	Stock on 31st March	1,87,400

Working Note: Calculation of Cost of Goods Sold

Particulars		₹
A	Sales (Given)	60,000
B	Less: Goods sent in March	(1,500)
	Goods not despatched till 16th April	(2,800)
	Returns on 12th April	(750)
	Others returns (Returns ex-other sales)	(450)
C	Less: Sales from isolated purchases	(6,500)
D	Sales of other items	48,000
E	Less: Gross Profit @ 25%	12,000
F	Cost of Goods sold (other items)	36,000

Note: It is assumed that the purchase of 100 articles for ₹ 11,000 [see paragraph (d) of the question] is included in (a).

PROBLEM 12

Hans Ltd. keeps no running stock records but a physical inventory of stock is made at the end of each quarter and evaluated at cost. The company's year ends on 31st March, 2018 and draft accounts have been prepared to that date. The stock inventory taken on 31st March, was accidentally destroyed before the items had been evaluated, the stock figure used in the draft accounts being that shown by the inventory taken on 31st Dec. 2017. The gross profit earned by company is 25% of cost. During year audit you discovered the following:

- (a) The cost of the stock on 31st Dec as shown by the inventory was ₹ 40,525.
- (b) On 31st Dec stocks sheets showed the following discrepancies:
 - (i) A page total of ₹ 5,059 had been carried to the summary as ₹ 5,509.
 - (ii) The total of a page had been undercast by ₹ 98.
 - (iii) 100 items which had cost ₹ 5 each had been taken at 25 paise each.
- (c) Invoice for purchases entered in the Purchases Books during the month of Jan, Feb., and March totalled ₹ 38,560. Of this total, ₹ 2,800 related to goods received on or prior to 31st Dec. Invoices entered in April relating to goods received in March totalled ₹ 3,700.
- (d) Sales invoiced to customers in Jan, Feb., and March totalled ₹ 51,073. Of this total, ₹ 3,824 related to goods despatched on or before 31st Dec. Goods despatched to customers before 30th March but invoiced in April totalled ₹ 5,241.
- (e) During the final quarter of the company's year, credit note at invoiced value of ₹ 1,280 had been issued to customers in respect of goods returned during that period.

You are required to prepare a statement showing the amount of the stock at cost as on 31st March, 2018.

SOLUTION:**STOCK (PHYSICAL BALANCE) AT COST AS ON 31ST MARCH, 2018**

Particulars		₹
A	Adjusted Stock on 31st Dec	
	Stock at cost on 31st Dec	40,525
	Add: Error in extension ($100 \times ₹ 4.75$)	475
	Add: Error in casting	98
	Less: Error in carrying forward of page total ($₹ 5,509 \times ₹ 5,059$)	(450)
		40,648
B	Adjusted Cost of Sales:	
	Sales: Jan.-Mar.	51,073
	Add: Goods despatched before 31st March but invoiced in April	5,241
	Less: Goods despatched before 31st Dec included in Sales	3,824
	Less: Goods Returned	1,280
		51,210
	Less: Gross Profit @ 20% on Sales	(10,242)
		40,968
C	Adjusted Purchases:	
	Purchases: Jan.-Mar.	38,560
	Add: Goods purchased before 31st March but entered in April	3,700
	Less: Goods purchased (received) before 31st Dec included in purchases	2,800
		39,460
D	Stock at cost (Physical balance) on 31st March (A – B + C)	39,140

PROBLEM 13

Closing stock is valued by Sudharashan Stores on generally accepted accounting principles.

Stock taking for the year ended 31st March, 2018 was completed by 10th April next, the valuation of which showed a stock figure of ₹ 1,67,500 at cost as on the completion date. After the end of the accounting year and till the date of completion of stock taking, sales for the next year were made for ₹ 6,875, profit margin being $33\frac{1}{3}$ per cent on cost. Purchases for the next year included in the stock amounted to ₹ 9,000 at cost less trade discount 10 per cent. During this period, goods were added to stock of the mark up price of ₹ 300 in respect of sales returns. After stock taking it was found that there were certain very old slow moving items costing ₹ 1,125 which should be taken at ₹ 525 to ensure disposal to an interested customer. Due to heavy floods, certain goods costing ₹ 1,550 were received from the supplier beyond the delivery date of customer. As a result, the customer refused to take delivery and net realisable value of the goods was estimated to be ₹ 1,250 on 30th September. Compute the value of stock for inclusion in the final accounts for the year ended 31st March, 2018.

SOLUTION:**STATEMENT SHOWING THE VALUATION OF STOCK AS ON 31ST MARCH, 2018**

<i>Particulars</i>		₹
A	Value of Stock as on 10th April	1,67,500
B	Add: Cost of sales after 30th September till stock taking (₹ 6,875 – ₹ 1,719)	5,156
C	Less: Purchases for the next period (net)	(8,100)
D	Less: Cost of Sales Returns	(225)
E	Less: Loss on revaluation of slow moving inventories	(600)
F	Less: Reduction in value on account of default	(300)
G	Stock as at 31st March	1,63,431

16

ACCOUNTING FOR DEPRECIATION

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of Depreciation
- ◇ Meaning of Depreciation Accounting
- ◇ Causes of Depreciation
- ◇ Need for Charging Depreciation
- ◇ Factors Affecting the Amount of Depreciation
- ◇ Depreciation on Additions to Fixed Assets
- ◇ Methods of Recording Depreciation
- ◇ Recording of Depreciation by Charging to Asset Account Method
- ◇ Methods of Allocating Depreciation
- ◇ Straight Line Method (SLM) – Meaning, Merits, Demerits, Suitability
- ◇ Written Down Value Method (WDV) – Meaning, Merits, Demerits, Suitability
- ◇ Distinction between Straight Line Method and Written Down Value Method
- ◇ Recording of Depreciation by Creating Provision for Depreciation Account Method
- ◇ Meaning and Objectives of Provision
- ◇ Meaning, Objectives and Types of Reserves
- ◇ Distinction between Revenue Reserve and Capital Reserve
- ◇ Distinction between Provision and Reserve
- ◇ Sinking Fund Method or Depreciation Fund Method
- ◇ Annuity Method
- ◇ Depletion Method [Or productive output method]
- ◇ Machine Hour Method or Service Hours Method
- ◇ Production Units Method
- ◇ Sum of Years' Digits Method (Or SYD Method)
- ◇ Provision For Repairs & Renewals Method
- ◇ Double Declining Method
- ◇ Revaluation Method

1.0 MEANING OF DEPRECIATION

1. On the basis of Fundamental Accounting Assumption of Going Concern, assets are classified as Fixed Assets and Current Assets. Fixed assets are used in the business to derive benefits for more than one accounting period. Periodic profit is measured by charging cost against periodic revenue. Since fixed assets are used to generate periodic revenue, an appropriate proportion of the cost of fixed assets, which is believed to be used or expired for generation of periodic revenue, needs to be charged as cost. Such an appropriate proportion of the cost of fixed assets is termed as **Depreciation**.
2. Depreciation is the permanent and continuous decrease in the book value of a depreciable fixed asset due to use, effluxion of time, obsolescence, expiration of legal rights or any other cause.
3. According to the Institute of Chartered Accountants in England and Wales, '**Depreciation represents that part of the cost of a fixed asset to its owner which is not recoverable when the asset is finally out of use by him. Provision against this loss of capital is an integral cost of conducting the business during the effective commercial life of the asset and is not dependent on the amount of profit earned**'.
4. Depreciation is not the result of fluctuations in the value of fixed assets since, the fluctuation is concerned with the market price of the fixed asset whereas the depreciations is concerned with the historical cost.
5. An analysis of the definition given above highlights the characteristics of depreciation as follows:
 - (a) It is related to **Depreciable fixed assets** only.
 - (b) It is a fall in the **book value** of depreciable fixed asset.
 - (c) The fall in the book value of an asset is **due to** the use of the asset in business operations, effluxion of time, obsolescence, expiration of legal rights or any other cause.
 - (d) It is a **permanent decrease** in the book value of an asset.
 - (e) It is a **continuous decrease** in the book value of an asset.
6. Comprehensively, the term '**Depreciation**' covers Depletion, Amortisation and Obsolescence,
7. The term '**Depletion**' refers to the physical deterioration by the exhaustion of natural resources (ore-deposits in mines, oil wells, quarries, timber stands etc.).
8. The term '**Amortisation**' refers to the economic deterioration by the expiration of intangible assets (patents, copyrights, goodwill etc.)
9. The term '**Obsolescence**' refers to the economic deterioration by (a) invention of improved technique or equipment (b) market decline due to change in taste and fashion etc. (c) inadequacy of existing plant to meet the increased business.

2.0 MEANING OF DEPRECIATION ACCOUNTING

According to the American Institute of Certified Public Accountants (AICPA), 'Depreciation Accounting is a system of accounting which aims to distribute cost or the basic value of tangible capital assets less salvage (if any), over the estimated useful life of the unit (which may be group of assets) in a systematic and rational manner. It is a process of allocation and not of valuations.'

3.0 CAUSES OF DEPRECIATION

The main causes of depreciation include the following:

1. **Physical wear and tear** — When the fixed assets are put to use, the value of such assets may decrease. Such decrease in the value of assets is said to be due to physical wear and tear.

2. **With the passage of time** — When the assets are exposed to the forces of nature like weather, winds, rains, etc. the value of such assets may decrease even if they are not put to any use.
3. **Changes in economic environment** — The value of an asset may decrease due to decrease in the demand of the asset. The demand of the asset may decrease due to technological changes, changes in the habits of consumers etc.
4. **Expiration of legal rights** — When the use of an asset (e.g., Patents, Leases) is governed by the time bound arrangement, the value of such assets may decrease with the passage of time.

4.0 NEED FOR CHARGING DEPRECIATION

The need for charging depreciation in accounting records arises due to any one *or* more of the following objectives to be achieved:

1. **To ascertain True Financial Performance** — For proper matching of costs with revenues, it is necessary to charge the depreciation (cost) against income (revenue) in each accounting period. Unless the depreciation is charged against income, the financial performance would be overstated. As a result the Income Statement would not present a true and fair view of the financial performance of an accounting entity.
2. **To present True and Fair view of the Financial Position** — For presenting, a true and fair view of the financial position, it is necessary to charge the depreciation. If the depreciation is not charged, the unexpired cost of the asset concerned would be overstated. As a result, the Position Statement (i.e., the Balance Sheet) would not present a true and fair view of the financial position of an accounting entity.
3. **To ascertain the True Cost of Production** — For ascertaining the cost of production, it is necessary to charge depreciation as an item of cost of production. If the depreciation on fixed assets is not charged, the cost records, would not present a true and fair view of the cost of production.
4. **To comply with Legal Requirements** — In case of companies, it is compulsory to charge depreciation on fixed assets before it declares dividend [Sec. 205(1) of The Companies Act, 2013].
5. **To accumulate Funds for Replacement of Assets** — A portion of profits is set aside in the form of depreciation and accumulated each year to provide a definite amount at a certain future date for the specific purpose of replacement of the asset at the end of its useful life.

5.0 FACTORS AFFECTING THE AMOUNT OF DEPRECIATION

The amount of depreciation is usually based on the following three factors:

1. **Historical cost** of a depreciable asset implies the cost incurred on its acquisition, installation, commissioning and for additions to *or* improvements thereof which are of capital nature.
2. **Expected Useful Life** of a depreciable asset implies *either* the period over which a depreciable asset is expected to be used by the enterprise *or* the number of production *or* similar units expected to be obtained from the use of the asset by the enterprise.
3. **Estimated Residual Value** of a depreciable asset implies the value expected to be realised on its sale *or* exchange on the expiry of its useful life.

6.0 DEPRECIATION ON ADDITIONS TO FIXED ASSETS

Strictly for examination purposes, the following approach is suggested:

Type of Rate of Depreciation given	Period for which Depreciation is to be charged
(a) When the Rate of Depreciation with the words, 'per annum' is given (e.g. 20% p.a.)	
(i) If the Date of Acquisition is given	(i) Charge depreciation for the period beginning with the date of acquisition & ending with the date of closing of accounting period.
(ii) If the Date of Acquisition is not given	(ii) Charge depreciation for half accounting period assuming that the asset was acquired in the middle of accounting period.
(b) When the Flat (or Blanket) Rate of Depreciation without the words, 'per annum' is given (e.g. 20%)	Charge depreciation for the full accounting period irrespective of the date of acquisition.

7.0 METHODS OF RECORDING DEPRECIATION

There are two methods of recording Depreciation as follows:

1. By Charging to Asset Account.
2. By Creating Provision for Depreciation/Accumulated Depreciation Account.

Let us discuss these methods one by one.

8.0 RECORDING OF DEPRECIATION BY CHARGING TO ASSET ACCOUNT METHOD

1. Under this method of recording depreciation, depreciation is directly credited to the 'Respective Asset Account'.
2. Respective Asset Account appears at its Book Value (i.e., Original Cost /less depreciation till date).
3. The various journal entries which are passed under this method are summarised as follows:

JOURNAL ENTRIES

1. To record Purchase of Asset	Asset A/c To Cash/Bank A/c (Being the Asset purchased)	Dr.
2. To provide Depreciation	Depreciation A/c To Asset A/c (Being the Depreciation provided)	Dr.
3. To Close Depreciation Account	Profit & Loss A/c To Depreciation A/c (Being the transfer of Depreciation A/c to P&L A/c)	Dr.
4. To record Sale of Asset	Cash/Bank A/c To Asset A/c (Being the Asset sold)	Dr.
5. To record Profit/Loss on Sale		
(a) In Case of Profit	Asset A/c To Profit & Loss A/c (Being the transfer of Profit on Sale)	Dr.
(b) In Case of Loss	Profit & Loss A/c To Asset A/c (Being the transfer of Loss on Sale)	Dr.

TUTORIAL NOTES

1. *Book Value as on date of Sale = Original Cost – Total Depreciation till date of sale*
2. *Profit = Sale Proceeds – Book Value as on date of sale*
3. *Loss = Book Value as on date of sale – Sale Proceeds*
4. *In case of exchange of an asset, Sale Proceeds imply the 'Trade in allowance' (i.e., the amount at which the vendor agrees to acquire the old asset)*
5. *In case of destruction/damage of an insured asset by fire or accident, Sale Proceeds imply Claim admitted by Insurance company together with Salvage Value (if any).*

9.0 METHODS OF ALLOCATING DEPRECIATION

There are several methods of allocating depreciation over the useful lives of the assets. Those most commonly employed in industrial and commercial enterprises are the Straight Line Method (SLM) and the Written Down Value Method (WDV).

10.0 'STRAIGHT LINE METHOD' OF DEPRECIATION (SLM)**MEANING OF STRAIGHT LINE METHOD**

Under the Straight Line Method, a fixed and equal amount of depreciation, calculated at a fixed percentage on the original cost of a Fixed Depreciable Asset is written off during each accounting period over the expected useful life of the asset.

HOW TO CALCULATE THE RATE OF DEPRECIATION UNDER SLM

Step 1: Total Cost of Asset	= Purchase Price + *Expenses to be Capitalised
Step 2: Amount of Depreciation	= $\frac{\text{Original Cost /less Residual Value}}{\text{Expected Useful Life of the Asset}}$
Step 3: Rate of Depreciation	= $\frac{\text{Amount of Depreciation}}{\text{Original Cost}} \times 100$

**Expenditure incurred upto the date at which the Asset becomes ready to commence commercial production (i.e., production intended for sale or capitative consumption) should be capitalized and expenditure incurred after this cut off date should be treated as Revenue Expenditure. Examples of such Expenses to be capitalized include:*

1. *Freight & in-transit Insurance*
2. *Import duties and other non refundable taxes*
3. *Cartage & Carriage Expenses*
4. *Site Preparation Costs*
5. *Installation Cost, such as special foundations for plant*
6. *Professional Fees of Architects and Engineers*
7. *Expenditure incurred on test runs and experimental production*
8. *Borrowing Costs incurred upto the date at which substantially all the activities necessary to prepare the qualifying asset for its intended use are complete.*

MERITS OF STRAIGHT LINE METHOD

1. It is easy to understand.
2. It is easy to calculate the amount and rate of depreciation.
3. Under this method, the book value of the asset becomes zero or equal to its scrap value at the expiry of its useful life.

DEMERITS OF STRAIGHT LINE METHOD

1. The total charge (i.e., Depreciation *plus* Repairs and Renewals) in later years is more as compared to that in earlier years since, the amount of repairs and renewals goes on increasing as the asset grows older whereas the amount of depreciation remains constant year after year.
2. It does not take into consideration the interest on the capital invested in the asset.
3. It does not provide for the replacement of the asset on the expiry of its useful life.

SUITABILITY OF STRAIGHT LINE METHOD (SLM)

SLM is suitable for those assets in relation to which (a) repair charges are less, and (b) the possibility of obsolescence is less. This method is suitable for Furniture, Patent, Copyright, Trademark, Lease etc.

ILLUSTRATION 1

On 1st Jan 2013, Tulsian Ltd. purchased a second-hand machine for ₹ 80,000 and spent ₹ 20,000 on its cartage, repairs and installation. The residual value at the end of its expected useful life of 4 years is estimated at ₹ 68,000. Calculate the amount of depreciation according to Straight Line Method for the first year ending on 31st March, 2013.

SOLUTION

Step 1: Total Cost of Asset = Purchase Price + Expenses to be capitalized
 = ₹ 80,000 + ₹ 20,000 = ₹ 1,00,000

Step 2: Amount of Depreciation per year
 = $\frac{\text{Total Cost of Assets} - \text{Estimated Residual Value}}{\text{Expected Useful Life}}$
 = $\frac{\text{₹}1,00,000 - \text{₹}68,000}{4} = \text{₹}8,000 \text{ per year}$

Step 3: Amount of Depreciation for the first year of Purchase
 Amount of Depreciation for 3 months = ₹ 8,000 × $\frac{3}{12}$ = ₹ 2,000

ILLUSTRATION 2 [CALCULATION OF PROFIT/LOSS ON SALE OF ASSET]

X Ltd. purchased a second-hand machine for ₹ 5,00,000 and spent ₹ 1,00,000 on its repairs. Depreciation is to be provided @ 10% p.a. according to Straight Line Method. This machine is sold for ₹ 4,50,000. Accounting year is financial year. Calculate the profit or loss on sale of machine in each of the following alternative cases:

- Case (a) If date of purchase is 1.4.2015 and date of sale is 31.3.2018.
 Case (b) If date of purchase is 1.4.2015 and date of sale is 30.9.2017
 Case (c) If date of purchase is 1.7.2015 and date of sale is 31.3.2018
 Case (d) If date of purchase is 1.7.2015 and date of sale is 30.9.2017

SOLUTION**CALCULATION OF PROFIT/LOSS ON SALE**

Particulars	Case (a)	Case (b)	Case (c)	Case (d)
A. Total Cost of Asset [₹5,00,000 + ₹ 1,00,000]	6,00,000	6,00,000	6,00,000	6,00,000

B. Less: Depreciation from date of purchase to date of sale	1,80,000 $(6,00,000 \times \frac{10}{100} \times \frac{36}{12})$	1,50,000 $(6,00,000 \times \frac{10}{100} \times \frac{30}{12})$	1,65,000 $(6,00,000 \times \frac{10}{100} \times \frac{33}{12})$	1,35,000 $(6,00,000 \times \frac{10}{100} \times \frac{27}{12})$
C. Book Value as on date of sale [A–B]	4,20,000	4,50,000	4,35,000	4,65,000
D. Less: Sale Proceeds	4,50,000	4,50,000	4,50,000	4,50,000
E. Loss on Sale (Profit on Sale)	(30,000)	–	(15,000)	15,000

ILLUSTRATION 3 [JOURNAL ENTRIES UNDER SLM]

On 1st April 2015, Tulsian Ltd. purchased a second-hand machine for ₹ 80,000 and spent ₹ 20,000 on its cartage, repairs and installation. The residual value at the end of its expected useful life of 4 years is estimated at ₹ 40,000. On 30th Sept. 2016, repairs & renewals amounted to ₹ 2,000. On 30th Sept. 2017, this machine is sold for ₹ 50,000. Depreciation is to be provided according to Straight Line Method.

Required: Prepare Journal, Machinery Account and Depreciation Account for the first three years assuming that the accounts are closed on 31st March each year.

SOLUTION**JOURNAL OF TULSIAN LTD.**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
01.04.2015	Machinery A/c Dr. To Bank A/c (Being the machinery purchased)		80,000	80,000
01.04.2015	Machinery A/c Dr. To Bank A/c (Being the cartage & installation charges paid)		20,000	20,000
31.03.2016	Depreciation A/c Dr. To Machinery A/c (Being the depreciation provided)		15,000	15,000
31.03.2016	Profit & Loss A/c Dr. To Depreciation A/c (Being the transfer of Depreciation A/c)		15,000	15,000
31.03.2016	Repairs & Renewals A/c Dr. To Cash A/c (Being the payment made for Repairs & Renewals)		2,000	2,000
31.09.2017	Depreciation A/c Dr. To Machinery A/c (Being the depreciation provided)		15,000	15,000
31.03.2017	Profit & Loss A/c Dr. To Depreciation A/c (Being the transfer of Depreciation A/c)		15,000	15,000
30.09.2017	Depreciation A/c Dr. To Machinery A/c (Being the depreciation provided)		7,500	7,500

30.09.2017	Bank A/c To Machinery A/c (Being the Machinery sold)	Dr.		50,000	50,000
30.09.2017	Profit & Loss A/c To Machinery A/c (Being the transfer of loss on sale of Machinery)	Dr.		12,500	12,500
31.03.2018	Profit & Loss A/c To Depreciation A/c (Being the transfer of depreciation A/c)	Dr.		7,500	7,500

Dr. **MACHINERY ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2015	To Bank A/c To Bank A/c	80,000 20,000	31.03.2016	By Depreciation A/c [1,00,000 × 15/100 × 12/12] By Balance c/d	15,000 85,000
		1,00,000			1,00,000
01.04.2016	To Balance b/d	85,000	31.03.2017	By Depreciation A/c [1,00,000 × 15/100 × 12/12] By Balance c/d	15,000 70,000
		85,000			85,000
01.04.2017	To Balance b/d	70,000	30.09.2018	By Depreciation A/c [1,00,000 × 15/100 × 6/12] By Bank A/c (Sale) By P & L A/c (loss)	7,500 50,000 12,500
		70,000			70,000

Dr. **DEPRECIATION ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2015	To Machinery A/c	15,000	31.03.2016	By Profit & Loss A/c	15,000
31.03.2016	To Machinery A/c	15,000	31.03.2017	By Profit & Loss A/c	15,000
30.09.2017	To Machinery A/c	7,500	31.03.2018	By Profit & Loss A/c	7,500

Working Notes:

1. CALCULATION OF THE RATE OF DEPRECIATION

Step 1: Calculation of Total Cost of Asset

$$= ₹ 80,000 + ₹ 20,000 = ₹ 1,00,000$$

Step 2: Calculation of Amount of Depreciation per year

$$= \frac{\text{Total Cost of Assets} - \text{Estimated Residual Value}}{\text{Expected Useful Life}} = \frac{₹1,00,000 - ₹40,000}{4} = ₹15,000$$

Step 3: Calculation of Rate of Depreciation under SLM

$$= \frac{\text{Amount of Depreciation}}{\text{Total Cost of Assets}} \times 100 = \frac{₹15,000}{₹1,00,000} \times 100 = 15\%$$

2. CALCULATION OF PROFIT/LOSS ON SALE OF MACHINE

<i>Particulars</i>	<i>₹</i>
A. Total Cost of Asset [₹ 80,000 + ₹ 20,000]	1,00,000
B. Less: Depreciation from date of purchase to date of sale [₹ 1,00,000 × 15/100 × 30/12]	37,500
C. Book Value as on date of sale [A – B]	62,500
D. Less: Sale Proceeds	50,000
E. Loss on sale of asset [C – D]	12,500

3. The amount spent on repairs & renewals on 30th Sept. is of revenue nature and not of capital nature and hence, not debited to Machinery Account.

ILLUSTRATION 4

A Transport company purchases 5 Trucks at ₹ 2,00,000 each on July 1, 2015. The company writes off depreciation @ 20% per annum on original cost.

On Jan 1, 2018 one of the trucks is involved in an accident and is completely destroyed. Insurance company pays ₹ 90,000 in full settlement of the claim. On the same day the company purchases a used truck for ₹ 1,00,000 and spends ₹ 20,000 on its overhauling. Prepare Truck Account for the three years ending on 31st March 2017.

SOLUTION

Dr.

TRUCKS ACCOUNT

Cr.

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
01.07.2015	To Bank A/c	10,00,000	31.03.2016	By Depreciation A/c [10,00,000 × 20/100 × 9/12]	1,50,000
				By Balance c/d	8,50,000
		10,00,000			10,00,000
01.04.2016	To Balance b/d	8,50,000	31.03.2017	By Depreciation A/c [10,00,000 × 20/100 × 12/12]	2,00,000
				By Balance c/d	6,50,000
		8,50,000			8,50,000
01.04.2017	To Balance b/d	6,50,000	01.01.2018	By Depreciation A/c [2,00,000 × 20/100 × 9/12]	30,000
01.01.2018	To Bank A/c	1,00,000		By Bank A/c (Claim)	90,000
	To Bank A/c (Exp.)	20,000		By Profit & Loss A/c	10,000
			31.03.2018	By Depreciation A/c: on Old Trucks [8,00,000 × 20/100 × 12/12]	1,60,000
				on New Truck [1,20,000 × 20/100 × 3/12]	6,000
			31.03.2018	By Balance c/d: Old Trucks	3,60,000
				New truck	1,14,000
		7,70,000			7,70,000

Working Notes:

- Book Value of one Truck on date of accident
 $= ₹ 2,00,000 - (₹ 2,00,000 \times 20/100 \times 30/12) = ₹ 1,00,000$
- Loss on Date of accident = ₹ 1,00,000 – ₹ 90,000 = ₹ 10,000

ILLUSTRATION 5

X Ltd. has imported a machine on Oct. 1, 2015 for ₹ 1,28,000, paid customs duty and freight ₹ 64,000 and incurred erection charges ₹ 48,000. Another local machinery costing ₹ 80,000 was purchased on April 1, 2016. On Oct. 1, 2017 a portion of the imported machinery (value one third) got out of order and was sold for ₹ 27,840. Another machinery was purchased to replace the same for ₹ 40,000. Depreciation to be calculated at 20% p.a. on original cost basis.

Prepare the Machinery Account for the first three years ending 31st March, 2018.

SOLUTION
Dr.
MACHINERY ACCOUNT
Cr.

Date	Particulars	₹	Date	Particulars	₹
01.10.2015	To Bank A/c (Machine I)	1,28,000	31.03.2016	By Depreciation A/c	24,000
01.10.2015	To Bank A/c (Expenses)	64,000		[2,40,000 × 20/100 × 6/12]	
01.10.2015	To Bank A/c (Expenses)	48,000		By Balance c/d	2,16,000
		2,40,000			2,40,000
01.04.2016	To Balance b/d:		31.03.2017	By Depreciation A/c:	
	Machine I	2,16,000		Machine I	48,000
01.04.2016	To Bank A/c			Machine II	16,000
	Machine II	80,000		By Balance c/d:	
				Machine I	1,68,000
				Machine II	64,000
		2,96,000			2,96,000
01.04.2017	To Balance b/d:		01.10.2017	By Bank A/c	27,840
	Machine I	1,68,000		By Depreciation A/c	8,000
	Machine II	64,000		[(1/3) × 2,40,000 × 10/100 × 6/12]	
01.10.2017	To Bank A/c			(on Machinery sold)	
	Machine III	40,000		By P & L A/c (loss on sale)	20,160
			31.03.2018	By Depreciation A/c:	
				Machine I	32,000
				Machine II	16,000
				Machine III	4,000
				By Balance c/d:	
				Machine I	80,000
				Machine II	48,000
				Machine III	36,000
		2,72,000			2,72,000

Working Note:**CALCULATION OF PROFIT/LOSS ON SALE OF MACHINERY**

<i>Particulars</i>	<i>₹</i>
A. Original Cost of machinery (₹ 2,40,000 × 1/3)	80,000
B. Less: Depreciation for 2 years from date of purchase to date of sale	32,000
C. Book Value as on date of sale [A – B]	48,000
D. Less: Sale Proceeds	27,840
E. Loss on sale of machinery [C – D]	20,160

ILLUSTRATION 6

On July 1, 2015 Vijay Ltd purchased second-hand machinery for ₹ 20,000 and spent ₹ 3,000 on reconditioning and installing it. On January 1, 2016 the firm purchased new machinery worth ₹ 12,000. On June 30, 2017 the machinery purchased on January 1, 2016 was sold for ₹ 8,000. On July 1, 2017 fresh machinery was purchased on instalment basis, payment for this machinery was to be made as follows: July 1, 2017 ₹ 5,000, June 30, 2018 ₹ 6,000, June 30, 2019 ₹ 5,500

Payments in 2018 and 2019 include interest ₹ 1,000 and ₹ 500 respectively.

The Company writes off depreciation @ 10% p.a. on original cost. The accounts are closed every year on 31st March. Show the Machinery Account for three years ending on March 31, 2018.

SOLUTION*Dr.***MACHINERY ACCOUNT***Cr.*

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
01.07.2015	To Bank A/c: Machine I	20,000	31.03.2016	By Depreciation A/c:	
	To Bank A/c (Expenses)	3,000		Machine I	1,725
				Machine	300
01.01.2016	To Bank A/c (Machine II)	12,000		By Balance c/d:	
				Machine I	21,275
				Machine II	11,700
		35,000			35,000
01.04.2016	To Balance b/d:		31.03.2017	By Depreciation A/c:	
	Machine I	21,275		Machine I	2,300
	Machine II	11,700		Machine II	1,200
				By Balance c/d	
				Machine I	18,975
				Machine II	10,500
		32,975			32,975
01.04.2017	To Balance b/d:		30.06.2017	By Depreciation A/c	300
	Machine I	18,975		By Bank A/c (Machine II)	8,000
	Machine II	10,500			
01.07.2017	To Hire vendor's A/c			By P & L A/c (Loss)	2,200
	(Cash price)	15,000	31.03.2018	By Depreciation A/c:	
	Machine III			Machine I	2,300
				Machine III	1,125
				By Balance c/d:	
				Machine I	16,675
				Machine III	13,875
		44,475			44,475

Working Notes:

1. Book value of Machine II as on date of sale = ₹ 10,500 – ₹ 300 = ₹ 10,200
2. Loss on Sale = ₹ 10,200 – ₹ 8,000 = ₹ 2,200
3. Cash price of Machine III = ₹ 5,000 + ₹ 6,000 + ₹ 5,500 – (₹ 1000 + ₹ 500) = ₹ 15,000
4. Depreciation on Machine III = ₹ 15000 × 10/100 × 9/12 = ₹ 1,125

11.0 'WRITTEN DOWN VALUE METHOD' OF DEPRECIATION (WDV)**MEANING OF WRITTEN DOWN VALUE METHOD**

Under the Written Down Value method, depreciation calculated at a fixed percentage on the Original Cost (in the first year) and on the Written Down Value, (in subsequent years) of a Fixed Depreciable Asset is written off during each accounting period over the expected useful life of the asset. Under this method, the rate of depreciation remains constant year after year whereas the amount of depreciation goes on decreasing.

HOW TO CALCULATE RATE OF DEPRECIATION UNDER WDV METHOD

$$R = \left[1 - \sqrt[n]{\frac{S}{C}} \right] \times 100$$

Where, R = Rate of Depreciation (in %), n = Useful life of the asset (in years)

S = Scrap value at the end of useful life of the asset

C = Cost of the asset

MERITS OF WDV METHOD

1. The total charge (i.e., Depreciation *plus* Repairs Renewals) remains almost uniform year after year, since in earlier years the amount of Depreciation is more and the amount of Repairs and Renewals is less, whereas in later years the amount of Depreciation is *less* and the amount of Repairs & Renewals is more.
2. This method is logical in the sense that as the asset grows older, the amount of depreciation also goes on decreasing.

DEMERITS OF WDV METHOD

1. It is difficult to calculate the rate of depreciation.
2. It does not take into consideration the interest on capital invested in the asset.
3. It does not provide for the replacement of the asset on the expiry of its useful life.
4. It takes a very long time to write an asset down to its break-up value, unless a very high rate is used.

SUITABILITY OF WDV METHOD

This method is suitable for those assets in relation to which (a) the amount of Repairs and Renewals goes on increasing as the asset grows older (b) the possibilities of obsolescence are more. This method is suitable for Plant and Machineries, Building etc.

ILLUSTRATION 7

On 1st April 2015, Tulsian Ltd. purchased a second-hand machine for ₹ 80,000 and spent ₹ 20,000 on its cartage, repairs and installation. On 30th Sept. 2016 Repairs & Renewals amounted to ₹ 2,000. On 30th Sept. 2017, this machine is sold for ₹ 50,000. Depreciation is to be provided @ 20% p.a. according to Written Down Value Method.

Required: Prepare Journal, Machinery Account and Depreciation Account for the first three years assuming that the accounts are closed on 31st March each year.

SOLUTION

JOURNAL OF TULSIAN LTD.

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
01.04.2015	Machinery A/c Dr. To Bank A/c (Being the machinery purchased)		80,000	80,000
01.04.2015	Machinery A/c Dr. To Bank A/c (Being the cartage & installation charges paid)		20,000	20,000
31.03.2016	Depreciation A/c Dr. To Machinery A/c (Being the depreciation provided)		20,000	20,000
31.03.2016	Profit & Loss A/c Dr. To Depreciation A/c (Being the transfer of Depreciation A/c)		20,000	20,000
31.03.2016	Repairs & Renewals A/c Dr. To cash A/c (Being the payment made for Repairs)		2,000	2,000
31.03.2017	Depreciation A/c Dr. To Machinery A/c (Being the depreciation provided)		16,000	16,000
31.03.2017	Profit & Loss A/c Dr. To Depreciation A/c (Being the transfer of Depreciation A/c)		16,000	16,000
30.09.2017	Depreciation A/c Dr. To Machinery (Being the depreciation provided)		6,400	6,400
30.09.2017	Bank A/c Dr. To Machinery A/c (Being the Machinery sold)		50,000	50,000
30.09.2017	Profit & Loss A/c Dr. To Machinery A/c (Being the transfer of loss on sale of Machinery)		7,600	7,600
31.03.2018	Profit & Loss A/c Dr. To Depreciation A/c (Being the transfer of Depreciation A/c)		6,400	6,400

Dr.

MACHINERY ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2015	To Bank A/c	80,000	31.03.2016	By Depreciation A/c	
	To Bank A/c	20,000		[1,00,000 × 20/100 × 12/12]	20,000
	(Expenses)			By Balance c/d	80,000
		1,00,000			1,00,000
01.04.2016	To Balance b/d	80,000	31.03.2017	By Depreciation A/c	16,000
				[80,000 × 20/100 × 12/12]	
				By Balance c/d	64,000
		80,000			80,000
01.04.2017	To Balance b/d	64,000	30.09.2017	By Depreciation A/c	
				[64,000 × 20/100 × 6/12]	6,400
				By Bank A/c (Sale)	50,000
				By P & L A/c (loss)	7,600
		64,000			64,000

Dr.

DEPRECIATION ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2016	To Machinery A/c	20,000	31.03.2016	By Profit & Loss A/c	20,000
31.03.2017	To Machinery A/c	16,000	31.03.2017	By Profit & Loss A/c	16,000
30.09.2017	To Machinery A/c	6,400	31.03.2018	By Profit & Loss A/c	6,400

Working Notes:**1. CALCULATION OF PROFIT/LOSS ON SALE OF MACHINE**

Particulars	₹
A. Total Cost of Asset [₹ 80,000 + ₹ 20,000]	1,00,000
B. Less: Depreciation for 1st year [20% of ₹ 1,00,000]	20,000
C. Book Value as on [A – B]	80,000
D. Less: Depreciation for 2nd year [20% of ₹ 80,000]	16,000
E. Book Value	64,000
F. Less: Depreciation upto date of sale for 6 months [20% of ₹ 64,000 for 1/2 year]	6,400
G. Book Value as on date of sale [E – F]	57,600
H. Less: Sale Proceeds	50,000
I. Loss on Sale [G – H]	7,600

2. The amount spent on repairs & renewals on 30th September is of revenue nature and not of capital nature and hence, not debited to Machinery Account.

ILLUSTRATION 8

On 1st April, 2015, X Ltd purchased a machinery for ₹ 58,000 and spent ₹ 2,000 on its erection. On 1st Oct. 2015 an additional machinery costing ₹ 20,000 was purchased. On 1st Oct. 2017 the machine purchased on 1st April 2015 was sold for ₹ 28,600 and on the same date, a new machine was purchased at a cost of ₹ 40,000.

Required: Show the Machinery Account for the first four years ending 31st March as per Written Down Value Method taking the rate of depreciation at 10% p.a.

SOLUTION

Dr.

MACHINERY ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2015	To Bank A/c Machine I	58,000	31.03.2016	By Depreciation A/c: Machine I	6,000
01.04.2015	To Bank A/c (erection charges)	2,000		Machine II	1,000
01.10.2015	To Bank A/c Machine II	20,000		By Balance c/d: Machine I	54,000
		80,000		Machine II	19,000
					80,000
01.04.2016	To Balance b/d: Machine I	54,000	31.03.2017	By Depreciation A/c: Machine I	5,400
	Machine II	19,000		Machine II	1,900
				By Balance c/d: Machine I	48,600
		73,000		Machine II	17,100
					73,000
01.04.2017	To Balance b/d: Machine I	48,600	01.10.2017	By Bank A/c (sale)	28,600
	Machine II	17,100		By Depreciation A/c: (on Machine sold)	2,430
01.10.2017	To Bank A/c Machine III	40,000		[48,600 × 10/100 × 6/12]	
				By P & L A/c (Loss on sale)	17,570
			31.03.2018	By Depreciation A/c: Machine II	1,710
				Machine III	2,000
				By Balance c/d: Machine II	15,390
				Machine III	38,000
		1,05,700			1,05,700
01.04.2018	To Balance b/d: Machine II	15,390	31.03.2019	By Depreciation A/c: Machine II	1,539
	Machine III	38,000		Machine III	3,800
				By Balance c/d: Machine II	13,851
				Machine III	34,200
		53,390			53,390

Working Note:**CALCULATION OF PROFIT/LOSS ON SALE OF MACHINERY**

<i>Particulars</i>	<i>₹</i>
A. Original cost	60,000
B. Less: Depreciation for first year	6,000
C. Book Value (A – B)	54,000
D. Less: Depreciation for Second year	5,400
E. Book Value (C – D)	48,600
F. Less: Depreciation up to date of Sale	2,430
G. Book Value as on date of Sale (E – F)	46,170
H. Less: Sale Proceeds	28,600
I. Loss on Sale (G – H)	17,570

ILLUSTRATION 9

Tulsian Ltd provides you the following information:

<i>Date</i>	<i>Particulars</i>
01.04.2015	Purchased 10 second hand Machines for ₹ 9,00,000. incurred ₹ 70,000 towards freight & insurance, ₹ 20,000 towards carriage inward, Residual Value ₹ 4,09,600, Useful life 4 years.
01.01.2016	Incurred ₹ 7,000 towards Repairs and ₹ 3,000 on installation of machines and ₹ 12,000 towards Annual Insurance Premium and commenced the commercial production.
01.10.2016	Sold one machine at a profit of 10%
01.01.2017	Incurred ₹ 10,000 on repairs of Machines
01.01.2018	Sold one machine at a loss of 10% and purchased a new machine for ₹ 90,000 and spent ₹ 10,000 on its installation

Required: Prepare the Machinery Account for three financial years using WDV Method.

SOLUTION

Dr.

MACHINE ACCOUNT

Cr.

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
1.04.2015	To Bank A/c	9,00,000	31.03.2016	By Depreciation A/c [10,00,000 × 20% × 3/12]	50,000
01.04.2015	To Bank A/c	90,000		By Balance c/d	9,50,000
01.01.2016	To Bank A/c	10,000			
		10,00,000			10,00,000
1.04.2016	To Balance b/d	9,50,000	01.10.2016	By Depreciation A/c [95,000 × 20% × 6/12]	9,500
	To P & L A/c [Profit] [(95,000 – 9,500) × 10%]	8,550		By Bank A/c [(95,000 – 9,500) + 10%]	94,050

			31.03.2017	By Depreciation A/c [(9,50,000 – 95,000) × 20% × 12/12]	1,71,000
				By Balance c/d	6,84,000
		9,58,550			9,58,550
01.04.2017	To Balance b/d	6,84,000	01.01.2018	By Depreciation A/c [76,000 × 20% × 9/12]	11,400
01.01.2018	To Bank A/c	90,000		By Bank A/c [(76,000 – 11,400) – 10%]	58,140
	To Bank A/c	10,000		By P & L A/c [Loss] [(76,000 – 11,400) × 10%]	6,460
			31.03.2018	By Depreciation A/c: Old [(6,84,000 – 76,000) × 20%]	1,21,600
				New [1,00,000 × 20% × 3/12]	5,000
				By Balance c/d: Old 4,86,400	
				New 95,000	5,81,400
		7,84,000			7,84,000

Note: WDV rate of Depreciation = $1 - 4 \sqrt[4]{\frac{₹4,09,600}{₹10,00,000}} = 20\%$

ILLUSTRATION 10

X Ltd. writes off depreciation @ 10% per annum on the diminishing balance. On April 1, 2017, the Machinery Account showed a balance of ₹ 2,98,000. It was discovered in the year 2017-2018 that:

- Heavy repairs effected to Plant and Machinery (completed on September 30, 2015) were debited to the Machinery Account. The amount was ₹ 30,000; and
- A machine costing ₹ 12,000 was entered in the Purchases Book on 1st January, 2016. The expenses on installation, ₹ 800, were debited to General Expenses Account.

Necessary corrections were made in the year 2017-2018. On September 30, 2017 a machine which had cost ₹ 40,000 on April 1, 2015 was disposed of for ₹ 29,000 and a new machine costing ₹ 58,000 was installed on the same date, the expenses on installing the machine being ₹ 3,000.

Required: Show the Machinery Account for the year ended March 31, 2018.

SOLUTION

Dr.

MACHINERY ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2017	To Balance b/f	2,98,000	01.04.2017	By Profit & Loss A/c (Repairs)	25,650
	To Profit & Loss A/c (for Machine Purchased on 1.1.96)	11,232		By Bank A/c	29,000

30.09.2017	To Bank A/c [₹ 58,000 + ₹ 3,000]	61,000	30.09.2017	By Depreciation—For 6 months on the machine sold (3)	1,620
				By Profit & Loss A/c (Loss)	1,780
			31.03.2018	By Depreciation A/c	28,168
			31.03.2018	By Balance c/d	2,84,014
		3,70,232			3,70,232

Working Notes:
1. CALCULATION OF BOOK VALUE OF REPAIRS AND NEW MACHINE

<i>Particulars</i>	<i>Repairs</i> ₹	<i>New Machine</i> ₹
A Cost on 1.09.2015/1.1.2016	30,000	12,800
B Less: Depreciation for 2015-2016	1,500	320
C Book value as on 1.4.2016	28,500	12,480
D Less: Depreciation for 2016-2017	2,850	1,248
E Book Value as on 1.4.2017	25,650	11,232

2. CALCULATION OF PROFIT/LOSS ON SALE OF MACHINE

<i>Particulars</i>	₹
A Cost as on 1.4.2015	40,000
B Less: Depreciation for 2015-2016	4,000
C Book value as on 1.4.2016	36,000
D Less: Depreciation for 2016-2017	3,600
E Book value as on 1.4.2017	32,400
F Less: Depreciation for 2017-2018 for 6 month	1,620
G Book value as on 1.10.2017	30,780
H Less: Sale Proceeds	29,000
I Loss on Sale (G – H)	1,780

3. CALCULATION OF BOOK VALUE OF MACHINERY (OTHER THAN SCRAPPED) (AFTER RECTIFICATION OF MISTAKES) AS ON 1.4.2017

<i>Particulars</i>	₹
A Unadjusted Book Value as on 1.4.2017	2,98,000
B Add: Book Value of Machine purchased on 1.1.2016	11,232
C Less: Book Value of repairs wrongly debited	25,650
D Less: Book Value of Machine sold	32,400
	2,51,182

4. CALCULATION OF DEPRECIATION FOR 2017-2018

<i>Particulars</i>	<i>₹</i>
A On old Machine [10% on ₹ 2,51,182]	25,118
B On New Machine [₹ 61,000 × 10/100 × 6/12]	3,050
	28,168

12.0 DISTINCTION BETWEEN STRAIGHT LINE METHOD & WRITTEN DOWN VALUE METHOD

Straight Line Method differs from Written Down Value Method in the following respects:

Basis of Distinction	Straight Line Method	Written Down Value Method
1. Basic of Calculation	Depreciation is calculated at a fixed percentage on the original cost .	Depreciation is calculated at a fixed percentage on original cost (in first year) and on written down value (in subsequent years).
2. Amount of Depreciation	The amount of depreciation remains constant .	The amount of depreciation goes on decreasing .
3. Total Charge (i.e., depreciation plus repairs and renewals)	Total charge in later years is more as compared to that in earlier years since the amount of repairs and renewals goes on increasing as the asset grows older, whereas the amount of depreciation remains constant year after year.	Total charge remains almost uniform year after year, since in earlier years the amount of depreciation is more and the amount of repairs and renewals is <i>less</i> whereas in later years, the amount of depreciation is <i>less</i> and the amount of repairs & renewals is more.
4. Book Value	The book value of the asset becomes zero or equal to its scrap value.	The book value of the asset does not become zero .
5. Suitability	This method is suitable for those assets in relation to which (a) repair charges are <i>less</i> (b) the possibility of obsolescence is less.	This method is suitable for those assets in relation to which (a) the amount of repairs & renewals goes on increasing as the asset grows older and (b) the possibilities of obsolescence are more.
6. Calculation – Easy or Difficult	It is easy to calculate the rate of depreciation.	It is difficult to calculate the rate of depreciation.

13.0 RECORDING OF DEPRECIATION BY CREATING PROVISION FOR DEPRECIATION ACCOUNT METHOD**MEANING OF DEPRECIATION BY CREATING PROVISION FOR DEPRECIATION A/C**

Under this method of recording depreciation, depreciation is credited to the Provision for Depreciation Account and as a result, the Respective Asset Account appears at its Original Cost.

ASSET DISPOSAL ACCOUNT

1. When the asset is sold or discarded, Asset Disposal Account is prepared to ascertain profit or loss.
2. Asset Disposal Account is debited with the original cost of the asset disposed off.
3. Asset Disposal Account is credited with (a) the Accumulated Depreciation on the asset disposed off and (b) the Sale Proceeds of the asset disposed off.

4. The excess of debit side total over the credit side total represents the Loss on asset disposed off and is transferred to the debit of Profit & Loss Account.
5. The excess of credit side total over the debit side total represents the Profit on asset disposed off and is transferred to the credit of Profit & Loss Account.

JOURNAL ENTRIES

1. For Providing Depreciation	Depreciation A/c To Provision for Depreciation A/c	Dr.
2. For Closure of Depreciation A/c	Profit & Loss A/c To Depreciation A/c	Dr.
3. On Disposal of an Asset		
(i) For transfer of original cost of asset disposed off	Asset Disposal A/c To Asset A/c	Dr.
(ii) For transfer of accumulated depreciation on asset disposed off	Provision for Depreciation A/c To Asset Disposal A/c	Dr.
(iii) For recording Sale Proceeds	Cash A/c/Bank A/c To Asset Disposal A/c	Dr.
(iv) For transfer of the balance in Asset Disposal Account		
(a) In case of Profit	Asset Disposal A/c To Profit & Loss A/c	Dr.
(b) In case of Loss	Profit & Loss A/c To Asset Disposal A/c	Dr.

ILLUSTRATION 11

On April 1, 2015, X Ltd. purchased a machinery for ₹ 12,00,000. On Oct 1, 2017, a part of the machinery purchased on April 1, 2015 for ₹ 80,000 was sold for ₹ 45,000 and a new machinery at a cost of ₹ 1,58,000 was purchased and installed on the same date. The company has adopted the method of providing 10% p.a. depreciation on the original cost of the machinery.

Required: Show the necessary ledger accounts assuming that (a) 'Provision for Depreciation Account' is not maintained, (b) 'Provision for Depreciation Account' is maintained.

SOLUTION

(a) When 'Provision for Depreciation Account' is not maintained

Dr. **MACHINERY ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2015	To Bank A/c	12,00,000	31.03.2016	By Depreciation A/c	1,20,000
				By Balance c/d	10,80,000
		12,00,000			12,00,000
01.04.2016	To Balance b/d	10,80,000	31.03.2017	By Depreciation A/c	1,20,000
				By Balance c/d	9,60,000
		10,80,000			10,80,000

01.04.2017	To Balance b/d	9,60,000	01.10.2017	By Bank A/c	45,000
01.10.2017	To Bank A/c	1,58,000		By Profit & Loss A/c	15,000
			01.10.2017	By Depreciation A/c	4,000
			31.03.2018	By Depreciation A/c	1,19,900
				By Balance c/d	9,34,100
		11,18,000			11,18,000

(b) When 'Provision for Depreciation Account' is maintained

Dr.

MACHINERY ACCOUNT (AT ORIGINAL COST)

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2015	To Bank A/c	12,00,000	31.03.2016	By Balance c/d	12,00,000
01.04.2016	To Balance b/d	12,00,000	31.03.2017	By Balance c/d	12,00,000
01.04.2017	To Balance b/d	12,00,000	01.10.2017	By Machinery	
01.10.2017	To Bank A/c	1,58,000	Disposal A/c	80,000	
			31.03.2018	By Balance c/d	12,78,000
		13,58,000			13,58,000

Dr.

PROVISION FOR DEPRECIATION ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2015	To Balance c/d	1,20,000	31.03.2015	By Depreciation A/c	1,20,000
31.03.2016	To Balance c/d	2,40,000	01.04.2016	By Balance b/d	1,20,000
			31.03.2017	By Depreciation A/c	1,20,000
		2,40,000			2,40,000
01.10.2017	To Machinery		01.04.2017	By Balance b/d	2,40,000
Disposal A/c	20,000		01.10.2017	By Depreciation A/c	4,000
31.03.2018	To Balance c/d	3,43,900	31.03.2018	By Depreciation A/c	1,19,900
		3,63,900			3,63,900

Dr.

MACHINERY DISPOSAL ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.10.2017	To Machinery A/c	80,000	01.10.2017	By Provision for	
			Depreciation A/c	20,000	
			By Bank A/c	45,000	
			By Profit and Loss A/c	15,000	
			(Loss on sale)		
		80,000			80,000

Working Notes:**1. CALCULATION OF PROFIT/LOSS ON SALE OF MACHINERY**

Particulars	₹
A. Original Cost	80,000
B. Less: Depreciation @ 10% p.a. for 2½ years [$₹ 80,000 \times 10/100 \times 2\frac{1}{2}$]	20,000

C. Book Value as on date of Sale [A – B]	60,000
D. Less: Sale Proceeds	45,000
E. Loss on Sale [C – D]	15,000

2. CALCULATION OF DEPRECIATION FOR CURRENT YEAR ON MACHINES (OTHER THAN SOLD)

Particulars	₹
A. On Old Machine of ₹ 11,20,000 for 1 year	1,12,000
B. On New Machine of ₹ 1,58,000 for 1/2 year	7,900
	1,19,900

ILLUSTRATION 12

On April 1, 2015, a firm purchased a machinery for ₹ 2,00,000. On 1st October in the same accounting year, additional machinery costing ₹ 1,00,000 was purchased. On 1st October, 2016, the machinery purchased on 1st April, 2015, having become obsolete, was sold off for ₹ 90,000. On October 1, 2017, new machinery was purchased for ₹ 2,50,000 while the machinery purchased on 1st October, 2015 was sold for ₹ 85,000 on the same day. The firm provides depreciation on its machinery @ 10% per annum on original cost on 31st March every year. Show Machinery Account, Provision for Depreciation Account and Depreciation Account for the period of three accounting years ending March 31, 2018.

SOLUTION

Dr. Cr.

MACHINERY ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
01.04.2015	To Bank A/c	2,00,000	31.03.2016	By Balance c/d	3,00,000
01.12.2015	To Bank A/c	1,00,000			
		3,00,000			3,00,000
01.04.2016	To Balance b/d	3,00,000	01.12.2016	By Bank A/c	90,000
				By Provision for Depreciation A/c	30,000
				By Profit and Loss A/c	80,000
			31.03.2017	By Balance c/d	1,00,000
		3,00,000			3,00,000
01.04.2017	To Balance b/d	1,00,000	01.12.2017	By Bank A/c	85,000
01.12.2017	To Bank A/c	2,50,000		By Provision for Depreciation A/c	20,000
	To Profit and Loss A/c	5,000	31.03.2018	By Balance c/d	2,50,000
		3,55,000			3,55,000

Dr. Cr.

DEPRECIATION ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
31.03.2016	To Provision for Depreciation A/c	25,000	31.03.2016	By Profit and Loss A/c	25,000
		25,000			25,000

01.12.2016	To Provision for Depreciation A/c	10,000	31.03.2017	By Profit and Loss A/c	20,000
31.03.2017	To Provision for Depreciation A/c	10,000			
		20,000			20,000
01.12.2017	To Provision for Depreciation A/c	5,000	31.03.2018	By Profit and Loss A/c	17,500
31.03.2018	To Provision for Depreciation A/c	12,500			
		17,500			17,500

Dr.

PROVISION FOR DEPRECIATION ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2016	To Balance c/d	25,000	31.03.2016	By Depreciation A/c (₹ 20,000 + ₹ 5,000)	25,000
		25,000			25,000
01.12.2016	To Machinery A/c (₹ 20,000 + ₹ 10,000)	30,000	01.04.2016	By Balance b/d	25,000
31.03.2017	To Balance c/d	15,000	01.12.2016	By Depreciation A/c	10,000
		45,000	31.03.2017	By Depreciation A/c	10,000
					45,000
01.12.2017	To Machinery A/c (₹ 5,000 + ₹ 10,000 + ₹ 5,000)	20,000	01.04.2017	By Balance b/d	15,000
31.03.2018	To Balance c/d	12,500	01.12.2017	By Depreciation A/c	5,000
		32,500	31.03.2018	By Depreciation A/c	12,500
					32,500

ILLUSTRATION 13

On April 1, 2015, X Ltd. purchased a machinery for ₹ 12,00,000. On Oct. 1, 2017, a part of the machinery purchased on April 1, 2015 for ₹ 80,000 was sold for ₹ 45,000 and a new machinery at a cost of ₹ 1,58,000 was purchased and installed on the same date. The company has adopted the method of providing 10% p.a. depreciation on the diminishing balance of the machinery.

Required: Show the necessary ledger accounts assuming that (a) 'Provision for Depreciation Account' is not maintained, (b) 'Provision for Depreciation Account' is maintained.

SOLUTION

(a) When 'Provision for Depreciation Account' is not maintained

Dr.

MACHINERY ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2015	To Bank A/c	12,00,000	31.03.2016	By Depreciation A/c	1,20,000
				By Balance c/d	10,80,000
		12,00,000			12,00,000
01.04.2016	To Balance b/d	10,80,000	31.03.2017	By Depreciation A/c	1,08,000
				By Balance c/d	9,72,000
		10,80,000			10,80,000

01.04.2017	To Balance b/d	9,72,000	01.10.2017	By Bank A/c	45,000
01.10.2017	To Bank A/c	1,58,000		By Profit & Loss A/c	16,560
				By Depreciation A/c	3,240
			31.03.2018	By Depreciation A/c	98,620
				By Balance c/d	9,66,580
		11,30,000			11,30,000

(b) When 'Provision for Depreciation Account' is maintained
Dr.
MACHINERY ACCOUNT (AT ORIGINAL COST)
Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2015	To Bank A/c	12,00,000	31.03.2016	By Balance c/d	12,00,000
01.04.2016	To Balance b/d	12,00,000	31.03.2017	By Balance c/d	12,00,000
01.04.2017	To Balance b/d	12,00,000	01.10.2017	By Machinery	
01.10.2017	To Bank A/c	1,58,000	31.03.2018	Disposal A/c	80,000
				By Balance c/d	12,78,000
		13,58,000			13,58,000

Dr.
PROVISION FOR DEPRECIATION ACCOUNT
Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2016	To Balance c/d	1,20,000	31.03.2016	By Depreciation A/c	1,20,000
31.03.2017	To Balance c/d	2,28,000	01.04.2016	By Balance b/d	1,20,000
		2,28,000	31.03.2017	By Depreciation A/c	1,08,000
					2,28,000
01.10.2017	To Machinery	18,440	01.04.2017	By Balance b/d	2,28,000
	Disposal A/c		01.10.2017	By Depreciation A/c	3,240
31.03.2018	To Balance c/d	3,11,420	31.03.2018	By Depreciation A/c	98,620
		3,29,860			3,29,860

Dr.
MACHINERY DISPOSAL ACCOUNT
Cr.

Date	Particulars	₹	Date	Particulars	₹
01.10.2017	To Machinery A/c	80,000	01.10.2017	By Provision for	
				Depreciation A/c	18,440
				By Bank A/c	45,000
				By P & L A/c	16,560
				(Loss on sale)	
		80,000			80,000

Working Notes:
1. CALCULATION OF PROFIT/LOSS ON SALE OF MACHINERY

Particulars	₹
A. Original Cost	80,000
B. Less: Depreciation @ 10% p.a. for First year	8,000

C. Book Value	72,000
D. Less: Depreciation @ 10% p.a. for Second year	7,200
E. Book Value	64,800
F. Less: Depreciation @ 10% p.a. upto date of sale [$\text{₹ } 64,800 \times 10/100 \times 6/12$]	3,240
G. Book Value as on Date of Sale	61,560
H. Sale Proceeds	45,000
I. Loss on Sale [G – H]	16,560

2. CALCULATION OF DEPRECIATION FOR CURRENT YEAR ON MACHINES (OTHER THAN SOLD)

Particulars	₹
A. On Old Machine 10% of [$\text{₹ } 9,72,000 - \text{₹ } 64,800$]	90,720
B. On New Machine of [$\text{₹ } 1,58,000 \times 10/100 \times 6/12$]	7,900
	98,620

14.0 MEANING AND OBJECTIVES OF PROVISION

MEANING OF PROVISION

The term 'provision' refers to any of the following amounts:

- The amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets; or
- The amount retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy.

EXAMPLES OF PROVISIONS

- Provision for Depreciation,
- Provision for Taxation,
- Provision for Doubtful Debts,
- Provision for Discount on Debtors,
- Provision for Repairs and Renewals.

Note: if the amount of any known liability can be determined with substantial accuracy, a definite liability should be created instead of making a provision for it e.g. Liability for Outstanding Rent/ Salary etc.

OBJECTIVE OF PROVISION

Provision is created to cover a loss in the value of assets, or a loss or expenses, the amount of which cannot be determined with substantial accuracy.

NEED FOR PROVISION FOR DOUBTFUL DEBTS

A provision for doubtful debts is created to cover the loss of possible bad debts by means of a predetermined percentage of net debtors (i.e., debtors less bad debts) with a view to bring in a certain element of certainty in the amount of bad debts charged for each accounting period.

NEED FOR PROVISION FOR DISCOUNT ON DEBTORS

Provision for Discount on Debtors is created to provide for discount likely to be allowed on good debtors (i.e., Sundry Debtors less additional bad debts given outside the Trial Balance and the provision for doubtful debts).

ACCOUNTING TREATMENT OF PROVISION

Provision is a **charge against the profits** and is created by debiting Profit & Loss Account.

DISCLOSURE OF PROVISION

Provision is shown *either* on assets side by way of deduction from the respective asset in relation to which it has been created (e.g. Provision for Depreciation is shown by way of deduction from the Respective Fixed Asset, Provision for Doubtful Debt is shown by way of deduction from Debtors) *or* on the liabilities side under the sub-head 'Provisions' e.g. Provision for tax.

15.0 MEANING, OBJECTIVES AND TYPES OF RESERVES

MEANING OF 'RESERVE'

The term 'Reserve' refers to the profits retained in the business not having any of the attributes of a 'provision'. If however, the provision exceeds the amount which is required to meet the loss *or* the liability, the excess is to be treated as reserve. In other words, Reserve means Accumulated *or* Undistributed profits.

OBJECTIVES OF RESERVE

1. To strengthen the financial position of the concern,
2. To provide funds for the modernization and/or expansion of existing plant *or* acquisition of a new plant,
3. To equalize the dividend during the periods of inadequate profits,
4. To comply with legal requirements e.g. Debenture Redemption Reserve, Capital Redemption Reserve under the Companies Act 1956, Development Allowance Reserve, Foreign Project Allowance Reserve under the Income Tax Act, 1961,
5. To meet unforeseen abnormal losses.

TYPES OF RESERVES

Basically, there are two types of reserves viz. Revenue Reserves and Capital Reserves.

- (a) **Revenue reserve** — Revenue Reserves are those reserves which are created out of profits available for distribution by way of dividend. Revenue Reserves may be classified into two categories as under:
- (i) **General reserve** — General Reserve is that reserve which is not created for a specific purpose. Examples of such reserves include General Reserve, Contingency Reserve etc.
 - (ii) **Specific reserve** — Specific reserve is that reserve which is created for a specific purpose. Examples of such reserves include Dividend Equalization Reserve, Debenture Redemption Reserve, Investment Fluctuation Reserve, Workmen Compensation Reserve.
- (b) **Capital reserve** — Capital reserves are those reserves which are not created out of operating profits. In case of companies, the following are the examples of capital profits:
- (a) Profits prior to incorporation, (b) Premium on the issue of shares and debentures, (c) Profit on reissue of forfeited shares, (d) Profit on redemption of debentures, (e) Profit on sale of fixed assets, (f) Profit on revaluation of fixed asset, (g) Profit on sale of the whole undertaking *or* a part of it.

DISTINCTION BETWEEN REVENUE AND CAPITAL RESERVE

Revenue reserve refers to the amounts which are free for distribution by way of dividend. Capital reserve refers to the amounts which are not free for distribution by way of dividend.

DISTINCTION BETWEEN PROVISION AND RESERVE

A Provision can be distinguished from a Reserve as follows:

Basis of Distinction	Provision	Reserve.
1. Purpose	It is created for a particular purpose and can only be used for that particular purpose.	It need not necessarily be created for a particular purpose . e.g., General reserve is not for any particular purpose.
2. Charge Vs. Appropriation	It is a charge against the profit and is required to be created irrespective of the amount of profit.	It is an appropriation out of profit and can be created only if profits have been earned.
3. Disclosure in Income Statement	It is shown on the debit side of P & L A/c.	It is shown on the debit side of P & L Appropriation A/c.
4. Disclosure in Balance Sheet	Usually a provision is shown by way of deduction from the amount of the items for which the it is created. e.g. Provision for Doubtful Debts.	Reserve is shown as a separate item under the head Reserves and Surplus on the liabilities side of the Balance Sheet.
5. Investment outside the business	There is no question of investment of the amount of provisions.	The amount of a reserve can be invested outside the business.
6. Utilisation for Dividends	It cannot be utilised for distribution by way of dividends.	It can be utilised for distribution by way of dividends.
7. Legal Necessity	It is made mainly because of legal necessity.	It is a matter of financial prudence.

16.0. CHANGE IN THE METHOD OF DEPRECIATION

When can a Change in Method of Depreciation be made?	If Adoption of new method is required - 1. By Statute. 2. To Comply with Accounting Standard. 3. To have more appropriate preparation & presentation of Financial Statements of enterprise
Calculation of Depreciation	Depreciation should be recalculated as per New Method from the date of asset coming into use.
Treatment of Deficiency	The Deficiency should be debited to Statement of Profit & Loss of the year in which Method of Depreciation is changed. Journal Entry: Profit & Loss A/c To Fixed Asset A/c Dr.
Treatment of Surplus	The Surplus should be credited to Statement of Profit & Loss of the year in which Method of Depreciation is changed. Journal Entry: Fixed Asset A/c To Profit & Loss A/c Dr.

PROCEDURE FOR RECORDING A CHANGE IN THE METHOD OF DEPRECIATION WITH RETROSPECTIVE EFFECT

Step 1: Calculate the Total Depreciation already provided on assets existing as at the end of previous accounting year (i.e., assets other than sold/discarded/destroyed or exchanged upto the end of previous accounting year) as per Old Method upto the end of previous accounting year.

Step 2: Calculate the Total Depreciation on assets existing as at the end of previous accounting year retrospectively from the date of the asset coming into use as per the New Method upto the end of previous accounting year.

Step 3: Calculate the difference between the Total Depreciation under Old Method (as per Step 1) and that under New Method (as per Step 2).

Step 4: Adjust the Short Depreciation (Excess of Step 2 over Step 1) as follows:

Profit & Loss A/c Dr.

To Asset A/c / Provision for Depreciation A/c

OR

Adjust the Excess Depreciation (Excess of Step 1 over Step 2) as follows:

Asset A/c / Provision for Depreciation A/c Dr.

To Profit & Loss A/c

Step 5: Charge Depreciation from the current accounting year and onwards as per New Method.

ILLUSTRATION 14

On 1st January 2015 Bharat Tulsian Ltd. purchased two Machines I and II, costing ₹ 50,000 each and provided depreciation @ 10% p.a. on Straight Line Method basis. At the end of 2018, the company decided to change the method of depreciation from Straight Line Method to Written Down Value Method retrospectively, the rate of depreciation remaining the same. Prepare the Machinery Account upto 2018.

SOLUTION

Step 1: Total Depreciation already provided as per Old Method = ₹ 1,00,000 × 10% × 3 = ₹ 30,000

STEP 2: CALCULATION OF THE TOTAL DEPRECIATION AS PER NEW METHOD.

Particulars	₹
A. Cost as on 1.1.2015	1,00,000
B. Less: Depreciation for 2015	10,000
C. Book Value as on 1.1.2016	90,000
D. Less: Depreciation for 2016	9,000
E. Book Value as on 1.1.2017	81,000
F. Less: Depreciation for 2017	8,100
G. Book Value as on 1.1.2018	72,900

Total Depreciation under New Method: = ₹ 10,000 + ₹ 9,000 + ₹ 8,100 = ₹ 27,100

Step 3: Calculation of the difference between the Total Depreciation as per Old Method (as per Step 1) and that as per New Method (as per Step 2)

A. Total Depreciation under Old Method	₹ 30,000
B. Total Depreciation under New Method	₹ 27,100
C. Difference being Excess Depreciation	₹ 2,900

Step 4: Journal Entry to adjust Excess Depreciation

Machinery A/c Dr. ₹ 2,900

To Profit and Loss A/c ₹ 2,900

Step 5: Depreciation for the Current Year = 10% of ₹ 72,900 = ₹ 7,290

Step 6:

Dr.

MACHINERY ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.2015	To Bank A/c	1,00,000	31.12.2015	By Depreciation A/c	10,000
				By Balance c/d	90,000
		1,00,000			1,00,000
01.01.2016	To Balance b/d	90,000	31.12.2016	By Depreciation A/c	10,000
				By Balance c/d	80,000
		90,000			90,000
01.01.2017	To Balance b/d	80,000	31.12.2017	By Depreciation A/c	10,000
				By Balance c/d	70,000
		80,000			80,000
01.01.2018	To Balance b/d	70,000	31.12.2018	By Depreciation A/c	7,290
01.12.2018	To P&L A/c (Excess depreciation written back on account of change from WDV Method to SLM)	2,900		[10% of ₹ 72,900]	
				By Balance c/d	65,610
		72,900			72,900

ILLUSTRATION 15

Assuming that Machine I was sold on 30th June 2017 for ₹ 30,000 in Previous Illustration prepare Machinery Account upto 2018.

SOLUTION

Step 1: Calculation of the total depreciation already provided on assets existing at the end of previous accounting year under old method upto the end of previous accounting year

Total Depreciation under Old Method = ₹ 50,000 × 10% × 3 = ₹ 15,000

Step 2: Calculation of the total depreciation on assets existing at the end of previous accounting year under new method upto the end of previous accounting year.

Particulars	₹
A. Cost as on 1.1.2015	50,000
B. Less: Depreciation for 2015	5,000
C. Book Value as on 1.1.2016	45,000
D. Less: Depreciations for 2016	4,500
E. Book Value as on 1.1.2017	40,500
F. Less: Depreciation for 2017	4,050
G. Book Value as on 1.1.2018	36,450

Total Depreciation under New Method: = ₹ 5,000 + ₹ 4,500 + ₹ 4,050 = ₹ 13,550

Step 3: Calculation of the difference between the total Depreciation under Old Method (as per Step 1) and that under New Method (as per Step 2)

Working Note: Calculation of Loss on Sale of Machine I

A. Cost of Machine I	₹ 50,000
B. Less: Depreciation for 2.5 years upto date of sale [₹ 50,000 × 2.5 × 10%]	₹ 12,500
C. Book Value as on date of sale [A – B]	₹ 37,500
D. Less: Sale Proceeds	₹ 30,000
E. Loss on Sale (C – D)	₹ 7,500

Note: Asset disposed off upto the end of previous accounting year has not been considered for recomputation of depreciation since the net effect on Profit and Loss Account remains the same irrespective of the fact whether or not such asset is considered for recomputation of depreciation. This can be observed from the following calculations:

Particulars	If Asset disposed off is not considered	If Asset disposed off is considered
A. Profit and Loss A/c to be debited with loss	₹ 7,500	₹ 8,950 [₹ 7,500 + ₹ 1,450]
B. P & L A/c to be credited with excess depreciation	₹ 1,450	₹ 2,900
C. Net Debit to P&L A/c	₹ 6,050	₹ 6,050

ILLUSTRATION 16

Assuming that Machine I was sold on 30th June 2018 for ₹ 30,000 in Illustration 14, prepare Machinery Account upto 2018.

SOLUTION

Step 1: Calculation of the total depreciation already provided on assets existing at the end of previous accounting year under old method upto the end of previous accounting year
Total Depreciation under Old Method = ₹ 1,00,000 × 10% × 3 = ₹ 30,000

Step 2: Calculation of the total depreciation on assets existing at the end of previous accounting year under new method upto the end of previous accounting year.

Particulars	₹
A. Cost as on 1.1.2015	1,00,000
B. Less: Depreciation for 2015	10,000
C. Book Value as on 1.1.2016	90,000
D. Less: Depreciation for 2016	9,000
E. Book Value as on 1.1.2017	81,000
F. Less: Depreciation for 2017	8,100
G. Book Value as on 1.1.2018	72,900

Total Depreciation under New Method: = ₹ 10,000 + ₹ 9,000 + ₹ 8,100 = ₹ 27,100

Step 3: Calculation of the difference between the total Depreciations under Old Method (as per Step 1) and that under New Method (as per Step 2)

A. Total Depreciation under Old Method	₹ 30,000
B. Total Depreciation under New Method	₹ 27,100
C. Difference being Excess Depreciation	₹ 2,900

Step 4: Journal Entry to adjust Excess Depreciation:

Machinery A/c	Dr.	₹ 2,900
To Profit and Loss A/c		₹ 2,900

Step 5: Depreciation for the current accounting year = 10% of ₹ 72,900 = ₹ 7,290

Step 6:

Dr.

MACHINERY ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.2015	To Bank A/c: Machine I Machine II	50,000 50,000	31.12.2015	By Depreciation A/c: Machine I Machine II By Balance c/d: Machine I Machine II	5,000 5,000 45,000 45,000
		1,00,000			1,00,000
01.01.2016	To Balance b/d: Machine I Machine II	45,000 45,000	31.12.2016	By Depreciation A/c: Machine I Machine II By Balance c/d: Machine I Machine II	5,000 5,000 40,000 40,000
		90,000			90,000
01.01.2017	To Balance b/d: Machine I Machine II	40,000 40,000	31.12.2017	By Depreciation A/c: Machine I Machine II By Balance c/d: Machine I Machine II	5,000 5,000 35,000 35,000
		80,000			80,000
01.01.2018	To Balance b/d: Machine I Machine II	35,000 35,000	30.06.2018	By Depreciation A/c (Machine I)	1,823
31.12.2018	To P&L A/c (Being the excess depreciation written back on account of change from WDV Method of SLM)	2,900	31.12.2018	By Bank A/c (Sale Proceeds)	30,000
			31.12.2018	By P&L A/c (Loss on Sale)	4,627
				By Depreciation A/c (10% of ₹ 36,450)	3,645
				By Balance c/d	32,805
		72,900			72,900

Working Note: Calculation of Loss on Sale of Machine I

Particulars	₹
A. Cost of Machine I	50,000
B. Less: Depreciation for 2015	5,000
C. Book Value as on 1.1.2016	40,500
D. Less: Depreciation for 2016	4,500

E. Book Value as on 1.1.2017	40,500
F. Less: Depreciation for 2017	4,050
G. Book Value as on 1.1.2018	36,450
H. Less: Depreciation upto 30.6.2018	1,823
I. Book Value as on 30.6.2018	34,627
J. Less: Sale Proceeds	30,000
K. Loss on Sale	4,627

ILLUSTRATION 17

Bharat Ltd. which depreciates its machinery at 10% p.a. straight line basis, had on 1st April 2017 ₹ 28,000 to the debit of Machinery Account. On 31st March 2018, the company decided to change the method of depreciation to diminishing balance method with effect from 1st April, 2014 being the date of purchase of machine and the rate of depreciation remaining the same. There was no purchase/sale of machine after 1st April, 2014. Pass the necessary journal entry on account of change in method of depreciation.

SOLUTION

Cost as on 1.4.2017 = ₹ 28,000/.70 = ₹ 40,000

- Total Depreciation under Old Method = ₹ 40,000 – ₹ 28,000 = ₹ 12,000
- Total Depreciation under New Method = ₹ 40,000 – [₹ 40,000 × 90% × 90% × 90%] = ₹ 10,840
- Excess Depreciation to be written back ₹ 1,160

JOURNAL ENTRY TO ADJUST EXCESS DEPRECIATION

Machinery A/c	Dr. ₹1,160
To Profit and Loss A/c	₹ 1,160

(Being the Excess Depreciation written back on a/c of change in method of Depreciation)

ILLUSTRATION 18

Bharat Tushar Ltd. which depreciates its machinery at 10% p.a. on diminishing balance method, had on 1st April 2017 ₹ 29,160, to the debit of Machinery Account. On 31st March 2018, the company decided to change the method of depreciation to Straight Line Method with effect from 1st April 2014 being the date of purchase of machine and the rate of depreciation remaining the same. There was no purchase/sale of machine after 1st April, 2014. Pass the necessary journal entry on account of change in method of depreciation.

SOLUTION

Cost as on 1.4.2017 = ₹ 29,160/(.90 × .90 × .90) = ₹ 40,000

- Total Depreciation under Old Method = ₹ 40,000 – ₹ 29,160 = ₹ 10,840
- Total Depreciation under New Method = ₹ 40,000 × 10% × 3 = ₹ 12,000
- Short Depreciation to be provided = ₹ 1,160

JOURNAL ENTRY TO ADJUST SHORT DEPRECIATION

Profit and Loss A/c	Dr. ₹ 1,160
To Machinery A/c	₹ 1,160

(Being the Short Depreciation provided on a/c of change in method of Depreciation)

ILLUSTRATION 19

Messrs Mill and Wright commenced business on January 1, 2014, when they purchased plant and equipment for ₹ 7,00,000. They adopted a policy of (i) charging depreciation at 15% p.a. on diminishing balance basis and (ii) charging full year's depreciation on additions. Over the years, their purchases of plant have been: 1.8.2015 ₹ 1,50,000, 30.9.2018 ₹ 2,00,000.

On 1.1.2018, it was decided to change the method and rate of depreciation to 10% p.a. on straight line basis with retrospective effective from 1.1.2014, the adjustment being made in the accounts for the year ending December 31, 2018.

Required: Calculate the difference in depreciation to be adjusted in the Plant and Equipment Account on 1.1.2018 and show the ledger account for the year 2018.

SOLUTION**CALCULATION OF SHORT/EXCESS DEPRECIATION**

Year A	Cost B	WDV as on 1.1.2017 C	Dep. under WDV D = B – C	Dep. under SLM E
2014	7,00,000	$(7,00,000 \times .85 \times .85 \times .85 \times .85) = ₹ 3,65,404$	3,34,596	$(7,00,000 \times 10\% \times 4) = 2,80,000$
2015	1,50,000	$(1,50,000 \times .85 \times .85 \times .85) = ₹ 92,119$	57,881	$(1,50,000 \times 10\% \times 3) = 45,000$
	8,50,000	4,57,523	3,92,477	3,25,000

Excess Depreciation charged = ₹ 3,92,477 – ₹ 3,25,000 = ₹ 67,477

Current year's profit would be increased by ₹ 67,477 due to change in the method of depreciation.

Dr.

PLANT AND EQUIPMENT ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.2018	To Balance b/d (8,50,000 – 3,92,477)	4,57,523	31.12.2018	By Depreciation A/c (10% of original cost)	1,05,000
30.09.2018	To Bank A/c	2,00,000	31.12.2018	By Balance c/d	6,20,000
31.12.2018	To Profit and Loss A/c (depreciation written back)	67,477			
		7,25,000			7,25,000

ILLUSTRATION 20

The Plant and Machinery Account of a Company had a debit balance of ₹ 1,47,390 on 1st January, 2018. The company was incorporated in 2015 and has been following the practice of charging full year's depreciation every year on Diminishing Balance System @ 15% p.a. In 2018, it was, however, decided to change the method from Reducing System to Straight Line with retrospective effect from 2015 and to give effect of the change while preparing the Final Accounts for the year ended 31st December, 2018, the rate of depreciation remaining same as before. In 2018, new machine was purchased at a cost of ₹ 50,000. All the other machines were acquired in 2015.

Required: Show the Plant and Machinery Account from 2015 to 2018.

SOLUTION

Dr.

PLANT AND MACHINERY ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.2015	To Bank A/c	2,40,000	31.12.2015	By Depreciation A/c (15% on ₹ 2,40,000)	36,000
				By Balance c/d	2,04,000
		2,40,000			2,40,000
01.01.2016	To Balance b/d	2,04,000	31.12.2016	By Depreciation A/c (15% of ₹ 2,04,000)	30,600
				By Balance c/d	1,73,400
		2,04,000			2,04,000
01.01.2017	To Balance b/d	1,73,400	31.12.2017	By Depreciation A/c (15% of ₹ 1,73,400)	26,010
				By Balance c/d	1,47,390
		1,73,400			1,73,400
01.01.2018	To Balance b/d	1,47,390	31.12.2018	By Depreciation A/c [15% of (₹ 2,40,000 + ₹ 50,000)]	43,500
	To Bank A/c (purchases)	50,000		By Profit and Loss A/c (Short provision due to change in method)	15,390
				By Balance c/d	1,38,500
		1,97,390			1,97,390

Working Notes:

- Cost as on 1.1.2015 = ₹ 1,47,390 × 100/85 × 100/85 × 100/85 = ₹ 2,40,000
- Short Provision of Depreciation*
 - Depreciation to be charged under SLM = [(15% on ₹ 2,40,000) × 3] 1,08,000
 - Depreciation already charged under WDV = [(₹ 36,000 + ₹ 30,600 + ₹ 26,010)] 92,610
 - Short depreciation to be charged due to change in method (A – B) 15,390

ILLUSTRATION 21

Ram Ltd which depreciates its machinery at 10% p.a. on Diminishing Balance Method, had on January 1, 2018 ₹ 9,72,000 on the debit side of Machinery Account. During the year 2018, machinery purchased on January 1, 2016 for ₹ 80,000 was sold for ₹ 45,000 on July 1, 2018 and a new machinery at a cost of ₹ 1,50,000 was purchased and installed on the same date, installation charges being ₹ 8,000. The company wanted to change the method of depreciation from Diminishing Balance Method to Straight Line Method with effect from January 1, 2016. Difference of depreciation upto December 31, 2018 to be adjusted. The rate of depreciation remains the same as before.

Required: Show Machinery Account.

SOLUTION

Dr.

MACHINERY ACCOUNT FOR THE YEAR 2018

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.2018	To Balance b/d	9,72,000	01.07.2018	By Bank A/c (Sale)	45,000
01.07.2018	To Bank A/c	1,50,000	01.07.2018	By Depreciation A/c	4,000
	To Bank A/c	8,000	31.12.2018	By P & L A/c (Loss on sale)	15,000
			31.12.2018	By P & L A/c (Additional Depreciation)	12,000
			31.12.2018	By Depreciation A/c	1,19,900
				By Balance c/d	9,34,100
		11,30,000			11,30,000

Working Notes:**1. CALCULATION OF W.D.V. AS ON 01.01.2016**

Particulars	₹
A. W.D.V. as on 1.1.2018	9,72,000
B. Add: Depreciation during 2017 ($\text{₹ } 9,72,000 \times 1/9$)	1,08,000
C. W.D.V. as on 1.1.2017	10,80,000
D. Add: Depreciation during 2016 ($\text{₹ } 10,80,000 \times 1/9$)	1,20,000
E. W.D.V. as on 1.1.2016	12,00,000

2. CALCULATION OF LOSS ON SALE OF MACHINERY

Particulars	₹
A. Original Cost as on 1.1.2016	80,000
B. Less: Depreciation @ 10% for 2½ years	20,000
C. Book Value as on 1.7.2018	60,000
D. Sale Proceeds	45,000
E. Loss on sale	15,000

3. CALCULATION OF DEPRECIATION FOR 2018

(a) On Machines (Other than sold one) existing as on 1.1.2018 @ 10% on ($\text{₹ } 12,00,000 - \text{₹ } 80,000$)	₹ 1,12,000
(b) On Machine Purchased on 1.7.2018 (10% on ₹ 1,58,000 for 6 months)	₹ 7,900
	₹ 1,19,900

4. CALCULATION OF DIFFERENCE IN THE AMOUNT OF DEPRECIATION UNDER OLD METHOD AND NEW METHOD ON THE MACHINERIES

A. Depreciation on SLM basis for 2 years [$\text{₹ } 12,00,000 \times 10\% \times 2$]	₹ 2,40,000
B. Depreciation on W.D.V. basis for 2 years	
for 2016 on	₹ 12,00,000 ₹ 1,20,000
for 2017 on	₹ 10,80,000 ₹ 1,08,000
C. Difference still to be adjusted (A – B)	₹ 12,000

ILLUSTRATION 22

Tulsian Ltd. provides you the following information:

<i>Date</i>	<i>Particulars</i>
01.04.2015	Purchased 10 second hand Machines for ₹ 9,00,000. incurred ₹ 70,000 towards freight & insurance, ₹ 20,000 towards carriage inward, Residual Value ₹ 4,09,600, Useful life 4 years.
01.01.2016	Incurred ₹ 7,000 towards Repairs and ₹ 3,000 on installation of machines and ₹ 12,000 towards Annual Insurance Premium and commenced the commercial production.
01.10.2016	Sold one machine at a profit of 10%
01.01.2017	Incurred ₹ 10,000 on repairs of Machines
01.01.2018	Sold one machine at a loss of 10% and purchased a new machine for ₹ 90,000 and spent ₹ 10,000 on its installation

Depreciation was annually provided on 31st March on the written down value. On 31st March, 2018, it was decided to adopt the method of providing depreciation @ 20% p.a. on original cost.

Required: Prepare the Machinery Account for three financial years .

SOLUTION

Dr.

MACHINE ACCOUNT

Cr.

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
01.04.2015	To Bank A/c	9,00,000	31.03.2016	By Depreciation A/c [10,00,000 × 20% × 3/12]	50,000
01.04.2015	To Bank A/c	90,000		By Balance c/d	9,50,000
01.01.2016	To Bank A/c	10,000			
		10,00,000			10,00,000
1.04.2016	To Balance b/d	9,50,000	01.10.2016	By Depreciation A/c [95,000 × 20% × 6/12]	9,500
	To P & L A/c [Profit] [(95,000 – 9,500) × 10%]	8,550		By Bank A/c [(95,000 – 9,500) + 10%]	94,050
			31.03.2017	By Depreciation A/c [(9,50,000 – 95,000) × 20% × 12/12]	1,71,000
				By Balance c/d	6,84,000
		9,58,550			9,58,550
01.04.2017	To Balance b/d	6,84,000	01.01.2018	By Depreciation A/c [76,000 × 20% × 9/12]	11,400
01.01.2018	To Bank A/c	90,000		By Bank A/c [(76,000 – 11,400) – 10%]	58,140
	To Bank A/c	10,000		By P & L A/c [Loss] [(76,000 – 11,400) × 10%]	6,460
			31.03.2018	By P & L A/c (Short Depreciation)	8,000
				By Depreciation A/c: Old [8,00,000 × 20%]	1,60,000

				New [1,00,000 × 20% × 3/12]	5,000
				By Balance c/d:	
				Old 4,40,000	
				New 95,000	5,35,000
		7,84,000			7,84,000

Working Notes:

- WDV rate of Depreciation = $1 - 4 \sqrt{\frac{₹4,09,600}{₹10,00,000}} = 20\%$
- Calculation of Excess/Short Depreciation on 8 Machines
 - Depreciation already provided on WDV basis @ 20% p.a.
 $= [8,00,000] - [8,00,000 \times .95 \times .80] = ₹ 1,92,000$
 - Depreciation which should have been provided on SLM basis @ 20% p.a.
 $= [8,00,000 \times 20\% \times 15/12] = ₹ 2,00,000$
 - Short Depreciation still to be written off (A – B) = ₹ 8,000

ILLUSTRATION 23

Tulsian Ltd. provides you the following information:

Date	Particulars
	The Machinery Account of Tulsian Ltd had a debit balance of ₹ 6,84,000 on 1st April, 2017
01.04.2015	Purchased 10 second hand Machines of the same type and incurred ₹ 70,000 towards freight & insurance, ₹ 20,000 towards carriage inward
01.01.2016	Incurred ₹ 7,000 towards Repairs and ₹ 3,000 on Installation of machines and ₹ 12,000 towards Annual Insurance Premium and commenced the commercial production.
01.10.2016	Sold one machine at a profit of 10%
01.01.2017	Incurred ₹ 10,000 on repairs of Machines
01.01.2018	Sold one machine at a loss of 10% and purchased a new machine for ₹ 90,000 and spent ₹ 10,000 on its installation

Depreciation was annually provided on 31st March @ 20% p.a on the written down value. On 31st March, 2018, it was decided to adopt the method of providing depreciation @ 20% p.a. on original cost.

Required: Prepare the Machinery Account for three financial years.

SOLUTION**CALCULATION OF PURCHASE PRICE OF 10 MACHINES AS ON 01.04.2015**

Particulars	₹
A. W.D.V. of 9 Machines as on 1.4.2017	8,64,000
B. Add: Depreciation during 2016-2017 (₹8,64,000 × 20/80)	1,71,000
C. W.D.V. of 9 Machines as on 1.4.2016	8,55,000
D. Book Value of 1 Machine (8,55,000 × 1/9)	95,000
E. W.D.V. of 10 Machines as on 1.4.2016	9,50,000
F. Add: Depreciation during 2015-2016 (₹ 9,50,000 × 5/95)	50,000
G. Total Cost of 10 Machines as on 1.1.2016	10,00,000

H. Less: Repairs and on Installation Incurred on 1.1.2016	10,000
I. Less: freight & insurance, and carriage inward Incurred on 1.4.2015	90,000
J. Purchase Price of 10 Machines as on 1.4.2015	9,00,000

Remaining solution same as given in the previous Problem.

ILLUSTRATION 24

X Ltd. purchased on 1st October, 2014, a machinery for ₹ 32,000 and spent ₹ 5,000 on freight and transit insurance. On 25th December, 2014, it further spent ₹ 3,000 on its erection. The machinery was put to use on 1-1-2015. On July 1, 2016, it purchased another machine for ₹ 10,000 and on July 1, 2017 sold off the first machine purchased in 2015 for ₹ 28,000; on the same date it purchased a machinery for ₹ 25,000. On 1st July, 2018 the second machinery purchased for ₹ 10,000 was also sold off for ₹ 2,000. Depreciation was provided on the Machinery at a rate of 10% p.a. on the original cost annually on 31st December. In 2018, however, the company changed the method of providing depreciation and adopted the written down value method, the rate of depreciation being 15% p.a. with effect from January 1, 2015.

Required: Prepare Machinery Account upto the year ending 31-12-2018.

SOLUTION

Dr.

MACHINERY ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.10.2014	To Bank A/c	32,000	31.12.2014	By Balance c/d	40,000
01.10.2014	To Bank A/c (Freight)	5,000			
25.12.2014	To Bank A/c (Erection)	3,000			
		40,000			5,00,000
01.01.2015	To Bank A/c: Machine I	40,000	31.12.2015	By Depreciation A/c	4,000
				By Balance c/d	36,000
		40,000			40,000
01.01.2016	To Balance b/d	36,000	31.12.2016	By Depreciation A/c:	
01.07.2016	To Bank A/c (Machine II)	10,000		Machine I 4,000	
				Machine II 500	4,500
				By Balance c/d:	
				Machine I 32,000	
				Machine II 9,500	41,500
		46,000			46,000
01.01.2017	To Balance b/d:		01.07.2017	By Depreciation A/c [₹ 40,000 × 10/100 × 6/12]	2,000
	Machine I 32,000				
	Machine II 9,500	41,500		By Profit & Loss A/c (Loss) [(₹ 32,000 – ₹ 2,000) – ₹ 28,000]	2,000
01.07.2017	To Bank A/c Machine III	25,000		By Bank A/c	28,000
			31.12.2017	By Depreciation A/c:	
				Machine II 1,000	
				Machine III 1,250	2,250

				By Balance c/d: Machine II 8,500 Machine III 23,750	32,250
		66,500			66,500
01.01.2018	To Balance b/d: Machine II 8,500 Machine III 23,750	32,250	01.07.2018	By Depreciation A/c	590
			01.07.2018	By Bank A/c	2,000
			31.12.2018	By Profit & Loss A/c (Loss) [₹ 7,272 – ₹ 2,000]	5,272
			31.12.2018	By Profit & Loss A/c [Short Depreciation]	1,263
			31.12.2018	By Depreciation A/c [15% on (₹ 25,000 – 15% of ₹ 25,000 for 6 months)]	3,469
				By Balance c/d	19,656
		32,250			32,250

Working Notes:
1. CALCULATION OF LOSS ON SALE OF MACHINE II

A. Cost of Machine II	₹ 10,000	
B. Less: Depreciation @ 15% for 1/2 year	₹ 750	
C. Book Value as on 31.2015.2016	₹ 9,250	
D. Less: Depreciation @ 15%	₹ 1,388	
E. Book Value as on 31.2015.2017	₹ 7,862	
F. Less: Depreciation @ 15% for 1/2 year	₹ 590	
G. Book Value as on Date of Sale	₹ 7,272	
H. Sale Proceeds Loss on Sale	₹ 2,000	₹ 5,272

2. CALCULATION OF EXCESS/SHORT DEPRECIATION ON MACHINE II & III

A. Depreciation already provided on SLM basis @ 10% p.a.	
Machine II (₹ 500 + ₹ 1,000)	₹ 1,500
Machine III	₹ 1,250
	₹ 2,750
B. Depreciation which should have been provided on WDV basis @ 15% p.a.	
Machine II [10,000 – (10,000 × .925 × .85)]	2,138
Machine III [25,000 – (25,000 × .925)]	1,875
	4,013
C. Short Depreciation still to be adjusted (A – B) = ₹ 4,013 – ₹ 2,750 = ₹ 1,263	

ILLUSTRATION 25

Green Channel Co. purchased a second-hand machine on 1st January, 2015 for ₹ 1,60,000. Overhauling and erection charges amounted to ₹ 40,000. Another machine was purchased for ₹ 80,000 on 1st July, 2015.

On 1st July, 2017, the machine installed on 1st January, 2015 was sold for ₹ 1,00,000. On the same date another machine was purchased for ₹ 30,000 and was installed on 30th September, 2017.

Under the existing practice the company provides depreciation @ 10% p.a. on original cost. However, from the year 2018 it decided to adopt WDV method and to charge depreciation @ 15% p.a. This change was to be made with retrospective effect.

Prepare Machinery Account in the book of Green Channel Co. for the year 2015 to 2018.

SOLUTION

Dr.

MACHINERY ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.2015	To Bank A/c	1,60,000	31.12.2015	By Depreciation A/c	24,000
01.01.2015	To Bank A/c (Erection charges)	40,000		(₹ 20,000 + ₹ 4,000)	
01.07.2015	To Bank A/c	80,000	31.12.2015	By Balance c/d (₹. 1,80,000 + ₹ 76,000)	2,56,000
		2,80,000			2,80,000
01.01.2016	To Balance b/d	2,56,000	31.12.2016	By Depreciation A/c	28,000
				(₹ 20,000 + ₹ 8,000)	
			31.12.2016	By Balance c/d (₹ 1,60,000 + ₹ 68,000)	2,28,000
		2,56,000			2,56,000
01.01.2017	To Balance b/d	2,28,000	01.07.2017	By Bank A/c	1,00,000
30.09.2017	To Bank A/c	30,000		By Profit and Loss A/c (Loss on Sale)	50,000
			31.12.2017	By Depreciation A/c	18,750
				(₹ 10,000 + ₹ 8,000 + ₹ 750)	
				By Balance c/d	89,250
		2,58,000		(₹ 60,000 + ₹ 29,250)	
					2,58,000
01.01.2018	To Balance b/d	89,250	31.12.2018	By Profit and Loss A/c	6,910
				By Depreciation A/c (₹ 8,019.75 + ₹ 4,331.25)	12,351
				By Balance c/d (₹ 45,445.25 + ₹ 24,543.75)	69,989
		89,250			89,250

Working Notes:**1. CALCULATION OF SLM DEPRECIATION AND LOSS ON SALE OF MACHINE**

Particulars	Machine I ₹	Machine II ₹	Machine III ₹
A. Cost	2,00,000	80,000	30,000
B. Depreciation for 2015	20,000	4,000	
C. Written down value as on 31.12.2015	1,80,000	76,000	
D. Depreciation for 2016	20,000	8,000	
E. Written down value as on 31.12.2016	1,60,000	68,000	
F. Depreciation for 2017	10,000	8,000	750

G. Written down value as on 31.12.2017	1,50,000	60,000	29,250
H. Sale Proceeds	1,00,000		
I. Loss on sale	50,000		

2. CALCULATION OF DEPRECIATION OF MACHINES UNDER WDV METHOD

<i>Particulars</i>	<i>Machine II</i> ₹	<i>Machine III</i> ₹
Cost	80,000	30,000
Depreciation		
2015	6,000	
2016	11,100	
2017	9,435	1,125
Total depreciation	26,535	1,125

3. RETROSPECTIVE EFFECT OF CHANGE IN DEP. METHOD FOR MACHINES II & III

<i>Particulars</i>	₹
A. Depreciation under WDV (₹ 26,535 + ₹ 1,125)	27,660
B. Depreciation under SLM (₹ 20,000 + ₹ 750)	20,750
C. Short depreciation to be charged to Profit & Loss A/c	6,910

ILLUSTRATION 26

ABC Ltd. purchased on 1st Jan., 2015 second hand plant for ₹ 30,000 and immediately spent ₹ 20,000 in overhauling it. On 1st July, 2015 additional machinery of a cost of Its. 25,000 was purchased. On 1st July 2017, the plant purchased on 1st Jan., 2015 became obsolete and was sold for ₹ 10,000. On that date new machinery was purchased at cost of ₹ 60,000.

Depreciation was provided at 10% per annum on the original cost of the asset. In 2018 the company changed this method of providing depreciation to 15% per annum W. D. V. with retrospective effect.

Required: Show Plant and Machinery A/c, Provision for Depreciation A/c and Machine Disposal Account for the years 2015-2018.

SOLUTION

Dr.

MACHINERY ACCOUNT

Cr.

<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
01.01.2015	To Bank A/c-I	30,000	31.12.2015	By Balance c/d	75,000
01.01.2015	To Bank A/c	20,000			
01.07.2015	To Bank A/c-II	25,000			
		75,000			75,000
01.01.2016	To Balance b/d	75,000	31.12.2016	By Balance c/d	75,000
01.01.2017	To Balance b/d	75,000	01.07.2017	By Machine Disposal A/c	50,000
01.06.2017	To Bank A/c-III	60,000	31.12.2017	By Balance c/d	85,000
		1,35,000			1,35,000
1.1.2018	By Balance b/d	85,000	31.12.2018	By Balance c/d	85,000

Dr.

PROVISION FOR DEPRECIATION ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Balance c/d	6,250	31.12.2015	By Depreciation A/c: I 5,000 II (6 months) 1,250	6,250
		6,250			6,250
31.12.2016	To Balance c/d	13,750	01.01.2016	By Balance b/d:	
				I 5,000 II 2,500	7,500
		13,750			13,750
01.07.2017	To Machine Disposal A/c	10,000	01.01.2017	By Balance b/d	13,750
	To Balance c/d	9,250	31.12.2017	By Depreciation II 2,500 (for 6 months) III 3,000	5,500
		19,250			19,250
31.12.2018	To Balance c/d	23,623	01.01.2018	By Balance b/d	
			31.12.2018	By Profit & Loss A/c (Additional Depreciation)	
			31.12.2018	By Depreciation A/c: Machine II 2,506 Machine II 8,325	10,831
		23,623			23,623

Dr.

MACHINE DISPOSAL ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.07.2017	To Machine A/c	50,000	01.07.2017	By Provision for Depreciation	10,000
				By Depreciation (for 6 months)	2,500
				By Bank A/c	10,000
				By Profit and Loss A/c Loss (Balancing figure)	27,500
		50,000			50,000

Working Notes:**1. CALCULATION OF EFFECT DUE TO CHANGE OF METHOD**

Old Method	New 10% SLM	Method 15% WDV
Depreciation for 2015		
Machine II	1,250	1,875
Depreciation for 2016		
Machine II	2,500	3,469

Depreciation for 2017		
Machine II	2,500	2,498
Machine III	3,000	4,500
	9,250	12,792

Depreciation to be provided = 3,542

2. *Depreciation for current year as per New Method*

Machine II $(25,000 - 1,875 - 3,469 - 2948) \times 15/100 = 2,506$

Machine III $(60,000 - 4,500) \times = 8,325$

ILLUSTRATION 27

M/s. S.S. Traders commenced business on 1st January, 2015, when they purchased machinery of ₹ 7,00,000. They adopted a policy of (i) charging depreciation at 15% per annum on diminishing balance basis, and (ii) charging full year's depreciation on additions made during the year. Over the years, the purchases of Machinery have been:

Date	₹
01.08.2016	1,50,000
30.09.2018	2,00,000

On 1st January, 2018, it was decided to change the method of depreciation and rate of depreciation to 10% on straight line basis with retrospective effect from 1-1-2015, the adjustment being made in the accounts for the year ending 31st December, 2018.

Required: Prepare Machinery Account and Provision for Depreciation Account for the year 2018.

SOLUTION

Dr. **PLANT AND MACHINERY ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.2018	To Balance b/d	8,50,000	31.12.2018	By Balance c/d	10,50,000
30.09.2018	To Bank A/c	2,00,000			
		10,50,000			10,50,000

Dr. **PROVISION FOR DEPRECIATION ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.2018	To Profit and Loss A/c	71,738	01.01.2018	By Balance b/d	3,11,738
	(Additional Depreciation written back)		31.12.2018	By Depreciation A/c	1,05,000
	To Balance c/d	3,45,000			
		4,16,738			4,16,738

Working Notes:

Dr. **(I) PLANT AND MACHINERY ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.2015	To Bank A/c	7,00,000	31.12.2015	By Balance c/d	7,00,000
01.01.2016	To Balance b/d	7,00,000	31.12.2016	By Balance c/d	8,50,000

01.08.2016	To Bank A/c	1,50,000			
		8,50,000			8,50,000
01.01.2017	To Balance b/d	8,50,000	31.12.2017	By Balance c/d	8,50,000

Dr.

(II) PROVISION FOR DEPRECIATION ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Balance c/d	1,05,000	31.12.2015	By Depreciation A/c	1,05,000
31.12.2016	To Balance c/d	2,16,750	01.01.2016	By Balance b/d	1,05,000
				By Depreciation A/c	1,11,750
		2,16,750			2,16,750
31.12.2017	To Balance c/d	3,11,738	01.01.2017	By Balance b/d	2,16,750
				By Depreciation A/c	94,988
		3,11,738			3,11,738

(III) CALCULATION OF SHORT/EXCESS DEPRECIATION

Particulars	15%WDV Old Method	10%SLM New Method
On Machine I ₹. 7,00,000		
for 2015	1,05,000	70,000
for 2016	89,250	70,000
for 2017	75,863	70,000
	2,70,113	2,10,000
On Machine- II ₹. 1.50,000		
for 2016	22,500	15,000
for 2017	19,125	15,000
	41,625	30,000
Total Depreciation:	3,11,738	2,40,000

Difference = ₹ 3,11,738 – ₹ 2,40,000 = ₹ 71,738

17.0 SINKING FUND METHOD OR DEPRECIATION FUND METHOD**MEANING OF SINKING FUND OR DEPRECIATION FUND METHOD**

Sinking fund is created to provide a definite amount at a certain future date for a specific purpose of replacement of the asset at the end of its useful life.

WORKING OF SINKING FUND OR DEPRECIATION FUND METHOD

The working of this method may be summarized here as follows:

- A Sinking Fund described as Depreciation Fund is established for the purpose of accumulating sufficient funds to replace the asset at the end of its useful life.
- Creation of Depreciation Fund**—An amount equal to the annual depreciation of the asset is charged against the profits every year and accumulated in the form of Depreciation Fund.
- Purchase of Investments**—An equivalent amount of cash (or in the multiples of a specific denomination say ₹ 10 or ₹ 100) is withdrawn from the business and is invested outside the business in securities which are readily convertible into cash.

- (d) **Interest on DFI**—The interest on Depreciation Fund Investments is credited to Depreciation Fund Account.
- (e) **Sale of Investments**—At the time of replacement of the asset, the investments made are realised, Profit/Loss on sale of Depreciation Fund Investments is transferred to Depreciation Fund Account and the available money is used in replacing the asset concerned.

10. For Transfer of Interest on Depreciation Fund Investments

Interest on Depreciation Fund Investments A/c Dr. (with the amount of Interest)
 To Depreciation Fund A/c

11. For Providing Depreciation

Depreciation A/c Dr. (with the amount of depreciation)
 To Depreciation Fund A/c

12. For closure of Depreciation A/c

Profit and Loss A/c Dr. (with the amount of depreciation)
 To Depreciation A/c

13. For realising the Depreciation Fund Investments

Bank A/c Dr. (with sale proceeds of Investments)
 To Depreciation Fund Investments A/c sold)

14. For transfer of Profit or Loss on realisation of Depreciation Fund Investments

(a) in case of profit
 Depreciation Fund Investments A/c Dr. (with the amount of profit)
 To Depreciation Fund A/c

(b) in case of Loss
 Reverse of the above entry will be passed

15. For transfer of the Balance in Depreciation Fund A/c

Depreciation Fund A/c Dr. (with the balance left in
 To Respective Asset A/c Depreciation Fund Account)

16. For sale of Asset as scrap

Bank A/c Dr. (with the scrap realized)
 To Respective Asset A/c

17. For closure of Respective Asset A/c

(a) in case of Debit Balance
 Profit and Loss A/c Dr. (with the balance left in Asset
 To Respective Asset A/c Account)

(b) in case of Credit Balance
 Reverse of the above entry is passed

DISCLOSURE OF DEPRECIATION FUND ACCOUNT

Depreciation Fund Account shall appear under the head '**Reserves and Surplus**' on the liabilities side of the Balance Sheet till the respective asset is disposed off.

DISCLOSURE OF DEPRECIATION FUND INVESTMENT ACCOUNT

Depreciation Fund Investment Account shall appear under the head '**Investments**' on the assets side of the Balance Sheet till the realisation of the investments.

HOW TO CALCULATE THE AMOUNT OF DEPRECIATION TO BE PROVIDED FOR

The amount of depreciation to be provided for is to be calculated as follows:

Amount of Depreciation to be provided by

$$= (\text{Original Cost less Scrap Value}) \times \text{Present Value of } ₹ 1 \text{ at a given rate of interest}$$

or

$$= \frac{(\text{Original Cost less Scrap Value})}{\text{Present Value of an Annuity of Re 1 at a given rate of Interest}}$$

ILLUSTRATION 28

A machine costing ₹ 5,00,000 is expected to have an estimated useful life of 4 years and scrap value of ₹ 35,900 at the end of useful life. The sinking fund table shows that ₹ 0.215470803 invested at the end of each year at 10% compound interest will amount to ₹ 1 at the end of 4 years and ₹ 1 p.a. at 10% compound interest amounts to ₹ 4.641 in 4 years.

SOLUTION

Amount of Depreciation to be provided for

$$= (\text{₹ } 5,00,000 - \text{₹ } 35,900)(0.215470803) = \text{₹ } 1,00,000$$

or

$$= (\text{₹ } 5,00,000 - \text{₹ } 35,900)/4.641 = \text{₹ } 1,00,000$$

HOW TO CALCULATE THE AMOUNT OF INVESTMENTS TO BE MADE

The amount of investments to be made may be calculated as follows:

- (a) In case the Investments are to be made in multiples of some specific denomination (say ₹ 10, ₹ 20) only, then only that amount which is fully divisible by the given denomination should be invested, e.g., if the amount available for investment is ₹ 95,238.09 and the investments are to be made in the multiple of ₹ 100 only, then only ₹ 95,200 will be invested and the balance of ₹ 38.09 will be kept separately in Depreciation Fund Cash A/c which shall be considered at the time of making the investments during the next period.
- (b) In other cases where no specific direction has been given, the amount of profit set aside (*in case of Non-cumulative Depreciation Fund*) or the amount of profit set aside together with the amount of interest received on Depreciation investments (*in case of Cumulative Depreciation Fund*) should be invested fully.

TUTORIAL NOTES

- (i) *Depreciation Fund may be either cumulative or non-cumulative.*
- (ii) *In case of Cumulative Depreciation Fund, Interest on Depreciation Fund Investments is credited to Depreciation Fund A/c and interest is reinvested.*
- (iii) *In case of Non-cumulative Depreciation Fund, Interest on Depreciation Fund Investments is credited to Profit and Loss A/c and interest is not reinvested.*
- (iv) *No investment should be made in the last year since there is no logic behind first making investments in the last year and then immediately realising the same.*

HOW TO CALCULATE THE AMOUNT OF INTEREST ON DEPRECIATION FUND INVESTMENTS

In general, the amount of interest on Depreciation Fund Investments is calculated on the Opening Balance of Depreciation Fund Investment Account. Following tables may be helpful for this purpose.

Table I showing the Calculation of the Amount of Investments to be made and Interest to be received [when Investments are to be made equal to the Entire Profits set aside]

[For example, Interest Rate = 10%, Profits to be set aside = ₹ 2,00,000, Year of Realisation of Investments—4th year]

Year	Opening Balance B	Interest C = B × 10/100	Savings D	Investments E	Closing Balance F = B + E
2014-2015	—	—	2,00,000	2,00,000	2,00,000
2015-2016	2,00,000	20,000	2,00,000	2,20,000	4,20,000
2016-2017	4,20,000	42,000	2,00,000	2,42,000	6,62,000
2017-2018	6,61,000	66,200	2,00,000	—	—

Table II showing the Calculation of the Amount of Investments to be made and Interest to be received [When Investments are to be made equal to the nearest multiple of particulars denomination say ₹ 10, ₹ 100 etc.]

[For example, Interest Rate = 10%, Profits to be set aside = ₹ 47,403.40, Investments to be made in the nearest multiple of ₹ 100, Year of Realisation of Investments—4th year]

<i>Year</i>	<i>Opening Balance</i> <i>B</i>	<i>Interest</i> <i>C = B × 10/100</i>	<i>Savings</i> <i>D</i>	<i>Investments</i> <i>E</i>	<i>Closing Balance</i> <i>F = B + E</i>
2014-2015	—	—	47,403.40	47,400	47,400
2015-2016	47,400	4,740	47,403.40	52,200	99,600
2016-2017	99,600	9,960	47,403.40	57,400	1,57,000
2017-2018	1,57,000	15,700	47,403.40	—	—

ADVANTAGE OF DEPRECIATION FUND METHOD

The main advantage of using this method is that this method not only provides depreciation on asset but simultaneously makes provision for the replacement of the asset at the end of its useful life. If the amounts were not invested outside the business, the withdrawal of funds from regular business operations could have crippled the normal financial working of the business.

DISADVANTAGE OF DEPRECIATION FUND METHOD

The disadvantage of using this method is that the combined charge of depreciation and repairs will not be uniform throughout the life of an asset.

ILLUSTRATION 29

Tulsian Ltd. purchased a machinery for ₹ 9,00,000 on 1 April 2014 and incurred ₹ 1,00,000 towards freight, insurance, carriage inwards and installation charges. It was estimated that the machinery will have a scrap value of ₹ 71,800 at the end of its useful life which is 4 years. It was decided to institute a sinking fund for the purpose of accumulating sufficient funds to replace the machinery at the end of its useful life and to invest in some readily convertible securities yielding 10% interest p.a. Reference to the table shows that ₹ 1 p.a. at 10% compound interest amounts to ₹ 4.641 in 4 years. Investments are to be made in the bonds of ₹ 100 each available at par. On 31 March 2018, the investments realised ₹ 6,80,000 and scrap value of machinery realised ₹ 73,800 only. A new machine costing ₹ 10,00,000 was purchased on 31.3.2018.

Required: Prepare the journal and the necessary ledger accounts in the books of Tulsian Ltd. for 4 years.

SOLUTION

JOURNAL OF TULSIAN LTD.

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
01.04.2014	Machinery Dr. To Bank A/c (Being the Machinery purchased)		9,00,000	9,00,000
01.04.2014	Machinery Dr. To Bank A/c (Being the expenses incurred towards freight, insurance, carriage inwards and installation charges)		1,00,000	1,00,000

31.03.2015	Depreciation A/c To Depreciation Fund A/c (Being the depreciation provided)	Dr.		2,00,000	2,00,000
	Profit and Loss A/c To Depreciation A/c (Being the closure of Depreciation A/c)	Dr.		2,00,000	2,00,000
	Depreciation Fund Investment A/c To Bank A/c (Being the investments made in the multiples of ₹ 100)	Dr.		2,00,000	2,00,000
31.03.2016	Bank A/c To Interest on DFI A/c (Being the receipt of interest on DFI)	Dr.		20,000	20,000
	Interest on DFI A/c To Depreciation Fund A/c (Being the transfer of Interest on DFI to DF A/c)	Dr.		20,000	20,000
	Depreciation A/c To Depreciation Fund A/c (Being the depreciation provided)	Dr.		2,00,000	2,00,000
	Depreciation Fund Investments A/c To Bank A/c (Being the Investment made in the multiples of ₹ 100)	Dr.		2,20,000	2,20,000
	Profit and Loss A/c To Depreciation A/c (Being the closure of Depreciation A/c)	Dr.		2,00,000	2,00,000
31.03.2017	Bank A/c To Interest on DFI A/c (Being the receipt of interest on DFI)	Dr.		42,000	42,000
	Interest on DFI A/c To Depreciation Fund A/c (Being the transfer of Interest on DFI to DF A/c)	Dr.		42,000	42,000
	Depreciation A/c To Depreciation Fund A/c (Being the depreciation provided)	Dr.		2,00,000	2,00,000
	Profit and Loss A/c To Depreciation A/c (Being the closure of Depreciation A/c)	Dr.		2,00,000	2,00,000
	Depreciation Fund Investment A/c To Bank A/c (Being the investments made in the multiples of ₹ 100)	Dr.		2,42,000	2,42,000
31.03.2018	Bank A/c To Interest on DFI A/c (Being the receipt of interest on DFI)	Dr.		66,200	66,200
	Interest on DFI A/c To Depreciation Fund A/c (Being the transfer of Interest on DFI to DF A/c)	Dr.		66,200	66,200

	Depreciation A/c To Depreciation Fund A/c (Being the depreciation provided)	Dr.		2,00,000	2,00,000
	Profit and Loss A/c To Depreciation A/c (Being the closure of Depreciation A/c)	Dr.		2,00,000	2,00,000
	Bank A/c To Depreciation Fund Investment A/c (Being the realisation of Investments)	Dr.		6,80,000	6,80,000
	Depreciation Fund Investment A/c To Depreciation Fund A/c (Being the transfer of profit on sale of Investments)	Dr.		18,000	18,000
	Debenture Redemption Fund A/c To Machinery A/c (Being the transfer of the balance in DF A/c to Asset Account)	Dr.		9,46,200	9,46,200
	Bank A/c To Machinery A/c (Being the machinery sold)	Dr.		73,800	73,800
	Machinery A/c To Profit and Loss A/c (Being the transfer of Profit on sale of machinery)	Dr.		20,000	20,000

**LEDGER ACCOUNTS
MACHINERY ACCOUNT**

Dr.

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2014	To Bank A/c	9,00,000	31.03.2015	By Balance c/d	10,00,000
01.04.2014	To Bank A/c (freight etc.)	1,00,000			
		10,00,000			10,00,000
01.04.2015	To Balance b/d	10,00,000	31.03.2016	By Balance c/d	10,00,000
01.04.2016	To Balance b/d	10,00,000	31.03.2017	By Balance c/d	10,00,000
01.04.2017	To Balance c/d	10,00,000	31.03.2018	By Depreciation Fund A/c	9,46,200
31.03.2018	To Profit and Loss A/c (Profit)	20,000		By Bank A/c (scrap realised)	73,800
		10,20,000			10,20,000

Dr.

DEPRECIATION FUND ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2015	To Balance c/d	2,00,000	31.03.2015	By Depreciation A/c	2,00,000
31.03.2016	To Balance c/d	4,20,000	01.04.2015	By Balance b/d	2,00,000
			31.03.2016	By Interest on DFI A/c	20,000
				By Depreciation A/c	2,00,000
		4,20,000			4,20,000

31.03.2017	To Balance c/d	6,62,000	01.04.2016	By Balance c/d	4,20,000
			31.03.2017	By Interest on DFI A/c	42,000
				By Depreciation A/c	1,00,000
		6,62,000			6,62,000
31.03.2018	To Machinery A/c (transfer)	9,46,200	01.04.2017	By Balance b/d	6,62,000
			31.03.2018	By Interest on DFI A/c	66,200
				By Depreciation A/c	2,00,000
				By Depreciation Fund Investment A/c (Profit)	18,000
		9,46,200			9,46,200

Dr. DEPRECIATION FUND INVESTMENT (DFI) ACCOUNT Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2015	To Bank A/c	2,00,000	31.03.2015	By Balance c/d	2,00,000
01.04.2015	To Balance b/d	2,00,000	31.03.2016	By Balance c/d	4,20,000
31.03.2016	To Bank A/c	2,20,000			4,20,000
		4,20,000			4,20,000
01.04.2016	To Balance b/d	4,20,000	31.03.2017	By Balance c/d	6,62,000
31.03.2017	To Bank A/c	2,42,000			6,62,000
		6,62,000			6,62,000
01.04.2017	To Balance b/d	6,62,000	31.03.2018	By Bank A/c (Sales)	6,80,000
31.03.2018	To Depreciation Fund A/c (Profit)	18,000			
		6,80,000			6,80,000

Dr. NEW MACHINERY ACCOUNT Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2018	To Bank A/c	10,00,000	31.03.2018	By Balance c/d	10,00,000

Working Notes:

1. CALCULATION OF THE AMOUNT TO BE CHARGED TO PROFIT AND LOSS ACCOUNT

Particulars	₹
A. Original Cost	9,00,000
B. Add: Capital Expenditure	1,00,000
C. Less: Estimated scrap value	71,800
D. Depreciate Cost (A + B – C)	9,28,200
E. Value of annuity per ₹ 1	4,641
F. Annual amount to be charged (D/E)	2,00,000

Year	Opening Balance <i>B</i>	Interest <i>C = B × 10/100</i>	Savings <i>D</i>	Investments <i>E</i>	Closing Balance <i>F = B + E</i>
2014-2015	—	—	2,00,000	2,00,000	2,00,000
2015-2016	2,00,000	20,000	2,00,000	2,20,000	4,20,000
2016-2017	4,20,000	42,000	2,00,000	2,42,000	6,62,000
2017-2018	6,61,000	66,200	2,00,000	—	—

18.0 ANNUITY METHOD

Under Annuity Method, such an amount is charged by way of depreciation which takes into account not only the cost of the asset but also interest thereon at a given rate.

1. It takes into account the interest on the amount invested in the purchase of asset.
2. Interest is provided each year on the opening balance of the asset account and goes on decreasing year after year.
3. A fixed amount of depreciation is charged each year. The amount of depreciation is computed with the help of annuity table as follows:

Fixed Amount of Depreciation = $\frac{[\text{Original Cost less Scrap Value} \times (\text{Value of Annuity for a given period at a given rate of interest})]}{\text{Plus}}$

Interest on scrap value (if any) for a year at a given rate of interest

4. **Effect on Profit & Loss Account** The net charge to Profit and Loss Account increases year after year even though the depreciation is a fixed sum. This is because of the interest amount decreases year after year. However, the total net charge to Profit and Loss Account is equal to the cost of lease.

The method takes into account the interest on the amount invested in the purchase of an asset.

When additions are made to the asset, fresh computation have to be made and the calculation becomes difficult. This method increases the book value of asset particularly in the initial years.

This method is suitable for leases in respect of which a lumpsum payment is made in advance.

The various journal entries which are required to be passed under this method are summarised below:

1. **For charging Interest on the opening balance of the Asset**
 Asset A/c Dr.
 To Interest A/c

Date	Particulars	₹	Date	Particulars	₹
31.03.2015	To Depreciation A/c	11,280	31.03.2015	By Interest A/c	2,000
31.03.2016	To Depreciation A/c	11,280	31.03.2016	By Interest A/c	1,536
31.03.2017	To Depreciation A/c	11,280	31.03.2017	By Interest A/c	1,048
31.03.2018	To Depreciation A/c	11,280	31.03.2018	By Interest A/c	536

ILLUSTRATION 31

Taking the same information as given in previous Illustration along with the fact that ₹ 4,000 would also be refunded after 4 years, show the Lease Account.

SOLUTION**CALCULATION OF ANNUAL DEPRECIATION CHARGE**

A Cost of Lease paid	₹	40,000
B Less: Refundable amount	₹	4,000
C Depreciable amount (A – B)	₹	36,000
D Annuity Factor @ 5% interest for 4 years	₹	0.2820
E Fixed Depreciation Charge (C × D)	₹	10,142
F Interest on Salvage @ 5% on ₹ 2,000 for a year	₹	200
G Annual Depreciation Charge (E + F)	₹	10,352

Dr.**LEASE ACCOUNT****Cr.**

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
01.04.2014	To Bank A/c	40,000	31.03.2015	By Depreciation A/c	10,352
31.03.2015	To Interest A/c (5% on ₹ 40,000)	2,000		By Balance c/d	31,648
		42,000			42,000
01.04.2015	To Balance b/d	31,648	31.03.2016	By Depreciation A/c	10,352
31.03.2016	By Interest A/c (5% on ₹ 31,648)	1,582		By Balance c/d	22,878
		33,230			33,230
01.04.2016	To Balance b/d	22,878	31.03.2017	By Depreciation A/c	10,352
31.03.2017	To Interest A/c (5% on ₹ 22,878)	1,144		By Balance c/d	13,670
		24,022			24,022
01.04.2017	To Balance b/d	13,670	31.03.2018	By Depreciation A/c	10,354
31.03.2018	To Interest A/c (5% on ₹ 6,835)	684		By Bank A/c	4,000
		14,354			14,354

19.0 DEPLETION METHOD [OR PRODUCTIVE OUTPUT METHOD]**MEANING OF DEPLETION**

Depletion refers to the physical deterioration by the exhaustion of natural resources (ore deposits in mines, oil wells, quarries, timber stands etc.)

MEANING OF DEPLETION METHOD

It is the method under which (a) the life of the asset is estimated in terms of output which could be raised during its life and (b) depreciation is related to the quantity taken out (amount of depletion) and not the passage of time. This method when applied to wasting assets like mines, quarries etc. is known as Depletion Method because wasting assets cannot be depreciated but can be gradually depleted.

USEFULNESS OF DEPLETION METHOD

It is used for depreciating natural resources like ore-deposit, oil-deposit etc.

HOW TO CALCULATE THE RATE OF DEPRECIATION PER UNIT

Rate of Depreciation per unit = $\frac{\text{Original cost less Residual Value}}{\text{Useful Life in terms of Productive Output}}$

HOW TO CALCULATE THE AMOUNT OF DEPRECIATION

Amount of Depreciation = Actual Output (in units) $\times$ Rate of Depreciation per Unit

SUITABILITY OF DEPLETION METHOD

This method is suitable where (a) the life of the asset can be estimated in terms of output (b) the utility of the asset is directly related to its productive life (c) Obsolescence is not a primary factor.

PRACTICAL EXAMPLE OF DEPLETION METHOD

Cost of acquiring a mine = ₹ 1,00,000

Estimated Qty of coal in the mine = 20,000 tonnes

Actual output in the year 2007 = 1,000 tonnes

Here,

Rate of Depreciation = $\frac{\text{₹ 1,00,000}}{20,000} = \text{₹ 5 per tonne}$

Amount of Depreciation for 2007 = 1,000 tonnes $\times$ ₹ 5 = ₹ 5,000

PRACTICAL STEPS INVOLVED IN THE CALCULATION OF AMOUNT OF DEPRECIATION ACCORDING TO PRODUCTIVE OUTPUT METHOD

Step 1 Calculate the Rate of Depreciation per Unit as under:

Rate of Depreciation per unit = $\frac{\text{Original cost less Residual Value}}{\text{Useful Life in terms of Productive Output}}$

Step 2 Calculate the Amount of Depreciation as under:

Amount of Depreciation = Actual Output (in units) $\times$ Rate of Depreciation per Unit

ILLUSTRATION 32

Tulsian Ltd. acquired a lease right for 10 years of a mine on 1.1.2013 on a lumpsum payment of ₹ 9,00,000 to the landlord. It was estimated by the expert that the coal deposit of the mine was 40,00,000 tonnes, 75% of which could be raised within time period allowed. Tulsian Ltd. decided to depreciate the lease on Depletion Method. The sales and stocks (in tonnes) were as under:

Year	2013	2014	2015	2016	2017	2018
Sales	30,000	62,000	1,96,000	4,02,000	4,02,000	3,98,000
Closing Stock	10,000	8,000	12,000	10,000	8,000	10,000

Required: Show the Lease Account from 1st Jan. 2013 to 31st Dec. 2018.

SOLUTION**Dr.****LEASE ACCOUNT****Cr.**

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
01.01.2013	To Bank A/c	9,00,000	31.12.2013	By Depreciation A/c	12,000
				By Balance c/d	8,88,000
		9,00,000			9,00,000
01.01.2014	To Balance b/d	8,88,000	31.12.2014	By Depreciation A/c	18,000
				By Balance c/d	8,70,000
		8,88,000			8,88,000
01.01.2015	To Balance b/d	8,70,000	31.12.2015	By Depreciation A/c	60,000
				By Balance c/d	8,10,000
		8,70,000			8,70,000
01.01.2016	To Balance b/d	8,10,000	31.12.2016	By Depreciation A/c	1,20,000
				By Balance c/d	6,90,000
		8,10,000			8,10,000
01.01.2017	To Balance b/d	6,90,000	31.12.2017	By Depreciation A/c	1,20,000
				By Balance c/d	5,70,000
		6,90,000			6,90,000
01.01.2018	To Balance b/d	5,70,000	31.12.2018	By Depreciation A/c	1,20,000
				By Balance c/d	4,50,000
		5,70,000			5,70,000

Working Notes:

- Depreciation per tonne = Total Cost/Total Expected Output within Lease Period
 $= ₹ 9,00,000 / 75\% \text{ of } 40,00,000 = ₹ 9,00,000 / 30,00,00$
 $= ₹ 0.30 \text{ per tonne}$
- Annual raisings = Sales + Closing Stock – Opening Stock

20.0 MACHINE HOUR METHOD OR SERVICE HOURS METHOD**MEANING OF MACHINE HOUR METHOD**

Under this Method, depreciation is provided by means of a fixed rate per hour calculated by dividing the value of the asset by the estimated number of effective working hours during the useful life of the asset. This method is considered to be appropriate for costly plant and machinery, air-craft etc.

HOW TO CALCULATE THE AMOUNT OF DEPRECIATION

**PRACTICAL STEPS INVOLVED IN THE CALCULATION OF AMOUNT OF DEPRECIATION
 ACCORDING TO MACHINE HOUR METHOD**

Step 1 Calculate the Rate of Depreciation per Hour as under:

Rate per Hour = Original Cost less Residual Value/Useful Life in terms of Effective Hours

Step 2 Calculate the Amount of Depreciation as under:

Amount of Depreciation = Actual Hours × Rate of Depreciation per Hour

ILLUSTRATION 33

Tulsian Ltd. purchased a machine for ₹ 2,20,000 on 1st January, 2013 and incurred ₹ 40,000 towards freight, insurance, carriage inwards and installation charges. It was estimated that the machinery will have a scrap value of ₹ 20,000 at the end of its useful life which is 10 years of 12,000 hours each. Tulsian Ltd. decided to depreciate the machines on 'Machine Hour Rate Method'. The machine hours during first six years were as under:

Year	2013	2014	2015	2016	2017	2018
Machine Hours	6,000	8,000	10,000	14,000	14,000	12,000

Show the Machinery Account from 1st January, 2013 to 31st December, 2018.

SOLUTION

Dr. **MACHINERY ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.2013	To Bank A/c	2,20,000	31.12.2013	By Depreciation A/c	12,000
	To Bank A/c	40,000		By Balance c/d	2,48,000
		2,60,000			2,60,000
01.01.2014	To Balance b/d	2,48,000	31.12.2014	By Depreciation A/c	16,000
				By Balance c/d	2,32,000
		2,48,000			2,48,000
01.01.2015	To Balance b/d	2,32,000	31.12.2015	By Depreciation A/c	20,000
				By Balance c/d	2,12,000
		2,32,000			2,32,000
01.01.2016	To Balance b/d	2,12,000	31.12.2016	By Depreciation A/c	28,000
				By Balance c/d	1,84,000
		2,12,000			2,12,000
01.01.2017	To Balance b/d	1,84,000	31.12.2017	By Depreciation A/c	28,000
				By Balance c/d	1,56,000
		1,84,000			1,84,000
01.01.2018	To Balance b/d	1,56,000	31.12.2018	By Depreciation A/c	24,000
				By Balance c/d	1,32,000
		1,56,000			1,32,000

Working Note: Calculation of Rate of depreciation per Machine Hour

$$\begin{aligned}\text{Machine Hour Rate} &= (\text{Cost of Acquisition} - \text{Scrap Value}) / \text{Life of the asset (in Hours)} \\ &= ₹ 2,00,000 - ₹ 20,000 / 10 \times 12,000 = ₹ 2 \text{ per hour}\end{aligned}$$

21.0 PRODUCTION UNITS METHOD**MEANING OF PRODUCTION UNITS METHOD**

Under this method depreciation is determined by comparing the annual production with the estimated total production.

HOW TO COMPUTE THE AMOUNT OF DEPRECIATION

$$\text{Depreciation for the period} = \frac{\text{Depreciable Amount} \times \text{Actual Production during the period}}{\text{Estimated Total Production}}$$

SUITABILITY OF PRODUCTION UNITS METHOD

The method is applicable to machines producing products of uniform specifications.

PRACTICAL EXAMPLE OF PRODUCTION UNITS METHOD

Cost of Machine	₹ 1,00,000
Estimated Total Production	20,000 units
Actual output during the year, 2018	1,000 units
Depreciation for the year 2014 = ₹ 1,00,000 × 1,000/20,000 = ₹ 5,000	

ILLUSTRATION 34

A machine is purchased for ₹ 4,00,000. Its estimated useful life is 10 years with a residual value of ₹ 40,000. The machine is expected to produce 3 lakh units during its life time. Expected distribution pattern of production is as follows:

Year	Production
1 – 3	40,000 units per year
4 – 7	30,000 units per year
8 – 10	20,000 units per year

Required: Determine the amount of depreciation for each year using production units method.

SOLUTION**STATEMENT SHOWING DEPRECIATION UNDER PRODUCTION UNITS METHOD**

Year	Annual Depreciation
1 – 3	40,000/3,00,000 (₹ 4,00,000 – ₹ 40,000) = ₹ 48,000
4 – 7	30,000/3,00,000 (₹ 4,00,000 – ₹ 40,000) = ₹ 36,000
8 – 10	20,000/3,00,000 (₹ 4,00,000 – ₹ 40,000) = ₹ 24,000

22.0 SUM OF YEARS' DIGITS METHOD (OR SYD METHOD)**MEANING**

Sum of years' Digits Method is one of the accelerating methods of depreciation which depreciates the asset at higher rate in the earlier years and at lower rate in the later years.

HOW TO COMPUTE THE AMOUNT OF DEPRECIATION**PRACTICAL STEPS INVOLVED IN THE CALCULATION OF AMOUNT OF DEPRECIATION ACCORDING TO SYD METHOD.**

Step 1: Calculate the 'Sum of Years' Digits as under:

$$\text{Sum of Years' Digits} = \frac{n(n+1)}{2} \text{ Where 'n' refers to useful life of the asset (in years).}$$

Step 2: Calculate the Rate of Depreciation for various years up to the useful life as under:

$$\text{for 1st year} = \frac{\text{nth year}}{\text{Sum of years' Digits}} \times 100 = \dots \%$$

$$\text{for 2nd year} = \frac{(n-1)\text{th year}}{\text{Sum of years' Digits}} \times 100 = \dots \%$$

$$\text{for 3rd year} = \frac{(n-2)\text{th year}}{\text{Sum of years' Digits}} \times 100 = \dots \%$$

$$\text{for nth year} = \frac{1}{\text{Sum of years' Digits}} \times 100 = \dots \%$$

Step 3: Calculate the Amount of Depreciation as under:

Amount of Depreciation = (Original Cost less Estimated Scrap Value) × Respective Rate of Depreciation for the given year.

ILLUSTRATION 35

On 1st April 2014, Tulsian Ltd. purchased a machinery for ₹ 2,00,000 and incurred ₹ 14,000 towards freight and insurance, ₹ 2,000 towards carriage inwards and ₹ 4,000 towards instalation charges. It was established that the machinery will have a scrap value of ₹ 20,000 at the end of its useful life which is 4 years. On 1st April, 2017, ₹ 4,000 were incurred on repairs and renewals of machine.

Required: Determine (a) Rate of Depreciation, (b) Amount of Depreciation, (c) Show the Machinery Account for the first four financial years ending on 31st March each year according to the Sum of Years' Digits Method.

SOLUTION

(a) Rate of Depreciation = Number of Years Life Remaining/Sum of Years Digits × 100

$$\text{Sum of Years' Digits} = n(n+1)/2 = 4(4+1)/2 = 20/2 = 10$$

$$1\text{st Year} = 4/10 \times 100 = 40\%, \quad 2\text{nd Year} = 3/10 \times 100 = 30\%$$

$$3\text{rd Year} = 2/10 \times 100 = 20\%, \quad 4\text{th Year} = 1/10 \times 100 = 10\%$$

(b) Calculation of the Amount of Depreciation p.a.

$$= \text{Number of Years Life Remaining/Sum of Years Digits} \times (\text{Original Cost} - \text{Scrap Value})$$

Year	Rate	Original Cost less Scrap Value [₹ 1,00,000 + ₹ 7,000 + ₹ 1,000 + ₹ 2,000 – ₹ 10,000]	Amount of Depreciation ₹
2014	40%	2,00,000	40% of 2,00,000 = 80,000
2015	30%	2,00,000	30% of 2,00,000 = 60,000
2016	20%	2,00,000	20% of 2,00,000 = 40,000
2017	10%	2,00,000	10% of 2,00,000 = 20,000

Dr.

(C) MACHINERY ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2014	To Bank A/c	2,00,000	31.03.2015	By Depreciation A/c	80,000
	To Bank A/c	14,000		By Balance c/d	1,40,000
	To Bank A/c	2,000			
	To Bank A/c	4,000			
		2,20,000			2,20,000
01.04.2015	To Balance b/d	1,40,000	31.03.2016	By Depreciation A/c	60,000
				By Balance c/d	80,000

		1,40,000			1,40,000
01.04.2016	To Balance b/d	80,000	31.03.2017	By Depreciation A/c	40,000
				By Balance c/d	40,000
		80,000			80,000
01.04.2017	To Balance b/d	40,000	31.03.2018	By Depreciation A/c	20,000
				By Balance c/d	20,000
		40,000			40,000

23.0 PROVISION FOR REPAIRS & RENEWALS METHOD

MEANING OF PROVISION FOR REPAIRS & RENEWALS METHOD

Repairs Provision Method takes into consideration not only the cost of the asset but also the estimated cost of repairs to be effected during the useful life of the asset.

HOW TO CALCULATE THE AMOUNT OF DEPRECIATION

$$\text{Amount of Depreciation} = \frac{(\text{Original Cost} - \text{Residual Value}) + \text{Estimated Total Cost of Repairs}}{\text{Useful Life of the Asset}}$$

ACCOUNTING TREATMENT OF PROVISION FOR REPAIRS & RENEWALS METHOD

- The amount of depreciation is debited to Profit and Loss Account and credited to Provision for Depreciation and Repairs Account.
- The actual amount incurred on repairs and renewals is debited to Provision for Depreciation and Repairs Account.
- At the end of useful life of the asset, the Provision for Depreciation and Repairs Account is closed by transferring it to the Asset Account.

MERIT OF PROVISION FOR REPAIRS & RENEWALS METHOD

The main merit of this method lies in the fact that it equalises the burden on the Profit and Loss Account in respect of depreciation and repairs.

SUITABILITY OF PROVISION FOR REPAIRS & RENEWALS METHOD

This method is considered to be appropriate where the service rendered by the asset is uniform over the useful life of the asset.

ILLUSTRATION 36

Tulsian Ltd. purchased a machine for ₹ 1,20,000 on 1st April, 2014 and incurred ₹ 40,000 towards freight, insurance, carriage inward and installation charges. It was estimated that its life is 4 years during which period a sum of ₹ 60,000 is likely to be spent on its repairs and maintenance and at the end of useful life, the scrap value will be ₹ 20,000. Actual repairs were as under:

2014-2015—₹ Nil, 2015-2016—₹ 10,000, 2016-2017—₹ 20,000, 2017-2018—₹ 30,000

At the end of useful life, the scrap value of the machine realised ₹ 16,000 only.

Prepare Machinery Account, and Provision for Depreciation and Repairs Account.

SOLUTION

Dr.

MACHINERY ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2014	To Bank A/c	1,20,000	31.03.2015	By Balance c/d	1,60,000
	To Bank A/c	40,000			
		1,60,000			1,60,000
01.04.2015	To Balance b/d	1,60,000	31.03.2016	By Balance c/d	1,60,000
01.04.2016	To Balance b/d	1,60,000	31.03.2017	By Balance c/d	1,60,000
01.04.2017	To Balance b/d	1,60,000	31.03.2018	By Provision for Depreciation and Repairs A/c	1,40,000
				By Bank A/c	16,000
				By P & L A/c (Loss)	4,000
		1,60,000			1,60,000

Dr.

PROVISION FOR DEPRECIATION AND REPAIRS ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2015	To Balance c/d	50,000	31.03.2015	By P & L A/c	50,000
31.03.2016	To Repairs A/c	10,000	01.04.2015	By Balance b/d	50,000
	To Balance c/d	90,000	31.03.2016	By P & L A/c	50,000
		1,00,000			1,00,000
31.03.2017	To Repairs A/c	20,000	01.04.2016	By Balance b/d	90,000
	To Balance c/d	1,20,000	31.03.2017	By P & L A/c	50,000
		1,40,000			1,40,000
31.03.2018	To Repairs A/c	30,000	01.04.2017	By Balance b/d	1,20,000
	To Machinery A/c	1,40,000	31.03.2018	By P & L A/c	50,000
		1,70,000			1,70,000

Working Note: Calculation of the annual amount to be provided for

Annual Amount to be provided for

= (Original Cost – Residual Value) + Estimated Total Cost of Repairs/Expected Useful Life of the Asset

= ₹ 1,60,000 – ₹ 20,000 + ₹ 60,000/4 = ₹ 2,00,000/4 = ₹ 50,000

ILLUSTRATION 37

The following particulars are available from the books of X Ltd. Provision for Repairs and Renewals as on 1.4.2016 ₹ 1,00,000. Actual repair charges incurred during 2016-2017—₹ 60,000, during 2017-2018—₹ 90,000.

X Ltd. transfers annually a sum of ₹ 80,000 to the Provision for Repairs and Renewals Account.

Required: Prepare the Provision for Repairs and Renewals Account for the year 2016-2017 and 2017-2018.

SOLUTION

Dr. PROVISION FOR REPAIRS AND RENEWALS ACCOUNT Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2017	To Bank A/c	60,000	01.04.2016	By Balance c/d	1,00,000
	To Balance c/d	1,20,000	31.03.2017	By Profit and Loss A/c	80,000
		1,80,000			1,80,000
31.03.2018	To Bank A/c	90,000	01.04.2017	By Balance b/d	1,20,000
	To Balance c/d	1,10,000	31.03.2018	By Profit and Loss A/c	80,000
		2,00,000			2,00,000

24.0 DOUBLE DECLINING METHOD

Double Declining Method is one of the accelerating methods of depreciation which depreciate the asset at higher rate in the earlier years and at lower rate in the later years. Under this method, a fixed double declining percentage calculated upon the diminishing value of the asset is written off in each accounting period during the expected useful life of the asset. The double declining rate is calculated ignoring the scrap value as under:

Rate of Depreciation (in percentage) = $2/n \times 100$, where 'n' = useful life of the Asset (in year)

Note: In the last year of the useful life of the asset, the depreciation amount should be charged in such a manner that the book value of the asset after charging depreciation is at least equal to the estimated scrap value of the asset.

ILLUSTRATION 38

On 1st April 2014, Tulsian Ltd. purchased a machinery for ₹ 2,00,000 and incurred ₹ 14,000 towards freight and insurance, ₹ 2,000 towards carriage inwards and ₹ 4,000 towards installation charges. It was established that the machinery will have a scrap value of ₹ 20,000 at the end of its useful life which is 4 years. On 1st April, 2017, ₹ 4,000 were incurred on repairs and renewals of machine.

Required: Determine (a) Rate of Depreciation, (b) Show the Machinery Account for the first four financial years ending on 31st March each year according to the Double Declining Method.

SOLUTION

(a) Rate of Depreciation $200\%/n = 200\%/4 = 50\%$

Dr. MACHINERY ACCOUNT Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2014	To Bank A/c	2,00,000	31.03.2015	By Depreciation A/c	1,10,000
	To Bank A/c	14,000		By Balance c/d	1,10,000
	To Bank A/c	2,000			
	To Bank A/c	4,000			
		2,20,000			2,20,000
01.04.2015	To Balance b/d	1,10,000	31.03.2016	By Depreciation A/c	55,000
				By Balance c/d	55,000
		1,10,000			1,10,000
01.04.2016	To Balance b/d	55,000	31.03.2017	By Depreciation A/c	27,500
				By Balance c/d	27,500
		55,000			55,000

01.04.2017	To Balance b/d	27,500	31.03.2018	By Depreciation A/c	7,500
				By Balance c/d	20,000
		27,500			27,500

Note: Though apparently, the amount of depreciation @ 50% p.a. on ₹ 27,500 comes to ₹ 13,750 but only a sum of ₹ 7,500 has been provided for as depreciation since the value of the asset is not to be reduced below the scrap value of the asset (i.e. ₹ 20,000)

25.0 REVALUATION METHOD

The method is also known as 'Inventory Method' or 'Inventory System of Depreciation'. This method is followed in case of assets which are larger in quantity but have small value such as loose tools, bottles, sacks, package material etc. This method is also used when life of an asset cannot be ascertained with certainty e.g., live stock etc.

Under this method the asset concerned is revalued at the end of every year. On account of usage or any other cause the value at the end of the year is likely to be lower than the value at the beginning of the year. The difference in the two figures (decrease in value) is charged as depreciation. The method of calculating depreciation is given below:

CALCULATION OF DEPRECIATION UNDER REVALUATION METHOD

			₹
A	Book Value of the Asset in the beginning		xxx
B	Add: Purchases		xxx
C	Less: (a) Sale Proceeds of the Asset sold during the accounting period	xxx	
	(b) Revalued figure of the Asset at the end	xxx	
D	Depreciation to be charged (A + B – C)		xxx

Note: If the revalued figure of the asset at the end exceeds the book value of the asset at the end, such appreciation should be ignored and the book value instead of revalued figure should be deducted as aforesaid.

The accounting treatment of depreciation under this method is similar to that of fixed instalment method or diminishing balance method i.e., it is debited to Depreciation Account and credited to the concerned asset account.

ILLUSTRATION 39

On 1st April, 2017, the value of loose tools was ₹ 20,000 and during the year ₹ 10,000 worth of tools were purchased and ₹ 2,000 realised by way of sale of scrapped loose tools. At the end of the year, the loose tools are considered to be worth only ₹ 12,000.

Required: Calculate the amount to be charged to Profit & Loss Account.

SOLUTION

CALCULATION OF AMOUNT TO BE CHARGED TO PROFIT AND LOSS ACCOUNT

Particulars	₹
A Opening Balance of Loose tools	20,000
B Add: Purchased during the year	10,000
C Less: (a) Sale of scrapped Loose tools	2,000
(b) Closing Balance of Loose tools (at revalued figure)	12,000
D Depreciation to be charged to Profit & Loss Account (A + B – C)	16,000

SOLVED PROBLEMS**PROBLEM 1**

Shippers Ltd. which depreciates the machines @ 25% p.a. on the reducing balance method, provides you the following particulars:

Cost on 31.12.2016 ₹ 2,46,000. Provision for Depreciation (on 31.12.2016) ₹ 1,24,000. No amounts being charged in the year of sale but full charge is being made for the years during which addition is made. On 1.7.2018, one new machine was purchased for ₹ 24,000 and old machinery purchased on 1.7.2015 for ₹ 20,000 was discarded but could not be sold immediately. However, it was expected to realise ₹ 5,000 for the same. Prepare (a) Machinery Account, (b) Provision for Depreciation Account, and (c) Machinery Disposal Account for the years 2017 and 2018.

SOLUTION:**DR.****MACHINERY ACCOUNT****CR.**

Date	Particulars	₹	Date	Particulars	₹
01.01.2017	To Balance b/d	2,46,000	31.12.2017	By Balance c/d	2,46,000
01.01.2018	To Balance b/d	2,46,000	01.07.2018	By Machinery	
01.07.2018	To Bank A/c	24,000		Disposal A/c	20,000
			31.12.2018	By Balance c/d	2,50,000
		2,70,000			2,70,000

DR.**PROVISION FOR DEPRECIATION ACCOUNT****CR.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Balance c/d	1,54,500	01.01.2017	By Balance b/d	1,24,000
			31.12.2017	By Depreciation A/c	
				[25% of (₹ 2,46,000 – ₹ 1,24,000)]	30,500
		1,54,500			1,54,500
01.07.2018	To Machinery Disposal A/c	11,563	01.01.2018	By Balance b/d	1,54,500
31.12.2018	To Balance c/d	1,69,703	31.12.2018	By Depreciation A/c	
				[25% of (₹ 2,50,000 – ₹ 1,54,500 + ₹ 11,563)]	26,766
		1,81,266			1,81,266

DR.**MACHINERY DISPOSAL ACCOUNT****CR.**

Date	Particulars	₹	Date	Particulars	₹
01.07.2018	To Machinery A/c	20,000	01.07.2018	By Provision for Depreciation A/c	11,563
				By P and L A/c (Loss) (Prudence concept)	3,437
				By Balance c/d	5,000
		20,000			20,000

Working Note: Calculation of Depreciation provided on Machine discarded

Particulars	Book Value ₹	Accumulated Values ₹
A Original Cost	20,000	—
B Less: Depreciation for 2015	5,000	5,000
C Book value on 1.1.2016	15,000	
D Less: Depreciation for 2016	3,750	3,750
E Book Value on 1.1.2017	11,250	
F Less: Depreciation for 2017	2,813	2,813
	8,437	11,563

PROBLEM 2

Metropol Ltd acquired a machine for ₹ 5,40,000 on April 1, 2015. Depreciation was to be charged at 20% p.a. on straight line method. During 2017-2018, a modification was made to improve its technical reliability at a cost of ₹ 50,000 which it was considered would extend the useful life of the machine for two years. At the same time an important component of the machine was replaced at a cost of ₹ 10,000 because of excessive wear and tear. Routine maintenance during the said accounting period cost ₹ 7,500. Show the Machinery Account, Provision for Depreciation on Machinery Account and the charge to Profit and Loss Account for the year ending March 31, 2018 only assuming that the company follows a policy of charging full year's depreciation on additions.

SOLUTION:**DR.****MACHINERY ACCOUNT****CR.**

Date	Particulars	₹	Date	Particulars	₹
01.04.2017	To Balance b/d	5,40,000	31.03.2018	By Balance c/d	6,00,000
2017-2018	To Bank A/c	50,000			
	To Bank A/c	10,000			
		6,00,000			6,00,000

DR.**AN EXTRACT OF PROFIT AND LOSS ACCOUNT****CR.**

Date	Particulars	₹	Date	Particulars	₹
	To Repair & Maintenance	7,500			
	To Depreciation on Machinery	76,800			

DR.**PROVISION FOR DEPRECIATION ACCOUNT****CR.**

Date	Particulars	₹	Date	Particulars	₹
31.03.2018	To Balance c/d	2,92,800	01.04.2017	By Balance b/d	
				[₹ 5,40,000 × 2 × 20/100]	2,16,000
			31.03.2018	By Depreciation A/c	
				[20% of (₹ 6,00,000 – ₹ 2,16,000)]	76,800
		2,92,800			2,92,800

Working Notes:

- (i) The amount spent on routine maintenance is of revenue nature and not of capital nature and hence not debited to Machinery Account.
- (ii) The unamortised depreciable amount (i.e. ₹ 5,40,000 – ₹ 2,16,000 + ₹ 50,000 + ₹ 10,000) has been charged over the revised remaining useful life (i.e. 5 years).

PROBLEM 3

A firm writes off 95% of the cost of machinery acquired over a period of 10 years by the straight line method, leaving 5% as estimated scrap value. Full depreciation is written off even if the machinery is in use only for part of a year. On 31st March, 2017, the original cost of the machinery was as follows:

	₹
Purchased in 2006-2007 or earlier	1,20,000
Purchased in 2008-2009	40,000
Purchased in 2012-2013	30,000

On September 30, 2017, a machine which had cost ₹ 10,000 in 2005-2006 was disposed off for ₹ 900; and on February 28, 2018, a machine acquired in 2012-2013 at a cost of ₹ 15,000 was sold for ₹ 5,000. On the same date, a new machinery was acquired for ₹ 45,000.

Prepare the machinery account for the year 2017-2018. The accounts being closed on 31st March each year.]

SOLUTION:

DR.
MACHINERY ACCOUNT
CR.

Date	Particulars	₹	Date	Particulars	₹
01.04.2017	To Balanced b/d	27,550	30.09.2017	By Bank A/c	900
30.09.2017	To Profit & Loss A/c (Profit)	400	28.02.2018	By Bank A/c	5,000
28.02.2018	To Bank A/c	45,000		By Depreciation A/c	1,425
				By Profit & Loss A/c (Loss)	1,450
			31.03.2018	By Depreciation A/c	9,500
				By Balance c/d	54,675
		72,950			72,950
01.04.2018	By Balance b/d	54,675			

Working Notes:

(i) Calculation of the Book Value of Machines as on 1.1.2017

A Year of Purchase	B Expired Useful Life (in years) as on 1.4.2017	C Cost	D Depreciation Already provided	E = C – D Book Value as on 1.4.2017
2006-2007	10	1,20,000	$(1,20,000 \times 95\% \times 10/10) = 1,14,000$	6,000
2008-2009	9	40,000	$(40,000 \times 95\% \times 9/10) = 34,200$	5,800
2012-2013	5	30,000	$(30,000 \times 95\% \times 5/10) = 14,250$	15,750
				27,550

(ii) Calculation of Profit/Loss on Sale of Machines

	Machine (2005-2006)	Machine (2012-2013)
A Original Cost	10,000	15,000
B Less: Depreciation upto date of sale	9,500	8,550
	$(10,000 \times 95\% \times 10/10)$	$(15,000 \times 95\% \times 6/10)$
C Book Value as on date of sale [A – B]	500	6,450
D Sale Proceeds	900	5,000
E Profit (Loss) [D – C]	400	(1,450)

(iii) Calculation of Depreciation for 2017-2018

Year of Purchase	Cost	Depreciation
2006-2007	1,10,000	Nil since 95% already written off
2008-2009	40,000	$(40,000 \times 95\% \times 1/10) = 3,800$
2012-2013	15,000	$(15,000 \times 95\% \times 1/10) = 1,425$
2017-2018	45,000	$(45,000 \times 95\% \times 1/10) = 4,275$
		<u>9,500</u>

AS 10- PROPERTY, PLANT AND EQUIPMENT

WHAT IS USEFUL LIFE OF AN ASSET?

Useful life is:

- the period over which an asset is expected to be available for use by an enterprise; or
- the number of production or similar units expected to be obtained from the asset by an enterprise.

WHAT FACTORS DETERMINE THE USEFUL LIFE OF AN ASSET?

The future economic benefits embodied in an asset are consumed by an enterprise principally through its use. However, other factors, such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:

- Expected usage of the asset. Usage is assessed by reference to the expected capacity or physical output of the asset.
- Expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.
- Technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.
- Legal or similar limits on the use of the asset, such as the expiry dates of related leases.

CAN USEFUL LIFE OF AN ASSET BE SHORTER THAN ECONOMIC LIFE OF AN ASSET?

The useful life of an asset is defined in terms of its expected utility to the enterprise. The asset management policy of the enterprise may involve the disposal of assets after a specified time or after consumption of a specified proportion of the future economic benefits embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgement based on the experience of the enterprise with similar assets.

SHOULD USEFUL LIFE OF AN ASSET BE REVIEWED?

The useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change should be accounted for as a change in an accounting estimate in accordance with AS-5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

WHAT IS DEPRECIABLE AMOUNT?

Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value. Thus, depreciable amount of an asset is determined after deducting its residual value.

WHAT IS RESIDUAL VALUE OF AN ASSET?

The residual value of an asset is the estimated amount that an enterprise would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

SHOULD RESIDUAL VALUE OF AN ASSET BE REVIEWED?

The residual of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change should be accounted for as a change in an accounting estimate in accordance with AS-5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

WHAT IS DEPRECIATION?

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

HOW SHOULD DEPRECIATION BE RECOGNISED?

As depreciation is a systematic allocation of depreciable amount of an asset over its useful life therefore it is a charge and the depreciation charge for each period should be recognised in the Statement of Profit and Loss. However, sometimes, the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories as per AS-2, Valuation of Inventories. Similarly, the depreciation of Property, Plant and Equipment used for development activities may be included in the cost of an intangible asset recognised in accordance with AS-26, Intangible Assets.

ILLUSTRATION 1

B Ltd. has a policy of not providing for depreciation on asset capitalised in the year until the following year, but provides for a full year's depreciation in the year of disposal of an asset. Is this acceptable?

SOLUTION

The depreciable amount of a tangible fixed asset should be allocated on a systematic basis over its useful life. The depreciation method should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. Useful life means the period over which the asset is expected to be available for use by the entity. Depreciation should commence as soon as the asset is acquired and is available for use. Thus, the policy of B Ltd. is not acceptable.

SHOULD DEPRECIATION BE RECOGNISED IF THE FAIR VALUE OF THE ASSET EXCEEDS ITS CARRYING AMOUNT?

Depreciation is recognised even if the fair value of the asset exceeds its carrying amount.

SHOULD DEPRECIATION BE RECOGNIZED IF RESIDUAL VALUE OF THE ASSET EXCEEDS ITS CARRYING AMOUNT?

Depreciation is not recognized if residual value of the asset exceeds its carrying amount.

ILLUSTRATION 2

A property costing ₹ 10,00,000 is bought in 2017. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 20 years. The estimated residual value in 20 years' time, based on 2017 prices, is:

Case (a) ₹ 10,00,000

Case (b) ₹ 9,00,000.

Calculate the depreciable amount and useful life of the asset.

SOLUTION

In the present case useful life of the assets is 20 years and not 50 years since management policy of the enterprise involve the disposal of assets after a specified time i.e. 20 years. Hence in this case useful life is shorter than economic life.

<i>Particulars</i>	<i>Case (a)</i>	<i>Case (b)</i>
A. Cost of an Asset	10,00,000	10,00,000
B. Less: Expected Residual Value	10,00,000	9,00,000
C. Depreciable Amount	Nil	1,00,000

CAN REPAIR AND MAINTENANCE OF THE ASSETS NEGATE THE NEED TO DEPRECIATE IT?

Repair and maintenance of an asset do not negate the need to depreciate it.

WHEN DOES DEPRECIATION OF AN ASSET BEGIN?

Depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

ILLUSTRATION 3

C Ltd. constructs a machine for its own use. Construction is completed on 1st November, 2017 but the company does not begin using the machine until 1st April, 2018. Comment.

SOLUTION

The entity should begin charging depreciation from the date the machine is ready for use – that is, 1st November 2017. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.

WHEN DOES DEPRECIATION OF AN ASSET CEASE?

Depreciation of an asset ceases at the earlier of the following date:

- (a) the date that the asset is retired from active use and is held for disposal and
- (b) the date that the asset is derecognised.

Therefore, depreciation does not cease when the asset becomes idle or is retired from active use (but not held for disposal) unless the asset is fully depreciated.

HOW SHOULD AN ITEM OF PROPERTY, PLANT AND EQUIPMENT BE DEPRECIATED?

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 should be depreciated separately. An enterprise should allocate the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciate each such part separately. For example, it may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease.

Note: A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

HOW SHOULD AN ENTERPRISE DEPRECIATE THE REMAINDER PARTS OF AN ITEM OF PROPERTY, PLANT AND EQUIPMENT THE COST OF WHICH ARE NOT SIGNIFICANT IN RELATION TO THE TOTAL COST OF AN ITEM?

An enterprise may depreciate separately the remainder parts of an item that do not have a cost that is significant in relation to the total cost of the item. If an enterprise has varying expectations for these remainder parts, approximation techniques may be necessary to depreciate them in a manner that faithfully represents the consumption pattern and/or useful life of these remainder and insignificant parts.

HOW LAND AND BUILDING SHOULD BE DEPRECIATED IF THEY ARE ACQUIRED TOGETHER?

Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.

IN WHICH CIRCUMSTANCES LAND SHOULD BE DEPRECIATED?

If the cost of land includes the costs of site dismantlement, removal and restoration, that portion of the land asset is depreciated over the period of benefits obtained by incurring those costs. In some cases, the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits to be derived from it.

WHAT METHOD OF DEPRECIATION SHOULD BE USED BY ENTERPRISE TO ALLOCATE DEPRECIABLE AMOUNT OF ASSET OVER ITS USEFUL LIFE?

The depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise. That method is applied consistently from period to period. A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method.

WHAT IS THE STRAIGHT–LINE METHOD OF DEPRECIATION?

Straight-line method of depreciation of results in a constant charge over the useful life if the residual value of the asset does not change.

WHAT IS THE DIMINISHING BALANCE METHOD OF DEPRECIATION?

The diminishing balance method of depreciation results in a decreasing charge over the useful life.

WHAT IS THE DIMINISHING BALANCE METHOD OF DEPRECIATION?

The units of production method of depreciation results in a charge based on the expected use or output. results in a decreasing charge over the useful life.

ILLUSTRATION 4

Z Ltd. manufactures industrial chemicals and uses blending machines in the production process. The output of the blending machines is consistent from year to year and they can be used for different products. However, maintenance costs increase from year to year and a new generation of machines with significant improvements over existing machines is available every 5 years. Suggest the depreciation method to the management.

SOLUTION

The straight–line depreciation method should be adopted, because the production output is consistent from year to year. Factors such as maintenance costs or technical obsolescence should be considered in determining the blending machines' useful life.

CAN METHOD OF CHARGING DEPRECIATION BE CHANGED?

The method is applied consistently from period to period unless

- (1) there is a change in the expected pattern of consumption of those future economic benefits or
- (2) that the method is changed in accordance with the statute to best reflect the way the asset is consumed.

Note: The depreciation method applied to an asset should be reviewed at least at each financial year –end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. Such a change should be accounted for as a change in an accounting estimate in accordance with AS – 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

CAN DEPRECIATION METHOD BASED ON REVENUE GENERATED BY AN ACTIVITY THAT INCLUDES THE USE OF AN ASSET BE APPLIED?

A depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate. The revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits of the asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing upon the way in which an asset is consumed.

WHEN CAN COST OF AN ITEM OF PROPERTY, PLANT AND EQUIPMENT UNDERGO CHANGES?

The cost of property, plant and equipment may undergo changes subsequent to its acquisition or construction on account of

- (1) changes in liabilities,
- (2) price adjustments,
- (3) changes in duties,
- (4) changes in initial estimates of amounts provided for dismantling, removing, restoration and similar factors

HOW SUCH CHANGE BE ACCOUNTED FOR IF RELATED ASSETS IS MEASURED USING COST MODEL?

Case	Accounting Treatment
(1) Increase in Liability	Relevant Asset A/c Dr. To Relevant Liability A/c (Being cost of an asset increases due to increase in liability) Note: If there is indication that new carrying amount of the asset may not be fully recoverable, then enterprise should test the asset for impairment by estimating its recoverable amount, and should account for any impairment loss, in accordance with AS – 28, Impairment of Assets.
(2) Decrease in Liability	Relevant Liability A/c Dr. To Relevant Asset A/c (Being cost of an asset decreases due to decrease in liability) Note: The amount deducted from the cost of the asset should not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess should be recognised immediately in the statement of profit and loss.

Notes:

- (i) Recoverable amount is the higher of an asset's net selling price and its value in use.
- (ii) An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.

HOW SUCH CHANGE BE ACCOUNTED FOR IF RELATED ASSETS IS MEASURED USING REVALUATION MODEL?

Case	Accounting Treatment
(1) Increase in Liability	Profit & Loss A/c Dr. To Relevant Liability A/c (Being loss recognized due to increase in liability) Note: If there is any credit balance existing in revaluation surplus in respect of the relevant asset then that balance would be first utilized for the purpose of absorbing loss due to increase in liability and remaining unabsorbed loss should be charged to Profit & Loss A/c.

(2) Decrease in Liability	Relevant Liability A/c Dr. To Revaluation Reserve A/c (Being profit due to decrease in liability recognised in revaluation reserve) Notes: (i) If the asset had been carried under cost model and decrease in liability has exceeded the carrying amount under cost model then the excess should be recognised immediately in the Profit and Loss A/c and (ii) If there was a revaluation deficit on the relevant asset that was previously recognised in the Profit & Loss A/c then the profit due to decrease in the liability to the extent that reverses previous revaluation deficit should be credited to Profit & Loss A/c

DOES CHANGE IN LIABILITY INDICATES THE NEED OF REVALUATION OF ASSET UNDER REVALUATION MODEL?

A change in the liability is an indication that the asset may have to be revalued in order to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. Any such revaluation should be taken into account in determining the amounts to be taken to the statement of profit and loss and the Revaluation Reserve. If a revaluation is necessary, all assets of that class should be revalued.

WHAT HAPPENS IN CASE OF CHANGE OF LIABILITY IF THE RELATED ASSET HAS REACHED THE END OF ITS USEFUL LIFE?

In case the related assets has reached the end of its useful life then all subsequent changes in the liability should be recognised in the Statement of Profit and Loss as they occur.

Note:

This applies both under the cost model and the revaluation model.

WHAT ARE THE GENERAL DISCLOSURE REQUIREMENTS AS PER AS – 10?

The financial statements should disclose, for each class of property, plant and equipment:

- (a) the measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount;
- (b) the depreciation methods used;
- (c) the useful lives or the depreciation rates used. In case the useful lives or the depreciation rates used are different from those specified in the statute governing the enterprise, it should make a specific mention of that fact;
- (d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and
- (e) a reconciliation of the carrying amount at the beginning and end of the period showing:
 - (i) Additions;
 - (ii) Assets retired from active use and held for disposal;
 - (iii) Acquisitions through business combinations;
 - (iv) Increases or Decreases resulting from revaluations and from impairment losses recognised or reversed directly in revaluation surplus in accordance with AS-28, Impairment of Assets;

- (v) Impairment losses recognised in the statement of profit and loss in accordance with AS–28, Impairment of Assets;
- (vi) Impairment losses reversed in the statement of profit and loss in accordance with AS–28, Impairment of Assets;
- (vii) Depreciation;
- (viii) The net exchange differences arising on the translation of the financial statements of a non-integral foreign operation in accordance with AS 11, The Effects of Changes in Foreign Exchange Rates; and
- (ix) Other changes.

WHAT ARE THE ADDITIONAL DISCLOSURE REQUIREMENTS AS PER AS–10?

The financial statements should also disclose:

- (a) The existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;
- (b) The amount of expenditure recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;
- (c) The amount of contractual commitments for the acquisition of property, plant and equipment;
- (d) If it is not disclosed separately on the face of the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in the statement of profit and loss; and
- (e) The amount of assets retired from active use and held for disposal.

WHAT ARE THE SPECIFIC DISCLOSURE REQUIREMENTS IN CASE REVALUATION MODEL IS USED?

If items of property, plant and equipment are stated at revalued amounts, the following should be disclosed:

- (a) the effective date of the revaluation;
- (b) whether an independent valuer was involved;
- (c) the methods and significant assumptions applied in estimating fair values of the items;
- (d) the extent to which fair values of the items were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques; and
- (e) the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

WHAT ARE THE VOLUNTARILY DISCLOSURE REQUIREMENTS?

An enterprise is encouraged to disclose the following:

- (a) the carrying amount of temporarily idle property, plant and equipment;
- (b) the gross carrying amount of any fully depreciated property, plant and equipment that is still in use;
- (c) for each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model;
- (d) the carrying amount of property, plant and equipment retired from active use and not held for disposal.

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning, Features, Parties, Specimen, and Accounting Treatment of a Promissory Note
- ◇ Meaning, Features, Parties, Specimen, and Advantages of a Bill of Exchange
- ◇ Distinction between a Bill of Exchange and a Promissory Note
- ◇ Term of a Bill
- ◇ Due Date of a Bill
- ◇ Days of Grace
- ◇ Date of Maturity of a Bill
- ◇ Bill at Sight — Meaning and Specimen
- ◇ Bill After Date — Meaning and Specimen
- ◇ How to Calculate Due Date of a Bill
- ◇ How to Calculate Date of Maturity in Case of Time Bills
- ◇ Negotiation — Meaning and Methods
- ◇ Endorsement — Meaning, Requirements and Kinds
- ◇ Drawing of a Bill (technically a draft)
- ◇ Acceptance of a Bill (technically a draft)
- ◇ Payment of a Bill or Honour of a Bill
- ◇ Options available to a holder of a bill
- ◇ When the bill is retained till the due date
- ◇ When the bill is sent to the bank for collection
- ◇ When the bill is discounted with the bank
- ◇ When the bill is endorsed in favour of a Creditor
- ◇ Dishonour of a Bill
- ◇ Renewal of a Bill
- ◇ Insolvency of the Acceptor of a Bill
- ◇ Retirement of a bill
- ◇ Bills Receivable book
- ◇ Bills Payable book
- ◇ Accommodation Bills

1.0 PROMISSORY NOTE

MEANING OF A PROMISSORY NOTE

A Promissory Note is an unconditional undertaking in writing given by the debtor to the creditor to pay on demand or at a fixed or determinable future time, a certain sum of money to or to the order of a specified person or to the bearer.

According to Sec. 4 of the Negotiable Instruments Act, 1881, "A promissory note is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument."

FEATURES OF A PROMISSORY NOTE

1. A promissory note is a **written unconditional promise**.
2. It is **drawn and signed** by the person to whom credit is granted or by the debtor.
3. It is **addressed to** the person **who grants credit** or to the **creditor**.
4. The amount is payable *either on demand* or at a **fixed** or **determinable future time**.
5. The amount is **payable either to the bearer** of the instrument **or to a specified person or to the order** of such a person.
6. The amount payable is a **certain sum** of money.

TWO PARTIES TO A PROMISSORY NOTE

1. **The Maker** — The person who makes or draws the promissory note is called the maker.
2. **The Payee** — The person to whom the payment is to be made, is called the payee.

SPECIMEN OF A PROMISSORY NOTE

Bharat Tulsian sells goods to Rahul Tulsian for ₹ 50,000 to be paid 3 months after date. If Rahul Tulsian promises to pay in writing, this promise will be Promissory Note

₹ 50,000/- only Three months after date I promise to pay Bharat Tulsian or his order the sum of Rupees Fifty Thousand, for value received. To Bharat Tulsian Harsh Vihar Pitam Pura, Delhi	| | | | | | | | | |	Rahul Tulsian Engg. Enclave, Delhi Jan. 17, 2018  RAHUL TULSIAN
PAYEE		MAKER

ACCOUNTING TREATMENT OF A PROMISSORY NOTE

1. A Promissory Note is treated as a Bill Receivable (B/R) by one who is entitled to receive the amount of the note.
2. A Promissory Note is treated as a Bill Payable (B/P) by one who is liable to pay the amount of the note.
3. The accounting entries relating to Promissory Note transactions are passed in the same manner as in case of a bill of exchange.

2.0 BILL OF EXCHANGE

MEANING OF A BILL OF EXCHANGE

A Bill of Exchange is an unconditional order in writing given by the creditor to the debtor to pay on demand, or at a fixed or determinable future time, a certain sum of money to or to the order of a specified person or to the bearer.

According to Sec. 5 of the Negotiable Instruments Act, 1881, “A bill of exchange is an instrument in writing containing an unconditional order signed by the maker directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument.”

FEATURES OF A BILL OF EXCHANGE

1. A bill of exchange is a **written unconditional order**.
2. It is **drawn and signed** by the person who grants credit or by the **creditor**.
3. It is **addressed to** the person to whom credit is granted or to the **debtor**.
4. The amount is payable *either* on **demand** or at a fixed or **determinable future time**.
5. The amount is payable *either* to the **bearer** of the instrument or to a **specified person** or to the **order** of such a person.
6. The amount payable is a **certain sum** of money.

THREE PARTIES TO A BILL OF EXCHANGE

1. Drawer	The person who draws the bill is called the drawer. In other words, he is the person who grants credit.
2. Drawee	The person on whom the bill is drawn for its acceptance by him is called the drawee. In other words, he is the person to whom the credit is granted.
3. Payee	The person in whose favour the bill is drawn is called the payee. The payee may be a third party or the drawer himself.

SPECIMEN OF A BILL OF EXCHANGE

Bharat Tulsian sells goods to Rahul Tulsian for ₹ 50,000 to be paid 3 months after date and buys goods from Rajat Tulsian for ₹ 50,000 on similar terms. If Bharat Tulsian directs Rahul Tulsian to pay the sum of ₹ 50,000 to Rajat Tulsian, this order will be a Bill of Exchange.

BILL OF EXCHANGE		
₹ 50,000/- only Three months after date pay to Rajat Tulsian or order the sum of Rupees Fifty Thousand, for value received.	Accepted Rahul Tulsian	Jan. 17, 2018 
To Rahul Tulsian Engg. Enclave, Pitam Pura, Delhi In case of need with Dena Bank, Pitam Pura, Delhi.		
PAYEE	DRAWEE	DRAWER

ADVANTAGES OF A BILL OF EXCHANGE

1. **Evidence of Indebtedness** — It acts as an evidence of indebtedness since it is acknowledgement of debt.
2. **Source of Finance** — It acts as a source of finance since it can be discounted before the due date.
3. **Means of Remittance** — It acts as a means of remittance since money can be transferred easily from one place to another by means of a bill.
4. **Device of Discharging a Debt** — It acts as a device of discharging a debt since it is a negotiable instrument.

3.0 DISTINCTION BETWEEN A BILL OF EXCHANGE AND A PROMISSORY NOTE

A Bill of Exchange can be distinguished from a Promissory Note as follows.

Basis of Distinction	Bill of Exchange	Promissory Note
1. No. of Parties	There are three parties—Drawer, Drawee and Payee and Payee.	There are two parties—Maker and Payee.
2. Promise/order	It contains an unconditional order given by a Creditor to a Debtor.	It contains an unconditional promise given by a debtor to a creditor.
3. Nature of Liability	The liability of the drawer is secondary and conditional .	The liability of the maker is primary and absolute .
4. Acceptance	It requires an acceptance to become a valuable instrument.	It does not require any acceptance since it is a valuable instrument right from the beginning.
5. Same identity of payer and payee	The drawer and payee may be the same person.	The maker and payee cannot be the same person.
6. Payable to bearer	It can be payable to the bearer.	It cannot be payable to bearer. It cannot be drawn as payable to bearer on demand.

7. Protest for Dishonour	It requires the protesting for dishonour.	It does not require any protesting.
8. Notice of Dishonour	Notice of dishonour must be given to all persons (including drawer) liable to pay.	Such notice is not required to be given to the maker .

4.0 TERM OF A BILL

1. The term of a bill of exchange may be of any duration.
2. Usually the term does not exceed 90 days from the date of the bill.
3. When a bill is drawn after sight, the term of the bill begins to run from the date of 'sighting', i.e., when the bill is accepted.
4. When a bill is drawn 'after date', the term of the bill begins to run from the date of drawing the bill.

5.0 DUE DATE OF A BILL

The date on which the term of the bill expires is called as 'Due Date of the bill'.

6.0 THREE DAYS OF GRACE

Every instrument payable other than on demand is entitled to three days of grace.

7.0 DATE OF MATURITY OF A BILL

The date which comes after adding three days to the due date of a bill, is called the date of maturity.

8.0 BILL AT SIGHT (INSTRUMENTS PAYABLE ON DEMAND)

Bill at Sight (*or Instruments payable on demand*) means the instruments in which no time for payment is mentioned. A cheque is always payable on demand. A promissory note *or* bill of exchange is payable on demand—

- (a) when no time for payment is specified, or
- (b) when it is expressed to be payable on demand, *or* at sight *or* on presentment.

Notes:

1. '*At sight*' and *presentment* means on demand.
2. *An instrument payable on demand may be presented for payment at anytime.*

SPECIMEN OF A BILL AT SIGHT

1. "I promise to pay B ₹ 500."
2. "I promise to pay B ₹ 500 on demand."
3. "Pay B ₹ 500 at sight."
4. "Pay B ₹ 500 on presentment."

9.0 BILL AFTER DATE (OR TIME INSTRUMENT)

Bill after date (*or Time Instrument*) means the instrument in which time for payment is mentioned. A promissory note *or* bill of exchange is a time instrument when it is expressed to be payable —

- (a) after a specified period

- (b) on a specific day
- (c) after sight
- (d) on the happening of event which is certain to happen

Notes:

1. The expression 'after sight' means—
 - (a) in a promissory note, after presentment for sight
 - (b) in a bill of exchange, after acceptance or noting for non-acceptance or protest for non-acceptance.
2. A cheque cannot be a time instrument because the cheque is always payable on demand.

SPECIMEN OF A BILL AFTER DATE

1. "I promise to pay B ₹ 500 after 3 months."
2. "I promise to pay ₹ 500 on 1st Jan., 2003."
3. "I promise to pay B ₹ 500 after sight."
4. "I promise to pay B ₹ 500 after C's death."

10.0 HOW TO CALCULATE DUE DATE OF A BILL

The due date of each bill is calculated as under:

Case	Due Date
(a) When the bill is made payable on a specific date.	(a) That specific date will be the due date.
(b) When the bill is made payable at a stated number of month(s) after date.	(b) That date on which the term of the bill shall expire will be the due date. Note: The term shall expire on that day of the month which corresponds with the day on which the bill is dated. If the month in which the period terminates has no corresponding day, the period shall be deemed to expire on the last day of such a month.
(c) When the bill is made payable at a stated number of days after date.	(c) That date which comes after adding stated number of days to the date of bill, shall be the due date. Note: The date of Bill is excluded.
(d) When the due date is a public holiday.	(d) The preceding business day will be the due date.
(e) When the due date is an emergency / unforeseen holiday.	(e) The next following day will be the due date.

TUTORIAL NOTES

1. The term of a **Bill after sight** commences from the date of acceptance of the bill where as the term of a **Bill after date** commences from the date of drawing a bill.
2. Public Holidays include all Sundays, 26th Jan. (Republic Day), 15th Aug. (Independence Day), 30th Sept. (bank holiday) and 1st April, (bank holiday).

11.0 HOW TO CALCULATE DATE OF MATURITY IN CASE OF TIME BILLS

In case of time or tenor bills, **three days** (called days of grace) are **added** to the due date to arrive at the date of maturity.

EXAMPLE

Find out the date of maturity of the following Bills Receivable:

Bill No.	Date of Drawing	Date of Acceptance	Payable
A-1	31.01.2018	02.02.2018	1 month after date
A-2	29.01.2018	03.02.2018	30 days after date
A-3	29.01.2018	02.02.2018	2 months after date
A-4	12.07.2018	14.07.2018	1 month after date
A-5	27.06.2018	28.06.2018	3 months after date
A-6	28.09.2018	01.10.2018	2 months after sight
A-7	23.12.2018	24.12.2018	1 month
A-8	02.01.2018	03.01.2018	On demand
A-9	05.01.2018	06.01.2018	At sight
A-10	10.01.2018	11.01.2018	On presentment

Drawer demanded the amount of last three bills on 24th Jan., 2018.

SOLUTION

Bill No.	Date of Drawing	Date of Maturity	
A-1	31.01.2018	03.03.2018	
A-2	29.01.2018	03.03.2018	
A-3	29.01.2018	31.03.2018	Since 1st April (being a bank holiday) is a public holiday.
A-4	12.07.2018	14.08.2018	Since 15th Aug. (being Independence Day) is a public holiday.
A-5	27.06.2018	29.09.2018	Since 30th Sept. (being a bank holiday) is a public holiday.
A-6	28.09.2018	04.12.2018	
A-7	23.12.2018	25.01.2018	Since 26th Jan. (being Republic Day) is a public holiday.
A-8	02.01.2018	24.01.2018	
A-9	05.01.2018	24.01.2018	
A-10	10.01.2018	24.01.2018	

Notes:

1. Three days of grace have been considered in case of Bills after date and Bills after sight, to ascertain the date of maturity.
2. The term of a 'Bill after sight' commences from the date of acceptance.

12.0 NEGOTIATION OF AN INSTRUMENT

A negotiable instrument may be transferred *either* by negotiation *or* by assignment.

MEANING OF NEGOTIATION

An instrument is said to be negotiated when a promissory note, bill of exchange *or* cheque is transferred to any person so as to constitute that person the holder of the instrument.

Thus, the essence of the negotiation is that it must be made with the intention of transferring a title of the instrument to the transferee.

Example X was the holder of a cheque of ₹ 10,000 payable to bearer. He delivered this cheque to Y to keep it in his (Y) safe custody. In this case there is no negotiation of cheque from X to Y because the transfer of the cheque to Y makes him a bearer (i.e., caretaker) only and not the holder of the cheque.

HOW TO EFFECT NEGOTIATION

There are **two methods** of transfer by negotiation as follows:

1. **Negotiation by delivery** — A promissory note, bill of exchange *or* cheque payable to bearer is negotiable by delivery thereof. Thus, the instrument must be actually delivered and the delivery must also be voluntary.

Example X was the holder of a cheque of ₹ 10,000 payable to bearer. He kept the cheque in his safe. Y, a thief stolen the cheque from X's safe. In this case, there is no negotiation of the cheque from X to Y because the cheque was not voluntarily delivered to Y. It may also be noted that if Y delivers this cheque for some consideration to Z who receives the same in good faith and before maturity. Z will become the holder in due course and will be entitled to receive the amount of the instrument.

2. **Negotiation by endorsement and delivery** — A promissory note, bill of exchange *or* cheque payable to order, is negotiable by the holder by endorsement and delivery thereof. Thus, a mere endorsement (i.e., signing of a negotiable instrument for the purpose of negotiation) does not amount to negotiation unless there is delivery of the same.

13.0 ENDORSEMENT OF AN INSTRUMENT

MEANING OF ENDORSEMENT

The process of transferring an instrument is called an endorsement. An endorsement means signing the negotiable instrument on the back *or* face thereof *or* on a slip of paper (called allonge) annexed thereto for the purpose of negotiation. The person who endorses the instrument is called the **Endorser** and the person in whose favour the instrument is endorsed is called the **Endorsee**.

WHO MAY ENDORSE/NEGOTIATE

Every sole maker, drawer, payee *or* endorsee, *or* all of several joint makers, drawers, payees *or* endorsees of a negotiable instrument may endorse and negotiate the same if the negotiability of such instrument has not been restricted *or* excluded. In other words, a stranger (i.e., a person other than those stated above) cannot indorse a negotiable instrument. If a stranger endorses it, the endorsement is void and he cannot be made liable as endorser.

ESSENTIAL REQUIREMENTS OF A VALID ENDORSEMENT

1. It must be **on the back or face of instrument or on a slip of paper (called allonge) annexed** thereto.
2. It must be **signed** by the endorser.
3. It must be completed by the **delivery** of the instrument.
4. It must be made **by the holder** of the instrument.

KINDS OF ENDORSEMENT

The meaning and specimen of various kinds of endorsements have been given below:

1. **General Endorsement or Blank Endorsement** — An endorsement is said to be in blank if the endorser signs his name only. An instrument endorsed in blank becomes payable to the bearer thereof even although it was originally payable to order.

SPECIMEN “P C TULSIAN”

2. **Special Endorsement or Full Endorsement** — An endorsement is said to be full if the endorser (a) signs his name, and (b) adds a direction to pay the amount to *or* to the order of a specified person.

Note: The use of words ‘*or order*’ is not necessary.

Specimen: (i) “Pay to B, P C Tulsian”, (ii) “Pay to B *or order*, P C Tulsian”

3. **Restrictive Endorsement** — An endorsement is said to be restrictive if it restricts/excludes the right of further negotiation. Thus, in case of restrictive endorsement, the endorsee does not become the owner of the instrument as in case of other endorsement.

SPECIMEN

- (i) “Pay the contents to C only, P C Tulsian”
- (ii) “Pay C for my use, P C Tulsian”
- (iii) “Pay C *or order* for the account of B. P C Tulsian”
- (iv) “The within must be credited to C. P C Tulsian”

4. **Partial Endorsement** — An endorsement is said to be a partial endorsement when it purports to transfer only a part of the amount of the instrument. A partial endorsement is invalid.

Specimen: In case of a Bill of ₹ 1,000 “Pay ₹ 50 to B. P C Tulsian”

Exception: Where an instrument has been paid in part, the fact of the part payment may be endorsed on the instrument and it may then be negotiated for the balance.

Specimen: “Pay B being the unpaid balance of the bill, P C Tulsian”

5. **Conditional Endorsement or Qualified Endorsement** — An endorsement is said to be a conditional endorsement if it limits *or* negatives the liability of the endorser.

EXAMPLES OF CONDITIONAL ENDORSEMENT

- (a) **Sans Recourse Endorsement** — An endorsement is said to be Sans Recourse Endorsement if the endorser endorses the instrument in such a way that he relieves himself from the liability to all subsequent endorsees.

SPECIMEN

- (i) “Pay B *or order* Sans Recourse, P C Tulsian”
- (ii) “Pay B *or order* without recourse to me, P C Tulsian”

Note: If an endorser who has excluded his own liability in this manner, afterwards becomes the holder of the instrument, all the intermediate endorser continue to be liable to him.

Specimen: “Pay B *or order* at his own risk, P C Tulsian”.

- (b) **Facultative Endorsement** — An endorsement is said to be a Facultative Endorsement if the endorser endorses the instrument in such a way that he waives some right to which he is entitled.

Specimen: “Pay B *or order* notice of dishonour waived, P C Tulsian”

- (c) **Sans Frais** — An endorsement is said to be Sans Frais endorsement if the endorser endorses the instrument in such a way that no expenses should be incurred on account of the bill.

Specimen: “Pay B or his order sans frais, P C Tulsian.”

- (d) **Contingency based Endorsement** — An endorsement is said to be contingency based endorsement if the endorser endorses the instrument in such a way that his liability depends upon the happening of an event which may or may not happen.

Specimen: “Pay B or order on the arrival of the ship at Kolkata. P C Tulsian”

Note: The condition is operative as between the endorser and endorsee. An endorsee cannot recover the amount either from the endorser or from any prior party until such event has happened. However, such endorsement does not affect the position of the party who has to pay for the instrument on its maturity.

Specimen: “Pay B or order on his marriage with C, P C Tulsian”

14.0 DRAWING OF A BILL (TECHNICALLY A DRAFT)

When a creditor writes and signs an unconditional order requiring the debtor to pay a certain sum of money in accordance with the terms and conditions stated therein, such an act of writing an order is traditionally called “drawing of a bill” and technically called “drawing of a draft”. No accounting entry is passed in the books of any party on drawing of a bill (technically a draft).

15.0 ACCEPTANCE OF A BILL (TECHNICALLY A DRAFT)

A bill is called a draft before its acceptance by a drawee. When the drawee puts his signature on the draft received from the drawer, such an act of putting the signature on the draft is traditionally called acceptance of a bill and technically called acceptance of a draft. After the acceptance of a draft, the draft becomes a bill. Such a bill is returned by the drawee to the drawer. In such a case, the following journal entry is passed in the books of drawer and drawee:

In the books of Drawer	In the books of Drawee
Bills Receivable A/c Dr. To Drawee's A/c (Being the acceptance of a bill received from....)	Drawer's A/c Dr. To Bills Payable A/c (Being the acceptance of a bill given to....)

16.0 PAYMENT OF A BILL (OR HONOUR OF A BILL)

When the amount of the bill is realised on the maturity, it is said to have been paid off or honoured. In such a case, the following journal entry is passed in the books of drawer and drawee:

In the Books of Holder of a Bill	In the books of a Drawee
Cash/Bank A/c Dr. To Bills Receivable A/c (Being the bill collected)	Bills Payable A/c Dr. To Cash/Bank A/c (Being the bill discharged)

17.0 OPTIONS AVAILABLE TO A HOLDER FOR DEALING WITH A BILL OF EXCHANGE

The various options available to a holder for dealing with a Bill of Exchange are as under:

1. He may retain the bill till due date.
2. He may send the bill to the Bank for collection.
3. He may get the bill discounted with a bank/other person.
4. He may endorse the bill to a creditor.

18.0 WHEN THE BILL IS RETAINED TILL THE DUE DATE**ILLUSTRATION 1**

On 1 Jan., A sold goods worth ₹ 10,000 to B and drew a bill on B at three months for the amount. B accepted the bill and returned it to A. The bill is duly honoured at maturity. Pass the necessary journal entries in the books of A and B, if A retained the bill till the due date.

SOLUTION**A'S JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Jan. 1	B To Sales A/c (Being the goods sold to B on credit)	Dr.	10,000	10,000
Jan. 1	Bills Receivable A/c To B (Being the acceptance of the bill received from B)	Dr.	10,000	10,000
Apr. 4	Bank A/c To Bills Receivable A/c (Being the bill collected)	Dr.	10,000	10,000

B'S JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Jan. 1	Purchases A/c To A (Being the goods purchased on credit from A)	Dr.	10,000	10,000
Jan. 1	A To Bills Payable A/c (Being the acceptance of the bill given to A)	Dr.	10,000	10,000
Apr. 4	Bills Payable A/c To Bank A/c (Being the bill discharged)	Dr.	10,000	10,000

19.0 WHEN THE BILL IS SENT TO THE BANK FOR COLLECTION

1. When a bill is sent to the bank with instructions that the bill should be retained till maturity and should be realised on that date, it is known as "Bill sent for Collection".
2. The bank after charging for this service, credits the net proceeds to the Customer's Account.
3. The accounting treatment is summarised as follows:

ACCOUNTING ENTRIES WHEN A BILL IS SENT FOR COLLECTION

Case	In the books of Drawer	In the books of Drawee
(a) On Sending the Bill	Bills sent for Collection A/c Dr. To Bills Receivable A/c (Being the bill sent for collection)	No Entry
(b) On Realising the amount of the Bill	Bank A/c Dr. Bank Charges A/c Dr. To Bills sent for Collection A/c (Being the bill collected by the Bank)	Bills Payable A/c To Cash A/c (Being the bill discharged)

ILLUSTRATION 2

On 1 Jan., A sold goods worth ₹ 10,000 to B and drew a bill on B at three months for the amount. B accepted the bill and returned it to A. One month after the acceptance, A sent the bill to his bank for collection. On the due date, the bank got the payment and charged 1% commission. Pass the Journal entries in the books of A and B.

SOLUTION

A'S JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	B Dr. To Sales A/c (Being the goods sold to B on credit)		10,000	10,000
Jan. 1	Bills Receivable A/c Dr. To B (Being the acceptance of the bill received from B)		10,000	10,000
Feb. 1	Bill sent for Collection A/c Dr. To Bills Receivable A/c (Being the bills sent for collection)		10,000	10,000
Apr. 4	Bank A/c Dr. Bank Charges A/c Dr. To Bills sent for Collection A/c (Being the bill collected by bank)		9,900 100	10,000

Note: Journal Entries in B's Journal will be the same as given in case of Illustration 1.

20.0 WHEN THE BILL IS DISCOUNTED WITH THE BANK

1. An act of selling of a bill to a bank or some other person to obtain payment for it before its maturity, is called as discounting of a bill.
2. The Purchaser of the bill usually charges the discount in terms of interest for the unexpired term of the bill.
3. Such a discount is an expense for the seller and a gain for the purchaser.
4. The accounting treatment is summarised as follows:

ACCOUNTING ENTRY WHEN A BILL IS DISCOUNTED

In the books of Drawer/Seller		In the books of Drawee
Bank A/c	Dr.	The discounting of a bill does not at all affect the drawee and therefore, would not require any accounting treatment in his books.
Discount A/c	Dr.	
To Bills Receivable A/c		
(Being the bill got discounted with the Bank @)		

ILLUSTRATION 3

On 1st Jan., A sold goods worth ₹ 10,000 to B and drew a bill on B at three months for the amount. B accepted the bill and returned it to A who discounted the bill with a bank on 4 Feb., at 15% p.a. The bill is duly honoured at maturity. Pass the necessary journal entries in the books of A and B.

SOLUTION**A'S JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	B To Sales A/c (Being the goods sold to B on credit)	Dr.	10,000	10,000
Jan. 1	Bills Receivable A/c To B (Being the acceptance of the bill received from B)	Dr.	10,000	10,000
Feb. 4	Bank A/c Discount A/c To Bills Receivable A/c (Being the bill got dis. with the bank @15% p.a.)	Dr. Dr.	9,750 250	10,000

B'S JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	Purchases A/c To A (Being the goods purchased on credit from A)	Dr.	10,000	10,000
Jan. 1	A To Bills Payable A/c (Being the acceptance of the bill given to A)	Dr.	10,000	10,000
Apr. 4	Bills Payable A/c To Bank A/c (Being the bill discharged)	Dr.	10,000	10,000

21.0 WHEN THE BILL IS ENDORSED IN FAVOUR OF A CREDITOR

1. An endorsement means the writing of a person's name on the face or back of a negotiable instrument or on a slip of paper (called allonge) annexed thereto for the purpose of negotiation.
2. The person who endorses the instrument is called the Endorser.
3. The person to whom the instrument is endorsed is called the Endorsee.
4. The accounting treatment is summarised as follows.

ACCOUNTING ENTRY WHEN A BILL IS ENDORSED

In the books of Drawer	In the books of Drawee	In the books of Endorsee
Endorsee's A/c Dr. To Bills Receivable A/c (Being the bill endorsed in favour of...)	The endorsement of a bill does not affect the drawee and therefore does not require any accounting treatment in his books.	Bills Receivable A/c To Endorser's A/c (Being the receipt of a bill duly endorsed)

ILLUSTRATION 4

On 1st Jan., A sold goods worth ₹ 10,000 to B and drew a bill on B at three months for the amount. B accepted the bill and returned it to A who endorsed the bill one month after the acceptance, in favour of a creditor C in settlement of his debt for ₹ 10,200. The bill is duly honoured at maturity. Pass the necessary journal entries in the books of A, B and C.

SOLUTION

A'S JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	B Dr. To Sales A/c (Being the goods sold to B on credit)		10,000	10,000
Jan. 1	Bills Receivable A/c Dr. To B (Being the acceptance of the bill received from B)		10,000	10,000
Feb. 1	C Dr. To Bills Receivable A/c To Discount Received A/c (Being a bill of ₹ 10,000 endorsed to C in settlement of ₹ 10,200)		10,200	10,000 200

B'S JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	Purchases A/c Dr. To A (Being goods purchased on credit from A)		10,000	10,000
Jan. 1	A Dr. To Bills Payable A/c (Being the acceptance of the bill given to A)		10,000	10,000
Apr. 4	Bills Payable A/c Dr. To Bank A/c (Being the bill discharged)		10,000	10,000

C'S JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Feb. 1	Bills Receivable A/c Dr. Discount Allowed A/c Dr. To A (Being the receipt of a duly endorsed bill)		10,000 200	10,200
Apr. 4	Bank A/c Dr. To Bills Receivable A/c (Being the bill collected on due date)		10,000	10,000

ILLUSTRATION 5

A owed B ₹ 8,000. He gave a bill for the same on 1 Aug., payable after 4 months at the Bank of India, Chandni Chowk, Delhi. Immediately after receiving the bill, B endorsed it to C in payment of his debts. On 4 Sept., C discounted the bill at 12 per cent per annum. The bill is met on due date. Pass the necessary Journal Entries in the books of A, B and C.

SOLUTION**A'S JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Aug. 1	B Dr. To Bills Payable A/c (Being the acceptance of the Bill given to B)		8,000	8,000
Dec. 4	Bills Payable A/c Dr. To Cash A/c (Being the bill discharged)		8,000	8,000

B'S JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Aug. 1	Bills Receivable A/c Dr. To A (Being the acceptance of the Bill received from A)		8,000	8,000
Aug. 1	C Dr. To Bills Receivable A/c (Being the bill endorsed to C)		8,000	8,000

C'S JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Aug. 1	Bills Receivable A/c Dr. To B (Being the acceptance of A received from B)		8,000	8,000
Sept. 4	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being the bill discounted with Bank @ 12% p.a.)		7,760 240	8,000

ILLUSTRATION 6

A drew a 3 months' bill for ₹ 10,000 upon B. This bill was endorsed in favour of C who endorsed in favour of D who in turn endorsed in favour of A to discharge his own acceptance. Prepare Journal of A, B, C and D.

SOLUTION**JOURNAL OF A**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bills Receivable A/c Dr. To B (Being the acceptance of the Bill received from B)		10,000	10,000
	C Dr. To Bills Receivable A/c (Being the bill endorsed in favour of C)		10,000	10,000
	Bills Receivable A/c (New) Dr. To Bills Receivable A/c (Old) (Being the receipt of a duly endorsed bill towards the payment of an old bill)		10,000	10,000

JOURNAL OF B

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	A Dr. To Bills Payable A/c (Being the acceptance of the Bill given to A)		10,000	10,000

JOURNAL OF C

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bills Receivable A/c Dr. To A (Being the receipt of a duly endorsed bill)		10,000	10,000
	D Dr. To Bills Receivable A/c (Being the endorsed bill endorsed in favour of D)		10,000	10,000

JOURNAL OF D

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bills Receivable A/c Dr. To C (Being the receipt of a duly endorsed bill)		10,000	10,000
	Bills Payable A/c Dr. To Bills Receivable A/c (Being own acceptance discharged by endorsing an endorsed bill)		10,000	10,000

ILLUSTRATION 7

A drew a 3 months' bill for ₹ 10,000 upon B. This bill was endorsed in favour of C who endorsed in favour of D who in turn endorsed in favour of B to discharge his own acceptance. Prepare Journal of A, B, C and D.

SOLUTION**JOURNAL OF A**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bills Receivable A/c Dr. To B (Being the acceptance of bill received from B)		10,000	10,000
	C Dr. To Bills Receivable A/c (Being the bill endorsed in favour of C)		10,000	10,000

JOURNAL OF B

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	A Dr. To Bills Payable A/c (Being the acceptance of bill given to A)		10,000	10,000
	Bills Payable A/c Dr. To Bills Receivable A/c (Old Bill) (Being own acceptance received back towards the payment of an old Bill)		10,000	10,000

JOURNAL OF C

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bills Receivable A/c Dr. To A (Being the receipt of duly endorsed a bill)		10,000	10,000
	D Dr. To Bills Receivable A/c (Being the endorsed bill endorsed in favour of D)		10,000	10,000

JOURNAL OF D

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bills Receivable A/c Dr. To C (Being the receipt of a duly endorsed bill)		10,000	10,000
	Bill Payable A/c Dr. To Bills Receivable A/c (Being own acceptance discharged by endorsing an endorsed bill)		10,000	10,000

22.0 DISHONOUR OF A BILL

1. A Bill of Exchange (excluding cheques) may be dishonoured by (a) non-acceptance or by (b) non-payment.
2. It is to be noted that a Promissory Note or Cheque can be dishonoured by non-payment only.
3. When a bill is dishonoured by non-acceptance, no accounting entry is passed in the books of drawer and drawee.
4. When a bill is dishonoured by non-payment, the accounting entries in the books of Drawer, Drawee, Bank and Endorsee are summarised below:

**ACCOUNTING ENTRIES IN THE BOOKS OF DRAWER, DRAWEE,
BANK/ENDORSEE ON DISHONOUR OF A BILL**

Case	In the books of Drawer	In the books of Drawee	In the books of Bank/ Endorsee
(a) When the bill is retained till Maturity	Drawee's A/c Dr. To Bills Receivable A/c To Cash A/c (Being the amount of dishonoured bill and noting charges debited to the drawee)	Bills Payable A/c Dr. Noting Charges A/c Dr. To Drawer's A/c (Being the amount of Dishonoured bill and noting charges credited to the drawer)	Not Applicable
(b) When the bill is sent to the bankers for collection	Drawee's A/c Dr. To Bills sent for Collection A/c To Bank A/c (Being the amount of dishonoured bill and noting charges debited to the drawee)	Same as above	In the books of Bank Customer's A/c Dr. To Bills Receivable A/c To Cash A/c (Being the amount of dishonoured bill and noting charges debited to customer)
(c) When the bill is got discounted	Drawee's A/c Dr. To Bank A/c (Being the amount of dishonoured bill and noting charges debited to the drawee)	Same as above	Same as above
(d) When the bill is endorsed	Drawee's A/c Dr. To Endorsee's A/c (Being the amount of dishonoured bill and noting charges debited to the drawee)	Same as above	In the books of Endorsee Endorser's A/c Dr. To Bills Receivable A/c To Cash A/c (Being the amount of dishonoured bill and noting charges debited to the endorser)

TUTORIAL NOTES

1. **Meaning of Noting** — *Noting is the recording of the fact of dishonour by a Notary Public. Such noting must be made within a reasonable time after dishonour.*
2. **Contents of Noting** — *Noting must specify (a) the date of dishonour, (b) the reason, if any, assigned for such dishonour (c) Noting Charges charged by Notary.*

3. **Recovery** — *The amount of noting charges is recoverable from the party who is responsible for dishonour.*
4. **Treatment in the books of the Drawer** — *The Drawee's Account is always debited with the total amount, i.e., the amount of the dishonoured bill plus the amount of noting charges (if any, incurred).*
5. **Treatment in the books of the Drawee** — *the Drawer's Account is always credited with the total amount, i.e., the amount of the dishonoured bill plus the amount of noting charges (if any, incurred).*
6. **Protest** — *Protest is the formal certificate given by the Notary Public. This certificate is based on the noting.*

ILLUSTRATION 8

A sold goods to B for ₹ 10,000 on 1st Jan. and drew upon him a three months bill for the amount. B accepted the bill and returned to A. At maturity, the bill was dishonoured. Pass the necessary journal entries in the books of A and B in each of the following alternative cases:

Case (a) When A retained the bill till the due date and paid noting charges of ₹ 100.

Case (b) When A got the bill discounted with his bankers @ 15% p.a. on 4th Feb. and the bank paid the noting charges of ₹ 100.

Case (c) When A endorsed the bill one month after the acceptance in favour of his creditor C in settlement of his debt for ₹ 10,200 and C paid the noting charges of ₹ 100.

Case (d) When A sent the bill to his bankers for collection and the bank paid the noting charges of ₹ 100.

SOLUTION**A'S JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan.1	Entries in all cases: B Dr. To Sales A/c (Being the goods sold to B on credit)		10,000	10,000
Jan. 1	Bills Receivable A/c Dr. To B (Being the acceptance of the bill received from B)		10,000	10,000
Apr.4	Additional Entry in Case (a): B Dr. To Bills Receivable A/c To Cash A/c (Being the amount of dishonoured bill and noting charges debited to the drawee)		10,100	10,000 100
Feb. 2	Additional Entries in Case (b): Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being the bill discounted @ 15% p.a)		9,750 250	10,000

Apr. 4	B To Bank A/c (Being the amount of dishonoured bill and noting charges debited to the drawee).	Dr.	10,100	10,100
Feb. 1	Additional Entries in Case (c): C To Bill Receivable A/c To Discount Received A/c (Being the bill of ₹ 10,000 endorsed to C in settlement of ₹ 10,200)	Dr.	10,200	10,000 200
Apr. 4	B Discount Received A/c To C (Being the amount of dishonoured bill and noting charges debited to the drawee and the discount received written back)	Dr. Dr.	10,100 200	10,300
Jan. 1	Additional Entries in Case (d): Bills sent for Collection A/c To Bills Receivable A/c (Being the bill sent for collection)	Dr.	10,000	10,000
Apr. 4	B To Bill sent for Collection A/c To Bank A/c (Being the amount of dishonoured bill & noting charges debited to the drawee)	Dr.	10,100	10,000 100

B'S JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan.1	Purchases A/c To A (Being the goods purchased on credit from A)	Dr.	10,000	10,000
Jan. 1	A To Bills Payable A/c (Being the acceptance of the bill given to A)	Dr.	10,000	10,000
April 4	Bills Payable A/c Noting Charges A/c To A (Being the amount of dishonoured bill & noting charges credited to the drawer)	Dr. Dr.	10,000 100	10,100

ILLUSTRATION 9

A bill receivable for ₹ 10,000, which had been discounted at ₹ 9,500, is dishonoured and bank paid ₹ 200 as Noting Charges. Give Journal Entries to record the above in the books of: (i) the Drawer; (ii) the Drawee, and (iii) the Bank.

SOLUTION**JOURNAL OF DRAWER**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Drawee's A/c Dr. To Bank A/c (Being the amount of dishonoured bill & Noting Charges debited to Drawee's A/c)		10,200	10,200

JOURNAL OF DRAWEE

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bills Payable A/c Dr. Noting Charges A/c Dr. To Drawer's A/c (Being the amount of dishonoured bill & Noting Charges credited to Drawer)		10,000 200	10,200

JOURNAL OF BANK

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Drawer's A/c Dr. To Bills Receivable Discounted A/c To Cash A/c (Being the dishonour of the bill and payment of Noting Charges)		10,200	10,000 200

ILLUSTRATION 10

Rahim owed Ram ₹ 70,000 for which he accepted a bill drawn on him by Ram payable after 3 Months from 1st January.

On the 4th January the bill was discounted by the drawer with his bank for 95% value.

The bill was not met on the due date and the bank, therefore, debited the same to the drawer's account with ₹ 10 incidental charges and ₹ 40 over due interest, on the 10th April.

The drawee settled the bill value together with cost on 11th April.

Required: Pass Journal Entries in the books of Rahim and of Ram for the above transactions.

SOLUTION**JOURNAL OF RAM**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan.1	Bills Receivable A/c Dr. To Rahim A/c (Being bill drawn on Rahim for 3 months and acceptance received)		70,000	70,000
Jan. 2	Bank A/c Dr. Discounting Charges A/c Dr. To Bills Receivable A/c (Being the bill discounted with bank for 95% value)		66,500 3,500	70,000

Jan. 10	Rahim A/c To Bank A/c (At maturity the discounted bill being dishonoured, Bill Value plus incidental charges & interest debited by Bank)	Dr.	70,050	70,050
Jan. 11	Bank A/c To Rahim A/c (Being the amount received from Rahim in settlement of the dishonoured bill)	Dr.	70,050	70,050

JOURNAL OF RAHIM

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	Bills of A/c To Bills Payable A/c (Being acceptance given to Ram)	Dr.	70,000	70,000
Apr. 4	Bills Payable A/c Interest A/c Incidental Charges A/c To Ram A/c (Being the acceptance dishonoured at maturity)	Dr. Dr. Dr.	70,000 40 10	70,050
Apr. 11	Ram A/c To Bank A/c (Being payment made to Ram in settlement of the dishonoured bill inclu.. incidental charges and interest)	Dr.	70,050	70,050

23.0 RENEWAL OF A BILL

MEANING OF RENEWAL OF A BILL

Cancellation of the original bill and drawing a fresh bill for another period on a request from the drawee is called renewal of a bill.

TREATMENT OF INTEREST FOR EXTENDED PERIOD

In case of renewal of a bill, the Interest for the extended period is *either* paid in cash *or* is included in the amount of the new bill.

ACCOUNTING ENTRIES WHEN A BILL IS RENEWED

Case	In the books of Drawer	In the books of Drawee
(a) On canceling the old bill	Drawee's A/c To Bills Receivable A/c	Bills Payable A/c To Drawer's A/c
(b) On making due the interest	Drawee's A/c To Interest A/c	Interest A/c To Drawer's A/c
(c) On receiving a portion of the amount due	Bank A/c To Drawee's A/c	Drawer's A/c To Bank A/c
(d) On the acceptance of a fresh bill	Bills Receivable A/c To Drawee's A/c	Drawer's A/c To Bills Payable A/c

ILLUSTRATION 11

On 1st January, B owes ₹ 10,000 and accepts a three months bill for the amount. On the date of maturity, B, not being able to meet the bill, offers A ₹ 4,000 and asks him to draw another bill for three months for the balance *plus* interest at 15% p.a. A agrees to this proposal. Pass the necessary journal entries in the books of A and B.

SOLUTION**A'S JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Jan. 1	Bills Receivable A/c Dr. To B (Being the acceptance of the bill received)		10,000	10,000
April 4	B Dr. To Bills Receivable A/c (Being the original bill cancelled)		10,000	10,000
	Cash A/c Dr. To B (Being the cash received on account)		4,000	4,000
	B Dr. To Interest A/c (Being the interest due @ 15% p.a. on ₹ 6,000 for 3 months)		225	225
	Bills Receivable A/c Dr. To B (Being the acceptance of the fresh bill received from B)		6,225	6,225

B'S JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Jan. 1	A Dr. To Bills Payable A/c (Being the acceptance of the bill given to A)		10,000	10,000
April 4	Bills Payable A/c Dr. To A (Being the original bill cancelled)		10,000	10,000
	A Dr. To Cash A/c (Being the cash paid to A)		4,000	4,000
	Interest A/c Dr. To A (Being the interest due @ 15% p.a., on ₹ 6,000 for three months)		225	225
	A Dr. To Bills Payable A/c (Being the acceptance of the fresh bills given to A)		6,225	6,225

ILLUSTRATION 12

X owes Y ₹ 3,000 and accepted a three months bill for the amount. Before the due date of the bill :

- X, approached us and pays ₹ 1,000 in cash and asks us to draw on him another bill for 5 months for ₹ 2,000 plus interest @ 18% p.a.
- X pays us interest @ 18% p.a. and accepts another bill for 5 months.
- X pays us ₹ 1,000 plus interest @ 18% p.a. and accepts another bill for 5 months for ₹ 2,000.
- X pays us ₹ 1,000 in cash and endorses over to us a bill of his for ₹ 1,000 and accepts a fresh bill for 5 months for the balance plus interest @ 18% p.a.

Required: Pass the necessary journal entries in the books of Y in each of the above alternative cases.

SOLUTION**JOURNAL OF Y**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(a)	X To Bills Receivable A/c (Being the original bill cancelled)	Dr.	10,000	10,000
	Cash A/c To X (Being cash received from X)	Dr.	1,000	1,000
	X To Interest A/c (Being the interest due from X)	Dr.	150	150
	Bills Receivable A/c To X (Being acceptance of B/R received)	Dr.	2,150	2,150
(b)	X To Bills Receivable A/c (Being the original bill cancelled)	Dr.	10,000	10,000
	X To Interest A/c (Being interest due from X)	Dr.	225	225
	Cash A/c To X (Being interest received)	Dr.	225	225
	Bills Receivable A/c To X (Being the acceptance of B/R received)	Dr.	3,000	3,000
(c)	X To Bills Receivable A/c (Being the original bill cancelled)	Dr.	10,000	10,000
	X To Interest A/c (Being interest due from X)	Dr.	150	150

	Cash A/c To X (Being cash received from X)	Dr.		1,150	1,150
	Bills Receivable A/c To X (Being B/R drawn upon X)	Dr.		2,000	2,000
(d)	X To Bills Receivable A/c (Being the original bill cancelled)	Dr.		10,000	10,000
	Cash A/c Bills Receivable A/c To X (Being cash & B/R received from X)	Dr. Dr.		1,000 1,000	2,000
	X To Interest A/c (Being interest due from X)	Dr.		75	75
	Bills Receivable A/c To X (Being acceptance of B/R received)	Dr.		1,075	1,075

24.0 INSOLVENCY OF THE ACCEPTOR OF A BILL

1. When the bill is dishonoured due to insolvency of the drawee (or acceptor) of the bill, *either* nothing is recovered *or* some partial payment (called dividend) in full settlement of the claims is recovered.
2. The dishonour of the bill due to insolvency of the acceptor is recorded in the same manner as explained in case of dishonour of a bill.
3. The amount which remains unpaid by the drawee (or acceptor) is treated as follows:

In the books of Drawer	In the books of Drawee
Such amount is debited to Bad Debts Account .	Such amount is transferred to the Deficiency Account .

ILLUSTRATION 13

If in Illustration 11, at maturity the second bill was dishonoured as B becomes insolvent and a dividend of 60 paise in a rupee was received from his estate, what additional entries would be required to be passed in the books of A and B?

SOLUTION**A'S JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
July 7	B To Bills Receivable A/c (Being the amount of dishonoured bill debited to B)	Dr.	6,225	6,225

	Bank A/c	Dr.	3,735	
	Bad Debts A/c	Dr.	2,490	
	To B			6,225
	(Being a dividend of 60 paise in a rupee received from B's estate and the balance written-off as bad debts)			

B'S JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
July 7	Bills Payable A/c	Dr.	6,225	
	To A			6,225
	(Being the amount of dishonoured bill credited to A)			
	A	Dr.	6,225	
	To Bank A/c			3,735
	To Deficiency A/c			2,490
	(Being a dividend of 60 paise in the rupee paid to A and the balance in A's A/c transferred to Deficiency A/c)			

ILLUSTRATION 14

Yashpal owed money to Srinivas and hence accepted two bills each of ₹ 4,850 of three months duration drawn on him by the latter, on July 1. Srinivas endorsed one of the bills in favour of Hariram on July 7. On the same date he discounted the other bill with his bank and received net proceeds of ₹ 4,675.

Yashpal failed to meet both the bills on the due date. On 4th Oct., the bank debited the account of Srinivas with value of second bill *plus* their charges of ₹ 20.

Yashpal is declared insolvent and his estate paid 60 paise in the rupee, on 1st Nov.

Required: Show Journal Entries in respect of the above in the books of Yashpal and Srinivas.

SOLUTION

JOURNAL OF YASHPAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
July. 1	Srinivas A/c	Dr.	9,700	
	To Bills Payable A/c			9,700
	(Being the two bills each of ₹ 4,850 payable 3 months after date accepted)			
Oct. 4	Bills Payable A/c	Dr.	9,700	
	Bank Charges A/c	Dr.	20	
	To Srinivas			9,720
	(Being the acceptances to Mr Srinivas dishonoured, ₹ 20 due to him for bank charges)			
Nov. 1	Srinivas A/c	Dr.	9,720	
	To Bank A/c			5,832
	To Deficiency A/c			3,888
	(Being the first and final payment made @ 60 paise in a rupee of the net amount due)			

JOURNAL OF SRINIVAS

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
July 1	Bills Receivable A/c Dr. To Yashpal A/c (Being the received two bills each of ₹ 4,850 payable 3 months after date)		9,700	9,700
July 7	Hari Ram A/c Dr. To Bills Receivable A/c (Being the bills endorsed to Hari Ram)		4,850	4,850
July 7	Bank A/c Dr. Discounting Charges A/c Dr. To Bills Receivable A/c (Being the bill discounted for ₹ 4,675)		4,675 175	4,850
Oct. 4	Yashpal A/c Dr. To Bank A/c (Being the dishonoured bill taken over from Bank on payment of Bill value <i>plus</i> Bank Charges)		4,870	4,870
	Yashpal A/c Dr. To Hari Ram A/c (Being the endorsed bill dishonoured)		4,850	4,850
Nov. 1	Bank A/c Dr. Bad Debts A/c Dr. To Yashpal A/c (Being the first and final dividend received @ 60 paise in a rupee of the net amount due)		5,832 3,888	9,720

ILLUSTRATION 15

Amarnath drew on Parker a bill of exchange for ₹ 1,00,000 on 1st January payable after 3 months from 1st January, which Parker accepted. On 4th January Amarnath discounted the bill with his bankers at 18% p.a. Parker failed to meet the bill on due date and the bill was returned to Amarnath with bank charges ₹ 200 debited to him by the bank. Amarnath claimed the bill value *plus* bank charges from Parker. However only 40% of the amount claimed could be recovered by Amarnath on 8th April as Parker was declared insolvent.

Required: Pass Journal Entries in the books of Amarnath and Parker for the above transactions.

SOLUTION**JOURNAL OF AMARNATH**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Jan. 1	Bills Receivable A/c Dr. To Parker A/c (Being the Acceptance received payable 3 months after date)		1,00,000	1,00,000
Jan.1	Bank A/c Dr. Discounting Charges A/c Dr. To Bills Receivable A/c (Being the bill discounted @ 18% p.a.)		95,500 4,500	1,00,000

Apr. 4	Parker A/c To Bank A/c (Being the acceptance dishonoured, Bank Charges being ₹ 200)	Dr.		1,00,200	1,00,200
Apr. 8	Bank A/c Bad Debts A/c To Parker A/c (Being the first and final dividend received @ 40% of the net amount due)	Dr. Dr.		40,080 60,120	1,00,200

JOURNAL OF PARKER

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	Amarnath A/c To Bills Payable A/c (Being the acceptance given for 3 months after date)	Dr.	1,00,000	1,00,000
Apr. 4	Bills Payable A/c Bank Charges A/c To Amarnath A/c (Being the B/P cancelled)	Dr. Dr.	1,00,000 200	1,00,200
Apr. 8	Amarnath A/c To Bank A/c To Deficiency A/c (Being the first and final payment made @ 40% of the net amount due)	Dr.	1,00,200	40,080 60,120

25.0 RETIREMENT OF A BILL

MEANING OF RETIREMENT OF A BILL

Making the Payment of a Bill before the date of maturity is called Retirement of a bill.

REBATE ON RETIREMENT OF A BILL

An Interest allowed by the holder of the bill to the drawee at an agreed rate of interest for the unexpired period of the bill as a consideration for premature payment is known as Rebate.

NATURE OF REBATE ON RETIREMENT OF A BILL

The Rebate on retirement of a bill is an **Income for the Drawee** and is an **Expense for the Payee**.

ACCOUNTING ENTRY WHEN A BILL IS RETIRED

In the books of Holder (i.e., Drawer or Endorsee)	In the books of Drawee
Bank A/c Rebate on Bill A/c To Bills Receivable A/c (Being the payment received on bill's retirement before the date of maturity and rebate allowed brought into account)	Bills Payable A/c To Bank A/c To Rebate on Bill A/c (Being the payment made on bill's retirement before the date of maturity and rebate earned brought into account)

ILLUSTRATION 16

A sold goods to B for ₹ 10,000 on 1 Jan. and drew upon him a three months bill for the amount. B accepted the bill and returned it to A. One month before the due date, B returned the bill under a rebate of 18% p.a. Pass the necessary journal entries in the books of A and B.

SOLUTION**A'S JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Jan. 1	B To Sales A/c (Being the goods sold to B on credit)	Dr.	10,000	10,000
Jan. 1	Bills Receivable A/c To B (Being the acceptance of the bill received from B)	Dr.	10,000	10,000
Mar. 1	Cash A/c Rebate on Bills A/c To Bills Receivable A/c (Being the bill collected after allowing rebate @ 18% p.a.)	Dr. Dr.	9,850 150	10,000

B'S JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Jan. 1	Purchases A/c To A (Being the goods purchased on credit)	Dr.	10,000	10,000
Jan. 1	A To Bills Payable A/c (Being the acceptance of bill given to A)	Dr.	10,000	10,000
Mar. 1	Bills Payable A/c To Cash A/c To Rebate on Bills A/c (Being the bill discharged under a rebate @ 18% p.a.)	Dr.	10,000	9,850 150

ILLUSTRATION 17

Mr David draws two bills of exchange on 1st Jan. for ₹ 6,000 and ₹ 10,000. The bills of exchange for ₹ 6,000 is for two months while the bill of exchange for ₹ 10,000 is for three months. These bills are accepted by Mr Thomas. On 4th March Mr Thomas requests Mr David to renew the first bill with interest at 18% p.a. for a period of two months. Mr David agrees to this proposal. On 20th March, Mr Thomas retires the acceptance for ₹ 10,000, the interest rebate i.e., discount being ₹ 100. Before the due date of the renewed bill, Mr Thomas becomes insolvent and only 50 paise in a rupee could be recovered from the estate. You are to required to give the journal entries in the books of Mr David.

SOLUTION**JOURNAL OF MR DAVID**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Jan. 1	Bills Receivable No. 1 A/c Dr. Bills Receivable No. 2 A/c Dr. To Mr Thomas (Beings bills due on 4th March and 4th April respectively accepted by Mr Thomas)		6,000 10,000	16,000
Mar. 4	Mr Thomas Dr. To Bills Receivable No. 1 A/c (Being cancellation of B/R No. 1 upon renewal)		6,000	6,000
Mar. 4	Mr Thomas Dr. To Interest A/c (Being the interest due on ₹ 6,000 @ 18% p.a. for 2 months on renewal of bill)		180	180
Mar. 4	Bills Receivable No. 3 A/c Dr. To Mr Thomas (Being B/R No. 3 due on 7th May, accepted by Mr Thomas in lieu of bill already cancelled)		6,180	6,180
Mar. 20	Cash A/c Dr. Rebate A/c Dr. To Bills Receivable No. 2 A/c (Being the amount received on retirement of B/R No. 2 before due date)		9,900 100	10,000
May 7	Mr Thomas Dr. To Bills Receivable No. 3 A/c (Being the entry for dishonour of B/R No. 3 on maturity)		6,180	6,180
	Cash A/c Dr. Bad Debts A/c Dr. To Mr Thomas (Being a dividend of 50 paise in a rupee received from official assignee of Mr Thomas and the irrecovered balance written off as bad debts)		3,090 3,090	6,180

26.0 BILLS RECEIVABLE BOOK**MEANING OF BILLS RECEIVABLE BOOK**

Bills Receivable Book is one of the subsidiary books which is used to record the details of Bills Receivable in favour of a person who is maintaining the Bills Receivable Book.

POSTING OF BILLS RECEIVABLE BOOK

- Individual amounts are daily posted to the credit of the accounts of individual debtors from whom the bills are received.
- Periodic total (normally monthly total) is posted to the debit of 'Bills Receivable Account' in the ledger by writing 'To Sundries as per B/R Book'.

FORMAT OF BILLS RECEIVABLE BOOK

The simplest format of a Bills Receivable Book is given on Page 17.32.

ILLUSTRATION 18

Enter the following transactions in the Bills Receivable Book of A.

29.12.2017	Drew on B at two months for ₹ 1,000.
30.12.2017	Drew on C at two months for ₹ 2,000 and he accepted the next day.
31.12.2017	Received from D a bill duly accepted for ₹ 3,000 dated 29 Dec., 2017 payable 60 days after date.
31.12.2017	Received from E, X's acceptance for ₹ 4,000 dated 30.12.2017 payable 60 days after date.
31.12.2017	Received from F, a bill for ₹ 5,000 dated 30.12.2017 accepted by Z and drawn by Y payable two months after date.

SOLUTION: [See Solution on page 17.32]

27.0 BILLS PAYABLE BOOK**MEANING OF BILLS PAYABLE BOOK**

Bills Payable Book is one of the subsidiary books which is used to record the details of Bills Payable accepted by the person who is maintaining the Bills Payable Book.

POSTING OF BILLS PAYABLE BOOK

1. Individual amounts are daily posted to the debit of the accounts of individual creditors to whom acceptances have been given.
2. The periodic total (normally monthly total) is posted to the credit of Bills Payable Account in the ledger by writing 'By Sundries as per B/P Book'.

FORMAT OF BILLS PAYABLE BOOK

The simplest format of a Bills Payable Book is given on Page 17.33.

ILLUSTRATION 19

Enter the following transactions in the Bills Payable Book of A.

29.12.2017	Accepted X's draft for ₹ 1,000 at two months.
30.12.2017	Y drew on A at two months for ₹ 2,000 and A accepted the same next day.
30.12.2017	Gave acceptance to Z for ₹ 3,000, dated 29 Dec., 2017 payable 60 days after date.

SOLUTION: [See Solution on page 17.33]

FORMAT OF A BILLS RECEIVABLE BOOK**BILLS RECEIVABLE BOOK**

S. No.	Date of Receipt	From whom received	Name of Drawer	Name of Acceptor	Date of Bill Drawn	Term of Bill	Date of Maturity	Where Receivable	Ledger Folio	Amount ₹

Solution to Illustration 18:**BILLS RECEIVABLE BOOK OF A**

S. No.	Date of Receipt of Bill	From Whom received	Name of Drawer	Name of Acceptor	Date of Bill drawn	Term of Bill	Date of Maturity	Where Receivable	Ledger Folio	Amount ₹
	2017				2017		2018			
1	Dec. 29	B	Self	B	Dec. 29	2 Months	Mar. 3	Delhi		1,000
2	Dec. 31	C	Self	C	Dec. 30	2 Months	Mar. 3	Mumbai		2,000
3	Dec. 31	D	Self	D	Dec. 29	60 Days	Mar. 1	Kolkata		3,000
4	Dec. 31	E	E	X	Dec. 30	60 Days	Mar. 2	Chennai		4,000
5	Dec. 31	F	Y	Z	Dec. 30	2 Months	Mar. 3	Chandigarh		5,000
									Total	15,000

Note: The places where the bills are payable, are imaginary.

FORMAT OF A BILLS PAYABLE BOOK**BILLS PAYABLE BOOK**

S. No.	Date of receipt	Name of Drawer	Name of Payee	Date of Bill Drawn	Term of Bill	Date of Maturity	Where Payable	Ledger Folio	Amount ₹

Solution to Illustration 19:**BILLS PAYABLE BOOK OF A**

S. No.	Date of receipt	Name of Drawer	Name of Payee	Date of Bill Drawn	Term of Bill	Date of Maturity	Where Payable	Ledger Folio	Amount ₹
1	2017			2017		2018			
2	Dec. 29	X	X	Dec. 29	2 Months	Mar. 3	Delhi		1,000
3	Dec. 30	Y	Y	Dec. 29	2 Months	Mar. 3	Mumbai		2,000
4	Dec. 30	Z	Z	Dec. 29	60 days	Mar. 1	Kolkata		3,000
								Total	6,000

Note: The places where the bills are payable, are imaginary.

28.0 ACCOMMODATION BILLS**MEANING OF ACCOMMODATION BILLS**

Accommodation Bills refer to those bills which are drawn, accepted or endorsed without any consideration.

PURPOSE OF ACCOMMODATION BILLS.

Accommodation Bills are drawn and accepted to meet the financial needs of the drawer/drawee/both temporarily.

HOW IS THE PROCEEDS OF THE ACCOMMODATION BILLS SHARED?

On discounting of Accommodation Bills, proceeds may be shared by drawer and drawee in an agreed ratio.

HOW IS THE DISCOUNT CHARGES OF ACCOMMODATION BILLS SHARED?

Each party bears the Discounts Charges of Accommodation Bills in the proportion in which it shares the proceeds of the bills unless otherwise agreed.

CAN THE DRAWER RECOVER IN CASE OF DISHONOUR OF ACCOMMODATION BILLS?

On dishonour of Accommodation Bills, drawer cannot file suit against the drawee because drawee is not liable to drawer.

ACCOUNTING ENTRIES PASSED IN CASE OF ACCOMMODATION BILLS

The accounting entries in case of Accommodation Bills are made in the usual manner as in case of trade bills.

DISTINCTION BETWEEN TRADE BILLS AND ACCOMMODATION BILLS

Basis of Distinction	Trade Bills	Accommodation Bills
1. Purpose	These bills are drawn to settle a business transaction.	These bills are drawn to meet the financial needs of the drawer/drawee/both temporarily.
2. Consideration	These bills are accepted for a consideration.	These bill are accepted without any consideration.
3. Role	These bills act as an evidence of indebtedness.	These bills act as a source of finance.
4. Sharing of Proceeds of the Bill	On discounting of such bills, proceeds remain with the holder.	On discounting of such bills, proceeds may be shared by drawer and drawee in an agree ratio.
5. Recovery in case of dishonour	On dishonour of such bills, drawer can file a suit against the drawee, because drawee is liable to drawer.	On dishonour of such bill, drawer cannot file suit against the drawee because drawee is not liable to drawer.

WHEN ONE BILL IS DRAWN FOR THE ACCOMMODATION OF ONE OF THE PARTIES

The following steps are involved in this case:

Step 1 : *The party in need draws a bill upon the other party.*

Step 2 : *The drawee after accepting the bill returns it to the drawer.*

Step 3 : *The drawer discounts the bill with his bankers.*

Step 4 : *Just before the due date of the bill, the drawer remits the amount of the bill to the drawee to enable him to meet the bill on maturity.*

ILLUSTRATION 20

On 1 Jan., Y accepted a three month bill for ₹ 2,000 drawn on him by X for latter's benefit. X discounted the bill on 4 Jan. @ 6% p. a. and at maturity sent Y a cheque for ₹ 2,000 in order to enable him to honour the bill. Y duly honoured his acceptance. Pass journal entries in the books of X and Y.

SOLUTION:**JOURNAL OF X**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	Bills Receivable A/c Dr. To Y (Being the acceptance of the bill received from Y)		2,000	2,000
Jan. 4	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being the bill discounted with bank @ 6% p.a.)		1,970 30	2,000
April 4	Y Dr. To Bank A/c (Being the amount of the bill remitted to Y)		2,000	2,000

JOURNAL OF Y

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	X Dr. To Bills Payable A/c (Being acceptance given)		2,000	2,000
April 4	Bank A/c Dr. To X (Being the cheque received from X)		2,000	2,000
April 4	Bills Payable A/c Dr. To Cash A/c (Being the bill discharged)		2,000	2,000

WHERE ONE BILL IS DRAWN FOR MUTUAL ACCOMMODATION

The following steps are involved in this case:

Step 1 : One party draws a bill upon the other party.

Step 2 : The drawee after accepting the bill returns it to the drawer.

Step 3 : The drawer discounts the bill with his bankers and remits drawee's agreed share in the proceeds.

Step 4 : Just before the due date of the bill, the drawer remits the balance due from him to the drawee to enable the drawee to meet the bill on maturity.

ILLUSTRATION 21

On 1st Jan X, for the temporary and mutual accommodation of himself and Y, draws upon the latter a bill of exchange at 3 months for ₹ 2,000. On 4th Jan. X discounts the bill @ 6% p.a and hands half the proceeds to Y. At maturity X remits the amount due to Y who meets the bill. Pass Journal entries in the books of both the parties.

SOLUTION:
X'S JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	Bills Receivable A/c Dr. To Y (Being the acceptance of the bill received from Y)		2,000	2,000
Jan. 4	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being the bill discounted with Bank @ 6% p.a.)		1,970 30	2,000
Jan. 4	Y Dr. To Cash A/c To Discount A/c (Being half the proceeds remitted to Y was also debited with half the discount.)		1,000	985 15
April 4	Y Dr. To Cash A/c (Being remaining half amount of the bill now remitted to Y to enable him to meet it.)		1,000	1,000

Y'S JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	X To Bills Payable A/c (Being the acceptance given in favour of X)	Dr.	2,000	2,000
Jan. 4	Cash A/c Dr. Discount A/c Dr. To X (Being half the proceeds received from X who is also credited with half the discount)		985 15	1,000

April 4	Cash A/c To X (Being the amount retained by X now received from him)	Dr.	1,000	1,000
April 4	Bills Payable A/c To Cash A/c (Being the bill discharged)	Dr.	2,000	2,000

WHEN BILL IS DRAWN BY EACH OTHER FOR EACH OTHER'S ACCOMMODATION**ILLUSTRATION 22**

On 1 January, X and Y drew on each other a bill for ₹ 2,000, payable three months date for their mutual benefit. On 4 January, they discounted with the banks each other's bill @ 6% per annum. At maturity each met his own acceptance. Record transactions in the journal of X and Y.

SOLUTION:**X'S JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	Bills Receivable A/c To Y (Being the acceptance of the bill received from A)	Dr.	2,000	2,000
Jan. 1	Y To Bills Payable A/c (Being the acceptance of a bill given to X)	Dr.	2,000	2,000
Jan. 4	Bank A/c Discount To Bills Receivable A/c (Being the bill discounted with Bank @ 6% p.a.)	Dr. Dr.	1,970 30	2,000
April 4	Bills Payable A/c To Cash A/c (Being the bill discharged)	Dr.	2,000	2,000

Y'S JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	X To Bills Payable A/c (Being the acceptance of the bill given to X)	Dr.	2,000	2,000
Jan. 1	Bills Receivable A/c To X (Bill the acceptance of a bill received from X)	Dr.	2,000	2,000
Jan. 4	Bank A/c Discount A/c To Bills Receivable A/c (Being the bill discounted with Bank @ 6% p.a.)	Dr. Dr.	1,970 30	2,000
April 4	Bills Payable A/c To Cash A/c (Being the bill discharged)	Dr.	2,000	2,000

ILLUSTRATION 23

X and Y were friends and in need of funds. On 1st Jan. X drew a bill for ₹ 2,00,000 for 3 months on Y. On 4th Jan. X got the bill discounted at 10% p.a. and remitted half of the proceeds to Y. On 1st April, X could not send the required sum, instead, he accepted Y's bill for ₹ 1,20,000 for two months. On 4th April, the bill was discounted by Y at 12% p.a. Out of this ₹ 7,800 were remitted to X. At maturity of second bill, due to financial crisis, X became insolvent and only 50 paise in a rupee could be recovered from his estate. Pass Journal Entries in the Books of X and Y.

SOLUTION:**JOURNAL OF X**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	Bills Receivable A/c Dr. To Y (Being the acceptance of a bill received from Y)		2,00,000	2,00,000
Jan. 4	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being the bill discounted @ 10% p.a.)		1,95,000 5,000	2,00,000
Jan. 4	Y Dr. To Bank A/c To Discount A/c (Being half the proceeds remitted to Y)		1,00,000	97,500 2,500
April 1	Y Dr. To Bills Payable A/c (Being the acceptance of a bill given to Y)		1,20,000	1,20,000
April 4	Bank A/c Dr. Discount A/c Dr. To Y (Being ₹ 7,800 received from Y and proportionate discount ₹ 2,200 (i.e. ₹ 2,400 - ₹ 1,07,800/ ₹ 1,17,600) debited]		7,800 2,200	10,000
April 7	Bills Payable A/c Dr. To Y (Being the second bill dishonoured on becoming bankrupt)		1,20,000	1,20,000
	Y Dr. To Bank A/c To Deficiency A/c (Being a dividend of 50 paise in rupee paid to Y and the unpaid balance transferred to Deficiency A/c)		1,10,000	55,000 55,000

JOURNAL OF Y

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Jan 1	X Dr. To Bills Payable A/c (Being the acceptance of a bill given to X)		2,00,000	2,00,000
Jan. 4	Bank A/c Dr. Discount A/c Dr. To X (Being the half the proceeds received from X)		97,500 2,500	1,00,000
April 1	Bills Receivable A/c Dr. To X (Being the acceptance of a bill received from X)		1,20,000	1,20,000
April 4	Bank A/c Dr. Discount A/c Dr. To Bill Receivable A/c (Being the bill discounted @ 12% p.a.)		1,17,600 2,400	1,20,000
	Bills Payable A/c Dr. To Bank A/c (Being the first bill discharged)		2,00,000	2,00,000
April 7	X Dr. To Bank A/c To Discount A/c (Being ₹ 7,800 remitted to X and proportionate discount ₹ 2,200 (i.e. ₹ 2,400 × ₹ 1,07,800 / ₹ 1,17,600 charged)		10,000	7,800 2,200
	X Dr. To Bank A/c (Being the bill of X dishonoured on X's bankruptcy)		1,20,000	1,20,000
	Bank A/c Dr. Bad Debts A/c Dr. To X (Being a dividend of 50 paise in rupee received on X's bankruptcy and the balance written off as bad debt)		55,000 55,000	1,10,000

ILLUSTRATION 24

Shubham draws on Rajendra a bill for ₹ 45,000 on 1st June for 3 months. Rajendra accepts the bill and sends it to Shubham who gets it discounted for ₹ 44,100. Shubham immediately remits ₹ 14,700 to Rajendra. On the due date Shubham, being unable to remit the amount due, accepts a bill for ₹ 63,000 for three months which is discounted by Rajendra for ₹ 61,650. Rajendra sends ₹ 11,100 to Shubham. On the due date Shubham becomes insolvent, his estate paying forty paise in the rupee. Give Journal Entries in the books of Shubham and Rajendra.

SOLUTION:**JOURNAL OF SHUBHAM**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
June	Bills Receivable A/c Dr. To Rajendra (Being acceptance received from Rajendra)		45,000	45,000
June 4	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being bill discounted with Bank)		44,100 900	45,000
June 4	Rajendra Dr. To Bank A/c To Discount A/c (Being 1/3rd proceeds of the discounted bill remitted to Rajendra)		15,000	14,700 300
Sept. 4	Rajendra Dr. To Bills Payable A/c (Being acceptance given to Rajendra)		63,000	63,000
Sept. 4	Bank A/c Dr. Discount A/c Dr. To Rajendra (Being amount received from Rajendra)		11,100 900	12,000
Dec. 7	Bills Payable A/c Dr. To Rajendra (Being bill dishonoured due to insolvency)		63,000	63,000
	Rajendra Dr. To Bank A/c To Deficiency (Being 40% share paid to Rajendra from our estate)		42,000	16,800 25,200

Working Note: Calculation of discount to be borne by Shubham

A. Amount due by Shubham but not remitted to Rajendra (₹ 45,000 – ₹ 15,000)	30,000
B. Add: Amount received by Shubham from Rajendra	11,100
C. Total amount due to Rajendra	41,100
D. Discount to be borne = ₹1,350 × 41,110/61,650 = ₹ 900	

JOURNAL OF RAJENDRA

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
June 1	Shubham Dr. To Bills Payable A/c (Being the acceptance given to Shubham)		45,000	45,000

June 4	Bank A/c	Dr.	14,700	
	Discount A/c		300	
	To Shubham			15,000
	(Being 1/3rd proceeds of discounted bill received from Shubham)			
Sept. 4	Bills Receivable A/c	Dr.	63,000	
	To Shubham			63,000
	(Being acceptance received from Shubham)			
	Bank A/c	Dr.	61,650	
	Discount A/c	Dr.	1,350	
	To Bills Receivable A/c			63,000
	(Being the bill discounted with the bank)			
	Bills Payable A/c	Dr.	45,000	
	To Bank A/c			45,000
	(Being the bill discharged)			
	Shubham	Dr.	12,000	
	To Bank A/c			11,100
Dec. 7	To Discount A/c			900
	(Being the amount paid to Shubham)			
	Shubham	Dr.	63,000	
	To Bank A/c			63,000
	(Being bill dishonoured due to Shubham's insolvency)			
	Bank A/c	Dr.	16,800	
	Bad Debts A/c	Dr.	25,200	
	To Shubham			42,000
	(Being 40% share received from Shubham)			

SOLVED PROBLEMS

PROBLEM 1

Record the following in the Journal of Ram.

- Shyam's acceptance for ₹ 4,500, due this day, returned dishonoured, Noting charges ₹ 10.
- Murli's acceptance for ₹ 20,000 renewed for three months, plus interest at 5% p.a.
- Our acceptance for ₹ 20,000 retired one month before the due date at a discount of 12% p.a.
- Our acceptance in favour of X for ₹ 1,500 dishonoured for want of instructions. X claims ₹ 1,510 which is paid by a cheque.
- Our acceptance to P for ₹ 900 renewed for 3 months on the condition that ₹ 300 is paid in cash immediately and the remaining balance to carry interest @ 12% p.a.
- K's Promissory Note for ₹ 720 endorsed in favour of D returned dishonoured. D paid ₹ 18 as noting charges. Ram pays D by cheque and accepts from K another bill for the amount due along with interest ₹ 48.

SOLUTION

JOURNAL OF RAM

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(a)	Shyam Dr. To Bills Receivable A/c To Cash A/c (Being B/R dishonoured, noting charges being ₹ 10)		4,510	4,500 10
(b)	(i) Murli Dr. To Bills Receivable A/c (Being the old bill cancelled)		20,000	20,000
	(ii) Murli Dr. To Interest A/c (Being interest due for 3 months)		250	250
	(iii) Bills Receivable A/c Dr. To Murli (Being B/R renewed)		20,250	20,250
(c)	Bills Payable A/c Dr. To Rebate on Bill A/c To Cash A/c (Being B/P retired @ 12% p.a. one month ago)		20,000	200 19,800
(d)	Bills Payable A/c Dr. Noting charges A/c Dr. To X (Being B/P dishonoured)		1,500 10	1,510
	X Dr. To Bank A/c (Being cheque issued to X)		1,510	1,510
(e)	Bills Payable A/c Dr. Interest A/c Dr. To P (Being the original Bills Payable cancelled and interest charged for renewal of the same)		900 18	918
	P A/c Dr. To Cash A/c To Bills Payable A/c (Being P was paid off partly in cash and partly through fresh acceptance)		918	300 618
(f)	K A/c Dr. To D A/c (Being the endorsed Bill dishonoured)		738	738
	D A/c Dr. To Bank A/c (Being D paid off)		738	738

	K A/c To Interest A/c (Being the acceptance received)	Dr.		48	48
	Bill Receivable A/c To K (Being the fresh acceptance received from K for the net amount due)	Dr.		786	786

PROBLEM 2

On 15 Jan. Sudarshan sold goods to Shashi for ₹ 3,000. Shashi paid ₹ 600 in cash and for balance accepted three Bills, No. 1 for ₹ 700 at one month, No. 2 for ₹ 800 at two months, and No. 3, ₹ 900 at three months.

Sudarshan endorsed 1st bill to Nahar his creditor on 16 Jan. in full settlement of ₹ 710; discounted the 2nd bill at his bank for ₹ 792 and retained the third bill till maturity.

The first bill is met at maturity. The second bill is dishonoured and ₹ 10 being paid as noting charges, Sudarshan charges ₹ 15 for interest and draws on Shashi a fourth bill for the amount at three months. At maturity, the third bill was renewed with interest @ 5% p.a. for three months. The fifth bill was duly accepted by Shashi. The fourth and fifth bills were met at maturity.

Required: Give journal entries in the books of Sudarshan.

SOLUTION**JOURNAL OF SUDARSHAN**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 15	Shashi's A/c To Sales A/c (Being the goods sold to Shashi)	Dr.	3,000.00	3,000.00
	Cash A/c Bills Receivable (No. 1) A/c Bills Receivable (No. 2) A/c Bills Receivable (No. 3) A/c To Shashi (Being the cash and the acceptance of three bills for 700, II for 800, and III for 900 received from Shashi)	Dr. Dr. Dr. Dr.	600.00 700.00 800.00 900.00	3,000.00
Jan. 16	Nahar To Bills Receivable (No. 1) A/c To Discount Received A/c (Being the first bill endorsed to Nahar in full settlement)	Dr.	710.00	700.00 10.00
	Bank A/c Discount A/c To Bills Receivable (No. 2) A/c (Being the second bill discounted with bank)	Dr. Dr.	792.00 8.00	800.00
Mar. 18	Shashi To Bank A/c (Being the second bill dishonoured on maturity and noting charges incurred ₹ 10)	Dr.	810.00	810.00

	Shashi To Interest A/c (Being the interest charged)	Dr.	15.00	15.00
	Bills Receivable (No. 4) A/c To Shashi (Being the acceptance of the fourth bill payable after three months received from Shashi)	Dr.	825.00	825.00
Apr. 18	Shashi To Bills Receivable A/c (Being the third bill cancelled)	Dr.	900.00	900.00
	Shashi To Interest A/c (Being the interest on the amount of third bill @ 5% p.a. for three months)	Dr.	11.25	11.25
	Bills Receivable A/c To Shashi (Being the acceptance of the fifth bill received from Shashi)	Dr.	911.25	911.25
June 21	Cash A/c To Bills Receivable (No. 4) A/c (Being the fourth bill met at maturity)	Dr.	825.00	825.00
July 21	Cash A/c To Bills Receivable (No. 5) A/c (Being the fifth bill met at maturity)	Dr.	911.25	911.25

PROBLEM 3

Ramratan sold goods to Ahmed for ₹ 10,000 on 30th June, 2017, for which the latter accepted 4 bills of ₹ 2,500 each drawn on him payable after 2, 4, 5 and 8 months respectively. Ramratan retained the first bill. The second bill was sent by him for collection. The third bill was endorsed by him to C in part payment of ₹ 4,000 owed to him. The fourth bill was discounted by him with his bankers at a discount of 15% p.a.

The first bill was met on the date. As regards the second bill, Ahmed met Ramratan two days before the maturity date of the bill and paid him ₹ 1,000 and accepted a fresh bill for 1 month for the balance with interest of 18% p.a. This bill as well as the third bill were met by the drawee.

Ahmed was declared as insolvent on 31st December, 2017 and on the fourth bill becoming due, the Bank debited Ramratan with the amount of the bill and noting charges of ₹ 250. It is ascertained by Ramratan that the estate of Ahmed will not be in a position to meet liabilities to an extent of more than 40%.

What will be the journal entries to be made in the books of Ramratan for the accounting years 2017 and 2018 assuming a dividend of 40 paise in a rupee was realised from Ahmed's estate on 15.3.2018. Show Journal Entries (without narrations) in the books of Ramratan.

SOLUTION:**JOURNAL OF RAMRATAN**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
2017	Ahmed's A/c Dr.		10,000.00	
Jun 30	To Sales A/c			10,000.00
	Bills Receivable (No. 1) A/c Dr.		2,500.00	
	Bills Receivable (No. 2) A/c Dr.		2,500.00	
	Bills Receivable (No. 3) A/c Dr.		2,500.00	
	Bills Receivable (No. 4) A/c Dr.		2,500.00	
	To Ahmed's A/c			10,000.00
	Bills sent for Collection A/c Dr.		2,500.00	
	To Bills Receivable (No. 2) A/c			2,500.00
	C's A/c Dr.		2,500.00	
	To Bills Receivable (No. 3) A/c			2,500.00
	Bank A/c Dr.		2,250.00	
	Discount A/c Dr.		250.00	
	To Bills Receivable (No. 4) A/c			2,500.00
Sep. 2	Bank A/c Dr.		2,500.00	
	To Bills Receivable (No. 1) A/c			2,500.00
Nov. 1	Ahmed's A/c Dr.		2,500.00	
	To Bills sent for Collection A/c			2,500.00
Nov. 1	Bank A/c Dr.		1,000.00	
	Bills Receivable (No. 5) A/c Dr.		1,522.50	
	To Ahmed's A/c			2,500.00
	To Interest A/c			22.50
Dec. 3	Bank A/c Dr.		1,522.50	
	To Bills Receivable (No. 5) A/c			1,522.50
Dec. 31	Profit and Loss A/c Dr.		1,500.00	
	To Provision for Doubtful Debts A/c			1,500.00
2018				
Mar. 3	Ahmed's A/c Dr.		2,750.00	
	To Bank A/c			2,750.00
Mar. 15	Bank A/c Dr.		1,100.00	
	Bad Debts A/c Dr.		1,650.00	
	To Ahmed's A/c			2,750.00

Notes:

No Entry is necessary

- (i) when Ramratan retains the first bill; and
- (ii) when Ahmed met the third bill which was earlier endorsed by Ramratan to Mr C.

PROBLEM 4

Inder drew upon Mohan a bill for ₹ 9,000 on 1 April for three months, for mutual accommodation. Mohan accepted the draft. On 4th April Inder got it discounted at 6% p.a. and remitted one-third of the proceeds to Mohan. At maturity, Inder was not able to send the required sums and asked Mohan to receive a two month Promissory Note for ₹ 6,090 which Mohan did. Mohan got the Note discounted for ₹ 6,000 and met his acceptance. Inder became insolvent just before his Promissory Note was due for payment. Only 50% was received from his estate. Give Journal entries in the book of both Inder and Mohan.

SOLUTION:**JOURNAL OF INDER**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
April 1	Bills Receivable A/c Dr. To Mohan (Being the receipt of Mohan's acceptance for mutual accommodation)		9,000	9,000
April 4	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being the bill discounted @ 6% p.a.)		8,865 135	9,000
"	Mohan Dr. To Cash A/c To Discount A/c (Being 1/3 of proceeds remitted to Mohan and 1/3 discount debited to him)		3,000	2,955 45
July 4	Interest A/c Dr. To Mohan (The interest due to Mohan for agreeing to wait for 2 months (₹ 6,090, the amount of new bill, minus ₹ 6,000 due)		90	90
July 4	Mohan Dr. To Bills Payable A/c (Being the amount of the pronote issued in favour of Mohan)		6,090	6,090
Sept. 7	Bills Payable A/c Dr. To Mohan (Being the note given to Mohan dishonoured due to insolvency)		6,090	6,090
"	Mohan Dr. To Cash A/c To Deficiency A/c (Being a dividend of 50 paise in a rupee paid to Mohan and the undischarged balance transferred to Deficiency A/c)		6,090	3,045 3,045

JOURNAL OF MOHAN

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
April	Inder Dr. To Bills Payable A/c (Being the acceptance issued in favour of Inder for mutual accommodation)		9,000	9,000
"	Cash A/c Dr. Discount A/c Dr. To Inder (Being 1/3 of the proceeds received from Inder and one-third discount credited to him.)		2,955 45	3,000
July 4	Inder Dr. To Interest A/c (Being Interest due from Inder for a 2-month extension of time)		90	90
"	Bills Receivable A/c Dr. To Inder (Being the receipt of his promissory note for ₹ 6,090)		6,000	6,000
"	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being the bill discounted for ₹ 6,000)		6,000 90	6,090
"	Bills Payable A/c Dr. To Cash A/c (Being the bill issued in favour of Inder discharged)		9,000	9,000
Sept. 7	Inder Dr. To Bank A/c (Being the dishonour of Inder's pronote due to insolvency)		6,090	6,090
"	Cash A/c Dr. Bad Debts A/c Dr. To Inder (Being the receipt of 50% of a amount due from Inder and the balance written-off as bad debt)		3,045 3,045	6,090

PROBLEM 5

A and B were both in need of temporary accommodation. On 1 April, A accepted B's draft for ₹ 2,000 for three months and B accepted A's draft for ₹ 1,000 for three months. The two bills were discounted at the respective banks for ₹ 1,971 and ₹ 980. At maturity, A met his acceptance but B could not arrange to send the required amount to A and accepted A's draft for ₹ 1,500 for two months. This was discounted for ₹ 1,460 and A remitted to B ₹ 230. On Sept. 6, B was declared insolvent and his estate paid only 30%. Give Journal entries in the Books of A and the ledger account of A in B's books.

SOLUTION:
JOURNAL OF A

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
April 1	<i>B</i> Dr. To Bills Payable A/c (Being the acceptance given in favour of <i>B</i>)		2,000	2,000
"	Bills Receivable A/c Dr. To <i>B</i> (Being the acceptance received from <i>B</i>)		1,000	1,000
"	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being the B/R discounted for ₹ 980)		980 20	1,000
"	Bills Payable A/c Dr. To Cash A/c (Being own acceptance for ₹ 2,000 met)		2,000	2,000
July 4	Bills Receivable A/c Dr. To <i>B</i> Dr. (Being the acceptance received from <i>B</i>)		1,500	1,500
"	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being <i>B</i> 's acceptance discounted for ₹ 1,460)		1,460 40	1,500
"	<i>B</i> Dr. To Cash A/c To Discount A/c (Being ₹ 230 remitted to <i>B</i> and proportionate discount ₹ 33.70 (i.e. ₹ 40 × ₹ 1,230/₹ 1,460 charged)		263.70	230.00 33.70
Sept. 7	<i>B</i> Dr. To Bank A/c (Being <i>B</i> 's acceptance dishonoured due to insolvency)		1,500	1,500
"	Cash A/c Dr. Bad Debts A/c Dr. To <i>B</i> (Being a dividend of 30 paise in a rupee received from <i>B</i> 's estate and the balance written-off as bad debt)		380.00 883.70	1,263.70

DR.**A'S ACCOUNT IN THE BOOKS OF B****CR.**

Date	Particulars	L.F.	₹	Date	Particulars	L.F.	₹
April 1	To Bills Payable A/c		1,000.00	April 1	By Bills Receivable A/c		2,000.00
July 4	To Bills Payable A/c		1,500.00	July 4	By Cash A/c		230.00
Sept. 7	To Cash A/c		379.00		By Discount A/c		33.70
"	To Deficiency (amount unpaid)		884.70		By Bills Payable A/c		1,500.00
			3,763.70				3,763.70

PROBLEM 6

On 1st July G drew a bill for ₹ 80,000 for 3 months on H for mutual accommodation. H accepted the bill of exchange.

G had purchased goods worth ₹ 81,000 from J on the same date. G endorsed H's acceptance to J in full settlement.

On 1st September J purchased goods worth ₹ 90,000 from H.J. endorsed the bill of exchange received from G to H and paid ₹ 9,000 in full settlement of the amount due to H.

On 1st October H purchased goods worth ₹ 1,00,000 from G. He paid the amount due to G by cheque.

Give the necessary Journal Entries in the books of H.

SOLUTION:**JOURNAL OF H**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
July 1	G Dr. To Bills Payable A/c (Being Bill accepted)		80,000	80,000
Sept. 1	J Dr. To Sales A/c (Being the goods sold to J)		90,000	90,000
	Bill Receivable A/c Dr. Cash A/c Dr. Discount A/c Dr. To J's Capital A/c (Being B/R of ₹ 80,000 & Cash ₹ 9,000 received from J and allowed him discount of ₹ 1,000.)		80,000 9,000 1,000	90,000
	Bills Payable A/c Dr. To Bills Receivable A/c (Being own acceptance received from J's endorsement, cancelled)		80,000	80,000

Oct. 1	Purchases A/c Dr. To G A/c (Being the goods purchased from G)	1,00,000	1,00,000
	G Dr. To Bank A/c (Being the Balance paid by cheque)	20,000	20,000

PROBLEM 7

The following bills were accepted on 1st January for four months:

(i) By B, ₹ 10,000 and by C, ₹ 15,000 in favour of A, (ii) By A, ₹ 20,000 and by C, ₹ 5,000 in favour of B, (iii) By A, ₹ 10,000 and by B ₹ 20,000 in favour of C.

All bills were discounted @ 18% p.a. and the proceeds were shared by the three parties equally. On the due date C becomes insolvent and later, a dividend of 30% was received from his estate. Give journal entries in the books of A.

SOLUTION:
JOURNAL OF A

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	Bills Receivable A/c Dr. To B To C (Being Bills accepted by B and C)		25,000	10,000 15,000
Jan. 1	B Dr. C Dr. To Bills Payable A/c (Being acceptances given to B and C)		20,000 10,000	30,000
Jan. 1	C Dr. To B (Being net effect of acceptances between B and C)		15,000	15,000
Jan. 1	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being Bills discounted with Bank)		23,500 1,500	25,000
Jan.1	Cash A/c Dr. Discount A/c Dr. To C (Being cash received from C to make distribution of proceeds equal)		1,567 100	1,667
	B Dr. To C (Being net effect of cash received by B from C)		1,667	1,667

May 4	C Dr.	15,000	
	To Bank A/c		15,000
	(Being bill accepted by C dishonoured)		
May 4	C Dr.	5,000	
	To B		5,000
	(Being bill accepted by C in favour of B dishonoured)		
May 4	Bills Payable A/c Dr.	30,000	
	To Cash A/c		30,000
	(Being Bills payable discharged)		
May 4	Cash A/c Dr.	8,000	
	Bad Debts A/c Dr.	18,666	
	To C		26,666
	(Being 30% proceeds received from C and balance written off as bad debts)		
May 4	B Dr.	9,333	
	To Bad Debts A/c		9,333
	(Being 50% bad debts transferred to B)		
May 4	Cash A/c Dr.	1,000	
	To B		1,000
	(Being Cash received from B in final settlement)		

Working Notes:

(i) Distribution of Proceeds

Total Value of the bills as ₹ 80,000 and net proceeds after discount is (₹ 80,000 – ₹ 4,800) ₹ 75,200. The proceeds have been distributed equally amount the three persons as under:

	Total	A	B	C
Gross Amount	80,000	26,667	26,667	26,666
Discount	4,800	1,600	1,600	1,600
Net Amt.	75,200	25,067	25,067	25,066
Less: Proceeds of own bills		23,500	23,500	28,200
		1,567	1,567	3,134

Hence C will pay ₹ 1,567 to A and ₹ 1,567 to B to make the distribution equal.

Similarly discount will also be shared equally. Total discount of ₹ 4,800 will be shared equally i.e. ₹ 1,600 by each party. Hence A and B bear additional discount of ₹ 100.

(ii) Bad Debts have been shared equally by A and B.

18

GOODS SENT ON APPROVAL OR ON SALE OR RETURN BASIS

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of Goods sent on approval
- ◇ Methods of Accounting for Goods Sent on approval
- ◇ Ordinary Sale Method
- ◇ Multi-column Journal Method
- ◇ Separate Day Books Method

1.0 MEANING OF GOODS SENT ON APPROVAL

Goods sent on 'approval' or 'on sale or return' basis mean the delivery of the goods to the customers with the option to retain or return them within a specified period. According to Sec. 24 of the Sale of Goods Act, 1893, in respect of such goods, the sale will take place or the property in the goods pass to the buyer:

- (i) When he signifies his approval or acceptance to the seller;
- (ii) When he does some act adopting the transaction; e.g. pledging such goods
- (iii) If he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection, on the expiry of the specified time (if a time has been fixed) or on the expiry of a reasonable time (if no time has been fixed).

2.0 METHODS OF ACCOUNTING FOR GOODS SENT ON APPROVAL

There are **three methods** to account for goods sent on 'approval' or 'on sale or return' basis viz. Ordinary Sale Method, Multicolumn Journal Method and Separate Day Books Method.

3.0 ORDINARY SALE METHOD

1. When the transactions are few, the goods sent on 'approval' or 'on sale or return' basis are treated as an ordinary sale (although theoretically it is incorrect to describe as such).
2. If, at the year-end, goods are still lying with customers and the specified time has not yet expired, the original entry for sales is cancelled.
3. Like an ordinary closing stock, such goods are considered as stock lying with customers on behalf of seller and are valued at cost or net realisable value whichever is lower.
4. **Journal Entries** The journal entries which are passed under this method are given on next page:

Journal Entries to be passed under Ordinary Sale Method		
1. When goods are sent on 'approval' 'or on sale or return' basis	Sundry Debtors A/c	Dr. [With Invoice Price] To Sales A/c
2. When such goods are returned within the specified time	Sales Returns A/c	Dr. [With Invoice Price] To Sundry Debtors A/c
3. When the customers take the delivery of such goods at a price lower than the invoice price	Sales A/c	Dr. [With Difference] To Sundry Debtors A/c
4. At the year end (i) When such goods are still lying with customers at year end and the specified time limit has not yet expired (ii) When such goods are brought into final accounts as closing stock at cost or net realizable value whichever is lower	Sales A/c To Sundry Debtors A/c Stock with Customers (on Sale or Return basis) A/c To Trading A/c	Dr. [With Invoice Price] Dr. [With Cost or NRV whichever is lower]

TUTORIAL NOTES

- Alternatively, Debtors' Suspense Account may be credited in place of Sundry Debtors Account in Entry 4.
- In the beginning of next accounting period, entry 4 should be reversed.
- No entry is required to be passed when such goods are retained by the customers on a subsequent date in the next accounting period.

ILLUSTRATION 1

Tulsian Ltd. sends out goods to customers on sale or return basis, customers' having the option to retain or return the goods within a month. The following transactions took place during the months of Mar., 2018 and Apr., 2018:

Date	Transactions
05.03.2018	Sent goods to the following customers on sale or return basis at 25% over and above cost price (being ₹ 100). W 20 Units, X 10 Units, Y 32 units, Z 24 Units
10.03.2018	Goods returned by W.
15.03.2018	Received letters of approval from X accepting the goods at ₹ 115 each to which the seller agreed.
02.04.2018	Goods returned by Z.
04.04.2018	Received intimation of acceptance from Y.

Tulsian Ltd. records sale or return transactions as ordinary sales. Give journal entries for the months of Mar., 2018 and Apr., 2018. Also show how these items will appear in the Balance Sheet as on 31st Mar., 2018 assuming that on 30th Mar., 2018, the Sundry Debtors Balance stood at ₹ 1,00,000 and Stock in-hand amounted to ₹ 60,000.

SOLUTION**JOURNAL OF TULSIAN LTD.**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
05.03.2018	Sundry Debtors A/c Dr. To Sales A/c (Being the goods sent to customers (W, X, Y and Z) on sale on return basis)		10,750	10,750
10.03.2018	Sales Returns A/c Dr. To Sundry Debtors A/c (Being the goods returned by W)		2,500	2,500
15.03.2018	Sales A/c. Dr. To Sundry Debtors A/c (Being the adjustment made for reduction in the selling price of 10 units @ ₹ 10 each)		100	100
31.03.2018	Sales A/c Dr. To Sundry Debtors A/c (Being the cancellation of original entry of sale in respect of goods not yet returned or retained)		7,000	7,000
31.03.2018	Stock with Customers (on Sale or Return basis) A/c Dr. To Trading A/c (Being the cost of goods lying with the customers not yet returned or retained, brought into final accounts)		5,600	5,600

AN EXTRACT OF BALANCE SHEET OF TULSIAN LTD. AS AT 31ST MARCH 2018

<i>Liabilities</i>	<i>₹</i>	<i>Assets</i>	<i>₹</i>
		Sundry Debtors	1,00,000
		Less: Debtors for goods on sale of return basis	7,000
		Stock-in trade in hand	60,000
		Add: Stock with customers on sale or return basis	5,600
			93,000
			65,600

JOURNAL OF TULSIAN LTD.

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
01.04.2018	Sundry Debtors A/c Dr. To Sales A/c (Being the reversal of adjusting entry passed on 31.12.2018)		7,000	7,000
02.04.2018	Sales Returns A/c Dr. To Sundry Debtors A/c (Being the goods returned by Z)		3,000	3,000

Note: No further entry is required to be passed on 04.01.2018 as sale had already been accounted for.

4.0 MULTICOLUMN JOURNAL METHOD

- Where a moderate number of articles are sent out on a sale or return basis, a Multicolumn Sale or Return Journal is maintained to record the deliveries, returns, sales and the balance of such goods.
- A simple format of Multicolumn Sale or Return Journal is given below:

Format of Multicolumn Sale or Return Journal										
Multicolumn Sale or Return Journal										
Sent on Approval			Goods Returned				Goods Approved			Balance
1	2	3	4	5	6	7	8	9	10	11
Date	Partic- ulars	Amt.	Date	Partic- ulars	Amt.	Date	Partic- ulars	Fol.	Amt.	Amt.

- The procedure for recording the various details in the aforesaid Journal is summarised below:

(a) When the goods are delivered on sale or return basis	Enter in Column 1 to 3
(b) When such goods are returned	Enter in Column 4 to 6
(c) When such goods are approved (or retained)	Enter in Column 7 to 10
(d) Value of goods sent out but neither sold nor returned till the close of accounting period	Enter in Column 11

- Accounting for Goods approved or retained** — It may be noted that when such goods are approved (or retained), the individual amounts (entered in column 10) are then posted to the debit of respective Customers' Accounts and the periodic total (normally monthly) of Column 10 is posted to the credit of Sales Account in the Ledger.

JOURNAL OF TULSIAN LTD.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Customer's A/c Dr			
	To Sales A/c			

- Accounting for Goods neither approved nor retained** — Like an ordinary stock, the goods sent out but neither sold nor returned till the close of accounting period are considered as stock lying with the customers on behalf of seller and are valued at 'Cost or Net Realizable Value whichever is lower'. Such goods are brought into final accounts by passing the following adjusting entry:

Stock with Customers (on Sale or Return basis) A/c	Dr.	[With Cost or Net Realizable Value whichever is lower]
To Trading A/c		

5.0 SEPARATE DAY BOOKS METHOD

- Where a large number of articles are sent out on a sale or return basis, the following books are maintained:
 - Sale on Approval Day Book (Like an ordinary Sales Day Book)
 - Sale on Approval Inward Day Book (Like an ordinary Sales Inward Day Book)
 - Sales on Approval Ledger

2. Sale On Approval Day Book

Sale on Approval Day Book is used for the purposes of recording the deliveries of the goods sent out to the customers on a sale or return basis. A simple format of this book is shown below:

Format of Sale on Approval Day Book				
Sale on Approval Day Book				
Date	Invoice No	Name of Customer	L.F.	₹

Posting Procedure— Individual amounts are posted to the respective Customers' Accounts and the periodic total (normal monthly) is posted to the credit of Sale on Approval Total Account in the Sale on Approval Ledger.

- 3. Sale On Approval Inward Day Book** Sale on Approval Inward Day Book is used for the purposes of recording the return or retention of such goods. A simple format of this book is shown below:

Format of Sale on Approval Inward Day Book					
Sale on Approval Day Book					
Date	Proforma Credit	Name of Customer	L.F.	Returned ₹	Retained

Posting Procedure— Individual amounts are posted to the credit of respective Customers' Accounts and the periodic total (normally monthly) is posted to the debit of Sale on Approval Total Account in the Sale on Approval Ledger.

It may be noted that when such goods are retained by the customers and are treated as sales, such transaction is recorded in two Day Books viz Sale on Approval Inward Day Book (to cancel the earlier entries) and Ordinary Sale Day Book (to record as an ordinary sale).

- 4. Sale On Approval Ledger—** In 'Sale on Approval Ledger', Sale on Approval Total Account and Accounts of Individual Customers for Sale on Approval are opened. The formats of Sale on Approval Total Account and Individual Customer for Sale on Approval Account are given below:

Format of Sale on Approval Total Account							
Dr.			Sale on Approval Total Account				Cr.
Date	Particulars	Folio	Date	Particulars	Folio	₹	
	To Sundries as per Sale on Approval Inward Book			By Sundries as per Sale on Approval Day Book			
	—Returned	xxx ²				xxx ¹	
	—Retained	xxx ³					
	To Balance c/d	xxx					
		xxx				xxx	

1. Periodic Total of Sale on Approval Day Book, 2. Periodic Total of Returned Column of Sale on Approval Inward Book, 3. Periodic Total of Retained Column of Sale on Approval Inward Book.

Format of Customer for Sale on Approval Account						
Dr.			Sale on Approval Total Account			Cr.
Date	Particulars	Folio	Date	Particulars	Folio	₹
	To Sale on Approval (Goods Sent) Total A/c	xxx ¹		By Sale on Approval Total A/c —Returned —Retained By Balance c/d		xxx ² xxx ³ xxx
		xxx				xxx

1. Individual Amount of Sale on Approval Day Book, 2. Individual Amount of Returned Column of Sale on Approval Inward Book, 3. Individual Amount of Retained Column of Sale on Approval Inward Book.

5. **Treatment of Credit Balance of Sale on Approval Total Account** It may be noted that the credit balance of the Sale on Approval Total Account must be equal to the sum of the debit balance of the Individual Customers' Accounts. The credit balance of the Sale on Approval Total Account at the close of the accounting period represents the value of goods sent out but neither sold nor returned. Such goods are considered as stock lying with the customers on behalf of seller and are valued at 'Cost or Net Realisable Value whichever is lower'. Such goods are brought into final accounts by passing the following adjusting entry:

Stock with Customers (on Sale or Return basis) A/c To Trading A/c	Dr.	[With Cost or Net Realizable Value whichever is lower]

ILLUSTRATION 2

'X' supplied goods on sale or return basis to customer, the particulars of which are as under:

Date of Despatch	Party's Name	Amount ₹	Remarks
10.03.2018	ABC Co.	10,000	No information till 31.03.2018
12.03.2018	DEF Co.	15,000	Returned on 16.03.2018
15.03.2018	GHI Co.	12,000	Goods worth ₹ 2,000 Returned on 20.03.2018
20.03.2018	DEF Co.	16,000	Goods Retained on 24.03.2018
25.03.2018	ABC Co.	11,000	Goods Retained on 28.03.2018
30.03.2018	GHI Co.	13,000	No information till 31.03.2018

Goods are to be returned within 15 days from the date of despatch, failing which it will be treated as Sales. The Books of 'X' are closed on the 31st March, 2018.

Prepare the following account in the book of 'X':

- Goods on Sales or Return, Sold and Returned Day Books.
- Goods on Sales or Return Total Account.

SOLUTION**GOODS ON SALES OR RETURN, SOLD AND RETURNED DAY BOOKS**

Date	Party to whom goods sent	L.F.	₹	Date	Sold ₹	Returned ₹
10.03.2018	M/s ABC Co.		10,000	25.03.2018	10,000	
12.03.2018	M/s DEF Co.		15,000	16.03.2018	—	15,000
15.03.2018	M/s GHI Co.		12,000	20.03.2018	10,000	2,000
20.03.2018	M/s DEF Co.		16,000	24.03.2018	16,000	
25.03.2018	M/s ABC Co.		11,000	28.03.2018	11,000	
30.03.2018	M/s GHI Co.		13,000	—	—	
			77,000		47,000	17,000

GOODS ON SALES OR RETURN TOTAL ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
31.03.2018	To Returns	17,000	31.03.2018	By Goods Sent on Sales or Return	77,000
	To Sales	47,000			
	To Balance c/d	13,000			
		77,000			77,000

ILLUSTRATION 3

Mr. A, a trader, dispatched goods costing ₹ 16,000 to his customer Mr B on sale or return basis after charging a gross profit of 20% on Sales. Mr. A had treated the transaction as credit sale at the time of dispatch of the goods.

Pass Journal entries in the books of Mr. A, if:

- the customer had approved the goods.
- the customer had rejected all the goods:
- the customer had retained half of the goods while rejecting the other half.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	When goods are sent on approval: Mr B's A/c Dr. To Sales A/c (Being goods sent on approval treated as credit sale)		20,000	20,000
(ii)	When goods are approved by customer: No entry needs to be passed. When the customer rejects all the goods: Sales A/c Dr. To Mr B's A/c (Being entry for credit sale reversed on rejection of the goods by the customer)		20,000	20,000
(iii)	When the customer retains half the goods while rejecting the other half: Sales A/c Dr. To Mr B's A/c (Being entry for credit sale reversed for the rejected portion i.e. half of the goods)		10,000	10,000

Working Note: Sales Value of goods sent on approval = ₹16,000 + 25% of ₹16,000 = ₹20,000

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ACCOUNTING FOR CONSIGNMENT

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of Consignment, Consignor and Consignee 1
- ◇ Features of Consignment
- ◇ Distinction Between Consignment and Sale
- ◇ Proforma Invoice
- ◇ Commission
- ◇ Advance From Consignee
- ◇ Account Sales
- ◇ Valuation of Unsold Stock Lying with the Consignee
- ◇ Treatment of Abnormal Loss
- ◇ Treatment of Normal Loss
- ◇ Distinction Between Normal Loss and Abnormal Loss in Consignment
- ◇ Consignment Account
- ◇ Accounting Treatment in the Books of Consignor
- ◇ Format of Consignment Account in Consignor's Books
- ◇ Format of Consignee's Account in Consignor's Books
- ◇ Accounting Treatment in the Books of the Consignee
- ◇ Invoice Price and Loading

1.0. MEANING OF CONSIGNMENT, CONSIGNOR AND CONSIGNEE

Consignment means the transaction of sending goods by one person to another, who is to sell those goods on behalf of the first person.

MEANING OF CONSIGNOR

The person who sends the goods is known as 'Consignor'.

MEANING OF CONSIGNEE

The person to whom the goods are sent is known as 'Consignee'.

NATURE OF RELATIONSHIP BETWEEN CONSIGNOR & CONSIGNEE

The legal relationship between these two persons is that of principal and agent.

MEANING OF OUTWARD/INWARD CONSIGNMENT

The Consignment is an '**Outward Consignment**' for the person who sends the goods for sale and an '**Inward Consignment**' for the person who receives the goods for sale.

EXAMPLE

If 'X' sends goods to 'Y' for sale on his behalf, Here, 'X' is known as Consignor or Principal and 'Y' is known as Consignee or Agent. It is an Outward Consignment for X and an Inward Consignment for Y.

2.0. FEATURES OF CONSIGNMENT

1. The **relationship** between Consignor and Consignee is that of **Principal and Agent**.
2. Only the **possession** of goods and **not the ownership** of goods is transferred to the Consignee.
3. **Risk** of goods remains **with the Consignor** because ownership of goods remain with the Consignor.
4. Consignee is entitled to **reimbursement of expenses** incurred by him on behalf of the Consignor as per agreement.
5. Consignee is entitled to an **agreed remuneration**.
6. The **profit/loss** on sale of goods sent on Consignment **belongs to the Consignor**.

3.0. DISTINCTION BETWEEN CONSIGNMENT AND SALE

Consignment differs from Sale in the following respects:

Basis of Distinction	Consignment	Sale
1. Nature of Relationship	The relation between the Consignor and the consignee is that of principle and agent .	The relation between the seller and the buyer is that of creditor and debtor .
2. Ownership and possession of goods	Only the possession and not the ownership is transferred to the consignee.	Both the possession and ownership are transferred.
3. Risk of goods	Risk remains with the Consignor because ownership remains with the Consignor.	Risk remains with the buyer since ownership remains with him.
4. Proforma Invoice/Invoice	Consignor prepares only a proforma invoice .	Seller prepares a sales invoice .
5. Subject matter of dealing	Only movable property may be its subject matter.	Any property may be its subject matter.
6. Who bears expenses	Expenses incurred by consignee are borne by Consignor .	Expenses incurred after sale by buyer are borne by him and not by seller.
7. Profit/Loss belongs to	Profit/Loss on sale of belongs to Consignor .	After the sale is complete, the profit/loss belongs to buyer .
8. Return of Goods	Goods are returnable if they are not sold by the consignee.	Goods once sold are not returnable .

9. Account Sales	Account Sales has to be submitted by the consignee to the Consignor from time to time.	No Account Sale is required to be submitted by the Buyer to the Seller.
10. Treatment of Unsold Goods	Unsold goods with the Consignee is be treated as stock of the Consignor.	The seller has nothing to do with the goods which could not be resold. Unsold Goods with the buyer is treated as Stock of the Buyer.

4.0. PROFORMA INVOICE**MEANING AND OBJECT OF PROFORMA INVOICE**

A proforma invoice looks like an invoice but is really not one. the object of the proforma invoice is only to convey information to the Consignee regarding quantity, varieties and prices of goods sent and expenses incurred and not to make him liable like a trade debtor.

WHO PREPARES PROFORMA INVOICE?

When the Consignor sends the goods to the Consignee, he prepares only a Proforma Invoice and not an Invoice.

A SPECIMEN OF PROFORMA INVOICE

Specimen of Proforma Invoice
M/s JALAN TRADERS

Proforma Invoice

Date: 01.04.2018

for Goods Sent on Consignment Basis to:

M/s Rahul Agencies

413, Haveli Haider Kuli

Chandni Chowk, Delhi 110006

S.No.	Particulars	Amount ₹
	10,000 Handles @ ₹ 20 each	2,00,000
	Charges:	
	Packing & Cartage ₹ 2,500	
	Insurance ₹ 5,000	
	Freight ₹ 40,000	47,500
	Total	2,47,500
	Goods despatched vide R.R.No. 9221723 dated 01.04.2018	
	Freight to pay	
E.&O.E		
		For M/s Jalan Traders
		Bimal Jalan
		Partner

5.0 COMMISSION

MEANING OF COMMISSION

Commission is the remuneration paid to the Consignee by the Consignor in consideration of the services rendered by the former in selling the goods consigned. This commission can be divided into two types (a) Ordinary Commission, and (b) Special Commission.

MEANING OF ORDINARY COMMISSION

It is a commission usually paid as a fixed percentage on gross sale proceeds. The term commission normally denotes ordinary commission, unless specified otherwise. The Consignee is not responsible for any bad debts and he does not guarantee the payment from all those who buy on credit so long as he is getting ordinary commission only.

MEANING OF SPECIAL COMMISSION

This is the commission which the Consignee gets over and above the ordinary commission. It can be sub-divided into two categories viz., (a) Over-Riding Commission and (b) Del-Credere Commission.

MEANING AND CALCULATION OF OVER-RIDING COMMISSION

1. **Meaning** — Over-riding commission is an extra commission allowed over and above the normal commission is generally offered:
 - (i) when the agent is required to put in hard work in introducing a new product in the market,
 - (ii) where he is entrusted with the work of supervising the performance of other agents in a particular area,
 - (iii) for effecting for sales at prices higher than the price fixed by the Consignor.
2. **How to Calculate** — Depending upon the terms of agreement it may be calculated on the actual total sales or on the difference between Actual total sales and Sales at special selling price or invoice price. However, in the absence of any such agreement, over-riding commission should be allowed on the difference between the actual total sales and sales at specified selling price and ordinary commission should be allowed on total sales at specified sales price.

MEANING AND CALCULATION OF DEL-CREDERE COMMISSION

1. **Meaning** — Del-Credere Commission is an additional commission paid by the Consignor to the Consignee for bearing the loss on account of bad debts, if any, arising out of credit sale of consignment goods. In case of a dispute regarding the delivery or quality etc. if a customer has deducted a particular amount, the Consignee will not bear this loss even if he is getting a del-credere commission. Thus, del-credere commission is a kind of insurance premium paid to cover the risk of bad debts.
2. **Who will bear the Bad Debts?**

<i>If Consignee gets Del-credere Commission</i>	<i>If Consignee does not get Del-credere Commission</i>
Consignee will bear the risk of bad debts	Consignor will bear the risk of bad debts.

How to Calculate — Del-credere commission may be allowed on credit sales or total sales. However, in the absence of any such agreement, the Consignor allows such commission on total sales and not merely on credit sales.

DISTINCTION BETWEEN ORDINARY COMMISSION AND DEL-GREDERE COMMISSION

Basis of Distinction	Ordinary Commission	Delcredere Commission
1. When allowed?	It is allowed to all the consignees for all the consignments for selling goods.	It is allowed to the consignee only when he undertakes the risk of bad debts arising out of credit sales.
2. Guarantee	In return of this commission, consignee guarantees only the proceeds of cash sales	In return of this commission, consignee guarantees the proceeds of cash sales and credit sales.
3. How to Calculate?	It is calculated at an agreed rate on the total sales.	It is calculated at an agreed rate <i>either</i> on total sales (if no agreement) <i>or</i> credit sales (if agreement provides).

ILLUSTRATION 1 [CALCULATION OF COMMISSION]

Mr X sent 250 units costing ₹ 10,000 each to Mr Y. The goods were to be sold so as to yield a gross profit of 20% on sales. Mr Y sold 150 units @ ₹ 14,200 per unit on credit and 75 units @ ₹ 14,000 for cash. Calculate the commission due to Mr Y in each of the following alternative cases.

- Case (a) Mr Y was entitled to a commission of ₹ 500 per unit.
- Case (b) Mr Y entitled to an ordinary commission of 5% and del-credere commission of 2%.
- Case (c) Mr Y was entitled to an ordinary commission of 5%, del-credere commission of 2% on sales and an over-riding commission of 25% of any surplus realised.
- Case (d) Mr Y was entitled to an ordinary commission of 5% on total sales, del-credere commission of 2% on credit sales and an over-riding commission of 25% of any surplus realised.
- Case (e) Mr Y was entitled to a commission of ₹ 500 per unit sold plus 25% of any surplus price realised.
- Case (f) Mr Y was entitled to a commission of ₹ 500 per unit sold plus 25% of any surplus realised as reduced by total commission.
- Case (g) Mr Y entitled to a commission of ₹ 500 per unit sold plus one forth of the amount by which the gross sale proceeds less total commission thereon exceeded a sum calculated at the specified selling price.

SOLUTION:

Case (a) Commission = $(150 + 75) \times ₹ 500 = 1,12,500$

Case (b) Total commission = Ordinary + Del-credere Commission
 = 5% of ₹ 31,80,000 + 2% of ₹ 31,80,000
 = ₹ 1,59,000 + ₹ 63,600 = ₹ 2,22,600

Note: Total Sales = Credit Sales + Cash Sales
 = $(150 \times ₹ 14,200) + (75 \times ₹ 14,000)$
 = ₹ 21,30,000 + ₹ 10,50,000 = ₹ 31,80,000

Case (c) Since over-riding commission as % of surplus has been given, other commission have been calculated on sales at specified selling price otherwise Mr Y will get unnecessarily ordinary commission and del-credere commission on surplus realised also.

A. Actual Total Sales = $(150 \times ₹ 14,200) + (75 \times ₹ 14,000)$
 = ₹ 31,80,000

B. Total Sales at Specified Selling Price = $(150 + 75) ₹ 12,500$
 = ₹ 28,12,500

C. Surplus [A – B]	=	₹ 3,67,500
Ordinary Commission = 5% of ₹ 28,12,500	=	₹ 1,40,625
Del-Credere Commission = 2% of ₹ 28,12,500	=	₹ 56,250
Over-riding Commission = 25% of ₹ 3,67,500	=	₹ 91,875
Total Commission	=	₹ 2,88,750
Case (d) Ordinary Commission = 5% of ₹ 31,80,000	=	₹ 1,59,000
Del-credere Commission = 2% of ₹ 21,30,000	=	₹ 42,600
Over-riding Commission = 25% of ₹ 3,67,500	=	₹ 91,875
Total Commission	=	₹ 2,93,475
Case (e) Fixed Commission = (150 + 75) × ₹ 500	=	₹ 1,12,500
Over-riding Commission = 25% of ₹ 3,67,500	=	₹ 91,875
	=	₹ 2,04,375
Case (f) Fixed Commission = (150 + 75) × ₹ 500	=	₹ 1,12,500
Let the total commission be X		
Variable commission = 25% of (₹ 3,67,500 – X)		
$X - 1,12,500 = 91,875 - .25X$, $X + .25 X = 1,12,500 + 91,875$, $1.25 X = ₹ 2,04,375 = ₹ 2,04,375/1.25 = ₹ 1,63,500$		
Case (g) Fixed Commission @ ₹ 500 = $225 \times ₹ 500 = ₹ 1,12,500$		
Let the total Commission be X		
Variable Commission = $1/4 [(\text{₹ } 31,80,000 - X) - (225 \times ₹ 12,500)]$		
$X - ₹ 1,12,500 = 1/4 [\text{₹ } 31,80,000 - X - ₹ 28,12,500]$		
$X - ₹ 1,12,500 = 1/4 (\text{₹ } 3,67,500 - X)$		
$X - ₹ 1,12,500 = 91,875 - 1/4 X$		
$X - 1,12,500 = 91,875 - .25 X$		
$1.25 X = 2,04,375$ $X = ₹ 2,04,375/1.25 = ₹ 1,63,500$		

ILLUSTRATION 2 [ADJUSTMENT OF VARIOUS TYPES OF COMMISSION]

M/s Jalan Traders consigned 10,000 units to M/s Rahul Agencies on 1st April, 2017 on the following terms:

- All units to be sold 50% above the cost of ₹ 20. Any deficiency in selling price is to be borne by M/s Rahul Agencies who is also entitled to retain 50% of any surplus price realised.
- M/s Rahul Agencies is to be paid 3% commission and 2% Del-Credere commission on all sales at specified sales price.

M/s Jalan Traders incurred packing, freight, Insurance charges of ₹ 47,500 in consigning these goods. Rahul Agencies remitted Dena Bank DD No. 420 dated 1st July 2017 for ₹ 50,000 as advance. M/s Rahul Agencies sent Account Sales on 31st March, 2018 disclosing 2,500 kg, sold @ ₹ 30 per kg., 2,000 kg. sold @ ₹ 28 per kg., 3,000 kg. sold @ ₹ 32 per kg.

M/s Rahul Agencies had incurred unloading charges of ₹ 9,800 and selling expenses of ₹ 16,450. He had collected the entire sale proceeds from all customers except from one who paid only 75 paise in rupee for his debt of ₹ 4,000 and from another who deducted ₹ 150 because of a dispute regarding quality. On 31st March 2018, M/s Rahul Agencies remitted the balance due vide Dena Bank Draft No. 1000.

You are required to calculate the commission due to Consignee.

SOLUTION**STATEMENT SHOWING THE CALCULATION OF COMMISSION**

A. Amount entitled to normal commission and Del-Credere commission	₹
2,500 kg @ ₹ 30 per kg	75,000
2,000 kg @ ₹ 30 per kg	60,000
3,000 kg @ ₹ 30 per kg	90,000
	2,25,000
B. Normal commission @ 3% on ₹ 2,25,000	6,750
C. Del-credere commission @ 2% on ₹ 2,25,000	4,500
D. Amount entitled to extra commission 3,000 kg @ ₹ 2	6,000
E. Extra commission @ 50% on ₹ 6,000	3,000
F. Total commission due to Consignee (B + C + E)	14,250

6.0 ADVANCE FROM CONSIGNEE

1. It is a common trade practice for the Consignor to demand some advance from the Consignee as a security for the goods despatched to him.
2. It may be in the form of cash or bank draft or in the form of a bill of exchange.
3. The Consignee will send some amount as an advance before or after he receives the goods from the Consignor.
4. The advance received from the Consignee should not be credited to Consignment Account as it is not a part of the sale proceeds.
5. The advance will be adjusted against the amount due from the Consignee when the accounts are finally settled.
6. In some cases, a bill may be drawn on the Consignee if he is not in a position to pay advance money. The Consignor can discount the bill with his bankers. In such a case the value of the bill (as advance) so accepted will be deducted from the sale proceeds. The discount paid to the bank should be charged to the Profit & Loss Account and not to Consignment Account because it represents the cost of raising finance and not the cost of consignment.
7. The worthnoting point here is that while calculating the amount due from the Consignee, the proportionate advance pertaining to unsold goods should not be adjusted.
8. Such proportionate advance should appear as a credit balance in Consignee's Account in the books of Consignor.

7.0 ACCOUNT SALES**MEANING OF ACCOUNT SALES**

An Account Sales is a statement sent by the Consignee to the Consignor periodically.

CONTENTS OF ACCOUNT SALES

An Account Sales contains the information like (i) Sales made (ii) Expenses incurred on behalf of Consignor (iii) Commission earned (iv) An Advance (if any) given (v) the balance due to the principal.

ACCOUNT SALES DIFFERS FROM SALES ACCOUNT

An Account Sales is different from Sales Account (which provides only the summary of sales made for cash and on credit).

ILLUSTRATION 3 [PREPARATION OF ACCOUNT SALES]

Taking the same information as given in Illustration 2, prepare the Account Sales:

SOLUTION:

ACCOUNT SALES SENT TO M/S JALAN TRADERS

S.No.	Particulars		Amount ₹
A.	Actual sales	2,27,000	
	Add: Deficit @ ₹ 2 on 2,000 kg	4,000	
			2,31,000
B.	Less:		
	Expenses incurred by Consignee		
	(a) Unloading charges	₹ 9,800	
	(b) Selling expenses	₹ 16,450	26,250
	Commission due	14,250	
	Non-realisation of ₹ 150 because of dispute regarding quality	150	40,650
			1,90,350
C	Less: Credit for Advance already given vide by Dena Bank Draft No. 420 dated 1.7.2012		37,500
D.	Balance Due remitted vide Dena Bank Draft No. 1000 dt. 31.3.2013		1,52,850
E. & O.E		For M/s Rahul Agencies	
Dated: 31.03.2013		Rahul	
		Partner	

8.0 VALUATION OF UNSOLD STOCK LYING WITH THE CONSIGNEE**VALUATION PRINCIPLE**

Basically Stock is to be valued at Cost Price or Net Realizable Value *whichever is lower* on the principle of "Prudence (Conservatism)" (i.e. Ignore Anticipated Profit but provide for Anticipated Losses).

MEANING OF COST PRICE

Cost Price for this purpose means the purchase price *plus* expenses which are incurred to bring the goods to their present location and condition (whether incurred by Consignor or Consignee).

MEANING OF MARKET PRICE

Market Price here refers to Net Realisable Value (NRV) i.e., the value which shall be realised if unsold goods in stock are disposed off in the market and not the "Replacement Value" i.e. the value which shall be required to replace the unsold goods in stock.

PRACTICAL STEPS IN THE VALUATION OF UNSOLD STOCK

Step 1 Compute the Cost of Unsold Stock as under:			
		<i>Units</i>	<i>₹</i>
A.	Cost of Goods sent by Consignor	x	xxx
B.	Add: All Expenses incurred by Consignor	—	xxx
C.	Total Cost of Goods sent (A + B)	x	xxx
D.	Less: Cost of Goods not reached the city of Consignee		
	(a) Goods lost-in-Transit	x	xxx
	(b) Goods still-in-transit	x	xxx
E.	Cost of Goods reached the city of Consignee (C—D)	x	xxx
F.	Add: Non-recurring Expenses incurred by Consignee	—	xxx
G.	Cost of Goods received by Consignee (E + F)	x	xxx
H.	Less: Expected Normal loss (units only)	x	—
I.	Cost of Goods available for sale (G – H)	x	xxx
J.	Cost of Unsold Stock	x	xxx
Step 2 Compute Net Realizable Value			
A.	Unsold Units		xxx
B.	Realizable Value per unit		xxx
C.	Total Realizable Value (A × B)		xxx
D.	Less: Realization Expenses (e.g. Commission on Sales)		(xxx)
E.	Net Realizable Value (C – D)		xxx
Step 3 Value of Unsold Stock (amount as per Step 1 or 2 whichever is lower)			

TUTORIAL NOTES

1. Non-recurring expenses of Consignee refer to those expenses which are incurred in order to bring the inventories to their present location and condition, whereas recurring expenses refer to those expenses which cannot be considered as relating to putting the inventories in their present location and condition.

<i>Examples of Consignor's Expenses</i>		<i>Examples of Consignee's Expenses</i>			
		A	Of Non-recurring Nature	B	Of Recurring Nature
(i)	Carriage outward	(i)	Clearing charges	(i)	Warehouse charges
(ii)	Freight	(ii)	Custom duty, Octroi, etc.	(ii)	Insurance charges
(iii)	Insurance	(iii)	Carriage inward/Transport charges upto Godown	(iii)	Office & Administration Expenses
(iv)	Packing			(iv)	Selling & Distribution Expenses
				(v)	Godown rent

2. Realizable expenses refer to those expenses which are required to be incurred in order to dispose off unsold goods in stock e.g. Consignee's commission is a realizable expense if he does not propose to waive as such.

ILLUSTRATION 4 [VALUATION OF CLOSING STOCK IN HAND]

Mr X provides you the following information:

1. Good sent by Mr X to his agent Mr Y—10,000 Units @ ₹ 20 per unit
2. Mr X's Forwarding and Insurance Expenses—₹ 50,000
3. Agent took delivery and brought the goods to his godown after incurring expenses @ Re 1 per unit
4. Goods sold by Agent—7,300 units @ ₹ 30
5. Agent's Commission—5%

Required: Calculate the amount of Closing Stock in each of the following alternative cases:

Case (a) If no other information is given

Case (b) If owing to fall in market price, the value of normal stock is to be reduced by 10%

Case (c) If owing to depression in the market, a special trade discount of 10% is to be allowed to sell normal stock.

SOLUTION**Case (a) STATEMENT SHOWING THE CALCULATION OF UNSOLD STOCK**

Particulars	Units	₹
A. Cost of Goods Sent	10,000	2,00,000
B. Consignor's Expenses	—	50,000
C. Total Cost of Goods Sent (A + B)	10,000	2,50,000
D. Add: Consignee's Non-recurring Expenses	—	10,000
E. Cost of Goods received by Consignee	10,000	2,60,000
F. Cost of Unsold Stock [$₹ 2,60,000 \times 2,700/10,000$]	2,700	70,200

Case (b)

Cost of Closing Stock ₹ 70,200

Less: 10% ₹ 7,020

Value of Closing Stock to be brought into accounts ₹ 63,180

Case (c)

(i) Cost of Closing Stock ₹ 70,200

(ii) Net Realizable Value

A. Gross Realizable Value ($2,700 \times ₹ 30 \times 90\%$) ₹ 72,900

B. Less: Realization Exp. (Agent's Commission) [5% of ₹ 72,900] ₹ 3,645

C. Net Realizable Value [A – B] ₹ 69,255

(iii) Value of Closing Stock to be brought into accounts ₹ 69,255

(at Cost or NRV whichever is lower)

ILLUSTRATION 5 [VALUATION OF CLOSING STOCK IN TRANSIT]

Mr X provides you the following information:

1. Good sent by Mr X to his agent Mr Y—10,000 Units @ ₹ 20 per unit
2. Mr X's Forwarding and Insurance Expenses ₹ 50,000
3. Goods still-in-transit—200 units

4. Agent took delivery and brought the goods to his godown after incurring expenses @ Re 1 per unit
5. Goods sold by Agent-7,300 units @ ₹ 30

Required: Calculate the amount of Closing stock.

SOLUTION

CALCULATION OF UNSOLD STOCK

Particulars	Units	₹
A. Cost of Goods Sent	10,000	2,00,000
B. Consignor's Expenses	—	50,000
C. Total Cost of Goods Sent (A + B)	10,000	2,50,000
D. Less: Cost of Goods still-in-transit	200	5,000
E. Cost of goods reached the city of Consignee (C – D)	9,800	2,45,000
F. Add: Consignee's recurring expenses	—	9,800
G. Cost of Goods received by Consignee [E + F]	9,800	2,54,800
H. Cost of Unsold Stock in hand [₹ 2,54,800 × 2,500/9,800]	2,500	65,000
I. Total Cost of Closing Stock [D + H]	2,700	70,000

9.0 TREATMENT OF ABNORMAL LOSS

MEANING OF ABNORMAL LOSS

Abnormal loss is an avoidable loss which occurs due to abnormal factors like fire, theft, abnormal spoilage/leakage/breakages/pilferage etc and not due to inherent nature of goods.

WHEN ABNORMAL LOSS MAY OCCUR

The abnormal loss may occur either before the goods are received by the Consignee (i.e. loss during transit) or after the goods are received by the Consignee (i.e. loss in Consignee's godown).

The point to be noted here is that when loss occurs during transit, the non-recurring expenses incurred by Consignee should be charged to the goods received by the Consignee (i.e. total goods sent minus goods lost in transit & goods still in transit) only.

HOW TO CALCULATE ABNORMAL LOSS

The amount of abnormal loss during transit and in Consignee's godown may be calculated as under:

CALCULATION OF ABNORMAL LOSS DURING TRANSIT

A. Cost Price of Goods lost during transit	xxx
B. Add: Consignor's Proportionate Expenses [i.e. Consignor's Total Expenses × Units Lost/Total Unit sent]	xxx
C. Cost of Abnormal Loss during transit [A + B]	xxx

CALCULATION OF ABNORMAL LOSS IN CONSIGNEE'S GODOWN

A. Cost Price of Goods lost in Consignee's Godown	xxx
B. Add: Consignor's Proportionate Expenses [i.e. Consignor's Total Expenses × Units Lost/Total Units sent]	xxx

C. Add: Consignee's Proportionate Non-Recurring Expenses [i.e. Consignor's Total Non-returning Expenses × Units Lost/ Total Units received by Consignee]	xxx
D. Cost of Abnormal Loss in Consignee's Godown [A + B + C]	xxx

TREATMENT OF ABNORMAL LOSS

1. Abnormal Loss is not treated as a part of cost.
2. The cost of Abnormal Loss is calculated in the same manner as the value of unsold stock.
3. **JOURNAL ENTRY** The following journal entry is passed to account for such a loss.

Profit & Loss A/c	Dr.	[With Irrecovered loss]
Insurance Company's A/c	Dr.	[With the claim admitted by Insurance Co.]
To Consignment A/c		[With total loss]

ILLUSTRATION 6 [VALUATION OF CLOSING STOCK WHEN THERE IS ABNORMAL LOSS-IN-TRANSIT]

Mr X provides you the following information:

1. Good sent by Mr X to his agent Mr Y-10,000 Units @ ₹ 20 per unit
2. Mr X's Forwarding and Insurance Expenses ₹ 50,000
3. Goods fully damaged in transit: 200 units (Insurance Co. paid 80% of loss)
4. Agent took delivery and brought the goods to his godown after incurring expenses @ Re 1 per unit
5. Goods sold by Agent: 7,300 units @ ₹ 30

Required: Calculate the amount of Closing Stock and Net Loss incurred on goods fully damaged-in-transit.

SOLUTION**CALCULATION OF UNSOLD STOCK**

Particulars	Units	₹
A. Cost of Goods Sent	10,000	2,00,000
B. Consignor's Expenses	—	50,000
C. Total Cost of Goods Sent (A + B)	10,000	2,50,000
D. Less: Cost of Goods fully damaged-in-transit	200	5,000
E. Cost of goods reached the city of Consignee (C – D)	9,800	2,45,000
F. Add: Consignee's recurring expenses	—	9,800
G. Cost of Goods received by Consignee [E + F]	9,800	2,54,800
H. Cost of Unsold Stock in hand [₹ 2,54,800 × 2,500/9,800]	2,500	65,000

CALCULATION OF NET LOSS ON GOODS LOST-IN-TRANSIT

Particulars	Units	₹
A. Cost of goods lost-in-transit		5,000
B. Less: Insurance Claim [80% of ₹ 5,000]		4,000
C. Net Loss		1,000

ILLUSTRATION 7 [VALUATION OF CLOSING STOCK WHEN THERE IS ABNORMAL LOSS-IN-AGENT'S GODOWN]

Mr X Ltd. provides you the following information:

1. Goods sent by Mr X to his agent Mr Y-10,000 Units @ ₹ 20 per unit
2. Mr X's Forwarding and Insurance Expenses ₹ 50,000
3. Agent took delivery and brought the goods to his godown after incurring expenses @ Re 1 per unit
4. Goods fully destroyed by fire in Agent's godown: 200 Units (Insurance Co. admitted 80% of loss)
5. Goods sold by Agent: 7,300 units @ ₹ 30

Required: Calculate the amount of Closing Stock and Net Loss incurred on Goods destroyed by fire in Agent's godown.

SOLUTION:**CALCULATION OF ABNORMAL LOSS AND UNSOLD STOCK**

<i>Particulars</i>	<i>Units</i>	<i>₹</i>
A. Cost of Goods Sent	10,000	2,00,000
B. Consignor's Expenses	—	50,000
C. Total Cost of Goods Sent (A + B)	10,000	2,50,000
D. Add: Consignee's non-recurring expenses	—	10,000
E. Cost of goods received by Consignee	10,000	2,60,000
F. Less: Cost of goods destroyed in Consignee's Godown	200	5,200
G. Cost of Goods available for sale	9,800	2,54,800
H. Cost of Unsold Stock [$\text{₹ } 2,54,800 \times 2,500/9,8000$]	2,500	65,000

CALCULATION OF NET LOSS ON GOODS DESTROYED BY FIRE

<i>Particulars</i>	<i>Units</i>	<i>₹</i>
A. Cost of goods destroyed by fire		5,200
B. Less: Insurance Claim		4,160
C. Net Loss		1,040

10.0. TREATMENT OF NORMAL LOSS**MEANING OF NORMAL LOSS**

Normal loss is an unavoidable loss due to inherent features of the goods (e.g. evaporation, normal leakage/spoilage).

TREATMENT OF NORMAL LOSS

Normal Loss is treated as a part of cost by inflating the cost per unit.

NO JOURNAL ENTRY

No separate journal entry is passed to account for such loss.

ILLUSTRATION 8 [VALUATION OF CLOSING STOCK WHEN THERE IS NORMAL LOSS]

1. Goods sent by Mr X to his agent Mr Y-10,000 Units @ ₹ 20 per unit
2. Mr X's forwarding and insurance expenses-₹ 50,000
3. Agent took delivery and brought the goods to godown after incurring expenses @ Re 1 per unit
4. Goods sold by Agent: 7,300 units @ ₹ 30
5. Goods lost in Agent's godown due to normal causes: 200 units

Required: Calculate the amount of Closing Stock.

SOLUTION:

CALCULATION OF VALUE OF UNSOLD STOCK

<i>Particulars</i>		<i>Units</i>	<i>₹</i>
A.	Cost of Goods sent	10,000	2,00,000
B.	Expenses incurred by Consignor	—	50,000
C.	Total Cost of Goods Sent (A + B)	10,000	2,50,000
D.	Non-recurring expenses incurred by Consignee	—	10,000
E.	Cost of Goods received by Consignee (C + D)	10,000	2,60,000
F.	Normal Loss in Godown	200	—
G.	Cost of Goods available for sale (E – F)	9,800	2,60,000
H.	Cost of unsold Goods (₹ 2,60,000 × 2,500/9,800)	2,500	66,327

Treatment of Normal Loss — In accounts, normal loss is adjusted by spreading over its cost proportionately to goods sold and unsold.

ILLUSTRATION 9 [VALUATION OF CLOSING STOCK WHEN THERE ARE BOTH THE ABNORMAL LOSS & NORMAL LOSS]

Calculate the value of unsold consignment stock and abnormal loss from the following information:

Goods consigned: 10,000 units @ ₹ 20 per unit;

Freight and Insurance expenses incurred by Consignor: ₹ 47,500

Expenses incurred by Consignee-Unloading charges ₹ 4,900 clearing custom and octroi charges ₹ 3,900, Carriage Inward ₹ 1,000, Storage expenses ₹ 1,450, Office & adm. expenses ₹ 5,000, Selling, and distribution expenses ₹ 10,000, Bad debts ₹ 1,625.

Goods sold by Consignee: 2500 units @ ₹ 25 per unit for cash and 5000 units @ ₹ 32.50 credit.

Rate of commission of Consignor: 5% (including 2% Del-Credere)

100 units of goods sent were lost in transit.

100 units of goods are still in transit.

100 units of goods lost by fire in Consignee's godown.

100 units of goods lost in the godown of Consignee due to inherent nature of goods.

SOLUTION**STATEMENT SHOWING THE CALCULATION OF ABNORMAL LOSS AND UNSOLD STOCK**

<i>Particulars</i>	<i>Units</i>	<i>₹</i>
A. Cost of Goods sent	10,000	2,00,000
B. Expenses incurred by Consignor	—	47,500
C. Total Cost of Goods Sent (A + B)	10,000	2,47,500
D. Less: Cost of Goods not reached the city of Consignee		
(a) Cost of Goods lost-in-transit ($2,47,500 \times 100/10,000$)	100	2,475
(b) Cost of Goods still-in-transit ($2,47,500 \times 100/10,000$)	100	2,475
E. Cost of Goods reached the city of Consignee (C – D)	9,800	2,42,550
F. Add: Non-recurring Expenses incurred by Consignee	10,000	2,60,000
[₹ 4,900 + ₹ 3,900 + ₹ 1,000]	—	9,800
G. Cost of Goods received by Consignee (E + F)	9,800	2,52,350
H. Less: Cost of Goods lost in Consignee's Godown	100	2,575
[₹ 2,52,350 $\times$ 100/9,800]		
I. Less: Expected Normal Loss (in Units)	100	—
J. Cost of Goods available for sale (G – H – I)	9,600	2,49,775
K. Cost of Unsold Stock [₹ 2,49,775 $\times$ 2,100/9,600]	2,100	54,638
L. Total Cost of Unsold Stock		57,113

11.0 DISTINCTION BETWEEN NORMAL LOSS AND ABNORMAL LOSS IN CONSIGNMENT

Normal loss differs from Abnormal loss in the following respects:

Basis of Distinction	Normal Loss	Abnormal Loss
1. Avoidable vs. Unavoidable	It is an unavoidable loss.	It is an avoidable loss.
2. Causes	It is caused due to the inherent feature of the goods e.g. evaporation, normal leakage/spoilage.	It is usually caused by fire, theft, abnormal spoilage/pilferage etc.
3. Part of Cost	It is treated as a part of cost.	It is not treated as a part of cost.
4. Valuation	Its value is not calculated separately.	Its value is calculated in the same manner as value of unsold stock.
5. Treatment	Its value is adjusted by inflating the cost per unit as under. Effective cost per unit =	Its value is credited to the consignment Account in order to calculate the normal profit/loss on consignment.
6. Journal Entry	No journal entry is passed to account for such loss.	The following journal entry is passed to account for such a loss: P&L A/c Dr. [irrecovered loss] Insurance Co. Dr. [Claim admitted] To Consignment A/c [Total Loss]

12.0 CONSIGNMENT ACCOUNT

OBJECT OF CONSIGNMENT ACCOUNT

The Consignor prepares a Consignment Account relating to each Consignment in order to ascertain the profit or loss on each consignment.

NATURE OF CONSIGNMENT ACCOUNT

Consignment Account is a Nominal Account like Trading and Profit & Loss Account.

DEBIT ITEMS OF CONSIGNMENTS ACCOUNT

Consignment Account is debited with the Cost of goods consigned, Expenses incurred by Consignor, Expenses incurred by Consignee, Commission due to Consignee.

CREDIT ITEMS OF CONSIGNMENT ACCOUNT

Consignment Account is credited with Sale Proceeds, Abnormal Loss, Closing Stock and the Cost of Goods Returned by Consignee.

BALANCE OF CONSIGNMENT ACCOUNT

Excess of credit side total over debit side total is regarded as Profit whereas Excess of Debit side total over credit side total is regarded as Loss.

CLOSURE OF CONSIGNMENT ACCOUNT

Consignment Account is closed by transferring the Profit or Loss to the Profit & Loss Account.

13.0 ACCOUNTING TREATMENT IN THE BOOKS OF CONSIGNOR

1. On Sending the Goods on Consignment

Consignment A/c	Dr. (With the cost of goods sent)
To Goods sent on Consignment A/c	
[Being Goods sent on Consignment]	

Notes:

- (i) *If consignments have been sent to more than one Consignee, the consignment accounts may be distinguished by adding the names of the places to the Consignment Account. (For example Consignment to Calcutta Account, Consignment to Bombay Account, etc.)*
- (ii) *Consignee is not debited as a debtor at the time of sending goods to him since the goods have not been sold to him, merely possession has been transferred. He becomes indebted to the Consignee when he sells the goods.*

2. On incurrance of Expenses by Consignor

Consignment A/c	Dr. (With the amount of expenses incurred by Consignor)
To Cash/Bank A/c	
[Being the expenses incurred]	

3. On receiving Security from Consignee

Cash/Bank/Bills Receivable A/c	Dr. (With the amount of security received from Consignee)
To Consignee's A/c	
[Being security received from Consignee]	

4. On getting the Bills Receivable (received from Consignee), discounted

Bank A/c Dr. *(With the amount of net proceeds)*

Discount A/c Dr. *(With the amount of Discount)*

To Bills Receivable A/c

[Being the B/R discounted with the bank @ ... % p.a.]

5. On receiving the Goods returned by Consignee

Goods Sent on Consignment A/c Dr.

To Consignment A/c

[Being the goods returned by the Consignee]

6. On incurrence of Expenses by Consignee

Consignment A/c Dr. *(With the amount of expenses incurred by Consignee)*

To Consignee's A/c

[Being expenses incurred by Consignee]

7. On Sales being made by Consignee

Consignee's A/c Dr. *(With the amount of sales made)*

To Consignment A/c

[Being sales made by Consignee]

8. On making the Commission due to Consignee

Consignment A/c Dr. *(With the amount of commission earned by Consignee)*

To Consignee's A/c

[Being the Commission due to Consignee]

9. On charging Bad Debts if Consignee is not entitled to Del-credere Commission

Consignment A/c Dr. *(With the amount of Bad Debts)*

To Consignee's A/c

[Being the Bad Debts charged]

Note: If the Consignee is entitled to del-credere commission, no entry for bad debts is to be passed since such loss is to be borne by the Consignee himself.

10. On receiving the Balance Due from the Consignee

Cash/Bank/Bills Receivable A/c Dr. *(With the amount of balance)*

To Consignee's A/c

[Being the balance due from Consignee received]

11. On accounting for the Unsold Stock with the Consignee

Consignment Stock A/c Dr. *(With the value of unsold stock)*

To Consignment A/c

[Being unsold stock with the Consignee brought into account]

12. On accounting for Abnormal Loss of Goods

(i) Profit & Loss A/c Dr. *(With irrecovered loss)*

Insurance company's A/c Dr. *(With the claim admitted by insurance company)*

To Consignment A/c *(With the total loss)*

[Being abnormal loss accounted for]

- (ii) Cash/Bank A/c Dr. (With the claim recovered)
 To Insurance Co.'s A/c
 [Being the claim received]

13. On accounting for Profit/Loss on Consignment

- (i) *In case of profit*
 Consignment A/c Dr. (With the amount of profit)
 To Profit & Loss A/c
 [Being the profit on Consignment transferred]
- (ii) *In case of loss*
 Profit & Loss A/c Dr. (With the amount of loss)
 To Consignment A/c
 [Being the loss on Consignment transferred]

14. On transfer of Goods Sent on Consignment Account

- Goods sent on Consignment A/c Dr.
 To Trading A/c
 [Being the Goods Sent on Consignment A/c t/f to Trading A/c]

15. On transfer of Discount Account (raised on discounting a Bills Receivable received from Consignee)

- Profit & Loss A/c Dr.
 To Discount A/c
 [Being the Discount A/c t/f to Profit & Loss A/c]

14.0 FORMAT OF CONSIGNMENT ACCOUNT IN CONSIGNOR'S BOOKS

DR. **CONSIGNMENT TO ... (NAME OF CITY) ... ACCOUNT** CR.

Particulars	₹	Particulars	₹
To Goods Sent on Consignment A/c	xxx	By Consignee's A/c (Sale Proceeds)	xxx
To Bank A/c (Consignor's Expenses)	xxx	By Goods damaged-in-transit A/c (Cost)	xxx
To Consignee's A/c (Expenses):		By Goods destroyed by Fire A/c (Cost)	xxx
Unloading Expenses	xxx	By Consignment Stock A/c:	
Landing & Clearing	xxx	In hand	xxx
Transport upto godown	xxx	In transit	xxx
Godown Rent	xxx		xxx
Establishment Expenses	xxx		
Selling & Distribution Exp.	xxx		
Advertisement Expenses	xxx		
To Consignee's A/c (Bad Debts)	xxx		
[where Consignee does not get Del-credare Commission]			
To Consignee's A/c:			
Normal Commission @ ...	xxx		
Del Credare Commission @ ...	xxx		
Over-riding Commission @ ...	xxx		
To Profit t/f to P&L A/c	xxx		
	xxx		xxx

15.0 FORMAT OF CONSIGNEE'S ACCOUNT IN CONSIGNOR'S BOOKS

DR.

CONSIGNEE'S ACCOUNT

CR.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Consignment A/c (sales)	xxx	By Bills Receivable A/c	xxx
To Goods damaged in Transit A/c (Sale Proceeds of Damaged Goods)	xxx	By Consignment A/c (Exp.)	xxx
		By Consignment A/c (Comm.)	xxx
To Goods destroyed by Fire A/c [Claim received by Consignee]	xxx	By Goods Damaged in Transit A/c (Commission on Sale of Damaged Goods)	xxx
		By Goods Damaged in Transit A/c (Cost of Repairs)	xxx
		By Bank A/c (Remittance)	xxx
		By Balance c/d	xxx
	xxx		xxx

16.0 ACCOUNTING TREATMENT IN THE BOOKS OF THE CONSIGNEE

The various accounting entries which may be required to be passed in the books of Consignee are summarised below:

1. On providing Security to Consignor

Consignor's A/c

To Cash/Bank/Bills Payable A/c

[Being the security provided to Consignor]

Dr. (With the amount of Security
to Consignor)**2. On incurring Expenses on behalf of Consignor**

Consignor's A/c

To Cash/Bank A/c

[Being the expenses incurred on behalf of Consignor]

Dr. (With the amount of expenses
incurred)**3. On Sale of Goods on behalf of Consignor**

Cash A/c/Consignment Debtors A/c

To Consignor's A/c

[Being the Goods sold on behalf of Consignor]

Dr. (With the amount of Sales)

4. On Receipt of Payment from Consignment Debtors

Cash/Bank A/c

To Consignment Debtors A/c

[Being the amount collected from Consignment Debtors]

Dr. (With the amount collected
from Consignment Debtors)**5. On non-realisation of any Book Debts****(i) Because of dispute regarding quality, quantity, delivery etc.**

Consignor's A/c

To Consignment Debtors A/c

[Being the debts not realised due to....]

Dr.

- (b) Expenses incurred by the Consignor towards loading freight, insurance, etc: ₹ 47,500.
- (c) A drew a bill on B for ₹ 50,000 payable on 30th June which B accepted. The bill was discounted by A with his bankers on 31st Jan. at 18 per cent p.a.
- (d) Expenses incurred by the Consignee: Unloading charges ₹ 4,900, Clearing charges ₹ 3,900, Carriage Inward ₹ 1,000, Storage ₹ 1,450, Office & Adm. Expenses ₹ 5,000, Selling & Distribution Expenses ₹ 10,000.
- (e) Goods sold by the Consignee: 2500 units @ ₹ 25 per unit for cash, 5,000 units @ ₹ 32.50 per unit on credit. Consignee collected full payment from all credit customers except one to whom 200 units were sold because insolvent and paid only 75 paise in a rupee.
- (f) B remitted the amount due to A after deducting his 5% commission (including 2% del-credere commission) on 31st Jan. 2018.

Required: (i) to pass necessary journal entries in the books of A & B and (ii) Prepare necessary ledger accounts in the books of A and B assuming that Consignee is not required to maintain proportionate security with the Consignor for the unsold stock.

SOLUTION:

JOURNAL OF A

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2018 Jan. 1	Consignment to Barelli A/c To Goods sent on Consignment A/c (Being 10,000 units @ ₹ 20 sent on consignment)	Dr.		2,00,000	2,00,000
	Consignment to Barelli A/c To Bank A/c (Being ₹ 47,500 for carriage, freight, Insurance, etc. paid)	Dr.		47,500	47,500
	Bills Receivable A/c To B's A/c (Being the acceptance of B/R received from B)	Dr.		50,000	50,000
	Bank A/c Discount A/c To Bills Receivable A/c (Being the Bill discounted @ 18% p.a.)	Dr. Dr.		46,250 3,750	50,000
Jan. 31	Consignment to Barelli A/c To B's A/c (Being the expenses incurred by B)	Dr.		26,250	26,250
	B's A/c To Consignment to Barelli A/c (Being 2,500 units @ ₹ 25 and 5000 units @ ₹ 32.50 sold by B as per Account sales)	Dr.		2,25,000	2,25,000
	Consignment to Barelli A/c To B's A/c (Being commission due @ 5% on sales)	Dr.		11,250	11,250
	Bank A/c To B's A/c (Being the amount received in full settlement of account)	Dr.		1,37,500	1,37,500

Consignment Stock A/c To Consignment to Barelli A/c (Being the unsold stock accounted for)	Dr.	64,325	64,325
Consignment to Barelli A/c To Profit and Loss A/c (Being profit on Consignment transferred to P & L A/c)	Dr.	4,325	4,325
Goods sent on Consignment A/c To Trading A/c (Being transfer of Goods sent on Consignment A/c to Trading A/c)	Dr.	2,00,000	2,00,000
Profit & Loss A/c To Discount A/c (Being transfer of Discount A/c to Profit & Loss A/c)	Dr.	3,750	3,750

LEDGER ACCOUNTS

Dr.

CONSIGNMENT TO BARELLI ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Goods sent on Consign.. A/c	2,00,000	By B (Sales Proceeds)	2,25,000
To Bank A/c (expenses)	47,500	By Consignment Stock A/c	64,325
To B (expenses):			
Unloading Charges	4,900		
Clearing Charges	3,900		
Carriage Inward	1,000		
Storage Expenses	1,450		
Office & Adm. Expenses	5,000		
Selling & Distribution Expen..	10,000		
To B (Commission @ 5% on 2,25,000)	11,250		
To Profit t/f to P & L A/c	4,325		
	2,89,325		2,89,325

DR.

B's ACCOUNT

CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Consignment to Barelli A/c (sales)	2,25,000	By Bills Receivable A/c	50,000
		By Consignment to Barelli A/c (Exp.)	26,250
		By Consignment to Barelli A/c (Comm.)	11,250
		By Bank A/c	1,37,500
	2,25,000		2,25,000

DR.

GOODS SENT ON CONSIGNMENT ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Trading A/c (transfer)	2,00,000		2,00,000

DR.

CONSIGNMENT STOCK ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Consignment to Barelli A/c	64,325	By Balance c/d	64,325
	64,325		

DR.

AN EXTRACT OF TRADING AND PROFIT & LOSS ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Purchases	?	By Sales (by Consignor)	?
To Gross Profit c/d	?	By Goods Sent on Consignment A/c	2,00,000
	?		?
To Discount	3,750	By Gross Profit b/d	?
To other expenses (by Consignor)	?	By Consignment to Barelli A/c	4,325
		Barelli A/c (Comm.)	11,250
To Net Profit	?	(Profit on consignment)	
	?		?

Working Note: Calculation of value of Unsold Stock

Particulars	Units	₹
A. Cost of Goods Sent	10,000	2,00,000
B. Add: Expenses incurred by Consignor	—	47,500
C. Total Cost of Goods Sent (A + B)	10,000	2,47,500
D. Add: Non-recurring Expenses incurred by Consignee		9,800
E. Total cost of Goods available for sale (C + D)	10,000	2,57,300
F. Cost of unsold stock (₹ 2,57,300 × 2500/10,000)	2,500	64,325

JOURNAL OF B

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018 Jan. 1	A's A/c To Bills Payable A/c (Being the acceptance of Bill given to A)	Dr.	50,000	50,000
	A's A/c To Bank A/c (Being the expenses incurred on consignment)	Dr.	26,250	26,250
	Bank A/c/Consignment Debtors A/c To A's A/c (Being 2500 units sold @ ₹ 25 for cash and 5000 units @ ₹ 32.50 on credit)	Dr.	2,25,000	2,25,000

Jan 31	A's A/c To Commission A/c (Being the commission on sales @ 5% due from A)	Dr.	11,250	11,250
	Bank A/c	Dr.	1,60,875	
	Bad Debts A/c To Consignment Debtors A/c (Being amount received from credit customers & an amount of ₹ 1,625 [i.e., 25% of (200 ₹ 32.50)] became bad)	Dr.	1,625	1,62,500
	A's A/c To Bank A/c (Being the amount remitted A in full settlement)	Dr.	1,37,500	1,37,500
	Commission A/c To Profit and Loss A/c (Being the Commission Account transferred to P & L A/c)	Dr.	11,250	11,250
	Profit & Loss A/c To Bad Debts A/c (Being the Bad Debts Account transferred to P & L A/c)	Dr.	1,625	1,625

LEDGER ACCOUNTS

DR. **A'S ACCOUNT** CR.

Particulars	₹	Particulars	₹
To Bills Payable A/c	50,000	By Bank A/c/Consignment Debtors A/c (Sales)	2,25,000
To Bank A/c (Expenses)	26,250		
To Commission A/c	11,250		
To Bank A/c (Balance remitted)	1,37,500		
	2,25,000		2,25,000

DR. **COMMISSION ACCOUNT** CR.

Particulars	₹	Particulars	₹
To Profit & Loss A/c	11,250	By A	11,250

DR. **AN EXTRACT OF PROFIT AND LOSS ACCOUNT** CR.

Particulars	₹	Particulars	₹
To Bad Debts	1,625	By Commission	11,250

ILLUSTRATION 11 [WHEN GOODS ARE CONSIGNED AT COST PRICE AND CONSIGNEE IS REQUIRED TO MAINTAIN PROPORTIONATE SECURITY]

What shall be the change in the solution of Illustration 10 if in this Illustration, Consignee is required to maintain proportionate security with the Consignor for the unsold stock?

SOLUTION:

DR.

B'S ACCOUNT IN THE BOOKS OF A

CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Consignment to Barelli A/c (sales)	2,25,000	By Bills Receivable A/c	50,000
To Balance c/d (security for unsold goods) (₹ 50,000 × 2,500/10,000)	12,500	By Consignment to Barelli A/c (Expenses)	26,250
		By Consignment to Barelli A/c (Comm.)	11,250
		By Bank A/c	1,50,000
	2,37,500		2,37,500

DR.

A'S ACCOUNT IN THE BOOKS OF B

CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bills Payable A/c	50,000	By Bank A/c/Consignment	50,000
To Bank A/c (Expenses)	26,250	Debtors A/c (Sales)	2,25,000
To Commission A/c	11,250	By Balance c/d	12,500
To Bank A/c	1,50,000	(Security for unsold goods) (₹ 50,000 × 2,500/10,000)	11,250
	2,37,500		2,37,500

ILLUSTRATION 12

Miss Rakhi consigned 1,000 radio sets costing ₹ 900 each to Miss Geeta, her agent on 1st Jan Miss Rakhi incurred the following expenditure on sending the consignment.

Carriage ₹ 650, Freight ₹ 7,000, Insurance 3,250

Miss Geeta received the delivery of 950 radio sets. Account Sale dated 30th May, showed that 750 sets were sold for ₹ 9,00,000 and Miss Geeta incurred ₹ 3,000 for carriage and ₹ 7,500 for customs duty at the time of taking the delivery. Miss Geeta was entitled to commission @ 6% on the sales effected by her. She incurred expenses amounting to ₹ 2,500 for repairing the damaged radio sets remaining in the stock. Miss Rakhi lodged a claim with the insurance company which was admitted at ₹ 35,000. Show Consignment Account and Miss Geeta's Account in the books of Miss Rakhi.

SOLUTION

Dr.

CONSIGNMENT ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Goods sent on Consignment A/c	9,00,000	By Miss Geeta	9,00,000
To Bank A/c:		By Insurance Co. (recovered abnormal loss)	35,000
Carriage 650		By Profit & Loss A/c (Irrecovered abnormal loss)	10,545
Freight 7,000		By Consignment Stock A/c	1,84,391
Insurance 3,250	10,900		
To Miss Geeta:			
Carriage 3,000			
Customs Duty 7,500			
Repairs 2,500			
Commission 54,000	67,000		
To Profit & Loss A/c (Profit)	1,52,036		
	11,29,936		11,29,936

Dr.

MISS GEETA'S ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Consignment A/c (Sales)	9,00,000	By Consignment A/c (Expenses):	50,000
		Carriage	3,000
		Customs Duty	7,500
		Repairs	2,500
		Commission	54,000
		By Balance c/d	8,33,000
	9,00,000		9,00,000

Working Notes:

- (i) Valuation of lost goods and unsold goods

	Lost Goods (50)	Unsold Goods (200)
A. Cost of sets @ ₹ 900	45,000	1,80,000
B. Add: Proportionate expenses of the Consignor @ ₹ 10.90	545	2,180
C. Add: Proportionate carriage and customs duty paid by the Consignee @ 11.0526	—	2,211
	<u>45,545</u>	<u>1,84,391</u>

- (ii) Irrecovered Loss = Cost of Abnormal loss – Claim from insurance Co.
= ₹ 45,545 – ₹ 35,000 = ₹ 10,545

ILLUSTRATION 13

Shri Mehta of Bombay consigns 1,000 cases of goods costing ₹ 100 each to Sri Sundaram of Madras. Shri Mehta pays the expenses in connection with consignment: Carriage ₹ 1,000, Freight ₹ 3,000, Loading charges ₹ 1,000. Sri Sundaram sells 700 cases at ₹ 140 per case and incurs the following expenses. Clearing charges ₹ 850, Warehousing and storage ₹ 1,700, Packing & selling expenses 600. It is found that 50 cases have been lost in transit and 100 cases are still in transit. Sri Sundaram is entitled to a commission of 10% on gross sales. Draw up the Consignment Account and Sundaram's Account in the books of Sri Mehta.

SOLUTION:

DR.

CONSIGNMENT TO MADRAS ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c	1,00,000	By Sundaram (Sales)	98,000
To Bank (Expenses)	5,000	By P & L A/c (Loss in Transit)	5,250
To Sundaram (Expenses)	3,150	By Consignment Stock A/c:	
To Sundaram (Commission)	9,800	In hand 150 cases 15,900	
To Profit on Consignment		In transit 100 cases 10,500	26,400
t/f to Profit & Loss A/c	11,700		
	1,29,650		1,29,650

DR.

SUNDARAM'S ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Consignment to Madras A/c (Sales)	98,000	By Consignment to Madras A/c (Expenses)	3,150 5,250
		By Consignment to Madras A/c (Commission)	9,800
		By Balance c/d	85,050
	98,000		98,000

Working Note: Calculation of Cost of Loss-in-transit, Goods-in-transit and Goods in hand

Particulars	Loss in transit (50 Units)	Goods in transit (100 Units)	Goods in hand (150 Units)
A. Cost of Units @ ₹ 100	5,000	10,000	15,000
B. Add: Consignor's proportionate expenses @ ₹ 5	250	500	750
C. Add: Consignee's proportionate expenses @ Re. 1	—	—	150
D. Total Cost	5,250	10,500	15,900

ILLUSTRATION 14

M of Mathura, consigned 5,000 kg of oil costing ₹ 20 per kg to S of Surat. M paid ₹ 25,000 as freight and insurance. 125 kg of oil was destroyed in transit. The insurance claim was settled at ₹ 2,250 and was paid directly to the Consignors.

S took delivery of consignment and accepted a Bill drawn upon them by M for ₹ 50,000. S reported as follows:

- 3,750 kg. were sold at ₹ 30 per kg
- His expenses were: Godown Rent ₹ 10,000, Wages ₹ 1,000, Printing & Stationery, ₹ 5,000
- 125 kg were lost due to leakage which is quite normal. S is entitled to a commission of 5% on the sales effected. S paid the amount due in respect of the consignment. Show the Consignment Account, the account of S and the Abnormal Loss Account in the books of M for the year ended 31st March.

SOLUTION

DR.

CONSIGNMENT TO MADRAS ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c	1,00,000	By Loss in Transit A/c (cost of 125 kg.)	3,125
To Cash A/c (freight & insurance)	25,000	By S (Sales)	1,12,500
To S A/c		By Consignment Stock A/c	25,658
Expenses incurred 16,000		By P & L A/c (Loss)	5,342
Commission 5,625	21,625		
	1,46,625		1,46,625

DR.

S'S ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Goods sent on	1,00,000	By Loss in Transit A/c	3,125
To Consignment to Madras A/c (Sales)	1,12,500	By Bills Receivable A/c	50,000
		By Consignment to Madras A/c:	
		Expenses	16,000
		Commission	5,625
		By Bank A/c	40,875
		(Balance remitted)	
	1,12,500		1,12,500

DR.

LOSS IN TRANSIT ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Consignment to Madras A/c	3,125	By Insurance Claim (recovered)	2,250
		By Profit & Loss A/c (irrecovered)	875
	3,125		3,125

Working Note: Calculation of Cost of Closing Stock

	Units	₹
A. Cost of 5,000 kg, @ ₹ 20	5,000	1,00,000
B. Add: Consignor's Expenses (Freight & insurance)	—	25,000
C. Total Cost of 5,000 kg. (A + B)	5,000	1,25,000
D. Less: Cost of 125 kg lost in transit (₹ 1,25,000 × 125/5,000)	125	3,125
E. Cost of 4,875 kg that have reached the city of Consignee (C – D)	4,875	1,21,875
F. Less: Normal Loss	125	—
G. Cost of 4,750 kg available for sale (since 125 kg is normal loss)	4,750	1,21,875
H. Cost of 1,000 kg in hand (₹ 1,21,875 × 1,000/4,750)	1,000	25,658

ILLUSTRATION 15

A of Agra, who entered into some consignment transactions with B of Bareilly, provides you the following information.

- Goods consigned: 10,000 units @ ₹ 20 per unit on 1.1.2018.
- Expenses incurred by the Consignor towards loading freight, insurance, etc: ₹ 47,500.
- A drew a bill on B for ₹ 50,000 payable on 30th June which B accepted. The bill was discounted by A with his bankers on 31st Jan. at 18 per cent p.a.
- Expenses incurred by the Consignee: Unloading charges ₹ 4,900, Clearing charges ₹ 3,900, Carriage Inward ₹ 1,000, Storage ₹ 1,450, Office & Adm. Expenses ₹ 5,000, Selling & Distribution Expenses ₹ 10,000.
- "Consignee reported that—
 - 2500 units were sold @ ₹ 25 per unit for cash, 5,000 units were sold @ ₹ 32.50 per unit on credit. Full payments were collected from all credit customers except one to whom 200 units were sold became insolvent and paid only 75 paise in a rupee.

- (ii) 100 units of goods are still in transit,
- (iii) 100 units of goods sent were lost in transit and Insurance Co. had admitted to pay ₹ 1,800 in full settlement of the claim,
- (iv) 100 units of goods lost by fire in his godown, and Insurance Co. had admitted to pay ₹ 1,800 in full settlement,
- (v) 100 units of goods lost in his godown due to inherent nature of goods.
- (f) B remitted the amount due to A after deducting his 5% commission (including 2% del-credere commission) on 31st Jan. 2018.

Required: Prepare Consignment Account, Loss in transit Account and Loss due to Fire Account and Trading and Profit & Loss Account.

SOLUTION

DR. **CONSIGNMENT TO BARELLI ACCOUNT** CR.

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c	2,00,000	By B (Sales Proceeds)	2,25,000
To Bank A/c (Expenses)	47,500	By Loss-in-transit A/c (100 units)	2,475
To B (Expenses)		By Loss due to fire A/c (100 units)	2,575
Unloading charges	4,900	By Consignment Stock A/c:	
Clearing charges	3,900	In hand (2100 units) 54,638	
Carriage Inward	1,000	In transit (100 units) 2,475	57,113
Storage Expenses	1,450		
Office & Adm. Expenses	5,000		
Selling & Distribution Expenses	10,000		
To B (Commission @ 5% on ₹ 2,25,000)	11,250		
To Profit t/f to P & L A/c	2,163		
	2,87,163		2,87,163

DR. **LOSS-IN-TRANSIT ACCOUNT** CR.

Particulars	₹	Particulars	₹
To Consignment to Barelli A/c	2,475	By Insurance Co (Recovered Loss)	1,800
		By P & L A/c (Irrecovered Loss)	675
	2,475		2,475

DR. **LOSS DUE TO FIRE ACCOUNT** CR.

Particulars	₹	Particulars	₹
To Consignment to Barelli A/c	2,575	By Insurance Co. (Recovered Loss)	1,800
		By P & L A/c (Irrecovered Loss)	775
	2,575		2,575

DR.

AN EXTRACT OF TRADING AND PROFIT AND LOSS ACCOUNT

CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Purchases	?	By Sales (by Consignor)	?
To Gross Profit c/d	?	By Goods sent on Consignment A/c	2,00,000
	?		?
To Discount	3,750	By Gross Profit b/d	?
To Loss-in-transit	675	By Consignment to Barelli A/c	
To Loss due to Fire	775	(Profit on Consignment)	2,163
To Net Profit	?		
	?		?

Working Note:**STATEMENT SHOWING THE CALCULATION OF ABNORMAL LOSS AND UNSOLD STOCK**

<i>Particulars</i>	<i>Units</i>	₹
A. Cost of Goods Sent	10,000	2,00,000
B. Expenses incurred by Consignor	—	47,500
C. Total Cost of Goods Sent (A + B)	10,000	2,47,500
D. Less: Cost of Goods not reached the city of Consignee		
(a) Cost of Goods lost-in-transit ($2,47,500 \times 100/10,000$)	100	2,475
(b) Cost of Goods still-in-transit ($2,47,500 \times 100/10,000$)	100	2,475
E. Cost of Goods reached the city of Consignee (C – D)	9,800	2,42,550
F. Add: Non-Recurring Expenses incurred by Consignee		
[4,900 + ₹ 3,900 + ₹ 1,000]	—	9,800
G. Cost of Goods received by Consignee (E + F)	9,800	2,52,350
H. Less: Cost of Goods lost in Consignee's Godown	100	2,575
[₹ 2,52,350 $\times$ 100/9,800]		
I. Less: Expected Normal Loss (in Units)	100	—
J. Cost of Goods available for sale [G – H – I]	9,600	2,49,775
K. Cost of Goods Unsold Stock [₹ 2,49,775 $\times$ 2,100/9,600]	2,100	54,638
	(App.)	

17.0 INVOICE PRICE AND LOADING**MEANING OF INVOICE PRICE**

Sometimes, the Consignor does not want to reveal the Cost of Goods to the Consignee and therefore, invoices goods at a price which is higher than the Cost Price (CP). Such price is known as 'Invoice Price' (IP).

MEANING OF LOADING

The difference between the Invoice Price (IP) and the Cost Price (CP) is called 'loading'.

IS INVOICE PRICE SAME AS SELLING PRICE?

It may also be noted that Invoice Price need not necessarily be same as selling price unless the Consignor directs the Consignee to sell the goods at the invoice price itself.

Goods sent on Consignment A/c	Dr.	(With the amount of Profit
To Consignment A/c		included in goods sent)
[Being profit included in Goods sent eliminated]		

Consignment A/c	Dr.	(With the amount of profit
To Consignment Stock Reserve A/c		included in unsold closing stock)
[Being profit included in unsold Closing Stock eliminated]		

Consignment Stock Reserve A/c Dr. (With the amount of profit
 To Consignment Stock A/c included in Unsold Opening Stock)
[Being profit included in unsold opening stock eliminated]

Consignment A/c	Dr.	(With the amount of Profit
To Goods Sent on Consignment A/c		included in Goods Returned)
[Being profit included in Goods returned eliminated]		

<i>DR.</i>	CONSIGNMENT TO ... (NAME OF CITY) ... ACCOUNT	<i>CR.</i>

<i>Particulars</i>		₹	<i>Particulars</i>	₹
To Goods Sent on Consignment A/c		xxx	By Consignee's A/c (Sale Proceeds)	xxx
To Bank A/c (Consignor's Expenses)		xxx	By Goods damaged-in-transit A/c (Cost)	xxx
To Consignee's A/c (Expenses):			By Goods destroyed by Fire A/c (Cost)	xxx
Unloading Expenses xxx			By Consignment Stock A/c:	
Landing & Clearing xxx			In hand xxx	
Transport upto godown xxx			In transit <u>xxx</u>	xxx
Godown Rent xxx			By Goods sent on Consignment A/c	
Establishment Expenses xxx			[Loading on Goods Sent]	xxx
Selling & Distribution Exp. <u>xxx</u>				
Advertisement Expenses xxx		xxx		
To Consignee's A/c (Bad Debts)		xxx		
[where Consignee does not get Del-credere Commission]				
To Consignee's A/c:				
Normal Commission @ ... xxx				
Del Credere Commission @ xxx				

Over-riding Commission @ <u>xxx</u>	xxx		
To Consignment Stock Reserve A/c			
[Loading on closing stock]	xxx		
To Profit t/f to P&L A/c	xxx		
	xxx		xxx

ILLUSTRATION 16 [CALCULATION OF INVOICE PRICE AND LOADING]

Calculate Invoice Price and loading in each of the following alternative cases:

- Goods sent on Consignment ₹ 1,20,000 (Cost), Goods are invoiced at cost plus 25%.
- Goods sent on Consignment ₹ 2,40,000 (Cost), Goods are invoiced at 25% above cost.
- Goods sent an Consignment ₹ 4,80,000 (Cost), Goods are invoiced at 125% of the Cost Price.
- Goods sent on Consignment ₹ 1,20,000 (Cost), Goods are invoiced to give a gross margin of 20% on invoice price.

SOLUTION:

Case	Invoice Price = Cost + Profit	Loading (Profit) $= \text{Total Invoice Price} \times \frac{\text{Profit}}{100 + \text{Profit}}$
(a)	₹ 1,20,000 + 25% of ₹ 1,20,000 = ₹ 1,50,000	₹ 1,50,000 × 25/125 = ₹ 30,000
(b)	₹ 2,40,000 + 25% of ₹ 2,40,000 = ₹ 3,00,000	₹ 3,00,000 × 25/125 = ₹ 60,000
(c)	₹ 4,80,000 × 125/100 = ₹ 6,00,000	₹ 6,00,000 × 25/125 = ₹ 1,20,000
(d)	If Invoice Price = ₹ 100, Profit = ₹ 20, Cost Price = ₹ 80 Thus, ₹ 1,20,000 × 100/80 = ₹ 1,50,000	₹ 1,50,000 × 20/100 = ₹ 30,000

ILLUSTRATION 17 [CALCULATION OF COST PRICE AND LOADING]

Calculate the Cost Price and Loading in each of the following alternative cases:

- Goods Sent on Consignment ₹ 1,50,000 (Invoice Price), Goods are invoiced to give a gross margin of 20% on Invoice Price.
- Goods sent on Consignment ₹ 3,00,000 (Invoice Price), Goods are invoiced at cost plus 25%.

SOLUTION:

Case	Invoice Price – Profit	Loading(Profit) $= \text{Total Invoice Price} \times \frac{\text{Profit}}{100 + \text{Profit}}$
(a)	₹ 1,50,000 – 20% of ₹ 1,50,000 = ₹ 1,20,000	₹ 1,50,000 × 20/100 = ₹ 30,000
(b)	If Cost = ₹ 100, Profit = ₹ 25 Invoice Price = ₹ 125 ₹ 3,00,000 × 100/125 = ₹ 2,40,000	₹ 3,00,000 × 25/125 = ₹ 60,000

ILLUSTRATION 18 [WHEN GOODS ARE CONSIGNED AT INVOICE PRICE]

A of Agra, who entered into some consignment transactions with B of Barelli, provides you the following information.

- Goods consigned: 10,000 units @ ₹ 25 per unit on 1st April. The proforma invoice was made by adding 25% to cost.
- Expenses incurred by the Consignor towards loading, freight, insurance etc.-₹ 47,500.
- A drew a bill on B for ₹ 50,000 payable on 30th September which B accepted. The bill was discounted by A with his bankers on 30th April at 18 per cent p.a.
- Expenses incurred by the Consignee: Unloading charges ₹ 4,900, Clearing charges ₹ 3,900, Carriage Inwards ₹ 1,000, Storage Expenses ₹ 1,450, Office & Adm. Expenses ₹ 5,000, Selling & Distribution Expenses ₹ 10,000.
- Goods sold by the Consignee: 2500 units @ ₹ 25 per unit for cash, 5,000 units @ ₹ 32.50 per unit on credit. Consignee collected full payments from all credit customers except one to whom 200 units were sold became insolvent and paid only 75 paise in a rupee.
- B remitted the amount due to A after deducting his 5% commission (including 2% del credere commission) on 30th April.

Required: Prepare the Consignment to Barelli Account in the books of A.

SOLUTION:

DR.

CONSIGNMENT TO BARELLI ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c	2,50,000	By B (Sale Proceeds)	2,25,000
To Bank A/c (Expenses)	47,500	By Consignment Stock A/c	76,825
To B (Expenses):		By Goods sent on Consignment A/c	50,000
Unloading charges	4,900	(10,000 units × ₹ 5) (Loading)	
Clearing charges	3,900		
Carriage Inward	1,000		
Storage Expenses	1,450		
Office & Adm Expenses	5,000		
Selling & Distribution expenses	10,000		
To B (Commission @ 5% on ₹ 2,25,000)	11,250		
To Consignment Stock Reserve A/c	12,500		
(2500 units × ₹ 5)			
To Profit t/f to P & L A/c	4,325		
	3,51,825		3,51,825

Working Note: Calculation of Value of Unsold Stock

Particulars	Units	₹
A. Cost of Goods Sent	10,000	2,00,000
B. Add: Expenses incurred by Consignor	—	47,500
C. Total Cost of Goods Sent (A + B)	10,000	2,47,500
D. Add: Non-recurring expenses incurred by Consignor	—	9,800

E.	Total Cost of Goods available for sale (C + D)	10,000	2,57,300
F.	Cost of Unsold Stock ($\text{₹ } 2,57,300 \times 2500/10,000$)	2,500	64,325
G.	Add: Loading (2500 units $\times$ ₹ 5)		12,500
H.	Invoice value of Unsold Stock (F + G)		76,825

ILLUSTRATION 19 [WHEN GOODS ARE CONSIGNEED AT INVOICE PRICE AND GOODS ARE LOST]

Taking the same information as given in previous Illustration, alongwith the following information, prepare Consignment Account, Loss-in-transit Account and Loss due to Fire Account.

“Consignee also reported that—

- 100 units of goods are still-in-transit;
- 100 units of goods sent were lost in transit and Insurance Co. had admitted to pay ₹ 1,800 in full settlement of the claim,
- 100 units of goods lost by fire in his godown and Insurance Co. had admitted to pay ₹ 1,800 in full settlement of the claim.
- 100 units of goods lost in his godown due to inherent nature of goods.”

SOLUTION

DR.

CONSIGNMENT TO BARELLI ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Goods Sent on Consignment A/c	2,50,000	By B (Sale Proceeds)	2,25,000
To Bank A/c (Expenses)	47,500	By Loss-in-transit A/c (100 units)	2,475
To B (Expenses)		By Loss due to Fire A/c (100 units)	2,575
Unloading Expenses	4,900	By Consignment Stock A/c:	
Clearing charges	3,900	In hand (2,100 units) 65,138	
Carriage Inwards	1,000	In transit (100 units) 2,975	68,113
Storage Expenses	1,450	By Goods Sent on Consignment A/c	50,000
Office & Adm. Expenses	5,000	(10,000 units $\times$ ₹ 5) (Loading)	
Selling & Distribution Expenses	10,000		
To B (Consignment @ 5% on ₹ 2,25,000)	11,250		
To Consignment Stock Reserve A/c (2,200 Units $\times$ ₹ 5)	11,000		
To Profit t/f to P & L A/c	2,163		
	3,48,163		3,48,163

DR.

LOSS-IN-TRANSIT ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Consignment to Barelli A/c	2,475	By Insurance Co (Recovered Loss)	1,800
		By P & L A/c (Irrecovered Loss)	675
	2,475		2,475

DR.

LOSS DUE TO FIRE ACCOUNT

CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Consignment to Barelli A/c	2,575	By Insurance Co. (Recovered Loss)	1,800
		By P & L A/c (Irrecovered Loss)	775
	2,575		2,575

Working Notes:**1. CALCULATION OF ABNORMAL LOSS AND UNSOLD STOCK**

<i>Particulars</i>	<i>Units</i>	₹
A. Cost of Goods Sent	10,000	2,00,000
B. Expenses incurred by Consignor	—	47,500
C. Total Cost of Goods Sent (A + B)	10,000	2,47,500
D. Less: Cost of Goods not reached the city of Consignee		
(a) Cost of Goods lost-in-transit ($2,47,500 \times 100/10,000$)	100	2,475
(b) Cost of Goods still-in-transit ($2,47,500 \times 100/10,000$)	100	2,475
E. Cost of Goods reached the city of Consignee (C – D)	9,800	2,42,550
F. Add: Non-Recurring Expenses incurred by Consignee [4,900 + ₹ 3,900 + ₹ 1,000]	—	9,800
G. Cost of Goods received by Consignee (E + F)	9,800	2,52,350
H. Less: Cost of Goods lost in Consignee's Godown [₹ 2,52,350 $\times$ 100/9,800]	100	2,575
I. Less: Expected Normal Loss (in Units)	100	—
J. Cost of Goods available for sale [G – H – I]	9,600	2,49,775
K. Cost of Goods Unsold Stock [₹ 2,49,775 $\times$ 2,100/9,600]	2,100	54,638
	(App.)	

2. CALCULATION OF INVOICE VALUE OF GOODS-IN-TRANSIT AND UNSOLD STOCK

<i>Particulars</i>	<i>Goods-in-transit (100 units) ₹</i>	<i>Unsold Stock (2100 units) ₹</i>
A. Cost	2,475	54,638
B. Add: Loading @ ₹ 5 per unit	500	10,500
C. Invoice Value [A + B]	2,975	65,138

ILLUSTRATION 20

On 1st Dec., goods which cost X ₹ 33,000 were consigned by him to his agent Y at a proforma price which was 20% over cost. X paid insurance and freight charges amounting to ₹ 1,250. Y was allowed ₹ 3,000 per annum towards establishment cost, 5% commission on gross sales and 3% del credere commission. He was also allowed 5% extra commission on the profit on such consignment sales after charging such commission. Y incurred an expense of ₹ 255 as landing charges.

3/4ths of goods were sold at 33% profit on cost, half of which were on credit; half of the balance of goods was damaged and a claim on insurance company was made for ₹ 4,400 which was settled at a discount of 10%.

Required: Prepare a Consignment Account and an Abnormal Loss Account in the books of X for the year ended 31st March.

SOLUTION:

DR.

CONSIGNMENT ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Goods sent on Consignment (33,000 × 120/100)	39,600	By Mahesh A/c	
To Bank A/c	1,250	Cash Sales 16,500	
(Insurance & Forwarding changes)		Credit Sales 16,500	33,000
[1/2 × 1/4 × (33,000 +		By Stock Lost on Consignment A/c	4,313
To Y's A/c:		1,250 + 255]	
Establishment 1,000		By Consignment Stock	5,138
Commission 1,650		[1/2 × 1/4 × (33,600 +	
(5% on ₹ 33,000)		1,250 + 255]	
Del-credere		By Goods sent on Consignment A/c	6,600
Commission 990	3,895	(Total Load =	
(3% on ₹ 33,000)		(₹ 39,600 – ₹ 33,000)	
To Stock Reserve A/c (₹ 6,600 × 1/8)	825		
To Y's (Extra Consignment))	165		
To Profit on Consignment (transferred to P&L A/c)	3,316		
	49,051		49,051

DR.

STOCK LOST ON CONSIGNMENT ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Consignment to Barelli A/c	4,313	By Insurance Co. (Recovered Loss) (90% of ₹ 4,400)	3,960
		By P & L A/c (Irrecovered Loss)	353
	4,313		4,313

ILLUSTRATION 21

Tulsian Traders of Delhi purchased 10,000 pieces of sarees @ ₹ 100 per saree. Out of these sarees, 6,000 sarees were sent on consignment to Vastralaya of Jabalpur at the selling price of ₹ 120 per saree. The Consignors paid ₹ 3,000 for packaging and freight. Vastralaya sold 5,000 sarees @ ₹ 125 per saree and incurred ₹ 1,000 for selling expenses and remitted ₹ 5,00,000 to Delhi on account. They are entitled to a commission of 5% on total sales plus a further 20% commission on any surplus price realised over ₹ 120 per saree. 3,000 sarees were sold at ₹ 110 per saree. Owing to depression in the market the selling price (₹ 120) of sarees has come down by 10%. Prepare the Consignment Account and Trading, Profit and Loss Account in the books of Tulsian Traders and their account in the books of the agents Messrs Vastralaya of Jabalpur.

SOLUTION

DR.

CONSIGNMENT TO JABALPUR ACCOUNT

CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Goods sent on Consignment A/c	7,20,000	By Vastralaya's A/c (Sales)	6,25,000
To Bank A/c (Expenses)	3,000	By Goods Sent on Consignment A/c	
To Vastralaya's A/c (Expenses)	1,000	(₹ 6,000 × ₹ 20)	1,20,000
To Vastralaya's A/c (Commission)	36,250	By Consignment Stock A/c	1,00,500
To Profit on Consignment t/f to Profit & Loss A/c	85,250		
	8,45,500		8,45,500

DR.

TRADING AND PROFIT AND LOSS ACCOUNT FOR THE PERIOD ENDING ON...

CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Purchases	10,00,000	By Sales (3,000 × ₹ 110)	3,30,000
To Gross Profit c/d	30,000	By Goods Sent on Consig.	6,00,000
		By Closing Stock (at cost being lower than NRV i.e. 108)	1,00,000
	10,30,000		10,30,000
To Net Profit	1,15,250	By Gross Profit b/d	30,000
		By Consignment to Jabalpur A/c (Profit on Consignment)	85,250
	11,45,250		11,45,250

TULSIAN TRADERS (DELHI)'S ACCOUNT

DR.

IN THE BOOKS OF VASTRALAYA (JABALPUR)

CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Cash A/c/Bank A/c (Expenses)	1,000	By Cash/Debtors (sales)	6,25,000
To Commission A/c	36,250		
To Bank A/c	5,00,000		
To Balance c/d	87,750		
	6,25,000		6,25,000

Working Notes :

1. Commission payable = 5% on ₹ 6,25,000 + 20% on ₹ 25,000
= ₹ 31,250 + ₹ 5,000 = ₹ 36,250

2. Valuation of Closing Stock as if there is no depression

A	Cost of 1,000 sarees @ ₹ 100 (1000 × ₹ 100)	1,00,000
B	Add: Proportionate expenses incurred by Consignor (1,000 × ₹ 3,000/6,000)	500
		<u>1,00,500</u>

3. Net Realisable Value

A	Realizable Value of Stock ($1,000 \times ₹ 108$)	1,08,000
B	Less: Realization Expenses (5% of ₹ 1,08,000)	5,400
C	Net Realizable Value (A – B)	<u>1,02,600</u>

4. Valuation of Closing Stock at ₹ 1,00,500 or ₹ 1,02,600 whichever is lower
ILLUSTRATION 22

X of Delhi purchased 10,000 meters of cloth for ₹ 2,00,000 of which 5,000 meters were sent on consignment to Y of Agra at the selling price of ₹ 30 per meter. X paid ₹ 5,000 for freight and ₹ 500 for packing, etc. Y sold 4,000 meters at ₹ 40 per meter and incurred ₹ 2,000 for selling expenses. Y is entitled to a commission of 5% on total sale proceeds plus a further 20 per cent on any surplus price realised over ₹ 30 per meter. 3,000 meters were sold at Delhi @ ₹ 30 per meter less ₹ 3,000 for expenses and commission. Owing to fall in market price, the stock of cloth in hand is to be reduced by 10 per cent. Prepare the Consignment Account and Trading and Profit & Loss Account in Books of X and his account in the books of Y.

SOLUTION:
DR.
CONSIGNMENT TO AGRA ACCOUNT
CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Goods sent on Consignment A/c ($5,000 \times ₹ 30$)	1,50,000	By Y's A/c (Sales)	1,60,000
To Cash A/c (Expenses)	5,500	By Goods sent on Consignment A/c ($5,000 \times ₹ 10$)	50,000
To Y's A/c (Expenses)	2,000	By Consignment Stock	
To Y's A/c (Commission)	16,000	($1,000 \times ₹ 20$)	20,000
To Profit on Consignment t/f to Profit & Loss A/c	55,490	Add: Expenses	1,100
		Less: 10%	<u>2,110</u>
	<u>2,28,990</u>		<u>18,990</u>
			<u>2,28,990</u>

DR.
TRADING AND PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDING ON...
CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Purchases	2,00,000	By Sales	90,000
To Gross Profit c/d	26,000	By Goods sent on Consignment	1,00,000
		By Closing Stock	
		Cost ($2,000 \times ₹ 20$)	40,000
		Less: 10%	<u>4,000</u>
	<u>2,26,000</u>		<u>36,000</u>
			<u>2,26,000</u>
To Expenses	3,000	By Gross Profit b/d	26,000
To Net Profit	78,490	By Consignment to Agra A/c (Profit)	55,490
	<u>81,490</u>		<u>81,490</u>

DR.

X'S ACCOUNT IN THE BOOKS OF Y

CR.

Particulars	₹	Particulars	₹
To Cash A/c (Selling Expenses)	2,000	By Cash A/c (Sales)	1,60,000
To Commission A/c	16,000		
To Balance c/d	1,42,000		
	1,60,000		1,60,000

3,60,900

ILLUSTRATION 23

'X' of Delhi purchased 10,000 pieces of Sarees @ ₹ 100 per Saree. Out of these Sarees, 6,000 were sent on consignment to 'Y' of Agra at a selling price of ₹ 120 per Saree. The Consignor paid ₹ 3,000 for packing and freight.

'Y' sold 5,000 Sarees at ₹ 125 per Saree and incurred ₹ 1,000 for selling expenses and remitted ₹ 5,00,000 to Delhi on account. They are entitled to a commission of 5% on total sales plus a further 20% commission on any surplus price realised over ₹ 120 per Saree.

3,000 Sarees were sold in Delhi at ₹ 110 per Saree. Owing to fall in market price, the value of stock of Sarees in hand is to be reduced by 10%.

Required: Prepare the Consignment Account in the books of 'X' and their account in the book of the agent 'Y' of Agra.

SOLUTION:

DR.

CONSIGNMENT ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c (6,000 × ₹ 120)	7,20,000	By Y-Sales (5,000 × ₹ 125)	6,25,000
To Bank A/c-Expenses	3,000	By Goods sent on Consignment A/c-Loading	
To Y-Selling Expenses 1,000		(6,000 × ₹ 20) 1,20,000	
Commission 36,250	37,250	By Stock on Consignment	1,08,450
To Stock Reserve	18,000		
To Net Profit	75,200		
	8,53,450		8,53,450

DR.

X'S ACCOUNT IN THE BOOKS OF 'Y' OF AGRA

CR.

Particulars	₹	Particulars	₹
To Bank A/c (Expenses)	1,000	By Bank A/c (Sales)	6,25,000
To Commission	36,250		
To Bank A/c (Remittance)	5,00,000		
To Balance c/d	87,750		
	6,25,000		6,25,000

Working Notes:

- (i) Commission Payable = 5% on ₹ 6,25,000 + 20% on ₹ (6,25,000 – 6,00,000 = 25,000)
= ₹ 31,250 + ₹ 5,000 = ₹ 36,250

(ii) Valuation of Closing Stock on Consignment	
1,000 sarees × ₹ 120	1,20,000
Add: Proportionate expenses	500
	1,20,500
Less: 10%	12,050
Value of Closing Stock	1,08,450
(iii) Loading on Closing Stock (Stock Reserve)	
1,000 sarees × ₹ 20	20,000
Less: 10%	2,000
	18,000

ILLUSTRATION 24

X of Calcutta on 15th January sent to Y of Bombay a consignment of 250 televisions costing ₹ 10,000 each. Expenses of ₹ 7,000 were met by the Consignor. Y of Bombay spent ₹ 4,500 for clearance on 30th January and the selling expenses were ₹ 500 per television as and when the sale made by Y.

Y sold, on 4th March, 150 televisions @ ₹ 14,000 per television and again on 10th April, 75 televisions @ ₹ 14,400.

Mr Y was entitled to a commission of ₹ 500 per television sold plus one-fourth of the amount by which the gross sale proceeds less total commission there on exceeded a sum calculated at the rate of ₹ 12,500 per television sold. Y sent the account sale and the amount due to X on 30th April by bank demand draft. Prepare the Consignment Account and Y's account in the books of X.

SOLUTION:

DR. **CONSIGNMENT TO BOMBAY ACCOUNT** CR.

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c	25,00,000	By Y's A/c (Sales):	
To Bank A/c (Expenses)	7,000	150 @ ₹ 14,000	21,00,000
To Y's A/c:		75 @ ₹ 14,400	10,80,000
Clearance 4,500			
Selling Expenses 1,12,500	1,17,000	By Consignment Stock A/c:	
To Y's A/c (Commission)	1,63,500	Cost of 25 TV	
To Profit & Loss A/c		@ ₹ 10,000	2,50,000
(Profit on Consignment)	6,43,650	Add: Consignor's Exp.	
		(7,000 × 25/250)	700
		Add: Consignee's Exp.	
		(4,500 × 25/250)	450
			2,51,150
	34,31,150		34,31,150

Dr. **Y's ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Consignment to Bombay A/c (Sales)	31,80,000	By Consignment to Bombay A/c:	
		Clearance 4,500	
		Selling Expenses 1,12,500	1,17,000
		By Consignment to Bombay A/c (Comm.)	1,63,500
		By Bank A/c	28,99,500
	31,80,000		31,80,000

Working Notes: Calculation of Consignee's Commission

1. Fixed Commission @ ₹ 500 = $225 \times ₹ 500 = ₹ 1,12,500$
2. Let the total Commission be X
 Variable Commission = $[(₹ 31,80,000 - X) - (225 \times ₹ 12,500)]$
 $X - ₹ 1,12,500 = [₹ 31,80,000 - X - ₹ 28,12,500]$
 $X - ₹ 1,12,500 = (₹ 3,67,500 - X)$
 $X - ₹ 1,12,500 = 91,875 - X$
 $X - 1,12,500 = 91,875 - .25 X$
 $1.25 X = 2,04,375$
 $X = ₹ 2,04,375 / 1.25 = 1,63,500$

SOLVED PROBLEMS**PROBLEM 1**

Mr A and Mr B entered into an agreement whereby Mr A was to purchase second hand cars from Mumbai and to send the same to Mr B of Delhi who was to sell after reconditioning on consignment basis .

1. Mr A purchased 102 cars-50% @ ₹ 30,000 and the balance @ ₹ 38,000.
2. Mr A paid freight & insurance charges of ₹ 1,02,000 on sending the cars to Mr B.
3. Mr A immediately drew upon Mr B a bill of ₹ 10,00,000 for 3 months. The acceptance was discounted @ 18% p.a.
4. During transit two cars met with an accident and the insurance company paid the actual cost less 10% as claim amount to Mr A.
5. Mr B reconditioned the cars by spending the following amounts:
 Air-conditioning (10 cars) ₹ 3,00,000
 Labour, paint and other expenses ₹ 15,00,000
6. During testing, one non-A/C car met with an accident and the insurance company paid the actual cost less 10% as claim amount to Mr B.
7. Mr B sold the cars as follows:
 9 A.C. cars at a profit of 100% on cost.
 81 Non-A.C. cars at a profit of 60% on sales.
 One customer to whom one AC Car was sold became insolvent and paid only 50%
8. Mr B retained one non-AC car for his personal use which was priced at actual cost.
9. Mr B was entitled to 5% commission on sales.
10. Mr B sent a Bank Draft for the balance.

Required: Prepare Consignment to Delhi Account and Mr B's Account.

SOLUTION:

DR.

CONSIGNMENT TO DELHI ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c		By Mr B (Sales):	
51 @ ₹ 30,000 15,30,000		9 AC Car 14,40,000	
51 @ ₹ 38,000 19,38,000	34,68,000	81 Non-AC Cars 1,01,25,000	1,15,65,000
To Bank A/c (Freight & Insurance)	1,02,000	By Bank (Claim)	
To Mr B (Air-conditioning)	3,00,000	(₹ 70,000 – 10%)	63,000
To Mr B (Expenses)	15,00,000	By P&L A/c (Loss)	7,000
To Mr B (Bad Debts)	80,000	By Mr B (Claim) (₹ 50,000 – 10%)	45,000
To Mr B (Commission)	5,78,250	By P&L A/c (Loss)	5,000
To Profit t/f to P&L A/c	61,36,750	By Mr B (Car for Personal use)	50,000
		By Consignment Stock A/c	
		1 AC Car 80,000	
		7 Non-AC Car 3,50,000	4,30,000
	1,21,65,000		1,21,65,000

DR.

MR B'S ACCOUNT IN THE BOOKS OF MR A

CR.

Particulars	₹	Particulars	₹
To Consignment to Delhi A/c (Sales)	1,15,65,000	By Bills Receivable A/c	10,00,000
To Consignment to Delhi A/c (Claim)	45,000	By Consignment to Delhi A/c	5,250
To Consignment to Delhi A/c (Car for Pvt. use)	50,000	(Air-conditioners)	3,00,000
		By Consignment to Delhi A/c (Exp.)	15,00,000
		By Consignment to Delhi A/c	26,400
		(Bad Debts)	80,000
		By Consignment to Delhi A/c	5,78,250
		(Commission)	11,250
		By Bank A/c	82,01,750
	1,16,60,000		1,16,60,000

Working Note: Calculation of Cost and Sale Price of AC and Non AC car

	AC	Non AC
A. Average Cost of Purchase (51 × ₹ 30,000 + 51 × ₹ 38,000)/(51 + 51)	34,000	34,000
B. Add: Freight & Insurance (₹ 1,02,000/102)	1,000	1,000
C. Total Cost in transit	35,000	35,000
D. Add: Air Conditioners (₹ 3,00,000/10)	30,000	–
Labour, Paint & Other Exp. (₹ 15,00,000/100)	15,000	15,000
E. Total Cost of a Car	80,000	50,000
F. Add: Profit @ 100% on Cost	80,000	–
Profit @ 60% on Sales	–	75,000
G. Sale Price of a Car [E + F]	1,60,000	1,25,000

PROBLEM 2

On 1st September goods of the cost of ₹ 2,64,000 were consigned by Shri Shyamlal of Bangalore to his agent Shri Mahesh of Cochin at proforma invoice price of 20% profit on cost price. Shri Shyamlal paid insurance and other forwarding charges on consignment amounting to ₹ 10,000. Shri Mahesh was allowed ₹ 2,000 being establishment cost. He was entitled to 5% commission on gross sales and an additional 3% Delcredere commission on credit sales only. Shri Mahesh made an expense of ₹ 2,040 as landing charges.

Three fourth of the goods were sold at $33\frac{1}{3}\%$ profit on cost, half of which were credit sales. One half of the balance of goods were destroyed by fire and a claim lodged for ₹ 28,000 was settled at a discount of 10%. The balance of goods were in stock. Show the Consignment Account and the Stock Loss on Consignment Account as on 31st Dec. in the books of Shri Shyamlal.

SOLUTION:

DR.

CONSIGNMENT ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Goods sent on Consignment (2,64,000 × 120/100)	3,16,800	By Mahesh A/c	
To Bank A/c (Insurance & Forwarding changes)	10,000	Cash Sales 1,32,000	
To Shri Mahesh A/c:		Credit Sales 1,32,000	2,64,000
Establishment 2,000		By Stock Lost on Consignment A/c	34,505
Landing charges 2,040		[$1/2 \times 1/4 \times [2,64,000 + 10,000 + 2,040]$]	
Commission 13,200		By Consignment Stock	41,105
(5% on ₹ 2,64,000)		[$1/2 \times 1/4 \times (3,16,800 +$	
Del-credere Commission 3,960	21,200	10,000 + 2,040)]	
(3% on ₹ 1,32,000)		By Goods sent on Consignment A/c	52,800
To Stock Reserve A/c (₹ 52,800 × 1/8)	6,600	(₹ 3,16,800 – ₹ 2,64,000)	
To Profit on Consignment (transferred to P&L A/c)	37,810		
	3,93,010		3,93,010

DR.

STOCK LOST ON CONSIGNMENT ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Consignment A/c	34,505	By Insurance Company (claim) (90% of ₹ 28,000)	25,200
		By P&L A/c	9,305
	34,505		34,505

PROBLEM 3

Ramesh consigned 2,000 MT of chemicals at a cost of ₹ 800 per MT to John, Ramesh paid freight and insurance charges of ₹ 20,000. Of the above 500 MT of chemicals were destroyed by fire during transit. John cleared the balance of 1,500 MT of chemicals and sold 1,000 MT at an average price

of ₹ 1,000 per MT. John incurred the following expenses. Godown Rent ₹ 5,000, Insurance ₹ 3,000, Clearing Charges ₹ 4,500. Insurance claim received against fire ₹ 4,00,000 after admitting the salvage value of Stock destroyed by fire at ₹ 10,000. John was entitled to a commission of 10% on sale proceeds. John sends the balance to Ramesh after adjusting his commission and expenses out of the sales proceeds, Prepare a Consignment Account and John's Account in the books of Ramesh.

SOLUTION:
DR. CONSIGNMENT TO JOHN ACCOUNT CR.

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c	16,00,000	By John's (Sales)	10,00,000
To Bank (Freight and Insurance)	20,000	By Abnormal Loss A/c	
To John's A/c (Commission)	1,00,000	(₹ 4,05,000 – ₹ 10,000)	3,95,000
To John's A/c (Godown Rent)	5,000	By Consignment Stock A/c:	
To John's A/c (Insurance)	3,000	Normal Stock	4,06,500
To John's A/c (Clearing Charges)	4,500	Salvaged Stock	10,000
To Profit and Loss A/c (Profit)	79,000		
	18,11,500		18,11,500

DR. JOHN'S ACCOUNT CR.

Particulars	₹	Particulars	₹
To Consignment to John A/c (Sale Proceeds)	10,00,000	By Consignment to John A/c:	
		Godown Rent	5,000
		Insurance	3,000
		Clearing Charges	4,500
		Commission	1,00,000
		By Bank A/c (Balance remitted)	8,87,500
	10,00,000		10,00,000

Working Note: Valuation of Goods Destroyed and Unsold Goods

Particulars	Goods Destroyed (500 MT) ₹	Unsold Goods (500 MT) ₹
A Cost (500 × ₹ 800)	4,00,000	4,00,000
B Proportionate Freight and Insurance (₹ 20,000 × 500/2,000)	5,000	5,000
C Proportionate Clearing Charges (₹ 4,500 × 500/1500)	—	1,500
D Total	4,05,000	4,05,000

PROBLEM 4

Rahim of Bombay consigned to Raju of Madras, goods to be sold at invoice price which represents 125% of cost. Raju is entitled to a commission of 10% on sales at invoice price and 25% of any excess realised over invoice price. The expenses on freight and insurance incurred by Rahim were ₹ 10,000. The account sales received by Rahim shows that Raju effected sales aggregating to ₹ 1,00,000 in respect of 75% of the consignment. His selling expenses to be reimbursed were ₹ 8,000. 10% of the consignment goods

of the value of ₹ 12,500 were destroyed in fire at the Madras godown and the Insurance Company paid ₹ 12,000 net of salvage. Raju remitted the balance in favour of Rahim. Prepare Consignment Account and the Account of Raju in the books of Rahim along with necessary workings.

SOLUTION:**DR.****CONSIGNMENT TO MADRAS ACCOUNT****CR.**

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Goods sent on Consignment A/c	1,25,000.00	By Raju's A/c (Sales)	1,00,000.00
To Bank A/c (Freight & Insurance)	10,000.00	By Loss due to Fire A/c	11,000.00
To Raju's A/c (Expenses Incurred)	8,000.00	By Consignment Stock A/c	20,250.00
To Raju's A/c (Commission)	10,937.50	By Goods sent on Consignment	25,000.00
To Consignment Stock Reserve A/c	3,750.00	[₹ 1,25,000 × 20/100]	
		By Profit & Loss A/c (Loss)	1,437.50
	1,57,687.50		1,57,687.50

DR.**RAJU'S ACCOUNT****CR.**

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Consignment to Madras A/c (Sales)	1,00,000.00	By Consignment to Madras A/c (Expenses)	8,000.00
To Loss due to Fire A/c (Insurance Claim)	12,000.00	By Consignment to Madras A/c (Commission)	10,937.50
	1,12,000.00	By Bank A/c (Balance remitted)	93,062.50
			1,12,000.00

Working Notes:

- (i)
- Invoice Value of Total Goods sent on Consignment*

(Invoice Value of Goods destroyed × 10)	1,25,000.00

- (ii)
- Calculation of Consignee's Commission*

A Sale Proceeds received by Raju on 75% of Consignment	1,00,000.00
B Invoice Value of 75% of Consignment (75% of 1,25,000)	93,750.00
C Excess sale price realised by Raju (A – B)	6,250.00
D Commission payable to Raju	
@ 10% on Invoice value of ₹ 93,750	9,375.00
@ 25% on Excess sale price realised	1,562.50
	10,937.50

- (iii)
- Calculation of Unsold Stock (being 15%)*

A Invoice value of Stock (₹ 1,25,000 × 15/100)	18,750
B Add: Proportionate Freight and Insurance (₹ 10,000 × 15/100)	1,500
C Value of Stock on Consignment (A + B)	20,250

- (iv)
- Stock Reserve at 25% on cost (₹ 18,750 × 25/125)*

	3,750

- (v)
- Calculation of Abnormal Loss*

A Cost price of goods destroyed (₹ 12,500 × 80/100)	10,000
B Add: Proportionate Freight and Insurance (₹ 10,000 × 10/100)	1,000
	11,000

PROBLEM 5

On 1st April, 2017 Mantu of Madras consigned goods of the value of ₹ 50,000 to Pandey of Patna. The proforma invoice was made by adding 25% to the cost. Mantu paid thereon ₹ 2,500 for freight and ₹ 1,500 for insurance. During transit one-tenth of the goods were totally destroyed by fire and a sum of ₹ 2,400 was realised from the insurance company. On arrival of the goods, Pandey paid ₹ 1,800 as Carriage Inward. During the year ended 31st March, 2018. Pandey paid ₹ 3,600 for godown rent and ₹ 1,900 for selling expenses. One-ninth of the remaining goods were again destroyed by fire in godown and nothing was recovered from the Insurance Company. On 1st March, 2018, Pandey sold half the original goods for ₹ 30,000 and charged a commission of 5% on sales. On 31st March, 2018 Pandey sent a Bank Draft to Mantu for the amount so far due from him. Prepare (a) Consignment to Patna Account, (b) Goods destroyed by Fire Account, and (c) Personal Account of Pandey.

SOLUTION:
DR. CONSIGNMENT TO PATNA ACCOUNT CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Goods sent on Consignment A/c	50,000	By Pandey's A/c (Sales)	30,000
To Cash A/c:		By Goods Destroyed by fire A/c	9,000
Freight	2,500	By Consignment Stock A/c	16,800
Insurance	1,500	By Goods sent on Consignment	10,000
To Pandey's A/c:		A/c (₹ 50,000 × 20/100)	
Carriage Inwards	1,800		
Godown Rent	3,600		
Selling Expenses	1,900		
To Pandey's A/c (Commission)	1,500		
(5% on ₹ 30,000)			
To Consignment Stock Reserve A/c	3,000		
(12,000 × 25/100)			
	65,800		65,800

Note: There is no normal profit or loss on Consignment.

DR. GOODS DESTROYED BY FIRE ACCOUNT CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Consignment to Patna A/c:		By Cash: (Insurance claim for goods lost in transit)	2,400
In transit:	4,400	By Profit and Loss A/c	
In godown:	4,600	(Irrecovered Abnormal loss)	6,600
	9,000		9,000

DR.

PANDEY'S ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Consignment to Patna A/c (Sales)	30,000	By Consignment to Patna A/c:	
		Expenses	7,300
		Commission	1,500
		By Bank A/c (Bank Draft)	21,200
	30,000		30,000

Working Note: Valuation of goods destroyed and Closing Stock

Particulars		Goods destroyed in-transit ₹	Goods destroyed in godown ₹	Unsold stock ₹
A	Cost of goods	4,000 (40,000 × 1/10)	4,000 (36,000/1/9)	12,000 (40,000 – 4,000 – 4,000 – 20,000)
B	Consignor's proportionate expenses	400 (4,000 × 4,000/40,000)	400 (4,000 × 4,000/40,000)	1,200 (4,000 × 12,000/40,000)
C	Consignee's proportionate expenses	—	200 (1,800 × 4,000/36,000)	600 (1,800 × 12,000/36,000) 3,000
D	Load	4,400	4,600	16,800

PROBLEM 6

A Co. Ltd manufactures and deals in edible oil, consigned to their Bangalore agent, 1,000 crates of oil (each crate containing 12 one-kilo sachets) in March. The consignment was sent at 20% over the cost price of ₹ 30 per kilo. A bill was drawn on the agent for 80% of the value of the consignment which was met on presentation. Expenses incurred by the company by way of freight and insurance came to ₹ 12,000. The agent received the consignment by lorry and sold in March, 900 crates at a profit margin of 25% on his cost (excluding consignor's expenses). He found that 500 sachets had got damaged in transit—the manufacturer accepted this as abnormal loss—and these were sold to consumers at ₹ 20 per sachet. The insurance company settled the loss claim for ₹ 2,500. Agent incurred expenses of ₹ 5,000 on his own account (unconnected with the liability under the agreement) and ₹ 3,000 on consignor's account. He is entitled to a commission of 5% on sales effected. By 15th April, the agent remitted the balance due by him to the company. Draw the accounts in the books of A Co. Ltd., to record the above transactions.

SOLUTION:

DR.

CONSIGNMENT TO BANGALORE ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c	4,32,000	By Bangalore Agent's A/c	
To Bank A/c (expenses)	12,000	(900 × 12 × 45)	4,86,000
To Consignment Stock Reserve A/c (700 × ₹ 6)	4,200	By Bangalore Agent's A/c (500 × ₹ 20)	10,000
To Bangalore Agent's A/c Expenses	3,000	By Loss in Transit A/c (500 × ₹ 11)	5,500

Particulars	₹	Particulars	₹
To Consignment to Banagalore A/c		By Bank A/c (Insurance claim)	2,500
[500 × ₹ 11]	5,500	By Profit and Loss A/c (Transfer)	3,000
	5,500		5,500

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Consignment to Bangalore A/c	72,000	By Consignment to Bangalore A/c	4,32,000
To Trading A/c (Transfer)	3,60,000		
	4,32,000		4,32,000

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Consignment to Bangalore A/c (900 × 12 × ₹ 45)	4,86,000	By B/R A/c (Remittance)	3,45,600
To Consignment to Bangalore A/c (500 × ₹ 20)	10,000	By Consignment to Bangalore A/c (Expenses & Commission)	27,800
		By Bank A/c (Remittance)	1,22,600
	4,96,000		4,96,000

(i) Cost of goods sent on consignment = 1,000 crates $\times$ 12 one – kilo sachets $\times$ ₹ 30
= ₹ 3,60,000

(ii) Invoice value of Goods sent on Consignment = ₹ 3,60,000 + 20% of ₹ 3,60,000
= ₹ 4,32,000

PROBLEM 7

A consigned goods to B costing ₹ 1,00,000. The proforma invoice was made so as to show a profit of 25 per cent on cost. A paid freight and Insurance ₹ 2,000. B sold part of consignment for ₹ 88,000 at uniform price of 10 per cent over invoice price and spent ₹ 3,000 as warehousing charges, ₹ 1,000 as selling expenses. B is entitled to a commission of 5 per cent on sales and 20 per cent of the net profit after charging such commission on sales. B paid the amount due by bank draft. Draw up the Consignment Account and B's Account in the books of A.

SOLUTION:**DR.****CONSIGNMENT ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Goods sent on Consignment A/c	1,25,000	By B's A/c (Sales Proceeds)	88,000
To Bank A/c (Freight and Insurance)	2,000	By Goods Sent on Consignment A/c	25,000
To B's A/c (Expenses):	4,000	(₹ 1,25,000 × 20/100)	
Commission 4,400		By Consignment Stock A/c	45,720
Share of Profit <u>2,864</u>	7,264		
To Consignment Stock Reserve A/c			
(45,000 × 25,000/1,25,000)	9,000		
To Profit & Loss A/c (Profit)	11,456		
	<u>1,58,720</u>		<u>1,58,720</u>

Working Notes:

- (i) *Calculation of value of Unsold Stock* ₹
- | | |
|---|---------------|
| A Invoice Value of Unsold Stock (₹ 1,25,000 – ₹ 80,000) | 45,000 |
| B Proportionate freight & Insurance (₹ 2,000 × 45,000/1,25,000) | 720 |
| C Unsold Stock (A + B) | <u>45,720</u> |
- (ii) Agent's share of profit = 20% of ₹ 14,320 = ₹ 2,864

PROBLEM 8

Krishnamurthy requests you to prepare a Consignment Account for the year ended 31st March and for the purpose gives you the following information to ascertain the profit earned on consignment.

(a) Agent's commission @ 5% on gross sales 20,000, (b) Cost of goods fully damaged in transit (Insurance claim recovered ₹ 18,000) 20,000, (c) Expenses incurred by the agent: Godown Rent ₹ 400, Landing & Clearing ₹ 1,000 Advertisements ₹ 200, Carriage Inward ₹ 900, Selling expenses ₹ 1,000, (d) Freight expenses incurred by Krishnamurthy 2,000, (e) Cost of unsold stock lying with agent at the end of the year 60,000 (f) All sales were effected by the agent at a profit of 25% on cost.

SOLUTION:**DR.****CONSIGNMENT ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Goods sent on Consignment A/c	4,00,000	By Agent's A/c (20,000 × 100/5)	4,00,000
To Bank A/c (Freight)	2,000	By Goods damaged in Transit A/c	20,100
To Agent's A/c (Expenses):		By Consignment Stock A/c	60,600
Godown rent 400			
Landing & clearing 1,000			
Advertisements 200			
Carriage Inward 900			
Selling expenses <u>1,000</u>	3,500		
To Agent's A/c (Commission)	20,000		
(5% on ₹ 4,00,000)			
To Profit & Loss A/c (Profit)	55,200		
	<u>4,80,700</u>		<u>4,80,700</u>

Working Notes:

(i) Calculation of Cost of goods sent on Consignment		₹
A Gross Sales		4,00,000
B Less: Gross Profit ($₹ 4,00,000 \times 20/100$)		80,000
C Cost of goods sold (A – B)		3,20,000
D Add: Cost of goods damaged		20,000
E Add: Cost of unsold stock		60,000
F Cost of goods sent on Consignment (C + D + E)		<u>4,00,000</u>
(ii) Calculation of Value of goods damaged	Damaged Goods	Unsold Goods
A Cost (given)	20,000	60,000
B Add: Proportionate expenses of Consignor (freight) @ 5%	100	300
C Add: Proportionate expenses of Agent (Landing and Clearing and Carriage Inward)	—	300
[$1,900 \times 60,000 / (4,00,000 - 20,000)$]	<u>20,100</u>	<u>60,600</u>

PROBLEM 9

The account sales received from an agent disclosed that the total sales effected by him during 2017-2018 amounted to ₹ 4,50,000. This included ₹ 3,12,500 for sales made at invoice price which is cost *plus* 25% and the balance at 10% above the Invoice price. He incurred expenses to the tune of ₹ 5,000 out of which a sum of ₹ 1,800 is recurring in nature. Forwarding expenses of the Consignor totalled ₹ 2,400. The Agent had remitted the balance due from him through Bank Draft after deducting the expenses, 5% commission on gross sales, Bad debts ₹ 850 and Bills Payable accepted by him for ₹ 10,000. The value of unsold stock at original cost lying with the Agent as on 31st March, 2018 amounted to ₹ 50,000. Prepare the Consignment Account and the Agents' Account in the Books of the Consignor.

SOLUTION:
DR.
CONSIGNMENT ACCOUNT
CR.

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c	5,00,000	By Agent's A/c (Gross Sales)	4,50,000
To Bank A/c (Exp.)	2,400	By Goods sent on Consignment A/c (₹ 5,00,000 – ₹ 4,00,000)	1,00,000
To Agent's A/c (Expenses)		By Consignment Stock A/c	63,200
Recurring 1,800			
Non-Recurring <u>3,200</u>	5,000		
To Agent's A/c (Commission)	22,500		
To Agent's A/c (Bad Debt)	850		
To Consignment Stock Reserve A/c [₹ 50,000 $\times$ 25/100]	12,500		
To Profit & Loss A/c (Profit)	69,950		
	<u>6,13,200</u>		<u>6,13,200</u>

DR.**AGENT'S ACCOUNT****CR.**

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Consignment A/c (Gross Sales)	4,50,000	By Consignment A/c (Exp)	5,000
		By Consignment A/c (Comm)	22,500
		By Consignment A/c (Bad Debts)	850
		By Bills Receivable A/c	10,000
		By Bank A/c (Draft sent)	4,11,650
	4,50,000		4,50,000

Working Notes:

- (i)
- Calculation of Invoice value of goods consigned*

	₹
A Invoice Price of Sale of ₹ 3,12,500	3,12,500
B Invoice Price of remaining sales [₹ 4,50,000 – ₹ 3,12,500) × 100/110]	<u>1,25,000</u>
C Total Invoice Price of goods sold (A + B)	4,37,500
D Total Cost price of goods sold [₹ 4,37,500 × 100/125]	3,50,000
E Add: Cost Price of unsold stock (given)	<u>50,000</u>
F Total Cost Price of Goods consigned (D + E)	4,00,000
G Total Invoice Price of goods consigned: [₹ 4,00,000 × 125/100]	<u>5,00,000</u>
H Total Load [₹ 5,00,000 – ₹ 4,00,000]	1,00,000

- (ii)
- Value of Unsold Stock*

A Invoice Price (₹ 50,000 × 125/100)	62,500
B Add: Proportionate Consignor's expenses: [2,400 × 50,000/4,00,000]	300
C Add: Proportionate Consignor's Non-Recurring expenses [3,200 × 50,000/4,00,000]	400
	<u>63,200</u>

PROBLEM 10

On 5th Aug. Zuben consigns 2,000 Cassettes to Suzie costing ₹ 15 each. The following invoice is made out to him at a figure to show a gross profit of 20% on sales, below which the consignee is not allowed to sell. On 25th Aug., the consignee sells half the consignment at a profit of 25% on sales. The expenses are:

5th Aug. Freight and insurance ₹ 1,500 (paid by consignor); 28th Aug. Landing charge, import duty, etc. ₹ 1,000 (paid by consignee). The Consignee is entitled to a commission of 5% on sales and to 1/6th of profits after both commission and share of profits. On 31st Aug. Suzie remits a sight draft for the balance to settle his account. Show the necessary accounts in the books of Consignor.

SOLUTION:**DR.****CONSIGNMENT ACCOUNT****CR.**

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Goods Sent on Consignment A/c (2,000 × ₹ 18.75)	37,500	By Suzie's A/c (Sales) (1,000 × ₹ 20)	20,000
To Bank A/c (Exp.)	1,500	By Consignment Stock A/c	20,000

To Suzie's A/c (Exp.)	1,000	By Goods sent on Consignment A/c	7,500
To Suzie's A/c		(2,000 × ₹ 3.75)	
Commission	1,000		
Share of Profit	393		
<u>To Consignment Stock Reserve</u>	<u>3,750</u>		
A/c (1,000 × ₹ 3.75)			
To Profit & Loss A/c (Profit)	2,357		
	47,500		47,500

DR. GOODS SENT ON CONSIGNMENT ACCOUNT CR.

Particulars	₹	Particulars	₹
To Consignment A/c (Load)	7,500	By Consignment A/c	37,500
To Trading A/c (Transfer)	30,000		
	37,500		37,500

DR. SUZIE'S ACCOUNT CR.

Particulars	₹	Particulars	₹
To Consignment A/c (Sales)	20,000	By Consignment A/c	
		(Landing charges, Import duty, etc.)	1,000
		By Consignment A/c:	
		Commission	1,000
		Share of profit	393
		<u>By Bank (Sight draft)</u>	<u>17,607</u>
	20,000		20,000

DR. CONSIGNMENT STOCK ACCOUNT CR.

Particulars	₹	Particulars	₹
To Consignment A/c	20,000	By Balance c/d	20,000

DR. CONSIGNMENT STOCK RESERVE ACCOUNT CR.

Particulars	₹	Particulars	₹
To Balance c/d	3,750	By Consignment A/c	3,750

Working Notes:

- (i) Calculation of Invoice Price and Load per Cassette

Let invoice Price be X

Invoice Price = Cost + Load; Invoice Price – Load = Cost, X — 1/5 X = ₹ 15

X = 15 × 5/4 = ₹ 18.75; Load = ₹ 18.75 – ₹ 15 = ₹ 3.75

- (ii) Calculation of Sale Price per cassette

Let Sale Price be X, X – 1/4 X = ₹ 15, X = 15 × 4/3 = ₹ 20

- (iii) Value of Closing Stock

Invoice Price of 2,000 cassettes (2,000 × ₹ 18.75) ₹ 37,500

Add: Freight and Insurance ₹ 1,500

Landing charges, Import duty, etc. ₹ 1,000 ₹ 2,500

Value of 2,000 Cassettes	₹ 40,000
Value of Closing Stock $(40,000 \times 1,000/2,000)$	₹ 20,000
(iv) <i>Amount of Consignee's Commission and Share of profit</i>	
A Total of Credit side of Consignment A/c	₹ 47,500
B Less: Total of Debit side of Consignment A/c (excluding Commission and Share of Profit)	₹ 43,750
C Surplus subject to Commission and Share of Profit (A – B)	₹ 3,750
D Less: Commission @ 5% of ₹ 20,000	₹ 1,000
E Profit after Commission but before Share of Profit (C – D)	₹ 2,750
F Less: Share of Profit (1/7th of ₹ 2,750)	₹ 393
G Profit after Commission and Share of Profit on Consignment (E – F)	₹ 2,357

PROBLEM 11

On 31st March, 2017 CAMII P. Ltd., a trading organisation owned inventory costing ₹ 3 lakhs of which inventory valued ₹ 1 lakh was with consignees. It also has in its possession inventory valued at ₹ 10 lakhs belonging to its own principals.

During the year ended 31st March, 2018 CAMII P. Ltd.:

- purchased inventory worth ₹ 50 lakhs of which 80% was despatched to its consignees, the transportation cost being 5% of the value of goods sent;
- received from its principals inventory of ₹ 150 lakhs;
- sold 90% of *own goods* received and lying with itself at 20% margin on sales;
- sold on behalf of principals 95% of goods available at 120% of the value thereof. CAMII P. Ltd. is entitled to commission at 10% of such sales.

The consignees sold at 125% of their per unit landed cost (consignees spending nil) 95% of goods available with them and were entitled to commission at 10% of sales.

Required: Prepare Consignment Account and Profit & Loss Account in the books of CAMII Ltd. for the year ended 31st March, 2018.

SOLUTION:**DR.****CONSIGNMENT ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Opening Stock	1,00,000	By Sales	
To Good sent on consignment	40,00,000	[43,00,000 × 95% × 125%]	51,06,250
To Transportation cost	2,00,000	By Closing Stock	
To Commission [51,06,250 × 10%]	5,10,625	[43,00,000 × 5%]	2,15,000
To Profit	5,10,625		
	53,21,250		53,21,250

REVENUE STATEMENT OF CAMII (P.) LTD.,
FOR THE YEAR ENDED 31ST MARCH, 2018

DR.

CR.

Particulars	₹	Particulars	₹
To Opening Stock	2,00,000	By Sales	13,50,000
To Purchases	50,00,000	By Good sent on consignment	
To Profit	26,04,625	[50,00,000 × 80%]	40,00,000
		By Closing Stock [12,00,000 × 10%]	1,20,000
		By Profit on consignment	5,10,625
		By Commission	
		[60,00,000 × 95% 120% × 10%]	18,24,000
	78,04,625		78,04,625

Working Note: Calculation of Sales and Commission

Particulars		Goods held as Trader ₹	Goods held by Consignee ₹	Goods held as Consignee ₹
A	Opening Stock	2,00,000	1,00,000	10,00,000
B	Goods Purchased/Received	50,00,000	40,00,000	150,00,000
C	Less: Goods Sent to consignee	(40,00,000)	—	—
D	Add: Transportation cost [5% of 40,00,000]	—	2,00,000	—
E	Cost of Goods available for sale [A + B – C + D]	12,00,000	43,00,000	160,00,000
F	Less: Closing Stock	1,20,000	2,15,000	8,00,000
		[10% of 12,00,000]	[5% of 4,30,000]	[5% of 160,00,000]
G	Cost of Goods sold [E – F]	10,80,000	40,85,000	152,00,000
H	Sales	13,50,000	51,06,250	182,40,000
		[10,80,000 × 100/80]	[125% of 40,85,000]	[120% of 152,00,000]
I	Commission @ 10% on Sales		5,10,625	18,24,000

PROBLEM 12

The Account Sales of 1,200 Transistor sets received from and sold on account of and at the risk of Sri M. Chopra, Calcutta.

	₹	₹
1,200 Transistor Sets @ ₹ 1,200		14,40,000
Less Expenses:		
	₹	
Unloading expenses	3,000	
Selling expenses	4,000	
Transport charges upto godown	6,100	
Godown rent	6,000	
Advertisements	2,000	21,100

Less Commission:			
5% Ordinary Commission	72,000		
1% Del credere Commission	<u>14,400</u>	<u>86,400</u>	<u>1,07,500</u>
			13,32,500
Less: Advance sent on 10.1.2018			<u>2,50,000</u>
Balance Draft enclosed herewith			<u>10,82,500</u>
Stock in hand (31.3.2018)-100 Sets.			
Dated, Madras			E & O.E
the 26th April, 2018			S. Raman

On further information received you come to know that:

- Bad debts amounted to ₹ 2,400 against 2 Sets.
- 20% above the invoice price is the sale price which is equal to cost *plus* 50%.
- Chopra incurred forwarding expenses @ ₹ 10 per Set.
- During transit 10 Sets became fully damaged and Chopra recovered from insurance the full amount of original cost.

Required: Prepare the Consignment Account, Goods sent on Consignment Account and Loss in Transit Account in the books of Mr Chopra.

SOLUTION:

DR.

CONSIGNOR'S ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Goods Sent on Consignment A/c	13,10,000	By B (Sale Proceeds)	14,40,000
To Bank A/c (Expenses)	13,100	By Loss-in-transit A/c	8,100
To B (Expenses): Unloading	3,000	By Consignment Stock A/c	1,01,700
Transport	6,100	By Goods Sent on	
Godown Rent	6,000	Consignment A/c (1,310 × ₹ 200)	2,62,000
Adv. Exp	2,000		
Selling Expenses	4,000		
To B (Commission)	86,400		
To Consignment Stock reserve A/c	20,000		
To Profit t/f to P&L A/c	<u>3,61,200</u>		
	18,11,800		18,11,800

DR.

B'S ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Consignment to A/c (sales)	14,40,000	By Bank A/c (Advance)	2,50,000
		By Consignment A/c (Exp.)	21,100
		By Consignment A/c (Comm.)	86,400
		By Bank A/c	<u>10,82,500</u>
	<u>14,40,000</u>		14,40,000

Working Notes:**(i) Statement showing the Calculation of Abnormal Loss and Unsold Stock**

<i>Particulars</i>	<i>Units</i>	<i>₹</i>
A. Cost of Goods Sent	1,310	10,48,000
B. Expenses incurred by Consignor	—	13,100
C. Total Cost of Goods Sent (A + B)	1,310	10,61,100
D. Less: Cost of Goods not reached the city of Consignee		
(a) Cost of Goods damaged-in-transit	10	8,100
E. Cost of Goods reached the city of Consignee (C – D)	1,300	10,53,000
F. Add: Non-recurring expenses incurred by Consignee	—	9,100
G. Cost of Goods received by Consignee	1,300	10,62,100
H. Cost of Unsold Stock	100	81,700

(II) CALCULATION OF INVOICE VALUE OF UNSOLD STOCK

<i>Particulars</i>	<i>Unsold Stock</i> <i>₹</i>
A. Cost	81,700
B. Add: Loading @ ₹ 200 per unit	20,000
C. Invoice Value [A + B]	1,01,700

(iii) Calculation of Invoice value of Unsold Stock

Let Cost be X and Invoice Price be Y

Sale Price = Cost + 50%

₹ 1,200 = X + 50% of X

$X = ₹ 1,200 / 1.5 = ₹ 800$

Sale Price = Invoice Price + 20% of Invoice Price

₹ 1,200 = Y + 20% of Y

$Y = ₹ 1,200 / 1.2 = ₹ 1,000$

Thus, Invoice Price = ₹ 1,000

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ACCOUNTING FOR JOINT VENTURE

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of Joint Venture
- ◇ Similarities between Joint Venture and Partnership
- ◇ Distinction between Partnership and Joint Venture
- ◇ Distinction between Joint Venture and Consignment
- ◇ Methods of Recording Joint Venture Transactions
- ◇ Method I—Separate set of Books Method
- ◇ Method II—Recording in the Books of One Co-Venturer Only
- ◇ Method III—Recording in the Books of All Co-Venturers
- ◇ Method IV—Memorandum Joint Venture Account Method

1.0 MEANING OF JOINT VENTURE

Joint venture may be described as a temporary partnership between two or more persons without the use of the firm name, for a limited purpose. In other words, under Joint Venture, two or more persons agree to undertake a particular venture (e.g. Joint consignment of goods, Joint construction of a building, Joint underwriting of a particular issue of shares or debentures) and to share the profits and losses thereof in an agreed ratio (if agreement is silent on this point, then in equal ratio).

MEANING OF 'JOINT VENTURERS' OR 'CO-VENTURERS'

The persons who have so agreed to undertake a Joint Venture are known as 'Joint Venturers' or 'Co-Venturers'.

LIFE OF JOINT VENTURE

Such limited partnership automatically expires on the completion of the venture for which it was formed.

2.0 SIMILARITIES BETWEEN JOINT VENTURE AND PARTNERSHIP

1. At least 2 persons are required in both joint venture and partnership.
2. Business is carried on for profit in both joint venture and partnership.

3.0 DISTINCTION BETWEEN PARTNERSHIP AND JOINT VENTURE

Basis of Distinction	Partnership	Joint Venture
1. Scope	It is not limited to a specific venture.	It is limited to a specific venture.
2. Persons involved	The persons carrying on business are individually called partners.	The persons carrying on business are called co-venturers.
3. Ascertainment of Profit/loss	The profits/losses are ascertained on an annual basis.	The profits/losses are ascertained at the end of specific venture (if venture continues for a short period) or an interim basis annually (if venture continues for a longer period).
4. Act governing	Partnership firms are governed by Indian Partnership Act, 1932.	The doctrine of implied authority is not applicable to co-venturers.
5. Doctrine of Implied Authority	The doctrine of implied authority is applicable to partners.	The co-venturers have such freedom.
6. Freedom to run competition	The partners do not have such freedom.	There is no need for firm name.
7. Name	A partnership firm always has a name.	There is no need for a separate set of books.
8. Separate Set of Books	Separate set of books have to be maintained.	The accounts can be maintained even in one of the Co-venturer's books only.
9. Admission of Minor	A minor can be admitted to the benefits of the firm.	A minor cannot be a co-venturer as he is incompetent to contract.

4.0 DISTINCTION BETWEEN JOINT VENTURE AND CONSIGNMENT

Basis of Distinction	Joint Venture	Consignment
1. Nature of Relationship	The relation between co-venturers is that of co-owners.	The relation between the consignor and the consignee is that of Principal and Agent.
2. Ownership & Risk of Goods	Both these remain with co-venturers.	Both these remain with the consignor.
3. Account Sales	No Account Sales is sent by one co-venturer to another Co-venturer.	An Account Sale is prepared and submitted by the consignee to his consignor.
4. Profit & Loss on transactions	Profit & losses are shared by the co-venturers in an agreed ratio.	Profit & losses are shared only by the consignor and not by the consignee.
5. Subject-Matter of Dealing	Any movable or immovable property may be its subject matter.	Only movable property may be its subject matter.

6. No. of Persons	In a venture, there may be two or more persons.	In a consignment, there are two persons—Consignor and Consignee.
7. Methods of Recording	There are four methods of recording.	There is only one method of recording.

5.0 METHODS OF RECORDING JOINT VENTURE TRANSACTIONS

There are four methods of recording the Joint Venture transactions as under:

Method I Separate set of Books Method Recording of all Joint Venture transactions in a separate set of books (i.e. not belonging to any of the Co-Venturers)

Method II Recording of all Joint Venture transactions only by one of the Co-Venturers in his own books of account.

Method III Recording of all Joint Venture transactions in the books of all Co-Venturers.

Method IV Memorandum Joint Venture Account Method Recording of the partial Joint Venture transactions concerning him only by each of the Co-Venturers in his own books of account.

6.0 SEPARATE SET OF BOOKS METHOD

Meaning Under this method, all the joint venture transactions are recorded in a separate set of books maintained for this purpose. Generally, the following accounts are opened in a separate set of books:

- Joint Bank Account** which is personal account in nature, is used to record Cash and Bank transactions;
- Co-Venturers' Accounts** which are personal in nature, are used to record their dealings with the Joint business and to ascertain the amount due to/from them;
- Joint Venture Account** which is nominal in nature, is used to calculate the profit/loss on joint venture.

Each Co-Venturer opens 'Joint Venture Investment Account' in his individual books of accounts.

JOURNAL ENTRIES The various journal entries which may be required to be passed, are summarised hereas under:

1. On Deposit of Capital brought in by the Co-Venturer into bank

Joint Bank A/c	Dr. <i>[with total]</i>
To Co-Venturers' Personal A/cs	<i>[with individual sum contributed]</i>

2. On Purchase of Goods

(a) For Cash

Joint Venture A/c	Dr.
To Joint Bank A/c	

(b) On Credit

Joint Venture A/c	Dr.
To Supplier's A/c	

(c) By any of Co-Ventures

Joint Venture A/c	Dr.
To Co-Venturer's Personal A/c	

3. (a) **On Making Payment to Supplier of Goods**

Supplier's A/c	Dr. [<i>with Total</i>]
To Cash/Joint Bank A/c/B/P A/C	[<i>with Payment made</i>]
To Joint Venture A/c	[<i>with Discount Received</i>]
3. (b) **On Discharging Bills Payable**

Bills Payable A/c	Dr.
To Joint Bank A/c\	
4. **On Supply of Goods out of Own Stock by any of the Co-Venturers**

Joint Venture A/c	Dr.
To Co-Venturer's Personal A/c	
5. **On Payment of Expenses**
 - (a) *Out of Joint Bank A/c*

Joint Venture A/c	Dr.
To Joint Bank A/c	
 - (b) *By any Co-Venturer*

Joint Venture A/c	Dr.
To Co-Venturer's Personal A/c	
6. **On Sale of Goods**
 - (a) *For Cash*

Joint Bank A/c	Dr.
To Joint Venture A/c	
 - (b) *On Credit*

Customers' A/c	Dr.
To Joint Venture A/c	
 - (c) *By any of Co-Ventures*

Coventurer's Personal A/c	Dr.
To Joint Venture A/c	
7. (a) **On Receiving Payment from a Customer**

Cash/Joint Bank A/c/B/R A/c	Dr. [<i>with Payment received</i>]
Joint Venture A/c	Dr. [<i>with Discount allowed/Bad Debts</i>]
To Customer's A/c	[<i>with Total</i>]
- (b) **On Discounting Bills Receivable**

Joint Bank A/c	Dr. [<i>with Net</i>]
Joint Venture A/c	Dr. [<i>with Discount</i>]
To Bills Receivable A/c	[<i>with Total</i>]
8. **On Sale of Goods by any of the Co-Venturers**

Co-Venturer's Personal A/c	Dr.
To Joint Venture A/c	
9. **On Taking away of Unsold Stock in Full/in Part by any of the Co-Venturers**

Co-Venturer's Personal A/c	Dr.
To Joint Venture A/c	

10. When any Co-Venturer is entitled to Some Commission/Salary

Joint Venture A/c Dr.
 To Co-Venturer's Personal A/c

11. On Transferring the Balance of Joint Venture Account**(a) In case of Profit**

Joint Venture A/c Dr.
 To All Co-Venturers' Personal A/cs [In Agreed Ratio]

(b) In case of Loss

All Co-Venturers Personal A/cs Dr. [In Agreed Ratio]
 To Joint Venture A/c

12. On Settlement of the Balance of Personal Accounts of Co-Venturers**(a) In case of a Debit balance**

Joint Bank A/c Dr.
 To Co-Venturer's Personal A/c

(b) In case of a Credit balance

Co-Venturer's Personal A/c Dr.
 To Joint Bank A/c

Note: Unless otherwise stated, a reference of Joint Bank is a sufficient indication of the existence of separate Joint Venture books.

7.0 JOINT VENTURE ACCOUNT

Nature	A joint venture account is a nominal account prepared by the co-venturers involved in the joint ventures.
Objective	The objective of preparing a joint venture account is to ascertain the profit or loss arising out of the joint venture business.
Contents	The joint venture account is debited with the value of goods or stores bought or used and expenses incurred on account of joint venture and is credited with sale proceeds of goods and value of closing stock.
Treatment of Balance	Joint venture account reflects profit or loss, which is divided between the Co-venturers in the agreed ratio.

**FORMAT OF JOINT VENTURE ACCOUNT
(UNDER SEPARATE SET OF BOOKS METHOD)**

DR.		JOINT VENTURE ACCOUNT		CR.	
Particulars		₹	Particulars		₹
To Joint Bank A/c (Purchases)		...	By Joint Bank (A/c (Sales):		
To Joint Bank A/c (Expenses)		...	Good units		...
To Bills Receivable A/c (Discount)		...	Damaged units		...
To X (Purchases)		...	By X (Sales)		...
To X (Expenses)		...	By Y (Sales)		...
To Y (Purchases)		...	By Joint Bank A/c (Claim)		...
To Y (Expenses)		...	By Closing Stocks:		

To Profit t/f to:		...	X	...	
X	... ____		Y	... ____	...
Y	... ____	...	By Loss t/f to:		
			X	...	
			Y	... ____	...
		...			...

ILLUSTRATION 1

X and Y entered into a Joint Venture, agreeing to share profits and losses in the ratio of their respective contributions. The following transactions took place during the course of the venture.

1. X and Y deposited ₹ 65,000 and ₹ 32,500 respectively into a Joint Bank Account,
2. Goods bought for ₹ 75,000.
3. Expenses incurred ₹ 10,950.
4. Goods sold for ₹ 90,000.
5. Goods unsold taken over by X at an agreed valuation of ₹ 2,700.

Pass the necessary journal entries and prepare the necessary ledger accounts.

SOLUTION:
JOURNAL

Particulars		L.F.	Dr. (₹)	Cr. (₹)
Joint Bank A/c	Dr.		97,500	
To X				65,000
To Y				32,500
(Being ₹ 65,000 and ₹ 32,500 contributed by X and Y respectively)				
Joint Venture A/c	Dr.		75,000	
To Joint Bank A/c				75,000
(Being the goods purchased)				
Joint Venture A/c	Dr.		10,950	
To Joint Bank A/c				10,950
(Being the expenses incurred)				
Joint Bank A/c	Dr.		90,000	
To Joint Venture A/c				90,000
(Being the goods sold)				
X	Dr.		2,700	
To Joint Venture A/c				2,700
(Being the goods taken by X at an agreed value of ₹ 2,700)				
Joint Venture A/c	Dr.		6,750	
To X				4,500
To Y				2,250
(Being the profit transferred)				

X	Dr.		66,800	
Y	Dr.		34,750	
To Joint Bank A/c				1,01,550
zz (Being the final payment made to X and Y)				

DR. JOINT VENTURE ACCOUNT CR.

Particulars	₹	Particulars	₹
To Joint Bank A/c (Goods purchased)	75,000	By Joint Bank A/c (Sales)	90,000
To Joint Bank A/c (Expenses)	10,950	By X (Goods taken)	2,700
To Profit transferred to:		X	4,500
		Y	2,250
	92,700		6,750
			92,700

DR. JOINT BANK ACCOUNT CR.

Particulars	₹	Particulars	₹
To X	65,000	By Joint Venture A/c (Expenses)	10,950
To Y	32,500	By Joint Venture A/c (Purchases)	75,000
To Joint Venture A/c	90,000	By X	66,800
		By Y	34,750
	1,87,500		1,87,500

DR. CO-VENTURERS' ACCOUNTS CR.

Particulars	X ₹	Y ₹	Particulars	X ₹	Y ₹
To Joint Venture A/c (Goods taken)	2,700	—	By Joint Bank A/c	65,000	32,500
To Joint Bank A/c (Final payment)	66,800	34,750	By Joint Venture A/c (Profit)	4,500	2,250
	69,500	34,750		69,500	34,750

ILLUSTRATION 2

A and B entered into joint venture agreeing to share profits and losses in the ratio of 2:1. The following transactions took place during the course of the venture:

	A	B
(a) Deposited into the Joint Bank	₹ 50,000	₹ 25,000
(b) Goods brought in by	₹ 10,000	₹ 5,000
(c) Expense incurred by	₹ 5,000	₹ 2,500
(d) Joint Transactions (i) Goods bought—from X for ₹ 20,000 and issued a current dated cheque, from Y on credit ₹ 40,000, (ii) Payment to Y by cheque in full settlement— ₹ 39,400 (iii) Expenses paid—₹ 1,800, (iv) Goods sold to D for ₹ 40,000 and received a current dated cheque and Goods sold to E on credit for ₹ 50,000 for 3 months. (v) E accepted a Bill		

Receivable which was discounted @ 18% p.a (e) A agreed to take over the balance of stock at an agreed valuation of ₹ 2,700. Pass the necessary journal entries and prepare the necessary ledger accounts assuming that the final settlement between A and B was made by cheque.

SOLUTION:
JOURNAL

<i>Particulars</i>		<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Joint Bank A/c	Dr.		75,000	
To A				50,000
To B				25,000
(Being ₹ 50,000 and ₹ 25,000 contributed by A and B respectively)				
Joint Venture A/c	Dr.		15,000	
To A				10,000
To B				5,000
(Being the goods brought in by A and B)				
Joint Venture A/c	Dr.		7,500	
To A				5,000
To B				2,500
(Being expenses incurred by Mr. A and B for Joint Venture)				
Joint Venture A/c	Dr.		60,000	
To Joint Bank A/c			20,000	
To Y				40,000
(Being Goods purchased for cash & credit)				
Joint Bank A/c	Dr.		40,000	
E	Dr.		50,000	
To Joint Venture A/c				90,000
(Being goods sold for cash for ₹ 40,000 and on credit for ₹ 50,000)				
Joint Venture A/c	Dr.		1,800	
To Joint Bank A/c				1,800
(Being expenses paid)				
Bills Receivable A/c	Dr.		50,000	
To E				50,000
(Being acceptance received from E)				
Y	Dr.		40,000	
To Joint Bank A/c				39,400
To Joint Venture A/c				600
(Being final payment made to Y)				
Joint Bank A/c	Dr.		47,750	
Joint Venture A/c	Dr.		2,250	
To Bills Receivable A/c				50,000
(Being Bill discounted @ 18% p.a)				

A To Joint Venture A/c (Being goods taken by Mr. A)	Dr.		2,700	2,700
Joint Venture A/c To A To B (Being profit on Joint Venture allocated)	Dr.		6,750	4,500 2,250
A B To Joint Bank A/c (Being final Payment made to A and B)	Dr. Dr.		66,800 34,750	1,01,550

DR. JOINT VENTURE ACCOUNT CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To A (Goods)	10,000	By Joint Bank A/c (Cash sales)	40,000
To A (Expenses)	5,000	By E (Credit sales)	50,000
To B (Goods)	5,000	By (Discount)	600
To B (Expenses)	2,500	By A (Goods taken)	2,700
To Joint Bank A/c (Goods)	20,000		
To Joint Bank A/c (Expenses)	1,800		
To Y (Credit Purchases)	40,000		
To Bill Receivable A/c (Discount)	2,250		
To Profit transferred to:			
A 4,500			
B 2,250	6,750		
	93,300		93,300

DR. CO-VENTURERS' ACCOUNTS CR.

<i>Particulars</i>	X ₹	Y ₹	<i>Particulars</i>	X ₹	Y ₹
To Joint Venture A/c	2,700	—	By Joint Bank A/c		
To Joint Bank A/c	66,800	34,750	(Deposit)	50,000	25,000
			By Joint Venture A/c		
			(Goods)	10,000	5,000
			By Joint Venture A/c		
			(Expenses)	5,000	2,500
			By Joint Venture A/c		
			Profit)	4,500	2,250
	69,500	34,750		69,500	34,750

DR.		JOINT BANK ACCOUNT		CR.
Particulars	₹	Particulars	₹	
To A	50,000	By Joint Venture A/c	20,000	
To B	25,000	By Y	39,400	
To Joint Venture A/c	40,000	By Joint Venture A/c	1,800	
To Bills Receivable A/c	47,750	By A	66,800	
		By B	34,750	
	1,62,750		1,62,750	

ILLUSTRATION 3

Piyush and Manish entered into a joint venture for purchase and sale of defence disposal goods. They agreed to share profits in the ratio of 2 : 1 respectively. The following transactions took place:

Jan. 1 Piyush and Manish paid into Bank Account (Joint Bank Account) ₹ 72,000 and ₹ 36,000 respectively.

Jan. 6 Paid rent of the shop ₹ 1,200.

Jan. 7 Purchased goods for cash ₹ 72,000, paid freight etc. ₹ 1,000.

Jan. 15 Piyush paid ₹ 200 for advertisement from his private account.

Jan. 28 Sold goods and money deposited into joint bank account ₹ 39,200.

Feb. 4 Sold goods for cash (again) ₹ 52,000 and deposited into joint bank account.

Feb. 15 Purchased goods for cash ₹ 12,000, sundry expense ₹ 120 paid by Manish from his private account.

Feb. 20 Sold goods for cash ₹ 28,000 and deposited into joint bank account.

Feb. 24 Piyush took away the balance of goods left unsold at an agreed price of ₹ 8,000.

Required: Prepare Joint Venture Account, Joint Bank Account and Accounts of Piyush and Manish. Assume final settlement was made on 28th Feb.

SOLUTION

DR.			JOINT VENTURE ACCOUNT		CR.
Date	Particulars	₹	Date	Particulars	₹
Jan. 6	To Joint Bank A/c	1,200	Jan. 28	By Joint Bank A/c	39,200
Jan. 7	To Joint Bank A/c	72,000	Feb. 4	By Joint Bank A/c	52,000
	To Joint Bank A/c	1,000	Feb. 20	By Joint Bank A/c	28,000
Jan. 15	To Piyush	200	Feb. 24	By Piyush (goods taken)	8,000
Feb. 15	To Joint Bank A/c				
	(Purchases)	12,000			
	To Manish (Exp.)	120			
Feb. 28	To Profit transferred to:				
	Piyush 27,120				
	Manish 13,560	40,680			
		1,27,200			1,27,200

DR.**JOINT BANK ACCOUNT****CR.**

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
Jan. 1	To Piyush	72,000	Jan. 6	By Joint Venture A/c	1,200
Jan. 1	To Manish	36,000	Jan. 7	By Joint Venture A/c	72,000
Jan. 28	To Joint Venture A/c	39,200	Jan. 7	By Joint Venture A/c	1,000
Feb. 4	To Joint Venture A/c	52,000	Feb. 15	By Joint Venture A/c	12,000
Feb. 20	To Joint Venture A/c	28,000	Feb. 28	By Piyush (Final payment)	91,320
			Feb. 28	By Manish (Final payment)	49,680
		2,27,200			2,27,200

DR.**PIYUSH'S ACCOUNT****CR.**

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
Feb. 24	To Joint Venture A/c	8,000	Jan. 1	By Joint Bank A/c	72,000
Feb. 28	To Joint Bank A/c (Balancing figure)	91,320	Feb. 15	By Joint Venture A/c	200
			Feb. 28	By Joint Venture A/c (Profit)	27,120
		99,320			99,320

DR.**MANISH'S ACCOUNT****CR.**

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
Feb. 28	To Joint Bank A/c (Balancing figure)	49,680	Jan. 1	By Joint Bank A/c	36,000
			Feb. 15	By Joint Venture A/c	120
			Feb. 28	By Joint Venture A/c (Profit)	13,560
		49,680			49,680

ILLUSTRATION 4

A, B and C jointly undertake to construct a building for a company at a contract price of ₹ 15,00,000 to be paid as to ₹ 12,00,000 in cash by instalments and ₹ 3,000. in fully paid shares of the company. They agreed to share profit or loss equally. They open a bank account and contribute:

A ₹ 1,80,000; C ₹ 1,30,000 and B ₹ 2,00,000. A gets the plan prepared and pays ₹ 20,000 for it. B brings into the joint venture machinery of ₹ 60,000 and C brings into the venture a truck of the value of ₹ 50,000. They also purchased materials worth ₹ 7,50,000 and wages paid were ₹ 4,95,000.

On completion of the venture, A takes over unused materials of the value of ₹ 35,000; B takes back machinery at ₹ 70,000 and C agrees to take back truck at a valuation of ₹ 20,000. A also agreed to take over shares of the company at a valuation of ₹ 2,60,000.

Required: Show the necessary ledger accounts assuming that a separate set of account books is maintained.

SOLUTION
DR. JOINT VENTURE ACCOUNT CR.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To A (Plant)	20,000	By A (Materials),	35,000
To B (Machinery)	60,000	By B (Machinery)	70,000
To C (Truck)	50,000	By C (Truck)	20,000
To Joint Bank A/c:		By Joint Bank A/c (Price)	12,00,000
Materials	7,50,000	By Shares A/c (Price)	3,00,000
Wages	4,95,000		
To Shares A/c	40,000		
To Profits transferred to:			
A	70,000		
B	70,000		
C	70,000		
	16,25,000		16,25,000

DR. JOINT BANK ACCOUNT CR.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To A	1,80,000	By Joint Venture A/c:	
To B	2,00,000	Materials	7,50,000
To C	1,30,000	Wages	4,95,000
To Joint Venture A/c (Price)	12,00,000	By B	2,60,000
To A	25,000	By C	2,30,000
	17,35,000		17,35,000

DR. COVENTURERS' ACCOUNTS CR.

<i>Particulars</i>	<i>A ₹</i>	<i>B ₹</i>	<i>C ₹</i>	<i>Particulars</i>	<i>A ₹</i>	<i>B ₹</i>	<i>C ₹</i>
To Joint Venture				By Joint Bank A/c	1,80,000	2,00,000	1,30,000
A/c	35,000	70,000	20,000	By Joint Venture			
To Shares A/c	2,60,000	—	—	A/c	20,000	60,000	50,000
To Joint Bank A/c	—	2,60,000	2,30,000	By Joint Venture A/c	70,000	70,000	70,000
				By Joint Bank A/c	25,000	—	—
	2,95,000	3,30,000	2,50,000		2,95,000	3,30,000	2,50,000

ILLUSTRATION 5

Mohan and Sohan enter into a joint venture for the construction of a Cinema Hall for a contract price of ₹ 6,00,000. For this purpose, Mohan put ₹ 1,20,000 and Sohan put ₹ 1,00,000 in a Joint Bank Account opened for this purpose. The following expenditures were made out of the Bank Account:

On Materials ₹ 75,000; On Wages ₹ 1,20,000; On Plant ₹ 20,000

In addition, Mohan supplied bags of cement which were valued at ₹ 10,000. The Cinema Hall was constructed, but due to certain defects, the owner deducted 10% from contract money. The plant was taken over by Sohan at ₹ 8,000 and the bales of cement left are taken back by Mohan at a value of ₹ 4,000. They shared Profit & Losses in the ratio of 3 : 2.

Required: Show the necessary Ledger Accounts.

SOLUTION

DR. JOINT VENTURE ACCOUNT CR.

Particulars	₹	Particulars	₹
To Joint Bank A/c	75,000	By Joint Bank A/c	5,40,000
To Joint Bank A/c	1,20,000	[₹ 6,00,000 – ₹ 60,000]	
To Joint Bank A/c	20,000	By Sohan	8,000
To Mohan	10,000	By Mohan	4,000
To Profit t/f to:			
Mohan	1,96,200		
Sohan	1,30,800		
	3,27,000		
	5,52,000		5,52,000

DR. JOINT BANK ACCOUNT CR.

Particulars	₹	Particulars	₹
To Mohan	1,20,000	By Joint Venture A/c	75,000
To Sohan	1,00,000	By Joint Venture A/c	1,20,000
To Joint Venture A/c	5,40,000	By Joint Venture A/c	20,000
		By Sohan	3,22,200
		By Mohan	2,22,800
	7,60,000		7,60,000

DR. MOHAN'S ACCOUNT CR.

Particulars	₹	Particulars	₹
To Joint Venture A/c	4,000	By Joint Bank A/c	1,20,000
To Joint Bank A/c	3,22,200	By Joint Venture A/c	10,000
		By Joint Venture A/c (Profit)	1,96,200
	1,56,500		3,26,200

DR. SOHAN'S ACCOUNT CR.

Particulars	₹	Particulars	₹
To Joint Venture A/c	8,000	By Joint Bank A/c	1,00,000
To Joint Bank A/c	2,22,800	By Joint Venture A/c	1,30,800
	2,30,800		2,30,800

ILLUSTRATION 6

X and Y jointly undertake to construct a building for Hot & Cold Ltd. for contract price of ₹ 50,00,000 payable as to 80% in cash by four equal instalments and the balance by in fully paid equity shares of ₹ 10 each at a premium of 100%. They opened a bank account in their joint name and deposited ₹ 21,00,000 in the ratio of 2 : 1. They agreed to distribute first ₹ 5,00,000 of profits equally and the balance in the ratio of 2 : 1. Their transactions were as follows:

- (a) Materials supplied by X ₹ 60,000.
- (b) Wages paid ₹ 6,00,000, Material bought ₹ 9,00,000, Mixer ₹ 1,00,000, Plant ₹ 3,00,000.
- (c) Expenses (including insurance premium) paid by Y ₹ 40,000.
- (d) On completion of Construction, the contract price was realised.
- (e) X took over unused materials at ₹ 40,000
Y took over mixer at ₹ 60,000
Plant was sold at ₹ 1,85,000
Materials costing ₹ 20,000 stolen against which claim of ₹ 15,000 was received.
- (f) X took-up 60% of the shares and Y took-up the balance shares at an agreed valuation of ₹ 15 per share.
- (g) Accounts were settled.

Required: Prepare Joint Venture Account, Joint Bank Account and Accounts of X and Y.

SOLUTION:

DR. JOINT VENTURE ACCOUNT CR.

Particulars	₹	Particulars	₹
To Joint Bank A/c:		By Joint Bank A/c	40,00,000
Wages 6,00,000		By Equity Shares A/c	10,00,000
Material 9,00,000		By X (Material)	40,000
Mixer 1,00,000		By Y (Mixer)	60,000
Plant 3,00,000	19,00,000	By Joint Bank A/c	
To X (Material)	60,000	(Plant)	1,85,000
To Y (Expenses)	40,000	By Joint Bank A/c	
To Equity Shares		(Claim)	15,000
[50,000 × ₹ 5]	2,50,000		
To Profit t/f to:			
X 19,50,000			
Y 11,00,000	30,50,000		
	53,00,000		53,00,000

DR. JOINT BANK ACCOUNT CR.

Particulars	₹	Particulars	₹
To X	14,00,000	By Joint Venture A/c	19,00,000
To Y	7,00,000	By X	29,20,000
To Joint Venture A/c	40,00,000	By Y	14,80,000
To Joint Venture A/c (Plant)	1,85,000		
To Joint Venture A/c (Claim)	15,000		
	63,00,000		63,00,000

DR.**CO-VENTURERS' ACCOUNTS****CR.**

<i>Particulars</i>	<i>X</i>	<i>Y</i>	<i>Particulars</i>	<i>X</i>	<i>Y</i>
To Joint Venture A/c	40,000	60,000	By Joint Bank A/c	14,00,000	7,00,000
To Equity Shares A/c	4,50,000	3,00,000	By Joint Venture A/c	60,000	40,000
To Joint Bank A/c	29,20,000	14,80,000	By Joint Venture A/c	19,50,000	11,00,000
	34,10,000	18,40,000		34,10,000	18,40,000

Working Note: Calculation of Share of Profit

First ₹ 5,00,000 (in 1 : 1 Ratio)	2,50,000	2,50,000
Balance ₹ 25,50,000 (in 2 : 1 ratio)	17,00,000	8,50,000
	<u>19,50,000</u>	<u>11,00,000</u>

ILLUSTRATION 7

Kapil and Tendulkar jointly underwrite and place on the market 50,000 equity shares of Bombay Machineries Ltd. of ₹ 10 each. It was agreed with the company that they would be allotted 2,000 Equity shares as fully paid towards their remuneration.

Their profit sharing ratio is 3 : 2.

Applications were received from the public only for 45,000 equity shares. Kapil paid ₹ 4,000 for postage and advertisement in addition to 60% of the amount required to take up the short subscription.

Tendulkar financed the balance amount. These are accounted for through Joint bank account. All the shares including those allotted for remuneration were sold. Kapil sold 3,000 Equity shares for ₹ 35,000 and Tendulkar sold the balance shares for ₹ 48,000. Tendulkar incurred expenses of ₹ 2,000. Sale proceeds were retained individually.

Required: Show necessary Ledger Accounts in the books of the venturers, which were separately kept for this purpose. The inter se account was settled through the Joint Bank Account.

SOLUTION**DR.****JOINT VENTURE ACCOUNT****CR.**

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Joint Bank A/c (5,000 Equity shares)	50,000	By Kapil (Sale proceeds of 3,000 Equity shares)	35,000
To Joint Bank A/c (Postage and Advertisement)	4,000	By Tendulkar (Sale proceeds of 4,000 Equity shares)	48,000
To Joint Bank A/c (Expenses)	2,000		
To Net Profit t/f to:			
Kapil	16,200		
Tendulkar	10,800		
	27,000		
	83,000		83,000

DR.

JOINT BANK ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Kapil (30,000 + 4,000)	34,000	By Joint Venture A/c (Postage etc.)	4,000
To Tendulkar (20,000 + 2,000)	22,000	By Joint Venture A/c (Expenses)	2,000
To Tendulkar	15,200	By Joint Venture A/c (Subscription of 5,000 Equity shares)	50,000
		By Kapil	15,200
	71,200		71,200

DR.

COVENTURERS' ACCOUNT

CR.

Particulars	Kapil ₹	Tendulkar ₹	Particulars	Kapil ₹	Tendulkar ₹
To Joint Venture A/c	35,000	48,000	By Joint Bank A/c	34,000	22,000
To Joint Bank A/c	15,200		By Joint Venture A/c	16,200	10,800
			By Joint Bank A/c	—	15,200
	50,200	48,000		50,200	48,000

Note: It has been assumed that 2,000 Equity shares issued against commission are over and above the 50,000 Equity shares to the public.

ILLUSTRATION 8

X and Y jointly underwrite 1,00,000 equity shares of ₹ 10 each issued by Tulsian Ltd. at a premium of ₹ 2 per share. The underwriting commission is 4% as provided in the Articles and is to be paid by issue of equity shares of ₹ 10 each at a price offered to public. Their profit sharing ratio is 3 : 2. Following expenses were incurred.

X : Stationery & Advertisement ₹ 40,800

Y : Registration Fees, Postage etc. ₹ 27,200

Application money received from the public was ₹ 10,08,000. X arranged 60% of the amount required to take the short subscription and Y arranged the balance amount. They sold all the shares including those allotted for remuneration. X sold 40% of the shares @ ₹ 15 per share and Y sold the balance @ ₹ 20 per share. Accounts were settled.

Required: Prepare the necessary ledgers accounts assuming the accounts were settled through Joint Bank Account.

SOLUTION:

DR.

(I) JOINT VENTURE ACCOUNT

CR.

Particulars	₹	Particulars	₹
To X (Stationery & Adv.)	40,800	By X (Sale of 8,000 shares @ ₹ 15)	1,20,000
To Y (Reg. Fee & Postage etc.)	27,200	By Y (Sale of 12,000 shares @ ₹ 20)	2,40,000
To Joint Bank A/c (16,000 shares)	1,92,000		
To Profit t/f to:			
X	60,000		
Y	40,000		
	3,60,000		3,60,000

DR.**(II) JOINT BANK ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To X (60% of ₹ 1,92,000)	1,15,200	By Joint Venture A/c (Purchase of 16,000 shares @ ₹ 12)	1,92,000
To Y (40% of ₹ 1,92,000)	76,800	By X (Balance paid)	96,000
To Y (Balance received)	96,000		
	2,88,000		2,88,000

DR.**(III) CO-VENTURERS' ACCOUNTS****CR.**

<i>Particulars</i>	X	Y	<i>Particulars</i>	X	Y
To Joint Venture	1,20,000	2,40,000	By Joint Venture A/c	40,800	27,200
To Joint Bank A/c	96,000	—	By Joint Bank A/c	1,15,200	76,800
			By Joint Venture A/c	60,000	40,000
			By Joint Bank A/c	—	96,000
	2,16,000	2,40,000		2,16,000	2,40,000

Working Notes:

- (i) Underwriting Commission = 4% of (1,00,000 × ₹ 12) = ₹ 48,000
 No. of shares to be received = (₹ 48,000/ ₹ 12) = 4,000 Shares
- (ii) No. of shares to be taken up = 1,00,000 shares – (₹ 10,08,000/₹ 12)
 = 16,000 shares

8.0 METHOD II—RECORDING IN THE BOOKS OF ONE CO-VENTURER ONLY**MEANING OF RECORDING IN BOOKS OF ONE CO-VENTURER ONLY**

Under this method, all the joint venture transactions are recorded by one of the Co-Venturers in his own book of accounts.

ACCOUNT OPENING IN THE BOOKS OF ONE CO-VENTURER ONLY

In the books of Co-Venturer authorised to record joint venture transactions, generally, the following accounts are opened under this method:

1. Joint Venture Account to ascertain profit/loss on Joint Venture
2. Personal Accounts of other Co-Venturers to record the Joint Venture transactions effected by other Co-Venturers and to ascertain the amount due to/from other Co-Venturer(s).

JOURNAL ENTRIES

The various journal entries which may be required to be passed, are summarized below:

1. (a) **On Receipt of any amount or Bills Receivable from other Co-Venturers**

Cash/Bank A/c/Bills Receivable A/c Dr.
 To Co-Venturer's Personal A/c

- (b) **On Discounting Bills Receivable**

Bank A/c Dr. [Net Proceeds]
 Joint Venture A/c Dr. [Discount]
 To Bills Receivable A/c [Total]

2. On Purchase of Goods for Joint Venture

(a) *By the Co-venturer recording transactions*

Joint Venture A/c	Dr. (with Total)
To Cash/Bank A/c	(with Cash purchases)
To Supplier's A/c	(with Credit purchases)

Note: While making purchases for joint venture, Joint Venture Account is debited and not the Purchases Account. Purchases Account is debited when Co-venturer makes purchases for his own business. Therefore, in order to distinguish joint purchases from individual purchases, Joint Venture Account is debited and not the Purchases Account.

(b) *By the Co-Venturer other than recording the transactions*

Joint Venture A/c	Dr.
To Co-Venturer's Personal A/c	

3. On Making Payment to Supplier

Supplier's A/c	Dr (with Total)
To Cash/Bank A/c	(with Payment made)
To Joint Venture A/c	(with Discount Received)

4. On Supply of Goods out of Own Stock by any of the Co-Venturers

(a) *By the Co-Venturer recording the transactions*

Joint Venture A/c	Dr.
To Purchases A/c/Goods sent on Joint Venture A/c	(if supplies at Cost)
To Sales A/c	(if supplies at Profit)

(b) *By the Co-Venturer other than recording the transactions*

Joint Venture A/c	Dr.
To Co-Venturer's Personal A/c	

5. On Payment of Expenses

Same entries as given under Point No. 2

6. On Sale of Goods

(a) *By the Co-venturer recording the transactions*

Cash/Bank A/c	Dr. (with Cash sales)
Customer's A/c	Dr. (with Credit sales)
To Joint Venture A/c	(with Total)

(b) *By the Co-venturer other than recording the transactions*

Co-Venturer's Personal A/c	Dr.
To Joint Venture A/c	

7. On Receiving Payment from a Customer

Cash/Bank A/c	Dr. (with Payment received)
Joint Venture A/c	Dr. (with Discount allowed/Bad debts)
To Customer's A/c	(with Total)

8. On Taking away of Unsold Goods by the Co-Venturers

(a) *By the Co-Venturer recording transactions*

Goods Sent on Joint Venture A/c	Dr.
To Joint Venture A/c	

- (b)
- By the Co-Venturer other than recording the transaction*

Co-Venturer's Personal A/c Dr.
 To Joint Venture A/c

9. When Co-Venturer recording the transaction is entitled to some Commission/Salary

Joint Venture A/c Dr
 To Commission/Salary A/c

10. On Transfer of the Balance of Joint Venture Account

- (a)
- In case of Profit*

Joint Venture A/c Dr. (with Total)
 To Profit and Loss A/c (with his own share of profit)
 To Personal Accounts of Co-Venturers (with other's share of profit)

- (b)
- In case of Loss*

Profit and Loss A/c Dr. (with his own share of loss)
 Personal Accounts of Co-Venturers Dr. (with other's share of loss)
 To Joint Venture A/c (with Total)

11. On Settlement of the balance of Personal A/cs of Co-Venturers

- (a)
- In case of a Debit balance*

Cash/Bank A/c Dr.
 To Co-Venturer's Personal A/c

- (b)
- In case of a Credit balance*

Co-Venturer's Personal A/c Dr.
 To Cash/Bank A/c

ILLUSTRATION 9

A enters into a Joint Venture with B. The following transactions took place during the course of the venture.

<i>Particulars</i>	<i>A</i>	<i>B</i>	<i>Particulars</i>	<i>A</i>	<i>B</i>
Cash sent by	—	5,000	Expenses incurred by	7,300	3,650
Cash received by	5,000	—	Goods sold by	70,000	20,000
Goods purchased by	40,000	20,000	Goods unsold taken		
Goods brought in			away by	1,800	900
from own stock	10,000	5,000			

Required: (i) Pass the necessary journal entries and (ii) Prepare the necessary ledger accounts in the books of A assuming that final settlement between A and B was made by cheque.

SOLUTION:**JOURNAL OF A**

<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Cash A/c Dr. To B (Being cash received from B)		5,000	5,000

Joint Venture A/c	Dr.	60,000	
To Bank A/c			40,000
To B			20,000
(Being goods purchased on Joint Account with B)			
Joint Venture A/c	Dr.	15,000	
To Goods sent on Joint Venture A/c			10,000
To B			5,000
(Being goods brought in from stock)			
Joint Venture A/c	Dr.	10,950	
To Bank A/c			7,300
To B			3,650
(Being expenses incurred on Joint Account)			
Bank A/c	Dr.	70,000	
B	Dr.	20,000	
To Joint Venture A/c			90,000
(Being goods sold)			
Goods sent on Joint Venture A/c	Dr.	1,800	
B	Dr.		900
To Joint Venture A/c			2,700
(Being unsold goods taken over)			
Joint Venture A/c	Dr.	6,750	
To Profit and Loss A/c			3,375
To B			3,375
(Being profit on Joint Venture transferred)			
B	Dr.		16,125
To Bank A/c			16,125
(Being final amount paid to B)			

DR.
JOINT VENTURE ACCOUNT
CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (Purchases)	40,000	By Bank A/c (Sales)	70,000
To B (Purchases)	20,000	By B (Sales)	20,000
To Goods sent on Joint Venture A/c (Supplies)	10,000	By Goods sent on Joint Venture A/c (Goods taken)	1,800
To B (supplies)	5,000	By B (Goods taken)	900
To B (expenses)	3,650		
To Bank A/c (Expenses)	7,300		
To Profit transferred to:			
P & L A/c	3,375		
B	3,375		
	92,700		92,700

Note: In the absence of profit sharing ratio, profits are shared by Co-Venturers equally.

DR.**B 'S ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Joint Venture A/c (Goods taken)	900	By Cash A/c	5,000
To Joint Venture A/c (Sales)	20,000	By Joint Venture A/c (Purchases)	20,000
To Bank A/c	16,125	By Joint Venture A/c (Supplies)	5,000
		By Joint Venture A/c (Expenses)	3,650
		By Joint Venture A/c (Profit)	3,375
	37,025		37,025

ILLUSTRATION 10

A of Agra and B of Bareilly enter into a joint venture, decide to share profits and losses in the ratio of 3:2. A purchases 3,000 kg of material I for ₹ 1,50,000 and sends it to S of Shahdra for processing. A pays the transport cost amounting to ₹ 6,000. B purchases 2,000 kg of material II for ₹ 2,00,000 and sends it to S of Shahdra for processing. The transport cost amounting to ₹ 10,000 is paid by B. S does the processing work and manufactures 4,800 units of finished product C. S prepares a 'conversion cost' bill on the Joint Venture at ₹ 20 per unit. A pays this bill. The goods are sent to Dr. Ram of Delhi, the transport cost amounting to ₹ 18,000 being paid by A. Dr Ram sells 90% of the goods at

₹ 150 per unit. He takes over the balance goods at ₹ 120 per unit. After deducting his own commission @ 10% of sale proceeds, he remits the amount to A. The Co-Venturers agree to settle the account, after retaining 30% of the profits for taxation on the income of Association of Persons. Show the ledger accounts in the books of A.

SOLUTION:**DR.****JOINT VENTURE ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (Purchases)	1,50,000	By Dr Ram (Goods Taken)	
To Bank A/c (Transport Cost)	6,000	(480 × ₹ 120)	57,600
To B (Purchases)	2,00,000	By Dr Ram (Sales)	
To B (Transport Cost)	10,000	(4,320 × ₹ 150)	6,48,000
To Bank A/c (Transport Cost)	18,000		
To Bank A/c (Conversion Cost)	96,000		
To Dr Ram (Commission)			
[₹ 6,48,000 × 10/100]	64,800		
To Provision for Income Tax	48,240		
To Profit transferred to:			
B	45,024		
Profit and Loss A/c	67,536		
	7,05,600		7,05,600

DR. B 'S ACCOUNT CR.

Particulars	₹	Particulars	₹
To Bank A/c	2,55,024	By Joint Venture A/c (Purchases)	2,00,000
		By Joint Venture A/c (Transport Cost)	10,000
		By Joint Venture A/c (Profit)	45,024
	2,55,024		2,55,024

DR. DR RAM'S ACCOUNT CR.

Particulars	₹	Particulars	₹
To Joint Venture A/c (Sales)	6,48,000	By Joint Venture A/c (Commission)	64,800
To Joint Venture A/c (Goods taken)	57,600	By Bank A/c	6,40,800
	7,05,600		7,05,600

Note: No commission has been given on 480 kg retained by Dr Ram.

ILLUSTRATION 11

Ram and Gautham entered into a joint venture to buy and sell TV sets, on 1st July. On 1st July Ram sent a draft for ₹ 2,50,000 in favour of Gautham and on 4th July the latter purchased 200 sets at a cost of ₹ 2,000 each. The sets were sent to Ram by lorry under freight "to pay" for ₹ 2,000, and were cleared by Ram on 15th July. Ram effected sales in the following manner:

Date	No. of Sets	Sale price per set ₹	Discount on Sale Price
16th July	20	3,000	10%
31st July	100	2,800	—
16th Aug	80	2,700	5%

On 25th Aug, Ram settled the account by sending a draft in favour of Gautham, profits being shared equally. Gautham does not maintain any books. Show the necessary accounts in Ram's books:

SOLUTION:
DR. JOINT VENTURE ACCOUNT CR.

Particulars	₹	Particulars	₹
To Gautam (200 × ₹ 2,000)	4,00,000	By Bank A/c [Sale proceeds (net)]:	
To Bank A/c (Freight)	2,000	20 sets @ ₹ 2,700 net	54,000
To profit transferred to P & L A/c 68,600		100 sets @ ₹ 2,800 net	2,80,000
Gautam 68,600	1,37,200	80 sets @ ₹ 2,565 net	2,05,200
	5,39,200		5,39,200

DR**GAUTAM'S ACCOUNT****CR**

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
1 July	To Bank A/c (draft sent)	2,50,000	4 July	By Joint Venture A/c	
25 Aug.	To Bank A/c (draft sent in settlement)	2,18,600	Aug. 25	(Purchases)	4,00,000
				By Joint Venture A/c	
				(Profit)	68,600
		4,68,600			4,68,600

9.0 METHOD III—RECORDING IN THE BOOKS OF ALL CO-VENTURERS

1. Under this method, all transactions relating to the joint venture are recorded in the books of all the Co-Venturers.
2. In order to complete the Joint Venture Account in the books of allco-venturers, each Co-Venturer sends the necessary information about his dealings to the other co-ventures.
3. There is not much of a difference in the recording of transactions between the second and third method. We will be having similar entries in the joint venture in each co-venturer's books.

ILLUSTRATION 12

Taking the same information as given in Illustration 9, pass the necessary journal entries and prepare the necessary ledger accounts, in the books of both the parties.

SOLUTION:

Journal entries & Ledger Accounts in the books of 'A'—same as given in Illustration 9. Journal entries & Ledger Accounts in the books of 'B' are given as follows:

JOURNAL OF B

<i>Particulars</i>		<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
A	Dr.	5,000	
To Cash A/c			5,000
(Being cash sent to A)			
Joint Venture A/c	Dr.	60,000	
To Bank A/c			20,000
To A			40,000
(Being goods purchased on Joint Account with A)			
Joint Venture A/c	Dr.	15,000	
To Goods sent on Joint Venture A/c			5,000
To A			10,000
(Being goods brought in from stock)			
Joint Venture A/c	Dr.	10,950	
To Bank A/c			3,650
To A			7,300
(Being expenses incurred on Joint Account)			

Bank A/c	Dr.	20,000	
A	Dr.	70,000	
To Joint Venture A/c			90,000
(Being goods sold)			
Goods sent on Joint Venture A/c	Dr.	900	
A	Dr.	1,800	
To Joint Venture A/c			2,700
(Being unsold goods taken over)			
Joint Venture A/c	Dr.	6,750	
To Profit and Loss A/c			3,375
To A			3,375
(Being profit on Joint Venture transferred)			
Bank A/c	Dr.	16,125	
To A			16,125
(Being final amount received from A)			

DR.
JOINT VENTURE ACCOUNT
CR.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Bank A/c (Purchases)	20,000	By Bank A/c (Sales)	20,000
To A (Purchases)	40,000	By A (Sales)	70,000
To Goods sent on Joint Venture A/c		By Goods sent on Joint Venture A/c	
(Supplies)	5,000	(Goods taken)	900
To A (Supplies)	10,000	By A (Goods taken)	1,800
To A (Expenses)	7,300		
To Bank A/c (Expenses)	3,650		
To Profit transferred to:			
P & L A/c	3,375		
A	3,375		
	6,750		
	92,700		92,700

Note: In the absence of profit sharing ratio, profits are shared by Co-Venturers equally.

DR.
A'S ACCOUNT
CR.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Cash A/c	5,000	By Joint Venture A/c (Purchases)	40,000
To Joint Venture A/c (Goods taken)	1,800	By Joint Venture A/c (Supplies)	10,000
To Joint Venture A/c (Sales)	70,000	By Joint Venture A/c (Expenses)	7,300
		By Joint Venture A/c (Profit)	3,375
		By Bank A/c	16,125
	76,800		76,800

ILLUSTRATION 13

Ram and Rahim enter into a Joint Venture to take a building contract for ₹ 24,00,000. They provide the following information regarding the expenditure incurred by them:

	<i>Ram</i> ₹	<i>Rahim</i> ₹
Materials	6,80,000	5,00,000
Cement	1,30,000	1,70,000
Wages	—	2,70,000
Architect's Fee	1,00,000	—
Licence Fees	—	50,000
Plant	—	2,00,000

Plant was valued at ₹ 1,00,000 at the end of the contract and Rahim agreed to take it at that value. Contract amount of ₹ 24,00,000 was received by Ram. Profits or losses to be shared equally. You are asked to show:

- (i) Joint Venture Account and Rahim's account in the books of Ram: and
- (ii) Joint Venture Account and Ram's Account in the books of Rahim.

SOLUTION:**BOOKS OF RAM**

DR.
JOINT VENTURE ACCOUNT
CR.

Particulars	₹	Particulars	₹
To Bank A/c:			
Materials	6,80,000	By Rahim's A/c	1,00,000
Cement	1,30,000	By Bank A/c	24,00,000
Architect's fee	1,00,000		
To Rahim's A/c:			
Materials	5,00,000		
Cement	1,70,000		
Wages	2,70,000		
License fees	50,000		
Plant	2,00,000		
To P&L A/c	2,00,000		
To Rahim's A/c	2,00,000		
	25,00,000		25,00,000

RAHIM'S ACCOUNT

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To JV A/c (Plant)	1,00,000	By Joint Venture A/c:	
To Balance c/d	12,90,000	Materials	5,00,000
		Cement	1,70,000
		Wages	2,70,000
		License fees	50,000
		Plant	2,00,000
		By Joint Venture A/c (Profit)	2,00,000
	13,90,000		13,90,000

BOOKS OF RAHIM

DR.

JOINT VENTURE ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Bank A/c:		By Plant A/c	1,00,000
Materials	5,00,000	By Ram's A/c	24,00,000
Cement	1,70,000		
Wages	2,70,000		
License fees	50,000		
Plant	2,00,000		
To Ram's A/c:			
Materials	6,80,000		
Cement	1,30,000		
Architect's fee	1,00,000		
To P&L A/c	2,00,000		
To Ram's A/c	2,00,000		
	25,00,000		25,00,000

DR.

RAM'S ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Joint Venture A/c	24,00,000	By Joint Venture A/c	
		(6,80,000 + 1,30,000 + 1,00,000)	9,10,000
		By Joint Venture A/c	2,00,000
		By Balance c/d	12,90,000
	24,00,000		24,00,000

ILLUSTRATION 14

Mr. M and Mr. N jointly agreed to underwrite the subscription at par of 1,00,000 shares of ₹. 10 each in X Ltd, and to pay all expenses upto allotment. The consideration in return for the guarantee was 5,000 other shares of ₹. 10 each fully paid to be issued to them. They were to share the profits in the ratio of 3 : 1.

Mr. M provided the funds to meet the following expenses:

Registration fees	₹. 4,850
Advertising charges	₹. 2,850
Printing charges	₹. 2,300

Mr. N contributed towards the payment of the following expenses:

Rent	₹. 5,000
Solicitor's charges	₹. 3,000

Applications fall short of the full issue by 10,000 shares. Mr. N took over on joint account and paid for the same in full.

The guarantee having been fulfilled, X Ltd. handed over to M and N 5,000 shares. They sold their all shares at ₹. 15 per share. The proceeds were shared by M for 4,000 shares and by N for the balance.

Required: Prepare Joint Venture A/c and Co-venturer's A/c in the books of both the parties.

SOLUTION

IN THE BOOKS OF MR. M
JOINT VENTURE ACCOUNT

DR.**CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank (Expenses):		By Bank A/c (Sale) (4,000 × ₹. 15)	60,000
— Registration Fees 4,850		By N (Sale) (11,000 × ₹. 15)	1,65,000
— Advertising Charges 2,850			
— Printing Charges <u>2,300</u>	10,000		
To N (Expenses):			
— Rent 5,000			
— Solicitor's Charges <u>3,000</u>	8,000		
To N (Payment to Co.)			
(10,000 shares × ₹ 10)	1,00,000		
To N (Share of Profit)	26,750		
To Profit & Loss A/c (Profit)	80,250		
	<u>2,25,000</u>		<u>2,25,000</u>

DR.**MR. N'S ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Joint Venture A/c		By Joint Venture A/c	8,000
(Sale of Shares)	1,65,000	By Joint Venture A/c	1,00,000
		By Joint Venture AVc(Profit)	26,750
		By Bank A/c (Bal. Fig.)	30,250
	<u>1,65,000</u>		<u>1,65,000</u>

IN THE BOOKS OF MR. N
JOINT VENTURE ACCOUNT

DR.**CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Mr. M (Expenses):		By M (Sales) (4,000 × ₹ 15)	60,000
— Registration Fees 4,850		By Bank A/c (Sales)	1,65,000
— Advertising Charges 2,850		(11,000 × ₹15)	1,65,000
— Printing Charges <u>2,300</u>	10,000		
To Bank A/c (Expenses):			
— Rent 5,000			
— Solicitor's Charges <u>3,000</u>	8,000		
To Bank (Payment to Co.)	1,00,000		
To M (Profit)	80,250		
To Profit & Loss A/c (Profit)	26,750		
	<u>2,25,000</u>		<u>2,25,000</u>

DR.		MR. N'S ACCOUNT		CR.
Particulars	₹	Particulars	₹	
To Joint Venture A/c (Sale of Shares)	60,000	By Joint Venture A/c (Exp.)	10,000	
To Bank A/c (Balancing Figure)	30,250	By Joint Venture A/c (Profit)	80,250	
	90,250		90,250	

Working Note: Out of 15,000 shares [10,000 shares due to under-subscription + 5,000 shares as per guarantee], 4,000 shares are sold by M and remaining shares i.e., 11,000 shares are sold by N @ ₹ 15 per share.

PROBLEM 15

B and T enter into a Joint Venture to buy and sell second-hand machines and to share the result as to 5 : 3 respectively.

On January 1, T purchases two machines for ₹ 20,000, and incurs ₹ 3,000 on repairs. One week later, he sells the machines for ₹ 28,000 subject to a 2% cash discount on payment within next 10 days. He deposited the sale proceeds into his bank account on the 15th January.

On 31st January, B purchases 5 machines for ₹ 50,000, of which he sells three for ₹ 36,000 the same day, without incurring any expenses. The fourth machine is sold on 7th February, 2006 for ₹ 13,000 in exchange of a bill receivable to be presented for payment three months after date.

On 31st March, the unsold fifth machine is taken over by T for personal use at an agreed valuation of ₹ 7,500. At this date the parties make a settlement between each other, B agreeing to take the bill at a value of ₹ 12,860.

Required: Prepare the Joint Venture and Coventurer's accounts in the books of both the parties.

SOLUTION

DR.		BOOKS OF T JOINT VENTURE ACCOUNT		CR.
Particulars	₹	Particulars	₹	
To Bank A/c (Purchases)	20,000	By Bank A/c:		
To Bank A/c (Exp.)	3,000	Sale Proceeds	28,000	
To B (Purchases of Machines)	50,000	Less: Cash Discount	560	27,440
To B (Discount of Bill)	140			
To Profit & Loss A/c		By B (Sales Proceeds		
— Share of Profit	4,050	of 3 machines)	36,000	
To B (Share of Profit)	6,750	By B (Sale of fourth machine)	13,000	
		By Drawing A/c: Machine takenover	7,500	
	83,940		83,940	

DR.		B'S ACCOUNT		CR.
Particulars	₹	Particulars	₹	
To Joint Venture A/c (Sales)	36,000	By Joint Venture A/c (Purchase)	50,000	
To Joint Venture A/c (Sales)	13,000	By Joint Venture A/c:		
To Bank A/c (Final)	7,890	— Bill discounting	140	
		— Share of Profit	6,750	
	56,890		56,890	

BOOKS OF B**DR.****JOINT VENTURE ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To T (Purchases)	20,000	By T-Sale proceeds	27,440
To T (Expenses)	3,000	By Bank A/c (Sale proceeds)	36,000
To Bank A/c (Purchases)	50,000	By Bank A/c (Sale proceeds)	13,000
To Bill discounting charge	140	By T (Machine takeover)	7,500
To Profit & Loss A/c:			
Profit	6,750		
To T-Profit	4,050		
	83,940		83,940

DR.**T'S ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Joint Venture A/c (Sale proceed)	27,440	By Joint Venture A/c	20,000
To Joint Venture A/c		By Joint Venture A/c	3,000
(Machine takeover)	7,500	By Joint Venture A/c (Share of Profit)	4,050
		By Bank A/c (Bal. Fig.)	7,890
	34,940		34,940

ILLUSTRATION 16

Mr. Gulab of Delhi and Mr. Vikas of Bombay entered into joint venture for sale of 100 machines. On 1st April, Mr. Gulab sent the machines costing ₹ 12,50,000 out of his stock.

Mr. Gulab paid ₹ 12,000 for transit insurance. Mr. Vikas paid ₹ 25,000 for freight while taking delivery on 5th April. On the same day he sent a draft of ₹ 5,50,000 to Mr. Gulab. Mr. Vikas spent ₹ 28,000 for advertisement and ₹ 7,500 for godown rent.

Mr. Vikas is entitled to commission at the rate of 4% on sales and share of 2/5th profit. By 30th April, all the machines were sold at the list price of ₹ 15,200 each less 5% discount. Mr. Vikas could not collect ₹ 2,500 from customers. He settled the amount due to Mr. Gulab on 30th April.

Required: Prepare the Joint Venture Account and Vikas' Account in the books of Gulab and the Joint Venture Account and Gulab's Account in the books of Vikas.

SOLUTION**IN THE BOOKS OF GULAB****DR.****JOINT VENTURE ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Purchase A/c (Goods supplied)	12,50,000	By Vikas (Sales)	
To Bank A/c (Insurance)	12,000	[₹ 15,200 × 100]	15,20,000
To Vikas (Expenses):		Less: Discount	
Freight	25,000	[₹ 15,20,000 × 5/100]	76,000
Advertisement	28,000	Net Sales	14,44,000
Godown Rent	7,500	Less: Bad Debts	2,500
	60,500		14,41,500

To Vikas (Commission)	57,760		
[₹ 14,44,000 × 4/100]			
To Profit & Loss A/c (Own Profit)	36,744		
To Vikas A/c (Share of Profit)	24,496		
	14,41,500		14,41,500

DR. VIKAS' ACCOUNT CR.

Particulars	₹	Particulars	₹
To Joint Venture A/c (Sales)	14,41,500	By Joint Venture A/c	25,000
		By Bank A/c (Draft)	5,50,000
		By Joint Venture A/c	35,500
		By Joint Venture A/c (Comm.)	57,760
		By Joint Venture A/c	24,496
		By Bank A/c (Bal. Fig.)	7,48,744
	14,41,500		14,41,500

IN THE BOOKS OF VIKAS

DR. JOINT VENTURE ACCOUNT CR.

Particulars	₹	Particulars	₹
To Gulab (Machines)	12,50,000	By Bank A/c (Sale Proceeds)	
To Gulab (Insurance)	12,000	Gross Sales	
To Bank A/c (Freight)	25,000	(₹ 15,200 × 100)	15,20,000
To Bank A/c [28,000 + 7,500]	35,500	Less: Discount	
(Advertisement & Godown Rent)		[15,20,000 × 5/100]	76,000
To Commission A/c	57,760		14,44,000
[₹ 14,44,000 × 4/100]		Less: Bad Debts	2,500
To Profit & Loss A/c (Share of Profit)	24,496		14,41,500
[₹ 61,240 × 2/5]			
To Gulab's A/c (Share of Profit)	36,744		
[₹ 61,240 × 3/5]			
	14,41,500		14,41,500

DR. GULAB'S ACCOUNT CR.

Particulars	₹	Particulars	₹
To Bank A/c (Draft)	5,50,000	By Joint Venture A/c	12,50,000
To Bank A/c (Bal. Fig)	7,48,744	By Joint Venture A/c	12,000
		By Joint Venture A/c (Profit)	36,744
	12,98,744		12,98,744

ILLUSTRATION 17

A and B entered into a Joint Venture sharing profits equally. A purchased goods for ₹ 2,25,000 and paid cash for the same. He drew a bill on B for ₹ 1,00,000 for 2 months and discounted it @ 18% p.a. The following transactions took place:

- (i) A spent ₹ 4,800 for conveyance; ₹ 6,000 for carriage and ₹ 2,000 for travelling expenses.
- (ii) B spent ₹ 3,000 for travelling expenses and ₹ 1,500 for miscellaneous expenses.
- (iii) A sold part of the goods for ₹ 1,80,000 and B for ₹ 1,10,000.
- (iv) Goods costing ₹ 6,000 and ₹ 4,000 were taken up by A and B respectively, at 20% above the cost.
- (v) B was to be allowed ₹ 4,500 for his godown having because for Joint Venture purposes.
- (vi) A was allowed a salary of ₹ 5,000 per month for three months,
- (vii) Discount on bill of exchange was to be treated as the expense of the Joint Venture.

Required: Assuming that each party records its own transactions, prepare the necessary accounts in the books of both parties.

SOLUTION

IN THE BOOKS OF A

DR. JOINT VENTURE ACCOUNT CR.

Particulars	₹	Particulars	₹
To Bank A/c (Goods)	2,25,000	By Bank A/c (Sales)	1,80,000
To BankA/c:		By B (Sales)	1,10,000
Conveyance 4,800		By Purchases A/c (Stock taken)	
Carriage 6,000		Cost 6,000	
Travelling Expenses 2,000	12,800	+ [20% of ₹ 6,000] 1200	7,200
To B (Expenses):		By B (Stock taken)	
Travelling Expenses 3,000		Cost 4,000	
Misc. Expenses 1,500		+ [20% of ₹ 4,000] 800	4800
(Godown Rent) 4,500	9,000		
To Salary (₹ 5000 × 3)	15,000		
To Discount Charge			
(Discout on B/R)	3,000		
To Profit & Loss A/c (Profit)	18,600		
To B (Profit)	18,600		
	3,02,000		3,02,000

B'S ACCOUNT CR.

Particulars	₹	Particulars	₹
To Joint Venture A/c	1,10,000	By Joint Venture A/c	4,500
To Joint Venture A/c	4,800	By Joint Venture A/c	4,500
To Bank A/c (Bal. Fig.)	12,800	By Bills Receivable A/c	1,00,000
		By Joint Venture A/c (Profit)	18,600
	1,27,600		1,27,600

IN THE BOOKS OF B
DR.
JOINT VENTURE ACCOUNT
CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To A (Goods)	2,25,000	By A (Sales)	11,80,000
To A (Expenses)	12,800	By Bank A/c (Sales)	1,10,000
To Bank A/c (Expenses)	4,500	By A (6,000 + 1200 Stock)	7,200
To Bank A/c (Godown Rent)	4,500	By Stock (4000 + 800)	4,800
To A (Salary)	15,000		
To A (Discounting of B/R)	3,000		
To Profit & Loss A/c	18,600		
To A (Profit)	18,600		
	3,02,000		3,02,000

DR.
A'S ACCOUNT
CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Joint venture A/c	1,80,000	By Joint venture A/c	2,25,000
To Joint venture A/c	7,200	By Joint venture A/c	12,800
To Bills Payable A/c	1,00,000	By Joint venture A/c	15,000
		By Joint venture A/c	3,000
		By Joint venture A/c	18,600
		By Bank A/c	12,800
	2,87,200		2,87,200

ILLUSTRATION 18

A of Agra and B of Bombay enter into a joint venture to consign 200 bales of cloth to D of Delhi to be sold on their joint risk which is in the proportion of 3/7 and 4/7 respectively. A sends 150 bales at ₹ 2,600 each, paying for freight and other charges ₹ 4,900. B sends 50 bales at ₹ 2,500 each, paying for expenses ₹ 3,600. All the bales were sold by D for ₹ 14,00,000 of which D deducts ₹ 6,000 for his expenses and 10% on total sales as his commission. D remits ₹ 3,00,000 to A and the balance amount to B through Bank Draft. Prepare necessary ledger accounts in the books of both Co-venturers.

SOLUTION:
LEDGER ACCOUNTS IN THE BOOKS OF A
DR.
JOINT VENTURE ACCOUNT
CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (Goods)	3,90,000	By D (Sales)	14,00,000
To Bank A/c (Freight etc)	4,900		
To B (Goods)	1,25,000		
To B (Expenses)	3,600		
To D (expenses)	6,000		
To D (Commission)	1,40,000		
To Profit transferred to:			
P & L A/c	3,13,071		
B	4,17,429		
	14,00,000		14,00,000

B'S ACCOUNT

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To D [14,00,000 – 1,40,000 – 6,000 – 3,00,000]	9,54,000	By Joint Venture A/c: Goods Expenses By Joint Venture A/c (Profit) By Bank A/c	1,25,000 3,600 4,17,429 4,07,971
	9,54,000		9,54,000

LEDGER ACCOUNTS IN THE BOOKS OF B**DR.****JOINT VENTURE ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (Goods)	1,25,000	By D (Sales)	14,00,000
To Bank A/c (Expenses)	3,600		
To A (Goods)	3,90,000		
To A (Freight etc)	4,900		
To D (Expenses)	6,000		
To D (Commission)	1,40,000		
To Profit transferred to: – P & L A/c – A (Profit)	4,17,429 3,13,071		
	14,00,000		14,00,000

A'S ACCOUNT

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To D	3,00,000	By Joint Venture A/c (Goods)	3,90,000
To Bank A/c	4,07,971	By Joint Venture A/c (Expenses)	4,900
		By Joint Venture A/c (Profit)	3,13,071
	7,07,971		7,07,971

10.0 METHOD IV—MEMORANDUM JOINT VENTURE ACCOUNT METHOD**MEMORANDUM JOINT VENTURE ACCOUNT METHOD**

- Each Co-Venturer records only those joint venture transactions which are effected by him with the help of a personal account designed as 'Joint Venture with....(Name of the other Co-Venturer) ... Account'. It is debited with the purchases/supplies made and expenses incurred by the Venturer. It is credited with the sales effected and unsold stock taken over by the Venturer.
- Each Co-Venturer sends a periodic statement of joint venture transactions effected by him only, to the other Co-Venturers.
- Each Co-Venturer on the receipt of the aforesaid statement, prepares Memorandum Joint Venture Account in order to ascertain the profit/loss on Joint Venture transactions. Since this account is in fact not a part and parcel of double entry system the word 'Memorandum' is prefixed. This account can be compared with 'Joint Venture Account', as follows:

4. Each Co-Venturer makes a Journal entry for his share of profit/loss in his books of account.
 - (i) Both these accounts are debited with the same items.
 - (ii) Both these accounts are credited with the same items.
 - (iii) Both these accounts show profit/loss on Joint Venture.
 - (iv) All the items posted in Joint Venture Account have their corresponding debits/credits in the books of accounts, whereas it is not so in the case of 'Memorandum Joint Venture Accounts'.
5. Each Co-Venturer settles the balances of 'Joint Venture with....Account' either by paying (if Cr. Balance) or receiving Cash (if Dr. Balance).

JOURNAL ENTRIES

The various journal entries which may be required to be passed are summarized here as under:

1. (a) **On Receipt of any amount/Bills Receivable from other Co-Venturer**

Cash/Bank A/c/Bills Receivable A/c	Dr.	
To Joint Venture with.....A/c		
- (b) **On Discounting Bills Receivable**

Bank A/c	Dr.	[with Net Proceeds]
Joint venture with.....A/c	Dr.	[with Discount]
To Bills Receivable A/c		[with Total]
2. **On Purchase of Goods**

Joint Venture with.....A/c	Dr.	(with Total)
To Cash/Bank A/c		(with cash purchases)
To Supplier's A/c		(with credit purchases)
3. **On Making Payment to Supplier**

Supplier's A/c	Dr.	(with Total)
To Cash/Bank A/c/B/P A/c		(with Payment made)
To Joint Venture with.....A/c		(with Discount received)
4. **On Supply of Goods out of own stock**

Joint Venture with.....A/c	Dr.	
To Purchases A/c/Goods sent on Joint Venture A/c		(if supplies at cost)
To Sales A/c		(if supplies at profit)
5. **On Payment of Expenses**

Joint Venture with.....A/c	Dr.	(with total)
To Cash/Bank A/c		(with cash expenses)
To Creditor's A/c		(with outstanding expenses)
6. **On Sale of Goods**

Cash/Bank A/c	Dr.	(with cash sales)
Customer's A/c	Dr.	(with credit sales)
To Joint Venture with....A/c		(with Total)

7. On Receiving Payment from a Customer

Cash/Bank A/c	Dr.	(with the payment received)
Joint Venture with.....A/c	Dr.	(Discount allowed/Bad Debts)
To Customer's A/c		(with Total)

8. On Taking Away of Unsold Goods

Goods Sent on Joint Venture A/c	Dr.
To Joint Venture with.....A/c	

9. When the Co-Venturer is entitled to some commission/salary

Joint Venture with.....A/c	Dr.
To Commission A/c/Salary A/c	

10. On Recording the Share of Profit/Loss**(a) In case of Profit**

Joint Venture with.....A/c	Dr.
To Profit and Loss A/c	

(b) In case of Loss

Profit and Loss A/c	Dr.
To Joint Venture with.....A/c	

11. On Settlement of Balance of Joint Venture with.....A/c**(a) In case of a debit balance**

Cash/Bank A/c	Dr.
To Joint Venture with.....A/c	

(b) In case of a credit balance

Joint Venture with.....A/c	Dr.
To Cash/Bank A/c	

Notes: (i) Transactions effected by other Co-Venturers are not recorded.

(ii) Transactions not involving any cash receipt/payment are not recorded in the books of either party, e.g. Return of goods by one Co-Venturer to another Co-Venturer is not recorded in the books of either party.

ILLUSTRATION 19

Taking the same information as given in Illustration 9, pass the necessary journal entries and prepare necessary accounts in the books of A and B assuming that every Co-Venturer records the transactions in his own books of account under Memorandum Method.

SOLUTION:**JOURNAL OF A**

Particulars		Dr. (₹)	Cr. (₹)
Bank A/c	Dr.	5,000	
To Joint Venture with B A/c (Being cash sent by B)			5,000
Joint Venture with B A/c	Dr.	40,000	
To Bank A/c (Being goods purchased)			40,000

Joint Venture with B A/c To Goods sent on Joint Venture A/c (Being goods brought in from own stock)	Dr.	10,000	10,000
Joint Venture with B A/c To Bank A/c (Being expenses incurred)	Dr.	7,300	7,300
Bank A/c To Joint Venture with B A/c (Being goods sold)	Dr.	70,000	70,000
Goods sent on Joint Venture A/c To Joint Venture with B A/c (Being goods taken away)	Dr.	1,800	1,800
Joint Venture with B A/c To Profit & Loss A/c (Being share of profit on Joint Venture ascertained)	Dr.	3,375	3,375
Joint Venture with B A/c To Bank A/c (Being payment made to B)	Dr.	16,125	16,125

DR. JOINT VENTURE WITH B ACCOUNT IN THE BOOKS OF A CR.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Bank A/c (Purchases)	40,000	By Bank A/c (Cash receipt)	5,000
To Goods sent on Joint Venture A/c (Supplies)	10,000	By Bank A/c (Sales)	70,000
To Bank A/c (Expenses)	7,300	By Goods sent on Joint Venture A/c (Takenover)	1,800
To Profit & Loss A/c (Profit)	3,375		
To Bank A/c (Payment)	16,125		
	76,800		76,800

JOURNAL OF B

<i>Particulars</i>		<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Joint Venture with A A/c To Bank A/c (Being cash sent to A)	Dr.	5,000	5,000
Joint Venture with A A/c To Bank A/c (Being goods purchased)	Dr.	20,000	20,000
Joint Venture with A A/c To Goods sent on Joint Venture A/c (Being goods brought in from own stock)	Dr.	5,000	5,000

Joint Venture with A A/c To Bank A/c (Being expenses incurred)	Dr.	3,650	3,650
Bank A/c To Joint Venture with A A/c (Being goods sold)	Dr.	20,000	20,000
Goods sent on Joint Venture A/c To Joint Venture with A A/c (Being goods taken away)	Dr.	900	900
Joint Venture with A A/c To Profit & Loss A/c (Being share of profit on Joint Venture ascertained)	Dr.	3,375	3,375
Bank A/c To Joint Venture with A A/c (Being payment received from A)	Dr.	16,125	16,125

DR. JOINT VENTURE WITH A ACCOUNT IN THE BOOKS OF B CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (Cash sent)	5,000	By Bank A/c (Sales)	20,000
To Bank A/c (Purchases)	20,000	By Goods sent on Joint Venture A/c (Taken over)	900
To Goods sent on Joint Venture A/c (Supplies)	5,000	By Bank A/c (Payment)	16,125
To Bank A/c (Expenses)	3,650		
To Profit & Loss A/c (Profit)	3,375		
	37,025		37,025

DR. MEMORANDUM JOINT VENTURE ACCOUNT CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Goods purchased:		By Sales made by:	
A 40,000		A 70,000	
B 20,000	60,000	B 20,000	90,000
To Goods supplied:		By Stock taken over by:	
A 10,000		A 1,800	
B 5,000	15,000	B 900	2,700
To Expenses incurred:			
A 7,300			
B 3,650	10,950		
To Profit transferred to:			
A 3,375			
B 3,375	6,750		
	92,700		92,700

ILLUSTRATION 20

Prepare the necessary ledger accounts in Illustration 8 assuming Memorandum Joint Venture Account Method.

SOLUTION:

DR. (I) MEMORANDUM JOINT VENTURE ACCOUNT CR.

Particulars	₹	Particulars	₹
To X (Stationery & Adv.)	40,800	By X (Sale of 8,000 Shares @ ₹ 15)	1,20,000
To Y (Regd. Fee etc.)	27,200	By Y (Sale of 12,000 shares @ ₹ 20)	2,40,000
To X (Purchase of Shares)	1,15,200		
To Y (Purchase of Shares)	76,800		
To Profit t/f to:			
X	60,000		
Y	40,000		
	3,60,000		3,60,000

DR. (II) JOINT VENTURE WITH Y ACCOUNT IN THE BOOKS OF X CR.

Particulars	₹	Particulars	₹
To Bank A/c	40,800	By Bank A/c	1,20,000
To Bank A/c	1,15,200	By Bank A/c	96,000
To Profit & Loss A/c	60,000		
	2,16,000		2,16,000

DR. (III) JOINT VENTURE WITH X ACCOUNT IN THE BOOKS OF Y CR.

Particulars	₹	Particulars	₹
To Bank A/c	27,200	By Bank A/c	2,40,000
To Bank A/c	76,800		
To Bank A/c	96,000		
To Profit & Loss A/c	40,000		
	2,40,000		2,40,000

Working Notes:

- (i) Underwriting Commission = 4% of (1,00,000 × ₹ 12) = ₹ 48,000
 No. of shares to be received = (₹ 48,000/₹ 12) = 4,000 Shares
 (ii) No. of shares to be taken up = 1,00,000 shares – (₹ 10,08,000/₹ 12)
 = 16,000 shares

ILLUSTRATION 21

A and B entered into a Joint Venture of underwriting the subscription at par of the entire share capital of C Ltd. consisting of 1,00,000 equity shares of ₹ 10 each and to pay all expenses up to allotment. The profits were to be shared by them in proportions of 3/5 and 2/5 ths. The consideration in return for this agreement was the allotment of 12,000 other shares of ₹ 10 each to be issued to them as fully paid. A provided the funds for registration fees ₹ 12,000, advertising expenses of ₹ 11,000, for expenses on printing and distributing the prospectus amounting to ₹ 7,500 and stationery expenses of ₹ 2,000. B contributed towards payment of office rent ₹ 3,000, Legal charges ₹ 13,750, salary to clerical staff of ₹ 9,000 and other petty disbursements of ₹ 1,750. The prospectus was issued and

application fell short of the issue by 15,000 shares. A took these over on Joint account and paid for the same in full. The venturers received the 12,000 fully paid shares as underwriting commission. They sold their entire holding @ ₹ 12.50 less 50 paise brokerage per share. The net proceeds were received by A for 15,000 shares and B for 12,000 shares.

Required: Prepare (a) Memorandum Joint Venture Account (b) Joint Venture with B Account in A's books (c) Joint Venture with A Account in B's books.

SOLUTION:

DR. MEMORANDUM JOINT VENTURE ACCOUNT CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To A:		By A (Sale proceeds of 15,000 shares @ Rs 12.50 each less 50 paise brokerage per share)	1,80,000
Registration Fee	12,000		
Advertising Expenses	11,000	By B (Sale proceeds of 12,000 shares @ ₹ 12.50 per share less 50 paise brokerage per share)	1,44,000
Printing of Prospectus	7,500		
Printing & Stationery and Distribution	2,000		
To B:			
Office rent	3,000		
Legal charges	13,750		
Clerical staff	9,000		
Petty payments	1,750		
To A (Cost of shares)	1,50,000		
To Profit transferred to:			
A	68,400		
B	45,600		
	3,24,000		3,24,000

DR. JOINT VENTURE WITH B ACCOUNT IN THE BOOKS OF A CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c:		By Bank A/c (Sale proceeds of 15,000 shares)	1,80,000
Registration Fee	12,000		
Advertising Expenses	11,000	By Bank A/c (Balance received from B)	70,900
Printing and Distribution of prospectus	7,500		
Printing & Stationery	2,000		
To Bank A/c (Payment for shares)	1,50,000		
To Profit & Loss A/c (Share of profit)	68,400		
	2,50,900		2,50,900

DR. JOINT VENTURE WITH A ACCOUNT IN THE BOOKS OF B CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c:		By Bank A/c (Sale Proceeds of 12,000 shares)	1,44,000
Office Rent	3,000		

Legal Charges	13,750		
Staff Salary	9,000		
Other Expenses	1,750		
To Profit & Loss A/c (Share of Profit)	45,600		
To Bank A/c (Balance paid to A)	70,900		
	1,44,000		1,44,000

ILLUSTRATION 22

A and B, who are sharebrokers agree to enter into Joint Venture to underwrite 5,00,000 equity shares of ₹ 10 each of X Ltd. agrees to allot as fully paid 4,000 shares in the company in consideration of the underwriting arrangement. In connection with the venture, the following expenses are incurred:

A: Printing and stationery (₹ 5,000); Postage (₹ 1,000); Advertisement (₹ 3,000)

B: Postage (₹ 750); Solicitor's fee (₹ 3,500); Entertainment expenses (₹ 4,000)

The public subscription was for 4,80,000 shares only and the underwriters were forced to take up the balance and pay for them. To enable them to do so, the two persons approached the Bank which, on the security of the shares, advanced the required sum on 1st July, @ 15% interest p.a. The underwriters paid for the shares on the same day and were also allotted the 4,000 shares by X Ltd. The underwriters through the Bank unloaded their lot of holdings in the market in equal lots and realised 90% of the face value of the first lot on 30th September and 85% for the second lot on 31st October. The sale proceeds were applied in full to discharge the bank loan and the relative interest on the same dates. Shares transfer fees of Rs 1,006.25 was met from the Joint Venture Bank Account.

Required: Draw a Memorandum Joint Venture Account, the account of A as appearing in B's Books and the account of B as appearing in A's Books and also the settlement of account between the parties.

SOLUTION:
DR. MEMORANDUM JOINT VENTURE ACCOUNT CR.

Particulars	₹	Particulars	₹
To A (Expenses):		By Bank A/c:	
Printing and Stationery	5,000.00	(Sale proceeds of shares):	
Postage	1,000.00	Sept 30 ₹1,08,000	
Advertisement	3,000.00	Oct. 31 ₹ 1,02,000	2,10,000.00
To B (Expenses):		By Loss transferred to:	
Postage	750.00	A	8,500.00
Solicitor's fees	3,500.00	B	8,500.00
Entertainment	4,000.00		
To Bank A/c (loan for purchase)	2,00,000.00		
To Bank A/c (Interest on Bank loan)	8,743.75		
To Bank A/c (Shares Transfer Fees)	1,006.25		
	2,27,000.00		2,27,000.00

Working Notes:

(i) Sale proceeds: On 30th Sept. 12,000 shares at ₹ 9 per share	1,08,000
On 31st Oct. 12,000 shares at ₹ 8.50 per share	1,02,000

(ii) Interest on Bank Loan:	2,10,000
On ₹ 2,00,000 for 3 months @ 15% p.a.	7,500.00
On ₹ 99,500, (i.e. ₹ 2,07,500 – ₹ 1,08,000)	
for 1 month @ 15% p.a.	1,243.75
	8,743.75
(iii) Joint Venture Bank Account	
A Sale proceeds of shares	2,10,000
B Less: Loan	2,00,000
Interest and Shares transfer Fee	9,750
	2,09,750
C Balance given to A	250

DR. JOINT VENTURE WITH B ACCOUNT IN THE BOOKS OF A CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (Expenses)	9,000	By Profit & Loss A/c (Share of loss)	8,500
		By Joint Venture Bank A/c	250
		By Bank A/c (Bal. received from B)	250
	9,000		9,000

DR. JOINT VENTURE WITH A ACCOUNT IN THE BOOKS OF B CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (Expenses)	8,250	By Profit & Loss (Share of loss)	8,500
To Bank A/c (Balance paid to A)	250		
	8,500		8,500

ILLUSTRATION 23

David of Bombay and Khosla of Delhi entered into a joint venture for the purpose of buying and selling secondhand motor cars. David to make purchases and Khosla to effect sales. Khosla remitted a sum of ₹ 1,50,000 to David towards the venture. David purchased 5 cars for ₹ 1,60,000 and paid ₹ 60,000 for their reconditioning and sent them to Delhi. He also incurred an expense of ₹ 5,000 in transporting the cars to Delhi. Khosla sold 4 cars for ₹ 2,40,000 and retained the fifth car for himself at an agreed value of ₹ 50,000. His expenses were: Insurance ₹ 1,000; Garage Rent ₹ 2,000; Brokerage ₹ 2,000; and Sundry Expenses ₹ 400. Each party's ledger contains a record of his own transactions on joint account. Prepare a Statement showing the result of the venture and the joint venture and the joint venture account with David in the books of Khosla as it will finally appear, assuming that the matter was finally settled between the parties.

SOLUTION:

DR. JOINT VENTURE ACCOUNT WITH DAVID IN THE BOOKS OF KHOSLA CR

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (Remittance to David)	1,50,000	By Bank A/c (Sales)	2,40,000
To Bank A/c (Insurance)	1,000	By Vehicles A/c (Car Purchase)	50,000
To Bank A/c (Garage Rent)	2,000		
To Bank A/c (Brokerage)	2,000		

To Bank A/c (Sundry Exp.)	400		
To Profit & Loss A/c (Share of Profit)	29,800		
To Bank A/c (Balance remitted to David)	1,04,800		
	2,90,000		2,90,000

DR
MEMORANDUM JOINT VENTURE ACCOUNT
CR

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To David (Cost of cars)	1,60,000	By Khosla (Sales)	2,40,000
To David (Reconditioning Expenses)	60,000	By Khosla (Car taken)	50,000
To David (Transport charges)	5,000		
To Khosla (Expenses)	5,400		
(₹ 1,000 + ₹ 2,000 + ₹ 2,000 + ₹ 400)			
To Profit transferred to:			
David	29,800		
Khosla	29,800		
	2,90,000		2,90,000

ILLUSTRATION 24

D of Delhi and B of Bombay entered into a joint venture for the purpose of buying and selling second hand typewriters. B to make purchases and D to effect sales. A sum of ₹ 15,000 was remitted by D to B towards the venture. B purchased 22 old typewriters for ₹ 15,000 and paid ₹ 9,000 for their reconditioning and sent them to Delhi. his other expences were: Buying commission ₹ 1,000; Cartage ₹ 200; and Miscellaneous ₹ 100. D took delivery of the typewriter and paid ₹ 270 for Octroi and ₹ 100 for Cartage. he sold 12 typewriters at ₹ 2,200 each; 4 typewriterw at ₹ 2,100 each and 3 typewriters at ₹ 2,000 each. He retained remaining typewriters for his personal use at an agreed value of ₹ 1,500. His other expenses-insurance ₹ 250; Rent ₹ 400; Brokerage ₹ 1,200 and Miscellaneous ₹ 200. Each party's ledger contains a record of his own transections of joint account. Plprepare a statement showing the result of the venture and the account of the venturer in D's Ledger as it will finally appear, assuming that the matter was finally settled between the parties.

SOLUTION
DR
MEMORANDUM JOINT VENTURE ACCOUNT
CR

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To B:		By D (Sales):	
Paid for purchases	15,000	12 Typewriters @ 2,200	26,400
Repairs	9,000	4 Typewriters @ 2,100	8,400
Buying Commission	1,000	3 Typewriters @ 2,000	6,000
Cartage	200	By D (3 Typewriters taken	
Misc. Expenses	100	over @ 500)	1,500
	25,300		
To D:			
Octroi	270		
Insurance	250		
Rent	400		

Brokerage	1,200			
Cartage	100			
Misc. Expenses	200			
Cartage	100			
Misc. Expenses	200	2,420		
To Profit on Joint Venture		14,580		
		42,300		42,300

DR**JOINT VENTURE WITH B ACCOUNT IN THE BOOK OF D****CR**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (Remittance to B)	15,000	By Bank A/c	
To Bank A/c (Expenses):		(Sale proceeds received)	40,800
Octroi	270	By Typewriters A/c (taken away)	1,500
Cartage	100		
Insurance	250		
Rent	400		
Brokerage	1,200		
Misc. Expenses	200		
	2,420		
To Profit & Loss A/c			
[share of pprofit (1/2)]	7,290		
To Bank A/c [Balance remitted to B]	17,590		
	42,300		42,300

ILLUSTRATION 25

B of Bombay and C of Calcutta enter into a joint venture to consign scrap iron to A of Agra, to be sold on their risk. They share profits or losses equally. A is entitled to a commission of 10% of the net proceeds after charging such commission. B sends 50 tonnes costing ₹ 4,300 per tonne and pays freight and other expenses of ₹ 30,000. C sends 70 tonnes costing ₹ 5,000 per tonne and pays freight and other expenses of ₹ 40,000. All the scraps are sold by A @ ₹ 10,000 per tonne and he pays selling expenses of ₹ 12,000. He remits ₹ 5,00,000 to B and the balance of the net proceeds to C by bank draft.

Required: (a) show the account in the books of B and C to record their own transactions and (b) prepare a Memorandum Joint Venture Account.

SOLUTION:**DR.****MEMORANDUM JOINT VENTURE ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To B:		By B (Sale proceeds received from A)	5,00,000
Purchases:		By C (Sale proceeds received from A)	5,80,000
50 tonnes @ ₹ 4,300			
per tonne	2,15,000		
Expenses	30,000		
	2,45,000		
To C: Purchases:			
70 tonnes @ ₹ 5,000			

per tonne	3,50,000			
Expenses	40,000	3,90,000		
To Profit transferred to:				
B	2,22,500			
C	2,22,500	4,45,000		
		10,80,000		10,80,000

DR JOINT VENTURE WITH C ACCOUNT IN THE BOOKS OF B CR

Particulars	₹	Particulars	₹
To Bank A/c:		By Bank A/c:	
Purchases 2,15,000		(Sale proceeds received from A)	
Expenses 30,000	2,45,000		
To profit & Loss A/c			
(Share of Profit)	2,22,500		
To Bank A/c (Balance paid to C)	32,500		
	5,00,000		5,00,000

DR JOINT VENTURE WITH B ACCOUNT IN THE BOOKS OF C CR

Particulars	₹	Particulars	₹
To Bank A/c:		By Bank A/c:	
Purchases 3,50,000		(Sale proceeds received from A)	5,80,000
Expenses 40,000	3,90,000	By Bank A/c:	
To Profit & Loss A/c (Share of Profit)	2,22,500	(Balance received from B)	32,500
	6,12,500		6,12,500

Working Note: Calculation of the amount remitted by A to C

A. Sale Proceeds of goods sold by A	₹
(120 tonnes sold Rs 10,000 per tonne)	12,00,000
B. Less: Selling expenses	12,000
C. Net sale proceeds before commission (A – B)	11,88,000
D. Less: A's commission (10/110 × 11,88,000)	1,08,000
E. Net Sale proceeds after commission (C – D)	10,80,000
F. Less: Amount remitted to B (Given)	5,00,000
G. Amount remitted to C (E – F)	5,80,000

SOLVED PROBLEMS
PROBLEM 1

X of Kashmir and Y of Kanyakumari entered into a joint venture for purchase and sale of Music Systems. The cost of each Music System was ₹ 3,600 and the fixed retail selling price ₹ 4,500. The following transactions were recorded between them:

July 1 X purchased 100 Music Systems paying ₹ 72,000 in cash on account.

July 1 X raised a loan from Bank for ₹ 50,000 at 18% p.a. which is repayable with interest on 1st Sept. X forwarded 80 Music Systems to Y incurring ₹ 2,880 as forwarding and insurance charges.

July 7 X received the consignment and paid ₹ 720 as clearing charges.

Aug. 1 X sold 5 Music Systems for cash. Y sold 20 Music Systems for cash.

Y raised a loan of ₹ 1,50,000 from Bank, repayable with interest at 18% p.a. on 1st Sept.

Y remitted ₹ 1,50,000 to X, incurring charges of ₹ 50. X paid the balance due.

Aug.26 X sold the balance Music Systems for cash and paid selling expenses ₹ 5,000, Y sold the balance Music Systems for cash and paid selling expenses ₹ 20,000.

Sept. 1 Accounts settled between the ventures and loans repaid, they shared profit equally.

You are required to show: (i) The Memorandum Joint Venture Account; (ii) Joint Venture with Y account in X's books; and (iii) Joint Venture with X Account in Y's books;

SOLUTION:

DR. MEMORANDUM JOINT VENTURE ACCOUNT CR.

Particulars	₹	Particulars	₹
To X:		By Sales:	
Cost of Music Systems	3,60,000	Y (80 × 4,500)	3,60,000
Forwarding & insurance	2,880	X (20 × 4,500)	<u>90,000</u>
Interest (for 2 months)	1,500		4,50,000
Selling Expenses	5,000		
To Y:			
Clearing Charges	720		
Interest (for the month)	2,250		
Sundry Expenses			
(Telegraphic transfer charges)	50		
Selling Expenses	20,000		
To Profit transferred to:			
X	28,800		
Y	28,800		
	4,50,000		4,50,000

DR. JOINT VENTURE WITH Y ACCOUNT IN THE BOOKS OF X CR.

Particulars	₹	Particulars	₹
To Bank A/c (part payment of cost)	72,000	By Bank A/c (sale proceeds)	22,500
To Bank A/c (forwarding charges)	2,880	By Bank A/c (remittance received)	1,50,000
To Bank A/c (Balance payment of cost)	2,88,000	By Bank A/c (sale proceeds)	67,500
To Bank A/c (selling expenses)	5,000	By Bank A/c (cash received	1,58,180
To Bank A/c (Interest)	1,500	in settlement)	
To Profit & Loss A/c (share of profit)	28,800		
	3,98,180		3,98,180

DR. JOINT VENTURE WITH X ACCOUNT IN THE BOOKS OF Y CR.

Particulars	₹	Particulars	₹
To Bank A/c (clearing charges)	720	By Bank A/c (Sale proceeds of	
To Bank A/c (remittance		20 Music Systems)	90,000
excluding charges)	1,50,000	By Bank A/c (Sale proceeds of	
To Bank A/c (selling expenses)	20,000	60 Music Systems)	2,70,000

To Bank A/c (interest)	2,250		
To Sundry Expenses	50		
To Profit & Loss A/c (share of profit)	28,800		
To Bank A/c (paid in settlement)	1,58,180		
	3,60,000		3,60,000

PROBLEM 2

A and B decided to work a joint venture for the sale of electric motors. On 21st May, 2017, A purchased 200 electric motors at ₹ 1,750 each and despatched 150 motors to B incurring ₹ 10,000 as freight and insurance charges. Ten electric motors were damaged in transit. On 1st February, 2018, ₹ 5,000 was received by A from the insurance company in full settlement of his claim. On 15th March, 2018, A sold 50 electric motors at ₹ 2,250 each. He received ₹ 1,50,000 from B on 1st April, 2018.

On 25th May, 2018 B took delivery of electric motors and incurred the following expenses:

Clearing charges ₹ 1,700; Repair charges for motors damaged in transit ₹ 3,000, Godown rent ₹ 6,000. He sold the electric motors as below:

1.2.2018	10 damaged motors at ₹ 1,700 each
1.2.2018	40 motors at ₹ 2,000 each
15.3.2018	20 motors at ₹ 3,150 each
1.4.2018	80 motors at ₹ 2,500 each

It is agreed that they are entitled to commission @ 10% on the respective sales effected by them and that the profits and losses shall be shared by A and B in the ratio of 2 : 1.

B remits to A the balance of money due on 30th April, 2018.

Prepare: (i) Joint Venture Account in the books of A and (ii) Memorandum Joint Venture Account.

SOLUTION:
DR. JOINT VENTURE ACCOUNT WITH B IN THE BOOKS OF A CR.

Date	Particulars	₹	Date	Particulars	₹
2017			2018		
May 21	To Cash (Purchases)	3,50,000	Feb. 01	By Cash (Receipt from insurance company)	5,000
May 21	To Cash (Expenses)	10,000			
2018			Mar. 15	By Cash (Sale Proceeds of 50 Motors)	1,12,500
Mar. 15	To Commission	11,250			
Apr. 30	To P & L Account (Share of Profit)	39,700	Apr. 01	By Cash (Receipt from B)	1,50,000
			Apr. 30	By Cash (Receipt from B)	1,43,450
		4,10,950			4,10,950

DR. MEMORANDUM JOINT VENTURE ACCOUNT CR.

Particulars	₹	Particulars	₹
To Cost of 200 motors	3,50,000	By Amount received from insurance company	5,000
To Freight and Insurance	10,000		
To Clearing Charges	1,700	By Sale Proceeds (of A)	1,12,500
To Repairs	3,000	By Sales Proceeds (of B)	3,60,000
To Godown Rent	6,000		

To A's Commission		11,250		
To B's Commission		36,000		
To Profit: A	39,700			
B	19,850	59,550		
		4,77,500		4,77,500

Working Note: Calculation of Sale Proceeds of B ₹

1.2.2018 = 10 × 1700 =	17,000
1.2.2018 = 40 × 2000 =	80,000
15.3.2018 = 20 × 3150 =	63,000
1.4.2018 = 80 × 2500 =	2,00,000
	<u>3,60,000</u>

PROBLEM 3

ILU & PILU entered into a Joint Venture to purchase, recondition and sell second hand cars. ILU purchased 100 cars during the period 1st Oct. to 31st March at the following prices and paid for the same:

20 cars	@ ₹ 15,000 each
40 cars	@ ₹ 25,000 each
40 cars	@ ₹ 55,000 each

PILU during the same period reconditioned the cars by spending the following amounts:

Spare Parts used	₹ 1,80,000	Testing Charges	₹ 20,000
Painting	₹ 2,00,000	Insurance	₹ 60,000
Air-conditioning-10 Cars	₹ 3,00,000	Labour Charges	₹ 10,40,000

ILU and PILU sold the cars, the details of which are as under:

Sold by

	ILU	PILU
A.C. Cars	5 @ ₹ 1.75 lakhs each	4 @ ₹ 1.75 lakhs each
Non-A.C. Cars	35 @ ₹ 1.25 lakhs each	35 cars @ ₹ 1.10 lakhs each 11 cars @ ₹ 0.80 lakhs each

During testing, one non-A.C. car met with an accident and the Insurance Company paid the actual cost as claim amount. ILU retained one Non-A.C. Car for his personal use which was priced at actual cost. Prepare the Memorandum Joint Venture Account and Joint Venture Account with PILU in the books of ILU.

SOLUTION:

DR.

MEMORANDUM JOINT VENTURE ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Cost of purchase of cars (ILU)		By Sale Proceeds (ILU)	
20 @ 15000	3,00,000	A.C. Cars	
40 @ 25,000	10,00,000	5 @ ₹ 1,75,000	8,75,000
40 @ 55,000	<u>22,00,000</u>	Non-A.C. Cars	
	35,00,000		

Particulars	₹	Particulars	₹
To Bank A/c (Cost of cars)	35,00,000	By Bank A/c (Sales)	52,50,000
To Profit & Loss A/c	29,55,000	By Drawings A/c (Cost of car taken)	50,000
		By Balance c/d	11,55,000
	64,55,000		64,55,000

Particulars	₹	Particulars	₹
To Bank A/c (Spare Parts used)	1,80,000	By Bank A/c (Sales)	54,30,000
To Bank A/c (Painting)	2,00,000	By Bank A/c (Claim)	50,000
To Bank A/c (Air-Conditioning)	3,00,000	By Balance c/d (Stock)	4,30,000
To Bank A/c (Testing Charges)	20,000		
To Bank A/c (Insurance)	60,000		
To Bank A/c (Labour Charges)	10,40,000		
To Profit & Loss A/c (Profit)	29,55,000		
To Balance c/d (Due to ILU)	11,55,000		
	59,10,000		59,10,000

Average Cost of Purchase		A.C. Car	Non-A.C. Car
$\left[\frac{20 \times 15,000 + 40 \times 25,000 + 40 \times 55,000}{20 + 40 + 40} \right]$		35,000	35,000
Spare Parts used	[₹ 1,80,000/100]	1,800	1,800
Painting	[₹ 2,00,000/100]	2,000	2,000
Air-Conditioning	[₹ 3,00,000/10]	30,000	—
Testing Charges	[₹ 20,000/100]	200	200
Insurance	[₹ 60,000/100]	600	600
Labour Charges	[₹ 10,40,000/100]	10,400	10,400
		<u>80,000</u>	<u>50,000</u>

PROBLEM 4

Aswin of Madras and Gupta of Delhi entered into a joint venture on 1st April, 2017 for the purpose of buying second hand cars, reconditioning and selling them as Diesel airconditioned cars. Aswin has agreed to buy second hand cars, recondition them and fit diesel engines. Gupta has agreed to fix air conditioners and sell them at Delhi. They have agreed to share the profits and losses equally and settle their accounts at the end of each year.

The following are the details of purchases, sale and expenses incurred by Aswin and Gupta during the year 1.4.2017 to 31.3.2018:

<i>Particulars</i>	<i>Aswin ₹</i>	<i>Gupta ₹</i>
Cost of 10 Cars purchased at average price	5,00,000	
Reconditioning expenditure	45,000	
Cost of 10 diesel engines	30,000	
Labour charges	18,000	32,000
8 Air conditioners purchased		4,00,000
Buying commission @ 5%	25,000	
Selling commission @ 5%		60,000
Sale value realised on sale of 8 cars		12,00,000
<i>Expenses incurred:</i>		
Freight—local	10,000	8,000
Delhi	30,000	
Rent— Office	10,000	10,000
Garage	12,000	20,000
Insurance	16,000	20,000
Miscellaneous expenses	6,000	10,000

Gupta sent a cheque for ₹ 6,00,000 to Aswin on 1.3.2018. Of the balance of two cars, one car met with accident on the way to garage before reconditioning and the insurance company settled that claim at ₹ 30,000 as a total loss. The old petrol engines were sold @ ₹ 500 per engine and one diesel engine was sold at ₹ 3,000 by Aswin. All of them were sold before 31.3.2018. Aswin retained the balance of one car as a non-airconditioned diesel car for his personal use which was priced at average cost. Aswin/Gupta settled the balance due to/by them on 31.3.2018 by sending a crossed cheque as the case may be. Prepare: (a) Memorandum Joint Venture Account. (b) Joint Venture Account with Gupta in the books of Aswin (c) Joint Venture Account with Aswin in the books of Gupta.

SOLUTION:**DR.****MEMORANDUM JOINT VENTURE ACCOUNT****CR.**

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Cost of purchase of cars (Aswin)	5,00,000	By Sales (Gupta)	12,00,000
To Reconditioning expenses (Aswin)	45,000	By Insurance claim (Aswin)	30,000
To Cost of Diesel engine (Aswin)	30,000	By Sale of Petrol Engine	
To Labour charges —Aswin	18,000	(9 × ₹ 500) (Aswin)	4,500
—Gupta	32,000	By Cost of car taken by Aswin	68,211
To Cost of airconditioners purchased	4,00,000	By Sale of Diesel Engine (Aswin)	3,000
To Commission —Buying	25,000		
—Selling	60,000		
To Freight-Local —Aswin	10,000		

—Gupta	8,000		
To Freight—Delhi —Aswin	30,000		
To Rent —Aswin	10,000		
—Gupta	10,000		
To Garage —Aswin	12,000		
To Garage —Gupta	20,000		
To Insurance —Aswin	16,000		
—Gupta	20,000		
To Misc. expenses —Aswin	6,000		
—Gupta	10,000		
To Profit on venture —Aswin 21,856			
—Gupta 21,855	43,711		
	13,05,711		13,05,711

DR. JOINT VENTURE WITH GUPTA ACCOUNT IN THE BOOKS OF ASWIN CR.

Particulars	₹	Particulars	₹
To Bank A/c (cost of cars purchased)	5,00,000	By Bank A/c (insurance claim)	30,000
To Bank A/c (reconditioning exp.)	45,000	By Bank A/c (sale of petrol engine)	
To Bank A/c (cost of diesel engines)	30,000	(₹ 500 × 9)	4,500
To Bank A/c (labour charges)	18,000	By Bank A/c (sale of diesel engine)	3,000
To Bank A/c (buying commission)	25,000	By Drawings A/c	
To Bank A/c (local freight)	10,000	(cost of car taken for personal use)	68,211
To Bank A/c (Delhi freight)	30,000	By Bank A/c	
To Bank A/c (office rent)	10,000	(remittance by Gupta on 1st Mar.)	6,00,000
To Bank A/c (garage rent)	12,000	By Bank A/c	
To Bank A/c (insurance)	16,000	(remittance by Gupta on 31st Mar.)	18,145
To Bank A/c (misc. expenses)	6,000		
To Profit and Loss A/c (share of profit)	21,856		
	7,23,856		7,23,856

DR. JOINT VENTURE WITH ASWIN ACCOUNT IN THE BOOKS OF GUPTA CR.

Particulars	₹	Particulars	₹
To Bank A/c (labour charges)	32,000	By Bank A/c (sales)	12,00,000
To Bank A/c (airconditioners)	4,00,000		
To Bank A/c (selling commission)	60,000		
To Bank A/c (Freight)	8,000		
To Bank A/c (office rent)	10,000		
To Bank A/c (garage rent)	20,000		
To Bank A/c (insurance)	20,000		
To Bank A/c (misc. exp.)	10,000		
To Profit & Loss A/c (Profit share)	21,855		
To Bank A/c (on 1st Mar.)	6,00,000		
To Bank A/c			
(remittance to Aswin on 31st Mar.)	18,145		
	12,00,000		12,00,000

Working Note: Calculation of Cost of Non-Airconditioned Diesel Car

		₹
Cost of Car		50,000
Reconditioning	(₹ 45,000/9)	5,000
Diesel engine	(₹ 30,000/10)	3,000
Labour charges	(₹ 18,000/9)	2,000
Buying commission	(₹ 25,000/10)	2,500
Local Freight incurred by Aswin	(₹ 10,000/10)	1,000
Local Insurance	(₹ 16,000/10)	1,600
Office Rent, Garage Rent and Misc. Expenses	(₹ 28,000/9)	3,111
		68,211

PROBLEM 5

John and Ali entered into a Joint Venture agreeing to share profits and losses in the ratio of 3 : 2.

On 4th Jan., Ali purchased goods costing ₹ 60,000 and spent 2,000 as expense. On the same date, he sent to John a part of these goods costing ₹ 40,000.

On 7th Feb., John sent ₹ 30,000 to Ali. On 10th Feb. he purchased goods costing ₹ 50,000 and sent half of the goods to Ali. He paid ₹ 1,000 as carriage.

On 24th March, Ali sold most of the goods in his possession for ₹ 55,000 and the remaining goods costing ₹ 3,000 were taken over by him at an agreed valuation of ₹ 4,000.

On 18th April, John sold all the goods in his possession for ₹ 75,000 except some damaged goods costing ₹ 5,000 which it was agreed to be written off as unsaleable. His selling expenses amounted to ₹ 2,000.

On 30th April, the amount required to settle the accounts between John and Ali was paid by the appropriate party. Show the Joint Venture Account and John's Account in the books of Ali.

SOLUTION:**DR. JOINT VENTURE ACCOUNT IN THE BOOKS OF ALI CR.**

Particulars	₹	Particulars	₹
To Bank A/c:		By Bank (A/c) (Goods sold)	55,000
Goods		By Goods A/c (Taken over)	4,000
Purchased	60,000	By John's A/c (Goods sold)	75,000
Expenses	<u>2,000</u>		
	62,000		
To John's A/c:			
Goods			
Purchased	50,000		
Carriage	<u>1,000</u>		
	51,000		
To John's A/c (Selling Expenses)	2,000		
To Profit transferred to:			
P&L A/c	7,600		
John's A/c	<u>11,400</u>		
	19,000		
	1,34,000		1,34,000

DR.**JOINT'S ACCOUNT IN THE BOOKS OF ALI****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Joint Venture A/c (Sales)	75,000	By Bank A/c (Advance)	30,000
To Bank A/c (Balance paid to John)	19,400	By Joint Venture A/c (Purchases & exp.)	51,000
		By Joint Venture A/c (Selling expenses)	2,000
		By Joint Venture A/c (Profit)	11,400
	94,400		94,400

Notes:

- (i) There will be no entries in respect of goods sent by Ali to John and also by John to Ali,
- (ii) There will be no entry for damaged goods for which nothing has been realised.

PROBLEM 6

Bhim and Arjun entered into a Joint Venture for buying and selling plastic goods and agreed to share profit and losses in the ratio of 3:2.

On October 1, Bhim purchases goods at a cost of ₹ 60,000 and half of the goods were handed over to Arjun. On October 15, he again purchased goods worth ₹ 20,000. He incurred expenses of ₹ 2,000.

On October 15, Arjun also made a purchase of ₹ 37,500 and on the same day he sent to Bhim goods worth ₹. 15,000. He incurred expenses of ₹ 900. On October 20, Bhim in order to help Arjun sent ₹ 16,000 to him. Both the parties sold goods at a profit of 25% on sale.

On March 31 Bhim had unsold stock of goods of ₹ 12,500, of these goods costing ₹ 5,000 were taken away by him and the remainder sold for ₹ 8,000. Arjun was able to sell away complete goods excepting goods costing ₹ 2,500 which were badly damaged and were treated as unsaleable. ₹ 3,000 owing to Bhim was unrecoverable and treated as joint loss. On March 31, The Parties decided to close the books.

You are required to prepare:

- (a) The Joint Venture Account as it would appear in the books of Bhim recording his own transactions, and
- (b) A memorandum Joint Venture Account, showing the profits of the business.

SOLUTION:**DR.****JOINT VENTURE WITH ARJUN'S ACCOUNT IN THE BOOKS OF BHIM****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (Purchases)	60,000	By Sales	70,000
To Bank A/c (Purchases)	20,000	By Purchases (Stock Taken over)	5,000
To Bank A/c (Expenses)	2,000	By Sales A/c (Stock sold)	8,000
To Bank (Adv. to Arjun)	16,000	By Bank A/c	33,760
To Profit & Loss A/c (Share of Profit)	15,760	(remittances received)	
To Bad Debts	3,000		
	1,16,760		1,16,760

DR.**MEMORANDUM JOINT VENTURE ACCOUNT****CR.**

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Purchases:		By Sales:	
Bhim	60,000	Bhim	70,000
Bhim	20,000	Arjun	66,667
Arjun	37,500	Bhim	8,000
To Expenses		By Stock (Taken over by Bhim)	5,000
Bhim	2,000		
Arjun	900		
To Bad Debts (incurred by Bhim)	3,000		
To Net Profit:			
Bhim	15,760		
Arjun	10,507		
	1,49,667		1,49,667

Working Note: Calculation of Sales:

	<i>Bhim ₹</i>	<i>Arjun ₹</i>
A Purchases	80,000	37,500
B Add: Received from their party	15,000	30,000
C Less: Sent to other party	30,000	15,000
D Less: Stock	12,500	2,500
E Cost of Goods Sold	52,500	50,000
F Add: Profit at 25% on Sales i.e. 33-1/3% on cost	17,500	16,667
G Sales (E + F)	<u>70,000</u>	<u>66,667</u>

SOLVED PROBLEMS II**PROBLEM 7**

Maganbhai of Rajkot and Ramanan of Madras enter into a joint venture deciding to share profits and losses in the ratio of 3:2. Maganbhai purchases 3,000 kg of material A for ₹ 1,50,000 and sends it to Nana of Pune for processing. Maganbhai pays the transport cost amounting to ₹ 6,000. Ramanan purchases 2,000 kg of material B for ₹ 2,00,000 and sends it to Nana of Pune for processing. The transport cost amounting to ₹ 10,000 is paid by Ramanan. Nana does the processing work and manufactures 4,800 units of finished product C. Nana prepares a "conversion cost" bill on the joint venture at ₹ 20 per unit. Maganbhai pays this bill. The goods are sent to Bannerjee of Calcutta. The transport cost amounting to ₹ 18,000 being paid by Maganbhai. Bannerjee sells 90% of the goods @ ₹ 150 per unit. He takes over the balance goods at ₹ 120 per unit. After deducting his own commission @ 10% of sale proceeds, he remits the amount to Maganbhai. The co-venturers agree to settle the account, after retaining 30% of the profits for taxation on the income of association of persons. Show the ledger accounts in the books of Maganbhai.

SOLUTION:

DR.

JOINT VENTURE ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Bank A/c:		By Banerjee A/c (Sales)	6,48,000
Purchases 1,50,000		By Banerjee A/c (Goods taken)	57,600
Transport Cost 6,000			
Conversion Cost 96,000			
Transportation Cost			
(Calcutta) 18,000	2,70,000		
To Romanan A/c:			
Purchases 2,00,000			
Transportation Cost 10,000	2,10,000		
To Banerjee A/c (Commission)	64,800		
To Net Profit c/d	1,60,800		
	7,05,600		7,05,600
To Provision for Taxation A/c @30%	48,200	By Net Profit b/d	1,60,800
To Profit & Loss A/c (Share of profit)	67,536		
To Romanan A/c (Share of profit)	45,024		
	1,60,800		1,60,800

DR.

RAMANAN ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Bank A/c (Balance sent)	2,55,024	By Joint Venture A/c	
		Purchases 2,00,000	
		Transport 10,000	
		Share of profit 45,024	2,55,024
	2,55,024		2,55,024

DR.

BANERJEE ACCOUNT

CR.

Particulars	₹	Particulars	₹
To Joint Venture Account (Sales)	6,48,000	By Joint Venture A/c (Commission)	64,800
To Joint Venture A/c (Goods taken)	57,600	By Bank A/c	6,40,800
	7,05,600		7,05,600

Note: It has been assumed that no commission is payable on the unsold stock taken over by Banerjee and the amount for the provision for taxation lies with Maganbhai.

PROBLEM 8

Brown and Turner agreed to enter into a joint venture to buy and sell second hand ice cream vehicles and to share profits and losses in the ratio of 5:3 respectively. It was agreed that Brown would record all details of the venture in his books of account. On 21st December, Turner purchased two vehicles and paid cash of ₹ 20,000. On 2nd January, he spent sums of ₹ 2,480 on repairs, ₹ 240 on driver's wages and ₹ 360 on temporary insurance cover. He sold the vehicles a week later for ₹ 28,000 subject to a 2% cash discount, if paid within 7 days. He paid the proceeds of sale into his bank account on 10th January. On 31st January, Brown purchased five vehicles for ₹ 50,000 of which he managed to sell three for ₹ 36,000 for cash on the same day, without incurring any expenses. The fourth vehicle was sold for ₹ 13,500 and, on 7th February, he received a bill receivable to be presented for payment

in three months time. On 31st March., the fifth vehicle was still unsold and it was agreed that Turner should take over this vehicle at a valuation of ₹ 7,500. On 31st March, the parties made a settlement between themselves, Brown agreeing to take the bill receivable at a value of ₹ 13,180.

Required: Prepare the Joint Venture Account, and Turner's Account as they would appear in the books of Brown.

SOLUTION:

DR. JOINT VENTURE ACCOUNT CR.

Particulars	₹	Particulars	₹
To Tumer A/—Pur.	20,000	By Tumer A/c (Sales)	28,000
To Tumer A/c:		By Bank A/c	36,000
Repairs	2,480	By Bills Receivable A/c	13,500
Driver's Wages 240		By Tumer A/c (taken over)	7,500
Insurance 360	3,080		
To Tumer A/c: (Discount)	560		
To Bank A/c	50,000		
To Dis. Received A/c (Bill)	320		
To P & L A/c (share of Profit)	6,900		
To Tumer A/c (Share of profit)	4,140		
	85,000		85,000

DR. TUMER ACCOUNT CR.

Particulars	₹	Particulars	₹
To Joint Venture A/c (Sales)	28,000	By Joint Venture A/c (Purchases)	20,000
To Joint Venture A/c (Taken over)	7,500	By Joint Venture A/c (Expenses)	3,080
		By Joint Venture A/c (Discount allowed)	560
		By Joint Venture A/c (Share of profit)	4,140
		By Bank A/c	7,720
	35,500		35,500

PROBLEM 9

Hari, an architect and Ram, a real estate dealer enter into an agreement for the purpose of purchasing a large land and converting it into plots. The purchase price (₹ 1,60,000) and the legal expenses (₹ 11,100) are paid by Hari, who borrowed the money from the bank.

Ram provides the materials costing ₹ 58,000 for the levelling of land and the development of plots. 10 plots of 200 sq. mts. each and 5 plots of 400 sq. mts. each are sold respectively @ ₹ 75 per sq. mt. and ₹ 70 per sq. mt. The sale proceeds of 5 plots of 200 sq. mts. each are received by Ram. The balance is received by Hari, who paid ₹ 15,000 for sales expenses. Hari repaid the loan and interest there on amounting to ₹ 9,600.

The agreement provides that after crediting Hari with the interest charged on the borrowed money and allowing 15 per cent on the cost of the levelling to cover overhead expenses. Hari is to receive two-third of the profit and Ram one-third.

Each party's ledger contains records of his own receipts and payments on the Joint Account. You are required to prepare (a) a statement showing the result of the venture, and (b) the account of the venture in each party's ledger as it will finally appear.

SOLUTION:
DR. MEMORANDUM JOINT VENTURE ACCOUNT CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Hari:		By Ram [Sales (5 × 200 × 75)]	75,000
Land 1,60,000		By Hari [Sales (5 × 20 × 75) + (5 × 500 × 70)]	2,15,000
Legal Expenses 11,100			
Sales Expenses 15,000			
Interest 9,600	1,95,700		
To Ram:			
Levelling & Dev. Exp 58,000			
Overhead Expenses 8,700	66,700		
To Profit on Venture			
Hari (2/3) 18,400			
Ram (1/3) 9,200	27,600		
	2,90,000		2,90,000

DR. JOINT VENTURE WITH RAM ACCOUNT IN HARI'S LEDGER CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c:		By Bank A/c (Sales)	
Land 1,60,000		200 Sq. mts plots 75,000	
Legal Expenses 11,100		(5 × 200 × 75)	
Sales Expenses 15,000		400 Sq. mts plots 1,40,000	2,15,000
Interest 9,600	1,95,700	(5 × 400 × 70)	
To P & L A/c (Share of Profit)	18,400		
To Balance c/d (due to Ram)	900		
	2,15,000		2,15,000

DR. JOINT VENTURE WITH HARI ACCOUNT IN RAM'S LEDGER CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c:		By Bank A/c (Sales)	75,000
(Levelling & Dev.) 58,000		[200 sq. mts plots (5 × 200 × 75)]	
Overhead Expenses 8,700	66,700	By Balance c/d (due from Hari)	900
To Profit & Loss A/c (Share of profit)	9,200		
	75,900		75,900

PROBLEM 10

Mr Peter and Mr Paul agree to share the ultimate profit or loss of a certain business venture in the proportion of 3 : 2.

Mr Peter, accordingly purchases a freehold house for ₹ 57,000. For this purpose Mr Peter borrows ₹ 30,000 from his bank and arranges ₹ 20,000 himself. Mr Paul pays the remaining ₹ 7,000. The house is converted into three flats at a total expense of ₹ 11,000 which is contributed equally by Mr Peter and Mr Paul. Timber from the garden is sold for ₹ 3,500 which is used to reduce Mr Peter's bank loan. The flats are let at rentals which produce ₹ 9,000 in all (received equally by the parties)

and finally the whole property is sold for ₹ 80,000 *less* agent's commission ₹ 1,750. The net proceeds are received by Mr Peter and he repays his bank loan *plus* interest ₹ 1,500 (agreed to be borne by the venture). As between the parties it is agreed that Mr Peter shall receive interest out of the venture ₹ 300 and Mr Paul ₹ 100. Finally the venture comes to an end and the accounts are settled among the parties.

Required: Prepare (a) Memorandum Joint Venture Account and (b) the account of the joint venture with Mr Peter in the books of Mr Paul.

SOLUTION:

DR. MEMORANDUM JOINT VENTURE ACCOUNT CR.

Particulars	₹	Particulars	₹
To Mr. Peter:		By Mr. Peter	
Freehold House 50,000		Sale (Timber) 3,500	
Expenses 5,500		Rentals 4,500	
Bank Interest 1,500		Sale (flats) 80,000	
Interest 300	57,300	Less: Agents Comm. 1,750	86,250
To Mr. Paul		By Mr. Paul (Rentals)	4,500
Freehold House 7,000			
Expenses 5,500			
Interest 100	12,600		
To Net Profit t/f to:			
Mr. Peter 12,510			
Mr. Paul 8,340	20,850		
	90,750		90,750

DR. JOINT VENTURE WITH MR. PETER ACCOUNT CR.

Particulars	₹	Particulars	₹
To Bank A/c (Freehold House) 7,000		By Bank A/c (Rentals) 4,500	
To Bank A/c (Expenses) 5,500		By Bank (final remittance) 16,440	
To Interest 100			
To Profit & Loss A/c (Share of Profit) 8,340			
	20,940		20,940

21

ACCOUNTING FOR ROYALTY

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of Royalty
- ◇ Meaning of Lessee
- ◇ Meaning of Lessor
- ◇ Examples of Royalty Agreements
- ◇ Minimum Rent (or Dead Rent)
- ◇ Short Working [Or Redeemable Dead Rent]
- ◇ Surplus Working
- ◇ Short Working Recoupment Clause
- ◇ Short Working Lapsed or Written off
- ◇ Accounting Treatment in the Books of Lessee
- ◇ Accounting Treatment in the Books of Landlord or Lessor
- ◇ Analysis of Royalty Payable and Short Workings

MEANING OF ROYALTY

Royalty is a periodic payment for the use of a certain property. Royalty is paid by the person who uses the property to the person who allows the use of the property. The payment of royalty is governed by 'Royalty Agreement' between the involved parties.

MEANING OF LESSEE

The person who makes such a payment is known as user, tenant or lessee.

MEANING OF LESSOR

The person to whom such payment made is known as owner, landlord or lessor.

EXAMPLES OF ROYALTY AGREEMENTS

1. In the case of mining royalties, the right to extract some mineral such as stone, coal, oil etc. is allowed by the landlord to the lessee.
2. In the case of patent royalties, the right to use certain patents for the manufacture of article is allowed by the patentee to the manufacturer.
3. In the case of right royalties, the right to publish and sell books is allowed by an author to the publisher.

MINIMUM RENT (OR DEAD RENT)

Minimum Rent or Dead Rent is a guaranteed amount which the lessee has to pay in the absence or inadequacy of the output or sales on which the royalty is based. It may be noted that unless otherwise provided in the agreement the minimum rent already fixed should be reduced proportionate to the period of strike when there is a general strike.

SHORT WORKING [OR REDEEMABLE DEAD RENT]

Short Working or Redeemable Dead Rent is the excess of minimum rent over the actual royalties based on actual output or sales as per the agreement. Normally, it is allowed to be recovered by the lessee and as such it is called redeemable dead rent.

SURPLUS WORKING

Surplus Working is the excess of royalties based on actual output or sales over the minimum rent.

Example: If the royalty payable is ₹ 10 per output produced, subject to a minimum of ₹ 10,000 p.a. and the annual output is only 800 units, the payment to the landlord will be ₹ 10,000 (viz. minimum rent being higher than the actual royalty of ₹ 8,000) and ₹ 2000 would be short working. But when the annual output is 1200 units, the payment to the landlord will be ₹ 12,000 (viz. actual royalty being higher than the minimum rent) subject to the short working recoupment clause (if any) and ₹ 2,000 would be surplus working.

SHORT WORKING RECOUPMENT CLAUSE

This clause enables the tenant to recoupe (i.e. recover) the short working out of the royalties in the subsequent periods when the royalty based on actual output/sales is more than the minimum rent. This clause is provided mainly to compensate the lessee for the excess amount paid by him whenever the actual royalty was less than the minimum rent. Such a clause may be drafted in various ways, e.g., such a clause may permit the lessor to exercise: (a) Fixed right, i.e. to set off the short working only within a specified number of years after the commencement of the lease or (b) Fluctuating Right, i.e. to set off short working within a specified number of year (s) following the year in which the short working occurs; or to carry forward the short working indefinitely.

Note: *In the absence of any 'Short Working Recoupment Clause' in 'Royalty Agreement', the short working if any, arises) is to be written off to Profit & Loss Account in the year of short working.*

SHORT WORKING LAPSED OR WRITTEN OFF

It is the amount of short working unrecovered by the lessee within the stipulated period of recoupment. It is a loss to the lessee and gain to the lessor.

ACCOUNTING TREATMENT IN THE BOOKS OF LESSEE

Royalty is an expense of revenue nature. Royalty Payable Account is a nominal account and is debited in the books of lessee. Royalty Payable Account is closed by transferring it to the debit of Manufacturing Account (if the royalty is based on output) or Profit & Loss Account (if the royalty is based on units sold or sales value). The various journal entries to be passed in the books of lessee are given below:

JOURNAL OF LESSEE

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Case (a)	When the Actual Royalty is less than the Minimum Rent			
1.	Royalty Payable A/c Dr. Short Working Recoupment A/c Dr. To Landlord's A/c (Being Minimum Royalty and Short Working provided for)			[Qty. of Actual output x Rate of Royalty per unit of output] [Excess of Minimum Rent over the Actual Royalty] [With the amount due]
2.	Landlord's A/c Dr. To Bank A/c (Being payment made to landlord)			[With the amount paid]
3.	Profit & Loss A/c Dr. To Short Working Recoupment A/c (Being Irrecoverable Short Workings w/o to Profit & Loss A/c)			[With the amount of Irrecoverable Short Workings]
4.	Manufacturing A/c/Profit & Loss A/c Dr. To Royalty Payable A/c (Being Royalty charged to Manufacturing A/c/Profit & Loss A/c)			[With the Balance of Royalty Payable A/c]
Case (b)	When the Actual Royalty exceeds the Minimum Rent			
1.	Royalty Payable A/c Dr. To Landlord's A/c (Being royalty payable provided for)			[Qty. of Actual output x Rate of Royalty per unit of output]
2.	Landlord's A/c Dr. To Short Working Recoupment A/c To Bank A/c (Being payment made after recovering maximum Short Working)			[With Actual Royalty] [With Short Working recovered] [With Net Amount Due]
3.	Profit & Loss A/c Dr. To Short Working Recoupment A/c (Being Irrecoverable Short Workings w/o to Profit & Loss A/c)			[With the amount of Irrecoverable Short Workings]
4.	Manufacturing A/c/Profit & Loss A/c Dr. To Royalty Payable A/c (Being Royalty charged to Manufacturing A/c/Profit & Loss A/c)			[With the Balance of Royalty Payable A/c]

ACCOUNTING TREATMENT IN THE BOOKS OF LANDLORD OR LESSOR

Royalty is an income of revenue nature. Royalty Receivable Account is a nominal account and is credited in the books of lessor. Royalty Receivable Account is closed by transferring it to the credit of Profit & Loss Account. The various journal entries to be passed in the books of Landlord are given on next page:

JOURNAL OF LANDLORD OR LESSOR

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Case (a)	When the Actual Royalty is less than the Minimum Rent			
1.	Lessee's A/c Dr. To Royalty Receivable A/c To Short Working Allowable A/c (Being Royalty Receivable and Short Working provided for)			[With the amount due] [Qty. of Actual output x Rate of Royalty per unit of output] [Excess of Minimum Rent over the Actual Royalty]
2.	Bank A/c Dr. To Lessee's A/c (Being payment received from lessee)			[With the amount received]
3.	Short Working Allowable A/c Dr. To Profit & Loss A/c (Being irrecoverable Short Working written off)			[With the amount of Unallowable Short Workings]
4.	Royalty Receivable A/c Dr. To Profit & Loss A/c (Being royalty received credited to Profit & Loss A/c)			[With the balance of Royalty Receivable A/c]
Case (b)	When the Actual Royalty exceeds the Minimum Rent			
1.	Lessee's A/c Dr. To Royalty Receivable A/c (Being royalty provided for)			[Qty. of Actual output x Rate of Royalty per unit of output]
2.	Bank A/c Dr. Short Working Allowable A/c Dr. To Lessee's A/c (Being payment received after allowing Short Working)			[With Net Amount Due] [With Short Working Allowed] [With Actual Royalty]
3.	Short Working Allowable A/c Dr. To Profit & Loss A/c (Being irrecoverable Short Working W/o)			[With the amount received]
4.	Royalty Receivable A/c Dr. To Profit & Loss A/c (Being royalty received credited to Profit & Loss A/c)			[With the amount of Unallowable Short Workings]

ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS

To account for royalty related items, the following analysis table is suggested to be prepared:

ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS

A Year	B Output (Units)	C = B × Rate Actual Royalty	D Minimum Rent	E = D – C Short Working	F Short Working Recouped	G = C + E – F Actual Payment	H Short Working W/O	$I_n = I_{n-1} + E - F - H$ Short Working C/F

Notes:

1. *Output Produced = Units Sold + Closing Stock – Opening Stock*
2. *Units Sold = Opening Stock + Output Produced – Closing Stock*

ILLUSTRATION 1

Tulsian Ltd. leased a mine for 20 years to Jalan Ltd. for a minimum rent of ₹ 94,000 for the first year with an annual increase of ₹ 2,000 till it reaches ₹ 1,00,000 merging into a royalty @ ₹ 100 per unit produced. Output (in units) were as under.

Year	2014	2015	2016	2017	2018
Outputs (in units)	500	900	1,140	1,260	200

Required: Prepare the Analysis of Royalty Payable and Short Workings in each of the following alternative cases:

Case (a) Short Working is not recoupable.

Case (b) Short Working is recoupable.

Case (c) Short Working is recoupable within first 3 years only.

Case (d) Short Working is recoupable within 3 years following the year in which the Short Working arose.

Case (e) In the event of strike or riot or flooding, the minimum rent would be reduced proportionately having regard to the length of the stoppage. During the year 2018 there was strike lasting 3 months. Short Working is recoupable within 3 year following the year in which Short Working arose.

Case (f) In the event of strike or riot or flooding, that the minimum rent not being reached. The minimum rent would be reduced 1/3rd. During the year 2018 there was strike lasting 3 months. Short Working is recoupable within 3 year following the year in which Short Working arose.

Case (g) In the event of strike or riot or flooding, that the minimum rent not being reached, the actual royalty earned during the year would be full royalty obligation for the year. During the year, 2018, there was strike lasting 3 months.

Case (h) In the event of strike, the minimum rent would be taken pro-rata on the basis of actual numbers of working days but in the event of lockout, the lessee would be enjoy a concession in respect of minimum rent of 50% of the period of lockout. There was strike for 73 days and lockout for 4 months during the year 2018. Recoupment of short working of each year is allowed during the next 3 years subject to maximum of ₹ 5,000 p.a.

SOLUTION

(A) ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS

A Year	B Output (Units)	C = B × Rate Actual Royalty	D Minimum Rent	E = D – C Short Working	F Short Working Recouped	G = C + E – F Actual Payment	H Short Working W/O	$I_n = I_{n-1} + E - F - H$ Short Working C/F
2014	500	50,000	94,000	44,000	—	94,000	44,000	—
2015	900	90,000	96,000	6,000	—	96,000	6,000	—
2016	1,140	1,14,000	98,000	—	—	1,14,000	—	—
2017	1,260	1,26,000	1,00,000	—	—	1,26,000	—	—
2018	200	20,000	1,00,000	80,000	—	1,00,000	80,000	—

(B) ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS

A Year	B Output (Units)	C = B × Rate Actual Royalty	D Minimum Rent	E = D – C Short Working	F Short Working Recouped	G = C + E – F Actual Payment	H Short Working W/O	$I_n = I_{n-1} + E - F - H$ Short Working C/F
2014	500	50,000	94,000	44,000	—	94,000	—	44,000
2015	900	90,000	96,000	6,000	—	96,000	—	50,000
2016	1,140	1,14,000	98,000	—	16,000	98,000	—	34,000
2017	1,260	1,26,000	1,00,000	—	26,000	1,00,000	—	8,000
2018	200	20,000	1,00,000	80,000	—	1,00,000	—	88,000

(C) ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS

A Year	B Output (Units)	C = B × Rate Actual Royalty	D Minimum Rent	E = D – C Short Working	F Short Working Recouped	G = C + E – F Actual Payment	H Short Working W/O	$I_n = I_{n-1} + E - F - H$ Short Working C/F
2014	500	50,000	94,000	44,000	—	94,000	—	44,000
2015	900	90,000	96,000	6,000	—	96,000	—	50,000
2016	1,140	1,14,000	98,000	—	16,000	98,000	34,000	—
2017	1,260	1,26,000	1,00,000	—	—	1,00,000	—	—
2018	200	20,000	1,00,000	80,000	—	1,00,000	80,000	—

(D) ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS

A Year	B Output (Units)	C = B × Rate Actual Royalty	D Minimum Rent	E = D – C Short Working	F Short Working Recouped	G = C + E – F Actual Payment	H Short Working W/O	$I_n = I_{n-1} + E - F - H$ Short Working C/F
2014	500	50,000	94,000	44,000	—	94,000	—	44,000
2015	900	90,000	96,000	6,000	—	96,000	—	50,000
2016	1,140	1,14,000	98,000	—	16,000	98,000	—	34,000
2017	1,260	1,26,000	1,00,000	—	26,000	1,00,000	2,000	6,000
2018	200	20,000	1,00,000	80,000	—	1,00,000	6,000	80,000

(E) ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS

A Year	B Output (Units)	C = B × Rate Actual Royalty	D Minimum Rent	E = D – C Short Working	F Short Working Recouped	G = C + E – F Actual Payment	H Short Working W/O	$I_n = I_{n-1} + E - F - H$ Short Working C/F
2014	500	50,000	94,000	44,000	—	94,000	—	44,000
2015	900	90,000	96,000	6,000	—	96,000	—	50,000
2016	1,140	1,14,000	98,000	—	16,000	98,000	—	34,000
2017	1,260	1,26,000	1,00,000	—	26,000	1,00,000	—	6,000
2018	200	20,000	1,00,000	55,000	—	1,00,000	6,000	55,000

(F) ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS

A Year	B Output (Units)	C = B × Rate Actual Royalty	D Minimum Rent	E = D – C Short Working	F Short Working Recouped	G = C + E – F Actual Payment	H Short Working W/O	$I_n = I_{n-1} + E - F - H$ Short Working C/F
2014	500	50,000	94,000	44,000	—	94,000	—	44,000
2015	900	90,000	96,000	6,000	—	96,000	—	50,000
2016	1,140	1,14,000	98,000	—	16,000	98,000	—	34,000
2017	1,260	1,26,000	1,00,000	—	26,000	1,00,000	2,000	6,000
2018	200	20,000	66,667	46,667	—	66,667	6,000	46,667

(G) ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS

A Year	B Output (Units)	C = B × Rate Actual Royalty	D Minimum Rent	E = D – C Short Working	F Short Working Recouped	G = C + E – F Actual Payment	H Short Working W/O	$I_n = I_{n-1} + E - F - H$ Short Working C/F
2014	500	50,000	94,000	44,000	—	94,000	—	44,000
2015	900	90,000	96,000	6,000	—	96,000	—	50,000
2016	1,140	1,14,000	98,000	—	16,000	98,000	—	34,000
2017	1,260	1,26,000	1,00,000	—	26,000	1,00,000	2,000	6,000
2018	200	20,000	1,00,000	—	—	20,000	6,000	—

(H) ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS

A Year	B Output (Units)	C = B × Rate Actual Royalty	D Minimum Rent	E = D – C Short Working	F Short Working Recouped	G = C + E – F Actual Payment	H Short Working W/O	$I_n = I_{n-1} + E - F - H$ Short Working C/F
2014	500	50,000	94,000	44,000	—	94,000	—	44,000
2015	900	90,000	96,000	6,000	—	96,000	—	50,000
2016	1,140	1,14,000	98,000	—	5,000	1,09,000	—	45,000
2017	1,260	1,26,000	1,00,000	—	5,000	1,21,000	34,000	6,000
2018	200	20,000	63,333	43,333	—	63,333	6,000	43,333

ILLUSTRATION 2

Tulsian Ltd. leased a mine for 20 years to Jalan Ltd. for a minimum rent of ₹ 94,000 for the first year with an annual increase of ₹ 20,000 till it reaches ₹ 1,00,000 merging into a royalty @ ₹ 100 per unit produced. Sales and closing stocks were an under.

Year	2014	2015	2016	2017	2018
Sale	400	800	1,200	1,100	450
Closing Stock	100	200	140	300	50

In the event of strike, the minimum rent would be taken pro-rata on the basis of actual numbers of working days but in the event of lockout, the lessee would be enjoy a concession in respect of minimum rent for 50% of the period of lockout. There was strike for 73 days and lockout for 4 months during the year 2018.

Recoupment of Short Working of each year is allowed during the next 5 years following the year in which the Short Working arose.

Required: Pass the necessary journal entries and prepare the necessary Ledger accounts in the books of Tulsian Ltd. and Jalan Ltd.

SOLUTION

Minimum Rent for 2018 = $1,00,000 - [(1,00,000 \times 73/365) + (1,00,000 \times 2/12)] = 63,333$

ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS

A Year	B Output (Units) Qty.	C = B × Rate Actual Royalty ₹	D Minimum Rent ₹	E = D – C Short Working ₹	F Short Working Recouped ₹	G = C + E – F Actual Payment ₹	H Short Working W/O ₹	I _n = I _{n-1} + E – F – H Short Working C/F ₹
2014	500	50,000	94,000	44,000	—	94,000	—	44,000
2015	900	90,000	96,000	6,000	—	96,000	—	50,000
2016	1,140	1,14,000	98,000	—	5,000	1,09,000	—	45,000
2017	1,260	1,26,000	1,00,000	—	5,000	1,21,000	34,000	6,000
2018	200	20,000	63,333	43,333	—	63,333	6,000	43,333

JOURNAL OF JALAN LTD.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2014	Royalty Payable A/c Dr. Short Working Recoupment A/c Dr. To Tulsian Ltd. A/c (Being minimum royalty short working and provided for)		50,000 44,000	94,000
	Tulsian Ltd. A/c Dr. To Bank A/c (Being payment made to landlord)		94,000	94,000
	Profit & Loss A/c Dr. To Royalty Payable A/c (Being Royalty debited to Profit & Loss A/c)		50,000	50,000
2015	Royalty Payable A/c Dr. Short Working Recoupment A/c Dr. To Tulsian Ltd. A/c (Being minimum royalty short working and provided for)		90,000 6,000	96,000

	Tulsian Ltd. A/c To Bank A/c (Being payment made to landlord)	Dr.		96,000	96,000
	Profit & Loss A/c To Royalty Payable A/c (Being royalty charged to Profit & Loss A/c)	Dr.		90,000	90,000
2016	Royalty Payable A/c To Tulsian Ltd. A/c (Being royalty payable provided full)	Dr.		1,14,000	1,14,000
	Tulsian Ltd. A/c To Bank A/c To Short Working Recoupment A/c (Being payment made after deducting maximum Short Working)	Dr.		1,14,000	1,09,000 5,000
	Royalty Payable A/c To Profit & Loss A/c (Being royalty charged to Profit & Loss A/c)	Dr.		1,14,000	1,14,000
2017	Royalty Payable A/c To Tulsian Ltd. A/c (Being royalty payable provided for)	Dr.		1,26,000	1,26,000
	Tulsian Ltd. A/c To Bank A/c To Short Working Recoupment A/c (Being payment made after deducting maximum Short Working)	Dr.		1,26,000	1,21,000 5,000
	Royalty Payable A/c To Profit & Loss A/c (Being royalty charged to Profit & Loss A/c)	Dr.		1,26,000	1,26,000
	Short Working Recoupment A/c To Profit & Loss A/c (Being irrecoverable Short Working written off)	Dr.		34,000	34,000
2018	Royalty Payable A/c Short Working Recoupment A/c To Tulsian Ltd. A/c (Being minimum royalty Short Working provided for)	Dr. Dr.		20,000 43,333	63,333
	Tulsian Ltd. A/c To Bank A/c (Being payment made to landlord)	Dr.		63,333	63,333
	Royalty Payable A/c To Profit & Loss A/c (Being royalty charged to Profit & Loss A/c)	Dr.		20,000	20,000
	Short Working Recoupment A/c To Profit & Loss A/c (Being irrecoverable Short Working provided for)	Dr.		6,000	6,000

Dr.

ROYALTY PAYABLE ACCOUNT

Cr.

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
2014	To Tulsian Ltd. A/c	50,000	2014	By P & L A/c	50,000
2015	To Tulsian Ltd. A/c	90,000	2015	By P & L A/c	90,000
2016	To Tulsian Ltd. A/c	1,14,000	2016	By P & L A/c	1,14,000
2017	To Tulsian Ltd. A/c	1,26,000	2017	By P & L A/c	1,26,000
2018	To Tulsian Ltd. A/c	20,000	2018	By P & L A/c	20,000

Dr.

TULSIAN LTD ACCOUNT

Cr.

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
2014	To Bank A/c	94,000	2014	By Royalty Payable A/c	50,000
			2014	By Short Working Recoupment A/c	44,000
		94,000			94,000
2015	To Bank A/c	96,000	2015	By Royalty Payable A/c	90,000
			2015	By Short Working Recoupment A/c	6,000
		96,000			96,000
2016	To Bank A/c	1,09,000	2016	By Royalty Payable A/c	1,14,000
2016	To Short Working Recoupment A/c	5,000			
		1,14,000			1,14,000
2017	To Bank A/c	1,21,000	2017	By Royalty Payable A/c	1,20,000
2017	To Short Working Recoupment A/c	5,000			
		1,26,000			1,26,000
2018	To Bank A/c	63,333	2018	By Royalty Payable A/c	20,000
			2018	By Short Working Recoupment A/c	43,333
		63,333			63,333

Dr.

SHORT WORKING RECOUPMENT ACCOUNT

Cr.

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
2014	To Tulsian Ltd. A/c	44,000	2014	By Balance c/d	44,000
2015	To Balance b/d	44,000	2015	By Balance c/d	50,000
2015	To Tulsian Ltd. A/c	6,000			
		50,000			50,000
2016	To Balance b/d	50,000	2016	By Tulsian Ltd. A/c	5,000
			2016	By Balance c/d	45,000
		50,000			50,000
2017	To Balance b/d	45,000	2017	By Tulsian Ltd. A/c	5,000
			2017	By P & L A/c	34,000
			2017	By Balance c/d	6,000
		45,000			45,000

2018	To Balance b/d	6,000	2018	By P & L A/c	6,000
2018	To Tulsian Ltd. A/c	43,333	2018	By Balance c/d	43,333
		49,333			49,333

JOURNAL OF TULSIAN LTD.

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
2014	Jalan Ltd. A/c Dr. To Royalty Receivable A/c To Short Working Allowable A/c (Being royalty receivable short working provided for)		94,000	50,000 44,000
	Bank A/c Dr. To Jalan Ltd. A/c (Being payment received from lessee)		94,000	94,000
	Royalty Receivable A/c Dr. To Profit & Loss A/c (Being royalty received credited to Profit & Loss A/c)		50,000	50,000
2015	Jalan Ltd. A/c Dr. To Royalty Receivable A/c To Short Working Allowable A/c (Being royalty and Short Working provided for)		96,000	90,000 6,000
	Bank A/c Dr. To Jalan Ltd. A/c (Being royalty received from the lessee)		96,000	96,000
	Royalty Receivable A/c Dr. To Profit & Loss A/c (Being royalty received credited to Profit & Loss A/c)		90,000	90,000
2016	Jalan Ltd. A/c Dr. To Royalty Receivable A/c (Being royalty provided for)		1,14,000	1,14,000
	Bank A/c Dr. Short Working Allowable A/c Dr. To Jalan A/c (Being payment received net off Short Working recoupable)		1,09,000 5,000	1,14,000
	Royalty Receivable A/c Dr. To Profit & Loss A/c (Being royalty received credited to Profit & Loss A/c)		1,14,000	1,14,000
2017	Jalan Ltd. A/c Dr. To Royalty receivable A/c (Being royalty provided for)		1,26,000	1,26,000
	Bank A/c Dr. Short Working Allowable A/c Dr. To Jalan A/c (Being payment received net off Short Working recoupable)		1,21,000 5,000	1,26,000

	Royalty Payable A/c To Profit & Loss A/c (Being royalty charged to Profit & Loss A/c)	Dr.		1,26,000	1,26,000
	Short Working Allowable A/c To Profit & Loss A/c (Being irrecoverable Short Working transferred to Profit & Loss A/c)	Dr.		34,000	34,000
2018	Jalan Ltd. A/c To Royalty Receivable To Short Working Allowable A/c (Being royalty & Short Working provided for)	Dr.		63,333	20,000 43,333
	Bank A/c To Jalan Ltd. A/c (Being payment received from lessee)	Dr.		63,333	63,333
	Royalty Receivable A/c To Profit & Loss A/c (Being royalty receivable credited to Profit & Loss A/c)	Dr.		20,000	20,000
	Short Working Allowable A/c To Profit & Loss A/c (Being irrecoverable Short Working written off)	Dr.		6,000	6,000

ROYALTY RECEIVABLE ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
2014	To P & L A/c	50,000	2014	By Jalan A/c	50,000
2015	To P & L A/c	90,000	2015	By Jalan A/c	90,000
2016	To P & L A/c	1,14,000	2014	By Jalan A/c	1,14,000
2017	To P & L A/c	1,26,000	2014	By Jalan A/c	1,26,000
2018	To P & L A/c	20,000	2014	By Jalan A/c	20,000

JALAN LTD ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
2014	To Royalty Receivable A/c	50,000	2014	By Bank A/c	94,000
2014	To Short Working Allowable A/c	44,000			
		94,000			94,000
2015	To Royalty Receivable A/c	90,000	2015	By Bank A/c	96,000
2015	To Short Working Allowable A/c	6,000			
		96,000			96,000
2016	To Royalty Receivable A/c	1,14,000	2016	By Bank A/c	1,09,000
			2016	By Short Working Allowable A/c	5,000
		1,14,000			1,14,000

2017	To Royalty Receivable A/c	1,26,000	2017	By Bank A/c	1,21,000
			2017	By Short Working Allowable A/c	5,000
		1,26,000			1,26,000
2018	To Royalty Receivable A/c	20,000	2018	To Bank A/c	63,333
2018	To Short Working Allowable A/c	43,333			
		63,333			63,333

Dr.

SHORT WORKING ALLOWABLE ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Balance c/d	44,000	2014	By Jalan Ltd. A/c	44,000
2015	To Balance c/d	50,000	2015	By Balance b/d	44,000
		50,000	2015	By Jalan Ltd. A/c	6,000
		50,000			50,000
2016	To Jalan Ltd. A/c	5,000	2016	By Balance b/d	50,000
	To Balance c/d	45,000			
		50,000			50,000
2017	To Jalan Ltd. A/c	5,000	2017	By Balance b/d	45,000
2017	To P & L A/c	34,000			
2017	To Balance c/d	6,000			
		45,000			45,000
2018	To P & L A/c	6,000	2018	By Balance b/d	6,000
	To Balance c/d	43,333	2018	By Jalan Ltd. A/c	43,333
		49,333			49,333

SUB-LEASING

If the terms of the original lease authorise the lessee to sub-lease, the lessee may sub-let the whole or a part of his rights available under the original lease to another person who is then called 'Sub-Lessee'. In such a case, the lessee acts in dual capacity as under:

- (a) **As regards the Original Lessor**— The lessee serves as a lessee and pays royalty on the entire output raised (or sold) by both the lessee and sub-lessee at the rate fixed between him and landlord. As a lessee, he maintains Royalty Payable Account, Short Working Recoupable Account and Landlord's Account.
- (b) **As regards the Sub-lessee**— The lessee serves as a landlord and receives the royalty on the output raised (or sold) by the sub-lessee at the rate fixed between him and the sub-lessee. As a landlord, he maintains Royalty Receivable Account, Short Working Allowable Account and Sub-Lessee's Account.

Notes:

- The royalty payable to the original landlord or lessor is calculated on the basis of total output of both lessee and sub-lessee.
- Lessee passes the following additional entry:

Royalty Receivable A/c	Dr.	[Qty of Actual output of Sub-less × Rate of
To Royalty Payable A/c		Royalty under original lease]

ILLUSTRATION 3

SN took on lease mining rights in an area of 100 square miles for a period of 33 years from 1st January 2016. Under the terms of the lease, a royalty of ₹ 1 per tonne is payable merging in a minimum rent of ₹ 40,000 per annum payable half-yearly on the 1st January and 1st July every year.

SN granted a sub-lease for 20 years on a portion of the above area measuring 50 square miles to KS from 1st June, 2016 in terms of which a royalty of ₹ 1.50 per tonne merging in a minimum rent of ₹ 39,000 per annum was payable—again in equal instalments on every 1st January and 1st July.

SN can recoup short working throughout the period of lease whereas the sub-lease provides that any short workings could be recouped only out of excess workings in any of the three half years immediately following that in which the workings occurred. Details for minerals obtained were:

Particulars	Minerals raised by (in tonnes)	
	SN	KS
For half year ending on:		
30th June, 2016	12,000	—
31st December, 2016	10,000	8,000
30th June, 2017	28,000	10,000
31st December, 2017	18,000	12,000
30th June, 2018	24,000	15,000
31st December, 2018	30,000	20,000

Required: Show the necessary accounts in the books of SN who close their books on a calendar year basis.

SOLUTION

Dr. **BOOKS OF SN LTD ROYALTY PAYABLE ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
30.06.2016	To Landlord's A/c	12,000	31.12.2016	By Royalty Receivable A/c	8,000
31.12.2016	To Landlord's A/c	18,000	31.12.2016	By Profit & Loss A/c	22,000
		30,000			30,000
30.06.2017	To Landlord's A/c	38,000	31.12.2017	By Royalty Receivable A/c	10,000
31.12.2017	To Landlord's A/c	30,000	31.12.2017	By Royalty Receivable A/c	12,000
				By Profit & Loss A/c	46,000
		68,000			68,000
30.06.2018	To Landlord's A/c	39,000	31.12.2018	By Royalty Receivable A/c	15,000
31.12.2018	To Landlord's A/c	50,000	31.12.2018	By Royalty Receivable A/c	20,000
				By Profit & Loss A/c	54,000
		89,000			89,000

Dr. **SHORT WORKING (RECOVERABLE) ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
30.06.2016	To Landlord's A/c	8,000	31.12.2016	By Balance c/d	10,000
31.12.2016	To Landlord's A/c	2,000			
		10,000			10,000
01.01.2017	To Balance c/d	10,000	30.06.2017	By Landlord's A/c	10,000

Dr.

LANDLORD'S ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.07.2016	To Bank A/c	20,000	30.06.2016	By Royalty Payable A/c	12,000
31.12.2016	To Balance c/d	20,000	30.06.2016	By Short Workings (Recoupable) A/c	8,000
			31.12.2016	By Royalty Payable A/c	18,000
			31.12.2016	By Short Workings (Recoupable) A/c	2,000
		40,000			40,000
01.01.2017	To Bank A/c	20,000	01.01.2017	By Balance b/d	20,000
30.06.2017	To Short Workings (Recoupable) A/c	10,000	30.06.2017	By Royalty Payable A/c	38,000
01.07.2017	To Bank A/c	28,000	31.12.2017	By Royalty Payable A/c	30,000
31.12.2017	To Balance c/d	30,000			88,000
		88,000			88,000
01.01.2018	To Bank A/c	30,000	01.01.2018	By Balance b/d	30,000
01.07.2018	To Bank A/c	39,000	30.06.2018	By Royalty Payable A/c	39,000
31.12.2018	To Balance c/d	50,000	31.12.2018	By Royalty Payable A/c	50,000
		1,19,000			1,19,000

Dr.

ROYALTY RECEIVABLE ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Royalty Payable A/c	8,000	31.12.2016	By M/s KS	12,000
	To Profit & Loss A/c	4,000			12,000
		12,000			12,000
30.06.2017	To Royalty Payable A/c	10,000	30.06.2017	By M/s KS	15,000
31.12.2017	To Royalty Payable A/c	12,000	31.12.2017	By M/s KS	18,000
31.12.2017	To Profit & Loss A/c	11,000			33,000
		33,000			33,000
30.06.2018	To Royalty Payable A/c	15,000	30.06.2018	By M/s KS	22,000
31.12.2018	To Royalty Payable A/c	20,000	31.12.2018	By M/s KS	30,000
31.12.2018	To Profit & Loss A/c	17,500			52,500
		52,500			52,500

Dr.

SHORT WORKING (ALLOWABLE) ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Balance c/d	7,500	31.12.2016	By M/s KS	7,500
31.12.2017	To Balance c/d	13,500	01.01.2017	By Balance b/d	7,500
			30.06.2017	By M/s KS	4,500
			31.12.2017	By M/s KS	1,500
		13,500			13,500

30.06.2018	To M/s KS	3,000	01.01.2018	By Balance b/d	13,500
30.06.2018	To Profit & Loss A/c	4,500			
31.12.2018	To M/s KS	6,000			
		13,500			13,500

Dr. **M/S KS'S ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Royalty Receivable A/c	12,000	31.12.2016	By Balance c/d	19,500
31.12.2016	To Short Workings (Allowable) A/c	7,500			
		19,500			19,500
01.01.2017	To Balance b/d	19,500	01.01.2017	By Bank A/c	19,500
30.06.2017	To Royalty Receivable A/c	15,000	01.07.2017	By Bank A/c	19,500
30.06.2017	To Short Workings (Allowable) A/c	4,500	31.12.2017	By Balance c/d	19,500
31.12.2017	To Royalty Receivable A/c	18,000			
31.12.2017	To Short Workings (Allowable) A/c	1,500			
		58,500			58,500
01.01.2018	To Balance b/d	19,500	01.01.2018	By Bank A/c	19,500
30.06.2018	To Royalty Receivable A/c	22,000	30.06.2018	To Short Workings (Allowable) A/c	3,000
31.12.2018	To Royalty Receivable A/c	30,000	01.07.2018	By Bank A/c	19,500
			31.12.2018	To Short Workings (Allowable) A/c	6,000
				By Balance c/d	24,000
		72,000			72,000

WHEN PAYMENTS MADE TO LANDLORD ARE GIVEN

ILLUSTRATION 4

The following balances appeared in the books of a lessee as on January 1, 2015:

Landlord's Account (Cr) ₹ 28,000 Short Working Account (Dr) ₹ 6,000 (out of which ₹ 3,000 arose in 2013, ₹ 2,000 in 2012 and the rest in 2011).

The Agreement of Royalty provided the following:

- Minimum rent ₹ 56,000 p.a.
- The power to recoup short working within 3 years immediately following the year in which it arise.
- Payments to the landlord to be made as under:

50% of the amount is payable in the year in which it becomes due and the balance of 50% in the next year.

You are given the following particulars from 2015 to 2018:

Year	Payments to Landlord ₹	Short Working ₹	Short Working Recouped ₹
2015	56,000	—	800
2016	58,000	—	5,000
2017	58,000	2,000	—
2018	60,000	—	2,000

Show the Royalty Account and Short Working Account from 2015 to 2018.

SOLUTION

Dr. **ROYALTY PAYABLE ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Short Workings Recoupable A/c	800	31.12.2015	By Manufacturing A/c (Transfer)	56,800
31.12.2015	To Landlord A/c	56,000			
		56,800			56,800
31.12.2016	To Short Workings Recoupable A/c	5,000	31.12.2016	By Manufacturing A/c (Transfer)	65,000
31.12.2016	To Landlord A/c	60,000			
		65,000			65,000
31.12.2017	To Landlord A/c	54,000	31.12.2017	By Manufacturing A/c (Transfer)	54,000
		54,000			54,000
31.12.2018	To Short Workings Recoupable A/c	2,000	31.12.2018	By Manufacturing A/c (Transfer)	66,000
31.12.2018	To Landlord A/c	64,000			
		66,000			66,000

Dr. **SHORT WORKING RECOUPABLE ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.2015	To Balance b/d	6,000	31.12.2015	By Royalty Payable A/c	800
			31.12.2015	By Profit & Loss A/c (w/o)	200
			31.12.2015	By Balance c/d	5,000
		6,000			6,000
01.01.2016	To Balance b/d	5,000	31.12.2016	By Royalty Payable A/c	5,000
31.12.2017	To Landlord's A/c	2,000	31.12.2017	By Balance c/d	2,000
01.01.2018	To Balance b/d	2,000	31.12.2018	By Royalty Payable A/c	2,000

Working Note**STATEMENT SHOWING THE CALCULATION OF ACTUAL ROYALTY**

A Year	B Total Payment made	C Payment for Previous year	D = B – C Payment for Current year	E = D × 2 Total Payment for due for Current year	F = E + S/W Recouped – S/W Actual Royalty
2015	56,000	28,000	28,000	56,000	56,000 + 800 = 56,800
2016	58,000	28,000	30,000	60,000	60,000 + 5,000 = 65,000
2017	58,000	30,000	28,000	56,000	56,000 – 2,000 = 54,000
2018	60,000	28,000	32,000	64,000	64,000 + 2,000 = 62,000

ILLUSTRATION 5

Birla Coal Co. Ltd. holds a lease of coal mines for a period of twelve years, commencing from 1st April 2012. According to the lease, the company is to pay ₹ 7.50 as royalty per ton with a minimum rent of ₹ 1,50,000 per year. Short workings can, however, be recovered out of the royalty in excess of the minimum rent of the next two years only. For the year of a strike the minimum rent is to be reduced to 60%. The output in tons for the 6 years ending 31st March, 2018 is as under : 2012-2013 : 10,000; 2013-2014: 12,000; 2014-2015: 25,000; 2015-2016: 20,000; 2016-2017: 50,000; and 2017-2018: 15,000 (strike). Write up the necessary Ledger Accounts in the books of Birla Coal Co. Ltd and in the books of Landlord.

SOLUTION**ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS**

		Fig in (₹)							
Year	Output (Tons)	Actual Royalties	Min. Rent	Excess Short Workings	Short workings				Amount
					Occurred	Recouped	Written off	C/F	Payable
2012-2013	10,000	75,000	150,000	—	75,000	—	—	75,000	150,000
2013-2014	12,000	90,000	150,000	—	60,000	—	—	135,000	150,000
2014-2015	25,000	187,500	150,000	37,500	—	37,500	37,500	60,000	150,000
2015-2016	20,000	150,000	150,000	—	—	—	60,000	—	150,000
2016-2017	50,000	375,000	150,000	225,000	—	—	—	—	375,000
2017-2018	15,000	112,500	90,000	22,500	—	—	—	—	112,500

BOOKS OF BIRLA COAL CO. LTD.**Dr.****ROYALTIES ACCOUNT****Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.03.2013	To Landlord's A/c	75,000	31.03.2013	By Profit & Loss A/c	75,000
31.03.2014	To Landlord's A/c	90,000	31.03.2014	By Profit & Loss A/c	90,000
31.03.2015	To Landlord's A/c	187,500	31.03.2015	By Profit & Loss A/c	187,500
31.03.2016	To Landlord's A/c	150,000	31.03.2016	By Profit & Loss A/c	150,000
31.03.2017	To Landlord's A/c	375,000	31.03.2017	By Profit & Loss A/c	375,000
31.03.2018	To Landlord's A/c	112,500	31.03.2018	By Profit & Loss A/c	112,500

Dr.**LANDLORD'S ACCOUNT****Cr.**

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
31.03.2013	To Bank A/c	150,000	31.03.2013	By Royalties A/c	75,000
				By Short workings A/c	75,000
		150,000			150,000
31.03.2014	To Bank A/c	150,000	31.03.2014	By Royalties A/c	90,000
				By Short workings A/c	60,000
		150,000			150,000
31.03.2015	To Bank A/c	150,000	31.03.2015	By Royalties A/c	187,500
	To Short workings A/c	37,500			
		187,500			187,500
31.03.2016	To Bank A/c	150,000	31.03.2016	By Royalties A/c	150,000
		150,000			150,000
31.03.2017	To Bank A/c	375,000	31.03.2017	By Royalties A/c	375,000
		375,000			375,000
31.03.2018	To Bank A/c	112,500	31.03.2018	By Royalties A/c	112,500
		112,500			112,500

Dr.**SHORT WORKINGS ACCOUNT****Cr.**

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
31.03.2013	To Landlord A/c	75,000	31.03.2013	By Balance c/d	75,000
		75,000			75,000
1.4.2013	To Balance b/d	75,000	31.03.2014	By Balance c/d	135,000
31.03.2014	To Landlord A/c	60,000			
		135,000			135,000
1.4.2014	To Balance b/d	135,000	31.03.2015	By Landlord A/c	37,500
				By Profit & Loss A/c	37,500
				By Balance c/d	60,000
		135,000			135,000
1.4.2015	To Balance b/d	60,000	31.03.2016	By Profit & Loss A/c	60,000
		60,000			60,000

BOOKS OF LANDLORD**Dr.****ROYALTY RECEIVABLE ACCOUNT****Cr.**

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
31.03.2013	To Profit & Loss A/c	75,000	31.03.2013	By Birla Coal Co.Ltd	75,000
31.03.2014	To Profit & Loss A/c	90,000	31.03.2014	By Birla Coal Co. Ltd	90,000
31.03.2015	To Profit & Loss A/c	1,87,500	31.03.2015	By Birla Coal Co. Ltd	1,87,500
31.03.2016	To Profit & Loss A/c	1,50,000	31.03.2016	By Birla Coal Co. Ltd	1,50,000
31.03.2017	To Profit & Loss A/c	3,75,000	31.03.2017	By Birla Coal Co. Ltd	3,75,000
31.03.2018	To Profit & Loss A/c	1,12,500	31.03.2018	By Birla Coal Co. Ltd	1,12,500

Dr.

BIRLA COAL CO. LTD. (LESSEE) ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2013	To Royalties Receivable A/c	75,000	31.03.2013	By Bank A/c	150,000
	To Short Workings Allowable A/c	75,000			
		150,000			150,000
31.03.2014	To Royalties Receivable A/c	90,000	31.03.2014	By Bank A/c	150,000
	To Short Workings Allowable A/c	60,000			
		150,000			150,000
31.03.2015	To Royalties Receivable A/c	187,500	31.03.2015	By Bank A/c	150,000
				By Short Workings Allowable A/c	37,500
		187,500			187,500
31.03.2016	To Royalties Receivable A/c	150,000	31.03.2016	By Bank A/c	150,000
		150,000			150,000
31.03.2017	To Royalties Receivable A/c	375,000	31.03.2017	By Bank A/c	375,000
		375,000			375,000
31.03.2018	To Royalties Receivable A/c	112,500	31.03.2018	By Bank A/c	112,500
		112,500			112,500

Dr.

SHORT WORKINGS ALLOWABLE ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2013	To Balance c/d	75,000	31.03.2013	By Birla Coal Co. Ltd	75,000
31.03.2014	To Balance c/d	1,35,000	01.04.2013	By Balance b/d	75,000
		1,35,000	31.03.2014	By Birla Coal Co. Ltd	60,000
31.03.2015	To Birla Coal Co. Ltd	37,000			1,35,000
	To Profit & Loss A/c	37,500	01.04.2014	By Balance b/d	1,35,000
	To Balance c/d	60,000	31.03.2015	By Birla Coal Co. Ltd	37,000
		1,72,500			1,72,500
31.03.2016	To Profit & Loss A/c	60,000	01.04.2015	By Balance b/d	60,000
		60,000			60,000

ILLUSTRATION 6

X Ltd. obtain from Y Ltd. a lease of some coal-bearing land, the terms being a royalty of ₹ 15 per ton of coal raised subject to a minimum rent of ₹ 75,000 p.a. with a right of recoupment of short-working over the first four years of the lease. From the following details, show (i) Short-working Account, (ii) Royalty Account and (iii) Y Ltd. Account in the books of X Ltd.

Year	Sales (Tons) ₹	Closing Stock (Tons) ₹
2014	2,000	300
2015	3,500	400
2016	4,800	600
2017	5,600	500
2018	8,000	800

SOLUTION

[Coal raised i.e., Production = Sales + Closing Stock – Opening Stock.]

Year	Sales	Closing Stock	Opening Stock	Net Production
2014	2,000	300	Nil	2,300
2015	3,500	400	300	3,600
2016	4,800	600	400	5,000
2017	5,600	500	600	5,500
2018	8,000	800	500	8,300

ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS

Year	Quantity	Rate ₹	Royalty ₹	Minimum Rent ₹	Short working ₹	Recoupment ₹	Short working carried forward ₹	Transferred to P&L A/c ₹	Payment to Landlord ₹
2014	2,300	15	34,500	75,000	40,500	---	40,500	---	75,000
2015	3,600	15	54,000	75,000	21,000	---	61,500	---	75,000
2016	5,000	15	75,000	75,000	---	---	61,500	---	75,000
2017	5,500	15	82,000	75,000	---	7,500	---	54,000	75,000
2018	8,300	15	1,24,500	75,000	---	---	---	---	1,24,500

IN THE BOOKS OF X LTD.**Dr.****Y LTD. (LANDLORD) ACCOUNT****Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Bank A/c	75,000	2014	By Royalty A/c	34,500
				By Short Working A/c	40,500
		75,000			75,000
2015	To Bank A/c	75,000	2015	By Royalty A/c	54,000
				By Short Working A/c	21,000
		75,000			75,000
2016	To Bank A/c	75,000	2016	By Royalty A/c	75,000
		75,000			75,000
2017	To Bank A/c	75,000	2017	By Royalty A/c	75,000
		75,000			75,000
2018	To Bank A/c	1,24,500	2018	By Royalty A/c	1,24,500
		1,24,500			1,24,500

Dr.

SHORT WORKING ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Y Ltd.	40,500	2014	By Balance c/d	40,500
		40,500			40,500
2015	To Balance b/d	40,500	2015	By Balance c/d	61,500
	To Y Ltd.	21,000			
		61,500			61,500
2016	To Balance b/d	61,500	2016	By Balance c/d	61,500
		61,500			61,500
2017	To Balance b/d	61,500	2017	By Royalty A/c	7,500
				By Profit & Loss A/c	54,000
		61,500			61,500

Dr.

ROYALTY ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Y Ltd.	34,500	2014	By Profit & Loss A/c	34,500
2015	To Y Ltd.	54,000	2015	By Profit & Loss A/c	54,000
2016	To Y Ltd.	75,000	2016	By Profit & Loss A/c	75,000
2017	To Short-working A/c	7,500	2017	By Profit & Loss A/c	82,500
	To Y Ltd.	75,000			
		82,500			82,500
2018	To Y Ltd.	1,24,500	2018	By Profit & Loss A/c	1,24,500

ILLUSTRATION 7

The following information has been obtained from the books of a lessee relating to the years 2014-2015 to 2017-2018 :

Payments to Landlord (after tax deducted @ 20% at Source):	2014-2015	₹ 12,000
	2015-2016	₹ 12,000
	2016-2017	₹ 12,000
	2017-2018	₹ 19,200
Short-working recovered :	2015-2016	₹ 2,500
	2016-2017	₹ 1,000
Short-working written-off :	2016-2017	₹ 500

Balance of Short-working Account forward on April 1, 2014 ₹ 800 (which are in 2014-2015). According to the terms of agreement short-working is recoverable within the next two years following the year in which short-working arises.

You are required to show the necessary accounts in the books of the lessee for the four years ended 31st March 2018.

SOLUTION

Before preparing the ledger accounts we are to find out some missing information :

1. The recoupment which was made is 2015-2016 for ₹ 2,500 is inclusive of ₹ 800 of 2013-2014 and the balance ₹ 1,700 for 2014-2015.

Again, the short-working which was recovered and written-off ₹ 1,000 and ₹ 500 (i.e., ₹ 1,500), respectively, in 2015-2016 are also for the year 2014-2015. So, the total short-working for 2014-2015 amounted to ₹ 3,200 (i.e., ₹ 1,700 + ₹ 1,500).

2. Rate of taxes @ 20% on gross i.e., 25% (i.e., $20/80 = 1/4$) on net amount paid.
3. Actual Payment = Annual Royalty + Short-working – Recoupment.

Thus, actual royalty is calculated as under :

<i>Particulars</i>	2014-2015	2015-2016	2016-2017	2017-2018
	₹	₹	₹	₹
Payment to landlord (after tax)	12,000	12,000	12,000	19,200
Add: Back Tax Deducted at Source @ $\frac{1}{4}$ th	3,000	3,000	3,000	4,800
Payment to landlord (before Tax)	15,000	15,000	15,000	24,000
Less: Short-working	3,200	—	—	—
Add: Recoupment	—	2,500	1,000	—
	11,800	17,500	16,000	24,000

IN THE BOOKS OF LESSEE

Dr. ROYALTY ACCOUNT Cr.

<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
31.03.2015	To Landlord A/c	11,800	31.03.2015	By Profit and Loss A/c	11,800
31.03.2016	To Short-working A/c	2,500	31.03.2016	By Profit and Loss A/c	17,500
	To Landlord A/c	15,000			17,500
		17,500			17,500
31.03.2017	To Short-working A/c	1,000	31.03.2017	By Profit and Loss A/c	16,000
	To Landlord A/c	15,000			16,000
		16,000			16,000
31.03.2018	To Landlord A/c	24,000	31.03.2018	By Profit and Loss A/c	24,000
		24,000			24,000

Dr. SHORT WORKING ACCOUNT Cr.

<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
01.04.2015	To Balance b/d	8 0 0	31.03.2015	By Balance c/d	4,000
	To Landlord A/c	3,200			4,000
		4,000			4,000
01.04.2016	To Balance b/d	4,000	31.03.2016	By Royalty A/c	2,500
		4,000		By Balance c/d	1,500
		4,000			4,000
01.04.2017	To Balance b/d	1,500	31.03.2017	By Royalty A/c	1,000
		1,500		By Balance c/d	5 0 0
		1,500			1,500

Dr.			LANDLORD ACCOUNT			Cr.		
Date	Particulars	Amount ₹	Date	Particulars	Amount ₹			
31.03.2015	To Income-Tax Payable A/c	3,000	31.03.2015	By Royalty A/c	11,800			
	To Bank A/c	12,000		By Short Working A/c	3,200			
		15,000			15,000			
31.03.2016	To Income-Tax Payable A/c	3,000	31.03.2016	By Royalty A/c	15,500			
	To Bank A/c	12,000						
		15,000			15,000			
31.03.2017	To Income-Tax Payable A/c	3,000	31.03.2017	By Royalty A/c	15,500			
	To Bank A/c	12,000						
		15,000			15,000			
31.03.2018	To Income-Tax Payable A/c	4,800	31.03.2018	By Royalty A/c	24,000			
	To Bank A/c	19,200						
		24,000			24,000			

ILLUSTRATION 8

A fire occurred in the office premises of lessee in the evening of 31.3.2018 destroying most of the books and records. From the documents saved, the following information is gathered :

Short-working recovered :

2015-2016 ₹ 2,000 (towards short-workings which arose in 2012-2013)

2016-2017 ₹ 4,000 (including ₹ 1,000 for short-working 2013-2014)

2017-2018 ₹ 1,000

Short-working lapsed :

2014-2015 ₹ 1,500

2015-2016 ₹ 1,800

2017-2018 ₹ 1,000

A sum of ₹ 25,000 was paid to the landlord in 2014-2015. The agreement of Royalty contains a clause of Minimum Rent payable for fixed amount and recoupment of short-workings within 3 years following the year in which Short-workings arise.

Information as regards payments to landlord subsequent to the year 2014-2015 is not four years ended 31.3.2018.

SOLUTION

Year	Royalty ₹	Short working ₹	Short Working recovered ₹	Short Working Lapsed ₹	Payment to Landlord ₹
2014-2015	—	—	—	1,500	25,000
2015-2016	—	—	₹ 2,000 (for 2012-2013)	1,800	—
2016-2017	—	—	₹ 4,000 (including ₹ 1,000 for 2013-2014)	—	—
2017-2018	—	—	1,000	1,000	—

From the above statement it is quite clear that :

- (i) Short-working lapsed in 2017-2018 ₹ 1,000 which relates to 2014-2015 as per terms, short-working should be recouped within three years i.e., 2017-2018 is the last year for recoupment.
- (ii) Short-working recovered in 2016-2017 ₹ 4,000, out of which ₹ 1,000 for 2013-2014 and the balance ₹ 3,000 for the year 2008-2012.
- (iii) Short-working recovered in 2017-2018 ₹ 1,000 which is also related to 2014-2015 in which year actually is arose.

Thus, the total short-working balance in 2014-2015 amounted to ₹ 5,000 (i.e., ₹ 1,000 + ₹ 3,000 + ₹ 1,000). Now, we can prepare our usual statement as under :

Hence, Actual Royalty = Payment to Landlord + Recoupment – Short-working

For, 2014-2015 = ₹ 25,000 + Nil – ₹ 5,000 = ₹ 20,000.

For, 2015-2016 = ₹ 25,000 + ₹ 2,000 – Nil = ₹ 27,000

For, 2016-2017 = ₹ 25,000 + ₹ 4,000 – Nil = ₹ 29,000

For, 2017-2018 = ₹ 25,000 + ₹ 1,000 – Nil = ₹ 26,000

Year	Royalty ₹	Short-working ₹	Recoupment ₹	Tr. to P&L A/c ₹	Payment to Landlord ₹
2014-2015	20,000	5,000	—	1,500	25,000
2015-2016	27,000	—	2,000	1,800	25,000
2016-2017	29,000	—	4,000	—	25,000
2017-2018	26,000	—	1,000	1,000	25,000

IN THE BOOKS OF LESSEE ROYALTY ACCOUNT

Dr.

Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Landlord A/c	20,000	31.3.2015	By P & L A/c	20,000
		20,000			20,000
31.3.2016	To Short Working A/c	2,000	31.3.2016	By P & L A/c	27,000
	To Landlord A/c	25,000			27,000
		27,000			27,000
31.3.2017	To Short Working A/c	4,000	31.3.2017	By P & L A/c	29,000
	To Landlord A/c	25,000			29,000
		29,000			29,000
31.3.2018	To Short Working A/c	1,000	31.3.2018	By P & L A/c	29,000
	To Landlord A/c	25,000			29,000
		26,000			26,000

Dr.

SHORT WORKING ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Balance b/d	6,300	31.3.2015	By P & L A/c	1,500
	To Landlord A/c	5,000		By Balance c/d	9,800
		11,300			11,300
31.3.2016	To Balance b/d	9,800	31.3.2016	By Royalty A/c	2,000

				By P & L A/c	1,800
				By Balance c/d	6,000
		9,800			9,800
31.3.2017	To Balance b/d	1,000	31.3.2017	By Royalty A/c	4,000
	To Landlord A/c	5,000		By Balance c/d	2,000
		6,000			6,000
31.3.2018	To Balance b/d	2,000	31.3.2018	By Royalty A/c	1,000
				By P & L A/c	1,000
		2,000			2,000

This includes the following :

Lapsed :	in 2014-2015	₹1,500
	in 2015-2016	₹1,800
Recoupment :	in 2015-2016	₹2,000
	in 2016-2017	₹1,000
		₹6,300

ILLUSTRATION 9

On 1.4.2013 X Ltd. got a mining lease and from that date a part of the mine was sub-leased to Y Ltd. The terms of payment and the production of 5 years are as below.

Particulars	Lessee	Sub-Lessee
Royalty (₹/Tonne)	2.00	3.00
Dead Rent per annum (₹)	15,000	10,000
Short working recoverable (Years)	3	2
Production (Year ended....31.3.)		
2014	1,000	1,000
2015	3,000	2,000
2016	12,000	5,000
2017	9,000	2,000 (strike)
2018	5,000	12,000

In case of strike, royalty earned will discharge all liabilities for the year only.

Show ledger accounts in the books of X Ltd.

SOLUTION

IN THE BOOKS OF X LTD. ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS

Year	Output (Tons)	Actual Royalties	Min. Rent	Excess Short Workings	Short Workings				Fig in (₹)	
					Occurred	Recouped	Written off	C/F	Amount	Payable
2014	2,000	4,000	15,000	—	11,000 0	—	—	11,000	15,000	
2015	5,000	10,000	15,000	—	5,000	—	—	16,000	15,000	
2016	17,000	34,000	15,000	19,000	—	16,000	—	—	18,000	
2017	11,000	22,000	15,000	7,000	—	—	—	—	22,000	
2018	17,000	34,000	15,000	19,000	—	—	—	—	34,000	

ANALYSIS OF ROYALTY RECEIVABLE AND SHORT WORKINGS

Year	Output (Tons)	Actual Royalties	Min. Rent	Excess Short Workings	Short Workings				Fig in (₹)
					Occurred	Recouped	Written off	C/F	Amount
									Payable
2014	1,000	3,000	10,000	—	7,000	—	—	7,000	10,000
2015	2,000	6,000	10,000	—	4,000	—	—	11,000	10,000
2016	5,000	15,000	10,000	5,000	—	5,000	2,000	4,000	10,000
2017	2,000	6,000	6,000	—	—	—	4,000	—	6,000
2018	12,000	36,000	10,000	26,000	—	—	—	—	36,000

Dr. SHORT WORKINGS ACCOUNT Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2014	To Landlord's A/c	11,000	31.03.2014	By Balance c/d	11,000
		11,000			11,000
01.04.2014	To Balance b/d	11,000	31.03.2015	By Balance c/d	16,000
31.03.2015	To Landlord's A/c	5,000			16,000
		16,000			16,000
01.04.2015	To Balance b/d	16,000	31.03.2016	By Royalty Payable A/c (recouped)	16,000
		16,000			16,000

Dr. SHORT WORKINGS ALLOWABLE ACCOUNT Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2014	To Balance c/d	7,000	31.03.2014	By Y Ltd. A/c	7,000
		7,000			7,000
31.03.2015	To Balance b/d	11,000	01.04.2014	By Balance b/d	7,000
		11,000	31.03.2015	By Y Ltd. A/c	4,000
					11,000
31.3.2016	To Royalty Receivable A/c	5,000	01.04.2015	By Balance b/d	11,000
	To P & L A/c	2,000			
	To Balance c/d	4,000			
		11,000			11,000
31.03.2017	To P & L A/c	4,000	01.04.2016	By Balance b/d	4,000
		4,000			4,000

Dr. ROYALTY RECEIVABLE ACCOUNT Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2014	To Royalties Payable A/c (1,000 × 2)	2,000	31.03.2014	By Pathan A/c (1,000 × 3)	3,000
	To Profit & Loss A/c	1,000			
		3,000			3,000

31.03.2015	To Royalties Payable A/c (2,000 × 2) To Profit & Loss A/c	4000 2,000	31.03.2015	By Y Ltd. A/c (2,000 × 3)	6,000
		6,000			6,000
31.03.2016	To Royalties Payable A/c (5,000 × 2) To Profit & Loss A/c	10,000 5,000	31.03.2016	By Short Workings Allowable A/c By Y Ltd. A/c (5,000 × 2)	5,000 10,000
		15,000			15,000
31.03.2017	To Royalties Payable A/c (2,000 × 2) To Profit & Loss A/c	4000 2,000	31.03.2017	By Y Ltd. A/c (2,000 × 3)	6,000
		6,000			6,000
31.03.2018	To Royalties Payable A/c (12,000 × 2) To Profit & Loss A/c	24000 12,000	31.03.2018	By Y Ltd. A/c (12,000 × 3)	36,000
		36,000			36,000

Dr.
ROYALTY PAYABLE ACCOUNT
Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2014	To Landlord A/c (2000 × 2)	4000	31.03.2014	By Royalty Receivable A/c (1000 × 2) By Profit & Loss A/c	2,000 2,000
		4,000			4,000
31.03.2015	To Landlord A/c (5000 × 2)	10000	31.03.2015	By Royalty Receivable A/c (2000 × 2) By Profit & Loss A/c	4,000 6,000
		10000			10,000
31.03.2016	To Short Workings A/c To Landlord A/c (17000 × 2)	16,000 18,000	31.03.2016	By Royalty Receivable A/c (5000 × 2) By Profit & Loss A/c	10,000 24,000
		34,000			34,000
31.03.2017	To Landlord A/c (11000 × 2)	22000	31.03.2017	By Royalty Receivable A/c (2000 × 2) By Profit & Loss A/c	4,000 18,000
		22000			22,000
31.03.2018	To Landlord A/c (17000 × 2)		31.03.2018	By Royalty Receivable A/c (12000 × 2) By Profit & Loss A/c	24,000 10,000
					34,000

Notes:

1. Royalty to be paid to Landlord on total production including the production from sub-lessee.
2. Royalties receivable from sub lease to be adjusted against the payable amount to the extent of royalty payable to Landlord.

Dr.**Y LTD.'S ACCOUNT****Cr.**

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
31.03.2014	To Royalties Receivable A/c	3,000	31.03.2014	By Bank A/c	10,000
	To Short Workings Allowable A/c	7,000			
		10,000			10,000
31.03.2015	To Royalties Receivable A/c	6,000	31.03.2015	By Bank A/c	10,000
	To Short Workings Allowable A/c	4,000			
		10,000			10,000
31.03.2016	To Royalties Receivable A/c	10,000	31.03.2016	By Bank A/c	10,000
		10,000			10,000
31.03.2017	To Royalties Receivable A/c	6,000	31.03.2017	By Bank A/c	6,000
		6,000			6,000
31.03.2018	To Royalties Receivable A/c	36,000	31.03.2018	By Bank A/c	36,000
		36,000			36,000

Dr.**LANDLORD'S ACCOUNT****Cr.**

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
31.03.2014	To Bank A/c	15,000	31.03.2014	By Royalties A/c	4,000
				By Short Workings A/c	11,000
		15,000			15,000
31.03.2015	To Bank A/c	15,000	31.03.2015	By Royalties A/c	10,000
				By Short Workings A/c	5,000
		15,000			15,000
31.03.2016	To Bank A/c	18,000	31.03.2016	By Royalties A/c	34,000
	To Short Workings A/c	16,000			
		34,000			34,000
31.03.2017	To Bank A/c	22,000	31.03.2017	By Royalties A/c	22,000
		22,000			22,000
31.03.2018	To Bank A/c	34,000	31.03.2018	By Royalties A/c	34,000
		34,000			34,000

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AVERAGE DUE DATE

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of Average Due Date
- ◇ Practical Steps to Calculate Average Due Date
- ◇ Short-cut Method in Case of Equal Instalments

1.0 MEANING OF AVERAGE DUE DATE

Average due date is a break-even date at which neither the party making the payment nor the receiving the payment suffers if the payment is made on that date. The person who has make the payment is able to make the payment in one instalment in lieu of several payments due on different dates. The person who has to receive the payment is able to calculate the interest on the total amount due for the days from the average due date to the settlement date. Thus, average due date facilitates the calculation of interest on total amount due for the period from the average due date to the actual date of settlement.

2.0 PRACTICAL STEPS TO CALCULATE AVERAGE DUE DATE

The practical steps to calculate the Average Due Date are given below:

Step 1 Take any date as base date (Note: Usually the due date of the first transaction is taken as the base date)	
Step 2 Calculate the due date of each transaction as under:	
(a) When the invoice/bill is made payable on a specific date	(a) That specific date will be the due date.
(b) When the invoice/bill is made payable at a stated number of month(s) after date	(b) That date on which the term of the invoice/ bill shall expire will be the due date. Note: <i>The term shall expire on that day of the month which corresponds with the day on which the invoice bill is dated. If the month in which the period terminates has no corresponding day, The period shall be deemed to expire on the last day of such a month.</i>
(c) When the invoice/bill is made payable at a stated no. of days after date	(c) That date which comes after adding stated number of days to the date of invoice/bill, shall be the due date Note: <i>The date of invoice/bill is excluded.</i>
(d) When the due date is a public holiday	(d) The preceeding business day will be the due date.
(e) When the due date is an emergency/unforeseen holiday.	(e) The next following day will be the due date.

Notes:

- (i) In case of time or tenor bills, three days (called days to grace) are added to the due date to arrive at the date of maturity.
- (ii) The term of a Bill after sight commences from the date of acceptance of the bill where as the term of a Bill after date commences from the date of drawing a bill.
- (iii) Public Holidays include all Sundays, 26th Jan. (Republic Day), 15th Aug. (Independence Day) 30th Sept., (bank holiday) and 1st April, (bank holiday)

Step 3 Calculate the number of days from the base date to the due date.

Step 4 Find out the product by multiplying the amount of transaction by corresponding number of days so calculated

Step 5 Find out the total of the product column.

Step 6 Find out the total of the amount column

Step 7 Divide the total of the product column by the total of the amount column to know the number of days to be adjusted to the base date.

Step 8 Calculate the Average Due Date by adding the aforesaid days to the base date (if quotient calculated as per Step 7 is positive) or by subtracting the aforesaid days from the base date (if quotient calculated as per Step 7 is negative).

ILLUSTRATION 1

Find out the due date of the following invoices:

<i>Date of Invoice (year 2017)</i>	<i>Credit Period Allowed</i>
31st Jan.	1 month
29th Jan.	30 days
2nd Mar.	30 days
16th July	30 days
30th June	3 months
26th Dec.	1 month

SOLUTION

<i>Date of Invoice</i>	<i>Due Date</i>
31st Jan.	28.02.2017
29th Jan.	28.02.2017
2nd Mar.	31.03.2017 Since 1st April (being a bank holiday) is a public holiday.
16th July	14.08.2017 Since 15th Aug. (being Independence Day) is a public holiday.
30th June	29.09.2017 Since 30th Sept. (being a bank holiday) is a public holiday.
26th Dec.	25.01.2018 Since 26th Jan. (being Republic Day) is a public holiday.

ILLUSTRATION 2

Find out the date of maturity of the following Bills Receivable:

<i>Bill No.</i>	<i>Date of Drawing</i>	<i>Date of Acceptance</i>	<i>Payable</i>
A-1	31.01.2017	02.02.2017	1 month after date
A-2	29.01.2017	03.02.2017	30 days after date

A-3	29.01.2017	02.02.2017	2 months after date
A-4	12.07.2017	14.07.2017	1 month after date
A-5	27.06.2017	28.06.2017	3 months after date
A-6	28.09.2017	01.10.2017	2 months after sight
A-7	23.12.2017	24.12.2017	1 month
A-8	02.01.2018	03.01.2018	On demand
A-9	05.01.2018	06.01.2018	At sight
A-10	10.01.2018	11.01.2018	On presentment

Drawer demanded the amount of last three bills on 24th Jan., 2018.

SOLUTION

Bill No.	Date of Drawing	Date of Maturity	
A - 1	31.01.2017	03.03.2017	
A - 2	29.01.2017	03.03.2017	
A - 3	29.01.2017	31.03.2017	Since 1st April (being a bank holiday) is a public holiday.
A - 4	12.07.2017	14.08.2017	Since 15th Aug., (being Independence Day) is a public holiday.
A - 5	27.06.2017	29.09.2017	Since 30th Sept, (being a bank holiday) is a public holiday.
A - 6	28.09.2017	04.12.2017	
A - 7	23.12.2017	25.01.2018	Since 26th Jan. (being Republic Day) is a public holiday.
A - 8	02.01.2018	24.01.2018	
A - 9	05.01.2018	24.01.2018	
A - 10	10.01.2018	24.01.2018	

Notes:

- Three days of grace have been considered in case of Bills after date and Bills after sight, to ascertain the date of maturity.
- The term of a 'Bill after sight' commences from the date of acceptance.

ILLUSTRATION 3

Calculate No. of days from the base date (i.e. 16th Aug.) X owes Y ₹ 2,000 on 16th Aug.

Date of Bill	Term	Amount
20th Oct.	2 months	5,000
20th Oct.	60 days	6,000

SOLUTION

Due Date of Bill (including 3 grace days)	No. of Days from Base Date	Amount
16th Aug.	0	2,000
23rd Dec.	15 + 30 + 31 + 30 + 23 = 129	5,000
22nd Dec.	15 + 30 + 31 + 30 + 22 = 128	6,000

ILLUSTRATION 4

Calculate Average Due Date from the following:

Base Date	1st April
Sum of Products	₹ 7,02,000
Sum of Amount	₹ 20,000

SOLUTION

$$\begin{aligned}\text{Average Due Date} &= 1\text{st April} + \frac{\text{Sums of Products}}{\text{Sum of Amount}} \\ &= 1\text{st April} + \frac{7,02,000}{20,000} = 1\text{st April} + 35.1 \text{ days} = 6\text{th May}\end{aligned}$$

ILLUSTRATION 5

From the following, calculate the amount of interest if X desires to pay the whole amount including interest @ 15% p.a. on 30th June: Average Due Date 6th May, Amount Due ₹ 20,000

SOLUTION

Period from 6th May to 30th June = 26 + 29 = 55 days

$$\text{Interest} = ₹ 20,000 \times \frac{55}{365} \times \frac{15}{100} = ₹ 452$$

ILLUSTRATION 6

X purchased the following goods from Y:

Date of Invoice	Amount (₹)	Credit Period Allowed
30.01.2018	1,000	30 days
31.01.2018	2,000	1 month
13.07.2018	1,000	30 days
28.09.2018	1,000	3 months

Y agreed to draw a bill for the total amount due on the average due date. Ascertain that date taking (i) the due date on 1st transaction as base date; (ii) 1st Jan., 2018 as base (iii) 1st April 2018 as base date. (iv) the due date of last transaction as base date.

SOLUTION
(I) CALCULATION OF AVERAGE DUE DATE (BASE DATE: 29.02.2018)

A Due Date	B Amount	C No. of days from Base Date to Due Date	D = B × C Products
29.02.2018	1,000	0	0
29.02.2018	2,000	0	0
12.08.2018	1,000	31 + 30 + 31 + 30 + 31 + 12 = 165	1,65,000
28.12.2018	1,000	31 + 30 + 31 + 30 + 31 + 31 + 30 + 31 + 30 + 28 = 303	3,03,000
	5,000		4,68,000

$$\begin{aligned}\text{Average Due Date} &= \text{Base Date} + \frac{\text{Total of Products}}{\text{Total Amount}} = 29\text{th Feb.} + \frac{4,68,000}{5,000} \text{ days} \\ &= 29\text{th Feb.} + 93.6 \text{ days} = 2\text{nd June, 2018}\end{aligned}$$

(II) CALCULATION OF AVERAGE DUE DATE (BASE DATE: 01.01.2018)

A Due Date	B Amount	C No. of days from Base Date to Due Date	D = B × C Products
29.02.2018	1,000	30 + 29 = 59	59,000
29.02.2018	2,000	30 + 29 = 59	1,18,000
12.08.2018	1,000	30 + 29 + 31 + 30 + 31 + 30 + 31 + 12 = 224	2,24,000
28.12.2018	1,000	366 – 4 = 362	3,62,000
	5,000		7,63,000

$$\begin{aligned}\text{Average Due Date} &= \text{Base Date} + \frac{\text{Total of Products}}{\text{Total Amount}} = 1\text{st Jan.} + \frac{7,63,000}{5,000} \text{ days} \\ &= 1\text{st Jan.} + 152.6 \text{ days} = 2\text{nd June, 2018}\end{aligned}$$

(III) CALCULATION OF AVERAGE DUE DATE (BASE DATE: 01.04.2018)

A Due Date	B Amount	C No. of days from Base Date to Due Date	D = B × C Products
29.02.2018	1,000	31 + 1 = (32)	(32,000)
29.02.2018	2,000	31 + 1 = (32)	(64,000)
12.08.2018	1,000	29 + 31 + 30 + 31 + 12 = 133	1,33,000
28.12.2018	1,000	29 + 31 + 30 + 31 + 31 + 30 + 31 + 30 + 28 = 271	2,71,000
	5,000		3,08,000

$$\begin{aligned}\text{Average Due Date} &= \text{Base Date} + \frac{\text{Total of Products}}{\text{Total Amount}} = 1\text{st April} + \frac{3,08,000}{5,000} \text{ days} \\ &= 1\text{st April} + 61.6 \text{ days} = 2\text{nd June 2018}\end{aligned}$$

(IV) CALCULATION OF AVERAGE DUE DATE (BASE DATE: 28.12.2018)

A Due Date	B Amount	C No. of days from Base Date to Due Date	D = B × C Products
29.02.2018	1,000	28 + 30 + 31 + 30 + 31 + 31 + 30 + 31 + 30 + 31 = (303)	(3,03,000)
29.02.2018	2,000	= (303)	(6,06,000)
12.08.2018	1,000	28 + 30 + 31 + 30 + 19 = (138)	(1,38,000)
28.12.2018	1,000	0	0
	5,000		(10,47,000)

$$\begin{aligned}\text{Average Due Date} &= \text{Base Date} + \frac{\text{Total of Products}}{\text{Total Amount}} = 28\text{th Dec.} + \frac{(10,47,000)}{5,000} \text{ days} \\ &= 28\text{th Dec} - 209.4 \text{ Days} = 2\text{nd June, 2018}\end{aligned}$$

ILLUSTRATION 7

X has accepted the following bills payable on different dates. He wants to accept only one bill on average due date and requests you to find out that date.

Serial No.	Date of Drawing	Amount (₹)	Payable After
101	31.01.2018	1,000	30 days
102	31.01.2018	2,000	1 month
103	12.07.2018	1,000	1 month
104	27.08.2018	1,000	1 month

Note: On 1st July, 2018 the day was Friday.

SOLUTION**CALCULATION OF AVERAGE DUE DATE: (BASE DATE: 3RD MARCH, 2018)**

A Serial	B Date of Maturity	C Amount	D No. of days from Base Date to Date of Maturity	E = C × D Product
101	03.03.2018	1,000	0	0
102	03.03.2018	2,000	0	0
103	13.08.2018	1,000	28 + 30 + 31 + 30 + 31 + 13 = 163	1,63,000
104	29.09.2018	1,000	28 + 30 + 31 + 30 + 31 + 31 + 29 = 210	2,10,000
		5,000	3,73,000	

$$\begin{aligned}\text{Average Due Date} &= \text{Base Date} + \frac{\text{Total of Products}}{\text{Total Amount}} = 3\text{rd Mar.} + \frac{3,73,000}{5,000} \text{ days} \\ &= 3\text{rd March} + 74.6 \text{ days} = 17\text{th May, 2018}\end{aligned}$$

Notes:

- (i) Three days of grace have been considered in each case to ascertain the date of maturity.
- (ii) In case of Bill No. 103, due date has been taken as 13th August instead of 15th Aug. since 15th Aug. being Independence Day and 14th Aug. being Sunday are public holidays.
- (iii) In case of Bill No. 104, due date has been taken as 29th Sept instead of 30th Sept since 30th Sept being a Bank Holiday is a public holiday.

ILLUSTRATION 8

Mr Green and Mr Red had the following mutual dealings and desire to settle their account on the balance on the average due date:

Purchases by Green from Red:

	₹
6th January, 2016	6,000
2nd February, 2016	2,800
31st March, 2016	2,000

Sales by Green to Red:

6th January, 2016	6,600
9th March, 2016	2,400
20th March, 2016	500

You are asked to ascertain the average due date. [CA (Foundation) Nov. 2016]

SOLUTION:

Let the base date be 6.1.2016

Purchases by Green

Due Date	Amount ₹	No. of Days from Base Date to Due Date	Products ₹
06.01.2016	6,000	0	0
02.02.2016	2,800	27	75,600
31.03.2016	2,000	84	1,68,000
	10,800		2,43,600

Sales by Green

<i>Due Date</i>	<i>Amount</i> ₹	<i>No. of Days from Base Date to Due Date</i>	<i>Products</i> ₹
06.01.2016	6,600	0	0
09.03.2016	2,400	62	1,48,800
20.03.2016	500	73	36,500
	9,500		1,85,300

No. of days from the Base date = $\frac{2,43,600 - 1,85,300}{10,800 - 9,500} = \frac{58,300}{1,300} = 44.85$ i.e. 45 days after 6 January, 2016 on 20 Feb., 2016.

On 20 Feb., 2016 Green has to pay ₹ 1,300 to clear the account.

ILLUSTRATION 9

X and Y had the following mutual dealings and desire to settle their account on the average due date:

01.01.2018	Balance owing by Mr X ₹ 5,000
30.01.2018	Goods sold to Y (credit period 30 days) ₹ 1,000
31.01.2018	Goods purchased by X (credit period 1 month) ₹ 2,000
13.07.2018	Goods sold to Y (credit period 30 days) ₹ 1,000
28.09.2018	Goods purchased by X (credit period 3 months) ₹ 1,000

Required: Ascertain the average due date.

SOLUTION

Let the Base Date be 01.01.2018

FOR OWINGS BY MR X

<i>A</i> <i>Due Date</i>	<i>B</i> <i>Amount</i>	<i>C</i> <i>No. of days from Base Date to Date</i>	<i>D = B × C</i> <i>Product</i>
01.01.2018*	5,000	1	5,000
29.02.2018	2,000	30 + 29 = 59	1,18,000
28.12.2018	1,000	366 - 4 = 362	3,62,000
	8,000		4,85,000

*It is the date of brought down balance and not the date of transaction.

FOR OWINGS TO MR X

<i>A</i> <i>Due Date</i>	<i>B</i> <i>Amount</i>	<i>C</i> <i>No. of days from Base Date to Date</i>	<i>D = B × C</i> <i>Product</i>
29.02.2018	1,000	30 + 29 = 59	59,000
12.08.2018	1,000	30 + 29 + 31 + 30 + 31 + 30 + 31 + 12 = 224	2,24,000
	2,000		2,83,000

$$\begin{aligned}
 \text{Average Due Date} &= \text{Base Date} + \frac{\text{Total of Products}}{\text{Total Amount}} \text{ days} \\
 &= 01.01.2018 + \frac{₹4,85,000 - ₹2,83,000}{₹8,000 - ₹2,000} \text{ Days} \\
 &= 01.01.2018 + 33.67 \text{ Days} = 04.02.2018
 \end{aligned}$$

ILLUSTRATION 10

X owes Y ₹ 5,000. The average due date of mutual transactions is 2nd June 2018. Calculate the amount to be paid by X to Y if X wants to pay off (a) on 2.6.2018 (b) on 14.8.2018 (c) On 21.3.2018. Interest is charged @ 18% P.a.

SOLUTION

A Case	B Principal	C Interest from Average Date to Actual Date of Payment	D = B ± C Total Amount to be paid
(a)	5,000	$₹ 5,000 \times 18/100 \times 0/365 = 0$	₹ 5,000
(b)	5,000	$₹ 5,000 \times 18/100 \times 73/365 = ₹ 180$ Note: Interest has been charged for deferred period of 73 days from 2.6.2018 to 14.8.2018.	₹ 5,180
(c)	5,000	$₹ 5,000 \times 18/100 \times (73)/365 = (₹ 180)$ Note: Rebate has been allowed for unexpired credit period of 73 days from 21.3.2018 to 2.6.2018.	₹ 4,820

ILLUSTRATION 11

X owes Y ₹ 10,000. The average due date of mutual transactions is 2nd June. Calculate the date on which X has to make the payment if X wants to pay (a) ₹ 10,000 only (b) ₹ 10,360 (c) ₹ 9,640. Interest is charged @ 18% p.a.

SOLUTION

Let the period from average due date to actual date of payment be x

$$\text{Interest} = \text{Principal} \times \frac{\text{Rate}}{100} \times \frac{\text{Period in Days}}{365 \text{ Days}}$$

$$\begin{aligned} \text{(a) Interest} &= \text{Actual Payment} - \text{Principal Amount} = ₹ 10,000 - ₹ 10,000 = 0 \\ &= ₹ 10,000 \times \frac{18}{100} \times \frac{x}{365} = 0 \end{aligned}$$

$$\text{Thus, } x = 0$$

Actual Date of Payment

$$\begin{aligned} &= \text{Average Due Date} + \text{Period from average due date to actual date of payment} \\ &= 2\text{nd June} + 0 = 2\text{nd June} \end{aligned}$$

$$\begin{aligned} \text{(b) Interest} &= ₹ 10,360 - ₹ 10,000 = ₹ 360 \\ &= ₹ 10,000 \times \frac{18}{100} \times \frac{x}{365} = ₹ 360 \end{aligned}$$

$$x = 360 \times 365 \times \frac{100}{18} \times \frac{1}{10,000} = 73 \text{ Days}$$

Actual Date of Payment

$$\begin{aligned} &= \text{Average Due Date} + \text{Period from average due date to actual date of payment} \\ &= 2\text{nd June} + 73 \text{ Days} = 14\text{th Aug.} \end{aligned}$$

$$\begin{aligned} \text{(c) Interest} &= ₹ 9,640 - ₹ 10,000 = - ₹ 360 \\ &= ₹ 10,000 \times \frac{18}{100} \times \frac{x}{365} = - ₹ 360 \end{aligned}$$

$$x = -360 \times 365 \times \frac{100}{18} \times \frac{1}{10,000} = -73 \text{ Days}$$

Actual Date of Payment

= Average Due Date – Period from average date to actual date of payment.

= 2nd June – 73 Days = 21st March

3.0 SHORT CUT METHOD IN CASE OF EQUAL INSTALMENTS

In case of equal instalments, the Short Cut method may be used instead of Product method as explained above. Under the short cut method, the time units (e.g. years, months or days) are added up and are divided by the number of instalments and its quotient (which shall be expressed in the same unit in which the time has been expressed) is then added to the lending date to arrive at the average due date. In the form of an equation, it may be expressed as follows:

$$\text{Average Due Date} = \text{Date of Lending} + \frac{\text{Sum of the periods' Digits from the date of loan to the date of repayment of each instalment}}{\text{Number of Periodic Instalments}}$$

Note: The periods may be expressed in terms of years, quarters, months, weeks or days.

ILLUSTRATION 12

Mr X lends ₹ 25,000 to Mr Y on 1st Jan., 2018. Calculate the average due date and interest if interest @ 18% p.a. to be charged by X in each of the following alternative cases:

- If the amount is repayable in 5 equal annual instalments commencing from 1st January, 2019.
- If the amount is repayable in 5 half yearly equal instalments commencing from 1st Jan. 2019.
- If the amount is repayable in three equal instalments at an interval of two years commencing from 30th June, 2018.
- If the amount is repayable in 5 equal instalments; as under:— I (01.01.2019); II (1.7.2019); III (1.7.2020); IV (01.01.2021); V (01.01.2022)

SOLUTION

Case (a)

$$\begin{aligned}\text{Average Due Date} &= \text{Date of Lending} + \frac{\text{Sum of Years' Digits}}{\text{Number of Instalments}} \\ &= 01.01.2018 + (1 + 2 + 3 + 4 + 5) / 5 = 01.01.2018 + 3 \text{ years} = 1 \text{st Jan, 2019} \\ \text{Interest} &= ₹ 25,000 \times 3 \times 18/100 = ₹ 13,500\end{aligned}$$

Case (b)

$$\begin{aligned}\text{Average Due Date} &= \text{Date of Lending} + \frac{\text{Sum of Years' Digits}}{\text{Number of Instalments}} \\ &= 01.01.2018 + (12 + 18 + 24 + 30 + 36) / 5 = 01.01.2018 + 120/5 \text{ months} \\ &= 01.01.2018 + 24 \text{ Months} = 1 \text{st Jan., 2018} \\ \text{Interest} &= ₹ 25,000 \times 24/12 \times 18/100 = ₹ 9,000\end{aligned}$$

Case (c)

$$\begin{aligned}\text{Average Due Date} &= \text{Date of Lending} + \frac{\text{Sum of Years' Digits}}{\text{Number of Instalments}} \\ &= 01.01.2018 + (2.5 + 4.5 + 6.5) / 3 = 01.01.2018 + 4.5 \text{ years} = 1 \text{st July, 2020} \\ \text{Interest} &= ₹ 25,000 \times 4.5 \times 18/100 = ₹ 20,250\end{aligned}$$

Case (d)

$$\begin{aligned}\text{Average Due Date} &= \text{Date of Lending} + \frac{\text{Sum of Years' Digits}}{\text{Number of Instalments}} \\ &= 01.01.2018 + (12 + 18 + 30 + 36 + 48) / 5 = 01.01.2018 + 28.8 \text{ months} \\ &= 25 \text{th May, 2018} \\ \text{Interest} &= ₹ 25,000 \times 27.8/12 \times 18/100 = ₹ 10,800\end{aligned}$$

SOLVED PROBLEMS

PROBLEM 1

From the following calculate the average due date and interest @ 10% p.a. if Mr X lent ₹ 25,000 to Mr Y on 1st Jan. 2018 which is repayable in 5 half yearly instalments commencing from 1st Jan. 2019.

SOLUTION

$$\begin{aligned} \text{A.D.D.} &= \text{Date of Lending} + \frac{\text{Sum of months from date of loan to date of each instalment}}{\text{Number of Instalments}} \\ &= 1.1.2018 + (12 + 18 + 24 + 30 + 36) / 5 \text{ months} \\ &= 1.1.2018 + 24 \text{ months} = 1.1.2020 \end{aligned}$$

$$\text{Interest} = ₹25,000 \times 10\% \times 2 \text{ years} = ₹5,000$$

PROBLEM 2

Ramesh drew upon Vinod several bills of exchange due for payment on different dates as under:

<i>Date of the Bill</i>	<i>Amount ₹</i>	<i>Tenure of the Bill</i>
1st June	1,200	3 Months
19th June	1,600	2 Months
10th July	2,000	3 Months
27th July	1,500	3 Months
7th Aug.	1,800	1 Month
15th Aug.	2,400	2 Months

Find out average due date in which payment may be made in one single amount.

SOLUTION

CALCULATION OF AVERAGE DUE DATE [BASE DATE: 22ND AUG.]

<i>A</i> <i>Date of Maturity</i>	<i>B</i> <i>Amount</i>	<i>C</i> <i>No. of days from base date</i>	<i>D = B × C</i> <i>Product</i>
4th Sept.	1,200	13	15,600
22nd Aug.	1,600	0	0
13th Oct.	2,000	52	1,04,000
30th Oct.	1,500	69	1,03,500
10th Sept.	1,800	19	34,200
18th Oct.	2,400	57	1,36,800
	10,500		3,94,100

$$\begin{aligned} \text{Average Due Date} &= \text{Base Date} + \frac{\text{Total of Products}}{\text{Total Amount}} \text{ days} \\ &= 22\text{nd Aug.} + \frac{3,94,100}{10,500} \text{ days} \\ &= 22\text{nd Aug.} + 38 \text{ Days} = 29\text{th Sep.} \end{aligned}$$

PROBLEM 3

R owes S the following sums of money due from him on the dates stated:

₹ 300 due on March 9, ₹ 1,000 due on April 2, ₹ 4,000 due on April 30, ₹ 100 due on June 1,

He wants to make the complete payment on 30th June. Calculate interest @ 5% p.a. with the help of average due date method.

SOLUTION**CALCULATION OF AVERAGE DUE DATE [BASE DATE 9TH MARCH]**

A <i>Date of Maturity</i>	B <i>Amount</i>	C <i>No. of days from base date</i>	D = B × C <i>Product</i>
9th March	300	0	
2nd April	1,000	24	24,000
30th April	4,000	52	2,08,000
1st June	100	84	8,400
	5,400		2,40,400

$$\begin{aligned}\text{Average Due Date} &= \text{Base Date} + \frac{\text{Total of Products}}{\text{Total Amount}} \text{ days} = 9\text{th Mar.} + 2,40,000/5,400 \text{ days} \\ &= 9\text{th March} + 44.52 \text{ days} = 23\text{rd April}\end{aligned}$$

Interest for 68 days from A.D.D. to date of payment = ₹ 5,400 × 5/100 × 68/365 = ₹ 50.30

PROBLEM 4

A partner has withdrawn the following sum during the half year ending 30th June:

<i>Particulars</i>	<i>₹</i>
January 15	500
February 10	400
March 12	700
April 5	800
May 20	1,000
June 18	900

Interest is to be charged at 10 per annum. Find out the average due date and calculate the interest on drawings.

SOLUTION**CALCULATION AVERAGE DUE DATE (BASE DATE 15TH JAN.)**

A <i>Date of Maturity</i>	B <i>Amount</i>	C <i>No. of days from base date</i>	D = B × C <i>Product</i>
January 15	500	0	0
February 10	400	26	10,400
March 12	700	56	39,200
April 5	800	80	64,000
May 20	1,000	125	1,25,000
June 18	900	154	1,38,600
	4,300		3,77,200

$$\begin{aligned}\text{Average Due Date} &= \text{Base Date} + \frac{\text{Total of Products}}{\text{Total Amount}} \text{ days} \\ &= 15\text{th Jan.} + (3,77,200/4,300) = 87.72 \text{ (or) } 88 \text{ days.} \\ \text{Average Due Date} &= 13\text{th April, Interest from 13th April to 30th June @ ₹ 10\%} \\ &= ₹ 4300 \times (78/365) \times (10/100) = ₹ 91.89\end{aligned}$$

PROBLEM 5

Shankar owed to Ramesh the following sums of money on the due dates given below:

<i>Due Date</i>	<i>Amount Due</i>
10th Aug.	500
25th Aug.	300
5th Sep.	1,000
10th Sep.	800
15th Sep.	400

Calculation the average due date on which Shankar may pay the total sum due.

SOLUTION
CALCULATION OF AVERAGE DUE DATE [BASE DATE: 10TH AUG.]

<i>A</i> <i>Date of Maturity</i>	<i>B</i> <i>Amount</i>	<i>C</i> <i>No. of days from base date</i>	<i>D = B × C</i> <i>Product</i>
10th Aug.	500	0	0
25th Aug.	300	15	4,500
5th Sept.	1,000	26	26,000
10th Sept.	800	31	24,800
15th Sept.	400	36	14,400
	3,000		69,700

$$\begin{aligned}\text{Average Due Date} &= \text{Base Date} + \frac{\text{Total of Products}}{\text{Total Amount}} \text{ days} \\ &= 10\text{th Aug.} + (69,700/3,000) \text{ days} \\ \text{Average Due Date} &= 10\text{th Aug.} + 23.23 \text{ days} = 2\text{nd September}\end{aligned}$$

PROBLEM 6

Find the Average Due Date for the following bills:

<i>Date of drawing of the bill</i>	<i>Amount (₹)</i>	<i>Period</i>
January 15	250	3 months
March 4	400	5 months
April 10	500	1 month
April 22	200	2 months

SOLUTION**CALCULATION OF AVERAGE DUE DATE [BASE DATE: 18 APRIL]**

A <i>Date of Maturity</i>	B <i>Amount</i>	C <i>No. of days from base date</i>	D = B × C <i>Product</i>
18th April	250	0	0
7th Aug.	400	111	44,400
13th May	500	25	12,500
25th June	200	68	13,600
	1,350		70,500

$$\begin{aligned}
 \text{Average Due Date} &= \text{Base Date} + \frac{\text{Total of Products}}{\text{Total Amount}} \text{ days} \\
 &= 18\text{th Apr.} + 70,500/1,350 \text{ days} \\
 &= 18\text{th April} + 52.22 \text{ days} = 9\text{th June}
 \end{aligned}$$

PROBLEM 7

Mr Arvind purchases goods on credit. His due dates for payments were as under:

	₹		
March 5	300	due date	April 8
April 15	200	due date	May 18
May 10	275	due date	June 13
June 5	400	due date	July 8

Calculate his average due date.

SOLUTION**CALCULATION OF AVERAGE DUE DATE [BASE DATE: 8TH APRIL]**

A <i>Date of Maturity</i>	B <i>Amount</i>	C <i>No. of days from base date</i>	D = B × C <i>Product</i>
8th April	300	0	0
18th May	200	40	8,000
13th June	275	66	18,150
8th July	400	91	36,400
	1175		62,550

$$\begin{aligned}
 \text{Average Due Date} &= \text{Base Date} + \frac{\text{Total of Products}}{\text{Total Amount}} \text{ days} \\
 &= 8\text{th Apr.} + 62,550 / 1,175 \text{ days} \\
 &= 8\text{th April} + 53.23 \text{ days} = 31\text{st May}
 \end{aligned}$$

PROBLEM 8

From the following particulars, you are required to ascertain the Average Due Date:

<i>Due Date</i>	<i>Amount of the Bill (₹)</i>
18th May	1,100
24th June	625
30th July	1,800
18th Aug.	1,750
20th Oct.	1,000
24th Nov.	500

SOLUTION**CALCULATION OF AVERAGE DUE DATE [BASE DATE: 18TH MAY]**

<i>A</i> <i>Date of Maturity</i>	<i>B</i> <i>Amount</i>	<i>C</i> <i>No. of days from Base Date</i>	<i>D = B × C</i> <i>Products</i>
18th May	1,100	0	0
24th June	625	13 + 24 = 37	23,125
30th July	1,800	13 + 30 + 30 = 73	1,31,400
18th Aug	1,750	13 + 30 + 31 + 18 = 92	1,61,000
20th Oct.	1,000	13 + 30 + 31 + 31 + 30 + 20 = 155	1,55,000
24th Nov.	500	13 + 30 + 31 + 31 + 30 + 31 + 24 = 190	95,000
	6,775		5,65,525

$$\begin{aligned}
 \text{Average Due Date} &= \text{Base Date} + \frac{\text{Total of Products}}{\text{Total Amount}} \text{ days} \\
 &= 18\text{th May} + 5,65,525/6,775 = 83.47 \text{ Days or 83 Days} \\
 &= 18\text{th May} + 83 \text{ days} = 9\text{th August}
 \end{aligned}$$

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of Account Current
- ◇ Methods of Preparing Account Current
- ◇ Interest on Individual Transaction Method
- ◇ Product of Individual Transaction Method
- ◇ Product of Balances Method

1.0 ACCOUNT CURRENT

MEANING OF ACCOUNT CURRENT

Account Current is a running statement in the form of a ledger account showing the transactions between two parties for a given period of time together with the interest due *or* payable. The heading of this statement is written as under:

“(Name of Receiving Party)—In Account Current with—(Name of Sending Party)—” to—(date)

For example, if X sends the Account Current to Y, it will be headed as “Y in Account Current with X”. If Y sends the Account Current to X, it will be headed as — X in Account Current with Y’.

Account Current is usually sent by (a) a banker to its customer (b) a lender to its borrower (c) a supplier to its customer (d) an agent to its principal (e) a co-venturer to another co-venturer.

METHODS OF PREPARING ACCOUNT CURRENT

There are three methods of preparing Account Current viz. Interest on Individual Transaction Method, Product of Individual Transaction Method, Product of Balances Method.

INTEREST ON INDIVIDUAL TRANSACTION METHOD

Under this method three additional columns on each of the sides of a ledger account are provided— One column to record the Due Date, Second to record the number of days counted from the due date of each transaction to the date of closing the account and third column to record the interest due on individual transaction. The format of Account Current according to this method is given on next page. The practical steps involved in the preparation of Account Current are given below:

PRACTICAL STEPS INVOLVED IN THE PREPARATION OF ACCOUNT CURRENT

Step 1	<i>Provide three additional columns on each of the sides of a ledger account— one for Due Date, second for Days and third for 'Interest'.</i>
Step 2	<i>Calculate the due date of each transaction and enter in due date column.</i>
Step 3	<i>Calculate the number of days from the due date of each transaction to the date of closing the account and enter the number of days in 'Days' column.</i>
Step 4	<i>Calculate the interest at the given rate of interest on the amount of individual transaction for the number of days entered against that item in 'Days' Column and enter the interest in 'Interest Column'.</i>
Step 5	<i>Calculate the balance of the 'interest' columns, enter such balance on the appropriate side in the 'Interest' column and total up the 'Interest' columns.</i>
Step 6	<i>Enter the net interest on the appropriate side in the 'Amount' column. This entry is made on the side other than that on which the balance of interest appears.</i>

ILLUSTRATION 1

From the following particulars, make up an Account Current to be rendered by Mr X to Mr Y on 31st December, 2018 taking interest into account at the rate of 18% p.a.

01.07.2018	Balance owing by Mr Y	₹ 600
30.07.2018	Goods sold to Mr Y (Credit Period allowed 1 Month)	₹ 300
01.08.2018	Goods purchased from Mr Y (Credit Period received 1 Month)	₹ 200
01.09.2018	Cash received from Mr Y	₹ 100
01.09.2018	Mr Y accepted Mr X's Draft at 3 Months date	₹ 100
01.10.2018	Mr Y accepted Mr X's Draft at 3 Months date	₹ 300

Required: Prepare the Account Current according to Interest on Individual Transaction Method.

SOLUTION

See next page for solution.

FORMAT OF ACCOUNT CURRENT (ACCORDING TO INTEREST ON INDIVIDUAL TRANSACTION METHOD)
Dr. — (NAME OF RECEIVING PARTY)—IN ACCOUNT CURRENT WITH—(NAME OF SENDING PARTY)—AS AT—(DATE)— Cr.

Date	Particulars	L.F.	Due Date	Amt. ₹	Days	Interest ₹ P	Date	Particulars	L.F.	Due Date	Amt. ₹	Days	Interest ₹ P

Solution to Illustration 1

Dr. MR Y IN ACCOUNT CURRENT WITH MR X (INTEREST TO 31ST DEC., 2018 @ 18% P.A.) Cr.

Date	Particulars	L.F.	Due Date	Amt. ₹	Days	Interest ₹ P	Date	Particulars	L.F.	Due Date	Amt. ₹	Days	Interest ₹ P
01.07.2018	To Balance b/d			600	184	54.44	01.08.2018	By Purchase A/c		Sep. 1	200	121	11.93
30.07.2018	To Sales A/c		Aug 30	300	123	18.20	01.09.2018	By Cash A/c		Sep. 1	100	121	5.97
31.12.2018	To Interest A/c			54			01.09.2018	By B/R A/c		Dec. 4	100	27	1.33
							01.10.2018	By B/R A/c		4.1.14	300	(4)	(0.59)
							31.12.2018	By Balance of Interest					54.00
				954		72.64	31.12.2018	By Balance c/d			254		
											954		72.64

PRODUCT OF INDIVIDUAL TRANSACTION METHOD

Under this method, **three additional columns** on each of the sides of a ledger account are provided—one column to record the **due date**, second column to record **number of days** counted from the due date of each transaction to the date of closing the account and third column to record the **product** (i.e. the amount multiplied by the number of days for which it has been outstanding). The format of Account Current according to this method is given on next page. The practical steps involved in the preparation of the Account Current are given below:

PRACTICAL STEP INVOLVED IN THE PREPARATION OF ACCOUNT CURRENT

Step 1	<i>Provide three additional columns on each of the sides of a ledger account—one for Due Date, Second for 'Days' and third for 'Product'.</i>
Step 2	<i>Calculate the due date of transaction and enter in Due Date Column.</i>
Step 3	<i>Calculate the number of days from the due date of each transaction to the date of closing the account and enter the number of days in 'Days' column.</i>
Step 4	<i>Calculate the product by multiplying the amount of transaction by corresponding number of days and enter the product in 'Product' column.</i>
Note:	<i>In case of transactions the due date of which falls after the date of closing the account, the product must be written either as negative product on the same side or as positive product on the opposite side (i.e. the side other than that on which the transaction appears). Traditionally, such product was used to be written in 'Red Ink' and interest on such 'Red Ink Product' was used to be called as "Red Ink Interest".</i>
Step 5	<i>Calculate the balance of the 'Product' columns, enter such balance on the appropriate side in the 'Product' column and total up the 'Product' columns.</i>
Step 6	<i>Calculate the interest at the given rate of interest on the bal. of the products for a single day.</i>
Step 7	<i>Enter the interest on the appropriate side in the 'Amount' Column. This entry is made on the side other than that on which the balance of product appears if the number of days are calculated from the due date of transaction to the date of closing the account.</i>

METHODS OF COMPUTING THE NUMBERS OF DAYS

Usually any of the following two methods is used for calculating the number of days:

1. **Forward Method** — Under this Method the number of days are calculated from the due date of the transaction to the date of closing the account.
2. **Backward (or Epoque Method)** — Under this method, the number of days are calculated from the opening date of statement to the due date of transaction.

Notes:

- (i) *In the case of brought down balance, the date of the balance is to be counted, For example, if the opening balance is on 1st July and the date of closing the account is 31st December, the number of days will be counted as under:*

$$31 \text{ (July)} + 31 \text{ (Aug.)} + 30 \text{ (Sept.)} + 31 \text{ (Oct.)} + 30 \text{ (Nov.)} + 31 \text{ (Dec.)} = 184 \text{ days,}$$
- (ii) *In the case of transaction, the date of transaction is to be excluded, For example, if the cash is received on 1st July and the date of closing the account is 31st December the number of days will be counted as under:*

$$30 \text{ (July)} + 31 \text{ (Aug.)} + 30 \text{ (Sept.)} + 31 \text{ (Oct.)} + 30 \text{ (Nov.)} + 31 \text{ (Dec.)} = 183 \text{ days.}$$
- (iii) *In the case of sale or purchase transactions, if any credit period is allowed then only the due date should be considered as an effective date of transaction. For example, if goods are sold (on one month credit) on 1st July and the date of closing the account is 31st Dec., the number of days will be counted as under.,*

$$30 \text{ (Aug.)} + 30 \text{ (Sept.)} + 31 \text{ (Oct.)} + 30 \text{ (Nov.)} + 31 \text{ (Dec.)} = 152 \text{ days}$$
- (iv) *In the case of Time Bills Receivable/Bills Payable, the due date (including days of grace) will be the effective date. For example, if a Bill Receivable for 3 months is received on 1st July, and the date of closing the account is 31st Dec. the number of days will be counted as under*

$$27 \text{ (Oct)} + 30 \text{ (Nov.)} + 31 \text{ (Dec.)} = 88 \text{ days}$$
- (v) *In case the effective due date of any transaction falls after the date of closing the account, the interest is calculated for the number of days by which the due date falls after closing date and charged to party's account. For example, if a Bill Receivable for 3 months is received on 1st Oct, 2018 and the date of closing the account is 31st Dec., 2018 the interest for 4 days from 1st Jan., 20X2 to 4th Jan., 20X2 will have to be charged.*

ILLUSTRATION 2

Taking the same information as given in Illustration 1 prepare the Account Current according to Product of Individual Transaction Method.

SOLUTION

For the purposes of computing products, the number of days may be calculated either from the due date of transaction to the closing date of account (Forward method) or from the opening date of account to the due date of transaction (Epoque Method). Here, Account Current has been shown according to both these methods.

- (a) Product of Individual Transaction Method (Forward Method) (see next page)
- (b) Product of Individual Transaction Method (Epoque Method) (see next page)

*Solution to Illustration 2***(a) Product of Individual Transaction Method (Forward Method)**

Dr. **MR Y IN ACCOUNT CURRENT WITH MR X (INTEREST TO 31ST DEC., 2018 @ 18% P.A.)** Cr.

Date	Particulars	L.F.	Due Date	Amt. ₹	Days	Product ₹ P	Date	Particulars	L.F.	Due Date	Amt. ₹	Days	Product ₹ P
01.07.2018	To Balance b/d			600	184	1,10,400	01.08.2018	By Purchases A/c		Sep. 1	200	121	24,200
30.07.2018	To Sales A/c		Aug 30	300	123	36,900	01.09.2018	By Cash A/c		Sep. 1	100	121	12,100
31.12.2018	To Interest on Balance for 1 day @ 18%			54			01.09.2018	By B/R A/c		Dec. 4	100	27	2,700
	$\left[\frac{1,09,500 \times 18 \times 1}{100 \times 365} \right]$						01.10.2018	By B/R A/c		4.1.14	300	(4)	(1,200)
							31.12.2018	By Bal. of Products					1,09,500
							31.12.2018	By Balance c/d			254		
				954		1,47,300							1,47,300

(b) Product of Individual Transaction Method (Epoque Method)

Dr. **MR Y IN ACCOUNT CURRENT WITH MR X (INTEREST TO 31ST DEC., 2018 @ 18% P.A.)** Cr.

Date	Particulars	L.F.	Due Date	Amt. ₹	Days	Product ₹ P	Date	Particulars	L.F.	Due Date	Amt. ₹	Days	Product ₹ P
01.07.2018	To Balance b/d			600	—	—	01.08.2018	By Purchases A/c		Sep. 1	200	63	12,600
30.07.2018	To Sales A/c		Aug 30	300	61	18,300	01.09.2018	By Cash A/c		Sep. 1	100	63	6,300
31.12.2018	To Balance of Product					1,09,500	01.09.2018	By B/R A/c		Dec. 4	100	157	15,700
31.12.2018	To Interest on Balance for 1 day @ 18%			54			01.10.2018	By B/R A/c		4.1.14	300	188	56,400
	$\left[\frac{1,09,500 \times 18 \times 1}{100 \times 365} \right]$						31.12.2018	By Bal. of Products [200 x 184]				184	36,800
							31.12.2018	By Balance c/d			254		
				954	—	1,27,800							1,27,800

PRODUCT OF BALANCES METHOD

This method, also known as 'Periodic Balance Method', is usually adopted by enterprises dealing in finance (e.g. banks) where the balance of account is taken out after every transaction. The format of Account Current according to this method is given on next page.

PRACTICAL STEPS INVOLVED IN THE PREPARATION OF ACCOUNT CURRENT

Step 1	<i>Provide three additional columns in the ledger account—One for Days, one for 'Dr. Product' and one for 'Cr. Product'.</i>
Step 2	<i>Calculate the number of days from the date of one transaction to the date of next transaction and enter the number of days in 'Days' column.</i>
Step 3	<i>Calculate the product by multiplying the balance by corresponding number of days and enter the product of debit balance in 'Dr. Product' column and the credit balance in 'Cr. Product' column.</i>
Step 4	<i>Calculate the total of 'Dr. Product' column and Cr. Product' columns.</i>
Step 5	<i>Calculate the interest on 'Total Dr Product' and 'Total Cr. Product' at the given rates of Interest.</i>
Step 6	<i>Calculate the net interest (i.e. the difference between the interest on 'Total Dr. Product' and Interest on 'Total Cr. product'.)</i>
Step 7	<i>Enter the net interest payable to the customer as 'By Interest A/c' and the net interest receivable from the customer as 'To Interest—A/c'.</i>

DAILY BALANCE METHOD OF COMPUTING THE NUMBER OF DAYS

Under this method, the number of days are calculated from the effective date of last transaction to the effective date of next transaction. It is to be noted that if a cheque or draft is deposited in a Bank, the effective date will be the date when credit for cheque/draft is given and not the date of deposit of cheque/draft. This method is usually—adopted by financial institutions.

ILLUSTRATION 3

Mr X, a customer of Canara Bank has the following transactions during the quarter ending 31st March, 2018:

Jan. 1	Credit Balance	₹ 10,000
Jan. 12	Withdrew	₹ 11,000
Feb. 15	Deposited	₹ 10,000
Mar. 10	Withdrew	₹ 10,000
Mar. 12	Deposited an outstation cheque (Cleared on March 16)	₹ 10,000

Required: Show Mr Y's Account as at 31st March in the bank's books assuming that the bank allows interest @ 2% p.a. and charges interest @ 18% p.a.

SOLUTION (See next page)

Working Notes:

- A. Interest charged on ₹ 40,000 for 1 Day @ 18% p.a. = $\frac{40,000 \times 18 \times 1}{365 \times 100} = ₹ 19.73$
- B. Interest allowed on ₹ 4,61,000 for 1 day @ 2% p.a. = $\frac{4,61,000 \times 2 \times 1}{365 \times 100} = ₹ 25.26$
- C. Net Interest allowed (B – A) = ₹ 5.53. rounded off to ₹ 6.

SOLVED PROBLEMS

PROBLEM 1

From the following transactions in the books of Anand, prepare an account current to be sent by Anand to Basu for the quarter ending 31st March, 2018 charging and following interest at 12% per annum.

Particulars	₹
January 1, Balance in Basu's account	3,000
January 14, sold goods to Basu	5,000
February 11, cash received from Basu	4,000
February 17, sold goods to Basu	3,000
February 19, received a bill of exchange from B one month after date	5,000

SOLUTION

BASU IN ACCOUNT CURRENT WITH ANAND
for the year ending on 31st March 2018

Date	Particulars	₹	Days	Product	Date	Particulars	₹	Days	Product
2018					2018				
Jan. 1	To Balance	3,000	90	2,70,000	Feb. 11	By Cash	4,000	48	1,92,000
Jan. 14	To Sales	5,000	76	3,80,000	Feb. 19	By Bills Receivable			
Feb. 17	To Sales	3,000	42	1,26,000		(Due date 22nd Mar.)	5,000	9	45,000
Mar. 31	To Interest	177			Mar. 31	By Balance c/d	2,177		5,39,000
		11,177		7,76,000			11,11,7		7,76,000
2018									
April	To Balance b/d	2,177		5,39,000					

$$\text{Interest} = 5,39,000 \times \frac{12}{100} \times \frac{1}{365} = 177$$

PROBLEM 2

From the following, prepare an account current as sent by Arun to Bhola on 30th June, 2018, charging interest on debits @ 6% p.a. and on credits @ 4% p.a.:

2018	Particulars	₹
Jan. 1	Balance due from Bhola	600
Jan. 10	Sold goods to Bhola,	520
Jan. 17	Bhola returned goods	125
Feb. 10	Bhola paid by cheque	400
Feb. 14	Bhola accepted Arun's draft for one month	300
Apr. 29	Goods sold to Bhola	615
May 15	Received cash from Bhola	700
June 5	Bhola accepted Arun's bill for 3 months	500

SOLUTION

BHOLA IN ACCOUNT CURRENT WITH ARUN
for the year ending on 30th June 2018

Date	Particulars	₹	Days	Product	Date	Particulars	₹	Days	Product
2018					2018				
Jan 1	To Balance b/d	600	181	1,08,600	Jan 17	By Sale Return	125	164	20,500
Jan 10	To Sales A/c	520	171	88,920	Feb 10	By Bank A/c	400	140	56,000
Apr 29	To Sales A/c	615	62	38,130	Feb 14	By B/R A/c (Due date: Mar. 17)	300	105	31,500
Jun 30	To Interest A/c	27.21	—	—	May 15	By Cash A/c	700	46	32,200
	To Balance c/d	262.79	—	—	June 5	By B/R (Due date: 8th Sept.	500	(70)	—35,000
		2,025	—	2,35,650			2,025	—	1,05,200

Interest on Debit side Product Total [2,35,650 × 6/100 × 1/365]	38.74
Interest on Credit side Product Total [1,05,200 × 4/100 × 1/365]	11.53
Net	27.21

PROBLEM 3

Mehra owed ₹ 3,000 on 1st Jan, 2018 to Somesh. The following are the transactions that took place between them during 2018. It is agreed between the parties that interest @ 6% p.a. is to be calculated on all transactions.

2018	Particulars	₹
January 16	Somesh sold goods to Mehra	2,000
January 29	Somesh purchase goods from Mehra	1,500
February 10	Somesh pays cash	1,500
March 7	Mehra accepts bill drawn by Somesh for one month	2,000

They desire to settle their accounts by one single, payment on 15th March 2018. Ascertain the amount to be paid to the earnest rupee. Ignore days of grace.

SOLUTION

MR MEHRA ACCOUNT CURRENT WITH MR SOMESH
for the period ended 15th March 2018

Date	Particulars	₹	Days	Product	Date	Particulars	₹	Days	Product
2018					2018				
Jan 1	To Balance b/d	3,000	74	2,22,000	Jan. 29	By Purchases	1,500	45	67,500
Jan 16	To Sales	2,000	58	1,16,000	Mar. 7	By B/R (Due date: Apr. 7)	2,000	—23	—46,000
Feb. 10	To Cash	1,500	33	49,500	15 Mar.	By Bal. of Product	—		3,66,000
Mar 15	To Interest	60				By Balance c/d	3,060	—	—
		6,560	—	3,87,500			6,560	—	3,87,500

$$\text{Interest} = 3,66,000 \times \frac{6}{100} \times \frac{1}{365} = 60.16 \text{ (or) ₹ 60.}$$

Single Payment on 15-3-2018 = ₹ 3,060

PROBLEM 4

From the following transactions, draw up an account current by means of product up to 31st December, 2018 to be rendered by X to Y and give the amount of interest charging @ 8% per annum.

Date	Particulars	Amounts (₹ thousands)
2018		
July 01	Balance owing by Y	600
July 15	Goods sold to Y	900
Aug. 21	Goods bought from Y	700
Aug. 23	Cash received from Y	450
Oct. 23	Y accepted X's bill at 3 months	300
Nov. 01	Goods bought from Y	950
Dec.03	Accepted a bill drawn by Y at 3 months (due date of bill is on Sunday)	400

On 31st December, 2018, X and Y settled their account after considering the interest factor. Show the cash amount received or paid by X on that date.

SOLUTION
Y IN ACCOUNT CURRENT WITH X FOR THE PERIOD FROM
Dr.
1st July, 2018 to 31st December, 2018
Cr.

Date	Due Date	Particulars	Days upto 31st Dec.	Amt. (₹ in 000s)	Product	Date	Due Date	Particulars	Days upto 31st Dec.	Amt. (₹ in 000s)	Product
2018	July 01	To Bal. b/d	184	600	1,10,400	2018	Aug. 21	By Purch. A/c	132	700	92,400
July 01							Aug. 21				
July 15	July 15	To Sales	169	900	1,52,100	Aug. 23	Aug. 23	By Cash A/c	130	450	58,500
Dec. 03	Mar. 05	To Bills Payable	(64)	400	(25,600)	Oct. 23	Jan.25	By Bills Receivable	(25)	300	(7,500)
						Nov. 01	Nov.01	By Purchases A/c	60	950	57,000
Dec. 31	Dec.31	To Interest [36,500 × 8%/365]		8			Dec. 31	By Bal. of Product			36,500
Dec. 31	Dec.31	To Cash A/c		492							
				2,400	2,36,900					2,400	2,36,900

PROBLEM 5

On 1st January 2018, X's Account in Y's Ledger showed a debit balance of ₹ 5,000. The following transactions took place between Y and X during the quarter ended 31st March 2018:

2018	Particulars	₹
Jan. 11	Y sold goods to X	6,000
Jan. 24	Y received a Promissory Note from X, 3 months date	5,000
Feb. 01	X sold goods to Y	10,000
Feb. 04	Y sold goods to X	8,200
Feb. 07	X returned goods to Y	1,000
March 01	X sold goods to Y	5,600
March 18	Y sold goods to X	9,200
March 23	X sold goods to Y	4,000

Accounts were settled on 31st March 2018, by means of a cheque. Prepare an Account Current to be submitted by Y to X as on 31st March 2018, taking interest into account at 10% per annum. Calculate Interest to the nearest multiple of a rupee.

SOLUTION**IN THE BOOKS OF Y (LEDGER FROM 1ST JAN 2018 TO 31ST MAR 2018)**

Dr. X IN ACCOUNT CURRENT WITH Y (INTEREST UPTO 31ST MARCH 2018 AT 10% P.A.) Cr.

Date	Particulars	₹	Days	Product	Date	Particulars	₹	Days	Product
Jan 1	To Bal. b/d	5,000	90	4,50,000	Jan 24	By B/R	5,000	(27)	(1,35,000)
Jan 11	To Sales	6,000	79	4,74,00	Feb 1	By Purchases	10,000	58	5,80,00
Feb 4	To Sales	8,200	55	4,51,000	Feb 7	By Sales Returns	1,000	52	52,000
Mar 18	To Sales	9,200	13	1,19,600	Mar 1	By Purchases	5,600	30	1,68,000
Mar 31	To Interest	219			Mar 23	By Purchases	4,000	8	32,0000
					Mar 31	By Bal. of Products			7,97,600
						By bal. c/d	3,019		
		28,619		14,94,600			28,619		14,94,600

24A

FINANCIAL STATEMENTS (WITHOUT ADJUSTMENTS)

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of Financial Statements
- ◇ Users of Financial Statements
- ◇ Trading Account — Meaning, Purpose, Contents, Format
- ◇ Profit and Loss Account – Meaning, Purpose, Contents, Format
- ◇ Balance Sheet [or Position Statement] – Meaning, Characteristics, Purpose, Contents
- ◇ Items to be shown on the Assets side of a Balance Sheet
- ◇ Items to be shown on the Liabilities side of a Balance Sheet
- ◇ Contingent Asset
- ◇ Contingent Liability
- ◇ Distinction between Contingent Liability and Other Liabilities
- ◇ Grouping and Marshalling of Assets and Liabilities
- ◇ Distinction between Order of Liquidity and Order of Permanence
- ◇ Distinction between Trading and Profit and Loss Account and Balance Sheet
- ◇ Distinction between a Trial Balance and a Balance Sheet
- ◇ Methods of Presenting the Final Accounts
- ◇ Treatment of some items which may be Direct items/Indirect items/Incomes/Expenses
- ◇ Classification of Capital and Revenue
- ◇ Distinction between Capital Expenditure and Revenue Expenditure
- ◇ Distinction between Capital Receipts and Revenue Receipts

1.0 MEANING OF FINANCIAL STATEMENTS

1. Basically, Financial Statements are organised summaries of detailed information about the financial position and performance of an enterprise.
2. Traditionally, the term 'Financial Statements' is used to denote only two basic statements which are as under:
 - (a) **Balance Sheet (or Position Statement)** which shows the **financial position** of an enterprise at a particular point of time,
 - (b) **Trading and Profit and Loss Account (or Income Statement)** which shows the **financial performance** of an enterprise **during an accounting period**.
3. Nowadays, in addition to the aforesaid two basic financial statements, a Cash Flow Statement and Value Added Statement are also prepared in practice.

2.0 USERS OF FINANCIAL STATEMENTS

1. The information contained in these statements is used by the management, present and potential investors, lenders, short-term creditors, employees, customers, governments and their agencies to satisfy some of their different needs for information.
2. Users can get better insight about the financial strengths and weaknesses of the firm if they properly analyse the information from their own points of view.
3. The usefulness of the Financial Statements for some of the users is explained below:

Users	Need for information
1. Short-term creditors [For example, Suppliers of raw materials/goods, suppliers of short-term loans]	Short-term creditors need information to determine whether the amount owing to them will be paid when due and whether they should extend, maintain or restrict the flow of credit to an individual enterprise.
2. Long-term creditors [For Example, Suppliers of long-term loans]	Long-term creditors need information to determine whether their principals and the interest thereof will be paid when due and whether they should extend, maintain or restrict the flow of credit to an enterprise.
3. Present investors [For example, Share Holders]	Present investors need information to judge prospects for their investment and to determine whether they should buy, hold or sell the shares.
4. Potential Investors [For example, those who want to invest in Shares]	Potential investors need information to judge prospects of an enterprise and to determine whether they should buy the shares.
5. Management	Management need information to review the firm's (a) Short-term Solvency, (b) Long-term Solvency, (c) Activity (viz., effective utilisation of its resources), (d) Profitability in relation to Turnover, (e) Profitability in relation to Investments and to decide upon the course of action to be taken in future.
6. Employees	Employees and their representative groups are interested in information about the stability and profitability of the employers. They are also interested in information which enables them to assess the ability of the enterprise to pay remuneration, retirement benefits and to provide employment opportunities and future promotions.
7. Tax Authorities	Tax authorities need information to assess the tax liabilities of an enterprise.
8. Customers	Customers have an interest in information about the continuation of an enterprise, especially when they have established a long term involvement with, or are dependent on, the enterprise.
9. Government and their agencies	Government and their agencies are interested in the allocation of resources and, therefore, the activities of enterprise. They also require information in order to regulate the activities of enterprise, determine taxation policies and as the basis the national income and similar statistics.
10. Public	Enterprises affect members of the public in a variety of ways. For example, enterprises may make a substantial contribution to the local economy in many ways including the number of people, they employ and their patronage of local suppliers. Financial statements may assist the public by providing information about trends and recent developments in the prosperity of the enterprise and the range of its activities.

While all the information needs of these users cannot be made by financial statements, there are some needs which are common to all users. The information contents of the financial statements which meet information needs of the investors *or* providers of risk capital will also meet most of the needs of other users.

3.0 TRADING ACCOUNT

After preparing a tallied trial balance at the end of an accounting period, the next step is to prepare Trading Account.

MEANING OF TRADING ACCOUNT

Trading account is one of the financial statements which shows the result of buying and selling of goods and/or services during an accounting period.

PURPOSE OF TRADING ACCOUNT

Trading account is prepared to know the Gross Profit *or* Gross Loss during the accounting period. The basis for the preparation of this account is the matching of Selling Prices of Goods and Services with the Cost of Goods sold and Services rendered.

Note: Gross Profit = Operating Revenues – Direct Operating Expenses

CONTENTS OF TRADING ACCOUNT

ITEMS TO BE SHOWN ON THE DEBIT SIDE OF TRADING ACCOUNT

1. **Opening Stock** refers to the Closing Stock of unsold goods at the end of previous accounting period which has been brought forward in the current accounting period.
2. **Purchases** refer to those goods which have been bought for resale. Purchases include cash as well as credit purchases. The following items are shown by way of deduction from the amount of total purchases:
 - (i) Purchases Returns *or* Return Outwards (i.e., Goods returned to suppliers)
 - (ii) Goods withdrawn by the proprietor for his personal use.
 - (iii) Goods distributed by way of free samples.
 - (iv) Goods given as charity.
 - (v) Goods destroyed by Fire, Flood, Earthquake *or* other abnormal factors.
3. **Direct expenses** refer to all those expenses which are incurred from the stage of purchase till the stage of making the Goods in saleable condition. Such expenses include the following expenses:
 - (i) Freight Inwards (ii) Import Duty (iii) Octroi (iv) Carriage Inwards and Cartage Inwards
 - (v) Wages.

ITEMS TO BE SHOWN ON THE CREDIT SIDE OF TRADING ACCOUNT

1. **Sales** refer to the Sales of those Goods and Services in which the enterprise deals. Sales include cash as well as credit sales.
2. **Sales Returns *or* Returns Inwards** (i.e., Goods returned by customers) are shown by way of deduction from the amount of credit Sales.
3. **Closing Stock** refers to the Stock of unsold goods at the end of the current accounting period. According to Prudence Principle, Stock is valued at cost *or* Net Realisable Value (NRV) whichever is lower.

HOW TO PREPARE TRADING ACCOUNT

Account(s) to be closed	Accounting Entry to be passed
(a) Purchases Returns Account	Purchase Returns A/c Dr. To Purchases A/c
(b) Opening Stock Account, Purchases Account and Accounts of Direct Expenses (e.g., Wages, Carriage Inwards, Freight Inwards)	Trading A/c Dr. To Opening Stock A/c To Purchases A/c To Direct Expenses A/c
(c) Sales Returns or Return Inwards Account	Sales A/c Dr. To Sales Returns A/c
(d) Sales	Sales A/c Dr. To Trading A/c

The Trading Account is closed by transferring its balance to the Profit and Loss Account by passing the following entry:

Nature of the Balance in Trading Account	Accounting Entry to be passed
(a) In case of Gross Profit (i.e., when the credit side exceeds the debit side)	Trading A/c Dr. To Profit & Loss A/c
(b) In case of Gross Loss (i.e., when the debit side exceeds the credit side)	Profit & Loss A/c Dr. To Trading A/c

A GENERAL FORMAT OF A TRADING ACCOUNT**TRADING ACCOUNT OF...***Dr.**for the period ending on. . .**Cr.*

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Opening Stock	xxx	By Sales	xxx
To Purchases	xxx	<i>Less: Return Inwards</i>	xxx
<i>Less: Returns outwards</i>	xxx	By Closing Stock	xxx
<i>Less: Abnormal Loss</i>	xxx	By *Gross Loss transferred to	
<i>Less: Goods for personal use</i>	xxx	P & L A/c	xxx
<i>Less: Goods distributed as</i>	xxx		
Free Samples			
<i>Less: Goods distributed for</i>			
Charity	xxx		
To Direct Expenses	xxx		
To Wages and Salaries	xxx		
To Freight Inward	xxx		
To Carriage Inward	xxx		
To Cartage Inward	xxx		
To *Gross Profit transferred to			
P & L A/c	xxx		
	xxx		xxx

*Either Gross Profit or Gross Loss shall appear.

ILLUSTRATION 1

From the following information, prepare the Trading Account for the year ending on 31st March 2018: Opening Stock ₹ 1,50,000, Cash Sales ₹ 60,000, Credit Sales ₹ 12,00,000, Returns Outwards ₹ 10,000, Wages & Salaries ₹ 4,000, Carriage Inward ₹ 2,000, Freight Inward ₹ 3,000, Cartage Inward ₹ 1,000, Cash Purchases ₹ 50,000, Credit Purchases ₹ 10,00,000, Returns Inward ₹ 20,000, Cost of Closing Stock ₹ 90,000 but its market value is ₹ 84,000.

SOLUTION**TRADING ACCOUNT***Dr.**for the year ending 31st March, 2018**Cr.*

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Opening Stock	1,50,000	By Sales	
To Purchases:		Cash Sales	60,000
Cash Purchases	50,000	Credit Sales	12,00,000
Credit Purchases	10,00,000	Total Sales	12,60,000
Total Purchases	10,50,000	<i>Less: Return Inward</i>	20,000
<i>Less: Return Outwards</i>	10,000	By Closing Stock	84,000
	10,40,000	<i>(valued at Cost or Net Realizable</i>	
To Freight Inward	3,000	<i>Value whichever is lower)</i>	
To Carriage Inward	2,000		

To Cartage Inward	1,000		
To Wages & Salaries	4,000		
To Gross Profit t/f to P & L A/c	1,24,000		
	13,24,000		13,24,000

ILLUSTRATION 2

From the following information, prepare the Trading Account for the year ending on 31st March 2018. Adjusted Purchases ₹ 11,06,000, Sales ₹ 12,40,000, Closing Stock ₹ 84,000, Freight and Cartage Inwards ₹ 6,000, Wages ₹ 4,000, Freight & Cartage Outwards ₹ 3,000.

SOLUTION**TRADING ACCOUNT**

Dr.

for the year ending 31st March, 2018

Cr.

Particulars	₹	Particulars	₹
To Adjusted Purchases	11,06,000	By Sales	12,40,000
To Freight and Cartage Inwards	6,000		
To Wages	4,000		
To Gross Profit t/f to P & L A/c	1,24,000		
	12,40,000		12,40,000

Notes:

- Adjusted Purchases = Net Purchases + Opening Stock – Closing Stock
- Closing Stock has not been shown on the credit of Trading Account since it has already been adjusted while calculating adjusted purchases.
- Freight & Cartage Outwards are indirect expenses and hence not debited to Trading Account.

ILLUSTRATION 3

From the following information, prepare the Trading Account for the year ending on 31st March 2018. Cost of Goods Sold ₹ 11,16,000, Sales ₹ 12,40,000, Closing Stock ₹ 84,000.

SOLUTION**TRADING ACCOUNT**

Dr.

for the year ending 31st March, 2018

Cr.

Particulars	₹	Particulars	₹
To Cost of Goods Sold	11,16,000	By Sales	12,40,000
To Gross Profit b/f to P & L A/c	1,24,000		
	12,40,000		12,40,000

Notes:

- Cost of Goods Sold = Opening Stock + Purchases + Direct Expenses – Closing Stock
- Closing Stock has not been shown on the credit of Trading Account since it has already been adjusted while calculating Cost of Goods sold.

4.0 PROFIT AND LOSS ACCOUNT

After preparing a Trading Account, the next step is to prepare Profit & Loss Account.

MEANING OF PROFIT & LOSS ACCOUNT

The Profit and Loss account is one of the financial statements. It shows the financial performance of an enterprise during an accounting period.

PURPOSE OF PROFIT & LOSS ACCOUNT

The Profit and Loss Account is prepared to ascertain the **Net Profit earned** or **Net Loss incurred** by an enterprise during an accounting period.

Notes:

1. **Net Profit** = All Revenues (whether Operating or Non-Operating) – Expenses & Losses (whether Operating or Non-Operating).
2. **Operating Profit** = Operating Revenues – Operating Expenses & Losses. It arises as a result of carrying out Operating Activities.
3. **Operating Activities** are the principal revenue producing activities of the enterprise and other activities that are not investing or financial activities. **For example** – Sales and Purchases of buildings by Builders and Property Dealers are operating activities. Granting loans to third parties by them are Investing Activities. Taking loans from third parties by them are financing Activities.

CONTENTS OF PROFIT & LOSS ACCOUNT

Items to be shown on the debit side of Profit & Loss Account	Items to be shown on the credit side of Profit & Loss Account
1. Discount Allowed	1. Discount Received
2. Commission Allowed	2. Commission Earned
3. Loss on Sale of Short-term Marketable Securities	3. Profit on Sale of Short-term Marketable Securities
4. Loss on Sale of Fixed Assets	4. Profit on Sale of Fixed Assets
5. Interest paid on Loans & Advances taken	5. Interest received on Loans & Advances given
6. Rent paid	6. Rent earned from Investment in Immovable Properties
7. Royalty paid for using Copyrights of Books, Mines etc.	7. Royalty Income from Copyrights of Books, Mines etc.
8. Loss of Stock due to fire, flood, earthquake etc.	8. Interest on Short-term Marketable Securities
9. Loss of Fixed Assets due to fire, flood, earthquake etc.	9. Interest earned from Investment in Debentures, Bonds
	10. Dividend received from Investment in Shares

HOW TO PREPARE PROFIT & LOSS ACCOUNT

The preparation of the Profit and Loss Account requires (a) to bring down the Gross Profit/Gross Loss and (b) to pass the necessary entries to transfer the balances of accounts of all the concerned items to the Profit and Loss Account. The entries required for such transfer are called closing entries since such entries will close the accounts of all the concerned items. The following closing entries are passed to give effect to such transfer of balances:

Case	Accounting Entry to be passed
(a) To close the Accounts of Indirect Expenses and Losses (i.e., other than those shown on the debit side of the Trading Account)	Profit & Loss A/c Dr. To Respective Items of Expenses & Losses (Individually)
(b) To close the Accounts of Indirect Incomes and Gains (i.e., other than those shown on the credit side of the Trading Account)	Respective Items of Income and Gains (Individually) Dr. To Profit & Loss A/c

HOW TO CLOSE PROFIT & LOSS ACCOUNT

The Profit and Loss Account is closed by transferring its balance to the Capital Account of the proprietor (in case of a proprietorship concern) or of the partners (in case of a partnership firm) by passing the following entry:

(a) In case of Net Profit (i.e., when the credit side exceeds the debit side)	Profit & Loss A/c Dr. To Capital A/c
(b) In case of Net Loss (i.e., when the debit side exceeds the credit side)	Capital A/c Dr. To Profit & Loss A/c

A GENERAL FORMAT OF A PROFIT & LOSS ACCOUNT

PROFIT AND LOSS ACCOUNT OF...

Dr.

for the period ending on...

Cr.

Particulars	₹	Particulars	₹
To Gross Loss b/d	xxx	By Gross Profit b/d	xxx
To Salaries & Wages	xxx	By Discount received	xxx
To Rent, Rates & Taxes	xxx	By Commission earned	xxx
To Fire Insurance Premium	xxx	By Interest on Short-term	
To Repairs & Maintenance	xxx	Marketable securities	xxx
To Depreciation	xxx	By Profit on Sale of Short-term	
To Audit Fees	xxx	Marketable Securities	xxx
To Bank Charges	xxx	By Operating Loss c/d	xxx
To Legal Charges	xxx		
To Miscellaneous Expenses	xxx		
To Carriage Outward	xxx		
To Freight Outward	xxx		
To Commission to Salesmen	xxx		
To Travelling Expenses	xxx		
To Entertainment Expenses	xxx		
To Sales Promotion Expenses	xxx		
To Advertising and Publicity	xxx		
To Bad Debts	xxx		
To Packing Expenses	xxx		
To Operating Profit c/d	xxx		
	xxx		xxx
To Operating Loss b/d	xxx	By Operating Profit b/d	xxx

To Interest on Loan	xxx	By Rent earned	xxx
To Loss on Sale of Fixed Assets	xxx	By Interest earned	xxx
To *Net Profit transferred to		By Profit on sale of fixed assets	xxx
Capital Account	xxx	By Income from investments	xxx
		By Dividend Received	xxx
		By *Net Loss transferred to	
		Capital Account	xxx
	xxx		xxx

*Either Net Profit or Net Loss shall appear.

ILLUSTRATION 4

From the following information, prepare the Profit & Loss Account showing Operating Profit separately in the account itself of a Trader for the year ending on 31st March, 2018:

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
Gross Profit	5,00,000	Commission Allowed	5,000
Salaries & Wages	10,000	Commission Received	17,000
Wages & Salaries	1,000	Interest on loan	3,000
Carriage Inwards	2,000	Interest Received	4,000
Carriage Outwards	5,000	Rent Paid	4,000
Freight Inward	3,000	General Expenses	1,000
Freight Outward	5,000	Rent Received	5,000
Discount Allowed	1,000	Brokerage Allowed	3,000
Discount Received	2,000	Loss on Sale of Fixed Assets	7,000
Dividend Received	3,000		
Profit on Sale of Fixed Assets	5,000		

SOLUTION

PROFIT & LOSS ACCOUNT

Dr.

for the year ending 31st March, 2018

Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Salaries & Wages	10,000	By Gross Profit	5,00,000
To Carriage Outwards	5,000	By Discount Received	2,000
To Freight Outwards	5,000	By Commission Received	17,000
To Discount Allowed	1,000		
To Commission Allowed	5,000		
To Rent Paid	4,000		
To General Expenses	1,000		
To Brokerage Allowed	3,000		
To Operating Profit c/d	4,85,000		
	5,19,000		5,19,000

To Interest on Loan	3,000	By Operating Profit b/d	4,85,000
To Loss on Sale of Fixed Asset	7,000	By Interest Received	4,000
To Net Profit t/f to Capital A/c	4,92,000	By Rent Received	5,000
		By Dividend Received	3,000
		By Profit on Sale of Fixed Assets	5,000
	5,02,000		5,02,000

ILLUSTRATION 5

From the following information, prepare the Profit & Loss Account for the year ending on March 31, 2018:

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
Gross Profit	62,000	Salaries and Wages	20,000
Discount received	1,000	Discount allowed	2,000
Interest on loan paid	2,500	Interest received	3,000
Commission received	2,000	Commission to Salesmen	1,500
Rent, Rates & Taxes paid	4,000	Rent received	1,000
Fire Insurance Premium	3,600	Carriage Outward	1,000
Freight outward	500	Repairs and Maintenance	600
Printing & Stationery	600	Traveling Expenses	1,600
Entertainment Expenses	1,200	Water and Electricity	1,200
Postage & Telegram	500	Advertising and Publicity	4,000
Sales Promotion Expenses	400	Telephone Expenses	1,000
Bad Debts	1,000	Packing Expenses	500
Audit Fees	2,000	Bank Charges	400
Depreciation on Furniture:		Legal Charges	1,000
– Sales office	1,000	Miscellaneous Expenses	1,000
– Administrative office	2,000	Loss on sale of Fixed Assets	500
Miscellaneous Incomes	2,000	Loss by theft	5,000
Profit on sale of Fixed Assets	8,500	Dividend received on Shares	300
Loss by Fire	1,000	Income from Investments	200
Loss by Embezzlement	1,000		

SOLUTION
PROFIT AND LOSS ACCOUNT
Dr.
for the year ending 31st March, 2018
Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Salaries & Wages	20,000	By Gross Profit b/d	62,000
To Rent, Rates & Taxes	4,000	By Discount earned	1,000
To Fire Insurance premium	3,600	By Interest earned	3,000
To Repairs & Maintenance	600	By Commission earned	2,000
To Printing & Stationery	600	By Rent earned	1,000
To Water & Electricity	1,200	By Profit on Sale of Fixed Assets	8,500

To Postage & Telegrams	500	By Income from investments	200
To Telephone Expenses	1,000	By Miscellaneous Incomes	2,000
To Depreciation on Furniture	3,000	By Dividend on Shares	300
To Audit Fees	2,000		
To Bank Charges	400		
To Legal Charges	1,000		
To Miscellaneous Expenses	1,000		
To Discount Allowed	2,000		
To Carriage Outward	1,000		
To Freight Outward	500		
To Commission to Salesmen	1,500		
To Travelling Expenses	1,600		
To Entertainment Expenses	1,200		
To Sales Promotion Expenses	400		
To Advertising & Publicity	4,000		
To Bad Debts	1,000		
To Packing Expenses	500		
To Interest on Loan	2,500		
To Loss on sale of Fixed Assets	500		
To Loss by Fire	1,000		
To Loss by Theft	5,000		
To Loss by Embezzlement	1,000		
To Net Profit transferred to Capital A/c	17,400		
	80,000		80,000

5.0 BALANCE SHEET [OR POSITION STATEMENT]

After preparing the Profit & Loss Account, the next step is to prepare a Balance Sheet.

MEANING OF BALANCE SHEET

A Balance Sheet is one of the financial statements. A Balance Sheet is a Statement of Financial Position of an enterprise at a given date which shows its Assets, External Liabilities, Capital and Reserves and Surplus. It is called a Balance Sheet because it is a sheet of balances of those ledger accounts (i.e., Personal Accounts, Real Accounts, Fictitious Assets Accounts not yet w/o) which are never closed.

CHARACTERISTICS OF A BALANCE SHEET

1. A Balance Sheet is **only a statement and not an account**. It has no debit side or credit side. The headings of the two sides are 'Assets' and 'Liabilities'.
2. A Balance Sheet is prepared **at a particular point of time and not for a particular period**. The information contained in a Balance Sheet is true only at that particular point of time at which it is prepared.
3. A Balance Sheet is a **summary of balances of** those ledger **accounts** which have **not been closed** by transfer to the Trading and Profit and Loss Account.

4. A Balance Sheet **shows the nature and value of assets** and the **nature and the amount of liabilities** at a given date.

PURPOSE OF BALANCE SHEET

1. To ascertain the Nature and Value of Assets of a business.
2. To ascertain the Nature and Amount of Liabilities of a business.
3. To find out the Financial Solvency of an enterprise. An enterprise is considered to be a solvent if its Assets exceed its External Liabilities.

WHEN IS BALANCE SHEET PREPARED

Balance Sheet is prepared after the preparation of Profit & Loss Account.

SIDES OF BALANCE SHEET

1. In India the right hand side of a Horizontal Balance Sheet is called the 'Assets' side and the left hand side is called the 'Liabilities' side.
2. In some of the other countries (for example Australia), The right hand side of a Balance Sheet is called the 'Liabilities' side and the left hand side is called the 'Assets' side.

NATURE OF ACCOUNTS SHOWN IN THE BALANCE SHEET

1. The debit balances of those ledger accounts (i.e., Personal Accounts, Real Accounts, Fictitious Assets Accounts) which still remain open even after the preparation of the Trading and Profit and Loss Account, are shown on the 'Assets' side of the Balance Sheet.
2. The credit balances of those ledgers accounts (i.e., Personal Accounts) which still remain open after the preparation of the Trading and Profit & Loss Account are shown on the 'Liabilities' side of the Balance Sheet.

6.0 ITEMS TO BE SHOWN ON THE ASSETS SIDE OF A BALANCE SHEET

1. **Fixed Assets** — Fixed Assets refer to those assets which are held for the purposes of producing or providing Goods or Services and those which are not held for resale in the normal course of business. Fixed Assets may be classified as follows:
 - (i) **A Tangible Asset** is an identifiable non-monetary asset, **with physical substance**, which is held for use in the production or supply of goods or services, or for rental to others, or for administrative purposes. For example, Land & Building, Plant & Machinery, Furniture & Fixtures.
 - (ii) **An Intangible Asset** is an identifiable non-monetary asset, **without physical substance**, which is held for use in the production or supply of goods or services, or for rental to others, or for administrative purposes. For example, Goodwill, Patents, Trade Marks.

Note: *Fixed assets are usually valued at Cost less Depreciation.*
2. **Investments** are assets held by an enterprise for earning income by way of Dividends, Interest, and rentals, for Capital Appreciation, or for other benefits to the investing enterprise.

For example, Investment in Shares, Investment in Debentures & Bonds, Investment in Immovable Properties.
3. **Current Assets** — Current assets are those assets which are held —
 - (i) in the form of cash,
 - (ii) for their conversion into cash, *either* within the Operating Cycle Period *or* within the 12 Months Period from the date of Balance Sheet and
 - (iii) for their consumption in the production of goods or rendering of services in the normal course of business.

For example, 1. Current Investments, 2. Inventories, 3. Trade Receivables, 4. Cash and Cash Equivalents, 5. Short-term Loans and Advances, 6. Other Current Assets

Note: Current Assets are usually valued at Cost or Net Realizable Value (i.e. Realizable Value less Realization Expenses) whichever is lower on the basis of Prudence Principle.

TUTORIAL NOTES

1. **An Asset** is a resource:
 - (a) which is controlled by an enterprise as a result of past events; and
 - (b) from which future economic benefits are expected to flow to the enterprise
2. **Non-Monetary Assets** are assets other than Monetary Assets. **Monetary Assets** are money held and assets to be received in fixed or determinable amounts of money. **For Example** Cash, Debtors, Bills Receivable, Investments held to maturity since their amount on maturity is determined.

7.0 DISTINCTION BETWEEN TANGIBLE ASSETS AND INTANGIBLE ASSETS

Tangible Assets differ from Intangible Assets in the following respects:

Basis of Distinction	Tangible Assets	Intangible Assets
1. Physical identity	These assets have physical identity.	These assets do not have physical identity.
2. Depreciation or Amortisation	Fixed tangible assets are depreciated .	Intangible assets are amortized .
3. Fixed vs. Current	Tangible assets can be Fixed Asset or Current Asset .	Intangible assets usually fall in the category of Fixed Assets .
4. Acceptance in security	Lenders accept such assets as security.	Lenders usually do not accept such assets as security for a loan given.
5. Risk of loss due to fire	These assets may be lost due to fire.	These assets cannot be lost due to fire.

8.0 DISTINCTION BETWEEN FIXED ASSETS AND CURRENT ASSETS

Fixed Assets differ from Current Assets in the following respects:

Basis of Distinction	Fixed Assets	Current Assets
1. Purposes of holding	These are the assets which are held for the purpose of producing or providing Goods or Services and those which are not held for resale in the normal course of business.	These are the assets which are held – (a) in the form of Cash or Cash equivalents (b) for their conversion into cash normally within an operating cycle or 12 months from Balance Sheet date (c) for their consumption in the production of goods or rendering of services in the normal course of business.

2. Valuation	Fixed assets are valued at cost less depreciation .	These assets are valued at cost or market price whichever is lower .
3. Subject to change	These assets are usually not subject to change.	These assets are usually subject to change.
4. Pledge	These assets cannot be pledged.	These assets can be pledged.
5. Fixed vs. Floating charge	Fixed charge can be created on these assets.	Floating charge can be created on these assets.
6. Nature of Profit on Sale	Profit on sale of these assets is of capital nature.	Profit on sale of these assets is of revenue nature.
7. Revaluation reserve in case of appreciation in the value	In case of appreciation in the value of such assets, revaluation reserve can be created .	In case of appreciation in the value of such assets, revaluation reserve cannot be created .
8. Source of finance	These assets are financed out of long-term funds .	These assets are mainly financed out of short-term funds .

9.0 ITEMS TO BE SHOWN ON THE LIABILITIES SIDE OF A BALANCE SHEET

- 1. Long term Liability** — Long term Liability refers to that liability which is expected to be settled after 12 months from the date of a Balance Sheet e.g., Loan from a financial institution, Debentures.
- 2. Current Liability** — Current Liability refers to that liability which is expected to be settled normally within 12 months from the date of Balance Sheet. e.g., Bills Payables, Trade Creditors, Outstanding Expenses, Bank Overdraft, Installments of Loan and Deposits payable within 12 months from the date of Balance Sheet.
- 3. Capital** — Capital is the excess of Assets over External liabilities. It refers to the amount invested in an enterprise by the proprietor (in case of a proprietorship concern) or partners (in case of a partnership concern), which is increased by the amount of profit earned and is decreased by the losses incurred and the amount withdrawn (whether in the form of cash or kind).

Note: *Drawings Account (which records the amount withdrawn by the proprietor whether in the form of cash or kind) is closed by transferring its balance to the debit side of the Capital Account. Usually, it is shown by way of deduction from the amount of capital in the Balance Sheet.*

TUTORIAL NOTE

A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

10.0 CONTINGENT ASSET

MEANING OF CONTINGENT ASSET

A Contingent Asset is a possible asset that arises from past events 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.

EXAMPLE OF CONTINGENT ASSET

Suppose the firm has filed a suit for some property now in the possession of someone else. If the suit is decided in the firm's favour, the firm will get the property; at the moment it is a contingent asset.

Similar would be the position for a patent applied for arising out of the firm's own research effort. Contingent liability in respect of contract for capital expenditure already entered into will give rise to an asset on payment; at present it is only a contingent asset.

11.0 CONTINGENT LIABILITY

MEANING OF CONTINGENT LIABILITY

A Contingent Liability is 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

TWO CHARACTERISTICS OF CONTINGENT LIABILITY

Contingent liabilities have two characteristics: (i) Uncertainty as to whether the amount will be payable at all; (ii) Uncertainty about the amount involved.

DISCLOSURE OF CONTINGENT LIABILITY

It is disclosed by way of a note to the balance sheet, unless there is a probability that a loss will materialize and its reasonable estimate can be made. In that event, it is no more a contingent liability and a specific provision should be made therefor.

EXAMPLES OF CONTINGENT LIABILITIES

1. Bills of exchange discounted but not yet matured;
2. Claim against the company not acknowledged as Debt e.g. suit for damages against the company which it is defending.
3. Arrears of dividends on cumulative preference shares;
4. Uncalled Liability on Partly paid shares held as investments.
5. Estimated amount of contracts remaining to be executed on capital account & not provided for
6. Guarantees given by the company to companies under the same management; and
7. Gratuities payable to staff on retirement or death.

12.0 DISTINCTION BETWEEN CONTINGENT LIABILITY AND OTHER LIABILITIES

Basis of Distinction	Contingent Liability	Other Liability
1. Meaning	It is an obligation which may or may not arise depending on the happening or non-happening of an uncertain future event.	These are financial obligations of an enterprise other than owners' equity.
2. Disclosure	It is disclosed by way of foot note to the Balance Sheet.	These are disclosed on the liabilities side of the Balance Sheet.
3. Example	1. Bills discounted but not yet matured 2. Arrears of dividend on Cum-Pref-Shares	1. Creditors for Goods 2. Outstanding Expenses

13.0 GROUPING AND MARSHALLING OF ASSETS AND LIABILITIES

MEANING OF GROUPING

The term '**Grouping**' means putting together items of a similar nature under a common heading. **For example**, under the heading 'Trade Creditors' the balances of the ledger accounts of all the suppliers from whom goods have been purchased on credit, will be shown.

MEANING OF MARSHALLING

The term '**Marshalling**' refers to the order in which the various assets and liabilities are shown in the Balance Sheet. The assets and liabilities can be shown *either* in the order of liquidity *or* in the order of permanency.

ORDER OF LIQUIDITY

1. The **assets** are arranged **in the order of their liquidity**, i.e., the most liquid asset (e.g., Cash-in-hand), is shown first. The least liquid asset (e.g., Goodwill) is shown last. The least liquid asset does not mean an asset which cannot be encashed.
2. The **liabilities** are arranged **in the order of their urgency of payment**, i.e., the most urgent payment to be made (e.g., Short-term Creditors), is shown first. The least urgent payment to be made (e.g., Long-term Creditors) is shown last.
3. Usually, the Banking and Financial Companies, Sole Proprietorship and the partnership Concerns prepare their Balance Sheets in the order of liquidity.

A GENERAL FORMAT OF A BALANCE SHEET IN ORDER OF LIQUIDITY

BALANCE SHEET OF AS AT

Liabilities	₹	Assets	₹
Current Liabilities:		Current Assets:	
Bank Overdraft	xxx	Cash-in-hand	xxx
Bills Payable	xxx	Cash at bank	xxx
Outstanding Expenses	xxx	Bills Receivable	xxx
Sundry Creditors	xxx	Sundry Debtors	xxx
Income received-in-advance	xxx	Prepaid Expenses	xxx
		Accrued income	xxx
Long-term Liabilities:		Closing Stock	xxx
Loan	xxx	Investments:	xxx
Capital:		Fixed Assets:	
Opening balance	xxx	Furniture and Fixture	xxx
Add: Net Profit		Plant and Machinery	xxx
(Less: Net Loss)	xxx	Building	xxx
	xxx	Land	xxx
Less: Drawing	xxx	Goodwill	xxx
	xxx		xxx

ORDER OF PERMANENCE

This order is exactly reverse of the liquidity order.

1. The **assets** are arranged **in the order of their permanence** i.e., the least liquid asset (e.g., Goodwill) is shown first and the most liquid asset (e.g., Cash-in-hand) is shown last.
2. The least urgent payment to be made (e.g., Owners) is shown first and the most urgent payment to be made (e.g., Short-term Creditors) is shown last.
3. The company as defined under the Companies Act, 1956 is required to prepare the Balance Sheet in order of permanence.

A GENERAL FORMAT OF A BALANCE SHEET IN THE ORDER OF PERMANENCE**BALANCE SHEET OF AS AT**

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital:		Fixed Assets:	
Opening Balance xxx		Goodwill xxx	
Add: Net Profit xxx		Land xxx	
(Less: Net Loss) xxx		Building xxx	
Less: Drawings xxx	xxx	Plant & Machinery xxx	
		Furniture & Fixtures xxx	
Long-term Liabilities:		Investments: xxx	
Loan xxx	xxx	Current Assets:	
Current Liabilities:		Closing Stock xxx	
Income received-in-advance xxx	xxx	Accrued income xxx	
Sundry Creditors xxx	xxx	Prepaid expenses xxx	
Outstanding Expenses xxx	xxx	Sundry Debtors xxx	
Bills Payable xxx	xxx	Bills Receivable xxx	
Bank Overdraft xxx	xxx	Cash at bank xxx	
		Cash in hand xxx	
	xxx		xxx

14.0 DISTINCTION BETWEEN ORDER OF LIQUIDITY AND ORDER OF PERMANENCE

Basis of Distinction	Order of Liquidity	Order of Permanence
1. Order of Assets	The assets are arranged in the order of their liquidity, i.e., the most liquid asset (e.g., Cash-in-hand), is shown first. The least liquid asset (e.g., Goodwill) is shown last. The least liquid asset does not mean an asset which cannot be encashed.	The assets are arranged in the order of their permanence i.e., the least liquid asset (e.g., Goodwill) is shown first and the most liquid asset (e.g., Cash-in-hand) is shown last.
2. Order of Liabilities	The liabilities are arranged in the order of their urgency of payment, i.e., the most urgent payment to be made (e.g., Short-term creditors) is shown first. The least urgent payment to be made (e.g., Long-term creditors) is shown last.	The liabilities are arranged in the order of their permanence i.e., the least urgent payment to be made (e.g., Owners) is shown first and the most urgent payment to be made (e.g., Short-term creditors) is shown last.
3. Users	Usually, the banking and financial companies, sole proprietorship and the partnership concerns prepare their balance sheets in the order of liquidity.	The company as defined under the Companies Act, 1956 is required to prepare the balance sheet in order of permanence.

ILLUSTRATION 6

From the following information, prepare a Balance Sheet of Mr X as at 31 March, 2018 (a) In order of liquidity, and (b) In order of permanence.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Plant and Machinery	1,00,000	Furniture and fixtures	20,000
Prepaid Expenses	1,000	Accrued Income	2,000
Income received in advance	2,000	Outstanding Expenses	1,000
Bills Payable	3,000	Bills Receivables	2,000
Sundry Debtors	1,00,000	Sundry Creditors	99,000
Bank Overdraft	10,000	Investments in Shares of X Ltd.	10,000
Long-term Loan from bank	1,00,000	Closing Stock	85,000
Capital	2,00,000	Building	1,00,000
Land	10,000	Goodwill	10,000
Drawings	10,000	Net Profit	60,000
Cash-in-hand	5,000	Cash at bank	19,000
Income Tax Paid	1,000		

SOLUTION
(a) In order of Liquidity
BALANCE SHEET OF MR X AS AT 31 MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Current Liabilities:		Current Assets:	
Bank Overdraft	10,000	Cash in hand	5,000
Bills Payable	3,000	Cash at bank	19,000
Outstanding Expenses	1,000	Bills receivable	2,000
Sundry Creditors	99,000	Sundry debtors	1,00,000
Income received in advance	2,000	Prepaid Expenses	1,000
Long-term Liabilities		Accrued Income	2,000
Loan	1,00,000	Closing Stock	85,000
Capital:		Investments:	
Opening Balance	2,00,000	Shares of X Ltd.	10,000
Add: Net Profit	60,000	Fixed Assets:	
	2,60,000	Furniture & Fixtures	20,000
Less: Drawings	10,000	Plant & Machinery	1,00,000
Less: Income Tax	1,000	Building	1,00,000
	2,49,000	Land	10,000
		Goodwill	10,000
	4,64,000		4,64,000

(b) In order of Permanence**BALANCE SHEET OF MR X AS AT 31 MARCH, 2018**

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital:		Fixed Assets:	
Opening Balance	2,00,000	Goodwill	10,000
Add: Net Profit	60,000	Land	10,000
	2,60,000	Building	1,00,000
Less: Drawings	10,000	Plant and machinery	1,00,000
Less: Income Tax	1,000	Furniture and fixtures	20,000
	2,49,000		
Long-term Liabilities:		Investments:	
Long-term Loan	1,00,000	Shares of X Ltd.	10,000
Current Liabilities:		Current Assets:	
Income received-in-advance	2,000	Closing Stock	85,000
Sundry Creditors	99,000	Accrued Income	2,000
Outstanding Expenses	1,000	Prepaid Expenses	1,000
Bills Payable	3,000	Sundry Debtors	1,00,000
Bank Overdraft	10,000	Bills receivable	2,000
		Cash at bank	19,000
		Cash in hand	5,000
	4,64,000		4,64,000

15.0 DISTINCTION BETWEEN TRADING & PROFIT & LOSS ACCOUNT & BALANCE SHEET

The Trading and Profit and Loss Account can be distinguished from the Balance Sheet as follows:

Basis of Distinction	Trading and Profit & Loss A/c	Balance Sheet
1. Need for Preparation	The Trading and Profit & Loss A/c is prepared to ascertain the Financial Performance during an accounting period.	The Balance Sheet is prepared to ascertain the Financial Position of an enterprise at a particular time.
2. Contents	The balances of all the ledger accounts of revenue nature are shown in the Trading and Profit & Loss A/c.	The balances of only those ledger accounts which still remain open even after the preparation of Trading and Profit & Loss A/c, are shown in the Balance Sheet.
3. Format	(a) The Trading & Profit & Loss A/c is a ledger account . (b) It has debit side and a credit side. (c) It is closed by transferring its balance to the Capital Account.	(a) The Balance Sheet is only a statement & not an account. (b) It has no debit side and credit side. (c) The headings of the two sides are 'Liabilities' and 'Assets'.

16.0 DISTINCTION BETWEEN A TRIAL BALANCE AND A BALANCE SHEET

A Trial Balance can be distinguished from a Balance Sheet as follows:

Basis of Distinction	Trial Balance	Balance Sheet
1. Need for Preparation	It is prepared to check the arithmetical accuracy of	It is prepared to ascertain the Financial Position of of an enterprise at a particular point of time.
2. Contents	All the ledger accounts are shown in the Trial Balance.	The balances of only those ledger accounts which still remain open even after the preparation of Trading & Profit & Loss Account are shown in the Balance Sheet.
3. Format	The headings of the two columns are ' debit balances ' and ' credit balances ' (in case of a Trial Balance by Balance Method).	The headings of the two sides are ' Liabilities ' and ' Assets '.
4. Closing Stock	Generally, the Closing Stock does not appear in the Trial Balance whereas the opening stock appears.	In a Balance Sheet, only the Closing Stock appears on the Assets side as a Current Assets.
5. Items of Adjustments (e.g., Outstanding Expenses, Prepaid Exp., Accrued Income etc.)	It can be prepared without incorporating the items of adjustments.	It cannot be prepared without incorporating the items of adjustments.
6. Net Profit /Net Loss	Information about net Profit/Net loss is not provided in a Trial Balance.	Information about net Profit/Net Loss is provided.
7. Periodicity	It can be prepared periodically (say) at the end of a month/quarter/half-year.	It is generally prepared at the end of an accounting period.
8. Can the preparation be dispensed with?	Its preparation can be dispensed with.	Its preparation cannot be dispensed with.

17.0 METHODS OF PRESENTING THE FINAL ACCOUNTS

The Trading and Profit and Loss Account and the Balance Sheet can be presented *either* in Horizontal Form *or* in Vertical Form.

- Horizontal Form** — Under this form of presentation, the items are presented in 'T' shape. The horizontal forms of presenting the Trading Account, Profit & Loss Account and Balance Sheet are shown on pages 16.6, 16.10 and 16.19 respectively.
- Vertical Form** — Under this form of presentation, the items are presented in a single column statement in a purposeful sequence. The vertical forms of presenting the Income Statement and the Balance Sheet are shown below:

VERTICAL FORM OF PROFIT AND LOSS ACCOUNT

<i>Particulars</i>	₹	₹	₹
A. Net Sales			
Sales (Gross)		XXXXX	
Less: Returns		XXXXX	XXXXX
B. Cost of Goods Sold			
Opening Stock	XXXXX		
Add: Purchases	XXXXX		
Less: Returns	XXXXX		
Add: Direct Expenses:			
Carriage/Cartage/Freight Inwards	XXXXX		
Wages and Salaries	XXXXX		
Cost of Goods available for sale	XXXXX		
Less: Closing Stock	XXXXX		XXXXX
C. Gross profit (A – B)			XXXXX
D. Operating Expenses			
(a) Selling Expenses			
Carriage outward	XXXXX		
Discount allowed	XXXXX		
Commission allowed	XXXXX		
Travelling Expenses	XXXXX		
Entertainment Expenses	XXXXX		
Sales Promotion Expenses	XXXXX		
Bad Debts	XXXXX	XXXXX	
(b) Office and Administration Expenses			
Salaries & Wages	XXXXX		
Rent/Rates & Taxes	XXXXX		
Repairs	XXXXX		
Insurance	XXXXX		
Printing & Stationery	XXXXX		
Water & Electricity	XXXXX		
Postage & Telegram	XXXXX		
Staff Welfare Expenses	XXXXX		
Conveyance Charges	XXXXX		
Miscellaneous Expenses	XXXXX		
Depreciation	XXXXX	XXXXX	XXXXX
E. Net Operating Profit/Loss (C – D)			XXXXX
F. Net Non-operating result			
(a) Interest earned	XXXXX		
Commission earned	XXXXX		
Discount earned	XXXXX		
Miscellaneous Incomes	XXXXX	XXXXX	

(b) Non-operating Expenses & Losses Interest allowed	xxxxx		
Loss on sale of a fixed Asset	xxxxx	xxxxx	xxxxx
G. Net Profit			xxxxxx

VERTICAL FORM OF BALANCE SHEET

<i>Particulars</i>	₹	₹	₹
A. Sources of Funds			
(a) Proprietor's Funds			xxxx
(b) Long-term Debts			xxxx
			xxxx
B. Application of Funds			
(a) Net Working Capital			
(i) Current Assets			
Cash in hand	xxxx		
Cash at bank	xxxx		
Bills receivable	xxxx		
Accrued income	xxxx		
Debtors	xxxx		
Stock	xxxx		
Prepaid Expenses	xxxx	xxxx	
(ii) Less: Current Liabilities			
Bank Overdraft	xxxx		
Accrued expenses	xxxx		
Bills payable	xxxx		
Trade creditors	xxxx		
Income received in advance	xxxx	xxxx	xxxx
(b) Investments			xxxx
(c) Fixed Assets			
Furniture & Fixtures		xxxx	
Patents & Trade Marks		xxxx	
Plant & Machinery		xxxx	
Building		xxxx	
Land			xxxx
Goodwill		xxxx	xxxx
			xxxx

A SCHEDULE OF PROPRIETOR'S FUNDS

<i>Particulars</i>	₹	₹
A. Capital in the beginning		xxxx
B. <i>Add:</i> Additional Capital Introduced	xxxx	
Interest on Capital	xxxx	
Salary to Partner	xxxx	

Profit for the current accounting period	xxxx	xxxx
C. Less: Drawings	xxxx	
Interest on Drawings	xxxx	
Loss for the current accounting period	xxxx	xxxx
D. Capital at the end of the year (A + B – C)		xxxx

18.0 TREATMENT OF SOME ITEMS WHICH MAY BE DIRECT ITEMS/INDIRECT ITEMS/INCOMES/EXPENSES

The treatment of some items which may be direct items/indirect items/incomes/expenses is shown below:

TREATMENT OF SOME ITEMS IN THE ABSENCE OF ANY SPECIFIC INFORMATION

Items	If item appears on debit side	If item appears on credit side	If it is not given whether debit or credit
(a) Returns	Shown on the credit side of Trading A/c by way of deduction from the amount of Sales.	Show on the debit side of Trading A/c by way of deduction from the amount of Purchases.	It may be assumed as Returns Inward or Returns outward by giving an assumption to that effect.
(b) Carriage	Shown on the debit side of Trading A/c (if assumed as carriage on purchases or P & L A/c (if assumed as carriage on sales).	—	It may be assumed as carriage on purchases or carriage on sales by giving an assumption to that effect.
(c) Freight	Shown on the debit side of Trading A/c (if assumed as Freight Inwards) or P & L A/c (if assumed as Freight outwards).	—	It may be assumed as Freight Inwards or Freight outwards by giving an assumption to that effect.
(d) Wages & Salaries	Shown on the debit side of Trading A/c	—	—
(e) Salaries & Wages	Shown on the debit side of P & L A/c	—	—
(f) Discount	Shown on the debit side of P & L A/c as Discount Allowed.	Shown on the credit side of P & L A/c as Discount Received.	It may be assumed as Discount Allowed or Received by giving an assumption to that effect.
(g) Commission	Shows on the debit side of P & L A/c as Discount Allowed.	Shown on the credit side of P & L A/c as Commission Earned	It may be assumed as Commission Allowed or Commission earned by giving an assumption to that effect.
(h) Interest	Shown on the debit side of P & L A/c as Interest Allowed.	Shown on the credit side of P & L A/c as interest Earned.	It may be assumed as Interest Allowed or Earned by giving an assumption to that effect.
(i) Rent	Shown on the debit side of P & L A/c as Rent Paid.	Shown on the credit side of P & L A/c as Rent Earned.	It may be assumed as Rent paid or Rent earned by giving an assumption to that effect.
(j) Apprenticeship	Shown on the debit side of P & L A/c as Apprenticeship Premium paid.	Shown on the credit side of P & L A/c as Apprenticeship Premium received.	It may be assumed as Apprenticeship Premium paid or received by giving an assumption to that effect.

ILLUSTRATION 7

The following is the Trial Balance of Shri Ram as at 31st March 2018:

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Land and Building	1,42,500	–
Plant and Machinery	42,500	–
Fixture & Furniture	47,500	–
Motor Vehicles	47,500	–
Opening Stock	75,000	–
Purchases/Sales	5,25,000	6,30,000
Returns	10,000	5,000
Carriage Inward	1,000	–
Carriage Outward	2,000	–
Wages and Salaries	4,000	–
Salaries and Wages	20,000	–
Discount	2,000	1,000
Commission	1,500	1,000
Interest	2,500	3 000
Rent, Rates & Taxes	3,000	
Repairs	600	–
Insurance	3,600	–
Printing & Stationery	600	–
Water & Electricity	1,200	–
Postage & Telegrams	500	–
Travelling Expenses	1,600	–
Conveyance Charges	1,200	–
Entertainment Expenses	1,200	–
Staff Welfare Expenses	1,200	–
Sales Promotion Expenses	2,400	–
Bad Debts/ Bad Debts Recovered	1,000	1,000
Depreciation	20,000	–
Miscellaneous Expenses/Incomes	1,000	1,500
Debtors/Creditors	2,05,000	50,000
Bills Receivables/Bills Payables	10,000	5,600
Investments	50,000	–
Loan from bank (Long-term)	–	50,000
Cash in hand	5,000	–
Cash at bank	10,000	–
Drawings	9, 000	–
Value Added Tax (VAT) Collected	–	4,000
Income Tax Paid	1,000	
Capital Account		5,00,000
	12,52,100	12,52,100

Additional Information: Closing Stock was ₹ 42,000.

Required: Pass the necessary closing entries and adjusting entries and prepare the Trading and Profit & Loss Account for the year ending on 31st March 2018 and a Balance Sheet as on that date.

SOLUTION

Closing Entries to be passed

JOURNAL OF SHRI RAM

Date	Particulars	L.F.	Dr. (₹)	Cr (₹)
2018 Mar. 31	Trading A/c Dr. To Stock A/c To Purchases A/c To Carriage Inward A/c To Wages and Salaries A/c To Returns Inward A/c (Being the transfer of balances to Trading A/c)		6,15,000	75,000 5,25,000 1,000 4,000 10,000
	Sales A/c Dr. Return Outwards A/c Dr. To Trading A/c (Being the transfer of Sales & Return Outwards to Trading A/c)		6,30,000 5,000	6,35,000
	Trading A/c Dr. To Profit & Loss A/c (Being the transfer of Gross Profit to Profit & Loss A/c)		62,000	62,000
	Profit & Loss A/c Dr. To Carriage Outwards A/c To Salaries & Wages A/c To Discount Allowed A/c To Commission Allowed A/c To Interest Allowed A/c To Rent, Rates & Taxes A/c To Repairs A/c To Insurance A/c To Printing & Stationery A/c To Water & Electricity To Postage & Telegram To Travelling Expenses A/c To Entertainment Expenses To Staff Welfare Expenses A/c To Conveyance Charges A/c To Sales Promotion Expenses A/c To Bad Debts A/c To Misc. Expenses A/c To Depreciation A/c (Being the transfer of balances to Profit & Loss A/c)		67,100	2,000 20,000 2,000 1,500 2,500 3,000 600 3,600 600 1,200 500 1,600 1,200 1,200 1,200 2,400 1,000 1,000 20,000

	Discount Received A/c	Dr.	1,000	
	Commission Received A/c	Dr.	1,000	
	Interest Received A/c	Dr.	3,000	
	Misc. Income A/c	Dr.	1,500	
	Bad Debts Recovered A/c	Dr.	1,000	
	To Profit and Loss A/c (Being the transfer of balances to Profit and Loss A/c)			7,500
	Profit & Loss A/c	Dr.	2,400	
	To Capital A/c (Being the transfer of Net Profit to Capital A/c)			2,400
	Capital A/c	Dr.	10,000	
	To Drawings A/c			9,000
	To Income Tax			1,000
	(Being the transfer of balance in Drawings A/c & Income Tax to Capital A/c)			
	Adjusting Entry to be passed:			
	Closing Stock A/c	Dr.	42,000	
	To Trading A/c (Being the value of stock on hand at the end of accounting period brought into account)			42,000

TRADING AND PROFIT & LOSS ACCOUNT

Dr.
for the year ending on 31 March, 2018
Cr.

Particulars	₹	Particulars	₹
To Opening Stock	75,000	By Sales	6,30,000
To Purchases	5,25,000	Less: Returns	10,000
Less: Returns	5,000	By Closing Stock	42,000
	5,20,000		
To Carriage Inwards	1,000		
To Wages & Salaries	4,000		
To Gross Profit transferred to P & L A/c	62,000		
	6,62,000		6,62,000
To Depreciation	20,000	By Gross Profit b/d	62,000
To Carriage Outward	2,000	By Discount	1,000
To Salaries & Wages	20,000	By Commission	1,000
To Discount	2,000	By Interest	3,000
To Commission	1,500	By Misc. Incomes	1,500
To Interest	2,500	By Bad Debts Recovered	1,000
To Rent, Rates & Taxes	3,000		
To Repairs	600		
To Insurance	3,600		
To Printing & Stationery	600		
To Water & Electricity	1,200		

To Postage & Telegram	500		
To Travelling Expenses	1,600		
To Entertainment Expenses	1,200		
To Staff Welfare Expenses	1,200		
To Conveyance Charges	1,200		
To Sales Promotion Expenses	2,400		
To Bad Debts	1,000		
To Misc. Expenses	1,000		
To Net Profit t/f to Capital A/c	2,400		
	69,500		69,500

BALANCE SHEET OF SHRI RAM
as at 31 March, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Current Liabilities:		Current Assets:	
Creditors	50,000	Cash in hand	5,000
Bills Payable	5,600	Cash at Bank	10,000
Value Added Tax Collected	4,000	Debtors	2,05,000
Loans:		Bills Receivables	10,000
Loan from Bank (Long-term)	50,000	Closing Stock	42,000
Capital Account:		Investments:	
Opening Balance	5,00,000	12% Investments	50,000
Add: Net Profit	2,400	Fixed Assets:	
Less: Drawings	(9,000)	Motor Vehicles	47,500
Less: Income Tax	(1,000)	Furniture, Fixture & Fittings	47,500
	4,92,400	Plant & Machinery	42,500
		Land & Building	1,42,500
	6,02,000		6,02,000

ILLUSTRATION 8

Taking the same information as given in Illustration 7, prepare the Income Statement and Balance Sheet in vertical form:

SOLUTION

INCOME STATEMENT
for the period ended 31 March, 2018

<i>Particulars</i>	₹	₹	₹
A. Net Sales			
Sales (Gross)		6,30,000	
Less: Returns		10,000	6,20,000
B. Cost of Goods Sold			
Opening Stock		75,000	

Purchases	5,25,000		
Less: Returns	5,000	5,20,000	
Carriage Inward		1,000	
Wages & Salaries		4,000	
Cost of Goods available for sale		6,00,000	
Less: Closing Stock		42,000	5,58,000
C. Gross Profit (A – B)			62,000
D. Operating Expenses			
(a) Selling Expenses			
Carriage Outward		2,000	
Discount allowed		2,000	
Commission allowed		1,500	
Travelling Expenses		1,600	
Entertainment Expenses		1,200	
Sales Promotion Expenses		2,400	
Bad Debts		1,000	11,700
(b) Office and Administration Expenses			
Salaries & Wages		20,000	
Rent, Rates & Taxes		3,000	
Repairs		600	
Insurance		3,600	
Printing & Stationery		600	
Water & Electricity		1,200	
Postage & Telegram		500	
Staff Welfare Expenses		1,200	
Conveyance Charges		1,200	
Misc. expenses		1,000	
Depreciation		20,000	52,900
Total Operating Expenses			64,600
E. Net Operating Profit (Loss) (C – D)			(2,600)
F. Net Non-operating Incomes			
(a) Non-Operating Incomes			
Interest earned	3,000		
Commission earned	1,000		
Discount earned	1,000		
Misc. Incomes	1,500		
Bad Debts Recovered	1,000	7,500	
(b) Non-operating Expenses & Losses			
Interest Allowed	2,500	(2,500)	5,000
G. Net Profit			2,400

BALANCE SHEET OF SHRI RAM*as at 31 March, 2018*

<i>Particulars</i>	₹	₹	₹
I. Sources of Funds			
(a) Proprietor's Funds			
Capital in the beginning	5,00,000		
Add: Net profit	2,400		
Less: Drawings	9,000		
Less: Income Tax	1,000		4,92,400
(b) Long term debts			50,000
			5,42,400
II. Application of Funds			
(a) Net Working Capital			
(i) Current Assets:			
Cash in hand	5,000		
Cash at bank	10,000		
Bills Receivables	10,000		
Debtors	2,05,000		
Stock	42,000	2,72,000	
(ii) Current Liabilities:			
Bills payable	5,600		
Creditors	50,000		
Value Added tax collected	4,000	59,600	2,12,400
(b) Investments			50,000
(c) Fixed Assets:			
Motor Vehicles		47,500	
Furniture & Fixtures & Fittings		47,500	
Plant & Machinery		42,500	
Land & Building		1,42,500	2,80,000
			5,42,400

ILLUSTRATION 9

A book keeper has submitted to you the following trial balance wherein the totals of the debit and credit balances are not equal:

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Creditors	1,00,000	—
Bills Payable	—	5,600
Loan from Bank	50,000	—
Capital Account	4,54,000	—
Sales	—	6,30,000
Purchase Returns	5,000	—

Discount Earned	1,000	—
Bad Debt Recovered	3,500	—
Interest on Investments	3,000	—
Fixed Assets	3,00,000	—
Opening Stock	75,000	—
Debtors	—	2,05,000
Bills Receivables	10,000	—
Investments	50,000	—
Cash in Hand	5,000	—
Cash at Bank	10,000	—
Drawings	—	9,000
Purchases	5,25,000	—
Sales Returns	—	10,000
Carriage	1,400	—
Freight Outward	—	2,000
Duty Paid on Purchases	—	1,600
Primary Packing Expenses	2,000	—
Rent Paid	—	3,000
Insurance Paid	3,600	—
Office & Administrative Expenses	13,200	—
Discount Allowed	—	2,000
Bad Debts	5,000	—
Interest on Loan from Bank	—	2,500
Delivery Expenses	6,600	—
Selling & Distribution Expenses	10,000	—
Income Tax paid	1,000	—
Value Added Tax Collected	2,000	—
Loose Tools	2,000	—
Apprentice Premium received	—	425
Commission received	—	375
	16,38,300	8,71,500

Closing Stock ₹ 40,000

- (i) Redraft the Trial Balance correctly as at 31st March, 2018.
- (ii) Prepare a Trading and Profit & Loss Account and a Balance Sheet.

SOLUTION

TRIAL BALANCE AS AT 31ST MARCH, 2018

S.No.	Particulars	Dr. (₹)	Cr. (₹)
1.	Creditors	—	1,00,000
2.	Bill payable	—	5,600
3.	Loan from bank	—	50,000

4.	Capital Account	—	4,54,000
5.	Sales	—	6,30,000
6.	Purchase returns		5,000
7.	Discount earned		1,000
8.	Bad debt Recovered		3,500
9.	Interest on Investments		3,000
10.	Fixed Assets	3,00,000	—
11.	Opening stock	75,000	—
12.	Debtors	2,05,000	—
13.	Bill receivables	10,000	—
14.	Investments	50,000	—
15.	Cash in hand	5,000	—
16.	Cash at bank	10,000	—
17.	Drawings	9,000	—
18.	Purchases	5,25,000	—
19.	Sales returns	10,000	—
20.	Carriage	1,400	—
21.	Freight outward	2,000	—
22.	Duty paid on purchases	1,600	—
23.	Primary Packing expenses	2,000	—
24.	Rent paid	3,000	-
25.	Insurance paid	3,600	—
26.	Office & Administrative Expenses	13,200	—
27.	Discount Allowed	2,000	—
28.	Bad debts	5,000	—
29.	Interest on loan from bank	2,500	—
30.	Delivery Expenses	6,600	—
31.	Selling & Distribution Expenses	10,000	—
32.	Income Tax Paid	1,000	—
33.	Value Added Tax (VAT) collected	—	2,000
34.	Loose Tools	2,000	—
35.	Apprentice Premium received	—	425
36.	Commission received	—	375
		12,54,900	12,54,900

TRADING AND PROFIT & LOSS ACCOUNT

Dr.

for the year ending on 31 March, 2018

Cr.

Particulars	₹	Particulars	₹
To Opening stock	75,000	By Sales	6,30,000
To Purchases	5,25,000	Less: Returns	10,000
Less: Returns	5,000	By Closing stock	40,000
To Duty on purchases	1,600		
To Carriage	1,400		

To Packaging expenses	2,000		
To Gross Profit c/d	60,000		
	6,60,000		6,60,000
To Freight outward	2,000	By Gross Profit b/d	60,000
To Rent	3,000	By Commission	375
To Interest on Loan	2,500	By Interest on Investments	3,000
To Discount	2,000	By Discount	1,000
To Insurance	3,600	By Apprentice premium received	425
To Delivery expenses	6,600	By Bad Debt Recovered	3,500
To Selling and distribution expenses	10,000		
To Office & Administrative expenses	13,200		
To Bad debts	5,000		
To Net Profit t/f to Capital A/c	20,400		
	68,300		68,300

BALANCE SHEET
as at 31 March, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital:		Fixed Assets:	3,00,000
Opening Balance	4,54,000	Investments:	
Add: Net Profit	20,400	Investments	50,000
Less: Drawings	9,000		
Less: Income tax	1,000	Current Assets:	
	4,64,400	Debtors	2,05,000
Loans:		Cash in hand	5,000
Bank Loan	50,000	B/R	10,000
Current Liabilities:		Cash at bank	10,000
Creditors	1,00,000	Closing stock	40,000
Bills Payable	5,600	Loose Tools	2,000
Value Added Tax Collected	2,000		
	6,22,000		6,22,000

19.0 CLASSIFICATION OF CAPITAL AND REVENUE

The Going Concern Assumption allows the accountant to classify the expenditure and receipts as Capital expenditure, Revenue expenditure, Deferred Revenue expenditure, Capital Receipts, Revenue Receipts.

20.0 CLASSIFICATION OF EXPENDITURE

An expenditure may be classified as follows:

CAPITAL EXPENDITURE

1. Meaning	It is an expenditure which is incurred: (a) to acquire <i>or</i> bring into existence an asset, or (b) to acquire <i>or</i> bring into existence an advantage <i>or</i> benefit of an enduring nature, or (c) to increase the productivity <i>or</i> earning capacity.			
2. Benefits	It normally <i>yields</i> benefits <i>beyond</i> current accounting period.			
3. Accounting Treatment	It is debited to the Respective Asset Account.			
4. Examples	(a) Cost of Land and Building (b) Cost of Plant and Machinery (c) Cost of Furniture and Fixtures			
5. Disclosure in Financial Statements	BALANCE SHEET AS AT			
	<i>Liabilities</i>	₹	<i>Assets</i>	₹
			Capital Expenditure	

REVENUE EXPENDITURE

1. Meaning	It is an expenditure which is incurred: (a) to maintain the productivity <i>or</i> earning capacity of a business. (b) to carry out operating activities in the normal course of business.			
2. Benefits	It normally does not yield benefits beyond current accounting period.			
3. Accounting Treatment	It is debited to Respective Revenue Expenses Account.			
4. Examples	(a) Depreciation on Land and Building (b) Rent of Machines (c) Repairs of Building (d) Insurance of Building			
5. Disclosure in Financial Statements	Dr. INCOME STATEMENT FOR THE PERIOD ENDED ON.... Cr.			
	<i>Particulars</i>	₹	<i>Particulars</i>	₹
	To Revenue Expenditure			

DISTINCTION BETWEEN CAPITAL AND REVENUE EXPENDITURE

Basis of Distinction	Capital Expenditure	Revenue Expenditure
1. Meaning	It is an expenditure which is incurred: (a) to acquire <i>or</i> bring into existence an asset, or (b) to acquire <i>or</i> bring into existence an advantage <i>or</i> benefit of an enduring nature, or (c) to increase the productivity <i>or</i> earning capacity.	It is an expenditure which is incurred: (a) to maintain the productivity <i>or</i> earning capacity of a business, or (b) to carry out operating activities in the normal course of business.

2. Benefits	It normally yields benefits during current accounting period.	It normally does not yield benefits during current accounting period.
3. Accounting Treatment	It is debited to the Respective Asset Account.	It is debited to Respective Expense Account.
4. Examples	(a) Cost of Land and Building (b) Cost of Plant and Machinery (c) Cost of Furniture and Fixtures	(a) Depreciation on Land & Building (b) Rent of Machines (c) Repairs of Building (d) Insurance of Building

DEFERRED REVENUE EXPENDITURE

1. Meaning	According to the Guidance note on 'Terms used in Financial Statements', issued by ICAI 'Deferred revenue expenditure is the expenditure for which payment has been made or a liability has been incurred but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods'. In short, it refers to that expenditure which is, for the time being, deferred from being charged to income. Such suspension of 'charging off' operation may be due to the nature of expenses and the benefit expected therefrom.		
4. Examples	Heavy advertising to launch a new product is a deferred revenue expenditure since the benefit from it will be availed over the next 3 to 5 years.		
3. Accounting Treatment	Normally such expenditure should be written off over a period of 3 to 5 years.		
5. Disclosure in Financial Statements	Dr. INCOME STATEMENT FOR THE PERIOD ENDED ON.... Cr.		
	<i>Particulars</i>	₹	<i>Particulars</i>
	To Deferred Revenue		
	Expenditure w/o	....	
	BALANCE SHEET AS AT		
	<i>Liabilities</i>	₹	<i>Assets</i>
			Deferred Revenue
			Expenditure (Unwritten off portion)

21.0 CLASSIFICATION OF RECEIPTS

The receipts may be classified as follows:

CAPITAL RECEIPTS

1. Meaning	Capital receipts refer to those receipts which are not revenue in nature.
2. Accounting Treatment	These are credited to the respective account of capital nature.
3. Examples	(a) Sale of Land and Building by a person other than a dealer in real estate. (b) Raising of Loan by a person other than one engaged in the business of finance/banking. (c) Raising of Capital.

REVENUE RECEIPTS

1. Meaning	Revenue receipts refer to those receipts which arise in the normal course of business.
2. Accounting Treatment	These are credited to Respective Revenue Account.
3. Examples	(a) Sale of Land and Building by a dealer in real estate. (b) Sale of Shares by a dealer in Securities.

DISTINCTION BETWEEN CAPITAL AND REVENUE RECEIPTS

Basis of Distinction	Capital Receipts	Revenue Receipts
1. Meaning	Capital receipts refer to those receipts which are not revenue in nature.	Revenue receipts refer to those receipts which arise in the normal course of business.
2. Accounting Treatment	These are credited to the Respective Account of Capital Nature.	These are credited to Respective Revenue Account.
3. Examples	(a) Sale of Land and Building by a person other than a dealer in real estate. (b) Raising of Loan by a person other than one engaged in the business of finance/banking. (c) Raising of Capital.	(a) Sale of Land and Building by a dealer in real estate. (b) Sale of Shares by a dealer in Securities.

ILLUSTRATION 10

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

- (a) Expenses on a foreign tour for purchasing a new machinery.
- (b) Freight & insurance on the new machinery.
- (c) Customs duty paid on import of a machinery.
- (d) Cartage paid to bring the new machines to factory.
- (e) Wages paid in connection with the erection of new machinery.
- (f) ₹ 1,000 spent on repairing a second hand machine before put to use.
- (g) ₹ 2,000 spent to remove a worn out part and replace it with a new engine.
- (h) A petrol driven engine of a passenger bus was replaced by a diesel engine.
- (i) ₹ 8,00,000 spent on advertising the introduction of a new product in the market, the benefit of which will be effective for 3 to 5 years.
- (j) ₹ 5,000 spent on repainting the factory.
- (k) Heavy amount spent on research for a particular product which ultimately did not result in success.
- (l) Repair ₹ 2,000 necessitated by negligence of an operator of machine.
- (m) ₹ 10,000 paid as compensation to employees who were retrenched.
- (n) Interest on a term loan for the purchase of machinery. The commercial production has not begun till the last day of the accounting year.
- (o) Interest on a term loan for the purchase of machinery. The commercial production has already begun.
- (p) Compensation paid for breach of contract to acquire stock-in-trade.
- (q) ₹ 30,000 spent as lawyer's fee to defend a suit that firm's factory belonged to the plaintiff. The suit was not successful.

SOLUTION

- (a) Items referred to in (a) to (f) represent capital expenditure since these expenditures are incurred up to the point the machine is ready for use.
- (g) It should be treated as revenue expenditure since it is incurred to keep the asset in working order. Such expenditure has *neither* resulted in increasing the life *or* efficiency of an existing asset *nor* in bringing into existence a new asset and as such cannot be treated as capital expenditure.
- (h) Such expenditure should be treated as capital expenditure since it will increase the profit capacity of the business through lowering of costs.
- (i) Such expenses should be treated as a deferred revenue expenditure and should be written-off each year over a period of 3 to 5 years.
- (j) Such expenses should be treated as a revenue expenditure since it is incurred to maintain the factory in good condition.
- (k) Such expenses should be treated as revenue expenditure as per AS-26.
- (l) Such expenses should be treated as revenue expenditure since it is incurred to keep the asset in working order.
- (m) Such expenses should be treated as revenue expenditure since it is *neither* bringing the benefit of enduring nature *nor* enhancing the value of any asset.
- (n) Such expenditure should be treated as capital expenditure since the commercial production has not begun till the last day of the accounting year.,
- (o) Such expenditure should be treated as revenue expenditure since the commercial production has already begun.
- (p) Such expenditure should be treated as revenue since it is *neither* bringing the benefit of enduring nature *nor* enhancing the value of any asset.
- (q) Such expenditure should be treated as revenue expenditure since it is incurred for the upkeep of fixed asset.

MANUFACTURING ACCOUNTING**MEANING OF MANUFACTURING ACCOUNT**

Who Prepares — Manufacturing Account is prepared by an enterprise engaged in manufacturing activities.

Why prepared — Manufacturing Account is prepared to ascertain the cost of goods manufactured during an accounting period.

How to Close — Manufacturing Account is closed by transferring its balance to the debit of Trading Account.

FORMAT OF MANUFACTURING ACCOUNT

DR. MANUFACTURING ACCOUNT OF ... FOR THE PERIOD ENDING ON... CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Opening Work-in progress	xxxx	By Sale of Scrap	xxxx
To Raw material consumed		By Closing Work-in-progress	xxxx
Opening Stock xxxx		By Trading Account	xxxx
Add: Purchases xxxx		(Cost of goods produced t/f)	
Add: Carriage Inward xxxx			
Add: Freight Inward xxxx			
Less: Return Outward (xxxx)			
Less: Closing Stock (xxxx)	xxxx		
To Wages	xxxx		

To Salary of Works Manager	xxxx		
To Power, Electricity & Water	xxxx		
To Fuel	xxxx		
To Postages & Telephone (Factory)	xxxx		
To Depreciation on:			
Plant & Machinery	xxxx		
Factory Land & Buildings	xxxx		
To Repairs to:			
Plant & Machinery	xxxx		
Factory Land & Building	xxxx		
To Insurance			
Plant & Machinery	xxxx		
Factory Land & Building	xxxx		
To Rent & Taxes	xxxx		
To General Expenses (Factory)	xxxx		
To Royalty based on production	xxxx		
	xxxx		xxxx

DISTINCTION BETWEEN MANUFACTURING ACCOUNT AND TRADING ACCOUNT

A Manufacturing Account can be distinguished from a Trading Account as follows:

Basis of Distinction	Manufacturing Account	Trading Account
1. Purpose	It is prepared to ascertain the cost of goods manufactured	It is prepared to ascertain the gross profit or gross loss.
2. Closure	It is closed by transferring its balance to the debit side of the Trading Account.	It is closed by transferring its balance to the debit side (in case of gross loss) or credit side (in case of gross profit) of the Profit and Loss Account.
3. Opening and Closing Stock of Finished Goods	It does not show the opening and closing stock of finished goods	It shows the opening and closing stock of finished goods.

ADVANTAGES OF MANUFACTURING ACCOUNT

1. It helps in ascertaining the total cost.
2. It helps in fixing selling prices or quotations.
3. It facilitates the comparison of (i) actual costs with the standard costs, and (ii) actual costs of one period with that of another period.
4. It helps in controlling the costs.
5. It helps in the preparation of estimates for submission of tenders.

COST OF RAW-MATERIALS CONSUMED

A	Opening Stock of Raw-Materials	xxx
B	Add: Purchases	xxx
C	Add: Carriage and Freight Inward	xxx
D	Less: Return Outward	xxx
E	Less: Closing Stock of Raw-Materials	xxx
F	Cost of Raw-Materials consumed (A + B + C – D – E)	xxx

MANUFACTURING COST OF FINISHED GOODS PRODUCED

A	Cost of Raw-Materials consumed	xxx
B	Add: Manufacturing Wages	xxx
C	Add: Manufacturing Overheads	xxx
D	Add: Opening Stock of WIP	xxx
E	Less: Closing Stock of WIP	xxx
F	Less: Sale of Scrap	xxx
G	Manufacturing Cost of Finished Goods produced (A + B + C + D – E – F)	xxx

MANUFACTURING COST OF FINISHED GOODS AVAILABLE FOR SALE

A	Manufacturing Cost of Finished Goods produced	xxx
B	Add: Opening Stock of Finished Goods	xxx
C	Manufacturing Cost of Finished Goods available for sale (A + B)	xxx

MANUFACTURING COST OF GOODS SOLD

A	Manufacturing Cost of Finished Goods produced	xxx
B	Add: Opening Stock of Finished Goods	xxx
C	Less: Closing Stock of Finished Goods	xxx
D	Manufacturing Cost of Finished Goods Sold (A + B – C)	xxx

ILLUSTRATION 11

From the following information, Calculate (a) The Cost of Raw Materials Consumed. (b) The Manufacturing Cost of Finished Goods produced. (c) The Manufacturing Cost of Finished Goods available for sale. (d) The Manufacturing Cost of Finished Goods sold.

	Opening	Closing
Stock of Raw Materials	1,00,000	2,00,000
Work-in-progress	3,00,000	4,00,000
Stock of Finished Goods	5,00,000	6,00,000

During the year Manufacturing Overhead Expenses amounted to ₹ 1,00,000, Manufacturing Wages to ₹ 2,00,000 and Purchases of Raw Materials to ₹ 7,20,000, Sale of Scrap ₹ 20,000. Freight and Carriage inward ₹ 10,000, Returns of Raw-Materials ₹ 20,000. There were no other direct expenses.

SOLUTION:

COST OF RAW-MATERIALS CONSUMED

	₹
A Opening Stock of Raw-Materials	1,00,000
B Add: Purchases	7,20,000
C Add: Carriage and Freight Inward	10,000
D Less: Returns Outward	20,000
E Less: Closing Stock of Raw-Materials	2,00,000
F Less: Sale of Scrap	20,000
G Cost of Raw-Materials consumed (A + B + C – D – E – F)	6,00,000

MANUFACTURING COST OF FINISHED GOODS PRODUCED

		₹
A	Cost of Raw-Materials consumed	6,00,000
B	Add: Manufacturing Wages	2,00,000
C	Add: Manufacturing Overheads	1,00,000
D	Add: Opening Stock of WIP	3,00,000
E	Less: Closing Stock of WIP	4,00,000
F	Manufacturing Cost of Finished Goods produced (A + B + C + D – E)	8,00,000

MANUFACTURING COST OF FINISHED GOODS AVAILABLE FOR SALE

		₹
A	Manufacturing Cost of Finished Goods produced	8,00,000
B	Add: Opening Stock of Finished Goods	5,00,000
C	Manufacturing Cost of Finished Goods available for sale (A + B)	13,00,000

MANUFACTURING COST OF GOODS SOLD

		₹
A	Manufacturing Cost of Finished Goods produced	8,00,000
B	Add: Opening Stock of Finished Goods	5,00,000
C	Less: Closing Stock of Finished Goods	6,00,000
D	Manufacturing Cost of Finished Goods Sold (A + B – C)	7,00,000

ILLUSTRATION 12

From the following information, prepare a Manufacturing Account for the year ending on 31st March 2018

	₹		₹
Work-in-progress (1.4.2017)	4,000	Wages	20,000
Raw-Material (31.3.2018)	90,000	Salary of Works Manager	8,000
Carriage Inward	3,000	Power, Electricity & Water	6,000
Freight Inward	2,000	Fuel	4,000
Returns Outward	2,200	Depreciation:	
Sales of Scrap	1,000	On Plant & Machinery	8,000
Work-in-progress (31.3.2018)	5,000	On Factory Building	4,000
Raw-Materials (1.4.2017)	74,000	Repairs & Insurance:	
Raw Material Purchased	45,000	— Paint & Machinery	6,000
		— Factory Building	2,000
		Factory Rent & Taxes	10,000
		General Expenses	2,000

SOLUTION:

MANUFACTURING ACCOUNT
for the year ending on 31st March, 2018

DR.
CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Opening WIP	4,000	By Sale of Scrap	1,000
To Raw-Materials consumed		By Closing WIP	5,000
Opening Stock 74,000		By Trading A/c (Cost of Goods	99,800
Add: Purchases 45,000		manufactured transferred)	
Add: Carriage Inward 3,000			
Add: Freight Inward 2,000			
Less: Returns Outwards (2,200)			
Less: Closing Stock (90,000)	31,800		
To Wages	20,000		
To Salary of Works Managers	8,000		
To Power, Electricity & Water	6,000		
To Fuel	4,000		
To Depreciation			
— on Plant & Machinery	8,000		
— on Factory Building	4,000		
To Repairs & Insurance			
— on Plant & Machinery	6,000		
— on Factory Building	2,000		
To Factory Rent & Taxes	10,000		
To General Expenses	2,000		
	1,05,800		1,05,800

ILLUSTRATION 13

From the following prepare: (a) Manufacturing Account; (b) Trading and Profit & Loss Account; and (c) Balance Sheet.

TRIAL BALANCE AS AT 31ST MARCH 2018

	₹		₹
Opening Stocks:		Insurance (Factory)	7,000
Raw Materials	57,100	Insurance (General)	800
Finished goods	5,60,000	Bad Debts	4,100
Work-in-Progress	10,000	General Expenses	29,420
Wages	2,00,000	Carriage Outward	94,240
Purchases	8,82,740	Other Assets	11,38,840
Carriage Inward	36,860	Drawings	10,000
Repairs	60,000	Sales	17,40,000
Salaries (Factory)	21,000	Profit and Loss Balance (Op)	1,20,000
Salaries (General)	10,000	Capital	13,10,000
Rates and Taxes	22,400	Sale of Scrap	10,000
Travelling Expenses	35,500		

Closing Stocks: Raw Materials ₹ 52,720; Finished Goods ₹ 3,43,240, Work-in-Progress ₹ 1,00,000.

SOLUTION:

MANUFACTURING ACCOUNT
for the year ending on 31st March, 2018

DR.

CR.

Particulars	₹	Particulars	₹
To Raw Material consumed:		By Sale of Scrap	10,000
Opening Stock 57,100		By Closing WIP	1,00,000
Add: Purchases 8,82,740		By Trading A/c (Cost of	
Less: Closing stock 52,720	8,87,120	Goods manufactured t/f)	11,11,980
To Opening WIP	10,000		
To Wages	2,00,000		
To Carriage Inward	36,860		
To Repairs	60,000		
To Salaries	21,000		
To Insurance	7,000		
	12,21,980		12,21,980

TRADING AND PROFIT & LOSS ACCOUNT

DR.

FOR THE YEAR ENDED 31ST MARCH 2018

CR.

Particulars	₹	Particulars	₹
To Opening Stock of Finished Goods	5,60,000	By Sales	17,40,000
To Manufacturing A/c (Cost of goods manufactured)	11,11,980	By Closing Stock of Finished Goods	3,43,240
To Gross Profit c/d	4,11,260		
	20,83,240		20,83,240
To Salaries (General)	10,000	By Gross Profit b/d	4,11,260
To Rent & Taxes	22,400		
To Travelling Expenses	35,500		
To Insurance (General)	800		
To Bad Debts	4,100		
To General Expenses	29,420		
To Carriage Outward	94,240		
To Net Profit transferred to Capital A/c	2,14,800		
	4,11,260		4,11,260

BALANCE SHEET AS AT 31ST MARCH 2018

Liabilities	₹	Assets	₹
<i>Capital Account:</i>		<i>Closing Stocks:</i>	
Opening Balance 13,10,000		Raw Materials	52,720
Less: Drawings 10,000	13,00,000	Work in progress	1,00,000
<i>Profit & Loss A/c</i>		Finished Goods	3,43,240
Opening Balance 1,20,000		<i>Other Assets:</i>	11,38,840
Add: Current year's profit 2,14,800	3,34,800		
	16,34,800		16,34,800

24B

FINANCIAL STATEMENTS (WITH ADJUSTMENTS)

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Rationale of making adjustments at the time of preparing Final Accounts
- ◇ Adjustment of Closing Stock
- ◇ Adjustment of Outstanding Expenses
- ◇ Adjustment of Prepaid Expenses
- ◇ Adjustment of Accrued Income
- ◇ Adjustment of Income received in advance (or Unaccrued Income)
- ◇ Adjustment of Depreciation
- ◇ Adjustment of Bad Debts
- ◇ Adjustment of Provision for Doubtful Debts
- ◇ Adjustment of Provision for Discount on Debtors
- ◇ Adjustment of Abnormal Loss of Stock
- ◇ Adjustment of Goods withdrawn for Personal Use
- ◇ Adjustment of Goods distributed as Free Samples
- ◇ Adjustment of Commission on Profit
- ◇ Treatment of Items of Adjustments appearing outside the Trial Balance
- ◇ Treatment of Items of Adjustments appearing in the Trial Balance

1.0 RATIONALE OF MAKING ADJUSTMENTS AT THE TIME OF PREPARING THE FINAL ACCOUNTS

The important considerations in the preparation of Final Accounts with adjustments are as under:

- (a) **Revenue Recognition Principle** which requires that generally the revenue should be recognized in the period in which the sale is deemed to have taken place.
- (b) **Matching Principle** which requires that the Expenses should be recognized in the same period as associated Revenues. Expenses recognition is tied to Revenue recognition. Let the Expenses follow the Revenues.

All Incomes, Expenses and Losses of Revenue nature are shown in the Trading and P & L Account. In order to prepare the Trading and Profit & Loss Account on accrual basis, generally the following guidelines are followed in practice:

1. Any Expense which has already been paid but relates to the succeeding period(s) is excluded.
2. Any Expense which relates to the Current Accounting Period whether paid in cash or not, is included.

3. Income which has already been received but relates to the succeeding period(s) is excluded.
4. Income which relates to the current accounting period whether received in cash or not, is included.

The usual items of adjustments have been discussed as follows:

2.0 ADJUSTMENT OF CLOSING STOCK

MEANING OF CLOSING STOCK

Closing Stock refers to the stock of unsold goods at the end of current accounting period which is carried forward in the next accounting period as opening stock.

VALUATION OF CLOSING STOCK

According to Prudence Principle, the Stock of finished Goods is valued at Cost or Net Realisable Value whichever is lower.

ACCOUNTING TREATMENT OF CLOSING STOCK

I. Adjusting Entry to be passed	Closing Stock To Trading A/c	Dr.
II. Treatment in Trading A/c	Shown on the Credit side.	
III. Treatment in Balance Sheet	Shown on the Assets side as a Current Asset.	

TREATMENT OF CLOSING STOCK IN TRIAL BALANCE

If Closing Stock already appears in the Trial Balance, then no Adjusting Entry is required to be passed since it has already been taken into account while computing the amount of 'Adjusted Purchases' or 'Cost of Goods Sold'. Such Closing Stock will be shown as a Current Asset in the Balance Sheet only and not in the Trading Account.

ILLUSTRATION 1

Closing Stock as at 31st March 2018 ₹ 10,000 appears outside the Trial Balance. Accounts are closed on 31st March. Pass an Adjusting Entry and show how this will appear in final accounts.

SOLUTION

ADJUSTING ENTRY

Closing Stock To Trading A/c	Dr.	₹ 10,000	₹ 10,000

TRADING ACCOUNT

Dr. for the year ended 31st March, 2018 Cr.

Particulars	₹	Particulars	₹
		By Closing Stock	10,000

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
		Current Assets:	
		Closing Stock	10,000

3.0 ADJUSTMENT OF OUTSTANDING EXPENSES**MEANING OF OUTSTANDING EXPENSES**

Outstanding Expenses refer to those expenses which have been incurred but not paid during the current accounting period.

ACCOUNTING TREATMENT OF OUTSTANDING EXPENSES

I. Adjusting Entry to be passed	Respective Expenses A/c To Outstanding Expenses A/c	Dr.
II. Treatment in Trading A/c (If it is a direct expense)	Added to the Respective Expenses (e.g., Wages) on the debit side.	
III. Treatment in P & L A/c (If it is an indirect expense)	Added to the Respective Expenses (e.g., Salaries) on the debit side.	
IV. Treatment in Balance Sheet	Shown on the Liabilities side as a Current Liability.	

TREATMENT OF OUTSTANDING EXPENSES IN TRIAL BALANCE

If Outstanding Expenses already appear in the Trial Balance, then no adjusting entry is required to be passed since these expenses have already been taken into account while computing the amount of Respective Expense. Such outstanding expenses will be shown as a Current Liability in the Balance Sheet only and not in the Income Statement.

ILLUSTRATION 2

Salary paid for 11 months from April 2017 to Feb. 2018 ₹ 1,10,000. Salary for the month of March has not yet been paid. Accounting year is financial year. Pass an Adjusting Entry and show how this will appear in final accounts.

SOLUTION**ADJUSTING ENTRY**

Salary A/c	Dr.	₹ 10,000	
To Outstanding Salary A/c			₹ 10,000

PROFIT AND LOSS ACCOUNT

Dr. *for the year ended 31st March, 2018* Cr.

Particulars	₹	Particulars	₹
To Salary Paid 1,10,000			
Add: Outstanding 10,000	1,20,000		

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Current Liabilities:			
Outstanding Salary	10,000		

4.0 ADJUSTMENT OF PREPAID EXPENSES (OR UNEXPIRED EXPENSES)
MEANING OF PREPAID EXPENSES

Prepaid Expenses refer to those expenses which have been paid during the current accounting period but the benefit of which will accrue in the subsequent accounting period or periods.

ACCOUNTING TREATMENT OF PREPAID EXPENSES

I. Adjusting Entry to be passed	Prepaid Expenses A/c Dr. To Respective Expenses A/c
II. Treatment in Trading A/c (If it is a direct expenses)	Deducted from the Respective Expenses (e.g., Wages) on the debit side.
III. Treatment in P & L A/c (If it is an indirect expense)	Deducted from the Respective Expenses (e.g., Insurance Premium) on the debit side.
IV. Treatment in Balance Sheet	Shown on the Assets side as a Current Asset.

TREATMENT OF PREPAID EXPENSES IN TRIAL BALANCE

If Prepaid Expenses already appear in the Trial Balance, then no adjusting entry is required to be passed since these expenses have already been excluded while computing the amount of relevant expense. Such Prepaid Expenses will be shown as a Current Asset in the Balance Sheet only and not in the Income Statement.

ILLUSTRATION 3

On 1.07.2017, a Fire Insurance Premium of ₹ 72,000 was paid on a policy which will expire on 30.6.2018. Accounts are closed on 31st March. Pass an adjusting entry and show how this will appear in final accounts.

SOLUTION
ADJUSTING ENTRY

Prepaid Insurance A/c Dr.	₹ 18,000	
To Insurance Premium A/c		₹ 18,000

PROFIT AND LOSS ACCOUNT

Dr. *for the year ended 31st March, 2018* Cr.

Particulars	₹	Particulars	₹
To Insurance Premium Paid 72,000			
Less: Prepaid 18,000	54,000		

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
		Current Assets:	
		Prepaid Insurance	18,000

5.0 DISTINCTION BETWEEN DEFERRED REVENUE EXPENSES & PREPAID EXPENSES**MEANING OF DEFERRED REVENUE EXPENDITURE**

The Guidance Note on “*Terms used in Financial Statement*” issued by the Institute of Chartered Accountants of India (ICAI), defines Deferred Revenue Expenditure as **that expenditure for which payment has been made or a liability incurred, but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods.**

In short, it refers to that expenditure that is, for the time being, deferred from being charged to income. Such suspension of ‘charging off’ operation may be due to the nature of expenses and the benefit expected therefrom. Deferred Revenue Expenditure should be revenue expenditure by nature in the first instance, for example, advertisement. But its matching with revenue may be deferred considering the benefit to be accrued in future.

TWO BASIC POINTS OF DIFFERENCE BETWEEN DEFERRED REVENUE EXPENSES AND PREPAID EXPENSES

1. **Estimation:** The benefits available from prepaid expenses can be precisely estimated but that is not so in case of deferred revenue expenses. Heavy advertising to launch a new product is a deferred expense since the benefit from it will be available over the next three to five years but one cannot say precisely how long. On the other hand, insurance premium paid say, for the year ending 30th June 2018, when the accounting year ends on 31st March 2018, will be an example of prepaid expense to the extent of premium relating to three months period, i.e., from 1st April 2018 to 30th June 2018. Thus, the insurance protection will be available precisely for three months after the close of the year and the amount of the premium to be carried forward can be calculated exactly.
2. **Nature:** Deferred expenses are considered Fictitious **Assets** but Prepaid Expenses are considered as Current **Assets**.

6.0 DISTINCTION BETWEEN OUTSTANDING EXPENSE AND PREPAID EXPENSE

Outstanding Expense differs from Prepaid Expense in the following respects:

Basis of Distinction	Outstanding Expense	Prepaid Expense
1. Meaning	It refers to an expense incurred but not paid during the current accounting period.	It refers to an expense paid but not incurred during the current accounting period.
2. Payment	It is yet to be paid .	It has already been paid .
3. Incurred	It has already been incurred .	It is yet to be incurred .
4. Year to which the item relates	It is an item of the current year .	It is an item of the following year .
5. Treatment in Income Statement	It is shown by way of addition to the relevant item.	It is shown by way of deduction from the relevant item.
6. Treatment in Balance Sheet	It is shown on the Liabilities side as a current liability .	It is shown on the Assets side as a current asset .

7.0 ADJUSTMENT OF ACCRUED INCOME**MEANING OF ACCRUED INCOME**

Accrued Income refers to that income which has been earned but not received during the current accounting period.

ACCOUNTING TREATMENT OF ACCRUED INCOME

I. Adjusting Entry to be passed	Accrued Income A/c Dr. To Respective Income A/c
II. Treatment in P & L A/c	Added to the Respective Income on the credit side.
III. Treatment in Balance Sheet	Shown on the Assets side as a Current Asset.

TREATMENT OF ACCRUED INCOME IN TRIAL BALANCE

If Accrued Income already appears in the Trial Balance, then no adjusting entry is required to be passed since it has already been taken into account while computing the amount of Relevant Income. Such Accrued Income will be shown as a Current Asset in the Balance Sheet only and not in the Income Statement.

ILLUSTRATION 4

On 1.4.2017 a loan of ₹ 1,00,000 was given to Ram at a rate of interest of 12%, per annum. During the year, interest was received for 11 months from Apr. to Feb. Interest for the month for March has not yet been received: Accounting year is financial year. Pass an adjusting entry and show how this will appear in final accounts.

SOLUTION**ADJUSTING ENTRY**

Accrued Interest A/c Dr.	₹ 1,000	
To Interest A/c		₹ 1,000

PROFIT AND LOSS ACCOUNT

Dr. *for the year ended 31st March, 2018* Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
		By Interest Received	11,000
		Add: Accrued	1,000
			12,000

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
		Investments:	
		12% Loan to Ram	1,00,000
		Current Assets:	
		Accrued Interest	1,000

8.0 ADJUSTMENT OF INCOME RECEIVED IN ADVANCE (OR UNACCRUED INCOME)**MEANING OF INCOME RECEIVED IN ADVANCE (OR UNACCRUED INCOME)**

Unaccrued Income refers to that income which has been received but not earned during the current accounting period.

ACCOUNTING TREATMENT OF UNACCRUED INCOME

I. Adjusting Entry to be passed	Respective Income A/c To Unaccrued Income A/c	Dr.
II. Treatment in P & L A/c	Deducted from the Respective Income on the credit side.	
III. Treatment in Balance Sheet	Shown on the Liabilities side as a Current Liability.	

TREATMENT OF UNACCRUED INCOME IN TRIAL BALANCE

If Unaccrued Income already appears in the Trial Balance, then no adjusting entry is required to be passed since it has already been excluded while computing the amount of Relevant Income. Such unaccrued income will be shown as a Current Liability in the Balance Sheet only and not in the Income Statement.

ILLUSTRATION 5

On 1.2.2018, a loan of ₹ 1,00,000 was given to Ravi for 3 months at a rate of interest of 12% per annum and Accounting year is financial year. Interest was received for 3 months from Feb. to April. Pass an adjusting entry and show how this will appear in final accounts.

SOLUTION**ADJUSTING ENTRY**

Interest A/c	Dr.	₹ 1,000	
To Unaccrued Interest A/c			₹ 1,000

Dr. **PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
		By Interest Received	3,000
		Less: Unaccrued	1,000
			2,000

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Current Liabilities:		Investments:	
Unaccrued Interest	1,000	Loan to Ravi	1,00,000

ILLUSTRATION 6

Following are the extracts of a Trial Balance as at 31st March, 2018:

<i>Particulars</i>	Dr. (₹)	Cr. (₹)
12% Loan from Shri Ram		1,00,000
Interest on 12% Loan from Shri Ram	9,000	

Required: Show how these items will appear in the final accounts.

SOLUTION

Dr. **PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Interest on loan to Shriram 9,000			
Add: Outstanding Interest 3,000	12,000		

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Long-term Loans:			
12% Loan from Shri Ram	1,00,000		
Current Liabilities:			
Outstanding Interest	3,000		

Note: In the absence of any information regarding the dates of 12% Loan from Shri Ram, it is reasonable to assume that this loan is outstanding since beginning of the accounting year.

9.0 DISTINCTION BETWEEN ACCRUED INCOME AND UNACCRUED INCOME

Accrued Income differs from Unaccrued Income in the following respects:

Basis of Distinction	Accrued Income	Unaccrued Income
1. Meaning	It refers to an income earned but not received during the current accounting period.	It refers to an income received but not earned during the current accounting period.
2. Receipt	It is yet to be received .	It has already been received .
3. Earned	It has already been earned .	It is yet to be earned .
4. Year to which the item relates	It is an item of the current year .	It is an item of the following year .
5. Treatment in Income Statement	It is shown by way of addition to the relevant item.	It is shown by way of deduction from the relevant item.
6. Treatment in Balance Sheet	It is shown on the Assets side as a Current Asset .	It is shown on the Liabilities side as a Current Liability .

10.0 ADJUSTMENT OF DEPRECIATION
MEANING OF DEPRECIATION

Depreciation represents that portion of the cost of a fixed asset which has been used in the business for the purpose of earning profits.

ACCOUNTING TREATMENT OF DEPRECIATION

I. Adjusting Entry to be passed	Depreciation A/c To Respective Asset A/c/Provision for Dep. A/c	Dr.
II. Treatment in P & L A/c	Shown on the debit side as a separate item.	
III. Treatment in Balance Sheet	Shown on the Assets side by way of deduction from the value of Respective Fixed Asset.	

TREATMENT OF DEPRECIATION IN TRIAL BALANCE

If Depreciation already appears in the Trial Balance, then no adjusting entry is required to be passed since it has already been taken into while computing the Closing Book Value of the Relevant Fixed Asset. Such depreciation will be shown only in the Income Statement and not in the Balance Sheet.

ILLUSTRATION 7

On 1.1.2018, a Machine costing ₹ 10,000 and a Furniture costing ₹ 20,000 were purchased. Write 5% off the Furniture and depreciate the Machinery @ 10% p.a. Accounting year is financial year. Pass an Adjusting Entry and show how this will appear in final accounts.

SOLUTION**ADJUSTING ENTRY**

Depreciation A/c	Dr.	₹ 1,250	
To Furniture A/c			₹ 1,000
To Machinery A/c			₹ 250

Dr. **PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

Particulars	₹	Particulars	₹
To Depreciation:			
— on Furniture	1,000		
— on Machinery	250		

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
		Fixed Assets:	
		Furniture	20,000
		Less: Depreciation	1,000
			<u>19,000</u>
		Machinery	10,000
		Less: Depreciation	250
			<u>9,750</u>

Note: Depreciation on furniture has been charged for the full year because a flat rate of 5% (and not 5% p.a.) has been given, whereas depreciation on machinery has been charged for three months from 1st January to 31st March.

ILLUSTRATION 8

Following are the extracts of a Trial Balance as at 31st March, 2018:

Particulars	Dr. (₹)	Cr. (₹)
Plant & Machinery	50,000	
Wages	5,000	

A Machine costing ₹ 20,000 was purchased on 1st July 2017. Wages ₹ 1,000 for its erection have been debited to Wages Account. Provide depreciation on Plant & Machinery @ 10% p.a. Show how these items will appear in the final accounts.

SOLUTION

Dr. **TRADING ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

Particulars	₹	Particulars	₹
To Wages 5,000			
Less: Erection of plant 1,000	4,000		

Dr. **PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

Particulars	₹	Particulars	₹
To Dep. on Plant & Machinery			
On ₹ 30,000 3,000			
On ₹ 21,000 1,575	4,575		

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
		Fixed Assets:	
		Plant & Machinery	
		Opening Balance 30,000	
		Add: Addition 20,000	
		Add: Wages 1,000	
		Total 51,000	
		Less: Depreciation 4,575	46,425

ILLUSTRATION 9

Following are the extracts of a Trial Balance as at 31st March, 2018:

Particulars	Dr. (₹)	Cr. (₹)
Plant & Machinery	50,000	
Wages	5,000	

A Machine costing ₹ 20,000 was purchased on 1st July, 2017 but it was not recorded in the books as no payment was made for it. Wages ₹ 1,000 paid for its erection have been debited to Wages Account. Provide depreciation on Plant & Machinery @ 10% p.a. Show how these items will appear in the final accounts.

SOLUTION

Dr. **TRADING ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

Particulars	₹	Particulars	₹
To Wages 5,000			
Less: Erection of plant 1,000	4,000		

Dr. **PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

Particulars	₹	Particulars	₹
To Dep. on Plant & Machinery			
On ₹ 50,000 ₹ 5,000			
On ₹ 21,000 ₹ 1,575	6,575		

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
		Fixed Assets:	
		Plant & Machinery	
		Opening Balance	50,000
		Add: Additions	20,000
		Add: Wages	1,000
		Total	71,000
		Less: Depreciation	6,575
			64,425

ILLUSTRATION 10

Following are the extracts of a Trial Balance as at 31st March, 2018:

Particulars	Dr. (₹)	Cr. (₹)
Plant & Machinery	50,000	
Wages	5,000	

A Machine costing ₹ 20,000 was purchased during the year 2017–2018. Wages ₹ 1,000 paid for its erection have been debited to Wages Account. Provide depreciation on Plant & Machinery @ 10% p.a. Show how these items will appear in the final accounts.

SOLUTION

Dr. **TRADING ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** *Cr.*

Particulars	₹	Particulars	₹
To Wages	5,000		
Less: Erection of plant	1,000		4,000

Dr. **PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** *Cr.*

Particulars	₹	Particulars	₹
To Dep. on Plant & Machinery			
On ₹ 30,000	3,000		
On ₹ 21,000	1,050		4,050

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
		Fixed Assets:	
		Plant & Machinery	
		Opening Balance	30,000
		Add: Additions	20,000
		Add: Wages	1,000
		Less: Depreciation	4,050
			46,950

Note: In the absence of actual date of purchase, depreciation has been provided for an average period of 6 months.

ILLUSTRATION 11

Following are the extracts of a Trial Balance as at 31st March, 2018:

Particulars	Dr. (₹)	Cr. (₹)
Plant & Machinery	50,000	
Wages	5,000	

A Machine costing ₹ 20,000 was purchased during the year 2017–2018. Wages ₹ 1,000 paid for its erection have been debited to Wages Account. Write 10% off the Plant & Machinery. Show how these items will appear in the final accounts.

SOLUTION

Dr. **TRADING ACCOUNT FOR THE YEAR ENDED AT 31ST MARCH, 2018** Cr.

Particulars	₹	Particulars	₹
To Wages 5,000			
Less: Erection of plant 1,000	4,000		

Dr. **PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

Particulars	₹	Particulars	₹
To Dep. on Plant & Machinery			
On ₹ 30,000 3,000			
On ₹ 21,000 2,100	5,100		

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
		Fixed Assets:	
		Plant & Machinery	
		Opening Balance 30,000	
		Add: Addition 20,000	
		Add: Erection of Plant 1,000	
		Less: Depreciation 5,100	45,900

Note: Depreciation has been charged for full year since the blanket rate of 10% without per annum is given.

ILLUSTRATION 12

Following are the extracts of a Trial Balance as at 31st March, 2018:

Particulars	Dr. (₹)	Cr. (₹)
Plant & Machinery	50,000	
Wages	5,000	

A Machine costing ₹ 20,000 was purchased on 1st July 2017. Wages ₹ 1,000 paid for its erection have been debited to Wages Account. Write 10% off the Plant & Machinery. Show how these items will appear in the final accounts.

SOLUTION

Same solution as given in Illustration 11 since the depreciation is to be charged for full year irrespective of the date of purchase as the rate of 10% without per annum is given.

ILLUSTRATION 13 [WHEN ACCUMULATED DEPRECIATION IS GIVEN]

Following are the extracts of a Trial Balance as at 31st March, 2018:

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Wages	5,000	
Plant & Machinery	80,000	
Accumulated Depreciation on Plant & Machinery		30,000

Provide depreciation on Plant & Machinery ₹ 8,000. Show how these items will appear in the final accounts.

SOLUTION

Dr. **TRADING ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Wages	5,000		

PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Depr. on Plant & Machinery	8,000		

BALANCE SHEET AS AT 31ST MARCH 2018

<i>Liabilities</i>	<i>₹</i>	<i>Assets</i>	<i>₹</i>
		Fixed Assets:	
		Plant & Machinery 80,000	
		Less: Depreciation 38,000	42,000

ILLUSTRATION 14 [WHEN ACCUMULATED DEPRECIATION IS GIVEN]

Following are the extracts of a Trial Balance as at 31st March, 2018:

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Wages	5,000	
Plant & Machinery	80,000	
Accumulated Depreciation on Plant & Machinery		30,000

Provide Depreciation according to Straight Line Method on Plant & Machinery @ 10% p.a. Show how these items will appear in the final accounts.

SOLUTION

Dr. **TRADING ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Wages	5,000		

PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Depr. on Plant & Machinery	8,000		

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
		Fixed Assets:	
		Plant & Machinery	80,000
		Less: Depreciation	38,000
			42,000

ILLUSTRATION 15 [WHEN ACCUMULATED DEPRECIATION IS GIVEN]

Following are the extracts of a Trial Balance as at 31st March, 2018:

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Wages	5,000	
Plant & Machinery	80,000	
Accumulated Depreciation on Plant & Machinery		30,000

Provide Depreciation according to Written Down Value Method on Plant & Machinery @ 10% p.a. Show how these items will appear in the final accounts.

SOLUTION

Dr. **TRADING ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Wages	5,000		

PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Depr. on Plant & Machinery	5,000		

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
		Fixed Assets:	
		Plant & Machinery	80,000
		Less: Depreciation	35,000
			45,000

11.0 ADJUSTMENT OF BAD DEBTS
MEANING OF BAD DEBT

Bad Debts refer to the amount due from the customers to whom goods have been sold on credit, which could not be recovered.

ACCOUNTING TREATMENT OF BAD DEBTS

I. Adjusting Entry	Bad Debts A/c To Debtors A/c	Dr.
II. Treatment in P & L A/c	Shown on the debit side as a separate item.	
III. Treatment in Balance Sheet	Shown on the Assets side by way of deduction from the 'Debtors'.	

ILLUSTRATION 16

Mr X, a debtor for ₹ 5,000, has become insolvent and nothing could be recovered from him. Debtors (including Mr X) appear at ₹ 2,05,000 in the Trial Balance as at 31st March 2018. Accounting year is financial year. Pass an adjusting entry and show how these items will appear in the final accounts.

SOLUTION**ADJUSTING ENTRY**

Bad Debts A/c To Mr X	Dr.	₹ 5,000	₹ 5,000

Dr. **PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

Particulars	₹	Particulars	₹
To Bad Debts	5,000		

BALANCE SHEET AS AT 31 MARCH, 2018

Liabilities	₹	Assets	₹
		Current Assets:	
		Debtors	2,05,000
		Less: Bad Debts	5,000
			2,00,000

12.0 ADJUSTMENT OF PROVISION FOR DOUBTFUL DEBTS**MEANING OF PROVISION FOR DOUBTFUL DEBTS**

A provision for doubtful debts refers to a provision created to cover the loss of possible bad debts by means of a predetermined percentage of Net Debtors (i.e., Debtors less Bad Debts) with a view to bring in a certain element of certainty in the amount of Bad Debts charged for each accounting period.

ACCOUNTING TREATMENT OF PROVISION FOR DOUBTFUL DEBTS

I. Adjusting Entry to be passed	Profit & Loss A/c To Provision for Doubtful Debts A/c	Dr.
II. Treatment in P & L A/c	Shown on the debit side as a separate item.	
III. Treatment in Balance Sheet	Shown on the Assets side by way of deduction from the amount of Sundry Debtors (i.e., Net of additional bad debts).	

ILLUSTRATION 17

Following are the extracts from the Trial Balance as at 31st March 2018:

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Sundry Debtors	2,05,000	
Bad Debts	3,000	

Additional Information:

- After preparing the Trial Balance, it is learnt that Mr X, a debtor has become insolvent and nothing could be recovered from him and, therefore, the entire amount of ₹ 5,000 due from him was irrecoverable.
- Create 10% provision for doubtful debts.

Required: Pass the necessary journal entries & show the relevant accounts (including final accounts).

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bad Debts A/c Dr. To Mr X (Being the amount due from Mr X proved to be bad)		5,000	5,000
	Profit & Loss A/c Dr. To Bad Debts A/c (Being the transfer of bad debts to P & L A/c)		8,000	8,000
	Profit & Loss A/c Dr. To Provision for Doubtful Debts A/c (Being the provision for doubtful debts created @ 10% on ₹ 2,00,000)		20,000	20,000

Dr. **SUNDRY DEBTORS ACCOUNT** *Cr.*

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Balance b/d	2,05,000	By Bad Debts A/c	5,000
		By Balance c/d	2,00,000
	2,05,000		2,05,000

Dr. **BAD DEBTS ACCOUNT** *Cr.*

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Balance b/d	3,000	By Profit & Loss A/c	8,000
To Sundry Debtors	5,000		
	8,000		8,000

Dr. **PROVISION FOR DOUBTFUL DEBTS ACCOUNT** *Cr.*

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Balance c/d	20,000	By Profit & Loss A/c	20,000

Dr. **PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bad Debts 3,000 (as given in the Trial Balance)			
Add: Additional Bad Debts 5,000	8,000		
To Provision for Doubtful Debts	20,000		

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
		Current Assets:	
		Sundry Debtors 2,05,000	
		Less: Additional Bad Debts 5,000	
		2,00,000	
		Less: Prov. for Doubtful Debts 20,000	1,80,000

ILLUSTRATION 18

Following are the extracts from the Trial Balance as at 31st March 2018:

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Sundry Debtors	2,05,000	
Provision for Doubtful Debts		10,000
Bad Debts	3,000	

Additional Information:

- (i) Further Bad Debts ₹ 5,000,
- (ii) Maintain the Provision for Doubtful Debts @ 10% on debtors.

Required: Pass the necessary journal entries & show the relevant accounts (including final accounts).

SOLUTION

JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bad Debts A/c Dr. To Sundry Debtors A/c (Being the additional bad debts recorded)		5,000	5,000
	Provision for Doubtful Debts A/c Dr. To Bad Debts A/c (Being bad debts, transferred to Provision for doubtful debts A/c)		8,000	8,000
	Profit & Loss A/c Dr. To Provision for Doubtful Debts A/c (Being the amount charged from P & L A/c to maintain provision for doubtful debts @ 10% on debtors)		18,000	18,000

Dr. **SUNDRY DEBTORS ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	2,05,000	By Bad Debts A/c	5,000
		By Balance c/d	2,00,000
	2,05,000		2,05,000

Dr. **BAD DEBTS ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	3,000	By Provision for Doubtful	8,000
To Sundry Debtors A/c	5,000	Debts A/c	
	8,000		8,000

Dr. **PROVISION FOR DOUBTFUL DEBTS ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Bad Debts A/c	8,000	By Balance b/d	10,000
To Balance c/d	20,000	By Profit & Loss A/c	18,000
[10% of (₹ 2,05,000 – ₹ 5,000)]			
	28,000		28,000

Dr. **PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

Particulars	₹	Particulars	₹
To Provision for Doubtful Debts	18,000		

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
		Current Assets:	
		Sundry Debtors	2,05,000
		Less: Add. bad debts	5,000
			2,00,000
		Less: Prov. for Doubtful Debts	20,000
			1,80,000

ILLUSTRATION 19

Following are the extracts from the Trial Balance as at 31st March 2018:

Particulars	Dr. (₹)	Cr. (₹)
Salaries		41,600
Debtors		2,08,000
Bad Debts	2,000	

- Debtors include Shyam for dishonoured bill of ₹ 800. Half the amount of Shyam's bill is irrecoverable.
- Remuneration of ₹ 2,000 paid to Mr B. Barua, a temporary employee, stands debited to his personal account.
- Create a Provision for Doubtful Debts @ 5% on Debtors.

Show how these items will appear in the final accounts.

SOLUTION

Dr. **PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Salaries 41,600			
Add: Salary to Barua 2,000	43,600		
To Bad Debts 2,000			
Add: Further Bad Debts 400			
Add: Prov. for Doubtful Debts 10,260	12,660		

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
		Current Assets:	
		Debtors 2,08,000	
		Less: Salary to Barua 2,000	
		Less: Bad Debts 400	
		2,05,600	
		Less: Provision for Doubtful Debts	
		@ 5% on ₹ 2,05,200 (i.e., 2,05,600	
		– ₹ 400 good debts) 10,260	1,95,340

13.0 ADJUSTMENT OF PROVISION FOR DISCOUNT ON DEBTORS**MEANING OF PROVISION FOR DISCOUNT ON DEBTORS**

Provision for Discount on Debtors refers to the provision created to provide for discount likely to be allowed on Good Debtors (i.e., Sundry Debtors *less* Additional Bad Debts given outside the Trial Balance and the Provision for Doubtful Debts).

ACCOUNTING TREATMENT OF PROVISION FOR DISCOUNT ON DEBTORS

I. Adjusting Entry to be passed	Profit & Loss A/c Dr. To Provision for Discount on Debtors A/c
II. Treatment in P & L A/c	Shown on the debit side as a separate item.
III. Treatment in Balance Sheet	Shown on the Assets side of the Balance Sheet by way of deduction from the Sundry Debtors.

ILLUSTRATION 20

Following are the extracts from the Trial Balance as at 31st March, 2018:

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Sundry Debtors	2,05,000	
Bad Debts	3,000	
Discount	1,800	

Additional Information:

- (i) Create a Provision for Doubtful Debts @ 10% on debtors.
- (ii) Create a Provision for Discount on Debtors @ 2% on debtors.
- (iii) Additional Discount given to the debtors ₹ 5,000.

Required: Pass the necessary journal entries & show the relevant accounts (including final accounts).

SOLUTION
JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Discount Allowed A/c Dr. To Sundry Debtors A/c (Being the additional discount allowed to debtors recorded)		5,000	5,000
	Profit & Loss A/c Dr. To Bad Debts A/c To Discount Allowed A/c (Being the transfer of bad debts & discount allowed to P & L A/c)		9,800	3,000 6,800
	Profit & Loss A/c Dr. To Provision for doubtful debts A/c (Being provision for doubtful debts created @ 10% on debtors of ₹ 2,00,000)		20,000	20,000
	Profit & Loss A/c Dr. To Provision for discount on debtors A/c (Being provision for discount created @ 2% on debtors of ₹ 1,80,000 (i.e., ₹ 2,00,000 – ₹ 20,000))		3,600	3,600

Dr. **SUNDRY DEBTORS ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	2,05,000	By Discount Allowed A/c	5,000
		By Balance c/d	2,00,000
	2,05,000		2,05,000

Dr. **BAD DEBTS ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	3,000	By Profit and Loss A/c	3,000

Dr. **PROVISION FOR DOUBTFUL DEBTS ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance c/d	20,000	By Profit and Loss A/c	20,000

Dr.

DISCOUNT ALLOWED ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	1,800	By Profit and Loss A/c	6,800
To S. Debtors	5,000		
	6,800		6,800

Dr.

PROVISION FOR DISCOUNT ON DEBTORS ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance c/d	3,600	By Profit & Loss A/c	3,600

Dr.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bad Debts (as given in the Trial Balance)	3,000		
To Provision for doubtful debts	20,000		
To Discount (as given in the Trial Balance)	1,800		
Add: Additional Discount	5,000		
	6,800		
To Provision for Discount on Debtors	3,600		

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
		Current Assets:	
		Debtors	2,05,000
		Less: Additional Discount	5,000
			2,00,000
		Less: Provision for	
		Doubtful Debts @ 10%	20,000
			1,80,000
		Less: Prov. for Discount @ 2%	3,600
			1,76,400

ILLUSTRATION 21

Following are the extracts from the Trial Balance of a firm as on 31st March, 2018:

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Sundry Debtors	2,05,000	
Provision for Doubtful Debts		10,000
Provision for Discount on Debtors		1,800
Bad Debts	3,000	
Discount	1,000	

Additional Information:

- (i) Additional Bad Debts ₹ 4,000
- (ii) Additional Discount allowed to Debtors ₹ 1,000
- (iii) Maintain a provision for bad debts @ 10% on debtors
- (iv) Maintain a provision for discount @ 2% on debtors

Required: Pass the necessary journal entries & show the relevant accounts (including final accounts).

SOLUTION
JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bad Debts A/c Dr. Discount A/c Dr. To Sundry Debtors A/c (Being the additional bad debts and additional discount on debtors recorded)		4,000 1,000	5,000
	Provision for Doubtful Debts A/c Dr. To Bad Debts A/c (Being the bad debts transferred to Provision for Doubtful Debts A/c)		7,000	7,000
	Provision for Discount on Debtors A/c Dr. To Discount A/c (Being the discount allowed transferred to Provision for Discount on Debtors A/c)		2,000	2,000
	Profit and Loss A/c Dr. To Provision for Doubtful Debts A/c (Being the amount charged from Profit & Loss Account to maintain a provision for doubtful debts @10% on debtors i.e., 10% of (₹ 2,05,000 – ₹ 5,000))		17,000	17,000
	Profit and Loss A/c Dr. To Provision for Discount on Debtors A/c (Being the amount charged from P & L A/c to maintain a provision for discount @ 2% on good debtors i.e., 2% of (₹ 2,05,000 – ₹ 5,000 – ₹ 20,000))		3,800	3,800

Ledger Accounts:

Dr. **SUNDRY DEBTORS ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	2,05,000	By Bad Debts A/c	4,000
		By Discount Allowed A/c	1,000
		By Balance c/d	2,00,000
	2,05,000		2,05,000

Dr. **BAD DEBTS ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	3,000	By Provision for Doubtful Debts A/c	7,000
To Sundry Debtors	4,000		
	7,000		7,000

Dr.

PROVISION FOR DOUBTFUL DEBTS ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bad Debts A/c	7,000	By Balance b/d	10,000
To Balance c/d	20,000	By Profit & Loss A/c (b/f)	17,000
[10% of ₹ 2,05,000 – ₹ 5,000]			
	27,000		27,000

Dr.

DISCOUNT ALLOWED ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	1,000	By Provision for Discount	
To Sundry Debtors A/c	1,000	on Debtors A/c	2,000
	2,000		2,000

Dr.

PROVISION FOR DISCOUNT ON DEBTORS ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Discount A/c	2,000	By Balance b/d	1,800
To Balance c/d	3,600	By Profit & Loss A/c (b/f)	3,800
[2% of (2,05,000 – 5,000 – 20,000)]			
	5,600		5,600

AN EXTRACT OF PROFIT & LOSS ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Provision for Doubtful Debts	17,000		
To Provision for Discount	3,800		

AN EXTRACT OF BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
		Current Assets:	
		Sundry Debtors	2,05,000
		Less: Additional Bad	
		Debts and Discount	5,000
			2,00,000
		Less: Provision	
		for Doubtful debts 10%	20,000
			1,80,000
		Less: Prov. for Discount @ 2%	3,600
			1,76,400

14.0 ADJUSTMENT OF ABNORMAL LOSS OF STOCK**MEANING OF ABNORMAL LOSS OF STOCK**

The abnormal loss of stock is an avoidable loss and is usually caused by fire, theft, abnormal spoilage/leakage/breakages/pilferage, etc.

ACCOUNTING TREATMENT OF ABNORMAL LOSS OF STOCK

I. Adjusting Entry to be passed	Loss of Stock A/c To Purchases A/c	Dr.
II. Treatment in Trading A/c	Total Value of Abnormal Loss (whether, recovered or not) is shown as deduction from Purchases.	
III. Treatment in P & L A/c	Total Value of Irrecovered Loss of Stock (i.e., Total Loss less amount if any, recovered from Insurance Co.) is shown on the debit side as a separate item.	
IV. Treatment in Balance Sheet	The amount if any, due from the Insurance Co., is shown on the Assets side as a 'Current Asset'.	

ILLUSTRATION 22

A fire broke out on 30th March, 2018 in the godown and Stock costing ₹ 1,00,000 was destroyed. The insurance company, admitted a claim of 60% only. Accounting year is financial year. Purchases are ₹ 5,00,000 Pass an adjusting entry and show how these items will appear in final accounts.

SOLUTION

ADJUSTING ENTRY

Loss of Stock by Fire A/c	Dr.	₹ 1,00,000	
To Purchases A/c			₹ 1,00,000
Insurance Co.	Dr.	₹ 60,000	
To Loss of Stock by Fire A/c			₹ 60,000

Dr. **TRADING ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

Particulars	₹	Particulars	₹
To Purchases 5,00,000			
Less: Loss of Stock 1,00,000	4,00,000		

Dr. **PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

Particulars	₹	Particulars	₹
To Loss of Stock by Fire A/c	40,000		

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
		Current Assets:	
		Insurance Co.	60,000

15.0 ADJUSTMENT OF GOODS WITHDRAWN FOR PERSONAL USE

MEANING OF GOODS WITHDRAWN FOR PERSONAL USE

When the proprietor withdraws goods for his personal use, Drawings Account is debited because the Goods withdrawn for personal use represent an increase in Drawings and Purchases Account is credited because cost of such goods withdrawn represent a decrease in Purchases (i.e., Business Expense) and not increase in Sales because no profit is earned on such goods.

ACCOUNTING TREATMENT OF GOODS WITHDRAWN FOR PERSONAL USE

I. Adjusting Entry to be passed	Drawings A/c Dr. To Purchases A/c (Being the goods withdrawn for personal use) Note: At the end of the accounting period, the balance in the Drawings A/c is transferred to the debit of Capital A/c.
II. Treatment in Trading A/c	Shown on the debit side by way of deduction from Purchases.
III. Treatment in Balance Sheet	Shown on the Liabilities side by way of deduction from the Capital.

ILLUSTRATION 23

On 31st March, 2018, Goods costing ₹ 2,000 were taken by the proprietor for his personal use but no entry has been made in the books of accounts. Purchases were ₹ 82,000. Capital ₹1,00,000. Accounting year is financial year. Pass an adjusting entry and show how these items will appear in final accounts.

SOLUTION**ADJUSTING ENTRY**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Drawings A/c Dr. To Purchases A/c (Being the Goods withdrawn for personal use)		2,000	2,000

Dr. **TRADING ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

Particulars	₹	Particulars	₹
Purchases 82,000			
Less: Goods taken for personal use 2,000	80,000		

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital:			
Opening Balance 1,00,000			
Less: Drawings(Goods) 2,000	98,000		

16.0 ADJUSTMENT OF GOODS DISTRIBUTED AS FREE SAMPLES**MEANING OF GOODS DISTRIBUTED AS FREE SAMPLES**

When Goods are given as Charity, the Charity Account is debited because Charity represents an increase in an indirect expense and Purchases Account is credited because it represents a decrease in direct expense.

ACCOUNTING TREATMENT OF GOODS DISTRIBUTED AS FREE SAMPLES

I. Adjusting Entry to be passed	Sales Promotion Expenses A/c To Purchases A/c (Being the Goods distributed as free samples)	Dr.
II. Treatment in Trading A/c	Shown on the debit side by way of deduction from Purchases.	
III. Treatment in P & L A/c	Shown on the debit side as Sales Promotion Expenses.	

ILLUSTRATION 24

Goods costing ₹ 2,000 were distributed as free samples but no entry has been made in the books of accounts. Purchases were ₹ 82,000. Accounting year is financial year. Pass an adjusting entry and show how these items will appear in final accounts.

SOLUTION**ADJUSTING ENTRY**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Sales Promotion Expenses A/c To Purchases A/c (Being the Goods distributed as free samples)	Dr.	2,000	2,000

Dr. **TRADING ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

Particulars	₹	Particulars	₹
Purchases 82,000			
Less: Goods taken for personal use 2,000	80,000		

Dr. **PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

Particulars	₹	Particulars	₹
To Sales Promotion Expenses	2,000		

17.0 ADJUSTMENT OF COMMISSION ON PROFIT**MEANING OF COMMISSION ON PROFIT**

Commission on profit is the remuneration on the basis of certain percentage of profits. Such profits may be *either* before or after charging such commission. In the absence of any information, commission is allowed as a percentage of net profit before charging such commission.

ACCOUNTING TREATMENT OF COMMISSION ON PROFIT

I. Adjusting Entry to be passed	Manager's Commission A/c To Outstanding Commission A/c	Dr.
II. Treatment in P & L A/c	Shown on the debit side as a separate item.	
III. Treatment in Balance Sheet	Shown on the Liabilities side as a Current Liability.	

ILLUSTRATION 25

The Net Profits of a firm are ₹ 10,500 before charging any commission. The manager of the firm is entitled to a commission of 5% on the net profits before charging such commission. Calculate the commission payable to the manager. Also show its treatment in Final Accounts ending on 31st March, 2018.

SOLUTION

$$\begin{aligned}\text{Commission} &= \text{Net Profit before charging such Commission} \times \frac{\text{Rate of Commission}}{100} \\ &= ₹ 10,500 \times 5/100 = ₹ 525\end{aligned}$$

Dr. **PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

Particulars	₹	Particulars	₹
To Manager's Commission	525		

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Current Liabilities:			
Manager's Commi. Outstanding	525		

ILLUSTRATION 26

The Net Profit of a firm amounts to ₹ 10,500 before charging commission. The manager of the firm is entitled to a commission of 5% on the net profits after charging such commission. Calculate the commission payable to the manager.

SOLUTION

Let the Net Profit after charging the commission be = ₹ 100

Commission @ 5% on net profit = ₹ 5

Therefore, Net Profit before charging such commission

$$= ₹ 100 + ₹ 5 = ₹ 105$$

$$\text{Commission} = ₹ 10,500 \times 5/105 = ₹ 500$$

Thus, in such a case, in the form of a formula, the manager's commission may be expressed as under:

$$\begin{aligned}\text{Commission} &= \text{Net Profit before charging such commission} \times \frac{\text{Rate of Commission}}{100 + \text{Rate of Commission}} \\ &= ₹ 10,500 \times 5/(100 + 5) = ₹ 500\end{aligned}$$

18.0 ADJUSTMENT OF GOODS SENT ON APPROVAL**MEANING OF GOODS SENT ON 'APPROVAL' OR 'ON SALE OR RETURN'**

Goods sent on 'approval' or 'on Sale or Return' basis mean the delivery of the goods to the customers with the option to retain or return them within a specified period.

METHOD OF ACCOUNTING

When such transactions are few, these transactions are accounted for as an ordinary sale.

TREATMENT OF GOODS STILL WITH CUSTOMERS

If at the year-end, goods are still lying with customers and the specified period has not yet expired, the original entry made for sale is cancelled. Like an ordinary closing stock, such goods are considered as stock lying with customers on behalf of sellers and are valued at cost.

ACCOUNTING TREATMENT OF GOODS SENT ON 'APPROVAL'

I. Adjusting Entry to be passed	(i) Sales A/c Dr. [with Selling Price] To Debtors' A/c (ii) Stock with customers A/c Dr. [with Cost] To Trading A/c
II. Treatment in Trading A/c	(i) Sales value of such goods is shown on credit side by way of deduction from Sales (ii) Cost of such goods is shown on the credit side by way of addition to Closing Stock-in-hand
III. Treatment in Balance Sheet	(i) Sales value of such goods is shown on the Assets side by way of deduction from Debtors (ii) Cost of such goods is shown on the Assets side by way of addition to Closing Stock-in-hand.

ILLUSTRATION 27

Following are the extracts of a Trial Balance as on 31.3.2018:

Particulars	Dr. (₹)	Cr. (₹)
Sales		1,11,243
Debtors	19,100	

Additional Information: Goods costing ₹ 600 were sent to a customer on sale or return for ₹ 700 on 30 March 2018 and has been recorded in the books as actual sales. Stock-in-hand on 31st March, 2018, was valued at ₹ 6,250. Show how these items will appear in the Final Accounts.

SOLUTION

TRADING ACCOUNT

Dr. Cr.
for the year ending on 31st March, 2018

Particulars	₹	Particulars	₹
		By Sales	1,11,243
		Less: Goods Sent on Approval	700
		By Closing Stock	6,250
		Add: Goods Sent on Approval	600
			1,10,543
			6,850

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
		Debtors	19,100
		Less: Debtor for Sale of	
		Goods sent on approval	700
		Stock-in-hand	6,250
		Stock with customer	
		(Sent on approval)	600
			18,400
			6,850

19.0 ADJUSTMENT OF GOODS-IN-TRANSIT**MEANING OF GOODS-IN-TRANSIT**

Generally, Goods-in-Transit refer to those goods which have been purchased but not received during the current accounting period. These goods should be treated as part of closing stock.

ACCOUNTING TREATMENT OF GOODS-IN-TRANSIT

I. Adjusting Entry to be passed	Goods-in-transit A/c Dr. To Trading A/c
II. Treatment in Trading Account	Shown on the Credit side
III. Treatment in Balance Sheet	Shown on the Assets side as a Current Asset.

ILLUSTRATION 28

Invoices for Goods costing ₹ 10,000 have been entered on 27th March, 2018 but the goods have not yet been received till 31st March, 2018. Accounting year is financial year. Pass the necessary adjusting entry and show the treatment in Final Accounts.

SOLUTION**ADJUSTING ENTRY**

Goods-in-Transit A/c Dr.	₹ 10,000	
To Trading A/c		₹ 10,000
(Being the goods purchased but not yet received)		

Dr. **TRADING ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
		By Goods-in-Transit	10,000

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
		Current Assets :	
		Goods-in-Transit	10,000

20.0 TREATMENT OF ITEMS OF ADJUSTMENTS APPEARING OUTSIDE THE TRIAL BALANCE

Item of Adjustment	Adjusting Entry	Treatment In Trading A/c	Treatment in P & L A/c	Treatment in Balance Sheet
1. Closing Stock	Closing Stock To Trading A/c	Dr. Shown on the Credit Side	X	Shown on the Assets side as a Current Asset
2. Outstanding Expenses	Respective Expense A/c To Outstanding Expenses A/c	Dr. Added to the respective direct exp. on the debit side	Added to the respective indirect expense on the debit side	Shown on the Liabilities side as a Current Liability
3. Prepaid Expenses (unexpired Expenses)	Prepaid Expenses A/c To Respective Expense A/c	Dr. Deducted from the respective direct expense on the debit side	Deducted from the respective indirect expense on the debit side	Shown on the Assets side as a Current Asset
4. Accrued Income (or Income earned but not received) or outstanding Income	Accrued Income A/c To Respective Income A/c	Dr. X	Added to the respective Income on the credit side	Shown on the Assets side as a Current Asset
5. Unearned Income (or Income received in advance)	Respective Income A/c To Unearned Income A/c	Dr. X	Deducted from the respective income on the credit side	Shown on the Liabilities side as a Current Liability
6. Depreciation	Depreciation A/c To Respective Asset A/c	Dr. X	Shown on the debit side as a separate item	Shown on the Assets side by way of deduction from the value of respective fixed asset .
7. Additional Bad Debts	Bad Debts A/c To Sundry Debtors A/c	Dr. X	Shown on the debit side by way of addition to Bad Debts (Inside the Trial Balance) (if no Provision for Doubtful Debts is maintained) or shown on the debit side of Provision for Doubtful Debts (if Provision A/c is maintained)	Shown on the Assets side by way of deduction from the amount of Sundry Debtors .
8. Provision for Doubtful debts	P & L A/c To Provision for Doubtful Debts A/c	Dr. X	Shown on the debit side as a separate item	Shown on the asset side by way of Deduction from the amount of Sundry Debtors (Net of additional bad debts)

9. Provision for Discount on Debtors	P & L A/c To Provision for Discount on Debtors A/c	Dr. X		Shown on the debit side as a separate item	Shown on the asset side by way of deduction from the amount of Sundry Debtors (Net of additional bad debts & Provisions for doubtful debts)
10. Abnormal Loss of Stock	Loss of Stock A/c To Purchases A/c	Dr.	Total value of abnormal loss of stock (Whether or not recovered) is shown by way of deduction from Purchases.	Total value of irrecovered loss of stock is shown on the debit side as a separate item.	The amount due from the insurance company is shown on the Assets side as a Current Asset .
11. Goods withdrawn for personal use	Drawings A/c To Purchases A/c	Dr.	Shown by way of deduction from Purchases.	X	Shown on the Liabilities side by way of deduction from the Capital
12. Goods distributed as free samples	Sales Promotion Expenses A/c Dr. To Purchases A/c		Shown by way of deduction from Purchases.	Shown on the debit side as Sales Promotion Expenses.	X
13. Manager's Commission on Profit	Manager's Commission To Outstanding Comm. A/c	Dr. X		Shown on the debit side as a separate item.	Shown on the Liabilities side as a Current Liability

Note: If any item of adjustment appears outside the Trial Balance, it will be shown at two appropriate places in the Final Accounts.

ILLUSTRATION 29

Give the necessary adjusting entries for the following items appearing outside the Trial Balance as on 31st March, 2018.

- (a) Closing Stock in hand ₹ 10,000
- (b) Salary due but not paid ₹ 1,000
- (c) Unexpired Insurance ₹ 2,000
- (d) Rent received in advance ₹ 3,000
- (e) Interest due but not received ₹ 600
- (f) Depreciation on Fixed **Assets** @
- (g) Bad debts to be written-off ₹ 5,000
- (h) Create Provision for Doubtful Debts @ 10%
- (i) Create Provision for Discount on Debtors @ 2%

Other Information as per Trial Balance: Fixed **Assets** ₹ 60,000; Debtors ₹ 2,05,000.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(a)	Closing Stock A/c Dr. To Trading A/c (Being the closing stock brought into Account)		10,000	10,000
(b)	Salaries A/c Dr. To Outstanding Salary A/c (Being the outstanding expenses brought into accounts)		1,000	1,000
(c)	Prepaid Insurance A/c Dr. To Insurance Premium A/c (Being the prepaid expenses brought into accounts)		2,000	2,000
(d)	Rent A/c Dr. To Rent-received-in-advance A/c (Being the income received in advance brought into accounts)		3,000	3,000
(e)	Accrued Interest A/c Dr. To Interest A/c (Being the interest due but not received brought into accounts)		600	600
(f)(i)	Depreciation A/c Dr. To Fixed Assets A/c (Being the depreciation charged)		20,000	20,000
(f)(ii)	Profit & Loss A/c Dr. To Depreciation A/c (Being the depreciation account closed by transferring to P & L A/c)		20,000	20,000
(g)(i)	Bad Debts A/c Dr. To Debtors A/c (Being the bad debts provided for)		5,000	5,000

(g)(ii)	Profit & Loss A/c To Bad Debts A/c (Being the bad debts account closed by transferring to P & L A/c)	Dr.	5,000	5,000
(h)	Profit & Loss A/c To Provision for Doubtful Debts A/c [Being the provision against debtors provided @ 10% on 2,00,000 (i.e., 2,05,000–5,000)]	Dr.	20,000	20,000
(i)	Profit & Loss A/c To Provision for Discount on Debtors A/c (Being the provision for discount on debtors provided for @ 2% on (2,05,000–5,000–20,000))	Dr.	3,600	3,600

ILLUSTRATION 30

A book keeper has submitted to you the following trial balance wherein the totals of the debit and credit balances are not equal:

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Creditors	1,00,000	—
Bills Payable	—	5,600
Loan from Bank	50,000	—
Capital Account	4,54,000	—
Sales	—	6,30,000
Purchase Returns	5,000	—
Discount Earned	1,000	—
Bad Debt Recovered	3,500	—
Interest on Investments	3,000	—
Fixed Assets	3,00,000	—
Opening Stock	75,000	—
Debtors	—	2,05,000
Bills Receivables	10,000	—
Investments	50,000	—
Cash in Hand	5,000	—
Cash at Bank	10,000	—
Drawings	—	9,000
Purchases	5,25,000	—
Sales Returns	—	10,000
Carriage	1,400	—
Freight Outward	—	2,000
Duty Paid on Purchases	—	1,600
Primary Packing Expenses	2,000	—
Rent Paid	—	3,000
Insurance Paid	3,600	—

Office & Administrative Expenses	13,200	
Discount Allowed	—	2,000
Bad Debts	5,000	—
Interest on Loan from Bank	—	2,500
Delivery Expenses	6,600	—
Selling & Distribution Expenses	10,000	—
Income Tax paid	1,000	—
Value Added Tax (VAT) Collected	2,000	
Loose Tools	2,000	—
Apprentice Premium received	—	425
Commission received	—	375
	16,38,300	8,71,500

You are required:

- (i) Redraft the trial balance correctly as at 31st March, 2018.
- (ii) Prepare a Trading and Profit & Loss Account and a Balance Sheet after taking into account the following adjustments:
 - (a) Closing Stock was ₹ 40,000.
 - (b) Rent outstanding for March 2018 ₹ 600.
 - (c) Insurance unexpired on 31st March, 2018 ₹ 900.
 - (d) Accrued Interest on Investments amounted to ₹ 1,500.
 - (e) One-third of the commission received is in respect of work to be done next year.
 - (f) ₹ 1,250 is due for interest on Bank Loan.
 - (g) Loose Tools are valued at ₹ 800.
 - (h) Provide for depreciation on fixed **Assets** @ 10% p.a.

SOLUTION**TRIAL BALANCE AS AT 31ST MARCH, 2018**

S. No.	Particulars	Dr. (₹)	Cr. (₹)
1.	Creditors	—	1,00,000
2.	Bill payable	—	5,600
3.	Loan from bank	—	50,000
4.	Capital Account	—	4,54,000
5.	Sales	—	6,30,000
6.	Purchase return		5,000
7.	Discount earned		1,000
8.	Bad debt Recovered		3,500
9.	Interest on Investments		3,000
10.	Fixed Assets	3,00,000	—
11.	Opening stock	75,000	—
12.	Debtors	2,05,000	—
13.	Bill receivables	10,000	—

14.	Investments	50,000	—
15.	Cash in hand	5,000	—
16.	Cash at bank	10,000	—
17.	Drawings	9,000	—
18.	Purchases	5,25,000	—
19.	Sales returns	10,000	—
20.	Carriage	1,400	—
21.	Freight outward	2,000	—
22.	Duty paid on purchases	1,600	—
23.	Primary Packing expenses	2,000	—
24.	Rent paid	3,000	—
25.	Insurance paid	3,600	—
26.	Office & Administrative Expenses	13,200	—
27.	Discount Allowed	2,000	—
28.	Bad debts	5,000	—
29.	Interest on loan from bank	2,500	—
30.	Delivery Expenses	6,600	—
31.	Selling & Distribution Expenses	10,000	—
32.	Income Tax Paid	1,000	—
33.	Value Added Tax (VAT) collected	—	2,000
34.	Loose Tools	2,000	—
35.	Apprentice Premium received	—	425
36.	Commission received	—	375
		12,54,900	12,54,900

Dr. **TRADING, P & L A/C FOR THE YEAR ENDING 31ST MARCH, 2018**

Cr.

Particulars	₹	Particulars	₹
To Opening stock	75,000	By Sales	6,30,000
To Purchases	5,25,000	Less: Returns	10,000
Less: Returns	5,000	By Closing stock	40,000
To Duty on purchases	1,600		
To Carriage	1,400		
To Packaging expenses	2,000		
To Gross Profit	60,000		
	6,60,000		6,60,000
To Freight outward	2,000	By Gross Profit	60,000
To Rent	3,000	By Commission	375
Add: Rent Outstanding	600	Less: Unaccrued commission	125
To Interest on loan	2,500	By Interest on investment	3,000
Add: Interest unpaid	1,250	Add: Accrued Interest	1,500
To Discount	2,000	By Discount	1,000
To Insurance	3,600	By Apprentice premium received	425

Less: Prepaid Insurance	900	2,700	By Bad Debt Recovered	3,500
To Delivery expenses		6,600	By Net Loss t/f to Capital A/c	10,375
To Selling and distribution expenses		10,000		
To Office & Administrative expenses		13,200		
To Bad debts		5,000		
To Depreciation on fixed Assets		30,000		
To Loss on Revaluation of Loose tools		1,200		
		80,050		80,050

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital:		Fixed Assets:	
Opening Balance	4,54,000	Fixed Assets	3,00,000
Less: Net Loss	10,375	Less: Depreciation	30,000
Less: Drawings	9,000	Investments:	
Less: Income tax	1,000	Investments	50,000
	4,33,625	Current Assets:	
Loans:		Debtors	2,05,000
Bank Loan	50,000	B/R	10,000
Add: Interest on loan	1,250	Cash in hand	5,000
Current Liabilities:		Cash at bank	10,000
Creditors	1,00,000	Closing Stock	40,000
Bills Payable	5,600	Prepaid insurance	900
Value Added Tax (VAT) Collected	2,000	Loose Tools [₹ 2,000 – ₹ 1,200]	800
Unaccrued commission	125	Interest Accrued on Investments	1,500
Outstanding rent	600		
	5,93,200		5,93,200

Note: Carriage has been assumed as carriage inward.

ILLUSTRATION 31

The following is the Trial Balance of Mr Clever as at 31st March, 2018:

Particulars	Dr. (₹)	Particulars	Cr. (₹)
Plant & Machinery		Creditors	1,00,000
(Purchased on 1.7.2017)	2,00,000	Bills Payables	5,600
Furniture & Fixtures		10% Loan From Bank	
(Purchased on 1.7.2017)	1,00,000	(taken on 1.7.2017)	50,000
Opening Stock	75,000	Capital Account	4,55,000
Debtors	2,05,000	Sales	6,30,000
Bills Receivables	10,000	Purchases Returns	5,000
12% Investments (purchased		Discount Earned	1,000
on 1.7.2017)	50,000	Bad Debts Recovered	2,500
Cash in Hand	5,000	Interest	3,000
Cash at Bank	11,250	Commission	3,750

Drawings	10,650		
Purchases	5,25,000		
Sales Returns	10,000		
Carriage Inwards	5,000		
Carriage Outwards	350		
Rent	3,000		
Insurance	3,600		
Office & Administration Expenses	13,200		
Discount Allowed	2,000		
Bad Debts	5,000		
Interest	2,500		
Selling & Distribution Expenses	18,300		
Income Tax paid	1,000		
	12,55,850		12,55,850

Additional Information:

- The Cost of Closing Stock was ₹ 50,000 but the Market Value was ₹ 40,000.
- Rent is payable at the rate of ₹ 300 per month. Insurance Premium was paid for the year ending on 30th June, 2018. ₹ 1,250 is due for interest on Bank loan.
- Accrued Interest on Investments amounted to ₹ 1,500. One-third of the commission received is in respect of work to be done next year.
- Write off further ₹ 5,000 as bad. Create a Provision for Doubtful debts @ 10%. Create Provision for discount on Debtors @ 2%.
- Provide for depreciation on Plant & Machinery @ 10% p.a. Write 10% off the Furniture & Fixtures.

Required: Prepare Trading and Profit and loss Account for the year ending on 31st March, 2018 and a Balance Sheet as at 31st March, 2018.

SOLUTION**TRADING AND PROFIT & LOSS ACCOUNT***Dr.**for the year ended on 31st March, 2018**Cr.*

Particulars	₹	Particulars	₹
To Opening Stock	75,000	By Sales	6,30,000
To Purchases	5,25,000	Less: Returns	10,000
Less: Returns	5,000		
To Carriage Inwards	5,000	By Closing Stock	40,000
To Gross Profit c/d	60,000	[Cost or NRV whichever is lower]	
	6,60,000		6,60,000
To Carriage Outward	350	By Gross Profit b/d	60,000
To Rent Paid	3,000	By Discount	1,000
Add: Outstanding	600	By Bad Debts Recovered	2,500
To Insurance Paid	3,600	By Interest	
Less: Prepaid	900	Received	3,000
To Office & Adm. Expenses	13,200	Add: Accrued but not due	1,500
			4,500

To Discount		2,000	By Commission Received	3,750	
To Bad Debts	5,000		Less: Advance	<u>1,250</u>	2,500
Add: Further	<u>5,000</u>	10,000	By Net Loss t/f to Capital A/c		32,000
To Interest					
Paid	2,500				
Add: Outstanding	<u>1,250</u>	3,750			
To Selling & Distribution Expenses		18,300			
To Provision for doubtful debts		20,000			
To Provision for Discount on Debtors		3,600			
To Dep. on Plant & Machinery		15,000			
[₹ 2,00,000 × 10/100 × 9/12]					
To Dep. on Furniture & Fixtures		10,000			
[₹ 1,00,000 × 10/100 × 12/12]					
		1,02,500			1,02,500

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital Account:		Fixed Assets:	
Opening Balance	4,55,000	Plant & Machinery	2,00,000
Less: Net Loss	32,000	Less: Depreciation	<u>15,000</u>
Less: Drawings	10,650	Furniture & Fixtures	1,00,000
Less: Income Tax	<u>1,000</u>	Less: Depreciation	<u>10,000</u>
	4,11,350	12% Investments	50,000
Loans:		Current Assets:	
Loan from Bank	50,000	Closing Stock	40,000
Add: Outstanding Interest	<u>1,250</u>	Debtors	2,05,000
	51,250	Less: Add. Bad Debts	<u>5,000</u>
Current Liabilities:			2,00,000
Creditors	1,00,000	Less: Provision for	
Bills Payable	5,600	doubtful debts @ 10%	<u>20,000</u>
Outstanding Rent	600		1,80,000
Commission received in advance	1,250	Less: Provision for discount	<u>3,600</u>
		Interest accrued but not due	1,500
		Cash in hand	5,000
		Cash at Bank	11,250
		Bills Receivable	10,000
		Prepaid Insurance	900
	5,70,050		5,70,050

21.0 TREATMENT OF ITEMS OF ADJUSTMENTS APPEARING IN THE TRIAL BALANCE

If any item of adjustment appears inside the Trial Balance, it will be shown only at one appropriate place in the final accounts. The treatment of such item has been shown below:

TREATMENT OF ITEMS OF ADJUSTMENT APPEARING INSIDE THE TRIAL

Item given in Trial Balance	Treatment in Profit & Loss A/c or Other Account	Treatment in Balance Sheet
1. Closing Stock	—	Shown on the Assets side as a Current Asset.
2. Outstanding Expense/ Accrued Expense	—	Shown on the Liabilities side as a Current Liability.
3. Prepaid Expense	—	Shown on the Assets side as a Current Asset.
4. Accrued Income	—	Shown on the Assets side as a Current Asset.
5. Unearned Income	—	Shown on the Liabilities side as a Current Liability.
6. Depreciation	Shown on the debit side of P & L A/c as a separate item.	—
7. Bad Debts if no Provision for Doubtful Debts A/c appears	Shown on the debit side of P & L A/c as a separate item.	—
8. Bad Debts if Provision for Doubtful Debts A/c appears	Shown on the debit side of Provision for Doubtful Debts A/c.	—
9. Discount allowed if no Provision for Discount on Debtors A/c appears	Shown on the debit side of P & L A/c as a separate item.	—
10. Discount allowed if Provision for Discount on Debtors A/c appears	Shown on the debit side of Provision for Discount of Debtors A/c.	—
11. Discount Received if no Reserve for Discount on Creditors A/c appears	Shown on the credit side of P & L A/c as a separate item.	—
12. Discount received if Reserve for Discount on Creditors A/c appears	Shown on the credit side of Reserve for Discount on Creditors A/c.	—

ILLUSTRATION 32

The following is the Trial Balance of Mr Wise Mind as on March 31, 2018:

Particulars	Dr. (₹)	Cr. (₹)
Fixed Assets	5,40,000	—
Depreciation on Fixed Assets	60,000	—
Cost of Goods Sold	11,16,000	—
Closing Stock	84,000	—
Trade Debtors/Trade Creditors	4,00,000	1,94,000
Bills Payables	—	11,200
Bills Receivables	20,000	—
12% Investments (Purchased on 1.7.2017)	1,00,000	—

Interest on Investments	–	9,000
Accrued Interest on Investments	3,000	–
Interest	5,000	–
Loan from Bank	–	8,000
Cash in Hand	10,000	–
Cash at Bank	20,000	–
Drawings	20,000	–
Interest on Drawings	–	2,000
Interest on Capital	80,000	
Capital	–	8,78,000
Sales	–	14,60,000
Return Inward	20,000	–
Carriage Outward	4,000	–
Discount	4,000	2,000
Bad Debts	13,000	–
Rent	7,200	–
Outstanding Rent	–	1,200
Insurance	5,400	
Prepaid Insurance	1,800	
Other Office and Administrative Expenses	26,400	
Selling and Distribution Expenses	89,800	
Provision for Doubtful Debts	–	53,000
Provision for Discount on Debtors	–	11,200

Required: Prepare the Trading and Profit & Loss Account for the year ending March 31, 2018 and the Balance Sheet as on March 31, 2018.

SOLUTION

TRADING AND PROFIT & LOSS ACCOUNT

Dr.

for the year ended 31st March, 2018

Cr.

Particulars	₹	Particulars	₹
To Cost of Goods Sold	11,16,000	By Sales	14,60,000
To Gross Profit c/d	3,24,000	Less: Returns	20,000
	14,40,000		14,40,000
To Carriage Outward	4,000	By Gross Profit b/d	3,24,000
To Insurance	5,400	By Discount	2,000
To Rent	7,200	By Interest on Drawings	2,000
To Office and Administrative Exp.	26,400	By Interest	9,000
To Selling and Distribution Exp.	89,800		
To Interest	5,000		
To Depreciation	60,000		
To Interest on Capital	80,000		
To Net Profit t/f to Capital A/c	59,200		
	3,37,000		3,37,000

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital:		Fixed Assets:	5,40,000
Opening Balance	8,78,000	Investments:	1,00,000
Less: Net Profit	59,200	Current Assets:	
Less: Drawings	20,000	Debtors	4,00,000
	9,17,200	Less: Provision for	
Loans:		Doubtful Debts	40,000
Loan from Bank	8,000		3,60,000
Current Liabilities:		Less: Provision for Dis.	7,200
Creditors	1,94,000	Bills Receivables	20,000
Bills Payables	11,200	Closing Stock	84,000
Outstanding Rent	1,200	Prepaid Insurance	1,800
		Interest accrued	3,000
		Cash in hand	10,000
		Cash at Bank	20,000
	11,31,600		11,31,600

SOLVED PROBLEMS**PROBLEM 1**

The following is the Trial Balance of Mr Smart Mind as at 31st March, 2018:

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Particulars</i>	<i>Cr. (₹)</i>
Plant & Machinery		Creditors	1,00,000
(Purchased on 1.7.2017)	1,90,000	Bills Payables	5,600
Furniture & Fixtures		10% Loan From Bank	
(Purchased on 1.7.2017)	1,00,000	(taken on 1.7.2017)	50,000
Opening Stock	75,000	Capital Account	5,19,000
Debtors	2,07,000	Sales	6,30,000
Bills Receivables	10,000	Purchases Returns	5,000
12% Investments		Discount Earned	1,000
(purchased on 1.7.2017)	50,000	Bad Debts Recovered	2,500
Cash in Hand	5,000	Interest	3,000
Cash at Bank	10,000	Commission	3,750
Drawings	10,650		
Purchases	5,25,000		
Sales Returns	10,000		
Wages	18,500		
Carriage Inwards	500		
Carriage Outwards	350		
Rent	3,000		

Insurance	3,600		
Salaries	11,200		
Discount Allowed	2,000		
Bad Debts	5,000		
Interest	2,500		
Selling & Distribution Expenses	15,800		
Income Tax paid	1,000		
Loose Tools	3,750		
Buildings	60,000		
	13,19,850		13,19,850

Additional Information:

- Closing Stock as on 31st March 2018 was ₹ 93,600. Loose Tools are valued at ₹ 1,250.
- Rent is payable at the rate of ₹ 300 per month. Insurance Premium was paid for the year ending on 30th June, 2018. ₹ 1,250 is due for interest on Bank Loan.
- Accrued Interest on investments amounted to ₹ 1,500. One-third of the commission received is in respect of work to be done next year.
- Provide for depreciation on Plant & Machinery @ 10% p.a. Write 10% off the Furniture & Fixtures. Depreciate Buildings by 5%.
- Write off further ₹ 5,000 as bad. Create Provision for discount on Debtors @ 2%. Create a Provision for Doubtful debts @ 10%.
- A fire occurred on 25th March 2018 in the godown and stock of ₹ 1,000 was destroyed, it was fully insured but the insurance company admitted the claim to the extent of 60% only.
- Goods costing ₹ 2,000 were taken by the proprietor for his personal use but no entry has been made in the books of accounts.
- Goods costing ₹ 3,000 were distributed as free samples but no entry has been made in the books of accounts.
- Manager is entitled to a commission of 5% on Net Profit after charging his commission.
- Wages include a sum of ₹ 4,000 spent on the erection of a cycle shed for employees and customers. Wages ₹ 10,000 paid for erection of machinery have been debited to Wages Account.
- Remuneration of ₹ 2,000 paid to Sh. B. Barua, a temporary employee, stands debited to his personal account.

Required: Prepare Trading and Profit and loss Account for the year ending on 31st March, 2018 and a Balance Sheet as at 31st March, 2018.

SOLUTION
TRADING AND PROFIT & LOSS ACCOUNT
Dr.
for the year ended 31st March, 2018
Dr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Opening Stock	75,000	By Sales	6,30,000
To Purchases	5,25,000	Less: Returns	10,000
Less: Returns	5,000	By Closing Stock	93,600
Less: Goods destroyed by fire	1,000		

Less: Goods taken for personal use	2,000			
Less: Goods distributed as free samples	<u>3,000</u>	5,14,000		
To Wages	18,500			
Less: Cost of Erection of a Cycle shed (Building)	4,000			
Less: for erection of new machinery	<u>10,000</u>	4,500		
To Carriage Inwards		500		
To Gross Profit c/d		1,19,600		
		7,13,600		7,13,600
To Carriage Outward		350	By Gross Profit b/d	1,19,600
To Rent Paid	3,000		By Discount	1,000
Add: Outstanding	<u>600</u>	3,600	By Bad Debts Recovered	2,500
To Insurance Paid	3,600		By Interest Received	3,000
Less: Prepaid	<u>900</u>	2,700	Add: Accrued but not due	<u>1,500</u>
To Salaries	11,200		By Commission Received	3,750
Add: Salary to Mr B. Barua	<u>2,000</u>	13,200	Less: Unaccrued	<u>1,250</u>
To Discount		2,000		2,500
To Bad Debts	5,000			
Add: Further	<u>5,000</u>	10,000		
To Interest Paid	2,500			
Add: Outstanding	<u>1,250</u>	3,750		
To Selling & Distribution Expenses		15,800		
To Provision for doubtful debts		20,000		
To Provision for Discount on Debtors		3,600		
To Dep. on Plant & Machinery		15,000		
[₹ 2,00,000 x 10/100 x 9/12]				
To Dep. on Furniture & Fixtures		10,000		
[₹ 1,00,000 x 10/100 x 12/12]				
To Depreciation on Buildings		3,200		
[₹ 64,000 x 5/100 x 12/12]				
To Loss on Revaluation of Loose tools		2,500		
To Loss of Stock by fire		400		
To Sales Promotion Expenses		3,000		
To Manager's Commission				
[21,000 x 5/105]		1,000		
To Net Profit t/f to Capital A/c		20,000		
		1,30,100		1,30,100

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Account:		Fixed Assets:	
Opening Balance	5,19,000	Plant & Machinery	2,00,000
Add: Net Profit	20,000	Less: Depreciation	<u>15,000</u> 1,85,000
Less: Drawings	10,650	Furniture & Fixtures	1,00,000
Less: Goods taken for personal use	2,000	Less: Depreciation	<u>10,000</u> 90,000
		Building	60,000
Less: Income Tax	<u>1,000</u> 5,25,350	Add: Cost of Cycle shed	4,000
Loans:		Less: Depreciation	<u>3,200</u> 60,800
Loan from Bank	50,000	12% Investments	50,000
Add: Outstanding Interest	<u>1,250</u> 51,250	Current Assets:	
Current Liabilities:		Closing Stock	93,600
Creditors	1,00,000	Debtors	2,07,000
Bills Payable	5,600	Less: Bad Debts	5,000
Outstanding Rent	600	Less: Salary to Mr B. Barua	<u>2,000</u>
Unaccrued Commission	1,250		2,00,000
Manager's Commission Outstanding	1,000	Less: Provision for doubtful debts @ 10%	<u>20,000</u>
			1,80,000
		Less: Provision for discount	<u>3,600</u> 1,76,400
		Interest accrued	1,500
		Cash in hand	5,000
		Cash at Bank	10,000
		Bills Receivable	10,000
		Prepaid Insurance	900
		Loose Tools [₹ 3,750 – ₹ 2,500]	1,250
		Insurance Company (claim)	600
	6,85,050		6,85,050

Note: Depreciation on furniture has been charged for the full year because a flat rate of 10% (and not 10% p.a.) has been given, whereas depreciation on machinery has been charged for 9 months from 1st July to 31st March.

PROBLEM 2

The following is the Trial Balance of Mr Master Mind as at 31st March, 2018:

TRIAL BALANCE

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Opening Stock	75,000	—
Sales/Purchases	5,25,000	6,30,000
Returns	10,000	5,000
Wages	23,500	—

Carriage Inwards	500	—
Carriage Outwards	350	—
Rent	3,000	—
Insurance	3,600	—
Salaries	11,200	—
Selling & Distribution Expenses	27,600	—
Commission	—	3,750
Interest	2,500	3,000
Bad Debts/ Bad Debts Recovered	5,000	2,500
Discount	2,000	1,000
Provision for Doubtful Debts	—	10,000
Provision for Discount on Debtors	—	1,800
Buildings	60,000	—
Plant & Machinery (Purchased on 1.7.2017)	2,10,000	—
Furniture & Fixtures (Purchased on 1.7.2017)	30,000	—
12% Investments (purchased on 1.7.2017)	50,000	—
Debtors/Creditors	2,12,000	1,00,000
Bills Receivable/ Bills Payable	10,000	5,600
Cash in Hand	5,000	—
Cash at Bank	50,000	—
Loose Tools	3,750	—
Capital/Drawings	10,650	5,19,000
Income Tax paid	1,000	—
10% Loan From Bank(taken on 1.7.2017)		50,000
	13,31,650	13,31,650

Additional Information:

- Closing Stock as on 31st March 2018 was ₹ 93,600. Loose Tools are valued at ₹ 1,250.
- Rent is payable at the rate of ₹ 300 per month. Insurance Premium was paid for the year ending on 30th June, 2018.
- One-third of the commission received is in respect of work to be done next year.
- Provide for depreciation on Plant & Machinery @ 10% p.a. Write 10% off the Furniture & Fixtures. Depreciate Buildings by 5%.
- Debtors include Shyam for dishonoured bill of ₹ 10,000. Half the amount of Shyam's bills is irrecoverable. Create Provision for discount on Debtors @ 2%. Create a Provision for Doubtful debts @ 10%.
- A fire occurred on 25th March 2018 in the godown and Stock of ₹ 1,000 was destroyed, it was fully insured but the insurance company admitted the claim to the extent of 60% only.
- Goods costing ₹ 2,000 were taken by the proprietor for his personal use but no entry has been made in the books of accounts.
- Goods costing ₹ 3,000 were distributed as free samples but no entry has been made in the books of accounts.
- Manager is entitled to a commission of 5% on Net Profit after charging his commission.
- Wages include a sum of ₹ 4,000 spent on the erection of a cycle shed for employees and customers.

- (k) Remuneration of ₹ 2,000 paid to Sh. B. Barua, a temporary employee, stands debited to his personal account.
- (l) A machine costing ₹ 1,90,000 was purchased on 1st July 2017. Wages ₹ 10,000 paid for its erection have been debited to Wages Account.
- (m) A furniture costing ₹ 45,000 was purchased on 1st July 2017 but it was not recorded in the books as no payment was made of it. Wages ₹ 5,000 paid for its erection have been debited to Wages Account.

Required: Prepare Trading and Profit and loss Account for the year ending on 31st March, 2018 and a Balance Sheet as at 31st March, 2018.

SOLUTION
TRADING AND PROFIT & LOSS ACCOUNT
Dr.
for the year ended 31st March, 2018
Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Opening Stock	75,000	By Sales	6,30,000
To Purchases	5,25,000	Less: Returns	10,000
Less: Returns	5,000	By Closing Stock	93,600
Less: Goods destroyed by fire	1,000		
Less: Goods taken for personal use	2,000		
Less: Goods distributed as free samples	3,000		
To Wages	18,500		
Less: Cost of Erection of a Cycle shed (Building)	4,000		
Less: for erection of new machinery	10,000		
To Carriage Inwards	500		
To Gross Profit c/d	1,19,600		
	7,13,600		7,13,600
To Carriage Outward	350	By Gross Profit b/d	1,19,600
To Rent Paid	3,000	By Discount	1,000
Add: Outstanding	600	By Bad Debts Recovered	2,500
To Insurance Paid	3,600	By Interest	
Less: Prepaid	900	Received	3,000
To Salaries	11,200	Add: Accrued but not due	1,500
Add: Salary to Mr B. Barua	2,000	By Commission	
To Bad Debts	5,000	Received	3,750
Add: Further	5,000	Less: Unaccrued	1,250
Add: New Provision	20,000		
Less: Old Provision	10,000		
To Discount	2,000		
Add: New Provision	3,600		

Less: Old Provision	1,800	3,800		
To Interest				
Paid	2,500			
Add: Outstanding	1,250	3,750		
To Selling & Distribution Expenses		27,600		
To Depreciation on				
New Plant & Machinery		15,000		
[₹ 2,00,000 x 10/100 x 9/12]				
To Depreciation on Old Plant				
& Machinery		2,000		
[₹ 20,000 x 10/100 x 12/12]				
To Dep. on Furniture & Fixtures		8,000		
[₹ 80,000 x 10/100 x 12/12]				
To Dep. on Buildings		3,200		
[₹ 64,000 x 5/100 x 12/12]				
To Loss on Revaluation of Loose tools		2,500		
To Loss of Stock by fire		400		
To Sales Promotion Expenses		3,000		
To Manager's Commission				
[21,000 x 5/105]		1,000		
To Net Profit t/f to Capital A/c		20,000		
		1,30,100		1,30,100

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital Account:		Fixed Assets:	
Opening Balance	5,19,000	Plant & Machinery	20,000
Add: Net Profit	20,000	Add: New Machinery	1,90,000
Less: Drawings	10,650	Add: Erection of machinery	10,000
Less: Goods taken for		Less: Depreciation	17,000
personal use	2,000	Furniture & Fixtures	30,000
Less: Income Tax	1,000	Add: New Furniture	45,000
	5,25,350	Add: Erection of Furniture	5,000
Loans:		Less: Depreciation	8,000
Loan from Bank	50,000	Building	60,000
Add: Outstanding Interest	1,250	Add: Cost of Cycle shed	4,000
Current Liabilities:		Less: Depreciation	3,200
Creditors	1,00,000	12% Investments	50,000
Bills Payable	5,600	Current Assets:	
Outstanding Rent	600	Closing Stock	93,600
Unaccrued Commission	1,250	Debtors	2,12,000
Manager's Commission Outstanding	1,000	Less: Add Bad Debts	5,000
Supplier of Furniture	45,000		

	Less: Salary to Mr B. Barua	2,000	
		<u>2,05,000</u>	
	Less: Provision for doubtful debts @ 10% on (2,05,000 – 5000)	20,000	
		<u>1,85,000</u>	
	Less: Provision for discount	3,600	1,81,400
	Interest accrued but not due		1,500
	Cash in hand		5,000
	Cash at Bank		50,000
	Bills Receivable		10,000
	Prepaid Insurance		900
	Loose Tools [₹ 3,750 – ₹ 2,500]		1,250
	Insurance Company (claim)		600
	7,30,050		7,30,050

Note: Depreciation on furniture has been charged for the full year because a flat rate of 10% (and not 10% p.a.) has been given, whereas depreciation on machinery has been charged for 9 months from 1st July to 31st Mar. No Provision for Discount on Debtors is required on Shyam's balance.

PROBLEM 3

From the following Trial Balance and additional information of Mr Bharat Tulsian, a proprietor, prepare Trading, Profit & Loss Account for the year ending on 31st March, 2018 and the Balance Sheet as at that date.

TRIAL BALANCE

S. No.	Particulars	Dr. (₹)	Cr. (₹)
1.	Closing Stock	40,000	—
2.	Sales/Cost of Goods Sold	5,60,000	6,20,000
3.	Rent	11,000	6,500
4.	Office & Administration Expenses	13,200	—
5.	General Expenses	6,000	—
6.	Selling & Distribution Expenses	36,075	—
7.	Income Tax Paid	1,000	—
8.	Interest	3,750	4,500
9.	Discount	2,000	1,000
10.	Bad Debts	3,000	—
11.	Investments	50,000	—
12.	Loan from Bank	—	50,000
13.	Bills Receivables/Bills Payables	10,000	5,600
14.	Debtors/Creditors	2,10,000	90,800
15.	Provision for Doubtful Debts	—	10,000
16.	Provision for Discount on Debtors	—	2,400
17.	Capital/Drawings	12,775	3,08,000

18.	Plant & Machinery	50,000	—
19.	Land & Building	60,000	—
20.	Furniture & Fixtures	30,000	—
21.	Outstanding Office Expenses	—	1,200
22.	Prepaid General Expenses	1,200	—
		11,00,000	11,00,000

Additional information:

- Rent has been paid for 11 months and has been received for 13 months.
- Write off further ₹ 6,000 as bad.
- Additional discount of ₹ 4,000 given to debtors after closing the accounts.
- Additional discount of ₹ 2,000 received from creditors after closing the accounts.
- Maintain a provision for discount @ 2% on debtors.
- Maintain a provision for doubtful debts @ 10%.
- A machine costing ₹ 20,000 was purchased on 1st July 2017. Wages ₹ 1,000 for its erection have been debited to General Expenses Account. Provide depreciation on Plant and Machinery @ 10% p.a..
- A furniture costing ₹ 20,000 was purchased on 1st July 2017 but it was not recorded in the books as no payment was made of it. Wages ₹ 1,000 paid for its erection have been debited to General Expenses Account. Depreciate furniture 10%.
- General Expenses include a sum of ₹ 4,000 spent on the erection of a cycle shed for employees and customers on 1st July, 2017. Provide 5% depreciation on building.
- A fire broke out on 1st April, 2018 destroying Goods costing ₹ 20,000.

SOLUTION**TRADING, PROFIT & LOSS ACCOUNT***Dr.**for the year ending 31st March, 2018**Cr.*

Particulars	₹	Particulars	₹
To Cost of Goods Sold	5,60,000	By Sales	6,20,000
To Gross Profit c/d	60,000		
	6,20,000		6,20,000
To Rent 11,000		By Gross Profit b/d	60,000
Add: Outstanding Rent 1,000	12,000	By Rent 6,500	
To Office and Administrative Expen.	13,200	Less: Unaccrued Rent 500	6,000
To Selling and Distribution Expen.	36,075	By Interest	4,500
To Interest 3,750		By Discount Received 1,000	
To General Expenses 6,000		Add: Further Discount 2,000	3,000
Less: Erection of furniture 1,000		By Net Loss t/f to Capital A/c	30,600
Less: Erection of Machinery 1,000			
Less: Erection of Cycle shed 4,000	—		
To Bad Debts 3,000			
Add: Further Bad Debts 6,000			
Add: New Provision 20,000			

Less: Old Provision	10,000	19,000	
To Discount Allowed	2,000		
Add: Further Discount	4,000		
Add: New Prov. for discount	3,600		
Less: Old Provision	2,400	7,200	
To Depreciation on:			
Plant & Machinery	4,575		
Furniture & Fixture	5,100		
Land and Building	3,200	12,875	
		1,04,100	1,04,100

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital:		Fixed Assets:	
Opening Balance	3,08,000	Plant & Machinery	30,000
Less: Net Loss	30,600	Add: New Machinery	20,000
Less: Drawings	12,775	Add: Erection of machinery	1,000
Less: Income Tax	1,000	Less: Depreciation	4,575
	2,63,625	Furniture & Fixtures	30,000
Loans:		Add: New Furniture	20,000
Loan from Bank	50,000	Add: Erection of Furniture	1,000
Current Liabilities:		Less: Depreciation	5,100
Creditors	90,800	Land & Building	60,000
Less: Further Discount	2,000	Add: Erection of Cycle shed	4,000
Bills Payables	5,600	Less: Depreciation	3,200
Outstanding Rent	1,000	Investments:	
Unaccrued Rent	500	Current Assets:	50,000
Supplier of Machinery A/c	20,000	Debtors	2,10,000
Outstanding Office Expenses	1,200	Less: Further Bad Debts	6,000
		Less: Further Discount	4,000
			2,00,000
		Less: Provision for Doubtful Debts	20,000
			1,80,000
		Less: Provision for Discount	3,600
		Bills Receivables	10,000
		Closing Stock	40,000
		Prepaid General Expenses	1,200
	4,30,725		4,30,725

Note: An event occurring after the date of Balance Sheet (i.e., fire as on 1.4.2018) does not affect the Balance Sheet.

PROBLEM 4

On 31st March, 2018, the following Trial Balance was extracted from the books of Mr. Ghayal.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Dr. Balances:		Rates, Taxes and Insurance	28,910
Drawings	30,000	Advertising	32,640
Sundry Debtors	2,01,000	General Expenses	34,890
Interest on Loan	2,850	Bill Receivable	68,820
Cash in hand	20,500	Cr. Balances:	
Opening Stock	68,390	Capital	2,80,000
Motor Vehicles	1,00,000	Sundry Creditors	1,04,010
Cash at Bank	35,550	Loan on Mortgage	95,000
Land and Buildings	1,20,000	Provision of doubtful debts	7,100
Bad Debts	5,250	Sales	11,02,430
Purchases	6,64,580	Purchases returns	13,460
Sales Returns	78,210	Discounts	5,400
Carriage Outward	24,190	Bills Payable	26,140
Carriage Inward	29,290	Rent Received	2,500
Salaries	90,970		

Required: Prepare Trading and Profit and Loss Account for the year ended 31st March, 2018 and Balance Sheet as on that date, after making adjustments for the following matters:

- Depreciate Land and Buildings at 2½ per cent and Motor Vehicles at 20 per cent.
- Interest on Loan at 6 per cent per annum is unpaid for six months.
- Goods costing ₹ 5,000 were sent to a customer on sale or return for ₹ 6,000 on 30th March, 2018 and had been recorded in the books as actual sales.
- Salaries amounting to ₹ 7,500 and rates amounting to ₹ 3,500 are outstanding.
- Prepaid Insurance amounted to ₹ 1,500.
- The provision for Doubtful Debts is to be maintained at 5 per cent Sundry Debtors.
- Provide for Manager's Commission at 10% on net profits after charging such commission.
- Closing Stock was valued at ₹ 62,500.

SOLUTION**TRADING AND PROFIT & LOSS ACCOUNT**

Dr.

for the year ending on 31st March, 2018

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Opening Stock	68,390	By Sales	11,02,430
To Purchases	6,64,580	Less: Sale Price of	
Less: Returns	13,460	Goods on approval	6,000
To Carriage Inwards	29,290	Less: Returns	78,210
To Gross Profit t/f to P & L A/c	3,36,920	By Stock in hand	62,500
		Add: Cost of Goods	
		Sent on Approval	5,000
	10,85,720		67,500
			10,85,720

To Interest on Loan	2,850		By Gross Profit b/d	3,36,970
Add: Outstanding	2,850	5,700	By Discount	5,400
To Bad Debts	5,250		By Rent Received	2,500
Add: New Provision	9,750			
Less: Old Provision	7,100	7,900		
To Carriage Outwards		24,190		
To Salaries (₹ 90,970 + 7,500)		98,470		
To Rates, Taxes, & Ins.	28,910			
Add: Rates due	3,500			
Less: Insurance Prepaid	1,500	30,910		
To Advertising		32,640		
To General Expenses		34,890		
To depreciation:				
Land & Building @ 2½%		3,000		
Motor vehicles @ 20%		20,000		
To Manager's Commission		7,920		
To Net Profit t/f to Capital A/c		79,200		
		3,44,820		3,44,820

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Billy Payable	26,140	Cash in hand	20,500
Sundry Creditors	1,04,010	Cash at bank	35,550
Outstanding Salaries	7,500	Bills Receivable	68,820
O/s Manager's Commission	7,920	Prepaid Insurance	1,500
Outstanding Rates	3,500	Sundry Debtors	2,01,000
Loans on Mortgage	95,000	Less: Goods sent on app.	8,000
Add: Interest	2,850	Less: Provision	9,750
Capital:		Stock (₹ 62,500 + ₹ 5,000)	67,500
Opening Balance	2,80,000	Land and Buildings	1,20,000
Less: Drawings (₹ 30,000)	30,000	Less: Depreciation	3,000
Add: Profit	79,200	Motor Vehicles	10,000
	3,29,200	Less: Depreciation	20,000
	5,76,120		5,76,120

PROBLEM 5

From the following figures extracted from the books of Shri Govind, you are required to prepare a Trading and Profit and Loss Account for the year ended 31st March, 2018 and a Balance Sheet as on that date after making the necessary adjustments:

Particulars	₹	Particulars	₹
Shri Govind's Capital	2,28,800	Bills payable	5,500
Shri Govind's drawings	13,200	Opening Stock	38,500

Plant and Machinery	99,000	Wages	35,200
Freehold property	66,000	Sundry Creditors	44,000
Purchases	1,10,000	Postage and Telegrams	1,540
Returns outwards	1,100	Insurance	1,760
Salaries	13,200	Gas and Fuel	2,970
Office expenses	2,750	Bad Debts	660
Office furniture	5,500	Office Rent	2,860
Discount A/c (Dr.)	1,320	Freight	9,900
Sundry Debtors	29,260	Loose Tools	2,200
10% Loan to Shri Krishna	44,000	Factory Lighting	1,100
Cash at Bank	29,260	Provision for Doubtful Debts	880
Sales	2,31,440	Interest on loan to Shri Krishna	1,100
		Cash in hand	2,640

Adjustments:

(a) Closing Stock was valued at ₹ 72,600. (b) A new machine was installed during the year costing ₹ 15,400 but it was not recorded in the books as no payment was made for it. Wages ₹ 1,100 paid for its erection have been debited to wages account. (c) Depreciate plant and machinery by 33–1/3%, Furniture by 10%, Freehold property by 5% (d) Loose tools were valued at ₹ 1,760 (e) Of the Sundry debtors ₹ 660 are bad and should be written off. (f) Maintain a provision of 5% on Sundry Debtors for doubtful debts. (g) The manager is entitled to a commission of 10% of the net profits after charging such commission.

SOLUTION**TRADING AND PROFIT & LOSS ACCOUNT**

Dr.

for the year ending on 31st March, 2018

Cr.

Particulars	₹	Particulars	₹
To Opening Stock	38,500	By Sales	2,31,440
To Purchases 1,10,000		By Closing Stock	72,600
Less: Returns Outward 1,100	1,08,900		
To Wages 35,200			
Less: for erection of new machinery 1,100	34,100		
To Gas & Fuel 2,970			
To Freight 9,900			
To Factory Lighting 1,100			
To Gross Profit c/d 1,08,570			
	3,04,000		3,04,000
To Salaries 13,200		By Gross Profit b/d	1,08,570
To Office expenses 2,750		By Interest 1,100	
To Postage & Telegram 1,540		Add: Accrued but not received 3,300	4,400
To Insurance 1,760		(10/100 × 44,000)	
To Office Rent 2,860			
To Discount Allowed 1,320			

To Provision for Doubtful Debts			
New Provision	1,430		
Add: Bad Debts (660 + 660)	<u>1,320</u>		
	2,750		
Less: Old Provision	<u>880</u>	1,870	
To Depreciation:			
Machinery	38,500		
Furniture	550		
Freehold property	3,300		
Loose Tools	<u>440</u>	42,790	
To Commission to Manager		4,080	
(10/100 × 44,880)			
To Net Profit (transferred to capital)		40,800	
		1,12,970	1,12,970

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital:		Plant & Machinery	99,000
Opening Balance	2,28,800	Add: New Machinery	<u>16,500</u>
Less: Drawings	13,200		1,15,500
Add: Net Profit	<u>40,800</u>	Less: Depreciation	<u>38,500</u>
Bills Payable	5,500	[1/3 × 1,15,500]	
Sundry Creditors	59,400	Freehold Property	66,000
O/s Commission to Manager	4,080	Less: Depreciation	<u>3,300</u>
		(20/100 × 66,000)	
		Office Furniture	5,500
		Less: Depreciation	<u>550</u>
		(10/100 × 5,500)	
		Loose Tools	2,200
		Less: Depreciation	<u>440</u>
		(2,200 – 1,760)	
		Closing Stock	
			72,600
		Sundry Debtors	28,600
		Less: Provision	<u>1,430</u>
		(5/100 × 28,600)	
		Loan to Shri Krishna	44,000
		Add: Interest accrued	<u>3,300</u>
		Cash at Bank	29,260
		Cash in Hand	2,640
	3,25,280		3,25,380

PROBLEM 6

The following Trial Balance was extracted from the Books of Mr. Selfish as on 31st March, 2018:

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Particulars</i>	<i>Cr. (₹)</i>
Plant and Machinery	2,00,000	Capital Account	8,00,000
Manufacturing wages	3,45,000	Sundry Creditors	4,45,600
Salaries	1,58,500	Bank loan	1,50,000
Furniture	1,00,000	Purchase returns	17,400
Freight on purchase	18,600	Sales	25,08,500
Freight on sales	21,400	Provision for Doubtful debts	
Buildings	2,40,000		
Manufacturing expenses	95,000		
Insurance and tax	42,000		
Goodwill	2,50,000		
General expenses	82,000		
Factory fuel and power	12,800		
Sundry debtors	7,82,000		
Factory lighting	9,500		
Opening Stock	3,42,000		
Motor car	1,20,000		
Purchases	10,20,000		
Sales returns	31,000		
Bad Debts	14,000		
Interests and Bank Charges	4,000		
Cash at bank	42,000		
Cash in hand	11,200		
	39,41,500		39,41,500

Required: Prepare the Trading Profit and Loss Accounts for the year ended 31st March, 2018, and the Balance Sheet as on that date taking into consideration the following information:

- Closing Stock was valued at ₹ 3,05,000.
- Deprecate Plant and Machinery by 10% p.a., Furniture by 5% p.a. and Motor car by ₹ 10,000.
- Create provision for doubtful debts at 5% on Sundry Debtors.
- A commission of 1% on the gross profit is to be provided to Works Manager.
- General Manager is to be allowed a commission @ 2% on net profit after charging works Manager's and before charging General Manager's Commission.

SOLUTION**TRADING AND PROFIT & LOSS ACCOUNT**

Dr.

for the year ending on 31st March, 2018

Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Opening Stock	3,42,000	By Sales	25,08,500
To Purchases	10,20,000	Less: Returns	31,000
Less: Returns	17,400		
		By Closing Stock	3,05,000

To Manufacturing wages	3,45,000		
To Freight on purchase	18,600		
To Manufacturing Expenses	95,000		
To Factory Fuel and Power	12,800		
To Factory lighting	9,500		
To Gross Profit c/d	9,57,000		
	<u>27,82,500</u>		<u>27,82,500</u>
To Works Manager's Commission	9,570	By Gross Profit b/d	9,57,000
To Salaries	1,58,500		
To Freight on Sales	21,400		
To Prov. for doubtful Debt 39,100			
Less: Existing provision <u>20,000</u>	19,100		
To Insurance	42,500		
To General Expenses	82,000		
To Bad Debts	14,000		
To Interest & Rent	4,000		
To Depreciation on:			
Plant & Machinery 20,000			
Furniture 5,000			
Motor Car <u>10,000</u>	35,000		
To General Manager's Commission	11,420		
To Net Profit t/f to capital A/c	5,59,510		
	<u>9,57,000</u>		<u>9,57,000</u>

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Current Liabilities:		Current Assets:	
Creditors	4,45,600	Cash in Hand	11,200
Outstanding Commission (Works)	9,570	Cash at Bank	42,000
Outstanding Commission (General)	11,420	Debtors	7,82,000
Loans:	1,50,000	Less: Provision <u>39,100</u>	7,52,900
Capital:		Closing Stock	3,05,000
Opening Balance 8,00,000		Fixed Assets:	
Add: Net Profit <u>5,59,510</u>	13,59,510	Furniture	1,00,000
		Less: Depreciation <u>5,000</u>	95,000
		Plant & Machinery	2,00,000
		Less: Depreciation <u>20,000</u>	1,80,000
		Motor Car	1,20,000
		Less: Depreciation <u>10,000</u>	1,10,000
		Goodwill	2,50,000
		Building	2,40,000
	<u>19,76,100</u>		<u>19,76,100</u>

PROBLEM 7

The following is the Trial Balance of Mr X as at 31st March 2018:

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Particulars</i>	<i>Cr. (₹)</i>
Opening Stock	46,800	X's Capital A/c	86,690
Returns Inwards	8,600	Sales	3,89,600
Purchases	3,21,700	Returns Outward	5,800
Freight & Carriage	18,600	Sundry Creditors	14,800
Rent & Taxes	5,700	Bank Loan @ 6% p.a.	20,000
Salaries & Wages	9,300	Miscellaneous Income	250
Sundry Debtors	24,000	Discount Earned	4,190
Bank Interest	900		
Printing and Advertising	14,600		
Cash at Bank	8,000		
Furniture & Fittings	5,000		
Discount Allowed	1,800		
General Expenses	11,450		
Insurance	1,300		
Postage & Telegrams	2,330		
Cash in hand	380		
Travelling Expenses	870		
Drawings	40,000		
	5,21,330		5,21,330

The following adjustments should be made:

(a) Included amongst the Debtors is ₹ 3,000 due from Z and included among the creditors ₹ 1,000 due to him. (b) Provision for Doubtful Debts be created @ 5% and Reserve for Discount @ 2% on Sundry Debtors. (c) Depreciation on furniture & Fittings @ 10% shall be written off. (d) Personal Purchases amounting to ₹ 600 had been included in the Purchases Day Book. (e) Interest on Bank Loan shall be provided for the whole year. (f) A quarter of the amount of Printing and Advertising is to be carried forward to the next year. (g) Credit Purchase Invoice amounting to ₹ 400 had been omitted from the Books. (h) Closing Stock was ₹ 78,600. Prepare Trading & P & L A/c for the year ended 31.3.2018 & Balance Sheet as on that date.

SOLUTION**TRADING AND PROFIT & LOSS ACCOUNT**

Dr.

for the year ending on 31st March, 2018

Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Opening Stock	46,800	By Sales	3,89,000
To Purchases	3,21,700	Less: Returns Inward	8,000
Add: Invoices Omitted	400	By Closing Stock	78,000
Less: Returns Outward	5,800		
Less: Drawing of Goods	600		
	3,15,700		
To Freight & Carriage	18,600		
To Gross Profit c/d	78,500		
	4,59,600		4,59,600

To Rent and Taxes	7,700	By Gross Profit b/d	78,500
To Salaries & Wages	9,300	By Miscellaneous Income	250
To Interest on Bank Loan	900	By Discount Earned	4,190
Add: Outstanding	300		
To Printing & Advertisement	14,600		
Less: Prepaid ($1/4 \times 14,600$)	3,650		
	10,950		
To Discount allowed	1,800		
To General expenses	11,450		
To Insurance	1,300		
To Postage & Telegram	2,330		
To Travelling expenses	870		
To Provision for Doubtful Debts	1,150		
To Provision for Disc.. on Debtors	437		
To Depreciation on Furniture	500		
To Net Profit (transferred to capital)	35,953		
	82,940		82,940

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital:		Furniture & Fitting	5,000
Opening balance	86,690	Less: Depreciation	500
Less: Drawing of Cash	40,000	Sundry Debtors	24,000
Less: Drawings of Goods	600	Less: Mutual Debt set off	
Add: Net Profit	35,953	(Mr. Abraham)	1,000
Bank Loan	20,000	Less: Provision for	
Outstanding Expenses:		Doubtful Debts	1,150
O/s Interest on Bank Loan	300	($23,000 \times 5/100$)	
Sundry Creditors	14,800		21,850
Add: Omitted Purchase	400	Less: Provisions for	
Less: Mutual debt set off	1,000	Discount of Debtors	437
	14,200	($21,850 \times 2/100$)	
		Closing Stock	78,600
		Prepaid Expenses:	
		Printing & Advertisement	3,650
		Cash at bank	8,000
		Cash in Hand	380
	1,16,543		1,16,543

PROBLEM 8

The following Trial Balance was extracted from the books of Mr "A" as on 31st March 2018:

Particulars	Dr. (₹)	Particulars	Cr. (₹)
Plant & Machinery	78,000	Capital Account	1,00,000
Furniture	2,000	Sales	1,27,000
Purchases	60,000	Returns of Goods	750
Returns of Goods	1,000	Discount	800
Opening Stock	30,000	Sundry Creditors	25,000
Discount	425	Provision for Doubtful debts	525
Sundry Debtors	45,000		
Salaries	7,550		
Manufacturing wages	10,000		
Carriage Outwards	1,200		
Rent, Rates and Taxes	10,000		
Advertisement	2,000		
Cash	6,9030		
	2,54,075		2,54,075

Prepare Trading and Profit and Loss Account for the year ended March 31, 2018, and a Balance Sheet as on that date after taking into account the following adjustments:—

- Closing Stock was valued at ₹ 34,220
- Provision for Doubtful Debts is to be kept at ₹ 500.
- Allow Interest on Capital at 10% p.a.
- Furniture was old and the same was disposed off for ₹ 760 in exchange of new furniture costing ₹ 1,680. The net invoice of ₹ 920 was passed through Purchase Register. (No Depreciation need be charged on old and new furniture).
- Depreciate Plant and Machinery by 10% p.a.
- The proprietor Mr A has taken goods worth ₹ 5,000 for personal use, and distributed goods worth ₹ 1,000 as samples.

SOLUTION

TRADING AND PROFIT & LOSS ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

Particulars	₹	Particulars	₹
To Opening Stock	30,000	By Sales	1,27,000
To Purchases	60,000	Less: Return Inward	1,000
Less: Drawings of Goods	5,000		
Less: Free Samples	1,000	By Closing stock	34,220
Less: Returns Outwards	750		
Less: Furniture wrongly debited	920		
	52,330		
To Manufactured Wages	10,000		
To Gross Profit c/d	67,890		
	1,60,220		1,60,220
To Salaries	7,550	By Gross Profit b/d	67,890
To Rent, Rates & Taxes	10,000	By Provision for Doubtful Debts	
To Carriage Outwards	1,200	Debts: Opening	525

To Distribution of Free Samples	1,000	Less: Closing	500	25
To Advertisement	2,000	By Discount Received		800
To Discount Allowed	425			
To Loss on sale of furniture (₹ 2,000 – ₹ 760)	1,240			
To Dep. on Plant & Machinery	7,800			
To Interest on capital	10,000			
To Net Profit (t/f to capital)	27,500			
	68,715			68,715

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital	1,00,000	Plant & Machinery	78,000
Less: Drawings of Goods	5,000	Less: Depreciation	7,800
Add: Interest on Capital	10,000	(10/100 × 18,000)	
Add: Net Profit	27,500	Furniture	2,000
Sundry Creditors	25,000	Add: Purchases	920
		Less: Loss on sale	1,240
		(₹ 2,000 – ₹ 760)	
		Closing Stock	34,220
		Sundry Debtors	45,000
		Less: Prov. for Doubtful Debts	500
		Cash in Hand	6,900
	1,57,500		1,57,500

PROBLEM 9

The following Trial Balance of Shri Om, as on 31st March, 2018. You are requested to prepare the Trading and Profit and Loss Account for the year ended 31st March, 2018 and a Balance Sheet as on that date after making the necessary adjustments:—

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Sundry Debtors/Creditors	5,00,000	2,00,000
Outstanding liability for Expenses	55,000	—
Wages	1,00,000	—
Carriage Outwards	1,10,000	—
Carriage Inwards	50,000	—
General Expenses	70,000	—
Cash Discounts	20,000	—
Bad Debts	10,000	—
Motor Car	2,40,000	—
Printing and Stationery	15,000	—
Furniture and Fittings	1,10,000	—
Advertisement	85,000	—

Insurance	45,000	—
Salesman's commission	87,500	—
Postage and Telephone	57,500	—
Salaries	1,60,000	—
Rates and Taxes	25,000	—
Capital Account/Drawings	20,000	14,43,000
Purchases/Sales	15,50,000	19,87,500
Opening Stock	2,50,000	—
Cash at Bank	60,000	—
Cash in Hand	10,500	—
	36,30,500	36,30,500

The following adjustments are to be made:

- Closing Stock was valued at ₹ 7,25,000.
- A Provision for Doubtful Debts are to be created to the extent of 5 percent on Sundry Debtors.
- Depreciate—Furniture and Fittings by 10%, Motor Car by 20%.
- Shri Om had withdrawn goods worth ₹ 25,000 during the year.
- On 31st March, Goods for ₹ 75,000 were sent to a customer on 'Sale or Return' basis at a profit of 50% on cost and recorded as actual sales.
- The Salesmen was entitled to a Commission of 5% on total sales.
- Debtors include ₹ 25,000 bad debts.
- Printing and Stationery expenses of ₹ 55,000 relating to previous year had not been provided in that year but was paid in this year by debiting outstanding **Liabilities**.
- Purchases include purchases of Furniture worth ₹ 50,000.

SOLUTION

TRADING AND PROFIT & LOSS ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

Particulars	₹	Particulars	₹
To Opening Stock	2,50,000	By Sales	19,87,500
To Purchases	15,50,000	Less: Goods sent	
Less: Drawings	25,000	out for approval	75,000
Less: Furniture	50,000		19,12,500
	14,75,000	By Closing Stock	7,25,000
To Wages	1,00,000	Add: Cost of Stock	
To Capital Inwards	50,000	out on approval	50,000
To Gross Profit c/d	8,12,500		7,75,000
	26,87,500		26,87,500
To Salaries	1,60,000	By Gross Profit b/d	8,12,500
To Rates & Taxes	25,000		
To Postage & Telephone	57,500		
To Insurance	45,000		
To Printing & Stationery	15,000		
To General Expenses	70,000		

To Depreciation:			
Furniture ($10/100 \times 1,60,000$)	16,000		
Motor Car ($20/100 \times 2,40,000$)	48,000		
To Salesmen's Commission 87,500			
Add: Outstanding <u>8,125</u>	95,625		
($5/100 \times 19,12,500$)			
To Advertisement	85,000		
To Carriage Outwards	1,10,000		
To Provision for Doubtful Debts	20,000		
($5/10 \times ₹ 4,00,000$)			
To Cash Discount	20,000		
To Bad Debts ($₹ 10,000 + ₹ 25,000$)	35,000		
To Net Profit t/f to Capital A/c)	10,375		
	8,12,500		8,12,500

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities		₹	Assets		₹
Capital	14,43,000		Furniture & Fittings	1,10,000	
Less: Drawings of Cash	20,000		Add: Purchased	50,000	
Less: Drawings of Goods	25,000		Less: Depreciation	<u>16,000</u>	1,44,000
Less: Printing & Stationery			Motor Car	2,40,000	
(expenses of previous year)	55,000		Less: Depreciation	<u>48,000</u>	1,92,000
Add: Net profit	<u>10,375</u>	15,53,375	Stock	7,25,000	
Sundry Creditors		2,00,000	Add: Stock on approval	<u>50,000</u>	7,75,000
Outstanding Commission			Sundry Debtors	5,00,000	
to Salesmen		8,125	Less: Goods sent		
			on Approval	75,000	
			Less: Add: Bad Debts	<u>25,000</u>	
				4,00,000	
			Less: Provision for	<u>20,000</u>	3,80,000
			($5/100 \times 4,00,000$)		
			Cash at bank		60,000
			Cash in Hand		10,500
		15,61,500			15,61,500

PROBLEM 10

Following are the extracts from the Trial Balance of Mr. Bharat Tulsian as at 31st March, 2018:

Particulars	₹	Particulars	₹
Purchases	5,70,000	Sales	7,77,500
Wages and Salaries	23,500	Capital	4,93,400
Freight Inward	25,000	Provision for Doubtful Debts	10,000
		(01.04.2017)	

Bad Debts [after recovery of bad debts of ₹ 2,500 w/o during 2016-2017]	500	Provision for Discount on Debtors (01.04.2017)	1,800
12% Investments	1,00,000	Trade Creditors	10,000
Trade Debtors	2,92,500	Interest on Investments	6,000
Salaries and Wages	11,200	Plant and Machinery	2,02,000
Salesmen's Commission	20,000	Furniture and Fixtures	30,000
Discount Allowed	2,000	Income Tax paid	10,000
Fire Insurance Premium	9,000	Prepaid Fire Insurance Premium	3,000

Additional Information:

1. Stock in hand on 31st March was ₹ 2,30,000. Market Value on 31st March 80%, Estimated Realisable Expenses 5%
2. Write off further ₹ 4,000 as bad. Additional discount of ₹ 1,000 given to debtors. Maintain Provision for Discount on Debtors @ 2%. Maintain a Provision for Doubtful debts @ 10%.
3. Goods costing ₹ 20,000 (Sale Price ₹ 25,000) were taken by the proprietor for his personal use but not recorded .
4. Goods costing ₹ 30,000 (Sale Price ₹ 37,500) were given away as free samples to Mahesh, a customer recorded in the sales book
5. On 31st March Goods costing ₹ 10,000 (Sale Price ₹ 12,500) were destroyed by fire it was fully insured but the insurance company admitted the claim to the extent of 60% only and paid the claim money on 10th April, 2018.
6. On 31st March, Goods for ₹ 50,000 were sent to a customer on 'Sale or Return' basis at a profit of 25% on cost and recorded as actual sales.
7. A Machine costing ₹ 1,90,000 was purchased on 1st July 2017. Wages ₹10,000 paid for its Installation have been debited to Wages Account.
8. On 1.4.2017 Machinery of the value of ₹ 10,000 was destroyed by fire and the insurance claim settled at ₹ 8,000 was credited to Machinery Account.
9. A Furniture costing ₹ 45,000 was purchased on 1st July 2017 but it was not recorded in the books as no payment was made for it. Wages ₹ 5,000 paid for its Installation have been debited to Wages Account.
10. On 1st Jan. 2018 Investments were sold at 10% profit, but the entire sales proceeds have been taken as Sales.
11. Provide for depreciation on Plant & Machinery @ 10% p.a. on straight line basis. Write 10% off the Furniture & Fixtures. .

Required: Prepare Trading & P & L A/c for the year ended 31st March, 2018 and Balance Sheet as on that date.

SOLUTION**TRADING AND PROFIT AND LOSS ACCOUNT**

Dr. *for the year ended 31st March, 2018* Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Purchases 5,70,000		By Sales 7,77,500	
Less: Goods for personal use 20,000		Less: Goods sent on approval 50,000	
Less: Free Samples 30,000		Less: Sale of Investments 1,10,000	
Less: Goods destroyed by fire 10,000	5,10,000	Less: Free Samples 37,500	5,80,000

To Wages & Salaries	23,500		By Closing Stock [Refer to WN 1]	2,05,200
Less: Installation of Machine	10,000			
Less: Installation of Furnitures	5,000	8,500		
To Freight Inward		25,000		
To Gross Profit c/d		2,41,700		
		7,85,200		7,85,200
To Salaries & Wages		11,200	By Gross Profit b/d	2,41,700
To Fire Insurance Premium		9,000	By Bad Debt recovered	2,500
To Sales Promotion Exp (Samples)		30,000	By Profit on Sale of Investments	10,000
To Loss of Stock by fire		4,000	By Interest on Investments	
To Loss of Machine by fire		2,000	Received	6,000
To Bad Debts [2,500 + 500]	3,000		Add: Accrued	<u>3,000</u>
Add: Further Bad Debts	4,000			9,000
Add: New Provision	20,000			
Less: Old Provision	<u>10,000</u>	17,000		
To Discount Allowed	2,000			
Add: Further Discount Allowed	1,000			
Add: New Provision	3,600			
Less: Old Provision	<u>1,800</u>	4,800		
To Depreciation on Machinery		16,000		
[Refer WN 3]				
To Depreciation on Furniture		8,000		
[₹ 80,000 × 10/100 × 12/12]				
To Salesmen's Commission		20,000		
To Net Profit t/f to Capital A/c		1,41,200		
		2,63,200		2,63,200

BALANCE SHEET OF BHARAT TULSIAN AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital Account:		Fixed Assets:	
Opening balance	4,93,400	Plant and Machinery [Refer WN 4]	1,94,000
Less: Goods for personal use (20,000)		Furniture & Fixtures (OB)	30,000
Less: Income Tax (10,000)		Add: Purchased	45,000
Add: Net Profit	<u>1,41,200</u>	Add: Installation charges	5,000
	6,04,600	Less: Depreciation	<u>8,000</u>
Current Liabilities:			72,000
Supplier of Furniture	45,000	Current Assets:	
Trade Creditors	10,000	Closing Stock [Refer to WN 1]	2,05,200
		Trade Debtors	2,92,500
		Less: Samples	37,500
		Less: Good sent on approval	50,000
		Less: Further Bad debts	4,000

		Less: Further Discount Allowed	1,000	
			2,00,000	
		Less: Provision for Doubtful Debts @ 10%	20,000	
			1,80,000	
		Less: Provision for Discount @ 2%	3,600	1,76,400
		Insurance Company (claim)		6,000
		Accrued Interest on Investments		3,000
		Prepaid Fire Insurance Premium		3,000
	6,59,600			6,59,600

Working Notes:

1. Calculation of Closing Stock

A.	Stock in hand as on 31st March	₹ 2,30,000
B.	Add: Cost of Stock with customer [₹ 50,000 × 80%]	₹ 40,000
C.	Total Stock as on 31st March [A+B]	₹ 2,70,000
D.	Market Value [₹ 2,70,000 × 80%]	₹ 2,16,000
E.	Realisable Expenses [₹ 2,16,000 × 5%]	₹ 10,800
F.	Net Realisable Value	₹ 2,05,200

2. Book Value of Machinery on 1.4.2017 = ₹ 2,02,000 - ₹ 1,90,000 + ₹ 8,000(Claim) = ₹ 20,000

3. Calculation of Depreciation

Old Machine I	01.04.2017	10,000 × 10% × 12/12	1,000
New Machine I	01.07.2017	2,00,000 × 10% × 9/12	15,000
			16,000

DR**4. MACHINERY ACCOUNT****CR**

Date	Particulars	₹	Date	Particulars	₹
01.04.2017	To Balance b/d [Refer WN 1]	20,000	01.04.2017	By Bank A/c	8,000
01.07.2017	To Bank A/c	1,90,000	01.04.2017	By P & L A/c (Loss)	2,000
01.07.2017	To Wages A/c	10,000	31.03.2018	By Depreciation A/c [Refer WN 3]	16,000
				By Balance c/d	1,94,000
		2,20,000			2,20,000

5. Depreciation on furniture has been charged for the full year because a flat rate of 10% (and not 10% p.a.) has been given, whereas depreciation on new machinery has been charged for 9 months from 1st July to 31st Mar.

PROBLEM 11

Following are the balances from the Trial Balance of Mr. Tushar Tulsian as at 31st March, 2018:

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Purchases	5,70,000	Sales	7,77,500
Wages and Salaries	23,500	Capital	7,98,100
12% Investments (purchased on 01.07.2018)	1,00,000	Provision for Doubtful Debts (01.04.2017)	10,000
Bad Debts [after recovery of bad debts of ₹ 2,500 w/o during 2016-2017]	500	Provision for Discount on Debtors (01.04.2017)	1,800
Freight Inward	25,000	Trade Creditors	10,000
Trade Debtors	2,56,000	Interest on Investments	6,000
Salaries and Wages	11,200	Plant and Machinery	4,88,200
Salesmen's Commission	20,000	Furniture and Fixtures	30,000
Discount Allowed	2,000	Income Tax paid	10,000
Fire Insurance Premium	9,000	Prepaid Fire Insurance Premium	3,000
Outstanding Liabilities for Expenses (Dr.)	55,000		

Additional Information:

1. Stock in hand was not taken on 31st March but only on 7th April. Following transactions had taken place during the period from 1st April to 7th April.
Sales ₹ 2,50,000, Purchases 1,50,000, Stock on 7th April, was ₹ 1,80,000 and the rate of gross profit on sales was 20%. Market Value on 31st March 80%, Estimated Realisable Expenses 5%
2. Write off further ₹ 4,000 as bad. Additional discount of ₹ 1,000 given to debtors. Maintain Provision for Discount on Debtors @ 2%. Maintain a Provision for Doubtful Debts @ 10%. Included amongst the Debtors is ₹ 3,000 due from Z and included among the Creditors ₹ 1,000 due to him.
3. On 31st March, Goods for ₹ 50,000 were sent to a customer on 'Sale or Return' basis at a profit of 25% on cost and recorded as actual sales.
4. It was discovered during 2017-2018 that ₹ 25,000 being repairs to Machinery incurred on 1st July, 2015 had been capitalized and ₹ 45,000 being the cost of Machinery purchased on 1st Oct, 2014 had been written off to Stores and Wages ₹ 5,000 paid for its Installation had been debited to Wages Account.
5. A Machine costing ₹ 1,90,000 was purchased on 1st July 2017. Wages ₹ 10,000 paid for its Installation have been debited to Wages Account.
6. On 1st July, 2017, an old Furniture having a book value of ₹ 2,000 on 1st April, 2017 was disposed off for ₹ 760 in exchange of new furniture costing ₹ 1,680. The net invoice of ₹ 920 was passed through Purchase Book.
7. The Salesmen were entitled to a Commission of 5% on total sales.
8. Printing and Stationery expenses of ₹ 55,000 relating to previous year had not been provided in that year but was paid in current year by debiting Outstanding Liabilities for Expenses.
9. Provide for depreciation on Plant & Machinery @ 20% p.a. on reducing balances basis. Write 10% off the Furniture & Fixtures. No depreciation need be provided on Furniture disposed off during the year.

Required: Prepare Trading and Profit and Loss Account for the year ended 31st March, 2018 and a Balance Sheet as on that date

SOLUTION**TRADING AND PROFIT AND LOSS ACCOUNT**

Dr.

for the year ended 31st March, 2018

Cr.

Particulars	₹	Particulars	₹
To Purchases 5,70,000		By Sales 7,77,500	
Less: Furniture wrongly debited <u>920</u>	5,69,080	Less: Goods sent on approval <u>50,000</u>	7,27,500
To Wages & Salaries 23,500		By Closing Stock [Refer to WN 1]	2,05,200
Less: Installation of Machine <u>10,000</u>	13,500		
To Freight Inward	25,000		
To Gross Profit c/d	3,25,120		
	<u>9,32,700</u>		<u>9,32,700</u>
To Salaries & Wages 11,200		By Gross Profit b/d	3,25,120
To Fire Insurance Premium 9,000		By Bad Debt recovered	2,500
To Loss on sale of furniture (₹ 2,000 – ₹ 760) 1,240		By Interest on Investments Received 6,000	
To Bad Debts [2,500 + 500] 3,000		Add: Accrued <u>3,000</u>	9,000
Add: Further Bad Debts 4,000			
Add: New Provision 20,000			
Less: Old Provision <u>10,000</u>	17,000		
To Discount Allowed 2,000			
Add: Further Discount Allowed 1,000			
Add: New Provision 3,600			
Less: Old Provision <u>1,800</u>	4,800		
To Depreciation on Machinery [Refer WN 6] 92,000			
To Depreciation on Furniture [₹ 29,680 × 10/100 × 12/12] 2,968			
To Salesman's Commission 20,000			
Add: O/s <u>16,375</u>	36,375		
To Net Profit t/f to Capital A/c <u>1,62,037</u>	1,62,037		
	<u>3,36,620</u>		<u>3,36,620</u>

BALANCE SHEET OF TUSHAR TULSIAN AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital Account:		Fixed Assets:	
Opening balance 7,98,100		Plant and Machinery [Refer WN 7] 4,18,000	
Less: Income Tax (10,000)		Furniture & Fixtures (OB) 30,000	
Less: O/s Liabilities for Exp (55,000)		Add: Purchased 920	
Add: Prior Period Item 28,800		Less: Loss on sale	
Less: Prior Period Item (17,000)		(₹ 2,000 – ₹ 760) 1,240	
Add: Net Profit <u>1,62,037</u>	9,06,937	Less: Depreciation <u>2,968</u>	26,712
		12% Investments 1,00,000	

Current Liabilities:		Current Assets:	
O/s Salesmen's Commission	16,375	Closing Stock [Refer to WN 1]	2,05,200
Trade Creditors	10,000	Trade Debtors	2,56,000
Less: Due to Z	<u>(1,000)</u>	Less: Due to Z	1,000
		Less: Good sent on approval basis	50,000
		Less: Further Bad debts	4,000
		Less: Further Discount Allowed	<u>1,000</u>
			2,00,000
		Less: Provision for doubtful debts @ 10%	<u>20,000</u>
			1,80,000
		Less: Provision for discount @ 2%	<u>3,600</u>
			1,76,400
		Accrued Interest on Investments	3,000
		Prepaid Fire Insurance Premium	3,000
	9,32,312		9,32,312

Working Notes:
1. Calculation of Closing Stock

A.	Stock as on 7th April	₹ 1,80,000
B.	Add: Cost of Goods sold (80% of ₹ 2,50,000)	₹ 2,00,000
C.	Less: Cost of Purchases	₹ 1,50,000
D.	Stock in hand as on 31st March	₹ 2,30,000
E.	Add: Cost of Stock with Customer [₹ 50,000 × 80%]	₹ 40,000
F.	Total Stock as on 31st March [A+B]	₹ 2,70,000
G.	Market Value [₹ 2,70,000 × 80%]	₹ 2,16,000
H.	Realisable Expenses [₹ 2,16,000 × 5%]	₹ 10,800
I.	Net Realisable Value	₹ 2,05,200

2. Book Value of Machinery on 1.4.2017 (before rectification)

$$= ₹ 4,88,200 - ₹ 1,90,000 = ₹ 2,98,200$$

3. Book Value of repairs to Machinery wrongly capitalized as at 1.4.2017

$$= ₹ 25,000 \times 85\% \times 80\% = ₹ 17,000$$

4. Book Value of Machinery wrongly w/o to Stores as at 1.4.2017

$$= ₹ 50,000 \times 90\% \times 80\% \times 80\% = ₹ 28,800$$

5. Balance of Machinery Account(after rectification) as at 1.4.2017

$$= ₹ 2,98,200 - ₹ 17,000 + ₹ 28,800 = ₹ 3,10,000$$

6. Calculation of Depreciation

Old Machines	01.04.2017	$3,10,000 \times 20\% \times 12/12$	62,000
New Machine I	01.07.2017	$2,00,000 \times 20\% \times 9/12$	30,000
			92,000

DR**7. MACHINERY ACCOUNT****CR**

Date	Particulars	₹	Date	Particulars	₹
01.04.2017	To Balance b/d [Refer WN 1]	2,98,200	01.04.2017	By P & L A/c (Error)	17,000
01.04.2017	To P & L A/c (error) [Refer WN 2]	28,800	31.03.2018	By Depreciation A/c [Refer WN 3]	92,000
01.07.2017	To Bank A/c	1,90,000		By Balance c/d	4,18,000
01.07.2017	To Wages A/c	10,000			
		5,27,000			5,27,000

8. Depreciation on new furniture has been charged for the full year because a flat rate of 10% (and not 10% p.a.) has been given, whereas depreciation on new machinery has been charged for 9 months from 1st July to 31st Mar.

REVIEW QUESTION

Following are the balances from the Trial Balance of Mr. Tushar Tulsian as at 31st March, 2018:

Particulars	₹	Particulars	₹
Purchases	5,70,000	Sales	7,77,500
Wages and Salaries	23,500	Capital	6,21,400
Freight Inward	25,000	Provision for Doubtful Debts (01.04.2017)	10,000
Bad Debts [after recovery of bad debts of ₹ 2,500 w/o during 2016-2017]	500	Provision for Discount on Debtors (01.04.2017)	1,800
12% Investments	1,00,000	Trade Creditors	10,000
Trade Debtors	3,05,500	Interest on Investments	6,000
Salaries and Wages	11,200	Plant and Machinery	2,02,000
Salesmen's Commission	20,000	Furniture and Fixtures	30,000
Discount Allowed	2,000	Income Tax paid	10,000
Fire Insurance Premium	9,000	Prepaid Fire Insurance Premium	3,000
Outstanding Liabilities for Expenses (Dr.)	55,000	Building	60,000

Additional Information:

1. Stock in hand was not taken on 31st March but only on 7th April. Following transactions had taken place during the period from 1st April to 7th April. Sales ₹ 2,50,000, Purchases 1,50,000, Stock on 7th April, was ₹ 1,80,000 and the rate of gross profit on sales was 20%. Market Value on 31st March 80%, Estimated Realisable Expenses 5%
2. Write off further ₹ 4,000 as bad. Additional discount of ₹ 1,000 given to debtors. Maintain Provision for discount on Debtors @ 2%. Maintain a Provision for Doubtful debts @ 10%. Debtors also include Shyam for dishonoured bill of ₹ 10,000. Half the amount of Shyam's bills is irrecoverable. Remuneration of ₹ 2,000 paid to Sh. B. Barua, a temporary employee, stands debited to his personal account. Included amongst the Debtors is ₹ 3,000 due from Z and included among the Creditors ₹ 1,000 due to him.
3. Goods costing ₹ 20,000 (Sale Price ₹ 25,000) were taken by the proprietor for his personal use but not recorded.

4. Goods costing ₹ 30,000 (Sale Price ₹ 37,500) were given away as free samples to Mahesh, a customer recorded in the sales book.
5. On 31st March Goods costing ₹ 10,000 (Sale Price ₹ 12,500) were destroyed by fire it was fully insured but the insurance company admitted the claim to the extent of 60% only and paid the claim money on 10th April, 2018.
6. On 31st March, Goods for ₹ 50,000 were sent to a customer on 'Sale or Return' basis at a profit of 25% on cost and recorded as actual sales.
7. A Machine costing ₹ 1,90,000 was purchased on 1st July 2017. Wages ₹10,000 paid for its Installation have been debited to Wages Account.
8. On 1.4.2017 Machinery of the value of ₹ 10,000 was destroyed by fire and the insurance claim settled at ₹ 8,000 was credited to Machinery Account.
9. A Furniture costing ₹ 45,000 was purchased on 1st July 2017 but it was not recorded in the books as no payment was made of it. Wages ₹ 5,000 paid for its Installation have been debited to Wages Account.
10. On 1st Jan. 2018 Investments were sold at 10% profit, but the entire sales proceeds have been taken as Sales
11. The Salesmen were entitled to a Commission of 5% on total sales.
12. Machinery costing ₹ 45,000 purchased on 1.10.2017 was shown as Purchases. Freight paid on the Machinery was ₹ 5,000, which is included in Freight on Purchases.
13. Machinery costing ₹ 35,000 purchased on 1st April 2015 was wrongly written off against Profit and Loss Account.
14. Wages include a sum of ₹ 4,000 spent on the erection of a cycle shed for employees and customers.
15. Provide for depreciation on Plant & Machinery @ 10% p.a. on straight line basis. Write 10% off the Furniture & Fixtures. Depreciate Buildings by 5%
16. Printing and Stationery expenses of ₹ 55,000 relating to previous year had not been provided in that year but was paid in current year by debiting Outstanding **Liabilities** for Expenses.

Required: Prepare Trading and Profit and Loss Account for the year ended 31st March, 2018 and a Balance Sheet as on that date

[ANS.GP ₹ 2,95,700 ,NP ₹ 1,70,000,TOTAL of B/S ₹ 7,97,400]

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ACCOUNTING FOR PARTNERSHIP FIRMS — FUNDAMENTALS

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of Partnership
- ◇ Essential Elements of Partnership
- ◇ Nature of Partnership
- ◇ Meaning of Partners, Firm and Firm Name
- ◇ Maximum Limit of Partners
- ◇ Partnership Deed
- ◇ Provisions Affecting Accounting Treatment
- ◇ Some other Important Provisions of the Act
- ◇ Two Methods of Maintaining Capital Accounts of Partners
- ◇ Interest of Drawings
- ◇ Calculation of Interest on Capital
- ◇ Accounting Treatment of Interest on Capital
- ◇ Interest on Partner's Loan to the Firm
- ◇ Salary or Commission to a Partner
- ◇ Division of Profit Among Partners
- ◇ Past Adjustments
- ◇ Goodwill

1.0 MEANING OF PARTNERSHIP

According to Sec. 4 of the Indian Partnership Act, 1932, the term '*Partnership*' is "*the relation between two or more persons who have agreed to share the profits of a business carried on by all or any of them acting for all.*"

2.0 ESSENTIAL ELEMENTS OF PARTNERSHIP

The essential elements of partnership are as follows:—

AT LEAST TWO PERSONS

There must be at least two persons to form a partnership and all such persons must be competent to contract. According to Section 11 of the Indian Contract Act, 1872, every person except the following, is competent to contract:

- (i) Minor
- (ii) Persons of unsound mind (e.g. lunatics, idiots), and
- (iii) Persons disqualified by any law to which they are subject (e.g., alien enemies, insolvents).

EXAMPLE 1

Two brothers X (age 18 years), Y (age 17 years), decide to form a partnership with a provision that Y will share the profits only. Can they do so?

SOLUTION

Decision: They can not do so.

Reason: There must be at least two persons and such persons must be competent to contract. In the given case, Y is not competent to contract because he is a minor. Hence, there is only one person X who alone cannot form a partnership.

EXAMPLE 2

Three brothers, X (age 19 years), Y (age 18 years) and Z (age 17 years), decide to form a partnership with a provision that Z will share the profits only. Can they do so?

SOLUTION

Decision: They can not do so.

Reason: All the persons entering into partnership agreement must be competent to contract. Z is not competent to contract because he is a minor. It may be noted that no partnership can be formed with a minor partner. But after the formation of partnership, a minor can be admitted to the benefits of partnership with the consent of all other partners of the firm as per the provisions of Section 30 of the Act.

AGREEMENT

There must be an Agreement to form a Partnership. This agreement may be express (whether written or oral) or implied. This essential element is further clarified under Section 5. Section 5 provides that the relation of partnership arises from contract and not from status. **For Example**, a Hindu undivided family carrying on a family business is not considered a partnership. The reason is that the coparceners (i.e. Members) of a Hindu undivided family acquire interest in the business because of their status (i.e., birth) in the family and not because of any agreement between them. Thus, partnership is voluntary and contractual in nature.

BUSINESS

There must exist a business. According to Section 2(b), the term 'Business' includes every trade, occupation and profession. **For Example**, an association created for charitable, religious or social purpose cannot be regarded as partnership because there does not exist any business. It may also be noted that an agreement to carry on business at a future time does not result in partnership unless that time arrives and the business is started.

SHARING OF PROFITS

There must be sharing of profits. An agreement to share profits does not necessarily mean an agreement to share losses. **For Example**, in case of Partner in profits only and minor there is only an agreement to share profits. Thus, sharing of losses is not an essential element of partnership. It may also be noted that sharing of profits is a *prima facie* evidence and not a conclusive evidence of partnership. That is why, everyone who shares the profits of business need not necessarily be a partner. **For Example**, a manager who receives a particular share in the profits of a business as part of his remuneration, is simply an employee and not a partner.

MUTUAL AGENCY

There must exist a mutual agency relationship among the partners. 'Mutual Agency' relationship means that each partner is both an agent and a principal. Each partner is an agent in the sense that

he has the capacity to bind other partners by his acts done. Each partner is a principal in the sense that he is bound by the acts of other partners. Such mutual agency relationship in case of a firm of X, Y and Z has been shown on below:

MUTUAL AGENCY RELATIONSHIP IN CASE OF A FIRM OF X, Y AND Z			
	When X does an act	When Y does an act	When Z does an act
Who is an Agent	X	Y	Z
Who are Principals	Y and Z	X and Z	X and Y

The mutual relationship of agency is emphasised in Section 18 of the Indian Partnership Act, which reads as under:

“Subject to the provision of this Act, a partner is the agent of the firm for the business of the firm.”

Moreover, the use of the words carried as all or by any of them acting for all, in Section 4 of the Act clearly emphasizes agency relationship.

Because of the existence of mutual agency relationship amongst the partners, the law of partnership is also regarded as an extension of the general law of agency. It may be noted that the mutual agency relationship is the true test of partnership and it distinguishes a partnership from simple agreement for sharing profits and co-ownership. **For Example**, an Agreement between X and Y to share the Rental Income of a Joint Property owned by X and Y, can not be regarded as partnership because of absence of mutual agency between X and Y.

3.0 NATURE OF PARTNERSHIP

A partnership firm has no separate legal entity apart from the partners constituting it.

Thus, a firm itself cannot enter into a contract for partnership though its partners can. **For Example**, two firms, namely, M/s A&B and M/s X & Y, themselves cannot form a new partnership though the partners of the individual firms can form a partnership.

4.0 MEANING OF ‘PARTNERS’, ‘FIRM’ AND ‘FIRM NAME’

Partners	Persons who have entered into partnership with one another are individually called partners.
Firm	Persons who have entered into partnership with one another are collectively called a firm.
Firm Name	The name under which business is carried on is called firm name.
Maximum Limit of Partners	As per Rule 10 of The Companies (Miscellaneous) 201– 50 for any Business

5.0 PARTNERSHIP DEED

Meaning	'Partnership Deed' is a written document which contains the terms and conditions of partnership agreed upon by all the partners.
Importance	1.It is important to have Partnership Deed in writing to settle any possible dispute with regard to the terms of partnership 2.It serves as an evidence in the Courts of Law.
Signature	Partnership Deed must be signed by all the partners.
Stamping	Partnership Deed must be duly stamped as per Indian Stamp Act, 1889.
Is it essential to have a partnership deed?	No. It is not essential to have a partnership deed. In this case the relevant provisions of the Indian Partnership Act, 1932, would be applicable.
It is essential to have the partnership agreement in writing?	No since an agreement to form a partnership may be implied or express (oral or written).
Need for Partnership Deed	1. To Settle the dispute and misunderstanding with regard to the terms and conditions of partnership 2. To regulate the Rights, Duties and Liabilities of each Partner.
Contents	1. Name of the firm; 2. Names and addresses of all partners; 3. Nature and place(s) of the business; 4. Duration of Partnership 5. Date of commencement of partnership; 6. Amount of capital contributed or to be contributed by each partner; 7. Ratio in which profits and losses are to be shared; 8. Interest on partners' capitals and drawings; 9. Interest on loan by a partner to the firm; 10. Salary, commission etc., if any, payable to a partner; 11. Method of computation and treatment of goodwill on the reconstitution of a firm; 12. Mode of settlement of accounts in case of retirement/death of a partner; 13. Mode of settlement of accounts in case of dissolution of a firm.
Terms of Partnership	Terms of Partnership may be changed by consent of all partners.

6.0 PROVISIONS AFFECTING ACCOUNTING TREATMENT

Where there is *neither* partnership deed *nor* express agreement or partnership deed is there but it is silent on any matter, then the relevant provisions of The Indian Partnership Act, 1932, would be applicable. Some of the provisions of the Act which have a direct bearing on the accounting treatment of the following items are as follows:

1. Salary/Commission to a partner	No remuneration for taking part in the conduct of business is to be allowed to any partner. [Sec 13 (a)]
2. Sharing of Profits & Losses	Profits & Losses are to be shared equally . [Sec 13(b)]
3. Interest on Capital	No Interest is to be allowed on Capital. [Sec 13(c)] If the agreement provides for interest on capital, such interest is payable only out of available profits.

4. Interest on Advances/Loans by a partner	Interest @ 6% p.a. is to be allowed on Advances/Loans. [Sec 13(d)]. Such interest is payable even if there are losses.
5. Interest on Drawings	No Interest is to be charged on Drawings.

7.0 SOME OTHER IMPORTANT PROVISIONS OF THE ACT

Registration	Registration of Firm is optional but not compulsory (Sec. 69)
Time of Registration	Registration of firm can be effected on <i>or</i> after the formation.
Suit by / against	No suit can be filed by unregistered firm <i>or</i> by its partners but third party can file suit against the unregistered firm <i>or</i> its partners.
Minor's Admission	A minor may be admitted to benefits of partnership with the consent of all partners (Sec. 30).
Admission of Partner	A person may be admitted as partner either with the consent of all partners <i>or</i> in accordance with express agreement among partners (Sec. 31)
Retirement of Partner	A partner may retire from firm either with the consent of all partners <i>or</i> in accordance with express agreement among partners (Sec. 32)
Dissolution of Firm	Unless otherwise agreed by partners, a firm may dissolve on the death of partner (Sec. 35)
Nature of Liability	Liability of partners is a joint and several (i.e. Unlimited Liability). Unlimited Liability of a partner means that Partners are liable for firm's debts jointly with other partners and also individually in their own capacity. Net Private Assets of a Partner (i.e. Private Assets – Private Debts) can be used to pay off Firm's Debts in case Firm's Assets are less than Firm's Debts.
Right to take part	Every partner has a right to take part in the conduct of the business. [Sec. 12]
Duty to Pay Personal Profit earned by a Partner	Every partner must pay to the firm the personal profits earned by him from any transaction of the firm <i>or</i> from the use of firm's property <i>or</i> from competing business. [Sec. 16]
Duty to bear Personal Loss	Every partner must bear the personal loss incurred by him from the use of firm's property.
Implied Authority	Every partner of a trading firm has an implied authority to purchase and sell the Goods but not an Immovable Property.

ILLUSTRATION 1

X and Y are partners They do not have any partnership agreement (partnership deed). What should be done in the following cases:

- X spends twice the time that Y devotes to business. X claims that he should get a salary of ₹ 6,000 per month for his extra time spent.
- Y has provided a capital of ₹ 50,000 whereas X has provided ₹ 5,000 only as capital. X however has provided ₹ 10,000 as loan to the firm. What interest (if any) will be given to X and Y?
- X wants to introduce his son Z into his business. Y objects to it.
- Y wants that profit should be distributed in the ratio of capitals but X wants that it should be distributed equally.

SOLUTION

- X is not entitled to any salary
- No interest on capital is allowed. X is entitled to claim an interest on his loan of ₹ 10,000 @ 6% p.a.
- X's son cannot be admitted as a partner if Y objects to it.
- Profits are to be distributed equally.

8.0 TWO METHODS OF MAINTAINING CAPITAL ACCOUNTS OF PARTNERS

The partners' Capital Accounts may be maintained according to Fluctuating Capital method or Fixed Capital method.

FLUCTUATING CAPITAL METHOD

- Under Fluctuating Capital method, **only one account** (viz. Capital Account) for each partner is **maintained**.
- All the transactions relating to a partner are recorded in his Capital Account.
- As a result, the balance in the Capital Account keeps on fluctuating.
- A Format of Capital Account under Fluctuating Capital Method is given below:

Dr. **PARTNER'S CAPITAL ACCOUNT UNDER FLUCTUATING CAPITAL METHOD** Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
*To Balance b/f	xxx	*By Balance b/f	xxx
To Cash/Bank A/c		By Cash/Bank A/c	xxx
[withdrawal of capital]	xxx	(Additional Capital)	
To Drawings	xxx	By Interest on Capital	xxx
To Interest on Drawings	xxx	By Salary	xxx
**To Profit & Loss A/c		By Commission	xxx
(Share of Loss)	xxx	**By P & L Appropriation A/c	xxx
***To Balance c/f	xxx	(Share of Profit)	
		***By Balance c/f	xxx
	xxx		xxx

*Only one figure will appear at a time.

**Only one figure will appear at a time.

***Only one figure will appear at a time.

FIXED CAPITAL METHOD

- Under Fixed Capital method, **two accounts** (viz. Capital Account and Current Account) for each partner are **maintained**.
- The transactions relating to introduction or withdrawal of Capital are recorded in Capital account.
- Other transactions like Interest on Capital, Drawings, Salary, Commission, Share of Profit/loss are recorded in Current Account.
- As a result of these, the Capital Account will continue to show the same balance from year to year unless some amount of Capital is introduced or withdrawn.
- The balance of Current Account keeps on fluctuating.

6. Inspite of regular and consistent losses year after year, the Fixed Capital Account does not show a debit balance since all transactions relating to Interest on Capital, Drawings, Salary, Commission, Share of Profit/loss are recorded in Current Account and not in Capital Account.
7. The formats of Capital Account and Current Account under Fixed Capital Method are given on next page:

Dr. **PARTNER'S CAPITAL ACCOUNT UNDER FIXED CAPITAL METHOD** Cr.

Particulars	₹	Particulars	₹
To Cash/Bank A/c		By Balance b/f	xxx
(Withdrawal of Capital)	xxx	By Cash/Bank A/c	xxx
To Balance c/f	xxx	(Additional Capital)	
	xxx		xxx

Dr. **PARTNER'S CURRENT ACCOUNT UNDER FIXED CAPITAL METHOD** Cr.

Particulars	₹	Particulars	₹
*To Balance b/f	xxx	*By Balance b/f	xxx
To Bank A/c (Drawings)	xxx	By Interest on Capital	xxx
To Interest on Drawings	xxx	By Salary	xxx
**To P&L A/c (Share of Loss)	xxx	By Commission	xxx
***To Balance c/f	xxx	**By P & L Appropriation A/c (Share or Profit)	xxx
	xxx	***By Balance c/f	xxx
	xxx		xxx

*Only one figure will appear at a time.

**Only one figure will appear at a time.

*** Only one figure will appear at a time.

DISTINCTION BETWEEN FIXED CAPITAL METHOD AND FLUCTUATING CAPITAL METHOD

Fixed Capital method and Fluctuating Capital method in partnership accounts can be distinguished as follows:

Basis of Distinction	Fixed Capital Method	Fluctuating Capital Method
1. Change in Capital	The capital normally remains unchanged except under special circumstances.	The capital fluctuates quite frequently from period to period.
2. No. of Accounts maintained	Two accounts are maintained for each partner viz. (a) Fixed Capital Account, (b) Current Account.	Only one account (viz., Capital Account) is maintained for each year.
3. Adjustments for drawings etc.	All adjustments for drawings, interest on drawings, interest on capital, salary, share of profit/loss are made in Current Account .	All adjustments for drawings, interest on capital, salary, share of profit/loss are made in Capital Account .
4. Can Capital Account show a negative balance?	Fixed Capital Account can never show a negative balance.	Fluctuating Capital Account can show a negative balance.

ILLUSTRATION 2

State where the following items shall appear in case the capitals are fixed.

(a) Interest on Capital	(b) Withdrawal of Capital
(c) Interest on Drawings	(d) Drawings
(e) Share of loss	(f) Salary to Partners
(g) Fresh Capital introduced	

SOLUTION

- (a) On Credit side of Partner's Current A/c
- (b) On Debit side of Partner's Capital A/c
- (c) On Debit side of Partner's Current A/c
- (d) On Debit side of Partner's Current A/c
- (e) On Debit side of Partner's Current A/c
- (f) On Credit side of Partner's Current A/c
- (g) On Credit side of Partner's Capital A/c

9.0 INTEREST ON DRAWINGS**MEANING OF DRAWINGS**

Drawings mean the amount withdrawn in cash or in kind for personal purposes. Drawings may be against profits or against capital.

DISTINCTION BETWEEN DRAWINGS AGAINST PROFITS AND DRAWINGS AGAINST CAPITAL

Drawings against Profits differ from drawings against Capital in the following respects:

Basis of Distinction	Drawings Against Profits	Drawings Against Capital
1. Part	It is part of profits .	It is part of Capital .
2. Whether considered for calculation of Interest on Capital	It is not considered to calculate interest on capital.	It is considered to calculate interest on capital.
3. Where debited?	It is debited in Drawings Account .	It is debited in Capital Account .
4. Whether reduces capital	It does not reduce capital.	It reduces Capital.
5. Popular Name	Drawings	Withdrawal of Capital

ACCOUNTING TREATMENT OF INTEREST ON DRAWINGS

When to charge	Interest on Drawings is to be charged from partners only when partnership agreement provides for the same.
Accounting Treatment	Interest on Drawings is a gain to the firm and hence is credited to Profit & Loss Appropriation Account. On the other hand, interest on drawings is a loss to the partner and hence is debited to his Capital Account (<i>in case of Fluctuating Capitals</i>) or Current Account (<i>in case of Fixed Capitals</i>).

JOURNAL ENTRIES	
(a) Adjusting Entry to charge Interest on Drawings	
Partner's Capital A/c (<i>In case of Fluctuating Capitals</i>)	Dr.
or	
Partner's Current A/c (<i>In case of Fixed Capitals</i>)	Dr.
To Interest on Drawings A/c	
(b) Closing Entry to close the Interest on Drawings Account	
Interest on Drawings A/c	Dr.
To Profit & Loss Appropriation A/c	

HOW CALCULATE INTEREST ON DRAWINGS

Interest on drawings is basically calculated with reference to the time period for which the money was withdrawn on the basis of Product Method. However, Short Cut Method may be used in case a Fixed Amount is withdrawn at uniform time-interval.

SHORT CUT METHOD

When a fixed amount is withdrawn at fixed dates, the interest on drawings may be calculated with the help of short cut formula as follows:

<i>If Fixed Amount is Withdrawn...</i>	<i>Interest on Drawings</i>
1. In the beginning of each month	$= \text{Total Drawings} \times \frac{\text{Rate of Interest}}{100} \times \frac{6\frac{1}{2}}{12}$
2. At the end of each month	$= \text{Total Drawings} \times \frac{\text{Rate of Interest}}{100} \times \frac{5\frac{1}{2}}{12}$
3. During the middle of each month	$= \text{Total Drawings} \times \frac{\text{Rate of Interest}}{100} \times \frac{6}{12}$
4. In the beginning of each quarter	$= \text{Total Drawings} \times \frac{\text{Rate of Interest}}{100} \times \frac{7\frac{1}{2}}{12}$
5. At the end of each quarter	$= \text{Total Drawings} \times \frac{\text{Rate of Interest}}{100} \times \frac{4\frac{1}{2}}{12}$
6. During the middle of each quarter	$= \text{Total Drawings} \times \frac{\text{Rate of Interest}}{100} \times \frac{6}{12}$

Note: The above formulae have been given on the assumption that Total Period of Drawings is 12 months. In case the Period of Drawings is less than 12 months, the above formulae will change accordingly.

* (Total Period + Time Interval)/2

** (Total Period – Time Interval)/2

PRODUCT METHOD

When an unequal amount is withdrawn at different dates, the interest on drawings is calculated with the help of Product Method as follows:

Step 1: Calculate the Period for which amount withdrawn has been used.

Step 2: Calculate the Product as follows:

$$\text{Product} = \text{Amount of Drawings} \times \text{Period of Use}$$

Step 3: Calculate the Total Product

Step 4: Calculate the Interest on Drawings as follows:

$$\text{If Period is expressed in a month} = \text{Total Product} \times \frac{\text{Rate of Interest}}{100} \times \frac{1}{12}$$

$$\text{If Period is expressed in a day} = \text{Total Product} \times \frac{\text{Rate of Interest}}{100} \times \frac{1}{365}$$

TUTORIAL NOTES

1. If the date of drawing is not given the interest on Total Drawings is calculated for 6 months.
2. Interest @ 10% without word 'per annum' means interest is to be calculated without any reference to time period.

ILLUSTRATION 3

Calculate the Interest on Drawings of Ram @ 10% p.a. for the year ended 31st Dec. 2018, if he withdrew ₹ 2,000 p.m. in the beginning of each month.

SOLUTION

$$\text{Interest on Drawings} = \text{Total Drawings} \times \frac{\text{Rate of Interest}}{100} \times \frac{6\frac{1}{2}}{12}$$

$$\text{Interest on Drawings} = ₹ 24,000 \times \frac{10}{100} \times \frac{6\frac{1}{2}}{12} = ₹ 1,300$$

ILLUSTRATION 4

Calculate the Interest on Drawings of Ram @ 10% p.a. for the year ended 31st Dec. 2018, if he withdrew ₹ 2,000 p.m. at the end of every month.

SOLUTION

$$\text{Interest on Drawings} = \text{Total Drawings} \times \frac{\text{Rate of Interest}}{100} \times \frac{5\frac{1}{2}}{12}$$

$$\text{Interest on Drawings} = ₹ 24,000 \times \frac{10}{100} \times \frac{5\frac{1}{2}}{12} = ₹ 1,100$$

ILLUSTRATION 5

Calculate the Interest on Drawings of Ram @ 10% p.a. for the year ended 31st Dec. 2018, if he withdrew ₹ 2,000 p.m. during the middle of each month.

SOLUTION

$$\text{Interest on Drawings} = \text{Total Drawings} \times \frac{\text{Rate of Interest}}{100} \times \frac{6}{12}$$

$$\text{Interest on Drawings} = ₹ 24,000 \times \frac{10}{100} \times \frac{6}{12} = ₹ 1,200$$

ILLUSTRATION 6

Calculate the Interest on Drawings of Ram @ 10% p.a. for the year ended 31st Dec. 2018, if he withdrew ₹ 6,000 in the beginning of each quarter.

SOLUTION

$$\text{Interest on Drawings} = \text{Total Drawings} \times \frac{\text{Rate of Interest}}{100} \times \frac{7.5}{12}$$

$$\text{Interest on Drawings} = ₹ 24,000 \times \frac{10}{100} \times \frac{7.5}{12} = ₹ 1,500$$

ILLUSTRATION 7

Calculate the Interest on Drawings of Ram @ 10% p.a. for the year ended 31st Dec. 2018, if he withdrew ₹ 6,000 at the end of each quarter.

SOLUTION

$$\text{Interest on Drawings} = \text{Total Drawings} \times \frac{\text{Rate of Interest}}{100} \times \frac{4.5}{12}$$

$$\text{Interest on Drawings} = ₹ 24,000 \times \frac{10}{100} \times \frac{4.5}{12} = ₹ 900$$

ILLUSTRATION 8

Calculate the Interest on Drawings of Ram @ 10% p.a. for the year ended 31st Dec. 2018, if he withdrew ₹ 6,000 per quarter.

SOLUTION

$$\text{Interest on Drawings} = \text{Total Drawings} \times \frac{\text{Rate of Interest}}{100} \times \frac{6}{12}$$

$$\text{Interest on Drawings} = ₹ 24,000 \times \frac{10}{100} \times \frac{6}{12} = ₹ 1,200$$

ILLUSTRATION 9

Calculate the Interest on Drawings of Ram @ 10% p.a. for the year ended 31st Dec. 2018, if his drawings during the year were ₹ 24,000.

SOLUTION

Assuming that the drawings were made evenly throughout the year, the interest on drawings has been calculated for an average period of 6 months.

$$\text{Interest on Drawings} = ₹ 24,000 \times \frac{10}{100} \times \frac{6}{12} = ₹ 1,200$$

ILLUSTRATION 10

Calculate the Interest on X's drawings @ 10% if he withdrew ₹ 24,000 during the year.

SOLUTION

$$\text{Interest on Drawings} = ₹ 24,000 \times \frac{10}{100} = ₹ 2,400$$

Note: Interest has been calculated for 12 months since the given question specifies merely a rate of 10% and not 10% p.a.

ILLUSTRATION 11

Calculate the Interest on Drawings of Ram @ 10% p.a. for the year ended 31st Dec. 2018. If he withdrew the following amounts as follows:

Jan. 31 ₹ 6,000, Mar. 31 ₹ 4,000, July 1 ₹ 8,000,

Sept. 30 ₹ 3,000, Nov. 1 ₹ 5,000,

SOLUTION**CALCULATION OF INTEREST ON DRAWINGS**

A <i>Date</i>	B <i>Amount of Drawings</i>	C <i>Months for which amount has been withdrawn</i>	D = B × C <i>Product</i>
Jan. 31	6,000	11	66,000
Mar. 31	4,000	9	36,000
Jul. 1	8,000	6	48,000
Sept. 30	3,000	3	9,000
Nov. 1	5,000	2	10,000
		Sum of Products	1,69,000

$$\text{Interest on Drawings} = ₹ 1,69,000 \times \frac{10}{100} \times \frac{1}{12} = ₹ 1,408.33$$

10.0 CALCULATION OF INTEREST ON CAPITAL**RATIONALE BEHIND THE PROVISION FOR INTEREST ON CAPITAL**

In case the profit sharing ratio differs from capital ratio, the provision for interest on capital compensates those partners who contribute capital more than the Proportionate Capital as per profit sharing ratio.

HOW TO CALCULATE INTEREST ON CAPITAL IN VARIOUS SITUATIONS

Interest is calculated at the given rate with reference to the time period for which the capital has been used as follows:

CALCULATION OF INTEREST

Particulars	₹
A. Interest on Opening Capital [Opening Capital × Rate/100 × 12/12]	xxx
B. Add: Interest on Additional Capital [Additional Capital × Rate/100 × Period from the date of Introduction to the end of accounting period/12]	xxx
C. Less: Interest on Capital withdrawn = Capital withdrawn × Rate/100 × Period from the date of withdrawal to the end of accounting period/12]	(xxx)
D. Total Interest on Capital [A + B – C]	xxx

ILLUSTRATION 12

X and Y started business on 1st April, 2017 with capitals of ₹ 5,00,000 and ₹ 3,00,000 respectively.

On 1st May 2017, X introduced an additional capital of ₹ 1,00,000 and Y withdrew ₹ 50,000 from his capital. On 1st October 2017, X withdrew ₹ 2,00,000 from his capital and Y introduced ₹ 2,50,000. Interest on capital is allowed @ 6% p.a. calculate the interest on capital for the year ending 31st March, 2018.

SOLUTION**CALCULATION OF INTEREST**

<i>Particulars</i>	<i>X ₹</i>	<i>Y ₹</i>
A. Interest on Opening Capital:		
X – ₹ 5,00,000 × $\frac{6}{100} \times \frac{12}{12}$	30,000	
Y – ₹ 3,00,000 × $\frac{6}{100} \times \frac{12}{12}$		18,000
B. Add: Interest on Additional Capital:		
X – ₹ 1,00,000 × $\frac{6}{100} \times \frac{11}{12}$	5,500	
Y – ₹ 2,50,000 × $\frac{6}{100} \times \frac{6}{12}$		7,500
C. Less: Interest on capital withdrawn:		
X – ₹ 2,00,000 × $\frac{6}{100} \times \frac{6}{12}$	-6,000	
Y – ₹ 50,000 × $\frac{6}{100} \times \frac{11}{12}$		-2,750
	29,500	22,750

ILLUSTRATION 13

X and Y started business on 1st April, 2017 with Capitals of ₹ 2,50,000 and ₹ 1,50,000 respectively. On 1st Oct. 2017, they decided that their capitals should be ₹ 2,00,000 each. The necessary adjustments in the capitals were made by introducing or withdrawing cash. Interest on capital is allowed at 8% p.a. Calculate the Interest on Capital on March 31, 2018.

SOLUTION

Interest on X's Capital:

On ₹ 2,50,000 for 6 months = ₹ 2,50,000 × 8/100 × 6/12 = ₹ 10,000

On ₹ 2,00,000 for 6 months = ₹ 2,00,000 × 8/100 × 6/12 = ₹ 8,000

Total Interest = ₹ 10,000 + ₹ 8,000 = ₹ 18,000

Interest on Y's Capital:

On ₹ 1,50,000 for 6 months = ₹ 1,50,000 × 8/100 × 6/12 = ₹ 6,000

On ₹ 2,00,000 for 6 months = ₹ 2,00,000 × 8/100 × 6/12 = ₹ 8,000

Total Interest = ₹ 6,000 + ₹ 8,000 = ₹ 14,000.

WHEN OPENING CAPITAL IS NOT GIVEN

Opening Capital is ascertained by adding those items which have already been subtracted (e.g. withdrawal of capital) and by subtracting those items which have already been added to the capital (e.g. Additional Capital).

CALCULATION OF OPENING CAPITAL

<i>In case of Fixed Capitals</i>	₹	<i>In case of Fluctuating Capitals</i>	₹
A. Closing Capital	xxx	A. Closing Capital	xxx
B. Add: Withdrawal of Capital	xxx	B. Add: Drawings	xxx
C. Less: Additional Capital	xxx	C. Add: Withdrawal of Capital	xxx
D. Opening Capital (A + B – C)	xxx	D. Less: Share of Profit	xxx
		E. Less: Additional Capital	xxx
		F. Opening Capital [A+B+C–D–E]	xxx

ILLUSTRATION 14

On 31st March, 2018 after the close of the accounts, the capital accounts of X and Y stood in the books of the firm at ₹ 4,00,000 and ₹ 5,00,000 respectively. On 1st May 2017, X introduced an additional capital of ₹ 1,00,000 and Y withdrew ₹ 50,000 from his capital. On 1st October 2017, X withdrew ₹ 2,00,000 from his capital and Y introduced ₹ 2,50,000. Interest on capital is allowed @ 6% p.a. Subsequently, it was discovered that interest on capital @ 6% p.a. had been omitted. The profits for the year ended 31st March, 2018 amounted to ₹ 2,00,000 and the partners' drawings had been: X ₹ 1,00,000 and Y ₹ 50,000. The profit sharing ratio of X and Y was 3 : 2.

Required: Calculate the interest on Capital if the Capitals are (a) fixed (b) fluctuating.

SOLUTION

(a) If the Capitals are Fixed

STEP 1: CALCULATION OF OPENING CAPITAL

<i>Particulars</i>	X (₹)	Y (₹)
A. Closing Capital	4,00,000	5,00,000
B. Add: Withdrawal of Capital	2,00,000	50,000
C. Less: Additional Capital	(1,00,000)	(2,50,000)
D. Opening Capital [A + B – C]	5,00,000	3,00,000

STEP 2: CALCULATION OF INTEREST ON CAPITAL

<i>Particulars</i>	X	Y
A. Interest on Opening Capital: X – ₹ 5,00,000 × $\frac{6}{100} \times \frac{12}{12}$, Y – ₹ 3,00,000 × $\frac{6}{100} \times \frac{12}{12}$	30,000	18,000
B. Add: Interest on Additional Capital: X – ₹ 1,00,000 × $\frac{6}{100} \times \frac{11}{12}$, Y – ₹ 2,50,000 × $\frac{6}{100} \times \frac{6}{12}$	5,500	7,500
C. Less: Interest on capital withdrawn: X – ₹ 2,00,000 × $\frac{6}{100} \times \frac{6}{12}$, Y – ₹ 50,000 × $\frac{6}{100} \times \frac{11}{12}$	(6,000)	(2,750)
	29,500	22,750

(b) If the Capitals are Fluctuating**STEP 1: CALCULATION OF OPENING CAPITAL**

<i>Particulars</i>	<i>X (₹)</i>	<i>Y (₹)</i>
A. Closing Capital	4,00,000	5,00,000
B. Add: Withdrawal of Capital	2,00,000	50,000
C. Add: Drawings	1,00,000	50,000
D. Less: Additional Capital	(1,00,000)	(2,50,000)
E. Less: Share of Profit	(1,20,000)	(80,000)
F. Opening Capital [A + B + C – D – E]	4,80,000	2,70,000

STEP 2: CALCULATION OF INTEREST ON CAPITAL

<i>Particulars</i>	<i>X</i>	<i>Y</i>
A. Interest on Opening Capital: $X - ₹ 4,80,000 \times \frac{6}{100} \times \frac{12}{12}$, $Y - ₹ 2,70,000 \times \frac{6}{100} \times \frac{12}{12}$	28,800	16,200
B. Add: Interest on Additional Capital: $X - ₹ 1,00,000 \times \frac{6}{100} \times \frac{11}{12}$, $Y - ₹ 2,50,000 \times \frac{6}{100} \times \frac{6}{12}$	5,500	7,500
C. Less: Interest on capital withdrawn: $X - ₹ 2,00,000 \times \frac{6}{100} \times \frac{6}{12}$, $Y - ₹ 50,000 \times \frac{6}{100} \times \frac{11}{12}$	(6,000)	(2,750)
	28,300	20,950

11.0 ACCOUNTING TREATMENT OF INTEREST ON CAPITAL**PROVISIONS RELATING TO INTEREST ON CAPITAL**

Case	Provision
I. If the Partnership Agreement is silent as to Interest on Capital.	I. No Interest on Capital will be allowed.
II. If the Partnership Agreement provides for Interest on Capital but is silent as to the treatment of interest as a charge or appropriation.	II. Interest on Capital will be allowed only if there are profits. [Sec 13(c)] (a) In case of Loss— No Interest on Capital will be allowed. (b) In case Profit before interest is equal to or more than the interest.— Full Interest on Capital will be allowed. (c) In case Profit before interest is less than the interest.— Profit will be distributed in the ratio of interest on Capital of each partner.
III. If the Partnership Agreement provides for interest on capital as a charge (i.e. to be allowed whether there are profits or losses).	III. Full Interest on Capital will be allowed whether there are profits or losses .

ILLUSTRATION 17

X and Y are partners sharing the profits and losses in the ratio of 2 : 3 with capitals of ₹ 20,000 and ₹ 10,000 respectively. The partnership deed provides for Interest on Capital @ 6% p.a and the trading profits for the year are ₹ 2,100. Show the distribution of profit/loss for the year 2017-2018 by preparing the relevant account.

SOLUTION**PROFIT AND LOSS APPROPRIATION ACCOUNT***Dr.**for the year ending on 31st March, 2018**Cr.*

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Interest on Capital:		By Profit & Loss A/c	2,100
X	1,200	(Profit for the year)	
Y	600		
To Profit transferred to:			
X's Capital A/c	120		
Y's Capital A/c	180		
	2,100		2,100

ILLUSTRATION 18

X and Y are partners sharing the profits and losses in the ratio of 2 : 3 with capitals of ₹ 20,000 and ₹ 10,000 respectively. The partnership deed provides for Interest on Capital @ 6% p.a. and the trading profits for the year are ₹ 1,500. Show the distribution of profit/loss for the year 2017-2018 by preparing the relevant account.

SOLUTION**PROFIT AND LOSS APPROPRIATION ACCOUNT***Dr.**for the year ending on 31st March, 2018**Cr.*

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Interest on Capital:		By Profit & Loss A/c	1,500
X	1,000	(Profit for the year)	
Y	500		
	1,500		1,500

Note: Since the amount of available profits is less than the total amount of interest on capital, the available profits have been distributed in the ratio of interest claims of X and Y i.e. ₹ 1,200 : ₹ 600.

ILLUSTRATION 19

X and Y are partners sharing the profits and losses in the ratio of 2 : 3 with capitals of ₹ 20,000 and ₹ 10,000 respectively. The partnership deed provides for Interest on Capital @ 6% p.a. even if it involves the firm in loss and the trading profits for the year are ₹ 1,500. Show the distribution of profit/loss for the year 2017-2018 by preparing the relevant account.

SOLUTION

PROFIT AND LOSS ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

Particulars	₹	Particulars	₹
To Interest on Capital:		By Profits before Interest	1,500
X	1,200	By Loss transferred to:	
Y	600	X's Capital A/c	120
		Y's Capital A/c	180
			300
	1,800		1,800

*Profit & Loss Appropriation Account should not be prepared since all the charges against the profits are shown in Profit & Loss Account and all appropriations out of profits are shown in Profit & Loss Appropriation Account.

12.0 INTEREST ON PARTNER'S LOAN TO THE FIRM

Rate of Interest to be allowed	Case	Rate of Interest								
	<i>I. If there is an agreement as to the rate of interest on Loan.</i>	Partner is entitled to an interest on loan at an agreed rate of interest.								
	<i>II. If there is no agreement as to the rate of interest on Loan.</i>	Partner is entitled to interest on loan @ 6% p.a. [Sec. 13(d)]								
Nature of Interest	Interest on Partner's loan is a charge against the profits and not an appropriation out of profits . In other words, interest on partner's loan is to be allowed whether there are profits or not.									
If Profit is less than Interest	If the amount of available profits is less than the total amount of interest on loan, the total amount of interest on loan should be debited to P&L A/c & the resulting loss should be distributed in the profit sharing ratio.									
Accounting Treatment	Interest on partner's loan is an expense for the firm and hence is debited to Profit & Loss Account. On the other hand, interest on partner's loan is a gain to partner in the capacity of a lender and hence is credited to his Loan Account and not his Capital Account. It may be noted that such interest on loan is a charge against the profits and hence must be transferred to the debit of Profit & Loss Account and not to the debit of Profit & Loss Appropriation Account. The following journal entries are passed to adjust Interest on Partners' Loan. Journal Entries (a) Adjusting Entry to provide for Interest on Partner's loan <table><tr><td>Interest on Partner's loan A/c</td><td>Dr.</td></tr><tr><td> To Partner's loan A/c</td><td></td></tr></table> (b) Closing Entry to close the Interest on Partner's loan Account <table><tr><td>Profit & Loss A/c</td><td>Dr.</td></tr><tr><td> To Interest on Partner's loan A/c</td><td></td></tr></table>		Interest on Partner's loan A/c	Dr.	To Partner's loan A/c		Profit & Loss A/c	Dr.	To Interest on Partner's loan A/c	
Interest on Partner's loan A/c	Dr.									
To Partner's loan A/c										
Profit & Loss A/c	Dr.									
To Interest on Partner's loan A/c										

ILLUSTRATION 20

X & Y are partners sharing the profits & losses in the ratio of 2 : 3 with Capitals of ₹ 20,000 & ₹ 10,000 respectively. On 1st Oct., 2017 X & Y granted loans of ₹ 40,000 and ₹ 20,000 respectively to the firm. The Partnership deed is silent as to the interest on Partner's Loan. The profits before any interest

for the year amounted to ₹ 2,100. Pass Journal Entries for Interest on Loan & distribution of profits/losses and Prepare Profit & Loss Account.

SOLUTION

When the partnership deed is silent as to the Interest on partner's loan, as per the Indian Partnership Act, 1932, interest @ 6% p.a. is to be allowed on loan by a partner.

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
31.03.2018	Interest on Partner's Loan A/c Dr To X's Loan A/c To Y's Loan A/c (Being Interest on Partner's Loan adjusted)		1,800	1,200 600
	Profit and Loss A/c ...Dr. To X's Capital A/c To Y's Capital A/c (Being the Profits distributed)		300	120 180

PROFIT AND LOSS ACCOUNT

Dr

for the year ending on 31st March, 2018

Cr.

Particulars	₹	Particulars	₹
To Interest on Loan:		By Profit before any interest	2,100
X 1,200			
Y 600	1,800		
To Net Profit transferred to:			
X's Capital A/c 120			
Y's Capital A/c 180	300		
	2,100		2,100

Working Notes:

- Interest on X's Loan = ₹ 40,000 × 6/100 × 6/12 = ₹ 1,200
- Interest on Y's Loan = ₹ 20,000 × 6/100 × 6/12 = ₹ 600

ILLUSTRATION 21

X and Y are partners sharing the profits and losses in the ratio of 2 : 3 with Capitals of ₹ 20,000 and ₹ 10,000 respectively. On 1st Oct., 2017 X and Y granted loans of ₹ 40,000 and ₹ 20,000 respectively to the firm. The Partnership deed is silent as to the interest on partner's loan. The profits before any interest for the year amounted to ₹ 1,500. Show the distribution of profits/losses for the year 2017-2018.

SOLUTION

When the partnership deed is silent as to the Interest on partner's loan, as per The Indian Partnership Act, 1932, interest @ 6% p.a. is to be allowed on loan by a partner.

2. Recording	It is debited to Profit and Loss Account.	It is debited to Profit and Loss Appropriation Account.
3. When made	It is made even if there is loss.	It is made only when there is profit.
4. Priority over each other	It is done before appropriation of Profit.	It is done after creation of all charges.
5. Examples	Rent paid to a partner, Interest on Partner's Loan.	Interest on Capital, Salary to Partner, Transfer to General Reserve

13.0 SALARY OR COMMISSION TO A PARTNER

When to Allow	Salary or Commission to a partner is to be allowed if the partnership agreement provides for the same.										
Nature	Salary or Commission to a partner is an appropriation out of profits and not a charge against the profits. In other words, it is to be allowed only if there are profits.										
How to calculate	Commission may be allowed as percentage of Net Profit before charging such commission or after charging such commission. I—Commission as % of Net Profit before charging such Commission $= \text{Net Profit before Commission} \times \frac{\text{Rate of Commission}}{100}$ II—Commission as % of Net Profit after charging such Commission $= \text{Net Profit before Commission} \times \frac{\text{Rate of Commission}}{100 + \text{Rate of Commission}}$										
If Profit is less than Salary/Commission	If the amount of available profits is less than the amount of appropriations to be made, the available profits should be distributed in the ratio of appropriations to be made (i.e. no particular appropriation item like salary/interest on capital has priority over another appropriation item).										
Accounting Treatment	Salary or Commission to a partner is an appropriation out of profits and hence must be transferred to the debit of Profit & Loss Appropriation Account and not to the debit of Profit & Loss Account . The following journal entries are passed to adjust salary or commission:										
	(a) Adjusting Entry to adjust salary or commission to a partner <table> <tr> <td>Salary or Commission A/c</td> <td>Dr.</td> </tr> <tr> <td> To Partner's Capital A/c (In case of Fluctuating Capitals), or</td> <td></td> </tr> <tr> <td> To Partner's Current A/c (In case of Fixed Capitals)</td> <td></td> </tr> </table> (b) Closing Entry to close Salary or Commission Account <table> <tr> <td>Profit & Loss Appropriation A/c</td> <td>Dr.</td> </tr> <tr> <td> To Salary or Commission A/c</td> <td></td> </tr> </table>	Salary or Commission A/c	Dr.	To Partner's Capital A/c (In case of Fluctuating Capitals), or		To Partner's Current A/c (In case of Fixed Capitals)		Profit & Loss Appropriation A/c	Dr.	To Salary or Commission A/c	
Salary or Commission A/c	Dr.										
To Partner's Capital A/c (In case of Fluctuating Capitals), or											
To Partner's Current A/c (In case of Fixed Capitals)											
Profit & Loss Appropriation A/c	Dr.										
To Salary or Commission A/c											

ILLUSTRATION 23

A and B are partners in a firm. A is to get a commission of 10% of Net Profit before charging any commission. B is to get a commission of 10% on Net Profit after charging all commissions. Net Profit before charging any commission was ₹ 55,000. Find out the commission of A and B.

SOLUTION

A's Commission = 10% of ₹ 55,000 = ₹ 5,500

B's Commission = (₹ 55,000 – ₹ 5,500) × 10/110 = ₹ 4,500.

ILLUSTRATION 24

X and Y are partners in a firm. X is entitled to a salary of ₹ 2,000 p.m. together with a commission of 10% of Net Profit before charging any commission. Y is entitled to a salary of ₹ 5,000 p.a. together with a commission of 10% of Net Profit after charging all commissions. Net profit before charging any commission for the year 2017-2018 was ₹ 55,000. Show the distribution of Profit.

SOLUTION**PROFIT AND LOSS APPROPRIATION ACCOUNT**

Dr.

for the year ending on 31st March, 2018

Cr.

Particulars	₹	Particulars	₹
To X's Salary	24,000	By Profit before Salary & Commission	
To Y's Salary	5,000	[₹ 55,000 + ₹ 24,000 (X's Salary)	
To X's Commission	5,500	+ ₹ 5,000 (Y's Salary)]	84,000
(₹ 55,000 × 10/100)			
To Y's Commission			
[(₹ 55,000 – ₹ 5,500) × 10/110]	4,500		
To Net Profit transferred to:			
X's Capital A/c	22,500		
Y's Capital A/c	22,500		
	45,000		
	84,000		84,000

ILLUSTRATION 25

X and Y are partners sharing the profits and losses in the ratio of 3 : 2. X being a non-working partner contributed ₹ 5,00,000 as his capital on 1st April, 2017. Y being a working partner agreed to work for the firm. The partnership deed provides for interest on capital @ 8% and salary to every working partner @ ₹ 2,000 p.m. On 31st October 2017, X advanced ₹ 2,00,000 by way of loan to the firm. Net Profit before providing for any interest and partner's salary for the year 2017-12 was ₹ 25,000. Show the distribution of profit.

SOLUTION**PROFIT & LOSS APPROPRIATION ACCOUNT**

Dr.

for the year ended 31st March 2018

Cr.

Particulars	₹	Particulars	₹
To Interest on X's Capital	12,500	By Net Profit as per P&L A/c	20,000
To Salary to Y	7,500	Given Profits	25,000
		Less: Interest on Loan	5,000
	20,000		20,000

Note: Interest on Loan = ₹ 2,00,000 × 5/12 × 6/100 = ₹ 5,000

Note: Since both interest on capital and salary to partner are appropriations and the available profits (₹ 25,000 – ₹ 5,000) are less than the amount of appropriations to be made, the available profits have been distributed in the ratio of appropriations to be made i.e. ₹ 40,000 (interest on capital ₹ 5,00,000 × 8/100) ₹ 24,000 (Salary (₹ 2,000 × 12)).

14.0 DIVISION OF PROFIT AMONG PARTNERS

After ascertaining the Net Profit as per Profit & Loss Account, usually the Profit & Loss Appropriation Account is prepared.

Meaning	P & L Appropriation Account shows the distribution of Net Profits as per P & L A/c among the partners by way of Interest on Capital, Salary, Commission to partners, Transfer to Reserves.
Purpose	P & L Appropriation is prepared to show the distribution of Net Profit among the partners. The balance in Profit & Loss Appropriation Account may be used: 1. To provide for Interest on Capitals of Partners (<i>if Partnership Deed so provides</i>). 2. To provide for Salary or Commission to partners (<i>if Partnership Deed so provides</i>). 3. To transfer the profits to General Reserve or Specific Reserve. 4. To distribute the profits among the partners in their profit sharing ratio. 5. To retain the profits in the business by ploughing back of profits.
Debited with	It is debited with Interest on Capital, Salary, Commission to Partners, Transfer to Reserves, Share of Profit etc.
Credited with	It is credited with Opening Balance b/f, Interest on Drawings, etc.
Balance	Its balance is transferred to the partners' Capital (or Current) Accounts in their agreed profit sharing ratio (or equally if there is no agreed profit sharing ratio).

DIFFERENCE BETWEEN PROFIT & LOSS ACCOUNT AND PROFIT & LOSS APPROPRIATION ACCOUNT

Profit & Loss Account is prepared to ascertain the Net Profit whereas P & L Appropriation Account is prepared to show the distribution of Net Profit among the partners.

DIFFERENCE BETWEEN PROFIT & LOSS APPROPRIATION ACCOUNT AND PROFIT & LOSS ADJUSTMENT ACCOUNT

P & L Appropriation Account is prepared to show the distribution of Net Profit among the partners whereas Profit & Loss Adjustment Account is prepared to show the effect of revaluation of assets and liabilities at the time of reconstitution of partnership. (i.e. Change in Profit sharing ratio, Admission, Retirement or Death of a Partner).

JOURNAL ENTRIES IN RELATION TO APPROPRIATION OF PROFITS

1. For Interest on Capital		
(a) On allowing Interest on Capital		
Interest on Capital A/c		Dr.
To Partner's Capital (or Current) A/c		
(b) On Closure of Interest on Capital A/c		
Profit & Loss Appropriation A/c		Dr.
To Interest on Capital A/c		
2. For Interest on Drawings		
(a) On Charging Interest on Drawings		
Partner's Capital (or Current) A/c		Dr.
To Interest on Drawings A/c		
(b) On Closure of Interest on Drawings A/c		
Interest on Drawings A/c		Dr.
To Profit & Loss Appropriation A/c		

- (a) 20% of Profits to be transferred to General Reserve.
- (b) Interest on Capital @ 12% p.a. and Interest on Drawings @ 10% p.a.
- (c) X to get a monthly salary of ₹ 2,000 and Y to get salary of ₹ 9,000 per quarter.
- (d) X is entitled to a commission of 2% on Sales. Sales for the year were ₹ 3,50,000.
- (e) Profits & Losses to be shared in the ratio of their Capital Contribution up to ₹ 70,000 and above ₹ 70,000 equally.

The profit for the year ended 31st March, 2018, before Interest on Partner's Loan was ₹ 2,00,600. A provision of 5% of the profits is to be made in respect of manager's commission. The drawings of X and Y were ₹ 40,000 and ₹ 50,000 respectively.

Required: Pass the necessary journal entries relating to appropriations out of profits. Prepare Profit and Loss Account, Profit and Loss Appropriation Account and Partners' Capital Accounts.

SOLUTION

JOURNAL OF X AND Y

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018 Mar. 31	Interest on X's Loan A/c [$20,000 \times 6\% \times 6/12$] Dr. To X's Loan A/c (Being the adjustment made for Interest on Loan)		600	600
	Manager's Commission A/c Dr. To Manager's Commission Outstanding A/c (Being the adjustment made for Interest on Loan & Manager's Commission)		10,000	10,000
	Profit & Loss A/c Dr. To Interest on X's Loan A/c To Manager's Commission A/c (Being the transfer of Interest on Loan & Manager's Commission to P&L A/c)		10,600	600 10,000
	Profit and Loss A/c Dr. To Profit and Loss Appropriation A/c (Being the transfer of Profit to P&L Appropriation A/c)		1,90,000	1,90,000
	Profit and Loss Appropriation A/c Dr. To General Reserve A/c (Being the transfer of 20% profits to General Reserve)		38,000	38,000
	Salary to Partners A/c Dr. To X's Capital A/c To Y's Capital A/c (Being the adjustment made for salary of X and Y)		60,000	24,000 36,000
	X's Commission A/c Dr. To X's Capital A/c (Being the adjustment made for X's Commission)		7,000	7,000
	Interest on Capital A/c Dr. To X's Capital A/c To Y's Capital A/c (Being the adjustment made for interest on capital)		16,800	9,600 7,200
	Profit and Loss Appropriation A/c Dr. To Salary to Partners A/c To Interest on Capital A/c To X's Commission A/c (Being the transfer of Salary to Partners, Interest on Capital & X's Commission to P&L Appr. A/c)		83,800	60,000 16,800 7,000

	X's Capital A/c [₹ 40,000 × 10% × 6/12]	Dr.		2,000	
	Y's Capital A/c [₹ 50,000 × 10% × 6/12]	Dr.		2,500	
	To Interest on Drawings A/c				4,500
	(Being the adjustment made for interest on drawings)				
	Interest on Drawings A/c	Dr.		4,500	
	To Profit and Loss Appropriation A/c				4,500
	(Being the t/f of Interest on drawings to P&L Appr. A/c)				
	Profit and Loss Appropriation A/c	Dr.		72,700	
	To X's Capital A/c				41,350
	To Y's Capital A/c				31,350
	(Being the transfer of profit)				

Dr.

PROFIT & LOSS ACCOUNT

Cr.

for the year ended 31st March, 2018

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Interest on X's Loan [₹ 20,000 x 6% x 6/12]	600	By Profit before Interest on X's Loan	2,00,600
To Manager's Commission (5% of ₹ 2,00,000)	10,000		
To Net Profit t/f to P & L Appr. A/c	1,90,000		
	2,00,600		2,00,600

PROFIT & LOSS APPROPRIATION ACCOUNT

Dr.

for the year ending on 31st Mar., 2018

Cr.

Particulars		₹	Particulars		₹
To General Reserve		38,000	By P&L A/c		1,90,000
[₹ 1,90,000 of 20%]					
To Interest on Capital:			By Interest on Drawings:		
X	9,600		X	2,000	
Y	7,200	16,800	Y	2,500	4,500
To Salary:					
X	24,000				
Y	36,000	60,000			
To Commission to X					
[2% of ₹ 3,50,000]		7,000			
To Profit transferred to:					
70,000	Balance				
X's Capital A/c 40,000	+ 1,350	41,350			
Y's Capital A/c 30,000	+ 1,350	31,350			
		1,94,500			1,94,500

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

<i>Particulars</i>	X ₹	Y ₹	<i>Particulars</i>	X ₹	Y ₹
To Drawings	40,000	50,000	By Bank A/c	80,000	60,000
To Interest on Drawings	2,000	2,500	By Interest on Capital	9,600	7,200
To Balance c/d	1,19,950	82,050	By Salary	24,000	36,000
			By Commission	7,000	—
			By P&L App. A/c	41,350	31,350
	1,61,950	1,34,550		1,61,950	1,34,550

Notes:

1. As per The Indian Partnership Act, Interest on Loan is to be allowed @ 6% p.a.
2. Interest on Drawings has been calculated for an average period of 6 months as the date of drawing is not given.

15.0 PAST ADJUSTMENTS

Meaning	Past Adjustments refer to those adjustments which affect the distribution of past profits like omission or commission in respect of Interest on Capital/ Drawings of a Partner, Salary/Commission to a Partner, Sharing of Profits.			
How to carry out	Past Adjustments should be carried out directly through the Capital Accounts of the concerned partners.			
How to Pass Single Adjusting Journal Entry	The passing of the necessary Adjusting Journal Entry involves the following steps: Step 1: <i>Calculate the amount already recorded by way of Share of Profit, Interest on Capital, Salary, Commission etc.</i> Step 2: <i>Calculate the amount which should have been recorded by way of Interest on Capital, Salary or Commission or Share of Profit etc.</i> Step 3: <i>Calculate the difference between the amounts calculated as per Step 1 and the amount calculated as per Step 2.</i> Step 4: <i>Find out the partner who received excess and the partner who received short.</i> Step 5: <i>Pass the Adjusting Journal Entry by debiting the Capital Account of Partner who received excess and by crediting the Capital Account of Partner who received short.</i>			
Format of Adjustment Table	A simplest format of Adjustment Table is given below:			
	ADJUSTMENT TABLE			
	Particulars	X	Y	Total
	A. Amounts already recorded: (e.g.)			
	Interest on Capital	....	....	....
	Interest on Drawings	(....)	(....)	(....)
	Salary/Commission to Partner	....	....	....
	Share of Profit	....	....	....
				

	B. Amounts which should have been recorded: (e.g.)			
	Interest on Capital	....	....	....
	Interest on Drawings	(....)	(....)	(....)
	Salary to Partner	....	....	....
	Commission to Partner	....	....	....
	Share of Revised Profit	....	....	....
				
	C. Difference [A – B]	....	....	....
Single Adjusting Journal Entry	Gaining Partner's Capital A/c (<i>who received excess</i>) Dr. To Sacrificing Partner's Capital A/c (<i>who received short</i>)			

ILLUSTRATION 27

X, Y, and Z are partners. Their Capitals as on 1st Jan., 2018 were: X ₹ 50,000, Y ₹ 1,00,000 and Z ₹ 1,50,000. Profits for the year 2018 amounting to ₹ 60,000 were distributed in the ratio of capitals without providing for the following:

- Interest on Capitals : X ₹ 5,000, Y ₹ 10,000, Z ₹ 15,000
- Interest on Drawings : X ₹ 3,000, Y ₹ 5,000, Z ₹ 8,000
- X's Salary of ₹ 1,000 p.m. and Y's Commission of ₹ 4,000

The Partnership Deed was silent as to the sharing of Profits & Losses.

Required: Pass the necessary single Adjusting Entry.

SOLUTION**STEP 1: ADJUSTMENT TABLE**

Particulars	X	Y	Z
I. Amounts already recorded:			
Share of Profit [₹ 60,000 in 1:2:3 ratio]	10,000	20,000	30,000
	10,000	20,000	30,000
II. Amounts which should have been recorded:			
Interest on Capital	5,000	10,000	15,000
Interest on Drawings	(3,000)	(5,000)	(8,000)
Salary [₹ 1,000 × 12]	12,000	—	—
Commission	—	4,000	—
Share of Profit [₹ 30,000* in 1:1:1 ratio]	10,000	10,000	10,000
	24,000	19,000	17,000
III. Difference [I – II]	(14,000)	1,000	13,000
	Sacrificing Partner	Gaining Partner	Gaining Partner

*Revised Profits = 60,000 – 5,000 – 10,000 – 15,000 + 3,000 + 5,000 + 8,000 – 12,000 – 4,000
= ₹ 30,000

STEP 2: ADJUSTING JOURNAL ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Y's Capital A/c		1,000	
	Z's Capital A/c		13,000	
	To X's Capital A/c			14,000
	(Being the rectification for adjustment of profits as per Partnership Deed and The Indian Partnership Act, 1932)			

ILLUSTRATION 28

X, Y, and Z are partners. Their fixed capitals as on 1st Jan., 2018 were: X ₹ 50,000, Y ₹ 1,00,000 and Z ₹ 1,50,000. Profits for the year 2018 amounting to ₹ 30,000 were distributed in the ratio of capitals after providing for the following:

- Interest on Capitals : X ₹ 5,000, Y ₹ 10,000, Z ₹ 15,000
- Interest on Drawings : X ₹ 3,000, Y ₹ 5,000, Z ₹ 8,000
- X's Salary of ₹ 1,000 p.m. and Y's Commission of ₹ 4,000

The Partnership Deed was silent as to the sharing of Profits & Losses, Interest on Capitals, Interest on Drawings and Partner's Salary and Commission.

Required: Pass the necessary single Adjusting Entry.

SOLUTION**STEP 1: ADJUSTMENT TABLE**

Particulars	X	Y	Z
I. Amounts already recorded:			
Interest on Capital	5,000	10,000	15,000
Interest on Drawings	(3,000)	(5,000)	(8,000)
Salary [₹ 1,000 × 12]	12,000	—	—
Commission	—	4,000	—
Share of Profit [₹ 30,000 in 1:2:3 ratio]	5,000	10,000	15,000
	19,000	19,000	22,000
II. Amounts which should have been recorded:			
Share of Profit [₹ 60,000* in 1:1:1 ratio]	20,000	20,000	20,000
	20,000	20,000	20,000
III. Difference [I – II]	(1,000)	(1,000)	2,000
	Sacrificing Partner	Sacrificing Partner	Gaining Partner
			Partner

*Revised Profits = 30,000 + 5,000 + 10,000 + 15,000 – 3,000 – 5,000 – 8,000 + 12,000 + 4,000
= ₹ 60,000

STEP 2: ADJUSTING JOURNAL ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Z's Current A/c		2,000	
	To X's Current A/c			1,000
	To Y's Current A/c			1,000
	(Being the rectification for adjustment of profits as per The Indian Partnership Act)			

ILLUSTRATION 29

X and Y are partners in a firm. Their capital accounts as on March 31, 2018 showed balances of ₹ 70,000 and ₹ 60,000 respectively. The drawings of X and Y during the year 2017-2018 were ₹ 8,000 and ₹ 6,000 respectively. After distributing the profits of the year 2017-2018 which amounted to ₹ 40,000, it was subsequently found that the following items have been left out while preparing the final accounts of the year ended 31st March, 2018.

- The partners were entitled to Interest on capitals @ 6% p.a.
- The interest on drawings was also to be charged @ 5% p.a.
- X was entitled to salary of ₹ 10,000 and Y a commission of ₹ 4,000 for the whole year.

Required: Pass the necessary single Adjusting Entry.

SOLUTION

STEP 1: CALCULATION OF OPENING CAPITALS

Particulars	X (₹)	Y (₹)
A. Closing Capital	70,000	60,000
B. Less: Share of Profit [₹ 40,000 in 1:1 ratio]	(20,000)	(20,000)
C. Add: Drawings	8,000	6,000
D. Capital at the beginning [A – B + C]	58,000	46,000

Step 2: Calculation of Interest on Capital

For X: $58,000 \times 6/100 = ₹ 3,480$, For Y: $46,000 \times 6/100 = ₹ 2,760$

Step 3: Calculation of Interest on Drawings

For X: $8,000 \times 5/100 \times 6/12 = ₹ 200$, For Y: $6,000 \times 5/100 \times 6/12 = ₹ 150$

Step 4 Calculation of Revised Profits

$= ₹ 40,000 - ₹ 3,480 - ₹ 2,760 + ₹ 200 + ₹ 150 - ₹ 10,000 - ₹ 4,000 = ₹ 20,110$

Step 5: Calculation of Share of Profit

X's Share $= ₹ 20,110 \times 1/2 = 10,055$, Y's Share $= ₹ 20,110 \times 1/2 = 10,055$

STEP 6: ADJUSTMENT TABLE

Particulars	X	Y	Total
I. Amounts already recorded:			
Share of Profit	20,000	20,000	40,000
II. Amounts which should have been recorded:			
Interest on Capital	3,480	2,760	6,240

Interest on Drawings	(200)	(150)	(350)
Salary	10,000	—	10,000
Commission	—	4,000	4,000
Share of Profit (Refer to Step 5)	10,055	10,055	20,110
	23,335	16,665	40,000
III. Difference [I – II]	(3,335)	3,335	—

STEP 7: ADJUSTING JOURNAL ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Y's Capital A/c Dr. To X's Capital A/c (Being the Omissions adjusted through Capital Accounts)		3,335	3,335

ILLUSTRATION 30

X, Y, and Z are partners. Their fixed capitals as on 31st Dec., 2018 were: X ₹ 50,000, Y ₹ 1,00,000 and Z ₹ 1,50,000. Profits for the year 2018 amounting to ₹ 60,000 were distributed. Interest on Capital was credited @ 10% p.a. though there was no such provision in the partnership deed. Pass the necessary adjusting entry.

SOLUTION**STEP 1: ADJUSTMENT TABLE**

Particulars	X ₹	Y ₹	Z ₹	Total ₹
I. Amount already credited by way of Interest on Capital	5,000	10,000	15,000	30,000
II. Amount which should have been credited by way of Share of Profit	10,000	10,000	10,000	30,000
III. Difference [I — II]	(5,000)	—	5,000	—

STEP 2: ADJUSTING JOURNAL ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Z's Current A/c Dr. To X's Current A/c (Being the interest on wrongly provided, now adjusted)		5,000	5,000

ILLUSTRATION 31

X, Y, and Z are partners. Their fixed capitals as on 31st Dec., 2018 were: X ₹ 50,000, Y ₹ 1,00,000 and Z ₹ 1,50,000. Profits for the year 2018 amounting to ₹ 60,000 were distributed. Interest on Capital was not credited @ 10% p.a. though there was such provision in the partnership deed. Pass the necessary adjusting entry.

SOLUTION**STEP 1: ADJUSTMENT TABLE**

<i>Particulars</i>	<i>X ₹</i>	<i>Y ₹</i>	<i>Z ₹</i>	<i>Total ₹</i>
I. Amount already credited by way of share of profit	10,000	10,000	10,000	30,000
II. Amount which should have been credited by way of Interest on Capital	5,000	10,000	15,000	30,000
III. Difference [I — II]	5,000	—	(5,000)	—

STEP 2: ADJUSTING JOURNAL ENTRY

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	X's Current A/c Dr. To Z's Current A/c (Being the interest omitted to be provided, now adjusted)		5,000	5,000

ILLUSTRATION 32

X, Y, and Z are partners. Their fixed capitals as on 31st Dec., 2018 were: X ₹ 50,000, Y ₹ 1,00,000 and Z ₹ 1,50,000. Profits for the year 2018 amounting to ₹ 60,000 were distributed. Interest on Capital was credited @ 10% p.a. instead of 12% p.a. Pass the necessary adjusting entries.

SOLUTION**STEP 1: ADJUSTMENT TABLE**

<i>Particulars</i>	<i>X ₹</i>	<i>Y ₹</i>	<i>Z ₹</i>	<i>Total ₹</i>
A. Amount already credited by way of Interest on Capital @ 10%	5,000	10,000	15,000	30,000
Share of Profit [(₹ 36,000 – ₹ 30,000) in ratio of 1:1:1]	2,000	2,000	2,000	6,000
	7,000	12,000	17,000	3,6000
B. Amount that should have been credited by way of:				
Interest on Capital @ 12%	6,000	12,000	18,000	36,000
C. Difference [A — B]	1,000	—	(1,000)	—

STEP 2: ADJUSTING JOURNAL ENTRY

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	X's Current A/c Dr. To Z's Current A/c (Being the interest on capital wrongly provided, now adjusted)		1,000	1,000

ILLUSTRATION 33

X, Y, and Z are partners. Their fixed capitals as on 31st Dec., 2018 were: X ₹ 50,000, Y ₹ 1,00,000 and Z ₹ 1,50,000. Profits for the year 2018 amounting to ₹ 60,000 were distributed. Interest on Capital was credited @ 12% p.a. instead of 10% p.a. Pass the necessary adjusting entry.

SOLUTION**STEP 1: ADJUSTMENT TABLE**

<i>Particulars</i>	<i>X ₹</i>	<i>Y ₹</i>	<i>Z ₹</i>	<i>Total ₹</i>
I. Interest on Capital already credited @ 12%	6,000	12,000	18,000	36,000
II. Amount that should have been credited by way of:				
Interest on capital @ 10%	5,000	10,000	15,000	30,000
Share of Profit [(₹ 36,000 – ₹ 30,000) in ratio of 1 : 1 : 1 :]	2,000	2,000	2,000	6,000
	7,000	12,000	17,000	36,000
III. Difference [I – II]	(1,000)	—	1,000	—

STEP 2: ADJUSTING JOURNAL ENTRY

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Z's Current A/c Dr. To X's Current A/c (Being the interest on capital wrongly provided, now adjusted)		1,000	1,000

ILLUSTRATION 34

A, B and C shared the profits of ₹ 75,000 in the ratio of 2:2:1 but the partnership deed was silent as to the profit sharing ratio. Pass the necessary adjusting entry.

SOLUTION**STEP 1: ADJUSTMENT TABLE**

<i>Particulars</i>	<i>A (₹)</i>	<i>B (₹)</i>	<i>C(₹)</i>
I. Amount already credited by way of			
Share of Profit in the ratio of 2:2:1	30,000	30,000	15,000
II. Amount which should have been credited by way of Share of Profit in the ratio of 1:1:1]	25,000	25,000	25,000
III. Difference (I – II)	5,000 (Dr.)	5,000 (Dr)	–10,000 (Cr.)
	Excess	Excess	Short

STEP 2: ADJUSTING JOURNAL ENTRY

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	A's Capital A/c Dr. B's Capital A/c Dr. To C's Capital A/c (Being the profits distributed in wrong ratio, now rectified)		5,000 5,000	10,000

ILLUSTRATION 35

Preeti, Mona and Nisha shared profits in the ratio of 3 : 2 : 1. The profits of the last three years were ₹ 1,40,000, ₹ 84,000 and ₹ 1,06,000 respectively. These profits were by mistake, shared equally for all the three years. It is now decided to correct the error. Pass necessary journal entry for the same.

SOLUTION
STEP 1: ADJUSTMENT TABLE

<i>Particulars</i>	<i>Preeti (₹)</i>	<i>Mona (₹)</i>	<i>Nisha (₹)</i>
Profits already received (3,30,000 in 1 : 1 : 1)	1,10,000	1,10,000	1,10,000
Profits to be received (3,30,000 in 3 : 2 : 1)	1,65,000	1,10,000	55,000
Difference	(55,000)	—	55,000
	Short		Excess

STEP 2: ADJUSTING JOURNAL ENTRY

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Nisha's Capital A/c Dr. To Preeti's Capital A/c (Being the adjustment made for profit divided in wrong ratio)		55,000	55,000

ILLUSTRATION 36

X, Y and Z are partners sharing profits and losses in the ratio of 3 : 2 : 1. After the final accounts have been prepared, it was discovered that interest on drawings @ 5% p.a. has not been taken into consideration. The drawings of the Partners were: X ₹ 15,000; Y ₹ 12,600; Z ₹ 12,000. Pass the necessary adjusting journal entry.

SOLUTION
Step 1: Calculation of Interest on Drawings:

Since date of drawings are not given, interest will be charged for 6 months.

<i>Particulars</i>	<i>₹</i>
X: ₹ 15,000 × 5/100 × 6/12	₹ 375
Y: ₹ 12,000 × 5/100 × 6/12	₹ 315
Z: ₹ 12,000 × 5/100 × 6/12	₹ 300
	₹ 990

STEP 2: ADJUSTMENT TABLE

<i>Particulars</i>	<i>X ₹</i>	<i>Y ₹</i>	<i>Z ₹</i>	<i>Total ₹</i>
I. Interest on Drawings (Dr.)	375	315	300	990
II. Divisions of ₹ 990 in 3 : 2 : 1 (Cr.)	495	330	165	990
III. Difference [I – II]	Cr. 120	Cr. 15	Dr. 135	—

STEP 3: ADJUSTING JOURNAL ENTRY

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Z's Capital A/c Dr. To X's Capital A/c To Y's Capital A/c (Being the Adjustment of omission of Interest on drawings)		135	120 15

ILLUSTRATION 37

A, B & C were partners. Their fixed capitals were A—₹ 30,000, B—₹ 20,000 and C—₹ 10,000 respectively. According to the Partnership Deed, they were entitled to an interest on capital at 5% p.a. In addition B was also entitled to draw a salary of ₹ 500 per month. C was entitled to a commission of 5% on the profits after charging the interest on capital, but before charging the salary payable to B. The net profits for the year were ₹ 30,000 distributed in the ratio of capitals without providing for any of the above adjustments. The profits were to be shared in the ratio of 5 : 2 : 3. Pass the necessary adjustment entry showing the working clearly.

SOLUTION**STEP 1: ADJUSTMENT TABLE**

<i>Particulars</i>	<i>A ₹</i>	<i>B ₹</i>	<i>C ₹</i>
I. Profit already wrongly credited [In 3 : 2 : 1]	15,000	10,000	5,000
II. Amount which should have been credited:			
Interest on Capital	1,500	1,000	500
Salary	—	6,000	—
Commission	—	—	1,350
Net Profit Distributed (5 : 2 : 3)	9,825	3,930	5,895
	11,325	10,930	7,745
III. Difference [I – II]	3,675(Dr.)	930(Cr.)	2,745(Cr.)

STEP 2: ADJUSTING JOURNAL ENTRY

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	A's Current A/c ...Dr.		3,675	
	To B's Current A/c			930
	To C's Current A/c			2,745
	(Being the adjusting entry passed)			

ILLUSTRATION 38

The capitals of A, B and C as on 31st Dec, 2018 amounted to ₹ 30,000, ₹ 1,10,000 and ₹ 2,20,000 respectively. The profits amounting to ₹ 60,000 for the year 2018 were distributed in the ratio of 4:1:1 after allowing interest on Capitals @ 10% p.a. During 2018 each partner withdrew ₹ 1,20,000. The partnership deed was silent as to profit sharing ratio but provided for interest on capital @ 12%.

Required: Pass the necessary adjusting journal entry.

SOLUTION**STEP 1: ADJUSTMENT TABLE**

<i>Particulars</i>	<i>X ₹</i>	<i>Y ₹</i>	<i>Z ₹</i>	<i>Total ₹</i>
I. Amount already credited				
Interest on Capital @ 10%	10,000	20,000	30,000	60,000
Share of Profit (in the ratio of 4:1:1)	40,000	10,000	10,000	60,000
	50,000	30,000	40,000	1,20,000

II. Amount which should have been credited:				
Interest on Capital @ 12%	12,000	24,000	36,000	72,000
Share of Profit (in the ratio of 1:1:1) (i.e. ₹ 1,20,000 – ₹ 72,000)	16,000	16,000	16,000	48,000
	28,000	40,000	52,000	1,20,000
III. Difference [I – II]	22,000	– 10,000	– 12,000	
	(Excess) Dr.	(Short) Cr.	(Short) Cr.	

STEP 2: ADJUSTING JOURNAL ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	A's Capital A/c Dr.		22,000	
	To B's Capital A/c			10,000
	To C's Capital A/c			12,000
	(Being the short interest on capital provided and profits distributed in wrong ratio, now rectified)			

Working Note:**CALCULATION OF INTEREST ON CAPITAL ALREADY PROVIDED AND OPENING CAPITALS**

Particulars	A ₹	B ₹	C ₹
A Closing Capitals	30,000	1,10,000	2,20,000
B Add: Drawings already debited	1,20,000	1,20,000	1,20,000
C Less: Profit already credited	40,000	10,000	10,000
D Opening Capitals plus Interest on Capitals	1,10,000	2,20,000	3,30,000
E Less: Interest on Capital (D × 10/110)	10,000	20,000	30,000
F Opening Capitals (D – E)	1,00,000	2,00,000	3,00,000

ADJUSTING ENTRY WHEN MANAGER IS TREATED A PARTNER**Step 1:** Calculate the amount already credited to manager.**Step 2:** Calculate the amount which should have been given as partner.**Step 3:** Calculate the difference between these two amounts**Step 4:** Pass the following Adjusting Entry:

Old Partner's Capital A/cs	...Dr.	[In Old Ratio]
To Incoming Partner's Capital A/c		[With Credit still to be given]

Note: Revised Profit for calculating Share of Profit = Given Profits + Amount already given as Manager – Amount to be given as Partner

ILLUSTRATION 39 [MANAGER TREATED AS PARTNER]

A and B are partners sharing profits and losses in the ratio of 3:2. They employed C as their manager to whom they paid a salary of ₹ 750 p.m. C had deposited ₹ 20,000 on which interest was payable @ 9% per annum. At the end of 2018 (after division of the year's profits), it was decided that C should be treated as a partner with effect from 1st Jan. 2015 with 1/6th share of profits, his deposit being considered as capital carrying interest at 6% per annum like capitals of other partners. The firm's

profits and losses after allowing interest on capitals were—2015 Profit ₹ 59,000; 2016 Profit ₹ 62,600; 2017 Loss ₹ 4,000; 2018 Profit ₹ 78,000. Record the necessary Journal Entries to give effect to the above. [Note: Interest on Capital is to be allowed as a charge]

SOLUTION**STEP 1: ADJUSTMENT TABLE**

<i>Particulars</i>	<i>₹</i>
I. Amount already credited to 'C':	
Interest on Loan ($\text{₹ } 20,000 \times 9/100 \times 4$)	7,200
Salary ($\text{₹ } 750 \times 12 \times 4$)	36,000
	43,200
II. Amount which should have been credited to 'C':	
Interest on Capital ($\text{₹ } 20,000 \times 6/100 \times 4$)	4,800
Share of Profit $1/6$ of ($\text{₹ } 1,95,600 + \text{₹ } 43,200 - \text{₹ } 4,800$)	39,000
	43,800
III. Difference (credit still to be given) (I – II)	– 600

STEP 2: ADJUSTING JOURNAL ENTRIES

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	C's Loan A/c Dr. To C's Capital A/c (Being C's Capital converted into Capital)		20,000	20,000
	A's Capital A/c Dr. B's Capital A/c Dr. To C's Capital A/c (Being the adjustment made account of admission of C an existing manager, as a partner)		360 240	600

16.0 GUARANTEE OF MINIMUM PROFIT TO A PARTNER

Guarantee to a Partner	It means assurance to give a minimum amount of Profit to a Partner.
Guaranteed Partner	A partner to whom guarantee of minimum profit has been provided is called ' Guaranteed Partner '.
Guaranteeing Partners	The partner(s) who has (have) given guarantee of minimum profit is (are) called ' Guaranteeing Partners '.
Guaranteed Amount	The minimum amount for which guarantee is given is called ' Guaranteed Amount '.
Who can provide Guarantee and in what ratio?	The guarantee may be provided by one or some or all of the partners in an existing profit sharing ratio or in some other agreed ratio.
Personal Guarantee	When guarantee is given by one or some or all of the partners in a ratio different from existing profit sharing ratio, such guarantee is said to be personal guarantee.

Firm Guarantee	When guarantee is given by all the partners in an existing profit sharing ratio, such guarantee is said to be firm guarantee.
Effect of Guarantee	If in any year, the actual Share of Profit of a Guaranteed Partner is less than the Guaranteed Amount, then the deficiency (i.e., excess of Guaranteed Amount over actual Share of Profit) is borne by the Guaranteeing Partners in their agreed ratio.

PRACTICAL STEPS INVOLVED IN THE DISTRIBUTION OF PROFITS UNDER GUARANTEE ARRANGEMENT

Step 1:	<i>Calculate the Actual Share of Profit/Loss of Guaranteed Partner for the given accounting period.</i>
Step 2:	<i>Calculate the Amount of Deficiency as follows:</i> $\text{Deficiency} = \text{Guaranteed Amount} - \text{Actual Share of Profit}$ or $= \text{Guaranteed Amount} + \text{Actual Share of Loss}$
Step 3:	<i>Distribute the Deficiency among the Guaranteeing Partners in their guaranteeing ratio</i>
Step 4:	<i>Distribute the Actual Profits/Losses among all the partners in their profit sharing ratio as if there is no guarantee arrangement.</i>
Step 5:	<i>Recover the Share of Deficiency (as per Step 3) from the Guaranteeing Partners and give credit for the same to Guaranteed Partner.</i>

ACCOUNTING TREATMENT

Case	Accounting Entry to be passed
I. In case the Actual Share is less than the Guaranteed Amount	(a) On Distributing the Profits as if there is no Guarantee Arrangement P & L Appropriation A/c Dr. To All Partners' Capital A/cs or (a) On Distributing the Loss as if there is no Guarantee Arrangement All Partners' Capital A/cs Dr. To P & L Appropriation A/c (b) On Charging Deficiency to guaranteeing partner(s) Guaranteeing Partners' Capital A/cs Dr. To Guaranteed Partner's Capital A/c
II. In case the Actual Share is more than the Guaranteed Amount	On Distributing the Profits as if there is no guarantee arrangement P&L Appropriation A/c Dr. To All Partners' Capital A/cs

TUTORIAL NOTE

Unless otherwise stated, it is presumed that all the existing partners (other than the Guaranteed Partner) have given such guarantee in their existing profit sharing ratio.

ILLUSTRATION 40 [GUARANTEE BY THE FIRM]

A and B are partners, sharing profits and losses in the ratio of 2: 1. On 1.4.2018, they admit C with 1/4th share in profits with Guaranteed Amount of ₹ 25,000. The profits for the year 2017-12 amounted to ₹ 76,000. Prepare Profit and Loss Appropriation Account.

SOLUTION**Step 1:** *Calculation of New shares*

Let the Total Share be = 1, C's Share = $\frac{1}{4}$

Remaining Share = $1 - \frac{1}{4} = \frac{3}{4}$, is to be divided among A and B in the ratio of 2:1 as under:

A's New Share = $\frac{2}{3} \times \frac{3}{4} = \frac{2}{4}$, B's new Share = $\frac{1}{3} \times \frac{3}{4} = \frac{1}{4}$

Step 2: C's Actual Share of Profit = $\frac{1}{4}$ of ₹ 76,000 = ₹ 19,000**Step 3:** Deficiency = Guaranteed amount – ₹ 19,000 = ₹ 25,000 – ₹ 19,000 = ₹ 6,000**Step 4:** Deficiency is to be borne by A and B in the ratio of 2:1 as follows:

Deficiency to be borne by A = $\frac{2}{3} \times ₹ 6,000 = ₹ 4,000$

Deficiency to be borne by B = $\frac{1}{3} \times ₹ 6,000 = ₹ 2,000$

Step 5: Preparation of Profit & Loss Appropriation Account**PROFIT AND LOSS APPROPRIATION ACCOUNT**

Dr.

for the year ending on 31st March, 2018

Cr.

Particulars	₹	Particulars	₹
To A's Capital A/c ($\frac{2}{4} \times ₹ 76,000$)	38,000	By Profit & Loss A/c	76,000
Less Deficiency borne ($\frac{2}{3} \times ₹ 6,000$)	(4,000)		
To B's Capital A/c ($\frac{1}{4} \times ₹ 76,000$)	19,000		
Less Deficiency borne ($\frac{1}{3} \times ₹ 6,000$)	(2,000)		
To C's Capital A/c ($\frac{1}{4} \times ₹ 76,000$)	19,000		
Add. Deficiency recovered from			
A	4,000		
B	2,000		
	76,000		76,000

ILLUSTRATION 41

A, B and C entered into partnership on 1st October 2017 to share profits & losses in the ratio of 4 : 3 : 3. A, however, personally guaranteed that C's share of profit after charging Interest on Capital @ 10% p.a. would not be less than ₹ 80,000 in any year. The Capital contributions were: A ₹ 3,00,000. B ₹ 2,00,000 and C ₹ 1,50,000.

The profit for the year ended on 31st March, 2018 amounted to ₹ 1,60,000.

Required: Prepare the Profit & Loss Appropriation Account.

SOLUTION
PROFIT & LOSS APPROPRIATION ACCOUNT
Dr.
for the year ending on 31st March, 2018
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Interest on Capital:		By Profit before appropriations	1,60,000
A	15,000		
B	10,000		
C	7,500		
	32,500		
To Net Profit transferred to:			
A (₹ 51,000 – ₹ 1,750)	49,250		
B (₹ 1,27,500 × 3/10)	38,250		
C (₹ 38,250 + ₹ 1,750)	40,000		
	1,27,500		
	1,60,000		1,60,000

Note: *Guaranteed Amount for half year = ₹ 80,000 × 1/2 = ₹ 40,000*
ILLUSTRATION 42 [GUARANTEE BY THE FIRM]

X, Y and Z entered into partnership on 1st April, 2016 to share profits and losses in the ratio of 12:8:5. It was provided that in no case Z's share in profits be less than ₹ 25,000 p.a. The profits and losses for the period ended 31st March were: 2015-2016 Profit ₹ 1,00,000, 2016-2017 Profit ₹ 1,50,000, 2017-2018 Loss ₹ 1,00,000. Pass the necessary journal entries in the books of the firm.

SOLUTION

<i>Particulars</i>	2015-2016 ₹	2016-2017 ₹	2017-2018 ₹
I. Guaranteed Amount	25,000	25,000	25,000
II. Z's Actual Share as per profit sharing ratio	20,000 (1,00,000 × 5/25)	30,000 (1,50,000 × 5/25)	(20,000) (1,00,000 × 5/25)
III. Deficiency (I – II)	5,000	–	45,000

Since no specific ratio in which the deficiency is to be borne is given, it means the remaining partners (A & B) shall bear the deficiency in their agreed profit sharing ratio which is 12:8 or 3:2.

JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
2015-2016	P&L Appropriation A/c Dr. To X's Capital A/c To Y's Capital A/c To Z's Capital A/c (Being the distribution of profits as if there is no guarantee)		1,00,000	48,000 32,000 20,000
	X's Capital A/c Dr. Y's Capital A/c Dr. To Z's Capital A/c (Being the deficiency met by guaranteeing partners)		3,000 2,000	5,000

2016-2017	P & L Appropriation A/c To X's Capital A/c To Y's Capital A/c To Z's Capital A/c (Being the distribution of profits)	Dr.		1,50,000	72,000 48,000 30,000
2017-2018	X's Capital A/c Y's Capital A/c Z's Capital A/c To Profit & Loss A/c (Being the distribution of losses as if there is no guarantee)	Dr. Dr. Dr.		48,000 32,000 20,000	1,00,000
	X's Capital A/c Y's Capital A/c To Z's Capital A/c (Being the deficiency borne by guaranteeing partners)	Dr. Dr.		27,000 18,000	45,000

ILLUSTRATION 43

The Partners of a firm distributed the profits for the year ended 31st March, 2018, ₹ 90,000 in the ratio of 3 : 2 : 1 without providing for the following adjustments:

- A & B were entitled to a salary of ₹ 375 each per quarter.
- B was entitled to a commission of ₹ 4,500.
- B & C had guaranteed a minimum profit of ₹ 35,000 p.a. to A.
- Profit were to be shared in the ratio of 3 : 3 : 2.

Required: Pass necessary journal entry for the above adjustments in the books of the firm.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	A's Capital A/c To B's Capital A/c To C's Capital A/c (Being adjustment entry passed for omission of salary, commission and change in profit sharing ratio of 3:3:2 among partners)	Dr.	8,500	4,500 4,000

Working Notes:

Dr.

ADJUSTED PROFIT AND LOSS ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Salary:		By P & L A/c	90,000
A's Capital	1,500		
B's Capital	1,500		
To Commission (B)	4,500		
To Profit transferred to:			
A	35,000		
B	28,500		
C	19,000		
	90,000		90,000

ADJUSTMENT TABLE

Particulars	A	B	C
Amount already recorded [₹ 90,000 in 3 : 2 : 1]	45,000	30,000	15,000
Amount to be recorded [Profit + Salary + Commission]	36,500	34,500	19,000
Adjustment	8,500	(4,500)	(4,000)

17.0 GOODWILL

Meaning of Goodwill	(a) Goodwill is the value of reputation of a firm in respect of the profits expected in future over and above the normal profits earned by other similar firms belonging to the same industry. Such excess of future profits over the normal profits is known as super profits. Thus, goodwill exists only when the firm earns super profits. (b) Any firm that earns only normal profits or is incurring losses has no goodwill. (c) If time value of money is considered, goodwill can be defined as the present value of anticipated super profits.
Nature of Goodwill	(a) Goodwill is regarded as an intangible asset and not a fictitious asset. (b) Goodwill is a valuable asset if the firm is earning profits and is a valueless asset if the firm is incurring losses. (c) However, in the periods of temporary recession, the goodwill of the firm which is incurring least losses as compared to other similar firms, may be a valuable asset.
Factors Affecting Goodwill	The factors giving rise to goodwill are as follows: 1. Nature of Business — A firm which produces high value added products or having a stable demand is able to earn more profits and therefore has more goodwill. 2. Favourable Location — When the business is centrally located or is at a place having heavy customer traffic, the goodwill tends to be high. 3. Efficiency of Management — A well-managed firm usually enjoys the advantages of high productivity and cost efficiency. This leads to higher profits and so the value of goodwill will also be high. 4. Market situation — The monopoly condition or limited competition enables the concern to earn high profits which leads to higher value of goodwill. 5. Special Advantages — The firm that enjoys special advantages like import licences, patents, trade marks, low rate and assured supply of electricity, long-term contracts for supply of materials, well-known collaborators etc. enjoy higher value of goodwill. 6. Technical know how 7. Quality of Products 8. After Sales Service 9. Producing/providing customers satisfying products 10. Management's attitude towards fulfillment of commitments (e.g. Timely delivery of goods to customers, timely payment to creditors, delivery of goods to customers at committed prices inspite of increase in market prices).

Need for Valuation of Goodwill	In case of a partnership firm, the need for valuation of goodwill may arise in the following circumstances: 1. When there is a change in profit-sharing ratio amongst the existing partners; 2. When a new partner is admitted; 3. When a partner retires; 4. When a partner dies; 5. When the firm is sold as a going concern; 6. When the firm is amalgamated with another firm.
Methods of Valuation of Goodwill	The various methods of valuing the goodwill are as follows:— 1. Average Profit Method, 2. Super Profits Method, and 3. Capitalisation Method.

18.0 AVERAGE PROFIT METHOD

- (a) Goodwill under this method is ascertained by multiplying the Average Future Maintainable Profit by a certain number of years' purchases.
- (b) It is based on the assumption that a new business will not be able to earn profits during the first few years of its operations.
- (c) Hence the person who purchases an existing business has to pay in the form of Goodwill a sum equal to Average Future Maintainable Profits multiplied by the number of years during which he is likely to receive the profits for the first few years.
- (d) While calculating past profits any abnormal gain is excluded by deducting from and any abnormal loss is excluded by adding to the past profits.
- (e) The various steps involved under this method are given below:

PRACTICAL STEPS INVOLVED UNDER AVERAGE PROFITS METHOD

Step 1:	Calculate Past profit for each of the relevant years (given) by adding abnormal losses and by deducting abnormal gains and Income from Non-trade Investments.
Step 2:	Calculate Total Profits by adding each relevant year's past profit.
Step 3:	Calculate Average Profits as under: Average Profits = Total Profit/No. of relevant years
Step 4:	Calculate Average Future Maintainable Profits after making future adjustments (if any)
Step 5:	Calculate Goodwill as under: Goodwill = Average Future Maintainable Profits × No. of years' Purchase.

ILLUSTRATION 44

Calculate the value of goodwill as on 1st Jan. 2019 on the basis of three years' purchases of the Average Profits of the last five years' profits. The profits & losses for the years were-2013 ₹ 30,000, 2014 Loss ₹ 40,000, 2015 ₹ 92,000, 2016 ₹ 55,000, 2017 ₹ 70,000, 2018 ₹ 90,000.

SOLUTION

Step 1: Total Profits = $-40,000 + 92,000 + 55,000 + 70,000 + 90,000 = ₹ 2,67,000$

Step 2: Average Profits = ₹ 53,400

Step 3: Goodwill = Average profits × No. of years' Purchases = ₹ 53,400 × 3 = 1,60,200.

ILLUSTRATION 45

If in Previous Illustration. Profit on sale of a fixed asset during 2014 amounted to ₹ 2,000, during 2016 amounted to ₹ 5,000, Loss on sale of a fixed asset during 2018 amounted to ₹ 5,000. Calculate the Value of Goodwill.

SOLUTION

Step 1: *Calculation of Profits excluding abnormalities.*

Adjusted Loss for 2014 = ₹ 40,000 + ₹ 2,000 = ₹ 42,000

Adjusted Profit for 2016 = ₹ 55,000 – ₹ 5,000 = ₹ 50,000

Adjusted Profit for 2017 = ₹ 90,000 + ₹ 5,000 = ₹ 95,000

Step 2: Total Profits = ₹ – 42,000 + ₹ 92,000 + ₹ 50,000 + ₹ 70,000 + ₹ 95,000 = ₹ 2,65,000

Step 3: Average Profit = $\frac{\text{Total Profits}}{\text{No. of years}} \times \frac{₹2,65,000}{5} = ₹ 53,000$

Step 4: Goodwill = Average Profit × No. of years' Purchases = ₹ 53,000 × 3 = ₹ 1,59,000.

ILLUSTRATION 46

The following were the profits of a firm for the last three years.

Year ending March 31	Profit (₹)
2016	5,00,000 (including an abnormal gain of ₹ 1,50,000)
2017	4,00,000 (after charging an abnormal loss of ₹ 2,00,000)
2018	6,00,000 (excluding ₹ 2,00,000 payable on the insurance of plant and machinery)

Calculate the value of firm's goodwill on the basis of four years' purchase of the average profits for the last three years.

SOLUTION

STEP 1: CALCULATION OF AVERAGE MAINTAINABLE PROFITS

Year ended	Profit	
2016	(5,00,000 – 1,50,000)	3,50,000
2017	(4,00,000 + 2,00,000)	6,00,000
2018	(6,00,000 – 2,00,000)	4,00,000
Total		13,50,000

Step 2: Average Profit = 13,50,000/3 = ₹ 4,50,000

Step 3: Goodwill at 4 years' purchase of Average Profit = ₹ 4,50,000 × 4 = ₹ 18,00,000

19.0 WEIGHTED AVERAGE PROFIT METHOD

If there exists clear increasing trend of profits, it is better to give more weightage to the profits of the recent years than those of earlier years. In case the profits show increasing trend, weights like 1,2,3,4 etc. may be used. In case profits show decreasing trend, weights like 4, 3, 2, 1, etc. may be used. The various steps involved under this method are given as follows:

PRACTICAL STEPS INVOLVED UNDER WEIGHTED AVERAGE PROFITS METHOD

- Step 1:** Calculate profits for each of the given years.
- Step 2:** Select the weights to be assigned
- Step 3:** Calculate the weighted profit for each of the years by multiplying the simple profits by the respective weight.
- Step 4:** Calculate the total of weights and total of weighted profits
- Step 5:** Calculate Weighted Average Profits as follows:

$$\text{Weighted Average Profits} = \text{Total of Weighted Profits} / \text{Total of Weights}$$
- Step 6:** Calculate the Value of Goodwill as under:

$$\text{Goodwill} = \text{Weighted Average Profit} \times \text{Agreed Number of years' purchase.}$$

ILLUSTRATION 47

The profits of a firm for the year ended 31st March for the last five years were as follows:

Year	Profit (₹)
2014	20,000
2015	30,000
2016	40,000
2017	50,000
2018	55,000

Calculate the value of goodwill on the basis of three years' purchase of weighted average profits after weights 1,2,3,4 and 5 respectively to the profits for 2014, 2015, 2016, 2017 and 2018.

SOLUTION

A Year ended 31 March	B Profit (₹)	C Weight	D = B × C Product
2014	20,000	1	20,000
2015	30,000	2	60,000
2016	40,000	3	1,20,000
2017	50,000	4	2,00,000
2018	55,000	5	2,75,000
Total		15	6,75,000

Weighted Average Profit = ₹ 6,67,000/15 = ₹ 44,466.67, Goodwill = ₹ 44,466.67 × 3 = ₹ 1,33,400

20.0 SUPER PROFIT METHOD

- Goodwill under this method is ascertained by multiplying the Super Profits by certain number of year's purchase.
- It is based on the assumption that a new business will not be able to earn excess profits (though it may earn normal profits) during the first few years of its operations.
- Hence the person who purchases an existing business has to pay in the form of Goodwill a sum equal to Super Profits multiplied by the number of years during which buyer is likely to receive excess profits for the first few years.
- The various steps involved under this method are given below:

PRACTICAL STEPS INVOLVED UNDER SUPER PROFIT METHOD

Step 1: Calculate Average Capital Employed as follows:

$$= (\text{Opening Capital Employed} + \text{Closing Capital Employed})/2$$

or

$$= \text{Closing Capital Employed} - \text{Half of current year's Profits} + \text{Half of Current year's Drawings}$$

Note: Capital Employed = All assets (other than goodwill, fictitious assets and non-trade investments) less Outsiders' Liabilities.

Step 2: Calculate Normal Profits as follows:

$$\text{Normal Profit} = \text{Average Capital Employed} \times \text{Normal Rate of Return.}$$

Note: Normal Rate of Return refers to the rate of return normally earned by an average firm belonging to the same industry.

Step 3: Calculate Average Future Maintainable Profits (according to steps given under Average Profits Method)

Step 4: Calculate Super Profits as follows:

$$\text{Super Profits} = \text{Average Future Maintainable Profits} - \text{Normal Profits}$$

Step 5: Calculate Goodwill as follows:

$$\text{Goodwill} = \text{Super Profits} \times \text{No. of years' Purchase.}$$

ILLUSTRATION 48

The profits and losses for the previous years are: 2015 Profit ₹ 10,000, 2016 Loss ₹ 17,000, 2017 Profit ₹ 50,000, 2018 Profit ₹ 75,000. The Average Capital employed in the business is ₹ 2,00,000, the rate of interest expected from capital invested is 10%. The remuneration of partners is estimated to be ₹ 6,000 p.a. Calculate the value of goodwill on the basis of 2 years' purchases of Super Profits based on the average of 3 years.

SOLUTION

- A. Total Profit for 3 years = – ₹ 17,000 + ₹ 50,000 + ₹ 75,000 = ₹ 1,08,000
- B. Average Profits = $\frac{\text{Total Profits}}{\text{No. of years}} \times \frac{₹1,08,000}{3} = ₹ 36,000$
 Average Profits for Goodwill = ₹ 36,000 – Partners' Remuneration
 = ₹ 36,000 – ₹ 6,000 = ₹ 30,000
- C. Normal Profit = Interest on Capital employed
 = ₹ 20,000 (i.e. ₹ 2,00,000 × 10/100) = ₹ 20,000
- D. Super Profit = Average Profit – Normal Profit = ₹ 30,000 – ₹ 20,000 = ₹ 10,000
- E. Goodwill = Super Profit × No. of years purchases = ₹ 10,000 × 2 = ₹ 20,000

ILLUSTRATION 49

On 1st April, 2018 an existing firm had assets of ₹ 75,000 including cash of ₹ 5,000. Its creditors amounted to ₹ 5,000 on that date. The firm had a Reserve Fund of ₹ 10,000 while partner's Capital accounts showed a balance of ₹ 60,000. If the Normal Rate of Return is 20% and the goodwill of the firm is valued at ₹ 24,000, at four year's purchase of super profit, find the average profits per year, of the existing firm.

SOLUTION

- A. Capital employed = ₹ 75,000 – ₹ 5,000 = ₹ 70,000
 B. Normal Profit = 20% of ₹ 70,000 = ₹ 14,000
 C. Goodwill = ₹ 24,000
 D. Super Profits = ₹ 24,000/4 = ₹ 6,000
 E. Average Profits = Normal Profit + Super Profit = ₹ 14,000 + ₹ 6,000 = ₹ 20,000

21.0 DISTINCTION BETWEEN AVERAGE PROFITS & SUPER PROFITS

Basis of Distinction	Average Profit	Super Profit
1. Meaning	Average Profit is the average of the profit of past few years.	Super Profit is the excess of Average Profits over Normal Profits.
2. Whether Average Capital Employed considered for calculation	Average Capital Employed is not considered while calculating Average Profits.	Average Capital Employed is considered while calculating Super profits.
3. Whether Normal Rate of Return considered for calculation?	Normal Rate of Return is not considered while calculating Average Profits.	Normal Rate of Return is Considered while calculating Average Profits.
4. Relevance while Valuing Super Goodwill	Average Profit is relevant for Average Profits Method, Super Profits Method and Capitalization Methods of valuation of Goodwill.	Super profits is relevant for Profits Method and Capitalization of Super Profits Method of valuation of Goodwill.

22.0 CAPITALISATION OF SUPER PROFIT

The goodwill under this method is ascertained by capitalising the super profits on the basis of Normal Rate of Return. The various steps involved in valuing the goodwill according to this method are given below:

PRACTICAL STEPS INVOLVED UNDER CAPITALISATION OF SUPER PROFITS

Step 1: Calculate Super Profits (according to steps given under Super Profits Method)

Step 2: Calculate Goodwill as under:

$$\text{Goodwill} = \text{Super Profits} \times \frac{100}{\text{Normal Rate of Return}}$$

ILLUSTRATION 50

A firm earns profits of ₹ 1,00,000. The Normal Rate of Return in a similar type of business is 10%. The value of total assets (excluding goodwill) and total outsiders' liabilities as on the date of valuation of goodwill are ₹ 11,00,000 and ₹ 2,80,000 respectively. Calculate the value of goodwill according to Capitalization of Super Profits Method.

SOLUTION

- A. Average Profit (given) = ₹ 1,00,000
 B. Normal Profit = (₹ 11,00,000 – ₹ 2,80,000) × 10/100 = ₹ 8,20,000 × 10/100 = ₹ 82,000
 C. Super Profit = ₹ 1,00,000 – ₹ 82,000 = ₹ 18,000
 D. Goodwill = ₹ 18,000 × 100/10 = ₹ 1,80,000

23.0 CAPITALIZATION OF AVERAGE PROFITS

The goodwill under this method is ascertained by deducting the actual capital employed (i.e. Net Assets as on the date of Valuation) in business from the Capitalised Value of the average profits on the basis of Normal Rate of Return. The various steps involved in valuing the goodwill according to this method are given below:

PRACTICAL STEPS INVOLVED UNDER CAPITALISATION OF AVERAGE PROFITS

Step 1: Calculate Average Future Maintainable Profits (according to steps given under Average Profits Method)

Step 2: Calculate the Capitalised Value of Average Profits as under:

$$\text{Capitalised Value} = \frac{\text{Average Profit}}{\text{Normal Rate of Return}} \times 100$$

Step 3: Calculate the value of Net Assets as on the date of valuation of goodwill as under:

Net Assets = All Assets (other than goodwill, fictitious assets and non-trade investments) at their current values less Outsiders' Liabilities.

Step 4: Calculate Goodwill as under:

$$\text{Goodwill} = \text{Capitalised Value} - \text{Net Assets}$$

ILLUSTRATION 51

Calculate the value of Goodwill according to Capitalization of Average Profits Method in the previous Illustration.

SOLUTION

- A. Average Profits = ₹ 1,00,000
 B. Capitalised Value of Average Profits = ₹ 1,00,000 × 100/10 = ₹ 10,00,000.
 C. Net Assets = Total Assets – Outsiders' Liabilities = ₹ 11,00,000 – ₹ 2,80,000 = ₹ 8,20,000
 D. Goodwill = ₹ 10,00,000 – ₹ 8,20,000 = ₹ 1,80,000

SOLVED PROBLEMS I**PROBLEM 1**

X, Y and Z are in partnership with capital of ₹ 1,20,000 (Credit), ₹ 1,00,000 (Credit) and ₹ 8,000 (Debit) respectively on 1st April, 2017. Their partnership deed provides for the following:

- 7.5% of Net Profit to be transferred to General Reserve.
- Partners are to be only allowed interest on capital @ 5% p.a. and are to be charged interest on drawings @ 6% p.a.
- Z is entitled to a salary of ₹ 7,000.

- (d) X is entitled to a remuneration of 10% of the net profit before making any appropriation.
- (e) Y is also entitled to a commission of 8% of the net profit before charging Interest on Drawings but after making all appropriations.

During the year, X withdrew ₹ 1,000 at the beginning of every month, Y ₹ 1,000 during the month and Z ₹ 1,000 at the end of every month. On 1st Oct. 2017, Z granted a loan of ₹ 6,00,000.

The Manager is entitled to a salary of ₹ 1,000 p.m. and a commission of 10% of net profits after charging his salary & commission.

The net profit of the firm for the year ended on 31st March, 2018 before providing for any of the above adjustments was ₹ 1,62,000.

Required: Prepare Profit and Loss Appropriation Account for the year ended on 31st March, 2018.

SOLUTION

PROFIT & LOSS ACCOUNT

Dr. *for the year ended on 31st March, 2018* Cr.

Particulars	₹	Particulars	₹
To Interest on Z's Loan [₹ 6,00,000 × 6/100 × 6/12]	18,000	By Net Profit before adjustments	1,62,000
To Manager's Salary [₹ 1,000 × 12]	12,000		
To Manager's Commission [(₹ 1,62,000 – ₹ 18,000 – ₹ 12,000) × 10/110]	12,000		
To Net Profit t/f to P & L App.A/c	1,20,000		
	1,62,000		1,62,000

PROFIT & LOSS APPROPRIATION ACCOUNT

Dr. *for the year ended on 31st March, 2018* Cr.

Particulars	₹	Particulars	₹
To General Reserve [7.5% of 1,20,000]	9,000	By Net Profit	1,20,000
To Interest on Capital:		By Interest on Drawings:	
X 6,000		X 390	
Y 5,000	11,000	Y 360	
To Z's Salary	7,000	Z 330	1,080
To X's Commission (10% of ₹ 1,20,000)	12,000		
To Y's Commission [(₹ 1,20,000 – 9,000 – 11,000 – 7,000 – 12,000) × 8/108]	6,000		
To Profit transferred to:			
X's Capital A/c	25,360		
Y's Capital A/c	25,360		
Z's Capital A/c	25,360		
	1,21,080		1,21,080

Working Notes:(i) *Calculation of Interest on Drawings*

$$\text{Interest on X's Drawings} = ₹ 12,000 \times \frac{6.5}{12} \times \frac{6}{100} = ₹ 390$$

$$\text{Interest on Y's Drawings} = ₹ 12,000 \times \frac{6}{12} \times \frac{6}{100} = ₹ 360$$

$$\text{Interest on Z's Drawings} = ₹ 12,000 \times \frac{5.5}{12} \times \frac{6}{100} = ₹ 330$$

(ii) Interest on partner's loan and Manager's Salary & Commission are charges against the profits and not the appropriations out of profits. Hence these items have been debited to Profit & Loss Account and not Profit & Loss Appropriation Account.

PROBLEM 2

From the following information, calculate the value of goodwill of BHARAT and TUSHAR.

- (i) At three years' purchase of Average Profit.
- (ii) At three years' purchase of Super Profit.
- (iii) On the basis of Capitalisation of Super Profit.
- (iv) On the basis of Capitalisation of Average Profit.

Information:

- (a) Average capital employed in the business—₹ 5,00,000.
- (b) Net Trading results of the firm for the past years: Profit 2016 ₹ 1,50,000;
Loss 2017—₹ 1,25,000; Profit 2018—₹ 4,25,000.
- (c) Rate of interest expected from capital having regard to the risk involved—15%.
- (d) Remuneration to each partner for his service—₹ 2,500 per month.
- (e) Assets (excluding goodwill)—₹ 6,00,000; Liabilities—₹ 50,000.

SOLUTION**(i) Goodwill at 3 years' purchase of Average Profit:**

$$\text{Average Profit} = [₹ 1,50,000 - ₹ 1,25,000 + ₹ 4,25,000/3] = ₹ 1,50,000$$

$$\begin{aligned} \text{Average Profit for Goodwill} &= ₹ 1,50,000 - \text{Remuneration of Partners} \\ &= ₹ 1,50,000 - (₹ 2,500 \times 12 \times 2) \\ &= ₹ 1,50,000 - ₹ 60,000 = ₹ 90,000 \end{aligned}$$

$$\text{Goodwill} = \text{Average Profit} \times 3 = ₹ 90,000 \times 3 = ₹ 2,70,000$$

(ii) Goodwill at 3 years' purchase of Super Profit:

$$\begin{aligned} \text{Normal Profit} &= \text{Average Capital Employed} \times \text{Normal Rate of Return} \\ &= ₹ 5,00,000 \times \frac{15}{100} = ₹ 75,000 \end{aligned}$$

$$\text{Super Profit} = \text{Average Profit} - \text{Normal Profit} = ₹ 90,000 - ₹ 75,000 = ₹ 15,000$$

$$\text{Goodwill} = \text{Super Profit} \times 3 = ₹ 15,000 \times 3 = ₹ 45,000$$

(iii) Goodwill under Capitalisation of Super Profit:

$$\text{Goodwill} = \text{Super Profit} \times \frac{100}{\text{Normal Rate of Return}} = ₹ 15,000 \times 100/15 = ₹ 1,00,000$$

(iv) Goodwill under Capitalisation of Average Profit:

$$\begin{aligned}\text{Step 1: Total Capitalised Value of the Firm} &= \frac{\text{Average Profit}}{\text{Normal Rate of Return}} \times 100 \\ &= \frac{\text{₹90,000}}{15} \times 100 = \text{₹ 6,00,000}\end{aligned}$$

$$\begin{aligned}\text{Step 2: Net Assets} &= \text{Total Assets (excluding goodwill)} - \text{Outsiders' Liabilities} \\ &= \text{₹ 6,00,000} - \text{₹ 50,000} = \text{₹ 5,50,000}\end{aligned}$$

$$\begin{aligned}\text{Step 3: Goodwill} &= \text{Total Capitalised Value of Business} - \text{Net Assets} \\ &= \text{₹ 6,00,000} - \text{₹ 5,50,000} = \text{₹ 50,000}\end{aligned}$$

PROBLEM 3

Shiv and Mohan are partners in a firm sharing profits and losses equally. On 31st March, 2018 the balances of their capital accounts were ₹ 3,00,000 and ₹ 2,00,000 respectively. The average profits of the firm are ₹ 1,36,000 and the rate of normal profit is 20%.

On 1st April, 2018 they agreed to admit Hari as a partner for one fourth share. Hari will bring ₹ 1,00,000 as capital.

You are required to compute the value of the goodwill of the firm on admission of Hari, if goodwill is to be calculated on the basis of:

- (1) 5 years' purchase of Super Profit (2) Capitalization Method
- (3) 3 years' purchase of Average Profit.

SOLUTION**VALUATION OF GOODWILL****(1) 5 years' Purchase of Super Profit**

$$\text{Value of Goodwill} = 5 \times \text{Super Profit} = 5 \times [\text{₹ 1,36,000} - (20\% \text{ of } \text{₹ 5,00,000})] = \text{₹ 1,80,000}$$

(2) Capitalisation Method

$$\begin{aligned}\text{Value of Goodwill} &= \text{Normal Value of business} - \text{Actual capital employed} = 6,80,000 \\ &= [\text{₹ 1,36,000}/20\%] - [\text{₹ 3,00,000} + \text{₹ 2,00,000}] = \text{₹ 1,80,000}\end{aligned}$$

(3) 3 years' Purchase of Average Profits

$$\text{Goodwill} = 3 \times \text{Average Profit} = 3 \times \text{₹ 1,36,000} = \text{₹ 4,08,000}$$

PROBLEM 4

Ram and Manohar are partners in a firm sharing profits and losses in the ratio of 7:3. According to the partnership deed, Ram was to be paid salary of ₹ 5,000 per month and Manohar was to get a bonus of ₹ 40,000 per annum. Interest on capital was to be allowed @ 10% per annum and interest on drawings was to be charged @ 8% per annum. Interest on Ram's drawings was ₹ 3,000 and on Manohar's drawings was ₹ 2,000. Their fixed capitals were ₹ 4,00,000 and ₹ 1,50,000 respectively. The firm earned a profit of ₹ 2,50,000 for the year ended 31.3.2018. Prepare Profit & Loss Appropriation A/c.

SOLUTION

Dr. P & L APPROPRIATION ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018 Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Ram's Salary (₹ 5,000 × 12)	60,000	By Net Profit as per P/L A/c	2,50,000
To Manohar's Bonus	40,000	By Interest on Drawings:	
To Interest on Capital:		Ram	3,000
Ram	40,000	Manohar	2,000
Manohar	15,000		5,000
To Profit t/f to Current A/c:			
Ram 7/10	70,000		
Manohar 3/10	30,000		
	1,00,000		
	2,55,000		2,55,000

PROBLEM 5

A and B start business on April 1, 2017, each partner contributing ₹ 1,50,000 as his share of capital. On October 1, 2017, B makes an additional contribution of ₹ 1,00,000 which is treated as a loan. The profit for the period ending March 2018 was ₹ 85,000 before charging any interest. All the partners were entitled to a salary of ₹ 3,000 each, per quarter. The partners had drawn ₹ 24,000 each on 1 st January 2018. Prepare the P&L Appropriation Account for the period ended March 31, 2018.

SOLUTION

Dr. PROFIT & LOSS APPROPRIATION ACCOUNT FOR THE PERIOD ENDED ON 31.3.2018 Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Salary:		By Net Profit as per P&L A/c	85,000
A (3,000 × 4)	12,000	Less: Interest on B's Loan	
B (3,000 × 4)	12,000	(1,00,000 × 6/100 × 6/12)	3,000
To Profit t/f to Capital A/cs:			82,000
A's 1/2	29,000		
B's 1/2	29,000		
	58,000		
	82,000		82,000

PROBLEM 6

A and B are partners sharing profits in the ratio of 3 : 2 with capitals of ₹ 50,000 and ₹ 30,000 respectively. Interest on capital is agreed @ 6% p.a. B is to be allowed an annual salary of ₹ 2,500. During 2017-2018 the profits of the year prior to calculation of interest on capital but after charging B's salary amounted to ₹ 12,500. A provision of 5% of the profits is to be made in respect of manager's commission. Prepare an account showing the allocation of profits and partners' capital accounts.

SOLUTION

Dr.

PROFIT & LOSS ACCOUNT
for the year ended 31st March, 2018

Cr.

Particulars	₹	Particulars	₹
To Manager's Commission (5% of ₹ 15,000)	750	By Profit before B's salary (12,500 + 2,500)	15,000
To Net Profit t/f to P & L Appr. A/c	14,250		
	15,000		15,000

PROFIT AND LOSS APPROPRIATION ACCOUNT

for the year ended 31st March, 2018

Dr.

Cr.

Particulars	₹	Particulars	₹
To Bs Salary	2,500	By Net Profit t/f from P & L A/c	14,250
To Interest on Capital:			
A	3,000		
B	1,800		
	4,800		
To Net Profit transferred to:			
A's Capital A/c	4,170		
B's Capital A/c	2,780		
	6,950		
	14,250		14,250

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	A ₹	B ₹	Particulars	A ₹	B ₹
To Balance c/d	57,170	37,080	By Balance b/d	50,000	30,000
			By P & L Appropriation A/c		
			— Interest on Capital	3,000	1,800
			— Profit	4,170	2,780
			— Salary		2,500
	57,170	37,080		57,170	37,080

Note: Manager's Commission is a charge against the profits. Hence, it is required to be provided for before making any appropriation (such as partner's salary, interest on capital).

PROBLEM 7

X and Y were partners in a firm sharing profits in the ratio of 3 : 2. On 1st April, 2017 their fixed capitals were ₹ 3,00,000 and ₹ 2,50,000 respectively. On 1st Oct, 2017, they decided that their total capital (fixed) should be ₹ 6,00,000 in their profit sharing ratio. Accordingly, they introduced extra capital or withdrew excess capital. The partnership deed provided for the following:

- (i) Interest on capital @ 12% p.a.
- (ii) Interest on drawing @ 18% p.a.
- (iii) A monthly salary of ₹ 2,000 to X and a monthly salary of ₹ 1,500 to Y. The drawings of X and Y during the year were as follows:

Date	X (₹)	Y (₹)
on 30th Sept. 2017	20,000	15,000
on 31st Dec. 2017	20,000	25,000

During the year ended 31st March, 2018 the firm earned a net profit of ₹ 1,50,000. 10% of this profit was to be transferred to general reserve. You are required to prepare: (i) Profit and Loss Appropriation Account (ii) Partners' Capital Accounts, and (iii) Partners' Current Accounts.

SOLUTION

Dr. **PROFIT AND LOSS APPROPRIATION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To General Reserve (₹ 1,50,000 × 10/100]	15,000	By P & L A/c (Net profit)	1,50,000
To Salary:		By Interest on Drawings:	
X [₹ 2,000 × 12]	24,000	X	2,700
Y [₹ 1,500 × 12]	18,000	Y	2,475
To Interest on Capital:			
X	39,600		
Y	29,400		
To Profit t/f to:			
X's Current A/c	17,505		
Y's Current A/c	11,670		
	1,55,175		1,55,175

Dr. **PARTNERS' CAPITAL ACCOUNTS** Cr.

Particulars	X ₹	Y ₹	Particulars	X ₹	Y ₹
To Cash A/c	—	10,000	By Balance b/d	3,00,000	2,50,000
To Balance c/d	3,60,000	2,40,000	By Cash A/c	60,000	
	3,60,000	2,50,000		3,60,000	2,50,000

Dr. **PARTNERS' CURRENT ACCOUNTS** Cr.

Particulars	X ₹	Y ₹	Particulars	X ₹	Y ₹
To Drawings	40,000	40,000	By Salary	24,000	18,000
To Interest on Drawings	2,700	2,475	By Interest on Capital	39,600	29,400
To Balance c/d	38,405	16,595	By P&L App. A/c (Profit)	17,505	11,670
	81,105	59,070		81,105	59,070

Working Notes:
1. Calculation of New capitals

₹ 6,00,000 in the ratio of 3 : 2

X's capital 3/5 of 6,00,000 = ₹ 3,60,000

Y's capital 2/5 of 6,00,000 = ₹ 2,40,000

2. Capital to be introduced by X = ₹ 3,60,000 – ₹ 3,00,000 = ₹ 60,000

Capital to be withdrawn by Y = ₹ 2,50,000 – ₹ 2,40,000 = ₹ 10,000

3. CALCULATION OF INTEREST ON CAPITAL

Particulars	X	Y
Upto 30th Sept	$3,00,000 \times \frac{12}{100} \times \frac{6}{12} = ₹ 18,000$	$2,50,000 \times \frac{12}{100} \times \frac{6}{12} = ₹ 15,000$
From 1st Oct. to 31st March	$3,60,000 \times \frac{12}{100} \times \frac{6}{12} = ₹ 21,600$	$2,40,000 \times \frac{12}{100} \times \frac{6}{12} = ₹ 14,400$
Total (₹)	39,600	29,400

4. CALCULATION OF INTEREST ON DRAWINGS

Particulars	X	Y
Upto 30th Sept	$20,000 \times \frac{18}{100} \times \frac{6}{12} = ₹ 1,800$	$15,000 \times \frac{18}{100} \times \frac{6}{12} = ₹ 1,350$
From 1st Oct. to 31st March	$20,000 \times \frac{18}{100} \times \frac{3}{12} = ₹ 900$	$25,000 \times \frac{18}{100} \times \frac{3}{12} = ₹ 1,125$
Total	₹ 2,700	₹ 2,475

PROBLEM 8

A, B and C were partners in a firm. On 1.1.2018 their capitals stood at ₹ 50,000, ₹ 25,000 and ₹ 25,000 respectively. As per the provisions of the partnership deed:

- C was entitled for a salary of ₹ 1,500 p.m.
- Partners were entitled to interest on capital at 5% p.a.
- Profits were to be shared in the ratio of capitals.

The net profit for the year 2018 of ₹ 45,000 was divided equally without providing for the above terms.

Required: Pass an adjusting entry to rectify the above error.

SOLUTION

STEP 1: ADJUSTMENT TABLE

Particulars	A ₹	B ₹	C ₹
I. Amounts already credited:			
Share of Profit (in ratio of 1:1:1)	15,000	15,000	15,000
II. Amounts which should have been credited:			
C's Salary	—	—	18,000
Interest on Capital	2,500	1,250	1,250
Share of Profit (in ratio of 2:1:1)	11,000	5,500	5,500
	13,500	6,750	24,750
III. Difference (I – II)	1,500	8,250	(9,750)

STEP 2: ADJUSTING JOURNAL ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	A's Capital A/c		1,500	
	Bs Capital A/c		8,250	
	To C's Capital A/c			9,750
	(Being the rectification for adjustment of profits as per partnership deed)			

PROBLEM 9

P, Q and R were partners in a firm sharing profits in the ratio of 1 : 2 : 2. After division of the profits for the year ended 31.3.2018 their capitals were: P ₹ 1,50,000; Q ₹ 1,80,000 and R ₹ 2,10,000. During the year they withdrew ₹ 20,000 each. The profit of the year was ₹ 60,000. The partnership deed provided that interest on capital will be allowed @ 10% p.a. While preparing the final accounts, interest on partners' capital was not allowed.

Required: You are required to calculate the capital of P, Q and R as on 1.4.2017 and pass the necessary adjustment entry for providing interest on capital.

SOLUTION**STEP 1: CALCULATION OF OPENING CAPITALS**

Particulars	P (₹)	Q (₹)	R (₹)	Total
A. Closing Capitals	1,50,000	1,80,000	2,10,000	5,40,000
B. Add: Drawings	20,000	20,000	20,000	20,000
C. Less: Share of Profit	12,000	24,000	24,000	60,000
D. Opening Capitals	1,58,000	1,76,000	2,06,000	5,00,000

STEP 2: ADJUSTMENT TABLE

Particulars	P (₹)	Q (₹)	R (₹)	Total
I. Share of Profit already credited	12,000	24,000	24,000	60,000
II. Amount which should have been Credited:				
(a) Interest on Capital @ 10%	15,800	17,600	20,600	54,000
(b) Share of Profit	1,200	2,400	2,400	6,000
	17,000	20,000	23,000	60,000
III. Difference [I – II]	–5,000	4,000	1,000	–

STEP 3: ADJUSTING JOURNAL ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Q's Capital A/c	Dr.	4,000	
	R's Capital A/c	Dr.	1,000	
	To P's Capital A/c			5,000
	(Being the omission of interest on capital rectified)			

PROBLEM 10

X, Y and Z are partners sharing profits & losses in the ratio of 3:2:1. After the final accounts have been prepared, it was discovered that Interest on drawings had not been taken into consideration, the Interest on drawings of partners amounted to —X ₹ 250; Y ₹ 190 and Z ₹ 100. Pass the necessary adjusting journal entry.

SOLUTION**STEP 1: ADJUSTMENT TABLE**

<i>Particulars</i>	<i>X ₹</i>	<i>Y ₹</i>	<i>Z ₹</i>
I. Amount which should have been debited by way of Interest on drawings	250	190	100
II. Amount which should have been credited by way of Share of Profit	270	180	90
III. Difference (I – II)	–20 (Cr.)	10 (Dr.)	10 (Dr.)

STEP 2: ADJUSTING JOURNAL ENTRY

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Y's Capital A/c Dr.		10	
	Z's Capital A/c Dr.		10	
	To X's Capital A/c			20
	(Being Interest on drawings omitted to be recorded, now adjusted)			

PROBLEM 11

R and S were partners in a firm sharing profits in 3 : 2 ratio. Their respective fixed capitals were ₹ 10,00,000 and ₹ 15,00,000. The partnership deed provided the following:

- (i) Interest on capital @ 10% p.a., (ii) Interest on drawing @ 12% p.a.

During the year ended 31.3.2018, R's drawings were ₹ 1,000 per month drawn at the end of every month and S's drawings were ₹ 2,000 per month drawn in the beginning of the every month. After the preparation of final accounts for the year ended 31.3.2018 it was discovered that interest on R's drawings was not taken into consideration.

Required: Calculate Interest on R's drawings and Pass necessary Adjusting Entry for the same.

SOLUTION

Step 1: Interest on R's Drawings = $12,000 \times 12/100 \times 5.5/12 = ₹ 660$

STEP 2: ADJUSTMENT TABLE

<i>Particulars</i>	<i>R (₹)</i>	<i>S (₹)</i>	<i>Total (₹)</i>
I. Amount which should have been debited (Interest on Drawings) (Dr.)	660	660	
II. Amount which should have been credited (Share of Profit) (Cr.)	396	264	660
III. Difference [I – II]	Dr. 264	Cr. 264	—

STEP 3: ADJUSTING ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	R's Current A/c Dr. To S's Current A/c (Being the Adjustment of omission of interest on drawings)		264	264

PROBLEM 12

Mohan, Vijay and Anil are equal partners, the balances in their capital accounts being ₹ 30,000, ₹ 25,000 and ₹ 20,000 respectively. In arriving at these figures, the profits for the year ended March 31st, 2018, ₹ 24,000 had already been credited to partners in the proportion in which they share profits. Their drawings were Mohan ₹ 5,000, Vijay ₹ 4,000 and Anil ₹ 3,000 during 2017-12. Subsequently, the following omissions were noticed and it was decided to bring them into account:

- (i) Interest on Capital at 10% per annum.
- (ii) Interest on Drawings at 10% per annum..

Required: Make the necessary corrections through a journal entry.

SOLUTION**STEP 1: CALCULATION OF OPENING CAPITALS AND INTEREST ON CAPITALS**

Particulars	Mohan ₹	Vijay ₹	Anil ₹
A. Closing Capitals	30,000	25,000	20,000
B. Add: Drawings	5,000	4,000	3,000
C. Less: Shares of Profit Credited	(8,000)	(8,000)	(8,000)
D. Opening Capitals	27,000	21,000	15,000
E. Interest @ 10%	2,700	2,100	1,500

Step 2: Calculation of Interest on Drawings:

Since date of drawings are not given, interest will be charged for 6 months.

Particulars	₹
Mohan: ₹ 5,000 × 10/100 × 6/12	₹ 250
Vijay : ₹ 4,000 × 10/100 × 6/12	₹ 200
Anil: ₹ 3,000 × 10/100 × 6/12	₹ 150
	₹ 600

STEP 3: CALCULATION REVISED PROFITS

Revised Profits = Given Profits + Interest on Drawings – Interest on Capitals
 = 24,000 + (250 + 200 + 150) – (2,700 + 2,100 + 1,500) = ₹ 18,300

STEP 4: ADJUSTMENT TABLE

Particulars	Mohan ₹	Vijay ₹	Anil ₹
I. Amount already credited:	8,000	8,000	8,000
II. Amount which should have been credited:			

Interest on Capital	2,700	2,100	1,500
Share of Profit (₹ 18,300 in 1 : 1 : 1)	6,100	6,100	6,100
Interest on Drawings	(250)	(200)	(150)
	8,550	8,000	7,450
III. Amount to be adjusted [I – II]	550	—	550

STEP 4: JOURNAL ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Anil's Capital A/c To Mohan's Capital A/c (Being the adjusting entry to correct the amounts of profit transferred to Capital Accounts)		550	550

SOLVED PROBLEMS II**PROBLEM 1**

Weak, Able and Lazy are in partnership sharing profits and losses in the ratio of 2 : 1 : 1. It is agreed that interest on capital will be allowed @ 10% per annum and interest on drawings will be charged @ 8 per cent per annum. (No interest will be charged/allowed on Current Accounts). The following are the **Particulars** of the Capital and Drawings Accounts of the partners:

Particulars	Weak ₹	Able ₹	Lazy ₹
Capital (1.1.2018)	75,000	40,000	30,000
Current Account (1.1.2018)	10,000	5,000	(Dr.) 5,000
Drawings during 2018	15,000	10,000	10,000

The draft accounts for 2018 showed a net profit of ₹ 60,000 before taking into account interest on capitals and drawings and subject to following rectification of errors:

- Life Insurance premium of Weak amounting to ₹ 750 paid by the firm has been charged to Miscellaneous Expenditure Account.
- Repairs of Machinery amounting to ₹ 10,000 has been debited to Plant Account and depreciation there on charged @ 20%.
- Travelling expenses of ₹ 3,000 of Able for a pleasure trip to UK paid by the firm on 30th June, 2018 has been debited to Travelling Expenses Account.

Required: Prepare the Profit and Loss Appropriation Account for the year ending on 31st Dec. 2018 and partners' Current Accounts for the year.

SOLUTION**PROFIT AND LOSS APPROPRIATION ACCOUNT**

Dr. Cr.
for the year ending on 31st Dec., 2018

Particulars	₹	Particulars	₹
To Interest on Capital:		By Net Profit (Adjusted)	55,750
Weak 7,500		By Interest on Drawings:	
Able 4,000		Weak 630	
Lazy 3,000	14,500	Able 520	

To Partner's Current A/cs:			Lazy	400	1,550
Share of Profit	Weak	21,400			
	Able	10,700			
	Lazy	10,700	42,800		
			57,300		57,300

Dr.

PARTNERS' CURRENT ACCOUNTS

Cr.

<i>Particulars</i>	<i>Weak</i>	<i>Able</i>	<i>Lazy</i>	<i>Particulars</i>	<i>Weak</i>	<i>Able</i>	<i>Lazy</i>
₹	₹	₹	₹	₹	₹	₹	₹
To Balance b/d	—	—	5,000	By Balance b/d	10,000	5,000	—
To Drawings	15,000	10,000	10,000	By P & L App. A/c			
To Life Insurance				(Int. on capital)	7,500	4,000	3,000
Premium	750	—	—	By P & L App. A/c	21,400	10,700	10,700
To Travelling Exps.	—	3,000	—	(Share of Profit)			
To P & L App. A/c				By Balance c/d	—	—	1,700
(Int. on Drawings)	630	520	400				
To Balance c/d	22,520	6,180	—				
	38,900	19,700	15,400		38,900	19,700	15,400

Working Notes:
(I) CALCULATION OF ADJUSTED PROFIT

	₹
A Net Profit as per Profit & Loss A/c	60,000
B Add: Drawings by Weak: (LIP charged to Misc. Exp)	750
C Add: Drawings by Able (Travelling Expenses of Able charged to Travelling Expenses A/c of the firm)	3,000
D Less: Repairs to Machinery wrongly capitalised	10,000
Less: Depreciation charged @ 20%	2,000
	55,750

(II) CALCULATION OF INTEREST ON DRAWINGS

<i>Particulars</i>	<i>Weak</i>	<i>Able</i>	<i>Lazy</i>
₹	₹	₹	₹
A Drawings	15,000	10,000	10,000
B Add: Rectificatory Adjustments	750	3,000	—
	15,750	13,000	10,000
D Interest @ 8% p.a. for 6 months	630	520	400

PROBLEM 2

A, B and C were working in partnership, sharing profits and losses in the ratio of 2 : 1 : 1. It had been agreed that interest would be allowed at the rate of 10% per annum on partners' Capital Accounts. The balance in the Capital Accounts of A, B, C, on 1st Jan. 2017, were ₹ 15,000, ₹ 8,000 and ₹ 6,000 respectively. The account for the year ended 31st Dec., 2017 showed a net profit of ₹ 24,000 after taking into account interest on partners' capitals. The amounts and the shares in profit were credited

to the currents accounts. During 2018, it was discovered that the following errors had occurred in the accounts for 2017.

(a) Rent of A's private house amounting to ₹ 300 and paid during 2017 had been included in Rent Account appearing in the P & L A/c. (b) Premium, amounting to ₹ 1,200 on B's life insurance and paid on 30th June, 2017 had been included in Insurance Expenses debited to the P & L. A/c. After the close of the year 2017, accounts, it was decided that, with effect from Jan. 1, 2017, the rate of interest on capital should be increased to 12%.

Required: Pass the necessary adjusting entry.

SOLUTION

ADJUSTMENT TABLE

<i>Particulars</i>	<i>A ₹</i>	<i>B ₹</i>	<i>C ₹</i>	<i>Total ₹</i>
A Amount already credited:				
(a) Interest on Capital	1,500	800	600	2,900
(b) Share of Profit	12,000	6,000	6,000	24,000
	13,500	6,800	6,600	26,900
B Amounts which should have been credited (or debited):				
(a) Interest on Capital	1,800	960	720	3,480
(b) Share of Profit	12,460	6,230	6,230	24,920
(c) Private Expenses	(300)	(1,200)	—	(1,500)
	13,960	5,990	6,950	26,900
C Difference (A – B)	(460)	810	(350)	—

ADJUSTMENT ENTRY

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	B's Current A/c Dr.		810	
	To A's Current A/c			460
	To C's Current A/c			350
	(Being the adjustments made through current accounts)			

Working Note:

COMPUTATION OF THE ACTUAL PROFIT FOR 2017

<i>Particulars</i>	<i>₹</i>
A Net Profit given	24,000
B Add: Interest on Capital already debited	2,900
C Add: Private Expenses wrongly debited (₹ 300 + ₹ 1,200)	1,500
D Profit before Interest	28,400
E Less: Interest on Capital @ 12%	3,480
F Profit after Interest	24,920

PROBLEM 3

A and B have been carrying on business in partnership. They share profit equally. After the profit for 2018 had been divided, it was agreed that with effect from Jan. 1, 2018 they would share profits and losses as—A: 3/5 and B: 2/5. At that time, it was also discovered that while preparing accounts for 2017 and 2018, the following expenses which had occurred and those paid in advance have been erroneously ignored.

<i>Particulars</i>	<i>2017</i> ₹	<i>2018</i> ₹
Outstanding expenses	5,000	7,200
Expenses paid in advance	1,000	500
Accrued Income	200	300

The profit during 2018 was ₹ 30,000 according to the accounts already prepared.

Required: Give the necessary single adjusting journal entry to adjust the accounts of partners.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	A's Capital A/c Dr.		460	
	B's Capital A/c Dr.		5,940	
	Prepaid Expenses A/c Dr.		500	
	Accrued Income A/c Dr.		300	
	To Outstanding Expenses A/c			7,200
	(Being the expenses and income not taken into account adjusted)			

Working Note:

ADJUSTMENT TABLE

<i>Particulars</i>	<i>A</i> ₹	<i>B</i> ₹
A Amount already credited	15,000	15,000
Share of Profit (in the ratio of 1 : 1)		
B Amount which should have been credited		
Share of Current Year's Profit (in the ratio of 3 : 2)		
Profit = ₹30,000 + ₹5,000 – ₹1,000 – ₹200 – ₹7,200 + ₹500 + ₹300) = ₹27,400	16,440	10,960
C Amount which should have been debited in respect of previous year's items (₹ 5,000 – ₹ 1,000 – ₹ 200) (in the ratio of 1 : 1)	(1,900)	(1,900)
D Net Amount with which to be debited [A – B + C]	460	5,940

PROBLEM 4

The firm of A, B and C has existed for some years, profit being shared as 2/5, 2/5 and 1/5 respectively. C, however, feels that this arrangement has not been satisfactory to him and requires to be placed on some basis as regards profits as A and B. He further wants that this arrangement shall apply not

only to future profits but also retrospectively to the profits of the past 3 years which were ₹ 10,000 ₹ 20,000 and ₹ 30,000. A and B have no objection to this. They further agree that in making such adjustment regard should be had to ₹ 5,000 value of goods which had been charged to profits but which actually were taken privately by B and ₹ 15,000 of office equipment no asset account had been opened in the books but charged to Profit and Loss Account. Plant and Machinery of the firm had not been depreciated over past years and it was estimated that the total of the amounts which should have been written off was ₹ 5,000. It was further agreed that after adjustments the capital accounts were to be equalized without, however, increasing or reducing the total capital of the firm.

Required: Show the Profit & Loss Adjustment Account and the Capital Accounts of the Partners after giving effect to the above agreement, assuming that immediately after the distribution of last year's profits, the capital accounts stood as: A—₹ 45,000; B—₹ 35,000 C—₹ 30,000.

SOLUTION

Dr. **PROFIT & LOSS ADJUSTMENT ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Dep. on Plant & Machinery	5,000	By A's Capital A/c	24,000
To Balance transferred to:		By B's Capital A/c	24,000
A's Capital A/c	25,000	By C's Capital A/c	12,000
B's Capital A/c	25,000	By B's Capital A/c (goods)	5,000
C's Capital A/c	25,000	By Office Equipment A/c	15,000
	80,000		80,000

Dr. **CAPITAL ACCOUNTS OF PARTNERS** Cr.

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To P&L Adjustment A/c	24,000	24,000	12,000	By Balance b/d	45,000	35,000	30,000
To Cash A/c	6,000	—	3,000	By P&L Adjustment A/c	25,000	25,000	25,000
To P&L Adjustment A/c	—	5,000	—	By Cash A/c	—	9,000	—
To Balance c/d	40,000	40,000	40,000				
	70,000	69,000	55,000		70,000	69,000	55,000

Notes:

- In order to adjust the partners' capital accounts in accordance with the new arrangement, the past three years' profits, that were credited to partners in the ratio of 2 : 2 : 1 have been written back.
- The total capital of the firm would be ₹ 1,20,000 (i.e. ₹ 1,10,000 plus ₹ 15,000 minus ₹ 5,000) and hence after equalising, each partner's capital would be ₹ 40,000 (i.e., one third of ₹ 1,20,000)

PROBLEM 5

A and B were in partnership sharing profits and losses in the ratio of 2 : 3. On 1st April, 2017, they agreed to admit their sales manager 'C' as a partner with a one third share in the profits and a salary of ₹ 6,000 p.a. It is agreed that C's share shall not be less than his present salary of ₹ 9,000 p.a. together with a commission of 5% of the net profits after charging such salary & commission.

The profits for the year ended 31st March, 2018, before charging any commission and salary were ₹ 93,000. The excess of C's 1/3rd share in the profits over his remuneration is to be borne by A and B in the ratio of 3 : 2.

Required: Prepare a Statement showing the Distribution of Profits.

SOLUTION

**STATEMENT SHOWING THE EXCESS OF C 'S SHARE
AS PARTNER OVER HIS REMUNERATION AS MANAGER**

<i>Particulars</i>	₹
A Remuneration of 'C' as manager	
Salary	9,000
Commission @ 5/105 of ₹ 84,000 being (₹ 93,000 – ₹ 9,000)	4,000
	13,000
B Amount to be received by 'C's as Partner— Salary	6,000
Profit (₹ 87,000 × 1/3)	29,000
	35,000
C Excess of C 's Share as Partner over his Remuneration as Manager, to be borne by A and B in the ratio of 3 : 2 (A – B)	22,000

DISTRIBUTION OF PROFITS

<i>Particulars</i>	A ₹	B ₹	C ₹
A Distribution of profits under old arrangement (₹ 93,000 – ₹ 13,000) divided in the ratio of 2 : 3	32,000	48,000	—
B Share of 'C ' under old arrangement	—	—	13,000
C Excess of Share of 'C ' as partner over his Remuneration as Manager divided in the ratio of 3 : 2	(13,200)	(8,800)	22,000
D Share under new arrangement	18,800	39,200	35,000

PROBLEM 6

With effect from 1st January, 2018, 'M' the manager in the firm of R, S and T who were sharing profits and losses in the ratio of 1/2 and 1/3 and 1/6 respectively, was admitted as partner in the firm with a 1/10th share. It was agreed that should M's share of profits exceed his remuneration as Manager, R should bear the excess. As manager, M was entitled to a salary of ₹ 2,000 p.m. together with a commission of 2% on profit after charging the salary and commission when accounts were drawn up for 2018, by mistake the salary and commission as given above for M were debited to the Profit and Loss Account which then showed a credited balance of ₹ 3,00,000.

Required: Prepare a Statement showing the Distribution of Profits for 2018 together with necessary journal entries.

SOLUTION

JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	P & L Adjustment A/c	Dr.	3,00,000	
	To R 's Capital A/c			1,50,000
	To S 's Capital A/c			1,00,000
	To T 's Capital A/c			50,000
	(Being the profits distributed as if 'M' is manager)			

	R 's Capital A/c To M 's Capital A/c (Being the deficiency met out of share of R)	Dr.		3,000	3,000

DISTRIBUTION OF PROFITS

Particulars	R ₹	S ₹	T ₹	M ₹
A Distribution of profits under old arrangement (₹ 3,00,000 divided in the ratio of 3 : 2 : 1)	1,50,000	1,00,000	50,000	—
B Share of M under old arrangement	—	—	—	30,000
C Excess of Share of M as Partner over his remuneration as Manager to be borne by R	(3,000)	—	—	3,000
D Profit under new arrangement	1,47,000	1,00,000	50,000	33,000

Working Notes:

Particulars	₹
(i) Calculation of Profit before charging salary and commission	
I Profit after Salary & Commission	3,00,000
II Commission @ 2%	6,000
III Salary @ ₹ 2,000 p.m.	24,000
(ii) Share of 'M' as partner (₹ 3,30,000 × 1/10)	33,000
(iii) Remuneration of 'M' as Manager	30,000
(iv) Excess of share as partner over remuneration as Manager to be borne by 'R'	3,000

PROBLEM 7

A, B and C are partners in a firm of which Partnership Deed includes the following provisions:

- B is entitled to a salary of ₹ 1,550 per month.
- C will get a salary of ₹ 950 per month to come out of B's share of Profit.
- In case C's share of profit, Interest on Capital and salary happens to be less than ₹ 50,000, the difference has to come out of A's share of profit.
- Partners are entitled to interest on capital @ 12% p.a.

On 31st March, 2017, the capital Accounts of A, B and C were ₹ 30,000, ₹ 60,000 and ₹ 80,000 respectively and they share the profits in the ratio of 3 : 2 : 1. Net profits of the firm for the year ending on March 31, 2018, were ₹ 1,59,000 before charging partners' salaries and interest on capital.

Required: Prepare Profit & Loss Appropriation Account.

SOLUTION**PROFIT AND LOSS APPROPRIATION ACCOUNT**

Dr.

for the year ending on 31st March, 2018

Cr.

Particulars	₹	Particulars	₹
To Salary to Partners:		By Profit before Adjustments	1,59,000
B 18,600			
C 11,400	30,000		

To Interest on Capital:			
A	3,600		
B	7,200		
C	9,600	20,400	
To Profit transferred to Capital A/cs:			
A	51,000		
B	28,600		
C	29,000	1,08,600	
		1,59,000	1,59,000

Working Notes:

- (i) Profits available for distribution (after Interest on Capital & B's salary)
= ₹ 1,59,000 – ₹ 39,000 = ₹ 1,20,000.
- (ii) Profits Shares of Partners: A ₹ 60,000; B ₹ 40,000; C ₹ 20,000.
- (iii) C's deficiency in profit = ₹ 50,000 – ₹ 20,000 – ₹ 21,000 = ₹ 9,000.
- (iv) Adjustments: A ₹ 60,000 – ₹ 9,000 = ₹ 51,000;
 B ₹ 40,000 – ₹ 11,400 = ₹ 28,600.
 C ₹ 20,000 + ₹ 9,000 = ₹ 29,000.

PROBLEM 8

Mehra and Ratnam are in partnership with capitals of ₹ 28,000, ₹ 14,000 respectively sharing profits and losses as 2 : 1. Interest on capital @ 5% per annum and salary of ₹ 2,800 per annum to Ratnam are allowable. Due to ill health Mehra ceased to take active part in the business with effect from 1st Jan. 2018, and the following terms were agreed upon:

- (a) That the Manager, Jahar shall be taken as a partner with a capital of ₹ 5,000, he being entitled to a salary of ₹ 5,250 per annum, the excess over ₹ 2,800 (the salary received by him as Manager) to be borne by Mehra personally.
- (b) That Ratnam shall get a salary of ₹ 3,500 per annum.
- (c) That Jahar shall be entitled to one tenth of profits and losses after charging interest on capitals and partners' salaries.
- (d) That interest on capital shall be allowed @ 5% per annum.

The net profit for the year ended 31st Dec., 2018, was ₹ 22,400 before charging interest on capital and partner's salaries.

Required: Show the division of the profit for the year 2018 between the partners.

SOLUTION**PROFIT AND LOSS APPROPRIATION ACCOUNT**

Dr.

for the year ending on 31st Dec., 2018

Cr.

Particulars	₹	Particulars	₹
To Ratnam's Salary	3,500	By Net Profit b/d	22,400
To Jahar's Salary	5,250		
To Interest on Capital: Mehra 1,400			
Ratnam 700			
Jahar 250	2,350		

To Profit transferred to Capital Accounts:			
Mehra (Balance)	6,045		
Ratnam (3/10 of ₹ 13,750 profit after interest and salaries, taking Jahar's salary to be ₹ 2,800)	4,125		
Jahar (1/10 of ₹ 11,300 profit after interest and partners salaries)	1,130		
	22,400		22,400

Alternative Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr.

for the year ending on 31st Dec., 2018

Cr.

Particulars	₹	Particulars	₹
To Ratnam's Salary	3,500	By Net Profit	22,400
To Jahar's Salary	2,800		
To Interest on Capital:			
Mehra	1,400		
Ratnam	700		
Jahar	250		
	2,350		
To Balance c/d	13,750		
	22,400		22,400
To Profit transferred to:			
Mehra: (6/10)	8,250		
Less: Excess salary of Jahar	2,450	By Balance b/d	13,750
Ratnam (3/10)	4,125		
Jahar: (1/10)	1,375		
Add: From Mehra for Salary (Bal.)	2,450		
	3,825		
	13,750		13,750

Note: The significant point seems to be that Ratnam should not suffer on account of increase in Jahar salary and that, for the purpose of ascertaining Ratnam's share, the salary of Jahar should be ₹ 2,800. From this point of view, the first solution is considered Proper. It cannot be that Jahar should derive a double benefit from increase in his salary and Mehra's agreeing to bear increased part of it.

PROBLEM 9

M/s CANJA & CO.'s Balance Sheet as at 31st March, 2018:

Particulars	₹
Bank overdraft (State Bank)	54,000
Sundry Creditors	1,56,000
Capital Accounts:	
Mr A	
Balance as per last B/S	4,02,000
Add: Profit for the year	95,400
	4,97,400

Less: Drawings	40,000	4,57,400
Mr B		
Balance as per last B/S	2,00,000	
Add: Profit for the year	95,400	
	2,95,400	
Less: Drawings	76,000	2,19,400
Cash at Bank of India		800
Sundry Debtors		2,80,000
Stock		1,00,000
Motor Cars cost as per last B/S	1,60,000	
Less: Depreciation till date	54,000	1,06,000
Machinery:		
Cost as per last B/S	3,00,000	
Less: Depreciation till date	1,40,000	1,60,000
Land and Buildings		2,40,000

You have examined the foregoing Draft of the Balance Sheet and have ascertained that the following adjustments are required to be carried out:

- Land and Buildings are shown at cost less ₹ 60,000 being the proceeds of the sale during the year of premises costing ₹ 70,000.
- Machinery having a net book value of ₹ 4,300 had been scrapped during the year. The original cost was ₹ 12,300.
- ₹ 2,000 paid for the Licence fees for the year ending 30th Sept., 2018 had been written off.
- Debts amounting to ₹ 10,420 were considered to be bad and further debts amounting to ₹ 5,400 were considered doubtful and required 100% provision. Provision for doubtful debts had previously been made for ₹ 10,000.
- An item in the Inventory was valued at ₹ 37,400, but had a realisable value of ₹ 26,000 only. Scrap material having a value of ₹ 6,600 had been omitted from the stock valuation.
- The cashier had misappropriated ₹ 700.
- The cash-book for the year ending 31st March, 2018 included payments amounting to ₹ 6,924, the cheques having been made out, but not despatched by suppliers until April, 2018.
- Interest is to be allowed on the Partners' opening Capital Account balances less drawings during the year at 9%.

You are required to prepare:

- Profit & Loss Adjustment Account for the year
- Capital Accounts of the Partners.

SOLUTION

Dr.

PROFIT AND LOSS ADJUSTMENT ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Land & Building Account	10,000	By Partners' Capital Accounts:	
(Loss on Sale)		Mr A	95,400
To Machinery Account	4,300	Mr B	95,400
(Loss on Scrapping)		By Prepaid Expenses	1,90,800

To Provision for Doubtful Debts (As per note below)	5,820	(Licence Fee)	1,000
To Stock Adjustment (Fall in Market Value)	11,400	By Stock Adjustment (Items omitted)	6,600
To Cash (Misappropriation)	700		
To Interest on Capitals:			
Mr A	32,580		
Mr B	11,160		
To Balance transfer to Capital Accounts:			
Mr A	61,220		
Mr B	61,220		
	1,98,400		1,98,400

Working Notes:

Dr.

(I) PROVISION FOR DOUBTFUL DEBTS ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Bad Debts	10,420	By Balance b/d	10,000
To Balance c/d (required)	5,400	By P & L Adjustment A/c (b.f.)	5,820
	15,820		15,820

Dr.

(II) CAPITAL ACCOUNT OF PARTNERS

Cr.

Particulars	Mr. A ₹	Mr. B ₹	Particulars	Mr. A ₹	Mr. B ₹
To Drawings	40,000	76,000	By Balance b/d	4,02,000	2,00,000
To P&L Adjustment A/c	95,400	95,400	By Profit for the year	95,400	95,400
To Balance c/d	4,55,800	1,96,380	By P&L Adjustment A/c:		
			Interest on Capital	32,580	11,160
			Profit for the year	61,220	61,220
	5,91,200	3,67,780		5,91,200	3,67,780

- (iii) Misappropriation by cashier may be debited to cashier. In that case ₹ 700 will not be debited to P & L Adjustment Account and profit to partners will be ₹ 1,23,140 (Mr A ₹ 61,570 and Mr B ₹ 61,570). The capital accounts will accordingly be different.
- (iv) The student may not reverse the distributed profit of last year. In that case Profit & Loss Adjustment A/c and Partners' Capital Accounts will differ from the solution. However, the balance of the Capital Accounts will remain the same.

PROBLEM 10

The partnership accounts of X and Y sharing in the ratio of 3 : 2 were maintained on cash basis right from its formation (in 2015). Now the partners decided to change into mercantile basis. Following details are given in this respect:

Particulars	2015 ₹	2016 ₹	2017 ₹	2018 ₹
Outstanding Salary	1,000	2,000	3,000	4,000
Prepaid Insurance Premium	1,500	3,000	4,500	6,000

Interest accrued but not received	2,000	4,000	6,000	8,000
Rent received in advance	3,000	6,000	9,000	12,000
Profits as per P & L A/c	10,500	20,500	30,500	40,500

Required: Pass the necessary single adjusting entry.

SOLUTION

CALCULATION OF PROFITS ON MERCANTILE BASIS

<i>Particulars</i>	<i>2015</i> ₹	<i>2016</i> ₹	<i>2017</i> ₹	<i>2018</i> ₹
A Cash Profits as given	10,500	20,500	30,500	40,500
B Add: Outstanding Expenses in the beginning of current year	—	1,000	2,000	3,000
C Add: Prepaid Expenses at the end of current year	1,500	3,000	4,500	6,000
D Add: Accrued Income at the end of current year	2,000	4,000	6,000	8,000
E Add: Unaccrued Income in the beginning of current year	—	3,000	6,000	9,000
F Less: Outstanding Expenses at the end of current year	(1,000)	(2,000)	(3,000)	(4,000)
G Less: Prepaid Expenses in the beginning of current year	—	(1,500)	(3,000)	(4,500)
H Less: Accrued Income in the beginning of current year	—	(2,000)	(4,000)	(6,000)
I Less: Unaccrued income at the end of current year	(3,000)	(6,000)	(9,000)	(12,000)
J Profits on Mercantile Basis	10,000	20,000	30,000	40,000

ADJUSTING JOURNAL ENTRY

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Prepaid Insurance Premium A/c Dr.		6,000	
	Interest Accrued A/c Dr.		8,000	
	X 's Capital A/c Dr.		1,200	
	Y 's Capital A/c Dr.		800	
	To Outstanding Salary A/c			4,000
	To Rent Received-in-advance A/c			12,000
	(Being the entry on Conversion of Cash Basis into Mercantile Basis)			

26

RECONSTITUTION OF PARTNERSHIP — CHANGE IN PROFIT SHARING RATIO

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of Reconstitution of a Firm
- ◇ Occasions when Reconstitution of a Firm can take place
- ◇ Meaning of Change in Profit Sharing Ratio
- ◇ Need for Change in Profit Sharing Ratio
- ◇ Adjustments Required at the time of Change in Profit Sharing Ratio
- ◇ Meaning of Sacrificing Partners
- ◇ Meaning of Sacrificing Ratio
- ◇ Meaning of Gaining Partners
- ◇ Meaning of Gaining Ratio
- ◇ Meaning of New Profit Sharing Ratio
- ◇ Adjustment of Goodwill
- ◇ Adjustments of Profit/Loss on Revaluation of Assets & Liabilities
- ◇ Adjustment of Reserves and Accumulated Profits/Losses
- ◇ Adjustment of Capitals

1.0 RECONSTITUTION OF A FIRM

Meaning	Any change in existing agreement of partnership amounts to reconstitution of a firm. As a result, the existing agreement comes to an end and a new agreement comes into existence and the firm continues.
When Takes Place	Reconstitution of the firm can take place on the following occasions: 1. Change in the Profit Sharing Ratio of existing partners. 2. Admission of a new partner [e.g. Admission of Z as partner in the firm of X and Y] 3. Retirement of an existing partner [e.g. Continuity of business by X and Y after the retirement of a third partner Z]. 4. Death of a partner [e.g. Continuity of business by X and Y after the death of a third partner Z]. 5. Amalgamation of two partnership firms. [e.g. Merger of a firm of X and Y with the firm of P and Q.]

2.0 CHANGE IN PROFIT SHARING RATIO

Meaning	1. A change in profit sharing ratio is one of the modes of reconstituting the firm under which old partnership comes to an end and a new one comes into existence. 2. A change in profit sharing ratio basically implies the purchase of share of profit by one partner from another partner. 3. Change in profit sharing ratio involves increase in share of profit of one or more partners and decrease in share of profit of one or more partners.
Need for Change in Profit Sharing Ratio	The need for change in profit sharing ratio arises in the following circumstances: 1. When the partners so decide. 2. When a new partner is admitted. 3. When a partner retires. 4. When a partner dies.
Adjustments Required	The various matters that need adjustment at the time of admission change in profit sharing ratio are given below: 1. Adjustment in Profit Sharing Ratio, 2. Adjustment of Goodwill, 3. Adjustment of Profit/Loss arising from the Revaluation of Assets and Liabilities, 4. Adjustment of Accumulated Profits, Reserves and Losses, 5. Adjustment of Capitals (if agreed).
Sacrificing Partners	The partners whose shares have decreased as a result of change are known as Sacrificing Partners.
Sacrificing Ratio	The ratio in which the partners have agreed to sacrifice their shares in profit in favour of other partner or partners, is known as sacrificing ratio. This ratio is calculated by taking out the difference between Old Profit Shares and New Profit Shares.
Gaining Partners	The partners whose shares have increased as a result of change are known as Gaining Partners.
Gaining Ratio	The ratio in which the partners have agreed to gain their shares in profit from the other partner or partners, is known as Gaining Partners. This ratio is calculated by taking out the difference between New Profit Shares and Old Profit Shares.
New Profit Sharing Ratio	The ratio in which all the partners share the future profits and losses is known as the New Profit Sharing Ratio.

ILLUSTRATION 1

X, Y and Z are sharing profits and losses in the ratio of 5 : 3 : 2. Calculate the new profit sharing ratio and the sacrificing ratio if Z acquires 1/10th share from Y.

SOLUTION

X's New Share = $5/10$, Y's New Share = $3/10 - 1/10 = 2/10$,

Z's New Share = $2/10 + 1/10 = 3/10$

New Profit Sharing Ratio of X, Y and Z = $5/10 : 2/10 : 3/10 = 5 : 2 : 3$

Share Sacrificed by Y = $1/10$, Share Gained by Z = $1/10$

ILLUSTRATION 2

X, Y and Z are sharing profits and losses in the ratio of 5 : 3 : 2. Calculate the new profit sharing ratio and the sacrificing ratio if Z acquires 1/10th share equally from X and Y.

SOLUTION

X's New Share = $5/10 - 1/20 = 9/20$, Y's New Share = $3/10 - 1/20 = 5/20$,

Z's New Share = $2/10 + 1/10 = 3/10$

New Profit Sharing Ratio of X, Y and Z = $9/20 : 5/20 : 3/10 = 9 : 5 : 6$

Share Gained by Z = $1/10$

Sacrificing Ratio of X & Y = 1 : 1

ILLUSTRATION 3

X, Y and Z are sharing profits and losses in the ratio of 5 : 3 : 2. Calculate the new profit sharing ratio and the sacrificing ratio if X, Y and Z decide to share future profits & losses equally.

SOLUTION

New Profit Sharing Ratio of X, Y and Z = 1 : 1 : 1

X's Sacrifice = $5/10 - 1/3 = 5/30$, Y's Gain = $3/10 - 1/3 = (1/30)$, Z's Gain = $2/10 - 1/3 = (4/30)$

Y gains by 1/30th share, Z gains by 4/30th share and X sacrifices by 5/30th share.

3.0 ADJUSTMENT OF GOODWILL

Why Adjustment Required?	Whenever there is a change profit sharing ratio, the Gaining Partner (i.e., the partner whose share has increased as a result of change) must compensate the Sacrificing Partner (i.e., the partner whose share has decreased as a result of change).
Amount of Compensation	The amount of compensation must be equal to the proportionate value of firm's goodwill. Thus, Amount of Compensation Payable = Value of Firm's Goodwill × Share of Profit Gained
Recommendation of AS 26	(a) Internally generated goodwill should not be recognized as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost. (b) Hence, when the goodwill is evaluated at the time of any change in the constitution of the firm (by way of admission/retirement/death/change in profit sharing ratio), the value of such goodwill should not be raised in the books of the firm. Rather the value of such goodwill should be adjusted through concerned partners' capital accounts.
Accounting Treatment	When there is a change in profit sharing ratio the following simplified approach is suggested to make adjustment for goodwill: Step 1: Calculate the Share Gained and Share Sacrificed. Share Gained = New Share – Old Share Share Sacrificed = Old Share – New Share Step 2: Calculate the Compensation payable by Gaining Partner (s) to Sacrifying Partner(s). Compensation = Firm's Goodwill × Share of Profit Gained

	Step 3: Write off the Existing Book Value of goodwill (if any) appearing in the books of the firm All Partners' Capital A/cs Dr. [In Old Ratio] To Goodwill A/c [With existing book value of Goodwill] (Being the existing goodwill written off in old ratio)
	Step 4: Give Credit for Proportionate amount of Goodwill to Sacrificing Partners. Gaining Partners' Capital A/cs Dr. [In Gaining Ratio] To Sacrificing Partners' Capital A/cs [In Sacrificing Ratio] (Being the adjustment made for goodwill on change in profit sharing ratio)

Tutorial Note: Unless otherwise stated, the partners' capitals should be assumed to be fluctuating. Current Accounts are to be used in case of Fixed Capitals.

ILLUSTRATION 4

X, Y and Z who are presently sharing profits & losses in the ratio of 5 : 3 : 2, decide to share future profits & losses equally with effect from 1st April, 2018. The goodwill of the firm has been valued at ₹ 1,80,000. Goodwill already appearing in the books is at ₹ 30,000. Show the necessary accounting treatment.

SOLUTION

STEP 1: CALCULATION OF GAIN/SACRIFICE OF PARTNERS

Particulars	X	Y	Z
New Shares	1/3	1/3	1/3
Old Shares	5/10	3/10	2/10
Difference	-5/30	1/30	4/30
	Sacrificing partner	Gaining partner	Gaining partner

Step 2: Compensation payable by Y to X = ₹ 1,80,000 × 1/30 = ₹ 6,000

Compensation payable by Z to X = ₹ 1,80,000 × 4/30 = ₹ 24,000

STEP 3 & 4: JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	X's Capital A/c [₹ 30,000 × 5/10] Dr.		15,000	
	Y's Capital A/c [₹ 30,000 × 3/10] Dr.		9,000	
	Z's Capital A/c [₹ 30,000 × 2/10] Dr.		6,000	
	To Goodwill A/c			30,000
	(Being the existing goodwill w/o in old ratio on change in profit sharing ratio.)			
	Y's Capital A/c [₹ 1,80,000 × 1/30] Dr.		6,000	
	Z's Capital A/c [₹ 1,80,000 × 4/30] Dr.		24,000	
	To X's Capital A/c [₹ 1,80,000 × 5/30]			30,000
	(Being the adjustment made for goodwill on change in the profit sharing ratio)			

ILLUSTRATION 5

Anita, Asha and Amrit are partners sharing profits in the ratio of 3 : 2 : 1 respectively. From 1st January, 2018 they decided to share profits in the ratio of 2 : 3 : 1. The Partnership Deed provides that in the event of any change in profit-sharing ratio, the goodwill should be valued at three years' purchase of the average of five years' profits. The profits and losses of the preceding five years are:

Profit: 2013—₹ 1,20,000; 2014—₹ 3,00,000; 2015—₹ 3,40,000; 2016—₹ 3,80,000;

Loss: 2017—₹ 1,40,000.

Showing the working clearly, give the necessary Journal entry to record the above change.

SOLUTION**Step 1: Valuation of Goodwill:**

Average Profits = $(₹ 1,20,000 + ₹ 3,00,000 + ₹ 3,40,000 + ₹ 3,80,000 - ₹ 1,40,000)/5 = ₹ 2,00,000$

Goodwill = $₹ 2,00,000 \times 3 = ₹ 6,00,000$

Step 2: Calculation of Gain or Sacrifice of Partners

Sacrifice Share = Old Share – New Share

Anita = $\frac{3}{6} - \frac{2}{6} = \frac{1}{6}$ (i.e., Sacrifice), Asha = $\frac{2}{6} - \frac{3}{6} = -\frac{1}{6}$ (i.e. a Gain)

Amrit = $\frac{1}{6} - \frac{1}{6} = 0$.

Anita is a sacrificing partner and Asha is a gaining partner.

Step 3: Compensation payable by Asha to Anita = $6,00,000 \times 1/6 = ₹ 1,00,000$

STEP 4: JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
01.01.2018	Asha's Capital A/c To Anita's Capital A/c (Being the adjustment for goodwill made on change in profit-sharing ratio)	Dr.	1,00,000	1,00,000

4.0 REVALUATION OF ASSETS AND LIABILITIES**WHY IS REVALUATION OF ASSETS AND LIABILITIES REQUIRED?**

At the time of change in profit sharing ratio, the assets and liabilities are revalued so that the profit or loss arising on account of such revaluation upto the **Date** of change in profit sharing ratio may be ascertained and adjusted in the partners' Capital Accounts in their old profit sharing ratio because such profit or loss relates to pre-change period and hence it is to be shared in Old Profit Sharing Ratio.

REVALUATION ACCOUNT

Meaning	Revaluation Account (or alternatively Profit & Loss Adjustment Account) is a Nominal Account.
Purpose	The purpose of Revaluation Account is to ascertain the Profit/Loss arising on account of revaluation of assets and liabilities.

Contents	Revaluation Account is credited with increase in the value of assets and decrease in the amount of liabilities (it is a gain) and debited with any decrease in the value of assets and increase in the amount of liabilities (it is a loss). Unrecorded assets are recorded through the Revaluation Account as increase in assets. Unrecorded liabilities are recorded through the Revaluation Account as increase in liabilities.
Balance	The balance of Revaluation Account shows the net effect on account of revaluation which is transferred to the Partners' Capital accounts in their old profit sharing ratio.

ACCOUNTING ENTRIES TO RECORD THE REVALUATION OF ASSETS AND LIABILITIES

1. For Increase in the Value of an Asset Concerned Asset A/c To Revaluation A/c (Being the increase in the value of an asset recorded)	Dr.
2. For Decrease in the Value of an Asset Revaluation A/c To Concerned Asset A/c (Being the decrease in the value of an asset recorded)	Dr.
3. For increase in the Amount of a Liability Revaluation A/c To Concerned Liability A/c (Being the increase in the amount of a liability recorded)	Dr.
4. For Decrease in the Amount of a Liability Concerned Liability A/c To Revaluation A/c (Being the decrease in the amount of a liability recorded)	Dr.
5. For Recording an Unrecorded Asset Unrecorded Asset A/c To Revaluation A/c (Being an agreed value of an unrecorded asset brought into account)	Dr.
6. For Recording an Unrecorded Liability Revaluation A/c To Unrecorded Liability A/c (Being an agreed amount of an unrecorded liability brought into account)	Dr.
7. For Transfer of Balance in Revaluation Account <i>(i) If credit side exceeds debit side (Net Gain)</i> Revaluation A/c To Partners' Capital A/cs (Individually in Ratio) (Being the net gain on revaluation transferred to partners' capital accounts in old profit sharing ratio)	Dr.

(ii) If debit side exceeds credit side (Net Loss)

Partners' Capital A/cs (Individually in Ratio)	Dr.
To Revaluation A/c	
(Being the net loss on revaluation transferred to partners' capital accounts in old profit sharing ratio)	

Tutorial Note: When Revaluation Account is prepared, the assets and liabilities appear in the Balance Sheet of new firm at their **revised figures**.

FORMAT OF REVALUATION ACCOUNT

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Decrease in Value of Assets	.....	By Increase in Value of assets	.....
To Increase in Value of Liabilities	.....	By Decrease in Value of Liabilities	.....
To Unrecorded Liabilities	.....	By Unrecorded Assets	.....
To Profit* t/f to the Partners' Capital A/cs (in the Old Profit-Sharing Ratio)	.....	By Loss* t/f to the Partners' Capital A/cs (in the Old Profit-Sharing Ratio)	.....
			

*Either Profit or Loss will appear.

ILLUSTRATION 6

X, Y and Z who are presently sharing profits & losses in the ratio of 5 : 3 : 2, decide to share future profits & losses in the ratio of 2 : 3 : 5 with effect from 1st April, 2018. An extract of their Balance Sheet as at 31st March, 2018 is as follows:

Particulars	₹
Sundry Creditors	3,00,000
Outstanding Rent	10,000
Land & Building	2,50,000
Plant & Machinery	1,00,000
Stock	80,000
Debtors	3,00,000
Less: Provision	10,000
	2,90,000

It is decided that:

1. Land & Building be valued at ₹ 2,90,000.
2. Plant & Machinery be depreciated by 15%.
3. Stock is found overvalued by ₹ 38,000.
4. Provision for doubtful debts is to be made equal to 5% of the debtors.
5. An item of ₹ 30,000 included in sundry creditors is not likely to be claimed.
6. Rent of ₹ 4,000 still Outstanding
7. Out of the amount of insurance which was debited entirely to P & L A/c, ₹ 5,000 be carried forward as an unexpired insurance.
8. Out of total commission received ₹ 3,000 is to be treated as advance commission. This amount was earlier credited to Profit & Loss Account.

Required: Pass the necessary Journal Entries and prepare Revaluation Account.

SOLUTION

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
01.04.2018	Land & Building A/c Dr. To Revaluation A/c (Being the increase in value of Land & Building recorded)		40,000	40,000
	Revaluation A/c Dr. To Plant & Machinery A/c (Being the decrease in value of Plant & Machinery recorded)		15,000	15,000
	Revaluation A/c Dr. To Stock A/c (Being the decrease in value of Stock recorded)		38,000	38,000
	Revaluation A/c [₹15,000 – ₹10,000] Dr. To Provision for Doubtful Debts A/c (Being the short provision now created)		5,000	5,000
	Creditors Dr. To Revaluation A/c (Being the decrease in the amount of creditors recorded)		30,000	30,000
	Revaluation A/c Dr. To Outstanding Rent A/c (Being the Outstanding Rent recorded)		4,000	4,000
	Prepaid Insurance Dr. To Revaluation A/c (Being the Prepaid Insurance Recorded)		5,000	5,000
	Revaluation A/c Dr. To Commission received in advance A/c (Being the Commission received in advance recorded)		3,000	3,000
	Revaluation A/c Dr. To X's Capital A/c To Y's Capital A/c To Z's Capital A/c (Being the transfer of Profit on Revaluation to Old Partners' Capital Accounts in their old profit sharing ratio)		10,000	5,000 3,000 2,000

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Stock	38,000	By Land & Building	40,000
To Provision for Doubtful Debts	5,000	By Sundry Creditors	30,000
To Plant & Machinery A/c	15,000	By Prepaid Insurance	5,000
To Outstanding Rent A/c	4,000		
To Commission received in advance A/c	3,000		

To Profit on Revaluation t/f to:			
X 's Capital A/c	5,000		
Y 's Capital A/c	3,000		
Z 's Capital A/c	2,000		
	75,000		75,000

5.0 ADJUSTMENTS OF PROFIT/LOSS ON REVALUATION OF ASSETS AND LIABILITIES THROUGH CAPITAL ACCOUNTS ONLY

HOW TO ADJUST PROFIT/LOSS ON REVALUATION

When the partners decide to record the net effect of revaluation of assets and liabilities without affecting the old figures of assets liabilities, single adjusting entry involving the capital accounts of gaining partners and sacrificing partners is passed. The following steps may be taken in this regard:

PRACTICAL STEPS TO PASS SINGLE ADJUSTING ENTRY

Step 1: Calculate the Net Effect of Revaluation			₹
A. Increase in Value of Assets			xxx
B. Add: Decrease in amount of Liabilities			xxx
C. Less: Decrease in Value of Assets			xxx
D. Less: Increase in Amount of Liabilities			xxx
E. Net Effect of Revaluation			xxx
Step 2: Calculate Gain/Loss of Share			
Their New Shares	x	x	x
Their Old Shares	x	x	x
Difference	x	x	x
Step 3: Calculate the Share of Gaining Partner and Sacrificing Partner in the Net Effect of Revaluation			
For Gaining Partner = Share gained × Net Effect of Revaluation			
For Sacrificing Partner = Share sacrificed × Net Effect of Revaluation			
Step 4: Pass the following Single Adjusting Journal Entry:			
In Case of Net Profit on Revaluation		In Case of Net Loss on Revaluation	
Gaining Partner's Capital A/c	Dr.	Sacrificing Partner's Capital A/c	Dr.
To Sacrificing Partner's Capital A/c		To Gaining Partner's Capital A/c	

Tutorial Note: When the Profit/Loss on Revaluation of Assets and Liabilities is adjusted through Capital Accounts only, the Assets and Liabilities appear in the Balance Sheet of the New Firm at their old figures.

ILLUSTRATION 7

X, Y and Z are sharing profits & losses in the ratio of 5 : 3 : 2. They decide to share future profits & losses in the ratio of 2 : 3 : 5 with effect from 1st April 2018. They also decide to record the effect of following revaluations without affecting the book values of the assets & liabilities, by passing a single adjusting entry:

Particulars	Book Figure	Revalued Figure
Land & Building	₹ 1,00,000	₹ 1,50,000
Plant & Machinery	₹ 1,50,000	₹ 1,40,000
Trade Creditors	₹ 50,000	₹ 45,000
Outstanding Expenses	₹ 45,000	₹ 60,000

Required: Pass the necessary single adjusting entry.

SOLUTION

STEP 1: CALCULATION OF NET EFFECT OF REVALUATION

Particulars	₹
A. Increase in value of Land & Building	50,000
B. Add: Decrease in Amount of Creditors	5,000
C. Less: Decrease in Value of Plant & Machinery	10,000
D. Less: Increase in Amount of Outstanding Expenses	15,000
E. Net Profit on Revaluation	30,000

STEP 2: CALCULATION OF GAIN/LOSS OF SHARE

Particulars	X	Y	Z
Their New Shares	2/10	3/10	5/10
Their Old Shares	5/10	3/10	2/10
Difference	(3/10)	–	3/10

STEP 3: CALCULATION OF PROPORTIONATE AMOUNT OF NET PROFIT ON REVALUATION

For X = $\frac{3}{10} \times ₹ 30,000 = ₹ 9,000$, For Z = $\frac{3}{10} \times ₹ 30,000 = ₹ 9,000$

STEP 4: ADJUSTING JOURNAL ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Z's Capital A/c	Dr.	9,000	
	To X's Capital A/c			9,000
	(Being the adjustment made for net profit on revaluation)			

6.0 ADJUSTMENT FOR RESERVES AND ACCUMULATED PROFITS/LOSSES

WHY IS ADJUSTMENT FOR RESERVES AND ACCUMULATED PROFITS/LOSSES REQUIRED?

If, at the time of change in Profit Sharing Ratio, any reserves or accumulated profits/losses exist in the books of the firm, these should be transferred to partners' Capital Accounts (*if capitals are fluctuating*) or Current Accounts (*if capital are fixed*) in their old profit sharing ratio since the reserves, accumulated profits/losses upto the **Date** of change in profit sharing ratio belong to the partners in their old profit sharing ratio.

ACCOUNTING TREATMENT OF RESERVES, ACCUMULATED PROFITS/LOSSES**1. For transfer of Reserves and Accumulated Profits**

Reserve A/c		Dr.
P & L A/c		Dr.
Workmen Compensation Reserve A/c	[Excess of Reserve over Actual Liability]	Dr.
Investment Fluctuation Reserve A/c	[Excess of Reserve over the difference between Book value and Market value]	Dr.
To Old Partners' Capital Accounts (individually) (Old Ratio)		
(Being the Reserves & Profits transferred to old partners in their old ratio)		

2. For transfer of Accumulated Losses

Old Partners' Capital Accounts (individually)	Dr. (Old Ratio)
To Profit & Loss A/c	
To Deferred Revenue Expenditure A/c	
(Being Accumulated Losses transferred to old partners in their old ratio)	

TUTORIAL NOTES

1. Reserves, Accumulated Profits/Losses should always be distributed even if the question is silent.
2. Workmen Compensation Reserve is a reserve created out of profit to meet the Workmen Compensation Liability, if any arise in future. Workmen Compensation Reserve (say ₹ 1,200) to the extent of liability (say ₹ 150) should be credited to Workmen Compensation Claim A/c and the balance of Workmen Compensation Reserve (₹ 1,050) should be credited to Partners' Capital Accounts.
3. Investment Fluctuation Reserve is a reserve created out of profit to adjust the difference between the Book Value and Market Value of Investments. Excess of Investment Fluctuation Reserve over difference between Book Value and Market Value is credited to partners in Profit Sharing Ratio.
4. Machinery Replacement Fund is in the nature of Accumulated Depreciation and not Accumulated Profits and hence it is not distributed among the partners.
5. Employees' Provident Fund represents statutory liability due to employees towards Provident Fund and is not an accumulated profit, hence it is not distributed among the partners.

ILLUSTRATION 8

X, Y and Z are sharing profits & losses in the ratio of 5 : 3 : 2. They decide to share future profits & losses in the ratio of 2 : 3 : 5 with effect from 1st April, 2018. The following items appear in the Balance Sheet as at 31st March, 2018:

General Reserve	₹ 30,000
Contingencies Reserve	₹ 5,000
Advertisement Suspense A/c (Dr.)	₹ 20,000
Profit & Loss A/c (Cr.)	₹ 15,000

Required: Pass the necessary Journal Entries.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
2018	General Reserve Dr.		30,000	
April 1	Contingencies Reserve Dr.		5,000	
	Profit & Loss A/c (Cr.) Dr.		15,000	
	To X's Capital A/c			25,000
	To Y's Capital A/c			15,000
	To Z's Capital A/c			10,000
	(Being the transfer of Reserves & Profits to old partners in their old ratio)			
	X's Capital A/c Dr.		10,000	
	Y's Capital A/c Dr.		6,000	
	Z's Capital A/c Dr.		4,000	
	To Advertisement Suspense A/c			20,000
	(Being the transfer of balance of Advertisement Suspense A/c to old partners in their old ratio)			

ILLUSTRATION 9 [TREATMENT OF WORKMEN COMPENSATION RESERVE]

X, Y and Z who are presently sharing profits & losses in the ratio of 5 : 3 : 2, decide to share future profits & losses in the ratio of 2 : 3 : 5 with effect from 1st April, 2018. Workmen Compensation Reserve appears at ₹ 1,200 in the Balance Sheet as at 31st March, 2018.

Required: Show the accounting treatment in each of the following alternative cases:

Case I If there is no other information.

Case II If a claim on account of Workmen's Compensation is estimated at ₹ 150 only.

Case III If a claim on account of Workmen's Compensation is estimated at ₹ 2,250.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
2018	Case I			
April 1	Workmen Compensation Reserve A/c Dr.		1,200	
	To X's Capital A/c			600
	To Y's Capital A/c			360
	To Z's Capital A/c			240
	(Being the transfer of Workmen Compensation Reserve to Partners' Capital Accounts in their old profit sharing ratio)			
	Case II			
	Workmen Compensation Reserve A/c Dr.		150	
	To Provision for Workmen Compensation Claim A/c			150
	(Being the provision made for Workmen Compensation Claim)			

	Workmen Compensation Reserve A/c Dr.		1,050	
	To X's Capital A/c			525
	To Y's Capital A/c			315
	To Z's Capital A/c			210
	(Being the transfer of surplus Workmen Compensation Reserve to Partners' Capital Account in their old profit sharing ratio)			
	Case III			
	Workmen Compensation Reserve A/c Dr.		1,200	
	Revaluation A/c Dr.		1,050	
	To Provision for Workmen Compensation Claim A/c			2,250
	(Being the provision created & short fall charged to Revaluation A/c)			
	X's Capital A/c Dr.		525	
	Y's Capital A/c Dr.		315	
	Z's Capital A/c Dr.		210	
	To Revaluation A/c			1,050
	(Being the transfer of loss on revaluation to partners' capital accounts in their old profit sharing ratio)			

ILLUSTRATION 10 [TREATMENT OF INVESTMENT FLUCTUATION RESERVE]

X, Y and Z who are presently sharing profits & losses in the ratio of 5 : 3 : 2, decide to share future profits & losses in the ratio of 2 : 3 : 5 with effect from 1st April, 2018. An extract of their Balance Sheet as at 31st March, 2018 is as follows:

Particulars	₹
Investment Fluctuation Reserve	1,500
Investments (at cost)	20,000

Required: Show the accounting treatment in each of the following alternative cases:

Case I If there is no other information is given.

Case II If the market value of investments is ₹ 20,000.

Case III If the market value of investments is ₹ 19,000.

Case IV If the market value of investments is ₹ 18,000.

Case V If the market value of investments is ₹ 20,500.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018 April 1	Case I 1st Alternative Assuming that the firm maintains Investment Fluctuation Reserve exactly equal to difference between the Cost & Market Price. No further entry is required.			

	2nd Alternative Assuming that the market value of investment is ₹ 20,000.			
	Investment Fluctuation Reserve A/c Dr. To X's Capital A/c To Y's Capital A/c To Z's Capital A/c (Being the transfer of excess Investments Fluctuation Reserve to partners' capital accounts in their old profit sharing ratio)		1,500	750 450 300
	Case II Same Solution as given in 2nd alternative of Case I			
	Case III Investment Fluctuation Reserve A/c Dr. To Investment A/c (Being the value of Investment brought upto market value)		1,000	1,000
	Investment Fluctuation Reserve A/c Dr. To X's Capital A/c To Y's Capital A/c To Z's Capital A/c (Being the transfer of excess Investments Fluctuation Reserve to partners' capital accounts in their old profit sharing ratio)		500	250 150 100
	Case IV Investment Fluctuation Reserve A/c Dr. Revaluation A/c Dr. To Investment A/c (Being the value of investments brought down to market value)		1,500 500	2,000
	X's Capital A/c Dr. Y's Capital A/c Dr. Z's Capital A/c Dr. To Revaluation A/c (Being the transfer of loss on revaluation)		250 150 100	500
	Case V Investment Fluctuation Reserve A/c Dr. To X's Capital A/c To Y's Capital A/c To Z's Capital A/c (Being the transfer of excess Investments Fluctuation Reserve to partners' capital accounts in their old profit sharing ratio)		1,500	750 450 300
	Investment A/c Dr. To Revaluation A/c (Being the value of invsts. brought up to market value)		500	500
	Revaluation A/c Dr. To X's Capital A/c To Y's Capital A/c To Z's Capital A/c (Being the transfer of profit on revaluation)		500	250 150 100

ILLUSTRATION 11

An Extract of Balance Sheet of X, Y and Z sharing profits and losses in the ratio of 5 : 3 : 2 respectively, on 31st March, 2018 is given below:

<i>Particulars</i>	<i>₹</i>
General Reserve	5,000
Contingencies Reserve	450
Profit and Loss Account	3,000
Investment Fluctuation Reserve	1,500
Machinery Replacement Fund	1,000
Workmen's Compensation Reserve	1,200
Employees' Provident Fund	2,000
Investment (Market Value ₹ 19,000)	20,000
Machinery Replacement Fund Investments	1,000
Advertisement Expenditure (Deferred Revenue)	1,000

With effect from April 1, 2018, they decided to share future profits & losses in the ratio of 2 : 3 : 5 respectively. A claim on account of workmen's compensation is estimated at ₹ 150 only.

Required: Give the necessary journal entries relating to the adjustment of accumulated profits and losses.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
2018 April, 1	Workmen Compensation Reserve A/c Dr. To Provision for Workmen Compensation Claim A/c (Being the provision made for Workmen Compensation claim)		150	150
	Workmen Compensation Reserve A/c Dr. To X's Capital A/c To Y's Capital A/c To Z's Capital A/c (Being the transfer of surplus Workmen Compensation Reserve to Partners' Capital Account in their old profit sharing ratio)		1,050	525 315 210
	Investment Fluctuation Reserve A/c Dr. To Investment A/c (Being the value of Investment brought upto market value)		1,000	1,000
	Investment Fluctuation Reserve A/c Dr. To X's Capital A/c To Y's Capital A/c To Z's Capital A/c (Being the transfer of excess Investments Fluctuation Reserve to partners' capital accounts in their old profit sharing ratio)		500	250 150 100

General Reserve	Dr.	5,000	
Contingencies Reserve	Dr.	450	
P & L A/c	Dr.	3,000	
To A's Capital A/c			4,225
To B's Capital A/c			2,535
To C's Capital A/c			1,690
(Being the transfer of accumulated profits to all the partners in their profit-sharing ratio)			
A's Capital A/c	Dr.	500	
B's Capital A/c	Dr.	300	
C's Capital A/c	Dr.	200	
To Advertisement Expenditure A/c			1,000
(Being the transfer of accumulated losses to all the partners in their profit-sharing ratio)			

Working Notes:

1. Excess Investment Fluctuation Reserve Account has been transferred directly to partners' capital accounts. after providing for an anticipated loss of ₹ 1,000 (i.e. ₹ 20,000 – ₹ 19,000) according to Prudence (conservatism) concept.
2. Excess Workmen's Compensation Reserve Account has been transferred directly to partners' capital accounts.
3. Machinery Replacement Fund has not been transferred since it is in the nature of accumulated depreciation and not in nature of accumulated profits.
4. Employees' Provident Fund represents statutory liability due to employees towards Provident Fund and is not an Accumulated Profit and hence is not distributed among the partners.

7.0 ADJUSTMENTS OF ACCUMULATED PROFITS, LOSSES OR RESERVES THROUGH CAPITAL ACCOUNTS ONLY
HOW TO ADJUST ACCUMULATED PROFITS, LOSSES or RESERVES

When the partners decide to record the net effect of accumulated profits, losses or reserves without affecting the old figures of accumulated profits, losses or reserves, single adjusting entry involving the capital accounts of gaining partners and sacrificing partners is passed.

PRACTICAL STEPS TO PASS SINGLE ADJUSTING ENTRY

Step 1: Calculate the Net Effect of Accumulated Profits, Reserves & Losses			₹
A. Accumulated Profits [e.g. P&L A/c (cr.)]			xxx
B. Add: Reserves [e.g. General Reserve, Contingency Reserve]			xxx
C. Less: Accumulated Losses			xxx
D. Net Effect			xxx
Step 2: Calculate Gain/Loss of Share			
Their New Shares	x	x	x
Their Old Shares	x	x	x
Difference	x	x	x

Step 3: Calculate Share of Gaining Partner and Sacrificing Partner in the Net Accumulated Profits, Losses and Reserves.

For Gaining Partner = Share gained × Net Effect.

For Sacrificing Partner = Share sacrificed × Net Effect.

Step 4: Pass the following Single Adjusting journal entry:

In Case of Net Profit		In Case of Net Loss	
Gaining Partner's Capital A/c	Dr.	Sacrificing Partner's Capital A/c	Dr.
To Sacrificing Partner's Capital A/c		To Gaining Partner's Capital A/c	

Tutorial Note: When Accumulated Profits, Reserves & Losses are adjusted through Capital Accounts only, then all Accumulated Profits, Reserves & Losses appear in the Balance Sheet of the new firm at their **old figures**.

ILLUSTRATION 12

X, Y and Z are sharing profits & losses in the ratio of 5 : 3 : 2. They decide to share future profits & losses in the ratio of 2 : 3 : 5 with effect from 1st April, 2018. They also decide to record the effect of the following accumulated profits, losses & reserves without affecting their book figures, by passing a single adjusting entry.

Particulars	Book Figure
General Reserve	₹ 30,000
Contingencies Reserve	₹ 5,000
Profit & Loss A/c (Cr.)	₹ 15,000
Advertisement Suspense A/c (Dr.)	₹ 20,000

Required: Pass the necessary single adjusting entry.

SOLUTION**STEP 1: CALCULATION OF NET EFFECT OF ACCUMULATED PROFITS/LOSSES or RESERVES**

General reserve	₹ 30,000	
Contingencies Reserve	₹ 5,000	
Profit & Loss A/c	₹ 15,000	
Less: Advertisement Suspense A/c (Dr.)	(₹ 20,000)	₹ 30,000

STEP 2 @ CALCULATION OF GAIN/LOSS OF SHARE

Particulars	X	Y	Z
Their New Shares	2/10	3/10	5/10
Their Old Shares	5/10	3/10	2/10
Difference	(3/10)	—	3/10

STEP 3: CALCULATION OF SHARE OF SACRIFICING AND GAINING PARTNER IN THE NET ACCUMULATED PROFITS, LOSSES AND RESERVES

For X = $\frac{3}{10} \times ₹ 30,000 = ₹ 9,000$, For Z = $\frac{3}{10} \times ₹ 30,000 = ₹ 9,000$

STEP 4: ADJUSTING JOURNAL ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Z's Capital A/c Dr. To X's Capital A/c (Being the adjustment made for net accumulated profits & reserves)		9,000	9,000

8.0 ADJUSTMENT OF CAPITALS

The various steps involved in adjusting the capitals of partners according to new profit sharing ratio are given below:

PRACTICAL STEPS INVOLVED IN ADJUSTING THE CAPITALS OF PARTNERS

Step 1: Calculate the Adjusted Old Capitals of Partners (i.e., after all adjustments relating to goodwill, profit/loss on revaluation and accumulated profits/reserves/losses) by preparing their Capital Accounts.

Step 2: Calculate Total Capital of new firm (if not given in question) as under:

Total Capital = Aggregate of Adjusted Old Capitals of Partners.

Step 3: Calculate the New Capitals of partners as follows:

= Total Capital of New Firm × New Share

Step 4: Calculate the Shortage or (Surplus) in each of the Partner's Capital Account as follows:

= New Capital – Adjusted Old Capital.

Step 5: Pass a Journal Entry to Adjust the Surplus by paying off or by transfer to the credit of his current account to and adjust the Shortage by asking the concerned partner to bring in the required amount or by transfer to the debit of his current account.

Tutorial Note: In the absence of any contract, Surplus or Shortage should be adjusted in Cash and not by transfer to Current Account.

ILLUSTRATION 13

X, Y and Z are partners sharing profits and losses in the ratio of 5 : 3 : 2. They decide to share future profits & losses in the ratio of 2 : 3 : 5. Their capitals remaining after adjustments relating to goodwill, profit/loss on revaluation and accumulated profits, losses & reserves are ₹ 59,000, ₹ 30,000 and ₹ 11,000 respectively. They also decide that their capitals should also be in their new profit sharing ratio.

Required: Calculate the amount of actual cash to be paid off or brought in by the old partners for this adjustment and pass the necessary journal entries.

SOLUTION

Step 1: Calculation of Total Capital of the New Firm

Total Capital = ₹ 59,000 + ₹ 30,000 + ₹ 11,000 = ₹ 1,00,000

Step 2® Calculation of New Capitals of all Partners

X	Y	Z
$1,00,000 \times 2/10 = 20,000,$	$1,00,000 \times 3/10 = 30,000,$	$1,00,000 \times 5/10 = 50,000$

STEP 3: CALCULATION OF ACTUAL CASH TO BE PAID OFF OR BROUGHT IN BY OLD PARTNERS

<i>Particulars</i>	<i>X</i>	<i>Y</i>	<i>Z</i>
Their New Capitals	20,000	30,000	50,000
Their Adjusted New Capitals	59,000	30,000	11,000
	(39,000)	—	39,000

STEP 4: JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Cash A/c Dr. To Z's Capital A/c (Being the shortage brought in by Z)		39,000	39,000
	X's Capital A/c Dr. To Cash A/c (Being the excess amount withdrawn by X)		39,000	39,000

SOLVED PROBLEMS**PROBLEM 1**

X, Y and Z are partners in a firm sharing profits & losses in the ratio of 5 : 3 : 2. They decide to share future profits & losses in the ratio of 2 : 5 : 3 with effect from 1st April, 2018. Their Balance Sheet showed a debit balance of ₹ 4,000 in Profit & Loss Account and a balance of ₹ 24,000 in General Reserve. For this purpose, it was agreed that—

- the goodwill of the firm be valued at ₹ 30,000.
- the Land (having book value of ₹ 50,000) be valued at ₹ 80,000.
- the Stock (having book value of ₹ 50,000) be depreciated by 6%.
- Creditors amounting to ₹ 400 were not likely to be claimed.
- Unrecorded Investments to be valued at ₹ 22,600.

Required: Give the necessary single adjusting entry to record the above arrangement.

SOLUTION**STEP 1: CALCULATION OF GAIN/SACRIFICE OF SHARE**

<i>Particulars</i>	<i>X</i>	<i>Y</i>	<i>Z</i>
Their Old Shares	5/10	3/10	2/10
Their New Shares	2/10	5/10	3/10
Difference	3/10	(2/10)	(1/10)
	<i>Sacrificing Partner</i>	<i>Gaining Partner</i>	<i>Gaining Partner</i>

STEP2 : CALCULATION OF NET EFFECT OF ADJUSTMENTS TO BE MADE

<i>Particulars</i>	<i>₹</i>
A. General Reserve	24,000
B. Less: Dr. Balance of P&L A/c	— 4,000

C. Value of Goodwill	30,000
D. Unrecorded Investments	22,600
E. Increase in Value of Land	30,000
F. Decrease in Value of Stock	– 3,000
G. Decrease in Creditors	400
H. Net Effect of Adjustment to be made	1,00,000

**STEP 3: ADJUSTING JOURNAL ENTRY
JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Y's Capital A/c [₹ 1,00,000 × 2/10] Dr.		20,000	
	Z's Capital A/c [₹ 1,00,000 × 1/10] Dr.		10,000	
	To X's Capital A/c [₹ 1,00,000 × 3/10]			30,000
	(Being the adjustment made on account of change in profit sharing ratio by debiting gaining partner and crediting sacrificing partners)			

PROBLEM 2

X, Y and Z are partners in a firm sharing profit in the ratio of 2 : 2 : 1. Their Balance Sheet as at March 31, 2018 was as follows:

Particulars	₹
Creditors	30,000
Bills Payable	15,000
X's Capital	60,000
Y's Capital	30,000
Z's Capital	15,000
General Reserve	12,000
Land	30,000
Building	30,000
Plant	60,000
Stock	30,000
Debtors	9,000
Cash	3,000

X, Y and Z decided to share the profit equally, w.e.f. April 1, 2018. For this purpose it was agreed that:

- (i) The goodwill of the firm should be valued at ₹ 18,000.
- (ii) Land should be revalued at ₹ 48,000 and building should be depreciated by 6%.
- (iii) Creditors amounting to ₹ 1,800 were not likely to be claimed and hence should be written off.

You are required to:—

- (a) Record the necessary journal entries to give effect to the above agreement, without opening Revaluation Account;
- (b) Prepare the Capital Accounts of the partners; and
- (c) Prepare the Balance Sheet of the firm after reconstitution.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
01.04.2018	Z's Capital A/c Dr. To X's Capital A/c To Y's Capital A/c (Being the adjustment made for goodwill on change in profit sharing ratio)		2,400	1,200 1,200
	Z's Capital A/c Dr. To X's Capital A/c To Y's Capital A/c (Being the adjustment made for profit on revaluation on change in the profit sharing ratio)		2,400	1,200 1,200
	General Reserve A/c Dr. To X's Capital A/c To Y's Capital A/c To Z's Capital A/c (Being the transfer of General Reserve to partners' capital accounts on change in profit sharing ratio)		12,000	4,800 4,800 2,400

*Dr.***PARTNERS' CAPITAL ACCOUNTS***Cr.*

<i>Particulars</i>	<i>X ₹</i>	<i>Y ₹</i>	<i>Z ₹</i>	<i>Particulars</i>	<i>X ₹</i>	<i>Y ₹</i>	<i>Z ₹</i>
To X's Capital A/c	—	—	1,200	By Balance b/d	60,000	30,000	15,000
To Y's Capital A/c	—	—	1,200	By Z's Capital A/c	1,200	1,200	—
To X's Capital A/c	—	—	1,200	By Z's Capital A/c	1,200	1,200	—
To Y's Capital A/c	—	—	1,200	By General Reserve	4,800	4,800	2,400
To Balance c/f	67,200	37,200	12,600				
	67,200	37,200	17,400		67,200	37,200	17,400

BALANCE SHEET OF X, Y AND Z AT 1.4. 2018

<i>Liabilities</i>	<i>₹</i>	<i>Assets</i>	<i>₹</i>
Creditors	30,000	Land	30,000
Bills Payable	15,000	Building	30,000
X's Capital	67,200	Plant	60,000
Y's Capital	37,200	Stock	30,000
Z's Capital	12,600	Debtors	9,000
		Cash	3,000
	1,62,000		1,62,000

PROBLEM 3

The Balance Sheet of A, B and C who are sharing profits in the ratio of 2:3:1, as at 31st March, 2018 is given below:

<i>Particulars</i>	<i>₹</i>
A's Capital	1,00,000
B's Capital	2,00,000
C's Capital	3,00,000
Workmen Compensation Reserve	20,000
Investment Fluctuation Reserve	10,000
Provision for Doubtful Debts	10,000
Sundry Creditors	3,00,000
Employees' Provident Fund	60,000
Goodwill	12,000
Land and Building	2,50,000
Investments [Market Value ₹ 46,000]	50,000
Stock	80,000
Debtors	3,00,000
Bank	2,96,000
Advertisement Suspense A/c	12,000

A, B and C decide to alter their profits sharing ratio as 3 : 2 : 1 from 1st April, 2018.

- Goodwill is to be valued at 2 years' purchase of average profits of last three completed years. The profits were - 2015-2016 ₹ 48,000, 2016-2017 ₹ 93,000, 2017-2018 ₹ 1,38,000.
- Land & Building was found under valued by ₹ 20,000 and Stock was found overvalued by ₹ 38,000.
- Provision for doubtful debts is to be made equal to 5% of the debtors.
- Claim on account of workmen compensation is ₹ 8,000.
- 10% of the sundry creditors be written back as no longer payable.
- Out of the amount of insurance which was debited entirely to P&L A/c, ₹ 5,000 be carried forward as an unexpired insurance.

Required: Pass the necessary journal entries and prepare the necessary ledger accounts and the Balance Sheet.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1	A's Capital A/c Dr. B's Capital A/c Dr. C's Capital A/c Dr. To Goodwill A/c (Being the existing goodwill w/o)		4,000 6,000 2,000	12,000
2	A's Capital A/c Dr. To B's Capital A/c (Being the goodwill adjusted by debiting gaining partner and crediting sacrificing partner)		31,000	31,000

3	Land & Building A/c Sundry Creditors Prepaid Insurance To Revaluation A/c (Being the increase in value of assets & decrease in Sundry Creditors recorded)	Dr. Dr. Dr.	20,000 30,000 5,000	55,000
4	Revaluation A/c To Stock A/c To Provision for Doubtful Debts A/c (Being the decrease in Value of assets & increase in provisions recorded)	Dr.	43,000	38,000 5,000
5	Revaluation A/c To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of profit on revaluation)	Dr.	12,000	4,000 6,000 2,000
6	Workmen Compensation Reserve A/c To Workmen Compensation Claim A/c To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of workmen compensation Reserve)	Dr.	20,000	8,000 4,000 6,000 2,000
7	Investment Fluctuation Fund A/c To Investment A/c To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of Investment Fluctuation Fund)	Dr.	10,000	4,000 2,000 3,000 1,000
8	A's Capital A/c B's Capital A/c C's Capital A/c To Advertisement Suspense A/c (Being the transfer of balance of Advertisement Suspense A/c)	Dr. Dr. Dr.	4,000 6,000 2,000	12,000

Ledger Accounts:

Dr.

1. REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Stock	38,000	By Land & Building	20,000
To Provision for Doubtful Debts	5,000	By Sundry Creditors	30,000
To Profit on Revaluation t/f to:		By Prepaid Insurance	5,000
A's Capital A/c	4,000		
B's Capital A/c	6,000		
C's Capital A/c	2,000		
	55,000		55,000

Dr.
2. PARTNERS' CAPITAL ACCOUNTS
Cr.

<i>Particulars</i>	<i>A ₹</i>	<i>B ₹</i>	<i>C ₹</i>	<i>Particulars</i>	<i>A ₹</i>	<i>B ₹</i>	<i>C ₹</i>
To Goodwill A/c	4,000	6,000	2,000	By Balance b/d	1,00,000	2,00,000	3,00,000
To B's Capital A/c	31,000	—	—	By A's Capital A/c	—	31,000	—
To Adv. Exp. Sus. A/c	4,000	6,000	2,000	By Revaluation A/c	4,000	6,000	2,000
To Balance c/d	71,000	2,34,000	3,01,000	By Work Com. Res.	4,000	6,000	2,000
				By Invest. Flus. Res.	2,000	3,000	1,000
	1,10,000	2,46,000	3,05,000		1,10,000	2,46,000	3,05,000

3. BALANCE SHEET AS AT 1ST APRIL, 2018

<i>Liabilities</i>	<i>₹</i>	<i>Assets</i>	<i>₹</i>
A's Capital	71,000	Land & Building	2,70,000
B's Capital	2,34,000	Investments	46,000
C's Capital	3,01,000	Stock	42,000
Sundry Creditors	2,70,000	Debtors	3,00,000
Workmen Compensation Claim	8,000	Less: Provision	15,000
Employees' Provident Fund	60,000	Bank	2,96,000
		Prepaid Insurance	5,000
	9,44,000		9,44,000

Working Notes:

1. A's gain = $\frac{3}{6} - \frac{2}{6} = \frac{1}{6}$, B's sacrifice = $\frac{2}{6} - \frac{3}{6} = (\frac{1}{6})$, C's gain = $\frac{1}{6} - \frac{1}{6} = 0$

2. Goodwill

A. Average Profits = $\frac{\text{₹ } 48,000 + \text{₹ } 93,000 + \text{₹ } 1,38,000}{3} = \text{₹ } 93,000$

B. Firm's Goodwill = $\text{₹ } 93,000 \times 2 = \text{₹ } 1,86,000$

C. A's Contribution = $\text{₹ } 1,86,000 \times \frac{1}{6} = \text{₹ } 31,000$

D. B's Share of Goodwill = $\text{₹ } 1,86,000 \times \frac{1}{6} = \text{₹ } 31,000$

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RECONSTITUTION OF PARTNERSHIP — ADMISSION OF A PARTNER

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of An Admission of a Partner
- ◇ How can a person be admitted as a Partner?
- ◇ Rights of a New Partner
- ◇ Adjustments required at the time of Admission of a New Partner
- ◇ Why is New Ratio determined even for Old Partners?
- ◇ Meaning of New Profit Sharing Ratio
- ◇ Meaning of Sacrificing Ratio
- ◇ Adjustment of Goodwill
- ◇ Adjustment of Profit/Loss on Revaluation of **Assets** and **Liabilities**
- ◇ Adjustment of Reserves and Accumulated Profits/Losses
- ◇ Adjustment of Capitals

1.0 AN ADMISSION OF A PARTNER

Meaning	Admission of a partner is one of the modes of reconstituting the firm under which old partnership comes to an end and a new one between all partners (including incoming partner) comes into existence.
How can be Admitted	According to the Sec 31(1) of Indian Partnership Act, 1932, a person can be admitted as a new partner only with the consent of all the existing partners unless otherwise agreed upon.
Two Main Rights of a New Partner	A new partner acquires two main rights in the firm — 1. Right to share the Assets of the firm; 2. Right to share the future profits of the firm.
Why a New Partner brings in Capital	A New Partner brings in the agreed amount of Capital to acquire the right to share the Assets of the firm.
Why a New Partner brings in Goodwill	A New Partner brings in his share of Goodwill (also called Premium) to acquire the Right to share the future profits of the firm.
Adjustments Required	The various matters that need adjustment at the time of admission of a new partner are as follows: 1. Adjustment in Profit Sharing Ratio, 2. Adjustment of Goodwill, 3. Adjustment of Profit/Loss arising from the Revaluation of Assets & Liabilities, 4. Adjustment of Accumulated Profits, Reserves and Losses, 5. Adjustment of Capitals (if agreed).

2.0 NEW PROFIT SHARING RATIO AND SACRIFICING RATIO

Why to determine new ratio even for old partners?	When a new partner is admitted, he acquires his share in profits from the old partners. This reduces the old partners' shares in profits hence, profit sharing ratio for old partners have to be calculated.
New Profit Sharing Ratio	The ratio in which all partners (including incoming partner) share the future profits and losses is known as the new profit sharing ratio. The determination of new profit sharing ratio depends upon the ratio in which the incoming partner acquires his share from the old partners. An incoming partner may acquire his share: (a) from the old partners in their old profit sharing ratio; (b) from the old partners in some agreed ratio (other than old profit sharing ratio); (c) from one or more of old partners (but not from all partners). Tutorial Note: Unless agreed otherwise, it is presumed that the new partner acquires his share in profits from the old partners in their old profit sharing ratio and the old partners continue to share the remaining profit in the old ratio and hence the New Profit Sharing Ratio of Old Partners will be the same as their Old Profit Sharing Ratio.
Sacrificing Ratio	The ratio in which the old partners have agreed to sacrifice their shares in profit in favour of a new partner is called the sacrificing ratio. This ratio is calculated by taking out the difference between Old Profit Share and the New Profit Share. Tutorial Note: Unless agreed otherwise it is presumed that the old partners sacrifice in their old profit sharing ratio and hence, Sacrificing Ratio of Old Partners will be the same as their Old Profit Sharing Ratio.

DIFFERENCE BETWEEN '1/3RD OF SHARE' AND '1/3RD FROM SHARE'

There exists difference between 'B surrenders 1/3rd of his share' and 'B surrenders 1/3rd from his share'. If B's share is $\frac{2}{5}$ th, it means in the former case he has surrendered $\frac{2}{15}$ th [i.e. $(\frac{1}{3}) \times (\frac{2}{5})$] share and B's New Share is $\frac{4}{15}$ [i.e. $(\frac{2}{5}) - (\frac{2}{15})$], in the latter case, he has surrendered 1/3rd share and B's New Share is $\frac{1}{15}$ [i.e. $(\frac{2}{5}) - (\frac{1}{3})$].

ILLUSTRATION 1

X and Y are partners in a firm sharing profits and losses in the ratio of 3 : 2. Z is admitted as partner with $\frac{1}{5}$ share in the profits. Calculate the new profit sharing ratio and the sacrificing ratio.

SOLUTION

- Let the Total Share be = 1
- Share of Incoming Partner = $\frac{1}{5}$
- Remaining Share $[(a) - (b)] = 1 - \frac{1}{5} = \frac{4}{5}$
- Existing Partners' shares are calculated by dividing the remaining share in their future profit sharing ratio (which in this case is old ratio since nothing is given as to how Z gets his share from X and Y) as under:

$$X's \text{ New Share} = \frac{3}{5} \text{ of } \frac{4}{5} = \frac{12}{25}; Y's \text{ New Share} = \frac{2}{5} \text{ of } \frac{4}{5} = \frac{8}{25}.$$
- New Ratio of X, Y & Z = $\frac{12}{25} : \frac{8}{25} : \frac{5}{25} = 12 : 8 : 5.$

The sacrificing ratio is the same as the old ratio 3 : 2 on the presumption that the existing partners make sacrifice in their old profit sharing ratio.

ILLUSTRATION 2

X and Y are partners sharing profits and losses in the ratio of 7 : 5. They admit Z, a new partner, who acquires his share as $\frac{1}{12}$ th from X and $\frac{1}{8}$ th from Y. Calculate the new profit sharing ratio and the sacrificing ratio.

SOLUTION

New Share of Old Partner = Old Share – Share acquired by Incoming partner

$$\text{X's New Share} = \frac{7}{12} - \frac{1}{12} = \frac{6}{12}$$

$$\text{Y's New Share} = \frac{5}{12} - \frac{1}{8} = \frac{7}{24}$$

$$\text{Share of Incoming Partner} = \frac{1}{12} + \frac{1}{8} = \frac{5}{24}$$

$$\text{New Ratio of X, Y \& Z} = \frac{12}{24} : \frac{7}{24} : \frac{5}{24} = 12 : 7 : 5$$

$$\begin{aligned} \text{Sacrificing Ratio} &= \text{Share acquired from one existing partner: Share acquired from another existing partner} \\ &= \frac{1}{12} : \frac{1}{8} = 2 : 3 \end{aligned}$$

ILLUSTRATION 3

X and Y are partners in a firm sharing profits and losses in the ratio of 3 : 2. Z is admitted as partner with $\frac{1}{4}$ share in profits. Z acquires his share from X and Y in the ratio of 2 : 1. Calculate the new profit sharing ratio.

SOLUTION

New Share of Old Partner = Old Share – Share acquired by Incoming Partner

$$\text{Share acquired by Z from X} = \frac{2}{3} \times \frac{1}{4} = \frac{2}{12}$$

$$\text{Share acquired by Z from Y} = \frac{1}{3} \times \frac{1}{4} = \frac{1}{12}$$

$$\text{Z's Share} = \frac{2}{12} + \frac{1}{12} = \frac{3}{12}$$

$$\text{X's New Share} = \frac{3}{5} - \frac{2}{12} = \frac{26}{60}$$

$$\text{Y's New Share} = \frac{2}{5} - \frac{1}{12} = \frac{19}{60}$$

$$\text{New Ratio of X, Y \& Z} = \frac{26}{60} : \frac{19}{60} : \frac{3}{60} = 26 : 19 : 3$$

ILLUSTRATION 4

X and Y are partners sharing profits and losses in the ratio of 7 : 3. X surrenders $\frac{1}{7}$ th of his share and Y surrenders $\frac{1}{3}$ rd of his share in favour of Z, a new partner. Calculate the new profit sharing ratio and the sacrificing ratio.

SOLUTION

New Share of Old Partner = Old Share – Share surrendered by Old Partners

$$\text{Share surrendered by X} = \frac{1}{7} \times \frac{7}{10} = \frac{1}{10}, \text{ Share surrendered by Y} = \frac{1}{3} \times \frac{3}{10} = \frac{1}{10},$$

$$\text{X's New Share} = \frac{7}{10} - \frac{1}{10} = \frac{6}{10}, \text{ Y's New Share} = \frac{3}{10} - \frac{1}{10} = \frac{2}{10}$$

$$\text{Z's Share} = \frac{1}{10} + \frac{1}{10} = \frac{2}{10}, \text{ New Ratio of X, Y and Z} = \frac{6}{10} : \frac{2}{10} : \frac{2}{10} = 3 : 1 : 1$$

Sacrificing Ratio of X & Y = Share surrendered by one existing partner: Share surrendered by another existing partner.

$$= \frac{1}{10} : \frac{1}{10} = 1 : 1$$

ILLUSTRATION 5

X and Y are partners sharing profits and losses in the ratio of 7 : 3. X surrenders 1/7th from his share and Y surrenders 1/3rd of his share in favour of Z, a new partner. Calculate the new profit sharing ratio and the sacrificing ratio.

SOLUTION

New Share of Old Partner = Old Share – Share surrendered by Old Partners

Share surrendered by X = 1/7,

$$\text{Share surrendered by Y} = \frac{1}{3} \times \frac{3}{10} = \frac{1}{10}, \text{ X's New Share} = \frac{7}{10} - \frac{1}{7} = \frac{39}{70}$$

$$\text{Y's New Share} = \frac{3}{10} - \frac{1}{10} = \frac{2}{10}, \text{ Z's Share} = \frac{1}{7} + \frac{1}{10} = \frac{17}{70}$$

$$\text{New Ratio of X, Y \& Z} = \frac{39}{70} : \frac{14}{70} : \frac{17}{70} = 39 : 14 : 17, \text{ Sacrificing Ratio} = \frac{1}{7} : \frac{1}{10} = 10 : 7$$

ILLUSTRATION 6

X and Y are partners sharing profits and losses in the ratio of 4 : 3. Z joins the firm as a new partner. The new profit sharing ratio of X, Y & Z is agreed at 7 : 4 : 3 respectively. Calculate the sacrificing ratio and the share of incoming partner.

SOLUTION

Share Sacrificed = Old Share – New Share

$$\text{X's Sacrifice} = \frac{4}{7} - \frac{7}{14} = \frac{1}{14}, \text{ Y's Sacrifice} = \frac{3}{7} - \frac{4}{14} = \frac{2}{14}$$

$$\text{Sacrificing Ratio of X and Y} = \frac{1}{14} : \frac{2}{14} = 1 : 2, \text{ Share of Z} = \frac{1}{14} + \frac{2}{14} = \frac{3}{14}$$

ILLUSTRATION 7

X and Y are partners in a firm sharing profits and losses in the ratio of 3 : 2. Z is admitted as partner with 1/8th share in profits. It is decided that X and Y will share profits and losses in future in the ratio of 4 : 3. Calculate the new profit sharing ratio and the sacrificing ratio.

SOLUTION

$$\text{Let the Total Share be } = 1, \text{ Share of Incoming Partner} = \frac{1}{8}, \text{ Remaining Share} = 1 - \frac{1}{8} = \frac{7}{8}$$

Existing Partners' New shares are calculated by dividing the remaining share in their future profits sharing ratio (i.e. 4 : 3) as under:

$$\text{X's New Share} = \frac{4}{7} \times \frac{7}{8} = \frac{28}{56}; \text{ Y's New Share} = \frac{3}{7} \times \frac{7}{8} = \frac{21}{56}$$

$$\text{New Ratio of X, Y \& Z} = \frac{28}{56} : \frac{21}{56} : \frac{7}{56} = 28 : 21 : 7 = 4 : 3 : 1$$

Calculation of Sacrificing Ratio

Share Sacrificed = Old Share – New Share

$$X's \text{ Sacrifice} = \frac{3}{5} - \frac{4}{8} = \frac{4}{40}; Y's \text{ Sacrifice} = \frac{2}{5} - \frac{3}{8} = \frac{1}{40}, \text{ Sacrificing Ratio of X and Y} = \frac{4}{40} : \frac{1}{40} = 4 : 1$$

ILLUSTRATION 8

X, Y and Z are partners in the ratio of 3 : 2 : 1. W is admitted with 1/6 share in profits. Z would retain his original share. Find out new profit sharing ratio.

SOLUTION

Let the total share be = 1

$$\text{Share of Z and W} = \frac{1}{6} - \frac{1}{6} = \frac{1}{3}, \text{ Remaining Share} = 1 - \frac{1}{3} = \frac{2}{3}$$

New Shares of X and Y are calculated by dividing the remaining share in their future profit sharing ratio (which in this case is old ratio since nothing is given as to how W gets his share from X and Y) as under:

$$X's \text{ New Share} = \frac{3}{5} \times \frac{2}{3} = \frac{6}{15}, Y's \text{ New Share} = \frac{2}{5} \times \frac{2}{3} = \frac{4}{15}$$

$$\text{New Ratio of X, Y, Z and W} = \frac{6}{15} : \frac{4}{15} : \frac{1}{6} : \frac{1}{6} = 12 : 8 : 5 : 5$$

ILLUSTRATION 9

X and Y are partners sharing profits and losses in the ratio of 3 : 2. Z is admitted for 1/4th share. Thereafter W enters for 20 paise in the rupee. Compute the profit sharing ratio of X, Y, Z and W after W's admission.

SOLUTION**Calculation of New Ratio after Z's admission**

Let the Total Share be = 1, Share of Z = 1/4

$$\text{Remaining Share} = 1 - \frac{1}{4} = \frac{3}{4}, X's \text{ New Share} = \frac{3}{5} \times \frac{3}{4} = \frac{9}{20}, Y's \text{ New Share} = \frac{2}{5} \times \frac{3}{4} = \frac{6}{20}$$

$$\text{New Ratio of X, Y and Z} = \frac{9}{20} : \frac{6}{20} : \frac{5}{20} = 9 : 6 : 5.$$

Calculation of New Ratio after W's admission

Let the Total Share be = 1, W's Share = 1/5

$$\text{Remaining Share} = 1 - \frac{1}{5} = \frac{4}{5}, X's \text{ New Share} = \frac{9}{20} \times \frac{4}{5} = \frac{36}{100}$$

$$Y's \text{ New Share} = \frac{6}{20} \times \frac{4}{5} = \frac{24}{100}, Z's \text{ New Share} = \frac{5}{20} \times \frac{4}{5} = \frac{20}{100}$$

Share of W = 20/100

New ratio of X, Y, Z & W = 36 : 24 : 20 : 20 = 9 : 6 : 5 : 5.

ILLUSTRATION 10

A and B are partners sharing profits in the ratio of 2 : 1. They admit C into partnership and the profit sharing ratio of the three partners is agreed at 2 : 2 : 1 respectively. Calculate the gain or sacrifice of the partners.

SOLUTION

Particulars	A	B
(a) Their Old Shares	2/3	1/3
(b) Their New Shares	2/5	2/5
(c) Difference [(a) – (b)]	4/15	(1/15)

A has sacrificed 4/15 out of his share of which B gets 1/15 and C gets 1/5.

ILLUSTRATION 11

A and B are partners sharing profits in the ratio of 3:2. They admit C for 1/5th share in the profit. C acquires 1/5th of his share from A. Calculate the new profit sharing ratio and sacrificing ratio.

SOLUTION

$$\text{Share acquired by C: from A} = \frac{1}{5} \times \frac{1}{5} = \frac{1}{25}, \quad \text{from B} = \frac{4}{5} \times \frac{1}{5} = \frac{4}{25}$$

$$\text{A's New Share} = \frac{3}{5} - \frac{1}{25} = \frac{14}{25} \quad \text{B's New Share} = \frac{2}{5} - \frac{4}{25} = \frac{6}{25}$$

New Profit Sharing Ratio of A, B and C = 14/25 : 6/25 : 5/25 = 14 : 6 : 5

Sacrificing Ratio of A and B = 1/25 : 4/25 = 1 : 4

ILLUSTRATION 12

A and B are partners sharing profits in the ratio of 3 : 2. They admit C, a new partner who acquires 1/5th of his share from A and 4/25th share from B. Calculate the new profit sharing ratio and sacrificing ratio.

SOLUTION

Step 1: Calculation of Share of Incoming Partner

Since C acquires 1/5th of his share from A, it means he acquires 4/5th (i.e. 1–1/5th) of his share from B.

If 4/5th shares = 4/25

$$1 \text{ share} = \frac{4}{25} \times \frac{5}{4} = \frac{1}{5}$$

Step 2: Calculation of New Shares

$$\text{Share acquired by C : from A} = \frac{1}{5} \times \frac{1}{5} = \frac{1}{25}, \quad \text{from B} = 4/25$$

$$\text{A's New Share} = \frac{3}{5} - \frac{1}{25} = \frac{14}{25}, \quad \text{B's New Share} = \frac{2}{5} - \frac{4}{25} = \frac{6}{25}$$

$$\text{Step 3: New Profit Sharing Ratio of A, B and C} = \frac{14}{25} : \frac{6}{25} : \frac{5}{25} = 14 : 6 : 5$$

$$\text{Step 4: Sacrificing Ratio of A and B} = \frac{1}{25} : \frac{4}{25} = 1 : 4$$

ILLUSTRATION 13

X and Y share profits and losses in the ratio of 5 : 3. Z is admitted for 3/10th share of profits half of which was gifted by X and the remaining share was taken by Z equally from X and Y. Calculate the new profit sharing ratio.

SOLUTION

$$\text{Share gifted by X} = \frac{1}{2} \times \frac{3}{10} = \frac{3}{20}$$

$$\text{Share acquired by Z : from X} = \frac{1}{2} \times \frac{3}{20} = \frac{3}{40},$$

from Y =

$$\text{X's New Share} = \frac{5}{8} - \frac{3}{20} - \frac{3}{40} = \frac{16}{40}$$

$$\text{Y's New Share} = \frac{3}{8} - \frac{3}{40} = \frac{12}{40}$$

$$\text{New Ratio of X, Y \& Z} = \frac{16}{40} : \frac{12}{40} : \frac{12}{40} = 16 : 12 : 12 = 4 : 3 : 3$$

ILLUSTRATION 14

X and Y are sharing profits and losses in the ratio of 5 : 3. They admit Z and decide that the profit sharing ratio between Y and Z shall be the same as existing between X and Y. Calculate the new profit sharing ratio and the sacrificing ratio.

SOLUTION

As the Ratio of X and Y is 5 : 3, Ratio of Y and Z should be 5 : 3. Since Y's share is 60% of X's share, Z's share should also be 60% of Y's share. Thus, Z's share is 60% of 3 = 1.8 New Ratio of X, Y & Z = 5 : 3 : 1.8 or 25 : 15 : 9

Calculation of Sacrificing Ratio

Share Sacrificed = Old Share – New Share

$$\text{X's Sacrifice} = \frac{5}{8} - \frac{25}{49} = \frac{45}{392},$$

$$\text{Y's Sacrifice} = \frac{3}{8} - \frac{15}{49} = \frac{27}{392}$$

$$\text{Sacrificing Ratio of X \& Y} = \frac{45}{392} : \frac{27}{392} = 5 : 3$$

3.0 ADJUSTMENT OF GOODWILL

Why is Adjustment of Goodwill required?	Whenever there is admission of a new partner the gaining partner (i.e., the partner whose share has increased as a result of change) must compensate the sacrificing partner (i.e., the partner whose share has decreased as a result of change). The new partner who gains by acquiring a right to share future profits must compensate the partner or partners who has or have made the sacrifice.
Amount of Compensation	The amount of compensation must be equal to the proportionate value of firm's goodwill. Thus, Amount of Compensation = Value of Firm's Goodwill × Share of Profit Sacrificed For Example, Z, a new partner acquires his 1/5th share of profits from X, an existing partner and the present value of firm's goodwill is ₹ 50,000. In this case, Z is required to pay 1/5th of ₹ 50,000, i.e. ₹ 10,000 to X.
Recommendation of AS 26	- Internally generated goodwill should not be recognized as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost. - Hence, when the goodwill is evaluated at the time of any change in the constitution of the firm (by way of admission/retirement/death/change in profit sharing ratio), the value of such goodwill should not be raised in the books of the firm. Rather the value of such goodwill should be adjusted through concerned partners' capital accounts.

4.0 ACCOUNTING TREATMENT OF GOODWILL UNDER DIFFERENT SITUATIONS**SITUATION-I : WHEN THE INCOMING PARTNER PAYS HIS SHARE OF FIRM'S GOODWILL PRIVATELY**

When the incoming partner pays his share of goodwill privately to the sacrificing partner(s) outside the business, no entry is passed in the books of the firm.

ILLUSTRATION 15

X and Y are partners in a firm sharing profits and losses in the ratio of 3 : 2. They admit Z as a partner for 1/5th share. Z paid ₹ 5,000 privately to X and Y as his share of goodwill. What should be the journal entry in the books of the firm?

SOLUTION

No journal entry will be passed in the books of the firm since Z has paid his share of goodwill to X and Y privately outside the firm.

SITUATION-II : WHEN THE INCOMING PARTNER BRINGS IN HIS SHARE OF FIRM'S GOODWILL IN CASH

When the incoming partner brings in his share of firm's goodwill in cash, the following simplified approach is suggested:

Step 1: Write off the Existing Book Value of Goodwill (if any) appearing in the books of the firm.		
Old Partners' Capital A/cs	Dr.	[In Old Ratio]
To Goodwill A/c		
(Being the existing goodwill written off in old ratio)		
Step 2: Record the Amount brought in by Incoming Partner		
Cash A/c/Bank A/c	Dr.	[With Capital & Share of Goodwill]
To Incoming Partner's Capital A/c		[With Capital]
To Premium for Goodwill A/c		[With Share of Goodwill brought in]
(Being the amount brought in by incoming partner)		
Step 3: Give Credit for Incoming Partner's Share of Goodwill to Sacrificing Partners.		
Premium for Goodwill A/c	Dr.	[With Share of Goodwill]
To Sacrificing Partners' Capital A/cs		[In Sacrificing Ratio]
(Being the share of incoming partner in firm's goodwill credited to sacrificing partners in their sacrificing ratio)		
Step 4: Record the Withdrawal (if any) of amount of goodwill by the Sacrificing Partner(s).		
Sacrificing Partners' Capital A/cs	Dr.	[To the extent of Withdrawal]
To Cash A/c/Bank A/c		
[Being the Goodwill amount withdrawn by Sacrificing Partner(s)]		

Tutorial Note: Unless otherwise stated, the Partners' Capitals should be assumed to be fluctuating. Current Accounts are to be used in case of Fixed Capitals.

ILLUSTRATION 16

A and B are partners sharing profits and losses in the ratio of 3 : 2. They admit C into partnership for 1/4th share. C brings in his requisite share of firm's goodwill in cash and ₹ 10,000 for capital. The goodwill of the firm is valued at ₹ 4,000. Goodwill already appears in the books at ₹ 500. Partners withdrew their share of goodwill. Give the necessary journal entries.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	A's Capital A/c [₹ 500 × 3/5] Dr.		300	
	B's Capital A/c [₹ 500 × 2/5] Dr.		200	
	To Goodwill A/c			500
	(Being the existing value of goodwill w/o old ratio)			
	Cash A/c [10,000 + 1,000] Dr.		11,000	
	To C's Capital A/c			10,000
	To Premium for Goodwill A/c			1,000
	(Being the amount brought in by C)			
	Premium for Goodwill A/c [₹ 4,000 × 1/4] Dr.		1,000	
	To A's Capital A/c [₹ 1,000 × 3/5]			600
	To B's Capital A/c [₹ 1,000 × 2/5]			400
	(Being the goodwill credited to sacrificing partners in their sacrificing ratio)			
	A's Capital A/c Dr.		600	
	B's Capital A/c Dr.		400	
	To Cash A/c			1,000
	(Being the goodwill credited to sacrificing partners withdrawn by them)			

Note: Unless otherwise stated, Sacrificing Ratio is the same as Old Profit Sharing Ratio.

ILLUSTRATION 17

A and B are partners sharing profits and losses in the ratio of 3 : 2 respectively. They admit C paying premium for 1/4th share while A and B as between them sharing profits and losses equally. Goodwill already appears at ₹ 5,000. Partners withdrew half of the goodwill. Goodwill of the firm is valued at ₹ 4,000. Give the necessary journal entries.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	A's Capital A/c [₹ 5,000 × 3/5] Dr.		3,000	
	B's Capital A/c [₹ 5,000 × 2/5] Dr.		2,000	
	To Goodwill A/c			5,000
	(Being the existing value of goodwill w/o in old ratio)			

	Cash A/c [₹ 4,000 × 1/4] Dr. To Premium for Goodwill A/c (Being the amount of goodwill brought in by C)		1,000	1,000
	Premium for Goodwill A/c Dr. To A's Capital A/c [₹ 1,000 × 9/10] To B's Capital A/c [₹ 1,000 × 1/10] (Being the goodwill credited to sacrificing partners in their sacrificing ratio of 9 : 1)		1,000	900 100
	A's Capital A/c [₹ 900 × 1/2] Dr. B's Capital A/c [₹ 100 × 1/2] Dr. To Cash A/c [₹ 1,000 × 1/2] (Being 50% goodwill credited to sacrificing partners withdrawn by them)		450 50	500

Working Note: Calculation of Sacrificing Ratio

Let Total Share = 1, Remaining Share for A & B = $1 - 1/4 = 3/4$

A's New share = $3/4 \times 1/2 = 3/8$, B's New Share = $3/4 \times 1/2 = 3/8$

A's Sacrifice = $3/5 - 3/8 = 9/40$, B's Sacrifices = $2/5 - 3/8 = 1/40$

Hence, Sacrificing Ratio of A and B = 9 : 1

ILLUSTRATION 18

A and B are in partnership sharing profits and losses in the ratio of 5 : 3. C is admitted as a partner paying ₹ 40,000 as capital and the necessary amount of goodwill which is valued at ₹ 60,000 for the firm. Goodwill already appears in the books at ₹ 8,000. Partners withdrew half of goodwill. He takes his share of profit : 1/10th from A and 1/10th from B. The profit for the first year of new partnership amounts to ₹ 24,000. Pass the necessary journal entries to adjust goodwill and to distribute profits.

SOLUTION
JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	A's Capital A/c [₹ 8,000 × 5/8] Dr. B's Capital A/c [₹ 8,000 × 3/8] Dr. To Goodwill A/c (Being the existing goodwill written off in old ratio)		5,000 3,000	8,000
	Cash A/c [₹ 40,000 + (₹ 60,000 + 1/5)] Dr. To C's Capital A/c To Premium for Goodwill A/c (Being the amount of goodwill & capital brought in by C)		52,000	40,000 12,000
	Premium for Goodwill A/c [₹ 60,000 × 1/5] Dr. To A's Capital A/c [₹ 12,000 × 1/2] To B's Capital A/c [₹ 12,000 × 1/2] (Being the goodwill credited to sacrificing partners in their sacrificing ratio of 1 : 1)		12,000	6,000 6,000

	A's Capital A/c [₹ 6,000 × 1/2]	Dr.	3,000	6,000
	B's Capital A/c [₹ 6,000 × 1/2]	Dr.	3,000	
	To Cash A/c [₹ 12,000 × 1/2]			
	(Being 50% of goodwill credited to sacrificing partners withdrawn by them)			
	Profit & Loss A/c	Dr.	24,000	12,600 6,600 4,800
	To A's Capital A/c [₹ 24,000 × 21/40]			
	To B's Capital A/c [₹ 24,000 × 11/40]			
	To C's Capital A/c [₹ 24,000 × 8/40]			
	(Being the profit credited to all partners in their new profit sharing ratio of 21 : 11 : 8)			

Working Note: Calculation of New Ratio

A's New Share = $5/8 - 1/10 = 21/40$, B's New Share = $3/8 - 1/10 = 11/40$

Hence, New Ratio of A, B and C = $21/40 : 11/40 : 8/40 = 21 : 11 : 8$

ILLUSTRATION 19

B and C are in partnership sharing profits and losses in the ratio of 3 : 1. They admit D for one third share of the profits. D brings ₹ 15,000 in cash for his share of goodwill. As between themselves, B and C agree to share future profits and losses equally. The amount of goodwill brought in cash is withdrawn by the concerned partners to the extent of 40% of what is credited to them. Draft Journal entries showing the appropriation of the premium money.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Cash A/c Dr. To Premium for Goodwill A/c (Being the amount brought in by D towards goodwill)		15,000	15,000
	Premium for Goodwill A/c Dr. To B's Capital A/c (Being the goodwill credited to sacrificing partner)		15,000	15,000
	C's Capital A/c [₹ 45,000 × 1/12] Dr. To B's Capital A/c (Being the adjustment made on account of change in profit sharing ratio. B loses 1/12th of profit and hence C compensates B for this loss in share of profit thus, 1/12th of ₹ 45,000, ₹ 3,750)		3,750	3,750
	B's Capital A/c [₹ 18,750 × 40/100] Dr. To Cash A/c (Being 40% of goodwill credited to sacrificing partner withdrawn by him)		7,500	7,500

Working Notes:

1. **Firm's Goodwill** = ₹ 15,000 × 3/1 = ₹ 45,000.

2. **Sacrificing Ratio**

Let Total Share = 1, Remaining Share = 1 – 1/3 = 2/3

B's New Share = 2/3 × 1/2 = 1/3, C's New Share = 2/3 × 1/2 = 1/3

B's Sacrifice = 3/4 – 1/3 = 5/12, C's Gain = 1/4 – 1/3 = (1/12)

ILLUSTRATION 20

A, B and C are partners sharing profits and losses in the ratio of 3 : 2 : 1. D is admitted. The new profit sharing ratio between A, B, C and D will be 3 : 3 : 2 : 2. Goodwill of the firm is valued at ₹ 3,00,000. Goodwill already appears in the books at ₹ 6,000. D brings his share of firm's goodwill in cash. The amount of goodwill is withdrawn by the concerned partners to the extent of 30% of what is credited to them. Give the journal entries relating to adjustment of goodwill.

SOLUTION
JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	A's Capital A/c [₹ 6,000 × 3/6] Dr.		3,000	
	B's Capital A/c [₹ 6,000 × 2/6] Dr.		2,000	
	C's Capital A/c [₹ 6,000 × 1/6] Dr.		1,000	
	To Goodwill A/c (Being the existing value of goodwill w/o in old ratio)			6,000
	Cash A/c [₹ 3,00,000 × 2/10] Dr.		60,000	
	To Premium for Goodwill A/c (Being the amount of goodwill brought in by D)			60,000
	C's Capital A/c [₹ 3,00,000 × 1/30] Dr.		10,000	
	Premium for Goodwill A/c [₹ 3,00,000 × 2/10] Dr.		60,000	
	To A's Capital A/c [₹ 3,00,000 × 2/10]			60,000
	To B's Capital A/c [₹ 3,00,000 × 1/30]			10,000
	(Being the adjustment for goodwill made on account of change in profit sharing ratio which resulted in loss of 6/30th to A and 1/30th to B and gain of 1/30th to C and 2/10th to D)			
	A's Capital A/c [₹ 60,000 × 30/100] Dr.		18,000	
	B's Capital A/c [₹ 10,000 × 30/100] Dr.		3,000	
	To Cash A/c [₹ 70,000 × 30/100]			21,000
	(Being the 30% of goodwill credited to sacrificing partner withdrawn by them)			

Working Note: Calculation of Sacrificing Ratio

A's Sacrifice = 3/10 – 3/6 = 6/30,

B's Sacrifice = 3/10 – 2/6 = 1/30

C's Gain = 1/6 – 2/10 = (1/30)

ILLUSTRATION 21

X and Y share profits & losses in the ratio of 5 : 3. Z is admitted for 3/10th share of profits half of which was gifted by X and the remaining share was taken by Z equally from X and Y. The goodwill of the firm is valued at ₹ 21,600. Z brings in his requisite share of firm's goodwill. The profit for the first year of new partnership amounts to ₹ 24,000. Pass the necessary journal entries to adjust goodwill and to distribute profits.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Cash A/c [₹ 21,600 × 3/20] Dr. To Premium for Goodwill (Being the amount of goodwill brought in by Z for purchased share of profit i.e. 3/20)		3,240	3,240
	Premium for Goodwill A/c Dr. To X's Capital A/c [₹ 3,240 × 1/2] To Y's Capital A/c [₹ 3,240 × 1/2] (Being the goodwill credited to sacrificing partners in their sacrificing ratio of 1:1)		3,240	1,620 1,620
	Profit and Loss A/c Dr. To X's Capital A/c [₹ 24,000 × 4/10] To Y's Capital A/c [₹ 24,000 × 3/10] To Z's Capital A/c [₹ 24,000 × 3/10] (Being the profit credited to all partners in their new profit sharing ratio of 4 : 3 : 3)		24,000	9,600 7,200 7,200

Working Note:

Calculation of New Profit Sharing Ratio-(Refer to Illustration 13).

SITUATION-III : WHEN THE INCOMING PARTNER BRINGS IN HIS SHARE OF GOODWILL IN KIND

- A new partner instead of bringing in cash may bring his share of goodwill in the form of **Assets**.
- Usually, this happens in the case of a sole proprietorship. The incoming partner joins hands with others to carry on the business as a partnership firm.
- In such a situation, the **Assets** brought in are debited and the incoming partner's capital account is credited with capital brought in and Premium Account is credited with amount of goodwill brought in.
- Afterwards, incoming partner's share of goodwill is transferred by debiting the Premium Account and crediting the capital accounts of the sacrificing partners in their sacrificing ratio.
- The two steps involved in this case are given below:

Step 1: Record Assets brought in by the Incoming partner

Assets A/c	Dr.	[Individually]
To Incoming Partner's Capital A/c		[With amount of Capital]
To Premium for Goodwill A/c		[With share of Goodwill brought in]

Step 2: Give Credit for Incoming Partner's Share of Goodwill to Sacrificing Partner

Premium for Goodwill A/c	Dr.	[With Share of Goodwill brought in]
To Sacrificing Partners' Capital A/cs		[In Sacrificing Ratio]

Tutorial Note: Unless otherwise stated, the Partners' Capitals should be assumed to be fluctuating. Current Accounts are to be used in case of Fixed Capitals.

ILLUSTRATION 22

X and Y are partners in a firm sharing profits in the ratio of 3 : 2. On April 1, 2018 they admit Z as a new partner. The new profit sharing ratio of X, Y and Z will be 5:5:3. Z contributed the following Assets towards his capital and for his share of goodwill:

Stock ₹ 80,000, Book Debts ₹ 20,000 (less provision for Doubtful Debts of 5%), Goodwill of his connections valued at ₹ 40,000, Land ₹ 61,000. Plant and Machinery ₹ 90,000. On the Date of admission of Z, the goodwill of the firm was valued at ₹ 6,50,000. Record the necessary journal entries in the books of the firm on Z admission.

SOLUTION**JOURNAL OF X, Y AND Z**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
01.04.2018	Stock Dr.		80,000	
	Book Debts Dr.		20,000	
	Land Dr.		61,000	
	Plant and Machinery A/c Dr.		90,000	
	Goodwill A/c Dr.		40,000	
	To Provision for Doubtful Debts A/c			1,000
	To Z's Capital A/c			1,40,000
	To Premium of Goodwill A/c [₹ 6,50,000 × 3/13]			1,50,000
	(Being Stock, Debtors, Land and Plant ,Machinery and Own Goodwill contributed by Z on his admission as his capital and his share of goodwill)			
	Premium for Goodwill A/c Dr.		1,50,000	
	To X's Capital A/c [₹ 1,50,000 × 14/15]			1,40,000
	To Y's Capital A/c [₹ 1,50,000 × 1/15]			10,000
	(Being the share of Z in goodwill credited to sacrificing partners in their sacrificing ratio)			

Working Note: Calculation of Sacrificing Ratio

Share Sacrificed = Old Share – New Share

X's Sacrifice = $3/5 - 5/13 = 14/65$, Y's Sacrifice = $2/5 - 5/13 = 1/65$,

Sacrificing Ratio = $14/65 : 1/65 = 14:1$

ILLUSTRATION 23

A and B are partners in a firm sharing profits and losses equally. They admitted C as a partner for 1/5th share of profit. C brought into partnership "Book Debts" amounting to ₹ 20,000 (less provision for Doubtful Debts of 5%), the Goodwill of his connections valued at ₹ 40,000 and the balance amount in cash, borrowed from his friend D, so as to take his Capital of ₹ 1,20,000.

Required: Show the Journal Entry in the books of the firm.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Sundry Debtors A/c Dr.		20,000	
	Goodwill A/c Dr.		40,000	
	Cash A/c Dr.		61,000	
	To Provision for Doubtful Debts A/c			1,000
	To C's Capital A/c			1,20,000
	(Being the amount brought in by C towards capital)			

SITUATION-IV : WHEN THE INCOMING PARTNER DOES NOT BRING HIS SHARE OF FIRM'S GOODWILL IN CASH

When the incoming partner does not bring in his share of firm's goodwill in cash, the following simplified approach is suggested:

Step 1: Write off the Existing Book Value of Goodwill (if any) appearing in the books	
Old Partners' Capital A/cs	Dr. [In Old Ratio]
To Goodwill A/c	
(Being the existing goodwill written off in old ratio)	
Step 2: Record the Amount brought in by Incoming Partner	
Cash A/c/Bank A/c	Dr. [With Capital brought in]
To Incoming Partner's Capital A/c	
(Being the Capital brought in by Incoming Partner)	
Step 3: Give Credit for Incoming Partner's Full Share of Goodwill to Sacrificing Partners.	
Incoming Partner's Capital A/c	Dr. [With Unpaid Share of Goodwill in case of Fluctuating Capitals]
To Sacrificing Partners' Capital A/cs	[In Sacrificing Ratio]
(Being the share of incoming partner in firm's goodwill credited to sacrificing partners in their sacrificing ratio)	

Tutorial Note: Unless otherwise stated, the Partners' Capitals should be assumed to be fluctuating. Current Accounts are to be used in case of Fixed Capitals.

ILLUSTRATION 24

X and Y are partners in a firm sharing profits and losses in the ratio of 3 : 2. They admit Z as a partner for 1/5th share. Z acquires his share from X and Y in the ratio of 2 : 3. The goodwill of the firm has been valued at ₹ 25,000. Goodwill already appears in the books at ₹ 20,000. Z bring in ₹ 1,00,000 as his capital. Pass the necessary journal entries.

SOLUTION

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	X's Capital A/c [₹ 20,000 × 3/5] Dr. Y's Capital A/c [₹ 20,000 × 2/5] Dr. To Goodwill A/c (Being the existing goodwill written off in the old ratio, i.e. 3:2)		12,000 8,000	20,000
(ii)	Cash A/c Dr. To Z's Capital A/c (Being the amount brought in by Z as his capital)		1,00,000	1,00,000
(iii)	Z's Capital A/c [₹ 25,000 × 1/5] Dr. To X's Capital A/c [₹ 5,000 × 2/5] To Y's Capital A/c [₹ 5,000 × 3/5] (Being the share of Z in goodwill credited to X and Y in their sacrificing ratio, i.e. 2 : 3)		5,000	2,000 3,000

SITUATION-V : WHEN INCOMING PARTNER BRINGS IN ONLY PART OF HIS SHARE OF FIRM'S GOODWILL IN CASH

When the incoming partner brings in only part of his share of firm's goodwill in cash, the following simplified approach is suggested:

Step 1: Write off the Existing Book Value of Goodwill (if any) appearing in the books	
Old Partners' Capital A/cs	Dr. [In Old Ratio]
To Goodwill A/c	
(Being the existing goodwill written off in the old ratio)	
Step 2: Record the Amount brought in by Incoming partner	
Cash A/c/Bank A/c	Dr. [With Capital & Share of goodwill]
To Incoming Partner's Capital A/c	[With Capital brought in]
To Premium for Goodwill A/c	[With Share of Goodwill brought in]
(Being the amount brought in by Incoming Partner)	
Step 3: Give Credit for Incoming Partner's Full Share of Firm's Goodwill to Sacrificing Partners as follows:	
Premium for Goodwill A/c	Dr. [With Share of Goodwill brought in]
Incoming Partner's Capital A/c	Dr. [With Unpaid Share of Goodwill in case of Fluctuating Capitals]
To Sacrificing Partners' Capital A/cs	[In Sacrificing Ratio]
(Being the Share of Incoming Partner in firm's goodwill credited to Sacrificing Partners in their Sacrificing Ratio)	
Step 4: Record the Withdrawal (if any) of amount of Goodwill by the Sacrificing Partner(s).	
Sacrificing Partners' Capital A/cs	Dr. [To the extent of withdrawal]
To Cash A/c/Bank A/c	
[Being the goodwill amount withdrawn by Sacrificing Partner(s)]	

Tutorial Note: Unless otherwise stated, the Partners' Capitals should be assumed to be fluctuating. Current Accounts are to be used in case of Fixed Capitals.

ILLUSTRATION 25

X and Y are partners in a firm sharing profits and losses in the ratio of 3:2. They admit Z as a new partner for 1/5th share. As between themselves, X and Y decide to share future profits & losses in the ratio of 13:7. The goodwill of the firm is valued at ₹ 25,000. Goodwill already appears in the books at ₹ 20,000. Z brings in 60% of his share of firm's goodwill and ₹ 1,00,000 as his capital in cash. The amount of goodwill is withdrawn by the concerned partners to the extent of 30% of what is credited to them. The profits for the first year of new partnership amount to ₹ 1,00,000.

Required: Give the necessary journal entries to adjust goodwill and to distribute profits.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	X's Capital A/c [₹ 20,000 × 3/5] Dr. Y's Capital A/c [₹ 20,000 × 2/5] Dr. To Goodwill A/c (Being the existing goodwill written off in the old ratio, i.e. 3:2)		12,000 8,000	20,000
(ii)	Cash A/c [₹ 1,00,000 + 60% of ₹ 5,000] Dr. To Z's Capital A/c To Premium for Goodwill A/c (Being the amount brought in by Z for his share of goodwill and capital)		1,03,000	1,00,000 3,000
(iii)	Premium for Goodwill A/c Dr. Z's Capital A/c Dr. To X's Capital A/c [₹ 5,000 × 2/5] To Y's Capital A/c [₹ 5,000 × 3/5] (Being the share of Z in goodwill credited to sacrificing partners in their sacrificing ratio, i.e. 2 : 3)		3,000 2,000	2,000 3,000
(iv)	X's Capital A/c [₹ 2,000 × 30/100] Dr. Y's Capital A/c [₹ 3,000 × 30/100] Dr. To Cash A/c [₹ 5,000 × 30/100] (Being 30% of the amount of goodwill credited to X & Y withdrawn by them)		600 900	1,500
(v)	Profit & Loss A/c Dr. To X's Capital A/c [₹ 1,00,000 × 13/25] To Y's Capital A/c [₹ 1,00,000 × 7/25] To Z's Capital A/c [₹ 1,00,000 × 5/25] (Being the profit credited to all partners in their new profit sharing ratio]		1,00,000	52,000 28,000 20,000

Working Note: Calculate of New Profit Sharing Ratio and Sacrificing Ratio

Let Total Share = 1. Z's Share = 1/5, Remaining Share = 1 – 1/5 = 4/5

X's New share = $\frac{13}{20} \times \frac{4}{5} = \frac{52}{100}$, Y's New Share = $\frac{7}{20} \times \frac{4}{5} = \frac{28}{100}$

$$\text{New Ratio of X, Y and Z} = \frac{52}{100} : \frac{28}{100} : \frac{20}{100} = 52 : 28 : 20 = 13 : 7 : 5$$

$$\text{X's Sacrifice} = \frac{3}{5} - \frac{52}{100} = \frac{8}{100}, \text{ Y's Sacrifice} = \frac{2}{5} - \frac{28}{100} = \frac{12}{100}$$

$$\text{Sacrificing Ratio of X and Y} = \frac{8}{100} : \frac{12}{100} = 2 : 3$$

ILLUSTRATION 26

X and Y are partners in a firm sharing profits and losses in the ratio of 3 : 2. They admit Z as a partner for 1/4th share. Z acquires his share from X and Y in the ratio of 2 : 1. The goodwill of the firm has been valued at ₹ 24,000. Goodwill already appears at ₹ 15,000. Pass the necessary journal entries under each of the following alternative cases.

Case (a) If Z brings his requisite share of firm's goodwill in cash.

Case (b) If Z is unable to bring his requisite share of firm's goodwill in cash.

Case (c) If Z brings only 60% of his requisite share of firm's goodwill in cash.

SOLUTION
JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	Case (a) X's Capital A/c Dr. Y's Capital A/c Dr. To Goodwill A/c (Being the existing value of goodwill written off)		9,000 6,000	15,000
(ii)	Cash A/c Dr. To Premium of Goodwill A/c [₹ 24,000 × 1/4] (Being the amount of goodwill brought in by Z)		6,000	6,000
(ii)	Premium of Goodwill A/c Dr. To X's Capital A/c To Y's Capital A/c (Being the share of Z in goodwill credited to X and Y in their sacrificing ratio i.e. 2:1)		6,000	4,000 2,000
(i)	Case (b) X's Capital A/c Dr. Y's Capital A/c Dr. To Goodwill A/c (Being the existing value of goodwill written off)		9,000 6,000	15,000
(ii)	Z's Capital A/c Dr. To X's Capital A/c To Y's Capital A/c (Being the share of Z in goodwill credited to X and Y in their sacrificing ratio i.e. 2:1)		6,000	4,000 2,000

(i)	Case (c)			
	X's Capital A/c	Dr.	9,000	
	Y's Capital A/c	Dr.	6,000	
	To Goodwill A/c (Being the existing value of goodwill written off)			15,000
(ii)	Cash A/c	Dr.	3,600	
	To Premium of Goodwill A/c (Being 60% of the share of goodwill brought in by Z)			3,600
(iii)	Premium of Goodwill A/c	Dr.	3,600	
	Z's Capital A/c	Dr.	2,400	
	To X's Capital A/c			4,000
	To Y's Capital A/c (Being the share of Z in goodwill credited to X and Y in their sacrificing ratio i.e. 2 : 1)			2,000

ILLUSTRATION 27

A and B are in partnership sharing profits and losses in the ratio of 3 : 1. They admit C for one third share of the profits. As between themselves, A and B agree to share future profits and losses equally. Pass the necessary journal entries in each of the following alternative cases:

Case (a) If C brings in ₹ 15,000 in cash towards his share of firm's goodwill.

Case (b) If C brings in ₹ 5,000 in cash & machinery worth ₹ 10,000 towards his share of firm's goodwill.

Case (c) If C is unable to bring his share (₹ 15,000) of firm's goodwill in cash.

Case (d) If C brings in ₹ 9,000 out of his share of ₹ 15,000 for goodwill in Cash.

SOLUTION**(A) JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Cash A/c	Dr.	15,000	
	To Premium for Goodwill A/c (Being the amount brought in by C towards goodwill)			15,000
	Premium for Goodwill A/c	Dr.	15,000	
	To A's Capital A/c (Being the goodwill credited to sacrificing partner)			15,000
	B's Capital A/c [₹ 45,000 × 1/12]	Dr.	3,750	
	To A's Capital A/c (Being the adjustment made on account of change in profit sharing ratio. B loses 1/12th of profit and hence B compensates A for this loss in share of profit thus, 1/12th of ₹ 45,000, ₹ 3,750) (Firm's goodwill ₹ 15,000 × 3/1 = ₹ 45,000)			3,750

Working Note: Calculation of Sacrificing Ratio

Let the Total Share be = 1, C's Share = $1/3$

Remaining Share = $1 - 1/3 = 2/3$

A's New Share = $1/2 \times 2/3 = 2/6$, B's Share = $1/2 \times 2/3 = 2/6$

Calculation of Sacrificing Ratio

Share Sacrificed (Gained) = Old Share – New Share

A's Sacrifice = $3/4 - 1/3 = 5/12$, B's Gain = $1/4 - 1/3 = 1/12$

(B) JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Cash A/c Dr. Machinery A/c Dr. To Premium for Goodwill A/c (Being the amount brought in by C towards goodwill)		5,000 10,000	15,000
	Premium for Goodwill A/c Dr. To A's Capital A/c (Being the goodwill credited to sacrificing partner)		15,000	15,000
	B's Capital A/c [₹ 45,000 × 1/12] Dr. To A's Capital A/c (Being the adjustment made on account of change in profit sharing ratio. B loses 1/12th of profit and hence B compensates A for this loss in share of profit thus, 1/12th of ₹ 45,000, ₹ 3,750) (Firm's goodwill ₹ 15,000 × 3/1 = ₹ 45,000)		3,750	3,750

Working Note: Same as in Case (a)

(C) JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	C's Capital A/c Dr. To A's Capital A/c (Being the goodwill credited to sacrificing partner)		15,000	15,000
	B's Capital A/c [₹ 45,000 × 1/12] Dr. To A's Capital A/c (Being the adjustment made on account of change in profit sharing ratio. B loses 1/12th of profit and hence B compensates A for this loss in share of profit thus, 1/12th of ₹ 45,000, ₹ 3,750) (Firm's goodwill ₹ 15,000 × 3/1 = ₹ 45,000)		3,750	3,750

Working Note: Same as in Case (a)

(D) JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Cash A/c Dr. To Premium for Goodwill A/c (Being the amount brought in by C towards goodwill)		9,000	9,000

	Premium for Goodwill A/c Dr.		9,000	
	C's Capital A/c Dr.		6,000	
	To A's Capital A/c			15,000
	(Being the goodwill credited to sacrificing partner)			
	B's Capital A/c [₹ 45,000 × 1/12] Dr.		3,750	
	To A's Capital A/c			3,750
	(Being the adjustment made on account of change in profit sharing ratio. B loses 1/12th of profit and hence B compensates A for this loss in share of profit thus, 1/12th of ₹ 45,000, ₹ 3,750) (Firm's goodwill ₹ 15,000 × 3/1 = ₹ 45,000)			

Working Note: Same as in Case (a)

5.0 CALCULATION OF HIDDEN GOODWILL

When the value of the goodwill of the firm is not specifically given, the value of goodwill has to be inferred on the basis of the Net Worth of the firm as follows:

CALCULATION OF HIDDEN GOODWILL

Particulars	₹
A. Net Worth (including goodwill) on the basis of capital brought in by Incoming Partner (Incoming Partner's Capital × Reciprocal of Share of Incoming Partner)	xxx
B. Less: Net Worth (excluding goodwill) of the reconstituted firm (including Incoming Partner's Capital)	xxx
C. Value of Goodwill (A – B)	xxx

TUTORIAL NOTE

Net Worth = Sundry Assets – Outsiders' Liabilities

or = Capitals of Partners + Net Accumulated Profits & Reserves (if any)

ILLUSTRATION 28

A and B are partners with capitals of ₹ 5,000 each. They admit C as a partner with 1/4th share in the profits of the firm. C brings ₹ 8,000. The Profit and Loss Account showed a credit balance of ₹ 4,000 as on Date of admission of C. Give the necessary journal entries on C's admission with regard to Capital & Goodwill.

SOLUTION

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c Dr.		8,000	
	To C's Capital A/c			8,000
	(Being the amount brought in by C)			
	C's Capital A/c [₹ 10,000 × 1/4] Dr.		2,500	
	To A's Capital A/c			1,250
	To B's Capital A/c			1,250
	(Being the share of C in the hidden goodwill adjusted through capital accounts by crediting sacrificing partners in their sacrificing ratio)			

Note: Hidden Goodwill = $\left(8,000 \times \frac{4}{1}\right) - (\text{₹ } 5,000 + \text{₹ } 5,000 + \text{₹ } 4,000 + \text{₹ } 8,000) = \text{₹ } 10,000$

ILLUSTRATION 29

A and B who share the profits & losses in the ratio of 3 : 2 are partners with Capitals of ₹ 30,000 and ₹ 20,000. On Date of C's admission, P&L A/c (Cr.) balance ₹ 6,000. Reserves ₹ 55,000, Advertisement Expenditure (Deferred Revenue) ₹ 1,000.

They admit C as a partner with 1/5th share in the profits of the firm. C brings ₹ 40,000. Give the necessary journal entries on C's admission with regard to capital and goodwill.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c Dr. To C's Capital A/c (Being the amount brought in by C)		40,000	40,000
	C's Capital A/c [₹ 50,000 × 1/5] Dr. To A's Capital A/c [₹ 10,000 × 3/5] To B's Capital A/c [₹ 10,000 × 2/5] (Being the share of C in the hidden goodwill adjusted through capital accounts by crediting sacrificing partners in their sacrificing ratio)		10,000	6,000 4,000

Working Note:**CALCULATION OF HIDDEN GOODWILL**

Particulars	₹
A. Net Worth (including goodwill) of new firm on the basis of Capital brought in by Incoming Partner (₹ 40,000 × 5/1)	2,00,000
B. Less: Net Worth (excluding goodwill) of new firm (Adjusted old Capitals of old partners + Incoming Partner's Capital) [(₹ 30,000 + ₹ 20,000 + ₹ 55,000 + ₹ 6,000 – 1,000) + ₹ 40,000]	1,50,000
C. Value of Goodwill [A – B]	50,000

ILLUSTRATION 30

Mr. A commenced business with a capital of ₹ 5,00,000 on 1st Jan. 2013. During the five years ending 31st Dec. 2017, the following profits and losses were made:

2013 Loss ₹ 10,000, 2014 Profit ₹ 26,000, 2015 Profit ₹ 34,000, 2016 Profit ₹ 40,000, 2017 Profit ₹ 50,000.

During this period, he had drawn ₹ 80,000 for his personal use. On 1st Jan. 2018, A admitted B into partnership on the following terms: B to bring capital equal to A's Capital for his half share in the business on 1st Jan. 2018 and to pay for one half share of goodwill of the business, on the basis of three times the average profits of the last five years. Prepare statement showing what amount B should invest to become a partner assuming that the goodwill is to be retained in the business and make entries to record the transactions pertaining to admission.

SOLUTION**(I) CALCULATION OF SHARE OF GOODWILL TO BE BROUGHT IN BY B**

<i>Particulars</i>	<i>₹</i>
A. Total Profits for five years	1,40,000
B. Average Profits (₹ 1,40,000/5)	28,000
C. Amount of goodwill (₹ 28,000 × 3)	84,000
D. Share of goodwill to be brought in by B (₹ 84,000/2)	42,000

(II) CALCULATION OF A'S CAPITAL AS ON 31-12-2017

<i>Particulars</i>	<i>₹</i>
A. Capital as on 1.1.2013	5,00,000
B. Add: Net Profit for five years	1,40,000
C. Less: Drawings	(80,000)
Total	5,60,000

(iii) Calculation of amount to be invested by B

$$\begin{aligned} \text{A's Capital after B's admission} &= ₹ 5,60,000 + \text{Amount of goodwill to be brought in} \\ &= ₹ 5,60,000 + ₹ 42,000 \end{aligned} \quad \dots\dots\dots \text{Eq. I}$$

Let B's Total investment be equal to X

X = Capital to be brought in by B + Goodwill to be brought in by B

or X = Capital + ₹ 42,000

or, Capital = X – ₹ 42,000 \dots\dots\dots \text{Eq. II}

Since B has to bring capital equal to A's Capital, both the equations may be equated as under:

$$X - ₹ 42,000 = ₹ 5,60,000 + ₹ 42,000$$

$$X = ₹ 5,60,000 + ₹ 42,000 + ₹ 42,000 = ₹ 6,44,000.$$

JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
01.01.2018	Cash A/c (₹ 6,02,000 + ₹ 42,000) Dr.		6,44,000	
	To B's Capital A/c			6,02,000
	To Premium for Goodwill A/c			42,000
	(Being the amount brought in by B)			
	Premium for Goodwill A/c Dr.		42,000	
	To A's Capital A/c			42,000
	(Being the amount of goodwill credited to A's Capital A/c)			

6.0 REVALUATION OF ASSETS AND LIABILITIES

Why is Revaluation Required?	At the time of admission of a partner, the Assets and Liabilities are revalued so that the profit or loss arising on account of such revaluation upto the Date of admission of a new partner may be ascertained and adjusted in the old partners' Capital Accounts in their old profit sharing ratio since it belongs to old partners and not to new partner.

How to record the Effect of Revaluation	The effect of revaluation of Assets and Liabilities may be recorded either through ' Revaluation Account (if Assets and Liabilities are to appear at revalued figures) or through Capital Accounts (if Assets and Liabilities are to appear at old figures).'

REVALUATION ACCOUNT

Meaning	Revaluation Account (or <i>alternatively Profit & Loss Adjustment Account</i>) is a Nominal Account .
Purpose	The purpose of Revaluation Account is to ascertain the profit/loss arising on account of Revaluation of Assets and Liabilities .
Contents	Revaluation Account is credited with increase in the value of Assets and decrease in the amount of Liabilities (it is a gain) and debited with decrease in the value of Assets and increase in the amount of Liabilities (it is a loss) . Unrecorded Assets are recorded through the Revaluation Account as increase in Assets. Unrecorded Liabilities are recorded through the Revaluation Account as increase in Liabilities.
Balance	The balance of Revaluation Account shows the net effect on account of revaluation which is transferred to the Partners' Capital accounts in their Old Profit Sharing Ratio .

ACCOUNTING ENTRIES TO RECORD THE REVALUATION OF ASSETS AND LIABILITIES

1. For Increase in the Value of an Asset	
Asset A/c	Dr.
To Revaluation A/c	
(Being the increase in the value of an asset recorded)	
2. For Decrease in the Value of an Asset	
Revaluation A/c	Dr.
To Asset A/c	
(Being the decrease in the value of an asset recorded)	
3. For Increase in the Amount of a Liability	
Revaluation A/c	Dr.
To Liability A/c	
(Being the increase in the amount of a liability recorded)	
4. For Decrease in the Amount of a liability	
Liability A/c	Dr.
To Revaluation A/c	
(Being the decrease in the amount of a liability recorded)	
5. For Recording an Unrecorded Asset	
Unrecorded Asset A/c	Dr.
To Revaluation A/c	
(Being an agreed value of an unrecorded asset brought into account)	

6. For Recording an Unrecorded Liability

Revaluation A/c Dr.
 To Unrecorded Liability A/c
 (Being an agreed amount of an unrecorded liability brought into account)

7. For Transfer of Balance in Revaluation Account**(i) If credit side exceeds debit side (Net Gain)**

Revaluation A/c Dr.
 To Old Partners' Capital A/cs (Individually in Old Ratio)
 (Being the Net Gain on Revaluation transferred to Old Partners' Capital Accounts in Old Profit Sharing Ratio)

(ii) If debit side exceeds credit side (Net Loss)

Old Partners' Capital A/cs (Individually in Old Ratio) Dr.
 To Revaluation A/c
 (Being the Net Loss on Revaluation transferred to Old Partners' Capital Accounts in Old Profit Sharing Ratio)

Tutorial Note: When Revaluation Account is prepared, the **Assets** and **Liabilities** appear in the Balance Sheet of new firm at their revised figures.

FORMAT OF REVALUATION ACCOUNT

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Decrease in Value of Assets	.....	By Increase in Value of Assets	.....
To Increase in Value of Liabilities	.....	By Decrease in Value of Liabilities	.....
To Unrecorded Liabilities	.....	By Unrecorded Assets	.....
To Profit* t/f to the Partners' Capital A/cs (in the Old Profit-Sharing Ratio)	.....	By Loss* t/f to the Partners' Capital A/cs (in the Old Profit-Sharing Ratio)	.....
			

*Either Profit or Loss will appear.

ILLUSTRATION 31

X, Y and Z who are presently sharing profits & losses in the ratio of 5:3:2, decide to admit W for 1/6th share with effect from 1st April, 2018. An extract of their Balance Sheet as at 31st March, 2018 is as follows:

Liabilities	₹	Assets	
Sundry Creditors	3,00,000	Land & Building	2,50,000
Outstanding Rent	10,000	Plant & Machinery	1,00,000
		Stock	80,000
		Debtors	3,00,000
		Less: Provision	10,000
			2,90,000

It is decided that:

1. Land & Building be valued at ₹ 2,85,000.
2. Plant & Machinery be depreciated by 15%.

3. Stock is found overvalued by ₹ 38,000.
4. Provision for doubtful debts is to be made equal to 5% of the debtors.
5. An item of ₹ 30,000 included in Sundry Creditors is not likely to be claimed.
6. Rent of ₹ 4,000 still Outstanding.
7. Out of the amount of insurance which was debited entirely to P&L A/c, ₹ 5,000 be carried forward as an unexpired insurance.
8. Out of total commission received ₹ 3,000 is to be treated as advance commission. This amount was earlier credited to Profit & Loss Account.
9. An unaccounted accrued income of ₹ 1,000 be provided for.
10. A debtor whose dues of ₹ 5,000 were written off as bad debts paid ₹ 4,000 in full settlement.

Required: Pass the necessary Journal Entries and prepare Revaluation Account.

SOLUTION

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Land & Building A/c Dr. To Revaluation A/c (Being the increase in value of Land & Building recorded)		35,000	35,000
2.	Revaluation A/c Dr. To Plant & Machinery A/c (Being the decrease in value of Plant & Machinery recorded)		15,000	15,000
3.	Revaluation A/c Dr. To Stock A/c (Being the decrease in value of Stock recorded)		38,000	38,000
4.	Revaluation A/c [₹15,000 – ₹10,000] Dr. To Provision for Doubtful Debts A/c (Being the short provision now created)		5,000	5,000
5.	Creditors Dr. To Revaluation A/c (Being the decrease in the amount of Creditors recorded)		30,000	30,000
6.	Revaluation A/c Dr. To Outstanding Rent A/c (Being the Outstanding Rent recorded)		4,000	4,000
7.	Prepaid Insurance Dr. To Revaluation A/c (Being the prepaid insurance recorded)		5,000	5,000
8.	Revaluation A/c Dr. To Commission received in advance A/c (Being the commission received in advance recorded)		3,000	3,000
9.	Accrued Income A/c Dr. To Revaluation A/c (Being the Accrued Income recorded)		1,000	1,000

10.	Bad Debts Recovered A/c To Revaluation A/c (Being the Bad Debts recovered, recorded)	Dr.		4,000	4,000
11.	Revaluation A/c To X's Capital A/c To Y's Capital A/c To Z's Capital A/c (Being the transfer of profit on revaluation to old partners' capital accounts in their old profit sharing ratio)	Dr.		10,000	5,000 3,000 2,000

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Stock	38,000	By Land & Building	35,000
To Provision for Doubtful Debts	5,000	By Sundry Creditors	30,000
To Plant & Machinery A/c	15,000	By Prepaid Insurance	5,000
To Outstanding Rent A/c	4,000	By Accured Income	1,000
To Commission received in adv. A/c	3,000	By Bad Debts Recovered	4,000
To Profit on Revaluation t/f to:			
X's Capital A/c	5,000		
Y's Capital A/c	3,000		
Z's Capital A/c	2,000		
	75,000		75,000

7.0 ADJUSTMENT FOR RESERVES AND ACCUMULATED PROFITS/LOSSES
WHY IS ADJUSTMENT FOR RESERVES AND ACCUMULATED PROFITS/LOSSES REQUIRED?

If, at the time of admission of a partner, any reserves or accumulated profits/losses exist in the books of the firm, these should be transferred to Old Partners' Capital Accounts in their old profit sharing ratio since the reserves, accumulated profits/losses upto the Date of admission of a new partner belong to the Old Partners only and not to the New Partner.

ACCOUNTING TREATMENT OF RESERVES, ACCUMULATED PROFITS/LOSSES

1. For transfer of Reserves and Accumulated Profits					
Reserve A/c					Dr.
P & L A/c					Dr.
Workmen Compensation					
Reserve A/c	[Excess of Reserve over Actual Liability]				Dr.
Investment Fluctuation	[Excess of Reserve over the difference				
Reserve A/c	between Book value and Market value]				Dr.
To Old Partners' Capital Accounts (individually)					(In Old Ratio)
(Being the Reserves & Profits transferred to old partners in their old ratio)					

2. For transfer of Accumulated Losses

Old Partners' Capital Accounts (individually)

Dr. (In Old Ratio)

To Profit & Loss A/c

To Deferred Revenue Expenditure A/c

(Being Accumulated Losses transferred to old partners in their old ratio)

TUTORIAL NOTES

1. Reserves, Accumulated Profits/Losses should always be distributed even if the question is silent.
2. Workmen Compensation Reserve (say ₹ 1,200) to the extent of liability (say ₹ 150) should be credited to Workmen Compensation Claim A/c and the balance of Workmen Compensation Reserve (₹ 1,050) should be credited to Old Partners' Capital Accounts.
3. Excess of Investment Fluctuation Reserve over difference between Book Value and Market Value is credited to Old Partners' Capital Accounts.
4. Machinery Replacement Fund is in the nature of accumulated depreciation and not in nature of accumulated profits and hence is not distributed among the partners.
5. Employees' Provident Fund represents statutory liability due to employees towards Provident Fund and is not an accumulated profit, hence it is not distributed among the partners.

ILLUSTRATION 32

X, Y and Z are sharing profits & losses in the ratio of 5:3:2. They decide to admit W for 1/6th share with effect from 1st April, 2018. The following items appear in the Balance Sheet as at 31st March, 2018:

General Reserve	₹ 30,000
Contingencies Reserve	₹ 5,000
Profit & Loss A/c (Cr.)	₹ 15,000
Advertisement Suspense A/c (Dr.)	₹ 20,000

Required: Pass the necessary Journal Entries.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018 April 1	General Reserve Dr.		30,000	
	Contingencies Reserve Dr.		5,000	
	Profit & Loss A/c (Cr.) Dr.		15,000	
	To X's Capital A/c			25,000
	To Y's Capital A/c			15,000
	To Z's Capital A/c			10,000
	(Being the transfer of Reserves & Profits to Old Partners in their Old Ratio)			
	X's Capital A/c Dr.		10,000	
	Y's Capital A/c Dr.		6,000	
	Z's Capital A/c Dr.		4,000	
	To Advertisement Suspense A/c			20,000
	(Being the transfer of balance of Advertisement Suspense A/c to Old Partners in their Old Ratio)			

ILLUSTRATION 33

An extract of the Balance Sheet of A & B sharing profits & losses in the ratio of 3 : 2 as at 31st March, 2018 was as under:

<i>Liabilities</i>	₹	<i>Assets</i>	₹
General Reserve	5,000	Investments (Market Value ₹ 19,000)	20,000
Contingencies Reserve	450	Machinery Replacement Fund Invst.	1,000
P & L A/c	3,000	Advertisement Expenditure (Deferred Revenue)	1,000
Investment Fluctuation Reserve	1,500		
Workmen's Compensation Reserve	1,200		
Machinery Replacement Fund	1,000		
Employees' Provident Fund	2,000		

New partner C was admitted for 1/5th share of profits to be acquired from both 'A' and B. A claim on account of workmen's compensation is estimated at ₹ 150 only.

Required: Give the necessary journal entries to adjust accumulated profits and losses.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Investment Fluctuation Reserve A/c Dr. To Investments A/c (Being the value of investments brought down to market value)		1,000	1,000
	Workmen Compensation Reserve A/c Dr. To Provision for Workmen Compensation Claim A/c (Being the workmen compensation claim provided for)		150	150
	General Reserve Dr. Contingencies Reserve Dr. P & L A/c Dr. Inves. Fluctuation Reserve A/c [1500 – (20,000 – 19,000)] Dr. Workmen's Compensation Reserve A/c [₹ 1,200 – ₹ 150] Dr. To A's Capital A/c To B's Capital A/c (Being the transfer of accumulated profits to Old Partners in their Old Profit Sharing Ratio)		5,000 450 3,000 500 1,050	6,000 4,000
	A's Capital A/c Dr. B's Capital A/c Dr. To Advertisement Expenditure A/c (Being the transfer of accumulated losses to old partners in their old profit sharing ratio)		600 400	1,000

Working Notes:

- Investment Fluctuation Reserve Account has been transferred directly to Partners' Capital Accounts. after providing for an anticipated loss of ₹ 1,000 (i.e. ₹ 20,000 – ₹ 19,000) according to Prudence (conservatism) concept.

2. The balance of Workmen's Compensation Reserve Account after making Provision for Claim has been transferred directly to Partners' Capital Accounts.
3. Machinery Replacement Fund is in the nature of accumulated depreciation and not in nature of accumulated profits and hence is not distributed among the partners.
4. Employees' Provident Fund represents statutory liability due to employees towards Provident Fund and is not an accumulated profits, hence it is not distributed among the partners.

ILLUSTRATION 34

Following is the Balance Sheet of Shashi and Aashu sharing profits as 3 : 2:

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Creditors	10,000	Goodwill	6,000
Employees' Provident Fund	8,000	Debtors	22,000
Contingency Reserve	28,500	Less: Provision for D.D.	1,000
Workmen's Compensation Fund	15,000	Land & Building	18,000
Investment Fluctuation Fund	1,500	Plants & Machinery	7,000
Capitals:		Investment (Market Value ₹ 4,000)	5,000
Shashi	15,000	Stock	11,000
Aashu	10,000	Bank	15,000
		Advertisement Expenditure	5,000
	88,000		88,000

On admission of Tanya for 1/6th share in the profits it was decided that:

- (a) Provision for doubtful debts to be increased by ₹ 1,500.
- (b) Value of land and building to be increased to ₹ 21,000.
- (c) Value of stock to be increased by ₹ 2,500.
- (d) The liability of workmen's compensation fund was determined to be ₹ 12,000.
- (e) Investments are to be brought down to market value.
- (f) Tanya brought in as her share of goodwill ₹ 10,000 in cash.
- (g) Tanya was to bring further cash of ₹ 15,000 for her capital.
- (h) A unrecorded Furniture having a value of ₹ 6,000 is to be brought into the books.

Required: Prepare Revaluation A/c, Capital A/cs and Balance Sheet of the new firm.

SOLUTION

Dr.

REVALUATION ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Provision for Doubtful Debts	1,500	By Land & Building	3,000
To Profit on Revaluation t/f to:		By Stock	2,500
Shashi's Capital A/c	6,000	By Furniture	6,000
Aashu's Capital A/c	4,000		
	11,500		11,500

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	Shashi ₹	Aashu ₹	Tanya ₹	Particulars	Shashi ₹	Aashu ₹	Tanya ₹
To Goodwill A/c	3,600	2,400	—	By Balance b/d	15,000	10,000	—
To Advertisement Exp.	3,000	2,000	—	By Contingency Res.	17,100	11,400	—
To Balance c/d	39,600	26,400	15,000	By Work Comp. Fund	1,800	1,200	—
				By Inves. Fluc. Fund	300	200	—
				By Revaluation A/c	6,000	4,000	—
				By Bank A/c	—	—	15,000
				By Premium for Goodwill	6,000	4,000	—
	46,200	30,800	15,000		46,200	30,800	15,000

BALANCE SHEET OF SHASHI, AASHU AND TANYA AS AT....

Liabilities	₹	Assets	₹
Creditors	10,000	Debtors	22,000
Employees' Provident Fund	8,000	Less: Provision	2,500
Liabilities for Workmen's Comp.	12,000	Land & Building	21,000
Capitals:		Plants & Machinery	7,000
Shashi	39,600	Investments	4,000
Aashu	26,400	Stock	13,500
Tanya	15,000	Bank	40,000
		Furniture	6,000
	1,11,000		1,11,000

ILLUSTRATION 35

Balance Sheet of A, B and C sharing profits in the ratio of 3 : 2 : 1 is given below:

Liabilities	₹	Assets	₹
A's Capital	4,00,000	Bank	40,000
B's Capital	4,00,000	Debtors	2,00,000
C's Capital	2,00,000	Less: Provision	3,000
Contingency Reserve	60,000	Stock	2,03,000
Trade Creditors	1,60,000	Furniture	30,000
Employees' Provident Fund	20,000	Machinery	5,30,000
Workmen Compensation Fund	60,000	Building	3,00,000
	13,00,000		13,00,000

It was decided to admit D into partnership on the following terms and conditions :

- New Profit Sharing ratio between A, B, C and D will be 3 : 3 : 2 : 2.
- Goodwill of the firm is valued at ₹ 3,00,000. D brings his share of goodwill in cash which is credited to the old partners.
- D brings ₹ 1,50,000 as his share of capital.
- Contingency Reserve is not required any more.
- Provision for Doubtful debt to be raised to 5% on debtors.
- Machinery is overvalued by ₹ 30,000 and Building is undervalued by ₹ 67,000.

Required: Prepare Revaluation A/c. Capital A/cs. of A, B, C and D, and the Balance Sheet of the firm after D's admission. Also show the calculations regarding goodwill.

SOLUTION

Dr. **REVALUATION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Provision for doubtful debts	7,000	By Building	67,000
To Machinery	30,000		
To Profit on Revaluation t/f to :			
A's Capital A/c	15,000		
B's Capital A/c	10,000		
C's Capital A/c	5,000		
	30,000		
	67,000		67,000

Dr. **A'S CAPITAL ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance c/d	5,35,000	By Balance b/d	4,00,000
		By Revaluation A/c	15,000
		By Contingency Reserve A/c	30,000
		By Workmen Compensation Fund	30,000
		By Premium for Goodwill A/c	51,429
		By C's Capital A/c	8,571
	5,35,000		5,35,000

Dr. **B'S CAPITAL ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance c/d	4,60,000	By Balance b/d	4,00,000
		By Revaluation A/c	10,000
		By Contingency Reserve A/c	20,000
		By Workmen Compensation Fund	20,000
		By Premium for Goodwill A/c	8,571
		By C's Capital A/c	1,429
	4,60,000		4,60,000

Dr. **C'S CAPITAL ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To A's Capital A/c	8,571	By Balance b/d	2,00,000
To B's Capital A/c	1,429	By Revaluation A/c	5,000
To Balance c/d	2,15,000	By Contingency Reserve A/c	10,000
		By Workmen Compensation Fund	10,000
	2,25,000		2,25,000

Dr.

D'S CAPITAL ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance c/d	1,50,000	By Bank A/c	1,50,000
	2,10,000		1,50,000

BALANCE SHEET AS AT...

Liabilities	₹	Assets	₹
Trade Creditors	1,60,000	Bank	2,50,000
Employees' Provident Fund	20,000	Debtors	2,00,000
A's Capital A/c	5,35,000	Less: Provision	10,000
B's Capital A/c	4,60,000	Stock	2,03,000
C's Capital A/c	2,15,000	Furniture	30,000
D's Capital A/c	1,50,000	Machinery	5,00,000
		Building	3,67,000
	15,40,000		15,40,000

Working Note: Calculations regarding Goodwill.

1. D's Share of Goodwill = ₹ 3,00,000 × 2/10 = ₹ 60,000
2. Change in profit sharing ratio will result in loss of 6/30th to A and 1/30 to B; gain of 1/30 to C and 2/10th to D. Hence the entry for adjustment of goodwill will be as under:

C's Capital A/c	Dr. 10,000 (i.e. 3,00,000 × 1/30)
Premium for Goodwill A/c	Dr. 60,000 (i.e. 3,00,000 × 2/10)
To A's Capital A/c	60,000 (i.e. 3,00,000 × 6/30)
To B's Capital A/c	10,000 (i.e. 3,00,000 × 1/30)

ILLUSTRATION 36

Murari and Vohra were partners in a firm with capital of ₹ 1,20,000 and ₹ 1,60,000 respectively. On 1st April, 2018 they admitted Yadav as a partner for one-fourth share in profits on his payment of ₹ 2,00,000 as his capital and ₹ 90,000 for his one-fourth share of goodwill.

On that Date the creditors of Murari and Vohra were ₹ 60,000 and Bank overdraft was ₹ 15,000. Their Assets apart from Cash included Stock ₹ 10,000; Debtors ₹ 40,000; Plant and Machinery ₹ 80,000; Land and Building ₹ 2,00,000. It was agreed that Stock should be depreciated by ₹ 2,000; Plant and Machinery by 20%, ₹ 5,000 should be written off as bad debts and Land and Building should be appreciated by 25%.

Required: Prepare the Revaluation Account, Capital Accounts of Partners and the Balance Sheet of the new firm.

SOLUTION

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Stock A/c	2,000	By Land and Building A/c	50,000
To Plant and Machinery A/c	16,000		
To Bad Debts Written off	5,000		
To Profit on Revaluation transferred to:			

Murari's Capital A/c	13,500		
Vohra's Capital A/c	13,500	27,000	
		50,000	50,000

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	Murari (₹)	Vohra (₹)	Yadav (₹)	Particulars	Murari (₹)	Vohra (₹)	Yadav (₹)
To Balance c/d	1,78,500	2,18,500	2,00,000	By Balance b/d	1,20,000	1,60,000	—
				By Cash/Bank A/c	—	—	2,00,000
				By Revaluation A/c (Profit)	13,500	13,500	—
				By Premium for Goodwill A/c	45,000	45,000	—
	1,78,500	2,18,500	2,00,000		1,78,500	2,18,500	2,00,000

BALANCE SHEET OF NEW FIRM
as at 1st April, 2018

Liabilities	₹	Assets	₹
Bank Overdraft	15,000	Cash in Hand	3,15,000
Creditors	60,000	Plant and Machinery	80,000
Murari's Capital	1,78,500	Less: Depreciation	16,000
Vohra's Capital	2,18,500	Land and Building	2,00,000
Yadav's Capital	2,00,000	Add: Appreciation	50,000
		Stock	10,000
		Less: Depreciation	2,000
		Debtors	40,000
		Less: Bad Debts	5,000
	6,72,000		6,72,000

Working Notes:
1. MEMORANDUM BALANCE SHEET (BEFORE YADAV'S ADMISSION)

Liabilities	₹	Assets	₹
Creditors	60,000	Land and Building	2,00,000
Bank Overdraft	15,000	Stock	10,000
Murari's Capital A/c	1,20,000	Debtors	40,000
Vohra's Capital A/c	1,60,000	Plant and Machinery	80,000
		Cash (Bal. Fig.)	25,000
	3,55,000		3,55,000

Dr.

2. CASH ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	25,000	By Balance c/d	3,15,000
To Premium for Goodwill	90,000		
To Yadav's Capital A/c	2,00,000		
	3,15,000		3,15,000

ILLUSTRATION 37

The Balance Sheet of X and Y sharing profits and losses in the ratio of 3 : 2, at 31st March, 2018 was as follows:

Liabilities	₹	Assets	₹
Creditors	18,000	Cash at Bank	10,000
Workmen's Compensation Fund	12,000	Debtors	65,000
Employees' Provident Fund	10,000	Less: Provision	5,000
General Reserve	20,000	Stock	30,000
X's Capital	84,000	Investments	50,000
Y's Capital	56,000	Patents	10,000
		Goodwill	40,000
	2,00,000		2,00,000

They decided to admit Z on that Date for 1/4th share on the following terms:

- New Profit Sharing Ratio will be 6 : 9 : 5. Z brings in ₹ 41,500 as his capital.
- Goodwill of the firm is to be valued at 4 years' purchase of the Average Super Profits of the last three years. Average profits of the last three years are ₹ 35,000, while the normal profits that can be earned with the capital employed are ₹ 15,000. No goodwill is to appear in the books.
- Patents to be written down to ₹ 1,500 and Stock is undervalued by ₹ 1,000. All Debtors are good. There is a liability of ₹ 500 included in Sundry Creditors that is not likely to arise.
- Unaccounted Accrued Income of ₹ 1,000 to be provided for. A debtor whose dues of ₹ 5,000 were written off as bad debts paid 80% in full settlement. A claim of ₹ 3,000 on account of workmen's compensation to be provided for.
- The market value of investments was ₹ 45,000. Half of the investments were to be taken over by old partners in their profit sharing ratio.

Prepare the Revaluation Account, Capital Accounts of the Partners and the Balance Sheet of the new Firm.

SOLUTION

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Patents	8,500	By Sundry Creditors	500
To Investments	5,000	By Accrued Income	1,000
		By Bad Debts Recovered	4,000
		By Stock	1,000
		By Provision for Doubtful Debts	5,000
		By Loss on Revaluation t/f to:	
		X's Capital A/c	1,200
		Y's Capital A/c	800
	13,500		2,000
			13,500

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Goodwill A/c	24,000	16,000	—	By Balance b/d	84,000	56,000	—
To Revaluation A/c	1,200	800	—	By General Reserve	12,000	8,000	—
To Investments A/c	13,500	9,000	—	By Workmen's Com.	5,400	3,600	—
To X's Capital A/c	—	4,000	20,000	By Z's Capital A/c	20,000	—	—
To Balance c/d	86,700	37,800	21,500	By Y's Capital A/c	4,000	—	—
				By Bank A/c	—	—	41,500
	1,25,400	67,600	41,500		1,25,400	67,600	41,500

BALANCE SHEET OF NEW FIRM AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Creditors	17,500	Cash at Bank	55,500
Employees' Provident Fund	10,000	Debtors	65,000
Workmen's Compensation Claim	3,000	Stock	31,000
X's Capital A/c	86,700	Investments	22,500
Y's Capital A/c	37,800	Patents	1,500
Z's Capital A/c	21,500	Accrued Income	1,000
	1,76,500		1,76,500

Working Notes:

1. X's sacrifice = $\frac{3}{5} - \frac{6}{20} = \frac{6}{20}$, Y's gain = $\frac{2}{5} - \frac{9}{20} = \frac{1}{20}$
2. Firm's Goodwill = Super Profits $\times 4 = (\text{₹ } 35,000 - \text{₹ } 15,000) \times 4 = \text{₹ } 80,000$
3. Z's Share of Goodwill = $\text{₹ } 80,000 \times \frac{1}{4} = \text{₹ } 20,000$
4. Y's Share of Goodwill = $\text{₹ } 80,000 \times \frac{1}{20} = \text{₹ } 4,000$

Dr.

5. CASH AT BANK ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Balance c/d	55,500
To Z's Capital A/c	41,500		
To Bad Debts Recovered	4,000		
	55,500		55,500

ILLUSTRATION 38

The Balance Sheet of X and Y who shares profits and losses in the ratio of 3 : 2, at 31st March, 2018 was as follows:

Liabilities	₹	Assets	₹
Creditors	36,000	Cash at Bank	20,000
Workmen's Compensation Fund	24,000	Debtors	1,30,000
Employees' Provident Fund	20,000	Less: Provision	10,000
General Reserve	40,000	Stock	60,000
X's Capital	1,68,000	Investments	1,00,000
Y's Capital	1,12,000	Patents	20,000
		Goodwill	80,000
	4,00,000		4,00,000

They decided to admit Z on that Date for 1/4th share on the following terms:

- New Profit Sharing Ratio will be 6 : 9 : 5. Z brings in ₹ 83,000 as his capital.
- Goodwill of the firm is to be valued at 4 years' purchase of the average super profits of the last three years. Average profits of the last three years are ₹ 90,000, while the normal profits that can be earned with the capital employed are ₹ 50,000. No goodwill is to appear in the books. Z brings in ₹ 24,000 cash out of his share of goodwill.
- Patents are overvalued by ₹ 17,000 and Stock to be written up to ₹ 62,000. 20% of General Reserve to be transferred to Provision for Doubtful Debts. ₹ 3,000 included in Sundry Creditors be written back as no longer payable.
- Out of the amount of insurance which was debited entirely to P&L A/c, ₹ 10,000 be carried forward as an Unexpired Insurance. A debtor whose dues of ₹ 10,000 were written off as bad debts paid ₹ 8,000 in full settlement. A claim of ₹ 6,000 on account of workmen's compensation to be provided for.
- Half of investments are to be taken over by old partners in their profit sharing ratio and remaining valued at ₹ 40,000.

Prepare the Revaluation Account, Capital Accounts of the Partners and the Balance Sheet of the new Firm.

SOLUTION

Dr. **REVALUATION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Patents	17,000	By Sundry Creditors	3,000
To Investments	10,000	By Prepaid Insurance	10,000
		By Bad Debts Recovered	8,000
		By Stock	2,000
		By Loss on Revaluation t/f to:	
		X's Capital A/c	2,400
		Y's Capital A/c	1,600
			4,000
	27,000		27,000

Dr. **PARTNERS' CAPITAL ACCOUNTS** Cr.

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Goodwill A/c	48,000	32,000	—	By Balance b/d	1,68,000	1,12,000	—
To Revaluation A/c	2,400	1,600	—	By General Reserve	19,200	12,800	—
To Investments A/c	30,000	20,000	—	By Workmen's Com.	10,800	7,200	—
To X's Capital A/c	—	8,000	16,000	By Premium for Goodwill	24,000	—	—
To Balance c/d	1,65,600	70,400	67,000	By Z's Capital A/c	16,000	—	—
				By Y's Capital A/c	8,000	—	—
				By Bank A/c	—	—	83,000
	2,46,000	1,32,000	83,000		2,46,000	1,32,000	83,000

BALANCE SHEET OF NEW FIRM AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Creditors	33,000	Cash at Bank	1,35,000
Employees' Provident Fund	20,000	Debtors	1,30,000
Workmen's Compensation Claim	6,000	Less: Provision	18,000
X's Capital A/c	1,65,600	Stock	62,000
Y's Capital A/c	70,400	Investments	40,000
Z's Capital A/c	67,000	Patents	3,000
		Prepaid Insurance	10,000
	3,62,000		3,62,000

Working Notes:

1. X's sacrifice = $3/5 - 6/20 = 6/20$, Y's gain = $2/5 - 9/20 = (1/20)$
2. Firm's Goodwill = Super Profits $\times 4 = (\text{₹ } 90,000 - \text{₹ } 50,000) \times 4 = \text{₹ } 1,60,000$
3. Z's Share of Goodwill = $\text{₹ } 1,60,000 \times 1/4 = \text{₹ } 40,000$
4. Y's Share of Goodwill = $\text{₹ } 1,60,000 \times 1/20 = \text{₹ } 8,000$

Dr.

5. CASH AT BANK ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	20,000	By Balance c/d	1,35,000
To Z's Capital A/c	83,000		
To Bad Debts Recovered	8,000		
To Premium for Goodwill	24,000		
	1,35,000		1,35,000

8.0 ADJUSTMENT OF CAPITAL

The capitals of the partners may be adjusted in any one of the following ways:

1. **Adjusting the Capitals of Old Partners on the Basis of the Capital of Incoming Partner when the Total Capital of New Firm is not given**

PRACTICAL STEPS INVOLVED IN ADJUSTING THE CAPITALS OF OLD PARTNERS

Step 1: Calculate New Profit Sharing Ratio

Step 2: Calculate Total Capital of New Firm as follows:

Total Capital = New Partner's Capital $\times$ Reciprocal of proportion of share of new partner.

Step 3: Calculate the New Capitals of Old Partners as follows:

New Capital of Old Partner = Total Capital of New Firm $\times$ New Share of Old Partner

Step 4: Calculate the Adjusted Old Capitals of Old Partners as follows:

	A	B
Old Capital before Adjustments	xxx	xxx
Share of Goodwill	xxx	xxx
Share of Profit (Loss) on Revaluation	xxx	xxx
Share of Reserve and Accumulated Profits (Loss)	xxx	xxx
	xxx	xxx

Step 5: Calculate the Shortage (Surplus) in each of the Old Partner's Capital A/c as follows:

Shortage (Surplus) = New Capital – Adjusted Old Capital

Step 6: Pass a Journal Entry to Adjust Shortage in case the Adjusted Old Capital is less than the New Capital.

Cash A/c or Concerned Partner's Current A/c Dr.

To Concerned Partner's Capital A/c

or

Pass a Journal Entry to Adjust Surplus in case the Adjusted Old Capital is more than the New Capital

Concerned Partner's Capital A/c Dr.

To Cash A/c or Concerned Partner's Current A/c

TUTORIAL NOTES

1. In the absence of any contract, Surplus or Deficiency should be adjusted in Cash and not by transfer to Current Account.
2. If the Capitals of Old Partners are to be adjusted on the basis of Capital of Incoming Partner and Incoming Partner is not bringing his full/part of his share of Goodwill in Cash, then Unpaid Share of Goodwill should be adjusted through his Current Account and not Capital Account. In this case Debit Balance of Current Account will appear on the Assets side of the Balance Sheet.

ILLUSTRATION 39

A and B are in partnership sharing profits and losses in the ratio of 3 : 2. The capitals of A and B before adjustments are ₹ 69,000 and ₹ 51,000 respectively. Firm's Goodwill ₹ 50,000, Loss on Revaluation of Assets and Liabilities ₹ 5,000, General Reserve ₹ 15,000. They admit C as a partner who contributes ₹ 35,000 as capital for 1/5th share of profits to be acquired equally from both A and B. The capital accounts of old partners are to be adjusted on the basis of the proportion of C's capital to his share in the business. Calculate the amount of actual cash to be paid off or brought in by the old partners for the purpose and pass the necessary journal entries.

SOLUTION

Step 1: Calculation of New Profit Sharing Ratio

A's New Share = $3/5 - 1/10 = 5/10$, B's New Share = $2/5 - 1/10 = 3/10$

Hence, New Profit Sharing Ratio of A : B : C = $5/10 : 3/10 : 1/5 = 5 : 3 : 2$

Step 2: Calculation of Total Capital of the reconstituted firm

Total Capital = ₹ 35,000 × 5/1 = ₹ 1,75,000

STEP 3: CALCULATION OF NEW CAPITALS OF ALL PARTNERS

Particulars	A	B	C
New Capitals (₹ 1,75,000 in ratio of 5 : 3 : 2)	₹ 87,500	₹ 52,500	₹ 35,000

STEP 4: ADJUSTED OLD CAPITALS OF OLD PARTNERS

Particulars	A	B
Old Capitals before Adjustments	69,000	51,000
Add: Share of Goodwill	5,000	5,000

Less: Share of Loss on Revaluation	(3,000)	(2,000)
Add: Share of General Reserve	9,000	6,000
	₹ 80,000	₹ 60,000

STEP 5: CALCULATION OF SHORTAGE/ SURPLUS

Particulars	A	B
(a) New Capitals (as per Step 3)	₹ 87,500	₹ 52,500
(b) Adjusted Old Capitals (as per Step 4)	₹ 80,000	₹ 60,000
(c) Surplus to be paid (Shortage to be brought in)	(₹ 7,500)	₹ 7,500

Step 6: Journal Entry
JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Cash A/c Dr. To A's Capital A/c (Being the shortage brought in by A)		7,500	7,500
	B's Capital A/c Dr. To Cash A/c (Being the excess amount withdrawn by B)		7,500	7,500

ILLUSTRATION 40

A and B are in partnership sharing profits and losses in the proportion of two-third and one-third respectively. Their Balance Sheet on 31st March, 2018 was as follows:

Cash ₹ 1,000; Sundry Debtors ₹ 15,000; Stock ₹ 22,000; Plant and Machinery ₹ 4,000; Sundry Creditors ₹ 1,000; Employees' Provident Fund ₹ 1,000; Bank Overdraft ₹ 15,000; A's Capital ₹ 15,000; B's Capital ₹ 10,000.

On 1st April, 2018, they admitted C into partnership on the following terms:

- C to purchase one quarter of the Goodwill for ₹ 3,000 and provide ₹ 10,000 as Capital. C brings necessary cash for goodwill and capital.
- Profits and Losses are to be shared in the proportion of one-half to A, one-quarter to B, and one quarter to C.
- Plant and Machinery is to be reduced by 10%, and ₹ 500 is to be provided for estimated bad debts. Stock is to be taken at a valuation of ₹ 24,940.
- By bringing in or withdrawing cash the capitals of A and B are to be made proportionate to that of C on their profit-sharing basis.

Required: Prepare the necessary ledger accounts and prepare the opening Balance Sheet of the new firm.

SOLUTION

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Plant and Machinery	400	By Stock	2,940
To Provision for doubtful debts	500		
To Profit on Revaluation t/f to:			
A's Capital A/c	1,360		
B's Capital A/c	680		
	2,040		
	2,940		2,940

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To Cash A/c (b.f.)	—	1,680	—	By Balance b/d	15,000	10,000	—
To Balance c/d	20,000	10,000	10,000	By Revaluation A/c	1,360	680	—
				By Premium for Goodwill A/c	2,000	1,000	—
				By Cash A/c b.f.)	1,640	—	10,000
	20,000	11,680	10,000		20,000	11,680	10,000

Dr.

CASH ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	1,000	By B's Capital A/c	1,680
To A's Capital A/c	1,640	By Balance c/d	13,960
To C's Capital A/c	10,000		
To Premium for Goodwill A/c	3,000		
	15,640		15,640

BALANCE SHEET OF THE NEW FIRM AS AT 1ST APRIL., 2018

Liabilities	₹	Assets	₹
Sundry Creditors	1,000	Cash	13,960
Employees' Provident Fund	1,000	Debtors	15,000
Bank Overdraft	15,000	Less: Provision	500
Capitals:		Stock	24,940
A	20,000	Plant and Machinery	3,600
B	10,000		
C	10,000		
	57,000		57,000

Note: Total Capital of Firm = ₹ 10,000 × 4/1 = ₹ 40,000

New Capital of A = ₹ 40,000 × 2/4 = ₹ 20,000, New Capital of B = ₹ 40,000 × 1/4 = ₹ 10,000

ILLUSTRATION 41

The Balance Sheet of X and Y who shares profits and losses in the ratio of 3 : 2, at 31st March, 2018 was as follows:

Liabilities	₹	Assets	₹
Creditors	18,000	Cash at Bank	10,000
Workmen's Compensation Fund	12,000	Debtors	65,000
Employees' Provident Fund	10,000	Less: Provision	5,000
General Reserve	20,000	Stock	30,000
X's Capital	84,000	Investments	50,000
Y's Capital	56,000	Patents	10,000
		Goodwill	40,000
	2,00,000		2,00,000

They decided to admit Z on that Date for 1/4th share on the following terms:

- New Profit Sharing Ratio will be 6 : 9 : 5. Z brings in ₹ 41,500 as his capital.
- Goodwill of the firm is to be valued at 4 years' purchase of the Average Super Profits of the last three years. Average profits of the last three years are ₹ 35,000, while the normal profits that can be earned with the capital employed are ₹ 15,000. No goodwill is to appear in the books. Z brings in ₹ 12,000 cash out of his share of goodwill.
- Patents are overvalued by ₹ 8,500 and Stock is written up to ₹ 31,000. All Debtors are good. There is a liability of ₹ 500 included in Sundry Creditors that is not likely to arise.
- Unaccounted Accrued Income of ₹ 1,000 to be provided for. A debtor whose dues of ₹ 5,000 were written off as bad debts paid 80% in full settlement. A claim of ₹ 3,000 on account of workmen's compensation to be provided for.
- The market value of investments was ₹ 45,000. Half of the investments were to be taken over by old partners in their profit sharing ratio.
- Capitals of the partners shall be proportionate to their profit-sharing ratio taking Z's Capital as base. Adjustments of capitals to be made by cash.

Prepare the Revaluation Account, Capital Accounts of the Partners and the Balance Sheet of the new Firm.

SOLUTION

Dr. **REVALUATION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Patents	8,500	By Sundry Creditors	500
To Investments	5,000	By Accrued Income	1,000
		By Bad Debts Recovered	4,000
		By Stock	1,000
		By Provision for Doubtful Debts	5,000
		By Loss on Revaluation t/f to:	
		X's Capital A/c	1,200
		Y's Capital A/c	800
	13,500		2,000
			13,500

Dr. **PARTNERS' CAPITAL ACCOUNTS** Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Goodwill A/c	24,000	16,000	—	By Balance b/d	84,000	56,000	—
To Revaluation A/c	1,200	800	—	By General Reserve	12,000	8,000	—
To Investments A/c	13,500	9,000	—	By Workmen's Com.	5,400	3,600	—
To X's Capital A/c	—	4,000	20,000	By Premium for Goodwill	12,000	—	—
To Balance c/d	86,700	37,800	21,500	By Z's Current A/c	8,000	—	—
				By Y's Capital A/c	4,000	—	—
				By Bank A/c	—	—	41,500
	1,25,400	67,600	41,500		1,25,400	67,600	41,500
To Bank A/c(b.f.)	36,900	—	—	By Balance b/d	86,700	37,800	41,500
To Balance c/d	49,800	74,700	41,500	By Bank A/c(b.f.)	—	36,900	—
	86,700	74,700	41,500		86,700	74,700	41,500

BALANCE SHEET OF NEW FIRM AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Creditors	17,500	Cash at Bank	67,500
Employees' Provident Fund	10,000	Debtors	65,000
Workmen's Compensation Claim	3,000	Stock	31,000
X's Capital A/c	49,800	Investments	22,500
Y's Capital A/c	74,700	Patents	1,500
Z's Capital A/c	41,500	Accrued Income	1,000
		Z's Current A/c	8,000
	1,96,500		1,96,500

Working Notes:

1. X's sacrifice = $3/5 - 6/20 = 6/20$, Y's gain = $2/5 - 9/20 = (1/20)$
2. Firm's Goodwill = Super Profits $\times 4 = (\text{₹ } 35,000 - \text{₹ } 15,000) \times 4 = \text{₹ } 80,000$
3. Z's Share of Goodwill = $\text{₹ } 80,000 \times 1/4 = \text{₹ } 20,000$
4. Y's Share of Goodwill = $\text{₹ } 80,000 \times 1/20 = \text{₹ } 4,000$
5. Total Capital of the firm = $\text{₹ } 41,500 \times 4/1 = \text{₹ } 1,66,000$
 X's New Capital = $\text{₹ } 1,66,000 \times 6/20 = \text{₹ } 49,800$
 Y's New Capital = $\text{₹ } 1,66,000 \times 9/20 = \text{₹ } 74,700$

Dr.

6. CASH AT BANK ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	10,000	By Y's Capital A/c	36,900
To Z's Capital A/c	41,500	By Balance c/d	67,500
To Bad Debts Recovered	4,000		
To Premium for Goodwill	12,000		
	1,04,400		1,04,400

ILLUSTRATION 42

Rao and Reddy were partners in a firm sharing profits in the ratio of 3 : 1. They admitted Kutty as a new partner for $3/8$ th share in the profits. The new profit-sharing ratio will be 3 : 2 : 3. Kutty brought ₹ 2,00,000 for his capital and ₹ 50,000 for his share of premium for goodwill. On 31st March, 2018, the Date of Kutty's admission, the Balance Sheet of Rao and Reddy was:

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Creditors	60,000	Cash	90,000
Bills Payable	20,000	Debtors	80,000
Capital A/cs:		Stock	1,50,000
Rao	4,00,000	Furniture	50,000
Reddy	1,00,000	Machinery	2,10,000
	5,80,000		5,80,000

It was agreed that

- (i) Stock to be valued at ₹ 2,00,000.
- (ii) Machinery will be depreciated by 12% and Furniture by ₹ 2,000.
- (iii) A Provision of 5% for Doubtful Debts will be made on Debtors.
- (iv) The Capital Accounts of all the partners were adjusted in the new profit-sharing ratio after admission. For surplus or deficiency, the Current Accounts were to be opened.

Required: Prepare the Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the new firm.

SOLUTION

Dr. **REVALUATION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Machinery A/c	25,200	By Stock A/c	50,000
To Furniture A/c	2,000		
To Provision for Doubtful Debts A/c	4,000		
To Profit on revaluation t/f to:			
Rao's Capital A/c (3/4)	14,100		
Reddy's Capital A/c (1/4)	4,700		
	18,800		
	50,000		50,000

Dr. **PARTNERS' CAPITAL ACCOUNTS** Cr.

Particulars	Rao (₹)	Reddy (₹)	Kutty (₹)	Particulars	Rao (₹)	Reddy (₹)	Kutty (₹)
To Rao's Current A/c (b.f.)	2,64,100	—	—	By Balance b/d	4,00,000	1,00,000	—
To Balance c/d	2,00,000	1,33,334	2,00,000	By Revaluation A/c	14,100	4,700	—
				By Bank A/c	—	—	2,00,000
				By Premium for Goodwill A/c	50,000	—	—
				By Reddy's Current A/c (b.f.)	—	28,634	—
	4,64,100	1,33,334	2,00,000		4,64,100	1,33,334	2,00,000

BALANCE SHEET OF THE NEW FIRM as at 1st April, 2018

Liabilities	₹	Assets	₹
Creditors	60,000	Cash	3,40,000
Bills Payable	20,000	(₹ 90,000 + ₹ 2,00,000 + ₹ 50,000)	
Rao's Current A/c	2,64,100	Debtors	80,000
Capital A/cs:		Less: Provision	4,000
Rao	2,00,000	Stock	2,00,000
Reddy	1,33,334	Furniture (₹ 50,000 – ₹ 2,000)	48,000
Kutty	2,00,000	Machinery (₹ 2,10,000 – ₹ 25,200)	1,84,800
		Reddy's Current A/c	28,634
	8,77,434		8,77,434

Working Notes:**1. Calculation of Sacrificing Ratio**

Sacrifice = Old Share – New Share

$$\text{Rao's sacrifice} = \frac{3}{4} - \frac{3}{8} = \frac{3}{8}, \text{ Reddy's sacrifice} = \frac{1}{4} - \frac{2}{8} = \text{Nil}$$

Only Rao sacrifices his share of profit.

2. Calculation of Partners' New Capitals

$$(a) \text{ Total Capital of the Firm} = \frac{\text{Capital of the New Partner (Kutty)}}{\text{Share of Profit of Kutty}}$$

$$= ₹ 2,00,000 \times 8/3 = ₹ 16,00,000/3$$

(b) New Capitals of Partners

$$\text{Rao} = \frac{₹16,00,000}{3} \times \frac{3}{8} = ₹ 2,00,000; \text{ Reddy} = \frac{₹16,00,000}{3} \times \frac{2}{8} = ₹ 1,33,334$$

ILLUSTRATION 43

The following is the Balance Sheet of A and B who had been sharing profits in proportion of three-fourths and one-fourths, on 31st March, 2018.

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Creditors	30,000	Goodwill	4,000
Employees' Provident Fund	7,500	Cash at Bank	22,500
Workmen Compensation Reserve	4,000	Bills Receivable	4,000
Investment Fluctuation Reserve	2,000	Debtors	16,000
A's Capital	33,000	Stock	20,000
B's Capital	17,000	Office Furniture	1,000
Provision for Doubtful Debts	1,000	Land & Building	25,000
		Advertisement Expenditure	2,000
	94,500		94,500

They agreed to take C into partnership on 1st April, 2018 on the following terms:

- That C pays ₹ 10,000 as his capital for one-fifth share in the future profits.
- That a Goodwill of the firm is valued at ₹ 20,000 but no goodwill is to appear in the books.
- That Stock and Furniture be reduced by 15% and 10% respectively and 5% provision for doubtful debts be created on debtors.
- That the Value of Land and Building be appreciated by 20%.
- That the Capital Accounts of the partners be re-adjusted on the basis of their profit sharing arrangement and any excess or deficiency be transferred to their Current Accounts. Prepare Revaluation Account, Partner's Capital Accounts and the Balance Sheet of the new firm.

SOLUTION

Dr.

REVALUATION ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Stock A/c	3,000	By Land & Building A/c	5,000
To Office Furniture A/c	100	By Provision for Doubtful Debts	
To Profit transferred to:		Existing	1,000
A's Capital A/c	1,575	Less: Required	
B's Capital A/c	525	[₹ 16,000 × 5/100]	800
	5,200		200
			5,200

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To Goodwill A/c	3,000	1,000	—	By Balance b/d	33,000	17,000	—
To Current A/c (b.f.)	7,575	8,525	—	By Bank A/c	—	—	10,000
To Advertise Exp.	1,500	500	—	By C's Current A/c	3,000	1,000	—
To Balance c/d	30,000	10,000	10,000	By Revaluation A/c	1,575	525	—
				By Worr. Com. Res.	3,000	1,000	—
				By Invest. Fluc. Res.	1,500	500	—
	42,075	20,025	10,000		42,075	20,025	10,000

BALANCE SHEET AS AT 1ST APRIL, 2018

Liabilities	₹	Assets	₹
Creditors	30,000	Cash at Bank	32,500
Employees' Provident Fund	7,500	Bills Receivable	4,000
Capital Accounts:		Debtors	16,000
A	30,000	Less: Provision	800
B	10,000	Stock	17,000
C	10,000	Office Furniture	900
Current Accounts:		Land & Building	30,000
A	7,575	C's Current A/c	4,000
B	8,525		
	1,03,600		1,03,600

Working Notes: Calculation of Total Capital and New Capitals of Partners

Total Capital = ₹ 10,000 × 5/1 = ₹ 50,000

A's Capital = ₹ 50,000 × 3/5 = ₹ 30,000, B's Capital = ₹ 50,000 × 1/5 = ₹ 10,000

2. Determining the New Partner's Capital on the Basis of Combined Capital of Old Partners**PRACTICAL STEPS INVOLVED IN THE DETERMINATION OF CAPITAL OF NEW PARTNER**

Step 1: Calculate the New Profit Sharing Ratio		
Step 2: Calculate the Adjusted Old capitals of Old Partners:		
	A	B
Old Capital before Adjustments	xxx	xxx
Share of Goodwill	xxx	xxx
Profit (Loss) on Revaluation	xxx	xxx
Share of Reserve and Accumulated Profits (Loss)	xxx	xxx
	xxx	xxx
Step 3: Calculate the Total Capital of New Firm as follows:		
Total Capital = Total Adjusted Old Capitals of Old Partners × Reciprocal of proportion of Share of Old Partners		
Step 4: Calculate the Proportionate Capital of New Partner as follows:		
New Partner's Capital = Total Capital × Proportion of Share of New Partner		

Tutorial Note: If Incoming Partner is bringing Proportionate Capital but is not bringing his full/part of his share of Goodwill in Cash, then Unpaid Share of Goodwill should be adjusted through his Current Account and not Capital Account. In this case Debit Balance of Current Account will appear on the Assets side of the Balance Sheet.

ILLUSTRATION 44

A and B are in partnership sharing profits and losses in the ratio of 3 : 2. The capitals of A and B before adjustments are ₹ 69,000 and ₹ 51,000 respectively. Firm's Goodwill ₹ 50,000, Loss on Revaluation of Assets and Liabilities ₹ 5,000, General Reserve ₹ 15,000. They admit C as a partner who has to contribute sufficient capital to acquire 1/5th share of profits to be acquired equally from both A and B. Calculate the amount of capital to be brought in by C.

SOLUTION

Step 1: Calculation of New Profit Sharing ratio

New Profit Sharing Ratio = 5 : 3 : 2 (as calculated in Illustration 47)

STEP 2 CALCULATION OF TOTAL ADJUSTED OLD CAPITALS OF OLD PARTNERS

Particulars	A	B
Old Capitals before Adjustments	69,000	51,000
Add: Share of Goodwill	5,000	5,000
Less: Share of Loss on Revaluation	(3,000)	(2,000)
Add: Share of General Reserve	9,000	6,000
	₹ 80,000	₹ 60,000

Total Adjusted Capital of Old Partners = ₹ 80,000 + ₹ 60,000 = ₹ 1,40,000

Step 3: Calculation of Total Capital of New Firm

Total Share of Old Partners = 1 – Share of Incoming Partner = 1 – 1/5 = 4/5

Reciprocal of Proportion of Total Share of old partners = 5/4

Total Capital = ₹ 1,40,000 × 5/4 = ₹ 1,75,000

Alternative Method – Let us assume, the total capital of new firm be X

$X = ₹ 80,000 + ₹ 60,000 + 1/5X$ or, $X - 1/5X = ₹ 1,40,000$

$X = ₹ 1,40,000 \times 5/4 = ₹ 1,75,000$

Step 4: Calculation of Proportionate Capital of Incoming Partner

New Partner's Capital = Total Capital × Proportion of Share of New Partner
 $= ₹ 1,75,000 \times 1/5 = ₹ 35,000$

ILLUSTRATION 45

Assuming that in Previous Illustration, it is decided that the Capitals of old partners should also be in their new profit sharing ratio. Calculate the amount of actual cash to be paid off or brought in by the old partners for this adjustment.

SOLUTION

Step 1, 2, 3: Same as given in Previous Illustration.

Step 4: Calculation of New Capitals of Partners

A's New Capital = ₹ 1,75,000 × 5/10 = ₹ 87,500

B's New Capital = ₹ 1,75,000 × 3/10 = ₹ 52,500

STEP 5: CALCULATION OF ACTUAL CASH TO BE PAID OFF or BROUGHT IN BY OLD PARTNERS

(a) New Capitals	₹ 87,500	₹ 52,500
(b) Adjusted Old Capitals	₹ 80,000	₹ 60,000
(c) Cash to be paid (to be brought in) (a-b)	(₹ 7,500)	₹ 7,500

ILLUSTRATION 46

A and B are in partnership sharing profits and losses in the ratio of 3 : 2. The capitals of A and B after adjustments are ₹ 90,000 and ₹ 70,000 respectively. Calculate Incoming Partner's proportionate capital and surplus/shortage of existing capitals of old partners (if any) in each of the following alternative cases:

Case (a) If C is to contribute proportionate capital for his 1/5th share.

Case (b) If C is to contribute 1/5th of the total capital of the new firm.

Case (c) If C is to contribute 1/4th of the combined capitals of the existing partners.

Case (d) If C is to contribute proportionate capital for his 1/5th share and the capitals of all the partners are to be adjusted in new profit sharing ratio of 3 : 1 : 1.

SOLUTION

Case (a) Let the Total Capital be X

Thus, $X = \text{Adjusted Old Capitals of old partners} + \text{Incoming Partners' Capital}$

$$X = ₹ 90,000 + ₹ 70,000 + 1/5X, X - 1/5X = ₹ 1,60,000 = ₹ 1,60,000 \times 5/4 = ₹ 2,00,000$$

Thus, Incoming Partner's proportionate capital = $1/5$ of ₹ 2,00,000 = ₹ 40,000

Case (b) Same solution as in Case (a)

Case (c) Incoming Partner's Capital = $1/4 \times (₹ 90,000 + ₹ 70,000) = ₹ 40,000$

Case (d) Let the Total Capital be X

Thus, $X = \text{Adjusted Old Capitals of old partners} + \text{Incoming Partners' Capital}$

$$X = ₹ 90,000 + ₹ 70,000 + 1/5X$$

$$X - 1/5X = ₹ 1,60,000 = ₹ 1,60,000 \times 5/4 = ₹ 2,00,000$$

Thus, Incoming Partner's Proportionate Capital = $1/5$ of ₹ 2,00,000 = ₹ 40,000.

Particulars	A	B
Their New Capitals	$3/5 \times ₹ 2,00,000 = ₹ 1,20,000$	$1/5 \times ₹ 2,00,000 = ₹ 40,000$
Their Adjusted Old Capitals	₹ 90,000	₹ 70,000
Shortage (Surplus)	₹ 30,000	(₹ 30,000)

ILLUSTRATION 47

The Balance Sheet of Madan and Mohan who share profits and losses in the ratio of 3 : 2, as at 31st March, 2018 was as follows:

Liabilities	₹	Assets	₹
Creditors	28,000	Cash at Bank	10,000
Workmen's Compensation Fund	12,000	Debtors	65,000
General Reserve	20,000	Less: Provision	5,000
Madan's Capital	60,000	Stock	30,000
Mohan's Capital	40,000	Investments	50,000
		Patents	10,000
	1,60,000		1,60,000

They decided to admit Gopal on 1st April, 2018 for 1/4th share on the following terms:

- Gopal shall bring ₹ 25,000 as his share of premium for goodwill.
- That unaccounted accrued income of ₹ 500 be provided for.
- The market value of investments was ₹ 45,000.
- A debtor whose dues of ₹ 1,000 were written off as bad debts paid ₹ 800 in full settlement.
- A claim of ₹ 2,000 on account of workmen's compensation to be provided for.
- Patents are undervalued by ₹ 5,000.
- Gopal to bring in capital equal to 1/4th of the total capital of the new firm after all adjustments.

Required: Prepare the Revaluation Account, Capital Accounts of the Partners and the Balance Sheet of the new firm.

SOLUTION

Dr. **REVALUATION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Investments	5,000	By Accrued Income	500
To Profit transferred to:		By Bad Debts Recovered	800
Madan's Capital A/c	780	By Patents	5,000
Mohan's Capital A/c	520		
	1,300		
	6,300		6,300

Dr. **PARTNERS' CAPITAL ACCOUNTS** Cr.

Particulars	Madan (₹)	Mohan (₹)	Gopal (₹)	Particulars	Madan (₹)	Mohan (₹)	Gopal (₹)
To Balance c/d	93,780	62,520	52,100	By Balance b/d	60,000	40,000	—
				By General Reserve	12,000	8,000	—
				By Revaluation A/c	780	520	—
				By Workmen's Compensation Fund	6,000	4,000	—
				By Premium for Goodwill	15,000	10,000	—
				By Bank A/c	—	—	52,100
	93,780	62,520	52,100		93,780	62,520	52,100

BALANCE SHEET OF THE NEW FIRM

as at 1st April, 2018

Liabilities	₹	Assets	₹
Creditors	28,000	Cash at Bank	87,900
Workmen's Compensation Claim	2,000	Debtors	65,000
Capital A/cs:		Less: Provision	5,000
Madan	93,780	Stock	30,000
Mohan	62,520	Investment	45,000
Gopal	52,100	Patents	15,000
		Accrued Income	500
	2,38,400		2,38,400

Working Notes:

1. **Total Capital of the Firm** = (₹ 93,780 + ₹ 62,520) × 4/3 = ₹ 2,08,400.
2. **Gopal's Capital in the New Firm** = ₹ 2,08,400 × 1/4 = ₹ 52,100.

Dr.
3. CASH ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	10,000	By Balance c/d	87,900
To Gopal's Capital A/c	52,100		
To Premium for Goodwill	25,000		
To Bad Debts Recovered	800		
	87,900		87,900

ILLUSTRATION 48

A and B are partners sharing profits and losses in the ratio of 3 : 2. Their Balance Sheet as at 31st March, 2018 was as follows:

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital A/cs:		Fixed Assets	96,000
A	70,000	Investments	40,000
B	60,000	Stock	46,000
Workmen Compensation Fund	22,000	Debtors	38,000
Bank Loan	18,000	Less: Provision	4,000
Creditors	70,000	Cash	24,000
	2,40,000		2,40,000

On 1st April, 2018, they admitted C for 25% share in profits on the following terms:

- (a) C brings in capital proportionate to his share after all adjustments and ₹ 8,000 for goodwill out of his share of ₹ 14,000.
- (b) Fixed Assets are overvalued by ₹ 3,000.
- (c) Half of Investments was to be taken over by A and B in their profit-sharing ratio and remaining valued at ₹ 25,800.
- (d) New Ratio will be 3 : 3 : 2.
- (e) A claim of ₹ 2,000 on account of workmen compensation to be provided for
- (f) A Provision for Doubtful Debts is to be maintained at 10% on Debtors.

Required: Prepare the Revaluation Account, Partners' Capital Accounts and the Balance Sheet and C's admission.

SOLUTION
Dr.
REVALUATION ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Fixed Assets	3,000	By Investments A/c	5,800
To Profit transferred to:		By Provision for Doubtful Debts	
A's Capital A/c	1,800	Existing	4,000
B's Capital A/c	1,200	Less: Required	3,800
	3,000	[₹ 38,000 × 10/100]	200
	6,000		6,000

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Investments A/c	12,000	8,000	—	By Balance b/d	70,000	60,000	—
To Balance c/d	84,400	62,600	49,000	By Cash A/c	—	—	49,000
				By C's Current A/c	5,400	600	—
				By Premium for Goodwill A/c	7,200	800	—
				By W. Comp. Fund	12,000	8,000	—
				By Revaluation A/c	1,800	1,200	—
	96,400	70,600	49,000		96,400	70,600	49,000

BALANCE SHEET OF A, B AND C
as at 1st April, 2018

Liabilities	₹	Assets	₹
Capital A/cs:		Fixed Assets [96,000 – 3,000]	93,000
A	84,400	Investments	25,800
B	62,600	Debtors	38,000
C	49,000	Less: Provision for	
Bank Loan	18,000	Doubtful Debts	3,800
Creditors	70,000	C's Current A/c	6,000
Workmen Compensation Claim	2,000	Stock	46,000
		Cash ₹ (24,000 + 8,000 + 49,000)	81,000
	2,86,000		2,86,000

Working Notes:
1. Sacrificing Ratio

$$A's \text{ sacrifice} = 3/5 - 3/8 = 9/40,$$

$$B's \text{ sacrifice} = 2/5 - 3/8 = 1/40$$

$$\text{Hence SR} = 9 : 1$$

2. For Goodwill not brought in cash i.e., ₹ 6,000

C's Current A/c	...Dr.	6,000	
To A's Capital A/c			5,400
To B's Capital A/c			600

3. Capital brought in by C

$$\text{Total Capital of Firm} = (\text{₹ } 84,400 + \text{₹ } 62,600) \times 4/3 = \text{₹ } 1,96,000.$$

$$C's \text{ Capital} = \text{₹ } 1,96,000 \times 1/4 = \text{₹ } 49,000.$$

ILLUSTRATION 49

The Balance Sheet of X and Y who shares profits and losses in the ratio of 3 : 2, at 31st March, 2018 was as follows:

Liabilities	₹	Assets	₹
Creditors	36,000	Cash at Bank	20,000
Workmen's Compensation Fund	24,000	Debtors	1,50,000
Employees' Provident Fund	20,000	Less: Provision	30,000
General Reserve	40,000	Stock	60,000
X's Capital	1,68,000	Investments	1,00,000
Y's Capital	1,12,000	Patents	20,000
		Goodwill	80,000
	4,00,000		4,00,000

They decided to admit Z on that Date for 1/4th share on the following terms:

- New Profit Sharing Ratio will be 6 : 9 : 5. Z is to bring in capital equal to 1/4th of the total capital of the new firm.
- Goodwill of the firm is to be valued at 4 years' purchase of the average super profits of the last three years. Average profits of the last three years are ₹ 70,000, while the normal profits that can be earned with the capital employed are ₹ 30,000. No goodwill is to appear in the books. Z brings in ₹ 24,000 cash out of his share of goodwill.
- Patents to be written down to ₹ 3,000 and Stock is undervalued by ₹ 2,000. ₹ 9,000 included in Sundry Creditors be written back as no longer payable. Unaccounted Accrued Income of ₹ 2,000 to be provided for. Out of the amount of insurance which was debited entirely to P&L A/c, ₹ 14,000 be carried forward as an Unexpired Insurance. A claim of ₹ 6,000 on account of workmen's compensation to be provided for.
- ₹ 15,000 of the debtors proved bad. A provision of 20% is to be maintained on Sundry Debtors for doubtful debts. A debtor whose dues of ₹ 10,000 were written off as bad debts paid 80% in full settlement. 20% of General Reserve to be transferred to Provision for Doubtful Debts.
- The market value of investments was ₹ 90,000. Half of the investments were to be taken over by old partners in their old profit sharing ratio.

Prepare the Revaluation Account, Capital Accounts of the Partners and the Balance Sheet of the new Firm.

SOLUTION

Dr.		REVALUATION ACCOUNT		Cr.	
Particulars	₹	Particulars	₹		
To Patents	17,000	By Sundry Creditors	9,000		
To Investments	10,000	By Prepaid Insurance	14,000		
To Provision for Doubtful Debts	4,000	By Bad Debts Recovered	8,000		
[(20% of ₹ 1,35,000) - ₹ 15,000 - ₹ 8,000]		By Stock	2,000		
To Profit on Revaluation t/f to:		By Accrued Income	2,000		
X's Capital A/c	2,400				
Y's Capital A/c	1,600				
	4,000				
	35,000				35,000

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Goodwill A/c	48,000	32,000	—	By Balance b/d	1,68,000	1,12,000	—
To Investments A/c	27,000	18,000	—	By General Reserve	19,200	12,800	—
To X's Capital A/c	—	8,000	—	By Revaluation A/c	2,400	1,600	—
To Balance c/d	1,73,400	75,600	83,000	By Workmen's Com.	10,800	7,200	—
				By Premium for Goodwill	24,000	—	—
				By Z's Current A/c	16,000	—	—
				By Y's Capital A/c	8,000	—	—
				By Bank A/c	—	—	83,000
	2,48,400	1,33,600	83,000		2,48,400	1,33,600	83,000

BALANCE SHEET OF NEW FIRM AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Creditors	27,000	Cash at Bank	1,35,000
Employees' Provident Fund	20,000	Debtors	1,35,000
Workmen's Compensation Claim	6,000	Less: Provision	27,000
X's Capital A/c	1,73,400	Stock	62,000
Y's Capital A/c	75,600	Investments	45,000
Z's Capital A/c	83,000	Patents	3,000
		Prepaid Insurance	14,000
		Accrued Income	2,000
		Z's Current A/c	16,000
	3,85,000		3,85,000

Working Notes:

1. X's sacrifice = $3/5 - 6/20 = 6/20$, Y's gain = $2/5 - 9/20 = (1/20)$
2. Firm's Goodwill = Super Profits $\times 4 = (\text{₹ } 70,000 - \text{₹ } 30,000) \times 4 = \text{₹ } 1,60,000$
3. Z's Share of Goodwill = $\text{₹ } 1,60,000 \times 1/4 = \text{₹ } 40,000$
4. Y's Share of Goodwill = $\text{₹ } 1,60,000 \times 1/20 = \text{₹ } 8,000$
5. Z's New Capital = $(\text{₹ } 1,73,400 + \text{₹ } 75,600) \times 1/3 = \text{₹ } 83,000$

Dr.

6. CASH AT BANK ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	20,000	By Balance c/d	1,35,000
To Z's Capital A/c	83,000		
To Bad Debts Recovered	8,000		
To Premium for Goodwill	24,000		
	1,35,000		1,35,000

9.0 ADMISSION OF A PARTNER DURING THE YEAR

Basis of Division of Profits	When a new partner is admitted during the year, the profits for the year should be divided between pre-admission period and post-admission period on some agreed basis (e.g., Time basis, Turnover basis). Unless otherwise agreed, the profits should be divided on time basis assuming that the profits are earned evenly throughout the year.
Profits for the Pre-admission period	Profits for the pre-admission period should be distributed among the Old Partners in Old Profit Sharing Ratio.
Profits for the post-admission period	Profits for the post-admission period should be distributed among All the Partners (including new one) in New Profit Sharing Ratio.

ILLUSTRATION 50

A and B are partners in a firm sharing profits and losses in the ratio of 3 : 2 with capital of ₹ 1,20,000 and ₹ 40,000 respectively. The amount of capital carries interest @ 10% p.a. They admit C into the partnership with effect from 1st Jan., 2018 on the following terms:

- That C is to bring in ₹ 10,000 for his share of goodwill in Cash.
- That C is to contribute ₹ 1,15,000 as his share of Capital;
- That the partners' capitals will carry interest @ 12% p.a.
- That the new profit sharing ratio of 'A', 'B' and 'C' will be 9 : 6 : 4.
- That A will be entitled to 5% commission on net profit.
- The profits for the year ending on 31st March, 2018 before providing for A's commission and interest on partners' capitals amounted to ₹ 76,000.

Required: Prepare Profit & Loss Appropriation Account for the year ending on 31st March, 2018.

SOLUTION

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr. *for the year ending on 31st March, 2018* Cr.

<i>Particulars</i>	<i>1.4.2017 to 31.12.2017 ₹</i>	<i>1.1.2018 to 31.3.2018 ₹</i>	<i>Particulars</i>	<i>1.4.2017 to 31.12.2017 ₹</i>	<i>1.1.2018 to 31.3.2018 ₹</i>
To Interest on Capital:			By Profit	57,000	19,000
A	9,000	4,860			
B	3,000	1,950			
C	—	3,450			
To Commission to A [5% of ₹ 19,000]	—	950			
To Net Profit t/f to:					
A	27,000	3,690			
B	18,000	2,460			
C	—	1,640			
	57,000	19,000		57,000	19,000

Working Notes:**1. CALCULATION OF SACRIFICING RATIO**

<i>Particulars</i>	<i>A</i>	<i>B</i>
Existing Shares	3/5	2/5
New shares	9/19	6/19
Share Surrendered	12/95	8/95

Thus, Sacrificing Ratio of A and B = 12 : 8 or 3 : 2.

2. CALCULATION OF CAPITAL OF A AND B AS ON 1.1.2018

<i>Particulars</i>	<i>A</i>	<i>B</i>
Opening Capital	₹ 1,20,000	₹ 40,000
Share of Goodwill Credited	₹ 6,000	₹ 4,000
Interest on Capital	₹ 9,000	₹ 3,000
Share of Profit	₹ 27,000	₹ 18,000
Capital as on 1.1.2018	₹ 1,62,000	₹ 65,000

SOLVED PROBLEMS I**PROBLEM 1**

The Balance Sheet of A, B and C who are sharing profits in the ratio of 2:3:1, as at 31st March, 2018 is given below:

<i>Liabilities</i>	<i>₹</i>	<i>Assets</i>	<i>₹</i>
A's Capital	1,00,000	Goodwill	12,000
B's Capital	2,00,000	Land and Building	2,50,000
C's Capital	3,00,000	Investments [Market Value ₹ 46,000]	50,000
Workmen Compensation Reserve	20,000	Stock	80,000
Investment Fluctuation Reserve	10,000	Debtors	3,00,000
Provision for Doubtful Debts	10,000	Bank	2,96,000
Sundry Creditors	3,00,000	Advertisement Suspense A/c	12,000
Employees' Provident Fund	60,000		
	10,00,000		10,00,000

A, B and C decide to admit D as a new partner from 1st April, 2018 and fix their new profit sharing ratio as 1:2:3:4. D brings in ₹ 4,00,000 as his capital and brings in ₹ 5,000 in cash and machinery worth ₹ 25,000 towards his share of firm's goodwill.

- Goodwill is to be valued at 2 years' purchase of average profits of last three completed years. The profits were — 2015-2016 ₹ 48,000, 2016-2017 ₹ 93,000, 2017-2018 ₹ 1,38,000.
- Land & Building was found under valued by ₹ 20,000 and Stock was found overvalued by ₹ 38,000. Provision for doubtful debts is to be made equal to 5% of the debtors.
- Claim on account of workmen compensation is ₹ 8,000. 10% of the sundry creditors be written back as no longer payable. Out of the amount of insurance which was debited entirely to P&L A/c, ₹ 5,000 be carried forward as an unexpired insurance.

Required: Pass the necessary journal entries and prepare the necessary ledger accounts and the Balance Sheet.

SOLUTION

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	A's Capital A/c Dr. B's Capital A/c Dr. C's Capital A/c Dr. To Goodwill A/c (Being the existing goodwill w/o)		4,000 6,000 2,000	12,000
2.	Cash A/c Dr. Machinery A/c Dr. To D's Capital A/c To Premium for Goodwill A/c Dr. (Being D brought in ₹ 4,00,000 as capital and cash (₹ 5,000) & Machinery (₹ 25,000) out of his share of goodwill of ₹ 74,400 (i.e. ₹ 1,86,000 × 4/10)		4,05,000 25,000	4,00,000 30,000
3.	D's Capital A/c Dr. Premium for Goodwill A/c Dr. To A's Capital A/c (₹ 74,400 × 14/32) To B's Capital A/c (₹ 74,400 × 18/32) (Being D's share of Goodwill (i.e. ₹ 74,400 credited to sacrificing partners)		44,400 30,000	32,550 41,850
4.	C's Capital A/c (₹ 1,86,000 × 8/60) Dr. To A's Capital A/c (₹ 24,800 × 14/32) To B's Capital A/c (₹ 24,800 × 18/32) (Being the adjustment made on account of change in profit sharing ratio-C's gain 8/60, A's sacrifice 14/60, B's sacrifice 18/60]		24,800	10,850 13,950
5	Land & Building A/c Dr. Sundry Creditors Dr. Prepaid Insurance Dr. To Revaluation A/c (Being the increase in value of Assets & decrease in Sundry Creditors recorded)		20,000 30,000 5,000	55,000
6	Revaluation A/c Dr. To Stock A/c To Provision for Doubtful Debts A/c (Being the decrease in Value of Assets & increase in provisions recorded)		43,000	38,000 5,000
7.	Revaluation A/c Dr. To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of profit on revaluation)		12,000	4,000 6,000 2,000

8.	Workmen Compensation Reserve A/c	Dr.	20,000	
	To Workmen Compensation Claim A/c			8,000
	To A's Capital A/c			4,000
	To B's Capital A/c			6,000
	To C's Capital A/c			2,000
	(Being the transfer of workmen compensation Reserve)			
9.	Investment Fluctuation Fund A/c	Dr.	10,000	
	To Investment A/c			4,000
	To A's Capital A/c			2,000
	To B's Capital A/c			3,000
	To C's Capital A/c			1,000
	(Being the transfer of Investment Fluctuation Fund)			
10.	A's Capital A/c	Dr.	4,000	
	B's Capital A/c	Dr.	6,000	
	C's Capital A/c	Dr.	2,000	
	To Advertisement Suspense A/c			12,000
	(Being the t/f of bal. of Advertisement Suspense A/c)			

Ledger Accounts:

Dr. **1. REVALUATION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Stock	38,000	By Land & Building	20,000
To Provision for Doubtful Debts	5,000	By Sundry Creditors	30,000
To Profit on Revaluation t/f to:		By Prepaid Insurance	5,000
A's Capital A/c	4,000		
B's Capital A/c	6,000		
C's Capital A/c	2,000		
	55,000		55,000

Dr. **2. PARTNERS' CAPITAL ACCOUNTS** Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Goodwill A/c	4,000	6,000	2,000	By Balance b/d	1,00,000	2,00,000	3,00,000
To A's Capital A/c	—	—	10,850	By Premium for Goodwill	13,125	16,875	—
To B's Capital A/c	—	—	13,950	By D's Capital A/c	19,425	24,975	—
To Adv. Exp. Sus. A/c	4,000	6,000	2,000	By C's Capital A/c	10,850	13,950	—
To Balance c/d	1,45,400	2,58,800	2,76,200	By Revaluation A/c	4,000	6,000	2,000
				By Work Com. Res.	4,000	6,000	2,000
				By Invest. Flus. Res.	2,000	3,000	1,000
	1,53,400	2,70,800	3,05,000		1,53,400	2,70,800	3,05,000

Dr.

3. D'S CAPITAL ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To A's Capital A/c	19,425	By Cash A/c	4,00,000
To B's Capital A/c	24,975		
To Balance c/d	3,55,600		
	4,00,000		4,00,000

4. BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
A's Capital	1,45,400	Machinery	25,000
B's Capital	2,58,800	Land & Building	2,70,000
C's Capital	2,76,200	Investments	46,000
D's Capital A/c	3,55,600	Stock	42,000
Sundry Creditors	2,70,000	Debtors	3,00,000
Workmen Compensation Claim	8,000	Less: Provision	15,000
Employees' Provident Fund	60,000	Bank	2,96,000
		Cash	4,05,000
		Prepaid Insurance	5,000
	13,74,000		13,74,000

Working Notes:
1. CALCULATION OF GAIN/SACRIFICE OF SHARE

Particulars	Old Share	New Share	Difference
A.	2/6	1/10	2/6-1/10=14/60
B.	3/6	2/10	3/6-2/10 = 18/60
C.	1/6	3/10	1/6-3/10 = -8/60

2. CALCULATION OF GOODWILL

- A. Average Profits = $\frac{₹ 48,000 + ₹ 93,000 + ₹ 1,38,000}{3} = ₹ 93,000$
- B. Firm's Goodwill = ₹ 93,000 × 2 = ₹ 1,86,000
- C. D's Share of Goodwill = ₹ 1,86,000 × 4/10 = ₹ 74,400
- D. D's Share of Goodwill not brought in = ₹ 74,400 – (₹ 5,000 + ₹ 25,000) = ₹ 44,400

PROBLEM 2

A and B are partners sharing profits in the ratio of 3:2. They admit C as a new partner from 1st April. A gives 1/3rd of his share while B gives 1/10th from his share. The Balance Sheet as at 31st March, 2018 is given below:

Liabilities	₹	Assets	₹
A's Capital	17,600	Goodwill	1,000
B's Capital	25,400	Land & Building	6,000
Workmen Compensation Fund	2,000	Investments [Market Value ₹ 4,500]	5,000
Investment Fluctuation Fund	1,000	Debtors	10,000

Employees' Provident Fund	1,000	Stock	30,000
Provision for Doubtful Debts	1,000	Bank Balance	25,000
C's Loan	30,000	Advertisement Suspense A/c	1,000
	78,000		78,000

Terms of C's admission are as follows:

1. C's loan will be converted into his capital. C brings in 60% of his share of goodwill in cash.
2. Goodwill is to be valued at 2 years' purchase of super profit of last three completed years. The profits were — 2015-2016 ₹ 48,000, 2016-2017 ₹ 93,000, 2017-2018 ₹ 1,38,000. The normal profits are ₹ 63,000. No Goodwill is to appear in the books of new firm.
3. Land & Building was found undervalued by ₹ 5,000, Stock was found overvalued by ₹ 7,000, Provision for doubtful debts is to be made equal to 5% of the debtors.
4. Claim on account of workmen compensation is ₹ 1,000. An Unaccounted Accrued Income of ₹ 1,000 be provided for. A Debtor whose dues of ₹ 5,000 were written off as bad debts paid ₹ 4,000 in full settlement.
5. Capital accounts of the partners be re-adjusted on the basis of their profit sharing ratio and any excess or deficiency be adjusted in cash.

Required: Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet.

SOLUTION

Dr. **REVALUATION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Stock	7,000	By Land & Building	5,000
To Profit on Revaluation t/f to:		By Provision for Doubtful Debts	
A's Capital A/c	2,100	By Accrued Income	1,000
B's Capital A/c	1,400	By Bad Debts Recovered	4,000
		Existing	1,000
		Less: Required [₹10,000 × 5%]	500
	10,500		5000
			10,500

Dr. **CAPITAL ACCOUNTS OF PARTNERS** Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Goodwill A/c	600	400	—	By Balance b/d	17,600	25,400	—
To Adv. Sus. A/c	600	400	—	By C's Loan A/c	—	—	30,000
To Balance c/d	31,400	32,600	30,000	By Premium			
				for Goodwill A/c	7,200	3,600	—
				By C's Current A/c	4,800	2,400	—
				By Revaluation A/c	2,100	1,400	—
				By Work. Compt. F.	600	400	—
				By Invest. Flu. Fund	300	200	—
	32,600	33,400	30,000		32,600	33,400	30,000
To Bank A/c (b.f.)	—	2,600	—	By Balance b/d	31,400	32,600	30,000
To Balance c/d	40,000	30,000	30,000	By Bank A/c (b.f.)	8,600	—	—
	40,000	32,600	30,000		40,000	32,600	30,000

BALANCE SHEET AS AT APRIL 1, 2018

Liabilities	₹	Assets	₹
A's Capital	40,000	Land & Building	11,000
B's Capital	30,000	Investments	4,500
C's Capital	30,000	Debtors	10,000
Employee Provident Fund	1,000	Less: Provision	500
Workmen Compensation Claim	1,000	Stock (30,000 – 7,000)	23,000
		Bank Balance	45,800
		Accrued Income	1,000
		C's Current A/c	7,200
	1,02,000		1,02,000

Working Notes:**1. Calculation of Incoming Partner's Share, Sacrificing Ratio and New Ratio.**

New Share = Old Share – Share surrendered

$$A's \text{ New Share} = \frac{3}{5} - \left(\frac{1}{3} \times \frac{3}{5} \right) = \frac{3}{5} - \frac{1}{5} = \frac{2}{5}$$

$$B's \text{ New Share} = \frac{2}{5} - \frac{1}{10} = \frac{3}{10}$$

$$C's \text{ Share} = \frac{1}{5} + \frac{1}{10} = \frac{3}{10}$$

$$\text{New Profit Sharing Ratio} = \frac{2}{5} : \frac{3}{10} : \frac{3}{10} = 4 : 3 : 3$$

Sacrificing Ratio of A and B = $1/5 : 1/10 = 2 : 1$

2. Calculation of Incoming Partner's Share of Goodwill.

A. Average Profits = $\frac{₹ 48,000 + ₹ 93,000 + ₹ 1,38,000}{3} = ₹ 93,000$

B. Normal Profits = ₹ 60,000

C. Super Profits = ₹ 93,000 – ₹ 63,000 = ₹ 30,000

D. Firm's Goodwill = ₹ 30,000 × 2 = ₹ 60,000

E. C's Share of Goodwill = ₹ 60,000 × $3/10$ = ₹ 18,000

3. JOURNAL ENTRY WITH RESPECT TO GOODWILL

Bank A/c	Dr.	10,800	
To Premium For Goodwill A/c			10,800
Premium For Goodwill A/c	Dr.	10,800	
To A's Capital A/c			7,200
To B's Capital A/c			3,600
C's Current A/c	Dr.	7,200	
To A's Capital A/c (₹ 7,200 × $2/3$)			4,800
To B's Capital A/c (₹ 7,200 × $1/3$)			2,400

4. Total Capital = ₹ 30,000 × $10/3$ = ₹ 1,00,000

A's New Capital = ₹ 1,00,000 × $4/10$ = ₹ 40,000

B's New Capital = ₹ 1,00,000 × $3/10$ = ₹ 30,000

Dr.

5. BANK ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	25,000	By B's Capital A/c	2,600
To Premium for Goodwill A/c	10,800	By Balance c/d	45,800
To Bad Debts Recovered	4,000		
To A's Capital	8,600		
	48,400		48,400

PROBLEM 3

A, B and C were partners sharing profits and losses in the ratio of 3 : 2 : 1 On 1st April, 2017 they admitted D into partnership on the following terms:—

D to have one sixth share which he purchased entirely from A, paying A ₹ 40,000 for the share of goodwill through the books of the firm. Of this amount, A was to withdraw ₹ 30,000 and D to bring in proportionate capital. It was further agreed that investments should be reduced to their market value viz. ₹ 18,000 and that plant should be reduced to ₹ 39,000. A sum of ₹ 3,000 included in creditors was to be written back as there was no liability to pay the amount. The balance sheet of A, B and C as on 31st March, 2017 was as follows.

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Creditors	1,05,000	Cash at Bank	40,000
Workmen Compensation Reserve	6,000	Debtors	60,000
A's Capital	57,000	Stock	50,000
B's Capital	38,000	Investments (at Cost)	30,000
C's Capital	19,000	Plant	45,000
	2,25,000		2,25,000

The profits for the year 2017-2018 were ₹ 60,000 and the drawings were ₹ 15,000 for A and B each and ₹ 7,500 for C and D each.

Required: Journalise the entries to be made on D's admission and give the Balance Sheet as at 31st March, 2018.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bank A/c Dr. To Premium for Goodwill A/c (Being the Share of Goodwill brought in by D)		40,000	40,000
	Premium for Goodwill A/c Dr. To A's Capital A/c (Being the goodwill credited to A)		40,000	40,000
	A's Capital A/c Dr. To Bank A/c (Being the part goodwill of ₹ 30,000 withdrawn by A)		30,000	30,000
	Revaluation A/c Dr. To Investment A/c To Plant A/c (Being the fall in the value of Assets recorded)		18,000	12,000 6,000

	Sundry Creditors A/c To Revaluation A/c (Being the decrease in amount of creditors recorded)	Dr.		3,000	3,000
	A's Capital A/c B's Capital A/c C's Capital A/c To Revaluation A/c (Being the transfer of loss on revaluation)	Dr. Dr. Dr.		7,500 5,000 2,500	15,000
	Workmen Compensation Reserve A/c To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of Work. Comp. Res.)	Dr.		6,000	3,000 2,000 1,000
	Bank A/c To D's Capital A/c (Being the capital brought in by D)	Dr.		23,000	23,000

Dr.
CAPITAL ACCOUNTS OF OLD PARTNERS
Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Cash A/c	30,000	—	—	By Balance b/d	57,000	38,000	19,000
To Revaluation A/c	7,500	5,000	2,500	By Work. Com. Res.	3,000	2,000	1,000
To Balance c/d	62,500	35,000	17,500	By Premium	40,000	—	—
	1,00,000	40,000	20,000		1,00,000	40,000	20,000
To Drawings A/c	15,000	15,000	7,500	By Balance b/d	62,500	35,500	17,500
To Balance c/d	67,500	40,000	20,000	By P & L A/c	20,000	20,000	10,000
	82,500	55,000	27,500		82,500	55,000	27,500

Dr.
D'S CAPITAL ACCOUNT
Cr.

Particulars	₹	Particulars	₹
To Drawings A/c	7,500	By Cash A/c	23,000
To Balance c/d	25,500	By P & L A/c	10,000
	33,000		33,000

BALANCE SHEET OF NEW FIRM AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Creditors	1,02,000	Cash at Bank	88,000
A's Capital	67,500	Debtors	60,000
B's Capital	40,000	Stock	50,000
C's Capital	20,000	Investments	18,000
D's Capital	25,500	Plant	39,000
	2,55,000		2,55,000

Working Notes:**1. Calculation of the amount to be brought in by D as capital**

- (a) Total Adjusted Capitals of Old Partners = ₹ 62,500 + ₹ 35,000 + ₹ 17,500 = ₹ 1,15,000
 (b) Total Capital of the New Firm = (₹ 1,15,000 × 6/5) = ₹ 1,38,000
 (c) Proportionate Capital of Incoming Partner = (₹ 1,38,000 × 1/6) = ₹ 23,000

2. Calculation of Cash as on 31.3.2018

Assuming that the profit earned during the year resulted in the change of cash balance only and no other **Assets**, Cash balance is calculated as under.

Dr. **CASH AT BANK ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.11	To Balance b/f	40,000	2017-12	By A's Capital A/c	30,000
	To Premium			By Drawings	45,000
	for Goodwill A/c	40,000	31.03.12	By Balance c/f	88,000
	To D's Capital A/c	23,000			
2017-12	To Profit for the year	60,000			
		1,63,000			1,63,000

PROBLEM 4

Jain and Gupta were partners in a firm sharing profits and losses in the ratio of 4 : 3. The following is the balance Sheet of the firm as on 31st March, 2018.

Liabilities	₹	Assets	₹
Sundry Creditors	20,000	Cash	14,800
Bank Overdraft	17,000	Debtors	20,500
Employees' Provident Fund	3,000	Less: Provision	300
Workmen Compensation Reserve	7,000	Stock	6,000
Jain's Capital A/c	66,000	Investments	14,000
Gupta's Capital A/c	57,000	Plant	40,000
		Buildings	75,000
	1,70,000		1,70,000

They agreed to admit Mishra with effect from 1st April 2018 with 1/4th share in profit on the following terms:

- (a) Mishra will bring in proportionate capital.
 (b) Buildings are to be appreciated by ₹ 13,000 and plant to be depreciated to ₹ 33,000.
 (c) The provision on debtors is to be raised to ₹ 1,000.
 (d) The Goodwill of the firm has been valued at ₹ 21,000 but no goodwill is to appear in the books.
 (e) Half of investments are to be taken over by Jain and Gupta in their profit sharing ratio and remaining valued at ₹ 8,000.

Required: Prepare the Revaluation account, Partners' Capital Accounts and the Balance Sheet of the firm after Mishra's admission.

SOLUTION
Dr.
REVALUATION ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Plant	7,000	By Building	13,000
To Provision on Debtors	700	By Investments	1,000
To Profit on Revaluation t/f to:			
Jain's Capital A/c	3,600		
Gupta's Capital A/c	2,700		
	14,000		14,000

Dr.
PARTNERS' CAPITAL ACCOUNTS
Cr.

<i>Particulars</i>	<i>Jain</i> ₹	<i>Gupta</i> ₹	<i>Mishra</i> ₹	<i>Particulars</i>	<i>Jain</i> ₹	<i>Gupta</i> ₹	<i>Mishra</i> ₹
To Investments	4,000	3,000	—	By Balance b/d	66,000	57,000	—
To Balance c/d	72,600	61,950	44,850	By Cash A/c	—	—	44,850
				By Workmen Com. Reserve	4,000	3,000	—
				By Revaluation A/c	3,600	2,700	—
				By Mishra's Curr. A/c	3,000	2,250	—
	76,600	64,950	44,850		76,600	64,950	44,850

BALANCE SHEET OF THE FIRM AS AT 01.04.2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Sundry Creditors	20,000	Cash [₹ 14,800 + ₹ 44,850]	59,650
Bank Overdraft	17,000	Debtors	20,500
Employees' Provident Fund	3,000	Less: Provision	1,000
Capitals:		Stock	6,000
Jain	72,600	Plant	33,000
Gupta	61,950	Building	88,000
Mishra	44,850	Investments	8,000
		Mishra's Current A/c	5,250
	2,19,400		2,19,400

Working Note: *Calculation of Mishra's Capital*
1. Total Capital of New Firm

Let Total Capital of New Firm be X

 $X = \text{Jain's Capital} + \text{Gupta's Capital} + \text{Mishra's Capital}$
 $X = ₹ 72,600 + ₹ 61,950 + 1/4X$
 $3/4X = ₹ 1,34,550 = ₹ 1,34,550 \times 4/3 = ₹ 1,79,400$
2. Mishra's Capital = ₹ 1,79,400 × 1/4 = ₹ 44,850

PROBLEM 5

A and B are partners sharing profits in the ratio of 3:2. They admit C as a new partner from 1st April. They decide to share future profits in the ratio of 4 : 3 : 3. The Balance Sheet as at 31st March, 2018 is given below:

<i>Liabilities</i>	₹	<i>Assets</i>	₹
A's Capital	17,600	Goodwill	1,000
B's Capital	25,400	Land & Building	6,000
Workmen Compensation Fund	2,000	Investments [Market Value ₹ 4,500]	5,000
Investment Fluctuation Fund	1,000	Debtors	10,000
Employees' Provident Fund	1,000	Stock	30,000
Provision for Doubtful Debts	1,000	Bank Balance	25,000
C's Loan	30,000	Advertisement Suspense A/c	1,000
	78,000		78,000

Terms of C's admission are as follows:

1. C contributes proportionate capital and 60% of his share of goodwill in cash.
2. Goodwill is to be valued at 2 years' purchase of super profit of last three completed years. The profits were — 2015-2016 ₹ 48,000, 2016-2017 ₹ 93,000, 2017-2018 ₹ 1,38,000. The normal profits are ₹ 53,000. No Goodwill is to appear in the books of new firm.
3. Land & Building was found undervalued by ₹ 10,000.
4. Stock was found overvalued by ₹ 7,000.
5. Provision for doubtful debts is to be made equal to 5% of the debtors.
6. Claim on account of workmen compensation is ₹ 1,000.

Required: Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet.

SOLUTION

Dr.

REVALUATION ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Stock	7,000	By Land & Building	10,000
To Profit on Revaluation t/f to:		By Provision for Doubtful Debts	500
A's Capital A/c	2,100	Existing	1,000
B's Capital A/c	1,400	Less: Required [₹ 10,000 × 5/100]	500
	10,500		10,500

Dr.

CAPITAL ACCOUNTS OF PARTNERS

Cr.

<i>Particulars</i>	A (₹)	B (₹)	C (₹)	<i>Particulars</i>	A (₹)	B (₹)	C (₹)
To Goodwill A/c	600	400	—	By Balance b/d	17,600	25,400	—
To Adv. Sus. A/c	600	400	—	By C's Loan A/c	—	—	30,000
To Balance c/d	35,400	34,600	30,000	By Premium			
				for Goodwill A/c	9,600	4,800	—
				By C's Current A/c	6,400	3,200	—
				By Revaluation A/c	2,100	1,400	—
				By Work. Compt. F.	600	400	—
				By Invest. Flu. Fund	300	200	—
	36,600	35,400	30,000		36,600	35,400	30,000

BALANCE SHEET AS AT APRIL 1, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
A's Capital	35,400	Land & Building	16,000
B's Capital	34,600	Investments	4,500
C's Capital	30,000	Debtors	10,000
Employee Provident Fund	1,000	Less: Provision	500
Workmen Compensation Claim	1,000	Stock (30,000 — 7,000)	23,000
C's Loan	30,000	Bank Balance	69,400
		C's Current A/c	9,600
	1,32,000		1,32,000

Working Notes:**1. CALCULATION OF INCOMING PARTNER'S SHARE, SACRIFICING RATIO**

<i>Particulars</i>	<i>A</i>	<i>B</i>
A Their Old Shares	3/5	2/5
B Their New Shares [A–B]	4/10	3/10
C Share surrendered by old partners	3/5 – 4/10 = 2/10	2/5 – 3/10 = 1/10
D C's Share = 3/10		
E Sacrificing Ratio = 2/10 : 1/10 = 2 : 1		

2. CALCULATION OF INCOMING PARTNER'S SHARE OF GOODWILL

- A. Average Profits = $\frac{₹ 48,000 + ₹ 93,000 + ₹ 1,38,000}{3} = ₹ 93,000$
- B. Normal Profits = ₹ 53,000, C. Super Profits = ₹ 93,000 – ₹ 53,000 = ₹ 40,000
- D. Firm's Goodwill = ₹ 40,000 × 2 = ₹ 80,000
- E. C's share of Goodwill = ₹ 80,000 × 3/10 = ₹ 24,000

3. JOURNAL ENTRY WITH RESPECT TO GOODWILL

Bank A/c	Dr.	₹ 14,400	
To Premium for Goodwill A/c			₹ 14,400
Premium for Goodwill A/c	Dr.	₹ 14,400	
To A's Capital A/c			₹ 9,600
To B's Capital A/c			₹ 4,800
C's Current A/c	Dr.	₹ 9,600	
To A's Capital A/c (₹ 9,600 × 2/3)			₹ 6,400
To B's Capital A/c (₹ 9,600 × 1/3)			₹ 3,200

4. Calculation of C's Capital

Let Total Capital of New Firm be X

X = Adjusted Old Capitals of A & B + 3/10 X

X = ₹ 35,400 + ₹ 34,600 + 3/10 X

X – 3/10 X = ₹ 70,000, X = ₹ 70,000 × 10/7 = ₹ 1,00,000

C's Capital = ₹ 1,00,000 × 3/10 = ₹ 30,000

5. Calculation of Closing Bank Balance

Dr.

BANK ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	25,000	By Balance c/d	69,400
To Premium for Goodwill A/c	14,400		
To C's Capital A/c	30,000		
	69,400		69,400

PROBLEM 6

The Balance Sheet of Amit, Bhushan and Charan, who share profits and losses as 3 : 2 : 1 respectively, as on 01.04.2018 is as follows:

Liabilities	₹	Assets	₹
Capital Accounts: Amit	1,80,000	Machinery	1,50,000
Bhushan	1,60,000	Furniture	1,50,000
Charan	1,40,000	Debtors	80,000
Current Accounts: Bhushan	16,000	Less: Provision	4,000
Creditors	1,20,000	Stock	2,10,000
		Cash	20,000
		Current Account: charan	10,000
	6,16,000		6,16,000

Dev is admitted as a partner on the above Date for 1/5th share in the profit and loss. Following are agreed upon:

- (1) The profit and loss sharing ratio among the old partners will be equal.
- (2) Dev brings in ₹ 1,50,000 as capital but is unable to bring the required amount of premium for goodwill.
- (3) The goodwill of the firm is valued at ₹ 60,000.
- (4) Assets and Liabilities are to be valued as follows:
Machinery ₹ 2,06,000 : Furniture ₹ 1,28,000 : Provision for doubtful debts @ 10% on debtors.
- (5) Necessary adjustments regarding goodwill and Profit/loss on revaluation are to be made through the Partner's Current Accounts.
- (6) It is decided that the revalued figures of Assets and Liabilities will not appear in the Balance Sheet of the new firm.
- (7) Capital Accounts of the old partners in the new firm should be proportionate to the new profit and loss sharing ratio, taking Dev's Capital as base. The existing partners will not bring cash for further capital. The necessary adjustments are to be made through the partner's Current Account.

Prepare Partner's Capital & Current Account, and the Balance Sheet of the new firm after admission.

SOLUTION

Dr.

PARNTER'S CAPITAL ACCOUNTS

Cr.

Particular	Amit	Bhushan	Charan	Dev	Particulars	Amit	Bhushan	Charan	Dev
To Balance c/d	2,00,000	2,00,000	2,00,000	1,50,000	By Balance b/d	1,80,000	1,60,000	1,40,000	
					By Bank A/c	—	—	—	1,50,000
					By Partner's Current A/cs (bal. fig)	20,000	40,000	60,000	—
	2,00,000	2,00,000	2,00,000	1,50,000		2,00,000	2,00,000	2,00,000	1,50,000

Dr.

PARNTER'S CAPITAL ACCOUNTS

Cr.

Particulars	Amit	Bhushan	Charan	Dev	Particulars	Amit	Bhushan	Charan	Dev
To Balance b/d	—	—	10,000	—	By Balance b/d	—	16,000	—	—
To Amit & Bhushan (Profit)	—	—	3,000	6,000	By Dev & Charan	7,000	2,000	—	—
To Amit and Bhushan (Goodwill adjustment)	—	—	6,000	12,000	By Dev and Charan (Goodwill adjustment)	14,000	4,000	—	—
To Partners Capital A/cs	20,000	40,000	60,000	—	By Balance c/d	—	18,000	79,000	18,000
To Balance c/d	1,000	—	—	—					
	21,000	40,000	79,000	18,000		21,000	40,000	79,000	18,000

BALANCE SHEET OF NEW FIRM AFTER DEV'S ADMISSION

Liabilities	₹	Assets	₹
Amit	2,00,000	Machinery	1,50,000
Bhushan	2,00,000	Furniture	1,50,000
Charan	2,00,000	Stock	2,10,000
Dev	1,50,000	Debtors	80,000
Current Account: Amit	1,000	Less: Provision	4,000
Creditors	1,20,000	Cash	1,70,000
		Current Accounts:	
		Bhushan	18,000
		Charan	79,000
		Dev	18,000
	8,71,000		1,15,000
			8,71,000

Working Notes:

- Dev. joins the business for 1/5th share and brings ₹ 1,50,000 as capital. Thus, total capital of new firm will be ₹ 7,50,000 (1,50,000 × 5). Total capital of Amit, Bhushan & Charan will be ₹ 6,00,000 (7,50,000 – 1,50,000) which will be shared by them equally i.e. 2,00,000 each.

2. NEW PROFIT SHARING RATIO

Amit	Bhushan	Charan	Dev
$4/5 \times 1/3$	$4/5 \times 1/3$	$4/5 \times 1/3$	1/5
4/15	4/15	4/15	3/15
NR = 4:4:4:3			

3. ADJUSTMENT OF GOODWILL

Sacrifice/Gain of Partners

Amit	Bhushan	Charan	Dev
$4/15 - 3/6$	$4/15 - 2/6$	$4/15 - 1/6$	1/5 (Gain)
= 21/90 (Sacrifice)	= 6/90 (Sacrifice)	= 9/90 (gain)	

JOURNAL ENTRY TO ADJUST GOODWILL

Charan [₹ 60,000 × 9/90]	Dr.	₹ 6,000	
Dev [₹ 60,000 × 1/5]	Dr.	₹ 12,000	
To Amit [₹ 60,000 × 21/90]			₹ 14,000
To Bhushan [₹ 60,000 × 6/90]			₹ 4,000

4. NET EFFECT OF REVALUATION OF ASSETS AND LIABILITIES

Increase in value of Machinery	₹ 56,000
Decrease in value of Furniture	(₹ 22,000)
Increase in Provision for Doubtful Debts	(₹ 4,000)
Journal Entry to Adjust Profit on Revolution	₹ 30,000

Charan [₹ 30,000 × 9/90]	Dr.	₹ 3,000	
Dev [₹ 30,000 × 1/5]	Dr.	₹ 6,000	
T Amit [30,000 × 21/90]			₹ 7,000
To Bhusan [30,000 × 6/90]			₹ 2,000

SOLVED PROBLEMS II**PROBLEM 7**

A, B and C who are sharing profits in the ratio of 2 : 3 : 1, decide to admit D as a new partner from 1st Jan. 2018 and fix their new profit sharing ratio as 1 : 2 : 3 : 4. D brings in ₹ 4,00,000 as his capital and also brings in ₹ 5,000 in cash and machinery worth ₹ 5,000 towards part of his share of firm's goodwill.

The goodwill of the firm of the firm is to be determined on the basis of 2 years' purchase of the average profits from the business of the last 5 years. The profits are 2012 Profit ₹ 30,000, 2013 Profit ₹ 20,000, 2014 Loss ₹ 10,000, 2015 Profit ₹ 20,000, 2016 Profit ₹ 25,000, 2017 Profit ₹ 30,000.

The above profits and losses are after charging the salary of A @ ₹ 500 per month. The profits for 2013 included a profit of ₹ 30,000 on sale of a fixed asset and the loss for the year 2014 was on account of loss by strike to the extent of ₹ 15,000 and loss on sale of another fixed asset to the extent of ₹ 5,000. The firm's Assets also included 12% ₹ 10,000 Debentures purchased on 1.1.2012 for ₹ 9,000. The following errors were also discovered:

- A Machinery costing ₹ 9,500 purchased in 2015 was charged to purchases account, the installation charges of ₹ 500 being charged to Machinery Repairs Account. The firm charges depreciation on machinery @ 10% on W.D.V. basis.
- Goods of the invoice value of ₹ 51,150 sent on sale or return basis has been recorded in the Sales Day Book of 2017. The firm's Gross Profit is 25% on Cost.
- ₹ 540 being the interest on trade investment due to the firm used by a partner for his personal expenses in 2017.
- ₹ 1,200 received during 2017 from a debtor towards rent of property sub-let was credited to his personal account instead of Rent Account so as to reduce his debit balance from ₹ 1,600 to ₹ 400 debit.
- Interest on 10% Mortgage loan of ₹ 12,000 was paid in advance upto 31st Dec., 2018 and the whole amount was charged to Interest Account in 2017.

Required: Calculate the value of goodwill as on 1.1.2018 and pass the necessary journal entries on admission of new partner.

SOLUTION
STEP 1 CALCULATION OF CORRECT PROFITS FOR PREVIOUS YEARS

<i>Particulars</i>	<i>2013</i>	<i>2014</i>	<i>2015</i>	<i>2016</i>	<i>2017</i>
A Profits as given	20,000	(10,000)	20,000	25,000	30,000
B Add: X's salary	6,000	6,000	6,000	6,000	6,000
C Add: Abnormal Losses	—	15,000	—	—	—
		5,000			
D Less: Abnormal Profits	(30,000)				
E Less: Income from Non-Trade Investments	(1,200)	(1,200)	(1,200)	(1,200)	(1,200)
F Add: Machinery debited to Purchases A/c	—	—	9,500		
G Add: Installation charges debited to Repairs			500		
H Less: Depreciation @ 10% on W.D.V.	—	—	(1,000)	(900)	(810)
I Less: Profits on Goods Sent on approval (20% of ₹ 51,150)	—	—	—	—	(10,230)
J Add: Interest on Trade Investment	—	—	—	—	540
K Add: Rent from sub-letting	—	—	—	—	1,200
L Add: Interest on 10% Mortgage Loan	—	—	—	—	1,200
	(5,200)	14,800	33,800	28,900	26,700

<i>Particulars</i>	<i>₹</i>
Step 2 Total Profits for last 5 years	99,000
Step 3 Average Profits (₹ 99,000/5)	19,800
Step 4 Goodwill (₹ 19,800 × 2)	39,600

JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1	Cash A/c Dr. Machinery A/c Dr. To D's Capital A/c (Being D brought in ₹ 4,00,000 as capital and cash (₹ 5,000) & Machinery (₹ 5,000) out of his share of goodwill of ₹ 15,840 (i.e. ₹ 39,600 × 4/10)		4,05,000 5,000	4,10,000
2	D's Capital A/c Dr. To A's Capital A/c (₹ 15,840 × 14/32) To B's Capital A/c (₹ 15,840 × 18/32) [Being D's share of Goodwill (i.e. ₹ 15,840) credited to sacrificing partners]		15,840	6,930 8,910
3	C's Capital A/c (₹ 39,600 × 8/60) Dr. To A's Capital A/c (₹ 5,280 × 14/32) To B's Capital A/c (₹ 5,280 × 18/32) (Being the adjustment made on account of change in profit sharing ratio-C's gain 8/60, A's sacrifice 14/60, B's sacrifice 18/60]		5,280	2,310 2,970

PROBLEM 8

Kapil, Chetan and minor Sachin are partners since 1.1.2015. They decided to admit Sanjay as an equal partner from 1.1.2018. Their Balance Sheet as at 31.12.2017.

Liabilities	₹	Assets	₹
Capital Accounts:		Land and Building	56,000
Kapil	30,000	Plant and Machinery	32,875
Chetan	30,000	Stock in Trade	41,125
Minor Sachin	30,000	Sundry Debtors	36,500
Profit & Loss A/c	19,600	Cash & Bank Balance	3,500
Sundry Creditors	52,000		
Outstanding Expenses	8,400		
	1,70,000		1,70,000

- (a) Profit and Loss Account consists of the followings: Profit of 2015 ₹ 25,000 (including insurance claim of ₹ 10,000 received), Loss of 2016 ₹ 15,400 (including voluntary Retirement compensation paid ₹ 5,000 and Profit on Sale of a Fixed Asset ₹ 1,000), Profit of 2017 ₹ 10,000 (after adjusting a loss on sale of a Fixed Asset ₹ 6,000).
- (b) The new partner is to bring the necessary amount towards goodwill in which the minor Sachin has no claim. Further, new partner to bring ₹ 30,000 towards his Capital.
- (c) Goodwill of the firm is to be valued at 6 years' purchase of last 3 years' average corrected profits.
- (d) Perusal of the books of accounts of the previous year disclosed the following errors.
 - (i) A Machinery cost ₹ 6,000, purchased on 1.1.2016 was debited to Repairs Account. Firm provides 10% depreciation on its plant and machinery (on WDV basis).
 - (ii) Goods sent on sale or return basis costing ₹ 4,000 has been recorded as credit sale of 2017. The firm's Gross Profit ratio is 25% on cost.
 - (iii) ₹ 540 being the fixed Deposit interest due to the firm used by Chetan for his personal expenses in 2017.

Required: Prepare Balance Sheet of the reconstituted firm giving effect to the above adjustments.

SOLUTION

Step 1: Old Ratio of Kapil, Chetan and Sachin 1:1:1 for profits and 1:1 for losses. Minor Sachin is not liable for losses. New Ratio of Kapil, Chetan Sachin and Sanjay 1:1:1:1 for Profit and 1:1:0:1 for losses.

Step 2: Computation of correct profit for various years

Particulars	2015 ₹	2016 ₹	2017 ₹	Total
A Profit as per profit and Loss A/c	25,000	(15,400)	10,000	
B Add: VRS compensation paid		5,000		
Loss on Sale of a Fixed Asset			6,000	
Machinery debited to Repairs		6,000		
Fixed Deposit interest used by partner Chetan not recorded in the books			540	
C Less: Insurance Claim	(10,000)			
Profit on Sale of a Fixed Asset		(1000)		

Depreciation on Machinery		(600)	(540)	
Goods sent on sale or return Basis (₹ 4,000 × 25%)			(1,000)	
D Correct Profit or (Loss) for the year	15,000	(6,000)	15,000	
Share of Kapil	5,000	(3,000)	5,000	7,000
Share of Chetan	5,000	(3,000)	5,000	7,000
Share of Minor Sachin	5,000	—	5,000	10,000

Step 3: Goodwill = $[(7,000 + 7,000 + 10,000)/3] \times 6 = ₹ 48,000$

Sanjay's Share of Goodwill = ₹ 48,000 × 1/4 = ₹ 12,000

Step 4:

Dr.

CAPITAL ACCOUNTS OF PARTNERS AS AT 31ST JAN., 2018

Cr.

Particulars	Kapil	Chetan	Minor Sachin	Sanjay	Particulars	Kapil	Chetan	Minor Sachin	Sanjay
₹	₹	₹	₹	₹	₹	₹	₹	₹	₹
To Fixed Deposit	—	540	—	—	By Balance b/d	30,000	30,000	30,000	—
To Kapil's Capital A/c	—	—	—	6,000	By P & L A/c	7,000	7,000	10,000	—
To Chetan's Capital A/c	—	—	—	6,000	By Cash A/c	—	—	—	42,000
To Balance c/d	43,000	42,460	40,000	30,000	By Sanjay's Capital A/c	6,000	6,000	—	—
	43,000	43,000	40,000	42,000		43,000	43,000	40,000	42,000

BALANCE SHEET OF KAPIL, CHETAN, SANJAY AND MINOR SACHIN AS AT 1.1.2018

Liabilities	₹	Assets	₹
Capital Accounts:		Land & Building	56,000
Kapil	43,000	Plant & Machinery	
Chetan	42,460	(32,875 + 6,000 – 1,140)	37,735
Sanjay	30,000	Stock in Trade (41,125 + 4,000)	45,125
Minor Sachin	40,000	Sundry Debtors (36,500 – 5,000)	31,500
Sundry Creditors	52,000	Cash on hand/Bank (3,500 + 42,000)	45,500
Outstanding Expenses	8,400		
	2,15,860		2,15,860

PROBLEM 9

X and Y are partners in a business started in 2015, sharing profits and losses in the ratio of 5 : 4. After the accounts for the calendar year 2018 were made up and their proportionate shares taken note of in their individual accounts, they decide to share profit and losses equally retrospectively for and from the year 2018. It was also discovered that in ascertaining the results in prior years certain adjustments details of which are given, below had not been noticed.

Particulars	2015 ₹	2016 ₹	2017 ₹	2018 ₹
Profit as per accounts	72,000	78,000	90,000	1,08,000
Incomes not taken into account	5,400	4,500	3,600	6,300
Expenses not provided for	9,000	6,000	10,800	7,200

On 31st Dec., 2017, Reserves stood at ₹ 54,000, Capitals of X and Y ₹ 1,26,000 and ₹ 96,000 respectively on 31st Dec. 2018.

On 1st Jan. 2019, Z was decided to be admitted as a partner and was allotted 1/5th share, Goodwill was decided to be ascertained by capitalising at 20% the average profit of the immediately two preceding years before admission. Z would bring in proportionate capital. Capitals of X and Y are to be equal, the differences to be adjusted in their current accounts.

Profits for 2019, were ₹ 1,26,000, Drawings of X, Y and Z for the year were ₹ 54,000, ₹ 48,000 and ₹ 18,000 respectively. Incomes not taken into account are received in subsequent year. Expenses not provided for are paid in subsequent year. Prepare Capital and Current accounts of the partners .

SOLUTION

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	X ₹	Y ₹	Z ₹	Particulars	X ₹	Y ₹	Z ₹
31.12.2018				31.12.2018			
To P & L Adj. A/c	60,000	48,000	—	By Balance b/d	1,26,000	96,000	—
To P & L Adj. A/c	4,000	3,200	—	By P & L Adj. A/c	57,150	57,150	—
To X's Capital A/c				By Reserve	30,000	24,000	—
(Goodwill)	—	12,300	—	By Y's Capital A/c			
To Balance c/d	1,61,450	1,13,650	—	(Goodwill)	12,300	—	—
	2,25,450	1,77,150	—		2,25,450	1,77,150	—
01.01.2019				01.01.2019			
To Balance c/d	1,98,600	1,98,600	99,300	By Balance b/d	1,61,450	1,13,650	—
				By Z's Current A/c	22,140	22,140	—
				By Bank A/c	—	—	99,300
				By Current A/c	15,010	62,810	—
	1,98,600	1,98,600	99,300		1,98,600	1,98,600	99,300

Dr.

PARTNERS' CURRENT ACCOUNTS

Cr.

Particulars	X ₹	Y ₹	Z ₹	Particulars	X ₹	Y ₹	Z ₹
To X's Capital A/c	—	—	22,140	By P & L A/c	50,400	50,400	25,200
To Y's Capital A/c	—	—	22,140	By Balance c/d	18,610	60,410	37,080
To Drawings A/c	54,000	48,000	18,000				
To Capital A/c	15,010	62,810	—				
	69,010	1,10,810	62,280		69,010	1,10,810	62,280

Note: Net outstanding expenses at the end of 2017 (i.e. Outstanding Expenses 10,800 less accrued income ₹ 3,600) has been debited to capital accounts of X & Y in the ratio of 5 : 4.

Working Notes:

Dr.

1. PROFIT & LOSS ADJUSTMENT ACCOUNT FOR 2018

Cr.

Particulars	₹	Particulars	₹
To Outstanding Expenses (2018)	7,200	By Partners' Capital A/cs	7,200
To Net Profit t/f to Capital A/cs:		(net outstanding expenses for 2017)	
X	57,150	By X's Capital A/c	60,000
Y	57,150	By Y's Capital A/c	48,000
		By Accrued Income (2018)	6,300
	1,21,500		1,21,500

2. CALCULATION OF ADJUSTED PROFIT FOR 2017 AND 2018

Particulars	2017 ₹	2018 ₹
A Cash Profit	90,000	1,08,000
B Add: Outstanding Expenses of previous year	6,000	10,800
C Add: Accrued Income of current year	3,600	6,300
D Less: Outstanding Expenses of current year	10,800	7,200
E Less: Accrued Income of previous year	4,500	3,600
F Adjusted Profit (A + B + C – D – E)	84,300	1,14,300

3. VALUATION OF GOODWILL ON CAPITALIZATION OF AVERAGE PROFIT BASIS

Particulars	₹
A Average Profit $[(₹ 84,300 + ₹ 1,14,300)/2]$	99,300
B Capital of X & Y (including goodwill) $(₹ 99,300 \times ₹ 100/20)$	4,96,500
C Capital of X & Y (excluding goodwill) $(₹ 1,61,450 + ₹ 1,13,650)$	2,75,100
D Value of Goodwill (B – C)	2,21,400

4. It has been assumed that total capital of the firm will not be increased on admission of Z otherwise Z will contribute 1/4 of the combined Capital of M/s X and Y i.e. 1/4 of ₹ 4,96,500.
5. X's new Capital = ₹ 4,96,500 $\times$ 2/5 = ₹ 1,98,600,
 Y's new Capital = ₹ 4,96,500 $\times$ 2/5 = ₹ 1,98,600,
 Z's new Capital = ₹ 4,96,500 $\times$ 1/5 = ₹ 99,300

Note: Though exact mode of valuation of goodwill on 1.1.2019 is not given, On 31st Dec., 2019 adjustment of goodwill may be recorded between X and Y—X has sacrificed 1/18 of his share of profit and Y has gained 1/18 share. Assuming value of goodwill on 1.1.2019 to be identical to what it is on 31.12.2019 i.e. ₹ 2,21,400, X has been credited by ₹ 12,300 and Y has been debited by this amount.

PROBLEM 10

Laurel and Hardy are partners of the firm LH & Co., from 1.4.2014 Initially both of them contributed ₹ 1,00,000 each as capital. They did not contribute any capital thereafter. They maintain accounts of the firm on mercantile basis. They were sharing profits and losses in the ratio of 5:4. After the accounts for the year ended 31.3.2003 were finalized, the partners decided to share profits and losses equally with effect from 1. 4. 2014.

It was also discovered that in ascertaining the results in the earlier years certain adjustments, details of which are given below, had not been noted.

Year ended 31st March	2015 ₹	2016 ₹	2017 ₹	2018 ₹
Profit as per accounts prepaid and finalized	1,40,000	2,60,000	3,20,000	3,60,000
Expenses not provided for (as at 31st March)	30,000	20,000	36,000	24,000
Incomes not taken into account (as at 31st March)	18,000	15,000	12,000	21,000

The partners decided to admit Chaplin as a partner with effect from 1.4.2018. It was decided that Chaplin would be allotted 20% share in the firm and he must bring 20% of the combined capital of Laurel and Hardy.

Following is the Balance sheet of the firm as on 31.3.2018 before admission of Chaplin and before adjustment of revised profits between Laurel and Hardy.

BALANCE SHEET OF LH & CO. AS AT 31.3.2018

Liabilities	₹	Assets	₹
Capital Accounts:		Plant and Machinery	60,000
Laurel	2,11,500	Cash on hand	10,000
Hardy	1,51,500	Cash at bank	5,000
Sundry Creditors	2,27,000	Stock in trade	3,10,000
		Sundry Debtors	2,05,000
	5,90,000		5,90,000

You are required to prepare:

- (i) Profit and Loss Adjustment account;
- (ii) Capital accounts of the partners; and
- (iii) Balance Sheet of the firm after the admission of Chaplin.

SOLUTION

Dr.

PROFIT & LOSS ADJUSTMENT ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Expenses not provided for (years 2004-2012)	1,10,000	By Income not considered (for years 2004-2012)	66,000
		By Partners' Capital A/c (loss)	
		Laurel	22,000
		Hardy	22,000
	1,10,000		1,10,000

Dr.

(II) PARTNER'S CAPITAL ACCOUNTS

Cr.

Particulars	Laurel ₹	Hardy ₹	Dhaplin ₹	Particular	Laurel ₹	Hardy ₹	Dhaplin ₹
To P & L Adjustment A/c	22,000	22,000	—	By Balance b/d	2,11,500	1,51,500	—
To Hardy	60,000			By Laurel	—	60,000	—
To Balance c/d	1,29,500	1,89,500	63,800	By Cash	—	—	63,800
	2,11,500	2,11,500	63,800		2,11,500	2,11,500	63,800

(III) BALANCE SHEET AS AT 1.4.2018 (AFTER ADMISSION OF CHAPLIN)

Liabilities	₹	Assets	₹
Capital Accounts:		Plant and machinery	60,000
Laurel	1,29,500	Sundry debtors	2,05,000
Hardy	1,89,500	Stock in trade	3,10,000
Chaplin	63,800	Accrued income	66,000
Sundry Creditors	2,27,000	Cash on hand (10,000 + 63,800)	73,800
Outstanding Expenses	1,10,000	Cash at bank	5,000
	7,19,800		7,19,800

Working Notes:**(i) Computation of Profit and Loss distributed among partners**

Total Profit = ₹ 1,40,000 + ₹ 2,60,000, ₹ 3,20,000 + ₹ 3,60,000 = ₹ 10,80,000

Particulars	Laurel ₹	Hardy ₹	Dhaplin ₹
Profit shared in old ratio i.e. 5:4	6,00,000	4,80,000	10,80,000
Profit to be shared as per new ratio i.e. 1:1	5,40,000	5,40,000	10,80,000
Excess share	60,000		
Deficit share		(60,000)	

Laurel to be debited by ₹ 60,000 and Hardy to be credited by ₹ 60,000.

(ii) Capital brought in by Chaplin

Capital to be brought in by Chaplin must be equal to 20% of the combine capital of Laurel and Hardy

Particulars	₹
Capital of Laurel (2,11,500 – 22,000 – 60,000)	1,29,500
Capital of Hardy (1,1,500 – 22,000 + 60,000)	1,89,500
Combined Capital	3,19,000
20% of the combined capital brought in by Chaplin (20% of ₹ 3,19,000)	63,800

PROBLEM 11

P, Q, R are three doctors who are running a Polyclinic. Their capital on 31st March, 2017 was ₹ 1,00,000 each. They agreed to admit X, Y and Z as partners w.e.f. 1st April 2018. The terms for sharing profits & losses were as follows:

- 70% of the visiting fee is to go to the specialist concerned.
- 50% of the chamber fee will be payable to the individual specialist.
- 40% of operation fee and fee for pathological reports, X-rays and ECG will accrue in favour of the doctor concerned.
- Balance of profit or loss is shared equally.
- All the partners are entitled for 6% interest on capital employed.

They further agreed that:

- X, Y and I brought in ₹ 20,000 each as goodwill. Goodwill is shared by the existing partners equally.
- X, Y and Z brought in ₹ 50,000 each as capital. Each of the original partners also contributed ₹ 50,000 by way of capital.

THE RECEIPTS FOR THE YEAR AFTER ADMISSION OF NEW PARTNERS WERE:

Name of doctors	Particulars	Visiting Fees ₹	Chambers Fees ₹	Fees for reports, operation etc. ₹
P	General Physician	1,50,000	2,00,000	—
Q	Gynecologist	25,000	1,75,000	1,00,000
R	Cardiologist		1,00,000	75,000
X	Child Specialist	1,00,000	1,50,000	—

Y	Pathologist			1,00,000
I	Radiologist		40,000	2,00,000
	Total	2,75,000	6,65,000	4,75,000

EXPENSES FOR THE YEAR WERE AS FOLLOWS

<i>Particulars</i>	₹
Medicines, injections and other consumables	1,00,000
Printing and stationery	5,000
Telephone expenses	5,000
Rent	42,000
Power and light	10,000
Nurses salary	20,000
Attendants wages	20,000
Total	2,02,000
Depreciation:	15,000
X-Ray machines	5,000
ECG equipments	5,000
Furniture	5,000
Surgical Equipments	5,000
Total	30,000

You are requested to:

- Pass necessary journal entries on admission of partners.
- Prepare the Profit and Loss Account of the polyclinic for the year ended 31st March, 2018.
- Prepare capital accounts of all the partners at the end of the financial year 2017-2018. Also show the distribution of profit among partners.

SOLUTION**(I) JOURNAL ENTRIES (ON ADMISSION OF PARTNERS)**

<i>Date</i>	<i>Particulars</i>		<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
01.04.2017	X's Capital A/c	Dr.	20,000	
	Y's Capital A/c	Dr.	20,000	
	Z's Capital A/c	Dr.	20,000	
	To P's Capital A/c			20,000
	To Q's Capital A/c			20,000
	To R's Capital A/c			20,000
	(Being goodwill adjusted through capital accounts)			
	Bank A/c	Dr.	2,10,000	
	To X's capital A/c (20,000 + 50,000)			70,000
	To Y's capital A/c (20,000 + 50,000)			70,000
	To Z's capital A/c (20,000 + 50,000)			70,000
	(Being goodwill and capital brought in by new partners)			

Bank A/c	Dr.	1,50,00	
To P's capital A/c			50,000
To Q's capital A/c			50,000
To R's capital A/c			50,000
(Being capital brought in by existing partners)			

(II) PROFIT & LOSS A/C FOR THE YEAR ENDED 31ST MARCH, 2018

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Medicines, injections and other consumables	1,00,000	By Visiting fee	2,75,000
To Printing and stationery	5,000	By Chamber fee	6,65,000
To Telephone expenses	5,000	By Fee for report, operation etc.	4,75,000
To Rent	42,000		
To Power and light	10,000		
To Nurses salary	20,000		
To Attendants wages	20,000		
To Depreciation			
X-ray machine	15,000		
ECG equipment	5,000		
Furniture	5,000		
Surgical equipment	5,000		
To Interest on capital	30,000		
To Net Profit	39,600		
	11,43,400		
	14,15,000		14,15,000

(II) PARTNERS' CAPITAL ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018
Debit side

<i>Particulars</i>	<i>P</i> ₹	<i>Q</i> ₹	<i>R</i> ₹	<i>X</i> ₹	<i>Y</i> ₹	<i>Z</i> ₹
To P, Q, & R A/cs (Goodwill)	—	—	—	20,000	20,000	20,000
To Balance c/d	4,56,600	3,96,600	3,31,600	2,69,400	1,64,400	2,24,400
	4,56,600	3,96,600	3,31,600	2,89,400	1,84,400	2,44,400

Credit side

<i>Particulars</i>	<i>P</i> ₹	<i>Q</i> ₹	<i>R</i> ₹	<i>X</i> ₹	<i>Y</i> ₹	<i>Z</i> ₹
By Balance b/d	1,00,000	1,00,000	1,00,000	—	—	—
By X, Y & Z /cs (Goodwill)	20,000	20,000	20,000	—	—	—
By Bank A/c	50,000	50,000	50,000	70,000	70,000	70,000
By Interest on Capital	10,200	10,200	10,200	3,000	3,000	3,000
By Fee (share)	2,05,000	1,45,000	80,000	1,45,000	40,000	1,00,000
By Profit (share)	71,400	71,400	71,400	71,400	71,400	71,400
	4,56,600	3,96,600	3,31,600	2,89,400	1,84,400	2,44,400

Working Notes:**(I) STATEMENT SHOWING DISTRIBUTION OF FEE AMONG PARTNERS**

Partner Name	Visiting Fees (70%) ₹	Chambers Fees (50%) ₹	Operations Fees (40%) ₹	Total ₹
P	1,05,000	1,00,000	—	2,05,000
Q	17,500	87,500	40,000	1,45,000
R	—	50,000	30,000	80,000
X	70,000	75,000	—	1,45,000
Y	—	—	40,000	40,000
Z	—	20,000	80,000	1,00,000
	1,92,500	3,32,500	1,90,000	7,15,000

(II) STATEMENT SHOWING DISTRIBUTION OF FEE AMONG PARTNERS

Particulars	₹
Profits as per profit and loss account	11,43,400
Less: Fee payable to partners	7,15,000
Profit to be divided equally among partners	4,28,400
Share of each partner in remaining profit = $4,28,400/6 = 71,400$.	

(III) INTEREST ON CAPITAL EMPLOYED

Particulars	P ₹	Q ₹	R ₹	X ₹	Y ₹	Z ₹
Opening balance	1,00,000	1,00,000	1,00,000	—	—	—
Add: Goodwill	20,000	20,000	20,000	—	—	—
Add: Capital brought in cash	50,000	50,000	50,000	50,000	50,000	50,000
	1,70,000	1,70,000	1,70,000	50,000	50,000	50,000
Interest @ 6%	10,200	10,200	10,200	3,000	3,000	3,000

Total Interest = ₹ 39,600

- (iv) It is assumed that amount of premium for goodwill brought in by new partners X, Y and Z has not been withdrawn by old partners P, Q and R and it is still kept in the business.

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of Retirement of a Partner
- ◇ How can a Partner retire?
- ◇ Liability of a Retiring Partner
- ◇ Adjustments required at the time of Retirement of a Partner
- ◇ Meaning of New Profit Sharing Ratio
- ◇ Meaning of Gaining Ratio
- ◇ Distinction between Sacrificing Ratio and Gaining Ratio
- ◇ Adjustment of Goodwill
- ◇ Hidden Goodwill
- ◇ Adjustment of Profit/Loss on Revaluation of Assets and Liabilities
- ◇ Adjustment of Reserves and Accumulated Profits/Losses
- ◇ Adjustment of Capitals
- ◇ Disposal of the Amount Due to the Retiring Partner
- ◇ Retirement during the Accounting year
- ◇ Death of a Partner
- ◇ Accounting Treatment of Joint Life Policy and Individual Life Policy in Case of Death of a Partner
- ◇ Outgoing Partner's Share in the Profits of the year of Death/Retirement
- ◇ Deceased Partner's Share of Goodwill
- ◇ Calculation of Amount Payable to Executors of a Capital Account Deceased Partner
- ◇ Preparation of a Deceased Partner's Capital Account and His Excecutor's Account

1.0 RETIREMENT OF A PARTNER

Meaning	Retirement of a partner is one of the modes of reconstituting the firm under which an old partnership comes to an end and a new one between the continuing partners '(i.e., partners other than the outgoing partner) comes into existence. However, the firm continues its business.
How can a Partner retire?	A partner may retire — 1. with the consent of all other partners (whether implied <i>or</i> expressed); 2. in accordance with an express agreement by the partners; <i>or</i> 3. by giving notice in writing, to all other partners of his intention to retire in case of partnership at will [Sec. 32(1)].

Liability of a Retiring Partner	1. Liability for the Firm's acts before his Retirement Retiring Partner continues to be liable to the third party unless he discharges himself for the same by Notation (i.e., by tripartite agreement between him, third party and the continuing partners) [Sec. 32(2)]. 2. Liability for the Firm's acts after his Retirement Retiring Partner continues to be liable to third party until public notice of his retirement is given by himself or any of the other partners. But he will not be liable to any third party if the latter deals with the firm without knowing, that the former was a partner [Sec. 32(3) & (4)].
Adjustments Required	The various matters that need adjustment at the time of retirement of a partner are: 1. Adjustment in Profit Sharing Ratio 2. Adjustment for Goodwill 3. Adjustment of Profit/Loss arising on the Revaluation of Assets and Liabilities 4. Adjustment of Accumulated Profits, Reserves and Losses 5. Adjustment of Capitals (if agreed).

2.0 NEW PROFIT SHARING RATIO AND GAINING RATIO

New Profit Sharing Ratio	The ratio in which the continuing partners (i.e., partners other than an outgoing one) decide to share the future profits and losses, is known as new profit sharing ratio. Tutorial Note: <i>Unless agreed otherwise, it is presumed that the continuing partners acquire the outgoing partner's share in their old profit sharing ratio so that the continuing partners continue to share the future profits in the old ratio & hence their New Profit Sharing Ratio is same as their Old Profit Sharing Ratio.</i>
Gaining Ratio	The ratio in which the continuing partners acquire the outgoing (retired or deceased) partner's share is called as gaining ratio. This ratio is calculated by taking out the difference between New Profit Share and Old Profit Share. Tutorial Note: <i>Unless agreed otherwise it is presumed that, the Continuing Partners gain in their old profit sharing ratio and hence their Gaining Ratio is same as their Old Profit Sharing Ratio.</i>
Example	A, B and C are partners in a firm sharing profits in the ratio of 3 : 2 : 1. B died on 1st January 2012. C, the son of B, is of the opinion that he is the rightful owner of his father's share of profits, and the profits of the firm be shared between A and C equally. A does not agree. Settle the dispute between A and C according to Indian Partnership Act. In the case C is not correct. Unless agreed otherwise, New Profit Sharing Ratio of Continuing Partners is same as their Old Profit Sharing Ratio i.e. 3 : 1.

3.0 DISTINCTION BETWEEN SACRIFICING RATIO AND GAINING RATIO

Sacrificing Ratio and Gaining Ratio can be distinguished as follows:

Basis of Distinction	Sacrificing Ratio	Gaining Ratio
1. Meaning	It is the ratio in which the old partners have agreed to sacrifice their shares in profit in favour of new partner.	It is the ratio in which the continuing partners acquire the outgoing (retired or deceased) partners share.

2. Purpose	It is calculated to determine the amount of compensation to be paid by the incoming partner to the sacrificing partners.	It is calculated to determine the amount of compensation to be paid by each of the continuing partners to the outgoing partner.
3. How to calculate?	It is calculated by taking out the difference between Old Share and New Share.	It is calculated by taking out the difference between New Share and Old Share.
4. When to calculate?	It is calculated at the time of admission of a new partner and change in profit sharing ratio.	It is calculated at the time of retirement or death of a partner and change in profit sharing ratio.

ILLUSTRATION 1

X, Y and Z are partners sharing profits in the ratio of $1/2 : 3/10 : 1/5$. Calculate the new profit sharing ratio and gaining ratio (a) If X retires (b) If Y retires (c) If Z retires.

SOLUTION

Let us convert the old ratio given in the form of fractions into one consisting of whole numbers, $1/2 : 3/10 : 1/5 = 5 : 3 : 2$.

New Ratio In such case, new ratio will be the same as the old ratio which existed between the remaining partners since the remaining partners continue to share the future profits and losses in the old ratio as existed immediately before the going out of a partner unless agreed otherwise.

Thus, the new ratio will be as under:

(a) between Y & Z	3 : 2
(b) between X & Z	5 : 2
(c) between X & Y	5 : 3

Gaining Ratio In such a case, gaining ratio will be the same as the old ratio which existed between the remaining partners since the remaining partners gain in their old ratio unless agreed otherwise.

Thus, the gaining ratio will be as under: —

(a) between Y & Z	3 : 2
(b) between X & Z	5 : 2
(c) between X & Y	5 : 3

ILLUSTRATION 2

X, Y & Z are partners sharing profits and losses in the ratio of $1/5, 1/3$ and $7/15$ respectively. Z retires and his share is taken up by X and Y in the ratio of 3 : 2. Calculate the new profit sharing ratio and the gaining ratio.

SOLUTION

New Share of Remaining Partner = Old Share + Share acquired

$$\text{Share acquired by X} = \frac{3}{5} \times \frac{7}{15} = \frac{21}{75}, \text{ Share acquired by Y} = \frac{2}{5} \times \frac{7}{15} = \frac{14}{75}$$

$$\text{X's New Share} = \frac{1}{5} + \frac{21}{75} = \frac{36}{75}, \text{ Y's New Share} = \frac{1}{3} + \frac{14}{75} = \frac{39}{75}$$

$$\text{Hence, New Ratio of X and Y} = \frac{36}{75} : \frac{39}{75} = 12 : 13$$

Gaining Ratio of X and Y = Share acquired by X : Share acquired by Y

$$= \frac{21}{75} : \frac{14}{75} = 21 : 14 = 3 : 2$$

ILLUSTRATION 3

X, Y & Z are partners sharing, profits and losses in the ratio of 1/2, 3/10 and 1/5 respectively. Y retires from the firm and X and Z decide to share future profits and losses in the ratio of 3 : 2. Calculate the gaining ratio.

SOLUTION

Gain of a Partner = New Share – Old Share

$$\text{X's Gain} = \frac{3}{5} - \frac{1}{2} = \frac{1}{10}, \text{Z's Gain} = \frac{2}{5} - \frac{1}{5} = \frac{2}{10}$$

Hence, Gaining Ratio of X & Z = $\frac{1}{10} : \frac{2}{10} = 1 : 2$

ILLUSTRATION 4

W, X, Y & Z are partners sharing profits and losses in the ratio of 1/3, 1/6, 1/3 and 1/6 respectively. Y retires and W, X & Z decide to share the profits and losses equally in future. Calculate the gaining ratio.

SOLUTION

Gain of a Partner = New Share – Old Share

$$\text{W's Gain} = \frac{1}{3} - \frac{1}{3} = 0, \text{X's Gain} = \frac{1}{3} - \frac{1}{6} = \frac{1}{6}, \text{Z's Gain} = \frac{1}{3} - \frac{1}{6} = \frac{1}{6}$$

Hence, Gaining Ratio of X & Z = 1 : 1

ILLUSTRATION 5

X, Y & Z are partners sharing profits and losses in the ratio of 2/5, 2/5 & 1/5 respectively. Z retires and X & Y decide to share the future profits & losses in the ratio of 2 : 1 respectively. Calculate the gaining ratio.

SOLUTION

Gain (Sacrifice) of a Partner = New Share – Old Share

$$\text{X's Gain} = \frac{2}{3} - \frac{2}{5} = \frac{4}{15}, \text{Y's Sacrifice} = \frac{1}{3} - \frac{2}{5} = \frac{1}{15}$$

In this case, Only X is gaining partner. Z has sacrificed his 1/5th share and Y has also sacrificed his share to the extent of 1/15 in favour of X who is required to compensate Z and Y for such sacrifice.

ILLUSTRATION 6

X, Y and Z are partners sharing the profits & losses in the ratio of 25 : 15 : 9. Y retires. It is decided that the profit sharing ratio between X and Z will be the same as existing between Y and Z. Calculate the new profit sharing ratio and gaining ratio.

SOLUTION

$$\text{Ratio of Y and Z} = 15 : 9 = 5 : 3$$

Therefore, New Ratio of X & Z should be 5 : 3

Gain of a Partner = New Share – Old Share

$$X's \text{ Gain} = \frac{5}{8} - \frac{25}{49} = \frac{45}{392}, Z's \text{ Gain} = \frac{3}{8} - \frac{9}{49} = \frac{75}{392}$$

Hence, Gaining Ratio of X and Z = $\frac{45}{392} : \frac{75}{392} = 3 : 5$

ILLUSTRATION 7

X, Y and Z are partners sharing profits & losses in the ratio of 4/9 : 1/3 : 2/9. Y retires and surrenders 1/9th of his share in favour of X and the remaining in favour of Z. Calculate the new profit sharing ratio and the gaining ratio.

SOLUTION**CALCULATION OF NEW RATIO**

Particulars	x	z
A. Their existing shares	4/9	2/9
B. Share surrendered by Y	$1/9 \times 1/3 = 1/27$	$8/9 \times 1/3 = 8/27$
C. New Share of remaining partner (A + B)	13/27	14/27
D. New Ratio of X and Z = 13 : 14		

$$\text{Share surrendered in favour of X} = \frac{1}{9} \times \frac{1}{3} = \frac{1}{27}$$

$$\text{Share surrendered in favour of Z} = \frac{8}{9} \times \frac{1}{3} = \frac{8}{27}$$

Hence, Gaining Ratio of X and Z = $\frac{1}{27} : \frac{8}{27} = 1 : 8$

$$\text{New Share} = \text{Old Share} + \text{Share acquired}$$

$$X's \text{ New Share} = \frac{4}{9} + \frac{1}{27} = \frac{13}{27}, Y's \text{ New Share} = \frac{2}{9} + \frac{8}{27} = \frac{14}{27}$$

$$\text{New Ratio of X and Z} = \frac{13}{27} : \frac{14}{27} = 13 : 14$$

ILLUSTRATION 8

X, Y and Z are partners sharing profits in the ratio of 4/9 : 1/3 : 2/9. Y retires and surrenders 1/9th from his share in favour of X and the remaining in favour of Z. Calculate the new profit sharing ratio and the gaining ratio.

SOLUTION

$$\text{Share surrendered by Y in favour of X} = 1/9$$

$$\text{Share surrendered by Y in favour of Z} = 3/9 - 1/9 = 2/9$$

Hence, Gaining Ratio of X and Z = $1/9 : 2/9 = 1 : 2$

$$X's \text{ New share} = \frac{4}{9} + \frac{1}{9} = \frac{5}{9},$$

$$Z's \text{ New share} = \frac{2}{9} + \frac{2}{9} = \frac{4}{9}$$

$$\text{New Ratio of X and Z} = \frac{5}{9} : \frac{4}{9} = 5 : 4$$

ILLUSTRATION 9

X, Y & Z share profits and losses in the ratio of $\frac{1}{2}$, $\frac{3}{10}$ & $\frac{1}{5}$ respectively. Y retires and his share is taken up by X & Z in the ratio of 2 : 1. Then immediately, W is admitted for $\frac{1}{4}$ th share of profits, half of which was gifted by X and the remaining share was taken by W equally from X & Z. Calculate the new profit sharing ratio after W's admission.

SOLUTION

Particulars	x	z
A. Their existing shares	$\frac{1}{2}$	$\frac{1}{5}$
B. Share acquired by remaining partners	$\frac{2}{3} \times \frac{3}{10} = \frac{2}{10}$	$\frac{1}{3} \times \frac{3}{10} = \frac{1}{10}$
C. New shares of remaining partners (A + B)	$\frac{7}{10}$	$\frac{3}{10}$
D. Share gifted by X	$\frac{1}{2} \times \frac{1}{4} = \frac{1}{8}$	—
E. Share acquired by W (other than gift)	$\frac{1}{2} \times \frac{1}{8} = \frac{1}{16}$	$\frac{1}{2} \times \frac{1}{8} = \frac{1}{16}$
F. New Shares (C – D – E)	$\frac{41}{80}$	$\frac{19}{80}$
G. New Ratio, of X, Z & W = $\frac{41}{80} : \frac{19}{80} : \frac{20}{80} = 41 : 19 : 20$		

ILLUSTRATION 10

X, Y, & Z share profits and losses in the ratio of 4 : 3 : 2 respectively. Y retires and X & Z decide to share future profits & losses in the ratio of 5 : 3. Then W is admitted for $\frac{3}{10}$ th share of profits half of which was gifted by X and the remaining share was taken by W equally from X & Z. Calculate the gaining ratio of X & Z on Y's retirement and the new profit sharing ratio after W's admission.

SOLUTION**CALCULATION OF GAINING RATIO OF X & Z**

$$\text{X's Gain} = \frac{5}{8} - \frac{4}{9} = \frac{13}{72}, \text{ Z's Gain} = \frac{3}{8} - \frac{2}{9} = \frac{11}{72}$$

Hence, Gaining Ratio of X & Z = $\frac{13}{72} : \frac{11}{72} = 13 : 11$

CALCULATION OF NEW RATIO OF X, Z & W

Particulars	x	z
A. Their new shares after retirement	$\frac{5}{8}$	$\frac{3}{8}$
B. Gifted by X	$\frac{1}{2}$ of $\frac{3}{10} = \frac{3}{20}$	—
C. Share acquired by W (other than gift)	$\frac{1}{2}$ of $\frac{3}{20} = \frac{3}{40}$	$\frac{1}{2}$ of $\frac{3}{20} = \frac{3}{40}$
D. New Shares after W's admission (A – B – C)	$\frac{16}{40}$	$\frac{12}{40}$
E. New Ratio of X, Z & W = $\frac{16}{40} : \frac{12}{40} : \frac{12}{40} = 16 : 12 : 12 = 4 : 3 : 3$		

4.0 ADJUSTMENT OF GOODWILL

Why is Adjustment of Goodwill required?	When an existing partner of a firm decides to retire from the firm, the continuing partner(s) will gain in future profits. The continuing partner who gains by acquiring an additional right to share future profits must compensate the outgoing partner who sacrifices by foregoing his right to share future profits.

Step 1: Write off the Existing Book Value of Goodwill (if any) appearing in the books of the firm.

All Partners' Capital A/cs	Dr.
[In Old Ratio]	
To Goodwill A/c	[With Existing Book Value of Goodwill]

(Being the existing goodwill written off in Old Ratio)

Step 2: Give credit for Outgoing Partner's Share of Goodwill to Outgoing Partner

Gaining Partners' Capital A/cs	Dr.
[In Gaining Ratio]	
To Outgoing Partner's Capital A/c	
[With his Share of Goodwill]	

(Being the adjustment made for goodwill on retirement)

Step 3: If any Existing Partner (other than Outgoing Partner) is also sacrificing his share, a separate entry to adjust proportionate Goodwill should be passed as follows:

Gaining Partner's Capital A/cs	Dr.
[In Gaining Ratio]	
To Sacrificing Partner's Capital A/c	
	[Firm's Goodwill × Share Sacrificed]

X, Y & Z are partners sharing profits & losses in the ratio of 4 : 3 : 2. Y retires and the goodwill of the firm is valued at ₹ 21,600. Goodwill account already appears in the books at ₹ 9,000. Assuming that X and Z will share the future profits in the ratio of 5 : 3, pass the necessary journal entries.

JOURNAL

Particulars		L.F.	Dr. (₹)	Cr (₹)
X's Capital A/c	Dr.		4,000	9,000
Y's Capital A/c	Dr.		3,000	
Z's Capital A/c	Dr.		2,000	
To Goodwill A/c				
(Being the existing goodwill written off in old ratio)				
X's Capital A/c [₹ 7,200 × 13/24]	Dr.		3,900	7,200
Z's Capital A/c [₹ 7,200 × 11/24]	Dr.		3,300	
To Y's Capital A/c [₹ 21,600 × 3/9]				
(Being Y's share of goodwill adjusted in the capital accounts of gaining partners in their gaining ratio of 13 : 11)				

Working Note: Calculation of Gaining Ratio

Gain of a Partner = New Share – Old Share

$$A \text{ gains} = \frac{5}{8} - \frac{4}{9} = \frac{13}{72} \quad B \text{ gains} = \frac{3}{8} - \frac{2}{9} = \frac{11}{72}$$

$$\text{Gaining Ratio} = \frac{13}{72} : \frac{11}{72} \text{ or } 13 : 11.$$

ILLUSTRATION 12

X, Y and Z are partners sharing profits & losses in the ratio of 14 : 5 : 6 respectively. Y retires and surrenders 5/25th of his share in favour of X. The goodwill of the firm is valued at 2 years' purchase of super profits based on average of last 3 years. The profits for the last 3 years are: ₹ 50,000, ₹ 55,000, ₹ 60,000. The normal profits for similar firm are ₹ 30,000. Goodwill already appears in the books of the firm at ₹ 75,000. The profit for the first year after Y's retirement was ₹ 1,00,000. Give the necessary journal entries to adjust goodwill and to distribute profits.

SOLUTION**JOURNAL**

Particulars	L.F.	Dr. (₹)	Cr (₹)
X's, Capital A/c [₹ 75,000 × 14/25]	Dr.	42,000	
Y's Capital A/c [₹ 75,000 × 5/25]	Dr.	15,000	
Z's Capital A/c [₹ 75,000 × 6/25]	Dr.	18,000	
To Goodwill A/c			75,000
(Being the existing goodwill written off in old ratio)			
X's Capital A/c [₹ 10,000 × 1/5]	Dr.	2,000	
Z's Capital A/c [₹ 10,000 × 4/5]	Dr.	8,000	
To Y's Capital A/c [₹ 50,000 × 1/5]			10,000
(Being Y's share of goodwill adjusted in the capital accounts of gaining partners in their gaining ratio of 1 : 4)			
Profit & Loss Appropriation A/c	Dr.	1,00,000	
To X's Capital A/c [₹ 1,00,000 × 3/5]			60,000
To Z's Capital A/c [₹ 1,00,000 × 2/5]			40,000
(Being the profits distributed among X & Z in their new profit sharing ratio)			

Working Notes:**1. CALCULATION OF NEW PROFIT SHARING RATIO**

Particulars	X	Z
Their Old Shares	14/25	6/25
Share surrendered by Y	1/5 × 1/5 = 1/25	4/5 × 1/5 = 4/25
Their New Shares	14/25 × 1/25 = 1/25	6/25 × 4/25 = 10/25
Their Gaining Ratio 1/25 : 4/25 = 1:4		
Their New Ratio = 15/25 : 10/25 = 15:10 or 3:2		

2. CALCULATION OF GOODWILL

(i) Average Profits = (₹ 50,000 + ₹ 55,000 + ₹ 60,000)/3 = ₹ 55,000

(ii) Super Profits = ₹ 55,000 – ₹ 30,000 = ₹ 25,000

(iii) Goodwill = ₹ 25,000 × 2 = ₹ 50,000

(iv) Y's Share of Goodwill = ₹ 50,000 × 1/5 = ₹ 10,000

ILLUSTRATION 13

A, B, C & D are partners sharing profits and losses in the ratio of 3 : 3 : 2 : 2. D retires and A, B and C decide to share the future profits in the ratio of 3 : 2 : 1. Goodwill of the firm is valued at ₹ 3,00,000. Goodwill already appears in the books at ₹ 1,00,000. The profits for the first year after D's retirement amount to ₹ 6,00,000. Give the necessary journal entries to record Goodwill and to distribute the profits.

SOLUTION**JOURNAL**

Particulars	L.F.	Dr. (₹)	Cr (₹)
A's Capital A/c [₹ 1,00,000 × 3/10] Dr.		30,000	
B's Capital A/c [₹ 1,00,000 × 3/10] Dr.		30,000	
C's Capital A/c [₹ 1,00,000 × 2/10] Dr.		20,000	
D's Capital A/c [₹ 1,00,000 × 2/10] Dr.		20,000	
To Goodwill A/c			1,00,000
(Being the existing goodwill w/o in old ratio)			
A's Capital A/c Dr.		60,000	
B's Capital A/c Dr.		10,000	
To C's Capital A/c			10,000
To D's Capital A/c			60,000
(Being the adjustment for goodwill made on account of change in profit sharing ratio which resulted in loss of 6/30th to D, 1/30th to C and gain of 1/30th to B and 2/10th to A)			
Profit & Loss Appropriation A/c Dr.		6,00,000	
To A's Capital A/c [₹ 6,00,000 × 3/6]			3,00,000
To B's Capital A/c [₹ 6,00,000 × 2/6]			2,00,000
To C's Capital A/c [₹ 6,00,000 × 1/6]			1,00,000
(Being the amount of profit distributed among A & C in their new profit sharing ratio which is 3 : 2 : 1)			

ILLUSTRATION 14

A, B and C are partners sharing profits and losses in the ratio of 4 : 3 : 1. B retires selling his share of profit to A and C for ₹ 8,100—₹ 3,600 being paid by A and ₹ 4,500 by C. The profit for the year after B's retirement was ₹ 10,500. Give the necessary journal entries.

SOLUTION**JOURNAL**

Particulars	L.F.	Dr. (₹)	Cr (₹)
Bank A/c Dr.		8,100	
To A's Capital A/c			3,600
To C's Capital A/c			4,500
(Being the amount brought in by A and C to pay on his retirement)			

A's Capital A/c	Dr.		3,600	
C's Capital A/c	Dr.		4,500	
To B's Capital A/c				8,100
(Being B's share of goodwill adjusted in capital accounts of gaining partners in their gaining ratio of 12 : 15)				
B's Capital A/c	Dr.		8,100	
To Bank A/c				8,100
(Being the amount paid to B on his retirement for selling his share)				
Profit & Loss Appropriation A/c	Dr.		10,500	
To A's Capital A/c				7,000
To C's Capital A/c				3,500
(Being the amount of profit distributed among A & C in their new profit sharing ratio which is 2 : 1)				

Working Note: Calculation of New Profit Sharing Ratio

Gaining Ratio of A and C = 3,600 : 4,500 = 4 : 5

$$\text{Share acquired by A} = \frac{4}{9} \times \frac{3}{8} = \frac{12}{72}, \text{ Share acquired by C} = \frac{5}{9} \times \frac{3}{8} = \frac{15}{72}$$

$$\text{A's New Share} = \frac{4}{8} + \frac{12}{72} = \frac{48}{72}, \text{ C's New Share} = \frac{1}{8} + \frac{15}{72} = \frac{24}{72}$$

Hence, New Ratio of A & C = $\frac{48}{72} : \frac{24}{72} = 2 : 1$

ILLUSTRATION 15

X, Y and Z share profits and losses in the ratio of 4 : 3 : 2 respectively. Y retires and X and Z decide to share future profits & losses in the ratio of 5 : 3. Then immediately W is admitted for 3/10th share of profits half of which was gifted by X and the remaining share was taken by W equally from X and Z. The Goodwill of the firm is valued at ₹ 21,600. W brings in the required amount of goodwill. The profit for the year after W's admission was ₹ 24,000. Give the necessary journal entries to adjust goodwill and to distribute profits.

SOLUTION
JOURNAL

Particulars	L.F.	Dr. (₹)	Cr (₹)
X's Capital A/c	Dr.	3,900	
Z's Capital A/c	Dr.	3,300	
To Y's Capital A/c			7,200
(Being Y's share of goodwill adjusted in the capital accounts of gaining partners in their gaining ratio of 13 : 11)			
Cash A/c	Dr.	3,240	
To Premium for Goodwill A/c			3,240
(Being the amount of goodwill brought in by W for purchased share of profit (i.e. 3/20))			

Premium for Goodwill A/c To X's Capital A/c To Z's Capital A/c (Being the goodwill credited to sacrificing partners in their sacrificing ratio of 1 : 1)	Dr.		3,240	1,620 1,620
Profit & Loss Appropriation A/c To X's capital A/c To Z's Capital A/c To W's Capital A/c (Being the profit credited to all partners in their new profit sharing ratio of 4 : 3 : 3)	Dr.		24,000	9,600 7,200 7,200

Working Note: For calculation of gaining Ratio and New Ratio, Refer to Illustration 10.

5.0 HIDDEN GOODWILL

If the firm has agreed to settle the account of retiring/deceased partner by paying him a lump-sum amount, then amount paid to him in excess of his capital and share in reserves/revaluation account etc. shall be treated as his share of goodwill. **For Example**, X, Y and Z are partners. Z retires, his capital account, after making adjustments for reserves and profit on revaluation exists at ₹ 1,00,000. X and Y have agreed to pay him ₹ 1,50,000 in full settlement of his claim. It implies that ₹ 50,000 is Z's share in the goodwill of the firm. This will be treated by debiting ₹ 50,000 in the capital accounts of X and Y in their gaining ratio and crediting Z's capital account.

ILLUSTRATION 16

X, Y and Z are partners sharing profits in the ratio of 4 : 3 : 2. Y retires and his capital after making adjustments for reserves and profits on revaluation stands at ₹ 92,800. X and Z agreed to pay him ₹ 1,00,000 in full settlement of his claim. Record the necessary Journal entry for the treatment of goodwill if the new profit-sharing ratio is decided at 5 : 3.

SOLUTION

Particulars	₹
Amount agreed to be paid in full settlement	1,00,000
Less: C's Capital (after all adjustments)	92,800
Hidden Goodwill	7,200

JOURNAL

Particulars	L.F.	Dr. (₹)	Cr (₹)
X's Capital A/c Z's Capital A/c To Y's Capital A/c (Being Y's share of goodwill adjusted in the capital accounts of gaining partners in their gaining ratio of 13 : 11)	Dr. Dr. 	3,900 3,300 	7,200

Working Note: Calculation of Gaining Ratio

Gain of a Partner = New Share – Old Share

$$A \text{ gains} = \frac{5}{8} - \frac{4}{9} = \frac{13}{72}; \quad B \text{ gains} = \frac{3}{8} - \frac{2}{9} = \frac{11}{72}.$$

$$\text{Gaining Ratio} = \frac{13}{72} : \frac{11}{72} \text{ or } 13 : 11.$$

6.0 REVALUATION OF ASSETS AND LIABILITIES

Why is Adjustment Required?	At the time of retirement of a partner, the Assets and Liabilities are revalued so that the due share of an outgoing partner in the profit/loss arising from such revaluation may be ascertained and adjusted in his Capital Account.
Accounting Treatment	For this purpose, a Revaluation Account (<i>or alternatively, Profit & Loss Adjustment Account</i>) is prepared exactly in the same manner as explained earlier in Chapter with regard to admission of a partner. Its balance is transferred to the Capital Accounts of All the Partners (including the Outgoing Partner) in their Old Profit Sharing Ratio.

ILLUSTRATION 17

The Balance sheet of A, B and C sharing profits & losses in the ratio of 5 : 3 : 2, on 31st March, 2018 was as under:

Liabilities	₹	Assets	₹
A's Capital	46,000	Land & Building	30,000
B's Capital	34,000	Plant & Machinery	35,000
C's Capital	25,000	Stock	12,800
Creditors	15,600	Debtors	₹ 16,000
		Less: Provision	₹ 800
		Cash & Bank	27,600
	1,20,000		1,20,000

On the same **Date**, B retires from the firm and A and C decide to share future profits and losses in the ratio of 3 : 2 respectively. The following adjustments were agreed upon:—

- that an amount of ₹ 1,100 included in Sundry Debtors be written off as no longer receivable;
- that a Provision for Doubtful Debts be maintained at an existing rate;
- that Stock be written down by ₹ 1,055;
- that Land and Building be written up by ₹ 11,500;
- that Plant & Machinery be reduced to ₹ 34,000;
- that an amount of ₹ 700 included in Sundry Creditors be written back as no longer payable;
- that provision of ₹ 600 be made for an outstanding repair bill;
- that B's Capital Account is to be transferred to his Loan Account.

Required: Pass the necessary journal entries and prepare the Revaluation Account.

SOLUTION

JOURNAL

Particulars	L.F.	Dr. (₹)	Cr (₹)
Bad Debts A/c Dr. To Debtors A/c (Being the bad debts written off)		1,100	1,100
Provision for Doubtful Debts A/c Dr. Revaluation A/c Dr. To Bad debts A/c (Being the balance in Bad Debts A/c transferred)		800 300	1,100

Revaluation A/c To Stock A/c (Being the fall in value of stock recorded)	Dr.		1,055	1,055
Land & Building A/c To Revaluation A/c (Being an increase in value of building recorded)	Dr.		11,500	11,500
Revaluation A/c To Plant & Machinery A/c (Being the fall in value of plant recorded)	Dr.		1,000	1,000
Sundry Creditors A/c To Revaluation A/c (Being the fall in amount of creditors recorded)	Dr.		700	700
Revaluation A/c To Outstanding Repairs A/c (Being an unrecorded liability provided for)	Dr.		600	600
Revaluation A/c To Provision for Doubtful Debts A/c (Being the provision created @ 5% on ₹ 14,900 i.e. ₹ 16,000 – ₹ 1,100)	Dr.		745	745
Revaluation A/c To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of net profit on revaluation)	Dr.		8,500	4,250 2,550 1,700

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Bad Debts	300	By Land & Building	11,500
To Stock	1055	By Sundry Creditors	700
To Plant & Machinery	1,000		
To Provision for Doubtful Debt.	745		
To Outstanding Repairs	600		
To Profit on Revaluation t/f to:			
A's Capital A/c	4,250		
B's Capital A/c	2,550		
C's Capital A/c	1,700		
	12,200		12,200

7.0 ADJUSTMENT FOR RESERVES AND ACCUMULATED PROFITS/LOSSES**WHY IS ADJUSTMENT FOR RESERVES AND ACCUMULATED PROFITS/LOSSES REQUIRED?**

If, at the time of retirement of a partner, any reserves, accumulated profits or losses exist in the books of the firm, these should be transferred to the **Capital Accounts of All the Partners (including Outgoing**

Partner) in their Old Profit Sharing Ratio so that the due share of an outgoing partner in the reserves, accumulated profits/losses upto the **Date** of retirement gets adjusted in his Capital Account.

ACCOUNTING TREATMENT OF RESERVES AND ACCUMULATED PROFITS/LOSSES

1. For transfer of Reserves and Accumulated Profits			
General Reserve			Dr.
P & L A/c			Dr.
Workmen Compensation Reserve	[Excess of Reserve over liability]		Dr.
Investment Fluctuation Reserve	[Excess of Reserve over difference between Book value and Market value]		Dr.
To All Partners' Capital A/cs	(Individually in their Old Profit Sharing Ratio)		
2. For transfer of Accumulated Losses [e.g. Profit & Loss Account (Dr Balance)]			
All Partners' Capital A/cs	Dr.	[Individually in their Old Profit Sharing Ratio]	
To Profit & Loss A/c			
To Deferred Revenue Expenditure A/c			

TUTORIAL NOTES

1. Reserves, Accumulated Profits/Losses should always be distributed even if the question is silent.
2. Workmen Compensation Reserve (say ₹ 1,200) to the extent of liability (say ₹ 150) should be credited to Workmen Compensation Claim A/c and the balance of Workmen Compensation Reserve (₹ 1,050) should be credited to Partners' Capital Accounts.
3. Excess of Investment Fluctuation Reserve over difference between Book Value and Market Value is credited to partners in Profit Sharing Ratio.
4. Machinery Replacement Fund is in the nature of accumulated depreciation and not in nature of accumulated profits and hence is not distributed among the partners.
5. Employees' Provident Fund represents statutory liability due to employees towards Provident Fund and is not an accumulated profit, hence it is not distributed among the partners.

ILLUSTRATION 18

X, Y and Z are partners in a firm sharing profits and losses in the ratio of 5 : 3 : 2. Z retires from the firm on 31st March, 2018. On the **Date** of Z's retirement, the following balances appeared in the books of the firm:

1. General Reserve ₹ 10,000; Profit and Loss Account (Dr.) ₹ 5,000.
2. Workmen's Compensation Reserve ₹ 20,000 out of which a liability of ₹ 8,000 is to be provided
3. Employees' Provident Fund ₹ 60,000.

Required: Pass the necessary Journal entries for the adjustment of these items on Z's retirement.

SOLUTION

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
31.03.2018	General Reserve ...Dr.		10,000	
	To X's Capital A/c			5,000
	To Y's Capital A/c			3,000
	To Z's Capital A/c			2,000
	(Being the transfer of General Reserve to all partners)			

31.03.2018	X's Capital A/c	...Dr.	2,500	
	Y's Capital A/c	...Dr.	1,500	
	Z's Capital A/c	...Dr.	1,000	
	To Profit and Loss A/c			5,000
	(Being the transfer of accumulated loss to all partners)			
31.03.2018	Workmen's Compensation Reserve	...Dr.	20,000	
	To Liability for Workmen Compensation A/c			8,000
	To X's Capital A/c			6,000
	To Y's Capital A/c			3,600
	To Z's Capital A/c			2,400
	(Being the Workmen's Compensation Reserve transferred to Capital Accounts on Z's retirement)			

Note: Employees Provident Fund is a statutory liability and is not an accumulated profit and hence is not distributed among the partners.

ILLUSTRATION 19

On 31st March, 2018, the Balance Sheet of M/s. A, B and C, sharing profits and losses in proportion to their capitals, stood as:

Liabilities	₹	Assets	₹
Creditors	1,08,000	Cash at Bank	80,000
Capital A/cs:		Debtors	1,00,000
A	4,50,000	Less: Pro. for Doubtful Debts	2,000
B	3,00,000	Stock	90,000
C	1,50,000	Machinery	2,40,000
		Land and Building	5,00,000
	10,08,000		10,08,000

On that Date, B retires from the firm and the remaining partners decide to carry on. The following readjustments of Assets and Liabilities have been agreed upon before the ascertainment of the amount payable to B:

- That out of the fire insurance premium paid during the year, ₹ 10,000 be carried forward as unexpired.
- That the Land and Building be appreciated by 10%.
- That the Provision for Doubtful Debts be brought up to 5% Debtors.
- That Machinery be depreciated by 5%.
- That a provision of ₹ 15,000 be made in respect of an outstanding bill for repairs.
- That the Goodwill of the entire firm be fixed at ₹ 1,80,000 and B's share of the same be adjusted in the accounts of A and C who share the future profits in the proportion of 3/4th and 1/4th respectively (no Goodwill Account being raised).
- That B be paid ₹ 50,000 in cash and the balance be transferred to his Loan Account.

Required: Prepare the Revaluation Account, Capital Accounts of Partners and the Balance Sheet of the firm of A and C.

SOLUTION

Dr.

REVALUATION ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Provision for Doubtful Debts A/c (₹ 5,000 – ₹ 2,000)	3,000	By Unexpired Fire Insurance Premium A/c	10,000
To Depreciation on Machinery A/c [2,40,000 × 5/100]	12,000	By Land and Building A/c [5,00,000 × 10/100]	50,000
To Provision for Outstanding Repairs A/c	15,000		
To Profit transferred to:			
A's Capital A/c	15,000		
B's Capital A/c	10,000		
C's Capital A/c	5,000		
	30,000		
	60,000		60,000

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

<i>Particulars</i>	A (₹)	B (₹)	C (₹)	<i>Particulars</i>	A (₹)	B (₹)	C (₹)
To B's Capital A/c	45,000	—	15,000	By Balance b/d	4,50,000	3,00,000	1,50,000
To Bank A/c	—	50,000	—	By Revaluation A/c	15,000	10,000	5,000
To B's Loan A/c – Transfer	—	3,20,000	—	By A's Capital A/c	—	45,000	—
To Balance c/d	4,20,000	—	1,40,000	By C's Capital A/c	—	15,000	—
	4,65,000	3,70,000	1,55,000		4,65,000	3,70,000	1,55,000

BALANCE SHEET OF A AND C AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Creditors	1,08,000	Cash at Bank	30,000
Outstanding Bill for Repairs	15,000	Stock	90,000
B's Loan	3,20,000	Debtors	1,00,000
Capital A/cs:		Less: Provision	5,000
A	4,20,000	Unexpired Fire Insurance	10,000
C	1,40,000	Machinery	2,40,000
		Less: Depreciation	12,000
		Land and Building	5,00,000
		Add: Appreciation	50,000
	10,03,000		10,03,000

Note: B's Share of Goodwill has been debited to A and C in their gaining ratio i.e. 3 : 1.

ILLUSTRATION 20

X, Y and Z were partners in a firm sharing profits in the proportions of 1/2, 1/3 and 1/6 respectively. The Balance Sheet of the firm on 31st March, 2018 was as follows:

Liabilities	₹	Assets	₹
Trade Creditors	15,000	Goodwill	6,000
Employees' Provident Fund	6,000	Cash at Bank	5,750
Workmen Compensation Fund	12,000	Debtors	40,000
Investment Fluctuation Fund	6,000	Less: Provision	2,000
X's Capital	68,000	Stock	30,000
Y's Capital	32,000	Investments [Market Value ₹ 17,600]	15,000
Z's Capital	21,000	Patents	10,000
		Plant and Machinery	50,000
		Advertisement Expenditure	5,250
	1,60,000		1,60,000

Z retired on the above **Date** on the following terms.

- Goodwill of the firm was valued at ₹ 34,800 but it was not to remain in the books of the new firm.
- Value of Patents was to be reduced by 20% and that of Plant and Machinery to 90%.
- Provision for doubtful debts was to be raised to 6%.
- Z took over the investments at market value.
- Liability on account of Provident Fund was only ₹ 2,775.
- Liability for workmen compensation to the extent of ₹ 750 is to be created.
- Trade Creditors to the extent of 2½% are not likely to claim their dues.
- Amount due to Z is to be settled on the following basis:
50% on retirement, 50% of the balance within one year and the balance by a Bill of Exchange (without interest) at 3 months.

Required: Show the necessary journal entries for the treatment of Goodwill, prepare Revaluation account, Capital accounts of the partners and the Balance Sheet of X and Y after Z's retirement.

SOLUTION**JOURNAL**

Particulars	L.F.	Dr. (₹)	Cr (₹)
X's Capital A/c	Dr.	3,000	
Y's Capital A/c	Dr.	2,000	
Z's Capital A/c	Dr.	1,000	
To Goodwill A/c			6,000
(Being the existing book value of goodwill w/o)			
X's Capital A/c	Dr.	3,480	
Y's Capital A/c	Dr.	2,320	
To Z's Capital A/c			5,800
(Being the Z's share of goodwill credited to him by debiting gaining partners in their gaining ratio of 3 : 2)			

Dr.
REVALUATION ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Patents	2,000	By Investments	2,600
To Plant & Machinery	5,000	By Provident fund	3,225
To Provision for Doubtful debts	400	By Creditors	375
		By Loss on Revaluation t/f to:	
		X's Capital A/c	600
		Y's Capital A/c	400
		Z's Capital A/c	200
	7,400		7,400

Dr.
PARTNERS' CAPITAL ACCOUNTS
Cr.

<i>Particulars</i>	X ₹	Y ₹	Z ₹	<i>Particulars</i>	X ₹	Y ₹	Z ₹
To Goodwill A/c	3,000	2,000	1,000	By Balance b/d	68,000	32,000	21,000
To Z's Capital A/c	3,480	2,320	—	By Work Com. F.	5,625	3,750	1,875
To Revaluation A/c	600	400	200	By Invest. Fluc. Fund	3,000	2,000	1,000
To Advertisement Exp.	2,625	1,750	875	By X's Capital A/c	—	—	3,480
To Investment A/c	—	—	17,600	By Y's Capital A/c	—	—	2,320
To Bank A/c	—	—	5,000				
To Loan from Z A/c	—	—	2,500				
To Bills Payable A/c	—	—	2,500				
To Balance c/d	66,920	31,280	—				
	76,625	37,750	29,675		76,625	37,750	29,675

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Trade Creditors	14,625	Cash at Bank [₹ 5,750 – ₹ 5,000]	750
Liability for Workmen Compensation	750	Debtors	40,000
Provident Fund	2,775	Less: Provision	2,400
Bill Payable	2,500	Stock	30,000
Loan from Z	2,500	Patents	8,000
X's Capital	66,920	Plant & Machinery	45,000
Y's Capital	31,280		
	1,21,350		1,21,350

ILLUSTRATION 21

The Balance Sheet of X, Y and Z sharing profits and losses in the ratio of 5 : 3 : 2 on 31st December, 2017 is given below:

Liabilities	₹	Assets	₹
Sundry Creditors	6,000	Goodwill	5,000
Employees' Provident Fund	3,000	Patents	26,000
Investment Fluctuation Reserve	3,500	Machinery	31,200
Workmen Compensation Reserve	3,500	Investments	3,000
X's Capital	67,500	Stock	10,000
Y's Capital	47,500	Sundry Debtors	12,000
Z's Capital	37,000	Less: Provision	2,000
		Loan to Z	500
		Cash at Bank	300
		Advertisement Expenditure	1,000
		Profit & Loss A/c (2017)	75,000
		Z's Drawings	6,000
	1,68,000		1,68,000

Z retires from 1st Jan., 2018 and X and Y decide to share future profits losses in the ratio of 3:5. It was agreed that:

- Goodwill be valued at 2-1/2 years' purchase of average of four completed years' profits which were: 2014 ₹ 1,01,000; 2015 ₹ 14,000; 2016 ₹ 16,000.
- Patents undervalued by ₹ 7,000, Machinery overvalued by ₹ 6,800, All Debtors are good. ₹ 500 included in Sundry Creditors is not likely to arise. Unaccounted Accrued Income of ₹ 1,100 to be provided for. A debtor whose dues of ₹ 200 were written off as bad debts paid 50% in full settlement. A claim of ₹ 500 on account of workmen's compensation to be provided for.
- Investments be sold for ₹ 4,100 and a sum of ₹ 5,600 be paid to Z immediately. The remainder to be paid in four equal half-yearly instalments together with interest @ 10% p.a. at half-yearly rest.

Prepare Revaluation Account, Capital Account of Partners and the Balance Sheet of New Firm.

SOLUTION

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Machinery	6,800	By Sundry Creditors	500
To Profit transferred to:		By Accrued Income	1,100
X's Capital A/c	2,500	By Bad Debts Recovered	100
Y's Capital A/c	1,500	By Patents	7,000
Z's Capital A/c	1,000	By Provision for Doubtful Debts	2,000
	5,000	By Investments	1,100
	11,800		11,800

Dr.
PARTNERS' CAPITAL ACCOUNTS
Cr.

<i>Particulars</i>	<i>X (₹)</i>	<i>Y (₹)</i>	<i>Z (₹)</i>	<i>Particulars</i>	<i>X (₹)</i>	<i>Y (₹)</i>	<i>Z (₹)</i>
To Drawings A/c	—	—	6,000	By Balance b/d	67,500	47,500	37,000
To Goodwill A/c	2,500	1,500	1,000	By Revaluation A/c	2,500	1,500	1,000
To P & L A/c	37,500	22,500	15,000	By Y's Capital A/c	4,375	—	7,000
To Z's Capital A/c	—	7,000	—	By Invest. F. Res.	1,750	1,050	700
To X's Capital A/c	—	4,375	—	By Work. Comp. Res.	1,500	900	600
To Loan to Z A/c	—	—	500				
To Adv. Exp.	500	300	200				
To Bank A/c	—	—	5,600				
To Z's Loan A/c	—	—	18,000				
To Balance c/d	37,125	15,275	—				
	77,625	50,950	46,300		77,625	50,950	46,300

BALANCE SHEET OF NEW FIRM AS AT 1ST JAN, 2018

<i>Liabilities</i>	<i>₹</i>	<i>Assets</i>	<i>₹</i>
Sundry Creditors	5,500	Patents	33,000
Employees' Provident Fund	3,000	Machinery	24,400
Z's Loan Account	18,000	Stock	10,000
X's Capital	37,125	Sundry Debtors	12,000
Y's Capital	15,275	Accrued Income	1,100
Bank Overdraft	1,100		
Workmen's Compensation Claim	500		
	80,500		80,500

Working Notes:

1. X's sacrifice = $3/8 - 5/10 = (5/40)$, Y's gain = $5/8 - 3/10 = 13/40$
2. Firm's Goodwill = $[(1,01,000 + 14,000 + 16,000 - 75,000)/4] \times 2.5 = ₹ 35,000$
3. Z's Share of Goodwill = $₹ 35,000 \times 2/10 = ₹ 7,000$
4. X's Share of Goodwill = $₹ 35,000 \times 5/40 = ₹ 4,375$

Dr.
5. CASH AT BANK ACCOUNT
Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Balance b/d	300	By Z's Capital A/c	5,600
To Investments	4,100		
To Bad Debts Recovered	100		
To Balance c/d (b.f.)	1,100		
	5,600		5,600

8.0 ADJUSTMENT OF CAPITALS

The capitals of the continuing partners may be required to be adjusted in any one of the following three ways:

1. WHEN THE TOTAL CAPITAL OF THE NEW FIRM IS GIVEN

The various steps involved in adjusting the capitals of the partners are given below:

**PRACTICAL STEPS INVOLVED IN ADJUSTING THE CAPITALS
[WHEN THE TOTAL CAPITAL OF THE NEW FIRM IS GIVEN]**

Step 1: Calculate New Profit Sharing Ratio & Gaining Ratio of Continuing Partners (if not given)			
Step 2: Calculate the Adjusted Old Capitals of Continuing Partners as follows:			
Particulars	A	B	C
Old Capital before Adjustments	xxx	xxx	xxx
Share of Goodwill Credited (Debited)	xxx	xxx	xxx
Share of Profit (Loss) on Revaluation	xxx	xxx	xxx
Share of Reserve and Accumulated Profit (Loss)	xxx	xxx	xxx
	xxx	xxx	xxx
Step 3: Calculate the New Capitals of Continuing Partners as follows: = Total Capital of New Firm × New Share of Continuing Partner			
Step 4: Calculate the Shortage to be brought in or Surplus to be paid off as follows: = New Capital – Adjusted Old Capital			
Step 5: Pass a Journal Entry in Case the Adjusted Old Capital is less than the New Capital (i.e. Shortage to be brought in) Cash A/c or Concerned Partner's Current A/c Dr. To Concerned Partner's Capital A/c or			
Step 6: Pass a Journal Entry in Case the Adjusted Old Capital is more than the New Capital (i.e. Surplus to be paid off) Concerned Partner's Capital A/c Dr. To Cash A/c or Concerned Partner's Current A/c			

Tutorial Note: In the absence of any contract Surplus or Deficiency should be adjusted in Cash and not by transferring it to Current Account.

ILLUSTRATION 22

A, B & C were partners sharing profits and losses in the ratio of 4 : 3 : 2 respectively. B retired on 31st March, 2018 when the capitals of A, B & C before the necessary adjustments stood at ₹ 21,950, ₹ 11,400 & ₹ 11,650 respectively. Firm's Goodwill ₹ 21,600, Loss on Revaluation of **Assets & Liabilities** ₹ 2,700. General Reserve ₹ 6,300. The entire capital of the newly constituted firm is fixed at ₹ 28,000 between A and C in the proportion of five-eighths and three-eighths after passing entries in their accounts for adjustments. Calculate the actual cash to be paid off or to be brought in by the continuing partners and pass the necessary journal entries.

SOLUTION

Step 1: Calculation of Gaining Ratio: Gain of a Partner = New Share – Old Share

$$\text{A gains} = \frac{5}{8} - \frac{4}{9} = \frac{13}{72};$$

$$\text{C gains} = \frac{3}{8} - \frac{2}{9} = \frac{11}{72}.$$

$$\text{Gaining Ratio} = \frac{13}{72} : \frac{11}{72} \text{ or } 13 : 11.$$

STEP 2: ADJUSTED OLD CAPITALS

Old Capital before Adjustments	21,950	11,400	11,650
Share of Goodwill in 13:11	(3,900)	7,200	(3,300)
Share of Loss on Revaluation in 4:3:2	(1,200)	(900)	(600)
Share of General Reserve in 4:3:2	2,800	2,100	1,400
Adjusted Old Capital	19,650	19,800	9,150

STEP 3: CALCULATION OF SHORTAGE TO BE BROUGHT IN or SURPLUS TO BE PAID OFF

<i>Particulars</i>	<i>A</i>	<i>C</i>
I. New Capital (₹ 28,000 in the ratio of 5 : 3)	₹ 17,500	₹ 10,500
II. Adjusted Old Capital	19,650	9,150
III. Cash to be brought in (paid off) (I – II)	(2,150)	1,350

STEP 4: JOURNAL

<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr (₹)</i>
A's Capital A/c Dr. To Cash A/c (Being the excess withdrawn by A)		2,150	2,150
Cash A/c Dr. To C's Capital A/c (Being the shortage brought in by C)		1,350	1,350

ILLUSTRATION 23

The Balance Sheet of A, B and C who were sharing profits in proportion to their capitals, stood as follows on 31st March 2018:

<i>Liabilities</i>	<i>₹</i>	<i>Assets</i>	<i>₹</i>
Sundry Creditors	6,000	Goodwill	9,000
Employees' Provident Fund	900	Cash at Bank	5,500
A's Capital A/c	20,000	Sundry Debtors	5,000
B's Capital A/c	15,000	Less: Provision	100
C's Capital A/c	10,000	Stock	8,000
Workmen Compensation Reserve	9,900	Plant & Machinery	8,500
		Factory Land & Building	25,000
		Advertisement Expenditure A/c	900
	61,800		61,800

B retires and the following re-adjustments of the Assets and Liabilities have been agreed upon before the ascertainment of the amount payable by the firm to B:

- That the Stock be depreciated by 6 per cent.
- That the Provision for doubtful debts be brought up to 5% on Debtors.
- That the Factory Land and Building be appreciated by 20%.

- (d) That a provision of ₹ 770 be made in respect of outstanding legal charges.
- (e) That the Goodwill of the entire firm be fixed at ₹ 10,800 and B's share of the same be adjusted into the accounts of A and C who are going to share in future in the proportion of five-eighths and three-eighths respectively (No goodwill account is to be raised).
- (f) That the entire capital of the firm as newly constituted be fixed at ₹ 28,000 between A and C in the proportion of five-eighths and three-eighths after passing entries in their accounts for adjustments (i.e., actual cash to be paid off *or* to be brought in by the continuing partners as the case may be).

Required: Pass the necessary journal entries to give effect to the above arrangement and prepare the Balance Sheet of A & C transferring the amount due to B to a separate Loan Account in his name.

SOLUTION

JOURNAL

Particulars	L.F.	Dr. (₹)	Cr (₹)
Revaluation A/c Dr.		1,400	
To Stock Reserve A/c			480
To Provision for Doubtful Debts A/c			150
To Provision for Legal Charges A/c			770
(Being the fall in value of Assets and increase in amount of Provision recorded)			
Land and Building A/c Dr.		5,000	
To Revaluation A/c			5,000
(Being the increase in value of Assets recorded)			
Revaluation A/c Dr.		3,600	
To A's Capital A/c			1,600
To B's Capital A/c			1,200
To C's Capital A/c			800
(Being the transfer of profit on revaluation)			
A's Capital A/c Dr.		4,000	
B's Capital A/c Dr.		3,000	
C's Capital A/c Dr.		2,000	
To Goodwill A/c			9,000
(Being the existing book value of Goodwill A/c)			
A's Capital A/c Dr.		1,950	
C's Capital A/c Dr.		1,650	
To B's Capital A/c			3,600
(Being B's share of goodwill credited to B and debited to the remaining partners in their gaining ratio which is 13 : 11)			
Workmen Compensation Reserve A/c Dr.		9,900	
To A's Capital A/c			4,400
To B's Capital A/c			3,300
To C's Capital A/c			2,200
(Being the transfer of Workmen Comp. Reserve)			

A's Capital A/c	Dr.	400	
B's Capital A/c	Dr.	300	
C's Capital A/c	Dr.	200	
To Advertisement Expenditure A/c (Being the transfer of Advertisement Expenditure)			900
B's Capital A/c	Dr.	19,800	
To B's Loan A/c (Being the transfer of amount due to B to his Loan A/c)			19,800
Bank A/c	Dr.	1,350	
To C's Capital A/c (Being the short amount brought in by C)			1,350
A's Capital A/c	Dr.	2,150	
To Bank A/c (Being the excess amount withdrawn by A)			2,150

BALANCE SHEET OF A AND C AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Sundry Creditors	6,000	Cash at bank	4,700
Employees' Provident Fund	900	Debtors	5,000
Provision for legal charges	770	Less: Provision	250
B's Loan A/c	19,800	Stock	8,000
A's Capital A/c	17,500	Less: Reserve	480
C's Capital A/c	10,500	Plant	8,500
		Land & Building	30,000
	55,470		55,470

Working Note:
1. Calculation of Gaining Ratio

Gain of a Partner = New Share – Old Share

$$A \text{ gains} = \frac{5}{8} - \frac{4}{9} = \frac{13}{72}; \quad B \text{ gains} = \frac{3}{8} - \frac{2}{9} = \frac{11}{72}.$$

$$\text{Gaining Ratio } \frac{13}{72} : \frac{11}{72} =$$

or 13 : 11.

2. Calculation of New Capitals of A & C

(a) Total Capital of the reconstituted firm = ₹ 28,000

(b) A's New Capital = ₹ 28,000 × 5/8 = ₹ 17,500

(c) C's New Capital = ₹ 28,000 × 3/8 = ₹ 10,500

3. Calculation of Cash to be paid off/brought in by remaining partners.

Dr.

CAPITAL ACCOUNTS OF PARTNERS

Cr.

<i>Particulars</i>	<i>A</i> ₹	<i>B</i> ₹	<i>C</i> ₹	<i>Particulars</i>	<i>A</i> ₹	<i>B</i> ₹	<i>C</i> ₹
To Goodwill A/c	4,000	3,000	2,000	By Balance b/d	20,000	15,000	10,000
To B's Capital A/c	1,950	—	1,650	By Revaluation A/c	1,600	1,200	800
To Advertisement Exp.	400	300	200	By Contingency Res.	4,400	3,300	2,200
To Bank A/c (b.f.)	2,150	—	—	By A's Capital A/c	—	1,950	—
To B's Loan A/c	—	19,800	—	By C's Capital A/c	—	1,650	—
To Balance c/d	17,500	—	10,500	By Bank A/c (b.f.)	—	—	1,350
	26,000	23,100	14,350		26,000	23,100	14,350

ILLUSTRATION 24

On 31st March 2018 the Balance Sheet of A, B and C who were sharing profits and losses in proportion to their capitals stood as follows:

<i>Liabilities</i>	<i>₹</i>	<i>Assets</i>	<i>₹</i>
Creditors	20,000	Goodwill	6,000
Employees' Provident Fund	1,600	Cash at Bank	16,000
A's Capital A/c	78,000	Debtors	20,000
B's Capital A/c	52,000	Less: Provision	400
C's Capital A/c	26,000	Stock	18,000
Contingency Reserve	30,000	Machinery	48,000
Workmen Compensation Reserve	6,000	Land & Building	1,00,000
	2,13,600		2,13,600

B retires and the following re-adjustments of the Assets and Liabilities have been agreed upon before the ascertainment of the amount payable to B:

- That out of the amount of insurance which was debited entirely to Profit and Loss Account, ₹ 2,000 be carried forward as an unexpired insurance.
- That the Land and Building be appreciated by 10%.
- That the Provision for Doubtful Debts be brought up to 5% on Debtors.
- That Machinery be depreciated by 5%.
- That a provision of ₹ 3,000 be made in respect of an outstanding bill for repairs.
- That the Goodwill of the entire firm be fixed at ₹ 36,000.
- That the entire capital of the firm as newly constituted be fixed at ₹ 1,20,000 between A and C in the proportion of 3/4 and 1/4 after passing entries in their accounts for adjustments i.e. actual cash to be paid off or to be brought in by the continuing partners as the case may be.
- That B be paid ₹ 6,000 in Cash and the balance be transferred to his loan account.

Required: Prepare the Revaluation Account, the Capital Accounts of the Partners and the Balance Sheet of the firm of A and C.

SOLUTION

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Provision for Doubtful Debts	600	By Unexpired Insurance	2,000
To Machinery	2,400	By Land & Building	10,000
To Outstanding Repairs	3,000		
To Profit on Revaluation t/f to:			
A's Capital A/c	3,000		
B's Capital A/c	2,000		
C's Capital A/c	1,000		
	12,000		12,000

Dr.

CAPITAL ACCOUNTS OF PARTNERS

Cr.

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To Goodwill A/c	3,000	2,000	1,000	By Balance b/d	78,000	52,000	26,000
To B's Capital A/c	9,000	—	3,000	By Revaluation A/c	3,000	2,000	1,000
(for goodwill)				By A's Capital A/c			
To Advertisement Exp.	3,000	2,000	1,000	(for goodwill)	—	9,000	—
To Bank A/c	—	6,000	—	By C's Capital A/c			
To B's Loan A/c	—	68,000	—	(for goodwill)	—	3,000	—
To Balance c/d	90,000	—	30,000	By Cont. Reserve	15,000	10,000	5,000
				By Work. Com. Reserve	3,000	2,000	1,000
				By Bank A/c	6,000	—	2,000
	1,05,000	78,000	35,000		1,05,000	78,000	35,000

BALANCE SHEET OF A AND C AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Creditors	20,000	Cash at Bank	18,000
Employees' Provident Fund	1,600	Debtors	20,000
Liability for repairs	3,000	Less: Provision	1,000
B's Loan A/c	68,000	Stock	18,000
A's Capital A/c	90,000	Machinery	45,600
C's Capital A/c	30,000	Land & Building	1,10,000
		Unexpired Insurance	2,000
	2,12,600		2,12,600

Working Note:

Dr.

1. CASH AT BANK ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	16,000	By B's Capital A/c	6,000
To A's Capital A/c	6,000	By Balance c/d	18,000
To C's Capital A/c	2,000		
	24,000		24,000

2. WHEN THE TOTAL CAPITAL OF THE NEW FIRM IS NOT GIVEN

The various steps involved in adjusting the Capitals of the partners are given below:

**PRACTICAL STEPS INVOLVED IN ADJUSTING THE CAPITALS
[WHEN THE TOTAL CAPITAL OF THE NEW FIRM IS NOT GIVEN]**

- Step 1:** Calculate the Adjusted Old Capitals of Continuing Partners after all other adjustments (as explained under Para 8.1)
- Step 2:** Calculate Total Capital of the New Firm as follows:
Total Capital of the New Firm = Total of Adjusted Old Capitals of Continuing Partners
- Step 3:** Then, Steps 3 to 5 as given in Para 8.1 should be taken.

ILLUSTRATION 25

A, B & C were partners sharing profits and losses in the ratio of 4 : 3 : 2 respectively. B retired on 31st March, 2018 when the capitals of A, B & C before the necessary adjustments stood at ₹ 21,950, ₹ 11,400 & ₹ 11,650 respectively. Firm's Goodwill ₹ 21,600, Loss on Revaluation of Assets & Liabilities ₹ 2,700. General Reserve ₹ 6,300. The entire capital of the reconstituted firm will be readjusted by bring in or paying off cash so that the future capital of A & C be in their future profit-sharing ratio of 5:3.. Calculate the amount of cash to be paid off or to be brought in the continuing partners and pass the necessary journal entries.

SOLUTION**Step 1: Calculation of Gaining Ratio: Gain of a Partner = New Share – Old Share**

$$A \text{ gains} = \frac{5}{8} - \frac{4}{9} = \frac{13}{72}; \quad C \text{ gains} = \frac{3}{8} - \frac{2}{9} = \frac{11}{72}. \quad \text{Gaining Ratio} = \frac{13}{72} : \frac{11}{72} \text{ or } 13 : 11.$$

STEP 2: ADJUSTED OLD CAPITALS

Old Capital before Adjustments	21,950	11,400	11,650
Share of Goodwill	(3,900)	7,200	(3,300)
Share of Loss on Revaluation	(1,200)	(900)	(600)
Share of General Reserve	2,800	2,100	1,400
	19,650	19,800	9,150

STEP 2: Total Capital of New Firm = ₹ 19,650 + ₹ 9,150 = ₹ 28,800

STEP 4: CALCULATION OF ACTUAL CASH TO BE PAID OFF or BROUGHT IN

Particulars	A	C
I. New Capital (₹ 28,800 in the ratio of 5 : 3)	₹ 18,000	₹ 10,800
II. Adjusted Old Capital	₹ 19,650	₹ 9,150
III. Cash to be brought in (paid off) (I – II)	(₹ 1,650)	₹ 1,650

STEP 5: JOURNAL

Particulars	L.F.	Dr. (₹)	Cr (₹)
A's Capital A/c Dr. To Cash A/c (Being the excess withdrawn by A)		1,650	1,650
Cash A/c Dr. To C's Capital A/c (Being the shortage brought in by C)		1,650	1,650

3. WHEN THE OUTGOING PARTNER IS TO BE PAID THROUGH CASH BROUGHT BY THE CONTINUING PARTNERS IN SUCH A WAY AS TO MAKE THEIR CAPITALS PROPORTIONATE TO THEIR NEW PROFIT SHARING RATIO

The various steps involved in adjusting the capitals of partners are given below:

PRACTICAL STEPS INVOLVED IN ADJUSTING THE CAPITALS OF PARTNERS

Step 1: Calculate the Adjusted Old Capitals of Continuing Partners after all other adjustments (as explained earlier)

Step 2: Calculate Total Capital of the New Firm as follows:

= Total Adjusted Old Capitals of Continuing Partners + Shortage of Cash to be brought in by Continuing Partners in order to make payment to Outgoing Partner

Step 3: Then, the Steps 3 to 5 given earlier should be taken.

ILLUSTRATION 26

A, B & C were partners sharing profits and losses in the ratio of 5 : 3 : 2 respectively. B retired on 31st March, 2018 when the capitals of A, B & C before the necessary adjustments stood at ₹ 1,10,000, ₹ 57,000 & ₹ 44,000 respectively. Firm's Goodwill ₹ 75,000, Profit on Revaluation of Assets & Liabilities ₹ 20,000. General Reserve ₹ 15,000. The cash and bank balance on 31st March, 2018 amounted to ₹ 11,000. B was to be paid through cash brought in by A and C in such a way as to make their capitals proportionate to their new profit sharing ratio of 3 : 2. Calculate the amount of cash to be paid off or to be brought in by the continuing partners and pass the necessary journal entries assuming that a minimum Cash & Bank Balance of ₹ 10,000 was to be maintained.

SOLUTION

Step 1: Calculation of Gaining Ratio: Gain of a Partner = New Share – Old Share

$$A's \text{ Gain} = \frac{3}{5} - \frac{1}{2} = \frac{1}{10}, C's \text{ Gain} = \frac{2}{5} - \frac{1}{5} = \frac{2}{10}$$

$$\text{Hence, Gaining Ratio of A \& C} = \frac{1}{10} : \frac{2}{10} = 1 : 2$$

Step 2: Adjusted Old Capitals

Old Capital before Adjustments	1,10,000	57,000	44,000
Share of Goodwill in 1:2	(7,500)	22,500	(15,000)
Share of Profit on Revaluation in 5 : 3 : 2	10,000	6,000	4,000
Share of General Reserve in 5 : 3 : 2	7,500	4,500	3,000
	1,20,000	90,000	36,000

Step 3: Shortage of Cash = Due to Outgoing Partner - Cash available = ₹ 90,000 - ₹ 1,000 = ₹ 89,000

Step 4: Total Capital of New Firm = Adjusted Old Capitals of A & C + Shortage of Cash

$$= (\text{₹ } 1,20,000 + \text{₹ } 36,000) + \text{₹ } 89,000 = \text{₹ } 2,45,000$$

Step 5: CALCULATION OF ACTUAL CASH TO BE PAID OFF or BROUGHT IN BY A AND C

Particulars	A	C
(a) New Capital (₹ 2,45,000 in the ratio of 3 : 2)	₹ 1,47,000	₹ 98,000
(b) Adjusted Old Capital	₹ 1,20,000	₹ 36,000
(c) Cash to be brought in (a – b)	₹ 27,000	₹ 62,000

STEP 6: JOURNAL

Particulars	L.F.	Dr. (₹)	Cr (₹)
Cash A/c Dr.		89,000	
To A's Capital A/c			27,000
To C's Capital A/c			62,000
(Being the shortage brought in by A & C)			

ILLUSTRATION 27

A, B and C were partners sharing profits and losses in the ratio of 5 : 3 : 2. On 31st March, 2018 the Balance Sheet of the firm stood as under:

Particulars	₹
Sundry Creditors	26,500
Employees' Provident Fund	3,500
Workmen Compensation Reserve	15,000
A's Capital	1,10,000
B's Capital	56,000
C's Capital	44,000
Bank (Minimum Balance)	10,000
Debtors	65,000
Stock	55,000
Fixed Assets	1,25,000

B retires on 31st March 2018. For the purpose the following adjustments were agreed upon:—

- That Goodwill be valued at ₹ 75,000 but no goodwill is to appear in the books of new firm.
- That Fixed Assets be appreciated by 20%;
- That Stock be reduced to ₹ 50,000
- That B be paid through cash brought in by A and C in such a way as to make their capitals proportionate to their new profit sharing ratio which is to be A-3/5 & C - 2/5;

Required: Give the Partners' Capital A/cs & the Balance Sheet of A and C.

SOLUTION

Dr.

CAPITAL ACCOUNTS OF PARTNERS

Cr.

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To B's Capital A/c	7,500	—	15,000	By Balance b/d	1,10,000	56,000	44,000
To Cash A/c	—	89,000	—	By Revaluation A/c	10,000	6,000	4,000
To Balance c/d	1,47,000	—	98,000	By Workmen Com. Reserve A/c	7,500	4,500	3,000
				By A's Capital A/c	—	7,500	—
				By C's Capital A/c	—	15,000	—
				By Cash A/c	27,000	—	62,000
	1,54,500	89,000	1,13,000		1,54,500	89,000	1,13,000

BALANCE SHEET OF A & C AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
A's Capital	1,47,000	Fixed Assets	1,50,000
C's Capital	98,000	Stock	50,000
Sundry Creditors	26,500	Debtors	65,000
Employees' Provident Fund	3,500	Bank	10,000
	2,75,000		2,75,000

Working Notes:**1. Calculation of Gaining Ratio**

Gain of a Partner = New Share – Old Share

$$A's \text{ Gain} = \frac{3}{5} - \frac{1}{2} = \frac{1}{10}, \quad C's \text{ Gain} = \frac{2}{5} - \frac{1}{5} = \frac{1}{5}$$

$$\text{Hence, Gaining Ratio of A \& C} = \frac{1}{10} : \frac{2}{10} = 1 : 2$$

2. Profit on Revaluation = (20% of ₹ 1,25,000) – (₹ 55,000 – ₹ 50,000) = ₹ 20,000

3. Total Capital of New Firm = Adjusted Old Capitals of A & C + Shortage of Cash
= (₹ 1,20,000 + ₹ 36,000) + ₹ 89,000 = ₹ 2,45,000

4. A's New Capital = ₹ 2,45,000 × 3/5 = ₹ 1,47,000

C is New Capital = ₹ 3,20,000 × 2/5 = ₹ 1,28,000

5. CALCULATION OF ACTUAL CASH TO BE PAID OFF or BROUGHT IN BY A AND C

Particulars	A	C
(a) New Capital (₹ 2,45,000 in the ratio of 3 : 2)	₹ 1,47,000	₹ 98,000
(b) Adjusted Old Capital	₹ 1,20,000	₹ 36,000
(c) Cash to be brought in (a – b)	₹ 27,000	₹ 62,000

9.0 DISPOSAL OF THE AMOUNT DUE TO THE RETIRING PARTNER**HOW TO DISCHARGE THE AMOUNT DUE TO A RETIRING PARTNER**

The amount due to the retiring partner is settled in the manner prescribed in the partnership deed. The amount due is either paid off immediately *or* is paid in instalments with *or* without interest as per agreement. In the absence of an agreement in this regard, the outgoing partner at his option is entitled to receive either interest @ 6% p.a. till the amount is paid off *or* a share of the profit which has been earned by using the amount due to him. [Section 37]

ACCOUNTING ENTRIES RELATING TO DISPOSAL OF THE AMOUNT DUE TO AN OUTGOING PARTNER

Entry for raising Loan from Bank	Bank A/c To Loan from Bank A/c Note: Loan from bank will appear on the Liabilities side of Balance Sheet.	...Dr.

Entry for discharging Outgoing Partner's Claim	Outgoing Partner's Capital A/c ...Dr. To Investment/ Asset A/c [with agreed value of asset (if any)] To Bills Payable A/c (if B/E is accepted) To Cash/ Bank A/c (if some immediate payment is made) To Outgoing Partner's Loan A/c (if amount is transferred to Loan A/c) Note: If all Investments have been taken over by an outgoing partner, Investments will not appear in the Balance Sheet.
Entries for Interest on Partner's Loan	Interest on Loan A/c ...Dr. To Outgoing Partner's Loan A/c
Entries for Payment of Partner's Loan	Outgoing Partner's Loan A/c ...Dr. To Bank / Cash A/c

ILLUSTRATION 28 (A)

A, B and C are in partnership sharing profits and of 5 : 3 : 2 respectively. 'A' retires from the firm as on 1st January, 2018 when his Capital Account shows a net credit balance of ₹ 82,100 after the necessary adjustments. 'A' is to be paid ₹ 82,100 in cash immediately on retirement. Show the necessary ledger accounts.

SOLUTION

Dr. **A'S CAPITAL ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Bank A/c	82,100	By Balance b/d (Net amount due)	82,100

ILLUSTRATION 28 (B)

A, B and C are in partnership sharing profits and of 5 : 3 : 2 respectively. 'A' retires from the firm as on 1st January, 2018 when his Capital Account shows a net credit balance of ₹ 82,100 after the necessary adjustments. 'A' is to be paid ₹ 22,100 in cash immediately on retirement and the balance in three equal annual instalments together with interest @ 5% p.a. on diminishing balance. Show the necessary ledger accounts.

SOLUTION

Dr. **A'S CAPITAL ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Bank A/c	22,100	By Balance b/d (Net amount due)	82,100
To A's Loan A/c	60,000		
	82,100		82,100

Dr. **A'S LOAN ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2018	To Bank A/c	23,000	01.01.2018	By A's Capital A/c	60,000
	To Balance c/d	40,000	31.12.2018	By Interest A/c	3,000
		63,000			63,000

31.12.2019	To Bank A/c	22,000	01.01.2019	By Balance b/d	40,000
	To Balance c/d	20,000	31.12.2019	By Interest A/c	2,000
		42,000			42,000
31.12.2020	To Bank A/c	21,000	01.01.2020	By Balance b/d	20,000
			31.12.2020	By Interest A/c	1,000
		21,000			21,000

Working Note:

Amount of each instalment (towards principal only) = $(₹ 82,100 - ₹ 22,100)/3 = ₹ 20,000$

ILLUSTRATION 28 (C)

A, B and C are in partnership sharing profits and of 5 : 3 : 2 respectively. 'A' retires from the firm as on 1st January, 2018 when his Capital Account shows a net credit balance of ₹ 82,100 after the necessary adjustments. 'A' is to be paid ₹ 22,100 in cash immediately on retirement and the balance in three equal annual instalments of ₹ 22,034 each (including interest @ 5% p.a.). Show the necessary ledger accounts.

SOLUTION
Dr.
A'S CAPITAL ACCOUNT
Cr.

Particulars	₹	Particulars	₹
To Bank A/c	22,100	By Balance b/d (Net amount due)	82,100
To A's Loan A/c	60,000		
	82,100		82,100

Dr.
A'S LOAN ACCOUNT
Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2018	To Bank A/c	22,034	01.01.2018	By A's Capital A/c	60,000
	To Balance c/d	40,966	31.12.2018	By Interest A/c	3,000
		63,000			63,000
31.12.2019	To Bank A/c	22,034	01.01.2019	By Balance b/d	40,966
	To Balance c/d	20,980	31.12.2019	By Interest A/c	2,048
		43,014			43,014
31.12.2020	To Bank A/c	22,034	01.01.2020	By Balance b/d	20,980
			31.12.2020	By Interest A/c	1,054
		22,034			22,034

Note: During the last year (2020) the amount of interest @ 5% p.a. comes to ₹ 1,049 but due to approximation used while computing the installment of ₹ 22,034, the difference has been adjusted in the final figure of interest.

ILLUSTRATION 29

A, B and C are partners in a firm. B retires and his claim including his capital and his share of goodwill is ₹ 60,000. He is paid in kind a vehicle valued at ₹ 30,000 unrecorded in the books of the firm till the Date of retirement and the balance in cash. Give the journal entries for recording the payment to B in the books of the firm.

SOLUTION**JOURNAL**

<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Vehicle A/c To Revaluation A/c (Being the unrecorded vehicle recorded)	Dr.	30,000	30,000
Revaluation A/c To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of profit on revaluation)	Dr.	30,000	10,000 10,000 10,000
B's Capital A/c To Vehicle A/c To Cash A/c (Being B's claim discharged)	Dr.	70,000	30,000 40,000

ILLUSTRATION 30

A, B and C are partners in a firm, B retires and his claim including his capital and his share of goodwill is ₹ 60,000. There was some unrecorded furniture estimated at ₹ 3,000, half of which was handed over to an unrecorded liability of ₹ 6,000 in settlement of claim of ₹ 3,000 and remaining half was handed over to B at a discount of 10% in part satisfaction of his claim. Balance of B's claim was discharged in cash. Give the journal entries to record this arrangement.

SOLUTION**JOURNAL**

<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Furniture A/c To Revaluation A/c (Being the unrecorded furniture recorded)	Dr.	1,350	1,350
Revaluation A/c To Unrecorded Liability A/c (Being the unrecorded liability recorded)	Dr.	3,000	3,000
A's Capital A/c B's Capital A/c C's Capital A/c To Revaluation A/c (Being the transfer of Loss on Revaluation)	Dr. Dr. Dr.	550 550 550	1,650
B's Capital A/c To Furniture A/c To Cash A/c (Being B's claim discharged)	Dr.	59,450	1,350 58,100

ILLUSTRATION 31

A, B, and C were partners in a firm sharing profits in 3 : 2 : 1 ratio. On 31st March 2018 B retired. On the Date of his retirement the balance in his capital account was ₹ 35,000. The other Assets and Liabilities of the firm on that Date were as follows:

Cash ₹ 10,000, Building ₹ 1,00,000, Plant & Machinery ₹ 40,000, Stock ₹ 20,000, Debtors ₹ 20,000 and Investments ₹ 30,000.

The following was agreed between the partners on B's retirement:

- Building to be appreciated by 20%.
- Plant and Machinery to be depreciated by 10%.
- A provision of 5% on debtors to be created for doubtful debts.
- Stock was to be valued at ₹ 18,000 and Investments at ₹ 35,000.
- An old photocopier previously written off was sold for ₹ 2,000.
- Partners had to pay ₹ 5,000 to the family of an employee who died in an accident. B was paid ₹ 10,000 in cash and the balance in three equal yearly instalments with interest @ 10% p.a. starting from 31.03.2019.

Required: Pass the necessary journal entries to record the above adjustments, prepare Revaluation account and B's loan account till it is finally paid. The firm closes its book on 31st March every year.

SOLUTION**JOURNAL**

Particulars	L.F.	Dr. (₹)	Cr. (₹)
Building A/c Dr.		20,000	
Investment A/c Dr.		5,000	
Photocopier A/c Dr.		2,000	
To Revaluation A/c			27,000
(Being increase in Assets recorded)			
Revaluation A/c Dr.		12,000	
To Plant and Machinery A/c			4,000
To Provision for Doubtful Debts			1,000
To Stock A/c			2,000
To Employees' claim A/c			5,000
(Being decrease in asset recorded)			
Revaluation A/c Dr.		15,000	
To A's Capital A/c			7,500
To B's Capital A/c			5,000
To C's Capital A/c			2,500
(Being Profit on Revaluation t/f to all partners in their profit sharing ratio)			
Cash A/c Dr.		2,000	
To Photocopier A/c			2,000
(Being Photocopier sold)			
Employees' Claim A/c Dr.		5,000	
To Cash A/c			5,000
(Being Cash paid for the Employees' claim)			

B's Capital A/c	Dr.		40,000	
To Cash A/c				10,000
To B's Loan A/c				30,000
(Being Cash paid to B and rest transferred to his loan A/c)				

Dr. **REVALUATION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Plant & Machinery	4,000	By Building A/c	20,000
To Provision for doubtful debts	1,000	By Investment A/c	5,000
To Stock A/c	2,000	By Photocopier A/c	2,000
To Employees' Claim A/c	5,000		
To Revaluation Profit t/f to:			
A's Capital A/c	7,500		
B's Capital A/c	5,000		
C's Capital A/c	2,500		
	27,000		27,000

Dr. **B'S CAPITAL ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Cash A/c	10,000	31.3.2018	By Balance b/d	35,000
31.3.2018	To B's Loan A/c	30,000	31.3.2018	By Revaluation A/c (Profit)	5,000
		40,000			40,000

Dr. **B'S LOAN ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Balance c/d	30,000	31.3.2018	By B's Capital A/c	30,000
31.3.2019	To Bank A/c		01.4.2018	By Balance b/d	30,000
	(10,000 + 3,000)	13,000	31.3.2019	By Interest A/c	
	To Balance c/d	20,000		[30,000 × 10/100 × 12/12]	3,000
		33,000			33,000
31.3.2020	To Cash A/c		01.4.2019	By Balance b/d	20,000
	[₹ 10,000 + 2,000]	12,000	31.3.2020	By Interest A/c	
	To Balance c/d	10,000		[20,000 × 10/100 × 12/12]	2,000
		22,000			22,000
31.3.2021	To Cash A/c		01.4.2020	By Balance b/d	10,000
	[₹ 10,000 + 1,000]	11,000	31.3.2021	By Interest A/c	
				[10,000 × 10/100 × 12/12]	1,000
		11,000			11,000

10.0 RETIREMENT DURING THE ACCOUNTING YEAR

When a partner retires from the firm during the accounting year, the retiring partner is entitled to the share of profits of the current year up to the Date of retirement, in addition to reserve, his share of goodwill and profits on revaluation of Assets and reassessment of Liabilities. His share of interim

profits is calculated as per the provisions of the Partnership Deed. If the Partnership Deed is silent, the amount of profits should be calculated in the manner as agreed among the partners. When it is calculated on the basis of last year's profit, the last year's profit is calculated for the period up to the Date of retirement and then share of profits of retiring partner is calculated.

The share of retiring partner on the basis of the average profits of the past few years is calculated and adjusted as follows:

PRACTICAL STEPS IN ADJUSTMENT OF SHARE OF RETIRING PARTNER IN CURRENT YEAR'S PROFITS

- Step 1:** Take the Total Profits of the given number of years.
- Step 2:** Calculate the Average Annual Profits = Total Profits/No. of years
- Step 3:** Calculate Profits for the period up to the **Date** of his retirement = Average Annual profits $\times$ Period up to **Date** of Retirement/12 months.
- Step 4:** Calculate the Share of Profits of the Retiring Partner = Profit for the period (as per Step 3) $\times$ Share of Retiring Partner
- Step 5:** Pass the following Journal Entry:
- Profit and Loss Suspense A/c
Dr. [Retiring Partner's Share of Profit]
 To Retiring Partner's Capital A/c
- Note:** Reverse Entry in Case of Loss.

TUTORIAL NOTES

1. The balance of the Profit and Loss Suspense Account is transferred to the Profit and Loss Appropriation Account at the end of accounting period.
2. The balance of Profit and Loss Suspense Account is shown in the interim Balance Sheet, i.e., Balance Sheet after retirement.
3. Retiring Partner's share of the profits will be credited to his Capital Account and debited to the continuing partners' Capital Accounts in the Gaining Ratio when the profit-share ratio of the continuing partners, in between them, does not remain the same.

Continuing Partners' Capital A/cs
Dr. [In Gaining Ratio]
 To Retiring Partner's Capital A/c

ILLUSTRATION 32

The Partnership deed of C and D contains a clause that any partner may retire from the firm on the following terms by giving six months' notice in writing:

The retiring partner shall be paid—

- (a) The amount standing to the credit of his Capital Account and Current Account.
- (b) His share of profit to the Date of retirement, calculated on the basis of the average profits of the three preceding completed years.
- (c) His share of the goodwill of the firm calculated on the basis of $1\frac{1}{2}$ times the average profits of the three preceding completed years.

C gave notice to retire with effect from 30th September 2018, on 31st March 2018, when the balance of his Capital was ₹ 16,000 and his Current Account (in debit) ₹ 500. The profit for the three preceding completed years were: year ended 31st March 2016, ₹ 3,000, year ended 31st March 2017, ₹ 2,000 and year ended 31st March, 2018, ₹ 1,600.

Required: What amount is due to C in accordance with the partnership agreement?

SOLUTION

Dr. **C'S CURRENT ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	500	By P & L Suspense A/c	550
To C's Capital A/c	1,700	By D's Current A/c (Share of Goodwill)	1,650
	2,200		2,200

Dr. **C'S CAPITAL ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance c/d	17,700	By Balance b/d	16,000
		By C's Current A/c	1,700
	17,700		17,700

Working Note: Calculation of C's Share of Goodwill

- Average Profits = $(₹ 3,000 + ₹ 2,000 + ₹ 1,600)/3 = ₹ 2,200$.
- Estimated Profit to the Date of retirement = $₹ 2,200 \times 6/12 = ₹ 1,100$.
- C's Share of profit to the Date of retirement = $₹ 1,100 \times 1/2 = ₹ 550$.
- Value of firm's goodwill = $₹ 2,200 \times 3/2 = ₹ 3,300$.
- C's Share of goodwill = $₹ 3,300 \times 1/2 = ₹ 1,650$.

ILLUSTRATION 33

X, Y and Z are partners' sharing profits and losses in the ratio of 5 : 3 : 2. Z retires on 31st March, 2018. The Balance Sheet of the firm as at 31st December, 2017 stood as follows:

Liabilities	₹	Assets	₹
X's Capital	5,50,000	Land and Building	9,00,000
Y's Capital	5,70,000	Investments	2,00,000
Z's Capital	3,80,000	Stock	3,00,000
Workmen Compensation Reserve	5,00,000	Sundry Debtors	5,00,000
Sundry Creditors	1,00,000	Cash & Bank	3,00,000
Employees Provident Fund	1,00,000		
	22,00,000		22,00,000

In order to arrive at the balance due to Z, it was mutually agreed that:

- Land and Building be valued at ₹ 11,00,000.
- Investments to be valued at ₹ 1,50,000.
- Stock be taken at ₹ 4,00,000.
- Goodwill be valued at two years' purchase of the average profit of the past five years. Goodwill will not appear in the books of reconstituted firm.
- Z's share of profits up to the Date of retirement be calculated on the basis of average profit of the preceding three years.

$$\begin{aligned}\text{Goodwill} &= 2 \text{ years' purchase of average profit} \\ &= 2 \times ₹ 3,00,000 = ₹ 6,00,000\end{aligned}$$

$$\text{Z's Share of Goodwill} = 6,00,000 \times 2/10 = ₹ 1,20,000.$$

2. Calculation of Z's Share of Profit:

$$(a) \text{ Average Profit} = (₹ 3,00,000 + ₹ 4,00,000 + ₹ 3,50,000)/3 = ₹ 3,50,000$$

$$(b) \text{ Profit (upto 3 months)} = ₹ 3,50,000 \times 3/12 = ₹ 87,500.$$

$$(c) \text{ Z's Share of Profits} = ₹ 87,500 \times 2/10 = ₹ 17,500.$$

ILLUSTRATION 34

The Balance Sheet of X, Y and Z sharing profits and losses in the ratio of 5 : 3 : 2 on 31st December, 2017 is given below:

Liabilities	₹	Assets	₹
Sundry Creditors	12,000	Goodwill	10,000
Employees' Provident Fund	6,000	Patents	52,000
Investment Fluctuation Reserve	7,000	Machinery	62,400
Workmen Compensation Reserve	7,000	Investments	6,000
X's Capital	1,35,000	Stock	20,000
Y's Capital	95,000	Sundry Debtors	24,000
Z's Capital	74,000	Less: Provision	4,000
		Loan to Z	1,000
		Cash at Bank	12,600
		Advertisement Expenditure	2,000
		Profit & Loss A/c (2017)	1,50,000
	3,36,000		3,36,000

Z retires from 1st May, 2018 and X and Y decide to share future profits losses in the ratio of 3:5. Z has withdrawn ₹ 10,000 during 2018. It was agreed that:

- Goodwill be valued at 2-1/2 years' purchase of average of four completed years' profits which were: 2014 ₹ 2,02,000; 2015 ₹ 28,000; 2016 ₹ 32,000.
- Z's Share of profit from the closure of last accounting year till Date of retirement be calculated on the basis of the average of three completed years' profits before retirement.
- Patents undervalued by ₹ 14,000, Machinery overvalued by ₹ 13,600, All Debtors are good. ₹ 1,000 included in Sundry Creditors is not likely to arise. Unaccounted Accrued Income of ₹ 2,200 to be provided for. A debtor whose dues of ₹ 400 were written off as bad debts paid 50% in full settlement. A claim of ₹ 1,000 on account of Workmen's Compensation to be provided for.
- Investments be sold for ₹ 8,200. Z was to be paid through Cash brought in by X and Y in such a way as to make their capitals proportionate to their new profit sharing ratio of 3 : 5 assuming that a minimum Cash & Bank Balance of ₹ 9,000 was to be maintained

Prepare Revaluation Account, Capital Account of Partners and the Balance Sheet of New Firm.

SOLUTION

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Machinery	13,600	By Sundry Creditors	1,000
To Profit transferred to:		By Accrued Income	2,200
X's Capital A/c	5,000	By Bad Debts Recovered	200
Y's Capital A/c	3,000	By Patents	14,000
Z's Capital A/c	2,000	By Provision for Doubtful Debts	4,000
		By Investments	2,200
	23,600		23,600

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Bank A/c	—	—	10,000	By Balance b/d	1,35,000	95,000	74,000
To Goodwill A/c	5,000	3,000	2,000	By Revaluation A/c	5,000	3,000	2,000
To P & L A/c	75,000	45,000	30,000	By Y's Capital A/c	8,750	—	14,000
To Z's Capital A/c	—	14,000	—	By Invest. F. Res.	3,500	2,100	1,400
To X's Capital A/c	—	8,750	—	By Work. Comp. Res.	3,000	1,800	1,200
To P&L Suspense A/c	—	—	2,000				
To Loan to Z A/c	—	—	1,000				
To Adv. Exp.	1,000	600	400				
To Bank A/c	—	—	47,200				
To Balance c/d	74,250	30,550	—				
	1,55,250	1,01,900	92,600		1,55,250	1,01,900	92,600
To Bank A/c (b.f.)	18,000	—	—	By Balance b/d	74,250	30,550	—
To Balance c/d	56,250	93,750	—	By Bank A/c (b.f.)	—	63,200	—
	74,250	93,750	—		74,250	93,750	—

BALANCE SHEET OF NEW FIRM AS AT 1ST MAY, 2018

Liabilities	₹	Assets	₹
Sundry Creditors	11,000	Patents	66,000
Employees' Provident Fund	6,000	Machinery	48,800
X's Capital	56,250	Stock	20,000
Y's Capital	93,750	Sundry Debtors	24,000
P & L Suspense A/c	2,000	Accrued Income	2,200
Workmen's Compensation Claim	1,000	Cash at Bank	9,000
	1,70,000		1,70,000

Working Notes:

1. X's sacrifice = $3/8 - 5/10 = (5/40)$, Y's gain = $5/8 - 3/10 = 13/40$
2. Firm's Goodwill = $[(2,02,000 + 28,000 + 32,000 - 1,50,000)/4] \times 2.5 = ₹ 70,000$
3. Z's Share of Goodwill = $₹ 70,000 \times 2/10 = ₹ 14,000$
4. X's Share of Goodwill = $₹ 70,000 \times 5/40 = ₹ 8,750$

5. Average Profit (Loss) of Last 3 years = $(28,000 + 32,000 - 1,50,000)/3 = (\text{₹ } 30,000)$
6. Z's Share of Loss = $(\text{₹ } 30,000) \times 4/12 \times 2/10 = (\text{₹ } 2,000)$
7. Cash available = $\text{₹ } 12,600 - \text{₹ } 10,000 + \text{₹ } 8,200 + \text{₹ } 200 - \text{₹ } 9,000 = \text{₹ } 2,000$
8. Total Capital of New Firm = $\text{₹ } 74,250 + \text{₹ } 30,550 + \text{₹ } 47,200 - \text{₹ } 2,000 = \text{₹ } 1,50,000$
9. X's New Capital = $\text{₹ } 1,50,000 \times 3/8 = \text{₹ } 56,250$, Z's New Capital = $\text{₹ } 1,50,000 \times 5/8 = \text{₹ } 93,750$

Dr.

10. CASH AT BANK ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	12,600	By Z's Capital A/c (Drawings)	10,000
To Investments	8,200	By Z's Capital A/c	47,200
To Y's Capital A/c	63,200	By X's Capital A/c	18,000
To Bad Debts Recovered	200	By Balance c/d	9,000
	84,200		84,200

11.0 DEATH OF A PARTNER**BASIC DIFFERENCES BETWEEN THE RETIREMENT OF A PARTNER AND DEATH OF A PARTNER**

The basic differences between the two situations are: (a) that the retirement of a partner may be planned to be effective from a particular **Date** whereas the death of a partner may occur any time during the year; (b) that the payment of the amount due is made to the retiring partner in case of retirement of a partner whereas the payment of the amount due is made to the legal representatives of a deceased partner in case of death of a partner.

HOW TO ASCERTAIN THE SHARE OF A DECEASED PARTNER

When a partner dies, the deceased partner's share in the firm is calculated in the same manner as in case of a retiring partner.

Dr.

FORMAT OF A DECEASED PARTNER'S CAPITAL ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Goodwill A/c [Existing Goodwill w/o]	xxx	By Balance b/d	xxx
To Drawings	xxx	By Gaining Partner's Capital A/c	
To Interest on Drawings	xxx	(Share of Goodwill)	xxx
To Undistributed Losses	xxx	By P & L Suspense A/c	
To Revaluation A/c	xxx	(Share of Profits)	xxx
(Share of Loss on Revaluation)		By Reserves (Share of Reserves)	xxx
To Deceased Partner's Executors' A/c	xxx	By Interest on Capital A/c	xxx
[Balancing Figure]		By Revaluation A/c	xxx
		[Share of Profit on Revaluation]	
	xxx		xxx

12.0 OUTGOING PARTNER'S SHARE IN THE PROFITS OF THE YEAR OF DEATH/RETIREMENT

HOW TO CALCULATE OUTGOING PARTNER'S SHARE IN THE PROFITS

The calculation of outgoing partner share in profits earned from the Date of last Balance Sheet to Date of death/retirement, involves the following two steps:

Step 1: Calculate the Profits of the firm from the Date of last Balance Sheet to the Date of death/retirement — Subject to agreement, such profit may be determined either on time basis or on sales basis using previous year's profits or average profits of the past years.

(i) **On Time Basis:** In such a case, the previous year's profits or average profits of past years are divided between pre-death (or retirement) period and post-death (or retirement) period on the basis of time assuming that the profits are earned evenly throughout the year as under:

$$\text{Profit from the date of last B/S to the date of death/retirement} = \frac{\text{No. of days or months from the date of last B/S to the date of death/retirement}}{365 \text{ days or 12 months}} \times \text{Previous year's profits or Average profits of a given number of past years}$$

(ii) **On Sales Basis:** In such a case, the previous year's profits or average profits of past years are apportioned between the pre-death (or retirement) period and post-death (or retirement) period on the basis of turnover as under:

$$\text{Profit from the date of last B/S to the date of death/retirement} = \frac{\text{Sales from the date of last B/S to the date of death/retirement}}{\text{Previous year's Sales or Average Sales of a given number of past years}} \times \text{Previous year's profits or Average profits of a given number of past years}$$

Step 2: Calculate Outgoing Partner's Share in Profits

Outgoing Partner's Share in Profits = (Profits of the firm from the **Date** of last Balance Sheet to the **Date** of death/retirement) × (Proportion of Share of Outgoing Partner)

ILLUSTRATION 35

X, Y and Z were partners sharing profits & losses in the ratio of 3 : 2 : 1 respectively. X died on 31st March, 2018. The partnership deed provided that the share of profit till the Date of death be estimated at the sum calculated on the average of the last three completed years' profits. The book showed the profits for the calendar years as under: 2013 – ₹ 5,000; 2014 – ₹ 5,000; 2015 ₹ 8,000; 2016 – ₹ 7,600 & 2017 – ₹ 9,000.

Calculate his share of profit during the accounting year 2018.

SOLUTION

Particulars	₹
A. Total Profits for last three years (₹ 8,000 + ₹ 7,600 + ₹ 9,000)	24,600
B. Average Profits (₹ 24,600/3)	8,200
C. Estimated Profits for the period from 1.1.20X6 to 31.3.20X6 (₹ 8,200 × 3/12)	2,050
D. Share of X (₹ 2,050 × 3/6)	1,025

ILLUSTRATION 36

X, Y and Z were partners sharing profits & losses in the ratio of 3 : 2 : 1 respectively. X died on 31st March, 2018. The partnership deed provided that the share of profit till the Date of death be estimated at the sum calculated on the sales till the Date of death by applying the ratio of Net Profit to Sales for the last accounting year. Sales from 1.1.2018 to 31.3.2018 amounted to ₹ 30,000. Sales and Net Profit for the year 2017 amounted to ₹ 3,60,000 and ₹ 54,000 respectively. Calculate his share of profit during the accounting year 2018.

SOLUTION

Particulars	₹
A. Estimated Profits for the period from 1.1.2018 to 31.3.2018 = $54,000 \times \frac{30,000}{3,60,000}$	4,500
B. Share of X ($\frac{₹ 4,500 \times 3}{6}$)	2,250

ACCOUNTING TREATMENT OF OUTGOING PARTNER'S SHARE IN THE PROFITS

The outgoing partner's share in the profits may be adjusted in either of the following ways:

- I. **Through Profit and Loss Suspense Account** — The Outgoing Partner's share in the profits between the **Date** of last balance sheet and the **Date** of death/retirement, should be credited to Outgoing Partner's Capital Account through Profit & Loss Suspense Account by passing the following Journal Entry:

Case	Accounting Entry to be passed
I. In Case of Profit	Profit & Loss Suspense A/c Dr. To Outgoing Partner's Capital A/c
II. In Case of Loss	Reverse of the above entry is passed.

TUTORIAL NOTES

1. The Profit & Loss Suspense Account should be closed by transferring its balance to the Profit & Loss Account at the end of accounting period.
2. This treatment is appropriate only when the new profit sharing ratio of continuing partners does not differ from their old profit sharing ratio.
- II. **Through Capital Accounts of the Gaining Partners** — Instead of using Profit & Loss Suspense Account, only the Outgoing Partner's share in the profits/losses may be adjusted through the Capital Accounts of the Gaining Partners in their gaining ratio. The following journal entry is passed to record such an adjustment:

Case	Accounting Entry to be passed
I. In Case of Profit	Gaining Partner's Capital A/cs Dr. [Gaining Ratio] To Outgoing Partner's Capital A/c
II. In Case of Loss	Reverse of the above entry is passed.

Tutorial Note: In case the new profit sharing ratio of continuing partners differ from their old profit sharing ratio, outgoing partner's share of profits must be adjusted through the Capital Accounts of Gaining Partners only.

ILLUSTRATION 37

A, B & C were partners sharing profits & losses in the ratio of 3 : 2 : 1 respectively. B died on 31st March, 2018. The profits from 1.1.2018 to 31.3.2018 amounted to ₹ 4,500. A and C decided to share the future profits in the ratio of 3 : 2 respectively with effect from 1.4.2018. Pass the necessary journal entry to record the B's share of profit to the Date of death.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
31.3.2018	Profit & Loss Suspense A/c Dr. To B's Capital A/c (Being B's Share of profits to the Date of death adjusted)		1,500	1,500
	Alternative Treatment: A's Capital A/c Dr. C's Capital A/c Dr. To B's Capital A/c (Being B's share of profit to the Date of death adjusted in the capital accounts of A & C in their gaining ratio of 3 : 7)		450 1,050	1,500

13.0 DECEASED PARTNER'S SHARE OF GOODWILL

A deceased partner's share of goodwill is calculated and adjusted in the same manner as in case of a retiring partner.

ILLUSTRATION 38

A, B and C are in partnership sharing profits in the ratio of 4 : 3 : 1. B died on 30th June 2018. The firm's profits for various years were-2013 (Profits ₹ 6,48,888), 2014 (Profits ₹ 1,60,000), 2015 (Profits ₹ 20,000), 2016 (Losses ₹ 20,000), 2017 (Profits ₹ 80,000), 2018 (Profits ₹ 1,00,000). A and C decided to share future profits in the ratio of 3 : 2. Goodwill is to be valued on the basis of 2 years' purchase of average profits of 4 completed years immediately preceding the year of death of a partner. Pass a Journal Entry to record B's Share of Goodwill.

SOLUTION

$$\text{A's Gain} = \frac{3}{5} - \frac{4}{8} = \frac{4}{40}, \text{ C's Gain} = \frac{2}{5} - \frac{1}{8} = \frac{11}{40}$$

$$\text{Gain in Ratio of A and C} = \frac{4}{40} : \frac{11}{40} = 4 : 11$$

A. Average Profits of 4 years = (₹ 1,60,000 + ₹ 20,000 – ₹ 20,000 + ₹ 80,000)/4 = ₹ 60,000

B. Firm's Goodwill = ₹ 60,000 × 2 = ₹ 1,20,000

C. B's Share of Goodwill = ₹ 1,20,000 × 3/8 = ₹ 45,000

JOURNAL ENTRY

Particulars	L.F.	Dr. (₹)	Cr. (₹)
A's Capital A/c Dr. C's Capital A/c Dr. To B's Capital A/c (Being the B's share of goodwill credited to B and debited to A and C in their gaining ratio of 4 : 11)		12,000 33,000	45,000

ILLUSTRATION 39

A, B and C are in partnership sharing profits in the ratio of 4 : 3 : 1. B died on 30th June 2018. The firm's profits for various years were-2013 (Profits ₹ 6,48,888), 2014 (Profits ₹ 1,60,000), 2015 (Profits ₹ 20,000), 2016 (Losses ₹ 20,000), 2017 (Profits ₹ 80,000), 2018 (Profits ₹ 1,00,000). A and C decided to share future profits in the ratio of 3 : 2. Goodwill is to be valued on the basis of such partner's share of 2 years' profits calculated on the average of 5 completed years' profits immediately preceding the year of death less 10%. Pass a Journal Entry to record B's Share of Goodwill.

SOLUTION

- A. Average Profits = $(₹ 6,48,888 + ₹ 1,60,000 + ₹ 20,000 - ₹ 20,000 + ₹ 80,000)/5 = ₹ 1,77,777.6$
- B. 2 years' Average profits = $₹ 1,77,777.6 \times 2 = ₹ 3,55,555.2$
- C. B's Share of 2 years' Average Profits = $₹ 3,55,555 \times 3/8 = ₹ 1,33,333.2$
- D. Firm's Goodwill = $₹ 1,33,333 - 10\% \text{ of } ₹ 1,33,333 = ₹ 1,20,000$
- E. B's Share of Goodwill = $₹ 1,20,000 \times 3/8 = ₹ 45,000$

Gaining Ratio and Journal Entry - Same as in Illustration 38.

ILLUSTRATION 40

A, B and C are in partnership sharing profits in the ratio of 4 : 3 : 1. B died on 30th June 2018. The firm's profits for various years were-2013 (Profits ₹ 6,48,888), 2014 (Profits ₹ 1,60,000), 2015 (Profits ₹ 20,000), 2016 (Losses ₹ 20,000), 2017 (Profits ₹ 80,000) 2018 (Profits ₹ 1,00,000). A and C decided to share future profits in the ratio of 3 : 2. Deceased partner's share of goodwill is to be valued at one half of the net profit credited to his account during the last four completed years immediately preceding the year of death. Pass a Journal Entry to record B's Share of Goodwill.

SOLUTION

- A. Total Profits of 4 years = $(₹ 1,60,000 + ₹ 20,000 - ₹ 20,000 + ₹ 80,000 = ₹ 2,40,000$
- B. B's Share of profit credited during 4 years = $₹ 2,40,000 \times 3/8 = ₹ 90,000$
- C. B's Share of Goodwill = $₹ 90,000 \times 1/2 = ₹ 45,000$

Gaining Ratio & Journal Entry - Same as in Illustration 38.

ILLUSTRATION 41

A, B and C are in partnership sharing profits in the ratio of 4 : 3 : 1. B died on 30th June 2018. The firm's profits for various years were-2013 (Profits ₹ 6,48,888), 2014 (Profits ₹ 1,60,000), 2015 (Profits ₹ 20,000), 2016 (Losses ₹ 20,000), 2017 (Profits ₹ 80,000), 2018 (Profits ₹ 1,00,000). A and C decided to share future profits in the ratio of 3 : 2. Goodwill is to be valued at three years' purchase of average profits of three years upto the **Date** of death. Pass a Journal Entry to record B's Share of Goodwill.

SOLUTION

- A. Average Profits, of three years upto **Date** of death comprise the profits earned from 1st July 20X3 to 30th June 20X6
 $= (50\% \text{ of } ₹ 20,000 - ₹ 20,000 + ₹ 80,000 + 50\% \text{ of } ₹ 1,00,000)/3 = ₹ 40,000$
- B. Firm's Goodwill = $₹ 40,000 \times 3 = ₹ 1,20,000$
- C. B's share of Goodwill = $₹ 1,20,000 \times 3/8 = ₹ 45,000$

Gaining Ratio & Journal Entry - Same as in Illustration 38

ILLUSTRATION 42

P, R and S are partners sharing profits in the ratio of 4 : 3 : 1 respectively. It is provided under the 'partnership deed that on the death of any partner his share of goodwill is to be valued at one half of the net profits credited to his account during the last 4 completed years and share of profit to the Date of death is to be based on the average profits of the last three completed years, plus 10% (books of accounts are closed on 31st December). R died on 14th March 2018. The firm's profits for the last 4 years were as follows: 2014 (Profits ₹ 1,20,000); 2015 (Profits ₹ 60,000), 2016 (Losses ₹ 20,000) and 2017 (Profits ₹ 80,000)

Pass a journal entries to adjust R's Share of Goodwill and Profit assuming that profit sharing ratio between P and S in future will be 3 : 2.

SOLUTION**1. Calculation of R's Share of goodwill**

- A. Total Profits = 1,20,000 + 60,000 – 20,000 + 80,000 = ₹ 2,40,000
 B. R's Share of Profits credited during 4 years = ₹ 2,40,000 × 3/8 = ₹ 90,000
 C. R's Share of Goodwill ₹ 90,000 × 1/2 = ₹ 45,000

2. Calculation of R's Share of Profits

$$\begin{aligned}\text{Average Profits} &= [(\text{₹ } 60,000 - \text{₹ } 20,000 + \text{₹ } 80,000)/3] + 10\% \\ &= \text{₹ } 40,000 + 10\% \text{ of } \text{₹ } 40,000 = \text{₹ } 44,000 \\ \text{R's Share of Profits} &= \text{₹ } 44,000 \times 73/365 \times 3/8 = \text{₹ } 3,300\end{aligned}$$

(B) JOURNAL ENTRIES

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	P's Capital A/c Dr. S's Capital A/c Dr. To R's Capital A/c (Being R's Share of goodwill credited to R and debited to P and S in their Gaining Ratio of 4 : 11)		12,000 33,000	45,000
	Profit & Loss Suspense A/c Dr. To R's Capital A/c (Being R's Share of Profits to the Date of death adjusted)		3,300	3,300

Working Note: Calculation of Gaining Ratio

$$\text{P's Gain} = \frac{3}{5} - \frac{4}{8} = \frac{4}{40}, \text{ S's Gain} = \frac{2}{5} - \frac{1}{8} = \frac{11}{40}, \text{ Gaining Ratio of P \& S} = \frac{4}{40} : \frac{11}{40} = 4 : 11$$

CALCULATION OF AMOUNT PAYABLE TO EXECUTORS OF A DECEASED PARTNER**ILLUSTRATION 43**

The Balance Sheet of Jassal, Jaipaul and Jyoti who are partners sharing profit in the ratio of 2 : 2 : 1, as on 31st March, 2018 is as follows:

Liabilities	₹	Assets	₹
Creditors	30,000	Goodwill	30,000
Employees' Provident Fund	10,000	Fixed Assets	60,000
Contingency Reserve	30,000	Stock	10,000
Jassal's Capital	30,000	Sundry Debtors	20,000
Jaipaul's Capital	25,000	Cash at Bank	15,000
Jyoti's Capital	15,000	Advertisement Expenditure	5,000
	1,40,000		1,40,000

Jaipaul died on 15th June, 2018. According to the Deed, his legal representatives were entitled to:

- Balance in Capital Account.
- Share of goodwill valued on the basis of thrice the average of the past four years' profits.
- Share in profits upto the Date of death on the basis of average profits for the past four years.
Profits for the years ending on March 31st, of 2015, 2016, 2017 and 2018 respectively were ₹ 15,000; ₹ 17,000; ₹ 19,000 and ₹ 13,000.
- Interest on Capital @ 12% p.a.
Jaipaul's legal representatives were to be paid the amount due. Jassal and Jyoti continued as partners by taking over Jaipaul's share equally.

Required: Work out the amount payable to Jaipaul's legal representatives

SOLUTION

1. Calculation of Share of Goodwill

A. Value of Goodwill = $[(15,000 + 17,000 + 19,000 + 13,000)/4] \times 3 = ₹ 48,000$

B. Jaipaul's Share of Goodwill = $₹ 48,000 \times 2/5 = ₹ 19,200$

2. Calculation of Share of Profits

A. Average Profit = ₹ 16,000

B. Estimated Profit upto Date of death = $(₹ 16,000/12) \times 2\frac{1}{2} = ₹ 3,333.33$

C. Jaipaul's Share of Profits = $₹ 3,333.33 \times 2/5 = ₹ 1,333.33$

3. Interest on Capital = $₹ 25,000 \times 2.5/12 \times 12/100 = ₹ 625$

4. Jaipaul's Share of Reserve = $₹ 30,000 \times 2/5 = ₹ 12,000$

5. Jaipaul's Share of Advertisement Expenditure = $₹ 5,000 \times 2/5 = ₹ 2,000$.

6. TOTAL AMOUNT PAYABLE TO JAIPAUL'S LEGAL REPRESENTATIVE.

Opening balance	25,000
Goodwill	19,200
Less: Goodwill w/o ($₹ 30,000 \times 2/5$)	(12,000)
Profits	1,333
Interest on Capital	625
Contingency Reserve	12,000
Less: Advertisement Expenditure	(2,000)
	44,158

ILLUSTRATION 44

Arti, Bharati and Seema are partners in a firm sharing profits in the proportion of 3:2:1. Their Balance Sheet as at 31st March, 2018 stood as follows:

Liabilities	₹	Assets	₹
Trade Payables	26,000	Buildings	21,000
General Reserve	12,000	Cash at Bank	25,700
Arti's Capital	20,000	Trade Receivables	16,300
Bharati's Capital	12,000	Stock	1,750
Seema's Capital	8,000	Investments	13,250
	78,000		78,000

Bharati died on 30th June, 2018 and according to the deed of the said partnership her executors are entitled to be paid as under:

- (i) The capital to her credit at the time of her death and interest thereon @ 10% per annum.
- (ii) Her proportionate share of general reserve.
- (iii) Her share of profits for the intervening period will be based on the sales during that period. Sales were calculated as ₹ 1,20,000. The rate of profit during past three years had been 10% on sales.
- (iv) Goodwill according to her share of profit to be calculated by taking twice the amount of profits of the last three years less 20%. The profits of the previous three years were:
2015-2016 ₹ 8,200, 2016-2017 ₹ 9,000, 2017-2018 ₹ 9,800

The investments were sold at par and her executors were paid out in full.

Required: Prepare Bharati's Capital Account and her Executor's Account.

SOLUTION

Dr. **BHARTI'S CAPITAL ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
30.06.2018	To Bharti's Executor A/c (Balancing Figure)	34,700	01.04.2018	By Balance b/d	12,000
			30.06.2018	By General Reserve	4,000
			30.06.2018	By Interest on Capital	300
			30.06.12	By P&L Suspense A/c	4,000
			30.06.12	By Aarti's Capital A/c	10,800
			30.06.12	By Seema's Capital A/c (Goodwill)	3,600
		34,700			34,700

Dr. **BHARTI'S EXECUTOR'S ACCOUNT** Cr.

Date	Particulars	₹	Date	Particulars	₹
30.06.2018	To Bank A/c (Bal. fig.)	34,700	30.06.2018	By Bharti's Capital A/c	34,700
		34,700			34,700

Working Notes:

1. **Interest on Capital** = $12,000 \times 10/100 \times 3/12 = ₹ 300$
2. **Share in General Reserve** = $12,000 \times 2/6 = ₹ 4,000$
3. **Share of Profit** = $1,20,000 \times 10/100 = ₹ 12,000$, Bharti's Share = $2/3 \times 12,000 = ₹ 8,000$
4. **Share of Goodwill**

Total Profit of Last 3 Years = $8,200 + 9,000 + 9,800 = ₹ 27,000$

Firm's Goodwill = $(27,000 \times 2) - (20\% \text{ of } ₹ 54,000) = ₹ 43,200$

Share of Goodwill = $43,200 \times 2/6 = ₹ 14,400$

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Arti's Capital Dr.		10,800	
	Seema's Capital A/c Dr.		3,600	
	To Bharti's Capital A/c			14,400
	(For Bharti's share of goodwill given to her by Arti and Seema in gaining ratio)			

ILLUSTRATION 45

In the partnership agreement between A, B and C who were sharing profits & losses in the ratio of 4 : 2 : 2, the goodwill was to be valued on the death of any partner on the basis of such partner's share of 4 years' profits calculated on the average of 5 years profits immediately preceding the year of death less 10%. The firm's profits were ₹ 20,000 in 2013, ₹ 60,000 in 2014, ₹ 80,000 in 2015 and, losses of ₹ 10,000 in 2016 and ₹ 4,000 in 2017. The deceased partner's share of profits for the period of his life-time in the year of death was to be based on the average of profits of the previous 3 years plus 10%. Investments (market value ₹ 10,000) were appearing in the books at ₹ 8,000.

A died on 31st May, 2018. His Capital Account showed a credit of ₹ 20,000 on 1st Jan, 2018 and he had drawn ₹ 6,000 since that **Date**. Interest on Capital is to be allowed and interest on drawings is to be charged @ 12% p.a.. Half of the Investments were sold at market value to pay off A's Executors' in part.

Required: Prepare A's Capital Account and A's Executor's A/c.

SOLUTION

Dr. **A'S CAPITAL ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Drawings	6,000	By Balance b/d	20,000
To Interest on Drawings (6,000 × 12/100 × 2.5/12)	150	By Interest on Capital (₹ 20,000 × 12/100 × 5/12)	1,000
To A's Executors' A/c	46,672	By P & L Suspense A/c (Share of profit)	5,042
		By B's Capital A/c (Share of goodwill)	13,140
		By C's Capital A/c (Share of goodwill)	13,140
		By Revaluation A/c (Profit)	500
	52,822		52,822

Dr. **A'S EXECUTORS' ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Bank A/c	5,000	By A's Capital A/c	46,672
To Balance c/d	41,672		
	46,672		46,672

Working Notes:**1. Calculation of A's Share of Goodwill**

- Average Profit of 5 years = $(₹ 20,000 + ₹ 60,000 + ₹ 80,000 - ₹ 10,000 - ₹ 4,000)/5 = ₹ 29,200$.
- 4 years' average profits = $₹ 29,200 \times 4 = ₹ 1,16,800$
- A's share of aforesaid profits = $₹ 1,16,800 \times 4/8 = ₹ 58,400$.
- Value of firm's goodwill = $₹ 58,400 - 10\% \text{ of } ₹ 58,400 = ₹ 52,560$.
- A's share of Goodwill = $₹ 52,560 \times 4/8 = ₹ 26,280$

2. Calculation of A's Share of Profits

- Average profits of 3 years = $(₹ 80,000 - ₹ 10,000 - ₹ 4,000)/3 = ₹ 22,000$
- Estimated Profits for 2018 = $₹ 22,000 + 10\% \text{ of } ₹ 22,000 = ₹ 24,200$.

C. Estimated Profits for 5 months = ₹ 24,200 × 5/12 = ₹ 10,083

D. A's Share of Profits = ₹ 10,083 × 1/2 = ₹ 5,042

3. A's Share of Profit on Revaluation = [(₹10,000/2) - (₹ 8000/2)] × 4/8 = ₹ 500

ILLUSTRATION 46

X and Y are partners. The Partnership deed provides inter alia:—

- (a) That the accounts be balanced on 31st December in each year.
- (b) That the profits be divided as follows: X one-half, Y one-third and carried to a Reserve Account one-sixth.
- (c) That in the event of the death of a partner, his executors be entitled to be paid out:
 - (i) The Capital to his credit at Date of death.
 - (ii) His proportion of profits to Date of death based on the average profits of the last three completed years.
 - (iii) By way of Goodwill, his proportion of the total profits for the three preceding years.
- (d) The Balance Sheet as at 31st Dec., 2017

Particulars	₹
X's Capital	9,000
Y's Capital	6,000
Contingency Reserve	3,000
Creditors	2,000
Employees' Provident Fund	1,000
Sundry Assets	21,000

The Profits for three years were: 2015-₹ 4,200; 2016-₹ 3,900; 2017-₹ 4,500. Y died on 1st May, 2018.

Required: Prepare Y's Capital Account and Y's Executors Account.

SOLUTION

Dr. Cr. **Y'S CAPITAL ACCOUNT**

Particulars	₹	Particulars	₹
To Y's Executors A/c	12,800	By Balance b/d	6,000
		By Conting. Reserve (₹ 3,000 × 2/5)	1,200
		By P & L Suspense A/c (Share of Profit)	560
		By X's Capital A/c (Share of Goodwill)	5,040
	12,800		12,800

Dr. Cr. **Y'S EXECUTORS' ACCOUNT**

Particulars	₹	Particulars	₹
To Balance c/d	12,800	By Y's Capital A/c	12,800

Working Notes:

1. Ratio between X and Y = 1/2 : 1/3 = 3 : 2

2. CALCULATION OF Y'S SHARE OF GOODWILL

A. Total Profits for previous three years	₹ 12,600
B. Y's Share of Goodwill (₹ 12,600 × 2/5)	₹ 5,040

3. CALCULATION OF Y'S SHARE OF PROFITS

A. Total Profit for previous three years	₹ 12,600
B. Average Profits (₹ 12,600/3)	₹ 4,200
C. Profit from 1.1.2018 to 30.4.2018 (₹ 4,200 × 4/12)	₹ 1,400
D. Y's Share of Profits (₹ 1,400 × 2/5)	₹ 560

ILLUSTRATION 47

R, S and T were partners sharing profits and losses in the ratio of 5 : 3 : 2 respectively. On 31st December 2017. Their Balance Sheet stood as under:

Liabilities	₹	Assets	₹
Sundry Creditors	50,000	Goodwill	25,000
Employees' Provident Fund	5,000	Leasehold	1,00,000
Contingency Reserve	20,000	Patents	30,000
Employees' Compensation Reserve	10,000	Machinery	1,50,000
Capital Accounts:		Stock	50,000
R	1,50,000	Debtors	40,000
S	1,25,000	Cash at Bank	40,000
T	75,000		
	4,35,000		4,35,000

T died on 1st May, 2018. It was agreed that:

- Goodwill to be valued at 2½ years' purchase of last four years' average profits which were: 2014-₹ 65,000, 2015-₹ 60,000, 2016-₹ 80,000 and 2017-₹ 75,000.
- Machinery be valued at ₹ 1,40,000; Patents be valued at ₹ 40,000; Leasehold be valued at ₹ 1,25,000.
- For the purpose of calculating T's share in the profits to 2018, the profits in 2018 should be taken to have accrued on the same scale as in 2017.
- A sum of ₹ 21,000 to be paid immediately to the executors of T and the balance to be paid in four equal half-yearly instalments together with interest @ 10% per annum.

Required: Pass the necessary journal entries to record the above transactions and T's Executors' Account for 2018.

SOLUTION**JOURNAL**

Particulars	L.F.	Dr. (₹)	Cr. (₹)
Revaluation A/c Dr. To Machinery A/c (Being the decrease in value of asset recorded)		10,000	10,000
Patents A/c Dr. Leasehold A/c Dr. To Revaluation A/c (Being the increase in value of Assets recorded)		10,000 25,000	35,000

Revaluation A/c	Dr.		25,000	
To R's Capital A/c				12,500
To S's Capital A/c				7,500
To T's Capital A/c				5,000
(Being the transfer of profit on revaluation)				
R's Capital A/c	Dr.		12,500	
S's Capital A/c	Dr.		7,500	
T's Capital A/c	Dr.		5,000	
To Goodwill A/c				25,000
(Being the existing goodwill w/o)				
R's Capital A/c [₹ 35,000 × 5/8]	Dr.		21,875	
S's Capital A/c [₹ 35,000 × 3/8]	Dr.		13,125	
To T's Capital A/c [₹ 1,75,000 × 2/10]				35,000
(Being T's share of goodwill adjusted through capital accounts)				
Profit & Loss Suspense A/c	Dr.		5,000	
To T's Capital A/c				5,000
(Being T's share of profit to Date of death credited)				
Contingency Reserve A/c	Dr.		20,000	
To R's Capital A/c				10,000
To S's Capital A/c				6,000
To T's Capital A/c				4,000
(Being the transfer of Contingency Reserve)				
Employees' Compensation Reserve	Dr.		10,000	
To R's Capital A/c				5,000
To S's Capital A/c				3,000
To T's Capital A/c				2,000
(Being the transfer of Workmen Compensation Reserve)				
T's Capital A/c	Dr.		1,21,000	
To T's Executor's A/c				1,21,000
(Being the transfer of T's capital A/c to his executor's A/c)				
T's Executor's A/c	Dr.		21,000	
To Bank A/c				21,000
(Being partial payment made to R's Executors)				

Dr.
T'S CAPITAL ACCOUNT
Cr.

Particulars	₹	Particulars	₹
To Goodwill A/c	5,000	By Balance b/d	75,000
To T's Executor's A/c	1,21,000	By Revaluation A/c	5,000
		By R's Capital A/c (Goodwill)	21,875
		By S's Capital A/c (Goodwill)	13,125
		By Profit and Loss A/c	5,000
		By Contingency Reserve	4,000
		By Employees' Comp. Reserve	2,000
	1,26,000		1,26,000

Dr.

T'S EXECUTORS' ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.05.2018	To Bank A/c	21,000	01.05.2018	By T's Capital A/c	1,21,000
31.10.2018	To Bank A/c	30,000	31.10.2018	By Interest A/c	
31.10.2018	To Balance c/d	75,000		(1,00,000 × 10/100 × 6/12)	5,000
		1,26,000			1,26,000
31.12.2018	To Balance c/d	76,250	01.11.2018	By Balance b/d	75,000
			31.12.2018	By Interest A/c (accrued)	
				(75,000 × 10/100 × 6/12)	1,250
		76,250			76,250

Working Notes:**1. CALCULATION OF GOODWILL**

Particulars	₹
A. Total profits for first 4 years	2,80,000
B. Average Profit (₹ 2,80,000/4)	70,000
C. Goodwill (₹ 70,000 × 2½)	1,75,000
D. T's share [₹ 1,75,000 × 2/10]	35,000

2. T's Share of Profit to the Date of death = ₹ 75,000 × 4/12 × 2/10 = ₹ 5,000

3. It may be noted that R's Executor's A/c has been required for 2018.

ILLUSTRATION 48

The following is the balance Sheet of Ram, Mohan and Sohan as on 31st December, 2017.

Liabilities	₹	Assets	₹
Sundry Creditors	10,000	Goodwill	5,000
Workmen Compensation Reserve	7,500	Tools	3,000
Ram's Capital	20,000	Furniture	13,000
Mohan's Capital	10,000	Stock	16,000
Sohan's Capital	10,000	Debtors	12,000
		Cash at bank	8,000
		Cash in hand	500
	57,500		57,500

Ram, Mohan and Sohan shared profits and losses in the ratio of 2 : 2 : 1. Sohan died on 31st March 2018. Under the Partnership agreement the executor of Sohan was entitled to:

- Amount standing to the credit of his Capital Account.
- Interest on Capital @ 6% p.a.
- Share of Goodwill on the basis of twice the average of past three years' profits.
- Share of profit from the closing of last financial year to the Date of death on the basis of average profits of past three years.

Profits for 2015, 2016 and 2017 were ₹ 10,000, ₹ 15,000 and ₹ 20,000 respectively. Sohan's executor was paid ₹ 1,400 on 1st April, 2018 and the balance in four equal yearly instalments from 31.3.2019 with interest @ 6% p.a.

Required: Pass necessary Journal entries and draw up Sohan's Account to be rendered to his executor and Sohan's Executor's Account till it is finally paid.

SOLUTION

JOURNAL

Particulars	L.F.	Dr. (₹)	Cr. (₹)
Interest on Capital Dr. To Sohan's Capital A/c (Being the interest on Capital provided)		150	150
Ram's Capital A/c [₹ 5,000 × 2/5] Dr. Mohan's Capital A/c [₹ 5,000 × 2/5] Dr. Sohan's Capital A/c [₹ 5,000 × 1/5] Dr. To Goodwill A/c (Being the existing goodwill w/o)		2,000 2,000 1,000	5,000
Ram's Capital A/c Dr. Mohan's Capital A/c Dr. To Sohan's Capital A/c (Being the Share of goodwill credited)		3,000 3,000	6,000
Profit & Loss Suspense A/c Dr. To Sohan's Capital A/c (Being the Share of profit credited)		750	750
Workmen Compensation Reserve Dr. To Sohan's Capital A/c (Being the Share of reserve credited)		1,500	1,500
Sohan's Capital A/c Dr. To Sohan's Executors' A/c (Being the transfer of Balance in Sohan's Capital A/c to Sohan's Executor's A/c)		17,400	17,400
Sohan's Executor's A/c Dr. To Cash A/c (Being the cash Paid to Sohan's Executors)		1,400	1,400

Dr.

SOHAN'S CAPITAL ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Goodwill A/c	1,000	By Balance b/d	10,000
To Sohan's Executor's A/c	17,400	By Interest on Capital	150
		By Ram's Capital A/c	3,000
		By Mohan's Capital A/c	3,000
		By P & L Suspense A/c	750
		By Workmen Comp. Reserve A/c	1,500
	18,400		18,400

Dr.

SOHAN'S EXECUTOR'S ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 April 1 Dec. 31	To Bank A/c To Balance c/d	1,400 16,720	2018 Mar. 31 Dec. 31	By Sohan's Capital A/c By Interest A/c [(17,400 – 1,400) × 6/100 × 9/12]	17,400 720
		18,120			18,120
2019 Mar 31 Dec. 31	To Cash A/c [₹ 4,000 + ₹ 960] To Balance c/d	4,960 12,540	2019 Jan 1 March 31 Dec. 31	By Balance b/d By Interest A/c [16,000 × 6/100 × 3/12] By Interest A/c [12,000 × 6/100 × 9/12]	16,720 240 540
		17,500			17,500
2020 Mar 31 Dec 31	To Cash A/c [₹ 4,000 + ₹ 720] To Balance c/d	4,720 8,360	2020 Jan 1 Mar 31 Dec. 31	By Balance b/d By Interest A/c [12,000 × 6/100 × 3/12] By Interest A/c [8,000 × 6/100 × 9/12]	12,540 180 360
		13,080			13,080
2021 Mar. 31 Dec. 31	To Cash A/c [₹ 4,000 + ₹ 480] To Balance c/d	4,480 4,180	2021 Jan. 1 Mar. 31 Dec 31	By Balance b/d By Interest A/c [8,000 × 6/100 × 3/12] By Interest A/c [4,000 × 6/100 × 9/12]	8,360 120 180
		8,660			8,660
2022 Mar 31	To Cash A/c [₹ 4,000 + ₹ 240]	4,240	2022 Jan 1 Mar 31	By Balance b/d By Interest A/c [4,000 × 6/100 × 3/12]	4,180 60
		4,240			4,240

Note: The Date of closing the accounts is 31st Dec. and Date of payment of instalment is 31st March.

Working Notes:**1. Calculation of Share of Goodwill**

- A. Present Value of Goodwill = $[(₹ 10,000 + ₹ 15,000 + ₹ 20,000)/3] \times 2 = ₹ 30,000$
 B. Deceased Partner's share of Goodwill = $₹ 30,000 \times 1/5 = ₹ 6,000$

2. Calculation of Share of Profits

- A. Average Profits = $(₹ 10,000 + ₹ 15,000 + ₹ 20,000)/3 = ₹ 15,000$
 B. Estimated Profits upto Date of death = $₹ 15,000 \times 3/12 = ₹ 3,750$
 C. Deceased Partner's Share of Profits = $₹ 3,750 \times 1/5 = ₹ 750$

ILLUSTRATION 49

On 31st December 2017, the Balance Sheet of P, Q and R who were partners in a firm, was as under:

Liabilities	₹	Assets	₹
Sundry Creditors	25,000	Building	26,000
Reserves Fund	20,000	Investments	11,000
P's Capital A/c	13,000	Debtors	15,000
Q's Capital A/c	9,000	Bills Receivable	6,000
R's Capital A/c	9,000	Stock	12,000
		Cash	6,000
	76,000		76,000

The partnership deed provides that the profits be shared in the ratio of 2 : 1 : 1 and that in the event of death of the partner, his executors will be entitled to be paid out:

- The capital to his credit at the Date of last Balance Sheet;
- His proportion of Reserve at the Date of last Balance Sheet;
- His proportion of profits to the Date of death based on the average profits of the last three completed years, plus 10%.
- By way of goodwill, his proportion of the total profits for the three preceding years
- The Net Profits for the last three years were:

2015 ₹ 16,000, 2016 ₹ 16,000, 2017 ₹ 15,400

R died on 1st April, 2018. He had withdrawn ₹ 5,000 to the Date of his death. The Investments were sold for ₹ 15,000 and R's executors were paid off.

Required: Prepare Partners' Capital Accounts, R's Executor's Account and Balance Sheet of the surviving partners P and Q.

SOLUTION

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	P ₹	Q ₹	R ₹	Particulars	P ₹	Q ₹	R ₹
To R's Capital	7,900	3,950		By Balance b/d	13,000	9,000	9,000
To Cash A/c			5,000	By Reserve Fund	10,000	5,000	5,000
To R's Executors' A/c			22,936	By P & L Susp. A/c			1,086
To Balance c/d	17,100	11,050		By P's Capital A/c			7,900
				By Q's Capital A/c			3,950
				By Revaluation A/c	2,000	1,000	1,000
	25,000	15,000	27,936		25,000	15,000	27,936

Dr.

CASH ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	6,000	By R's Capital A/c (Drawings)	5,000
To Investments	15,000	By R's Executors' A/c (Amount Due)	22,936
To Balance c/d (b.f.) (Overdraft Bal)	6,936		
	27,936		27,936

Dr.

R'S EXECUTOR ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Cash A/c	22,936	By R's Capital A/c	22,936
	22,936		22,936

BALANCE SHEET OF P AND Q AS AT 1ST APRIL, 2018

Liabilities	₹	Assets	₹
Sundry Creditors	25,000	Building	26,000
P's Capital A/c	17,100	Debtors	15,000
Q's Capital A/c	11,050	Bills Receivable	6,000
Overdraft	6,936	Stock	12,000
		P & L Suspense A/c	1,086
	60,086		60,086

Working Notes:**1. R's Share of Profits**

$$\begin{aligned}\text{Average Profits} &= \frac{16,000 + 16,000 + 15,400}{3} + 10\% \\ &= 15,800 + 10\% \text{ of } ₹ 15,800 = ₹ 17,380\end{aligned}$$

$$\text{R's Share of Profits} = 17,380 \times 3/12 \times 1/4 = ₹ 1,086$$

$$\text{2. R's Share in Goodwill} = 47,400 \times 1/4 = ₹ 11,850$$

ILLUSTRATION 50

Khanna, Seth and Mehta were partners in a firm sharing profits in the ratio of 3 : 2 : 5. On 31-12-2017 the Balance Sheet of Khanna, Seth and Mehta was as follows:

Liabilities	₹	Assets	₹
Khanna's Capital	5,00,000	Goodwill	3,00,000
Seth's Capital	2,05,000	Fixed Assets	6,60,000
Mehta's Capital A/c	3,00,000	Investments	10,000
Workmen Compensation Reserve	1,00,000	Stock	30,000
Employees' Provident Fund	20,000	Debtors	1,20,000
Loan from Seth	50,000	Cash	50,000
Creditors	51,000	P&L Account (for the year 2017)	60,000
Provision for Doubtful Debts	4,000		
	12,30,000		12,30,000

On 14th March 2018, Seth died. He had withdrawn ₹ 5,000 during 2018.

The partnership deed provided that on the death of a partner the executor of the deceased partner is entitled to:

- (i) Balance in Capital Account;
- (ii) Share in Profits upto the Date of death on the basis of Last year's profit;
- (iii) His Share in Profit/Loss on Revaluation of Assets and re-assessment of Liabilities which were as follows:
 - (a) Fixed Assets were to be valued at ₹ 7,35,000.

- (b) Stock was overvalued by ₹ 11,000
- (c) A provision of 2½% for doubtful debts was to maintained on Debtors;
- (d) Creditors of ₹ 2,000 are not to be paid.
- (e) Investments were sold for ₹ 20,000
- (iv) Half of the net amount payable to Seth's executors was paid immediately and the balance was transferred to his loan account which was to be paid later.

Required: Prepare Revaluation Account, Partners' Capital Accounts, Seth's Executors A/c and the Balance Sheet of Khanna and Mehta who decided to continue the business keeping their capital balances in their new profit sharing ratio. Any surplus or deficit to be transferred to Current Accounts of the partners.

Note: Firm enjoys Bank Overdraft facility.

SOLUTION

Dr. **1. REVALUATION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Stock A/c	11,000	By Fixed Assets	
To Profit on Revaluation t/f to:		[₹ 7,35,000 – ₹ 6,60,000]	75,000
Khanna's Capital A/c	23,100	By Provision for Doubtful	
Seth's Capital A/c	15,400	Existing	4,000
Mehta's Capital A/c	38,500	Less: Required	3,000
		[₹ 1,20,000 × 2.5/100]	
		By Creditors	2,000
		By Investments	10,000
	88,000		88,000

Dr. **2. PARTNER'S CAPITAL ACCOUNTS** Cr.

Particulars	Khanna ₹	Seth ₹	Mehta ₹	Particulars	Khanna ₹	Seth ₹	Mehta ₹
To Cash A/c (Drawings)	—	5,000	—	By Balance b/d	5,00,000	2,05,000	3,00,000
To Goodwill A/c (w/o)	90,000	60,000	1,50,000	By W. Comp Reserve	30,000	20,000	50,000
To Profit & Loss A/c	18,000	12,000	30,000	By Revaluation A/c (Profit)	23,100	15,400	38,500
To P&L Susp. A/c (Loss)	—	2,400	—				
To Seth's Executor's A/c	—	1,61,000	—				
To Balance c/d	4,45,100	—	2,08,500				
	5,53,100	2,40,400	3,88,500		5,53,100	2,40,400	3,88,500

Dr. **3. SETH'S EXECUTOR'S ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Cash A/c	1,05,500	By Seth's Capital A/c	1,61,000
To Seth's Executor's Loan A/c	1,05,500	By Seth's Loan A/c	50,000
	2,11,000		2,11,000

4. BALANCE SHEET OF KHANNA & MEHTA*as at 14th March, 2018*

Liabilities	₹	Assets	₹
Khanna's Capital	2,45,100	Fixed Assets	7,35,000
Mehta's Capital	4,08,500	Stock	19,000
Creditors [51,000 – 2,000]	49,000	Debtors	1,20,000
Seth's Executors' Loan A/c	1,05,500	Less: Provision	3,000
Profit & Loss Suspense A/c	2,400	Mehta's Current A/c	2,00,000
Khanna's Current A/c	2,00,000		
Bank Overdraft	40,500		
Employees' Provident Fund	20,000		
	10,71,000		10,71,000

Working Notes:

1. **Calculation of Seth's Share in Loss** = ₹ 60,000 × 73/365 × 2/10 = ₹ 2,400

2. **Calculation of Khanna's New Capital and Mehta's New Capital**

Total Capital on New Firm = Total Adjusted Old Capitals = ₹ 4,45,100 + ₹ 2,08,500 = ₹ 6,53,600

Khanna's New Capital = ₹ 6,53,600 × 3/8 = ₹ 2,45,100

Mehta's New Capital = ₹ 6,53,600 × 5/8 = ₹ 4,08,500

T/f to Khanna's Current A/c (Cr.) = ₹ 4,45,100 – ₹ 2,45,100 = ₹ 2,00,000

T/f to Mehta's Current A/c (Dr.) = ₹ 2,08,500 – ₹ 4,08,500 = ₹ 2,00,000

*Dr.***CASH ACCOUNT***Cr.*

Particulars	₹	Particulars	₹
To Balance b/d	50,000	By Seth's Capital A/c (Drawings)	5,000
To Investments	20,000	By Seth's Executors's A/c	1,05,500
To Bank Overdraft (Bal. Figure)	40,500		
	1,10,500		1,10,500

Note: Due to Shortage of Cash, Bank Overdraft has been taken.

ILLUSTRATION 51

The Balance Sheet of X, Y and Z sharing profits and losses in the ratio of 5 : 3 : 2 on 31st December, 2017 is given below:

Liabilities	₹	Assets	₹
Sundry Creditors	6,000	Goodwill	5,000
Employees' Provident Fund	3,000	Patents	26,000
Investment Fluctuation Reserve	3,500	Machinery	31,200
Workmen Compensation Reserve	3,500	Investments	3,000
X's Capital	67,500	Stock	10,000
Y's Capital	47,500	Sundry Debtors	12,000
Z's Capital	37,000	Less: Provision	2,000
		Loan to Z	500
		Cash at Bank	6,300
		Advertisement Expenditure	1,000
		Profit & Loss A/c (2017)	75,000
	1,68,000		1,68,000

Z dies on 1st May, 2018 and X and Y decide to share future profits and losses in the ratio of 3:5. Z has withdrawn ₹ 5,000 during 2018. It was agreed that:

- Goodwill be valued at 2-1/2 years' purchase of average of four completed years' profits which were: 2014 ₹ 1,01,000; 2015 ₹ 14,000; 2016 ₹ 16,000.
- Z's Share of profit from the closure of last accounting year till Date of death be calculated on the basis of the average of three completed years' profits before death.
- Patents undervalued by ₹ 7,000, Machinery overvalued by ₹ 6,800, all Debtors are good. ₹ 500 included in Sundry Creditors is not likely to arise. Unaccounted Accrued Income of ₹ 1,100 to be provided for. A debtor whose dues of ₹ 200 were written off as bad debts paid 50% in full settlement. A claim of ₹ 500 on account of workmen's compensation to be provided for.
- Investments be sold for ₹ 4,100 and a sum of ₹ 5,600 be paid to Z's Executors. The remainder to be paid in four equal half-yearly instalments together with interest @ 10% p.a. at half-yearly rest.

Prepare Revaluation Account, Capital Account of Partners and the Balance Sheet of New Firm and Z's Executors' Account up to 31st December, 2018.

SOLUTION

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Machinery	6,800	By Sundry Creditors	500
To Profit transferred to:		By Accrued Income	1,100
X's Capital A/c	2,500	By Bad Debts Recovered	100
Y's Capital A/c	1,500	By Patents	7,000
Z's Capital A/c	1,000	By Provision for Doubtful Debts	2,000
	5,000	By Investments	1,100
	11,800		11,800

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Bank A/c	—	—	5,000	By Balance b/d	67,500	47,500	37,000
To Goodwill A/c	2,500	1,500	1,000	By Revaluation A/c	2,500	1,500	1,000
To P & L A/c	37,500	22,500	15,000	By Y's Capital A/c	4,375	—	7,000
To Z's Capital A/c	—	7,000	—	By Invest. F. Res.	1,750	1,050	700
To X's Capital A/c	—	4,375	—	By Work. Comp. Res.	1,500	900	600
To P&L Suspense A/c	—	—	1,000				
To Loan to Z A/c	—	—	500				
To Adv. Exp.	500	300	200				
To Z's Executors A/c	—	—	23,600				
To Balance c/d	37,125	15,275	—				
	77,625	50,950	46,300		77,625	50,950	46,300

BALANCE SHEET OF NEW FIRM AS AT 1ST MAY, 2018

Liabilities	₹	Assets	₹
Sundry Creditors	5,500	Patents	33,000
Employees' Provident Fund	3,000	Machinery	24,400
Z's Loan Account	18,000	Stock	10,000
X's Capital	37,125	Sundry Debtors	12,000
Y's Capital	15,275	Accrued Income	1,100
P & L Suspense A/c	1,000		
Bank Overdraft	100		
Workmen's Compensation Claim	500		
	80,500		80,500

Dr.

Z'S EXECUTORS' ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.05.2018	To Bank A/c	5,600	01.05.2018	By Z's Capital A/c	23,600
31.10.2018	To Bank A/c	5,400	31.10.2018	By Interest A/c	900
31.10.2018	To Balance c/d	13,500			
		24,500			24,500
31.12.2018	To Balance c/d	13,725	01.11.2018	By Balance b/d	13,500
			31.12.2018	By Interest A/c (accrued)	225
		13,725			13,725

Working Notes:

1. X's sacrifice = $3/8 - 5/10 = (5/40)$, Y's gain = $5/8 - 3/10 = 13/40$
2. Firm's Goodwill = $[(1,01,000 + 14,000 + 16,000 - 75,000)/4] \times 2.5 = ₹ 35,000$
3. Z's Share of Goodwill = $₹ 35,000 \times 2/10 = ₹ 7,000$
4. X's Share of Goodwill = $₹ 35,000 \times 5/40 = ₹ 4,375$
5. Average Profit (Loss) of Last 3 years = $(14,000 + 16,000 - 75,000)/3 = (₹ 15,000)$
6. Z's Share of Loss = $(₹ 15,000) \times 4/12 \times 2/10 = (₹ 1,000)$

Dr.

7. CASH AT BANK ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	6,300	By Z's Capital A/c (Drawings)	5,000
To Investments	4,100	By Z's Executors' A/c	5,600
To Bad Debts Recovered	100		
To Balance c/d	100		
	10,600		10,600

RETIREMENT CUM ADMISSION**ILLUSTRATION 52**

Dowell & Co. is a partnership firm with partners Mr. A, Mr. B and Mr. C, sharing profits and losses in the ratio of 10: 6: 4. The Balance Sheet of the firm as at 31st March, 2018 is as under:

Liabilities	₹	Assets	₹
A's Capital	90,000	Goodwill	20,000
B's Capital	26,000	Land	10,000
Cs Capital	34,000	Buildings	2,00,000
Contingency Reserves	5,000	Plant and Machinery	1,30,000
Workmen Compensation Reserve	15,000	Furniture	43,000
Investment Fluctuation Reserve	5,000	Investments [Market value ₹ 15,000]	12,000
Employees' Provident Fund	10,000	Stock	1,30,000
Long Term Debt	3,00,000	Debtors	1,39,000
Bank Overdraft	44,000	Advertisement Expenditure	5,000
Trade Creditors	1,60,000		
	6,89,000		6,89,000

It was mutually agreed that Mr. B will retire from partnership and in his place Mr. D will be admitted as a partner with effect from 1st April, 2018. For this purpose, the following adjustments are to be made:

- Goodwill is valued at ₹ 1 lakh and D brings in his share of goodwill in cash.
- Buildings and Plant and Machinery are to be depreciated by 5 percent and 20 percent respectively. Investments are to be taken over by the retiring partner at market value. Provision of 20 percent is to be made on debtors to cover doubtful debts.
- In the reconstituted firm, the total capital will be ₹ 2 lakhs which will be contributed by Mr. A, Mr. C and Mr. D in their new profit sharing ratio, which is 2 : 2 : 1.
- The surplus funds, if any, will be used for repaying the Bank Overdraft.
- The amount due to his retiring partner shall be transferred to his loan account.

Required: Prepare (a) Revaluation A/c; (b) Partner's Capital Accounts; (c) Bank Account; and (d) Balance Sheet of the reconstituted firm as at 1st April, 2018.

SOLUTION

Dr. **REVALUATION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Building A/c	10,000	By Investments A/c	3,000
To Plant and Machinery A/c	26,000	By Loss on Revaluation T/f to:	
To Provision for doubtful debts A/c	27,800	A's Capital A/c	30,400
		B's Capital A/c	18,240
		C's Capital A/c	12,160
	63,800		63,800

Dr. **CAPITAL ACCOUNTS OF PARTNERS** Cr.

Particulars	A ₹	B ₹	C ₹	D ₹	Particulars	A ₹	B ₹	C ₹	D ₹
To Goodwill A/c	10,000	6,000	4,000		By Balance b/d	90,000	26,000	34,000	—
To Revaluation A/c	30,400	18,240	12,160	—	By Cont. Res. A/c	2,500	1,500	1,000	—
To A's Capital A/c	—	—	10,000	—	By Inves. Fluc. Res.	2,500	1,500	1,000	—
To B's Capital A/c	—	—	10,000	—	By Inves. Fluc. Res.	2,500	1,500	1,000	—
To Investments A/c		15,000	—	—	By Workmen C. R.	7,500	4,500	3,000	—
To Advert. Exp. A/c	2,500	1,500	1,000	—	By C Cap. A/c	10,000	10,000	—	—
To B's Loan A/c	—	22,760	—	—	By Premium for Goodwill	—	20,000	—	—
To Balance c/d	80,000	—	80,000	40,000	By Bank A/c (b.f.)	10,400	—	78,160	40,000
	1,22,900	63,500	1,17,160	40,000		1,22,900	63,500	1,17,160	40,000

Dr.

BANK ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To As Capital A/c	10,400	By Balance b/d (Bank Overdraft)	44,000
To Cs Capital A/c	78,160	By Balance c/d	1,04,560
To Premium for Goodwill A/c	20,000		
To D's Capital A/c	40,000		
	1,48,560		1,48,560

BALANCE SHEET OF DOWELL & CO. AS AT 1ST APRIL, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Accounts:		Land	10,000
A	80,000	Buildings	1,90,000
C	80,000	Plant and Machinery	1,04,000
D	40,000	Furniture	43,000
Long Term Debt	3,00,000	Stock	1,30,000
Trade Creditors	1,60,000	Debtors	1,39,000
Employees' P.F.	10,000	Less: Provision	27,800
B's Loan Account	22,760	Balance at Bank	1,04,560
	6,92,760		6,92,760

ILLUSTRATION 53

Ram, Rahim and Robert are partners, sharing Profits and Losses in the ratio of 5 : 3 : 2. It was decided that Robert would retire on 31.3.2018 and in his place Richard would be admitted as a partner with new profit sharing between Ram, Rahim and Richard at 3 : 2 : 1.

BALANCE SHEET OF RAM, RAHIM AND ROBERT AS AT 31.3.2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Accounts:		Cash in Hand	20,000
Ram	1,00,000	Cash at Bank	1,00,000
Rahim	1,50,000	Sundry Debtors	5,00,000
Robert	2,00,000	Stock in Trade	2,00,000
General Reserve	2,00,000	Plant & Machinery	3,00,000
Sundry Creditors	8,00,000	Land & Building	5,30,000
Loan from Richard	2,00,000		
	16,50,000		16,50,000

Retirement of Robert and admission of Richard is on the following terms:

- Plant & Machinery to be depreciated by ₹ 30,000.
- Land and Building to be valued at ₹ 6,00,000.
- Stock to be valued at 95% of book value.
- Provision for doubtful debts @ 10% to be provided on debtors.
- The firm's goodwill to be valued at 2 years' purchase of the average profits of the last 3 years.
Profits are: 2014-2015 ₹ 50,000, 2015-2016 ₹ 60,000, 2016-2017 ₹ 55,000

(f) Out of the amount due to Robert ₹ 2,00,000 would be retained as loan by the firm and the balance will be settled immediately.

(g) Richard's capital should be equal to 50% of the combined capital of Ram and Rahim.

Prepare (i) Capital accounts of the partners; and (ii) Balance Sheet of the reconstituted firm.

SOLUTION

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	Ram ₹	Rahim ₹	Robert ₹	Richard ₹	Particulars	Ram ₹	Rahim ₹	Robert ₹	Richard ₹
To Revaluation A/c	10,000	6,000	4,000	—	By Balance b/d	1,00,000	1,50,000	2,00,000	—
To Robert	—	22,000	—	—	By General Reserve	1,00,000	60,000	40,000	—
To Rahim	—	—	—	18,333	By Rahim	—	—	22,000	—
To Loan from Robert A/c	—	—	2,00,000	—	By Richard	—	18,333	—	—
To Bank	—	—	58,000	—	By Loan A/c-transfer	—	—	—	2,00,000
To Balance c/d	1,90,000	2,00,333	—	1,95,167	By Bank(b.f.)	—	—	—	13,500
	2,00,000	2,28,333	2,62,000	2,13,500		2,00,000	2,28,333	2,62,000	2,13,500

BALANCE SHEET OF THE RECONSTITUTED FIRM (AFTER ADMISSION OF RICHARD)

Liabilities	₹	Assets	₹
Capital Accounts:		Land and Building	6,00,000
Ram	1,90,000	Plant and machinery	2,70,000
Rahim	2,00,333	Stock	1,90,000
Richard	1,95,167	Debtors	4,50,000
Sundry Creditors	8,00,000	Cash at bank	55,500
Loan from Robert	2,00,000	Cash in hand	20,000
	15,85,500		15,85,500

Working Notes:

(i) Calculation of Goodwill:

Average Profit = (₹ 50,000 + ₹ 60,000 + ₹ 55,000)/3 = ₹ 55,000

Goodwill = ₹ 55,000 × 2 years = ₹ 1,10,000.

Robert's share of Goodwill = ₹ 1,10,000 × 2/10 = ₹ 22,000

Richard's share of Goodwill = ₹ 1,10,000 × 1/6 = ₹ 18,333

Ram's new share = $3/6 - 5/10 = 0$, Rahim's new share = $2/6 - 3/10 = 1/30$

It means that Rahim is gaining partner as well as sacrificing partner.

(ii) Amount to be brought in by Richard

Combined capital of Ram and Rahim = ₹ 1,90,000 + ₹ 2,00,333 = ₹ 3,90,333

Richard's capital = ₹ 3,90,333 × 50% = ₹ 1,95,167

Amount to be brought in by Richard = Richard's existing Loan - His share of Goodwill - His share of Capital = ₹ 2,00,000 - ₹ 18,333 - ₹ 1,95,167 = ₹ 13,500

Dr.

(III) BANK ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	1,00,000	By Robert's Capital A/c	58,000
To Richard's Capital A/c	13,500	By Balance c/d	55,500
	1,13,500		1,13,500

(IV) REVALUATION ACCOUNT

Particulars	₹	Particulars	₹
To Plant and Machinery	30,000	By Land and building	70,000
To Stock	10,000	By Partners' Capital Accounts.	
To Debtors	50,000	Ram	10,000
		Rahim	6,000
		Robert	4,000
	90,000		90,000

ILLUSTRATION 54

E, F and G were partners sharing Profits and Losses in the ratio of 5:3:2 respectively. On 31st March, 2018 Balance Sheet of the firm stood as follows:

Liabilities	₹	Assets	₹
Capital A/cs:		Buildings	55,000
E	50,000	Furniture	25,000
F	40,000	Stock	42,000
G	28,000	Debtors	20,000
Creditors	33,500	Cash at Bank	11,200
Outstanding Expenses	1,700		
	1,53,200		1,53,200

On 31st March, 2018, E decided to retire and F and G decided to continue as equal partners. Other terms of retirement were as follows:

- (i) Building be appreciated by 20%.
- (ii) Furniture be depreciated by 10%.
- (iii) A provision of 5% be created for bad debts on debtors.
- (iv) Goodwill be valued at two years' purchase of profit for the latest accounting year. The firm's profit for the year ended 31st March, 2018 was ₹ 25,000. No goodwill account is to be raised in the books of accounts.
- (v) Fresh capital be introduced by F and G to the extent of ₹ 10,000 and ₹ 35,000 respectively.
- (vi) Out of sum payable to retiring partner E, a sum of ₹ 45,000 be paid immediately and the balance be transferred to his loan account bearing interest @ 12% per annum. The loan is to be paid off by 31st March, 2020.

One month after E's retirement, F and G agreed to admit E's son H as a partner with one-fourth share in Profits/Losses. E agreed that the balance in his loan account be converted into H's Capital. E also agreed to forgo one month's interest on his loan.

It was also agreed that H will bring in, his share of goodwill through book adjustment, valued at the price on the Date of E's retirement. No goodwill account is to be raised in the books.

You are requested to pass necessary Journal Entries to give effect to the above transactions and prepare Partner's Capital Accounts.

SOLUTION

JOURNAL

Date.	Particulars	Dr. (₹)	Cr. (₹)
1.	Building A/c To Revaluation A/c (Being building appreciated)	Dr. 11,000	11,000
2.	Revaluation A/c To Furniture A/c To Provision for Doubtful Debts A/c (Being furniture depreciated by 10% and Provision for doubtful debts created @ 5% on Debtors)	Dr. 3,500	2,500 1,000
3.	Revaluation A/c To E's Capital A/c To F's Capital A/c To G's Capital A/c (Being profit on revaluation transferred to capital accounts of partners)	Dr. 7,500	3,750 2,250 1,500
4.	F's Capital A/c G's Capital A/c To E's Capital A/c (Being adjustment for E's share of goodwill)	Dr. Dr. 10,000 15,000	25,000
5.	Bank A/c To F's Capital A/c To G's Capital A/c (Being fresh capital introduced by F and G)	Dr. 45,000	10,000 35,000
6.	E's Capital A/c To Bank A/c To E's Loan A/c (Being settlement of E's capital on his retirement)	Dr. 78,750	45,000 33,750
7.	E's Loan A/c To H's Capital A/c (Transfer of E's Loan Account to H's Capital Account)	Dr. 33,750	33,750
8.	H's Capital A/c To F's Capital A/c To G's Capital A/c (Being adjustment entry passed for H's share of goodwill)	Dr. 12,500	6,250 6,250

Dr.

PARTNER'S CAPITAL ACCOUNTS

Cr.

Particulars	E ₹	F ₹	G ₹	H ₹	Particulars	E ₹	F ₹	G ₹	H ₹
To E (Goodwill)	—	10,000	15,000	—	By Balance b/d	50,000	40,000	28,000	—
To Bank	45,000	—	—	—	By Revaluation A/c	3,750	2,250	1,500	—
To E's Loan A/c	33,750	—	—	—	By F (Goodwill)	10,000	—	—	—
To Balance c/d	—	42,250	49,500	—	By G (Goodwill)	15,000	—	—	—
					By Bank(fresh capital)	—	10,000	35,000	—
	78,750	52,250	64,500	—		78,750	52,250	65,500	—
To F (Goodwill)	—	—	—	6,250	By Balance b/d	—	42,250	49,500	—
To G (Goodwill)	—	—	—	6,250	By E's Loan A/c	—	—	—	33,750
To Balance c/d	—	48,500	55,750	21,250	By H (goodwill)	—	6,250	6,250	—
	—	48,500	55,750	33,750		—	48,500	55,750	33,750

Working Notes:**(I) CALCULATION OF GAINING RATIO**

Partners	New ratio	Old ratio	Gain	Sacrifice
E		5/10		5/10
F	1/2	3/10	$1/2 - 3/10 = 2/10$	
G	1/2	2/10	$1/2 - 2/10 = 3/10$	

Hence, ratio of gain between F and G = 2:3

(ii) Value of Total Goodwill of the firm = ₹ 25,000 × 2 = ₹ 50,000

E's Share = ₹ 50,000 × 5/10 = ₹ 25,000

F will bear = ₹ 25,000 × 2/5 = ₹ 10,000

G will bear = ₹ 25,000 × 3/5 = ₹ 15,000

(iii) H's share of goodwill = ₹ 50,000 × 1/4 = ₹ 12,500

F and G share equal profits. Therefore, their sacrificing ratio will also be equal

Hence, each of them will be credited with ₹ 6,250.

ILLUSTRATION 55

The Balance Sheet X & Y as at 31st March, 2018 was as follows:

Liabilities	₹	Assets	₹
X's Capital	32,000	Stock	56,000
Y's Capital	29,000	Debtors	3,000
Creditors	6,000	Bank	8,000
	67,000		67,000

On the same Date, X by agreement, retires and his son Z joins the firm for one-third share of profit. Sufficient money is to be introduced so as to enable X to be paid off and leave ₹ 4,000 in Bank. Y and Z are to provide such as to make their capitals proportionate to their shares of profit. X agrees to contribute from his capital half of the amount Z has to provide.

Required: Assuming that the agreement was carried out, show the necessary journal entries and prepare the Balance Sheet.

SOLUTION**JOURNAL**

Particulars	L.F.	Dr. (₹)	Cr. (₹)
Bank A/c Dr.		9,500	
X's Capital A/c Dr.		9,500	
To Z's Capital A/c			19,000
(Being ₹ 9,500 transferred to Z's A/c from X's A/c and balance brought in by Z)			
Bank A/c Dr.		9,000	
To Y's Capital A/c			9,000
(Being the amount brought in by Y)			
X's Capital A/c Dr.		22,500	
To Bank A/c			22,500
(Being the amount paid to X)			

BALANCE SHEET OF Y AND Z AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Y's Capital	38,000	Stock	56,000
Z's Capital	19,000	Debtors	3,000
Sundry Creditors	6,000	Cash at Bank	4,000
	63,000		63,000

Working Notes:

- Total Capital of reconstituted firm** = Stock + Debtors + Bank – Creditors
 $= ₹ 56,000 + ₹ 3,000 + ₹ 4,000 - ₹ 6,000 = ₹ 57,000$
- Y's New Capital** = ₹ 57,000 × 2/3 = ₹ 38,000,
Z's New Capital = ₹ 57,000 × 1/3 = ₹ 19,000

3. CALCULATION OF CASH TO BE BROUGHT IN BY Y AND Z

Particulars	Y	Z
(a) Their New Capitals	₹ 38,000	₹ 19,000
(b) Their Adjusted Old Capitals	₹ 29,000	
(c) Capital transferred from X's Capital A/c		₹ 9,500
(d) Amount to be brought in	₹ 9,000	₹ 9,500

APPLICATION OF SEC 37

If the amount due to the Retiring Partner *or* Legal Representative of a Deceased Partner is not settled and the business is carried on the Retiring Partner *or* Legal Representative of a Deceased Partner at his option is entitled to receive *either* interest @ 6% p.a. till the amount is paid off *or* a share of the profit which has been earned by using the amount due to him. [Section 37].

ILLUSTRATION 56

A, B and C were partners sharing profits and losses in the ratio of 2: 2: 1. C retired on 1st Oct, 2014 on which Date the capitals of A, B and C after all necessary adjustments stood at ₹ 5,00,000, ₹ 3,00,000 and 2,00,000 respectively. A and B continued to carry on the business for six months without settling the accounts of C. During the period of six months from 1st Oct, 2014, a profit of ₹ 1,00,000 is earned by the use of the firm's property. State which of the two options available u/s 37 of the Indian Partnership Act 1932 should be exercised by C.

SOLUTION

- Share in the subsequent profits attributable to the use of his property
 $= [2,00,000 / (5,00,000 + 3,00,000 + 2,00,000)] \times 1,00,000 = ₹ 20,000$
- Interest @ 6% p.a. on the use of his property = ₹ 2,00,000 × 6/12 × 6/100 = ₹ 6,000
 C should exercise option (i) since the amount payable to him under this option is more as compared to the amount payable to him under option (ii).

ILLUSTRATION 57

Jeet, Meet, and Reet were partners sharing profits and losses in the ratio of 2/5, 2/5 and 1/5. On 1st Jan. 2018 their Balance Sheet stood as follows:

Liabilities	₹	Assets	₹
Creditors	40,000	Fixed Assets	1,00,000
Reserve	10,000	Stock	25,000
Capital Accounts:		Debtors	35,000
Jeet	50,000	Cash	10,000
Meet	40,000		
Reet	30,000		
	1,70,000		1,70,000

The firm had taken out a Joint Life Policy for ₹ 1,00,000 the premiums on which were charged to the Profit and Loss Accounts. On 1st July, 2018 Reet died. His representatives agree that:

(a) Goodwill of the firm be valued at ₹ 50,000; (b) Fixed Assets be written down by ₹ 10,000; and (c) In lieu of profits, upto his death, Reet should be paid interest at the rate of 25% p.a. on his capital as on 1st Jan. 2018. The policy money was received on December 31, 2018 and Reet's heirs were paid the total amount due to them. The accounts reveal that the firm had made a profit of ₹ 40,500 during the year after writing off ₹ 9,500 as depreciation on Fixed Assets (of which ₹ 5,000 was up to 1st July, 2018). At the end of the year, the creditors had been reduced by ₹ 5,000 and debtors by ₹ 6,000 and stock had increased by ₹ 8,000 (as compared to the figures on 1st Jan, 2018). The drawings of the partners were;

Particulars	Up to 1st July 2018 ₹	After 1st July 2018 ₹
Jeet	4,125	5,000
Meet	4,125	5,000
Reet	1,750	—

Required: Prepare the Balance Sheet of the firm as on 31st Dec, 2018, assuming that goodwill is to be adjusted through capital accounts only.

SOLUTION**BALANCE SHEET OF JEET AND MEET AS ON 31ST DEC., 2018**

Liabilities	₹	Assets	₹
Sundry Creditors	35,000	Fixed Assets: 90,000	
Capital Accounts:		Less: Depreciation 9,500	80,500
Jeet	90,938	Current Assets:	
Meet	80,939	Stock	33,000
		Debtors	29,000
		Cash in hand	64,377
	2,06,877		2,06,877

Working Notes:

Dr.

(I) PROFIT & LOSS ACCOUNT

Cr.

Particulars	₹ (for first 6 months)	₹ (for second 6 months)	Particulars	₹ (for first 6 months)	₹ (for second 6 months)
To Dep. A/c	5,000	4,500	By Profit before Dep.	25,000	25,000
To Reet's Capital A/c (interest in lieu of profit)	3,750	—	[(₹ 40,500 + ₹ 9,500)/2]		
To Reet's Executors' A/c	—	6,623			
To Profit transferred to Capital A/cs:					
Jeet	8,125	6,938			
Meet	8,125	6,939			
	25,000	25,000		25,000	25,000

Dr.

(III) CAPITAL ACCOUNTS (FROM 1.1.2018 TO 30.6.2018)

Cr.

Particulars	Jeet ₹	Meet ₹	Reet ₹	Particulars	Jeet ₹	Meet ₹	Reet ₹
To Reet	5,000	5,000	—	By Balance b/d	50,000	40,000	30,000
To Fixed Assets A/c	4,000	4,000	2,000	By Reserve	4,000	4,000	2,000
To Drawings A/c	4,125	4,125	1,750	By Jeet A/c	—	—	5,000
To Reet's Executor's A/c	—	—	42,000	By Meet A/c	—	—	5,000
To Balance c/d	49,000	39,000	—	By Profit & Loss A/c	8,125	8,125	3,750
	62,125	52,125	45,750		62,125	52,125	45,750

Dr.

(IV) CAPITAL ACCOUNTS (FROM 1.7.2018 TO 31.12.2018)

Cr.

Particulars	Jeet ₹	Meet ₹	Reet's Ex ₹	Particulars	Jeet ₹	Meet ₹	Reet's Ex ₹
To Drawings A/c	5,000	5,000	—	By Balance b/d	49,000	39,000	42,000
To Cash A/c	—	—	68,623	By Joint Life Policy	40,000	40,000	20,000
To Balance c/d	90,938	80,939	—	By Profit & Loss A/c	6,938	6,939	6,623
	95,938	85,993	68,623		95,938	85,993	68,623

Dr.

(V) CASH ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Reet's Executor's A/c	68,623
To Joint Life Policy	1,00,000	By Decrease in Sundry Creditors	5,000
To Profit <i>plus</i> Depreciation	50,000	By Increase in Stock	8,000
To Decrease in Debtors	6,000	By Drawings:	
		Jeet	9,125
		Meet	9,125
		Reet	1,750
		By Balance c/d	20,000
			64,377
	1,66,000		1,66,000

Working Notes:

1. Capitals on 1st July, 2018 have been ascertained without taking into account the Joint Life Policy (since the amount has not yet received) but after crediting the goodwill to all partners.
2. Profit for the year 2018 has been segregated into two parts—profits before Reet's death and after Reet's death. Total profit for the year, before depreciation, is ₹ 40,500 + ₹ 9,500 or ₹ 50,000. It has also been assumed that profit is earned evenly throughout the year. Hence profit before depreciation upto 30th June, 2018 is ₹ 25,000 and profit after depreciation for the same period is ₹ 20,000.
3. According to Sec. 37 of Indian Partnership Act 1932, Reet's executors have an option to claim either of the following two amounts:

(a) Share of Profits = $\frac{\text{Reet's Capital on 1.7.2018}}{\text{Total Capital of the firm on 1.7.2018}} \times \text{Profit} = \frac{42,000}{1,30,000} \times 20,500 = ₹ 6,623$

(b) Interest = ₹ 42,000 × 6/100 × 6/12 = ₹ 1,260

The remaining profit shall be shared by Jeet and Meet in their profit sharing ratio.
4. Cash Account is prepared on the assumption that:
 - (a) Profit for the year is realised in cash; and
 - (b) Increase in the value of Assets and decrease in the value of Liabilities mean reduction in cash and vice versa.

SOLVED PROBLEMS I**PROBLEM 1**

The Balance Sheet of A, B and C sharing profits and losses in the ratio of 5 : 3 : 2 respectively, on 31st March, 2018:

Liabilities	₹	Assets	₹
A's Capital	40,000	Land and Building	30,000
B's Capital	30,000	Plant and Machinery	35,000
C's Capital	25,000	Investment (Market Value ₹ 19,000)	20,000
General Reserve	5,000	Machinery Replacement Fund Invests.	1,000
Profit and Loss Account	3,450	Current Assets	28,000
Investment Fluctuation Reserve	1,500	Advt. Expend. (Deferred Revenue)	1,000
Machinery Replacement Fund	1,000		
Workmen's Compensation Reserve	1,200		
Employees' Provident Fund	2,000		
Creditors	5,850		
	1,15,000		1,15,000

On this Date, B retires from the firm and A and C continue to share future profits & losses in the ratio of 3 : 2 respectively. A claim on account of workmen's compensation is estimated at ₹ 150 only.

Required: Pass the necessary journal entries relating to the adjustment of accumulated profits and losses.

SOLUTION

JOURNAL

Particulars	L.F.	Dr. (₹)	Cr. (₹)
Investment Fluctuation Reserve A/c Dr. To Investment A/c (Being the value of investments brought down to market value)		1,000	1,000
Workmen Compensation Reserve A/c Dr. To Provision for Workmen Compensation Claim A/c (Being the workmen's compensation claim provided to the extent of ₹ 150)		150	150
General Reserve Dr. P & L A/c Dr. Investment Fluctuation Reserve A/c [1,500– (20,000–19,000)] Dr. Workmen's Compensation Reserve A/c Dr. To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of accumulated profits to all the partners in their profit-sharing ratio)		5,000 3,450 500 1,050	5,000 3,000 2,000
A's Capital A/c Dr. B's Capital A/c Dr. C's Capital A/c Dr. To Advertisement Expenditure A/c (Being the transfer of accumulated losses to all the partners in their profit-sharing ratio)		500 300 200	1,000

Working Notes:

- Investment Fluctuation Reserve Account has been transferred directly to partners' capital accounts. After providing for an anticipated loss of ₹ 1,000 (i.e. ₹ 20,000 – ₹ 19,000) according to Prudence (conservatism) concept.
- The balance of Workmen's Compensation Reserve Account after making Provision for Claim has been transferred directly to partners' capital accounts.
- Machinery Replacement Fund is in the nature of accumulated depreciation and not in nature of accumulated profits and hence is not distributed among the partners.
- Employees' Provident Fund represents statutory liability due to employees towards Provident Fund and is not an accumulated profits, hence it is not distributed among the partners.

PROBLEM 2

The Balance Sheet of A, B and C who are sharing profits in the ratio of 2:3:1, as at 31st March, 2018 is given below:

Liabilities	₹	Assets	₹
A's Capital	1,00,000	Goodwill	12,000
B's Capital	2,00,000	Land and Building	2,50,000
C's Capital	3,00,000	Investments [Market Value ₹ 46,000]	50,000

Workmen Compensation Reserve	20,000	Stock	80,000
Investment Fluctuation Reserve	10,000	Debtors	3,00,000
Provision for Doubtful Debts	10,000	Bank	2,96,000
Sundry Creditors	3,00,000	Advertisement Suspense A/c	12,000
Employees' Provident Fund	60,000		
	10,00,000		10,00,000

C retires from 1st April, 2018 and A and B decide to share future profits losses in the ratio of 3:2 and 50% is to be paid immediately and the balance in two equal annual instalments together with interest @ 10% p.a.

1. Goodwill is to be valued at 2 years' purchase of average profits of last three completed years. The profits were - 2015-2016 ₹ 48,000, 2016-2017 ₹ 93,000, 2017-2018 ₹ 1,38,000.
2. Land & Building was found under valued by ₹ 20,000 and Stock was found overvalued by ₹ 38,000.
3. Provision for doubtful debts is to be made equal to 5% of the debtors.
4. Claim on account of workmen compensation is ₹ 8,000.
5. 10% of the sundry creditors be written back as no longer payable.
6. Out of the amount of insurance which was debited entirely to P&L A/c, ₹ 5,000 be carried forward as an unexpired insurance.

Required: Pass the necessary journal entries and prepare the necessary ledger accounts and the Balance Sheet.

SOLUTION

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(1)	As Capital A/c Dr. B's Capital A/c Dr. C's Capital A/c Dr. To Goodwill A/c (Being the existing goodwill w/o)		4,000 6,000 2,000	12,000
(2)	A's Capital A/c (₹ 1,86,000 × 8/30) Dr. To B's Capital (₹ 1,86,000 × 3/30) To C's Capital A/c (₹ 1,86,000 × 5/30) (Being the goodwill adjusted by debiting gaining partner (A for 8/30) and crediting Sacrificing partners (B for 3/30) and (C for 1/6)]		49,600	18,600 31,000
(3)	Land & Building A/c Dr. Sundry Creditors Dr. Prepaid Insurance Dr. To Revaluation A/c (Being the increase in value of Assets & decrease in Sundry Creditors recorded)		20,000 30,000 5,000	55,000
(4)	Revaluation A/c Dr. To Stock A/c To Provision for Doubtful Debts A/c (Being the decrease in Value of Assets & increase in provisions recorded)		43,000	38,000 5,000

(5)	Revaluation A/c Dr. To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of profit on revaluation)		12,000	4,000 6,000 2,000
(6)	Workmen Compensation Reserve A/c Dr. To Workmen Compensation Claim A/c To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of workmen compensation Reserve)		20,000	8,000 4,000 6,000 2,000
(7)	Investment Fluctuation Fund A/c Dr. To Investment A/c To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of Investment Fluctuation Fund)		10,000	4,000 2,000 3,000 1,000
(8)	A's Capital A/c Dr. B's Capital A/c Dr. C's Capital A/c Dr. To Advertisement Suspense A/c (Being the transfer of balance of Advertisement Suspense A/c)		4,000 6,000 2,000	12,000
(9)	C's Capital A/c Dr. To Bank A/c To C's Loan A/c (Being 50% paid and the balance t/f to Loan A/c)		3,32,000	1,66,000 1,66,000

Ledger Accounts:
Dr.
1. REVALUATION ACCOUNT
Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Stock	38,000	By Land & Building	20,000
To Provision for Doubtful Debts	5,000	By Sundry Creditors	30,000
To Profit on Revaluation t/f to:		By Prepaid Insurance	5,000
A	4,000		
B	6,000		
C	2,000		
	55,000		55,000

Dr.

2. PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To Goodwill A/c	4,000	6,000	2,000	By Balance b/d	1,00,000	2,00,000	3,00,000
To B's Capital A/c	18,600	—	—	By A's Capital A/c	—	18,600	31,000
To C's Capital A/c	31,000	—	—	By Revaluation A/c	4,000	6,000	2,000
To Adv. Exp. Sus. A/c	4,000	6,000	2,000	By Work Com. Res.	4,000	6,000	2,000
To Bank A/c	—	—	1,66,000	By Invest. Flus. Res.	2,000	3,000	1,000
To C's Loan A/c	—	—	1,66,000				
To Balance c/d	52,400	2,21,600	—				
	1,10,000	2,33,600	3,36,000		1,10,000	2,33,600	3,36,000

3. BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
A's Capital	52,400	Land & Building	2,70,000
B's Capital	2,21,600	Investments	46,000
C's Loan	1,66,000	Stock	42,000
Sundry Creditors	2,70,000	Debtors	3,00,000
Workmen Compensation Claim	8,000	Less: Provision	15,000
Employees' Provident Fund	60,000	Bank	1,30,000
		Prepaid Insurance	5,000
	7,78,000		7,78,000

Working Notes:1. **Gain/Sacrifice** = New Share – Old ShareA's Gain = $3/5 - 2/6 = 8/30$, B's Gain = $2/5 - 3/6 = -3/30$ 2. **Calculation of Goodwill**A. Average Profits = $\frac{₹48,000 + ₹93,000 + ₹1,38,000}{3} = ₹93,000$

B. Firm's Goodwill = ₹ 93,000 × 2 = ₹ 1,86,000

PROBLEM 3

The Balance Sheet to A, B and C who were sharing profits in proportion in their capitals stood as follows as on 31st Dec., 2017.

Liabilities	₹	Assets	₹
Expenses Owing	900	Goodwill	9,000
Trade Creditors	5,000	Cash at Bank	15,500
Employees' Provident Fund	1,000	Sundry Debtors	5,000
Reserve Fund	5,400	Less: Provision	100
Workmen Compensation Reserve	1,200	Stock	9,000
Investment Fluctuation Fund	1,900	Investments [Market value ₹ 8,700]	9,700
A's Capital	21,600	Land and Building	15,000
B's Capital	16,200	Advertisement Expenditure	900
C's Capital	10,800		
	64,000		64,000

B retires on 31.12.2017, and the following readjustments of the Assets and Liabilities have been agreed upon before the ascertainment of the amount payable to B:

- (a) That the Stock be written down to ₹ 8,520.
- (b) That the provision for doubtful debts be brought upto 5% on debtors.
- (c) That the Land and Building be written up by ₹ 5,000.
- (d) That a provision of ₹ 4,420 be made in respect of outstanding legal charges.
- (e) That out of the amount of insurance which was debited entirely to P & L A/c, ₹ 2,000 be carried forward as an unexpired insurance.
- (f) That Expenses owing to be brought down to ₹ 625.
- (g) That Trade Creditors agree to allow a discount of $2\frac{1}{2}\%$.
- (h) That 'X' an old customer whose account was written off as bad had promised in writing to pay ₹ 350 in settlement of his full debt of ₹ 500.
- (i) That claim on account of workmen's compensation is estimated at ₹ 300.
- (j) That A and C are going to share in future in the proportion of five eighths and three eighths respectively.
- (k) That the goodwill is to be valued at 2 years' purchase of the average profits of 3 completed years preceding the Date of retirement. The profits for 2013 ₹ 3,000, for 2014 ₹ 3,520, for 2015 ₹ 6,600, for 2016, ₹ 7,700, 2017 ₹ 8,000. No goodwill account is to be raised.
- (l) That the investments are taken over by B at market value.
- (m) B is to be paid the amount due to him by raising a loan of ₹ 7,000 on the security of land and building and ₹ 460 by a Bill of Exchange (without interest) payable at the expiry of 3 months and carrying the remainder to be paid in four equal half yearly instalments together with interest @ 6% p.a. on half yearly rests.

Required: Pass the necessary journal entries, Prepare Partners' Capital Accounts and the Balance Sheet after B's retirement:

SOLUTION

JOURNAL

Particulars	L.F.	Dr. (₹)	Cr. (₹)
Revaluation A/c Dr.		5,050	
To Stock Reserve A/c			480
To Provision for Doubtful Debts A/c			150
To Provision for Outstanding Legal Charges A/c			4,420
(Being the fall in value of Assets and increase in amount of provision recorded)			
Land & Building Dr.		5,000	
Prepaid Insurance Dr.		2,000	
Expenses Owing Dr.		275	
Reserve for Discount on Trade Creditors Dr.		125	
Mr. X Dr.		350	
To Revaluation A/c			7,750
(Being the increase in value of Assets, decrease in Liabilities and Reserve for discount on creditors recorded)			

Revaluation A/c	Dr.		2,700	
To A's Capital A/c				1,200
To B's Capital A/c				900
To C's Capital A/c				600
(Being the transfer of profit on revaluation to all partners in their profit sharing ratio of 4 : 3 : 2)				
Workmen Compensation Reserve	Dr.		1,200	
To Provision for Workmen Compensation Claim A/c				300
To A's Capital A/c				400
To B's Capital A/c				300
To C's Capital A/c				200
(Being provision made for workmen compensation and surplus Workmen Compensation reserve transferred)				
Investment Fluctuation Reserve A/c	Dr.		1,900	
To Investments A/c				1,000
To A's Capital A/c				400
To B's Capital A/c				300
To C's Capital A/c				200
(Being investments brought down to its market value and surplus t/f to capital a/cs)				
Reserve Fund	Dr.		5,400	
To A's Capital A/c				2,400
To B's Capital A/c				1,800
To C's Capital A/c				1,200
(Being the transfer of reserve to all partners in their profit sharing ratio of 4 : 3 : 2)				
A's Capital A/c	Dr.		400	
B's Capital A/c	Dr.		300	
C's Capital A/c	Dr.		200	
To Advertisement Expenditure A/c				900
(Being the transfer of Advertisement Expenditure to all partners in their profit sharing ratio of 4 : 3 : 2)				
A's Capital A/c	Dr.		4,000	
B's Capital A/c	Dr.		3,000	
C's Capital A/c	Dr.		2,000	
To Goodwill A/c				9,000
(Being the existing book value of Goodwill w/o)				
A's Capital A/c	Dr.		2,145	
C's Capital A/c	Dr.		1,815	
To B's Capital A/c				3,960
(Being share of goodwill credited to B and debited to the remaining partners in their gaining ratio which is 13 : 11)				

Bank A/c	Dr.		7,000	
To Loan from Bank A/c				7,000
(Being the loan from Bank raised on the security of Land & Building)				
B's Capital A/c	Dr.		20,160	
To Investments A/c				8,700
To Bank A/c				7,000
To Bills Payable A/c				460
To 6% B's Loan A/c				4,000
(Being B's claim discharged-Investments ₹ 8,700, Cheque ₹ 7,000, B/P ₹ 460 and the balance transferred to his Loan A/c)				

Dr.

CAPITAL ACCOUNTS OF PARTNERS

Cr.

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To Goodwill A/c	4,000	3,000	2,000	By Balance b/d	21,600	16,200	10,800
To B's Capital A/c	2,145	—	1,815	By Revaluation A/c	1,200	900	600
To Adv. Exp. A/c	400	300	200	By Work. Comp. Res.	400	300	200
To Investments A/c	—	8,700	—	By Invest. Flu. Res.	400	300	200
To Bills Payable A/c	—	460	—	By Reserve A/c	2,400	1,800	1,200
To Bank A/c	—	7,000	—	By A's Capital A/c	—	2,145	—
To B's Loan A/c	—	4,000	—	By C's Capital A/c	—	1,815	—
To Balance c/d	19,455	—	8,985				
	26,000	23,460	13,000		26,000	23,460	13,000

BALANCE SHEET OF A AND C AS AT 31ST DEC., 2017

Liabilities	₹	Assets	₹
Expenses Owing	625	Cash at Bank	15,500
Trade Creditors	5,000	Sundry Debtors	5,000
Less: Reserve	125	Less: Provision	250
Employees' Provident Fund	1,000	Mr X	350
Provision for Workmen's		Prepaid Insurance	2,000
Compensation claim	300	Stock	9,000
Provision for Outstanding Legal		Less: Reserve	480
Charges	4,420	Land & Building	20,000
Bills Payable	460		
Loan from Bank	7,000		
6% B's Loan	4,000		
A's Capital	19,455		
C's Capital	8,985		
	51,120		51,120

Working Notes:

- Average Profits** = $(₹ 3,520 + ₹ 6,600 + ₹ 7,700)/3 = ₹ 5,940$
- Firm's Goodwill** = $₹ 5,940 \times 2 = ₹ 11,880$
- B's Share of Goodwill** = $₹ 11,880 \times 3/9 = ₹ 3,960$
- Alternatively:* Excess Workmen Compensation Reserve (i.e., ₹ 1,050) may directly be transferred to the Capital accounts of partners in their profit sharing ratio and accordingly the profit on revaluation will be reduced by ₹ 1,050.

PROBLEM 4

A, B and C were partners sharing profits and losses in the ratio of 5 : 3 : 2. On 31.12.2017, the Balance Sheet was as under:

Liabilities	₹	Assets	₹
Trade Creditors	26,500	Bank	20,000
Employees' Provident Fund	3,500	Debtors	30,000
Reserve	20,000	Stock	55,000
A's Capital	1,00,000	Fixed Assets	1,15,000
B's Capital	50,000	Goodwill	15,000
C's Capital	40,000	Advertisement Expenditure	5,000
	2,40,000		2,40,000

B retires on 1.1.2018. For the purpose, the following adjustments were agreed upon:

- That the goodwill be valued at 2 years' purchase of the average profits of 3 completed years preceding the Date of retirement. The profits for previous years were: 2014 ₹ 45,000, 2015 ₹ 50,000, 2016 ₹ 55,000, 2017 ₹ 60,000.
- That Fixed Assets were found undervalued by ₹ 25,000.
- That Stock was found overvalued by ₹ 5,000.
- That the new profit sharing ratio of A and C will be 3 : 2
- That B be paid through cash brought in by A and C in such a way as to make their capitals proportionate. Minimum Bank Balance is to be maintained at ₹ 10,000.
- The partners decide that Goodwill is not to appear in the Balance Sheet of New Firm.

Required: Prepare Revaluation Account, Capital Account of Partners & the Balance Sheet of A & C.

SOLUTION

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Stock	5,000	By Fixed Assets	25,000
To Profit on Revaluation t/f to:			
A's Capital A/c (5/10)	10,000		
B's Capital A/c (3/10)	6,000		
C's Capital A/c (2/10)	4,000		
	25,000		25,000

Dr.

CAPITAL ACCOUNTS OF PARTNERS

Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To B's Capital A/c	2,000	—	4,000	By Balance b/d	1,00,000	50,000	40,000
To Goodwill A/c	7,500	4,500	3,000	By Revaluation	10,000	6,000	4,000
To B's Capital A/c	9,000	—	18,000	By Reserve	10,000	6,000	4,000
To Adv. Exp. A/c	2,500	1,500	1,000	By A's Capital A/c	—	11,000	—
To Balance c/d	99,000	89,000	22,000	By C's Capital A/c	—	22,000	—
	1,20,000	95,000	48,000		1,20,000	95,000	48,000
To Bank A/c	—	89,000	—	By Balance b/d	99,000	89,000	22,000
To Balance b/d	1,20,000	—	80,000	By Bank A/c	21,000	—	58,000
	1,20,000	89,000	80,000		1,20,000	89,000	80,000

BALANCE SHEET OF A AND C AS AT 1ST JAN., 2018

Liabilities	₹	Assets	₹
A's Capital	1,20,000	Fixed Assets	1,40,000
C's Capital	80,000	Stock	55,000
Sundry Creditors	26,500	Less: Reserve	5,000
Employees' Provident Fund	3,500	Debtors	30,000
		Bank	10,000
	2,30,000		2,30,000

Working Notes:

- Average Profits** = (₹ 50,000 + ₹ 55,000 + ₹ 60,000)/3 = ₹ 55,000
- Firm's Goodwill** = ₹ 55,000 × 2 = ₹ 1,10,000
- B's Share of Goodwill** = ₹ 1,10,000 × 3/10 = ₹ 33,000
- Shortage of Cash** = ₹ 89,000 – ₹ 10,000 (i.e. ₹ 20,000 — ₹ 10,000) = ₹ 79,000
- Total Capital of New Firm** = ₹ 99,000 + ₹ 22,000 + ₹ 79,000 = ₹ 2,00,000
- A's New Capital** = ₹ 2,00,000 × 3/5 = ₹ 1,20,000,
C's New Capital ₹ 2,00,000 × 2/5 = ₹ 80,000.

PROBLEM 5

The Balance Sheet to A, B and C who were sharing profits in proportion in their capitals stood as follows as on 31st Dec., 2017.

Liabilities	₹	Assets	₹
Expenses Owng	900	Goodwill	9,000
Trade Creditors	5,000	Cash at Bank	15,500
Employees' Provident Fund	1,000	Sundry Debtors	5,000
Reserve Fund	5,400	Less: Provision	100
Workmen Compensation Reserve	1,200	Stock	9,000
Investment Fluctuation Fund	1,900	Investments [Market value ₹ 8,700]	9,700
A's Capital	21,600	Land and Building	15,000
B's Capital	16,200	Advertisement Expenditure	900
C's Capital	10,800		
	64,000		64,000

B retires on 31.12.2017, and the following readjustments of the Assets and Liabilities have been agreed upon before the ascertainment of the amount payable to B:

- (a) That the Stock be written down to ₹ 8,520.
- (b) That the provision for doubtful debts be brought upto 5% on debtors.
- (c) That the Land and Building be written up by ₹ 5,000.
- (d) That a provision of ₹ 4,420 be made in respect of outstanding legal charges.
- (e) That out of the amount of insurance which was debited entirely to P & L A/c, ₹ 2,000 be carried forward as an unexpired insurance.
- (f) That Expenses owing to be brought down to ₹ 625.
- (g) That Trade Creditors agree to allow a discount of 2½%.
- (h) That 'X' an old customer whose account was written off as bad had promised in writing to pay ₹ 350 in settlement of his full debt of ₹ 500.
- (i) That claim on account of workmen's compensation is estimated at ₹ 300.
- (j) That A and C are going to share in future in the proportion of five eighths and three eighths respectively.
- (k) That the goodwill is to be valued at 2 years' purchase of the average profits of 3 completed years preceding the Date of retirement. The profits for 2013 ₹ 3,000, for 2014 ₹ 3,520, for 2015 ₹ 6,600, for 2016, ₹ 7,700, 2017 ₹ 8,000. No goodwill account is to be raised.
- (l) That the investments are taken over by B at market value.
- (m) B is to be paid through Cash brought in by A and C in such a way as to make their capitals proportionate to their new profit sharing ratio subject to the condition that a bank balance of ₹ 10,000 is to be maintained.

Required: Pass the necessary journal entries, Prepare Partners' Capital Accounts and the Balance Sheet after B's retirement:

SOLUTION

JOURNAL

Particulars	L.F.	Dr. (₹)	Cr. (₹)
Revaluation A/c Dr. To Stock Reserve A/c To Provision for Doubtful Debts A/c To Provision for Outstanding Legal Charges A/c (Being the fall in value of Assets and increase in amt. of pro. recorded)		5,050	480 150 4,420
Land & Building Dr. Prepaid Insurance Dr. Expenses Owing Dr. Reserve for Discount on Trade Creditors Dr. Mr. X Dr. To Revaluation A/c (Being the increase in value of Assets, decrease in Liabilities and Reserve for discount on creditors recorded)		5,000 2,000 275 125 350	7,750
Revaluation A/c Dr. To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of profit on revaluation to all partners in their profit sharing ratio of 4 : 3 : 2)		2,700	1,200 900 600

Workmen Compensation Reserve Dr.		1,200	
To Provision for Workmen Compensation Claim A/c			300
To A's Capital A/c			400
To B's Capital A/c			300
To C's Capital A/c			200
(Being provision made for workmen compensation and surplus Workmen Compensation reserve transferred)			
Investment Fluctuation Reserve A/c Dr.		1,900	
To Investments A/c			1,000
To A's Capital A/c			400
To B's Capital A/c			300
To C's Capital A/c			200
(Being investments brought down to its market value and surplus t/f to capital a/cs)			
Reserve Fund Dr.		5,400	
To A's Capital A/c			2,400
To B's Capital A/c			1,800
To C's Capital A/c			1,200
(Being the transfer of reserve to all partners in their profit sharing ratio of 4 : 3 : 2)			
A's Capital A/c Dr.		400	
B's Capital A/c Dr.		300	
C's Capital A/c Dr.		200	
To Advertisement Expenditure A/c			900
(Being the transfer of Advertisement Expenditure to all partners in their profit sharing ratio of 4 : 3 : 2)			
A's Capital A/c Dr.		4,000	
B's Capital A/c Dr.		3,000	
C's Capital A/c Dr.		2,000	
To Goodwill A/c			9,000
(Being the existing book value of Goodwill w/o)			
A's Capital A/c Dr.		2,145	
C's Capital A/c Dr.		1,815	
To B's Capital A/c			3,960
(Being share of goodwill credited to B and debited to the remaining partners in their gaining ratio which is 13 : 11)			
B's Capital A/c Dr.		20,160	
To Investments A/c			8,700
To Bank A/c			11,460
(Being B's Claim discharged)			
Bank A/c Dr.		5,960	
To A's Capital A/c			2,045
To C's Capital A/c			3,915
(Being the additional cash brought In by remaining partners)			

Dr.

CAPITAL ACCOUNTS OF PARTNERS

Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Goodwill A/c	4,000	3,000	2,000	By Balance b/d	21,600	16,200	10,800
To B's Capital A/c	2,145	—	1,815	By Revaluation A/c	1,200	900	600
To Adv. Exp. A/c	400	300	200	By Work. Com. Res.	400	300	200
To Investments A/c	—	8,700	—	By Invest. Fluc. Res.	400	300	200
To Balance c/d	19,455	11,460	8,985	By Reserve A/c	2,400	1,800	1,200
				By A's Capital A/c	—	2,145	—
				By C's Capital A/c	—	1,815	—
	26,000	23,460	13,000		26,000	23,460	13,000
To Bank A/c	—	11,460	—	By Balance b/d	19,455	11,460	8,985
To Balance c/d	21,500	—	12,900	By Bank A/c (b.f.)	2,045	—	3,915
	21,500	11,460	12,900		21,500	11,460	12,900

BALANCE SHEET OF A AND C AS AT 31ST DEC., 2017

Liabilities	₹	Assets	₹
Expenses Owning	625	Cash at Bank	10,000
Trade Creditors	5,000	Sundry Debtors	5,000
Less: Reserve	125	Less: Provision	250
Employees Provident Fund	1,000	Mr X	350
Provision for Workmen		Prepaid Insurance	2,000
Compensation Claim	300	Stock	9,000
Provision for Outstanding		Less: Reserve	480
Legal Charges		Land & Building	20,000
Legal Charges	4,420		
A's Capital	21,500		
C's Capital	12,900		
	45,620		45,620

Working Notes:

- Shortage of Cash** = ₹ 11,460 – ₹ 5,500 (i.e. ₹ 15,500 — ₹ 10,000) = ₹ 5,960
- Total Capital of New Firm** = ₹ 19,455 + ₹ 8,985 + ₹ 5,960 = ₹ 34,400
- A's New Capital** = ₹ 34,400 × 5/8 = ₹ 21,500,
C's New Capital = ₹ 34,400 × 3/8 = ₹ 12,900

PROBLEM 6

X and Y are partners. The partnership deed provides as under:

- That the account be balanced on 31st Dec. each year.
- That the profit be divided as follows: X one half, Y one third and carried to a Reserve Account one sixth.
- That in the event of the death of a partner, his executors be entitled to be paid out:
 - The capital to his credit.
 - His proportion of profit to the Date of death based on the average of profits of the last 3 completed years immediately preceding the year of death.

(iii) By way of goodwill, his proportion of total profits for 3 preceding years.

(iv) Interest on Capital @ 3% p.a.

His drawings are to bear interest at an average rate of 2% on the amount. Their Balance Sheet as on 31.12.2017 were as under:

Liabilities	₹	Assets	₹
X's Capital	9,000	Fixed Assets	15,000
Y's Capital	6,000	Investments	5,000
Reserve	4,000	Current Assets	1,000
Creditors	3,000	Advertisement Expenditure	1,000
	22,000		22,000

The profit for 2014 ₹ 1,000, 2015 ₹ 4,200, 2016 ₹ 3,900, 2017 ₹ 4,500. Y died on 1st May 2018. His drawings in 2018 amounted to ₹ 1,000.

On 1st May, 2018, the Investments of the firm were sold for ₹ 10,000 and proceeds were given to executors. Prepare Y's Capital Account and Y's Executors' Account.

SOLUTION

Dr.

Y'S CAPITAL ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Drawings	1,000	By Balance b/d	6,000
To Interest on Drawings (2% of ₹ 1,000)	20	By Reserve (₹ 4,000 × 2/5)	1,600
To Adv. Exp. [₹ 1,000 × 2/5]	400	By P & L Suspense A/c (share of profits)	560
To Y's Executors' A/c	13,840	By X's Capital A/c (share of goodwill)	5,040
		By Interest on Capital [6,000 × 3/100 × 4/12]	60
		By Revaluation A/c (₹ 5,000 × 2/5)	2,000
	15,260		15,260

Dr.

Y'S EXECUTORS' ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Bank A/c	10,000	By Y's Capital A/c	13,840
To Balance c/d	3,840		
	13,840		13,840

Working Notes:

1. Ratio between X and Y = $1/2 : 1/3 = 3 : 2$

2. CALCULATION OF Y'S SHARE OF GOODWILL

Particulars	₹
A. Total Profits for previous three years	12,600
B. Y's Share of Goodwill (₹ 12,600 × 2/5)	5,040

3. CALCULATION OF Y'S SHARE OF PROFITS

<i>Particulars</i>	₹
A. Total Profits for previous three years	12,600
B. Average Profits (₹ 12,600/3)	4,200
C. Profit from 1.1.20X5 to 30.4.20X5 (₹ 4,200 × 4/12)	1,400
D. Y's Share of Profits (₹ 1,400 × 2/5)	560

4. CALCULATION OF Y'S SHARE OF MATURED POLICIES

<i>Particulars</i>	₹
A. Sum Assured of Joint Life Policy	75,000
B. Sum Assured of Individual Life Policy	7,500
C. Total Sum Assured of Maturated Policies (A + B)	82,500
D. Y's Share of Maturated policies (₹ 82,500 × 2/5)	33,000

5. CALCULATION OF Y'S SHARE IN SURRENDER VALUE OF UNMATURED POLICY

<i>Particulars</i>	₹
A. Surrender value of X's individual life policy (50% of ₹ 15,000)	7,500
B. Y's share (₹ 7,500 × 2/5)	3,000

PROBLEM 7

The Balance Sheet of A, B and C who are sharing profits in the ratio of 2:3:1, as at 31st March, 2018 is given below:

<i>Liabilities</i>	₹	<i>Assets</i>	₹
A's Capital	1,00,000	Goodwill	12,000
B's Capital	2,00,000	Land and Building	2,50,000
C's Capital	3,00,000	Investments [Market Value ₹ 46,000]	50,000
Workmen Compensation Reserve	20,000	Stock	80,000
Investment Fluctuation Reserve	10,000	Debtors	3,00,000
Provision for Doubtful Debts	10,000	Bank	2,96,000
Creditors	3,60,000	Advertisement Suspense A/c	12,000
	10,00,000		10,00,000

C dies on 1st April, 2018 and A and B decide to share future profits & losses in the ratio of 3:2 and 50% is to be paid immediately and the balance in two equal annual instalments together with interest @ 10% p.a.

- Goodwill is to be valued at 2 years' purchase of average profits of last three completed years. The profits were - 2015-2016 ₹ 45,000, 2016-2017 ₹ 90,000, 2017-2018 ₹ 1,35,000.
- Land & Building was found under valued by ₹ 25,000 and Stock was found overvalued by ₹ 8,000.
- Provision for doubtful debts is to be made equal to 5% of the debtors.
- Claim on account of workmen compensation is ₹ 8,000. Pass the necessary journal entries and prepare the necessary ledger accounts and the Balance Sheet.

SOLUTION

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(1)	A's Capital A/c Dr. B's Capital A/c Dr. C's Capital A/c Dr. To Goodwill A/c (Being the existing goodwill w/o)		4,000 6,000 2,000	12,000
(2)	A's Capital A/c (₹ 1,80,000 × 8/30) Dr. To B's Capital (₹ 1,80,000 × 3/30) To C's Capital A/c (₹ 1,80,000 × 5/30) (Being the goodwill adjusted by debiting gaining partner (A for 8/30) and crediting Sacrificing partners (B for 3/30) and (C for 1/6)]		48,000	18,000 30,000
(3)	Land & Building A/c Dr. To Revaluation A/c (Being the increase in value of Assets recorded)		25,000	25,000
(4)	Revaluation A/c Dr. To Stock A/c To Provision for Doubtful Debts A/c (Being the decrease in Value of Assets & increase in provisions recorded)		13,000	8,000 5,000
(5)	Revaluation A/c Dr. To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of profit on revaluation)		12,000	4,000 6,000 2,000
(6)	Workmen Compensation Reserve A/c Dr. To Workmen Compensation Claim A/c To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of workmen compensation Reserve)		20,000	8,000 4,000 6,000 2,000
(7)	Investment Fluctuation Fund A/c Dr. To Investment A/c To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of Investment Fluctuation Fund)		10,000	4,000 2,000 3,000 1,000
(8)	A's Capital A/c Dr. B's Capital A/c Dr. C's Capital A/c Dr. To Advertisement Suspense A/c (Being the t/f of balance of Advertisement Suspense A/c)		4,000 6,000 2,000	12,000

(9)	C's Capital A/c To C's Executors' A/c (Being the balance in C's Capital t/f to Executor's A/c)	Dr.		3,31,000	3,31,000
(10)	C's Executors A/c To Bank A/c (Being 50% paid to C's Executors)	Dr.		1,65,500	1,65,500

Ledger Accounts:

Dr.

1. REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Stock	8,000	By Land & Building	25,000
To Provision for Doubtful Debts	5,000		
To Profit on Revaluation t/f to:			
A	4,000		
B	6,000		
C	2,000		
	25,000		25,000

Dr.

2. PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Goodwill A/c	4,000	6,000	2,000	By Balance b/d	1,00,000	2,00,000	3,00,000
To B's Capital A/c	18,000	—	—	By A's Capital A/c	—	18,000	30,000
To C's Capital A/c	30,000	—	—	By Revaluation A/c	4,000	6,000	2,000
To Adv. Exp. Sus. A/c	4,000	6,000	2,000	By Work Com. Res.	4,000	6,000	2,000
To C's Executors' A/c	—	—	3,31,000	By Invest. Flus. Res.	2,000	3,000	1,000
To Balance c/d	54,000	2,21,000	—				
	1,10,000	2,33,000	3,35,000		1,10,000	2,33,000	3,35,000

3. BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
A's Capital	54,000	Land & Building	2,75,000
B's Capital	2,21,000	Investments	46,000
C's Executors'	1,65,500	Stock	72,000
Creditors	3,60,000	Debtors	3,00,000
Workmen Compensation Claim	8,000	Less: Provision	15,000
		Bank	1,30,500
	8,08,500		8,08,500

Working Notes:**1. CALCULATION OF GAIN/SACRIFICE OF SHARE**

Particulars	New Share	Old Share	Difference
A.	3/5	2/6	$3/5 - 2/6 = 8/30$
B.	2/5	3/6	$2/5 - 3/6 = - 3/30$

2 Calculation of Goodwill

$$A. \text{ Average Profits} = \frac{\text{₹}45,000 + \text{₹}90,000 + \text{₹}1,35,000}{3} = \text{₹}90,000$$

$$B. \text{ Firm's Goodwill} = \text{₹} 90,000 \times 2 = \text{₹} 1,80,000$$

PROBLEM 8

A, B and C were partners sharing profits and losses in the ratio of 5 : 3 : 2. On 31st December, 2017 their Balance Sheet was as follows:

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Sundry Creditors	11,000	Goodwill	5,000
Investment Fluctuation Reserve	3,500	Patents	26,000
Workmen Compensation Reserve	3,500	Machinery	31,200
A's Capital	67,500	Investments	3,000
B's Capital	47,500	Stock	10,000
C's Capital	37,000	Sundry Debtors	12,000
		Loan to C	1,000
		Cash at Bank	5,800
		Advertisement Expenditure	1,000
		Profit & Loss A/c (2017)	75,000
	1,70,000		1,70,000

C died on 1st May, 2018. C has withdrawn ₹ 5,000 during 2018. It was agreed between his executors and the remaining partners that:—

- Goodwill be valued at 2-1/2 years' purchase of average of four completed years' profits which were: 2014 ₹ 1,01,000; 2015 ₹ 14,000; 2016 ₹ 16,000.
- C's Share of profit from the closure of last accounting year till Date of death be calculated on the basis of the average of three completed years' profits before death.
- Patents undervalued by ₹ 17,000; Machinery overvalued by ₹ 3,200.
- Investments be sold for ₹ 4,200 and a sum of ₹ 5,200 be paid to C's Executors immediately. The remainder to be paid in four equal half-yearly instalments together with interest @ 10% p.a. at half-yearly rest.

You are required:

- to give the necessary journal entries to be passed on C's death;
- to prepare the Capital Accounts of all the partners;
- to prepare the Balance Sheet of A and B immediately after C's death;
- to prepare C's Executor's Account till it is finally settled.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	A's Capital A/c	Dr.	2,500	
	B's Capital A/c	Dr.	1,500	
	C's Capital A/c	Dr.	1,000	
	To Goodwill A/c			5,000
	(Being the existing goodwill written off)			

2.	A's Capital A/c [₹ 7,000 × 5/8] Dr. B's Capital A/c [₹ 7,000 × 3/8] Dr. To C's Capital A/c [₹ 35,000 × 2/10] (Being C's share of goodwill adjusted)		4,375 2,625	7,000
3.	C's Capital A/c Dr. To Profit & Loss Suspense A/c (Being C's share of loss to Date of death recorded)		1,000	1,000
4.	Investment Fluctuation Reserve Dr. Workmen Compensation Reserve Dr. To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of reserves)		3,500 3,500	3,500 2,100 1,400
5.	A's Capital A/c Dr. B's Capital A/c Dr. C's Capital A/c Dr. To Advertisement Expenditure A/c (Being the transfer of Advertisement Expenditure)		500 300 200	1,000
6.	A's Capital A/c Dr. B's Capital A/c Dr. C's Capital A/c Dr. To Profit & Loss A/c (Being the transfer of Accumulated Loss)		37,500 22,500 15,000	75,000
7.	Revaluation A/c Dr. To Machinery A/c (Being the decrease in value of asset recorded)		3,200	3,200
8.	Patents A/c Dr. To Revaluation A/c (Being the increase in value of Assets recorded)		17,000	17,000
9.	Revaluation A/c Dr. To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the transfer of profit on revaluation)		13,800	6,900 4,140 2,760
10.	Bank A/c Dr. To Investments A/c (Being the investments sold)		4,200	4,200
11.	Investments A/c Dr. To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the profit on sale of investments transferred)		1,200	600 360 240

12.	C's Capital A/c To Loan to C A/c (Being the transfer of Loan to C A/c to his capital A/c)	Dr.		1,000	1,000
13.	C's Capital A/c To C's Executors' A/c (Being the transfer of C's Capital A/c to his executors' A/c)	Dr.		25,200	25,200
14.	C's Executors' A/c To Bank A/c (Being partial payment made to C's Executors)	Dr.		5,200	5,200

Dr.
CAPITAL ACCOUNTS OF PARTNERS
Cr.

<i>Particulars</i>	<i>A (₹)</i>	<i>B (₹)</i>	<i>C (₹)</i>	<i>Particulars</i>	<i>A (₹)</i>	<i>B (₹)</i>	<i>C (₹)</i>
To Bank A/c	—	—	5,000	By Balance b/d	67,500	47,500	37,000
To Goodwill A/c	2,500	1,500	1,000	By Revaluation A/c	6,900	4,140	2,760
To P & L A/c	37,500	22,500	15,000	By As Capital A/c	—	—	4,375
To C's Capital A/c	4,375	2,625	—	By B's Capital A/c	—	—	2,625
To P & L Suspense A/c	—	—	1,000	By Invest. F. Res.	1,750	1,050	700
To Loan to C A/c	—	—	1,000	By Work. Comp. Res.	1,750	1,050	700
To Adv. Exp.	500	300	200	By Investments A/c	600	360	240
To C's Executors' A/c	—	—	25,200				
To Balance c/d	33,625	27,175	—				
	78,500	54,100	48,400		78,500	54,100	48,400

BALANCE SHEET OF A AND B AS AT 1ST MAY 2018

<i>Liabilities</i>	<i>₹</i>	<i>Assets</i>	<i>₹</i>
Sundry Creditors	11,000	Patents	43,000
C's Executors' Account	20,000	Machinery	28,000
A's Capital	33,625	Stock	10,000
B's Capital	27,175	Sundry Debtors	12,000
P & L Suspense A/c	1,000		
Bank Overdraft	200		
	93,000		93,000

Dr.
C'S EXECUTORS' ACCOUNT
Cr.

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
01.05.2018	To Bank A/c	5,200	01.05.2018	By C's Capital A/c	25,200
31.10.2018	To Bank A/c (5,000 + 1,000)	6,000	31.10.2018	By Interest A/c [20,000 × 10/100 × 6/12]	1,000
31.10.2018	To Balance c/d	15,000			
		26,200			26,200
31.12.2018	To Balance c/d	15,250	01.11.2018	By Balance b/d	15,000
			31.12.2018	By Interest A/c (Accrued) [15,000 × 10/100 × 2/12]	250
		15,250			15,250

30.04.2019	To Bank A/c (5000 + 250 + 500)	5,750	01.01.2019	By Balance b/d	15,250
30.04.2019	To Balance c/d	10,000	30.04.2019	By Interest A/c [15,000 × 10/100 × 4/12]	500
		15,750			15,750
31.10.2019	To Bank A/c (5,000 + 500)	5,500	01.05.2019	By Balance b/d	10,000
31.10.2019	To Balance c/d	5,000	31.10.2019	By Interest A/c [10,000 × 10/100 × 6/12]	500
		10,500			10,500
31.12.2019	To Balance c/d	5,083	01.11.2019	By Balance b/d	5,000
			31.12.2019	By Interest A/c (Accured) [5,000 × 10/100 × 2/12]	83
		5,083			5,083
30.4.2020	To Bank A/c [5,000 + 83 + 167]	5,250	01.01.2020	By Balance b/d	5,083
			30.04.2020	By Interest A/c [5,000 × 10/100 × 4/12]	167
		5,250			5,250

Working Notes:**1. C's Share of Goodwill**

Firm's Goodwill = $[(1,01,000 + 14,000 + 16,000 - 75,000)/4] \times 2.5 = ₹ 35,000$

C's Share of Goodwill = $₹ 35,000 \times 2/10 = ₹ 7,000$

2. C's Share of Profit (Loss) till Date of death

Average Profit (Loss) of Last 3 years = $(14,000 + 16,000 - 75,000)/3 = (₹ 15,000)$

C's Share of Loss = $(₹ 15,000) \times 4/12 \times 2/10 = (₹ 1,000)$

Dr.

3. BANK ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	5,800	By C's Capital A/c (Drawings)	5,000
To Investments	4,200	By C's Executors' A/c	5,200
To Balance c/d (b.f.)	200		
	10,200		10,200

SOLVED PROBLEMS II**RETIREMENT OF A PARTNER****PROBLEM 10**

Manish, Jatin and Paresh were partners sharing Profits/Losses in the ratio of Manish 40 per cent, Jatin 35 per cent, and Paresh 25 per cent. The draft Balance Sheet of the partnership as on 31st December, 2017 was as follows:

Liabilities	₹	Assets	₹
Sundry Creditors	30,000	Cash on hand and at Bank	67,000
Bills payable	8,000	Stock	42,000
Loan from Jatin	30,000	Sundry Debtors	34,000
Current Accounts:		Less: Pro. for Doubtful Debts	6,000
Manish	12,000	Plant and Machinery (at cost)	80,000
Jatin	8,000	Less: Depreciation	28,000
Paresh	6,000	Premises (at cost)	75,000
Capital Accounts:			
Manish	90,000		
Jatin	50,000		
Paresh	30,000		
	1,70,000		
	2,64,000		2,64,000

Jatin retired on 31st December, 2017. Manish and Paresh continued in partnership sharing Profits/Losses in the ratio of Manish 60 per cent and Paresh 40 per cent. 50 per cent of Jatin's loan was repaid on 1-1-2018 and it was agreed that of the amount then remaining due to him a sum of ₹ 80,000 should remain as loan to partnership and the balance to be carried forward as ordinary trading liability. The following adjustments were agreed to be made to the above mentioned Balance Sheet:

- ₹ 10,000 should be written off from the premises.
- Plant and Machinery was revalued at ₹ 58,000.
- Provision for doubtful debts to be increased by ₹ 1,200.
- ₹ 5,000 due to creditors for expenses had been omitted from the books of account.
- ₹ 4,000 to be written off stocks.
- Provide ₹ 1,200 for professional charges in connection with revaluation.

As per the deed of partnership, in the event of the retirement of a partner, goodwill was to be valued at an amount equal to one year's purchase of the average profits of the preceding three years on the Date of retirement. Before determining the said average profits a notional amount of ₹ 80,000 should be charged for remuneration to partners. The necessary profits before charging such remuneration were:

Year ending 31.12.2015	₹ 1,44,000
Year ending 31.12.2016	₹ 1,68,000
Year ending 31.12.2017	₹ 1,88,200 (as per draft accounts)

It was agreed that, for the purpose of valuing goodwill, the amount of profit for the year 2017 be recomputed after charging the loss on revaluation in respect of premises and stock, the unprovided expenses (except professional expenses) and increase in the provision for doubtful debts.

You are required to prepare:

- Revaluation Account;
- Capital Accounts (merging current accounts therein);
- Jatin's Accounts showing balance due to him; and
- Balance Sheet of Manish and Paresh as at 1st January, 2018.

SOLUTION

Dr.

(I) REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Premises	10,000	By Plant & Machinery	6,000
To Provision for Doubtful Debts	1,200	By Loss transferred to Capital A/c's:	
To Outstanding Expenses	5,000	Manish (40%)	6,160
To Stock	4,000	Jatin (35%)	5,390
To Provision for Profess. Charges	1,200	Paresh (25%)	3,850
	21,400		15,400
			21,400

Dr.

(II) CAPITAL ACCOUNTS OF PARTNERS

Cr.

Particulars	Manish ₹	Jatin ₹	Paresh ₹	Particulars	Manish ₹	Jatin ₹	Paresh ₹
To Revaluation A/c (Loss)	6,160	5,390	3,850	By Balance b/f	90,000	50,000	30,000
To Jatin's Capital A/c	16,000	—	12,000	By Current A/c	12,000	8,000	6,000
To Personal A/c (b.t.)	—	80,610	—	By Manish Capital A/c	—	16,000	—
To Balance c/f	79,840	—	20,150	By Paresh's Capital A/c	—	12,000	—
	1,02,000	86,000	36,000		1,02,000	86,000	36,000

Dr.

(III) JATIN'S PERSONAL ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Bank (50% of old loan)	15,000	By Loan Account (old)	30,000
To Loan Account (new transferred)	80,000	By Capital Account[t/f]	80,160
To Balance c/d	15,610*		
	1,10,610		1,10,610

* For the balance amount due to Jatin, candidates may show Jatin's loan account at ₹ 95,000 (consisting of old loan ₹ 15,000 and new loan ₹ 80,000) and the balance i.e. ₹ 610 can be carried as an ordinary trading liability.

(IV) BALANCE SHEET OF M/S MANISH AND PARESH

as on 1st January 2018

Liabilities	₹	Assets	₹
Bills Payable	8,000	Current Assets:	
Sundry Creditors	30,000	Cash in hand & at Bank	52,000
Jatin's Personal A/c	15,610	Sundry Debtors	34,000
Creditors For Expenses	5,000	Less: Provision	7,200
Professional Expenses o/s	1,200	Stock in Trade	26,800
Loan A/c—Jatin	80,000	Fixed Assets:	
Mr. Manish's Capital	79,840	Plant & Machinery	
Mr. Paresh's Capital	20,150	As Ravalued	86,000
		Less: Deprecation	28,000
		Premises (at cost)	75,000
		Less: Written off	10,000
	2,39,800		65,000
			2,39,800

Working Notes:

1. Manish's Gain = $60/100 - 40/100 = 20/100$, Paresh's Gain = $40/100 - 25/100 = 15/100$, GR = 4:3

2. PROFIT FOR THE YEAR ENDING 31ST DECEMBER 2017

Particulars		₹
As per Draft A/c		1,88,200
Less: Premises Written off	10,000	
Provision for Doubtful Debts	1,200	
Outstanding Expenses	5,000	
Stock	4,000	20,200
		1,68,000

3. VALUATION OF GOODWILL

Particulars		₹
Profit for the year ended 31st December 2017 (adjusted)	1,68,000	
Profit for the year ended 31st December 2016	1,68,000	
Profit for the year ended 31st December 2015	1,44,000	4,80,000
Average Profits, before Partners' Salaries		1,60,000
Less: Partners' Salaries (notional)		80,000
Super profit and Goodwill (one year's Purchase)		80,000

PROBLEM 11

Anuj, Ayush and Piyush are in partnership sharing profits and losses in the ratio 2 : 2 : 1. Their Balance Sheet as on 31.3.2018 is as follows:

Liabilities	₹	Assets	₹
Anuj's Capital	3,75,000	Plant	7,87,000
Ayush's Capital	2,80,000	Stock	1,03,000
Piyush's Capital	2,25,000	Debtors	1,56,000
General Reserve	1,88,000	Bank FD	2,25,000
Creditors	2,16,000	Bank balance	13,000
	12,84,000		12,84,000

Anuj decided to retire with effect from 1.4.2018.

The remaining partners agreed to share profits and losses equally in future.

The following adjustments were agreed to be made upon retirement of Anuj:

- (i) Goodwill was to be valued at 1 year purchase of the average profits of the preceding 3 years on the Date of retirement.

The average profits of the past 3 years were as follows:

Year ended	₹
31.3.2018	3,30,000 (as per draft accounts)
31.3.2017	2,32,000
31.3.2016	2,20,000

The partners decided not to raise goodwill account in the books.

- (ii) Plant to be depreciated by 10%; Creditors amounting to ₹ 10,000 were omitted to be recorded; ₹ 6,000 is to be written off from stock; Provision for doubtful debts to be created @ 5% of the debtors; Interest accrued on FD amounting to ₹ 9,000 was omitted to be recorded.

The above adjustments were to be made from the profit for the year ended 31.3.2018 before calculation of goodwill.

- (iii) Anuj agreed to make over the bank FD including interest accrued thereon in part payment of his dues and the balance would remain as a loan carrying interest of 8% p.a.
- (iv) Ayush and Piyush agree to bring in sufficient cash to make their capital proportionate and maintain a bank balance of ₹ 1,50,000.

You are required to prepare (1) Capital accounts of partners and (2) Balance Sheet as on 1.4.2018 after Anuj's retirement.

SOLUTION

Dr.

CAPITAL ACCOUNTS OF PARTNERS

Cr.

Particulars	Anuj ₹	Ayush ₹	Piyush ₹	Particulars	Anuj ₹	Ayush ₹	Piyush ₹
To Anuj's Capital A/c		22,950	68,850	By Balance b/d	3,75,000	2,80,000	2,25,000
To Bank FD A/c	2,25,000			By General Reserve A/c	75,200	75,200	37,600
To Accrued interest on FD	9,000			By Ayush's Capital A/c	22,950	—	—
To Revaluation A/c	37,400	37,400	18,700	By Piyush's Capital A/c	68,850		
To Anuj's Loan A/c	2,70,600			By Bank A/c	—	8,600	1,28,400
To Balance C/f	—	3,03,450	3,03,450				
	5,42,000	3,63,800	3,91,000		5,42,000	3,63,800	3,91,000

BALANCE SHEET AS ON 31.3.2018 (AFTER ANUJ'S RETIREMENT)

Liabilities	₹	Assets	₹
Capital A/cs:		Plant	7,87,000
Ayush (8,77,500/2)	3,03,450	Less: Depreciation	(78,700)
Piyush (8,77,500/2)	3,03,450	Stock	1,03,000
Creditors [2,16,000 – 10,000]	2,26,000	Less: Written off	(6,000)
Anuj's Loan	2,70,600	Debtors	1,56,000
		Less: Provisions	(7,800)
		Interest Accrued on FD	9,000
		Less: Taken over by Anuj	(9,000)
		Bank FD	2,25,000
		Less: Taken over by Anuj	(2,25,000)
		Bank Balance	1,50,000
		(13,000 + 8,600 + 1,28,400)	
	11,03,500		11,03,500

Working Notes:

Dr.

1. REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Plant A/c	78,700	By interest accrued on FD	9,000
To Creditors A/c	10,000	By Loss on Revaluation t/f to:	
To Stock A/c	6,000	Anuj's Capital A/c	37,400
To RDD A/c	7,800	Ayush's Capital A/c	37,400
		Piyush's Capital A/c	18,700
			93,500
	1,02,500		1,02,500

2. GOODWILL VALUATION

Profit for the year ended 31.3.2016		₹ 2,20,000
Profit for the year ended 31.3.2017		₹ 2,32,000
Profit for the year ended 31.3.2018:		
Profit as per draft accounts	3,30,000	
Less: Depreciation on plant	(78,700)	
Less: Unrecorded creditors/purchases	(10,000)	
Less: Amount written off from stock	(6,000)	
Less: Provision	(7,800)	
Add: Interest accrued on FD	9,000	₹ 2,36,500
Total Profit for 3 years		₹ 6,88,500
Average Profit = 6,88,500/3 year = 2,29,500		
Goodwill = 2,29,500 × 1 years' purchase = ₹ 2,29,500		

3. Anuj's Share of Goodwill = ₹ 2,29,500 × 2/5 = ₹ 91,800 to be contributed by Ayush & Piyush in their Gaining Ratio i.e. 1:3. Ayush's gain = $1/2 - 2/5 = 1/10$ & Piyush's gain = $1/2 - 1/5 = 3/10$

PROBLEM 12

X, Y and Z were in partnership sharing profits and losses as one-half, one fourth and one-fourth respectively. It was agreed that interest should be allowed at the rate of 10% per annum on partners' capital accounts and charged at the rate of 8 per cent per annum on their drawings. No interest was to allowed or charged on current accounts.

The following are the **Particulars** of their capital accounts, current accounts and drawings (as shown by the draft accounts):

Particulars	Capital Account balance on 1.1.2018 ₹	Current Account balance on 1.1.2018 ₹	Drawings for year ended 31st Dec. 2018 ₹	Interest on Drawings ₹
X	1,50,000 Cr.	20,000 Cr.	30,000	2,000
Y	80,000 Cr.	10,000 Cr.	20,000	760
Z	60,000 Cr.	10,000 Dr.	20,000	1,400

The draft accounts for the year up to 31st December, 2018 showed a net profit of ₹ 1,20,000 before taking into account interest on partners' capital account balances and drawings. The audit of the draft accounts revealed the following errors:

- (a) The rent of X's private house, amounting to ₹ 1,500 and paid on 31st December, 2018 had been included in rents charged in profit and loss account.
- (b) Repairs amounting to ₹ 20,000 had been treated as additions to machinery, depreciation on which had been charged at the rate of 20 per cent.
- (c) The premium, amounting to ₹ 6,000, on Y's Life Insurance Policy, and paid on 30th June, 2018 had been included as insurance charges in the profit and loss account.

Z retired from the partnership on 31st December, 2018 and agreed to leave the amount due to him from the firm as a loan repayable by agreed instalments. X and Y agreed to continue in partnership, sharing profits and losses as two-third and one-third. In ascertaining the amount due to Z from the firm and for the purposes of the new partnership, it was agreed to make the following adjustments:

- (a) Goodwill to be valued at ₹ 1,44,000, but no account for goodwill to be raised in the books. (b) The value of freehold premises to be increased by ₹ 40,000. (c) The provision for doubtful debts to be increased by ₹ 12,000.

You are required to prepare (a). The Profit and Loss Appropriation account for the year ended 31st December 2018, making all the necessary adjustments for the errors revealed, and (b) Partners' Capital and Current Accounts (in columnar form) for the year ended 31st December, 2018 incorporating the adjustment on Z's retirement;

SOLUTION

STATEMENT SHOWING THE CALCULATION OF NET PROFIT FOR THE YEAR

Particulars	₹
A Amount as per draft accounts	1,20,000
B Add: Rent of X wrongly charged	1,500
Depreciation wrongly debited	4,000
Premium on Y's Life policy wrongly charged	6,000
	1,31,500
C Less: Repairs previously capitalised	20,000
D Net Profit (A + B – C)	1,11,500

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr.

for the year ending on 31st December, 2018

Cr.

Particulars	₹	Particulars	₹
To Interest on Capital:		By Net Profit (as calculated above)	1,11,500
X	15,000	By Interest on Drawings:	
Y	8,000	X	2,000
Z	6,000	Y (₹ 760 + ₹ 240)	1,000
		Z	1,400
To Net Profit t/f to Current A/cs:			4,400
X	43,450		
Y	21,725		
Z	21,725		
	86,900		
	1,15,900		1,15,900

Dr.

PARTNERS' CURRENT ACCOUNTS

Cr.

Particulars	X ₹	Y ₹	Z ₹	Particulars	X ₹	Y ₹	Z ₹
To Balance b/d	—	—	10,000	By Balance b/d	20,000	10,000	—
To Drawings	30,000	20,000	20,000	By Interest on Capital	15,000	8,000	6,000
To Rent of House	1,500	—	—	By Z's Capital A/c	—	—	6,675
To Life Policy Premium	—	6,000	—	By P & L Appropriation A/c	43,450	21,725	21,725
To Interest on Drawings	2,000	1,000	1,400				
To Provision for Doubtful Debts	6,000	3,000	3,000				
To Balance c/d	38,950	9,725	—				
	78,450	39,725	34,400		78,450	39,725	34,400

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	X ₹	Y ₹	Z ₹	Particulars	X ₹	Y ₹	Z ₹
To Z (Goodwill)	24,000	12,000	—	By Balance b/d	1,50,000	80,000	60,000
To Z's Current A/c	—	—	6,675	By X (Goodwill)	—	—	24,000
To Z's Loan Account	—	—	99,325	By Y (Goodwill)	—	—	12,000
To Balance c/d	1,46,000	78,000	—	By Freehold Premises	20,000	10,000	10,000
	1,70,000	90,000	1,06,000		1,70,000	90,000	1,06,000

DEATH OF A PARTNER**PROBLEM 13**

Wise, Clever and Dull were trading in partnership sharing profits and losses in the ratio of 4 : 3 : 3 respectively. The accounts of the firm made up to 31st December every year. The partnership provided, inter alia, that :

On the death of a partner, the goodwill was to be valued at three years' purchase of average profits of three years upto the Date of death after deducting interest @ 8 per cent on capital employed and a fair remuneration of each partner. The profits are assumed to be earned evenly throughout the year.

On 30th June, 2018, Wise died and it was agreed on his death to adjust goodwill in the capital accounts without showing any amount of goodwill in the Balance Sheet. For the purpose of valuation of goodwill, the fair remuneration for work by each partner would be ₹ 15,000 per annum and that the capital employed would be ₹ 1,56,000. Clever and Dull were to continue the partnership, sharing profits and losses equally after death of wise. The following were the amount of profits of earlier years before charging interest on capital employed.

2015 ₹ 67,200, 2016 ₹ 75,600, 2017 ₹ 72,000, 2018 ₹ 62,400

Required: Compute the value of goodwill and show the adjustment thereof in the books of the firm.

SOLUTION

(i) Average Profit for three years, ending 30th June before death:

Profit for the Year ending 30th June, 2016

= 1/2 of 2015 + 1/2 of 2016

= ₹ 33,600 + ₹ 37,800 = ₹ 71,400

Profit for the Year ending 30th June, 2017

$$= 1/2 \text{ of } 2016 + 1/2 \text{ of } 2017$$

$$= ₹ 37,800 + ₹ 36,000 = ₹ 73,800$$

Profit for the Year ending 30th June, 2018

$$= 1/2 \text{ of } 2017 + 1/2 \text{ of } 2018$$

$$= ₹ 36,000 + ₹ 31,200 = ₹ 67,200$$

(a) Total Profits for 3 years = ₹ 2,12,400

(b) Average Profits (₹ 2,12,400/3) = ₹ 70,800

(ii) Super Profit = Average Profit – Partner's remuneration – 8% on Capital employed

$$= ₹ 70,800 - ₹ 45,000 - ₹ 12,480 = ₹ 13,320$$

(iii) Goodwill @ three years' Purchase (13,320 × 3) = ₹ 39,960

Adjusting Entry for Goodwill:

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Particulars	L.F.	Dr. (₹)	Cr. (₹)
Clever's Capital A/c	Dr.	7,992	
Dull's Capital A/c	Dr.	7,992	
To Wise's Capital A/c			15,984
(Being Wise's share of goodwill adjusted in the capital accounts of gain partners in their gaining ratio of 1 : 1)			

PROBLEM 14

Peter, Paul and Prince were partners sharing profits and losses in the ratio of 2 : 1 : 1. It was provided in the partnership deed that in the event of retirement/death of a partner, he/his legal representatives would be paid:

- The balance in the Capital Account.
- His share of Goodwill of the firm valued at two years' purchase of normal average profits (after charging interest on fixed capital) for the last three years up to 31st of December preceding his retirement or death.
- His share of profits from the beginning of the accounting year to the Date of retirement or death, which shall be taken on proportionate basis of profits of the previous years as increased by 25%.
- Interest on Fixed Capital @ 10% p.a. though payable to the partners will not be payable in the year of death or retirement.
- All the Assets are to be revalued on the Date of retirement or death and the profit or loss to be debited/credited to Partners in the profit sharing ratio.

Peter died on 30th Sep., 2018. The books of Account are closed on calendar year basis from 1st January to 31st December. The balance in the Fixed Capital Accounts as on 1st January, 2018 were: Peter ₹ 10,000, Paul ₹ 5,000 and Prince ₹ 5,000. The balance in the Current Accounts as on 1st January, 2018 were: Peter ₹ 20,000, Paul ₹ 10,000 and Prince ₹ 7,000. Drawings of Peter till 30th Sep. 2018 ₹ 10,000. The Profits of the firm before charging interest on capital for the calendar years 2015, 2016 and 2017 were ₹ 1,00,000, ₹ 1,20,000 and ₹ 1,50,000 respectively. The profits include the following abnormal items of credit:—

Particulars	2015	2016	2017
Profit on sale of Assets	5,000	7,000	10,000
Insurance claim received	3,000		12,000

The firm has taken out a Joint Life Policy for ₹ 1,00,000. Besides, the partners had severally insured their lives for ₹ 50,000 each, the premium, in respect thereof being charged to the Profit and Loss Account. The surrender value of the Policies were 30% of the face value. On 30th June, 2018, the firm received notice from the insurance company that the insurance premium in respect of a fire policy had been undercharged to the extent of ₹ 6,000 in the year 2017 and the firm has to pay immediately. The revaluation of the Assets indicate an upward revision in value of Assets to the extent of ₹ 20,000. Prepare an account showing the amount due to Peter's legal representatives as on 30th September, 2018 alongwith necessary workings.

SOLUTION
Dr.
PETER'S CURRENT ACCOUNT
Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Drawings	10,000.00	By Balance b/d	20,000.00
To Profit & Loss Adjustment A/c (Share in Pre. undercharged)	3,000.00	By Paul A/c (Goodwill)	53,500
To Peter's Executor's A/c	2,81,031.25	By Prince A/c (Goodwill)	53,500
		By Insurance Co. (Share of Matured Policies)	75,000.00
		By Paul's Current A/c	7,500.00
		By Prince's Current A/c (Share of Unmatured Policies)	7,500.00
		By Revaluation A/c	10,000.00
		By P & L Suspense A/c (Share of Profit)	67,031.25
	2,94,031.25		2,94,031.25

Dr.
PETER'S EXECUTOR'S ACCOUNT
Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Balance c/d	2,91,031.25	By Peter's Capital A/c	10,000.00
		By Peter's Current A/c	2,81,031.25
	2,91,031.25		2,91,031.25

Working Notes:
1. CALCULATION OF PETER'S SHARE OF GOODWILL

<i>Particulars</i>	<i>2015</i> <i>₹</i>	<i>2016</i> <i>₹</i>	<i>2017</i> <i>₹</i>
A Profit as per Profit & Loss A/c	1,00,000	1,20,000	1,50,000
B Less: Interest on Capital	2,000	2,000	2,000
C Less: Insurance Premium	—	—	6,000
D Less: Abnormal Items:			
Profit on Sale of Assets	5,000	7,000	10,000
Insurance Claim received	3,000	—	12,000
E Adjusted Past Profits	90,000	1,11,000	1,20,000
F Average Profits $(₹ 90,000 + ₹ 1,11,000 + ₹ 1,20,000)/3 = ₹ 1,07,000$			
G Goodwill at 2 years' Purchases $= (1,07,000 \times 2) = ₹ 2,14,000$			
H Peter's Share $(₹ 2,14,000 \times 2/4) = ₹ 1,07,000$			

2. CALCULATION OF PETER'S SHARE OF INSURANCE POLICIES

Sum Assured of Joint Life Policy of all Partners	₹ 1,00,000
Sum Assured of Individual Life Policy of Peter	₹ 50,000
Total Sum Assured of Matured Policies	₹ 1,50,000
Peter's Share (₹ 1,50,000 × 2/4)	₹ 75,000
Surrender Value of Policies of Paul & Prince: 30% of (₹ 50,000 + ₹ 50,000)	₹ 30,000
Peter's Share (₹ 30,000 × 2/4)	₹ 15,000

3. Calculation of Peter's Share of Profits

(a) Correct Profit for the year 2017 = ₹ 1,50,000 – ₹ 6,000 – ₹ 1,000 (being Interest payable to other partners)

$$= ₹ 1,43,000$$

(b) Estimated Profit for 2018 = 125% of ₹ 1,43,000 = ₹ 1,78,750

(c) Proportionate till 30.9.2018 (₹ 1,78,750 × 9/12) = ₹ 1,34,062.50

(d) Peter's Share (₹ 1,34,062.50 × 2/4) = ₹ 67,031.25

4. Peter's Share of Profit on Revaluation of Assets = ₹ 20,000 × 2/4 = ₹ 10,000

5. Peter's share of Insurance Premium undercharged for the year 2013

$$= ₹ 6,000 \times 2/4 = ₹ 3,000$$

PROBLEM 15

The Balance Sheet of Amitabh, Abhishek and Amrish as at 31.12.2017 stood as follows: X

Liabilities	₹	Assets	₹
Capitals:		Land & Buildings	74,000
Amitabh	60,000	Investments	10,000
Abhishek	40,000	Goodwill	37,800
Amrish	40,000	Life Policy (at surrender value):	
Creditors	25,800	Amitabh	2,500
General Reserve	8,000	Abhishek	2,500
Investment Fluctuation Reserve	2,400	Amrish	1,000
		Stock	20,000
		Debtors	20,000
		Less: Provision	1,600
		Cash & bank balance	18,400
			10,000
	1,76,200		1,76,200

Amrish died on 31 March, 2018, due to this reason the following adjustments were agreed upon:

- Land and Buildings be appreciated by 50%.
- Investment be valued at 6% less than the cost.
- All debtors (except 20% which are considered as doubtful) were good.
- Stock to be reduced to 94%.
- Goodwill to be valued at 1 year's purchase of the average profits of the past five years.
- Amrish's share of profit to the Date of death be calculated on the basis of average profits of the three completed years immediately preceeding the year of death. The profits of the last five years are: 2013 ₹ 23,000, 2014 ₹ 28,000, 2015 ₹ 18,000, 2016 ₹ 16,000, 2017 ₹ 20,000

The life policies have been shown at their surrender values representing 10% of the sum assured in each case. The annual premium of ₹ 1,000 is payable every year on 1st August.

Give the necessary Journal Entries in the books of account and prepare the Balance Sheet of the reconstituted firm.

SOLUTION
JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	Insurance Company's A/c To Life Policy A/c (Being the policy on the life of Amrish matured on his death)	Dr. 10,000	10,000
2.	Life Policy A/c To Amitabh's Capital A/c To Abhishek's Capital A/c To Amrish's Capital A/c (Being the transfer of balance in life policy account to all partners' capital accounts)	Dr. 	 3,000 3,000 3,000
3.	Amitabh's Capital A/c Abhishek's Capital A/c Amrish's Capital A/c To Goodwill A/c (Being goodwill standing in the books written off fully)	Dr. Dr. Dr. 	 37,800
4.	Land & Buildings A/c To Revaluation A/c (Being an increase in the value of Assets recorded)	Dr. 	 37,000
5.	Investment Fluctuation Reserve A/c To Investment A/c (Being reduction in the cost of investment adjusted through Investment Fluctuation Reserve)	Dr. 	 600
6.	Revaluation A/c To Stock A/c To Provision for Doubtful Debts A/c (Being the fall in value of Assets recorded)	Dr. 	 1,200 2,400
7.	Amitabh's Capital A/c Abhishek's Capital A/c To Amrish's Capital A/c (Being the share of Amrish's revalued goodwill adjusted through capital accounts of the remaining partners)	Dr. Dr. 	 7,000
8.	Profit & Loss Suspense Account To Amrish's Capital A/c (Being Amrish's Share of profit to Date of death credited to his account)	Dr. 	 1,500

9.	Revaluation A/c To Amitabh's Capital A/c To Abhishek's Capital A/c To Amrish's Capital A/c (Being the transfer of profit on revaluation)	Dr.	33,400	11,133 11,133 11,134
10.	General Reserve A/c Investment Fluctuation Reserve A/c (₹ 2,400 – ₹ 600) To Amitabh's Capital A/c To Abhishek's Capital A/c To Amrish's Capital A/c (Being the transfer of accumulated profits to capital accounts)	Dr. Dr.	8,000 1,800	3,267 3,267 3,266
11.	Amrish's Capital A/c To Amrish's Executor's A/c (Being the transfer of Amrish's Capital A/c to his Executor's A/c)	Dr.	53,300	53,300

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Amithabh's Capital Account	61,300	Land & Building	1,11,000
Abhishek's Capital Account	41,300	Life Policy: Amitabh	2,500
Amrish's Executor's Account	53,300	Abhishek	2,500
Sundry Creditors	25,800	Investments	9,400
		Stock	
		Debtors	20,000
		Less: Provisions	4,000
		Insurance Company	10,000
		Cash & Bank Balance	10,000
		Profit and loss Suspense A/c	1,500
	1,81,700		1,81,700

Working Notes:

- Amrish's Share of Profit** = $[(₹ 18,000 + ₹ 16,000 + ₹ 20,000) \times 3/12] \times 1/3 = ₹ 1,500$
- Value of Goodwill** = $[(₹ 23,000 + ₹ 28,000 + ₹ 18,000 + ₹ 16,000 + ₹ 20,000) / 5] \times 1 = ₹ 21,000$
- Amrish's Share of Goodwill** = $₹ 21,000 \times 1/3 = ₹ 7,000$

RETIREMENT CUM ADMISSION**PROBLEM 16**

P, Q and R were partners sharing profits and losses in the ratio of 2 : 2 : 1. R wants to retire from partnership on 31-3-2018 and S wants to join the partnership on the same **Date**, to which both P & Q agreed. The Balance Sheet of the partnership firm as on 31-03-2018 and other information were as detailed below:

BALANCE SHEET AS AT 31-03-2018

Liabilities	₹	Assets	₹
Partners' Capital A/cs:		Fixed Assets	6,00,000
P	4,80,000	Stockinhand	2,00,000
Q	3,20,000	Sundry debtors	2,80,000
R	2,40,000	Cash at bank	1,60,000
General reserve	40,000	Cash in hand	40,000
Sundry creditors	2,00,000		
	12,80,000		12,80,000

P, Q and S agree to share profits and losses in equal ratio in future. Value of goodwill is taken to be ₹ 1,80,000. Fixed Assets are revalued upwards by ₹ 1,20,000 and stock by ₹ 40,000. A debtor from whom ₹ 20,000 was due, become insolvent. No amount will be received from him in future and same is not recorded in the books and balance sheet as above. Claim of R will be settled in full. P, Q and S agree to make their capital proportionate to their new profits sharing ratio. Balance amount receivable from/payable to partners will be brought in by partners/paid to partners immediately. All these transactions viz., claim of R and amount receivable/payable to partners will be routed through bank only. New partners also want to maintain ₹ 3,20,000 bank balance for working capital requirement.

- (i) Revaluation account
- (ii) Capital accounts of partners and
- (iii) Balance Sheet of the firm as newly constituted.

SOLUTION

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Sundry Debtors	20,000	By Fixed Assets	1,20,000
To Profit on Revaluation t/f to:		By Stock in hand	40,000
P's Capital A/c	56,000		
Q's Capital A/c	56,000		
R's Capital A/c	28,000		
	1,60,000		1,60,000

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	P ₹	Q ₹	R ₹	S ₹	Particulars	P ₹	Q ₹	R ₹	S ₹
To P, Q, and R	—	—	—	60,000	By Balance b/d	4,80,000	3,20,000	2,40,000	—
To Bank (b.f.)	1,04,000	—	3,12,000	—	By General reserve	16,000	16,000	8,000	—
To Balance c/d	4,60,000	4,60,000	—	4,60,000	By Reva. profit	56,000	56,000	28,000	—
					By S(Goodwill)	12,000	12,000	36,000	—
					By Bank (Bal. fig)	—	56,000	—	5,20,000
	5,64,000	4,60,000	3,12,000	5,20,000		5,64,000	4,60,000	3,12,000	5,20,000

BALANCE SHEET AS AT 31.03.2018 (AFTER RETIREMENT OF R AND ADMISSION OF S)

Liabilities		₹	Assets		₹
Partners' capital A/cs (Bal. fig.)			Fixed Assets		7,20,000
P	4,60,000		Stock in hand		2,40,000
Q	4,60,000		Sundry debtors		2,60,000
S	4,60,000	13,80,000	Cash at bank		3,20,000
Sundry Creditors		2,00,000	Cash in hand		40,000
		15,80,000			15,80,000

Working Notes:

(I) ADJUSTMENT OF GOODWILL

P's gain(loss = $1/3 - 2/5 = (1/15)$, Q's gain(loss = $1/3 - 2/5 = (1/15)$, S's gain = $1/3$

Q's share of Goodwill = ₹ 1,80,000 × 1/15 = ₹ 12,000

R's share of Goodwill = ₹ 1,80,000 × 1/15 = ₹ 12,000

S's share of Goodwill = ₹ 1,80,000 × 1/5 = ₹ 36,000

P's share of Goodwill = ₹ 1,80,000 × 1/3 = ₹ 60,000

(ii) As per balance sheet as on 31.03.2018 (after retirement of R and admission of S), balancing figure of total partners' capital is ₹ 13,80,000 (i.e. Total Assets ₹ 15,80,000 – Sundry creditors ₹ 2,00,000). Since partners agree to make their capital proportionate to their new profit sharing ratio i.e. 1:1:1, capital of each partner will be ₹ 4,60,000 (i.e. ₹ 13,80,000/3).

Dr.

(III) BANK ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	1,60,000	By P's Capital A/c	1,04,000
To Q's Capital A/c	56,000	By R's Capital A/c	3,12,000
To S's Capital A/c	5,20,000	By Balance c/d	3,20,000
	7,36,000		7,36,000

PROBLEM 17

Avinash, Basuda Ltd. and Chinmoy Ltd. were in partnership sharing profits and losses in the ratio of 9 : 4 : 2. Basuda Ltd. retired from the partnership on 31st March, 2018, when the firm's balance sheet was as under:

₹ in thousands

Liabilities	₹	Assets	₹
Sundry Creditors	600	Cash and Bank	284
Capital accounts:		Sundry Debtors	400
Avinash	2,700	Stock	800
Basuda Ltd.	1,200	Furniture	266
Chinmoy Ltd.	600	Plant	850
		Land and Building	2,500
	5,100		5,100

Basuda Ltd.'s share in goodwill and capital was acquired by Avinash and Chinmoy Ltd. in the ratio of 1 : 3, the continuing partners bringing in the necessary finance to pay off Basuda Ltd. The partnership deed provides that on retirement or admission of a partner, the goodwill of the firm is to be valued at three times the average annual profits of the firm for the four years ended on the Date of retirement or admission. The profits of the firm during the four years ended 31st March, 2018 in thousands of rupees were: 2014-2015 ₹ 450, 2015-2016 ₹ 250, 2016-2017 ₹ 600, 2017-2018 ₹ 700.

The continuing partners agreed that with effect from 1st April, 2018, Ghanashyam, son of Avinash is to be admitted as a partner with 25% share of profits and Capital of all partners are to be in Profit sharing ratio.

Avinash gifts to Ghanashyam, by transfer from his capital account, an amount sufficient to cover up 12.5% of capital and goodwill requirement. The balance 12.5% of capital and goodwill requirement is purchased by Ghanashyam from Avinash and Chinmoy Ltd. in the ratio of 2 : 1.

The firm asks you to:

- (i) Prepare a statement showing the continuing partners' shares;
- (ii) Pass journal entries including for bank transactions; and
- (iii) Prepare the balance sheet of the firm after Ghanashyam's admission.

SOLUTION

(I) STATEMENT SHOWING THE PARTNERS' SHARES

Particulars	Avinash Ltd.	Basuda Ltd.	Chinmoy	Ghanashyam
I Their existing shares	9/15	4/15	2/15	
II Share acquired from retiring partner	(+)1/15	—	(+)3/15	
III New ratio before admission of Ghanashyam [I + II]	10/15		5/15	
IV Gift by Avinash (12.5/100)	(-)1/8			1/8
V Purchase from Avinash & Chinmoy Ltd.	(-)2/24		(-)1/24	(+)3/24
VI New Ratio [IV + V]	11/24		7/24	6/24

(II) JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
31.03.2018	Avinash's Capital A/c Dr. Chinmoy Ltd.'s Capital A/c Dr. To Basuda Ltd.'s Capital A/c (Being purchase by Avinash and Chinmoy Ltd. of share from Basuda Ltd.)		1,00,000 3,00,000	4,00,000
04.04.2018	Avinash's Capital A/c Dr. Bank A/c Dr. To Ghanashyam's Capital A/c (Being gift made by Avinash to G and remaining capital brought in by Ghanashyam)		7,50,000 9,37,500	16,87,500
	Bank A/c Dr. To Avinash's Capital A/c To Chinmay Ltd.'s Capital A/c (Being continuing partners brought in the necessary finance to pay off Barmuda Ltd.)		16,00,000	4,00,000 12,00,000

	Basuda Ltd.'s Capital A/c Dr. To Bank A/c (Being final payment made to Basuda Ltd. on retirement)		16,00,000	16,00,000
	Ghanashyam's Capital A/c Dr. To Avinash's Capital A/c To Chinmoy Ltd.'s Capital A/c (Being goodwill credited to sacrificing partners for share purchased in the ratio of 2 : 1)		1,87,500	1,25,000 62,500
	Bank A/c Dr. To Avinash's Capital A/c To Chinmoy Ltd.'s Capital A/c To Ghanashyam's Capital A/c (Being capital brought in by the partners)		15,00,000	3,75,000 1,87,500 9,37,500

(III) BALANCE SHEET AS AT 1ST APRIL, 2018

Liabilities	₹	Assets	₹
Sundry Creditors	6,00,000	Cash and Bank	17,84,000
Capital accounts:		Sundry Debtors	4,00,000
Avinash	27,50,000	Stock	8,00,000
Chinmoy Ltd.	17,50,000	Furniture	2,66,000
Ghanashyam	15,00,000	Plant	8,50,000
		Land and Building	25,00,000
	66,00,000		66,00,000

Working Notes:

(₹ in thousands)

1. Adjustment of Goodwill on Retirement

$$\text{Value of Goodwill} = (450 + 250 + 600) \times \frac{3}{4} = 1,500$$

$$\text{Share of Basuda Ltd.} = 1,500 \times \frac{4}{15} = 400$$

Adjustment through partners' capital accounts

$$\text{Avinash: } 400 \times \frac{1}{4} = 100 \text{ (Dr.)}$$

$$\text{Basuda Ltd.: } 1500 \times \frac{4}{15} = 400 \text{ (Cr.)}$$

$$\text{Chinmoy Ltd.: } 400 \times \frac{3}{4} = 300 \text{ (Dr.)}$$

2. Closing Balances of Capital Accounts

A Adjusted old Capital of Continuing Partners = 4,500

B Total Capital of New firm = Adjusted Old Capital + Incoming Partner's Capital

$$X = 4,500 + 25\% \text{ of } X$$

$$(\frac{3}{4})X = 4,500$$

$$X = 4,500 \times \frac{4}{3} = 6,000$$

C New Capital of Partners: Avinash = ₹ 6,000 × 11/24 = ₹ 2,750,

$$\text{Chinmay} = ₹ 6,000 \times \frac{7}{24} = ₹ 1,750$$

$$\text{Ghanshyam} = ₹ 6,000 \times \frac{6}{24} = ₹ 1,500$$

3. Adjustment of Goodwill on Admission

Goodwill of the firm = 1,500

Total Share of Ghanshyam = $1500 \times \frac{1}{4} = 375$

Goodwill to be brought in share Purchased by Avinash = $375 \times \frac{1}{2} = 187.5$

Amount to be brought in by Ghanashyam = $750 + 187.50 = 937.50$

(a) Gift by Avinash = $\frac{1}{2} \times 375 = 187.5$ (included in the gift of 750)

(b) Purchase from Avinash and Chinmoy Ltd. = 187.5 (in 2 : 1 ratio)

Thus, adjustment of goodwill purchased through capital accounts

Avinash: 187.5 = 125 (Cr.)

Chinmoy Ltd.: 187.5 = 62.5 (Cr.)

Ghanashyam: 375 = 187.5 (Dr.)

4. Amount brought in by Partners

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	Avinash	Basuda	Chinmoy	Ghana-shyam	Particulars	Avinash	Basuda	Chinmoy	Ghana-shyam
To Basuda Ltd.	100	—	300	—	By Balance b/d	2,700	1,200	600	—
To Ghanashyam	750	—	—	—	By Avinash and Chinmoy Ltd.	—	400	—	—
To Avinash and Chinmoy Ltd.	—	—	—	187.5	By Bank A/c	400	—	1,200	—
To Cash & Bank	—	1,600	—	—	By Cash&Bank (b.f)	375	—	187.5	937.5
To Balance c/d	2,750	—	1,750	1,500	By Avinash	—	—	—	750
					By Ghanashyam	125	—	62.5	—
	3,600	1,600	2,050	1,687.5		3,600	1,600	2,050	1,687.5

5. CASH AND BANK

Particulars	₹
Amount given	284
Amount brought in by partners	3,100
Less: Payment to Basuda Ltd.	1,600
	1,748
Net Increase (Equivalent to the value of goodwill) = 1,500	

PROBLEM 18

A, B and C were partners, sharing profits and losses in the ratio of 5 : 3 : 2 respectively. On 31st March, 2017 their Balance Sheet stood as follows:

Liabilities	₹	Assets	₹
A's Capital	7,79,000	Plant and Machinery	13,62,000
B's Capital	7,07,800	Furniture and Fittings	2,36,000
C's Capital	6,86,200	Stock	7,02,000
Creditors	4,91,000	Debtors	1,91,000
		Cash at Bank	1,73,000
	26,64,000		26,64,000

On 31st July 2017 A died. According to partnership deed, on the death of a partner, the capital account of the deceased partner was to be credited with:

- (i) his share of profit for the relevant part of the year of death calculated on the basis of profit earned during the immediately preceding accounting year, and
- (ii) his share of goodwill.

Goodwill was to be valued at two years' purchase of the average profits of immediately preceding three accounting years. The profits, as per books of account, were as follows:

Particulars	₹
For accounting year ended 31st March, 2015	3,29,000
For accounting year ended 31st March, 2016	3,46,000
For accounting year ended 31st March, 2017	3,78,000

However, while going through the books of account on A's death, it came to light that ₹ 30,000 worth of wages were spent on installation of a new machinery, but the sum was not capitalised; the machinery was put into operation on 1st October, 2016. Depreciation was provided on the machinery @ 20% per annum.

On 1st October, 2017 A's son D was admitted into partnership with immediate effect on the following terms:

- (a) D would get one-fourth share in the profit of the firm, while the relative profit sharing ratio between B and C would remain unchanged.
- (b) The final balance of A's capital account would be credited to D's Capital Account.
- (c) An adjustment would be made in the Capital Accounts for D's share of goodwill. The basis of valuation of firm's goodwill would be the same as was adopted of the time of the death of his father.

On 31st March, 2018 the Profit and Loss Account of the firm showed that the firm had earned a profit of ₹ 4,16,000 for the year. The respective drawings accounts showed that while B and C had withdrawn ₹ 60,000 each during the year, D's drawing totalled ₹ 30,000. The Drawings Accounts are closed at the end of the year by transfer to respective capital accounts.

You are required to:

- (i) Prepare a statement showing distribution of profits for the accounting year ended 31st March, 2018; and
- (ii) Pass journal entries for all the transactions relating to death of the partner, D's admission into partnership, and at the end of the year relating to transfer of Drawings Accounts and distribution of profit for the year.

SOLUTION

(I) STATEMENT SHOWING DISTRIBUTION OF PROFITS FOR THE ACCOUNTING YEAR ENDED 31ST MARCH 2018

Particulars	₹	₹
Net Profit for the year ended 31.03.2018		4,16,000
A's Share		
(Profit distributed to deceased partner A & his executor)		
(a) Profit for 4 months (1.4.2017 – 31.7.2017) (W.N.1)	67,500	
(b) Application of Sec. 37 (1.8.2017 – 30.9.2017) (W.N.5)	28,021	95,521
B's Share		

(a) Profit for 4 months (1.4.2017 – 31.7.2017) (W.N.3)	42,700	
(b) Profit for 2 months (1.8.2017 – 30.9.2017) (W.N.6)	24,787	
(c) Profit for 3 months (1.10.2017 – 31.3.2018) (W.N.10)	93,600	1,61,087
C's share		
(a) Profit for 4 months (1.4.2017 – 31.7.2017) (W.N.3)	28,467	
(b) Profit for 2 months (1.8.2017 – 30.9.2017) (W.N.6)	16,525	
(c) Profit for 6 months (1.10.2017 – 31.3.2018) (W.N.10)	62,400	1,07,392
D's Share		
(a) Profit for 6 months (1.10.2017 – 31.3.2018) (W.N.10)	52,000	52,000
		4,16,000

(II) JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2017 July 31	Machinery A/c Dr. To A's Capital A/c To B's Capital A/c To C's Capital A/c (Wages spent on installation of new machinery capitalised and credited to partners' capital accounts after providing depreciation for six months ended 31st March, 2000)		27,000	13,500 8,100 5,400
	Profit and Loss Suspense A/c Dr. To A's Capital A/c (A's share of profit for four months as calculated in W.N. 1 credited to his capital to his capital account)		67,500	67,500
	B's Capital A/c Dr. C's Capital A/c Dr. To A's Capital A/c (Goodwill credited to A)		2,16,000 1,44,000	3,60,000
	A's Capital A/c Dr. To A's Executor's A/s (Balance due to A transferred to his executor's account)		12,20,000	12,20,000
	Profit & Loss Suspense A/c Dr. To A's Executor's A/c (Profit earned out of the unsettled capital credited to A's executor's account as per W.N. 5)		28,021	28,021
Oct. 1	A's Executor's A/c Dr. To D's Capital A/c (Final balance of A's executor's account transferred to D's capital account)		12,48,021	1248,021
	D's Capital A/c Dr. To B's Capital A/c To C's Capital A/c (Goodwill Credited to sacrificing partners in the ratio of 3 : 2)		1,80,000	1,08,000 72,000

Mar. 31	B's Capital A/c	Dr.	60,000	
	C's Capital A/c	Dr.	60,000	
	D's Capital A/c	Dr.	30,000	
	To B's Drawings A/c			60,000
	To C's Drawings A/c			60,000
	To D's Drawing A/c			30,000
	(Drawings debited to partners' capital accounts)			
Mar. 31	Profit and Loss Appropriation A/c	Dr.	4,16,000	
	To Profit and Loss Suspense A/c (₹ 67,500 + 28,021)			95,521
	To B's Capital A/c			1,61,087
	To C's Capital A/c			1,07,392
	To D's Capital A/c			52,000
	(Division of profits as shown in statement of distribution of profits and balance of profit & loss suspense account transferred to profit and loss appropriation account)			

Working Notes:**1. A's Share in profit for the period 1.4.2017 – 31.7.2017**

Particulars	₹
A. Profit for the year ended 31st March, 2017	3,78,000
B. Add: Capital expenditure of wages spent on installation of new machinery, treated, treated as revenue expenditure	30,000
C. Less: Dep. on ₹ 30,000 (being the value of machinery @ 20% p.a. for 6 months)	3,000
D. Correct profit for the year ended 31st March, 2017	4,05,000
E. Profit for 4 months on the basis of last year's profit [₹ 4,05,000 × 4/12]	1,35,000
F. A's share in profit [1,35,000 × 5/10]	67,500

2. Valuation of Goodwill = $[(3,29,000 + 3,46,000 + 4,05,000)/3] \times 2 = ₹ 7,20,000$

3. DISTRIBUTION OF PROFITS FOR 4 MONTHS ENDED 31ST JULY, 2017

Particulars	₹
Net Profit [₹ 4,16,000 × 4/12]	1,38,667
A's share [as per Working Note (i)]	67,500
B's share [₹ 71,167 × 3/5]	42,700
C's share [₹ 71,167 × 2/5]	28,467

Dr.

4. PARTNERS' CAPITAL ACCOUNTS AS ON 31ST JULY, 2017

Cr.

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To A's Capital A/c	—	2,16,000	1,44,000	By Balance b/d	7,79,000	7,07,800	6,86,200
To Drawings	—	20,000	20,000	By Plant & Machinery	13,500	8,100	5,400
To A's Executor's A/c	12,20,000	—	—	By B's Capital A/c	2,16,000	—	—
To Balance c/d	—	5,22,600	5,56,067	By C's Capital A/c	1,44,000	—	—
				By Share in profit (W.N. 3)	67,500	42,700	28,467
	12,20,000	7,58,600	7,20,067		12,20,000	7,58,600	7,20,067

5. Application of Section 37 of the Indian Partnership Act, 1932 Either

(i) Interest of ₹ 12,20,000 × 6/100 × 2/12 = ₹ 12,200

or

(ii) Profit earned out of unsettled capital

$$₹ 4,16,000 \times \frac{2}{12} \times \frac{₹ 12,20,000}{₹ (12,20,000 + 9,54,600 + 8,44,067)} = ₹ 28,021 \text{ (approx.)}$$

In the absence of specific agreement amongst partners on the above subject matter, the representatives of the deceased partner can receive at their option, interest at the rate of 6% p.a. or share of profit earned for the amount due to the deceased partner.

In the above case, it would be rational to assume that A's representatives would opt for ₹ 28,021.

6. DISTRIBUTION OF PROFIT FOR 2 MONTHS ENDED 31ST OCT., 2017

Particulars	₹
Net profit (₹ 4,16,000 × 2/12)	69,333
A's executor's share [as per Working Note (v)]	28,021
B's share (₹ 41,312 × 3/5)	24,787
C's share (₹ 41,312 × 2/5)	16,525

Dr.

7. A'S EXECUTOR'S ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To D's Capital A/c	12,48,021	By A's Capital A/c	12,20,000
		By Share in profit (W.N. 6)	28,021
	12,48,021		12,48,021

8. PARTNERS' CAPITAL ACCOUNTS

(1st August, 2017 to 30th Sept., 2017)

Dr.

Cr.

Particulars	B ₹	C ₹	Particulars	B ₹	C ₹
To Drawings	10,000	10,000	By Balance b/d	5,22,600	5,56,067
To Balance c/d	5,37,387	5,62,592	By P & L A/c	24,787	16,525
	5,47,387	5,72,592		5,47,387	5,72,592

9. Computation of new profit sharing ratio between B, C & D

B's new ratio = $3/4 \times 3/5 = 9/20$, C's new ratio = $3/4 \times 2/5 = 6/20$, D's new ratio = $1/4 = 5/20$

New profit sharing ratio = 9 : 6 : 5

10. DISTRIBUTION OF PROFIT FOR 6 MONTHS ENDED 31ST MARCH, 2018

Particulars	₹
Net profit (₹ 4,16,000 × 6/12)	2,08,000
B's share (₹ 2,08,000 × 9/20)	93,600
C's share (₹ 2,08,000 × 6/20)	62,400
D's share (₹ 2,08,000 × 5/20)	52,000

Dr.

11. PARTNERS' CAPITAL ACCOUNTS AS ON 31ST MARCH, 2018

Cr.

<i>Particulars</i>	<i>B ₹</i>	<i>C ₹</i>	<i>D ₹</i>	<i>Particulars</i>	<i>B ₹</i>	<i>C ₹</i>	<i>D ₹</i>
To B's Capital A/c	—	—	1,08,000	By Balance b/d	5,37,387	5,62,592	—
To C's Capital A/c	—	—	72,000	By A's Executor's A/c	—	—	12,48,021
To Drawings	30,000	30,000	30,000	By D's Capital A/c	1,08,000	72,000	—
To Balance c/d	7,08,987	6,66,992	10,90,021	By Share of profit (W.N. 10)	93,600	62,400	52,000
	7,38,987	6,96,992	13,00,021		7,38,987	6,96,992	13,00,021

12. It is assumed that profit was earned uniformly throughout the year. Although notional profit was calculated for the first four months, it is to be transferred from the current year's profit (as calculated in working note 3). The question requires that A's share of profit for this period is to be calculated on the basis of profit earned during year ended 31st March, 2017. The balance amount after calculating his share has been credited to B and C in ratio 3 : 2.
13. It is assumed that drawings were made evenly throughout the year. However, single entry has been given at the year end in the main solution relating to transfer of drawings and distribution of profit but the Partners' capital accounts shown in the working notes include entries of drawings and distribution of profit of respective Dates within the year.

29

LIMITED LIABILITY PARTNERSHIP [LLP]

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Introduction
- ◇ Meaning and Features of Limited Liability Partnership
- ◇ Comparison Between Existing Partnership and LLP
- ◇ Comparison Between Company and LLP
- ◇ Who Can Become a Partner in LLP? [Sec 5]
- ◇ Disqualifications of an Individual to Become a Partner [Sec 5]
- ◇ Minimum Number of Partners [Sec 6]
- ◇ Designated Partners [Sec 7]
- ◇ Incorporation Document [Sec 11]
- ◇ Incorporation by Registration [Sec 12]
- ◇ Effects of Registration [Sec 14]
- ◇ Partner as Agent of LLP and not of other Partners [Sec. 26]
- ◇ Extent of Liability of LLP [Sec 27]
- ◇ Extent of Liability of Partner [Sec 28,29,30]
- ◇ Whistle Blowing [Sec 31]
- ◇ Contribution [Sec 32 & 33]
- ◇ Maintenance of Books of Account, Other Records and Audit, etc [Sec 34]
- ◇ Annual Return [Sec 35]
- ◇ Partner's Transferable Interest [Sec 42]
- ◇ Taxation of LLP

1.0 INTRODUCTION

1. 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.
2. It extends to the whole of India.

2.0 MEANING AND FEATURES OF LIMITED LIABILITY PARTNERSHIP

Meaning	Limited Liability Partnership means a partnership formed and registered under this Act. [Sec 2(1) (n)]
Features	Body Corporate: A Limited Liability Partnership 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: It shall have perpetual succession. Any change in the partners of a Limited Liability Partnership shall not affect the existence, rights or liabilities of the limited liability partnership. Non-Applicability: The provisions of The Indian Partnership Act, 1932 (9 of 1932) shall not apply to a LLP unless otherwise provided.

3.0 COMPARISON BETWEEN EXISTING PARTNERSHIP AND LLP

An Existing Partnership and LLP may be compared as follows:

<i>Basis of Distinction</i>	<i>Partnership</i>	<i>LLP</i>
Regulating Law	It is governed by ' The Indian Partnership Act, 1932 '	It is governed by ' The Limited Liability Partnership Act, 2008 '
Registration	Registration is optional .	Registration is compulsory .
Creation	It is created by agreement .	It is created by Law .
Separate Legal Entity	It has no separate legal entity.	It has separate legal entity.
Name of Entity	It can have any name as per choice.	Its Name to contain ' Limited Liability Partnership ' or ' LLP ' as suffix.
Perpetual Succession	It does not have perpetual succession . The death, insolvency or unsoundness of its members may affect its existence.	It has perpetual succession. The death, insolvency or unsoundness of its members does not affect its existence. Members may come and go but LLP goes forever.
Charter Document	Partnership Deed is a charter of the firm which denotes its scope of operation and rights and duties of the partners	LLP Agreement is a charter of the LLP which denotes its scope of operation and rights and duties of the partners vis-à-vis LLP.
Common Seal	There is no concept of common seal in partnership.	It may have its own common seal (i.e. Official Signature) as per its Agreement.

Incorporation Formalities	1. Partnership Deed 2. Form / Affidavit 3. Prescribed Fee. required to be filled with Registrar of Firms.	1. LLP Agreement 2. Various e Forms 3. Prescribed Fee. required to be filled with Registrar of LLP.
Time taken to incorporate	It takes 7 days (approx.) to incorporate.	It takes 10 days (approx.) to incorporate (inclusive of time taken to obtain DPIN)
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 in a Partnership Firm in India.	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 belonging to partnership firm.	The LLP being a legal entity independent of the partners has ownership of assets
Rights/Duties/Obligation of the Partners/Managing 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 . Partners are severally and jointly liable for actions of other partners and the firm and liability extend to their personal assets.	Liability of Partner is limited , to the extent their contribution towards LLP, except in case of intentional fraud or wrongful act of omission or commission by the partner.
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.	It must have at least 2 two individuals as Designated Partners, of whom at least one must be resident in India. Each Designated Partner is required to have a DPIN before appointment.
Digital Signature	There is no requirement of obtaining Digital Signature	Atleast one Designated Partner must have Digital Signatures since e forms are filled electronically.
Dissolution	Its Dissolution may take place By Mutual Agreement, Insolvency, Certain Contingencies, and by Court Order.	Its Dissolution may take place Voluntarily or by order of National Company Law Tribunal.
Maintenance of Minutes	There is 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 required to be filed with Registrar of LLP every year.
Audit of Accounts	Partnership Firms are only required to have Tax Audit of their accounts as per the provisions of the Income Tax Act.	An LLP is required to get their accounts audited annually as per the provisions of LLP Act 2008 if its turnover exceeds ₹ 40 Lacs or its capital contribution exceeds ₹ 25 Lacs in any financial year.
Compromise/Arrangements/Merger/Amalgamation	Partnership cannot merge with other firm or enter into Compromise or Arrangement with creditors or partners.	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 or firm.
Admission of Minor	Minor can be admitted to the benefits of Partnership as per its Agreement.	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.

4.0 COMPARISON BETWEEN COMPANY AND LLP

A Company and LLP may be compared as follows:

Basis of Distinction	Company	LLP
Prevailing Law	It is governed by ' The Companies Act, 2013 '	It is governed by ' The Limited Liability Partnership Act, 2008 '
Motive	It can be formed for Profit or Service motive .	It can be formed only for Profit motive .
Cost of Formation ₹ 6,000 and that of Public Company is ₹ 19,000.	Minimum Statutory fee for incorporation of Private Company is	Minimum cost of Formation of LLP is ₹ 800 only , comparatively much lesser than the cost of formation of Company.
Charter Document	Memorandum of Association is the charter of the company which defines its scope of operations.	LLP Agreement is a charter of the LLP which denotes its scope of operations.

Common Seal	It must have its own common seal (i.e. Official Signature).	It may have its own common seal (i.e. Official Signature) as per its Agreement.
Formalities of Incorporation	1. Memorandum & Articles of Association 2. Various e Forms 3. Prescribed Fee. required to be filled with Registrar of Companies.	1. LLP Agreement 2. Various e Forms 3. Prescribed Fee. required to be filled with Registrar of LLP.
Number of Members	Private Company : Minimum 2 members & maximum 200 members. Public Company: Minimum 7 members but their is no limit on maximum number of partners.	Minimum 2 but their is no limit on maximum number of partners.
Liability of Partners/ Members	Generally limited to the amount required to be paid up on each share.	Liability of Partner is Limited, to the extent their contribution towards LLP, except in case of intentional fraud or wrongful act of omission or commission by the partner.
Transfer of Share/ Partnership rights in case of death	Shares are transmitted to the legal heirs.	Legal heirs will not become partners. The legal heirs have the right to get the refund of the capital contribution + Share in Accumulated Profits, if any.
Transferability of Interest	A member of a public company can freely transfer his interest.	A partner can transfer his interest subject to the LLP Agreement
Admission as Partner/ Member	A person can become member by buying shares of a company.	A person can be admitted as a partner as per the LLP Agreement.
Cessation as Partner/ Member	A member / shareholder can cease to be a member by selling the shares.	A person can cease to be a partner as per the LLP Agreement or in absence of the same by giving 30 days prior notice to the LLP.
Meetings	Board Meetings and General Meetings are required to be conducted at appropriate time.	There is no provision in regard to holding of any meeting.
Maintenance of Minutes	The proceedings of meetings of the Board of Directors / Shareholders are required to be recorded in minutes.	A LLP by agreement may decide to record the proceedings of meetings of the Partners/Designated Partners
Voting Rights	Voting rights are decided as per the number of shares held by the members.	Voting rights shall be as decided as per LLP Agreement.

Remuneration of Managerial Personnel for day to day administration	Company can pay remuneration to its Directors as per The Companies Act, 1956.	LLP can pay remuneration to partners as per LLP Agreement.
Restrictions on Contracts with Partners/Director	There are restrictions on Board regarding some specified contracts, in which directors are interested.	There are no restrictions on partners to enter into any contract.
Filing of Annual Statement of Solvency	Annual Statement of Solvency is not required to be filed with the Registrar of Companies every year.	Annual Statement of Solvency is required to be filed with the Registrar of LLP every year.
Share Certificate	Ownership of Shares is evidenced by Share Certificates.	The ownership of the partners in the firm is evidenced by LLP Agreement.
Audit of Accounts	Companies are required to get their accounts audited annually as per the provisions of the Companies Act, 1956.	An LLP is required to get their accounts audited annually as per the provisions of LLP Act 2008 if its turnover exceeds ₹ 40 Lacs or its capital contribution exceeds ₹ 25 Lacs in any financial year.
Applicability of Accounting Standards	Companies have to mandatorily comply with accounting standards	The necessary rules in regard to the application of accounting standards are not yet issued.
Oppression and Mismanagement	Provisions relating to remedy against Oppression and mismanagement exist.	No Provisions relating to remedy against Oppression and mismanagement exist.
Whistle Blowing	No such provision is provided under the Companies Act, 1956.	Provision has been made to provide protection to employees & partners, providing useful information during an investigation or convicting any partner or firm.

v

5.0 WHO CAN BECOME A PARTNER IN LLP? [SEC 5]

Any individual or body corporate may be a partner in a limited liability partnership:

6.0 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—

1. he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
2. he is an undercharged insolvent; or
3. he has applied to be adjudicated as an insolvent and his application is pending.

7.0 MINIMUM NUMBER OF PARTNERS [SEC 6]**MINIMUM NO OF PARTNERS**

Every LLP must have at least 2 partners.

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.

8.0 DESIGNATED PARTNERS [SEC 7]

Meaning	Designated Partner means any partner designated as such u/s Sec 7.
Minimum No & only Individual	Every LLP must have at least 2 individuals as designated partners and at least 1 of them must be a resident in India . The term “resident in India” means a person who has stayed in India for a period of at least 182 days during the immediately preceding 1 year. Note: Nominees (who must be individuals) of bodies corporate partners of LLP can act as designated partners.
Who will be a Designated partner? [Sec 7 (2)]	Subject to Sec 7 (1), if the Incorporation Document- (a) specifies who are to be designated partners, such persons shall be designated partners on incorporation; <i>or</i> (b) states that each of the partners from time to time of LLP is to be designated partner, every partner shall be a designated partner;
Who can become/ cease to be a Designated Partner?	Any partner may become /cease to be a designated partner in accordance with the LLP agreement.
Prior Consent [Sec 7 (3)]	An individual must give his prior consent to act as a designated partner in prescribed form and manner before his appointment.
Filing with the Registrar [Sec 7 (4)]	Every LLP must file with the Registrar the particulars of every individual who has given his consent to act as designated partner in prescribed form and manner within 30 days of his appointment .
Satisfy Conditions [Sec 7 (5)]	An individual eligible to be a designated partner must satisfy prescribed conditions and requirements.
Designated Partner Identification Number (DPIN) [Sec 7 (6)]	Every Designated Partner of a LLP must obtain a Designated Partner Identification Number (DPIN) from the Central Government and the provisions of Sections 266A to 266G (both inclusive) of The Companies Act, 1956 shall apply <i>mutatis mutandis</i> for the said purpose.

Liabilities [Sec 8]	Unless expressly provided otherwise in this Act, a designated partner shall be— (a) responsible for the doing of all acts, matters and things as are required to be done by the LLP in respect of compliance of the provisions of this Act including filing of any document, return, statement and the like report pursuant to the provisions of this Act and as may be specified in the LLP agreement; and (b) liable to all penalties imposed on the LLP for any contravention of those provisions.
Changes in Designated Partners [Sec 9]	A LLP may appoint a designated partner within 30 days of a vacancy arising for any reason and provisions of Sec 7(4) & (5) shall apply in respect of such new designated partner. Note: <i>If No designated partner is appointed, or if at any time there is only one designated partner, each partner shall be deemed to be a designated partner.</i>
Punishment for contravention of Sections 7, 8 and 9[Sec 10]	1. If the LLP contravenes the provisions of section 7(1), the LLP and its every partner shall be punishable with fine which shall not be less than ₹ 10,000 but which may extend to ₹ 5,00,000. 2. If the LLP contravenes the provisions of Section 7(4) &(5), section 8 or section 9, the LLP and its every partner shall be punishable with fine which shall not be less than ₹ 10,000 but which may extend to ₹ 1,00,000.

9.0 INCORPORATION DOCUMENT [SEC 11]

1. At least two Subscribers	Two or more persons associated for carrying on a lawful business with a view to profit must subscribe their names to an incorporation document.
2. Contents	The incorporation document shall— (a) be in a form as may be prescribed; (b) state the name of the limited liability partnership; (c) state the proposed business of the limited liability partnership; (d) state the address of the registered office of the limited liability partnership; (e) state the name and address of each of the persons who are to be partners of the LLP on incorporation; (f) state the name and address of the persons who are to be designated partners of the LLP on incorporation; (g) contain such other information concerning the proposed LLP as may be prescribed.
3. Filing	The incorporation document must be filed along with the Compliance Statement in such manner and with such fees, as may be prescribed with the Registrar of the State in which the registered office of the LLP is to be situated.
4. Compliance Statement	A statement in the prescribed form, made by either an advocate, or a Company Secretary or a Chartered Accountant or a Cost Accountant, who is engaged in the formation of the LLP and by any one who subscribed his name to the incorporation document, that all the requirements of this Act and the rules made thereunder have been complied with, in respect of incorporation and matters precedent and incidental thereto.

5. Penalty	If a person makes a statement which he knows to be false; or does not believe to be true, shall be punishable with imprisonment for a term upto 2 years and with fine which shall not be less than ₹ 10,000 but which may extend to ₹ 5,00,000 .

10.0 INCORPORATION BY REGISTRATION [SEC 12]

1. Certificate	On compliance of all the requirements as per Section 11 the Registrar shall register the incorporation document and give a certificate that the LLP is incorporated by the name specified therein within 14 days .
2. Signature	The certificate issued shall be signed by the Registrar .
3. Official Seal	The certificate issued shall authenticated by Official Seal of the Registrar .
4. Conclusive Evidence	The certificate shall be conclusive evidence that the LLP is incorporated by the name specified therein.

11.0 EFFECTS OF REGISTRATION [SEC 14]

On registration, a LLP shall by its name, be capable of—

- suing and being sued;
- acquiring, owning, holding and developing or disposing of property, whether movable or immovable, tangible or intangible;
- having a common seal, if it decides to have one; and
- doing and suffering such other acts and things as bodies corporate may lawfully do and suffer.

When cease to be a Partner	A person shall cease to be a partner of a LLP— (a) on his death or dissolution of the LLP; or (b) if he is declared to be of unsound mind by a competent court; or (c) if he has applied to be adjudged as an insolvent or declared as an insolvent.
Duty of Former Partner	Where a person has ceased to be a partner of a LLP (hereinafter referred to as “former partner”), the former partner is to be regarded (in relation to any person dealing with the LLP) as still being a partner of the LLP unless— (a) the person has notice that the former partner has ceased to be a partner of the LLP; or (b) notice that the former partner has ceased to be a partner of the LLP has been delivered to the Registrar.
Obligation of Former Partner	The cessation of a partner from the LLP does not by itself discharge the partner from any obligation to the LLP or to the other partners or to any other person which he incurred while being a partner.
Right to receive Capital & Net Accumulated Profits	Where a partner of a LLP ceases to be a partner, unless otherwise provided in the LLP agreement, the former partner or a person entitled to his share in consequence of the death or insolvency of the former partner, shall be entitled to receive from the LLP— (a) an amount equal to the capital contribution of the former partner actually made to the LLP; and (b) his right to share in the accumulated profits of the LLP, after the deduction of accumulated losses of the LLP, determined as at the date the former partner ceased to be a partner.
No Right to Interfere	A former partner or a person entitled to his share in consequence of the death or insolvency of the former partner shall not have any right to interfere in the management of the LLP.

12.0 PARTNER AS AGENT OF LLP AND NOT OF OTHER PARTNERS [SEC. 26]

Every partner of a LLP is, for the purpose of the business of the LLP, the agent of the LLP, but not of other partners.

13.0 EXTENT OF LIABILITY OF LLP [SEC 27]

When not liable	A LLP is not bound by anything done by a partner in dealing with a person if— (a) the partner in fact has no authority to act for the LLP in doing a particular act; and (b) the person knows that he has no authority or does not know or believe him to be a partner of the LLP.
When liable	The LLP is liable if a partner of a LLP is liable to any person as a result of a wrongful act or omission on his part in the course of the business of the LLP or with its authority.
Obligation of LLP	An obligation of the LLP whether arising in contract or otherwise, shall be solely the obligation of the limited liability partnership.
How to meet Liabilities	The liabilities of the LLP shall be met out of the property of the limited liability partnership.

14.0 EXTENT OF LIABILITY OF PARTNER [SEC 28,29,30]**PERSONAL LIABILITY OF A PARTNER [SEC. 28]**

<i>For his own Wrongful Act or Omission</i>	A partner is personally liable.
<i>For the Wrongful Act or Omission of any other Partner of the LLP</i>	A partner is not personally liable.
<i>For any Other Act</i>	A partner is not personally liable.

PARTNER BY HOLDING OUT [SEC. 29]

Meaning	Any person, who by words spoken or written or by conduct, represents himself, or knowingly permits himself to be represented to be a partner in a LLP is known as a Partner by Holding Out .
Liability of Partner by Holding Out	Partner by Holding Out is liable to any person who has on the faith of any such representation given credit to the LLP, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit.
Liability of LLP	Where any credit is received by LLP as a result of such representation, the LLP shall, without prejudice to the liability of the person so representing himself or represented to be a partner, be liable to the extent of credit received by it or any financial benefit derived thereon.
No Liability of Deceased Partner's Legal Representative	Where after a partner's death the business is continued in the same LLP name, the continued use of that name or of the deceased partner's name as a part thereof shall not of itself make his legal representative or his estate liable for any act of the LLP done after his death.

UNLIMITED LIABILITY IN CASE OF FRAUD [SEC 30]

For Fraudulent Act carried out by a LLP	The Liability of both the LLP and Partners who acted with intent to defraud creditors or for any fraudulent purpose shall be unlimited for all or any of the debts or other liabilities of the LLP.
For Fraudulent Act carried out by a partner with the knowledge or the authority of LLP	LLP is liable to the same extent as the partner.
For Fraudulent Act carried out by a partner without the knowledge or the authority of LLP	LLP shall not be liable.
Punishment [Sec. 30(2)]	Every person who was knowingly a party to the carrying on of the business for fraudulent purpose shall be punishable with imprisonment for a term not exceeding 2 years and with fine which shall not be less than ₹ 50,000 but which may extend to ₹ 5,00,000 .
Liability to pay Compensation [Sec. 30(3)]	Where a LLP or any partner or designated partner or employee of such LLP has conducted the affairs of the LLP in a fraudulent manner, then without prejudice to any criminal proceedings which may arise under any law for the time being in force, the LLP and any such partner or designated partner or employee shall be liable to pay compensation to any person who has suffered any loss or damage by reason of such conduct.
No Liability of LLP [Proviso to [Sec. 30(3)]]	LLP shall not be liable if any such partner or designated partner or employee has acted fraudulently without knowledge of the LLP .

15.0 WHISTLE BLOWING [SEC 31]

Power of Court or Tribunal to reduce or waive Penalty	The Court or Tribunal may reduce or waive any penalty leviable against any partner or employee of a limited liability partnership, if it is satisfied that— (a) such partner or employee of a LLP has provided useful information during investigation of such LLP; <i>or</i> (b) when any information given by any partner or employee (whether or not during investigation) leads to LLP or any partner or employee of such LLP being convicted under this Act or any other Act.
Restrictions on Discharge etc. of Partner or Employee	No partner or employee of any LLP may be discharged, demoted, suspended, threatened, harassed or in any other manner discriminated against the terms and conditions of his LLP or employment merely because of his providing information or causing information to be provided.

16.0 CONTRIBUTION[SEC 32 & 33]

Nature of Contribution	A contribution of a partner may consist of tangible, movable or immovable or intangible property or other benefit to the LLP, including money, promissory notes, other agreements to contribute cash or property, and contracts for services performed or to be performed.

Accounting of Contribution Obligation to Contribute [Sec. 33(1)]	The monetary value of contribution of each partner shall be accounted for and disclosed in the accounts of the LLP in the prescribed manner. The obligation of a partner to contribute money or other property or other benefit or to perform services for a LLP shall be as per the LLP agreement.
Right of a Creditor to enforce the original obligation against Partner. [Sec. 33(2)]	A creditor of a LLP, which extends credit or otherwise acts in reliance on an obligation described in that agreement, without notice of any compromise between partners, may enforce the original obligation against such partner.

17.0 MAINTENANCE OF BOOKS OF ACCOUNT, OTHER RECORDS AND AUDIT, ETC [SEC 34]

Duty to maintain Proper Books at R.O	The LLP must maintain prescribed proper books of accounts relating to its affairs for each year of its existence on cash basis or accrual basis and according to double entry system of accounting and shall maintain the same at its registered office for prescribed period.
Duty to prepare a Statement of Account and Solvency	Every LLP must, within a period of 6 months from the end of each financial year, prepare a Statement of Account and Solvency for the said financial year as at the last day of the said financial year in prescribed form and such statement must be signed by the designated partners of the LLP.
Duty to file Statement of Account and Solvency	Every LLP must file within the prescribed time, the Statement of Account and Solvency with the Registrar every year alongwith prescribed fees.
Duty to get Accounts Audited	The accounts of LLP shall be audited in accordance with prescribed rules unless exempted by the Central Government.
Penalty for Default u/s 34	LLP shall be punishable with fine which shall not be less than ₹ 25,000 but which may extend to ₹ 5,00,000 and its every designated partner shall be punishable with fine which shall not be less than ₹ 10,000 but which may extend to ₹ 1,00,000 .

18.0 ANNUAL RETURN [SEC 35]

Duty to file Annual Return u/s 35	Every LLP must file an annual return duly authenticated with the Registrar within 60 days of closure of its financial year in prescribed form and manner alongwith prescribed fees.
Penalty for Default u/s 35	LLP shall be punishable with fine which shall not be less than ₹ 25,000 but which may extend to ₹ 5,00,000 and its every designated partner shall be punishable with fine which shall not be less than ₹ 10,000 but which may extend to ₹ 1,00,000. Notes: (i) Inspection of Documents [SEC 36] Any person may inspect the incorporation document, names of partners and changes, if any, made therein, Statement of Account and Solvency and Annual Return filed by each LLP with the Registrar in prescribed manner and on payment of prescribed fee. (ii) Penalty for False Statement [SEC 37] If in any return, statement or other document required by or for the purposes of any of the provisions of this Act, any person makes a statement—

	(a) which is false in any material particular, knowing it to be false; or (b) which omits any material fact knowing it to be material, He shall, save as otherwise expressly provided in this Act, be punishable with imprisonment for a term not exceeding 2 years, and shall also be liable to fine which not exceeding ₹ 5,00,000 but which shall not be less than ₹ 1,00,000.

19.0 PARTNER'S TRANSFERABLE INTEREST [SEC 42]

Partner's Right to Transfer Interest	The rights of a partner to a share of the profits and losses of the LLP and to receive distributions in accordance with the LLP agreement are transferable either wholly or in part .
Effect of Transfer	The transfer of any right by any partner does not by itself cause the disassociation of the partner or a dissolution and winding up of the LLP.
Restriction on Transferee or Assignee	The transfer of right does not, by itself, entitle the transferee or assignee to participate in the management or conduct of the activities of the LLP, or access information concerning the transactions of the LLP.

20.0 TAXATION OF LLP

TREATED AS PARTNERSHIP FIRM

LLP is treated as a Partnership Firm for the purpose of Income Tax w.e.f Financial Year 2009–2010.

CHANGE IN DEFINITION OF FIRM, PARTNER & PARTNERSHIP

The Budget 2009-10 has amended the definition of Firm and Partners in the following manner:

- (i) Firms shall have the meaning assigned to it in The Indian Partnership Act, 1932 and shall include a LLP as defined in The LLP Act, 2008.
- (ii) Partner shall have the meaning assigned to it in The Indian Partnership Act, 1932 and shall include:
 - Any person, being a minor, has been admitted to the benefits of partnership; and
 - A partner of a LLP as defined in the LLP Act 2008.
4. If any person acts in contravention of this rule or of any direction of the Central Government made there under, he shall be punishable with imprisonment for a term which may extend to 6 months or with fine which may extend to ₹ 50,000, or with both;

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FINANCIAL STATEMENTS OF NOT-FOR-PROFIT ORGANISATIONS

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning and Examples of Not-for-Profit Organisations
- ◇ Distinction between Profit Seeking and Not-for-Profit Organisations
- ◇ Fund Based Accounting
- ◇ Accounting for Not-for-Profit Organisations
- ◇ Receipts and Payments Account – Meaning, Features and Format
- ◇ Income and Expenditure Account – Meaning, Features and Format
- ◇ Meaning and Accounting Treatment of Some Peculiar Items
- ◇ Distinction between Receipts and Payments Account and Income and Expenditure Account
- ◇ Distinction between Income and Expenditure Account and Profit & Loss Account
- ◇ Preparation of an Income and Expenditure Account from a Receipts and Payments Account
- ◇ Preparation of Balance Sheet of A Not-for-Profit Organisation
- ◇ Practical steps Involved in the Preparation of a Receipts & Payments Account from an Income and Expenditure Accounts
- ◇ Practical steps Involved in the Preparation of a Balance Sheet from Receipts and Payments Account and Income and Expenditure Account
- ◇ Accounts of a Professional Firm

1.0 MEANING OF NOT-FOR-PROFIT ORGANISATIONS

Not-for-Profit organisations refer to those organisations which:

- (a) are formed for the purpose of promoting commerce, art, science, religion, charity or any other useful object,
- (b) intend to spend their Income in promoting their objectives, and
- (c) prohibit the payment of any dividend to their members.

EXAMPLES OF NOT-FOR-PROFIT ORGANISATIONS

The examples of such organisations include Sports Clubs, Social Clubs, Libraries, Charitable Hospitals, Charitable Educational Institutions, Temples, Churches, Gurudwaras, Masjids and Professional Bodies (e.g. The Institute of Chartered Accountants of India, The Institute of Cost Accountants of India, The Institute of Company Secretaries of India).

RESTRICTION ON APPLICATION OF INCOME AND NOT ON EARNING OF INCOME

Not-for-Profit Organisations may or may not have trading activities. If trading activities are carried on by such entities, then the profit arising therefrom is used for the purposes of promoting the objectives

for which such entities were formed. **For Example**, if a Sports Club also runs a Restaurant, the profit of such a Restaurant is used to promote the service objectives.

It may be noted that the restriction is on the Application of Income and not on the Earning of Income by not-for-profit organisations.

2.0 DISTINCTION BETWEEN A PROFIT SEEKING ORGANISATION AND A NOT-FOR-PROFIT ORGANISATION

A Profit seeking Organisation may be distinguished from a Not-for-Profit Organisation as under:

Basis of Distinction	Profit seeking organisation	Not-for-profit organization.
1. Primary Motive	The primary motive of such an entity is to earn profit.	The primary motive of such an entity is to provide services.
2. Owner's Fund Vs. Capital Fund	Interest of owners is known as Owner's Fund which represents the owner's investments <i>plus</i> accumulated reserves and surplus.	Interest of members is known as Capital Fund which represents the accumulated surplus of subscriptions, donations and net Income from activities carried on by such an entity.
3. Net Result of activities	The net result of the activities of such an entity is known as the profit/loss.	The net result of the activities of such an entity is known as the surplus/deficit.
4. Accounting Statements	The accounting statements of such type of entity include: (a) a Manufacturing A/c (b) a Trading A/c; (c) a Profit and Loss A/c; (d) a Balance Sheet.	The accounting statements of such an entity includes: (a) a Receipts and Payments A/c; (b) an Income and Expenditure A/c (c) a Trading A/c; (d) a Balance Sheet.

3.0 FUND BASED ACCOUNTING

MEANING OF FUND BASED ACCOUNTING

- Fund theory calls for fund based accounting rather than entity based accounting (which is done in case of profit seeking organizations).
- Fund based accounting essentially involves preparation of financial statements fundwise and consolidation of those statements to represent the financial results/position of the organisation as a whole.
- According to Governmental Accounting Standards Board, USA Codification of Governmental Accounting and Financial Reporting Standards, A fund may be defined as an accounting entity "with a self balancing set of accounts regarding cash and/or other resources together with all related Liabilities and residual equities or balances, and changes therein, which is segregated for the purpose of carrying specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations." Thus, every fund is aimed at fulfilling some purpose and the services embodied in the Assets are the primary means to achieve that purpose.
- The accounting for these not-for-profit entities is primarily based on the fund theory. The fund theory is based on the following equation:

$$\text{Assets} = \text{Restrictions on Assets}$$

- (e) Assets represent prospective services to the fund and Liabilities represent restrictions against the Assets of the fund. **For Example**, in case of a university, the most commonly used specific funds are endowment funds, development funds etc.
- (f) Each of these funds has its specific Assets restricted for particular purposes. Under the fund theory, the balance sheet is considered an 'inventory statement' of Assets and those restrictions applicable to the Assets.
- (g) In fund-based accounting, the following statements are to be prepared to get a consolidated picture of the organization as a whole:
 1. Income and Expenditure Account for each of the Revenue Funds. [Whether restricted or Unrestricted] or Statement of Activity
 2. Statement showing changes in Balances of each Fund [Whether Revenue Fund or Specific Fund]
 3. Balance Sheet of each of the Funds [Whether Revenue Fund or Specific Fund]
 4. General Balance Sheet of the organization as a whole.
- (h) Some academicians argue that the Income and Expenditure account should better be called 'Statement of activity' A not-for-profit organization may have no Income other than grants and gifts received from government and well wishers. In that situation, it is proper to name the statement showing the normal revenue operations of the organization as the statement of Activity. But in case of educational institutions like Schools, Colleges or Universities, fees from students form a significant portion of revenue receipts. Therefore, we can continue to call the Statement of Activity as Income and Expenditure Account.

CLASSIFICATION OF FUNDS

Funds may be classified as follows:

1. **Revenue Funds**
 - Restricted Revenue Fund
 - Unrestricted Revenue Fund
2. **Specific Funds** e.g. Endowment Fund, Loan Funds, Life Income Funds

REVENUE FUNDS

Revenue Funds essentially record normal revenue transactions. In other words, revenue funds are received to meet operating expenses. The accrual basis of accounting is used to recognize revenue and expense in the revenue fund (or Operating Funds). However, the use of Revenue Fund may be restricted or unrestricted.

- (a) **Restricted Funds Account** for resources whose use is restricted by the donor. Restrictions may be externally imposed by the grantors of gifts or endowments. In addition, the governing body of the organisation may designate monies for specific purpose. In case of restricted funds revenue is recognised to the extent of resources expended.
- (b) **The Unrestricted Fund Account** for the resources that may be expended to carry out the primary purposes of the institution (e.g. instructions, research, maintenance etc.) and that are not restricted to specific purposes. The accounting basis of the unrestricted fund is the accrual method as used for commercial entities. The primary sources of Income for this fund are membership fees, unrestricted government grants, gifts from individuals, Income from investments. Another important source of revenue in the unrestricted fund is from auxiliary enterprises/operations. Such enterprises include students canteen, book stores, hostel accommodation etc. There may be transfers out of revenue funds to specific funds and vice-versa. Some transfers are mandatory and some are non-mandatory. There may be a provision for life membership fees wherein a willing member is required to make a life time contribution. The lump sum lifetime contribution is determined in such a manner that the Income from such

contribution is more *or less* equal to the annual membership fees. Such lifetime contribution is directly credited to life membership fund. That fund is simultaneously invested in outside securities. Income from such investment is credited to unrestricted operating fund. When a life member expires or his membership terminated for some reasons, the proportionate fund balance is transferred from life membership fund to unrestricted operating fund. The corresponding investment may or may not be sold.

- (c) **Mandatory and non-mandatory transfers:** Inter fund transfers are permissible for any type of not-for-profit entities. However, the terms mandatory and non-mandatory transfers are unique to college and universities accounting and reporting. Mandatory transfers are transfers out of the revenue funds to other funds resulting from binding legal agreements or grant agreements. Non-mandatory transfers are discretionary transfers specified by the governing board for a variety of purposes such as new additions to building, repairs & replacement of plant etc. Non-mandatory transfers may also be made from specific funds to the revenue funds. Both mandatory and non-mandatory transfers are reported separately in the financial statements of the revenue funds. Also the governing board may designate unrestricted revenue fund resources for specific purposes in future periods. These board – designated funds are internal designations similar to appropriations of retained earnings for a commercial entry.

SPECIAL FUNDS

Special Funds essentially record transactions of capital nature. These funds account for those resources which may not be currently expended.

For Example — Endowment Fund, Development Fund, Membership Fund, Loan Fund. The main features of Special Funds are:

- (i) These funds record the transaction of capital nature,
- (ii) Contributions and transfers are directly credited to the respective fund accounts.
- (iii) A statement showing changes in balances of each of specific funds is prepared.
- (iv) Balance Sheet of each of specific funds is prepared.
- (v) No Income & Expenditure Account (or Statement of Activity) is prepared for such funds.

4.0 ACCOUNTING FOR NOT-FOR-PROFIT ORGANISATIONS

1. The following books are generally kept by every not-for-profit organisation:
 - (a) Cash book with *or* without Analysis Column
 - (b) Members' Register
 - (c) Register of Assets
2. In case of large not-for-profit organisations, almost the same accounting system is followed as in the case of profit seeking organisations.
3. In case of small not-for-profit organisations, usually the Cash Book is prepared and with the help of such a cash book, a Receipts & Payments Account is prepared and with the help of such account and additional information, an Income & Expenditure Account and a Balance Sheet are prepared.

5.0 RECEIPTS AND PAYMENTS ACCOUNT

MEANING OF RECEIPTS & PAYMENTS ACCOUNT

The 'Receipts & Payment Account' is an Asset Account (or Real Account) which shows the classified summary of transactions of a Cash Book along with the Cash & Bank balances in the beginning and at the end of an accounting period.

In other words, it is an Asset Account which shows all Receipts and Payments (whether Capital or Revenue or whether relating to previous, current or following accounting year) alongwith Cash and Bank Balance in the beginning and at the end of an accounting period.

FEATURES OF RECEIPTS & PAYMENTS ACCOUNT

1. It starts with the Opening Balance of Cash in hand and Cash at Bank.
2. It is debited with all sums received.
3. It is credited with all sums paid out.
4. It records all receipts and payments whether they are of revenue nature or capital nature.
5. It records all receipts and payments whether they relate to the previous, current or following accounting year.
6. It does not record non-cash items (e.g. Depreciation).
7. It ends with Closing Balance of Cash in hand and Cash at bank.

FORMAT OF RECEIPTS & PAYMENTS ACCOUNT

RECEIPTS AND PAYMENTS ACCOUNT

Dr.

for the period ending on ...

Cr.

Receipts	₹	Payments	₹
To Balance b/f:		By Balance b/d (Bank overdraft)	xxx
Cash xxx		By Annual Sports Expenses	xxx
Bank xxx	xxx	By Salaries & Wages	xxx
To Subscription:		By Rent, Rates & Taxes	xxx
for previous year xxx		By Insurance	xxx
for current year xxx		By Furniture	xxx
for next year xxx	xxx	By Sports Equipments	xxx
To Entrance Fees	xxx	By Books & Periodicals	xxx
To Donation for Building	xxx	By Audit Fees	xxx
To General Donations	xxx	By Printing & Stationery	xxx
To Life Membership Fees	xxx	By Honorarium	xxx
To Legacy	xxx	By Bank Charges	xxx
To Grant from Govt.	xxx	By Postage & Telegrams	xxx
To Contribution for Annual Dinner	xxx	By Water & Electricity	xxx
To Dividend	xxx	By Conveyance & Travelling	xxx
To Interest	xxx	By Repairs & Maintenance	xxx
To Rent	xxx	By Sundry Expenses	xxx
To Receipt on Annual Sports	xxx	By Annual Dinner Expenses	xxx
To Sale of Old Sports Materials	xxx	By 12% Investments	xxx
To Sale of Old Magazines	xxx	By Balance c/f:	xxx
To Sundry Receipts	xxx	Cash xxx	
To Balance c/d (Bank overdraft)	xxx	Bank xxx	xxx
	xxx		xxx

ILLUSTRATION 1

From the information given below, prepare Receipts & Payments Account of Tulsian Club, Delhi for the year ending on March 31, 2018.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
Cash as at 1.4.2017	1,025	Sale of old Bats etc.	50
Subscription received (including ₹ 40 for 2016-2017 & ₹ 60 for 2018-2019)	2,150	12% General Investments (made on 1.11.2017)	500
Upkeep of fields	220	12% Tournament Fund Investments (made on 1.11.2017)	1,500
Admission Fees	40	Tournament Expenses	1,200
Salaries	600	Sale of old furniture (cost ₹ 100)	60
Drama Expenses	450	Bats and Balls purchased	700
Life Membership Subscription	100	Proceeds of drama tickets	950
Newspapers purchased	150	Interest on 12% General Invest. received	12.50
Books purchased	100	Printing & Stationery	100
Subscription for Tournament received (on 1.11.2017)	1,500	Interest on 12% Tournament Fund & Investment received	37.50
Donations received (on 1.11.2017)	500	Subscription received for Governor's Party	3,450
Municipal Taxes	40	Furniture	250
Charity given	350		
Sale of old newspapers	45		

SOLUTION
RECEIPTS AND PAYMENTS ACCOUNT OF TULSIAN CLUB, DELHI
Dr.
for the year ending on 31st March, 2018
Cr.

<i>Receipts</i>	<i>₹</i>	<i>Payments</i>	<i>₹</i>
To Balance b/f (Cash)	1,025	By Upkeep of fields	220
To Subscription		By Salaries	600
2016-2017 40		By Drama Expenses	450
2017-2018 2,050		By Newspapers	150
2018-2019 60	2,150	By Books	100
To Admission Fees	40	By Municipal Taxes	40
To Life Membership Subscription	100	By Charity	350
To Donations (on 1.11.2017)	500	By Tournament Expenses	1,200
To Subscription for Tournament (on 1.11.2017)	1,500	By 12% General Investments (on 1.11.2017)	500
To Sale of old furniture (costing ₹ 100)	60	By 12% Tournament Fund Investments (on 1.11.2017)	1,500
To Sale of old bats etc.	50	By Bats, Balls etc.	700
To Proceeds of drama tickets	950	By Printing & Stationery	100
To Sales of old newspapers	45	By Furniture	250
To Interest on 12% General Investments	12.50	By Balance c/f (Cash)	3,760

To Interest on 12% Tournament Fund Investments	37.50		
To Subscription for Governor's Party	3,450		
	9,920		9,920

6.0 INCOME AND EXPENDITURE ACCOUNT**MEANING OF INCOME & EXPENDITURE ACCOUNT**

An Income and Expenditure Account is a final account like Profit & Loss Account, which shows the classified summary of Revenue Incomes, Revenue Expenses and Losses for Current Accounting Period along with Surplus (i.e., the Excess of Income over Expenditure) or Deficit (i.e., Excess of Expenditure over Income) which is transferred to the Capital Fund.

FEATURES OF INCOME & EXPENDITURE ACCOUNT

1. It is debited with the Expenses and Losses.
2. It is credited with the Incomes.
3. It records only those Incomes, Expenses and Losses which are of **Revenue Nature**.
4. It records only those Incomes, Expenses and Losses which **relates to Current Accounting Year**.
5. It records Non-Cash Items also (e.g. depreciation).
6. Its balance at the end which represents either the Net Surplus (if credit side exceeds debit side) or Net Deficit (if debit side exceeds credit side) is transferred to the Capital Fund in the Balance Sheet.

FORMAT OF INCOME & EXPENDITURE ACCOUNT**INCOME AND EXPENDITURE ACCOUNT***Dr.**for the year ending on**Cr.*

Expenditure	₹	Income	₹
To Salaries and Wages paid xxx		By Subscription Received xxx	
Add: Outstanding at the end xxx		Add: Outstanding at the end xxx	
Less: Prepaid at the end xxx		Less: Advance at the end xxx	
Add: Prepaid in the beginning xxx		Add: Advance in the beginning xxx	
Less: Outstanding in the beg. xxx	xxx	Less: Outstanding in the beginning xxx	xxx
To Rent, Rates and Taxes xxx	xxx	By Entrance Fees (only that portion which is to be treated as revenue) xxx	xxx
To Insurance Premium xxx	xxx	By General Donations xxx	xxx
To Depreciation on Furniture and Sports equipments xxx	xxx	By Life membership Fees (only that portion which is to be treated as revenue) xxx	xxx
To Books and Periodicals xxx	xxx	By Profit from Annual Dinner Contribution xxx	xxx
To Audit fees xxx	xxx		
To Printing & Stationery xxx	xxx		
To Honorarium xxx	xxx		
To Bank Charges xxx	xxx		

To Postage & Telegram	xxx	Less: Expenses	xxx	xxx
To Electricity & Water	xxx	By Profit on Annual sports		
To Conveyance & Travelling	xxx	(Receipts – expenses)		xxx
To Sundry Expenses	xxx	By Profit on sale of provisions		
To* Surplus i.e., excess of Income over Expenditure	xxx	(Sale + Closing Stock – Purchases – Opening Stock)		xxx
		By Rent of Club Hall		xxx
		By Dividend & Interest		xxx
		By Sundry Receipts		xxx
		By* Deficit i.e. Excess of Expenditure over Income		xxx
	xxx			xxx

**Either Surplus or Deficit shall appear.*

7.0 MEANING AND ACCOUNTING TREATMENT OF SUBSCRIPTION

MEANING OF SUBSCRIPTION

Subscription is the major source of revenue Income of a not-for-profit entity. Subscriptions are the amounts paid by the members of such entity to maintain their membership. Subscriptions may be paid periodically (usually on yearly basis) or as a lump sum for lifetime membership.

ACCOUNTING TREATMENT OF SUBSCRIPTION

(a) Periodical Subscriptions	These are treated as Revenue Receipts and hence credited to Income & Expenditure Account .
(b) Life Membership Subscriptions	These subscriptions are treated as a Capital Receipt and hence are added to the Capital Fund .

HOW TO CALCULATE INCOME FROM SUBSCRIPTIONS

Where the accrual basis of accounting is used, only that amount of subscriptions which relates to current accounting period, should be treated as revenue Income of that period. In order to calculate this amount, the amount of subscriptions received during the current accounting period should be adjusted in the light of outstanding and advance subscriptions in the beginning and at the end of the current accounting period. The subscription Income for current accounting period may be computed in any of the following three ways:

(a) In Statement Form, (b) In Account Form, and (c) In Equation Form.

(a) **In Statement Form:**

COMPUTATION OF INCOME FROM SUBSCRIPTIONS FOR THE CURRENT YEAR

<i>Particulars</i>	₹
A. Subscriptions received during the current year	xxx
B. Add: (i) Outstanding Subscriptions at the end of current year	xxx
(ii) Advance Subscriptions in the beginning of current year	xxx
C. Less: (i) Outstanding Subscriptions in the beginning of current year	xxx
(ii) Advance Subscriptions at the end of current year	xxx
D. Subscription Income to be credited to Income & Expenditure Account (A + B – C)	xxx

(b) In Account Form:

Dr.

SUBSCRIPTION ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Outstanding Subscription A/c (Outstanding Subscription in the beginning)	xxx	By Advance Subscription A/c (Advance Subscription in the beginning)	xxx
To Income & Expenditure A/c (balancing figure)	xxx	By Bank A/c (Total Subscription received during the current year)	xxx
To Advance Subscription A/c (Advance Subscription at the end)	xxx	By Outstanding Subscription A/c (Outstanding subscription at the end)	xxx
	xxx		xxx

- (c) In Equation Form:** The entire process of computation of subscription **Income** for the current year may be described through the following equation:

$$S_1 = SR + OS_2 + AS_1 - OS_1 - AS_2$$

Where, S_1 = Subscription Income for the current accounting period

SR = Subscription received during the current accounting period

OS_2 = Outstanding Subscription at the end of the current year

AS_1 = Advance Subscription in the beginning of the current year

OS_1 = Outstanding Subscription in the beginning of the current year

AS_2 = Advance Subscription at the end of the current year

ILLUSTRATION 2 [Income From Subscription]

- Subscription received during the year 2017-2018 ₹ 60,000. Compute the Income from Subscription for the year 2017-2018.
- Subscription received during the year 2017-2018 ₹ 60,000. Subscription ₹ 30,000 is still outstanding. Compute the Income from Subscription for the year 2017-2018.
- Subscription received during the year 2017-2018 ₹ 60,000. Subscription ₹ 20,000 received in advance for the year 2018-2019. Compute the Income from Subscription for the year 2017-2018.
- Subscription received during the year 2017-2018 ₹ 60,000. Subscription ₹ 40,000 was outstanding at the end of the previous year. Compute the Income from Subscription for the year 2017-2018.
- Subscription received during the year 2017-2018 ₹ 60,000. Subscription ₹ 90,000 was received in advance at the end of the previous year. Compute the Income from Subscription for the year 2017-2018.

SOLUTION**COMPUTATION OF INCOME FROM SUBSCRIPTION**

<i>Particulars</i>	(a)	(b)	(c)	(d)	(e)
Subscription Received	60,000	60,000	60,000	60,000	60,000
Add: O/s at the end	—	30,000	—	—	—
Less: Advance at the end	—	—	(20,000)	—	—

Add: Advance in the beg.	–	–	–	–	90,000
Less: O/s in the beg.	–	–	–	(40,000)	–
	60,000	90,000	40,000	20,000	1,50,000

ILLUSTRATION 3

Compute the Income from Subscription for the year 2017-2018 from the following **Particulars** relating to a club:

Particulars	1.4.2017	31.3.2018
Outstanding Subscription	₹ 9,500	₹ 7,000
Advance Subscription	₹ 2,800	₹ 5,200

Subscription received during 2017-2018, ₹ 1,48,900, Subscriptions of ₹ 1,000 are still in arrears for the year 2016-2017.

SOLUTION

(a) In Statement Form:

COMPUTATION OF INCOME FROM SUBSCRIPTION

Particulars	₹	₹
A. Subscription received		1,48,900
B. Add: (a) Outstanding Subscription at the end	7,000	
(b) Advance Subscription at the beginning	2,800	9,800
C. Less: (a) Outstanding Subscription at the beginning	9,500	
(b) Advance Subscription at the end	5,200	14,700
D. Subscription Income for the year (A + B – C)		1,44,000

(b) In Account Form:

Dr. **SUBSCRIPTION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Outstanding Subscription A/c (in the beginning)	9,500	By Advance Subscription A/c (in the beginning)	2,800
To Income & Expenditure A/c (balancing figure)	1,44,000	By Outstanding Subscription A/c (at the end)	7,000
To Advance Subscription A/c	5,200	By Bank A/c	1,48,900
	1,58,700		1,58,700

(c) In Equation Form:

$$S_1 = SR + OS_2 + AS_1 - OS_1 - AS_2$$

$$= ₹ 1,48,900 + ₹ 7,000 + ₹ 2,800 - ₹ 9,500 - ₹ 5,200 = ₹ 1,44,000$$

Where, S_1 = Subscription **Income**, SR = Subscription Received,

OS_2 = Outstanding Subscription at the end,

AS_1 = Advance Subscription in the beginning,

OS_1 = Outstanding Subscription in the beginning,

AS_2 = Advance Subscription at the end.

ILLUSTRATION 4

From the following information, Compute the Outstanding Subscription for the year 2017-2018:

(a) A Club has 70 members, each paying annual subscription of	₹ 1,000
(b) Subscription received during 2017-2018 [including ₹ 7,000 for 2016-2017]	₹ 70,000
(c) Subscription received in advance as at 31.3.2017	₹ 12,000
(d) Subscription received in advance as at 31.3.2018	₹ 11,000
(e) Subscription outstanding as at 31.3.2017	₹ 16,000

SOLUTION

Dr.

SUBSCRIPTION ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Outstanding Subscription A/c (in the beginning)	16,000	By Advance Subscription A/c (in the beginning)	12,000
To Income & Expenditure A/c (70 × ₹ 1,000)	70,000	By Bank A/c	70,000
To Advance Subscription A/c	11,000	By Outstanding Subscription A/c (at the end) (B.f.)	15,000
	97,000		97,000

Outstanding Subscription for the year 2017-2018 = ₹ 15,000 – ₹ 9,000 = ₹ 6,000

ILLUSTRATION 5

From the following information, Compute the Outstanding Subscription for the year 2016-2017:

(a) A Club has 75 members, each paying annual subscription of	₹ 1,000
(b) Subscription received during 2017-2018	₹ 80,000
(c) Subscription received in advance as at 31.3.2017	₹ 15,000
(d) Subscription received in advance as at 31.3.2018	₹ 10,000
(e) Subscription outstanding as at 31.3.2017	₹ 26,000
(f) Subscription outstanding for the year 2017-2018	₹ 4,000

SOLUTION

Dr.

SUBSCRIPTION ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Outstanding Subscription A/c (in the beginning)	26,000	By Advance Subscription A/c (in the beginning)	15,000
To Income & Expenditure A/c (75 × ₹ 1,000)	75,000	By Bank A/c	80,000
To Advance Subscription A/c	10,000	By Outstanding Subscription A/c (at the end) (b.f.)	16,000
	1,11,000		1,11,000

Outstanding Subscription for the year 2016-2017 = ₹ 16,000 – ₹ 4,000 = ₹ 12,000

ILLUSTRATION 6

From the following information, Compute the Advance Subscription for the year 2019-2020:

(a) A Club has 39 members, each paying annual subscription of	₹ 1,000
(b) Subscription received during 2017-2018	₹ 45,000
(c) Subscription received in Advance as at 31.3.2017	₹ 10,000
(d) Subscription outstanding as at 31.3.2018	₹ 9,000
(e) Subscription outstanding as at 31.3.2017	₹ 18,000
(f) Subscription received in Advance for the year 2018-2019	₹ 10,000
(g) 5 Members died without paying annual subscription for current year	

SOLUTION

Dr. **SUBSCRIPTION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Outstanding Subscription A/c (in the beginning)	18,000	By Advance Subscription A/c (in the beginning)	10,000
To Income & Expenditure A/c (39 × ₹ 1,000)	39,000	By Bank A/c	45,000
		By Income & Expenditure A/c (5 × ₹ 1,000)(w/o)	5,000
To Advance Subscription A/c	12,000	By Outstanding Subscription A/c (at the end)	9,000
	69,000		69,000

Advance Subscription for the year 2019-2020 = ₹ 12,000 – ₹ 10,000 = ₹ 2,000

ILLUSTRATION 7

How will you deal with the following items while preparing the Income & Expenditure Account for the year ended March 31, 2018 and the Balance Sheet as on that date?

Dr. **AN EXTRACT OF RECEIPTS AND PAYMENTS ACCOUNT** Cr.

Receipts	₹	Payments	₹
To Subscription			
2016-2017 250			
2017-2018 1,000			
2018-2019 200	1,450		

Information:

The club has 50 members, each paying annual subscription of ₹ 25. Subscriptions outstanding on March 31, 2018 were ₹ 300.

SOLUTION**AN EXTRACT OF INCOME AND EXPENDITURE ACCOUNT***Dr.**for the year ended 31st March, 2018**Cr.*

Expenditure	₹	Income	₹
		By Subscription (50 × ₹ 25)	1,250

AN EXTRACT OF BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Subscription received in advance	200	Subscription Outstanding	
		for 2016-2017	50
		for 2017-2018 [1,250 - 1,000]	250
			300

ILLUSTRATION 8

From the following extracts of Receipts & Payments Account and the additional information, you are required to calculate the Income from Subscriptions for the year ending March 31, 2018 and show them in the Income & Expenditure Account, and the Balance Sheet of a Club.

AN EXTRACT OF RECEIPTS & PAYMENTS ACCOUNT*Dr.**for the year ended 31st March, 2018**Cr.*

Receipts	₹	Payments	₹
To Subscription			
2016-2017	5,000		
2017-2018	30,000		
2018-2019	6,000	41,000	

Information:

(a) Subscription outstanding on 31.3.2017	₹ 6,000
(b) Subscription outstanding on 31.3.2018	₹ 5,000
(c) Subscription received-in-advance on 31.3.2017	₹ 6,000

SOLUTION**AN EXTRACT OF INCOME AND EXPENDITURE ACCOUNT***Dr.**for the year ended 31st March, 2018**Cr.*

Expenditure	₹	Income	₹
		By Subscription	40,000

AN EXTRACT OF BALANCE SHEET*for the year ended 31st March, 2018*

Liabilities	₹	Assets	₹
Subscription in advance	6,000	Subscription Outstanding	
		for 2016-2017 (6000 – 5000)	1,000
		for 2017-2018 (5000 – 1000)	4,000
			5,000

Working Note:
CALCULATION OF SUBSCRIPTION INCOME FOR 2017-2018

A. Subscription received during 2017-2018 for 2017-2018	₹ 30,000
B. Subscription received during 2016-2017 for 2017-2018	₹ 6,000
C. Subscription outstanding for 2017-2018 as at 31.3.2018	₹ 4,000
	₹ 40,000

ILLUSTRATION 9

How will you deal with the following case while preparing the final accounts for the year 2017-2018:

- Subscription received during 2017-2018: for 2016-2017 ₹ 5,000, for 2017-2018 ₹ 30,000, for 2018-2019 ₹ 6,000
- Subscription received in advance as at 31.3.2017 — ₹ 6,000
- Subscription Outstanding as at 31.3.2017 — ₹ 6,000
- Subscription Outstanding for the year 2017-2018 — ₹ 4,000

SOLUTION
AN EXTRACT OF INCOME & EXPENDITURE ACCOUNT

Dr. Cr.
for the year ended 31st March, 2018

Expenditure	₹	Income	₹
		By Subscription	40,000

AN EXTRACT OF BALANCE SHEET AS AT 31ST MARCH, 2018

for the year ended 31st March, 2018

Liabilities	₹	Assets	₹
Subscription received in advance	6,000	Subscription Outstanding	
		for 2016-2017 (6,000 – 5,000)	1,000
		for 2017-2018	4,000
			5,000

ILLUSTRATION 10

Prepare the Subscription Account from the following items for the year ending on March 31, 2018:

- Subscription in arrears on 31.3.2017 — ₹ 500
- Subscription received in advance on 31.3.2017 — ₹ 1,100
- Total Subscription received during 2017 – 2018 (including ₹ 400 for 2016 – 2017, ₹ 900 for 2018 – 2019 and ₹ 300 for 2019 – 2020), — ₹ 35,400.
- Subscription outstanding for 2017 – 2018 — ₹ 400

SOLUTION

Dr. Cr.
SUBSCRIPTION ACCOUNT

Particulars	₹	Particulars	₹
To Outstanding Subscription A/c	500	By Advance Subscription A/c	1,100
To Income & Expenditure A/c	35,300	By Bank A/c	35,400
To Advance Subscription A/c		By Outstanding Subscription A/c	
for 2018 – 2019	900	for 2016 – 2017	100
for 2019 – 2020	300	for 2017 – 2018	400
	1,200		500
	37,000		37,000

ILLUSTRATION 11

From the following extracts of the Receipts and Payments Account and the additional information, you are required to compute the Income from subscription for the year ending on March 31, 2018 and show the subscription items in the Income and Expenditure Account and the Balance Sheet as on 31.3.2018.

AN EXTRACT OF RECEIPTS AND PAYMENTS ACCOUNT

Dr. *for the year ending on 31st March, 2018* Cr.

<i>Receipts</i>	₹	<i>Payments</i>	₹
To Subscription			
2016-2017	9,000		
2017-2018	1,34,400		
2018-2019	5,200		

Information: Subscription outstanding as on 31.3.2017 ₹ 9,200. Subscription received in advance as on 31.3.2017 ₹ 2,800 (including ₹ 800 for 2017-2018). There are 1,440 members each paying an annual subscription of ₹ 100.

SOLUTION**AN EXTRACT OF INCOME AND EXPENDITURE ACCOUNT**

Dr. *for the year ending on 31st March, 2018* Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
		By Subscription Income	1,44,000

AN EXTRACT OF BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Subscription received in advance	7,200	Subscription outstanding for 2016-2017 (₹ 9,200 – ₹ 9,000) 200	
		2017-2018 8,800	9,000

Working Note: Calculation of Subscription outstanding for 2017-2018

Dr. **SUBSCRIPTION ACCOUNT** Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To O/s Account (Beg.)	9,200	By Advance Subsc. A/c (Beg.)	2,800
To Income & Expenditure A/c	1,44,000	By Bank A/c	1,48,600
To Advance Subscription A/c	7,200	By Outstanding Subscription A/c (Balancing figure)	9,000
	1,60,400		1,60,400

ILLUSTRATION 12

How will you deal with the following items while preparing the Income and Expenditure Account for the year ending on 31st March, 2018 and the Balance Sheet as on that date?

Subscription outstanding as on 31.3.2017: ₹ 9,500 (including ₹ 500 for 2015-2016) Subscription received in advance as on 31.3.2017: ₹ 3,000 (including ₹ 200 for 2018-2019)

Subscription received during 2017-2018: for 2015-2016 ₹ 400, for 2016-2017 ₹ 8,900, for 2017-2018 ₹ 1,34,400, for 2018-2019 ₹ 4,000, for 2019-2020 ₹ 1,200.

Subscription outstanding as on 31.3.2018: ₹ 7,000.

Subscription of 2015-2016 written off during 2017-2018 ₹ 50.

SOLUTION

AN EXTRACT OF INCOME AND EXPENDITURE ACCOUNT

Dr.

for the year ended 31st March, 2018

Cr.

Expenditure	₹	Income	₹
To Subscriptions w/o	50	By Subscriptions (See working note)	1,44,000

AN EXTRACT OF BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Subscription received in advance		Subscription Outstanding	
for 2018-2019 (₹ 200 + ₹ 4,000) 4,200		for 2015-2016 (₹ 500 – ₹ 400 – ₹ 50) 50	
for 2019-2020 1,200	5,400	for 2016-2017 (₹ 9,000 – ₹ 8,900) 100	
		for 2017-2018 (₹ 7,000 – ₹ 100 – ₹ 100) 6,800	6,950

Working Note:

CALCULATION OF SUBSCRIPTION INCOME FOR THE YEAR 2017-2018 SUBSCRIPTION ACCOUNT

Dr.

Cr.

Particulars	₹	Particulars	₹
To O/s A/c (Beg.)	9,500	By Advance Subscription A/c (Beg.)	3,000
To Income & Exp. A/c (b.f.)	1,44,000	By Bank A/c	1,48,900
To Advance Subscription (end)	5,400	By Income & Exp. A/c (w/o)	50
		By Outstanding Subscription A/c	6,950
	1,58,900		1,58,900

8.0 TREATMENT OF ENTRANCE FEE/ADMISSION FEE

MEANING OF ENTRANCE FEE/ADMISSION FEE

Entrance Fee (or Admission Fee) is an initial amount payable at the time of seeking admission by a person who intends to become a member of a club, association, or society.

ACCOUNTING TREATMENT OF ENTRANCE FEE/ADMISSION FEE

The entrance fees may be accounted for in any of the following three ways:

1. It may be treated exclusively as a Revenue Receipt and thus, be credited to Income & Expenditure Account.
2. It may be treated exclusively as a Capital Receipt and thus, be added to the Capital Fund on the Liabilities side of the Balance Sheet.
3. Some portion of Entrance Fee (say 40%) may be treated as a Revenue receipt and thus, be credited to Income & Expenditure Account and remaining portion (say 60%) may be treated as a Capital receipt and thus, be, added to the Capital Fund on the Liabilities side of the Balance Sheet as per the Accounting Policy of the organisation.

ILLUSTRATION 13

How will you deal with the Entrance fees while preparing the final accounts for the year ending on 31st March 2018 in each of the following alternative cases:

Case (a) During the year 2017–2018, Entrance Fees received ₹ 1,00,000

Case (b) During the year 2017–2018 Entrance Fees received ₹ 1,00,000. The accounting policy of the club is to treat the entrance fees as of revenue nature.

Case (c) During the year 2017–2018 Entrance Fees received ₹ 1,00,000. The accounting policy of the club is to treat the entrance fees as of capital nature.

Case (d) During the year 2017–2018 Entrance Fees received ₹ 1,00,000. According to accounting policy of the club, 40% of the entrance fees is to be capitalised. There was no pending membership as on 31st March 2018.

SOLUTION

Case (a) Entrance Fees ₹ 1,00,000 may either be credited to **Income & Expenditure** Account (if entrance fees is treated as of revenue nature), *or* be added to the Capital Fund (if entrance fee is to be treated as of capital nature) by giving a specific note to that effect.

Case (b) Entrance Fees ₹ 1,00,000 must be credited to **Income & Expenditure** Account

Case (c) Entrance Fees ₹ 1,00,000 must be added to the Capital Fund.

Case (d) Entrance Fees ₹ 60,000 (i.e., 60% of ₹ 1,00,000) must be credited to **Income & Expenditure** Account and ₹ 40,000 (i.e., 40% of ₹ 1,00,000) must be added to Capital Fund.

9.0 TREATMENT OF DONATIONS AND LEGACIES**MEANING OF DONATIONS AND LEGACIES**

Donations represent the amount donated by any person (whether member *or* outsider) to the organisation for a general *or* specific purpose. Legacies represent the donations which are given under a will on the death of a donor.

ACCOUNTING OF TREATMENT OF DONATIONS AND LEGACIES

The accounting treatment is summarised below:

Types of Donations and Legacies	Accounting Treatment
(a) General Donations and Legacies	These donations & legacies are treated as Revenue Receipts and thus, are credited to Income & Expenditure Account .
(b) Specific Donations and Legacies	1. These donations & legacies are treated as Capital Receipts and thus, are transferred to a 'Special Fund Account' (e.g., Building Fund) maintained for the purpose. 2. Any Income relating to such 'Special Fund Account' is added to the Respective Fund. 3. Any Revenue Expenditure relating to 'Special Fund Account' is deducted from the Respective Fund. 4. However, any Expenditure of capital nature on account of this Special Fund (e.g., Expenditure on the construction of building out of Building Fund) should be shown on the Assets side of the Balance Sheet and an equal amount should be transferred from that Special Fund to the Capital Fund.

ILLUSTRATION 14

Show how will you deal with the Prizes awarded ₹ 2,000 while preparing the final accounts of a Club for the year ending on March 31, 2018.

SOLUTION
AN EXTRACT OF INCOME AND EXPENDITURE ACCOUNT
Dr.
for the year ended 31st March, 2018
Cr.

<i>Expenditure</i>	<i>₹</i>	<i>Income</i>	<i>₹</i>
To Prizes awarded	2,000		

Reason: There does not exist any Prize Fund.

ILLUSTRATION 15

Show how will you deal with the following items while preparing the final accounts of a Club for the year ending on March 31, 2018:

Prizes awarded ₹ 2,000,

Prize Fund as at 31.3.2017 ₹ 12,000,

Donations for Prizes received during the year 2017–2018 ₹ 2,800,

10% Prize Fund Investments as at 31.3.2017 ₹ 12,000.

Interest on Prize Fund Investments ₹ 1,200.

SOLUTION
AN EXTRACT OF BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	<i>₹</i>	<i>Assets</i>	<i>₹</i>
Prize Fund:		10% Prize Fund Investments	12,000
Opening Balance 12,000			
Add: Donations 2,800			
Add: Interest on Prize fund Investments 1,200			
Less: Prizes awarded 2,000	14,000		

ILLUSTRATION 16

Show how will you deal with the following items while preparing the final accounts of a Club for the year ending on March 31, 2018:

Prizes awarded ₹ 17,000,

Prize Fund as at 31.3.2017 ₹ 12,000,

Donations for Prizes received during the year 2017–2018 ₹ 2,800,

10% Prize Fund Investments as at 31.3.2017 ₹ 12,000.

Interest on Prize Fund Investments ₹ 1,200.

SOLUTION**AN EXTRACT OF INCOME AND EXPENDITURE ACCOUNT***Dr.**for the year ended 31st March, 2018**Cr.*

Expenditure	₹	Income	₹
To Prizes awarded	1,000		

AN EXTRACT OF BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Prize Fund:			
Opening Balance	12,000		
Add: Donations	2,800		
Add: Interest on Prize Fund Investments	1,200		
Less: Prizes awarded	17,000		
T/F to I & E Exp. A/c	(1,000)		

ILLUSTRATION 17

Show how will you deal with the following items while preparing the final accounts for the year ending on 31st March 2018:

Expenditure on Construction of Building ₹ 3,00,000. The construction work is in progress and has not yet completed. Opening Capital Fund ₹ 9,00,000.

SOLUTION**AN EXTRACT OF BALANCE SHEET AS AT 31ST MARCH, 2018**

Liabilities	₹	Assets	₹
Capital Fund:			
Opening Balance	9,00,000	Building-in-progress	3,00,000

ILLUSTRATION 18

Show how will you deal with the following items while preparing the final accounts for the year ending on 31st March 2018:

Expenditure on construction of Building ₹ 3,00,000. The construction work is in progress and has not yet completed.

Opening Building Fund	₹ 4,00,000
Donation for Building received	₹ 5,00,000
Opening Capital Fund	₹ 9,00,000

SOLUTION
AN EXTRACT OF BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Fund:		Building in progress	3,00,000
Opening Balance	9,00,000		
Add: T/f from Building fund	3,00,000		
Building Fund:			
Opening Balance	4,00,000		
Add: Donations	5,00,000		
Less: T/f to Capital Fund	3,00,000		
	6,00,000		

ILLUSTRATION 19

Show how will you deal with the following items while preparing the final accounts for the year ending on 31st March 2018:

Expenditure on construction of Building ₹ 3,00,000. The construction work is in progress and has not yet completed.

Opening Building Fund	₹ 4,00,000
Opening 10% Building Fund Investments	₹ 4,00,000
Donation for Building received	₹ 5,00,000
Interest received on Building Fund Investments	₹ 40,000
Opening Capital Fund	₹ 9,00,000.

SOLUTION
AN EXTRACT OF BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Fund:		Building in progress	3,00,000
Opening Balance	9,00,000	10% Building Fund Investments	4,00,000
Add: T/f from Building Fund	3,00,000		
Building Fund:			
Opening Balance	4,00,000		
Add: Donations	5,00,000		
Add: Interest on B.F. Investments	40,000		
Less: T/f to Capital Fund	3,00,000		
	6,40,000		

ILLUSTRATION 20

How will you deal with the following items while preparing for the Tulsian Cricket Club's Income and Expenditure Account for the year ending on March 31, 2018 and its Balance Sheet as on March 31, 2018.

Particulars	₹
(i) Building Fund as on 1.04.2017	2,00,000
Donations received for the Building	5,54,000
Expenditure on Building construction	5,92,000
The construction work is continuing,	
(ii) Tournament Fund: as on April 1, 2017	3,760
Donation received for Tournament	18,400
Tournament Expenses	30,200
Proceeds from Sale of Tournament Tickets	10,000
(iii) Life Membership fees received during the year	16,000
(iv) Subscription for Governor's Party received	20,000
Outstanding Subscription for Governor's Party	5,000
(v) Capital Fund as on 1.04.2017.	10,00,000

SOLUTION

All the receipts mention in the above Illustration are of capital nature. Hence these are capitalised and are shown in Balance Sheet as under:

AN EXTRACT OF BALANCE SHEET OF TULSIAN CRICKET CLUB

as at 31st March, 2018

Liabilities	₹	Assets	₹
Capital Fund:		Building in progress	5,92,000
Add: Transferred from		Outstanding Subscription for Governor's Party	5,000
Building Fund	5,92,000		
Opening Balance	10,00,000		
Add: Life Membership fees	16,000		
	6,08,000		
Building Fund:			
Opening Balance	2,00,000		
Add: Donations received	5,54,000		
Less: T/F to Capital Fund	5,92,000		
	1,62,000		
Tournament Fund:			
Opening Balance	3,760		
Add: Donations Received	18,400		
Add: Sale Proceeds	10,000		
	32,160		
Less: Expenses	30,200		
	1,960		
Subscription for Governor's Party	25,000		
(₹ 20,000 + ₹ 5,000)			

10.0 TREATMENT OF SALE OF OLD NEWSPAPERS AND PERIODICALS

The sale proceeds of old newspapers and periodicals are treated as **Revenue Receipts** and thus, are **credited to the Income & Expenditure Account**.

11.0 TREATMENT OF SALE OF OLD FIXED ASSETS

The sale proceeds of old fixed Assets are treated as Capital Receipts and thus, are credited to the Respective Fixed Asset Account. However, the Profit or Loss on Sale of fixed Assets is shown in the Income & Expenditure Account.

ILLUSTRATION 21

Furniture as on 31.3.2017 ₹ 1,10,000, Furniture (having a book value as on 1.4.2017 of ₹ 10,000) sold at a profit of 20% on 31.12.2017, Furniture purchased on 1.10.2017 ₹ 50,000. Furniture is to be depreciated @ 10% p.a. Prepare the Furniture account for the year ending on March 31, 2018

SOLUTION

Dr.		FURNITURE ACCOUNT		Cr.	
Particulars	₹	Particulars	₹		
To Balance b/d	1,10,000	By Depreciation A/c	750		
To Bank A/c (Purchases)	1,850	$\left[₹10,000 \times \frac{10}{100} \times \frac{9}{12} \right]$			
To Income & Expenditure A/c [Profit @ 20% on ₹ 9,250]	50,000	By Bank A/c (Sale proceeds) [(10,000 – 750) + 20% of 9,250]	11,100		
		By Depreciation A/c: on 1,00,000 for 1 year 10,000			
		on 50,000 for 1/2 year 2,500	12,500		
		By Balance c/d	1,37,500		
	1,61,850		1,61,850		

ILLUSTRATION 22

Furniture as on 31.3.2017 ₹ 2,20,000. Furniture (having a book value as on 1.4.2017 of ₹ 20,000) sold at a loss of 20% on 31.12.2017, Furniture is to be depreciated @ 10% p.a. Furniture costing ₹ 1,50,000 was also purchased on 1.10.2017. Prepare the Furniture Account for the year ending on March 31, 2018.

SOLUTION

Dr.		FURNITURE ACCOUNT		Cr.	
Particulars	₹	Particulars	₹		
To Balance b/d	2,20,000	By Depreciation A/c $\left[₹20,000 \times \frac{10}{100} \times \frac{9}{12} \right]$	1,500		
To Bank A/c (Purchases)	1,50,000	By Bank A/c (Sale Proceeds) [(₹ 20,000 – ₹ 1,500) – 20% of ₹ 18,500]	14,800		
		By Income & Expenditure A/c [20% of ₹ 18,500]	3,700		
		By Depreciation A/c on ₹ 2,00,000 for 1 year, 20,000			
		on ₹ 1,50,000 for 1/2 year 7,500	27,500		
		By Balance c/d	3,22,500		
	3,70,000		3,70,000		

12.0 TREATMENT OF AID FROM GOVERNMENT AND OTHER INSTITUTIONS

Aids from the government and other institutions are accounted for as follows:

Type of Aid	Accounting treatment
(a) General Aids	(a) These aids are treated as Revenue Receipts and thus, are credited to the Income & Expenditure Account .
(b) Special Aids	(b) These aids are treated as Capital Receipts and thus, are added to the Capital Fund .

13.0 TREATMENT OF CONSUMABLE ITEMS CONSUMED DURING THE YEAR

1. Sometimes Not-for-profit organisations consume some consumable item e.g. Stationery, Sports Materials, Medicines.
2. In such a case Total Creditors Account should be prepared to ascertain Credit Purchases (*if missing*).
3. A separate Stock Account for each of the consumable items is prepared to ascertain the amount of consumable item consumed during the year.
4. Such amount consumed is debited to Income & Expenditure Account.

ILLUSTRATION 23

How will you deal with the following items while preparing the Income and Expenditure Account for the year ending on March 31, 2018 and a Balance Sheet as on that date?

Particulars	As at 1.4.2017 ₹	As at 31.3.2018 ₹
Creditors for Sports Materials	2,000	1,200
Stock of Sports Materials	2,100	500

During 2017–2018, the payment made to these creditors was ₹ 10,800. Cash Purchases 10% of Credit purchases.

SOLUTION**AN EXTRACT OF INCOME AND EXPENDITURE ACCOUNT**

Dr. for the year ending on 31st March, 2018 Cr.

Expenditure	₹	Income	₹
To Sports Materials consumed	12,600		

AN EXTRACT OF BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Creditors for Sports Materials	1,200	Stock of Sports Materials	500

Working Notes:**(I) CREDITORS FOR SPORTS MATERIALS ACCOUNT**

Dr. Cr.

Particulars	₹	Particulars	₹
To Bank A/c	10,800	By Balance b/d	2,000
To Balance c/d	1,200	By Stock of Sports Materials A/c (Credit purchases) (b. f.)	10,000
	12,000		12,000

Dr.

(II) STOCK OF SPORTS MATERIALS ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	2,100	By Income and Expenditure A/c (Sports Materials consumed)	
To Creditors for Sports Materials (transfer)	10,000	(Balancing figure)	12,600
To Bank A/c (cash purchases)	1,000	By Balance c/d	500
	13,100		13,100

ILLUSTRATION 24

How will you deal with the following items while preparing the Income and Expenditure Account for the year ending on March 31, 2018 and a Balance Sheet as on that date?

<i>Particulars</i>	As at 1.4.2017 ₹	As at 31.3.2018 ₹
Amount due to suppliers of Sports Materials	15,000	9,750
Advances to suppliers of Sports Materials	5,000	3,750
Stock of Sports Materials	10,500	2,500

During 2017–2018, the payment made to the suppliers of Sports Materials was ₹ 54,000. Cash Purchases 10% of Credit purchases.

SOLUTION
AN EXTRACT OF INCOME AND EXPENDITURE ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Sports Materials consumed	63,000		

AN EXTRACT OF BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Creditors for Sports Materials	9,750	Advance for Sports Materials	3,750
		Stock of Sports Materials	2,500

Working Notes:

Dr.

(I) CREDITORS FOR SPORTS MATERIALS ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	5,000	By Balance b/d	15,000
To Bank A/c	54,000	By Stock of Sports Materials A/c (Credit purchases)	
To Balance c/d	9,750	(Balancing figure)	50,000
		By Balance c/d	3,750
	68,750		68,750

Dr.

(II) STOCK OF SPORTS MATERIALS ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	10,500	By Income and Expenditure A/c (Sports Materials consumed)	
To Creditor for Sports Materials (transfer)	50,000	(Balancing figure)	63,000
To Bank A/c (cash purchases)	5,000	By Balance c/d	2,500
	65,500		65,500

14.0 TREATMENT OF PROFIT/LOSS FROM TRADING ACTIVITIES

1. Sometimes Not-for-profit organisations carry on trading activities e.g. A Restaurant/Bar run by a club, Chemist shop by a hospital, Book-Shop by a library.
2. In such a case, a separate Trading Account for each of the trading activities is prepared to ascertain the Profit/Loss from each of such trading activities.
3. Such Profit/Loss is transferred to **Income & Expenditure** Account.
4. Trading Account is prepared in the same manner as in case of commercial organisations.
5. Sometimes the figures of Credit Purchases and Credit Sales are missing in the questions, in such case Total Creditors' Account and Total Debtors' Account should be prepared to ascertain credit purchases and credit sales respectively.

ILLUSTRATION 25

Bharat Club provides you the following information:

Stock in Restaurant on 31.3.2017 ₹ 3,900, and on 31.3.2018 ₹ 4,500, Restaurant Takings ₹ 3,61,600, Restaurant Purchases ₹ 2,04,800, Wages (including ₹ 50,000 for Restaurant) ₹ 92,300, Fuel ₹ 17,700, China Glass Cutlery on 31.3.2017 ₹ 2,500, Depreciation @ 20% is to be provided on China Glass Cutlery.

Required: Show how will you deal with the above items while preparing Restaurant Trading Account, Income & Expenditure Account and Balance Sheet.

SOLUTION**RESTAURANT TRADING ACCOUNT**

Dr.

for the year ended 31st March, 2018

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Opening Stock	3,900	By Restaurant Takings	3,61,600
To Purchases	2,04,800	By Closing Stock	4,500
To Wages	50,000		
To Fuel	17,700		
To Depreciation on China Glass Cutlery	500		
To Surplus transferred to Income & Expenditure A/c	89,200		
	3,66,100		3,66,100

AN EXTRACT OF INCOME & EXPENDITURE ACCOUNT

Dr.

for the year ended 31st March, 2018

Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Wages	42,300	By Profit from Restaurant	89,200

AN EXTRACT OF BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
		Restaurant Stock	4,500
		China Glass Cutlery 2,500	
		Less: Depreciation @ 20% 500	2,000

15.0 DISTINCTION BETWEEN RECEIPTS AND PAYMENTS ACCOUNT AND INCOME AND EXPENDITURE ACCOUNT

A 'Receipt & Payment Account' and 'Income & Expenditure Account' can be distinguished as follows:

Basis of Distinction	Receipts & Payments A/c	Income & Expenditure A/c
1. Nature of Account	It is a real account.	It is a nominal account.
2. Period to which items relate	It records the receipts and payments whether they relate to previous, current or following accounting periods.	It records only those Incomes, expenses and losses which relate to current accounting period.
3. Nature of items recorded—Revenue Vs. Capital.	It records all the receipts and payments whether of capital or revenue nature .	It records the Incomes, Expenditures and losses of revenue nature .
4. Non-cash Items	Non-cash items are not shown in this account.	Non-cash items such as depreciation, bad debts, etc., are shown .
5. Items of Debit side	It is debited with all the sums received .	It is debited with the expenses and losses .
6. Items of Credit side	It is credited with all the sums paid out .	It is credited with the Incomes .
7. Closing balance	Closing balance represents cash or bank balance (or bank overdraft) at the end of the accounting period .	Its closing balance represents either net surplus or net deficit .
8. Treatment of closing balance	Its closing balance is carried forward in the same account of the next period .	Its closing balance is transferred to the Capital Fund in the Balance Sheet.
9. Opening balance	Opening balance represents cash or bank balances (or Bank Overdraft) in the beginning of the accounting period .	It has no opening balance.
10. Basic Structure	It is basically a summarised Cash Book .	It is like a Profit & Loss Account .
11. Object	It is prepared to present a summary of cash transactions during an accounting period.	It is prepared to ascertain the net results of all the transactions during an accounting period.

16.0 DISTINCTION BETWEEN *INCOME* AND *EXPENDITURE* ACCOUNT AND PROFIT AND LOSS ACCOUNT

Income & Expenditure Account differs from Profit & Loss Account in the following respects:

Basis of Distinction	Income & Expenditure A/c	Profit & Loss A/c
1. Object	The main object of Income and Expenditure Account is to ascertain excess of Income over Expenditure or excess of Expenditure over Income.	The main object of Profit and Loss Account is to ascertain Net Profit or Net Loss.
2. Who prepares?	This account is prepared by Non-Profit Organisations.	This account is prepared by Trading Institutions.
3. Basis of Preparation	This account is prepared on the basis of Receipts and Payments Account and other information.	This account is prepared on the basis of Trial Balance.
4. Balance	The balance of this account represents Surplus or Deficit	The balance of this account represents Net Profit or Net Loss.

17.0 HOW TO PREPARE AN *INCOME* AND *EXPENDITURE* ACCOUNT FROM A RECEIPTS AND PAYMENTS ACCOUNT

The practical steps involved in the preparation of an Income & Expenditure Account from the Receipts & Payments Account are given as follows:

PRACTICAL STEPS INVOLVED IN THE PREPARATION OF AN *INCOME* & *EXPENDITURE* ACCOUNT FROM THE RECEIPTS & PAYMENTS ACCOUNT

Step 1: Ascertain the Revenue <i>Income</i> (e.g. Subscriptions) for the current accounting period as under and show on the credit side of <i>Income & Expenditure</i> Account:		
		₹
A. Revenue Receipts during the current year	xxx	
B. Add: (a) Outstanding <i>Income</i> at the end of current year	xxx	
(b) Advance <i>Income</i> in the beginning of current year	xxx	xxx
C. Less: (a) Outstanding <i>Income</i> in the beginning of current year	xxx	
(b) Advance <i>Income</i> at the end of current year	xxx	xxx
D. Revenue <i>Income</i> for the current year (A + B – C)		xxx
Step 2: Ascertain 'Revenue Expense' (e.g. Salaries) for the current accounting period as under and show on the debit side of <i>Income & Expenditure</i> Account;		
		₹
A. Revenue Payments during the current year		xxx
B. Add: (a) Outstanding expenses at the end of current year	xxx	
(b) Prepaid expenses in the beginning of current year	xxx	xxx
C. Less: (a) Outstanding expenses in the beginning of current year	xxx	
(b) Prepaid expenses at the end of current year	xxx	xxx
D. Revenue Expenses for the current year (A + B – C)		xxx
Step 3: Ascertain the Non-Cash Expenses (e.g. depreciation on fixed <i>Assets</i>) from the additional information and show such charges on the debit side of <i>Income & Expenditure</i> Account.		

Step 4: Calculate the amount of Profit or Loss on Trading Activities and show the amount of profit on the credit side of **Income & Expenditure** Account or the amount of Loss on the debit side of **Income & Expenditure** Account separately.

Step 5: Calculate the difference between the total of debit side and the total of credit side. If the total of credit side exceeds the total of debit side, show the **Surplus** (i.e. excess of **Income** over **Expenditure**) on the debit side. If the total of debit side exceeds the total of credit side, show the **Deficit** (i.e. excess of **Expenditure** over **Income**) on the credit side of **Income & Expenditure** Account.

TUTORIAL NOTE

The following items appearing in the Receipts & Payments Account are not shown in the Income & Expenditure Account:

1. Opening Cash and Bank Balances
2. Closing Cash and Bank Balances
3. Capital Receipts (e.g. Special Donations, Sale Proceeds of Fixed Assets), Entrance Fees & Life Membership Fees to the extent Capitalised)
4. Capital Payments (e.g. Purchase of Fixed Assets)
5. Expenses paid for the previous year(s) or following year(s)
6. Incomes received for the previous year(s) or following year(s).

ILLUSTRATION 26

- (a) Salaries paid during the year 2017-2018 ₹ 60,000. Compute the Salaries for the year 2017-2018.
- (b) Salaries paid during the year 2017-2018 ₹ 60,000. Salaries ₹ 30,000 is still outstanding. Compute the Salaries for the year 2017-2018.
- (c) Salaries paid during the year 2017-2018 ₹ 60,000. Salaries ₹ 20,000 paid in advance for the year 2018-2019. Compute the Salaries for the year 2017-2018.
- (d) Salaries paid during the year 2017-2018 ₹ 60,000. Salaries ₹ 40,000 was outstanding at the end of the previous year. Compute the Salaries for the year 2017-2018.
- (e) Salaries paid during the year 2017-2018 ₹ 60,000. Salaries ₹ 90,000 was paid in advance at the end of the previous year. Compute the Salaries for the year 2017-2018.

SOLUTION

COMPUTATION OF SALARIES FOR THE CURRENT YEAR

Particulars	(a)	(b)	(c)	(d)	(e)
Salaries paid	60,000	60,000	60,000	60,000	60,000
Add: O/s at the end	—	30,000	—	—	—
Less: Advance at the end	—	—	(20,000)	—	—
Add: Advance in the beg.	—	—	—	—	90,000
Less: O/s in the beg.	—	—	—	(40,000)	—
Salaries for the Current Year	60,000	90,000	40,000	20,000	1,50,000

ILLUSTRATION 27

Compute the Salaries for the year 2017-2018 from the following information:

<i>Particulars</i>	<i>1.4.2017</i>	<i>31.3.2018</i>
Outstanding Salaries	₹ 9,500	₹ 7,000
Prepaid Salaries	₹ 2,800	₹ 5,200
Salaries paid during 2017-2018 ₹ 1,48,900		

SOLUTION

Dr.

SALARIES ACCOUNT

Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Prepaid Salaries A/c (in the beginning)	2,800	By Outstanding Salaries A/c (in the beginning)	9,500
To Bank A/c	1,48,900	By Income & Expenditure A/c (balancing figure)	1,44,000
To Outstanding Salaries A/c (at the end)	7,000	By Prepaid Salaries A/c (at the end)	5,200
	1,58,700		1,58,700

ACCOUNTING TREATMENT OF SPECIAL ITEMS

Item	Accounting Treatment
1. Subscriptions	These are treated as Revenue Receipts and hence are credited to Income & Expenditure Account .
2. Life Membership Subscriptions	These are treated as Capital Receipts and hence are added to the Capital Fund in the Balance Sheet.
3. Entrance Fees	1. If treated as a Revenue Receipt and is credited to Income & Expenditure Account . 2. If treated as a Capital Receipt and is added to the Capital Fund in the Balance Sheet.
4. Amount of Consumable Item (e.g. Stationery, Sports Material, Medicines) consumed during the year	Such Amount is debited to Income & Expenditure Account .
5(a). Profit on Sale of Asset [Sale Proceeds – Book Value]	It is credited to Income & Expenditure Account .
5(b). Loss on Sale of Asset [Book Value – Sale Proceeds]	It is debited to Income & Expenditure Account .
6. Sale of Old Sports Materials already w/o	It is credited to Income & Expenditure Account .
7. Sale of Old Newspapers & Periodicals	It is credited to Income & Expenditure Account .
8. Depreciation	It is debited to Income & Expenditure Account .
9. General Donations and Legacies	These donations & legacies are treated as Revenue Receipts and hence, are Credited to Income & Expenditure Account .

Given below is the Receipts and Payments Accounts of Tulsian Sports Club for the year ended 31.3.2018:

Dr.	for the year ended 31st March, 2018	Cr.

Receipts	₹	Payments	₹
Balance b/f:		Salary (inclu. ₹ 1,000 for 2016-2017)	11,000
Cash 400		Billiards table	8,000
Bank 3,600	4,000	Office Expenses	
Subscriptions	11,000	(including ₹ 1,000 for 2018-2019)	4,400
Lift membership fee	8,000	Stationary	700
Tournament fund	15,000	Tournament expenses	16,000
Donation for Building	40,000	Furniture purchased	5,000
Locker rent	2,000	Sports equipments purchased	6,000
Sale of Old Sports Material		Fixed deposit on 1.4.2017	5,900
(Costing ₹ 5,000)	3,000	@ 12% p.a.	
Sale of Old Newspapers	2,000	Balance c/f:	
Legacy	10,000	Cash 200	
Entrance fee	5,000	Bank 53,154	53,354
Interest on Fixed Deposit	354		
Interest on Building Fund	10,000		
	1,10,354		1,10,354

Additional Information:

- (a) On 1.4.2017 subscriptions outstanding were ₹ 800 and on 31.3.2018 ₹ 900.
- (b) On 1.4.2017 the Club had Building ₹ 50,000; Furnitures ₹ 20,000 and Sports Equipment ₹ 14,000. Charge depreciation @ 10% on these items (including purchases).
- (c) Stock of Stationery at the beginning and at the end of year was ₹ 3,000 and ₹ 1,000.
- (d) Donation for Building includes ₹ 4,000 General Donation.

Prepare Income and Expenditure Account of the Club for the year ended 31.3.2018.

SOLUTION**INCOME AND EXPENDITURE ACCOUNT**

Dr.

for the year ended 31st March., 2018

Cr.

Expenditure	₹	Income	₹
To Salary [₹ 11,000 – ₹ 1,000]	10,000	By Subscriptions 11,000	
To Office Expenses		Less: O/s in the Beg. 800	
[₹ 4,400 – ₹ 1000]	3,400	Add: O/s at end 900	11,100
To Stationery	2,700	By Locker Rent	2,000
[₹ 3,000 + ₹ 700 – ₹ 1,000]		By Sale of Old Newspapers	2,000
To Loss on Sale of Sports material	2,000	By Entrance Fee	5,000
To Depreciation on		By General Denations	4,000
Building	5,000	By Interest on Fixed Deposit	
Furniture		Received 354	
10/100 [20,000 + 5,000]	2,500	Accrued 354	708
Sports Equipment		By Deficit	4,592
10/100 [14,000 + 6,000 + 800]	2,800		
To Tournament Expenses	1,000		
[₹ 16,000 – ₹ 15,000]			
	29,400		29,400

Notes:

1. Billiards Table has been treated as part of Sports Equipments.
2. Entrance Fees have been treated as of Revenue nature.
3. Excess Tournament Expenses have been charged to **Income & Exp. A/c**.

ILLUSTRATION 29

From the following Receipts & Payments Account, prepare the Income & Expenditure Account for the year 31st March, 2018:

Receipts	₹	Payments	₹
To Balance b/f	10,000	By Rent	
To Entrance Fees:		(including ₹ 1,500 for 2016-2017)	6,000
2016-2017	1,000	By Insurance Premium	
2017-2018	5,000	(including ₹ 1,500 for 2018-2019)	6,000

To Subscriptions:		By Sports Materials	5,000
2016-2017	1,000	By Sports Equipment	
2017-2018	9,000	(Purchased on 31.3.2018)	6,000
2018-2019	500	By 8% Fixed Deposits	
To Life Membership Subscription	2,000	(made on 1.10.2017)	12,000
To Donations	12,000	By Tournament Expenses	1,000
To Donation for Tournament	5,000	By Purchase of Books	2,000
To Subsc. for Governor's Party	1,500	By Postage Stamps	500
To Interest on 8% Fixed Deposit	240	By Printing & Stationery	1,500
To Sale of Old Sports Materials	30	By Newspapers & Periodicals	2,000
To Sale of Old Sports Equipment		By Balance c/f	6,000
(Book Value ₹ 120)	50		
To Locker Rents			
(including ₹ 60 for 2016-2017)	500		
To Sale of Old Newspapers & Periodicals	180		
	48,000		48,000

SOLUTION
INCOME & EXPENDITURE ACCOUNT
Dr.
for the year ended 31st March, 2018
Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Loss on Sale of Sports Equip. (₹ 120 – 50)	70	By Entrance Fees	5,000
To Rent		By Subscription	9,000
Paid	6,000	By Donations	12,000
Less: O/s in the beginning	1,500	By Interest on Deposits	
To Insurance Premium:		Received	240
Paid	6,000	Add: Accrued	240
Less: Prepaid at the end	1,500	By Sale of Sports Materials	30
To Sports Materials	5,000	By Locker Rent	440
To Postage Stamps	500	By Sale of Old Newspapers & Periodicals	180
To Printing & Stationery	1,500		
To Newspapers & Periodicals	2,000		
To Surplus t/f to Capital Fund	9,060		
	27,130		27,130

Notes:

1. Sports Equipments, 8% Fixed Deposits and Books represent Assets which will appear in the closing Balance Sheet.
2. In the absence of any information regarding the rate of depreciation on Sports Equipment & Books, no depreciation has been provided.
3. Tournament Expenses will be deducted from Tournament Fund.

4. Donation for Tournament & Subscription for Governor's party will appears on Liabilities side of Balance Sheet.
5. Entrance Fees have been treated as of revenue nature.
6. Life Membership Subscription has been treated as of Capital nature and hence, not shown on the credit side of Income & Expenditure Account.
7. It has been assumed that there is no Stock of Sports Materials in hand.

18.0 PREPARATION OF BALANCE SHEET OF A NOT-FOR-PROFIT ORGANISATION

MEANING OF A BALANCE SHEET

1. A Balance Sheet is the Statement of Assets and Liabilities of an accounting unit at a given date.
2. It is prepared at the end of an accounting period after the Income & Expenditure Account has been prepared.
3. It is called a Balance Sheet because it is a sheet of balances of ledger accounts which are open even after the preparation of Income & Expenditure Account.
4. In Not-for-Profit organisations, the excess of Total Assets over Total Outside Liabilities is known as Capital Fund. While preparing the Balance Sheet, the excess of Income over Expenditure is added to the opening Capital Fund and the excess of Expenditure over the Income is deducted from the opening Capital Fund.

FORMAT OF BALANCE SHEET

A general format of a Balance Sheet of a Not-for-Profit Organisation is given below:

BALANCE SHEET OF... AS AT...

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Fund:		Fixed Assets:	
Opening Balance xxx		Building	
Add: Surplus xxx		Opening Balance xxx	
(or Less: Deficit) xxx		Add: Additions xxx	
Add: Entrance Fees xxx		Less: Depreciation xxx	xxx
(to the extent capitalised)		Furniture	
Add: Life Membership		Opening Balance xxx	
Subscriptions xxx		Add: Additions xxx	
(to the extent capitalised)		Less: Book Value of asset sold xxx	
Add: Amt. of Capital Expenditure		Less: Depreciation xxx	xxx
transferred from A Special		Sports Equipment xxx	
Fund (e.g. Building Fund) xxx	xxx	Less: Depreciation xxx	xxx
Prize Fund:		Investments:	
Opening Balance xxx		Prize Fund Investments	xxx
Add: Donation for prizes xxx		Building Fund Investments	xxx
Add: Income from		10% Govt. Securities	xxx
Prize Fund Investments xxx		Fixed Deposits	xxx
Less: Expenses xxx	xxx	Current Assets:	

Building Fund:			Sports Materials	xxx
Add: Donation for Building	xxx		Outstanding Subscriptions	xxx
Add: Income from			Accrued Interest	xxx
Building Fund Investments	xxx		Accrued Rent	xxx
Less: Transfer to Capital Fund	xxx	xxx	Cash in hand	xxx
Current Liabilities:			Cash at bank	xxx
Subscription received in Advan.	xxx			
Outstanding Expenses		xxx		
Bank Overdraft		xxx		
Creditors		xxx		
		xxx		xxx

ILLUSTRATION 30

From the following information, prepare Opening and Closing Balance Sheets:

<i>Particulars</i>	<i>31st March 2017</i> ₹	<i>31st March 2018</i> ₹
Building (subject to 10% depreciation)	30,000	?
Furniture (subject to 10% depreciation)	—	10,000
Stock of Sports Materials	2,500	1,000
Prepaid Insurance	1,500	3,000
Outstanding Subscription	6,000	4,000
Advance Subscription	3,000	2,000
Outstanding Locker Rent	—	3,000
Advance Locker Rent received	—	1,000
Outstanding Rent for Godown	3,000	1,500
12% General Fund Investments	1,00,000	?
Accrued Interest on above	—	2,000
Cash Balance	500	32,000
Bank Balance	1,000	—
Bank Overdraft	—	1,000

Note: Entrance Fees received ₹ 10,000, Life Membership Fees received ₹ 10,000, Surplus from Income & Expenditure Account ₹ 30,000. It is the policy of the club to treat 60% of Entrance Fees and 40% of Life Membership Fees as of revenue nature.

SOLUTION
BALANCE SHEET AS AT 31ST MARCH 2017

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Outstanding Rent	3,000	Building	30,000
Advance Subscription	3,000	Stock of Sports Materials	2,500
Capital Fund (Balancing Figure)	1,35,500	Prepaid Insurance	1,500
		Outstanding Subscription	6,000
		12% General Fund Investments	1,00,000
		Cash Balance	500
		Bank Balance	1,000
	1,41,500		1,41,500

BALANCE SHEET AS AT 31ST MARCH 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Outstanding Rent	1,500	Building	
Advance Subscription	2,000	Book Value	30,000
Advance Locker Rent	1,000	Less: Depreciation	3,000
Bank Overdraft	1,000	Furniture Cost	10,000
Capital Fund:		Less: Depreciation	1,000
Opening Balance	1,35,500	Stock of Sports Materials	1,000
Add: Entrance Fees		Prepaid Insurance	3,000
[10,000 × 40%]	4,000	Outstanding Subscription	4,000
Add: Life Membership Fees		Outstanding Locker Rent	3,000
[₹ 10,000 × 60%]	6,000	12% General Fund Investments	1,00,000
Add: Surplus	30,000	Accrued Interest on 12% General Fund Investments	2,000
	1,75,500	Cash Balance	32,000
	1,81,000		1,81,000

PREPARATION OF AN INCOME & EXPENDITURE A/C AND THE BALANCE SHEET**ILLUSTRATION 31**

From the following Receipts and Payments A/c of Mumbai Club, prepare Income and Expenditure A/c for the year ended 31.3.2018 and its Balance Sheet as on that date:

<i>Receipts</i>	₹	<i>Payments</i>	₹
Cash in Hand	4,000	Salary	2,000
Cash at Bank	10,000	Repair Expenses	500
Donations	5,000	Purchase of Furniture	6,000
Subscriptions	12,000	Misc. Expenses	500
Entrance Fees	1,000	Purchase of Investments	6,000
Interest on Investments	100	Insurance Premium	200
Interest Received from Bank	400	Billiard Table	8,000
Sale of Old Newspaper	150	Paper, Ink, etc.	150
Sale of Drama Tickets	1,050	Drama Expenses	500
		Cash in Hand (Closing)	2,650
		Cash at bank (Closing)	7,200
	33,700		33,700

Information:

- Subscriptions in arrears for 2017-2018 ₹ 900 and Subscription in advance for 2018-2019 ₹ 350,
- Insurance premium Outstanding ₹ 40, Misc. Expenses Prepaid ₹ 90,
- 50% of donation is to be capitalised, Entrance Fees are to be treated as revenue Income,
- 8% Interest has accrued on Investment for five months,
- Billiard Table costing ₹ 30,000 was purchased during the last year and ₹ 22,000 were paid for it.

SOLUTION
INCOME AND EXPENDITURE ACCOUNT
Dr.
for the year ended 31st March, 2018
Cr.

Expenditure	₹	Income	₹
To Salary	2,000	By Subscriptions	12,000
To Repair Expenses	500	Add: Outstanding in beg.	900
To Misc. Expenses	500		12,900
Less: Prepaid	90	Less: Advance at end	350
To Insurance Premium	200	By Entrance Fees	1,000
Add: Outstanding	40	By Interest on Investment	
		(100 + 200)	300
To Paper, ink, etc.	150	By Sale of Drama Tickets	1,050
To Drama expenses	500	By Interest received from Bank	400
To Surplus — Excess of Income		By Sale of Newspaper	150
over Expenditure	14,150	By Donation	5,000
		Less: Capitalised (50%)	2,500
	17,950		2,500
			17,950

BALANCE SHEET OF MUMBAI CLUB AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Outstanding Expenses	40	Billiards table	30,000
Subscription in advance	350	Furniture	6,000
Capital Fund	36,000	Prepaid Expenses (Misc.)	90
Add: Surplus	14,150	Subscription receivable	900
Add: Donations	2,500	Investments	6,000
	52,650	Interest accrued	200
		Bank balance	7,200
		Cash on hand	2,650
	53,040		53,040

Working Note: *Calculation of Opening Capital Fund*
BALANCE SHEET OF MUMBAI CLUB AS AT 31ST MARCH, 2017

Liabilities	₹	Assets	₹
Creditors for Billiards Table	8,000	Billiards table	30,000
Capital Fund (Balancing figure)	36,000	Bank Balance	10,000
		Cash on Hand	4,000
	44,000		44,000

ILLUSTRATION 32

Excellent Library Society showed the following position on 31st March 2017:

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Fund	7,93,000	Electrical Fittings	1,50,000
Expenses Due	7,000	Furniture	50,000
		Books	4,00,000
		Investments in Securities	1,50,000
		Cash at Bank	25,000
		Cash on Hand	25,000
	8,00,000		8,00,000

The Receipts and Payments Account for the year ending on 31st March 2018 is given below:

<i>Receipts</i>	₹	<i>Payments</i>	₹
To Balance b/f		By Electric charges	7,200
Cash at Bank	25,000	By Postage & Stationery	5,000
Cash on Hand	25,000	By Telephone charges	5,000
To Entrance Fees	30,000	By Books purchased (on 1.4.2017)	60,000
To Membership Subscription	2,00,000	By Outstanding Expenses Paid	70,00
To Sale Proceeds of old Papers	1,500	By Rent Account	88,000
To Hire of Lecture Hall	20,000	By Investment in Securities	40,000
To Interest on Securities	8,000	By Salaries	66,000
		By Balance c/f:	
		Cash at Bank	20,000
		Cash on Hand	11,300
	3,09,500		3,09,500

You are required to prepare an Income and Expenditure Account for the year ending 31.03.2018 and a Balance Sheet as on that date after making the following adjustments:

- Membership subscriptions included ₹ 10,000 received in advance.
- Provide for Outstanding Rent ₹ 4,000 and Salaries ₹ 3,000.
- Books to be depreciated @ 10% including additions. Electrical Fittings and Furniture are also to be depreciated at the same rate.
- 75% of the Entrance fees is to be capitalised.
- Interest on Securities is to be calculated @ 5% p.a. including purchases of investments made on 1.7.2017 for ₹ 40,000.

SOLUTION**INCOME AND EXPENDITURE ACCOUNT**

Dr.

for the year ended on 31st March, 2018

Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Electric changes	7,200	By Entrance Fees	7,500
To Postage & Stationary	5,000	By Membership Subscription	
To Telephone Charges	5,000	Received	2,00,000
To Rent	88,000	Less: Advance at the end	10,000
			1,90,000

Add: Due	4,000	92,000	By Sale proceeds of old papers	1,500
To Salaries	66,000		By Interest on Securities	8,000
Add: Due	3,000	69,000	Add: Due	500
To Depreciation:			By Hire of Lecture Hall	20,000
Electrical Fittings	15,000		By Deficit i.e., Excess of	
Furniture	5,000		Expenditure over Income	16,700
Books	46,000	66,000		
		2,44,200		2,44,200

Working Note:

CALCULATION OF INTEREST ON INVESTMENTS

@ 5% on ₹ 1,50,000 for one year	₹ 7,500
@ 5% on ₹ 40,000 for 6 months	₹ 1,000
Less: Received	₹ 8,500
Due	₹ 8,000
	₹ 500

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Fund:		Electrical Fittings	1,50,000
Opening Balance	7,93,000	Less: Depreciation	15,000
Add: Entrance Fees	22,500	Furniture	50,000
	8,15,500	Less: Depreciation	5,000
Less: Deficit	16,700	Books	4,00,000
	7,98,800	Additions	60,000
Expenses Due:			4,60,000
Rent	4,000	Less: Depreciation	46,000
Salaries	3,000	Investments	1,50,000
Subscription received in advance	10,000	Additions	40,000
		Accrued interest on Securities	500
		Cash at bank	20,000
		Cash on hand	11,300
	8,15,800		8,15,800

ILLUSTRATION 33

Prepare the Income & Expenditure Account and the Balance Sheet from the following information:

RECEIPTS AND PAYMENTS ACCOUNT OF TULSIAN CLUB, DELHI

Dr.

for the year ending on 31st March, 2018

Cr.

<i>Receipts</i>	₹	<i>Payments</i>	₹
To Balance b/f (cash)	1,025	By Upkeep of fields	220
To Subscriptions:		By Salaries	600

2016-2017	40		By Drama Expenses	450
2017-2018	2,050		By Newspapers	150
2018-2019	60	2,150	By Books	100
To Admission Fees		40	By Municipal Taxes	40
To Life Membership subscription		100	By Charity	350
To Donations (on 1.11.2017)		500	By 12% General Investments (on 1.11.2017)	500
To Subscription for Tournament (on 1.11.2017)		1,500	By 12% Tournament Fund Investments (on 1.11.2017)	1,500
To Sales of old newspapers		45	By Tournament Expenses	1,200
To Sale of old bats etc.		50	By Bats, Balls etc.	700
To Proceeds of drama tickets		950	By Printing & Stationery	100
To Sale of old furniture (costing ₹ 100)		60	By Furniture	250
To Interest on 12% General Investments		12.50	By Prizes	1,115
To Interest on 12% Tournament Fund Investments		37.50	By Balance c/f (Cash)	3,725
To Subscription for Governor's Party		3,450		
To Prize Fund		1,080		
		11,000		11,000

Additional Information:

- There are 500 members each paying an annual subscription of ₹ 5. ₹ 50 are still in arrear, for the year 2016-2017.
- Municipal taxes amounting to ₹ 40 per year have been paid upto June 30, 2018 and ₹ 50 are outstanding for salaries.
- On 1.4.2017 the club owned building valued at ₹ 5,000, Stock of Bats and Balls ₹ 1,500, Printing and Stationery ₹ 200, Cash at Bank ₹ 3,000, Books ₹ 500 and Furniture ₹ 600.
- Write 50% off Bats and Balls (without considering sale), 25% off printing and stationery.
- Special subscription for governor's party outstanding ₹ 550.
- Admission fees to be treated as of revenue nature but Life Membership is to be treated as of Capital nature.

SOLUTION**INCOME & EXPENDITURE ACCOUNT OF TULSIAN CLUB**

Dr.

for the year ending on 31st March, 2018

Cr.

Expenditure	₹	Income	₹
To Upkeep of fields	220	By Subscription (500 × ₹ 5)	2,500
To Salaries paid	600	By Admission Fees	40
Add: Outstanding at end	50	By Donations	500
To Drama Expenses	450	By Sale of old newspapers	45
To Newspapers	150	By Sale of old bats etc.	50
To Municipal Taxes Paid	40	By Proceeds of drama tickets	950

Add: Pre. in the beginning	10		By Interest on General Invest..		
Less: Prepaid at end	10	40	(500 × 12/100 × 5/12)		
To Charity		350	Received	₹ 12.5	
To Loss on sale of furniture		40	Accrued	₹ 12.5	25
To Printing & Stationery		75			
To Bats & balls consumed		1,100			
To Prize Exp. (1,115 – 1,080)		35			
To Surplus		1,000			
		4,110			4,110

BALANCE SHEET OF TULSIAN CLUB AS AT 31ST MARCH, 2018

<i>Liabilities</i>		₹	<i>Assets</i>		₹
Capital Fund:			Cash in hand		3,725
Opening Balance	11,925		Cash at bank		3,000
Add: Surplus	1,000		Outstanding Subscription:		
Add: Life Membership			for 2016-2017	50	
subscription	100	13,025	for 2017-2018	450	500
Tournament Fund:			Printing & Stationery:		
Opening Balance	Nil		Opening Balance	200	
Add: Subscription	1,500		Add: Purchases	100	
Add: Interest on				300	
Tournament Fund			Less: Charged	75	225
Invest. [1500 × 12% × 5/12]	75		Stock of Bats & Ball:		
Less: Tournament expenses	1,200	375	Opening Balance	1,500	
Subscription for Governor's			Add: Purchases	700	
Party Received	3,450			2,200	
Add: Outstanding	550	4,000	Less: Charged	1,100	1,100
Outstanding Salaries		50	Books:		
Advance Subscription		60	Opening Balance	500	
			Add: Additions	100	600
			12% Investments		2,000
			Furniture:		
			Opening Balance	600	
			Add: Additions	250	
			Less: Sale	100	750
			Building		5,000
			Accrued Interest:		
			on General Investments	12.5	
			on Tournament Fund		
			Investments	37.5	50
			Outstanding subscription for		
			Governor's Party		550
			Prepaid Municipal Taxes		10
		17,510			17,510

Working Note:**BALANCE SHEET OF TULSIAN CLUB AS AT 31ST MARCH, 2017**

Liabilities	₹	Assets	₹
Capital Fund (balancing figure)	11,925	Cash in hand	1,025
		Cash at bank	3,000
		O/s subscription (50 + 40)	90
		Printing & Stationery	200
		Stock of Bats & Balls	1,500
		Books	500
		Furniture	600
		Building	5,000
		Prepaid Municipal Taxes	10
	11,925		11,925

Notes:

1. Since yearly municipal charges are ₹ 40, ₹ 10 must have been paid during the previous year for current year.
2. Excess Prize Expenses have been charged to **Income & Expenditure** Account.

ILLUSTRATION 34

Following is the Trial Balance of the Tulsian Public School on 31st March 2018:

Debit Balances	₹	Credit Balances	₹
Land	50,000	Capital Fund	15,60,000
School Building	15,00,000	Tuition Fees Received	25,10,000
Furniture	3,00,000	Salaries Payable	1,75,000
Salaries:		Prize Fund	2,00,000
Teaching Staff	12,00,000	Tournament Fund	3,00,000
Adm. Staff	2,60,000	General Reserve Fund	2,00,000
Investments	7,00,000	Interest received on	
Stationery, Postage	1,73,000	Fund Investments	77,000
Lighting	36,000	Donation for School Hall	1,50,000
General Expenses	65,000		
Prizes awarded	20,000		
Tournament Expenses	30,000		
Library Books	3,75,000		
Bank Balance	4,63,000		
	51,72,000		51,72,000

Depreciation is to be provided as follows: Building 2%, Furniture 10% and Library Books 20%. The investments were made against the various funds commonly. Prepare the Income and Expenditure Account for 2017–2018 and the Balance Sheet as at March 31, 2018.

SOLUTION
INCOME AND EXPENDITURE ACCOUNT
Dr.
for the year ending on 31st March, 2018
Cr.

<i>Expenditure</i>		₹	<i>Income</i>	₹
To Salaries:			By Interest on Investments	22,000
Teaching Staff	12,00,000		[₹ 77,000 × ₹ 2,00,000/₹ 7,00,000]	
Adm. Staff	2,60,000	14,60,000	By Tuition Fees	25,10,000
To Stationery, Postage		1,73,000		
To Lighting		36,000		
To General Expenses		65,000		
To Depreciation:				
Buildings	30,000			
Furniture	30,000			
Library Books	75,000	1,35,000		
To Surplus		6,63,000		
		25,32,000		25,32,000

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>		₹	<i>Assets</i>	₹
Capital Fund:	15,60,000		Fixed Assets:	
Add: Surplus	6,63,000	22,23,000	Land	50,000
General Reserve Fund		2,00,000	School Building	15,00,000
Tournament Fund:			Less: Depreciation	30,000
Opening Balance	3,00,000		Furniture	3,00,000
Add: Interest on TFI	33,000		Less: Depreciation	30,000
[₹ 77,000 × ₹ 3,00,000/ ₹ 7,00,000]			Library Books	3,75,000
Less: Tournament Ext.	30,000	3,03,000	Less: Depreciation	75,000
Prize Fund:			Investments:	
Opening Balance	2,00,000		Tournament Fund	
Add: Interest on PFI	22,000		Investments	3,00,000
[₹ 77,000 × ₹ 2,00,000/ ₹ 7,00,000]			Prize Fund Investments	2,00,000
Less: Cost of Prize awarded	20,000	2,02,000	General Reserve Fund	
School Hall Fund		1,50,000	Investment	2,00,000
Current Liabilities:			Current Assets:	
Salaries Payable		1,75,000	Bank Balance	4,63,000
		32,53,000		32,53,000

ILLUSTRATION 35

The following is the Receipts and Payments Account of the Social Club in respect of the year ended 31st March, 2018:

<i>Receipts</i>	₹	<i>Payments</i>	₹
To Balance b/d	10,250	By Salaries	20,800
To Subscriptions:		By Stationery	4,000
2016-2017 450		By Rates	6,000
2017-2018 21,100		By Telephone	1,000
2018-2019 750	22,300	By Investment	12,500
To Profit on sports meet	15,500	By Sundry expenses	9,250
To Income from investments	10,000	By Balance c/d	4,500
	58,050		58,050

The following additional information is provided to you:

- (i) There are 450 members each paying an annual subscription of ₹ 50; ₹ 500 were in arrears for 2016-2017 as on 1st April, 2017.
- (ii) On 31st March, 2018, the rates were prepaid to 30th June, 2018; the charge paid every year being ₹ 6,000.
- (iii) There was an outstanding telephone bill for ₹ 350 on 31st March, 2018.
- (iv) Outstanding sundry expenses as on 31st March, 2017 totalled ₹ 700.
- (v) Stock of stationery on 31st March, 2017 was ₹ 500; on 31st March, 2018 it was ₹ 900.
- (vi) On 31st March, 2017, building stood in the books at ₹ 1,00,000 and it was subject to depreciation at 5% per annum.
- (vii) Investments on 31st March, 2017 stood at ₹ 2,00,000.
- (viii) On 31st March, 2018 **Income** accrued on investments purchased during the year amounted ₹ 375.

Required: Prepare an **Income** and **Expenditure** Account for the year ended 31st March, 2018 and the Balance Sheet as at that date.

SOLUTION

INCOME AND EXPENDITURE ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Salaries	20,800	By Subscriptions	22,500
To Stationery-Stock 500		By Profit on sports meet	15,500
Add: Purchases 4,000	4,500	By Income on investments 10,000	
Less: Closing stock 900	3,600	Add: Income accrued 375	10,375
To Rates 6,000			
Less: Prepaid at the end 1,500	4,500		
Add: Prepaid in the beg. 1,500	6,000		
To Telephone 1,000			
Add: Outstanding at the end 350	1,350		
To Sundry Expenses 9,250			
Less: Outstanding in the beg. 700	8,550		
To Depreciation on Building 5,000			
To Surplus 3,075			
	48,375		48,375

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Fund 3,12,050		Outstanding Subscriptions	1,450
Add: Surplus 3,075	3,15,125	Investments (2,00,000 + 12,500)	2,12,500
Advance Subscription in	750	Building 1,00,000	
Outstanding telephone bill	350	Less: Depreciation 5,000	95,000
		Prepaid rates	1,500
		Stock of stationery	900
		Cash	4,500
		Income on investments accrued	375
	3,16,225		3,16,225

Working Notes:
Dr.
(I) SUBSCRIPTION ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Outstanding Subscription A/c Beg.	500	By Cash A/c	22,300
To Income and Expenditure A/c (₹ 50 × 450)	22,500	By Outstanding Subscription A/c End. (balancing figure)	1,450
To Advance Subscription A/c	750		
	23,750		23,750

(II) BALANCE SHEET AS AT 31ST MARCH, 2017

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Outstanding sundry expenses	700	Building	1,00,000
Capital Fund (Balancing figure)	3,12,050	Investments	2,00,000
		Stock of stationery	500
		Cash	10,250
		Prepaid rates	1,500
		Outstanding Subscriptions	500
	3,12,750		3,12,750

ILLUSTRATION 36

From the following Receipts and Payments Account of Excellent Recreation Club for the year ended 31.3.2018 and additional information given, prepare an Income and Expenditure Account for the year ended 31.3.2018 and Balance Sheet as on 31.3.2018:

<i>Receipts</i>	₹	<i>Payments</i>	₹
Opening Balance:		Secretary's Salary	12,000
Cash in hand and at bank	3,180	Salaries to Staff	25,000
Subscription	18,000	Charities	1,000
Sale of Old Newspapers	2,500	Printing and Stationery	600
Legacies	4,000	Postage Expenses	120
Interest on Investments	2,000	Rates and Taxes	1,500

Endowment Fund Receipts	20,000	Upkeep of the Land	2,000
Proceeds of Sport and Concerts	4,020	Purchase of Sports Materials	10,000
Advertisement in the Year Book	5,000	Telephone Expenses	3,480
		Closing Balance:	
		Cash in hand and at bank	3,000
	58,700		58,700

Assets and Liabilities were as follows:

<i>Particulars</i>	<i>Opening ₹</i>	<i>Closing ₹</i>
Subscription in arrears	2,000	1,000
Subscription received in advance	500	400
Furniture	2,000	1,800
Land	10,000	10,000

Depreciation shall be charged at 10% p.a. under the diminishing value method. Legacies received shall be capitalised. Investments were made in Securities, the rate of interest being 12% p.a., the date of investment was 1.6.2016 and the amount of investments was ₹ 20,000. Due date of interest 31st March every year. Stock of sports materials on 31.3.2018 were useless and valued at NIL price

SOLUTION

INCOME AND EXPENDITURE ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

<i>Expenditure</i>	<i>₹</i>	<i>Income</i>	<i>₹</i>
To Secretary's salary	12,000	By Subscription	17,100
To Salaries to staff	25,000	By Sale of old newspapers	2,500
To Charities	1,000	By Interest on securities	2,000
To Printing and stationary	600	Add: Amount due	400
To Postage expenses	120	By Proceeds of sport and concerts	4,020
To Rates & Taxes	1,500	By Advertisement in the Year Book	5,000
To Upkeep of Land	2,000	By Deficit, Excess of	
To Sports materials written off	10,000	Expenditure over Income	24,880
To Telephone expenses	3,480		
To Depreciation on furniture	200		
	55,900		55,900

BALANCE SHEET OF EXCELLENT RECREATION CLUB AS AT 31ST MARCH, 2018

<i>Liabilities</i>	<i>₹</i>	<i>₹</i>	<i>Assets</i>	<i>₹</i>	<i>₹</i>
Capital Fund:			Land		10,000
Opening balance	36,680		Furniture	2,000	
Less: Deficit.	24,880		Less: Depreciation	200	1,800
Add: Legacies	4,000	15,800	Sports Materials	10,000	
Endowment Fund		20,000	Less: Written off	10,000	—
Advance Subscription		400	Investment in Securities		20,000

		Outstanding Subscriptions	1,000
		Interest Due	400
		Cash in hand and at Bank	3,000
	36,200		36,200

Working Notes:
(I) BALANCE SHEET OF EXCELLENT RECREATION CLUB AS AT 31ST MARCH, 2017

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital (<i>Balancing Figure</i>)	36,680	Land	10,000
Advance Subscription	500	Furniture	2,000
		Investments in Securities	20,000
		Outstanding Subscription	2,000
		Cash in hand and at Bank	3,180
	37,180		37,180

Dr.
(II) SUBSCRIPTION ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Outstanding Subscription A/c	2,000	By Advance Subscription A/c	500
To Income & Expenditure A/c (b/f)	17,100	By Bank A/c	18,000
To Advance Subscription A/c	400	By Outstanding Subscription A/c	1,000
	19,500		19,500

ILLUSTRATION 37

The Accountant of Diana Club furnishes you the following Receipts and Payments account for the year ending 31st March, 2018:

<i>Receipts</i>	₹	<i>Payments</i>	₹
Opening Balance:		Honoraria to Secretary	9,600
Cash and Bank	16,760	Misc. Expenses	3,060
Subscriptions	21,420	Rates and Taxes	2,520
Sale of Old Newspapers	4,800	Groundman's Wages	1,680
Entertainment Fees	8,540	Printing and Stationery	940
Bank Interest	460	Telephone Expenses	4,780
Bar Receipts	14,900	Payment for Bar Purchases	11,540
		Repairs	640
		New car (Less-sale Proceeds of Old Car ₹ 6,000)	25,200
		Closing Balance:	
		Cash and Bank	6,920
	66,880		66,880

Additional Informations:

Particulars	Opening ₹	Closing ₹
(i) Subscription due (not received)	2,400	1,960
(ii) Cheques issued, but not presented for payment of printing	180	60
(iii) Club premises at cost	58,000	—
(iv) Depreciation on club premises provided so far	37,600	—
(v) Car at cost	24,380	—
(vi) Depreciation on car	20,580	—
(vii) Value of Bar stock	1,420	1,740
(viii) Amount unpaid for bar purchases	1,180	860

- (ix) Depreciation is to be provided @ 5% p.a. on the written down value of the club premises and @ 15% p.a. on car for the whole year.

Required: Prepare an Income and Expenditure account of Diana Club for the year ending 31st March, 2018 and Balance Sheet as on that date.

SOLUTION**INCOME AND EXPENDITURE ACCOUNT***Dr.**for the year ended 31st March, 2018**Cr.*

Expenditure	₹	Income	₹
To Honoraria to Secretary	9,600	By Subscriptions	20,980
To Misc. Expenses	3,060	By Sale of Old Newspapers	4,800
To Rates and Taxes	2,520	By Entertainment Fees	8,540
To Groundman's Wages	1,680	By Bank Interest	460
To Printing and Stationary	940	By Bar Receipts	14,900
To Telephone Expenses	4,780	By Profit on Sale of Car	2,200
To Bar Expenses Opening Bar Stock	1,420		
<i>Add: Purchases</i>	11,220		
<i>Less: Closing Bar Stock</i>	1,740		
	10,900		
To Repairs	640		
To Depreciation:			
Club Premises	1,020		
Car	4,680		
	5,700		
To Surplus t/f to Capital Fund	12,060		
	51,880		51,880

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital Fund		Club Premises	19,380
Opening Balance	43,600	Car	26,520
<i>Add: Excess of Income</i>		Bar Stock	1,740
<i>over Expenditure</i>	12,060	Outstanding Subscription	1,960
Outstanding Liabilities for		Cash and Bank	6,920
Bar Purchases	860		
	56,520		56,520

Working Note:

(I) BALANCE SHEET OF DIANA CLUB
as at 31st March, 2017

Liabilities	₹	Assets	₹
Amount Due for Bar Purchases	1,180	Club Premises	58,000
Capital Fund on 1.10.2002	43,600	Less: Depreciation	37,600
(Balancing Figure)		Car	24,380
		Less: Depreciation	20,580
		Bar Stock	1,420
		Outstanding Subscription	2,400
		Cash and Bank	16,760
	44,780		44,780

(II) CALCULATION OF BAR PURCHASES FOR THE YEAR

Particulars	₹
A. Bar payments as per receipts and payments account	11,540
B. Add: Amount due at the end	860
C. Less: Amount due in the beginning	(1,180)
	11,220

(III) CALCULATION OF SUBSCRIPTIONS ACCRUED DURING THE YEAR

Particulars	₹
A. Subscriptions received	21,420
B. Add: Outstanding at the end	1,960
C. Less: Outstanding at the beginning	(2,400)
	20,980

(IV) DEPRECIATION ON CLUB PREMISES AND W.D.V

Particulars	₹
A. Written down value on 1st April (58,000 – 37,600)	20,400
B. Less: Depreciation for the year @ 5% p.a.	(1,020)
	19,380

(V) CALCULATION OF PROFIT ON SALE OF CAR

Particulars	₹
A. Sale Proceeds of old car	6,000
B. Less: Written down value of old car:	
Cost of car	24,380
Less: Depreciation	20,580
	2,200

(VI) DEPRECIATION ON CAR AND WRITTEN DOWN VALUE

Particulars	₹
A. Cost of new car purchased (25,200 + 6,000)	31,200
B. Less: Depreciation for the year @ 15% p.a.	4,680
C. Written down value	26,520

Note: The opening and closing balance of cash and bank shown in the Receipts and Payments Account (given in the question), include the bank balance as per cash book. Therefore, no adjustment has been made in the above solution on account of cheques issued, but not presented for payment of printing.

19.0 PRACTICAL STEPS INVOLVED IN THE PREPARATION OF A RECEIPTS AND PAYMENTS ACCOUNT FROM AN INCOME AND EXPENDITURE ACCOUNT

The practical steps involved in the preparation of a Receipts & Payments Account from an Income & Expenditure Account are given below:

Step 1: Ascertain the opening Cash and Bank balances (or Bank Overdraft) from the additional information or from the opening Balances Sheet (if available) and show the Cash and Bank Balance on the debit side and Bank Overdraft on the credit side of Receipts & Payments account.		
Step 2: Ascertain 'Revenue Receipts' (e.g. Subscription) received during the current accounting period as under and show on the debit side of Receipts & Payments Account:		
Particulars		₹
A. Revenue Income for the current year		xxx
B. Add: (a) Outstanding Income in the beginning of current year	xxx	
(b) Advance Income at the end of current year	xxx	xxx
C. Less: (a) Outstanding Income at the end of current year	xxx	
(b) Advance Income in the beginning of current year	xxx	xxx
D. Revenue Receipts during the current year (A + B – C)		xxx
Step 3: Ascertain revenue Payments' (e.g. rent) made during the current accounting period as under and show on the credit side of Receipts & Payments Account.		
Particulars		₹
A. Revenue Expenses for the current year		xxx
B. Add: (a) Outstanding expenses in the beginning of current year	xxx	
(b) Prepaid expenses at the end of current year	xxx	
C. Less: (a) Outstanding expenses at the end of current year	xxx	
(b) Prepaid expenses in the beginning of current year	xxx	xxx
D. Revenue payments during the current year (A + B – C)		xxx
Step 4: Ascertain all capital receipts (e.g. Life Membership Fees/Entrance Fees) and capital payments (e.g. purchase of fixed Assets) from the additional information or Balance Sheets (if available) or by preparing the Accounts of Capital Items such as fixed Assets, special funds and show the capital receipts on the debit side and the capital payments on the credit side of the Receipts & Payments account.		
Step 5: Calculate the difference between the total of debit side and the total of credit side. If the total of debit side exceeds the total of credit side, show the Cash balance (if the Bank Balance is given) or the Bank Balance (if the Cash Balance is given) on the credit side of the Receipts & Payments Account. If the total of credit side exceeds the total of debit side, show the Bank Overdraft on the debit side of Receipts & Payments Account.		

Tutorial Note: The following items appearing in the Income & Expenditure Account are not shown in the Receipts & Payments Account:

(a) Non-Cash items (e.g. Depreciation, Loss on sale of a fixed asset) (b) Outstanding or Prepaid Expenses (c) Accrued or Unaccrued Incomes (d) Surplus or Deficit.

ILLUSTRATION 38 [SUBSCRIPTION RECEIVED]

- Income** from Subscription for the year 2017-2018 ₹ 60,000. Compute the Subscription received during the year 2017-2018.
- Income** from Subscription for the year 2017-2018 ₹ 90,000. Subscription ₹ 30,000 is still outstanding. Compute the Subscription received during the year 2017-2018.
- Income** from Subscription for the year 2017-2018 ₹ 40,000. Subscription ₹ 20,000 received in advance for the year 2017-2018. Compute the Subscription received during the year 2017-2018.
- Income** from Subscription for the year 2017-2018 ₹ 20,000. Subscription ₹ 40,000 was outstanding at the end of the previous year. Compute the Subscription received during the year 2017-2018.
- Income** from Subscription for the year 2017-2018 ₹ 1,50,000. Subscription ₹ 90,000 was received in advance at the end of the previous year. Compute the Subscription received during the year 2017-2018

SOLUTION

COMPUTATION OF SUBSCRIPTION RECEIVED

Particulars	(a)	(b)	(c)	(d)	(e)
Subscription Income	60,000	90,000	40,000	20,000	1,50,000
Less: O/s at the end	—	(30,000)	—	—	—
Add: Advance at the end	—	—	20,000	—	—
Less: Advance in the beg.	—	—	—	—	(90,000)
Add: O/s in the beg.	—	—	—	40,000	—
Subscription Received	60,000	60,000	60,000	60,000	60,000

ILLUSTRATION 39

Compute the Subscription received during the year 2017-2018 from the following **Particulars** relating to a club:

Particulars	1.4.2017	31.3.2018
Outstanding Subscription	₹ 9,500	₹ 7,000
Advance Subscription	₹ 2,800	₹ 5,200

Subscription Income for the year 2017-2018, ₹ 1,44,000, Subscriptions of ₹ 1,000 are still in arrears for the year 2017-2018.

SOLUTION**(a) In Statement Form:****COMPUTATION OF SUBSCRIPTION RECEIVED**

<i>Particulars</i>	₹	₹
A. Subscription Income for the year		1,44,000
B. Less: (a) Outstanding Subscription at the end	7,000	
(b) Advance Subscription at the beginning	2,800	(9,800)
C. Add: (a) Outstanding Subscription at the beginning	9,500	
(b) Advance Subscription at the end	5,200	14,700
D. Subscription received (A + B – C)		1,48,900

(b) In Account Form:

Dr.

SUBSCRIPTION ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Outstanding Subscription A/c (in the beginning)	9,500	By Advance Subscription A/c (in the beginning)	2,800
To Income & Expenditure A/c	1,44,000	By Bank A/c (balancing figure)	1,48,900
To Advance Subscription A/c	5,200	By Outstanding Subscription A/c (at the end)	7,000
	1,58,700		1,58,700

(c) In Equation Form:

$$SR = S_1 - OS_2 - AS_1 + OS_1 + AS_2$$

$$= ₹ 1,44,000 - ₹ 7,000 - ₹ 2,800 + ₹ 9,500 + ₹ 5,200 = ₹ 1,48,900$$

Where, S_1 = Subscription **Income**, SR = Subscription Received,

OS_2 = Outstanding Subscription at the end,

AS_1 = Advance Subscription in the beginning,

OS_1 = Outstanding Subscription in the beginning,

AS_2 = Advance Subscription at the end.

ILLUSTRATION 40

- Salaries for the year 2017-2018 ₹ 60,000. Compute Salaries paid during the year 2017-2018.
- Salaries for the year 2017-2018 ₹ 90,000. Salaries ₹ 30,000 is still outstanding. Compute Salaries paid during the year 2017-2018.
- Salaries for the year 2017-2018 ₹ 40,000. Salaries ₹ 20,000 paid in advance for the year 2017-2018. Compute Salaries paid during the year 2017-2018.
- Salaries for the year 2017-2018 ₹ 20,000. Salaries ₹ 40,000 was outstanding at the end of the previous year. Compute Salaries paid during the year 2017-2018.
- Salaries for the year 2017-2018 ₹ 1,50,000. Salaries ₹ 90,000 was paid in advance at the end of the previous year. Compute Salaries paid during the year 2017-2018.

SOLUTION
COMPUTATION OF SALARIES PAID DURING THE CURRENT YEAR

<i>Particulars</i>	(a)	(b)	(c)	(d)	(e)
Salaries for the year	60,000	90,000	40,000	20,000	1,50,000
Less: O/s at the end	—	(30,000)	—	—	—
Add: Advance at the end	—	—	20,000	—	—
Less: Advance in the beg.	—	—	—	—	(90,000)
Add: O/s in the beg.	—	—	—	40,000	—
Salaries Paid	60,000	60,000	60,000	60,000	60,000

ILLUSTRATION 41

Compute the Salaries paid during the year 2017-2018 from the following information:

<i>Particulars</i>	1.4.2017	31.3.2018
Outstanding Salaries	₹ 9,500	₹ 7,000
Prepaid Salaries	₹ 2,800	₹ 5,200
Salaries for the year 2017-2018 ₹ 1,44,000		

SOLUTION

Dr.

SALARIES ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Prepaid Salaries A/c (in the beginning)	2,800	By Outstanding Salaries A/c (in the beginning)	9,500
To Bank A/c (balancing figure)	1,48,900	By Income & Expenditure A/c	1,44,000
To Outstanding Salaries A/c (at the end)	7,000	By Prepaid Salaries A/c (at the end)	5,200
	1,58,700		1,58,700

ILLUSTRATION 42

From the following Income & Expenditure Account, prepare the Receipts & Payments Account for the year 2017-2018:

Dr.

INCOME & EXPENDITURE ACCOUNT

Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Loss on Sale of Sports Material [Book value ₹ 500]	300	By Subscription: Received	10,000
To Rent:		Add: O/s at the end	4,000
Paid	6,000	Add: Advance in the beg.	3,000
Add: O/s at the end	1,500	Less: O/s in the beg.	6,000
Less: O/s in the beg.	3,000	Less: Advance at the end	2,000
To Insurance Premium:		By Entrance Fees	6,000
	4,500		9,000

Paid	6,000		(40% capitalised)	
Add: Prepaid in the beginning	1,500		By Life Membership Fees	
Less: Prepaid at the end	3,000	4,500	(60% capitalised)	4,000
To Sports Materials	4,000		By General Donations	10,000
Add: Opening Stock	2,000		By Locker Rent:	
Less: Closing Stock	1,000	5,000	Received	4,000
To Newspapers & Periodicals		1,200	Add: Outstanding at the end	3,000
To Dep. @ 10% on old Building		3,000	Less: Advance at the end	1,000
To Depreciation @ 10% on New Furniture			By Interest on 12%	
(Purchased on 1.4.2017)		1,000	General Fund Investments:	
To Salaries		4,500	Received	10,000
To Surplus		30,000	Add: Accrued	2,000
			By Sale of Newspapers	100
			By Income from Charity Show:	
			Charity Show Proceeds	10,900
			Less: Show Expenses	4,000
				6,900
		54,000		54,000

Note: Cash Balance as on 1.4.2017 and on 31.3.2018 ₹ 500 and ₹ 32,000 respectively. Bank Balance as on 1.4.2017 ₹ 1,000.

SOLUTION

RECEIPTS & PAYMENTS ACCOUNT

Dr.

for the year ending 31st March, 2018

Cr.

Receipts	₹	Payments	₹
To Balance b/d		By Rent	6,000
Cash	500	By Insurance Premium	6,000
Bank	1,000	By Sports Materials Purchased	4,000
To Subscription	10,000	By Newspapers & Periodicals	1,200
To Entrance Fees [₹ 6,000/.60]	10,000	By Furniture [₹ 1,000/.10]	10,000
To Life Materialship Fees [₹ 4,000/.40]	10,000	By Salaries	4,500
To General Donations	10,000	By Charity Show Expenses	4,000
To Locker Rent	4,000	By Balance c/d:	
To Interest on 10% General Fund Investment	10,000	Cash	32,000
To Sale of Newspapers	100		
To Proceeds of Charity Show	10,900		
To Sale of Sports Materials [₹ 500 – ₹ 300]	200		
To Balance c/d:			
[Bank overdraft] (Balancing Figure)	1,000		
	67,700		67,700

ILLUSTRATION 43

Jalan Cricket Club provides you the following formation:

INCOME & EXPENDITURE ACCOUNT

for the year ended 31st March, 2018

Dr.

Cr.

Expenditure	₹	Income	₹
To Remuneration to coach	18,000	By Donation and Subscription	1,00,000
To Salaries and Wages	24,000	By Bar Room:	
To Rent	23,000	Receipts	24,000
To Miscellaneous expenses	7,000	Less: Expenses	20,000
To Honorarium to Secretary	18,000	By Bank Interest	2,000
To Depreciation on Equipment	5,000	By Hire-Club-Hall	14,000
To Surplus	25,000		
	1,20,000		1,20,000

BALANCE SHEETS

Particulars	31.3.2017	31.3.2018
	₹	₹
Capital Fund	48,000	48,000
Add: Entrance Fees		10,000
Add: Surplus		25,000
Subscription in advance	4,000	3,000
Miscellaneous expenses	5,500	5,000
Salaries & Wages	—	1,000
Honorarium to Secretary	1,000	—
Equipment	25,000	20,000
Outstanding subscription	6,000	6,000
Cash in hand	4,000	2,000
Cash at bank	2,500	10,000
Fixed Deposit	20,000	50,000
Accrued Hire charges of Club Hall	—	2,000
Prepaid Rent	1,000	2,000

Required: Prepare the Receipts & Payments Account of the Club for the year ended March 31, 2018

SOLUTION
RECEIPTS & PAYMENTS ACCOUNT OF JALAN CRICKET CLUB

for the year ending on 31st March, 2018

Dr.

Cr.

Receipts	₹	Payments	₹
To Balance b/d:		By remuneration to Cash	18,000
Cash in hand	4,000	By Rent	24,000
Cash at bank	2,500	By Miscellaneous Expenses	7,500
To Donations & Subscriptions	99,000	By Salaries & wages	23,000
To Entrance Fees	10,000	By Honorarium to Secretary	19,000

To Bar Receipts	24,000	By Fixed deposits	30,000
To Bank Interest	2,000	By Bar expenses	20,000
To Hire of Club Hall	12,000	By balance c/d	
		Cash in hand	2,000
		Cash at bank	10,000
	1,53,500		1,53,500

Working Notes:

Dr. **(I) DONATIONS AND SUBSCRIPTIONS ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	6,000	By Balance b/d	4,000
To Income & Expenditure A/c	1,00,000	By Bank A/c (balancing figure)	99,000
To Balance c/d	3,000	By Balance c/d	6,000
	1,09,000		1,09,000

Dr. **(II) MISCELLANEOUS EXPENSES ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Bank A/c (balancing figure)	7,500	By balance b/d	5,500
To Balance c/d	5,000	By Income & Expenditure a/c	7,000
	12,500		12,500

Dr. **(III) SALARIES AND WAGES ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Bank A/c (balancing figure)	23,000	By Income & Expenditure A/c	24,000
To Balance c/d	1,000		
	24,000		24,000

Dr. **(IV) HONORARIUM TO SECRETARY ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Bank A/c (balancing figure)	19,000	By Balance b/d	1,000
		By Income & Expenditure A/c	18,000
	19,000		19,000

Dr. **(V) RENT ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	1,000	By Income & Expenditure A/c	23,000
To Bank A/c (balancing figure)	24,000	By Balance c/d	2,000
	25,000		25,000

Dr. **(VI) CLUB HALL HIRE CHARGES ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Income & Expenditure A/c	14,000	By Bank A/c (balancing figure)	12,000
		By Balance c/d	2,000
	14,000		14,000

ILLUSTRATION 44

The Lok Kalyan Dispensary had the following:

INCOME AND EXPENDITURE ACCOUNT
for the year ending on 31st March, 2018

<i>Expenditure</i>	₹	<i>Income</i>	₹
Salaries	23,500	Subscriptions	25,000
Surgery & Dispensary	3,000	Interest	9,000
Rent and Taxes	500	Donations	4,000
Insurance	200	Miscellaneous Receipts	300
Office expenses	800		
Depreciation:			
Building 3,750			
Furniture 120			
Instruments 100	3,970		
Surplus	6,330		
	38,300		38,300

Information:

<i>Particulars</i>	31.03.2017	31.03.2018
Cash in hand and at bank	?	18,700
4.5% Tax free Government securities (Face value ₹ 2,00,000)	1,80,000	1,80,000
Subscription outstanding	7,000	10,000
Subscription received in advance	200	600
Salaries unpaid	1,000	1,500
Furniture	2,000	1,980
Land & Buildings	1,00,000	96,250
Instruments	3,500	3,900
Surgery expenses due	200	300
Stock of medicines	300	100

Prepare Receipts and Payments Account for 2017-2018 and also the Balance Sheet.

SOLUTION

RECEIPTS AND PAYMENTS ACCOUNT
for the year ending on 31st March, 2018

Dr.

Cr.

<i>Receipts</i>	₹	<i>Payments</i>	₹
To Balance b/d		By Salaries	23,000
Cash in hand and at bank		By Surgery and Dispensary:	2,700
(balancing figure)	10,800	By Rent & taxes	500
To Subscriptions:	22,400	By Insurance	200
To Interest	9,000	By Office expenses	800
To Donation	4,000	By Instruments bought	500
To Miscellaneous receipts	300	By Furniture bought	100
		Cash in hand and at bank	18,700
	46,500		46,500

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Fund:		Land and Building	1,00,000
Opening Balance	3,02,200	Less: Depreciation	3,750
Add: Surplus	6,330	Instruments	3,900
Subscriptions received in advance	600	Furniture	1,980
Salaries outstanding	1,500	Govt. Securities	1,80,000
Surgery expenses due	300	Stock of medicines	100
		Subscriptions outstanding	10,000
		Cash in hand and at bank	18,700
	3,10,930		3,10,930

Working Notes**(I) BALANCE SHEET AS AT 31ST MARCH, 2017**

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Subscriptions received in advance	200	Cash in hand and at bank	10,800
Salaries unpaid	1,000	Govt. Securities	1,80,000
Surgery expenses due	200	Subscriptions outstanding	7,000
Capital Fund (balancing figure)	3,02,200	Furniture	2,000
		Land and Buildings	1,00,000
		Instruments	3,500
		Stock of medicines	300
	3,03,600		3,03,600

Dr.

(II) SUBSCRIPTION ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d (O/s in the beg.)	7,000	By Balance b/d	
To Income and Expenditure A/c	25,000	(O/s Advance in the beg.)	200
To Balance c/d (Advance at the end)	600	By Bank A/c (b.f.)	22,400
		By Balance c/d (O/s at the end)	10,000
	32,600		32,600

Dr.

(III) SALARIES ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (b.f.)	23,000	By Salaries Outstanding A/c (beg.)	1,000
To Salaries outstanding A/c (end)	1,500	By Income and Expenditure A/c	23,500
	24,500		24,500

Dr.

(IV) STOCK OF MEDICINES ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	300	By Income & Expenditure A/c	3,000
To Creditors for medicine etc. (Purchases)	2,800	By Balance c/d	100
	3,100		3,100

Dr.

(V) CREDITORS FOR MEDICINES ETC. ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (b.f)	2,700	By Balance b/d	200
To Balance c/d	300	By Stock of Medicine A/c (Cr. Purchases)	2,800
	3,000		3,000

Dr.

(VI) INSTRUMENTS ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	3,500	By Depreciation A/c	100
To Bank A/c (Purchases) (b.f.)	500	By Balance c/d	3,900
	4,000		4,000

Dr.

(VII) FURNITURE ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	2,000	By Depreciation A/c	120
To Bank A/c (b.f.)	100	By Balance c/d	1,980
	2,100		2,100

ILLUSTRATION 45

Following is the Income and Expenditure Account of Victoria Club for the year ending 31st March, 2018:

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Salaries & Wages	19,000	By Subscription	30,000
To Misc. Expenses (including Insurance)	2,000	By Entrance Fees received	1,000
To Audit fees	1,000	By Annual Sports Income	
To Chief Executives' Honorarium	4,000	Receipts	6,000
To Printing & Stationery	1,800	Less: Expenses	3,000
To Annual day Celebration Exp.	6,000		
Less: Donation	4,000		
To Interest on Bank loan	600		
To Dep. on Sports Equipment	1,200		
To Excess of Income over Expen.	2,400		
	34,000		34,000

Additional Information:

<i>Particulars</i>	<i>Opening</i> ₹	<i>Closing</i> ₹
(i) Subscription outstanding	2,400	3,000
(ii) Subscription received in advance	1,800	1,080
(iii) Salaries outstanding	1,600	1,800

(iv) Sports equipment (after deducting depreciation)	10,400	10,800
(v) Prepaid Insurance	—	240
(vi) Cash in Hand	?	6,400

(vi) The Club owned a Sports' ground of ₹ 40,000

(vii) The Club took a loan of ₹ 8,000 from a bank during the year 2016-17, which was not paid in 2017-18.

(viii) Audit fee of 2017-18 was outstanding, but Audit fees of ₹ 800 for 2016-2017 was paid in 2017-18.
Prepare Receipts and Payments Account for the year ending 31st March, 2018 and a Balance Sheet on that date.

SOLUTION

VICTORIA CLUB
RECEIPT AND PAYMENT ACCOUNT
for the year ended 31st March, 2018

Dr.

Cr.

Receipts	₹	Payments	₹
To Balance b/d	5,560	By Salaries & wages	
To Donation for Annual Day	4,000	for current year	19,000
To Subscription		+ O/s into beg.	1,600
for current year	30,000	– O/s at the end	1,800
+ O/s in the beg.	2,400	By Misc. expenses	
– O/s at the end	3,000	for current year	2,000
+ Advance at the end	1,080	+ Prepaid at the end	240
– Advance in the beg.	1,800	By Audit fees for current year	1,000
To Entrance fees	1,000	+ O/s in the beg.	800
To Annual sports receipts	6,000	– O/s at the end	1,000
		By Chief Executive's Honorarium	4,000
		By Printing & Stationery	1,800
		By Annual Day Expenses	6,000
		By Interest on Bank Loan	600
		By Annual Sport Expenses	3,000
		By Sports Equipment	1,600
		By Balance c/d	6,400
	45,240		45,240

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital fund:		Sports Ground	40,000
Opening Balance	46,160	Sports equipment	
Add: Surplus	2,400	Opening balance	10,400
Loan from Bank	8,000	Add: Addition	1,600
Subscription received in advance	1,080	Less: Depreciation	1,200
Salaries outstanding	1,800	Subscription Outstanding	3,000
Audit fees outstanding	1,000	Prepaid Insurance	240
		Cash	6,400
	60,440		60,440

Working Notes:
Dr.
(I) SPORTS EQUIPMENT ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	10,400	By Depreciation A/c	1,200
To Cash A/c (b/f)	1,600	By Balance b/d	10,800
	12,000		12,000

(II) OPENING BALANCE SHEET AS AT 31.3.2017

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Loan from Bank	8,000	Sports ground	40,000
Subscription received in advance	1,800	Sports equipment	10,400
Salaries outstanding	1,600	Subscription outstanding	2,400
Audit fees o/s	800	Cash	5,560
Capital fund (b/f)	46,160		
	58,360		58,360

ILLUSTRATION 46

The Income and Expenditure Account of City Sports Club for the year ended 31st March, 2018 was as follows:

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Salaries	1,20,000	By Subscriptions	1,60,000
To Printing and Stationery	6,000	By Entrance Fees	10,000
To Rent	12,000	By Contribution for Annual dinner	20,000
To Repairs	10,000	By Profit on Annual Sports meet	20,000
To Sundry Expenses	8,000		
To Annual Dinner Expenses	30,000		
To Interest to Bank	6,000		
To Depreciation of Sports equipment	6,000		
To Surplurs	12,000		
	2,10,000		2,10,000

The above account had been prepared after the following adjustments:

<i>Particulars</i>	₹
Subscriptions outstanding in the beg.	12,000
Subscriptions received in advance in the beg.	9,000
Subscriptions received in advance at the end.	5,400
Subscriptions outstanding at the end.	15,000

Salaries outstanding at the beginning and at the end of the financial year were ₹ 8,000 and ₹ 10,000 respectively. Sundry expenses included prepaid insurance expenses of ₹ 1,200.

The Club owned a freehold ground valued ₹ 2,00,000. The Club has sports equipment on 01.04.2008 valued at ₹ 52,000. At the end of the year, after depreciation, the sports equipment amounted to ₹ 54,000. The Club raised a loan of ₹ 40,000 from a bank on 01.01.2017, which was unpaid till 31.03.2018. On 31.03.2018, cash in hand was ₹ 32,000.

Required: Prepare Receipts and Payments account of the Club for the year ended 31st March, 2018 and Balance Sheet as on that date.

SOLUTION

Dr. **RECEIPT AND PAYMENTS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** *Cr.*

<i>Receipts</i>	(₹)	<i>Payments</i>	(₹)
To Balance b/d (Bal. Fig.)	27,800	By Salaries:	
To Subscription:		for 2016-2017	8,000
for 2016-2017	12,000	for 2017-2018	1,10,000
for 2017-2018	1,36,000	By Printing & Stationery	6,000
for 2018-2019	5,400	By Rend	12,000
To Entrance Fees	10,000	By Repairs	10,000
To Contribution for Annual Dinner	20,000	By Sundry Expenses (8,000 + 1,200)	9,200
To Profit on Annual Sports Meet	20,000*	By Annual Dinner Expenses	30,000
		By Interest to Bank	6,000
		By Sports Equipment	8,000
		By Balance c/d	32,000
	2,31,200		2,31,200

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	(₹)	(₹)	<i>Assets</i>	(₹)	(₹)
Capital Fund	2,34,800		Freehold Ground		2,00,000
Add: Surplus	12,000	2,46,800	Sports Equipment	52,000	
Bank Loan		40,000	Add: Additions	8,000	
Outstanding Salaries		10,000		60,000	
Subscription in Advance		5,400	Less: Depreciation	(6,000)	54,000
			Subscription in Arrear		15,000
			Prepaid Insurance		1,200
			Cash in Hand		32,000
		3,02,200			3,02,200

Working Notes:

(I) BALANCE SHEET AS AT 31ST MARCH, 2017

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Fund (Bal. Fig.)	2,34,800	Freehold Ground	2,00,000
Bank Loan	40,000	Sports Equipment	52,000
Outstanding Salaries	8,000	Subscription in Arrear	12,000
Subscription in Advance	9,000	Cash in hand	27,800
	2,91,800		2,91,800

Dr.

(II) SPORTS EQUIPMENT ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	52,000	By Depreciation A/c	6,000
To Bank A/c	8,000	By Balance c/d	54,000
	60,000		60,000

Dr.

(III) SUBSCRIPTION ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Income & Exp. A/c	1,60,000	By Advance Subscription A/c	9,000
		By Bank A/c	1,36,000
		By O/s Subscription A/c	15,000
	1,60,000		1,60,000

20.0 PRACTICAL STEPS INVOLVED IN THE PREPARATION OF A BALANCE SHEET FROM RECEIPTS AND PAYMENTS ACCOUNT AND INCOME AND EXPENDITURE ACCOUNT

The practical steps involved in the preparation of a Balance sheet are shown below:

Step 1: Open only one account for each of the various items given in Receipts & Payments Account, Income & Expenditure Account and additional information avoiding duplication (i.e. no account should be opened twice).	
Step 2: Post the following items in various ledger accounts as under:	
(a) Receipts shown on the debit side of Receipts & Payments Account	Show on the credit side of respective account
(b) Payments shown on the credit side of Receipts & Payments Account	Show on the debit side of respective account
(c) Revenue Expenses and losses shown on the debit side of Income	Show on the credit side of respective account
(d) Revenue Incomes shown on the credit side of Income & Expenditure Account account	Show on the debit side of respective account
Step 3: Calculate the difference between the total of debit side and the total of credit side of each account. Show the difference as Opening Balance (if the credit side exceeds the debit side) or as Closing Balance (if the debit side exceeds the credit side).	
Step 4: Prepare Opening Balance Sheet on the basis of opening Balances (including opening cash and Bank Balances) and Closing Balance Sheet on the basis of Closing Balances (including Closing Cash and Bank Balances).	

Tutorial Note: Expenses paid for the current year and Income received for the current year will not appear in the Balance Sheet.

ILLUSTRATION 47

Taking the same information as given in Illustration 45, prepare Opening and Closing Balance Sheets:

SOLUTION**BALANCE SHEET AS AT 31ST MARCH, 2017**

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Outstanding Rent	3,000	Building [₹ 3,000/.10]	30,000
Advance Subscription	3,000	Stock of Sports Materials	
Capital Fund (Balancing Figure)	1,35,500	[₹ 500 + ₹ 2,000]	2,500
		Prepaid Insurance	1,500
		Outstanding Subscription	6,000
		12% General Fund Investments	1,00,000
		[₹ 12,000/.12]	
		Cash Balance	500
		Bank Balance	1,000
	1,41,500		1,41,500

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Outstanding Rent	1,500	Building	
Advance Subscription	2,000	Book Value	30,000
Advance Locker Rent	1,000	Less: Depreciation	3,000
Bank Overdraft	1,000	Furniture [Cost ₹ 1,000/.10]	10,000
Capital Fund:		Less: Depreciation	1,000
Opening Balance	1,35,500	Stock of Sports Materials	1,000
Add: Entrance Fees		Prepaid Insurance	3,000
[6,000 × 4/.6]	4,000	Outstanding Subscription	4,000
Add: Life Membership Fees		Outstanding Locker Rent	3,000
[₹ 4,000 × 6/.4]	6,000	12% General Fund Investments	1,00,000
Add: Surplus	30,000	Accrued Interest on 12% General	
	1,75,500	Fund Investments	2,000
		Cash Balance	32,000
	1,81,000		1,81,000

ILLUSTRATION 48

The following **Particulars** relate to a sports club's Income & Expenditure Account for the year ended 31st March, 2018:

Dr.

INCOME & EXPENDITURE ACCOUNT

Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Salaries	1,500	By Entrance Fees	10,100
To Printing and Stationery	2,200	By Subscriptions	15,600

To Advertising	1,600	By Rent	4,000
To Audit Fees	100		
To Fire Insurance	1,000		
To Dep. on Sports Equipments	9,000		
To Excess of Income over Expen.	14,300		
	29,700		29,700

RECEIPTS & PAYMENTS ACCOUNT
Dr.
for the year ended 31st March, 2018
Cr.

<i>Receipts</i>	₹	<i>Payments</i>	₹
To Balance b/d	4,200	By Salaries	1,000
To Entrance Fee	10,100	By Printing & Stationery	2,600
To Subscriptions		By Advertising	1,600
2016-2017	600	By Fire Insurance	1,200
2017-2018	15,000	By Investments	20,000
2018-2019	400	By Balance c/d	7,400
To Rent Received	3,500		
	33,800		33,800

The **Assets** on 1st April, 2017 included club grounds and pavilion ₹ 44,000, sports equipments ₹ 25,000 and furniture and fixture ₹ 4,000. Subscription in arrears on that date was ₹ 800. Prepare Opening and Closing Balance Sheets.

SOLUTION
BALANCE SHEET AS AT 31.3.2017

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Fund (Balancing figure)	78,000	Cash	4,200
		Sports Equipments	25,000
		Club Ground & Pavilion	44,000
		Furniture & Fixture	4,000
		Subscription in arrear	800
	78,000		78,000

BALANCE SHEET AS AT 31.3.2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Salaries outstanding	500	Cash in hand	7,400
Audit Fees outstanding	100	Sports Equipments	25,000
Subscription received in advance	400	Less: Depreciation	9,000
Capital Fund	78,000	Club Ground & Pavilion	44,000
Add: Surplus	14,300	Furniture & Fixtures	4,000
	92,300	Investments	20,000
		Prepaid Printing & Stationery	400
		Prepaid Insurance	200
		Rent Receivable	500
		Subscriptions Due: 2016-2017	200
		2017-2018	600
	93,300		93,300

ILLUSTRATION 49

The following **Particulars** relate to Hanuman Sports Club:

INCOME & EXPENDITURE ACCOUNT

for the year ending on 31st March, 2018

Dr.

Cr.

Expenditure	₹	Income	₹
To Secretary's Salary	1,500	By Entrance Fees	10,500
To Printing & Stationery	2,200	By Subscriptions	15,600
To Advertising	1,600	By rent	2,800
To Audit Fees	500	By Interest on Investments	1,200
To Fire Insurance	1,000		
To Depreciation:			
—Sports Equipments	9,000		
—Furniture	500		
To Surplus	13,800		
	30,100		30,100

RECEIPTS & PAYMENTS ACCOUNT

for the year ending on 31st March, 2018

Dr.

Cr.

Receipts	₹	Payments	₹
To Balance b/d	4,200	By Secretary's Salary	1,000
To Entrance Fee 2016-2017	1,000	By Printing & stationery	2,600
-do- 2017-2018	10,000	By Advertising	1,600
To Subscriptions 2016-2017	600	By Fire Insurance	1,200
To Subscription 2017-2018	15,000	By 12% Investments	
-do- 2018-2019	400	(purchased on 1.7.2018)	20,000
To Rent received	2,400	By Furniture	2,000
To Interest received	600	By Balance c/d	5,800
	34,200		34,200

The **Assets** on 1st April, 2017 included Club Grounds & Pavilion ₹ 44,000, Sports Equipments ₹ 25,000 and Furniture and Fixtures ₹ 4,000. Subscriptions in arrear on that date were ₹ 800. Subscriptions received in advance on that date were ₹ 200. Creditors for Printing & Stationery on that date were ₹ 500. Prepare opening and closing Balance Sheets.

SOLUTION**BALANCE SHEET OF HANUMAN SPORTS CLUB**

as at 31st March, 2017

Liabilities	₹	Assets	₹
Funds:		Fixed Assets:	
Capital Fund (b.f)	78,300	Club Grounds & Pavilion	44,000
Current Liabilities:		Furniture & Fixture	4,000
Subscription received in advance	200	Sports Equipments	25,000
Creditors for Printing & Stationery	500	Current Assets:	
		Entrance Fees Outstanding	1,000
		Subscription Outstanding	800
		Cash at Bank	4,200
	79,000		79,000

BALANCE SHEET OF HANUMAN SPORTS CLUB
as at 31st March, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Funds:		Fixed Assets :	
Capital fund:		Club Grounds & Pavilion	44,000
Opening Balance	78,300	Furniture & Fixtures	4,000
Add: surplus	13,800	Add: Additions	2,000
	92,100		6,000
Current Liabilities :		Less: Depreciation	500
Outstanding Salary	500	Sports Equipments	25,000
Outstanding Audit Fees	500	Less: Depreciation	9,000
Creditors for Printing & Stationery	100	Investments:	16,000
Subscription received in advance	400	Investments (at cost)	20,000
		Current Assets :	
		Accrued rent	400
		Subscription outstanding	
		for 2016-2017	200
		for 2017-2018	400
		Entrance Fees Outstanding	500
		Cash at Bank	5,800
		Prepaid Insurance	200
		Accrued Interest [₹ 1,200 – ₹ 600]	600
	93,600		93,600

CORRECTION OF WRONG STATEMENTS

ILLUSTRATION 50

Modern (India) Citizens Club was registered in a city and the accountant prepared the following Receipts and Payments Account for the year ended on March 31, 2018 and showed a deficit of ₹ 14,520:

<i>Receipts</i>	₹	<i>Payments</i>	₹
Subscriptions	62,130	Premises	30,000
Fair Receipts	7,200	Honorarium to Secretary	12,000
Variety Show Receipts (Net)	12,810	Rent	2,400
Interest	690	Rates and Taxes	3,780
Bar Collections	22,350	Printing and Stationery	1,410
Cash Spent More	1,000	Wages	2,520
Deficit	14,520	Sundry Expenses	5,350
		Fair Expenses	7,170
		Bar Purchases Payments	17,310
		Repairs	960
		New Car (Less proceeds of old Car ₹ 9,000)	37,800
	1,20,700		1,20,700

Information:

Particulars	1.4.2017 ₹	31.3.2018 ₹
Cash in hand	450	—
Bank Balance as per Pass Book	24,690	10,440
Cheque issued not presented for sundry expenses	270	90
Subscriptions Due	3,600	2,940
Premises at Cost	87,000	1,17,000
Accumulated Depreciation on Premises	56,400	?
Car at Cost	36,570	46,800
Accumulated Depreciation—Car	30,870	?
Bar Stock	2,130	2,610
Creditors for Bar Purchases	1,770	1,290

(a) Cash overspent represents honorarium to Secretary not withdrawn due to cash deficit. His annual honorarium is ₹ 12,000.

(b) Depreciation on Premises and Car is to be provided at 5% and 20% on written down value.

Required: Prepare the Correct Receipts and Payments Accounts, Income and Expenditure Account for the year 2017-2018 and Balance Sheet as on 31st March 2018.

SOLUTION**RECEIPTS AND PAYMENTS ACCOUNT***Dr.**for the year ending on 31st March, 2018**Cr.*

Receipts	₹	Payments	₹
Opening Balances		Premises	30,000
Cash Balance as per Cash Book	450	Honorarium to secretary	11,000
Bank Balance as per Pass Book	24,690	Rent	2,400
Subscriptions	62,130	Rates and Taxes	3,780
Fair Receipts	7,200	Printing and Stationery	1,410
Variety Show Receipts	12,810	Sundry Expenses (5,350 + 270 – 90)	5,530
Interest	690	Wages	2,520
Bar Collections	22,350	Fair Expenses	7,170
		Bar Purchases	17,310
		Repairs	960
		New Car (less proceeds of old car)	37,800
		Bank Balance as per Pass Book	10,440
	1,30,320		1,30,320

INCOME AND EXPENDITURE ACCOUNT*Dr.**for the year ending on 31st March, 2018**Cr.*

Expenditure	₹	Income	₹
To Honorarium to Secretary	12,000	By Subscriptions	61,470
To Rent	2,400	By Fair Receipts	7,200
To Rates and Taxes	3,780	By Variety Show Receipts	12,810

To Printing and Stationery	1,410	By Interest	690
To Sundry Expenses (5,530 – 270 + 90)	5,350	By bar Collections	22,350
To Wages	2,520	By Profit on Sale of old car	3,300
To Fair Expenses	7,170		
To Bar Stock Consumed	16,350		
To Repairs	960		
To Depreciation on:			
Premises (5% on 60,600)	3,030		
Car (20% on 46,800)	9,360		
To Surplus t/f to Capital Fund	43,490		
	1,07,820		1,07,820

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Creditors for Bar Purchases	1,290	Premises	57,570
Secretary—honorarium outstanding	1,000	Car	37,440
Capital Fund		Subscriptions Due	2,940
Opening Balance 65,130		Bar Stock	2,610
Add: Surplus 43,490		Cash at Bank as per Cash Book (10,440 – 90)	10,350
	1,08,620		
	1,10,910		1,10,910

Working Notes:
BALANCE SHEET AS AT 31ST MARCH, 2017

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Creditors for Bar Purchases	1,770	Cash in Hand	450
Capital Fund (Balancing figure)	65,130	Bank Balance as per Cash Book (24,690 – 270)	24,420
		Subscriptions Due	3,600
		Premises (at cost) 87,000	
		Less: Depreciation 56,400	30,600
		Car (at cost) 36,570	
		Less: Depreciation 30,870	5,700
		Bar Stock	2,130
	66,900		66,900

Dr.
(II) SUBSCRIPTION ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	3,600	By Bank A/c	62,130
To Income & Expenditure (b.f.)	61,470	By Balance c/d	2,940
	65,070		65,070

Dr.

(III) CREDITORS FOR BAR ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c	17,310	By balance b/d	1,770
To Balance c/d	1,290	By Bar Stock A/c (Purchases) (b.f.)	16,830
	18,600		18,600

Dr.

(IV) BAR STOCK ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	2,130	By Income & Expenditure A/c (b.f.)	16,350
To Creditors for Bar Stock (Purchas.)	16,830	By Balance c/d	2,610
	18,960		18,960

(v) Premises		
Original Cost (as on 1.4.2017)		87,000
Less: Accumulated Depreciation on 1.4.2017		56,400
Add: Purchases during the year		30,000
		60,600
Less: Depreciation @ 5%		3,030
		57,570
(vi) Profit on sale of car		
Original cost (as on 1.4.2017)		36,570
Less: Accumulated Depreciation as on 1.4.2017		30,870
		5,700
Sale Price (given)		9,000
Profit on sale		3,300
(vii) New Car		
Purchase price (₹ 37,800 + ₹ 9,000)		46,800
Less: Depreciation @ 20%		9,360
		37,440

ILLUSTRATION 51

The Receipts and Payments account of Trustwell Club prepared on 31st March, 2018 is as follows:

RECEIPTS AND PAYMENTS ACCOUNT

<i>Receipts</i>	₹	<i>Payments</i>	₹
To Balance b/d	450	By Expenses (including	
To Annual Income from Subscription		Payment for sports material ₹ 2,700)	6,300
Add: Outstanding of	4,590	By Loss on Sale of Furniture	
last year received this year	180	(cost price ₹ 450)	180
	4,770	By Balance c/d	90,450
Less: Prepaid of last year	90		
To Other fees	1,800		
To Donation for Building	90,000		
	96,930		96,930

Additional Information:

Trustwell club had balances as on 1.4.2017:

Furniture ₹ 1,800; Investment at 5% ₹ 27,000; Sports material ₹ 6,660; Balance as on 31.3.2018: Subscription Receivable ₹ 270; Subscription received in advance ₹ 90; Stock of sports material ₹ 1,800.

Do you agree with above Receipts and Payments account? If not, prepare correct Receipts and Payments account and Income and Expenditure account for the year ended 31st March, 2018 and Balance Sheet on that date.

SOLUTION
CORRECTED RECEIPTS AND PAYMENTS ACCOUNT OF TRUSTWELL CLUB

Dr. *for the year ended 31st March, 2018* Cr.

Receipts	₹	Payments	₹
To Balance b/d	450	By Expenses (₹ 6,300 – ₹ 2,700)	3,600
To Subscription		By Sports Material	2,700
Annual Income	4,590	By Balance c/d	90,720
Less: Receivable at end	270	(Cash in Hand and at Bank)	
Add: Advance at end	90		
Add: Receivable at the end	180		
Less: Advance received at end	90		
To Other fees	1,800		
To Donation for Building	90,000		
To Sale of Furniture	270		
	97,020		97,020

INCOME AND EXPENDITURE ACCOUNT OF TRUSTWELL CLUB

Dr. *for the year ended 31st March, 2018* Cr.

Expenditure	₹	Income	₹
To Sundry Expenses	3,600	By Subscription	4,590
To Sports Material		By Other fees	1,800
Balance as on 1.4.2018	6,660	By Interest on investment	1,350
Add: Purchases	2,700	(5% on ₹ 27,000)	
Less: Balance as on		By Deficit: Excess of	
31.3.2018	(1,800)	Expenditure over Income	3,600
To Loss on Sale of Furniture	180		
	11,340		11,340

BALANCE SHEET OF TRUSTWELL CLUB

as on 31st March, 2018

Liabilities	₹	Assets	₹
Capital Fund	36,000	Furniture	1,800
Less: Excess of Expenditure over Income	(3,600)	Less: Sold	(450)
Building Fund	90,000	5% Investment	27,000
Subscription Received in Advance	90	Interest Accrued on Investment	1,350
		Sports Material	1,800
		Subscription Receivable	270
		Cash in Hand and at Bank	90,720
	1,22,490		1,22,490

Working Note:**BALANCE SHEET OF TRUSTWELL CLUB AS ON 1ST APRIL, 2017**

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Subscription Received in Advance	90	Furniture	1,800
Capital Fund (Balancing Figure)	36,000	Investment	27,000
		Sports Material	6,660
		Subscription Receivable	180
		Cash in Hand and at Bank	450
	36,090		36,090

SOLVED PROBLEMS**PROBLEM 1**

How will you deal with the following items while preparing the Income and Expenditure Account of Tulsian Club for the year ending on March 31, 2018 and a Balance Sheet as on that date?

<i>Particulars</i>	<i>As at 1.4.2017</i> ₹	<i>As at 31.3.2018</i> ₹
Outstanding Subscription	9,500	7,000
Advance Subscription	2,800	5,200
Outstanding Salaries	15,000	9,000
Prepaid Salaries	5,000	3,000
Amount due to Suppliers of Sports Materials	15,000	9,000
Advances to Suppliers of Sports Materials	5,000	3,000
Stock of Sports Materials	15,000	7,000

During 2017–2018, the payment made to the suppliers of Sports Materials was ₹ 54,000 and Cash Purchases amounted to 10% of Credit Purchases. Subscription received ₹ 1,48,900, Salaries paid ₹ 54,000.

SOLUTION**AN EXTRACT OF INCOME AND EXPENDITURE ACCOUNT***Dr.**for the year ended 31st March, 2018**Cr.*

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Sports Materials consumed	63,000	By Subscription	1,44,000
To Salaries	50,000		

AN EXTRACT OF BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Advance Subscription	5,200	Outstanding Subscription	7,000
Creditors for Sports Materials	9,000	Advance for Sports Materials	3,000
		Stock of Sports Materials	7,000

Working Notes:
Dr.
1. SUBSCRIPTION ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Outstanding Subscription A/c (in the beginning)	9,500	By Advance Subscription A/c (in the beginning)	2,800
To Income & Expenditure A/c (balancing figure)	1,44,000	By Bank A/c	1,48,900
To Advance Subscription A/c	5,200	By Outstanding Subscription A/c (at the end)	7,000
	1,58,700		1,58,700

Dr.
2. SALARIES ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Prepaid Salaries A/c (in the beginning)	5,000	By Outstanding Salaries A/c (in the beginning)	15,000
To Bank A/c	54,000	By Income & Expenditure A/c (balancing figure)	50,000
To Outstanding Salaries A/c (at the end)	9,000	By Prepaid Salaries A/c (at the end)	3,000
	68,000		68,000

Dr.
3. CREDITORS FOR SPORTS MATERIALS ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	5,000	By Balance b/d	15,000
To Bank A/c	54,000	By Stock of Sports Materials A/c (Credit purchases)	
To Balance c/d	9,000	(Balancing figure)	50,000
		By Balance c/d	3,000
	68,000		68,000

Dr.
4. STOCK OF SPORTS MATERIALS ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	15,000	By Income and Expenditure A/c (Sports Materials consumed)	
To Creditor for Sports Materials (transfer)	50,000	(Balancing figure)	63,000
To Cash Purchases [₹ 50,000 × 10/100]	5,000	By Balance c/d	7,000
	70,000		70,000

PROBLEM 2

Show how will you deal with the following items while preparing the final accounts of Tulsian Club for the year ending on March 31, 2018:

AN EXTRACT OF RECEIPTS AND PAYMENTS ACCOUNT OF TULSIAN CLUB, DELHI

Dr.

for the year ended 31st March, 2018

Cr.

<i>Receipts</i>	₹	<i>Payments</i>	₹
Admission Fees	5,000	Prizes awarded	2,000
Life Membership Subscription	50,000	Tournament Expenses	1,00,000
Donations	1,00,000	Construction of Building	3,00,000
Tournament Fund	50,000	12% Fixed Deposit on 1.7.2017	1,00,000
Proceeds of Tournament tickets	40,000		
Donations for Prizes	2,800		
Donation for Building	5,00,000		
Interest on 12% Fixed Deposit	6,000		
Subscription for Governor's Party	3,450		
Interest on Prize Fund Inves.	1,200		
Interest on Building Fund Inves.	40,000		

Additional Information:

<i>Particulars</i>	<i>As at 1.4.2017</i> ₹	<i>As at 31.3.2018</i> ₹
Tournament Fund	5,000	?
Prize Fund	12,000	?
10% Prize Fund Investments	12,000	?
Building Fund	4,00,000	?
10% Building Fund Investments	4,00,000	?
Capital Fund	9,00,000	?
Subscription for Governor's party outstanding	—	550

SOLUTION**AN EXTRACT OF INCOME AND EXPENDITURE ACCOUNT**

Dr.

for the year ended 31st March, 2018

Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Tournament Expenses	5,000	By Interest on 12% Fixed Deposit	
		Received	6,000
		Accrued	3,000
		By Admission Fees	5,000
		By Donations	1,00,000

AN EXTRACT OF BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Fund:		Building in progress	3,00,000
Opening Balance	9,00,000	10% Building Fund Investments	4,00,000
Add: T/F from		10% Prize Fund Investments	12,000
Building Fund	3,00,000	12% Fixed Deposit	1,00,000
Add: Life Membership		Interest Accru. on Fixed Deposit	3,000

Subscription	50,000	12,50,000	Subscription for Governor's party outstanding	550
Building Fund:				
Opening Balance	4,00,000			
Add: Donations	5,00,000			
Add: Interest	40,000			
Less: T/F to Capital Fund	3,00,000	6,40,000		
Prize Fund:				
Opening Balance	12,000			
Add: Donations	2,800			
Add: Interest on Prize fund				
Investments	1,200			
Less: Prizes awarded	2,000	14,000		
Tournament Fund:				
Opening Balance	5,000			
Add: Donations	50,000			
Add: Proc. of tickets	40,000			
Less: Expenses	1,00,000			
T/F to I & E Exp. A/c	(5,000)	Nil		
Subscription for Governor's Party	3,450			
Add: Outstanding	550	4,000		

PROBLEM 3

The following is the Receipts and Payments Account of the Calcutta Club for the year ending 31.3.2018

<i>Receipts</i>	<i>₹</i>	<i>Payments</i>	<i>₹</i>
Opening Balances:		Salaries	6,000
Cash	1,025	Sports Expenses	6,900
Stamps	50	Electricity	1,000
Bank F.D.	10,000	Telephone	1,200
S.B. Account	4,200	Postage Expenses	200
Current Account	2,100	General Body Expenses	700
10% Govt. Securities	1,80,000	Printing and Stationery	850
Subscriptions:		Building Purchase Account	12,000
2016-2017	1,010	Repairs	
2017-2018	18,900	Closing Balances:	400
2018-2019	900	Cash	1,740
Donations	7,000	Stamps	25
Bank Interest Received	1,340	Bank F.D.	11,000
Receipts from Sports	2,600	S.B. Account	22,310
Telephone Recoveries	900	Current Account	3,700
Interest on Govt Securities (After T.D.S. 10%)	18,000	10% Govt. Securities	1,80,000
	2,48,025		2,48,025

A building costing one lac of rupees was purchased during the last year and ₹ 88,000 was paid for it.

Subscription outstanding for 2017-2018	₹ 1,100
Salaries outstanding	₹ 200
Interest accrued on Bank deposits but not received	₹ 200

The Government Securities of the face value of ₹ 2,00,000 (cost ₹ 1,80,000) present investment of the Endowment Fund.

Required: From the above, prepare Income and Expenditure Account for the year 2017-2018 and also the Balance Sheet as on 31.3.2018 of the Calcutta Club.

SOLUTION

INCOME AND EXPENDITURE ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Salaries 6,000		By Subscriptions 18,900	
Add: Outstanding 200	6,200	Add: Outstanding 1,100	20,000
To Sports Expenses	6,900	By Donations	7,000
To Electricity 1,000		By Bank Interest 1,340	
To Telephone 1,200		Add: Accrued 200	1,540
To Postage Expenses:		By Receipts from Sports	2,600
Cash 175		By Telephone Recoveries 900	
Stamps 25	200		
To General Body Expenses	700		
To Printing and Stationery	850		
To Repairs	400		
To Surplus (Excess of Income over <i>Expenditure</i>)	14,590		
	32,040		32,040

BALANCE SHEET AS AT 31ST MARCH 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Subscription Received in Advance 900		Building 1,00,000	
Outstanding Salary 200		Govt. Securities 1,80,000	
Endowment Fund:		Fixed Deposit 11,000	
Opening Balance 1,80,000		T.D.S. on Interest (18,000 × 10/90) 2,000	
Add: Interest 20,000	2,00,000	Saving Bank Account 22,310	
(10% of ₹ 2,00,000)		Current Account 3,700	
Capital Fund:		Stamps 25	
Opening Balance 1,06,385		Cash 1,740	
Add: Surplus 14,590	1,20,975	Subscriptions Receivable 1,100	
		Accrued Bank Interest 200	
	3,22,075		3,22,075

Working Note:

Furniture	3,200	?
Stock of Foodstuff	120	80
6% Government Securities (Face Value ₹ 30,00,000)	2,580	?
Subscription Outstanding	600	250
Subscription in Advance	—	300
Outstanding Miscellaneous Expenses	200	250

Accounting policies followed by Tulsian Sports Club, Delhi are, provide as under:

- The sports equipments and furniture are to be depreciated @ 25% and 19% p.a. respectively.
- One half of the entrance fees and life membership fee are to be treated as **Income**.

SOLUTION

INCOME AND EXPENDITURE ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

Expenditure	₹ '000	Income	₹ '000
To Insurance	225	By Subscription	6,350
To Honorarium to Cricket Coach	600	By General Donations	2,000
To Miscellaneous Expenses	3,925	By Entrance Fees	100
To Postage		By Life Membership subscription	250
Cash 175		By Cricket Fees	250
Stamps 25	200	By Sale of old periodicals	72
To Depreciation on		By Interest on Secur. (144 × 100/80)	180
— Sports equipment 1,675		By Profit on sale of foodstuff	
— Furniture 665	2,340	Sales 3,100	
To Surplus transferred to		Add: Closing Stock 80	
Capital Fund 2,872	2,872	Less: Opening Stock 120	
		Less: Purchases 2,100	960
	10,162		10,162

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹ '000	Assets	₹ '000
Capital Fund:		Fixed Assets:	
Opening Balance 3,000		Furniture	
Add: 50% of Entrance Fees 100		Opening balance 3,200	
Add: 50% of Life Membership fees 250		Add: Additions 600	
Add: Surplus 2,872	6,222	3,800	
Club Pavilion Fund:		Less: Depreciation 665	3,135
Opening Balance 5,000		Sports Equipments	
Add: Donations 10,000		Opening Balance 4,500	
Add: Interest on Club Pavilion		Add: Additions 2,200	
Fund Investments 250	15,250	6,700	
		Less: Depreciation 1,675	5,025

Current Liabilities:		Investments:	
Subscription received in advance	300	6% Government Securities	2,580
Outstanding Miscellaneous Exp.	250	10% Club Pavilion Fund Investments	10,000
		Current Assets:	
		Stock of foodstuff	80
		Subscription in arrears	250
		Cash in hand	52
		Cash at bank	514
		Stamps	25
		T.D.S. on interest on: Government Securities (144 × 20/80)	36
		Accrued Interest on Club Pavilion Fund	
		Investments (RBI Bonds)	250
		Prepaid Insurance	75
	22,022		22,022

Working Notes:
(I) BALANCE SHEET AS AT 1ST APRIL, 2017

Liabilities	₹ '000	Assets	₹ '000
Capital Fund (balancing figure)	3,000	Sports Equipments	4,500
Club Pavilion Fund	5,000	Furniture	3,200
Bank Overdraft	3,000	Stock of Foodstuff	120
Outstanding Miscellaneous Exp.	200	Government Securities	2,580
		Subscription in arrears	600
		Cash in hand	150
		Stamps	50
	11,200		11,200

Dr.
(II) SUBSCRIPTION ACCOUNT
Cr.

Particulars	₹ '000	Particulars	₹ '000
To Outstanding Subscription A/c (in the beginning)	600	By Cash A/c	7,000
To Income and Expenditure A/c (b.f.)	6,350	By Outstanding Subscription A/c (at the end)	250
To Advance Subscription A/c (at the end)	300		
	7,250		7,250

Dr.
(III) MISCELLANEOUS EXPENSES ACCOUNT
Cr.

Particulars	₹ '000	Particulars	₹ '000
To Cash A/c	3,875	By Outstanding Expenses A/c (in the beginning)	200
To Outstanding Expenses A/c (at the end)	250	By Income and Expenditure A/c (Balancing figure)	3,925
	4,125		4,125

- (iv) Interest on Fixed Deposits has accrued for 3 months @ 10% p.a. and has been credited to Pavilion Fund, since Fixed Deposit has been made out of the donation for Pavilion Fund.
- (v) Blanket Rate of Depreciation (without p.a.) has been given on sports equipment.

PROBLEM 5

Prepare Income and Expenditure Account and Balance Sheet of Bhagat Singh College Sports Club, Delhi from the following information:

RECEIPTS AND PAYMENTS ACCOUNT OF BHAGAT SINGH COLLEGE SPORTS CLUB, DELHI

Dr.

for the year ended on 31st March, 2018

Cr.

<i>Receipts</i>	<i>₹ '000</i>	<i>Payments</i>	<i>₹ '000</i>
To Balance b/d: Cash	500	By Rent	9,750
Bank	4,000	By Miscellaneous Expenses	28,800
Stamps	300	By Postage Expenses	1,200
To Subscription		By Furniture	8,000
2016-2017	4,650	By Creditors for Sports Material	12,200
2017-2018	67,200	By Cost of prizes (to be awarded)	4,150
2018-2019	2,600	By Cash purchase of Sports Materials	2,000
	74,450	By Match Expenses	7,030
To Entrance Fees	8,000	By Balance c/d:	
To General Donations	4,050	Cash	545
To Donations for Prize Fund	2,800	Bank	26,000
To Sale of old Sports Materials	5,200	Stamps	150
To Interest on Prize Fund Investments	300		26,695
To Miscellaneous Receipts	225		
	99,825		99,825

Information:

<i>Particulars</i>	<i>1.4.2017</i> ₹	<i>31.3.2018</i> ₹
Sports Materials	4,000	5,000
Furniture	40,000	?
5% Prize Fund Investments (Face Value ₹ 12,000)	11,700	?
Creditors for Sports Materials	1,400	2,950
Subscription in arrears	4,750	?
Subscription in advance	1,400	?
Prize Fund	12,000	?
Rent paid in advance	—	750
Outstanding Rent	750	—
Outstanding Miscellaneous Expenses	2,280	4,020
Miscellaneous Expenses paid in advance	750	850

Book Value of Sports Materials sold was ₹ 4,000. Depreciation on furniture is to be provided @ 10%. Half of entrance fees to be capitalised. There are 720 members, each paying an annual subscription of ₹ 100.

SOLUTION

BHAGAT SINGH COLLEGE SPORTS CLUB, DELHI
INCOME AND EXPENDITURE ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

<i>Expenditure</i>	₹ '000	<i>Income</i>	₹ '000
To Rent	8,250	By Subscriptions	72,000
To Miscellaneous Expenses	30,440	By General Donations	4,050
To Postage Expenses:		By Entrance Fees	4,000
Cash 1,050		By Profit on sale of old sports materials	1,200
Stamps 150	1,200	By Miscellaneous Receipts	225
To Sports Materials consumed	10,750		
To Depreciation on Furniture	4,800		
To Match Expenses	7,030		
To Surplus trans. to Capital Fund	19,005		
	81,475		81,475

BHAGAT SINGH COLLEGE SPORTS CLUB, DELHI
BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹ '000	<i>Assets</i>	₹ '000
Capital Fund:		Fixed Assets:	
Opening Balance 48,170		Furniture	43,200
Add: Surplus 19,005		Investments:	
Add: Entrance Fees 4,000	71,175	5% Prize Fund Investments	11,700
Prize Fund:		Current Assets:	
Opening Balance 12,000		Sports Materials	5,000
Add: Donations 2,800		Subscription in arrears	
Add: Income @ 5% on ₹ 12,000 600		for 2016-2017 ₹ 100	
15,400		for 2017-2018 ₹ 3,400	3,500
Less: Expenses 4,150	11,250	Prepaid Miscellaneous Expenses	850
Current Liabilities:		Cash Balance	545
Creditors for sports materials	2,950	Bank Balance	26,000
Subscription in advance	2,600	Stamps	150
Outstanding Miscellaneous		Prepaid Rent	750
Expenses 4,020		Accrued Interest on Prize	
		Fund Investments (₹ 600 – ₹ 300)	300
	91,995		91,995

Working Notes:

(I) BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Fund (Balancing figure)	48,170	Fixed Assets:	
Prize Fund	12,000	Furniture	40,000
Current Liabilities:		Investments:	11,700

Creditors for Sports Materials	1,400	5% Prize Funds Investments	
Subscription in advance	1,400	Current Assets :	
Outstanding Miscellaneous Exp.	2,280	Subscription in arrears	4,750
Rent Outstanding	750	Sports materials	4,000
		Miscellaneous Exp. paid in advance	750
		Cash Balance	500
		Bank Balance	4,000
		Stamps	300
	66,000		66,000

Dr.

(II) SUBSCRIPTION ACCOUNT

Cr.

Particulars	₹ '000	Particulars	₹ '000
To Outstanding Subscription A/c (In the beginning)	4,750	By Advance Subscriptions A/c (in the beginning)	1,400
To Income and Expenditure A/c (720 × ₹ 100)	72,000	By Bank A/c	74,450
To Advance Subscription A/c (at the end)	2,600	By Outstanding Subscription A/c (at the end)	3,500
	79,350		79,350

Dr.

(III) MISCELLANEOUS EXPENSES ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Prepaid Expenses A/c (in the beginning)	750	By Outstanding Expenses A/c (in the beginning)	2,280
To Bank A/c	28,800	By Income and Expenditure A/c (Balancing figure)	30,440
To Outstanding Expenses A/c (at the end)	4,020	By Prepaid Expenses A/c (at the end)	850
	33,570		33,570

Dr.

(IV) RENT ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Bank A/c	9,750	By Outstanding Rent A/c	750
		By Income and Expenditure A/c (Balancing figure)	8,250
		By Prepaid Rent A/c (at the end)	750
	9,750		9,750

Dr.

(V) CREDITORS FOR SPORTS MATERIALS ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Bank A/c	12,200	By Balance b/d	1,400
To Balance c/d	2,950	By Stock of Sports Materials (Credit purchases) (Balancing figure)	13,750
	15,150		15,150

Dr.
(VI) STOCK OF SPORTS MATERIALS ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	4,000	By Income and Expenditure A/c (b/f)	10,750
To Creditors for Sports Materials (Credit purchases)	13,750	By Bank A/c	5,200
To Bank A/c (Cash purchases)	2,000	By Balance c/d	5,000
To Income and Expenditure A/c (Profit on sale)	1,200		
	20,950		20,950

Dr.
(VII) FURNITURE ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	40,000	By Depreciation A/c	4,800
To Bank A/c	8,000	By Balance c/d	43,200
	48,000		48,000

PROBLEM 6

The following balances have been extracted from the books of XYZ Club for the year ended on 31st March, 2018.

Furniture as on 31st March, 2018: ₹ 8,400, Additions to Furniture during the year ₹ 5,400, Billiard Table and other accessories as on 31st March, 2018: ₹ 8,900, China Glass Cutlery and Linex as on 31st March, 2018: ₹ 2,500, Restaurant receipts during the year: ₹ 3,61,600, Restaurant stock as on 31st March, 2018: ₹ 3,900, Receipts from Billiard room during the year: ₹ 25,600, Subscriptions received during the year: ₹ 31,500, Interest on deposit received during the year: ₹ 1,500, Secretary's honorarium; ₹ 30,000, Purchases for restaurant: ₹ 2,07,800, Rent and Rates: ₹ 34,900, Wages (restaurant ₹ 50,000) ₹ 92,300, Repairs and Renewals: ₹ 17,900, Fuel: ₹ 17,700, Lighting: ₹ 2,200, Sundry Expenses: ₹ 13,400, Cash in Hand as on 31st March, 2018: ₹ 1,350, Bank Balances as on 31st March, 2018: ₹ 9,150, Bank Deposit at 10% as on 31st March, 2018: ₹ 30,000.

The Payment for purchases includes ₹ 3,000 for the year ending on 31st March, 2018. Restaurant stock on 31st March, 2018: ₹ 4,500. Included in the subscriptions received were ₹ 4,800 for the previous year and ₹ 1,200 for the year ending on 31st March, 2017. Subscriptions outstanding on 31st March, 2018 were ₹ 5,000. Depreciation should be provided as follows:

China glass and cutlery at 20%. Furniture 10% and Billiard Table and Accessories 15%. The cost of the boarding expenses of the staff is estimated at ₹ 27,500 of which ₹ 20,000 is to be charged to the restaurant. Cash in hand on March 31, 2018: ₹ 2,600.

Required: Prepare the Receipts and Payments Account, Income and Expenditure Account and the Balance Sheet showing the working of the restaurant separately.

SOLUTION
RECEIPTS AND PAYMENTS ACCOUNTS
Dr.
for the year ending on 31st March, 2018
Cr.

<i>Receipts</i>	₹	<i>Payments</i>	₹
To Balance b/d		By Furniture	5,400
Cash in hand	1,350	By Purchases for Restaurant	2,07,800
Cash at bank	9,150	By Rent and Rates	34,900

Bank Deposit	30,000	By Wages	92,300
To Restaurant Receipts	3,61,600	By Repairs and Renewals	17,900
To Billiard Receipts	25,600	By Fuel	17,700
To Subscriptions	31,500	By Lighting	2,200
To Interest on Deposit	1,500	By Sundry Expenses	13,400
		By Secretary's Honorarium	30,000
		By Balance c/d	
		Cash in hand	2,600
		Cash at bank (Balancing figure)	6,500
		Bank Deposit	30,000
	4,60,700		4,60,700

RESTAURANT TRADING ACCOUNTDr. *for the year ending on 31st March, 2018*

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Opening Stock	3,900	By Restaurant's receipts	3,61,600
To Purchases 2,07,800		By Cost of boarding of staff	27,500
Less: Outstanding in the beg. 3,000	2,04,800	By Closing stock	4,500
To Wages	50,000		
To Board Exp. of Restaurant staff	20,000		
To Fuel	17,700		
To Dep. of China glass, cutlery	500		
To Surplus transferred to Income & Expenditure Account	96,700		
	3,93,600		3,93,600

INCOME AND EXPENDITURE ACCOUNTDr. *for the year ending on 31st March, 2018*

Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Repairs and Renewals	17,900	By Subscription 31,500	
To Wages (₹ 92,300 – ₹ 50,000)	42,300	Less: for 2017-2018 4,800	
To Secretary's Honorarium	30,000	20X3-2017 1,200	
To Rent and Rates	34,900	Add: Outstanding 25,500	
To Lighting	2,200	for 2018-20X3 5,000	30,500
To Boarding Expenses	7,500	By Billiards receipts	25,600
To Sundry Expenses	13,400	By Interest received 1,500	
To Depreciation on:		Add: Outstanding 1,500	3,000
Furniture 1,380		By Profit from Restaurant	96,700
Billiard Tables 1,335	2,715		
To Excess of Income over Expenditure transferred to Capital Fund	4,885		
	1,55,800		1,55,800

BALANCE SHEET OF XYZ CLUB AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital Fund		Cash in hand	2,600
Opening Balance 66,000		Cash at bank	6,500
Add: Surplus 4,885	70,885	Bank Deposit	30,000
Subscription received in advance 1,200		Accrued Interest	1,500
		Subscription receivable	5,000
		Restaurant stock	4,500
		Furniture:	
		Opening balance 8,400	
		Addition 5,400	
		13,800	
		Less: Depreciation 1,380	12,420
		Billiard table 8,900	
		Less: Depreciation 1,335	7,565
		China glass etc. 2,500	
		Less: Depreciation 500	2,000
	72,085		72,085

Note: It has been assumed that depreciation on furniture is to be charged to Income & Expenditure Account.

PROBLEM 7

From the following Trial Balance and the necessary information given below for a public school, prepare Income and Expenditure Account for the year 2018, and a Balance Sheet as at March 31, 2018.

Debit Balances	₹	Credit Balances	₹
Buildings	2,50,000	Admission fees	5,000
Furnitures and Fittings	40,000	Tuition and other fees received	2,00,000
Library books	60,000	Creditors for supplies	6,000
9% Investments	2,00,000	Rent for the Hall	4,000
Salaries	2,00,000	Miscellaneous Receipts	12,000
Stationery	15,000	Govt. Grant	1,40,000
General expenses	8,000	General Fund	4,00,000
Annual Sports—Expenses	6,000	Donation received for purchase	
Cash at bank	20,000	of library books	25,000
Cash in hand	1,000	Sale of Old Furniture	8,000
	8,00,000		8,00,000

Fees yet to be received for the year ₹ 10,000. Salaries yet to be paid amount to ₹ 12,000. Furniture costing ₹ 15,000 was purchased on 1.10.2017. The book value of the Furniture sold (on 30.9.2017) was ₹ 20,000 on 1.4.2017. Depreciation is to be charged @ 10% per annum on Furniture and Fittings; 15% on Library Books and 5% on Buildings.

SOLUTION**INCOME AND EXPENDITURE ACCOUNT***Dr.**for the year ending on 31st March, 2018**Cr.*

Expenditure		₹	Income	₹
To Salaries	2,00,000		By Admission fees	5,000
Add: Outstanding	12,000	2,12,000	By Tuition fees	2,00,000
To Stationery		15,000	Add Accrued	10,000
To General Expenses		8,000	By Hall Rent	4,000
To Annual Sports Expenses		6,000	By Miscellaneous Receipts	12,000
To Depreciation on furniture		2,250	By Govt Grants	1,40,000
To Loss on Sale of Furniture		11,000	By Accrued Interest on Investment	18,000
To Depreciation on Library Books		9,000		
To Depreciation on Buildings		12,500		
To Surplus t/f to Capital fund		1,13,250		
		3,89,000		3,89,000

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Creditors for suppliers	6,000	Buildings	2,50,000
Library funds	25,000	Less: Depreciation	12,500
Salaries due	12,000	Furniture and Fittings	20,000
General fund	4,00,000	Less: Depreciation	1,250
Add: Surplus	1,13,250	Library Books	60,000
	5,13,250	Less: Depreciation	9,000
		9% Investments	2,00,000
		Interest Accrued on Inve. @ 9% p.a.	18,000
		Bank	20,000
		Cash	1,000
		Tuition Fees Due	10,000
	5,56,250		5,56,250

Working Note:

Since Sale of old furniture for ₹ 8,000 appears in the Trial Balance, it means, no accounting effect has yet been given in respect of Furniture Account. After passing the rectifying entry the Furniture Account will appear as under:

Opening Balance of furniture as at 1.4.2017 = ₹ 40,000 – ₹ 15,000 = ₹ 25,000

Book Value of Unsold Old Furniture = ₹ 25,000 – ₹ 20,000 = ₹ 5,000

Dr.

FURNITURE ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance (Unadjusted given)	40,000	By Depreciation on old furniture (20,000 × 10/100 × 612)	1,000
		By Sale of Furniture A/c	8,000
		By Income & Expenditure A/c (Loss)	11,000
		By Depreciation A/c:	
		On Old furniture of ₹ 5,000	500
		On New furniture of ₹ 15,000	750
		By Balance c/d	18,750
	40,000		40,000

PROBLEM 8

The following is the Income and Expenditure Account of the Red Roses Club for the year ended on March, 31 2018.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Salaries	24,000	By Subscriptions	72,000
To Rent	10,800	By Entrance fees	8,000
To Rates and Taxes	600	By Surplus on Publication of brochure	4,500
To Postage and Telephones	720	By Profit on sale of old sports as sets	1,200
To Affiliation fees to the All-India Lawn Tennis Association	1,200	By Interest on 4% investments	600
To Sports Materials	15,750	By Miscellaneous Income	225
To Electricity Charges	1,200		
To Repairs and Maintenance to tennis court	9,600		
To Depreciation on Assets at 10% of gross book value at end of year	4,800		
To Surplus carried to Capital Fund	17,855		
	86,525		86,525

The following further information is made available:

<i>Particulars</i>	<i>Balances on 31.3.2017 ₹</i>	<i>Balances as at 31.3.2018 ₹</i>
(a) Sundry Assets	44,000	?
Bank Balance	4,800	?
Subscriptions in arrear	4,750	3,500
Subscription received in advance	1,400	2,600
4% Investments [Face value ₹ 15,000]	12,000	12,000
(b) Expenses Outstanding:		
Salaries	600	1,200
Rent	900	1,800

Rates & Taxes	Nil	600
Tennis court maintenance	780	320
(c) Outstanding for purchase of sports materials	1,400	2,950
(d) Prize Fund	4,600	3,250

- (e) The book value, as on 1.4.2017 of sports goods sold in the year was ₹ 4,000.
- (f) Prize Fund is separately maintained. All receipts are credited to it separately and **Expenditure** is met out of the fund directly. During the year, credits to the account amounted to ₹ 2,800.
- (g) Interest received this year was only for two quarters.
- (h) The club was admitted as a member of the All India Lawn Tennis Federation on 1.10.2017 when it paid subscription till 30.9.2018.
- (i) Advertisement charges on brochure—yet to be collected—₹ 450.
- (j) A fixed deposit of ₹ 25,000 was made on 31st March, 2018.

Prepare the Receipts and Payments Account for the year ended on March 31, 2018 and the Balance-Sheet as on that date of the Red Roses Club.

SOLUTION**RECEIPTS AND PAYMENT ACCOUNTS OF RED ROSES CLUB***Dr.**for the year ending on 31st March, 2018**Cr.*

Receipts	₹	Payments	₹
To Balance b/d	4,800	By Electricity Charges	1,200
To Subscription	74,450	By Salaries	23,400
To Entrance fee	8,000	By Rent	9,900
To Brochure receipts, Surplus	4,050	By Postage and Telephone	720
To Old Sports material	5,200	By A.I. and T.F. Affiliation fee	2,400
To Interest on Investments	300	By Purchase of Sports Material	14,200
To Miscellaneous receipts	225	By Repairs and Maintenance to tennis court	10,060
To Prize Fund receipts	2,800	By Sundry Assets	8,000
		By Prize Fund	4,150
		By Fixed deposit	25,000
		By Balance c/d	795
	99,825		99,825

BALANCE SHEET OF RED ROSES CLUB AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
General Fund	55,870	Sundry Assets	48,000
Add: Surplus for the year	17,855	Less: Depreciation	4,800
Prize Fund	3,250	4% Investments [FV ₹ 15,000]	12,000
Liability for purchases and expenses	6,870	Fixed Deposit	25,000
Subscription received in advance	2,600	Subscriptions receivable	3,500
		Advance affiliation fee paid	1,200
		Advt. charges receivable	450
		Interest due to Investments	300
		Cash at Bank	795
	86,445		86,445

Working Notes:
(I) BALANCE SHEET AS AT 31ST MARCH, 2017

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Subscriptions received in advance	1,400	5% Investments	12,000
Expenses Outstanding	2,280	Sports Materials	4,000
Sundry suppliers (sports materials)	1,400	Sundry Assets	40,000
Prize Fund	4,600	Bank Balance	4,800
Capital Fund (Balancing figure)	55,870	Subscriptions receivable	4,750
	65,550		65,550

Dr. (II) SUBSCRIPTION ACCOUNT Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Outstanding Subscription A/c (Opening)	4,750	By Advance Subscription A/c (Beg.)	1,400
To Income and Expenditure Account	72,000	By Bank (Balancing figure)	74,450
To Advance Subscription A/c (end)	2,600	By Outstanding Subscription A/c (Closing)	3,500
	79,350		79,350

Dr. (III) SUNDRY ASSETS ACCOUNT Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d (₹ 44,000 – ₹ 4,000)	40,000	By Depreciation A/c	4,800
To Bank A/c (Balancing figure)	8,000	By Balance c/d [₹ 4,800 (Dep.) × 100/10] – ₹ 4,800]	43,200
	48,000		48,000

Dr. (IV) STOCK OF SPORTS MATERIALS ACCOUNT Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	4,000	By Bank A/c	5,200
To Income & Expenditure A/c (Profit)	1,200	By Income & Expenditure A/c (Materials Consumed)	15,750
To Creditors for Sports Materials A/c	15,750		20,950
	20,950		20,950

Dr. (V) CREDITORS FOR SPORTS MATERIALS ACCOUNT Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (b.f.)	14,200	By Balance b/d	1,400
To Balance c/d	2,950	By Credit Purchases	15,750
	17,150		17,150

Dr. (VI) PRIZE FUND ACCOUNT Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank (Prize Awarded) (b.f.)	4,150	By Balance b/d	4,600
To Balance c/d	3,250	By Bank A/c	2,800
	7,400		7,400

- (vii) Total interest due @ 4% on ₹ 15,000 i.e. ₹ 600; half of it is received and the other half is still due.
- (viii) AILTF Affiliation fee paid is ₹ 1,200 (October-March) i.e. for the current year and advance payment is also ₹ 1,200 (April-September).

PROBLEM 9

Tulsian Sports Club which is also running a Restaurant provides you the following information:

1. OPENING AND CLOSING BALANCES

<i>Particulars</i>	<i>As on 1.4.2017</i> ₹	<i>As on 31.3.2018</i> ₹
Furniture	2,20,000	?
Sports Equipment	2,20,000	?
China Glass, Cutlery etc.,	25,000	?
6% Govt. Securities [Face value ₹ 3,00,000]	2,50,000	?
Stock of Sports Materials	3,000	500
Advances to Suppliers of Sports Materials	1,000	500
Due to Suppliers of Sports Materials	3,000	1,800
Stock of Stationery	2,000	?
Unpresented cheques being payment for stationery	900	300
Subscription Outstanding	4,750	3,500
Subscription Received-in-Advance	1,400	2,600
Outstanding Miscellaneous Expenses	4,750	3,500
Miscellaneous Expenses paid in advance	1,400	2,600
Outstanding Wages	5,000	4,000
Cash Balance	10,000	30,000
Bank Balance as per Pass Book	5,00,000	?
Stock of Provisions	30,000	3,80,000
Debtors for Provisions	30,000	40,000
Creditors for Provisions	1,00,000	50,000

2. PAYMENTS

<i>Particulars</i>	₹
Suppliers of Sports Materials	10,800
Miscellaneous Expenses	74,450
Wages	51,000
Stationery	1,600
Furniture (Purchased on 1.10.2017)	1,50,000
Sports Equipment (purchased on 1.10.2017)	1,50,000
8% R.B.I Tax Free Bonds (Purchased on 1.1.2018)	79,200
[Face Value ₹ 1,00,000]	
Creditors for Provisions	10,50,000
Cash Purchases of Provisions – 1/11th of Total Purchases	

3. RECEIPTS

<i>Particulars</i>	₹
Subscription	74,450
Interest on 6% Govt. Securities (After T.D.S. @ 10%)	8,100
Collection from Debtors for Provisions	8,90,000
Cash Sales of Provisions –10% of Total Sales	

4. Depreciation Rates:

- On China Glass & Cutlery — 20%
 - On Furniture — 10% p.a.
 - On Sports Equipment — 10%
- The cost of the boarding expenses—Restaurant staff ₹ 20,000—other staff ₹ 7,500.
 - Furniture (having a book value of ₹ 20,000) as on 1.4.2017 was sold at a loss of 20% on 31.12.2017.
 - Write 25% off Stationery.

Required: Prepare Restaurant Trading Account, Income & Expenditure Account and the Closing Balance Sheet.

SOLUTION

RESTAURANT TRADING ACCOUNT

Dr.

for the year ended 31st March, 2018

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Opening Stock	30,000	By Sales of Provisions	
To Purchases Of Provisions		Cash Sales	1,00,000
Cash Purchases	1,00,000	Credit Sales	9,00,000
Credit Purchases	10,00,000	By Boarding Expenses	
To Restaurant & Other Staff Expenses	20,000	of Restaurant Staff	27,500
To Wages	50,000	By Stock of Provisions	3,80,000
To Depreciation on Cutlery	5,000		
To Profit t/f to Income & Expenditure A/c	2,02,500		
	14,07,500		14,07,500

INCOME & EXPENDITURE ACCOUNT

Dr.

for year ended 31st March 2018

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Depreciation on Furniture	29,000	By Profit from Restaurant	2,02,500
To Depreciation on Sport Equipment	37,000	By Subscription A/c	72,000
To Sports Materials Consumed	12,600	By Interest on Govt. Securities	
To Stationery w/o	750	Received	8,100
To Miscellaneous Expenses A/c	72,000	T.D.S	900
To Loss on Sale	3,700	Add: Accrued Interest	9,000
To Boarding Expenses of other Staff	7500	By Accrued Interest on	
To Surplus	1,31,950	8% RBI Tax free Bonds	2,000
	2,94,500		2,94,500

BALANCE SHEET AS AT 31 MARCH, 2018

Liabilities	₹	Assets	₹
Capital Fund:		Furniture	3,22,500
Opening Balance 11,82,100		Sport Equipment	
Add: Surplus 1,31,950	13,14,050	Opening Balance 2,20,000	
Subscription received in advance	2,600	Add: Purchases 1,50,000	
Outstanding Misc. Expenses	3,500	Less: Depreciation (37,000)	3,33,000
Outstanding Wages	4,000	China, Glass Cutlery	20,000
Due to Suppliers of Sports Materials	1,800	Govt. Securities	
Creditors for Provisions	50,000	(Face Value ₹ 3,00,000)	2,50,000
Bank overdraft as per Cash Book	1,00,000	8% RBI Tax free Bonds	
		(Face Value ₹ 1,00,000)	79,200
		Stock of Provisions	3,80,000
		Stock of Sports Material	500
		Stock of Stationery	2,250
		Debtors for Provisions	40,000
		Ad. to Suppliers of Sports Materials	500
		Subscription Outstanding	3,500
		Prepaid Misc. Expenses	2,600
		Accrued Interest on Govt. Securities	9,000
		Accrued Interest on	
		8% RBI Tax free Bonds	2,000
		T.D.S	900
		Cash	30,000
	14,75,950		14,75,950

Working Notes:

Dr.

(I) SUBSCRIPTION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Subscription Outstanding A/c (beginning)	4,750	By Subscription received in advance A/c (beg)	1,400
To Income & Expenditure A/c	72,000	By Bank A/c	74,450
To Subscription received in advance A/c (end)	2,600	By Subscription Outstanding A/c (end)	3,500
	79,350		79,350

Dr.

(II) MISCELLANEOUS EXPENSES ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Expenses Prepaid A/c (beginning)	1,400	By Expenses Outstanding A/c (beg.)	4,750
To Expenses Outstanding A/c (end)	3,500	By Expenses Prepaid A/c (end)	2,600
To Bank A/c	74,450	By Income & Expenditure A/c	72,000
	79,350		79,350

Dr. **(III) SUPPLIERS OF SPORTS MATERIALS ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d (advance)	1,000	By Balance b/d (outstanding)	3,000
To Bank A/c	10,800	By Stock of Sports Material A/c	10,100
To Balance c/d (outstanding)	1,800	By Balance c/d (advance)	500
	13,600		13,600

Dr. **(IV) STOCK OF SPORTS MATERIALS ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	3,000	By Income & Expenditure A/c	
To Supplier's A/c	10,100	(consumed)	12,600
		By Balance c/d	500
	13,100		13,100

(v) Purchases of stationery = Payment as per Pass Book + Unpresented cheques at the end – Unpresented cheques at the beginning 1600 + 300 – 900 = 1,000

Dr. **(VI) STOCK OF STATIONERY ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	2,000	By Income & Expenditure A/c	
To Purchases A/c	1,000	(consumed)	750
		By Balance c/d	2,250
	3,000		3,000

Dr. **(VII) DEBTORS FOR PROVISIONS ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	30,000	By Bank A/c	8,90,000
To Credit Sales	9,00,000	By Balance c/d	40,000
	9,30,000		9,30,000

Dr. **(VIII) CREDITORS FOR PROVISIONS ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Bank A/c	10,50,000	By Balance b/d	1,00,000
To Balance c/d	50,000	By Credit purchases	10,00,000
	11,00,000		11,00,000

Dr. **(IX) FURNITURE ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	2,20,000	By Depreciation A/c	
To Bank A/c	1,50,000	Sold (20,000 × 10% × 9/12)	1,500
		By Bank A/c (sales)	14,800
		By Income & Expenditure A/c (Loss)	3,700
		By Dep. A/c (Old (2,00,000 × 10%))	20,000
		New (1,50,000 × 10% × 6/12)	7,500
		By Balance c/d	3,22,500
	3,70,000		3,70,000

Dr.

(X) CASH & BANK ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d: Cash	10,000	By Creditors for Provisions A/c	10,50,000
Bank Balance as per Pass Book	5,00,000	By Wages A/c	51,000
To Debtors for Provisions A/c	8,90,000	By Suppliers of Sports Materials A/c	10,800
To Interest on Govt. Securities	8,100	By Furniture A/c	1,50,000
To Subscription	74,450	By Miscellaneous Expenses A/c	74,450
To Cash Sales of Provisions	1,00,000	By Sport Equipment	1,50,000
To Furniture	14,800	By Stationery A/c	1,600
To Balance c/d:		By Cash Purchases of Provisions	1,00,000
Bank Overdraft as per Pass Book	99,700	By 8% RBI Tax free Bonds	79,200
		By Balance c/d (cash)	30,000
	16,97,050		16,97,050

(XI) BANK RECONCILIATION STATEMENT

<i>Particulars</i>	31.3.2017 (₹)	31.3.2018 (₹)
A. Bank Balance (overdraft) as per Pass Book	5,00,000	(99,700)
B. Less: Unpresented cheques for stationery	(900)	(300)
C. Bank Balance (overdraft) as per Cash Book	4,99,100	(1,00,000)

(XII) BALANCE SHEET AS AT 31 MARCH, 2017

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Fund	11,82,100	Furniture	2,20,000
Creditors for Provisions	1,00,000	Sport Equipment	2,20,000
Due to Suppliers of Sports Materials	3,000	China, Glass Cutlery	25,000
Subscription received in advance	1,400	Govt. Securities	
Outstanding Misc. Expenses	4,750	(Face Value ₹ 3,00,000)	2,50,000
Outstanding Wages	5,000	Stock of Provisions	30,000
		Stock of Sports Material	3,000
		Stock of Stationery	2,000
		Debtors for Provisions	30,000
		Advance to Supp. of Sports Materials	1,000
		Subscription Outstanding	4,750
		Prepaid Misc. Expenses	1,400
		Cash	10,000
		Bank Balance As per Cash Book	4,99,100
	12,96,250		12,96,250

PROBLEM 10

The accountant of City Club gave the following information about the receipts and payments of the Club for the year ended on 31st March, 2018:

Receipts: Subscriptions: ₹ 62,130; Fair Receipts: ₹ 7,200; Variety Show Receipts (net): ₹ 12,810; Interest: ₹ 690; Bar Collections: ₹ 22,350.

Payments: Premises: ₹ 30,000; Rent: ₹ 2,400; Rates and Taxes: ₹ 3,780; Printing and Stationery: ₹ 1,410; Sundry Expenses: ₹ 5,350; Wages: ₹ 2,520; Bar Purchases (Payments): ₹ 17,310; Repairs: ₹ 960; New Car (less proceeds of old car ₹ 9,000): ₹ 37,800; Fair Expenses ₹ 7,170; Honorarium to Secretary ₹ 11,000.

Information:

Particulars	Opening ₹	Closing ₹
Cash in Hand	450	Nil
Bank Balance as per Cash-book	24,420	10,350
Cheque issued for Sundry Expenses not presented to the bank (entry has been duly made in the cash-book)	270	90
Subscriptions Due	3,600	2,940
Premises (at cost)	87,000	1,17,000
Provision for Depreciation on Premises	56,400	
Car (at cost)	36,570	46,800
Accumulated Depreciation on Car	30,870	
Bar Stock	2,130	2,610
Creditors for Bar Purchases	1,770	1,290

Annual Honorarium to Secretary is ₹ 12,000. Depreciation on Premises is to be provided at 5% on written down value. Depreciation on new Car is to be provided at 20%.

You are required to prepare the Receipts and Payments Account and Income and Expenditure Account for the year ended on 31.3.2018.

SOLUTION

RECEIPTS AND PAYMENTS ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

Receipts	₹	Payments	₹
To Opening Balances:		By Premises	30,000
Cash in Hand	450	By Rent	2,400
Bank Balance	24,420	By Rates and Taxes	3,780
To Subscriptions	62,130	By Printing and Stationery	1,410
To Fair Receipts	7,200	By Sundry Expenses	5,350
To Variety Show Receipts (Net)	12,810	By Wages	2,520
To Interest	690	By Fair Expenses	7,170
To Bar Collections	22,350	By Honorarium to Secretary	11,000
To Sale Proceeds of old car	9,000	By Bar Purchases (Payments)	17,310
		By Repairs	960
		By New Car	46,800
		By Closing Balances:	
		Cash on hand	Nil
		Bank balance	10,350
	1,39,050		1,39,050

INCOME AND EXPENDITURE ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

Expenditure	₹	Income	₹
To Rent	2,400	By Subscriptions	62,130
To Rent and Taxes	3,780	Add: O/s at the end	2,940
To Printing and Stationery	1,410	Less: O/s in the beg.	3,600
To Wages	2,520		61,470
To Honorarium to Secretary	12,000	By Surplus from Fair:	
To Sundry Expenses	5,350	Fair receipts	7,200
To Repairs	960	Less: Fair expenses	7,170
To Depreciation on:			30
Premises @ 5%	3,030	By Surplus from variety show	12,810
Car @ 20%	9,360	By Interest	690
To Excess of Income over		By Profit from Bar	6,000
Expenditure transferred to Capital Fund	43,490	By Profit on sale of car	3,300
	84,300		84,300

Working Notes:

Dr.

(I) BAR CREDITORS ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Bank A/c	17,310	By Balance b/d	1,770
To Balance c/d	1,290	By Bar Purchases (Balancing figure)	16,830
	18,600		18,600

(ii) Profit on sale of car = Sale Proceeds – WDV = ₹ 9,000 – ₹ 5,700 = ₹ 3,300

(iii) Bar Stock Consumed = Opening Stock + Purchases – Closing Stock
= ₹ 2,130 + ₹ 16,830 – ₹ 2,610 = ₹ 16,350

(iv) Profit from Bar = Bar Collection – Bar Stock Consumed = ₹ 22,350 – ₹ 16,350 = ₹ 6,000

PROBLEM 11

The following informations were obtained from the books of Delhi Club as on 31.3.2018 at the end of the first year of the Club. You are required to prepare Receipts and Payments Account, Income and Expenditure Account for the year ended 31.3.2018 and a Balance Sheet as at 31.3.2018 on mercantile basis:

(i) Donations received for Building and Library Room ₹ 2,00,000

(ii) Other revenue **Income** and actual receipts:

Particulars	Revenue Income ₹	Actual Receipts ₹
Entrance Fees	17,000	17,000
Subscription	20,000	19,000
Locker Rents	600	600
Sundry Income	1,600	1,060
Refreshment Account	—	16,000

(iii) Other revenue **Expenditure** and actual payments:

Particulars	Revenue Income ₹	Actual Payments ₹
Land (cost ₹ 10,000)	—	10,000
Furniture (cost ₹ 1,46,000)	—	1,30,000
Salaries	5,000	4,800
Maintenance of Playgrounds	2,000	1,000
Rent	8,000	8,000
Refreshment Account	—	8,000

Donations to the extent of ₹ 25,000 were utilised for the purchase of Library Books, balance was still unutilised. In order to keep it safe, 9% Govt. Bonds of ₹ 1,60,000 were purchased on 31.3.2018. Remaining amount was put in the Bank on 31.3.2018 under the term deposit. Depreciation at 10% p.a. was to be provided for the whole year on Furniture and Library Books.

SOLUTION

RECEIPTS AND PAYMENTS ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

Receipts	₹	Payments	₹
To Donation for Building & Library Room	2,00,000	By Purchase of Land	10,000
To Entrance Fees	17,000	By Purchase of Furniture	1,30,000
To Subscription	19,000	By Salaries	4,800
To Locker Rents	600	By Maintenance of Play grounds	1,000
To Sundry Income	1,060	By Rent	8,000
To Refreshment Receipts	16,000	By Refreshment Payments	8,000
To Balance c/d [Bank overdraft]	1,08,140	By Library Books	25,000
		By 9% Govt Bonds	1,60,000
		By Term Deposit with Bank	15,000
	3,61,800		3,61,800

INCOME & EXPENDITURE ACCOUNT

Dr.

for the year ended 31st March, 2018

Cr.

Expenditure	₹	Income	₹
To Salaries [₹ 4,800 + ₹ 200]	5,000	By Entrance Fees	17,000
To Maintenance of playgrounds	2,000	By Subscription [₹ 19,000 + ₹ 1,000]	20,000
To Rent	8,000	By Locker Rents	600
To Depreciation on Furniture	14,600	By Sundry Income [₹ 1,060 + ₹ 540]	1,600
To Depreciation on Library Books	2,500	By Profit on Refreshment A/c	
To Surplus t/f to Capital fund	15,100	Receipts	16,000
		Less: Expenses	8,000
	47,200		47,200

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital Fund:		Fixed Assets :	
Surplus 15,100		Land 10,000	
Add: Trans. from Library F. 25,000	40,100	Furniture Cost 1,46,000	
Building & Library Fund:		Less: Depreciation 14,600	1,31,400
Donation Received 2,00,000		Library books cost 25,000	
Less: utilized and		Less: Depreciation 2,500	22,500
t/f Capital Fund 25,000	1,75,000	Investments:	
Supplier of Furniture 16,000		9% Govt. Bonds (Face	
Outstanding Salary 200		Value ₹ 1,60,000)	1,60,000
Outstanding Maintenance		Term Deposit with bank 15,000	
of Playgrounds 1,000		Current Assets :	
Bank Overdraft 1,08,140	1,08,140	Outstanding Subscription 1,000	
		Accused Sundry Income 540	
	3,40,440		3,40,440

PROBLEM 12

Summary of Receipts and Payments of Bombay Medical Aid Society for the year ended 31st March, 2018 are as follows:

Opening Cash balance in hand ₹ 8,000, Subscription ₹ 50,000, donation ₹ 15,000. Interest on Investments @ 9% p.a. ₹ 9,000, Payments for medicine supply ₹ 30,000, Honorarium to Doctors ₹ 10,000, Salaries ₹ 28,000 sundry Expenses ₹ 1,000, Equipment purchase ₹ 15,000, Charity show expenses ₹ 1,500, Charity show collections. ₹ 12,500.

Additional informations:

Particulars	Opening	Closing
Subscription due	1,500	2,200
Subscription received in advance	1,200	700
Stock of medicine	10,000	15,000
Amount due for medicine supply	9,000	13,000
Value of equipment	21,000	30,000
Value of building	50,000	48,000

Required: Prepare Receipts and Payments Account and Income and Expenditure Account for the year ended 31st March, 2018 and Balance Sheet as on 31st March, 2018.

SOLUTION**RECEIPTS AND PAYMENTS ACCOUNT**

Dr.

for the year ended 31st March, 2018

Cr.

Receipts	₹	Payments	₹
To Cash in hand (Opening)	8,000	By Medicine supply	30,000
To Subscription	50,000	By Honorarium to doctors	10,000
To Donation	15,000	By Salaries	28,000

To Interest on investments	9,000	By Sundry expenses	1,000
To Charity show collections	12,500	By Purchase of Equipment	15,000
		By Charity show expenses	1,500
		By Cash in hand (closing)	9,000
	94,500		94,500

INCOME AND EXPENDITURE ACCOUNT

Dr.
for the year ended 31st March, 2018
Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Medicine consumed	29,000	By Subscription	51,200
To Honorarium to doctors	10,000	By Donation	15,000
To Salaries	28,000	By Interest on investments	9,000
To Sundry expenses	1,000	By Profit on charity show:	
To Depreciation on:		Show collections	12,500
Equipment	6,000	Show expenses	1,500
Building	2,000		11,000
To Surplus-Excess of Income			
Over Expenditure	10,200		
	86,200		86,200

BALANCE SHEET

as on 31st March, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Fund:		Building	50,000
Opening Balance	1,80,300	Less: Depreciation	2,000
Add: surplus	10,200	Equipment	21,000
Subscription received in advance	700	Add: Purchase	15,000
Amount due for medicine supply	13,000		36,000
		Less: Depreciation	6,000
		Stock of medicine	15,000
		Investments	1,00,000
		Subscription receivable	2,200
		Cash in hand	9,000
	2,04,200		2,04,200

Working Notes:
Dr.

(I) SUBSCRIPTION ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Outstanding Subscription A/c (beg.)	1,500	By Advance Subscription A/c (beg.)	1,200
To Income & Expenditure A/c	51,200	By Bank A/c	50,000
To Advance Subscription A/c	700	By Outstanding Subscription A/c (end)	2,200
	53,400		53,400

Dr.

(II) CREDITORS FOR MEDICINES ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c	30,000	By Balance b/d	9,000
To Balance c/d	13,000	By Credit Purchases	34,000
	43,000		43,000

Dr.

(III) STOCK OF MEDICINES ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	10,000	By Income & Expenditure A/c	29,000
To Purchases	34,000	By Balance c/d	15,000
	44,000		44,000

Dr.

(IV) EQUIPMENT ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	21,000	By Depreciation A/c	6,000
To Bank A/c (Purchases)	15,000	By Balance c/d	30,000
	36,000		36,000

(V) BALANCE SHEET OF MEDICAL AID SOCIETY*as on 31st March, 2017*

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital fund (balancing figure)	1,80,300	Building	50,000
Subscription received in advance	1,200	Equipment	21,000
Amount due for medicine supply	9,000	Stock of medicine	10,000
		Investments	1,00,000
		Subscription receivable	1,500
		Cash in hand	8,000
	1,90,500		1,90,500

Note: Donation has been credited directly to the Income and Expenditure account assuming that donation is of revenue nature. Alternatively, donation may be treated as of capital nature and thus, be credited to capital fund.

21.0 ACCOUNTS OF A PROFESSIONAL FIRM

Professionals (like solicitors, doctors, chartered accountants, architects etc.) or Professionals firms generally prefer to prepare Income and Expenditure Account to find out surplus generated from professional activities during a particular accounting period, Receipts and Expenditure Account for allocation of such surplus and Balance Sheet to show financial position at the end of a particular period.

MEANING OF RECEIPTS AND EXPENDITURE ACCOUNT

1. Receipts and **Expenditure** Account is an **Income** statement which is prepared by professionals (like Chartered Accountants) or professional firms to ascertain the final results of their professional activities during an accounting period.
2. In Receipts and **Expenditure** Account, all **expenses** are recognised **on accrual basis** and all **Incomes** are recognised on cash basis. In other words, all outstanding expenses are considered but all outstanding fees and charges or work-in-progress are not considered.

REASON FOR NON-RECOGNITION OF OUTSTANDING FEES

The reason for non-recognition of outstanding fees is that professionals consider it imprudent and risky to recognize the outstanding fees.

REASON FOR DIFFERENCE BETWEEN THE PROFIT AS SHOWN BY THE *INCOME & EXPENDITURE* ACCOUNT AND RECEIPTS AND *EXPENDITURE* ACCOUNT.

Such difference arises because of non-recognition of outstanding fees and charges and work-in-progress in Receipts & Expenditure Account.

PRACTICAL GUIDELINES FOR PREPARING FINAL ACCOUNTS OF A PROFESSIONAL FIRM

1. Prepare the *Income* and *Expenditure* Account in the usual manner after taking into account the following:
 - (i) Fees and Charges for Completed Work in respect of which bills have been submitted,
 - (ii) Value of the Incomplete Work in the beginning, and
 - (iii) Value of the Incomplete Work at the end.
2. Transfer the Surplus from the *Income* and *Expenditure* Account to the credit of Receipts and *Expenditure* Account
3. Make 'Provision for Outstanding fees and charges (for Completed Work) and for the Value of Incomplete Work' at the end by debiting the Receipts and *Expenditure* Account.
4. Take credit of 'Provision for Outstanding fees and charges (for Completed Work) and for the value of Incomplete Work' existing at the beginning by crediting the Receipts and *Expenditure* Account.
5. Give credit to partners for the share in direct business at an agreed rate (if any).
6. Allocate the balance of surplus among the partners in an agreed profit sharing ratio.

FORMAT OF *INCOME* AND *EXPENDITURE* ACCOUNT OF A PROFESSIONAL FIRM**INCOME AND EXPENDITURE ACCOUNT OF A PROFESSIONAL FIRM**

Dr.

for the year ending on...

Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Incomplete Work (in the beg.):		By Bills of Cost Rendered (Fees Bills):	
A's Clients xxx		A's Clients xxx	
B's Client xxx	xxx	B's Clients xxx	xxx
To Salaries & Wages	xxx	By Incomplete Work (at the end):	
To Stipend to Trainees	xxx	A's Clients xxx	
To Printing & Stationary	xxx	B's Clients xxx	xxx
To Conveyance Charges	xxx		
To Travelling Expenses	xxx		
To Postage, Telephone,			
Telegram Expenses	xxx		
To General Office Expenses	xxx		
To Depreciation	xxx		
To Surplus transferred to			
Receipts and Expenditure A/c	xxx		
	xxx		xxx

FORMAT OF RECEIPTS AND EXPENDITURE ACCOUNT OF A PROFESSIONAL FIRM**RECEIPTS AND EXPENDITURE ACCOUNT OF A PROFESSIONAL FIRM***Dr.**for the year ending on.....**Cr.*

Expenditure	₹	Receipts	₹
To Provision for Outstanding Fees & value of Incomplete Work (at the end):		By Surplus transferred from Income & Expenditure A/c	xxx
A's Clients xxx		By Provision for Outstanding Fees & value of Incomplete Work (in the beginning):	
B's Clients xxx	xxx	A's Clients xxx	
To Partner's Capital Accounts (Share in direct business)		B's Client xxx	xxx
A xxx			
B xxx	xxx		
To Partner's Capital Accounts (Balance of Surplus)			
A xxx			
B xxx	xxx		
	xxx		xxx

ILLUSTRATION 52

Dr Arun Gupta's Receipts and Payments for the year ending on 31st March 2018 was as follows:

Receipts	₹	Payments	₹
To Balance b/d	66,100	By Rent (for 18 months to 30.6.2018)	45,000
To Fees	2,14,200	By Telephone Charges	4,500
To Miscellaneous Receipts	200	By Salaries to assistants	33,000
To Sale of old Equipment	4,000	By Journals etc.	1,000
		By Library Books (Purchased on 1.7.2017)	5,000
		By Medical Equipments	8,000
		By Furniture (Purchased on 1.10.2017)	7,000
		By Purchases of Medicines	43,000
		By Conveyance Expenses	50,000
		By Drawings	60,000
		By Misc. Expenses	1,000
		By Balance c/d	27,000
	2,84,500		2,84,500

Information:

- Fees outstanding: on 31.3.2017 ₹ 2,000, on 31.3.2018 ₹ 5,000
- Stock of Medicines: on 31.3.2017 ₹ 10,000, on 31.3.2018 ₹ 18,600
- Creditors for Medicines: on 31.3.2017 ₹ 100, on 31.3.2018 ₹ 300

- (d) Medical Equipment on 31.3.2017 ₹ 50,000. Medical Equipment was sold as well as purchased on 1st Jan. 2018. The book value of the equipment sold being ₹ 6,000 as on 1.4.2017. Equipment is subject to depreciation @ 20% p.a.
- (e) Furniture on 31.3.2017 ₹ 5,000, Library Books on 31.3.2017 ₹ 1,000 Depreciate furniture by 10% and Library Books by 20%.
- (f) Salary to assistant still payable is ₹ 3,000.
- (g) 40% of conveyance is for domestic purposes.

Required: Prepare the Receipts and Expenditure Account of Dr. Arun for the year 2017-2018 and the Balance Sheet as at 31.3.2018.

SOLUTION
RECEIPTS AND EXPENDITURE ACCOUNT OF DR. ARUN
Dr.
for the year ending on 31st March, 2018
Cr.

Expenditure	₹	Receipts	₹
To Medicine Consumed	34,600	By Fees	2,14,200
To Rent [₹ 45,000 × 12/18]	30,000	By Misc. Receipts	200
To Telephone charges	4,500		
To Salaries to assistants paid 33,000			
Add: O/s at the end 3,000	36,000		
To Journals etc.	1,000		
To Misc. Expenses	1,000		
To Depreciation Medical Equipment	10,100		
To Depreciation on Library Books	1,200		
To Depreciation on furniture	1,200		
To Loss on sale of Equipment	1,100		
To Conveyance [60% of ₹ 50,000]	30,000		
To Surplus t/f to Capital Fund	63,700		
	2,14,400		2,14,400

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Creditors for Medicines	300	Cash in hand	27,000
Salary outstanding	3,000	Medical Equipments	42,800
Capital		Furniture	10,800
Opening Balance 1,24,500		Library Books	4,800
Add: Surplus 63,700		Stock of Medicines	18,600
1,88,200		Fees Outstanding 5,000	
Less: Drawings		Less: Provision against	
Cash 60,000		Outstanding Fees 5,000	—
Conveyance 20,000 80,000	1,08,200	Prepaid Rent [₹ 45,000 × 3/18]	7,500
(40% of ₹ 50,000)			
	1,11,500		1,11,500

Working Notes:**(I) BALANCE SHEET AS AT 31ST MARCH, 2017**

Liabilities	₹	Assets	₹
Creditors for Medicines	100	Cash in hand	66,100
Rent Outstanding [₹ 45,000 × 3/18]	7,500	Medical Equipment	50,000
Capital (Balancing figure)	1,24,500	Furniture	5,000
		Library Books	1,000
		Stock of Medicines	10,000
		Fees Outstanding	2,000
		Less: Provision	2,000
			—
	1,32,100		1,32,100

Dr. **(II) CREDITORS FOR MEDICINES ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Cash A/c	43,000	By Balance b/d	100
To Balance c/d	300	By Stock of Medicines A/c (Purchases)	43,200
	43,300		43,300

(III) STOCK OF MEDICINES ACCOUNT

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Income & Expenditure A/c (b.f.)	34,600
To Creditors for Medicines A/c	43,200	By Balance c/d	18,600
	53,200		53,200

Dr. **(IV) MEDICAL EQUIPMENT ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	50,000	By Depreciation A/c	900
To Cash A/c (Purchases)	8,000	By Cash A/c (Sale Proceeds)	4,000
		By Income & Expenditure A/c (Loss) [(₹ 6,000 – ₹ 900) – ₹ 4,000]	1,100
		By Depreciation A/c on ₹ 44,000 for 1 year	8,800
		on ₹ 8,000 for 1/4 year	400
		By Balance c/d	42,800
	58,000		58,000

Dr. **(V) FURNITURE ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	5,000	By Depreciation A/c	1,200
To Cash A/c (Purchases)	7,000	By Balance c/d	10,800
	12,000		12,000

Dr.

(VI) LIBRARY BOOKS ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	1,000	By Depreciation A/c	1,200
To Bank A/c (Purchases)	5,000	By Balance c/d	4,800
	6,000		6,000

Dr.

(VII) PROVISION AGAINST OUTSTANDING FEES ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Fees A/c		By Balance b/d	2,000
[Ope. Reserve no longer required]	2,000	By Fees A/c	5,000
To Balance c/d	5,000		
	7,000		7,000

Dr.

(VIII) FEES ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	2,000	By Provision against outstanding fees A/c	2,000
To Provision against outstanding fees A/c	5,000	By Cash A/c	2,14,200
To Income & Expenditure A/c (t/f)	2,14,200	By Balance c/d	5,000
	2,21,200		2,21,200

ILLUSTRATION 53

M/s Sagar and Boond are a firm of solicitors whose partners Anand and Ashok share profits in equal shares, after charging a management fee of 5% thereof to Anand. For the year ended on 31st March 2018, the books maintained by the firm reveal the following **Particulars**:

Particulars	₹	Particulars	₹
Capitals:	33,000	Office Rent	12,000
Drawings: Anand	20,000	Office Expenses	3,600
Ashok	18,000	Furniture and Library books	24,600
Life Insurance Premium paid: Anand	6,000	Client's disbursements	2,600
Ashok	12,000	Amount owing by clients for bills of cost rendered	17,200
Salaries to staff and juniors	46,000	Profit costs	1,42,000
Amounts received from clients on accounts of pending matters	32,000	Fixed deposits with Bank	15,000
Salary debts owing by the firm	3,400	Bank accounts: Clients	31,800
Reserve against bills of costs not collected and work-in-progress as on 1.4.2017	5,000	Office	6,600
		Work-in-progress on 31.3.2018	8,200

The following additional information is also available:

- Capital accounts of partners, at the beginning of the year, were of equal amounts.
- Included in the bills of costs sent to clients are sundry disbursements like postage, telephone charges, etc. debited in the books to office expenses account. At the end of the year, items on the debit side of Clients' Disbursements Account, amounting to ₹ 3,200, had not been charged to clients in bills of costs. Of these, ₹ 200 was received and credited to their accounts in the year.

Required: Prepare the Receipts and **Expenditure** Account for the year ended on 31st March 2018, and a Balance Sheet of the firm as on that date.

SOLUTION**RECEIPTS AND EXPENDITURE ACCOUNT***Dr.**for the year ending on 31st March, 2018**Cr.*

Expenditure	₹	Receipts	₹
To Salaries for staff	46,000	By Reserve against Bills of	
To Office Rent	12,000	Cost not collected and W.I.P.	5,000
To Office Expenses		By Profit Costs	1,42,000
[(₹ 3,600) – (₹ 3,200 – ₹ 2,600)]	3,000	By Work-in-progress	8,200
To Reserve against Bills of cost not collected and work-in-progress (₹ 17,200 + ₹ 8,200)	25,400		
To Management fee to Anand (5% of ₹ 68,800)	3,440		
(Contd)			
To Net Profit transferred to Partners' Capital A/cs:			
Anand 32,680			
Ashok 32,680	65,360		
	1,55,200		1,55,200

BALANCE SHEET OF M/S SAGAR AND BOOND AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital Accounts:		Furniture and Library	24,600
Anand:		Fixed Deposits with Bank	15,000
Opening balance 16,500		Debtors for Bills of cost rendered	17,200
Add: Management fee 3,440		Work-in-progress	8,200
Net Profit 32,680		Debtors for Disbursements (₹ 3,200 – ₹ 200)	3,000
Less: Drawings and Insurance Premium 26,000		Cash at Bank:	
Ashok:	26,620	Office 6,600	
Opening Balance 16,500		Clients 31,800	38,400
Add: Net Profit 32,680			
Less: Drawings and Insurance premium 30,000	19,180		
Reserve against Debtors not collected & WIP [₹ 17,200 + ₹ 8,200]	25,400		
Sundry Creditors	3,400		
Clients Deposit (₹ 32,000 – ₹ 200)	31,800		
	1,06,400		1,06,400

ILLUSTRATION 54

A doctor, after retiring from Government Service, started private practice on 1st April, 2014 with ₹ 20,000 of his own and ₹ 30,000 borrowed at an interest of 15% per annum on the security of his life policies. His accounts for the year were kept on a cash basis and the following is his summarized Cash Account:

Dr.

Cr.

<i>Receipts</i>	₹	<i>Payments</i>	₹
Own Capital	20,000	Medicines purchased	24,500
Loan	30,000	Surgical Equipments	25,000
Prescription Fees	52,500	Motor Car	32,000
Gifts from Patients	13,500	Motor Car Expenses	12,000
Visiting Fees	25,000	Wages and Salaries	10,500
Fees from Lectures	2,400	Rent of Clinic	6,000
Pension received	30,000	General Charges	4,900
		Household Expenses	18,000
		Household Furniture	2,500
		Expenses on daughter's Marriage	21,500
		Interest on loan	4,500
		Balance at Bank	11,000
		Cash in Hand	1,000
	1,73,400		1,73,400

You are required to prepare his Capital Account and Income and Expenditure Account for the year ended 31st March, 2018 and a Balance Sheet as on that date. One-third of the motor car expenses may be treated as applicable to the private use of car and ₹ 3,000 of the wages and salaries are in respect of domestic servants.

The stock of medicines in hand on 31st March, 2018 was valued at ₹ 9,500.

SOLUTION
CAPITAL ACCOUNT

Dr.

For the year ended 31st March, 2018

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Drawings		By Cash/bank	20,000
Motor Car expenses	4,000	By cash/bank (Pension)	30,000
(one-third of ₹ 12,000)		By Net Income from	
Household expenses	18,000	Practice (derived from	47,500
Daughter's marriage exp.	21,500	Income and Expenditure A/c)	
Wages of domestic servants	3,000		
Household furniture	2,500		
To Balance c/d	48,500		
	97,500		97,500

**INCOME AND EXPENDITURE ACCOUNT
FOR THE YEAR ENDED 31ST MARCH, 2018**

Dr.

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Medicines consumed		By Prescription fees	52,500
Purchases 24,500		By Gifts from patients	13,500
Less: Cl.Stock 9,500	15,000	By Visiting fees	25,000
To Motor car expenses	8,000	By Fees from lectures	2,400
To Wages and Salaries	7,500		
(₹ 10,500 – ₹ 3000)			
To Rent of clinic	6,000		
To General charges	4,900		
To Interest on loan	4,500		
To Net Income	47,500		
	93,400		93,400

**BALANCE SHEET
as on 31st March, 2018**

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital	48,500	Motor Car	32,000
Loan	30,000	Surgical Equipments	25,000
		Stock of medicines	9,500
		Cash at bank	11,000
		Cash in hand	1,000
	78,500		78,500

ILLUSTRATION 54

Old and New are in partnership, practising as Chartered Accountants under the name and style Oldnew & Co., sharing profits in the manner stated below. They close their accounts on 31st March. The following was their Balance Sheet as on 31st March, 2017.

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Partners' Capitals:		Motor Car	20,000
Old 26,000		Office Machinery	3,000
New 18,000	44,000	Furniture	8,000
Audit Fees Collected in	1,000	Outstanding Audit Fees:	
Advance (old clients)		Old's clients 4,000	
Client Accounts	2,000	New's clients 5,000	9,000
Liabilities for Establishment exp.	500	Cash at bank	12,500
Provision against Outstanding		Cash in hand	1,500
Audit Fees	9,000	Library Books	2,500
	56,500		56,500

The following is the summary of their Cash Transactions for the year ended on 31st March 2018.

<i>Receipts</i>	₹	<i>Disbursements</i>	₹
Opening Cash and Bank Balance	14,000	Establishment charges	24,000
Audit Fees:		Motor car expenses	10,000
Old clients 90,000		Printing and Stationery	700
New clients 50,000	1,40,000	Postage and Telegrams	300
Fees for other service:		Subscription for journals	600
Old's Account 40,000		Library Books	1,500
New's Account 20,000	60,000	Calculating Machine	7,500
Miscellaneous Income	500	Travelling and Conveyance	2,500
		Member Fees 400	
		Drawings:	
		Old 50,000	
		New 40,000	90,000
		Disbursement on Clients	1,500
		Cash in hand	2,500
		Cash in bank	73,000
	2,14,500		2,14,500

The following Particulars are further available:

- Depreciation to be provided on: Books @ 10%, Motor Cars @ 20% p.a., Furniture @ 10% p.a., Office Machine @ 15%.
- Audit Fees Receivable: New's clients: ₹ 2,000, Old's clients: ₹ 6,000.
- Outstanding liability for establishment expenses at the end: ₹ 1,000.
- It has been agreed that 40% of Audit Fees and 20% of Fees for other services should be transferred to **Income** and **Expenditure** Account in respect of each partner's account, the balance being credited directly to the Capital Accounts, Profits and Losses are to be divided between the partners in the ratio at 2:1.

Required: Prepare the **Income** and **Expenditure** Account for the year 2017-2018 and a Balance Sheet as on 31st March, 2018.

SOLUTION

INCOME AND EXPENDITURE ACCOUNT

Dr.

for the year ended on 31st March, 2018

Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Establishment	24,500	By Audit Fees (₹ 36,400 + ₹ 20,000)	56,400
To Motor Car expenses	10,000	By Fee for other Services	12,000
To Printing and Stationery	700	By Miscellaneous Receipts	500
To Postage and Telegrams	300		
To Subscription for Journals	600		
To Travelling and Conveyance	2,500		
To Membership Fees	400		
To Depreciation	6,775		
To Profit:			
Old's Share 15,417			
New's Share 7,708	23,125		
	68,900		68,900

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital Accounts:		Library Books (₹ 4,000 – ₹ 400)	3,600
Old 78,017		Motor Car (₹ 20,000 – ₹ 4,000)	16,000
New 31,708	1,09,725	Furniture (₹ 8,000 – ₹ 800)	7,200
Liabilities for establishment expenses	1,000	Office Machinery (₹ 10,500 – ₹ 1,575)	8,925
Clients Accounts	500	Outstanding Audit Fees:	
Provision against Audit Fees		Old's clients 6,000	
Receivable	8,000	New's clients 2,000	8,000
		Cash in hand	2,500
		Cash in bank	73,000
	1,19,225		1,19,225

Working Notes:

Dr. **(I) AUDIT FEES ACCOUNT** Cr.

Particulars	Old ₹	New ₹	Particulars	Old ₹	New ₹
To Balance b/d (Beg.)	4,000	5,000	By Provision against outstanding Fees A/c	4,000	5,000
To Capital A/c (60%)	54,600	30,000	By Advance Fees A/c (in the beginning)	1,000	
To Income and Expenditure A/c (40%)	36,400	20,000	By Cash A/c	90,000	50,000
To Provision against Outstanding Fees A/c (at the end)	6,000	2,000	By Balance c/d (at the end)	6,000	2,000
	1,01,000	57,000		1,01,000	57,000

Dr. **(II) PROVISION AGAINST OUTSTANDING AUDIT FEE ACCOUNT** Cr.

Particulars	Old ₹	New ₹	Particulars	Old ₹	New ₹
To Audit Fees A/c	4,000	5,000	By Balance b/d	4,000	5,000
To Balance c/d	6,000	2,000	By Audit fees A/c	6,000	2,000
	10,000	7,000		10,000	7,000

Dr. **(III) FEES FOR OTHER SERVICE ACCOUNT** Cr.

Particulars	Old ₹	New ₹	Particulars	Old ₹	New ₹
To Capital A/c (80%)	32,000	16,000	By Cash A/c	40,000	20,000
To Income & Expenditure A/c (20%)	8,000	4,000			
	40,000	20,000		40,000	20,000

Dr.

(IV) CAPITAL ACCOUNTS OF PARTNERS

Cr.

Particulars	Old ₹	New ₹	Particulars	Old ₹	New ₹
To Drawings	50,000	40,000	By Balance b/d	26,000	18,000
To Balance c/d	78,017	31,708	By Audit fees (60%)	54,600	30,000
			By Other Services 80%	32,000	16,000
			By Share of Profit	15,417	7,708
	1,28,017	71,708		1,28,017	71,708

REVIEW QUESTIONS

1. How will you deal with the following items while preparing the **Income** and **Expenditure** Account for the year ending on 31st December, 2018 and the Balance Sheet as on that date?

Subscription outstanding as on 31.12.2018 ₹ 19,000 (including ₹ 1,000 for 2017) Subscription received in advance as on 31.12.2018 ₹ 6,000 (including ₹ 400 for 2016)

Subscription received during 2018: for 2017 ₹ 800, for 2018 ₹ 17,800, for 2018 ₹ 2,68,800, for 2016 ₹ 8,000, for 2017 ₹ 2,400.

Subscription outstanding as on 31.12.2018 ₹ 14,000.

Subscription of 2017 written off during the year ₹ 100.

[Ans. ₹ 2,88,000]

2. How will you deal with the following items while preparing for the Tulsian Cricket Club's **Income** and **Expenditure** Account for the year ending on March 31, 2018 and its Balance Sheet as on March 31, 2018.

(i) Building Fund as on 1.04.2017	4,00,000
Donations received for the Building	11,08,000
Expenditure on Building construction	11,84,000
The construction work in continuing,	
(ii) Tournament Fund: as on April 1, 2017	7,520
Donation received for Tournament	36,800
Tournament Expenses	60,400
Proceeds from Sale of Tournament Tickets	20,000
(iii) Life Membership fees received during the year	32,000
(iv) Subscription for Governor's Party received	40,000
Outstanding Subscription for Governor's Party	10,000
(v) Capital Fund as on 1.04.2017.	20,00,000

[Ans. Capital Fund: ₹ 12,16,000, Building Fund ₹ 3,24,000, Building in progress ₹ 11,84,000, Tournament Fund ₹ 3,920, Subscription for Governor's Party ₹ 50,000, O/s Subscription ₹ 10,000]

3. How will you deal with the following items while preparing the **Income** and **Expenditure** Account of Tulsian Club for the year ending on March 31, 2018 and a Balance Sheet as on that date?

Particulars	1.04.2017 ₹	31.03.2018 ₹
Outstanding Subscription	19,000	14,000
Advance Subscription	5,600	10,400

Outstanding Salaries	30,000	18,000
Prepaid Salaries	10,000	6,000
Amount due to Suppliers of Sports Materials	30,000	18,000
Advances to Suppliers of Sports Materials	10,000	6,000
Stock of Sports Materials	30,000	14,000

During 2017–2018, the payment made to the suppliers of Sports Materials was ₹ 1,08,000 & Cash Purchases amounted to 10% of Credit Purchases. Subscription received ₹ 2,97,800, Salaries paid ₹ 1,08,000.

[Ans. Sports Materials consumed ₹ 1,26,000, Salaries ₹ 1,00,000, Subscription ₹ 2,88,000]

4. Show how will you deal with the following items while preparing the final accounts of Tulsian Club for the year ending on March 31, 2018:

RECEIPTS AND PAYMENTS ACCOUNT OF TULSIAN CLUB, DELHI

Dr.

for the year ended 31st March, 2018

Cr.

Receipts	₹	Payments	₹
Admission Fees	10,000	Prizes awarded	4,000
Life Membership Subscription	1,00,000	Tournament Expenses	2,00,000
Donations	2,00,000	Construction of Building	6,00,000
Tournament Fund	1,00,000	12% Fixed Deposit on 1.7.2017	2,00,000
Proceeds of Tournament tickets	80,000		
Donations for Prizes	5,600		
Donation for Building	10,00,000		
Interest on 12% Fixed Deposit	12,000		
Subscription for Governor's Party	6,900		
Interest on Prize Fund Investments	2,400		
Interest on Building Fund			
Investments	80,000		

Additional Information:

Particulars	1.04.2017 ₹	31.03.2018 ₹
Tournament Fund	10,000	
Prize Fund	24,000	
10% Prize Fund Investments	24,000	
Building Fund	8,00,000	
10% Building Fund Investments	8,00,000	
Capital Fund	18,00,000	
Subscription for Governor's party outstanding	—	1,100

[Ans. Income and Expenditure Account: Tournament Expenses ₹ 10,000, Interest on F D ₹ 18,000, Admission Fees ₹ 10,000, Donations ₹ 2,00,000, Balance Sheet: Liabilities: Capital Fund: ₹ 25,00,000, Building Fund: ₹ 12,80,000, Prize Fund: ₹ 28,000, Tournament Fund: ₹ Nil, Subscription for Governor's Party ₹ 8,000, Assets: Building in progress ₹ 6,00,000, 10% Building Fund Investments ₹ 8,00,000, 10% Prize Fund Investments ₹ 24,000, 12% F D ₹ 2,00,000, Interest Accrued on F D ₹ 6,000, O/S Subscription for Governor's party ₹ 1,100.]

5. From the following information of TULSIAN CLUB, prepare the Restaurant Trading A/c, Income & Expenditure A/c for the year ended 31st March, 2018 and Balance Sheet as on that date:

Receipts	₹	Payments	₹
Opening Balances:		Restaurant Purchases	2,04,800
Stamps	50	Wages (including ₹ 50,000 for Restaurant).	92,300
Bank FD	10,000	Fuel	17,700
Bank Balance (as per Pass Book)	6,300	Supplier of Sports material	54,000
Restaurant Takings	3,61,600	Postage Expenses	200
Subscription:		Tournament Expenses	5,530
2015-2016	400	Rent	1,48,500
2016-2017	8,900	Rates & Taxes	300
2017-2018	1,34,400	Telephone charges	1,500
2018-2019	4,000	Affiliation Fee	2,400
2019-2020	1,200	Honorarium	12,000
Entrance Donation	1,00,000	Purchases of Books & Periodicals (including ₹.19,000 for Purchase of Books)	29,000
Donation for Prizes	2,800	Sundry Assets	8,000
Donation for Building	2,80,000	Prize awarded	2,000
Bank Interest received	1340	Expenditure on Building (31.3.2018)	2,00,000
Interest on Govt. Securities (after TDS @ 10%)	18,000	Expenditure on Pavilion	30,000
Sale of old Sports Assets	5,200	Closing Balances:	
Interest on Prize Fund Investments	600	Bank Balance (as per Pass Book)	1,76,535
Interest on Building Fund Investments	60,000	Stamps	25
Cash overspent	1,000	Bank FD	11,000
	9,95,790		9,95,790

Additional Information:
(A) OPENING & CLOSING BALANCES

	01.04.2017	31.03.2018
Stock in Restaurant	3,900	4,500
China Glass Cutlery	2,500	?
Subscription Outstanding *(including 500 for 2015-2016)	*9,500	6,900
Advance Subscription *(including 200 for 2018-2019)	*3,000	?
Amount due to suppliers of Sports material	15,000	9,750
Advances to supplier of Sports Material	5,000	3,250
Stock of Sports material	15,000	2,500
Rates & Taxes	?	?
Telephone charges	?	?

Entrance Donation received pending membership	1,00,000	
Cheques issued but not presented for Tournament Expenses	270	90
Pavilion at cost	87,000	1,17,000
Accumulated Depreciation on Pavilion	56,400	
Sundry Assets	44,000	43,200
Building Fund [represented by 10% Investments]	12,00,000	?
Prize Fund [represented by 10% Investments]	12,000	?
10% Govt. Securities [Face Value ₹ 2,00,000]	1,80,000	

- (b) Boarding expenses - restaurant staff ₹ 20,000, other staff ₹ 7,500.
- (c) Subscription of ₹ 100 for 2015-2016 written off.
- (d) 50% of Entrance Donation was to be capitalised. There was no pending membership as on 31.3.2018. A sum of ₹ 20,000 received in October 2017 as Entrance Donation was to be refunded. The refund was made on 3.6.2018.
- (e) Interest accrued on Bank deposit but not received ₹ 200.
- (f) Govt. Securities of ₹ 2,00,000 (cost ₹ 1,80,000) present investment in Endowment Fund.
- (g) Cash overspent represents Honorarium not withdrawn due to cash deficit. Annual Honorarium ₹ 12,000.
- (h) Depreciation on China Glass Cutlery @ 20% is to be provided, Depreciation on Pavilion is to be provided at 5% on WDV basis, Rate of Depreciation on Books 10%
- (i) The Club was admitted as a member of All India Lawn Tennis Federation on 1.10.2017 when it paid subscription till 30.9.2018.
- (j) Book value as on 1.4.2017 of Sports **Assets** sold was ₹ 4,000.
- (k) Rent for 1 month is outstanding
- (l) At 31.3.2018, rates & taxes were prepaid to the following 31 Jan., yearly charge ₹ 300.
- (m) A quarter charge for telephone is outstanding, the amount accrued ₹ 300. The charge for each quarter is same.

[**Ans.** Profit from Restaurant Trading ₹ 96,700, Surplus ₹ 38,560, Opening C.F. ₹ **188,230**, Total of Closing B/S ₹ 19,80,740]

31

ACCOUNTING FOR SHARE CAPITAL

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning, Nature and Characteristics of a Company
- ◇ Private Company and Public Company
- ◇ Meaning and Categories of Share Capital
- ◇ Meaning, Nature and Classes of Shares
- ◇ Important Points in case of an Issue of Shares to the Public
- ◇ Issue of Shares at Par
- ◇ Issue of Shares at a Premium [Sec. 52]
- ◇ Issue of Shares at a Discount [Sec. 53]
- ◇ Under-Subscription
- ◇ Over-Subscription
- ◇ *Pro rata* allotment
- ◇ Calls-In-arrears and Calls-in-advance
- ◇ Issue of Shares for Consideration other than Cash
- ◇ Forfeiture of Shares
- ◇ Re-Issue of Shares
- ◇ Forfeiture and Re-issue of Shares Allotted on Pro-rata basis in Case of Over-Subscription
- ◇ Disclosure of Share Capital in Company's Balance Sheet
- ◇ Private Placement of Shares

With the expansion in the scale of operations and increase in risk involved, non- corporate forms of organizations (i.e., sole proprietorship, partnership firms) found themselves unequal to the task of meeting all the capital requirements and increased risks of the present day large scale business operations. Thus, a relatively new form of business organisation came into vogue and this is called a 'Joint Stock Company' or simply, a company.

1.0 MEANING, CHARACTERISTICS AND NATURE OF A COMPANY

Meaning

A company is an incorporated association which is an artificial person created by law, having a corporate and legal personality distinct and separate from its members, perpetual succession and a common seal.

Characteristics	The essential characteristics of a company are as follows: (a) It is an incorporated (registered) association (b) It is an artificial person created by law. (c) It has a separate legal entity. (d) It has a perpetual succession, (i.e. Continued Existence) (it can be created and wound up by law only). (e) It has a common seal, i.e., official signature of the company.
Nature	A company is a corporate and legal personality distinct and separate from its members.

2.0 REGISTERED or INCORPORATED COMPANY

MEANING OF REGISTERED COMPANY

A registered company is one which is registered in accordance with the provisions of the Companies Act of 2013 and also includes the existing companies. By existing company we mean a company formed and registered under any of the previous laws. A registered company comes into existence only when it receives the certificate of incorporation. Registered companies are governed by the provisions of The Companies Act.

A Registered Company may *either* be a private company *or* a public company.

MEANING OF PRIVATE COMPANY [SECTION 2(68)]

A Private Company means a company which by its articles—

- (a) restricts the right to transfer its shares, if any,
- (b) except in case of one person company limits the number of its members to 200, and
- (c) prohibits any invitation to the public to subscribe for any securities of the company.

Notes:

1. *Since the above-mentioned four restrictions must be contained in the articles of a private limited company, it is necessary for a private company to frame its own articles. However, the articles of a private company not having share capital is not required to contain the restriction regarding the transfer of shares.*
2. *A private company may be (a) a company limited by shares, or (b) a company limited by guarantee, or (c) an unlimited company.*
3. *In case a private company is a limited company, then it must add the words 'Private Limited' at the end of its name.*
4. *If a private company does not comply with any of the restrictions contained in the articles, it ceases to enjoy some of the privileges granted to a private company.*
5. *A private company must have at least 2 directors.*

MEANING OF PUBLIC COMPANY [SECTION 2(71)]

Public company means a company which is

Either

- (a) not a private company; *or*
- (b) is a private company which is subsidiary of public company.

Notes:

1. *There is no restriction on the maximum number of members. However, the maximum number of members depends upon the number of shares allotted.*
2. *A public company may be (a) a company limited by shares, or (b) a company limited by guarantee, or (c) an unlimited company.*
3. *In case a public company is a limited company, then it must add the words 'Limited' at the end of its name.*
4. *A public company must have at least 7 members. [Section 12(1)]*
5. *A public company must have at least 3 directors.*

3.0 SHARE CAPITAL

Meaning	Share Capital means the capital raised by the issue of shares. The amounts invested by the shareholders towards the face value of shares are collectively known as 'Share Capital' which is quite distinct from the capital put in by individual shareholders.
Three	The share capital is divided under the following three heads: 1. Authorised Capital — An Authorised Capital refers to that capital which is authorised by the Memorandum of Association to be the maximum amount of share capital of the company. This is the maximum limit of the company which it is authorised to raise and beyond which the company cannot raise unless the capital clause in the Memorandum is changed. 2. Issued Capital — An Issued Capital refers to the nominal value of that part of authorised capital, which the company issues from time to time for subscription. 3. Subscribed Capital — Subscribed Capital refers to the capital which has been subscribed by the members of a company.
Other Terms used under The Act	1. Unissued Capital — Unissued Capital refers to that portion of the authorized capital which has not yet been issued. 2. Uncalled Capital — Uncalled capital refers to that portion of the issued capital which has not yet been called up by the company. 3. Reserve Capital — It refers to that portion of uncalled share capital which shall not be capable of being called up except in the event and for the purposes of the company being wound up (Sec. 65).

ILLUSTRATION 1

Calculate (a) Authorised Capital (b) Issued Capital (c) Unissued Capital (d) Subscribed Capital, (e) Called-up capital, (f) Uncalled Capital (g) Paid-up Capital in each of the following alternative cases:

Case (i) X Ltd. was formed with a capital of ₹ 10,00,000 divided into shares of ₹ 10 each. X offered the entire shares and called up fully on application. The subscribers paid ₹ 10,00,000.

Case (ii) X Ltd. was formed with a capital of ₹ 10,00,000 divided into shares of ₹ 10 each. It offered 90% shares and called up fully on application. The subscribers paid ₹ 9,00,000.

Case (iii) X Ltd. was formed with a capital of ₹ 10,00,000 divided into shares of ₹ 10 each. It offered 90% shares and called up fully on application. The subscribers paid ₹ 8,10,000.

Case (iv) X Ltd. was formed with a capital of ₹ 10,00,000 divided into shares of ₹ 10 each. It offered 90% shares and called up 60% on application. The subscribers paid ₹ 4,86,000.

SOLUTION:**CALCULATION OF VARIOUS TYPES OF CAPITAL**

<i>Type of Capital</i>	<i>Case (i) (₹)</i>	<i>Case (ii) (₹)</i>	<i>Case (iii) (₹)</i>	<i>Case (iv) (₹)</i>
A. Authorised Capital	10,00,000	10,00,000	10,00,000	10,00,000
B. Issued Capital	10,00,000	9,00,000	9,00,000	9,00,000
C. Unissued Capital [A – B]	NIL	1,00,000	1,00,000	1,00,000
D. Subscribed Capital	10,00,000	9,00,000	8,10,000	4,86,000
E. Called-up Capital	10,00,000	9,00,000	8,10,000	4,86,000
F. Uncalled Capital	NIL	NIL	NIL	3,24,000
G. Paid-up Capital	10,00,000	9,00,000	8,10,000	4,86,000

DISTINCTION BETWEEN AUTHORISED CAPITAL AND ISSUED CAPITAL

Authorised Capital and Issued Capital can be distinguished as follows:

Basis of Distinction	Authorised Capital	Issued Capital
1. Meaning	It refers to that amount which is stated in the Memorandum of Association as the share capital of the company.	It refers to the nominal value of that part of authorised capital which has been (i) subscribed for by the signatories to the Memorandum of Association and (ii) allotted for cash or consideration other than cash.
2. Consideration of future requirements	Its amount is determined after considering present and future requirements .	Its amount is determined after considering the present requirements .
3. Disclosure in Memorandum of Association	Its amount is required to be disclosed in Memorandum of Association.	Its amount is not required to be disclosed in the Memorandum of Association.
4. Is it the basis of Stamp Duty?	Stamp Duty is payable on the basis of authorised capital .	It is not the basis for calculating stamp duty .
5. Is it the basis of Company registration fees?	Company registration fee is payable on the basis of authorised capital.	Issued capital is not the basis for registration fees.
6. Does the change amount to an alteration of Memorandum?	Any change in the amount of authorised capital amounts to an alteration of Memorandum of Association.	Any change in the amount of issued capital does not amount to an alteration of Memorandum of Association.
7. Whether one can exceed other	It can exceed issued capital.	It cannot exceed authorised capital.

DISTINCTION BETWEEN RESERVE CAPITAL AND CAPITAL RESERVE

Reserve Capital should not be confused with Capital Reserve which is created out of profits. Reserve Capital and Capital Reserve can be distinguished as follows:

Basis of Distinction	Reserve Capital	Capital Reserve
1. Meaning	It refers to those portion of uncalled share capital which shall not be capable of being called up except in the event and for the purpose of the company being wound up. (Sec. 65)	It refers to those amounts which are not regarded as free for distribution by way of divided through Profit and Loss Account.
2. Mandatory or Not	It is not mandatory to create Reserve Capital.	It is mandatory to create Capital Reserve in case of profit on forfeited shares.
3. Disclosure in Balance Sheet	It is not disclosed in the company's Balance Sheet.	It is required to be disclosed as the 1st item under the head 'Reserves and Surplus' on the liabilities side of the Balance Sheet.
4. Time when it can be used	It can be used during only at the time of winding up.	It can be used during the life of the company.
5. Realised vs. Unrealised	It refers to the amount which has neither been called up nor been received.	It (excluding items like revaluation profit) refers to that amount which has already been realised.
6. Can it be used to write off capital losses?	It cannot be used to write off capital losses.	It can be used to write off capital losses.
7. Can it be used to declare share bonus?	It cannot be used to declare a share bonus.	It (excluding items like revaluation profit) can be used to declare a share bonus.

4.0 SHARE

Meaning	A 'Share' is one of the units into which the capital of the company is divided. Section 2(84) of the Companies Act, 2013 defines a share as "a share in the share capital of a company, and includes stock except where a distinction between stock and share is expressed or implied". <i>For example</i> , where a company has a share capital of ₹ 1,00,000 divided into 10,000 units of ₹ 10 each, then each unit of ₹ 10 is called a share of ₹ 10 each and a person who has taken 10 shares of that company is said to have share in the share capital of the company to the extent of ₹ 100. A share may be partly paid up or fully paid up. The persons who contribute money through shares are called Shareholders.
Nature	A share is not a sum of money but is an interest measured by a sum of money and is made of various rights and obligations contained in the contract (i.e., Articles of Association). The shares are the movable properties transferable in the manner provided by the Articles of the company.
Disclosure	The amount of authorized capital, together with the number of shares in which it is divided, is stated in the Memorandum of Association but the classes of shares in which the company's capital is to be divided, along with their respective rights and obligations, are determined by the Articles of Association of the company.

Classes	Under the existing provisions of Sec. 43 of the Companies Act, now only two kinds of shares may be issued, viz., Preference shares and Equity shares. I. Preference Share — According to Sec. 43, a preference share is one which carries the following two rights: - a right to receive dividend at a stipulated rate <i>or</i> of a fixed amount before any dividend is paid on equity shares. - a right to receive repayment of capital on winding up of the company, before the capital of equity shareholders is returned. In addition to the aforesaid two preferential rights, a preference share may carry some other rights. On the basis of additional rights, preference shares can be classified as follows: Cumulative Preference Share is that share on which arrears of dividend accumulate. It implies that in case no dividend is declared in any particular year(s), the arrears of dividend shall be paid in the year in which dividend is declared. The arrears of dividend on cumulative preference shares are shown in the Balance Sheet as a Commitments. Non-cumulative Preference Share is that share on which arrears of dividend do not accumulate as per the express provision in the Articles of Association. It implies that in case no dividend is declared in any particular year, the right to receive such dividend for that year expires. Participating Preference Share is that share which, in addition to two basic preferential rights, also carries one <i>or</i> more of the following rights as per Articles: - a right to participate in the surplus profits left after paying dividend to equity shareholders at a stipulated rate. - a right to participate in the surplus assets left after the repayment of capital to equity shareholders on the winding up of the company. Non-participating Preference Share is that share which is not a participating share. Unless otherwise stated, a preference share is always deemed to be a non-participating preference share. Convertible Preference Share is that share which confers on its holder a right of conversion into equity share. Non-convertible Preference Share is that share which does not confer on its holder a right of conversion into equity share. Unless otherwise stated, a preference share is always deemed to be a non-convertible one. Redeemable Preference Share is that share which is redeemable in accordance with the provisions of Sec. 55. Now, no company limited by shares can issue any preference share which is irredeemable. II. Equity Share An equity share is a share which is not a preference share. According to Section 43(a) equity share capital may be (i) with voting rights; <i>or</i> (ii) with differential rights as to voting, dividend <i>or</i> otherwise in accordance with such rules and subject to such conditions as may be prescribed.

DISTINCTION BETWEEN AN EQUITY SHARE AND PREFERENCE SHARE

An Equity Share and Preference Share can be distinguished as follows:—

Basis of Distinction	An Equity Share	A Preference Share
1. Preferential right as to the payment of dividend	Payment of equity dividend is made after the payment of preference dividend.	Payment of preference dividend is made before the payment of equity dividend.
2. Preferential right as to the repayment of capital	Repayment of Equity share capital is made after the repayment of preference share capital.	Repayment of preference share capital is made before the repayment of equity share capital.
3. Fluctuations in the rate of dividend	The rate of equity dividend may vary from year to year depending upon the decision of directors and members.	The rate of preference dividend is fixed .
4. Arrears of dividend	In case of an equity share, arrears of dividend cannot accumulate in any case.	In case of a preference share, arrears of dividend may accumulate .
5. Convertibility	It cannot be convertible.	It may be convertible.
6. Voting Rights	Equity shareholders generally enjoy voting rights.	Preference shareholders do not have any voting rights except at their class meetings .
7. Redeemability	It is not redeemable during the life time of the company unless the company decides to buyback the shares.	It is redeemable during the life time of the company.

5.0 IMPORTANT POINTS IN CASE OF AN ISSUE OF SHARES TO THE PUBLIC

Prospectus	When a Public company intends to raise capital by issuing its shares to the public, it invites the public to make an offer to buy its shares through a document called 'Prospectus'. According to Sec. 26, a copy of prospectus is required to be delivered to the Registrar for registration on or before the date of publication thereof. Prospectus must be issued with 90 days of its registration.
Compulsory Listing	Every company, intending to offer shares or debentures to the public for subscription by the issue of a prospectus must, before such issue, make an application to at least one recognised stock exchange for permission for the shares or debentures intending to be so offered to be dealt in the stock exchange [Sec 40]. The name of such stock exchange(s) must be stated in the prospectus.
Applications	1. An application for shares is an offer to take shares made by an applicant. 2. The amount which the applicant is required to pay with the application is called as 'Application Money'. 3. Minimum Application Money Per Share — The amount payable on application on each share must be at least 5% of the nominal amount of share. [Sec. 39]. However, as per SEBI Guidelines the minimum Application Monies to be paid by an applicant along with the application must be (i) at least 25% of the issue price (ii) within the range of ₹ 5,000 to ₹ 7,000. 4. Application Money to be Deposited in a Scheduled Bank — All moneys received from applicants for shares shall be deposited and kept deposited

	in a Scheduled Bank— (i) until the certificate to commence business is obtained; <i>or</i> (ii) where such certificate has already been obtained, until the full amount of minimum subscription has been received by the company.
Allotment	- Allotment is an acceptance by the company of the offer made by an applicant. The term 'Allotment' means the appropriation out of the previously unappropriated capital of the company, of a certain number of shares to a person. It is on allotment that shares come into existence. - The amount payable on allotment is called 'Allotment Money'. - In case of first allotment of shares, no allotment shall be made unless the amount stated in the prospectus as the minimum subscription has been subscribed and the sum payable on application for the stated amount has been received by the company. [Sec 39] As per SEBI Guidelines, in case of non-receipt by the company of 90% of the issued amount from public subscription <i>plus</i> accepted devolvement from underwriters <i>or</i> from other sources in case of under subscribed issues, within 60 days from the date of closure of the issue, the company must refund the subscription amount in full within 78 days without interest and with interest @ 15% p.a. for the delayed period beyond 78 days from the date of closure of the issue. - The basis of allotment is decided by the Board of Directors in consultation with the concerned recognised Stock Exchange and as a result, the following courses of action are taken:— In case of Application rejected fully — Letters of Regret along with refund orders are sent. In case of Application accepted fully — Letters of Allotment are sent In case of Applications accepted partially — Letters of Allotment along with refund orders in respect of excess Application Money not adjusted towards other sums due on shares are sent.
Calls	- A call in the strict sense, is a demand by the company for payment of part of the issue price of shares <i>or</i> debentures which has not been paid and the date of whose payment was not specified in the terms of the issue. - The remaining amount (i.e. other than Application Money and allotment money) due from shareholders may be demanded in one <i>or</i> more parts which are termed as 'First Call', 'Second Call' and so on. A word 'Final' is added to the last call. <i>For example</i>, in case the second call is the last one, then the Second Call will be termed as 'Second & Final Call'. - It may be noted that the instalments of the issue price specified in the terms of issue, are strictly not calls unless the Articles specifically provides therefore. - The legal provisions relating to calls are as under: - A call must be made under a resolution of the Board of Directors passed at a meeting of the Board [Sec 179]. - The calls must be made on a uniform basis on all shares falling under the same class. Shares of the same nominal value on which different amounts have been paid up shall not be deemed to fall under the same class. (Sec. 49). - A company may, if so authorised by its articles, accept from any member the whole <i>or</i> a part of the amount remaining unpaid on any shares held by him although no part of that amount has been called up. [Sec. 50].

	(iv) The call must be made strictly in according with the provisions of the Articles. If the Articles are silent, the provisions laid down in Table 'A' shall be applicable. Table 'A' imposes the following restrictions:— (i) The amount of call must not exceed 25% of the nominal value of the shares; (ii) At least 1 month must have elapsed since the date which was fixed for the payment of the last preceding call. (iii) At least 14 days notice specifying the time and place of payment must be given. (v) As per SEBI guidelines, the calls must be structured in such a manner that the entire subscription money is received within 12 months from the date of allotment and if the investor fails to pay call money within 12 months, the subscription money already paid may be forfeited.

6.0 ISSUE OF SHARES

WORTH NOTHING POINTS

Consideration	Shares may be issued for Cash <i>or</i> for Consideration other than Cash.
Issue Price	Issue Price means the price at which shares are issued. Shares may be issued at par <i>or</i> at a premium <i>or</i> at a discount.
Payment of Issue Price	Issue Price may be payable <i>either</i> in lump sum along with application <i>or</i> in instalments at different stages (e.g., partly on application, partly on allotment, partly on call).
Par Value	Par Value means the Nominal <i>or</i> Face Value of a share. Each company can decide its own par value say ₹ 1, ₹ 2, ₹ 5, ₹ 10, ₹ 20, ₹ 50, ₹ 100 as per SEBI Guidelines.

ACCOUNTING PROCEDURE FOR THE ISSUE OF SHARES FOR CASH

Step 1: *Record the receipt of Application Money*

Step 2: Situation I — When No. of Shares applied = No. of Shares offered

Transfer Application Money on the shares allotted to 'Share Capital A/c'.

OR

Situation II — When No. of Shares applied < No. of Shares offered

(a) If the Minimum Subscription has at least been received.

Transfer Application Money on the shares allotted to 'Share Capital A/c'.

(b) If the Minimum Subscription has not been received.

Refund Application Money to all the applicants.

OR

Situation III — When No. of Shares applied > No. of Shares offered

Transfer Application Money on the shares allotted to 'Share Capital A/c' and Transfer excess Application Money (not exceeding the amount due on allotment) to 'Share Allotment Account' in case of partially accepted applications and Refund Application Money in case of rejected applications and excess Application Money over and above the allotment money in case of partially accepted applications.

Note: *The aforesaid treatment is suggested when question is silent about the treatment of Excess Application Money.*

Step 3: Make due Allotment Money on shares allotted.

Step 4: Record the receipt of Allotment Money.

Step 5: Make due the First Call money on shares allotted.

Step 6: Record the receipt of First Call Money and so on.

7.0 ISSUE OF SHARES AT PAR

MEANING OF SHARES ISSUED AT PAR

Shares are said to be issued at par when they are issued at a **price equal to the face value**, i.e., when the issue price is equal to the face value. *For example*, if a share of ₹ 10 is issued at ₹ 10, it is said that the share has been issued at par. The issue price of a share may be payable *either* in lump sum along with the application *or* in instalments.

JOURNAL ENTRIES IF THE ISSUE PRICE IS PAYABLE IN LUMP SUM

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	On Receipt of Application Money Bank A/c Dr. To Share Application & Allotment A/c (Being the Application Money received)		(With Application Money received)	
2.	On Adjustment of Application Money Share Application & Allotment A/c Dr. To Share Capital A/c To Bank A/c (Being the Application Money adjusted and Surplus refunded)		(With Application Money received) (With Application Money due on Shares allotted) (With Application Money on Rejected Applications)	

JOURNAL ENTRIES IF THE ISSUE PRICE IS PAYABLE IN INSTALMENTS

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	On Receipt of Application Money Bank A/c Dr. To Share Application A/c (Being the Application Money received)		(With Application Money received) [No. of Shares Applied × Application Money Per Share]	
2.	On Adjustment of Application Money Share Application A/c Dr. To Bank A/c To Share Capital A/c (Being the Application Money adjusted and Surplus refunded)		(With Application Money on Rejected Applications) (With Application Money due on Shares allotted) [No. of Shares Allotted × Application Money Per Share]	

3.	On Making Allotment Money due Share Allotment A/c To Share Capital A/c (Being the Allotment Money due)	Dr.	(With Allotment Money due) [No. of Shares Allotted × Allotment Money Per Share]
4.	On Receipt of Allotment Money Bank A/c To Share Allotment A/c (Being the Allotment Money received)	Dr.	(With Allotment Money received)
5.	On Making the First Call Share First Call A/c To Share Capital A/c (Being the First Call Money due)	Dr.	(With First Call Money due) [No. of Shares Allotted × 1 Call Money Per Share]
6.	On Receipt of the First Call Bank A/c To Share First Call A/c (Being the First Call Money received)	Dr.	(With First Call Money received)

TUTORIAL NOTES

Entries for Second Call, Third call	<i>Similar entries may be made for the second call and third call through Share Second Call Account and Share Third Call Account respectively. In case of last call, the word 'final' is also added to the concerned 'Share Call Account'. In case the entire balance is payable on a single call, usually the term 'Share Call Account' is used.</i>
Cash Book	<i>In case the Cash Book is required to be prepared, all cash and bank transactions will be entered in the cash book and other transactions will be entered in the 'Journal Proper'.</i>
Equity or Preference	<i>In order to distinguish one type of share from the other one, the name of the share (i.e., whether Equity or Preference) must be prefixed with the word 'Share' e.g., Preference Share Capital Account, Equity Share Capital Account, Preference Share Application Account.</i>
Share Application & Allotment A/c	<i>Instead of preparing separate Share Application A/c & Share Allotment A/c, entries relating to the application and allotment may be passed through a combined, 'Share Application & Allotment A/c'. In such a case, an entry for transferring the surplus Application Money towards allotment on partially accepted applications, is not required to be passed.</i>
Lump sum Issue Price	<i>In case the issue price is payable in lump sum in one instalment, the entries should be passed through a combined Account namely: 'Share Application and Allotment Account'.</i>
Nature of Share Application A/c	<i>Share Application Account is a personal account of applicants who have applied for shares.</i>
Nature of Share Allotment A/c	<i>Share Allotment Account is a personal account of allottees to whom the shares have been allotted.</i>
Adjustment of Excess Application Money	<i>Unless otherwise stated in the question, the excess Application Money over and above that due on allotment should be refunded to the allottees.</i>

ILLUSTRATION 2 [ISSUE PRICE IS PAYABLE IN INSTALMENTS]

X Ltd. was registered with a capital of ₹. 10,00,000 in shares of ₹ 10 each. It issued a prospectus inviting applications for 10,000 shares payable as follows:

On Application	₹ 4	On Allotment	₹ 3
On First Call	₹ 2	On Second Call	Balance

Applications were received for 10,000 shares. All money was duly received. Pass the necessary Journal entries.

SOLUTION:
JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Bank A/c Dr. To Share Application A/c (Being the Application Money received on 10,000 @ ₹ 4 per share)		40,000	40,000
2.	Share Application A/c Dr. To Share Capital A/c (Being the Application Money adjusted)		40,000	40,000
3.	Share Allotment A/c Dr. To Share Capital A/c (Being the allotment money due on 10,000 shares @ ₹ 3 per share)		30,000	30,000
4.	Bank A/c Dr. To Share Allotment A/c (Being the allotment money received)		30,000	30,000
5.	Share First Call A/c Dr. To Share Capital A/c (Being the 1st Call money due on 10,000 shares @ ₹ 2 per share)		20,000	20,000
6.	Bank A/c Dr. To Share 1st Call A/c (Being the share 1st call money received on 10,000 shares @ ₹ 2 per share)		20,000	20,000
7.	Share Second & Final Call A/c Dr. To Share Capital A/c (Being the share second & final call money due on 10,000 shares @ ₹ 1 per share)		10,000	10,000
8.	Bank A/c Dr. To Share Second & Final Call A/c (Being the share second & final call money received on 10,000) @ ₹ 1 per share)		10,000	10,000

ILLUSTRATION 3 [ISSUE PRICE IS PAYABLE IN LUMP SUM]

X Ltd. invited applications for 10,000 Equity Shares of ₹ 10 each issued at par. The whole amount was payable on application. The issue was fully subscribed. Pass the necessary Journal entries.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	Bank A/c To Share Application & Allotment A/c (Being the Application Money received)	Dr.	1,00,000	1,00,000
2.	Share Application & Allotment A/c To Share Capital A/c (Being the Application Money adjusted)	Dr.	1,00,000	1,00,000

8.0 ISSUE OF SHARES AT A PREMIUM [SEC. 52]

Meaning	(a) Shares are said to be issued at a premium when they are issued at a price higher than the face value. (b) The excess of issue price over the face value is called as the amount of 'Securities Premium', e.g., if a share of ₹ 10 is issued at ₹ 15, it is said that the share has been issued at a premium of ₹ 5.
Nature	Securities Premium (whether received in cash or in kind) is a capital receipt and not a revenue receipt.
Treatment	The premium must be credited to a separate account called ' Securities Premium Account '.
Demand	1. The amount of securities premium may be demanded along with the Application Money/allotment money/call money. 2. The amount of securities premium may be demanded <i>either</i> in lump sum <i>or</i> in instalments e.g., partly with Application Money and balance with allotment money.
Consideration	A company may issue securities at premium for cash or consideration other than cash.
Not Free	Securities Premium can not be treated as free reserves except
Reserve	for the purpose of Buy-back of shares.
Disclosure	The balance of Securities Premium Account appears under the head ' Shareholders' Funds ' and sub-head ' Reserves and Surplus ' in the Balance Sheet.
Purposes	(a) According to Sec. 52 of the Companies Act 2013, the Securities Premium may be applied only for the following purposes: 1. To issue fully paid Bonus Shares to the members. 2. To write off Preliminary Expenses of the company. 3. To write off the expenses of or the commission paid or discount allowed on any issue of shares or debentures of the company. 4. To provide for the premium payable on the redemption of any Redeemable Preference Shares or of any Debentures of the company. 5. To purchase its own shares or other securities u/s 68.

EXAMPLE 1

X Ltd. paid up share capital of ₹ 60,00,000 has a balance of ₹ 15,00,000 in Securities Premium Account. The company management does not want to carry over this balance. You are required to suggest the method for utilising this premium money that would achieve the objective of the management and maximize the return to shareholders.

SOLUTION

As per Sec. 52 of the Companies Act Securities premium money can be utilised to issue fully paid Bonus Shares to members. Hence the management should utilise the securities premium of ₹ 15,00,000 by issue of bonus shares to the shareholders in the ratio of 1 : 4 (i.e. one bonus share for every four share held).

EXAMPLE 2

Shubh Limited has the following balances appearing in its Balance Sheet:

Securities Premium	₹ 22,00,000
9% Debentures	₹ 1,20,00,000
Underwriting Commission	₹ 10,00,000

The company decided to redeem its 9% Debentures at a premium of 10%. You are required to suggest the ways in which the company can utilise the securities premium amount.

SOLUTION

- (i) Utilize ₹ 10,00,000 to write off underwriting commission.
- (ii) Utilize remaining ₹ 12,00,000 to provide for premium on redemption of 9% Debentures.

METHODS OF RECORDING

There are two methods of recording the securities premium:

1. Due Method	Under Due Method (i) an entry is passed for securities premium, when it becomes due and (ii) on receipt of securities premium, the Share Allotment Account is credited with the amount received (including securities premium) on allotment.
2. Receipt Method	Under Receipt Method (i) no entry is passed for securities premium when it becomes due, and (ii) on receipt of securities premium, the 'Securities Premium Account' is credited with the amount of securities premium received. The advantage of this method is that the 'Securities Premium Account' will not be required to be debited in the event of the forfeiture of those shares on which the securities premium money has not been received.

Note: Due Method of recording 'Securities Premium' has been followed in this book.

JOURNAL ENTRIES IF THE ISSUE PRICE IS PAYABLE IN LUMP SUM

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	On Receipt of Application Money			
	Bank A/c Dr.		(With Application Money received)	
	To Share Application & Allotment A/c			
	(Being the Application Money received)			

All entries (except entry No. 3) are same as mentioned in case of issue of shares at par. However, assuming that the premium is demanded along with allotment money, the 3rd entry shall appear as follows:

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Share Allotment A/c Dr.		(With Total Allotment Money)	
	To Share Capital A/c		(With Face Value on Allotment due)	
	To Securities Premium A/c		(With Premium Money due)	
	(Being the Allotment Money due)			

X Ltd. was registered with a capital of ₹ 10,00,000 in shares of ₹ 10 each. It issued a prospectus inviting applications for 10,000 shares at 40% premium payable as follows:

On First Call ₹ 3 (including ₹ 1 Premium), On Second Call Balance..

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Bank A/c Dr. To Share Application A/c (Being the Application Money received on 10,000 @ ₹. 5 per share)		50,000	50,000
2.	Share Application A/c Dr. To Share Capital A/c To Securities Premium A/c (Being the Application Money adjusted)		50,000	40,000 10,000
3.	Share Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c (Being the Allotment Money due on 10,000 shares)		40,000	30,000 10,000

4.	Bank A/c To Share Allotment A/c (Being the Allotment Money received)	Dr.		40,000	40,000
5.	Share First Call A/c To Share Capital A/c To Securities Premium A/c (Being the 1st Call Money due on 10,000 shares)	Dr.		30,000	20,000 10,000
6.	Bank A/c To Share 1st Call A/c (Being the share 1st call money received on 10,000 shares @ ₹ 2 per share)	Dr.		30,000	30,000
7.	Share Second & Final Call A/c To Share Capital A/c To Securities Premium A/c (Being the Share Second & Final Call Money due on 10,000 shares)	Dr.		20,000	10,000 10,000
8.	Bank A/c To Share Second & Final Call A/c (Being the Share Second & Final Call Money received)	Dr.		20,000	20,000

ILLUSTRATION 5 [ISSUE PRICE IS PAYABLE IN INSTALMENTS]

X Ltd. invited applications for 10,000 Equity Shares of ₹ 10 each issued at 40% Premium. The whole amount was payable on application. The issue was fully subscribed. Pass the necessary Journal entries.

SOLUTION
JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Bank A/c To Share Application & Allotment A/c (Being the Application Money received)	Dr.	1,40,000	1,40,000
2.	Share Application Allotment A/c To Share Capital A/c To Securities Premium A/c (Being the Application Money adjusted)	Dr.	1,40,000	1,00,000 40,000

9.0 ISSUE OF SHARES AT A DISCOUNT [SEC. 53]

Meaning	(a) Shares are said to be issued at a discount when they are issued at a price lower than the face value. (b) The excess of the face value over the issue price is called as the amount of discount, e.g., if a share of ₹ 10 is issued at ₹ 9, it is said that the share has been issued at a discount of ₹ 1.

Legal Provision	1. Except the issue of Sweat Equity shares, a company shall not issue shares at a discount. 2. Any share issued by a company at a discounted price shall be void. 3. Where a company contravenes the provisions of this section, the company shall be punishable with fine which shall be at least ₹ 1,00,000 but which may extend to ₹ 5,00,000 and every officer who is in default shall be punishable with imprisonment for a term which may extend to 6 months or with fine which shall be at least ₹ 1,00,000 but which may extend to ₹ 5,00,000 or with both.

10.0 UNDER-SUBSCRIPTION**MEANING OF UNDER-SUBSCRIPTION**

Shares are said to be under-subscribed when the number of shares applied for is *less* than the number of shares offered. *For example*, in case a company has offered 5,000 shares to public but the public applied for 4,500 shares only, it is called a case of under-subscription. In such a case, it must be ensured that the company has received the minimum subscription.

SEBI GUIDELINES

As per SEBI Guidelines, Minimum Subscription is 90% of the issued amount from public subscription *plus* accepted devolvement from underwriters or from other sources in case of under subscribed issues. In case of non-receipt minimum subscription within 60 days from the date of closure of the issue, the company must refund the subscription amount in full within 78 days without interest and with interest @ 15% p.a. for the delayed period beyond 78 days from the date of closure of the issue.

ILLUSTRATION 6

X Ltd. was registered with a capital of ₹ 10,00,000 in shares of ₹ 10 each. It issued a prospectus inviting applications for 10,000 shares at par payable as follows:

On Application	₹ 4	On Allotment	₹ 2
On First Call	₹ 2	On Second Call	Balance

Applications were received for 9,000 shares. All money was duly received.

Required: Pass the necessary Journal entries.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Bank A/c Dr. To Share Application A/c (Being the Application Money received on 9,000] @ ₹ 4 per share)		36,000	36,000
2.	Share Application A/c Dr. To Share Capital A/c (Being the Application Money adjusted)		36,000	36,000
3.	Share Allotment A/c Dr. To Share Capital A/c (Being the allotment money due on 9,000 shares)		18,000	18,000

4.	Bank A/c To Share Allotment A/c (Being the allotment money received)	Dr.		18,000	18,000
5.	Share First Call A/c To Share Capital A/c (Being the 1st Call money due on 9,000 shares)	Dr.		18,000	18,000
6.	Bank A/c To Share 1st Call A/c (Being the 1st call money received on 9,000 shares)	Dr.		18,000	18,000
7.	Share Second & Final Call A/c To Share Capital A/c (Being the share second & final call money due on 9,000 shares)	Dr.		18,000	18,000
8.	Bank A/c To Share Second & Final Call A/c (Being the share second & final call money received on 9,000 shares)	Dr.		18,000	18,000

ILLUSTRATION 7

X Ltd. invited applications for 10,000 Equity Shares of ₹ 10 each issued at par. The whole amount was payable on application. The issue was under subscribed by 1,000 shares. Pass the necessary Journal entries.

SOLUTION
JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Bank A/c To Share Application & Allotment A/c (Being the Application Money received)	Dr.	90,000	90,000
2.	Share Application & Allotment A/c To Share Capital A/c (Being the Application Money adjusted)	Dr.	90,000	90,000

ILLUSTRATION 8

Y Ltd. invited applications for 10,000 Equity Shares of ₹ 10 each issued at 40% premium. The whole amount was payable on application. The issue was under subscribed by 1,000 shares. Pass the necessary Journal entries.

SOLUTION
JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Bank A/c To Share Application & Allotment A/c (Being the Application Money received)	Dr.	1,26,000	1,26,000

2.	Share Application & Allotment A/c To Share Capital A/c To Securities Premium A/c (Being the Application Money adjusted)	Dr.	1,26,000	90,000 36,000

11.0 OVER-SUBSCRIPTION**MEANING OF OVER-SUBSCRIPTION**

Shares are said to be over-subscribed when the numbers of shares applied is more than the number of shares offered. *For example*, in case a company has offered 5,000 shares to public but the public applied for 6,000 only, it is called a case of over-subscription.

DISTINCTION BETWEEN OVER-SUBSCRIPTION AND UNDER-SUBSCRIPTION

Over-subscription and Under-subscription of shares can be distinguished as follows:

Basis of Distinction	Over-Subscription of Shares	Under-Subscription of Shares
1. No. of Shares applied as compared to No. of shares offered.	In case of over-subscription, number of shares applied for is more than the number of shares offered by the company.	In case of under-subscription, number of shares applied for is less than the number of shares offered by the company.
2. Acceptance of all Applications	All applications are not accepted in full .	All applications are accepted in full .
3. Problem of Minimum Subscription when shares are issued for the first time.	This problem does not arise at all.	If the minimum subscription has not been subscribed, all application money may be required to be returned .
4. Return of Money if minimum subscription has been received	The company returns the money to the applicants whose applications have <i>either</i> been rejected <i>or</i> have been accepted partially.	The question of returning the money does not arise at all.

ALTERNATIVES AVAILABLE IN CASE OF OVER-SUBSCRIPTION

Following three alternatives are available to deal with the situation of oversubscription:

Alternative	Course of Action
1. First Alternative Applications] [Rejection of Excess Applications]	1. Excess Applications are rejected. 2. Shares are allotted in full to the remaining applicants rejected. 3. Application Money on rejected excess applications is refunded.
2. Second Alternative. [Pro rata Allotment]	1. Shares are allotted on proportionate basis to all the applicants.

3. Third Alternative [Any Combination of above Two Alternatives]	Combination 1. Some Applications are rejected and shares are allotted on proportionate basis to the remaining applicants. Combination 2. Some Applications are accepted in full and shares are allotted on proportionate basis to the remaining applicants. Combination 3. Some Applications are accepted in full, some applications are rejected in full and shares are allotted on proportionate basis to the remaining applicants.

MEANING OF PRO RATA ALLOTMENT

Meaning	<i>Pro rata</i> allotment means allotment of less number of shares to applicants for more number of shares on proportionate basis.
When required	<i>Pro rata</i> allotment is required in case of over-subscription (i.e. when the number of shares applied for is more than the number of shares offered by the company.)
<i>Pro rata</i> Ratio	In case of <i>Pro rata</i> Allotment one should always calculate <i>Pro rata</i> Ratio (which means the Ratio of Total Number of Shares Applied to the Total Number of Shares Allotted). This <i>Pro rata</i> Ratio is used to ascertain: (a) the Number of Shares Allotted to an applicant if Number of Shares Applied by him is given. (b) the Number of Shares Applied by an applicant if Number of Shares Allotted to him is given.

Note: In *pro rata* allotment when shares are issued at a premium, excess money received on application will first be adjusted towards the share capital. Any excess thereon will be utilized towards the Securities Premium Reserve.

ILLUSTRATION 9

As a director of a company you had invited applications for 30,000 equity shares of ₹ 10 each. The total Application Money received @ ₹ 2 per share was ₹ 72,000. Name the kind of subscription. List the three alternatives for allotting these shares.

SOLUTION

Shares applied by the public = $\frac{\text{Total Application Money received}}{\text{Application Money per Share}} = ₹ 72,000 / ₹ 2 = 36,000$

It is a case of over subscription since the number of shares applied (i.e., 36,000) is more than the number of shares offered (i.e., 30,000).

Following are the alternatives for allotting these shares:

Alternative	Course of Action
1.	Reject applications for 6,000 shares and make full allotment to the remaining applicants of 30,000 shares.
2.	Make <i>pro rata</i> allotment to all the applicants in the <i>pro rata</i> Ratio of 5:6 (i.e., 30,000/36,000)
3.	Reject applications for 3,000 shares and make <i>pro rata</i> allotment to the remaining applicants in the <i>pro rata</i> Ratio of 10:11 (i.e., 30,000/33,000)
4.	Allot 3,000 shares in full and make <i>pro rata</i> allotment to the remaining applicants in the <i>pro rata</i> Ratio of 9:11 (i.e., 27,000/33,000)
5.	Reject applications for 3,000 shares, accept 3,000 shares in full and make <i>pro rata</i> allotment to the remaining applicants in the <i>pro rata</i> Ratio of 9 :10 (i.e., 27,000/30,000)

STATEMENT SHOWING THE ADJUSTMENT OF APPLICATION MONEY RECEIVED

In case of oversubscription, the following Adjustment Table may be prepared to show the adjustment of Application Money received.

Category	Shares Applied	Shares Allotted	Application Money Received	Adjustment of Application Money Received			
				Share Capital	Share Allotment	Calls-in Advance	Refund

ILLUSTRATION 10

X Ltd. invited applicants for 2,00,000 shares of ₹ 10 each payable as ₹ 2 on application, ₹ 5 on allotment and ₹ 3 on call. Application for 6,55,000 shares were received and the allotments was made as follows:

Category	Shares applied	Shares allotted
I	50,000	50,000
II	50,000	40,000
III	35,000	10,000
IV	90,000	20,000
V	1,00,000	20,000
VI	3,30,000	60,000

Required: Prepare the statement showing the adjustment of Application Money received (a) If excess Application Money was adjusted towards sum due on allotment, (b) If excess Application Money was adjusted towards other sums due on shares.

SOLUTION**CASE (A) IF EXCESS APPLICATION MONEY WAS ADJUSTED TOWARDS SUM DUE ON ALLOTMENT**

Category	Shares Applied	Shares Allotted	Application Money Received	Adjustment of Application Money Received			
				Share Capital	Share Allotment	Calls-in Advance	Refund
I	50,000	50,000	1,00,000	1,00,000	–	–	–
II	50,000	40,000	1,00,000	80,000	20,000	–	–
III	35,000	10,000	70,000	20,000	50,000	–	–
IV	90,000	20,000	1,80,000	40,000	1,00,000	–	40,000
V	1,00,000	20,000	2,00,000	40,000	1,00,000	–	60,000
VI	3,30,000	60,000	6,60,000	1,20,000	3,00,000	–	2,40,000

CASE (B) IF EXCESS APPLICATION MONEY WAS ADJUSTED TOWARDS OTHER SUMS DUE ON SHARES

Category	Shares Applied	Shares Allotted	Application Money Received	Adjustment of Application Money Received			
				Share Capital	Share Allotment	Calls-in Advance	Refund
I	50,000	50,000	1,00,000	1,00,000	—	—	—
II	50,000	40,000	1,00,000	80,000	20,000	—	—
III	35,000	10,000	70,000	20,000	50,000	—	—
IV	90,000	20,000	1,80,000	40,000	1,00,000	40,000	—
V	1,00,000	20,000	2,00,000	40,000	1,00,000	60,000	—
VI	3,30,000	60,000	6,60,000	1,20,000	3,00,000	1,80,000	60,000

TREATMENT OF EXCESS APPLICATION MONEY ON APPLICATIONS ACCEPTED

Following treatment is suggested to deal with the Excess Application Money on Applications accepted:

Situation	Suggested Treatment
1. If the Question is silent or If the Question states: "Money overpaid on applications was to be applied towards sum due on allotment." or "The excess application money received was to be adjusted against allotment only."	Retain the excess Application Money (received on Applications accepted) only upto the Allotment Money due and Refund the remaining excess Application Money. Journal Entry to Adjust Application Money Share Application A/c Dr. [with Application Money received] To Share Capital A/c [with Application Money due on Shares allotted] To Share Allotment A/c [with Application Money adjusted towards allotment] To Bank A/c [with Application Money refunded on rejected applications]
2. If the Question states: "Money overpaid on applications was to be applied towards other sum due on shares."	Retain the excess Application Money (received on Applications accepted) upto the Allotment and Calls Money due and Refund the remaining excess Application Money. Journal Entry to Adjust Application Money Share Application A/c Dr. [with Application Money received] To Share Capital A/c [with Application Money due on Shares allotted] To Share Allotment A/c [with Application Money adjusted towards allotment] To Calls-in-Advance A/c [with Application Money adjusted towards Calls] To Bank A/c [With Application Money refunded on rejected applications]

ILLUSTRATION 11

X Ltd. invited applications for 10,000 Equity Shares of ₹ 10 each issued at par. The whole amount was payable on application. The issue was over subscribed by 2,000 shares. Pass the necessary Journal entries.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	Bank A/c Dr. To Share Application & Allotment A/c (Being the Application Money received)		1,20,000	1,20,000
2.	Share Application & Allotment A/c Dr. To Share Capital A/c To Bank A/c (Being the Application Money adjusted and Surplus refunded)		1,20,000	1,00,000 20,000

ILLUSTRATION 12

Y Ltd. invited applications for 10,000 Equity Shares of ₹ 10 each issued at 40% premium. The whole amount was payable on application. The issue was over subscribed by 2,000 shares. Pass the necessary Journal Entries.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	Bank A/c Dr. To Share Application & Allotment A/c (Being the Application Money received)		1,68,000	1,68,000
2.	Share Application & Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c To Bank A/c (Being the Application Money adjusted and Surplus refunded)		1,68,000	1,00,000 40,000 28,000

ILLUSTRATION 13

Shakti Ltd. invited applications for issuing 1,00,000 Equity shares of ₹ 10 each. The amount was payable as follows:

- (i) On Application ₹ 3 per share
- (ii) On Allotment ₹ 2 per share
- (iii) On First and Final Call ₹ 5 per share

Applications were received for 2,20,000 shares. Applications for 20,000 shares were rejected and their application money was refunded. Shares were allotted to the remaining applicants as follows:

- I Allotted 50% shares to Raman who had applied for 40,000 shares.
- II Allotted in full to Akbar who had applied for 20,000 shares.
- III Allotted balance of the shares on *pro rata* basis to the other application.

Excess application money was utilised in payment of allotment and final call. All calls were made and were duly received. Pass the necessary Journal entries in the books of Shakti Ltd.

SOLUTION
JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	Bank A/c Dr. To Share Application A/c (Being the application money received)		6,60,000	6,60,000
2.	Share Application A/c Dr. To Share Capital A/c (1,00,000 × ₹ 3) To Share Allotment A/c (80,000 × ₹ 2) To Bank a/c (20,000 × ₹ 3) To Calls-in Advance A/c (Being the Application Money adjusted & Surplus refunded)		6,60,000	3,00,000 1,60,000 60,000 1,40,000
3.	Share Allotment A/c Dr. To Share Capital A/c (Being the Allotment Money due)		2,00,000	2,00,000
4.	Bank A/c [₹ 2,00,000 – ₹ 1,60,000] Dr. To Share Allotment A/c (Being the Allotment Money received)		40,000	40,000
5.	Share First & Final Call A/c Dr. To Share Capital A/c (Being the First & Final Call Money due)		5,00,000	5,00,000
6.	Bank A/c Dr. Calls-in-advance A/c Dr. To Share First & Final Call A/c (Being the First and Final Call Money received and Calls in advance adjusted)		3,60,000 1,40,000	5,00,000

Working Note:
STATEMENT SHOWING THE ADJUSTMENT OF APPLICATION MONEY RECEIVED

<i>Category</i>	<i>Shares Applied</i>	<i>Shares Allotted</i>	<i>Application Money Received</i>	<i>Adjustment of Application Money Received</i>			
				<i>Share Capital</i>	<i>Share Allotment</i>	<i>Calls-in Advance</i>	<i>Refund</i>
—	20,000	0	60,000	0	0	0	60,000
I	40,000	20,000	1,20,000	60,000	40,000	20,000	—
II	20,000	20,000	60,000	60,000	—	—	—
III	1,40,000	60,000	4,20,000	1,80,000	1,20,000	1,20,000	—
Total	2,20,000	1,00,000	6,60,000	3,00,000	1,60,000	1,40,000	60,000

ILLUSTRATION 14

Srijan Ltd. issued ₹ 10,00,000 new capital divided into ₹ 100 shares at a premium of ₹ 20 per share payable, as under:

On Application	₹ 10 per share
On Allotment	₹ 40 per share (Including ₹ 10 premium)
On First and Final Call	Balance

Overpayments on application were to be applied towards sums due on allotment and call. Where no allotment was made, money was to be returned in full. The issue was over-subscribed to the extent of 13,000 shares. Applicants for 12,000 shares were allotted only 2,000 shares and applicants for 3,000 shares were sent letters of regret and application deposits were returned to them. All the money due on allotment and final call was duly received.

Required: Make the necessary entries in the Company's books to record the above transactions.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	Bank A/c Dr. To Share Application A/c (Being the Application Money received on 23,000 shares @ ₹10 per share)		2,30,000	2,30,000
2.	Share Application A/c Dr. To Share Capital A/c To Share Allotment A/c To Bank A/c To Calls-in Advance A/c (Being the Applications Money adjusted and the Surplus refunded)		2,30,000	1,00,000 80,000 30,000 20,000
3.	Share Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c (Being the Allotment Money due)		4,00,000	3,00,000 1,00,000
4.	Bank A/c Dr. To Share Allotment A/c (Being the Allotment Money money received)		3,20,000	3,20,000
5.	Share First and Final Call A/c Dr. To Share Capital A/c To Securities Premium A/c (Being the Final Call made due)		7,00,000	6,00,000 1,00,000
6.	Bank A/c Dr. Calls-in Advance A/c Dr. To Share First and Final Call A/c (Being the Final Call Money received)		6,80,000 20,000	7,00,000

Working Note:**ADJUSTMENT OF APP. MONEY RECEIVED ON SHARES ALLOTTED ON *pro rata* BASIS**

A. Application Money received on shares applied ($12,000 \times ₹ 10$)	₹ 1,20,000
B. Less: Application Money due on shares allotted ($2,000 \times ₹ 10$)	₹ 20,000
C. Excess Application Money	₹ 1,00,000
D. Less: Allotment Money due on shares allotted ($2,000 \times ₹ 40$)	(₹ 80,000)
E. Calls-in Advance received	₹ 20,000

HOW TO CALCULATE THE AMOUNT DUE BUT NOT RECEIVED FROM DEFAULTING SHAREHOLDER TO WHOM SHARES WERE ALLOTTED ON *pro rata* BASIS

Step 1: Calculate the Total Number of Shares applied for (if not given) as under:

$$\frac{\text{Total no. of Shares applied under prorata category}}{\text{Total no. of Shares allotted under prorata category}} \times \text{No. of Shares allotted to defaulter}$$

OR

Calculate the Total Number of Shares allotted (if not given) as under:

$$\frac{\text{Total no. of Shares allotted under prorata category}}{\text{Total no. of Shares applied under prorata category}} \times \text{No. of Shares applied to defaulter}$$

Step 2: Calculate the Total Application Money received on shares applied by defaulter

$$= \text{No. of Shares applied by defaulter} \times \text{Application Money per share}$$

Step 3: Calculate the Application Money due on Shares allotted to defaulter

$$= \text{No. of Shares Allotted to Defaulter} \times \text{Application Money per share}$$

Step 4: Calculate the Excess Application Money

$$= \text{Amount as per Step 2} - \text{Amount as per Step 3}$$

Step 5: Calculate the Allotment or Call Money due on shares allotted

$$\text{No. of Shares allotted to Defaulter} \times \text{Allotment Money/Call Money per share}$$

Step 6: Calculate the Allotment or Call Money due but not received

$$= \text{Amount as per Step 5} - \text{Amount as per Step 4.}$$

HOW TO CALCULATE THE AMOUNT RECEIVED ON ALLOTMENT STAGE

Step 1: Calculate the Total Allotment Money due

$$[= \text{Total No. of Shares Allotted} \times \text{Allotment Money per share}]$$

Step 2: Deduct Allotment Money already received on Application stage.

Step 3: Deduct Allotment Money not received from Defaulting Shareholders.

Step 4: Add: Calls-in-advance (if any) received on Allotment stage.

Step 5: Calculate the Amount Received On Allotment Stage

$$= \text{Step 1} - \text{Step 2} - \text{Step 3} + \text{Step 4}$$

ILLUSTRATION 15

BT Ltd issued a prospectus inviting applications for 20,000 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 & Final Call ₹ 2.

Applications were received for 30,000 shares and *pro rata* allotment was made on the applications for 24,000 shares. It was decided to utilise excess Application Money towards the amount due on allotment. Ramesh to whom 400 shares were allotted failed to pay the allotment money and Mohan, the holder of 600 shares failed to pay the two calls.

Required: Pass the necessary journal entries.

SOLUTION**JOURNAL OF BT LTD.**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Bank A/c (30,000 × ₹ 2) Dr. To Share Application A/c (Being the Application Money received on 30,000 shares)		60,000	60,000
2.	Share Application A/c (30,000 × ₹ 2) Dr. To Share Capital A/c (20,000 × ₹ 2) To Bank A/c (6,000 × ₹ 2) To Share Allotment A/c (4,000 × ₹ 2) (Being the Application Money adjusted & Surplus refunded)		60,000	40,000 12,000 8,000
3.	Share Allotment A/c (20,000 × ₹ 5) Dr. To Share Capital A/c (20,000 × ₹ 3) To Securities Premium A/c (20,000 × ₹ 2) (Being the Allotment Money due)		1,00,000	60,000 40,000
4.	Bank A/c (₹ 1,00,000 – ₹ 8,000 – ₹ 1,840) Dr. To Share Allotment A/c (Being the remaining Allotment Money received on 19,600 shares) [See Working Note 2 & 3]		90,160	90,160
5.	Share First Call A/c (20,000 × ₹ 3) Dr. To Share Capital A/c (20,000 × ₹ 3) (Being the First Call Money due)		60,000	60,000
6.	Bank A/c (19,000 × ₹ 3) Dr. To Share First Call A/c (Being the First Call Money received on 19,000 shares)		57,000	57,000
7.	Share Second & Final Call A/c (20,000 × ₹ 2) Dr. To Share Capital A/c (Being the Second & Final Call due)		40,000	40,000
8.	Bank A/c (19,000 × ₹ 2) Dr. To Share Second & Final Call A/c (Being the Second & Final Call received on 19,000 shares)		38,000	38,000

WORKING NOTES:

1. Total No. of Shares applied by Ramesh = $(400 \times 24,000/20,000) = 480$

2. CALCULATION OF THE AMOUNT DUE BUT NOT RECEIVED ON ALLOTMENT FROM RAMESH

Particulars	₹
A. Application Money received on shares applied $(480 \times ₹ 2)$	960
B. Less: Application Money due on shares allotted $(400 \times ₹ 2)$	800
C. Excess Application Money [A – B]	160
D. Allotment Money due on shares allotted $(400 \times ₹ 5)$	2,000
E. Allotment Money due but not received $(₹ 2,000 – ₹ 160)$	1,840

3. CALCULATION OF ALLOTMENT MONEY RECEIVED LATER ON

Particulars	₹
A. Total Allotment Money Due $(20,000 \times ₹ 5)$	1,00,000
B. Less: Allotment Money Already received on application stage $(4,000 \times ₹ 2)$	(8,000)
C. Less: Allotment Money not received [as per Note (2)]	(1,840)
	90,160

12.0 CALLS-IN-ARREARS AND CALLS-IN-ADVANCE

Meaning	Calls-in-arrears refer to the amount called up by the company which has not yet been received from the shareholders till the last day fixed for the payment thereof. The total of the unpaid amounts on account of one or more instalments may or may not be transferred to Calls-in-arrears Account or Calls Unpaid Account.
Nature	Calls-in-arrears Account is an Asset Account which represents the Called up Amount not received from some shareholders.
Disclosure	The amount of Calls-in-arrears is shown in the Notes to Accounts 'Share Capital' to the Balance Sheet.
Rate of Interest	The directors can charge interest on calls-in-arrears at a rate specified in the Articles from the last date fixed for payment to the date of actual payment. But if the Articles are silent, Table F shall be applicable which empowers the Board of Directors to charge interest at a rate not exceeding 10% p.a. However, the directors have the authority to waive the payment of interest on calls-in-arrears at their discretion.

JOURNAL ENTRIES RELATING TO CALLS-IN-ARREARS

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	On Non-receipt of Call till the day fixed Calls-in-arrears A/c Dr. To Relevant Call A/c		(With Called up amount not received)	
2.	On Receipt of Calls-in-arrears at a subsequent date Bank A/c Dr. To Calls-in-arrears A/c		(With the Calls-in-arrears received)	
3.	On Making due the interest on Calls-in-arrears Sundry Members' A/c Dr. To Interest on Calls-in-arrears A/c		(With Interest due)	

4.	On Receipt of Interest on Calls-in-arrears Bank A/c To Sundry Members' A/c	Dr.	(With Interest received)
5.	On Transfer of Interest on Calls in arrears A/c to Profit & Loss A/c at the end of the accounting period Interest on Calls-in-arrears A/c To Profit and Loss A/c	Dr.	(With Interest)

13.0 CALLS-IN-ADVANCE

Meaning	Calls-in-advance refer to the Uncalled up amount received in advance from some shareholders. A company may accept calls-in-advance only if Articles authorise to do so.
Nature	Calls-in-advance Account is a Liability Account which represents the Uncalled amount received in advance from some shareholders.
Disclosure	The balance in Calls-in-advance Account is shown under the head ' Current Liabilities ' and sub-head ' Other current Liabilities '.
Rate of Interest	The Board must pay interest on calls-in-advance at a rate specified in the Articles from the date of its receipt to the date when the call becomes due. But if the Articles are silent, Table 'F' shall be applicable which gives option to Board of Directors to pay interest on calls-in-advance at a rate not exceeding 12% p.a.

JOURNAL ENTRIES RELATING TO CALLS-IN-ADVANCE

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	On Receipt of Calls-in-Advance Bank A/c To Calls in-Advance A/c	Dr.	(With the Uncalled up amount received in advance)	
2.	On Adjustment of Calls-in-Advance when such amount is called up Calls-in-Advance A/c To Relevant Call A/c	Dr.	(With Calls-in-Advance adjusted)	
3.	On Making due the Interest on Calls-in Advance Interest on Calls-in-Advance A/c To Sundry Members' A/c	Dr.	(With the Interest payable)	
4.	On Payment of Interest on Calls-in Advance Sundry Members' A/c To Bank A/c	Dr.	(With Interest paid)	
5.	On T/f of Interest on Calls-in-Advance A/c to P&L A/c at the end of the accounting period Profit and Loss A/c To Interest on Calls-in-Advance A/c	Dr.	(With Interest)	

TUTORIAL NOTES

1. Interest on Calls-in-advance is a charge against the profit and hence is to be paid whether there are profits or not.
2. Outstanding Interest on Calls-in-advance appears under the head 'Current liabilities' and sub-head Other Current Liabilities in the Balance Sheet.

14.0 DISTINCTION BETWEEN CALLS-IN-ARREARS & CALLS-IN-ADVANCE

Calls-in-arrears differ from Calls-in-advance in the following respects:

Basis of Distinction	Calls-in-arrears	Calls-in-advance
1. Meaning	It refers to the Called up amount not yet received from some shareholders till the last day fixed for payment thereof.	It refers to the Uncalled up amount received in advance from some shareholders.
2. Authority under Articles	There is no question of any authority under Articles.	A company may accept Calls-in-advance only if Articles permit.
3. Interest	Interest is charged on Calls-in-arrears.	Interest is allowed on Calls-in-advance.
4. Maximum Rate of Interest	The maximum rate of interest as per Table F is 10% p.a.	The maximum rate of interest as per Table F is 12% p.a.
5. Disclosure	The amount of Calls-in-arrears is shown in the Notes to Accounts 'Share Capital' to the Balance Sheet.	The amount of Calls-in-advance is shown under the head ' Current Liabilities ' and sub-head ' Other Current Liabilities '.

ILLUSTRATION 16

Bharat Tushar Ltd. offered 20,000 shares of ₹ 10 each at a premium of 10% payable as follows:

On Application ₹ 2 (1st Jan.), On Allotment ₹ 4 (including premium) (1st April), on First Call ₹ 3 (1st June), on Second & Final Call ₹ 2 (1st Aug).

Applications were received for 18,000 shares and the directors made allotment. One shareholder to whom 400 shares were allotted paid the entire balance on his share holdings with allotment money and another shareholder did not pay allotment and 1st call money on his 600 shares but which he paid with final call.

Required: Calculate the amount of interest paid and received on Calls-in-advance and Calls in arrears respectively on 1st Aug. Also give Journal entries to record the above transactions assuming that Calls-in-arrears Account is maintained.

SOLUTION**CALCULATION OF INTEREST ON CALLS-IN-ADVANCE**

On ₹ 1200 (i.e. $400 \times ₹ 3$) for 2 months @ 12 % p.a.	₹ 24
On ₹ 800 (i.e. $400 \times ₹ 2$) for 4 months @ 12 % p.a.	₹ 32
	₹ 56

CALCULATION OF INTEREST ON CALLS-IN-ARREARS

On ₹ 2,400 (i.e. $600 \times ₹ 4$) for 4 months @ 10% p.a.	₹ 80
On ₹ 1,800 (i.e. $600 \times ₹ 3$) for 2 months @ 10% p.a.	₹ 30
	₹ 110

JOURNAL OF BHARAT TUSHAR LTD.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1.	Bank A/c [18,000 × ₹ 2] To Share Application A/c (Being the Application Money received on 18,000 shares)	Dr.	36,000	36,000

Apr. 1.	Share Application A/c To Share Capital A/c (Being the Application Money adjusted)	Dr.		36,000	36,000
.	Share Allotment A/c [18000 × ₹ 4] To Share Capital A/c [18,000 × ₹ 3] To Securities Premium A/c [18,000 + ₹ 1] (Being the Allotment Money due)	Dr.		72,000	54,000 18,000
	Bank A/c [(17,400 × ₹ 4) + (400 × ₹ 5)] Calls-in-arrears A/c [600 × ₹ 4] To Share Allotment A/c [18,000 × ₹ 4] To Call-in-advance A/c [400 × ₹ 5] (Being the allotment money received on 17,400 shares & Calls-in-advance on 400 shares)	Dr. Dr.		71,600 2,400	72,000 2,000
June 1	Share First Call A/c [18,000 × ₹ 3] To Share Capital A/c (Being the First Call Money due on 18,000 shares)	Dr.		54,000	54,000
	Bank A/c [17,000 × ₹ 3] Calls-in-advance A/c [400 × ₹ 3] Calls-in-arrears A/c [600 × ₹ 3] To Share First Call A/c (Being the First Call Money received except on 600 shares, Call-in-advance on 400 shares adjusted)	Dr. Dr. Dr.		51,000 1,200 1,800	54,000
August 1	Share Second & Final Call A/c [18,000 × ₹ 2] To Share Capital A/c (Being the Second & Final Call Money due)	Dr.		36,000	36,000
	Bank A/c [(17,600 × ₹ 2) + (600 × ₹ 7)] Calls-in-advance A/c [400 × ₹ 2] To Share Second & Final Call A/c To Calls-in-arrears A/c [600 × ₹ 3] (Being the Second & Final Call Money received along with Calls-in-arrears and Call-in-advance on 400 shares adjusted)	Dr. Dr.		39,400 800	36,000 4,200
	Sundry Members' A/c To Interest on Calls-in-arrears A/c (Being the Interest on Calls-in-arrears due)	Dr.		110	110
	Bank A/c To Sundry Members' A/c (Being the Interest on Calls-in-arrears received)	Dr.		110	110
	Interest on Calls-in-Advance A/c To Sundry Members' A/c (Being Interest on Calls in-advance)	Dr.		56	56
	Sundry Members' A/c To Bank A/c (Being the Interest on Calls-in-advance paid)	Dr.		56	56

Note: At the end of accounting period Interest Accounts will be transferred to Profit & Loss A/c.

ILLUSTRATION 17

X Ltd. issued to the public for subscription 40,000 shares of ₹ 10 each at par payable as ₹ 2 each on Application, Allotment and First Call and the balance on the Final Call. Applications were received for 60,000 Shares and allotment was made *pro rata* to 80% of applicants. R to whom 1,600 shares were allotted paid only the Application Money and S who had applied for 2,400 shares paid the entire call money due along with the allotment. Pass the necessary Journal entries to record the above transactions assuming that Calls-in-arrears Account is maintained.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bank A/c [60,000 × ₹ 2] Dr. To Share Application A/c (Being the Application Money received on 60,000 shares)		1,20,000	1,20,000
	Share Application A/c Dr. To Share Capital A/c (40,000 × ₹ 2) To Bank A/c (12,000 × ₹ 2) To Share Allotment A/c (8,000 × ₹ 2) (Being the Application Money adjusted & Surplus Refunded)		1,20,000	80,000 24,000 16,000
	Share Allotment A/c (40,000 × ₹ 2) Dr. To Share Capital A/c (Being the allotment money due on 40,000 shares)		80,000	80,000
	Bank A/c Dr. Calls-in-Arrears A/c Dr. To Share Allotment A/c To Calls-in-Advance A/c (Being the allotment money received except for 1,600 shares of R along with calls money in advance for 2,000 shares of S) [Refer to WN 1, 2, 3]		73,440 2,560	64,000 12,000
	Share First Call A/c [40,000 × ₹ 2] Dr. To Share Capital A/c (Being the first call money due on 40,000 shares)		80,000	80,000
	Bank A/c Dr. Calls-in-Arrears A/c Dr. Calls-in-Advance A/c Dr. To Share First Call A/c (Being the First Call Money received except on 1,600 shares and Calls-in-Advance adjusted for 2,000 shares)		72,800 3,200 4,000	80,000
	Share Final Call A/c Dr. To Share Capital A/c (Being the final call money due on 40,000 shares)		1,20,000	1,20,000

Bank A/c [Balancing Figure]	Dr.	1,45,600	
Calls-in-Arrear A/c [1,600 × ₹ 4]	Dr.	6,400	
Calls-in-Advance A/c [2,000 × ₹ 4]	Dr.	8,000	
To Share Final Call A/c			1,60,000
(Being the final call money received except for 1,600 shares of R and Calls-in-Advance adjusted for 2,000 shares of S)			

Working Notes:**1. CALCULATION OF ALLOTMENT MONEY DUE BUT NOT RECEIVED FROM R.**

Shares applied by R = $(48,000/40,000) \times 1,600 = 1,920$ Shares.	
Application Money received R = $(1,920 \times ₹ 2)$	₹ 3,840
Less: Application Money due $(1,600 \times ₹ 2)$	3,200
Excess Application Money	640
Allotment Money due $(1,600 \times ₹ 2)$	3,200
Allotment Money due but not received from R.	2,560

2. CALCULATION OF CALLS-IN-ADVANCE RECEIVED FROM S:

- (a) No. of Shares allotted to S = $(40,000/48,000) \times 2,400 = 2,000$ Shares.
 (b) Calls-in-Advance = $2,000 \times ₹ 6 = ₹ 12,000$

3. ALLOTMENT MONEY RECEIVED LATER ON

Total Amount due on Allotment $(40,000 \times ₹ 2)$	80,000
Less: Excess Application Money adjusted	(16,000)
Less: Allotment Money not received from R	(2,560)
Add: Calls-in-Advance from S	12,000
	73,440

ILLUSTRATION 18

Petromax Ltd. issued 50,000 shares of ₹ 10 each at a premium of ₹ 2 per share payable as ₹ 3 on application, ₹ 5 including premium on allotment and the balance in equal instalments over two calls. Applications were received for 92,000 shares and the allotment was done as under:

- A. Applicants of 40,000 shares — Allotted 30,000 Shares
 B. Applicants of 40,000 shares — Allotted 20,000 Shares
 C. Applicants of 12,000 shares — Nil

Suresh, who had applied for 2,000 shares (Category A) did not pay any money other than Application Money. Chander, who was allotted 800 shares (Category B) paid the calls money due along with allotment. All other allottees paid their dues as per schedule.

Required: Pass the necessary Journal entries in the books of Petromax Ltd. to record the above assuming that Calls-in-arrears Account is maintained.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c [92,000 × ₹ 3] Dr. To Share Application A/c (Being the Application Money received on 92,000 shares @ ₹ 3 per share)		2,76,000	2,76,000

Share Application A/c	Dr.	2,76,000	
To Share Capital A/c (50,000 × ₹ 3)			1,50,000
To Bank A/c (12,000 × ₹ 3)			36,000
To Share Allotment A/c (30,000 × ₹ 3)			90,000
(Being the Application Money adjusted)			
Share Allotment A/c (50,000 × ₹ 5)	Dr.	2,50,000	
To Share Capital A/c (50,000 × ₹ 3)			1,50,000
To Securities Premium A/c (50,000 × ₹ 2)			1,00,000
(Being the Allotment Money due on 50,000 shares)			
Bank A/c	Dr.	1,57,200	
Calls-in-Arrears A/c	Dr.	6,000	
To Share Allotment A/c [₹ 2,50,000 – ₹ 90,000]			1,60,000
To Calls-in-Advance A/c [800 × ₹ 4]			3,200
(Being the Allotment Money received except on 1,500 shares and Calls in advance received on 800 shares) [Refer to WN: 1, 2, 3, 4]			
Share First Call A/c (50,000 × ₹ 2)	Dr.	1,00,000	
To Share Capital A/c			1,00,000
(Being the First Call Money due on 50,000 shares)			
Bank A/c [Balance Figure]	Dr.	95,400	
Calls-in-Advance A/c (800 × ₹ 2)	Dr.	1,600	
Calls-in-Arrears A/c (1,500 × ₹ 2)	Dr.	3,000	
To Share First call A/c			1,00,000
(Being the first call money received except on 1,500 shares and Calls-in-Advance adjusted on 800 shares)			
Share Final Call A/c [50,000 × ₹ 2]	Dr.	1,00,000	
To Share Capital A/c			1,00,000
(Being the Final Call Money due on 50,000 shares)			
Bank A/c	Dr.	95,400	
Calls-in-Advance A/c	Dr.	1,600	
Calls-in-Arrears A/c	Dr.	3,000	
To Share Final call A/c			1,00,000
(Being the Final Call Money received except on 1,500 Shares and Calls-in-Advance adjusted on 800 shares)			

Working Notes:
1. CALCULATION OF ALLOTMENT MONEY DUE BUT NOT RECEIVED FROM SURESH.

Number of shares allotted = $30,000/40,000 \times 2,000 = 1,500$ Shares	
Application Money received [(2,000 × ₹ 3)]	6,000
Application Money due [1,500 × ₹ 3]	4,500
Excess Application Money adjusted on allotment. [₹ 6,000 – ₹ 4,500]	1,500
Money due from Suresh on allotment [1,500 × ₹ 5]	7,500
Allotment Money due not received [7,500 – 1,500]	6,000

2. CALCULATION OF ALLOTMENT MONEY RECEIVED LATER ON

Total Allotment Money due (50,000 × ₹ 5)	2,50,000
Less: Excess Application Money adjusted at application stage	(90,000)
Less: Allotment Money not received from Suresh	6,000
	1,54,000

3. Calls-in-Advance on 800 shares = $800 \times ₹ 4 = ₹ 3,200$

4. Total Money received at the Time of Allotment = ₹ 1,54,000 + ₹ 3,200 = ₹ 1,57,200.

15.0 ISSUE OF SHARES FOR CONSIDERATION OTHER THAN CASH**MEANING OF ISSUE OF SHARES FOR CONSIDERATION OTHER THAN CASH**

When the company purchases some assets (including services), instead of making the payment to the supplier in the form of cash, it issues its fully paid shares, such issue of shares is called as the issue of shares for consideration other than cash. Such shares can be issued at par, premium or at a discount.

PURCHASE CONSIDERATION

Purchase Consideration is the amount paid by purchasing company in consideration for purchase of assets/business from another enterprise. Unless otherwise stated, Purchase consideration on Net Assets basis is arrived at as follows:

Purchase Consideration

= Agreed Value of All Assets taken over – Agreed Amount of Liabilities assumed

For Example, X Ltd. has acquired from Y Assets worth ₹ 20,00,000 and Liabilities of ₹ 6,00,000. In this case, Purchase Consideration is ₹ 14,00,000 (i.e. ₹ 20,00,000 – ₹ 6,00,000.)

TREATMENT OF DIFFERENCE BETWEEN PURCHASE CONSIDERATION AND NET ASSETS ACQUIRED

Case	Accounting Treatment
If Purchase Consideration > Net Assets	The excess of Purchase Consideration over Net Assets acquired should be debited to ' Goodwill Account '.
If Net Assets > Purchase Consideration	The excess of Net Assets acquired over Purchase Consideration should be credited to ' Capital Reserve Account '.

DISCLOSURE

Number and Class of Shares issued for consideration other than Cash are disclosed in Notes to Accounts 'Share Capital' in the Balance Sheet of a company.

JOURNAL ENTRIES

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	On Purchase of Business/Assets			
	Sundry Assets Dr.		(With the Agreed Values of Assets taken over)	
	*Goodwill A/c Dr.		(With Excess of Purchase Consideration over the Value of Net Assets)	
	To Sundry Liabilities		(With the Agreed Amount of Liabilities taken over)	

	To Vendor's A/c To *Capital Reserve A/c (Being the purchase of Assets/Business) *Either Goodwill or Capital Reserve		(With Purchase consideration Payable) (With Excess of Value of Net Assets over the Purchase Consideration)
2.	On Part Payment to Vendor Vendor's A/c Dr. To Cash A/c To Bank A/c To Bills Payable A/c (Being the Part Payment made to Vendor)		[With Part Payment] [With Cash Payment] [With Cheque/Bank Draft] [With Promissory Note]
3.	On Issue of Shares (a) If Shares are issued to Vendor at Par: Vendor's A/c Dr. To Share Capital A/c		(With Balance Purchase Consideration)
(b)	If Shares are issued to Vendor at Premium: Vendor's A/c Dr. To Share Capital A/c To Securities Premium A/c		(With Balance Purchase Consideration) (With the Nominal Value) (With Premium on Issue)
(c)	If Shares are issued to Vendor at a Discount: Vendor's A/c Dr. Discount on issue of Shares A/c Dr. To Share Capital A/c		(With Balance Purchase consideration) (With Discount on Issue) (With Nominal Value)

ILLUSTRATION 19

On April,1,2018, X Ltd. took over the Assets of ₹ 6,80,000 and Creditors of ₹ 80,000 of Y Ltd. payable 10% by a cheque and the balance by the issue of fully paid Equity Shares of ₹ 100 each. Pass the necessary Journal Entries in the books of the company on April,1,2018 if such Shares are issued

(a) at par (b) at a premium of 20%.

SOLUTION
JOURNAL OF X LTD.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Entry 1 in all cases Sundry Assets A/c Dr. To Sundry Creditors To Y Ltd. (Being the purchase of Business from Y Ltd.)		6,80,000	80,000 6,00,000

2.	Case (a) Y Ltd. Dr. To Bank A/c [₹ 6,00,000 X 10/100] To Equity Share Capital A/c (Being 10% by a cheque and the balance the issue of 5,400 shares at par to Y Ltd.) [No. of Shares to be issued = ₹ 5,40,000 / ₹ 100 = 5,400]		6,00,000	60,000 5,40,000
	Case (b) Y Ltd. Dr. To Bank A/c [₹ 6,00,000 X 10/100] To Equity Share Capital A/c To Securities Premium A/c (Being 10% by a cheque and the balance the issue of 4,500 shares at 20% premium to Y Ltd.) [No. of Shares to be issued = ₹ 5,40,000 / ₹ 120 = 4,500]		6,00,000	60,000 4,50,000 90,000

ILLUSTRATION 20

On April 1, 2018, X Ltd. purchased a running business from Y Ltd. for ₹ 10,40,000 payable as to 25% by a cheque and the balance by an issue of fully paid Equity Shares of ₹ 100 each at a premium of 4%. The assets and liabilities consisted of the following:

Building ₹ 6,00,000, Plant and Machinery ₹ 1,00,000, Inventories ₹ 2,00,000, Trade Receivables ₹ 1,80,000, Trade Payables ₹ 80,000.

Pass the necessary journal entries in the books of X Ltd on April, 1, 2018.

SOLUTION**JOURNAL OF X LTD.**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Building Dr. Plant and Machinery Dr. Inventories Dr. Trade Receivables Dr. Goodwill A/c [Balancing Figure] Dr. To Trade Payables To Y Ltd. (Being the purchase of Business from Y Ltd.)		6,00,000 1,00,000 2,00,000 1,80,000 40,000	80,000 10,40,000
2.	Y Ltd. Dr. To Bank A/c [10,40,000 × 25%] To Equity Share Capital A/c To Securities Premium A/c [₹ 7,50,000 × 4%] (Being 25% by a cheque and the balance by an issue of 7,500 shares at 20% premium to Y Ltd.) [No. of Shares to be issued = ₹ 7,80,000 / ₹ 104 = 7,500]		10,40,000	2,60,000 7,50,000 30,000

ILLUSTRATION 21

On April 1, 2018, X Ltd. purchased a running business from Y Ltd. for ₹ 9,60,000 payable as to 25% by a cheque and the balance by an issue of fully paid Equity Shares of ₹ 100 each at a premium of 20%. The assets and liabilities consisted of the following:

Building ₹ 6,00,000, Plant and Machinery ₹ 1,00,000, Inventories ₹ 2,00,000, Trade Receivables ₹ 1,80,000, Trade Payables ₹ 80,000.

Pass the necessary journal entries in the books of X Ltd on April, 1, 2018.

SOLUTION**JOURNAL OF X LTD.**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Building Dr. Plant and Machinery Dr. Inventories Dr. Trade Receivables Dr. To Trade Payables To Y Ltd. To Capital Reserve A/c [Balancing Figure] (Being the purchase of Business from Y Ltd.)		6,00,000 1,00,000 2,00,000 1,80,000	80,000 9,60,000 40,000
2.	Y Ltd. Dr. To Bank A/c [₹ 9,60,000 × 25%] To Equity Share Capital A/c To Securities Premium A/c [₹ 6,00,000 × 20%] (Being 25% by a cheque and the balance by an issue of 6,000 shares at 20% premium to Y Ltd.) [No. of Shares to be issued = ₹ 7,20,000 / ₹ 120 = 6,000]		9,60,000	2,40,000 6,00,000 1,20,000

ILLUSTRATION 22

X Ltd. issued 2,000 shares of ₹ 10 each credited as fully paid to the promoters for their services and issued 1,000 shares of ₹ 10 each credited as fully paid to the underwriters for their underwriting services. Journalise these transactions.

SOLUTION**JOURNAL OF X LTD.**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Incorporation Costs A/c Dr. To Share Capital A/c (Being the issue of 2,000 shares of ₹ 10 each at par to promoters as per Board's Resolution dated...)		20,000	20,000

2.	Underwriting Commission A/c To Underwriter's A/c (Being the underwriting commission due on shares)	Dr.	10,000	10,000
3.	Underwriter's A/c To Share Capital A/c (Being the issue of 1,000 shares of ₹ 10 each at par to underwriters as per the Board's Resolution dated...)	Dr.	10,000	10,000

16.0 FORFEITURE OF SHARES**FORFEITURE OF SHARES**

Meaning	Forfeiture of shares means the cancellation of allotment to defaulting shareholders and to treat the amount already received on such shares as forfeited to the company. Thus, forfeiture of shares is at the instance of company.
Authority	When a shareholder fails to pay one or more instalments (viz., allotment money and/or call money) due on the shares held by him, the company has the authority to forfeit such shares by strictly following the procedure specified in its Articles of Association.
SEBI Guidelines	According to SEBI Guidelines, the subscription money must be received within twelve months from the date of allotment. If the investor fails to pay the call money within twelve months, the subscription money already paid may be forfeited.
Property	Forfeited shares become the property of the company.

SURRENDER OF SHARES

Meaning	Surrender of shares is a voluntary return of shares for the purposes of cancellation. Surrender of Shares is at the instance of Shareholder.
Authority	The directors can accept the surrender of shares only when the Articles authorise them to do so.
Lawful	Surrender is lawful only in two cases viz. a) where it is done as a short cut to forfeiture to avoid the formalities for a valid forfeiture & b) Where shares are surrendered in exchange for new shares of the same nominal value (but with different rights).
Void	A surrender will be void if it amounts to purchase of the shares by the company or if it is accepted for the purpose of relieving a member from his liabilities.
Accounting Treatment	So far as accounting treatment is concerned, the Surrender of Shares is considered similar to the Forfeiture of Shares. Surrendered Shares may be reissued in the same way as Forfeited Shares.

ACCOUNTING TREATMENT OF FORFEITURE OF SHARES

Generally speaking, accounting treatment on forfeiture is to reverse all the entries (except those relating to Securities Premium received) already passed till the stage of forfeiture and to treat the amount already received (excluding Securities Premium) as forfeited to the company. The accounting treatment to record the forfeiture of shares in various cases is summarised as follows:

17.0 FORFEITURE OF SHARES WHICH WERE ISSUED AT PAR**A/C TO BE DEBITED**

Debit 'Share Capital Account' with the amount called up on such shares till the stage of forfeiture.

A/CS TO BE CREDITED

1. Credit Share Allotment Account and/or Share Call(s) Account (or Calls-in- arrears Account, if any, maintained) with the amount due but not received on such shares.
2. Credit 'Forfeited Shares Account' with the amount received on such shares.

JOURNAL ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Share Capital A/c Dr.		(With the amount called up on shares forfeited)	
	To Forfeited Shares A/c		(With the amount already received)	
	To Share Allotment A/c		(With the amount due but not received on allotment)	
	To Share Call A/c		(With the amount due but not received on Call)	
	(Being ... shares forfeited for non-payment of...)			

Notes:

1. In case "Calls-in-Arrears" account is maintained by the company, "Calls-in-Arrears" account would be credited in the above entry instead of 'Share Allotment' and/or 'Share Call/Calls' accounts.
2. Always use Calls-in-arrears Account if the nature of the amount called up but not received is not clear in the question.

DISCLOSURE

The balance of the Forfeited Shares Account is shown in **Notes to Accounts 'Share Capital'** to the Balance Sheet till the Forfeited Shares are reissued.

ILLUSTRATION 23

X Ltd. issued 2,000 shares of ₹ 10 each at par payable as under: On application ₹ 2 per share, on allotment ₹ 3 per share. On first call ₹ 3 per share, on second call ₹ 2 per share. Mr. X was allotted 40 shares. Mr. X failed to pay allotment money and on his subsequent failure to pay the first call, his shares were forfeited. Pass the necessary journal entry relating to the forfeiture of shares.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Share Capital A/c (40 × ₹ 8) Dr.		320	
	To Share Allotment A/c (40 × ₹ 3)			120
	To Share First Call A/c / Calls-in-arrears A/c (40 × ₹ 3)			120
	To Forfeited Shares A/c (40 × ₹ 2)			80
	(Being 40 shares forfeited for non-payment of allotment money and first call money)			

ILLUSTRATION 24

X Ltd. forfeited 40 shares of ₹ 10 each (₹ 8 called up) issued at par to Mr. X on which he had paid ₹ 2 per share. Journalise.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Share Capital A/c (40 × ₹ 8) Dr.		320	
	To Calls-in-arrears A/c (40 × ₹ 6)			240
	To Forfeited Shares A/c (40 × ₹ 2)			80
	(Being 40 shares forfeited for non-payment of called up amount)			

ILLUSTRATION 25

Paliwal Exports Ltd. with a share capital of ₹ 1,00,000 divided into 2,000 shares of ₹ 50 each offers the shares to the public as under:

₹ 10 per share payable on application; ₹ 10 per share payable on allotment; ₹ 15 per share payable on 1st call; and ₹ 15 per share payable on second call.

Shareholder 'A' who holds 30 shares has paid only the Application Money.

Shareholder 'B' who holds 20 shares has paid Application Money on 20 shares and allotment money on only 10 shares. He has not paid only other calls.

Shareholder 'C' who holds 18 shares has paid only the application and allotment money.

Shareholder 'D' who holds 5 shares has paid application, allotment and first call money.

Shareholder 'E' who holds 3 shares has paid application, allotment and first call money in full and second call money on only 2 shares.

The company forfeits the shares of the above shareholders who have not paid the arrears.

Required: Journalise the above transactions including entries relating to Bank in the books of Paliwal Exports Ltd.

SOLUTION**JOURNAL OF PALIWAL EXPORTS LTD.**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c Dr.		20,000	
	To Share Application A/c			20,000
	(Being the Application Money received on 2,000 shares)			
	Shares Application A/c Dr.		20,000	
	To Share Capital A/c			20,000
	(Being the transfer of Application Money on 2,000 shares to Share Capital A/c)			
	Share Allotment A/c Dr.		20,000	
	To Share Capital A/c			20,000
	(Being the allotment money due)			

	Bank A/c Dr. To Share Allotment A/c (Being the allotment money received on 1,960 shares)		19,600	19,600
	Share First Call A/c Dr. To Share Capital A/c (Being the first call money due)		30,000	30,000
	Bank A/c Dr. To Share First Call A/c (Being the first call money received on 1,932 shares)		28,980	28,980
	Share Second & Final Call A/c Dr. To Share Capital A/c (Being the second & final call money due)		30,000	30,000
	Bank A/c Dr. To Share Second & Final Call A/c (Being the second & final call received on 1,926 shares)		28,890	28,890
	Share Capital A/c Dr. To Forfeited Shares A/c To Share Allotment A/c To Share First Call A/c To Share Second & Final Call A/c (Being 74 shares forfeited as per Board's Resolution dated....)		3,700	1,170 400 1,020 1,110

ILLUSTRATION 26

A Ltd. has an authorised capital of ₹ 2,00,000 divided into shares of ₹ 10 each. Of these, 6,000 shares were issued as fully paid in payment of building purchased from B Ltd. 8,000 shares were subscribed for by the public and during the first year ₹ 5 per share was called up payable ₹ 2 on application, ₹ 1 on allotment, ₹ 1 on the first call and ₹ 1 on second call. The amounts received in respect of these shares were as follows:-

On 6,000 Shares	Full amount called
On 1,250 Shares	₹ 4 Per Share
On 500 Shares	₹ 3 Per Share
On 250 Shares	₹ 2 Per Share

The directors forfeited the 750 shares, on which less than ₹ 4 per share had been paid. Pass Journal Entries recording the above transactions (including cash transactions).

SOLUTION
JOURNAL OF A LTD.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Building A/c Dr. To B Ltd. (Being the purchase of building from B Ltd. as per agreement dated....)		60,000	60,000

	B Ltd. To Share Capital A/c (Being the issue of 4,000 shares at par)	Dr.		60,000	60,000
	Bank A/c To Share Application A/c (Being the Application Money received)	Dr.		16,000	16,000
	Share Application A/c To Share Capital A/c (Being the Application Money adjusted)	Dr.		16,000	16,000
	Share Allotment A/c To Share Capital A/c (Being the allotment money due)	Dr.		8,000	8,000
	Bank A/c To Share Allotment A/c (Being the allotment money received on 7,750 shares)	Dr.		7,750	7,750
	Share First Call A/c To Share Capital A/c (Being the first call due)	Dr.		8,000	8,000
	Bank A/c To Share First Call A/c (Being the first call received on 7,250 shares)	Dr.		7,250	7,250
	Share Second Call A/c To Share Capital A/c (Being the second call due)	Dr.		8,000	8,000
	Bank A/c To Share Second Call A/c (Being the second call received on 6,000 shares)	Dr.		6,000	6,000
	Share Capital A/c To Forfeited Shares A/c To Share Allotment A/c To Share First Call A/c To Share Second Call A/c (Being 750 shares forfeited as per Board's Resolution dated...)	Dr.		3,750	2,000 250 750 750

18.0 FORFEITURE OF SHARES WHICH WERE ISSUED AT A PREMIUM

A/cs to be Debited	- Debit 'Share Capital Account' with the amount called up (excluding Securities Premium) on such shares till the stage of forfeiture; - Debit 'Securities Premium Account' with the amount of premium due but not received on such shares (Note: This treatment is required only when an entry has already been passed for Securities Premium when it becomes due)

A/cs to be Credited	1. Credit Share Allotment Account and/or Share Call(s) Account (or Calls-in-arrears Account, if any, maintained) with the amount due but not received (excluding Securities Premium, if any received) on such shares. 2. Credit 'Forfeited Shares Account' with the amount received (excluding Securities Premium, if any, already received)

JOURNAL ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Share Capital A/c Dr.		(With the Called up amount on shares forfeited)	
	Securities Premium A/c Dr.		(With the Securities of Premium not received)	
	To Forfeited Shares A/c		(With the amount already received excluding Securities Premium)	
	To Share Allotment A/c		(With the amount due but not received on Allotment)	
	To Share Call A/c		(With the amount due but not paid on Call)	
	(Being...shares forfeited for non-payment of....)			

Notes:

1. In case "Calls-in-Arrears" account is maintained by the company, "Calls-in-Arrears" account would be credited in the above entry instead of 'Share Allotment' and/or 'Share Call/Calls' accounts.
2. Always use Calls-in-arrears Account if the nature of the amount called up but not received is not clear in the question.

ILLUSTRATION 27

X Ltd. issued 2,000 equity shares of ₹ 10 each at a premium of ₹ 4 per share payable as under: On application ₹ 3 per share (including ₹ 1 premium), on allotment ₹ 4 per share (including ₹ 1 premium), on first call ₹ 4 per share (including ₹ 1 premium), on second call Balance. Mr. X was allotted 40 shares. Mr. X failed to pay allotment money and on his subsequent failure to pay the first call, his shares were forfeited. Pass the necessary journal entry relating to the forfeiture of shares.

SOLUTION

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Share Capital A/c (40 × ₹ 8) Dr.		320	
	Securities Premium A/c (40 × ₹ 2) Dr.		80	
	To Share Allotment A/c (40 × ₹ 4)			160
	To Share First Call A/c / Calls-in-arrears A/c (40 × ₹ 4)			160
	To Forfeited Shares A/c (40 × ₹ 2)			80
	(Being 40 shares forfeited for non-payment of allotment money and first call money)			

ILLUSTRATION 28

X Ltd. forfeited 40 shares of ₹ 10 each (₹ 8 called up) issued at 40% premium (payable on final call) to Mr. X on which he had paid ₹ 2 per share. Journalise.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Share Capital A/c (40 × ₹ 8) Dr.		320	
	To Calls-in-arrears A/c (40 × ₹ 6)			240
	To Forfeited Shares A/c (40 × ₹ 2)			80
	(Being 40 shares forfeited for non-payment of called up amount)			

19.0 FORFEITURE OF SHARES WHICH WERE ISSUED AT A DISCOUNT

A/cs to be Debited	Debit 'Share Capital Account' with the amount called up on such shares till the stage of forfeiture;
A/cs to be Credited	1. Credit 'Discount on Issue of Shares Account' with the amount of discount allowed on such shares. (Note: This treatment is required so that the balance on 'Discount on Issue of Shares Account' relates only to the remaining shares forming part of Share Capital Account.) 2. Credit 'Share Allotment and/or Share Call(s) Account' (or Calls-in-arrears Account if any, maintained) with the amount due but not paid on such shares. 3. Credit 'Forfeited Shares Account' with the amount received on such shares.

JOURNAL ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Share Capital A/c Dr.		(With the amount called up on shares forfeited)	
	To Forfeited Shares A/c		(With the amount already received)	
	To Discount on Issue of Shares A/c		(With the Discount originally allowed)	
	To Share Allotment A/c		(With the amount due but not received on Allotment)	
	To Share Call A/c		(With the amount due but not received on Call)	
	(Being...shares forfeited for non-payment of...)			

Notes:

1. In case "Calls-in-Arrears" account is maintained by the company, "Calls-in-Arrears" account would be credited in the above entry instead of 'Share Allotment' and/or 'Share Call/Calls' accounts.
2. Always use Calls-in-arrears Account if the nature of the amount called up but not received is not clear in the question.

ILLUSTRATION 29

X Ltd. issued 2,000 equity shares of ₹ 10 each at a discount of ₹ 1 per share payable as under: On application ₹ 2 per share, on allotment ₹ 2 per share, on first call ₹ 3 per share, on second call ₹ 2 per share. Mr. X was allotted 40 shares. Mr. X failed to pay allotment money and on his subsequent failure to pay the first call, his shares were forfeited. Pass the necessary Journal entry relating to the forfeiture of shares.

SOLUTION
JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Share Capital A/c (40 × ₹ 8) Dr.		320	
	To Discount on Issue of Shares A/c (40 × ₹ 1)			40
	To Share Allotment A/c (40 × ₹ 2)			80
	To Share First Call A/c/ Calls-in-arrears A/c (40 × ₹ 3)			120
	To Forfeited Shares A/c (40 × ₹ 2)			80
	(Being 40 shares forfeited for non-payment of allotment money and first call money)			

ILLUSTRATION 30

X Ltd. forfeited 40 shares of ₹ 10 each (₹ 8 Called up) issued at 10% discount to Mr. X on which he had paid ₹ 2 per share. Journalise.

SOLUTION
JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Share Capital A/c (40 × ₹ 8) Dr.		320	
	To Discount on Issue of Shares A/c (40 × ₹ 1)			40
	To Calls-in-arrears A/c (40 × ₹ 5)			200
	To Forfeited Shares A/c (40 × ₹ 2)			80
	(Being 40 shares forfeited for non-payment of the called up amount)			

20.0 RE-ISSUE OF SHARES
MEANING OF RE-ISSUE OF SHARES

Reissue of shares is merely a sale of Forfeited Shares and not an allotment of shares. The forfeited shares can be reissued as per the provisions of the Articles of the company.

RE-ISSUE PRICE OF FORFEITED SHARES

The forfeited shares can be re-issued at par, premium or discount.

MINIMUM RE-ISSUE PRICE

The Re-issue Price of forfeited shares must be at least equal to the difference between the Paid up Value of Re-issued Shares and the Amount Forfeited on Re-issued Shares.

In other words, Re-issue Price must not be less than the amount unpaid on Forfeited Shares.

MAXIMUM AMOUNT OF DISCOUNT WHICH MAY BE ALLOWED ON RE-ISSUE

Case	Maximum Permissible Discount On Re-issue
(a) When the Forfeited Shares were originally issued at par or at a premium.	The amount credited to Forfeited Share Account.
(b) When the Forfeited Shares were originally issued at a discount	The amount credited to 'Forfeited Share Account' plus the amount of original discount.

ACCOUNTS TO BE DEBITED

1. Debit 'Bank Account' with the amount received on shares re-issued.
Amount = No. of Shares re-issued × Re-issue Price per share
2. Debit 'Discount on Issue of Shares Account' with the amount of discount originally allowed on such shares. In case shares were originally issued at a discount.
3. Debit Forfeited Shares Account with the excess of re-issue discount over original discount (if any) allowed on shares re-issued. Such amount is calculated as under:
= No. of Shares re-issued × [Paid-up Value per share – Re-issue Price per share – Original Discount per share (if any)]

ACCOUNTS TO BE CREDITED

1. Credit Share Capital Account with the paid-up value of shares re-issued.
Amount = No. of Shares re-issued × Paid-up Value per share
2. Credit 'Securities Premium Account' with Excess of Re-issue Price over Paid-up Value.

TUTORIAL NOTE

Neither 'Discount on Issue of Shares A/c' nor 'Forfeited Shares A/c' is debited when the Forfeited Shares are re-issued at a premium (i.e. Excess of Re-issue Price over Paid up Value)

**JOURNAL ENTRY ON RE-ISSUE OF SHARES WHICH WERE
ORIGINALLY ISSUED AT PAR OR AT A PREMIUM**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c	Dr.		(With the amount received on re-issue)
	Forfeited Shares A/c	Dr.		(With the discount allowed on re-issue)
	To Share Capital A/c			(With the amount credited as paid-up)

JOURNAL ENTRY ON RE-ISSUE OF FORFEITED SHARES AT A PREMIUM

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c	Dr.		(With Re-issue Price)
	To Share Capital A/c			[With Paid Up value]
	To Securities Premium A/c			[With Excess of Re-issue Price over paid up value]

JOURNAL ENTRY ON TRANSFER OF PROFIT ON RE-ISSUE

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Forfeited Shares A/c To Capital Reserve A/c	Dr.	(with Profit on Re-issue)	

CALCULATION OF PROFIT ON RE-ISSUE OF SHARES

Particulars	Defaulter 1	Defaulter 2
A. Amount forfeited on Shares re-issued $\left[\frac{\text{Total amount forfeited}}{\text{No. of Shares forfeited}} \times \text{No. of Shares reissued} \right]$	xxx	xxx
B. Less: Re-issue Discount (other than original discount, if any)	xxx	xxx
C. Profit on re-issue to be t/f to Capital Reserve [A – B]	xxx	xxx

TREATMENT OF BALANCE OF FORFEITED SHARES ACCOUNT

(a) If all the Forfeited Shares have been re-issued	The credit balance left on the Forfeited Shares Account is transferred to Capital Reserve Account by passing the following entry: Forfeited Shares A/c To Capital Reserve A/c
(b) If some of the Forfeited Shares have been re-issued	The profit on re-issue of shares is transferred to Capital Reserve Account and the balance on the Forfeited Shares Account relating to shares not yet re-issued is carried forward and is shown in Notes to Account 'Share Capital' in the Balance Sheet.

RE-ISSUE OF SHARES WHICH WERE ORIGINALLY ISSUED AT A PREMIUM**ILLUSTRATION 31**

P Ltd. forfeited 50 shares of ₹ 100 each issued at 10% premium for non-payment of allotment money of ₹ 30 per share (including premium) and first call of ₹ 30 per share. The second & final call of ₹ 20 per share was not yet called.

- State whether these shares can be reissued.
- State whether these shares can be reissued at premium only.
- State with reason whether these shares can be reissued as ₹ 80 paid up for the ₹ 40 per share.
- If 20 of these shares were re-issued as ₹ 80 paid-up for ₹ 70 per share. Pass Journal Entries regarding forfeiture and re-issue of shares and prepare Forfeited Shares Account.

SOLUTION

- Yes. The forfeited shares can be reissued as per the provisions of the Articles of the company.
- No. The forfeited shares can be reissued at par, premium or discount.
- No. Reason:** The maximum permissible discount on re-issue is the amount forfeited on Re-issued shares (i.e. ₹ 30). In the given case, re-issue discount is ₹ 40 which is not permissible.

(IV) JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	On Forfeiture of 50 shares			
	Share Capital A/c (50 × ₹ 80) Dr.		4,000	
	Securities Premium A/c [50 × ₹ 10] Dr.		500	
	To Share Allotment A/c (50 × ₹ 30)			1,500
	To Share First Call A/c / Calls-in-arrears A/c (50 × ₹ 30)			1,500
	To Forfeited Shares A/c (50 × ₹ 30)			1,500
	(Being 50 shares forfeited for non-payment of first call money)			
2.	On Re-Issue of 20 shares			
	Bank A/c (20 × ₹ 70) Dr.		1,400	
	Forfeited Shares A/c (20 × ₹ 10) Dr.		200	
	To Share Capital A/c (20 × ₹ 80)			1,600
	(Being 20 shares re-issued as ₹ 80 paid-up for ₹ 90 per share)			
3.	Forfeited Shares A/c [(20 × ₹ 30) – ₹ 200] Dr.		400	
	To Capital Reserve A/c			400
	(Being the transfer of profit on re-issue of 20 shares)			

Dr.

FORFEITED SHARES ACCOUNT

Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Share Capital A/c	200	By Share Capital A/c	1,500
To Capital Reserve A/c	400		
To Balance c/d	900		
	1,500		1,500

ILLUSTRATION 32

Bharat Ltd. forfeited 600 shares of ₹ 10 each issued at a premium of 30% to W who had paid an application money of ₹ 5 (including ₹ 1 premium), for non-payment of allotment money of ₹ 5 (including ₹ 1 premium). At different intervals of time, out of these 100 shares were re-issued to X as ₹ 8 called up for ₹ 7 per share, 100 shares were re-issued to Y as ₹ 8 paid up for ₹ 9 per share and 400 shares were re-issued to Z, credited as fully paid for ₹ 9 per share. Record the journal entries for forfeiture and reissue of shares.

SOLUTION**JOURNAL OF BHARAT LTD**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	On Forfeiture of 600 Shares			
	Share Capital A/c (600 × ₹ 8) Dr.		4,800	
	Securities Premium A/c (600 × ₹ 1) Dr.		600	
	To Share Allotment A/c (600 × ₹ 5)			3,000
	To Forfeited Shares A/c (600 × ₹ 4)			2,400
	(Being 600 shares forfeited for non-payment of Allotment money)			

2.	On Re-issue of 100 Shares as ₹ 8 paid-up for ₹ 7 per share Bank A/c (100 × ₹ 7) Dr. Forfeited Shares A/c (100 × ₹ 1) Dr. To Share Capital A/c (100 × ₹ 8) (Being 100 shares re-issued as ₹ 8 paid-up for ₹ 7 per share)		700 100	800
3.	Forfeited Shares A/c [(₹ 2,400 × 100/600) – ₹ 100] Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		300	300
4.	On Re-issue of 100 Shares as ₹ 8 paid-up for ₹ 9 per share Bank A/c (100 × ₹ 9) Dr. To Share Capital A/c (100 × ₹ 8) To Securities Premium A/c (100 × ₹ 1) (Being 100 shares re-issued as ₹ 8 paid-up for ₹ 9 per share)		900	800 100
5.	Forfeited Shares A/c (₹ 2,400 × 100/600) Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		400	400
6.	On Re-issue of 400 Shares Bank A/c (400 × ₹ 9) Dr. Forfeited Shares A/c (400 × ₹ 1) Dr. To Share Capital A/c (400 × ₹ 10) (Being 400 shares re-issued as fully paid-up for ₹ 9 per share)		3,600 400	4,000
7.	Forfeited Shares A/c [(₹ 2,400 × 400/600) – ₹ 400] Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		1,200	1,200

ILLUSTRATION 33

Tushar Ltd. forfeited 600 shares of ₹ 10 each issued at a premium of 30% to *W* for non-payment of first and final call money of ₹ 3 (including ₹ 1 premium). At different intervals of time, out of these 400 shares were re-issued to *Z*, credited as fully paid for ₹ 9 per share and 100 shares were re-issued to *X* as ₹ 10 paid up for ₹ 11 per share. Record the journal entries for forfeiture and reissue of shares.

SOLUTION
JOURNAL OF TUSHAR LTD

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	On Forfeiture of 600 Shares Share Capital A/c (600 × ₹ 10) Dr. Securities Premium A/c (600 × ₹ 1) Dr. To Calls-in-arrears A/c (600 × ₹ 3) To Forfeited Shares A/c (600 × ₹ 8) (Being 600 shares forfeited for non-payment of call money)		6,000 600	1,800 4,800
2.	On Re-issue of 400 Shares Bank A/c (400 × ₹ 9) Dr. Forfeited Shares A/c (400 × ₹ 1) Dr. To Share Capital A/c (400 × ₹ 10) (Being 400 shares re-issued as fully paid-up for ₹ 9 per share)		3,600 400	4,000

3.	Forfeited Shares A/c [(₹ 4,800 × 400/600) – ₹ 400] To Capital Reserve A/c (Being the transfer of profit on re-issue)	Dr.	2,800	2,800
4.	On Re-issue of 100 Shares Bank A/c (100 × ₹ 11) To Share Capital A/c (100 × ₹ 10) To Securities Premium A/c (100 × ₹ 1) (Being 100 shares re-issued as fully paid-up for ₹ 11 per share)	Dr.	1,100	1,000 100
5.	Forfeited Shares A/c (₹ 4,800 × 100/600) To Capital Reserve A/c (Being the transfer of profit on re-issue)	Dr.	800	800

RE-ISSUE OF SHARES WHICH WERE ORIGINALLY ISSUED AT A DISCOUNT**JOURNAL ENTRY ON RE-ISSUE OF FORFEITED SHARES WHICH WERE ORIGINALLY ISSUED AT A DISCOUNT**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c Dr.		(With the amount received on re-issue)	
	Forfeited Shares A/c Dr.		(With the excess of Re-issue Discount over the Original Discount)	
	To Share Capital A/c		(With the amount credited as Paid-up)	

JOURNAL ENTRY ON RE-ISSUE OF FORFEITED SHARES AT A PREMIUM

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c Dr.		(With Re-issue Price)	
	To Share Capital A/c		[With Paid Up value]	
	To Securities Premium A/c		[With Excess of Re-issue Price over Paid up value]	

ILLUSTRATION 34

A Ltd. forfeited 10 shares of ₹ 10 each (₹ 6 called up) issued at a discount of 10% to Y on which he had paid ₹ 2 per share.

- State whether these shares can be re-issued?
- State whether these shares can be re-issued at discount only?
- State with reason whether these shares can be re-issued as ₹ 6 called up at ₹ 2 per share.
- If 8 of these shares were re-issued as ₹ 8 called up for ₹ 6 per share, pass journal entries to record forfeiture and re-issue of shares and prepare Forfeited Shares Account.

SOLUTION

- Yes. The forfeited shares can be re-issued as per the provisions of the Articles of the company.
- No. The forfeited shares can be re-issued at par or premium.

- (iii) **No. Reason:** The maximum permissible discount on re-issue is the amount forfeited on Re-issued shares. (i.e. ₹ 2). In the given case, discount is ₹ 4 which is not permissible.

(IV) JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	On Forfeiture of 10 shares Share Capital A/c (10 × ₹ 6) Dr. To Discount on Issue of Shares A/c (10 × ₹ 1) To Forfeited Shares A/c (10 × ₹ 2) To Calls-in-arrears A/c (10 × ₹ 3) (Being 10 shares forfeited for non-payment of called up amount)		60	10 20 30
2.	On Re-issue of 8 shares Bank A/c (8 × ₹ 6) Dr. Forfeited Shares A/c (8 × ₹ 1) Dr. To Share Capital A/c (8 × ₹ 8) (Being 8 shares re-issued as ₹ 8 called up for ₹ 6 per share)		56 8	64
3.	Forfeited Shares A/c (8 × ₹ 1) Dr. To Capital Reserve A/c (8 × ₹ 1) (Being the transfer of profit on re-issue)		8	8

Dr. **FORFEITED SHARES ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Share Capital A/c	8	By Share Capital A/c	20
To Capital Reserve A/c	8		
To Balance c/d	4		
	20		20

ILLUSTRATION 35

Cloud & Rain Ltd. invited applications for 20,000 Equity shares of ₹ 10 each payable as under:

On applications ₹ 2 per share, on Allotment ₹ 2 per share, on First call ₹ 3 per share, on Final call ₹ 3 per share

The entire issue was subscribed for and paid with the following exceptions:

- P, who was allotted 200 shares, failed to pay the money due on allotment and calls.
- Q, who held 150 shares, did not pay the first call and second call.
- R, who held 50 shares, did not pay the amount on second call.

The Board of Directors passed a Resolution forfeiting all the shares of P, Q and R. These shares were subsequently re-issued as fully paid at a discount of 20%.

Required: Pass Journal entries to record transactions in books of Cloud & Rain Ltd.

SOLUTION

JOURNAL OF CLOUD & RAIN LTD.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Bank A/c Dr. To Share Application A/c (Being the Application Money received on 20,000 shares)		40,000	40,000

2.	Share Application A/c To Share Capital A/c (Being the Application Money transferred to Share Capital Account)	Dr.	40,000	40,000
3.	Share Allotment A/c To Share Capital A/c (Being the allotment money due on 20,000 shares @ ₹ 2 per share)	Dr.	40,000	40,000
4.	Bank A/c To Share Allotment A/c (Being the allotment money received on 19,800 shares)	Dr.	39,600	39,600
5.	Share 1st Call A/c To Share Capital A/c (Being 1st call money due on 20,000 shares ₹ 3 per share)	Dr.	60,000	60,000
6.	Bank A/c To Share 1st Call A/c (Being, 1st call money received on 19,650 shares)	Dr.	58,950	58,950
7.	Share 2nd & Final Call A/c To Share Capital A/c (Being 2nd and final call money due on 20,000 shares @ ₹ 3 per share)	Dr.	60,000	60,000
8.	Bank A/c To Share 2nd & Final Call A/c (Being 2nd and final call money received on 19,600 shares)	Dr.	58,800	58,800
	Share Capital A/c To Forfeited Shares A/c To Share Allotment A/c To Share 1st Call A/c To Share 2nd and Final Call A/c (Being 400 shares forfeited)	Dr.	4,000	1,350 400 1,050 1,200
	Bank A/c Forfeited Shares A/c To Share Capital A/c (Being 400 shares re-issued at ₹ 8 per share)	Dr. Dr.	3,200 800	4,000
	Forfeited Shares A/c To Capital Reserve A/c (Being the transfer of profit on re-issue of 400 forfeited shares to Capital Reserve)	Dr.	550	550

23.0 FORFEITURE AND RE-ISSUE OF SHARES ALLOTTED ON *Pro rata* BASIS IN CASE OF OVER-SUBSCRIPTION

In case an applicant has been allotted *less* than the number of shares applied for and the excess Application Money has been adjusted towards other sum due on shares allotted, such amount so adjusted should be deducted from the amount due on the allotment/call against which the excess Application Money was adjusted, to arrive at the net amount due but not paid by the shareholder. In such a case, the procedure given below may be followed to ascertain the amount due but not paid:

HOW TO CALCULATE THE AMOUNT DUE BUT NOT RECEIVED FROM DEFAULTER**Step 1:** Calculate the Total Number of Shares Applied for (if not given) as under:

$$\frac{\text{Total no. of Shares applied under prorata category}}{\text{Total no. of Shares allotted under prorata category}} \times \text{No. of Shares allotted to defaulter}$$

OR

Calculate the Total Number of Shares allotted (if not given) as under:

$$\frac{\text{Total no. of Shares allotted under prorata category}}{\text{Total no. of Shares applied under prorata category}} \times \text{No. of Shares applied to defaulter}$$

Step 2: Calculate the Total Application Money received on shares applied by defaulter

$$= \text{No. of Shares applied by defaulter} \times \text{Application Money per share}$$

Step 3: Calculate the Application Money due on Shares allotted to defaulter

$$= \text{No. of Shares Allotted to Defaulter} \times \text{Application Money per share}$$

Step 4: Calculate the Excess Application Money

$$= \text{Amount as per Step 2} - \text{Amount as per Step 3}$$

Step 5: Calculate the Allotment or Call Money due on shares allotted

$$\text{No. of Shares allotted to Defaulter} \times \text{Allotment Money/Call Money per share}$$

Step 6: Calculate the Allotment or Call Money due but not received

$$= \text{Amount as per Step 5} - \text{Amount as per Step 4.}$$

ILLUSTRATION 36

Bharat Ltd. forfeited 600 shares of ₹ 10 each issued at a premium of 30% to W who had applied for 1140 shares and paid an application money of ₹ 5 (including ₹ 1 premium), for non-payment of allotment money of ₹ 5 (including ₹ 1 premium). At different intervals of time, out of these 100 shares were re-issued to X as ₹ 8 called up for ₹ 7 per share, 100 shares were re-issued to Y as ₹ 8 paid up for ₹ 9 per share and 400 shares were re-issued to Z, credited as fully paid for ₹ 9 per share. Record the journal entries for forfeiture and reissue of shares assuming that the company follows the policy of adjusting excess Application Money towards other sums due on shares.

SOLUTION**JOURNAL OF BHARAT LTD**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	On Forfeiture of 600 Shares Share Capital A/c (600 × ₹ 8) Dr. Securities Premium A/c (₹ 3,000 – ₹ 2,700) Dr. To Share Allotment A/c To Forfeited Shares A/c (₹ 5,700 – ₹ 600 – ₹ 300) (Being 600 shares forfeited for non-payment of Allotment money)		4,800 300	300 4,800
2.	On Re-issue of 100 Shares as ₹ 8 paid-up for ₹ 7 per share Bank A/c (100 × ₹ 7) Dr. Forfeited Shares A/c (100 × ₹ 1) Dr. To Share Capital A/c (100 × ₹ 8) (Being 100 shares re-issued as ₹ 8 paid-up for ₹ 7 per share)		700 100	800

3.	Forfeited Shares A/c [(₹ 4,800 × 100/600) – ₹ 100] Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		700	700
4.	On Re-issue of 100 Shares as ₹ 8 paid-up for ₹ 9 per share Bank A/c (100 × ₹ 9) Dr. To Share Capital A/c (100 × ₹ 8) To Securities Premium A/c (100 × ₹ 1) (Being 100 shares re-issued as ₹ 8 paid-up for ₹ 9 per share)		900	800 100
5.	Forfeited Shares A/c (₹ 4,800 × 100/600) Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		800	800
6.	On Re-issue of 400 Shares Bank A/c (400 × ₹ 9) Dr. Forfeited Shares A/c (400 × ₹ 1) Dr. To Share Capital A/c (400 × ₹ 10) (Being 400 shares re-issued as fully paid-up for ₹ 9 per share)		3,600 400	4,000
7.	Forfeited Shares A/c [(₹ 4,800 × 400/600) – ₹ 400] Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		2,800	2,800

CALCULATION OF ALLOTMENT MONEY DUE BUT NOT RECEIVED

Particulars	₹
Application Money received from defaulter (1140 × ₹ 5)	5,700
Less: Application Money adjusted (600 × ₹ 5)	(3,000)
Excess Application Money	2,700
Allotment Money due (600 × ₹ 5)	3,000
Amount due but not received on Allotment towards Securities Premium	300

ILLUSTRATION 37

Tushar Ltd. forfeited 600 shares of ₹ 10 each issued at a premium of 30% to W who had applied for 1500 shares for non-payment of first and final call money of ₹ 3 (including ₹ 1 premium). At different intervals of time, out of these 400 shares were re-issued to Z, credited as fully paid for ₹ 9 per share and 100 shares were re-issued to X as ₹ 10 paid up for ₹ 11 per share. Record the journal entries for forfeiture and reissue of shares assuming that the company follows the policy of adjusting excess Application Money towards other sums due on shares.

SOLUTION**JOURNAL OF TUSHAR LTD**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	On Forfeiture of 600 Shares Share Capital A/c (600 × ₹ 10) Dr. Securities Premium A/c (₹ 1800 – ₹ 1500) Dr. To Calls-in-arrears A/c To Forfeited Shares A/c [₹ 7,500 – ₹ 600 – ₹ 600 – ₹ 300] (Being 600 shares forfeited for non-payment of call money)		6,000 300	300 6,000

2.	On Re-issue of 400 Shares Bank A/c (400 × ₹ 9) Dr. Forfeited Shares A/c (400 × ₹ 1) Dr. To Share Capital A/c (400 × ₹ 10) (Being 400 shares re-issued as fully paid-up for ₹ 9 per share)		3,600 400	4,000
3.	Forfeited Shares A/c [(₹ 6,000 × 400/600) – ₹ 400] Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		3,600	3,600
4.	On Re-issue of 100 Shares Bank A/c (100 × ₹ 11) Dr. To Share Capital A/c (100 × ₹ 10) To Securities Premium A/c (100 × ₹ 1) (Being 100 shares re-issued as fully paid-up for ₹ 11 per share)		1,100	1,000 100
5.	Forfeited Shares A/c (₹ 6,000 × 100/600) Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		1,000	1,000

CALCULATION OF CALL MONEY DUE BUT NOT RECEIVED

Particulars	₹
Application Money received from defaulter (1,500 × ₹ 5)	7,500
Less: Application & Allotment Money adjusted (600 × ₹ 10)	6,000
Excess Application Money	1,500
Excess Application Money adjusted on Call	(1,500)
Call Money due (600 × ₹ 3)	1,800
Amount due but not received on Call towards Securities Premium	300

21.0 HOW TO DISCLOSE 'SHARE CAPITAL' IN THE COMPANY'S BALANCE SHEET

Share Capital is disclosed in the company's Balance Sheet as follows:

AN EXTRACT OF BALANCE SHEET OF LTD AS AT

Particulars	Note No	Current Year ₹	Previous Year ₹
Equity & Liabilities			
I. Shareholders' Funds			
Share Capital			

Notes to Accounts:

NOTE 1: SHARE CAPITAL

Particulars	₹	₹
Authorised Capital		
..... Shares of ₹ ... each		xxx
Issued Capital		
..... Shares of ₹ ... each		xxx
Subscribed Capital and fully paid		

..... Shares of ₹ ... each, ₹ ... per share paid up	xxx	
*Subscribed Capital but not fully paid		
..... Shares of ₹ ... each, ₹ ... per share paid up	xxx	
Add: Forfeited Shares	xxx	xxx

Notes:

- For the period of 5 years immediately preceding the date as at which the Balance Sheet is prepared
 - Aggregate Number and Class of **Shares** allotted as fully paid up pursuant to a contract **without payments being received in cash**
 - Aggregate Number and Class of **Shares** allotted as fully paid up by way of **Bonus Shares**
 - Aggregate Number and Class of **Shares bought back**
- Calls Unpaid on Shares by Directors & Officers ₹ xxx
- Forfeited Shares (amount originally paid up) ₹ xxx
- Reconciliation of the No of shares outstanding at the beginning and at the end of the reporting period
- Shares in the company held by each shareholder holding more than 5% shares specifying the number of shares h
- Shares Reserved for issue under options and contracts/commitments for the sale of shares/ disinvestment, including the terms and amounts

***Note:** Subscribed and Paid up Share Capital will include Unpaid Amount on Shares subscribed by Subscribers to Memorandum of Association and such Unpaid Amount will be disclosed under the head 'Current Assets' and sub-head 'Other Current Assets'.

ILLUSTRATION 38 [DISCLOSURE OF SHARE CAPITAL]

Tulsian Ltd. was formed with a capital of ₹ 70,00,000 divided into 7,00,000 equity shares of ₹ 10 each. The company allotted 10,000 equity shares of ₹ 10 each as fully paid to the signatories to the Memorandum of Association and 5,000 equity shares of ₹ 10 each as fully paid to the vendors against the purchase of building and offered 5,50,000 equity shares of ₹ 10 each at a premium of 10%. The issue price was payable as under:

On Application ₹ 5, on Allotment ₹ 4 (including premium), on Call Balance

The company did not make the call during the year. The public applied for 5,00,000 equity shares. All money were duly received except the allotment money on 1000 shares which were forfeited.

Prepare an extract of Balance Sheet as per Schedule III to The Companies Act 2013 disclosing the above information. Also prepare 'notes to accounts' for the same.

SOLUTION**AN EXTRACT OF BALANCE SHEET OF TULSIAN LTD AS AT ...**

Particulars	Note No	Current Year ₹	Previous Year ₹
Equity & Liabilities			
I. Shareholders' Funds			
Share Capital	1	41,47,000	
Reserves & Surplus (Premium)		4,99,000	

Notes To Accounts:
NOTE 1: SHARE CAPITAL

<i>Particulars</i>	<i>₹</i>
Authorised Capital:	
7,00,000 Equity Shares of ₹ 10 each	70,00,000
Issued Capital:	
5,65,000 Equity Shares of ₹ 10 each	56,50,000
Subscribed Capital and fully paid	
15,000 Equity Shares of ₹ 10 each	1,50,000
(Allotted as fully paid up pursuant to a contract without payments being received in cash.)	
Subscribed Capital but not fully paid	
4,99,000 Equity Shares of ₹ 10 each ₹ 8 paid up	39,92,000
Add: Forfeited Shares (1,000 × ₹ 5)	5,000
	41,47,000

22.0 PRIVATE PLACEMENT OF SHARES

Meaning	(a) According to Section 42 private placement of shares implies issue and allotment of shares to a selected group of persons. In other words, an issue, which is not a public issue but offered to a select group of persons, is called 'Private Placement of Shares'. (b) All SEBI Guidelines concerning preferential issue are applicable to private placement of shares as well. (c) In order to make of shares through the private placement route, a company must pass a special Resolution to this effect. Where no special resolution is passed, the company must pass ordinary resolution and obtain the consent of the Central Government stating that the proposal is most beneficial to the company.
Accounting Treatment	Accounting entries relating to the private placement of securities are similar to those discussed at the time of application and allotment.

23.0 RIGHT SHARES [SEC. 62]

Meaning	As per Sec. 62 in case of further issue of shares, further shares must be offered to the existing shareholders in proportion to their existing shareholdings at that date. Such shares are called 'Rights Shares'.
When Available	Such right is available when it is proposed to increase the subscribed capital of the company by allotment of further shares at any time after the expiry of 2 years from the formation of a company or after the expiry of 1 year from the first allotment of shares, whichever is earlier.
Option available	The existing shareholder to whom the offer is made, may: 1. Accept the offer in full or in part 2. Reject the offer in full 3. Renounce the right in full or in part

Value of Right	The computation of Value of Right consists of the following two steps: Step 1: Calculate Average Price of a share $= \frac{\text{Market Price of the Existing Shares} + \text{Issue Price of proportionate Right Shares}}{\text{No. of Existing Shares} + \text{No. of Rights Shares}}$ Step 2: Calculate Value of Right Value of Right = Market Price of a Share — Average Price of a Share
Accounting Treatment	Accounting treatment of right issue of shares is similar to the treatment discussed under application and allotment.

EXAMPLE

X Ltd. offers new shares of ₹ 100 each at 10% premium to the existing shareholders in the ratio of two shares for every five shares held. The Market Price of share is ₹ 124. Calculate the Value of Right.

SOLUTION

Step 1: Average Price = $(₹124 \times 5) + (₹110 \times 2) / 5 \times 2 = ₹ 120$

Step 2: Value of Right = ₹ 124 – ₹ 120 = ₹ 4.00

24.0 PREFERENTIAL ALLOTMENT

Meaning	A preferential allotment is one that is made at a pre-determined price to the pre-identified people who wish to take a strategic stake in the company such as promoters, venture capitalists, financial institutions, buyers of companies' products or its suppliers.
Guidelines	Some of the guidelines in this regard are as follows: Lock-in-Period—The allottees will not sell their securities in the open market for a minimum period of three years from the date of allotment. This period is known as the lock in period. This period is applicable in case of promoters' contribution. However in case of pre-issue of share capital of an unlisted company, the lock-in-period is one year from the date of commencement of commercial production or the date of allotment in the public issue, whichever is earlier. Special Resolution—The preferential allotment can take place only if three-fourths of the shareholders agree to the issue on preferential basis. Minimum Issue Price—The minimum price of such an issue has to be an average of highs and lows of the 26 weeks preceding the date on which the board resolves to make the preferential allotment. Open Offer—If the preferential allotments are made over and above 15 per cent of the equity, an open offer is mandated by the SEBI.

25.0 SWEAT EQUITY SHARES [SEC. 54]

Meaning	Sweat equity shares means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called. [Sec. 2 (88)]

Five Conditions	According to Section 54, a company may issue Sweat Equity Shares if the following conditions are fulfilled, namely: 1. the shares must belong to a class of shares already issued; 2. the issue must be authorised by a special resolution passed by the company in the general meeting. 3. the resolution must specify the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued. 4. at least 1 year must have completed since the date on which the company was entitled to commence business; 5. the sweat equity shares of a company whose equity shares are listed on a recognised stock exchange must be issued as per the regulations made by the SEBI. Provided that in the case of a company whose equity shares are not listed on any recognised stock exchange, the Sweat Equity Shares are issued as per the guidelines prescribed.

26.0 BUY-BACK OF SHARES

Meaning	The term 'Buy-back of Shares' implies the act of purchasing its own shares by a company.
Three Sources of Funds [Sec. 68]	A company may purchase its own shares or other specified securities out of— 1. its Free Reserves; or 2. the Securities Premium Account; or 3. the Proceeds of any Shares or other Specified Securities;

ISSUE, FORFEITURE & RE-ISSUE

ILLUSTRATION 39

Bharat Ltd issued a prospectus inviting applications for 20,000 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 & Final Call ₹ 2.

Applications were received for 30,000 shares and *pro rata* allotment was made on the applications for 24,000 shares. It was decided to utilise excess Application Money towards the amount due on allotment. Ramesh to whom 400 shares were allotted failed to pay the allotment money and Mohan, the holder of 600 shares failed to pay the two calls. These were subsequently forfeited after the second call was made. Of the shares forfeited, 800 shares were sold to Krishan credited as full paid for ₹ 9 per share, the whole of Ramesh's shares being included.

Required: Pass the necessary Journal Entries.

SOLUTION

JOURNAL OF BHARAT LTD.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Bank A/c (30,000 × ₹ 2) Dr. To Share Application A/c (Being the Application Money received on 30,000 shares)		60,000	60,000

2.	Share Application A/c (30,000 × ₹ 2) Dr. To Share Capital A/c (20,000 × ₹ 2) To Bank A/c (6,000 × ₹ 2) To Share Allotment A/c (4,000 × ₹ 2) (Being the Application Money adjusted & Surplus refunded)		60,000	40,000 12,000 8,000
3.	Share Allotment A/c (20,000 × ₹ 5) Dr. To Share Capital A/c (20,000 × ₹ 3) To Securities Premium A/c (20,000 × ₹ 2) (Being the Allotment Money due)		1,00,000	60,000 40,000
4.	Bank A/c (₹ 1,00,000 – ₹ 8,000 – ₹ 1,840) Dr. To Share Allotment A/c (Being the remaining Allotment Money received on 19,600 shares) [See Working Note 2 & 3]		90,160	90,160
5.	Share First Call A/c (20,000 × ₹ 3) Dr. To Share Capital A/c (20,000 × ₹ 3) (Being the First Call Money due)		60,000	60,000
6.	Bank A/c (19,000 × ₹ 3) Dr. To Share First Call A/c (Being the First Call Money received on 19,000 shares)		57,000	57,000
7.	Share Second & Final Call A/c (20,000 × ₹ 2) Dr. To Share Capital A/c (Being the Second & Final Call due)		40,000	40,000
8.	Bank A/c (19,000 × ₹ 2) Dr. To Share Second & Final Call A/c (Being the Second & Final call received on 19,000 shares)		38,000	38,000
9.	Share Capital A/c (1,000 × ₹ 10) Dr. Securities Premium A/c (400 × ₹ 2) Dr. To Share Allotment A/c (₹ 2,000 – ₹ 160) To Share 1st Call A/c (1,000 × ₹ 3) To Share Second & Final Call A/c (1,000 × ₹ 2) To Forfeited Shares A/c (₹ 960 + ₹ 3,000) (Being 400 shares forfeited for non-payment of allotment money & the calls money and 600 shares for non-payment of two calls money)		10,000 800	1,840 3,000 2,000 3,960
10.	Bank A/c (800 × ₹ 9) Dr. Forfeited Shares A/c (800 × ₹ 1) Dr. To Share Capital A/c (800 × ₹ 10) (Being the re-issue of 800 shares @ ₹ 9 as fully paid up)		7,200 800	8,000
11.	Forfeited Shares A/c (₹ 560 + ₹ 1,600) Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		2,160	2,160

Working Notes:

1. **Total No. of Shares applied by Ramesh** = $(400 \times 24,000/20,000) = 480$

2. CALCULATION OF THE AMOUNT DUE BUT NOT RECEIVED ON ALLOTMENT FROM RAMESH

Particulars	₹
A. Application Money received on shares applied $(480 \times ₹ 2)$	960
B. Less: Application Money due on shares allotted $(400 \times ₹ 2)$	800
C. Excess Application Money $[A - B]$	160
D. Allotment Money due on shares allotted $(400 \times ₹ 5)$	2,000
E. Allotment Money due but not received $(₹ 2,000 - ₹ 160)$	1,840

3. CALCULATION OF ALLOTMENT MONEY RECEIVED LATER ON

Particulars	₹
A. Total Allotment Money Due $(20,000 \times ₹ 5)$	1,00,000
B. Less: Allotment Money Already received on application stage $(4,000 \times ₹ 2)$	(8,000)
C. Less: Allotment Money not received [as per Note (2)]	(1,840)
	90,160

4. CALCULATION OF AMOUNT TO BE FORFEITED

Particulars	Ramesh	Mohan
A. Amount Received	960	4,200
B. Less: Premium Received (600×2)	—	1,200
C. Amount to be forfeited $[A - B]$	960	3,000

5. CALCULATION OF PROFIT ON RE-ISSUE TO BE TRANSFERRED TO CAPITAL RESERVE

Particulars	Ramesh	Mohan
A. Amount forfeited on Re-issued Shares	960	2,000 [3000 × 400/600]
B. Less: Re-issue Discount	400	400
C. Profit on Re-issue to be t/f to Capital Reserve	560	1,600

6. Since the question is silent as to the utilization of ₹ 160 (received for Ramesh) between Share Capital and Securities Premium, it has been assumed that the entire excess of ₹ 160 is exclusively for Share Capital and hence credited to Forfeited Shares A/c in full.

ILLUSTRATION 40

Tushar Ltd issued a prospectus inviting applications for 20,000 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 & Final Call ₹ 2.

Applications were received for 30,000 shares and *pro rata* allotment was made on the applications for 24,000 shares. It was decided to utilise excess Application Money towards the amount due on allotment. Ramesh who applied for 480 shares, failed to pay the allotment money and on his subsequent failure to pay the first call, his shares were forfeited. Mohan, the holder of 600 shares, failed to pay the two calls and on his such failure, his shares were forfeited. Of the shares forfeited, 800 shares were sold to Krishan credited as fully paid for ₹ 9 per share, the whole of Ramesh's shares being included.

Required: Pass the necessary Journal Entries.

SOLUTION

JOURNAL OF TUSHAR LTD.

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	Bank A/c (30,000 × ₹ 2) Dr. To Share Application A/c (Being the Application Money received on 30,000 shares)		60,000	60,000
2.	Share Application A/c (30,000 × ₹ 2) Dr. To Share Capital A/c (20,000 × ₹ 2) To Bank A/c (6,000 × ₹ 2) To Share Allotment A/c (4,000 × ₹ 2) (Being the Application Money adjusted & Surplus refunded)		60,000	40,000 12,000 8,000
3.	Share Allotment A/c (20,000 × ₹ 5) Dr. To Share Capital A/c (20,000 × ₹ 3) To Securities Premium A/c (20,000 × ₹ 2) (Being the allotment money due)		1,00,000	60,000 40,000
4.	Bank A/c (₹ 1,00,000 – ₹ 8,000 – ₹ 1,840) Dr. To Share Allotment A/c (Being the remaining allotment money received on 19,600 shares)[See Working Notes1, 2, 3]		90,160	90,160
5.	Share First Call A/c (20,000 × ₹ 3) Dr. To Share Capital A/c (20,000 × ₹ 3) (Being the First Call Money due)		60,000	60,000
6.	Bank A/c (19,000 × ₹ 3) Dr. To Share First Call A/c (Being the First Call Money received on 19,000 shares @ ₹ 3 Per share)		57,000	57,000
7.	Share Capital A/c (400 × ₹ 8) Dr. Securities Premium A/c (400 × ₹ 2) Dr. To Share Allotment A/c (₹ 2,000 – ₹ 160) To Share First Call A/c (400 × ₹ 3) To Forfeited Shares A/c (480 × ₹ 2) (Being 600 shares forfeited for non-payment of allotment money and the First Call Money)		3,200 800	1,840 1,200 960
8.	Share Second & Final Call A/c (19,600 × ₹ 2) Dr. To Share Capital A/c (Being the second and final call due on 19,600 shares)		39,200	39,200
9.	Bank A/c (19,000 × ₹ 2) Dr. To Share Second and Final Call A/c (Being the second and final call received on 19,000 shares)		38,000	38,000

10.	Share Capital A/c (600 × ₹ 10) Dr. To Share First Call A/c (600 × ₹ 3) To Share Second and Final Call A/c (600 × ₹ 2) To Forfeited Shares A/c (600 × ₹ 5) (Being 600 shares forfeited for non-payment of the first call and final call)		6,000	1,800 1,200 3,000
11.	Bank A/c (800 × ₹ 9) Dr. Forfeited Shares A/c (800 × ₹ 1) Dr. To Share Capital A/c (800 × ₹ 10) (Being the re-issue of 800 shares @ ₹ 9 as fully paid up)		7,200 800	8,000
12.	Forfeited Shares A/c (₹ 560 + ₹ 1,600) Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		2,160	2,160

Working Notes:

- No. of Shares allotted to Ramesh = $480 \times (20,000/24,000) = 400$
- to 5 same as in Previous Problem.

ILLUSTRATION 41

Bharat Tushar Ltd issued a prospectus inviting applications for 20,000 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 & final call ₹ 2.

Applications were received for 30,000 shares and *pro rata* allotment was made on the applications for 24,000 shares. It was decided to utilise excess Application Money towards the amount due on allotment. Ramesh to whom 400 shares were allotted failed to pay the allotment money and on his subsequent failure to pay the first call, his shares were forfeited.

Mohan who applied for 720 shares, failed to pay the two calls and on his such failure, his shares were forfeited. Of the shares forfeited, 800 shares were sold to Krishan credited as fully paid for ₹ 11 per share, the whole of Mohan's shares being included.

Required: Pass the necessary Journal Entries.

SOLUTION
JOURNAL OF BHARAT TUSHAR LTD.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1-10	First 10 Entries upto Second Forfeiture are Same as in Previous Problem			
11.	Bank A/c (800 × ₹ 11) Dr. To Share Capital A/c (800 × ₹ 10) To Securities Premium A/c (800 × ₹ 1) (Being the issue of 800 shares of ₹ 11 as fully paid-up)		8,800	8,000 800
12.	Forfeited Shares A/c (₹ 480 + ₹ 3,000) Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		3,480	3,480

Working Notes:

1. to (4) same as in Illustration 39

5. CALCULATION OF PROFIT ON RE-ISSUE TO BE T/F TO CAPITAL RESERVE

Particulars	Ramesh	Mohan
A. Amount Forfeited on Re-issued shares	480	3,000 [₹ 960 × 200/400]
B. Less: Re-issue Discount	—	—
C. Profit on Re-issue to be t/f to Capital Reserve [A – B]	480	3,000

ILLUSTRATION 42

SRCC Ltd. offered 40,000 shares of ₹ 10 each at 20% premium payable as follows:

On application ₹ 6 (including ₹ 1 premium) and balance on allotment. Public has applied for 65,000 shares. Shares were allotted on *pro rata* to the applicants of 50,000 shares. Money overpaid on applications was employed on account of sum due on allotment. All the shareholders have paid the amount up to allotment except Mohan, the allottee of 8,000 shares. His shares were forfeited. 40% of the forfeited shares were reissued at ₹ 11 per share as fully paid up. Pass the necessary journal entries.

SOLUTION**JOURNAL OF SRCC LTD.**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(1)	Bank A/c (65,000 × ₹ 6) Dr. To Share Application A/c (Being the application money received on 65,000 shares)		3,90,000	3,90,000
(2)	Share Application A/c (65,000 × ₹ 6) Dr. To Share Capital A/c (40,000 × ₹ 5) To Securities Premium A/c (40,000 × ₹ 1) To Bank A/c (15,000 × ₹ 6) To Share Allotment A/c (10,000 × ₹ 6) (Being the application money adjusted & surplus refunded)		3,90,000	2,00,000 40,000 90,000 60,000
(3)	Share Allotment A/c (40,000 × ₹ 6) Dr. To Share Capital A/c (40,000 × ₹ 5) To Securities Premium A/c (40,000 × ₹ 1) (Being the allotment money due)		2,40,000	2,00,000 40,000
(4)	Bank A/c Dr. To Share Allotment A/c (Being the remaining allotment money received on 32,000 shares) [See working note (ii) & (iii)]		1,44,000	1,44,000
(5)	Share Capital A/c (8,000 × ₹ 10) Dr. Securities Premium A/c (8,000 × ₹ 1) Dr. To Share Allotment A/c [(8,000 × ₹ 6) – ₹ 12,000] To Forfeited Shares A/c (₹ 60,000 – ₹ 8,000) (Being 8,000 shares forfeited for non-payment of full allotment money)		80,000 8,000	36,000 52,000

(6)	Bank A/c (3,200 × ₹ 11) To Share Capital A/c (3,200 × ₹ 10) To Securities Premium A/c (3,200 × ₹ 1) (Being the re-issue of 3,200 shares @ for 11 as fully paid up)	Dr.	35,200	32,000 3,200
(7)	Forfeited Shares A/c (₹ 52,000 × 3,200/8000) To Capital Reserve A/c (Being the transfer of profit on re-issue)	Dr.	20,800	20,800

Working Notes:

1. Total No. of Shares applied by Mohan = $8,000 \times 50,000/40,000 = 10,000$

2. AMOUNT DUE BUT NOT RECEIVED ON ALLOTMENT FROM MOHAN

Particulars	₹
A. Application money received on shares applied (₹ 10,000 × ₹ 6)	60,000
B. Less: Application Money due on shares allotted (8,000 × ₹ 6)	(48,000)
C. Excess Application Money [A – B]	12,000
D. Allotment Money due on shares allotted (8,000 × ₹ 6)	48,000
E. Allotment Money due but not received (₹ 48,000 – ₹ 12,000)	36,000

3. CALCULATION OF ALLOTMENT MONEY RECEIVED LATER ON

Particulars	₹
A. Total allotment money due (40,000 × ₹ 6)	2,40,000
B. Less: Allotment Money Already received on application stage (10,000 × ₹ 6)	(60,000)
C. Less: Allotment Money not received [as per note (ii)]	(36,000)
	1,44,000

4. CALCULATION OF AMOUNT TO BE FORFEITED

Particulars	₹
A. Amount Received	60,000
B. Less: Premium Received (8,000 × ₹ 1)	(8,000)
C. Amount to be forfeited [A – B]	52,000

ILLUSTRATION 43

Sangita Ltd. Invited applications for issuing into 60,000 shares of ₹ 10 each payable as ₹ 2 per share on application, ₹ 3 per share on allotment and the balance on First and Final Call. Applications for 92,000 shares were received on which the directors allotted as follows:

Applications for 40,000 shares - Full,

Applications for 50,000 shares - 40 per cent,

Applications for 2,000 shares - Nil

₹ 1,08,000 was realised on account of allotment money (excluding the amount carried from Application Money) and ₹ 2,50,000 on account of call. The directors decided to forfeit shares of those applicants to whom full allotment was made and on which allotment money was overdue.

Required: Pass Journal entries in the company's books.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	Bank A/c Dr. To Share Application A/c (Being the Application Money received)		1,84,000	1,84,000
2.	Share Application A/c Dr. To Share Capital A/c [60,000 × ₹ 2] To Bank A/c [2,000 × ₹ 2] To Share Allotment A/c [30,000 × ₹ 2] (Being the Application Money adjusted and surplus refunded)		1,84,000	1,20,000 4,000 60,000
3.	Share Allotment A/c [60,000 × ₹ 3] Dr. To Share Capital A/c (Being the Allotment Money due)		1,80,000	1,80,000
4.	Bank A/c Dr. To Share Allotment A/c (Being the Allotment Money received)		1,08,000	1,08,000
5.	Share First & Final Call A/c [60,000 × ₹ 5] Dr. To Share Capital A/c (Being the First Call Money due)		3,00,000	3,00,000
6.	Bank A/c Dr. To Share First & Final Call A/c (Being the First Call Money received)		2,50,000	2,50,000
7.	Share Capital A/c [4,000 × ₹ 10] Dr. To Share Allotment A/c [4,000 × ₹ 3] To Share First & Final Call A/c [4,000 × ₹ 5] To Forfeited Shares A/c [4,000 × ₹ 2] (Being 300 shares forfeited for non-payment of Allotment Money and the call money)		40,000	12,000 20,000 8,000

Notes:

$$\begin{aligned} \text{No. of Shares Forfeited} &= \frac{\text{Allotment Money Not received}}{\text{Allotment Money per share}} = \frac{(\text{₹}1,80,000 - \text{₹}60,000) - \text{₹}1,08,000}{\text{₹}3} \\ &= 4000 \text{ Shares} \end{aligned}$$

ILLUSTRATION 44

TULSIAN Ltd. invited applications for issuing 1,00,000 Equity shares of ₹ 10 each issued at a premium of ₹ 3 per share payable as follows:

On Application	₹ 5 per share(including premium ₹ 1)
On Allotment	₹ 5 per share(including premium ₹ 1)
On Call	Balance

Applications were received for 2,20,000 shares. Applications for 20,000 shares were rejected and their application money was refunded. Shares were allotted to the remaining applicants as follows:

- I. Allotted in full to *Katrina* who had applied for 10,000 shares.
 - II. Applications for 40,000 shares were allotted 30,000 shares on *pro rata* basis.
 - III. Allotted balance of the shares on *pro rata* basis to the other applicants
- Excess application money was utilised in payment of allotment and call. The Call was duly made.

X, who applied for 800 shares in II category failed to pay the allotment money and his shares were forfeited immediately after allotment. Y, to whom 600 shares were allotted in III category failed to pay the call money and on his such failure, his shares were forfeited. Of the shares forfeited, 900 shares were re-issued to Z, credited as fully paid for ₹ 9 per share, the whole of Y's shares being included. Pass the necessary journal entries in the books of company.

SOLUTION
JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Bank A/c Dr. To Share Application A/c (Being the application money received)		11,00,000	11,00,000
2.	Share Application A/c Dr. To Share Capital A/c (1,00,000 × ₹ 4) To Securities Premium A/c To Share Allotment A/c To Bank a/c (20,000 × ₹ 5) To Calls-in Advance A/c (Being the Application Money adjusted & Surplus refunded)		11,00,000	4,00,000 1,00,000 3,50,000 1,00,000 1,50,000
3.	Share Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c (Being the Allotment Money due)		5,00,000	4,00,000 1,00,000
4.	Bank A/c [₹ 5,00,000 – ₹ 3,50,000 – ₹ 2,000] Dr. To Share Allotment A/c (Being the Allotment Money received)		1,48,000	1,48,000
5	Share Capital A/c (600 × ₹ 8) Dr. Securities Premium A/c (600 × ₹ 1) Dr. To Share Allotment A/c To Forfeited Shares A/c [₹ 4,000 – ₹ 600] (Being 600 shares forfeited for non-payment of allotment money)		4,800 600	2000 3,400
6.	Share First & Final Call A/c Dr. To Share Capital A/c To Securities Premium A/c (Being the First & Final Call Money due)		2,98,200	1,98,800 99,400

7.	Bank A/c	Dr.	1,47,900	2,98,200
	Calls-in-advance A/c	Dr.	1,50,000	
	Calls-in-arrears A/c	Dr.	300	
	To Share First & Final Call A/c			
	(Being the First and Final Call Money received except on 600 shares and Calls in advance adjusted)			
8	Share Capital A/c (600 × ₹ 10)	Dr.	6,000	6,000
	Securities Premium A/c (₹1,800 – ₹1,500)	Dr.	300	
	To Calls-in-arrears A/c			
	To Forfeited Shares A/c [₹ 7,500 – ₹ 600 – ₹ 600 – ₹ 300]			
	(Being 600 shares forfeited for non-payment of call money)			
9	Bank A/c (900 × ₹ 9)	Dr.	8,100	9,000
	Forfeited Shares A/c (900 × ₹ 1)	Dr.	900	
	To Share Capital A/c			
	(Being 900 forfeited shares reissued @ ₹ 9 per share as fully paid-up)			
10	Forfeited Shares A/c [(₹6,000 + ₹ 1,700) – ₹ 900]	Dr.	6,800	6,800
	To Capital Reserve A/c			
	(Being the Profit on re-issue t/f to Capital Reserve)			

Working Note:**1. STATEMENT SHOWING THE ADJUSTMENT OF APPLICATION MONEY RECEIVED**

Category	Shares Applied	Shares Allotted	Application Money Received	Adjustment of Application Money Received			
				Share Capital	Share Allotment	Calls-in Advance	Refund
—	20,000	0	1,00,000	0	0	0	1,00,000
I	10,000	10,000	50,000	50,000	—	—	—
II	40,000	30,000	2,00,000	1,50,000	50,000	—	—
III	1,50,000	60,000	7,50,000	3,00,000	3,00,000	1,50,000	—
Total	2,20,000	1,00,000	11,00,000	5,00,000	3,50,000	1,50,000	1,00,000

2. Total No. of Shares allotted to X = $(30,000 \times 800 / 40,000) = 600$ Shares**3. CALCULATION OF ALLOTMENT MONEY DUE BUT NOT RECEIVED**

Particulars	₹
Application Money received from defaulter (800 × ₹ 5)	4,000
Less: Application Money adjusted (600 × ₹ 5)	(3,000)
Excess Application Money	1,000
Allotment Money due (600 × ₹ 5)	3,000
Amount due but not received on allotment	2,000

4. Total No. of Shares applied by Y = $(1,50,000 \times 600 / 60,000) = 1,500$ Shares

5. CALCULATION OF CALL MONEY DUE BUT NOT RECEIVED

Particulars	₹
Application Money received from defaulter $(1,500 \times ₹ 5)$	7,500
Less: Application Money adjusted $(600 \times ₹ 5)$	3,000
Excess Application Money	4,500
Less: Excess Application Money adjusted on allotment $(600 \times ₹ 5)$	(3,000)
Excess Application Money adjusted on Call	(1,500)
Call Money due $(600 \times ₹ 3)$	1,800
Amount due but not received on Call	300

6. CALCULATION OF CALL MONEY RECEIVED LATER ON

Particulars	₹
Total Call Money due $(99,400 \times ₹ 3)$	2,98,200
Less: Surplus Application Money adjusted	(1,50,000)
Less: Not received from Defaulter	(300)
	1,47,900

SOLVED PROBLEMS

PROBLEM 1

Record the journal entries for forfeiture and reissue of shares in the following cases:

- X Ltd. forfeited 20 shares of ₹ 10 each, ₹ 7 called up on which the shareholder had paid application and allotment money of ₹ 5 per share. Out of these, 15 shares were re-issued to Naresh as ₹ 7 per share paid up for ₹ 8 per share.
- Y Ltd. forfeited 90 shares of ₹ 10 each, ₹ 8 called up issued at a premium of ₹ 2 per share to 'R' for non-payment of allotment money of ₹ 5 per share (including premium). Out of these, 80 shares were re-issued to Sanjay as ₹ 8 called up for ₹ 10 per share.
- Z Ltd. forfeited 300 shares of ₹ 10 each issued at a discount of ₹ 1 per share for non-payment of first and final call of ₹ 4 per share. Out of these 200 shares were reissued at ₹ 3 per share fully paid up.

SOLUTION

(A) JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Share Capital A/c $(20 \times ₹ 7)$ Dr. To Call in Arrears A/c $(20 \times ₹ 2)$ To Forfeited Shares A/c $(20 \times ₹ 5)$ (Being 20 shares forfeited for non-payment of 1st call)		140	40 100
2.	Bank A/c $(15 \times ₹ 8)$ Dr. To Share Capital A/c $(15 \times ₹ 7)$ To Securities Premium A/c $(15 \times ₹ 1)$ (Being 15 shares re-issued as ₹ 7 paid-up for ₹ 8 per share)		120	105 15

3.	Forfeited Shares A/c [(15 × ₹ 5)] To Capital Reserve A/c (Being the transfer of profit on re-issue)	Dr.		75	75

(B) JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Share Capital A/c (90 × ₹ 8) Securities Premium A/c To Share Allotment A/c (90 × ₹ 5) To Forfeited Shares A/c (90 × ₹ 5) (Being 90 shares forfeited for non-payment of first call money)	Dr.	720 180	450 450
2.	Bank A/c (80 × ₹ 10) To Share Capital A/c (80 × ₹ 8) To Securities Premium A/c (80 × ₹ 2) (Being 80 shares re-issued as ₹ 8 paid-up for ₹ 10 per share)	Dr.	800	640 160
3.	Forfeited Shares A/c [(80 × ₹ 5)] To Capital Reserve A/c (Being the transfer of profit on re-issue)	Dr.	400	400

(C) JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Share Capital A/c (300 × ₹ 10) To Discount on Issue of Shares A/c (300 × ₹ 1) To Forfeited Shares A/c (300 × ₹ 6) To Calls-in-arrears A/c (300 × ₹ 3) (Being 300 shares forfeited for non-payment of called up amount)	Dr.	3,000 300	1,800 900
2.	Bank A/c (200 × ₹ 4) Forfeited Shares A/c (200 × ₹ 6) To Share Capital A/c (200 × ₹ 10) (Being 200 shares re-issued as ₹ 10 paid up for ₹ 3 per share)	Dr. Dr.	800 1,200	2,000

PROBLEM 2

Windfall & Storm Ltd. issued applications for 1,00,000 equity shares of ₹ 10 each, at a premium of ₹ 4 per share. The amount was payable as follows:

On application ₹ 6 (including ₹ 2 premium), on Allotment ₹ 6 (including ₹ 2 premium), Balance on first and final call.

Applications for 1,50,000 shares were received. Allotment was made to all the applicants on pro-rata basis. Subodh to whom 200 shares were allotted, failed to pay allotment and call money. Vikram to whom 100 shares were allotted, failed to pay the call money. These shares were forfeited and afterwards re-issued @ ₹ 8 per share fully paid-up. Pass the necessary journal entries.

SOLUTION

JOURNAL OF WINDFALL & STORM LTD.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Bank A/c Dr. To Share Application A/c (Being the Application Money received on 1,50,000 shares)		9,00,000	9,00,000
2.	Share Application A/c Dr. To Share Capital A/c To Securities Premium A/c To Share Allotment A/c (Being the Application Money adjusted and surplus refunded)		9,00,000	4,00,000 2,00,000 3,00,000
3.	Share Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c (Being the allotment money due)		6,00,000	4,00,000 2,00,000
4.	Bank A/c Dr. To Share Allotment A/c (Being the remaining allotment money received on 99,800 shares)		2,99,400	2,99,400
5.	Share First & Final Call A/c Dr. To Share Capital A/c (Being the first call money due)		2,00,000	2,00,000
6.	Bank A/c Dr. To Share First & Final Call A/c (Being the first call money received on share @ ₹ 3 per share)		1,99,400	1,99,400
7.	Share Capital A/c Dr. Securities Premium A/c Dr. To Share Allotment A/c To Share First Call A/c To Forfeited Shares A/c [₹ 1,800 — ₹ 400 + ₹ 800] (Being 300 shares forfeited for non-payment of full allotment money and the first call money)		3,000 400 2,200	600 600
8.	Bank A/c Dr. Forfeited Shares A/c Dr. To Share Capital A/c (Being the re-issue of 300 shares @ ₹ 8 as fully paid-up)		2,400 600	3,000
9.	Forfeited Shares A/c Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		1,600	1,600

Working Notes:**1. CALCULATION OF THE AMOUNT DUE BUT NOT RECEIVED ON ALLOTMENT FROM SUBODH**

A. Total No. of shares applied by Subodh ($200 \times 1,50,000/1,00,000$)	300
B. Application Money received on shares applied ($300 \times ₹ 6$)	₹ 1,800
C. Excess Application Money [$₹ 1,800 - (200 \times ₹ 6)$]	₹ 600
D. Allotment Money due on shares allotted ($200 \times ₹ 6$)	₹ 1,200
E. Allotment Money due but not received ($₹ 1,200 - ₹ 600$)	₹ 600

2. CALCULATION OF ALLOTMENT MONEY RECEIVED LATER ON

A. Total allotment money due ($1,00,000 \times ₹ 6$)		₹ 6,00,000
B. Less: (a) Already received	₹ 3,00,000	
(b) Not received (as per Note 1)	₹ 600	₹ 3,00,600
		₹ 2,99,400

3. Since the question is silent as to the utilization of ₹ 600 (received from Subodh between share capital and securities premium, it has been assumed that the entire excess of ₹ 600 is exclusively for share capital and hence credited to Forfeited Shares A/c in full)

PROBLEM 3

Sun & Moon Ltd. invited applications for issuing 2,00,000 equity shares of ₹ 10 each. The amount was payable as follows:

On Application	₹ 3 per share
On Allotment	₹ 5 per share
On First and Final call	₹ 2 per share

Application for 3,00,000 shares were received and pro-rata allotment was made to all the applicants on the following basis:

Applications for 2,00,000 shares were allotted 1,50,000 shares on *pro rata* basis.

Applications for 1,00,000 shares were allotted 50,000 shares on *pro rata* basis.

Bajaj, who was allotted 3,000 shares out of the group applying for 2,00,000 shares, failed to pay the allotment money. His shares were forfeited immediately after allotment.

Sharma who had applied for 2,000 shares out of the group applying for 1,00,000 shares failed to pay the first and final call. His shares were also forfeited.

Out of the forfeited shares 3,500 shares were re-issued as fully paid up @ ₹ 8 per share. The re-issued shares included all the forfeited shares of Bajaj.

Required: Pass the necessary journal entries to record the above transactions.

SOLUTION**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Bank A/c Dr. To Equity Share Application A/c (Being the Application Money received @ ₹ 3 per share on 3,00,000 Shares)		9,00,000	9,00,000

2.	Equity Share Application A/c To Equity Share Capital A/c To Equity Share Allotment A/c (Being the adjustment of Application Money)	Dr.	9,00,000	6,00,000 3,00,000
3.	Equity Share Allotment A/c To Equity Share Capital A/c (Being the allotment money due)	Dr.	10,00,000	10,00,000
4.	Bank A/c To Equity Share Allotment A/c (Being the allotment money received)	Dr.	6,88,000	6,88,000
5.	Equity Share Capital A/c To Forfeited Shares A/c To Equity Share Allotment A/c (Being the 3,000 shares forfeited due to non-payment of allotment money)	Dr.	24,000	12,000 12,000
6.	Equity Share First & Final Call A/c To Equity Share Capital A/c (Being the first & Final call money due on 1,97,000)	Dr.	3,94,000	3,94,000
7.	Bank A/c To Equity Share First & Final Call A/c (Being the call money received)	Dr.	3,92,000	3,92,000
8.	Equity Share Capital A/c To Forfeited Shares A/c To Equity Share First & Final Call A/c (Being the shares forfeited due to non-payment of call money)	Dr.	10,000	8,000 2,000
9.	Bank A/c Forfeited Shares A/c To Equity Share Capital A/c 3(Being the Re-issue of 3,500 forfeited shares @ ₹ 8 per share)	Dr. Dr.	28,000 7,000	35,000
10.	Forfeited Shares A/c To Capital Reserve A/c (Being the transfer of profit on re-issue of shares to capital reserve)	Dr.	9,000	9,000

Working Notes:

- Shares applied by Bajaj = $3,000 \times 2,00,000/1,50,000 = 4,000$
- Shares allotted to Sharma = $2,000 \times 50,000/1,00,000 = 1,000$

3. AMOUNT NOT RECEIVED FROM BAJAJ ON ALLOTMENT

Particulars	₹
A. Application Money received on shares applied ($4,000 \times ₹ 3$)	12,000
B. Less: Application Money due on shares allotted ($3,000 \times ₹ 3$)	(9,000)
C. Excess Application Money [₹ 12,000 – ($3,000 \times ₹ 3$)]	3,000

D. Allotment Money due on shares allotted ($3,000 \times ₹ 5$)	15,000
E. Allotment Money due but not received ($₹ 15,000 - ₹ 3,000$)	12,000

4. CALCULATION OF AMOUNT RECEIVED ON ALLOTMENT LATER ON

<i>Particulars</i>	₹
A. Total allotment money due	10,00,000
B. Less: Allotment money already received	(3,00,000)
C. Less: Allotment money due but not received	(12,000)
D. Amount received on Allotment [A – B – C]	6,88,000

5. CALCULATION OF AMOUNT TRANSFERRED TO CAPITAL RESERVE

<i>Particulars</i>	₹
A. Balance in Shares Forfeited A/c ($₹ 12,000 + ₹ 8,000$)	20,000
B. Less: Amount to be retained in respect of 500 shares not yet re-issued	(4,000)
C. Less: Discount allowed on re-issue	(7,000)
	9,000

PROBLEM 4

Star & Sky Ltd. invited applications for 1,00,000 Equity Shares of ₹ 10 each. The shares were issued at a premium of ₹ 5 per share. The amount was payable as follows:

On application and Allotment ₹ 8 per share (including premium ₹ 3). Balance on the first and final call. Applications for 1,50,000 shares were received. Applications for 10,000 shares were rejected and pro-rata allotment was made to the remaining applicants on the following basis:

- (i) Applications for 80,000 shares were allotted 60,000 shares; and
- (ii) Applications for 60,000 shares were allotted 40,000 shares.

X, who belonged to the first category and was allotted 300 shares, failed to pay the call money. Y who belonged to the second category and was allotted 200 shares also failed to pay the call money, their shares were forfeited. The forfeited shares were re-issued @ ₹ 12 per share fully paid up.

Required: Prepare Cash Book and pass necessary Journal entries.

SOLUTION

Dr.

CASH BOOK (BANK COLUMN)

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Equity share Application & Allotment A/c	12,00,000	By Equity Share Application & Allotment A/c	80,000
To Equity Share First Final Call A/c	3,78,100	By Balance c/d	15,04,100
To Equity Share Capital A/c	5,000		
To Securities Premium A/c	1,000		
	15,84,100		15,84,100

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Equity Share Application & Allotment A/c Dr. To Equity Share Capital A/c To Securities Premium A/c To Calls-in-Advance A/c (Being the Application Money transferred to Share Capital Share Premium and Calls-in-advance)		11,20,000	5,00,000 3,00,000 3,20,000
2.	Equity Share First & Final Call A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Being the Call money due)		7,00,000	5,00,000 2,00,000
3.	Call-in-Advance A/c Dr. Calls-in-Arrears A/c Dr. To Equity Share First and Final Call A/c (Being the Calls-in-advance & Calls-in-arrears adjusted against Call)		3,20,000 1,900	3,21,900
4.	Equity Share Capital A/c Dr. Securities Premium A/c Dr. To Forfeited Shares A/c To Calls-in-Arrears A/c (Being the Forfeiture of 500 equity shares)		5,000 1,000	4,100 1,900
5.	Forfeited Shares A/c Dr. To Capital Reserve A/c (Being the transfer of Profit on re-issue)		4,100	4,100

Working Notes:

1. CALCULATION OF CALL MONEY NOT RECEIVED

Particulars	X	Y
A. No. of Shares Allotted	300	200
B. No. of Shares Applied	400	300
C. Money received on application and allotment	3,200	2,400
D. Money due on application & allotment	2,400	1,600
E. Excess application and allotment money (C – D)	800	800
F. First and Final Call Money due	2,100	1,400
G. First and Final Call Money due but not received (F – E)	1,300	600

2. CALCULATION OF CALL MONEY RECEIVED LATER ON

Particulars	₹
A. Total call money due	7,00,000
B. Less: Calls-in-advance	(3,20,000)
C. Less: Amount unpaid by X & Y	(1,900)
D. Amount received on call [A – B – C]	3,78,100

3. CALCULATION OF AMOUNT TO BE FORFEITED

<i>Particulars</i>	<i>₹</i>
A. Amount received from X & Y (₹ 3,200 + ₹ 2,400)	5,600
B. Less: Premium received (500 × 3)	1,500
C. Amount forfeited [A – B]	4,100

PROBLEM 5

Shakti Ltd. invited application for issuing 1,00,000 Equity shares of ₹ 10 each. The amount was payable as follows:

- (i) On Application ₹ 3 per share
- (ii) On Allotment ₹ 2 per share
- (iii) On First and Final Call Balance

Applications were received for 2,20,000 shares. Applications for 20,000 shares were rejected and their application money was refunded. Shares were allotted to the remaining applicants as follows:

- I Allotted 50% shares to Raman who had applied for 40,000 shares.
- II Allotted in full to Akbar who had applied for 20,000 shares.
- III Allotted balance of the shares on *pro rata* basis to the other applicants.

Excess application money was utilised in payment of allotment and final call. All calls were made and were duly received except the first and final call on 600 shares allotted to an applicant in III category. His shares were forfeited. The forfeited shares were reissued for ₹ 9 per share fully paid up. Pass the necessary Journal entries in the books of Shakti Ltd.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	Bank A/c Dr. To Share Application A/c (Being the application money received)		6,60,000	6,60,000
2.	Share Application A/c Dr. To Share Capital A/c (1,00,000 × ₹ 3) To Share Allotment A/c (80,000 × ₹ 2) To Bank a/c (20,000 × ₹ 3) To Calls-in Advance A/c (Being the Application Money adjusted & Surplus refunded)		6,60,000	3,00,000 1,60,000 60,000 1,40,000
3.	Share Allotment A/c Dr. To Share Capital A/c (Being the Allotment Money due)		2,00,000	2,00,000
4.	Bank A/c [₹ 2,00,000 – ₹ 1,60,000] Dr. To Share Allotment A/c (Being the Allotment Money received)		40,000	40,000
5.	Share First & Final Call A/c Dr. To Share Capital A/c (Being the First & Final Call Money due)		5,00,000	5,00,000

6.	Bank A/c Dr. Calls-in-advance A/c Dr. Calls-in-arrears A/c Dr. To Share First & Final Call A/c (Being the First and Final Call Money received except on 600 shares and Calls in advance adjusted)		3,58,200 1,40,000 1,800	5,00,000
7.	Share Capital A/c Dr. To Forfeited Shares A/c To Calls-in-Arrears A/c (Being 600 shares forfeited for non-payment of call money)		6,000	4,200 1,800
8.	Bank A/c (600 × ₹ 9) Dr. Forfeited shares A/c (500 × ₹ 1) Dr. To Share Capital A/c (Being 600 forfeited shares reissued @ ₹ 9 per share as fully paid-up)		5,400 600	6,000
9.	Forfeited Shares A/c [₹ 4,200 – ₹ 600] Dr. To Capital Reserve A/c (Being the Profit on re-issue t/f to Capital Reserve)		3,600	3,600

Working Notes:
1. ADJUSTMENT OF APPLICATION MONEY RECEIVED

Category	Shares Applied	Shares Allotted	Application Money Received	Adjustment of Application Money Received			
				Share Capital	Share Allotment	Calls-in Advance	Refund
—	20,000	0	60,000	0	0	0	60,000
I	40,000	20,000	1,20,000	60,000	40,000	20,000	—
II	20,000	20,000	60,000	60,000	—	—	—
III	1,40,000	60,000	4,20,000	1,80,000	1,20,000	1,20,000	—
Total	2,20,000	1,00,000	6,60,000	3,00,000	1,60,000	1,40,000	60,000

2. Total No. of Shares applied by Defaulter: = $1,40,000 \times 600/60,000 = 1,400$

3. CALCULATION OF CALL MONEY DUE BUT NOT RECIEVED

Particulars	₹
Application Money received from defaulter ($1,400 \times ₹ 3$)	4,200
Less: Application Money adjusted ($600 \times ₹ 3$)	(1,800)
Excess Application Money	2,400
Less: Excess Application Money adjusted on allotment ($600 \times ₹ 2$)	(1,200)
Excess Application Money adjusted on First and Final Call	(1,200)
First and Final Call Money due ($600 \times ₹ 5$)	3,000
Amount due but not recieved on First and Final Call	1,800

4. CALCULATION OF CALL MONEY RECEIVED LATER ON

<i>Particulars</i>	<i>₹</i>
Total Call Money due	5,00,000
Less: Surplus Application Money adjusted	(1,40,000)
Less: Not received from Defaulter	(1,800)
	3,58,200

PROBLEM 6

On 1st April 2012 Moneplus Company issued for public subscription 75,000 shares of the value of ₹ 10 each at a par payable as follows:

₹ 2 per share on application, ₹ 3 per share on allotment and the balance on call. The company received applications for 1,50,000 shares. The allotment was done as under:

- Applicants of 15,000 shares were allotted 5,000 shares.
- Applicants of 70,000 shares were allotted 40,000 shares.
- Remaining applicants were allotted 30,000 shares.

Money in excess to allotment was returned. Hari, a shareholder who had applied for 3,500 shares out of group B failed to pay allotment and call money. Rohan a shareholder who was allotted 3,000 shares paid the call money along with the allotment. Rohan also belonged to group B.

Pass the necessary journal entries .

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	Bank A/c Dr. To Share Application A/c (Being the application money received)		3,00,000	3,00,000
2.	Share Application A/c Dr. To Share Capital A/c To Share Allotment A/c To Bank A/c (Being the Application Money adjusted & Surplus refunded)		3,00,000	1,50,000 1,45,000 5,000
3.	Share Allotment A/c Dr. To Share Capital A/c (Being the Allotment Money due)		2,25,000	2,25,000
4.	Bank A/c Dr. Calls in arrears A/c Dr. To Share Allotment A/c To Calls-in-Advance A/c (Being the Allotment money and Calls-in-Advance on shares received)		92,000 3,000	80,000 15,000

5.	Share First & Final Call A/c To Share Capital A/c (Being the First & Final Call Money due)	Dr.		3,75,000	3,75,000
6.	Bank A/c [₹ 3,75,000 – ₹ 15,000 – ₹ 10,000] Calls-in-advance A/c Calls-in-arrears A/c [2,000 × ₹ 5] To Share First & Final Call A/c (Being the First and Final Call Money received except on 2,000 shares and Calls in advance adjusted)	Dr. Dr. Dr.		3,50,000 15,000 10,000	3,75,000

Working Notes:
1. STATEMENT SHOWING THE ADJUSTMENT OF APPLICATION MONEY RECEIVED

Category	Shares Applied	Shares Allotted	Application Money Received	Adjustment of Application Money Received		
				Share Capital	Share Allotment	Refund
A	15,000	5,000	30,000	10,000	15,000	5,000
B	70,000	40,000	1,40,000	80,000	60,000	—
C	65,000	30,000	1,30,000	60,000	70,000	—
Total	1,50,000	75,000	3,00,000	1,50,000	1,45,000	5,000

2. Total No. of Shares allotted to Hari: = $\frac{40,000}{70,000} \times 3,500 = 2,000$ Shares

3. CALCULATION OF CALL MONEY DUE BUT NOT RECIEVED

Particulars	₹
Application Money received from defaulter (3,500 × ₹ 2)	7,000
Less: Application Money adjusted (2,000 × ₹ 2)	(4,000)
Excess Application Money adjusted on allotment	3,000
Allotment Money due (2,000 × ₹ 3)	6,000
Amount due but not recieved on Allotment	3,000

4. CALCULATION OF MONEY RECEIVED AT THE TIME OF ALLOTMENT

Particulars	₹
Total Allotment Money due	2,25,000
Less: Surplus Application Money adjusted	(1,45,000)
Less: Not received from Defaulter	(3,000)
	77,000
Add: Calls-in-advance (3,000 × ₹ 5)	15,000
	92,000

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning and Nature of Debenture
- ◇ Distinction Between a Share and a Debenture
- ◇ Types of Debentures
- ◇ Debenture Trust Deed
- ◇ Issue of Debentures for Cash
- ◇ Issue of Debentures for Consideration other than Cash
- ◇ Issue of Debentures as Collateral Security
- ◇ Interest on Debentures

1.0 MEANING AND NATURE OF DEBENTURE

Meaning	Debenture is a written instrument acknowledging a debt and containing provisions as regards the repayment of principal and the payment of interest at a fixed rate. According to Sec. 2(30) of the Companies Act, 2013, Debenture includes Debentures, Stock, Bonds and any Other Securities of a company whether constituting a charge on the assets of the company or not.
Nature	Debenture represents a debt.
Characteristics	The characteristics of a debenture are as follows: 1. It is an acknowledgement of indebtedness by the company to its holder for the amount stated in it. 2. It is issued under the common seal of the company. 3. It provides for a fixed rate of interest. 4. It provides for repayment of principal sum at the fixed date or dates except in case of perpetual (or irredeemable) debentures. 5. It may or may not be secured. 6. It is expressed to be one of a series of like debentures except where single debenture is issued to one person.

2.0 DISTINCTION BETWEEN A SHARE AND A DEBENTURE

A Share and A Debenture can be distinguished as follows:

Basis of Distinction	A Share	A Debenture
1. Capital vs. Loan	Share is a part of owned capital .	Debenture constitutes a loan .
2. Reward for Investment	Reward is the payment of dividend .	Reward is the payment of interest .
3. Fluctuations in the rate of interest and dividend	The rate of dividend may vary from year to year depending upon the profit decisions of directors and members.	The rate of interest is fixed except in case of Debentures carrying Floating Rate of Interest.
4. Charge vs. Appropriation	Payment of dividend is an appropriation out of profit and this cannot be made if there is not profit.	Payment of interest is a charge against profits and is to be made even if there is no profit.
5. Priority as to payment of interest/dividend	Payment of dividend gets no priority over the payment of interest.	Payment of interest gets priority over the payment of dividend.
6. Priority as to repayment of principal during winding up	Payment of share capital is made after the repayment of debentures .	Payment of debentures is made before the payment of share capital .
7. Secured by charge	Shares are not secured by any charge.	Non-Convertible Debentures redeemable on or after 18 months are secured by a charge.
8. Restriction on issue discount	Sec. 53 prohibits the issue of shares at discount.	No restriction is imposed on the issue of debentures at discount.
9. Voting rights	Shareholders generally enjoy voting rights.	Debenture-holders do not have any voting rights (except at their class-meetings).
10. Convertibility	Equity shares can never be convertible .	Debentures can be convertible .
11. Trust Deed	Trust Deed is required to be executed.	Debenture Trust Deed is required to be executed.

3.0 TYPES OF DEBENTURES

Debentures can be classified as follows:

1. From the point of view of Security
2. From the point of view of Tenure of Redemption
3. From the point of view of Mode of Redemption
4. From the point of view of Coupon Rate
5. From the point of view of Registration

FROM THE POINT OF VIEW OF SECURITY

1. Unsecured Debentures	These are the Debentures which are not secured on any asset.
2. Fully Secured Debentures	These are the Debentures which are secured either by a fixed charge (i.e., on a particular asset) or by a floating charge (i.e., on the floating assets of the company in general) Note: <i>Charge is one of the form in which a title to property is transferred by way of security for money borrowed. "Charge" includes a Mortgage (i.e., Transfer of Interest in specific Immovable Property). The charge may be fixed charge or floating charge.</i>
(a) having Fixed Charge	A fixed charge is created against specific assets of the enterprise which are held by the enterprise for use in operations and are not meant for sale.
(b) having Floating Charge	A floating charge is a charge upon a class of assets (e.g., Stock-in-trade, Trade Debtors) (both present and future) which are changing from time to time in the ordinary course of business. This implies that Creditors holding a floating charge will have a priority as to repayment over Unsecured Creditors.
3. Partly Secured Debentures	In case of Partly Secured Debentures/bond, specific assets are given by way of charge but their value is less than the amount owed by the company.
First Mortgage Debentures	These are the Debentures which have a first claim on the assets charged.
Second Mortgage Debentures	These are the Debentures which have a second claim on the assets charged.

FROM THE POINT OF VIEW OF TENURE OF REDEMPTION

1. Redeemable Debentures	These are the Debentures which are repayable after a specified period in lumpsum or by instalments during the life time of the company.
2. Irredeemable Debentures	These are the Debentures which are not redeemable during the life time of the company.

FROM THE POINT OF VIEW OF MODE OF REDEMPTION

1. Convertible Debentures (CD)	These are the Debentures which are convertible into equity shares or other securities either at the option of debenture holders or at the option of the company as the case may be. Convertible debentures are of two types.
(a) Fully Convertible Debentures (FCD)	These are the Debentures where the full amount is convertible into shares or other securities at agreed terms and conditions. Where the conversion is to be made at or after 18 months from the date of allotment but before 36 months, the conversion is optional on the part of debenture holders as per SEBI Guidelines.
(b) Partly Convertible Debentures (PCD)	These are the Debentures where only a portion of the amount of debenture is convertible into shares or other securities at a specified time and remaining part of debenture is redeemable on agreed terms. The portion of debenture which is fully convertible into shares is termed as FCD (i.e., Fully Convertible Debenture) portion and the remaining portion which is not convertible into shares is termed as NCD (i.e., Non-convertible Debenture) portion or popularly known as Khokha in Stock Market.
2. Non-convertible Debentures (NCD)	The Debentures which are not convertible into shares or any other securities are called Non-convertible Debentures.

FROM THE POINT OF VIEW OF COUPON RATE

1. Debentures carrying Fixed Rate of Interest	These Debentures carry a specified fixed rate of interest which is called as coupon rate. For example, 15% Debentures.
2. Debentures carrying Floating Rate of Interest	These Debentures carry a floating rate of interest. The floating interest rate is usually tagged with the Bank Rate and yield on treasury bond plus a reward for risk. Since the bank rate [i.e. Prime Lending Rate (PLR)] and yield on treasury securities keep on fluctuating over a period of time, any change is compensated in the risk premium. The rate of interest in such a case is quoted as "PLR + 50 basis points. In this case, if we assume a PLR of 9%, the rate of interest would be 9.5%. The + basis points is determined in relation to risk involved.
3. A Zero Coupon Bond	A Zero Coupon Bond is one which does not carry a specified rate of interest. In order to compensate the investors, such bonds are then issued at a substantial discount. The difference between the Maturity Value and Issue Price is the total amount of interest related to the duration of the bond.

FROM THE POINT OF VIEW OF REGISTRATION

1. Registered Debentures	These are the Debentures which are payable to the persons whose names appear in the Register of Debenture-holders. These can be transferred only by executing a transfer deed. Interest is paid to the registered holder.
2. Bearer Debentures	These are the Debentures which are payable to the bearer thereof. These can be transferred merely by delivery. Interest is paid to the person who produces the interest coupon attached to such debentures.

DISTINCTION BETWEEN REGISTERED DEBENTURES & BEARER DEBENTURES

Basis of Distinction	Registered Debentures	Bearer Debentures
1. Payable	These are payable to the persons whose name appears in the Register of Debentureholders.	These are payable to the bearer thereof.
2. Transferable	These can be transferred only by executing a transfer deed.	These can be transferred merely by delivery.
3. Interest	Interest is paid to the registered holder.	Interest is paid to the person who produces the interest coupon attached to such debentures.

DISTINCTION BETWEEN CONVERTIBLE & NON-CONVERTIBLE DEBENTURES

Convertible Debentures	Non-convertible Debentures
These are the Debentures where the full amount is convertible into shares or other securities at agreed terms and conditions.	These are the Debentures which are not convertible into shares or any other securities.
Debenture Redemption Reserve is not required to be created.	Debenture Redemption Reserve is required to be created.

DISTINCTION BETWEEN FIXED CHARGE & FLOATING CHARGE DEBENTURES

Fixed Charge Debentures	Floating Charge Debentures
1. These are secured against specific assets of the enterprise which are held by the enterprise for use in operations and are not meant for sale.	1. These are secured upon a class of assets (e.g., Stock-in trade, Trade Debtors) (both present and future) which are changing from time to time in the ordinary course of business.
2. Fixed Charge Debentures have priority as to repayment over Floating Charge Debentures.	2. Floating Charge Debentures have a priority as to repayment over Unsecured Creditors.

DISTINCTION BETWEEN FULLY & PARTLY CONVERTIBLE DEBENTURES

Fully Convertible Debentures differ from the Partly Convertible Debentures in the following respects:

Basis of Distinction	Fully Convertible Debentures	Partly Convertible Debentures
1. Classification for computing debt equity ratio	They are fully classified as equity for computing debt equity ratio.	Convertible portion is classified as ' equity ' and non-convertible portion as ' debt '.
2. Impact on Debt Equity Ratio	These result in lower debt equity ratio.	These result in relatively higher debt equity ratio.
3. Capital Base	These result in higher equity capital on conversion of debentures.	These result in relatively lower equity capital on conversion of debentures.
4. Suitability	These are better suited for companies without established track record.	These are better suited for companies with established track record.
5. Servicing of equity	These involve higher burden of servicing of equity.	These involve relatively lesser burden of equity servicing.
6. Debenture Redemption Reserve (DRR)	DRR is not required to be created.	DRR is required to be created for 50% of the face value of the non-convertible portion.
7. Buy-back arrangements	No buy-back arrangement is required	Buy back arrangement may be made for non-convertible portion.

MEANING OF PARI PASSU CLAUSE

1. When debentures are described as ranking pari passu it means all the debentures of a particular series will rank together without any priority of one over the other as regards the charge created. The effect of such a clause is that the debentures of that series are to be discharged rateably in the event of insufficient funds.
2. When there is no pari passu clause, a debenture will rank for priority for the purposes of repayment etc. according to the date of issue and if all of them were issued on the same date, then according to their respective numbers.
3. A company cannot, however, create a new series of debentures to rank pari passu with an old series, unless the power to do so is expressly reserved and contained in the debentures trust deed of the prior series.

4.0 DEBENTURE TRUST DEED

Debenture Trust Deed is a document created by the company whereby trustees are appointed to protect the interest of debenture holders before they are offered for public subscription. Debenture Trust deed is required to be prepared before the issue of prospectus or letter of offer to the public for subscription of debentures.

5.0 ISSUE OF DEBENTURES FOR CASH

Consideration	Debentures may be issued for Cash or for Consideration other than Cash.
Issue Price	Issue Price means price at which Debentures are issued. Debentures may be issued at Par, Premium or Discount.
Payment of issue Price	Issue Price may be payable either in lumpsum or in instalments at different stages.
Par value	Par Value = Nominal Value = Face Value of Debenture
Over Subscription	Debentures are said to over subscribed when No. of Debentures applied (6000) is more than the No. of Debentures offered (5000).
Under Subscription	Debentures are said to be under subscribed when No. of Debentures applied (4500) is less than No. of Debentures offered (5000).
Nature of Debenture Application A/c	Debenture Application Account is Personal Account of applicants who have applied for Debentures.
Nature of Debenture Allotment A/c	Debenture Allotment Account is Personal Account of allottees to whom Debentures have been allotted.
Nature of Debenture A/c	Debenture Account is Personal Account of Debentureholders.
Adjustment of Excess Application Money	Unless otherwise stated in question the excess application money over and above that due on allotment should be refunded to allottees.
Entry When issue Price is payable in lump sum	In case Issue Price is payable in lump sum in single instalment, entry should be passed using ' Debenture Application & Allotment A/c. '
Redemption	Redemption of Debentures means discharge of liability on account of debentures by repayment made to the debentureholders.
Redemption Price	Practically speaking, Debentures may be redeemed at par or premium.
Accounting	The pattern of accounting entries on the issue of debentures is basically similar to the one on the issue of shares. The only differences are: (a) The term 'Debentures' is substituted for the word 'Share' (b) The percentage of interest is prefixed to the term 'Debentures' (say 15% Debentures) (c) The terms and conditions of redemption of debentures are to be considered.
Different Cases	Depending upon the terms and conditions of Issue and Redemption of Debentures, practically speaking there may be the following six cases:

Case No.	Conditions of Issue	Conditions of Redemption
I	Issue at Par (e.g. at ₹ 100)	Redemption at Par (e.g. at ₹ 100)
II	Issue at Premium (e.g. at ₹ 105)	Redemption at Par (e.g. at ₹ 100)
III	Issue at Discount (e.g. at ₹ 90)	Redemption at Par (e.g. at ₹ 100)
IV	Issue at Par (e.g. at ₹ 100)	Redemption at Premium (e.g. at ₹ 110)
V	Issue at Discount (e.g. at ₹ 90)	Redemption at Premium (e.g. at ₹ 110)
VI	Issue at Premium (e.g. at ₹ 105)	Redemption at Premium (e.g. at ₹ 110)

6.0 DEBENTURES ISSUED AT PAR AND REDEEMABLE AT PAR**MEANING**

- (a) Debentures are said to have been issued at par when the Issue Price is equal to the Face Value.
- (b) Debentures are said to be redeemable at par when the Redeemable Value is equal to the Face Value.

Example: An issue of a Debenture of ₹ 100 at ₹ 100 and redeemable at ₹ 100.

JOURNAL ENTRIES IF THE ISSUE PRICE IS PAYABLE IN LUMP SUM

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr.(₹)</i>
1.	On Receipt of Application money Bank A/c To Debenture Application & Allotment A/c (Being the Application Money received)	Dr.		
2.	On Adjustment of Application Money Debenture Application & Allotment A/c To X% Debentures A/c (Being the issue of% Debentures of the ₹ each at par)	Dr.		

JOURNAL ENTRIES IF THE ISSUE PRICE IS PAYABLE IN INSTALMENTS

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr.(₹)</i>
1.	On Receipt of Application Money Bank A/c To Debenture Application A/c (Being the Application Money received)	Dr.		
2.	On Acceptance of Applications Debenture Application A/c To X% Debentures A/c (Being the Application Money adjusted)	Dr.		
3.	On Making Allotment Money due Debenture Allotment A/c To X% Debentures A/c (Being the Allotment Money due)	Dr.		
4.	On Receipt of Allotment Money Bank A/c To Debenture Allotment A/c (Being the Allotment Money received)	Dr.		
5.	On Making the First Call Due Debenture First Call A/c To X% Debentures A/c (Being the First Call Money due)	Dr.		
6.	On Receipt of the First Call Bank A/c To Debenture First Call A/c (Being the First Call Money received)	Dr.		

TUTORIAL NOTES

1. Similar entries may be made for the Second Call and Third Call through Debenture Second Call Account & Debenture Third Call Account respectively. In case of last Call, the word 'Final' is also added to the concerned 'Debenture Call Account'. In case, the entire balance is payable on a single call, usually the term 'Debenture Call Account' is used.
2. In case the Cash Book is required to be prepared, all cash and bank transactions will be entered in the 'Cash Book' and other transactions will be entered in the 'Journal Proper'.
3. Instead of preparing separate 'Debenture Application A/c' and 'Debenture Allotment A/c', entries relating to the application and allotment may be passed through a combined 'Debenture Application and Allotment A/c'. In such a case, an entry for transferring the surplus application money towards allotment on partially accepted applications, is not required to be passed.

ILLUSTRATION 1 [PAYMENT OF ISSUE PRICE IN LUMP SUM]

A Ltd. issues at par 20,000, 12% Debentures of ₹ 100 each redeemable at par after 4 years. Journalise.

SOLUTION

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c Dr. To Debenture Application & Allotment A/c (Being the Application Money received)		20,00,000	20,00,000
	Debenture Application & Allotment A/c Dr. To 12% Debentures A/c (Being the issue of 20,000 12% Debentures of ₹ 100 each at par)		20,00,000	20,00,000

ILLUSTRATION 2 [PAYMENT OF ISSUE PRICE IN INSTALMENTS]

X Ltd. issued 10,000, 12% Debentures of ₹ 100 each at par, redeemable at par after 5 years, payable as ₹ 60 on application and the balance on allotment. The debentures were fully subscribed and all money was duly received. Journalise these transactions.

SOLUTION

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c Dr. To Debenture Application A/c (Being the Application Money received)		6,00,000	6,00,000
	Debenture Application A/c Dr. To 12% Debentures A/c (Being the Application Money adjusted)		6,00,000	6,00,000
	Debenture Allotment A/c Dr. To 12% Debentures A/c (Being the Allotment Money due)		4,00,000	4,00,000
	Bank A/c Dr. To Debenture Allotment A/c (Being the Allotment Money received)		4,00,000	4,00,000

7.0 DEBENTURES ISSUED AT A PREMIUM BUT REDEEMABLE AT PAR**MEANING**

Debentures are said to have been issued at premium but redeemable at par when the Issue Price is more than the Face Value but Redeemable Value is equal to Face Value. Example: An Issue of a Debenture of ₹ 100 at ₹ 110 and redeemable at ₹ 100.

SECURITIES PREMIUM

1. Demand	(a) The Securities Premium may be demanded either in lumpsum or in instalments (b) The Securities Premium may be demanded along with Application Money or Allotment Money or Call Money.
2. Treatment	The amount of premium is credited to a separate account called 'Securities Premium Account'.
3. Disclosure	Securities Premium Account appears under the head 'Shareholders' Funds and sub-head 'Reserves & Surplus' in the company's Balance Sheet.

JOURNAL ENTRIES IF THE ISSUE PRICE IS PAYABLE IN LUMP SUM

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr.(₹)</i>
1.	On Receipt of Application Money Bank A/c Dr. To Debenture Application & Allotment A/c (Being the Application Money received)			
2.	On Adjustment of Application Money Debenture Application & Allotment A/c Dr. To X% Debentures A/c To Securities Premium A/c (Being the issue of % Debenture of ₹ each at a premium of)			

JOURNAL ENTRIES IF THE ISSUE PRICE IS PAYABLE IN INSTALMENTS

All entries (except entry No. 3) are same as mentioned in case of issue of Debentures at par. However, assuming that the premium is demanded alongwith allotment money, the 3rd entry will appear as follows:

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr.(₹)</i>
3.	On Making Allotment Money due Debenture Allotment A/c Dr. To X% Debentures A/c To Securities Premium A/c (Being the Allotment Money due)			

ILLUSTRATION 3 [PAYMENT OF ISSUE PRICE IN LUMP SUM]

B Ltd. issues 40,000, 12% Debentures of ₹ 100 each at a premium of 5% redeemable at par after 4 years. Journalise.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bank A/c Dr. To Debenture Application & Allotment A/c (Being the Application Money received)		42,00,000	42,00,000
	Debenture Application & Allotment A/c Dr. To 12% Debentures A/c To Securities Premium A/c (Being the issue of 40,000, 12% Debentures of ₹ 100 each, at a premium of 5%)		42,00,000	40,00,000 2,00,000

ILLUSTRATION 4 [PAYMENT OF ISSUE PRICE IN INSTALMENTS]

X Ltd. issued 10,000, 12% Debentures of ₹ 100 each at 6% premium, redeemable at par after 5 years, payable as ₹ 66 on application (including Premium) and the balance on allotment. Debentures were fully subscribed and all money was duly received. Journalise these transactions.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bank A/c Dr. To Debentures Application A/c (Being the Application Money received)		6,60,000	6,60,000
	Debentures Application A/c Dr. To 12% Debentures a/c To Securities Premium A/c (Being the Application Money adjusted)		6,60,000	6,00,000 60,000
	Debenture Allotment A/c Dr. To 12% Debentures A/c (Being the Allotment Money due)		4,00,000	4,00,000
	Bank A/c Dr. To Debentures Allotment A/c (Being the Allotment Money received)		4,00,000	4,00,000

8.0 DEBENTURES ISSUED AT A DISCOUNT BUT REDEEMABLE AT PAR**MEANING**

Debentures are said to have been issued at discount but redeemable at par when **the Issue Price is less than the Face Value but Redeemable Value is equal to Face Value**. **Example:** An issue of a Debenture of ₹ 100 at ₹ 90 and redeemable at ₹ 100.

DISCOUNT ON ISSUE OF DEBENTURES

1. Treatment	The amount of discount is debited to a separate account called ' Discount on issue of Debentures Account ', which represents a capital loss.
2. Writing off	Discount should be written off as far as possible to Securities Premium Account or Profit & Loss Account during the life of debentures before the redemption of debentures.
3. Disclosure of unwritten off Discount	(i) Under the head ' Non-Current Assets ' and sub-head ' Other Non-Current Assets ' if it is to be written off after 12 months from the Balance Sheet Date or after the Operating Cycle Period. (ii) Under the head ' Current Assets ' and sub-head ' Other Current Assets ' if it is to be written off within 12 months from Balance Sheet Date or within the Operating Cycle Period.
4. When Debited	(a) Discount on issue of Debentures is debited while making allotment money due. (b) The amount demanded on allotment is generally presumed as net of discount.

JOURNAL ENTRIES IF THE ISSUE PRICE IS PAYABLE IN LUMP SUM

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr.(₹)</i>
1.	On Receipt of Application Money Bank A/c Dr. To Debenture Application & Allotment A/c (Being the Application Money received)			
2.	On Adjustment of Application Money Debenture Application & Allotment A/c Dr. Discount on Issue of Debentures A/c Dr. To X% Debentures A/c (Being the issue of % Debentures of ₹ each at a discount of)			

JOURNAL ENTRIES IF THE ISSUE PRICE IS PAYABLE IN INSTALMENTS

All entries (except entry No. 3) are same as mentioned in case of issue of Debentures at par.

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr.(₹)</i>
3.	On Making Allotment Money due Debenture Allotment A/c Dr. Discount on Issue of Debentures A/c Dr. To X% Debentures A/c (Being the Allotment Money due)			

Tutorial Note: The amount demanded on allotment should be presumed as net of discount.

ILLUSTRATION 5 [PAYMENT OF ISSUE PRICE IN LUMP SUM]

C Ltd. issues 30,000, 12% Debentures of ₹ 100 each at a discount of 5% redeemable at par after 4 years. Journalise.

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<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bank A/c Dr. To Debenture Application & Allotment A/c (Being the Application money received)		28,50,000	28,50,000
	Debenture Application & Allotment A/c Dr. Discount on issue of Debentures A/c Dr. To 12% Debentures A/c (Being the issue of 30,000 12% Debentures of ₹ 100 each at a discount of 5%)		28,50,000 1,50,000	30,00,000

ILLUSTRATION 6 [PAYMENT OF ISSUE PRICE IN INSTALMENTS]

X Ltd. issued 10,000, 12% Debentures of ₹ 100 each at 6% discount, redeemable at par after 5 years, payable as ₹ 60 on application and the balance on allotment. Debentures were fully subscribed and all money was duly received. Journalise these transactions.

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<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bank A/c Dr. To Debenture Application A/c (Being the Application Money received)		6,00,000	6,00,000
	Debenture Application A/c Dr. To 12% Debentures A/c (Being the Application Money adjusted)		6,00,000	6,00,000
	Debenture Allotment A/c Dr. Discount on Issue of Debentures A/c Dr. To 12% Debentures A/c (Being the Allotment Money due)		3,40,000 60,000	4,00,000
	Bank A/c Dr. To Debenture Allotment A/c (Being the Allotment Money received)		3,40,000	3,40,000

9.0 DEBENTURES ISSUED AT PAR BUT REDEEMABLE AT PREMIUM
MEANING

Debentures are said to have been issued at par but redeemable at premium when the Issue Price is equal to the Face Value but the Redeemable Value is more than the Face Value.

Example: An issue of a Debenture of ₹ 100 at ₹ 100 but redeemable at ₹ 106.

LOSS ON ISSUE OF DEBENTURES

1. Meaning	The difference between the Redeemable Value and the Face Value is treated as the anticipated loss to be incurred at the time of redemption of debentures according to Prudence Principle. For example, In an issue of a Debenture of ₹ 100 at ₹ 100 but redeemable at ₹ 106, ₹ 6 (i.e. ₹ 106 – ₹ 100) is treated as the loss on issue of debentures.
2. Treatment	The amount of loss on issue of debentures is debited to a separate account called ' Loss on Issue of Debentures Account '.
3. Writing Off	Loss on issue of debentures should be written off as far as possible to <i>Securities Premium Account</i> or <i>Profit or Loss Account</i> during the life of the debentures before the redemption of debentures.
4. Disclosure	(i) Under the head ' Non-Current Assets ' and sub-head ' Other Non-Current Assets ' if it is to be written off after 12 months from the Balance Sheet <i>Date</i> or after the Operating Cycle Period. (ii) Under the head ' Current Assets ' and sub-head ' Other Current Assets ' if it is to be written off within 12 months from Balance Sheet <i>Date</i> or within the Operating Cycle Period.
5. When Debited	Loss on Issue of Debentures is debited while making the Allotment money due.

PREMIUM ON REDEMPTION OF DEBENTURES

1. Treatment	The amount of premium payable on redemption of debentures is credited to a separate account called ' Premium on Redemption of Debentures Account '.
2. Nature	This account is a personal account which represents a liability of the company in respect of premium payable on redemption.
3. Disclosure	(i) Under the head ' Non-Current Liabilities ' and sub-head ' Other Long-term Liabilities ' if Debentures are shown as ' Long-term Borrowings ' (ii) Under the head ' Current Liabilities ' and sub-head ' Other Current Liabilities ' if Debentures are shown as ' Current Maturities of Long-term Debts '

JOURNAL ENTRIES IF THE ISSUE PRICE IS PAYABLE IN LUMP SUM

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	On Receipt of Application Money Bank A/c Dr. To Debenture Application & Allotment A/c (Being the Application Money received)			
2.	On Adjustment of Application Money Debenture Application & Allotment A/c Dr. Loss on Issue of Debentures A/c Dr. To X% Debentures A/c To Premium on Redemption of Debentures A/c (Being the issue of % Debentures of ₹ each at par redeemable at premium of)		(With Premium Payable) (With Nominal Value) (With Premium Payable)	

JOURNAL ENTRIES IF THE ISSUE PRICE IS PAYABLE IN INSTALMENTS

All entries (except entry No. 3) are same as mentioned in case of issue of Debentures at par.

Date	Particulars	L.F.	Dr. (₹)	Cr.(₹)
3.	On Making Allotment Money due			
	Debenture Allotment A/c Dr.			
	(With the Allotment Money due)			
	Loss on Issue of Debentures A/c Dr.			
	(With Premium Payable on redemption)			
	To X% Debentures A/c (With Nominal Value)			
	To Premium on Redemption of Debentures A/c			
	(With Premium Payable on redemption)			
	(Being the Allotment Money due)			

ILLUSTRATION 7 [PAYMENT OF ISSUE PRICE IN LUMP SUM]

D Ltd. issues ₹ 50,000, 12% Debentures of ₹ 100 each at par but redeemable at 105% after 4 years. Journalise.

SOLUTION
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Date	Particulars	L.F.	Dr. (₹)	Cr.(₹)
	Bank A/c Dr.		50,000	
	To Debenture Application & Allotment A/c			50,000
	(Being the Application Money received)			
	Debenture Application & Allotment A/c Dr.		50,000	
	Loss on Issue of Debentures A/c Dr.		2,500	
	To 12% Debentures A/c			50,000
	To Premium on Redemption of Debentures A/c			2,500
	(Being the issue of ₹ 50,000, 12% Debentures of ₹ 100 each at par redeemable at 105%)			

ILLUSTRATION 8 [PAYMENT OF ISSUE PRICE IN INSTALMENTS]

X Ltd. issued 10,000, 12% Debentures of ₹ 100 each at par, redeemable at 6% premium after 5 years, payable as ₹ 60 on application and the balance on allotment. The debentures were fully subscribed and all money was duly received. Journalise these transactions.

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Date	Particulars	L.F.	Dr. (₹)	Cr.(₹)
	Bank A/c Dr.		6,00,000	
	To Debenture Application A/c			6,00,000
	(Being the Application Money received)			

	Debenture Application A/c To 12% Debentures A/c (Being the Application Money adjusted)	Dr.		6,00,000	6,00,000
	Debenture Allotment A/c Loss on Issue of Debentures A/c To 12% Debentures A/c To Premium on Redemption of Debentures A/c (Being the Allotment Money due)	Dr. Dr.		4,00,000 60,000	4,00,000 60,000
	Bank A/c To Debenture Allotment A/c (Being the Allotment Money received)	Dr.		4,00,000	4,00,000

10.0 DEBENTURES ISSUED AT DISCOUNT BUT REDEEMABLE AT PREMIUM**MEANING**

Debentures are said to have been issued at discount but redeemable at premium when the Issue Price is less than the Face Value but the Redeemable Value is more than the Face Value.

Example: An issue of a Debenture of ₹ 100 at ₹ 94 but redeemable at ₹ 106.

LOSS ON ISSUE OF DEBENTURES

1. Meaning	From the accounting point of view, Loss on issue of Debentures represents the total of the following two losses: (a) Actual Loss incurred at the time of issue of Debentures by way of Discount. (b) Anticipated Loss to be incurred at the time of Redemption by way of Premium payable on Redemption as per Prudence Principle. For example, In an issue of a Debenture of ₹ 100 at ₹ 94 but redeemable at ₹ 106, ₹ 12 (i.e. ₹ 106 – ₹ 94) is treated as the loss on issue of debentures.
2. Treatment	The amount of loss on issue of debentures is debited to a separate account called ' Loss on Issue of Debentures Account '.
3. Writing Off	Loss on issue of debentures should be written off as far as possible to <i>Securities Premium Account or Profit or Loss Account</i> during the life of the debentures before the redemption of debentures.
4. Disclosure	(i) Under the head ' Non-Current Assets ' and sub-head ' Other Non-Current Assets ' if it is to be written off after 12 months from the Balance Sheet Date or after the Operating Cycle Period. (ii) Under the head ' Current Assets ' and sub-head ' Other Current Assets ' if it is to be written off within 12 months from Balance Sheet Date or within the Operating Cycle Period.
5. When Debited	Loss on Issue of Debentures is debited while making the Allotment Money Due.

JOURNAL ENTRIES IF THE ISSUE PRICE IS PAYABLE IN LUMP SUM

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	On Receipt of Application Money Bank A/c To Debenture Application & Allotment A/c (Being the Application Money received)	Dr.		

2.	On Adjustment of Application Money Debiture Application & Allotment A/c Dr. <i>(With Application Money received)</i> Loss on Issue of Debentures A/c Dr. <i>(With Discount allowed on issue plus Premium on Redemption)</i> To X% Debentures A/c <i>(With Nominal Value of Debentures allotted)</i> To Premium on Redemption of Debentures A/c <i>(With Premium Payable on redemption)</i> (Being the issue of% Debentures of ₹ each at% Discount and redeemable at% Premium)			

JOURNAL ENTRIES IF THE ISSUE PRICE IS PAYABLE IN INSTALMENTS

All entries (except entry No. 3) are same as mentioned in case of Issue of Debentures at discount.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
3.	On Making Allotment Money due Debiture Allotment A/c Dr. <i>(With the Allotment Money due)</i> Loss on Issue of Debentures A/c Dr. <i>(With Discount allowed on issue plus Premium on Redemption)</i> To X% Debentures A/c <i>(With Nominal Value of Debentures allotted)</i> To Premium on Redemption of Debentures A/c <i>(With Premium Payable on redemption)</i> (Being the Allotment Money due)			

ILLUSTRATION 9 [PAYMENT OF ISSUE PRICE IN LUMP SUM]

E Ltd. issues ₹ 60,000, 12% Debentures of ₹ 100 each at a discount of 5% redeemable at a premium of 10% after 4 years. Journalise.

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Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c Dr. To Debenture Application & Allotment A/c (Being the Application money received)		57,000	57,000
	Debiture Application & Allotment A/c Dr. Loss on Issue of Debentures A/c [3,000 + 6,000] Dr. To 12% Debentures A/c To Premium on Redemption of Debentures A/c (Being the issue of ₹ 60,000 12% Debentures at a discount of 5% and repayable at a premium of 10%)		57,000 9,000	60,000 6,000

ILLUSTRATION 10 [PAYMENT OF ISSUE PRICE IN INSTALMENTS]

X Ltd. issued 10,000, 12% Debentures of ₹ 100 each at 6% discount, redeemable at 10% premium after 5 years, payable as ₹ 60 on application and the balance on allotment. The issue was over-subscribed by 1,000 debentures and allotment was made on *prorata* basis. All money was duly received. Journalise these transactions.

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<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bank A/c Dr. To Debenture Application A/c (Being the Application Money received)		6,60,000	6,60,000
	Debenture Application A/c Dr. To 12% Debentures A/c To Debenture Allotment A/c (Being the Application Money adjusted)		6,60,000	6,00,000 60,000
	Debenture Allotment A/c Dr. Loss on Issue of Debentures A/c [60,000 + 1,00,000] Dr. To 12% Debentures A/c To Premium on Redemption of Debentures A/c (Being the Allotment Money due)		3,40,000 1,60,000	4,00,000 1,00,000
	Bank A/c Dr. To Debenture Allotment A/c (Being the Allotment Money received)		2,80,000	2,80,000

11.0 DEBENTURES ISSUED AT PREMIUM AND REDEEMABLE AT PREMIUM**MEANING**

Debentures are said to have been issued at premium and redeemable at premium when both the Issue Price and the Redeemable Value are more than the Face Value.

Example: An issue of a Debenture of ₹ 100 at ₹ 105 and redeemable at ₹ 106.

LOSS ON ISSUE OF DEBENTURES

1. Meaning	The difference between the Redeemable Value and the Face Value is treated as the anticipated to be incurred at the time of redemption of debentures according to Prudence Principle. For example, In an issue of a Debenture of ₹ 100 at ₹ 106 and redeemable at ₹ 106, ₹ 6 (i.e. ₹ 106 – ₹ 100) is treated as the loss on issue of debentures.
2. Treatment	The amount of loss on issue of debentures is debited to a separate account called ' Loss on Issue of Debentures Account '.
3. Writing Off	Loss on issue of Debentures should be written off as far as possible to Securities Premium Account or Profit or Loss Account during the life of the debentures before the redemption of debentures.

4. Disclosure	(i) Under the head ' Non-Current Assets ' and sub-head ' Other Non-Current Assets ' if it is to be written off after 12 months from the Balance Sheet Date or after the Operating Cycle Period. (ii) Under the head ' Current Assets ' and sub-head ' Other Current Assets ' if it is to be written off within 12 months from Balance Sheet Date or within the Operating Cycle Period.
5. When Debited	Loss on issue of Debentures is debited while making the Allotment Money due.

PREMIUM ON REDEMPTION OF DEBENTURES

1. Treatment	The amount of premium payable on redemption of debentures is credited to a separate account called ' Premium on Redemption of Debentures Account '.
2. Nature	Premium on Redemption of Debentures Account is a personal account which represents a liability of the company in respect of premium payable on redemption.

JOURNAL ENTRIES IF THE ISSUE PRICE IS PAYABLE IN LUMP SUM

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	On Receipt of Application Money Bank A/c Dr. To Debenture Application & Allotment A/c (Being the Application Money received)			
2.	On Adjustment of Application Money Debenture Application & Allotment A/c Dr. (With Application Money received) Loss on Issue of Debentures A/c Dr. (With Premium Payable on redemption) To X% Debentures A/c (With Nominal Value of Debentures allotted) To Premium on Redemption of Debentures A/c (With Premium Payable on redemption) To Securities Premium A/c (With Premium on Issue) (Being the issue of% Debentures of ₹ each at a premium of and redeemable at a premium of)			

JOURNAL ENTRIES IF THE ISSUE PRICE IS PAYABLE IN INSTALMENTS

All entries (except entry No. 3) are same as mentioned in case of issue of Debentures at par. However, assuming that the premium is demanded alongwith allotment money, the 3rd entry shall appear as follows:

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
3.	On Making Allotment Money due			
	Debenture Allotment A/c Dr.			
	(With the Allotment Money due)			
	Loss on Issue of Debentures A/c Dr.			
	(With Premium Payable on redemption)			
	To X% Debentures A/c			
	(With Nominal Value of Debentures allotted)			
	To Premium on Redemption of Debentures A/c			
	(With Premium Payable on redemption)			
	To Securities Premium A/c			
	(With Premium on Issue)			
	(Being the Allotment Money due)			

ILLUSTRATION 11 [PAYMENT OF ISSUE PRICE IN LUMP SUM]

F Ltd. issues ₹ 70,000, 12% Debentures of ₹ 50 each at a premium of 5% redeemable at a premium of ₹ 10 per Debenture after 4 years. Journalise.

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Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c Dr.		73,500	
	To Debenture Application & Allotment A/c			73,500
	(Being the Debenture Application Money received)			
	Debenture Application & Allotment A/c Dr.		73,500	
	Loss on Issue of Debentures A/c Dr.		14,000	
	To 12% Debentures A/c			70,000
	To Securities Premium A/c			3,500
	To Premium on Redemption of Debentures A/c			14,000
	(Being the issue of ₹ 1,400, 12% Debentures of ₹ 50 each at a premium of 5% and redeemable at a premium of ₹ 10 per Debenture)			

ILLUSTRATION 12 [PAYMENT OF ISSUE PRICE IN INSTALMENTS]

X Ltd. issued 10,000, 12% Debentures of ₹ 100 each at 6% premium, redeemable at 10% premium after 5 years, payable as ₹ 60 on application and the balance on allotment (including premium). The Debentures were over-subscribed by 1,000 Debentures and allotment was made on prorata basis. All money was duly received. Journalise these transactions.

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Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c Dr.		6,60,000	
	To Debenture Application A/c			6,60,000
	(Being the Application Money received)			

	Debenture Application A/c To 12% Debentures A/c To Debentures Allotment A/c (Being the Application Money adjusted)	Dr.		6,60,000	6,00,000 60,000
	Debenture Allotment A/c Loss on Issue of Debentures A/c To 12% Debentures A/c To Securities Premium A/c To Premium on Redemption of Debentures A/c (Being the Allotment Money due)	Dr. Dr.		4,60,000 1,00,000	4,00,000 60,000 1,00,000
	Bank A/c To Debenture Allotment A/c (Being the Allotment Money received)	Dr.		4,00,000	4,00,000

ILLUSTRATION 13

Pass Journal Entries in each of the following alternative cases assuming the face value of a debenture being ₹ 100.

- A 12% Debenture issued at ₹ 100 repayable at ₹ 100.
- A 12% Debenture issued at ₹ 95 repayable at ₹ 100.
- A 12% Debenture issued at ₹ 105 repayable at ₹ 100.
- A 12% Debenture issued at ₹ 100 repayable at ₹ 105.
- A 12% Debenture issued at ₹ 95 repayable at ₹ 105.
- A 12% Debenture issued at ₹ 105 repayable at ₹ 110.
- A 12% Debenture issued at ₹ 90 repayable at ₹ 95.

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Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(a)	Bank A/c To Debenture Application & Allotment A/c (Being the receipt of Debenture Application Money)	Dr.	100	100
	Debenture Application & Allotment A/c To 12% Debentures A/c (Being the issue of debentures at par)	Dr.	100	100
(b)	Bank A/c To Debenture Application & Allotment A/c (Being the receipt of Debenture Application Money)	Dr.	95	95
	Debenture Application & Allotment A/c Discount on Issue of Debentures A/c To 12% Debentures A/c (Being the issue of debentures at 5% discount)	Dr. Dr.	95 5	100

(c)	Bank A/c To Debenture Application & Allotment A/c (Being the receipt of Debenture Application & Allotment Money)	Dr.		105	105
	Debenture Application & Allotment A/c To 12% Debentures A/c To Securities Premium A/c (Being the issue of debentures at 5% premium)	Dr.		105	100 5
(d)	Bank A/c To Debenture Application & Allotment A/c (Being the receipt of Debenture Application Money)	Dr.		100	100
	Debenture Application & Allotment A/c Loss on Issue of Debentures A/c To 12% Debentures A/c To Premium on Redemption of Debentures A/c (Being the issue of debentures at par but redeemable at 5% premium)	Dr. Dr.		100 5	100 5
(e)	Bank A/c To Debenture Application & Allotment A/c (Being the receipt of Debenture Application Money)	Dr.		95	95
	Debenture Application & Allotment A/c Loss on Issue of Debentures A/c [₹ 5 + ₹ 5] To 12% Debentures A/c To Premium on Redemption of Debentures A/c (Being the issue of debenture at 5% discount which are redeemable at 5% premium)	Dr. Dr.		95 10	100 5
(f)	Bank A/c To Debenture Application & Allotment A/c (Being the receipt of Debenture Application Money)	Dr.		105	105
	Debenture Application & Allotment A/c Loss on Issue of Debentures A/c To 12% Debentures A/c To Securities Premium A/c To Premium on Redemption of Debentures A/c (Being the issue of debenture at 5% premium but redeemable at 10% premium)	Dr. Dr.		105 10	100 5 10
(g)	Bank A/c To Debenture Application & Allotment A/c (Being the receipt of Debenture Application Money)	Dr.		90	90
	Debenture Application & Allotment A/c Discount on Issue of Debentures A/c To 12% Debentures A/c (Being the issue of debenture at 10% discount)	Dr. Dr.		90 10	100

Note: According to prudence and realisation concepts, the latter discount (which is to materialise on redemption) being an unrealised gain, should not be taken into account at the time of issue and allotment of debentures. Practically speaking, this case is not found in practice.

12.0 ISSUE OF DEBENTURES FOR CONSIDERATION OTHER THAN CASH**MEANING**

When the company purchases some assets (including services) and instead of making the payment to the supplier in the form of cash, issues its fully paid debentures, such issue of debentures is called as the issue of debentures for consideration other than cash. Such debentures can be issued at par, at premium or at a discount.

PURCHASE CONSIDERATION

Purchase consideration is the amount paid by purchasing company in consideration for purchase of assets/business from another enterprise. Unless otherwise stated, Purchase consideration is arrived at as follows:

Purchase Consideration = Agreed Value of All Assets taken over – Agreed amount of Liabilities assumed.

For Example, X Ltd. has acquired from Y assets worth ₹ 20,00,000 and liabilities of ₹ 6,00,000. in this case, purchase consideration on Net Assets basis is ₹ 14,00,000 (i.e. ₹ 20,00,000—₹ 6,00,000).

TREATMENT OF DIFFERENCE

Case	Accounting Treatment
If Purchase Consideration > Net Assets	The excess of Purchase Consideration over Net Assets acquired should be debited to Goodwill Account .
If Net Assets > Purchase Consideration	The excess of net assets acquired over Purchase Consideration should be credited to Capital Reserve Account .

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Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	On Purchase of Business/Assets Sundry Assets Dr. <i>(with the Agreed Value of Assets taken over)</i> *Goodwill A/c Dr. <i>(with Excess of Purchase Consideration over the Value of Net Assets)</i> To Sundry Liabilities <i>(with the Agreed Amount of Liabilities taken over)</i> To Vendor's A/c <i>(with Purchase Consideration)</i> To *Capital Reserve A/c <i>(with Excess of Value of Net Assets over the Purchase Consideration)</i> (Being the purchase of Business/Asset from) *Either Goodwill or Capital Reserve.			
2.	On Making Part Payment Vendor's A/c <i>(with Part Payment)</i> Dr. To Cash A/c <i>(with Cash)</i> To Bank A/c <i>(with Cheque/Draft)</i> To Bills Payable A/c <i>(with Promissory Note)</i> (Being the part payment to).			

3.	On Issue of Debentures (i) At Par Vendor's A/c (with Purchase Consideration) Dr. To X% Debentures A/c (with Nominal Value) (Being the issue of% Debentures of ₹ each at par to) 			
	(ii) At a Premium Vendor's A/c (with Purchase Consideration) Dr. To X% Debentures A/c (with the Nominal Value) To Securities Premium A/c (with Premium) (Being the issue of% Debentures of ₹ each at a premium of to) 			
	(iii) At a Discount Vendor's A/c (with Purchase Consideration) Dr. Discount on Issue of Debentures A/c Dr. To X% Debentures A/c (with Nominal Value) (Being the issue of % Debentures of ₹ each at a discount of ₹) 			

DISCLOSURE

Debentures issued for consideration other than Cash appear under the head '**Non-Current Liabilities**' and sub-head '**Long-term Borrowings**' in the Balance Sheet.

ILLUSTRATION 14

On April, 1, 2018, X Ltd. took over the Assets of ₹ 6,80,000 and Creditors of ₹ 80,000 of Y Ltd. payable 10% by a cheque and the balance by the issue of fully paid 15% Debentures of ₹ 100 each. Pass the necessary Journal Entries in the books of the company on April, 1, 2018 if such Debentures are issued (a) at par (b) at a premium of 20%. (c) at a discount of 10%.

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Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Entry 1 & 2 in all cases			
1.	Sundry Assets A/c Dr. To Sundry Creditors To Y Ltd. (Being the purchase of Business from Y Ltd.)		6,80,000	80,000 6,00,000
2.	Y Ltd. Dr. To Bank A/c (Being the part payment made to Vendor by a cheque)		60,000	60,000
3.	Case (a) Y Ltd. Dr. To 15% Debentures A/c (Being the issue of 5,400 Debentures at par to Y Ltd.) [No. of Debentures to be issued = ₹ 5,40,000/₹ 100 = 5,400]		5,40,000	5,40,000

3.	Case (b) Y Ltd. Dr. To 15% Debentures A/c To Securities Premium A/c (Being the issue of 4,500 Debentures at 20% premium to Y Ltd.) [No. of Debentures to be issued = ₹ 5,40,000/₹ 120 = 4,500]		5,40,000	4,50,000 90,000
3.	Case (c) Y Ltd. Dr. Discount on Issue of Shares A/c Dr. To 15% Debentures A/c (Being the issue of 6,000 Debentures at a discount of 10% to Y Ltd.) [No. of Debentures to be issued = ₹ 5,40,000/₹ 90 = 6,000]		5,40,000 60,000	6,00,000

ILLUSTRATION 15

On April 1, 2018, X Ltd. purchased a running business from Y Ltd. for ₹ 10,40,000 payable as to 25% by a cheque and the balance by an issue of 12% Debentures of ₹ 500 each at a premium of 4 % redeemable at a premium of ₹ 30 per Debenture in three equal installments starting from the end of third year. The assets and liabilities consisted of the following:

Building ₹ 6,00,000, Plant and Machinery ₹ 1,00,000, Inventories ₹ 2,00,000, Trade Receivables ₹ 1,80,000, Trade Payables ₹ 80,000.

Pass the necessary journal entries in the books of X Ltd on April, 1, 2018.

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Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
01.04.2018	Building . Dr. Plant and Machinery . Dr. Inventories Dr. Trade Receivables . Dr. Goodwill A/c[Balancing Figure] Dr. To Trade Payables To Y Ltd. (Being the purchase of Business from Y Ltd.)		6,00,000 1,00,000 2,00,000 1,80,000 40,000	80,000 10,40,000
	Y Ltd. Dr. Loss on issue of Debentures A/c Dr. To Bank A/c [10,40,000 × 25%] To 12% Debentures A/c To Securities Premium A/c [₹ 7,50,000 × 4%] To Premium on Redemption of Debentures A/c (Being 25% by a cheque and the balance by an issue of 1500 Debentures at a premium of 4% redeemable at premium of ₹ 30 per Debenture). [No. of Debentures to be issued = ₹ 7,80,000 / ₹ 520 = 1,500]		10,40,000 45,000	2,60,000 7,50,000 30,000 45,000

ILLUSTRATION 16

On 01.04.2018, X Ltd. purchased a running business from Y Ltd. for ₹ 9,60,000 payable as to 25% by a cheque and the balance by an issue of 12% Debentures of ₹ 100 each at a discount of 4 % redeemable at a premium of 6% in three equal installments starting from the end of third year. The assets and liabilities consisted of the following:

Building ₹ 6,00,000, Plant and Machinery ₹ 1,00,000, Inventories ₹ 2,00,000, Trade Receivables ₹ 1,80,000, Trade Payables ₹ 80,000.

Pass the necessary journal entries in the books of X Ltd on April, 1, 2018.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
01.04.2018	Building Dr.		6,00,000	
	Plant and Machinery Dr.		1,00,000	
	Inventories Dr.		2,00,000	
	Trade Receivables Dr.		1,80,000	
	To Trade Payables			80,000
	To Y Ltd.			9,60,000
	To Capital Reserve A/c [Balancing Figure]			40,000
	(Being the purchase of Business from Y Ltd.)			
	Y Ltd. Dr.		9,60,000	
	Loss on issue of Debentures A/c Dr.		75,000	
	To Bank A/c [9,60,000 × 25%]			2,40,000
	To 12% Debentures A/c			7,50,000
	To Premium on redemption of Debentures A/c			45,000
	(Being 25% by a cheque and the balance by an issue of 7500 Debentures @ ₹ 100 each at a discount of 4% redeemable at a premium of 6%)			
	[No. of Debentures to be issued = ₹ 7,20,000 / ₹ 96 = 7500]			

ILLUSTRATION 17

X Ltd. issued 2,000, 15% Debentures of ₹ 100 each credited as fully paid to the promoters for their services and issued 1,000, 15% Debentures of ₹ 100 each credited as fully paid to the underwriters for their underwriting services. Journalise these transactions.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	Incorporation Costs A/c Dr.		2,00,000	
	To 15% Debentures A/c			2,00,000
	(Being the issue of 2,000 Debentures of ₹ 100 each at par to promoters as per Board's Resolution dated...)			

2.	Underwriting Commission A/c To Underwriter's A/c (Being the underwriting commission due on shares)	Dr.	1,00,000	1,00,000
3.	Underwriter's A/c To 15% Debentures A/c (Being the issue of 1,000 Debentures of ₹ 100 each at par to underwriters as per the Board's Resolution dated...)	Dr.	1,00,000	1,00,000

13.0 ISSUE OF DEBENTURES AS COLLATERAL SECURITY

MEANING OF DEBENTURES ISSUED AS COLLATERAL SECURITY

The issue of debentures as a collateral security means the issue of debentures as a secondary security against the loan in addition to prime or principal security. It implies stand-by or additional security to obtain secured loan. When the lender is of the view that the primary security is not enough to cover the risk, he/she may ask for further security and the borrower may issue bonds/debentures by way of additional security in favour of lender known as collateral security.

FEATURES OF DEBENTURES ISSUED AS COLLATERAL SECURITY

1. No interest is payable on such debentures.
2. Such Debentures do not carry any voting rights.
3. Such debentures may either be presented for redemption or sold in the market if the realisable value of primary security is insufficient to cover the outstanding loan amount. However, if the lender has any surplus from sale of security after meeting his dues, he is under obligation to return the same to the borrower.

TREATMENT OF DEBENTURES ISSUED AS COLLATERAL SECURITY

There are two methods of dealing with such debentures as follows:

1. First Method or No Accounting Entry Method — Since no immediate liability is created by the company, no journal entries are passed. The existence of such debentures is disclosed **by way of a Note** in the Balance Sheet under the specific loan account. It creates a **Contingent Liability**. The disclosure of issue of debentures as collateral security in the Balance Sheet of the borrower is shown below:

AN EXTRACT OF BALANCE SHEET AS AT

Particulars	Note No.	₹
Equity and Liabilities		
Non-Current Liabilities:		
Long-term Borrowings	1	

Note to Accounts:

Particulars	₹
1. Long-term Borrowings	
Long-term Loan from Bank (Secured by Assets and X% Debentures of ₹ ... each as Collateral security)	

2. Second Method or An Accounting Entry Method

One accounting entry is passed at the time of issue of such debentures and this entry is cancelled at the time of repayment of loan.

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
(i)	On Issue of Debentures as Collateral Security: Debenture Suspense A/c Dr. To Debentures A/c			
(ii)	On Release of such Debentures: Debentures A/c Dr. To Debentures Suspense A/c			

ILLUSTRATION 18

X Ltd. secured a loan of ₹ 8,00,000 from the ICICI Bank on mortgage of Land & Building and issue of 10,000, 15% Debentures of ₹ 100 each as collateral security. How will you treat the issue of such debentures?

SOLUTION**(a) First Method****AN EXTRACT OF BALANCE SHEET OF X LTD. AS AT**

<i>Particulars</i>	<i>Note No.</i>	<i>₹</i>
Equity and Liabilities		
Non-Current Liabilities:		
Long-term Borrowings	1	8,00,000

Note to Accounts:

<i>Particulars</i>	<i>₹</i>
1. Long-term Borrowings	
Long-term Loan from ICICI Bank (Secured by Land & Building and the issue of 10,000, 15% Debentures of ₹ 100 each as collateral security)	8,00,000

(b) Second Method**JOURNAL OF X LTD.**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Debentures Suspense A/c Dr. To 15% Debentures A/c (Being the issue of 10,000, 15% Debentures of ₹ 100 each as collateral security for a loan from a bank as per Board's Resolution dated...)		10,00,000	10,00,000

AN EXTRACT OF BALANCE SHEET OF X LTD. AS AT

Particulars	Note No.	₹
Equity and Liabilities		
Non-Current Liabilities:		
Long-term Borrowings	1	8,00,000

Note to Accounts:

Particulars		₹
1. Long-term Borrowings		
Loan from ICICI Bank (Secured by Land & building and the issue of 10,000, 15% Debentures of ₹ 100 each as collateral security)		8,00,000
10,000, 15% Debentures of ₹ 100 each (issued as collateral security)	10,00,000	
Less: Debenture Suspense Account	10,00,000	Nil
		8,00,000

ILLUSTRATION 19

A Ltd. issued 5,000, 9% Debentures of ₹ 100 each at par and also raised a loan of ₹ 80,000 from bank, collaterally secured by ₹ 1,00,000, 9% Debentures. How will you show Debentures in the Balance Sheet of the company assuming that the company has recorded the issue of Debentures as collateral in the books? Also journalise the issue of debentures

SOLUTION

JOURNAL OF A LTD.

[₹ in lakhs]

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c Dr. To Debenture Application & Allotment A/c (Being the Application Money received)		5,00,000	5,00,000
	Debenture Application & Allotment A/c Dr. To 9% Debentures A/c (Being the issue of 5,000, 9% Debentures of ₹ 100 each at par)		5,00,000	5,00,000
	Debentures Suspense A/c Dr. To 9% Debentures A/c (Being the issue of 1,000, 9% debentures of ₹ 100 each as collateral security for a loan from a bank as per Board's resolution dated...)		1,00,000	1,00,000

AN EXTRACT OF BALANCE SHEET OF X LTD. AS AT

Particulars	Note No.	₹
Equity and Liabilities		
Non-Current Liabilities:		
Long-term Borrowings	1	5,80,000

Note to Accounts:

<i>Particulars</i>		₹
1. Long-term Borrowings		
5,000 9% Debentures of ₹ 100 each		5,00,000
Loan from Bank (Secured by the issue of 1,000, 9% Debentures of ₹ 100 each as collateral security)		80,000
1,000 9% Debentures of ₹ 100 each (issued as collateral security)	1,00,000	
Less: Debenture Suspense Account	1,00,000	Nil
		5,80,000

14.0 TREATMENT OF DISCOUNT ON ISSUE OF DEBENTURES**MEANING OF DISCOUNT ON ISSUE OF DEBENTURES**

Discount on Issue of Debentures (being the Excess of Face Value over Issue Price) represents capital loss. It should be written off as far as possible to Securities Premium Account or Profit & Loss Account during the life of debentures before the redemption of Debentures.

JOURNAL ENTRY TO WRITE OFF DISCOUNT

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Securities Premium A/c (Amount w/o out of Securities Premium)	Dr.		
	Profit & Loss A/c (Amount w/o out of profits) To Discount on Issue of Debentures A/c (Being a portion of discount on issue of Debentures w/o)	Dr.		

DISCLOSURE OF UNWRITTEN OFF DISCOUNT

The unwritten off balance, if any, of Discount on issue of Debentures Account appears under the head 'Non-Current Assets' and sub-head 'Other Non-Current Assets' in the Company's Balance Sheet.

How to write off Discount when the Debentures are to be redeemed in Lump sum

In such a case, the total amount of discount on issue of debentures is spread equally over the period after which the debentures will be redeemed.

Amount of Discount to be written off annually

$$= \frac{\text{Total Amount of Discount}}{\text{No. of Years after which Debentures will be redeemed}}$$

HOW TO WRITE OFF DISCOUNT WHEN THE DEBENTURES ARE TO BE REDEEMED IN INSTALMENTS

In such a case, the total amount of discount on issue of debentures should be written off in the ratio in which the effective amount of debentures has been used each year. The calculation of the amount of discount to be written off each year involves the following practical steps:

- Step 1:** Calculate the Face Value of Debentures outstanding in the beginning of each period.
- Step 2:** Calculate the period for which the Face Value of Debentures has been used.
- Step 3:** Calculate the product by multiplying the Face Value of Debentures outstanding by the period of use.
- Step 4:** Calculate the Ratio of various products calculated as per Step 3.
- Step 5:** Distribute the Total Amount of Discount in the ratio of various products.

TABLE STATEMENT SHOWING THE DEBENTURES DISCOUNT TO BE WRITTEN OFF EACH YEAR

Period ended	Face value of Debentures Outstanding in the beginning of period	Period of use	Product	Ratio of Products	Amount of Discount to be w/o
A	B	C	$D = B \times C$	E	Total Discount $\times E_n$ / Total E
				E_1	Total Discount $\times E_1$ / Total E
				E_2	Total Discount $\times E_2$ / Total E
				E_3	Total Discount $\times E_3$ / Total E
				E_4	Total Discount $\times E_4$ / Total E
				Total E	

TUTORIAL NOTES

1. The Companies can write off any higher amount of discount out of available Securities Premium or Profits.
2. If the balance of 'Securities Premium Account' is available and is used to write off some portion of Discount on Issue of Debentures, then only the balance of 'Discount on Issue of Debentures Account' is to be written off during the life of debentures.

ILLUSTRATION 20

On 01.04.2018, A Ltd. issued 1,000, 15% Debentures of ₹ 100 each at a discount of 10% redeemable at par. Show the 'Discount on Issue of Debentures A/c' if (a) such debentures are redeemable after 4 years, and (b) such debentures are redeemable by equal annual drawings in 4 years. A Ltd. follows financial year as its accounting year.

SOLUTION

(a) When Debentures are redeemable after 4 years:

A. Total Discount allowed ($\text{₹ } 1,00,000 \times 10/100$)	= ₹ 10,000
B. Period for which Debentures are held	= 4 Years
C. Amount of discount to be written off to P & L A/c every year (A/B)	= ₹ 2,500

Dr.

DISCOUNT ON ISSUE OF DEBENTURES ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2018	To 15% Debentures A/c	10,000	31.03.2019	By P & L A/c	2,500
				By Balance c/d	7,500
		10,000			10,000
01.04.2019	To Balance b/d	7,500	31.03.2020	By P & L A/c	2,500
				By Balance c/d	5,000
		7,500			7,500
01.04.2020	To Balance b/d	5,000	31.03.2021	By P & L A/c	2,500
				By Balance c/d	2,500
		5,000			5,000
01.04.2021	To Balance b/d	2,500	31.03.2022	By P & L A/c	2,500

(b) When Debentures are redeemable by equal annual drawings in 4 years:

STATEMENT SHOWING THE DEBENTURE DISCOUNT TO BE WRITTEN OFF EACH YEAR

Year ended on A	Face Value of Deb. used B	Period of Use C	Product $D = B \times C$	Ratio E	Amount of Discount to be w/o $10,000 \times E/10$
31.03.2019	1,00,000	12 months	12,00,000	4	4,000
31.03.2020	75,000	12 months	9,00,000	3	3,000
31.03.2021	50,000	12 months	6,00,000	2	2,000
31.03.2022	25,000	12 months	3,00,000	1	1,000
				10	10,000

Dr.

DISCOUNT ON ISSUE OF DEBENTURES ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2018	To 15% Debentures A/c	10,000	31.03.2019	By P & L A/c	4,000
				By Balance c/d	6,000
		10,000			10,000
01.04.2019	To Balance b/d	6,000	31.03.2020	By P & L A/c	3,000
				By Balance c/d	3,000
		6,000			6,000
01.04.2020	To Balance b/d	3,000	31.03.2021	By P & L A/c	2,000
				By Balance c/d	1,000
		3,000			3,000
01.04.2021	To Balance b/d	1,000	31.03.2022	By P & L A/c	1,000

ILLUSTRATION 21

On 1.4.2018, X Ltd. issued ₹ 1,00,000 15% Debentures of ₹ 100 each at 94% red. at par as follows:

Year end	2	3	4	5
Nominal Value of Debentures to be redeemed	10%	20%	30%	40%

Required: Calculate the amount of discount to be written off each year assuming that the company closes its accounts on financial year basis.

SOLUTION

Total Discount to be w/o = ₹ 1,00,000 × 6/100 = ₹ 6,000

STATEMENT SHOWING THE DEBENTURE DISCOUNT TO BE W/O EACH YEAR

Year ended on A	Face Value of Debentures outstanding (₹) B	Proportion C	Amount of Discount to be w/o $D = ₹ 6,000 \times C/40$
31.03.2019	1,00,000	10	₹ 6,000 × 10/40 = 1,500
31.03.2020	1,00,000	10	₹ 6,000 × 10/40 = 1,500
31.03.2021	90,000	9	₹ 6,000 × 19/40 = 1,350
31.03.2022	70,000	7	₹ 6,000 × 19/40 = 1,050
31.03.2023	40,000	4	₹ 6,000 × 14/40 = 600
		40	6,000

ILLUSTRATION 22

F Ltd. issued 12% Debentures of ₹ 100 each valued at ₹ 3,00,000 at a discount of 4%, repayable at par in equal proportions at the end of the 2nd, 4th and 6th year. Calculate the amount of discount to be written off at the end of each year and prepare 'Discount on issue of Debentures Account'.

SOLUTION

Total Discount to be written off = ₹ 3,00,000 × 4/100 = ₹ 12,000

CALCULATION OF AMOUNT OF DISCOUNT WRITTEN OFF EACH YEAR

Year	O/s Debentures (₹)	Ratio	Discount written off
I	3,00,000	3	12,000 × 3/12 = ₹ 3,000
II	3,00,000	3	12,000 × 3/12 = ₹ 3,000
III	2,00,000	2	12,000 × 2/12 = ₹ 2,000
IV	2,00,000	2	12,000 × 2/12 = ₹ 2,000
V	1,00,000	1	12,000 × 1/12 = ₹ 1,000
VI	1,00,000	1	12,000 × 1/12 = ₹ 1,000
		12	12,000

Dr.

DISCOUNT ON ISSUE OF DEBENTURES ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
I	To 12% Debentures A/c	12,000	I	By Profit & Loss A/c	3,000
				By Balance c/d	9,000
		12,000			12,000
II	To Balance c/d	9,000	II	By Profit & Loss A/c	3,000
				By Balance c/d	6,000
		9,000			9,000
III	To Balance b/d	6,000	III	By Profit & Loss A/c	2,000
				By Balance c/d	4,000
		6,000			6,000
IV	To Balance b/d	4,000	IV	By Profit & Loss A/c	2,000
				By Balance c/d	3,000
		4,000			4,000
V	To Balance b/d	2,000	V	By Profit & Loss A/c	1,000
				By Balance c/d	1,000
		2,000			2,000
VI	To Balance b/d	1,000	VI	By Profit & Loss A/c	1,000

ILLUSTRATION 23

Y Ltd. issued 1 lakh, 8% Debentures of ₹ 100 each at a discount of 6% on April 1, 2018 redeemable as follows:

40,000 Debentures on March 31, 2020, 20,000 Debentures on March 31, 2021 and remaining Debentures on March 31, 2022.

Required: Calculate the amount of discount to be written off in each of the years till the Debenture are paid. Also prepare Discount on Issue of Debenture Account.

SOLUTION

Total Discount to be w/o = ₹ 100,00,000 × 6/100
= ₹ 6,00,000

CALCULATION OF DISCOUNT ON ISSUE OF DEBENTURES TO BE W/O EACH YEAR

Year ended on A	Face Value of Debentures outstanding (₹) B	Proportion C	Amount of Discount to be w/o $D = ₹ 6,00,000 \times C/30$ D
31.03.2019	1,00,00,000	10	$6,00,000 \times 10/30 = 2,00,000$
31.03.2020	1,00,00,000	10	$6,00,000 \times 10/30 = 2,00,000$
31.03.2021	60,00,000	6	$6,00,000 \times 6/30 = 1,20,000$
31.03.2022	40,00,000	4	$6,00,000 \times 4/30 = 80,000$

Dr.

DISCOUNT ON ISSUE OF DEBENTURES ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2018	To 5% Debentures	6,00,000	31.03.2019	By Profit & Loss A/c	2,00,000
				By Balance c/f	4,00,000
		6,00,000			6,00,000
01.04.2019	To Balance b/f	4,00,000	31.03.2020	By Profit & Loss A/c	2,00,000
				By Balance c/f	2,00,000
		4,00,000			4,00,000
01.04.2020	To Balance b/f	2,00,000	31.03.2021	By Profit & Loss A/c	1,20,000
				By Balance c/f	80,000
		2,00,000			2,00,000
01.04.2021	To Balance b/f	80,000	31.03.2022	By Profit & Loss A/c	80,000

ILLUSTRATION 24

X Ltd issued 12,000, 10% Debentures of ₹ 100 each at a discount of 5% on April 1, 2018. Debentures are repayable in five equal installments starting from the end of third year the Securities Premium Account showed a balance of ₹ 10,000 on the above date.

Required: Calculate the amount of discount to be written off and record the transaction in the books of X Ltd.

SOLUTION**JOURNAL OF X LTD.**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
01.04.2018	Bank A/c To Debentures Application & Allotment A/c (Being the Application Money received)	Dr.	11,40,000	11,40,000
	Debenture Application & Allotment A/c Discount on Issue of Debentures A/c To 10% Debentures A/c (Being the Application Money Adjusted)	Dr. Dr.	11,40,000 60,000	12,00,000

31.03.2019	Securities Premium A/c To Discount on issue of Debentures A/c (Being the discount written off out of Securities Premium)	Dr.		10,000	10,000
	Profit and Loss A/c To Discount on issue of Debentures A/c (Being the discount written off)	Dr.		10,000	10,000
31.03.2020	Profit and Loss A/c To Discount on issue of Debentures A/c (Being the discount written off)	Dr.		10,000	10,000
31.03.2021	Profit and Loss A/c To Discount on issue of Debentures A/c (Being the discount written off)	Dr.		10,000	10,000
31.03.2022	Profit and Loss A/c To Discount on issue of Debentures A/c (Being the discount written off)	Dr.		8,000	8,000
31.03.2023	Profit and Loss A/c To Discount on issue of Debentures A/c (Being the discount written off)	Dr.		6,000	6,000
31.03.2024	Profit and Loss A/c To Discount on issue of Debentures A/c (Being the discount written off)	Dr.		4,000	4,000
31.03.2025	Profit and Loss A/c To Discount on issue of Debentures A/c (Being the discount written off)	Dr.		2,000	2,000

Working Note:

Balance of Discount to be w/o = ₹ 60,000 – ₹ 10,000 = ₹ 50,000

DISCOUNT ON ISSUE OF DEBENTURES TO BE CHARGED TO P & L A/C EACH YEAR

Date A	Amount of Debentures outstanding (₹) B	Proportion C	Discount to be w/o $D = ₹ 50,000 \times C/25$ D
31.03.2019	120,00,000	5	$5/25 \times ₹ 50,000 = ₹ 10,000$
31.03.2020	120,00,000	5	$5/25 \times ₹ 50,000 = ₹ 10,000$
31.03.2021	120,00,000	5	$5/25 \times ₹ 50,000 = ₹ 10,000$
31.03.2022	96,00,000	4	$4/25 \times ₹ 50,000 = ₹ 8,000$
31.03.2023	72,00,000	3	$3/25 \times ₹ 50,000 = ₹ 6,000$
31.03.2024	48,00,000	2	$2/25 \times ₹ 50,000 = ₹ 4,000$
31.03.2025	24,00,000	1	$1/25 \times ₹ 50,000 = ₹ 2,000$
		25	50,000

ILLUSTRATION 25

Y Ltd. issued Debentures @ 94% for ₹ 1,00,000 on 1st Jan., 2018 repayable by five equal annual drawings of ₹ 20,000 each.

Required: Calculate the amount of discount to be written off each year assuming that the company closes its accounts on 31st March each year.

SOLUTION

Total Discount to be w/o = ₹ 1,00,000 × 6/100 = ₹ 6,000

STATEMENT SHOWING THE DEBENTURE DISCOUNT TO BE WRITTEN OFF EACH YEAR

<i>Period</i> A	<i>Face Value of Deb. (in lakhs)</i> B	<i>Period of Use (month)</i> C	<i>Product D = B × C</i> D	<i>Ratio</i> E	<i>Amount of Discount to be w/o</i> ₹ 6,000 × E/60	<i>Amount of Discount to be w/o Each Year</i>
1.1.2018 – 31.03.2018	1.00	3	3.00	5	500	500
1.4.2018 – 31.12.2018	1.00	9	9.00	15	1,500	
1.1.2019 – 31.03.2019	0.80	3	2.40	4	400	1,900
1.4.2019 – 31.12.2019	0.80	9	7.20	12	1,200	
1.1.2020 – 31.03.2020	0.60	3	1.80	3	300	1,500
1.4.2020 – 31.12.2020	0.60	9	5.40	9	900	
1.1.2021 – 31.03.2021	0.40	3	1.20	2	200	1,100
1.4.2021 – 31.12.2021	0.40	9	3.60	6	600	
1.1.2022 – 31.03.2022	0.20	3	0.60	1	100	700
1.4.2022 – 31.12.2022	0.20	9	1.80	3	300	300

15.0 TREATMENT OF LOSS ON ISSUE OF DEBENTURES**MEANING OF LOSS ON ISSUE OF DEBENTURES**

From the accounting point of view, Loss on issue of Debentures represents the total of the following two losses:

1. Actual Loss incurred at the time of issue of Debentures by way of Discount.
2. Anticipated Loss to be incurred at the time of Redemption by way of Premium payable on Redemption as per Prudence Principle.

ACCOUNTING TREATMENT

Loss on issue of debentures is treated in the accounts in the same manner as the Discount on Issue of Debentures.

ILLUSTRATION 26

On 01.04.2018 X Ltd. issued 500, 15% Debentures of ₹ 100 each, at a discount of 10% redeemable at a premium of 10%.

Required: Show the 'Loss on Issue of Debentures A/c', if (i) such debentures are redeemable after 4 years, and (ii) such debentures are redeemable by equal annual drawings in 4 years. X Ltd. follows financial year as its accounting year.

SOLUTION
(A) WHEN THE DEBENTURES ARE REDEEMABLE AFTER 4 YEARS

A. Discount allowed = ₹ 50,000 × 10/100	= ₹ 5,000
B. Premium on Redemption = ₹ 50,000 × 10/100	= ₹ 5,000
C. Total Loss [A + B]	= ₹ 10,000
D. Redemption Period	= 4 Years
E. Amount of loss to be written off to P & L A/c every year (C/D)	= ₹ 2,500

Dr.
LOSS ON ISSUE OF DEBENTURES ACCOUNT
Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2018	To 15% Debentures A/c	5,000	31.03.2019	By P & L A/c	2,500
	To premium on Red. of Debentures A/c	5,000		By Balance c/d	7,500
		10,000			10,000
01.04.2019	To Balance b/d	7,500	31.03.2020	By P & L A/c	2,500
		7,500		By Balance c/d	5,000
01.04.2020	To Balance b/d	5,000	31.03.2021	By P & L A/c	2,500
		5,000		By Balance c/d	2,500
01.04.2021	To Balance b/d	2,500	31.03.2022	By P & L A/c	2,500

(B) WHEN THE DEBENTURES ARE RED. BY EQUAL ANNUAL DRAWINGS IN 4 YEARS:

Year ended on A	Face Value of Deb. used (in lacs) B	Period of Use (Month) C	Product $D = B \times C$ D	Ratio E	Amount of Loss to be w/o ₹ 10,000 × E/10
31.03.2019	50,000	12 months	6,00,000	4	4,000
31.03.2020	37,500	12 months	4,50,000	3	3,000
31.03.2021	25,000	12 months	3,00,000	2	2,000
31.03.2022	12,500	12 months	1,50,000	1	1,000
				10	10,000

Dr.
LOSS ON ISSUE OF DEBENTURES ACCOUNT
Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2018	To 15% Debentures A/c	5,000	31.03.2019	By P & L A/c	4,000
	To premium on Red. of Debentures A/c	5,000		By Balance c/d	6,000
		10,000			10,000
01.04.2019	To Balance b/d	6,000	31.03.2020	By P & L A/c	3,000
		6,000		By Balance c/d	3,000
01.04.2020	To Balance b/d	3,000	31.03.2021	By P & L A/c	2,000
		3,000		By Balance c/d	1,000
01.04.2021	To Balance b/d	1,000	31.03.2022	By P & L A/c	1,000

ILLUSTRATION 27

On April 1, 2018, X Ltd issued 5,000, 8% Debentures of ₹ 100 each at a discount of 4% redeemable after 5 years at a premium of 6%.

Required: Pass the necessary journal entries for issue of Debentures and writing off Loss on Issue Debentures Account. Also prepare Loss on Issue of Debentures Account.

SOLUTION

A. Discount Allowed = ₹ 5,00,000 × 4/100	= ₹ 20,000
B. Premium on Redemption = ₹ 5,00,000 × 6/100	= ₹ 30,000
C. Total Loss	= ₹ 50,000
D. Redemption Period	= 5 years
E. Amount of Loss to be w/o to P & L A/c each year	= ₹ 50,000/5 = ₹ 10,000

JOURNAL OF X LTD.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
01.04.2018	Bank A/c Dr. To Debenture Application & Allotment A/c (Being the receipt of Application Money)		4,80,000	4,80,000
01.04.2018	Debenture Application & Allotment A/c Dr. Loss on Issue of Debentures A/c Dr. To 8% Debentures A/c To Premium on Redemption of Debentures A/c (Being 5,000, 8% Debentures issued at discount redeemable at premium)		4,80,000 50,000	5,00,000 30,000
31.03.2019	Profit & Loss A/c Dr. To Loss on Issue of Debentures A/c (Being the Loss on issue of debenture written off)		10,000	10,000
31.03.2020	Profit & Loss A/c Dr. To Loss on Issue of Debentures A/c (Being the loss on issue of debenture written off)		10,000	10,000
31.03.2021	Profit & Loss A/c Dr. To Loss on Issue of Debenture A/c (Being the loss on issue of debenture written off)		10,000	10,000
31.03.2022	Profit & Loss A/c Dr. To Loss on Issue of Debenture A/c (Being the loss on issue of debenture written off)		10,000	10,000
31.03.2023	Profit & Loss A/c Dr. To Loss on Issue of Debenture A/c (Being the loss on issue of debenture written off)		10,000	10,000

Dr.

LOSS ON ISSUE OF DEBENTURES ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2018	To 8% Debentures	20,000	31.03.2019	By Profit & Loss A/c	10,000
	To Premium on Red. of Debentures A/c	30,000		By Balance c/f	40,000
		50,000			50,000
01.04.2019	To Balance b/f	40,000	31.03.2020	By Profit & Loss A/c	10,000
		40,000		To Balance c/f	30,000
		40,000			40,000
01.04.2020	To Balance b/f	30,000	31.03.2021	By Profit & Loss A/c	10,000
		30,000		By Balance c/f	20,000
		30,000			30,000
01.04.2021	To balance b/f	20,000	31.03.2022	By Profit & Loss A/c	10,000
		20,000		By Balance c/f	10,000
		20,000			20,000
01.04.2022	To Balance b/f	10,000	31.03.2023	By Profit & Loss A/c	10,000

16.0 INTEREST ON DEBENTURES

Meaning	Interest on Debentures is the cost of serving the money raised by the issue of Debentures.	
Nature	Interest on Debentures is a charge against the profits of the company and is payable irrespective of the fact whether there are profits or not.	
How to Calculate	Interest on Debentures is calculated on the face value and not on the issue price.	
TDS (Tax deducted at Source)	The company is also required to deduct income-tax at the prescribed rate from the gross amount of interest in certain cases. The amount of tax so deducted is required to be deposited within the prescribed time limit.	
Journal Entries	The following entries are required to be passed:	
	Case	Journal Entry
	(a) For making Interest due	Interest on Debentures A/c Dr. To Debenture-holders A/c To TDS from Deb. Interest A/c (Being the Interest due for...months & T.D.S. @ %)
	(b) For making Payment of Interest	Debenture-holder's A/c Dr. To Bank A/c (Being the Payment of Interest)
	(c) For payment of T.D.S. (Tax Deducted at Source)	TDS from Deb. Interest A/c Dr. To Bank A/c (Being the Payment of TDS)
	(d) For transfer of Debenture interest	Profit & Loss A/c Dr. To Interest on Debentures A/c (Being the t/f of Debenture Interest)

TUTORIAL NOTES

1. *No interest is payable on Debentures issued as collateral security.*
2. *Interest accrued (whether due or not) on Debentures appears under the head 'Current Liabilities' and sub-head 'Other Current Liabilities'.*
3. *Interest on Debentures appears in the Statement of Profit and Loss in the Expense Part under the head 'Finance Costs'*

For Example, X Ltd. issued 1,000, 12% Debentures of ₹ 100 each on 1st July 2017 (Interest dates being 30th June and 31st Dec.). Accounting year is April to March, No interest has been paid till 31st March 2018. In this case, Interest from 1st July 2017 to 31st Dec. 2017 is called 'Interest accrued and due or simply 'Outstanding Interest'. Interest from 1st Jan 2018 to 31st March 2018 is called 'Interest Accrued but not due' or simply 'Accrued Interest'.

ILLUSTRATION 28

Y Ltd. issued 1000, 15% Debentures of ₹ 100 each on 1st April, 2018 at a discount of 10% redeemable at a premium of 10% after 4 years.

Required: Pass Journal entries for the period ended 31st March, 2019 assuming that the Interest is payable half yearly on 30th September and 31st March (assume the rate of Tax deducted at source being 10% and Y Ltd. follows financial year as its accounting year, Loss on Issue of Debentures to be written off equally over 4 years).

SOLUTION**JOURNAL OF Y LTD.**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
01.04.2018	Bank A/c Dr. To Debenture Application & Allotment A/c (Being the Application money received)		90,000	90,000
	Debenture Application & Allotment A/c Dr. Loss on Issue of Debentures A/c Dr. To 15% Debentures A/c To Premium on Redemption of Debentures A/c (Being the issue of 1000, 15% Debentures of ₹ 100 each at 10% discount & redeemable at 10% premium)		90,000 20,000	1,00,000 10,000
30.09.2018	Interest on Debentures A/c Dr. [1000 × ₹ 100 × 15% × 6/12] To Debentureholders' A/c (₹ 7,500 × 90%) To TDS From Deb. Int. A/c [₹ 7,500 × 10%] (Being the Interest due for 6 months & T.D.S. @ 10%)		7,500	6,750 750
30.09.2018	Debentureholders' A/c Dr. To Bank A/c (Being the payment of Interest)		6,750	6,750
30.09.2018	TDS from Deb. Interest A/c Dr. To Bank A/c (Being the payment of T.D.S.)		750	750

31.03.2019	Interest on Debentures A/c [1000 × ₹ 100 × 15% × 6/12] To Debenture-holders A/c [₹ 7,500 × 90%] To TDS From Deb. Interest A/c [₹ 7,500 × 10%] (Being the Interest due for 6 months)	Dr.		7,500	
					6,750
					750
31.03.2019	Debentureholders' A/c To Bank A/c (Being the payment of Interest)	Dr.		6,750	
					6,750
31.03.2019	TDS from Deb. Interest A/c To Bank A/c (Being the payment of T.D.S.)	Dr.		750	
					750
31.03.2019	Profit & Loss A/c [₹ 7,500 + ₹ 7,500] To Interest on Debentures A/c (Being the transfer of Debentures Interest to P & L A/c)	Dr.		15,000	
					15,000
31.03.2019	Profit & Loss A/c [(₹ 10,000 + ₹ 10,000)/4] To Loss on Issue of Debentures A/c (Being the loss on issue of Debentures written off)	Dr.		5,000	
					5,000

Note: Loss on Issue of Debentures to be written off equally over 4 years = ₹ 20,000/4 = ₹ 5,000.

SOLVED PROBLEMS

PROBLEM 1

On 01.04.2018, Tushar Tulsian Ltd. purchased a running business from Y Ltd. for ₹ 9,60,000 payable as to 25% by a cheque and the balance by an issue of 12% Debentures of ₹ 100 each at a discount of 4 % redeemable at a premium of 6% in three equal installments starting from the end of third year. The assets and liabilities consisted of the following:

Building ₹ 6,00,000, Plant and Machinery ₹ 1,00,000, Inventories ₹ 2,00,000, Trade Receivables ₹ 1,80,000, Trade Payables ₹ 80,000.

Interest is payable half yearly on 30th September and 31st March. Pass the necessary Journal Entries in the books of Tushar Tulsian Ltd for the first year (assume the rate of Tax deducted at source being 10%).

SOLUTION

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
01.04.2018	Building Plant and Machinery Inventories Trade Receivables To Trade Payables To Y Ltd. To Capital Reserve A/c [Balancing Figure] (Being the purchase of Business from Y Ltd.)	Dr. Dr. Dr. Dr. 	6,00,000 1,00,000 2,00,000 1,80,000 	 80,000 9,60,000 40,000

01.04.2018	Y Ltd. Loss on issue of Debentures A/c To Bank A/c [$\text{₹ } 9,60,000 \times 25\%$] To 12% Debentures A/c To Premium on Redemption of Debentures A/c (Being issue of 7500 Debentures @ ₹ 100 each at a discount of 4% redeemable at a premium of 6%) [No. of Debentures to be issued = $\text{₹ } 7,20,000 / \text{₹ } 96 = 7500$]	Dr. Dr.	9,60,000 75,000	2,40,000 7,50,000 45,000
30.09.2018	Interest on Debentures A/c [$7500 \times \text{₹ } 100 \times 12\% \times 6/12$] To Debenture holders' A/c ($\text{₹ } 45,000 \times 90\%$) To TDS from Deb. Int. A/c [$\text{₹ } 45,000 \times 10\%$] (Being the Interest due for 6 months & T.D.S. @ 10%)	Dr.	45,000	40,500 4,500
30.09.2018	Debenture holders' A/c TDS from Deb. Interest A/c To Bank A/c (Being the payment of Interest & TDS)	Dr. Dr.	40,500 4,500	45,000
31.03.2019	Interest on Debentures A/c [$7500 \times \text{₹ } 100 \times 12\% \times 6/12$] To Debenture holders' A/c ($\text{₹ } 45,000 \times 90\%$) To TDS from Deb. Int. A/c [$\text{₹ } 45,000 \times 10\%$] (Being the Interest due for 6 months & T.D.S. @ 10%)	Dr.	45,000	40,500 4,500
31.03.2019	Debenture holders' A/c TDS from Deb. Interest A/c To Bank A/c (Being the payment of Interest & TDS)	Dr. Dr.	40,500 4,500	45,000
31.03.2019	Profit and Loss A/c To Loss on issue of Debentures A/c To Interest on Debentures A/c (Being the Loss on issue of Debentures & Interest w/o to P & L A/c)	Dr.	1,08,750	18,750 90,000

Working Note:**LOSS ON ISSUE OF DEBENTURES TO BE CHARGED TO P & L A/C EACH YEAR**

Date A	Face Value of Debentures outstanding (₹) B	Proportion C	Loss to be w/o $D = \text{₹ } 75,000 \times C/12$ D
31.03.2019	7,50,000	3	$3/12 \times \text{₹ } 75,000 = \text{₹ } 18,750$
31.03.2020	7,50,000	3	$3/12 \times \text{₹ } 75,000 = \text{₹ } 18,750$
31.03.2021	7,50,000	3	$3/12 \times \text{₹ } 75,000 = \text{₹ } 18,750$
31.03.2022	5,00,000	2	$2/12 \times \text{₹ } 75,000 = \text{₹ } 12,500$
31.03.2023	2,50,000	1	$1/12 \times \text{₹ } 75,000 = \text{₹ } 6,250$
		12	75,000

PROBLEM 2

On April 1, 2018, Bharat Tulsian Ltd. purchased a running business from Y Ltd. for ₹ 10,40,000 payable as to 25% by a cheque and the balance by an issue of 12% Debentures of ₹ 500 each at a premium of 4 % redeemable at a premium of ₹ 30 per Debenture in three equal installments starting from the end of third year. The assets and liabilities consisted of the following:

Building ₹ 6,00,000, Plant and Machinery ₹ 1,00,000, Inventories ₹ 2,00,000, Trade Receivables ₹ 1,80,000, Trade Payables ₹ 80,000.

Interest is payable half yearly on 30th September and 31st March. Pass the necessary Journal Entries in the books of Bharat Tulsian Ltd for the first year (assume the rate of Tax deducted at source being 10%).

SOLUTION
JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
01.04.2018	Building Dr. Plant and Machinery Dr. Inventories Dr. Trade Receivables Dr. Goodwill A/c [Balancing Figure] Dr. To Trade Payables To Y Ltd. (Being the purchase of Business from Y Ltd.)		6,00,000 1,00,000 2,00,000 1,80,000 40,000	80,000 10,40,000
01.04.2018	Y Ltd. Dr. Loss on issue of Debentures A/c Dr. To Bank A/c [₹ 10,40,000 × 25%] To 12% Debentures A/c To Securities Premium A/c [₹ 7,50,000 × 4%] To Premium on Redemption of Debentures A/c (Being issue of 1500 Debentures at a premium of 4% redeemable at premium of ₹ 30 per Debenture). [No. of Debentures to be issued = ₹ 7,80,000 / ₹ 520 = 1,500]		10,40,000 45,000	2,60,000 7,50,000 30,000 45,000
30.09.2018	Interest on Debentures A/c Dr. [1500 × ₹ 500 × 12% × 6/12] To Debenture holders' A/c (₹ 45,000 × 90%) To TDS from Deb. Int. A/c [₹ 45,000 × 10%] (Being the Interest due for 6 months & T.D.S. @ 10%)		45,000	40,500 4,500
30.09.2018	Debenture holders' A/c Dr. TDS from Deb. Interest A/c Dr. To Bank A/c (Being the payment of Interest & TDS)		40,500 4,500	45,000

31.03.2019	Interest on Debentures A/c Dr. [1500 × ₹ 500 × 12% × 6/12] To Debenture holders' A/c (₹45,000 × 90%) To TDS from Deb. Int. A/c [₹45,000 × 10%] (Being the Interest due for 6 months & T.D.S. @ 10%)		45,000	40,500 4,500
31.03.2019	Debenture holders' A/c Dr. TDS from Deb. Interest A/c Dr. To Bank A/c (Being the payment of Interest & TDS)		40,500 4,500	45,000
31.03.2019	Securities Premium A/c To Loss on issue of Debentures A/c (Being the Loss written off out of Securities Premium)		30,000	30,000
31.03.2019	Profit and Loss A/c Dr. To Loss on issue of Debentures A/c To Interest on Debentures A/c (Being the Loss on issue of Debentures & Interest w/o to P & L A/c)		93,750	3,750 90,000

Working Note:

Balance of Loss to be w/o = Loss on issue of Debentures – Securities Premium

$$= ₹ 45,000 - ₹ 30,000 = ₹ 15,000$$

LOSS ON ISSUE OF DEBENTURES TO BE CHARGED TO P & L A/C EACH YEAR

Date A	Face Value of Debentures outstanding (₹) B	Proportion C	Loss to be w/o $D = ₹ 15,000 \times C/12$ D
31.03.2019	7,50,000	3	$3/12 \times ₹ 15,000 = ₹ 3,750$
31.03.2020	7,50,000	3	$3/12 \times ₹ 15,000 = ₹ 3,750$
31.03.2021	7,50,000	3	$3/12 \times ₹ 15,000 = ₹ 3,750$
31.03.2022	5,00,000	2	$2/12 \times ₹ 15,000 = ₹ 2,500$
31.03.2023	2,50,000	1	$1/12 \times ₹ 15,000 = ₹ 1,250$
		12	15,000

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FINANCIAL STATEMENTS OF A COMPANY

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- ◇ Meaning of Financial Statements
- ◇ Meaning of Financial Year
- ◇ Objective of Financial Statements
- ◇ Parties Interested in Financial Statements
- ◇ Limitations of Financial Statements
- ◇ Legal Requirements
- ◇ Contents and Forms
- ◇ Form of Preparing a Statement of Profit and Loss
- ◇ Terms used in the preparation of a Balance Sheet of a Company
- ◇ Vertical Form of Summarised Balance Sheet [with major headings only]
- ◇ Vertical Form of Detailed Balance Sheet
- ◇ Distinction between a Company's Balance Sheet and Firm's Balance Sheet

1.0 MEANING OF FINANCIAL STATEMENTS

GENERAL MEANING

The financial statements are historical documents which show the organised summaries of detailed information about the financial performance of an accounting entity for an accounting period and financial position at the end of an accounting period.

There are two basic financial statements, viz., Income statement and Balance Sheet.

1. **An Income Statement** is a Statement of Revenue from Operations, Other Incomes and Expenses during a given accounting period. It indicates the Financial Performance of an enterprise for an accounting period.
2. **A Balance Sheet** is a Statement of Assets (Current and Non-Current), Liabilities (Current and Non-Current) and Equity (i.e., Shareholders' Funds) indicating the Financial Position of an enterprise at a given date.

LEGAL MEANING

As per Section 2(40) of the Companies Act, 2013, Financial Statements include-

- (i) a Balance Sheet as at the end of the financial year;
- (ii) a Profit and Loss Account, or in the case of a company carrying on any activity not for profit, an Income and Expenditure Account for the financial year;
- (iii) Cash Flow Statement for the financial myear;

- (iv) a Statement of Changes in Equity, if applicable; and
- (v) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to (iv):

Provided that the Financial Statements, with respect to One Person Company, small company and dormant company, may not include the Cash Flow Statement.

2.0 MEANING OF FINANCIAL YEAR

The Financial Year in relation to any company or body corporate, means the period ending on the 31st day of March every year, and where it has been incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year, in respect whereof financial statement of the company or body corporate is made up

3.0 OBJECTIVES OF FINANCIAL STATEMENTS

The objectives of financial statements are:

- 1. To provide information about the Financial Performance of an enterprise**
- 2. To provide information about the Financial Position of an enterprise and**
- 3. To provide information about the Cash Flows** of an enterprise from Operating Activities, Investing Activities and Financing Activities and Net Change in Cash and Cash Equivalents between the dates of two consecutive Balance Sheets.

4.0 PARTIES INTERESTED IN FINANCIAL STATEMENTS

The users of financial statements include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. They use financial statements in order to satisfy some of their information needs. These needs include the following:

1. Investors	The investors are interested in information on the risk and return on their investments. They need information to determine whether they should buy, hold or sell. They are also interested in information which enables them to assess the ability of the enterprise to pay dividends.
2. Employees	Employees and their unions are interested in information about the stability and profitability of their employers. They are also interested in information which enables them to assess the ability of the enterprise to provide remuneration, retirement benefits and employment opportunities.
3. Lenders	Lenders are interested in information which enables them to determine whether their loans, and the interest will be paid when due.
4. Suppliers & other trade Creditors	Suppliers and other creditors are interested in information which enables them to determine whether their dues will be paid when due. Trade creditors are likely to be interested in an enterprise over a shorter period than lenders unless they are dependent upon the continuance of the enterprise as a major customer.
5. Customers	Customers are interested in information about the continuance of an enterprise, especially when they have a long-term involvement with, or are dependent on, the enterprise.
6. Governments and their agencies	Governments and their agencies are interested in the allocation of resources and, therefore, the activities of enterprises. They also require information in order to regulate the activities of enterprises and determine taxation policies, and to serve as the basis for determination of national income and similar statistics.

7. Public	Enterprises affect members of the public in a variety of ways. For example, enterprises may make a substantial contribution to the local economy in many ways including the number of people they employ and their patronage of local suppliers. Financial statements may assist the public by providing information about the trends and recent developments in the prosperity of the enterprise and the range of its activities.

While all of the information needs of these users cannot be met by financial statements, there are needs which are common to all users. As providers of risk capital to the enterprise, investors need more comprehensive information than other users.

5.0 LIMITATIONS OF FINANCIAL STATEMENTS

The major limitations of financial statements are as follows:

1. Ignores the qualitative elements	Financial statements ignore the qualitative elements like quality of management, quality of labour force, public relations.
2. Not free from personal bias	Financial statements are not free from personal bias since the subjectivity is inherent in personal judgments involved in making decision regarding method of depreciation, method of inventory valuation, materiality, provision for doubtful debt etc.
3. Ignores the Price Level Changes	Financial statements prepared on historical basis ignore the price level changes since the financial statements are prepared on historical cost basis and not on current cost basis.
4. Relates to past and not to future	Financial statements relate to the past and not to the future.

6.0 LEGAL REQUIREMENTS

1. Company's Duty to prepare Books of Account, etc., [Sec 128 (1)]

Every company must prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches.

2. On Accrual Basis: Such books must be kept on accrual basis and according to the double entry system of accounting [Sec 128(1)].

3. At Place other than Registered Office: All or any of the books of account aforesaid and other relevant papers may be kept at such other place in India as the Board of Directors may decide and where such a decision is taken, the company must, within 7 days thereof, file with the Registrar a notice in writing giving the full address of that other place [Provisio to Sec 128(1)].

4. In Electronic Mode: The company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed. [Provisio to Sec 128(1)]

5. Auditor's Report to be attached: The Auditors' Report shall be attached to every financial statement [Sec 134 (2)].

6. BOD's Report to be attached: The Board's Report must be attached to statements laid before a company in general meeting.

7. Corporate Social Responsibility (CSR):

- Every company having **Net Worth of at least ₹ 500 hundred crore or Turnover of at least ₹ 1,000 crore or a Net Profit of at least ₹ 5 crores** during any financial year must constitute a Corporate Social Responsibility Committee of the Board consisting of at least 3 directors, out of which at least one director shall be an Independent Director [Sec 135 (1)].

- (b) The Board's Report must disclose the composition of the Corporate Social Responsibility Committee [Sec 135 (2)].
- (c) The Corporate Social Responsibility Committee is required,—**
- (i) To Formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;
 - (ii) To Recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and
 - (iii) To Monitor the Corporate Social Responsibility Policy of the company from time to time. [Sec 135(3)]
- (d) The Board of every company is required,—**
- (i) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and
 - (ii) ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company. [Sec 135(4)]
- (e) Spending of 2% of Average Net Profits on CSR:** The Board of every company must ensure that the company spends, in every financial year, **at least 2% of the Average Net Profits (as per Sec 198)** of the company made **during 3 immediately preceding financial years**, in pursuance of its Corporate Social Responsibility Policy. [Sec 135(5)]
- 8. In case of Branch Books of Account:** Where a company has a branch office in India *or* outside India, it shall be deemed to have complied with the provisions of the Act, if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarized returns periodically are sent by the branch office to the company at its registered office *or* such other place where accounts are kept. [Sec 128 (2)]
- 9. Preservation of Books etc:** The books of account of every company relating to a period of at least 8 financial years immediately preceding a financial year, *or* where the company had been in existence for a period *less* than 8 years, in respect of all the preceding years together with the vouchers relevant to any entry in such books of account shall be kept in good order.
- However, where an investigation has been ordered in respect of the company under Chapter XIV, the Central Government may direct that the books of account may be kept for such longer period as it may deem fit [Sec 128 (5)].
- 10. Compliance with AS and in Forms as per Schedule III:** The Financial Statements must give a true and fair view of the state of affairs of the company *or* companies, comply with the accounting standards notified under Sec 133 and must be in the form *or* forms as may be provided for different class *or* classes of companies in Schedule III [Sec 129 (1)]:
- 11. BOD's Responsibility to lay:** At every annual general meeting of a company, the Board of Directors of the company must lay before such meeting Financial Statements for the financial year [Sec 129 (2)].
- 12. Reasons for Deviation from AS:** Where the financial statements of a company do not comply with the accounting standards the company must disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation [Sec 129 (5)].

7.0 CONTENTS AND FORMS [SECTION 129]

- (a) The Balance Sheet is required to give a true and fair view of the state of affairs of the company as at the end of the financial year and is to be in the form set out in Part I of Schedule III.
- (b) The Statement of Profit and Loss is required to give a true and fair view of the profit *or* loss of the company for the financial year and is to be in the form set out in Part II of Schedule III.

8.0 FORM OF PREPARING A STATEMENT OF PROFIT AND LOSS

1. **Vertical form** has been prescribed under The Companies Act, 2013 for Statement of Profit and Loss of a company.
2. A format of Statement of Profit and Loss has been given on next page:

SPECIMEN OF STATEMENT OF PROFIT & LOSS

NAME OF THE COMPANY.....

STATEMENT OF PROFIT AND LOSS FOR THE YEAR ENDED

<i>Particulars</i>	<i>Note No.</i>	<i>Figures for the Current Reporting Period</i>	<i>Figures for the Previous Reporting Period</i>
		₹	₹
I. Revenue from Operations	1	xxx	xxx
II. Other Income	2	xxx	xxx
III. Total Revenue [I + II]		xxx	xxx
IV. Expenses:			
Cost of Materials consumed	3	xxx	xxx
Purchases of Stock-in-Trade		xxx	xxx
Changes in Inventories	4	xxx	xxx
Employee Benefits Expense	5	xxx	xxx
Finance Costs	6	xxx	xxx
Depreciation and Amortization Expense	7	xxx	xxx
Other Expenses	8	xxx	xxx
Total Expenses		xxx	xxx
V. Profit before Tax(III–IV)		xxx	xxx
VI. Exceptional Items		xxx	xxx
VII. Profit Before Extraordinary Items and Tax (V – VI)		xxx	xxx
VIII. Extraordinary Items		xxx	xxx
IX. Profit before tax (VII – VIII)		xxx	xxx
X. Tax Expense:			
(1) Current Tax		xxx	xxx
(2) Deferred Tax		xxx	xxx
		xxx	xxx
XI. Profit (Loss) for the period		xxx	xxx
XII. Earnings per Equity Share:			
(1) Basic		xxx	xxx
(2) Diluted		xxx	xxx

Notes to Accounts:
NOTE 1: REVENUE FROM OPERATIONS

(a) From Sale of Products	xxx	xxx
(b) From Sale of Services	xxx	xxx
(c) From Other Operating Revenues [Trading Commission]	xxx	xxx
(d) Less: Excise Duty	(xxx)	(xxx)
	xxx	xxx

NOTE 2: OTHER INCOME

(a) Interest Income (in case of a company other than a finance company)	xxx	xxx
(b) Dividends From Subsidiary Companies	xxx	xxx
(c) Dividend Income From Companies other than Subsidiary Companies	xxx	xxx
(d) Net Gain/Loss on Sale of Investments [Gain – Loss]	xxx	xxx
(e) Other Non-Operating Income (Net of Expenses directly attributable to such income) [Income – Expenses]	xxx	xxx
(f) Net Gain on Foreign Currency Transaction of Translation (other than considered as Finance Cost)	xxx	xxx
	xxx	xxx

NOTE 3: COST OF MATERIALS CONSUMED

(a) Opening Stock of Materials	xxx	xxx
(b) Add: Purchases of Materials	xxx	xxx
(c) Less: Closing Stock of Materials	(xxx)	(xxx)
Cost of Materials consumed	xxx	xxx

NOTE 4: CHANGES IN INVENTORIES

<i>Particulars</i>	<i>Work-in-Progress (₹)</i>	<i>Finished Goods (₹)</i>	<i>Total</i>
Closing Stock	xxx	xxx	xxx
Less: Opening Stock	(xxx)	(xxx)	(xxx)
	xxx	xxx	xxx

NOTE 5: EMPLOYEE BENEFITS EXPENSE

Salaries and Wages	xxx	xxx
Contribution To Provident and Other Funds	xxx	xxx
Expense On Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP)	xxx	xxx
Staff Welfare Expenses	xxx	xxx
	xxx	xxx

NOTE 6: FINANCE COSTS

(a) Interest Expense	xxx	xxx
(b) Other Borrowing Costs	xxx	xxx
(c) Applicable Net Gain/Loss on Foreign Currency Transactions and Translation	xxx	xxx
	xxx	xxx

NOTE 7: DEPRECIATION AND AMORTIZATION EXPENSE

Buildings	xxx	xxx
Plant and Equipment	xxx	xxx
Vehicles	xxx	xxx
Office Equipment	xxx	xxx
Brands	xxx	xxx
Computer Software	xxx	xxx
	xxx	xxx

NOTE 8: OTHER EXPENSES

(a) Consumption of Stores and Spare Parts	xxx	xxx
(b) Power and Fuel	xxx	xxx
(c) Rent.	xxx	xxx
(d) Repairs to Buildings	xxx	xxx
(e) Repairs to Machinery	xxx	xxx
(f) Insurance	xxx	xxx
(g) Rates and Taxes [Excluding Taxes on Income]	xxx	xxx
(h) Miscellaneous Expenses	xxx	xxx
(i) Provisions for Losses of Subsidiary Companies	xxx	xxx
(j) Net Gain on Foreign Currency Transaction of Translation (other than considered as Finance Cost)	xxx	xxx
(k) Provisions, if material	xxx	xxx
(l) Withdrawal from Provisions, if material	xxx	xxx
(m) Expenditure on Corporate Social Responsibility (CSR)	xxx	xxx
(j) Payments to the Auditor as:		
(a) Auditor	xxx	xxx
(b) For Taxation Matters	xxx	xxx
(c) For Company Law Matters	xxx	xxx
(d) For Management Services	xxx	xxx
(e) For Other Services	xxx	xxx
(f) For Reimbursement of Expenses	xxx	xxx
	xxx	xxx

NOTE: SURPLUS I.E. BALANCE IN THE STATEMENT OF P&L TO BE TAKEN TO BALANCE SHEET

Opening Balance	xxx	xxx
Add: Profit for the period	xxx	xxx
Less: Transfer to Reserve	(xxx)	(xxx)
Less: Interim Dividend	(xxx)	(xxx)
Less: Proposed Preference Dividend	(xxx)	(xxx)
Less: Proposed Equity Dividend	(xxx)	(xxx)
Less: Dividend Distribution Tax	(xxx)	(xxx)
Closing Balance	xxx	xxx

Notes:

1. Any item of Income or Expenditure which exceeds **1% of the Revenue from Operations or ₹ 1,00,000, whichever is higher** is to be disclosed separately.
2. The Statement of Profit and Loss shall also contain by way of a note the following information, namely:
 - (a) **Value of imports calculated on C.I.F. basis** by the company during the financial year in respect of—
 - I. Raw Materials; II. Components and spare parts; III. Capital Goods;
 - (b) **Expenditure in Foreign Currency** during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters;
 - (c) **Total Value of all imported raw materials, spare parts and components** consumed during the financial year and the total value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption;
 - (d) **The amount remitted during the year in Foreign Currencies** on account of dividends with a specific mention of the total number of Non-Resident Shareholders, the total number of shares held by them on which the dividends were due and the year to which the dividends related.
 - (e) **Earnings in Foreign Exchange** classified under the following heads, namely:—
 - I. Export of Goods calculated on F.O.B. basis;
 - II. Royalty, know-how, professional and consultation fees;
 - III. Interest and Dividend;
 - IV. Other Income, indicating the nature thereof.

ILLUSTRATION 1

From the following information, prepare Statement of Profit and Loss for the year ended 31st March, 2018:

<i>Particulars</i>	<i>(₹ in lacs)</i>
Revenue from Operations	2605
Other Income	40
Cost of Materials consumed	1000
Changes in Inventories	(275)
Employee Benefits Expense	850
Finance Costs	20
Depreciation and Amortization Expense	150
Other Expenses	100
Tax Rate @ 30%	

SOLUTION

TULSIAN LTD.
STATEMENT OF PROFIT AND LOSS FOR THE YEAR ENDED 31ST MARCH, 2018

<i>Particulars</i>	<i>Note No.</i>	<i>(₹ in lacs)</i>
I. Revenue from Operations		2605
II. Other Income		40
III. Total Revenue [I + II]		2645

IV. Expenses:		
Cost of Materials consumed		1000
Changes in Inventories		(275)
Employee Benefits Expense		850
Finance Costs		20
Depreciation and Amortization Expense		150
Other Expenses		100
Total Expenses		1845
V. Profit before Tax(III – IV)		800
VI. Tax Expense@30%		(240)
VII. Profit for the period		560

ILLUSTRATION 2

From the following information, prepare the relevant Notes to Accounts:

<i>Particulars</i>	<i>(₹ in lacs)</i>
Sales of Products	2700
Sales of Services	30
Trading Commission	60
Excise Duty	185
Interest Income	20
Dividends From Companies	10
Net Loss on Sale of Investments	4
Rental Income	15
Rental Collection Expenses	1

SOLUTION**1. REVENUE FROM OPERATIONS**

<i>Particulars</i>	<i>(₹ in lacs)</i>
(a) From Sale of Products	2700
(b) From Sale of Services	30
(c) From Other Operating Revenues [Trading Commission]	60
(d) Less:Excise Duty	(185)
	2605

2. OTHER INCOME

<i>Particulars</i>	<i>(₹ in lacs)</i>
(a) Interest Income	20
(b) Dividends From Companies	10
(c) Net Loss on Sale of Investments	(4)
(d) Rental Income (15 lacs – 1lac Collection Expenses)	14
	40

ILLUSTRATION 3

From the following information, prepare the relevant Notes to Accounts:

<i>Particulars</i>	<i>(₹ in lacs)</i>
Opening Stock of Materials	84.6
Purchases of Materials	955.2
Closing Stock of Materials	39.8
Opening Stock of WIP	150
Closing Stock of WIP	200
Opening Stock of Finished Goods	175
Closing Stock of Finished Goods	400

SOLUTION
3. COST OF MATERIALS CONSUMED

<i>Particulars</i>	<i>(₹ in lacs)</i>
(a) Opening Stock of Materials	84.6
(b) <i>Add:</i> Purchases of Materials	955.2
(c) <i>Less:</i> Closing Stock of Materials	(39.8)
Cost of Materials consumed	1000

4. CHANGES IN INVENTORIES

<i>Particulars</i>	<i>Work-in-Progress (₹ in lacs)</i>	<i>Finished Goods (₹ in lacs)</i>	<i>Total (₹ in lacs)</i>
Opening Stock	150	175	325
<i>Less:</i> Closing Stock	200	400	600
	(50)	(225)	(275)

ILLUSTRATION 4

From the following information, prepare the relevant Notes to Accounts:

<i>Particulars</i>	<i>(₹ in lacs)</i>
Salaries and Wages	600
Contribution To Provident and Other Funds	72
Expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP)	28
Staff Welfare Expenses	150
Interest Expense	24
Other Borrowing Costs(Brokerage)	4
Gain on Foreign Currency Transactions and Translation	8

SOLUTION**5. EMPLOYEE BENEFITS EXPENSE**

<i>Particulars</i>	<i>(₹ in lacs)</i>
Salaries and Wages	600
Contribution To Provident and Other Funds	72
Expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP)	28
Staff Welfare Expenses	150
	850

6. FINANCE COSTS

<i>Particulars</i>	<i>(₹ in lacs)</i>
(a) Interest Expense	24
(b) Other Borrowing Costs(Brokerage)	4
(c) Gain on Foreign Currency Transactions and Translation	(8)
	20

ILLUSTRATION 5

From the following information, prepare the relevant Notes to Accounts:

<i>Particulars</i>	<i>(₹ in lacs)</i>	<i>Particulars</i>	<i>(₹ in lacs)</i>
Buildings	400	Provision for Doubtful Debts	2
Plant and Equipment	200	Consumption of Stores and Spare Parts	14
Vehicles	50	Power and Fuel	16
Furniture and Fixtures	60	Rent	10
Brands	200	Repairs to Buildings	8
Computer Software	90	Repairs to Machinery	6
Insurance	4	Rates and Taxes	2
Sundry Debtors	80	Miscellaneous Expenses	2
Payments to the Auditor	32		

(a) Depreciate Buildings @ 5%, Plant and Equipment @ 20%, Vehicles @ 20%, Furniture and Fixtures @ 10% and Brands@ 10%,Computer Software@60%.

(b) Maintain a Provision for Doubtful Debts @ 10%

SOLUTION**7. DEPRECIATION AND AMORTIZATION EXPENSE**

<i>Particulars</i>	<i>(₹ in lacs)</i>
Buildings [5% of ₹ 400 lacs]	20
Plant and Equipment [20% of ₹ 200 lacs]	40
Vehicles [20% of ₹ 50 lacs]	10
Furniture & Fixtures [10% of ₹ 60 lacs]	6
Brands [10 % of ₹ 200 lacs]	20
Computer Software [60% of ₹ 90 lacs]	54
	150

8. OTHER EXPENSES

<i>Particulars</i>	<i>(₹ in lacs)</i>
(a) Consumption of Stores and Spare Parts	14
(b) Power and Fuel	16
(c) Rent.	10
(d) Repairs to Buildings	8
(e) Repairs to Machinery	6
(f) Insurance	4
(g) Rates and Taxes	2
(h) Miscellaneous Expenses	2
(i) Provision for Doubtful Debts [(10% of ₹ 80 lacs) – ₹ 2 lac]	6
(j) Payments to the Auditor	32
	100

ILLUSTRATION 6

From the following information, prepare the relevant Notes to Accounts:

<i>Particulars</i>	<i>(₹ in lacs)</i>
Opening Balance of Profit and Loss Statement	452
Profit for the period	560
Transfer to Reserve @ 5%	
Interim Dividend	100
Proposed Preference Dividend	140
Proposed Equity Dividend	200
Debenture Redemption Reserve	100

SOLUTION**9. SURPLUS IN THE STATEMENT OF P & L TO BE TAKEN TO BALANCE SHEET**

<i>Particulars</i>	<i>(₹ in lacs)</i>
Opening Balance	452
Add: Profit for the period	560
Less: Transfer to Reserve @ 5%	(28)
Less: Interim Dividend	(100)
Less: Proposed Preference Dividend	(140)
Less: Proposed Equity Dividend	(200)
Less: Debenture Redemption Reserve	(100)
Closing Balance	444

ILLUSTRATION 7

The following items appear in the Trial Balance of Bharat Ltd. as at 31st March, 2018:

<i>Particulars</i>	<i>₹</i>
1. Revenue from Operations	48,00,000
2. Other Income	2,00,000
3. Expenses other than Interest	7,60,000

4. 12%, 20,000 Debentures of ₹ 100 each fully paid up
5. Opening Balance of Profit and Loss Statement ₹ 6,56,000.
6. Transfer to Reserve @ 5%
7. Interim Dividend ₹ 1,60,000
8. 14%, 10,000 Preference Shares of ₹ 100 each fully paid up
9. The recommendation of the company's Board of Directors include Proposed Equity Dividend ₹ 80,000. Transfer to Debenture Redemption Reserve @ 25% of Debentures.
10. Corporate Tax 30% and Corporate Dividend Tax 20%.

Required: Show the above items in Statement of Profit and Loss and calculate Surplus i.e. Balance in Statement of Profit & Loss.

SOLUTION

BHARAT LTD.
STATEMENT OF PROFIT AND LOSS FOR THE YEAR ENDED 31ST MARCH, 2018

<i>Particulars</i>	<i>Note No.</i>	<i>(₹ in lacs)</i>
I. Revenue from Operations		48
II. Other Income		2
III. Total Revenue [I + II]		50
IV. Expenses:		
Finance Costs		2.4
Other Expenses		7.6
Total Expenses		10.0
V. Profit before Tax(III – IV)		40
VI. Tax Expense [30% of ₹ 40 lacs]		(12)
VII. Profit for the period		28

SURPLUS I.E. BALANCE IN STATEMENT OF PROFIT & LOSS

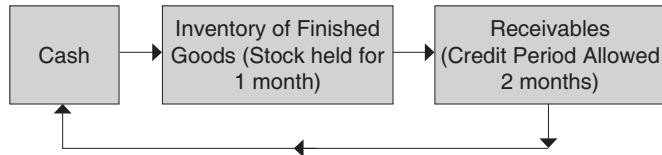
Opening Balance	6.56
Add: Profit for the period	28.00
Less: Transfer to Reserve @ 5%	(1.4)
Less: Interim Dividend	(1.6)
Less: Proposed Preference Dividend	(1.4)
Less: Proposed Equity Dividend	(0.8)
Less: Corporate Dividend Tax [20% of (1.6 + 1.4 + 0.8)]	(0.76)
Less: Debenture Redemption Reserve [25% of ₹ 20 lacs]	(5)
	23.60

9.0 TERMS USED IN THE PREPARATION OF BALANCE SHEET OF A COMPANY

1. An Operating Cycle

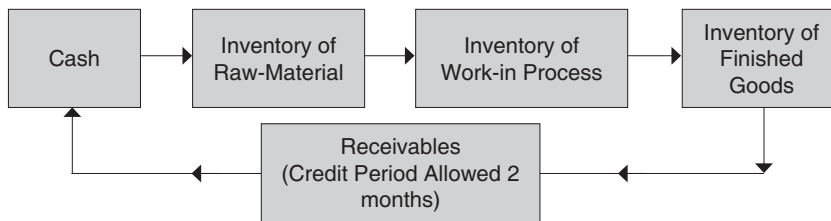
An Operating Cycle is the time between the acquisition of assets for processing and their realization in cash or cash equivalents. Where the normal operating cycle cannot be identified, it is assumed to have a duration of 12 months.

Operating Cycle in a Trading firm



Hence, Operating Cycle = 1 month + 2 months = 3 months.

Operating Cycle in a manufacturing firm



Hence, Operating Cycle = 1 month + ½ month + 1 month + 2 Months = 4½ Months

2. Current Assets	An asset shall be classified as current when it satisfies any of the following criteria: (a) it is expected to be realized in, or is intended for sale or consumption in, the company's normal operating cycle; [e.g. <i>Trade Receivables, Stock of Finished Goods, Stock of Raw-Materials</i>] (b) it is held primarily for the purpose of being traded; [e.g. <i>Stock of Finished Goods</i>] or (c) it is expected to be realized within 12 months after the reporting date; or (d) it is Cash or Cash Equivalent unless it is restricted from being exchanged or used to settle a liability for at least 12 months after the reporting date. [e.g. <i>Cash-in-hand, Bank Balance</i>]
3. Non-Current Assets	All other assets shall be classified as non-current.
4. Current Liabilities	A liability shall be classified as current when it satisfies any of the following criteria: (a) it is expected to be settled in the company's normal operating cycle [Trade payables, Outstanding Business Expenses]; (b) it is held primarily for the purpose of being traded; (c) it is due to be settled within 12 months after the reporting date; or (d) the company does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

5. Non-Current Liabilities	All other liabilities shall be classified as non-current.
6. Trade Receivable	A receivable shall be classified as a 'trade receivable' if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business. [e.g., <i>Trade Debtors, Bills Receivables</i>]
7. Trade Payable	A payable shall be classified as a 'trade payable' if it is in respect of the amount due on account of goods purchased or services received in the normal course of business. [e.g., <i>Trade Creditors, Bills payables</i>]
8. Quoted Investment	Quoted Investment is an investment in respect of which a quotation or permission to deal on a recognised stock exchange has been granted. Schedule VI requires to disclose the aggregate amount of the company's quoted investments and the market value thereof.
9. Unquoted Investment	Unquoted Investment is an investment in respect of which a quotation or permission to deal on a recognised stock exchange has not been granted. Schedule VI requires to disclose the aggregate amount of the company's unquoted investments.
10. Trade Investment	Trade Investment is an investment by a company in the shares or debentures of another company, not being its subsidiary , for the purpose of promoting the trade or business of the first company.
11. Other Investment	Investment other than a Trade Investment is called 'Other Investment'.
12. Use of Prefix 'At' instead of 'On'	It may be noted that the prescribed form of Balance Sheet <i>prefixes 'At' instead of 'On'</i> . For example , if a Balance Sheet of X Ltd. is prepared on 31st March, then the date of the balance-sheet will be stated as 'At 31st March, 2012' and not as 'On 31st March, 2012'. The word 'On' refers to the entire duration (which consists of 24 hours) of the day whereas the word 'At' refers to a specific point of time. Since the balance-sheet is prepared to represent the financial position of the concern at a particular point of time (viz. at the end of the day's business hours), it is appropriate to use the word 'At' instead of 'On' .

10.0 DISTINCTION BETWEEN A COMPANY'S BALANCE SHEET & FIRM'S BALANCE SHEET

A company's Balance Sheet differs from a firm's Balance Sheet in the following respects:

1. A Company's Balance Sheet is prepared in the **order of permanence** whereas a partnership firm's Balance Sheet is usually prepared in the **order of liquidity**.
2. For company's Balance Sheet, there is **vertical form** prescribed under the Companies Act, 2013 whereas, there is **no standard form** prescribed under The Indian Partnership Act, 1932 for a partnership firm's Balance Sheet.
3. In case of a company's Balance Sheet, **previous year's figures** are required to be given whereas it is **not** so in the case of a partnership firm's Balance Sheet.

11.0 VERTICAL FORM OF SUMMARISED BALANCE SHEET [WITH MAJOR HEADINGS ONLY]

Part I of Schedule III to the Companies Act, 2013 prescribes only vertical form of Balance Sheet of a Company

**...NAME OF THE COMPANY...
BALANCE SHEET AS AT...**

(Rupees in...)

<i>Particulars</i>	<i>Note No.</i>	<i>Figures for the Current Reporting Period</i>	<i>Figures for the Previous Reporting Period</i>
I. EQUITY AND LIABILITIES			
(1) Shareholders' Funds		xxx	xxx
(2) Share Application Money pending Allotment		xxx	xxx
(3) Non-Current Liabilities		xxx	xxx
(4) Current Liabilities		xxx	xxx
Total		xxx	xxx
II. ASSETS			
(1) Non-Current Assets		xxx	xxx
(2) Current Assets		xxx	xxx
Total		xxx	xxx

12.0 VERTICAL FORM OF DETAILED BALANCE SHEET

**...NAME OF THE COMPANY...
BALANCE SHEET AS AT...**

(Rupees in...)

<i>Particulars</i>	<i>Note No.</i>	<i>Figures for the Current Reporting Period</i>	<i>Figures for the Previous Reporting Period</i>
I. EQUITY AND LIABILITIES			
(1) Shareholders' Funds			
(a) Share Capital	1	.....	.....
(b) Reserves and Surplus [e.g. Debit Balance of Profit & Loss A/c as negative figure]	2	.....	.....
(c) Money received against Share Warrants		.....	.....
(2) Share Application Money pending Allotment		.....	.....
(3) Non-Current Liabilities			
(a) Long-term Borrowings [e.g. Bonds/ Debentures/Loans repayable after 12 months]	3	.....	.....
(b) Deferred Tax Liabilities (Net)		.....	.....
(c) Other Long term Liabilities [e.g. Trade Payables to be settled after 12 months]		.....	.....
(d) Long-term Provisions [e.g. Provision for Employee Benefits to be settled after 12 months]		.....	.....

(4) Current Liabilities			
(a) Short-Term Borrowings [e.g. Loans repayable on demand or within 12 months]	4	.....	.....
(b) Trade Payables [e.g. Trade Creditors, Bills Payables to be settled within 12 months]	5	.....	.....
(c) Other Current Liabilities [e.g. Bank Overdraft, Unpaid Dividend/matured Deposits/ matured Debentures, That portion of Long-term Borrowings repayable within 12 months, Interest accrued (whether due or not) on borrowings, Calls-in-Advance, Outstanding Expenses, Tax Payable]	6	.....	.....
(d) Short-Term Provisions [e.g. Provision for Tax, Proposed Dividend, Provision for Employee Benefits to be settled within 12 months]	7	.....	.....
Total		.....	.....
II. ASSETS			
(1) Non-Current Assets			
(a) Fixed Assets			
(i) Tangible Assets [e.g. Land, Buildings, Plant & Equipment]	8	.....	.....
(ii) Intangible Assets [e.g. Goodwill Purchased, Goodwill on Consolidation, Brands/Trademarks]	9	.....	.....
(iii) Capital Work-in-Progress [e.g. Building under construction]		.....	.....
(iv) Intangible Assets under Development [e.g. Computer Software under Development]		.....	.....
(b) Non-Current Investments [e.g. Investment in Property/Partnership Firms]	10	.....	.....
(c) Deferred Tax Assets (Net)		.....	.....
(d) Long-Term Loans and Advances [e.g. Capital Advances, Security Deposits, Loans & Advances receivable after 12 months]	11	.....	.....
(e) Other Non-Current Assets [e.g. Unamortised Expenses like Discount/Loss on issue of Debentures to be amortised after 12 months, Amalgamation Adjustment A/c]	12	.....	.....
(2) Current Assets			
(a) Current Investments	13	.....	.....
(b) Inventories [e.g. Raw- Materials, Work-in-Progress, Finished Goods, Loose Tools, Stores & Spares]	14	.....	.....

(c) Trade Receivables [e.g. Trade Debtors, Bills Receivables to be realized within 12 months, Provision for Doubtful Debts by way of deduction]	15	.....	.....
(d) Cash and Cash Equivalents [e.g. Cheques/ Drafts on hand, Bank Deposits with more than 12 months maturity]	16	.....	.....
(e) Short-term Loans and Advances [e.g. Loans & Advances receivable within 12 months]	17	.....	.....
(f) Other Current Assets [e.g. Prepaid Expenses]	18	.....	.....
Total		.....	.....

Notes To Accounts:
NOTE 1: SHARE CAPITAL

<i>Particulars</i>	₹	₹
Authorised Capital		
..... Shares of ₹... each	xxx	xxx
Issued Capital		
..... Shares of ₹... each	xxx	xxx
Subscribed Capital and fully paid		
..... Shares of ₹... each ₹... per share paid up	xxx	xxx
*Subscribed Capital but not fully paid		
..... Shares of ₹... each ₹... per share paid up	xxx	xxx
Less: Calls unpaid:		
(a) by Directors & Officers	(xxx)	(xxx)
(b) by Others	(xxx)	(xxx)
Add: Forfeited Shares	xxx	xxx
	xxx	xxx

Notes:

- For the period of 5 years immediately preceding the date as at which the Balance Sheet is prepared
 - Aggregate Number and Class of **Shares** allotted as fully paid up pursuant to a contract **without payments being received in cash**
 - Aggregate Number and Class of **Shares** allotted as fully paid up by way of **Bonus Shares**
 - Aggregate Number and Class of Shares bought back
- Shares in the company held by each shareholder holding more than 5% shares specifying the number of shares
- Shares Reserved for issue under options and contracts/commitments for the sale of shares/ disinvestment, including the terms and amounts
- Shares held by Holding Company/Ultimate Holding Company/Subsidiaries/Associates of Holding Company/Ultimate Holding Company.
- Reconciliation** of the No of shares outstanding at the beginning and at the end of the reporting period

<i>Particulars</i>	<i>Figures for the Current Reporting Period</i>	<i>Figures for the Previous Reporting Period</i>
A. Shares at the beginning of the year		
B. Add: Shares allotted as fully paid up pursuant to a contract without payments being received in cash		
C. Add: Shares issued on Right/Preferential/Private Placement basis		
D. Add: Shares allotted as fully paid up by way of Bonus Shares		
E. Add: Shares Issued on exercise of Employee Stock Options		
F. Add: Shares Issued on conversion/surrender of Debentures/Bonds/ Term Loan.		
G. Less: Shares cancelled on buy back of Shares		
H. Less: Shares Foreited but not resued during the current year		
I. Shares at the end of the year		

***Note:** *Subscribed and Paid up Share Capital will include Unpaid Amount on Shares subscribed by Subscribers to Memorandum of Association and such Unpaid Amount will be disclosed under the head 'Current Assets' and sub-head 'Other Current Assets'.*

NOTE 2: RESERVES AND SURPLUS

<i>Particulars</i>	<i>₹</i>	<i>₹</i>
Capital Reserve		
Capital Redemption Reserve		
Securities Premium Reserve		
Debenture Redemption Reserve		
Revaluation Reserve		
Share Options Outstanding Account		
Other Reserves – (specify the nature and purpose of each reserve and the amount in respect thereof)		
General Reserve, Dividend Equalisation Reserve, Reserve for Contingent Liabilities, Reserve for bad debts, Tonnage Tax Reserve created under the Income-tax Act, 1961.		
Surplus i.e. Balance in Statement of Profit & Loss		
Opening Balance		
Add: Profit for the period		
Less: Transfer to Reserve		
Less: Used for Bonus Shares		
Less: Interim Dividend		
Less: Proposed Preference Dividend		
Less: Proposed Equity Dividend		
Less: Dividend Distribution Tax		
Closing Balance		

Notes:

1. Debit Balance of Profit & Loss A/c is to be shown as negative figure.
2. Similarly Debit Balance of Reserve & Surplus is shown as negative figure.
3. 'Fund' is to be used if Reserve is earmarked for specific purpose.

NOTE 3: LONG-TERM BORROWINGS

<i>Particulars</i>	₹	₹
Bonds/Debentures		
Term Loans from Banks		
Term Loans from Other Parties		
Deferred Payment Liabilities		
Deposits		
Loans and Advances from Related Parties		
Long term Maturities of Finance Lease Obligations		
Other Loans and Advances (specify nature)		

Notes:

1. Aggregate Amount of Secured Borrowings along with Nature of security.
2. Aggregate Amount of Unsecured Borrowings
3. Aggregate Amount of Loans guaranteed by Directors *or* Others under each head
4. Bonds/debentures (along with the Rate of Interest and particulars of redemption *or* conversion, as the case may be) in descending order of maturity *or* conversion, starting from farthest redemption *or* conversion date, as the case may be. Where bonds/debentures are redeemable by installments, the date of maturity for this purpose must be reckoned as the date on which the first installment becomes due.
5. Particulars of any Redeemed Bonds/Debentures which the company has power to reissue shall be disclosed.
6. Terms of Repayment of Term Loans and Other Loans
7. Period and amount of continuing default as on the Balance Sheet Date in repayment of Loans and Interest

NOTE 4: SHORT-TERM BORROWINGS

<i>Particulars</i>	₹	₹
Loans repayable on demand from Banks		
Loans repayable on demand from Other Parties		
Loans and Advances from Related Parties		
Deposits		
Other Loans and Advances (specify nature)		

Notes:

1. Aggregate Amount of Secured Borrowings along with Nature of security and Unsecured Borrowings.
2. Aggregate Amount of Unsecured Borrowings
3. Aggregate Amount of Loans guaranteed by Directors *or* Others under each head
4. Period and amount of continuing default as on the Balance Sheet Date in repayment of Loans and Interest

NOTE 5: TRADE PAYABLES

<i>Particulars</i>	₹	₹
Sundry Creditors		
Bills Payables		

NOTE 6: OTHER CURRENT LIABILITIES

Particulars	₹	₹
Current maturities of Long-term Debt		
Current maturities of Finance Lease Obligations		
Interest accrued but not due on Borrowings		
Interest accrued and due on Borrowings		
Income received in advance		
Unpaid Dividends		
Application Money received for allotment of securities and due for refund and interest accrued thereon.		
Unpaid matured Deposits and Interest accrued thereon		
Unpaid matured Debentures and Interest accrued thereon		
Other Payables (specify nature e.g.)		
Bank Overdraft		
Outstanding Expenses		
Calls-in-Advance		

NOTE 7: SHORT-TERM PROVISIONS

Particulars	₹	₹
Provision for Employees' Benefit		
Provision for Income Tax		
Provision for Dividend Distribution Tax		
Proposed Equity Dividend		
Proposed Preference Dividend		

NOTE 8: TANGIBLE ASSETS

[illegible]

Others (specify nature)									
Assets under Lease									

Notes:

1. Impairment Losses/Reversals
2. Every Balance Sheet subsequent to date of Capital Reduction/Revaluation must show the reduced or increased figures and must by way of a note also show the amount of the reduction or increase together with the date thereof for the first 5 years subsequent to the date of such reduction or increase.

NOTE 9: INTANGIBLE ASSETS

Asset	Original Cost in the beg	Additions	Disposal	Original Cost at the end	Total Depreciation in the beg	Depreciation for Current year	Depreciation on Asset Disposed off	Total Depreciation at the end	W.D.V at the end
A	B	C	D	$E = B + C - D$	F	G	H	$I = F + G - H$	$J = E - I$
Goodwill									
Brands									
Trademarks									
Computer Software									
Mastheads and Publishing Titles.									
Mining Rights.									
Copyrights, and Patents and Other Intellectual Property Rights, Services & Operating Rights.									
Recipes, Formulae, Models, Designs and Prototypes.									
Licenses and Franchise.									
Others (Specify Nature).									

Notes: Same as for Tangible Assets
NOTE 10: NON-CURRENT INVESTMENTS

Particulars	₹	₹
Trade Investments		
Investment in Property		
Investments In Equity Instruments		

Investments In Preference Shares		
Investments In Government or Trust Securities		
Investments In Debentures or Bonds		
Investments In Mutual Funds		
Investments In Partnership Firms		
Other Non-Current Investments (Specify Nature)		

Notes:

1. Basis for Valuation in case of Investments carried at other than at cost
2. Aggregate amount of Quoted Investments and Market Value thereof;
3. Aggregate amount of Unquoted Investments;
4. Aggregate Provision for Diminution in Value of Investments

NOTE 11: LONG-TERM LOANS AND ADVANCES

<i>Particulars</i>	₹	₹
Capital Advances		
Security Deposits		
Loans and Advances to Related Parties		
Other Loans and Advances (specify nature)		

Notes:

1. Amount of Secured Loans & Advances considered good
2. Amount of Unsecured Loans & Advances considered good
3. Amount of Loans & Advances considered Doubtful
4. Allowance for Bad and Doubtful on Loans and Advances
5. Loans and advances due by directors or other officers of the the company or any of them either severally or jointly with any other persons or amounts due by firms or private companies respectively in which any director is a partner or a director or a member

NOTE 12: OTHER NON-CURRENT ASSETS

<i>Particulars</i>	₹	₹
Long Term Trade Receivables (including trade receivables on deferred credit terms)		
Others (specify nature e.g.)		
Discount/Loss on Issue of Debentures		
Amalgamation Adjustment A/c		

Notes: Same as for Long-term Loans and Advances**NOTE 13: CURRENT INVESTMENTS**

<i>Particulars</i>	₹	₹
Investments In Equity Instruments		
Investments In Preference Shares		
Investments In Government or Trust Securities		
Investments In Debentures or Bonds		
Investments In Mutual Funds		

Investments In Partnership Firms		
Other Current Investments (Specify Nature)		

Notes: Same as for Non-Current Investments

NOTE 14: INVENTORIES

<i>Particulars</i>	₹	₹
Raw- Materials		
Work-in-Progress		
Finished Goods		
Stock-in-Trade		
Stores & Spares		
Loose Tools		
Others (specify nature)		

Notes:

1. Goods-in-transit
2. Mode of Valuation

NOTE 15: TRADE RECEIVABLES

<i>Particulars</i>	₹	₹
Sundry Debtors		
Less: Provision for Doubtful Debts		
Bills Receivables		

Notes:

1. Aggregate amount of Trade Receivables outstanding for a period exceeding six months from the date they are due for payment
2. Other Notes Same as for Long-term Loans and Advances

NOTE 16: CASH AND CASH EQUIVALENTS

<i>Particulars</i>	₹	₹
Bank Balance		
Cheques/Drafts on hand		
Cash Balance		
Others (specify nature)		

Notes:

1. Earmarked balances with banks (**For Example** for unpaid dividend)
2. Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments
3. Repatriation restrictions, if any, in respect of cash and bank balances
4. Bank deposits with more than 12 months maturity

NOTE 17: SHORT-TERM LOANS AND ADVANCES

<i>Particulars</i>	₹	₹
Loans and Advances to Related Parties		
Other Loans and Advances (specify nature)		

Notes: Same as for Long-term Loans and Advances

NOTE 18: OTHER CURRENT ASSETS (SPECIFY NATURE E.G.)

<i>Particulars</i>	₹	₹
Prepaid Expenses		
Unpaid Amount on Shares subscribed by Subscribers to Memorandum of Association		

**NOTE 19: CONTINGENT LIABILITIES AND COMMITMENTS
(TO THE EXTENT NOT PROVIDED FOR)**

<i>Particulars</i>	₹	₹
(i) CONTINGENT LIABILITIES		
(a) Claims against the company not acknowledged as debt (e.g., Towards Excise, Customs, VAT, Service Tax, Income Tax, Suppliers, Customers)		
(b) Guarantees (e.g. to Banks on behalf of others)		
(c) Other money for which the company is contingently liable (e.g. Bills Discounted but not yet matured)		
(ii) COMMITMENTS		
(a) Estimated amount of contracts remaining to be executed on Capital Account and not provided for;		
(b) Uncalled Liability on Shares and Other Investments (e.g. Debentures) partly paid		
(c) Other Commitments (e.g. Arrears of Fixed Cumulative Dividends on Preference Shares)		

ILLUSTRATION 8

Name the major headings into which the **Liabilities side** of a company's Balance Sheet is organised and presented, as per the Schedule III to The Companies Act 2013.

SOLUTION

(1) Shareholders' Funds	(2) Share Application Money pending Allotment
(3) Non-Current Liabilities	(4) Current Liabilities

ILLUSTRATION 9

Name the major headings into which the **Assets side** of a company's Balance Sheet is organised and presented, as per the Schedule III to The Companies Act 2013.

SOLUTION

- (1) Non-Current Assets
- (2) Current Assets

ILLUSTRATION 10

Prepare the format of the Balance Sheet of a Company (with main headings only), as per the Schedule III to The Companies Act 2013.

SOLUTION

<i>Particulars</i>	<i>Note No.</i>	<i>Figures for the Current Reporting Period</i>	<i>Figures for the Previous Reporting Period</i>
I. EQUITY AND LIABILITIES			
(1) Shareholders' Funds		xxx	xxx
(2) Share Application Money pending Allotment		xxx	xxx
(3) Non-Current Liabilities		xxx	xxx
(4) Current Liabilities		xxx	xxx
Total		xxx	xxx
II. ASSETS			
(1) Non-Current Assets		xxx	xxx
(2) Current Assets		xxx	xxx
Total		xxx	xxx

ILLUSTRATION 11

Prepare a layout of information required to be given under sub-heading 'Share Capital' of the company's Balance Sheet, as per the Schedule III to The Companies Act 2013.

SOLUTION**NOTE 1: SHARE CAPITAL**

<i>Particulars</i>	<i>₹</i>	<i>₹</i>
Authorised Capital		
..... Shares of ₹... each	xxx	xxx
Issued Capital		
..... Shares of ₹... each	xxx	xxx
Subscribed Capital and fully paid		
..... Shares of ₹... each ₹... per share paid up	xxx	xxx
*Subscribed Capital but not fully paid		
..... Shares of ₹... each ₹... per share paid up	xxx	xxx
Less: Calls unpaid:		
(a) by Directors & Officers	(xxx)	(xxx)
(b) by Others	(xxx)	(xxx)
Add: Forfeited Shares	xxx	xxx
	xxx	xxx

ILLUSTRATION 12

List any four items which are included under the head **Reserves and Surplus** of the company's Balance Sheet, as per the Schedule III to The Companies Act 2013.

SOLUTION

1. Capital Reserves;
2. Capital Redemption Reserve;
3. Securities Premium Reserve;
4. Debenture Redemption Reserve;
5. Revaluation Reserve;
6. Surplus i.e. balance in Statement of Profit & Loss

ILLUSTRATION 13

List any four items which are included in **Other Reserves** under the head 'Reserves and Surplus' of the company's Balance Sheet, as per the Schedule III to The Companies Act 2013.

SOLUTION

1. General Reserve.
2. Dividend Equalisation Reserve.
3. Reserve for Contingent Liabilities.
4. Reserve for bad debts.
5. Tonnage Tax Reserve created under the Income-tax Act, 1961.

ILLUSTRATION 14

List any four items which are included under the head **Non-Current Liabilities** of the company's Balance Sheet, as per the Schedule III to The Companies Act 2013.

SOLUTION

1. Long-term Borrowings
2. Deferred Tax Liabilities (Net)
3. Other Long term Liabilities
4. Long-term Provisions

ILLUSTRATION 15

List any four items which are included under the head **Current Liabilities** of the company's Balance Sheet, as per the Schedule III to The Companies Act 2013.

SOLUTION

1. Short-Term Borrowings
2. Trade Payables
3. Other Current Liabilities
4. Short-Term Provisions

ILLUSTRATION 16

List any four items which are included under the head **Non-Current Assets** of the company's Balance Sheet, as per the Schedule III to The Companies Act 2013.

SOLUTION

1. Fixed Assets
2. Non-Current Investments
3. Deferred Tax Assets (Net)
4. Long-Term Loans and Advances
5. Other Non-Current Assets

ILLUSTRATION 17

List any four items which are included under the head **Fixed Assets** of the company's Balance Sheet, as per the Schedule III to The Companies Act 2013.

SOLUTION

1. Tangible Assets
2. Intangible Assets
3. Capital Work-in-Progress
4. Intangible Assets under Development

ILLUSTRATION 18

Prepare "Notes to Accounts" giving details of Tangible Fixed Assets with imaginary figures, as per the Schedule III to The Companies Act 2013.

SOLUTION**NOTE NO. 3 TANGIBLE FIXED ASSETS**

<i>Particulars</i>	<i>(₹ in "000)</i>
(a) Land	5,000
(b) Buildings	2,000
(c) Plant and equipments	3,000
(d) Furniture and fixtures	1,000
(e) Vehicles	2,000
(f) Office equipment	3,000
Total	16,000

ILLUSTRATION 19

List any four items which are included under the head Current Assets of the company's Balance Sheet, as per the Schedule III to The Companies Act 2013.

SOLUTION

1. Current Investments
2. Inventories

3. Trade Receivables
4. Cash and Cash Equivalents
5. Short-term Loans and Advances
6. Other Current Assets

ILLUSTRATION 20

Prepare "Notes to Accounts" giving details of Inventories with imaginary figures, as per the Schedule III to The Companies Act 2013.

SOLUTION**NOTE NO. 4: INVENTORIES**

<i>Particulars</i>	<i>(₹ in "000)</i>
(a) Raw materials	50
(b) Work-in-progress	10
(c) Finished goods	100
(d) Stock in trade	—
(e) Stores and spares	5
(f) Loose tools	3
Total	168

ILLUSTRATION 21

Give two examples each of Contingent Liabilities and Commitments as per the Schedule III to The Companies Act 2013.

SOLUTION**(i) Contingent Liabilities**

- (a) Claims against the company not acknowledged as debt;
- (b) Guarantees;
- (c) Other money for which the company is contingently liable (e.g. Bills Discounted but not yet matured)

(ii) Commitments

- (a) Estimated amount of contracts remaining to be executed on Capital Account and not provided for;
- (b) Uncalled Liability on Shares and Other Investments partly paid
- (c) Other Commitments (e.g. Arrears of Fixed Cumulative Dividends on Preference Shares)

ILLUSTRATION 22

How will you disclose the following items while preparing the Balance Sheet of a company, as per the Schedule III to The Companies Act, 2013?

1. Bank Overdraft
2. Preliminary Expenses
3. Arrears of Fixed Cumulative Dividends on Preference Shares
4. Proposed Dividend

SOLUTION**DISCLOSURE AS PER SCHEDULE III TO THE COMPANIES ACT, 2013**

Item	Major Head	Sub- Head
1. Bank Overdraft	Current Liabilities	Other Current Liabilities
2. Preliminary Expenses	NO WHERE AS PER AS 26	
3. Arrears of Fixed Cumulative Dividends on Preference Shares	Notes to Accounts	Contingent Liabilities and Commitments–Commitments
4. Proposed Dividend	Current Liabilities [Note: This treatment is as per ICAI's Guidance Note and AS4] It may be noted that Schedule III requires merely the disclosure in Notes to Accounts.	Short-Term Provisions

ILLUSTRATION 23

How will you disclose the following items while preparing the Balance Sheet of a company, as per the Schedule III to The Companies Act, 2013?

1. Debit Balance of Profit & Loss A/c
2. Computer Software under Development
3. Building under construction
4. Uncalled Liability on partly paid Debentures held as Investments

SOLUTION**DISCLOSURE AS PER SCHEDULE III TO THE COMPANIES ACT, 2013**

Item	Major Head	Sub- Head	Sub- Sub- Head
1. Debit Balance of Profit & Loss A/c	Shareholders' Funds	Reserves and Surplus (As a negative figure)	
2. Computer Software under Development	Non-Current Assets	Fixed Assets	Intangible Assets under Development
3. Building under construction	Non-Current Assets	Fixed Assets	Capital Work-in-Progress
4. Uncalled Liability on partly paid Debentures held as Investments	Notes to Accounts	Contingent Liabilities and Commitments	Commitments

ILLUSTRATION 24

How will you disclose the following items while preparing the Balance Sheet of a company, as per the Schedule III to The Companies Act, 2013?

1. Premium on Redemption of Debentures
2. Employees' earned leave payable on retirement
3. Security Deposit for Telephone
4. Share Application Money pending Allotment

SOLUTION**DISCLOSURE AS PER SCHEDULE III TO THE COMPANIES ACT, 2013**

Item	Major Head	Sub- Head
1. Premium on Redemption of Debentures	Non-Current Liabilities	Other Long-term Liabilities
2. Employees' earned leave payable on retirement	Non-Current Liabilities	Long-term Provisions
3. Security Deposit for Telephone	Non-Current Liabilities	Long-term Loans & Advances
4. Share Application Money pending Allotment	Equity and Liabilities	

ILLUSTRATION 25

How will you disclose the following items while preparing the Balance Sheet of a company, as per the Schedule III to The Companies Act, 2013?

1. Cheques/Drafts on hand
2. Calls-in-Advance
3. Calls Unpaid
4. Investment in Land & Building

SOLUTION**DISCLOSURE AS PER SCHEDULE III TO THE COMPANIES ACT, 2013**

Item	Major Head	Sub- Head
1. Cheques/Drafts on hand	Current Assets	Cash and Cash Equivalents
2. Calls-in-Advance	Current Liabilities	Other Current Liabilities
3. Calls Unpaid	Notes to Accounts	
4. Investment in Land & Building	Non-Current Assets	Non-Current Investments

ILLUSTRATION 26

How will you disclose the following items while preparing the Balance Sheet of a company, as per the Schedule III to The Companies Act, 2013?

1. Investment in Bonds of Reliance Ltd. (Redeemable within 1 year)
2. Interest accrued on Bonds of Reliance Ltd.
3. Tonnage Tax Reserve

SOLUTION**DISCLOSURE AS PER SCHEDULE III TO THE COMPANIES ACT, 2013**

Item	Major Head	Sub- Head	Sub- Sub- Head
1. Investment in Bonds of Reliance Ltd. (Redeemable within 1 year)	Current Assets	Current Investments	

2. Interest accrued on Bonds of Reliance Ltd.	Current Assets	Other Current Assets	
3. Tonnage Tax Reserve	Shareholders' Funds	Reserves and Surplus	Other Reserves

ILLUSTRATION 27

State under which head these accounts should be classified in Balance Sheet, as per Schedule III to The Companies Act 2013:

1. Share application money received in excess of issued share capital.
2. Share option outstanding account.
3. Unpaid matured debenture and interest accrued thereon.
4. Uncalled liability on shares and other partly paid investments.

SOLUTION**DISCLOSURE AS PER SCHEDULE III TO THE COMPANIES ACT, 2013**

Item	Accounts	Head
1.	Share application money received in excess of issued share capital	1. Other Current Liabilities
2.	Share option outstanding account	2. Reserves & Surplus
3.	Unpaid matured debentures and interest accrued thereon	3. Other Current Liabilities
4.	Uncalled liability on shares and other partly paid investments	4. Contingent Liabilities and commitments-commitments to the extent not provided for

ILLUSTRATION 28

State under which head these accounts should be classified in Balance Sheet, as per Schedule III to The Companies Act 2013:

1. Calls unpaid.
2. Intangible Assets under development.
3. Money received against share warrant.
4. Long term maturity of finance lease obligation.

SOLUTION**DISCLOSURE AS PER SCHEDULE III TO THE COMPANIES ACT, 2013**

Item	Accounts	Head
1.	Calls unpaid	1. Share Capital
2.	Intangible Assets under development	2. Fixed Assets
3.	Money received against share warrant	3. Shareholder's Funds
4.	Long term maturity of finance lease obligation	4. Long Term Borrowings

ILLUSTRATION 29 [DISCLOSURE OF SHARE CAPITAL]

Tulsian Ltd. was formed with a capital of ₹ 1,00,000 divided into 10,000 Equity Shares of ₹ 10 each. Out of these 2,000 Equity Shares were issued to the Vendors as fully paid as purchase consideration for a fixed asset acquired. 6,000 Equity Shares were offered to the public and the issue was fully subscribed. The directors called ₹ 6 per share and received the entire amount except a call of ₹ 2 per share on 500 shares out of which 200 shares were forfeited.

Required: How would you show the relevant items in the Balance Sheet of Tulsian Ltd., as per Schedule III to The Companies Act, 2013.

SOLUTION**AN EXTRACT OF BALANCE SHEET OF TULSIAN LTD AS AT**

<i>Particulars</i>	<i>Note No</i>	<i>Current Year</i> ₹	<i>Previous Year</i> ₹
Equity & Liabilities			
I. Shareholders' Funds			
Share Capital	1	55,000	

Notes To Accounts:**NOTE 1: SHARE CAPITAL**

<i>Particulars</i>	₹	₹
Authorised Capital:		
10,000 Equity Shares of ₹ 10 each		1,00,000
Issued Capital:		
8,000 Equity Shares of ₹ 10 each		80,000
Subscribed Capital and fully paid		
2,000 Equity Shares of ₹ 10 each		20,000
(allotted as fully paid up pursuant to a contract without payments being received in cash)		
Subscribed Capital but not fully paid		
5,800 Equity Shares of ₹ 10 each ₹ 6 paid up		34,800
Less: Calls unpaid (300 × ₹ 2)		(600)
Add: Forfeited Shares (200 × ₹ 4)		800
		55,000

ILLUSTRATION 30 [DISCLOSURE OF SHARE CAPITAL]

X Ltd. has authorised capital of ₹ 70,00,000 divided into 7,00,000 equity shares of ₹ 10 each. X Ltd. allotted 10,000 equity shares of ₹ 10 each as fully paid to the signatories to the Memorandum of Association and 5,000 equity shares of ₹ 10 each as fully paid to the vendors against the purchase of building and offered 5,00,000 equity shares of ₹ 10 each (₹ 8 called up). The issue was fully subscribed. All money were duly received with the following exceptions.

Mr. X who holds 4,000 shares has not paid anything after Application Money (₹ 2 per share).

Mr. Y (director of X Ltd.) who holds 600 shares, has paid only ₹ 6 per share.

Mr. Z who holds 400 shares, has paid only ₹ 6 per share. 4,000 shares held by Mr. X were forfeited.

Required: Show how the Share Capital will appear in the Balance Sheet of X Ltd., as per Schedule III to The Companies Act, 2013.

SOLUTION

AN EXTRACT OF BALANCE SHEET OF X LTD AS AT

Particulars	Note No	Current Year ₹	Previous Year ₹
Equity & Liabilities			
I. Shareholders' Funds			
Share Capital	1	41,24,000	

Notes To Accounts:

NOTE 1: SHARE CAPITAL

Particulars	₹
Authorised Capital:	
7,00,000 Equity Shares of ₹ 10 each	70,00,000
Issued Capital:	
5,15,000 Equity Shares of ₹ 10 each	51,50,000
Subscribed Capital and Fully paid	
15,000 Equity Shares of ₹ 10 each	1,50,000
(Allotted as fully paid up pursuant to a contract without payments being received in cash)	
Subscribed Capital but not Fully Paid	
4,96,000 Equity Shares of ₹ 10 each, ₹ 8 per share paid up	39,68,000
Less: Calls unpaid	
(a) By Directors (600 × ₹ 2)	(1,200)
(b) By Others (400 × ₹ 2)	(800)
Add: Forfeited Shares (4,000 × ₹ 2)	8,000
	41,24,000

ILLUSTRATION 31

How will you disclose the following items while preparing the Balance Sheet of a company?

1. Trade Receivables
2. Trade Payables
3. Current Maturities of Long-term Debt

SOLUTION

1. Trade Receivables are to be classified as Current Assets if Expected Realisation Period is either within the Operating Cycle Period or within the 12 Months Period.
2. Trade Payable are to be classified as Current Liabilities if Expected Payment Period is either within the Operating Cycle Period or within the 12 Months Period.
3. Current Maturities of Long-term Debt represents that portion of Long-term Borrowings which is due within 12 Months from the date of Balance Sheet or with in Operating Cycle Period. It appears under the head 'Current Liabilities' and sub-head 'Other Current Liabilities'. For Example, 12% Debentures of Reliance Ltd. ₹ 100 lacs [20% Redeemable within 1 year]. ₹ 20 lacs will appear as Current Maturities of Long-term Debt under the head 'Current Liabilities' and sub-head 'Other Current Liabilities' and ₹ 80 lacs will appear under the head 'Non-Current Liabilities' and sub head 'Long-term Borrowings'.

ILLUSTRATION 32

X Ltd. provides you the following information:

1. Raw material stock holding period: 3 months
2. Work-in-progress holding period: 1 month
3. Finished goods holding period: 4 months
4. Debtors collection period: 6 months
5. Creditors Payment Period:: 1 month

You are required to compute the operating cycle

SOLUTION

As per Schedule III "An operating cycle is the time between the acquisition of assets for processing and their realization in cash or cash equivalents".

Operating Cycle = Raw material stock holding period + Work-in-progress holding period + Finished goods holding period + Debtors collection period - Creditors Payment Period

= 3 + 1 + 4 + 6 - 1 = 13 months.

ILLUSTRATION 33

State giving reason whether the Trade Receivables are Current Assets or Non-Current Assets as per Schedule III in the following cases:

Case	Operating Cycle Period	Expected Realisation Period
1.	11 Months	10 Months
2.	11 Months	12 Months
3.	11 Months	13 Months
4.	14 Months	13 Months
5.	14 Months	15 Months

SOLUTION

Case	Current Assets or Non-Current Assets	Reason
1.	Current Assets	Expected Realisation Period — is <i>less</i> than the Operating Cycle Period and — is within 12 Months.
2.	Current Assets	Expected Realisation Period is within 12 Months although it is more than the Operating Cycle Period.
3.	Non-Current Assets	Expected Realisation Period is more than the Operating Cycle Period and 12 Months Period.
4.	Current Assets	Expected Realisation Period is <i>less</i> than the Operating Cycle Period although it is more than the 12 Months Period.
5.	Non-Current Assets	Expected Realisation Period is more than the Operating Cycle Period and the 12 Months Period.

ILLUSTRATION 34

State giving reason whether the Trade Payables are Current Liabilities or Non-Current Liabilities as per Schedule III in the following cases:

Case	Operating Cycle Period	Expected Payment Period
1.	11 Months	10 Months
2.	11 Months	12 Months
3.	11 Months	13 Months
4.	14 Months	13 Months
5.	14 Months	15 Months

SOLUTION

Case	Current Assets or Non-Current Assets	Reason
1.	Current Assets	Expected Payment Period — is /less than the Operating Cycle Period and — is within 12 Months.
2.	Current Assets	Expected Payment Period is within 12 Months although it is more than the Operating Cycle Period.
3.	Non-Current Assets	Expected Payment Period is more than the Operating Cycle Period and 12 Months Period.
4.	Current Assets	Expected Payment Period is /less than the Operating Cycle Period although it is more than the 12 Months Period.
5.	Non-Current Assets	Expected Payment Period is more than the Operating Cycle Period and the 12 Months Period.

ILLUSTRATION 35

PCT Ltd. is in the process of finalizing its accounts for year ended 31st March, 2018 and furnishes the following information:

- (i) Finished goods normally are held for 1 month before sale.
- (ii) Sales realization from Debtors usually takes 2 months from date of credit invoice.
- (iii) Raw materials are held in stock to cover 1 month's production requirements.
- (iv) Packing materials, being specifically made for the company and having lead time of 3 months is held in stock for 3 months.
- (v) The holding period in respect of unfinished goods is 1 month.
- (vi) Being a monopoly PCT Ltd. enjoys a credit period of 12.5 months from its suppliers who sometimes at the end of their credit period opt for conversion of their dues into long term debt of PCT Ltd.

You are required to compute the operating cycle of PCT Ltd. as per Schedule III of The Companies Act, 2013. As the suppliers of the company are paid off after a credit period of 12.5 months should this be part of Current Liability? Would your answer be the same if the creditors are settled in 330 days?

SOLUTION

Operating Cycle = 1 + 1 + 3 + 1 + 2 = 8 months

Classification of liability to suppliers: Schedule III provides that:

“A liability shall be classified as current when it satisfies any of the following criteria:

- (i) it is expected to be settled in the company's normal operating cycle;
 - (ii) it is held primarily for the purpose of being traded;
 - (iii) it is due to be settled within 12 months after the reporting date; or
 - (iv) the company does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments and do not affect its classification.”
- (a) **When credit period is 12.5 months:** It will be treated as non-current liability since it is not due to be settled within 12 months after the reporting date.
- (b) **When credit period is 330 days (i.e. 11 months approx.):** It will be treated as current liability since it is due to be settled within 12 months after the reporting date.

ILLUSTRATION 36

The management of X Ltd. contends that the work in process is not valued since it is difficult to ascertain the same in view of the multiple processes involved. They opined that the value of opening and closing work in process would be more or less the same. Accordingly, the management had not separately disclosed work in process in its financial statements. Comment in line with Schedule III.

SOLUTION

Schedule III to the Companies Act, 2013 requires the disclosure of opening and closing WIP under broad heads by way of additional information [General Instructions 5 (iii)]. In addition, AS-2 also requires the valuation of WIP. Therefore, the non-disclosure in the financial statements by the company amounts to violation of Schedule III.

ILLUSTRATION 37

TULSIAN Ltd is having the following Fixed Deposit Receipts:

Bank	Date of FDR	Maturity Date	Amount
Yes Bank Limited	01-Jan-2018	2-Jan-2019	30,00,000
Bank of Baroda	01-Jan-2018	31-Mar-2019	20,00,000
State Bank of India	28-Feb-2018	30-May-2019	10,00,000
ICICI Bank	1-Jan-2017	1-Apr-2019	40,00,000

Prepare Notes to Accounts showing the above Deposits in accordance with the requirements of Schedule III as at the Balance Sheet date i.e. 31st March, 2018.

SOLUTION

NOTE 'X': CASH & BANK BALANCES AS AT 31.03.2018 (BALANCE SHEET DATE)

Particulars	₹
A. Cash in Hand	xxx
B. Balances with Bank	
(i) Less than or equal to 12 Months Maturity.	
– Cash Equivalent as per AS-3 (less than 3 Months Maturity) [SBI]	10,00,000
– Other Bank Balances [30,00,000 + 20,00,000]	50,00,000
(ii) More than 12 Months Maturity [ICICI]	40,00,000
	100,00,000

ILLUSTRATION 38

From the following information extracted from the books of XY Ltd., prepare a Balance Sheet of the company as at 31st March, 2018 as per Schedule III of the Companies Act. 2013:

<i>Particulars</i>	<i>(₹ in "000)</i>
Long term borrowings	500
Share Capital	390
Fixed Assets (tangible)	600
Trade Receivables	80
Share Application Money pending Allotment	10
Trade Payables	20
Reserve and Surplus	90
Inventories	20
Cash and Cash Equivalents	120
Non-Current Investments	200
Proposed Dividend	10

SOLUTION

XY LTD.
BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Particulars</i>	<i>Note No</i>	<i>2017-2018 (₹ in "000)</i>	<i>2016-2017 (₹ in "000)</i>
I. EQUITY AND LIABILITIES			
(1) Shareholders' Funds			
(a) Share Capital		390	
(b) Reserves and Surplus		90	
(2) Share Application Money pending Allotment		10	
(3) Non-Current Liabilities			
(a) Long term Borrowings		500	
(4) Current Liabilities			
(a) Trade Payables		20	
(b) Short-term Provisions (Proposed Dividend)		10	
Total		1020	
II. ASSETS			
1. Non-Current Assets			
(a) Fixed Assets			
(i) Tangible Assets		600	
(b) Non-Current Investments		200	
2. Current Assets		–	
(a) Inventories		20	
(b) Trade Receivables		80	
(c) Cash and Cash Equivalents		120	
Total		1020	

ILLUSTRATION 39

From the following information, prepare the relevant Notes to Accounts:

Capital Reserve	20
Capital Redemption Reserve	40
Securities Premium	60
General Reserve	160
Opening Balance of Profit and Loss Statement	452
Profit for the period	560
Transfer to General Reserve @ 5%	
Interim Dividend	100
Proposed Preference Dividend	140
Proposed Equity Dividend	200
Dividend Distribution Tax	88
Transfer to Debenture Redemption Reserve	100

SOLUTION**2. RESERVES AND SURPLUS**

Capital Reserve		20
Capital Redemption Reserve		40
Securities Premium		60
Debenture Redemption Reserve		100
General Reserve [160 + 28]		188
Profit & Loss Account:		
Opening Balance	452	
Add: Profit for the period	560	
Less: Transfer to General Reserve @ 5%	(28)	
Less: Interim Dividend	(100)	
Less: Proposed Preference Dividend	(140)	
Less: Proposed Equity Dividend	(200)	
Less: Dividend Distribution Tax	(88)	
Less: Debenture Redemption Reserve	(100)	356
		764

ILLUSTRATION 40

From the following information, prepare the relevant Notes to Accounts:

Sundry Creditors	40
Bills Payables	20
Bank Overdraft	10
Unpaid Dividend	2
Outstanding Expenses	4
Calls-in-Advance	2

Interest accrued on Borrowings	24
Current Maturity of 12% Debentures	40
Provision for Tax	240
Proposed Preference Dividend	140
Proposed Equity Dividend	200
Dividend Distribution Tax	88

SOLUTION**3. TRADE PAYABLES**

Sundry Creditors	40
Bills Payables	20
	60

4. OTHER CURRENT LIABILITIES

Bank Overdraft	10
Unpaid Dividend	2
Outstanding Expenses	4
Calls-in-Advance	2
Interest accrued on Borrowings [12% of ₹ 100 lacs (12% Debentures)]	24
Current Maturity of 12% Debentures	40
	82

5. SHORT-TERM PROVISIONS

Provision for Tax	240
Proposed Preference Dividend	140
Proposed Equity Dividend	200
Dividend Distribution Tax	88
	668

ILLUSTRATION 41

From the following information, prepare the relevant Notes to Accounts:

<i>Particulars</i>	<i>Cost</i>	<i>Provision for Depreciation/ Amortization</i>
Buildings	400	20
Plant and Equipment	200	40
Vehicles	50	10
Furniture and Fixtures	60	6
Brands	200	20
Computer Software	90	54

SOLUTION**6. TANGIBLE ASSETS**

<i>Particulars</i>	<i>Cost</i>	<i>Provision for Depreciation</i>	<i>Closing WDV</i>
Buildings	400	20	380
Plant and Equipment	200	40	160
Vehicles	50	10	40
Furniture and Fixtures	60	6	54
	710	76	634

7. INTANGIBLE ASSETS

<i>Particulars</i>	<i>Cost</i>	<i>Provision for Amortization</i>	<i>Closing WDV</i>
Brands	200	20	180
Computer Software	90	54	36
	290	74	216

ILLUSTRATION 42

From the following information, prepare the relevant Notes to Accounts:

Trade Investments	
300 lacs Shares of X Ltd of ₹ 10 each, ₹ 8 paid up	2400
6 lacs, 14% Debentures of ₹ 100 each, ₹ 80 paid up	480
Other Investments	26
Discount/Loss on Issue of Debentures	2
Amalgamation Adjustment A/c	4

SOLUTION**8. NON-CURRENT INVESTMENTS**

Trade Investments		
300 lacs Shares of X Ltd of ₹ 10 each, ₹ 8 paid up	2400	
6 lacs, 14% Debentures of ₹ 100 each, ₹ 80 paid up	480	2880
Other Investments		26
		2906

9. OTHER NON-CURRENT ASSETS

Discount/Loss on Issue of Debentures	2
Amalgamation Adjustment A/c	4
	6

ILLUSTRATION 43

From the following information, prepare the relevant Notes to Accounts:

Closing Stock of Materials	39.8
Closing Stock of WIP	200.00
Closing Stock of Finished Goods	400.00
Loose Tools	12.00
Stores & Spares	8.00
Sundry Debtors	80
Provision for Doubtful Debts	8
Bills Receivables	20
Cash Balance	4
Bank Balance	16
Cheques/Drafts on hand	4
Prepaid Expenses	2
Interest accrued on Investments	2

SOLUTION**10. INVENTORIES**

Closing Stock of Materials	39.80
Closing Stock of WIP	200.00
Closing Stock of Finished Goods	400.00
Loose Tools	12.00
Stores & Spares	8.00
	659.8

11. TRADE RECEIVABLES

Sundry Debtors	80
<i>Less: Provision for Doubtful Debts</i>	(8)
Bills Receivables	20
	92

12. CASH AND CASH EQUIVALENTS

Cash Balance	4
Bank Balance	16
Cheques/Drafts on hand	4
	24

13. OTHER CURRENT ASSETS

Prepaid Expenses	2
Interest accrued on Investments	2
	4

ILLUSTRATION 44

From the following information, prepare the relevant Notes to Accounts:

1. Bills Discounted but not yet matured ₹ 2 lacs
2. 300 lacs Shares of X Ltd of ₹ 10 each, ₹ 8 paid up held as Investments
3. 6 lacs, 14% Debentures of ₹ 100 each, ₹ 80 paid up held as Investments

SOLUTION**14. CONTINGENT LIABILITIES AND COMMITMENTS (TO THE EXTENT NOT PROVIDED FOR)**

(i) Contingent Liabilities	
Bills Discounted but not yet matured	2
(ii) Commitments	
(a) Uncalled Liability on partly paid Shares [300 lacs Shares of X Ltd of ₹ 10 each, ₹ 8 paid up]	600
(b) Uncalled Liability on partly paid Debentures held as Investments [6 lacs, 14% Debentures of ₹ 100 each, ₹ 80 paid up]	120

ILLUSTRATION 45

From the details given below prepare Balance Sheet of TULSIAN Ltd. as at 31st March, 2018, as per the Schedule III to The Companies Act 2013:

	(₹ in '000)
P & L A/c (Dr.)	200
12% Debentures	200
Proposed Dividend	20
Equity Share Capital (₹ 10 each)	500
Cheques & Drafts on hand	48
15% Pref. Share Capital (₹ 100 each)	400
Prepaid Expenses	50
Bank Overdraft	45
Interest accrued on Debentures of Tata Steels	12
Building under construction	115
2,500, 12% Tata Steel Deb. of ₹ 100 each, ₹ 80 paid up	200
Premium on Red. of Debentures	20
Application Money pending allotment	40
Bills Payables	75
Calls-in Advance	5
Employees' earned leave payable on Retirement	45
Stores & Spares	50
Securities Deposit for Telephone	5
Brands	110
Computer Software under development	20
Bills Receivables	120
Plant & Machinery	120
12% Debentures of Reliance Ltd. [20% Redeemable within 1 year]	100
Investment in Land & Building	200

Note: Bills Discounted but not yet matured ₹ 25,000, Dividends on Preference Shares are in arrears for 2 years

SOLUTION

**TULSIAN LTD.
BALANCE SHEET AS AT 31ST MARCH, 2018**

<i>Particulars</i>	<i>Note No</i>	<i>2017-2018 (₹ in '000)</i>	<i>2016-2017 (₹ in '000)</i>
I. EQUITY AND LIABILITIES			
(1) Shareholders' Funds			
(a) Share Capital	1	900	
(b) Reserves and Surplus [P & L A/c (Dr.)]		(200)	
(2) Share Application Money pending Allotment		40	
(3) Non - Current Liabilities			
(a) Long term Borrowings [12% Debentures]		200	
(b) Other Long term Liabilities			
(Premium on Red. of Debentures)		20	
(c) Long term Provisions (Earned Leave)		45	
(4) Current Liabilities			
(a) Trade Payables (B/P)		75	
(b) Other Current Liabilities	2	50	
(c) Short term Provisions (Proposed Dividend)		20	
Total		1150	
II. ASSETS			
(1) Non-Current Assets			
(a) Fixed Assets			
(i) Tangible Assets (Plant & Machinery)		120	
(ii) Intangible Assets (Brands)		110	
(iii) Capital Work in progress (Building)		115	
(iv) Intangible Assets under development		20	
(b) Non-Current Investments	3	480	
(c) Long-term Loans & Advances (Security)		5	
(2) Current Assets			
(a) Current Investments (Deb. of Reliance Ltd.)		20	
(b) Inventories (Stores & Spares)		50	
(c) Trade Receivables (B/R)		120	
(d) Cash and Cash Equivalents (Ch. & DD)		48	
(e) Other Current Assets	4	62	
Total		1150	

Notes to Accounts:

<i>Particulars</i>	<i>2017-2018 (₹ in '000)</i>	<i>2016-2017 (₹ in '000)</i>
1. Share Capital		
50,000 Equity Shares of ₹10 each	500	
4,000, 15% Pref. Shares of ₹100 each	400	
	900	
2. Other Current Liabilities		
Bank Overdraft	45	
Calls-in-advance	5	
	50	
3. Non-Current Investments		
2,500, 12% Tata Steel Deb. of ₹100 each, ₹80 paid up	200	
12% Debentures of Reliance Ltd. [100 – 20]	80	
Investment in Land & Building	200	
	480	
4. Other Current Assets		
Prepaid Expenses	50	
Interest accrued on Debentures of Tata Steels	12	
	62	
5. Contingent Liabilities & Commitments		
(i) Contingent Liabilities		
Bills Discounted but not yet matured	25	
(ii) Commitments		
(a) Uncalled Liability on partly paid Debentures held as Investments [2,500, 12% Tata Steel Debentures of ₹ 100 each, ₹ 80 paid up] [2,500 × ₹ 20]	50	
(b) Arrears of Fixed Cumulative Dividends on Preference Shares [₹ 4,00,000 × 15/100 × 2]	120	

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand:

- Meaning of Ratio Analysis
- Meaning of a Ratio
- Expression of Ratio
- Objectives of Ratio Analysis
- Advantages and Uses of Ratio Analysis
- Limitations of Ratio Analysis
- Benchmarks
- Classification of Ratios on the Basis of Financial Statements
- Classification of Ratios from User's Point of View
- Liquidity Ratios
- Solvency Ratios
- Activity Ratios
- Profitability Ratios

1.0 MEANING OF RATIO ANALYSIS

- (a) Ratio Analysis is one of the most important tools of Financial Statement Analysis.
- (b) Ratio Analysis is the process of establishing and interpreting the quantitative relationship between two related items of Financial Statements to make a qualitative judgement about the:
1. Liquidity (Short-term Solvency)
 2. Long-term Solvency
 3. Operating Efficiency and
 4. Profitability of the enterprise.

2.0 MEANING OF A RATIO

(a)	Since we are using the term 'Ratio' in relation to financial statement analysis, it may properly mean 'An Accounting Ratio' or 'Financial Ratio'.
(b)	An Accounting Ratio is a mathematical expression of a quantitative relationship between two related items (having mutual cause & effect relationship) of Financial Statements which the analyst may use to make a qualitative judgement about the: 1. Liquidity (Short-term Solvency) 2. Long-term Solvency 3. Operating Efficiency and 4. Profitability of the enterprise. Example I The figure of Gross Profit can be said to be significantly related to the figure of Revenue from Operations. Example II The figure of Gross Profit cannot be said to be related to the figure of Securities Premium.

3.0 EXPRESSION OF RATIO

Ratios can be expressed as:

1. **Percentage say**, Gross Profit Ratio is 20% of Revenue from Operations [calculated by dividing Gross Profit (₹ 20,000) by Revenue from Operations (₹ 1,00,000) and multiplying by 100];
2. **Proportion say**, Current Ratio is 2 : 1 [calculated by dividing current assets (₹ 1,00,000) by Current Liabilities (₹ 50,000)];
3. **Fraction say**, Proprietors' Funds are one-tenth of Total Assets [calculated by dividing Proprietors' Funds (₹ 10,000) by Total Assets (₹ 1,00,000)];
4. **Times say**, Debtors Turnover Ratio is 5 times [calculated by dividing Credit Revenue from Operations (₹ 1,00,000) by Average Trade Receivables (₹ 20,000)].

4.0 OBJECTIVES OF RATIO ANALYSIS

The main Objectives of Ratio Analysis are:

1. **To determine Liquidity (Short-term Solvency)** (i.e., ability of the enterprise to meet its short-term obligations as and when they become due).
2. **To determine Long-term Solvency** (i.e., ability of the enterprise to pay the interest regularly and to repay the principal on maturity or in pre-determined instalments at due dates).
3. **To determine Operating Efficiency** with which Resources are utilised in generating Revenue
4. **To determine Profitability with respect to Revenue from Operations and Investment**
5. **To compare Intra Firm Position** (i.e., Evaluating the Financial Position and Performance of the same enterprise over a period of time) and to identify the strong and weak areas (if any) and to take the necessary corrective action.
6. **To compare Inter Firm Position** (i.e., Evaluating the Relative Financial Position and Performance of the enterprise in the industry) and to identify the strong and weak areas (if any) and to take the necessary corrective action.

5.0 ADVANTAGES AND USES OF RATIO ANALYSIS

The various Advantages and Uses of Ratio Analysis are as follows:

1. **Useful in determining Liquidity (Short-term Solvency):** The short-term creditors like bankers and suppliers of material can determine the ability of the enterprise to meet its short-term obligations as and when they become due with the help of Liquidity Ratios such as Current Ratio and Quick Ratio.
2. **Useful in determining Long-term Solvency:** The long-term creditors like debenture-holders and financial institutions can determine the ability of the enterprise to pay the interest regularly and to repay the principal on maturity or in pre-determined instalments at due dates with the help of Solvency Ratios such as Debt Equity Ratio.
3. **Useful in determining Operating Efficiency:** The management can determine the Operating Efficiency with which Resources are utilized in generating Revenue with the help of Activity Ratios such as Working Capital Turnover Ratio, Inventory Turnover Ratio, Debtors Turnover Ratio etc.
4. **Useful in determining Profitability:** The management and the investors can determine the Profitability with respect to Revenue from Operations and Investment with the help of Profitability Ratios such as Gross Profit Ratio, Operating Profit Ratio, Net Profit Ratio, Return on Investment etc. After analysing the relevant ratios, the present investors can decide whether to hold, sell or purchase the shares and the prospective investor can decide whether or not to buy the shares.

5. **Useful in Intra Firm Comparison:** Ratio Analysis is useful (a) in evaluating the Financial Position and Performance of the same enterprise over a period of time by comparing the ratios of one period with those of another period, (b) in identifying the strong and weak areas (if any) and (c) in taking the necessary corrective action.
6. **Useful in Inter Firm Comparison:** Ratio Analysis is useful (a) in evaluating the relative Financial Position and Performance of the enterprise in comparison to a standard enterprise belonging to the same industry by comparing the actual ratios of the enterprise with the ratios of a standard enterprise belonging to the same industry, (b) in identifying the strong and weak areas (if any) and (c) in taking the necessary corrective action.
7. **Useful in Pattern/Industry Comparison:** Ratio Analysis is useful in evaluating the relative Financial Position and Performance of the enterprise in the industry by comparing the actual ratios of the enterprise with the ratios of industry to which the firm belongs, (a) in identifying the strong and weak areas (if any) and (b) in taking the necessary corrective action.

6.0 LIMITATIONS OF RATIO ANALYSIS

The major limitations of Ratio Analysis are as follows:

1. **Ratio Analysis ignores Qualitative Factors:** The ratio analysis is only quantitative analysis and not qualitative analysis. **For Example**, while conducting the credit analysis of a customer seeking credit, he may deserve a credit to be granted on the basis of financial statements submitted by him but in reality his character (i.e., intention to repay) and credit worthiness may be doubtful.
2. **Ratio Analysis ignores Price-level changes:** A ratio can be accurately interpreted only if the effect of change in prices which may have taken place, is adjusted in the figures used in the ratio. **For Example**, Fixed Asset Turnover Ratio would not give a brighter picture than that justified by the circumstances unless the fixed assets are revalued at their current replacement cost.
3. **Ratio Analysis is not free from Personal Bias:** In many situations, the accountant has to make choice out of various alternatives available, e.g., choice in the method of depreciation (e.g., Straight line or Written Down), choice in the method of inventory valuation (e.g., FIFO, LIFO etc.). Since the subjectivity is inherent in personal judgement, the financial statements, are therefore not free from personal bias. As a result, the ratio analysis also cannot be said to be free from personal bias.
4. **Ratio Analysis is a Historical analysis:** Ratio analysis is basically historical in nature because the financial statements on the basis of which the ratios are established, are historical in nature unless the ratio analysis is based on the projected financial statements prepared to plan for the future.
5. **Ratio Analysis provides Only symptoms and not cure:** Ratios are at best only symptoms and like the symptoms displayed by a human body may have their origin at a place different from where the symptom appears. Like doctor, it becomes the duty of the management to unearth underlying causes.
6. **Ratio Analysis does not consider the reality behind the Financial Statements:** The relationship between the two figures can be well interpreted only after studying the reality behind the statements on the basis of which the ratio has been established. **For Example**, the Quick Ratio of a dry fruit merchant, calculated just 10-15 days before Deepawali (i.e., an Indian festival) may be lower because of heavy accumulation of inventories. An analyst may conclude that the short-term financial position of this concern is not a satisfactory one unless he takes into account the fact that the accumulation of inventories is in anticipation of demand in near future.
7. **The quality of the Ratio Analysis depends upon the Accuracy of the accounts:** The quality of the ratios very much depends upon the quality of the accounts on the basis of which these are established. **For Example**, if the closing Inventory is over-valued, not only the profitability will be overstated but also the financial position will appear to be better. Thus, the ratios are as accurate as the accounts.

7.0 BENCHMARKS

Benchmark is a yardstick against which actual ratio is to be compared in order to make a qualitative judgement about the various aspects of the financial position and performance of an enterprise. Benchmark may be:

A Past Ratio of the same enterprise	A ratio could be compared with the past ratio of the same enterprise. This type of comparisons is known as Intra-firm comparison as is done under Time Series Analysis.		
Same Industry Ratio of Similarv	A ratio could be compared with the ratio of similar firms belonging to the same industry at the same point of time. This type of comparison is known as inter-firm comparison as is done under Cross Sectional Analysis.		
Industry Average	A ratio could be compared with the industry average at the same point of time. This type of comparison is known as pattern comparison as in done under Cross Sectional Analysis.		
Rule of Thumb	Rule of Thumb have evolved over a period of time. A ratio could be compared with rule of thumb. However these rules of thumb should be used cautiously.		
	Ratio	Rule of Thumb	Meaning
	1. Current Ratio	2:1	Current Assets should be twice the Current Liabilities.
	2. Quick Ratio	1:1	Quick Assets should be equal to Current Liabilities.
	3. Debt-Equity Ratio	2:1	Debt could be twice the Shareholders' Funds.

8.0 CLASSIFICATION OF RATIOS ON THE BASIS OF FINANCIAL STATEMENTS

1. Income Statement Ratios	These ratios are calculated on the basis of Income Statement Items. Example: Gross Profit Ratio, Operating Profit Ratio, Net Profit Ratio
2. Position Statement Ratios	These ratios are calculated on the basis of Position Statement (i.e. Balance Sheet) Items. Example: Current Ratio, Quick Ratio, Debt-Equity Ratio,
3. Composite Ratios	These ratios are calculated on the basis of Items of both the Income Statement and Position Statement. Example: Inventory Turnover Ratio, Debtors Turnover Ratio, Creditors Turnover Ratio, Return on Investment

9.0 CLASSIFICATION OF RATIOS FROM USER'S POINT OF NEW

In view of the requirements of various users (e.g., Short-term Creditors, Long-term Creditors, Management, Investors) of the ratios, one may classify the ratios into the following four groups:

CLASSIFICATION OF RATIOS

1. Liquidity Ratios
2. Solvency Ratios
3. Activity Ratios
4. Profitability Ratios

10.0 LIQUIDITY RATIOS

Meaning	Liquidity Ratios measure the Short-term solvency which means the ability of the enterprise to meet its short-term obligations as and when they become due.
Liquidity Ratios	Usually the following liquidity ratios are calculated to judge the short term solvency of the enterprise: 1. Current Ratio, 3. Absolute Cash/Liquidity Ratio 2. Quick Ratio 4. Internal Interval Measure Ratio

11.0 CURRENT RATIO**MEANING OF CURRENT RATIO**

Current ratio establishes a relationship between Current Assets and Current Liabilities.

OBJECTIVE OF CURRENT RATIO

The objective of computing Current Ratio is to measure the ability of the firm to meet its short-term obligations as and when due. In other words, the objective is to measure the safety margin available for short-term creditors.

COMPONENTS OF CURRENT RATIO

There are two components of Current Ratio as follows:

- 1. Current Assets:** Current Assets refer to those assets which *either* are in the form of Cash or Cash Equivalent *or* are held for their conversion into Cash within Operating Cycle or 12 months from the date of Balance Sheet. An asset is classified *either* as a Current Asset or Non - Current Asset on the basis of the purpose for which an asset is held in the hands of user.

EXAMPLES OF CURRENT ASSETS

1. Current Investments	<i>[e.g. Investments having maturity of more than 3 months but not more than 1 year from the date of acquisition]</i>
2. Inventories	<i>[e.g. Raw Materials, Work-in-Progress, Finished Goods, Stores & Spares, Loose Tools]</i>
3. Trade Receivables	<i>[e.g. Trade Receivables, Bills Receivables to be realized within 12 months]</i>
4. Cash and Cash Equivalents	<i>[e.g. Bank Balance, Cheques/Drafts on hand, Cash Balance, Investments having maturity of 3 months or less]</i>
5. Short-term Loans & Advances	<i>[e.g. Loans & Advances receivable within 12 months, Advance tax]</i>
6. Other Current Assets	<i>[e.g. Prepaid Expenses, Incomes accrued but not received, Advance Tax]</i>

TUTORIAL NOTES

- The 'Provision for doubtful Trade Receivables' is **deducted** from the total amount of Trade Receivables in order to ascertain the realisable value of Trade Receivables.
- Non-realizable portion of Current Investments is also **deducted** from the total value of Current Investments in order to ascertain the realizable value of Current Investments.
- Unless otherwise stated, it is assumed that Trade Receivables and Current Investments are realizable at their given book values.

CALCULATION OF CURRENT ASSETS

- (a) Current Assets = Current Investments + Inventories + Trade Receivables + Cash and Cash Equivalents + Short-term Loans and Advances + Other Current Assets
- (b) Current Assets = Current Liabilities + Working Capital
[Note: Working Capital = Current Assets – Current Liabilities]
- (c) Current Assets = Total Assets – Non-Current Assets
2. **Current Liabilities:** Current Liabilities refer to those liabilities which are expected to be settled within Operating Cycle or 12 months from the date of Balance Sheet.

EXAMPLES OF CURRENT LIABILITIES

1. Short-Term Borrowings	<i>[e.g. Loans repayable on demand or within 12 months, Deposits/ Advances repayable within 12 months]</i>
2. Trade Payables	<i>[e.g. Trade Payables, Bills Payables to be settled within 12 months]</i>
3. Other Current Liabilities	<i>[e.g. Bank Overdraft, Unpaid Dividend, Unpaid matured Deposits, Unpaid matured Debentures, That portion of Long-term Borrowings repayable within 12 months, Interest accrued (whether due or not) on borrowings, Calls-in-Advance, Outstanding Expenses, Tax Payable, Incomes received-in-advance]</i>
4. Short-Term Provisions	<i>[e.g. Provision for Tax, Proposed Dividend, Provision for Employee Benefits to be settled within 12 months]</i>

CALCULATION OF CURRENT LIABILITIES

- (a) Current Liabilities = Short-Term Borrowings + Trade Payables + Other Current Liabilities + Short-Term Provisions
- (b) Current Liabilities = Current Assets – Working Capital
- (c) Current Liabilities = Total Debts [Whether Long-term or Short-term] – Non-Current Liabilities

COMPUTATION OF CURRENT RATIO

Current Ratio is computed by dividing the Current Assets by the Current Liabilities. This ratio is usually expressed as a pure ratio e.g. 2 : 1. In the form of a formula, this ratio may be expressed as follows:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

TUTORIAL NOTES

- (a) Current Ratio is calculated at a particular date and not for a particular period.
- (b) The excess of Current Assets over Current Liabilities is known as Working Capital.

INTERPRETATION OF CURRENT RATIO

Current Ratio indicates rupees of current assets available for each rupee of current liability. Higher the ratio, greater the margin of safety for short-term creditors and vice versa.

Traditionally, a Current Ratio of 2 : 1 is considered to be a satisfactory ratio. On the basis of this traditional rule, if the Current Ratio is 2 or more, it means the firm is adequately liquid and has the ability to meet its current obligations but if the Current Ratio is less than 2, it means

the firm has difficulty in meeting its current obligations. The logic behind this rule is that even if the value of current assets becomes half, the firm can still meet its short-term obligations.

A too high Current Ratio may be the result of excessive investment in current assets which may result in idle funds which further results in low profitability since idle funds earn nothing. On the other hand, a too low Current Ratio may be the result of inadequate investment in current assets which may result in low liquidity and may threaten the solvency of the enterprise. Higher liquidity means lower profitability and vice versa.

PRECAUTION WHILE USING CURRENT RATIO

While computing and using the Current Ratio, it must be ensured, (a) that the quality of both receivables (Trade Receivables and Bills Receivable) and inventory, has been carefully assessed and (b) that all Current Assets and Current Liabilities have been properly valued.

ILLUSTRATION 1

From the following information, calculate Current Ratio:

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
Trade Payables	70,000	Inventories	95,000
Advance Tax	4,000	Trade Receivables	3,40,000
Short-Term Borrowings	10,000	Current Investments	10,000
Accrued Incomes	2,000	Provision for Doubtful Debts	30,000
Other Current Liabilities	20,000	Cash & Cash Equivalents	10,000
Short-term Provisions	1,20,000	Short-term Loans & Advances	4,000
Prepaid Expenses	5,000		

SOLUTION:

STEP 1: CALCULATION OF CURRENT ASSETS AND CURRENT LIABILITIES

<i>Current Assets</i>	<i>₹</i>	<i>Current Liabilities</i>	<i>₹</i>
Current Investments	10,000	Short-Term Borrowings	10,000
Inventories	95,000	Trade Payables	70,000
Trade Receivables	3,10,000	Other Current Liabilities	20,000
Cash and Cash Equivalents	10,000	Short-Term Provisions	1,20,000
Short-term Loans and Advances	4,000		
Other Current Assets	11,000		
[4,000 + 2,000 + 5,000]	4,40,000		2,20,000

$$\text{Step 2: Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{₹4,40,000}{₹2,20,000} = 2 : 1$$

ILLUSTRATION 2

The ratio of Current Assets (₹ 3,00,000) to Current Liabilities (₹ 2,00,000) is 1.5 : 1. The accountant of this firm is interested in maintaining a Current Ratio of 2 : 1 by paying some part of current liabilities. You are required to suggest him the amount of current liabilities which must be paid for this purpose.

SOLUTION:

Step 1: Let the amount of Current Liabilities to be paid be X

$$\text{Step 2:} \quad \text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\text{₹}3,00,000 - X}{\text{₹}2,00,000 - X} = 2$$

$$\text{or,} \quad \text{₹}4,00,000 - 2X = \text{₹}3,00,000 - X$$

$$X = \text{₹}1,00,000$$

ILLUSTRATION 3

The ratio of Current Assets (₹ 5,00,000) to Current Liabilities (₹ 2,00,000) is 2.5 : 1. The accountant of this firm is interested in maintaining a Current Ratio of 2 : 1 by acquiring some current assets on credit. You are required to suggest him the amount of current assets which must be acquired for this purpose.

SOLUTION:

Step 1: Let the amount of Current Assets to be acquired be X

$$\text{Step 2:} \quad \text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\text{₹}5,00,000 + X}{\text{₹}2,00,000 + X} = 2$$

$$\text{₹}4,00,000 + 2X = \text{₹}5,00,000 + X$$

$$X = \text{₹}1,00,000$$

ILLUSTRATION 4

A firm had Current Assets of ₹ 1,50,000. It then paid a Current Liability of ₹ 30,000. After this payment, the Current Ratio was 2 : 1. Determine the size of Current Liabilities and Working Capital after and before the payment was made.

SOLUTION:

Step 1: Let the Current Liabilities after payment be X

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\text{₹}1,50,000 - \text{₹}30,000}{X} = 2$$

$$2X = \text{₹}1,20,000$$

$$X = \text{₹}1,20,000/2 = \text{₹}60,000$$

Step 2: Working Capital after payment = ₹ 1,20,000 – ₹ 60,000 = ₹ 60,000

Step 3: Current Liabilities before payment = Current liabilities after payment + Payment
= ₹ 60,000 + ₹ 30,000 = ₹ 90,000

Step 4: Working Capital before payment = ₹ 1,50,000 – ₹ 90,000 = ₹ 60,000

ILLUSTRATION 5

A firm had Current Liabilities of ₹ 90,000. It then acquired Stock-in-trade at a cost of ₹ 10,000 on credit. After this acquisition, the Current Ratio was 2 : 1. Determine the size of Current Assets and Working Capital after and before the Inventories was acquired.

SOLUTION:

Step 1: Let the Current assets after acquisition of Inventories be X

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{X}{\text{₹}90,000 + \text{₹}10,000} = 2$$

$$X = \text{₹}1,00,000 \times 2 = \text{₹}2,00,000$$

Step 2: Working Capital after acquisition = ₹ 2,00,000 – ₹ 1,00,000 = ₹ 1,00,000

Step 3: Current Assets before acquisition

$$= \text{Current Assets After acquisition} - \text{Purchase of Stock on credit} \\ = ₹ 2,00,000 - ₹ 10,000 = ₹ 1,90,000$$

Step 4: Working Capital before acquisition = ₹ 1,90,000 – ₹ 90,000 = ₹ 1,00,000

IMPORTANT INSTRUCTION

To know the effect of a transaction on Current Ratio, Take the following Practical Steps:

Step 1: Assume some figure of Current Assets and Current Liabilities.

Step 2: Put the effect of transaction in Assumed figures of Current Assets & Current Liabilities and Calculate the New figures.

Step 3: Calculate the New Current Ratio.

Step 4: Compare this New Current Ratio with Old Current Ratio to ascertain Improvement or Decline or no Change.

ILLUSTRATION 6

State giving reason, whether the Current Ratio will improve or decline or will have no effect in each one of the following transactions if Current Ratio is (I) 2 : 1, (II) 1 : 1, (III) 0.8 : 1.

- Cash paid to Trade Payables
- Bills Receivable endorsed to creditors
- Bills Payable discharged
- Payment of Final Dividend already declared
- Purchase of Stock-in-trade on credit
- Bills Receivable endorsed to creditors dishonoured
- Purchase of Stock-in-trade for Cash
- Sale of Stock-in-trade (Costing ₹ 10,000) for ₹ 12,000
- Sale of Fixed Asset (Book Value ₹ 10,000) for ₹ 9,000

SOLUTION:

I. If the Current Ratio is 2 : 1

Statement showing the Effect of Various Transactions on Current Ratio of 2 : 1

Transaction	Effect on Current Ratio	Reason = Current Assets are more than Current Liabilities and ...
(a)	Improve	Both the total Current Assets and total Current Liabilities are decreased by the same amount.
(b)	Improve	Both the total Current Assets and total Current Liabilities are decreased by the same amount.
(c)	Improve	Both the total Current Assets and total Current Liabilities are decreased by the same amount.
(d)	Improve	Both the total Current Assets and total Current Liabilities are decreased by the same amount.
(e)	Decline	Both the total Current Assets and total Current Liabilities are increased by the same amount.

(f)	Decline	Both the total Current Assets and total Current Liabilities are increased by the same amount.
(g)	No Effect	<i>Neither</i> the total Current Assets <i>nor</i> the total Current Liabilities are affected since there is only a conversion of one Current Asset into another Current Asset.
(h)	Improve	Total Current Assets are increased by ₹ 2,000 but total Current Liabilities remain unchanged.
(i)	Improve	Total Current Assets are increased by ₹ 9,000 but total Current Liabilities remain unchanged.

II. If the Current Ratio is 1 : 1
Statement showing the Effect of Various Transactions on Current Ratio of 1 : 1

Transaction	Effect on Current Ratio	Reason = Current Assets are more than Current Liabilities and ...
(a)	No effect	Both the total Current Assets and total Current Liabilities are decreased by the same amount.
(b)	No effect	Both the total Current Assets and total Current Liabilities are decreased by the same amount.
(c)	No effect	Both the total Current Assets and total Current Liabilities are decreased by the same amount.
(d)	No effect	Both the total Current Assets and total Current Liabilities are decreased by the same amount.
(e)	No effect	Both the total Current Assets and total Current Liabilities are increased by the same amount.
(f)	No effect	Both the total Current Assets and total Current Liabilities are increased by the same amount.
(g)	No Effect	<i>Neither</i> the total Current Assets <i>nor</i> the total Current Liabilities are affected since there is only a conversion of one Current Asset into another Current Asset.
(h)	Improve	Total Current Assets are increased by ₹ 2,000 (Profit) but total Current Liabilities remain unchanged.
(i)	Improve	Total Current Assets are increased by ₹ 9,000 but total Current Liabilities remain unchanged.

III. If the Current Ratio is 0.8 : 1
Statement showing the effect of Various Transactions on Current Ratio of 0.8 : 1

Transaction	Effect on Current Ratio	Reason = Current Assets are more than Current Liabilities and ...
(a)	Decline	Both the total Current Assets and total Current Liabilities are decreased by the same amount.
(b)	Decline	Both the total Current Assets and total Current Liabilities are decreased by the same amount.
(c)	Decline	Both the total Current Assets and total Current Liabilities are decreased by the same amount.
(d)	Decline	Both the total Current Assets and total Current Liabilities are decreased by the same amount.

(e)	Improve	Both the total Current Assets and total Current Liabilities are increased by the same amount.
(f)	Improve	Both the total Current Assets and total Current Liabilities are increased by the same amount.
(g)	No Effect	<i>Neither</i> the total Current Assets <i>nor</i> the total Current Liabilities are affected since there is only a conversion of one Current Asset into another Current Asset.
(h)	Improve	Total Current Assets are increased by ₹ 2,000 (Profit) but total Current Liabilities remain unchanged.
(i)	Improve	Total Current Assets are increased by ₹ 9,000 but total Current Liabilities remain unchanged.

12.0 QUICK RATIO [OR LIQUID RATIO *or* ACID TEST RATIO]

MEANING OF QUICK RATIO

Quick Ratio establishes a relationship between Quick Assets and Current Liabilities.

OBJECTIVE OF QUICK RATIO

The objective of this ratio is to measure the ability of the firm to meet its short-term obligations as and when due without relying upon the realization of Inventories.

COMPONENTS OF QUICK RATIO

There are two components of this ratio as follows:

1. **Quick Assets:** Quick Assets refer to those current assets which can be converted into cash immediately *or* at a short notice without a loss of value.

EXAMPLES OF QUICK ASSETS

1. Current Investments	<i>[e.g. Investments having maturity of more than 3 months but not more than 1 year from the date of acquisition]</i>
2. Trade Receivables	<i>[e.g. Trade Receivables, Bills Receivables to be realized within 12 months]</i>
3. Cash and Cash Equivalents	<i>[e.g. Bank Balance, Cheques/Drafts on hand, Cash Balance, Investments having maturity of 3 months or less]</i>
4. Short-term Loans and Advances	<i>[e.g. Loans & Advances receivable within 12 months, Advance tax]</i>

TUTORIAL NOTES

- (a) *Inventories are not considered as quick assets because:*
 - (i) *There is uncertainty as to whether or not and at what price the inventories can be sold;*
 - (ii) *Time is required to convert the raw-materials and work-in-progress into finished goods and to convert the finished goods into debtors.*
- (b) *Prepaid Expenses are not considered as quick assets because they usually cannot be converted into cash.*
- (c) *The 'Provision for doubtful Trade Receivables' is deducted from the total amount of Trade Receivables in order to ascertain the realisable value of Trade Receivables.*
- (d) *Non-realizable portion of Current Investments is also deducted from the total value of Current Investments in order to ascertain the realizable value of Current Investments.*

- (e) *Unless otherwise stated, it is assumed that Trade Receivables and Current Investments are realizable at their given book values.*

CALCULATION OF QUICK ASSETS

- (a) Quick Assets = Current Investments + Trade Receivables + Cash and Cash Equivalents + Short-term Loans and Advances
- (b) Quick Assets = Current Assets – Inventories – Other Current Assets
2. **Current Liabilities:** Current Liabilities refer to those liabilities which are expected to be settled within Operating Cycle or 12 months from the date of Balance Sheet.

EXAMPLES OF CURRENT LIABILITIES

1. Short-Term Borrowings	<i>[e.g. Loans repayable on demand or within 12 months, Deposits/ Advances repayable within 12 months]</i>
2. Trade Payables	<i>[e.g. Trade Payables, Bills Payables to be settled within 12 months]</i>
3. Other Current Liabilities	<i>[e.g. Bank Overdraft, Unpaid Dividend, Unpaid matured Deposits, Unpaid matured Debentures, That portion of Long-term Borrowings repayable within 12 months, Interest accrued (whether due or not) on borrowings, Calls-in-Advance, Outstanding Expenses, Tax Payable, Incomes received-in-advance]</i>
4. Short-Term Provisions	<i>[e.g. Provision for Tax, Proposed Dividend, Provision for Employee Benefits to be settled within 12 months]</i>

CALCULATION OF CURRENT LIABILITIES

(a) Current Liabilities	= Short-Term Borrowings + Trade Payables + Other Current Liabilities + Short-Term Provisions
(b) Current Liabilities	= Current Assets – Working Capital [Note: Working Capital = Current Assets – Current Liabilities]
(c) Current Liabilities	= (Quick Assets + Inventories + Other Current Assets) – Working Capital
(d) Current Liabilities	= Total Debts – Non-Current Liabilities
(e) Current Liabilities	= Current Assets/Current Ratio

COMPUTATION OF QUICK RATIO

Quick Ratio is computed by dividing the Quick Assets by the Current Liabilities. This ratio is usually expressed as a pure ratio e.g., 1 : 1. In the form of a formula, this ratio may be expressed as under:

$$\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}}$$

TUTORIAL NOTES

- (a) *Quick Ratio is calculated at particular date and not for a particular period.*
- (b) *The excess of Current Assets over Current Liabilities is known as Working Capital.*

INTERPRETATION OF QUICK RATIO

Quick Ratio indicates rupees of quick assets available for each rupee of current liability. Traditionally, a quick ratio of 1 : 1 is considered to be a satisfactory ratio. However, this traditional rule should not

be used blindly since a firm having a quick ratio of more than 1, may not be meeting its short-term obligations in time if its current assets consist of doubtful and slow paying debtors while a firm having a quick ratio of less than 1, may be meeting its short-term obligations in time because of its very efficient inventory management.

PRECAUTION WHILE USING QUICK RATIO

While computing and using the quick ratio, it must be ensured, (a) that the quality of the receivables (debtors and bills receivable) has been carefully assessed and (b) that all Quick Assets and Current Liabilities have been properly valued.

13.0 DISTINCTION BETWEEN CURRENT RATIO AND QUICK RATIO

<i>Basis of Distinction</i>	<i>Current Ratio</i>	<i>Quick Ratio</i>
1. Relationship	Current Ratio shows relationship between Current Assets and Current Liabilities.	Quick Ratio shows relationship between Quick Assets and Current Liabilities.
2. Objective	Current Ratio measures ability to meet current obligations as and when they fall due for payment over a period normally not exceeding 12 months.	Quick Ratio measures enterprise's ability to meet current obligations without relying on the sale and collection of inventories.
3. Components of Ratio	The components of Current Ratio are Current Assets and Current Liabilities.	The components of Quick Ratio are Quick Assets and Current Liabilities.
4. Formula for Computation	Current Ratio = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$	Quick Ratio = $\frac{\text{Quick Assets}}{\text{Current Liabilities}}$
5. Traditional Satisfactory Standard	It is 2 : 1.	It is 1 : 1.
6. Precaution	While computing and using Current Ratio, quality of both Inventories and Trade Receivables is required to be carefully assessed.	While computing and using Quick Ratio, quality of Trade Receivables is required to be carefully assessed (since the Inventories have already been excluded).

ILLUSTRATION 7

Current Assets ₹ 4,40,000, Inventories ₹ 95,000, Prepaid Expenses ₹ 5,000, Current Liabilities ₹ 3,40,000, Trade Payables ₹ 20,000. Calculate the Quick Ratio.

SOLUTION:

Step 1: Quick Assets = Current Assets – Inventories – Prepaid Expenses
 $= ₹ 4,40,000 - ₹ 95,000 - ₹ 5,000 = ₹ 3,40,000$

Step 2: Quick Ratio = $\frac{\text{Quick Assets}}{\text{Current Liabilities}} = \frac{₹ 3,40,000}{₹ 3,40,000} = 1:1$

Note: Trade Payables are already included in Current Liabilities.

ILLUSTRATION 8

X Ltd. has a Liquid Ratio of 1.5 : 1. Its Net Working Capital is ₹ 1,20,000 and its Inventory is ₹ 80,000. Calculate Current Assets.

SOLUTION:

Step 1: Current Liabilities

$$\text{Liquid Ratio} = \frac{\text{Liquid Assets}}{\text{Current Liabilities}} = \frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}} = 1.5$$

or, Current Assets – ₹ 80,000 = 1.5 Current Liabilities

or, Current Assets – 1.5 Current Liabilities = ₹ 80,000 Eq. I

Working Capital = Current Assets – Current Liabilities

or, Current Assets – Current Liabilities = ₹ 1,20,000 Eq. II

Subtracting Eq. II from Eq. I

0.5 Current Liabilities = ₹ 40,000

Current Liabilities = ₹ 40,000/0.5 = ₹ 80,000

Step 2: Current Assets = ₹ 80,000 + ₹ 1,20,000 = ₹ 2,00,000

ILLUSTRATION 9

X Ltd. has a Current Ratio of 3 : 1 and Liquid Ratio of 1 : 1. Its Working Capital is ₹ 2,00,000. Calculate the value of Inventories.

SOLUTION:

Step 1: Current Assets & Current Liabilities

$$\text{Current Ratio} = \frac{\text{Current Assets (CA)}}{\text{Current Liabilities (CL)}} = 3$$

CA – 3CL = 0 Eq. I

CA – CL = ₹ 2,00,000 Eq. II

Subtracting Equation II from Equation I

2CL = ₹ 2,00,000

CL = ₹ 2,00,000/2 = ₹ 1,00,000

Current Assets = Current Liabilities × Current Ratio

= ₹ 1,00,000 × 3 = ₹ 3,00,000

Step 2: Quick Assets

$$\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}} = \frac{\text{Quick Assets}}{₹ 1,00,000} = 1$$

Quick Assets = ₹ 1,00,000 × 1 = ₹ 1,00,000

Step 3: Inventories = Current Assets – Quick Assets

= ₹ 3,00,000 – ₹ 1,00,000 = ₹ 2,00,000

ILLUSTRATION 10

X Ltd. has a Current Ratio of 4.5 : 1 and Quick Ratio of 3 : 1. If its Inventories are ₹ 36,000, find out its Total Current Assets, and Total Current Liabilities and Quick Assets.

SOLUTION:

Step 1: $\text{Current Ratio} = \frac{\text{Current Assets (CA)}}{\text{Current Liabilities (CL)}} = 4.5$
 or, $CA - 4.5 CL = 0$ Eq. I

Step 2: $\text{Quick Ratio} = (CA - \text{Stock})/CL = 3$
 or, $CA - ₹ 36,000 - 3CL = 0$
 or $CA - 3CL = ₹ 36,000$ Eq. II

Step 3: Subtracting Equation II from Equation I
 $1.5 CL = ₹ 36,000$
 $CL = ₹ 36,000/1.5 = ₹ 24,000$

Step 4: $CA = ₹ 24,000 \times 4.5 = ₹ 1,08,000$

Step 5: $\text{Quick Assets} = ₹ 1,08,000 - ₹ 36,000 = ₹ 72,000$

ILLUSTRATION 11

The Quick Ratio of a company is 2 : 1. State, giving reason, which of the following would improve, reduce or not change the ratio:

- (i) Purchase of Stock-in-trade for Cash;
- (ii) Cash collected from Trade Receivables;
- (iii) Sale of Stock-in-trade (costing ₹ 10,000) for ₹ 11,000 and
- (iv) Sale of an Office Furniture (Book value ₹ 10,000) for 9,000,
- (v) Payment of Dividend.

SOLUTION:**EFFECT OF TRANSACTION ON QUICK RATIO**

Transaction	Effect	Reason
(i)	Reduce	Quick Assets will decrease due to reduction of Cash.
(ii)	No Change	Quick Assets will not change due to conversion of Trade Receivables into cash.
(iii)	Improve	Quick Assets will increase due to increase in cash.
(iv)	Improve	Quick Assets will increase due to increase in cash.
(v)	Improve	Both the Quick Assets and Current Liabilities are decreased by the same amount.

14.0 ABSOLUTE CASH/LIQUIDITY RATIO**MEANING OF ABSOLUTE CASH/LIQUIDITY RATIO**

Absolute Cash/Liquidity Ratio measures a relationship between Cash & Marketable Securities and Current Liabilities.

OBJECTIVE OF ABSOLUTE CASH/LIQUIDITY RATIO

The objective of computing Absolute Cash/Liquidity Ratio is to measure the ability of the enterprise to meet its short-term obligations as and when due without relying upon the realization of Inventory and Trade Receivables.

COMPONENTS OF ABSOLUTE CASH/LIQUIDITY RATIO

There are two components of this ratio as follows :

1. Cash and Marketable Securities and 2. Current Liabilities

COMPUTATION OF ABSOLUTE CASH /LIQUIDITY RATIO

This ratio is computed by dividing the Cash and Marketable Securities by Current Liabilities. This ratio is usually expressed as a pure ratio e.g. 1 : 1. In the form of a formula, this ratio may be expressed as under :

$$\text{Absolute Cash/Liquidity Ratio} = \frac{\text{Cash \& Marketable Securities}}{\text{Current Liabilities}}$$

INTERPRETATION OF ABSOLUTE CASH /LIQUIDITY RATIO

It indicates Cash and Marketable Securities available for each rupee of Current Liability. A very high absolute ratio indicates high liquidity at the cost of profitability since idle cash does not generate any return and marketable securities generate return at a rate lower than the rate of operating margin.

ILLUSTRATION 12

From the following, calculate Absolute Cash Ratio :

	₹		₹
Current Investments	1,00,000	Short-Term Borrowings	1,10,000
Inventories	4,00,000	Trade Payables	3,70,000
Trade Receivables	3,50,000	Other Current Liabilities	20,000
Cash and Cash Equivalents	2,00,000		

SOLUTION:

$$\begin{aligned} \text{Absolute Cash/Liquidity Ratio} &= (\text{Cash} + \text{Marketable Securities})/\text{Current Liabilities} \\ &= (\text{₹ } 2,00,000 + \text{₹ } 1,00,000)/\text{₹ } 5,00,000 = 0.6 \end{aligned}$$

15.0 INTERNAL INTERVAL MEASURE RATIO**MEANING OF INTERNAL INTERVAL MEASURE RATIO**

This ratio measures a relationship between Quick Assets and Average Daily Operating Expenses.

OBJECTIVE OF INTERNAL INTERVAL MEASURE RATIO

The objective of computing this ratio is to measure the average period for which quick assets are available to meet average daily operating expenses.

COMPONENTS OF INTERNAL INTERVAL MEASURE RATIO

There are two components of this ratio as follows :

1. Quick Assets which means Current Assets *minus* Stock and Prepaid Expenses
2. Average Daily Operating Expenses

$$= \frac{[\text{Cost of Goods Sold} + \text{Other Operating Expenses} - \text{Non-Cash Operating Cost (e.g. Depreciation)}]}{\text{No. of Days in a year}}$$

COMPUTATION OF INTERNAL INTERVAL MEASURE RATIO

This ratio is computed by dividing the Quick Assets by Average Daily Operating Expenses. This ratio is usually expressed in terms of days/weeks/months. In the form of a formula, this ratio may be expressed as follows :

$$\text{Internal Interval Measure Ratio} = \frac{\text{Quick Assets}}{\text{Average Daily Operating Expenses}}$$

INTERPRETATION OF INTERNAL INTERVAL MEASURE RATIO

It indicates the period for which average daily operating expenses can be met out of available Quick Assets.

PRECAUTION WHILE USING INTERNAL INTERVAL MEASURE RATIO

While computing and using this ratio, it must be ensured that (a) the quality of the receivables (debtors and bills receivable) has been carefully assessed, (b) that all quick assets have been properly valued, (c) that all cash operating expenses have been properly taken into account.

ILLUSTRATION 13

From the following, calculate Internal Interval Measure Ratio:

	₹		₹
Current Investments	1,00,000	Cost of Goods sold	8,00,000
Inventories	4,00,000	Other Operating Expenses	50,000
Trade Receivables	3,50,000	Depreciation	1,20,000
Cash and Cash Equivalents	2,00,000	Provision for Doubtful Debts	50,000

SOLUTION:

Step 1 : Quick Assets = (₹ 3,50,000 – ₹ 50,000) + ₹ 2,00,000 + ₹ 1,00,000 = ₹ 6,00,000

Step 2 : Average Daily Operating Expenses = (₹ 8,00,000 + ₹ 50,000 – ₹ 1,20,000)/365 = ₹ 2,000

Step 3 : Internal Interval Measure Ratio = Quick Assets/Average Daily Operating Expenses
= ₹ 6,00,000/₹ 2,000 = 300 days.

16.0 SOLVENCY RATIOS

Meaning	Long-term Creditors are primarily interested in long-term solvency of the enterprise since their claims are to be met in the long-run. Long-term creditors are the liabilities having maturity after one year. Long-term solvency means the ability of the enterprise to meet long-term obligations on the due date. Long-term lender of funds is basically interested in two things: (a) Safety of Principal which is given by way of a loan during the term of the loan. (b) Regular servicing of the loan in the form of — (i) Payment of Interest on loan, and (ii) Repayment of Instalment of loan. <i>For example</i> — A loan of ₹ 1 crore at 12% rate of interest is granted by X Ltd. for a term of 5 years repayable in 60 EMIs of ₹ 2,10,000 each. X Ltd. would like to be sure that — (i) the principal amount of ₹ 1 crore is safe for 5 years (ii) it will get an EMI of ₹ 2,10,000 every month at due date. Solvency Ratios measure the long-term financial solvency which means the enterprise's ability to pay the interest regularly and to repay the principal on maturity or in pre-determined instalments at due dates.

Solvency Ratios	Usually the following ratios are calculated to judge the long-term financial solvency of the enterprise: Capital Structure Ratios 1. Debt-Equity Ratio 2. Debt to Total Assets Ratio 3. Proprietary Ratio 4. Capital Gearing Ratio 5. Equity Ratio Coverage Ratios 6. Interest Coverage Ratio 7. Preference Dividend Coverage Ratio 8. Debt Service Coverage Ratio 9. Fixed Charges Coverage Ratio

17.0 DEBT-EQUITY RATIO

MEANING OF DEBT-EQUITY RATIO

Debt-Equity Ratio establishes a relationship between Debt (i.e., Non-Current Liabilities) and Equity (i.e., Shareholders' Funds).

OBJECTIVE OF DEBT-EQUITY RATIO

The basic objective of computing Debt-Equity ratio is to measure the long-term financial solvency. (i.e., the enterprise's ability to pay the interest regularly and to repay the principal on maturity or in pre-determined instalments at due dates).

COMPONENTS OF DEBT-EQUITY RATIO

There are two components of this ratio as follows:

1. **Debt** which means Non-Current Liabilities (e.g. Long-term Borrowings like Debentures, Bonds, Term Loans From Banks, Financial Institutions, Long-term Loans & Advances, Long-term Provisions) which are expected to be settled after 12 months from the date of Balance Sheet. Debt may be calculated as follows:
 - (a) Debt = Long-term Borrowings + Long-term Provisions
 - (b) Debt = Total Debt – Current Liabilities
 - (c) Debt = Capital Employed – Equity

[Note: Capital Employed = Equity + Debt]
2. **Equity** which means Funds belonging to all the Shareholders (whether Equity or Preference). Equity may be calculated as follows:
 - (a) Equity = Equity Share Capital + Pref. Share Capital + Reserves & Surplus
 - (b) Equity = Non-Current Assets + Current Assets – Current Liabilities – Non-Current Liabilities
 - (c) Equity = Non-Current Assets + Working Capital – Non-Current Liabilities
 - (d) Equity = Capital Employed – Non-Current Liabilities
 - (e) Equity = Total Assets – Total Debt

COMPUTATION OF DEBT-EQUITY RATIO

Debt-Equity Ratio is computed by dividing the Debt by Equity. This ratio is usually expressed as a pure ratio e.g., 2 : 1. In the form of a formula, this ratio may be expressed as follows:

$$\text{Debt-Equity Ratio} = \frac{\text{Long-term Debts}}{\text{Shareholders' Funds}}$$

TUTORIAL NOTE

Debt-Equity Ratio is calculated at a particular date and not for a particular period.

INTERPRETATION OF DEBT-EQUITY RATIO

Debt-Equity Ratio indicates the margin of safety to long-term creditors. A low debt-equity ratio implies the use of more equity than debt which means a larger safety margin for creditors since owner's equity is treated as a margin of safety by creditors and vice versa. Traditionally, a Debt Equity Ratio of 2 : 1 is considered to be satisfactory which means debt could be twice the equity. The implications from the point of view of creditors and the firm may be seen as follows:

Case	Implications from the point of view of	
	Trade Payables	Firm
A. In case of Low Debt-Equity Ratio	Larger margin of safety since owner's equity is treated as margin of safety by creditors.	1. Debt servicing is <i>less</i> burdensome. 2. Less pressure and interference of creditors in management. 3. Capacity to raise additional debt. 4. Not much benefit of trading on equity when the firm earns a rate higher than the interest rate on borrowed funds.
B. In case of High Debt-Equity Ratio	Greater the risk to creditors	1. Debt servicing is burdensome under adverse business conditions. 2. Pressure & interference of creditors in management. 3. Difficulties in raising additional debt. 4. Benefits of trading on equity when the firm earns a rate higher than the interest rate on borrowed funds.

Thus, an enterprise should have *neither* a very high *nor* a very low ratio, it should have a satisfactory ratio. To judge whether the ratio is satisfactory *or* not, it should be compared with its own past ratios *or* with the ratio of similar enterprises in the same industry *or* with the industry average.

ILLUSTRATION 14

From the following information Calculate Debt-Equity Ratio:

Particulars	₹	Particulars	₹
Equity Share Capital (₹ 10 each)	1,50,000	Tangible Fixed Assets	9,00,000
18% Pref. Share capital	1,00,000	Intangible Fixed Assets	1,50,000
Reserves & Surplus	1,50,000	Non-Current Investments	50,000
15% Long-term Borrowings	8,00,000	Current Assets	5,00,000
Current Liabilities	4,00,000		

SOLUTION:

Step 1: Debt = Long-term Borrowings = ₹ 8,00,000

Step 2: Equity = Equity Share Capital + Pref. Share Capital + Reserves & Surplus
 = ₹ 1,50,000 + ₹ 1,00,000 + ₹ 1,50,000 = ₹ 4,00,000

$$\begin{aligned}
 \text{or,} \quad \text{Equity} &= \text{Non-Current Assets} + \text{Current Assets} - \text{Current Liabilities} - \text{Non-Current Liabilities} \\
 &= [\text{₹ } 9,00,000 + \text{₹ } 1,50,000 + \text{₹ } 50,000] + \text{₹ } 5,00,000 - \text{₹ } 4,00,000 - \text{₹ } 8,00,000 = \text{₹ } 4,00,000
 \end{aligned}$$

$$\text{Step 3: Debt-Equity Ratio} = \frac{\text{Long-term Debts}}{\text{Shareholders' Funds}} = \frac{\text{₹ } 8,00,000}{\text{₹ } 4,00,000} = 2 : 1$$

ILLUSTRATION 15

X Ltd. has a Liquid Ratio of 1.5:1 and Current Ratio of 2.5 :1. Its Inventories are ₹ 80,000. Non-Current Assets ₹ 1,80,000, Total Debt ₹ 2,80,000. Calculate Debt-Equity Ratio.

SOLUTION:

Step 1: Current Assets and Current Liabilities

$$\text{Liquid Ratio} = (\text{CA} - \text{Stock}) / \text{CL} = 1.5$$

$$\text{or, Current Assets} - \text{₹ } 80,000 = 1.5 \text{ Current Liabilities}$$

$$\text{or, Current Assets} - 1.5 \text{ Current Liabilities} = \text{₹ } 80,000 \quad \text{..... Eq. I}$$

$$\text{Current Ratio} = \text{Current Assets} / \text{Current Liabilities} = 2.5$$

$$\text{or, CA} - 2.5 \text{ CL} = 0 \quad \text{..... Eq. II}$$

Subtracting Eq. II from Eq. I

$$\text{Current Liabilities} = \text{₹ } 80,000$$

$$\text{Current Assets} = \text{₹ } 80,000 \times 2.5 = \text{₹ } 2,00,000$$

$$\begin{aligned}
 \text{Step 2: Total Assets} &= \text{Non-Current Assets} + \text{Current Assets} = \text{₹ } 1,80,000 + \text{₹ } 2,00,000 \\
 &= \text{₹ } 3,80,000
 \end{aligned}$$

$$\text{Step 3: Debt} = \text{Total Debt} - \text{Current Liabilities} = \text{₹ } 2,80,000 - \text{₹ } 80,000 = \text{₹ } 2,00,000$$

$$\text{Step 4: Equity} = \text{Total Assets} - \text{Total Debt} = \text{₹ } 3,80,000 - \text{₹ } 2,80,000 = \text{₹ } 1,00,000$$

$$\text{Step 5: Debt-Equity Ratio} = \text{Debt/Equity} = \text{₹ } 2,00,000 / \text{₹ } 1,00,000 = 2 : 1$$

ILLUSTRATION 16

Assuming that the Debt-Equity Ratio (defined as ratio of Debt to Equity) is 2, state, giving reason, whether this ratio will increase or decrease or will have no change in each one of the following cases:

- Purchase of a Fixed Asset on a credit of 2 months
- Purchase of a Fixed Asset on long-term deferred payment basis.
- Sale of a Fixed Asset (book value ₹ 4,000) at a loss of ₹ 3,000
- Sale of a Fixed Asset (book value ₹ 4,000) for ₹ 5,000
- Sale of a Fixed Asset (book value ₹ 4,000) for ₹ 4,000
- Issue of New Shares for cash
- Issue of New Shares against the purchase of a Fixed Asset
- Issue of Bonus Shares
- Redemption of Debentures for cash
- Conversion of Debentures into Equity Shares
- Declaration of a Final Dividend
- Payment of Final Dividend already declared
- Redemption of Redeemable Preference Shares
- Payment to Trade Creditors
- Discounting a Bill of Exchange of ₹ 50,000 at a discount of 10%.

SOLUTION:

**STATEMENT SHOWING THE EFFECT OF VARIOUS TRANSACTIONS
ON DEBT-EQUITY RATIO OF 2 : 1**

Transaction	Effect on D/E Ratio	Reason
(a)	No Effect	<i>Neither</i> the Debt <i>nor</i> the Equity are affected.
(b)	Increase	Debt is increased but Equity remains unchanged.
(c)	Increase	Equity is decreased by the amount of loss but Debt remains unchanged.
(d)	Decrease	Equity is increased by the amount of profit but Debt remains unchanged.
(e)	No Effect	<i>Neither</i> the Debt <i>nor</i> the Equity is affected.
(f)	Decrease	Equity is increased by the amount of issue of shares but Debt remains unchanged.
(g)	Decrease	Equity is increased by the amount of share capital issued but Debt remains unchanged.
(h)	No Effect	<i>Neither</i> the Debt <i>nor</i> the Equity is affected since there is only a conversion of accumulated profits into Share Capital.
(i)	Decrease	Debt is decreased but Equity remains unchanged.
(j)	Decrease	Debt is decreased and Equity is increased by the same amount.
(k)	No Effect	It represents merely the conversion of Provision into a Current Liability.
(l)	No Effect	<i>Neither</i> the Debt <i>nor</i> the Equity is affected.
(m)	Increase	Equity is decreased but Debt remains unchanged.
(n)	No Effect	<i>Neither</i> the Debt <i>nor</i> the Equity is affected.
(o)	Increase	Equity is decreased by ₹ 5,000 (discount) but Debt remains unchanged.

18.0 DEBT TO TOTAL ASSETS RATIO**MEANING OF DEBT TO TOTAL ASSETS RATIO**

Debt to Total Assets Ratio establishes a relationship between Debt and Total Assets.

OBJECTIVE OF DEBT TO TOTAL ASSETS RATIO

The objective of computing Debt to Total Assets Ratio is to measure the proportion of Total Assets financed with debt. It measures the safety margin available to the suppliers of long-term debts or the extent to which debt is being covered by assets.

COMPONENTS OF DEBT TO TOTAL ASSETS RATIO

There are two components of this ratio as follows:

- Debt** which means Non-Current Liabilities (e.g. Long-term Borrowings like Debentures, Bonds, Term Loans From Banks, Financial Institutions, Long-term Loans & Advances, Long-term Provisions) which are expected to be settled after 12 months from the date of Balance Sheet. Debt may be calculated as follows:

(a) Debt = Long-term Borrowings + Long-term Provisions

(b) Debt = Total Debt – Current Liabilities

(c) Debt = Capital Employed – Equity [**Note:** Capital Employed = Equity + Debt]

2. Total Assets mean all the Assets (i.e. Non-Current Assets & Current Assets). Total Assets may be calculated as follows:

(a) Total Assets = Non-Current Assets + Current Assets

(b) Total Assets = Equity Share Capital + Pref. Share Capital + Reserves & Surplus + Non-Current Liabilities + Current Liabilities

(c) Total Assets = Shareholders' Funds + Non-Current Liabilities + Current Liabilities

(d) Total Assets = Capital Employed + Current Liabilities

COMPUTATION OF DEBT TO TOTAL ASSETS RATIO

Debt to Total Assets Ratio is computed by dividing the Total Assets by the Debt. This ratio is usually expressed as a pure ratio e.g. 2 : 1. In the form of formula, this ratio may be expressed as follows:

$$\text{Debt to Total Assets Ratio} = \frac{\text{Debt}}{\text{Total Assets}}$$

TUTORIAL NOTE

Debt to Total Assets Ratio is calculated at a particular date and not for a particular period.

INTERPRETATION OF DEBT TO TOTAL ASSETS RATIO

Debt to Total Assets Ratio indicates the margin of safety to long-term creditors. A high Debt to Total Assets Ratio implies the use of more Equity than Debt which means a larger safety margin for Long-term creditors since owner's equity is treated as a margin of safety by Long-term Creditors and vice versa.

ILLUSTRATION 17

From the following information Calculate Debt to Total Assets Ratio:

Particulars	₹	Particulars	₹
Equity Share Capital (₹ 10 each)	1,50,000	Tangible Fixed Assets	9,00,000
18% Pref. Share capital	1,00,000	Intangible Fixed Assets	1,50,000
Reserves & Surplus	1,50,000	Non-Current Investments	50,000
15% Long-term Borrowings	8,00,000	Current Assets	5,00,000
Current Liabilities	4,00,000		

SOLUTION:

Step 1: Debt = Long-term Borrowings = ₹ 8,00,000

Step 2: Total Assets = Non-Current Assets + Current Assets

$$= [₹ 9,00,000 + ₹ 1,50,000 + ₹ 50,000] + ₹ 5,00,000 = ₹ 16,00,000$$

or, Total Assets = Equity Share Capital + Pref. Share Capital + Reserves & Surplus + Non-Current Liabilities + Current Liabilities

$$= ₹ 1,50,000 + ₹ 1,00,000 + ₹ 1,50,000 + ₹ 8,00,000 + ₹ 4,00,000 = ₹ 16,00,000$$

Step 3: Debt to Total Assets Ratio = $\frac{\text{Debt}}{\text{Total Assets}} = \frac{₹ 8,00,000}{₹ 16,00,000} = 1 : 2$

19.0 PROPRIETARY RATIO**MEANING OF PROPRIETARY RATIO**

Proprietary Ratio measures a relationship between Proprietors' Funds and Total Assets.

OBJECTIVE OF PROPRIETARY RATIO

The objective of computing this ratio is to measure the proportion of Total Assets financed by the Proprietors' Funds.

COMPONENTS OF PROPRIETARY RATIO

There are two components of this ratio as follows:

1. **Proprietors' Funds [or Shareholders' Funds]** which mean Funds belonging to all the Shareholders (*whether Equity or Preference*). Proprietors' Funds may be calculated as follows:
 - (a) Proprietors' Funds = Equity Share Capital + Pref. Share Capital + Reserves & Surplus
 - (b) Proprietors' Funds = Non-Current Assets + Current Assets – Current Liabilities – Non Current Liabilities
 - (c) Proprietors' Funds = Capital Employed – Non-Current Liabilities
 - (d) Proprietors' Funds = Non-Current Assets + Working Capital – Non-Current Liabilities
 - (e) Proprietors' Funds = Total Assets – Total Debts
2. **Total Assets** mean all the Assets (i.e. Non-Current Assets & Current Assets). Total Assets may be calculated as follows:
 - (a) Total Assets = Non-Current Assets + Current Assets
 - (b) Total Assets = Equity Share Capital + Pref. Share Capital + Reserves & Surplus + Non-Current Liabilities + Current Liabilities
 - (c) Total Assets = Shareholders' Funds + Non-Current Liabilities + Current Liabilities
 - (d) Total Assets = Capital Employed + Current Liabilities
 - (e) Total Assets = Shareholders' Funds + Total Debts

COMPUTATION OF PROPRIETARY RATIO

Proprietary Ratio is computed by dividing the Proprietors' Funds by Total Assets. It is expressed as a pure ratio e.g., 1 : 4. In the form of a formula, this ratio may be expressed as follows:

$$\text{Proprietary Ratio} = \frac{\text{Proprietors' Funds}}{\text{Total Assets}}$$

INTERPRETATION OF PROPRIETARY RATIO

Proprietary Ratio indicates the extent to which the assets of the enterprise have been financed out of Proprietors' Funds. A high proprietary ratio indicates the larger safety margin for creditors and the enterprise is not taking the benefit of trading on equity. A low proprietary ratio indicates the greater risk to creditors and the enterprise is taking the benefit of trading on equity.

ILLUSTRATION 18

From the following information Calculate Proprietary Ratio:

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
Equity Share Capital (₹ 10 each)	1,50,000	Tangible Fixed Assets	9,00,000
18% Pref. Share capital	1,00,000	Intangible Fixed Assets	1,50,000
Reserves & Surplus	1,50,000	Non-Current Investments	50,000
15% Long-term Borrowings	8,00,000	Current Assets	5,00,000
Current Liabilities	4,00,000		

SOLUTION:

Step 1: Proprietors' Funds = Equity Share Capital + Pref. Share Capital + Reserves & Surplus = ₹ 1,50,000 + ₹ 1,00,000 + ₹ 1,50,000 = ₹ 4,00,000

or, Proprietors' Funds = Non-Current Assets + Current Assets – Current Liabilities – Non-Current Liabilities

= [₹ 9,00,000 + ₹ 1,50,000 + ₹ 50,000] + ₹ 5,00,000 – ₹ 4,00,000 – ₹ 8,00,000 = ₹ 4,00,000

Step 2: Total Assets = Non-Current Assets + Current Assets

= [₹ 9,00,000 + ₹ 1,50,000 + ₹ 50,000] + ₹ 5,00,000 = ₹ 16,00,000

or, Total Assets = Equity Share Capital + Pref. Share Capital + Reserves & Surplus + Non-Current Liabilities + Current Liabilities

= ₹ 1,50,000 + ₹ 1,00,000 + ₹ 1,50,000 + ₹ 8,00,000 + ₹ 4,00,000 = ₹ 16,00,000

Step 3: Proprietary Ratio = $\frac{\text{Proprietors' Funds}}{\text{Total Assets}} = \frac{₹ 4,00,000}{₹ 16,00,000} = 1 : 4$

ILLUSTRATION 19

Total Debt ₹ 24,00,000, Capital Employed ₹ 20,00,000, Current Assets ₹ 10,00,000, Working Capital ₹ 2,00,000. Calculate Debt-Equity Ratio, Debt to Total Assets Ratio and Proprietary Ratio.

SOLUTION:

Step 1: Current Liabilities = Current Assets – Working Capital

= ₹ 10,00,000 – ₹ 2,00,000 = ₹ 8,00,000

Step 2: Debt = Total Debt – Current Liabilities

= ₹ 24,00,000 – ₹ 8,00,000 = ₹ 16,00,000

Step 3: Total Assets = Capital Employed + Current Liabilities

= ₹ 20,00,000 + ₹ 8,00,000 = ₹ 28,00,000

Step 4: Proprietors' Funds (or Equity) = Total Assets – Total Debt

= ₹ 28,00,000 – ₹ 24,00,000 = ₹ 4,00,000

or, = Capital Employed – Debt = ₹ 20,00,000 – ₹ 16,00,000 = ₹ 4,00,000

Step 5: Debt-Equity Ratio = Debt/Equity = ₹ 16,00,000/₹ 4,00,000 = 4 : 1

Step 6: Debt to Total Assets Ratio = Debt/Total Assets = ₹ 16,00,000/₹ 28,00,000 = 4 : 7

Step 7: Proprietary Ratio = $\frac{\text{Proprietors' Funds}}{\text{Total Assets}} = \frac{₹ 4,00,000}{₹ 28,00,000} = 1 : 7$

20.0 CAPITAL GEARING RATIO**MEANING OF CAPITAL GEARING RATIO**

This ratio establishes a relationship between Funds bearing Fixed Financial Payments and Equity Shareholders' Funds.

OBJECTIVE OF CAPITAL GEARING RATIO

The objective of computing this ratio is to measure the relative proportion of funds bearing Fixed Financial Payments to Equity Shareholders' Funds.

COMPONENTS OF CAPITAL GEARING RATIO

There are two components of this ratio as follows:—

- Funds bearing Fixed Financial Payments** e.g., Debentures, Bonds, Loans from financial institutions, Preference Share Capital.
- Equity Shareholders' Funds which mean** Equity Share Capital + Reserves & Surplus *minus* fictitious assets.

COMPUTATION OF CAPITAL GEARING RATIO

This ratio is computed by dividing the funds bearing fixed financial payments by Equity Shareholders' Funds. This ratio is usually expressed as a pure ratio e.g., 3 : 1. In the form of formula, this ratio may be expressed as follows

$$\text{Capital Gearing Ratio} = \frac{\text{Funds bearing Fixed Financial payments}}{\text{Equity Shareholders' Funds}}$$

TUTORIAL NOTE

Capital Gearing Ratio is calculated at a particular date and not for a particular period.

INTERPRETATION OF CAPITAL GEARING RATIO

It indicates the margin of safety available to suppliers of funds fixed financial payments. A high total Capital Gearing Ratio implies the use of *less* equity than funds bearing fixed financial payments which means a lower safety margin for funds bearing funds financial payments since owner's equity is treated as a margin of safety by the suppliers of funds bearing fixed financial payments and *vice versa*.

If the Capital Gearing Ratio is *less* than 1, the company is said to be lowly geared and if it is more than 1, it is said to be highly geared. Capital gearing shows the extent of the risk (in relation to payment of fixed financial payments) to which the company is subject and also the opportunity for trading on equity. Thus, the position of highly geared and lowly geared company is as follows:

Basis of Comparison	Highly Geared Company	Lowly Geared Company
1. Risk	High	Low
2. Opportunity for Trading on Equity	High	Low
3. Equity Shareholders' Gain	Increases more if ROI > Rate of Interest & Pref. Dividend Decreases more if ROI < Rate of Interest & Pre. Dividend	Increases less if ROI > Rate of Interest & Pref. Dividend Decreases less if ROI < Rate of Interest & Pref. Dividend

Thus, an enterprise should have *neither* a very high *nor* a very low ratio, it should have a satisfactory ratio. To judge whether the ratio is satisfactory *or* not, it should be compared with its own past ratios *or* with the ratio of similar enterprises in the same industry *or* with the industry average.

ILLUSTRATION 20

Calculate Capital Gearing Ratio from the following information:
 15% Long-term Debts ₹ 8,00,000, 18% Preference Share Capital ₹ 1,00,000.
 Equity Share Capital ₹ 1,50,000. Reserves & Surplus ₹ 1,50,000.

SOLUTION:

$$\text{Capital Gearing Ratio} = \frac{\text{Funds bearing Fixed Financial payments}}{\text{Equity Shareholders' Funds}} = \frac{\text{₹8,00,000} + \text{₹1,00,000}}{\text{₹1,50,000} + \text{₹1,50,000}} = 3 : 1$$

21.0 EQUITY RATIO**MEANING OF EQUITY RATIO**

This ratio establishes a relationship between Shareholders' Funds and Capital Employed.

OBJECTIVE OF EQUITY RATIO

The objective of computing this ratio is to measure the proportion of Shareholders' Funds to Capital Employed.

COMPONENTS OF EQUITY RATIO

There are two components of this ratio as follows:

1. **Shareholders' Funds** which mean Funds belonging to all the Shareholders (*whether Equity or Preference*). **Shareholders' Funds** may be calculated as follows:
 - (a) Shareholders' Funds = Equity Share Capital + Pref. Share Capital + Reserves & Surplus
 - (b) Shareholders' Funds = Non-Current Assets + Current Assets – Current Liabilities – Non-Current Liabilities
 - (c) Shareholders' Funds = Capital Employed – Non-Current Liabilities
 - (d) Shareholders' Funds = Non-Current Assets + Working Capital – Non-Current Liabilities
 - (e) Shareholders' Funds = Total Assets – Total Debts
2. **Capital Employed** means long-term funds supplied by the long-term creditors and shareholders. It comprises the Non-Current Liabilities and Shareholders' Funds. It can be calculated as follows:
 - (a) Capital Employed = [(Equity Share Capital + Pref. Share Capital + Reserves & Surplus)] + Non-Current Liabilities.
 - (b) Capital Employed = Shareholders' Funds + Non-Current Liabilities
 - (c) Capital Employed = Non-Current Assets (Excluding Non-Trade Investments) + Current Assets – Current Liabilities.
 - (d) Capital Employed = Non-Current Assets (Excluding Non-Trade Investments) + Working Capital
 - (e) Capital Employed = Total Assets (Excluding Non-Trade Investments) – Current Liabilities

COMPUTATION OF EQUITY RATIO

This ratio is computed by dividing the Shareholders' Funds by Capital Employed. This ratio is usually expressed as a pure ratio e.g. 2 : 1. In the form of formula, this ratio may be expressed as follows:

$$\text{Equity Ratio} = \frac{\text{Shareholders' Funds}}{\text{Capital Employed}}$$

TUTORIAL NOTE

Equity Ratio is calculated at a particular date and not for a particular period.

INTERPRETATION OF EQUITY RATIO

Equity Ratio indicates the proportion of Shareholders' Funds to Capital Employed. A high Equity ratio implies the use of more Equity than Debt which means a larger safety margin for Long-term creditors since owner's equity is treated as a margin of safety by Long-term Creditors and vice versa.

ILLUSTRATION 21

From the following information Calculate Equity Ratio:

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
Equity Share Capital (₹ 10 each)	1,50,000	Tangible Fixed Assets	9,00,000
18% Pref. Share Capital	1,00,000	Intangible Fixed Assets	1,50,000
Reserves & Surplus	1,50,000	Non-Current Investments [Trade]	50,000
15% Long-term Borrowings	8,00,000	Current Assets	5,00,000
Current Liabilities	4,00,000		

SOLUTION:

- Step 1:** Shareholders' Funds = Equity Share Capital + Pref. Share Capital + Reserves & Surplus
 $= ₹ 1,50,000 + ₹ 1,00,000 + ₹ 1,50,000 = ₹ 4,00,000$
 or, Shareholders' Funds = Non-Current Assets + Current Assets – Current Liabilities – Non-Current Liabilities
 $= [₹ 9,00,000 + ₹ 1,50,000 + ₹ 50,000] + ₹ 5,00,000 - ₹ 4,00,000 - ₹ 8,00,000 = ₹ 4,00,000$
- Step 2:** Capital Employed = [(Equity Share Capital + Pref. Share Capital + Reserves & Surplus) + Non-Current Liabilities.
 $= ₹ 1,50,000 + ₹ 1,00,000 + ₹ 1,50,000 + ₹ 8,00,000 = ₹ 12,00,000$
 or, Capital Employed = Non-Current Assets + Current Assets – Current Liabilities
 $= [₹ 9,00,000 + ₹ 1,50,000 + ₹ 50,000] + ₹ 5,00,000 - ₹ 4,00,000 = ₹ 12,00,000$
- Step 3:** Equity Ratio = Shareholders' Funds /Capital Employed = ₹ 4,00,000/ ₹ 12,00,000= 1:3

COVERAGE RATIOS**22.0 INTEREST COVERAGE RATIO (OR TIMES – INTEREST EARNED RATIO)****MEANING OF INTEREST COVERAGE RATIO**

Interest Coverage Ratio establishes a relationship between Net Profit before Interest and Tax and Interest on Long-term Borrowings.

OBJECTIVE OF INTEREST COVERAGE RATIO

The objective of computing Interest Coverage Ratio is to measure the Debt Servicing Capacity of a firm so far as Fixed Interest on Long-term Borrowings is concerned.

COMPONENTS OF INTEREST COVERAGE RATIO

There are two components of Interest Coverage Ratio as follows:

- 1. Net Profit before Interest and Tax**
- 2. Interest on Long-term Borrowings**

COMPUTATION OF INTEREST COVERAGE RATIO

Interest Coverage Ratio is computed by dividing the Net Profit before Interest and Tax by Interest on Long-term Borrowings. This ratio is usually expressed as 'X' number of times. In the form of a formula, this ratio may be expressed as under:

$$\text{Interest Coverage Ratio} = \frac{\text{Profit before Interest \& Tax}}{\text{Interest on Long-term Debt}} = \dots \text{Times}$$

INTERPRETATION OF INTEREST COVERAGE RATIO

Interest Coverage Ratio shows the number of times the amount of Interest on long-term Borrowings is covered by the profits out of which that will be paid. It indicates the limit beyond which the ability of the firm to service its debt would be adversely affected. **For Example**, an Interest Coverage of 5 times would imply that even if the firm's Net Profit before Interest and Tax decreases by 80% of present level, the firm will still be able to pay interest out of profits. Higher the ratio, greater the firm's ability to pay interest but very high ratio may imply lesser use of debt and very efficient operations.

ILLUSTRATION 22

Net Profit before Interest and Tax ₹ 6,00,000. 15% Long term Borrowings ₹ 8,00,000. Calculate Interest Coverage Ratio.

SOLUTION:

Step 1: Interest on Long-term Borrowing = ₹ 8,00,000 × 15/100 = ₹ 1,20,000

Step 2: Interest Coverage Ratio = $\frac{\text{Net Profit before Interest and Tax}}{\text{Interest on Long-term Borrowings}} = \frac{\text{₹ 6,00,000}}{\text{₹ 1,20,000}} = 5 \text{ times}$

ILLUSTRATION 23

Net Profit after Interest and Tax ₹ 3,36,000, 15% Long term Borrowings ₹ 8,00,000. Tax Rate 30%, Calculate the Interest Coverage Ratio.

SOLUTION:

STEP 1: NET PROFIT BEFORE INTEREST & TAX

Particulars	₹
A Net Profit after interest & Tax	3,36,000
B Add: Tax [(₹ 3,36,000/0.70) × 30%]	1,44,000
C Net Profit after Interest but before Tax (A + B)	4,80,000
D Add: Interest on Long-term Borrowings [₹ 8,00,000 × 15%]	1,20,000
E Net Profit before Interest & tax (C + D)	6,00,000

Step 2: Interest Coverage Ratio = $\frac{\text{Net Profit before Interest and Tax}}{\text{Interest on Long-term Borrowings}} = \frac{\text{₹ 6,00,000}}{\text{₹ 1,20,000}} = 5 \text{ times}$

23.0 PREFERENCE DIVIDEND COVERAGE RATIO

MEANING OF PREFERENCE DIVIDEND COVERAGE RATIO

This ratio establishes a relationship between Net Profits after Interest and Taxes and Preference Dividend on Preference Shares.

OBJECTIVE OF PREFERENCE DIVIDEND COVERAGE RATIO

The objective of computing this ratio is to measure the Preference Shares servicing capacity of a firm so far as Fixed Dividend on Preference Shares is concerned.

COMPONENTS OF PREFERENCE DIVIDEND COVERAGE RATIO

There are two components of this ratio as follows:

1. Net Profits after Interest and Taxes;
2. Preference Dividend on Preference Shares

COMPUTATION OF PREFERENCE DIVIDEND COVERAGE RATIO

This ratio is computed by dividing the Net Profits after Interest and Taxes by Preference Dividend on Preference Shares. This ratio is usually expressed as 'X' number of times. In the form of a formula, this ratio may be expressed as follows:

$$\text{Preference Dividend Coverage Ratio} = \frac{\text{Net Profit after Interest and taxes}}{\text{Preference Dividend on Pref. Shares}}$$

INTERPRETATION OF PREFERENCE DIVIDEND COVERAGE RATIO

Preference Dividend Coverage Ratio shows the number of times the amount of Preference Dividend is covered by the profits out of which that will be paid. It indicates the limit beyond which the ability of the firm to service its preference share capital would be adversely affected. For instance, a Preference Dividend Coverage of five times would imply that even if the firm's Net Profits after Interest and Tax decrease by 80% of the present level, the firm will still be able to pay preference dividend out of profits. Higher the ratio, greater the firm's ability to pay preference dividend but very high ratio may imply lesser use of preference share capital and very efficient operations.

ILLUSTRATION 24

Calculate Preference Dividend Coverage Ratio from the following information:

15% Long term Borrowings ₹ 8,00,000, Net Profit before Interest & Tax ₹ 6,00,000, Tax ₹ 30%. 18% ₹ 1,00,000 Pref. Shares of ₹ 100 each.

SOLUTION:

$$\text{Interest on Long-term Borrowings} = ₹ 8,00,000 \times 15/100 = ₹ 1,20,000$$

$$\begin{aligned} \text{Net Profit after Interest \& Tax} &= \text{Net Profit before interest \& tax} - \text{Interest} - \text{tax} \\ &= ₹ 6,00,000 - ₹ 1,20,000 - ₹ 1,44,000 = ₹ 3,36,000 \end{aligned}$$

$$\text{Pref. Dividend} = 18\% \text{ of } ₹ 1,00,000 = ₹ 18,000$$

$$\begin{aligned} \text{Pref. Dividend Coverage Ratio} &= \frac{\text{Net Profit after Interest and taxes}}{\text{Preference Dividend on Pref. Shares}} \\ &= ₹ 3,36,000 / ₹ 18,000 = 18.67 \text{ times} \end{aligned}$$

24.0 DEBT-SERVICE COVERAGE RATIO

MEANING OF DEBT-SERVICE COVERAGE RATIO

This ratio measures the relationship between Net Profits before Interest & Tax **and** Interest + Principal portion of instalment.

OBJECTIVE OF DEBT-SERVICE COVERAGE RATIO

The objective of computing this ratio is to determine the firm's capacity to pay off both the Interest and Principal portion of the Instalment.

COMPONENTS OF DEBT-SERVICE COVERAGE RATIO

There are two components of this ratio as follows:

1. Net Profit before Interest and Tax
2. Interest and Principal portion of Instalment

COMPUTATION OF DEBT-SERVICE COVERAGE RATIO

This ratio is calculated by dividing the Net Profit before Interest and Tax by the aggregate of Interest and Principal portion of Instalment. It is usually expressed in number of times. In the form of a formula, this ratio may be expressed as follows:

$$\text{Debt – Service Ratio} = \frac{\text{Net Profit before Interest and Tax}}{\text{Interest} + \frac{\text{Principal portion of instalment}}{1 - \text{Tax Rate}}} = \dots \text{ times}$$

Note: The principal portion of instalment is adjusted for tax effects since such payment is not deductible from net profit for tax purposes.

INTERPRETATION OF DEBT-SERVICE COVERAGE RATIO

Debt-Service Coverage Ratio shows the number of times the amount of interest on long-term debts and the principal portion of instalment is covered by the profits out of which that will be paid. It indicates the limit beyond which the ability of the firm to service its debt would be adversely affected. For instance, a Debt Service Ratio of five times would imply that even if the firm's Net Profits before Interest and Tax decrease by 80% of the present level, the firm will still be able to pay interest and instalment out of profits. Higher the ratio, greater the firm's ability to pay current interest and instalment but very high ratio may imply lesser use of debt and very efficient operations.

Thus, an enterprise should have *neither* a very high *nor* a very low ratio, it should have a satisfactory ratio. To judge whether the ratio is satisfactory or not, it should be compared with its own past ratios or with the ratio of similar enterprises in the same industry or with the industry average.

ILLUSTRATION 25

Net Profit before Interest and Tax ₹ 8,50,000, 10% Debentures (payable in 10 instalments) ₹ 7,00,000. Tax Rate 30%, Calculate Debt-Service Coverage Ratio.

SOLUTION:

$$\begin{aligned} \text{Debt Service Coverage Ratio} &= \frac{\text{Net Profit before Interest and Tax}}{\text{Interest} + \frac{\text{Principal portion of instalment}}{1 - \text{Tax Rate}}} \\ &= \frac{₹8,50,000}{₹70,000 + \frac{₹70,000}{(1 - 0.3)}} = 5 \text{ times} \end{aligned}$$

ALTERNATIVE APPROACH

Some Accountants who are interested in determining the firm's Operating capacity to pay off both interest and principal, prefer to calculate the Debt Service Coverage Ratio as follows:

$$\text{Debt-Service Coverage Ratio} = \frac{\text{Funds from operations before Interest and Tax}}{\text{Interest} + \frac{\text{Principal portion of instalment}}{1 - \text{Tax Rate}}}$$

Note: Funds from operations before Interest and Taxes is computed as follows:

A. Net Profit before Interest and Taxes	xxx
B. Add: Depreciation	xxx
C. Add: Amortisation like goodwill, preliminary expenses	xxx
D. Add: Non-Operating Adjustments like Loss on Sale of Fixed Assets	xxx
E. Funds from operations	xxx

ILLUSTRATION 26

Net Profit before Interest and Tax ₹ 8,50,000, 10% Debentures (payable in 10 instalments) ₹ 7,00,000, Depreciation ₹ 1,00,000, Goodwill w/o ₹ 50,000, Loss on Sale of Fixed Assets ₹ 20,000, Tax Rate 30% Calculate Debt Service Coverage Ratio.

SOLUTION:**STEP 1: CASH FROM OPERATIONS BEFORE INTEREST AND TAX**

A. Net Profit before Interest and Tax	8,50,000
B. Add: Depreciation	1,00,000
C. Add: Goodwill w/o	50,000
D. Add: Loss on Sale of Fixed Asset	20,000
E. Funds from Operations before Interest and Tax	10,20,000

Step 2:

$$\begin{aligned} \text{Debt-Service coverage Ratio} &= \frac{\text{Funds from operations before Interest and Tax}}{\text{Interest} + \frac{\text{Principal portion of instalment}}{1 - \text{Tax Rate}}} \\ &= \frac{₹10,20,000}{₹70,000 + \frac{₹70,000}{1 - 0.3}} = ₹ 10,20,000 / ₹ 1,70,000 = 6 \text{ times} \end{aligned}$$

25.0 FIXED CHARGES COVERAGE RATIO**MEANING OF FIXED CHARGES COVERAGE RATIO**

This ratio measures the relationship between Cash from operations before Interest and Taxes and Interest *plus* Fixed Financial Charges before tax.

OBJECTIVE OF FIXED CHARGES COVERAGE RATIO

The objective of computing Fixed Charges Coverage Ratio is to measure the Capacity of an enterprise to pay off its Fixed Financial Charges.

COMPONENTS OF FIXED CHARGES COVERAGE RATIO

There are two components of this ratio as follows:

- Cash from Operations before Interest and Taxes** which is computed as follows:

A. Net Profit before Interest and Taxes	xxx
B. Add: Depreciation	xxx
C. Add: Amortisation like goodwill, preliminary expenses	xxx
D. Add: Non-Operating Adjustments like Loss on Sale of Fixed Assets	xxx
E. Add: Decrease in Current Assets and Increase in Current Liabilities	xxx
F. Less: Increase in Current Assets and Decrease in Current Liabilities	(xxx)
G. Cash from operations	xxx

- Interest *plus* Fixed Financial Charges before tax.**

COMPUTATION OF FIXED CHARGES COVERAGE RATIO

This ratio is calculated by dividing the **Cash from operations before Interest and Taxes** by the aggregate of Interest *plus* Fixed Financial Charges before tax. It is usually expressed in number of times. In the form of a formula, this ratio may be expressed as follows:

$$\text{Fixed Charges Coverage Ratio} = \frac{\text{Cash from operations before Interest and Taxes}}{\text{Interest plus Fixed Financial Charges before tax}}$$

INTERPRETATION OF FIXED CHARGES COVERAGE RATIO

Fixed Charges Coverage Ratio shows the number of times the amount of Fixed Financial Charges is covered by the Cash from operations out of which that will be paid. It indicates the limit beyond which the ability of the firm to service its Fixed Financial Charges would be adversely affected. **For Example**, a Fixed Charges Coverage Ratio of 5 times would imply that even if the firm's Cash from operations before Interest and Tax decreases by 80% of present level, the firm will still be able to pay Fixed Financial Charges. Higher the ratio, greater the firm's ability to pay Fixed Financial Charges but very high ratio may imply lesser use of debt and very efficient operations.

Thus, an enterprise should have *neither* a very high *nor* a very low ratio, it should have a satisfactory ratio. To judge whether the ratio is satisfactory *or* not, it should be compared with its own past ratios *or* with the ratio of similar enterprises in the same industry *or* with the industry average.

ILLUSTRATION 27

Net Profit before Interest and Tax ₹ 8,50,000, Interest ₹ 70,000, Depreciation ₹ 1,00,000, Goodwill w/o ₹ 50,000, Loss on Sale of Fixed Asset ₹ 20,000, Increase in Current Assets ₹ 3,10,000, Decrease in Current Liabilities ₹ 2,00,000, Tax Rate 30%, Fixed Charges other than Interest ₹ 1,00,000 Calculate Fixed Charges Coverage Ratio.

SOLUTION:

STEP 1: CASH FROM OPERATIONS BEFORE INTEREST AND TAX

A. Net Profit before Interest and Tax	8,50,000
B. Add: Depreciation	1,00,000
C. Add: Goodwill w/o	50,000
D. Add: Loss on Sale of Fixed Asset	20,000
E. Less: Increase in Current Assets	(3,10,000)
Decrease in Current Liabilities	(2,00,000)
F. Cash from Operations before Interest and Tax	5,10,000

$$\begin{aligned} \text{Fixed Charges Coverage Ratio} &= \frac{\text{Cash from operations before Interest and Taxes}}{\text{Interest plus Fixed Financial Charges before tax}} \\ &= \frac{₹ 5,10,000}{₹ 70,000 + ₹ 1,00,000} = 3 \text{ times} \end{aligned}$$

26.0 ACTIVITY RATIOS

Meaning	Activity Ratios measure the effectiveness with which a firm uses its available resources. These ratios help in commenting on the efficiency of the enterprise in managing its assets. These ratios are also called 'Turnover Ratios' since they indicate the speed with which the resources are being turned (or converted) into Revenue from Operations.

Activity Ratios	Usually the following Activity Turnover Ratios are calculated: 1. Total Assets Turnover Ratio 2. Capital Turnover Ratio 3. Fixed Assets Turnover Ratio 4. Current Assets Turnover Ratio 5. Net Working Capital Turnover Ratio 6. Inventory/Stock Turnover Ratio 7. Receivables/Debtors Turnover Ratio 8. Payables/Creditors Turnover Ratio TUTORIAL NOTE <i>These ratios may be calculated with reference to Revenue from Operations or Cost of Revenue from Operations but the same basis (i.e., Revenue from Operations or Cost of Revenue from Operations) once selected, should be used on consistent basis so as to facilitate the comparison of figures of one year with that of another year.</i>

27.0 TOTAL ASSETS TURNOVER RATIO

MEANING OF TOTAL ASSETS TURNOVER RATIO

This ratio establishes a relationship between Net Revenue from Operations/Net Sales and Average Total Assets.

OBJECTIVE OF TOTAL ASSETS TURNOVER RATIO

The objective of computing this ratio is to determine the efficiency with which the Total Assets are utilised.

COMPONENTS OF TOTAL ASSETS TURNOVER RATIO

There are two components of this ratio as follows:

1. **Net Revenue from Operations/Net Sales = Credit Revenue from Operations + Cash Revenue from Operations**
2. **Average Total Assets = [Opening Total Assets + Closing Total Assets]/2**

Note: Total Assets may be calculated as follows:

- (a) Total Assets = Non-Current Assets + Current Assets
- (b) Total Assets = Equity Share Capital + Pref. Share Capital + Reserves & Surplus + Non-Current Liabilities + Current Liabilities
- (c) Total Assets = Shareholders' Funds + Non-Current Liabilities + Current Liabilities
- (d) Total Assets = Capital Employed + Current Liabilities

TUTORIAL NOTES

- (a) *Non-Operating Assets (e.g., Non- Trade Investments, Advance for purchase of Fixed Assets, Capital Work-in-Progress) should not be considered while computing 'Total Assets' since these Non-Operating Assets have not been put to use to generate Revenue from Operations/ Sales. If these Non-Operating Assets are considered while computing 'Total Assets', Total Assets Turnover Ratio will unnecessarily be lower which does not reflect the true picture at all.*

- (b) 'Provision for Doubtful Debts' is not deducted from the total amount of Trade Receivables.
- (c) Author feels that the figure of 'Total Assets' should be fairly representative of the investment in Total Assets throughout the accounting period and hence it is advised to make use of the concept of 'Average Total Assets'.
- (d) This Ratio should be calculated with reference to Average Total Assets as per the requirement and availability of information. If information is available, then Average shall be taken.
- (e) If 'Average Total Assets' cannot be ascertained due to non-availability of information, 'Closing Total Assets' may be used by giving a suitable note to that effect.

COMPUTATION OF TOTAL ASSETS TURNOVER RATIO

This ratio is computed by dividing the Net Revenue from Operations/Net Sales by Average Total Assets. This ratio is usually expressed as 'x' number of times. In the form of a formula, this ratio may be expressed as follows:

$$\text{Total Assets Turnover Ratio} = \frac{\text{Net Revenue from Operations/Net Sales}}{\text{Average Total Assets}} = \dots \text{Times}$$

INTERPRETATION OF TOTAL ASSETS TURNOVER RATIO

It indicates the firm's ability to generate Revenue from Operations/Sales per rupee of Investment in Total Assets. In general, higher the ratio, the more efficient the management and utilisation of Total Assets, and vice versa. It may be noted that there is no direct relationship between Sales and All Total Assets since the Sales are influenced by other factors as well (e.g., quality of product, delivery terms, credit terms, after sales service, advertisement and publicity etc.).

To judge whether the ratio is satisfactory or not, it should be compared with its own past ratios or with the ratio of similar enterprises in the same industry or with the industry average.

PRECAUTION WHILE USING TOTAL ASSETS TURNOVER RATIO

While computing and using the Total Assets Turnover Ratio it must be ensured (a) that the age and quality of Total Assets have been carefully assessed (b) that all the Total Assets have been properly valued. An enterprise whose Total Assets are old may show a higher Total Assets Turnover Ratio than the enterprise which has purchased them recently.

ILLUSTRATION 28

From the following information, Calculate Total Assets Turnover Ratio:

Particulars	₹	Particulars	₹
Equity Share Capital (₹ 10 each)	6,30,000	Tangible Fixed Assets	14,00,000*
		*including ₹ 5,00,000 for Building under construction	
18% Pref. Share capital	1,00,000	Intangible Fixed Assets	1,50,000
Reserves & Surplus	1,50,000	Non- Current Investments (Trade)	50,000
15% Long-term Borrowings	8,00,000	Current Assets ₹ 5,00,000	
Current Liabilities	4,00,000	Less: Provision for Doubtful Debts (₹ 20,000)	4,80,000
Credit Revenue from Operations	15,00,000	Cash Revenue from Operations	5,00,000

SOLUTION:

Step 1: Revenue from Operations = ₹ 15,00,000 + ₹ 5,00,000 = ₹ 20,00,000

Step 2: Total Assets = Non-Current Assets + Current Assets
 = [₹ 9,00,000 + ₹ 1,50,000 + ₹ 50,000] + ₹ 5,00,000 = ₹ 16,00,000

Step 3: Total Assets Turnover Ratio = $\frac{\text{Net Revenue from Operations}}{\text{Average Total Assets}} = \frac{\text{₹ 20,00,000}}{\text{₹ 16,00,000}} = 1.25 \text{ times}$

Notes:

1. Non-Operating Asset (i.e Building under construction) has not be considered while computing 'Total Assets' since it has not yet been put to use to generate any Revenue from Operations/ Sales.
2. 'Provision for Doubtful Debts' is not deducted from the total amount of Trade Receivables .
3. Since 'Average Total Assets' cannot be ascertained due to non-availability of information, 'Closing Total Assets' have been used.

28.0 CAPITAL TURNOVER RATIO**MEANING OF CAPITAL TURNOVER RATIO**

This ratio establishes a relationship between Net Revenue from Operations/Net Sales and Average Capital Employed.

OBJECTIVE OF CAPITAL TURNOVER RATIO

The objective of computing this ratio is to determine the efficiency with which the Capital Employed is utilised.

COMPONENTS OF CAPITAL TURNOVER RATIO

There are two components of this ratio as follows:

1. **Net Revenue from Operations/Net Sales = Credit Revenue from Operations + Cash Revenue from Operations**
2. **Average Capital Employed = [Opening Capital Employed + Closing Capital Employed]/2**

Note: Capital Employed means long-term funds supplied by the Long-term Creditors and Shareholders. It can be calculated as follows:

- (a) Capital Employed = [(Equity Share Capital + Pref. Share Capital + Reserves & Surplus)] + Non-Current Liabilities.
- (b) Capital Employed = Shareholders' Funds + Non-Current Liabilities
- (c) Capital Employed = Non-Current Assets (excluding Non-Operating Assets) + Current Assets – Current Liabilities.
- (d) Capital Employed = Non-Current Assets (excluding Non-Operating Assets) + Working Capital
- (e) Capital Employed = Total Assets (excluding Non-Operating Assets) – Current Liabilities

TUTORIAL NOTES

- (a) *Non-Operating Assets (e.g., Non- Trade Investments, Advance for purchase of Fixed Assets, Capital Work-in-Progress) should not be considered while computing 'Capital Employed' since these Non-Operating Assets have not been put to use to generate Revenue from Operations/ Sales. If these Non-Operating Assets are considered while computing 'Capital Employed', Capital Turnover Ratio will unnecessarily be lower which does not reflect the true picture at all.*

- (b) 'Provision for Doubtful Debts' is not deducted from the total amount of Trade Receivables.
- (c) Author feels that the figure of 'Capital Employed' should be fairly representative of the capital investment throughout the accounting period and hence it is advised to make use of the concept of 'Average Capital Employed'.
- (d) This Ratio should be calculated with reference to Average Capital Employed as per the requirement and availability of information. If information is available, then Average shall be taken.
- (e) If 'Average Capital Employed' cannot be ascertained due to non-availability of information, 'Closing Capital Employed' may be used by giving a suitable note to that effect.

COMPUTATION OF CAPITAL TURNOVER RATIO

This ratio is computed by dividing the Net Revenue from Operations/Net Sales and Average Capital Employed. This ratio is usually expressed as 'x' number of times. In the form of a formula, this ratio may be expressed as follows:

$$\text{Capital Turnover Ratio} = \frac{\text{Net Revenue from Operations/Net Sales}}{\text{Average Capital Employed}} = \dots \text{Times}$$

INTERPRETATION OF CAPITAL TURNOVER RATIO

It indicates the firm's ability to generate Revenue from Operations/Sales per rupee of Capital Employed. In general, higher the ratio, the more efficient the management and utilisation of capital employed. A too high ratio may indicate the situation of over-trading (or under-capitalisation) if current ratio is lower than that required reasonably and vice versa.

Thus, an enterprise should have *neither* a very high *nor* a very low ratio, it should have a satisfactory ratio. To judge whether the ratio is satisfactory or not, it should be compared with its own past ratios or with the ratio of similar enterprises in the same industry or with the industry average.

ILLUSTRATION 29

From the following information Calculate Capital Turnover Ratio:

Particulars	₹	Particulars	₹
Equity Share Capital (₹ 10 each)	6,30,000	Tangible Fixed Assets	14,00,000*
		*including ₹ 5,00,000 for Building under construction	
18% Pref. Share capital	1,00,000	Intangible Fixed Assets	1,50,000
Reserves & Surplus	1,50,000	Non- Current Investments (Trade)	50,000
15% Long-term Borrowings	8,00,000	Current Assets ₹ 5,00,000	
Current Liabilities	4,00,000	Less: Provision for Doubtful Debts (₹ 20,000)	4,80,000
Credit Revenue from Operations	15,00,000	Cash Revenue from Operations	5,00,000

SOLUTION:

Step 1: Revenue from Operations = ₹ 15,00,000 + ₹ 5,00,000 = ₹ 20,00,000

Step 2: Capital Employed = Non-Current Assets + Current Assets – Current Liabilities
 = [₹ 9,00,000 + ₹ 1,50,000 + ₹ 50,000] + ₹ 5,00,000 – ₹ 4,00,000 = ₹ 12,00,000

Step 3: Capital Turnover Ratio = $\frac{\text{Revenue from Operations}}{\text{Average Capital Employed}} = \frac{₹ 20,00,000}{₹ 12,00,000} = 1.667 \text{ times}$

Notes:

1. Non-Operating Asset (i.e Building under construction) has not be considered while computing 'Total Assets' since it has not yet been put to use to generate any Revenue from Operations/ Sales.
2. 'Provision for Doubtful Debts' is not deducted from the total amount of Trade Receivables .
3. Since 'Average Capital Employed' cannot be ascertained due to non-availability of information, 'Closing Capital Employed' has been used.

29.0 FIXED ASSETS TURNOVER RATIO**MEANING OF FIXED ASSETS TURNOVER RATIO**

This ratio establishes a relationship between Net Revenue from Operations/Net Sales and Average Net Fixed Assets .

OBJECTIVE OF FIXED ASSETS TURNOVER RATIO

The objective of computing this ratio is to determine the efficiency with which the Fixed Assets are utilised.

COMPONENTS OF FIXED ASSETS TURNOVER RATIO

There are two components of this ratio as follows:

1. **Net Revenue from Operations/Net Sales = Credit Revenue from Operations + Cash Revenue from Operations**
2. **Average Net Fixed Assets = Opening Net Fixed Assets + Closing Net Fixed Assets]/2**

Note: Net Fixed Assets=Gross Fixed Assets – Depreciation thereon.

TUTORIAL NOTES

- (a) *Non-Operating Assets (e.g., Non- Trade Investments, Advance for purchase of Fixed Assets, Capital Work-in-Progress) should not be considered while computing 'Fixed Assets' since these Non-Operating Assets have not been put to use to generate Revenue from Operations/ Sales. If these Non-Operating Assets are considered while computing 'Fixed Assets',Fixed Assets Ratio will unnecessarily be lower which does not reflect the true picture at all.*
- (b) *Author feels that the figure of Net Fixed Assets' should be fairly representative of the investment in Net Fixed assets throughout the accounting period and hence it is advised to make use of the concept of 'Average Net Fixed Assets'*
- (c) *This Ratio should be calculated with reference to Average Net Fixed Assets as per the requirement and availability of information. If information is available,then Average shall be taken.*
- (d) *If 'Average Net Fixed Assets' cannot be ascertained due to non-availability of information, 'Closing Net Fixed Assets' may be used by giving a suitable note to that effect.*

COMPUTATION OF FIXED ASSETS TURNOVER RATIO

This ratio is computed by dividing the Net Revenue from Operations/Net Sales by the Net Fixed Assets. This ratio is usually expressed as 'x' number of times. In the form of a formula, this ratio may be expressed as follows:

$$\text{Fixed Assets Turnover Ratio} = \frac{\text{Revenue from Operations/Sales}}{\text{Average Net Fixed Assets}} = \dots \text{Times}$$

INTERPRETATION OF FIXED ASSETS TURNOVER RATIO

It indicates the firm's ability to generate Revenue from Operations/Sales per rupee of Investment in Fixed Assets. In general, higher the ratio, the more efficient the management and utilisation of fixed assets, and vice versa. It may be noted that there is no direct relationship between sales and fixed assets since the sales are influenced by other factors as well (e.g., quality of product, delivery terms, credit terms, after sales service, advertisement and publicity etc.)

To judge whether the ratio is satisfactory or not, it should be compared with its own past ratios or with the ratio of similar enterprises in the same industry or with the industry average.

PRECAUTION WHILE USING FIXED ASSETS TURNOVER RATIO

While computing and using the Fixed Assets Turnover Ratio it must be ensured (a) that the age and quality of fixed assets have been carefully assessed (b) that all the fixed assets have been properly valued. An enterprise whose fixed assets are old may show a higher Fixed Assets Turnover Ratio than the enterprise which has purchased them recently.

ILLUSTRATION 30

Tangible Fixed Assets (including ₹ 5,00,000 for Building under construction) (at cost) ₹ 14,00,000, Intangible Fixed Assets (at cost) ₹ 3,00,000, Accumulated Depreciation till date ₹ 1,00,000, Credit Revenue from Operations ₹ 15,00,000, Cash Revenue from Operations ₹ 5,00,000. Calculate Fixed Assets Turnover Ratio.

SOLUTION:

Step 1: Revenue from Operations = ₹ 15,00,000 + ₹ 5,00,000 = ₹ 20,00,000

Step 2: Net Fixed Assets = Tangible Fixed Assets (at cost) + Intangible Fixed Assets (at cost) – Depreciation
 = (₹ 14,00,000 – ₹ 5,00,000) + ₹ 3,00,000 – ₹ 1,00,000 = ₹ 11,00,000

Step 3: Fixed Assets Turnover Ratio = $\frac{\text{Revenue from Operations}}{\text{Average Net Fixed Assets}} = \frac{\text{₹ 20,00,000}}{\text{₹ 11,00,000}} = 1.818 \text{ Times}$

Notes:

1. Non-Operating Asset (i.e Building under construction) has not be considered while computing 'Fixed Assets' since it has not yet been put to use to generate any Revenue from Operations/ Sales.
2. Since 'Average Net Fixed Assets' cannot be ascertained due to non-availability of information, 'Closing Net Fixed Assets' have been used.

30.0 CURRENT ASSETS TURNOVER RATIO**MEANING OF CURRENT ASSETS TURNOVER RATIO**

This ratio establishes a relationship between Net Revenue from Operations/Net Sales and Average Current Assets .

OBJECTIVE OF CURRENT ASSETS TURNOVER RATIO

The objective of computing this ratio is to determine the efficiency with which the Current Assets are utilised.

COMPONENTS OF CURRENT ASSETS TURNOVER RATIO

There are two components of this ratio as follows:

1. Net Revenue from Operations/NetSales = Credit Revenue from Operations + Cash Revenue from Operations
2. Average Current Assets = [Opening Current Assets + Closing Current Assets]/2

TUTORIAL NOTES

- (a) 'Provision for Doubtful Debts' is not deducted from the total amount of Trade Receivables .
- (b) Author feels that the figure of 'Current Assets' should be fairly representative of the investment in Current Assets throughout the accounting period and hence it is advised to make use of the concept of 'Average Current Assets. '
- (c) This Ratio should be calculated with reference to Average Current Assets as per the requirement and availability of information. If information is available, then Average shall be taken.
- (d) If 'Average Current Assets ' cannot be ascertained due to non-availability of information, 'Closing Current Assets ' may be used by giving a suitable note to that effect.

COMPUTATION OF CURRENT ASSETS TURNOVER RATIO

This ratio is computed by dividing the Net Revenue from Operations/Net Sales by the Average Current Assets. This ratio is usually expressed as 'x' number of times. In the form of a formula, this ratio may be expressed as follows:

$$\text{Current Assets Turnover Ratio} = \frac{\text{Net Revenue from Operations/Net Sales}}{\text{Average Current Assets}} = \dots \text{Times}$$

INTERPRETATION OF CURRENT ASSETS TURNOVER RATIO

It indicates the firm's ability to generate Net Revenue from Operations/Net Sales per rupee of Investment in Current Assets. In general, higher the ratio, the more efficient the management and utilisation of current assets, and vice versa. It may be noted that there is no direct relationship between Sales and Current Assets since the sales are influenced by other factors as well (e.g., quality of product, delivery terms, credit terms, after sales service, advertisement and publicity etc.). To judge whether the ratio is satisfactory or not, it should be compared with its own past ratios or with the ratio of similar enterprises in the same industry or with the industry average.

ILLUSTRATION 31

Inventories ₹ 2,50,000, Trade Receivables ₹ 2,00,000, Other Current Assets ₹ 50,000, Provision for Doubtful Debts ₹ 20,000, Credit Revenue from Operations ₹ 15,00,000, Cash Revenue from Operations ₹ 5,00,000. Calculate Fixed Assets Turnover Ratio.

SOLUTION:

Step 1: Revenue from Operations = ₹ 15,00,000 + ₹ 5,00,000 = ₹ 20,00,000

Step 2: Current Assets = ₹ 2,50,000 + ₹ 2,00,000 + ₹ 50,000 = ₹ 5,00,000

Step 3: Current Assets Turnover Ratio = $\frac{\text{Net Revenue from Operations}}{\text{Average Current Assets}} = \frac{\text{₹ 20,00,000}}{\text{₹ 5,00,000}} = 4 \text{ Times}$

Notes:

1. 'Provision for Doubtful Debts' is not deducted from the total amount of Trade Receivables.
2. Since 'Average Current Assets' cannot be ascertained due to non-availability of information, 'Closing Current Assets' have been used.

31.0 WORKING CAPITAL TURNOVER RATIO**MEANING OF WORKING CAPITAL TURNOVER RATIO**

Working Capital Turnover ratio establishes a relationship between Net Revenue from Operations/Net Sales and Average Working Capital.

OBJECTIVE OF WORKING CAPITAL TURNOVER RATIO

The objective of computing Working Capital Turnover ratio is to determine the efficiency with which the Working Capital is utilised.

COMPONENTS OF WORKING CAPITAL TURNOVER RATIO

There are two components of Working Capital Turnover Ratio as follows:

1. **Net Revenue from Operations/Net Sales = Credit Revenue from Operations + Cash Revenue from Operations**
2. **Average Working Capital = [Opening Working Capital + Closing Working Capital]/2**

Note: Working Capital = Current Assets – Current Liabilities.

TUTORIAL NOTES

- (a) 'Provision for Doubtful Debts' is not deducted from the total amount of Trade Receivables .
- (b) Author feels that the figure of 'Working Capital' should be fairly representative of the investment in Working Capital throughout the accounting period and hence it is advised to make use of the concept of 'Average Working Capital. '
- (c) This Ratio should be calculated with reference to Average Working Capital as per the requirement and availability of information. If information is available, then Average shall be taken.
- (d) If 'Average Working Capital ' cannot be ascertained due to non-availability of information, 'Closing Working Capital ' may be used by giving a suitable note to that effect.

COMPUTATION OF WORKING CAPITAL TURNOVER RATIO

Working Capital Turnover Ratio is computed by dividing the Net Revenue from Operations/Net Sales by Average Working Capital. This ratio is usually expressed as 'x' number of times. In the form of a formula, this ratio may be expressed as follows:

$$\text{Working Capital Turnover Ratio} = \frac{\text{Net Revenue from Operations/Net Sales}}{\text{Average Working Capital}} = \dots \text{Times}$$

INTERPRETATION OF WORKING CAPITAL TURNOVER RATIO

Working Capital Turnover indicates the firm's ability to generate Revenue from Operations/Sales per rupee of Working Capital. In general, higher the ratio, the more efficient the management and utilisation of working capital and vice versa.

To judge whether the ratio is satisfactory or not, it should be compared with its own past ratios or with the ratio of similar enterprises in the same industry or with the industry average.

ILLUSTRATION 32

Inventories ₹ 2,50,000, Trade Receivables ₹ 2,00,000, Other Current Assets ₹ 50,000, Provision for Doubtful Debts ₹ 20,000, Current Liabilities ₹ 4,00,000, Credit Revenue from Operations ₹ 15,00,000, Cash Revenue from Operations ₹ 5,00,000. Calculate Working Capital Turnover Ratio.

SOLUTION:

Step 1: Revenue from Operations = ₹ 15,00,000 + ₹ 5,00,000 = ₹ 20,00,000

Step 2: Working Capital = Current Assets – Current Liabilities
 = [₹ 2,50,000 + ₹ 2,00,000 + ₹ 50,000] – ₹ 4,00,000 = ₹ 1,00,000

Step 3:
$$\frac{\text{Net Revenue from Operations}}{\text{Average Working Capital}} = \frac{\text{₹ 20,00,000}}{\text{₹ 1,00,000}} = 20 \text{ times}$$

Notes:

1. 'Provision for Doubtful Debts' is not deducted from the total amount of Trade Receivables .
2. Since 'Average Working Capital ' cannot be ascertained due to non-availability of information, 'Closing Working Capital ' has been used.

32.0 INVENTORY TURNOVER RATIO**MEANING OF INVENTORY TURNOVER RATIO**

Inventory Turnover Ratio establishes a relationship between Cost of Revenue from Operations and Average Inventory.

OBJECTIVE OF INVENTORY TURNOVER RATIO

The objective of computing Inventory Turnover ratio is to determine the efficiency with which the Inventory of Finished Goods is converted into Revenue from Operations.

COMPONENTS OF INVENTORY TURNOVER RATIO

There are two components of Inventory Turnover Ratio as follows:

1. Cost of Revenue from Operations

Note: Cost of Revenue from Operations can be calculated as follows:

- (a) = Opening Inventory + Net Purchases + Direct Expenses – Closing Inventory
- (b) = Cost of Materials Consumed + Purchases of Stock-in-Trade + Changes in Inventories of Finished Goods + Direct Expenses
- (c) = Revenue from Operations – Gross Profit
- (d) = Revenue from Operations + Gross Loss

2. Average Inventory = (Opening Inventory + Closing Inventory)/2**TUTORIAL NOTES**

- (a) *Inventory here means Inventory of Finished Goods.*
- (b) *If 'Average Inventory' cannot be ascertained due to non-availability of information, 'Closing Inventory' may be used by giving a suitable note to that effect.*
- (c) *If Cost of Revenue from Operations can not be ascertained, Revenue from Operations may be used by giving a suitable note to that effect.*
- (d) *Cost of Revenue from Operations/Revenue from Operations should be Net of Excise Duty.*
- (e) *In case of enterprises (e.g., Departmental Retail Stores) valuing their inventories at selling prices, the Inventory Turnover Ratio is best expressed through the relationship between 'Revenue from Operations' and 'Average Inventory at Selling Prices'.*

COMPUTATION OF INVENTORY TURNOVER RATIO

Inventory Turnover Ratio is computed by dividing the Cost of Revenue from Operations by the Average Inventory. This ratio is usually expressed as 'x' number of times. In the form of a formula, this ratio may be expressed as follows:

$$\text{Inventory Turnover Ratio} = \frac{\text{Cost of Revenue from Operations}}{\text{Average Inventory}} = \dots \text{Times}$$

INTERPRETATION OF INVENTORY TURNOVER RATIO

Inventory turnover indicates the speed with which the Inventory is converted into Revenue from Operations. In general, a high ratio indicates efficient performance since an improvement in the ratio shows that *either* the same volume of Revenue from Operations has been maintained with a lower investment in Inventory, *or* the volume of Revenue from Operations has increased without any increase in the amount of Inventory. However, too high ratio and too low ratio call for further investigation. A too high ratio may be the result of a very low inventory levels which may result in frequent Inventory-outs and thus the firm may incur high Inventory-out costs. On the other hand, a too low ratio may be the result of excessive inventory levels, slow-moving or obsolete inventory and thus, the firm may incur high carrying costs. Thus, a firm should have *neither* a very high *nor* a very low Inventory Turnover Ratio, it should have a satisfactory level.

INVENTORY VELOCITY

Inventory Velocity indicates the period for which Revenue from Operations can be generated with the help of an Average Inventory maintained and is expressed in terms of period. This velocity may be calculated as follows:

$$\text{Inventory Velocity} = \frac{\text{Average Inventory}}{\text{Average Cost of Revenue from Operations per day}} = \dots \text{Days}$$

$$\text{or} \quad = \frac{12 \text{ months} / 52 \text{ weeks} / 365 \text{ days}}{\text{Inventory Turnover Ratio}} = \dots \text{Months/Weeks/Days}$$

Note: Average Cost of Revenue from Operations per day

$$= \frac{\text{Cost of Revenue from Operations}}{\text{No. of Working Days in the year}}$$

ILLUSTRATION 33

Opening Inventory ₹ 20,000, Closing Inventory ₹ 6,000, Purchases ₹ 46,000, Wages ₹ 3,000, Carriage inward ₹ 2,000, Freight outward ₹ 5,000. Calculate Inventory Turnover Ratio.

SOLUTION:

Step 1: Cost of Revenue from Operations

$$\begin{aligned} &= \text{Opening Inventory} + \text{Purchases} + \text{Direct Expenses} - \text{Closing Inventory} \\ &= ₹ 20,000 + ₹ 46,000 + (₹ 3,000 + ₹ 2,000) - ₹ 6,000 = ₹ 65,000 \end{aligned}$$

Step 2: Average Inventory = (Opening Inventory + Closing Inventory) / 2

$$= (₹ 20,000 + ₹ 6,000) / 2 = ₹ 13,000$$

$$\text{Step 3: Inventory Turnover Ratio} = \frac{\text{Cost of Revenue from Operations}}{\text{Average Inventory}} = \frac{₹ 65,000}{₹ 13,000} = 5 \text{ Times}$$

ILLUSTRATION 34

Cash Revenue from Operations ₹ 1,00,000, Credit Revenue from Operations ₹ 3,00,000, Gross Profit 25% on Revenue from Operations, Opening Inventory was 1/3rd of the value of Closing Inventory, Closing Inventory was 30% of Cost of Revenue from Operations. Calculate Inventory Turnover Ratio.

SOLUTION:

Step 1: Cost of Revenue from Operations = Revenue from Operations – Gross Profit

$$= (₹ 1,00,000 + ₹ 3,00,000) - (25\% \text{ of } ₹ 4,00,000) = ₹ 3,00,000$$

Step 2: Closing Inventory = 30% of ₹ 3,00,000 = ₹ 90,000

Step 3: Opening Inventory = ₹ 90,000 × 1/3 = ₹ 30,000

Step 4: Average Inventory = (Opening Inventory + Closing Inventory)/2
= (₹ 90,000 + ₹ 30,000)/2 = ₹ 60,000

Step 5: Inventory Turnover Ratio = $\frac{\text{Cost of Revenue from Operations}}{\text{Average Inventory}}$ = ₹3,00,000/₹60,000 = 5 times

ILLUSTRATION 35

Cash Revenue from Operations 25% of total Revenue from Operations, Credit Revenue from Operations ₹ 3,00,000, Gross Profit 33-1/3% on Cost of Revenue from Operations, Inventory Turnover Ratio 3 Times, Inventory at the end was 3 times that in the beginning. Calculate Opening Inventory and Closing Inventory.

SOLUTION:

Step 1: Cost of Revenue from Operations
= (Cash Revenue from Operations + Credit Revenue from Operations) – Gross Profit
= (₹ 1,00,000 + ₹ 3,00,000) – (₹ 4,00,000 × 25/100) = ₹ 3,00,000

Step 2: Inventory Turnover Ratio = $\frac{\text{Cost of Revenue from Operations}}{\text{Average Inventory}}$

$$3 = ₹3,00,000/\text{Average Inventory}$$

$$\text{Average Inventory} = ₹ 3,00,000/3 = ₹ 1,00,000$$

$$(\text{OS} + \text{CS})/2 = ₹ 1,00,000$$

$$\text{or, OS} + \text{CS} = ₹ 1,00,000 \times 2 = ₹ 2,00,000$$

$$\text{OS} + \text{CS} = ₹ 2,00,000$$

Eq. I

$$\text{CS} - 3 \text{ OS} = 0$$

Eq. II

Subtracting Eq. II from Eq. I

$$4 \text{ OS} = ₹ 2,00,000$$

$$\text{OS} = ₹ 2,00,000/4 = ₹ 50,000$$

$$\text{CS} = ₹ 50,000 \times 3 = ₹ 1,50,000$$

ILLUSTRATION 36

Cash Revenue from Operations 25% of total Revenue from Operations, Credit Revenue from Operations ₹ 3,00,000, Gross Profit 33-1/3% on Cost of Revenue from Operations, Inventory Turnover Ratio 3 Times, Inventory at the end was 3 times more than that in the beginning. Calculate Opening Inventory and Closing Inventory.

SOLUTION:

Step 1: Cost of Revenue from Operations
= Cash Revenue from Operations + Credit Revenue from Operations – Gross Profit
= ₹ 1,00,000 + ₹ 3,00,000 – (₹ 4,00,000 × 25/100) = ₹ 3,00,000

Step 2: Inventory Turnover Ratio = $\frac{\text{Cost of Revenue from Operations}}{\text{Average Inventory}}$

$$3 = ₹3,00,000/\text{Average Inventory}$$

$$\text{Average Inventory} = ₹ 3,00,000/3 = ₹ 1,00,000$$

$$(\text{OS} + \text{CS})/2 = ₹ 1,00,000$$

$$\text{or, OS} + \text{CS} = ₹ 1,00,000 \times 2 = ₹ 2,00,000$$

$$\text{OS} + \text{CS} = ₹ 2,00,000$$

...Eq. I

$$\text{CS} - 4\text{OS} = 0$$

...Eq. II

Subtracting Eq. II from Eq. I

$$5 \text{ OS} = ₹ 2,00,000$$

$$\text{OS} = ₹ 2,00,000 / 5 = ₹ 40,000$$

$$\text{CS} = ₹ 40,000 \times 4 = ₹ 1,60,000$$

ILLUSTRATION 37 [EFFECT ON INVENTORY TURNOVER RATIO]

The Inventory Turnover Ratio of company is 5 times. State giving reason. Which of the following transaction will, (a) increase, (b) decrease or (c) not alter the Inventory Turnover Ratio:

1. Purchase of Stock-in-trade ₹ 20,000
2. Purchase Returns ₹ 20,000
3. Revenue from Operations on Sale of Stock-in-trade costing ₹ 20,000 for ₹ 25,000
4. Stock-in-trade costing ₹ 20,000 withdrawn for personal use
5. Stock-in-trade costing ₹ 20,000 distributed as free samples.

SOLUTION:

EFFECT ON INVENTORY TURNOVER RATIO

Transaction	Effect on Inventory Turnover Ratio	Reason
1.	Decrease	1. Cost of Revenue from Operations will not change due to increase in Purchases & Closing Inventory. 2. Average Inventory will increase due to increase in Closing Inventory.
2.	Increase	1. Cost of Revenue from Operations will not change due to decrease in Purchases & Closing Inventory. 2. Average Inventory will decrease due to decrease in Closing Inventory.
3.	Increase	1. Cost of Revenue from Operations will increase due to decrease in Closing Inventory. 2. Average Inventory will decrease due to decrease in Closing Inventory.
4.	Increase	1. Cost of Revenue from Operations will not change due to decrease in purchases & Closing Inventory. 2. Average Inventory will decrease due to decrease in Closing Inventory.
5.	Increase	1. Cost of Revenue from Operations will not change due to decrease in purchases & Closing Inventory. 2. Average Inventory will decrease due to decrease in Closing Inventory.

33.0 DEBTORS TURNOVER RATIO**MEANING OF DEBTORS TURNOVER RATIO**

Debtors Turnover Ratio establishes a relationship between Credit Revenue from Operations and Average Trade Receivables.

OBJECTIVE OF DEBTORS TURNOVER RATIO

The objective of computing Debtors Turnover Ratio is to determine the efficiency with which the Trade Receivables are managed and collected.

COMPONENTS OF DEBTORS TURNOVER RATIO

There are two components of Debtors Turnover Ratio as follows:

1. Credit Revenue from Operations

= Revenue from Operations – Cash Revenue from Operations

2. Average Trade Receivables = (Opening Trade Receivables + Closing Trade Receivables)/ 2

Note: Trade Receivables = Trade Debtors + Bills Receivable

TUTORIAL NOTES

- (a) *The term 'Trade Receivables' do not include Debtors which do not arise from the Sale of goods in which the enterprise deals in.*
- (b) *The 'Provision for doubtful debts' is not deducted from the total amount of Trade Receivables since here, the purpose is to calculate the number of days for which Revenue from Operations are tied up in Trade Receivables and not to ascertain the Realizable Value of Trade Receivables. If the 'Provision for doubtful debts' were deducted, it would give an impression that a portion of Trade Receivables (to the extent of such provision) has already been collected and Debtors Turnover Ratio will unnecessarily be higher which does not reflect the true picture at all.*
- (c) *If Average Trade Receivables cannot be ascertained due to non-availability of information, Closing Trade Receivables may be used by giving a suitable note to that effect.*
- (d) *If Credit Revenue from Operations are not ascertainable, Total Revenue from Operations given may be used assuming that all Revenue from Operations are credit Revenue from Operations.*

COMPUTATION OF DEBTORS TURNOVER RATIO

Debtors Turnover Ratio is computed by dividing the Credit Revenue from Operations by Average Trade Receivables. This ratio is usually expressed as 'x' number of times. In the form of a formula, this ratio may be expressed as follows:

$$\text{Debtors Turnover Ratio} = \frac{\text{Credit Revenue from Operations}}{\text{Average Trade Receivables}} = \dots \text{Times}$$

INTERPRETATION OF DEBTORS TURNOVER RATIO

Debtors Turnover Ratio indicates both the quality of Trade Receivables and the credit collection efforts of the enterprise. It indicates the speed with which the debtors are converted into cash each year. In general, a high ratio indicates the shorter collection period which implies prompt payments by Trade Receivables, and a low ratio indicates a longer collection period which implies delayed payments by Trade Receivables. However, too high ratio and too low ratio calls for further investigation. A too high ratio may be the result of a restrictive credit and collection policy which may curtail the Revenue from Operations and consequently profits. On the other hand, a too low ratio may be the result of liberal

and inefficient credit and collection policy which may involve the risk of bad debts and burden of high interest cost involved in maintaining a higher level of Trade Receivables. Thus, a firm should *neither* have a very high *nor* a very low Debtors Turnover Ratio, but should have a satisfactory level.

DEBT COLLECTION PERIOD (OR TRADE RECEIVABLES VELOCITY)

Debt Collection Period shows an average period for which the Credit Revenue from Operations remains outstanding *or* the Average Credit Period actually enjoyed by the Trade Receivables. It measures the quality of Trade Receivables. It indicates the rapidity *or* slowness with which the money is collected from Trade Receivables. This period may be calculated as follows:

$$\text{Debt Collection Period} = \frac{\text{Average Trade Receivables}}{\text{Average Credit Revenue from Operation per day}} = \dots \text{Times}$$

$$\text{or,} \quad = \frac{12 \text{ months}/52 \text{ weeks}/365 \text{ days}}{\text{Debtors Turnover Ratio}} = \dots \text{Months/Weeks/Days}$$

Note: *Average Credit Revenue from Operations per day*

$$= \frac{\text{Net Credit Revenue from Operations for the year}}{\text{No. of Working Days in the year}} = \dots \text{per day}$$

ILLUSTRATION 38

Calculate the Debtors Turnover Ratio and Average Debt Collection Period for the year from the following information provided by Bharat dealing in clothes:

Particulars	Opening ₹	Closing ₹
Trade Debtors	15,000	60,000*
* (including ₹ 15,000 due from a buyer of an old furniture)		
Bills Receivable	5,000	15,000
Provision for Doubtful Debts	1,500	4,500

Total Revenue from Operations ₹ 2,00,000, Cash Revenue from Operations ₹ 40,000.

SOLUTION:

Step 1: Credit Revenue from Operations

$$= \text{Total Revenue from Operations} - \text{Cash Revenue from Operations}$$

$$= ₹ 2,00,000 - ₹ 40,000 = ₹ 1,60,000$$

Step 2: Average Trade Receivables

$$= (\text{Opening Trade Receivables} + \text{Closing Trade Receivables}) / 2$$

$$= \frac{(\text{₹}15,000 + \text{₹}5,000) + (\text{₹}45,000 + \text{₹}15,000)}{2} = ₹ 40,000$$

Step 3: Debtors Turnover Ratio = $\frac{\text{Credit Revenue from Operations}}{\text{Average Trade Receivables}} = ₹ 1,60,000 / ₹ 40,000 = 4 \text{ times}$

Step 4: Average Debt Collection Period = $\frac{12 \text{ months}}{\text{Debtors Turnover Ratio}} = \frac{12 \text{ months}}{4 \text{ Times}} = 3 \text{ Months}$

Notes:

1. Provision for Doubtful debts is not deducted from Trade Receivables.
2. A debtor for old furniture has been excluded he does not arise from the sale of goods in which the enterprise deals in.

ILLUSTRATION 39

Cash Revenue from Operations 33-1/3% of Credit Revenue from Operations, Cost of Revenue from Operations ₹ 3,00,000, Gross Profit 25% on Revenue from Operations,, Debtors Turnover Ratio 3 Times. Trade Receivables at the end were 3 times that in the beginning. Calculate Opening Trade Receivables and Closing Trade Receivables.

SOLUTION:

Step 1: Total Revenue from Operations

$$= \text{Cost of Revenue from Operations} + \text{Gross Profit}$$

$$= ₹ 3,00,000 + (₹ 3,00,000 \times 1/3) = ₹ 4,00,000$$

Step 2: Credit Revenue from Operations

$$= \text{Total Revenue from Operations} - \text{Cash Revenue from Operations}$$

$$= ₹ 4,00,000 - (₹ 4,00,000 \times 25/100) = ₹ 3,00,000$$

Step 3: Debtors Turnover Ratio = $\frac{\text{Credit Revenue from Operations}}{\text{Average Trade Receivables}} = ₹ 3,00,000 / ₹ 1,00,000 = 3$

$$\text{Average Trade Receivables} = ₹ 3,00,000/3 = ₹ 1,00,000$$

$$(\text{OR} + \text{CR})/2 = ₹ 1,00,000$$

$$\text{or, } \text{OR} + \text{CR} = ₹ 1,00,000 \times 2 = ₹ 2,00,000$$

$$\text{OR} + \text{CR} = ₹ 2,00,000 \quad \dots \text{Eq. I}$$

$$\text{CR} - 3 \text{ OR} = 0 \quad \dots \text{Eq. II}$$

Subtracting Eq. II from Eq. I

$$4 \text{ OR} = ₹ 2,00,000$$

$$\text{OR} = ₹ 2,00,000/4 = ₹ 50,000$$

$$\text{CR} = ₹ 50,000 \times 3 = ₹ 1,50,000$$

ILLUSTRATION 40

Cash Revenue from Operations 33-1/3% of Credit Revenue from Operations, Cost of Revenue from Operations ₹ 3,00,000, Gross Profit 25% on Revenue from Operations, Debtors Turnover Ratio 3 Times. Trade Receivables at the end were 3 times more than that in the beginning. Calculate Opening Trade Receivables and Closing Trade Receivables.

SOLUTION:

Step 1: Total Revenue from Operations

$$= \text{Cost of Revenue from Operations} + \text{Gross Profit}$$

$$= ₹ 3,00,000 + (₹ 3,00,000 \times 1/3) = ₹ 4,00,000$$

Step 2: Credit Revenue from Operations

$$= \text{Total Revenue from Operations} - \text{Cash Revenue from Operations}$$

$$= ₹ 4,00,000 - (₹ 4,00,000 \times 25/100) = ₹ 3,00,000$$

Step 3: Debtors Turnover Ratio = $\frac{\text{Credit Revenue from Operations}}{\text{Average Trade Receivables}} = ₹ 3,00,000 / ₹ 1,00,000 = 3$

$$\text{Average Trade Receivables} = ₹ 3,00,000/3 = ₹ 1,00,000$$

$$(\text{OR} + \text{CR})/2 = ₹ 1,00,000$$

$$\text{or, } \text{OR} + \text{CR} = ₹ 1,00,000 \times 2 = ₹ 2,00,000$$

$$\text{OR} + \text{CR} = ₹ 2,00,000 \quad \dots \text{Eq. I}$$

$$\text{CR} - 4 \text{ OR} = 0 \quad \dots \text{Eq. II}$$

Subtracting Eq. II from Eq. I

$$5 \text{ OR} = ₹ 2,00,000$$

$$\text{OR} = ₹ 2,00,000/5 = ₹ 40,000$$

$$\text{CR} = ₹ 40,000 \times 4 = ₹ 1,60,000$$

34.0 CREDITORS TURNOVER RATIO

MEANING OF CREDITORS TURNOVER RATIO

Creditors Turnover Ratio establishes a relationship between Net Credit Purchases and Average Trade Payables.

OBJECTIVE OF CREDITORS TURNOVER RATIO

The objective of computing Creditors Turnover Ratio is to determine the efficiency with which the Trade Payables are managed and paid.

COMPONENTS OF CREDITORS TURNOVER RATIO

There are two components of Creditors Turnover ratio as follows:

- 1. Net Credit Purchases = Net Purchases – Cash Purchases**
- 2. Average Trade Payables = (Opening Trade Payables + Closing Trade Payables)/2**

Note: Trade Payables = Trade Creditors + Bills Payable

TUTORIAL NOTES

- The term 'Trade Payables' do not include Creditors which do not arise from the purchases of goods in which the enterprise deals in.*
- The 'Reserve for Discount on Trade Payables is not deducted from the total amount of Trade Payables since, here the purpose is to calculate the numbers of days for which the purchases remain outstanding and not to ascertain the net amount likely to be paid (after discount). If the 'Reserve for Discount on Trade Payables were deducted, it would give an impression that a portion of Trade Payables (to the extent of such reserve) has already been discharged and Creditors Turnover Ratio will unnecessarily be higher which does not reflect the true picture at all.*
- If Average Trade Payables cannot be ascertained due to non-availability of information, Closing Trade Payables may be used by giving a suitable note to that effect.*
- If Net Credit Purchases are not ascertainable Total Purchases given may be used assuming that all purchases are Credit Purchases.*

COMPUTATION OF CREDITORS TURNOVER RATIO

Creditors Turnover ratio is computed by dividing the Net Credit Purchases by Average Trade Payables. This ratio is usually expressed as 'x' number of times. In the form of formula, this ratio may be expressed as follows:

$$\text{Creditors Turnover Ratio} = \frac{\text{Net Credit Purchases}}{\text{Average Trade Payables}} = \dots \text{Times}$$

INTERPRETATION OF CREDITORS TURNOVER RATIO

Creditors Turnover indicates the speed with which the Creditors turn over on an average each year. In general, a high ratio indicates the shorter payment period which implies *either* the availability of less credit or earlier payments and a low ratio indicates a larger payment period which implies *either* the availability of more credit or delayed payments.

AVERAGE DEBT PAYMENT

Average Debt payment period shows an average period for which the credit purchases remain outstanding or the average credit period actually availed of. This period may be calculated as follows:

$$\text{Average Debt Payment Period} = \frac{\text{Average Trade Payables}}{\text{Average Net Credit Purchases per day}} = \dots \text{Times}$$

or

$$= \frac{12 \text{ months}/52 \text{ weeks}/365 \text{ days}}{\text{Creditors Turnover Ratio}} = \dots \text{Months/Weeks/Days}$$

Note: Average Credit Revenue from Operations per day

$$= \frac{\text{Net Credit Purchases for the year}}{\text{No. of Working Days in the year}} = \dots \text{per day}$$

ILLUSTRATION 41

Calculate the Creditors Turnover Ratio and Average Debt payment Period for the year from the following information provided by Bharat dealing in clothes:

Particulars	Opening (₹)	Closing (₹)
Trade Creditors *(including ₹ 15,000 due to a supplier of new furniture),	15,000	60,000*
Bills Payable	5,000	15,000
Reserve for Discount on Trade Payables	1,500	4,500
Total Purchases ₹ 2,00,000, Cash Purchases ₹ 40,000.		

SOLUTION:

Step 1: Net Credit Purchases = Total Purchases – Cash Purchases

$$= ₹ 2,00,000 - ₹ 40,000 = ₹ 1,60,000$$

Step 2: Average Trade Payables = (Opening Trade Payables + Closing Trade Payables)/2

$$= [(\₹ 15,000 + ₹ 5,000) + (\₹ 45,000 + ₹ 15,000)] / 2 = ₹ 40,000$$

Step 3: Creditors Turnover Ratio = $\frac{\text{Net Credit Purchases}}{\text{Average Trade Payables}} = ₹ 1,60,000 / ₹ 40,000 = 4 \text{ Times}$

Step 4: Average Debt Payment Period = $\frac{12 \text{ months}}{\text{Creditors Turnover Ratio}} = 12 / 4 = 3 \text{ Months}$

Notes:

1. Reserve for Discount on Closing Trade Payables is not deducted from Trade Payables.
2. A creditor for new furniture has been excluded since he does not arise from the purchase of goods in which the enterprise deals in.

ILLUSTRATION 42

Cash Purchases 25% of Total Purchases, Revenue from Operations ₹ 4,00,000, Gross Profit @ 25% on Revenue from Operations, Opening Inventory ₹ 1,00,000, Closing Inventory ₹ 2,00,000, Creditors Turnover Ratio 3 Times. Trade Payables at the end were 3 times that in the beginning. Calculate Opening Trade Payables and Closing Trade Payables.

SOLUTION:

Step 1: Cost of Revenue from Operations = Revenue from Operations – Gross Profit

$$= ₹ 4,00,000 - (25\% \text{ of } ₹ 4,00,000) = ₹ 3,00,000$$

Step 2: Total Purchases = Cost of Revenue from Operations + Closing Inventory – Opening Inventory
 = ₹ 3,00,000 + ₹ 2,00,000 – ₹ 1,00,000 = ₹ 4,00,000

Step 3: Net Credit Purchases = Total Purchases – Cash Purchases
 = ₹ 4,00,000 – (25% of ₹ 4,00,000) = ₹ 3,00,000

Step 4: Creditors Turnover Ratio = $\frac{\text{Net Credit Purchases}}{\text{Average Trade Payables}}$
 $3 = ₹ 3,00,000 / \text{Average Trade Payables}$
 Average Trade Payables = ₹ 3,00,000 / 3 = ₹ 1,00,000

$$(\text{OP} + \text{CP}) / 2 = ₹ 1,00,000$$

$$\text{or, OP} + \text{CP} = ₹ 1,00,000 \times 2 = ₹ 2,00,000 \quad \dots \text{Eq. I}$$

$$\text{CP} - 3 \text{ OP} = 0 \quad \dots \text{Eq. II}$$

Subtracting Eq. II from I

$$4 \text{ OP} = ₹ 2,00,000$$

$$\text{OP} = ₹ 2,00,000 / 4 = ₹ 50,000$$

$$\text{CP} = ₹ 50,000 \times 3 = ₹ 1,50,000$$

ILLUSTRATION 43

Cash Purchases 25% of Total Purchases, Revenue from Operations ₹ 4,00,000, Gross Profit @ 25% on Revenue from Operations, Opening Inventory ₹ 1,00,000, Closing Inventory ₹ 2,00,000, Creditors Turnover Ratio 3 Times. Trade Payables at the end were 3 times more than that in the beginning. Calculate Opening Trade Payables and Closing Trade Payables.

SOLUTION: I

Step 1: Cost of Revenue from Operations = Revenue from Operations – Gross Profit
 = ₹ 4,00,000 – (25% of ₹ 4,00,000) = ₹ 3,00,000

Step 2: Total Purchases = Cost of Revenue from Operations + Closing Inventory – Opening Inventory
 = ₹ 3,00,000 + ₹ 2,00,000 – ₹ 1,00,000 = ₹ 4,00,000

Step 3: Net Credit Purchases = Total Purchases – Cash Purchases
 = ₹ 4,00,000 – (25% of ₹ 4,00,000) = ₹ 3,00,000

Step 4: Creditors Turnover Ratio = $\frac{\text{Net Credit Purchases}}{\text{Average Trade Payables}}$
 $3 = ₹ 3,00,000 / \text{Average Trade Payables}$
 Average Trade Payables = ₹ 3,00,000 / 3 = ₹ 1,00,000

$$(\text{OP} + \text{CP}) / 2 = ₹ 1,00,000$$

$$\text{or, OP} + \text{CP} = ₹ 1,00,000 \times 2 = ₹ 2,00,000 \quad \dots \text{Eq. I}$$

$$\text{CP} - 4 \text{ OP} = 0 \quad \dots \text{Eq. II}$$

Subtracting Eq. II from I

$$5 \text{ OP} = ₹ 2,00,000$$

$$\text{OP} = ₹ 2,00,000 / 5 = ₹ 40,000$$

$$\text{CP} = ₹ 40,000 \times 4 = ₹ 1,60,000$$

35.0 PROFITABILITY RATIOS**MEANING OF PROFITABILITY RATIOS**

Profitability Ratios measure management's overall effectiveness as shown by the returns generated on Revenue from Operations and Investment.

TYPES OF PROFITABILITY RATIOS

The various types of Profitability Ratios are as follows:

I. Profitability Ratios In relation to Revenue from Operations/Sales:

1. Gross Profit Ratio,
2. Operating Profit Ratio
3. Operating Ratio
4. Net Profit Ratio
5. Expenses Ratios

II. Profitability Ratios In relation to Investment:

1. Return on Total Assets (ROTA)
2. Return on Capital Employed/ Investment (ROCE/ROI)
3. Return on Shareholders' Funds/ Equity (ROE)
4. Return on Equity Shareholders' Funds (ROES)

III. Profitability Ratios In relation to Equity Shareholders' Funds

1. Return on Equity Shareholders' Funds
2. Earning per Share [EPS]
3. Dividend per Share [DPS]
4. Price-Earning Ratio [P/E Ratio]
5. Dividend Payout Ratio [D/P Ratio]
6. Earning Yield [EY]
7. Dividend Yield [DY]
8. Market Response Ratio [MRR]

I. PROFITABILITY RATIOS IN RELATION TO REVENUE FROM OPERATIONS/SALES**36.0 GROSS PROFIT RATIO****MEANING OF GROSS PROFIT RATIO**

Gross Profit Ratio measures the relationship between Gross Profit and Revenue from Operations.

OBJECTIVE OF GROSS PROFIT RATIO

The main objective of computing Gross Profit Ratio is to determine the efficiency with which production and/or purchase operations and selling operations are carried on.

COMPONENTS OF GROSS PROFIT RATIO

There are two components of Gross Profit Ratio as follows:

1. Gross Profit

= Revenue from Operations (both Cash & Credit) – Cost of Revenue from Operations.

Note: Cost of Revenue from Operations

= Opening Inventory + Net Purchases + Direct Expenses – Closing Inventory

or, = Average Inventory × Inventory Turnover Ratio

2. Revenue from Operations

= Credit Revenue from Operations + Cash Revenue from Operations

COMPUTATION OF GROSS PROFIT RATIO

Gross Profit Ratio is computed by dividing the Gross Profit by the Revenue from Operations. It is expressed as percentage. In the form of a formula, this ratio may be expressed as follows:

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Revenue from Operations}} \times 100 = \dots \%$$

INTERPRETATION OF GROSS PROFIT RATIO

Gross Profit Ratio indicates (a) an average Gross Margin earned on a Revenue from Operations of ₹ 100, (b) the limit beyond which the fall in Selling prices will definitely result in losses, and (c) what portion of Revenue from Operations is left to cover Operating Expenses (other than the Cost of Revenue from Operations) and Non-Operating Expenses. (e.g., Interest on Borrowings), to pay dividend and to create Reserves. In general Higher the ratio, the more efficient the production and/or purchase management.

CAUSE OF INCREASE IN GROSS PROFIT RATIO

Gross Profit ratio may increase due to one of the following factors:

1. Higher Revenue from Operations Prices with constant Cost of Revenue from Operations;
2. Lower Cost of Revenue from Operations with constant Revenue from Operations Prices;
3. A combination of aforesaid two factors

ILLUSTRATION 44

From the following information, Calculate Gross Profit Ratio:

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Opening Inventory	50,000	Purchases	11,50,000
Cash Revenue from Operations	4,00,000	Wages	80,000
Credit Revenue from Operations	16,00,000	Carriage Inward	20,000
Closing Inventory	1,00,000		

SOLUTION:

STEP 1: GROSS PROFIT

<i>Particulars</i>	₹	₹
A Revenue from Operations (₹ 4,00,000 + ₹ 16,00,000)		20,00,000
B Less: Cost of Revenue from Operations:		
Opening Inventory	50,000	
Purchases	11,50,000	
Wages	80,000	
Carriage inward	20,000	
Less: Closing Inventory	(1,00,000)	(12,00,000)
C Gross Profit (A – B)		8,00,000

Step 2: Gross Profit Ratio = $\frac{\text{Gross Profit}}{\text{Revenue from Operations}} \times 100 = (\text{₹}8,00,000/\text{₹}20,00,000) \times 100 = 40\%$

ILLUSTRATION 45

Average Inventory ₹ 80,000, Inventory Turnover Ratio 8 times, Average Trade Receivables ₹ 1,00,000, Average Debt Collection Period 2 months, Cash Revenue from Operations 25% of Revenue from Operations. Calculate Gross Profit Ratio.

SOLUTION:

Step 1: Cost of Revenue from Operations

$$= \text{Average Inventory} \times \text{Inventory Turnover Ratio} = ₹ 80,000 \times 8 = ₹ 6,40,000$$

Step 2: Credit Revenue from Operations = Average Trade Receivables $\times$ Debtors Turnover Ratio

$$= ₹ 1,00,000 \times (12/2) = ₹ 6,00,000$$

Step 3: Revenue from Operations

$$= \text{Credit Revenue from Operations} + \text{Cash Revenue from Operations}$$

$$= ₹ 6,00,000 + (₹ 6,00,000 \times 1/3) = ₹ 8,00,000$$

Step 4: Gross Profit = Revenue from Operations – Cost of Revenue from Operations

$$= ₹ 8,00,000 - ₹ 6,40,000 = ₹ 1,60,000$$

Step 5: Gross Profit Ratio = $\frac{\text{Gross Profit}}{\text{Revenue from Operations}} \times 100 = (\frac{₹ 1,60,000}{₹ 8,00,000}) \times 100 = 20\%$

ILLUSTRATION 46 [EFFECT ON GROSS PROFIT RATIO]

The Gross Profit Ratio of a Company is 20%. State giving reason, which of the following transactions will (a) increase (b) decrease or (c) not alter the Gross Profit Ratio.

1. Purchase of Stock-in-Trade ₹ 20,000
2. Purchase Returns ₹ 20,000
3. Revenue from Operations on Sale of Stock-in-Trade ₹ 25,000
4. Stock-in-Trade costing ₹ 20,000 withdrawn for personal use
5. Stock-in-Trade costing ₹ 20,000 distributed as free samples.

SOLUTION:**EFFECT ON GROSS PROFIT RATIO**

Transaction	Effect on GP Ratio	Reason
1.	No change	Both Purchases & Closing Inventory will increase & hence Cost of Revenue from Operations will remain unchanged.
2.	No change	Both Purchases & Closing Inventory will decrease & hence Cost of Revenue from Operations will remain unchanged.
3.	No change	Revenue from Operations will increase but Closing Inventory will decrease by the same percentage (Not by same amount). As a result, Cost of Revenue from Operations will increase by the same percentage as the Revenue from Operations increase.
4.	No change	Both Purchases and Closing Inventory will decrease & hence Cost of Revenue from Operations will remain unchanged.
5.	No Change	Cost of Revenue from Operations increases as well as decreases by the same amount.

37.0 OPERATING RATIO**MEANING OF OPERATING RATIO**

Operating Ratio measures the relationship between Operating Cost and Revenue from Operations.

OBJECTIVE OF OPERATING RATIO

The main objective of computing Operating Ratio is to determine the operational efficiency with which Production and/or Purchases and Selling Operations are carried on.

COMPONENTS OF OPERATING RATIO

There are two components of Operating Ratio as follows:

1. **Operating Cost** is the cost relating to the Operations of a business enterprise.

Operating Cost = Cost of Revenue from Operations + Operating Expenses (e.g., Employees' Benefit Expense, Depreciation, Interest on Short-term Borrowings, Discount Allowed and Bad Debts).

2. **Revenue from Operations = Credit Revenue from Operations + Cash Revenue from Operations**

COMPUTATION OF OPERATING RATIO

Operating ratio is computed by dividing the Operating Cost by the Revenue from Operations. This ratio is expressed as a percentage. In the form of a formula, this ratio may be expressed as follows:

$$\text{Operating Ratio} = \frac{\text{Operating Cost}}{\text{Revenue from Operations}} \times 100 = \dots \%$$

Note: Operating Cost = Cost of Revenue from Operations + Operating Expenses

where

1. Cost of Revenue from Operations
= Opening Inventory + Purchases (both cash & Credit) + Direct Expenses + Manufacturing Expenses – Closing Inventory

OR

= Revenue from Operations – Gross Profit

OR

= Revenue from Operations + Gross Loss

OR

= Average Inventory × Inventory Turnover Ratio
2. Operating Expenses = Employees' Benefit Expense + Depreciation + Interest on Short-term Borrowings + Discount Allowed + Bad Debts

INTERPRETATION OF OPERATING RATIO

Operating Ratio indicates an Average Operating Cost incurred on a Revenue from Operations of ₹ 100. Lower the ratio, greater is the Operating Profit to cover the non-operating expenses, to pay dividend and to create reserves and vice versa.

TUTORIAL NOTE

Both Operating Profit Ratio and Operating Ratio are complementary to each other and thus, if one of such ratios is deducted from 100, another ratio may be obtained.

ILLUSTRATION 47

From the following information Calculate Operating Ratio.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Opening Inventory	50,000	Purchases	11,50,000
Cash Revenue from Operations	4,00,000	Wages	80,000
Credit Revenue from Operations	16,00,000	Carriage Inward	20,000
Closing Inventory	1,00,000	Depreciation	80,000
Bad Debts	6,000	Cash Discount allowed to cus.	10,000
Interest on Bills Payable	4,000	Employees' Benefit Expense	1,00,000

SOLUTION:**STEP 1: OPERATING COST**

<i>Particulars</i>	₹	₹
A Cost of Revenue from Operations:		
Opening Inventory	50,000	
Purchases	11,50,000	
Wages	80,000	
Carriage inward	20,000	
Less: Closing Inventory	(1,00,000)	12,00,000
B Add: Operating Expenses:		
Employees' Benefit Expense	1,00,000	
Depreciation	80,000	
Cash Discount allowed	10,000	
Bad Debts	6,000	
Interest on Bills Payable	4,000	2,00,000
C Operating Cost (A + B)		14,00,000

Step 2: Operating Ratio = $\frac{\text{Operating Cost}}{\text{Revenue from Operations}} \times 100 = (\frac{₹14,00,000}{₹20,00,000}) \times 100 = 70\%$

ILLUSTRATION 48

Operating Cost ₹ 27,20,000, Operating Expenses ₹ 3,20,000, Gross Profit Ratio 25%. Calculate Operating Ratio.

SOLUTION:

Step 1: Cost of Revenue from Operations = Operating Cost – Operating Expenses
 $= ₹ 27,20,000 - ₹ 3,20,000 = ₹ 24,00,000$

Step 2: Let Revenue from Operations = ₹ 100, Gross Profit = ₹ 25, Cost ₹ 75,
 If Cost is ₹ 75, then Revenue from Operations = ₹ 100

If Cost is ₹ 24,00,000 then Revenue from Operations = $₹ 24,00,000 \times \frac{100}{75} = ₹ 32,00,000$

Step 3: Operating Ratio = $\frac{\text{Operating Cost}}{\text{Revenue from Operations}} \times 100 = (\frac{₹27,20,000}{₹32,00,000}) \times 100 = 85\%$

ILLUSTRATION 49

The Operating Ratio of a company is 80%. State giving reasons, which of the following transactions will (a) increase (b) decrease or (c) not alter the operating ratio:

1. Purchases of Stock-in-Trade ₹ 20,000
2. Purchase Returns ₹ 20,000
3. Revenue from Operations on Sale of Stock-in-Trade ₹ 25,000
4. Stock-in-Trade costing ₹ 1,000 withdrawn for personal use
5. Payment to Trade Payables ₹ 2,00,000
6. Sold Building ₹ 2,00,000
7. Paid Income Tax ₹ 5,000

[Assume that Operating Cost is variable i.e. varies with Revenue from Operations]

SOLUTION:**EFFECT ON OPERATING RATIO**

<i>Transaction</i>	<i>Effect on Operating Ratio</i>	<i>Reason</i>
1.	No change	Both Purchases & Closing Inventory will increase & hence Cost of Revenue from Operations will remain unchanged.
2.	No change	Both Purchases & Closing Inventory will decrease & hence Cost of Revenue from Operations will remain unchanged.
3.	No change	Revenue from Operations will increase but Closing Inventory will decrease by the same percentage (Not by same amount). As a result, Cost of Revenue from Operations will increase by the same percentage as the Revenue from Operations increase.
4.	No change	Both Purchases and Closing Inventory will decrease & hence Cost of Revenue from Operations will remain unchanged.
5.	No change	<i>Neither Operating Cost nor Revenue from Operations change</i>
6.	No change	<i>Neither Operating Cost nor Revenue from Operations change</i>
7.	No change	<i>Neither Operating Cost nor Revenue from Operations change</i>

38.0 OPERATING PROFIT RATIO**MEANING OF OPERATING PROFIT RATIO**

Operating Profit Ratio measures the relationship between Operating Profit and Revenue from Operations.

OBJECTIVE OF OPERATING PROFIT RATIO

The main objective of computing Operating Profit Ratio is to determine the operational efficiency of the management.

COMPONENTS OF OPERATING PROFIT RATIO

There are two components of Operating Profit Ratio as follows:

1. **Operating Profit = Gross Profit – Other Operating Expenses** (e.g., Employees' Benefit Expense, Depreciation, Interest on Short-term Borrowings, Discount Allowed and Bad Debts) and
or, **Operating Profit = Revenue from Operations – Operating Cost**
2. **Revenue from Operations**
= **Credit Revenue from Operations + Cash Revenue from Operations**
or, = **Cost of Revenue from Operations + Gross Profit**

COMPUTATION OF OPERATING PROFIT RATIO

Operating Profit Ratio is computed by dividing the Operating Profit by the Revenue from Operations. It is expressed as a percentage. In the form of a formula, this ratio may be expressed as follows:

$$\text{Operating Ratio} = \frac{\text{Operating Profit}}{\text{Revenue from Operations}} \times 100 = \dots \%$$

INTERPRETATION OF OPERATING PROFIT RATIO

Operating Profit Ratio indicates (a) an average operating margin earned on Revenue from Operations of ₹ 100 and (b) what portion of Revenue from Operations is left to cover non-operating expenses, to pay dividend and to create reserves. In general, Higher the ratio, the more efficient is the operating management.

CAUSES FOR INCREASE IN OPERATING PROFIT RATIO

Operating Profit Ratio may increase due to any one of the following factors:

1. Higher Gross Profit;
2. Lower Operating Expenses;
3. A combination of aforesaid two factors.

39.0 DISTINCTION BETWEEN OPERATING RATIO AND OPERATING PROFIT RATIO

Operating Ratio differs from Operating Profit Ratio in the following respects:

<i>Basis of Distinction</i>	<i>Operating Ratio</i>	<i>Operating Profit Ratio</i>
1. Relationship	It shows the relationship between Operating Cost and Revenue from Operations	It shows the relationship between Operating Profit and RFO.
2. Objective	The objective of computing this ratio is to determine the efficiency with which production/purchase & selling operations are carried on.	The objective of computing this ratio is to determine the operational efficiency of the management.
3. Interpretation	This ratio indicates an average operating cost incurred on a sales of ₹ 100.	This ratio indicates (a) an average operating margin as RFO of ₹ 100. (b) What portion of sales is left to over Non-Operating Expenses to pay Dividend and to create Reserves.
4. Formula	$\frac{\text{Operating Cost}}{\text{Revenue from Operations}} \times 100$	$\frac{\text{Operating Profit}}{\text{Revenue from Operations}} \times 100$

ILLUSTRATION 50

From the following information Calculate Operating Profit Ratio.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
Opening Inventory	50,000	Purchases	11,50,000
Cash Revenue from Operations	4,00,000	Wages	80,000
Credit Revenue from Operations	16,00,000	Carriage Inward	20,000
Closing Inventory	1,00,000	Depreciation	80,000
Bad Debts	6,000	Cash Discount allowed to cus.	10,000
Interest on Bills Payable	4,000	Employees' Benefit Expense	1,00,000

SOLUTION:
STEP 1: OPERATING PROFIT

Particulars	₹	₹
A. Revenue from Operations		20,00,000
B. Less: Cost of Revenue from Operations:		
Opening Inventory	50,000	
Purchases	11,50,000	
Wages	80,000	
Carriage inward	20,000	
Less: Closing Inventory	(1,00,000)	(12,00,000)
C. Gross Profit (A – B)		8,00,000
D. Less: Operating Expenses:		
Employees' Benefit Expense	1,00,000	
Depreciation	80,000	
Cash Discount allowed	10,000	
Bad Debts	6,000	
Interest on Bills Payable	4,000	(2,00,000)
E. Operating Profit (C – D)		6,00,000

Step 2: Operating Ratio = $\frac{\text{Operating Profit}}{\text{Revenue from Operations}} \times 100 = (\text{₹}6,00,000/\text{₹}20,00,000) \times 100 = 30\%$

ILLUSTRATION 51

Operating Cost ₹ 8,50,000, Gross Profit Ratio 20%, Operating Expenses ₹ 50,000. Calculate Operating Profit Ratio.

SOLUTION:

Step 1: Cost of Revenue from Operations = Operating Cost – Operating Expenses
= ₹ 8,50,000 – ₹ 50,000 = ₹ 8,00,000

Step 2: Revenue from Operations = Cost of Revenue from Operations + Gross Profit
= ₹ 8,00,000 + (₹ 8,00,000 × 25/100) = ₹ 10,00,000

Step 3: Operating Profit = Revenue from Operations – Operating Cost
= ₹ 10,00,000 – ₹ 8,50,000 = ₹ 1,50,000

Step 4: Operating Ratio = $\frac{\text{Operating Profit}}{\text{Revenue from Operations}} \times 100 = (\text{₹}1,50,000/\text{₹}10,00,000) \times 100 = 15\%$

ILLUSTRATION 52

Calculate Operating Profit Ratio if Operating Ratio is 20%.

SOLUTION:

Operating Profit Ratio = 100% – Operating Ratio = 100% – 20% = 80%

ILLUSTRATION 53 [EFFECT ON OPERATING PROFIT RATIO]

The Operating Profit Ratio of a Company is 20%. State giving reason, which of the following transactions will (a) increase (b) decrease or (c) not alter the Operating Profit Ratio.

1. Purchase of Stock-in-Trade ₹ 20,000
2. Purchase Returns ₹ 20,000
3. Revenue from Operations on Sale of Stock-in-Trade ₹ 25,000
4. Stock-in-Trade costing ₹ 20,000 withdrawn for personal use

[Assume that Operating Cost is variable i.e. varies with Revenue from Operations]

SOLUTION:**EFFECT ON OPERATING PROFIT RATIO**

<i>Transaction</i>	<i>Effect on Operating Profit Ratio</i>	<i>Reason</i>
1.	No change	Both Purchases & Closing Inventory will increase & hence Cost of Revenue from Operations will remain unchanged.
2.	No change	Both Purchases & Closing Inventory will decrease & hence Cost of Revenue from Operations will remain unchanged.
3.	No change	Revenue from Operations will increase but closing Inventory will decrease by the same percentage (Not by same amount). As a result, Cost of Revenue from Operations will increase by the same percentage as the Revenue from Operations increase.
4.	No change	Both Purchases and closing Inventory will decrease & hence Cost of Revenue from Operations will remain unchanged.

40.0 NET PROFIT RATIO**MEANING OF NET PROFIT RATIO**

Net Profit Ratio measures the relationship between Net Profit and Revenue from Operations.

OBJECTIVE OF NET PROFIT RATIO

The main objective of computing Net Profit ratio is to determine the overall profitability due to various factors such as operational efficiency, trading on equity etc.

COMPONENTS OF NET PROFIT RATIO

There are two components of Net Profit Ratio as follows:

1. **Net Profit = Revenue from Operations – Cost of Revenue from Operations – Operating Expenses – Non-Operating Expenses + Non-Operating Incomes**

$$\text{or,} = \text{Revenue from Operations} - \text{Operating Cost} - \text{Non-Operating Expenses} + \text{Non-Operating Incomes}$$

$$\text{or,} = \text{Operating Profit} - \text{Non-Operating Expenses} + \text{Non-Operating Incomes}$$
2. **Revenue from Operations = Credit Revenue from Operations + Cash Revenue from Operations**

COMPUTATION OF NET PROFIT RATIO

Net Profit Ratio is computed by dividing the Net Profit by the Revenue from Operations. The figure of Net Profit may be taken *either* before tax *or* after tax. It is expressed as a percentage. In the form of a formula, this ratio may be expressed as follows:

$$\text{Net Profit Ratio} = \frac{\text{Net Profit Before Tax}}{\text{Revenue from Operations}} \times 100 = \dots \%$$

or,

$$\text{Net Profit Ratio} = \frac{\text{Net Profit After Tax}}{\text{Revenue from Operations}} \times 100 = \dots \%$$

INTERPRETATION OF NET PROFIT RATIO

Net Profit Ratio indicates (a) an average Net Margin earned on a Revenue from Operations of ₹ 100 (b) what portion of Revenue from Operations is left to pay dividend and to create reserves, and (c) firm's capacity to withstand adverse economic conditions when selling price is declining, cost of production is rising and the demand for the product is falling. In general, Higher the ratio, greater is the capacity of the firm to withstand adverse economic conditions and vice versa.

ILLUSTRATION 54

From the following information Calculate Net Profit Ratio.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Opening Inventory	50,000	Purchases	11,50,000
Cash Revenue from Operations	4,00,000	Wages	80,000
Credit Revenue from Operations	17,00,000	Carriage Inward	20,000
Revenue from Operations Returns	1,00,000	Office & Adm. Expenses	1,00,000
Closing Inventory	1,00,000	Selling & Distribution Exp.	80,000
Interest & Dividend on		Finance Expenses:	
Long-term Investments	3,000	Cash Discount allowed to cus.	10,000
Profit on Sale of Long-term Invst.	2,000	Bad Debts	6,000
Compensation for acquisition of Land	1,000	Interest on Bills Payable	4,000
Value of Furniture lost by fire	6,000	Interest on Long-term Borrowings	1,20,000
Provision for Tax	2,40,000		

SOLUTION:

STEP 1: NET PROFIT

<i>Particulars</i>	₹	₹
A Revenue from Operations		20,00,000
B Less: Cost of Revenue from Operations:		
Opening Inventory	50,000	
Purchases	11,50,000	
Wages	80,000	
Carriage inward	20,000	
Less: Closing Inventory	(1,00,000)	(12,00,000)
C Gross Profit (A – B)		8,00,000

D	Less: Operating Expenses:		
	Employees' Benefit Expense	1,00,000	
	Depreciation	80,000	
	Cash Discount allowed	10,000	
	Bad Debts	6,000	
	Interest on Bills Payable	4,000	(2,00,000)
E	Operating Profit (C – D)		6,00,000
F	Less: Non-operating Expenses:		
	Long-term Borrowings	1,20,000	
	Value of Furniture lost by fire	6,000	(1,26,000)
G	Add: Non-operating Incomes:		
	Interest & Dividend as long-term investment	3,000	
	Profit on sale of long-term Investment	2,000	
	Compensation for acquisition of land	1,000	6,000
H	Net Profit before tax (E – F + G)		4,80,000
I	Less: Tax		(2,40,000)
J	Net Profit after tax (H – I)		2,40,000

Step 2: Net Profit Ratio = $\frac{\text{Net Profit Before Tax}}{\text{Revenue from Operations}} \times 100 = (\text{₹}4,80,000/\text{₹}20,00,000) \times 100 = 24\%$

or, Net Profit Ratio = $\frac{\text{Net Profit After Tax}}{\text{Revenue from Operations}} \times 100 = (\text{₹}2,40,000/\text{₹}20,00,000) \times 100 = 12\%$

ILLUSTRATION 55

Cash Revenue from Operations 25% of Revenue from Operations, Average Trade Receivables ₹ 1,50,000, Debtors Turnover Ratio 5, Gross Profit 2/3rd on Cost, Operating Expenses ₹ 1,00,000. Non-Operating Expenses ₹ 63,000, Non-Operating Incomes ₹ 3,000, Calculate Gross Profit Ratio, Operating Ratio, Operating Profit Ratio and Net Profit Ratio.

SOLUTION:

Step 1: Credit Revenue from Operations

$$= \text{Average Trade Receivables} \times \text{Debtors Turnover Ratio} \\ = ₹ 1,50,000 \times 5 = ₹ 7,50,000$$

Step 2: Revenue from Operations = ₹ 7,50,000 + 33-1/3% ₹ 7,50,000 = ₹ 10,00,000

Step 3: Let Cost = ₹ 3, Gross Profit = $3 \times \frac{2}{3} = ₹ 2$, Revenue from Operations = ₹ 5

Step 4: Gross Profit = ₹ 10,00,000 $\times \frac{2}{5} = ₹ 4,00,000$

Step 5: Cost of Revenue from Operations

$$= \text{Revenue from Operations} - \text{Gross Profit} \\ = ₹ 10,00,000 - ₹ 4,00,000 = ₹ 6,00,000$$

Step 6: Operating Cost = Cost of Revenue from Operations + Operating Expenses

$$= ₹ 6,00,000 + ₹ 1,00,000 = ₹ 7,00,000$$

Step 7: Operating Profit = Revenue from Operations – Operating Cost

$$= ₹ 10,00,000 - ₹ 7,00,000 = ₹ 3,00,000$$

Step 8: $\text{Net Profit} = \text{Operating Profit} + \text{Non-Operating Income} - \text{Non-Operating Expenses}$
 $= ₹ 3,00,000 + ₹ 3,000 - ₹ 63,000 = ₹ 2,40,000$

Step 9: $\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Revenue from Operations}} \times 100 = (\frac{₹4,00,000}{₹10,00,000}) \times 100 = 40\%$

Step 10: $\text{Operating Ratio} = \frac{\text{Operating Cost}}{\text{Revenue from Operations}} \times 100 = (\frac{₹7,00,000}{₹10,00,000}) \times 100 = 70\%$

Step 11: $\text{Operating Profit Ratio} = \frac{\text{Operating Profit}}{\text{Revenue from Operations}} \times 100 = (\frac{₹3,00,000}{₹10,00,000}) \times 100 = 30\%$

Step 12: $\text{Net Profit Ratio} = \frac{\text{Net Profit}}{\text{Revenue from Operations}} \times 100 = (\frac{₹2,40,000}{₹10,00,000}) \times 100 = 24\%$

ILLUSTRATION 56

Gross Profit Ratio 25%, Operating Ratio 90%, Operating Expenses ₹1,50,000. Non-Operating Expenses ₹ 5,000, Non-Operating Income ₹ 55,000. Calculate Net Profit Ratio.

SOLUTION:

Step 1: $\text{Cost of Goods Sold Ratio} = 100\% - \text{Gross Profit Ratio} = 100\% - 25\% = 75\%$

Step 2: $\text{Operating Expenses Ratio} = \text{Operating Ratio} - \text{Cost of Goods Sold Ratio} = 90\% - 75\% = 15\%$

Step 3: $\text{Revenue from Operations} = \frac{\text{Operating Expenses}}{\text{Operating Expenses Ratio}}$
 $= \frac{₹1,50,000}{15\%} = ₹ 10,00,000$

Step 4: $\text{Operating Profit Ratio} = 100\% - \text{Operating Ratio} = 100\% - 90\% = 10\%$

Step 5: $\text{Operating Profit} = ₹ 10,00,000 \times 10/100 = ₹ 1,00,000$

Step 6: $\text{Net Profit} = \text{Operating Profit} + \text{Non-Operating Incomes} - \text{Non-Operating Exp.}$
 $= ₹ 1,00,000 + ₹ 55,000 - ₹ 5,000 = ₹ 1,50,000$

Step 7: $\text{Net Profit Ratio} = \frac{\text{Net Profit}}{\text{Revenue from Operations}} \times 100 = (\frac{₹1,50,000}{₹10,00,000}) \times 100 = 15\%$

41.0 EXPENSES RATIOS

To identify the causes of variations in the operating ratio, the following expenses ratios may be calculated:

- 1. Material Consumed Ratio** — This ratio indicates the efficiency or otherwise in purchasing/ utilising the raw materials. It is expressed as a percentage. In the form of a formula, this ratio may be expressed as follows:

$$\text{Material Consumed Ratio} = \frac{\text{Material Consumed pertaining to units sold}}{\text{Net Revenue from operations/Net Sales}} \times 100 = \dots\%$$

- 2. Conversion Cost Ratio** — This ratio indicates the efficiency or otherwise of the manufacturing process. This ratio is expressed as a percentage. In the form of a formula, this ratio may be expressed as follows:

Conversion Cost Ratio

$$= \frac{\text{All Manufacturing Expenses (excluding cost of material) pertaining to units sold}}{\text{Net Revenue from operations/Net Sales}} \times 100 = \dots\%$$

- 3. Administrative Expenses Ratio** — This ratio indicates the efficiency or otherwise in the incurrance of administrative expenses. It is expressed as a percentage. In the form of a formula, this ratio may be expressed as follows:

$$\text{Administrative Exp. Ratio} = \frac{\text{Administrative Expenses}}{\text{Net Revenue from operations/Net Sales}} \times 100 = \dots\%$$

4. **Selling and Distribution Expenses Ratio** — This ratio indicates the efficiency or otherwise in the incurrence of selling and distribution expenses. It is expressed as a percentage. In the form of a formula, this ratio may be expressed as follows:

$$\text{Selling \& Distribution Exp. Ratio} = \frac{\text{Selling \& Distribution Expenses}}{\text{Net Revenue from operations/Net Sales}} \times 100 = \dots \%$$

ILLUSTRATION 57

Calculate the Material Cost Ratio, Conversion Cost Ratio, Administrative Expenses Ratio, and Selling and Distribution Expenses Ratio from the following information:

Revenue from Operations ₹ 20,00,000, Material Consumed ₹ 10,00,000, Wages ₹ 1,20,000, Manufacturing Expenses ₹ 80,000, Administrative Expenses ₹ 1,80,000, Selling and Distribution ₹ 20,000. There were no inventories of Finished Goods in the beginning and at the end.

SOLUTION:

$$\begin{aligned} \text{Material Consumed Ratio} &= \frac{\text{Material Consumed pertaining to units sold}}{\text{Net Revenue from operations/Net Sales}} \times 100 \\ &= \frac{\text{₹ 10,00,000}}{\text{₹ 20,00,000}} \times 100 = 50\% \end{aligned}$$

$$\begin{aligned} \text{Conversion Cost Ratio} &= \frac{\text{All Manufacturing Expenses (excluding cost of material) pertaining to units sold}}{\text{Net Revenue from operations/Net Sales}} \times 100 \\ &= \frac{\text{₹ 2,00,000}}{\text{₹ 20,00,000}} \times 100 = 10\% \end{aligned}$$

$$\begin{aligned} \text{Administrative Exp. Ratio} &= \frac{\text{Administrative Expenses}}{\text{Net Revenue from operations/Net Sales}} \times 100 \\ &= \frac{\text{₹ 1,80,000}}{\text{₹ 20,00,000}} \times 100 = 8\% \end{aligned}$$

$$\begin{aligned} \text{Selling \& Distribution Exp. Ratio} &= \frac{\text{Selling \& Distribution Expenses}}{\text{Net Revenue from operations/Net Sales}} \times 100 \\ &= \frac{\text{₹ 20,000}}{\text{₹ 20,00,000}} \times 100 = 1\% \end{aligned}$$

II. PROFITABILITY RATIOS IN RELATION TO INVESTMENT

42.0 RETURN ON TOTAL ASSETS [ROTA]

MEANING OF RETURN ON TOTAL ASSETS

Return of Total Assets Ratio measures a relationship between 'Net Profit before Interest and Tax' and 'Average Total Assets'.

OBJECTIVE OF RETURN ON TOTAL ASSETS

The objective of computing Return on Total Assets Ratio is to find out how efficiently the Total Assets have been used by the management.

COMPONENTS OF RETURN ON TOTAL ASSETS

There are two components of Return on Total Assets Ratio as follows:

1. **Net Profit before Interest and Tax.**
2. **Average Total Assets** = All Assets (excluding Non-Operating Assets)
 - or, = Shareholders' Funds + Total Debts
 - or, = Capital Employed + Current Liabilities

TUTORIAL NOTES

- (a) *Non-Operating Assets (e.g., Non- Trade Investments, Advance for purchase of Fixed Assets, Capital Work-in-Progress) should not be considered while computing 'Capital Employed' since these Non-Operating Assets have not been put to use to generate Revenue from Operations/ Sales. If these Non-Operating Assets are considered while computing 'Capital Employed', ROTA Ratio will unnecessarily be lower which does not reflect the true picture at all.*
- (b) *Income from Non-Operating Assets (if any) should also be excluded while calculating the Net Profit before Interest & Tax. '*
- (c) *Provision for Doubtful Debts' is not deducted from the total amount of Trade Receivables.*
- (d) *This Ratio may be calculated on Pre-tax or Post-tax basis.*
- (e) *Author feels that the figure of 'Total Assets' should be fairly representative of the investment in Total Assets throughout the accounting period and hence it is advised to make use of the concept of 'Average Total Assets'.*
- (f) *This Ratio may be calculated with reference to Average Total Assets/ Average Non - Current Assets/ Average Tangible Assets as per the requirement and availability of information. If information is available, then Average shall be taken.*
- (g) *If 'Average Total Assets / Average Non - Current Assets/ Average Tangible Assets ' cannot be ascertained due to non-availability of information, 'Closing Total Assets / Non - Current Assets/ Tangible Assets ' may be used by giving a suitable note to that effect.*

COMPUTATION OF RETURN ON TOTAL ASSETS

This Ratio is expressed as a percentage. In the form of a formula, this ratio may be expressed as follows:

Return on Total Assets (Pre-tax)

$$= \frac{\text{Net Profit before Interest and Tax}}{\text{Average Total Assets/Average Non-Current Assets/Average Tangible Assets}} \times 100 = \dots \%$$

Return on Total Assets(Post-tax)

$$= \frac{\text{Net Profit after Interest and Tax + Interest}}{\text{Average Total Assets/Average Non-Current Assets/Average Tangible Assets}} \times 100 = \dots \%$$

INTERPRETATION OF RETURN ON TOTAL ASSETS

Return on Total Assets Ratio indicates the firm's ability of generating profit per rupee of Total Assets. Higher the ratio, the more efficient the management and utilisation of total assets.

An enterprise should have a satisfactory ratio. To judge whether the ratio is satisfactory or not, it should be compared with its own past ratios or with the ratio of similar enterprises in the same industry or with the industry average.

ILLUSTRATION 58

From the following information, calculate Return on Total Assets(ROTA):

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Equity Share Capital	1,50,000	Tangible Fixed Assets	9,00,000
18% Pref. Share capital	1,00,000	Intangible Fixed Assets	1,50,000
Reserves & Surplus	1,50,000	Non-Current Investments [Trade]	50,000
15% Long-term Borrowings	8,00,000	Current Assets	5,00,000
Current Liabilities	4,00,000	Net Profit after Interest & Tax ₹ 3,36,000, Tax 30%	

SOLUTION:**STEP 1: NET PROFIT BEFORE INTEREST & TAX**

<i>Particulars</i>	₹
A Net Profit after Interest & Tax	3,36,000
B Add: Tax [(₹ 3,36,000/0.70) x 30%]	1,44,000
C Net Profit after Interest but before Tax (A + B)	4,80,000
D Add: Interest on Long-term Borrowings [₹ 8,00,000 x 15%]	1,20,000
E Net Profit before Interest & tax (C + D)	6,00,000

Step 2: Total Assets = Non-Current Assets + Current Assets
 $= (\text{₹ } 9,00,000 + \text{₹ } 1,50,000 + \text{₹ } 50,000) + \text{₹ } 5,00,000 = \text{₹ } 16,00,000$

Step 3: Return on Total Assets(Pre-tax)

$$= \frac{\text{Net Profit before Interest and Tax}}{\text{Average Total Assets}} \times 100$$

$$= (\text{₹ } 6,00,000 / \text{₹ } 16,00,000) \times 100 = 37.5\%$$

Return on Total Assets(Post-tax)

$$= \frac{\text{Net Profit after Interest and Tax + Interest}}{\text{Average Total Assets}} \times 100$$

$$= (\text{₹ } 3,36,000 + \text{₹ } 1,20,000) / \text{₹ } 16,00,000 \times 100 = 28.5\%$$

Note: Since 'Average Total Assets' cannot be ascertained due to non-availability of information, 'Closing Total Assets' have been used.

43.0 RETURN ON INVESTMENT (ROI) [OR RETURN ON CAPITAL EMPLOYED (ROCE)]**MEANING OF RETURN ON INVESTMENT**

Return on Investment Ratio measures a relationship between Net Profit before Interest and Tax and Average Capital Employed.

OBJECTIVE OF RETURN ON INVESTMENT

The objective of computing Return on Investment Ratio is to find out how efficiently the Long-term Funds supplied by the Long-term Creditors and Shareholders have been used.

COMPONENTS OF RETURN ON INVESTMENT

There are two components of this ratio as follows:

1. Net Profit before Interest, Tax & Pref. Dividend
2. Average Capital Employed = $[\text{Opening Capital Employed} + \text{Closing Capital Employed}] / 2$
Note: Capital Employed means long-term funds supplied by the Long-term Creditors and Shareholders. It can be calculated as follows:
 - (a) Capital Employed = $[(\text{Equity Share Capital} + \text{Pref. Share Capital} + \text{Reserves \& Surplus}) + \text{Non-Current Liabilities}]$
 - (b) Capital Employed = $\text{Shareholders' Funds} + \text{Non-Current Liabilities}$
 - (c) Capital Employed = $\text{Non-Current Assets (excluding Non-Operating Assets)} + \text{Current Assets} - \text{Current Liabilities}$
 - (d) Capital Employed = $\text{Non-Current Assets (excluding Non-Operating Assets)} + \text{Working Capital}$
 - (e) Capital Employed = $\text{Total Assets (excluding Non-Operating Assets)} - \text{Current Liabilities}$

TUTORIAL NOTES

- (a) *Non-Operating Assets (e.g., Non- Trade Investments, Advance for purchase of Fixed Assets, Capital Work-in-Progress) should not be considered while computing 'Capital Employed' since these Non-Operating Assets have not been put to use to generate Revenue from Operations/ Sales. If these Non-Operating Assets are considered while computing 'Capital Employed', Capital Employed Turnover Ratio will unnecessarily be lower which does not reflect the true picture at all.*
- (b) *'Provision for Doubtful Debts' is not deducted from the total amount of Trade Receivables.*
- (c) *Income from Non-Operating Assets (if any) should also be excluded while calculating the Net Profit before Interest & Tax.*
- (d) *This Ratio may be calculated on Pre-tax or Post-tax basis.*
- (e) *Author feels that the figure of 'Capital Employed' should be fairly representative of the capital investment throughout the accounting period and hence it is advised to make use of the concept of 'Average Capital Employed'.*
- (f) *This Ratio should be calculated with reference to Average Capital Employed as per the requirement and availability of information. If information is available, then Average shall be taken.*
- (g) *If 'Average Capital Employed' cannot be ascertained due to non-availability of information, 'Closing Capital Employed' may be used by giving a suitable note to that effect.*

COMPUTATION OF RETURN ON INVESTMENT

1. It is expressed as a percentage. In the form of formula, this ratio may be expressed as follows:

$$\text{Return on Capital Employed (Pre-tax)} = \frac{\text{Net Profit before Interest and Tax}}{\text{Average Capital Employed}} \times 100 = \dots \%$$

$$\text{Return on Capital Employed (Post-tax)} = \frac{\text{Net Profit after Interest and Tax} + \text{Interest}}{\text{Average Capital Employed}} \times 100 = \dots \%$$

2. ROI is the product of two ratios i.e. EBIT Ratio and Capital Turnover Ratio.

$$\begin{aligned} \text{ROI} &= \text{EBIT Ratio} \times \text{Capital Turnover Ratio} \\ &= \frac{\text{EBIT}}{\text{Revenue from Operations}} \times \frac{\text{Revenue from Operations}}{\text{Average Capital Employed}} \end{aligned}$$

INTERPRETATION OF RETURN ON INVESTMENT

Return on Investment Ratio indicates the firm's ability of generating profit per rupee of Capital Employed. Higher the Ratio, the more efficient the management and utilisation of Capital Employed.

An enterprise should have a satisfactory ratio. To judge whether the ratio is satisfactory or not, it should be compared with its own past ratios *or* with the ratio of similar enterprises in the same industry *or* with the industry average.

USES OF RETURN ON INVESTMENT

The Return on Investment is a very important concept in the field of operational management and the financial management. Its managerial uses include the following:

1. It is a measure of overall profitability of an enterprise.
2. It can be used to measure and compare the performance of various divisions within an enterprise.
3. It can be used to compare the performance of various enterprises within an industry.
4. It can be used for evaluating Investment Decisions (or Capital Budgeting Decisions or Capital Expenditure Decisions) Investment Decision is a decision to invest in long-term assets. Other things remaining the same, the projects yielding higher Rate of Return on Investment may be selected.
5. It can be used for planning the Capital Structure. Capital Structure Decision is a decision to decide upon the proportion of various sources of long-term funds, viz., long-term debts, preference shares, equity funds (including retained earnings). A financial manager should not take the financial risk by employing the funds carrying fixed financial charges if he is not in position to generate a Rate of Return on Investment greater than the Rate of Fixed Financial Charges.
6. It can be used for determining the price of a product/contract. The price of a product/contract should be fixed in such a way that a reasonable rate of return on investment is obtained after recovering the operating cost of that product/contract.

ILLUSTRATION 59

From the following information, calculate Return on Capital Employed [ROCE].

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Equity Share Capital	1,50,000	Tangible Fixed Assets	9,00,000
18% Pref. Share capital	1,00,000	Intangible Fixed Assets	1,50,000
Reserves & Surplus	1,50,000	Non-Current Investments [Trade]	50,000
15% Long-term Borrowings	8,00,000	Current Assets	5,00,000
Current Liabilities	4,00,000	Net Profit after Interest & Tax ₹ 3,36,000, Tax 30%	

SOLUTION:**STEP 1: NET PROFIT BEFORE INTEREST & TAX**

<i>Particulars</i>	₹
A Net Profit after interest & Tax	3,36,000
B Add: Tax[(₹ 3,36,000/0.70) x 30%]	1,44,000
C Net Profit after Interest but before Tax (A + B)	4,80,000
D Add: Interest on Long-term Borrowings	1,20,000
E Net Profit before Interest & tax (C + D)	6,00,000

STEP 2: CAPITAL EMPLOYED

- Capital Employed = Equity Share Capital + Pref. Share Capital + Reserves & Surplus + Non-Current Liabilities.

$$= ₹ 1,50,000 + ₹ 1,00,000 + ₹ 1,50,000 + ₹ 8,00,000 = ₹ 12,00,000$$

or,

- Capital Employed = Non-Current Assets (Excluding Non-Operating Assets) + Current Assets – Current Liabilities.

$$= ₹ 9,00,000 + ₹ 1,50,000 + ₹ 50,000 + ₹ 5,00,000 - ₹ 4,00,000 = ₹ 12,00,000$$

$$\begin{aligned} \text{STEP 3: Return on Capital Employed (Pre-tax)} &= \frac{\text{Net Profit before Interest and Tax}}{\text{Average Capital Employed}} \times 100 \\ &= \frac{₹ 6,00,000}{₹ 12,00,000} \times 100 = 50\% \end{aligned}$$

$$\begin{aligned} \text{Return on Capital Employed (Post-tax)} &= \frac{\text{Net Profit after Interest and Tax + Interest}}{\text{Average Capital Employed}} \times 100 \\ &= \frac{₹ 3,36,000 + ₹ 1,20,000}{₹ 12,00,000} \times 100 = 38\% \end{aligned}$$

Note: Since 'Average Capital Employed' cannot be ascertained due to non-availability of information, 'Closing Capital Employed' have been used.

ILLUSTRATION 60

A Company's Return on Investment (ROI) is 25% before tax. Tax is paid by the Company at 30%. The company has a 15% Long-term Loan of ₹ 25 lakhs as part of the Capital employed. What is amount by which shareholders' gain from there being the Loan?

SOLUTION:

Particulars	₹
A. Earning before Interest and tax (@ 25% on ₹ 25 lakhs)	6,25,000
B. Less: Interest @ 15% on ₹ 25 lakhs	3,75,000
C. Earning after Interest (A – B)	2,50,000
D. Less: Tax @ 30%	(75,000)
E. Earnings after Tax	1,75,000
Net Gain to Shareholders from there being Loan	1,75,000

ILLUSTRATION 61

EBIT Ratio 30%, Capital Turnover Ratio 1.67 times. Calculate Return on Investment (ROI)

$$\text{SOLUTION: ROI} = \text{EBIT Ratio} \times \text{Capital Turnover Ratio} = 30\% \times 1.67 = 50.1\%$$

44.0 RETURN ON SHAREHOLDERS' FUNDS (OR RETURN ON EQUITY) (ROE)
MEANING OF RETURN ON SHAREHOLDERS' FUNDS (OR RETURN ON EQUITY)

Return on Shareholders' Funds (or Return on Equity) Ratio measures a relationship between Net Profit after Interest and Tax, and Average Shareholders' Funds.

OBJECTIVE OF RETURN ON EQUITY

The objective of computing Return on Equity Ratio is to find out how efficiently the funds supplied by the Shareholders have been used.

COMPONENTS OF RETURN ON EQUITY

There are two components of Return on Equity ratio as follows:

1. Net Profit after Interest and Tax
2. Average Shareholders' Funds

$$= [\text{Opening Shareholders' Funds} + \text{Closing Shareholders' Funds}] / 2$$

Note: Shareholders' Funds mean Funds belonging to all the Shareholders (whether Equity or Preference). These may be calculated as follows:

- (a) Shareholders' Funds = Equity Share Capital + Pref. Share Capital + Reserves & Surplus
- (b) Shareholders' Funds = Non-Current Assets + Current Assets – Current Liabilities – Non-Current Liabilities
- (c) Shareholders' Funds = Non-Current Assets + Working Capital – Non-Current Liabilities
- (d) Shareholders' Funds = Capital Employed – Non-Current Liabilities
- (e) Shareholders' Funds = Total Assets – Total Debt

TUTORIAL NOTE

- (a) *Author feels that the figure of 'Shareholders Funds' should be fairly representative of the shareholders' investment throughout the accounting period and hence it is advised to make use of the concept of 'Average Shareholders' Funds'.*
- (b) *This Ratio may be calculated with reference to Average Shareholders' Funds as per the requirement and availability of information. If information is available, then Average shall be taken.*
- (c) *If 'Average Shareholders' Funds' cannot be ascertained due to non-availability of information, 'Closing Shareholders' Funds' may be used by giving a suitable note to that effect.*

COMPUTATION OF RETURN ON EQUITY

Return on Equity Ratio is computed by dividing the Net Profit after Interest and Tax by Average Shareholders' Funds. It is expressed as a percentage. In the form of a formula, this ratio may be expressed as follows:

$$\text{Return on Shareholders' Funds} = \frac{\text{Net Profit after Interest and Tax}}{\text{Average Shareholders' Funds}} \times 100 = \dots \%$$

INTERPRETATION OF RETURN ON EQUITY

Return on Equity Ratio indicates the firm's ability of generating profit per rupee of Shareholders' Funds. Higher the ratio, the more efficient the management and utilization of Shareholders' Funds.

An enterprise should have a satisfactory ratio. To judge whether the ratio is satisfactory or not, it should be compared with its own past ratios or with the ratio of similar enterprises in the same industry or with the industry average.

ILLUSTRATION 62

From the following information, calculate Return on Equity:[ROE]

Particulars	₹	Particulars	₹
Equity Share Capital (₹ 10 each)	1,50,000	Tangible Fixed Assets	9,00,000
18% Pref. Share capital	1,00,000	Intangible Fixed Assets	1,50,000

Reserves & Surplus	1,50,000	Non-Current Investments [Trade]	50,000
15% Long-term Borrowings	8,00,000	Current Assets	5,00,000
Current Liabilities	4,00,000	Net Profit before Interest & Tax ₹ 6,00,000, Tax 30%	

SOLUTION:
STEP 1: NET PROFIT AFTER INTEREST & TAX

Particulars	₹
A. Net Profit before Interest & Tax	6,00,000
B. Less: Interest on Long-term Borrowings [₹ 8,00,000 x 15/100]	(1,20,000)
C. Net Profit before tax	4,80,000
D. Less: Tax @30%	(1,44,000)
E. Net Profit after Interest & Tax	3,36,000

STEP 2: Shareholders' Funds

- Shareholders' Funds = Equity Share Capital + Pref. Share Capital + Reserves & Surplus
 $= ₹ 1,50,000 + ₹ 1,00,000 + ₹ 1,50,000 = ₹ 4,00,000$
or,
- Shareholders' Funds = Non-Current Assets (Excluding Non-Trade Investments) + Current Assets – Non-Current Liabilities – Current Liabilities.
 $= ₹ 9,00,000 + ₹ 1,50,000 + ₹ 50,000 - ₹ 5,00,000 - ₹ 8,00,000 = ₹ 4,00,000$

STEP 3: Return on Shareholders' Funds

$$\begin{aligned} \text{Return on Shareholders' Funds} &= \frac{\text{Net Profit after Interest and Tax}}{\text{Average Shareholders' Funds}} \times 100 \\ &= \frac{₹ 3,36,000}{₹ 4,00,000} \times 100 = 84\% \end{aligned}$$

Note: Since 'Average Shareholders' Funds' cannot be ascertained due to non-availability of information, 'Closing Shareholders' Funds' have been used.

III. PROFITABILITY RATIOS IN RELATION TO EQUITY SHAREHOLDERS' FUNDS
45.0 RETURN ON EQUITY SHAREHOLDERS' FUNDS [ROE]
MEANING OF RETURN ON EQUITY SHAREHOLDERS' FUNDS

Return on Equity Shareholders' Funds Ratio measures a relationship between Net Profit after Interest, Tax, and Preference Dividend, and Average Equity Shareholders' Funds.

OBJECTIVE OF RETURN ON EQUITY SHAREHOLDERS' FUNDS

The objective of computing this ratio is to find out how efficiently the funds supplied by the Equity Shareholders have been used.

COMPONENTS OF RETURN ON EQUITY SHAREHOLDERS' FUNDS

There are two components of this ratio as follows:

1. Net Profit after Interest, Tax and Preference Dividend (including participating dividend if any, due to Participating Preference Shareholders).
2. Average Equity Shareholders' Funds = [Opening Equity Shareholders' Funds + Closing Equity Shareholders' Funds]/2

Note: Equity Shareholders' Funds mean Funds belonging to Equity Shareholders. These may be calculated as follows:

- (a) Equity Shareholders' Funds = Equity Share Capital + Net Reserves & Surplus
- (b) Equity Shareholders' Funds = Non-Current Assets + Current Assets – Current Liabilities – Non-Current Liabilities – Pref. Share Capital
- (c) Equity Shareholders' Funds = Non-Current Assets + Working Capital – Non-Current Liabilities – Pref. Share Capital
- (d) Equity Shareholders' Funds = Capital Employed – Non-Current Liabilities – Pref. Share Capital
- (e) Equity Shareholders' Funds = Total Assets – Total Debt – Pref. Share Capital

TUTORIAL NOTE

- (a) *Author feels that the figure of 'Equity Shareholders Funds' should be fairly representative of the Equity Shareholders' investment throughout the accounting period and hence it is advised to make use of the concept of 'Average Equity Shareholders' Funds'.*
- (b) *This Ratio may be calculated with reference to Average Equity Shareholders' Funds as per the requirement and availability of information. If information is available, then Average shall be taken.*
- (c) *If 'Average Equity Shareholders' Funds' cannot be ascertained due to non-availability of information, 'Closing Equity Shareholders' Funds' may be used by giving a suitable note to that effect.*

COMPUTATION OF RETURN ON EQUITY SHAREHOLDERS' FUNDS

Return on Equity Shareholders' Funds Ratio is computed by dividing the Net Profit after Interest, Tax and Preference Dividend by Average Equity Shareholders' Funds. This ratio is expressed as a percentage. In the form of a formula, this ratio may be expressed as follows:

Return on Equity Shareholders' Funds

$$= \frac{\text{Net Profit after Interest, Tax and Preference Dividend}}{\text{Average Equity Shareholders' Funds}} \times 100 = \dots\%$$

INTERPRETATION OF RETURN ON EQUITY SHAREHOLDERS' FUNDS

Return on Equity Shareholders' Funds ratio indicates the firm's ability of generating profit per rupee of Equity Shareholders' Funds. Higher the ratio, the more efficient the management and utilisation of Equity Shareholders' Funds.

An enterprise should have a satisfactory ratio. To judge whether the ratio is satisfactory or not, it should be compared with its own past ratios or with the ratio of similar enterprises in the same industry or with the industry average.

ILLUSTRATION 63

From the following information, calculate Return on Equity:

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Equity Share Capital (₹ 10 each)	1,50,000	Tangible Fixed Assets	9,00,000
18% Pref. Share capital	1,00,000	Intangible Fixed Assets	1,50,000
Reserves & Surplus	1,50,000	Non-Current Investments [Trade]	50,000
15% Long-term Borrowings	8,00,000	Current Assets	5,00,000
Current Liabilities	4,00,000	Net Profit before Interest & Tax ₹ 6,00,000, Tax 30%	

SOLUTION:**STEP 1: NET PROFIT AFTER INTEREST, TAX & PREF. DIVIDEND**

<i>Particulars</i>	₹
A. Net Profit before Interest & Tax	6,00,000
B. Less: Interest on Long-term Borrowings [₹ 8,00,000 x 15/100]	(1,20,000)
C. Net Profit before tax	4,80,000
D. Less: Tax @30%	(1,44,000)
E. Net Profit after Interest & Tax	3,36,000
F. Less: Pref. Dividend	(18,000)
G. Net Profit after Interest, Tax and Preference Dividend	3,18,000

STEP 2: Equity Shareholders' Funds

- Equity Shareholders' Funds = Equity Share Capital + Reserves & Surplus
 $= ₹1,50,000 + ₹ 1,50,000 = ₹ 3,00,000$
 or,
- Equity Shareholders' Funds = Non-Current Assets (Excluding Non-Trade Investments)
 + Current Assets – Non-Current Liabilities – Current
 Liabilities – Pref. Share Capital
 $= ₹ 9,00,000 + ₹ 1,50,000 + ₹ 50,000 + ₹ 5,00,000 – ₹ 8,00,000 – ₹ 4,00,000 – ₹ 1,00,000$
 $= ₹ 3,00,000$

STEP 3: Return on Equity Shareholders' Funds

$$= \frac{\text{Net Profit after Interest, Tax and Preference Dividend}}{\text{Average Equity Shareholders' Funds}} \times 100 = \frac{₹ 3,18,000}{₹ 3,00,000} \times 100 = 106\%$$

Note: Since 'Average Equity Shareholders' Funds' cannot be ascertained due to non-availability of information, 'Closing Equity Shareholders' Funds' have been used.

46.0 EARNING PER SHARE (EPS)**MEANING OF EARNING PER SHARE (EPS)**

EPS measures the Earnings available to an Equity Shareholders on a per share basis.

OBJECTIVE OF EARNING PER SHARE (EPS)

The objective of computing EPS ratio is to measure the profitability of the firm on per equity share basis.

COMPONENTS OF EARNING PER SHARE (EPS)

1. Net Profit after Interest, Tax and Preference Dividend;
2. Number of Equity Shares

COMPUTATION OF EARNING PER SHARE (EPS)

EPS ratio is computed by dividing the Net Profit after Interest, Tax and Preference Dividend by the Number of Equity Shares. It is expressed as an absolute figure. In the form of a formula, this ratio may be expressed as follows:

$$\text{EPS} = \frac{\text{Net Profit after Interest, Tax and Preference Dividend}}{\text{Number of Equity Shares}} = ₹ \dots \text{ per share}$$

INTERPRETATION OF EARNING PER SHARE (EPS)

In general, higher the EPS, better it is and vice versa. While interpreting this ratio, it must be seen whether there is any increase in Equity Shareholders' Funds as a result of retained earnings without any change in numbers of outstanding shares. For instance, in the case of a company which is following a practice of ploughing back of profits and which is not capitalising its profits by way of issue of bonus shares, the interpretation of EPS without considering the effect of profits ploughed back in the business on earnings, will not be appropriate. EPS helps in determining the market price of the equity shares of the company. It also helps in estimating the company's capacity to pay dividend.

An enterprise should have a satisfactory ratio. To judge whether the ratio is satisfactory or not, it should be compared with its own past ratios or with the ratio of similar enterprises in the same industry or with the industry average.

ILLUSTRATION 64

From the following information, calculate Earning Per Share:

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Equity Share Capital (₹ 10 each)	1,50,000	Tangible Fixed Assets	9,00,000
18% Pref. Share Capital	1,00,000	Intangible Fixed Assets	1,50,000
Reserves & Surplus	1,50,000	Non-Current Investments [Trade]	50,000
15% Long-term Borrowings	8,00,000	Current Assets	5,00,000
Current Liabilities	4,00,000	Net Profit before Interest & Tax ₹ 6,00,000, Tax 30%	

SOLUTION:**STEP 1: NET PROFIT AFTER INTEREST, TAX & PREF. DIVIDEND**

<i>Particulars</i>	₹
A. Net Profit before Interest & Tax	6,00,000
B. Less: Interest on Long-term Borrowings [₹ 8,00,000 x 15/100]	(1,20,000)
C. Net Profit before tax	4,80,000
D. Less: Tax @30%	(1,44,000)
E. Net Profit after Interest & Tax	3,36,000
F. Less: Pref. Dividend	(18,000)
G. Net Profit after Interest, Tax and Preference Dividend	3,18,000

STEP 2: No of Equity Shares = ₹ 1,50,000/ ₹10 = 15,000

$$\text{STEP 3: EPS} = \frac{\text{Net Profit after Interest, Tax and Preference Dividend}}{\text{Number of Equity Shares}} = \frac{\text{₹ 3,18,000}}{15,000} \\ = \text{₹ 21.20 per share}$$

47.0 DIVIDEND PER SHARE

MEANING OF DIVIDEND PER SHARE

This ratio measures the dividend distributed per equity share.

OBJECTIVE OF DIVIDEND PER SHARE

The objective of computing this ratio is to measure the dividend distributed per equity share.

COMPONENTS OF DIVIDEND PER SHARE

There are two components of this ratio as follows:

1. Profits Distributed as Equity Dividend
2. Number of Equity Shares

COMPUTATION OF DIVIDEND PER SHARE

This ratio is computed by dividing the Profit Distributed as Equity Dividend by the Number of Equity Shares. It is expressed as an absolute figure. In the form of a formula, this ratio may be expressed as follows:

$$\text{DPS} = \frac{\text{Profit distributed as Equity Dividend}}{\text{Number of Equity Shares}} = \text{₹... per share}$$

INTERPRETATION OF DIVIDEND PER SHARE

In general, higher the DPS, better it is and vice versa. An enterprise should have a satisfactory ratio. To judge whether the ratio is satisfactory *or* not, it should be compared with its own past ratios *or* with the ratio of similar enterprises in the same industry *or* with the industry average.

ILLUSTRATION 65

Equity Share Capital (₹ 10 each) ₹ 1,50,000, 18% Pref. Share Capital ₹ 1,00,000, Net Profit after Interest & Tax ₹ 3,36,000, Profit distributed as Dividend on all shares ₹ 2,08,800, Calculate Dividend Per Share.

SOLUTION:

Profit distributed as Equity Dividend = ₹ 2,08,800 – ₹ 18,000 = ₹ 1,90,800

$$\text{DPS} = \frac{\text{Profit distributed as Equity Dividend}}{\text{Number of Equity Shares}} \\ = \frac{\text{₹ 1,90,800}}{15,000} = \text{₹ 12.72}$$

48.0 PRICE EARNING RATIO

MEANING OF PRICE EARNING RATIO

This ratio measures the relationship between the Market Price per Share and Earning Per Share.

OBJECTIVE OF PRICE EARNING RATIO

The objective of computing this ratio is to find out expectations of the shareholders about the earnings of the firm.

COMPONENTS OF PRICE EARNING RATIO

There are two components of this ratio as follows:

1. Market Price Per Share
2. Earning Per Share (EPS)

COMPUTATION OF PRICE EARNING RATIO

This ratio is computed by dividing Market Price per Share by Earning Per Share. It is usually expressed as a pure number. In the form of a formula, this ratio may be expressed as follows:

Note: Market Price per share may be Average Share Price or Closing Share Price

$$\text{Price-Earning Ratio} = \frac{\text{Market Price Per Share}}{\text{Earning Per Share (EPS)}}$$

INTERPRETATION

It indicates the number of times of EPS, the share is being quoted in the market. In other words, it indicates the Payback Period within which the prospective investor can recover his investment in a single share by way of Earning Per Share (EPS). Unless affected by speculation usually higher P/E Ratio indicates that the company is growing and has good earning prospects but a lower P/E ratio need not always necessarily mean that the company is not growing and has no good prospects as it happens in case of a closely held public company where only a few shares are available in the market for general investors who generally do not trade much in those limited shares.

ILLUSTRATION 66

Earning Per Share ₹ 21.20, Market Price Per Share ₹ 424. Calculate Price-Earning Ratio.

SOLUTION:

$$\text{Price-Earning Ratio} = \frac{\text{Market Price Per Share}}{\text{Earning Per Share (EPS)}} = \frac{\text{₹ 424}}{\text{₹ 21.20}} = 20$$

49.0 DIVIDEND PAYOUT RATIO**MEANING OF DIVIDEND PAYOUT RATIO**

This ratio measures the portion of Earning Per Share distributed as dividend.

OBJECTIVE OF DIVIDEND PAYOUT RATIO

The objective of computing this ratio is to measure the portion of EPS distributed as dividend.

COMPONENTS OF DIVIDEND PAYOUT RATIO

There are two components of this ratio as follows:

1. Earning Per Share (EPS)
2. Dividend Per Share (DPS)

COMPUTATION OF DIVIDEND PAYOUT RATIO

This ratio is computed by dividing the DPS by EPS. It is usually expressed as a percentage. In the form of formula, this ratio may be expressed as follows:

$$\text{Dividend Payout Ratio} = \frac{\text{Earning Per Share (EPS)}}{\text{Dividend Per Share (DPS)}} \times 100$$

Note: Dividend Payout Ratio is complementary to Retention Ratio which is equal to 100% – Dividend Payout Ratio.

INTERPRETATION OF DIVIDEND PAYOUT RATIO

In general higher the D/P Ratio, better it is. However, D/P Ratio should not be looked at in isolation. D/P Ratio should be considered in the light of various factors such as Availability of Divisible Profits, Availability of Profitable Reinvestment Opportunities, Availability of Liquidity, Company's Own Policy regarding Stability of Dividend, Contractual Restrictions by Financial Institutions, Extent of Access to External Sources, Attitude and Objectives of Management etc.

An enterprise should have a satisfactory ratio. To judge whether the ratio is satisfactory or not, it should be compared with its own past ratios or with the ratio of similar enterprises in the same industry or with the industry average.

ILLUSTRATION 67

Calculate Dividend Payout Ratio from the following:

Dividend Per Share ₹ 12.72, Earning Per Share ₹ 21.20.

SOLUTION:

$$\text{Dividend Payout Ratio} = \frac{\text{Earning Per Share (EPS)}}{\text{Dividend Per Share (DPS)}} \times 100 = \frac{\text{₹ 12.72}}{\text{₹ 21.20}} \times 100 = 60\%$$

50.0 EARNING YIELD (EY)

MEANING OF EARNING YIELD

This ratio measures the relationship between Earning Per Share (EPS) and Market Price per share.

OBJECTIVE OF EARNING YIELD

The objective of computing this ratio is to measure the performance of Earnings in relation to Market Price per share.

COMPONENTS OF EARNING YIELD

There are two components of this ratio as follows:

1. Earning Per Share,
2. Market Price Per Share (preferably Average Market Price per share)

COMPUTATION OF EARNING YIELD

This ratio is computed by dividing EPS by the Market Price per share. It is usually expressed as a percentage. In the form of a formula, this ratio may be expressed as follows:

$$\text{Earning Yield} = \frac{\text{Earning Per Share}}{\text{Market Price Per Share}} \times 100 = \dots\%$$

INTERPRETATION OF EARNING YIELD

It indicates the return (in terms of EPS) on market price. It indicates earning as % of market price. In general higher the ratio, better it is.

An enterprise should have a satisfactory ratio. To judge whether the ratio is satisfactory *or* not, it should be compared with its own past ratios *or* with the ratio of similar enterprises in the same industry *or* with the industry average.

ILLUSTRATION 68

Earning Per Share ₹ 21.20, Market Price Per Share ₹ 424. Calculate Earning Yield.

SOLUTION:

$$\text{Earning Yield} = \frac{\text{Earning Per Share}}{\text{Market Price Per Share}} \times 100 = \frac{\text{₹ 21.20}}{\text{₹ 424}} \times 100 = 5\%$$

51.0 DIVIDEND YIELD (EY)**MEANING OF DIVIDEND YIELD**

This ratio measure the relationship between Dividend Per Share (DPS) and Market Price per share.

OBJECTIVE OF DIVIDEND YIELD

The objective of computing this ratio is to measure the performance of dividend in relation to market price per share.

COMPONENTS OF DIVIDEND YIELD

There are two components of this ratio as follows:

1. Dividend Per Share (DPS)
2. Market Price Per Share. (preferably Average Market Price Per Share)

COMPUTATION OF DIVIDEND YIELD

This ratio is computed by dividing the DPS by the Market Price Per Share. It is usually expressed as a percentage. In the form of a formula, this ratio may be expressed as a percentage. In the form of a formula, this ratio may be expressed as follows:

$$\text{Dividend Yield} = \frac{\text{Dividend Per Share}}{\text{Market Price Per Share}} \times 100$$

INTERPRETATION OF DIVIDEND YIELD

In indicates the return (in terms of DPS) on market price. It indicates dividend as % of market price. In general higher the ratio, better it is.

An enterprise should have a satisfactory ratio. To judge whether the ratio is satisfactory *or* not, it should be compared with its own past ratios *or* with the ratio of similar enterprises in the same industry *or* with the industry average.

ILLUSTRATION 69

Dividend Per Share ₹ 12.72, Market Price Per Share ₹ 424. Calculate Dividend Yield.

SOLUTION:

$$\text{Dividend Yield} = \frac{\text{Dividend Per Share}}{\text{Market Price Per Share}} \times 100 = \frac{\text{₹ 12.72}}{\text{₹ 424}} \times 100 = 3\%$$

52.0 MARKET RESPONSE RATIO**MEANING OF MARKET RESPONSE RATIO**

This ratio measures a relationship between Market Value per share and Book Value per share.

OBJECTIVE OF MARKET RESPONSE RATIO

The objective of computing this ratio is to measure market response to the Book Value of a share.

COMPONENTS OF MARKET RESPONSE RATIO

There are two components of this ratio as follows:

1. **Market Value per share (preferably Average Market Price of a share)**
2. **Book Value per share = Net Assets available for Equity Shareholders / Number of Equity Shares.**

COMPUTATION OF MARKET RESPONSE RATIO

This ratio is computed by dividing the Market Price per share by Book Value per share. In the form of a formula, this ratio may be expressed as follows:

$$\text{Market Response Ratio} = \frac{\text{Market Value per share}}{\text{Book Value per share}} \times 100$$

$$\text{Or, Market Response Ratio} = \frac{\text{Average Market Value per share}}{\text{Net Worth/No. of Equity Shares}} \times 100$$

INTERPRETATION OF MARKET RESPONSE RATIO

This ratio indicates market response to the book value of a share. Higher the ratio better is the shareholders' position in terms of capital gains. Price/Book Value is the price paid for the company's assets. Lower the price to book value, more attractive the Investment Opportunity.

However, price to book value should not be looked at in isolation. The quality of the Assets, Profitability, and Return on Equity should also be considered.

ILLUSTRATION 70

Market Value of an Equity Share ₹ 424, Net Assets available for Equity Shareholders ₹ 3,00,000, Number of Equity Shares 15,000. Calculate the Market Response Ratio.

SOLUTION:

$$\begin{aligned} \text{Market Response Ratio} &= \frac{\text{Market Value per share}}{\text{Book Value per share}} \times 100 \\ &= \frac{\text{₹ 424}}{\text{₹ 20}} \times 100 = 2120\% \end{aligned}$$

Note: Book Value per share = Net Assets available for Equity Shareholders / Number of Equity Shares = ₹ 3,00,000 / 15,000 = ₹ 20

ILLUSTRATION 71 [COMPREHENSIVE]

Following in the Balance Sheet of Tulsian Ltd as at 31.3.2018:

BALANCE SHEET OF TULSIAN LTD AS AT 31.03.2018

<i>Particulars</i>	<i>31.03.2018</i> ₹
I. EQUITY AND LIABILITIES	
(1) Shareholders' Funds	
(a) Share Capital(including 18% Pref. Share Capital ₹ 1,00,000) (₹ 10 each)	2,00,000
(b) Reserves and Surplus	2,00,000
(2) Non-Current Liabilities	
Long-term Borrowings	8,00,000
(3) Current Liabilities	
Short-term Borrowings	40,000
Trade Payables	1,00,000
Other Current Liabilities	1,40,000
Short-term Provisions	1,20,000
Total	16,00,000
II. ASSETS	
(1) Non-Current Assets	
Fixed Assets	10,00,000
Non-Current Investments	1,00,000
(2) Current Assets	
Current Investments	20,000
Inventories	1,90,000
Trade Receivables	2,60,000
Cash & Cash Equivalents	10,000
Short-term Loans & Advances	10,000
Other Current Assets(Prepaid Expenses)	10,000
Total	16,00,000

Net Profit after Interest & Tax for the year 2017-2018 ₹ 2,40,000, Tax Rate 50%, Equity Dividend 60% of Earning Per Share, Operating Expenses ₹ 2,00,000, Market Price of an Equity Share ₹ 225, Net Sales ₹ 20,00,000, Sales Returns ₹ 1,00,000.

Required: (a) Gross Profit Ratio, (b) Operating Ratio, (c) Net Profit Ratio, (d) Return on Investment, (e) Earning Per Share, (f) Dividend per Share, (g) Price Earning Ratio. (h) Dividend Payout Ratio, (i) Earning Yield, (j) Dividend Yield, (k) Market Response Ratio (l) Return on Total Assets (m) Return on Shareholders' Funds (n) Return on Equity Shareholders' Funds.

SOLUTION:
CALCULATION OF CAPITAL EMPLOYED

<i>Liabilities Side Approach</i>	₹	<i>Assets Side Approach</i>	₹
Equity Share Capital	1,00,000	Net Fixed Assets	10,00,000
Add: Reserves & Surplus	2,00,000	Add: Non-Current Investments	1,00,000
Equity Shareholders' Funds	3,00,000	Add: Current Assets	5,00,000
Add: Preference Share Capital	1,00,000	Total Assets	16,00,000
Shareholders' Funds	4,00,000	Less: Current Liabilities	(4,00,000)
Add: Long-term Debts	8,00,000		
Capital Employed	12,00,000	Capital Employed	12,00,000

CALCULATION OF NET PROFIT BEFORE INTEREST & TAX, GROSS PROFIT AND OPERATING COST

A. Net Profit after Interest & Tax	2,40,000
B. Add: Tax [$\text{₹}2,43,000/0.50 \times 0.50$]	2,40,000
C. Net Profit Before Tax [A + B]	4,80,000
D. Add: Interest on Long-term Debt [15% on ₹ 8,00,000]	1,20,000
E. Net Profit Before Interest & Tax	6,00,000
F. Add: Operating Expenses	2,00,000
G. Gross Profit (F + G)	8,00,000
H. Net Sales	20,00,000
I. Cost of Goods Sold (I – H)	12,00,000
J. Operating Cost (G + J)	14,00,000

$$(a) \text{ Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Revenue from Operations}} \times 100 = (\text{₹}8,00,000/\text{₹}20,00,000) \times 100 = 40\%$$

$$(b) \text{ Operating Ratio} = \frac{\text{Operating Cost}}{\text{Revenue from Operations}} \times 100 = (\text{₹}14,00,000/\text{₹}20,00,000) \times 100 = 70\%$$

$$(c) \text{ Net Profit Ratio} = \frac{\text{Net Profit Before Tax}}{\text{Revenue from Operations}} \times 100 = (\text{₹}4,86,000/\text{₹}20,00,000) \times 100 = 24.3\%$$

$$\text{or, Net Profit Ratio} = \frac{\text{Net Profit After Tax}}{\text{Revenue from Operations}} \times 100$$

$$= (\text{₹}2,43,000/\text{₹}20,00,000) \times 100 = 12.15\%$$

$$(d) \text{ Return on Capital Employed or Investment} = \frac{\text{Net Profit before Interest and Tax}}{\text{Average Capital Employed}} \times 100$$

$$= (\text{₹}6,00,000 / \text{₹}12,00,000) \times 100 = 50\%$$

$$(e) \text{ Earning Per Share} = \frac{\text{Net Profit after Interest, Tax and Preference Dividend}}{\text{Number of Equity Shares}}$$

$$= (\text{₹}2,25,000 / \text{₹}10,000) = \text{₹}22.50$$

$$(f) \text{ Dividend Per Share} = \frac{\text{Profit distributed as Equity Dividend}}{\text{Number of Equity Shares}} = (\text{₹}1,35,000 / \text{₹}10,000) = \text{₹}13.50$$

- (g) Price Earning Ratio = $\frac{\text{Market Price Per Share}}{\text{Earning Per Share (EPS)}} = \frac{₹225}{₹22.50} = 10$
- (h) Dividend Payout Ratio = $\frac{\text{Dividend Per Share (DPS)}}{\text{Earning Per Share (EPS)}} = \frac{₹13.50}{₹22.50} \times 100 = 60\%$
- (i) Earning Yield = $\frac{\text{Earning Per Share}}{\text{Market Price Per Share}} = \frac{₹22.50}{₹225} \times 100 = 10\%$
- (j) Dividend Yield = $\frac{\text{Dividend Per Share}}{\text{Market Price Per Share}} = \frac{₹13.50}{₹225} \times 100 = 6\%$
- (k) Market Response Ratio = $\frac{\text{Market Price per share}}{\text{Book Value per share}} = \frac{₹225}{₹40} \times 100 = 562.50\%$

Note: Book Value Per Share = $\frac{\text{Equity Shareholders' Funds}}{\text{No. of Equity Shares}}$

= $\frac{₹4,00,000}{₹10,000} = ₹40$ per share.

- (l) Return on Total Assets = $\frac{\text{Net Profit before Interest and Tax}}{\text{Average Total Assets}} \times 100$
 = $\frac{₹6,00,000}{₹16,00,000} \times 100 = 37.5\%$

Note: Since 'Average Total Assets' cannot be ascertained due to non-availability of information, 'Closing Total Assets' have been used.

- (m) Return on Shareholders' Funds = $\frac{\text{Net Profit after Interest and Tax}}{\text{Average Shareholders' Funds}} \times 100$
 = $\frac{₹2,40,000}{₹4,00,000} \times 100 = 60\%$

Note: Since 'Average Shareholders' Funds' cannot be ascertained due to non-availability of information, 'Closing Shareholders' Funds' have been used.

- (n) Return on Equity Shareholders' Funds
 = $\frac{\text{Net Profit after Interest, Tax and Preference Dividend}}{\text{Average Equity Shareholders' Funds}} \times 100 = \frac{₹2,22,000}{₹3,00,000} = 74\%$

Note: Since 'Average Equity Shareholders' Funds' cannot be ascertained due to non-availability of information, 'Closing Equity Shareholders' Funds' have been used.

53.0 INTER-FIRM COMPARISON

MEANING OF INTER-FIRM COMPARISON

Inter-firm comparison is a technique of comparing the information of similar other concerns for assessing its own performance and ascertaining the reasons for any difference in performance and efficiency. In this regard, financial statements as prepared by the concern are an important source of information. In order to evaluate and interpret the financial performance and efficiency of the concern, accounting ratios are extensively used. The same procedure may also be useful in comparing the inter-firm financial information.

ACCOUNTING RATIOS USED FOR INTER-FIRM COMPARISON

The important accounting ratios that may be used in inter-firm comparison are as follows:

1. **ROI:** The return on investment popularly known as ROI calculated as operating profit to operating assets provides an insight into the financial performance of the concern. This ratio can be broken into two components, viz., profit margin on sales and the turnover ratios to capital.

2. **Debt-Equity Ratio:** The debt-equity ratio, i.e., the ratio of long-term debt to the total of long-term funds i.e., capital and reserves, and long-term debt. A change in this ratio would indicate a change in the financial policy pursued by the company. Set against the ratio for the industry as a whole, it would indicate to what extent the particular company is deviating from the norms. Diversified business will be able to maintain a higher debt-equity ratio than a company which depends only on one product line. This is because profit volatility is relatively *less* in diversified business on the basis of which higher degree of leverage risk can be assumed.
3. **Current Ratio:** The current ratio which would indicate the efficiency with which the company would be able to meet its short-term commitments. Current Ratio higher than unity indicates that the business covers the Current Liabilities at least at the book value. Higher the current ratio, better is the Current Liabilities coverage. On the other hand, too high a current ratio may mean idle Working Capital.

Strictly speaking, these three ratios would be able to throw a good deal of light on the performance of the company. But these figures should be seen along with the progress in absolute terms. It is possible to maintain good ratios even in a declining business.

In this connection, it is necessary to point out that the criteria laid down for inter-firm comparison in respect of costs also hold good for comparison on the basis of accounting ratios. What may be suitable for a small firm may be unsuitable for a big one and vice-versa; the ratios worked out on the basis of financial statements in the case of old firms may not really be valid in terms whereas ratios in the case of new firm would be nearer the truth since the balance sheet figures would reflect more or less current values.

OBJECTIVES OF INTER-FIRM COMPARISON

Inter-firm comparison has been used on a large scale with the objectives of making choice of investment by potential investors. The investor conducts inter-firm comparison for determining the status of security of investment as also the returns in the form of dividends. Whereas the small investor who is interested in regular dividends conducts the analysis from the dividend and profitability angle, the large investors look to inter-firm comparison with a view to have not only returns but also to have the capital appreciation. This involves an inter-firm comparison of both profitability trends as also the trends pertaining to the quality, strength and fibre of share-holders' equity.

The technique of inter-firm comparison has also been increasingly used by companies. The main objectives for which this technique is being used may be summarised as follows:

1. Diagnosing the real problems, over-all technical and accounting analysis, of each firm in relation to others, detecting weak spots and evaluating their real importance.
2. Helping the management to prepare specific plans of action under the existing circumstances after taking into account all relevant technical, financial and other factors.
3. Preparing the base for standardisation of products and practices, for uniform accounting systems and records, mutual exchange of information between firms and other factors.
4. Determining the conditions of a particular firm and special reasons of lower efficiency beyond the control due to geographical and other reasons, so that suggestions of allowing subsidies, loans and other amenities may be considered.
5. Facilitating introduction of collective incentive schemes and allowing the employees to understand the importance of such schemes.

In case of inter-firm comparison service, *neither* past performance as such *nor* arbitrary standard is followed but a direct and relevant yardstick having regard to the peculiarities of the industry and of the current business should be used. The ultimate objective is to strive for better operational efficiency and better financial position of the industry as a whole due to the impact of individual striving in his field only. Every unit can focus its attention on its weakest spot. The most vulnerable points of the industry also come to broad day-light. By subscribing to the self-discipline, the management has a constant review of the position. Otherwise, at times it may try an appraisal, and on other occasions appraisal may not be undertaken.

Thus, the objective of inter-firm comparison is to provide information regarding the competitive position of participating companies since it helps in improving the profitability and efficiency of these companies.

Some Performance indicators published in economic newspapers like Economic Times etc.

(a) Book Value per Share	(b) Earning Per Share (EPS)
(c) Dividend (%)	(d) Yield (%) = $\text{Equity Dividend} \times 100 / \text{Market Price}$
(e) Pay Out Ratio (%) = $\times 100$	(f) Gross Margin/Sales (%)
(g) Gross Margin/Capital Employed (%)	(h) Price Earning Ratio (P/E)
(i) Current Ratio	

54.0 INTERPRETATION OF RATIOS

Situation	Interpretation
1. High Current Ratio, High Quick Ratio	The proportion of either Cash or Debtors or both in the current assets is quite high.
2. High Current Ratio, Low Quick Ratio	The proportion of Stock in the current assets is quite high, i.e., Accumulation of Inventory
3. Low Current Ratio, High Quick Ratio	The proportion of bank overdraft in current liability is quite high & the firm is using quick liabilities as denominator while calculating quick liabilities.
4. Low Current Ratio, Low Quick Ratio	The proportion of either Cash or Debtors or both in the current assets is quite low & there is no accumulation of stock.
5. High Current Ratio, Low Capital Turnover Ratio	It indicates that the firm does not have profitable opportunities and is not in a position to employ the available funds hence it has idle funds. In other words, there is over capitalisation or under trading.
6. Low Current Ratio, High Capital Turnover Ratio	It indicates that the firm has profitable opportunities and is in a position to employ the available funds but it has shortage of funds. In other words, there is under capitalisation or over trading.
7. High Current Ratio, High Quick Ratio, Low Absolute Cash Ratio	The proportion of either Cash or Marketable Securities or both in the current assets is quite low but proportion of Debtors is quite high.
8. High Current Ratio, Low Quick Ratio, Low Absolute Cash Ratio	The proportion of Cash, Marketable Securities and Debtors in the current asses is quite low but proportion of Stock is quite high.
9. Low Current Ratio, Low Quick Ratio, Low Absolute Cash Ratio	The proportion of all the components of the current assets is quite low.
10. Increase in Stock Turnover and Debtors Turnover	Such increase causes decline in liquidity since the proportion of stock & debtors is quite low.

55.0 HOW TO CALCULATE VARIOUS ITEMS OF VARIOUS RATIOS

CALCULATION OF VARIOUS ITEMS BASED ON INCOME STATEMENT

Particulars	₹	₹
A Revenue from Operations [Credit + Cash]		.....
B Less: Cost of Revenue from Operations:		
Opening Inventory	.....	
Purchases [Net Credit Purchases + Cash Purchases]	.....	
Direct Expenses (e.g., Wages, Carriage/Feight Inward)	.....	
Less: Closing Inventory	(.....)	(.....)
C Gross Profit (A – B)		.....
D Less: Operating Indirect Expenses: (e.g.)		
Employees' Benefit Expense	.....	
Depreciation	.....	
Cash Discount allowed	.....	
Bad Debts	.....	
Interest on Bills Payable	.....	(.....)
E Operating Profit (C – D)		.....
F Less: Non-Operating Expenses: (e.g.)		
Interest on Long-Term-Borrowings	.....	
Value of Fixed Assets lost by fire	.....	(.....)
G Add: Non-Operating Incomes: (e.g.)		
Interest & Dividend as Non-Current Investments	.....	
Profit an Sale of Non-Current Investments	.....	
Compensation for acquisition of land	.....	.....
H Net Profit before tax (E – F + G)		.....
I Less: Tax		(.....)
J Net Profit after tax (H – I)		.....

Note: Operating Cost = Cost of Revenue from Operations + Operating Expenses

CALCULATION OF VARIOUS ITEMS BASED ON BALANCE SHEET

Particulars	₹
A. Non-Current Assets	.....
B. Current Assets	.....
C. Total Assets [A + B]	.....
D. Less: Current Liabilities	(.....)
E. Capital Employed [C – D]	.....
F. Less: Non-Current Liabilities	(.....)
G. Shareholders' Funds/Proprietors' Funds/Equity [E – F]	.....
H. Less: Preference Share Capital	.....
I. Equity Shareholders' Funds [G – H]	.....

Notes:

1. *Quick Assets = Current Assets – Inventory – Other Current Assets (e.g., Prepaid Expenses, Accrued Incomes, Advance Tax)*
2. *Working Capital = Current Assets – Current Liabilities*
3. *Total Debt = Current Liabilities + Non-Current Liabilities*
4. *Capital Employed = Non-Current Assets + Working Capital*
5. *Shareholders' Funds = Total Assets – Total Debt*
6. *Shareholders' Funds = Share Capital + Reserves & Surplus*
7. *Average Inventory = (Opening Inventory + Closing Inventory)/2*
8. *Average Trade Receivables = (Op. Trade Receivables + Cl. Trade Receivables)/2*
9. *Average Trade Payables = (Op. Trade Payables + Cl. Trade Payables)/2*

IMPORTANT POINTS TO REMEMBER

1. While calculating Current Ratio and Quick Ratio– (i) The 'Provision for doubtful debts/bills' is deducted from the total amount of Trade Receivables. (ii) Inventories and Prepaid Expenses are not considered as Quick Assets.
2. While calculating Inventory Turnover Ratio– (i) If 'Average Inventory' cannot be ascertained due to <i>non-availability of information</i>, 'Closing Inventory' may be used by giving a suitable note to that effect. (ii) If Cost of Revenue from Operations can not be ascertained, RFO may be used by giving a suitable note to that effect.
3. While calculating Debtors Turnover Ratio– (i) The 'Provision for doubtful debts' is not deducted from the total amount of Trade Receivables. (ii) If Average Trade Receivables cannot be ascertained due to <i>non-availability of information</i>, Closing Trade Receivables may be used by giving a suitable note to that effect. (iii) If Credit Revenue from Operations are not ascertainable, Total RFO given may be used assuming that all sales are credit sales.
4. While calculating Creditors Turnover Ratio– (i) The 'Reserve for discount on creditors' is not deducted from the total amount of Trade Payables. (ii) If Average Trade Payables cannot be ascertained due to <i>non-availability of information</i>, Closing Trade Payables may be used by giving a suitable note to that effect. (iii) If Net Credit Purchases is not ascertainable, Total Purchases given may be used assuming that all purchases are credit purchases.
5. While calculating Net Profit Ratio, the figure of Net Profit may be taken <i>either before tax or after tax</i>.
6. Both Operating Profit Ratio and Operating Ratio are complementary to each other and thus, if one of such ratios is deducted from 100, another ratio may be obtained.

7. While calculating Return on Capital Employed/Return on Investment (ROI)–

- (i) Non-Operating Assets do not form part of Capital Employed (e.g., Non-Trade Investments, Advance for purchase of Fixed Assets, Capital Work-in-Progress, Intangible Assets under development)
- (ii) Income from Non-Operating Assets (if any) should also be excluded while calculating the Net Profit before Interest & Tax.

SOLVED PROBLEMS**PROBLEM 1**

Current Ratio 8 : 5, Quick Ratio 6 : 5, Debtors' Velocity 4 months, Inventory Velocity 4 months, Creditors' Velocity 4 months, Cash Revenue from Operations being 33-1/3% of Credit Revenue from Operations, Cash Purchases 1/3rd of Credit Purchases, Gross Profit @ 33-1/3% on Cost was ₹ 1,00,000, Inventory at the end was 3 times that in the beginning. Trade Receivables at the end were 3 times more than that in the beginning. Opening Trade Payables were 1/4th of Closing Trade Payables. In Current Assets there was no asset other than Inventory, Trade Receivables and Cash Balance. Non-Current Assets/Proprietary Funds 0.75. Reserves and Surplus ₹ 1,80,000. There are no Non - Current Liabilities. Prepare the Balance Sheet.

SOLUTION:

Step 1: Revenue from Operations = ₹ 1,00,000/25% = ₹ 4,00,000

Step 2: Credit Revenue from Operations = ₹ 4,00,000 × 75% = ₹ 3,00,000

Step 3: Opening and Closing Trade Receivables

Debtors Turnover Ratio = 12 Months/ Debtors' Velocity = 12/4 = 3

$$\begin{aligned}\text{Debtors Turnover Ratio} &= \frac{\text{Credit Revenue from Operations}}{\text{Average Trade Receivables}} = 3 \\ &= ₹ 3,00,000 / \text{Average Trade Receivables} = 3\end{aligned}$$

Avg. Trade Receivables = ₹ 3,00,000 / 3 = ₹ 1,00,000

$$(\text{OR} + \text{CR})/2 = ₹ 1,00,000$$

$$\text{OR} + \text{CR} = ₹ 1,00,000 \times 2 = ₹ 2,00,000$$

Eq. I

$$\text{CR} - 4 \text{ OR} = 0$$

Eq. II

Subtracting Eq. II from Eq. I

$$5 \text{ OR} = ₹ 2,00,000$$

$$\text{OR} = ₹ 2,00,000/5 = ₹ 40,000$$

$$\text{CR} = ₹ 40,000 \times 4 = ₹ 1,60,000$$

Thus, Opening Trade Receivables = ₹ 40,000, Closing Trade Receivables = ₹ 1,60,000

Step 4: Cost of Revenue from Operations = ₹ 4,00,000 × 75% = ₹ 3,00,000

Step 5: Opening and Closing Inventory

Inventory Turnover Ratio = 12 months/ Inventory Velocity = 12/4 = 3 times

$$\begin{aligned}\text{Inventory Turnover Ratio} &= \frac{\text{Cost of Revenue from Operations}}{\text{Average Inventory}} = 3 \text{ Times} \\ &= ₹ 3,00,000 / \text{Average Inventory} = 3\end{aligned}$$

$$\text{Average Inventory} = ₹ 3,00,000/3 = ₹ 1,00,000$$

$$(\text{OS} + \text{CS})/2 = ₹ 1,00,000$$

$$OS + CS = ₹ 1,00,000 \times 2 = ₹ 2,00,000$$

Eq. I

$$CS - 3OS = 0$$

Eq. II

Subtracting Eq. II from III Eq. I

$$4OS = ₹ 2,00,000$$

$$OS = ₹ 2,00,000/4 = ₹ 50,000$$

$$CS = ₹ 50,000 \times 3 = ₹ 1,50,000$$

Thus, Opening Inventory = ₹ 50,000, Closing Inventory = ₹ 1,50,000

Step 6: Current Assets & Current Liabilities

$$\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}} = \frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}$$

$$6 / 5 = (CA - ₹ 1,50,000) / \text{Current Liabilities}$$

$$5CA - ₹ 7,50,000 = 6 CL$$

$$5CA - 6CL = ₹ 7,50,000$$

... Eq. I

$$\text{Current Ratio} = \frac{CA}{CL} = \frac{8}{5}$$

$$5CA = 8CL$$

$$CA = 8/5 CL$$

...Eq. II

Putting Eq. II in Eq. I

$$5 \times 8/5 CL - 6 CL = ₹ 7,50,000$$

...Eq. III

Multiplying Eq. III by 5

$$40 CL - 30 CL = ₹ 37,50,000$$

$$CL = ₹ 37,50,000/10 = ₹ 3,75,000$$

$$CA = ₹ 3,75,000 \times 8/5 = ₹ 6,00,000$$

Step 7: Working Capital = ₹ 6,00,000 – ₹ 3,75,000 = ₹ 2,25,000

Step 8: Closing Cash Balance = CA – Closing Trade Receivables – Closing Inventory
= ₹ 6,00,000 – ₹ 1,60,000 – ₹ 1,50,000 = ₹ 2,90,000

Step 9: Non- Current Assets

Proprietary Funds + Current Liabilities = Non-Current Assets + Current Assets

Let us assume the Proprietary Funds be 'X'

$$X + ₹ 3,75,000 = .75X + ₹ 6,00,000$$

$$X - .75X = ₹ 6,00,000 - ₹ 3,75,000 = ₹ 2,25,000$$

$$X = ₹ 2,25,000/.25 = ₹ 9,00,000$$

Step 10: Share Capital = ₹ 9,00,000 – ₹ 1,80,000 = ₹ 7,20,000

Step 11: Non-Current Assets = 75% of ₹ 9,00,000 = ₹ 6,75,000

Step 12: Total Purchases

= Cost of Revenue from Operations + Closing Inventory – Opening Inventory

$$= ₹ 3,00,000 + ₹ 1,50,000 - ₹ 50,000 = ₹ 4,00,000$$

Step 13: Net Credit Purchases = Total Purchases – Cash Purchases

$$= ₹ 4,00,000 - (25\% \text{ of } ₹ 4,00,000) = ₹ 3,00,000$$

Step 14: Opening and Closing Trade Payables

$$\text{Creditors Turnover Ratio} = 12 \text{ Months/ Creditors' Velocity} = 12/4 = 3$$

$$\text{Creditors Turnover Ratio} = \frac{\text{Net Credit Purchases}}{\text{Average Trade Payables}}$$

$$3 = ₹3,00,000 / \text{Average Trade Payables}$$

$$\text{Average Trade Payables} = ₹ 3,00,000 / 3 = ₹ 1,00,000$$

$$(\text{OP} + \text{CP}) / 2 = ₹ 1,00,000$$

$$\text{or, } \text{OP} + \text{CP} = ₹ 1,00,000 \times 2 = ₹ 2,00,000 \quad \dots \text{Eq. I}$$

$$\text{OP} = 1/4 \text{ CP}$$

$$\text{CP} - 4 \text{ OP} = 0 \quad \dots \text{Eq. II}$$

Subtracting Eq. II from I

$$5 \text{ OP} = ₹ 2,00,000$$

$$\text{OP} = ₹ 2,00,000 / 5 = ₹ 40,000$$

$$\text{CP} = ₹ 40,000 \times 4 = ₹ 1,60,000$$

Thus, Opening Trade Payables = ₹ 40,000, Closing Trade Payables = ₹ 1,60,000

BALANCE SHEET AS AT 31ST MARCH, 2018

Particulars	Note No	(₹ in lacs)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds		
(a) Share Capital		7.20
(b) Reserves and Surplus		1.80
(2) Non - Current Liabilities		—
(3) Current Liabilities		
(a) Trade Receivables		1.60
(b) Other Current Liabilities		2.15
Total		12.75
II. ASSETS		
(1) Non-Current Assets		6.75
(2) Current Assets		
(a) Inventory		1.50
(b) Trade Receivables		1.60
(c) Cash and Cash Equivalents		2.90
Total		12.75

PROBLEM 2

Bharat Ltd. provides you the following information:

Gross Profit Ratio 40%, Net Profit (after tax) 12%, Operating Ratio 70%, 15% Debt-Equity Ratio 2:1, Tax Rate 50%, Shareholders' Funds ₹ 4,00,000.

Required: Calculate (a) Gross Profit (b) Operating Expenses, (c) Interest Coverage Ratio, (d) Return on Capital Employed, (e) Return on Shareholders' Funds.

SOLUTION:

Step 1: 15% Long-term Debt = ₹ 4,00,000 × 2 = ₹ 8,00,000

Interest on 15% Long-term Debt = 15% of ₹ 8,00,000 = ₹ 1,20,000

STEP 2: LET US ASSUME THE SALES BE X

A. Sales	x
B. Less: Cost of Goods Sold (b.f.)	0.6x
C. Gross Profit [A-B]	0.4x
D. Less: Operating Expenses (b.f.)	0.1x
E. Operating Profit @ 30%	0.3x
F. Less: Interest on Long-term Debt	1,20,000
G. Profit before Tax	0.3x – ₹ 1,20,000
H. Less: Tax @ 50%	50% (0.3x – ₹ 1,20,000)
I. Profit after tax	0.15x – ₹ 60,000

Step 3: Net Profit Ratio = $\frac{\text{Profit after tax}}{\text{Net Sales}} \times 100$
 $0.12x = 0.15x - 60,000x$

$$0.15x - 0.12x = ₹ 60,000$$

$$x = ₹ 60,000 / 0.03 = ₹ 20,00,000$$

Step 4:

(a) Gross Profit = 40% of ₹ 20,00,000 = ₹ 8,00,000

(b) Operating Expenses = 10% of ₹ 20,00,000 = ₹ 2,00,000

(c) Interest Coverage Ratio = $\frac{\text{Profit before Interest \& Tax}}{\text{Interest on Long-term Debt}}$
 $= \frac{30\% \text{ of } ₹ 20,00,000}{₹ 1,20,000} = 5 \text{ times}$

(d) Return on Capital Employed = $\frac{\text{Profit before Interest \& Tax}}{\text{Capital Employed}} \times 100$
 $= \frac{30\% \text{ of } ₹ 20,00,000}{₹ 12,00,000} \times 100 = 50\%$

(e) Return on Shareholders Funds = $\frac{\text{Profit after Interest \& Tax}}{\text{Shareholders' Funds}} \times 100$
 $= \frac{₹ 2,40,000}{₹ 4,00,000} \times 100 = 60\%$

Note: Profit after Interest & Tax = 50% [0.30 × (₹ 20,00,000) – ₹ 1,20,000]

= 50% [₹ 6,00,000 – ₹ 1,20,000] = ₹ 2,40,000

PROBLEM 3

From the following information, calculate Return on Total Assets and prepare the Balance Sheet:

Net Profit after Interest, Tax & Preference Dividend ₹ 2,22,000, Tax Rate 50%

18% Preference Share Capital?

15% Debentures?

Return on Capital Employed 50%

Return on Shareholders' Funds 60%

Return on Equity Shareholders' Funds 74%

Current Ratio 2:1

Net Fixed Assets ₹ 9,00,000

SOLUTION:

Equity Shareholders' Funds = $(2,22,000 / 74) \times 100 = ₹ 3,00,000$

Let Pref. Share Capital be x, Hence, Pref. Dividend = 18% x

Return on Shareholders' Funds = $\frac{\text{Profit after Interest \& Tax}}{\text{Shareholders' Funds}} \times 100 = 60\%$

$$= 2,22,000 + 0.18 \times 3,00,000 + x = 0.6$$

$$2,22,000 + 0.18x = 1,80,000 + 0.6x$$

$$0.42x = 42,000$$

$$x = ₹ 1,00,000$$

Thus, Pref. Share Capital = ₹ 1,00,000

Earning after Tax = ₹ 2,22,000 + ₹ 18,000 = ₹ 2,40,000

Tax = 50% of EBT or 100% of EAT = ₹ 2,40,000

EBT = EAT + Tax = ₹ 2,40,000 + ₹ 2,40,000 = ₹ 4,80,000

Let 15% Debentures be y

Interest = 0.15 y

EBIT = EBT + Interest on Long-term Debt

EBIT = 4,80,000 + 0.15 y

Return on Capital Employed = $\frac{\text{Profit before Interest \& Tax}}{\text{Capital Employed}} \times 100$

$$= 4,80,000 + 0.15y / 4,00,000 + y = 0.5$$

$$4,80,000 + 0.15y = 2,00,000 + 0.5y$$

$$0.35y = 2,80,000$$

$$y = ₹ 8,00,000$$

Thus, 15% Debentures = ₹ 8,00,000

Capital Employed = Shareholders' Funds + Long-term Debts

= (₹ 3,00,000 + ₹ 1,00,000) + ₹ 8,00,000

= ₹ 12,00,000

Working Capital = Capital Employed – Net Fixed Assets

= ₹ 12,00,000 – ₹ 9,00,000 = ₹ 3,00,000

or, CA – CL = ₹ 3,00,000

... Eq. I

Current Ratio = CA/CL = 2:1

or, CA – 2CL = 0

... Eq. II

Subtracting Eq. II from Eq. I

$$CL = ₹ 3,00,000$$

$$CA = ₹ 3,00,000 \times 2 = ₹ 6,00,000$$

$$\begin{aligned} \text{Total Assets} &= \text{Fixed Assets} + \text{Current Assets} \\ &= ₹ 9,00,000 + ₹ 6,00,000 = ₹ 15,00,000 \end{aligned}$$

$$\begin{aligned} \text{EBIT} &= ₹ 4,80,000 + 15\% \text{ of } ₹ 8,00,000 \\ &= ₹ 6,00,000 \end{aligned}$$

$$\begin{aligned} \text{Return on Total Assets} &= \frac{\text{Earnings before Interest \& Tax}}{\text{Total Assets}} \times 100 \\ &= \frac{₹ 6,00,000}{₹ 15,00,000} \times 100 = 40\% \end{aligned}$$

BALANCE SHEET AS AT 31ST MARCH, 2018

Particulars	Note No	(₹ in lacs)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds		4
(2) Non - Current Liabilities (15% Debentures)		8
(3) Current Liabilities		3
Total		15
II. ASSETS		
(1) Non-Current Assets		9
(2) Current Assets		6
Total		15

Notes to Accounts:

Particulars	(₹ in lacs)
1. Share Capital	
Equity Shares	3
18% Pref. Shares	1
	4

PROBLEM 4

From the following information, prepare Trading, Profit and Loss Account, for the year ending 31st March, 2018 and the Balance Sheet of Tulsian Ltd. as at 31st March, 2018.

1. Current Ratio 2.5
2. Quick Ratio 1.5
3. Working Capital ₹ 1,20,000
4. Prepaid Expenses ₹ 35,000
5. Bank Overdraft ₹ 20,000
6. Working Capital Velocity 1.5 Months
7. Debtors' Velocity 3 months
8. Stock Velocity 3/4 Month

9. Cash Sales 33-1/3% of Credit Sales.
10. Closing Stock was ₹ 10,000 in excess of Opening Stock
11. Operating Ratio 75%
12. Provision for Tax @ 20%
13. Opening Balance of Profit and Loss A/c (cr) : ₹ 30,000
14. Opening Balance of General Reserve : ₹ 6,000
15. Transfer to General Reserve : 1/3 of Current year's Profits
16. Interim Dividend Paid : 37% of Paid up Capital
17. Debtors in the beginning were 3 times more than that at the end.
18. Current Assets consist of Cash, Marketing Securities, Stock, Debtors, Prepaid Expenses. Cash to Marketable Securities Ratio is 100%.
19. Fixed Assets to Proprietors' Funds 0.75
20. There are no long-term debts.

SOLUTION:
TRADING AND PROFIT AND LOSS ACCOUNT OF TULSIAN LTD.
Dr.
For the year ending 31st March, 2018
Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Opening Stock	35,000	By Sales	9,60,000
To Purchases (Balancing Figure)	6,50,000	By Closing Stock	45,000
To Gross Profit c/d	3,20,000		
	10,05,000		10,05,000
To Expenses (Balancing Figure)	80,000	By Gross Profit b/d	3,20,000
To Provision for Tax (20% of ₹ 2,40,000)	48,000		
To Net Profit after tax c/d	1,92,000		
	3,20,000		3,20,000
To General Reserve	64,000	By Balance b/d	30,000
To Interim Dividend [37% of ₹ 4,00,000]	1,48,000	By Net Profit	1,92,000
To Balance c/d	10,000		
	2,22,000		2,22,000

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Particulars</i>	<i>Note No</i>	<i>(₹ in lacs)</i>
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds		
(a) Share Capital		4.00
(b) Reserves and Surplus		0.80
(2) Non - Current Liabilities		—
(3) Current Liabilities		
(a) Short term borrowings (Bank overdraft)		0.20
(b) Short term provisions (Provision for Tax)		0.48
(c) Other Current Liabilities		0.12
Total		5.60

II. ASSETS		
(1) Non-Current Assets		3.60
(2) Current Assets		
(a) Inventory		0.45
(b) Trade Receivables		0.72
(c) Cash and Cash Equivalents		0.48
(d) Other Current Assets (Prepaid Expenses)		0.35
Total		5.60

Working Notes:*(i) Calculation of Current Assets and Current Liabilities*

$$\text{Current Ratio} = \text{CA/CL} = 2.5$$

$$\text{CA} = 2.5 \text{ CL}$$

$$\text{CA} - 2.5\text{CL} = 0 \quad \dots(\text{I})$$

$$\text{Working Capital} = \text{CA} - \text{CL} = ₹ 1,20,000 \quad \dots(\text{ii})$$

Substituting Equation (i) in Equation (ii)

$$2.5 \text{ CL} - \text{CL} = 1,20,000$$

$$\text{CL} = 1,20,000/1.5 = ₹ 80,000$$

$$\text{CA} = ₹ 80,000 \times 2.5 = ₹ 2,00,000$$

(ii) Calculation of Closing Stock

$$\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{CL}}$$

$$= \frac{\text{Current Assets} - \text{Inventory} - \text{Prepaid Exp.}}{\text{Current Liabilities}}$$

$$= (\text{₹ } 2,00,000 - \text{Stock} - \text{₹ } 35,000) / ₹ 80,000 = 1.5$$

$$\text{Stock} = ₹ 1,65,000 - (80,000 \times 1.5) = ₹ 45,000$$

*(iii) Opening Stock = ₹ 45,000 – ₹ 10,000 = ₹ 35,000**(iv) Calculation of Total Sales*

$$\text{Working Capital Velocity} = 12/\text{Working Capital Turnover} = 1.5$$

$$\text{Working Capital Turnover} = \text{Net Sales}/\text{Working Capital} = \text{Net Sales}/₹ 1,20,000 = 8$$

$$\text{Net Sales} = ₹ 1,20,000 \times 8 = ₹ 9,60,000$$

(v) Stock Turnover Ratio = Cost of Goods Sold/Average Stock = 12/0.75 = 16

$$\text{Cost of Goods Sold} = 16 \times (\text{₹ } 4,00,000 + \text{₹ } 35,000)/2 = ₹ 6,40,000$$

*(vi) Gross Profit = Net Sales – Cost of Goods Sold = ₹ 9,60,000 – ₹ 6,40,000 = ₹ 3,20,000**(vii) Closing Debtors*

$$\text{Cash Sales} + \text{Cr. Sales} = \text{Net Sales}$$

$$1/3x + x = ₹ 9,60,000$$

$$x = ₹ 9,60,000 \times 3/4 = ₹ 7,20,000$$

$$\text{Debtors Turnover Ratio} = 12/3 = 4 \text{ times}$$

$$\text{Average Debtors} = \text{Net Cr. Sales} / 4 = ₹ 7,20,000/4$$

$$(\text{OD} + \text{CD})/2 = ₹ 1,80,000$$

$$\text{OD} + \text{CD} = ₹ 1,80,000 \times 2 = ₹ 3,60,000 \quad \dots \text{Eq. I}$$

$$4\text{CD} - \text{OD} = 0 \quad \dots \text{Eq. II}$$

Adding both the equations

$$5CD = ₹ 3,60,000$$

$$CD = ₹ 3,60,000/5 = ₹ 72,000$$

$$\begin{aligned} \text{(viii) Operating Profit before tax Ratio} &= 100 - \text{Operating Ratio} = 100\% - 75\% = 25\% \\ &= 25\% \text{ of } ₹ 9,60,000 = ₹ 2,40,000 \end{aligned}$$

(ix) Calculation of Proprietors' Funds (Let us assume as X)

$$\text{Proprietors' Funds} + \text{CL} = \text{FA} + \text{CA}$$

$$X + ₹ 80,000 = 0.75X + ₹ 2,00,000$$

$$X = ₹ 1,20,000/0.25 = ₹ 4,80,000$$

$$\text{(x) Fixed Assets} = 75\% \text{ of } ₹ 4,80,000 = ₹ 3,60,000$$

$$\text{(xi) New Reserve Created} = ₹ 1,92,000 \times 1/3 = ₹ 64,000$$

(xii) Calculation of Share Capital (Let share capital be X).

$$\text{SC} + \text{Op. Reserve} + \text{New Reserve} + \text{Op. P\&L} + \text{Balance of P\&L} = \text{Proprietors' Funds}$$

$$X + ₹ 6,000 + ₹ 64,000 + ₹ 30,000 + (₹ 1,92,000 - ₹ 64,000 - 0.37 X) = ₹ 4,80,000$$

$$X = ₹ 2,52,000/0.63 = ₹ 4,00,000$$

PROBLEM 5

From the following information, Calculate Capital Turnover Ratio:

Debt-Equity Ratio (Long-term Debt/Shareholders' Funds)	2:1
Capital Gearing Ratio (Funds bearing Fixed Payments to Equity Shareholder's Funds)	3:1
15% Long-term Debts	₹ 8,00,000
Return on Equity Shareholder's Funds	25%
15% Preference Share Capital	?
Gross Profit Ratio 25%, Operating Expenses Ratio 12.5%, Tax Rate 50%	

SOLUTION:

$$\text{Capital Turnover Ratio} = \text{Sales} / \text{Capital Employed} = ₹ 24,00,000 / (₹ 8,00,000 + ₹ 4,00,000) = 2 \text{ Times}$$

Working Notes:

(i) Calculation of Equity Shareholders' Funds Long-term Debts

$$\text{Debt Equity Ratio} = \frac{\text{Long-term Debts}}{\text{Shareholders' Funds}}$$

$$2 = ₹ 8,00,000 / \text{Shareholders' Funds}$$

$$\text{Shareholders' Funds} = ₹ 8,00,000/2 = ₹ 4,00,000$$

$$\text{Supposing Pref. Share Capital} = x$$

$$\text{Equity Shareholders' Funds} = ₹ 4,00,000 - x$$

(ii) Calculation of Pref. Share Capital

$$\text{Capital Gearing Ratio} = \frac{\text{Long-term Debts plus Pref. Share Capital}}{\text{Equity Shareholders' Funds}}$$

$$3 = (₹ 8,00,000 + x) / (₹ 4,00,000 - x)$$

$$₹ 12,00,000 - 3x = ₹ 8,00,000 + x$$

$$x = ₹ 1,00,000$$

Pref. Share Capital = ₹ 1,00,000

Equity Shareholders' Funds = ₹ 4,00,000 – ₹ 1,00,000 = ₹ 3,00,000

(iii) *Calculation of Operating Profit*

$$\text{Return on Equity} = \frac{\text{Net Profit after Interest, Tax and Preference Dividend}}{\text{Average Equity Shareholders' Funds}} \times 100$$

$$25\% = x / ₹ 3,00,000$$

$$x = ₹ 75,000$$

Particulars	₹
A. Net Profit after Int., Tax & Pref. Dividend	75,000
B. Add: Pref. Dividend	15,000
C. Net Profit after Int. & Tax (A+B)	90,000
D. Add: Tax @ 50%	90,000
E. Net Profit before Tax	1,80,000
F. Interest on Long-term Debt @ 15% on ₹ 8,00,000	1,20,000
G. Operating Profit (E + F)	3,00,000

(iv) *Calculation of Sales*

Cost of Goods Sold Ratio = 100% – Gross Profit Ratio 25% = 75%

Operating Expenses Ratio = 12.5%

Operating Ratio = 75% + 12.5% = 87.5%

Operating Profit Ratio = 100% – 87.5% = 12.5%

Sales = Operating Profit / Operating Profit Ratio = ₹ 3,00,000/12.5% = ₹ 24,00,000

PROBLEM 6

Fill in the blanks in the following:

TRADING AND PROFIT & LOSS ACCOUNT

Dr.

For the year ended 31st March 2018

Cr.

Particulars	₹	Particulars	₹
To Opening Stock	?	By Sales	?
To Purchases	?	By Closing Stock	?
			
To Sundry Expenses	?	By Gross Profit b/d	?
To Provision for Tax	?		
To Net Profit after Tax	?		
			

Liabilities & Assets as at 31.03.2018	₹
Equity Share Capital	?
Preference Share Capital	?
Profit & Loss A/c	?

General Reserve	?
Debentures	?
Trade Creditors	?
Bills Payables	20,000
Bank Overdraft	?
Provision for Income Tax	?
Fixed Assets	?
Stock	?
Trade Debtors	?
Bills Receivables	40,000
Prepaid Expenses	?
Cash & Bank Balances	?

Other Information:

1. Current Ratio	3
2. Quick Ratio	2
3. Working Capital	₹ 2,20,000
4. Cost of Goods Sold	₹ 6,40,000
5. Cash Purchases	₹ 1,40,000
6. Cash Sales	1/3rd of Credit Sales
7. Stock Velocity	1.5 months
8. Average Debt Collection Period	3 months
9. Creditors Velocity	3 months
10. Gross Profit Ratio	20%

11. Net Profit after tax to Equity Capital 10%
12. Stock as on 1.4.2014 was ₹ 10,000 in excess of the Stock as on 31.3.2015
13. Creditors on 31.3.2015 were *less* than that in the beginning of year by ₹ 45,000.
14. Debtors as on 1.4.2014 were ₹ 20,000 more than that at the end of the year.
15. Proprietary Ratio (Fixed Assets/Net Capital Employed) 0.75
16. Capital Gearing Ratio (Pref. Shares & Debentures to Equity Shareholders' Funds) $33 \times \frac{1}{3}\%$
17. Preference Share Capital to Debentures 3
18. General Reserve & Profit & Loss to Equity Capital 25%
19. Provision for Income Tax 10%

SOLUTION:
TRADING AND PROFIT & LOSS ACCOUNT
Dr.
For the year ended 31st March 2018
Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Opening Stock	85,000	By Sales	8,00,000
To Purchases	6,30,000	By Closing Stock	75,000
To Gross Profit c/d	1,60,000		
	8,75,000		8,75,000

To Sundry Expenses (b.f)	1,01,333	By Gross Profit b/d	1,60,000
To Provision for Tax	5,867		
To Net Profit after Tax	52,800		
	1,60,000		1,60,000

Liabilities & Assets as at 31.03.2018	₹
Equity Share Capital	5,28,000
Preference Share Capital	1,65,000
Profit & Loss A/c	52,800
General Reserve	79,200
Debentures	55,000
Trade Creditors	80,000
Bills Payables	20,000
Bank Overdraft	4,133
Provision for Income Tax	5,867
Fixed Assets	6,60,000
Stock	75,000
Trade Debtors	1,00,000
Bills Receivables	40,000
Prepaid Expenses	35,000
Cash & Bank Balances	80,000

Working Notes:

- (i)
- Calculation of Total Current Assets, Total Current Liabilities & Stock & Prepaid expenses*

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = 3$$

$$\text{Or} \quad \text{CA} - 3 \text{ CL} = 0 \quad \dots\dots\dots \text{I}$$

$$\text{CA} - \text{CL} = ₹ 2,20,000 \quad \dots\dots\dots \text{II (given)}$$

Subtracting II from I equation

$$\text{CL} = ₹ 1,10,000$$

$$\text{Therefore,} \quad \text{CA} = ₹ 1,10,000 \times 3 = ₹ 3,30,000$$

$$\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}} = 2 = \text{QA} / ₹ 1,10,000 = 2$$

$$\text{QA} = ₹ 2,20,000$$

$$\text{Stock \& Prepaid Expenses} = \text{CA} - \text{QA} = ₹ 3,30,000 - ₹ 2,20,000 = ₹ 1,10,000$$

- (ii)
- Calculation of Closing Stock*

$$\text{Stock Velocity} = 12 \text{ Months} / \text{Stock Turnover Ratio}$$

$$1.5 = 12 / \text{Stock Turnover Ratio}$$

$$\text{or,} \quad \text{Stock Turnover Ratio} = 12 / 1.5 = 8 \text{ Times}$$

$$\text{or,} \quad 8 = \text{Cost of Goods Sold} / \text{Average Stock}$$

$$\text{or,} \quad 8 = ₹ 6,40,000 / \text{Average Stock}$$

$$\begin{aligned}
 \text{or,} \quad & \text{Average Stock} = ₹ 80,000 \\
 \text{or,} \quad & (\text{Opening Stock} + \text{Closing Stock})/2 = ₹ 80,000 \\
 \text{or,} \quad & \text{Opening Stock} + \text{Closing Stock} = ₹ 1,60,000 \quad \dots\dots\dots \text{I} \\
 & \text{Opening Stock} - \text{Closing Stock} = ₹ 10,000 \quad \dots\dots\dots \text{II (given)}
 \end{aligned}$$

Adding I & II Equations

$$\begin{aligned}
 & 2 \text{ Opening Stock} = ₹ 1,70,000 \\
 \text{or,} \quad & \text{Opening Stock} = ₹ 85,000 \\
 & \text{Closing Stock} = ₹ 85,000 - ₹ 10,000 = ₹ 75,000
 \end{aligned}$$

(iii) *Calculation of Credit Sales*

If Gross Profit on Sales is 20%

Cost of Goods Sold to Sales Ratio is 80% (100% – 20%)

$$\begin{aligned}
 \text{Thus,} \quad & \text{Sales} = ₹ 6,40,000 \times 100/80 = ₹ 8,00,000 \\
 & \text{Cash Sales} = ₹ 8,00,000 \times 25/100 = ₹ 2,00,000 \\
 & \text{Credit Sales} = ₹ 6,00,000
 \end{aligned}$$

(iv) *Calculation of Closing Total Debtors*

$$\begin{aligned}
 & \text{Debtors' Velocity} = 12 \text{ Months} / \text{Debtors' Turnover Ratio} \\
 & 3 = 12/\text{Debtors, Turnover Ratio} \\
 \text{or,} \quad & \text{Debtors' Turnover Ratio} = 12/3 = 4 \text{ times} \\
 \text{or,} \quad & 4 = \text{Net Credit Sales}/\text{Average Debtors} \\
 \text{or,} \quad & 4 = ₹ 6,00,000/\text{Average Debtors} \\
 \text{or,} \quad & \text{Average Debtors} = ₹ 1,50,000 \\
 \text{or,} \quad & (\text{Opening Drs.} + \text{Closing Drs.}) / 2 = ₹ 1,50,000 \\
 \text{or,} \quad & \text{Opening Drs.} + \text{Closing Drs.} = ₹ 3,00,000 \quad \dots \text{Eq. I} \\
 & \text{Opening Debtors} - \text{Closing Debtors} = ₹ 20,000 \quad \dots \text{Eq. II} \\
 & \text{Adding I \& II Equations}
 \end{aligned}$$

$$\begin{aligned}
 & 2 \text{ Opening Debtors} = ₹ 3,20,000 \\
 \text{or,} \quad & \text{Opening Debtors} = ₹ 1,60,000 \\
 & \text{Closing Debtors} = ₹ 1,60,000 - ₹ 20,000 = ₹ 1,40,000
 \end{aligned}$$

$$\begin{aligned}
 \text{(v)} \quad & \text{Sundry Debtors} = \text{Total Debtors} - \text{B/R} \\
 & = ₹ 1,40,000 - ₹ 40,000 = ₹ 1,00,000
 \end{aligned}$$

(vi) *Calculation of Credit Purchases*

TRADING ACCOUNT

Particulars	₹	Particulars	₹
To Opening Stock	85,000	By Sales	8,00,000
To Purchases	6,30,000	By Closing Stock	75,000
To Gross Profit c/d	1,60,000		
	8,75,000		8,75,000

$$\text{Credit Purchases} = ₹ 6,30,000 - ₹ 1,40,000 = ₹ 4,90,000$$

(vii) *Calculation of Closing Total Creditors*

$$\text{Creditors' Velocity} = 12 \text{ Months}/\text{Creditors Turnover Ratio}$$

$$3 = 12/\text{Creditors Turnover Ratio}$$

or, Creditors Turnover Ratio = $12/3 = 4$ times

or, $4 = \text{Net Credit Purchases}/\text{Average Creditors}$

or, Average Creditors = ₹ 1,22,500

or, $(\text{Opening Crs.} + \text{Closing Crs.})/2 = ₹ 1,22,500$

or, Opening Crs. + Closing Crs. = ₹ 2,45,000 (I)

Opening Crs. – Closing Crs. = ₹ 45,000 ... (Given)

Adding I & II Equations

$$2 \text{ Opening Crs.} = ₹ 2,90,000$$

or, Opening Creditors = ₹ 1,45,000

$$\text{Closing Creditors} = ₹ 1,45,000 - ₹ 45,000 = ₹ 1,00,000$$

(viii) Sundry Creditors = Total Creditors – B/P = ₹ 1,00,000 – ₹ 20,000 = ₹ 80,000

(ix) Prepaid Expenses = ₹ 1,10,000 – ₹ 75,000 = ₹ 35,000

(x) Cash & Bank Balances = Total Current Assets – Current Assets other than Cash
= ₹ 3,30,000 – ₹ 2,50,000 = ₹ 80,000

(xi) *Calculation of Net Capital Employed*

$$\text{Proprietor Ratio} = \text{Fixed Assets}/\text{Net Capital Employed} = 0.75$$

or, = Working Capital/Net Capital Employed

$$= 1 - 0.75 = 0.25$$

$$\text{Net Capital Employed} = ₹ 2,20,000/0.25 = ₹ 8,80,000$$

(xii) Fixed Assets = 75% of ₹ 8,80,000 = ₹ 6,60,000

(xiii) *Calculation of Pref. Shares & Debentures*

$$\text{Capital Gearing Ratio} = \frac{\text{Long-term Debts plus Pref. Share Capital}}{\text{Equity Shareholders' Funds}}$$

$$\frac{1}{3} = \frac{\text{Long-term Debts plus Pref. Share Capital}}{\text{Capital Employed} - (\text{Long-term Debts} + \text{Pref. Share Capital})}$$

Taking Pref. Shares & Deb. As "x"

$$\frac{1}{3} = \frac{x}{₹ 8,80,000 - x}$$

$$x = \frac{1}{3} ₹ 8,80,000 - x$$

$$x = (8,80,000/3) - (x/3)$$

$$3x + x = ₹ 8,80,000$$

$$x = ₹ 2,20,000$$

(xiv) *Calculation of Debentures:*

$$\text{Pref. Shares} + \text{Debentures} = ₹ 2,20,000$$

Taking Debentures as X

$$3X + X = ₹ 2,20,000$$

$$X = ₹ 2,20,000/4 = ₹ 55,000$$

(xv) Pref. Shares Capital = ₹ 2,20,000 – ₹ 55,000 = ₹ 1,65,000

(xvi) *Calculation of Equity Capital, Reserve & Profit & Loss*

Taking Equity Capital as X

$$X + 0.15x + 0.10x = ₹ 6,60,000$$

$$1.25x = ₹ 6,60,000$$

$$x = ₹ 5,28,000$$

$$\text{General Reserve} = 15\% \text{ of } ₹ 5,28,000 = ₹ 79,200$$

$$\text{Profit \& Loss} = 10\% \text{ of } ₹ 5,28,000 = ₹ 52,800$$

(xvii) Calculation of Provision for Tax

Let Net Profit before tax be x

$$\text{Net Profit after tax} = x - 10\% \text{ of } x$$

$$₹ 52,800 = 0.9x$$

$$X = 52,800/0.9 = ₹ 58,667$$

$$\text{Provision for Tax} = 10\% \text{ of } ₹ 58,667 = ₹ 5,867$$

(XVIII) CALCULATION OF BANK OVERDRAFT

A. Total Current Liabilities		₹ 1,10,000
B. Current Liabilities other than than Bank Overdraft		
a) Trade Creditors	₹ 80,000	
b) Bills Payables	₹ 20,000	
c) Provision for Tax	₹ 5,867	₹ 1,05,867
C. Bank Overdraft (A–B)		₹ 4,133

Tulsian's

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Preface

We are thankful to the Readers and Teachers for their response and encouragement given to the previous editions of the textbook. This Quick Revision book has been conceptualised and developed to meet the needs of the students in the last month before the examination.

Two important Questions which usually arise in the mind of every student are:

1. What Minimum to Revise to Maximise the Marks?

2. What to Revise One Day Before Examination?

Tulsian's Quick Revision provides Answers to above two Questions by providing the following contents:

SECTION 1 : TULSIAN'S FULL SOLVED SCANNER FOR THEORETICAL QUESTIONS
(C.A. Foundation Examination Questions with Authentic Answers)
True & False Questions
Important Distinctions
Important Short Notes

SECTION 2 : TULSIAN'S FULL SOLVED SCANNER FOR PRACTICAL QUESTIONS
(C.A. Foundation Examination Problems with Authentic Solutions)

SECTION 3 : TULSIAN'S REVISION TEST PAPER WITH ANSWERS

SECTION 4 : TULSIAN'S MODEL TEST PAPERS WITH ANSWERS

SECTION 5 : CA FOUNDATION EXAMINATION PAPERS

IMPORTANT NOTES FOR STUDENTS

1. Tulsian's Quick Revision is a Supplement BUT not a Substitute to the main Text Book 'Tulsian's Accountancy'.
2. A Good Text Book has no other alternative.
3. An Opportunity Cost of not using A Good Text Book is very high.
4. "DO NOT IGNORE THEORY"

Special word of thanks is also due to our favourite students **Piyush, Pranav, Arushi and Aman Mittal** who provided incisive comment and useful feedback.

We must conclude that this book would never has been written without the support, encouragement and prodding of our family members. Many thanks to them.

Any criticisms or suggestions for further improvement of the book will be gratefully acknowledged and appreciated.

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**PAPER 1: PRINCIPLES AND PRACTICE OF ACCOUNTING FOR
CA FOUNDATION COURSE**

SECTION 1

**TULSIAN'S
FULL SOLVED SCANNER
FOR THEORETICAL QUESTIONS**

True and False Questions

Important Distinctions

Important Short Notes

1

TRUE AND FALSE QUESTIONS

1. INTRODUCTION TO ACCOUNTING

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. Capital + Long Term Liabilities = Fixed Assets + Current Assets + Cash – Current Liabilities. [Dec. 1993]
2. Capital is all assets *less* fictitious assets. [May 2001]
3. Transactions and events are guided by generally accepted accounting principles subject to laws of land. [Nov. 2002]
4. Accounting can be viewed as an information system which has its input processing methods and outputs. [May 2003]
5. Equity + LTL – CL = FA + CA [May 2003]
6. Accounting involves communication. [Nov. 2003]
7. Capital is equal to assets *less* external liabilities. [Nov. 2004]
8. As per AS – 1, Fundamental Accounting Assumptions are Going Concern, Full Disclosure and Accrual.
9. Qualitative Characteristics of Financial Statements are – Understanding, Relevance, Reliability and Materiality .
10. Major considerations governing the selection and application of accounting policies are Prudence, Substance over Form and Full Disclosure.
11. Valuation Principles are – Historical Cost Base, Current Cost Base, Realizable Value Base and Future Value Base.
12. Accounting is the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by the external users of accounts.
13. A person who owes money to the firm is a creditor.
14. A person to whom the firm owes money is a debtor.
15. Furniture purchased by Rama Motors is a current asset.
16. Furniture purchased by Rama Furniture is a fixed asset.
17. A transaction which increases the capital is called 'Income'.
18. Amount owed to outsiders (other than proprietor) is called capital.
19. An increase in assets is always due to profits.
20. Profit/Loss = Closing Capital + Additional Capital – Drawings – Opening Capital.

ANSWERS:

S. No.	Reason
1.	False: The right hand side of the equation includes cash twice-once as a part of current assets and another separately. The basic accounting equation is: $\text{Capital} + \text{Long Term Liabilities} = \text{Fixed Assets} + \text{Current Assets} - \text{Current Liabilities}.$
2.	False: Capital is all assets <i>less</i> fictitious assets <i>less</i> outside liabilities.
3.	True: Transactions and events are guided by generally accepted accounting principles subject to laws of land. For example, the Companies Act has prescribed the format of financial statements of companies. All transactions with suppliers and customers are governed by The Contract Act, The Sale of Goods Act and The Negotiable Instruments Act, etc.
4.	True: Accounting is a process of identifying, measuring and communicating economic information to permit informed judgements and decisions by the users of accounts. Here, Input = Financial transactions Processing Methods = Recording, Classifying, Summarizing, Analysing and Interpreting Output = Communicating the accounting information to the users
5.	False: The basic accounting equation is: $\text{Equity} + \text{LTL} = \text{FA} + \text{CA} - \text{CL}$
6.	True: Accounting is the process of identifying, measuring and <i>communicating</i> economic informations to permit informed judgements and decisions by the users of accounts. Hence, accounting involves communication.
7.	True: Capital is equal to all assets (whether tangible or intangible but not fictitious) <i>less</i> external liabilities.
8.	False: As per AS – 1, Fundamental Accounting Assumptions are Going Concern, Consistency and Accrual
9.	False: Qualitative Characteristics of Financial Statements are – Understanding, Relevance, Reliability and Comparability.
10.	False: Major considerations governing the selection and application of accounting policies are Prudence, Substance over Form and Materiality.
11.	False: Valuation Principles are – Historical Cost Base, Current Cost Base, Realizable Value Base and Present Value Base.
12.	False: Accounting is the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by the all users of accounts.
13.	False: A person who owes money to the firm is a debtor.
14.	False: A person to whom the firm owes money is a creditor.
15.	False: Furniture purchased by Rama Motors is a fixed asset.
16.	False: Furniture purchased by Rama Furniture is a current asset.
17.	False: A transaction which increases the capital need not necessarily be 'Income'. It may be additional capital contribution.
18.	False: Amount owed to outsiders (other than proprietor) is called External Liability.
19.	False: An increase in assets is not necessarily due to profits. It may be due to purchase of assets.
20.	False: $\text{Profit/Loss} = \text{Opening Capital} + \text{Additional Capital} - \text{Drawings} - \text{Closing Capital}.$

2. ACCOUNTING PRINCIPLES

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. Prudence is a concept to recognise unrealized profits and not losses. [June 1993]
2. In accounting, all business transactions are recorded as having dual aspect. [Nov. 1996]
3. Accrual concept implies accounting on cash basis. [May 1998, Nov. 2001 and May 2004]
4. Revenues are matched with expenses in accordance with the matching principle. [May 2003]
5. The financial statement must disclose all the relevant and reliable information in accordance with the full disclosure principle. [May 2003]
6. The economic life of an enterprise is artificially split into periodic intervals in accordance with the going concern assumptions. [Nov. 2003]
7. Accounting principle is general rule followed in preparation of financial statements. [Nov. 2004]
8. As per the concept of conservatism, the accountant should provide for all possible losses, but should not anticipate income. [Nov. 2005]
9. The Assets are classified as Current Assets and Fixed Assets as per Full Disclosure Principle.
10. The Assets and Incomes are not overstated and the Liabilities and Losses are not understated as per Accrual Principle.
11. Accounting of a small calculator as an Expense and not as an Asset is as per Going Concern Principle.
12. The Accounting Data should be definite, verifiable and free from personal-bias as per Materiality Principle.
13. Materiality Principle is an exception to Consistency Principle.
14. Valuation of Inventory at Lower of Cost or Net Realizable Value (NRV), making Provision for Doubtful Debts and Discount on Debtors are the applications of Consistency Principle.
15. Disclosure is required if Fundamental Assumptions are followed.
16. Disclosure is required if a particular Accounting Policy is followed.
17. Prudence Principle is an exception to Full Disclosure Principle.
18. Change in Accounting Estimate has to be given Retrospective Effect.
19. Personal transactions are distinguished from business transactions in accordance with the Money Measurement Assumption.
20. When stock is valued at cost in one accounting period and at lower of Cost and net realisable value in another accounting period Consistency Principle conflicts with the Prudence Principle.
21. Accrual means recognition of revenue as it is earned and of costs as they are paid.
22. Going Concern Concept fixes up the time frame for which the performance is to be measured and financial position is to be appraised.
23. According to Matching Principle, Periodic Profit = All Revenues – All expenses.
24. According to Accounting Standard (AS-1), the fundamental accounting assumptions are Going Concern, Conservatism and Accrual.
25. Prudence is the inclusion of a degree of caution in the exercise of judgement needed in making the estimates required under condition of uncertainty so that assets and income are not understated, and loss and liabilities are not overstated.
26. X purchased goods for ₹ 20,000 and sold 9/10th of the goods for ₹ 24,000 and met expenses of ₹ 2,000. He counted net profit as ₹ 2,000 (i.e. ₹ 24,000 – ₹ 20,000 – ₹ 2,000). He has violated the Cost Concept.

27. X Ltd purchased a machine for ₹ 1,00,000 on 1.1.2018. The market price of the machine was ₹ 1,20,000 on 31.12.2018. The accountant of X Ltd values machine for ₹ 1,20,000 while finalising the accounts. He has violated the Realisation Concept.
28. X purchased merchandise worth ₹ 24,000 and sold 11/12 of the merchandise. The market value of the remaining merchandise was ₹ 1,920. He valued the closing stock at ₹ 2,000. He has violated the Realisation Concept.
29. Prudence is a concept to recognise realised losses and not profits.
30. Prudence is a concept to recognise all losses and not profits.

ANSWERS:

S. No.	Reason
1.	False: Prudence is a concept to recognize unrealized losses and not profits.
2.	True: Being associated with the double entry system of book keeping every transaction has a <i>two-fold effect</i> in accounting whereby one account is debited and another is credited by the same amount.
3.	False: Accrual concept implies accounting on 'accrual' basis. Accrual basis of accounting involves recognition of revenues and costs as and when they accrue irrespective of actual receipts or payments.
4.	False: Expenses are matched with revenues in accordance with the matching principle. Concept of matching requires accrual and periodicity concepts as accrued revenues are matched with accrued expenses of a definite accounting period.
5.	True: The financial statement must disclose all the relevant and reliable information in accordance with AS-1 Disclosure of Accounting Policies.
6.	True: The economic life of an enterprise is artificially split into periodic intervals in accordance with the accounting period assumption or the periodicity concept. The going concern assumption assumes that an enterprise will continue in operation for indefinite period of time.
7.	True: Accounting principles may be defined as those rule of action, which are adopted by the accountants universally while recording accounting transactions.
8.	True: The financial position of a business should not be shown better than what it is. Hence an accountant should not anticipate income but should provide for all possible losses.
9.	False: The Assets are classified as Current Assets and Fixed Assets as per Going Concern Principle.
10.	False: The Assets and Incomes are not overstated and the Liabilities and Losses are not understated as per Prudence Principle.
11.	False: Accounting of a small calculator as an Expense and not as an Asset is as per Materiality Principle.
12.	False: The Accounting Data should be definite, verifiable and free from personal-bias as per Objectivity Principle.
13.	False: Materiality Principle is an exception to Full Disclosure Principle.
14.	False: Valuation of Inventory at Lower of Cost or Net Realizable Value (NRV), making Provision for Doubtful Debts and Discount on Debtors are the applications of Prudence Principle.
15.	False: No disclosure is required if Fundamental Assumptions are followed.
16.	False: Disclosure is required if a particular Accounting Policy is followed.
17.	False: Prudence Principle is an exception to Consistency Principle.

18.	False: Change in Accounting Estimate has not to be given Retrospective Effect.
19.	False: Personal transactions are distinguished from business transactions in accordance with the Accounting Entity Assumption.
20.	False: When stock is valued at cost in one accounting period and at lower of Cost and net realisable value in another accounting period Prudence Principle conflicts with the Consistency Principle
21.	False: Accrual means recognition of revenue as it is earned and of costs as they are incurred.
22.	False: Accounting Period Concept fixes up the time frame for which the performance is to be measured and financial position is to be appraised.
23.	False: According to Matching Principle, Periodic Profit = All Accrued Revenues – All Accrued expenses
24.	False: According to Accounting Standard (AS–1), the fundamental accounting assumptions are Going Concern, Consistency and Accrual
25.	False: Prudence is the inclusion of a degree of caution in the exercise of judgement needed in making the estimates required under condition of uncertainty so that assets and income are not overstated, and loss and liabilities are not understated.
26.	False: X purchased goods for ₹ 20,000 and sold 9/10th of the goods for ₹ 24,000 and met expenses of ₹ 2,000. He counted net profit as ₹ 2,000 (i.e. ₹ 24,000 – ₹ 20,000 – ₹ 2,000). He has violated the Matching Concept.
27.	False: X Ltd purchased a machine for ₹ 1,00,000 on 1.1.2018. The market price of the machine was ₹ 1,20,000 on 31.12.2018. The accountant of X Ltd values machine for ₹ 1,20,000 while finalising the accounts. He has violated the Cost Concept.
28.	False: X purchased merchandise worth ₹ 24,000 and sold 11/12 of the merchandise. The market value of the remaining merchandise was ₹ 1,920. He valued the closing stock at ₹ 2,000. He has violated the Prudence Concept.
29.	False: Prudence is a concept to recognise unrealised losses and not profits.
30.	False: Prudence is a concept to recognise all unrealised losses and not profits.

3. JOURNALISING, POSTING AND BALANCING

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

- The sales day book is a part of the ledger. [Nov. 1994, Nov. 2001 and May 2004]
- Sale of office furniture should be credited to Sales Account. [Nov. 1995, Nov. 1997, Nov. 2001 and May 2004]
- When we buy furniture on cash we debit Cash Account. [June 1993]
- Patent right is in the nature of nominal account. [Nov. 1995, Nov. 2001 and of May 2004]
- Outstanding expenditure is a nominal account. [Nov. 1999]
- The debts written off as bad, if recovered subsequently are credited to Debtors Account. [Nov. 1996 and May 2002]
- Wages paid for erection of machinery are debited to Profit and Loss Account. [Nov. 1995, Nov. 2000 and May 2002]
- The return of goods by a customer should be debited to Return Outward Account. [Nov. 2003]
- The balance of an account is always known by the side which is shorter. [Nov. 2003]

10. Nominal accounts are balanced at the end of the accounting year. [May 1999]
11. The allowance made for prompt payment is called trade discount. [June 1994]
12. Bank Account is a Real Account. [Nov. 2005]
13. Goods costing ₹ 600 taken by the proprietor for personal use should be credited to Sales Account. [May 2005]
14. Rent paid account is a Nominal Account whereas, rent received account is a Real Account. [May 2005]
15. Where subsidiary books are maintained journal is not required. [May 2005]
16. Fixed Assets + Current Assets – External Liabilities = Capital + Creditors
17. Reserve for Discount on Creditors has a credit balance.
18. Normally Personal and Nominal accounts are balanced and not Real Accounts.
19. Real and Personal Accounts are closed at the end of accounting period.
20. The return of goods to a suppliers should be credited to Return Inward Account.
21. Prepaid Expense is a Nominal Account.
22. The allowance made for promoting sales is called cash discount.
23. When trade discount is allowed to a customer, trade discount allowed is credited.
24. Goods costing ₹ 600 distributed as free samples should be credited to Sales Account.
25. The recovery of debts (due from Mohan ₹ 10,000) written off in the previous year should be credited to Mohan's Account.
26. Debit means an increase in liability and a decrease in an asset.
27. Credit means an increase in asset and a decrease in a liability.
28. Journal is a book of secondary entry.
29. Ledger is a book of original entry.
30. L.F. (i.e. Ledger Folio column) in the journal is filled at the time of journalising.
31. The words 'To Balance b/d' or By Balance b/d are recorded in the particulars column at the time of balancing.
32. A sale of goods to Ram for cash should be debited to Ram.
33. A withdrawal of cash from business by the proprietor should be credited to Drawing Account.
34. Goods were sold to Ram for ₹ 1,000 on 1.4.2018. On 1.5.2018, Ram paid ₹ 950 on account. Ram's Account should be credited with ₹ 1,000.
35. Ram paid ₹ 900 towards a debt of ₹ 950 which was written off as bad in the previous year. Ram's Account should be credited with ₹ 950.
36. Goods worth ₹ 100 taken by the proprietor for personal use should be credited to Sales Account
37. In case of debit balance. The words 'To Balance c/d' are written on credit side
38. While posting an opening entry in the ledger, in case of an Account having debit balance, the words 'To Balance b/d' are written on credit side and in case of an Account having credit balance the words 'By Balance b/d' are written on debit side

ANSWERS:

S. No.	Reason
1.	False: The sales day book is a book of prime entry and hence it is a part of journal .
2.	False: Sale of office furniture should be credited to Furniture Account because it is a capital receipt.

3.	False: When we buy the furniture on cash the furniture account is debited and cash account is credited.
4.	False: Patent-right being an intangible asset is in the nature of real account .
5.	False: Outstanding expenditure is a personal account of representative nature because it represents a liability due to some person.
6.	False: The debts written off as bad, if recovered subsequently, shall be treated as gain and be credited to Bad Debts Recovered Account which is closed by transferring it to the Profit and Loss Account.
7.	False: Such wages being capital expenditure should be debited to the machinery account.
8.	False: The return of goods by a customer should be debited to Returns Inward Account .
9.	False: The balance of an account is always known by the side which is higher .
10.	False: Nominal accounts are not balanced but are closed by transferring their balances to the Income Statement.
11.	False: The allowance made for prompt payment is called cash discount .
12.	False: Bank Account is a Personal Account
13.	False: Goods taken by the proprietor for personal use should be credited to Purchases Account.
14.	False: Rent paid and rent received—both are nominal accounts as they relate with expenses and incomes.
15.	False: Journal is required even where subsidiary books are maintained. Opening and closing entries, rectification entries, transfer and adjusting entries and other miscellaneous entries are recorded in the journal.
16.	False: Fixed Assets + Current Assets + Fictitious Assets = Capital + External Liabilities Creditors also included in the External Liabilities.
17.	False: Reserve for Discount on Creditors has a debit balance.
18.	False: Normally Personal and Real accounts are balanced and not Nominal Accounts.
19.	False: Real and Personal Accounts are balanced and not closed at the end of accounting period.
20.	False: The return of goods to a suppliers should be credited to Return Outward Account.
21.	False: Prepaid Expense is a personal Account of representative nature because it represents an asset due from some person.
22.	False: The allowance made for promoting sales is called trade discount .
23.	False: When trade discount is allowed to a customer, trade discount allowed is not recorded at all.
24.	False: Goods costing ₹ 600 distributed as free samples should be credited to Purchases Account.
25.	False: The recovery of debts (due from Mohan ₹ 10,000) written off in the previous year should be credited to Bad Debts Recovered Account.
26.	False: Debit means a decrease in liability and an increase in an asset.
27.	False: Credit means in a decrease asset and an increase in a liability.
28.	False: Journal is a book of original entry.
29.	False: Ledger is a book of secondary entry.
30.	False: L.F. (i.e. Ledger Folio column) in the journal is filled at the time of posting.

31.	False: The words 'To Balance c/d' or By Balance c/d are recorded in the particulars column at the time of balancing.
32.	False: A sale of goods to Ram for cash should be debited to Cash.
33.	False: A withdrawal of cash from business by the proprietor should be credited to Cash Account.
34.	False: Goods were sold to Ram for ₹ 1,000 on 1.4.2018. On 1.5.2018, Ram paid ₹ 950 on account. Ram's Account should be credited with ₹ 950.
35.	False: Ram paid ₹ 900 towards a debt of ₹ 950 which was written off as bad in the previous year. Bad Debt Recovered Account should be credited with ₹ 900.
36.	False: Goods worth ₹ 100 taken by the proprietor for personal use should be credited to Purchases Account
37.	False: In case of debit balance. The words 'To Balance b/d' are written on debit side
38.	False: While posting an opening entry in the ledger, In case of debit balance, the words 'To Balance b/f' are written on debit side and In case of credit balance the words 'By Balance b/f' are written on credit side

4. CASH BOOK

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

- The balance in the Petty Cash Book represents expense. [Dec. 1993, May 1999, May 2005]
- The balance in the cash book shows net income. [May 1996]
- Bank column of the cash book will show only a debit balance. [Nov. 2002]
- Cash column of a Cash Book may show a debit or credit balance.
- In a Cash Book, Discount Columns may show either debit balance or credit balance. [May 1997 and May 2000]
- If a cheque received is further endorsed, it must be entered on both sides of the cash book. [Nov. 2003]
- A crossed cheque is always payable across the bank counter. [Nov. 2002]
- Cash Book is a special Journal and not a Ledger.
- In a Cash Book, Trade Discount received is recorded on the debit side of Cash Book and Trade Discount allowed is recorded on the credit side of Cash Book.
- In a Cash Book, Cash Discount received is recorded on the debit side of Cash Book and Cash Discount allowed is recorded on the credit side of Cash Book.
- When a firm maintain a Three-column Cash Book, it need not maintain Cash Account, Bank Account and Discount A/c in the Ledger.
- If a debit as well as credit aspects of a transaction are recorded in the Cash Book itself, it is called a double Entry.
- The allowance made for prompt payment is called Trade Discount.
- The total of Discount column on debit side of Cash Book is posted to the Credit of Discount Account.

ANSWERS:

S. No.	Reason
1.	False: The balance in the Petty Cash Book represents unspent petty cash balance lying with the Petty Cashier. It is shown on the asset side of the Balance Sheet under the heading 'Cash & Bank Balances'.

2.	False: The balance in the cash book shows <i>cash in hand</i> .
3.	False: Bank column of the cash book <i>may show credit balance in case of bank overdraft</i> .
4.	False: Cash Column of a cash book always shows a debit balance
5.	False: Discount Columns of a Cash Book are merely totalled but never balanced. Debit total of discount column represents discount allowed and that of credit side represents discount received. These are merely totalled and transferred to Discount Allowed and Discount Received Account respectively.
6.	True: The cash book is debited when the cheque is received and it is credited when it is endorsed in favour of somebody.
7.	False: Only a <i>bearer</i> cheque is payable across the bank counter.
8.	False: Cash Book is both special Journal and Ledger.
9.	False: In a Cash Book, Cash Discount is recorded and not the Trade Discount.
10.	False: In a Cash Book, Cash Discount received is recorded on the credit side of Cash Book and Cash Discount allowed is recorded on the debit side of Cash Book.
11.	False: When a firm maintain a Three-column Cash Book, it need not maintain Cash Account and Bank Account. Discount A/cs are maintained in the Ledger
12.	False: If a debit as well as credit aspects of a transaction are recorded in the Cash Book itself, it is called a contra Entry
13.	False: The allowance made for prompt payment is called Cash Discount.
14.	False: The total of Discount column on debit side of Cash Book is posted to the debit of Discount Allowed Account.

5. SUBSIDIARY BOOKS OTHER THAN CASH BOOK

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

- Purchase book records all purchases of goods. [Nov. 1996]
- The purchase day book is a part of the ledger. [Nov. 2002, Nov. 2005]
- The Sales book is kept to record all sales. [Nov. 2002]
- The debit notes issued are used to prepare sales return book. [May 2003]
- Opening, Closing, Rectifying and Adjusting entries are recorded in journal proper. [Nov. 2003]
- An individual transaction of Purchase Book is posted to the credit of Purchases A/c.
- Purchases A/c in the ledger shows all purchases.
- The Credit Notes are used to prepare Purchases Returns Book.
- Where Cash Book, Purchases Book, Sales Book, Purchases Returns Book, Sales Returns Book, Bill Receivable Book and Bill Payable Book are maintained, Journal need not be maintained.
- Purchases Returns Book is used to record return of all assets purchased on credit.
- Sales Returns Book is used to record return of assets sold on credit.
- When a customer returns the goods, a debit note is sent to him.
- When the goods are returned to a supplier, a credit note is sent to him.
- Purchase of a fixed asset on credit is recorded in Purchases Book.
- The allowance made for prompt payment is called Trade Discount.
- The total of Purchases Returns Book is posted to the debit of Purchases Account.

ANSWERS:

S. No.	Reason
1.	False: Purchase book records <i>only credit purchases</i> of goods dealt in or of material and stores used in the factory.
2.	False: Purchase day book is a book of prime entry and hence it is a part of <i>journal</i> .
3.	False: The Sales book is kept to record <i>only the credit sales</i> of goods dealt in by the firm, Cash sales are entered in the cash book.
4.	False: The debit notes issued are used to prepare <i>purchase return book</i> .
5.	True: All the Opening, Closing, Rectifying and Adjusting entries are recorded in journal proper because these entries can not be recorded in any other subsidiary book.
6.	False: An individual transaction of Purchase Book is posted to the credit of Individual Supplier's A/c.
7.	False: Purchases A/c in the ledger shows all purchases of goods (whether cash or on credit).
8.	False: The Credit Notes are used to prepare Sales Returns Book.
9.	False: Where Cash Book, Purchases Book, Sales Book, Purchases Returns Book, Sales Returns Book, Bill Receivable Book and Bill Payable Book are maintained, Journal is also required to be maintained for transactions which can not be recorded in any other subsidiary book.
10.	False: Purchases Returns Book is used to record return of goods purchased on credit.
11.	False: Sales Returns Book is used to record return of goods sold on credit.
12.	False: When a customer returns the goods, a credit note is sent to him.
13.	False: When the goods are returned to a supplier, a debit note is sent to him.
14.	False: Purchase of a fixed asset on credit is recorded in Journal Proper.
15.	False: The allowance made for prompt payment is called Cash Discount.
16.	False: The total of Purchases Returns Book is posted to the credit of Purchases Returns Account.

6. BANK RECONCILIATION STATEMENT

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

- Bank reconciliation statement is prepared to arrive at the bank balance.
[Dec. 1993, May 1995, Nov. 1997, Nov. 2000, May 2002 and Nov. 2004]
- Interest charged by the bank will be deducted, when the overdraft as per the cash book is the starting point for making the bank reconciliation statement. [Nov. 1996 and May 1997]
- If the balance as per cash book and pass book are the same, there is no need to prepare a reconciliation statement. [May 2003]
- Direct collection received by the bank on behalf of its customers will increase the balance as per the Bank Pass Book as compared to the balance as per the Cash Book.
- The interest charged by Banker to customer on overdrawn account is called Red in interest. [Nov. 2005]
- While preparing a BRS taking the balance as per pass book as starting point undercast of bank (debit) column of Cash Book is added.

7. While preparing a BRS taking the balance as per cash book as starting point wrong credit in pass book is subtracted..
8. Amended Cash Book is prepared by passing Rectifying Entries in respect of errors committed in Cash Book and Pass Book.
9. While preparing a BRS taking balance as per Amended Cash Book, Uncollected Cheques, Unpresented Cheques and all items which appear only in Pass Book are considered.
10. In Balance Sheet bank balance as per unamended cash book appears and not as per Pass Book.
11. Bank Reconciliation Statement is a part of Cash Book.
12. Bank Reconciliation Statement is prepared by a Bank.
13. Credit balance in Pass Book means overdraft.
14. A debit balance of ₹ 1,000 has been brought forward as a credit balance of ₹ 100 on the next page in the Pass Book. ₹ 900 should be added to the balance as per Pass Book in order to ascertain the balance as per Cash Book.
15. A Bank Reconciliation statement is prepared to reconcile the Cash Balance as per Cash Book with Bank Balance as per Pass Book.
16. The Pass Book is a copy of the Bank column of Cash Book of the account holder.
17. When balance as per Cash Book is the starting point, unpresented cheques are subtracted.
18. When balance as per Pass Book is the starting point, uncollected cheques are subtracted.
19. When balance as per Pass Book is the starting point, direct deposits by customers into the bank are added.

ANSWERS:

S. No.	Reason
1.	False: Bank reconciliation statement is prepared <i>to reconcile</i> 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.	False: Interest charged by the bank will be added because this charge when accounted for, will increase the overdraft (credit balance) as shown by the cash book.
3.	False: Bank reconciliation statement is prepared to find out the causes of difference in individual items of cash book and pass book even if the balance as per cash book and pass book are same.
4.	True: Because unless the customer is informed and records in the cash book, the balance as per Cash Book will remain lower as compared to Bank Balance as per Pass Book.
5.	False: Interest charged by banker to customer on overdrawn account is called 'interest on overdraft' whereas 'red-ink interest' is applied in account current if the due date of a bill falls after the date of costing the account. The red-ink interest is treated as negative interest.
6.	False: While preparing a BRS taking the balance as per pass book as starting point undercast of bank (debit) column of Cash Book is subtracted.
7.	False: While preparing a BRS taking the balance as per cash book as starting point wrong credit in pass book is added.
8.	False: Amended Cash Book is prepared by passing Rectifying Entries in respect of errors committed in Cash Book and by passing Adjusting Entries in respect of correct items which appear only in Pass Book.

9.	False: While preparing a BRS taking balance as per Amended Cash Book Uncollected Cheques, Unpresented Cheques and Wrong Entry only in Pass Book are considered.
10.	False: In Balance Sheet bank balance as per amended cash book appears and not as per Pass Book.
11.	False: Bank Reconciliation Statement is not a part of Cash Book.
12.	False: Bank Reconciliation Statement is prepared by a Account holder.
13.	False: Credit balance in Pass Book means clear balance.
14.	False: A debit balance of ₹ 1,000 has been brought forward as a credit balance of ₹ 100 on the next page in the Pass Book. ₹ 1,100 should be subtracted from the balance as per Pass Book is order to ascertain the balance as per Cash Book.
15.	False: A Bank Reconciliation statement is prepared to reconcile the Bank Balance as per Cash Book with Bank Balance as per Pass Book.
16.	False: The Pass Book is a copy of the Bank Account of account holder in bank books.
17.	False: When balance as per Cash Book is the starting point, unpresented cheques are added.
18.	False: When balance as per Pass Book is the starting point, uncollected cheques are added.
19.	False: When balance as per Pass Book is the starting point, direct deposits by customers into the bank are subtracted.

7. TRIAL BALANCE, ERRORS AND THEIR RECTIFICATION

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. A tallied trial balance means that the books of accounts contain no errors.

or

A tallied Trial balance is a conclusive proof of accuracy of books of accounts.

2. Errors of principle will affect trial balance. [June 1993]
3. Errors of principle involves an incorrect allocation of expenditure or receipt between capital and revenue. [May 1997, May 1998, Nov. 2000 and May 2002]
4. Any type of error affects the agreement of trial balance. [Nov. 1995]
5. Wrong casting of subsidiary books does not affect the trial balance. [June 1994 and Nov. 2002]
6. If the amount is posted in the wrong account or it is written on the wrong side of an account, it is called an error of commission. [Dec. 1993 and May 1999]
7. Under or over-casting of a subsidiary book is an example of error of commission. [Nov. 2004]
8. Purchase of office furniture has been debited to general expenses account. It is a compensating error. [May 1996]
9. A tallied trial balance will not reveal compensating errors and errors on account of wrong balancing. [May 1995, May 1998 and May 2001]
10. Error of carry-forward of totals of purchase journal affects two accounts. [Nov. 1996]
11. Travelling expenses of ₹ 80,000 paid to a technician for the installation of a new machine is debited to a profit and loss account. [May 2000]
12. Errors of complete omission will be located, if trial balance is prepared. [Nov. 2002]
13. Rectification of mistakes is necessary to tally the trial balance.

[June 1993, Nov. 1994, May 2005]

14. Rectifying errors in subsequent accounting period always affects the profit or loss of that period. [Nov. 2004]
15. Salary paid to Ram will be debited to Ram's Personal account. [Nov. 2005]
16. A trial balance will reveal all errors of commission .
17. A trial balance will reveal all errors of posting.
18. The object of opening Suspense Account is to avoid the delay in preparation of Trial Balance.
19. The balance of Suspense A/c represents the net effect of all errors whether detected or not.
20. After the preparation of financial statements, Profit & Loss Adjustment Account is used to rectify all errors involving Real & Personal A/cs in the subsequent year so as not to affect the Profit / Loss of that period.
21. The preparation of a Trial Balance helps in locating errors of complete omission.
22. Freight Inward Account shows a debit balance but a Freight Outward Account shows a credit balance.
23. Errors of recording in the books of original entry will affect the Trial Balance.
24. Correct recording in the Journal Proper but not posted in the ledger at all will affect the Trial Balance.
25. Trial Balance is prepared for a particular period which may be a week, month, quarter, half year or year.
26. When some of the errors affecting the Trial Balance are located and rectified, the Suspense Account automatically stands balanced.
27. The difference in the Trial Balance is transferred on the debit side of the Suspense Account if the total of debit column of the Trial Balance exceeds that of credit column .
28. Trial Balance is prepared after preparing the Profit & Loss Account.

ANSWERS:

S. No.	Reason
1.	False: Agreement of trial balance is not an absolute proof of the accuracy, because there may be some errors like errors of principle, compensating errors etc. which do not affect the agreement of trial balance.
2.	False: Errors of principle will not affect trial balance because both the aspects (debit & credit) of a transaction are recorded. Error of Principle involves incorrect allocation of payments/receipts between capital and revenue.
3.	True: Recording the transaction in a <i>fundamentally incorrect manner in contravention of accounting principles is an error of principle.</i>
4.	False: Every error does not affect the agreement of trial balance. For example: Errors of Principle, compensating errors do not affect the agreement of trial balance.
5.	False: Wrong casting of subsidiary books affects the trial balance. For example, if Purchase Book is undercast by ₹ 1,000, the total of debit column will be lower by ₹ 1,000.
6.	True: Errors of commission includes errors on account of wrong posting, wrong balancing of an account, wrong carry forward, wrong casting etc., whether of subsidiary books or any other books.
7.	True: Errors of commission includes errors on account of wrong posting wrong balancing of an account, wrong carry forward, wrong casting etc., whether of subsidiary books or any other books.

8.	False: It is an error of principle because an item of capital nature has been treated as an item of revenue nature.
9.	Partly True, Partly False: A tallied trial balance will not reveal compensating errors as it will agree inspite of the existence of these errors. However, in the case of errors on account of wrong balancing, the trial balance will not tally. However, the statement will be true in the limited cases where the errors on account of wrong balancing get fully compensated.
10.	False: It will affect only one account i.e. purchases account and hence it will affect the agreement of trial balance.
11.	False: Such expenses being a capital expenditure should be debited to Machinery Account.
12.	False: Such errors cannot be located because both debit and credit aspects of an entry are not recorded and hence it will not affect trial balance.
13.	False: The trial balance can be tallied by debiting or crediting the difference amount to suspense account. However, rectification of mistakes is necessary to have a proper accounting of transactions and if all errors are located and rectified then there is no reason for disagreement of trial balance.
14.	False: Rectifying errors involving Real & Personal Accounts will not affect the profit of that period.
15.	False: Salary paid to Ram will be debited to Salaries account.
16.	False: A trial balance will reveal all errors of commission other than error of recording and error of posting involving to wrong account on correct side with correct amount.
17.	False: A trial balance will not reveal errors of posting involving to wrong account on correct side with correct amount.
18.	False: The object of opening Suspense Account is to avoid the delay in preparation of Financial Statements.
19.	False: The balance of Suspense A/c represents the net effect of errors which still remain undetected.
20.	False: After the preparation of financial statements, Profit & Loss Adjustment Account is used to rectify all errors involving Nominal A/c in the subsequent year so as not to affect the Profit / Loss of that period.
21.	False: The preparation of a Trial Balance helps in locating one sided errors of commission.
22.	False: Freight Inward Account shows a debit balance but a Freight Outward Account shows a debit balance.
23.	False: Errors of recording in the books of original entry will not affect the Trial Balance.
24.	False: Correct recording in the Journal Proper but not posted in the ledger at all will not affect the Trial Balance.
25.	False: Trial Balance is prepared at a particular date.
26.	False: When all the errors affecting the Trial Balance are located and rectified, the Suspense Account automatically stands balanced.
27.	False: The difference in the Trial Balance is transferred on the credit side of the Suspense Account if the total of debit column of the Trial Balance exceeds that of credit column .
28.	False: Trial Balance is prepared before preparing the Profit & Loss Account.

8. CAPITAL AND REVENUE EXPENDITURE

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. Pre-operative expenses are revenue expenses. [June 1993]
2. An expenditure intended to benefit the current period is a revenue expenditure. [June 1994, Nov. 1997 and Nov. 2002]
3. Expenditure which results in acquisition of a permanent asset is a capital expenditure. [May 1995, Nov. 1997, Nov. 2000 and Nov. 2001]
4. Deferred revenue expenditure is current year's revenue expenditure to be paid in the later years. [Nov. 1994 and Nov. 2002]
5. Heavy expenditure incurred on advertisement at the time of introducing a new product is a deferred revenue expenditure. [June 1993]
6. Expenses incurred to keep the machine in working condition is a capital expenditure. [Dec. 1993]
7. Wages paid to workers to produce a tool to be captively consumed is capital expenditure. [Nov. 1994, May 1998]
8. Amount paid for acquiring goodwill is deferred revenue expenditure. [Nov. 1995 and Nov. 2002]
9. Overhaul expenses of a second-hand machinery purchased are revenue expenditure. [May 1996 and Nov. 1996]
10. Amount spent for replacement of worn out parts of a machine is a capital expenditure. [May 1999]
11. Expenditure incurred on white washing of factory building done after every six months is revenue expenditure. [May 199]
12. Amounts written off from the cost of fixed assets is capital expenditure. [Nov. 1994]
13. Legal fees paid to acquire a property is capital expenditure. [Nov. 1999, Nov. 2002 and Nov. 2004]
14. Expenditure on renovation of a theatre which has increased the seating capacity by 10% is deferred revenue expenditure. [May 2000]
15. Temporary shed put up at project site to house materials is a capital expenditure. [Nov. 1999]
16. Overhauling expenses of ₹ 25,000 for the engine of a motor car to get better fuel efficiency are revenue expenses.
17. Inauguration expenses of ₹ 25 lacs incurred on the opening of a new manufacturing unit in an existing business are capital expenditure.
18. Compensation of ₹ 2.5 crores paid to workers, who opted for voluntary retirement in capital expenditure.
19. Amount paid to Management company for consultancy to reduce the working expenses is revenue expenditure. [May 2005]
20. Wages incurred by a factory in manufacturing a part for its plant, is a revenue expense. [Nov. 2005]
21. The classification of expenditures and receipts each into Capital and Revenue is as per Accrual Principle.
22. Sale of land & buildings by a real estate dealer is a Capital receipt.
23. Expenditure incurred on repairs and whitewashing at the time of purchase of an old building in order to make it useable is a Revenue Expenditure.
24. Expenditure incurred to provide one more exit in a cinema hall in compliance with a government order is a Revenue Expenditure.

25. Registration fees paid at the time of purchase of a building is a Revenue Expenditure.
26. Expenditure incurred on the maintenance of a tea garden which will produce tea after four years is a Revenue Expenditure.
27. The expenditure incurred in erecting a platform on which a machine will be fixed is a Revenue Expenditure.
28. Advertising expenditure, the benefits of which a machine will last for five years is a Revenue Expenditure.
29. Cost of ₹ 80,000 for dismantling, removing and reinstalling plant by a Cotton mill incurred in connection with the removal of works to a more suitable locality is a Capital Expenditure.
30. A sum of ₹ 50,000 spent for alternation of existing plant incorporating thereby new devices which could affect substantial reduction in power consumption is a Revenue Expenditure.
31. Imported goods worth ₹ 1,00,000 confiscated by Customs Authorities for non-disclosure of material facts is a capital loss.
32. Expenditure of ₹ 20,000 for advertisement in newspapers is a Capital Expenditure.
33. Expenditure of ₹ 30,000 on neon-sign board at the airport is a Revenue Expenditure.
34. Spent ₹ 50,000 for remodeling the factory is a Capital Expenditure and the value of factory is enhanced by ₹ 20,000.
35. ₹ 1,00,000 spent on renewal fee of patent rights is a Capital Expenditure.
36. Expenses incurred in connection with obtaining a licence for starting the Factory are Revenue Expenditure.
37. Rings and Pistons of an engine were changed at a cost of ₹ 5,000 to get fuel efficiency. This is Revenue Expenditure.
38. ₹ 2,00,000 spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the plaintiff. The suit was not successful. This is Capital Expenditure
39. ₹ 1,00,000 paid as compensation to the two employees who were retrenched is a Capital Expenditure.
40. ₹ 10,000 Customs Duty paid on import of a machinery for modernisation of the factory production during the current year is a Revenue Expenditure.
41. ₹ 5,000 paid on Import Duty for purchase of Raw Materials is a Capital Expenditure.
42. ₹ 12,000 Interest had accrued during the year on term loan obtained and utilised for the construction of factory Building and purchase of machineries, however the production has not commenced till the last date of the accounting year .It is a Revenue Expenditure.
43. Any expenditure which is unreasonably large is capital expenditure.
44. Premium received on issue of shares is a revenue receipt.

ANSWERS:

S. No.	Reason
1.	False: Pre-operative expenses are incurred prior to commencement of commercial production and hence are generally capitalized.
2.	True: Revenue expenditure is that expenditure the benefit of which does not extend beyond the current accounting period.
3.	True: Expenditure which result in acquisition of a permanent asset is a capital expenditure since it will generate enduring benefits and help in revenue generation over more than one accounting period.
4.	False: Deferred revenue expenditure is that expenditure for which payment has been made or a liability has been incurred during current year but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods.

5.	True: It is considered as deferred revenue expenditure because its benefit would accrue over a subsequent period or periods.
6.	False: It is a revenue expenditure because it is not increasing the benefits but only keeping the machine in working condition.
7.	True: Wages paid to workers for the creation of an asset to be used in the business is capital expenditure.
8.	False: Amount paid for acquiring goodwill is capital expenditure because it involves acquisition of an intangible asset which is classified as fixed asset.
9.	False: Such expenses are capital expenditure because these are incurred to put second-hand machinery in good/working condition to derive long term benefits of enduring nature.
10.	False: Amount spent for replacement of any worn out part of a machine is revenue expenditure because it is part of its maintenance cost.
11.	True: These expenses are revenue expenditure because these are incurred in the course of normal maintenance of the asset.
12.	False: Amount written off from the cost of fixed assets is treated as revenue expenditure and charged to profit and loss account. Depreciation is an example of such write-off.
13.	True: Legal fees paid to acquire a property is a part of the cost of that property. Hence it is taken as capital expenditure.
14.	False: It is a capital expenditure because it has increased the revenue earning capacity of the business over more than one accounting period.
15.	True: Temporary shed put up at a project site to house materials is incidental to the main construction and the expenditure on it, is a part of construction cost and hence, it is a capital expenditure.
16.	False: These expenses should be capitalised because these are incurred for the engine of a motor car to derive better fuel efficiency. These expenses will reduce the running cost in future and thus the benefit is in form of endurable long term advantage.
17.	False: Such expenses are revenue expenditure because such expenditure may not generate any enduring benefit to the business over more than one accounting period.
18.	False: Such compensation is revenue expenditure. Since the magnitude of the amount of expenditure is very significant, it may be better to treat it as deferred revenue expenditure.
19.	False: Amount paid to management company for consultancy to reduce the working expenses is deferred revenue expenditure as this expenditure will generate long-term benefit to the entity.
20.	False: Wages incurred by a factory in manufacturing a part of its plant, is a capital expenditure. This expenditure will be included in the cost of plant.
21.	False: The classification of expenditures and receipts each into Capital and Revenue is as per Going Concern Principle.
22.	False: Sale of land & buildings by a real estate dealer is a Revenue receipt and not a Capital receipt.
23.	False: Expenditure incurred on repairs and whitewashing at the time of purchase of an old building in order to make it useable is a Capital Expenditure.
24.	False: Expenditure incurred to provide one more exit in a cinema hall in compliance with a government order is a Capital Expenditure.

25.	False: Registration fees paid at the time of purchase of a building is a Capital Expenditure.
26.	False: Expenditure incurred on the maintenance of a tea garden which will produce tea after four years is a Deferred Revenue Expenditure.
27.	False: The expenditure incurred in erecting a platform on which a machine will be fixed is a Capital Expenditure.
28.	False: Advertising expenditure, the benefits of which a machine will last for five years is a Deferred Revenue Expenditure
29.	False: Cost of ₹ 80,000 for dismantling, removing and reinstalling plant by a Cotton mill incurred in connection with the removal of works to a more suitable locality is a Revenue Expenditure.
30.	False: A sum of ₹ 50,000 spent for alternation of existing plant incorporating thereby new devices which could affect substantial reduction in power consumption is a Capital Expenditure
31.	False: Imported goods worth ₹ 1,00,000 confiscated by Customs Authorities for non-disclosure of material facts is a revenue loss.
32.	False: Expenditure of ₹ 20,000 for advertisement in newspapers is a Revenue Expenditure.
33.	False: Expenditure of ₹ 30,000 on neon-sign board at the airport is a Capital Expenditure.
34.	False: ₹ 20,000 for remodelling the factory is a Capital Expenditure and the balance ₹ 30,000 is a Revenue Expenditure.
35.	False: ₹ 1,00,000 spent on renewal fee of patent rights is a Revenue Expenditure.
36.	False: Expenses incurred in connection with obtaining a licence for starting the Factory are Capital Expenditure.
37.	False: Rings and Pistons of an engine were changed at a cost of ₹ 5,000 to get fuel efficiency. This is Capital Expenditure
38.	False: ₹ 2,00,000 spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the plaintiff. The suit was not successful. This is Revenue Expenditure
39.	False: ₹ 1,00,000 paid as compensation to the two employees who were retrenched is a Revenue Expenditure.
40.	False: ₹ 10,000 Customs Duty paid on import of a machinery for modernisation of the factory production during the current year is a Capital Expenditure.
41.	False: ₹ 5,000 paid on Import Duty for purchase of Raw Materials is a Revenue Expenditure.
42.	False: It is a Capital Expenditure.
43.	False: Any expenditure which is unreasonably large need not be capital expenditure. For example, ₹ 20,00,000 paid as arrears of salaries & wages will be Revenue Expenditure although the amount is large.
44.	False: Premium received on issue of shares is a capital receipt.

9. DEPRECIATION

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. Depreciation is an amortised expenditure. [June 1993]
2. Depreciation is a process of allocation of the cost of fixed asset. [Nov. 2003]

3. Depreciable amount refers to the difference between historical cost and the market value of an asset. [May 2004]
4. Depreciation cannot be provided in case of loss, in a financial year. [Nov. 1994 and Nov. 1997]
5. Depreciation is a cash expenditure like other normal expenses. [Nov. 2002]
6. Land is also a depreciable asset. [May 2001]
7. Providing depreciation ensures sufficient cash for asset replacement. [Dec. 1993]
8. Reducing balance method for depreciation is followed to have a uniform charge for depreciation and repairs and maintenance together. [June 1993]
9. Depreciation can be charged on Goodwill by Fixed Instalment Method [May 2006]
10. Depletion refers to economic deterioration of natural resources like ore deposits in mines, oil wells.
11. Amortization refers to the physical deterioration of intangible assets like Goodwill, Patents, Copy Rights.
12. Obsolescence refers to physical deterioration by change in technology or taste or fashion.
13. Depreciation Accounting is the process of valuation and not allocation.
14. If market value of a fixed asset is higher than its cost ,then Depreciation need not be provided.
15. Depreciation is non-cash and non- operating expense which is to be provided for if there are profits.
16. Providing depreciation in the accounts reduces the amount of cash profits .
17. Fixed Assets are stated in the Balance Sheet at their market value.
18. There exists difference between the Written Down Value Method and Diminishing Balance Method of Depreciation.
19. The expressions—depreciation is to be charged at 10% and 10% p.a. on furniture carry the same meaning.
20. M/s Ram & Co need not provide any depreciation on Plant & Machinery as its market value (₹ 10,00,000) is much higher than the cost of purchase (₹ 9,00,000).
21. Straight Line Method of Depreciation is followed to have a uniform charge for depreciation and Repairs & Maintenance together.

ANSWERS:

S. No.	Reason
1.	True: Depreciation is charged on value of fixed assets over their useful life. Thus, by way of depreciation charge, capital expenditure is amortised over the useful life of depreciable asset.
2.	True: Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset.
3.	False: Depreciable amount refers to historical cost less estimated salvage values.
4.	False: Depreciation being a charge against profit has to be provided for whether there is profit or loss in a financial year.
5.	False: Depreciation is non-cash expenditure because it does not involve any cash outflow.
6.	False: Land is not a depreciable asset because its useful life is not limited to few years.
7.	False: Providing depreciation <i>does not necessarily</i> ensure sufficient cash for asset replacement especially under inflationary conditions.

8.	True: In the early periods of useful life of a fixed assets, repairs and maintenance expenses are relatively low because the asset is new but depreciation charge is high. Whereas in later periods, as the asset become old, repairs and maintenance expenses increase continuously but depreciation charge reduces continuously. Thus, depreciation and repair and maintenance expenses become more or less uniform throughout the useful life of the asset.
9.	True: Depreciation can be charged on goodwill by fixed instalment method because fixed instalment method is suitable where the risk of obsolescence is less.
10.	False: Depletion refers to physical deterioration of natural resources like ore deposits in mines, oil wells.
11.	False: Amortization refers to the economic deterioration of intangible assets like Goodwill, Patents, Copy Rights.
12.	False: Obsolescence refers to economic deterioration by change in technology or taste or fashion.
13.	False: Depreciation Accounting is the process of allocation and not valuation.
14.	False: Depreciation needs be provided since Depreciation is not concerned with the Fluctuations in market price.
15.	False: Depreciation is non-cash but operating expense which is to be provided for whether there are profits/ losses.
16.	False: Providing depreciation in the accounts does not reduce the amount of cash profits .
17.	False: Fixed Assets are stated in the Balance Sheet at their cost less depreciation.
18.	False: There does not exist any difference between the Written Down Value Method and Diminishing Balance Method of Depreciation.
19.	False: The expressions—depreciation is to be charged at 10% and 10% p.a. on furniture do not carry the same meaning. Depreciation at 10% means charge depreciation without reference to time but Depreciation at 10% p.a. means charge depreciation with reference to time
20.	False: M/s Ram & Co must provide depreciation since depreciation is not affected by fluctuations in the market value .
21.	False: Reducing Balance Method of Depreciation is followed to have a uniform charge for depreciation and Repairs & Maintenance together.

10. INVENTORY VALUATION

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. Finished goods are normally valued at cost or market price which ever is higher.
[June 1994, May 1995 and Nov. 2001]
2. The inventory under AS-2 is valued on the basis of cost price or current replacement cost, which ever is less.
[Nov. 2004, Nov. 2005]
3. Damaged inventory should be valued at cost or market price, which ever is lower. [May 2004]
4. Inventory of by-products, should be valued at net realisable value where cost of by-products can be separately determined.
[Nov. 2003]
5. Periodic Inventory System is a method of recording inventory balances after each issue and receipt.

6. Inventories include Stock of Materials, Work-in-Progress and Finished Goods, Maintenance Supplies, Consumables, Loose Tools and Machinery Spares.
7. Cost of Conversion consists of Direct Labour, Direct Expenses, Sub-Contracted Work and Production Overheads as per Marginal Costing Method.
8. The Cost of Inventories includes:
 - (i) Abnormal amounts of wasted material labour or other production cost.
 - (ii) Storage Cost.
 - (iii) Administrative Overheads.
 - (iv) Selling and Distribution Cost.
9. As per AS-2 'Valuation of Inventories', the historical cost of inventories should normally be determined by FIFO (First In First Out), LIFO and Weighted Average Cost Formula.
10. As per AS-2, the historical cost of manufactured Inventories should be arrived at by Marginal costing.
11. As per AS-2, the historical cost may be compared with Net Realizable Value (NRV) by item by item method only.
12. As per AS-2, the Inventory of Raw Materials is valued at Cost or NRV whichever is lower.
13. As per AS-2, the inventory of Materials and other Supplies is valued at Cost or NRV whichever is lower even if Finished Products are expected to be sold at or above cost.
14. If Closing Stock is understated, the Cost of Goods sold will increase but Profit and Current Assets will decrease.
15. Under inflationary conditions, LIFO method will show Lower Cost of Goods Sold, higher income and Higher value of Closing Stock.
16. Cost of Unsold Goods lying with others on our behalf (e.g. Cost of Goods Sent on Approval Basis/ Consignment Basis/ Joint Venture Basis) should not form part of our Closing Stock at Balance Sheet Date.
17. In Balance Sheet Stock as per physical verification as on date of balance sheet appears.

ANSWERS:

S. No.	Reason
1.	False: Finished goods are normally valued at cost or net realisable value which ever is lower.
2.	False: According to AS-2 on Valuation of Inventories, inventory is valued at the lower of historical cost and net realisable value.
3.	False: Damaged inventory should be valued at net realisable value.
4.	False: Inventory of by-products, should be valued at net realisable value where cost of by-products <i>cannot</i> be separately determined.
5.	False: Perpetual Inventory System is a method of recording inventory balances after each issue and receipt.
6.	False: Inventories include Stock of Materials, Work-in-Progress and Finished Goods, Maintenance Supplies, Consumables and Loose Tools but does not include Machinery Spares.
7.	False: Cost of Conversion consists of Direct Labour, Direct Expenses, Sub-Contracted Work and Production Overheads as per Absorption Costing Method.

8.	False: The Cost of Inventories excludes: (i) Abnormal amounts of wasted material labour or other production cost. (ii) Storage Cost. (iii) Administrative Overheads. (iv) Selling and Distribution Cost.
9.	False: As per AS-2 'Valuation of Inventories', the historical cost of inventories should normally be determined by FIFO (First In First Out) and Weighted Average Cost Formula.
10.	False: As per AS-2, the historical cost of manufactured Inventories should be arrived at by absorption costing.
11.	False: As per AS-2, the historical cost may be compared with Net Realizable Value (NRV) by item by item method or group of items method.
12.	False: As per AS-2, the Inventory of Finished Goods is valued at Cost or NRV whichever is lower.
13.	False: As per AS-2, the inventory of Materials and other Supplies is not written down below Cost if Finished Products are expected to be sold at or above cost.
14.	False: If Closing Stock is understated, the Cost of Goods sold will decrease but Profit and Current Assets will increase.
15.	False: Under inflationary conditions, FIFO method will show Lower Cost of Goods Sold, higher income and Higher value of Closing Stock.
16.	False: Cost of Unsold Goods lying with others on our behalf (e.g. Cost of Goods Sent on Approval Basis/ Consignment Basis/ Joint Venture Basis) should form part of our Closing Stock at Balance Sheet Date.
17.	False: In Balance Sheet Stock as per books appears and not Stock as per physical verification.

11. FINANCIAL STATEMENTS

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

- Fixed cost remain relatively unaffected in a defined period of time. [Dec. 1993]
- Current cost gives an alternative measurement base. [Nov. 1999]
- Net profit is reflected in higher cash balances and net loss is reflected in lower net worth. [Dec. 1993]
- Profit and loss account shows the financial position of the concern. [Dec. 1993, Nov. 1994, Nov. 1997]
- A profit and loss account is a point statement whereas a balance sheet is a period statement. [May 1995]
- Fixed assets are stated in the balance sheet at their market value. [Nov. 1994]
- Trial balance is prepared after preparing the profit and loss account. [Nov. 1995]
- The provision for discount on debtors is calculated before deducting the provision for doubtful debts from debtors. [Nov. 1995, May 1998, Nov. 2002 and Nov. 2004]
- Provision for doubtful debts is debited to sundry debtors account. [May 2000]
- The gain from sale of capital assets need not be added to revenue to ascertain the net profit of a business. [May 1997 and Nov. 2000]

11. Freight and cartage expenses paid on purchases of goods is added to the amount of purchase. [May 1998 and Nov. 2000]
12. The debit balance in the profit & loss account is surplus. [May 2001]
13. Debit balance of profit and loss account is a real asset. [Nov. 2002]
14. Assets and Liabilities of a particular accounting period are shown in the balance sheet. [Nov. 2002 of Foundation]
15. Under the 'liquidity approach' assets which are most liquid are presented at the bottom of the balance sheet. [Nov. 2002]
16. The value of human resources is generally shown as asset in the Balance Sheet. [May 2003]
17. A withdrawal of cash from the business by the proprietor should be charged to profit and loss account as an expense. [June 1994]
18. The proprietor of a shop feels that he has made a loss due to closing stock being zero. [May 1995 and Nov. 1997]
19. Marshalling and Grouping has the same meaning.
20. Sundry Debtors are liquid assets. [May 2006]
21. Closing stock will never appear in the trial. [May 2006]
22. Income Statement is prepared to ascertain the financial position but Balance Sheet is prepared to ascertain financial performance at the end of a given accounting period.
23. Income Statement is prepared on the basis of closing entries relating to Nominal and Real Accounts but Balance Sheet is prepared on the basis of balances of Real and Nominal Accounts.
24. Gross Profit means excess of all revenue over all expenses.
25. Operating Profit means excess of operating revenues over all expenses and losses.
26. Net Profit means excess of all operating revenues over all expenses and losses.
27. Depreciable fixed assets are valued at Cost.
28. Current assets are usually valued at Net Realizable Value or Cost whichever is higher.
29. Under order of liquidity the most liquid assets is shown last and least urgent payment is shown first.
30. The company as defined under Companies Act, 2013 prepares Balance Sheet in the Order of liquidity.
31. Banking and finance companies, and sole proprietorships prepare their balance sheets in the Order of Permanence.
32. Under order of performance least liquid asset is shown last and most urgent payment is shown first.
33. In Trading Account Returns having debit balance and credit balance are shown by way of deduction from amount of purchases and sales respectively.
34. If Closing Stock, Outstanding Expenses, Prepaid Expenses and Accrued Income and Unaccrued Income appear inside the Trial Balance, these appear only in Income Statement and not in the Balance Sheet.
35. If Depreciation, Interest on Capital, Interest on Drawings appear inside the Trial Balance, these will appear in only in the Balance Sheet and not in Income Statement.
36. Provision for Doubtful Debt is calculated after deducting additional bad debts and additional discount appearing outside the trial balance and Provision for Discount on Debtors.
37. If opening entry and adjusting entries are not passed both trial balance and balance sheet will not be tallied.

38. Reserve for Discount on Creditors has credit balance.
39. Bank Account, Provision for Doubtful Debts, Provision for Discount on Debtors, Reserve for Discount on Creditors, Provision for Depreciation are Nominal Accounts.
40. Bills Receivable Account and Bills Payable Account are Real Accounts.
41. Prepaid Insurance, Accrued Interest, Commission received in advance and Closing Stock are Nominal Accounts.
42. Manufacturing A/c is prepared by an enterprise engaged in trading Activities.
43. Manufacturing A/c is prepared to ascertain the cost of goods sold.
44. Manufacturing A/c is closed by transferring its balance to the credit of Profit & Loss A/c.
45. Opening and Closing Stock of Raw Materials, Work in Progress and Finished Goods are considered while preparing Manufacturing A/c.
46. A Balance Sheet is a statement of assets and liabilities of an enterprise for a particular accounting period.
47. The most liquid asset is shown first and the most urgent payment to be made is shown last in order of liquidity.
48. The least liquid asset is shown first and the least urgent payment to be made is shown last in order of permanence.
49. Contingent liability is an ascertained liability but its amount and due date are indeterminate.
50. Deferred revenue expenditure is current year's expenditure to be paid in future year.

ANSWERS

S. No.	Reason
1.	True: Fixed costs represent that part of cost of production which, by its very nature, remain relatively unaffected in a defined period of time provided there is <i>no change in the level of production</i> and there is <i>no change in factor prices</i> .
2.	True: Current cost is another alternative of measurement basis according to which assets are carried at the amount at which the same or an equivalent asset can be acquired currently. This is used under Current Cost Accounting. Historical Cost is used under Historical Cost Accounting.
3.	False: Net profit may not be reflected in higher cash balance because of credit transactions. On the other hand, cash may increase because of fresh loan or fresh capital. Net worth is the sum of capital, reserves and profit and loss account balance. Net worth is reduced by net loss. But net worth may also be reduced by withdrawal by the proprietor/partners. So lower net worth may not necessarily reflect net loss.
4.	False: Profit and loss account shows the financial performance of a concern for a particular accounting period.
5.	False: A profit and loss account is a periodic statement and a balance sheet is a point statement.
6.	False: Fixed assets are stated in the balance sheet <i>at cost less depreciation</i> .
7.	False: Trial balance is prepared before preparing the profit and loss account.
8.	False: The provision for discount on debtors is calculated after deducting the provision for doubtful debts from debtors.
9.	False: Provision for doubtful debts is debited to profit and loss account. In the balance sheet, it is shown as deduction from 'Debtors'.

10.	True: The profit on sale of capital assets should not be added to ascertain the true net profit of a business because it is not due to normal business operations.
11.	True: As per AS-2 Freight paid to bring the goods purchased into the business premises/factory are included in the 'cost of purchase'. Alternatively , the statement may be taken as 'false' since for accounting purposes, these expenses are not added to the amount of purchases but are shown separately in the trading account.
12.	False: The debit balance in the Profit and Loss account is deficit or loss because expenses are more than revenues.
13.	False: Debit balance of profit and loss account is a fictitious asset .
14.	False: Assets and Liabilities at a particular date are shown in the Balance Sheet.
15.	False: Under the 'liquidity approach' assets which are most liquid are presented first .
16.	False: It is not shown in the balance sheet as per money measurement concept because it cannot be measured in monetary terms.
17.	False: Such Cash withdrawal should be treated as drawings and not a business expense chargeable to profit and loss account. Such drawings should be deducted from the proprietors capital.
18.	False: The level of closing stock does not directly determine the profits of a business. The operational efficiency and other factors affecting cost determine the profits. The whole stock might have been sold out.
19.	False: The term ' <i>Grouping</i> ' means putting together items of a similar nature under a common heading. For example, under the heading 'Trade Creditors' the balances of the ledger accounts of all the suppliers from whom goods have been purchased on credit, will be shown. The term ' <i>Marshalling</i> ' refers to the order in which the various assets and liabilities are shown in the Balance Sheet. The assets and liabilities can be shown <i>either</i> in the order of liquidity <i>or</i> in the order of permanency.
20.	True: Sundry debtors are liquid assets because these are readily convertible into cash.
21.	False: Closing stock may appear in the trial balance if an adjusting entry relating to closing stock has already been passed. If closing stock appears in trial balance it will appear only on the asset side of the Balance Sheet.
22.	False: Income Statement is prepared to ascertain the Financial performance for a given accounting period but Balance Sheet is prepared to ascertain financial Position at the end of a given accounting period.
23.	False: Income Statement is prepared on the basis of closing entries relating to Nominal Accounts but Balance Sheet is prepared on the basis of balances of Real and Personal Accounts.
24.	False: Gross Profit means excess of operating revenue over direct operating expenses.
25.	False: Operating Profit means excess of operating revenues over operating expenses and losses.
26.	False: Net Profit means excess of all revenue (whether operating or non-operating) over expenses and losses (whether operating or non-operating).
27.	False: Depreciable fixed assets are valued at Cost less Depreciation.
28.	False: Current assets are usually valued at Net Realizable Value or Cost whichever is lower.
29.	False: Under order of liquidity the most liquid assets is shown first and least urgent payment is shown last.

30.	False: The company as defined under Companies Act, 2013 prepares Balance Sheet in the Order of Permanence.
31.	False: Banking and finance companies, and sole proprietorships prepare their balance sheets in the order of liquidity
32.	False: Under order of performance least liquid asset is shown first and most urgent payment is shown last.
33.	False: In Trading Account Returns having debit balance and credit balance are shown by way of deduction from amount of sales and purchases respectively.
34.	False: If Closing Stock, Outstanding Expenses, Prepaid Expenses and Accrued Income and Unaccrued Income appear inside the Trial Balance, these appear only in the Balance Sheet and not in Income Statement.
35.	False: If Depreciation, Interest on Capital, Interest on Drawings appear inside the Trial Balance, these will appear in Income Statement and not in the Balance Sheet.
36.	False: Provision for Doubtful Debt is calculated after deducting additional bad debts and additional discount appearing outside the trial balance but before deducting Provision for Discount on Debtors
37.	False: If opening entry and adjusting entries are not passed both trial balance and balance sheet will be tallied.
38.	False: Reserve for Discount on Creditors has debit balance.
39.	False: Bank Account, Provision for Doubtful Debts, Provision for Discount on Debtors, Reserve for Discount on Creditors, are Personal Accounts but Provision for Depreciation is Real Account.
40.	False: Bills Receivable Account and Bills Payable Account are Personal Account.
41.	False: Prepaid Insurance, Accrued Interest, Commission received in advance are Personal Accounts but Closing Stock is Real Account.
42.	False: Manufacturing A/c is prepared by an enterprise engaged in Manufacturing Activities.
43.	False: Manufacturing A/c is prepared to ascertain the cost of goods manufactured.
44.	False: Manufacturing A/c is closed by transferring its balance to the debit of Trading A/c.
45.	False: Opening and Closing Stock of Raw Materials and Work in Progress and not Finished Goods are considered while preparing Manufacturing A/c.
46.	False: A Balance Sheet is a statement of assets and liabilities of an enterprise at a particular date.
47.	False: The most liquid asset is shown first and the most urgent payment to be made is shown first in order of liquidity.
48.	False: The least liquid asset is shown first and the least urgent payment to be made is shown first in order of permanence.
49.	False: Contingent liability is an unascertained liability but its amount and due date are indeterminate.
50.	False: Deferred revenue expenditure is future year's expenditure but paid in current year.

12. NOT FOR PROFIT ORGANISATIONS

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. Receipts and Payments Account is a summary of all capital receipts and payments. [Nov. 1995, Nov. 1997, May 2005]

Or

The Receipts and Payments account records receipts and payments of revenue nature only. [May 1996]

2. Scholarship granted to students out of funds provided by Government will be debited to Income and Expenditure Account. [May 1995]
3. If there appears a sports fund, the expenses incurred on sports activities will be taken to income and expenditure account. [May 1997]
4. Receipts and Payments Account highlights total income and expenditure. [Nov. 1999]
5. Only revenue items are disclosed in Income and Expenditure account. [Nov. 2005]
6. Receipts and payments Account is a summary of all receipts and payments(whether capital or revenue) relating to current year.
7. Income and Expenditure Account is a summary of all revenue receipts and revenue payments relating to current year.
8. Income and Expenditure Account is a summary of all revenue income and payments relating to current year.

ANSWERS:

S. No.	Reason
1.	False: Receipts and Payments Account is a summary of all cash/bank receipts and payments whether capital or revenue in nature.
2.	False: The scholarship granted to students should be shown as deduction from the funds provided by the Government for the same purpose in the Balance Sheet.
3.	False: Such expenses will be deducted from sports fund only.
4.	False: Receipts and payments account is a classified summary of cash/bank receipts and payments over an accounting period together with cash and bank balances at the beginning and close of the period.
5.	True: Income and Expenditure Account is a revenue statement prepared to find out surplus/deficit. Hence, only revenue items are shown in the Income and Expenditure Account.
6.	False: Receipts and payments Account is a summary of all receipts and payments(whether capital or revenue) relating to current year,previous year or future year.
7.	False: Income and Expenditure Account is a summary of all revenue incomes and revenue expenses relating to current year.
8.	False: Income and Expenditure Account is a summary of all revenue income and revenue expenses relating to current year.

13. CONSIGNMENT

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. The relationship between consignor and consignee is that of principal and agent. [June 1994, Nov. 1995, Nov. 1997, May 1998, Nov. 2000 and May 2002]

2. In consignment, the goods are dispatched on the basis that the goods will be sold on behalf of, at the expense of and at the risk of the consignee. [May 1995]
3. Account sales is the statement sent by the consignor to the consignee. [May 1996]
4. Del-credere commission is normally calculated on total sales. [May 1996]
5. Loss of stock is said to be abnormal loss when such loss is due to inherent characteristics of the commodities. [Nov. 1996, May 2005]
6. Loss of stock is said to be normal loss when such loss is not due to inherent characteristics of the commodities. [May 1998]
7. If the consignee is not authorized to get the del-credere commission, then he is liable for all losses on account of non-recovery of debts. [May 1997]
8. Consignee has no right in the profit on goods sent on consignment. [May 2001, Nov. 2005]
9. In consignment account, ownership of the goods remains with the consignor. [Nov. 2002]
10. The party to whom goods are sent is called 'consignee'. [Nov. 2003]
11. Over-riding commission is calculated on credit sales only. [Nov. 2004]
12. The additional commission to the consignee who agrees to bear the loss on account of bad debts is called overriding commission. [May 2005]
13. Overriding commission is granted to an agent in case of sales exceeding targets. [Nov. 2005]
14. The relationship between Consignee and Consignor is that of Principal and Agent.
15. Unless otherwise agreed, Del-credere Commission is calculated on credit sales.
16. Any property may be the subject matter of consignment.
17. Discount charges on discounting a B/R accepted by Consignee are credited to Consignment A/c.
18. Total Cost of Abnormal Loss not recovered is debited to Consignment A/c.
19. Consignor sends Invoice but Consignee sends Sales Account.
20. Cost of Unsold Consignment Stock lying with Consignee consists of Cost of Unsold Goods, Consignor's Proportionate Expenses and Consignee's all Expenses of non-recurring nature.
21. Consignee will not pass a journal entry in his books for the amount of bad debts if del-credere commission is allowed.
22. Consignor allows overriding Commission to the consignee to bear the bad debts on account of credit sales.
23. Non-recurring expenses are those expenses which are incurred after the goods reach the Consignee's godown.
24. The Consignee gives advance to the consignor as a part payment of goods received.
25. Loading charges paid by the Consignee are non-recurring expenses.
26. All expenses incurred by the Consignee are debited to his account.
27. When defective goods are returned by the Consignee, the Consignor debits it to Consignee's Account.
28. Consignee does not pass any entry for goods sent on consignment, profit/loss on Consignment and Consignment Stock.
29. The cost of Consignment stock is the cost at which the goods are consigned plus all the non-recurring expenses.
30. Goods returned by the Consignee should be charged to Consignment Account at cost or market price whichever is lower.
31. Expenses incurred in forwarding the defective goods should be debited to Profit & Loss Account.

32. Loss of weight due to evaporation is abnormal loss.
33. Normal Loss does not affect the valuation of Closing Stock.
34. Abnormal Loss affects the valuation of Closing Stock.
35. Abnormal Loss is debited to Consignment Account.
36. The amount of loss not accepted by the Insurance Company is debited to Consignment Account.
37. Loading is the difference between Selling Price and Cost Price.
38. Consignor always consigns goods at invoice price.
39. Sending goods at invoice price shall result in more profit in the Consignment Account, if no adjustment is made for the loading.
40. Invoice price is always equal to selling price.
41. Consignor consigns the goods at invoice price to conceal the actual profit earned on consignment.
42. Loading on closing stock will be nullified by debiting Stock Reserve Account and crediting Closing Stock Account.
43. All the entries of adjustment for loading are recorded in the books of consignee.
44. Sales Account and Account Sales are synonymous terms:

ANSWERS:

S. No.	Reason
1.	True: The relationship between consignor and consignee is that of principal and agent. The consignee acts only on behalf of and at the instructions of the consignor and not as partner of the consignor.
2.	False: In a consignment business, goods are generally sold on behalf of, at the expense of and at the risk of the consignor . However, if the consignee gets del-credere commission, the risk of bad debts is borne by him.
3.	False: Account sales is a statement sent by the <i>consignee to consignor</i> , showing (a) the details of sales made, (b) the expenses incurred on behalf of the consignor, (c) the commission earned by the consignee, (d) any advance given to the consignor and (e) the balance due to the consignor.
4.	True: Although it arises in relation to credit sales, it is calculated on the total sales, not merely on credit sales unless otherwise agreed.
5.	False: When loss is caused by abnormal factors like fire, theft, abnormal, spoilage etc., loss is said to be abnormal.
6.	False: Loss due to inherent features of goods is a normal loss.
7.	False: If the consignee is not authorized to get the del-credere commission, then he is not responsible for any bad-debts that may arise in due course of business.
8.	True: The consignee being an agent earns only commission and not profit.
9.	True: The ownership of goods remains with the consignor. The consignee does not become owner even though the goods are in his possession.
10.	True: In consignment accounts, the party which sends the goods is called the consignor, while the party to whom goods are sent is called the consignee.
11.	False: In case the sales exceeds a specific amount, an extra commission is allowed to the consignee. This commission is termed as over-riding commission. It is calculated on total sales, unless specifically agreed between the consignor and the consignee.
12.	False: The additional commission to the consignee who agrees to bear the loss on account of bad debts is called del credere commission.

13.	False: Overriding commission is granted to an agent in case the sales exceed a specific target.
14.	False: The relation between Consignee and Consignor is that of Agent and Principal.
15.	False: Unless otherwise agreed, Del-credere Commission is calculated on total sales and not on credit sales.
16.	False: Only movable property may be the subject matter of consignment.
17.	False: Discount charges on discounting a B/R accepted by Consignee are debited to Profit & Loss A/c and not to Consignment A/c.
18.	False: Total Cost of Abnormal Loss (whether recovered or not) is credited to Consignment A/c.
19.	False: Consignor sends Proforma Invoice but Consignee sends Account Sales.
20.	False: Cost of Unsold Consignment Stock lying with Consignee consists of Cost of Unsold Goods, Consignor's Proportionate Expenses and Consignee's Proportionate Expenses of non-recurring nature.
21.	False: Consignee will pass a journal entry in his books for the amount of bad debts if del-credere commission is allowed. Or False: Consignee will not pass a journal entry in his books for the amount of bad debts if del-credere commission is not allowed.
22.	False: Consignor allows overriding Commission to the consignee to achieve sales exceeding a specific amount.
23.	False: Non-recurring expenses are those expenses which are incurred before the goods reach the Consignee's godown.
24.	False: The Consignee gives advance to the consignor as a security for the goods despatched to him..
25.	False: Loading charges paid by the Consignee after the goods reach the Consignee's godown are recurring expenses.
26.	False: All expenses incurred by the Consignee are credited to his account.
27.	False: When defective goods are returned by the Consignee, the Consignor debits it to Goods Sent on Consignment Account.
28.	True: Consignor passes entry for goods sent on consignment, profit/loss on Consignment and Consignment Stock.
29.	False: The cost of Consignment Stock is the cost at which the goods are consigned plus Proportionate non-recurring expenses.
30.	False: Goods returned by the Consignee should be credited to Consignment Account at cost or Net Realisable Value whichever is lower.
31.	False: Expenses incurred in forwarding the defective goods should be debited to Consignment Account.
32.	False: Loss of weight due to evaporation is normal loss.
33.	False: Normal Loss affects the valuation of Closing Stock.
34.	False: Abnormal Loss does not affect the valuation of Closing Stock.
35.	False: Abnormal Loss is credited to Consignment Account.
36.	False: The amount of loss not accepted by the Insurance Company is credited to Consignment Account.

37.	False: Loading is the difference between Invoice Price and Cost Price.
38.	False: Consignor need not always consign the goods at Invoice Price. Goods may be consigned at cost also.
39.	False: Sending goods at invoice price shall result in less profit in the Consignment Account, if no adjustment is made for the loading. Profit shall be reduced by the amount of loading on Goods Sold.
40.	False: Invoice price is always equal to Cost plus profit.
41.	False: Consignor consigns the goods at invoice price to conceal the actual Cost of Goods to the Consignee .
42.	False: Loading on closing stock will be nullified by debiting Consignment Account. and crediting Stock Reserve Account.
43.	False: All the entries of adjustment for loading are recorded in the books of consignor.
44.	False: Sales Account and Account Sales are different terms:

14. JOINT VENTURE

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. A joint venture business has a definite life. [May 1997 and May 2002]
2. Joint venture is a very short duration of business mainly confined to single deal entered into by two or more persons jointly. [Nov. 1999]
3. Joint Venture is a temporary partnership between two or more persons for limited purpose and has a definite life.
4. Only Movable property may be subject matter of Joint Venture.
5. Joint Venture is a partnership under Partnership Act and follows going concern concept.
6. The relationship between Co-venturers is that of Principal and Agent like partners.
7. Discount Charges on Discounting a Bill Receivable drawn on Co-venturer are credited and unrecovered Abnormal Loss of Goods are debited to Joint Venture A/c.
8. A joint venture is a partnership formed under the Indian Partnership Act.
9. The goods supplied from his stock at cost by the Co-venturer maintaining the accounts are credited to Sales A/c.
10. In Memorandum Joint Venture Account Method, the Co-Venturer records all the transactions of the Joint Venture.
11. Memorandum Joint Venture Account is prepared to find out the amount due from the Co-venturer.
12. The share of profit of the Co-venturer maintaining the records is credited to other Co-venturer's personal account.
13. Any bad debts incurred on account of joint venture are debited to Bad Debts Account.
14. In case of separate set of Books method of Joint Venture, Co-venturer's Contribution in the form of goods is debited to Joint Bank Account.
15. In case of separate set of Books Method of Joint Venture, expenses paid by a Co-venturer are credited to Joint Bank Account.
16. Co-venturer's Contribution in cash is debited to Co-venturer's personal account.
17. Discount on discounting a Bills Receivable is not debited to Joint Venture Account.
18. The loss of goods due to fire is credited to Joint Venture Account.
19. There is no difference between Joint Venture Account and Memorandum Joint Venture Account.

ANSWERS:

S. No.	Reason
1.	True: A joint venture business has a definite life and automatically comes to an end on the completion of the venture for which it was formed.
2.	True: Joint Venture is a very short duration business (i.e. for specific purpose), generally confined to a single transaction entered into by two or more persons jointly named as co-venturers.
3.	True: Under Joint Venture, two or more persons agree to undertake a particular venture. Such limited partnership automatically expires on the completion of the venture for which it was formed.
4.	False: Any property may be subject matter of Joint Venture.
5.	False: Joint Venture is not a partnership under Partnership Act and does not follow going concern concept.
6.	False: The relationship between Co-venturers is that of Co-owners.
7.	False: Discount Charges on Discounting a Bill Receivable drawn on Co-venturer are debited to Joint Venture A/c but unrecovered Abnormal Loss of Goods is not recorded in Joint Venture A/c.
8.	False: A joint venture is not a partnership formed under the Indian Partnership Act.
9.	False: The goods supplied from his stock at cost by the Co-venturer maintaining the accounts are credited to Goods sent on Joint Venture A/c.
10.	False: In Memorandum Joint Venture Account Method, Each Co-Venturer records only those joint venture transactions which are effected by him with the help of a personal account designed as 'Joint Venture with....(Name of the other Co-Venturer) ... Account'.
11.	False: Memorandum Joint Venture Account is prepared to ascertain the profit/loss on Joint Venture transactions.
12.	False: The share of profit of the Co-venturer maintaining the records is credited to Profit & Loss Account.
13.	False: Any bad debts incurred on account of joint venture are debited to Joint Venture Account.
14.	False: In case of separate set of Books Method of Joint Venture, Co-venturer's Contribution in the form of goods is debited to Joint Venture Account.
15.	False: In case of separate set of Books Method of Joint Venture, expenses paid by a Co-venturer are credited to Co-venturer's personal Account.
16.	False: Co-venturer's Contribution in cash is credited to Co-venturer's personal account.
17.	False: Discount on discounting a Bills Receivable is debited to Joint Venture Account.
18.	False: The loss of goods due to fire is not credited to Joint Venture Account.
19.	False: There is difference between Joint Venture Account and Memorandum Joint Venture Account. All the items posted in Joint Venture Account have their corresponding debits/credits in the books of accounts, whereas it is not so in the case of 'Memorandum Joint Venture Accounts'.

15. BILL OF EXCHANGE

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. A bill given to a creditor is called bills payable. [May 1996, Nov. 2001 and May 2004]
2. A promissory note can be made payable to the bearer. [May 1996, Nov. 2000]
3. A has drawn a bill on B. B accepts the same and endorses the bill to C. [May 2000]
4. No cancellation entry is required when a bill is renewed.
[May 1997, May 1998, Nov. 2001, May 2004]
5. Cancelling old bill and drawing new bill is called renewal of bill. [May 2001]
6. Discount at the time of retirement of a bill is a gain for the drawee. [Nov. 1996 and May 2002]
7. At the time of Renewal of a bill, Interest account is debited in the books of a drawee.
[May 2006]
8. Promissory Note requires acceptance. [May 2006]
9. Refusal by the acceptor to make payment of the bill on the maturity date is called Retirement of the bill. [May 2005]
10. A bill of exchange is a conditional order in writing given by a Debtor to a Creditor. [Nov. 2005]
11. A Promissory Note is a written unconditional order to pay by a Creditor to a Debtor but a Bill of Exchange is a written unconditional undertaking to pay by a Debtor to a Creditor.
12. The term of bill after date commences from the date of acceptance of the bill but the term of Bill after sight commences from the date of drawing a bill.
13. In case of all bills of exchange, three days (days of grace) are added to due date to arrive at date of maturity.
14. In case of Insolvency of Acceptor, the amount which could not be recovered is debited to Deficiency A/c in the books of drawer and the amount which could not be paid is credited to Bad Debts A/c in books of drawee.
15. Rebate on Retirement of bill is an Expense for Drawer and an Income for Drawee.
16. On discounting of accommodation bills, the proceeds are shared by drawer and drawee equally. The party bears the discount in the proportion in which it shares the proceeds of bill, unless otherwise agreed.
17. In case of a public holiday the due date of the bill falls on the next working day.
18. Bill of Exchange is an unconditional promise to pay in writing.
19. When bill is endorsed or discounted, no entry is passed in the books of drawer.
20. When an endorsed or discounted bill is honoured, no entry is passed in the books of drawee.
21. When the bill is honoured on the due date, the drawee credits Bills Payable A/c in his books.
22. When the bill is discounted or endorsed, no entry for payment of the bill is passed in the books of the drawee.
23. In case of the dishonour of a bill, noting charges are initially paid by the drawee.
24. The bill is treated as dishonoured in case of insolvency of the drawee who pays only 75%.
25. When the bill is dishonoured, in drawee's books the banker (in case bill has been discounted) and Endorsee (in case bill has been endorsed) will be debited.
26. For drawing an accommodation bill some valuable consideration must pass between the two parties.
27. A Bills Receivable drawn on Ram recorded in B/R Book is posted to the debit of Bills Receivable A/c.

28. All individual entries from Bills Payable Journal are to be posted to the debit of Bills Payable A/c.
29. A bill of exchange is an unconditional promise in writing given by a debtor to a creditor.
30. A promissory note is an unconditional order in writing given by a creditor to a debtor.
31. Drawee and Payee can be the same person in a Bills Receivable.
32. Days of grace are added to date of maturity of bill to arrive at due date.

ANSWERS:

S. No.	Reason
1.	True: A bill given to a creditor is called Bills Payable because the debtor commits to pay by giving a bill to creditor.
2.	False: A promissory note cannot be made payable to the bearer. It is <i>payable to or to the order of a certain person</i> .
3.	False: B cannot endorse the bill to C because he is a drawee. Only A, the drawer can do so.
4.	False: When the bill is renewed, entries are passed first for cancellation of the old bill and then for recording of the new bill.
5.	True: When the acceptor of a bill fails to make the payment on the due date, a new bill may be drawn on him after cancellation of the old bill. This is known as renewal of a bill.
6.	True: Discount at the time of retirement of a bill is a gain for the drawee and loss for the drawer. Gain is basically an interest for the unexpired term of the bill.
7.	True: At the time of renewal of a bill, interest account is debited in the books of a drawee because it represents an expense for drawee.
8.	False: Promissory note does not require acceptance because it is already a valuable instrument. Bills receivable requires acceptance.
9.	False: Refusal by the acceptor to make payment of the bill on the maturity date is called dishonour of the bill.
10.	False: A bill of exchange is an unconditional order in writing given by a creditor to a debtor.
11.	False: A Promissory Note is a written unconditional undertaking to pay by a Debtor to a Creditor but a Bill of Exchange is a written unconditional order to pay by a Creditor to a Debtor.
12.	False: The term of bill after date commences from the date of drawing a bill but the term of Bill after sight commences from the date of acceptance of the bill.
13.	False: In case of all bills of exchange (other than payable on demand), three days (days of grace) are added to due date to arrive at date of maturity.
14.	False: In case of Insolvency of Acceptor, the amount which could not be recovered is debited to Bad Debts A/c in the books of drawer and the amount which could not be paid is credited to Deficiency A/c in books of drawee.
15.	False: Rebate on Retirement of bill is an Income for Drawer and an Expense for Drawee.
16.	False: On discounting of accommodation bills, the proceeds are shared by drawer and drawee in agreed ratio. The party bears the discount in the proportion in which it shares the proceeds of bill, unless otherwise agreed
17.	False: In case of a public holiday the due date of the bill falls on the preceding working day.
18.	False: Bill of Exchange is an unconditional order to pay in writing.

19.	False: When bill is endorsed or discounted, no entry is passed in the books of drawee.
20.	False: When an endorsed or discounted bill is honoured, no entry is passed in the books of drawer.
21.	False: When the bill is honoured on the due date, the drawee debits Bills Payable A/c in his books.
22.	False: When the bill is discounted or endorsed, no entry for payment of the bill is passed in the books of the drawer.
23.	False: In case of the dishonour of a bill, noting charges are initially paid by the holder of the bill.
24.	True: The bill is treated as dishonoured in case of insolvency of the drawee since he fails to pay at the date of maturity.
25.	False: When the bill is dishonoured, the drawer will be debited in books of drawee whether the bills is retained, endorsed or discounted.
26.	False: For drawing an accommodation bill consideration need not pass between the two parties
27.	False: A Bills Receivable drawn on Ram recorded in B/R Book is posted to the credit of Ram's A/c
28.	False: All individual entries from Bills Payable Journal are to be posted to the debit of drawer's A/c.
29.	False: A bill of exchange is an unconditional order in writing given by a creditor to a debtor.
30.	False: A promissory note is an unconditional promise in writing given by a debtor to a creditor.
31.	False: Drawer and Payee can be the same person in a Bills Receivable.
32.	False: Days of grace are added to due date of bill to arrive at date of maturity.

16. AVERAGE DUE DATE AND ACCOUNT CURRENT

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. If payment is made on the average due date, it results in loss of interest to creditors. [Nov. 1995 and May 1999]
2. Average due date is the median average of several due dates for payments. [May 1999]
3. In the calculation of average due date, only the due date of first transaction must be taken as the base date. [May 1999, Nov. 2003]
4. In Account Current, red-ink interest is treated as negative interest. [Nov. 1999 and May 2003]

ANSWERS:

S. No.	Reason
1.	False: Average due date is 'no loss no gain' date to either party i.e. neither the debtor nor the creditor stands to lose or gain anything by way of interest.
2.	False: Average due date is <i>mean/equated date</i> for several due dates of payments.
3.	False: While calculating the average due date, <i>any transaction date</i> may be taken as the base date.
4.	True: In case the due date of a bill falls after the date of closing the account, interest from the date of closing to such due date is written in 'Red-Ink' in the appropriate side of Account Current. This red-ink interest is treated as negative interest.

17. GOODS SENT ON APPROVAL

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. Sales or Return Account in the Sale or return ledger represents the value of goods still lying with the customers for approval. [May 2006]
2. If Goods Sent on Approval are temporarily pledged by customer for security purposes only with the lender, it does not mean that goods have been sold to the customer.
3. If Goods Sent on Approval to a customer are sent by that customer on approval basis to any other person, it does not mean that goods have been sold to the customer
4. Credit Balance of Sale on Approval A/c at the close of Accounting Period represents total value of Goods Sent Out.
5. Goods sent out on Approval but neither sold nor Returned till the close of accounting period are included in the stock of the customer at Cost or Net Realizable Value whichever is higher.

ANSWERS:

S. No.	Reason
1.	True: The balance of Sale or Return Account in Sale or Return ledger represents the value of goods lying with the customers who have <i>neither</i> returned <i>nor</i> accepted goods till date.
2.	False: If Goods Sent on Approval are pledged by customer as security with the lender, it amounts to acceptance of goods and it means that goods have been sold to the customer.
3.	False: If Goods Sent on Approval to a customer are sent by that customer on approval basis to any other person, it amounts to acceptance of goods and it means that goods have been sold to the customer.
4.	False: Credit Balance of Sale on Approval A/c at the close of Accounting Period represents total value of Goods Sent Out but neither Sold nor Returned.
5.	False: Goods sent out on Approval but neither sold nor Returned till the close of accounting period are considered as goods lying with customer on behalf of seller and included in the stock of the Seller at Cost or Net Realizable Value whichever is lower.

18. PARTNERSHIP—FUNDAMENTALS

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. A joint venture is a partnership under the Partnership Act. [May 2000, May 2003]
2. A partner who devotes more time to a business than other partners is entitled to get a salary. [May 2000]
3. Partners can share profits or losses in their capital ratio, when there is no agreement. [May 2001]
4. The business of partnership firm must be carried on by all the partners. [Nov. 2005]
5. When there is no agreement among the partners, the profit or loss of the firm will be shared in their capital ratio. [May 2005]
6. Sharing of Profit is conclusive evidence of partnership but Mutual Agency is only a prima facie evidence of partnership.
7. Registration of a firm has to be effected before the formation of partnership.
8. Every partner is only jointly liable to third parties.
9. It is necessary to have Partnership Agreement in writing.

10. Terms of Partnership and nature of business of firm can be changed with the consent of majority of partners.
11. If the amount of available profits is less than the total amount of interest on capital, the available profits should be distributed in the profit sharing ratio of partners.
12. If Partnership Deed is silent, Rate of Interest on loan by firm to a Partner shall be 6% p.m.
13. A partnership deed must be in writing.
14. In the absence of any provision in the partnership deed, the partners share profit and losses in the ratio of their capitals.
15. In the absence of any provision in the partnership deed, only a working partner (and not non-working partner) is entitled to remuneration.
16. In the absence of any provision in the partnership deed, interest will be calculated on the total amount of drawings for a period of 12 months assuming that the amounts were drawn evenly throughout the year.
17. If a fixed amount is withdrawn on the first day of every month, the interest on the total amount of drawings will be calculated for a period of 6 months.
18. If a fixed amount is withdrawn on the last day of every month, the interest on the total of drawings will be calculated for a period of 6.5 months.
19. Interest on loan given by a partner to the firm shall be paid if there are profits.
20. Current accounts of partners are maintained under the Fluctuating capital Method.

ANSWERS:

S. No.	Reason
1.	False: Joint venture is not a partnership under the Partnership Act. Since it is only a kind of temporary trading relationship between co-venturers to carry out a commercial venture.
2.	False: No partner is entitled to a salary unless the partnership deed specifically provides for the same.
3.	False: Profits or losses are to be shared equally among partners if there is no agreement.
4.	False: The business of the partnership firm can be carried on by all the partners or by any one of them acting for all.
5.	False: According to the Indian Partnership Act, in the absence of any agreement to the contrary, profits and losses of the firm are shared equally among partners.
6.	False: Sharing of Profit is only a prima facie evidence of partnership but Mutual Agency is a conclusive evidence of partnership.
7.	False: Registration of a firm is optional and not compulsory and can be effected on or after the formation of partnership.
8.	False: Every partner is jointly and severally liable to third parties.
9.	False: It is not necessary to have Partnership Agreement in writing.
10.	False: Terms of Partnership and nature of business of firm can be changed only with the consent of all partners.
11.	False: If the amount of available profits is less than the total amount of interest on capital, the available profits should be distributed in the ratio of interest claims of partners.
12.	False: The Partnership Act has not prescribed any Rate of Interest on Loan by firm to Partner.
13.	False: A partnership deed need not be in writing.

14.	False: In the absence of any provision in the partnership deed, the partners share profit be and losses equally.
15.	False: In the absence of any provision in the partnership deed, no partner is entitled to remuneration.
16.	False: In the absence of any provision in the partnership deed, interest will be calculated on the total amount of drawings for a period of six months assuming that the amounts were drawn evenly throughout the year.
17.	False: If a fixed amount is withdraw on the first day of every month, the interest on the total amount of drawings will be calculated for a period of 6.5 months.
18.	False: If a fixed amount is withdrawn on the last day of every month, the interest on the total of drawings will be calculated for a period of 5.5 months.
19.	False: Interest on loan given by a partner to the firm shall be paid even if there are losses.
20.	False: Current accounts of partners are maintained under the Fixed Capital Method.

19. ADMISSION OF A PARTNER

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. Goodwill is a fictitious asset. [May 1996, May 2001, Nov. 2001 and May 2004]

Or

- Goodwill is a current asset. [May 1998]
2. Goodwill is in the nature of personal account. [May 1999]
3. Goodwill brought in by an incoming partner in cash for joining a partnership firm is taken away by the old partners in their new profit sharing ratio. [May 2000]
4. A person may be admitted as partner either with the consent of majority of partners or in accordance with express agreement among partners .
5. There exists no difference between 'Y' surrenders 1/3rd of his share and 'Y' surrenders 1/3rd from his share.
6. Machinery Replacement Fund is credited to partners in their sacrificing.
7. Excess of Investment Fluctuation Reserve over difference between book value and market value is credited to Revaluation Account.
8. Excess of Workmen Compensation Reserve over Liability of Workmen Compensation is credited to Revaluation Account.
9. The ratio in which the old partners have agreed to sacrifice their shares in profit in favour of a new partner is called the gaining ratio.
10. Unless given otherwise, the ratio of sacrifice is the same as old profit sharing ratio.
11. The amount of goodwill brought in by the new partner is shared by old partners in their old profit sharing ratio.
12. The assets and liabilities are revalued at the time of admission of a partner so that the profit or loss arising on the revaluation of assets and liabilities upto the date of admission may be adjusted in the capital accounts of sacrificing partners only.
13. If, at the time of admission, provision for doubtful debts is to be reduced, it will be debited to Debtors Accounts.
14. Any amount released from the sale of unrecorded asset is debited to the old partners' capital accounts.

15. Any amount paid to discharge an unrecorded liability is credited to the old partners' capital accounts.
16. Gain or loss arising from revaluation of assets and liabilities is shared by old partners in their sacrificing ratio.
17. All accumulated profits, reserves, losses and fictitious assets appearing in the books of the firm at the time of admission, are transferred to old partners' capital accounts in their respective sacrificing ratio.

ANSWERS:

S. No.	Reason
1.	False: Goodwill is an intangible asset and not fictitious or current asset.
2.	False: Goodwill is an intangible asset therefore it is an item of <i>real account</i> .
3.	False: When a new partner brings in cash for goodwill, it is taken away by the old partners in their sacrificing ratio.
4.	False: A person may be admitted as partner either with the consent of all partners or in accordance with express agreement among partners (Sec. 31)
5.	False: There exists difference between 'B surrenders 1/3rd of his share' and 'B surrenders 1/3rd from his share'. If B's share is 2/5th, it means in the former case he has surrendered 2/15th [i.e. $(1/3) \times (2/5)$] share and B's New Share is 4/15 [i.e. $(2/5) - (2/15)$], in the latter case, he has surrendered 1/3rd share and B's New Share is 1/15 [i.e. $(2/5) - (1/3)$].
6.	False: Machinery Replacement Fund is not credited to partners because it is in the nature of accumulated depreciation and not accumulated profit.
7.	False: Excess of Investment Fluctuation Reserve over difference between book value and market value is credited to partners in Profit Sharing Ratio.
8.	False: Excess of Workmen Compensation Reserve over Liability of Workmen Compensation is credited to partners in Profit Sharing Ratio
9.	False: The ratio in which the old partners have agreed to sacrifice their shares in profit in favour of a new partner is called the sacrificing ratio.
10.	True: Unless given otherwise, it is presumed that old partners have surrendered their share in favour of incoming partner in their respective old profit sharing ratio.
11.	False: The amount of goodwill brought in by the new partner is shared by old partners in their sacrificing ratio.
12.	False: The assets and liabilities are revalued at the time of admission of a partner so that the profit or loss arising on the revaluation of assets and liabilities upto the date of admission may be adjusted in the capital accounts of old partners only.
13.	False: If, at the time of admission, provision for doubtful debts is to be reduced, it will be debited to Provision for Doubtful Debts Account.
14.	False: Any amount released from the sale of unrecorded asset is debited to Cash/Bank Account.
15.	False: Any amount paid to discharge an unrecorded liability is credited to Cash/Bank Account
16.	False: Gain or loss arising from revaluation of assets and liabilities is shared by old partners in their respective old profit sharing ratio.
17.	False: All accumulated profits, reserves, losses and fictitious assets appearing in the books of the firm at the time of admission, are transferred to old partners' capital accounts in their respective old profit sharing ratio.

20. PARTNERSHIP—RETIREMENT/DEATH OF A PARTNER

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. If a partner retires, then other partners have a gain in their profit sharing ratio. [May 2001]
2. Joint life policy is taken by the partners in order to provide working capital for the firm. [June 1994]

Or

The objective of taking a joint life policy by the partnership firm is to secure the lives of the existing partners of the firm. [Nov. 2002]

3. A partner may retire from firm either with the consent of majority of partners or in accordance with express agreement among partners.
4. Deceased Partner's Share of Profit is adjusted through P&L Suspense A/c which appears on the Liabilities side of the Balance Sheet.
5. The ratio in which the continuing partners acquire the outgoing (retired or deceased) partner's share is called as sacrificing ratio.
6. Unless given otherwise, the gaining ratio is the same as old profit ratio.
7. The assets and liabilities are revalued at the time of retirement/death of a partner so that the profit or loss arising on the revaluation of assets and liabilities up to date of retirement/death of a partner may be adjusted in the capital accounts of continuing partners only.
8. Gain or loss arising from revaluation of assets and liabilities up to date of retirement/death of a partner is shared only by continuing partners in their respective old profit sharing ratio.
9. All accumulated profits, reserves, losses and fictitious assets appearing in the books of the firm at the time of retirement of a partner are transferred only to continuing partners' capital accounts in their respective old profit sharing ratio.
10. The amount standing to the credit of deceased partner 'capital account is transferred to his/her loan account in case it is not paid immediately.
11. Joint Life Policy is an assurance policy covering the lives of the partners jointly & severally .
12. Joint Life Policy becomes due in the event of death of any of the partners or on the maturity of the policy, whichever is later.
13. Surrender value of an insurance policy means the realizable value of an insurance policy in the event of the surrender of the policy to the Insurance company at the date of maturity.
14. A retired partner or the legal representative of a deceased partner can not claim a share in the subsequent profits of the firm in any case.

ANSWERS:

S. No.	Reason
1.	True: If a partner retires, his share of profit or loss will be shared by the other partners in their profit sharing ratio unless otherwise agreed.
2.	False: The objective of taking a joint life policy is to minimize the financial hardships in the event of payment of a large sum to the legal representatives of a deceased partner or to the <i>retiring partner</i> .
3.	False: A partner may retire from firm either with the consent of all other partners or in accordance with express agreement among partners.
4.	False: Deceased Partner's Share of Profit is adjusted through P&L Suspense A/c which appears on the Assets side of the Balance Sheet.

5.	False: The ratio in which the continuing partners acquire the outgoing (retired or deceased) partner's share is called as gaining ratio.
6.	True: Unless given otherwise, it is presumed that continuing partners have acquired the outgoing (retired or deceased) partner's share in their respective old profit sharing ratio.
7.	False: The assets and liabilities are revalued at the time of retirement/death of a partner so that the profit or loss arising on the revaluation of assets and liabilities up to date of retirement/death may be adjusted in the capital accounts of all the partners.
8.	False: Gain or loss arising from revaluation of assets and liabilities up to date of retirement/death of a partner is shared by all partners in their respective old profit sharing ratio.
9.	False: All accumulated profits, reserves, losses and fictitious assets appearing in the books of the firm at the time of retirement of a partner are transferred to all partners' capital accounts in their respective old profit sharing ratio.
10.	False: The amount standing to the credit of deceased partner 'capital account' is transferred to his/her Executors's Loan Account in case it is not paid immediately.
11.	False: Joint Life Policy is an assurance policy covering the lives of the partners jointly.
12.	False: Joint Life Policy becomes due in the event of death of any of the partners or on the maturity of the policy, whichever is earlier.
13.	False: Surrender value of an insurance policy means the realizable value of an insurance policy in the event of the surrender of the policy to the Insurance company before the date of maturity.
14.	False: A retired partner or the legal representative of a deceased partner can claim a share in the subsequent profits of the firm if his accounts are not settled.

21. ACCOUNTING FOR SHARE CAPITAL

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

- Maximum number of members in case of private company is 50.
- Maximum paid up capital for Public Company is ₹ 5 lakhs and for Private Company is ₹ 1 lakh.
- Equity Share Capital with differential rights as to voting or dividend can not be issued.
- Unless otherwise stated a preference share is always deemed to be Non-Cumulative, Non-participating & Non-convertible.
- Participating Preference Share is that share which in addition to two basic preferential rights also carries a right to participate in surplus profits and surplus assets.
- Securities Premium can be applied to issue partly paid bonus shares.
- Under the Capital Clause of Memorandum of Association, the amount of Issued Capital and its division into shares of fixed amount is required to be stated.
- Issued Capital refers to paid up value of all shares allotted.
- Shares issued to supplier of a fixed asset are required to be disclosed separately under the sub-head 'Issued Capital'
- Reserve Capital and Capital Reserve carry the same meaning.
- As per Table F, the Minimum rate of interest that can be charged on Calls-in-Arrear and that can be allowed on calls-in-advance are 10% p.m. and 12% p.m. respectively.
- While passing an entry for Forfeiture, Share Capital A/c is debited with the amount Paid-up (excluding Securities Premium) till the stage of forfeiture.
- While passing an entry for Forfeiture, Securities Premium is debited only with the amount of total Securities premium.

14. While passing an entry for Forfeiture Forfeited Shares A/c is credited with the total amount already received (whether on application or allotment or call).
15. While passing an entry for re-issue Share Capital is credited with the amount called up.
16. While passing an entry for re-issue, Securities Premium is credited with excess of re-issue price over the face value.
17. Share Application Account, Share Allotment Account, Share Call Account and Share Capital Account are Real Accounts.
18. Forfeited Shares Account, Securities Premium Account, Calls- in –arrears Account and Calls – in advance Account are Nominal Accounts.

ANSWERS:

S. No.	Reason
1.	False: Maximum number of members in case of private company is 200
2.	False: Minimum paid up capital for Public Company is ₹ 5 lakhs and for Private Company is ₹ 1 lakh.
3.	False: Equity Share Capital with differential rights as to voting or dividend may be issued.
4.	False: Unless otherwise stated a preference share is always deemed to be Cumulative, Non-participating & Non-convertible.
5.	False: Participating Preference Share is that share which in addition to two basic preferential rights also carries a right to participate in surplus profits and/ or surplus assets.
6.	False: Securities Premium can be applied to issue fully paid bonus shares.
7.	False: Under the Capital Clause of Memorandum of Association, the amount of Authorized Capital and its division into shares of fixed amount is required to be stated.
8.	False: Issued Capital refers to nominal value of all shares allotted.
9.	False: Shares issued to supplier of a fixed asset are required to be disclosed separately under the sub-head 'Subscribed Capital'.
10.	False: Reserve Capital refers to that portion of uncalled up share capital which shall not be capable of being called up except in the event and for the purposes of the company being wound up.. Capital Reserve refers to those amounts which are not regarded as free for distribution by way of dividend.
11.	False: As per Table F, the maximum rate of interest that can be charged on Calls-in-Arrear and that can be allowed on calls-in-advance are 10% p.a. and 12% p.a. respectively.
12.	False: While passing an entry for Forfeiture,,Share Capital A/c is debited with the amount called up (excluding Securities Premium) till the stage of forfeiture.
13.	False: While passing an entry for Forfeiture, Securities Premium is debited only with the amount of Securities premium due but not received.
14.	False: While passing an entry for Forfeiture Forfeited Shares A/c is credited with the amount already received (excluding Securities Premium) (whether on application or allotment or call).
15.	False: While passing an entry for re-issue Share Capital is credited with the amount of Paid-up Value.
16.	False: While passing an entry for re-issue, Securities Premium is credited with excess of re-issue price over the paid up value.
17.	False: Share Application Account, Share Allotment Account, Share Call Account and Share Capital Account are Personal Accounts.
18.	False: Forfeited Shares Account, Securities Premium Account are Nominal Accounts but Calls- in –arrears Account and Calls – in advance Account are Personal Accounts.

22. ACCOUNTING FOR DEBENTURES

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. Now Debentures can be issued at par /Premium but not at discount.
2. Like Shares a company can issue debentures with voting rights.
3. Debenture interest is calculated on issue price and is payable when there are profits after the payment of any dividend on shares.
4. Debenture Redemption Premium Account and Discount on issue of debentures Account are Nominal Accounts.

ANSWERS:

S. No.	Reason
1.	False: Debentures can be issued at par /Premium/ discount since there are no restrictions on issue of debentures at discount.
2.	False: Like Shares a company cannot issue debentures with voting rights.
3.	False: Debenture interest is calculated on face value and not on issue price and is payable irrespective of fact whether there are profits or not before the payment of any dividend on shares.
4.	False: Debenture Redemption Premium Account is a Personal Account but Discount on Issue of Debentures Account is a Nominal Account.

23. RATIO ANALYSIS

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. Comparison of actual ratios of one firm with those of other similar firms belonging to the same industry or industry average at the same point of time is called Time Series Analysis.
2. Comparison of actual ratios of one period with those of earlier periods for the same enterprise is called Cross-Sectional Analysis.
3. Classification of Ratios as Liquidity Ratios, Solvency Ratios, Activity Ratios and Profitability Ratios is on the basis of Financial Statements.
4. Liquidity Ratios show the long-term solvency.
5. Stock and Prepaid Expenses are excluded while computing Current Ratio.
6. Rule of Thumb for judging Current Ratio and Debt-Equity Ratio is 1 : 1.
7. Solvency Ratios show the short-term solvency.
8. While computing Debt-Equity Ratio and Proprietary Ratio, Equity represents Equity Shareholders' Funds.
9. Liquidity and Solvency Ratios are in the nature of Flow Ratios.
10. Activity and Profitability Ratios are in the nature of Stock Ratios.
11. Activity Ratios are calculated with reference to Sales only.
12. Provision for Doubtful Debts and Discount on Debtors are deducted from the total amount of debtors, while computing Current Ratio, Quick Ratio and Debtors Turnover Ratio.
13. The difference between Long-term Funds and Long-term Debt is Equity Shareholders' Funds.
14. Profitability Ratios are calculated with reference to Sales only.
15. Gross Profit Ratio and Operating Ratio are complementary to each other.

16. Operating Profit Ratio and Cost of Goods to Sales Ratio are complementary to each other.
17. While computing Capital Turnover Ratio and Return on Capital Employed, Non-Trading Assets also form part of capital employed.
18. While computing Return on Capital Employed, Income from Non-Trading Assets are not excluded while calculating Net Profit before Interest & Tax.
19. The difference between Gross Profit Ratio and Operating Profit Ratio represents Operating Ratio.
20. The product of Capital Turnover Ratio and Operating Profit Ratio is called Return on Total Assets.
21. Too high Current Ratio but too low Quick Ratio means too high Outstanding Debtors.
22. Too high Capital Turnover Ratio but too low Current Ratio means Over Capitalization.
23. Too low Capital Turnover Ratio but too high Current Ratio means Under Capitalization.
24. Interest on Long-term Debt and Income from Non-Trading Assets are excluded while computing Return on Investment and Return on Equity.
25. Trading on Equity is profitable when the Return on Investment is less than the Cost of Debt.

ANSWERS:

S. No.	Reason
1.	False: Comparison of actual ratios of one firm with those of other similar firms belonging to the same industry or industry average at the same point of time is called Cross-Sectional Analysis .
2.	False: Comparison of actual ratios of one period with those of earlier periods for the same enterprise is called Time Series Analysis .
3.	False: Classification of Ratios as Liquidity Ratios, Solvency Ratios, Activity Ratios and Profitability Ratios is on the basis of purpose which the ratio serves .
4.	False: Liquidity Ratios show the short-term solvency .
5.	False: Stock and Prepaid Expenses are excluded while computing Quick Ratio .
6.	False: Rule of Thumb for judging Current Ratio and Debt-Equity Ratio is 2 : 1 .
7.	False: Solvency Ratio show the short-term solvency .
8.	False: While computing Debt-Equity Ratio and Proprietary Ratio, Equity represents Shareholders' Funds (which include Preference Share Capital also) .
9.	False: Liquidity and Solvency Ratios are in the nature of Stock Ratios .
10.	False: Activity and Profitability Ratios are in the nature of Flow Ratios .
11.	False: Activity Ratios are calculated with reference to Sales or Cost of Sales .
12.	False: Provision for Doubtful Debts and Discount on Debtors are deducted while computing Current Ratio and Quick Ratio and not Debtors Turnover Ratio .
13.	False: The difference between Long-term Funds and Long-term Debt is Shareholders' Funds .

14.	False: Profitability Ratios are calculated with reference to Sales or Investments .
15.	False: Operating Profit Ratio and Operating Ratio are complementary to each other.
16.	False: Gross Profit Ratio and Cost of Goods to Sales Ratio are complementary to each other.
17.	False: While computing Capital Turnover Ratio and Return on Capital Employed, Non-Trading Assets do not form part of capital employed.
18.	False: While computing Return on Capital Employed, Income from Non-Trading Assets are excluded while calculating Net Profit before Interest & Tax.
19.	False: The difference between Gross Profit Ratio and Operating Profit Ratio represents Operating Expenses Ratio .
20.	False: The product of Capital Turnover Ratio and Operating Profit Ratio is called Return on Investment .
21.	False: Too high Current Ratio but too low Quick Ratio means too high accumulation of stock .
22.	False: Too high Capital Turnover Ratio but too low Current Ratio means Under Capitalization or Over Trading .
23.	False: Too low Capital Turnover Ratio but too high Current Ratio means Over Capitalization or Under Trading .
24.	False: Interest on Long-term Debt is excluded while computing Return on Equity and not Return on Investment . Income from Non-Trading Assets is excluded while computing Return on Investment and not Return on Equity.
25.	False: Trading on Equity is profitable when the Return on Investment is more than the Cost of Debt.

24. LIMITED LIABILITY PARTNERSHIP

State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

1. LLP is an entity registered under 'The Limited Liability Partnership Act, 2018'
2. LLP has no separate legal entity.
3. LLP is created by agreement and not by Law.
4. LLP **has no** perpetual succession.
5. Name of LLP need not contain 'Limited Liability Partnership' or 'LLP' as suffix.
6. For LLP Minimum number of partners required is 2 but their is limit of 20 on maximum number of partners.
7. Liability of LLP Partner is unlimited,
8. LLP Partners act as agents of LLP and other partners.
9. Minor can be admitted to the benefits of LLP.
10. Foreign National can not become a Partner in a LLP.
11. LLP must have at least 2 individuals as Designated Partners who must be residents in India.
12. Each Designated Partner of LLP is required to have a DPIN before appointment.
13. All Designated Partner must have Digital Signatures since e forms are filled electronically.
14. All Partners of LLP are liable for Legal Compliance.

ANSWERS:

S. No.	Reason
1.	False: LLP is an entity registered under 'The Limited Liability Partnership Act, 2008'
2.	False: LLP has separate legal entity.
3.	False: LLP is created by Law.
4.	False: LLP has perpetual succession. The death, insolvency or unsoundness of its members does not affect its existence. Members may come and go but LLP goes forever.
5.	False: Name of LLP must contain 'Limited Liability Partnership' or 'LLP' as suffix.
6.	False: For LLP Minimum number of partners required is 2 but there is no limit on maximum number of partners.
7.	False: Liability of LLP Partner is limited, to the extent their contribution towards LLP, except in case of intentional fraud or wrongful act of omission or commission by the partner.
8.	False: LLP Partners act as agents of LLP and not of other partners.
9.	False: Minor can not be admitted to the benefits of LLP.
10.	False: Foreign National can become a Partner in a LLP.
11.	False: LLP must have at least 2 individuals as Designated Partners, of whom at least one must be resident in India
12.	False: Each Designated Partner of LLP is required to have a DIN before appointment.
13.	False: Atleast one Designated Partner must have Digital Signatures since e forms are filled electronically.
14.	False: Only Designated Partners of LLP are liable for Legal Compliance.

2

IMPORTANT DISTINCTIONS

1.0 DISTINGUISH BETWEEN ACCRUAL BASIS OF ACCOUNTING AND CASH BASIS OF ACCOUNTING [JUNE 1993, MAY 2003, NOV. 2005]

Accrual basis of accounting differs from Cash basis of accounting in the following respects:

Basis of Distinction	Accrual Basis of Accounting	Cash Basis of Accounting
1. Prepaid/Outstanding Expenses/accrued/unaccrued Income in Balance Sheet	Under this, there may be Prepaid/Outstanding Expenses and Accrued/Unaccrued Incomes in the Balance Sheet.	Under this, there is no Prepaid/Outstanding Expenses or Accrued/Unaccrued Incomes.
2. Higher/lower Income in case of Prepaid Expenses and Accrued Income	Income Statement will show a relatively higher income.	Income Statement will show lower income.
3. Higher/Lower Income in case of outstanding expenses and Unaccrued Income	Income Statement will show a relatively lower income.	Income Statement will show higher Income.
4. Recognition under the Companies Act, 2013	This basis is recognised under the Companies Act, 2013.	This basis is not recognised under the Companies Act, 2013.
5. Availability of options to an accountant to manipulate the accounts by way of choosing the most suitable method out of several alternative methods of accounting e.g. FIFO/LIFO/SLM/WDV	Under this, an accountant has options .	Under this an accountant has no option to make a choice as such.

2.0 DISTINGUISH BETWEEN CAPITAL EXPENDITURE AND REVENUE EXPENDITURE [JUNE 1993, NOV. 1996, MAY 1997, NOV. 2001, NOV. 2004]

Basis of Distinction	Capital Expenditure	Revenue Expenditure
1. Meaning	It is an expenditure which is incurred: (a) to acquire <i>or</i> bring into existence an asset, or (b) to acquire <i>or</i> bring into existence an advantage <i>or</i> benefit of an enduring nature, or (c) to increase the productivity <i>or</i> earning capacity.	It is an expenditure which is incurred: (a) to maintain the productivity <i>or</i> earning capacity of a business, or (b) to carry out operating activities in the normal course of business.

2.2 Quick Revision for Accounting for CA Foundation Course

2. Benefits	It normally yields benefits during current accounting period.	It normally does not yield benefits during current accounting period.
3. Accounting Treatment	It is debited to the Respective Asset Account.	It is debited to Respective Expense Account.
4. Examples	(a) Cost of Land and Building (b) Cost of Plant and Machinery (c) Cost of Furniture & Fixtures	(a) Depreciation on Land and Building (b) Rent of Machines (c) Repairs of Building (d) Insurance of Building

3.0 DISTINGUISH BETWEEN CAPITAL RECEIPTS AND REVENUE RECEIPTS

[NOV. 1994, MAY 1996, MAY 1998]

Basis of Distinction	Capital Receipts	Revenue Receipts
1. Meaning	Capital receipts refer to those receipts which are not revenue in nature.	Revenue receipts refer to those receipts which arise in the normal course of business.
2. Accounting Treatment	These are credited to the respective account of capital nature.	These are credited to Respective Revenue Account which appears in the Income Statement.
3. Examples	(a) Sale of Land and Building by a person other than a dealer in real estate. (b) Raising of Loan by a person other than one engaged in the business of finance/banking. (c) Raising of Capital.	(a) Sale of Land and Building by a dealer in real estate. (b) Sale of Securities by a dealer in securities

4.0 DISTINGUISH BETWEEN DEFERRED REVENUE EXPENSES & PREPAID EXPENSES

[MAY 1995]

The Guidance Note on "Terms used in Financial Statement" issued by the Institute of Chartered Accountants of India (ICAI), defines deferred revenue expenditure as that expenditure for which payment has been made or a liability incurred, but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods. "In short, it refers to that expenditure that is, for the time being, deferred from being charged to income. Such suspension of 'charging off' operation may be due to the nature of expenses and the benefit expected therefrom.

Deferred revenue expenditure should be revenue expenditure by nature in the first instance, for example, advertisement. But its matching with revenue may be deferred considering the benefit to be accrued in future.

A thin line of difference exists between deferred revenue expenses and prepaid expenses. The benefits available from prepaid expenses can be precisely estimated but that is not so in case of deferred revenue expenses. Heavy advertising to launch a new product is a deferred expense since the benefit from it will be available over the next three to five years but one cannot say precisely how long. On the other hand, insurance premium paid say, for the year ending 30th June 2018, when the accounting year ends on 31st March 2018, will be an example of prepaid expense to the extent of premium relating to three months period, i.e., from 1st April 2018 to 30th June 2018. Thus, the insurance protection will be available precisely for three months after the close of the year and the amount of the premium to be carried forward can be calculated exactly.

Deferred expenses are considered fictitious assets but prepaid expenses are considered as current assets.

5.0 DISTINGUISH BETWEEN CONTINGENT LIABILITY AND OTHER LIABILITIES

Basis of Distinction	Contingent Liability	Other Liabilities
1. Meaning	It is an obligation which may <i>or</i> may not arise depending on the happening <i>or</i> non-happening of an uncertain future event.	These are financial obligations of an enterprise other than owners' equity.
2. Disclosure	It is disclosed by way of foot note to the Balance Sheet.	These are disclosed on the liabilities side of the Balance Sheet.
3. Example	1. Bills discounted but not yet matured 2. Arrears of dividend on Cum-Pref-Shares	1. Creditors for Goods 2. Outstanding Expenses

6.0 DISTINGUISH BETWEEN PROVISION AND CONTINGENT LIABILITY

Basis of Distinction	Provision	Contingent Liability
1. Meaning	Provision is a present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation..	It is an obligation which may <i>or</i> may not arise depending on the happening <i>or</i> non-happening of an uncertain future event.
2. Recognition criteria	A provision meets the recognition criteria.	A contingent liability fails to meet the same.
3. Conditions for Recognition	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.

EXAMPLE TO UNDERSTAND THE DISTINGUISH BETWEEN PROVISIONS AND CONTINGENT LIABILITIES.

The GST officer imposes a penalty on X Ltd. for violation of a provision in the GST Act. The company files 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.

7.0 DISTINCTION BETWEEN FUNDAMENTAL ACCOUNTING ASSUMPTIONS AND ACCOUNTING POLICIES

The Fundamental accounting assumptions differ from Accounting policies in the following respects:

Basis of Distinction	Fundamental Accounting Assumptions	Accounting Policies
1. Number	There are only three fundamental accounting assumptions viz. Going Concern, Consistency and Accrual.	There is no single list of accounting policies which are applied in all circumstances. As a result, there may be different accounting policies adopted by different enterprises.
2. Disclosure if followed	No disclosure is required if all the fundamental assumptions have been followed.	Disclosure is required if a particular accounting policy has been followed
3. Disclosure if not followed	In case the fundamental assumptions are not followed; the fact has to be disclosed in the financial statements together with the reasons.	In case, the policy is changed in subsequent year, the reasons for such change and the resulting financial consequences have to be disclosed.
4. Choice	There is no choice.	The firm has a choice to select a particular policy

8.0 DISTINGUISH BETWEEN PERSONAL ACCOUNTS AND IMPERSONAL ACCOUNTS. [NOV. 1997, NOV. 1999, NOV. 2002]

Types of Accounts	Meaning	Examples
(a) Personal Accounts	These accounts relate to natural persons, artificial persons and representative persons.	Natural —Ram's A/c Artificial —Ram & Co.'s etc Representative —Outstanding Salary A/c, Prepaid Insurance
(b) Impersonal Accounts		
(i) Real Accounts	These accounts relate to the tangible or intangible real assets.	Tangible —Land A/c Intangible —Goodwill A/c
(ii) Nominal Accounts	These accounts relate to losses, profit & gains.	Expenses —Purchases A/c Loss —Loss by fire A/c Profits & Gains —Sales A/c, Discount Received A/c

9.0 DISTINGUISH BETWEEN JOURNAL AND LEDGER [NOV. 2001]

Journal differs from the Ledger in the following respects:

Basis of Distinction	Journal	Ledger
1. Nature of Book	It is book of original or prime entry .	It is book of final or secondary entry .
2. Basis for Preparation	It is prepared on the basis of source documents of transactions.	It is prepared on the basis of journal .
3. Stage of Recording	Recording in the journal is the first stage.	Recording in the ledger is the second stage.

4. Object	It is prepared to record all transactions in chronological order.	It is prepared to know the net effect of various transactions affecting a particular account.
5. Format	In Journal, there are five column — 1. Date 2. Particulars 3. Ledger Folio 4. Debit Amount 5. Credit Amount	In ledger, there are identical four column on debit side and credit side. 1. Date 2. Particulars 3. Folio 4. Amount
6. Balancing	Journal is not balanced.	All ledger accounts (except nominal account) are balanced in the ledger.
7. Narration	Narration is written for each entry.	No narration is given.
8. Name of the Process of recording entries	The process of recording in journal is called Journalising.	The process of recording in the ledger is called Posting.
9. Basis for Preparation of Final Accounts	Journal directly does not serve as basis for the preparation of final accounts.	Ledger serves the basis for the preparations of final accounts.

10.0 DISTINGUISH BETWEEN BOOKS OF ORIGINAL ENTRY AND LEDGER

Books of Original Entry and Ledger can be distinguished as follows:

Basis of Distinction	Books of Original Entry	Ledger
1. Nature of Book	There are books of original <i>or</i> prime entry.	This is a book of final <i>or</i> secondary entry.
2. Basis for Preparation	These books are prepared on the basis of source documents.	This book is prepared on the basis of books of original entry.
3. Stage of Recording	Recording of entries in these books is the first stage.	Recording of entries in the ledger is the second stage.
4. Net effect of various transactions	These books do not help to know the net effect of the various transactions affecting a particular account.	A ledger helps to know the net effect of the various transactions affecting a particular account.
5. Format	In the Journal, there is one column for particulars and two columns for amounts – one for debit and another for credit. Special journals (except Cash Book) have only one column of amount.	In the ledger, there are two divided sides having identical columns. The left side is known as debit and the right side is known as credit.
6. Balancing	In the books of original entry (except Cash Book) balancing is not done.	In the ledger, all the accounts (except nominal accounts) are balanced.
7. Next stage of accounting process	From the books of original entry, entries are transferred to the ledger.	From the ledger, first the trial balance is drawn and then financial statements are prepared.

8. Name of the process of recording entries	The process of recording entries in these books is called 'journalising'.	The process of recording entries in the ledger is called 'posting'.

11.0 DISTINGUISH BETWEEN TRADE DISCOUNT AND CASH DISCOUNT

[JUNE 1993, NOV. 2002]

Basis of Distinction	Trade Discount	Cash Discount
1. Meaning	It is a reduction granted by a supplier from the List Price of goods or services on business considerations (such as quantity bought, trade practices, etc.) other than for prompt payment.	A reduction granted by a supplier from the Invoice Price in consideration of immediate payment or payment within a credit period allowed.
2. Purpose	It is allowed to promote the sales or as a trade practices.	It is allowed to encourage the prompt payment.
3. Time when allowed	It is allowed on purchase of goods.	It is allowed on immediate payment or payment within a specified period.
4. Disclosure in the Invoice	It is shown by way of deduction in the invoice itself.	It is not shown in the invoice.
5. Ledger Account	Trade Discount Account is not opened in the ledger.	Cash Discount Account is opened in the ledger.
6. Variation	It may vary with the quantity purchased.	It may vary with the period within which the payment is made.

12.0 DISTINGUISH BETWEEN COMMISSION AND DISCOUNT.

[May 1995, May 1997, May 1998, Nov. 2000, Nov. 2002]

Commission The term 'commission' may be defined as remuneration of an employee or agent relating to services performed in connection with sales, purchases, collections or other types of business transactions and usually based on a percentage of the amounts involved. The various examples of commission include the following:

- Commission to selling or buying agents.
- Commission to brokers and bankers for services rendered.
- Commission to property dealers for assistance in renting out properties or for services in connection with purchase/sale of properties.
- Commission to export-import agents in foreign trade.

Commission earned is accounted for as an income in the books of the beneficiary and Commission allowed is accounted for as expenses or deferred revenue expenditure in the books of the party availing of such facility.

Discount The term 'discount' is used to express one of the following situations:

- An allowance given for the settlement of a debt before it is due, that is, cash discount.
- An allowance given to the wholesalers or bulk buyers on the list price or retail price, known as trade discount.
- The excess of par or face value of shares or debentures over the amount paid by subscriber, that is, discount on issue of shares or debentures.
- The amount charged by a bank on discounting of a bill of exchange.

Discount earned is accounted for as an income in the books of the beneficiary and discount allowed is accounted for as expenses or deferred revenue expenditure in the books of the party availing of such facility.

13.0 DISTINGUISH BETWEEN IMPREST AND NON-IMPREST SYSTEM OF PETTY CASH.

Meaning of Imprest or Float: 'Imprest' or 'Float' is the amount which the main cashier hands over to the petty cashier in order to meet the petty cash expenses of a given period.

Petty Cash book may be maintained on imprest system or non-imprest system.

- (a) **Imprest System of Petty Cash**—Under imprest system. The Chief Cashier makes the reimbursement of the amount spent by the Petty Cashier and the Petty Cashier again has the same amount of petty cash at the end as in the beginning.
- (b) **Non-imprest System of Petty Cash**—Under non-imprest system, the Chief Cashier may hand over the cash to the Petty Cashier equal to/more than/less than the amount spent by the petty cashier. The Petty cashier may or may not have the same closing balance of petty cash as opening balance.

14.0 DISTINGUISH BETWEEN DEBIT NOTE AND CREDIT NOTE.

Basis of Distinction	Debit Note	Credit Note
1. Who prepares?	It is prepared by Purchaser .	It is prepared by Seller .
2. Contents	(a) Date of return (b) Name of supplier to who returned (c) Details of goods returned (d) Reasons for returning goods	(a) Date of return (b) Name of Customer who returned (c) Details of goods returned (d) Reason for returning goods
3. Source Document	It is used as source document for recording in Purchase Return Book .	It is used as source document for recording in Sales Return Book .
4. Why Prepared?	It is prepared to debit supplier's account.	It is prepared to give credit to customer.

15.0 DISTINGUISH BETWEEN SALES DAY BOOK AND SALES ACCOUNT. [NOV. 2001]

Basis of Distinction	Sales Day Book	Sales Account
1. Nature	It is a book of original entry.	It is opened in the books of secondary entry i.e. ledger.
2. Basis for preparation	It is prepared on the basis of sales invoices raised.	It is prepared on the basis of Sales Day Book (for Credit Sales) and Cash Book (for Cash Sales)
3. Nature of transactions recorded	It records only the credit sales of goods in which the enterprise deals in.	It contains the effect of both Cash Sales and Credit Sales.

16.0 DISTINGUISH BETWEEN BANK STATEMENT AND BANK RECONCILIATION STATEMENT

Bank Statement differs from the Bank Reconciliation Statement in the following respects:

Basis of Distinction	Bank Statement/Pass Book	Bank Reconciliation Statement
1. Who prepares	It is prepared by the Bank .	It is prepared by the bank Customer i.e., account holder.
2. Object	It is prepared to inform the customer about all transactions which have taken place during the period covered by the Statement.	It is prepared to reconcile the bank balance as per cash book with the bank balance shown by the Bank Statement.
3. Timing When Prepared	It is prepared for a particular period .	It is prepared on a particular date .
4. Necessity	It is compulsory for the bank to prepare it.	It is not compulsory .
5. Contents	It shows — (a) Dates of Transactions (b) Particulars of Transactions (c) Withdrawals (d) Deposits (e) Balances	It shows — (a) Causes of disagreement & (b) Amount thereof
6. Starting Amount	It starts with the balance as per customer's account in bank ledger.	It may start with bank balance as per cash book or Bank Statement.
7. Final Result	It shows the balance in customer's account as per bank ledger at the end of the period.	It may show the bank balance as per cash book or Bank Statement at the end of period.

17.0 DISTINGUISH BETWEEN ERROR OF PRINCIPLE AND CLERICAL ERRORS. [JUNE 1994]**Error of Principle**

Meaning: This error arises when the transaction is recorded ignoring the distinction between the capital item and revenue item. In other words, this error involves an incorrect allocation of expenditure or receipt between Capital and Revenue. The correct allocation between Capital and Revenue is of paramount importance because any incorrect allocation would disturb the final results as disclosed by the Financial Statements.

Effect: It may lead to under/over stating of Incomes or Expenses of Assets or Liabilities. This error **does not affect the trial balance**.

Example: Freight paid for bringing a new machinery is debited to Freight A/c

Effect

1. Effect on Revenue Expenditure (i.e., Freight) – Overstated
2. Effect on Capital Expenditure (i.e., Cost of Machinery) – Understated
3. Effect on Depreciation on Machinery – Undercharged
4. Effect on Net Profit – Understated by the Net Effect (i.e., the difference between the amount of Freight and amount of Depreciation).

Note: *The costs incurred on the acquisition, installation and commissioning of a fixed asset up to the point the fixed asset is ready for use represent capital expenditures.*

Clerical Errors

Meaning—Clerical errors refer to those errors which arise because of mistakes committed in the ordinary course of the accounting work.

Type—There are three types of clerical errors as follows:

1. Error of Omission	
(a) Error of Complete Omission	This error arises when any transaction is not recorded in the books of original entry at all or, the transaction is recorded in General Journal (or Journal Proper) but is not posted in the ledger at all. This error does not affect the trial balance
(b) Error of Partial Omission	An Error of Omission other than an Error of Complete Omission is called an Error of Partial Omission. This error affects the trial balance..
2. Error of Commission	This error arises due to wrong recording, wrong casting, wrong carry forward, wrong posting, wrong balancing etc., Errors of commission may be classified as follows. 1. Error of Recording 3. Error of Carrying Forward 2. Error of Casting 4. Error of Posting This error may or may not affect the trial balance..
3. Compensating Errors	These errors arise when two or more errors are committed in such a way that the net effect of these errors on the debits and credits of accounts involved is nil. In other words, compensating errors refer to such a group of errors wherein the effect of one error is compensated by the effect of other error or errors. These errors do not affect the agreement of the trial balance but may or may not affect the figure of net profit.

18.0 DISTINGUISH BETWEEN FIFO AND LIFO METHOD OF VALUATION OF INVENTORY [JUNE 1994, NOV. 1998]

Fifo Method of Valuation of inventory differs from LIFO Method in the following respects:

Basis of Distinction	FIFO	LIFO
1. Basic Assumption	Goods received first are issued first.	Goods received last are issued first.
2. Cost of Goods Sold	Cost of goods sold represents cost of earlier purchases.	Cost of goods sold represents cost of recent purchases.
3. Ending Inventory	Ending inventory represents cost of recent purchases.	Ending inventory represents cost of earlier purchases.
4. In case of Rising prices	Higher income is reported since old costs (which are lower than current costs) are matched with current revenue. As a result, income tax liability is increased.	Lower income is reported since current costs (which are higher than the old costs) are matched with current revenue. As result, income tax liability is reduced.
5. Distortion in Balance Sheet	Balance Sheet shows the ending inventory at a value nearer the current market price.	Balance Sheet is distorted because ending inventory is understated at old costs.

19.0 DISTINGUISH BETWEEN FIFO AND WEIGHTED AVERAGE METHOD OF STOCK VALUATION.

[MAY 2002]

FIFO

1. **Basic Assumption**—Goods received first are issued first.
2. **Cost of Goods Sold**—Cost of goods sold represents cost of earlier purchases.
3. **Ending Inventory**—Ending inventory represents cost of recent purchases.
4. **In case of Rising prices**—Higher income is reported since old costs (which are lower than current costs) are matched with current revenue. As a result, in-come tax liability is increased.
5. **Distortion in Balance Sheet**—Balance Sheet shows the ending inventory at a value nearer the current market price.

WEIGHTED AVERAGE PRICE METHOD

The Weighted Average Price Method is based on the assumption that each issue of goods consists of a due proportion of the earlier lots and is valued at the weighted average price. Weighted average price is calculated by dividing the total cost of goods in stock by the total quantity of goods in stock. This weighted average price is used for pricing all the issues until a new lot is received when a new weighted average price would be calculated. This method evens out the effect of widely varying prices of different lots which make up the stock.

20.0 DISTINGUISH BETWEEN PERIODIC INVENTORY SYSTEM AND PERPETUAL INVENTORY SYSTEM

Periodic Inventory System differs from Perpetual Inventory System in the following respects:

Basis of Distinction	Periodic Inventory System	Perpetual Inventory System
1. Basis of Ascertaining Inventory	Inventory is ascertained by taking an actual physical count	Inventory is ascertained on the basis of records.
2. Calculation of Inventory	Inventory is directly calculated by applying the method of valuation of inventories.	Inventory is calculated as a residual figure as under: Closing Inventory = Opening Inventory + Purchases - Cost of Goods Sold
3. Calculation of cost of goods sold	Cost of Goods Sold is calculated as a residual figure as under:	Cost of Goods Sold is directly calculated by applying the method of valuation of inventories. Cost of Goods Sold = Opening Inventory + Purchases - Closing Inventory
4. Lost Goods lost goods (if any).	Cost of Goods sold includes (if any).	Inventory includes lost goods
5. Closing Down of work for Stock taking	It requires closing down of work for stock taking.	It does not require closing down of work for Stock taking.
6. Continuous Stock stock checking.	It does not facilitate the Checking	It facilitates the continuous continuous stock checking.
7. Simplicity and cost	It is simple and inexpensive.	It is elaborate and expensive.

21.0 DISTINGUISH BETWEEN STRAIGHT LINE METHOD & WRITTEN DOWN VALUE METHOD [JUNE 1993, MAY 2002]

Straight Line Method differs from Written Down Value Method in the following respects:

Basis of Distinction	Straight Line Method	Written Down Value Method
1. Basic of Calculation	Depreciation is calculated at a fixed percentage on the original cost .	Depreciation is calculated at a fixed percentage on original cost (in first year) and on written down value (in subsequent years).
2. Amount of Depreciation	The amount of depreciation remains constant .	The amount of depreciation goes on decreasing .
3. Total Charge (i.e., depreciation plus repairs and renewals)	Total charge in later years is more as compared to that in earlier years since the amount of repairs and renewals goes on increasing as the asset grows older, whereas the amount of depreciation remains constant year after year.	Total charge remains almost uniform year after year, since in earlier years the amount of depreciation is more and the amount of repairs and renewals is <i>less</i> whereas in later years, the amount of depreciation is <i>less</i> and the amount of repairs & renewals is more.
4. Book Value	The book value of the asset becomes zero or equal to its scrap value.	The book value of the asset does not become zero .
5. Suitability	This method is suitable for those assets in relation to which (a) repair charges are <i>less</i> (b) the possibility of obsolescence is less.	This method is suitable for those assets in relation to which (a) the amount of repairs & renewals goes on increasing as the asset grows older and (b) the possibilities of obsolescence are more.
6. Calculation – Easy or Difficult	It is easy to calculate the rate of depreciation.	It is difficult to calculate the rate of depreciation.

22.0 DISTINGUISH BETWEEN REVENUE AND CAPITAL RESERVE

Revenue reserve refers to the amounts which are free for distribution by way of dividend. Capital reserve refers to the amounts which are not free for distribution by way of dividend.

23.0 DISTINGUISH BETWEEN PROVISION AND RESERVE. [NOV. 1996, NOV. 2000, NOV. 2002]

A Provision can be distinguished from a Reserve as follows:

Basis of Distinction	Provision	Reserve
1. Purpose	It is created for a particular purpose and can only be used for that particular purpose.	It need not necessarily be created for a particular purpose . e.g., General reserve is not for any particular purpose.
2. Charge Vs. Appropriation	It is a charge against the profit and is required to be created irrespective of the amount of profit.	It is an appropriation out of profit and can be created only if profits have been earned.
3. Disclosure in Income Statement	It is shown on the debit side of P & L A/c .	It is shown on the debit side of P & L Appropriation A/c .

4. Disclosure in Balance Sheet	Usually a provision is shown by way of deduction from the amount of the items for which the it is created. e.g. Provision for Doubtful Debts.	Reserve is shown as a separate item under the head Reserves and Surplus on the liabilities side of the Balance Sheet.
5. Investment outside the business	There is no question of investment of the amount of provisions.	The amount of a reserve can be invested outside the business .
6. Utilisation for Dividends	It cannot be utilised for distribu tion by way of dividends.	It can be utilised for distribution by way of dividends.
7. Legal Necessity	It is made mainly because of legal necessity .	It is a matter of financial prudence .

24.0 DISTINGUISH BETWEEN A BILL OF EXCHANGE AND A PROMISSORY NOTE.
[NOV. 1994, MAY 1995, NOV. 1997, NOV. 1999, NOV. 2000]

A Bill of Exchange can be distinguished from a Promissory Note as follows.

Basis of Distinction	Bill of Exchange	Promissory Note
1. No. of Parties	There are three parties—Drawer, Drawee and Payee and Payee.	There are two parties—Maker and Payee.
2. Promise/order	It contains an unconditional order given by a Creditor to a Debtor.	It contains an unconditional promise given by a debtor to a creditor.
3. Nature of Liability	The liability of the drawer is secondary and conditional .	The liability of the maker is primary and absolute .
4. Acceptance	It requires an acceptance to become a valuable instrument.	It does not require any acceptance since it is a valuable instrument right from the beginning.
5. Same identity of payer and payee	The drawer and payee may be the same person.	The maker and payee cannot be the same person.
6. Payable to bearer	It can be payable to the bearer.	It cannot be payable to bearer. It cannot be drawn as payable to bearer on demand.
7. Protest for Dishonour	It requires the protesting for dishonour.	It does not require any protesting.
8. Notice of Dishonour	Notice of dishonour must be given to all persons (including drawer) liable to pay.	Such notice is not required to be given to the maker .

25.0 DISTINGUISH BETWEEN TRADE BILLS AND ACCOMMODATION BILLS. **[MAY 2006]**

Basis of Distinction	Trade Bills	Accommodation Bills
1. Purpose	These bills are drawn to settle a business transaction.	These bills are drawn to meet the financial needs of the drawer/ drawee/both temporarily.
2. Consideration	These bills are accepted for a consideration.	These bill are accepted without any consideration.
3. Role	These bills act as an evidence of indebtedness.	These bills act as a source of finance.

4. Sharing of Proceeds of the Bill	On discounting of such bills, proceeds remain with the holder.	On discounting of such bills, proceeds may be shared by drawer and drawee in an agree ratio.
5. Recovery in case of dishonour	On dishonour of such bills, drawer can file a suit against the drawee, because drawee is liable to drawer.	On dishonour of such bill, drawer cannot file suit against the drawee because drawee is not liable to drawer.

26.0 DISTINGUISH BETWEEN CONSIGNMENT AND SALE. [NOV. 1994, NOV. 1997, MAY 2002]

Consignment differs from Sale in the following respects:

Basis of Distinction	Consignment	Sale
1. Nature of Relationship	The relation between the Consignor and the consignee is that of principle and agent .	The relation between the seller and the buyer is that of creditor and debtor .
2. Ownership and possession of goods	Only the possession and not the ownership is transferred to the consignee.	Both the possession and ownership are transferred.
3. Risk of goods	Risk remains with the Consignor because ownership remains with the Consignor.	Risk remains with the buyer since ownership remains with him.
4. Proforma Invoice/Invoice	Consignor prepares only a proforma invoice .	Seller prepares a sales invoice .
5. Subject matter of dealing	Only movable properly may be its subject matter.	Any property may be its subject matter.
6. Who bears expenses	Expenses incurred by consignee are borne by Consignor .	Expenses incurred after sale by buyer are borne by him and not by seller.
7. Profit/Loss belongs to	Profit/Loss on sale of belongs to Consignor .	After the sale is complete, the profit/loss belongs to buyer .
8. Return of Goods	Goods are returnable if they are not sold by the consignee.	Goods once sold are not returnable .
9. Account Sales	Account Sales has to be submitted by the consignee to the Consignor from time to time.	No Account Sale is required to be submitted by the Buyer to the Seller.
10. Treatment of Unsold Goods	Unsold goods with the Consignee is be treated as stock of the Consignor.	The seller has nothing to do with the goods which could not be resold. Unsold Goods with the buyer is treated as Stock of the Buyer.

27.0 DISTINGUISH BETWEEN ORDINARY COMMISSION AND DEL-GREDERE COMMISSION

Basis of Distinction	Ordinary Commission	Delcredere Commission
1. When allowed?	It is allowed to all the consignees for all the consignments for selling goods.	It is allowed to the consignee only when he undertakes the risk of bad debts arising out of credit sales.
2. Guarantee	In return of this commission, consignee guarantees only the proceeds of cash sales	In return of this commission, consignee guarantees the proceeds of cash sales and credit sales.
3. How to Calculate?	It is calculated at an agreed rate on the total sales.	It is calculated at an agreed rate <i>either</i> on total sales (if no agreement) <i>or</i> credit sales (if agreement provides).

28.0 DISTINGUISH BETWEEN NORMAL LOSS AND ABNORMAL LOSS IN CONSIGNMENT.

[NOV. 2002]

Normal loss differs from Abnormal loss in the following respects:

Basis of Distinction	Normal Loss	Abnormal Loss
1. Avoidable vs. Unavoidable	It is an unavoidable loss.	It is an avoidable loss.
2. Causes	It is caused due to the inherent feature of the goods e.g. evaporation, normal leakage/spoilage.	It is usually caused by fire, theft, abnormal spoilage/pilferage etc.
3. Part of Cost	It is treated as a part of cost.	It is not treated as a part of cost.
4. Valuation	Its value is not calculated separately.	Its value is calculated in the same manner as value of unsold stock.
5. Treatment	Its value is adjusted by inflating the cost per unit as under. Effective cost per unit =	Its value is credited to the consignment Account in order to calculate the normal profit/loss on consignment.
6. Journal Entry	No journal entry is passed to account for such loss.	The following journal entry is passed to account for such a loss: P&L A/c [irrecovered loss] Dr. Insurance Co. Dr. [Claim admitted] To Consignment A/c [Total Loss]

29.0 DISTINGUISH BETWEEN PARTNERSHIP AND JOINT VENTURE.

[NOV. 2004, NOV. 2005, NOV. 2002]

Basis of Distinction	Partnership	Joint Venture
1. Scope	It is not limited to a specific venture.	It is limited to a specific venture.

2. Persons involved	The persons carrying on business are individually called partners.	The persons carrying on business are called co-venturers.
3. Ascertainment of Profit/loss	The profits/losses are ascertained on an annual basis.	The profits/losses are ascertained at the end of specific venture (if venture continues for a short period) or an interim basis annually (if venture continues for a longer period).
4. Act governing	Partnership firms are governed by Indian Partnership Act, 1932.	The doctrine of implied authority is not applicable to co-venturers.
5. Doctrine of Implied Authority	The doctrine of implied authority is applicable to partners.	The co-venturers have such freedom.
6. Freedom to run competition	The partners do not have such freedom.	There is no need for firm name.
7. Name	A partnership firm always has a name.	There is no need for a separate set of books.
8. Separate Set of Books	Separate set of books have to be maintained.	The accounts can be maintained even in one of the Co-venturer's books only.
9. Admission of Minor	A minor can be admitted to the benefits of the firm.	A minor cannot be a co-venturer as he is incompetent to contract.

30.0 DISTINGUISH BETWEEN JOINT VENTURE AND CONSIGNMENT.**[JUNE 1993]**

Basis of Distinction	Joint Venture	Consignment
1. Nature of Relationship	The relation between co-venturers is that of co-owners.	The relation between the consignor and the consignee is that of Principal and Agent.
2. Ownership & Risk of Goods	Both these remain with co-venturers.	Both these remain with the consignor.
3. Account Sales	No Account Sales is sent by one co-venturer to another Co-venturer.	An Account Sale is prepared and submitted by the consignee to his consignor.
4. Profit & Loss on transactions	Profit & losses are shared by the co-venturers in an agreed ratio.	Profit & losses are shared only by the consignor and not by the consignee.
5. Subject-Matter of Dealing	Any movable or immovable property may be its subject matter.	Only movable property may be its subject matter.
6. No. of Persons	In a venture, there may be two or more persons.	In a consignment, there are two persons—Consignor and Consignee.
7. Methods of Recording	There are four methods of recording.	There is only one method of recording.

31.0 DISTINGUISH BETWEEN ORDER OF LIQUIDITY AND ORDER OF PERMANENCE

Basis of Distinction	Order of Liquidity	Order of Permanence
1. Order of Assets	The assets are arranged in the order of their liquidity, i.e., the most liquid asset (e.g., Cash-in-hand), is shown first. The least liquid asset (e.g., Goodwill) is shown last. The least liquid asset does not mean an asset which cannot be encashed.	The assets are arranged in the order of their permanence i.e., the least liquid asset (e.g., Goodwill) is shown first and the most liquid asset (e.g., Cash-in-hand) is shown last.
2. Order of Liabilities	The liabilities are arranged in the order of their urgency of payment, i.e., the most urgent payment to be made (e.g., Short-term creditors) is shown first. The least urgent payment to be made (e.g., Long-term creditors) is shown last.	The liabilities are arranged in the order of their permanence i.e., the least urgent payment to be made (e.g., Owners) is shown first and the most urgent payment to be made (e.g., Short-term creditors) is shown last.
3. Users	Usually, the banking and financial companies, sole proprietorship and the partnership concerns prepare their balance sheets in the order of liquidity.	The company as defined under the Companies Act, 1956 is required to prepare the balance sheet in order of permanence.

32.0 DISTINGUISH BETWEEN TRADING & PROFIT & LOSS ACCOUNT & BALANCE SHEET**[NOV. 1994]**

The Trading and Profit and Loss Account can be distinguished from the Balance Sheet as follows:

Basis of Distinction	Trading and Profit & Loss A/c	Balance Sheet
1. Need for Preparation	The Trading and Profit & Loss A/c is prepared to ascertain the Financial Performance during an accounting period.	The Balance Sheet is prepared to ascertain the Financial Position of an enterprise at a particular time.
2. Contents	The balances of all the ledger accounts of revenue nature are shown in the Trading and Profit & Loss A/c.	The balances of only those ledger accounts which still remain open even after the preparation of Trading and Profit & Loss A/c, are shown in the Balance Sheet.
3. Format	(a) The Trading & Profit & Loss A/c is a ledger account . (b) It has debit side and a credit side. (c) It is closed by transferring its balance to the Capital Account.	(a) The Balance Sheet is only a statement & not an account. (b) It has no debit side and credit side. (c) The headings of the two sides are 'Liabilities' and 'Assets'.

33.0 DISTINGUISH BETWEEN A TRIAL BALANCE AND A BALANCE SHEET**[MAY 1995, MAY 1997, MAY 1998, MAY 2002]**

A Trial Balance can be distinguished from a Balance Sheet as follows:

Basis of Distinction	Trial Balance	Balance Sheet
1. Need for Preparation	It is prepared to check the arithmetical accuracy of	It is prepared to ascertain the Financial Position of of an enterprise at a particular point of time.
2. Contents	All the ledger accounts are shown in the Trial Balance.	The balances of only those ledger accounts which still remain open even after the preparation of Trading & Profit & Loss Account are shown in the Balance Sheet.
3. Format	The headings of the two columns are ' debit balances ' and ' credit balances ' (in case of a Trial Balance by Balance Method).	The headings of the two sides are ' Liabilities ' and ' Assets '.
4. Closing Stock	Generally, the Closing Stock does not appear in the Trial Balance whereas the opening stock appears.	In a Balance Sheet, only the Closing Stock appears on the Assets side as a Current Assets.
5. Items of Adjustments (e.g., Outstanding Expenses, Prepaid Exp., Accrued Income etc.)	It can be prepared without incorporating the items of adjustments.	It cannot be prepared without incorporating the items of adjustments.
6. Net Profit /Net Loss	Information about net Profit/Net loss is not provided in a Trial Balance.	Information about net Profit/Net Loss is provided.
7. Periodicity	It can be prepared periodically (say) at the end of a month/quarter/half-year.	It is generally prepared at the end of an accounting period.
8. Can the preparation be dispensed with?	Its preparation can be dispensed with.	Its preparation cannot be dispensed with.

34.0 DISTINGUISH BETWEEN FIXED CAPITAL METHOD AND FLUCTUATING CAPITAL METHOD.**[NOV. 1995, NOV. 2004]**

Fixed Capital method and Fluctuating Capital method in partnership accounts can be distinguished as follows:

Basis of Distinction	Fixed Capital Method	Fluctuating Capital Method
1. Change in Capital	The capital normally remains unchanged except under special circumstances.	The capital fluctuates quite frequently from period to period.
2. No. of Accounts maintained	Two accounts are maintained for each partner viz. (a) Fixed Capital Account, (b) Current Account.	Only one account (viz., Capital Account) is maintained for each year.

3. Adjustments for drawings etc.	All adjustments for drawings, interest on drawings, interest on capital, salary, share of profit/loss are made in Current Account .	All adjustments for drawings, interest on capital, salary, share of profit/loss are made in Capital Account .
4. Can Capital Account show a negative balance?	Fixed Capital Account can never show a negative balance.	Fluctuating Capital Account can show a negative balance.

35.0 DISTINCTION BETWEEN AVERAGE PROFITS & SUPER PROFITS

Basis of Distinction	Average Profit	Super Profit
1. Meaning	Average Profit is the average of the profit of past few years .	Super Profit is the excess of Average Profits over Normal Profits .
2. Whether Average Capital Employed considered for calculation	Average Capital Employed is not considered while calculating Average Profits.	Average Capital Employed is considered while calculating Super profits.
3. Whether Normal Rate of Return considered for calculation?	Normal Rate of Return is not considered while calculating Average Profits.	Normal Rate of Return is Considered while calculating Average Profits.
4. Relevance while Valuing Super Goodwill	Average Profit is relevant for Average Profits Method, Super Profits Method and Capitalization Methods of valuation of Goodwill.	Super profits is relevant for Profits Method and Capitalization of Super Profits Method of valuation of Goodwill.

36.0 DISTINGUISH BETWEEN PERSONAL GUARANTEE AND FIRM GUARANTEE .

Personal Guarantee	When guarantee is given by one <i>or</i> some <i>or</i> all of the partners in a ratio different from existing profit sharing ratio, such guarantee is said to be personal guarantee.
Firm Guarantee	When guarantee is given by all the partners in an existing profit sharing ratio, such guarantee is said to be firm guarantee.

37.0 DISTINGUISH BETWEEN SACRIFICING RATIO AND GAINING RATIO

Sacrificing Ratio and Gaining Ratio can be distinguished as follows:

Basis of Distinction	Sacrificing Ratio	Gaining Ratio
1. Meaning	It is the ratio in which the old partners have agreed to sacrifice their shares in profit in favour of new partner.	It is the ratio in which the continuing partners acquire the outgoing (retired <i>or</i> deceased) partners share.
2. Purpose	It is calculated to determine the amount of compensation to be paid by the incoming partner to the sacrificing partners.	It is calculated to determine the amount of compensation to be paid by each of the continuing partners to the outgoing partner.

3. How to calculate?	It is calculated by taking out the difference between Old Share and New Share.	It is calculated by taking out the difference between New Share and Old Share.
4. When to calculate?	It is calculated at the time of admission of a new partner and change in profit sharing ratio.	It is calculated at the time of retirement or death of a partner and change in profit sharing ratio.

38.0 DISTINGUISH BETWEEN EXISTING PARTNERSHIP AND LLP.

<i>Basis of Distinction</i>	<i>Partnership</i>	<i>LLP</i>
Regulating Law	It is governed by ' The Indian Partnership Act, 1932 '	It is governed by ' The Limited Liability Partnership Act, 2008 '
Registration	Registration is optional .	Registration is compulsory .
Creation	It is created by agreement .	It is created by Law .
Separate Legal Entity	It has no separate legal entity.	It has separate legal entity.
Name of Entity	It can have any name as per choice.	Its Name to contain ' Limited Liability Partnership ' or ' LLP ' as suffix.
Perpetual Succession	It does not have perpetual succession . The death, insolvency or unsoundness of its members may affect its existence.	It has perpetual succession. The death, insolvency or unsoundness of its members does not affect its existence. Members may come and go but LLP goes forever.
Can Foreign National become partner?	Foreign National can not become a partner in a Partnership Firm in India.	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.
Liability of Partners	Liability of Partner is unlimited . Partners are severally and jointly liable for actions of other partners and the firm and liability extend to their personal assets.	Liability of Partner is limited , to the extent their contribution towards LLP, except in case of intentional fraud or wrongful act of omission or commission by the partner.
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.	It must have at least 2 two individuals as Designated Partners, of whom at least one must be resident in India. Each Designated Partner is required to have a DPIN before appointment.
Digital Signature	There is no requirement of obtaining Digital Signature	Atleast one Designated Partner must have Digital Signatures since e forms are filled electronically.

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 or firm.
Admission of Minor	Minor can be admitted to the benefits of Partnership as per its Agreement.	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.

39.0 DISTINGUISH BETWEEN COMPANY AND LLP

<i>Basis of Distinction</i>	<i>Company</i>	<i>LLP</i>
Prevailing Law	It is governed by ' The Companies Act, 2013 '	It is governed by 'The Limited Liability Partnership Act, 2008'
Motive	It can be formed for Profit or Service motive .	It can be formed only for Profit motive .
Cost of Formation	Minimum Statutory fee for incorporation of Private Company is ₹ 6,000 and that of Public Company is ₹ 19,000 .	Minimum cost of Formation of LLP is ₹ 800 only , comparatively much lesser than the cost of formation of Company.
Charter Document	Memorandum of Association is the charter of the company which defines its scope of operations.	LLP Agreement is a charter of the LLP which denotes its scope of operations.
Common Seal	It must have its own common seal (i.e. Official Signature).	It may have its own common seal (i.e. Official Signature) as per its Agreement.
Formalities of Incorporation	1. Memorandum & Articles of Association 2. Various e Forms 3. Prescribed Fee. required to be filled with Registrar of Companies.	1. LLP Agreement 2. Various e Forms 3. Prescribed Fee. required to be filled with Registrar of LLP.
Number of Members	Private Company : Minimum 2 members & maximum 200 members. Public Company: Minimum 7 members but their is no limit on maximum number of partners.	Minimum 2 but their is no limit on maximum number of partners.
Liability of Partners/ Members	Generally limited to the amount required to be paid up on each share.	Liability of Partner is Limited, to the extent their contribution towards LLP, except in case of intentional fraud or wrongful act of omission or commission by the partner.

Transfer of Share/ Partnership rights in case of death	Shares are transmitted to the legal heirs.	Legal heirs will not become partners. The legal heirs have the right to get the refund of the capital contribution + Share in Accumulated Profits, if any.
Filing of Annual Statement of Solvency	Annual Statement of Solvency is not required to be filed with the Registrar of Companies every year.	Annual Statement of Solvency is required to be filed with the Registrar of LLP every year.
Audit of Accounts	Companies are required to get their accounts audited annually as per the provisions of the Companies Act, 1956.	An LLP is required to get their accounts audited annually as per the provisions of LLP Act 2008 if its turnover exceeds ₹ 40 Lacs or its capital contribution exceeds ₹ 25 Lacs in any financial year.
Whistle Blowing	No such provision is provided under the Companies Act, 1956.	Provision has been made to provide protection to employees & partners, providing useful information during an investigation or convicting any partner or firm.

40.0 DISTINGUISH BETWEEN A PROFIT SEEKING ORGANISATION AND A NOT-FOR-PROFIT ORGANISATION

A Profit seeking Organisation may be distinguished from a Not-for-Profit Organisation as under:

Basis of Distinction	Profit seeking organisation	Not-for-profit organization.
1. Primary Motive	The primary motive of such an entity is to earn profit.	The primary motive of such an entity is to provide services.
2. Owner's Fund Vs. Capital Fund	Interest of owners is known as Owner's Fund which represents the owner's investments <i>plus</i> accumulated reserves and surplus.	Interest of members is known as Capital Fund which represents the accumulated surplus of subscriptions, donations and net Income from activities carried on by such an entity.
3. Net Result of activities	The net result of the activities of such an entity is known as the profit/loss.	The net result of the activities of such an entity is known as the surplus/deficit.
4. Accounting Statements	The accounting statements of such type of entity include: (a) a Manufacturing A/c (b) a Trading A/c; (c) a Profit and Loss A/c; (d) a Balance Sheet.	The accounting statements of such an entity includes: (a) a Receipts and Payments A/c; (b) an Income and Expenditure A/c (c) a Trading A/c; (d) a Balance Sheet.

41.0 DISTINGUISH BETWEEN RECEIPTS AND PAYMENTS ACCOUNT AND INCOME AND EXPENDITURE ACCOUNT [NOV. 2002, MAY 2005]

A 'Receipt & Payment Account' and 'Income & Expenditure Account' can be distinguished as follows:

Basis of Distinction	Receipts & Payments A/c	Income & Expenditure A/c
1. Nature of Account	It is a real account.	It is a nominal account.
2. Period to which items relate	It records the receipts and payments whether they relate to previous, current or following accounting periods.	It records only those incomes, expenses and losses which relate to current accounting period.
3. Nature of items recorded—Revenue Vs. Capital.	It records all the receipts and payments whether of capital or revenue nature .	It records the incomes, expenditures and losses of revenue nature .
4. Non-cash Items	Non-cash items are not shown in this account.	Non-cash items such as depreciation, bad debts, etc., are shown .
5. Items of Debit side	It is debited with all the sums received .	It is debited with the expenses and losses .
6. Items of Credit side	It is credited with all the sums paid out .	It is credited with the incomes .
7. Closing balance	Closing balance represents cash or bank balance (or bank overdraft) at the end of the accounting period.	Its closing balance represents either net surplus or net deficit .
8. Treatment of closing balance	Its closing balance is carried forward in the same account of the next period .	Its closing balance is transferred to the Capital Fund in the Balance Sheet.
9. Opening balance	Opening balance represents cash or bank balances (or Bank Overdraft) in the beginning of the accounting period.	It has no opening balance.
10. Basic Structure	It is basically a summarised Cash Book .	It is like a Profit & Loss Account .
11. Object	It is prepared to present a summary of cash transactions during an accounting period.	It is prepared to ascertain the net results of all the transactions during an accounting period.

42.0 DISTINGUISH BETWEEN INCOME AND EXPENDITURE ACCOUNT AND PROFIT AND LOSS ACCOUNT

Income & Expenditure Account differs from Profit & Loss Account in the following respects:

Basis of Distinction	Income & Expenditure A/c	Profit & Loss A/c
1. Object	The main object of Income and Expenditure Account is to ascertain excess of income over expenditure or excess of expenditure over income .	The main object of Profit and Loss Account is to ascertain Net Profit or Net Loss .
2. Who prepares?	This account is prepared by Non-Profit Organisations .	This account is prepared by Trading Institutions .

3. Basis of Preparation	This account is prepared on the basis of Receipts and Payments Account and other information.	This account is prepared on the basis of Trial Balance.
4. Balance	The balance of this account represents Surplus or Deficit	The balance of this account represents Net Profit or Net Loss.

43.0 DISTINGUISH BETWEEN RESERVE CAPITAL AND CAPITAL RESERVE

Reserve Capital should not be confused with Capital Reserve which is created out of profits. Reserve Capital and Capital Reserve can be distinguished as follows:

Basis of Distinction	Reserve Capital	Capital Reserve
1. Meaning	It refers to those portion of uncalled share capital which shall not be capable of being called up except in the event and for the purpose of the company being wound up. (Sec. 65)	It refers to those amounts which are not regarded as free for distribution by way of divided through Profit and Loss Account.
2. Mandatory or Not	It is not mandatory to create Reserve Capital.	It is mandatory to create Capital Reserve in case of profit on forfeited shares.
3. Disclosure in Balance Sheet	It is not disclosed in the company's Balance Sheet.	It is required to be disclosed as the 1st item under the head 'Reserves and Surplus' on the liabilities side of the Balance Sheet.
4. Time when it can be used	It can be used during only at the time of winding up.	It can be used during the life of the company.
5. Realised vs. Unrealised	It refers to the amount which has neither been called up nor been received.	It (excluding items like revaluation profit) refers to that amount which has already been realised.
6. Can it be used to write off capital losses?	It cannot be used to write off capital losses.	It can be used to write off capital losses.
7. Can it be used to declare share bonus?	It cannot be used to declare a share bonus.	It (excluding items like revaluation profit) can be used to declare a share bonus.

44.0 DISTINGUISH BETWEEN AN EQUITY SHARE AND PREFERENCE SHARE

An Equity Share and Preference Share can be distinguished as follows:—

Basis of Distinction	An Equity Share	A Preference Share
1. Preferential right as to the payment of dividend	Payment of equity dividend is made after the payment of preference dividend.	Payment of preference dividend is made before the payment of equity dividend.
2. Preferential right as to the repayment of capital	Repayment of Equity share capital is made after the repayment of preference share capital.	Repayment of preference share capital is made before the repayment of equity share capital.

3. Fluctuations in the rate of dividend	The rate of equity dividend may vary from year to year depending upon the decision of directors and members.	The rate of preference dividend is fixed .
4. Arrears of dividend	In case of an equity share, arrears of dividend cannot accumulate in any case.	In case of a preference share, arrears of dividend may accumulate .
5. Convertibility	It cannot be convertible.	It may be convertible.
6. Voting Rights	Equity shareholders generally enjoy voting rights.	Preference shareholders do not have any voting rights except at their class meetings .
7. Redeemability	It is not redeemable during the life time of the company unless the company decides to buyback the shares.	It is redeemable during the life time of the company.

45.0 DISTINGUISH BETWEEN CALLS-IN-ARREARS & CALLS-IN-ADVANCE

Calls-in-arrears differ from Calls-in-advance in the following respects:

Basis of Distinction	Calls-in-arrears	Calls-in-advance
1. Meaning	It refers to the Called up amount not yet received from some shareholders till the last day fixed for payment thereof.	It refers to the Uncalled up amount received in advance from some shareholders.
2. Authority under Articles	There is no question of any authority under Articles.	A company may accept Calls-in-advance only if Articles permit.
3. Interest	Interest is charged on Calls-in-arrears.	Interest is allowed on Calls-in-advance.
4. Maximum Rate of Interest	The maximum rate of interest as per Table F is 10% p.a.	The maximum rate of interest as per Table F is 12% p.a.
5. Disclosure	The amount of Calls-in-arrears is shown in the Notes to Accounts 'Share Capital' to the Balance Sheet.	The amount of Calls-in-advance is shown under the head 'Current Liabilities' and sub-head 'Other Current Liabilities' .

46.0 DISTINGUISH BETWEEN A SHARE AND A DEBENTURE

A Share and A Debenture can be distinguished as follows:

Basis of Distinction	A Share	A Debenture
1. Capital vs. Loan	Share is a part of owned capital .	Debenture constitutes a loan .
2. Reward for Investment	Reward is the payment of dividend .	Reward is the payment of interest .
3. Fluctuations in the rate of interest and dividend	The rate of dividend may vary from year to year depending upon the profit decisions of directors and members.	The rate of interest is fixed except in case of Debentures carrying Floating Rate of Interest.

4. Charge vs. Appropriation	Payment of dividend is an appropriation out of profit and this cannot be made if there is not profit.	Payment of interest is a charge against profits and is to be made even if there is no profit.
5. Priority as to payment of interest/dividend	Payment of dividend gets no priority over the payment of interest.	Payment of interest gets priority over the payment of dividend.
6. Priority as to repayment of principal during winding up	Payment of share capital is made after the repayment of debentures .	Payment of debentures is made before the payment of share capital .
7. Secured by charge	Shares are not secured by any charge.	Non-Convertible Debentures redeemable on or after 18 months are secured by a charge.
8. Restriction on issue discount	Sec. 53 prohibits the issue of shares at discount.	No restriction is imposed on the issue of debentures at discount.
9. Voting rights	Shareholders generally enjoy voting rights.	Debenture-holders do not have any voting rights (except at their class-meetings).
10. Convertibility	Equity shares can never be convertible .	Debentures can be convertible .
11. Trust Deed	Trust Deed is required to be executed.	Debenture Trust Deed is required to be executed.

47.0 DISTINGUISH BETWEEN CURRENT RATIO AND QUICK RATIO

<i>Basis of Distinction</i>	<i>Current Ratio</i>	<i>Quick Ratio</i>
1. Relationship	Current Ratio shows relationship between Current Assets and Current Liabilities.	Quick Ratio shows relationship between Quick Assets and Current Liabilities.
2. Objective	Current Ratio measures ability to meet current obligations as and when they fall due for payment over a period normally not exceeding 12 months.	Quick Ratio measures enterprise's ability to meet current obligations without relying on the sale and collection of inventories.
3. Components of Ratio	The components of Current Ratio are Current Assets and Current Liabilities.	The components of Quick Ratio are Quick Assets and Current Liabilities.
4. Formula for Computation	Current Ratio = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$	Quick Ratio = $\frac{\text{Quick Assets}}{\text{Current Liabilities}}$
5. Traditional Satisfactory Standard	It is 2 : 1.	It is 1 : 1.
6. Precaution	While computing and using Current Ratio, quality of both Inventories and Trade Receivables is required to be carefully assessed.	While computing and using Quick Ratio, quality of Trade Receivables is required to be carefully assessed (since the Inventories have already been excluded).

48.0 DISTINGUISH BETWEEN OPERATING RATIO AND OPERATING PROFIT RATIO

Operating Ratio differs from Operating Profit Ratio in the following respects:

Basis of Distinction	Operating Ratio	Operating Profit Ratio
1. Relationship	It shows the relationship between Operating Cost and Revenue from Operations	It shows the relationship between Operating Profit and RFO.
2. Objective	The objective of computing this ratio is to determine the efficiency with which production/purchase & selling operations are carried on.	The objective of computing this ratio is to determine the operational efficiency of the management.
3. Interpretation	This ratio indicates an average operating cost incurred on a sales of ₹ 100.	This ratio indicates (a) an average operating margin as RFO of ₹ 100. (b) What portion of sales is left to cover Non-Operating Expenses to pay Dividend and to create Reserves.
4. Formula	$\frac{\text{Operating Profit}}{\text{Revenue from Operations}} \times 100$	$\frac{\text{Operating Profit}}{\text{Revenue from Operations}} \times 100$

49.0 DISTINCTION BETWEEN A COMPANY'S BALANCE SHEET & FIRM'S BALANCE SHEET

A company's Balance Sheet differs from a firm's Balance Sheet in the following respects:

1. A Company's Balance Sheet is prepared in the **order of permanence** whereas a partnership firm's Balance Sheet is usually prepared in the **order of liquidity**.
2. For company's Balance Sheet, there is **vertical form** prescribed under the Companies Act, 2013 whereas, there is **no standard form** prescribed under The Indian Partnership Act, 1932 for a partnership firm's Balance Sheet.
3. In case of a company's Balance Sheet, **previous year's figures** are required to be given whereas it is **not** so in the case of a partnership firm's Balance Sheet.

3

IMPORTANT SHORT NOTES

1. WRITE A SHORT NOTE ON ACCRUAL BASIS OF ACCOUNTING.

1. Accrual Basis of Accounting is a method of recording transactions by which Revenue, Costs, Assets and Liabilities are recognised during the accounting period in which they accrue.
2. This basis includes consideration relating to deferrals, allocations, depreciation and amortisation.
3. This basis is also known as **Mercantile** basis of accounting.
4. Under the Companies Act 2013, all companies are required to maintain the books of accounts according to accrual basis of accounting.

2. WRITE A SHORT NOTE ON CASH BASIS OF ACCOUNTING.

Cash Basis of Accounting is a method of recording transactions by which Revenues, Costs, Assets and Liabilities are recognised during the accounting period in which Actual Receipts and Actual Payments take place.

3. WRITE A SHORT NOTE ON HYBRID BASIS OF ACCOUNTING.

It is a combination of both Cash Basis of Accounting and Accrual Basis of Accounting. Under the hybrid basis of accounting, Incomes are recorded on Cash basis (i.e., during the accounting period in which they are received irrespective of when they accrue) and Expenses are recorded on Accrual Basis, (i.e., during the accounting period in which they arise irrespective of when they are paid).

4. WRITE A SHORT NOTE ON LIMITATIONS OF ACCOUNTING.

[NOV. 2003]

1. **Ignores the Qualitative Elements** — Since the accounting is confined to the monetary matters only, the qualitative elements like quality of management, quality of labour force, public relations are ignored.
2. **Not Free from Bias** — In many situations, the accountant has to make a choice out of various alternatives available, eg., choice in the method of depreciation (e.g., Straight Line or Written down), choice in the method of inventory valuation (e.g., FIFO, LIFO etc.). Since the subjectivity is inherent in personal judgement, the financial statements are therefore not free from bias. As a result, the analysis of financial statements also cannot be said to be free from bias.
3. **Ignores the Price Level Changes in case of Financial Statements Prepared on Historical Costs** — In case of financial statements prepared on historical costs, the Fixed Assets are shown in the Balance Sheet at historical costs less depreciation and not at the replacement value which is often far higher than the value stated in the Balance Sheet. The analysis of such financial statements will not yield strictly comparable results unless the price-level changes are taken into account.
4. **Estimated Position and not Real Position** — Since the financial statements are prepared on a going concern basis as against liquidation basis, they report only the estimated periodic results and not the true results since the true results can be ascertained only on the liquidation of an enterprise.

- 5. Danger of Window Dressing** — When the management decides to enter wrong figures to artificially inflate or deflate the figure of Profits, Assets and Liabilities, the Income Statement fails to provide true and fair view of the Financial Performance and Balance Sheet fails to provide true and fair view of the Financial Position of the enterprise.

5. WRITE A SHORT NOTE ON QUALITATIVE CHARACTERISTICS.

[NOV. 2003]

The qualitative characteristics are attributes that improve the usefulness of information provided in financial statements. The framework suggests that the financial statements should observe and maintain the following four qualitative characteristics as far as possible within limits of reasonable cost/benefit.

1. Understandability	The financial statements should present information in a manner as to be readily understandable by the users with reasonable knowledge of business and economic activities. It is not right to think that more one discloses better it is. A mass of irrelevant information creates confusion and can be even more harmful than non-disclosure. No relevant information can be however withheld on the grounds of complexity.
2. Relevance	The financial statements should contain relevant information only. Information, which is likely to influence the economic decisions by the users, is said to be relevant. Such information may help the users to evaluate past, present or future events or may help in confirming or correcting past evaluations. The relevance of a piece of information should be judged by its materiality. A piece of information is said to be material if its omission or misstatement can influence economic decisions of a user.
3. Reliability	To be useful, the information must be reliable; that is to say, they must be free from material error and bias. The information provided are not likely to be reliable unless: (a) Transactions and events reported are faithfully represented. (b) Transactions and events are reported in terms of their substance and economic reality not merely on the basis of their legal form. This principle is called the principle of 'substance over form'. (c) The reporting of transactions and events are neutral, i.e. free from bias. (d) Prudence is exercised in reporting uncertain outcome of transactions or events.
4. Comparability	Comparison of financial statements is one of the most frequently used and most effective tools of financial analysis. The financial statements should permit both inter-firm and intra-firm comparison. One essential requirement of comparability is disclosure of financial effect of change in accounting policies.
5. True and Fair View	Financial statements are required to show a true and fair view of the performance, financial position and cash flows of an enterprise. The conceptual framework does not deal directly with this concept of true and fair view, yet the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements portraying true and fair view of information about an enterprise.

6. WRITE A SHORT NOTE ON DOUBLE ENTRY SYSTEM OF BOOK-KEEPING. [MAY 1999]**MEANING OF DOUBLE ENTRY SYSTEM OF BOOK-KEEPING**

1. Double Entry System of Book-keeping refers to a system of accounting under which both the aspects (i.e., Debit or Credit) of every transaction are recorded in the accounts involved.
2. **Dual Aspect** — Two fold aspect of a transaction is called dual aspect or duality of a transaction. This duality is the basis of double entry records.
3. **As the name implies, the entry made for each transaction is composed of two parts** — one for debit and another for credit. The double entry system may be compared with the Newton's law of motion, viz to every action there is always an equal and contrary reaction.
4. Every debit has equal amount of credit. So the total of all debits must be equal to the total of all credits.
5. **The terms debit and credit used today have their origin from the terms** — Debito and Credito as used by Luca fra Pacioli in his book.
6. **Account** — The individual record of a person or thing or an item of income or an expense is called an account.

ADVANTAGES OF DOUBLE ENTRY SYSTEM

1. It facilitates the accuracy of ledger accounts through the device of trial balance.
2. It facilitates the ascertainment of Financial Performance.
3. It facilitates the ascertainment of Financial Position.
4. It facilitates the comparability of Financial Statements.

7. WRITE A SHORT NOTE ON CLASSIFICATION OF ACCOUNTS. [NOV. 1999, NOV. 2002, DEC. 1993]

<i>Types of Accounts</i>	<i>Meaning</i>	<i>Examples</i>
(a) Personal Accounts	These accounts relate to natural persons, artificial persons and representative persons.	Natural —Ram's A/c Artificial —Ram & Co.'s etc Representative —Outstanding Salary A/c, Prepaid Insurance
(b) Impersonal Accounts		
(i) Real Accounts	These accounts relate to the tangible or intangible real assets.	Tangible —Land A/c Intangible —Goodwill A/c
(ii) Nominal Accounts	These accounts relate to losses, profit & gains.	Expenses —Purchases A/c Loss —Loss by fire A/c Profits & Gains —Sales A/c, Discount Received A/c

8. WRITE A SHORT NOTE ON DEFERRED REVENUE EXPENDITURE. [JUNE 1994, MAY 2004]

1. Meaning	According to the Guidance note on 'Terms used in Financial Statements', issued by ICAI 'Deferred revenue expenditure is the expenditure for which payment has been made or a liability has been incurred but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods'. In short, it refers to that expenditure which is, for the time being, deferred from being charged to income. Such suspension of 'charging off' operation may be due to the nature of expenses and the benefit expected therefrom.

2. Examples	Heavy advertising to launch a new product is a deferred revenue expenditure since the benefit from it will be availed over the next 3 to 5 years.
3. Accounting Treatment	Normally such expenditure should be written off over a period of 3 to 5 years. The written off portion is debited to P&L Account and unwritten off portion is shown on the Assets Side of Balance Sheet.

4. Disclosure in Financial Statements			
<i>Dr.</i>	INCOME STATEMENT FOR THE PERIOD ENDED ON....		<i>Cr.</i>
Particulars	₹	Particulars	₹
To Deferred Revenue Expenditure w/o	....		
BALANCE SHEET AS AT			
Liabilities	₹	Assets	₹
		Deferred Revenue Expenditure (Unwritten off portion)	....

9. WRITE A SHORT NOTE ON CONTINGENT ASSET.

MEANING OF CONTINGENT ASSET

According to Accounting Standard 29, "a contingent asset is a possible asset that arises from past events 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. It usually arises from unplanned or unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise."

EXAMPLE OF CONTINGENT LIABILITY

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

NO RECOGNITION IN FINANCIAL STATEMENTS

As per the concept of prudence as well as the present accounting standards, an enterprise should not recognize a contingent asset. It is possible that recognition of contingent assets may result in recognition of income that may never be realized. However, when the realisation of income is virtually certain, then the related asset no longer remains as contingent asset.

NO DISCLOSURE OF 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 (i.e., Board of Directors in the case of a company, and the corresponding approving authority in the case of any other enterprise), if an inflow of economic benefits is probable.

WHEN RECOGNISED

Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

10. WRITE A SHORT NOTE ON CONTINGENT LIABILITIES.**[MAY 1998, MAY 2005]****MEANING OF CONTINGENT LIABILITY**

According to Accounting Standard 29, 'Contingent liability' is

- (a) a possible obligation that arises from past events 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
- (b) 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.

Where,

- **Possible Obligation** - An obligation is a possible obligation if, based on the evidence available, its existence at the balance sheet date is considered not probable.
- **Present Obligation** - An obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

NO RECOGNITION OF CONTINGENT LIABILITY

An enterprise should not recognise a contingent liability.

DISCLOSURE OF CONTINGENT LIABILITY BY WAY OF NOTE TO THE BALANCE SHEET

A Contingent liability is required to be disclosed by way of Note to the Balance Sheet unless possibility of outflow of a resource embodying economic benefits is remote.

WHEN RECOGNISED

Contingent 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.

11. WRITE A SHORT NOTE ON PROVISION.**MEANING OF PROVISION**

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."

As per AS 29, A provision is a liability which can be measured only by using a substantial degree of estimation.

CONDITIONS FOR RECOGNITION OF PROVISION

A provision should be recognised when:

- (a) An enterprise has a present obligation as a result of a past event.
- (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and
- (c) a reliable estimate can be made of the amount of the obligation.

12. WRITE A SHORT NOTE ON FUNDAMENTAL ACCOUNTING ASSUMPTIONS.

[MAY 1996, MAY 1999, MAY 2003, MAY 2004, MAY 2006]

As per Accounting Standard (AS-1) 'Disclosure of Accounting Policies' issued by Institute of Chartered Accountants of India (ICAI), there are three Fundamental Accounting Assumptions:

- 1. Going Concern 2. Consistency 3. Accrual**

DISCLOSURE REQUIREMENTS

1. If all the Fundamental Accounting Assumptions are followed in financial statements, specific disclosure is not required.
2. If any fundamental accounting assumption is not followed, the fact should be disclosed.

13. WRITE A SHORT NOTE ON GOING CONCERN ASSUMPTION.

MEANING OF GOING CONCERN ASSUMPTION

1. The enterprise is normally viewed as a going concern, i.e. as continuing operations for the foreseeable future.
2. It is assumed that the enterprise has *neither* the intention *nor* the necessity of liquidation *or* curtailing materially its scale of operations.
3. If an enterprise is not a going concern, valuation of its assets and liabilities on historical cost becomes irrelevant and as a consequence its profit/loss may not give reliable information.

IMPLICATIONS OF GOING CONCERN ASSUMPTION

It is because of the Going Concern Assumption:

1. that the assets are classified as Current Assets and Fixed Assets.
2. that the liabilities are classified as Short-term Liabilities and Long-term liabilities.
3. that the unused resources are shown as unutilised costs (or unexpired costs) as against the break-up values as in case of liquidating enterprise. Accordingly, the earning power and not the break-up value evaluates the continuing enterprise.

DISCLOSURE OF GOING CONCERN ASSUMPTION

According to Accounting Standard (1) issued by the Institute of Chartered Accountants of India, if this fundamental assumption is followed, this fact need not be disclosed in the financial statements since its acceptance and use are assumed. In case this concept is not followed, the fact should be disclosed in the financial statement together with reasons.

14. WRITE A SHORT NOTE ON CONSISTENCY ASSUMPTION.

MEANING OF CONSISTENCY ASSUMPTION

1. It is assumed that accounting policies are consistent from one period to another.
2. This adds the virtue of comparability to accounting data.
3. If comparability is lost, the relevance of accounting data for users' judgement and decision making is gone.
4. According to Consistency Assumption, whatever accounting practices (whether logical *or* not) are selected for a given category of transactions, they should be followed on a horizontal basis from one accounting period to another to achieve compatability.

NEED FOR CONSISTENCY ASSUMPTION

The consistency principle is applied when alternative methods of accounting are equally acceptable.

EXAMPLES OF CONSISTENCY ASSUMPTION

1. If the inventory is valued on LIFO basis, this basis should be followed year after year.
2. If a particular asset is depreciated according to WDV method, this method should be followed year after year.

EFFECT OF NOT OBSERVING CONSISTENCY

If Consistency Assumption is not followed, the intra-firm comparison (i.e., comparison of actual figures of one period with those of another period for the same firm), Inter-firm comparison (i.e. comparison of actual figures of one firm with those of another firm belonging to the same industry) and Pattern comparison (i.e., comparison of actual figures of one firm with those of industry to which the firm belongs) cannot be made.

CONSISTENCY DIFFERS FROM UNIFORMITY

The consistency should not be confused with mere uniformity or inflexibility and should not be allowed to become an impediment to the introduction of improved accounting standards. It is not appropriate for an enterprise to leave its accounting policies unchanged when more relevant and reliable alternatives exist.

15. WRITE A SHORT NOTE ON ACCRUAL ASSUMPTION.

MEANING OF ACCRUAL ASSUMPTION

1. Revenues and Costs are accrued, that is, recognised as they are earned *or* incurred (and not as money is received *or* paid) and recorded in the financial statements of the periods to which they relate.
2. This assumption is the core of accrual accounting system.
3. For companies it is mandatory to keep accounts on accrual basis under the Companies Act, 2013.

MEANING OF REVENUE

Revenue is the gross inflow of cash, receivables *or* other considerations arising in the course of ordinary activities of an enterprise from the sale of goods, rendering of services and use of enterprise resources by others yielding interests, royalties and dividends. It excludes the amount collected on behalf of third parties such as certain taxes. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables *or* other considerations.

16. WRITE A SHORT NOTE ON MATERIALITY PRINCIPLE.

MEANING OF MATERIALITY PRINCIPLE

1. According to the Materiality Principle, all relatively relevant items, the knowledge of which might influence the decision of the users of the financial statements, should be disclosed in the financial statements.
2. Which information is more relevant than others is largely a matter of judgement. For instance, accounting and recording of a small calculator as an asset in the balance sheet may not be justified due to the excess of cost of recording over the benefits in terms of usefulness of recording and the accounting of calculators as assets.

WHAT IS MATERIALITY?

1. The materiality depends not only upon the amount of item but also upon the size of business, level and nature of information, level of the person/department who makes the judgement about materiality, for instance a worker reporting to his foreman about the production in grams (e.g. part of kilogram), a foreman to his supervisor in kilograms, a supervisor to his production manager in quintals and the production manager to the top management in tonnes, may be justified with regard to the circumstances. It hardly makes any difference if the production manager reports to the top management that the production is 1,99,000.90 kilograms or simply 200 tonnes (nearly).
2. It is desirable to establish and follow uniform policies governing material or non-material items so that while measuring income for an accounting period, the non-material items can be ignored on uniform basis.

EXCEPTION TO THE FULL DISCLOSURE PRINCIPLE

1. This Principle is basically an exception to the Full Disclosure Principle.
2. The full disclosure principle requires that all facts necessary to ensure that the financial statements are not misleading, must be disclosed, whereas the materiality principle requires that the items or events having an insignificant economic effect or not being relevant to the user's need not be disclosed.

17. WRITE A SHORT NOTE ON PRUDENCE PRINCIPLE (OR CONSERVATISM PRINCIPLE).

MEANING OF PRUDENCE PRINCIPLE

1. According to Prudence Principle, the principle of '**Anticipate no profit but provide for all probable losses**' should be applied.
2. In other words, the Prudence Principle requires that in the situation of uncertainty and doubt, the business transactions should be recorded in such a manner that the Profits and Assets are not overstated and the Losses and Liabilities are not understated.

Note: *Prudence Principle should be applied rationally only in circumstances in which great uncertainty and doubt exists as the over-conservatism may result in misrepresentation.*

EXAMPLES OF APPLICATIONS OF PRUDENCE PRINCIPLE

1. Valuation of Stock-in-trade at a lower of Cost or Net Realisable Value.
2. Making the Provisions for Doubtful Debts and Discount on Debtors.

CONFLICTS WITH CONSISTENCY

When the Stock is valued at Cost in one accounting period and at a lower of Cost or Net Realisable Value in another accounting period, this Principle conflicts with the Principle of Consistency.

CONFLICTS WITH FULL DISCLOSURE

When excessive Provisions for Doubtful Debts and Depreciation are charged, it leads to the creation of Secret Reserves, and thus, this Principle conflicts with the Full Disclosure Principle.

CONFLICTS WITH OBJECTIVITY

1. The estimation of probable losses is a subjective judgment and thus, this principle conflicts with the Principle of Objectivity.

2. The practice of making provisions for doubtful debts and the like implies lesser charges in the following accounting periods.
3. It reduces the current income and raises the future income and thus it conflicts with the matching principle.

18. WRITE A SHORT NOTE ON MEANING OF ACCOUNTING POLICIES.

Accounting policies refer to the specific accounting principles and methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements. There is no single list of accounting policies which are applicable to all enterprises in all circumstances. The management of each enterprise has to select appropriate accounting policies having regard to the nature and circumstances of the enterprise.

19. WRITE A SHORT NOTE ON EXAMPLES OF ACCOUNTING POLICIES.

Following are the examples of some of the areas in which different accounting policies may be adopted by different enterprises:

- (i) Methods of depreciation, depletion and amortisations;
- (ii) Treatment of expenditure during construction;
- (iii) Conversion or translation of foreign currency items;
- (iv) Valuation of inventories;
- (v) Treatment of goodwill;
- (vi) Valuation of investments;
- (vii) Treatment of retirement benefits;
- (viii) Recognition of profit on long-term contracts;
- (ix) Valuation of fixed assets;
- (x) Treatment of contingent liabilities.

This list should not be taken as exhaustive, it is only illustrative.

20. WRITE A SHORT NOTE ON MAJOR CONSIDERATIONS IN THE SELECTION OF ACCOUNTING POLICIES.

The primary considerations in the selection of accounting policies should be to prepare and present financial statements in a way that they represent a true and fair view of the state of affairs of the enterprise as at the Balance Sheet date and of the Profit & Loss Account for the period ended on that date. The major considerations governing the selection and application of accounting policies are as under:

1. **Prudence** Uncertainties inevitably surround many transactions. This should be recognized by exercising prudence in preparing financial statements. Prudence does not, however, justify the creation of secret or hidden reserves.
2. **Substance over form** Transactions and other events should be accounted for and presented in accordance with their substance and financial reality and not merely with their legal form.
3. **Materiality** Financial Statements should disclose all material items, that is, items, the knowledge of which might influence the decision of the users of the financial statements.

21. WRITE A SHORT NOTE ON DISCLOSURE OF ACCOUNTING POLICIES.

According to AS-1 issued by the Institute of Chartered Accountants of India—

- (a) All significant accounting policies adopted in the preparation and presentations of financial statements should be disclosed.

- (b) The disclosure of the significant accounting policies as such should form a part of the financial statements and the significant accounting policies should normally be disclosed in one place.

22. WRITE A SHORT NOTE ON CHANGE IN ACCOUNTING POLICY.**WHEN THE CHANGE IN ACCOUNTING POLICY IS RECOMMENDED**

The change in Accounting Policy is recommended only in the following circumstances:

- If it is required by statute for compliance with an accounting standard.
- If it is considered that the change would result in a more appropriate presentation of the financial statements of an enterprise.

DISCLOSURE REQUIREMENTS IN CASE OF CHANGE IN ACCOUNTING POLICY

The disclosure requirements are as follows:

Case	Disclosure Requirements
1. If change has a material effect in current period and the effect of change is ascertainable.	The amount of change should be disclosed.
2. If change has a material effect in current period and the effect of change is not ascertainable, wholly or in part.	The fact should be disclosed.
3. If change has no material effect in current period but which is reasonably expected to have a material effect in later periods	The fact of such change should be appropriately disclosed.

EXAMPLE OF CHANGE IN ACCOUNTING POLICY

X Ltd. changed the method of depreciation from WDV to SLM, with effect from 1.4.2017. The depreciation has been recomputed from the date of commissioning of these assets at SLM rates applicable to those years. Consequent to this there has been an additional charge for depreciation during the year of ₹ 100 crore due to said change which relates to the previous years and an equal amount has been withdrawn from the General Reserve and credited to Profit & Loss Account. Had there been no change in the method of depreciation, the charge for the year would have been lower by ₹ 10 crore excluding the charge relating to the previous years. Consequently, the Net Block of Fixed Assets and Reserves and Surplus are lower by ₹ 110 Crore.

23. WRITE A SHORT NOTE ON ACCOUNTING AS A MEASUREMENT DISCIPLINE.

1. Accounting is not an exact measurement discipline because accounting measures information mostly in money terms which is —
 - (a) not a stable scale
 - (b) not having universal applicability
 - (c) not stable in dimension for comparison over the time.
2. Though measurement is an important part of accounting discipline but a set of theorems which govern the measurement system (such as Going Concern, Consistency and Accrual) should be carefully understood to know how the cogs of the accounting - wheel work.
3. Although quantitative information is also required in many cases but such information is only supplementary to monetary information.

24. WRITE A SHORT NOTE ON VALUATION PRINCIPLES OR MEASUREMENT BASES.

There are **four** generally accepted valuation principles or measurement bases.

HISTORICAL COST BASE

As per Historical Cost base —

- (a) the assets are recorded at the amount of cash or cash equivalent paid *or* incurred *or* fair value of the asset at the time of acquisition.
- (b) Liabilities are recorded at the amount of proceeds received in exchange for the obligation.

CURRENT COST BASE

As per Current Cost base —

- (a) the assets are recorded at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently.
- (b) Liabilities are recorded at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

REALIZABLE VALUE BASE

As per Realizable Value base —

- (a) The assets are recorded at the amount of cash or cash equivalent that could currently be obtained by selling the assets in an orderly disposal.
- (b) Liabilities are recorded at the undiscounted amount of cash or cash equivalents expressed to be paid to satisfy the liabilities in the normal course of business.

PRESENT VALUE BASE

As per Present Value Base—

- (a) An asset is recorded at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business.
- (b) Liabilities are recorded 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.

EXAMPLE:

X Ltd. purchased a machine for ₹ 1,00,000 on 1.4.2014 on 31st March 2018—

- (a) The similar machine could be purchased for ₹ 1,20,000.
- (b) The same machine could be disposed off for ₹ 80,000.
- (c) The present discounted value of the future net cash inflows that the machinery was expected to generate in the normal course of business is calculated at ₹ 1,50,000.

In the above case —

- (a) Historical Cost is ₹ 1,00,000
- (b) Current Cost is ₹ 1,20,000
- (c) Realizable Value is ₹ 80,000
- (d) Present Value is ₹ 1,50,000

25. WRITE A SHORT NOTE ON MEASUREMENT AND VALUATION.

1. In economics, the value of an object, ability *or* idea is the utility (i.e. satisfaction) of an economic resource to the person contemplating *or* enjoying its use. Economists use ordinal scale to indicate the level of satisfaction.

2. In accounting, the value of an object, ability *or* idea is always measured in terms of money. Accountants use only cardinal scales.

26. WRITE A SHORT NOTE ON ACCOUNTING ESTIMATES.

WHEN REQUIRED

Accounting estimates are required when many items of financial statements can not be measured with precision due to uncertainties inherent in business activities. The estimation process involves judgement based on the latest information available.

EXAMPLES OF ACCOUNTING ESTIMATES

Accounting estimates are required in respect of:

- (a) Doubtful debts
- (b) Useful lives of Depreciable Assets
- (c) Residual Value
- (d) Inventory Obsolescence
- (e) Employees Retirement Benefit Obligations
- (f) Provision for Unseen Contingencies while using percentage of Completion Method is long term contract.

MEANING OF CHANGE IN ACCOUNTING ESTIMATES

Change in Accounting Estimate means differences arising between certain parameters estimated earlier and

- (a) re-estimated during the current period, *or*
- (b) actual results achieved during the current period.

WHEN AN ACCOUNTING ESTIMATE REQUIRES REVISION

An accounting estimate may require revision —

- (a) if changes occur regarding circumstances on which the estimate was based, or
- (b) as a result of new information, more experience or subsequent developments

EXAMPLES OF CHANGE IN ACCOUNTING ESTIMATE INCLUDE

- (a) Change in the amount of doubtful debts
- (b) Change in the estimated useful life of the depreciable asset
- (c) Change in the estimated residual value of the depreciable asset.

NO RETROSPECTIVE EFFECT

Change in accounting estimates can not be given a retrospective effect.

REQUIREMENTS OF AS 5

1. The effect of change in an accounting estimate should be included in the determination of net profit or loss —
 - (a) in the period of the change if the change affects the period only (e.g. change in the estimated amount of doubtful debts)

- (b) in the period of change and future periods if the change affects both (e.g. change in the estimated useful life of a depreciable asset)
2. The effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. (For example, previously included as an extraordinary item should be reported as an extraordinary item)
 3. The nature and the amount of change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods should be disclosed. If it is impracticable to quantify the amount, this fact should be disclosed.

27. WRITE A SHORT NOTE ON ADVANTAGES OF SETTING ACCOUNTING STANDARDS.**[NOV. 2003]**

1. Reduction in Variations	Standards reduce to a reasonable extent <i>or</i> eliminate altogether confusing variations in the accounting treatments used to prepare financial statements.
2. Disclosure Beyond that Required by Law	There are certain areas where important information is not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.
3. Facilitates Comparison	The application of accounting standards would, to a limited extent, facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in accounting standards practised in different countries.

28. WRITE A SHORT NOTE ON COMPENSATING ERRORS.**MEANING OF COMPENSATING ERRORS**

These errors arise when two *or* more errors are committed in such a way that the net effect of these errors on the debits and credits of accounts involved is nil. In other words, compensating errors refer to such a group of errors wherein the effect of one error is compensated by the effect of other error *or* errors.

EFFECTS OF COMPENSATING ERRORS

These errors **do not affect the agreement of the trial balance but may *or* may not affect the figure of net profit.**

EXAMPLES OF COMPENSATING ERRORS

Example 1. If the total of Purchases Book is posted in the ledger as ₹ 1,000 instead of ₹ 100 and at the same time Ram's A/c is credited in the ledger as ₹ 1,000 instead of ₹ 100, as a result of these errors, there is an excess credit of ₹ 900 in Ram's Account and an excess debit of ₹ 900 in Purchases Account. Thus, these two errors nullify the effects of each other. The first error will increase the figure of Purchases and consequently will reduce the figure of Profit.

Example 2. If the total of Bills Receivable Book is posted in the ledger as ₹ 1,000 instead of ₹ 100 and at the same time total of Bills Payable Book is posted as ₹ 1,000 instead of ₹ 100, as a result of these errors, there is excess credit of ₹ 900 in Bills Payable Account and an excess debit of ₹ 900 in Bills Receivable Account. These two errors will nullify the effect of each other. These errors will not affect the figure of profit in anyway.

29. WRITE A SHORT NOTE ON ERROR OF PRINCIPLE.

MEANING OF ERROR OF PRINCIPLE

This error arises when the transaction is recorded ignoring the distinction between the capital item and revenue item. In other words, this error involves an incorrect allocation of expenditure or receipt between Capital and Revenue. The correct allocation between Capital and Revenue is of paramount importance because any incorrect allocation would disturb the final results as disclosed by the Financial Statements.

EFFECT OF ERROR OF PRINCIPLE

It may lead to under/over stating of Incomes or Expenses of Assets or Liabilities. This error **does not affect the trial balance**.

EXAMPLE OF ERROR OF PRINCIPLE

Error: Freight paid for bringing a new machinery is debited to Freight A/c

Effects:

1. On Revenue Expenditure (i.e., Freight) – Overstated
2. On Capital Expenditure (i.e., Cost of Machinery) – Understated
3. On Depreciation on Machinery – Undercharged
4. On Net Profit – Understated by the Net Effect (i.e., the difference between the amount of Freight and amount of Depreciation).

Note: *The costs incurred on the acquisition, installation and commissioning of a fixed asset up to the point the fixed asset is ready for use represent capital expenditures.*

30. WRITE A SHORT NOTE ON SUSPENSE ACCOUNT.

[NOV 1997]

MEANING OF SUSPENSE ACCOUNT

A Suspense Account is an account in which the amount of difference in the trial balance is put till such time that errors are located and rectified.

PREPARATION OF SUSPENSE ACCOUNT

The difference in the trial balance is transferred on the credit side of the Suspense Account (if the debit side of the trial balance exceeds the credit side) or on the debit side of the Suspense Account (if the credit side of the trial balance exceeds the debit side). Thus, the difference is put on the shorter side.

UTILITY OF SUSPENSE ACCOUNT

The rationale behind the opening of a Suspense Account is to avoid delay in the preparation of financial statements.

DISPOSAL OF BALANCE OF SUSPENSE ACCOUNT

When the errors affecting the Suspense Account are located, they are rectified with the help of the Suspense Account. When all the errors affecting the trial balance are located and rectified, the Suspense Account automatically stands balanced.

TREATMENT OF BALANCE OF SUSPENSE ACCOUNT

1. The balance of Suspense Account represents the net effect of errors affecting the trial balance which are still to be located and rectified.

2. Its Debit Balance will be shown on the assets side of the Balance Sheet.
3. Its Credit Balance will be shown on the liabilities side of the Balance Sheet.

31. WRITE A SHORT NOTE ON SINKING FUND METHOD.**[MAY 2000]**

Meaning: Sinking fund is created to provide a definite amount at a certain future date for a specific purpose of replacement of the asset at the end of its useful life.

Working: The working of this method may be summarized here as follows:

- (a) A Sinking Fund described as Depreciation Fund is established for the purpose of accumulating sufficient funds to replace the asset at the end of its useful life.
- (b) Creation of Depreciation Fund—An amount equal to the annual depreciation of the asset is charged against the profits every year and accumulated in the form of Depreciation Fund.
- (c) Purchase of Investments—An equivalent amount of cash (or in the multiples of a specific denomination say ₹ 10 or ₹ 100) is withdrawn from the business and is invested outside the business in securities which are readily convertible into cash.
- (d) Interest on DFI—The interest on Depreciation Fund Investments is credited to Depreciation Fund Account.
- (e) Sale of Investments—At the time of replacement of the asset, the investments made are realised, Profit/Loss on sale of Depreciation Fund Investments is transferred to Depreciation Fund Account and the available money is used in replacing the asset concerned.

32. WRITE A SHORT NOTE ON DEPLETION UNIT/PRODUCTION METHOD OF DEPRECIATION.**[NOV. 1995, NOV. 1998]**

Meaning of Depletion: Depletion refers to the physical deterioration by the exhaustion of natural resources (ore deposits in mines, oil wells, quarries, timber stands etc.)

Meaning of Depletion Method: It is the method under which (a) the life of the asset is estimated in terms of output which could be raised during its life and (b) depreciation is related to the quantity taken out (amount of depletion) and not the passage of time. This method when applied to wasting assets like mines, quarries etc. is known as Depletion Method because wasting assets cannot be depreciated but can be gradually depleted.

Usefulness: It is used for depreciating natural resources like ore-deposit, oil-deposit etc.

Rate of Depreciation per unit = $\frac{\text{Original cost less Residual Value}}{\text{Useful Life in terms of Productive Output}}$

Amount of Depreciation = Actual Output (in units) $\times$ Rate of Depreciation per Unit

Suitability: This method is suitable where (a) the life of the asset can be estimated in terms of output (b) the utility of the asset is directly related to its productive life (c) Obsolescence is not a primary factor.

Practical Example: Cost of acquiring a mine = ₹ 1,00,000, Estimated Qty of coal in the mine = 20,000 tonnes, Actual output in the year 2018 = 1,000 tonnes

Here,

Rate of Depreciation = $\frac{\text{₹ 1,00,000}}{20,000} = \text{₹ 5 per tonne}$

Amount of Depreciation for 2018 = 1,000 tonnes $\times$ ₹ 5 = ₹ 5,000

33. WRITE A SHORT NOTE ON RENEWAL AND RETIREMENT OF BILL.**[MAY 1996, NOV. 2003]**

Renewal of Bill- Cancellation of the original bill and drawing a fresh bill for another period on a request from the drawee, is called renewal of a bill. In such a case, the interest for the extended

period is either paid in cash or is included in the amount of the new bill.

Retirement of Bill:

- (i) **Meaning:** Making the payment of a bill before the date of maturity is called retirement of a bill.
- (ii) **Rebate:** Usually the holder of the bill allows at an agreed rate of interest for the unexpired period of the bill as a consideration for premature payment.
- (iii) **Nature of Rebate:** Such rebate on retirement of a bill is an income for the drawee and is an expense for the payee.

34. WRITE A SHORT NOTE ON NOTING CHARGES AND PROTEST.**[May 2003]**

- (i) **Meaning of Noting**—Noting is the recording of the fact of dishonour by a Notary Public. Such noting must be made within a reasonable time after dishonour.
- (ii) **Contents of Noting**—Noting must specify (a) the date of dishonour, (b) the reason, if any, assigned for such dishonour (c) Noting Charges—The fee charged by Notary Public for noting is known as noting charges.
- (iii) **Recovery**—The amount of noting charges charged is recoverable from the party who is responsible for dishonour.
- (iv) **Treatment in the books of the Drawer**—The Drawee's Account is always debited with the total amount, i.e., the amount of the dishonoured bill plus the amount of noting charges (if any, incurred).
- (v) **Treatment in the books of the Drawee**—The Drawer's Account is always credited with the total amount, i.e., the amount of the dishonoured bill plus the amount of noting charges (if any, incurred).
- (vi) **Protest**—Protest is the formal certificate given by the Notary Public. This certificate is based on the noting.

35. WRITE A SHORT NOTE ON ACCOMMODATION BILL.**[JUNE 1994, MAY 2005]**

- (i) **Meaning**—Accommodation Bills refer to those bills which are drawn, accepted or endorsed without any consideration.
- (ii) **Purpose**—Such bills are drawn and accepted to meet the financial needs of the drawer/drawee/ both temporarily.
- (iii) **Sharing of Proceeds of the Bill**—On discounting of such bills, proceeds may be shared by drawer and drawee in an agreed ratio.
- (iv) **Sharing of Discount**—The party bears the discounts in the proportion in which it shares the proceeds of the bill unless otherwise agreed.
- (v) **Recovery in case of Dishonour**—On dishonour of such bill, drawer cannot file suit against the drawee because drawee is not liable to drawer.
- (vi) **Accounting Entries**—The accounting entries are made in the usual manner as in case of trade bills.

36. WRITE A SHORT NOTE ON DEL-CREDERE COMMISSION. [DEC. 1993, NOV. 1995, MAY 2004]

Meaning: Del-Credere Commission is an additional commission paid by the consignor to the consignee for bearing the loss on account of bad debts, if any, arising out of credit sale of consignment goods. In case of a dispute regarding the delivery or quality etc. if a customer has deducted a particular amount, the consignee will not bear this loss even if he is getting a del-credere commission. Thus, del-credere commission is a kind of insurance premium paid to cover the risk of bad debts.

Who will bear the Bad Debts?

- (i) If consignee gets Del-credere Commission, Consignee will bear the risk of bad debts
- (ii) If consignee does not get Del-credere Commission, Consignor will bear the risk of bad debts.

How to Calculate? Del-credere commission may be allowed on credit sales or total sales. However, in the absence of any such agreement, the consignor allows such commission on total sales and not merely on credit sales.

37. WRITE A SHORT NOTE ON OVER-RIDING COMMISSION.

[NOV. 2003]

Meaning: Over-riding commission is an extra commission allowed over and above the normal commission generally offered:

When allowed: It is generally allowed—

- (i) to provide incentive for effecting for sales at prices higher than the price fixed by the consignor,
- (ii) to provide incentive for introducing a new product in the market,
- (iii) to provide incentive for supervising the performance of other agents in a particular area.

How to Calculate? Depending upon the terms of agreement it may be calculated on the actual total sales or on the difference between Actual total sales and Sales at special selling price or invoice price. However, in the absence of any such agreement, over-riding commission should be allowed on the difference between the actual total sales and sales at specified selling price and ordinary commission should be allowed on total sales at specified sales price.

38. WRITE A SHORT NOTE ON MEMORANDUM JOINT VENTURE ACCOUNT METHOD.

1. Each Co-Venturer records only those joint venture transactions which are effected by him with the help of a personal account designed as 'Joint Venture with....(Name of the other Co-Venturer) ... Account'. It is debited with the purchases/supplies made and expenses incurred by the Venturer. It is credited with the sales effected and unsold stock taken over by the Venturer.
2. Each Co-Venturer sends a periodic statement of joint venture transactions effected by him only, to the other Co-Venturers.
3. Each Co-Venturer on the receipt of the aforesaid statement, prepares Memorandum Joint Venture Account in order to ascertain the profit/loss on Joint Venture transactions. Since this account is in fact not a part and parcel of double entry system the word 'Memorandum' is prefixed. This account can be compared with 'Joint Venture Account', as follows:
4. Each Co-Venturer makes a Journal entry for his share of profit/loss in his books of account.
5. Each Co-Venturer settles the balances of 'Joint Venture with....Account' either by paying (if Cr. Balance) or receiving Cash (if Dr. Balance).
 - (i) Both these accounts are debited with the same items.
 - (ii) Both these accounts are credited with the same items.
 - (iii) Both these accounts show profit/loss on Joint Venture.
 - (iv) All the items posted in Joint Venture Account have their corresponding debits/credits in the books of accounts, whereas it is not so in the case of 'Memorandum Joint Venture Accounts'.

39. WRITE A SHORT NOTE ON SHORT WORKING [OR REDEEMABLE DEAD RENT].

Short Working or Redeemable Dead Rent is the excess of minimum rent over the actual royalties based on actual output or sales as per the agreement. Normally, it is allowed to be recovered by the lessee and as such it is called redeemable dead rent.

40. WRITE A SHORT NOTE ON SURPLUS WORKING.

Surplus Working is the excess of royalties based on actual output or sales over the minimum rent.

Example: If the royalty payable is ₹ 10 per output produced, subject to a minimum of ₹ 10,000 p.a. and the annual output is only 800 units, the payment to the landlord will be ₹ 10,000 (viz. minimum rent being higher than the actual royalty of ₹ 8,000) and ₹ 2000 would be short working. But when the annual output is 1200 units, the payment to the landlord will be ₹ 12,000 (viz. actual royalty being higher than the minimum rent) subject to the short working recoupment clause (if any) and ₹ 2,000 would be surplus working.

41. WRITE A SHORT NOTE ON SHORT WORKING RECOUPMENT CLAUSE.

This clause enables the tenant to recoupe (i.e. recover) the short working out of the royalties in the subsequent periods when the royalty based on actual output/sales is more than the minimum rent. This clause is provided mainly to compensate the lessee for the excess amount paid by him whenever the actual royalty was less than the minimum rent. Such a clause may be drafted in various ways, e.g., such a clause may permit the lessor to exercise: (a) Fixed right, i.e. to set off the short working only within a specified number of years after the commencement of the lease or (b) Fluctuating Right, i.e. to set off short working within a specified number of year (s) following the year in which the short working occurs; or to carry forward the short working indefinitely.

Note: *In the absence of any 'Short Working Recoupment Clause' in 'Royalty Agreement', the short working if any, arises) is to be written off to Profit & Loss Account in the year of short working.*

42. WRITE A SHORT NOTE ON SUB-LEASING.

If the terms of the original lease authorise the lessee to sub-lease, the lessee may sub-let the whole or a part of his rights available under the original lease to another person who is then called 'Sub-Lessee'. In such a case, the lessee acts in dual capacity as under:

- (a) **As regards the Original Lessor—** The lessee serves as a lessee and pays royalty on the entire output raised (or sold) by both the lessee and sub-lessee at the rate fixed between him and landlord. As a lessee, he maintains Royalty Payable Account, Short Working Recoupable Account and Landlord's Account.
- (b) **As regards the Sub-lessee—** The lessee serves as a landlord and receives the royalty on the output raised (or sold) by the sub-lessee at the rate fixed between him and the sub-lessee. As a landlord, he maintains Royalty Receivable Account, Shortworking Allowable Account and Sub-Lessee's Account.

Notes:

1. *The royalty payable to the original landlord or lessor is calculated on the basis of total output of both lessee and sub-lessee.*
2. Lessee passes the following additional entry:

Royalty Receivable A/c	Dr.	[Qty of Actual output of Sub-less × Rate of
To Royalty Payable A/c		Royalty under original lease]

43. WRITE A SHORT NOTE ON ACCOUNT CURRENT.

[DEC. 1993, JUNE 1994, NOV. 1997, NOV. 2005]

Meaning: Account Current is a running statement in the form of a ledger account showing the transactions between two parties for a given period of time together with the interest due or payable. The heading of this statement is written as under:

“(Name of Receiving Party)—In Account Current with—(Name of Sending Party)—” to—(date)

For example, if X sends the Account Current to Y, it will be headed as "Y in Account Current with X". If Y sends the Account Current to X, it will be headed as — X in Account Current with Y'.

Who sends to whom: Account Current is usually sent by (a) a banker to its customer (b) a lender to its borrower (c) a supplier to its customer (d) an agent to its principal (e) a co-venturer to another co-venturer.

Methods of Preparing:

There are three methods of preparing Account Current viz. Interest on Individual Transaction Method, Product of Individual Transaction Method, Product of Balances Method.

44. WRITE A SHORT NOTE ON RED INK INTEREST.

[DEC. 1993, MAY 2004]

In case of transactions the due date of which falls after the date of closing the account, the product must be written either as negative product on the same side or as positive product on the opposite side (i.e. the side other than that on which the transaction appears). Traditionally, such product was used to be written in 'Red Ink' and interest on such 'Red Ink Product' was used to be called as "Red Ink Interest".

45. WRITE A SHORT NOTE ON RECEIPTS AND EXPENDITURE ACCOUNT. [MAY 1999, NOV. 2003]

Meaning:

1. Receipts and Expenditure Account is an income statement which is prepared by professionals (like Chartered Accountants) or professional firms to ascertain the final results of their professional activities during an accounting period.
2. In Receipts and Expenditure Account, all expenses are recognised on accrual basis and all incomes are recognised on cash basis. In other words, all outstanding expenses are considered but all outstanding *fees and charges or work-in-progress are not considered*.

Reason for non-recognition of Outstanding Fees:

The reason for non-recognition of outstanding fees is that professionals consider it imprudent and risky to recognize the outstanding fees.

Reason for difference between the profit as shown by the Income & Expenditure Account and Receipts and Expenditure account.

Such difference arises because of non-recognition of outstanding fees and charges and work-in-progress in Receipts & Expenditure Account.

46. WRITE A SHORT NOTE ON GUARANTEE OF MINIMUM PROFIT TO A PARTNER.

Guarantee to a Partner	It means assurance to give a minimum amount of Profit to a Partner.
Guaranteed Partner	A partner to whom guarantee of minimum profit has been provided is called ' Guaranteed Partner '.
Guaranteeing Partners	The partner(s) who has (have) given guarantee of minimum profit is (are) called ' Guaranteeing Partners '.
Guaranteed Amount	The minimum amount for which guarantee is given is called ' Guaranteed Amount '.
Who can provide Guarantee and in what ratio?	The guarantee may be provided by one <i>or</i> some <i>or</i> all of the partners in an existing profit sharing ratio <i>or</i> in some other agreed ratio.
Personal Guarantee	When guarantee is given by one <i>or</i> some <i>or</i> all of the partners in a ratio different from existing profit sharing ratio, such guarantee is said to be personal guarantee.

Firm Guarantee	When guarantee is given by all the partners in an existing profit sharing ratio, such guarantee is said to be firm guarantee.
Effect of Guarantee	If in any year, the actual Share of Profit of a Guaranteed Partner is less than the Guaranteed Amount, then the deficiency (i.e., excess of Guaranteed Amount over actual Share of Profit) is borne by the Guaranteeing Partners in their agreed ratio.

47. WRITE A SHORT NOTE ON LIMITED LIABILITY PARTNERSHIP.

1. It is an entity registered under 'The Limited Liability Partnership Act, 2008'
2. It has separate legal entity.
3. It is created by Law.
4. It has perpetual succession. The death, insolvency or unsoundness of its members does not affect its existence. Members may come and go but LLP goes forever.
5. Its Name to contain 'Limited Liability Partnership' or 'LLP' as suffix.
6. Minimum number of partners required is 2 but there is no limit on maximum number of partners.
7. Liability of its Partner is limited, to the extent their contribution towards LLP, except in case of intentional fraud or wrongful act of omission or commission by the partner.
8. Partners act as agents of LLP and not of other partners.
9. Minor can not be admitted to the benefits of LLP.
10. Foreign National can become a Partner in a LLP.
11. It must have at least 2 individuals as Designated Partners, of whom at least one must be resident in India

48. WRITE A SHORT NOTE ON DESIGNATED PARTNERS.

1. LLP must have at least 2 two individuals as Designated Partners, of whom at least one must be resident in India. Each Designated Partner is required to have a DIN before appointment.
2. At least one Designated Partner must have Digital Signatures since e forms are filled electronically.
3. Only Designated Partners are liable for Legal Compliance.

49. WRITE A SHORT NOTE ON PERSONAL LIABILITY OF A PARTNER.

<i>For his own Wrongful Act or Omission</i>	A partner is personally liable.
<i>For the Wrongful Act or Omission of any other Partner of the LLP</i>	A partner is not personally liable.
<i>For any Other Act</i>	A partner is not personally liable.

50. WRITE A SHORT NOTE ON METHODS OF VALUATION OF GOODWILL.

Average Profit Method: Goodwill under this method is ascertained by multiplying the Average Future Maintainable Profit by a certain number of years' purchases.

$$\text{Goodwill} = \text{Average profits} \times \text{No. of years' Purchases}$$

Super Profit Method: Goodwill under this method is ascertained by multiplying the Super Profits by certain number of year's purchase.

$$\text{Goodwill} = \text{Super profits} \times \text{No. of years' Purchases}$$

Capitalisation of Super Profit: The goodwill under this method is ascertained by capitalising the super profits on the basis of Normal Rate of Return.

$$\text{Goodwill} = \text{Super Profits} \times \frac{100}{\text{Normal Rate of Return}}$$

Capitalization of Average Profits:

The goodwill under this method is ascertained by deducting the actual capital employed (i.e. Net Assets as on the date of Valuation) in business from the Capitalised Value of the average profits on the basis of Normal Rate of Return.

$$\text{Goodwill} = \text{Capitalised Value} - \text{Net Assets}$$

Where,

$$\text{Capitalised Value} = \frac{\text{Average Profit}}{\text{Normal Rate of Return}} \times 100$$

Net Assets = All Assets (other than goodwill, fictitious assets and non-trade investments) at their current values less Outsiders' Liabilities

51. WRITE A SHORT NOTE ON LIMITATIONS OF FINANCIAL STATEMENTS.

The major limitations of financial statements are as follows:

1. Ignores the qualitative elements	Financial statements ignore the qualitative elements like quality of management, quality of labour force, public relations.
2. Not free from personal bias	Financial statements are not free from personal bias since the subjectivity is inherent in personal judgments involved in making decision regarding method of depreciation, method of inventory valuation, materiality, provision for doubtful debt etc.
3. Ignores the Price Level Changes	Financial statements prepared on historical basis ignore the price level changes since the financial statements are prepared on historical cost basis and not on current cost basis.
4. Relates to past and not to future	Financial statements relate to the past and not to the future.

52. WRITE A SHORT NOTE ON PRIVATE PLACEMENT OF SHARES.

Meaning	(a) According to Section 42 private placement of shares implies issue and allotment of shares to a selected group of persons. In other words, an issue, which is not a public issue but offered to a select group of persons, is called 'Private Placement of Shares'. (b) All SEBI Guidelines concerning preferential issue are applicable to private placement of shares as well. (c) In order to make of shares through the private placement route, a company must pass a special resolution to this effect. Where no special resolution is passed, the company must pass ordinary resolution and obtain the consent of the Central Government stating that the proposal is most beneficial to the company.
Accounting Treatment	Accounting entries relating to the private placement of securities are similar to those discussed at the time of application and allotment.

53. WRITE A SHORT NOTE ON RIGHT SHARES.

Meaning	As per Sec. 62 in case of further issue of shares, further shares must be offered to the existing shareholders in proportion to their existing shareholdings at that date. Such shares are called 'Rights Shares'.
When Available	Such right is available when it is proposed to increase the subscribed capital of the company by allotment of further shares at any time after the expiry of 2 years from the formation of a company or after the expiry of 1 year from the first allotment of shares, whichever is earlier.
Option available	The existing shareholder to whom the offer is made, may: 1. Accept the offer in full or in part 2. Reject the offer in full 3. Renounce the right in full or in part
Value of Right	The computation of Value of Right consists of the following two steps: Step 1: Calculate Average Price of a share $\frac{\text{Market Price of the Existing Shares} + \text{Issue Price of proportionate Right Shares}}{\text{No. of Existing Shares} + \text{No. of Rights Shares}}$ Step 2: Calculate Value of Right Value of Right = Market Price of a Share — Average Price of a Share
Accounting Treatment	Accounting treatment of right issue of shares is similar to the treatment discussed under application and allotment.

EXAMPLE:

X Ltd. offers new shares of ₹ 100 each at 10% premium to the existing shareholders in the ratio of two shares for every five shares held. The Market Price of share is ₹ 124. Calculate the Value of Right.

SOLUTION:

$$\text{Step 1: Average Price} = \frac{(\text{₹}124 \times 5) + (\text{₹}110 \times 2)}{5 \times 2} = \text{₹ } 120 = \text{₹ } 120$$

$$\text{Step 2: Value of Right} = \text{₹ } 124 - \text{₹ } 120 = \text{₹ } 4.00$$

54. WRITE A SHORT NOTE ON PREFERENTIAL ALLOTMENT.

Meaning	A preferential allotment is one that is made at a pre-determined price to the pre-identified people who wish to take a strategic stake in the company such as promoters, venture capitalists, financial institutions, buyers of companies' products or its suppliers.
Guidelines	Some of the guidelines in this regard are as follows: 1. Lock-in-Period —The allottees will not sell their securities in the open market for a minimum period of three years from the date of allotment. This period is known as the lock in period. This period is applicable in case of promoters' contribution. However in case of pre-issue of share capital of an unlisted company, the lock-in-period is one year from the date of commencement of commercial production or the date of allotment in the public issue, whichever is earlier.

	2. Special Resolution—The preferential allotment can take place only if three-fourths of the shareholders agree to the issue on preferential basis. 3. Minimum Issue Price— The minimum price of such an issue has to be an average of highs and lows of the 26 weeks preceding the date on which the board resolves to make the preferential allotment. 4. Open Offer—If the preferential allotments are made over and above 15 per cent of the equity, an open offer is mandated by the SEBI.

55. WRITE A SHORT NOTE ON SWEAT EQUITY SHARES.

Meaning	Sweat equity shares means equity shares issued by the company to employees <i>or</i> directors at a discount <i>or</i> for consideration other than cash for providing know-how <i>or</i> making available right in the nature of intellectual property rights <i>or</i> value additions, by whatever name called. [Sec. 2 (88)]
Five Conditions	According to Section 54, a company may issue Sweat Equity Shares if the following conditions are fulfilled, namely: 1. the shares must belong to a class of shares already issued; 2. the issue must be authorised by a special resolution passed by the company in the general meeting. 3. the resolution must specify the number of shares, current market price, consideration, if any, and the class <i>or</i> classes of directors <i>or</i> employees to whom such equity shares are to be issued. 4. at least 1 year must have completed since the date on which the company was entitled to commence business; 5. the sweat equity shares of a company whose equity shares are listed on a recognised stock exchange must be issued as per the regulations made by the SEBI. Provided that in the case of a company whose equity shares are not listed on any recognised stock exchange, the Sweat Equity Shares are issued as per the guidelines prescribed.

SECTION 2

TULSIAN'S FULLY SOLVED SCANNER FOR PRACTICAL QUESTIONS

CH.No	Chapter Name
1.	Errors and Their Rectification
2.	Bank Reconciliation Statement
3.	Valuation of Inventory
4.	Accounting for Depreciation
5.	Accounting for Bills of Exchange
6.	Goods Sent on Approval or on Sale or Return Basis
7.	Accounting for Consignment
8.	Accounting for Joint Venture
9.	Accounting for Royalty
10.	Average Due Date
11.	Account Current
12.	Financial Statements
13.	Accounting for Partnership Firms — Fundamentals
14.	Reconstitution of Partnership — Change in Profit Sharing Ratio
15.	Reconstitution of Partnership — Admission of a Partner
16.	Reconstitution of Partnership-Retirement/Death of a Partner
17.	Financial Statements of Not-for-Profit Organisations
18.	Accounting for Share Capital
19.	Issue of Debentures
20.	Financial Statements of a Company
21.	Ratio Analysis

1

ERRORS AND THEIR RECTIFICATION

PROBLEM 1

A book-keeper, while preparing his trial balance finds that the debit exceeds by ₹ 7,250. Being required to prepare the final accounts, he places the difference to a Suspense Account. In the next year, the following mistakes were discovered:

- A sale of ₹ 4,000 has been passed through the Purchase Day-book. The entry in customer's account has been correctly recorded.
- Goods worth ₹ 2,500 taken away by the proprietor for his use has been debited to Repairs Account.
- A Bill receivable for ₹ 1,300 received from Krishna has been dishonoured on maturity, but no entry passed.
- Salary ₹ 650 paid to a clerk has been debited to his Personal Account.
- A Purchase of ₹ 750 from Raghubir has been debited to his account. Purchases Account has been correctly debited.
- A sum of ₹ 2,250 written off as depreciation on furniture has not been debited to Depreciation Account.

Draft the Journal entries for rectifying the above mistakes and prepare Suspense Account.

SOLUTION:

JOURNAL

Date	Particulars	Dr. (₹)	Cr. (₹)
(a)	Suspense A/c To P & L Adjustment a/c (Entry for rectifying a credit sale entered in purchase book)	Dr. 8,000	8,000
(b)	Drawing A/c To P & L Adjustment A/c (Goods drawn for personal use wrongly debited to repairs, now rectified)	Dr. 2,500	2,500
(c)	Krishna's A/c To Bills Receivable A/c (Being entry for bill dishonoured on maturity)	Dr. 1,300	1,300
(d)	P & L Adjustment A/c To Clerk's A/c (Being salary wrongly debited to Clerk's A/c, now rectified)	Dr. 650	650
(e)	Suspense A/c To Raghubir's A/c (Being wrong debit to Raghubir's A/c, now rectified)	Dr. 1,500	1,500
(f)	P & L Adjustment A/c To Suspense A/c (Being depreciation on furniture not posted to Depreciation A/c, now rectified)	Dr. 2,250	2,250

DR.**SUSPENSE ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To P & L Adjustment A/c	8,000	By Balance b/d	7,250
To Raghubir's A/c	1,500	By P & L Adjustment A/c	2,250
	9,500		9,500

PROBLEM 2

On 31st March, 2018, a book-keeper finds the difference in the Trial Balance and he puts it in the Suspense Account. Later on he detects the following errors:

- (i) ₹ 50,000 received from A was posted to the debit of his Account.
- (ii) ₹ 20,000 being purchases returns were posted to the debit of Purchases Account.
- (iii) Discount of ₹ 8,000 received were posted to the debit of Discount Account.
- (iv) ₹ 9,060 paid for repairs of Motor Car was debited to Motor Car Account as ₹ 7,060.
- (v) ₹ 40,000 paid to B was debited to A's Account.

Required: Give Journal Entries to rectify the above errors and ascertain the amount transferred to Suspense Account on 31st March, 2018 by showing the Suspense Account, assuming that the Suspense Account is balanced after the above corrections. [May 2001]

SOLUTION:**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
(i)	Suspense A/c Dr. To A's A/c (Being the rectification of error by which Amount received from A was wrongly debited to his account)	1,00,000	1,00,000
(ii)	Suspense A/c Dr. To Purchase A/c To Purchases Returns A/c (Being the rectification of error by which purchases returns had been wrongly posted to the purchases account)	40,000	20,000 20,000
(iii)	Suspense A/c Dr. To Discount A/c (Being the rectification of error by which discount received was wrongly debited to discount account)	16,000	16,000
(iv)	Motor Car Repairs A/c Dr. To Motor Car A/c To Suspense A/c (Being the rectification of error by which motor car repair expenses ₹ 9,060 wrongly debited to motor car account as ₹ 7,060)	9,060	7,060 2,000
(v)	B's A/c Dr. To A's A/c (Being the rectification of error by which amount paid to B had been wrongly debited to A)	40,000	40,000

DR.**SUSPENSE ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To A's A/c	1,00,000	By Difference in trial balance	1,54,000
To Purchases A/c	20,000	(balancing figure)	2,250
To Purchases Returns A/c	20,000	By Motor Car Repairs A/c	2,000
To Discount A/c	16,000		
	1,56,000		1,56,000

PROBLEM 3

There was an error in the Trial Balance of Mr. Steel on 31st March, 2018, and the difference in Books was carried to a Suspense Account. On going through the Books you find that:

- (i) ₹ 5,400 received from Mr. A was posted to the debit of his account.
- (ii) ₹ 1,000 being purchases return were posted to the debit of purchases Account.
- (iii) Discount received ₹ 2,000 was posted to the debit of Discount Account.
- (iv) ₹ 2,740 paid for Repairs to Motor Car was debited to Motor Car Account as ₹ 1,740.
- (v) ₹ 4,000 paid to B was debited to A's Account.

Required: Give Journal Entries to rectify the above error and ascertain the amount transferred to Suspense Account on 31st March, 2018 by showing the Suspense Account, assuming that the Suspense Account is balanced after the above corrections.

State which types of errors are not disclosed by the agreement of the Trial Balance.

SOLUTION:**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1)	Suspense A/c Dr. To A's A/c (Being the cash received from A debited to his account, now rectified)	10,800	10,800
2)	Suspense A/c Dr. To Purchases A/c To Purchases Returns A/c (Being the purchase returns posted to Purchases, rectified)	2,000	1,000 1,000
3)	Suspense A/c Dr. To Discount A/c (Being discount received treated as discount allowed, now rectified)	4,000	4,000
4)	Repairs to Motor car A/c Dr. To Motor car A/c To Suspense A/c (Being repairs to car, treated as capital expense now rectified)	2,740	1,740 1,000
5)	B's A/c Dr. To A's A/c (Being Money received from B debited to A's A/c, rectified)	4,000	4,000

DR.**SUSPENSE ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To A's A/c	10,800	By Balance b/d (b.f)	15,800
To Purchases A/c	1,000	By Repairs to Motor Car A/c	1,000
To Purchases Returns A/c	1,000		
To Discount A/c	4,000		
	16,800		16,800

The various errors not affecting Trial Balance are—

1. Errors of principle
2. Compensating errors
3. Errors of complete omission
4. Error of recording in books of original entry.
5. Positing a correct amount on correct side of a wrong account.

PROBLEM 4

The Trial Balance of ABC Ltd. as on March 31, 2018 did not agree. The difference was put to a Suspense Account. During the next trading period, the following errors were discovered:

- (i) The total of the Sales-book of one page ₹ 6,531 was carried forward to the next page as ₹ 6,351.
- (ii) Goods returned by a customer for ₹ 1,200, but entered in Purchases Return Book.
- (iii) Personal Car Expenses amounting to ₹ 250 were debited to Trade Expenses.
- (iv) Sales Return Book was undercast by ₹ 2,750.
- (v) ₹ 50 discount allowed by a supplier, was wrongly posted to debit side of Discount Account.
- (vi) An item of purchases of ₹ 151 was entered in Purchases Book as ₹ 15 and posted to Supplier's account as ₹ 51.

Required: Pass Journal Entries to rectify the errors through Profit & Loss Adjustment A/c in a way so as to show the Current year's profit or loss correctly.

SOLUTION:**JOURNAL OF ABC LTD**

<i>Date</i>	<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
(i)	Suspense A/c Dr. To Profit & Loss Adjustment A/c (Being total of sales book of one page ₹ 6,531 carried forward wrongly as ₹ 6,351, now rectified)	180	180
(ii)	Profit and Loss Adjustment A/c Dr. To Customer's A/c (Being goods returned by a customer, wrongly entered in Purchase Return Book last year, now rectified)	2,400	2,400
(iii)	Drawings A/c Dr. To Profit and Loss Adjustment A/c (Being personal car expenses wrongly debited to trade expenses last year, now rectified)	250	250

(iv)	Profit and Loss Adjustment A/c To Suspense A/c (Being sales return book under cast last year, now rectified)	Dr.	2,750	2,750
(iv)	Suspense A/c To Profit and Loss Adjustment A/c (Being discount received ₹ 50 wrongly debited to discount account, now rectified)	Dr.	100	100
(vi)	Profit and Loss Adjustment A/c To Supplier's A/c To Suspense A/c (Being purchases A/c short debited by ₹ 136 and supplier A/c short credited by ₹ 100, now rectified)	Dr.	136	100 36

PROBLEM 5

The difference in Trial Balance is kept by Rajesh in Suspense account. Before preparing the Final Accounts, the following errors were detected by him:

- Purchase for ₹ 1,080 was written in Sales day book, but was posted to the correct side of the Party's account.
- Salary account total ₹ 25,200 was carried over to the next page as ₹ 2,520 on the wrong side.
- Interest on Overdraft ₹ 1,300 was not posted to the Ledger from the Cash-book.

Pass the Rectification entries and prepare the suspense account.

SOLUTION:
JOURNAL

Date	Particulars	Dr. (₹)	Cr. (₹)
	Sales A/c Purchases A/c To Suspense A/c (Being Purchase wrongly recorded, now rectified)	Dr. Dr. 2,750	 2,160
	Salary A/c To Suspense A/c (Being Salary A/c total wrongly carried over, now rectified)	Dr. 27,720	 27,720
	Interest & Overdrafts A/c To Suspense A/c (Being interest on O/D omitted to be posted, now rectified)	Dr. 1,300	 1,300

DR.
SUSPENSE ACCOUNT
CR.

Particulars	₹	Particulars	₹
To Difference in Trial Balance	31,180	By Sales A/c By Purchase A/c By Salary A/c By Interest on Overdraft	1,080 1,080 27,720 1,300
	31,180		31,180

2

BANK RECONCILIATION STATEMENT

PROBLEM 1

Following are the entries recorded in the Bank Column of the Cash Book of Mr. X for the month ending on 31.03.2018

CASH BOOK (BANK COLUMN)

Date	Particulars	₹	Date	Particulars	₹
2018			2018		
Mar 15	To Cash	36,000	Mar. 01	By Balance b/d	40,000
Mar 20	To Roy	24,000	Mar. 04	By John	2,000
Mar 22	To Kapoor	10,000	Mar. 06	By Krishnan	400
Mar 31	To Balance c/d	7,640	Mar. 15	By Kailash	240
			Mar. 20	by Joshi	35,000
				By Balance b/d	7,640
		77,640			77,640

On 31.3.2018 Mr. X received the Bank Statement. On perusal of the statement Mr. X ascertained the following information:

(a) Cheques deposited but not credited by the bank ₹ 10,000 (b) Interest on securities collected by the bank but not recorded in cash book ₹ 1,080 (c) Credit transfer not recorded in the cash book ₹ 200 (d) Dividend collected by the bank directly but not recorded in the cash book ₹ 1,000 (e) Cheques issued but not presented for payment ₹ 37,400 (f) Interest debited by the bank but not recorded in the cash book ₹ 1,000 (g) Bank charges not recorded in the cash book ₹ 340.

From the above information you are asked to prepare a Bank reconciliation statement to ascertain the balance as per Bank Statement.

SOLUTION:

BANK RECONCILIATION STATEMENT AS AT 31.03.2018

Particulars	Plus items ₹	Minus items ₹
A Bank overdraft as per Cash Book		7,640
B Cheque deposited but not credited		10,000
C Interest on securities collected by Bank but not recorded in Cash Book	1,080	—
D Credit transfer not recorded in Cash Book	200	
E Dividend collected by Bank directly but not recorded in Cash Book	1,000	
F Cheques issued but not presented for payment	37,400	
G Interest debited by the bank but not recorded in the Cash Book		1,000
H Bank Charges not recorded in Cash Book		340
	39,680	18,980
I Bank Balance as per Pass Book	20,700	

PROBLEM 2

Prepare a Bank Reconciliation Statement as on 31st March, 2018 from the following particulars:

	₹
Bank balance as per the Pass-book	10,000
Cheque deposited into the bank, but no entry was passed in the Cash-book	500
Cheque received, but not sent to bank	1,200
Credit side of the bank column cast short	200
Insurance Premium paid directly by the bank under the standing advice	600
Bank charges entered twice in the Cash-book	20
Cheque issued, but not presented to the bank for payment	500
Cheque received entered twice in the Cash-book	1,000
Bills discounted dishonoured not recorded in the Cash-book	5,000

SOLUTION:

BANK RECONCILIATION STATEMENT AS ON 31st MARCH, 2018

Particulars	₹	₹
A. Bank Balance as per Pass Book	10,000	
B. Add: (i) Cheque received but not sent to the bank	1,200	
(ii) Credit side of the bank column cast short	200	
(iii) Insurance Premium paid directly not recorded in the cash book	600	
(iv) Cheque received entered twice in the cash book	1,000	
(v) Bills dishonoured not recorded in the cash book	5,000	
C. Less: (i) Cheque deposited into the bank but no entry was passed in the cash book		500
(ii) Bank charges recorded twice in the cash book		20
(iii) Cheque issued but not presented to the bank		500
	18,000	1,020
D. Bank balance as per Cash Book	16,980	

PROBLEM 3

From the following particulars, prepare the Bank Reconciliation Statement as on 31st March, 2018.

(i) Bank overdraft as per Pass-book	₹ 21,494
(ii) A cheque deposited as per Pass-book, but not recorded in Cash-book	₹ 700
(iii) Debit side of Bank column undercast	₹ 100
(iv) A cheque of ₹ 5,000 deposited, but credited to Pass-book as	₹ 4,996
(v) A party's cheque returned dishonoured as per Pass-book only	₹ 530
(vi) Bills collected directly by Bank	₹ 3,500
(vii) Bank charges recorded twice in the Cash-book	₹ 25
(viii) A Bill for ₹ 8,000 discounted for ₹ 7,900 returned dishonoured by the Bank. Noting charges being	₹ 15
(ix) Cheque deposited, but not yet collected by the Bank	₹ 2,320
(x) Cheque issued, but not yet presented to the bank for payment	₹ 1,250

SOLUTION:**BANK RECONCILIATION STATEMENT AS ON 31ST MARCH, 2018**

<i>Particulars</i>	₹	₹
Bank Overdraft as per Pass-book		21,494
<i>Less:</i> Cheque deposited but not recorded in Cash-book		700
Undercasting of debit side of Bank column		100
Bills collected directly by Bank		3,500
Bank charges recorded twice in Cash-book		25
Cheque issued but not presented for encashment		1,250
<i>Add:</i> Cheque for ₹ 5,000 deposited but collection shown as per Bank statement ₹ 4,996	4	
Cheque returned dishonoured as per Bank statement only	530	
Bill for ₹ 8,000 discounted for ₹ 7,960 returned dishonoured by Bank (including noting charges ₹ 15)	8,015	
Cheque deposited but not collected	2,320	
	10,869	27,069
Bank Overdraft as per Cash-book		16,200

Note: It has been assumed that a party's i.e. debtor's cheque had been returned dishonoured.

PROBLEM 4

The Cash Book of Mr. X shows ₹ 16,928 as the balance at the Bank as on 31st March, 2018, but you find this does not agree the balance as per the Bank Pass Book. On scrutiny, you find the following discrepancies:

- On 15th March the Payments side of the Cash Book was undercast by ₹ 400.
- A cheque for ₹ 462 issued on 25th March was recorded in the Cash Column.
- One deposit of ₹ 500 was recorded in the Cash Book as if there is no Bank Column therein.
- On 18th March a debit balance of ₹ 3,152 as on the previous day, was brought forward as a credit balance.
- Of the total cheques amounting to ₹ 23,228 drawn in the last week of March, cheques aggregating ₹ 15,630 were encashed in March.
- Dividends of ₹ 700 collected by the Bank and subscription of ₹ 120 paid by it were not recorded in the Cash Book.
- One outgoing cheque of ₹ 900 was recorded twice in the cash Book.

Required: Prepare a Reconciliation Statement (i) without amended Bank Balance (ii) amended Bank Balance.

SOLUTION:**(i) Without Amended Cash Book****BANK RECONCILIATION STATEMENT OF MR X AS AT 31.03.2018**

<i>Particulars</i>	<i>Plus items ₹</i>	<i>Minus items ₹</i>
A. Debit Balance as per Cash Book	16,928	
B. <i>Add:</i> Mistake in bringing forward as credit balance on 18th Dec.,	6,034	
Cheques issued but not presented	7,598	
Dividends directly collected by bank but not yet entered in the Cash book	700	

2.4 Quick Revision for Accounting for CA Foundation Course

Cheques issued recorded twice	900	
Deposit not recorded in the Bank Column	500	
C. Less: Wrong casting in the Cash Book on 15th Dec. Cheques issued but not entered in the Bank Pass Book Subscription paid by the bank not yet recorded in the Cash Book		400
		462
		400
	32,930	1,262
D. Credit Balance as per Pass Book	31,668	

DR. (II) X'S CASH BOOK (WITH AMENDED BANK COLUMN) CR.

Date	Particulars	₹	Date	Particulars	₹
31.03.2018	To Balance b/d	16,928	31.03.2018	By Wrong casting	400
	To Mistake in bringing forward	6,304		By Cheques issued	462
	To Dividend collected	700		By Subscription	400
	To Cheques recorded twice	900		By Balance c/d	24,070
	To Deposit not recorded	500			
		25,332			25,332

BANK RECONCILIATION STATEMENT AS AT 31.03.2018

A. Corrected Debit Balance as per Cash Book	₹ 24,070
B. Add: Cheques issued but not presented	₹ 7,598
C. Credit Balance as per Pass Book	₹ 31,668

PROBLEM 5

The Cash Book of a trader showed on Overdraft balance of ₹ 33,000 on 31st March, 2018. On scrutiny of the Cash Book and Pass Book, it was discovered that:

- On 22nd March, sundry cheques totalling ₹ 6,500 were sent to Bank for collection out of which a cheque for ₹ 1,500 was wrongly recorded on the credit side of the Cash Book and cheques amounting to ₹ 3,300 could not be collected by the Bank till 6th April next.
- A cheque for ₹ 4,000 was issued to a supplier on 28th March. The cheque was not presented to Bank till 10th April
- Bank had debited ₹ 2,000 towards interest on overdraft and ₹ 600 for Bank charges. But the bank advice was sent on 15th April.
- Credit side of the Bank Column of the Cash Book was undercast by ₹ 100.
- Cheques for ₹ 2,000 drawn for office expenses were not encashed till 2nd April.
- A cheque for ₹ 1,000 was issued to a creditor on 27th March and was omitted to be entered in the Cash Book. It was, however, presented to Bank on 31st March.
- Dividends amounting to ₹ 500 had been collected directly by the Bank and not entered in Cash Book.

Required: Prepare Bank Reconciliation Statement with amended Cash Balance.

SOLUTION:

DR. CASH BOOK (WITH AMENDED BANK COLUMN) CR.

Date	Particulars	₹	Date	Particulars	₹
31.03.2018	To Sundry Debtors	3,000	31.03.2018	By Balance b/d	33,000
	To Dividends	500		By Interest on O/D	2,000
	To Balance c/d	33,200		By Bank Charges	600
				By Error in casting	100
				By Sundry Creditors	1,000
		36,700			36,700

BANK RECONCILIATION STATEMENT AS AT 31.3. 2018

<i>Particulars</i>	<i>Plus items ₹</i>	<i>Minus items ₹</i>
A. Overdraft as per Cash Book (amended)		33,200
B. Less: Cheques sent to the Bank for collection but not yet collected		3,300
C. Add: Cheques issued but not yet presented for payment	4,000	
D. Add: Cheques issued for office expenses but not yet encashed	2,000	
	6,000	36,500
E. Overdrafts as per Pass Book		30,500

PROBLEM 6

On 31st March, 2018, the bank account of X, according to the Bank Column of the Cash Book, was over drawn to the extent of ₹ 4,162. An examination of the Cash Book and Bank Statement reveals the following:

- A Cheque for ₹ 1,240 deposited on 29th March was credited by the bank only on 3rd April.
- A payment by cheque for ₹ 260 has been entered twice in the Cash Book. [Note: The Bank has made the payment of this cheque.]
- On 29th March the bank credited an amount of ₹ 1,840 received from a customer of X, but the advice was not received by X until 1st April.
- Bank charges amounting to ₹ 158 had not been entered in the Cash Book.
- On 6th March the bank credited ₹ 2,100 to X in error.
- A bill of exchange for ₹ 1,100 was discounted by X with his bank. The bill was dishonoured on 28th March, but no entry had been made in the books of X.
- Cheques issued upto 31st March but not presented for payment upto that date totalled ₹ 3,860.

Required: Show the appropriate rectifications required in the Cash Book of X, to arrive at the correct balance on 31st March, 2018; and prepare a Bank Reconciliation Statement as on that date.

SOLUTION:**DR.****CASH BOOK (WITH AMENDED BANK COLUMN)****CR.**

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
31.03.2018	To Party A/c	260	31.03.2018	By Balance b/d	4,162
	To Customer A/c (Direct Deposit)	1,840		By Bank Charges	158
	To Balance c/d	3,320		By Customer A/c (B/R dishonoured)	1,100
		5,420			5,420

(B) BANK RECONCILIATION STATEMENT AS AT 31.3.2018

<i>Particulars</i>	<i>Plus items ₹</i>	<i>Minus items ₹</i>
A. Overdraft as per Cash Book (amended)		3,320
B. Less: Cheque deposited but not collected upto 31st Mar.		1,240
C. Add: Cheques issued but not presented for payment up to 31st Mar.	3,860	
D. Add: Credit by Bank erroneously on 6th Mar.	2,100	
	5,960	4,560
E. Balance as per Bank Statement	1,400	

PROBLEM 7

The following is a summary of Cash Book presented to you for the month of March, 2018

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Receipt	1,469	Balance brought forward	761
Balance carried forward	554	Payment	1,262
	2,023		2,023

All receipts are banked and all payments are made by cheque. On investigation you discover:

- Bank charges of ₹ 136 entered in the Bank Statement had not been entered in the Cash Book.
- Cheques drawn amounting to ₹ 267 had not been presented to the bank for payment.
- Cheques received totalling ₹ 762 had been entered in the Cash book and paid into the bank, but had not been credited by the bank until April.
- A cheque for ₹ 22 had been entered as a receipt in the cash book instead of as a payment.
- A cheque for ₹ 25 had been debited by the bank in error.
- A cheque received for ₹ 80 had been returned by the bank marked 'No funds available.' No adjustment had been made in the cash book.
- All dividends receivables are credited directly to the bank account. During March amounts totalling ₹ 62 were credited by the bank and no entries made in the Cash Book.
- A cheque drawn for ₹ 6 had been incorrectly entered in the cash book as ₹ 66.
- The balance brought forward should have been ₹ 711.
- The bank statement as on 31st March 2018 showed an overdraft of ₹ 1,162.

You are required to: (i) Show the adjustments required in the cash book. (ii) Prepare a Bank Reconciliation Statement as on 31st March, 2018.

SOLUTION:**DR.****(I) CASH BOOK (WITH AMENDED BANK COLUMN)****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Dividends collected by bank	62	By Balance b/d	554
To Adjustment of cheque drawn (for ₹ 6 entered as 66)	60	By Bank Charges	136
		By Adjustment repayment entered as a receipt	44
To Adjustment of balance B/F at 1st March, 2018	50	By Adjustment cheque returned uncollected	80
To Balance c/d	642		
	814		814

(II) BANK RECONCILIATION STATEMENT AS AT 31.3.2018

<i>Particulars</i>	Plus items ₹	Minus items ₹
A. Overdraft as per Bank Statement		1,162
B. Less: Cheques issued but not yet presented		267
C. Add: Deposits not yet credited	762	
Cheque debited in error	25	787
	787	1,429
D. Overdraft as per Cash Book		642

PROBLEM 8

According to the Cash-book of Gopi, there was a balance of ₹ 44,500 standing to his credit in bank on 31st March, 2018. On investigation you find that:

- (i) Cheques amounting to ₹ 60,000 issued to creditors have not been presented for payment till that 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 31st March, 2018.
- (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 30th Sept., 2018 paid by the Bank ₹ 2,700 not entered in the Cash-book.
- (v) The payment side of the Cash-book had been undercast by ₹ 50.
- (vi) Bank charges ₹ 50, shown in the Pass-book had not been entered in the Cash-book.
- (vii) A bill payable for ₹ 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.

You are required:

- (i) to make the appropriate adjustments in the Cash-book, and
- (ii) to prepare a statement reconciling it with the Bank Pass-book.

SOLUTION:

DR.

(I) CASH BOOK (WITH AMENDED BANK COLUMN)

CR.

Date	Particulars	₹	Date	Particulars	₹
31.03.2018	To Balance b/d	44,500	31.03.2018	By Insurance Premium A/c	2,700
	To Dividend A/c	4,000		By Error in Casting	50
	To Rent A/c	6,000		By Bank charges	50
	To Bills Receivable A/c	5,900		By Bills Payable	2,000
				By Balance c/d	55,600
		60,400			60,400

(II) BANK RECONCILIATION STATEMENT AS AT 31.03.2018

Particulars	Plus items ₹	Minus items ₹
A. Bank Balance as per amended Cash Book	55,600	
B. Add: Cheques issued but not yet presented	60,000	
C. Less: Cheques deposited but not yet collected		50,000
	1,15,600	50,000
D. Bank Balance as per Pass Book	65,600	

PROBLEM 9

From the following information (as on 31.3.2018), prepare a Bank Reconciliation Statement after making necessary amendments in the Cash-book:

	Amount (₹)
Bank balance as per Cash Book (Dr.)	3,25,000
Cheques deposited, but not yet credited	4,47,500
Cheques issued but, not yet presented for payment	3,56,200
Bank charges debited by Bank but not recorded in Cash-book	1,250
Dividend directly collected by bank	12,500
Insurance premium paid by bank as per standing instruction not intimated	15,900
Cash sales wrongly recorded in the Bank column of the Cash-book	25,500
Customer's cheque dishonoured by bank not recorded in Cash-book	13,000
Wrong Credit given by bank	15,000

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

SOLUTION:

CASH BOOK AS ON 31.3.2018

DR. (AFTER MAKING NECESSARY AMENDMENTS) CR.

Particulars	₹	Particulars	₹
To Balance b/d	3,25,000	By Bank charges	1,250
To Divided	12,500	By Insurance premium	15,900
		By Cash Sales (wrongly recorded)	25,500
		By Debtors (cheque dishonoured)	13,000
		By Balance c/d	2,81,850
	3,37,500		3,37,500

BANK RECONCILIATION STATEMENT AS ON 31.3.2018

Particulars	Plus items ₹	Minus items ₹
A. Bank Balance as per Cash Book	2,81,850	
B. Add: Cheques issued, not yet presented for payment	3,56,200	
Wrong credit given by bank	15,000	
C. Less: Cheques deposited, not yet credited by bank		4,47,500
	6,53,050	4,47,500
D. Balance as per Pass Book	2,05,550	

The bank balance of ₹ 2,81,850 will appear in the trial balance as on 31st March, 2018.

3

VALUATION OF INVENTORY

PROBLEM 1

A company, started on April 1, 2017 purchased raw material during 2017-2018 as stated below:

April 2	800 kg	@ ₹ 62 per kg
May 26	1,200 kg	@ ₹ 57 per kg
July 13	2,500 kg	@ ₹ 59 per kg
Oct. 10	3,000 kg	@ ₹ 56 per kg
Dec. 18	1,500 kg	@ ₹ 60 per kg
Feb. 29	1,000 kg	@ ₹ 65 per kg

While preparing its final accounts on March 31, 2018 the company had 1,300 kg of raw material in its godown.

Calculate the values of closing stock of raw materials according to—

- 'First in First Out' basis,
- 'Last in First Out' basis, and
- 'Weighted Average' basis.

SOLUTION:

VALUATION OF CLOSING STOCK

Particulars	₹
I. On FIFO basis	
1,000 kg @ ₹ 65 per kg	65,000
300 kg @ ₹ 60 per kg	18,000
Value of Closing Stock	83,000
II. On LIFO basis	
800 kg @ ₹ 62 per kg	49,600
500 kg @ ₹ 57 per kg	28,500
Value of Closing Stock	78,100

III. On Weighted Average basis

Weighted Average Cost is computed as under:

Date of Purchase	Price ₹	Quantity	Price × Quantity ₹
Apr. 2, 2017	62	800	49,600
May 26, 2017	57	1,200	68,400
July 13, 2017	59	2,500	1,47,500
Oct. 10, 2017	56	3,000	1,68,000
Dec. 18, 2017	60	1,500	90,000
Feb. 29, 2018	65	1,000	65,000
		10,000	5,88,500

3.2 Quick Revision for Accounting for CA Foundation Course

Weighted Average Price = $5,88,500/10,000 = ₹ 58.85 \text{ Kg}$

Value of Closing Stock, viz., 1,300 Kg = $1,300 \times ₹ 58.85 = ₹ 76,505$

PROBLEM 2

A firm dealing in cloth has 30,000 meters of cloths on 1st April, 2017 valued at ₹ 3,00,000 on LIFO method. It purchased 40,000 metre during the period ending 31st March, 2018 at the rate of ₹ 12 per metre and sold during the same period 60,000 meters @ ₹ 25 per metre. Ascertain the profit of the firm during the period ending on 31st March, 2018, the closing stock to be value on LIFO method. Give workings.

SOLUTION:

TRADING ACCOUNT			
DR.			CR.
Particulars	₹	Particulars	₹
To Opening Stock (30000 × ₹10)	3,00,000	By Sales (60000 × ₹25)	15,00,000
To Purchases (40000 × ₹12)	4,80,000	By Closing Stock (10000 × ₹10)	1,00,000
To Gross Profit	8,20,000	[30000 + 40000 – 60000]	
	16,00,000		16,00,000

PROBLEM 3

In pricing the petrol sold, service station X follows FIFO while service station Y follows LIFO. On April 1st 2018 both had the same quantity of petrol in stock, viz. 8,000 litres at ₹ 25 per litre. During April each station purchased additional supplies of 3,000 litres at ₹ 26 per litre. Sales for each of these stations during the month were 10,000 liters at ₹ 27 per litre. Calculate for each service station the profit earned during the month and the value of petrol in stock at the end of the month.

SOLUTION:

SERVICE STATION X (USING FIFO METHOD)

Particulars	₹
A. Opening Stock 8,000 litres @ ₹ 25	2,00,000
B. Purchases 3,000 litres @ ₹ 26	78,000
C. Less: Value of Closing Stock: [1,000 litres @ ₹ 26]	(26,000)
D. Cost of Sales [A + B – C]	2,52,000
E. Sales 10,000 litres @ ₹ 27	2,70,000
F. Profit during April [E – D]	18,000

SERVICE STATION Y (USING LIFO METHOD)

Particulars	₹
A. Opening Stock 8,000 litres @ ₹ 25	2,00,000
B. Purchases 3,000 litres @ ₹ 26	78,000
C. Less: Value of Closing Stock: [1,000 litres @ ₹ 25]	(25,000)
D. Cost of Sales [A + B – C]	2,53,000
E. Sales: 10,000 litres @ ₹ 27	2,70,000
F. Profit during April [E – D]	17,000

PROBLEM 4

Calculate Cost of Goods Sold, Value of Closing Stock and Profit under LIFO method of stock valuation from the following information:

December 30, 2017 Stock 200 units at ₹ 6 each
 January 16, 2018 Bought 240 units at ₹ 8 each
 February 3, 2018 Bought 220 units at ₹ 10 each
 February 21, 2018 Bought 280 units at ₹ 12 each
 During March, 2018, 800 units were sold at ₹ 16 each

SOLUTION:**STORES LEDGER (ACCORDING TO LIFO METHOD)**

Date	Receipts			Sales			Balance		
	Unit	Cost ₹	Amount ₹	Unit	Cost ₹	Amount ₹	Unit	Cost ₹	Amount ₹
2017									
Dec 30					—		200	6	1,200
2018							200	6	1,200
Jan 16	240	8	1,920		—		240	8	1,920
							200	6	1,200
Feb 3	220	10	2,200				240	8	1,920
							220	10	2,200
Feb 21	280	12	3,360				200	6	1,200
							240	8	1,920
							220	10	2,200
							280	12	3,360
March				280	12	3,360			
				220	10	2,200			
				240	8	1,920			
				60	6	360	140	6	840
			7,480			7,840			

1. Cost of Goods Sold = ₹ 7,840 (i.e. ₹ 3,360 + 2,200 + 1,920 + 360)
2. Stock at the end = ₹ 840
3. Profit = Sales – Cost of Goods Sold
 = (800 × ₹ 16) – (₹ 3,360 + ₹ 2,200 + ₹ 1,920 + ₹ 360) = ₹ 12,800 – ₹ 7,840 = ₹ 4,960

PROBLEM 5

The following are the details of a spare part of Sriram Mills:

01.01.2018	Opening stock	Nil
01.01.2018	Purchases	100 units @ ₹ 30 per unit
15.01.2018	Issued for consumption	50 units
01.02.2018	Purchases	200 units @ ₹ 40 per unit

3.4 Quick Revision for Accounting for CA Foundation Course

15.02.2018	Issued for consumption	100 units
20.02.2018	Issued for consumption	100 units
01.03.2018	Purchases	150 units @ ₹ 50 per unit
15.03.2018	Issued for consumption	100 units

Required: Find out the Value of Stock as on 31.03.2018 if the company follows:

(a) First in First Out basis; (b) Last in First Out basis; (c) Weighted Average basis.

SOLUTION

(A) STOCK LEDGER (ON FIFO BASIS)

Date	Receipts			Sales			Balance		
	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹
01.01.2018	Balance								Nil
01.01.2018	100	30	3,000				100	30	3,000
15.01.2018				50	30	1,500	50	30	1,500
01.02.2018	200	40	8,000				50	30	1,500
							200	40	8,000
15.02.2018				50	30	1,500			
				50	40	2,000	150	40	6,000
20.02.2018				100	40	4,000	50	40	2,000
01.03.2018	150	50	7,500				50	40	2,000
							150	50	7,500
15.03.2018				50	40	2,000			
				50	50	2,500	100	50	5,000

Therefore, the Value of Stock as on 31.3.2018: 100 units @ ₹ 50 = ₹ 5,000.

(B) STOCK LEDGER (ON LIFO BASIS)

Date	Receipts			Sales			Balance		
	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹
01.01.2018	Balance								Nil
01.01.2018	100	30	3,000				100	30	3,000
15.01.2018				50	30	1,500	50	30	1,500
01.02.2018	200	40	8,000				50	30	1,500
							200	40	8,000
15.02.2018				100	40	4,000	50	30	1,500
							100	40	4,000
20.02.2018				100	40	4,000	50	30	1,500
01.03.2018	150	50	7,500				50	30	1,500
							150	50	7,500
15.03.2018				100	50	5,000	50	30	1,500
							50	50	2,500

Therefore, the Value of Stock as on 31.3.2018

$$= [50 \text{ units @ ₹ 30} + 50 \text{ units @ ₹ 50}] = ₹ 4,000$$

(C) STOCK LEDGER (ON WEIGHTED AVERAGE BASIS)

Date	Receipts			Sales			Balance		
	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹
01.01.2018	Balance								Nil
01.01.2018	100	30	3,000				100	30	3,000
15.01.2018				50	30	1,500	50	30	1,500
01.02.2018	200	40	8,000				250	38	9,500
15.02.2018				100	38	3,800	150	38	5,700
20.02.2018				100	38	3,800	50	38	1,900
01.03.2018	150	50	7,500				200	47	9,400
15.03.2018				100	47	4,700	100	47	4,700

Therefore, the Value of Stock as on 31.3.2018

$$= 100 \text{ units @ ₹ 47} = ₹ 4,700.$$

PROBLEM 6

Navkar Ltd. was following LIFO method of valuation of stock. Due to promulgation of revised accounting standard, they want to switch over to FIFO method. From the following information:

- Draw up stock ledgers under FIFO and LIFO methods of valuation of stocks.
- Find out the closing stock and cost of materials consumed under each of the above two methods:

Opening Stock:	5,000 MT @ ₹ 22 per MT ₹ 1,10,000
Purchases:	
1.6.2018	1,000 MT @ ₹ 30 per MT
5.6.2018	2,000 MT @ ₹ 35 per MT
10.6.2018	1,500 MT @ ₹ 38 per MT
15.6.2018	1,500 MT @ ₹ 35 per MT
20.6.2018	2,000 MT @ ₹ 32 per MT
25.6.2018	2,000 MT @ ₹ 35 per MT
30.6.2018	1,500 MT @ ₹ 30 per MT
Issues:	
1–5.6.2018	2,000 MT
6–10.6.2018	3,000 MT
11–20.6.2018	4,000 MT
21–25.6.2018	3,000 MT
26–30.6.2018	3,000 MT

SOLUTION:
STOCK LEDGER (ON FIFO BASIS)

Date	Purchases			Sales			Balance		
	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹	Quantity	Rate ₹	Amount ₹
2018	Op. Bal.					5,000	22	1,10,000	
June 1	1,000	30	30,000				5,000	22	1,10,000
							1,000	30	30,000
June 1-5				2,000	22	44,000	3,000	22	66,000
							1,000	30	30,000
June 5	2,000	35	70,000				3,000	22	66,000
							1,000	30	30,000
							2,000	35	70,000
June 6-10				3,000	22	66,000	1,000	30	30,000
							2,000	35	70,000
June 10	1,500	38	57,000				1,000	30	30,000
							2,000	35	70,000
							1,500	38	57,000
June 15	1,500	35	52,500				1,000	30	30,000
							2,000	35	70,000
							1,500	38	57,000
							1,500	35	52,500
June 11-20				1,000	30	30,000			
				2,000	35	70,000			
				1,000	38	38,000	500	38	19,000
							1,500	35	52,500
June 20	2000	32	64,000				500	38	19,000
							1,500	35	52,500
							2,000	32	64,000
June 21-25				500	38	19,000			
				1,500	35	52,500			
				1,000	32	32,000	1,000	32	32,000
June 25	2,000	35	70,000				1,000	32	32,000
							2,000	35	70,000
June 26-30				1,000	32	32,000			
				2,000	35	70,000	—	—	—
June 30	1500	30	45,000				1,500	30	45,000
Total			3,88,500			4,53,500			

Particulars	FIFO	LIFO
Closing Stock	₹ 45,000	₹ 45,000
Cost of Materials Consumed	₹ 4,53,500	₹ 4,53,500

Assumption: In case of purchases and issues of goods on the same day, it has been assumed that the issues were made before making purchases.

PROBLEM 7

From the following data, find out value of inventory as on 30th April using (a) LIFO method, and (b) Weighted Average Method:

1. 1st April Purchased	10 units @ ₹.70 per unit
2. 6th April Sold	5 units @ ₹.90 per unit
3. 9th April Purchased	20 units @ ₹.75 per unit
4. 18th April Sold	14 units @ ₹.100 per unit

SOLUTION:

(A) VALUATION OF CLOSING INVENTORY BY LIFO METHOD

Date	Receipts			Issue			Balance		
	Unit	Cost/unit	Amount	Unit	Cost/unit	Amount	Unit	Cost/unit	Amount
Apr. 1	10	70	700				10	70	700
Apr. 6				5	70	350	5	70	350
Apr. 9	20	75	1500				5	70	350
							20	75	1500
Apr. 18				14	75	1,050	5	70	350
							6	75	450

Value of Closing Inventory as per LIFO Method = (4 units × ₹ 70) + (6 units × ₹ 75) = ₹ 730

(B) VALUATION OF CLOSING INVENTORY BY WEIGHTED AVERAGE METHOD

Date	Receipts			Issue			Balance		
	Unit	Cost/unit	Amount	Unit	Cost/unit	Amount	Unit	Cost/unit	Amount
Apr. 1	10	70	700				10	70	700
Apr. 6				5	70	350	5	70	350
Apr. 9	20	75	1500				25	74	1850
Apr. 18				14	74	1,036	11	74	814

Value of Closing Inventory as per WEIGHTED AVERAGE Method: = ₹ 814

PROBLEM 8

HP is a leading distributor of petrol. A detail inventory of petrol in hand is taken when the books are closed at the end of each month. At the end of month following information is available:

Sales: ₹ 47,25,000
 General overheads cost ₹ 1,25,000
 Inventory at beginning 1,00,000 litres @ ₹ 15 per litre

Purchases:

June 1 two lakh litres @ ₹ 14.25

June 30 one lakh litres @ ₹ 15.15

Closing inventory 1.30 lakh litres

Compute the following by the FIFO as per AS 2:

- (i) Value of Inventory on June, 30.
- (ii) Amount of cost of goods sold for June.
- (iii) Profit/Loss for the month of June.

SOLUTION

(i)	Cost of closing inventory for 1,30,000 litres as on 30th June	₹
	1,00,000 litres @ ₹ 15.15	15,15,000
	30,000 litres @ ₹ 14.25	4,27,500
	Total	19,42,500
(ii)	Calculation of Cost of Goods Sold	₹
	Opening inventories (1,00,000 litres @ ₹ 15)	15,00,000
	Purchases: June-1 (2,00,000 litres @ ₹ 14.25)	28,50,000
	June-30 (1,00,000 litres @ ₹ 15.15)	15,15,000
		58,65,000
	Less: Closing inventories	19,42,500
	Cost of goods sold	39,22,000
(iii)	Profit = ₹ 47,25,000 – (₹ 39,22,500 + ₹ 1,25,000) = ₹ 6,77,500	

PROBLEM 9

Unsold units with Agent	1,000
Cost per unit	₹ 10
Estimated Selling Price per unit as at Balance Sheet Date	₹ 8
Agent's Commission on Sales	5 %
What should be the Value of Closing Stock?	

SOLUTION:

I. Cost of Closing Stock (1,000 × ₹ 10)	₹ 10,000
II. Net Realizable Value	
A. Total Realizable Value (1,000 × ₹ 8)	₹ 8,000
B. Less: Realizable Expenses (here agent's commission is realizable expense) (₹ 8,000 × 5/100)	₹ 400
C. Net Realizable Value (A – B)	₹ 7,600
III. Valuation since out of cost (which is ₹ 10,000 as calculated above) and NRV (which is ₹ 7,600), NRV is lower, the said unsold stock should be valued at ₹ 7,600.	

PROBLEM 10

Best Ltd. deals in five products, P, Q, R, S, and T which are neither similar nor interchangeable. At the time of closing of its accounts for the year ending 31st March 2018, the historical cost and net realizable value of the items of the dosing stock are determined as follows:

Items	Historical Cost ₹	Net Realizable Value ₹
P	5,70,000	4,75,000
Q	9,80,000	10,32,000
R	3,16,000	2,89,000
S	4,25,000	4,25,000
T	1,60,000	2,15,000

What will be the value of closing stock as at 31st March 2018 as per AS 2 "Valuation of Inventories"?

SOLUTION:

As per para 5 of AS 2 "Valuation of Inventories, inventories should be valued at the lower of cost and net realizable value. Inventories should be written down to net realizable value on an item-by-item basis.

VALUATION OF INVENTORY (ITEM WISE) AS AT 31ST MARCH 2018

Item	Historical Cost ₹	Net realizable value ₹	Valuation of closing stock ₹
P	5,70,000	4,75,000	4,75,000
Q	9,80,000	10,32,000	9,80,000
R	3,16,000	2,89,000	2,89,000
S	4,25,000	4,25,000	4,25,000
T	1,60,000	2,15,000	1,60,000
			23,29,000

The value of inventory as at 31st March 2018 = ₹ 23,29,000.

PROBLEM 11

X who was closing his books on 31.3.2018 failed to take the actual Stock which he did only on 9th April, when it was ascertained by him to be worth ₹ 25,000.

It was found that sales are entered in the sales book on the same day of despatch and return inwards in the returns book as and when the goods are received back. Purchases are entered in the purchases day book once the invoices are received.

It was found that sales between 31st March and 9th April as per the sales day book are ₹ 1,720. Purchases between 31st March and 9th April as per purchases day book are ₹ 120, out of these goods amounting to ₹ 50 were not received until after the stock was taken.

Goods invoiced during the month of March, but goods received only on 4th April, amounted to ₹ 100. Rate of gross profit is 33-1/3% on cost.

Required: Ascertain the value of physical stock as on 31.3.2018.

[CA (Foundation)]

SOLUTION:
STATEMENT OF VALUATION OF PHYSICAL STOCK AS ON 31ST MARCH, 2018

<i>Particulars</i>		₹
A	Value of Stock as on 9th April	25,000
B	Add: Cost of Sales during the intervening period [$₹ 1,720 \times 25\%$]	1,290
C	Less: Purchases actually received during the intervening period [$₹ 120 - ₹ 50$]	70
D	Less: Purchases during March received on 4th April	100
E	Value of Physical Stock as on 31st March (A + B – C – D)	26,120

PROBLEM 12

Mr Vijay's financial year ends on 31st March 2018, but actual stock is not taken until the following 8th April when it is ascertained at ₹ 7,425.

You find that:

- Sales are entered in the sales book on the same day as despatched and returns inward in the return inward book the day the goods are received back.
- Purchases are entered in the purchases day book as the invoices are received.
- Sales between 31st March and 8th April as per the sales day book and cash book are ₹ 8,600.
- Purchases between 31st March and 8th April as per the purchases day book are ₹ 660 but, of these goods amounting to ₹ 60 are not received until after the stock was taken.
- Goods invoiced during the March (before 30th March) but not received until after 30th March amounted to ₹ 500 of which ₹ 350 worth are received between 31st March and 8th April.
- Rate of Gross Profit is $33\frac{1}{3}\%$ on cost.

Ascertain the value of Stock on 31st March, 2018

SOLUTION:
STATEMENT SHOWING COMPUTATION OF STOCK AS ON 31ST MARCH, 2018

<i>Particulars</i>		₹
A	Stock as on 8th April	7,425
B	Add: Cost of goods sold after 31, March [75% of ₹ 8,600]	6,450
C	Less: Cost of goods purchased & received after 31st March [$₹ 660 - ₹ 60$]	600
D	Add: Purchases invoiced before 31st March, not received upto 8th April ($₹ 500 - ₹ 350$)	150
E	Stock as on 31st March	13,425

PROBLEM 13

Ratan closes financial books on 31st March every year. Stock-taking continues one week after this date. In 2018 the value of closing stock came to ₹ 37,400 without making the following adjustments:

- Goods purchased are recorded in the books as on the date of invoice.
- Purchase invoice was received on 28th March for ₹ 10,000 but goods against this invoice were received on 24th March.
- Purchase invoice was received on 29th March for ₹ 1,000 but goods against this were not received until the stock-taking was completed.

- (d) Goods worth ₹ 1,400 were received on 31st March, the invoice of which was received on 3rd April.
- (e) Purchase invoice of ₹ 500 was received on 5th April, the goods against which were not received until the stock-taking was completed.
- (f) Purchase invoice of ₹ 500 was received on 6th April but goods of only ₹ 160 could be received up to the time of stock-taking.

Required: Calculate the value of stock as on March 31, 2018.

SOLUTION:

STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH. 2018

<i>Particulars</i>		₹
A.	Physical Stock as at 7th April	37,400
B.	Add: Purchases of year ending 31st March	1,000
C.	Less: Purchases of Next Year	(1,400)
D.	Less: Purchases of New Year	(160)
E.	Value of Stock as per Books as at 31st March	36,840

PROBLEM 14

Determine the value of stock to be taken for Balance Sheet as on 31st March, 2018 from the following information:

The stock was physically verified on 23rd March, and was valued at ₹ 6,00,000. Between 23rd March, and 31st March, the following transactions had taken place:

- (a) Purchases ₹ 50,000, of this, goods worth ₹ 20,000 were delivered on 5th April.
- (b) Out of goods sent on consignment, goods worth ₹ 30,000 (at cost) were unsold.
- (c) Sales were ₹ 1,70,000. These includes goods worth ₹ 40,000 sent on approval. Half of these were returned before 31st March, as regards remaining, no information is received. Option period is 2 weeks.
- (d) Normally firm sells goods on cost + 25%. However, one lot of goods costing ₹ 30,000 was sold for ₹ 15,000.

SOLUTION:

STATEMENT SHOWING THE VALUATION OF STOCK AS ON 31ST MARCH, 2018

<i>Particulars</i>		₹
A	Physical Stock as on 23rd March	6,00,000
B	Add: (a) Cost of Goods purchased after stock taking till 31st March	
	Goods received	30,000
	Goods in transit	20,000
	(b) Cost of Stock on Consignment	30,000
C	Less: Cost of Goods sold after stock taking till 31st March	
	(a) Cost of Normal Sales (80% of ₹ 1,15,000)	92,000
	(b) Cost of Abnormal Sales	30,000
D	Stock as on 31st March (A + B – C)	5,58,000

Working Note: Calculation of Normal Sales

	₹
A Actual Sales (given)	1,70,000
B Less (a) Sale of Abnormal Items	15,000
(b) Goods sent on approval basis	40,000
C Normal Sales (A – B)	<u>1,15,000</u>

Note: Since the stock given on 23rd March already includes the cost of goods sent on approval basis, no adjustment is required in this respect. It is assumed that Goods are being sold after 23rd March.

PROBLEM 15

Following informations are available from the books of accounts of AB and Co. for the year 2017-2018:

Purchases during the year	28,200
Stock on 1-4-2017	5,960
Sales during the year	31,610

At the time of valuation of stock for 2016-2017, a part of the stock costing ₹ 1,800 was recorded in the books for ₹ 1,560; one-third of these goods were sold during the year for ₹ 610.

Required: Find out the value of the stock as on 31st March 2018 assuming that firm makes 25% profit on cost. [C.A.]

SOLUTION:
STATEMENT SHOWING THE VALUE OF STOCK AS ON 31ST MARCH 2018

Particulars	Normal Item ₹	Abnormal Item ₹	Total ₹
A Opening Stock	4,400	1,560	5,960
B Purchases	28,200	—	28,200
C Cost of goods available for sale (A + B)	32,600	1,560	34,160
D Less: Cost of goods sold:	24,800	520	25,320
Normal [80% of ₹ 31,610 - ₹ 610]			
Abnormal [1/3 of ₹ 1,560]			
E Value of Closing Stock	7,800	1,040	8,840

Thus, Book value of Closing Stock ₹ 8,840.

PROBLEM 16

From the following information, ascertain the value of stock as on 31.3.2018:

	₹
Value of Stock on 1.4.2017	70,000
Purchases during the period from 1.4.2017 to 31.3.2018	3,46,000
Manufacturing expenses during the above period	70,000
Sales during the same period	5,22,000

At the time of valuing stock on 31.3.2017, a sum of ₹ 6,000 was written off a particular item which was originally purchased for ₹ 20,000 and was sold for ₹ 16,000. But for the other transactions the gross profit earned during the year was 25% on cost. [CA (Foundation)]

SOLUTION:**STATEMENT SHOWING THE VALUATION OF CLOSING STOCK AS AT 31ST MARCH, 2018**

<i>Particulars</i>		₹
A	Normal Sales [₹ 5,22,000 – ₹ 16,000]	5,06,000
B	Less: Gross Profit @ 20% on Sales	1,01,200
C	Cost of Goods sold	4,04,800
D	Less: Opening Stock of Normal Goods [₹ 70,000 – ₹ 14,000]	56,000
	Purchases	3,46,000
	Manufacturing Expenses	70,000
E	Value of Stock as on 31.3.2018	67,200

PROBLEM 17

From the following information ascertain the value of stock as on 31st March, 2018 and also the profit for the year:

Stock as on 1.4.2017	₹ 14,250	Administrative Expenses	₹ 3,000
Purchases	₹ 76,250	Financial Charges	₹ 2,150
Manufacturing Expenses	₹ 15,000	Sales	₹ 1,24,500
Selling Expenses	₹ 6,050		

At the time of valuing stock as on 31st March, 2017, a sum of ₹ 1,750 was written off on a particular item, which was originally purchased for ₹ 5,000 and was sold during the year at ₹ 4,500. Barring the transaction relating to this item, the gross profit earned during the year was 20 percent on sales.

SOLUTION:**STATEMENT OF VALUATION OF STOCK AS ON 31ST MARCH, 2018**

<i>Particulars</i>		₹	₹
A..	Stock as on 1st April, 2017	14,250	
B.	Less: Book value of abnormal stock (₹ 5,000 – 1,750)	3,250	11,000
C.	Add: Purchases		76,250
	Manufacturing Expenses		15,000
			1,02,250
D	Less: Cost of Normal Sales:[80% (1,24,500 - 4,500)]		96,000
E	Stock as on 31st March, 2018		6,250

STATEMENT SHOWING NET PROFIT FOR THE YEAR

<i>Particulars</i>		₹	₹
A.	Gross Profit on Normal Sales		24,000
B.	Add: Profit on abnormal item[4,500 - 3,250]		1,250
C.	Less: Overhead Expenses:		
	Selling Expenses	6,050	
	Administrative Expenses	3,000	
	Financial Charges	2,150	11,200
D.	Net Profit		14,050

PROBLEM 18

The Profit and Loss Account of Hanuman showed a net profit of ₹ 60,000, after considering the closing stock of ₹ 37,500 on 31st March, 2018. Subsequently the following information was obtained from scrutiny of the books:

- (i) Purchases for the year included ₹ 1,500 paid for new electric fittings for the shop.
- (ii) Hanuman gave away goods valued at ₹ 4,000 as free samples for which no entry was made in the books of accounts.
- (iii) Invoices for goods amounting to ₹ 25,000 have been entered on 27th March, but the goods were not included in stock.
- (iv) In March, goods of ₹ 20,000 sold and delivered were taken in the Sales for April, 2018.
- (v) Goods costing ₹ 7,500 were sent on sale or return in March, 2018 at a margin of profit of $33\frac{1}{3}\%$ on cost. Though approval was given in April, these were taken as sales for March.

Required: Calculate the value of stock on 31st March, 2018 and the Adjusted Net Profit for the year ended on that date. [CA (Foundation)]

SOLUTION:
STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH, 2018

Particulars	₹
A Stock as already stated	37,500
B Add: Purchases not included	25,000
C Add: Cost of Goods sent on approval	7,500
D Stock as on 31st March 2018	70,000

DR. PROFIT & LOSS ADJUSTMENT ACCOUNT CR.

Particulars	₹	Particulars	₹
To Customer's A/c (Selling Price of Goods sent on approval)	10,000	By Profit as per P & L A/c	60,000
To Net Profit for the year	1,04,000	By Fixtures & Fittings A/c	1,500
		By Closing Stock (in transit) A/c	25,000
		By Customer's A/c	20,000
		By Closing Stock with customer (on approval)	7,500
	1,14,000		1,14,000

Note: Since the rectifying entry in case of free samples involves both the revenue accounts (i.e. Advertisement A/c and Purchases A/c). Profit & Loss Adjustment A/c is to be debited as well as credited and hence not shown in the above account.

PROBLEM 19

The Profit and Loss Account of Cardamom for the year ended 31st March, 2018 showed a net profit of ₹ 2,800 after taking into account the closing stock of ₹ 4,720.

On a scrutiny of the books the following information could be obtained:

- (a) Cardamom has taken goods valued ₹ 1,500 for his personal use without making entry in the books.

- (b) Purchases of the year included ₹ 600 spent on acquisition of a ceiling fan for his shop.
- (c) Invoices for goods amounting to ₹ 4,000 have been entered on 29th March, but such goods were not included in stock.
- (d) ₹ 500 have been included in closing stock in respect of goods purchased and invoiced on 28th March, but included in purchase for April 2018.
- (e) Sale of goods amounting to ₹ 610 sold and delivered in March, had been entered in April sales.

Required: Ascertain the correct amount of closing stock as on 31st March, 2018 and the adjusted net profit for the year ended on that date.

SOLUTION:

STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH 2018

<i>Particulars</i>		₹
A.	Stock as already stated	₹ 4,720
B.	Add: Purchases not included	₹ 4,000
C.	Stock as on 31st March	₹ 8,720

DR.

PROFIT AND LOSS ADJUSTMENT ACCOUNT

CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Suppliers A/c	500	By Profit as per P&L A/c	2,800
To Net Profit for the year	9,010	By Drawings A/c (Goods taken for domestic use)	1,500
		By Fixture and Fittings A/c (Ceiling fan) (b)	600
		By Closing Stock A/c (In transit)	4,000
		By Customer's A/c (e)	610
	9,510		9,510

PROBLEM 20

FY Ltd. conducts physical stock taking every year at the end of the accounting year. Due to certain difficulties, it was not possible for it to conduct physical stock taking at the end of the accounting year ending on 31 March, 2018. Physical stock was taken on 7th April when it was valued at ₹ 34,500.

The following transactions took place during 1st April to 7th April.

- (a) Sales during the period were ₹ 9,340. These goods were sold at the usual rate of gross profit 25% on cost except goods which realised ₹ 840 on the basis of 20% profit on cost.
- (b) Purchases during the period were ₹ 7,500, of which ₹ 800 worth of goods were delivered to the company on 10th April.
- (c) Sales returns during the period were ₹ 1,500, of which 50% were out of the sales at 20% gross profit mentioned above.
- (d) On 5th April, goods worth ₹ 4,000 were received, which were to be sold on consignment basis.

Required: Prepare a statement showing clearly the value of the stock to be taken into account in FY Ltd.'s final accounts for the year ended 31st March, 2018.

SOLUTION:**STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH 2018**

<i>Particulars</i>		₹
A.	Physical Stock as at 7th April	34,500
B.	Add: Cost of Sales after 31st March (₹ 6,800 + ₹ 700)	7,500
C.	Less: Cost of goods purchased & received after 31st March (₹ 7,500 – ₹ 800)	(6,700)
D.	Less: Cost of Sales returns after 31st March (₹ 600 + ₹ 625)	(1,225)
E.	Less: Consignment Stock	(4,000)
F.	Value of Stock as at 31st March	30,075

PROBLEM 21

SG Ltd. closes its books on 31st March each year. In the beginning of March 2018 because of a proposal for sale of business (which later fell through), the firm carried out stock taking on 10th March. The figure of stock was established as ₹ 62,500 (cost) as on that date. The firm decided not to carry out any stock taking on 31st March, 2018. From the information given below, arrive at the stock as on that date:

- Sales from 11th March to 31st March totalled ₹ 43,200 including ₹ 3,000 sale of goods which had cost ₹ 3,600. The firm's mark up on cost is 25%.
- Purchases during the same period totalled ₹ 29,200.
- Sales returns and purchase returns were respectively ₹ 2,200 and ₹ 1,200 in this period.
- Goods with customers on sale or return basis were ₹ 10,000 (proforma invoice value). The goods had been sent on 9th March the customers had the right of returning the goods within four weeks but it was known that one customer who had goods worth ₹ 4,000 had pledged them with a bank.

SOLUTION:**STATEMENT SHOWING THE VALUATION OF STOCK AS AT 31ST MARCH 2018**

<i>Particulars</i>		₹
A.	Physical Stock as at 10th March	62,500
B.	Less: Cost of Sales (₹ 32,160 + ₹ 3,600)	(35,600)
C.	Add: Cost of Purchases	29,200
D.	Add: Cost of Sales Returns (80% of ₹ 2,200)	1,760
E.	Less: Cost of Purchase Returns	(1,200)
F.	Add: Cost of goods sent on approval [(80% of (10,000 – 4,000))]	4,800
		61,300

Note: Pledge of goods amounts to acceptance of goods.

4

ACCOUNTING FOR DEPRECIATION

PROBLEM 1

Ram Ltd which depreciates its machinery at 10% p.a. on Diminishing Balance Method, had on January 1, 2018 ₹ 9,72,000 on the debit side of Machinery Account. During the year 2018, machinery purchased on January 1, 2016 for ₹ 80,000 was sold for ₹ 45,000 on July 1, 2018 and a new machinery at a cost of ₹ 1,50,000 was purchased and installed on the same date, installation charges being ₹ 8,000. The company wanted to change the method of depreciation from Diminishing Balance Method to Straight Line Method with effect from January 1, 2016. Difference of depreciation upto December 31, 2018 to be adjusted. The rate of depreciation remains the same as before.

Required: Show Machinery Account.

SOLUTION:

Dr.

MACHINERY ACCOUNT FOR THE YEAR 2018

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.2018	To Balance b/d	9,72,000	01.07.2018	By Bank A/c (Sale)	45,000
01.07.2018	To Bank A/c	1,50,000	01.07.2018	By Depreciation A/c	4,000
	To Bank A/c	8,000	31.12.2018	By P & L A/c (Loss on sale)	15,000
			31.12.2018	By P & L A/c (A/D)	12,000
			31.12.2018	By Depreciation A/c	1,19,900
				By Balance C/d	9,34,100
		11,30,000			11,30,000

Working Notes:

1. CALCULATION OF W.D.V. AS ON 01.01.2016

Particulars	₹
A. W.D.V. as on 1.1.2018	9,72,000
B. Add: Depreciation during 2017 ($₹ 9,72,000 \times 1/9$)	1,08,000
C. W.D.V. as on 1.1.2017	10,80,000
D. Add: Depreciation during 2016 ($₹ 10,80,000 \times 1/9$)	1,20,000
E. W.D.V. as on 1.1.2016	12,00,000

2. CALCULATION OF LOSS ON SALE OF MACHINERY

Particulars	₹
A. Original Cost as on 1.1.2016	80,000
B. Less: Depreciation @ 10% for $2\frac{1}{2}$ years	20,000
C. Book Value as on 1.7.2018	60,000
D. Sale Proceeds	45,000
E. Loss on sale	15,000

3. CALCULATION OF DEPRECIATION FOR 2018

(a) On Machines (Other than sold one) existing as on 1.1.2018 @ 10% on (₹ 12,00,000 – ₹ 80,000)	₹ 1,12,000
(b) On Machine Purchased on 1.7.2018 (10% on ₹ 1,58,000 for 6 months)	₹ 7,900
	₹ 1,19,900

4. CALCULATION OF DIFFERENCE IN THE AMOUNT OF DEPRECIATION UNDER OLD METHOD AND NEW METHOD ON THE MACHINERIES

A. Depreciation on SLM basis for 2 years [₹ 12,00,000 × 10% × 2]	₹ 2,40,000
B. Depreciation on W.D.V. basis for 2 years	
for 2016 on	₹ 12,00,000 ₹ 1,20,000
for 2017 on	₹ 10,80,000 ₹ 1,08,000
C. Difference still to be adjusted (A – B)	₹ 12,000

PROBLEM 2

Green Channel Co. purchased a second-hand machine on 1st January, 2015 for ₹ 1,60,000. Overhauling and erection charges amounted to ₹ 40,000. Another machine was purchased for ₹ 80,000 on 1st July, 2015.

On 1st July, 2017, the machine installed on 1st January, 2015 was sold for ₹ 1,00,000. On the same date another machine was purchased for ₹ 30,000 and was installed on 30th September, 2017.

Under the existing practice the company provides depreciation @ 10% p.a. on original cost. However, from the year 2018 it decided to adopt WDV method and to charge depreciation @ 15% p.a. This change was to be made with retrospective effect.

Prepare Machinery Account in the book of Green Channel Co. for the year 2015 to 2018.

SOLUTION:

Dr.

MACHINERY ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.2015	To Bank A/c	1,60,000	31.12.2015	By Depreciation A/c	24,000
01.01.2015	To Bank A/c	40,000		(₹ 20,000 + ₹ 4,000)	
	(Erection charges)				
01.07.2015	To Bank A/c	80,000	31.12.2015	By Balance c/d (₹.	2,56,000
				1,80,000 + ₹ 76,000)	
		2,80,000			2,80,000
01.01.2016	To Balance b/d	2,56,000	31.12.2016	By Depreciation A/c	28,000
				(₹ 20,000 + ₹ 8,000)	
			31.12.2016	By Balance c/d (₹	2,28,000
				1,60,000 + ₹ 68,000)	
		2,56,000			2,56,000
01.01.2017	To Balance b/d	2,28,000	01.07.2017	By Bank A/c	1,00,000
30.09.2017	To Bank A/c	30,000		By Profit and Loss A/c	50,000
				(Loss on Sale)	
			31.12.2017	By Depreciation A/c	18,750
				(₹ 10,000 + ₹ 8,000 + ₹	
				750)	
				By Balance c/d	89,250
				(₹ 60,000 + ₹ 29,250)	
		2,58,000			2,58,000

01.01.2018	To Balance b/d	89,250	31.12.2018	By Profit and Loss A/c	6,910
				By Depreciation A/c (₹ 8,019.75 + ₹ 4,331.25)	12,351
				By Balance c/d (₹ 45,445.25 + ₹ 24,543.75)	69,989
		89,250			89,250

Working Notes:**1. CALCULATION OF SLM DEPRECIATION AND LOSS ON SALE OF MACHINE**

<i>Particulars</i>	<i>Machine I</i> ₹	<i>Machine II</i> ₹	<i>Machine III</i> ₹
A. Cost	2,00,000	80,000	30,000
B. Depreciation for 2015	20,000	4,000	
C. Written down value as on 31.12.2015	1,80,000	76,000	
D. Depreciation for 2016	20,000	8,000	
E. Written down value as on 31.12.2016	1,60,000	68,000	
F. Depreciation for 2017	10,000	8,000	750
G. Written down value as on 31.12.2017	1,50,000	60,000	29,250
H. Sale Proceeds	1,00,000		
I. Loss on sale	50,000		

2. CALCULATION OF DEPRECIATION OF MACHINES UNDER WDV METHOD

<i>Particulars</i>	<i>Machine II</i> ₹	<i>Machine III</i> ₹
Cost	80,000	30,000
Depreciation		
2015	6,000	
2016	11,100	
2017	9,435	1,125
Total depreciation	26,535	1,125

3. RETROSPECTIVE EFFECT OF CHANGE IN DEP. METHOD FOR MACHINES II & III

<i>Particulars</i>	₹
A. Depreciation under WDV (₹ 26,535 + ₹ 1,125)	27,660
B. Depreciation under SLM (₹ 20,000 + ₹ 750)	20,750
C. Short depreciation to be charged to Profit & Loss A/c	6,910

PROBLEM 3

X Ltd. purchased on 1st January, 2015 certain machinery for ₹ 1,94,000 and spent ₹ 6,000 on its erection. On 1st July, 2015 additional machinery costing ₹ 1,00,000 was purchased. On 1st July, 2017 the machinery purchased on 1st January, 2015 having become obsolete was auctioned for ₹ 1,00,000 and on the same date, new machinery was purchased at a cost of ₹ 1,50,000. Depreciation was provided for annually on 31st December at the rate of 10% per annum on the original cost of the machinery. No depreciation need be provided when a machinery is sold or auctioned, for that

part of the year in which sale or auction took place. In 2018 however, X Ltd. changed this method of providing depreciation and adopted the method of writing off 15% p.a. on the written down value on the balance as appeared in machinery account on 1-1-2018.

Required: Show the machinery account for the calendar years 2015 to 2018.

SOLUTION:

Dr.			MACHINERY ACCOUNT			Cr.		
<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>			
01.01.2015	To Bank A/c: Machine I	1,94,000	31.12.2015	By Depreciation A/c:				
01.01.2015	To Bank A/c (expenses)	6,000		on Machine I 20,000				
				on Machine II 5,000		25,000		
01.07.2015	To Bank A/c: Machine II	1,00,000	31.12.2015	By Balance c/d:				
				Machine I 1,80,000				
				Machine II 95,000		2,75,000		
		3,00,000						3,00,000
01.01.2016	To Balance b/d:		31.12.2016	By Depreciation A/c:				
	Machine I 1,80,000			on Machine I 20,000				
	Machine II 95,000	2,75,000		on Machine II 10,000		30,000		
			31.12.2016	By Balance c/d:				
				Machine I 1,60,000				
				Machine II 85,000		2,45,000		
		2,75,000						2,75,000
01.01.2017	To Balance b/d:		01.07.2017	By Bank A/c				1,00,000
	Machine I 1,60,000		01.07.2017	By Profit & Loss A/c				60,000
	Machine II 85,000	2,45,000		[1,60,000 – 1,00,000]				
01.07.2017	To Bank A/c (Machine III)	1,50,000	31.12.2017	By Depreciation A/c:				
				on Machine II 10,000				
				on Machine III 7,500		17,500		
				By Balance c/d:				
				Machine II 75,000				
				Machine III 1,42,500		2,17,500		
		3,95,000						3,95,000
01.01.2018	To Balance b/d:		31.12.2018	By Profit & Loss A/c				11,919
	Machine II 75,000		31.12.2018	By Depreciation A/c				
	Machine III 1,42,500	2,17,500		on Machine II 10,024				
				on Machine III 20,812		30,836		
			31.12.2018	By Balance c/d:				
				Machine II 56,807				
				Machine III 1,17,938		1,74,745		
		2,17,500						2,17,500

Working Note:**CALCULATION OF EXCESS/SHORT DEPRECIATION ON MACHINE II & III**

<i>Particulars</i>	<i>Machine II</i>	<i>Machine III</i>	<i>Total</i>
A. Depreciation on SLM Basis @ 10%			
1,00,000 × 10/100 × 2.5	25,000		25,000
1,50,000 × 10/100 × 0.5		7,500	7,500
	25,000	7,500	32,500
B. Depreciation on WDV basis @15%			
for 2015	7,500	–	7,500
for 2016	13,875	–	13,875
for 2017	11,794	11,250	23,044
	33,169	11,250	44,419
C. Short Depreciation still to be adjusted [A – B]			11,919

PROBLEM 4

X Ltd. purchased on January 1, 2014 a second hand plant for ₹ 60,000 and immediately spent ₹ 40,000 in putting the same in working condition. On July 1, 2014 additional machinery costing ₹ 40,000 was purchased. On January 1, 2016 the plant purchased on January 1, 2014 became obsolete and was sold for ₹ 50,000. On July 1, 2016 new machinery was purchased at a cost of ₹ 1,20,000. The firm provided depreciation on straight line method at 10% per annum on the original cost of the asset. In 2018, the company decided to provide depreciation on written down value basis at 15% p.a. Show Machinery Account for the calendar years 2014 to 2018.

SOLUTION:**Dr.****PLANT AND MACHINERY ACCOUNT****Cr.**

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
01.01.2014	To Bank A/c (Cost)	60,000	31.12.2014	By Depreciation A/c:	
01.01.2014	To Bank A/c (Overhaul)	40,000		Machine I 10,000	
				Machine II 2,000	12,000
01.07.2014	To Bank A/c (Machine II)	40,000		By Balance c/d:	
				Machine I 90,000	
				Machine II 38,000	1,28,000
		1,40,000			1,40,000
01.01.2015	To Balance b/d:		31.12.2015	By Depreciation A/c:	
	Machine I 90,000			Machine I 10,000	
	Machine II 38,000	1,28,000		Machine II 4,000	14,000
				By Balance c/d:	
				Machine I 80,000	
				Machine II 34,000	1,14,000
		1,28,000			1,28,000
01.01.2016	To Balance b/d:		01.01.2016	By Bank A/c (Sale Proceeds)	50,000
	Machine I 80,000				
	Machine II 34,000	1,14,000		By P & L A/c (Loss on Sale) [₹ 80,000 – ₹ 50,000]	30,000
01.07.2016	To Bank A/c (Machine III)	1,20,000			

			31.12.2016	By Depreciation A/c: Machine II 4,000 Machine III 6,000 By Balance c/d: Machine II 30,000 Machine III 1,14,000	10,000 1,44,000
		2,34,000			2,34,000
01.01.2017	To Balance b/d: Machine II 30,000 Machine III 1,14,000	1,44,000	31.12.2017	By Depreciation A/c: Machine II 4,000 Machine III 12,000 By Balance c/d: Machine II 26,000 Machine III 1,02,000	16,000 1,28,000
		1,44,000			1,44,000
01.01.2018	To Balance b/d: Machine II 26,000 Machine III 1,02,000	1,28,000	31.12.2018 31.12.2018	By Profit & Loss A/c [Short Depreciation] By Depreciation A/c: Machine II 3,408 Machine III 14,153 By Balance c/d: Machine II 19,314 Machine III 80,197	10,928 17,561 99,511
		1,28,000			1,28,000

Working Notes:
1. CALCULATION OF EXCESS/SHORT DEPRECIATION ON MACHINE II AND III

Particulars	Machine II	Machine III	Total
A Depreciation on SLM basis @ 10% p.a.			
40,000 × 10/100 × 3.5	14,000	—	14,000
1,20,000 × 10/100 × 1.5		18,000	18,000
	14,000	18,000	32,000
B Depreciation on WDV basis @ 15% p.a.			
for 2014	3,000	—	3,000
for 2015	5,550	—	5,550
for 2016	4,718	9,000	13,718
for 2017	4,010	16,650	20,660
	17,278	25,650	42,928
C Short Depreciation still to be adjusted (A – B)			10,928

2. CALCULATION OF DEPRECIATION ON MACHINE II AND III FOR CURRENT YEAR

Particulars	Machine II	Machine III
A Cost	40,000	1,20,000
B Less: Depreciation [as per WN (i)]	17,278	25,650
C WDV on 1.1.2018	22,722	94,350
D Less: Depreciation for 2018 @ 15% p.a.	3,408	14,153
E WDV as on 31.2015.2018	19,314	80,197

PROBLEM 5

Hanuman Enterprises purchased on 1.4.2015 certain machinery for ₹ 72,800 and paid ₹ 2,200 on its installation. On 1.10.2015 another machinery for ₹ 25,000 was acquired. On 1.4.2016, the first machinery was sold at ₹ 50,000 and on the same date a fresh machinery was purchased at a cost of ₹ 45,000. Depreciation was annually provided on 31st March at 10% p.a. on written down value. On 1.4.2017, however, the firm decided to change the method of providing depreciation and adopted the method of providing depreciation @ 10% p.a. on the original cost, with retrospective effect.

Required: Ascertain the value of machinery as on 31.3.2018.

SOLUTION:

Dr. **MACHINERY ACCOUNT** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
01.04.2015	To Bank A/c: Machine I	72,800	31.03.2016	By Depreciation A/c:	
	To Bank A/c (Installation Charges)	2,200		Machine I 7,500	
01.10.2015	To Bank A/c (Machine II)	25,000		Machine II 1,250	8,750
				By Balance c/d:	
				Machine I 67,500	
				Machine II 23,750	91,250
		1,00,000			1,00,000
01.04.2016	To Balance b/d:		01.04.2016	By Bank A/c	50,000
	Machine I 67,500			By P & L A/c (loss on sale)	17,500
	Machine II 23,750	91,250			
	To Bank A/c (Machine III)	45,000	31.03.2017	By Depreciation A/c:	
				Machine II 2,375	
				Machine III 4,500	6,875
				By Balance c/d:	
				Machine II 21,375	
				Machine III 40,500	61,875
		1,36,250			1,36,250
01.04.2017	To Balance b/d:		01.04.2017	By P & L A/c [Short Depreciation provided in earlier years written-off]	125
	Machine II 21,375			By Depreciation A/c	
	Machine III 40,500	61,875	31.03.2018	Machine II [10% on 25,000] 2,500	
				Machine III [10% on 45,000] 4,500	7,000
				By Balance c/d:	
				Machine II 18,750	
				Machine III 36,000	54,750
		61,875			61,875

Working Note:**CALCULATION OF EXCESS/SHORT DEPRECIATION ON MACHINE II & III**

Particulars	Machine II	Machine III	Total
A Depreciation on WDV basis @ 10%			
for 2015—2016	1,250	—	1,250
for 2016—2017	2,375	4,500	6,875
	3,625	4,500	8,125
B Depreciation on SLM basis @ 10%			
25,000 × 10/100 × 1.5 years	3,750	—	3,750
45,000 × 10 × 100 × 1 year	—	4,500	4,500
	3,750	4,500	8,250
C Short Depreciation to be written off [A – B]			125

PROBLEM 6

A Company had a balance of ₹ 4,05,000 on 1st January, 2018 in its Machinery account. 10% per annum depreciation was charged by diminishing balance method. On 1st July, 2018, the company sold a part of machinery for ₹ 87,500, which was purchased on 1st January, 2016 for ₹ 1,20,000 as a part of it become useless, and on the same date i.e., on 1st July, 2018, the company purchased a new machine for ₹ 2,50,000. On 31st December, 2018, the Directors of the company decide to adopt the fixed instalment method of depreciation from 1st January, 2016 instead of diminishing balance method. The rate of depreciation will remain the same.

Required: Prepare Machinery account in the books of company for the year ending 2018 [Nov., 2004]

SOLUTION:**Dr.****MACHINERY ACCOUNT****Cr.**

Date	Particulars	₹	Date	Particulars	₹
01.01.2018	To Balance b/d		01.07.2018	By Cash A/c	87,500
	(i) 97,200		01.07.2018	By Depreciation A/c	4,860
	(ii) 3,07,800	4,05,000	01.07.2018	By Profit and Loss A/c	
01.07.2018	To Cash A/c	2,50,000		(Loss on Sale)	4,840
			31.12.2018	By Profit and Loss A/c	
				(Additional Depreciation)	3,800
			31.12.2018	By Depreciation A/c	
				(ii) 38,000	
				(iii) 12,500	50,500
			31.12.2018	By Balance c/d	5,03,500
		6,55,000			6,55,000

Working Notes:

- (i) Calculation of written down value (W.D.V.) of machinery on 01.07.2018 and Loss on its sale.

A.	Cost of machine on 01.01.2016	₹ 1,20,000
B.	Less: Depreciation @ 10% for 2016	12,000
C.	W.D.V. on 01.01.2017	1,08,000

D. Less: Depreciation @ 10% for 2017	10,800
E. W.D.V. on 01.01.2018	97,200
F. Less: Depreciation @ 10% for 6 months	4,860
G. W.D.V. on 01.07.2018	92,340
H. Less: Amount received from sale	87,500
I. Loss on sale	4,840
(ii) Calculation of book value of unsold machine on 01.01.2016:	₹
If ₹ 97,200 is the W.D.V. on 01.01.2018 then cost	1,20,000
If ₹ 3,07,800 is the W.D.V. on 01.01.2018 then cost	$\frac{1,20,000 \times 3,07,800}{97,200} = 3,80,000$

(iii) Calculation of additional depreciation because of change in method of depreciation:

	<i>Fixed instalment method (F.I.M.)</i>	<i>Diminishing balance method (D.B.M.)</i>
	₹	₹
A. Cost of machine on 01.01.2016	3,80,000	3,80,000
B. Less: Depreciation @ 10% p.a.	38,000	38,000
C. W.D.V. on 01.01.2017	3,42,000	3,42,000
D. Less: Depreciation @ 10% p.a.	38,000	34,200
E. W.D.V. on 01.01.2018	3,04,000	3,07,000
F. Additional depreciation to be charged:		₹
A. W.D.V. by D.B.M.		3,07,800
B. Less: W.D.V. by F.I.M.		3,04,000
		3,800

PROBLEM 7

ABC Ltd. purchased on 1st October, 2014, a machinery for ₹ 4,50,000 and spent ₹ 10,000 on freight and transit insurance. On 25th December, 2014, it further spent ₹ 40,000 on its erection. The machinery was put to use on 1-1-2015. On 1st July 2015, it purchased another machinery for ₹ 1,00,000. During the year 2016, it spent 10,000 for repairs on 1-4-2016.

However, on 1-4-2017, a part of the machinery, purchased on 1-10-2014, costing ₹ 2,00,000 was sold for ₹ 1,50,000. On 1-10-2017 it purchased another machinery for ₹ 3,00,000.

On 1st July, 2018, however, machinery purchased on 1st July, 2015 was sold for ₹ 65,000. Depreciation was charged by the firm @ 10% per annum by written down value method. During the year 2018, ABC Ltd. decided to change the method of providing depreciation and adopted the Straight Line Method of charging depreciation @ 10% per annum.

Required: Prepare Machinery Account upto the year ending 31-12-2018.

SOLUTION:

Dr.

MACHINERY ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.12.2014	To Bank A/c	4,50,000	31.12.2014	By Balance c/d	5,00,000
01.12.2014	To Bank A/c (Freight)	10,000			
25.12.2014	To Bank A/c (Erection)	40,000			
		5,00,000			5,00,000

01.01.2015	To Balance b/d	5,00,000	31.12.2015	By Depreciation A/c:	
01.07.2015	To Bank A/c (II)	1,00,000		I	50,000
				II	5,000
			31.12.2015	By Balance c/d:	55,000
				I	4,50,000
				II	95,000
		6,00,000			5,45,000
					6,00,000
01.01.2016	To Balance b/d	5,45,000	31.12.2016	By Depreciation A/c:	
				I	45,000
				II	9,500
			31.12.2016	By Balance c/d:	54,500
				I	4,05,000
				II	85,500
		5,45,000			4,90,000
					5,45,000
01.01.2017	To Balance b/d	4,90,500	01.04.2017	By Bank A/c	1,50,000
01.12.2017	To Bank A/c	3,00,000	01.04.2017	By Depreciation A/c	4,050
			01.04.2017	By Profit & Loss A/c-Loss	7,950
			31.12.2017	By Depreciation	40,350
				By Balance c/d	5,88,150
		7,90,500			7,90,500
					7,90,500
01.01.2018	To Balance c/d	5,88,150	01.07.2018	By Depreciation A/c	5,000
			01.07.2018	By Bank A/c	65,000
				By Profit & Loss A/c (loss)	5,000
			31.12.2018	By Profit & Loss A/c	10,650
				– Additional dep.	
				By Depreciation A/c	60,000
				By Balance c/d	4,42,500
		5,88,150			4,42,500
					5,88,150

Working Notes:

1. Loss on sale of Machine = Sale Proceeds – WDV as on date of Sale

$$= ₹ 1,50,000 - (₹ 2,00,000 \times 90\% \times 90\% \times 97.5\%) = ₹ 7,950$$

2. DEPRECIATION FOR 2017

Particulars	₹
W.D.V. of Total Machine on 1.1.2017	4,90,500
Less: W.D.V. of Machine sold of on 1.1.2017	1,62,000
W.D.V. of Machine used during 2017	3,28,500
Depreciation for 2015 for full year	32,850
Depreciation on Machine Purchased on 01.10.2017 for months	7,500
	40,350

3. Loss on sale of Machine = Sale Proceeds – Book Value as on date of Sale

$$= ₹ 65,000 - [₹ 1,00,000 - (₹ 1,00,000 \times 10\% \times 3 \text{ years})] = ₹ 5,000$$

4. EFFECT OF CHANGE OF DEPRECIATION

<i>Particulars</i>	<i>W.D.V.</i>	<i>S.L.M.</i>
Cost of Machine on 01.01.2015 (₹. 3,00,000)		
Depreciation for 2015	30,000	30,000
Depreciation for 2016	27,000	30,000
Depreciation for 2017	24,300	30,000
Cost of Machine II ₹ 3,00,000		
Depreciation for 2017	7,500	7,500
A. Total Depreciation	88,800	97,500
Cost of Machine on 1.7.2015 (₹ 1,00,000)		
Depreciation for 2015	5,000	5,000
Depreciation for 2016	9,500	10,000
Depreciation for 2017	8,550	10,000
B. Total Depreciation	23,050	25,000
C. Total Depreciation (A + B)	1,11,850	1,22,500

Additional Depreciation to be charged = ₹ 1,22,500 – ₹ 1,11,850 = ₹ 10,650

Note: Depreciation is charged from the date the machine is put to use. Since machine is put to use on 1.01.2015 so depreciation has been charged from 1.01.2015 onward and not from 2014.

PROBLEM 8

A company purchased second hand machinery on 1st January, 2015 for ₹ 3,00,000, subsequent to which ₹ 60,000 and ₹ 40,000 were spent on its repairs and installation, respectively. On 1st July, 2016 another machinery was purchased for ₹ 2,60,000. On 1st July, 2017, the first machinery having become outdated was auctioned for ₹ 3,00,000 and on the same date, another machinery was purchased for ₹ 2,50,000.

On 1st July, 2018, the second machinery was also sold off and it fetched ₹ 2,30,000.

Depreciation was provided on machinery @ 10% on the original cost annually on 31st December, under the Fixed Instalment method. From 1st January, 2017, the method of providing depreciation was changed to Reducing Balance method, the rate being 15% p.a.

You are required to prepare the following accounts in the books of the company:

- (i) Machinery Account for the years ending 2015 to 2018.
- (ii) Machinery Disposal Account.

Note: The figures are rounded off to the nearest multiple of Rupees ten.

[Nov. 2005]

SOLUTION:

Dr.

MACHINERY ACCOUNT

Cr.

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
01.01.2015	To Bank A/c(A)–Cost	3,00,000	31.12.2015	By Depreciation (A)	40,000
	–Repairs	60,000		By Balance c/d (A)	3,60,000
	–Installation	40,000			
		4,00,000			4,00,000

01.01.2016	To Balance b/d	3,60,000	31.12.2016	By Depreciation	
01.07.2016	To Bank A/c (B)	2,60,000		(A)–40,000	
				(B)– <u>13,000</u>	53,000
				By Balance b/d	
				(A)–3,20,000	
				(B)– <u>2,47,000</u>	5,67,000
		6,20,000			6,20,000
01.01.2017	To Balance b/d	5,67,000	01.07.2017	By Machinery Disposal	
01.07.2017	To Bank A/c (C)	2,50,000		A/c (A)	2,67,320
			31.12.2017	By Depreciation A/c	
				(A)–21,680	
				(B)–36,080	
				(C)– <u>18,750</u>	76,510
				By Profit and Loss A/c-	
				Short Depreciation	
				(A)–31,000	
				(B)– <u>6,500</u>	37,500
				By Balance c/d	
				(B)–2,04,420	
				(C)– <u>2,31,250</u>	4,35,670
		8,17,000			8,17,000
01.01.2018	To Balance b/d	4,35,670	01.07.2018	By Machinery Disposal	
				A/c (B)	1,89,090
			31.12.2018	By Depreciation A/c	
				(B)–15,330	
				(C)– <u>34,690</u>	50,020
				By Balance c/d	1,96,560
		4,35,670			4,35,670

Dr.
MACHINERY DISPOSAL ACCOUNT
Cr.

Date	Particulars	₹	Date	Particulars	₹
01.07.2017	To Machinery A/c (A)	2,67,320	01.07.2017	By Bank A/c	3,00,000
	To Profit Loss A/c (Profit)	32,680			
		3,00,000			3,00,000
01.07.2018	To Machinery A/c (B)	1,89,090	01.07.2018	By Bank A/c	2,30,000
	To P & L A/c (Profit)	40,910			
		2,30,000			2,30,000

Working Notes:

(i)	Machinery	S.L.M		W.D.V	
		Depreciation @ 10% p.a.	Book value	Depreciation @ 15% p.a.	Book value
(A)	Purchased for ₹ 4,00,000				
	on Jan. 1, 2015	40,000	3,60,000	60,000	3,40,000
	Year-2016	40,000	3,20,000	51,000	2,89,000
		<u>80,000</u>		<u>1,11,000</u>	
	Year till July, 2017			21,680	2,67,320
(B)	Purchased for ₹ 2,60,000				
	on July 1, 2016	13,000	2,47,000	19,500	2,40,500
	Year-2017			36,080	2,04,420
	Year till July, 2018			15,330	1,89,090
(C)	Purchased for ₹ 2,50,000				
	on July 1, 2017			18,750	2,31,250
	Year-2018			34,690	1,96,560

(ii) Adjusted Depreciation till 2016

	S.L.M.	– W.D.V	₹	
Machinery (A)	₹ 80,000	–₹ 1,11,000	31,000	(deficit to be charged to profit and loss a/c)
Machinery (B)	₹ 13,000	–₹ 19,500	6,500	(deficit to be charged to profit and loss a/c)
			<u>37,500</u>	

PROBLEM 9

A lease was purchased on 1.4.2013 for five years at a cost of ₹ 1,00,000. It is proposed to depreciate the lease by annuity method charging interest at 5% p.a. Show the Lease Account for 5 years and also the relevant entries in the Profit and Loss Account. The reference to the annuity table shows that to depreciate ₹ 1 by annuity method over 5 years by charging interest @ 5% p.a. one must write off a sum of ₹ 0.230975 every year. [C.A.]

SOLUTION:**DR.****LEASE ACCOUNT****CR.**

Date	Particulars	₹	Date	Particulars	₹
01.04.2013	To Bank A/c	1,00,000.00	31.03.2014	By Depreciation A/c	23,097.50
31.03.2014	To Interest A/c (5% on ₹ 1,00,000)	5,000.00	31.03.2014	By Balance c/d	81,902.50
		<u>1,05,000.00</u>			<u>1,05,000.00</u>
01.04.2014	To Balance b/d	81,902.50	31.03.2015	By Depreciation A/c	23,097.50
31.03.2015	To Interest A/c	4,095.12	31.03.2015	By Balance c/d	62,900.12
		<u>85,997.62</u>			<u>85,997.62</u>
01.04.2015	To Balance b/d	62,900.12	31.03.2016	By Depreciation A/c	23,097.50
31.03.2016	To Interest A/c	3,145.00	31.03.2016	By Balance c/d	42,947.62
		<u>66,045.12</u>			<u>66,045.12</u>

01.04.2016	To Balance b/d	42,947.62	31.03.2017	By Depreciation A/c	23,097.50
31.03.2017	To Interest A/c	2,147.38	31.03.2017	By Balance c/d	21,997.50
		45,095.00			45,095.00
01.04.2017	To Balance b/d	21,997.50	31.03.2018	By Depreciation A/c	23,097.50
31.03.2018	To Interest A/c	1,100.00			
		23,097.50			23,097.50

DR.
AN EXTRACT OF PROFIT AND LOSS ACCOUNT
CR.

Date	Particulars	₹	Date	Particulars	₹
31.03.2014	To Depreciation A/c	23,097.50	31.03.2014	By Interest A/c	5,000.00
31.03.2015	To Depreciation A/c	23,097.50	31.03.2015	By Interest A/c	4,095.12
31.03.2016	To Depreciation A/c	23,097.50	31.03.2016	By Interest A/c	3,145.00
31.03.2017	To Depreciation A/c	23,097.50	31.03.2017	By Interest A/c	2,147.38
31.03.2018	To Depreciation A/c	23,097.50	31.03.2018	By Interest A/c	1,100.00

Working Notes:

(i) Annual Depreciation = $\text{Re } 0.230975 \times ₹ 1,00,000 = ₹ 23,097.50$

(ii) It is assumed that the financial year is the accounting year.

PROBLEM 10

The following particulars are available from the books of X Ltd. Provision for Repairs and Renewals as on 1.4.2016 ₹ 1,00,000. Actual repair charges incurred during 2016-2017—₹ 60,000, during 2017-2018—₹ 90,000.

X Ltd. transfers annually a sum of ₹ 80,000 to the Provision for Repairs and Renewals Account.

Required: Prepare the Provision for Repairs and Renewals Account for the year 2016-2017 and 2017-2018. [C.A.]

SOLUTION:
Dr.
PROVISION FOR REPAIRS AND RENEWALS ACCOUNT
Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.2017	To Bank A/c	60,000	01.04.2016	By Balance c/d	1,00,000
	To Balance c/d	1,20,000	31.03.2017	By Profit and Loss A/c	80,000
		1,80,000			1,80,000
31.03.2018	To Bank A/c	90,000	01.04.2017	By Balance b/d	1,20,000
	To Balance c/d	1,10,000	31.03.2018	By Profit and Loss A/c	80,000
		2,00,000			2,00,000

5

ACCOUNTING FOR BILLS OF EXCHANGE

PROBLEM 1

Arun and Anand were friends and in need of funds. On 1st Jan., Arun drew a bill for ₹ 2,00,000 for 3 months on Anand. On 4th Jan. Arun got the bill discounted at 10% p.a. and remitted half of the proceeds to Anand. At maturity, Anand could not meet the bill, instead, Arun accepted Anand's bill for ₹ 1,20,000 on 4th April for two months. This was discounted by Anand at 12% p.a. Out of this, ₹ 19,600 was paid to Arun after deducting ₹ 400 discounting charges. Due to financial crisis, Arun became insolvent and the bill drawn on him was dishonoured and his estate paid 50%. Days of grace for discount purposes may be ignored. Give journal entries in the books of Arun. Also prepare Anand's Account in Arun's books and Arun's Account in the books of Anand. [Dec. 1993]

SOLUTION:

JOURNAL OF ARUN

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	Bills Receivable A/c Dr. To Anand (Being the bill for ₹ 2,00,000 drawn on Anand)		2,00,000	2,00,000
Jan. 4	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being the bill discounted @ 10% p.a.)		1,95,000 5,000	2,00,000
Jan. 4	Anand Dr. To Bank A/c To Discount A/c (Being half the proceeds sent to Anand)		1,00,000	97,500 2,500
April 4	Anand Dr. To Bills Payable A/c (Being the bill of Anand accepted)		1,20,000	1,20,000
April 4	Bank A/c Dr. Discount A/c Dr. To Anand (Being proceeds received from Anand)		19,600 400	20,000
July 7	Bills Payable A/c Dr. To Anand (Being the bill dishonoured)		1,20,000	1,20,000
	Anand Dr. To Bank A/c To Deficiency A/c (Being 50% payments made to Anand and unpaid balance transferred to Deficiency A/c)		1,20,000	60,000 60,000

Dr. ANAND'S ACCOUNT IN THE BOOKS OF ARUN Cr.

Particulars	₹	Particulars	₹
To Bank A/c	97,500	By Bills Receivable A/c	2,00,000
To Discount A/c	2,500	By Bank A/c	19,600
To Bills Payable A/c	1,20,000	By Discount A/c	400
To Bank A/c	60,000	By Bills Payable A/c	1,20,000
To Deficiency A/c	60,000		
	3,40,000		3,40,000

Dr. ARUN'S ACCOUNT IN THE BOOKS OF ANAND Cr.

Particulars	₹	Particulars	₹
To Bills Payable A/c	2,00,000	By Bank A/c	97,500
To Bank A/c	19,600	By Discount A/c	2,500
To Discount A/c	400	By Bills Receivable A/c	1,20,000
To Bank A/c	1,20,000	By Bank A/c	60,000
		By Bad Debts A/c	60,000
	3,40,000		3,40,000

PROBLEM 2

On 1st Jan, A drew and B accepted a bill at three months for ₹ 2,000. On 4th Jan, A discounted the bill at 15% p.a. and remitted half the proceeds to B. On 1st Feb., B drew and A accepted a bill at four months for ₹ 1,500. On 4th Feb. B discounted the bill at 15% p.a. and remitted half the proceeds to A. A and B agreed to share the discounts equally. At maturity, A met his acceptance but B failed to meet and recourse was had to A. A drew and B accepted a new bill at three months for the amounts of the original bill *plus* interest at 18% p.a. On July 1, B became a bankrupt and paid to his creditors only 50 paise in the rupee. Record these transactions in A's journal and prepare B's Account. [Nov, 1994]

SOLUTION:

A'S JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	Bills Receivable A/c Dr. To B (Being the acceptance of a bill received from B)		2,000.00	2,000.00
Jan. 4	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being the bill discounted @ 15% p.a.)		1,925.00 75.00	2,000.00
Jan. 4	B Dr. To Bank A/c To Discount A/c (Being half of the proceeds remitted to B)		1,000.00	962.50 37.50
Feb. 1	B Dr. To Bills Payable A/c (Being the acceptance of a bill given to B)		1,500.00	1,500.00

Feb. 4	Bank A/c	Dr.	712.50	
	Discount A/c	Dr.	37.50	
	To B			750.00
	(Being half of the proceeds of the bill received from B)			
April 4	B	Dr.	2,000.00	
	To Bank A/c			2,000.00
	(Being the bill dishonoured)			
April 4	B	Dr.		90.00
	To Interest A/c			90.00
	(Being the interest charged for 3 months on ₹ 2,000 @ 18% p.a.)			
April 4	Bills Receivable A/c	Dr.	2,090.00	
	To B			2,090.00
	(Being the acceptance of a bill received from B)			
June 4	Bills Payable A/c	Dr.	1,500.00	
	To Bank A/c			1,500.00
	(Being the bill discharged at maturity)			
July 1	B	Dr.	2,090.00	
	To Bills Receivable A/c			2,090.00
	(Being the bill dishonoured)			
July 1	Bank A/c	Dr.	920.00	
	Bad Debts A/c	Dr.	920.00	
	To B			1,840.00
	(Being a dividend of 50 paise in a rupee received from estate of B and the balance written off as bad debts)			

Dr.**B'S ACCOUNT IN A'S LEDGER****Cr.**

Date	Particulars	₹	Date	Particulars	₹
Jan. 4	To Bank A/c	962.50	Jan. 1	By Bills Receivable A/c	2,000.00
Jan. 4	To Discount A/c	37.50	Feb. 4	By Bank A/c	712.50
Feb. 1	To Bills Payable A/c	1,500.00	Feb. 4	By Discount A/c	37.50
Apr. 4	To Bank A/c		Apr. 4	By Bills Receivable A/c	2,090.00
	(B/R dishonoured)	2,000.00	July 1	By Bank A/c	920.00
Apr. 4	To Interest A/c	90.00	July 1	By Bad Debts A/c	920.00
July 1	To Bills Receivable A/c				
	(Dishonoured)	2,090.00			
		6,680.00			6,680.00

PROBLEM 3

Shubham draws on Rajendra a bill for ₹ 45,000 on 1st June for 3 months. Rajendra accepts the bill and sends it to Shubham who gets it discounted for ₹ 44,100. Shubham immediately remits ₹ 14,700 to Rajendra. On the due date Shubham, being unable to remit the amount due, accepts a bill for

5.4 Quick Revision for Accounting for CA Foundation Course

₹ 63,000 for three months which is discounted by Rajendra for ₹ 61,650. Rajendra sends ₹ 11,100 to Shubham. On the due date Shubham becomes insolvent, his estate paying forty paise in the rupee. Give Journal Entries in the books of Shubham and Rajendra. [May 1999]

SOLUTION:

JOURNAL OF SHUBHAM

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
June	Bills Receivable A/c Dr. To Rajendra (Being acceptance received from Rajendra)		45,000	45,000
June 4	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being bill discounted with Bank)		44,100 900	45,000
June 4	Rajendra Dr. To Bank A/c To Discount A/c (Being 1/3rd proceeds of the discounted bill remitted to Rajendra)		15,000	14,700 300
Sept. 4	Rajendra Dr. To Bills Payable A/c (Being acceptance given to Rajendra)		63,000	63,000
Sept. 4	Bank A/c Dr. Discount A/c Dr. To Rajendra (Being amount received from Rajendra)		11,100 900	12,000
Dec. 7	Bills Payable A/c Dr. To Rajendra (Being bill dishonoured due to insolvency)		63,000	63,000
	Rajendra Dr. To Bank A/c To Deficiency (Being 40% share paid to Rajendra from our estate)		42,000	16,800 25,200

Working Note: Calculation of discount to be borne by Shubham

- A Amount due by Shubham but not remitted to Rajendra (₹ 45,000 – ₹ 15,000) 30,000
- B Add: Amount received by Shubham from Rajendra 11,100
- C Total amount due to Rajendra 41,100
- D Discount to be borne = $\text{Rs } 1,350 \times \frac{41,110}{61,650} = \text{Rs } 900$

JOURNAL OF RAJENDRA

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
June 1	Shubham Dr. To Bills Payable A/c (Being the acceptance given to Shubham)		45,000	45,000
June 4	Bank A/c Dr. Discount A/c To Shubham (Being 1/3rd proceeds of discounted bill received from Shubham)		14,700 300	15,000
Sept. 4	Bills Receivable A/c Dr. To Shubham (Being acceptance received from Shubham)		63,000	63,000
	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being the bill discounted with the bank)		61,650 1,350	63,000
	Bills Payable A/c Dr. To Bank A/c (Being the bill discharged)		45,000	45,000
	Shubham Dr. To Bank A/c To Discount A/c (Being the amount paid to Shubham)		12,000	11,100 900
Dec. 7	Shubham Dr. To Bank A/c (Being bill dishonoured due to Shubham's insolvency)		63,000	63,000
	Bank A/c Dr. Bad Debts A/c Dr. To Shubham (Being 40% share received from Shubham)		16,800 25,200	42,000

PROBLEM 4

On 1st July *G* drew a bill for ₹ 80,000 for 3 months on *H* for mutual accommodation. *H* accepted the bill of exchange.

G had purchased goods worth ₹ 81,000 from *J* on the same date. *G* endorsed *H*'s acceptance to *J* in full settlement.

On 1st September *J* purchased goods worth ₹ 90,000 from *H.J.* endorsed the bill of exchange received from *G* to *H* and paid ₹ 9,000 in full settlement of the amount due to *H*.

On 1st October *H* purchased goods worth ₹ 1,00,000 from *G*. He paid the amount due to *G* by cheque.

Give the necessary Journal Entries in the books of *H*.

[May 2000]

SOLUTION:
JOURNAL OF H

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
July 1	G Dr. To Bills Payable A/c (Being Bill accepted)		80,000	80,000
Sept. 1	J Dr. To Sales A/c (Being the goods sold to J)		90,000	90,000
	Bill Receivable A/c Dr. Cash A/c Dr. Discount A/c Dr. To J's Capital A/c (Being B/R of ₹ 80,000 & Cash ₹ 9,000 received from J and allowed him discount of ₹ 1,000.)		80,000 9,000 1,000	90,000
	Bills Payable A/c Dr. To Bills Receivable A/c (Being own acceptance received from J's endorsement, cancelled)		80,000	80,000
Oct. 1	Purchases A/c Dr. To G A/c (Being the goods purchased from G)		1,00,000	1,00,000
	G Dr. To Bank A/c (Being the Balance paid by cheque)		20,000	20,000

PROBLEM 5

Record the following transactions in the Journals of Ram and Hari:

Ram sells goods for ₹ 1,00,000 to Hari on 1st January and on the same day draws a bill on Hari at three months for the amount. Hari accepts it and returns it to Ram, who discounts it on 4th January with his bank at 12% per annum. The acceptance is dishonoured on due date and the bank pays ₹ 250 as noting charges. [May 2001]

SOLUTION:
RAM'S JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Jan. 1	Hari's A/c Dr. To Sales A/c (Being the goods sold to Hari on credit)		1,00,000	1,00,000
	Bills Receivable A/c Dr. To Hari's A/c (Bill accepted Hari for the amount due)		1,00,000	1,00,000

Jan. 4	Bank A/c	Dr.	97,000	
	Discount A/c	Dr.	3,000	
	To Bills Receivable A/c			1,00,000
	(Bill accepted by Hari discounted with the bank at 12% p.a.)			
	Hari's A/c	Dr.	1,00,250	
	To Bank A/c			1,00,250
	(Being the amount of bill dishonoured and noting charges paid thereon, debited to Hari's account)			

HARI'S JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	Purchases A/c	Dr.	1,00,000	
	To Ram's A/c			1,00,000
	(Being the goods purchased from Ram on credit)			
	Ram's A/c	Dr.	1,00,000	
	To Bills Payable A/c			1,00,000
	(Being the Acceptance given on the bill drawn by Ram)			
Jan. 4	Bills Payable A/c	Dr.	1,00,000	
	Trade Expenses A/c	Dr.	250	
	To Ram's A/c			1,00,250
	(Dishonour of the bill accepted by Ram on the due date)			

PROBLEM 6

Anil draws a bill for ₹ 9,000 on Sanjay on 5th April for 3 months, which Sanjay returns it to Anil after accepting the same. Anil gets it discounted with the bank for ₹ 8,820 and remits one-third amount to Sanjay.

On the due date Anil fails to remit the amount due to Sanjay, but he accepts a bill for ₹ 12,600 for three months, which Sanjay discount it for ₹ 12,330 and remits ₹ 2,220 to Anil. Before the maturity of the renewed bill Anil becomes insolvent and only 50% was realised from his estate on 15th October.

Required: Pass necessary Journal entries for the above transactions in the books of Anil. [Nov. 2004]

SOLUTION:

JOURNAL OF ANIL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Apr. 5	Bills Receivable A/c	Dr.	9,000	
	To Sanjay's A/c			9,000
	(Being acceptance received from Sanjay for mutual accommodation)			
	Bank A/c	Dr.	8,820	
	Discount A/c	Dr.	180	
	To Bills receivable A/c			9,000
	(Being Bill discounted with bank)			

5.8 Quick Revision for Accounting for CA Foundation Course

	Sanjay's A/c Dr.	3,000	
	To Bank A/c		2,940
	To Discount A/c		60
July 8	(Being one-third proceeds of the bill sent to Sanjay)		
	Sanjay's A/c Dr.	12,600	
	To Bills payable A/c		12,600
	(Being acceptance given)		
	Bank A/c Dr.	2,220	
	Discount A/c Dr.	180	
	Discount A/c $\left(270 \times \frac{(6,000 + 2,220)}{12,330} \right)$		
	To Sanjay's A/c		2,400
	(Being proceeds of second bill received from Sanjay)		
Oct. 11	Bills payable A/c Dr.	12,600	
	To Sanjay's A/c		12,600
	(Being bill dishonoured due to insolvency)		
Oct. 15	Sanjay's A/c (6,000 + 2,400) Dr.	8,400	
	To Bank A/c		4,200
	To Deficiency A/c		4,200
	(Being insolvent, only 50% amount paid to Sanjay)		

6

GOODS SENT ON APPROVAL OR ON SALE OR RETURN BASIS

PROBLEM 1

M/s Metha Bros. sends out goods on approval as follows:

January 10. A - ₹ 300 January 13. A returned ₹ 100 rest retained.

January 12. B - ₹ 200 January 22. B retained all the goods.

January 30. C - ₹ 1,500 January 31. No intimation.

Show how these transactions will appear when books are kept on double entry system. Give Journal entries and ledger accounts. [C.A.]

SOLUTION:

JOURNAL OF M/S MEHTA BROS.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 10	A's A/c Dr. To Sale or Return A/c [Being goods sent on approval to 'A' entered in sale or return ledger]		300	300
Jan. 12	B's A/c Dr. To Sale or Return A/c [Being goods sent to B on approval entered in Sale or Return ledger]		200	200
Jan. 13	Sale or Return A/c Dr. To A's A/c [Being goods returned by A entered in Sale or Return Ledger]		100	100
Jan. 13	A's A/c (in main ledger) Dr. To A (in Sale or Return Leger) [Being goods approved transferred to Personal A/c in the main ledger]		200	200
Jan. 13	Sale or Return A/c Dr. To Sales A/c (in main ledger) [Being goods approved transferred from Sale or Return ledger to main ledger]		200	200
Jan. 22	B's A/c (in main ledger) Dr. To B (in Sale or Return ledger) [Being goods approved transferred to Personal A/c in the main ledger]		200	200

6.2 Quick Revision for Accounting for CA Foundation Course

Jan. 22	Sale or Return A/c (in Sale or Return ledger) To Sales A/c (in main ledger) [Being goods approved transferred from Sale or Return ledger to main ledger]	Dr.	200	200
Jan. 30	C's A/c To Sale or Return A/c [Being goods sent on approval to C entered in Sale or Return ledger]	Dr.	1,500	1,500

Step 1: Recording in the books

SALE OR RETURN DAY BOOK

Date	Customer's Name	Sale or Return (L.F)	Amount (₹)
Jan. 10	A		300
Jan. 12	B		200
Jan. 30	C		1,500
			2,000

SALES AND RETURNS BOOK

Goods Sold					Goods Returned			
Date	Customer's Name	Regular L.F	Sale or Return L.F	₹	Date	Customer's Name	Sale or Return L.F	₹
Jan. 13	A			200	Jan. 13	A		100
Jan. 22	B			200				

Step 2: Posting to Sales or Returns Ledger.

A'S ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
Jan. 10	To Sale or Return A/c	300	Jan. 13	By A's A/c (in main ledger)	200
				By Sale or Return A/c	100
		300			300

B'S ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
Jan. 12	To Sale or Return A/c	200	Jan. 22	By B's A/c (in main ledger)	200
		200			200

C'S ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
Jan. 30	To Sale or Return A/c	1,500	Jan. 31	By Balance c/d	1,500
		1,500			1,500

SALE OR RETURN ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
Jan. 13	To A's A/c (returns)	100	Jan. 10	By A's A/c	300
Jan. 13	To Sales A/c (in main ledger)	200	Jan. 12	By B's A/c	200
Jan. 22	To Sales A/c (in main ledger)	200			
Jan. 31	To Balance c/d	1,500	Jan. 30	By C's A/c	1,500
		2,000			2,000

Step 3: Posting to Main Ledger.

A'S ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
Jan. 13	To A (in Sale or Return ledger)	200	Jan. 31	By Balance c/d	200
		200			200

B'S ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
Jan. 22	To B (in Sale or Return ledger)	200	Jan. 31	Balance c/d	200
		200			200

SALES ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
Jan 31	To Balance c/d	400	Jan 13	By Sale or Return A/c (in Sale or Return ledger)	200
			Jan 22	By Sale or Return A/c (in Sale or Return ledger)	200
		400			400

PROBLEM 2

On 31-12-2018 goods sold at sales price of ₹ 3,000 were lying with customer Anu to whom they were sold on 'Sale or Return' basis and recorded as actual sales. Since no consent has been received from the customer, you are required to pass adjustment entries presuming goods were sent on approval at a profit of cost plus 20%. Present market price is 10% less than the cost price. [C.A.]

SOLUTION:

JOURNAL OF ANU

Date	Particulars	Dr. (₹)	Cr. (₹)
Dec. 31	Sales A/c Dr. To Anu's A/c [Being cancellation of sale entry for goods not yet approved]	3,000	3,000
	Stock with customers A/c Dr. To Trading A/c [Being stock with customers recorded at Market price]	2,250	2,250

Working Note: Calculation of Cost and Market Price of Stock with customer

A. Sale price of goods sent on approval	₹ 3,000
B. Less: Profit [$3,000 \times 20/120$]	500
C. Cost of goods	<u>2,500</u>
D. Market price = $2,500 - (2,500 \times 10\%) = 2,250$	

Note: Since the market price is less than the cost price, stock with customer is valued at market price.

PROBLEM 3

Ramu sells goods to his approved customers on 'Sale or Return' basis at a profit of 20% on sales, treating as actual sales. On 15th December, goods costing ₹ 1,000 were sent to Usha Traders. No confirmation has been received from Usha Traders until 31st December.

Give the necessary journal entries in the books of Ramu.

[C.A.]

SOLUTION:

JOURNAL

Date	Particulars	Dr. (₹)	Cr. (₹)
15th Dec.	Usha Traders A/c Dr. To Sales A/c (Being the sales made with sale value of ₹ 1,250 (cost = 1,000 + Profit 20% on sales (25% on cost – $1000 \times 25/100$)))	1,250	1,250
31st Dec.	Sales A/c Dr. To Usha traders (Being the cancellation of sale recorded earlier)	1,250	1,250
31st Dec.	Stock with customers A/c Dr. To Trading A/c (Being stock at the end recorded with the customers at cost price)	1,000	1,000

7

ACCOUNTING FOR CONSIGNMENT

PROBLEM 1

Mr Y consigned 800 packets of toothpaste, each packet containing 100 toothpastes. Cost price of each packet was ₹ 900. Mr Y spent ₹ 100 per packet as cartage, freight, insurance and forwarding charges. One packet was lost on the way and Mr Y lodged claim with insurance company and could get ₹ 570 as claim on average basis. Consignee took delivery of the rest of the packets and spent ₹ 39,950 as other non-recurring expenses and ₹ 22,500 as recurring expenses. He sold 740 packets at the rate of ₹ 12 per toothpaste. He was entitled to 2% commission on sales plus 1% del-credere commission.

Required: prepare Consignment Account. Calculate the cost of stock at the end abnormal loss and profit or loss on consignment.

SOLUTION:

Dr.		CONSIGNMENT ACCOUNT		Cr.	
Particulars	₹	Particulars	₹		
To Goods sent on consignment (800 × ₹ 900)	7,20,000	By Consignee's A/c (Sales) (740 × ₹ 1,200)	8,88,000		
To Bank A/c (Freight charges insurance etc (800 × ₹ 100)	80,000	By Cash A/c (claim)	570		
To Consignee's A/c:		By Profit & Loss A/c (abnormal loss)	430		
Non Recurring Expenses	39,950	[₹ 1,000 – ₹ 570]			
Recurring Expenses	22,500	By Consignment Stock A/c			
To Consignees A/c (Commission)		Cost of 59 packets	53,100		
2% on ₹ 8,88,000	17,760	Add: Consignee's Exp.			
1% on ₹ 8,88,000	8,880	(₹ 80,000 × 59/800)	5,900		
To Profit & Loss A/c (Profit)	61,860	Add: Consignee's Exp.			
		(₹ 39,950 × 59/799)	2,950		
	9,50,950		61,950		
			9,50,950		

Working Note: Calculation of Abnormal Loss

	₹
A. Cost of 1 packet	900
B. Consignor's Expenses	100
C. Total Cost of 1 packet [A + B]	1,000
D. Less: Claim accepted	570
E. Abnormal loss [C – D]	430

PROBLEM 2

M/s Ram & Co. of Delhi purchased 20,000 pieces of sarees @ ₹ 200 per saree. Out of these, 12,000 sarees were sent on consignment to M/s Laxman Traders of Bombay at the selling price of ₹ 240 per saree. The Consignors paid ₹ 6,000 for packing and freight.

M/s Laxman Traders sold 10,000 sarees @ ₹ 250 per saree and incurred ₹ 2,000 towards selling expenses and remitted ₹ 10,00,000 to Delhi on account. M/s Laxman Traders are entitled to a commission of 5 per cent on total sales plus a further 20 per cent commission on any surplus price realised over ₹ 240 per saree.

6,000 sarees were sold at ₹ 220 per saree by the Consignor. Owing to fall in the market price, the value of stock of sarees in hand is to be reduced by 10 per cent.

Prepare the Consignment Account and the account of M/s Laxman Traders in the books of the Consignor.

SOLUTION:

In the Books of M/s Ram & Co., Delhi

Dr.	CONSIGNMENT TO BOMBAY ACCOUNT	Cr.

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c (12,000 × ₹ 240)	28,80,000	By Laxman Traders (sales) (10,000 × 250)	25,00,000
To Bank A/c (expenses)	6,000	By Goods sent on Consignment (loading: 12,000 × ₹ 40)	4,80,000
To Laxman Traders (expenses)	2,000	By Consignment Stock A/c	3,60,900
To Laxman Traders (Commission)	1,45,000		
To Profit & Loss A/c (Profit)	3,07,900		
	33,40,900		33,40,900

Dr.	LAXMAN TRADERS ACCOUNT	Cr.

Particulars	₹	Particulars	₹
To Consignment A/c (sales)	25,00,000	By Consignment A/c (Expenses)	2,000
		By Consignment A/c (Commission)	1,45,000
		By Bank A/c	10,00,000
		By Balance c/d	13,53,000
	25,00,000		25,00,000

Working Notes:

(i) Consignee's Commission = 5% of ₹ 25,00,000 + 20% of ₹ 1,00,000 = ₹ 1,45,000

(ii) Valuation of Closing Stock on Consignment

A. Cost of 2,000 Sarees [2,000 × ₹ 200]	4,00,000
B. Add: proportionate expenses [₹ 6,000 × 2,000/12,000]	1,000
	4,01,000
C. Less: 10%	40,100
D. Value of closing stock to be brought into accounts	

PROBLEM 3

Mr A of Assam sent on 18th February, a consignment of 1000 DVD player to B of Bengal costing of ₹ 100 each. Expenses of ₹ 1,500 were met by the Consignor. B spent ₹ 3,000 for clearance and selling expenses were ₹ 20 per DVD player.

B sold on 15th March, 600 DVD Players sold @ ₹ 160 per DVD Player and again on 20th may, 300 DVD Players @ ₹ 170.

B is entitled to a commission of ₹ 25 per DVD Player sold plus 1/4 pf the amount by which the gross sale proceeds less total commission thereon exceeded a sum calculated @ ₹ 125 per DVD Player sold. B sent the amount due to A on 30th June.

You are requested to show the consignment account and B's account in the books of A.

SOLUTION:

Dr. CONSIGNMENT ACCOUNT IN THE BOOKS OF A Cr.

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c	1,00,000	By B's A/c (sales) (600 × ₹ 160)	96,000
To Cash/Bank A/c (Expenses)	1,500	By B's A/c (Sales) (300 × ₹ 170)	51,000
To B's A/c (Clearance charges)	3000	By Consignment Stock A/c	10,450
To B's A/c			
Selling expenses (900 × ₹ 20)	18,000		
Commission	24,900		
To Profit and Loss A/c	10,500		
	1,57,450		1,57,450

Dr. B'S ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Consignment A/c (Sales)	96,000	By Consignment A/c	
To Consignment A/c (Sales)	51,000	(Clearance charges)	3,000
		By Consignment A/c	
		Selling expenses	18,000
		Commission	24,900
		By Cash/Bank A/c	1,01,000
	1,47,000		1,47,000

Working Notes:

1. Calculation of Total Commission:

Let total commission be x

$$x = 900 \times ₹ 25 + [(\text{₹ } 96,000 + \text{₹ } 51,000) - x - (900 \times ₹ 125)]$$

$$x = ₹ 22,500 + [\text{₹ } 1,47,000 - x - ₹ 1,12,500]$$

$$x = ₹ 22,500 + [\text{₹ } 34,500 - x]$$

$$4x + x = ₹ 90,000 + ₹ 34,500$$

$$5x = ₹ 1,24,500$$

$$x = ₹ 24,900$$

2. Valuation of Consignment Stock:

100 DVD players @ ₹ 100 each	₹ 10,000
Add: Proportionate expenses of A	150
Proportionate expenses paid by B	300
	<u>10,450</u>

PROBLEM 4

Ramesh consigned 2,000 MT of chemicals at a cost of ₹ 800 per MT to John, Ramesh paid freight and insurance charges of ₹ 20,000. Of the above 500 MT of chemicals were destroyed by fire during transit. John cleared the balance of 1,500 MT of chemicals and sold 1,000 MT at an average price of ₹ 1,000 per MT. John incurred the following expenses. Godown Rent ₹ 5,000, Insurance ₹ 3,000, Clearing Charges ₹ 4,500. Insurance claim received against fire ₹ 4,00,000 after admitting the salvage value of Stock destroyed by fire at ₹ 10,000. John was entitled to a commission of 10% on sale proceeds. John sends the balance to Ramesh after adjusting his commission and expenses out of the sales proceeds, Prepare a Consignment Account and John's Account in the books of Ramesh.

SOLUTION:
Dr. CONSIGNMENT TO JOHN ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c	16,00,000	By John's (Sales)	10,00,000
To Bank (Freight and Insurance)	20,000	By Abnormal Loss A/c	
To John's A/c (Commission)	1,00,000	(₹ 4,05,000 – ₹ 10,000)	3,95,000
To John's A/c (Godown Rent)	5,000	By Consignment Stock A/c:	
To John's A/c (Insurance)	3,000	Normal Stock	4,06,500
To John's A/c (Clearing Charges)	4,500	Salvaged Stock	10,000
To Profit and Loss A/c (Profit)	79,000		
	18,11,500		18,11,500

Dr. JOHN'S ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Consignment to John A/c		By Consignment to John A/c:	
(Sale Proceeds)	10,00,000	Godown Rent	5,000
		Insurance	3,000
		Clearing Charges	4,500
		Commission	1,00,000
		By Bank A/c (Balance remitted)	8,87,500
	10,00,000		10,00,000

Working Note: Valuation of Goods Destroyed and Unsold Goods

Particulars	Goods Destroyed (500 MT) ₹	Unsold Goods (500 MT) ₹
A Cost (500 × ₹ 800)	4,00,000	4,00,000
B Proportionate Freight and Insurance (₹ 20,000 × 500/2,000)	5,000	5,000
C Proportionate Clearing Charges (₹ 4,500 × 500/1500)	—	1,500
D Total	4,05,000	4,05,000

PROBLEM 5

Rahim of Bombay consigned to Raju of Madras, goods to be sold at invoice price which represents 125% of cost. Raju is entitled to a commission of 10% on sales at invoice price and 25% of any excess realised over invoice price. The expenses on freight and insurance incurred by Rahim were ₹ 10,000. The account sales received by Rahim shows that Raju effected sales aggregating to ₹ 1,00,000 in respect of 75% of the consignment. His selling expenses to be reimbursed were ₹ 8,000. 10% of the consignment goods of the value of ₹ 12,500 were destroyed in fire at the Madras godown and the Insurance Company paid ₹ 12,000 net of salvage. Raju remitted the balance in favour of Rahim. Prepare Consignment Account and the Account of Raju in the books of Rahim along with necessary workings. [C.A. (Foundation)]

SOLUTION:

Dr. CONSIGNMENT TO MADRAS ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c	1,25,000.00	By Raju's A/c (Sales)	1,00,000.00
To Bank A/c (Freight & Insurance)	10,000.00	By Loss due to Fire A/c	11,000.00
To Raju's A/c (Expenses Incurred)	8,000.00	By Consignment Stock A/c	20,250.00
To Raju's A/c (Commission)	10,937.50	By Goods sent on Consignment	
To Consignment Stock Reserve A/c	3,750.00	[₹ 1,25,000 × 20/100]	25,000.00
		By Profit & Loss A/c (Loss)	1,437.50
	1,57,687.50		1,57,687.50

Dr. RAJU'S ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Consignment to Madras A/c (Sales)	1,00,000.00	By Consignment to Madras A/c (Expenses)	8,000.00
To Loss due to Fire A/c (Insurance Claim)	12,000.00	By Consignment to Madras A/c (Commission)	10,937.50
	1,12,000.00	By Bank A/c (Balance remitted)	93,062.50
			1,12,000.00

Working Notes:

(i) Invoice Value of Total Goods sent on Consignment	
(Invoice Value of Goods destroyed × 10)	1,25,000.00
(ii) Calculation of Consignee's Commission	
A Sale Proceeds received by Raju on 75% of Consignment	1,00,000.00
B Invoice Value of 75% of Consignment (75% of 1,25,000)	93,750.00
C Excess sale price realised by Raju (A – B)	6,250.00
D Commission payable to Raju	
@ 10% on Invoice value of ₹ 93,750	9,375.00
@ 25% on Excess sale price realised	1,562.50
	10,937.50

(iii) Calculation of Unsold Stock (being 15%)

A Invoice value of Stock ($\text{₹ } 1,25,000 \times 15/100$)	18,750
B Add: Proportionate Freight and Insurance ($\text{₹ } 10,000 \times 15/100$)	1,500
C Value of Stock on Consignment (A + B)	20,250

(iv) Stock Reserve at 25% on cost ($\text{₹ } 18,750 \times 25/125$) 3,750

(v) Calculation of Abnormal Loss

A Cost price of goods destroyed ($\text{₹ } 12,500 \times 80/100$)	10,000
B Add: Proportionate Freight and Insurance ($\text{₹ } 10,000 \times 10/100$)	1,000
	11,000

PROBLEM 6

M of Mathura, consigned 5,000 kg of oil costing ₹ 20 per kg to S of Surat. M paid ₹ 25,000 as freight and insurance. 125 kg of oil was destroyed in transit. The insurance claim was settled at ₹ 2,250 and was paid directly to the consignors.

S took delivery of consignment and accepted a Bill drawn upon them by M for ₹ 50,000. S reported as follows:

- (i) 3,750 kg. were sold at ₹ 30 per kg
- (ii) His expenses were: Godown Rent ₹ 10,000, Wages ₹ 1,000, Printing & Stationery, ₹ 5,000
- (iii) 125 kg were lost due to leakage which is quite normal.

S is entitled to a commission of 5% on the sales effected. S paid the amount due in respect of the consignment. Show the Consignment Account, the account of S and the Abnormal Loss Account in the books of M for the year ended 31st March, 2018. [May, 2006]

SOLUTION:

Dr. CONSIGNMENT TO MADRAS ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c	1,00,000	By Loss in Transit A/c (cost of 125 kg.)	3,125
To Cash A/c (freight & insurance)	25,000	By S (Sales)	1,12,500
To S A/c		By Consignment Stock A/c	25,658
Expenses incurred 16,000		By P & L A/c (Loss)	5,342
Commission 5,625	21,625		
	1,46,625		1,46,625

Dr. RAMESH & CO.'S ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Consignment to Madras A/c (Sales)	1,12,500	By Bills Receivable A/c	50,000
		By Consignment to Madras A/c:	16,000
		Expenses	5,625
		Commission	40,875
		By Bank A/c (Balance remitted)	
	1,12,500		1,12,500

Dr.**LOSS IN TRANSIT ACCOUNT****Cr.**

Particulars	₹	Particulars	₹
To Consignment to Madras A/c	3,125	By Insurance Claim (recovered)	2,250
		By Profit & Loss A/c (irrecovered)	875
	3,125		3,125

Working Note: Calculation of Cost of Closing Stock

	Units	₹
A Cost of 5,000 kg, @ ₹ 20	5,000	1,00,000
B Add: Consignor's Expenses (Freight & insurance)	—	25,000
C Total Cost of 5,000 kg. (A + B)	5,000	1,25,000
D Less: Cost of 125 kg lost in transit ($₹ 1,25,000 \times 125/5,000$)	125	3,125
E Cost of 4,875 kg that have reached the city of Consignee (C – D)	4,875	1,21,875
F Less: Normal Loss	125	—
G Cost of 4,750 kg available for sale (since 125 kg is normal loss)	4,750	1,21,875
H Cost of 1,000 kg in hand ($₹ 1,21,875 \times 1,000/4,750$)	1,000	25,658

PROBLEM 7

Mr Karamchand, whose accounting year ends on 31st March consigned 100 bags of sugar, each bag costing ₹ 300 to Amarchand of Bombay on 1st Jan. He had paid ₹ 500 towards freight and insurance. 15 bags were damaged in transit and on 30th March, the consignor had received ₹ 1,000 on account of the damaged bags from the Insurance Company. Amarchand took delivery of the goods on 10th Jan. and immediately accepted a bill drawn on him for ₹ 20,000 for 60 days. On 31st March, the consignee reported that— (i) 70 bags were sold @ ₹ 350 per bag. (ii) The damaged bags were sold @ ₹ 110 per bag and (iii) He had paid Godown rent ₹ 700 Clearing charges ₹ 1,000, Carriage outwards ₹ 300.

He is entitled to a commission at 10% on the sale proceeds of all goods excepting damaged goods.

Assuming that Amarchand remits the balance by bank draft on 31st March, show the journal entries in the books of Mr Karamchand (including the entries passed at the time of closing the books). Assuming that no portion of the expenses incurred by the consignee is attributable to the damaged bags, determine the loss on the damaged bags.

SOLUTION:**JOURNAL OF MR KARAMCHAND**

Date	Particulars	Dr. (₹)	Cr. (₹)
2018 Jan. 1	Consignment to Bombay A/c To Goods sent on Consignment A/c (For 100 bags of sugar costing ₹ 300 per bag sent on consignment to Amarchand of Bombay)	Dr. 30,000	30,000
	Consignment to Bombay A/c To Bank A/c (For freight and insurance charges paid in respect of consignment to Bombay)	Dr. 500	500
Jan. 10	Bills Receivable A/c To Amarchand's A/c (For B/R received from Amarchand)	Dr. 20,000	20,000

Mar. 30	Bank A/c To Consignment to Bombay A/c (For amount of claim received from Insurance Co.)	Dr.	1,000	1,000
Mar. 31	Amarchand's A/c To Consignment to Bombay A/c (For sale of 70 bags @ ₹ 350 per bag & 15 @ ₹ 110 per bag)	Dr.	26,150	26,150
	Abnormal Loss A/c To Consignment to Bombay A/c (For loss suffered on account of damage done to 15 bags)	Dr.	1,925	1,925
	Consignment to Bombay A/c To Amarchand's A/c (For expenses incurred and commission charged by the consignee as follows: Godown rent ₹ 700, Clearing Charges ₹ 1,000, Carriage outwards ₹ 300 and Commission @ 10% on ₹ 24,500, i.e. ₹ 2,450)	Dr.	4,450	4,450
	Bank A/c To Amarchand's A/c (For the Bank Draft received for balance due from him)	Dr.	1,700	1,700
	Consignment Stock A/c To Consignment to Bombay A/c (For stock with the consignee valued at cost <i>plus</i> proportionate non-recurring expenses)	Dr.	4,751	4,751
	Profit & Loss A/c To Consignment to Bombay A/c (For loss transferred to Profit and Loss A/c)	Dr.	1,124	1,124

Working Notes:(i) *Valuation of Closing Stock with Consignee:*

	Damaged goods (15)	Unsold goods (15)	
A	Cost of bags @ ₹ 300	4,500	4,500
B	Add: Proportionate non-recurring expenses of Consignor @ ₹ 5	75	75
C	Add: Proportionate non-recurring expenses of Consignee @ ₹ 11.76	—	176
	4,575	<u>4,751</u>	<u>176</u>

(ii) Loss on damaged goods = Cost – Sale proceeds – Claim from Insurance Co.

$$= ₹ 4,575 - ₹ 1,650 - ₹ 1,000 = ₹ 1,925$$

(iii) It has been assumed that carriage outwards ₹ 300 spent by the consignee relates to sales.

(iv) Figures have been rounded off to the nearest rupee.

PROBLEM 8

On 1st January goods cost price of which was ₹ 1,32,000, were consigned by Shri Ganesh of Madras to his agent Shri Hari at Amritsar at a proforma invoice price of 20% above cost. Shri Harish paid freight and other forwarding charges amounting to ₹ 4,000. He was allowed ₹ 2,000 p.a. towards establishment costs, 5% commission and 5% del-credere commission on gross sales. Shri Harish paid ₹ 1,000 as rent of godown for the 3 months ended 31st March.

Three-fourth of the goods were sold at 33-1/3% profit on cost, half of which were credit sales. Half the balance goods were stolen, but the stock being insured a claim lodged for ₹ 14,000 was settled for ₹ 13,800. Balance stock was valued at proforma invoice price.

Required: Prepare the Consignment Account and Stock lost on Consignment Account giving effect to abnormal loss, for 3 months ending on 31st March in the books of Shri Ganesh.

SOLUTION:

Dr. **CONSIGNMENT ACCOUNT** **Cr.**

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c (1,32,000 × 120/100)	1,58,400	By Mahesh A/c:	
To Bank A/c (Insurance & Forwarding charges)	4,000	Cash Sales 66,000	
To Y A/c:		Credit Sales 66,000	1,32,000
Establishment 500		By Stock Lost on Consignment A/c	17,000
Rent 1,000		By Consignment Stock A/c	20,300
Commission 6,600		[1/2 × 1/4 × (1,58,400 + 4,000)]	
(5% on ₹ 1,32,000)		By Goods sent on Consignment A/c	26,400
Del-credere Comm. 3,960	12,060	(₹ 1,58,400 – ₹ 1,32,000)	
(3% on ₹ 1,32,000)			
To Stock Reserve A/c (₹ 26,400 × 1/8)	3,300		
To Profit on Consignment (transferred to P&L A/c)	17,940		
	1,95,400		1,95,400

Dr. **STOCK LOST ON CONSIGNMENT ACCOUNT** **Cr.**

Particulars	₹	Particulars	₹
To Consignment A/c	17,000	By Insurance Company (claim)	13,800
		By P&L A/c	3,200
	17,000		17,000

PROBLEM 9

On 1st April 2017, Mr Doshi of Darjeeling consigned 2,000 Kg. of Tea costing ₹ 60 per Kg. to Mr Naik of Nagpur. Mr Doshi incurred the following expenses:

Freight ₹ 2,000, Insurance ₹ 300, Sundry Expenses ₹ 700.

During the year ended 31st March, 2018, Mr Naik incurred the following expenses:

Freight ₹ 600, Godown Rent ₹ 500, Carriage to godown ₹ 1,000.

On 1st December, 2017, Mr Naik sold 1,200 Kg. of tea for cash at a profit of 25% on sales. On 15th December, 2017, Mr Naik returned 150 Kg. of Tea, which were of poor quality, to Mr Doshi and paid return freight and carriage of ₹ 250. Out of the remaining Tea, 200 Kg. being partially damaged were valued at 30% less than cost. Mr Naik charged his commission at 5% and the balance so far due from him to Mr Doshi on 31st March, 2018. Mr Doshi closes his books every year on 31st March.

Required: Prepare the following Accounts in the books of Mr Doshi:

- (a) Consignment to Nagpur. (b) Goods sent on Consignment, and (c) Personal Account of Mr Naik.

SOLUTION:

Dr. CONSIGNMENT TO NAGPUR ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Goods Sent on Consignment A/c	1,20,000	By Naik (Sale Proceeds)	
To Bank A/c (Expenses)	3,000	(1,200 × 80)	96,000
To Naik (Expenses)	2,100	By Consignment Stock A/c:	
To Naik (Return Freight)	250	Goods	27,900
To B (Commission [5% on ₹ 96,000])	4,800	Damaged	7,980
To Profit t/f to P&L A/c	15,150	By Profit & Loss A/c	
		(Loss on Damaged) (12,400 – 7,980)	4,420
		By Goods Sent on	
		Consignment A/c (Return) (150 × ₹ 60)	9,000
	1,45,300		1,45,300

Dr. NAIK'S ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Consignment to Nagpur		By Consignment to Nagpur A/c (Exp.)	2,100
A/c (sales)	96,000	By Consignment to Nagpur A/c (Exp.)	250
		By Consignment to Nagpur A/c (Comm.)	4,800
		By Bank A/c	88,850
	96,000		96,000

Working Notes:

(i) Statement showing the Calculation of Abnormal Loss and Unsold Stock

Particulars	Units	₹
A. Cost of Goods Sent	2,000	1,20,000
B. Expenses incurred by Consignor	—	3,000
C. Total Cost of Goods Sent (A + B)	2,000	1,23,000
D. Add: Non-recurring expenses incurred by Consignee	—	1,000
E. Cost of Goods received by consignee	2,000	1,24,000
F. Cost of Unsold Stock (Goods units) (450 kg)	450	27,900
G. Cost of Damaged units (200 kg)	200	12,240
H. Gross Realizable Value of Damaged Units (Cost—30%) (12,000 – 3,000)		8,400
I. Less: Consignee's Commission @ 5%		420
J. Net Realizable Value		7,980

Since stock is to be valued at cost or NRV w.e. lower, stock has been valued at ₹ 7,980.

PROBLEM 10

Mr Shetty is a consignee agent for Electra Engineers Ltd., Bombay, who manufacture transistors. Model P and Model T are the most popular models with fixed retail selling price of ₹ 200 and ₹ 250 respectively, on which the manufacturers have a profit of 20% calculated on the selling prices. The consignment arrangement with Mr Shetty provides for the following commission structure:

- (i) Model P— $2\frac{1}{2}\%$ on the selling price, (ii) Model T—4% on the selling price,

On July 1 stock with Mr Shetty was 200 Nos. of Model T and 200 Nos. of Model P. During the half year ended 31st Dec. the transactions were:

	Model P	Model T
Goods sent to Mr Shetty	2000 Nos.	1000 Nos.
Sales by Mr Shetty	2100 Nos.	900 Nos.

The consignments sent to Mr Shetty cost ₹ 30,000 in terms of freight incurred at consignor's end, and were transferred at cost. FIFO Method has been used.

Required: Show the Consignment A/c in the books of Electra Engineers Ltd., showing separately the computation of commission due and the value of closing stock.

SOLUTION:

Dr. CONSIGNMENT TO SHETTY ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Consignment Stock A/c:		By Shetty A/c-Sale proceeds:	
P 200 @ ₹ 160 32,000		P 2,100 @ ₹ 200 4,20,000	
T 200 @ ₹ 200 40,000	72,000	T 900 @ ₹ 250 2,25,000	6,45,000
To Goods Sent on Consignment A/c:		By Consignment Stock A/c:	
P 2,000 @ ₹ 160 3,20,000		P 17,000	
T 1,000 @ ₹ 200 2,00,000	5,20,000	T 63,000	80,000
To Bank A/c (freight) 30,000			
To Shetty A/c-commission			
2.5% on ₹ 4,20,000 10,500			
4% on ₹ 2,25,000 9,000	19,500		
To Profit on Consignment transferred to P/L A/c 83,500			
	7,25,000		7,25,000

Working Notes:

- (i) Cost price of each set: Model P = 80% of ₹ 200 = ₹ 160,
Model T = 80% of ₹ 250 = ₹ 200

- (ii) Freight charged per set: ₹ 30,000/3,000 = ₹ 10

- (iii) Valuation of closing stock:

P 100 @ ₹ 160	₹ 16,000
T 300 @ ₹ 200	60,000
	76,000
Add: Freight for 400 sets @ ₹ 10	4,000
	80,000

PROBLEM 11

Ram & Co., Calcutta, sent 50 cases of hair oil valued at ₹ 200 each, to Krishna of Kakinada, for sale on consignment basis. They paid freight and insurance ₹ 200. Each case contained 40 bottles. When Krishna received the consignment, he found two cases damaged and he salvaged 40 bottles out of them.

Krishna, whose terms of commission were 5% normal commission and 1% Del Credere, sold 1,300 bottles at ₹ 8 each partly on credit and partly for cash. One customer who had lifted 100 bottles paid only for 75 bottles and the balance has become a bad debt.

Ram & Co., have decided to treat the damage in transit as an abnormal loss to be separately written off in their Profit and Loss Account. Show in the books of Ram and Co.;

(a) Consignment a/c; (b) Krishna's a/c, showing the amount due from him; and (c) Notes on calculation of closing stock on Consignment a/c.

SOLUTION:

Dr. CONSIGNMENT TO KAKINADA ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Goods Sent on Consignment A/c	10,000	By Krishna (Sale Proceeds)	
To Bank A/c (Expenses)	200	(1,300 × ₹ 8)	10,400
To B (Commission)		By Loss-in-transit A/c	204
[₹ 10,400 × 6/100]	624	By Consignment Stock A/c	3,366
To Profit t/f to P & L A/c	3,146		
	13,970		13,970

Dr. KRISHNA'S ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Consignment to Kakinada A/c (sales)	10,400	By Consignment to Kakinada A/c (Comm.)	624
		By Balance c/d	9,776
	10,400		10,400

Working Note:**(I) STATEMENT SHOWING THE CALCULATION OF ABNORMAL LOSS AND UNSOLD STOCK**

Particulars	Units	₹
A. Cost of Goods Sent	2,000	1,000
B. Expenses incurred by Consignor	—	200
C. Total Cost of Goods Sent (A + B)	2,000	10,200
D. Less: Cost of Goods lost-in-transit	40	204
E. Cost of Goods reached the city of Consigned (C – D)	1,960	9,966
F. Cost of Unsold Stock [₹ 9,966 × 660/1960]	660	3,566

PROBLEM 12

Niresh consigns 1,000 bats costing ₹ 500 each to Swaroop for sales and incurs ₹ 4,000 towards freight and ₹ 1,000 for insurance. Swaroop was able to take delivery of 900 bats only and 100 bats were destroyed in transit. Insurance Co. admitted the claim and paid the same. Swaroop will be entitled to a commission of 5% on sales, 2% Del credere commission on credit sales only. He will be entitled for additional commission of 25% of the excess if the sale price exceeds the cost price by more than 20%. Swaroop has spent ₹ 2,000 towards sales expenses. The sale account is as under:—

500 bats at ₹ 600 per bat each, 200 bats at ₹ 700 per bat credit.

Consignment debtors paid their dues except one customer to whom 4 bats sold for ₹ 2,800 could pay ₹ 800. Show Consignment Account, Consignment Debtors A/c, Swaroop A/c and commission calculation.

SOLUTION:

Dr. **CONSIGNMENT ACCOUNT** **Cr.**

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c (₹ 1,000 × ₹ 500)	5,00,000	By Swaroop A/c	
To Bank A/c:		Cash Sales 3,00,000	
Freight 4,000		(500 × ₹ 600)	
Insurance 1,000	5,000	Credit Sales 1,40,000	4,40,000
		(200 × ₹ 700)	
To Swaroop A/c (Exp. & Comm.)		By Stock Destroyed in Transit A/c	50,500
Sales Expenses 2,000		[100/1000 (₹ 5,00,000 + ₹ 5,000)]	
Commission 22,000		By Consignment Stock A/c	1,01,000
(5% on 40,000)		[200/1000 (5,00,000 + 5,000)]	
Del-credere Commission 2,800			
(2% on 1,40,000)			
Special Commission 5,000	31,800		
25/100 × [4,40,000 – (700 × 500 × 120/100)]			
To Profit on Consignment (transferred to P&L A/c)	54,700		
	5,91,500		5,91,500

Dr. **CONSIGNMENT DEBTORS ACCOUNT** **Cr.**

Particulars	₹	Particulars	₹
To Swaroop A/c	1,40,000	By Bank A/c	1,38,000
		[1,40,000 – (2,800 – 800)]	
		By Swaroop A/c (Bad debts)	2,000
	1,40,000		1,40,000

Dr.**SWAROOP'S ACCOUNT****Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Consignment A/c [Sales]	4,40,000	By Consignment A/c	31,800
To Consignment Debtors A/c	2,000	By Consignment Debtors	1,40,000
		By Bank (remittance)	2,70,200
	4,42,000		4,42,000

PROBLEM 13

Goods are invoiced by Shri Amar, Consignor, to his agent Shri Ashok at selling price. The agent reports sales made and collection of book-debts by him and by monthly advice. He received 5% commission on cash collected *plus* an allowance of expenses @ ₹ 400 per annum.

During the half year ended 30th Sept. goods were invoiced to the agent at a value of ₹ 80,600. Such goods cost Shri Amar ₹ 59,000 *plus* freight and packing charges thereon ₹ 3,740. During the same period, sales were made by the agent amounting to ₹ 68,400. Debts collected were ₹ 57,600 and discounts were allowed amounted to ₹ 400. The agent remitted to Shri Amar ₹ 56,000. Some of the goods consigned to Shri Ashok were damaged in transit and a claim on the insurance company was settled for ₹ 1,240.

On 30th Sept., the stock in the hands of the agent and unsold represented a cost of Shri Amar ₹ 8,200.

Required: Prepare the consignment account and the account of Shri Ashok in the books of Shri Amar, for the half year ended 30th Sept.

SOLUTION:**Dr.****CONSIGNMENT TO ASHOK ACCOUNT****Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Goods Sent on Consignment A/c	59,000	By Ashok A/c-sales	68,400
To Bank A/c (freight etc.)	3,740	By Loss in Transit A/c	776
To Ashok A/c:		By Consignment Stock A/c	8,720
Allowance for expenses for			
6 months	6,200		
Discount allowed to customers	400		
Commission @ 5% on ₹ 57,600	2,880		
To Profit on Consignment			
transferred to P/L A/c			
	11,676		
	77,896		77,896

Dr.**LOSS IN TRANSIT ACCOUNT****Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Consignment to Ashok A/c	776	By Bank A/c (insurance claim	
To Profit & Loss A/c (transfer)	464	recovered)	1,240
	1,240		1,240

Dr.**ASHOK'S ACCOUNT****Cr.**

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Consignment to Ashok A/c	68,400	By Consignment to Ashok A/c:	
		Allowable for expenses	200
		Discount allowed to customers	400
		Commission	2,880
		By Bank A/c	56,000
		By Balance c/f	8,920
	68,400		68,400

Working Notes:(i) *Cost of goods damaged in transit:*

A. Cost of good sent	59,000
B. Less: Cost of goods sold: ₹ 59,000 × ₹ 68,400/₹ 80,600]	50,069
C. Less: Cost of Stock in the hands of consignee	8,200
D. Cost of goods damaged	731

(ii) *Value of Goods damaged and Unsold Stock*

A. Cost of Goods sent	59,000
B. Consignor's Expenses	3,740
C. Total Cost of Goods sent	62,740
D. Less: Cost of Goods lost in transit [62,740 × 730/59,000]	776
E. Cost of Goods reached the city of consignee	61,964
F. Add: Non-recurring Expenses	—
G. Cost of Goods received by Consignee	61,964
H. Cost of Unsold Stock [62,740 × 8,200/59,000]	8,720

PROBLEM 14

2,000 shirts were consigned by Bhagwan & Company of Delhi to Shreyans to Tokyo at a cost of ₹ 150 each. Bhagwan & Company paid freight ₹ 20,000 and insurance ₹ 3,000.

During the transit 200 shirts were totally damaged by fire. Shreyans took delivery of the remaining shirts and paid ₹ 28,800 as customs duty.

Shreyans had sent a bank draft to Bhagwan & Company for ₹ 1,00,000 as advance payment, 1,600 shirts were sold by him at ₹ 200 each. Expenses incurred by Shreyans on godown rent and advertisements, etc. amounted to ₹ 4,000. He is entitled to a commission of 5%.

One of the customers to whom the goods sold on credit could not pay the cost of 10 shirts.

Required: Prepare the consignment account and the account of Mr Shrenyas in the books of Bhagwan & Co., Shreyans settled his account immediately. Nothing was recovered from the insurers for the damaged goods.

SOLUTION:
Dr. **CONSIGNMENT ACCOUNT** **Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Goods sent on Consignment	10,000	By Shila & Co. (sales)	10,500
To Bank A/c (Freight & Insurance	600	By Goods sent on Consignment	2,500
To Shila & Co. (Exp. & Comm.)		(₹ 10,000 × 25/100)	
Import 1,000		By Consignment Stock A/c	2,360
Dock Dues 200		(20% of [10,000 + 600 + 1,000 + 200])	
Commission			
(5/100 × 10,500) 525	1,725		
To Consignment Stock Reserve			
(20/100 × 2,500)	500		
To Profit transferred to P&L A/c	2,535		
	15,360		15,360

Dr. **SHILA & CO.S ACCOUNT** **Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Consignment A/c	10,500	By Consignment A/c	
		Import Duty 1,000	
		Dock Dues 200	
		Commission 525	1,725
		By Bank A/c (Bal. figure)	8,775
	10,550		10,550

PROBLEM 16

On 1st Jan. Mr John of Bombay consigned to Mr Raj of Madras goods for sale at invoice price. Mr Raj is entitled to a commission of 5 per cent on sales at invoice price and 20 per cent of any surplus price realised. Goods costing ₹ 1,00,000 were consigned to Madras at the invoice price of ₹ 1,50,000. The direct expenses of the consignment amounted to ₹ 10,000. On 31st March an account sales was received by Mr John from Mr Raj showing that he had effected sales of ₹ 1,20,000 in respect of 4/5th of the quantity of goods consigned to him. His actual expenses were ₹ 3,000. Mr Raj accepted a bill drawn by Mr John for ₹ 1,00,000 and remitted the balance due in cash.

Show the Consignment Account and the account of Mr Raj in the books Mr John.

SOLUTION:

Dr. **CONSIGNMENT TO MADRAS ACCOUNT** **Cr.**

Particulars	₹	Particulars	₹
To Goods sent on Consignment A/c	1,50,000	By Mr. Raj A/c (sales)	1,20,000
To Bank A/c (Expenses)	10,000	By Goods sent on Consignment	50,000
To Mr. Raj A/c (Exp. & Comm.)		[Total Load = (1,50,000 – 1,00,000)]	
Expenses	3,000	By Consignment Stock A/c	
Commission	6,000	[1/5 (1,50,000 + 10,000)]	32,000
To Stock Reserve A/c [30,000 × 1/3]	10,000		
To Profit on Consignment (transferred)	23,000		
	2,02,000		2,02,000

Dr. **MR. RAJ'S ACCOUNT** **Cr.**

Particulars	₹	Particulars	₹
To Consignment A/c	1,20,000	By Consignment A/c:	
		Expenses	3,000
		Commission	6,000
			9,000
		By Bills Receivable A/c	1,00,000
		By Cash A/c	11,000
	1,20,000		1,20,000

PROBLEM 17

Karnath sold goods on behalf of Vijay Sales Corporation on Consignment basis. On April 1, 2018, he had with him a stock of ₹ 20,000 consignment.

Karnath had instruction to sell the goods at cost *plus* 25% and was entitled to a commission of 4% on sales in addition to 1% del-credere commission on total sales.

During the year ended 31st March, 2018, cash sales were ₹ 1,20,000, credit sales were ₹ 1,05,000 and Karnath's expenses relating to the consignment ₹ 3,000 being salaries and insurance. Bad debts were ₹ 3,000 and goods sent on consignment ₹ 2,00,000.

Required: Prepare Consignment Account in the books of Vijay Sales Corp.

SOLUTION:

Dr. **CONSIGNMENT ACCOUNT** **Cr.**

Particulars	₹	Particulars	₹
To Consignment Stock A/c (op. stock)	20,000	By Karnath's A/c (Sales)	2,25,000
To Goods sent on consignment	2,00,000	By Consignment Stock A/c	40,000
To Karnath's A/c (Exp. & Comm.)		(Closing Stock)	
Salaries & Insurance	3,000	[20,000 + 2,00,000 –	
		(100/125 × 2,25,000)]	

Ordinary Commission	9,000		
(4% on 2,25,000)			
Del-credere Commission	2,250	14,250	
(1% on $\times$ 2,25,000)			
To Profit on Consignment		30,750	
transferred to Profit & Loss A/c			
		2,65,000	2,65,000

PROBLEM 18

Punjab Cycle Co. of Ludhiana consigned 100 bicycles to Kanpur Cycle Co. of Kanpur costing ₹ 1,500 each, invoiced at ₹ 2,000 each. The consignor paid freight ₹ 10,000 and insurance in transit ₹ 1,500. During transit, 10 bicycles were totally damaged. Kanpur Cycle Co. took delivery of the remaining bicycles and paid ₹ 1,530 for octroi duty. Kanpur Cycle Co. sent a bank draft to Punjab Cycle Co. for ₹ 50,000 as advance and later on sent an account sales showing that 80 bicycles had been sold @ ₹ 2,200 each. Expenses incurred by Kanpur Cycle Co. on godown rent were ₹ 2,000. Kanpur Cycle Co. is entitled to a commission of 5% on invoice price and 25% on any surplus of sale price over invoice price. Insurance claim was settled at ₹ 14,000.

Required: Prepare consignment account, consignee's account and accidental loss account in the books of the consignor.

SOLUTION:**Dr.****CONSIGNMENT TO KANPUR ACCOUNT****Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Goods Sent on Consignment A/c	2,00,000	By Kanpur Cycle Co.	
To Bank A/c (Expenses)	11,500	(Sale Proceeds)	
To Kanpur Cycle Co. (Expenses):		(80 $\times$ ₹ 2,200)	1,76,000
Octroi	1,530	By Loss-in-transit	21,320
Godown Rent	2,000	By Consignment Stock A/c	
To Kanpur Cycle Co. (Commission)	12,000	By Goods Sent on Consignment	50,000
To Consignment Stock Reserve A/c	5,000	A/c (100 $\times$ ₹ 500)	
To Profit f/t to P & L A/c	31,440		
	2,63,470		2,63,470

Dr.**KANPUR CYCLE CO. ACCOUNT****Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Consignment to Kanpur A/c		By Bank A/c (Advance)	50,000
(sales)	1,76,000	By Consignment to Kanpur A/c	
		(Exp.)	3,530
		By Consignment to Kanpur A/c	
		(Comm.)	12,000
		By Balance c/d	1,10,470
	1,76,000		1,76,000

Dr.

LOSS-IN-TRANSIT ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Consignment to Kanpur A/c	16,150	By Insurance Co. (Recovered Loss)	14,000
		By Profit & Loss A/c (Loss)	2,150
	16,150		16,150

Working Notes:**(I) STATEMENT SHOWING THE CALCULATION OF ABNORMAL LOSS AND UNSOLD STOCK**

Particulars	Units	₹
A. Cost of Goods Sent	100	1,50,000
B. Expenses incurred by Consignor	—	11,500
C. Total Cost of Goods Sent (A + B)	100	1,61,500
D. Less: Cost of Goods lost-in-transit	10	16,150
E. Cost of Goods reached the city of Consignee C – D	90	1,45,350
F. Add: Non-recurring expenses incurred by Consignee	—	1,530
G. Cost of Goods received by consignee (E + F)	90	1,46,880
H. Cost of Unsold Stock	10	16,320

(II) CALCULATION OF INVOICE VALUE OF GOODS-IN-TRANSIT AND UNSOLD STOCK

Particulars	Unsold Stock
A. Cost	16,320
B. Add: Loading @ ₹ 500 per unit	5,000
C. Invoice Value [A + B]	21,320

(iii) Commission

5% on Invoice Price ($80 \times ₹ 2,000 \times 5/100$)	8,000
25% of Surplus ($80 \times ₹ 200 \times 25/100$)	4,000
	<u>12,000</u>

PROBLEM 19

Kay sent 500 articles to his agent Jay at an invoice price of ₹ 25 per article and paid freight and cartage ₹ 460. Jay sold 300 articles @ ₹ 30 per article and sent an account sales, deducting ₹ 200 for storage charges and ₹ 300 for selling expenses. He charged 10% commission on the gross sale proceeds and remitted the amount due to Kay. Jay also informed Kay that 50 articles had been damaged in transit and they could fetch 70% of their cost.

Required: Record the above mentioned transactions in Kay's ledger showing the profit earned by the consignor.

SOLUTION:**Dr.****CONSIGNMENT TO KANPUR ACCOUNT****Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Goods Sent on Consignment A/c	12,500	By Jay (Sale Proceeds)	
To Bank A/c (Expenses)	460	(300 × ₹ 30)	9,000
To Jay (Expenses):	500	By Loss on Goods damaged-in-	
To Jay Commission		transit A/c	389
[₹ 9,000 × 10/100]	900	By Consignment Stock A/c:	
		Good	3,888
		Damaged	907
		By Loss t/f to P&L A/c	176
	14,360		14,360

Working Note:**(I) STATEMENT SHOWING THE CALCULATION OF ABNORMAL LOSS AND UNSOLD STOCK**

<i>Particulars</i>	<i>Units</i>	₹
A. Cost of Goods Sent	500	12,500
B. Expenses incurred by Consignor	—	460
C. Total Cost of Goods Sent (A + B)	500	12,960
D. Cost of Unsold Stock (Good)	150	3,888
E. Cost of Damaged units	50	1,296
F. Less: 30% Loss on damaged units		388.8
G. Realizable Value of damaged goods		907.2

PROBLEM 20

Renco Ltd., consign on 1st Nov., 1,000 tins of groundnut oil from Ulhasnagar to their agent Khem Singh at Dhanbad. Each tin costs ₹ 30 at the rate of ₹ 3 per kg. Renco Ltd., pay 5,000 by way of freight and other expenses. During transit 25 tins were accidentally destroyed. Khem Singh takes delivery on 15th Nov. and accepts a bill for ₹ 2,000 drawn by Renco Ltd. At 3 months. On 31st March Khem Singh sold 800 tins @ ₹ 50 per tin and reports to Renco Ltd., a theft of 35 tins. Khem Singh had also paid ₹ 600 as clearing charges, ₹ 1,000 as godown rent and ₹ 2,000 by way of labour charges and fire insurance. Khem Singh is entitled to receive a commission of 5% *plus* 1% for *del credere* risk.

Required: Show important Ledger Accounts up to 31st March in the books of Renco Ltd. Assuming that Khem Singh pays the dues by bank draft.

SOLUTION:
Dr. CONSIGNMENT TO DHANBAD ACCOUNT Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Goods Sent on Consignment A/c	30,000	By Khem Singh A/c (sale proceeds)	40,000
To Bank A/c (freight and other expenses)	5,000	By Profit & Loss A/c (accidental loss)	875
To Khem Singh A/c—expenses:		By Profit & Loss A/c (loss due to theft)	1,247
Clearing charges	600	By Consignment Stock A/c	4,986
Godown rent	1,000		
Labour charges	2,000		
	3,600		
To Khem Singh A/c (commission)			
Ordinary	2,000		
Del credere	400		
	2,400		
To Profit on Consignment			
Transferred to P/L A/c	6,108		
	47,108		47,108

Dr. KHEM SINGH (CONSIGNEE) ACCOUNT Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Consignment to Dhanbad A/c (Sales)	40,000	By Bills Receivable A/c	20,000
		By Consignment to Dhanbad A/c:	
		Expenses	3,600
		Commission	2,400
		By Bank A/c (balance received)	14,000
	40,000		40,000

Working Note: Valuation of losses and unsold stock:

<i>Particulars</i>	<i>Units</i>	₹
A. Cost of Goods Sent	1,000	30,000
B. Consignor in Expenses	—	5,000
C. Total Cost of of Goods Sent	1,000	35,000
D. Less: Cost of Loss in transit	25	875
E. Cost of Goods reached the city of consignee	975	34,125
F. Add: Non-recurring expenses	—	600
G. Cost of Goods received by consignee	975	34,725
H. Cost of Goods Stolen $[34,725 \times 35/975]$		1,247
I. Cost of Unsold Stock $[34,725 \times 140/975]$		4,986

PROBLEM 21

Shri Jayaram of Madras consigned 1,000 cases of tinned fruit (Cost ₹ 7,500) to Govind Lal of Bombay on the 1st April charging them at a proforma invoice price to show a profit of 25 per cent on sales. Jayaram paid on the same date ₹ 600 in respect of freight etc. During the half year ending 30th Sept, Govind Lal Incurred expenses of ₹ 200 on godown rent and sold 800 cases of the consignment for ₹ 8,000. Govind Lal is entitled to 5% Commission on sales. Record the entries in the books of Shri Jayaram. Also give the solution by Memorandum Column Method.

SOLUTION:**Dr.****CONSIGNMENT TO BOMBAY ACCOUNT****Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Goods sent on Consignment A/c [₹ 7,500 + (₹ 7,500 × 25/75)]	10,000	By Govind Lal (Sales)	8,000
To Cash A/c (Freight and Insurance)	600	By Goods sent on Consignment A/c [₹ 10,000 × 25/100]	2,500
To Govind Lal (Expenses)	200	By Consignment Stock A/c	
To Govind Lal (Commission)	400	Invoice Price 2,000	
To Consignment Stock Reserve A/c [₹ 2,000 × 25/100]	500	Add: Prop. Freight 120	2,120
To Profit & Loss A/c (Profit)	920		
	12,620		12,620

Dr.**GOVIND LAL'S ACCOUNT****Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Consignment to Bombay A/c (Sales)	8,000	By Consignment to Bombay A/c:	
		Expenses	200
		Commission	400
		By Balance c/d	7,400
	8,000		8,000

Dr.**MEMORANDUM COLUMN METHOD CONSIGNMENT TO BOMBAY ACCOUNT****Cr.**

<i>Particulars</i>	<i>Invoice Price ₹</i>	<i>Cost ₹</i>	<i>Particulars</i>	<i>Invoice Price ₹</i>	<i>Cost ₹</i>
To Goods sent on Consignment (1,000 cases)	10,000	7,500	By Govind Lal (800 cases)	8,000	8,000
To Cash (Freight & Insurance)	600	600	By Stock (200 cases) (Cost ₹ 1,500 plus ₹ 120)	2,120	1,620
To Govind Lal Commission	400	400	By Loss	1,080	
To Govind Lal Expenses	200	200			
To P & L A/c		920			
	11,200	9,620		11,200	9,620

PROBLEM 22

The Calicut Consignment Stock Account in the books of Ranjit of Bombay showed a debit balance of ₹ 1,500 representing the cost of ten bicycles on 1st April. On 1st June, Ranjit sent a further consignment to Calicut of 40 bicycles costing ₹ 160 each. The freight and other charges amounted to ₹ 210. On 30th Sept., Calicut agent sent an account sale showing that 8 bicycles from the old stock realised ₹ 140 each and 25 bicycles from the second consignment realised ₹ 200 each. 15 bicycles remained in stock unsold. The Calicut agent remitted an acceptance for ₹ 4,000 which was discounted for ₹ 3,915. Two bicycles from the old stock were unsalable, which the Agent returned to Bombay, on which he incurred an expenditure of ₹ 30. The agent is entitled to 5% commission, which covers all out of pocket expenses to consignment. Prepare Consignment Stock, Consignment Trading, Consignment Expenses and Consignment Profit & Loss Account, supposing that Ranjit closes his accounts on 31st March.

SOLUTION:
Dr. CALICUT CONSIGNMENT STOCK ACCOUNT Cr.

Particulars	No.	₹	Particulars	No.	₹
To Balance b/d	10	1,500	By Consignment Trading A/c	33	5,200
To Goods sent on Consignment A/c	40	6,400	By Goods sent on Consignment A/c (Return)	2	300
			By Balance c/d	15	2,400
	50	7,900		50	7,900

CALICUT CONSIGNMENT TRADING ACCOUNT
Dr. FOR THE PERIOD ENDING ON 31ST MARCH Cr.

Particulars	₹	Particulars	₹
To Consignment Stock A/c (Cost of goods sold)	5,200	By Calicut Agent's A/c (Sales)	6,120
To Gross Profit t/f to Profit & Loss A/c	920		
	6,120		6,120

Dr. CALICUT CONSIGNMENT EXPENSES ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Bank A/c (freight & other charges)	210	By Calicut Consignment Profit & Loss A/c	467
To Calicut Agent's A/c (Expenses & Commission)	336	By Balance c/d (freight etc, on 15 bicycles)	79
	546		546

Dr. CALICUT CONSIGNMENT PROFIT AND LOSS ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Consignment Expenses A/c	467	By Calicut Consignment Trading A/c (Gross Profit)	920
To Profit & Loss A/c (Profit)	453		
	920		920

PROBLEM 23

Star Mills Ltd. Surat, sends regular consignments of yarn to X who is the selling agent of the Mill and is entitled to a commission of 10 paise per kg of yarn sold. This includes del credere commission. Following further information is furnished to you: On 1st April 2017, stock of yarn with the agent 20,000 kg, costing ₹ 50,000. During the year ended 31st March, 2018. Total quantity of yarn consigned—1,60,000 kg @ ₹ 3 per kg, Total quantity of yarn sold—1,50,000 kg @ ₹ 3.75 per kg (these included that opening stock of 20,000 kg). Total remittances by the Agent—₹ 5,10,000, Railway freight paid by the agent—₹ 40,000. Of the sales made, X could not collect ₹ 11,000 due to the insolvency of the customer. 5,000 kg of yarn were damaged in transit by Railway for which the agent recovered ₹ 6,000. The damaged goods were sold at the rate of ₹ 1.50 per kg. Show the following Ledger Accounts in the books of Star Mills Ltd. for the year ended 31st March, 2018.

(a) Consignment Account (b) Goods damaged-in-transit Account, and (c) X's Account.

SOLUTION:

DR. **CONSIGNMENT ACCOUNT** **CR.**

Particulars	₹	Particulars	₹
To Consignment Stock A/c (20,000 kg)	50,000	By X's A/c (Sales) (1,50,000 kg sold @ ₹ 3.75 per kg)	5,62,500
To Goods sent on Consignment A/c (1,60,000 kg @ ₹ 3 per kg)	4,80,000	By Goods Damaged A/c (Value of 5,000 kg damaged)	16,250
To X's A/c (Railway freight)	40,000	By Consignment Stock A/c	81,250
To X's A/c (Commission @ 10 Paise)	15,000		
To Profit & Loss A/c (Profit)	75,000		
	6,60,000		6,60,000

DR. **GOODS DAMAGED (IN TRANSIT) ACCOUNT** **CR.**

Particulars	₹	Particulars	₹
To Consignment A/c (5,000 kg)	16,250	By X's A/c (Amount recovered from Railway)	6,000
To X's A/c (Commission) [@ 10 Paise per kg on 5,000 kg]	500	By X's A/c (5,000 kg damaged goods sold @ ₹ 1.50 per kg)	7,500
		By Profit and Loss A/c	3,250
	16,750		16,750

DR. **X'S ACCOUNT** **CR.**

Particulars	₹	Particulars	₹
To Consignment A/c (1,50,000 kg of goods sold)	5,62,500	By Consignment A/c (Railway freight)	40,000
To Goods Damaged A/c (Amount recovered from Railway)	6,000	By Consignment A/c (Commission)	15,000
To Goods Damaged A/c (5,000 kg of damaged goods sold)	7,500	By Goods Damaged A/c (Commission)	500
		By Bank A/c (Remittance)	5,10,000
		By Balance c/d	10,500
	5,76,000		5,76,000

Working Note: Valuation of Goods Damaged in Transit and Closing Stock

Particulars	Goods damaged in transit (5,000 kg) ₹	Unsold stock (25,000 kg) ₹
A Cost @ ₹ 3 per kg	15,000	75,000
B Add: Proportionate freight @ 25 Paise per kg	1,250	6,250
	16,250	81,250

PROBLEM 24

Messrs. Goswami Brothers were appointed Agents by Sunrise Limited in 2017. You are given the following particulars relating to the year 2017-2018.

	₹
(i) Cost of Goods despatched by the Company on consignment	7,50,000
(ii) Goods fully destroyed in Transit (original cost)	50,000
(iii) Expenses incurred by the Company towards:	
Freight	2,500
Insurance	1,500
(iv) Expenses incurred by Goswami Brothers:	
Landing & Clearing	1,500
Godown Rent	1,000
Transport Charges upto Godown	1,000
Advertisements	800
Insurance	800
(v) Advance remitted by the Agent	1,50,000
(vi) Bills payable accepted	25,000
(vii) Goods destroyed by fire (at original cost) in Agent's godown	35,000
(viii) Bad Debts	3,000
(ix) Unsold stock with Agent at the close of the year (at original cost)	50,000
(x) Insurance claim recovered by the Consignor towards loss in transit	48,000
(xi) Insurance claim recovered by the Agent towards loss by fire.	35,000

All sales were effected by the Agent at 25% on original cost.

The Agent is entitled to a Commission of 10% on gross sales.

Required: Show the Consignor's Account (Sunrise Ltd.) as would appear in the Books of Goswami Brothers.

SOLUTION:

Dr. **CONSIGNOR'S ACCOUNT** **Cr.**

Particulars	₹	Particulars	₹
To Cash/Bank A/c (Advance)	1,50,000	By Cash/Bank A/c (Claim)	35,000
To Cash/Bank A/c (Expenses)	5,100	By Cash/Bank A/c (Sales)	
To Bills Payable A/c	25,000	Cost	7,50,000
To Bad Debts	3,000	Lost in Transit	(50,000)
To Commission A/c	76,875	Lost-in-Godown	(35,000)
(10% on ₹ 7,68,750)		Unsold Stocks	(50,000)
To Balance c/d	5,43,775		6,15,000
		Add: Profit	1,53,750
	8,03,750		7,68,750
			8,03,750

8

ACCOUNTING FOR JOINT VENTURE

PROBLEM 1

Mr S and Mr R carrying on a business separately as contractors, jointly take up the work of constructing a building at an agreed price of ₹ 3,50,000 payable in cash ₹ 2,40,000 and the balance in fully paid shares of a Company. A bank account is opened in which Mr S and Mr R paid ₹ 75,000 and ₹ 50,000 respectively. The following costs were incurred in completing the construction and the contract price was duly realised:

Wages paid ₹ 90,000, Materials purchased for cash ₹ 2,10,000, Materials supplied by Mr R from the stock ₹ 27,000, Consulting Engineer's fees paid by Mr S ₹ 6,000.

The Accounts were closed, Mr. S taking up all the shares of the company at an agreed valuation of ₹ 48,000, and Mr R taking the remaining stock of materials at ₹ 9,000.

Required: Prepare and close the Joint Venture Account and the Personal Accounts of Mr S and Mr R assuming that the net result of the venture is shared by Mr S and Mr R in the ratio of 2 : 1.

SOLUTION:

Dr. **JOINT VENTURE ACCOUNT** **Cr.**

Particulars	₹	Particulars	₹
To Joint Bank A/c:		By Joint Bank A/c	2,40,000
Wages 90,000		By Equity Shares A/c	1,10,000
Material <u>2,10,000</u>	3,00,000	By Mr R (Material)	9,000
To Mr R (Material)	27,000	By Loss t/f to:	
To Mr S (Fees)	6,000	Mr S	24,000
To Equity Shares	62,000	Mr R	12,000
	3,95,000		3,95,000

Dr. **JOINT BANK ACCOUNT** **Cr.**

Particulars	₹	Particulars	₹
To S	75,000	By Joint Venture A/c	3,00,000
To R	50,000	By Mr S	9,000
To Joint Venture A/c	2,40,000	By Mr R	56,000
	3,65,000		3,65,000

Dr. **CO-VENTURERS' ACCOUNT** **Cr.**

Particulars	S (₹)	R (₹)	Particulars	S (₹)	R (₹)
To Equity Shares A/c	48,000	—	By Joint Bank A/c	75,000	50,000
To Joint Bank A/c	—	9,000	By Joint Venture A/c	6,000	27,000
To Joint Venture A/c	24,000	12,000			
To Joint Bank A/c	9,000	56,000			
	81,000	77,000		81,000	77,000

PROBLEM 2

Gopal and Govind entered into a joint venture agreement to undertake the subscriptions of 50,000 Equity Shares of ₹ 10 each issued by a newly formed Limited Company at a premium of ₹ 2 per share. The underwriting commission is 4% as provided in the Articles:

Public subscriptions were received for 38,000 shares and the underwriters duly discharged their obligations by taking up the remaining shares. Gopal and Govind contributed ₹80,000 each and deposited the same in a Joint Bank Account. Sundry expenses incurred out of the joint Bank amounted to ₹ 5,000. The underwriting commission was received by cheque.

Towards the end of the venture 10,000 shares were sold by them in the open market @ ₹ 14 per share and the rest of the shares were taken up by them equally @ ₹ 13 per share.

Profits of the venture were shared equally.

Required: Prepare the joint venture account, joint Bank account and the personal accounts of the co-venturers according to the above mentioned transactions.

SOLUTION:

Dr. JOINT VENTURE ACCOUNT Cr.			
Particulars	₹	Particulars	₹
To Joint Bank A/c (Exp.)	40,000	By Co. (Under Comm.)	
To Joint Bank A/c (12,000 shares @ ₹ 12)	1,44,000	[4% on ₹ 6,00,000]	24,000
To Profit t/f to:		By Joint Bank (10,000 @ ₹ 14)	1,40,000
Gopal	20,500	By Gopal (1,000 @ 13)	13,000
Govind	20,500	By Govind (1,000 @ 13)	13,000
	1,86,000		1,86,000

Dr. JOINT BANK ACCOUNT Cr.			
Particulars	₹	Particulars	₹
To Gopal	80,000	By Joint Venture A/c	5,000
To Govind	80,000	By Joint Venture A/c	1,44,000
To Joint Venture A/c	1,40,000	By Gopal	87,500
To Joint Bank A/c	24,000	By Govind	87,500
	3,24,000		3,24,000

Dr. CO-VENTURERS' ACCOUNT Cr.					
Particulars	Gopal ₹	Govind ₹	Particulars	Gopal ₹	Govind ₹
To Joint Venture A/c	13,000	13,000	By Joint Bank A/c	80,000	80,000
To Joint Bank A/c	87,500	87,500	By Joint Venture A/c	20,500	20,500
	1,00,500	1,00,500		1,00,500	1,00,500

PROBLEM 3

A of Agra and B of Bareilly enter into a joint venture to consign 100 bales to C of Shahdra, to be sold on their joint risk, which is in proportion of 4/7 and 3/7 respectively. A sent 75 bales of ₹ 2,600 each, paying for freight & other charges ₹ 4,900. B sent 25 bales at 2,500 each, paying for freight and other charges ₹ 1,800. All the bales except 5 reached in time. A recovered ₹ 12,000 from the Insurance Company. C sold the remaining bales @ ₹ 3,000 each. C after deducting ₹ 400 for his expenses and his commission @ 4%, remitted a bank draft for ₹ 2,20,000 to A and bank draft for the balance to

B. Prepare Joint Venture Account and B's Account in the books of A assuming the final settlement between A and B was made by cheque.

SOLUTION:

Dr.		JOINT VENTURE ACCOUNT		Cr.	
<i>Particulars</i>	₹	<i>Particulars</i>	₹		
To Purchases A/c (Goods)	1,95,000	By Bank A/c (Claim)	12,000		
To Bank A/c (Exp.)	4,900	By C (Sales)	2,85,000		
To B (Goods)	62,500				
To Bank A/c (Exp.)	1,800				
To C (Exp.)	400				
To C (Commission) [4% of ₹ 2,85,000]	11,400				
To Profit t/f to:					
A	12,000				
B	9,000				
	2,97,000				2,97,000

Dr.		B'S ACCOUNT		Cr.	
<i>Particulars</i>	₹	<i>Particulars</i>	₹		
To C A/c	53,200	By Joint Venture A/c	62,500		
To Bank A/c	20,100	By Joint Venture A/c	1,800		
		By Joint Venture A/c	9,000		
	73,300				73,300

PROBLEM 4

A and B enter into a Joint Venture agreeing to share profits and losses in the ratio of 3:1 respectively. A sends ₹ 1,00,000 to B who purchased and sent the following goods to A. 200 silk shirts @ ₹ 100, 750 tericot shirts @ ₹ 80, 400 cotton shirts @ ₹ 50. The expenses incurred by B amounted to ₹ 1,000. A sold the first two varieties at double the purchase price but in respect of last variety, he made a profit of 33-1/3% on sales only. His expenses amounted to ₹ 4,000.

Required: Prepare Joint Venture Account, B's Account in the books of A, assuming the final settlement is made by cheque.

SOLUTION:

Dr.		JOINT VENTURE ACCOUNT		Cr.	
<i>Particulars</i>	₹	<i>Particulars</i>	₹		
To B (Goods)		By Bank A/c:			
Sick Shirts 20,000		Silk Shirts 40,000			
Ter. Shirts 60,000		Ter. Shirts 1,20,000			
Cott. Shirts <u>20,000</u>	1,00,000	Cotton Shirts <u>30,000</u>			1,90,000
To B (Exp.)	1,000				
To Bank A/c (Exp.)	4,000				
To Profit t/f to:					
A	63,750				
B	21,250				
	1,90,000				1,90,000

8.4 Quick Revision for Accounting for CA Foundation Course

Dr.

B'S ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Bank A/c	1,00,000	By Joint Venture A/c	1,00,000
To Bank A/c	22,250	By Joint Venture A/c	1,800
		By Joint Venture A/c	21,250
	1,22,250		1,22,250

PROBLEM 5

Singh Sons bought goods of the value of ₹ 7,500 and consigned them to Rahim Sons to be sold by them on a joint venture, profits being divided equally. Singh sons paid ₹ 550 for freight and insurance. Singh Sons drew on Rahim Sons bill for ₹ 3,000. The bill was discounted for ₹ 2,900 Rahim Sons paid ₹ 300 for warehousing, cartage etc. Goods were sold for ₹ 12,500 and sales expenses paid by Rahim Sons amounted to ₹ 250. Rahim Sons sent Demand Draft for balance amount after deducting 5% commission the gross sale proceeds.

Required: Prepare Journal and Ledger Accounts in the books of both the parties.

SOLUTION:

Dr.

JOINT VENTURE ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Bank (Goods)	7,500	By Rahim (Sales)	12,500
To Bank A/c (Exp.)	550		
To B/R (Discount)	100		
To Rahim (Exp.)	300		
To Rahim (Sales Exp.)	250		
To Rahim (Commission)	625		
To Profit t/f to:			
P&L A/c	1,587		
Rahim & Sons	1,588		
	12,500		12,500

Dr.

RAHIM SONS' ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Joint Venture A/c	12,500	By Joint Venture A/c	3,000
		By Joint Venture A/c	300
		By Joint Venture A/c	250
		By Joint Venture A/c	625
		By Joint Venture A/c	1,588
		By Bank A/c	6,737
	12,500		12,500

Note: Students are required to prepare the necessary accounts in the books of other party on the above pattern.

PROBLEM 6

Thread of Tatanagar are Needle of Nagpur entered into a Joint Venture to trade together in the buying and reselling of cheap machinery. Profit or loss to be shared in the ratio 2:3. Thread undertook to make the purchases and Needle to effect sales. Needle remitted ₹ 75,000 to Thread towards the

Joint Venture. Thread purchased machinery worth ₹ 60,000 and paid ₹ 28,500 for repairs of these, 2-1/2% as buying commission and ₹ 2,700 for other sundry expenses. He then sent all the machines purchased and repaired to Needle at Nagpur. While taking delivery of the machinery at Nagpur, Needle incurred ₹ 4,500 towards Railway Freight and 2,100 towards Octroi. He sold part of the machinery for ₹ 1,05,000 and kept the remaining for himself at an agreed value of ₹ 22,500. Other expenses of Needle were (i) Godown rent ₹ 1,350 (ii) Insurance ₹ 1,680 (iii) Brokerage ₹ 2,490 and (iv) Miscellaneous ₹ 1,920.

Both the parties decided to close the venture at this stage. You are required to prepare Accounts for the Joint Venture to show how matters stood in each party's ledger and prepare a statement showing the result of the Venture.

SOLUTION:**STATEMENT SHOWING THE RESULT OF THE VENTURE**

<i>Particulars</i>		₹
A Sale Proceeds received by Needle		1,05,000
B Value of Machinery retained by Needle		22,500
		1,27,500
C Less: Purchase and Expenses by Thread:		
Purchase of Machinery	60,000	
Cost of Repairs	28,500	
Buying Commission (2.5% of ₹ 60,000)	1,500	
Sundry Expenses	2,700	92,700
D Expenses by Needle:		
Railway Freight	4,500	
Octroi	2,100	
Godown Rent	1,350	
Insurance	1,680	
Brokerage	2,490	
Miscellaneous Expenses	1,920	14,040
E Total Cost (C + D)		1,06,740
F Profit: Thread (2/5)	8,304	
Needle (3/5)	12,456	20,760

Dr. JOINT VENTURE WITH NEEDLE ACCOUNT IN THREADS' LEDGER Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c:		By Bank A/c: (from Needle)	75,000
Purchases of Machinery	60,000	By Balance c/d	26,004
Repairs	28,500		
Buying Commission	1,500		
Sundry Expenses	2,700		
To P & L A/c (Share of profit)	8,304		
	1,01,004		1,01,004

Dr. JOINT VENTURE WITH THREAD ACCOUNT IN NEEDLE LEDGER Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Bank A/c (sent to Thread)	75,000	By Bank A/c (Sales proceeds)	1,05,000
To Bank A/c:		By Purchases A/c: (Machinery)	22,500
Railway Freight	4,500		
Octroi	2,100		
Godown Rent	1,350		
Insurance	1,680		
Brokerage	2,490		
Miscellaneous Expenses	1,920		
To Profit & Loss A/c (Share of profit)	12,456		
To Balance c/d	26,004		
	1,27,500		1,27,500

PROBLEM 7

Mr *H* and Mr *S* entered into a joint venture to buy and sell Computer monitors on 1st August.

On 1st Aug. *H* sent a draft for ₹ 5,00,000 in favour of *S* and on 5th Aug. *S* purchased 250 Monitors at a cost of ₹ 4,000 each. The monitors were sent to Mr *H* by Truck under 'freight to pay' for ₹ 8,000 and were cleared by him on 12th Aug.

Hard effected sales in the following manner:

<i>Date</i>	<i>Nos. of Units</i>	<i>Sale price per unit ₹</i>	<i>Discount on sales price</i>
13th Aug.	50	4,700	400 per unit
30th Sept.	100	5,000	10%
30th Oct.	100	4,600	5%

On 15th Nov. Mr *H* settled the account by sending a draft in favour of Mr *S*. Profits being shared equally. *S* does not maintain any books. Show in *H*'s book.

(i) Joint venture with Mr *S* Account; and

(ii) Memorandum Joint Venture Account.

[May, 2005]

SOLUTION:

Dr. JOINT VENTURE WITH MR S ACCOUNT IN THE BOOKS OF H Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Bank A/c	5,00,000	By Bank A/c	
To Bank A/c (Freight)	8,000	(sale proceeds)	2,15,000
To Profit and loss A/c		By Bank A/c	
(share of profit)	47,000	(sale proceeds)	4,50,000
To Bank account (draft sent in settlement)	5,47,000	By Bank A/c	
		(sale proceeds)	4,37,000
	11,02,000		11,02,000

Dr.**MEMORANDUM JOINT VENTURE ACCOUNT****Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To S (250 × ₹ 4,000)	10,00,000	By H—Sales (net):	
To H (Freight)	8,000	50 monitors @ ₹ 4,300	2,15,000
To Profit:		100 monitors @ ₹ 4,500	4,50,000
H	47,000	100 monitors @ ₹ 4,370	4,37,000
S	47,000		
	94,000		
	11,02,000		11,02,000

PROBLEM 8

M and *N* entered into a Joint venture for the purchase and sale of second-hand motor car and to share profits and losses in the ratio of 3:2.

On January 15, *M* bought 5 cars for ₹ 43,000 and on January 20, he paid tax and insurance amounting to ₹ 1,600. On January 31, he sold these cars for ₹ 58,000 out of which he remitted ₹ 11,000 to *N* paying the balance into his own bank account.

On January 20, *N* bought 3 cars for ₹ 36,000 and on January 25, he paid tax and insurance ₹ 1,400 and repair charges amounting to ₹ 2,000. He sold one car on February 2, for ₹ 14,000 which he paid into his own bank account. *M* then took other cars at a valuation of ₹ 26,000 and the venture was closed on February 10.

Required: Prepare the Memorandum Joint Venture Account and the Account of the Joint Venture with *N* in the books of *M*.

SOLUTION:**Dr.****MEMORANDUM JOINT VENTURE ACCOUNT****Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To M:		By M (Sales)	58,000
Purchases	43,000	By N (Sales)	14,000
Tax etc.	1,600	By N (Taken away)	26,000
To N:			
Purchases	36,000		
Tax etc.	1,400		
Repairs	2,000		
To Profit t/f to:			
M	8,400		
N	5,600		
	98,000		98,000

Dr.**JOINT VENTURE WITH N ACCOUNT IN THE BOOKS OF M****Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c	44,600	By Bank A/c	58,000
To Bank A/c	11,000	By Balance c/d	6,000
To P&L A/c	8,400		
	64,000		64,000

PROBLEM 9

Mr A and Mr B entered into a joint venture of purchase and sell crackers during Diwali season. Profit or losses were to be shared equally between Mr A and Mr B. Mr A was to purchase crackers from Sivakasi and send it to Mr B of Bombay who would sell it.

On 1st August Mr A purchased crackers worth ₹ 1,00,000 and incurred the following expenses in sending it to Mr B.

- (i) Forwarding charges ₹ 6,000
- (ii) Insurance charges ₹ 2,000.

He immediately drew upon Mr B ₹ 1,00,000 for 3 months. The acceptance was discounted @ 18% p.a.

Mr B paid the following expenses:

- (i) Cartage charges ₹ 3,000,
 - (ii) Commission to agents ₹ 5,000 and
 - (iii) Rental charges ₹ 4,000. The whole crackers were disposed off for ₹ 2,00,000. He forwarded a cheque to Mr A for the amount due on 31st October. You are required to prepare the following accounts:
- (a) Memorandum Joint Venture Account,
 - (b) Mr B in Joint Venture Account in the books of Mr A,
 - (c) Mr A in Joint Venture Account in the books of Mr B.

[Nov. 1996]

SOLUTION:

**MEMORANDUM JOINT VENTURE ACCOUNT
FOR THE PERIOD FROM AUGUST 1 TO OCTOBER 31...**

Dr.

Cr.

Particulars	₹	Particulars	₹
To A's A/c		By B's A/c (Sales)	2,00,000
Purchase of crackers	1,00,000		
Forwarding charges	6,000		
Insurance charges	2,000		
Discount charges	4,500		
To B's A/c:			
Cartage charges	3,000		
Rental charges	4,000		
Commission to Agents	5,000		
To Profit transferred to:			
A 37,750			
B <u>37,750</u>	75,500		
	2,00,000		2,00,000

Dr.

B IN JOINT VENTURE ACCOUNT IN THE BOOKS OF A

Cr.

Particulars	₹	Particulars	₹
To Bank A/c		By Bills Receivable A/c	1,00,000
(Purchases of crackers)	1,00,000	By Bank A/c	50,250
To Bank A/c:			
Forwarding charges	6,000		
Insurance charges	2,000		
To Discount charges	4,500		
To Profit and Loss A/c (Profit)	37,750		
	1,50,250		1,50,250

Dr. A IN JOINT VENTURE ACCOUNT IN THE BOOKS OF B Cr.

Particulars	₹	Particulars	₹
To Bank A/c:		By Bank A/c (Sale proceeds)	2,00,000
Cartage charges	3,000		
Commission to agents	5,000		
Rental charges	4,000		
To Bills Payable A/c	1,00,000		
To Profit and Loss A/c (Profit)	37,750		
To Bank A/c	50,250		
	2,00,000		2,00,000

PROBLEM 10

A and B decided to work a Joint Venture for the sale of electric motors. On 21st May, 2017, A purchased 200 electric motors at ₹ 175 each and despatched 150 motors to B incurring ₹ 1,000 as freight and insurance charges. 10 electric motors were damaged in transit. On 1st February, 2018, ₹ 500 were received by A from the Insurance Co., in full settlement of his claim. On 15th March, 2018, A sold 50 electric motors at ₹ 225 each. He received ₹ 15,000 from B on 1st April, 2018.

On 25th May, 2017 B took delivery of electric motors and incurred the following expenses:

Clearing Charges ₹ 170

Repair charges for 10 Electric Motors damaged in transit ₹ 300

Godown Rent for 3 months ₹ 600

He sold the Electric Motors as below:

1.2.2018 10 damaged motors at ₹ 170 each, 40 motors at ₹ 200 each

15.3.2018 20 motors at ₹ 315 each

1.4.2018 80 motors at ₹ 250 each

It is agreed that they are entitled to commission @ 10% on the respective sale effected by them and that the profits and losses shall be shared between A and B in the ratio of 2 : 1. B remits to A the balance of monies due on 30th April, 2018. Prepare: (i) Joint Venture Account in the books of A. (ii) Memorandum Joint Venture Account. [Nov, 1994]

SOLUTION:

Dr. JOINT VENTURE WITH B ACCOUNT IN THE BOOKS OF A Cr.

Date	Particulars	₹	Date	Particulars	₹
2017			2018		
May 21	To Bank A/c (Goods purchased)	35,000	Feb. 01	By Bank A/c (Claim from Insurance Co.)	500
May 21	To Bank A/c (Freight and Insurance charges)	1,000	Mar. 15	By Bank A/c (Sales)	11,250
2018			Apr. 01	By Bank A/c (from B)	15,000
Apr. 30	To Commission on Sales (10% of ₹ 11,250)	1,125	Apr. 30	By Bank A/c (remittance from B)	14,345
	To Profit & Loss A/c (Share of Profit)	3,970			
		41,095			41,095

Dr.

MEMORANDUM JOINT VENTURE ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
2017			2018		
May 21	To Purchases (A)	35,000	Feb. 1	By Bank A/c (Claim from Insurance)	500
	To Expenses				
May 21	A	1,000	Mar. 15	By Sales (A) (50 × ₹ 225)	11,250
May 25	B (₹ 170 + ₹ 300			By Sales (B) (10 × ₹ 170)	1,700
2018	+ ₹ 600)	1,070	Feb. 1	By Sales (B) (40 × ₹ 200)	8,000
Apr. 30	To Commission			By Sales (B) (20 × ₹ 315)	6,300
	A (10% on 11,250)	1,125	Feb. 1	By Sales (B) (80 × ₹ 250)	20,000
	B (10% on 36,000)	3,600			
	To Profit transferred to:		Mar. 15		
	A 2/3 ₹	3,970			
	B 1/3 ₹	1,985	Apr. 1		
		5,955			
		47,750			47,750

Notes:

- (i) It has been presumed that no more rent of godown is payable by B.
(ii) No entry will be made for sending goods to the other party.

PROBLEM 11

Arun & Balu entered into a Joint Venture to purchase, recondition and sell second hand cars. Arun purchased 100 cars during the period 1st Oct. to 31st March at the following prices and paid for the same:

20 cars	@ ₹ 15,000 each
40 cars	@ ₹ 25,000 each
40 cars	@ ₹ 55,000 each

Balu during the same period reconditioned the cars by spending the following amounts:

Spare Parts used	₹ 1,80,000	Testing Charges	₹ 20,000
Painting	₹ 2,00,000	Insurance	₹ 60,000
Air-conditioning-10 Cars	₹ 3,00,000	Labour Charges	₹ 10,40,000

Arun and Balu sold the cars, the details of which are as under:

	Sold by	
	Arun	Balu
A.C. Cars	5	4
Non-A.C. Cars	35	46

A.C. cars were sold at ₹ 1,75,000 each. Non-A.C. cars were sold:

Arun	35 cars @ ₹ 1.25 lakhs each
Balu	35 cars @ ₹ 1.10 lakhs each
	11 cars @ ₹ 0.80 lakhs each

During testing, one non-A.C. car met with an accident and the Insurance Company paid the actual cost as claim amount. Prepare the Memorandum Joint-venture Account and Account of Balu in the books of Arun. [Nov. 1999]

SOLUTION:**Dr. MEMORANDUM JOINT VENTURE ACCOUNT Cr.**

Particulars	₹	Particulars	₹
To Cost of purchase of cars (Arun)		By Sales Proceeds (Arun)	
20 @ 15000 3,00,000		A.C. Cars	
40 @ 25,000 10,00,000		5 @ ₹ 1,75,000 8,75,000	
40 @ 55,000 22,00,000	35,00,000	Non-A.C. Cars	
To Spare Parts used (Balu)	1,80,000	35 @ ₹ 1,25,000 43,75,000	52,50,000
To Painting (Balu)	2,00,000	By Sales Proceeds (Balu)	
To Air-Conditioning (Balu)	3,00,000	A.C. Cars	
To Testing Charger	20,000	4 @ 1,75,000 7,00,000	
To Insurance	60,000	Non-A.C. Cars	
To Labour Charges	10,40,000	35 @ ₹ 1,10,000 38,50,000	
To Profit on venture:		11 @ ₹ 80,000 8,80,000	54,30,000
Arun 29,55,000		By Insurance Claim (Balu)	50,000
Balu 29,55,000	59,10,000	By Closing Stock	
		1 A.C. Car @ 80,000 80,000	
		8 Non-A.C. Cars 4,00,000	4,80,000
	112,10,000		112,10,000

Dr. JOINT VENTURE WITH BALU ACCOUNT IN THE BOOKS OF ARUN Cr.

Particulars	₹	Particulars	₹
To Bank A/c		By Bank A/c	52,50,000
(Cost of cars purchased)	35,00,000	By Balance c/d	12,05,000
To Profit & Loss A/c	29,55,000		
	64,55,000		64,55,000

Working Note: Calculation of Cost of AC and Non-AC Car

Average Cost of Purchase		A.C. Car	Non-A.C. Car
$\left[\frac{20 \times 15,000 + 40 \times 25,000 + 40 \times 55,000}{20 + 40 + 40} \right]$		35,000	35,000
Spare Parts used [₹ 1,80,000/100]		1,800	1,800
Painting [₹ 2,00,000/100]		2,000	2,000
Air-Conditioning [₹ 3,00,000/10]		30,000	—
Testing Charges [₹ 20,000/100]		200	200
Insurance [₹ 60,000/100]		600	600
Labour Charges [₹ 10,40,000/100]		10,400	10,400
		<u>80,000</u>	<u>50,000</u>

PROBLEM 12

'D' of Delhi and 'B' of Mumbai entered into Joint Venture to purchase and sell old machines. 'D' to make the purchases and 'B' to make the sales. It was decided to share profit and loss in proportion of 2 : 3 respectively. 'B' remitted ₹ 40,000 to 'D' towards the Joint Venture. 'D' purchased old machines worth ₹ 45,000 and paid 2% purchase commission, ₹ 12,000 for its repairs and ₹ 600 for other Sundry expenses. He despatched the machines to Mumbai.

'B' took delivery of the machine paying ₹ 2,400 for freight and ₹ 600 for octroi. He sold some of machines for ₹ 85,000 and kept the remaining machines for himself at an agreed value of ₹ 7,200. His other expenses were Godown rent ₹ 500 and Advertisement ₹ 1,700. Final settlement was made on Joint Venture.

Prepare Memorandum Joint Venture Account and also Joint Venture with 'D's Account in the book of 'B' and Joint Venture with 'B's Account in the book of 'D'. [Nov. 2003]

SOLUTION:

Dr. MEMORANDUM JOINT VENTURE ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Purchases (D)	45,000	By Sales(B)	85,000
To Expenses:		By Stock	7,200
D 13,500			
B <u>5,200</u>	18,700		
To Profit:			
D 11,400			
B <u>17,100</u>	28,500		
	92,200		92,200

Dr. JOINT VENTURE WITH 'B' ACCOUNT IN THE BOOKS OF 'D' Cr.

Particulars	₹	Particulars	₹
To Bank A/c (Purchases)	45,000	By Bank A/c	40,000
To Bank A/c (Repair & others)	13,500	(from B)	
To Profit & Loss A/c		By Bank A/c	29,900
(Share of profit)	11,400	(Final settlement)	
	69,900		69,900

Dr. JOINT VENTURE WITH 'D' ACCOUNT IN THE BOOKS OF 'B' Cr.

Particulars	₹	Particulars	₹
To Bank (Remittance)	40,000	By Bank (Sales)	85,000
To Bank Expenses	3,000	By Purchases (Stock)	7,200
To Bank Expenses	2,200		
To Profit and Loss A/c (Share of profit)	17,100		
To Bank A/c (Final settlement)	29,900		
	92,200		92,200

PROBLEM 13

Aswin of Madras and Gupta of Delhi entered into a joint venture on 1st April, 2017 for the purpose of buying second hand cars, reconditioning and selling them as Diesel airconditioned cars. Aswin has agreed to buy second hand cars, recondition them and fit diesel engines. Gupta has agreed to fix air conditioners and sell them at Delhi. They have agreed to share the profits and losses equally and settle their accounts at the end of each year.

The following are the details of purchases, sale and expenses incurred by Aswin and Gupta during the year 1.4.2017 to 31.3.2018:

Particulars	Aswin ₹	Gupta ₹
Cost of 10 Cars purchased at average price	5,00,000	
Reconditioning expenditure	45,000	
Cost of 10 diesel engines	30,000	
Labour charges	18,000	32,000
8 Air conditioners purchased		4,00,000
Buying commission @ 5%	25,000	
Selling commission @ 5%		60,000
Sale value realised on sale of 8 cars		12,00,000
<i>Expenses incurred:</i>		
Freight — local	10,000	8,000
Delhi	30,000	
Rent — Office	10,000	10,000
Garage	12,000	20,000
Insurance	16,000	20,000
Miscellaneous expenses	6,000	10,000

Gupta sent a cheque for ₹ 6,00,000 to Aswin on 1.3.2018. Of the balance of two cars, one car met with accident on the way to garage before reconditioning and the insurance company settled that claim at ₹ 30,000 as a total loss. The old petrol engines were sold @ ₹ 500 per engine and one diesel engine was sold at ₹ 3,000 by Aswin. All of them were sold before 31.3.2018. Aswin retained the balance of one car as a non-airconditioned diesel car for his personal use which was priced at average cost. Aswin/Gupta settled the balance due to/by them on 31.3.2018 by sending a crossed cheque as the case may be. Prepare: (a) Memorandum Joint Venture Account. (b) Joint Venture Account with Gupta in the books of Aswin (c) Joint Venture Account with Aswin in the books of Gupta. [Dec, 1993]

SOLUTION:**Dr.****MEMORANDUM JOINT VENTURE ACCOUNT****Cr.**

Particulars	₹	Particulars	₹
To Cost of purchase of cars (Aswin)	5,00,000	By Sales (Gupta)	12,00,000
To Reconditioning expenses (Aswin)	45,000	By Insurance claim (Aswin)	30,000
To Cost of Diesel engine (Aswin)	30,000	By Sale of Petrol Engine	
To Labour charges —Aswin	18,000	(9 × ₹ 500) (Aswin)	4,500
—Gupta	32,000	By Cost of car taken by Aswin	68,211
To Cost of airconditioners purchased	4,00,000	By Sale of Diesel Engine (Aswin)	3,000
To Commission —Buying	25,000		
—Selling	60,000		
To Freight-Local —Aswin	10,000		
—Gupta	8,000		
To Freight—Delhi —Aswin	30,000		
To Rent —Aswin	10,000		
—Gupta	10,000		
To Garage —Aswin	12,000		
To Garage —Gupta	20,000		
To Insurance —Aswin	16,000		
—Gupta	20,000		
To Misc. expenses —Aswin	6,000		
—Gupta	10,000		
To Profit on venture —Aswin 21,856			
—Gupta 21,855	43,711		
	13,05,711		13,05,711

Dr. JOINT VENTURE WITH GUPTA ACCOUNT IN THE BOOKS OF ASWIN Cr.

Particulars	₹	Particulars	₹
To Bank A/c (cost of cars purchased)	5,00,000	By Bank A/c (insurance claim)	30,000
To Bank A/c (reconditioning exp.)	45,000	By Bank A/c (sale of petrol engine)	
To Bank A/c (cost of diesel engines)	30,000	(₹ 500 × 9)	4,500
To Bank A/c (labour charges)	18,000	By Bank A/c (sale of diesel engine)	3,000
To Bank A/c (buying commission)	25,000	By Drawings A/c	
To Bank A/c (local freight)	10,000	(cost of car taken for personal use)	68,211
To Bank A/c (Delhi freight)	30,000	By Bank A/c	
To Bank A/c (office rent)	10,000	(remittance by Gupta on 1st Mar.)	6,00,000
To Bank A/c (garage rent)	12,000	By Bank A/c	
To Bank A/c (insurance)	16,000	(remittance by Gupta on 31st Mar.)	18,145
To Bank A/c (misc. expenses)	6,000		
To Profit and Loss A/c (share of profit)	21,856		
	7,23,856		7,23,856

Dr. JOINT VENTURE WITH ASWIN ACCOUNT IN THE BOOKS OF GUPTA Cr.

Particulars	₹	Particulars	₹
To Bank A/c (labour charges)	32,000	By Bank A/c (sales)	12,00,000
To Bank A/c (airconditioners)	4,00,000		
To Bank A/c (selling commission)	60,000		
To Bank A/c (Freight)	8,000		
To Bank A/c (office rent)	10,000		
To Bank A/c (garage rent)	20,000		
To Bank A/c (insurance)	20,000		
To Bank A/c (misc. exp.)	10,000		
To Profit & Loss A/c			
(share of profit)	21,855		
To Bank A/c (on 1st Mar.)	6,00,000		
To Bank A/c			
(remittance to Aswin on 31st Mar.)	18,145		
	12,00,000		12,00,000

Working Note: Calculation of Cost of Non-Airconditioned Diesel Car

		₹
Cost of Car		50,000
Reconditioning	(₹ 45,000/9)	5,000
Diesel engine	(₹ 30,000/10)	3,000
Labour charges	(₹ 18,000/9)	2,000
Buying commission	(₹ 25,000/10)	2,500
Local Freight incurred by Aswin	(₹ 10,000/10)	1,000
Local Insurance	(₹ 16,000/10)	1,600
Office Rent, Garage Rent and Misc. Expenses	(₹ 28,000/9)	3,111
		68,211

PROBLEM 14

A of Agra and B of Kanpur entered into a joint venture for purchase and sale of C.D. players. The cost of each C.D. player was ₹ 3,600 and the fixed retail selling price ₹ 4,500. The following transactions were recorded between them:

July 1 A purchased 100 C.D. players paying ₹ 72,000 in cash on account.

July 1 A raised a loan from Bank for ₹ 50,000 at 18% p.a. which is repayable with interest on 1st Sept. A forwarded 80 C.D. players to B incurring ₹ 2,880 as forwarding and insurance charges.

July 7 A received the consignment and paid ₹ 720 as clearing charges.

Aug. 1 A sold 5 C.D. players for cash.

B sold 20 C.D. players for cash.

A raised a loan of ₹ 1,50,000 from Bank, repayable with interest at 18% p.a. on 1st Sept.

B remitted ₹ 1,50,000 to A, incurring charges of ₹ 50. A paid the balance due for the C.D. players.

Aug.26 A sold the balance C.D. players for cash and paid selling expenses ₹ 5,000, B sold the balance C.D. players for cash and paid selling expenses ₹ 20,000.

Sept. 1 Accounts settled between the ventures and loans repaid, they shared profit equally.

You are required to show: (i) The memorandum Joint Venture Account; (ii) Joint Venture with B account in A books; and (iii) Joint Venture with A Account in B books;

[May, 2006]

SOLUTION:

**MEMORANDUM JOINT VENTURE ACCOUNT
FOR THE PERIOD FROM JULY 1 TO SEPT 1 ...**

Dr.**Cr.**

Particulars	₹	Particulars	₹
To A:		By Sales:	
Cost of C.D. players	3,60,000	(80 × 4,500)	3,60,000
Forwarding & insurance	2,880	A (20 × 4,500)	<u>90,000</u>
Interest (for 2 months)	1,500		
Selling Expenses	5,000		
To B:			
Clearing Charges	720		
Interest (for the month)	2,250		
Sundry Expenses			
(Telegraphic transfer charges)	50		
Selling Expenses	20,000		
To Profit transferred to:			
A	28,800		
B	28,800		
	<u>4,50,000</u>		<u>4,50,000</u>

Dr. JOINT VENTURE WITH B ACCOUNT IN THE BOOKS OF A Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (part payment of cost)	72,000	By Bank A/c (sale proceeds)	22,500
To Bank A/c (forwarding charges)	2,880	By Bank A/c (remittance from Laxman)	1,50,000
To Bank A/c (balance cost of purchases)	2,88,000	By Bank A/c (sale proceeds)	67,500
To Bank A/c (selling expenses)	5,000	By Bank A/c (cash received in settlement)	1,58,180
To Bank A/c (Interest)	1,500		
To Profit & Loss A/c (share of profit)	28,800		
	3,98,180		2,98,180

Dr. JOINT VENTURE WITH A ACCOUNT IN THE BOOKS OF B Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (clearing charges)	720	By Bank A/c (Sale proceeds of 20 C.D. players)	90,000
To Bank A/c remittance excluding charges)	1,50,000	By Bank A/c (Sale proceeds of 60 C.D. players)	2,70,000
To Bank A/c (selling expenses)	20,000		
To Bank A/c (interest)	2,250		
To Sundry Expenses	50		
To Profit & Loss A/c (share of profit)	28,800		
To Bank A/c (paid in settlement)	1,58,180		
	3,60,000		3,60,000

9

ACCOUNTING FOR ROYALTY

No question has been asked so far.

10

AVERAGE DUE DATE

PROBLEM 1

Hari owes Ram ₹ 2,000 on 1st April, 2018. From 1st April, 2018 to 30th June, 2018 the following further transactions took place between Hari and Ram:

April	10	Hari buys goods from Ram for ₹ 5,000.
May	16	Hari receives cash loan of ₹ 10,000 from Ram.
June	9	Hari buys goods from Ram for ₹ 3,000.

Hari pays the whole amount, together with interest @ 15% per annum, to Ram on 30th June, 2018. Calculate the interest payable on 30th June, 2018 by the average due-date method. [Nov. 1996]

SOLUTION:

CALCULATION OF AVERAGE DUE DATE [BASE DATE 1ST APRIL]

Due Date	Amount ₹	No. of Days from Base Date to Due Date	Products ₹
April 1	2,000	0	0
April 10	5,000	9	45,000
May 16	10,000	45	4,50,000
June 9	3,000	69	2,07,000
	20,000		7,02,000

Average Due Date = Base Date + Days equal to $\frac{\text{Total of Products}}{\text{Total Amount}}$ days

Average Due Date = 1st April + $\frac{7,02,000}{20,000}$ = 1st April + 35.1 days = 6th May, 2018

Interest therefore has been calculated on ₹ 20,000 from 6th May, 2018 to 30th June, 2018 i.e., for 55 days @ 15% per annum.

Interest = $20,000 \times \frac{15}{100} \times \frac{55}{365}$ = ₹ 452.05

PROBLEM 2

Mr Green and Mr Red had the following mutual dealings and desire to settle their account on the balance on the average due date:

Purchases by Green from Red:

	₹
6th January, 2016	6,000
2nd February, 2016	2,800
31st March, 2016	2,000

Sales by Green to Red:

6th January, 2016	6,600
9th March, 2016	2,400
20th March, 2016	500

You are asked to ascertain the average due date.

[Nov. 2016]

SOLUTION:

Let the base date be 6.1.2016

Purchases by Green

<i>Due Date</i>	<i>Amount</i> ₹	<i>No. of Days from Base Date to Due Date</i>	<i>Products</i> ₹
06.01.2016	6,000	0	0
02.02.2016	2,800	27	75,600
31.03.2016	2,000	84	1,68,000
	10,800		2,43,600

Sales by Green

<i>Due Date</i>	<i>Amount</i> ₹	<i>No. of Days from Base Date to Due Date</i>	<i>Products</i> ₹
06.01.2016	6,600	0	0
09.03.2016	2,400	62	1,48,800
20.03.2016	500	73	36,500
	9,500		1,85,300

No. of days from the Base date = $\frac{2,43,600 - 1,85,300}{10,800 - 9,500} = \frac{58,300}{1,300} = 44.85$ i.e. 45 days after 6 January, 2016 on 20 Feb., 2016.

On 20 Feb., 2016 Green has to pay ₹ 1,300 to clear the account.

PROBLEM 3

E owes to F the following amounts:

(i) ₹ 5,000 due on 10th March, 2018	(ii) ₹ 18,000 due on 2nd April, 2018
(iii) ₹ 60,000 due on 30th April, 2018	(iv) ₹ 2,000 due on 10th June, 2018

He desires to make full payment on 30th June, 2018 with interest at 10% per annum from the average due date. Find out the average due date and the amount of interest. [C.A.]

SOLUTION:

CALCULATION OF AVERAGE DUE DATE [BASE DATE = 10TH MARCH]

<i>Due Date</i>	<i>Amount</i> ₹	<i>No. of Days from Base Date to Due Date</i>	<i>Products</i> ₹
March 10	5,000	0	0
April 2	18,000	21 + 2 = 23	4,14,000
April 30	60,000	21 + 30 = 51	30,60,000
June 10	2,000	21 + 30 + 31 + 10 = 92	1,84,000
Total	85,000		Total 36,58,000

$$\text{Average due date} = \text{Base date} + \frac{\text{Total of Products}}{\text{Total Amount}}$$

$$= 10\text{th March} + \frac{36,58,000}{85,000}$$

$$= 10\text{th March} + 43.04 \text{ day}$$

$$= 10\text{th March} + 43 \text{ days (app.)}$$

$$\text{Average due date} = 22\text{nd April 2018}$$

$$\text{Interest} = 85,000 \times \frac{10}{100} \times \frac{69}{365} = ₹ 1606.85 \text{ or } ₹ 1,607$$

PROBLEM 4

Calculate Average due date from the following information:

[Nov. 2002]

<i>Date of Bill</i>	<i>Term</i>	<i>Amount (₹)</i>
1st March, 2018	2 months	4,000
10th March, 2018	3 months	3,000
5th April, 2018	2 months	2,000
20th April, 2018	1 month	3,750
10th May, 2018	2 months	5,000

SOLUTION:**CALCULATION OF AVERAGE DUE DATE**

(Taking 4th May, 2018 as the base date)

<i>Date of bill</i>	<i>Term</i>	<i>Due Date</i>	<i>Amount</i>	<i>No. of Days from Base Date to Due Date</i>	<i>Products</i>
2018		2018			
1st March	2 months	4th May	4,000	0	0
10th March	3 months	13th June	3,000	40	1,20,000
5th April	2 months	8th June	2,000	35	70,000
20th April	1 month	23rd May	3,750	19	71,250
10th May	2 months	13th July	5,000	70	3,50,000
			17,750		6,11,250

$$\text{Average due date} = \text{Base date} + \text{Days equal to } \frac{\text{Sum of Products}}{\text{Sum of Amounts}}$$

$$= 4\text{th May, 2018} + ₹ \frac{6,11,250}{17,750} \text{ i.e. 34 days (approx)}$$

$$= 7\text{th June, 2018}$$

PROBLEM 5

Calculate average due date from the following informations:

<i>Date of Bill</i>	<i>Term</i>	<i>Amount ₹</i>
16 August, 2015	3 months	3,000
20 October, 2015	60 days	2,500

10.4 Quick Revision for Accounting for CA Foundation Course

14 December, 2015	2 months	2,000
24 January, 2016	60 days	1,000
06 March, 2016	2 months	1,500

[CA(PE I) Nov.]

SOLUTION:**CALCULATION OF AVERAGE DUE DATE**

(Taking November 19, 2015 as the base date)

<i>Date of Bill</i>	<i>Term</i>	<i>Due Date (including 3 grace days)</i>	<i>Amount</i>	<i>No. of days from the base date i.e., Nov. 19, 2015</i>	<i>Product (No. of days × Amount)</i>
August 16, 2015	3 months	Nov. 19, 2015	3,000	0	0
October 20, 2015	60 days	Dec. 22, 2015	2,500	33	82,500
December 14, 2015	2 months	Feb. 17, 2016	2,000	90	1,80,000
January 24, 2016	60 days	March 27, 2016	1,000	129	1,29,000
March 06, 2016	2 months	May 09, 2016	1,500	172	2,58,000
			10,000		6,49,500

Average due date = Base date + Days equal to $\frac{\text{Sum of products}}{\text{Sum of amounts}}$

$$\begin{aligned}
 &= \text{November 19, 2015} + \frac{6,49,500}{10,000} \\
 &= \text{November 19, 2015} + 65 \text{ days (approx.)} \\
 &= \text{January 23, 2016}
 \end{aligned}$$

PROBLEM 6

From the following calculate the average due date and interest @ 10% p.a. if Mr X lent ₹ 25,000 to Mr Y on 1st Jan. 2018 which is repayable in 5 half yearly instalments commencing from 1st Jan. 2019.

SOLUTION:

$$\text{A.D.D.} = \text{Rate of Lending} + \frac{\text{Sum of months from 1.1.2000 to date of each instalment}}{\text{No of Instalments}}$$

$$= 1.1.2018 + \frac{12 + 18 + 24 + 30 + 36 \text{ months}}{5}$$

$$= 1.1.2018 + 24 \text{ months} = 1.1.2020$$

$$\text{Interest} = ₹ 25,000 \times \frac{10}{100} \times 2 \text{ years} = ₹ 5,000$$

11

ACCOUNT CURRENT

PROBLEM 1

Mr A owed ₹ 4,000 on 1st January, 2016 to Mr X. The following transactions took place between them. It is agreed between the parties that interest @ 10% p.a. is to be calculated on all transactions.

₹

15 January, 2016	Mr X sold goods to Mr A	2,230
29 January, 2016	Mr X bought goods from Mr A	1,200
10 February, 2016	Mr A paid cash to Mr X	1,000
13 March 2016	Mr A accepted a bill drawn by Mr X for one Month	2,000

They agree to settle their complete accounts by one single payment on 15th March 2016. Prepare Mr A in Account Current with Mr X and ascertain the amount to be paid. Ignore days of grace.

[May 2005]

SOLUTION:

MR. A IN ACCOUNT CURRENT WITH MR. X

Dr.

(INTEREST UPTO 15TH MARCH, 2016 @ 10% P.A.)

Cr.

Date 2016	Particulars	₹	Days	Product	Date 2016	Particulars	₹	Days	Product
Jan. 01	To Balance b/d	4,000	75	2,00,000	Jan 29	By Purchases A/c	1,200	46	56,200
Jan 15	To Sales A/c	2,230	60	1,33,800	Feb 10	By Cash A/c	1,000	34,	34,000
Mar. 13	To Red ink product (₹ 2,000 × 29)			58,000	Mar 13	By Bills Receivable A/c	2,000		
Mar	To Interest A/c $\left(\frac{\text{Rs } 4,02,600 \times 10 \times 1}{100 \times 366} \right)$				Mar 15	By Balance of product			4,02,000
		110							
		6,340		4,91,800			6,340		4,91,800

12

FINANCIAL STATEMENTS

PROBLEM 1

From the following particulars extracted from the books of Mr. G, prepare Trading, Profit and Loss Account and Balance Sheet as on 31st March, 2018 after making the necessary adjustments:

	₹		₹
Opening Capital Account	54,050	Sundry Debtors	12,000
Stock	23,400	Sundry Creditors	7,400
Sales	1,44,800	Loan from Dena Bank Ltd. @ 12%	10,000
Sales Returns	4,300	Interest paid	450
Purchases	1,21,550	Printing and Stationery	1,700
Purchases Returns	2,900	Advertisement	5,600
Carriage Inwards	9,300	Interest received	725
Rent	2,850	Audit fees	350
Salaries	4,650	Fire Insurance Premium	300
Cash with Traders Bank Ltd.	4,000	Travelling Expenses	1,165
Discounts received	1,495	Postage and Telegrams	435
Investments @ 5% as on 1.4.2017	2,500	Cash on hand	190
Furniture (as on 1.4.2017)	900	Deposits @ 10% as on 1.4.2017 (Dr.)	15,000
Discount allowed	3,770	Drawings	5,000
General expenses	1,960		

Adjustments:

- Value of Stock as on 31st March, 2018 is ₹ 39,300. This includes goods returned by customers on 31st March, 2018 to the value of ₹ 1,500 of which no entry has been passed in the books.
- Purchases include furniture purchased on 1st January, 2018 for ₹ 1,000.
- Depreciation should be provided on furniture @ 13% per annum.
- The loan account from Dena Bank in the books of Ganguli appears as follows:

31.03.2018	To Balance c/d	10,000	01.04.2017	By Balance b/d	5,000
			31.03.2018	By Bank A/c	5,000
		10,000			10,000

- Sundry Debtors included ₹ 2,000 due from Mr. Robert and Sundry Creditors included ₹ 1,000 due to him.
- Interest paid included ₹ 300 paid to Dena Bank.
- Interest received represents ₹ 100 from the Sundry Debtors and the balance on investments and deposits.
- Provide for interest payable to Dena Bank for interest receivable on investments and deposits.

- (i) Provide provision for doubtful debts at 5% on the balance under "Sundry Debtors". No provision need be created for the deposits.

SOLUTION

**TRADING AND PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31ST MARCH, 2018**

Dr.
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Opening Stock	23,400	By Sales	1,44,800
To Purchases	1,21,550	Less: Returns	
Less: Furniture	1,000	(₹ 4,300 + ₹ 1,500)	5,800
Less: Returns	2,900	By Closing Stock	39,300
To Carriage Inwards	9,300		
To Gross Profit c/d	27,950		
	1,78,300		1,78,300
To Rent	2,850	By Gross Profit b/d	27,950
To Salaries paid	4,650	By Interest Received	725
To Interest paid	450	Add: Interest accrued	1,000
Add: outstanding	300	By Discount Received	1,495
To Printing & Stationery	1,700		
To Advertisements	5,600		
To Discount allowed	3,770		
To General Expenses	1,960		
To Audit Fees	350		
To Fire Insurance Premium	300		
To Travelling Expenses	1,165		
To Postage & Telegrams	435		
To Dep. on Furniture [₹ 900 × 13% × 12/12] + [₹ 1,000 × 13% × 3/12]			
(On ₹ 900 for 12 months,			
On ₹ 1,000 for 3 months)	150		
To Provision for Doubtful Debts	475		
To Net Profit transferred to Capital A/c	7,015		
	31,170		31,170

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Liabilities</i>	₹
Capital Account:		Furniture:	
Opening Balance	54,050	Opening Balance	900
Add: Net Profit	7,015	Add: Purchases	1,000
Less: Drawings	5,000	Less: Depreciation	150
	56,065		1,750
Loan from Dena Bank:		Investments:	2,500
Opening Balance	5,000	Closing stock	39,300
Add: Addition	5,000	Sundry Debtors	12,000
	10,000		

O/S Interest on Bank Loan			Less: Returns not entered	1,500	
Sundry Creditors	7,400	300	Less: Adjusted in creditors	1,000	
Less: Adjusted in Debtors	1,000	6,400		9,500	
			Less: Provision	475	9,025
			Interest Receivable		1,000
			Deposit		15,000
			Cash at Bank		4,000
			Cash in hand		190
		72,765			72,765

PROBLEM 2

From the following Trial balance of Hari and additional information, prepare Trading and Profit & Loss Account for the year ended 31st March, 2018 and a Balance Sheet as on that date:

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital & Drawing	24,000	1,00,000	Bad Debt Written off	7,000	—
Furniture	20,000	—	Provision for Doubtful Debts	—	6,000
Purchases & Purchase Returns	1,50,000	5,000	Printing & Stationery	8,000	—
Debtors & Creditors	2,00,000	1,20,000	Insurance	12,000	—
Interest Earned	—	4,000	Opening Stock	50,000	—
Salaries	30,000	—	Office Expenses	12,000	—
Sales & Sales Return	10,000	3,21,000	Provision for Depreciation	—	2,000
Wages	20,000	—			
Rent	15,000	—			

Additional Information:

(a) Depreciate Furniture by 10% on original cost; (b) A provision for Doubtful Debts is to be created to the extent of 5% on Sundry Debtors; (c) Salaries for the month of March, 2018 amounting to ₹ 3,000 were unpaid which must be provided for. However, salaries included ₹ 2,000 paid in advance; (d) Insurance amounting to ₹ 2,000 is prepaid; (e) Provide for outstanding office expenses ₹ 8,000; (f) Stock used for private purpose ₹ 6,000; (g) Closing Stock ₹ 60,000.

SOLUTION:**TRADING AND PROFIT AND LOSS ACCOUNT OF HARI****Dr.****FOR THE YEAR ENDED 31ST MARCH, 2018****Cr.**

Particulars	₹	Particulars	₹
To Opening Stock	50,000	By Sales	3,21,000
To Purchases	1,50,000	Less: Returns	10,000
Less: Returns	5,000		3,11,000
Less: Drawings	6,000	By Closing stock	60,000
To Wages	20,000		
To Gross Profit c/d	1,62,000		
	3,71,000		3,71,000

12.4 Quick Revision for Accounting for CA Foundation Course

To Salaries	30,000		By Gross Profit b/d	1,62,000
Add: Outstanding	3,000		By Interest	4,000
Less: Prepaid	2,000	31,000		
To Office expenses	12,000			
Add: Outstanding	8,000	20,000		
To Rent		15,000		
To Insurance	12,000			
Less: Prepaid	2,000	10,000		
To Printing & Stationery		8,000		
To Bad debts		7,000		
To Provision for Doubtful debts	10,000			
Less: Existing Provision	6,000	4,000		
To Depreciation on Furniture		2,000		
To Net Profit t/f to Capital A/c		69,000		
		1,66,000		1,66,000

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
<i>Capital Account:</i>		Furniture	20,000
Opening Balance	1,00,000	Less: Depreciation	4,000
Add: Net Profit	69,000	Stock	60,000
Less: Drawings	24,000	Debtors	2,00,000
Less: Goods for personal use	6,000	Less: Provision	10,000
	1,39,000	Prepaid Salaries	2,000
Creditors	1,20,000	Prepaid Insurance	2,000
O/s Salaries	3,000		
O/s Office Expenses	8,000		
	2,70,000		2,70,000

PROBLEM 3

From the following particulars prepare Trading and Profit and Loss Account of Mr R for the year ended 31.3.2018 and a Balance Sheet as on 31.3.2018.

Particulars	Debit Balance ₹	Credit Balance ₹
Building	5,00,000	
Machineries	2,00,000	
Furniture	1,00,000	
Cash & Bank	1,00,000	
15% p.a. Loan obtained by Mr. R on 1.4.2017 on mortgage of his building		3,00,000
Capital		5,20,000
Sundry Debtors/Sundry Creditors	5,00,000	4,00,000

Opening Stock	1,20,000	
Purchases/Sales	25,00,000	32,20,000
Sales returns/Purchases returns	1,20,000	1,00,000
Rent	60,000	
Establishment expenses	1,80,000	
Electricity charges	15,000	
Telephone charges	10,000	
Commission on sales	30,000	
Insurance Premium	10,000	
Bad debts	20,000	
Bills Receivable	75,000	
	45,40,000	45,40,000

You are required to provide for depreciation on building at 5% p.a.; on machinery at 25% p.a.; on furniture at 10% p.a. Provision for doubtful debts is to be made at 5% on sundry debtors. Mr R's manager is entitled to a commission of 10% on the net profit after charging his commission. Closing stock was not taken on 31st March but only on 7th April. Following transactions had taken place during the period from 1st April to 7th April. Sales ₹ 2,50,000, Purchases 1,50,000, Stock on 7th April, was ₹ 1,80,000 and the rate of gross profit on sales after was 20%. Insurance premium mentioned in the trial balance was in respect of building and machineries. Interest on mortgage loan to be provided up to 31.3.2018.

SOLUTION:**TRADING AND PROFIT AND LOSS ACCOUNT****DR.****FOR THE YEAR ENDED 31ST MARCH, 2018****CR.**

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Opening Stock	1,20,000	By Sales	32,20,000
To Purchases	25,00,000	Less: Returns	1,20,000
Less: Returns	1,00,000	By Closing Stock	2,30,000
To Gross Profit c/d	8,10,000		
	33,30,000		33,30,000
To Rent	60,000	By Gross Profit b/d	8,10,000
To Establishment Expenses	1,80,000		
To Electricity Charges	15,000		
To Telephone Charges	10,000		
To Commission on Sales	30,000		
To Insurance Premium	10,000		
To Bad Debts	20,000		
To Interest on Loan	45,000		
To Depreciation on Building	25,000		
To Depreciation on Machinery	50,000		
To Depreciation on Furniture	10,000		
To Provision for Doubtful Debts	25,000		
To Manager's Commission	30,000		
To Net Profit t/f to Capital A/c	3,00,000		
	8,10,000		8,10,000

BALANCE SHEET OF MR R AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
O/S Manager's Commission	30,000	Cash & Bank	1,00,000
Sundry Creditors	4,00,000	Sundry Debtors	5,00,000
18% p.a. Loan (on mortgage of Building)	3,00,000	Less: Provision	25,000
Add: Interest	45,000	Bills Receivable	75,000
Capital Account:		Closing Stock	2,30,000
Opening Balance	5,20,000	Furniture	1,00,000
Add: Net Profit	3,00,000	Less: Depreciation	10,000
	8,20,000	Machineries	2,00,000
		Less: Depreciation	50,000
		Buildings	5,00,000
		Less: Depreciation	25,000
	15,95,000		15,95,000

Working Note: Calculation of Closing Stock

A. Stock as on 7th April	₹ 1,80,000
B. Add: Cost of Goods sold (80% of ₹ 2,50,000)	₹ 2,00,000
C. Less: Cost of Purchases	₹ 1,50,000
	<u>₹ 2,30,000</u>

PROBLEM 4

From the following trial balance and information, prepare Trading and Profit and Loss Account of Mr Rishabh for the year ended 31st March, 2018 and a Balance Sheet as on that date:

Particulars	Debit Balance ₹	Credit Balance ₹
Capital & Drawings	12,000	1,00,000
Land and Buildings	90,000	—
Plant and Machinery	20,000	—
Furniture	5,000	—
Sales & Return Inward	5,000	1,40,000
Debtors & Creditors	18,400	12,000
Loan from Gajanand on 1.7.2017 @ 6% p.a.	—	30,000
Purchases & Return Outward	80,000	4,000
Carriage	10,000	—
Sundry Expenses	600	—
Printing and Stationery	500	—
Insurance Expenses	1,000	—
Provision for Doubtful Debts	—	1,000
Provision for Discount on Debtors	—	380
Bad Debts	400	—
Profit of Textile Deptt.	—	10,000
Stock of General Goods on 1.4.2017	21,300	—
Salaries and Wages	18,500	—
Trade Expenses	800	—
Stock of Textile Goods on 31.3.2018	8,000	—
Cash & Bank	5,880	—
	<u>2,97,380</u>	<u>2,97,380</u>

Information:

- (a) Stock of General goods on 31.3.2018 valued at ₹ 27,300.
- (b) Fire occurred on 23rd March, 2018 and ₹ 10,000 worth of general goods were destroyed. The Insurance Company accepted claim for ₹ 6,000 only and paid the claim money on 10th April, 2018.
- (c) Bad Debts amounting to ₹ 400 are to be written off. Provision for Bad and Doubtful debts is to be made at 5% and for discount at 2% on debtors.
- (d) Received ₹ 6,000 worth of goods on 27th March, 2018 but the invoice of purchase was not recorded in Purchases Book.
- (e) Rishabh took away goods worth ₹ 2,000 for personal use but no record was made thereof.
- (f) Charge depreciation at 2% on Land and Buildings, 20% on Plant and Machinery, and 5% on Furniture.
- (g) Insurance prepaid amounts to ₹ 200.

SOLUTION:

TRADING AND PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31ST MARCH, 2018

DR.**CR.**

Particulars	₹	Particulars	₹
To Opening Stock	21,300	By Sales	1,40,000
To Purchases	80,000	Less: Returns	5,000
Less: Returns	4,000	By Loss by Fire A/c	10,000
Add: Omitted Purchases	6,000	By Closing Stock	27,300
Less: Drawings	2,000		
To Carriage	10,000		
To Gross Profit c/d	61,000		
	1,72,300		1,72,300
To Sundry Expenses	600	By Gross Profit b/d	61,000
To Printing & Stationery	500	By Profit of Textile Deptt.	10,000
To Insurance Expenses		By Provision for Discount on Debtors	38
Paid	1,000		
Less: Prepaid	200		
To Salaries & Wages	18,500		
To Trade Expenses	800		
To Depreciation on:			
Land & Building	1,800		
Plant & Machinery	4,000		
Furniture	250		
To Interest on Loan	1,350		
[30,000 × 6% × 9/12]			
To Bad Debts	400		
Add: Additional	400		
Add: New Provision	900		
Less: Old Provision	1,000		
To Loss by Fire A/c	4,000		
To Net Profit t/f to Capital A/c	37,738		
	71,038		71,038

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities		₹	Assets		₹
Creditors	12,000	18,000	Cash & Bank Debtors	18,400	5,880
Add: Omitted Purchases	6,000		Less: Additional Bad Debts	400	
Loan from Gajanand		31,350		18,000	
Balance	30,000		Less: Provision for Doubtful Debts	900	
Add: Interest	1,350	1,23,738		17,100	
Capital:			Less: Provision for Discount	342	16,758
Opening Balance	1,00,000	1,73,088	Stock of General Goods		27,300
Add: Net Profit	37,738		Stock of Textile Goods		8,000
Less: Drawings	12,000	1,73,088	Insurance Company		6,000
Less: Goods taken	2,000		Prepaid Insurance		200
		1,73,088	Furniture	5,000	
			Less: Depreciation	250	4,750
		1,73,088	Plant & Machinery	20,000	
			Less: Depreciation	4,000	16,000
		1,73,088	Land & Building	90,000	
			Less: Depreciation	1,800	88,200
		1,73,088			1,73,088

PROBLEM 5

The following in the Trial Balance of Shri Arihant as on 31st March 2018.

Particulars	Debit Balance ₹	Credit Balance ₹
Capital & Drawings	75,000	14,00,000
Opening Stock	80,000	—
Purchases & Sales	16,20,000	25,00,000
Freight on Purchases	15,000	—
Wages	1,10,000	—
Salaries	1,00,000	—
Travelling Expenses	23,000	—
Miscellaneous Expenses	35,000	—
Printing and Stationery	27,000	—
Advertisement Expenses	25,000	—
Postage and Telegrams	13,000	—
Discounts	7,600	14,500
Bad Debts written off (after adjusting recovery of bad debts of ₹ 6,000 written off in 2016-2017)	14,000	—
Building	10,00,000	—
Machinery	75,000	—
Furniture	40,000	—

Debtors	1,50,000	—
Provision for Doubtful Debts	—	19,000
Creditors	—	1,60,000
Investments (12% Purchased on 1st Jan. 2018)	6,00,000	—
Bank Balance	83,900	—
	40,93,500	40,93,500

Adjustments:

- Closing Stock ₹ 2,25,000
- Goods worth ₹ 5,000 were taken for personal use, but no entry was made in the books.
- Machinery worth ₹ 35,000 purchased on 1st April 2015 was wrongly written off against Profit and Loss Account. This asset is to be brought into account on 1st April 2017 taking depreciation at 10% per annum on straight line basis upto 31st March 2017.
- Depreciate Building at 2-1/2% p.a., Machinery at 10% p.a. and Furniture at 10% p.a.
- Provision for Doubtful Debts should be 6% on Debtors.
- The Manager is entitled to a commission of 5% of Net Profits after charging his commission.

Required: Prepare Trading and Profit and Loss Account for the year ending 31st March 2018 and a Balance Sheet as at that date.

SOLUTION:**TRADING AND PROFIT AND LOSS ACCOUNT****DR.****FOR THE YEAR ENDED 31ST MARCH, 2018****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Opening Stock	80,000	By Sales	25,00,000
To Purchases	16,20,000	By Closing Stock	2,25,000
Less: Drawings	5,000		
To Freight	15,000		
To Wages	1,10,000		
To Gross Profit c/d	9,05,000		
	27,25,000		27,25,000
To Depreciation:		By Gross Profit b/d	9,05,000
Building	25,000	By Discount Received	14,500
Machinery	11,000	By Bad debts recovered	6,000
Furniture	4,000	By Interest Accrued on Investments	18,000
To Salaries	1,00,000		
To Travelling Expenses	23,000		
To Misc Expenses	35,000		
To Printing & Stationary	27,000		
To Advertisement Expenses	25,000		
To Postage & Telegram	13,000		
To Discount Allowed	7,600		
To Provision for Doubtful debts	10,000		
To Manager's Commission O/s	31,567		
To Net Profit t/f to Capital A/c	6,31,333		
	9,43,500		9,43,500

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital 14,00,000		Building 10,00,000	
Less: Drawings (Cash) 75,000		Less: Depreciation 25,000	9,75,000
Less: Drawings (Goods) 5,000		Machinery 75,000	
Add: NP 6,31,333		Add: P&L A/c 28,000	
Add: Prior Period Item 28,000	19,79,333	Less: Depreciation 11,000	92,000
Creditors 1,60,000		Furnitures 40,000	
O/s Manager's Commission 31,567		Less: Depreciation 4,000	36,000
		Debtors 1,50,000	
		Less: Provision 9,000	1,41,000
		Investments 6,00,000	
		Accrued Interest on Investment 18,000	
		Bank balance 83,900	
		Closing stock 2,25,000	
	21,70,900		21,70,900

Working Notes:**(I) DR.****PROVISION FOR DOUBTFUL DEBTS ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bad Debts (14,000 + 6000)	20,000	By Balance b/d	19,000
To Balance c/d [6% on ₹ 1,50,000]	9,000	By Profit & Loss A/c (b.f)	10,000
	29,000		29,000

(ii) Book Value of Machinery wrongly charged to P & L A/c

= Original Cost – Depreciation for 2 years

= ₹ 35,000 – (₹ 35,000 × 10% × 2) = ₹ 28,000

(iii) Calculation of Depreciation on Machinery

(a) On Machinery wrongly charged to P & L A/c (an SLM Basis)

₹ 3,500

(b) On other Machinery [10% of ₹ 75,000]

₹ 7,500

₹ 11,000**PROBLEM 6**

The following is the Trial Balance of K on 31st March, 2018:

<i>Particulars</i>	<i>Debit Balance ₹</i>	<i>Credit Balance ₹</i>
Capital & Drawing	60,000	8,00,000
Opening Stock	75,000	—
Purchases & Sales	15,95,000	23,10,000
Freight on Purchases	25,000	—
Wages (11 months upto 29.2.2018)	66,000	—
Salaries	1,40,000	—
Postages, Telegrams, Telephones	12,000	—

Printing and Stationery	18,000	—
Miscellaneous Expenses	30,000	—
Investments	1,00,000	—
Discounts Received	—	15,000
Debtors & Creditors	2,50,000	3,00,000
Bad Debts	15,000	—
Provision for Doubtful Debts	—	8,000
Building	3,00,000	—
Machinery	5,00,000	—
Furniture	40,000	—
Commission on Sales	45,000	—
Interest on Investments	—	12,000
Insurance (Year upto 31.7.2018)	24,000	—
Bank Balance	1,50,000	—
	34,45,000	34,45,000

Adjustments:

- Closing Stock ₹ 2,25,000.
- Machinery worth ₹ 45,000 purchased on 1.10.2017 was shown as Purchases. Freight paid on the Machinery was ₹ 5,000, which is included in Freight on Purchases.
- Commission is payable at 2½% on Sales.
- Investments were sold at 10% profit, but the entire sales proceeds have been taken as Sales.
- Write off Bad Debts ₹ 10,000 and create a provision for Doubtful Debts at 5% of Debtors.
- Depreciate Building by 2½% p.a. and Machinery and Furniture at 10% p.a.

Required: Prepare Trading and Profit and Loss Account for the year ending 31st March, 2018 and a Balance Sheet as on that date.

SOLUTION:

TRADING AND PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31ST MARCH, 2018

DR.**CR.**

Particulars	₹	Particulars	₹
To Opening Stock	75,000	By Sales	23,10,000
To Purchases	15,95,000	Less: Sale of	
Less: Machinery	45,000	investments	1,10,000
To Freight on Purchases	25,000	By Closing Stock	2,25,000
Less: Freight on Machinery	5,000		
To Wages	66,000		
Add: O/s Wages	6,000		
To Gross Profit t/f to P&L A/c	7,08,000		
	24,25,000		24,25,000
To Salaries	1,40,000	By Gross Profit b/d	7,08,000
To Postage, Telegrams & Telephones	12,000	By Discount	15,000
To Printing & Stationery	18,000	By Interest on investment	12,000

To Miscellaneous Expenses		30,000	By Profit on Sale of Investment	10,000
To Commission on Sale	45,000			
Add: O/s	10,000	55,000		
To Insurance				
Paid		24,000		
Less Pre paid	8,000	16,000		
To Bad debts	15,000			
Add: Additional Bad debt	10,000			
Less: Old Provision	8,000			
Add: New Provision	12,000	29,000		
To Depreciation on Building		7,500		
To Depreciation on Machinery		52,500		
To Depreciation on Furniture		4,000		
To Net Profit t/f to Capital A/c		3,81,000		
		7,45,000		7,45,000

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities		₹	Assets		₹
Capital	8,00,000		Building	3,00,000	
Less: Drawings	60,000		Less: Depreciation	7,500	2,92,500
Add: Net profit	3,81,000	11,21,000	Machinery	5,00,000	
Outstanding Wages		6,000	Add: Purchases	45,000	
Creditors		3,00,000	Add: Freight	5,000	
Outstanding Commission		10,000	Less: Depreciation	52,500	4,97,500
			Furniture	40,000	
			Less: Depreciation	4,000	36,000
			Prepaid insurance		8,000
			Bank Balance		1,50,000
			Closing Stock		2,25,000
			Debtors	2,50,000	
			Less: Add Bad debts	10,000	
			Less: Provision	12,000	2,28,000
		14,37,000			14,37,000

PROBLEM 7

Mr James submits you the following information for the year ended 31.3.2018:

	₹
Stock as on 1.4.2017	1,50,500
Purchases	4,37,000
Manufacturing Expenses	85,000
Expenses on Sales	33,000

Expenses on Administration	18,000
Financial Charges	6,000
Sales	6,25,000

During the year damaged goods costing ₹ 12,000 were sold for ₹ 5,000. Barring the above transaction the Gross Profit has been @ 20% on Sales.

Required: Compute the Net Profit of Mr James for the year ended 31.3.2018.

SOLUTION

TRADING AND PROFIT AND LOSS ACCOUNT

DR.

FOR THE YEAR ENDED 31ST MARCH, 2018

CR.

Particulars	₹	Particulars	₹
To Opening Stock	1,50,500	By Sales	6,25,000
To Purchases	4,37,000	By Closing stock (balancing figure)	1,64,500
To Manufacturing expenses	85,000		
To Gross Profit c/d	1,17,000		
(₹ 1,24,000 – ₹ 7,000)	7,89,500		7,89,500
To Administration expenses	18,000	By Gross Profit b/d	1,17,000
To Selling expenses	33,000		
To Financial Charges	6,000		
To Net profit	60,000		
	1,17,000		1,17,000

PROBLEM 8

The following is the Trial Balance of Mr. 'A' as on 31st March 2018. You are required to prepared the Trading and Profit & Loss Account for the year ended 31st March, 2018 and Balance Sheet as on that date after making the necessary adjustments.

Particulars	Debit Balance ₹	Credit Balance ₹
Opening Stock	5,50,000	—
Purchases and Sales	19,25,000	29,35,000
Wages and Salaries	1,25,000	—
Discount	—	2,000
Carriage inward	40,000	—
Bill Receivable and Bill Payable	2,25,000	1,85,000
Insurance	35,000	—
Debtors and Creditors	15,00,000	9,32,500
Consignor's Balance (1-4-2017)	—	4,00,000
Capital	—	8,95,000
Commission	40,000	—
Cash sent to Consignor	8,00,000	—
Interest	35,000	—
Trade Expenses	34,500	—

Furniture (1-4-2017)	60,000	—
Consignment Sales	—	6,40,000
Cash in hand and at Bank	4,22,500	—
Rent and Taxes	1,27,500	—
Sale of furniture (31-3-2018)	—	10,000
Charges paid against Consignment	80,000	—
	59,99,500	59,99,500

Adjustments:

- Closing Stock was valued at ₹ 8,00,000 (including stock of stationery ₹ 800)
- Bill receivable include a dishonoured bill of ₹ 8,000.
- Trade expenses include payment for stationery of ₹ 22,500.
- Stock in the beginning include stock of stationery ₹ 1,800.
- Furniture sold was appearing in the Balance Sheet on 31st March, 2018 at ₹ 13,000.
- Creditors at the end include creditors for stationery ₹ 3,000 for credit purchases.
- Commission receivable on sale of consignment is ₹ 40,000.
- Stationery of ₹ 2,000 was consumed by Mr 'A'.
- Make provision for bad and doubtful debts at 5% on debtors.
- Depreciate furniture at 10% p.a.

SOLUTION:
TRADING AND PROFIT AND LOSS ACCOUNT OF MR A
Dr.
FOR THE YEAR ENDED 31ST MARCH, 2018
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Opening Stock 5,50,000		By Sales	29,35,000
Less: Stock of stationery 1,800	5,48,200	By Closing Stock 8,00,000	
To Purchases 19,25,000		Less: Stock of Stationery 800	7,99,200
Less: Stationery 3,000	19,22,000		
To Wages and Salaries	1,25,000		
To Carriage inward	40,000		
To Gross Profit c/d	10,99,000		
	37,34,200		37,34,200
To Insurance	35,000	By Gross Profit b/d	10,99,000
To Commission	40,000	By Discount	2,000
To Interest	35,000	By Commission from consignment business	40,000
To Rent & taxes	1,27,500		
To Trade expenses 34,500			
Less: Stationery 22,500	12,000		
To Stationery consumed	24,500		
To Provision for doubtful debts	75,400		
To Loss on sale of furniture	1,700		
To Depreciation on furniture	6,000		
To Net profit t/f to Capital A/c	7,83,900		
	11,41,000		11,41,000

BALANCE SHEET OF MR A AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital	8,95,000	Furniture	60,000
Add: Net Profit	7,83,900	Less: Furniture sold	11,700
Less: Drawings	2,000	Less: Depreciation	6,000
	16,76,900		42,300
Consignor's balance	1,20,000	Debtors	15,00,000
Creditors for goods	9,29,500	Add: B/R Dish	8,000
Creditors for stationery	3,000	Less: Provision	75,400
Bills payable	1,85,000	Bill Receivable	2,25,000
		Less: B/R Dish	8,000
		Closing Stock	7,99,200
		Stock of stationery	800
		Cash in hand & at Bank	4,22,500
	29,14,400		29,14,400

Working Notes:**(I) Dr. CONSIGNOR'S ACCOUNT Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Cash	8,00,000	By Balance b/d	4,00,000
To Charges	80,000	By Consignment sales	6,40,000
To Commission	40,000		
To Balance c/d	1,20,000		
	10,40,000		10,40,000

(ii) Loss on sale of furniture = (₹. 13,000 × 10%) – ₹ 10,000 = ₹ 1,700

(III) Dr. STATIONERY ACCOUNT Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	1,800	By Drawing	2,000
To Cash purchases	22,500	By Profit & loss A/c	24,500
To Credit purchases	3,000	(stationery consumed)	
		By Balance c/d	800
	27,300		27,300

PROBLEM 9

Mr. Neel had prepared the following Trial Balance from his ledger as on 31st March, 2018

<i>Particulars</i>	<i>Debit Balance ₹</i>	<i>Credit Balance ₹</i>
Opening Stock	5,00,000	
Purchases and Returns	31,00,000	45,000
Sales and Returns	55,000	41,50,000
Cash & Bank	7,50,000	
Capital & Drawings	45,000	22,59,200

Rates and Taxes	50,000	
Salaries	95,000	
Postage and Telegram	1,05,000	
Insurance	90,000	
Salesman Commission	78,000	
Printing and Stationery	95,500	
Advertisement	1,70,000	
Furniture and Fittings	5,50,000	
Motor Car	48,000	
Discounts	50,000	75,000
General Expenses	65,700	
Carriage Inwards	10,000	
Carriage Outwards	22,000	
Wages	50,000	
Sundry Debtors/Creditors	10,00,000	4,00,000
Total	69,29,200	69,29,200

Additional Information:

- Closing Stock ₹ 1,45,000.
- Neel had withdrawn goods worth ₹ 50,000 during the year.
- Purchases include Purchase of furniture worth ₹ 1,00,000.
- Debtors include ₹ 50,000 bad debts.
- Sales include goods worth ₹ 1,50,000 sent out to NN & Co. on approval and remained unsold as on 31st March, 2018. The cost of the goods was ₹ 1,00,000/.
- Provision for Doubtful Debts is to be created at 5% of Sundry Debtors.
- Depreciate Furniture and Fittings by 10% and Motor Car by 20%.
- The salesman is entitled to a commission of 10% on total sales.

You are required to prepare Trading and Profit & Loss Account for the year ended on 31st March, 2018 and Balance Sheet as on that date.

SOLUTION:

TRADING AND PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31ST MARCH, 2018

Dr.
Cr.

Particulars	₹	Particulars	₹
To Opening Stock	5,00,000	By Sales	41,50,000
To Purchases	31,00,000	Less: Returns	55,000
Less: Returns	45,000	Less: Sent on approval	1,50,000
Less: For personal Use	50,000	By Closing Stock	1,45,000
Less: Furniture	1,00,000	Add: Cost of goods sent on approval	1,00,000
To Carriage Inwards	10,000		
To Wages	50,000		
To Gross Profit c/d	7,25,000		
	41,90,000		41,90,000

To Rates and Taxes	50,000	By Gross Profit b/d	7,25,000
To Salaries	95,000	By Discounts Received	75,000
To Postage and Telegram	1,05,000	By Net Loss	5,02,300
To Salesman's Commission	78,000		
Add: O/s	3,16,500		
	3,94,500		
To Insurance	90,000		
To Advertisement	1,70,000		
To Printing and Stationery	95,500		
To Bad Debts	50,000		
To Provision for Doubtful Debts (5% of ₹ 8,00,000)	40,000		
To Discounts Allowed	50,000		
To General Expenses	65,700		
To Carriage Outwards	22,000		
To Depreciation:			
Furniture and Fittings	65,000		
Motor Car	9,600		
	74,600		
	13,02,300		13,02,300

**BALANCE SHEET OF MR. NEEL
AS ON 31ST MARCH 2018**

<i>Liabilities</i>		₹	<i>Assets</i>		₹
Capital	22,59,200		Furniture & Fittings	5,50,000	
Less: Net Loss	5,02,300		Add: Addition	1,00,000	
Less: Drawings			Less: Dep	65,000	5,85,000
(45,000 + 50,000)	95,000	16,61,900	Motor Car	48,000	
Sundry Creditors		4,00,000	Less: Dep	9,600	38,400
O/s Salesman's Commission		3,16,500	Sundry Debtors	10,00,000	
			Less: on approval	1,50,000	
				8,50,000	
			Less: Bad Debts	50,000	
			Less: Provision	40,000	7,60,000
			Cash & Bank		7,50,000
			Closing Stock	1,45,000	
			Add: Sent on approval	1,00,000	2,45,000
		23,78,400			23,78,400

PROBLEM 10

The following are the balances as at 31st March, 2018 extracted from the books of Mr. XYZ.

	₹		₹
Plant and Machinery	19,550	Bad debts	1,100
Furniture and Fittings	10,250	Bad debt recovered	450
Bank Overdraft	80,000	Salaries	22,550
Capital Account	65,000	Salaries payable	2,450
Drawings	8,000	Prepaid rent	300
Purchases	1,60,000	Rent	4,300
Opening Stock	32,250	Carriage inward	1,125
Wages	12,165	Carriage outward	1,350
Provision for doubtful debts	3,200	Sales	2,15,300
Provision for Discount on debtors	1,375	Advertisement Expenses	3,350
Sundry Debtors	1,20,000	Printing and Stationery	1,250
Sundry Creditors	47,500	Cash & Bank	4,575
Interest paid on loan	3,000	Office Expenses	10,160

Additional Information:

- Purchases include sales return of ₹ 2,575 and sales include purchases return of ₹ 1,725.
- Goods withdrawn by Mr XYZ for own consumption ₹ 3,500 included in purchases.
- Wages paid in the month of April for installation of Plant and Machinery amounting to ₹ 450 were included in wages account.
- Free samples distributed for Publicity costing ₹ 825.
- Create a provision for doubtful debts @ 5% and provision for discount on debtors @ 2.5%.
- Depreciation is to be provided on Plant and Machinery @ 15% p.a. and on furniture and fittings @ 10% p.a.
- Bank overdraft is secured against hypothecation of stock. Bank overdraft outstanding as on 31.3.2018 has been considered as 80% of real value of stock (deducting 20% as margin) and after adjusting the marginal value 80% of the same has been allowed to draw as on overdraft.

Required: Prepare a trading and Profit Loss Account for the year ended 31st March, 2018, and a Balance Sheet as on that date. Also show the rectification entries.

SOLUTION:
JOURNAL

	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	Returns Inward A/c Dr.		2,575	
	Sales A/c Dr.		1,725	
	To Purchases A/c			2,575
	To Returns outward A/c			1,725
	(Being sales return and purchases return wrongly included in purchases and sales respectively, now rectified)			
(ii)	Drawings A/c Dr.		3,500	
	To Purchases A/c			3,500
	(Being goods withdrawn for own consumption included in purchases, now rectified)			

(iii)	Plant and Machinery A/c	Dr.	450	
	To Wages A/c (Being wages paid for installation of plant and machinery wrongly debited to wages, now rectified)			450
(iv)	Advertisement expenses A/c	Dr.	825	
	To Purchases A/c (Being free samples distributed for publicity out of purchases, now rectified)			825

TRADING AND PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31ST MARCH, 2018

Dr.**Cr.**

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Opening Stock	32,250	By Sales	2,13,575
To Purchases	1,53,000	Less: Sales returns	2,575
Less: Returns	1,725		
To Carriage inward	1,125	By Closing Stock	
To Wages	11,715	[80,000 × (100/80) × (100/80)]	1,25,000
To Gross profit c/d	1,39,535		
	3,36,000		3,36,000
To Salaries	22,550	By Gross profit b/d	1,39,535
To Rent	4,300	By Bad debts recovered	450
To Advertisement expenses	4,175		
To Printing and stationery	1,250		
To Bad debts	1,100		
To Carriage outward	1,350		
To Provision for doubtful debts			
5% of ₹ 1,20,000	6,000		
Less: Existing provision	3,200		
To Provision for discount on debtors			
2.5% of ₹ 1,14,000	2,850		
Less: Existing provision	1,375		
To Depreciation:			
Plant and Machinery	3,000		
Furniture and Fittings	1,025		
To Office expenses	10,160		
To Interest on loan	3,000		
To Net t/f to Capital A/c	83,800		
	1,39,985		1,39,985

BALANCE SHEET OF MR XYZ AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
<i>Capital account:</i>		Plant and machinery	20,000
Opening Balance	65,000	Less: Depreciation	3,000
Add: Net profit	83,800	Furniture and fittings	10,250
Less: Drawings	11,500	Less: Depreciation	1,025
	1,37,300	Closing Stock	1,25,000
Bank overdraft	80,000	Sundry Debtors	1,20,000
Sundry creditors	47,500	Less: Provision for doubtful debts	6,000
Payable salaries	2,450	Less: Provision for Discount	2,850
		Prepaid rent	300
		Cash & bank	4,575
	2,67,250		2,67,250

PROBLEM 11

From the following Trial Balance of Shri Shivam as on 31st March, 2018, you are required to prepare a Trading and Profit and Loss Account for the year ended 31st March, 2018 and Balance Sheet as on that date, after making the necessary adjustment as mentioned hereunder:

<i>Particulars</i>	<i>Debit Balance ₹</i>	<i>Credit Balance ₹</i>
Capital & Drawings	24,000	1,60,000
Furniture and fixtures	8,000	—
Plant and machinery	60,000	—
Patents (ten years from 1.4.2017)	40,000	—
Opening Stock	40,000	—
Purchases & Sales	1,70,000	2,64,000
Salaries	14,800	—
Wages	30,000	—
Sundry Debtors & Creditors	20,400	24,000
Land	28,350	—
Loan from Shyam (at 6% from 1.10.2017)	—	20,000
Postage and fax	3,000	—
Rent, rates and taxes	7,200	—
Bad debts	800	—
Discount	—	1,200
Carriage inward	400	—
Interest on loan	300	—
Insurance	1,600	—
Travelling expenses	1,000	—
Sundry expenses	600	—
Cash & Bank	33,750	—
Bank overdraft	—	15,000
Total	4,84,200	4,84,200

Adjustments:

- Closing Stock is valued at ₹ 30,000
- A new machine was installed on 1st April, 2017 for ₹ 3,000. No entry in this respect was passed in the books. Wages of ₹ 1,000 paid for installing the machine were debited to Wages Account.
- Of the sundry debtors, ₹ 200 are bad and are to be written off. You are required to maintain a provision for doubtful debts @ 5% on debtors and provision for discount on debtors @2%.
- Goods costing ₹ 2,000 were given away as free samples for publicity.
- Depreciate Plant and Machinery at 20% per annum and Furniture and Fixtures at 10% per annum.
- On 1.4.2004 machinery of the value of ₹ 10,000 was destroyed by fire and the insurance claim settled at ₹ 8,000 was credited to Machinery Account.
- Goods for ₹ 1,200 were sent to a customer at a profit of 20% on cost on 30th March, 2018 on sale or return basis. This was recorded as actual sales.

SOLUTION:**TRADING AND PROFIT AND LOSS ACCOUNT****Dr.***for the year ended 31st March, 2018***Cr.**

Particulars	₹	Particulars	₹
To Opening Stock	40,000	By Sales	2,64,000
To Purchases	1,70,000	Less: Sent for approval	1,200
Less: Free samples	2,000	By Closing stock	30,000
To Carriage Inward	400	Add: Sent for approval	1,000
To Wages	30,000		
Less: Installation	1,000		
To Gross Profit c/d	56,400		
	2,93,800		2,93,800
To Rent, rates and taxes	7,200	By Gross profit b/d	56,400
To Salaries	14,800	By Discount received	1,200
To Postage and fax	3,000		
To Sundry expenses	600		
To Travelling expenses	1,000		
To Interest on loan	300		
Add: Accured interest	300		
To Advertising	2,000		
To Insurance	1,600		
To Loss of machinery by fire	2,000		
To Bad debts	800		
Add: Written off	200		
Add: Provision	950		
To Provision for Discount on debtors	361		
To Depreciation:			
Plant and machinery	12,400		
Furniture and fixtures	800		
Patents	4,000		
To Net Profit t/f to Capital a/c	5,289		
	57,600		57,600

BALANCE SHEET OF MR XYZ AS ON 31ST MARCH, 2018

Liabilities	₹	Assets	₹
<i>Capital Account:</i>		Land	28,350
Opening Balance 1,60,000		Plant and machinery 60,000	
Add: Net Profit 5,289		Add: Purchased 3,000	
Less: Drawings 24,000	1,41,289	Add: installation charges 1,000	
Loans from Shyam @6% 20,000		Less: Loss by fire 2,000	
Add: Accrued interest 300	20,300		62,000
Sundry Creditors	24,000	Less: Depreciation 12,400	49,600
Creditor for machinery 3,000		Patents 40,000	
Bank Overdraft 15,000		Less: Depreciation 4,000	36,000
		Furniture & Fixtures 8,000	
		Less: Depreciation 800	7,200
		Closing Stock 30,000	
		Add: with Customers 1,000	31,000
		Debtors 20,400	
		Less: Sent on approval 1,200	
		Less: Bad debts w/o 200	
			19,000
		Less: Provision doubtful debts @ 5% 950	
		Less: Provision for discount @2% 361	17,689
		Cash & bank	33,750
	2,03,589		2,03,589

PROBLEM 12

The following is the Trial Balance of Mr X on 31.3.2018. Prepare a Trading and Profit and Loss Account for the year 2017–2018 and Balance Sheet as at 31.3.2018 from it.

Debit Balances	₹	Credit Balances	₹
Purchases	1,80,000	Sales	2,05,000
Opening Stock	10,000	Loans (10%)	10,000
Salary Less P.F.	5,400	Creditors	15,000
P.F. remittance including		Capital	55,000
Proprietor's contribution 50%	1,200		
Rent @ 250 p.m.	2,750		
Machinery	29,000		
Wages	3,000		
Furniture & Fittings	5,000		
Electricity	550		
Trade Expenses	1,500		

Debtors	10,500	
Interest on Loan	900	
Commission	200	
Buildings	30,000	
Drawings	5,000	
	2,85,000	2,85,000

Additional Information:

On 1.4.2017, machinery worth ₹ 5,000 was sold for ₹ 4,000 and credited to Sales account. Wages include ₹ 1,000 paid for machinery erection charges. Purchases include cost of Moped Scooter for ₹ 5,000. Proprietor has taken goods costing ₹ 1,000 for which no entry has been made. Sundry debtors include ₹ 500 which have become bad. Provide 10% provision for doubtful debts. Electricity outstanding ₹ 50. Goods costing ₹ 5,000 were destroyed by fire, and insurance claim was received for ₹ 4,000. Provide depreciation @ 10% on machinery, furniture and moped. Provide depreciation @ 5% on building. Closing stock is ₹ 12,000.

SOLUTION:**TRADING AND PROFIT & LOSS ACCOUNT****DR.***for the year ending on 31st March, 2018***CR.**

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Opening Stock	10,000	By Sales	2,05,000
To Purchases	1,80,000	Less: Sales of Machs.	4,000
Less: Cost of Moped	5,000	By Closing Stock	12,000
Less: Loss of stock	5,000		
Less: Drawings of goods	1,000		
To Wages	3,000		
Less: Machinery			
erection charged	1,000		
To Gross Profit c/d	32,000		
	2,13,000		2,13,000
To Salaries	5,400	By Gross Profit b/d	32,000
Add: PF (employees share)	600		
Add: PF (employer share)	600		
To Rent	2,750		
Add: Outstanding	250		
To Electricity	550		
Add: Outstanding	50		
To Trade Expenses			
To Interest on loan	900		
Add: Outstanding	100		
(10/100 × 10,000 – 900)			
To Commission			
To Bad debts			

To Provision for doubtful debts	1,000		
T Stock destroyed by fire	1,000		
To Loss on sale of Machinery (₹ 5,000 – ₹ 4,000)	1,000		
To Depreciation:			
Building	1,500		
Machinery	2,900		
Moped Scooter	500		
Furniture	500	5,400	
To Net Profit t/f to Capital		10,200	
		32,000	32,000

BALANCE SHEET

as at 31st March, 2018

Liabilities	₹	Assets	₹
<i>Capital:</i>		Building	30,000
Opening Balance	55,000	Less: Depreciation	1,500
Less: Drawings	5,000	(5,100 × ₹ 30,000)	
Less: Drawing of goods	1,000	Machinery	29,000
Add: Net Profit	10,200	Add: Erection	1,000
	59,200	Less: Loss on Sale	1,000
Creditors	15,000	(₹ 5,000 – ₹ 4,000)	29,000
10% of Loan	10,000	Less: Depreciation	2,900
O/s Electricity Expenses	50	(10/100 × 29,000)	
O/s Rent	250	Moped Scooter	5,000
O/s Interest or Loan	100	Less: Depreciation	500
		(10/100 × 5,000)	
		Furniture	5,000
		Less: Depreciation	500
		(10/100 × 5,000)	
		Closing Stock	
		Debtors	10,500
		Less: Add. Bad debts	500
		Less: Provision	
		(10/100 × 10,000)	1,000
	84,600		9,000
			84,600

PROBLEM 13

From the following particulars prepare the Trading and Profit and Loss Account for the year 2017–2018 and Balance Sheet as on 31.3.2018 of Mr X.

<i>Particulars</i>	<i>Debit Balance ₹</i>	<i>Credit Balance ₹</i>
Building	50,000	
Machinery	22,000	
Furniture	10,000	
Bank	9,000	
Cash	1,000	
10% Loan (since 1.4.2017)		30,000
Capital		52,000
Debtors/Creditors	50,000	40,000
Opening Stock	12,000	
Purchases>Returns	2,50,000	10,000
Sales>Returns	12,000	3,22,000
Rent	6,000	
Establishment	16,000	
P.F. deducted from Salaries		1,000
Interest on loan	2,000	
Electricity	1,000	
Phone	1,000	
Commission	6,000	
Insurance Premium	1,000	
Bad Debts	2,000	
Bills Receivable	4,000	
	4,55,000	4,55,000

Provide depreciation on Building @ 5%, Machinery @ 15% and Furniture @ 10%. Stock was not taken on 31.03.2018 but only on 7th April. The transactions from 1st April to 7th April are—Sales ₹ 25,000. Purchases ₹ 15,000, Stock on 7th April ₹ 18,000 and the Gross Profit 20%. During the year machinery to the value of ₹ 10,000 was destroyed by fire and the insurance claim was settled at ₹ 8,000 and credit to Machinery Account. Also provide—Employers' share of P.F. ₹ 1,000, Provision for Doubtful Debts at 5%, Commission to the Manager @ 10% on net profit after providing the commission.

SOLUTION:**TRADING AND PROFIT & LOSS ACCOUNT****Dr.***for the year ending on 31st March, 2018***Cr.**

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Opening Stock	12,000	By Sales	3,22,000
To Purchases	2,50,000	Less: Returns	12,000
Less: Returns	10,000		
To Gross Profit c/d	81,000	By Closing Stock:	
		(Stock 7th Jan)	18,000
		Add: Cost of sale	20,000
		during 1st Apr. to 7th Apr.	
		(80/100 × 25,000)	
		Less: Purchases during	
		1st Apr. to 7th Apr.	15,000
	3,33,000		23,000
			3,33,000

To Rent	6,000	By Gross Profit b/d	81,000
To Establishment	6,000		
To Provident Fund Contribution	1,000		
To Interest on Loan	2,000		
Add: Outstanding	1,000		
	3,000		
To Electricity	1,000		
To Phone	1,000		
To Commission	6,000		
To Insurance	1,000		
To Bad Debts	2,000		
To Loss on machine destroyed			
by fire (₹ 10,000 – ₹ 8,000)	2,000		
To Depreciation on Building	2,500		
To Depreciation on Machinery	3,000		
To Depreciation on Furniture	1,000		
To Provision for Doubtful Debts	2,500		
To Provision for Manager's Commission	3,000		
(10/110 × ₹ 33,000)			
To Net Profit t/f to Capital A/c	30,000		
	81,000		81,000

BALANCE SHEET

as at 31st March, 2018

Liabilities	₹	Assets	₹
<i>Capital Account:</i>		Building	50,000
Opening Balance	52,000	Less: Depreciation	2,500
Add: Profit	30,000		47,500
	82,000		
Loan	30,000	Machinery	22,000
O/s Interest on Loan	1,000	Less: Destroyed by fire	10,000
Sundry Creditors	40,000	Add: Insurance Claim	8,000
Provident Fund:		Less: Depreciation	3,000
Employees: Contribution	1,000		17,000
Employer's Contribution	1,000	Furniture	10,000
O/s Manager's Commission	3,000	Less: Depreciation	1,000
			9,000
		Stock in trade	23,000
		Debtors	50,000
		Less: Provision	2,500
			47,500
		Bills Receivable	4,000
		Cash at Bank	9,000
		Cash in hand	1,000
	1,58,000		1,58,000

PROBLEM 14

From the following trial balance of Mr. X, prepare Trading and Profit and Loss Account for the year ending on 31st March 2018, and Balance Sheet as on that date after taking into consideration the adjustment given at the end of the trial balance:—

TRIAL BALANCE AS AT 31ST MARCH, 2018

<i>Debit Balances</i>	₹	<i>Credit Balances</i>	₹
Purchases (adjusted)	3,49,600	Sales	3,70,000
Wages	10,450	Capital Account	34,250
National Insurance	150	Discount earned	300
Carriage Inwards	200	Creditors	10,000
Carriage Outwards	250	Dividends Received	150
Lighting	300		
Rates and Insurance (including premium of ₹ 150 p.a. paid up to 30th Sept 2018)	200		
Stock at 31.3.2018	30,625		
Cash & bank	875		
Plant and Machinery	15,000		
Discount Allowed	50		
Debtors	3,000		
Furniture	4,000		
	4,14,700		4,14,700

Adjustments: (a) National Insurance also includes employee's contribution of ₹ 75. Wages are shown "Net" after deducting national insurance contribution borne by the employee. (b) Owing to the nature of employment, some employees are housed in the building of the business. The rental value of such portion is assessed at ₹ 250 p.a. The benefit to the employee treated as wages and the rental as income for Mr X. (c) Depreciate Plant and Machinery @ 15% p.a. and Furniture @ 10% p.a. (d) Goods costing ₹ 2,000 given by Mr. X. to his son. (e) The Manager is entitled to a commission of 20% of the Net Profit after charging his commission. (Calculation may be made nearest to the multiple of a Rupee).

SOLUTION:**TRADING AND PROFIT & LOSS ACCOUNT****Dr.***for the year ending on 31st March, 2018***Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Purchases 3,49,600		By Sales 3,70,000	
Less: Drawings 2,000	3,47,600		
To Wages 10,450			
Add: Employees			
Contribution to			
National Insurance 75			
Employer's Contribution			
to National Insurance 75			

Rental Value of free Accommodation	250	10,850		
To Carriage Inwards		200		
To Gross Profit c/d		11,350		
		3,70,000		3,70,000
To Carriage Outward		250	By Gross Profit b/d	11,350
To Lighting		300	By Discount earned	300
To Rates & Insurance	200		By Dividends received	150
Less: Prepaid	75	125	By Rental Value of Free Accommodation	250
To Discount Allowed		50		
To Depreciation P & M (15,100 × 15,000)		2,250		
To Depreciation on Furniture (10/100 × 4,000)		400		
To Manager's Commission (20/120 × 8,675)		1,446		
To Net Profit t/f to Capital A/c		7,229		
		12,050		12,050

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
<i>Capital Account:</i>		Plant & Machinery	15,000
Opening Balance	34,250	Less: Depreciation	2,250
Less: Drawings	2,000	Furniture	4,000
(goods given to son)	32,250	Less: Depreciation	400
Add: Net Profit	7,229	Stock-in-trade	30,625
	39,479	Sundry Debtors	3,000
Sundry Creditors	10,000	Prepaid Insurance	75
Manager's Commission (yet to be paid)	1,446	Cash & Bank	875
	50,925		50,925

13

ACCOUNTING FOR PARTNERSHIP FIRMS — FUNDAMENTALS

PROBLEM 1

A and B have been carrying on business since 1st April, 2014, and the results of their business have been as follows after allowing interest on capitals @ 10% per annum:

2014-2015	Loss ₹ 16,000	2016-2017	Profit ₹ 82,000
2015-2016	Profit ₹ 72,000	2017-2018	Profit ₹ 1,07,200

Capitals of the two partners have remained unchanged at ₹ 1,50,000 and ₹ 1,00,000, respectively for A and B, who shared profits and losses in the same ratio. On 1st April 2014, C, the Manager, gave a loan of ₹ 25,000 at 16% p.a. interest. The interest has been regularly paid but the loan has not been repaid yet. C was paid a salary of ₹ 2,000 per annum.

It was decided on 31st March, 2018 that C should be treated as a partner with effect from 1st April, 2014 giving him one-fifth share of profits. His loan was to be treated as capital bearing interest @ 10% p.a. as a charge; C's salary was to be ₹ 12,000 p.a. with effect from 1st April, 2014.

Required: What would be the entries to adjust matters? Treat the capitals as fixed and Interest on Capital and Salary to partner as charge against profits.

SOLUTION:

STATEMENT SHOWING THE ADJUSTMENT TO BE MADE

Particulars	Cr.(₹)
I. Amount already credited to C:	
Interest on Loan ($₹ 25,000 \times 16/100 \times 4$)	16,000
Salary ($₹ 20,000 \times 4$)	80,000
	96,000
II. Amount which should have been credited to C:	
Interest on Capital ($₹ 25,000 \times 10/100 \times 4$)	10,000
Salary ($₹ 8,000 \times 4$)	32,000
Share of Profit 1/5 of ($₹ 2,45,200 + ₹ 96,000 - ₹ 10,000 - ₹ 32,000$)	59,840
	1,01,840
III. Difference (credit still to be given I-II)	-30,560

Adjusting Journal Entry:

A's Capital A/c	Dr.	₹ 3,504	
B's Capital A/c	Dr.	₹ 2,336	
To C's Capital A/c			₹ 5,840

(Being the adjustment made account of admission of C an existing manager, as a partner)

PROBLEM 2

X, Y, and Z entered into partnership on 1st April 2015 to share profits and losses in the ratio of 12 : 8 : 5. It was provided that in no case Z's share in profits be less than ₹ 15,000 p.a. The profits and losses for the period ended 31st March were: 2015-2016 Profit ₹ 60,000, 2016-2017 Profit ₹ 90,000, 2017-2018 Loss ₹ 60,000. Pass the necessary journal entries in the books of the firm.

SOLUTION:

Particulars	2015-2016 ₹	2016-2017 ₹	2017-2018 ₹
I. Guaranteed Amount	15,000	15,000	15,000
II. Z's Actual Share as per profit sharing ratio	12,000	18,000	(12,000)
	$(60,000 \times 5/25)$	$(90,000 \times 5/25)$	$60,000 \times 5/25$
III. Deficiency (I-II)	3,000	—	27,000

Since no specific ratio in which the deficiency is to be borne is given, it means the remaining partners (A & B) shall bear the deficiency in their agreed profit sharing ratio which is 12:8 or 3:2.

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Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2015-2016	P&L Adjustment A/c Dr.		60,000	
	To X's Capital A/c			28,800
	To Y's Capital A/c			19,200
	To Z's Capital A/c			12,000
	(Being the distribution of profits as if there is no guarantee)			
	X's Capital A/c Dr.		1,800	
2016-2017	Y's Capital A/c Dr.		1,200	
	To Z's Capital A/c			3,000
	(Being the deficiency met by guaranteeing partners)			
	P&L Adjustment A/c Dr.		90,000	
	To X's Capital A/c			43,200
	To Y's Capital A/c			28,800
2017-2018	To Z's Capital A/c			18,000
	(Being the distribution of profits)			
	X's Capital A/c Dr.		28,800	
	Y's Capital A/c Dr.		19,200	
	Z's Capital A/c Dr.		12,000	
	To P&L Adjustment A/c			60,000
	(Being the distribution of losses as if there is no guarantee)			
	X's Capital A/c Dr.		16,200	
	Y's Capital A/c Dr.		10,800	
	To Z's Capital A/c			27,000
	(Being the deficiency borne by guaranteeing partners)			

PROBLEM 3

A, B and C entered into partnership on 1st Apr., 2017 to share profits and losses in the ratio of 5 : 3 : 2. A, however personally guaranteed that C's share of profits after charging interest on capital @ 10% p.a. would not be less than ₹ 15,000 in any year. The capital was provided as follows: A ₹ 80,000, B ₹ 50,000, C ₹ 40,000. The profits for the year ended 31st March., 2018 amounted to ₹ 79,500 before charging any interest. Show the Profit & Loss Appropriation Account.

SOLUTION:**PROFIT & LOSS APPROPRIATION ACCOUNT****Dr.***for the year ending on 31st Mar., 2018***Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Interest on Capital:		By Profit & Loss A/c (Net Profit)	79,500
A 8,000			
B 5,000			
C 4,000	17,000		
To Balance c/d	62,500		
	79,500		79,500
To Share of Profit		By Balance b/d	62,500
A: 5/10 of ₹ 62,500 31,250			
Less: Deficiency borne 2,500	28,750		
B: 3/10 of ₹ 62,500 18,750			
C: 2/10 of ₹ 62,500 12,500			
Add: Deficiency received 2,500	15,000		
	62,500		62,500

PROBLEM 4

A and B were partners sharing profits & losses in the ratio of 5 : 3. C was their manager who was receiving a salary of ₹ 300 p.m. in addition to a commission of 5% on net profits remaining after charging such salary and commission. With effect from 1st April 2017 C is admitted as a partner with 1/5th share but it is agreed that any additional income which comes to C over what he was getting as manager should come out of A's share. The profits for year ended 31st March 2018 were ₹ 49,800 before charging C's salary and commission. Prepare the Profit & Loss Appropriation Account.

SOLUTION:**PROFIT & LOSS APPROPRIATION ACCOUNT****Dr.***for the year ending on 31st March 2018***Cr.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To C		By Profit & Loss A/c	49,800
Salary 3,600			
Commission 2,200			
Deficiency recovered from A 4,160	9,960		
To A (5/8 × ₹ 44,000) 27,500			
Less: Deficiency borne 4,160	23,340		
To B (3/8 × ₹ 4,000) 16,500			
	49,800		49,800

Working Notes:

- (i) C's share as partner = ₹ 49,800 × 1/5 = ₹ 9,960
- (ii) C's remuneration as manager = (₹ 300 × 12) + (49,800 – 3,600) × 5/105
= ₹ 3,600 + ₹ 2,200 = ₹ 5,800.
- (iii) Deficiency = ₹ 9,960 – ₹ 5,800 = ₹ 4,160
- (iv) Profit after C's Salary & Commission ₹ 44,000 [i.e. 49,800 – (3,600 + 2,200)] have been divided among A and B in their old profit sharing ratio as if C is manager.

PROBLEM 5

From the following information, calculate the value of goodwill of a firm of X & Y (a) at 3 years' purchase of Super profit (b) on the basis of capitalization of Super Profits.

- (a) Average Capital employed in the business ₹ 7,00,000
- (b) Net Trading results of the firm for the past years—Profit 2015-2016 ₹ 1,47,600. Loss 2016-2017 ₹ 1,48,100. Profit 2017-2018 ₹ 4,48,700.
- (c) Rate of interest expected from capital having regard to the risk involved 18%.
- (d) Fair remuneration to each partner for his service ₹ 500 p.m.
- (e) Sundry Assets (excluding goodwill) of the firm ₹ 7,54,762. Sundry Liabilities ₹ 31,329.

SOLUTION:

Total Profit = ₹ 1,47,600 – ₹ 1,48,100 + ₹ 4,48,700 = ₹ 4,48,200

Average Profit = ₹ 4,48,200/3 = ₹ 1,49,400

Normal Profit = Normal return + remuneration

= ₹ 1,26,000 (i.e. 18% of ₹ 7,00,000) + ₹ 12,000 = ₹ 1,38,000

Super Profit = Average Profit – Normal Profit = ₹ 1,49,400 – ₹ 1,38,000 = ₹ 11,400

Goodwill = Super Profit × 3 = ₹ 11,400 × 3 = ₹ 34,200

PROBLEM 6

Good, Better and Best are in Partnership sharing profits and losses in the ratio 3:2:4. Their Capital Account balances as on 31st March 2018 are as follows: Good ₹ 1,70,000 (Cr), Better ₹ 1,10,000 (Cr), Best ₹ 1,22,000 (Cr). Following further information provided:

- 1. ₹ 22,240 is to be transferred to General Reserve.
- 2. Good, Better and Best are paid monthly salary in cash amounting to ₹ 2,400, ₹ 1,600 and ₹ 1,800 respectively.
- 3. Partners are allowed interest on their Closing Capital Balance at 6% p.a. and are charged interest on drawings at 8% p.a.
- 4. Good and Best are entitled to Commission at 8% and 10% respectively of the Net Profit before making any appropriation.
- 5. Better is entitled to Commission at 15% of the Net Profit before charging Interest on Drawings but after making all other appropriations.
- 6. During the year, Good withdrew ₹ 2,000 at the beginning of every month, Better ₹ 1,750 at the end of every month and Best ₹ 1,250 at the middle of every month.
- 7. The Firm's Accountant is entitled to a Salary of ₹ 2,000 per month and a Commission of 12% of Net Profit after charging such Commission.

The Net Profit of the Firm for the year ended 31st March 2018, before providing for any of the above adjustments was ₹ 2,76,000. You are required to prepare Profit and Loss Appropriation Account for the year ended on 31st March 2018.

SOLUTION:

Dr. **PROFIT AND LOSS ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Accountant's Salary (2,000 × 12)	24,000	By Net Profit b/d	2,76,000
To Accountant's Commission [(2,76,000 – 24,000) × 12/112]	27,000		
To Net Profit c/d (bal. fig.)	2,25,000		
	2,76,000		2,76,000

Dr. **PROFIT AND LOSS APPROPRIATION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To General Reserve	22,240	By Net Profit b/d	2,25,000
To Salary:		By Interest on Drawings:	
Good (2,400 × 12)	28,800	Good (24,000 × 8% × 6.5 / 12)	1,040
Better (1,600 × 12)	19,200	Better (21,000 × 8% × 5.5 / 12)	770
Best (1,800 × 12)	21,600	Best (15,000 × 8% × 5.5 / 12)	600
To Interest on Capital:			2,410
Good (1,70,000 × 6%)	10,200		
Better (1,10,000 × 6%)	6,600		
Best (1,22,000 × 6%)	7,320		
To Commission:			
Good (2,25,000 × 8%)	18,000		
Best (2,25,000 × 10%)	22,500		
Better (68,540 × 15%)	10,281		
To Net Profit trfd to Capital A/c:			
Good (60,669 × 3/9)	20,223		
Better (60,669 × 2/9)	13,482		
Best (60,669 × 4/9)	26,964		
	2,27,410		2,27,410

Notes:

- Salary and Commission to Firm's Accountant are in the nature of charges against Firm's Profits, and not an appropriation out of Profit to Partners. Hence, this amounts have been debited to Profit & Loss Account.
- Better's Commission = $[2,25,000 - 22,240 - 69,600 - 24,120 - 40,500] \times 15\% = ₹ 10,281$

14

RECONSTITUTION OF PARTNERSHIP — CHANGE IN PROFIT SHARING RATIO

PROBLEM 1

X and Y are partners in a firm sharing profits in the ratio of 2:3. The Balance Sheet of the firm as at March 31, 2018 is given below:

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capitals:		Land	3,00,000
X 4,80,000		Buildings	3,60,000
Y <u>7,20,000</u>	12,00,000	Plant	4,80,000
Creditors	1,86,000	Furniture	72,000
Outstanding Expenses	42,000	Stock	1,08,000
		Debtors	90,000
		Cash	18,000
	14,28,000		14,28,000

The partners decided to share profits in equal ratio w.e.f. April 1, 2018. The following adjustments were agreed upon:

- The goodwill of the firm was valued at ₹ 2,40,000 but it was not to appear in books.
- Land was valued at ₹ 4,80,000, Plant at ₹ 4,32,000 and Furniture at ₹ 60,000 and were to appear at revalued amounts in the balance sheet.

Pass the necessary Journal entries to give effect the above and prepare the Balance Sheet.

SOLUTION:

JOURNAL OF X AND Y

<i>Date</i>	<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
01.04.2018	X's Capital A/c [₹ 2,40,000 × 1/10] Dr.	24,000	
	To Y's Capital A/c		24,000
	(Being the adjustment made for goodwill on change in profit sharing ratio)		
	Revaluation A/c Dr.	60,000	
	To Plant A/c		48,000
	To Furniture		12,000
	(Being the decrease in value of assets recorded)		
	Land A/c Dr.	1,80,000	
	To Revaluation A/c		1,80,000
	(Being the increase in value of land recorded)		
	Revaluation A/c Dr.	1,20,000	
	To X's Capital A/c		48,000
	To Y's Capital A/c		72,000
	(Being the transfer of profit on revaluation in old profit sharing ratio)		

BALANCE SHEET OF X & Y AS AT 1.4.2018

Liabilities	₹	Assets	₹
X's Capital	5,04,000	Land	4,50,000
Y's Capital	8,16,000	Building	3,60,000
Creditors	1,86,000	Plant	4,32,000
Outstanding expenses	42,000	Furniture	60,000
		Stock	1,08,000
		Debtors	90,000
		Cash	18,000
	15,48,000		15,48,000

Working Note:

Calculation Gain or Sacrifice

Their old shares	2/5	3/5
Their new shares	1/2	1/2
Difference	(1/10)	(1/10)
	Gaining Partner	Sacrificing Partner

PROBLEM 2

B and C are partners in a firm, sharing profit or losses in the ratio of 5:3. Their Balance Sheet on 1.4.2018 was as follows:

Liabilities	₹	Assets	₹
B's Capital	32,000	Goodwill	8,000
C's Capital	34,000	Machinery	38,000
General Reserve	4,800	Furniture	5,000
Bank Loan	6,000	Debtors	23,000
Creditors	5,000	Stock	7,000
Employees' Provident Fund	1,000	Bank	5,000
Workmen Compensation Reserve	4,000	Advertisement Suspense A/c	800
	86,800		86,800

They decided to change their profit sharing ratio 3:5 and decided that:

- Goodwill be valued on the basis of 2 years' purchase of the average profits of the last three years. Average profits of the last three years are ₹ 6,000.
- Machinery and stock be revalued at ₹ 45,000 and ₹ 8,000 respectively.
- Goodwill not to be shown in the books of the new firm.

Required: Prepare a Revaluation Account and Partners' Capital Accounts and the Balance Sheet of the new firm.

SOLUTION:

Dr.	REVALUATION ACCOUNT		Cr.
Particulars	₹	Particulars	₹
To Profit on Revaluation t/f to:		By Machinery A/c	7,000
B's Capital A/c 5,000		By Stock A/c	1,000
C's Capital A/c <u>3,000</u>	8,000		
	8,000		8,000

Dr.**CAPITAL ACCOUNTS OF PARTNERS****Cr.**

<i>Particular</i>	<i>B</i> ₹	<i>C</i> ₹	<i>Particular</i>	<i>B</i> ₹	<i>C</i> ₹
To Goodwill A/c	5,000	3,000	By Balance b/d	32,000	34,000
To Adv. Suspense A/c	500	300	By General Reserve	3,000	1,800
To B's Capital A/c	—	3,000	By C's Capital A/c	3,000	—
To Balance c/d	40,000	34,000	By Revaluation A/c	5,000	3,000
			By Workmen Compr. Reserve	2,500	1,500
	45,500	40,300		45,500	40,300

BALANCE SHEET TO THE NEW FIRM AS ON 1ST APRIL, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
B's Capital	40,000	Machinery	45,000
C's Capital	34,000	Furniture	5,000
Bank Loan	6,000	Debtors	23,000
Creditors	5,000	Stock	8,000
Employees' Provident Fund	1,000	Bank	5,000
	86,000		86,000

Notes: Present value of Goodwill (₹ 6,000 × 2) = ₹ 12,000**PROBLEM 3**

L and M share the profits of a business in the ratio of 5:3. They agreed to change their profit sharing ratio 3:5. On the date of change the Balance Sheet of the firm was as follows:

<i>Liabilities</i>	₹	<i>Assets</i>	₹
L's Capital	30,000	Machinery	26,000
M's Capital	20,000	Furniture	18,000
Contingency Reserve	2,800	Stock	10,000
Workmen's Compensation Fund	2,000	Debtors	8,000
Bank Loan	12,000	Bank	6,000
Creditors	1,000	Advertisement Suspense A/c	800
Employees' Provident Fund	1,000		
	68,800		68,800

They also decided that:

- Goodwill of the firm be value at 4 years' purchase of the average super profit of the last three years. Average profits of the last three years are ₹ 20,000, while the normal profits that can be earned with the capital employed are ₹ 12,000. No Goodwill is to be raised.
- Furniture be appreciated by ₹ 6,000 and the value of stock to be reduced by 20%.

Required: Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet 20% of the firm after taking into account the above adjustments.

SOLUTION:

Dr. **REVALUATION ACCOUNT** **Cr.**

Particulars	₹	Particulars	₹
To Stock A/c	2,000	By Furniture A/c	6,000
To Profit on Revaluation t/f to:			
L's Capital A/c	2,500		
M's Capital A/c	1,500		
	4,000		
	6,000		6,000

Dr. **PARTNERS' CAPITAL ACCOUNTS** **Cr.**

Particulars	L ₹	M ₹	Particulars	L ₹	M ₹
To Adv. Suspense A/c	500	300	By Balance b/d	30,000	20,000
To Balance c/d	35,000	23,000	By Revolution A/c	2,500	1,500
			By Work. Comp. Fund	1,250	750
			By Contingency Res.	1,750	1,050
			By M's Capital A/c	8,000	—
	35,500	23,300		35,500	23,300

BALANCE SHEET OF RECONSTITUTED FIRM AS AT ...

Liabilities	₹	Assets	₹
L's Capital A/c	35,000	Machinery	26,000
M's Capital A/c	23,000	Furniture	24,000
Bank Loan	12,000	Stock	8,000
Creditors	1,000	Debtors	8,000
Employees' Provident Fund	1,000	Bank	6,000
	72,000		72,000

Working Notes:

(i) Super Profit = Average Profit – Normal Profits = ₹ 20,000 – ₹ 12,000 = ₹ 8,000

(ii) Goodwill = Super Profit × 4 = ₹ 8,000 × 4 = ₹ 32,000.

15

RECONSTITUTION OF PARTNERSHIP — ADMISSION OF A PARTNER

PROBLEM 1

A and B are partners of X & Co. sharing profits and losses in 3 : 2 ratio between themselves. On 31st March, 2018, the Balance Sheet of the firm was as follows:

Liabilities	₹	Assets	₹
Capital Accounts:		Plant and Machinery	20,000
A	37,000	Furniture and Fittings	5,000
B	28,000	Stock	15,000
Sundry Creditors	5,000	Sundry Debtors	20,000
		Cash on Hand	10,000
	70,000		70,000

X agrees to join the business on the following conditions as and from 1.4.2018:

- He will introduce ₹ 25,000 as his capital and pay ₹ 15,000 to the partners as premium for Goodwill for 1/3rd share of the future profits of the firm.
- A revaluation of assets of the firm will be made by reducing the value of Plant and Machinery to ₹ 15,000, Stock by 10%, Furniture and Fittings by ₹ 1,000 and by making a provision for doubtful debts at ₹ 750 on Sundry debtors.

You are asked to prepare Profit and Loss Adjustment account, Capital accounts of partners including the incoming partner X, Balance Sheet of the firm after admission of X and also find out the new profit sharing ratio assuming the relative ratios of the old partners will be in equal proportion after admission. [Nov. 1998]

SOLUTION:

Dr. PROFIT AND LOSS ADJUSTMENT ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Plant and Machinery	5,000	By Loss on Revaluation transferred to:	
To Stock	1,500	A (3/5)	4,950
To Furniture and Fittings	1,000	B (2/5)	3,300
To Provision for doubtful debts	750		
	8,250		8,250

Dr. CAPITAL ACCOUNTS OF PARTNERS Cr.

Particulars	A ₹	B ₹	X ₹	Particulars	A ₹	B ₹	X ₹
To A's Capital A/c	—	—	12,000	By Balance b/d	37,000	28,000	—
To B's Capital A/c	—	—	3,000	By Cash A/c	—	—	40,000
To P & L Adjustment A/c	4,950	3,300	—	By X's Capital A/c	12,000	3,000	—
To Balance c/d	44,050	27,700	25,000				
	49,000	31,000	40,000		49,000	31,000	40,000

Dr.		CASH ACCOUNT		Cr.	
Particulars		₹	Particulars		₹
To Balance b/f		10,000	By Balance c/d		50,000
To X's Capital A/c		40,000			
		50,000			50,000

BALANCE SHEET OF X & CO. AS at 1st April, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
A's Capital	44,050	Plant & Machinery	
B's Capital	27,700	(₹ 20,000 – ₹ 5,000)	15,000
X's Capital	25,000	Furniture and Fittings	
Sundry Creditors	5,000	(₹ 5,000 – ₹ 1,000)	4,000
		Stock (₹ 15,000 – ₹ 1,500)	13,500
		Sundry debtors (₹ 20,000 – ₹ 750)	19,250
		Cash in hand	50,000
	1,01,750		1,01,750

Calculation of New Profit Sharing Ratio

Let the total share be 1, Incoming Partner's share = $\frac{1}{3}$

Remaining share $\frac{2}{3}$ (i.e. $1 - \frac{1}{3}$) is shared by A & B equally

Thus, A's new share = $\frac{2}{3} \times \frac{1}{2} = \frac{1}{3}$, B's new share = $\frac{2}{3} \times \frac{1}{2} = \frac{1}{3}$

∴ New Profit sharing Ratio of A : B : C = $\frac{1}{3} : \frac{1}{3} : \frac{1}{3} = 1 : 1 : 1$

PROBLEM 2

Hari and Ram were in partnership, sharing profits and losses equally. On 1st April 2017, Suraj was admitted into partnership on the following terms:

Suraj is to have one-sixth share in the profits/losses, which he has got from Hari, paying him ₹ 40,000 for that share as goodwill. Out of this amount, Hari is to withdraw ₹ 30,000 and the balance amount is to remain in the firm. It was further agreed that the value of investments should be reduced to ₹ 18,000 and plant to be valued at ₹ 29,000. Creditors were to be reduced by ₹ 3,000 as one of the creditors has closed his business and gone.

Suraj is to bring in proportionate capital on his admission.

The Balance Sheet as at 31st March, 2017 was as follows:

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Creditors	1,05,000	Cash at Bank	40,000
<i>Capitals:</i>		Book Debts	60,000
Hari	60,000	Stock	50,000
Ram	60,000	Investments	30,000
		Furniture	10,000
		Plant	35,000
	2,25,000		2,25,000

The profits for the year ended 31st March, 2018 were ₹ 60,000 and the drawings were: Hari ₹ 15,000; Ram ₹ 22,500 and Suraj ₹ 7,500.

Journalise the entries on Suraj's admission and give the Capital Accounts and the Balance Sheet as at 31st March, 2018.

SOLUTION:

JOURNAL

<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Bank A/c Dr. To Suraj's Capital A/c (Being the amount brought in by Suraj)		63,000	63,000
Suraj's Capital A/c Dr. To Hari's Capital A/c (Being the goodwill credited to Hari)		40,000	40,000
Hari's Capital A/c Dr. To Bank A/c (Being the goodwill to the extent of ₹ 30,000 withdrawn by Hari)		30,000	30,000
Revaluation A/c Dr. To Investment Fluctuation Reserve A/c To Plant A/c (Being the fall in the value of assets recorded)		18,000	12,000 6,000
Sundry Creditors A/c Dr. To Revaluation A/c (Being the decrease in amount of creditors recorded)		3,000	3,000
Hari's Capital A/c Dr. Ram's Capital A/c Dr. To Revaluation A/c (Being the transfer of loss on revaluation)		7,500 7,500	15,000

Dr.

CAPITAL ACCOUNTS OF PARTNERS

Cr.

<i>Particulars</i>	<i>Hari ₹</i>	<i>Ram ₹</i>	<i>Suraj ₹</i>	<i>Particulars</i>	<i>Hari ₹</i>	<i>Ram ₹</i>	<i>Suraj ₹</i>
To Bank A/c	30,000	—	—	By Balance b/d	60,000	60,000	—
To Revaluation A/c	7,500	7,500	—	By Bank A/c	—	—	63,000
To Hari's	—	—	40,000	By Suraj's			
To Balance c/d	62,500	52,500	23,000	Capital A/c	40,000	—	—
	1,00,000	60,000	63,000		1,00,000	60,000	63,000
To Drawings	15,000	22,500	7,500	By Balance b/d	62,500	52,500	23,000
To Balance c/d	67,500	60,000	25,500	By P&L A/c	20,000	30,000	10,000
	82,500	82,500	33,000		82,500	82,500	33,000

BALANCE SHEET OF NEW FIRM AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Creditors	1,02,000	Cash at Bank	88,000
Hari's Capital	67,500	Debtors	60,000
Ram's Capital	60,000	Stock	50,000
Suraj's Capital	25,500	Investments	₹ 30,000
		Less: Reserve	₹ 12,000
		Furniture	10,000
		Plant	29,000
	2,55,000		2,55,000

Working Notes:(i) *Calculation of the amount to be brought in by New Partner as capital*

- (a) Aggregate capital (after adjustment) of old partners ₹ 1,15,000
 (b) Total Capital of the New Firm ($₹ 1,15,000 \times 6/5$) ₹ 1,38,000
 (c) Proportionate Capital of New Partner ($₹ 1,38,000 \times 1/6$) ₹ 23,000

(ii) *Calculation of Cash as on 31.3.2018*

Assuming that the profit earned during the year resulted in the change of cash balance only and no other assets. Cash balance is calculated as under.

- (a) Cash Balance as on 1.4.2017 ₹ 40,000
 (b) Add: Cash inflow during the year:
 Amount brought in by New Partner ₹ 63,000
 Profit for 2017-2018 ₹ 60,000 ₹ 1,23,000
 (c) Less: Cash outflow during the year:
 Cash withdrawn by Hari ₹ 30,000
 Drawings of Partners ₹ 45,000 ₹ 75,000
 (d) Cash Balance as on 31.3.2018 (a + b – c) ₹ 88,000

PROBLEM 7

Gopal and Govind are partners sharing profits and losses in the ratio of 3 : 2. The firm's Balance Sheet as on 31.03.2018 was as follows:

Liabilities	₹	Assets	₹
Capital Accounts:		Fixed Assets	3,00,000
Gopal	1,20,000	Investments	50,000
Govind	80,000	Current Assets	2,00,000
Long Term Loan	2,00,000	Loans and Advances	1,00,000
Current Liabilities	2,50,000		
	6,50,000		6,50,000

Due to financial difficulties, they have decided to admit Guru as a partner in the firm from 01.04.2018 on the following terms:

- (a) Guru will be paid 40% of the profits.
 (b) Guru will bring in cash ₹ 1,00,000 as Capital. It is agreed that Goodwill of the firm will be valued at 2 years' purchase of 3 years' normal average profits of the firm and Guru will bring in his

share of Goodwill. It was also decided that partners will not withdraw their share of goodwill *nor* will the goodwill appear in the books of account.

(c) The profits of the previous three years were as follows:

For the year ended 31.3.2016 Profit ₹ 20,000 (includes insurance claim received of ₹ 40,000)

For the year ended 31.3.2017 Loss ₹ 80,000 (includes voluntary retirement compensation paid ₹ 1,10,000)

For the year ended 31.3.2018 Profit ₹ 1,05,000 (includes a profit of ₹ 25,000 on the sale of Assets)

(d) It was decided to revalue the assets on 31.3.2018 as follows:

Fixed Assets (net) ₹ 4,00,000, Investment Nil, Current Assets ₹ 1,80,000, Loans and advances ₹ 1,00,000.

(e) The new profit sharing ratio after the admission of Guru was 35 : 25 : 40.

Required: Pass Journal Entries on admission, show goodwill calculation and prepare Revaluation Account, Partners' Capital Accounts and Balance-Sheet as on 01.04.2018 after admission of Guru.

SOLUTION:

Calculation of Sacrificing Ratio

Share sacrificed by Gopal = 60% – 35% = 25%

Share sacrificed by Govind = 40% – 25% = 15%

Sacrificing Ratio = 25% : 15% or 5 : 3

STATEMENT SHOWING THE CALCULATION OF GOODWILL

Particulars	For the year ending on		
	31.3.2016	31.3.2017	31.3.2018
A Profit (loss)	20,000	(80,000)	1,05,000
B Add: (less) : Abnormal Items	(40,000)	1,10,000	(25,000)
C Net Profit (loss)	(20,000)	30,000	80,000

D Average Profits = [(₹ 20,000) + ₹ 30,000 + ₹ 80,000] / 3 = ₹ 30,000

E Firm's Goodwill = ₹ 30,000 × 2 = ₹ 60,000

F Share of Goodwill of Guru = ₹ 60,000 × 40% = ₹ 24,000

G Gopal's Share in Goodwill brought in by Guru = ₹ 24,000 × 5/8 = ₹ 15,000

H Govind's Share in Goodwill brought in by Guru = ₹ 24,000 × 3/8 = ₹ 9,000

JOURNAL

Particulars	L.F.	Dr. (₹)	Cr. (₹)
Bank A/c Dr. To Guru's Capital A/c (Being the amount brought in by Guru in cash)		1,24,000	1,24,000
Guru's A/c Dr. To Gopal's Capital A/c To Govind's Capital A/c (Being the goodwill credited to sacrificing partners in their sacrificing ratio i.e. 5 : 3)		24,000	15,000 9,000

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Investments	50,000	By Fixed Assets	1,00,000
To Current Assets	20,000		
To Profit on Revaluation transferred to:			
Gopal (60%)	18,000		
Govind (40%)	12,000		
	1,00,000		1,00,000

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	Gopal ₹	Govind ₹	Particulars	Gopal ₹	Govind ₹
To Balance c/d	1,53,000	1,01,000	By Balance b/d	1,20,000	80,000
			By Guru's Capital A/c	15,000	9,000
			By Revaluation A/c	18,000	12,000
	1,53,000	1,01,000		1,53,000	1,01,000

BALANCE SHEET OF NEW FIRM AS AT 1ST APRIL, 2018

Liabilities	₹	Assets	₹
Gopal's Capital	1,53,000	Fixed Assets	4,00,000
Govind's Capital	1,01,000	Current Assets	3,04,000
Guru's Capital	1,00,000	Loans & Advances	1,00,000
Long term Loan	2,00,000		
Current Liabilities	2,50,000		
	8,04,000		8,04,000

PROBLEM 8

A and B in partnership sharing profits and losses in the proportion of three-fourth and one fourth respectively. Their Balance Sheet on 31st March, 2018 was as follows:

Cash ₹ 1,000; Sundry Debtors ₹ 25,000; Stock ₹ 22,000; Plant and Machinery ₹ 4,000; Sundry Creditors ₹ 12,000; Bank Overdraft ₹ 15,000; A's Capital ₹ 15,000; B's Capital ₹ 10,000

On 1st April, 2018, they admitted C into partnership on the following terms:

- C to purchase one-third of the Goodwill for ₹ 2,000 and provide ₹ 10,000 as Capital. Goodwill not to appear in books.
- Future profits and losses are to be shared by A, B and C equally.
- Plant and Machinery is to be reduced by 10% and ₹ 5,000 is to be provided for estimated bad debts. Stock is to be taken at a valuation of ₹ 24,940.
- By bringing in or withdrawing cash the capitals of A and B are to be made proportionate to that of C on their profit sharing basis.

Required: Set out entries relating to the above arrangement in the firm's journal, give the partners' Capital Accounts in tabular form and submit the opening Balance Sheet of the new firm.

SOLUTION
JOURNAL

<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Cash A/c Dr. To C 's Capital A/c (Being the amount brought in by C as capital and share of goodwill)		12,000	12,000
C 's Capital A/c Dr. To A's Capital A/c (Being the goodwill brought in by C credited to sacrificing partner, A)		2,000	2,000
B 's Capital A/c Dr. To A's Capital A/c (Being an adjustment for goodwill made on account of purchase of 1/12th share by B from A)		500	500
Revaluation A/c Dr. To Plant and Machinery To Provision for Doubtful Debts A/c (Being Reduction in value of machinery and provision for doubtful debts adjusted)		900	400 500
Stock A/c Dr. To Revaluation A/c (Being increase in value of Stock recorded)		2,940	2,940
Revaluation A/c Dr. To A's Capital A/c To B 's Capital A/c (Being the transfer of profit on Revaluation)		2,040	1,530 510
A's Capital A/c Dr. B 's Capital A/c Dr. To Cash A/c (Being the surplus amount withdrawn by the partners)		9,030 10	9,040

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

<i>Particulars</i>	<i>A ₹</i>	<i>B ₹</i>	<i>C ₹</i>	<i>Particulars</i>	<i>A ₹</i>	<i>B ₹</i>	<i>C ₹</i>
To A's Capital A/c		500	2,000	By Balance b/d	15,000	10,000	
To Cash A/c	9,030	10		By Revaluation A/c	1,530	510	
To Balance c/d	10,000	10,000	10,000	By Cash A/c			12,000
				By B 's Capital A/c	500		
				By C 's Capital A/c	2,000		
	19,030	10,510	12,000		19,030	10,510	12,000

BALANCE SHEET OF A NEW FIRM AS AT 1 APRIL, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
S. Creditors	12,000	Cash	3,960
Bank Overdraft	15,000	S. Debtors	25,000
Capital Accounts:		Less: Provision	500
A	10,000	Stock	24,940
B	10,000	Plant & Machinery	3,600
C	10,000		
	57,000		57,000

Working Notes:**1. Calculation of Sacrificing Ratio**

$$A's \text{ Sacrifice} = 3/4 - 1/3 = 5/12$$

$$B's \text{ Gain} = 1/4 - 1/3 = 1/12$$

2. Value of Firm's Goodwill = ₹ 2,000 × 3/1 = ₹ 6,000

$$B \text{ has to be debited for} = ₹ 6,000 \times 1/12 = ₹ 500$$

$$A \text{ has to be credited for} = ₹ 6,000 \times 5/12 = ₹ 2,500$$

Dr.

3. CASH ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	1,000	By A's Capital A/c	10
To C's Capital A/c	12,000	By B's Capital A/c	9,030
		By Balance c/d	3,960
	13,000		13,000

PROBLEM 9

A, B and C were in partnership, sharing profits and losses as to A one-half, B one-third and C one-sixth. As from 1st January, 2018 they admitted D into partnership on the following terms:

D to have a one-sixth share which he purchased entirely from A paying A ₹ 8,000 for the share of Goodwill. Of this amount, A had withdrawn ₹ 6,000 and put the balance in the firm as additional capital. As a condition to admission of D as a partner D also brought ₹ 5,000 capital into the firm. It was further agreed that the investments should be valued at its market value of ₹ 3,600 and plant be valued at ₹ 5,800.

The Balance sheet of the old firm on 31.12.2017 was as follows:

Cash at Bank ₹ 8,000; Debtors ₹ 12,000; Stock ₹ 10,000; Investments at Cost ₹ 6,000; Furniture ₹ 2,000; Plant ₹ 7,000; Creditors ₹ 21,000; Capital: A ₹ 12,000; B ₹ 8,000 and C ₹ 4,000.

The profits for the year 2018 were ₹ 12,000 and the drawings were: A ₹ 6,000, B ₹ 6,000, C ₹ 3,000 and D ₹ 3,000.

Required: Journalise the opening adjustments, prepare the opening Balance Sheet of the new firm as on 1st January, 2018 and give the capital account of each partner as on 31st December, 2018.

SOLUTION**JOURNAL**

<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Cash A/c To D 's Capital A/c (Being amount brought in by D)	Dr.	13,000	13,000
D 's Capital A/c To A's Capital A/c (Being goodwill credited to sacrificing partner 'A')	Dr.	8,000	8,000
A's Capital A/c To Cash A/c (Being Cash withdrawn by A)	Dr.	6,000	6,000
Revaluation A/c To Investments A/c To Plant A/c (Being Revaluation of investments and plant recorded)	Dr.	3,600	2,400 1,200
A's Capital A/c B 's Capital A/c C 's Capital A/c To Revaluation A/c (Being Loss on Revaluation transferred to old partners in 3 : 2 : 1 ratio)	Dr. Dr. Dr.	1,800 1,200 600	3,600

OPENING BALANCE SHEET OF NEW FIRM AS ON 1 JAN., 2018

<i>Liabilities</i>	<i>₹</i>	<i>Assets</i>	<i>₹</i>
Creditors	21,000	Cash at Bank	15,000
Capital Accounts:		Investments	3,600
A	12,200	Debtors	12,000
B	6,800	Stock	10,000
C	3,400	Furniture	2,000
D	5,000	Plant	5,800
	48,400		48,400

Dr. **CAPITAL ACCOUNTS OF PARTNERS AS ON 31ST DEC., 2018** *Cr.*

<i>Particulars</i>	<i>A ₹</i>	<i>B ₹</i>	<i>C ₹</i>	<i>D ₹</i>	<i>Particulars</i>	<i>A ₹</i>	<i>B ₹</i>	<i>C ₹</i>	<i>D ₹</i>
To Drawings	6,000	6,000	3,000	3,000	By Balance b/d	12,200	6,800	3,400	—
To Balance c/d	10,200	4,800	2,400	4,000	By Cash A/c	—	—	—	5,000
					By P & L A/c	4,000	4,000	2,000	2,000
	16,200	10,800	5,400	7,000		16,200	10,800	5,400	7,000

PROBLEM 13

Amit and Sumit are partners sharing profits and losses in the ratio of 3:2. Their Balance Sheet as on 31st March 2018 is given below:

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Accounts:		Land & building	3,20,000
Amit	1,76,000	Investments (Market value ₹ 55,000)	50,000
Sumit	2,54,000	Debtors	3,00,000
Loan from Puneet	3,00,000	Less: Provision	10,000
General Reserve	30,000	Stock	1,10,000
Employer's provident fund	10,000	Cash at bank	50,000
Creditors	50,000		
	8,20,000		8,20,000

They decided to admit Puneet as a new partner from 1st April, 2018 on the following terms:

- (1) Amit will give 1/3rd of his share and Sumit will give 1/4th of his share to Puneet.
- (2) Puneet's loan account will be converted into his capital.
- (3) The Goodwill of the firm is valued at ₹ 3,00,000. Puneet will bring his share of goodwill in cash and the same was immediately withdrawn by the partners.
- (4) Land and building was found undervalued by ₹ 1,00,000.
- (5) Stock was found overvalued by ₹ 60,000.
- (6) Provision for doubtful debts will be made equal to 5% of debtors.
- (7) Investments are to be valued at their market price.

It was decided that the total capital of the firm after admission of new partner would be ₹ 10,00,000. Capital accounts of partners will be readjusted on the basis of their profit sharing ratio and excess or deficiency will be adjusted in cash.

Required: Prepare (a) Revaluation A/c (b) Partners' capital A/cs (c) Balance Sheet of the firm after admission of a new partner

SOLUTION:

Dr.

REVALUATION ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Stock	60,000	By Land & building	1,00,000
To Provision for doubtful debts	5,000	By Investments	5,000
To Profit transferred to:			
Amit's capital A/c	24,000		
Sumit's capital A/c	16,000		
	1,05,000		1,05,000

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

<i>Particulars</i>	<i>Amit ₹</i>	<i>Sumit ₹</i>	<i>Puneet ₹</i>	<i>Particulars</i>	<i>Amit ₹</i>	<i>Sumit ₹</i>	<i>Puneet ₹</i>
To Amit's Capital A/c	—	—	60,000	By Balance b/d	1,76,000	2,54,000	—
To Puneet's Capital A/c	—	—	30,000	By Puneets' Loan A/c	—	—	3,00,000
To Bank A/c	60,000	30,000	—	By Puneet's capital A/c	60,000	30,000	—
To Balance c/d	4,00,000	3,00,000	3,00,000	By Bank A/c	—	—	90,000
				By Revaluation A/c	24,000	16,000	
				By General reserve	18,000	12,000	—
				By Bank	1,82,000	18,000	—
	4,60,000	3,30,000	3,90,000		4,60,000	3,30,000	3,90,000

BALANCE SHEET AS AT 1ST APRIL, 2018

<i>Liabilities</i>	<i>₹</i>	<i>Assets</i>	<i>₹</i>
Capital accounts:		Land & Building	
Amit	4,00,000	(3,20,000 + 1,00,000)	4,20,000
Sumit	3,00,000	Investments	55,000
Puneet	3,00,000	Debtors	3,00,000
Creditors	50,000	Less: Provision for	
Employers' Provident Fund	10,000	doubtful debts (15,000)	2,85,000
		Stock (1,10,000 – 60,000)	50,000
		Cash at bank	2,50,000
	10,60,000		10,60,000

Working Notes:**(I) CALCULATION OF INCOMING PARTNER'S SHARE, NEW PROFIT SHARING RATIO AND SACRIFICING RATIO**

<i>Particulars</i>	<i>Amit</i>	<i>Sumit</i>
Old profit sharing ratio	3/5	2/5
Surrendered by old partners	$3/5 \times 1/3 = 1/5$	$2/5 \times 1/4 = 1/10$
Remaining share	$3/5 - 1/5 = 2/5$	$2/5 - 1/10 = 3/10$

Puneet's total share in profits = $1/5 + 1/10 = 3/10$

New profit sharing ratio of Amit: Sumit: Puneet = $2/5 : 3/10 : 3/10 = 4:3:3$

Sacrificing ratio of Amit: Sumit is $1/5 : 1/10$: or 2:1

(ii) Share of Puneet in goodwill = ₹ 3,00,000 $\times$ $3/10 =$ ₹ 90,000

Goodwill will be distributed among the old partners in their sacrificing ratio of 2:1 i.e. ₹ 60,000 by Amit and ₹ 30,000 by Sumit.

Dr.

(III) BANK ACCOUNT

Cr.

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Balance b/d	50,000	By Amit's Capital A/c	60,000
To Puneet's Capital A/c	90,000	By Sumit's Capital A/c	30,000
To Sumit's Capital A/c	18,000	By Balance c/d	2,50,000
To Amit's Capital A/c	1,82,000		
	3,40,000		3,40,000

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RECONSTITUTION OF PARTNERSHIP-RETIREMENT/ DEATH OF A PARTNER

RETIREMENT OF A PARTNER

PROBLEM 1

A, B and C are partners in a firm sharing profits and losses in the ratio of 4 : 3 : 2. B decides to retire from the firm. Calculate the new profit sharing ratio of A and C in the following circumstances:

- (i) If B gives his share to A and C in the original ratios of A and C.
- (ii) If B gives his share to A and C in equal proportion.
- (iii) If B gives his share to A and C in the ratio of 3 : 1.
- (iv) If B gives his share to A only.

[Nov., 2005]

SOLUTION:

- (i) If B gives his share to A and C in the original ratios of A and C. i.e. 4 : 2, then

Out of $\frac{1}{3}$: A will get $\frac{1}{3} \times \frac{2}{3} = \frac{2}{9}$ and C will get $\frac{1}{3} \times \frac{1}{3} = \frac{1}{9}$.

Thus, New share: $A = \frac{4}{9} + \frac{2}{9} = \frac{6}{9}$, and $C = \frac{2}{9} + \frac{1}{9} = \frac{3}{9}$

Hence, new profit sharing ratio is 6 : 3 or 2 : 1.

- (ii) If B gives his share to A and C in equal proportion, then

Out of $\frac{1}{3}$, $\frac{1}{6}$ th each will be given to A and C.

Thus, New share: $A = \frac{4}{9} + \frac{1}{6} = \frac{11}{18}$, and $C = \frac{2}{9} + \frac{1}{6} = \frac{7}{18}$.

Hence, new profit sharing ratio will be 11 : 7.

- (iii) If B gives his share to A and C in the ratio of 3 : 1, then

A will get $\frac{1}{3} \times \frac{3}{4} = \frac{3}{12}$, and C will get $\frac{1}{3} \times \frac{1}{4} = \frac{1}{12}$

Thus, New share: $A = \frac{4}{9} + \frac{3}{12} = \frac{25}{36}$, and $B = \frac{2}{9} + \frac{1}{12} = \frac{11}{36}$.

Hence, new profit sharing ratio will be 25 : 11.

- (iv) If B gives his share to A only, then

New share: $A = \frac{4}{9} + \frac{1}{3} = \frac{7}{9}$, and $C = \frac{2}{9}$.

Hence, new profit sharing ratio will be 7 : 2.

PROBLEM 2

A, B, C were in partnership sharing profits and losses in the ratio of 3 : 2 : 1. The Balance Sheet of the firm as on 31-3-2018 was as under:

Liabilities		₹	Assets		₹
Capital Accounts:			Goodwill		40,000
A	1,50,000		Fixtures		30,000
B	1,00,000		Stock		1,70,000
C	50,000	3,00,000	Sundry Debtors		90,000
Sundry Creditors		40,000	Cash		10,000
		3,40,000			3,40,000

A on account of ill health, gave notice that he wished to retire from the firm. A retirement agreement was, therefore, entered into as on 31.3.2018, the terms of which were as follows:

- The Profit and Loss Account for the year ended 31.3.2018, which showed a net profit of ₹ 42,000 was to be re-opened. B was to be credited with ₹ 6,000 as bonus, in consideration of the extra work, which had devolved upon him during the year. The profit sharing basis was to be revised and the revised ratio to be 2 : 3 : 1 as and from 1st April, 2017.
- Goodwill was to be valued at two years' purchase of the average profits of five years. Profits for these five years ending on 31st March were as under:

	₹
1st Year	15,000
2nd Year	23,000
3rd Year	25,000
4th Year	35,000
5th Year	42,000

- Fixtures are to be valued at ₹ 39,800 and a provision of 2% was to be made for doubtful debts and the remaining assets were to be taken at their book value.
- That the amount payable to A shall be paid by B.

B and C agreed, as between themselves, to continue the business, sharing profits and losses in the ratio of 3 : 1 and decided to eliminate goodwill from Balance Sheet, to retain fixtures in the books at the revised value and increase the provision for doubtful debts to 6%. Total capital of the firm will be ₹ 3 lakh as before to be maintained in the new ratio as between B and C.

You are required to give the necessary entries to give effect to the above arrangements. Prepare Capital Account of Partners, Cash Account and Balance Sheet of B and C after giving effect to the above arrangements on the retirement of A. [CA (Foundation) Nov 2003]

SOLUTION:
JOURNAL

Date	Particulars	Dr. (₹)	Cr. (₹)
(i)	A's Capital A/c Dr.	21,000	
	B's Capital A/c Dr.	14,000	
	C's Capital A/c Dr.	7,000	
	To Profit & Loss Adjustment A/c		42,000
	(Being the profit written back for making adjustments)		
(ii)	Profit and Loss Adjustment A/c Dr.	6,000	
	To B's Capital A/c		6,000
	(Being the bonus credited to B's Capital Account)		

(iii)	Profit & Loss Adjustment A/c	Dr.	36,000	
	To A's Capital A/c			12,000
	To B's Capital A/c			18,000
	To C's Capital A/c			6,000
	(Being the distribution of profits in the new ratio)			
(iv)	Goodwill A/c (56,000 – 40,000)	Dr.	16,000	
	Fixtures A/c	Dr.	9,800	
	To Provision for Doubtful debts A/c			1,800
	To A's Capital A/c			8,000
	To B's Capital A/c			12,000
	To C's Capital A/c			4,000
	(Being the revaluation of assets on A's retirement)			
(v)	B's Capital A/c	Dr.	44,700	
	C's Capital A/c	Dr.	14,900	
	To Goodwill A/c			56,000
	To Provision for Doubtful debts A/c			3,600
	(Being the written off goodwill and raising provision for bad debts)			
(vi)	A's Capital A/c	Dr.	1,49,000	
	To B's Capital A/c			1,49,000
	(Being the amount payable to A paid by B)			

Dr.
PARTNER'S CAPITAL ACCOUNTS
Cr.

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To P & L	21,000	14,000	7,000	By Balance b/d	1,50,000	1,00,000	50,000
Adjustment A/c				By P&L	—	6,000	—
To Goodwill	—	44,700	14,900	Adjustment A/c			
and Provision				By P & L	12,000	18,000	6,000
for Doubtful debts				Ad justment A/c			
To B's Capital A/c	1,49,000	—	—	By Goodwill and	8,000	12,000	4,000
To Cash A/c	—	1,300	—	Fixtures			
To Balance c/d	—	2,25,000	75,000	By A's Capital A/c	—	1,49,000	—
				By Cash A/c	—	—	36,900
	1,70,000	2,85,000	96,900		1,70,000	2,85,000	96,900

Dr.
CASH ACCOUNT
Cr.

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By B's Capital A/c	1,300
To C's Capital A/c	36,900	By Balance c/d	45,600
	46,900		46,900

BALANCE SHEET OF B AND C

as on 31st March, 2018 (after retirement of A)

Liabilities	₹	Assets	₹
B	2,25,000	Fixtures	39,800
C	75,000	Stock	1,70,000
Sundry Creditors	40,000	Sundry Debtors	90,000
		Less: Provision	5,400
		Cash	45,600
	3,40,000		3,40,000

Working Note: Calculation of goodwillA. Average profit = $[\text{₹ } 15,000 + \text{₹ } 23,000 + \text{₹ } 25,000 + \text{₹ } 35,000 + \text{₹ } 42,000]/5 = \text{₹ } 28,000$ B. Goodwill at two year's purchase = $\text{₹ } 28,000 \times 2 = \text{₹ } 56,000$ **PROBLEM 3**

On 31st March, 2018 the Balance Sheet of M/s Ram, Hari & Mohan sharing profits and losses in the ratio of 2 : 3 : 2, stood as follows:

Liabilities	₹	Assets	₹
Capital Accounts:		Goodwill	7,00,000
Ram	10,00,000	Land and Buildings	10,00,000
Hari	15,00,000	Machinery	17,00,000
Mohan	10,00,000	Closing Stock	5,00,000
Workmen Compensation Reserve	10,50,000	Sundry Debtors	6,00,000
Sundry Creditors	5,00,000	Cash and Bank Balances	5,50,000
	55,50,000		55,50,000

On same date Hari desired to retire from the firm and the remaining partners decided to carry on. It was agreed to revalue the Assets and Liabilities on that date on the following basis:

- Land & Buildings be appreciated by 30%.
- Machinery be depreciated by 20%.
- Closing Stock to be valued at ₹ 4,50,000.
- Provision for doubtful debts be made at 5%.
- Old credit balances of Sundry Creditors ₹ 50,000 be written back.
- Goodwill of the entire firm be valued at ₹ 6,30,000. Ram and Mohan decided to share the future profits & losses in the ratio of 3 : 2.
- The total capital of the firm is to be the same as before retirement. Individual capitals be in their profit sharing ratio.
- Amount due to Hari is to be settled on the following basis: 50% on retirement and the balance 50% within one year.

Required: Prepare Revaluation Account, Capital Accounts of Partners, Cash Account and Balance Sheet of New Firm.

SOLUTION

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Machinery	3,40,000	By Land & Building	3,00,000
To Closing Stock	50,000	By Creditors written back	50,000
To Provision for doubtful debts	30,000	By Loss on Revaluation t/f to:	
		Ram's Capital A/c	20,000
		Hari's Capital A/c	30,000
		Mohan's Capital A/c	20,000
	4,20,000		4,20,000

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	Ram ₹	Hari ₹	Mohan ₹	Particulars	Ram ₹	Hari ₹	Mohan ₹
To Goodwill A/c	2,00,000	3,00,000	2,00,000	By Balance b/d	10,00,000	15,00,000	10,00,000
To Revaluation A/c	20,000	30,000	20,000	By Work.Comp. Res.	3,00,000	4,50,000	3,00,000
To Hari (Goodwill)	1,98,000	—	72,000	By Ram(Goodwill)	—	1,98,000	—
To Cash A/c	—	9,45,000	—	By Mohan(Goodwill)	—	72,000	—
To Hari's Loan A/c	—	9,45,000	—	By Cash A/c	12,18,000		3,92,000
To Balance c/d	21,00,000		14,00,000		25,18,000	22,20,000	16,92,000
	25,18,000	22,20,000	16,92,000				

Dr.

CASH AND BANK ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	5,50,000	By Hari's Capital A/c	9,45,000
To Ram's Capital A/c	12,18,000	By Balance c/d	12,15,000
To Mohan's Capital A/c	3,92,000		
	21,60,000		21,60,000

BALANCE SHEET OF M/S RAM & MOHAN AS AT 1ST APRIL, 2018

Liabilities	₹	Assets	₹
Capital Accounts:		Land & Building	13,00,000
Ram	21,00,000	Machinery	13,60,000
Mohan	14,00,000	Closing Stock	4,50,000
Sundry Creditors	4,50,000	Sundry Debtors:	
Hari's Loan A/c	9,45,000	Balance	6,00,000
		Less: Provision	30,000
		Cash and Bank Balances	12,15,000
	48,95,000		48,95,000

Working Notes:

1. **Calculation of Gaining Ratio:** Ram's Gain = $3/5 - 2/7 = 11/35$,

Mohan's Gain = $2/5 - 2/7 = 4/35$ Thus, Gaining Ratio of Ram and Mohan = 11 : 4

2. **Hari's Share of Goodwill** = ₹ 6,30,000 × $3/7 = ₹ 2,70,000$ which is to be contributed by Ram and Mohan in their Gaining Ratio of 11 : 4 as under:

Ram: ₹ 2,70,000 × $11/15 = ₹ 1,98,000$, Mohan ₹ 2,70,000 × $4/15 = ₹ 72,000$

PROBLEM 4

On 31st March, 2018, the Balance Sheet of M/s A, B & C sharing profits and losses in proportionate to their capitals stood as follows:

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Accounts:		Land and Buildings	2,00,000
A	2,00,000	Machinery	3,00,000
B	3,00,000	Closing Stock	1,00,000
C	2,00,000	Sundry Debtors	1,00,000
Sundry Creditors	1,00,000	Cash and Bank Balances	1,00,000
	8,00,000		8,00,000

On 31st March, 2018, A desired to retire from the firm and the remaining partners decided to carry on. It was agreed to revalue the Assets and Liabilities on the date on the following basis:

(a) Land & Buildings be appreciated by 30% (b) Machinery the depreciated by 20%. (c) Closing stock to be valued at ₹ 75,000. (d) Provision for doubtful debts be made at 5%. (e) Old credit balances of Sundry Creditors ₹ 20,000 be written back. (f) Joint Life Policy of the partners surrendered and cash obtained ₹ 80,000. (g) Goodwill of the entire firm be valued at ₹ 1,40,000 and A's share of the Goodwill be adjusted in the accounts of B and C who share the future profits equally. No Goodwill Account being raised. (h) The total capital of the firm is to be the same as before retirement. Individual capitals be in their profit sharing ratio. (i) Amount due to A is to be settled on the following basis: 50% on retirement and the balance 50% within one year.

Required: Prepare Revaluation Account, Capital Accounts of Partners, Cash Account and Balance Sheet as at 31st March, 2018 of M/s B & C. [Nov 1993, May 1995]

SOLUTION

Dr.

REVALUATION ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Machinery	60,000	By Land and Building	60,000
To Stock	25,000	By Creditors	20,000
To Provision for doubtful debts	5,000	By Loss on Revaluation t/f to:	
		A's Capital A/c	2,857
		B's Capital A/c	4,286
		C's Capital A/c	2,857
	90,000		90,000

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Revaluation A/c	2,857	4,286	2,857	By Balance c/d	2,00,000	3,00,000	2,00,000
To A (Goodwill)	—	10,000	30,000	By Insurance Co. A/c	22,857	34,286	22,857
To Cash A/c	1,30,000	—	—	By B (Goodwill)	10,000	—	—
To A's Loan A/c	1,30,000	—	—	By C (Goodwill)	30,000	—	—
To Balance c/d	—	3,50,000	3,50,000	By Cash A/c	—	30,000	1,60,000
	2,62,857	3,64,286	3,82,857		2,62,857	3,64,286	3,82,857

Dr.

CASH AND BANK ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance b/d	1,00,000	By A's Capital A/c	1,30,000
To Insurance Co (Joint Life Policy)	80,000	By Balance c/d	2,40,000
To B's Capital A/c	30,000		
To C's Capital A/c	1,60,000		
	3,70,000		3,70,000

BALANCE SHEET OF B AND C AS ON 31ST MARCH, 2018

Liabilities	₹	Assets	₹
B's Capital	3,50,000	Land & Buildings	2,60,000
C's Capital	3,50,000	Machinery	2,40,000
A's Loan	1,30,000	Stock	75,000
Creditors	80,000	Debtors	1,00,000
		Less: Provision	5,000
		Cash & Bank Balance	2,40,000
	9,10,000		9,10,000

PROBLEM 5

Atul, Balbir and Chatur were carrying on a business in partnership sharing profits in the ratio of 5 : 3 : 2 respectively. On 31st March, 2018 their Balance Sheet stood as follows:

Liabilities	₹	Assets	₹
Atul's Capital	6,25,000	Goodwill	80,000
Balbir's Capital	3,75,000	Land & Buildings	7,00,000
Chatur's Capital	2,50,000	Furniture	1,65,000
General Reserve	1,00,000	Stock	2,86,000
Trade Creditors	2,10,000	Trade Debtors	1,80,000
		Less: Provision	3,600
		Cash at Bank	1,52,600
	15,60,000		15,60,000

Atul retired on the above mentioned date and partners agreed that:

- (i) The current value of goodwill be taken to be equal to the book value of the asset.
- (ii) Land and Buildings be considered worth ₹ 9,00,000.
- (iii) The provision for bad debts on trade debtors be raised to 5%.
- (iv) Provision be made for compensation of ₹ 5,000 to an ex-employee.
- (v) Half of the amount due to Atul be paid immediately in cash and the balance be treated as 10% loan, repayable within 3 years.

In order to facilitate cash payment to Atul, Balbir and Chatur brought in ₹ 3,00,000 in the ratio of 3 : 2 respectively.

Prepare Revaluation Account, the Capital of all the partners and Bank Account. Also draw the initial Balance Sheet of Balbir and Chatur, immediately after Atul's retirement.

SOLUTION:

Dr. **REVALUATION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Provision for Doubtful Debts	5,400	By Building	2,00,000
To Provision for compensation	5,000		
To Profit on Revaluation t/f to:			
Atul	94,800		
Balbir	56,880		
Chatur	37,920		
	2,00,000		2,00,000

Dr. **PARTNERS' CAPITAL ACCOUNTS** Cr.

Particulars	Atul ₹	Balbir ₹	Chatur ₹	Particulars	Atul ₹	Balbir ₹	Chatur ₹
To Goodwill A/c	40,000	24,000	16,000	By Balance b/d	6,25,000	3,75,000	2,50,000
To Cash A/c	3,84,900			By General Reserve	50,000	30,000	20,000
To 10% Loan	3,84,900			By Revaluation A/c	94,800	56,880	37,920
To Atul Capital A/c	—	24,000	16,000	By Balbir & Chatur's A/c	40,000		
To Balance c/d		5,93,880	3,95,920	By Cash A/c		1,80,000	1,20,000
	8,09,800	6,41,880	4,27,920		8,09,800	6,41,880	4,27,920

BANK ACCOUNT

Particulars	₹	Particulars	₹
To Balance b/s	1,52,600	By Atul's Capital A/c	3,84,900
To Balbir's capital A/c	1,80,000	By Balance c/d	67,700
To Chatur's capital A/c	1,20,000		
	4,52,600		4,52,600

BALANCE SHEET OF AS AT 31.03.2018 (ATUL'S RETIREMENT)

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Balbir's Capital	5,93,880	Land and Building	9,00,000
Chatur's Capital	3,95,920	Furniture	1,65,000
10% Loan from Atul	3,84,900	Stock	2,86,000
Trade Creditors	2,10,000	Trade Debtors	1,80,000
Provision for Compensation	5,000	Less: Provision	9,000
		Cash at Bank	67,700
	15,89,700		15,89,700

DEATH OF A PARTNER**PROBLEM 6**

The following was the Balance Sheet of OM and Co. in which X, Y and Z were partners sharing profits and losses in the ratio of 1 : 2 : 2 as on 31st March 2018. Mr Z died on 31st Dec. 2018. His account has to be settled under the following terms:

BALANCE SHEET OF OM & CO. AS ON 31.3.2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Sundry Creditors	20,000	Goodwill	30,000
Bank Loan	50,000	Building	1,20,000
General Reserve	30,000	Computers	80,000
<i>Capital Accounts:</i>		Stock	20,000
X	40,000	Sundry Debtors	20,000
Y	80,000	Cash at Bank	20,000
Z	80,000	Investments	10,000
	3,00,000		3,00,000

Goodwill is to be calculated at the rate of two years' purchase on the basis of average of last three years' profits and losses. The profits and losses for the three years were as detailed below:

<i>Year ending on</i>	<i>Profit/Loss</i>
	₹
31-3-2018	30,000
31-3-2017	20,000
31-3-2016	(10,000) Loss

No Goodwill is to appear in the books.

Profit for the period from 1-4-2018 to 31-12-2018 shall be ascertained proportionately on the basis of average profits and losses of the preceding three years.

During the year ending on 31-3-2018 a car costing ₹ 40,000 was purchased on 1-4-2017 and debited to travelling expenses account on which depreciation is to be calculated at 20% p.a. This asset is to be brought into account at the depreciated value.

Other values of assets were agreed as follows:

Stock at ₹ 16,000; Building at ₹ 1,40,000; Computers at ₹ 50,000; Investments at ₹ 6,000. Sundry Debtors were considered good. You are asked to prepare partners' Capital Accounts and Balance Sheet of the firm Om & Co. as on 31-12-2018 assuming that other items of assets and liabilities remained the same.

[May 2000].

SOLUTION:
Dr.
PARTNERS' CAPITAL ACCOUNTS
Cr.

Particulars	Hari ₹	Ram ₹	Suraj ₹	Particulars	Hari ₹	Ram ₹	Suraj ₹
To Goodwill A/c	6,000	12,000	12,000	By Balance b/d	40,000	80,000	80,000
To Z's Executors' A/c			1,10,080	By General Reserve	6,000	12,000	12,000
To Z's Capital A/c	6,400	12,800		By X's Capital A/c	—	—	6,400
To Balance c/d	35,440	70,880		By Y's Capital A/c	—	—	12,800
				By P & L Suspense A/c	—	—	7,200
				By Revaluation A/c	1,840	3,680	3,680
	47,840	95,680	1,22,080		47,840	95,680	1,22,080

BALANCE SHEET AS AT 31ST DEC. 2018

Liabilities	₹	Assets	₹
Sundry Creditors	20,000	Building (1,20,000 + 20,000)	1,40,000
Bank Loan	50,000	Computers (80,000 – 30,000)	50,000
Z's Executors' A/c	1,10,080	Stock (20,000 – 4,000)	16,000
X's Capital	35,440	Car (40,000 – 8,000 – 4,800)	27,200
Y's Capital	70,880	Sundry Debtors	20,000
		Cash at Bank	20,000
		Investments (10,000 – 4,000)	6,000
		Profit & Loss Suspense A/c	7,200
	2,86,400		2,86,400

Working Notes:

(i) Calculation of Book Value of Car as on 1.4.2018 and 31.12.2018

A Original cost of car as on 1.4. 2017	₹ 40,000
B Less: Depreciation @ 20% for 2017-2018	₹ 8,000
C Book Value as on 31.3. 2018 [A – B]	₹ 32,000
D Less: Depreciation @ 20% for 9 months [32,000 × 20% × 9/12]	₹ 4,800
E Book Value as on 31.12. 2018 [C – D]	₹ 27,200

(ii) Calculation of Profit/Loss on Revaluation

Dr.
REVALUATION ACCOUNT
Cr.

Particulars	₹	Particulars	₹
To Stock	4,000	By Building	20,000
To Computer	30,000	By Car	27,200
To Investments	4,000		
To Profit on Revaluation t/f to:			
X's Capital A/c	1,840		
Y's Capital A/c	3,680		
Z's Capital A/c	3,680		
	47,200		47,200

- (iii) Average Profit = $[\text{₹ } 30,000 + \text{₹ } 32,000] + \text{₹ } 20,000 - \text{₹ } 10,000 / 3 = \text{₹ } 72,000 / 3 = \text{₹ } 24,000$
- (iv) Z's share of Goodwill = $\text{₹ } 24,000 \times 2 \times 2/5 = \text{₹ } 19,200$
- (v) Z's share of Profit = $\text{₹ } 24,000 \times 9/12 \times 2/5 = \text{₹ } 7,200$

PROBLEM 7

Peter, Paul and Prince were partners sharing profits and losses in the ratio of 2 : 1 : 1. It was provided in the partnership deed that in the event of retirement/death of a partner, he/his legal representatives would be paid:

- The balance in the Capital Account.
- His share of Goodwill of the firm valued at two years' purchase of normal average profits (after charging interest on fixed capital) for the last three years up to 31st of December preceding his retirement or death.
- His share of profits from the beginning of the accounting year to the date of retirement or death, which shall be taken on proportionate basis of profits of the previous years as increased by 25%.
- Interest on Fixed Capital @ 10% p.a. though payable to the partners will not be payable in the year of death or retirement.
- All the assets are to be revalued on the date of retirement or death and the profit or loss to be debited/credited to Partners in the profit sharing ratio.

Peter died on 30th Sep., 2018. The books of Account are closed on calendar year basis from 1st January to 31st December. The balance in the Fixed Capital Accounts as on 1st January, 2018 were: Peter ₹ 10,000, Paul ₹ 5,000 and Prince ₹ 5,000. The balance in the Current Accounts as on 1st January, 2018 were: Peter ₹ 20,000, Paul ₹ 10,000 and Prince ₹ 7,000. Drawings of Peter till 30th Sep. 2018 ₹ 10,000. The Profits of the firm before charging interest on capital for the calendar years 2015, 2016 and 2017 were ₹ 1,00,000, ₹ 1,20,000 and ₹ 1,50,000 respectively. The profits include the following abnormal items of credit:—

Particulars	2015	2016	2017
Profit on sale of Assets	5,000	7,000	10,000
Insurance claim received	3,000		12,000

The firm has taken out a Joint Life Policy for ₹ 1,00,000. Besides, the partners had severally insured their lives for ₹ 50,000 each, the premium, in respect thereof being charged to the Profit and Loss Account. The surrender value of the Policies were 30% of the face value. On 30th June, 2018, the firm received notice from the insurance company that the insurance premium in respect of a fire policy had been undercharged to the extent of ₹ 6,000 in the year 2017 and the firm has to pay immediately. The revaluation of the assets indicate an upward revision in value of assets to the extent of ₹ 20,000. Prepare an account showing the amount due to Peter's legal representatives as on 30th September, 2018 alongwith necessary workings. [June 1994]

SOLUTION:

Dr.

PETER'S CURRENT ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Drawings	10,000.00	By Balance b/d	20,000.00
To Profit & Loss Adjustment A/c (Share in Pre. undercharged)	3,000.00	By Paul A/c (Goodwill)	53,500
To Peter's Executor's A/c	2,81,031.25	By Prince A/c (Goodwill)	53,500
		By Insurance Co. (Share of Matured Policies)	75,000.00
		By Paul's Current A/c	7,500.00

		By Prince's Current A/c (Share of Unmatured Policies)	7,500.00
		By Revaluation A/c	10,000.00
		By P & L Suspense A/c (Share of Profit)	67,031.25
	2,94,031.25		2,94,031.25

Dr.

PETER'S EXECUTOR'S ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Balance c/d	2,91,031.25	By Peter's Capital A/c	10,000.00
		By Peter's Current A/c	2,81,031.25
	2,91,031.25		2,91,031.25

Working Notes:
1. CALCULATION OF PETER'S SHARE OF GOODWILL

Particulars	2015 ₹	2016 ₹	2017 ₹
A Profit as per Profit & Loss A/c	1,00,000	1,20,000	1,50,000
B Less: Interest on Capital	2,000	2,000	2,000
C Less: Insurance Premium	—	—	6,000
D Less: Abnormal Items:			
Profit on Sale of Assets	5,000	7,000	10,000
Insurance Claim received	3,000	—	12,000
E Adjusted Past Profits	90,000	1,11,000	1,20,000
F Average Profits (₹ 90,000 + ₹ 1,11,000 + ₹ 1,20,000)/3 = ₹ 1,07,000			
G Goodwill at 2 years' Purchases = (1,07,000 × 2) = ₹ 2,14,000			
H Peter's Share (₹ 2,14,000 × 2/4) = ₹ 1,07,000			

2. CALCULATION OF PETER'S SHARE OF INSURANCE POLICIES

Sum Assured of Joint Life Policy of all Partners	₹ 1,00,000
Sum Assured of Individual Life Policy of Peter	₹ 50,000
Total Sum Assured of Matured Policies	₹ 1,50,000
Peter's Share (₹ 1,50,000 × 2/4)	₹ 75,000
Surrender Value of Policies of Paul & Prince: 30% of (₹ 50,000 + ₹ 50,000)	₹ 30,000
Peter's Share (₹ 30,000 × 2/4)	₹ 15,000

3. Calculation of Peter's Share of Profits

(a) Correct Profit for the year 2017 = ₹ 1,50,000 – ₹ 6,000 – ₹ 1,000 (being Interest payable to other partners)

= ₹ 1,43,000

(b) Estimated Profit for 2018 = 125% of ₹ 1,43,000 = ₹ 1,78,750

(c) Proportionate till 30.9.2018 (₹ 1,78,750 × 9/12) = ₹ 1,34,062.50

(d) Peter's Share (₹ 1,34,062.50 × 2/4) = ₹ 67,031.25

4. Peter's Share of Profit on Revaluation of Assets = ₹ 20,000 × 2/4 = ₹ 10,000

5. Peter's share of Insurance Premium undercharged for the year 2013

= ₹ 6,000 × 2/4 = ₹ 3,000

RETIREMENT CUM ADMISSION

PROBLEM 8

K, L and M are partners sharing Profits and Losses in the ratio of 5 : 3 : 2. Due to illness, L wanted to retire from the firm on 31.3.2017 and admit his son N in his place.

BALANCE SHEET OF K, L AND M AS AT 31.3.2018

Liabilities	₹	Assets	₹
Capitals:		Goodwill	30,000
K	40,000	Furnitures	20,000
L	60,000	Sundry Debtors	50,000
M	30,000	Stock in Trade	50,000
Reserve	50,000	Cash and Bank Balances	50,000
Sundry Creditors	20,000		
	2,00,000		2,00,000

On retirement of 'L' assets were revalued:

Goodwill ₹ 50,000, Furniture ₹ 10,000, Stock in Trade ₹ 30,000. No Goodwill is to appear in the books.

50% of the amount due to 'L' was paid off in cash and the balance was retained in the firm as capital of N.

On admission of the new partner, goodwill has been written off.

M is paid off his extra balance to make capital proportionate.

Required: Pass necessary Journal Entries and prepare Balance Sheet of M/s K, M, N as on 01.04.2018. [Nov. 1999]

SOLUTION:

JOURNAL

Particulars	L.F.	Dr. (₹)	Cr. (₹)
K's Capital A/c Dr.		15,000	
L's Capital A/c Dr.		9,000	
M's Capital A/c Dr.		6,000	
To Goodwill A/c			30,000
(Being the existing goodwill w/o)			
N's Capital A/c Dr.		15,000	
To L's Capital A/c			15,000
(Being the adjustment for goodwill made)			
Reserve A/c Dr.		50,000	
To K's Capital A/c			25,000
To L's Capital A/c			15,000
To M's Capital A/c			10,000
(Being the reserve distributed among the partners)			

Revaluation A/c	Dr.	30,000	
To Furniture A/c			10,000
To Stock-in-trade			20,000
(Being the decrease in value of assets recorded)			
K's Capital A/c	Dr.	15,000	
L's Capital A/c	Dr.	9,000	
M's Capital A/c	Dr.	6,000	
To Revaluation A/c			30,000
(Being the loss on revaluation t/f to partners' capital accounts)			
L's Capital A/c	Dr.	72,000	
To N's Capital A/c			36,000
To Bank A/c			36,000
(Being the 50% of the amount due was paid off and the balance retained as N's Capital)			
M's Capital A/c	Dr.	14,000	
To Bank A/c			14,000
(Being the surplus balance paid to M)			

BALANCE SHEET (AFTER N'S ADMISSION) AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
<i>Capital Accounts:</i>		Furniture (20,000 – 10,000)	10,000
K	35,000	Sundry Debtors	50,000
M	14,000	Stock in trade (50,000 — 20,000)	30,000
N	21,000	Cash and Bank Balances	
Sundry Creditors	20,000	[50,000 — 36,000 — 14,000]	
	90,000		90,000

Working Note: Calculation of Balances of Capital Accounts

Dr.
CAPITAL ACCOUNT OF PARTNERS
Cr.

Particulars	K ₹	L ₹	M ₹	N ₹	Particulars	K ₹	L ₹	M ₹	N ₹
To Revaluation A/c	15,000	9,000	6,000	—	By Balance b/d	40,000	60,000	30,000	—
To L's Capital A/c	—	—	—	15,000	By N's Capital A/c	—	15,000	—	—
To N's Capital A/c		36,000			By Reserve A/c	25,000	15,000	10,000	
To Bank A/c		36,000			By L's Capital A/c	—	—	—	36,000
To Goodwill A/c	15,000	9,000	6,000	—					
To Bank A/c		—	14,000	—					
(Balancing figure)									
To Balance c/d	35,000	—	14,000	21,000					
	65,000	90,000	40,000	36,000		65,000	90,000	40,000	36,000

PROBLEM 9

M/s X and Co. is a partnership firm with the partners A, B and C sharing Profits and Losses in the ratio of 3: 2: 5. The Balance Sheet of the firm as on 31st March, 2018 is given below.

BALANCE SHEET OF X AND CO. AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
A's Capital A/c	1,04,000	Land	1,00,000
B's Capital A/c	76,000	Building	2,00,000
C's Capital A/c	1,40,000	Plant and Machinery	3,80,000
Long term Loan	4,00,000	Investments	22,000
Bank overdraft A/c	44,000	Stock	1,16,000
Trade Creditors	1,93,000	Sundry Debtors	1,39,000
	9,57,000		9,57,000

It was mutually agreed that B will retire from Partnership and in his place D will be admitted as a partner with effect from 1st April, 2018. For this purpose, the following adjustments are to be made:

- Goodwill of the firm is to be valued at ₹ 2 lakh due to the firm's locational advantage but the same will not appear as an asset in the books of the reconstituted firm.
- Buildings and Plant and Machinery are to be valued at 90% and 85% of the respective Balance Sheet values. Investments are to be taken over by the retiring partner at ₹ 25,000. Sundry Debtors are considered good only 90% of Balance Sheet figure. Balance to be considered Bad.
- In the reconstituted firm, the total Capital will be ₹ 3 lakh, which will be contributed by A, C and D in their new profit sharing ratio, which is 3: 4: 3.
- The surplus funds, if any, will be used for repaying bank overdraft.
- The amount due to retiring partner shall be transferred to his Loan Account. You are required to prepare (1) Revaluation Account (2) Partner's Capital Account (3) Bank Account and (4) Balance Sheet of the reconstituted firm as on 1st April, 2018.. [May 2002]

SOLUTION:

Dr. **REVALUATION ACCOUNT** **Cr.**

Particulars	₹	Particulars	₹
To Building A/c	2,000	By Investments A/c	3,000
To Plant & Machinery	57,000	By A's Capital A/c	26,370
To Debtors	13,900	By B's Capital A/c	17,580
		By C's Capital A/c	43,950
	90,900		90,900

Dr. **CAPITAL ACCOUNTS OF PARTNERS** **Cr.**

Particulars	A ₹	B ₹	C ₹	D ₹	Particulars	A ₹	B ₹	C ₹	D ₹
To Revaluation A/c	26,370	17,580	43,950	—	By Balance b/d	1,04,000	76,000	1,40,000	—
To Investments	—	25,000	—	—	By D's Capital A/c	—	40,000	20,000	—
To B's Capital A/c	—	—	—	40,000	By Bank A/c	12,370	—	3,950	1,50,000
To C's Capital A/c	—	—	—	20,000					
To B's Loan A/c	—	73,420	—	—					
To Balance c/d	90,000	—	1,20,000	90,000					
	1,16,370	1,16,000	1,63,950	1,50,000		1,16,370	1,16,000	1,63,950	1,50,000

Dr.

BANK ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To D's Capital A/c	1,50,000	By Balance b/d	44,000
To C's Capital A/c	3,950	(Overdraft)	
To A's Capital A/c	12,370	By Balance c/d	1,22,320
	1,66,320		1,66,320

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Creditors	1,93,000	Bank	1,22,320
Long term loan	4,00,000	Debtors	1,25,100
B's Loan A/c	73,420	Stock	1,16,000
A's Capital A/c	90,000	Plant & Machinery	3,23,000
C's Capital A/c	1,20,000	Building	1,80,000
D's Capital A/c	90,000	Land	1,00,000
	9,66,420		9,66,420

PROBLEM 10

A, B and C are partners of the firm ABC & Co., sharing profits and losses in the ratio of 5:3:2. Following is the Balance Sheet of the firm as at 31.3.2018:

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Partners' capital accounts:		Goodwill	1,00,000
A	4,50,000	Building	10,50,000
B	1,30,000	Machinery	6,50,000
C	1,70,000	Furniture	2,15,000
Investment fluctuation reserve	1,00,000		
Contingency reserve	75,000	Investments (market) value ₹ 75,000	60,000
Long-term loan	15,00,000	Stock	6,50,000
Bank overdraft	2,20,000	Sundry debtors	6,95,000
Sundry creditors	8,00,000	Advertisement suspense	25,000
	34,45,000		34,45,000

It was decided that B would retire from the partnership on 1.4.2018 & D would be admitted as a partner on the same date. Following adjustments are agreed amongst the partners for the retirement/ admission:

- Goodwill is to be valued at ₹ 5,00,000, but the same will not appear as an asset in the books of the firm.
- Building and machinery are to be revalued at ₹ 10,00,000 and ₹ 5,20,000 respectively.
- Investments are to be taken over by B at the market value.
- Provision for doubtful debts is to be maintained at 20% on sundry debtors.
- The capital of the reconstituted firm will be ₹ 10,00,000 to be contributed by the partners A, C and D in their new profit sharing ratio of 2 : 2 : 1.
- Surplus funds, if any will be used to pay the bank overdraft.
- Amount due to retiring partner B will be transferred to his loan account.

Prepare:

- (i) Revaluation Account;
- (ii) Capital Accounts of the partners; and
- (iii) Balance Sheet of the firm after reconstitution.

SOLUTION:

Dr. **(I) REVALUATION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Building	50,000	By Investments	15,000
To Machinery (Loss on revaluation)	1,30,000	By Partners' capital A/cs	
To Provision for doubtful debts	1,39,000	A	1,52,000
		B	91,200
		C	60,800
	3,19,000		3,04,000
			3,19,000

Dr. **(II) PARTNERS' CAPITAL ACCOUNTS** Cr.

Particulars	A ₹	B ₹	C ₹	D ₹	Particulars	A ₹	B ₹	C ₹	D ₹
To Revaluation A/c	1,52,000	91,200	60,800	—	By Balance b/d	4,50,000	1,30,000	1,70,000	—
To Goodwill	50,000	30,000	20,000	—	By Contingency Reserve	37,500	22,500	15,000	—
To A and B	—	—	1,00,000	1,00,000	By Investment	50,000	30,000	20,000	—
To Investments	—	75,000	—	—	Fluctuation Reserve	—	—	—	—
To Advertisement suspense	12,500	7,500	5,000	—	By C and D	50,000	1,50,000	—	—
To B's Loan A/c(b.f.)	—	1,28,800	—	—	By Bank (b.f.)	27,000	—	3,80,800	3,00,000
To Balance c/d	4,00,000	—	4,00,000	2,00,000					
	6,14,500	3,32,500	5,85,800	3,00,000		6,14,500	3,32,500	5,85,800	3,00,000

**(III) BALANCE SHEET AS AT 01.04.2018
(AFTER RETIREMENT OF B AND ADMISSION OF D)**

Liabilities	₹	Assets	₹
Partners' Capital Accounts :		Building	10,00,000
A	4,00,000	Machinery	5,20,000
C	4,00,000	Furniture	2,15,000
D	2,00,000	Stock	6,50,000
Long term loan	15,00,000	Debtors	6,95,000
B's loan	1,28,800	Less: Provision for	
Sundry creditors	8,00,000	doubtful debts	1,39,000
		Cash at bank	4,87,800
	34,28,800		34,28,800

Working Notes:

Dr. **(I) BANK ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To A's capital A/c	27,000	By Balance b/d (Overdraft)	2,20,000
To C's capital A/c	3,80,800	By Balance c/d (Bal. fig.)	4,87,800
To D's capital A/c	3,00,000		
	7,07,800		7,07,800

(ii) Calculation of sacrificing and gaining ratio

Partners	New share	Old share	Share Sacrificed	Share Gained
A	2/5	5/10	$2/5 - 5/10 = 1/10$	
B		3/10		3/10
C	2/5	2/10	$2/5 - 2/10 = 1/5$	
D	1/5			1/5

ADJUSTING ENTRY TO ADJUST GOODWILL

Particulars	Dr. (₹)	Cr. (₹)
C's Capital A/c (₹ 5,00,000 × 1/5)	Dr. 1,00,000	
D's Capital A/c (₹ 5,00,000 × 1/5)	Dr. 1,00,000	
To A's Capital A/c (₹ 5,00,000 × 1/10)		50,000
To B's Capital A/c (₹ 5,00,000 × 3/10)		1,50,000

(III) CAPITALS OF A, C AND D AS PER NEW RATIO

Particulars	₹
Total Capital of the firm after admission	10,00,000
A's share [10,00,000 × 2/5]	4,00,000
C's share [10,00,000 × 2/5]	4,00,000
D's share [10,00,000 × 1/5]	2,00,000

PROBLEM 11

A, B and C are in partnership sharing profits and losses in the ratio of 2 : 3 : 5. A retires on 31st March 2018 and D is admitted to partnership on the same date, the new profit sharing ratio between B, C and D being 2 : 3 : 1. Following is the Balance Sheet of A, B and C on 31st March, 2018.

Liabilities	₹	Assets	₹
A's Capital	10,000	Land & Building	10,000
B's Capital	15,000	Machinery	30,000
C's Capital	20,000	Stock	20,000
General Reserve	40,000	Debtors	30,000
Loan from D	50,000	Cash in hand	2,000
Sundry Creditors	50,000	Cash at Bank	93,000
	1,85,000		1,85,000

D is admitted on the following terms:

(a) Machinery is to be depreciated by 10%, (b) Land and building is revalued at 300%, (c) Stock is to be written off to the extent of ₹ 5,000 (d) Provision @ 5% for Doubtful Debts is to be made. (e) General Reserve is to be apportioned among the partners. (f) The firm's goodwill is to be valued at two years' purchase profits for the last three financial years. The figures are: For 2014-2015 Profit ₹ 20,000, for 2015-2016 Loss ₹ 15,000, 2016-2017 Profit ₹ 40,000. (g) The amount due to A is to be retained in the business as loan. (h) D's Capital contribution should be 1/5th of the combined capital of B and C after making the above adjustments. D's share of capital will be transferred from his Loan A/c.

Required: Pass the necessary journal entries to give effect to the above.

SOLUTION**JOURNAL**

<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Revaluation A/c Dr. To Machinery A/c To Stock A/c To Provision for Doubtful Debts A/c (Being the fall in value of assets recorded)		9,500	3,000 5,000 1,500
Land & Building A/c Dr. To Revaluation A/c (Being an increase in value of assets recorded)		20,000	20,000
Revaluation A/c Dr. To A's Capital A/c To B 's Capital A/c To C 's Capital A/c (Being the transfer of profit on revaluation)		10,500	2,100 3,150 5,250
General Reserve A/c Dr. To A's Capital A/c To B 's Capital A/c To C 's Capital A/c (Being the transfer of general reserve)		40,000	8,000 12,000 20,000
B 's Capital A/c Dr. D 's Capital A/c Dr. To A's Capital A/c (Being the Goodwill Credited to A & debited to sacrificing partners)		1,000 5,000	6,000
A's Capital A/c Dr. To A's Loan A/c (Being the transfer of A's capital A/c to his loan A/c)		26,100	26,100
D's Loan A/c Dr. To D 's Capital A/c (Being the transfer of D 's Capital contribution on his admission, from his Loan Account)		14,880	14,880

Working Notes:**1. CALCULATION OF VALUE OF GOODWILL**

(a) Total Profit for previous three years	₹ 45,000
(b) Average Profit (₹ 45,000/3)	₹ 15,000
(c) Goodwill (₹ 15,000 × 2)	₹ 30,000

2. CALCULATION OF CAPITAL OF D

(a) Aggregate capital (after all other adjustments) of B and C	₹ 74,400
(b) D 's Capital (₹ 74,400 × 1/5)	₹ 14,880

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FINANCIAL STATEMENTS OF NOT-FOR-PROFIT ORGANISATIONS

PROBLEM 1

The following is the Receipts and Payments Account of Apollo Club in respect of the year to March 31, 2018.

<i>Receipts</i>	₹	<i>Payments</i>	₹
To Balance b/d (Cash in hand)	2,000	By Salaries	3,000
To Subscriptions:		By Stationery	1,000
2016-2017 3,000		By Rates and Taxes	300
2017-2018 4,000		By Telephone Charges	1,500
2018-2019 1,000	8,000	By 12% Securities at par	5,000
To Profit on sports	3,000	By Sundry Expenses	200
To Interest on 12% Securities	1,000	By Balance c/d (Cash in hand)	3,000
	14,000		14,000

The following additional facts are ascertained:

- There are 500 members, each paying an annual subscription of ₹ 10; ₹ 3,500 being in arrears for 2016-2017 at the beginning of 2017-2018. During 2016-2017, subscriptions were paid in advance by 30 members for 2017-2018.
- Stock of stationery at March 31, 2017 was ₹ 400 and at March 31, 2018, ₹ 500.
- At March 31, 2018, the rates and taxes were prepaid to the following 31st January, the yearly charge being ₹ 300.
- A quarter's charge for telephone is outstanding, the amount accrued being ₹ 300. The charge for each quarter is same for both 2016-2017 and 2017-2018.
- Sundry Expenses accruing at March 31, 2017 were ₹ 50 and at March 31, 2018 ₹ 60.
- At March 31, 2017 Building stood in the books at ₹ 30,000 and it is required to write off depreciation at 10% p.a.
- Face Value of 12% Securities at March 31, 2017 was ₹ 10,000 which were purchased at that date for ₹ 15,000. Additional Securities worth ₹ 5,000 are purchased at par on 31 March, 2018.

You are required to prepare:

- An Income and Expenditure Account for the year ended March 31, 2018, and
- A Balance Sheet at that date.

SOLUTION:

INCOME AND EXPENDITURE ACCOUNT

Dr.

for the year ending 31st March, 2018

Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Salaries	3,000	By Subscriptions	4,000
To Stationery:	1,000	<i>Add: Adv in the beg</i>	300
<i>Add: Opening stock</i>	400	<i>Add: O/s at end</i>	700
			5,000

Less: Closing Stock	500	900	By Profits on Sports	3,000
To Rates and Taxes	300		By Interest on Securities	1,000
Less: Prepaid at end	250		Add: Accrued	200
Add: Prepaid in the beg	250	300	[(12% on ₹ 10,000 – ₹ 1,000)]	1,200
To Telephone charges	1,500			
Less: O/s in the beg	600			
Add: O/s at the end	300	1,200		
To Sundry Expenses	200			
Less: O/s in the beg	50			
Add: O/s at the end	60	210		
To Depreciation on Building		3,000		
To Surplus transferred to Capital Fund		590		
		9,200		9,200

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Outstanding Expenses	60	Cash in Hand	3,000
Outstanding Telephone charge	300	Subscriptions Receivable:	
Subscriptions received in advance	1,000	for 2016-2017	500
Capital fund:		for 2017-2018	700
Opening Balance	50,200	Accrued Interest on 12% Securities	200
Add: Surplus	590	12% Securities (₹ 15,000 + ₹ 5,000)	20,000
	50,790	[Face Value ₹ 15,000]	
		Prepaid Rates and Taxes (300 × 10/12)	250
		Building	30,000
		Less: Depreciation	3,000
		Stock of Stationery	500
	52,150		52,150

Working Note:
BALANCE SHEET AS AT 31ST MARCH, 2017

Liabilities	₹	Assets	₹
Outstanding Expenses	50	Cash in Hand	2,000
Telephone Charges due		Subscriptions Receivable	3,500
[₹ 1,500 – (₹ 1,200 – 300)]	600	Investments in 10% Securities	15,000
Subscriptions Received in Advance	300	[Face Value ₹ 10,000]	
(30 × 10)		Building	30,000
Capital Fund (Balancing figure)	50,200	Stock of Stationery	400
		Prepaid Rates and Taxes	
		(10/12 of ₹ 300)	250
	51,150		51,150

PROBLEM 2

The following is the Receipts and Payments Account of the Social Club in respect of the year ended 31st March, 2018:

<i>Receipts</i>	₹	<i>Payments</i>	₹
To Balance b/d	10,250	By Salaries	20,800
To Subscriptions:		By Stationery	4,000
2016-2017 450		By Rates	6,000
2017-2018 21,100		By Telephone	1,000
2018-2019 750	22,300	By Investment	12,500
To Profit on sports meet	15,500	By Sundry expenses	9,250
To Income from investments	10,000	By Balance c/d	4,500
	58,050		58,050

The following additional information is provided to you:

- There are 450 members each paying an annual subscription of ₹ 50; ₹ 500 were in arrears for 2016-2017 as on 1st April, 2017.
- On 31st March, 2018, the rates were prepaid to 30th June, 2018; the charge paid every year being ₹ 6,000.
- There was an outstanding telephone bill for ₹ 350 on 31st March, 2018.
- Outstanding sundry expenses as on 31st March, 2017 totalled ₹ 700.
- Stock of stationery on 31st March, 2017 was ₹ 500; on 31st March, 2018 it was ₹ 900.
- On 31st March, 2017, building stood in the books at ₹ 1,00,000 and it was subject to depreciation at 5% per annum.
- Investments on 31st March, 2017 stood at ₹ 2,00,000.
- On 31st March, 2018 income accrued on investments purchased during the year amounted ₹ 375.

Required: Prepare an Income and Expenditure Account for the year ended 31st March, 2018 and the Balance Sheet as at that date.

SOLUTION:**INCOME AND EXPENDITURE ACCOUNT**

Dr.

for the year ending on 31st March, 2018

Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Salaries	20,800	By Subscriptions	22,500
To Stationery-Stock 500		By Profit on sports meet	15,500
Add: Purchases 4,000	4,500	By Income on investments 10,000	
Less: Closing stock 900	3,600	Add: Income accrued 375	10,375
To Rates 6,000			
Less: Prepaid at the end 1,500	4,500		
Add: Prepaid in the beg. 1,500	6,000		
To Telephone 1,000			
Add: Outstanding at the end 350	1,350		
To Sundry Expenses 9,250			
Less: Outstanding in the beg. 700	8,550		
To Depreciation on Building 5,000			
To Surplus 3,075			
	48,375		48,375

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Fund 3,12,050		Outstanding Subscriptions	1,450
Add: Surplus 3,075	3,15,125	Investments (2,00,000 + 12,500)	2,12,500
Advance Subscription in	750	Building 1,00,000	
Outstanding telephone bill	350	Less: Depreciation 5,000	95,000
		Prepaid rates	1,500
		Stock of stationery	900
		Cash	4,500
		Income on investments accrued	375
	3,16,225		3,16,225

Working Notes:
Dr.
(I) SUBSCRIPTION ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Outstanding Subscription A/c Beg.	500	By Cash A/c	22,300
To Income and Expenditure A/c (₹ 50 × 450)	22,500	By Outstanding Subscription A/c End. (balancing figure)	1,450
To Advance Subscription A/c	750		
	23,750		23,750

(II) BALANCE SHEET AS AT 31ST MARCH, 2017

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Outstanding sundry expenses	700	Building	1,00,000
Capital Fund (Balancing figure)	3,12,050	Investments	2,00,000
		Stock of stationery	500
		Cash	10,250
		Prepaid rates	1,500
		Outstanding Subscriptions	500
	3,12,750		3,12,750

PROBLEM 3*

From the following Receipts and Payments Account of Excellent Recreation Club for the year ended 31.3.2018 and additional information given, prepare an Income and Expenditure Account for the year ended 31.3.2018 and Balance Sheet as on 31.3.2018:

<i>Receipts</i>	₹	<i>Payments</i>	₹
Opening Balance:		Secretary's Salary	12,000
Cash in hand and at bank	3,180	Salaries to Staff	25,000
Subscription	18,000	Charities	1,000
Sale of Old Newspapers	2,500	Printing and Stationery	600
Legacies	4,000	Postage Expenses	120
Interest on Investments	2,000	Rates and Taxes	1,500

Endowment Fund Receipts	20,000	Upkeep of the Land	2,000
Proceeds of Sport and Concerts	4,020	Purchase of Sports Materials	10,000
Advertisement in the Year Book	5,000	Telephone Expenses	3,480
		Closing Balance:	
		Cash in hand and at bank	3,000
	58,700		58,700

Assets and Liabilities were as follows:

Particulars	Opening ₹	Closing ₹
Subscription in arrears	2,000	1,000
Subscription received in advance	500	400
Furniture	2,000	1,800
Land	10,000	10,000

Depreciation shall be charged at 10% p.a. under the diminishing value method. Legacies received shall be capitalised. Investments were made in Securities, the rate of interest being 12% p.a., the date of investment was 1.6.2016 and the amount of investments was ₹ 20,000. Due date of interest 31st March every year. Stock of sports materials on 31.3.2018 were useless and valued at NIL price

SOLUTION:

INCOME AND EXPENDITURE ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

Expenditure	₹	Income	₹
To Secretary's salary	12,000	By Subscription	17,100
To Salaries to staff	25,000	By Sale of old newspapers	2,500
To Charities	1,000	By Interest on securities	2,000
To Printing and stationary	600	Add: Amount due	400
To Postage expenses	120	By Proceeds of sport and concerts	4,020
To Rates & Taxes	1,500	By Advertisement in the Year Book	5,000
To Upkeep of Land	2,000	By Deficit, Excess of	
To Sports materials written off	10,000	Expenditure over Income	24,880
To Telephone expenses	3,480		
To Depreciation on furniture	200		
	55,900		55,900

BALANCE SHEET OF EXCELLENT RECREATION CLUB AS AT 31ST MARCH, 2018

Liabilities	₹	₹	Assets	₹	₹
Capital Fund:			Land		10,000
Opening balance	36,680		Furniture	2,000	
Less: Deficit.	24,880		Less: Depreciation	200	1,800
Add: Legacies	4,000	15,800	Sports Materials	10,000	
Endowment Fund		20,000	Less: Written off	10,000	—
Advance Subscription		400	Investment in Securities		20,000
			Outstanding Subscriptions		1,000
			Interest Due		400
			Cash in hand and at Bank		3,000
		36,200			36,200

Working Notes:
(I) BALANCE SHEET OF EXCELLENT RECREATION CLUB AS AT 31ST MARCH, 2017

Liabilities	₹	Assets	₹
Capital (<i>Balancing Figure</i>)	36,680	Land	10,000
Advance Subscription	500	Furniture	2,000
		Investments in Securities	20,000
		Outstanding Subscription	2,000
		Cash in hand and at Bank	3,180
	37,180		37,180

Dr.
(II) SUBSCRIPTION ACCOUNT
Cr.

Particulars	₹	Particulars	₹
To Outstanding Subscription A/c	2,000	By Advance Subscription A/c	500
To Income & Expenditure A/c (b/f)	17,100	By Bank A/c	18,000
To Advance Subscription A/c	400	By Outstanding Subscription A/c	1,000
	19,500		19,500

PROBLEM 4

The Accountant of Diana Club furnishes you the following Receipts and Payments account for the year ending 31st March, 2018:

Receipts	₹	Payments	₹
Opening Balance:		Honoraria to Secretary	9,600
Cash and Bank	16,760	Misc. Expenses	3,060
Subscriptions	21,420	Rates and Taxes	2,520
Sale of Old Newspapers	4,800	Groundman's Wages	1,680
Entertainment Fees	8,540	Printing and Stationery	940
Bank Interest	460	Telephone Expenses	4,780
Bar Receipts	14,900	Payment for Bar Purchases	11,540
		Repairs	640
		New car (Less-sale Proceeds of Old Car ₹ 6,000)	25,200
		Closing Balance:	
		Cash and Bank	6,920
	66,880		66,880

Additional Informations:

Particulars	Opening ₹	Closing ₹
(i) Subscription due (not received)	2,400	1,960
(ii) Cheques issued, but not presented for payment of printing	180	60
(iii) Club premises at cost	58,000	—
(iv) Depreciation on club premises provided so far	37,600	—
(v) Car at cost	24,380	—

(vi) Depreciation on car	20,580	—
(vii) Value of Bar stock	1,420	1,740
(viii) Amount unpaid for bar purchases	1,180	860

- (ix) Depreciation is to be provided @ 5% p.a. on the written down value of the club premises and @ 15% p.a. on car for the whole year.

Required: Prepare an Income and Expenditure account of Diana Club for the year ending 31st March, 2018 and Balance Sheet as on that date.

SOLUTION:

INCOME AND EXPENDITURE ACCOUNT

Dr.

for the year ended 31st March, 2018

Cr.

Expenditure	₹	Income	₹
To Honoraria to Secretary	9,600	By Subscriptions	20,980
To Misc. Expenses	3,060	By Sale of Old Newspapers	4,800
To Rates and Taxes	2,520	By Entertainment Fees	8,540
To Groundman's Wages	1,680	By Bank Interest	460
To Printing and Stationary	940	By Bar Receipts	14,900
To Telephone Expenses	4,780	By Profit on Sale of Car	2,200
To Bar Expenses Opening Bar Stock	1,420		
Add: Purchases	11,220		
Less: Closing Bar Stock	1,740		
	10,900		
To Repairs	640		
To Depreciation:			
Club Premises	1,020		
Car	4,680		
	5,700		
To Surplus t/f to Capital Fund	12,060		
	51,880		51,880

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital Fund		Club Premises	19,380
Opening Balance	43,600	Car	26,520
Add: Excess of Income		Bar Stock	1,740
over Expenditure	12,060	Outstanding Subscription	1,960
	55,660	Cash and Bank	6,920
Outstanding Liabilities for			
Bar Purchases	860		
	56,520		56,520

Working Note:

(I) BALANCE SHEET OF DIANA CLUB
as at 31st March, 2017

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Amount Due for Bar Purchases	1,180	Club Premises	58,000
Capital Fund on 1.10.2002	43,600	Less: Depreciation	37,600
(Balancing Figure)		Car	24,380
		Less: Depreciation	20,580
		Bar Stock	1,420
		Outstanding Subscription	2,400
		Cash and Bank	16,760
	44,780		44,780

(II) CALCULATION OF BAR PURCHASES FOR THE YEAR

<i>Particulars</i>	₹
A. Bar payments as per receipts and payments account	11,540
B. Add: Amount due at the end	860
C. Less: Amount due in the beginning	(1,180)
	11,220

(III) CALCULATION OF SUBSCRIPTIONS ACCRUED DURING THE YEAR

<i>Particulars</i>	₹
A. Subscriptions received	21,420
B. Add: Outstanding at the end	1,960
C. Less: Outstanding at the beginning	(2,400)
	20,980

(IV) DEPRECIATION ON CLUB PREMISES AND W.D.V

<i>Particulars</i>	₹
A. Written down value on 1st April (58,000 – 37,600)	20,400
B. Less: Depreciation for the year @ 5% p.a.	(1,020)
	19,380

(V) CALCULATION OF PROFIT ON SALE OF CAR

<i>Particulars</i>	₹
A. Sale Proceeds of old car	6,000
B. Less: Written down value of old car:	
Cost of car	24,380
Less: Depreciation	20,580
	2,200

(VI) DEPRECIATION ON CAR AND WRITTEN DOWN VALUE

<i>Particulars</i>	<i>₹</i>
A. Cost of new car purchased (25,200 + 6,000)	31,200
B. Less: Depreciation for the year @ 15% p.a.	4,680
C. Written down value	26,520

Note: The opening and closing balance of cash and bank shown in the Receipts and Payments Account (given in the question), include the bank balance as per cash book. Therefore, no adjustment has been made in the above solution on account of cheques issued, but not presented for payment of printing.

PROBLEM 5

The following is the Receipts and Payments Account of Sydney Club for the year ended on 31st March, 2018:

<i>Receipts</i>	<i>₹</i>	<i>Payments</i>	<i>₹</i>
<i>Opening Balances:</i>		Salaries	1,20,000
Cash	10,000	Creditors	15,20,000
Bank	3,850	Printing and Stationery	70,000
Subscription Received	2,02,750	Postage	40,000
Entrance Donation	1,00,000	Telephones and Telex	52,000
Interest Received	58,000	Repairs and Maintenance	48,000
Sale of Assets	8,000	Glass and Table Linen	12,000
Miscellaneous Income	9,000	Crockery and Cutlery	14,000
<i>Receipts at:</i>		Garden Upkeep	8,000
Coffee Room	10,70,000	Membership Fees	4,000
Wines and Spirits	5,10,000	Insurance	5,000
Swimming Pool	80,000	Electricity	28,000
Tennis Court	1,02,000	<i>Closing Balances:</i>	
		Cash	8,000
		Bank	2,24,600
	21,53,600		21,53,600

The Assets and Liabilities as on 1.4.2017 were as follows:

Fixed Assets (net): ₹ 5,00,000; Stock: ₹ 3,80,000; Investment in 12% Tax free Government Securities: ₹ 5,00,000; Outstanding Subscription: ₹ 12,000; Prepaid Insurance: ₹ 1,000; Sundry Creditors: ₹ 1,12,000; Subscription received in advance: ₹ 15,000, Entrance Donation Received pending membership: ₹ 1,00,000; Gratuity Fund: ₹ 1,50,000.

The following adjustments are to be made while drawing up the Accounts:

- Subscription received in advance as on 31st March, 2018 was ₹ 18,000.
- Outstanding Subscription as on 31st March, 2018 was ₹ 7,000.
- Outstanding Expenses are: Salaries: ₹ 8,000 and Electricity: ₹ 15,000.
- 50% of the Entrance Donation was to be capitalised. There was no pending membership as on 31st March, 2018.
- The cost of assets sold net as on 1.4.2017 was ₹ 10,000.

- (f) Depreciation is to be provided at the rate of 10% on assets.
- (g) A sum of ₹ 20,000 received in October 2017 as Entrance Donation from an applicant was to be refunded as he had not fulfilled the requisite membership qualifications. The refund was made on 3.6.2018.
- (h) Purchases made during the year amounted to ₹ 15,00,000.
- (i) The value of closing stock was ₹ 2,10,000.
- (j) The club as a matter of policy charges off to Income and Expenditure Account all purchases made on Account of crockery, cutlery, glass and linen in the year of purchase.

You are required to prepare an Income and Expenditure Account for the year ended on 31st March, 2018 and the Balance Sheet as on 31st March, 2018 alongwith necessary workings.

SOLUTION:

INCOME AND EXPENDITURE ACCOUNT OF SYDNEY CLUB
FOR THE YEAR ENDING ON 31ST MARCH, 2018

Dr.
Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Salaries	1,28,000	By Subscription	1,94,750
To Printing and Stationery	70,000	By Entrance Donation	90,000
To Postage	40,000	By Interest	60,000
To Telephone and Telex	52,000	By Miscellaneous Income	9,000
To Repairs and Maintenance	48,000	By Profit from Operations	92,000
To Glass and Table Linen	12,000	By Deficit t/f to Capital Fund	30,250
To Crockery and Cutlery	14,000		
To Garden Upkeep	8,000		
To Membership Fees	4,000		
To Insurance	6,000		
To Electricity Charges	43,000		
To Loss on Sale of Assets	2,000		
To Depreciation	49,000		
	4,76,000		4,76,000

BALANCE SHEET OF SYDNEY CLUB AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
<i>Capital Fund:</i>		<i>Fixed Assets:</i>	
Opening Balance	10,29,850	Opening Balance	5,00,000
Add: Donation	90,000	Less: Sale	10,000
Less: Deficit	30,250	Less: Depreciation	49,000
	10,89,600		4,41,000
Gratuity Fund	1,50,000	Stock	2,10,000
Sundry Creditors	92,000	Investments	5,00,000
Subscription Received in Advance	18,000	Outstanding Subscription	7,000
Entrance Donation refundable	20,000	Interest Accrued	2,000
Outstanding Salaries	8,000	Bank	2,24,600
Outstanding Electricity Charges	15,000	Cash	8,000
	13,92,600		13,92,600

Working Notes:**1. BALANCE SHEET OF SYDNEY CLUB AS AT 1ST APRIL, 2017**

Liabilities	₹	Assets	₹
Sundry Creditors	1,12,000	Fixed Assets	5,00,000
Subscription Received in Advance	15,000	Stock	3,80,000
Entrance Donation Received in Advance	1,00,000	Investments	5,00,000
Gratuity Fund	1,50,000	Outstanding Subscription	12,000
Capital Fund (<i>Balancing figure</i>)	10,29,850	Prepaid Expenses	1,000
		Cash	10,000
		Bank	3,850
	14,06,850		14,06,850

Dr.**2. SUBSCRIPTION ACCOUNT****Cr.**

Particulars	₹	Particulars	₹
To Outstanding Subscription A/c (Beginning)	12,000	By Advance Subscription A/c (Beginning)	15,000
To Income and Expenditure A/c	1,94,750	By Bank A/c	2,02,750
To Advance Subscription A/c (End)	18,000	By Outstanding Subscription A/c (End)	7,000
	2,24,750		2,24,750

3. Entrance Donation

A Entrance Donation received during the year	1,00,000
B Add: Received in Advance as on 1.4.2017	1,00,000
C Less: Entrance Donation refundable in respect of In-eligible Member	<u>20,000</u>
	1,80,000
D Less: 50% Capitalised	<u>90,000</u>
E Taken to Income and Expenditure Account	<u>90,000</u>

4. Loss on Sale of Assets = Cost – Sale Proceeds = ₹ 10,000 – ₹ 8,000 = ₹ 2,000.**5. Depreciation** = On unsold Fixed Assets = 10% of (₹ 5,00,000 – ₹ 10,000) = ₹ 49,000.**6. Interest Accrued** = ₹ 60,000 – ₹ 58,000 = ₹ 2,000**Dr.****7. TRADING ACCOUNT****Cr.**

Particulars	₹	Particulars	₹
To Opening Stock	3,80,000	By Receipts from Coffee Room	10,70,000
To Purchases	15,00,000	By Receipts from Wines and Spirits	5,10,000
To Profit from Operations	92,000	By Receipts from Swimming Pool	80,000
		By Receipts from Tennis Court	1,02,000
		By Closing Stock	2,10,000
	19,72,000		19,72,000

Dr.

8. SUNDRY CREDITORS ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Bank A/c	15,20,000	By Balance b/d	1,12,000
To Balance c/d	92,000	By Purchases	15,00,000
	16,12,000		16,12,000

PROBLEM 6

The accountant of City Club gave the following information about the receipts and payments of the Club for the year ended on 31st March, 2018:

Receipts: Subscriptions: ₹ 62,130; Fair Receipts: ₹ 7,200; Variety Show Receipts (net): ₹ 12,810; Interest: ₹ 690; Bar Collections: ₹ 22,350.

Payments: Premises: ₹ 30,000; Rent: ₹ 2,400; Rates and Taxes: ₹ 3,780; Printing and Stationery: ₹ 1,410; Sundry Expenses: ₹ 5,350; Wages: ₹ 2,520; Bar Purchases (Payments): ₹ 17,310; Repairs: ₹ 960; New Car (less proceeds of old car ₹ 9,000): ₹ 37,800; Fair Expenses ₹ 7,170, Honorarium to Secretary ₹ 11,000.

Information:

Particulars	Opening ₹	Closing ₹
Cash in Hand	450	Nil
Bank Balance as per Cash-book	24,420	10,350
Cheque issued for Sundry Expenses not presented to the bank (entry has been duly made in the cash-book)	270	90
Subscriptions Due	3,600	2,940
Premises (at cost)	87,000	1,17,000
Provision for Depreciation on Premises	56,400	
Car (at cost)	36,570	46,800
Accumulated Depreciation on Car	30,870	
Bar Stock	2,130	2,610
Creditors for Bar Purchases	1,770	1,290

Annual Honorarium to Secretary is ₹ 12,000. Depreciation on Premises is to be provided at 5% on written down value. Depreciation on new Car is to be provided at 20%.

You are required to prepare the Receipts and Payments Account and Income and Expenditure Account for the year ended on 31.3.2018.

SOLUTION

RECEIPTS AND PAYMENTS ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

Receipts	₹	Payments	₹
To Opening Balances:		By Premises	30,000
Cash in Hand	450	By Rent	2,400
Bank Balance	24,420	By Rates and Taxes	3,780
To Subscriptions	62,130	By Printing and Stationery	1,410
To Fair Receipts	7,200	By Sundry Expenses	5,350

To Variety Show Receipts (Net)	12,810	By Wages	2,520
To Interest	690	By Fair Expenses	7,170
To Bar Collections	22,350	By Honorarium to Secretary	11,000
To Sale Proceeds of old car	9,000	By Bar Purchases (Payments)	17,310
		By Repairs	960
		By New Car	46,800
		By Closing Balances:	
		Cash on hand	Nil
		Bank balance	10,350
	1,39,050		1,39,050

INCOME AND EXPENDITURE ACCOUNTDr. *for the year ending on 31st March, 2018*

Cr.

Expenditure	₹	Income	₹
To Rent	2,400	By Subscriptions	62,130
To Rent and Taxes	3,780	Add: O/s at the end	2,940
To Printing and Stationery	1,410	Less: O/s in the beg.	3,600
To Wages	2,520	By Surplus from Fair:	
To Honorarium to Secretary	12,000	Fair receipts	7,200
To Sundry Expenses	5,350	Less: Fair expenses	7,170
To Repairs	960	By Surplus from variety show	
To Depreciation on:		By Interest	
Premises @ 5%	3,030	By Profit from Bar	
Car @ 20%	9,360	By Profit on sale of car	
To Excess of Income over			
Expenditure transferred to Capital Fund	43,490		
	84,300		84,300

Working Notes:Dr. **(I) BAR CREDITORS ACCOUNT**

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c	17,310	By Balance b/d	1,770
To Balance c/d	1,290	By Bar Purchases (Balancing figure)	16,830
	18,600		18,600

(ii) Profit on sale of car = Sale Proceeds – WDV = ₹ 9,000 – ₹ 5,700 = ₹ 3,300

(iii) Bar Stock Consumed = Opening Stock + Purchases – Closing Stock
= ₹ 2,130 + ₹ 16,830 – ₹ 2,610 = ₹ 16,350

(iv) Profit from Bar = Bar Collection – Bar Stock Consumed = ₹ 22,350 – ₹ 16,350 = ₹ 6,000

PROBLEM 7

The following informations were obtained from the books of Delhi Club as on 31.3.2018 at the end of the first year of the Club. You are required to prepare Receipts and Payments Account, Income and Expenditure Account for the year ended 31.3.2018 and a Balance Sheet as at 31.3.2018 on mercantile basis:

(i) Donations received for Building and Library Room ₹ 2,00,000

(ii) Other revenue income and actual receipts:

<i>Particulars</i>	<i>Revenue Income</i> ₹	<i>Actual Receipts</i> ₹
Entrance Fees	17,000	17,000
Subscription	20,000	19,000
Locker Rents	600	600
Sundry Income	1,600	1,060
Refreshment Account	—	16,000

(iii) Other revenue expenditure and actual payments:

<i>Particulars</i>	<i>Revenue Income</i> ₹	<i>Actual Payments</i> ₹
Land (cost ₹ 10,000)	—	10,000
Furniture (cost ₹ 1,46,000)	—	1,30,000
Salaries	5,000	4,800
Maintenance of Playgrounds	2,000	1,000
Rent	8,000	8,000
Refreshment Account	—	8,000

Donations to the extent of ₹ 25,000 were utilised for the purchase of Library Books, balance was still unutilised. In order to keep it safe, 9% Govt. Bonds of ₹ 1,60,000 were purchased on 31.3.2018. Remaining amount was put in the Bank on 31.3.2018 under the term deposit. Depreciation at 10% p.a. was to be provided for the whole year on Furniture and Library Books.

SOLUTION:

RECEIPTS AND PAYMENTS ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

<i>Receipts</i>	₹	<i>Payments</i>	₹
To Donation for Building & Library Room	2,00,000	By Purchase of Land	10,000
To Entrance Fees	17,000	By Purchase of Furniture	1,30,000
To Subscription	19,000	By Salaries	4,800
To Locker Rents	600	By Maintenance of Play grounds	1,000
To Sundry Income	1,060	By Rent	8,000
To Refreshment Receipts	16,000	By Refreshment Payments	8,000
To Balance c/d [Bank overdraft]	1,08,140	By Library Books	25,000
		By 9% Govt Bonds	1,60,000
		By Term Deposit with Bank	15,000
	3,61,800		3,61,800

INCOME & EXPENDITURE ACCOUNT

Dr.

for the year ended 31st March, 2018

Cr.

Expenditure	₹	Income	₹
To Salaries [₹ 4,800 + ₹ 200]	5,000	By Entrance Fees	17,000
To Maintenance of playgrounds	2,000	By Subscription [₹ 19,000 + ₹ 1,000]	20,000
To Rent	8,000	By Locker Rents	600
To Depreciation on Furniture	14,600	By Sundry Income [₹ 1,060 + ₹ 540]	1,600
To Depreciation on Library Books	2,500	By Profit on Refreshment A/c	
To Surplus t/f to Capital fund	15,100	Receipts	16,000
		Less: Expenses	8,000
	47,200		47,200

BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital Fund:		Fixed Assets:	
Surplus	15,100	Land	10,000
Add: Trans. from Library F.	25,000	Furniture Cost	1,46,000
Building & Library Fund:		Less: Depreciation	14,600
Donation Received	2,00,000	Library books cost	25,000
Less: utilized and		Less: Depreciation	2,500
t/f Capital Fund	25,000	Investments:	
Supplier of Furniture	16,000	9% Govt. Bonds (Face	
Outstanding Salary	200	Value ₹ 1,60,000)	1,60,000
Outstanding Maintenance		Term Deposit with bank	15,000
of Playgrounds	1,000	Current Assets:	
Bank Overdraft	1,08,140	Outstanding Subscription	1,000
		Accused Sundry Income	540
	3,40,440		3,40,440

PROBLEM 8

Summary of Receipts and Payments of Bombay Medical Aid Society for the year ended 31st March, 2018 are as follows:

Opening Cash balance in hand ₹ 8,000, Subscription ₹ 50,000, donation ₹ 15,000. Interest on Investments @ 9% p.a. ₹ 9,000, Payments for medicine supply ₹ 30,000, Honorarium to Doctors ₹ 10,000, Salaries ₹ 28,000 sundry Expenses ₹ 1,000, Equipment purchase ₹ 15,000, Charity show expenses ₹ 1,500, Charity show collections. ₹ 12,500.

Additional informations:

Particulars	Opening	Closing
Subscription due	1,500	2,200
Subscription received in advance	1,200	700
Stock of medicine	10,000	15,000
Amount due for medicine supply	9,000	13,000
Value of equipment	21,000	30,000
Value of building	50,000	48,000

Required: Prepare Receipts and Payments Account and Income and Expenditure Account for the year ended 31st March, 2018 and Balance Sheet as on 31st March, 2018.

SOLUTION:

RECEIPTS AND PAYMENTS ACCOUNT

Dr. *Cr.*
for the year ended 31st March, 2018

<i>Receipts</i>	₹	<i>Payments</i>	₹
To Cash in hand (Opening)	8,000	By Medicine supply	30,000
To Subscription	50,000	By Honorarium to doctors	10,000
To Donation	15,000	By Salaries	28,000
To Interest on investments	9,000	By Sundry expenses	1,000
To Charity show collections	12,500	By Purchase of Equipment	15,000
		By Charity show expenses	1,500
		By Cash in hand (closing)	9,000
	94,500		94,500

INCOME AND EXPENDITURE ACCOUNT

Dr. *Cr.*
for the year ended 31st March, 2018

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Medicine consumed	29,000	By Subscription	51,200
To Honorarium to doctors	10,000	By Donation	15,000
To Salaries	28,000	By Interest on investments	9,000
To Sundry expenses	1,000	By Profit on charity show:	
To Depreciation on:		Show collections	12,500
Equipment	6,000	Show expenses	1,500
Building	2,000		11,000
To Surplus-Excess of Income			
Over Expenditure	10,200		
	86,200		86,200

BALANCE SHEET

as on 31st March, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Fund:		Building	50,000
Opening Balance	1,80,300	Less: Depreciation	2,000
Add: surplus	10,200	Equipment	21,000
Subscription received in advance	700	Add: Purchase	15,000
Amount due for medicine supply	13,000		36,000
		Less: Depreciation	6,000
		Stock of medicine	15,000
		Investments	1,00,000
		Subscription receivable	2,200
		Cash in hand	9,000
	2,04,200		2,04,200

Working Notes:

Dr. **(I) SUBSCRIPTION ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Outstanding Subscription A/c (beg.)	1,500	By Advance Subscription A/c (beg.)	1,200
To Income & Expenditure A/c	51,200	By Bank A/c	50,000
To Advance Subscription A/c	700	By Outstanding Subscription A/c (end)	2,200
	53,400		53,400

Dr. **(II) CREDITORS FOR MEDICINES ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Bank A/c	30,000	By Balance b/d	9,000
To Balance c/d	13,000	By Credit Purchases	34,000
	43,000		43,000

Dr. **(III) STOCK OF MEDICINES ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Income & Expenditure A/c	29,000
To Purchases	34,000	By Balance c/d	15,000
	44,000		44,000

Dr. **(IV) EQUIPMENT ACCOUNT** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	21,000	By Depreciation A/c	6,000
To Bank A/c (Purchases)	15,000	By Balance c/d	30,000
	36,000		36,000

(V) BALANCE SHEET OF MEDICAL AID SOCIETY
as on 31st March, 2017

Liabilities	₹	Assets	₹
Capital fund (balancing figure)	1,80,300	Building	50,000
Subscription received in advance	1,200	Equipment	21,000
Amount due for medicine supply	9,000	Stock of medicine	10,000
		Investments	1,00,000
		Subscription receivable	1,500
		Cash in hand	8,000
	1,90,500		1,90,500

Note: Donation has been credited directly to the income and expenditure account assuming that donation is of revenue nature. Alternatively, donation may be treated as of capital nature and thus, be credited to capital fund.

ILLUSTRATION 9

Following is the Income and Expenditure Account of Victoria Club for the year ending 31st March, 2018:

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Salaries & Wages	19,000	By Subscription	30,000
To Misc. Expenses (including Insurance)	2,000	By Entrance Fees received	1,000
To Audit fees	1,000	By Annual Sports Income	
To Chief Executives' Honorarium	4,000	Receipts	6,000
To Printing & Stationery	1,800	Less: Expenses	3,000
To Annual day Celebration Exp.	6,000		
Less: Donation	4,000		
To Interest on Bank loan	600		
To Dep. on Sports Equipment	1,200		
To Excess of Income over Expen.	2,400		
	34,000		34,000

Additional Information:

<i>Particulars</i>	<i>Opening</i> ₹	<i>Closing</i> ₹
(i) Subscription outstanding	2,400	3,000
(ii) Subscription received in advance	1,800	1,080
(iii) Salaries outstanding	1,600	1,800
(iv) Sports equipment (after deducting depreciation)	10,400	10,800
(v) Prepaid Insurance	—	240
(vi) Cash in Hand	?	6,400

(vi) The Club owned a Sports' ground of ₹ 40,000

(vii) The Club took a loan of ₹ 8,000 from a bank during the year 2016-2017, which was not paid in 2017-2018.

(viii) Audit fee of 2017-2018 was outstanding, but Audit fees of ₹ 800 for 2016-2017 was paid in 2017-2018.

Prepare Receipts and Payments Account for the year ending 31st March, 2018 and a Balance Sheet on that date.

SOLUTION:

VICTORIA CLUB
RECEIPT AND PAYMENT ACCOUNT
for the year ended 31st March, 2018

Dr.

Cr.

<i>Receipts</i>	₹	<i>Payments</i>	₹
To Balance b/d	5,560	By Salaries & wages	
To Donation for Annual Day	4,000	for current year	19,000
To Subscription		+ O/s into beg.	1,600
for current year	30,000	– O/s at the end	1,800
+ O/s in the beg.	2,400	By Misc. expenses	
– O/s at the end	3,000	for current year	2,000
+ Advance at the end	1,080	+ Prepaid at the end	240
			2,240

– Advance in the beg.	1,800	28,680	By Audit fees for current year	1,000	
To Entrance fees		1,000	+ O/s in the beg.	800	
To Annual sports receipts		6,000	– O/s at the end	1,000	800
			By Chief Executive's Honorarium		4,000
			By Printing & Stationery		1,800
			By Annual Day Expenses		6,000
			By Interest on Bank Loan		600
			By Annual Sport Expenses		3,000
			By Sports Equipment		1,600
			By Balance c/d		6,400
		45,240			45,240

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital fund:		Sports Ground	40,000
Opening Balance	46,160	Sports equipment	
Add: Surplus	2,400	Opening balance	10,400
Loan from Bank	8,000	Add: Addition	1,600
Subscription received in advance	1,080	Less: Depreciation	1,200
Salaries outstanding	1,800	Subscription Outstanding	3,000
Audit fees outstanding	1,000	Prepaid Insurance	240
		Cash	6,400
	60,440		60,440

Working Notes:

Dr.

(I) SPORTS EQUIPMENT ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	10,400	By Depreciation A/c	1,200
To Cash A/c (b/f)	1,600	By Balance b/d	10,800
	12,000		12,000

(II) OPENING BALANCE SHEET AS AT 31.3.2017

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Loan from Bank	8,000	Sports ground	40,000
Subscription received in advance	1,800	Sports equipment	10,400
Salaries outstanding	1,600	Subscription outstanding	2,400
Audit fees o/s	800	Cash	5,560
Capital fund (b/f)	46,160		
	58,360		58,360

ILLUSTRATION 10

The Income and Expenditure Account of City Sports Club for the year ended 31st March, 2018 was as follows:

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Salaries	1,20,000	By Subscriptions	1,60,000
To Printing and Stationery	6,000	By Entrance Fees	10,000
To Rent	12,000	By Contribution for Annual dinner	20,000
To Repairs	10,000	By Profit on Annual Sports meet	20,000
To Sundry Expenses	8,000		
To Annual Dinner Expenses	30,000		
To Interest to Bank	6,000		
To Depreciation of Sports equipment	6,000		
To Surplurs	12,000		
	2,10,000		2,10,000

The above account had been prepared after the following adjustments:

<i>Particulars</i>	₹
Subscriptions outstanding in the beg.	12,000
Subscriptions received in advance in the beg.	9,000
Subscriptions received in advance at the end.	5,400
Subscriptions outstanding at the end.	15,000

Salaries outstanding at the beginning and at the end of the financial year were ₹ 8,000 and ₹ 10,000 respectively. Sundry expenses included prepaid insurance expenses of ₹ 1,200.

The Club owned a freehold ground valued ₹ 2,00,000. The Club has sports equipment on 01.04.2008 valued at ₹ 52,000. At the end of the year, after depreciation, the sports equipment amounted to ₹ 54,000. The Club raised a loan of ₹ 40,000 from a bank on 01.01.2017, which was unpaid till 31.03.2018. On 31.03.2018, cash in hand was ₹ 32,000.

Required: Prepare Receipts and Payments account of the Club for the year ended 31st March, 2018 and Balance Sheet as on that date.

SOLUTION:

Dr. RECEIPT AND PAYMENTS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018 Cr.

<i>Receipts</i>	(₹)	<i>Payments</i>	(₹)
To Balance b/d (Bal. Fig.)	27,800	By Salaries:	
To Subscription:		for 2016-2017	8,000
for 2016-2017	12,000	for 2017-2018	1,10,000
for 2017-2018	1,36,000	By Printing & Stationery	6,000
for 2018-2019	5,400	By Rend	12,000
To Entrance Fees	10,000	By Repairs	10,000
To Contribution for Annual Dinner	20,000	By Sundry Expenses (8,000 + 1,200)	9,200
To Profit on Annual Sports Meet	20,000*	By Annual Dinner Expenses	30,000
		By Interest to Bank	6,000
		By Sports Equipment	8,000
		By Balance c/d	32,000
	2,31,200		2,31,200

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	(₹)	(₹)	<i>Assets</i>	(₹)	(₹)
Capital Fund	2,34,800		Freehold Ground		2,00,000
Add: Surplus	12,000	2,46,800	Sports Equipment	52,000	
Bank Loan		40,000	Add: Additions	8,000	
Outstanding Salaries		10,000		60,000	
Subscription in Advance		5,400	Less: Depreciation	(6,000)	54,000
			Subscription in Arrear		15,000
			Prepaid Insurance		1,200
			Cash in Hand		32,000
		3,02,200			3,02,200

Working Notes:**(I) BALANCE SHEET AS AT 31ST MARCH, 2017**

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Fund (Bal. Fig.)	2,34,800	Freehold Ground	2,00,000
Bank Loan	40,000	Sports Equipment	52,000
Outstanding Salaries	8,000	Subscription in Arrear	12,000
Subscription in Advance	9,000	Cash in hand	27,800
	2,91,800		2,91,800

Dr.

(II) SPORTS EQUIPMENT ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	52,000	By Depreciation A/c	6,000
To Bank A/c	8,000	By Balance c/d	54,000
	60,000		60,000

Dr.

(III) SUBSCRIPTION ACCOUNT

Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Income & Exp. A/c	1,60,000	By Advance Subscription A/c	9,000
		By Bank A/c	1,36,000
		By O/s Subscription A/c	15,000
	1,60,000		1,60,000

PROBLEM 11

The Receipts and Payments account of Trustwell Club prepared on 31st March, 2018 is as follows:

RECEIPTS AND PAYMENTS ACCOUNT

<i>Receipts</i>	₹	<i>Payments</i>	₹
To Balance b/d	450	By Expenses (including	
To Annual Income from Subscription		Payment for sports material ₹ 2,700)	6,300
Add: Outstanding of	4,590	By Loss on Sale of Furniture	
last year received this year	180	(cost price ₹ 450)	180

	4,770		By Balance c/d	90,450
Less: Prepaid of last year	90	4,680		
To Other fees		1,800		
To Donation for Building		90,000		
		96,930		96,930

Additional Information:

Trustwell club had balances as on 1.4.2017:

Furniture ₹ 1,800; Investment at 5% ₹ 27,000; Sports material ₹ 6,660; Balance as on 31.3.2018: Subscription Receivable ₹ 270; Subscription received in advance ₹ 90; Stock of sports material ₹ 1,800.

Do you agree with above Receipts and Payments account? If not, prepare correct Receipts and Payments account and Income and Expenditure account for the year ended 31st March, 2018 and Balance Sheet on that date.

SOLUTION:
CORRECTED RECEIPTS AND PAYMENTS ACCOUNT OF TRUSTWELL CLUB

Dr. *for the year ended 31st March, 2018* Cr.

<i>Receipts</i>	₹	<i>Payments</i>	₹
To Balance b/d	450	By Expenses (₹ 6,300 – ₹ 2,700)	3,600
To Subscription		By Sports Material	2,700
Annual Income	4,590	By Balance c/d	90,720
Less: Receivable at end	270	(Cash in Hand and at Bank)	
Add: Advance at end	90		
Add: Receivable at the end	180		
Less: Advance received at end	90		
	4,500		
To Other fees	1,800		
To Donation for Building	90,000		
To Sale of Furniture	270		
	97,020		97,020

INCOME AND EXPENDITURE ACCOUNT OF TRUSTWELL CLUB

Dr. *for the year ended 31st March, 2018* Cr.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Sundry Expenses	3,600	By Subscription	4,590
To Sports Material		By Other fees	1,800
Balance as on 1.4.2018	6,660	By Interest on investment	1,350
Add: Purchases	2,700	(5% on ₹ 27,000)	
Less: Balance as on		By Deficit: Excess of	
31.3.2018	(1,800)	Expenditure over Income	3,600
	7,560		
To Loss on Sale of Furniture	180		
	11,340		11,340

BALANCE SHEET OF TRUSTWELL CLUB*as on 31st March, 2018*

Liabilities	₹	Assets	₹
Capital Fund 36,000		Furniture 1,800	
Less: Excess of Expenditure over Income (3,600)	32,400	Less: Sold (450)	1,350
Building Fund 90,000		5% Investment 27,000	
Subscription Received in Advance 90		Interest Accrued on Investment 1,350	
		Sports Material 1,800	
		Subscription Receivable 270	
		Cash in Hand and at Bank 90,720	
	1,22,490		1,22,490

Working Note:**BALANCE SHEET OF TRUSTWELL CLUB AS ON 1ST APRIL, 2017**

Liabilities	₹	Assets	₹
Subscription Received in Advance 90		Furniture 1,800	
Capital Fund (Balancing Figure) 36,000		Investment 27,000	
		Sports Material 6,660	
		Subscription Receivable 180	
		Cash in Hand and at Bank 450	
	36,090		36,090

18

ACCOUNTING FOR SHARE CAPITAL

No question has been asked so far.

19

ISSUE OF DEBENTURES

No question has been asked so far.

20

FINANCIAL STATEMENTS OF A COMPANY

No question has been asked so far.

21

RATIO ANALYSIS

No question has been asked so far.

**PAPER 1: PRINCIPLES AND PRACTICE OF ACCOUNTING
FOR CA FOUNDATION COURSE**

SECTION 3

**TULSIAN'S
REVISION TEST PAPER WITH ANSWERS**

PAPER-1: PRINCIPLES AND PRACTICE OF ACCOUNTING

TULSIAN'S REVISION TEST PAPER

Answer all Questions as if unsolved and then compare your answer with the suggested answer given to IDENTIFY & RECTIFY your ERRORS and learn therefrom.

1.0 TRUE AND FALSE QUESTIONS

- 1. State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):**
 - 1.1** Prudence is a concept to recognise all losses and not profits.
 - 1.2** Revenues are matched with expenses in accordance with the matching principle.
 - 1.3** Accrual means recognition of revenue as it is earned and of costs as they are paid.
 - 1.4** Reserve for Discount on Creditors has a credit balance.
 - 1.5** Real and Personal Accounts are closed at the end of accounting period.
 - 1.6** While posting an opening entry in the ledger, in case of an Account having debit balance, the words 'To Balance b/d' are written on credit side and in case of an Account having credit balance the words 'By Balance b/d' are written on debit side.
 - 1.7** In a Cash Book, Discount Columns may show either debit balance or credit balance.
 - 1.8** An individual transaction of Purchase Book is posted to the credit of Purchases A/c.
 - 1.9** Bank reconciliation statement is prepared to arrive at the bank balance.
 - 1.10** The object of opening Suspense Account is to avoid the delay in preparation of Trial Balance.
 - 1.11** After the preparation of financial statements, Profit & Loss Adjustment Account is used to rectify all errors involving Real & Personal A/cs in the subsequent year so as not to affect the Profit / Loss of that period.
 - 1.12** Deferred revenue expenditure is current year's revenue expenditure to be paid in the later years.
 - 1.13** Reducing balance method for depreciation is followed to have a uniform charge for depreciation and repairs and maintenance together.
 - 1.14** Depreciation Accounting is the process of valuation and not allocation.
 - 1.15** Depreciation is non-cash and non-operating expense which is to be provided for if there are profits.
 - 1.16** Finished goods are normally valued at cost or market price whichever is higher.
 - 1.17** As per AS - 2, the Inventory of Raw Materials is always valued at Cost or NRV whichever is lower.
 - 1.18** Net profit is reflected in higher cash balances and net loss is reflected in lower net worth.
 - 1.19** The gain from sale of capital assets need not be added to revenue to ascertain the true net profit of a business.
 - 1.20** Marshalling and Grouping has the same meaning.

- 1.21 Contingent liability is an ascertained liability but its amount and due date are indeterminate.
- 1.22 Consignor sends Invoice but Consignee sends Sales Account.
- 1.23 Any property may be the subject matter of consignment.
- 1.24 Discount charges on discounting a B/R accepted by Consignee and Cost of Abnormal Loss not recovered are debited to Consignment A/c.
- 1.25 The relationship between Consignee and Consignor is that of Principal and Agent .
- 1.26 The relationship between Co-venturers is that of Principal and Agent like partners.
- 1.27 Discount Charges on Discounting a Bill Receivable drawn on Co-venturer and unrecovered Abnormal Loss of Goods are debited to Joint Venture A/c.
- 1.28 A promissory note can be made payable to the bearer.
- 1.29 In case of all bills of exchange, three days (days of grace) are added to date of maturity of bill to arrive at due date.
- 1.30 In case of a public holiday the due date of the bill falls on the next working day.
- 1.31 If Goods Sent on Approval to a customer are sent by that customer on approval basis to any other person, it does not mean that goods have been sold to the customer.
- 1.32 If Partnership Deed is silent, Rate of Interest on loan by firm to a Partner shall be 6% p.m.
- 1.33 A person may be admitted as partner either with the consent of majority of partners or in accordance with express agreement among partners .
- 1.34 The objective of taking a joint life policy by the partnership firm is to secure the lives of the existing partners of the firm.
- 1.35 A retired partner or the legal representative of a deceased partner can not claim a share in the subsequent profits of the firm in any case.
- 1.36 Unless otherwise stated a preference share is always deemed to be Non-Cumulative, Non-participating & Non-convertible.
- 1.37 Participating Preference Share is that share which in addition to two basic preferential rights also carries a right to participate in surplus profits and surplus assets.
- 1.38 As per Table F, the Minimum rate of interest that can be charged on Calls-in-Arrear and that can be allowed on calls-in-advance are 10% p.m. and 12% p.m. respectively.
- 1.39 Debenture Redemption Premium Account and Discount on issue of debentures Account are Nominal Accounts.
- 1.40 Provision for Doubtful Debts and Discount on Debtors are deducted from the total amount of debtors, while computing Current Ratio, Quick Ratio and Debtors Turnover Ratio.
- 1.41 Interest on Long-term Debt and Income from Non-Trading Assets are excluded while computing Return on Investment and Return on Equity.
- 1.42 LLP Partners act as agents of LLP and other partners.
- 1.43 LLP must have at least 2 individuals as Designated Partners who must be residents in India.
- 1.44 All Partners of LLP are liable for Legal Compliance.

ANSWERS

S. No.	Reason
1.1	False: Prudence is a concept to recognise all unrealised losses and not profits.
1.2	False: Expenses are matched with revenues in accordance with the matching principle. Concept of matching requires accrual and periodicity concepts as accrued revenues are matched with accrued expenses of a definite accounting period.

1.3	False: Accrual means recognition of revenue as it is earned and of costs as they are incurred.
1.4	False: Reserve for Discount on Creditors has a debit balance.
1.5	False: Real and Personal Accounts are balanced and not closed at the end of accounting period.
1.6	False: While posting an opening entry in the ledger, In case of debit balance, the words 'To Balance b/f' are written on debit side and In case of credit balance the words 'By Balance b/f' are written on credit side
1.7	False: Discount Columns of a Cash Book are merely totalled but never balanced. Debit total of discount column represents discount allowed and that of credit side represents discount received. These are merely totalled and transferred to Discount Allowed and Discount Received Account respectively
1.8	False: An individual transaction of Purchase Book is posted to the credit of Individual Supplier's A/c.
1.9	False: Bank reconciliation statement is prepared <i>to reconcile</i> 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.
1.10	False: The object of opening Suspense Account is to avoid the delay in preparation of Financial Statements.
1.11	False: After the preparation of financial statements, Profit & Loss Adjustment Account is used to rectify all errors involving Nominal A/c in the subsequent year so as not to affect the Profit / Loss of that period.
1.12	False: Deferred revenue expenditure is that expenditure for which payment has been made or a liability has been incurred during current year but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods.
1.13	True: In the early periods of useful life of a fixed assets, repairs and maintenance expenses are relatively low because the asset is new but depreciation charge is high. Whereas in later periods, as the asset become old, repairs and maintenance expenses increase continuously but depreciation charge reduces continuously. Thus, depreciation and repair and maintenance expenses become more or less uniform throughout the useful life of the asset.
1.14	False: Depreciation Accounting is the process of allocation and not valuation.
1.15	False: Depreciation is non-cash but operating expense which is to be provided for whether there are profits/ losses.
1.16	False: Finished goods are normally valued at cost or net realisable value whichever ever is lower.
1.17	False: As per AS - 2, the inventory of Materials and other Supplies is not written down below Cost if Finished Products are expected to be sold at or above cost.
1.18	False: Net profit may not be reflected in higher cash balance because of credit transactions. On the other hand, cash may increase because of fresh loan or fresh capital. Net worth is the sum of capital, reserves and profit and loss account balance. Net worth is reduced by net loss. But net worth may also be reduced by withdrawal by the proprietor/partners. So lower net worth may not necessarily reflect net loss.
1.19	True: The profit on sale of capital assets should not be added to ascertain the true net profit of a business because it is not due to normal business operations.

1.20	False: The term '<i>Grouping</i>' means putting together items of a similar nature under a common heading. For example, under the heading 'Trade Creditors' the balances of the ledger accounts of all the suppliers from whom goods have been purchased on credit, will be shown. The term '<i>Marshalling</i>' refers to the order in which the various assets and liabilities are shown in the Balance Sheet. The assets and liabilities can be shown <i>either</i> in the order of liquidity <i>or</i> in the order of permanency.
1.21	False: Contingent liability is an unascertained liability but its amount and due date are indeterminate
1.22	False: Consignor sends Proforma Invoice but Consignee sends Account Sales.
1.23	False: Only movable property may be the subject matter of consignment.
1.24	False: Discount charges on discounting a B/R accepted by Consignee and Cost of Abnormal Loss not recovered are debited to Profit & Loss A/c and not to Consignment A/c.
1.25	False: The relation between Consignee and Consignor is that of Agent and Principal.
1.26	False: The relationship between Co-venturers is that of Co-owners.
1.27	Partly True, Partly False: Discount Charges on Discounting a Bill Receivable drawn on Co-venturer are debited to Joint Venture A/c but unrecovered Abnormal Loss of Goods is not recorded in Joint Venture A/c.
1.28	False: A promissory note cannot be made payable to the bearer. It is <i>payable to or to the order of a certain person</i> .
1.29	False: In case of all bills of exchange (other than payable on demand), three days (days of grace) are added to due date to arrive at date of maturity.
1.30	False: In case of a public holiday the due date of the bill falls on the preceding working day.
1.31	False: If Goods Sent on Approval to a customer are sent by that customer on approval basis to any other person, it amounts to acceptance of goods and it means that goods have been sold to the customer.
1.32	False: The Partnership Act has not prescribed any Rate of Interest on Loan by firm to Partner.
1.33	False: A person may be admitted as partner either with the consent of all partners or in accordance with express agreement among partners (Sec. 31)
1.34	False: The objective of taking a joint life policy is to minimize the financial hardships of the firm in the event of payment of a large sum to the legal representatives of a deceased partner or to the <i>retiring partner</i> .
1.35	False: A retired partner or the legal representative of a deceased partner can claim a share in the subsequent profits of the firm if his accounts are not settled.
1.36	False: Unless otherwise stated a preference share is always deemed to be Cumulative, Non-participating & Non-convertible.
1.37	False: Participating Preference Share is that share which in addition to two basic preferential rights also carries a right to participate in surplus profits and/ or surplus assets.
1.38	False: As per Table F, the maximum rate of interest that can be charged on Calls-in-Arrear and that can be allowed on calls-in-advance are 10% p.a. and 12% p.a. respectively.
1.39	Partly True, Partly False: Debenture Redemption Premium Account is a Personal Account but Discount on Issue of Debentures Account is a Nominal Account.

1.40	False: Provision for Doubtful Debts and Discount on Debtors are deducted while computing Current Ratio and Quick Ratio and not Debtors Turnover Ratio .
1.41	False: Interest on Long-term Debt is excluded while computing Return on Equity and not Return on Investment . Income from Non-Trading Assets is excluded while computing Return on Investment and not Return on Equity.
1.42	False: LLP Partners act as agents of LLP and not of other partners.
1.43	False: LLP must have at least 2 individuals as Designated Partners, of whom at least one must be resident in India
1.44	False: Only Designated Partners of LLP are liable for Legal Compliance.

2.0 RECTIFICATION OF ERRORS

2.1 Rectify the following errors:

- A Cash Sale of goods of ₹ 3,000 to Krishan posted to the credit of Kishan as ₹ 30,000.
- A Credit Purchase of old machinery from Sohan for ₹ 17,000 was entered in the Purchases Book as purchase from Mohan for ₹ 71,000. ₹ 3,000 paid as Repair Charges of this Machinery debited to General Expenses Account.
- An amount of ₹ 8,000 owing by a customer had been omitted from the list of Sundry Debtors.
- A credit sale of old furniture to Rohan for ₹ 17,000 omitted to be posted.
- On 26th March, goods of the sale value of ₹ 2,00,000 were sent on sale or return basis to Gopal, a customer, the period of approval being two weeks. He returned 20% of the goods and approved 80% of the remaining on 31st March. These goods were sent at a profit of 25% on cost.

SOLUTION:

JOURNAL

Date	Particulars	Dr. (₹)	Cr. (₹)
(a)	Kishan Dr. To Sales A/c To Suspense A/c (Being wrong positing, now rectified)	30,000	3,000 27,000
(b)	Mohan Dr. Machinery A/c Dr. To Sohan To Purchases A/c To General Expenses A/c (Being purchase of old machinery recorded in the Purchases Book and repairing charges debited to General Expenses A/c, now rectified)	71,000 20,000	17,000 71,000 3,000
(c)	Sundry Debtors Dr. To Suspense A/c (Being a debtor omitted from the list now included) [Note: Debtor's A/c need not be posted again in the ledger in this case since it is already correctly balanced].	8,000	8,000

(d)	No Journal Entry is to be passed as it has already been correctly passed in the Journal. Merely posting in both the accounts in the ledger is required.		
(e)	(i) Sales Returns Dr. To Gopal (Being 20% of ₹ 2,00,000, returned)	40,000	40,000
	(ii) (a) Sales A/c Dr. To Gopal (Being 20% of 1,60,000, not yet approved, now adjusted)	32,000	32,000
	(b) Closing Stock Dr. To Trading A/c (Being 80% of ₹ 32,000, treated as parts of stock)	25,600	25,600

2.2 It was discovered during 2017-2018 that:

- ₹ 25,000 being Repairs to Machinery incurred on 30th June, 2015 had been capitalized.
- ₹ 50,000 being the cost of Generator purchased on 1st Oct, 2014 had been written off to Stores.

Rectify the errors assuming that the Rate of Depreciation is 20% p.a. on reducing balances basis.

SOLUTION:

- Book Value of repairs to machinery as at 1.4.2017 = ₹ 25,000 × 85% × 80% = ₹ 17,000
- Book Value of Generator as at 1.4.2017 = ₹ 50,000 × 90% × 80% × 80% = ₹ 28,800

JOURNAL

Date	Particulars	Dr. (₹)	Cr. (₹)
(a)	Profit & Loss Adjustment A/c Dr. To Machinery A/c (Being Repairs to Machinery capitalized, now rectified)	17,000	17,000
(b)	Machinery A/c Dr. To Profit & Loss Adjustment A/c (Being the Cost of Generator w/o to Stores, now rectified)	28,800	28,800

3.0 BANK RECONCILIATION STATEMENT

3.1 On 31st March, 2018, the pass book of Miss Meenu showed a debit balance of ₹ 5,091. On scrutiny, you found that:

- The debit balance of ₹ 1,500 as on the previous day was brought forward as a credit balance of ₹ 5,100 in Cash Book.
- A deposit of ₹ 5,432 was recorded in withdrawal column as ₹ 5,342 in pass book.
- A cheque of ₹ 2,345 issued by Miss Meena was recorded in deposit column as ₹ 2,435 in pass book.

Required: Prepare Bank Reconciliation Statement with amended Cash Book Balance.

SOLUTION:

DR.

CASH BOOK (WITH AMENDED BANK COLUMN)

CR.

Date	Particulars	₹	Date	Particulars	₹
31.03.2018	To Error in carry forward	6,600	31.03.2018	By Balance b/d	3,352
				By Balance c/d	3,248
		6,600			6,600

(B) BANK RECONCILIATION STATEMENT AS AT 31.3.2018

Particulars	Plus items ₹	Minus items ₹
A. Balance as per Amended Cash Book	3,248	
B. Less: Wrong Debit by Bank in withdrawal column [₹ 5,432 + ₹ 5,342]		10,774
C. Add: Wrong Credit by Bank in deposit column	2,435	
	5,683	10,774
D. Debit Balance as per Bank Statement	5,091	

Working Note: Calculation of Balance as per Cash Book(before amendments)**BANK RECONCILIATION STATEMENT AS AT 31.3.2018**

Particulars	Plus items ₹	Minus items ₹
A. Debit Balance as per Bank Statement		5,091
B. Less: Error in carry forward		6,600
C. Add: Wrong Debit by Bank in withdrawal column [₹5,432+ ₹ 5,342]	10,774	
D. Less: Wrong Credit by Bank in deposit column		2,435
	10,774	14,126
E. Credit Balance as per Cash Book		3,352

4.0 VALUATION OF INVENTORY

4.1 The accounting year of Mr X ends on March 31, 2018 but the stock on hand was physically verified only on 15th April. You are required to determine the value of closing stock (at cost) as on 31st March from the following information:

- The physical stock (value at cost) was ₹ 50,000.
- The purchases from 1st April to 15th April amounted to ₹ 8,000 of which goods costing ₹ 1,000 were received on 16th April.
- The sales from 1st April to 15th April amounted to ₹ 4,800 including the following:
 - Goods sold for ₹ 800 at a loss of 20% on cost due to damage on 31st March.
 - Other sales are at a profit of 1/3rd of cost.
 - Goods (sold for ₹ 2,500) were delivered to the customers on 16th April.

- (d) On 25th March, goods of the value of ₹ 10,000 were sent on sale or return basis to a customer, the period of approval being 4 weeks. He returned 40% of the goods on 10th April, approving 80% of the rest, the customer was invoiced on 16th April. Mr X sold these goods at a profit of 25% on cost.

The sales referred to in (d) are not included in (c) above.

SOLUTION:

VALUATION OF STOCK AS AT 31ST MARCH, 2018

<i>Particulars</i>		₹
A	Physical Stock as at 15th April	50,000
B	Add: Cost of Goods sold and delivered after 31st March till stock taking	
	(iii) Damaged Goods (Valued at realizable value)	800
	(iv) Other goods 75% of (₹ 4,000 – 2,500)	1,125
C	Add: Cost of goods sent on approval basis (6,000 × 80%)	4,800
D	Less: Cost of goods purchased and received after 31st March till stock taking	(7,000)
E	Stock as at 31st March	49,725

- 4.2 The stock was physically verified on 24th March and was valued at ₹ 2,00,000. Goods are normally sold by the trader at a profit of 25% on cost. On 21st March goods of the sale value of ₹ 1,00,000 were sent on sale or return basis to a customer, the period of approval being two weeks. He returned 20% of the goods and approved 80% of the remaining on 31st March. Determine the value of stock to be taken to the Balance Sheet of PCT Ltd. as at 31st March.

SOLUTION:

VALUATION OF STOCK AS AT 31ST MARCH

<i>Particulars</i>	₹
A. Value of Stock as at 24th March	2,00,000
B. Add: Cost of Goods sent on approval and received back	
[20% of ₹ 1,00,000 – 20% of ₹ 20,000]	16,000
Cost of Goods sent on approval and still with customer	
[20% of 80% of ₹ 1,00,000 – 20% of ₹ 16,000]	12,800
C. Value of Stock as at 31st March	2,28,800

5.0 DEPRECIATION

- 5.1 On 1.4.2017 the balance of Machinery Account ₹ 5,17,000. It was discovered during 2017-2018 that ₹ 25,000 being repairs to machinery incurred on 30 June, 2015 had been capitalized. After rectification and depreciation @ 20% p.a. on reducing balances, Calculate the balance of Machinery Account as at 31.03.2018.

SOLUTION:

$$\begin{aligned}\text{Book Value of repairs to machinery as at 1.4.2017} &= ₹ 25,000 \times 85\% \times 80\% \\ &= ₹ 17,000\end{aligned}$$

$$\begin{aligned}\text{Balance of Machinery Account(after rectification) as at 1.4.2017} &= ₹ 5,17,000 - ₹ 17,000 \\ &= ₹ 5,00,000\end{aligned}$$

Balance of Machinery Account(after rectification) as at 31.03.2018 = ₹ 5,00,000 – [₹ 5,00,000 × 20%]
= ₹ 4,00,000

- 5.2** On 1.04.2017, the balance of Machinery Account ₹ 4,71,200. It was discovered during 2017-2018 that ₹ 50,000 being the cost of Generator purchased on 1st Oct, 2014 had been written off to Stores. After rectification and depreciation @ 20% p.a. on reducing balances, Calculate the balance of Machinery Account as at 31.03.2018.

SOLUTION:

Book Value of Generator as at 1.4.2017 = ₹ 50,000 × 90% × 80% × 80%
= ₹ 28,800

Balance of Machinery Account(after rectification) as at 1.4.2017 = ₹ 4,71,200 + ₹ 28,800
= ₹ 5,00,000

Balance of Machinery Account(after rectification) as at 31.03.2018 = ₹ 5,00,000 – [₹ 5,00,000 × 20%]
= ₹ 4,00,000

- 5.3** Tulsian Ltd. provides you the following information:

<i>Date</i>	<i>Particulars</i>
	The Machinery Account of Tulsian Ltd had a debit balance of ₹ 6,84,000 on 1st April, 2017
01.04.2015	Purchased 10 second hand Machines of the same type and incurred ₹ 70,000 towards freight & insurance, ₹ 20,000 towards carriage inward
01.01.2016	Incurred ₹ 7,000 towards Repairs and ₹ 3,000 on Installation of machines and ₹ 12,000 towards Annual Insurance Premium and commenced the commercial production.
01.10.2016	Sold one machine at a profit of 10%
01.01.2017	Incurred ₹ 10,000 on repairs of Machines
01.01.2018	Sold one machine at a loss of 10% and purchased a new machine for ₹ 90,000 and spent ₹ 10,000 on its installation

Depreciation was annually provided on 31st March @ 20% p.a on the written down value.

Calculate Purchase Price of 10 Machines as on 01.04.2015

SOLUTION:**CALCULATION OF PURCHASE PRICE OF 10 MACHINES AS ON 01.04.2015**

<i>Particulars</i>	<i>₹</i>
A. W.D.V. of 9 Machines as on 1.4.2017	8,64,000
B. Add: Depreciation during 2016-2017 (₹8,64,000 × 20/80)	1,71,000
C. W.D.V. of 9 Machines as on 1.4.2016	8,55,000
D. Book Value of 1 Machine (8,55,000 × 1/9)	95,000
E. W.D.V. of 10 Machines as on 1.4.2016	9,50,000
F. Add: Depreciation during 2015-2016 (₹ 9,50,000 × 5/95)	50,000
G. Total Cost of 10 Machines as on 1.1.2016	10,00,000
H. Less: Repairs and on Installation Incurred on 1.1.2016	10,000
I. Less: freight & insurance, and carriage inward Incurred on 1.4.2015	90,000
J. Purchase Price of 10 Machines as on 1.4.2015	9,00,000

- 5.4** Bharat Ltd. which depreciates its machinery at 10% p.a. straight line basis, had on 1st April 2017 ₹ 28,000 to the debit of Machinery Account. On 31st March 2018, the company decided to change the method of depreciation to diminishing balance method with effect from 1st April, 2014 being the date of purchase of machine and the rate of depreciation remaining the same. There was no purchase/sale of machine after 1st April, 2014. Pass the necessary journal entry on account of change in method of depreciation.

SOLUTION:

1. Cost as on 1.4.2014 = ₹ 28,000/.70 = ₹ 40,000
2. Calculation of Excess Depreciation
 - A. Total Depreciation under Old Method = ₹ 40,000 – ₹ 28,000 = ₹ 12,000
 - B. Total Depreciation under New Method = ₹ 40,000 – [₹ 40,000 × 90% × 90% × 90%]
= ₹ 10,840
 - C. Excess Depreciation to be written back (A – B) = ₹ 1,160

3. Journal Entry to adjust Excess Depreciation

Machinery A/c	Dr. ₹ 1,160	
To Profit and Loss A/c		₹ 1,160

(Being the Excess Depreciation written back on a/c of change in method of Depreciation)

- 5.5** Tushar Ltd. which depreciates its machinery at 10% p.a. on diminishing balance method, had on 1st April 2017 ₹ 29,160, to the debit of Machinery Account. On 31st March 2018, the company decided to change the method of depreciation to Straight Line Method with effect from 1st April 2014 being the date of purchase of machine and the rate of depreciation remaining the same. There was no purchase/sale of machine after 1st April, 2014. Pass the necessary journal entry on account of change in method of depreciation

SOLUTION:

1. Cost as on 1.4.2014 = ₹ 29,160/(.90 × .90 × .90) = ₹ 40,000
2. Calculation of Short Depreciation
 - A. Total Depreciation under Old Method = ₹ 40,000 – ₹ 29,160 = ₹ 10,840
 - B. Total Depreciation under New Method = ₹ 40,000 × 10% × 3 = ₹ 12,000
 - C. Short Depreciation to be provided (A – B) = ₹ 1,160

3. Journal Entry to adjust Short Depreciation

Profit and Loss A/c	Dr. ₹ 1,160	
To Machinery A/c		₹ 1,160

(Being the Short Depreciation provided on a/c of change in method of Depreciation)

- 5.6** Bharat Tushar Ltd. which depreciates its machinery at 20% p.a. on diminishing balance method, had on 1st April 2017 ₹ 6,08,000 to the debit of Machinery Account. On 31st March 2018, the company decided to change the method of depreciation to Straight Line Method with effect from 1st Jan 2016 being the date of purchase and put to use of machine and the rate of depreciation remaining the same. There was no purchase/sale of machine after 1st Jan, 2016. Pass the necessary journal entry on account of change in method of depreciation

SOLUTION:

1. Cost as on 1.1.2016 = ₹ 6,08,000/(.95 × .80) = ₹ 8,00,000
2. Calculation of Short Depreciation
 - A. Depreciation already provided on WDV basis @ 20% p.a.
= [8,00,000] – [8,00,000 × .95 × .80] = ₹ 1,92,000

B. Depreciation which should have been provided on SLM basis @ 20% p.a.

$$= [8,00,000 \times 20\% \times 15/12] = ₹ 2,00,000$$

C. Short Depreciation still to be written off (A – B) = ₹ 8,000

3. Journal Entry to adjust Short Depreciation

Profit and Loss A/c	Dr. ₹ 8,000
To Machinery A/c	₹ 8,000

(Being the Short Depreciation provided on a/c of change in method of Depreciation)

- 5.7 Tulsian Ltd. purchased a machinery for ₹ 9,00,000 on 1 April 2018 and incurred ₹ 1,00,000 towards freight, insurance, carriage inwards and installation charges. It was estimated that the machinery will have a scrap value of ₹ 71,800 at the end of its useful life which is 4 years. It was decided to institute a sinking fund for the purpose of accumulating sufficient funds to replace the machinery at the end of its useful life and to invest in some readily convertible securities yielding 10% interest p.a. Reference to the table shows that ₹ 1 p.a. at 10% compound interest amounts to ₹ 4.641 in 4 years. Investments are to be made in the bonds of ₹ 100 each available at par. Calculate the annual amount to be charged to Profit and Loss Account.

SOLUTION:

	₹
A. Original Cost	9,00,000
B. Add: Capital Expenditure	1,00,000
C. Less: Estimated scrap value	71,800
D. Depreciable Cost (A + B – C)	9,28,200
E. Value of annuity per ₹ 1	4.641
F. Annual amount to be charged (D/E)	2,00,000

- 5.8 A lease is purchased on 1st April, 2018 for 4 years at a cost of ₹ 40,000. It is proposed to depreciate the lease by the annuity method charging interest @ 5% p.a. A reference to the annuity table shows that to depreciate ₹ 1 by annuity method over 4 years charging interest at 5% p.a. one must write off a sum of ₹ 0.2820. ₹ 4,000 would also be refunded after 4 years. Calculate the Annual Depreciation Charge as per Annuity Method.

SOLUTION:

CALCULATION OF ANNUAL DEPRECIATION CHARGE

A Cost of Lease paid	₹ 40,000
B Less: Refundable amount	₹ 4,000
C Depreciable amount (A – B)	₹ 36,000
D Annuity Factor @ 5% interest for 4 years	₹ 0.2820
E Fixed Depreciation Charge (C × D)	₹ 10,142
F Interest on Salvage @ 5% on ₹ 2,000 for a year	₹ 200
G Annual Depreciation Charge (E + F)	₹ 10,352

- 5.9 Tulsian Ltd. acquired a lease right for 10 years of a mine on 1.4.2017 on a lumpsum payment of ₹ 9,00,000 to the landlord. It was estimated by the expert that the coal deposit of the mine was 40,00,000 tonnes, 75% of which could be raised within time period allowed. Tulsian Ltd. decided to depreciate the lease on Depletion Method. The sales and stocks (in tonnes) were as under:

Year	2017-2018	2018-2019
Sales	30,000	62,000
Closing Stock	10,000	8,000

Calculate the Depreciation for the year 2017-2018 & 2018-2019.

SOLUTION:

- Depreciation per tonne = Total Cost/Total Expected Output within Lease Period
 $= ₹ 9,00,000/75\% \text{ of } 40,00,000 = ₹ 9,00,000/30,00,00$
 $= ₹ 0.30 \text{ per tonne}$
 - Annual raisings = Sales + Closing Stock – Opening Stock
For 2017-2018 = 30,000 + 10,000 – 0 = 40,000,
For 2018-2019 = 62,000 + 8,000 – 10,000 = 60,000
 - Depreciation for the year 2017-2018 = 40,000 × ₹ 0.30 per tonne = ₹ 12,000
 - Depreciation for the year 2018-2019 = 60,000 × ₹ 0.30 per tonne = ₹ 18,000
- 5.10** Tulsian Ltd. purchased a machine for ₹ 2,20,000 on 1st April, 2017 and incurred ₹ 40,000 towards freight, insurance, carriage inwards and installation charges. It was estimated that the machinery will have a scrap value of ₹ 20,000 at the end of its useful life which is 10 years of 12,000 hours each. Tulsian Ltd. decided to depreciate the machines on 'Machine Hour Rate Method'. The machine hours during the year 2017-2018 were 6,000. Calculate the Depreciation for the year 2017-2018.

SOLUTION:

- Calculation of Rate of depreciation per Machine Hour
Machine Hour Rate = (Cost of Acquisition – Scrap Value)/Life of the asset (in Hours)
 $= ₹ 2,00,000 - ₹ 20,000 / 10 \times 12,000 = ₹ 2 \text{ per hour}$
 - Depreciation for the year 2017-2018 = 6,000 × ₹ 2 per hour = ₹ 12,000
- 5.11** On 1st April 2017, Tulsian Ltd. purchased a machinery for ₹ 2,00,000 and incurred ₹ 14,000 towards freight and insurance, ₹ 2,000 towards carriage inwards and ₹ 4,000 towards installation charges. It was established that the machinery will have a scrap value of ₹ 20,000 at the end of its useful life which is 4 years. Calculate the Depreciation for the year 2017-2018 according to the Double Declining Method.

SOLUTION:

- Rate of Depreciation $200\%/n = 200\%/4 = 50\%$
 - Depreciation for the year 2017-2018 = 50% [(₹ 2,00,000 + ₹ 14,000 + ₹ 2,000 + ₹ 4,000) – 50%]
 $= ₹ 1,10,000$
- 5.12** On 1st April 2017, Tulsian Ltd. purchased a machinery for ₹ 2,00,000 and incurred ₹ 14,000 towards freight and insurance, ₹ 2,000 towards carriage inwards and ₹ 4,000 towards installation charges. It was established that the machinery will have a scrap value of ₹ 20,000 at the end of its useful life which is 4 years. Determine the Amount of Depreciation for the year 2017-2018 according to the Sum of Years' Digits Method.

SOLUTION:

- Rate of Depreciation = Number of Years Life Remaining/Sum of Years Digits × 100
Sum of Years' Digits = $n(n+1)/2 = 4(4+1)/2 = 20/2 = 10$

1st Year = $4/10 \times 100 = 40\%$

2nd Year = $3/10 \times 100 = 30\%$

3rd Year = $2/10 \times 100 = 20\%$

4th Year = $1/10 \times 100 = 10\%$

2. Calculation of the Amount of Depreciation p.a.

= Number of Years Life Remaining/Sum of Years Digits $\times$ (Original Cost – Scrap Value)

Depreciation for the year 2015 = $40\% [(\text{₹ } 2,00,000 + \text{₹ } 14,000 + \text{₹ } 2,000 + \text{₹ } 4,000) - \text{₹ } 20,000]$
= ₹ 80,000

- 5.13** On 1st April, 2017, the value of loose tools was ₹ 20,000 and during the year ₹ 10,000 worth of tools were purchased and ₹ 2,000 realised by way of sale of scrapped loose tools. At the end of the year, the loose tools are considered to be worth only ₹ 12,000. Calculate the amount to be charged to Profit & Loss Account.

SOLUTION:

AMOUNT TO BE CHARGED TO PROFIT AND LOSS ACCOUNT

Particulars	₹
A Opening Balance of Loose tools	20,000
B Add: Purchased during the year	10,000
C Less: (a) Sale of scrapped Loose tools	2,000
(b) Closing Balance of Loose tools (at revalued figure)	12,000
D Depreciation to be charged to Profit & Loss Account (A + B – C)	16,000

6.0 BILLS OF EXCHANGE

- 6.1** X draws on Y a bill for ₹ 2,00,000 on 1st April for 3 months. Y accepts the bill and sends it to X who gets it discounted for ₹ 1,95,000. X immediately remits ₹ 97,500 to Y. On due date, X being unable to remit the amount due accepts a bill for ₹ 1,20,000 for 2 months which is discounted by Y for ₹ 1,17,600. Y sends ₹ 7,800 to X out of the same. How much discount will be borne by X at the time of remittance of ₹ 7,800? Also Pass Journal Entry in the Books of X on receipt of ₹ 7,800.

SOLUTION:

Proportionate Discount to be borne by X = $(\text{₹ } 2,400 \times \text{₹ } 1,07,800 / \text{₹ } 1,17,600) = \text{₹ } 2,200$

JOURNAL OF X

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
April 4	Bank A/c Dr.		7,800	
	Discount A/c Dr.		2,200	
	To Y			10,000
	(Being ₹ 7,800 received from Y and proportionate discount ₹ 2,200 (i.e. ₹ 2,400 $\times$ ₹ 1,07,800 / ₹ 1,17,600) debited]			

7.0 GOODS SENT ON APPROVAL

7.1 Mr. A, a trader, dispatched goods costing ₹ 16,000 to his customer Mr B on sale or return basis after charging a gross profit of 20% on Sales. Mr. A had treated the transaction as credit sale at the time of dispatch of the goods.

Pass Journal entries in the books of Mr. A, if:

- (i) the customer had approved the goods.
- (ii) the customer had rejected all the goods:
- (iii) the customer had retained half of the goods while rejecting the other half.

SOLUTION:**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	When goods are sent on approval:			
	Mr B's A/c Dr.		20,000	
	To Sales A/c			20,000
	(Being goods sent on approval treated as credit sale)			
(i)	When goods are approved by customer:			
	No entry need to be passed.			
(ii)	When the customer rejects all the goods:			
	Sales A/c Dr.		20,000	
	To Mr B's A/c			20,000
	(Being entry for credit sale reversed on rejection of the goods by the customer)			
(iii)	When the customer retains half the goods while rejecting the other half:			
	Sales A/c Dr.		10,000	
	To Mr B's A/c			10,000
	(Being entry for credit sale reversed for the rejected portion i.e. half of the goods)			

Working Note: Sales Value of goods sent on approval = ₹16,000 + 25% of ₹16,000 = ₹20,000

8.0 CONSIGNMENT

8.1 Mr X sent 250 units costing ₹ 10,000 each to Mr Y. The goods were to be sold so as to yield a profit of 20% on sales. Mr Y sold 150 units @ ₹ 14,200 per unit on credit and 75 units @ ₹ 14,000 for cash. Mr Y was entitled to an ordinary commission of 5%, del-credere commission of 2% on sales and an over-riding commission of 25% of any surplus realised. Calculate the commission due to Mr Y.

SOLUTION:

Since over-riding commission as % of surplus has been given, other commission have been calculated on sales at specified selling price otherwise Mr Y will get unnecessarily ordinary commission and delcredere commission on surplus realised also.

A. Actual Total Sales = $(150 \times ₹ 14,200) + (75 \times ₹ 14,000)$	= ₹ 31,80,000
B. Total Sales at Specified Selling Price = $(150 + 75) ₹ 12,500$	= ₹ 28,12,500
C. Surplus [A – B]	= ₹ 3,67,500
Ordinary Commission = 5% of ₹ 28,12,500	= ₹ 1,40,625
Del-Credere Commission = 2% of ₹ 28,12,500	= ₹ 56,250
Over-riding Commission = 25% of ₹ 3,67,500	= ₹ 91,875
Total Commission	= ₹ 2,88,750

8.2 X sent out goods costing ₹ 80,000 to Y so as to show 20% profit on invoice price. 40% goods were lost in transit. 60% of the goods received by consignee was sold at 25% above invoice price. Rate of commission is 10% on sales at invoice price plus 50% of the surplus over invoice price. Calculate the commission due to Y.

SOLUTION:

Invoice Price of Goods sold = 60% $(₹ 1,00,000 - 40\%) = ₹ 36,000$

Surplus over invoice price = ₹ 36,000 $\times 25\% = ₹ 9,000$

Commission = $(36,000 \times 10/100) + (9,000 \times 50/100) = ₹ 8,100$

8.3 X sent goods to B at 125% of cost which is invoice price. The Rate of Commission is 10% on sales at IP and 25% of any surplus realized above IP. 10% of the goods sent out on consignment, invoice value of which is ₹ 12,500 were destroyed. 75% of the total consignment is sold by B at ₹ 1,00,000. What will be the amount of commission payable to B?

SOLUTION:

Invoice Price of Goods Sent = ₹ 12500/10% = ₹ 125000

Invoice Price of Goods Sold = ₹ 12500 $\times 75\% = ₹ 93750$

Surplus = ₹ 1,00,000 – ₹ 93,750 = ₹ 6,250

Commission = $(10\% \text{ of } ₹ 93,750) + (25\% \text{ of } ₹ 6,250)$
= ₹ 10,937.50

8.4 X sent out goods costing ₹ 80,000 to Y so as to show 20% profit on invoice price. 40% goods were lost in transit. 60% of the goods received were sold half at invoice price and the balance at 25% above the invoice price. Rate of Commission is 10% on sales at invoice price plus 50% of gross sales less all commission exceeds the invoice price. Calculate the commission due to Y.

SOLUTION:

Sale at invoice price = ₹ 36,000 $\times 50/100 = ₹ 18,000$

Sale at 25% above invoice price = ₹ 36,000 $\times 50/100 \times 25/100 = ₹ 22,500$

Surplus over invoice price = ₹ 36,000 $\times 50/100 \times 25\% = ₹ 4,500$

Let total Commission be X

$$X = (₹ 36,000 \times 10/100) + 50\% [₹ 40,500 - X - ₹ 36,000]$$

$$= ₹ 3,600 + 2,250 - 0.5X$$

$$1.5 X = ₹ 5,850$$

$$X = ₹ 5,850/1.5 = ₹ 3,900$$

8.5 Mr X sent 250 units costing ₹ 10,000 each to Mr Y. The goods were to be sold so as to yield a gross profit of 20% on sales. Mr Y sold 150 units @ ₹ 14,200 per unit on credit and 75 units @ ₹ 14,000 for cash. Mr Y entitled to a commission of ₹ 500 per unit sold plus one fourth of

the amount by which the gross sale proceeds less total commission thereon exceeded a sum calculated at the specified selling price. Calculate the commission due to Y.

SOLUTION:

$$\text{Fixed Commission @ ₹ 500} = 225 \times ₹ 500 = ₹ 1,12,500$$

Let the total Commission be X

$$\text{Variable Commission} = 1/4 [(\text{₹ } 31,80,000 - X) - (225 \times ₹ 12,500)]$$

$$X - ₹ 1,12,500 = 1/4 [\text{₹ } 31,80,000 - X - ₹ 28,12,500]$$

$$X - ₹ 1,12,500 = 1/4 (\text{₹ } 3,67,500 - X)$$

$$X - ₹ 1,12,500 = 91,875 - 1/4 X$$

$$X - ₹ 1,12,500 = 91,875 - 25 X$$

$$1.25 X = 2,04,375 \quad X = ₹ 2,04,375 / 1.25 = ₹ 1,63,500$$

- 8.6** Two thousands kg of apples are consigned to a wholesaler, the cost being ₹ 3 per kg plus ₹ 800 of freight, it is known that a loss of 15% is unavoidable. Calculate the cost per kg.

SOLUTION:

$$\begin{aligned} \text{Cost per kg} &= [(2000 \text{ kg} \times ₹ 3) + ₹ 800] / (2000 \text{ kg} - 300 \text{ kg}) \\ &= ₹ 4 \end{aligned}$$

- 8.7** X sent out 1000 units to Y at an invoice price of ₹ 125 each calculated at a profit of 25% profit on cost. X incurred ₹ 20,000. 1/5th of the goods were lost in transit. Y incurred ₹ 4,000 towards transportation upto godown and ₹ 5,000 as godown rent. 3/5th of goods received were sold by Y. 1/5th of balance goods were destroyed in consignee's godown due to fire. Calculate the cost of abnormal loss in transit and godown.

SOLUTION:

$$\begin{aligned} \text{Cost of abnormal loss in transit} &= [(1000 \times ₹ 100) + ₹ 20,000] \times 200/1000 \text{ kg} \\ &= ₹ 24,000 \end{aligned}$$

$$\begin{aligned} \text{Cost of abnormal loss in godown} &= [(64 \times ₹ 100) + (₹ 20,000 \times 64/1000) \\ &\quad + (₹ 4,000 \times 64/800)] \\ &= ₹ 8,000 \end{aligned}$$

- 8.8** X sent out 1000 units to Y at an invoice price of ₹ 125 each calculated at a profit of 25% profit on cost. X incurred ₹ 20,000. 1/5th of the goods were lost in transit. Y incurred ₹ 4,000 towards transportation upto godown and ₹ 5,000 as godown rent. 3/5th of goods received were sold by Y. 1/5th of balance goods were destroyed in consignee's godown due to fire. Calculate the amount of stock reserve.

SOLUTION:

$$320 \times ₹ 25 = ₹ 8,000$$

- 8.9** X sent out goods at invoice value of ₹ 2,50,000 to Y at 25% profit on cost price. Consignor's exp. ₹ 25,000, Consignee's Expenses-Non recurring ₹ 17,500, Selling expenses ₹ 2,500. 1/10th of the goods were lost in transit. 9/10th of the balance goods were sold. Calculate the cost of consignment stock.

SOLUTION:

$$₹ 18,000 + (₹ 25,000 \times ₹ 18,000/₹ 2,00,000) + (₹ 17,500 \times ₹ 18,000/₹ 1,80,000) = ₹ 22,000$$

- 8.10** X sent out goods at invoice value of ₹ 2,50,000 to Y at 25% profit on cost price. Consignor's exp. ₹ 25,000, Consignee's Expenses–Non-recurring ₹ 17,500, selling expenses ₹ 2,500. 1/10th of the goods were lost in transit. 9/10th of the balance goods were sold. Calculate the amount of stock reserve on consignment stock.

SOLUTION:

$$₹ 18,000 \times 25\% = ₹ 4,500$$

- 8.11** Goods sent by X to Y—10,000 Units @ ₹ 20 per unit, X's Forwarding and Insurance Expenses—₹ 50,000, 2% of Goods sent were lost in transit(Insurance Co. paid 80% of loss). Expenses incurred by Y: Unloading charges ₹ 4,900, clearing custom and octroi charges ₹ 3,900, Carriage Inward ₹ 1,000, Storage & other expenses ₹ 11,850. 50% Goods received were sold by Y so as to yield a gross profit of 25% on cost to consignee. 50% the balance goods were taken over by Y at an average cost. X drew a bill on Y for an amount equivalent to 80% of original cost of goods. X got it discounted at ₹ 1,50,000. Y's Commission:10%.Calculate the amount of Profit on Consignment.

SOLUTION:

Note: Selling price = $(₹ 2,54,800/9800) + 25\% \text{ of } ₹ 26] = ₹ 32.50$

CALCULATION OF UNSOLD STOCK

<i>Particulars</i>	<i>Units</i>	<i>₹</i>
A. Cost of Goods Sent	10,000	2,00,000
B. X's Expenses	—	50,000
C. Total Cost of Goods Sent (A + B)	10,000	2,50,000
D. Less: Cost of Goods fully damaged-in-transit	200	5,000
E. Cost of goods reached the city of Y (C – D)	9,800	2,45,000
F. Add: Y's Non-Recurring expenses	—	9,800
G. Cost of Goods received by Y [E + F]	9,800	2,54,800
H. Cost of Unsold Stock in hand [₹ 2,54,800 × 2450/9,800]	2,450	63,700
I. Cost of Stock taken over by Y [₹ 2,54,800 × 2450/9,800]	2,450	63,700

<i>Particulars</i>	<i>₹</i>
Sales(4,900 × ₹ 32.50)	1,59,250
Closing Stock	63,700
Cost of Stock taken over by Y	63,700
Cost of Goods fully damaged-in-transit	5,000
	2,91,650
Less:	
Cost of Goods Sent	200000
X's Expenses	50,000
Y's Expenses	21,650
Y's Commission [₹1,59,250 × 10/100]	15,925
	2,87,575
Profit on Consignment	4,075

- 8.12** X invoiced goods to Y at 25% profit on cost. 40% of goods were lost in transit. 60% of goods received were sold by consignee at 25% above the invoice price. Rate of commission is 10% on sales at invoice price plus 50% of the surplus over invoice price. The amount of commission earned by consignee is ₹ 8,100. Calculate the cost of goods sent on consignment,

SOLUTION:

Let Invoice price of Goods Sold = X

Total Commission = (10% of X) + (50% of 0.25X) = ₹ 8,100

8,100 = X + 125X

X = ₹ 8,100/0.225 = ₹ 36,000

Cost of Goods Sold = ₹ 36,000/125% = ₹ 28,800

Cost of Goods received = ₹ 28,800/60% = ₹ 48,000

Cost of Goods Sent = ₹ 48,000/60% = ₹ 80,000

9.0 JOINT VENTURE

- 9.1** A and B enter into a joint venture sharing profit and losses in the ratio 3:2. A purchased goods costing ₹ 2,00,000. B sold 95% goods for ₹ 2,50,000. B incurred General Expenses (including insurance) ₹ 1,000. A is entitled to get 1% commission on purchase and B is entitled to get 5% commission on sales. A drew a bill on B for an amount equivalent to 80% of original cost of goods. A got it discounted at ₹ 1,52,000. 60% of the balance goods destroyed by fire against which Insurance Co. paid 5,000 and the rest of the goods were taken over by B at cost. Calculate B's share of profit.

SOLUTION:

Particulars	₹
Sales	2,50,000
Insurance Co. claim	5,000
B [40% of (5% of ₹ 2,00,000)]	4,000
	2,59,000
Less:	
Purchases	2,00,000
A's Commission [₹ 2,00,000 × 1/100]	2,000
B's Commission [₹ 2,50,000 × 5/100]	12,500
General Expenses (including insurance)	1,000
Discount Charges [₹ 2,00,000 - ₹ 1,52,000]	8,000
	2,23,500
Net Profit	35,500
B's Share of Profit (35,500 × 2/5)	14,200

- 9.2** X and Y enter into a joint venture sharing profit and losses in the ratio 3:2:1. Good sent by X to Y—10,000 Units @ ₹ 20 per unit, X's Forwarding and Insurance Expenses—₹ 50,000, 2% of goods sent were lost in transit(Insurance Co. paid 80% of loss). Expenses incurred by Y:Unloading charges ₹ 4,900, clearing custom and octroi charges ₹ 3,900, Carriage Inward ₹ 1,000, Storage & other expenses ₹ 11,850. 50% Goods received were sold by Y so as to yield a gross profit of 25% on cost to Y. 50% the balance goods were taken over by Y at an average

cost. X drew a bill on Y for an amount equivalent to 80% of original cost of goods. X got it discounted at ₹ 1,50,000. Calculate the amount of Profit on Joint Venture.

SOLUTION:

Note: Selling price = (₹ 2,54,800/9800) + 25% of ₹ 26] = ₹ 32.50

CALCULATION OF UNSOLD STOCK ETC.

<i>Particulars</i>	<i>Units</i>	<i>₹</i>
A. Cost of Goods Sent	10,000	2,00,000
B. X's Expenses	–	50,000
C. Total Cost of Goods Sent (A + B)	10,000	2,50,000
D. Less: Cost of Goods fully damaged-in-transit	200	5,000
E. Cost of goods reached the city of Y (C – D)	9,800	2,45,000
F. Add: Y's non-recurring expenses	–	9,800
G. Cost of Goods received by Y [E + F]	9,800	2,54,800
H. Cost of Unsold Stock in hand [₹ 2,54,800 × 2450/9,800]	2,450	63,700
I. Cost of Stock taken over by Y [₹ 2,54,800 × 2450/9,800]	2,450	63,700

CALCULATION OF PROFIT ON JOINT VENTURE

<i>Particulars</i>	<i>₹</i>
Sales (4,900 × ₹ 32.50)	1,59,250
Closing Stock	63,700
Cost of Stock taken over by Y	63,700
Insurance Claim (5,000 × 80%)	4,000
	2,90,650
Less:	
Cost of Goods Sent	200000
X's Expenses	50,000
Y's Expenses	21,650
Discount Charges	10000
	2,81,650
Profit on Joint Venture	9,000

10.0 ROYALTY

10.1 Tulsian Ltd. leased a mine for 20 years to Jalan Ltd. for a minimum rent of ₹ 94,000 for the first year with an annual increase of ₹ 2,000 till it reaches ₹ 1,00,000 merging into a royalty @ ₹ 100 per unit produced. Sales and closing stocks were an under.

Year	2014	2015	2016	2017	2018
Sales	400	800	1,200	1,100	450
Closing Stock	100	200	140	300	50

In the event of strike, the minimum rent would be taken pro-rata on the basis of actual numbers of working days but in the event of lockout, the lessee would be enjoy a concession in respect of minimum rent for 50% of the period of lockout. There was strike for 73 days and lockout for 4 months during the year 2018.

Recoupment of Short Working of each year is allowed during the next 5 years following the year in which the Short Working arose.

Required: Prepare the ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS.

SOLUTION:

ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS

A Year	B Output (Units) Qty.	C = B × Rate Actual Royalty ₹	D Minimum Rent ₹	E = D – C Short Working ₹	F Short Working Recouped ₹	G = C + E – F Actual Payment ₹	H Short Working W/O ₹	I _n = I _{n-1} + E – F – H Short Working C/F ₹
2014	500	50,000	94,000	44,000	—	94,000	—	44,000
2015	900	90,000	96,000	6,000	—	96,000	—	50,000
2016	1,140	1,14,000	98,000	—	5,000	1,09,000	—	45,000
2017	1,260	1,26,000	1,00,000	—	5,000	1,21,000	34,000	6,000
2018	200	20,000	63,333	43,333	—	63,333	6,000	43,333

10.2 Tulsian Ltd provides you the following information:

Short Working B/F [₹ 6,000 for 2015, ₹ 10,000 for 2016]

Royalty @ ₹ 100 per unit produced subject to Minimum Rent of ₹ 1,00,000.

Sales of 2018: 950 units and Closing Stock: for 2017 300 units, for 2018 50 units

In the event of strike, the minimum rent would be taken pro-rata on the basis of actual numbers of working days but in the event of lockout, the lessee would be enjoy a concession in respect of minimum rent of 50% of the period of lockout. There was strike for 73 days and lockout for 4 months during the year 2018. Recoupment of short working of each year is allowed during the next 3 years subject to maximum of ₹ 5,000 p.a. Calculate the Actual Payment and Short Working C/F.

SOLUTION:

$$\begin{aligned}\text{Minimum Rent for 2018} &= 1,00,000 - [(1,00,000 \times 73/365) + (1,00,000 \times 2/12)] \\ &= 63,333\end{aligned}$$

ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS

A Year	B Output (Units)	C = B × Rate Actual Royalty	D Minimum Rent	E = D – C Short Working	F Short Working Recouped	G = C + E – F Actual Payment	H Short Working W/O	I _n = I _{n-1} + E – F – H Short Working C/F
2018	700	70,000	63,333	—	5,000	65,000	1,000	10,000

11.0 AVERAGE DUE DATE

11.1 On 31st Dec. 2017. Mr. X drew a Bill after date of ₹ 1,00,000 for 2 months upon Mr Y who accepted the same on 5th Jan. 2015. Calculate the date of maturity of bill.

SOLUTION:

3rd March 2018, i.e., 28th Feb + 3 days of grace

11.2 On 1st April, 2018, Mr. A advanced ₹ 30,000 to Mr. B on 1st April. The amount is repayable in 6 equal monthly instalments commencing from 1st May. Compute the average due date for the loan.

SOLUTION:

$$\text{Average Due Date} = \frac{\text{Date of loan} + \text{Sum of months from the date of lending to repayment}}{\text{No. of instalments}}$$

$$= 1.4.2018 + 3.5 \text{ months} = 16\text{th July 2018}$$

11.3 Average Due Date 6th May, Amount Due ₹ 20,000, Calculate the interest @ 15% p.a. payable on 30th June:

SOLUTION:

No. of Days from 6th May to 30th June = 55

$$\text{Interest} = ₹ 20,000 \times 15/100 \times 55/365 = ₹ 452.05$$

12.0 ACCOUNT CURRENT

12.1 Mr. X owed ₹ 4,000 on 1st Jan 2018 to Mr. Y. On 13th March, Mr. X accepted a Bill of ₹ 2,000 drawn by Mr. X for 1 month. Interest is to be calculated @ 10% p.a. Ascertain the amount to be paid if they agree to settle by one single payment on 15th March 2018.

SOLUTION:

MR. X IN ACCOUNT CURRENT WITH MR. Y

Dr.

(INTEREST UPTO 15TH MARCH, 2018 @ 10% P.A.)

Cr.

Date	Particulars	₹	Days	Product	Date	Particulars	₹	Days	Product
2018					2018				
Jan. 01	To Balance b/d	4,000	74	2,96,000	Mar. 13	By B/R A/c	2,000	(32)	(64,000)
Mar. 15	To Interest A/c [360000 × 10% × 1/365]		99		Mar. 15	By Balance of Product (amount to be paid)			3,60,000
		4,099		2,96,000			4,099		2,96,000

13.0 FINANCIAL STATEMENTS

13.1 Following are the extracts from the Trial Balance of Mr. Bharat Tulsian as at 31st March, 2018:

Particulars	₹	Particulars	₹
Purchases	5,70,000	Sales	7,40,000
Trade Debtors	2,68,000	Capital (Opening Balance)	6,21,400

Additional Information:

- Closing stock was not taken on 31st March but only on 7th April. Following transactions had taken place during the period from 1st April to 7th April. Sales ₹ 2,50,000, Purchases 1,50,000, Stock on 7th April, was ₹ 1,80,000 and the rate of gross profit on sales after was 20%. Market Value on 31st March 80%, Estimated Realisable Expenses 5%
- On 31st March, Goods for ₹ 50,000 were sent to a customer on 'Sale or Return' basis at a profit of 25% on cost and recorded as actual sales.

3. Goods costing ₹ 20,000 (Sale Price ₹ 25,000) were taken by the proprietor for his personal use but not recorded .
4. Goods costing ₹ 30,000 (Sale Price ₹ 37,500) were distributed as free samples but not recorded.
5. On 31st March Goods costing ₹ 10,000 (Sale Price ₹ 12,500) were destroyed by fire it was fully insured but the insurance company admitted the claim to the extent of 60% only and paid the claim money on 10th April, 2018.

Required: Show how these items will appear in the Financial Statements for the year ended 31st March, 2018

SOLUTION:

AN EXTRACT OF TRADING AND PROFIT & LOSS ACCOUNT

Dr.

for the year ending on 31st March, 2018

Cr.

Particulars	₹	Particulars	₹
To Purchases 5,70,000		By Sales 7,40,000	
Less: Goods for personal use 20,000		Less: Goods sent on approval 50,000	6,90,000
Less: Free Samples 30,000			
Less: Goods destroyed by fire 10,000	5,10,000	By Closing Stock [Refer to WN]	2,05,200
To Sales Promotion Exp (Samples)	30,000		
To Loss of Stock by fire	4,000		

AN EXTRACT OF BALANCE SHEET AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Capital Account:		Closing Stock [Refer to WN 1]	2,05,200
Opening balance 6,21,400		Trade Debtors 2,68,000	
Less: Goods for personal use (20,000)	6,01,400	Less: Good sent on approval basis 50,000	2,18,000
		Insurance Company (claim)	6,000

Working Note: Calculation of Closing Stock

A.	Stock as on 7th April	₹ 1,80,000
B.	Add: Cost of Goods sold (80% of ₹ 2,50,000)	₹ 2,00,000
C.	Less: Cost of Purchases	₹ 1,50,000
D.	Stock as on 31st March	₹ 2,30,000
E.	Add: Cost of Stock with customer [₹ 50,000 × 80%]	₹ 40,000
F.	Total Stock as on 31st March	₹ 2,70,000
G.	Market Value [₹ 2,70,000 × 80%]	₹ 2,16,000
H.	Realisable Expenses [₹ 2,16,000 × 5%]	₹ 10,800
I.	Net Realisable Value	₹ 2,05,200

13.2 Following are the extracts from the Trial Balance of Mr. Bharat Tulsian as at 31st March, 2018:

Particulars	₹	Particulars	₹
Salaries and Wages	11,200	Sales	7,40,000
Trade Debtors	2,68,000	Provision for Doubtful Debts [1.4.2017]	10,000

Bad Debts [after recovery of bad debts of ₹ 2,500 w/o during 2016-2017]	500	Provision for Discount on Debtors [1.4.2017]	1,800
Discount Allowed	2,000	Trade Creditors	10,000

Additional Information:

1. Closing stock was not taken on 31st March but only on 7th April. Following transactions had taken place during the period from 1st April to 7th April. Sales ₹ 2,50,000, Purchases 1,50,000, Stock on 7th April, was ₹ 1,80,000 and the rate of gross profit on sales after was 20% .Market Value on 31st March 80%, Estimated Realisable Expenses 5%
2. On 31st March, Goods for ₹ 50,000 were sent to a customer on 'Sale or Return' basis at a profit of 25% on cost and recorded as actual sales.
3. Write off further ₹ 4,000 as bad. Additional discount of ₹ 1,000 given to debtors. Maintain Provision for discount on Debtors@ 2%. Maintain a Provision for Doubtful debts @ 10%. Debtors also include Shyam for dishonoured bill of ₹ 10,000. Half the amount of Shyam's bills is irrecoverable. Remuneration of ₹ 2,000 paid to Sh. B. Barua, a temporary employee, stands debited to his personal account. Included amongst the Debtors is ₹ 3,000 due from Z and included among the Creditors ₹ 1,000 due to him.

Required: Show how these items will appear in the Financial Statements for the year ended 31st March, 2018

SOLUTION:**AN EXTRACT OF TRADING AND PROFIT & LOSS ACCOUNT***Dr.**for the year ending on 31st March, 2018**Cr.*

<i>Particulars</i>		₹	<i>Particulars</i>	₹
			By Sales 7,40,000	
			Less: Goods sent on approval 50,000	6,90,000
			By Closing Stock [Refer to WN 1]	2,05,200
To Salaries & Wages 11,200			By Bad Debt recovered	2,500
Add: Salary to Barua 2,000		13,200		
To Bad Debts [2,500 + 500] 3,000				
Add: Further Bad Debts				
[4,000 + 5,000 (Shyam)] 9,000				
Add: New Provision 20,000				
Less: Old Provision 10,000		22,000		
To Discount Allowed 2,000				
Add: Further Discount Allowed 1,000				
Add: New Provision 3,600				
Less: Old Provision 1,800		4,800		

AN EXTRACT OF BALANCE SHEET OF BHARAT TULSIAN AS AT 31ST MARCH, 2018

<i>Liabilities</i>		₹	<i>Assets</i>	₹
Trade Creditors 10,000			Closing Stock [Refer to WN 1]	2,05,200
Less: Due to Z (1,000)		9,000	Trade Debtors 2,68,000	
			Less: Due to Z 1,000	

		Less: Good sent on approval basis	
		50,000	
		Less: Further Bad debts	9,000
		[₹ 4,000 + ₹ 5,000 (Shyam)]	
		Less: Further Discount Allowed	1,000
		Less: Salary to Mr B. Barua	2,000
			2,05,000
		Less: Provision for doubtful debts	
		10% (on ₹ 2,05,000 – ₹ 5,000)	20,000
			1,85,000
		Less: Provision for discount	3,600
		@ 2% (on ₹ 1,85,000 – ₹ 5,000)	1,81,400

Working Note: Calculation of Closing Stock

A.	Stock as on 7th April	₹ 1,80,000
B.	Add: Cost of Goods sold (80% of ₹ 2,50,000)	₹ 2,00,000
C.	Less: Cost of Purchases	₹ 1,50,000
D.	Stock as on 31st March	₹ 2,30,000
E.	Add: Cost of Stock with customer [₹ 50,000 × 80%]	₹ 40,000
F.	Total Stock as on 31st March	₹ 2,70,000
G.	Market Value [₹ 2,70,000 × 80%]	₹ 2,16,000
H.	Realisable Expenses [₹ 2,16,000 × 5%]	₹ 10,800
I.	Net Realisable Value	₹ 2,05,200

13.3 Following are the extracts from the Trial Balance of Mr. Bharat Tulsian as at 31st March, 2018:

Particulars	₹	Particulars	₹
Purchases	5,70,000	Sales	7,40,000
Wages and Salaries	23,500	Capital	6,21,400
Freight Inward	25,000	Outstanding Liabilities for Expenses (Dr.)	55,000
12% Investments	1,00,000	Salesmen's Commission	20,000
Building	60,000	Income Tax paid	10,000
Plant and Machinery	2,02,000	Interest on Investments	6,000
Furniture and Fixtures	30,000	Prepaid Fire Insurance Premium	3,000
Fire Insurance Premium	9,000		

Additional Information:

- Wages include a sum of ₹ 4,000 spent on the erection of a cycle shed for employees and customers.
- A Machine costing ₹ 1,90,000 was purchased on 1st July 2017. Wages ₹10,000 paid for its Installation have been debited to Wages Account.
- Machinery costing ₹ 45,000 purchased on 1.10.2017 was shown as Purchases. Freight paid on the Machinery was ₹ 5,000, which is included in Freight on Purchases.

4. Machinery costing ₹ 35,000 purchased on 1st April 2015 was wrongly written off against Profit and Loss Account.
5. On 1.4.2017 Machinery of the value of ₹ 10,000 was destroyed by fire and the insurance claim settled at ₹ 8,000 was credited to Machinery Account.
6. A Furniture costing ₹ 45,000 was purchased on 1st July 2017 but it was not recorded in the books as no payment was made of it. Wages ₹ 5,000 paid for its Installation have been debited to Wages Account.
7. Provide for depreciation on Plant & Machinery @ 10% p.a. on straight line basis. Write 10% off the Furniture & Fixtures. Depreciate Buildings by 5%.
8. On 1st Jan. 2018 Investments were sold at 10% profit, but the entire sales proceeds have been taken as Sales.
9. The Salesmen were entitled to a Commission of 5% on total sales.
10. Printing and Stationery expenses of ₹ 55,000 relating to previous year had not been provided in that year but was paid in current year by debiting Outstanding Liabilities for Expenses.

Required: Show how these items will appear in the Financial Statements for the year ended 31st March, 2018

SOLUTION:**AN EXTRACT OF TRADING ACCOUNT**

Dr. *for the year ending on 31st March, 2018* *Cr.*

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Purchases 5,70,000		By Sales 7,40,000	
Less: Purchase of Machine 45,000	5,25,000	Less: Sale of Investments 1,10,000	6,30,000
To Wages & Salaries 23,500			
Less: Erection of a Cycle shed 4,000			
Less: Installation of Machine 10,000			
Less: Installation of Furnitures 5,000	4,500		
To Freight Inward 25,000			
Less: Freight on Machine 5,000	20,000		

AN EXTRACT OF PROFIT & LOSS ACCOUNT

Dr. *for the year ending on 31st March, 2018* *Cr.*

<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Salaries & Wages 11,200		By Profit on Sale of Investments	10,000
Add: Salary to Barua 2,000	13,200		
To Fire Insurance Premium 9,000		By Interest on Investments	
To Loss of Machine by fire 2,000		Received 6,000	
		Add: Accrued 3,000	9,000
To Depreciation on Machinery 22,000			
[Refer WN 3]			
To Depreciation on Furniture 8,000			
[₹ 80,000 × 10/100 × 12/12]			
To Depreciation on Buildings 3,200			
[₹ 64,000 × 5/100 × 12/12]			
To Salesman's Commission 20,000			
Add: O/s 11,500	31,500		

AN EXTRACT OF BALANCE SHEET OF BHARAT TULSIAN AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Capital Account:		Fixed Assets:	
Opening balance	6,21,400	Plant and Machinery [Refer WN 4]	2,66,000
Less: Income Tax	(10,000)	Furniture & Fixtures (OB)	30,000
Less: O/s Liabilities for Exp	(55,000)	Add: Purchased	45,000
Add: Prior Period Item	28,000	Add: Installation charges	5,000
Current Liabilities:		Less: Depreciation	8,000
O/s Salesmen's Commission	11,500	Building (OB)	60,000
Supplier of Furniture	45,000	Add: Erection of a cycle shed	4,000
		Less: Depreciation	3,200
		Accrued Interest on Investments	3,000
		Prepaid Fire Insurance Premium	3,000

Working Notes:

- Book Value of Machinery on 1.4.2017 = ₹ 2,02,000 - ₹ 1,90,000 + ₹ 8,000(Claim) = ₹ 20,000
- Book Value of Machinery wrongly charged to P & L A/c
 = Original Cost – Depreciation for 2 years
 = ₹ 35,000 – (₹ 35,000 × 10% × 2) = ₹ 28,000
- Calculation of Depreciation

Old Machine I	01.04.2017	$10,000 \times 10\% \times 12/12$	1,000
Old Machine II	01.04.2017	$35,000 \times 10\% \times 12/12$	3,500
New Machine I	01.07.2017	$2,00,000 \times 10\% \times 9/12$	15,000
New Machine II	01.10.2017	$50,000 \times 10\% \times 6/12$	2,500
		Total Depreciation	22,000

4. Dr

MACHINERY ACCOUNT

Cr

<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
01.04.2017	To Balance b/d [Refer WN 1]	20,000	01.04.2017	By Bank A/c	8,000
01.04.2017	To P & L A/c (error) [Refer WN 2]	28,000	01.04.2017	By P & L A/c (Loss)	2,000
01.07.2017	To Bank A/c	1,90,000	31.03.2018	By Depreciation A/c	22,000
01.07.2017	To Wages A/c	10,000		[Refer WN 3]	
01.10.2017	To Purchases A/c	45,000		By Balance c/d	2,66,000
01.10.2017	To Freight A/c	5,000			
		2,98,000			2,98,000

- Depreciation on furniture has been charged for the full year because a flat rate of 10% (and not 10% p.a.) has been given, whereas depreciation on machinery has been charged for 9 months from 1st July to 31st Mar. No provision for discount on Debtors is required on Shyam's balance.

14.0 PARTNERSHIP: FUNDAMENTALS

- 14.1** X, Y and Z entered into a partnership on 1st Oct. 2017 to share the profits and losses in the ratio of 5: 3: 2. The total capital was fixed at ₹ 18,00,000 to be contributed by X, Y and Z in the ratio of 4: 3: 2. X granted a loan of ₹ 1,00,000 on 1st Jan. 2018. The partnership deed provided for Interest on Capital @ 10% p.a. Interest on Drawings @ 12% p.a. salary to Y @ ₹ 6,000 p.m. and salary to Z @ ₹ 6,000 per quarter. Y's Drawings during the period ended 31st March, 2018 were ₹ 50,000. The profits of the firm for the period ended 31st March, 2018 before providing for any Interest and Salary were ₹ 2,16,000. Prepare Profit & Loss Appropriation Account.

SOLUTION:

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT Cr.
for the year ended 31st March, 2018

Particulars	₹	Particulars	₹
To Interest on Capital:		By Net Profit as per P & L A/c	
X's Current A/c	40,000	Profit before Interest	2,16,000
Y's Current A/c	30,000	Less: Interest on Loan	1,500
Z's Current A/c	20,000		2,14,500
		(₹1,00,000 × 6/100 × 3/12)	
To Salary:		By Interest on Drawings:	
Y's Current A/c [₹ 6,000 × 6]	36,000	Y's Current A/c	1,500
Z's Current A/c [₹ 6,000 × 2]	12,000	(₹50,000 × 12/100 × 3/12)	
To Profit t/f to:			
X's Current A/c	39,000		
Y's Current A/c	23,400		
Z's Current A/c	15,600		
	2,16,000		2,16,000

- 14.2** A, B and C entered into a partnership on 1st Oct., 2017 to share profits and losses in the ratio of 3: 2: 1. A, however, personally guaranteed that C's share of profit after charging interest on capitals @ 5% p.a would not be less than ₹ 30,000 p.a. The capital contributions were A-₹ 3,00,000; B-₹ 2,00,000 and C-₹ 1,00,000. The profits for the period ended 31st March, 2018 were ₹ 1,20,000. Calculate Deficiency to be charged to A.

SOLUTION:

Profit after charging interest on capitals = ₹ 1,20,000 – (₹ 6,00,000 × 5/100 × 6/12) = ₹ 1,05,000

C's Actual Share = ₹ 1,05,000 × 1/6 = ₹ 17,500

Guaranteed Amount for half year = ₹ 30,000 × 6/12 = ₹ 15,000.

Since Actual Share (₹ 17,500) exceeds the Guaranteed Amount, no Deficiency is to be charged to A.

- 14.3** X, Y and Z entered into partnership on 1st Oct., 2017 to share profits and losses in the ratio of 5: 3: 2. They contributed ₹ 8,00,000, ₹ 6,00,000 and ₹ 4,00,000 respectively as their capitals. Partners are entitled to interest on capital @ 10% per annum and salary to Y @ ₹ 6,000 per month and commission of ₹ 12,000 to Z respectively as per the provisions of the partnership deed. X's share of profit (excluding interest on capital but including salary) is guaranteed at a not less than of ₹ 50,000 p.a. Y's share of profit, including interest on capital but excluding salary, is guaranteed at not less than ₹ 1,10,000 p.a. Any deficiency arising on that account shall be met by Z. The profits of the firm for the year ended 31st March, 2018 amounted to ₹ 2,16,000. Prepare Profit & Loss Appropriation Account for the year ended on 31st March, 2018.

- 14.5** X and Y are partners. They are entitled for 9% interest on their capital contributions. The firm allowed ₹ 54,000 towards interest on capital to partners. Calculate the capital contribution of each partner if interest on X's capital is ₹ 13,500 more than the interest on Y's capital.

SOLUTION:

Let interest on Y's capital 'x' then interest on X's capital will be $x + 13500$

$$\text{Total interest} = x + 13500 + x = 54000$$

or

$$x = (54,000 - 13,500)/2 = 20,250$$

Interest on X's capital ($x + 13500$) = $20250 + 13500 = ₹ 33750$ and her capital

$$= 33750/9\% = ₹ 3,75,000$$

Interest on Y's capital (x) = ₹ 20250 and his capital = $20250/9\% = ₹ 2,25,000$

15.0 PARTNERSHIP: CHANGE IN PROFIT SHARING RATIO

15.1 X, Y and Z who are presently sharing profits & losses in the ratio of 5:3:2, decide to share future profits & losses equally. The goodwill of the firm has been valued at ₹ 1,80,000. Goodwill already appearing in the books is at ₹ 30,000. Show the necessary accounting treatment.

SOLUTION:**JOURNAL**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	X's Capital A/c [₹ 30,000 × 5/10] Dr.		15,000	
	Y's Capital A/c [₹ 30,000 × 3/10] Dr.		9,000	
	Z's Capital A/c [₹ 30,000 × 2/10] Dr.		6,000	
	To Goodwill A/c (Being the existing goodwill w/o in old ratio on change in profit sharing ratio.)			30,000
	Y's Capital A/c [₹ 1,80,000 × 1/30] Dr.		6,000	
	Z's Capital A/c [₹ 1,80,000 × 4/30] Dr.		24,000	
	To X's Capital A/c [₹ 1,80,000 × 5/30] (Being the adjustment made for goodwill on change in the profit sharing ratio)			30,000

Working Note:**CALCULATION OF GAIN/LOSS**

	X	Y	Z
New Shares	1/3	1/3	1/3
Old Shares	5/10	3/10	2/10
Difference	-5/30	1/30	4/30
	Sacrificing partner	Gaining partner	Gaining partner

16.0 PARTNERSHIP: ADMISSION OF A PARTNER

16.1 X and Y share profits & losses in the ratio of 5: 3. Z is admitted for 3/10th share of profits half of which was gifted by X and the remaining share was taken by Z equally from X and Y. The goodwill of the firm is valued at ₹ 21,600. Z brings in his requisite share of firm's goodwill. The profit for the first year of new partnership amounts to ₹ 24,000. Pass the necessary journal entries to adjust goodwill and to distribute profits.

SOLUTION**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Cash A/c [₹ 21,600 × 3/20] Dr. To Z's Capital A/c (Being the amount of goodwill brought in by Z for purchased share of profit i.e. 3/20)		3,240	3,240
	Z's Capital A/c Dr. To X's Capital A/c [₹ 3,240 × 1/2] To Y's Capital A/c [₹ 3,240 × 1/2] (Being the goodwill credited to sacrificing partners in their sacrificing ratio of 1:1)		3,240	1,620 1,620
	Profit and Loss A/c Dr. To X's Capital A/c [₹ 24,000 × 4/10] To Y's Capital A/c [₹ 24,000 × 3/10] To Z's Capital A/c [₹ 24,000 × 3/10] (Being the profit credited to all partners in their new profit sharing ratio of 4: 3: 3)		24,000	9,600 7,200 7,200

Working Note:**CALCULATION OF NEW PROFIT SHARING RATIO.**

<i>Particulars</i>	<i>X</i>	<i>Y</i>
A Their old shares	5/8	3/8
B Share gifted by X	1/2 of 3/10 = 3/20	—
C Share acquired by Z	1/2 of 3/20 = 3/40	1/2 of 3/20 = 3/40
D Their new shares [A – B – C]	16/40	12/40
E New Ratio of X, Y & Z = 16/40: 12/40: 12/40 = 16: 12: 12 = 4: 3: 3.		

16.2 X and Y are partners in a firm sharing profits in the ratio of 3:2. They admitted Z as a new partner and fixed the new profit sharing ratio as 3:3:2. At the time of admission of Z, Debtors, Provision for Doubtful Debts and General Reserve appeared at ₹ 1,50,000, ₹ 30,000 and ₹ 40,000 respectively. ₹ 15,000 of the debtors proved bad. A provision of 20% is to be created on Sundry Debtors for doubtful debts. A debtor whose dues of ₹ 10,000 were written off as bad debts paid 80% in full settlement. 20% of General Reserve to be transferred to Provision for Doubtful Debts Pass the necessary journal entries.

SOLUTION:**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bad Debts A/c Dr. To Debtors A/c (Being the Bad Debts w/o)		15,000	15,000

	Provision for Doubtful Debts A/c Dr.		15,000	15,000
	To Bad Debts A/c (Being the Bad Debts t/f to Provision for Doubtful Debts A/c)			
	General Reserve [20% of ₹ 40,000] Dr.		8,000	8,000
	To Provision for Doubtful Debts A/c (Being the t/f of 20% of General Reserve)			
	Revaluation A/c Dr.		4,000	4,000
	To Provision for Doubtful Debts A/c [20% (₹ 1,50,000 – ₹ 15,000)] – [(₹ 30,000 + ₹ 8,000 – ₹ 15,000)] (Being the short Provision for Doubtful Debts created so as to maintain 20% Provision)			
	Bank A/c [Bad Debts Recovered] Dr.		8,000	8,000
	To Revaluation A/c (Being Bad Debts Recovered)			
	Revaluation A/c Dr.		4,000	2,400
	To X's Capital A/c			1,600
	To Y's Capital A/c (Being the Profit on Revaluation t/f to partners in their old profit sharing ratio)			

17.0 RETIREMENT/DEATH OF A PARTNER

17.1 In the partnership agreement between A, B and C who were sharing profits & losses in the ratio of 4 : 2 : 2, the goodwill was to be valued on the death of any partner on the basis of such partner's share of 4 years' profits calculated on the average of 5 years profits immediately preceding the year of death *less* 10%. The firm's profits were ₹ 20,000 in 2013, ₹ 60,000 in 2014, ₹ 80,000 in 2015 and, losses of ₹ 10,000 in 2016 and ₹ 4,000 in 2017. The deceased partner's share of profits for the period of his life-time in the year of death was to be based on the average of profits of the previous 3 years *plus* 10%. Investments (market value ₹ 10,000) were appearing in the books at ₹ 8,000.

A died on 31st May, 2018. His Capital Account showed a credit of ₹ 20,000 on 1st Jan, 2018 and he had drawn ₹ 6,000 since that date. Interest on Capital is to be allowed and interest on drawings is to be charged @ 12% p.a. . Half of the Investments were sold at market value to pay off A's Executors' in part.

Required: Prepare A's Capital Account and A's Executor's A/c.

SOLUTION:

Dr.

A'S CAPITAL ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Drawings	6,000	By Balance b/d	20,000
To Interest on Drawings (6,000 × 12/100 × 2.5/12)	150	By Interest on Capital (₹ 20,000 × 12/100 × 5/12)	1,000

To A's Executors' A/c	46,672	By P & L Suspense A/c (Share of profit)	5,042
		By B's Capital A/c (Share of goodwill)	13,140
		By C's Capital A/c (Share of goodwill)	13,140
		By Revaluation A/c (Profit)	500
	52,822		52,822

Dr.

A'S EXECUTORS' ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Bank A/c	5,000	By A's Capital A/c	46,672
To Balance c/d	41,672		
	46,672		46,672

Working Notes:**1. Calculation of A's Share of Goodwill**

- A. Average Profit of 5 years = $(₹ 20,000 + ₹ 60,000 + ₹ 80,000 - ₹ 10,000 - ₹ 4,000)/5 = ₹ 29,200$.
- B. 4 years' average profits = $₹ 29,200 \times 4 = ₹ 1,16,800$
- C. A's share of aforesaid profits = $₹ 1,16,800 \times 4/8 = ₹ 58,400$.
- D. Value of firm's goodwill = $₹ 58,400 - 10\% \text{ of } ₹ 58,400 = ₹ 52,560$.
- E. A's share of Goodwill = $₹ 52,560 \times 4/8 = ₹ 26,280$

2. Calculation of A's Share of Profits

- A. Average profits of 3 years = $(₹ 80,000 - ₹ 10,000 - ₹ 4,000)/3 = ₹ 22,000$
- B. Estimated Profits for 2018 = $₹ 22,000 + 10\% \text{ of } ₹ 22,000 = ₹ 24,200$.
- C. Estimated Profits for 5 months = $₹ 24,200 \times 5/12 = ₹ 10,083$
- D. A's Share of Profits = $₹ 10,083 \times 1/2 = ₹ 5,042$

3. A's Share of Profit on Revaluation = $[(₹ 10,000/2) - (₹ 8000/2)] \times 4/8 = ₹ 500$ **18.0 NOT FOR PROFIT ORGANISATIONS**

18.1 How will you show the following items in the Financial Statements Account of a club for the year ended 31st March 2018?

- (a) Rates and Taxes paid ₹ 300, At March 31, 2018, the rates and taxes were prepaid to the following 31st Jan., the yearly charge being ₹ 300.
- (b) Telephone charges paid ₹ 1,500, A quarter's charge for telephone is outstanding, the amount accrued being ₹ 300. The charge for each quarter is same for both 2016-2017 and 2017-2018.

SOLUTION:Dr. **INCOME & EXPENDITURE ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 2018** Cr.

Expenditure		₹	Income	₹
To Rates & Taxes:				
Paid:	300			

Less: Prepaid at end	250			
Add: Prepaid in beg.(b.f.)	250	300		
To Telephone charges:				
Paid:	1,500			
Less: O/s in beginning (b. f)	600			
Add: O/s at end	300	1,200		

BALANCE SHEET AT 31.3.2018

Liabilities	₹	Assets	₹
O/s Telephone Charges	300	Prepaid Rates & Taxes	250

BALANCE SHEET AT 31.3.2017

Liabilities	₹	Assets	₹
O/s Telephone Charges	600	Prepaid Rates & Taxes	250

18.2 How will you deal with the following items in the final accounts of a club for the year ended 31st March 2018?

- Entrance Donation received during 2017-2018 ₹ 1,00,000
- Entrance Donation received pending membership ₹ 1,00,000 as on 1.4.2017
- A sum of ₹ 20,000 received in October 2017 as Entrance Donation from an applicant was to be refunded as he had not fulfilled the requisite membership qualifications. The refund was made on 3.6.2018.
- 50% of entrance denoation was to be capitalized. There was no pending membership as on 31.3.2018.

SOLUTION:

Particulars	₹
A. Entrance fees received in advance as at beg. of the year	1,00,000
B. Add: Entrance fees received during the year	1,00,000
C. Less: Entrance fees refundable in respect of ineligible member	20,000
	1,80,000
D. Less: 50% capitalized and to be added to Capital Fund	90,000
E. 50% Revenue Income and to be credited to Income & Expenditure A/c	90,000

Dr. **INCOME & EXPENDITURE ACCOUNT FOR THE YEAR ENDED 31ST MARCH 2018** Cr.

Expenditure	₹	Income	₹
		By Entrance Donation	90,000

CLOSING BALANCE SHEET AS AT 31.3.2018

Liabilities	₹	Assets	₹
Capital Fund:			
Opening Balance			
+ Entrance Donation	90,000		
Entrance Donation refundable	20,000		

OPENING BALANCE SHEET AS AT 31.3.2017

Liabilities	₹	Assets	₹
Entrance Donation received in advance	1,00,000		

18.3 How will you deal with the following items in the final accounts of a club?

- Donation received for building and Library Room ₹ 2,00,000.
- Donation to the extent of ₹ 25,000 were utilized for the purchase of Library Books, balance was still untillized.
- Depreciation on Books @ 10% p.a. was to be provided for the whole year.

SOLUTION:

Dr. INCOME & EXPENDITURE ACCOUNT Cr.

Expenditure	₹	Income	₹
To Depreciation on Books	2,500		

BALANCE SHEET AS AT...

Liabilities	₹	Assets		₹
Capital Fund:		Library Books	25,000	
Opening Balance	?	Less: Depreciation	(2,500)	22,500
Add: T/f from Library Fund	25,000			
Building & Library Fund:				
Donation received	2,00,000			
Less: Utilized & t/f to Capital Fund	25,000			
	1,75,000			

18.4 Following is the Receipts & Payments Accounts for the year ended 31st March, 2018.

Receipts	₹	Payments	₹
To Balance as per Pass Book	8,230	By Honorarium of Secretary	4,800
To Cash Overspent	20	By Printing & Stationary	470
		By Balance as per Pass Book	3,480

Unpresented cheques being payment on printing on 1.4.2017 ₹ 90, and on 31.3.2018 ₹ 30.

Cash Overspent represents amount of honorarium to the treasurer not drawn due to shortage of fund. But the total salary payable to him for the year was already included in ₹ 4,800.

Required: How will you show the above items in final accounts of a club for the year ended 31st March, 2018?

SOLUTION:

Dr. INCOME & EXPENDITURE ACCOUNT FOR THE YEAR ENDED 31ST MARCH 2018 Cr.

Expenditure	₹	Income	₹
To Honorarium to Secretary	4,800		
To Printing & Stationary			

Paid as per Pass Book	470		
Add: Unpresented			
Ch. at end	30		
Less: Unpresented			
Ch. at beg.	(90)	410	

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Outstanding Liabilities for	20	Bank Balance as per Cash Balance	
Honorarium of Secretary		as per Pass Book	3,480
		Less: Unpresented ch. at end	(30)
			3,450

19.0 SHARE CAPITAL

19.1 X Ltd. was formed with a capital of ₹ 10,00,000 divided into shares of ₹ 10 each. It offered 90% shares. 40% payable on application, 20% payable on allotment and the balance on final call. The applicants paid ₹ 3,60,000 on application and ₹ 1,69,000 on allotment. Final call had not yet been made. Calculate (a) Authorised Capital (b) Issued Capital (c) Subscribed Capital (d) Called-up Capital, (e) Paid-up Capital, (f) Calls in Arrears.

SOLUTION

CALCULATION OF VARIOUS TYPES OF CAPITAL

<i>Particulars</i>	₹
A. Authorised Capital	10,00,000
B. Issued Capital	9,00,000
C. Subscribed Capital	9,00,000
D. Called-up Capital	5,40,000
E. Paid-up Capital	5,29,000
F. Calls in Arrears	11,000

19.2 SKY Ltd.. issued 1,00,000 shares of ₹ 100 each payable as follows:

₹ 20 on application payable on 1st March; ₹ 30 on allotment payable on 1st May, ₹ 20 on first call payable on 1st August and ₹ 30 on second and final call payable on 1st December,. All these shares were subscribed for and amounts duly received. MOON, who had 8,000 shares, paid the amount of both the calls alongwith allotment. SUN, who had 4,000 shares, paid the amount of second and final call with the first Call. Calculate the amount of interest on Calls-in-Advance payable to MOON and SUN. The company adopts **Table F**.

SOLUTION:

(i) Interest on Calls-in-advance payable to MOON

On First Call = $(8,000 \times 20 \times 12/100 \times 3/12)$ = ₹ 4,800
On Second & Final Call = $(8,000 \times 30 \times 12/100 \times 7/12)$ = ₹ 16,800
= ₹ 21,600

(ii) Interest on Calls-in-advance payable to SUN

On Second & Final Call = $(4,000 \times 30 \times 12/100 \times 4/12)$ = ₹ 4,800

19.3 DN Ltd. Issued 50,000 shares of ₹ 10 each at a premium of 10% payable as ₹ 2 per share on application, ₹ 3 (including premium) On allotment and ₹ 2.50 each on first and final call. Applications were received for 70,000 shares. It was decided:

- (a) to refuse allotment to the applicants for 10,000 shares,
- (b) to allot 20,000 shares to Mohan who has applied for similar number and
- (c) to allot the remaining shares on prorata basis.

Mohan failed to pay the allotment money and Sohan who belonged to Category 'c' and was allotted 3,000 shares paid both the calls with allotment. Calculate the amount received on allotment.

SOLUTION:

CALCULATION OF ALLOTMENT MONEY RECEIVED LATER ON

A.	Total allotment money due (50,000 × ₹ 3)	1,50,000
B.	Less: Allotment Money Already received on application stage [(40,000 – 30,000) × ₹ 2]	(20,000)
C.	Less: Allotment Money not received (20,000 × ₹ 3)	(60,000)
D.	Allotment Money received	70,000
E.	Add: Calls in Advance received (3,000 × ₹ 5)	15,000
		85,000

19.4 Y Ltd. forfeited 40 shares of ₹ 10 each issued at a premium of 40% to Mr. Ramesh who had applied for 48 shares. After having paid ₹ 6 (including ₹ 2 premium), he did not pay allotment money of ₹ 2 (including ₹ 1 premium) and on his subsequent failure to pay the first call of ₹ 3 (including ₹ 1 premium) his shares were forfeited. Calculate the amount to be credited to Forfeited Shares Account.

SOLUTION:

A.	Application Money received on shares applied (48 × 6)	₹ 288
B.	Less: Application Money due on shares allotted (40 × 6)	₹ 240
C.	Excess Application Money [A–B]	₹ 48
D.	Allotment money due on shares allotted (40 × 2)	₹ 80
E.	Excess Application Money adjusted towards Share Capital	₹ 40
F.	Excess Application Money adjusted towards Securities Premium	₹ 8

Amount to be credited to Forfeited Shares Account

$$= \text{Application Money adjusted towards Share Capital} = [40 \times ₹ 4] + [40 \times ₹ 1] = ₹ 200$$

19.5 Anil applied for 2,000 shares of ₹ 10 each at a premium of ₹ 2.50 per share. But he was allotted only 1,000 shares. After having paid ₹ 3 per share on application, he did not pay allotment money of ₹ 4.50 per share (including premium) and on his subsequent failure to pay the first call of ₹ 2 per share, his shares were forfeited. These shares were re-issued at the rate of ₹ 8 per share credited as fully paid. Calculate the amount to be transferred to Capital Reserve.

SOLUTION:

A.	Application Money received on shares applied (2,000 × ₹ 3)	₹ 6,000
B.	Less: Application Money due on shares allotted (1,000 × ₹ 3)	₹ 3,000
C.	Excess Application Money [₹ 6,000 – (1,000 × ₹ 3)]	₹ 3,000
D.	Allotment money due on shares allotted (1,000 × ₹ 4.50)	₹ 4,500
E.	Excess Application Money adjusted towards Share Capital	₹ 2,000
F.	Excess Application Money adjusted towards Securities Premium	₹ 1,000
G.	Amount forfeited on shares reissued [(2,000 × ₹ 3) – 1,000]	₹ 5,000
H.	Re-issue Discount out of forfeited amount [1000 × ₹ 2]	₹ 2,000
I.	Amount to be transferred to Capital Reserve [A – B]	₹ 3,000

19.6 Bharat Ltd. forfeited 600 shares of ₹ 10 each issued at a premium of 30% to W who had applied for 1140 shares and paid an application money of ₹ 5 (including ₹ 1 premium), for non-payment of allotment money of ₹ 5 (including ₹ 1 premium). At different intervals of time, out of these 100 shares were re-issued to X as ₹ 8 called up for ₹ 7 per share, 100 shares were re-issued to Y as ₹ 8 paid up for ₹ 9 per share and 400 shares were re-issued to Z, credited as fully paid for ₹ 9 per share. Record the journal entries for forfeiture and reissue of shares assuming that the company follows the policy of adjusting excess Application Money towards other sums due on shares..

SOLUTION:**JOURNAL OF BHARAT LTD**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	On Forfeiture of 600 Shares Share Capital A/c (600 × ₹ 8) Dr. Securities Premium A/c (₹ 3,000 – ₹ 2,700) Dr. To Share Allotment A/c To Forfeited Shares A/c (₹ 5,700 – ₹ 600 – ₹ 300) (Being 600 shares forfeited for non-payment of Allotment money)		4,800 300	300 4,800
2.	On Re-issue of 100 Shares as ₹ 8 paid-up for ₹ 7 per share Bank A/c (100 × ₹ 7) Dr. Forfeited Shares A/c (100 × ₹ 1) Dr. To Share Capital A/c (100 × ₹ 8) (Being 100 shares re-issued as ₹ 8 paid-up for ₹ 7 per share)		700 100	800
3.	Forfeited Shares A/c [(₹ 4,800 × 100/600) – ₹ 100] Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		700	700
4.	On Re-issue of 100 Shares as ₹ 8 paid-up for ₹ 9 per share Bank A/c (100 × ₹ 9) Dr. To Share Capital A/c (100 × ₹ 8) To Securities Premium A/c (100 × ₹ 1) (Being 100 shares re-issued as ₹ 8 paid-up for ₹ 9 per share)		900	800 100
5.	Forfeited Shares A/c (₹ 4,800 × 100/600) Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		800	800

6.	On Re-issue of 400 Shares Bank A/c (400 × ₹ 9) Dr. Forfeited Shares A/c (400 × ₹ 1) Dr. To Share Capital A/c (400 × ₹ 10) (Being 400 shares re-issued as fully paid-up for ₹ 9 per share)		3,600 400	4,000
7.	Forfeited Shares A/c [(₹ 4,800 × 400/600) – ₹ 400] Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		2,800	2,800

CALCULATION OF ALLOTMENT MONEY DUE BUT NOT RECEIVED

Particulars	₹
Application Money received from defaulter (1140 × ₹ 5)	5,700
Less: Application Money adjusted (600 × ₹ 5)	(3,000)
Excess Application Money	2,700
Allotment Money due (600 × ₹ 5)	3,000
Amount due but not received on Allotment towards Securities Premium	300

19.7 Tushar Ltd. forfeited 600 shares of ₹ 10 each issued at a premium of 30% to W who had applied for 1500 shares for non-payment of first and final call money of ₹ 3 (including ₹ 1 premium). At different intervals of time, out of these 400 shares were re-issued to Z, credited as fully paid for ₹ 9 per share and 100 shares were re-issued to X as ₹ 10 paid up for ₹ 11 per share. Record the journal entries for forfeiture and reissue of shares assuming that the company follows the policy of adjusting excess Application Money towards other sums due on shares.

SOLUTION:**JOURNAL OF TUSHAR LTD**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	On Forfeiture of 600 Shares Share Capital A/c (600 × ₹ 10) Dr. Securities Premium A/c (₹ 1800 – ₹ 1500) Dr. To Calls-in-arrears A/c To Forfeited Shares A/c [(₹ 7,500 – ₹ 600 – ₹ 600 – ₹ 300)] (Being 600 shares forfeited for non-payment of call money)		6,000 300	300 6,000
2.	On Re-issue of 400 Shares Bank A/c (400 × ₹ 9) Dr. Forfeited Shares A/c (400 × ₹ 1) Dr. To Share Capital A/c (400 × ₹ 10) (Being 400 shares re-issued as fully paid-up for ₹ 9 per share)		3,600 400	4,000
3.	Forfeited Shares A/c [(₹ 6,000 × 400/600) – ₹ 400] Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		3,600	3,600
4.	On Re-issue of 100 Shares Bank A/c (100 × ₹ 11) Dr. To Share Capital A/c (100 × ₹ 10) To Securities Premium A/c (100 × ₹ 1) (Being 100 shares re-issued as fully paid-up for ₹ 11 per share)		1,100	1,000 100

5.	Forfeited Shares A/c (₹ 6,000 × 100/600) To Capital Reserve A/c (Being the transfer of profit on re-issue)	Dr.		1,000	1,000

CALCULATION OF CALL MONEY DUE BUT NOT RECEIVED

Particulars	₹
Application Money received from defaulter (1,500 × ₹ 5)	7,500
Less: Application & Allotment Money adjusted (600 × ₹ 10)	6,000
Excess Application Money	1,500
Excess Application Money adjusted on Call	(1,500)
Call Money due (600 × ₹ 3)	1,800
Amount due but not received on Call towards Securities Premium	300

20.0 ISSUE OF DEBENTURES

20.1 On 01.04.2018, Tushar Tulsian Ltd. issued 7500, 12% Debentures of ₹ 100 each at a discount of 4 %. Calculate the amount of Loss on issue of Debentures to be written off each year if :

- such debentures are redeemable at a premium of 6% after 3 years,
- such debentures are redeemable at a premium of 6% by equal annual drawings in 3 years
- such debentures are redeemable at a premium of 6% in three equal installments starting from the end of third year.
- such debentures are redeemable at a premium of 6% in three equal installments at the end of the 2nd, 4th and 6th year.
- such debentures are redeemable at a premium of 6% in four installments of 10%, 20%, 30% and 40% at the end of the 2nd, 3rd, 4th and 5th year respectively.

SOLUTION:**(A) LOSS ON ISSUE OF DEBENTURES TO BE CHARGED TO P & L A/C EACH YEAR**

A. Discount allowed = ₹ 7,50,000 × 4/100	= ₹ 30,000
B. Premium on Redemption = ₹ 7,50,000 × 6/100	= ₹ 45,000
C. Total Loss [A + B]	= ₹ 75,000
D. Redemption Period	= 3 Years
E. Amount of loss to be written off to P & L A/c every year (C/D)	= ₹ 25,000

(B) LOSS ON ISSUE OF DEBENTURES TO BE CHARGED TO P & L A/C EACH YEAR

Year ended A	Face Value of Debentures O/S B	Ratio C	Loss to be w/o ₹ 75,000 × C/6
I	7,50,000	3	37,500
II	5,00,000	2	25,000
III	2,50,000	1	12,500
		6	75,000

(C) LOSS ON ISSUE OF DEBENTURES TO BE CHARGED TO P & L A/C EACH YEAR

Year ended A	Face Value of Debentures O/S B	Ratio C	Loss to be w/o $D = ₹ 75,000 \times C/12$ D
I	7,50,000	3	$3/12 \times ₹ 75,000 = ₹ 18,750$
II	7,50,000	3	$3/12 \times ₹ 75,000 = ₹ 18,750$
III	7,50,000	3	$3/12 \times ₹ 75,000 = ₹ 18,750$
IV	5,00,000	2	$2/12 \times ₹ 75,000 = ₹ 12,500$
V	2,50,000	1	$1/12 \times ₹ 75,000 = ₹ 6,250$
VI		12	75,000

(D) LOSS ON ISSUE OF DEBENTURES TO BE CHARGED TO P & L A/C EACH YEAR

Year ended A	Face Value of Debentures O/S B	Ratio C	Loss to be w/o $D = ₹ 75,000 \times C/12$ D
I	7,50,000	3	$3/12 \times ₹ 75,000 = ₹ 18,750$
II	7,50,000	3	$3/12 \times ₹ 75,000 = ₹ 18,750$
III	5,00,000	2	$2/12 \times ₹ 75,000 = ₹ 12,500$
IV	5,00,000	2	$2/12 \times ₹ 75,000 = ₹ 12,500$
V	2,50,000	1	$1/12 \times ₹ 75,000 = ₹ 6,250$
VI	2,50,000	1	$1/12 \times ₹ 75,000 = ₹ 6,250$
		12	75,000

(E) LOSS ON ISSUE OF DEBENTURES TO BE CHARGED TO P & L A/C EACH YEAR

Year ended A	Face Value of Debentures O/S B	Ratio C	Loss to be w/o $D = ₹ 75,000 \times C/40$ D
I	7,50,000	10	$10/40 \times ₹ 75,000 = ₹ 18,750$
II	7,50,000	10	$10/40 \times ₹ 75,000 = ₹ 18,750$
III	6,75,000	9	$9/40 \times ₹ 75,000 = ₹ 16,875$
IV	5,25,000	7	$7/40 \times ₹ 75,000 = ₹ 13,125$
V	3,25,000	4	$4/40 \times ₹ 75,000 = ₹ 7,500$
		40	75,000

20.2 On April 1, 2018, Bharat Tulsian Ltd. purchased a running business from Y Ltd. for ₹ 10,40,000 payable as to 25% by a cheque and the balance by an issue of 12% Debentures of ₹ 500 each at a premium of 4 % redeemable at a premium of ₹ 30 per Debenture in three equal installments starting from the end of third year. The assets and liabilities consisted of the following:

Building ₹ 6,00,000, Plant and Machinery ₹ 1,00,000, Inventories ₹ 2,00,000, Trade Receivables ₹ 1,80,000, Trade Payables ₹ 80,000.

Interest is payable half yearly on 30th September and 31st March. Pass the necessary Journal Entries in the books of Bharat Tulsian Ltd for the first year (assume the rate of Tax deducted at source being 10%).

SOLUTION
JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
01.04.2018	Building Dr. Plant and Machinery Dr. Inventories Dr. Trade Receivables Dr. Goodwill A/c[Balancing Figure] Dr. To Trade Payables To Y Ltd. (Being the purchase of Business from Y Ltd.)		6,00,000 1,00,000 2,00,000 1,80,000 40,000	80,000 10,40,000
01.04.2018	Y Ltd. Dr. Loss on issue of Debentures A/c Dr. To Bank A/c [10,40,000 × 25%] To 12% Debentures A/c To Securities Premium A/c [₹ 7,50,000 × 4%] To Premium on Redemption of Debentures A/c (Being issue of 1500 Debentures at a premium of 4% redeemable at premium of ₹ 30 per Debenture). [No. of Debentures to be issued = ₹ 7,80,000 / ₹ 520 = 1,500]		10,40,000 45,000	2,60,000 7,50,000 30,000 45,000
30.09.2018	Interest on Debentures A/c Dr. [1500 × ₹ 500 × 12% × 6/12] To Debentureholders' A/c (₹45,000 × 90%) To TDS From Deb. Int. A/c [₹45,000 × 10%] (Being the Interest due for 6 months & T.D.S. @ 10%)		45,000	40,500 4,500
30.09.2018	Debentureholders' A/c Dr. TDS from Deb. Interest A/c Dr. To Bank A/c (Being the payment of Interest & TDS)		40,500 4,500	45,000
31.03.2019	Interest on Debentures A/c Dr. [1500 × ₹ 500 × 12% × 6/12] To Debentureholders' A/c (₹45,000 × 90%) To TDS From Deb. Int. A/c [₹45,000 × 10%] (Being the Interest due for 6 months & T.D.S. @ 10%)		45,000	40,500 4,500
31.03.2019	Debentureholders' A/c Dr. TDS from Deb. Interest A/c Dr. To Bank A/c (Being the payment of Interest & TDS)		40,500 4,500	45,000

31.03.2019	Securities Premium A/c To Loss on issue of Debentures A/c (Being the Loss written off out of Securities Premium)		30,000	30,000
31.03.2019	Profit and Loss A/c Dr. To Loss on issue of Debentures A/c To Interest on Debentures A/c (Being the Loss on issue of Debentures & Interest w/o to P & L A/c)		93,750	3,750 90,000

Working Note:

Balance of Loss to be w/o = Loss on issue of Debentures – Securities Premium

$$= ₹ 45,000 - ₹ 30,000 = ₹ 15,000$$

LOSS ON ISSUE OF DEBENTURES TO BE CHARGED TO P & L A/C EACH YEAR

Date A	Face Value of Debentures outstanding (₹) B	Proportion C	Discount to be w/o $D = ₹ 15,000 \times C/12$ D
31.03.2019	7,50,000	3	$3/12 \times ₹ 15,000 = ₹ 3,750$
31.03.2020	7,50,000	3	$3/12 \times ₹ 15,000 = ₹ 3,750$
31.03.2021	7,50,000	3	$3/12 \times ₹ 15,000 = ₹ 3,750$
31.03.2022	5,00,000	2	$2/12 \times ₹ 15,000 = ₹ 2,500$
31.03.2023	2,50,000	1	$1/12 \times ₹ 15,000 = ₹ 1,250$
		12	15,000

21.0 FINANCIAL STATEMENTS

21.1 X Ltd. provides you the following information:

1. Raw material stock holding period: 3 months
2. Work-in-progress holding period: 1 month
3. Finished goods holding period: 4 months
4. Debtors collection period: 6 months
5. Creditors Payment Period:: 1 month

You are required to compute the operating cycle.

SOLUTION:

As per Schedule III "An operating cycle is the time between the acquisition of assets for processing and their realization in cash or cash equivalents".

Operating Cycle = Raw material stock holding period + Work-in-progress holding period + Finished goods holding period + Debtors collection period - Creditors Payment Period = 3 + 1 + 4 + 6 – 1 = 13 months.

21.2 Operating Cycle Period of MODI Ltd is 14 Months but Expected Realisation Period of Trade Receivables is 13 Months from the date of Balance Sheet. State giving reason whether its Trade Receivables are Current Assets or Non-Current Assets as per Schedule III to The Companies Act ,2013

SOLUTION:

Current Assets since Expected Realisation Period is less than the Operating Cycle Period although it is more than the 12 Months Period.

22.0 RATIO ANALYSIS

22.1 Bharat Ltd. provides you the following information:

Gross Profit Ratio 40%, Net Profit (after tax) 12%, Operating Ratio 70%, 15% Debt-Equity Ratio 2:1, Tax Rate 50%, Shareholders' Funds ₹ 4,00,000.

Required: Calculate (a) Gross Profit (b) Operating Expenses, (c) Interest Coverage Ratio, (d) Return on Capital Employed, (e) Return on Shareholders' Funds.

SOLUTION:

Step 1: 15% Long-term Debt = ₹ 4,00,000 × 2 = ₹ 8,00,000,
Interest on 15% Long-term Debt = 15% of ₹ 8,00,000 = ₹ 1,20,000

STEP 2: LET US ASSUME THE SALES BE X

A. Sales	x
B. Less: Cost of Goods Sold (b.f.)	0.6x
C. Gross Profit [A–B]	0.4x
D. Less: Operating Expenses (b.f.)	0.1x
E. Operating Profit @ 30%	0.3x
F. Less: Interest on Long-term Debt	1,20,000
G. Profit before Tax	0.3x – ₹ 1,20,000
H. Less: Tax @ 50%	50% (0.3x – ₹ 1,20,000)
I. Profit after tax	0.15x – ₹ 60,000

Step 3: Net Profit Ratio = $\frac{\text{Profit after tax}}{\text{Net Sales}} \times 100$

$$12\% = \frac{0.15x - 60,000}{x} \times 100$$

$$0.15x - 0.12x = ₹ 60,000$$

$$x = ₹ 60,000 / 0.03 = ₹ 20,00,000$$

Step 4: (a) Gross Profit = 40% of ₹ 20,00,000 = ₹ 8,00,000

(b) Operating Expenses = 10% of ₹ 20,00,000 = ₹ 2,00,000

(c) Interest Coverage Ratio = $\frac{\text{Profit before Interest \& Tax}}{\text{Interest on Long-term Debt}}$
 $= \frac{30\% \text{ of } ₹ 20,00,000}{₹ 1,20,000} = 5 \text{ times}$

(d) Return on Capital Employed = $\frac{\text{Profit before Interest \& Tax}}{\text{Capital Employed}} \times 100$
 $= \frac{30\% \text{ of } ₹ 20,00,000}{₹ 12,00,000} \times 100 = 50\%$

$$\begin{aligned}
 \text{(e) Return on Shareholders Funds} &= \frac{\text{Profit after Interest \& Tax}}{\text{Shareholders' Funds}} \times 100 \\
 &= \frac{\text{₹ 2,40,000}}{\text{₹ 4,00,000}} \times 100 = 60\%
 \end{aligned}$$

Note: Profit after Interest & Tax = 50% [0.30 × (₹ 20,00,000) – ₹ 1,20,000]
 = 50% [₹ 6,00,000 – ₹ 1,20,000] = ₹ 2,40,000

22.2 From the following information, calculate Return on Total Assets and prepare the Balance Sheet:

Net Profit after Interest, Tax & Preference Dividend ₹ 2,22,000, Tax Rate 50%

18% Preference Share Capital?

15% Debentures?

Return on Capital Employed 50%

Return on Shareholders' Funds 60%

Return on Equity Shareholders' Funds 74%

Current Ratio 2:1

Net Fixed Assets ₹ 9,00,000

SOLUTION:

$$\text{Equity Shareholders' Funds} = \frac{\text{₹ 2,22,000}}{74} \times 100 = \text{₹ 3,00,000}$$

Let Pref. Share Capital be x, Hence, Pref. Dividend = 18% x

$$\text{Return on Shareholders' Funds} = \frac{\text{EAT}}{\text{Shareholders' Funds}} \times 100 = 60\%$$

$$= \frac{2,22,000 + 0.18x}{3,00,000 + x} \times 100 = 60$$

$$2,22,000 + 0.18x = 1,80,000 + 0.6x$$

$$0.42x = 42,000$$

$$x = \text{₹ 1,00,000}$$

Thus, Pref. Share Capital = ₹ 1,00,000

$$\text{Earning after Tax} = \text{₹ 2,22,000} + \text{₹ 18,000} = \text{₹ 2,40,000}$$

$$\text{Tax} = 50\% \text{ of EBT or } 100\% \text{ of EAT} = \text{₹ 2,40,000}$$

$$\text{EBT} = \text{EAT} + \text{Tax} = \text{₹ 2,40,000} + \text{₹ 2,40,000} = \text{₹ 4,80,000}$$

Let 15% Debentures be y

$$\text{Interest} = 0.15 y$$

$$\text{EBIT} = \text{EBT} + \text{Interest on Long-term Debt}$$

$$\text{EBIT} = \text{₹ 4,80,000} + 0.15 y$$

$$\text{Return on Capital Employed} = \frac{\text{EBIT}}{\text{Capital Employed}} \times 100$$

$$= \frac{\text{₹ 4,80,000} + 0.15 y}{\text{₹ 4,00,000} + y} \times 100 = 50$$

$$\text{₹ 4,80,000} + 0.15 y = \text{₹ 2,00,000} + 0.5y$$

$$0.35y = \text{₹ 2,80,000}$$

$$y = \text{₹ 8,00,000}$$

Thus, 15% Debentures = ₹ 8,00,000

Capital Employed = Shareholders' Funds + Long-term Debts
 = (₹ 3,00,000 + ₹ 1,00,000) + ₹ 8,00,000
 = ₹ 12,00,000

Working Capital = Capital Employed – Net Fixed Assets
 = ₹ 12,00,000 – ₹ 9,00,000 = ₹ 3,00,000

or, CA – CL = ₹ 3,00,000

... Eq. I

Current Ratio = $\frac{CA}{CL} = 2:1$

or, CA – 2CL = 0

... Eq. II

Subtracting Eq. II from Eq. I

CL = ₹ 3,00,000

CA = ₹ 3,00,000 × 2 = ₹ 6,00,000

Total Assets = Fixed Assets + Current Assets
 = ₹ 9,00,000 + ₹ 6,00,000 = ₹ 15,00,000

EBIT = ₹ 4,80,000 + 15% of ₹ 8,00,000
 = ₹ 6,00,000

Return on Total Assets = $\frac{\text{Earnings before Interest \& Tax}}{\text{Total Assets}} \times 100$

= $\frac{₹ 6,00,000}{₹ 15,00,000} \times 100 = 40\%$

BALANCE SHEET AS AT 31ST MARCH, 2018

Particulars	Note No	(₹ in lacs)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds		
(a) Share Capital	1	4
(b) Reserves and Surplus		
(2) Non - Current Liabilities		
(a) Long term Borrowings [15% Debentures]		8
(3) Current Liabilities		3
Total		15
II. ASSETS		
(1) Non-Current Assets		9
(2) Current Assets		6
Total		15

Notes to Accounts:

<i>Particulars</i>	<i>(₹ in lacs)</i>
1. Share Capital	
Equity Shares	3
18% Pref. Shares	1
	4

22.3 From the following information, Calculate Capital Turnover Ratio:

Debt-Equity Ratio (Long-term Debt/Shareholders' Funds)	2:1
Capital Gearing Ratio (Funds bearing Fixed Payments to Equity Shareholders' Funds)	3:1
15% Long-term Debts	₹ 8,00,000
Return on Equity Shareholder's Funds	25%
Tax Rate	50%
15% Preference Share Capital	?
Gross Profit Ratio 25% ,Operating Expenses Ratio 12.5%	

SOLUTION:

$$\text{Capital Turnover Ratio} = \text{Sales} / \text{Capital Employed} = ₹ 24,00,000 / (₹ 8,00,000 + ₹ 4,00,000) \\ = 2 \text{ Times}$$

Working Notes:

(i) *Calculation of Equity Shareholders' Funds & Long-term Debts*

$$\text{Debt Equity Ratio} = \frac{\text{Long-term Debts}}{\text{Shareholders' Funds}}$$

$$2 = ₹ 8,00,000 / \text{Shareholders' Funds}$$

$$\text{Shareholders' Funds} = ₹ 8,00,000 / 2 = ₹ 4,00,000$$

$$\text{Supposing Pref. Share Capital} = x$$

$$\text{Equity Shareholders' Funds} = ₹ 4,00,000 - x$$

(ii) *Calculation of Pref. Share Capital*

$$\text{Capital Gearing Ratio} = \frac{\text{Long-term Debts plus Pref. Share Capital}}{\text{Equity Shareholders' Funds}}$$

$$3 = \frac{₹ 8,00,000 + x}{₹ 4,00,000 - x}$$

$$₹ 12,00,000 - 3x = ₹ 8,00,000 + x$$

$$x = ₹ 1,00,000$$

$$\text{Pref. Share Capital} = ₹ 1,00,000$$

$$\text{Equity Shareholders' Funds} = ₹ 4,00,000 - ₹ 1,00,000 = ₹ 3,00,000$$

(iii) *Calculation of Operating Profit*

$$\text{Return on Equity} = \frac{\text{Net Profit after Interest, Tax \& Pref. Dividend}}{\text{Equity Shareholders' Funds}} \times 100$$

$$25\% = x / ₹ 3,00,000$$

$$x = ₹ 75,000$$

Particulars	₹
A. Net Profit after Int., Tax & Pref. Dividend	75,000
B. Add: Pref. Dividend	15,000
C. Net Profit after Int. & Tax (A+B)	90,000
D. Add: Tax @ 50%	90,000
E. Net Profit before Tax	1,80,000
F. Interest on Long-term Debt @ 15% on ₹ 8,00,000	1,20,000
G. Operating Profit (E + F)	3,00,000

(iv) *Calculation of Sales*

Cost of Goods Sold Ratio = $100\% - \text{Gross Profit Ratio } 25\% = 75\%$

Operating Expenses Ratio = 12.5%

Operating Ratio = $75\% + 12.5\% = 87.5\%$

Operating Profit Ratio = $100\% - 87.5\% = 12.5\%$

Sales = Operating Profit / Operating Profit Ratio = $\text{₹ } 3,00,000 / 12.5\% = \text{₹ } 24,00,000$

**PAPER 1: PRINCIPLES AND PRACTICE OF ACCOUNTING
FOR CA FOUNDATION COURSE**

SECTION 4

**TULSIAN'S
MODEL TEST PAPERS WITH ANSWERS**

Tulsian's Model Test Paper 1

Tulsian's Model Test Paper 2

⚡ATTENTION PLEASE⚡

Dear Students

Your Sincere and 100% Accurate Attempt of Tulsian's Model Test Papers under Examination conditions guarantees you 100% SURE SUCCESS in the Paper 1: Principles and Practice of Accounting.

BEST OF LUCK!

PAPER-1: PRINCIPLES AND PRACTICE OF ACCOUNTING

TULSIAN'S MODEL TEST PAPER 1

Questions No. 1 is compulsory.

Answer any four questions from the remaining five questions.

Working notes should form part of the answer.

“Wherever necessary, suitable assumptions may be made and indicated in answer.”

1. (a) **State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):**
 - (i) Bank reconciliation statement is prepared to arrive at the bank balance.
 - (ii) Deferred revenue expenditure is current year's revenue expenditure to be paid in the later years.
 - (iii) Reducing balance method for depreciation is followed to have a uniform charge for depreciation and repairs and maintenance together.
 - (iv) Reserve for Discount on Creditors has a credit balance.
 - (v) A promissory note can be made payable to the bearer.
 - (vi) The gain from sale of capital assets need not be added to revenue to ascertain the net profit of a business.
1. (b) **Give any four points of difference between Partnership and LLP.**
1. (c) **Rectify the following errors:**
 - (i) A Credit Sale of goods to X ₹ 3,000 posted as ₹ 30,000.
 - (ii) A Cash Sale of goods to Y ₹ 3,000 posted as ₹ 30,000
 - (iii) A Credit Sale of Furniture to Z ₹ 3,000 posted as ₹ 30,000.
 - (iv) A Credit Sale of goods of ₹ 3,000 to Krishan entered in the purchases book as ₹ 30,000. and posted therefrom to the credit of Kishan as ₹ 3,000.
 - (v) A Cash Sale of goods of ₹ 3,000 to Krishan posted to the credit of Kishan as ₹ 30,000.
 - (vi) A Credit Purchase of old machinery from Sohan for ₹ 17,000 was entered in the Purchases Book as purchase from Mohan for ₹ 71,000. ₹ 3,000 paid as Repair Charges of this Machinery debited to General Expenses Account..
 - (vii) A Bill drawn on Meenu for ₹ 30,000. was passed through bills payable book with ₹ 3,000. and posted therefrom to the credit of Meena as ₹ 300.
 - (viii) Sales included a sale of furniture having a book of value of ₹ 900 for ₹ 850 on 31st March, 2018.
2. (a) **X of Kashmir and Y of Kanyakumari entered into a joint venture for purchase and sale of Music Systems. The cost of each Music System was ₹ 3,600 and the fixed retail selling price ₹ 4,500. The following transactions were recorded between them:**
 - July 1 X purchased 100 Music Systems paying ₹ 72,000 in cash on account.
 - July 1 X raised a loan from Bank for ₹ 50,000 at 18% p.a. which is repayable with interest on 1st Sept. X forwarded 80 Music Systems to Y incurring ₹ 2,880 as forwarding and insurance charges.

- July 7 X received the consignment and paid ₹ 720 as clearing charges.
- Aug. 1 X sold 5 Music Systems for cash. Y sold 20 Music Systems for cash.
Y raised a loan of ₹ 1,50,000 from Bank, repayable with interest at 18% p.a. on 1st Sept. Y remitted ₹ 1,50,000 to X, incurring charges of ₹ 50. X paid the balance due for the Music Systems.
- Aug.26 X sold the balance Music Systems for cash and paid selling expenses ₹ 5,000, Y sold the balance Music Systems for cash and paid selling expenses ₹ 20,000.
- Sept. 1 Accounts settled between the ventures and loans repaid, they shared profit equally.
- You are required to show: (i) The Memorandum Joint Venture Account; (ii) Joint Venture with Y Account in X's books; and (iii) Joint Venture with X Account in Y's books;
2. (b) Ram Ltd which depreciates its machinery at 10% p.a. on Diminishing Balance Method, had on January 1, 2018 ₹ 9,72,000 on the debit side of Machinery Account. During the year 2018, machinery purchased on January 1, 2016 for ₹ 80,000 was sold for ₹ 45,000 on July 1, 2018 and a new machinery at a cost of ₹ 1,50,000 was purchased and installed on the same date, installation charges being ₹ 8,000. The company wanted to change the method of depreciation from Diminishing Balance Method to Straight Line Method with effect from January 1, 2016. Difference of depreciation upto December 31, 2018 to be adjusted. The rate of depreciation remains the same as before. Show Machinery Account for the year 2018.
2. (c) X and Y were friends and in need of funds. On 1st Jan. X drew a bill for ₹ 2,00,000 for 3 months on Y. On 4th Jan. X got the bill discounted at 10% p.a. and remitted half of the proceeds to Y. On 1st April, X could not send the required sum, instead, he accepted Y's bill for ₹ 1,20,000 for two months. On 4th April, the bill was discounted by Y at 12% p.a. Out of this ₹ 7,800 were remitted to X. At maturity of second bill, due to financial crisis, X became insolvent and only 50 paise in a rupee could be recovered from his estate. Pass Journal Entries in the Books of X and Y.
2. (d) The accounting year of Mr X ends on March 31, 2018 but the stock on hand was physically verified only on 15th April. You are required to determine the value of closing stock (at cost) as on 31st March from the following information:
- The physical stock (value at cost) was ₹ 50,000.
 - The purchases from 1st April to 15th April amounted to ₹ 8,000 of which goods costing ₹ 1,000 were received on 16th April.
 - The sales from 1st April to 15th April amounted to ₹ 21,500 including the following:
 - Goods sent on consignment ₹ 12,500 at invoice price which is made up of cost plus 25%.
 - Goods sent to own branch at invoice price ₹ 4,200. Invoice is made at profit of 20% on cost.
 - Goods sold for ₹ 800 at a loss of 20% on cost due to damage on 31st March.
 - Other sales are at a profit of 1/3rd of cost.
 - Goods (sold for ₹ 2,500) were delivered to the customers on 16th April.
 - On 15th March, goods of the value of ₹ 10,000 were sent on sale or return basis to a customer, the period of approval being 4 weeks. He returned 40% of the goods on 10th April, approving the rest, the customer was invoiced on 16th April. Mr X makes a profit of 20% on such sales.
 - On 15th March, Mr X had received goods costing ₹ 8,000 for sale on consignment basis; 20% of the goods had been sold by 31st March, and another 50% by 15th April. The sales referred to in (d) and (e) are not included in (c) above.

3 The following is the Income and Expenditure Account of the Red Roses Club for the year ended on March, 31 2018.

<i>Expenditure</i>	₹	<i>Income</i>	₹
To Salaries	24,000	By Subscriptions	72,000
To Rent	10,800	By Entrance fees	8,000
To Rates and Taxes	600	By Surplus on Publication of brochure	4,500
To Postage and Telephones	720	By Profit on sale of old sports as sets	1,200
To Affiliation fees to the All-India Lawn Tennis Association	1,200	By Interest on 4% investments	600
To Sports Materials	15,750	By Miscellaneous Income	225
To Electricity Charges	1,200		
To Repairs and Maintenance to tennis court	9,600		
To Depreciation on assets at 10% of gross book value at end of year	4,800		
To Surplus carried to Capital Fund	17,855		
	86,525		86,525

The following further information is made available:

<i>Particulars</i>	<i>Balances on 31.3.2017</i> ₹	<i>Balances as at 31.3.2018</i> ₹
(a) Sundry assets	44,000	?
Bank Balance	4,800	?
Subscriptions in arrear	4,750	3,500
Subscription received in advance	1,400	2,600
4% Investments [Face value ₹ 15,000]	12,000	12,000
(b) Expenses Outstanding:		
Salaries	600	1,200
Rent	900	1,800
Rates & Taxes	Nil	600
Tennis court maintenance	780	320
(c) Outstanding for purchase of sports materials	1,400	2,950
(d) Prize Fund	4,600	3,250

- (e) The book value, as on 1.4.2017 of sports goods sold in the year was ₹ 4,000.
- (f) Prize Fund is separately maintained. All receipts are credited to it separately and expenditure is met out of the fund directly. During the year, credits to the account amounted to ₹ 2,800.
- (g) Interest received this year was only for two quarters.
- (h) The club was admitted as a member of the All India Lawn Tennis Federation on 1.10.2017 when it paid subscription till 30.9.2018.
- (i) Advertisement charges on brochure—yet to be collected—₹ 450.
- (j) A fixed deposit of ₹ 25,000 was made on 31st March, 2018.
- Prepare the Receipts and Payments Account for the year ended on March 31, 2018 and the Balance-Sheet as on that date of the Red Roses Club.

- 4 (a) TULSIAN Ltd. invited applications for issuing 1,00,000 Equity shares of ₹ 10 each issued at a premium of ₹ 3 per share payable as follows:

On Application	₹ 5 per share(including premium ₹ 1)
On Allotment	₹ 5 per share(including premium ₹ 1)
On Call	Balance

Applications were received for 2,20,000 shares. Applications for 20,000 shares were rejected and their application money was refunded. Shares were allotted to the remaining applicants as follows:

- I. Allotted in full to *Katrina* who had applied for 10,000 shares.
- II. Applications for 40,000 shares were allotted 30,000 shares on *prorata* basis.
- III. Allotted balance of the shares on *prorata* basis to the other applicants

Excess application money was utilised in payment of allotment and call. The Call was duly made.

X, who applied for 800 shares in II category failed to pay the allotment money and his shares were forfeited immediately after allotment. Y, to whom 600 shares were allotted in III category failed to pay the call money and on his such failure, his shares were forfeited. Of the shares forfeited, 900 shares were re-issued to Z, credited as fully paid for ₹ 9 per share, the whole of Y's shares being included. Pass the necessary journal entries in the books of company.

- 4 (b) On 01.04.2018, Tushar Tulsian Ltd. purchased a running business from Y Ltd. for ₹ 9,60,000 payable as to 25% by a cheque and the balance by an issue of 12% Debentures of ₹ 100 each at a discount of 4 % redeemable at a premium of 6% in three equal installments starting from the end of third year. The assets and liabilities consisted of the following:

Building ₹ 6,00,000, Plant and Machinery ₹ 1,00,000, Inventories ₹ 2,00,000, Trade Receivables ₹ 1,80,000, Trade Payables ₹ 80,000.

Interest is payable half yearly on 30th September and 31st March. Pass the necessary Journal Entries in the books of Tushar Tulsian Ltd for the first year (assume the rate of Tax deducted at source being 10%).

- 4 (c) The Balance Sheet of X and Y who shares profits and losses in the ratio of 3 : 2, at 31st March, 2018 was as follows:

Liabilities	₹	Assets	₹
Creditors	36,000	Cash at Bank	20,000
Workmen's Compensation Fund	24,000	Debtors	1,30,000
Employees' Provident Fund	20,000	Less: Provision	10,000
General Reserve	40,000	Stock	60,000
X's Capital	1,68,000	Investments	1,00,000
Y's Capital	1,12,000	Patents	20,000
		Goodwill	80,000
	4,00,000		4,00,000

They decided to admit Z on that date for 1/4th share on the following terms:

- (a) New Profit Sharing Ratio will be 6 : 9 : 5. Z is to bring in capital equal to 1/4th of the total capital of the new firm.
- (b) Goodwill of the firm is to be valued at 4 years' purchase of the average super profits of the last three years. Average profits of the last three years are ₹ 70,000, while the normal profits that can be earned with the capital employed are ₹ 30,000. No goodwill is to appear in the books. Z brings in ₹ 24,000 cash out of his share of goodwill.

- (c) Patents to be written down to ₹ 3,000 and Stock is undervalued by ₹ 2,000. 20% of General Reserve to be transferred to Provision for Doubtful Debts. ₹ 9,000 included in Sundry Creditors be written back as no longer payable.
- (d) Out of the amount of insurance which was debited entirely to P&L A/c, ₹ 10,000 be carried forward as an Unexpired Insurance. Unaccounted Accrued Income of ₹ 2,000 to be provided for. A debtor whose dues of ₹ 10,000 were written off as bad debts paid 80% in full settlement. A claim of ₹ 6,000 on account of workmen's compensation to be provided for.
- (e) The market value of investments was ₹ 90,000. Half of the investments were to be taken over by old partners in their old profit sharing ratio.

Prepare the Revaluation Account, Capital Accounts of the Partners and the Balance Sheet of the new Firm.

- 5 (a)** Current Ratio 8 : 5, Quick Ratio 6 : 5, Debtors' Velocity 4 months, Inventory Velocity 4 months, Creditors' Velocity 4 months, Cash Revenue from Operations being 33-1/3% of Credit Revenue from Operations, Cash Purchases 1/3rd of Credit Purchases, Gross Profit @ 33-1/3% on Cost was ₹ 1,00,000, Inventory at the end was 3 times that in the beginning. Trade Receivables at the end were 3 times more than that in the beginning. Opening Trade Payables were 1/4th of Closing Trade Payables. In Current Assets there was no asset other than Inventory, Trade Receivables and Cash Balance. Non-Current Assets/Proprietary Funds 0.75. Reserves and Surplus ₹ 1,80,000. There are no Non - Current Liabilities. Prepare the Balance Sheet.

- 5 (b)** From the details given below prepare Balance Sheet of TULSIAN Ltd. as at 31st March, 2018, as per the Schedule III to The Companies Act 2013:

	(₹ in '000)
P & L A/c (Dr.)	200
12% Debentures	200
Proposed Dividend	20
Equity Share Capital (₹ 10 each)	500
Cheques & Drafts on hand	48
15% Pref. Share Capital (₹ 100 each)	400
Prepaid Expenses	50
Bank Overdraft	45
Interest accrued on Debentures of Tata Steels	12
Building under construction	115
2,500, 12% Tata Steel Deb. of ₹ 100 each, ₹ 80 paid up	200
Premium on Red. of Debentures	20
Application Money pending allotment	40
Bills Payables	75
Calls-in Advance	5
Employees' earned leave payable on Retirement	45
Stores & Spares	50
Securities Deposit for Telephone	5
Brands	110
Computer Software under development	20
Bills Receivables	120
Plant & Machinery	120
12% Debentures of Reliance Ltd. [20% Redeemable within 1 year]	100

Investment in Land & Building

200

Note: Bills Discounted but not yet matured ₹ 25,000, Dividends on Preference Shares are in arrears for 2 years

6 (a) On 31st March, 2018, the bank account of Miss Meenu, according to the Bank Column of the Cash Book, was over drawn to the extent of ₹ 2,315. On scrutiny, you find that:

- (a) On 27th March, Cheques of ₹ 21,500 were collected from customers and recorded in the Cash Book of which:
 - (i) A cheque for ₹ 1,000 was omitted to be banked in March and the rest were sent to bank on 28th March.
 - (ii) A Cheque of ₹ 5,100 was recorded as ₹ 1,500 on the credit side of the Cash Book as if there is no Bank Column therein and
 - (iii) Cheques of ₹ 13,000 collected by the bank in March.
- (b) On 28th March, Cheques of ₹ 20,000 were drawn of which:
 - (i) A Cheque issued for ₹ 250 was recorded as ₹ 205 on the debit side of the Cash Book as if there is no Bank Column therein
 - (ii) One outgoing cheque of ₹ 300 was recorded twice in the Cash Book
 - (iii) Cheques of ₹ 3,000 were presented to the bank in March.
- (c) A bill for ₹ 10,000 was retired by the bank under a rebate of ₹ 150 but the full amount of the bill was credited in the Bank Column of the Cash Book.
- (d) A bill receivable for ₹ 520 previously discounted for ₹ 500 with bank had been dishonoured and recorded in the Pass Book but not in the Cash Book
- (e) The Bank has charged Interest of ₹ 521 instead of ₹ 512 but not recorded in the Cash Book
- (f) The debit balance of ₹ 1,500 as on the previous day was brought forward as a credit balance of ₹ 5,100 in Cash Book.
- (g) A deposit of ₹ 5,432 was recorded in withdrawal column as ₹ 5,342 in pass book.
- (h) A cheque of ₹ 2,345 issued by Mrs Meena was recorded in deposit column as ₹ 2,435 in pass book.

Required: Prepare Bank Reconciliation Statement with amended Cash Book Balance.

6 (b) Tulsian Ltd. leased a mine for 20 years to Jalan Ltd. for a minimum rent of ₹ 94,000 for the first year with an annual increase of ₹ 20,000 till it reaches ₹ 1,00,000 merging into a royalty @ ₹ 100 per unit produced. Sales and closing stocks were an under.

Year	2014	2015	2016	2017	2018
Sale	400	800	1,200	1,100	450
Closing Stock	100	200	140	300	50

In the event of strike, the minimum rent would be taken pro-rata on the basis of actual numbers of working days but in the event of lockout, the lessee would be enjoy a concession in respect of minimum rent for 50% of the period of lockout. There was strike for 73 days and lockout for 4 months during the year 2018.

Recoupment of Short Working of each year is allowed during the next 5 years following the year in which the Short Working arose.

Required: Prepare the necessary Ledger accounts in the books of Tulsian Ltd. and Jalan Ltd.

ANSWERS TO MODEL TEST PAPER 1
ANSWER TO Q 1(A):

S. No.	Reason
(i)	False: Bank Reconciliation Statement is prepared <i>to reconcile</i> 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.
(ii)	False: Deferred Revenue Expenditure is that expenditure for which payment has been made or a liability has been incurred during current year but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods.
(iii)	True: In the early periods of useful life of a fixed assets, repairs and maintenance expenses are relatively low because the asset is new but depreciation charged is high. Whereas in later periods, as the asset become old, repairs and maintenance expenses increase continuously but depreciation charged reduces continuously. Thus depreciation and repair and maintenance expenses become more or less uniform throughout the useful life of the asset.
(iv)	False: Reserve for Discount on Creditors has a debit balance.
(v)	False: A promissory note cannot be made payable to the bearer. It is <i>payable to or to the order of a certain person</i> .
(vi)	True: The profit on sale of capital assets should not be added to ascertain the true net profit of a business because it is not due to normal business operations.

ANSWER TO Q 1(B):

Basis of Distinction	Partnership	LLP
Regulating Law	It is governed by 'The Indian Partnership Act, 1932'	It is governed by 'The Limited Liability Partnership Act, 2008'
Registration	Registration is optional .	Registration is compulsory .
Creation	It is created by agreement .	It is created by Law .
Separate Legal Entity	It has no separate legal entity.	It has separate legal entity.
Name of Entity	It can have any name as per choice.	Its Name to contain ' Limited Liability Partnership ' or ' LLP ' as suffix.
Perpetual Succession	It does not have perpetual succession . The death, insolvency or unsoundness of its members may affect its existence.	It has perpetual succession. The death, insolvency or unsoundness of its members does not affect its existence. Members may come and go but LLP goes forever.
Can Foreign National become partner?	Foreign National can not become a partner in a Partnership Firm in India.	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.

Liability of Partners	Liability of Partner is unlimited . Partners are severally and jointly liable for actions of other partners and the firm and liability extend to their personal assets.	Liability of Partner is limited , to the extent their contribution towards LLP, except in case of intentional fraud or wrongful act of omission or commission by the partner.
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.	It must have at least 2 two individuals as Designated Partners, of whom at least one must be resident in India. Each Designated Partner is required to have a DPIN before appointment.
Digital Signature	There is no requirement of obtaining Digital Signature	Atleast one Designated Partner must have Digital Signatures since e forms are filled electronically.
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 or firm.
Admission of Minor	Minor can be admitted to the benefits of Partnership as per its Agreement.	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.

SOLUTION TO Q 1 (C):**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
(i)	Suspense A/c To X (Being wrong positing, now rectified)	Dr. 27,000	27,000
(ii)	Sales A/c To Suspense A/c (Being wrong positing, now rectified)	Dr. 27,000	27,000
(iii)	Furniture A/c To Z A/c (Being wrong posting, now rectified)	Dr. 27,000	27,000
(iv)	Krishan Kishan Suspense A/c To Sales A/c To Purchases A/c (Being sale recorded as purchase with wrong amount and wrong posting therefrom, now rectified)	Dr. 3,000 Dr. 3,000 Dr. 27,000	3,000 30,000
(v)	Kishan To Sales A/c To Suspense A/c (Being wrong positing, now rectified)	Dr. 30,000	3,000 27,000

(vi)	Mohan	Dr.	71,000	
	Machinery A/c	Dr.	20,000	
	To Sohan			17,000
	To Purchases A/c			71,000
	To General Expenses A/c			3,000
	(Being purchase of old machinery recorded the Purchases Book and repairing charges debited to General Expenses A/c, now rectified)			
(vii)	Bills Receivable A/c	Dr.	30,000	
	Bills Payable A/c	Dr.	3,000	
	Meena	Dr.	300	
	To Meenu			30,000
	To Suspense A/c			3,300
	(Being B/R drawn recorded in B/P Book, now rectified)			
(viii)	Sales A/c	Dr.	850	
	Loss on Sale of Furniture A/c	Dr.	50	
	To Furniture A/c			900
	(Being the sale of furniture recorded as sales, now rectified)			

SOLUTION TO Q 2 (A):
DR.
MEMORANDUM JOINT VENTURE ACCOUNT
CR.

Particulars	₹	Particulars	₹
To X:		By Sales:	
Cost of Music Systems	3,60,000	Y (80 × 4,500)	3,60,000
Forwarding & insurance	2,880	X (20 × 4,500)	90,000
Interest (for 2 months)	1,500		
Selling Expenses	5,000		
To Y:			
Clearing Charges	720		
Interest (for the month)	2,250		
Sundry Expenses			
(Telegraphic transfer charges)	50		
Selling Expenses	20,000		
To Profit transferred to:			
X	28,800		
Y	28,800		
	4,50,000		4,50,000

DR.
JOINT VENTURE WITH Y ACCOUNT IN THE BOOKS OF X
CR.

Particulars	₹	Particulars	₹
To Bank A/c (part payment of cost)	72,000	By Bank A/c (sale proceeds)	22,500
To Bank A/c (forwarding charges)	2,880	By Bank A/c (remittance)	1,50,000
To Bank A/c (balance payment of cost)	2,88,000	By Bank A/c (sale proceeds)	67,500
To Bank A/c (selling expenses)	5,000	By Bank A/c (cash received in settlement)	1,58,180
To Bank A/c (Interest)	1,500		
To Profit & Loss A/c (share of profit)	28,800		
	3,98,180		3,98,180

DR. JOINT VENTURE WITH X ACCOUNT IN THE BOOKS OF Y CR.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (clearing charges)	720	By Bank A/c (Sale proceeds of 20 Music Systems)	90,000
To Bank A/c remittance excluding charges)	1,50,000	By Bank A/c (Sale proceeds of 60 Music Systems)	2,70,000
To Bank A/c (selling expenses)	20,000		
To Bank A/c (interest)	2,250		
To Sundry Expenses	50		
To Profit & Loss A/c (share of profit)	28,800		
To Bank A/c (paid in settlement)	1,58,180		
	3,60,000		3,60,000

SOLUTION TO Q 2 (B):**Dr. MACHINERY ACCOUNT FOR THE YEAR 2018 Cr.**

<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
01.01.2018	To Balance b/d	9,72,000	01.07.2018	By Bank A/c (Sale)	45,000
01.07.2018	To Bank A/c	1,50,000	01.07.2018	By Depreciation A/c	4,000
	To Bank A/c	8,000	31.12.2018	By P & L A/c (Loss on sale)	15,000
			31.12.2018	By P & L A/c (Additional Depreciation)	12,000
			31.12.2018	By Depreciation A/c	1,19,900
				By Balance c/d	9,34,100
		11,30,000			11,30,000

Working Notes:**1. CALCULATION OF W.D.V. AS ON 01.01.2016**

<i>Particulars</i>	₹
A. W.D.V. as on 1.1.2018	9,72,000
B. Add: Depreciation during 2017 ($\text{₹ } 9,72,000 \times 1/9$)	1,08,000
C. W.D.V. as on 1.1.2017	10,80,000
D. Add: Depreciation during 2016 ($\text{₹ } 10,80,000 \times 1/9$)	1,20,000
E. W.D.V. as on 1.1.2016	12,00,000

2. CALCULATION OF LOSS ON SALE OF MACHINERY

<i>Particulars</i>	₹
A. Original Cost as on 1.1.2016	80,000
B. Less: Depreciation @ 10% for 2½ years	20,000
C. Book Value as on 1.7.2018	60,000
D. Sale Proceeds	45,000
E. Loss on sale	15,000

3. CALCULATION OF DEPRECIATION FOR 2018

(a) On Machines (Other than sold one) existing as on 1.1.2018 @ 10% on (₹ 12,00,000 – ₹ 80,000)	₹ 1,12,000
(b) On Machine Purchased on 1.7.2018 (10% on ₹ 1,58,000 for 6 months)	₹ 7,900
	₹ 1,19,900

4. CALCULATION OF DIFFERENCE IN THE AMOUNT OF DEPRECIATION UNDER OLD METHOD AND NEW METHOD ON THE MACHINERIES

A. Depreciation on SLM basis for 2 years [₹ 12,00,000 × 10% × 2]	₹ 2,40,000
B. Depreciation on W.D.V. basis for 2 years	
for 2016 on	₹ 12,00,000 ₹ 1,20,000
for 2017 on	₹ 10,80,000 ₹ 1,08,000
C. Difference still to be adjusted (A – B)	₹ 12,000

SOLUTION TO Q 2 (C):
JOURNAL OF X

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	Bills Receivable A/c Dr. To Y (Being the acceptance of a bill received from Y)		2,00,000	2,00,000
Jan. 4	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being the bill discounted @ 10% p.a.)		1,95,000 5,000	2,00,000
Jan. 4	Y Dr. To Bank A/c To Discount A/c (Being half the proceeds remitted to Y)		1,00,000	97,500 2,500
April 1	Y Dr. To Bills Payable A/c (Being the acceptance of a bill given to Y)		1,20,000	1,20,000
April 4	Bank A/c Dr. Discount A/c Dr. To Y (Being ₹ 7,800 received from Y and proportionate discount ₹ 2,200 (i.e. ₹ 2,400 × ₹ 1,07,800 / ₹ 1,17,600) debited]		7,800 2,200	10,000
April 7	Bills Payable A/c Dr. To Y (Being the second bill dishonoured on becoming bankrupt)		1,20,000	1,20,000
	Y Dr. To Bank A/c To Deficiency A/c (Being a dividend of 50 paise in rupee paid to Y and the unpaid balance transferred to Deficiency A/c)		1,10,000	55,000 55,000

JOURNAL OF Y

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Jan 1	X Dr. To Bills Payable A/c (Being the acceptance of a bill given to X)		2,00,000	2,00,000
Jan. 4	Bank A/c Dr. Discount A/c Dr. To X (Being the half the proceeds received from X)		97,500 2,500	1,00,000
April 1	Bills Receivable A/c Dr. To X (Being the acceptance of a bill received from X)		1,20,000	1,20,000
April 4	Bank A/c Dr. Discount A/c Dr. To Bill Receivable A/c (Being the bill discounted @ 12% p.a.)		1,17,600 2,400	1,20,000
	Bills Payable A/c Dr. To Bank A/c (Being the first bill discharged)		2,00,000	2,00,000
April 7	X Dr. To Bank A/c To Discount A/c (Being ₹ 7,800 remitted to X and proportionate discount ₹ 2,200 (i.e. ₹ 2,400 × ₹ 1,07,800/ ₹ 1,17,600 charged)		10,000	7,800 2,200
	X Dr. To Bank A/c (Being the bill of X dishonoured on X's bankruptcy)		1,20,000	1,20,000
	Bank A/c Dr. Bad Debts A/c Dr. To X (Being a dividend of 50 paise in rupee received on X's bankruptcy and the balance written off as bad debt)		55,000 55,000	1,10,000

SOLUTION TO Q 2 (D):**VALUATION OF STOCK AS AT 31ST MARCH ,2018**

<i>Particulars</i>	<i>₹</i>
A Physical Stock as at 15th April	50,000
B Add: Cost of Goods sold and delivered after 31st March till stock taking	
(i) Goods sent on consignment (80% of ₹ 12,500)	10,000
(ii) Goods sent to branch (5/6th of ₹ 4,200)	3,500
(iii) Damaged Goods (Valued at realizable value)	800

	(iv) Other goods 75% of (₹ 4,000 – 2,500)	1,125
C	Add: Cost of goods sent on approval basis (6,000 × 80%)	4,800
D	Less: Cost of goods received on consignment basis (30% of ₹ 8,000)	2,400
E	Less: Cost of goods purchased and received after 31st March till stock taking	7,000
F	Stock as at 31st March	60,825

SOLUTION TO Q 3:**RECEIPTS AND PAYMENT ACCOUNTS OF RED ROSES CLUB**

Dr.

for the year ending on 31st March, 2018

Cr.

Receipts	₹	Payments	₹
To Balance b/d	4,800	By Electricity Charges	1,200
To Subscription	74,450	By Salaries	23,400
To Entrance fee	8,000	By Rent	9,900
To Brochure receipts, Surplus	4,050	By Postage and Telephone	720
To Old Sports material	5,200	By A.I. and T.F. Affiliation fee	2,400
To Interest on Investments	300	By Purchase of Sports Material	14,200
To Miscellaneous receipts	225	By Repairs and Maintenance to tennis court	10,060
To Prize Fund receipts	2,800	By Sundry assets	8,000
		By Prize Fund	4,150
		By Fixed deposit	25,000
		By Balance c/d	795
	99,825		99,825

BALANCE SHEET OF RED ROSES CLUB AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
General Fund	55,870	Sundry Assets	48,000
Add: Surplus for the year	17,855	Less: Depreciation	4,800
Prize Fund	3,250	4% Investments [FV ₹ 15,000]	12,000
Liability for purchases and expenses	6,870	Fixed Deposit	25,000
Subscription received in advance	2,600	Subscriptions receivable	3,500
		Advance affiliation fee paid	1,200
		Advt. charges receivable	450
		Interest due to Investments	300
		Cash at Bank	795
	86,445		86,445

Working Notes:**(I) BALANCE SHEET AS AT 31ST MARCH, 2017**

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Subscriptions received in advance	1,400	5% Investments	12,000
Expenses Outstanding	2,280	Sports Materials	4,000
Sundry suppliers (sports materials)	1,400	Sundry Assets	40,000
Prize Fund	4,600	Bank Balance	4,800
Capital Fund (<i>Balancing figure</i>)	55,870	Subscriptions receivable	4,750
	65,550		65,550

Dr. (II) SUBSCRIPTION ACCOUNT Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Outstanding Subscription A/c (Opening)	4,750	By Advance Subscription A/c (Beg.)	1,400
To Income and Expenditure Account	72,000	By Bank (Balancing figure)	74,450
To Advance Subscription A/c (end)	2,600	By Outstanding Subscription A/c (Closing)	3,500
	79,350		79,350

Dr. (III) SUNDRY ASSETS ACCOUNT Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d (₹ 44,000 – ₹ 4,000)	40,000	By Depreciation A/c	4,800
To Bank A/c (Balancing figure)	8,000	By Balance c/d [₹ 4,800 (Dep.) × 100/10] – ₹ 4,800]	43,200
	48,000		48,000

Dr. (IV) STOCK OF SPORTS MATERIALS ACCOUNT Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	4,000	By Bank A/c	5,200
To Income & Expenditure A/c (Profit)	1,200	By Income & Expenditure A/c (Materials Consumed)	15,750
To Creditors for Sports Materials A/c	15,750		
	20,950		20,950

Dr. (V) CREDITORS FOR SPORTS MATERIALS ACCOUNT Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (b.f.)	14,200	By Balance b/d	1,400
To Balance c/d	2,950	By Credit Purchases	15,750
	17,150		17,150

Dr. (VI) PRIZE FUND ACCOUNT Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank (Prize Awarded) (b.f.)	4,150	By Balance b/d	4,600
To Balance c/d	3,250	By Bank A/c	2,800
	7,400		7,400

- (vii) Total interest due @ 4% on ₹ 15,000 i.e. ₹ 600; half of it is received and the other half is still due.
- (viii) AILT Affiliation fee paid is ₹ 1,200 (October-March) i.e. for the current year and advance payment is also ₹ 1,200 (April-September).

SOLUTION TO Q 4 (A):**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	Bank A/c Dr. To Share Application A/c (Being the application money received)		11,00,000	11,00,000
2.	Share Application A/c Dr. To Share Capital A/c (1,00,000 × ₹ 4) To Securities Premium A/c To Share Allotment A/c To Bank a/c (20,000 × ₹ 5) To Calls-in Advance A/c (Being the Application Money adjusted & Surplus refunded)		11,00,000	4,00,000 1,00,000 3,50,000 1,00,000 1,50,000
3.	Share Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c (Being the Allotment Money due)		5,00,000	4,00,000 1,00,000
4.	Bank A/c [₹ 5,00,000 – ₹ 3,50,000 – ₹ 2,000] Dr. To Share Allotment A/c (Being the Allotment Money received)		1,48,000	1,48,000
5	Share Capital A/c (600 × ₹ 8) Dr. Securities Premium A/c (600 × ₹ 1) Dr. To Share Allotment A/c To Forfeited Shares A/c [₹ 4,000 – ₹ 600] (Being 600 shares forfeited for non-payment of allotment money)		4,800 600	2000 3,400
6.	Share First & Final Call A/c Dr. To Share Capital A/c To Securities Premium A/c (Being the First & Final Call Money due)		2,98,200	1,98,800 99,400
7.	Bank A/c Dr. Calls-in-advance A/c Dr. Calls-in-arrears A/c Dr. To Share First & Final Call A/c (Being the First and Final Call Money received except on 600 shares and Calls in advance adjusted)		1,47,900 1,50,000 300	2,98,200

8	Share Capital A/c ($600 \times ₹ 10$)	Dr.	6,000	
	Securities Premium A/c ($₹ 1,800 - ₹ 1,500$)	Dr.	300	
	To Calls-in-arrears A/c			300
	To Forfeited Shares A/c [$₹ 7500 - ₹ 600 - ₹ 600 - ₹ 300$] (Being 600 shares forfeited for non-payment of call money)			6,000
9	Bank A/c ($900 \times ₹ 9$)	Dr.	8,100	
	Forfeited Shares A/c ($900 \times ₹ 1$)	Dr.	900	
	To Share Capital A/c (Being 900 forfeited shares reissued @ ₹9 per share as fully paid-up)			9,000
10	Forfeited Shares A/c [$(₹ 6,000 + ₹ 1,700) - ₹ 900$]	Dr.	6,800	
	To Capital Reserve A/c (Being the Profit on re-issue t/f to Capital Reserve)			6,800

Working Notes:**1. STATEMENT SHOWING THE ADJUSTMENT OF APPLICATION MONEY RECEIVED**

Category	Shares Applied	Shares Allotted	Application Money Received	Adjustment of Application Money Received			
				Share Capital	Share Allotment	Calls-in Advance	Refund
—	20,000	0	1,00,000	0	0	0	1,00,000
I	10,000	10,000	50,000	50,000	—	—	—
II	40,000	30,000	2,00,000	1,50,000	50,000	—	—
III	1,50,000	60,000	7,50,000	3,00,000	3,00,000	1,50,000	—
Total	2,20,000	1,00,000	11,00,000	5,00,000	3,50,000	1,50,000	1,00,000

2. Total No. of Shares allotted to X = $(30,000 \times 800 / 40,000) = 600$ Shares

3. CALCULATION OF ALLOTMENT MONEY DUE BUT NOT RECEIVED

Particulars	₹
Application Money received from defaulter ($800 \times ₹ 5$)	4,000
Less: Application Money adjusted ($600 \times ₹ 5$)	(3,000)
Excess Application Money	1,000
Allotment Money due ($600 \times ₹ 5$)	3,000
Amount due but not received on allotment	2,000

4. Total No. of Shares applied by Y = $(1,50,000 \times 600 / 60,000) = 1,500$ Shares

5. CALCULATION OF CALL MONEY DUE BUT NOT RECEIVED

Particulars	₹
Application Money received from defaulter ($1,500 \times ₹ 5$)	7,500
Less: Application Money adjusted ($600 \times ₹ 5$)	3,000
Excess Application Money	4,500
Less: Excess Application Money adjusted on allotment ($600 \times ₹ 5$)	(3,000)
Excess Application Money adjusted on Call	(1,500)
Call Money due ($600 \times ₹ 3$)	1,800
Amount due but not received on Call	300

SOLUTION TO Q 4 (B):

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
01.04.2018	Building Dr. Plant and Machinery Dr. Inventories Dr. Trade Receivables Dr. To Trade Payables To Y Ltd. To Capital Reserve A/c [Balancing Figure] (Being the purchase of Business from Y Ltd.)		6,00,000 1,00,000 2,00,000 1,80,000	 80,000 9,60,000 40,000
01.04.2018	Y Ltd. Dr. Loss on issue of Debentures A/c Dr. To Bank A/c [₹ 9,60,000 × 25%] To 12% Debentures A/c To Premium on Redemption of Debentures A/c (Being issue of 7500 Debentures @ ₹ 100 each at a discount of 4% redeemable at a premium of 6%) [No. of Debentures to be issued = ₹ 7,20,000 / ₹ 96 = 7500]		9,60,000 75,000	 2,40,000 7,50,000 45,000
30.09.2018	Interest on Debentures A/c Dr. [7500 × ₹ 100 × 12% × 6/12] To Debenture holders' A/c (₹45,000 × 90%) To TDS from Deb. Int. A/c [₹45,000 × 10%] (Being the Interest due for 6 months & T.D.S. @ 10%)		45,000	 40,500 4,500
30.09.2018	Debenture holders' A/c Dr. TDS from Deb. Interest A/c Dr. To Bank A/c (Being the payment of Interest & TDS)		40,500 4,500	 45,000
31.03.2019	Interest on Debentures A/c Dr. [7500 × ₹ 100 × 12% × 6/12] To Debenture holders' A/c (₹45,000 × 90%) To TDS from Deb. Int. A/c [₹45,000 × 10%] (Being the Interest due for 6 months & T.D.S. @ 10%)		45,000	 40,500 4,500

31.03.2019	Debenture holders' A/c TDS from Deb. Interest A/c To Bank A/c (Being the payment of Interest & TDS)	Dr. Dr.	40,500 4,500	45,000
31.03.2019	Profit and Loss A/c To Loss on issue of Debentures A/c To Interest on Debentures A/c (Being the Loss on issue of Debentures & Interest w/o to P & L A/c)	Dr.	1,08,750	18,750 90,000

Working Note:**LOSS ON ISSUE OF DEBENTURES TO BE CHARGED TO P & L A/C EACH YEAR**

Date A	Face Value of Debentures outstanding (₹) B	Proportion C	Loss to be w/o $D = ₹ 75,000 \times C/12$ D
31.03.2019	7,50,000	3	$3/12 \times ₹ 75,000 = ₹ 18,750$
31.03.2020	7,50,000	3	$3/12 \times ₹ 75,000 = ₹ 18,750$
31.03.2021	7,50,000	3	$3/12 \times ₹ 75,000 = ₹ 18,750$
31.03.2022	5,00,000	2	$2/12 \times ₹ 75,000 = ₹ 12,500$
31.03.2023	2,50,000	1	$1/12 \times ₹ 75,000 = ₹ 6,250$
		12	75,000

SOLUTION TO Q 4 (C):

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Patents	17,000	By Sundry Creditors	9,000
To Investments	10,000	By Prepaid Insurance	10,000
To Profit on Revaluation t/f to:		By Bad Debts Recovered	8,000
X's Capital A/c	2,400	By Stock	2,000
Y's Capital A/c	1,600	By Accrued Income	2,000
	31,000		31,000

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Goodwill A/c	48,000	32,000	—	By Balance b/d	1,68,000	1,12,000	—
To Investments A/c	27,000	18,000	—	By General Reserve	19,200	12,800	—
To X's Capital A/c	—	8,000	—	By Revaluation A/c	2,400	1,600	—
To Balance c/d	1,73,400	75,600	83,000	By Workmen's Com.	10,800	7,200	—
				By Premium for Goodwill	24,000	—	—
				By Z's Current A/c	16,000	—	—
				By Y's Capital A/c	8,000	—	—
				By Bank A/c	—	—	83,000
	2,48,400	1,33,600	83,000		2,48,400	1,33,600	83,000

BALANCE SHEET OF NEW FIRM AS AT 31ST MARCH, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Creditors	27,000	Cash at Bank	1,35,000
Employees' Provident Fund	20,000	Debtors	1,30,000
Workmen's Compensation Claim	6,000	Less: Provision	18,000
X's Capital A/c	1,73,400	Stock	62,000
Y's Capital A/c	75,600	Investments	45,000
Z's Capital A/c	83,000	Patents	3,000
		Prepaid Insurance	10,000
		Accrued Income	2,000
		Z's Current A/c	16,000
	3,85,000		3,85,000

Working Notes:

- X's sacrifice = $3/5 - 6/20 = 6/20$, Y's gain = $2/5 - 9/20 = (1/20)$
- Firm's Goodwill = Super Profits $\times 4 = (\text{₹ } 70,000 - \text{₹ } 30,000) \times 4 = \text{₹ } 1,60,000$
- Z's Share of Goodwill = $\text{₹ } 1,60,000 \times 1/4 = \text{₹ } 40,000$
- Y's Share of Goodwill = $\text{₹ } 1,60,000 \times 1/20 = \text{₹ } 8,000$
- Z's New Capital = $(\text{₹ } 1,73,400 + \text{₹ } 75,600) \times 1/3 = \text{₹ } 83,000$

Dr.
6. CASH AT BANK ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	20,000	By Balance c/d	1,35,000
To Z's Capital A/c	83,000		
To Bad Debts Recovered	8,000		
To Premium for Goodwill	24,000		
	1,35,000		1,35,000

SOLUTION TO Q 5 (A):
Step 1: Revenue from Operations = $\text{₹ } 1,00,000 / 25\% = \text{₹ } 4,00,000$
Step 2: Credit Revenue from Operations = $\text{₹ } 4,00,000 \times 75\% = \text{₹ } 3,00,000$
Step 3: Opening and Closing Trade Receivables
Debtors Turnover Ratio = **12 Months/ Debtors' Velocity** = $12/4 = 3$

$$\begin{aligned} \text{Debtors Turnover Ratio} &= \frac{\text{Credit Revenue from Operations}}{\text{Average Trade Receivables}} = 3 \\ &= \frac{\text{₹ } 3,00,000}{\text{Average Trade Receivables}} = 3 \end{aligned}$$

Avg. Trade Receivables = $\text{₹ } 3,00,000 / 3 = \text{₹ } 1,00,000$
 $(\text{OR} + \text{CR})/2 = \text{₹ } 1,00,000$
 $\text{OR} + \text{CR} = \text{₹ } 1,00,000 \times 2 = \text{₹ } 2,00,000$
 $\text{CR} - \text{OR} = 0$

Eq. I

Eq. II

Subtracting Eq. II from Eq. I

$$5 \text{ OR} = ₹ 2,00,000$$

$$\text{OR} = ₹ 2,00,000/5 = ₹ 40,000$$

$$\text{CR} = ₹ 40,000 \times 4 = ₹ 1,60,000$$

Thus, Opening Trade Receivables = ₹ 40,000, Closing Trade Receivables = ₹ 1,60,000

Step 4: Cost of Revenue from Operations = ₹ 4,00,000 × 75% = ₹ 3,00,000

Step 5: Opening and Closing Inventory

Inventory Turnover Ratio = 12 months/ Inventory Velocity = 12/4 = 3 times

Inventory Turnover Ratio = $\frac{\text{Cost of Revenue from Operations}}{\text{Average Inventory}}$ = 3 Times

$$= \frac{₹ 3,00,000}{\text{Average Inventory}} = 3$$

$$\text{Average Inventory} = ₹ 3,00,000/3 = ₹ 1,00,000$$

$$(\text{OS} + \text{CS})/2 = ₹ 1,00,000$$

$$\text{OS} + \text{CS} = ₹ 1,00,000 \times 2 = ₹ 2,00,000$$

Eq. I

$$\text{CS} - 3\text{OS} = 0$$

Eq. II

Subtracting Eq. II from III Eq. I

$$4\text{OS} = ₹ 2,00,000$$

$$\text{OS} = ₹ 2,00,000/4 = ₹ 50,000$$

$$\text{CS} = ₹ 50,000 \times 3 = ₹ 1,50,000$$

Thus, Opening Inventory = ₹ 50,000, Closing Inventory = ₹ 1,50,000

Step 6: Current Assets & Current Liabilities

$$\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}} = \frac{\text{CA} - \text{Inventory}}{\text{Current Liabilities}}$$

$$6/5 = \frac{\text{CA} - ₹ 1,50,000}{\text{Current Liabilities}}$$

$$5\text{CA} - ₹ 7,50,000 = 6 \text{ CL}$$

$$5\text{CA} - 6\text{CL} = ₹ 7,50,000$$

... Eq. I

$$\text{Current Ratio} = \text{CA}/\text{CL} = 8/5$$

$$5\text{CA} = 8\text{CL}$$

$$\text{CA} = 8/5 \text{ CL}$$

...Eq. II

Putting Eq. II In Eq. I

$$5 \times 8/5 \text{ CL} - 6 \text{ CL} = ₹ 7,50,000$$

...Eq. III

Multiplying Eq. III by 5

$$40 \text{ CL} - 30 \text{ CL} = ₹ 37,50,000$$

$$\text{CL} = ₹ 37,50,000/10 = ₹ 3,75,000$$

$$\text{CA} = ₹ 3,75,000 \times 8/5 = ₹ 6,00,000$$

Step 7: Working Capital = ₹ 6,00,000 – ₹ 3,75,000 = ₹ 2,25,000

Step 8: Closing Cash Balance = CA – Closing Trade Receivables – Closing Inventory

$$= ₹ 6,00,000 - ₹ 1,60,000 - ₹ 1,50,000 = ₹ 2,90,000$$

Step 9: Non- Current Assets

Proprietary Funds + Current Liabilities = Non-Current Assets + Current Assets

Let us assume the Proprietary Funds be 'X'

$$X + ₹ 3,75,000 = .75X + ₹ 6,00,000$$

$$X - .75X = ₹ 6,00,000 - ₹ 3,75,000 = ₹ 2,25,000$$

$$X = ₹ 2,25,000 / .25 = ₹ 9,00,000$$

Step 10: Share Capital = ₹ 9,00,000 – ₹ 1,80,000 = ₹ 7,20,000

Step 11: Non-Current Assets = 75% of ₹ 9,00,000 = ₹ 6,75,000

Step 12: Total Purchases

= Cost of Revenue from Operations + Closing Inventory – Opening Inventory

$$= ₹ 3,00,000 + ₹ 1,50,000 - ₹ 50,000 = ₹ 4,00,000$$

Step 13: Net Credit Purchases = Total Purchases – Cash Purchases

$$= ₹ 4,00,000 - (25\% \text{ of } ₹ 4,00,000) = ₹ 3,00,000$$

Step 14: Opening and Closing Trade Payables

Creditors Turnover Ratio = 12 Months/ Creditors' Velocity = 12/4 = 3

$$\text{Creditors Turnover Ratio} = \frac{\text{Net Credit Purchases}}{\text{Average Trade Payables}}$$

$$3 = \frac{₹ 3,00,000}{\text{Average Trade Payables}}$$

$$\text{Average Trade Payables} = ₹ 3,00,000 / 3 = ₹ 1,00,000$$

$$(\text{OP} + \text{CP}) / 2 = ₹ 1,00,000$$

$$\text{or, OP} + \text{CP} = ₹ 1,00,000 \times 2 = ₹ 2,00,000 \quad \dots \text{Eq. I}$$

$$\text{OP} = 1/4 \text{ CP}$$

$$\text{CP} - 4 \text{ OP} = 0 \quad \dots \text{Eq. II}$$

Subtracting Eq. II from I

$$5 \text{ OP} = ₹ 2,00,000$$

$$\text{OP} = ₹ 2,00,000 / 5 = ₹ 40,000$$

$$\text{CP} = ₹ 40,000 \times 4 = ₹ 1,60,000$$

Thus, Opening Trade Payables = ₹ 40,000, Closing Trade Payables = ₹ 1,60,000

BALANCE SHEET AS AT 31ST MARCH, 2018

Particulars	Note No	(₹ in lacs)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds		
(a) Share Capital		7.20
(b) Reserves and Surplus		1.80
(2) Non - Current Liabilities		—
(3) Current Liabilities		
(a) Trade Receivables		1.60
(b) Other Current Liabilities		2.15
Total		12.75

II. ASSETS		
(1) Non-Current Assets		6.75
(2) Current Assets		
(a) Inventory		1.50
(b) Trade Receivables		1.60
(c) Cash and Cash Equivalents		2.90
Total		12.75

SOLUTION TO Q 5 (B):**BALANCE SHEET AS AT 31ST MARCH, 2018**

<i>Particulars</i>	<i>Note No</i>	<i>2017-2018 (₹ in "000)</i>	<i>2016-2017 (₹ in "000)</i>
I. EQUITY AND LIABILITIES			
(1) Shareholders' Funds			
(a) Share Capital	1	900	
(b) Reserves and Surplus [P & L A/c (Dr.)]		(200)	
(2) Share Application Money pending Allotment		40	
(3) Non - Current Liabilities			
(a) Long term Borrowings [12% Debentures]		200	
(b) Other Long term Liabilities			
(Premium on Red. of Debentures)		20	
(c) Long term Provisions (Earned Leave)		45	
(4) Current Liabilities			
(a) Trade Payables (B/P)		75	
(b) Other Current Liabilities	2	50	
(c) Short term Provisions (Proposed Dividend)		20	
Total		1150	
II. ASSETS			
(1) Non-Current Assets			
(a) Fixed Assets			
(i) Tangible Assets (Plant & Machinery)		120	
(ii) Intangible Assets (Brands)		110	
(iii) Capital Work in progress (Building)		115	
(iv) Intangible Assets under development		20	
(b) Non-Current Investments	3	480	
(c) Long-term Loans & Advances (Security)		5	
(2) Current Assets			
(a) Current Investments (Deb. of Reliance Ltd.)		20	
(b) Inventories (Stores & Spares)		50	
(c) Trade Receivables (B/R)		120	
(d) Cash and Cash Equivalents (Ch. & DD)		48	
(e) Other Current Assets	4	62	
Total		1150	

Notes to Accounts:

<i>Particulars</i>	<i>2017-2018 (₹ in '000)</i>	<i>2016-2017 (₹ in '000)</i>
1. Share Capital		
50,000 Equity Shares of ₹10 each	500	
4,000, 15% Pref. Shares of ₹100 each	400	
	900	
2. Other Current Liabilities		
Bank Overdraft	45	
Calls-in-advance	5	
	50	
3. Non-Current Investments		
2,500, 12% Tata Steel Deb. of ₹100 each, ₹80 paid up	200	
12% Debentures of Reliance Ltd. [100 – 20]	80	
Investment in Land & Building	200	
	480	
4. Other Current Assets		
Prepaid Expenses	50	
Interest accrued on Debentures of Tata Steels	12	
	62	
5. Contingent Liabilities & Commitments		
(i) Contingent Liabilities		
Bills Discounted but not yet matured	25	
(ii) Commitments		
(a) Uncalled Liability on partly paid Debentures held as Investments [2,500, 12% Tata Steel Debentures of ₹ 100 each, ₹ 80 paid up] [2,500 × ₹ 20]	50	
(b) Arrears of Fixed Cumulative Dividends on Preference Shares [₹ 4,00,000 × 15/100 × 2]	120	

SOLUTION TO Q 6 (A):
DR.
CASH BOOK (WITH AMENDED BANK COLUMN)
CR.

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
31.03.2018	To Customer A/cs	6,600	31.03.2018	By Balance b/d	2,315
	To Creditors A/c	300		By Creditors A/cs	455
	To Rebate A/c	150		By Drawee's A/c	520
	To Error in carry forward	6,600		By Bank Interest	512
				By Balance c/d	9,848
		13,650			13,650

(B) BANK RECONCILIATION STATEMENT AS AT 31.3.2018

Particulars	Plus items ₹	Minus items ₹
A. Balance as per Cash Book (amended)	9,848	
B. Less: Cheque deposited but not collected upto 31st Mar. [₹ 21,500 - ₹ 13,000]		8,500
C. Add: Cheques issued but not presented for payment up to 31st Mar. [₹ 20,000 - ₹ 3,000]	17,000	
D. Less: Wrong Debit of Interest by Bank [₹ 321 - ₹ 312]		9
D. Less: Wrong Debit by Bank in withdrawal column [₹ 5,432 + ₹ 5,342]		10,774
D. Add: Wrong Credit by Bank in deposit column	2,435	
	29,283	19,283
E. Balance as per Bank Statement	10,000	

SOLUTION TO Q 6 (B):

Minimum Rent for 2015 = $1,00,000 - [(1,00,000 \times 73/365) + (1,00,000 \times 2/12)] = 63,333$

ANALYSIS OF ROYALTY PAYABLE AND SHORT WORKINGS

A Year	B Output (Units) Qty.	C = B × Rate Actual Royalty ₹	D Minimum Rent ₹	E = D - C Short Working ₹	F Short Working Recouped ₹	G = C + E - F Actual Payment ₹	H Short Working W/O ₹	I _n = I _{n-1} + E - F - H Short Working C/F ₹
2014	500	50,000	94,000	44,000	—	94,000	—	44,000
2015	900	90,000	96,000	6,000	—	96,000	—	50,000
2016	1,140	1,14,000	98,000	—	5,000	1,09,000	—	45,000
2017	1,260	1,26,000	1,00,000	—	5,000	1,21,000	34,000	6,000
2018	200	20,000	63,333	43,333	—	63,333	6,000	43,333

Dr.

ROYALTY PAYABLE ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Tulsian Ltd. A/c	50,000	2014	By P & L A/c	50,000
2015	To Tulsian Ltd. A/c	90,000	2015	By P & L A/c	90,000
2016	To Tulsian Ltd. A/c	1,14,000	2016	By P & L A/c	1,14,000
2017	To Tulsian Ltd. A/c	1,26,000	2017	By P & L A/c	1,26,000
2018	To Tulsian Ltd. A/c	20,000	2018	By P & L A/c	20,000

Dr.

TULSIAN LTD ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Bank A/c	94,000	2014	By Royalty Payable A/c	50,000
			2014	By Short Working Recoupment A/c	44,000
		94,000			94,000
2015	To Bank A/c	96,000	2015	By Royalty Payable A/c	90,000
			2015	By Short Working Recoupment A/c	6,000

		96,000			96,000
2016	To Bank A/c	1,09,000	2016	By Royalty Payable A/c	1,14,000
2016	To Short Working Recoupment A/c	5,000			
		1,14,000			1,14,000
2017	To Bank A/c	1,21,000	2017	By Royalty Payable A/c	1,20,000
2017	To Short Working Recoupment A/c	5,000			
		1,26,000			1,26,000
2018	To Bank A/c	63,333	2018	By Royalty Payable A/c	20,000
			2018	By Short Working Recoupment A/c	43,333
		63,333			63,333

Dr.

SHORT WORKING RECOUPMENT ACCOUNT

Cr.

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
2014	To Tulsian Ltd. A/c	44,000	2014	By Balance c/d	44,000
2015	To Balance b/d	44,000	2015	By Balance c/d	50,000
2015	To Tulsian Ltd. A/c	6,000			
		50,000			50,000
2016	To Balance b/d	50,000	2016	By Tulsian Ltd. A/c	5,000
			2016	By Balance c/d	45,000
		50,000			50,000
2017	To Balance b/d	45,000	2017	By Tulsian Ltd. A/c	5,000
			2017	By P & L A/c	34,000
			2017	By Balance c/d	6,000
		45,000			45,000
2018	To Balance b/d	6,000	2018	By P & L A/c	6,000
2018	To Tulsian Ltd. A/c	43,333	2018	By Balance c/d	43,333
		49,333			49,333

ROYALTY RECEIVABLE ACCOUNT

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
2014	To P & L A/c	50,000	2014	By Jalan A/c	50,000
2015	To P & L A/c	90,000	2015	By Jalan A/c	90,000
2016	To P & L A/c	1,14,000	2014	By Jalan A/c	1,14,000
2017	To P & L A/c	1,26,000	2014	By Jalan A/c	1,26,000
2018	To P & L A/c	20,000	2014	By Jalan A/c	20,000

JALAN LTD ACCOUNT

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
2014	To Royalty Receivable A/c	50,000	2014	By Bank A/c	94,000
2014	To Short Working Allowable A/c	44,000			
		94,000			94,000
2015	To Royalty Receivable A/c	90,000	2015	By Bank A/c	96,000
2015	To Short Working Allowable A/c	6,000			
		96,000			96,000
2016	To Royalty Receivable A/c	1,14,000	2016	By Bank A/c	1,09,000
			2016	By Short Working Allowable A/c	5,000
		1,14,000			1,14,000
2017	To Royalty Receivable A/c	1,26,000	2017	By Bank A/c	1,21,000
			2017	By Short Working Allowable A/c	5,000
		1,26,000			1,26,000
2018	To Royalty Receivable A/c	20,000	2018	To Bank A/c	63,333
2018	To Short Working Allowable A/c	43,333			
		63,333			63,333

Dr.

SHORT WORKING ALLOWABLE ACCOUNT

Cr.

<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
2014	To Balance c/d	44,000	2014	By Jalan Ltd. A/c	44,000
2015	To Balance c/d	50,000	2015	By Balance b/d	44,000
			2015	By Jalan Ltd. A/c	6,000
		50,000			50,000
2016	To Jalan Ltd. A/c	5,000	2016	By Balance b/d	50,000
	To Balance c/d	45,000			
		50,000			50,000
2017	To Jalan Ltd. A/c	5,000	2017	By Balance b/d	45,000
2017	To P & L A/c	34,000			
2017	To Balance c/d	6,000			
		45,000			45,000
2018	To P & L A/c	6,000	2018	By Balance b/d	6,000
	To Balance c/d	43,333	2018	By Jalan Ltd. A/c	43,333
		49,333			49,333

PAPER–1: PRINCIPLES AND PRACTICE OF ACCOUNTING

TULSIAN'S MODEL TEST PAPER 2

Questions No. 1 is compulsory.

Answer any four questions from the remaining five questions.

Working notes should form part of the answer.

“Wherever necessary, suitable assumptions may be made and indicated in answer.”

1 (a) State with reason whether the following statements are true or false (No Marks shall be awarded without valid reason):

- (i) Revenues are matched with expenses in accordance with the matching principle.
- (ii) Depreciation is non-cash and non- operating expense which is to be provided for if there are profits.
- (iii) Net Profit is reflected in higher cash balances and net loss is reflected in lower net worth.
- (iv) If Partnership Deed is silent, Rate of Interest on loan by firm to a Partner shall be 6% p.m.
- (v) Participating Preference Share is that share which in addition to two basic preferential rights also carries a right to participate in surplus profits and surplus assets.
- (vi) As per Table F, the Minimum rate of interest that can be charged on Calls-in-Arrear and that can be allowed on calls-in-advance are 10% p.m. and 12% p.m. respectively.

1 (b) Give any four points of difference between Fundamental Accounting Assumptions and Accounting Policies.

1 (c) Rectify the following errors:

- (i) Goods (Cost ₹ 423, Sale Price ₹ 432) taken by Ganesh, the proprietor for his personal use recorded in the sales book.
- (ii) Goods (Cost ₹ 423, Sale Price ₹ 432) given away as free samples to Mahesh, a customer recorded in the sales book
- (iii) An amount of ₹ 5,720 due from Ramesh, written off as bad in a previous year, was recovered and credited to the personal account of Mahesh.
- (iv) A discounted Bill of Exchange receivable for ₹ 16,000 returned by the firm's bank had been credited to the Bank Account and debited to Bills Receivable Account. A cheque was received later from the Customer for ₹ 16,000 and duly paid.
- (v) An amount of ₹ 8,000 owing by a customer had been omitted from the list of Sundry Debtors.
- (vi) A credit sale of old furniture to Rohan for ₹ 17,000 omitted to be posted.
- (vii) On 26th March, goods of the sale value of ₹ 2,00,000 were sent on sale or return basis to Gopal, a customer, the period of approval being two weeks. He returned 20% of the goods and approved 80% of the remaining on 31st March. These goods were sent at a profit of 25% on cost.
- (viii) Discount allowed ₹ 1,320 had been debited to Discount received as ₹ 132.
- (ix) Materials from store of ₹ 10,000 and Wages ₹ 4,000 had been used in making Tools and Implements for use in own factory, but no adjustments were made in the books.

- 2 (a)** X of Calcutta on 15th January sent to Y of Bombay a consignment of 250 televisions costing ₹ 10,000 each. Expenses of ₹ 7,000 were met by the Consignor. Y of Bombay spent ₹ 4,500 for clearance on 30th January and the selling expenses were ₹ 500 per television as and when the sale made by Y.

Y sold, on 4th March, 150 televisions @ ₹ 14,000 per television and again on 10th April, 75 televisions @ ₹ 14,400.

Mr Y was entitled to a commission of ₹ 500 per television sold plus one-fourth of the amount by which the gross sale proceeds less total commission there on exceeded a sum calculated at the rate of ₹ 12,500 per television sold. Y sent the account sale and the amount due to X on 30th April by bank demand draft. Prepare the Consignment Account and Y's account in the books of X.

- 2 (b)** X and Y had the following mutual dealings and desire to settle their account on the average due date:

01.01.2018	Balance owing by Mr X ₹ 5,000
30.01.2018	Goods sold to Y (credit period 30 days) ₹ 1,000
31.01.2018	Goods purchased by X (credit period 1 month) ₹ 2,000
13.07.2018	Goods sold to Y (credit period 30 days) ₹ 1,000
28.09.2018	Goods purchased by X (credit period 3 months) ₹ 1,000

Required: Ascertain the average due date.

- 2 (c)** From the following particulars, make up an Account Current to be rendered by Mr X to Mr Y on 31st December, 2018 taking interest into account at the rate of 18% p.a.

01.07.2018	Balance owing by Mr Y	₹ 600
30.07.2018	Goods sold to Mr Y (Credit Period allowed 1 Month)	₹ 300
01.08.2018	Goods purchased from Mr Y (Credit Period received 1 Month)	₹ 200
01.09.2018	Cash received from Mr Y	₹ 100
01.09.2018	Mr Y accepted Mr X's Draft at 3 Months date	₹ 100
01.10.2018	Mr Y accepted Mr X's Draft at 3 Months date	₹ 300

Required: Prepare the Account Current.

- 2 (d)** 'X' supplied goods on sale or return basis to customer, the particulars of which are as under:

Date of Despatch	Party's Name	Amount ₹	Remarks
10.03.2018	ABC Co.	10,000	No information till 31.03.2018
12.03.2018	DEF Co.	15,000	Returned on 16.03.2018
15.03.2018	GHI Co.	12,000	Goods worth ₹ 2,000 Returned on 20.03.2018
20.03.2018	DEF Co.	16,000	Goods Retained on 24.03.2018
25.03.2018	ABC Co.	11,000	Goods Retained on 28.03.2018
30.03.2018	GHI Co.	13,000	No information till 31.03.2018

Goods are to be returned within 15 days from the date of despatch, failing which it will be treated as Sales. The Books of 'X' are closed on the 31st March, 2018.

Prepare the following account in the book of 'X':

- Goods on Sales or Return, Sold and Returned Day Books.
- Goods on Sales or Return Total Account.

3. From the following Trial Balance of Shri Shivam as on 31st March, 2018, you are required to prepare a Trading and Profit and Loss Account for the year ended 31st March, 2018 and Balance Sheet as on that date, after making the necessary adjustment as mentioned hereunder:

<i>Particulars</i>	<i>Debit Balance</i> ₹	<i>Credit Balance</i> ₹
Capital & Drawings	24,000	1,60,000
Furniture and fixtures	8,000	—
Plant and machinery	60,000	—
Patents (ten years from 1.4.2017)	40,000	—
Opening Stock	40,000	—
Purchases & Sales	1,70,000	2,64,000
Salaries	14,800	—
Wages	30,000	—
Sundry Debtors & Creditors	20,400	24,000
Land	28,350	—
Loan from Shyam (at 6% from 1.10.2017)	—	20,000
Postage and fax	3,000	—
Rent, rates and taxes	7,200	—
Bad debts	800	—
Discount	—	1,200
Carriage inward	400	—
Interest on loan	300	—
Insurance	1,600	—
Travelling expenses	1,000	—
Sundry expenses	600	—
Cash & Bank	33,750	—
Bank overdraft	—	15,000
Total	4,84,200	4,84,200

Adjustments:

- Closing Stock is valued at ₹ 30,000
- A new machine was installed on 1st April, 2017 for ₹ 3,000. No entry in this respect was passed in the books. Wages of ₹ 1,000 paid for installing the machine were debited to Wages Account.
- Of the Sundry Debtors, ₹ 200 are bad and are to be written off. You are required to maintain a provision for doubtful debts @ 5% on debtors and provision for discount on debtors @2%.
- Goods costing ₹ 2,000 were given away as free samples for publicity.
- Depreciate Plant and Machinery at 20% per annum and Furniture and Fixtures at 10% per annum.
- On 1.4.2017 machinery of the value of ₹ 10,000 was destroyed by fire and the insurance claim settled at ₹ 8,000 was credited to Machinery Account.
- Goods for ₹ 1,200 were sent to a customer at a profit of 20% on cost on 30th March, 2018 on sale or return basis. This was recorded as actual sales.

4 (a) Record the Journal Entries for forfeiture and reissue of shares in the following cases assuming that the company follows the policy of adjusting excess Application Money towards other sums due on shares:

- (i) Bharat Ltd. forfeited 600 shares of ₹ 10 each issued at a premium of 30% to W who had applied for 1140 shares and paid an application money of ₹ 5 (including ₹ 1 premium), for non-payment of allotment money of ₹ 5 (including ₹ 1 premium). At different intervals of time, out of these 100 shares were re-issued to X as ₹ 8 called up for ₹ 7 per share, 100 shares were re-issued to Y as ₹ 8 paid up for ₹ 9 per share and 400 shares were re-issued to Z, credited as fully paid for ₹ 9 per share.
- (ii) Tushar Ltd. forfeited 600 shares of ₹ 10 each issued at a premium of 30% to W who had applied for 1500 shares for non-payment of first and final call money of ₹ 3 (including ₹ 1 premium). At different intervals of time, out of these 400 shares were re-issued to Z, credited as fully paid for ₹ 9 per share and 100 shares were re-issued to X as ₹ 10 paid up for ₹ 11 per share.

4 (b) On April 1, 2018, Bharat Tulsian Ltd. purchased a running business from Y Ltd. for ₹ 10,40,000 payable as to 25% by a cheque and the balance by an issue of 12% Debentures of ₹ 500 each at a premium of 4 % redeemable at a premium of ₹ 30 per Debenture in three equal installments starting from the end of third year. The assets and liabilities consisted of the following:

Building ₹ 6,00,000, Plant and Machinery ₹ 1,00,000, Inventories ₹ 2,00,000, Trade Receivables ₹ 1,80,000, Trade Payables ₹ 80,000.

Interest is payable half yearly on 30th September and 31st March. Pass the necessary Journal Entries in the books of Bharat Tulsian Ltd for the first year (assume the rate of Tax deducted at source being 10%).

4 (c) The Balance Sheet of X, Y and Z sharing profits and losses in the ratio of 5 : 3 : 2 on 31st December, 2017 is given below:

Liabilities	₹	Assets	₹
Sundry Creditors	12,000	Goodwill	10,000
Employees' Provident Fund	6,000	Patents	52,000
Investment Fluctuation Reserve	7,000	Machinery	62,400
Workmen Compensation Reserve	7,000	Investments	6,000
X's Capital	1,35,000	Stock	20,000
Y's Capital	95,000	Sundry Debtors	24,000
Z's Capital	74,000	Less: Provision	4,000
		Loan to Z	1,000
		Cash at Bank	12,600
		Advertisement Expenditure	2,000
		Profit & Loss A/c (2017)	1,50,000
	3,36,000		3,36,000

Z retires from 1st May, 2018 and X and Y decide to share future profits losses in the ratio of 3:5. Z has withdrawn ₹ 10,000 during 2018. It was agreed that:

- (a) Goodwill be valued at 2-1/2 years' purchase of average of four completed years' profits which were: 2014 ₹ 2,02,000; 2015 ₹ 28,000; 2016 ₹ 32,000.
- (b) Z's Share of profit from the closure of last accounting year till date of retirement be calculated on the basis of the average of three completed years' profits before retirement.
- (c) Patents undervalued by ₹ 14,000, Machinery overvalued by ₹ 13,600, All Debtors are good. ₹ 1,000 included in Sundry Creditors is not likely to arise. Unaccounted Accrued Income of ₹ 2,200 to be provided for. A debtor whose dues of ₹ 400 were written off

as bad debts paid 50% in full settlement. A claim of ₹ 1,000 on account of Workmen's Compensation to be provided for.

- (d) Investments be sold for ₹ 8,200. Z was to be paid through Cash brought in by X and Y in such a way as to make their capitals proportionate to their new profit sharing ratio of 3 : 5 assuming that a minimum Cash & Bank Balance of ₹ 9,000 was to be maintained

Prepare Revaluation Account, Capital Accounts of Partners and the Balance Sheet of New Firm.

5 (a) From the following information, Calculate Closing Inventory, Share Capital and Fixed Assets:

Working Capital	₹ 1,20,000	Current Ratio	2.5
Reserves and Surplus	₹ 80,000	Quick Ratio	1.5
Non-Current Assets/Proprietary Funds	0.75	Bank Overdraft	₹ 20,000

There are *neither* Non-Current Liabilities *nor* Prepaid Expenses.

5 (b) From the following information, prepare Trading, Profit and Loss Account, for the year ending 31st March, 2018 and the Balance Sheet of Tulsian Ltd. as at 31st March, 2018.

- Current Ratio 2.5
- Quick Ratio 1.5
- Working Capital ₹ 1,20,000
- Prepaid Expenses ₹ 35,000
- Bank Overdraft ₹ 20,000
- Working Capital Velocity 1.5 Months
- Debtors' Velocity 3 months
- Stock Velocity 3/4 Month
- Cash Sales 33-1/3% of Credit Sales.
- Closing Stock was ₹ 10,000 in excess of Opening Stock
- Operating Ratio 75%
- Provision for Tax @ 20%
- Opening Balance of Profit and Loss A/c (cr) : ₹ 30,000
- Opening Balance of General Reserve : ₹ 6,000
- Transfer to General Reserve : 1/3 of Current year's Profits
- Interim Dividend Paid : 37% of Paid up Capital
- Debtors in the beginning were 3 times more than that at the end.
- Current Assets consist of Cash, Marketing Securities, Stock, Debtors, Prepaid Expenses. Cash to Marketable Securities Ratio is 100%.
- Fixed Assets to Proprietors' Funds 0.75
- There are no long-term debts.

5 (c) PCT Ltd. is in the process of finalizing its accounts for year ended 31st March, 2018 and furnishes the following information:

- Finished goods normally are held for 1 month before sale.
- Sales realization from Debtors usually takes 2 months from date of credit invoice.
- Raw materials are held in stock to cover 1 month's production requirements.
- Packing materials, being specifically made for the company and having lead time of 3 months is held in stock for 3 months.

- (v) The holding period in respect of unfinished goods is 1 month.
- (vi) Being a monopoly PCT Ltd. enjoys a credit period of 12.5 months from its suppliers who sometimes at the end of their credit period opt for conversion of their dues into long term debt of PCT Ltd.

You are required to compute the operating cycle of PCT Ltd. as per Schedule III of The Companies Act, 2013. As the suppliers of the company are paid off after a credit period of 12.5 months should this be part of Current Liability? Would your answer be the same if the creditors are settled in 330 days?

6 (a) Tulsian Ltd. provides you the following information:

Date	Particulars
	The Machinery Account of Tulsian Ltd had a debit balance of ₹ 6,84,000 on 1st April, 2017
01.04.2015	Purchased 10 second hand Machines of the same type and incurred ₹ 70,000 towards freight & insurance, ₹ 20,000 towards carriage inward
01.01.2016	Incurred ₹ 7,000 towards Repairs and ₹ 3,000 on Installation of machines and ₹ 12,000 towards Annual Insurance Premium and commenced the commercial production.
01.10.2016	Sold one machine at a profit of 10%
01.01.2017	Incurred ₹ 10,000 on repairs of Machines
01.01.2018	Sold one machine at a loss of 10% and purchased a new machine for ₹ 90,000 and spent ₹ 10,000 on its installation

Depreciation was annually provided on 31st March @ 20% p.a on the written down value. On 31st March, 2018, it was decided to adopt the method of providing depreciation @ 20% p.a. on original cost.

Required: Prepare the Machinery Account for three financial years.

6 (b) ILU & PILU entered into a Joint Venture to purchase, recondition and sell second hand cars. ILU purchased 100 cars during the period 1st Oct. to 31st March at the following prices and paid for the same:

20 cars	@ ₹ 15,000 each
40 cars	@ ₹ 25,000 each
40 cars	@ ₹ 55,000 each

PILU during the same period reconditioned the cars by spending the following amounts:

Spare Parts used	₹ 1,80,000	Testing Charges	₹ 20,000
Painting	₹ 2,00,000	Insurance	₹ 60,000
Air-conditioning-10 Cars	₹ 3,00,000	Labour Charges	₹ 10,40,000

ILU and PILU sold the cars, the details of which are as under:

Sold by			
ILU		PILU	
A.C. Cars	5 @ ₹ 1.75 lakhs each	4 @ ₹ 1.75 lakhs each	
Non-A.C. Cars	35 @ ₹ 1.25 lakhs each	35 cars @ ₹ 1.10 lakhs each	
		11 cars @ ₹ 0.80 lakhs each	

During testing, one non-A.C. car met with an accident and the Insurance Company paid the actual average cost as claim amount. ILU retained one Non-A.C. Car for his personal use which was priced at actual average cost. Prepare the Memorandum Joint Venture Account, Joint Venture Account with ILU in the books of PILU and Joint Venture Account with PILU in the books of ILU.

ANSWERS TO MODEL TEST PAPER 2**ANSWERS TO Q 1 (A):**

S. No.	Reason
(i)	False: Expenses are matched with revenues in accordance with the matching principle. Concept of matching requires accrual and periodicity concepts as accrued revenues are matched with accrued expenses of a definite accounting period.
(ii)	False: Depreciation is non-cash but operating expense which is to be provided for whether there are profits/ losses.
(iii)	False: Net profit may not be reflected in higher cash balance because of credit transactions. On the other hand, cash may increase because of fresh loan or fresh capital. Net worth is the sum of capital, reserves and profit and loss account balance. Net worth is reduced by net loss. But net worth may also be reduced by withdrawal by the proprietor/partners. So lower net worth may not necessarily reflect net loss.
(iv)	False: The Partnership Act has not prescribed any Rate of Interest on Loan by firm to Partner.
(v)	False: Participating Preference Share is that share which in addition to two basic preferential rights also carries a right to participate in surplus profits and/ or surplus assets.
(vi)	False: As per Table F, the maximum rate of interest that can be charged on Calls-in-Arrear and that can be allowed on calls-in-advance are 10% p.a. and 12% p.a. respectively.

ANSWERS TO Q 1 (B):

Basis of Distinction	Fundamental Accounting Assumptions	Accounting Policies
1. Number	There are only three fundamental accounting assumptions viz. Going Concern, Consistency and Accrual.	There is no single list of accounting policies which are applied in all circumstances. As a result, there may be different accounting policies adopted by different enterprises.
2. Disclosure if followed	No disclosure is required if all the fundamental assumptions have been followed.	Disclosure is required if a particular accounting policy has been followed
3. Disclosure if not followed	In case the fundamental assumptions are not followed; the fact has to be disclosed in the financial statements together with the reasons.	In case, the policy is changed in subsequent year, the reasons for such change and the resulting financial consequences have to be disclosed.
4. Choice	There is no choice.	The firm has a choice to select a particular policy

SOLUTION TO Q 1(C):
JOURNAL

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
(i)	Sales A/c Dr. Drawings A/c Dr. To Ganesh's Capital A/c To Purchases A/c (Being the goods taken by proprietor for his personal use recorded in sales book, now rectified)		432 423	432 423
(ii)	Sales A/c Dr. Sales Promotion A/c Dr. To Mahesh To Purchases A/c (Being the goods given away as free samples recorded in sales book, now rectified)		432 423	432 423
(iii)	Mahesh Dr. To Bad Debts Recovered A/c (Being Bad Debts Recovered wrongly credited to Mahesh now rectified)		5,720	5,720
(iv)	Customer's A/c Dr. To Bills Receivable A/c (Being dishonour of a B/R wrongly debited to Bills Receivable A/c now rectified)		16,000	16,000
(v)	Sundry Debtors Dr. To Suspense A/c (Being a debtor omitted from the list now included) [Note: Debtor's A/c need not be posted again in the ledger in this case since it is already correctly balanced].		8,000	8,000
(vi)	No Journal Entry is to be passed as it has already been correctly passed in the Journal. Merely posting in both the accounts in the ledger is required.			
(vii)	(i) Sales Returns Dr. To Gopal (Being 20% of ₹ 2,00,000, returned) (ii) (a) Sales A/c Dr. To Gopal (Being 20% of 1,60,000, not yet approved, now adjusted) (b) Closing Stock Dr. To Trading A/c (Being 80% of ₹ 32,000, treated as parts of stock)		40,000 32,000 25,600	40,000 32,000 25,600

(viii)	Discount Allowed A/c To Discount Received A/c To Suspense A/c (Being wrong posting, now rectified)	Dr.	1,320	132 1,188
(ix)	Tools & Implements A/c To Materials To Wages (Being materials & wages used in tools, now adjusted)	Dr.	14,000	10,000 4,000

SOLUTION TO Q 2(A):

DR.

CONSIGNMENT TO BOMBAY ACCOUNT

CR.

Particulars		₹	Particulars		₹
To Goods sent on Consignment A/c		25,00,000	By Y's A/c (Sales):		
To Bank A/c (Expenses)		7,000	150 @ ₹ 14,000	21,00,000	
To Y's A/c:			75 @ ₹ 14,400	10,80,000	31,80,000
Clearance	4,500		By Consignment Stock A/c:		
Selling Expenses	1,12,500	1,17,000	Cost of 25 TV		
To Y's A/c (Commission)		1,63,500	@ ₹ 10,000	2,50,000	
To Profit & Loss A/c			Add: Consignor's Exp.		
(Profit on Consignment)		6,43,650	(7,000 × 25/250)	700	
			Add: Consignee's Exp.		
			(4,500 × 25/250)	450	2,51,150
		34,31,150			34,31,150

Dr.

Y's ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Consignment to Bombay A/c (Sales)	31,80,000	By Consignment to Bombay A/c:	
		Clearance	4,500
		Selling Expenses	1,12,500
		By Consignment to Bombay A/c	
		(Commission)	1,63,500
		By Bank A/c	28,99,500
	31,80,000		31,80,000

Working Notes: Calculation of Consignee's Commission1. Fixed Commission @ ₹ 500 = $225 \times ₹ 500 = ₹ 1,12,500$

2. Let the total Commission be X

$$\text{Variable Commission} = [(\text{₹ } 31,80,000 - X) - (225 \times ₹ 12,500)]$$

$$X - ₹ 1,12,500 = [\text{₹ } 31,80,000 - X - ₹ 28,12,500]$$

$$X - ₹ 1,12,500 = (\text{₹ } 3,67,500 - X)$$

$$X - ₹ 1,12,500 = 91,875 - X$$

$$X - 1,12,500 = 91,875 - .25 X$$

$$1.25 X = 2,04,375$$

$$X = ₹ 2,04,375 / 1.25 = 1,63,500$$

SOLUTION TO Q 2(B):

Let the Base Date be 01.01.2018

FOR OWINGS BY MR X

A Due Date	B Amount	C No. of days from Base Date to Date	D = B × C Product
01.01.2018*	5,000	1	5,000
29.02.2018	2,000	30 + 29 = 59	1,18,000
28.12.2018	1,000	366 - 4 = 362	3,62,000
	8,000		4,85,000

*It is the date of brought down balance and not the date of transaction.

FOR OWINGS TO MR X

A Due Date	B Amount	C No. of days from Base Date to Date	D = B × C Product
29.02.2018	1,000	30 + 29 = 59	59,000
12.08.2018	1,000	30 + 29 + 31 + 30 + 31 + 30 + 31 + 12 = 224	2,24,000
	2,000		2,83,000

$$\begin{aligned}\text{Average Due Date} &= \text{Base Date} + \frac{\text{Total of Products}}{\text{Total Amount}} \text{ days} \\ &= 01.01.2018 + \frac{₹ 4,85,000 - ₹ 2,83,000}{₹ 8,000 - ₹ 2,000} \text{ Days} \\ &= 01.01.2018 + 33.67 \text{ Days} = 04.02.2016\end{aligned}$$

SOLUTION TO Q 2(C):

MRY IN ACCOUNT CURRENT WITH MR X (INTEREST TO 31ST DEC., 2018 @ 18% P.A.)														Dr.	Cr.
Date	Particulars	L.F.	Due Date	Amt. ₹	Days	Product ₹ P	Date	Particulars	L.F.	Due Date	Amt. ₹	Days	Product ₹ P		
01.07.2018	To Balance b/d			600	184	1,10,400	01.08.2018	By Purchases A/c		Sep. 1	200	121	24,200		
30.07.2018	To Sales A/c		Aug 30	300	123	36,900	01.09.2018	By Cash A/c		Sep. 1	100	121	12,100		
31.12.2018	To Interest on Balance for 1 day @ 18%			54			01.09.2018	By B/R A/c		Dec. 4	100	27	2,700		
	$\left[\frac{1,09,500 \times 18 \times 1}{100 \times 365} \right]$						01.10.2018	By B/R A/c		4.1.14	300	(4)	(1,200)		
							31.12.2018	By Bal. of Products			254		1,09,500		
				954		1,47,300	31.12.2018	By Balance c/d							
											954		1,47,300		

SOLUTION TO Q 2(D):
GOODS ON SALES OR RETURN, SOLD AND RETURNED DAY BOOKS

Date	Party to whom goods sent	L.F.	₹	Date	Sold ₹	Returned ₹
10.03.2018	M/s ABC Co.		10,000	25.03.2018	10,000	
12.03.2018	M/s DEF Co.		15,000	16.03.2018	—	15,000
15.03.2018	M/s GHI Co.		12,000	20.03.2018	10,000	
20.03.2018	M/s DEF Co.		16,000	24.03.2018	16,000	2,000
25.03.2018	M/s ABC Co.		11,000	28.03.2018	11,000	
30.03.2018	M/s GHI Co.		13,000	—	—	
			77,000		47,000	17,000

GOODS ON SALES OR RETURN TOTAL ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
31.03.2018	To Returns	17,000	31.03.2018	By Goods Sent on Sales or Return	77,000
	To Sales	47,000			
	To Balance c/d	13,000			
		77,000			77,000

SOLUTION TO Q 3:
TRADING AND PROFIT AND LOSS ACCOUNT
Dr.
for the year ended 31st March, 2018
Cr.

Particulars	₹	Particulars	₹
To Opening Stock	40,000	By Sales	2,64,000
To Purchases	1,70,000	Less: Sent for approval	1,200
Less: Free samples	2,000		2,62,800
	1,68,000	By Closing stock	30,000
To Carriage Inward	400	Add: Sent for approval	1,000
To Wages	30,000		31,000
Less: Installation	1,000		
	29,000		
To Gross Profit c/d	56,400		
	2,93,800		2,93,800
To Rent, rates and taxes	7,200	By Gross profit b/d	56,400
To Salaries	14,800	By Discount received	1,200
To Postage and fax	3,000		
To Sundry expenses	600		
To Travelling expenses	1,000		
To Interest on loan	300		
Add: Accured interest	300		
	600		
To Sales Promotion Exp.	2,000		
To Insurance	1,600		
To Loss of machinery by fire	2,000		

To Bad debts	800		
Add: Written off	200		
Add: Provision	950	1,950	
To Provision for Discount on debtors		361	
To Depreciation:			
Plant and machinery	12,400		
Furniture and fixtures	800		
Patents	4,000	17,200	
To Net Profit t/f to Capital a/c		5,289	
		57,600	57,600

BALANCE SHEET AS AT 31ST MARCH, 2018

<i>Liabilities</i>		₹	<i>Assets</i>		₹
<i>Capital Account:</i>			Land		28,350
Opening Balance	1,60,000		Plant and machinery	60,000	
Add: Net Profit	5,289		Add: Purchased	3,000	
Less: Drawings	24,000	1,41,289	Add: installation charges	1,000	
Loans from Shyam @6%	20,000		Less: Loss by fire	2,000	
Add: Accrued interest	300	20,300		62,000	
Sundry Creditors		24,000	Less: Depreciation	12,400	49,600
Creditor for machinery		3,000	Patents	40,000	
Bank Overdraft		15,000	Less: Depreciation	4,000	36,000
			Furniture & Fixtures	8,000	
			Less: Depreciation	800	7,200
			Closing Stock	30,000	
			Add: with Customers	1,000	31,000
			Debtors	20,400	
			Less: Sent on approval	1,200	
			Less: Bad debts w/o	200	
				19,000	
			Less: Provision doubtful	950	
			debts @ 5%	18,050	
			Less: Provision for		
			discount @2%	361	17,689
			Cash & bank		33,750
		2,03,589			2,03,589

SOLUTION TO Q 4(A):
(I) JOURNAL OF BHARAT LTD

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	On Forfeiture of 600 Shares Share Capital A/c (600 × ₹ 8) Dr. Securities Premium A/c (₹ 3,000 – ₹ 2,700) Dr. To Share Allotment A/c To Forfeited Shares A/c (₹ 5,700 – ₹ 600 – ₹ 300) (Being 600 shares forfeited for non-payment of Allotment money)		4,800 300	300 4,800
2.	On Re-issue of 100 Shares as ₹ 8 paid-up for ₹ 7 per share Bank A/c (100 × ₹ 7) Dr. Forfeited Shares A/c (100 × ₹ 1) Dr. To Share Capital A/c (100 × ₹ 8) (Being 100 shares re-issued as ₹ 8 paid-up for ₹ 7 per share)		700 100	800
3.	Forfeited Shares A/c [(₹ 4,800 × 100/600) – ₹ 100] Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		700	700
4.	On Re-issue of 100 Shares as ₹ 8 paid-up for ₹ 9 per share Bank A/c (100 × ₹ 9) Dr. To Share Capital A/c (100 × ₹ 8) To Securities Premium A/c (100 × ₹ 1) (Being 100 shares re-issued as ₹ 8 paid-up for ₹ 9 per share)		900	800 100
5.	Forfeited Shares A/c (₹ 4,800 × 100/600) Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		800	800
6.	On Re-issue of 400 Shares Bank A/c (400 × ₹ 9) Dr. Forfeited Shares A/c (400 × ₹ 1) Dr. To Share Capital A/c (400 × ₹ 10) (Being 400 shares re-issued as fully paid-up for ₹ 9 per share)		3,600 400	4,000
7.	Forfeited Shares A/c [(₹ 4,800 × 400/600) – ₹ 400] Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		2,800	2,800

CALCULATION OF ALLOTMENT MONEY DUE BUT NOT RECEIVED

Particulars	₹
Application Money received from defaulter (1140 × ₹ 5)	5,700
Less: Application Money adjusted (600 × ₹ 5)	(3,000)
Excess Application Money	2,700
Allotment Money due (600 × ₹ 5)	3,000
Amount due but not received on Allotment towards Securities Premium	300

(II) JOURNAL OF TUSHAR LTD

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1.	On Forfeiture of 600 Shares Share Capital A/c (600 × ₹ 10) Dr. Securities Premium A/c (₹ 1800 – ₹ 1500) Dr. To Calls-in-arrears A/c To Forfeited Shares A/c [₹ 7,500 – ₹ 600 – ₹ 600 – ₹ 300] (Being 600 shares forfeited for non-payment of call money)		6,000 300	300 6,000
2.	On Re-issue of 400 Shares Bank A/c (400 × ₹ 9) Dr. Forfeited Shares A/c (400 × ₹ 1) Dr. To Share Capital A/c (400 × ₹ 10) (Being 400 shares re-issued as fully paid-up for ₹ 9 per share)		3,600 400	4,000
3.	Forfeited Shares A/c [(₹ 6,000 × 400/600) – ₹ 400] Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		3,600	3,600
4.	On Re-issue of 100 Shares Bank A/c (100 × ₹ 11) Dr. To Share Capital A/c (100 × ₹ 10) To Securities Premium A/c (100 × ₹ 1) (Being 100 shares re-issued as fully paid-up for ₹ 11 per share)		1,100	1,000 100
5.	Forfeited Shares A/c (₹ 6,000 × 100/600) Dr. To Capital Reserve A/c (Being the transfer of profit on re-issue)		1,000	1,000

CALCULATION OF CALL MONEY DUE BUT NOT RECEIVED

<i>Particulars</i>	<i>₹</i>
Application Money received from defaulter (1,500 × ₹ 5)	7,500
Less: Application & Allotment Money adjusted (600 × ₹ 10)	6,000
Excess Application Money	1,500
Excess Application Money adjusted on Call	(1,500)
Call Money due (600 × ₹ 3)	1,800
Amount due but not received on Call towards Securities Premium	300

SOLUTION TO Q 4(B):**JOURNAL**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
01.04.2018	Building Dr. Plant and Machinery Dr. Inventories Dr. Trade Receivables Dr. Goodwill A/c [Balancing Figure] Dr. To Trade Payables To Y Ltd. (Being the purchase of Business from Y Ltd.)		6,00,000 1,00,000 2,00,000 1,80,000 40,000	80,000 10,40,000

01.04.2018	Y Ltd. Loss on issue of Debentures A/c To Bank A/c [$\text{₹ } 10,40,000 \times 25\%$] To 12% Debentures A/c To Securities Premium A/c [$\text{₹ } 7,50,000 \times 4\%$] To Premium on Redemption of Debentures A/c (Being issue of 1500 Debentures at a premium of 4% redeemable at premium of ₹ 30 per Debenture). [No. of Debentures to be issued = $\text{₹ } 7,80,000 / \text{₹ } 520 = 1,500$]	Dr. Dr.	10,40,000 45,000	2,60,000 7,50,000 30,000 45,000
30.09.2018	Interest on Debentures A/c [$1500 \times \text{₹ } 500 \times 12\% \times 6/12$] To Debenture holders' A/c ($\text{₹ } 45,000 \times 90\%$) To TDS from Deb. Int. A/c [$\text{₹ } 45,000 \times 10\%$] (Being the Interest due for 6 months & T.D.S. @ 10%)	Dr.	45,000	40,500 4,500
30.09.2018	Debenture holders' A/c TDS from Deb. Interest A/c To Bank A/c (Being the payment of Interest & TDS)	Dr. Dr.	40,500 4,500	45,000
31.03.2019	Interest on Debentures A/c [$1500 \times \text{₹ } 500 \times 12\% \times 6/12$] To Debenture holders' A/c ($\text{₹ } 45,000 \times 90\%$) To TDS from Deb. Int. A/c [$\text{₹ } 45,000 \times 10\%$] (Being the Interest due for 6 months & T.D.S. @ 10%)	Dr.	45,000	40,500 4,500
31.03.2019	Debenture holders' A/c TDS from Deb. Interest A/c To Bank A/c (Being the payment of Interest & TDS)	Dr. Dr.	40,500 4,500	45,000
31.03.2019	Securities Premium A/c To Loss on issue of Debentures A/c (Being the Loss written off out of Securities Premium)		30,000	30,000
31.03.2019	Profit and Loss A/c To Loss on issue of Debentures A/c To Interest on Debentures A/c (Being the Loss on issue of Debentures & Interest w/o to P & L A/c)	Dr.	93,750	3,750 90,000

Working Note:

Balance of Loss to be w/o = Loss on issue of Debentures – Securities Premium

$$= ₹ 45,000 - ₹ 30,000 = ₹ 15,000$$

LOSS ON ISSUE OF DEBENTURES TO BE CHARGED TO P & L A/C EACH YEAR

Date A	Face Value of Debentures outstanding (₹) B	Proportion C	Loss to be w/o $D = ₹ 15,000 \times C/12$ D
31.03.2019	7,50,000	3	$3/12 \times ₹ 15,000 = ₹ 3,750$
31.03.2020	7,50,000	3	$3/12 \times ₹ 15,000 = ₹ 3,750$
31.03.2021	7,50,000	3	$3/12 \times ₹ 15,000 = ₹ 3,750$
31.03.2022	5,00,000	2	$2/12 \times ₹ 15,000 = ₹ 2,500$
31.03.2023	2,50,000	1	$1/12 \times ₹ 15,000 = ₹ 1,250$
		12	15,000

SOLUTION TO Q 4(C):

Dr.

REVALUATION ACCOUNT

Cr.

Particulars	₹	Particulars	₹
To Machinery	13,600	By Sundry Creditors	1,000
To Profit transferred to:		By Accrued Income	2,200
X's Capital A/c	5,000	By Bad Debts Recovered	200
Y's Capital A/c	3,000	By Patents	14,000
Z's Capital A/c	2,000	By Provision for Doubtful Debts	4,000
		By Investments	2,200
	23,600		23,600

Dr.

PARTNERS' CAPITAL ACCOUNTS

Cr.

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Bank A/c	—	—	10,000	By Balance b/d	1,35,000	95,000	74,000
To Goodwill A/c	5,000	3,000	2,000	By Revaluation A/c	5,000	3,000	2,000
To P & L A/c	75,000	45,000	30,000	By Y's Capital A/c	8,750	—	14,000
To Z's Capital A/c	—	14,000	—	By Invest. F. Res.	3,500	2,100	1,400
To X's Capital A/c	—	8,750	—	By Work. Comp. Res.	3,000	1,800	1,200
To P&L Suspense A/c	—	—	2,000				
To Loan to Z A/c	—	—	1,000				
To Adv. Exp.	1,000	600	400				
To Bank A/c	—	—	47,200				
To Balance c/d	74,250	30,550	—				
	1,55,250	1,01,900	92,600		1,55,250	1,01,900	92,600
To Bank A/c (b.f.)	18,000	—	—	By Balance b/d	74,250	30,550	—
To Balance c/d	56,250	93,750	—	By Bank A/c (b.f.)	—	63,200	—
	74,250	93,750	—		74,250	93,750	—

BALANCE SHEET OF NEW FIRM AS AT 1ST MAY, 2018

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Sundry Creditors	11,000	Patents	66,000
Employees' Provident Fund	6,000	Machinery	48,800
X's Capital	56,250	Stock	20,000
Y's Capital	93,750	Sundry Debtors	24,000
P & L Suspense A/c	2,000	Accrued Income	2,200
Workmen's Compensation Claim	1,000	Cash at Bank	9,000
	1,70,000		1,70,000

Working Notes:

- X's sacrifice = $3/8 - 5/10 = (5/40)$, Y's gain = $5/8 - 3/10 = 13/40$
- Firm's Goodwill = $[(2,02,000 + 28,000 + 32,000 - 1,50,000)/4] \times 2.5 = ₹ 70,000$
- Z's Share of Goodwill = $₹ 70,000 \times 2/10 = ₹ 14,000$
- X's Share of Goodwill = $₹ 70,000 \times 5/40 = ₹ 8,750$
- Average Profit (Loss) of Last 3 years = $(28,000 + 32,000 - 1,50,000)/3 = (₹ 30,000)$
- Z's Share of Loss = $(₹ 30,000) \times 4/12 \times 2/10 = (₹ 2,000)$
- Cash available = $₹ 12,600 - ₹ 10,000 + ₹ 8,200 + ₹ 200 - ₹ 9,000 = ₹ 2,000$
- Total Capital of New Firm = $₹ 74,250 + ₹ 30,550 + ₹ 47,200 - ₹ 2,000 = ₹ 1,50,000$
- X's New Capital = $₹ 1,50,000 \times 3/8 = ₹ 56,250$, Z's New Capital = $₹ 1,50,000 \times 5/8 = ₹ 93,750$

Dr.
10. CASH AT BANK ACCOUNT
Cr.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance b/d	12,600	By Z's Capital A/c (Drawings)	10,000
To Investments	8,200	By Z's Capital A/c	47,200
To Y's Capital A/c	63,200	By X's Capital A/c	18,000
To Bad Debts Recovered	200	By Balance c/d	9,000
	84,200		84,200

SOLUTION TO Q 5(A):
Step 1: Current Assets and Current Liabilities

Current Assets – Current Liabilities = Working Capital = ₹ 1,20,000 Eq. I

Current Assets/Current Liabilities = 2.5

or, Current Assets – 2.5 Current Liabilities = 0 Eq. II

Subtracting Eq. II from Eq. I

1.5 Current Liabilities = ₹ 1,20,000

Current Liabilities = ₹ 1,20,000/1.5 = ₹ 80,000, Current Assets = ₹ 80,000 × 2.5 = 2,00,000

Step 2: Quick Assets = Current Liabilities × Quick Ratio = ₹ 80,000 × 1.5 = ₹ 1,20,000

Step 3: Closing Inventory = Current Assets – Quick Assets = ₹ 2,00,000 – ₹ 1,20,000 = ₹ 80,000

Step 4: Proprietary Funds + Current Liabilities = Non-Current Assets + Current Assets

Let us assume the Proprietary Funds be 'X'

$X + ₹ 80,000 = .75X + ₹ 2,00,000$

$X - .75X = ₹ 2,00,000 - ₹ 80,000 = ₹ 1,20,000$

$X = ₹ 1,20,000/.25 = ₹ 4,80,000$

Step 5: Share Capital = ₹ 4,80,000 – ₹ 80,000 = ₹ 4,00,000

Step 6: Non-Current Assets = 75% of ₹ 4,80,000 = ₹ 3,60,000

SOLUTION TO Q 5(B):

TRADING AND PROFIT AND LOSS ACCOUNT OF TULSIAN LTD.

Dr.

For the year ending 31st March, 2018

Cr.

Particulars	₹	Particulars	₹
To Opening Stock	35,000	By Sales	9,60,000
To Purchases (Balancing Figure)	6,50,000	By Closing Stock	45,000
To Gross Profit c/d	3,20,000		
	10,05,000		10,05,000
To Expenses (Balancing Figure)	80,000	By Gross Profit b/d	3,20,000
To Provision for Tax (20% of ₹ 2,40,000)	48,000		
To Net Profit after tax c/d	1,92,000		
	3,20,000		3,20,000
To General Reserve	64,000	By Balance b/d	30,000
To Interim Dividend [37% of ₹ 4,00,000]	1,48,000	By Net Profit	1,92,000
To Balance c/d	10,000		
	2,22,000		2,22,000

BALANCE SHEET AS AT 31ST MARCH, 2018

Particulars	Note No	(₹ in lacs)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds		
(a) Share Capital		4.00
(b) Reserves and Surplus		0.80
(2) Non - Current Liabilities		—
(3) Current Liabilities		
(a) Short term Borrowings (Bank overdraft)		0.20
(b) Short term Provisions (Provision for Tax)		0.48
(c) Other Current Liabilities		0.12
Total		5.60
II. ASSETS		
(1) Non-Current Assets		3.60
(2) Current Assets		
(a) Inventory		0.45
(b) Trade Receivables		0.72
(c) Cash and Cash Equivalents		0.48
(d) Other Current Assets (Prepaid Expenses)		0.35
Total		5.60

Working Notes:

(i) *Calculation of Current Assets and Current Liabilities*

$$\text{Current Ratio} = \text{CA/CL} = 2.5$$

$$\text{CA} = 2.5 \text{ CL}$$

$$\text{CA} - 2.5\text{CL} = 0 \quad \dots(\text{I})$$

$$\text{Working Capital} = \text{CA} - \text{CL} = ₹ 1,20,000 \quad \dots(\text{II})$$

Substituting Equation (i) in Equation (ii)

$$2.5 \text{ CL} - \text{CL} = 1,20,000$$

$$\text{CL} = 1,20,000/1.5$$

$$= ₹ 80,000$$

$$\text{CA} = ₹ 80,000 \times 2.5$$

$$= ₹ 2,00,000$$

(ii) *Calculation of Closing Stock*

$$\text{Quick Ratio} = \text{Quick Assets/CL}$$

$$= \frac{\text{Current Assets} - \text{Inventory} - \text{Prepaid Exp}}{\text{Current Liabilities}}$$

$$= (\text{₹ } 2,00,000 - \text{Stock} - ₹ 35,000)/₹ 80,000 = 1.5$$

$$\text{Stock} = ₹ 1,65,000 - (80,000 \times 1.5) = ₹ 45,000$$

(iii) *Opening Stock* = ₹ 45,000 – ₹ 10,000 = ₹ 35,000

(iv) *Calculation of Total Sales*

$$\text{Working Capital Velocity} = 12/\text{Working Capital Turnover} = 1.5$$

$$\text{Working Capital Turnover} = 12/1.5 = 8$$

$$\text{Working Capital Turnover Ratio} = \text{Net Sales} / \text{Working Capital}$$

$$\text{Net Sales} = \text{Working Capital} \times \text{Working Capital Turnover} = ₹ 1,20,000 \times 8 = ₹ 9,60,000$$

(v) *Stock Velocity* = 12/ *Stock Turnover Ratio* = 3/4

$$\text{Stock Turnover Ratio} = 12 \times 4/3 = 16 \text{ times}$$

$$\text{Stock Turnover Ratio} = \text{Cost of Goods Sold}/\text{Average Stock}$$

$$\text{Cost of Goods Sold} = \text{Stock Turnover Ratio} \times \text{Average Stock}$$

$$= 16 \times [(\text{₹ } 45,000 + ₹ 35,000)/2] = ₹ 6,40,000$$

(vi) *Gross Profit* = *Net Sales* – *Cost of Goods Sold*

$$= ₹ 9,60,000 - ₹ 6,40,000 = ₹ 3,20,000$$

(vii) *Closing Debtors*

$$\text{Cash Sales} + \text{Cr. Sales} = \text{Net Sales}$$

$$1/3x + x = ₹ 9,60,000$$

$$x = ₹ 9,60,000 \times 3/4 = ₹ 7,20,000$$

$$\text{Debtors Turnover Ratio} = 12/3 = 4 \text{ times}$$

$$\text{Average Debtors} = \text{Net Cr. Sales} / 4 = ₹ 7,20,000/4$$

$$(\text{OD} + \text{CD})/2 = ₹ 1,80,000$$

$$\text{OD} + \text{CD} = ₹ 1,80,000 \times 2 = ₹ 3,60,000 \quad \dots \text{Eq. I}$$

$$4\text{CD} - \text{OD} = 0 \quad \dots \text{Eq. II}$$

Adding both the equations $5CD = ₹ 3,60,000$

$$CD = ₹ 3,60,000/5 = ₹ 72,000$$

$$\begin{aligned} \text{(viii) Operating Profit before tax Ratio} &= 100 - \text{Operating Ratio} = 100\% - 75\% = 25\% \\ &= 25\% \text{ of } ₹ 9,60,000 = ₹ 2,40,000 \end{aligned}$$

(ix) *Calculation of Proprietors' Funds (Let us assume as X)*

$$\text{Proprietors' Funds} + \text{CL} = \text{FA} + \text{CA}$$

$$X + ₹ 80,000 = 0.75X + ₹ 2,00,000$$

$$X = ₹ 1,20,000/0.25 = ₹ 4,80,000$$

$$\text{(x) Fixed Assets} = 75\% \text{ of } ₹ 4,80,000 = ₹ 3,60,000$$

$$\text{(xi) New Reserve Created} = ₹ 1,92,000 \times 1/3 = ₹ 64,000$$

(xii) *Calculation of Share Capital (Let share capital be X).*

$$\text{SC} + \text{Op. Reserve} + \text{New Reserve} + \text{Op. P\&L} + \text{Balance of P\&L} = \text{Proprietors' Funds}$$

$$X + ₹ 6,000 + ₹ 64,000 + ₹ 30,000 + (₹ 1,92,000 - ₹ 64,000 - 0.37 X) = ₹ 4,80,000$$

$$X = ₹ 2,52,000/0.63 = ₹ 4,00,000$$

SOLUTION TO Q 5(C):

Operating Cycle = 1 + 1 + 3 + 1 + 2 = 8 months

Classification of liability to suppliers: Schedule III provides that:

"A liability shall be classified as current when it satisfies any of the following criteria:

- (i) it is expected to be settled in the company's normal operating cycle;
- (ii) it is held primarily for the purpose of being traded;
- (iii) it is due to be settled within 12 months after the reporting date; or
- (iv) the company does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments and do not affect its classification."
 - (a) **When credit period is 12.5 months:** It will be treated as non-current liability since it is not due to be settled within 12 months after the reporting date.
 - (b) **When credit period is 330 days (i.e. 11 months approx.):** It will be treated as current liability since it is due to be settled within 12 months after the reporting date.

SOLUTION TO Q 6(A):

CALCULATION OF PURCHASE PRICE OF 10 MACHINES AS ON 01.04.2015

Particulars	₹
A. W.D.V. of 9 Machines as on 1.4.2017	8,64,000
B. Add: Depreciation during 2016-2017 ($₹ 8,64,000 \times 20/80$)	1,71,000
C. W.D.V. of 9 Machines as on 1.4.2016	8,55,000
D. Book Value of 1 Machine ($8,55,000 \times 1/9$)	95,000
E. W.D.V. of 10 Machines as on 1.4.2016	9,50,000
F. Add: Depreciation during 2015-2016 ($₹ 9,50,000 \times 5/95$)	50,000
G. Total Cost of 10 Machines as on 1.1.2016	10,00,000
H. Less: Repairs and on Installation Incurred on 1.1.2016	10,000
I. Less: freight & insurance, and carriage inward Incurred on 1.4.2015	90,000
J. Purchase Price of 10 Machines as on 1.4.2015	9,00,000

Dr.

MACHINERY ACCOUNT

Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.2015	To Bank A/c	9,00,000	31.03.2016	By Depreciation A/c [10,00,000 × 20% × 3/12]	50,000
01.04.2015	To Bank A/c	90,000		By Balance c/d	9,50,000
01.01.2016	To Bank A/c	10,000			
		10,00,000			10,00,000
1.04.2016	To Balance b/d	9,50,000	01.10.2016	By Depreciation A/c [95,000 × 20% × 6/12]	9,500
	To P & L A/c [Profit] [(95,000 – 9,500) × 10%]	8,550		By Bank A/c [(95,000 – 9,500) + 10%]	94,050
			31.03.2017	By Depreciation A/c [(9,50,000 – 95,000) × 20% × 12/12]	1,71,000
				By Balance c/d	6,84,000
		9,58,550			9,58,550
01.04.2017	To Balance b/d	6,84,000	01.01.2018	By Depreciation A/c [76,000 × 20% × 9/12]	11,400
01.01.2018	To Bank A/c	90,000		By Bank A/c [(76,000 – 11,400) – 10%]	58,140
	To Bank A/c	10,000		By P & L A/c [Loss] [(76,000 – 11,400) × 10%]	6,460
			31.03.2018	By P & L A/c (Short Depreciation)	8,000
				By Depreciation A/c: Old [8,00,000 × 20%]	1,60,000
				New [1,00,000 × 20% × 3/12]	5,000
				By Balance c/d: Old 4,40,000 New 95,000	5,35,000
		7,84,000			7,84,000

Working Note: Calculation of Excess/Short Depreciation on 8 Machines

- (A) Depreciation already provided on WDV basis @ 20% p.a.
 $= [8,00,000] - [8,00,000 \times .95 \times .80] = ₹ 1,92,000$
- (B) Depreciation which should have been provided on SLM basis @ 20% p.a.
 $= [8,00,000 \times 20\% \times 15/12] = ₹ 2,00,000$
- (C) Short Depreciation still to be written off (A – B) = ₹ 8,000

SOLUTION TO Q 6(B):**DR.****MEMORANDUM JOINT VENTURE ACCOUNT****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Cost of purchase of cars (ILU)		By Sale Proceeds (ILU)	
20 @ 15000 3,00,000		A.C. Cars	
40 @ 25,000 10,00,000		5 @ ₹ 1,75,000 8,75,000	
40 @ 55,000 22,00,000	35,00,000	Non-A.C. Cars	
To Spare Parts used (PILU)	1,80,000	35 @ ₹ 1,25,000 43,75,000	52,50,000
To Painting (PILU)	2,00,000	By Sale Proceeds (PILU)	
To Air-Conditioning (PILU)	3,00,000	A.C. Cars	
To Testing Charger (PILU)	20,000	4 @ 1,75,000 7,00,000	
To Insurance (PILU)	60,000	Non-A.C. Cars	
To Labour Charges (PILU)	10,40,000	35 @ ₹ 1,10,000 38,50,000	
To Profit on venture:		11 @ ₹ 80,000 8,80,000	54,30,000
ILU 29,55,000		By Insurance Claim (PILU)	50,000
		By Cost of car taken by ILU	50,000
PILU 29,55,000	59,10,000	By Closing Stock	
		1 A.C. Car @ 80,000 80,000	
		7 Non-A.C. Cars 3,50,000	4,30,000
	112,10,000		112,10,000

DR.**JOINT VENTURE WITH PILU ACCOUNT IN THE BOOKS OF ILU****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (Cost of cars)	35,00,000	By Bank A/c (Sales)	52,50,000
To Profit & Loss A/c	29,55,000	By Drawings A/c (Cost of car taken)	50,000
		By Balance c/d	11,55,000
	64,55,000		64,55,000

DR.**JOINT VENTURE WITH ILU ACCOUNT IN THE BOOKS OF PILU****CR.**

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Bank A/c (Spare Parts used)	1,80,000	By Bank A/c (Sales)	54,30,000
To Bank A/c (Painting)	2,00,000	By Bank A/c (Claim)	50,000
To Bank A/c (Air-Conditioning)	3,00,000	By Balance c/d (Stock)	4,30,000
To Bank A/c (Testing Charges)	20,000		
To Bank A/c (Insurance)	60,000		
To Bank A/c (Labour Charges)	10,40,000		
To Profit & Loss A/c (Profit)	29,55,000		
To Balance c/d (Due to ILU)	11,55,000		
	59,10,000		59,10,000

Working Note: Calculation of Cost of AC and Non-AC Car

Average Cost of Purchase		A.C. Car	Non-A.C. Car
$\left[\frac{20 \times 15,000 + 40 \times 25,000 + 40 \times 55,000}{20 + 40 + 40} \right]$		35,000	35,000
Spare Parts used	[₹ 1,80,000/100]	1,800	1,800
Painting	[₹ 2,00,000/100]	2,000	2,000
Air-Conditioning	[₹ 3,00,000/10]	30,000	—
Testing Charges	[₹ 20,000/100]	200	200
Insurance	[₹ 60,000/100]	600	600
Labour Charges	[₹ 10,40,000/100]	10,400	10,400
		<u>80,000</u>	<u>50,000</u>

**PAPER 1: PRINCIPLES AND PRACTICE OF ACCOUNTING
FOR CA FOUNDATION COURSE**

SECTION 5

CA FOUNDATION EXAMINATION PAPERS

PAPER-1: PRINCIPLES AND PRACTICE OF ACCOUNTING
CA FOUNDATION EXAMINATION PAPER
MAY 2018

Questions No. 1 is compulsory.

*Answer any **four** questions from the remaining five questions.*

Working notes should form part of the answer.

"Wherever necessary, suitable assumptions may be made and indicated in answer."

1. (a) State with reason whether the following statements are true or false:
- (i) Expenses in connection with obtaining a license for running the Cinema Hall is Revenue Expenditure.
 - (ii) Re-issue of forfeited shares is allotment of shares but not a sale.
 - (iii) If the effect of errors committed cancel out, the errors will be called compensating errors and the trial balance will disagree.
 - (iv) There are two ways of preparing an account current.
 - (v) When there is no partnership deed prevails, the interest on loan of a partner to be paid @ 6%.
 - (vi) Interest coverage ratio indicates the firm's ability to pay off current interest and installments. (6 Statements × 2 Marks = 12 Marks)
- (b) Differentiate between provision and contingent liability. (4 Marks)
- (c) Give journal entries (narrations not required) to rectify the following:
- (i) Purchase of Furniture on credit from Nigam for ₹ 3,000 posted to Subham account as ₹ 300.
 - (ii) A Sales Return of ₹ 5,000 to Jyothy was not entered in the financial accounts though it was duly taken in the stock book.
 - (iii) Investments were sold for ₹ 75,000 at a profit of ₹ 15,000 and passed through Sales account.
 - (iv) An amount of ₹ 10,000 withdrawn by the proprietor (Darshan) for his personal use has been debited to Trade Expenses account. (4 Marks)
2. (a) Shri Ganpath of Nagpur consigns 500 cases of goods costing ₹ 1,500 each to Rawat of Jaipur, Shri Ganpath pays the following expenses in connection with the consignment:
Carriage ₹ 15,000, Freight ₹ 45,000, Loading Charges ₹ 15,000
Shri Rawat sells 350 cases at ₹ 2,100 per case and incurs the following expenses:
Clearing charges ₹ 18,000, Warehousing and Storage charges ₹ 25,000, Packing and selling expenses ₹ 7,000
It is found that 50 cases were lost in transit and another 50 cases were in transit. Shri Rawat is entitled to a commission of 10% on gross sales. Draw up the Consignment Account and Rawat's Account in the books of Shri Ganpath. (10 Marks)
- (b) Mr. Alok owes Mr. Chirag ₹ 650 on 1st January 2018. From January to March, the following further transactions took place between Alok and Chirag:
January 15 Alok buys goods ₹ 1,200, February 10 Alok buys goods ₹ 850, March 7 Alok receives Cash loan ₹ 1,500

Alok pays the whole amount on 21st March, 2018 together with interest @ 6% per annum. Calculate the interest by average due date method. (5 Marks)

(c) Attempt **any one** of the following two sub-parts i.e. either (i) or (ii)

(i) Mr. Badhri sends goods to his customers on Sale or Return. The following transactions took place during the month of December 2017.

December 2nd — Sent goods to customers on sale or return basis at cost *plus* 25% – ₹ 80,000

December 10th — Good returned by customers — ₹ 35,000

December 17th — Received letters from customers for approval – ₹ 35,000

December 23rd — Goods with customers awaiting approval – ₹ 15,000

Mr Badhri records sale or return transactions as ordinary sales. You are required to pass the necessary Journal Entries in the books of Mr. Dadhri assuming that the accounting year closes on 31st December 2017. (5 Marks)

(ii) From the following prepare on account current, as sent by Avinash to Bhuvanesh on 31st March, 2018 by means of products method charging interest @ 5% per annum: (5 Marks)

<i>Date</i>	<i>Particulars</i>	<i>Amount</i>
2018 January 1	Balance due from Bhuvanesh	1,800
January 10	Sold goods to Bhuvanesh	1,500
January 15	Bhuvanesh returned goods	650
February 12	Bhuvanesh paid by cheque	1,000
February 20	Bhuvanesh accepted a bill drawn by Avinash for one month	1,500
March 11	Sold goods to Bhuvanesh	720
March 14	Received cash from Bhuvanesh	800

3. The following are the balances extracted from the books of Shri Raghuram as on 31.03.2018, who carries on business under the name and style of M/s Raghuram and Associates, at Chennai:

<i>Particulars</i>	<i>Debit (₹)</i>	<i>Credit (₹)</i>
Capital A/c		14,11,400
Purchases / Purchases Returns	12,00,000	18,000
Sales / Sales Returns	24,000	15,00,000
Freight Inwards	62,000	
Carriage Outwards	8,500	
Rent of Godown	55,000	
Rates and Taxes	24,000	
Salaries	72,000	
Discount allowed / Discount received	7,500	12,000
Drawings	20,000	
Printing and Stationery	6,000	
Insurance premium	48,000	
Electricity charges	14,000	

General expenses	11,000	
Bank charges	3,800	
Bad debts	12,200	
Repairs to Motor vehicle	13,000	
Interest on loan	4,400	
Provision for Bad debts		10,000
Loan from Mr. Rajan		60,000
Motor vehicles	1,00,000	
Land and Buildings	5,00,000	
Office equipment	2,00,000	
Furniture and Fixtures	50,000	
Opening Stock	3,20,000	
Sundry creditors / Sundry debtors	2,80,000	62,000
Cash at Bank	22,000	
Cash in Hand	16,000	
Total	30,73,400	30,73,400

Prepare Trading and Profit and Loss Account for the year ended 31.03.2018 and the Balance Sheet as at that date after making provision for the following:

- Depreciate Building by 5% Furniture and Fixtures by 10%, Office Equipment by 15% and Motor Car by 20%.
- Value stock at the close of the year was ₹4,10,000.
- One month rent for godown is outstanding.
- Interest on loan from Rajan is payable @ 10% per annum. This loan was taken on 01.07.2017.
- Reserve for bad debts is to be maintained at 5% of Sundry debtors.
- Insurance premium includes ₹42,000 paid towards proprietor's life insurance policy and the balance of the insurance charges cover the period from 01.04.2017 to 30.06.2018.

(20 Marks)

4. (a) Piyush Limited is a company with an authorized share capital of ₹2,00,00,000 in equity shares of ₹ 10 each, of which 15,00,000 shares had been issued and fully paid on 30th June, 2017. The company proposed to make a further issue of 1,30,000 shares of ₹ 10 each at a price of ₹12 each, the arrangements for payment being:

- ₹ 2 per share payable on application, to be received by 1st July, 2017.
- Allotment to be made on 10th July, 2017 and a further ₹ 5 per share (including the premium) to be payable.
- The final call for the balance to be made, and the money received by 30th April, 2018.

Applications were received for 4,20,000 shares and were dealt with as follows:

- Applicants for 20,000 shares received allotment in full;
- Applicants for 1,00,000 shares received an allotment of one share for every two applied for; no money was returned to these applicants, the surplus on application being used to reduce the amount due on allotment.
- Applicants for 3,00,000 shares received an allotment of one share for every five shares applied for; the money due on allotment was retained by the company, the excess being returned to the applicants; and

(4) The money due on final call was received on the due date.

You are required to record these transactions (including cash items) in the journal of Piyush limited.

(b) A, B and C are partners sharing profits in the ratio of 3 : 2 : 1. Their Balance Sheet as at 31st March, 2018 stood as:

Liabilities		₹	Assets		₹
Capital Accounts			Building		10,00,000
A	8,00,000		Furniture		2,40,000
B	4,20,000		Office equipments		2,80,000
C	4,00,000	16,20,000	Stock		2,50,000
Sundry Creditors		3,70,000	Sunday debtors	3,00,000	
General Reserves		3,60,000	Less: Provision	30,000	2,70,000
			Joint life policy		1,60,000
			Cash at Bank		1,50,000
		23,50,000			23,50,000

B retired on 1st April, 2018 subject to the following conditions:

- Office Equipments revalued at ₹ 3,27,000.
- Building revalued at ₹15,00,000. Furniture is written down by ₹ 40,000 and Stock is reduced to ₹ 2,00,000.
- Provision for Doubtful Debts is to be created @ 5% on Debtors.
- Joint Life Policy will appear in the Balance Sheet at surrender value after B's retirement. The surrender value is ₹ 1,50,000.
- Goodwill was to be valued at 3 years purchase of average 4 years profit which were: 2014 ₹ 90,000, 2015 ₹ 1,40,000, 2016 ₹ 1,20,000, 2017 ₹ 1,30,000
- Amount due to B is to be transferred to his Loan Account.

Prepare the Revaluation Account, Partners' Capital Accounts and the Balance Sheet immediately after B's retirement. (10 Marks)

5. (a) You are provided with the following details. (10 Marks)

Current ratio	2.5	Liquidity ratio	1.5
Net Working Capital	₹ 3,00,000	Stock Turnover Ratio	6 times
Ratio of Gross Profit on Sales	20%	Turnover to Fixed assets (net)	2 times
Average debt collection period	2 months	Fixed Assets to net worth	0.8
Reserve and Surplus to Capital	0.5		

Draw up the Balance Sheet as at 31st March, 2018 of Zoom Ltd. with appropriate figures:

BALANCE SHEET OF ZOOM LTD. AS AT 31ST MARCH, 2018

Liabilities	₹	Assets	₹
Share Capital	?	Fixed Assets	?
Reserves and Surplus	?	Stock	?
Long-Term Borrowings	1,50,000	Debtors	?
Current Liabilities	?	Bank	50,000
Total	11,00,000		11,00,000

- (b) Calculate the Trade Receivables Turnover Ratio, the average collection period and Gross Profit Ratio from the following information: (10 Marks)

Particulars	₹
Total revenue from operations	6,00,000
Cash revenue from operations	25% of Total Revenue from operations
Trade Receivables as at 01.04.2017	60,000
Trade Receivables as at 31.03.2018	1,40,000
Cost of Revenue from Operations	4,20,000

6. (a) The Bank Pass Book of Account No. 5678 of Mrs. Rani showed an overdraft of ₹ 33,575 on 31st March 2018. On going through the Pass Book, the accountant found the following:
- A Cheque of ₹ 1,0,80 credited in the pass book on 28th March 2018 being dishonoured is debited again in the pass book on 1st April 2018. There was no entry in the cash book about the dishonour of the cheque until 15th April 2018.
 - Bankers had credited her account with ₹ 2,800 for interest collected by them on her behalf, but the same has not been entered in her cash book.
 - Out of ₹ 20,500 paid in by Mrs. Rani in cash and by cheques on 31st March 2018 cheques amounting to ₹ 7,500 were collected on 7th April 2018.
 - Out of Cheques amounting to ₹ 7,800 drawn by her on 27th March 2018 a cheque for ₹ 2,500 was encashed on 3rd April 2018.
 - Bankers seems to have given her wrong credit for ₹ 500 paid in by her in Account No. 8765 and a wrong debit in respect of a cheque for ₹ 300 against her account No. 8765.
 - A Cheque for ₹ 1,000 entered in Cash Book but omitted to be banked on 31st March, 2018.
 - A Bill Receivable for ₹ 5,200 previously dishonoured (Discount ₹ 200) with the Bank had been dishonoured but advice was received on 1st April 2018.
 - A Bill for ₹ 10,000 was retired/paid by the bank under a rebate of ₹ 175 but the full amount of the bill was credited in the bank column of the Cash Book.
 - A Cheque of ₹ 2,400 deposited into bank but omitted to be recorded in Cash Book and was collected by the bank on 31st March, 2018.

Prepare Bank Reconciliation Statement as on 31st March 2018.

(10 Marks)

- (b) Miss Daisy was unable to agree the Trial Balance last year and wrote off the difference to the profit and loss account of that year. On verifying the old book by a Chartered Accountant next year, the following mistakes were found.
- Purchase account was under cast by ₹ 8,000.
 - Sale of goods to Mr. Rahim for ₹ 2,500 was omitted to be recorded.
 - Receipt of cash from Mr. Asok was posted to be account of Mr. Anbu ₹ 1,200.
 - Amount of ₹ 4,167 of sales was wrongly posted as ₹ 4,617.
 - Repairs to Machinery was debited to Machinery Account ₹ 1,800.
 - A credit purchase of goods from Mr. Paul for ₹ 3,000 entered as sale. Suggest the necessary rectification entries.

(10 Marks)