CHAPTER	
1	**Theoretical Framework**
Unit: 1	**Meaning and Scope of Accounting**

SELF STUDY QUESTIONS

Q 1. Write Introduction to Accounting.

Answer:

In all activities (whether profit making or non-profit making) and in all organisations (like manufacturing entities, trading entities, or non-profit organisations like schools, hospitals, clubs, temples, political parties) some or the other kind of economic activities are performed. Such activities require money and other economic resources for which accounting is required to account for these resources.

Such economic activities are performed through "transactions and events". In other words, wherever money is involved, accounting is required to account for it. **Accounting is thereby often called language of business.** Basic function of any language is to serve as a means of communication, and accounting serves that purpose.

Transactions and Events

Transaction is defined as a business, performance of an act, an agreement, while event is used to mean a happening, as a consequence of transaction, or a result. Events are the end results or conclusions of all the transactions taking place round the year.

Nalin starts a music shop by introducing capital of ₹ 5,00,000. He purchases goods worth ₹ 2,20,000, pays shop rent and electricity charges, ₹ 15,000. He sells goods worth ₹ 1,80,000 for ₹ 2,35,000.

The individual performs an economic activity. He carries on a few transactions and encounters with some events. Obviously he would want to know the result of his activities.

Result of the above activity may be ascertained as follows:

	₹
Sales	2,35,000
Less: Cost of goods sold	1,80,000
Gross Profit	55,000
Less: Expenses paid	15,000
Net Profit/Surplus	40,000

Earning surplus of ₹ 40,000 is an event, and closing inventory in hand ₹40,000 (2,20,000 – 1,80,000) is also an event. Introduction of capital, purchase of goods, sale of goods and payment of expenses are all transactions.

Likewise, Government collects taxes, pays salary to employees and spends on other developmental activities.

Everybody wants to keep record of all such transactions and accounting helps us to keep record of all such transactions and events.

The aim of accounting is to meet the informational needs of the rational and sound decision-makers, and thus, it is called language of business.

Q 2. Write Meaning and Definition of Accounting.

Answer:

Accounting is a process of recording financial transactions, summarising them and communicating the financial information to users viz, the proprietor, creditors, investors, government agencies, etc. It is because of these characteristics, that accounting is called the language of business.

The committee on Terminology formed by American Institute of Certified Public Accountants gave the following definition of Accounting —

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

The American Accounting Association defined accounting as –
"The process of identifying, measuring and communicating economic information to permit informed judgements and decisions by the users of accounts".
Accounting helps to ascertain the impact of events and transactions occurred during the period in terms of money. It not only helps in recording the transactions but also relates to interpreting the results thereof.

Q3. What are the Procedural Aspects of Accounting?
Answer:

(i) **Generating financial information:**
Recoding the business events and transactions of financial nature in Primary Books (Journal) and other subsidiary books with the help of invoices, sales bills, passbooks, etc.
Classification of transaction and events is done to group identical transactions together and to describe them by the name of account. This classification is done in secondary books called ledger, by posting transactions from Journal.
Summarising the transactions is the systematic presentation of recorded data so that it is understandable and useful for its users. It is the combined effect of all recorded transactions and is obtained by preparing various financial statements such as:
1. Trial Balance
2. Profit & Loss A/c
3. Balance Sheet
4. Cash flow statement.

Analysing provides the basis for interpreting the recorded data. It involves critical examination of accounting data. It is the process to evaluate the relationship between various components of financial statements.
Interpreting is the process of giving meaning to the analysed data so that proper judgement regarding profitability and financial position of business operations can be made. It helps in planning the future business activities.

Communication is the process of transmitting the financial statements in the form of accounting reports, balance sheets etc. to the users to help them in the decision making process.

(ii) **Using the Financial Information:**
Financial information is used not only by the management of business but also by other stakeholders, such as creditors, investors, employees, bankers, competitors, government etc. Various stakeholders require information related to the business for different purposes.
The financial information required for different purposes must be presented in different forms so that it meets the objective of the users which may be internal or external. Information regarding internal working should be in detail for the use by management; however, information can be in charts and graphs with less details for external users, who only want an overview of the business.

Q 4. How was Evolution of Accounting as a Social Science done?
Answer:
Phase I: The root of financial accounting system was Stewardship Accounting. This traditional approach of accounting places an obligation on stewards or agents to manage the property and provide relevant financial information relating to their resources to the owner which were usually the wealthy persons or businessmen.
Phase II: Then emerged the idea of joint stock company in the second phase of evolution. It is a type of business organisation with the basic idea of separating ownership from the management. For better disclosure of financial data, various tools such as profit and loss account and Balance Sheet were introduced.

These were the information systems used by the different users such as investors, employees, managers, and other stakeholders for getting meaningful information.

Phase III: Then came the new dimension of accounting in the third phase called as Management Accounting, which was seen as "value creator". It was developed in 20th century. Its focus was to apply professional knowledge and kills in such a way so as to assist the management in making quality decisions.

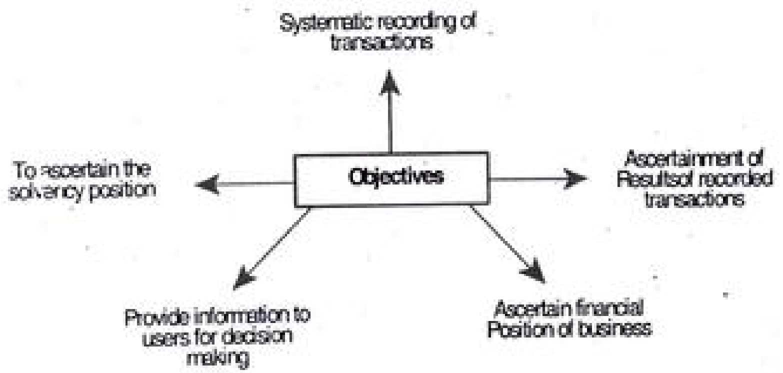
Phase IV: Social Responsibility Accounting is the process of communicating the social and environmental effects of an organisation's actions to particular groups of society and society at large. It broadens the scope of accounting in a sense that it should:

- concern itself with more than only economic events;
- not be exclusively expressed in financial terms; and
- be accountable to a broader group of stakeholders beyond reporting financial success.

Social Science studies man as a member of society and concerns about social purposes, contribution to the social progress. Hence, Accounting is treated as **social science.**

Q 5. What are Objectives of Accounting?

Answer:



1. **Systematic recording of transactions** – of financial nature for further analysis. Recording is usually done in Journal or other subsidiary books and the entries are later posted to secondary books (ledger) on the basis of classification.
2. **Ascertainment of Results of recorded transactions** – by keeping proper records of expenses and revenue.
   If income/revenue < expenses = Loss.
   If income/revenue > expenses = Profit
   This is calculated by preparing Profit and loss Account. It helps management to take necessary actions accordingly.
3. **Ascertainment of financial position of business** – by preparing a Balance Sheet. A Balance Sheet is a statement of Assets and liabilities of the business organisation which serves as a barometer for ascertaining the financial health of business at a particular point of time or date.
4. **Providing information to users for rational decision making –** who analyse it as per their individual needs at the required point of time. Information is provided by preparing and communicating financial statements to various stakeholders for the purpose of decision making.
5. **To ascertain the solvency position** – If the organisation is able to meet its liabilities as and when due, in the long run, the enterprise is said to be solvent. Also, organisation must maintain its liquidity position so as to meet its short-term liabilities at relevant due date.

Q 6. What are Functions of Accounting?

Answer:

(i) **Measurement:** Accounting helps the business organisation to measure its financial performance of earlier years along with current position.

(ii) **Comparison:** It facilitates comparison of financial position of earlier years with the current year.

(iii) **Evaluation:** Accounting helps to evaluate the financial results of a business organisation by providing proper disclosures about the accounting policies used in preparation of books of accounts.

(iv) **Forecasting:** 'It helps in predicting the future business activities by using the past data.

(v) **Control:** Accounting keeps a check on operational system and thus identifies weaknesses which can be overcome by implementing necessary measures.

(vi) **Government Regulation and Taxation:** Accounting information helps the government to keep a check on business activities and facilitates collection of various taxes.

Q 7. Define Book Keeping.

Answer:

1. Book keeping is the systematic recording of financial transactions on a day to day basis.
2. It includes —
   - Recording of transactions and events in books of Accounts.
   - Classifying the recorded transactions and events in ledger [i.e. posting]
3. The end product of book keeping is the 'financial statements' which includes Profit and Loss A/c, Balance sheet, Notes to Accounts and Cash flow statement.
4. The transactions of financial nature [which are related to money] are recorded. For, example Appointment of a director or employee in the company is not a financial transaction, hence need not be a part of book keeping. On the other hand if a loan is given to director of ₹ 1,00,000, it is a financial transaction, and hence will be recorded as a part of book keeping.
5. The person responsible for maintaining the records of business is known as **book keeper.**
6. Book Keeping helps to know the true picture of company's income, expenses, assets, liabilities, etc.
7. Various laws such as Companies Act, Income tax Act, Banking Regulation Act, Insurance Act, etc. guide about proper preparation, presentation and preservation of books of Accounts of the company.

Q 8. What are Objectives of Book Keeping?

Answer:

1. **Complete recording of transactions** in orderly and systematic manner, so that proper documentary base is created which can be referred by any person and he is able to interpret the same.
2. **Ascertain the financial effect** of the business transaction done during a specified period on the business as a whole in terms of profit or loss.
3. **To know the financial position** of business as and when required.
4. **Facilitating management** to discharge their duties by providing information for taking business decisions.

Q 9. Differentiate between Book Keeping and Accounting.

Answer:

Basis of Difference	Book Keeping	Accounting
1. Scope	Recording of transaction in a systematic manner	Summarising of the recorded transactions
2. Stage	Primary Stage or initial stage	Accounting begins where book keeping ends.
3. Decision-making	Cannot be done	Can be done.
4. Nature of job	Clerical and routine. Can be done by lower staff	Analytical in nature an requires special knowledge and ability.
5. Objective	Accurate and complete record of financial transaction of business.	Apply further financial analysis to financial records.
6. Financial Position of business	Cannot be ascertained	Can be ascertained.

Relationship of Book Keeping, Accounting, and Accountancy.

Book Keeping is the primary function of accounting and focuses on proper recording and maintenance of books of accounts.

Accounting is the secondary function. It **starts where book keeping ends.**

Accountancy is the systematic knowledge applied in the process of accounting.

It can be said that accountancy is a broader term that acts as a guide for preparation of books of accounts and it involves book keeping and accounting.

Q 10. What are the Sub Fields of Accounting?

Answer:

1. **Financial Accounting:** It is concerned with recording, summarising and interpreting the financial transactions and communication of the same to the users.

   It focuses on preparation of profit and loss account and balance sheet to ascertain the financial position of business at the end of an accounting period.

2. **Management Accounting:** It is a recent development in accounting. It deals with the aspect of costing and cost control. It includes costing department which keeps records of various products and services. It is the process of analysis, interpretation and presentation of accounting

information collected with the help of financial accounting and cost accounting in order to assist the managerial staff in decision making and day to day operations of the business.

3. **Cost Accounting:** It ascertains the cost of products manufactured or the services rendered and helps the management in taking pricing decisions and exercising control. According to Institute of cost management accounts of England, "Cost Accounting is the process of accounting for cost which begins with the recording of income and expenditure or the base on which they are calculated, and ends with the preparation of periodical statements and reports for ascertaining and controlling costs.

4. **Social Responsibility Accounting:** It is the ability to provide correct information in company's financial statements regarding the estimated social cost and social benefits generated due to business operations. For example, if a factory is setup, it will benefit the society by way of generation of employment opportunities crates etc. Similarly, if a product is found defective or harmful to the users then it may adversely affect the image of the company. The organisations which creates value for its users and society usually survive in the long run. Thus, the demand of social responsibility accounting has increased.

5. **Human Resource Accounting:** It is the process of assigning, budgeting and reporting the cost of human resources incurred by an organisation. It includes salaries or wages paid, training expenses, recruitment costs, etc. It is a new branch of accounting which includes the management of human resource which will ultimately enhance the quantity and quality of goods and services.

Q 11. Who are the Users of Accounting Information?
Answer:

Users of Accounting Information

Internal Users	**External Users**
- Employees	- Investors/Potential investors
- Management	- Creditors & Suppliers
- Owners	- Government
	- Customers
	- Lenders
	- Public

Internal Users:

(a) Employees
- They have direct relationship with the growth of the business organisation.
- They are entitled to incentives linked to profit earned by the business and thus are interested in financial statements.

(b) Management
- Accounting information acts as a guiding tool for various managerial decisions such as ascertaining the selling price of a product, investment in a new project, market entry strategy, etc.
- They are concerned with using their expertise knowledge about the business operations to improve the performance and increase the efficiency within the company.

(c) Owners
- They are the persons who contribute towards the capital of the business and are therefore exposed to business risk.
- Owners are concerned with the profits and losses of the business.

External Users:

(a) investors or Potential investors
- Accounting information helps the investors to know the return on investment made, or to be made.
- It helps them to know how safe is their investment and also whether the business will survive, prosper and pay good dividends, or not.

(b) Creditors & Suppliers
- Creditors are those who supply goods and services to the business organisation and are concerned whether business will survive in a long run.
- Before granting credit, creditors want to satisfy themselves about the credit worthiness of the business and formulate credit policy accordingly.

(c) Government
- Government regulates day to day activities of the business, and imposes various taxes. Therefore, it is necessary for it to inquire into the financial statements of the business organisation to find whether the correct account of taxes due are paid, or not.
- Accounting information also helps the government in price fixation of essential commodities, compilation of National Income and other necessary information.

(d) Customers
- Customers are concerned with the fact whether the company offers products at fair prices, and its survival, for honouring product warranties.
- They want to know about the stability and profitability of the business enterprise since they are dependent on products and services of such businesses.

(e) Lenders
- They are the providers of loan funds and hence want to assure themselves about the recovery of loans alongwith interest, if any, as and when due.

- "Lenders" includes banks & financial institutions which are interested to know the performance of business, whether the business is flourishing as projected at the time of raising of loan, or do the terms of loans need to be revised.

(f) **Public**

- Public needs to know whether the business is contributing substantially for the growth of economy, or not.
- Public also wants to know whether the products and services provided are useful, for providing employment to the public without adversely affecting the environment.

Q 12. What is the Relationship of Accounting with other disciplines?

Answer:

1. **Accounting and Economics:**
   - Economic theories help to develop the decision making tools which are used in accounting. Accountants gets the idea about income, value, capital maintenance, etc. from economics and applies the same in accounting of business operations.
   - Economics is regarded as science of rational decision making for use of scarce resources efficiently to satisfy the human wants. Accounting provides financial data which is relevant for taking such decisions.
   - Accountants use various methods to analyse expenses, incomes, budgets etc., whereas economics on the other hand is concerned with interpreting the financial patterns for understanding the economic behaviour of such transactions, and takes rational decisions for the business.
2. **Accounting and Statistics:**
   - Statistics deals with typical values, behaviour, trends of a given period of time and the degree of deviation over a series of observations while accounting focuses on accuracy in recording of financial transactions of business.
   - The main object of both is to make arithmetical figures in such form which is understandable and usable to the management and other concerned parties.

   - Various accounting and financial ratios are formulated on the basis of statistical method. Accounting records are usually viewed for short term, however statistical analysis takes long term view of events.
3. **Accounting and Mathematics**
   - For accounting, it is necessary to have to knowledge of algebra, arithmetic for calculation of interest, lease rentals, depreciation, tax due, penalties, etc.
   - For better understanding of financial information, analysts use various presentation tools such as matrix, graphs, charts, and hence it has become essential to have knowledge of geometry, trigonometry for proper understanding.
   - Accounting expression cap be expressed in algebraic forms. For example double entry book keeping can be stated in algebraic form Assets = Liabilities + Equity.
4. **Accounting and Law**
   - All the transactions of a business organisation are governed by several Acts such as contract Act, companies Act, sales of goods Act, Labour Laws, etc. These laws need to be followed to prevent the organisation from being penalised due to non-compliance.
   - There cannot be enactment of legislation about accounting system unless accounting discipline is developed correspondingly. Therefore, it can be said that accounting influences law and is also influenced by laws.
5. **Accounting and Management**
   - Management decisions are based on accounting data provided by the accountant. Accountants are thus required to present the data in an understandable and usable manner.
   - With the information provided by accountants, management is able to analyse past performance of business organisation, and accordingly plan future operations.
   - Various functions of management are linked with accounting. For example – Planning of budget requires costing of a product; controlling function requires management to control cost/expenditure which can only be done if management is aware about the standard

cost to be incurred for a product and the excess or deficit in actual cost in making of the product. All this requires accounting data. Hence, we can say that both the disciplines are related to each other.

Q 13. What are Limitations of Accounting?

Answer:

- Various qualitative factors are ignored such as expertise and knowledge of managerial personnels, loyalty of employees, etc., although responsible for success of business, as they are not measurable in term of money.
- Accounting for future projections are done on basis of various assumptions and estimations which may not hold good if conditions change in future in an unpredictable manner.
- Accounting ignores time value of money for recording transactions.
- Selection of different methods for calculation of depreciation such as SLM, WDV, method of calculation of valuation of closing stock such as LIFO, FIFO etc. may give different results for the financial period.
- Selection of methods, assumptions, etc., may vary from organisation to organisation. Hence, it becomes difficult to compare the two organisations.
- Financial statements are subject to window dressing, and hence, may not show the true picture of the business operations and financial position of the company.
- Accounting is based on personal judgement of accountants for various estimates, and hence, may provide different results from time to time.

Q 14. What is the Role of Accountant in the society?

Answer:

Accounting profession serves the society in various ways such as —

A. Areas of Services

1. **Maintenance of Books of Accounts** of business and preparation of financial statements such as profit and loss account, Balance Sheet,-which assist various users for decision making.

2. **Taxation:** Accounting records helps to assess the tax liability of a person and also assists in tax planning.
3. **Analysis:** Accounting Data of various years is compared, and thus, the performance of business can be monitored.
4. **Statutory Audits:** Books of Accounts must give true and fair view. For limited companies, statutory audit is necessary, which must be done by a Chartered Account or a firm of Chartered Accountants.
5. **Internal Audits:** To ensure that proper controls are implemented by the management over the assets of company and preparation of financial statements, firms appoint internal Auditors who are responsible to check controls and communicate deficiencies, if any, to management in a timely manner.
6. **Management and Consultancy Services:** Various functions of management, including decision making, requires financial data. Hence, Accountant may play advisory role in such decision making process.
7. **Financial Advice:** Accountants are believed to be financial literate persons, i.e., having expertise knowledge, and so they can give advice in areas such as–
   (a) Insurance
   (b) Business Expansion
   (c) Investment
   (d) Sale of business
   (e) Tax relief under various Pension Schemes
8. **Investigation:** Accountants are required to investigate into various financial matters such as:
   (a) Variation in profit figures as compared to previous years.
   (b) Costing of a product or service rendered.
   (c) Detection of Fraud and remedial action required to lower the impact of such fraud.
   (d) Valuation of business for ascertaining correct tax liability, for purchase or sale of business, etc.

9. **Other Services:**
   (a) Portfolio Management
   (b) Secretarial Work
   (c) Company incorporation
   (d) Feasibility study
   (e) Arbitration
   (f) Share Transfer and Registration work
   (g) Act as a liquidator, Receiver, Arbitrator
   (h) Cost Accounting Work
   (i) Supply of information.

B. Chartered Accountants in Industry

- Act as financial advisor of management for planning future activities.
- Performs various business functions such as setting of budgets, ascertaining cost of product, calculation of profit linked bonus of employees, etc.

C. Chartered Accountants in Public Sector

- Preparation of report of public corporations to know whether the expenditure by several departments exceeds the budget sanctioned to them, or not.
- To keep a check, whether the Public Sector units are performing their functions properly, challenges faced by them, if any, and making the general public aware about the authenticity of various items appearing in financial statements and other reports.

D. Chartered Accountant in Framing Fiscal Policies

- Fiscal Policy is the spending made by the government which influences the economy of the nation. Accountants help in development of trade, commerce, industry, and hence, help to determine suitable fiscal policies.
- There is a social responsibility on Accountants along with the industry to give true and correct disclosures regarding financial results as are necessary in calculation of national income.

E. Chartered Accountants and Economic Growth

- High quality corporate reporting helps in transparency and mobilisation of various investments and generating confidence among investors across the globe, hence facilitating economic growth of the nation.
- Chartered Accountants are responsible for proper reporting and encouraging the business organisations for efficient working and true and fair disclosures. This, in turn, contributes to the growth of the economy.

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. The main objectives of Book-Keeping are:
   (a) Complete Recording of Transactions
   (b) Ascertainment of Financial Effect on the Business
   (c) Analysis and Interpretation of data
   (d) (a) and (b) both
2. At the end of the financial year, after sale of goods worth ₹2,00,000, there was a closing stock of ₹10,000. This is:
   (a) An event
   (b) A transaction
   (c) Both event as well as transaction
   (d) None of these
3. Financial Statements are a part of:
   (a) Accounting
   (b) Book - Keeping
   (c) Both
   (d) None

4. _____ of American Institute of Certified Public Accountants enumerated the functions of Accounting:
   (a) Accounting Principles Board
   (b) Accounting Standards Board
   (c) Accounting Concepts Board
   (d) None of these
5. Management Accounting:
   (a) Is a clerical work
   (b) Is accounting for future
   (c) Is a recording technique of the management related transactions
   (d) Is an analysis of the past business activities
6. The direct advantage of accounting does not include:
   (a) Preparation of financial statements
   (b) Competitive advantage
   (c) Ascertainment of profit or loss
   (d) Information to interested groups
7. Double Accounting System owes its origin to:
   (a) Lucas Pacioli
   (b) Adam Smith
   (c) Kohler
   (d) Karl Marx
8. On 31st December, 2005, Ashok Ltd. purchased a machine from Mohan Ltd. for ₹1,75,000. This is: (Year end: 31st December)
   (a) A transaction
   (b) An event
   (c) None of these
   (d) Both transaction as well as event
9. The problems related to price-rise are handled under:
   (a) Management Accounting
   (b) Cost Accounting
   (c) Financial Accounting
   (d) Inflation Accounting

10. Financial statements users include
    (a) Shareholders
    (b) Government
    (c) Vendors
    (d) All of the above
11. Which of these is not available in the Financial Statements of a Company?
    (a) Total Sales
    (b) Total Profit & Loss
    (c) Capital
    (d) Cost of Production
12. ₹5000 paid as rent of office premises is an/a ______
    (a) Event
    (b) Transaction
    (c) Both
    (d) None.
13. Which of the following is correct? Owner's Equity is:
    (a) (Current Asset + Fixed Asset) + (Current Liabilities + Long term Liabilities)
    (b) (Current Asset + Fixed Asset) - (Current Liabilities + Long term Liabilities)
    (c) (Current Asset - Fixed Asset) - (Current Liabilities + Long term Liabilities)
    (d) None of the above.
14. If owner's capital is ₹50,000 liability is ₹30,000 and fixed assets is ₹70,000, then what is the value of current assets?
    (a) ₹10,000
    (b) ₹40,000
    (c) ₹80,000
    (d) ₹1,00,000
15. Net Profit or Loss will be derived at _____ stage of accounting
    (a) Classifying
    (b) Interpretation

(c) Recording
(d) Summarising

16. Which one of the following is not a main objective of accounting?
(a) Systematic recording of the transaction
(b) Ascertainment of the profitability of the business.
(c) Ascertainment of the financial position of the business.
(d) Solving tax disputes with tax authorities

17. At the end of the financial year, Mr. X earns a profit of ₹57,000 in his business. This is
(a) a transaction
(b) an event
(c) a transaction as well as an event
(d) neither a transaction nor an event

18. Which of the following is an event?
(a) Sale of goods for ₹5,000
(b) Closing stock of worth ₹4,000
(c) Purchase of goods for ₹8,000
(d) Rent paid ₹2,000

19. Accounting has universal application for recording __________ and events and presenting suitable information for decision making
(a) Entries
(b) Transactions
(c) Data
(d) Figures.

20. _______ was the root of financial accounting system:
(a) Social accounting
(b) Stewardship accounting
(c) Management accounting
(d) Responsibility accounting

21. Interpreting Financial Statements means:
(a) Methodical classification of the data given in the financial statements.
(b) Preparation and presentation of the classified data in a manner useful to the users of financial statements.

(c) Systematic analysis of the recorded data so as to put information in usable form.
(d) Explaining the meaning and significance of the relationship of analysis of accounting data.

22. The process of recording financial data along with the preparation of trial balance are covered under:-
(a) Book Keeping
(b) Accounting
(c) Classifying
(d) Summarising

23. All items relating to fixed assets are put at one place while all items relating to current assets are put at another place. Which procedural stage of the accounting is being referred?
(a) Communicating
(b) Analysing
(c) Interpreting
(d) Recording

24. Government raises funds through taxes and spends on various development activities. The deficit or surplus at the end of accounting year is:
(a) A transaction
(b) An event
(c) A transaction as well as an event
(d) Neither transaction nor an event.

25. "Substance of any transaction should be considered while recording them and not only the legal form." This statement holds true for?
(a) Substance over form
(b) Disclosure of accounting policies
(c) Both (a) and (b)
(d) None of the three

26. Financial position of the business is ascertained on the basis of:
(a) Records prepared under book keeping process
(b) Trial balance
(c) Accounting Reports
(d) None of the above

27. On March 31st, 2016, after sale of goods worth ₹45,000, businessman is left with the closing inventory of ₹20,000. This is:
    (a) an event
    (b) a transaction
    (c) a transaction as well as an event
    (d) neither a transaction nor an event
28. BOD, government, lender, suppliers, customers, managers, investors, partners. From the above identify the external and internal stakeholders.
    (a) Internal: BOD, lender, suppliers, manager, partners
    External: Investor, customers, government
    (b) Internal: BOD, managers, partners
    External: Investor, customer, government, lender, supplier
    (c) Internal: BOD, lenders
    External: Suppliers, managers, partners, investors, customers, government
    (d) Internal: BOD, partners
    External: Suppliers, managers, investors, lenders, customers
29. Procedure of accounting includes two main components, namely:
    (a) Generating and using financial information
    (b) Generating and reporting financial information
    (c) Generating and classifying financial information
    (d) Reporting and communicating information

ANSWER

1.	(d)	2.	(a)	3.	(a)	4.	(a)	5.	(c)
6.	(b)	7.	(a)	8.	(d)	9.	(d)	10.	(d)
11.	(d)	12.	(b)	13.	(b)	14.	(a)	15.	(d)
16.	(d)	17.	(b)	18.	(b)	19.	(b)	20.	(b)
21.	(d)	22.	(a)	23.	(b)	24.	(b)	25.	(a)
26.	(c)	27.	(a)	28.	(b)	29.	(b)		

SHORT PRACTICE QUESTIONS

1. State with reasons whether following statements are **True** or **False**.
    (i) The term book keeping and accountancy can be used interchangeably.
    (ii) Accounting deals with quantifiable information.
    (iii) Accounting is the language of business.
    (iv) Accounting aims to communicate financial information to investors only.

    Answer:
    (i) False. (ii) True
    (iii) True (iv) False
2. Define Accounting. What are the objectives of Accounting?
3. Enumerate the advantages on Accounting.
4. What are the limitations of accounting?
5. Differentiate between Book keeping and Accounting.
6. What are the sub-fields of Accounting?
7. Write short note on 'transaction' and 'events'.
8. Accounting is treated as a social science. Explain.

LONG PRACTICE QUESTIONS

1. Explain in detail different categories of users of Accounting information.
    [Hint: Refer Question 11]
2. The practice of Accountancy has crossed its usual domain of preparation of financial statements, interpretation of such statements and audit thereof. Enumerate various areas of service for an Accountant.
    [Hint Refer Question 14]

Past Year Questions and Answers

Objective Questions

1996 - Nov [5] State with reasons whether the following statement is True or False:

1. In accounting, all business transactions are recorded as having dual aspect. (2 marks)

Answer:

True: Being associated with the system of double entry book keeping, every transaction has a two-fold effect in accounting whereby one account is debited and another is credited by the same amount.

2002 - Nov [5] State with reasons whether the following statement is True or False:

(d) Assets and Liabilities of a particular accounting period are shown in the Balance Sheet. (2 marks)

Answer:

False: A balance sheet shows the position of the assets and liabilities as on a particular date.

2003 - May [5] State with reasons whether the following statements are true or false:

(i) Accounting can be viewed as an information system which has its input processing methods and output. (2 marks)

(ii) The value of human resources is generally shown as assets in the Balance Sheet. (2 marks)

(ix) Equity + LTL - CL = FA + CA. (2 marks)

Answer:

(i) **True:** Acccunting is a processing system whose input is financial transaction and output is financial statements communicating various information to various interested groups.

(ii) **False:** The human recourse still cannot be defined in terms of money.

(ix) **False:** The correct equation is as follows:–

Equity +LTL+ CL= CA+FA.

2003 - Nov [5] State with reasons whether the following statement is true or false:

(i) Accounting involves communication. (2 marks)

Answer:

True: Accounting starts only when there is a communication of business transactions to the accounting department. It also communicates the results obtained from arranging of data to interested parties like investors, creditors, employees etc.

Short Notes

1999 - May [6] Write short note on the following:

(ii) Double Entry System. (5 marks)

Answer:

Double Entry System:

It is a system of book keeping. It was developed in England. It is a system which recognises that every transaction has a two fold effect. Under "Double Entry System" there are two approaches of recording business transactions:

(i) Traditional Approach i.e. Book Keeping Approach.

(ii) Modern Approach i.e. Accounting-equation Approach.

Under the traditional approach, transactions are recorded into different books of accounts i.e. Journal, Ledger, Subsidiary Book, etc.

Under the modern approach, business transactions are recorded through accounting equation i.e. Assets = Capital + Liabilities.

Advantages:

1. There is a complete record of every transaction because under this system all the accounts i.e. personal, real and nominal are maintained and all the aspects of debit and credit are recorded.
2. It provides all day-to-day and reliable information.
3. It easily makes available the full details of every transaction.

4. It helps in checking of unnecessary expenditures.
5. It helps in testing of ledger posting by trial balance and also the arithmetical accuracy.
6. It helps in ascertaining the financial position of the business by preparing Balance Sheet.

2004 - Nov [6] Write short note on the following:
(v) Role of Accountants in society. (5 marks)

Answer:

Role of Accountants in society: In the present competitive scenario, accountants play a dual role. They not only look into conventional matters relating to tax, costing, management accounting, company legislation etc., but also act in matters of modern concepts like financial policies, economic principles etc.

In brief, we can put forward the role of accountants in the following points:

(i) They maintain the books and accounts of the business in a way that they show a true & fair view of the position of the business.
(ii) They act as an auditor both internal and external.
(iii) They provide service as an tax consultant.
(iv) They act as financial advisors.
(v) They also assist in the share registration, registration of company etc.

2005 - Nov [6] Write short note on the following:
(ii) Qualitative characteristics of Financial Statements. (3 marks)

Answer:

Qualitative Characteristics of Financial Statements: Financial statements have some qualitative characteristics so that they may provide more information to the users. These are the qualitative characteristics of financial statements:

(1) Understandability;
(2) Relevance;
(3) Reliability;
(4) Comparability;
(5) Faithful Representation; and
(6) Completeness.

(1) **Understandability:** Required quality of information should be provided so that financial statements become more understandable for users. For this reason, it is assumed that users have a reasonable knowledge of business and economic activities and they study information with reasonable diligence. Information regarding complicated matters should be included in the statement because of its relevance to the economic decision-making needs of the users and it should not be excluded merely on the ground that it may be too difficult for some users to understand.

(2) **Relevance:** Incorporate that information in the financial statement which is relevant for decision making. Quality of relevance of the information is determined when it influences the economic decisions of users.

(3) **Reliability:** Information must be reliable. Level of reliability of the information is high when it is free from material errors and biased decisions. Information may be relevant but so unreliable in nature or representation that its recognition may be badly misleading.

(4) **Comparability:** Financial Statements should be prepared in such a way that users of the financial statements must be able to compare their information with other information or financial statements in order to identify trends in performance, Cash flows, and financial position.

(5) **Faithful Representation:** Information must be represented faithfully so that its degree of reliability is high.

(6) **Completeness:** In order to present more reliable information in the financial statements, it must be complete within the boundaries of materiality and cost. An omission of information may cause information to be false or misleading and therefore unreliable and deficient in terms of relevance.

DESCRIPTIVE QUESTIONS

1998 - Nov [5] Discuss briefly the relationship of Accounting with:
(i) Economics. (3 marks)
(ii) Statistics. (3 marks)

(iii) Mathematics. (3 marks)
(iv) Law. (3 marks)
(v) Management. (3 marks)

Answer:

(i) Accounting & Economics:

Accounting has some economic specialty of its own. It deals with prices and not the values. It deals with the prices of property and services and not with the property and services themselves. Accounting uses price because it can serve as a quantitative representation of the physical and actual property and services. From the viewpoint of economists, there is a very close relationship between accounting and economics. Emphasis has been laid down to test the economic theories and to apply the economic principles in the concern where accounting is a rich source. Accounting is a major supplier of information to economic agents about the various aspects.

(ii) Accounting and statistics:

Statistical methods are very helpful and useful in the interpretation and development of the accounting data. While the accounting records generally take a view of events in short term and are mainly confined to a year, a statistical analysis is more useful if a long-term view is taken for the purpose. Statistical tools are very helpful in taking decisions when they are applied to accounting data.

(iii) Accounting and Mathematics:

The dual aspect concept of fundamental accounting assumption is expressed in terms of mathematical equation, which is popularly known as Accounting Equation i.e.

Assets = Capital + Liabilities.

Mathematics has a useful impact on the users of the accounts. If the mathematics of the user is strong, its accounting may also be strong because the knowledge of mathematics helps in computations and calculations. The econometric models are also being developed for the users.

(iv) Accounting and Law:

An enterprise works under various statutory laws. The transactions and accounts are also affected by various laws such as companies Act, Sales of goods Act, Negotiable Instrument Act, Customs Act, etc. The financial statements must be prepared in accordance with relevant provisions of the applicable laws.

(v) Accounting and Management:

Accounting provides necessary information to the management for discharging its functions. Since an accountant plays an active role in management, he knows the needs of the system and data. A large portion of accounting information is made for management's decision making. Thus management and accounting are related to each other.

CHAPTER

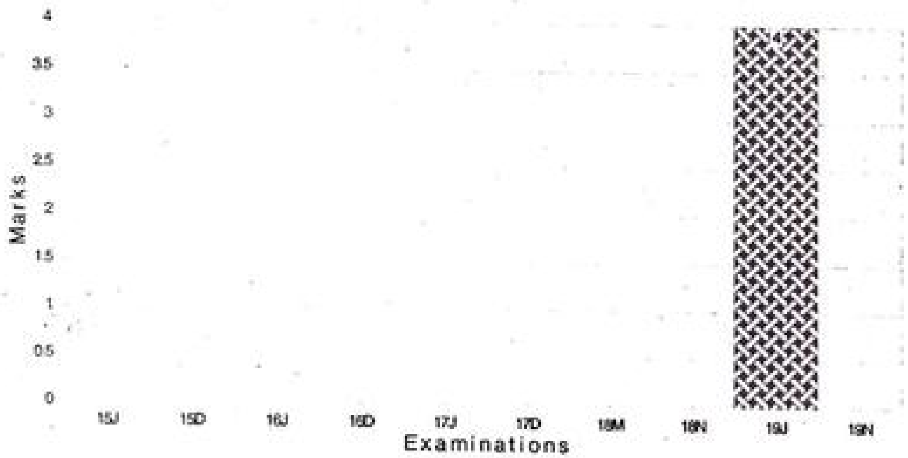
1 Theoretical Framework

Unit: 2 **Accounting Concepts, Principles and Conventions**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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SELF STUDY QUESTIONS

Q1. Introduce Accounting and GAAPs.

Answer:

Accounting is the language of business. It is not merely the systematic record of financial transactions of a business organisation but also a tool to analyse the financial position of the organisation in the current period and change in the position over a span of time. It enables the comparison of data with not only past period of same organisation but also with other business organisations within the same industry. It is necessary that financial statements prepared for different years or for different organisations must adopt uniformity and consistency in its preparation, which would enable the users to compare the same as and when required.

Suppose Mr. X, a businessman approached his CA to prepare the financial statements from the records provided by him. For assuring the correctness, he further gave the same records to 3 other accountants. All the four accountants submit their statements to Mr. X a week later. When Mr. X read the statements, all the statements were different from one another, showing different figures under different heads. The profits of the statements also varied among themselves. Mr. X is unable to decide which statement is true and correct about his business profits.

To prevent such situations and to build the confidence of general public and the users over the correctness of preparation of financial statements, a set of generally accepted rules have been developed which helps to bring uniformity, and consistency in the preparation of the financial statements which makes the statements understandable and reliable.

Generally Accepted Accounting Principles (GAAP) is applied to accounting procedure by the accountants so as to prepare the financial statements which are uniform in nature. GAAP is the backbone of accounting system which describes rules, principles, conventions, concepts, on the basis of which accounting reports are prepared. GAAP are supported by accounting bodies such as ICAI.

Q2. What are Accounting Concepts ?

Answer:

- These are the basic assumptions upon which accounting is based.
- These concepts help in interpreting the financial statements.

Q3. What are Accounting Principles?

Answer:

- The rules and guidelines to be followed in preparation of financial statements.
- The acceptance of accounting principles depends on following:
  - → Usefulness, i.e. meaningful information,
  - → Based on realistic assumptions,
  - → Consistency,
  - → Objectivity, i.e., free from personal biases,
  - → Simplicity, i.e., easy to understand and implement.

Q4. What are Accounting Conventions?

Answer:

- The customs or traditions or guidelines used over a period of time in preparation of accounting statements and reports.
- These can be altered with the changing needs of today's business environment, thus they may not have universal application.

Q5. What are Concepts, Principles and Conventions?

Answer:

(i) **Accounting concepts, Principles and conventions are discussed as follows:**

(a) **Accounting Concepts:** They define the assumptions on the basis of which financial statements of a business entity are prepared. Concepts have a universal application. They lay down the foundation, on the basis of which, accounting principles are formulated.

(b) **Accounting Principles:** These are a body of doctrines commonly associated with the theory and procedures of accounting serving as an explanation of current practice and a guide for selection of accounting alternative.

(c) **Accounting Conventions:** They emerge out of accounting practices, commonly known as accounting principles, adopted by various organizations over a period of time. These are derived from usage and practice and need not have universal application.

(ii) **Money Measurement Concept**

- Transactions and events which can be ascertained in monetary terms must form the part of accounting records.
- Money is considered as yardstick. Measurement makes the accounting data meaningful and helpful for analysing the financial results of the business organisations.
- Events which may have huge importance but are not ascertainable in money terms are not recorded in financial statements.
- The main focus of this concept in on monetary value, i.e., the home currency in which the accounts of the enterprise are being prepared. All the transactions must be converted in the home currency and in the same denomination before forming the part of financial statements.

(iii) **Periodicity Concept**

- The life of business is divided into small parts, usually, per year, so as to analyse the results after each year and also to compare the performance of different years.
- These small divisions of the life are termed as accounting periods. An accounting period of a business starts from 1st April and ends on 31st March.
- The financial statements are prepared on the assumption that the entity is a going concern, i.e., it will carry its operations for a foreseeable period. However, various users such as investors, creditors, management, employees, are interested to know the current position rather than to wait for a longer period. Thus, due to periodicity concept or accounting period concept, they can get the desired information at regular intervals.

- The periodicity concept helps in comparing the financial results of different years. It focuses on matching of periodic expenses with periodic income so as to get true profit for the accounting period.

(iv) **Accrual Concept**

- Transactions are recorded at the time when they occur irrespective of the fact that the settlement is on a later date.
- If any revenue income is received which does not belong to current period but to next period, it must not form part of current year. Similarly, if any payment is done in an earlier year, or, say, next year, but the expense pertains to current year, the same must be recorded in the current year itself irrespective of the payment being done in different period. Company law mandates preparation of accounting books under accrual basis for companies.

For examples:

Mr. A, a trader started retail business. During the year he sold goods worth ₹60,000 for ₹1,20,000 out of which only ₹100,000 was collected during the year. He had a closing stock of ₹15,000. His other business expenses for the period were ₹20,000 out of which ₹10,000 was outstanding at the year-end. Ascertain his total profit. In accrual system, revenue and expense should be recognised as they are earned or incurred and not as money is paid or received. So profit would be:

Sales		1,20,000
Less:	Purchase cost	60,000
		60,000
Less:	Expenses Incurred	20,000
	Profit	40,000

(v) **Matching Concept**

- Under this concept, expenses incurred for an accounting period are recognised in the period when the related revenue is earned.

- This makes the owner aware of the progress or shortfall in its business after comparing the performances of different years.
- To ascertain the true profit of the accounting period, it is important to match the revenue earned for the period with the expenses incurred to earn such revenues.

(vi) **Going Concern Concept**

- The financial statements of the enterprise are prepared on the basis of the assumption that the entity is a going concern, i.e., it will carry on its business operations for a foreseeable period.
- It is assumed that there is no intention that the business will stop its operations in the near future, and thus, the expenses are classified as revenue ,expenditure and capital expenditure. Revenue expenditure is that the benefits of which are realised in a short span of time, say, one year; while capital expenditure is that the benefit of which is realised in a long run.
- Depreciation on fixed assets is charged on the basis of useful life of the asset.

(vii) **Cost Concept**

- Under this concept, assets are recorded at the acquisition cost, i.e., the price paid at the time of purchase of such asset. This cost becomes relevant for subsequent years' accounting i.e., changing the depreciation on asset over its useful life.
- The market value, realisable value, actual worth of assets, etc. are not recognised, hence the value recorded is free from any personal bias of the makers of financial statements.

Merits:

- Objectivity and reliability of accounting data since the information is not manipulated.
- Simple and convenient in recording.
- Consistency in preparation and makes the financial statements comparable.

Demerits:

- Does not consider the changes in price level due to inflation.
- Unrealistic profit, since revenue is recognised on current value while depreciation is charged on historical cost.
- Depreciation is charged at lower rates than required for making sufficient provision for replacement.

(viii) Realisation Concept

- Under this concept, revenue is recognised at the point of sale or at the time of rendering of the service incase of long term contracts, hire purchase contracts, etc.

(ix) Dual aspect concept

- Under this concept, all the business transactions have two-fold aspects which needs to be recorded in the books of accounts. It is the core of entire accounting system.
- Every credit entry has an equivalent debit and *vice-versa*. Double entry book keeping system is based on this concept. There is a relationship between assets and liabilities which can be expressed as:

  Assets = Owner's Equity + Liabilities

  Or

  Equity = Assets – Liabilities

(x) Conservatism:

- Under this concept accounting entries are recorded on the basis of prudence, that is, all probable losses must be accounted for, and anticipated profits, should be ignored.
- This concept presents the realistic financial position of the enterprise without any window-dressing for showing better position that it actually has.
- It encourages accountants to create provisions, overstate the liabilities and understate the assets in Balance Sheet. However this concept must be applied with caution so that the real results are not the misleading results.

- The three qualitative characteristic for applying this concept are
  - (a) Produce
  - (b) Neutrality
  - (c) Faithful representation of values.
- It is due to this concept that stock is shown on cost or market value, whichever is lower.

For Example

X traders purchased goods for ₹30,00,000 and sold 70% of such goods during the accounting year ended 31st March 2017. The market value of remaining goods was ₹6,00,000. As per conservatism, the valuation stock should be valued as cost or market price whichever is lower, i.e. ₹6,00,000 and not ₹9,00,000.

(xi) Consistency

- Under this concept, all the accounting principles and policies are applied in a similar manner i.e. consistently in different accounting periods, so that the users may make comparison of the performance for different years.
- The method once chosen for a particular period must be applied in all subsequent periods until change required is for better presentation and disclosures.
- Any change in a accounting policy must be reflected in notes to accounts attached with balance sheet so as to enable the users to understand the reason for change in a particular item and take rational decisions accordingly.
- Any change in a accounting policy can be done:
  - → To comply with law;
  - → To present books as per the accounting standards; or
  - → to reflect true and fair view in presentation of financial standards.

(xii) Materiality

- It is a subjective term – an item material for one business may not be material for another. It usually happens due to various factors such as size of business, level of information, and person requiring to take decision.

- Materiality means the relative importance of an item. If the knowledge of a particular item affects the decision of the user, it may be said to be material. In other words, omission of a material item may lead to incorrect decision making.
- Under this concept, items of material nature are disclosed separately, while immaterial items are ignored or merged with other items.

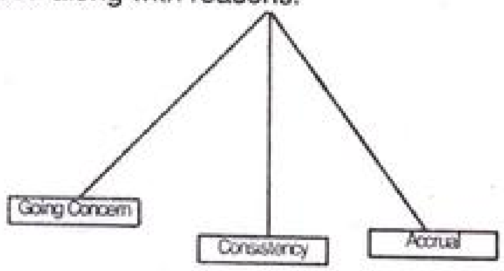
Q6. What are Fundamental Accounting Assumptions?

Answer:

There are three fundamental accounting assumptions:

(i) Going Concern (ii) Consistency (iii) Accrual.

All the above fundamental accounting assumptions are assumed to be followed in the preparation of financial statements and do not require a mention. However, if any of them is not followed, then this fact should be specifically disclosed along with reasons.



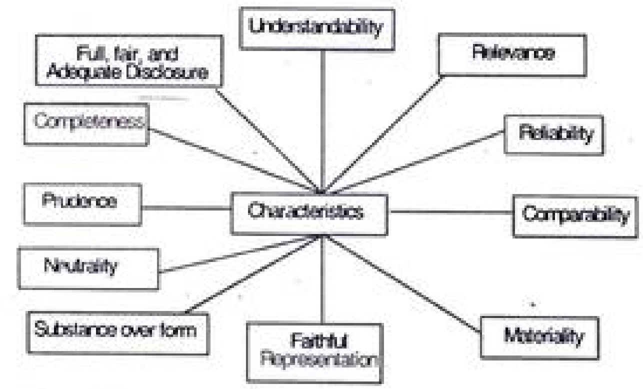
Q7. What are Financial Statements?

Answer:

- Financial statements are the accounting reports prepared to ascertain the financial position and performance of the business at a given point of time.
- It comprises of Profit and Loss Account, which reflects the details of income and expenditure and the net result of such transactions [i.e. Profit / Loss]; Balance Sheet, which reflects the details regarding owner's equity, outside liabilities, and total assets of the business; and cash flow statement, which reflects the details of cash inflows and outflows during an accounting period.

Q8. What are Qualitative Characteristic of Financial Statements?

Answer:



(a) Understandability:

- Financial statements must be prepared in such manner that the information can be easily understood by the users.

(b) Relevance:

- Information must be relevant i.e. it must be communicated at the time it is required for decision making.
- It should be able to influence the decision of user and help in analysing the financial position.

(c) Reliability:

- Financial information used to prepare accounting statements must be from reliable sources and evidenced by proper supporting documents, such as sale bills, vouchers, etc.
- Unreliable information may result in misleading result which may adversely affect the user.

(d) Comparability:

- Financial statements must be comparable, i.e. they should be prepared by following relevant accounting standards and policies so that users could compare the performance of different organisations.
- Any changes in accounting policies must be communicated along with the monetary effect to the users requiring such statements.

(e) Materiality:

- Information is material if its misstatement (i.e. omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information.
- Materiality depends on the size and nature of the item under consideration.
- All material facts must be disclosed in the financial statements.
- Omission of paise and showing the rounded off figure is based on this concept.

(f) Faithful Representation:

- Due to certain inherent limitations of accounting, there are instances where adequate disclosures regarding particular transactions may not be given.
- Information or figures projected in various statements should truly represent the business. No under or over presentation of organisation's position should be projected.
- If any information given in statements is subject to risk of error, the certainty of such risk should be mentioned so as to make users act accordingly.

(g) Substance Over Form:

- Transactions must be recorded in financial statements on the economic substance, i.e., for recording the transactions, a proper judgement should be made to present it in the best manner to reflect the true essence of transaction; and the legal aspects may have to be given less attention to give true and fair disclosure of business affairs.

(h) Neutrality:

- Information in financial statements must be free from personal bias.
- Faithful representation of transactions in the financial statements make the statements reliable.

(i) Prudence:

- Prudence is the degree of caution for making judgements while recording any particular item of income or expense.
- Prudence concept is described as "Don't anticipate profit, but provide for all possible losses".

(j) Completeness:

- Transactions must be recorded properly so that the complete information is displayed about the nature of such transaction in financial statements.
- If any omission of information misleads the decision making of user, it is said that the information is incomplete and hence not reliable.

(k) Full, Fair and Adequate Disclosure:

- All the information relevant for decision making of users must be fully disclosed in the financial statements.
- Financial statements must be prepared on the basis of 'Generally Accepted Accounting Principles' (GAAP), so the users can rely on them.
- Proper disclosure of accounting policies, contingent liabilities and other relevant information necessary to understand the statements must be given.

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. Provision for bad and doubtful debts is result of:
   (a) Conservatism concept
   (b) Going concern concept
   (c) Disclosure concept
   (d) Consistency concept
2. Recording of Fixed Assets at Cost ensures adherence to:
   (a) Conservatism
   (b) Cost Concept
   (c) Going Concern Concept
   (d) Accrual Concept

3. Fundamental Accounting Assumptions are:
   (a) Going Concern, Conservatism, Accrual
   (b) Going Concern, Matching, Consistency
   (c) Going Concern, Consistency, Accrual
   (d) Going Concern, Entity, Periodicity
4. When Fixed assets are sold:
   (a) Total assets will increase
   (b) Total liabilities will increase
   (c) Total assets will decrease
   (d) There is no change in total assets
5. The Accounting Equation is based on:
   (a) Going Concern Concept
   (b) Dual Aspect Concept
   (c) Money Measurement Concept
   (d) All of these
6. _____Concept is the basic idea that the business is separate from owner.
   (a) Dual Aspect
   (b) Entity
   (c) Realization
   (d) Materiality
7. The owner of a company included his personal medical expenses in the company's income statement. Indicate the principle that is violated.
   (a) Cost principle
   (b) Conservatism
   (c) Disclosure
   (d) Entity Concept
8. Two primary qualitative characteristics of financial statements are:
   (a) Understandability and Materiality
   (b) Relevance and Reliability
   (c) Materiality and Reliability
   (d) Relevance and Understandability

9. Money owed from an Outsider is a:
   (a) Asset
   (b) Liability
   (c) Expense
   (d) Capital
10. Cost of Machinery ₹10,00,000
    Installation charges ₹1,00,000
    Market Value on 31.3.06 ₹12,00,000
    While finalizing the accounts, if the company values the machinery at ₹12,00,000. Which concept is violated by the Company?
    (a) Cost
    (b) Matching
    (c) Realization
    (d) Periodicity
11. Capital as on 1-4-05 ₹90,000
    Capital introduced ₹25,000
    Drawings made ₹35,000
    Capital as on 31-3-06 ₹1,25,000
    What is the amount of profit added to the Capital?
    (a) ₹50,000
    (b) ₹60,000
    (c) ₹75,000
    (d) ₹45,000
12. GAAP's are:
    (a) Generally Accepted Accounting Policies
    (b) Generally Accepted Accounting Principles
    (c) Generally Accepted Accounting Provisions
    (d) None of these
13. _______ refers to the general agreement on the usage and practices in social or economic life:
    (a) Accounting Assumptions
    (b) Accounting Conventions

(c) Accounting Policies
(d) Accounting Principles

14. Double Entry Principle means:
(a) Writing twice the same entry
(b) Writing all the entries twice in the book
(c) Having debit for every credit and credit for each debit
(d) All of the above

15. No inference of profit and provision making policy for all possible losses is due to:
(a) Convention of Consistency
(b) Convention of Conservatism
(c) Convention of Disclosure
(d) Convention of Materiality

16. The underlying accounting principle necessitating amortization of Intangible Assets is/are:
(a) Cost Concept
(b) Realization Concept
(c) Matching Concept
(d) Both 'b' and 'c'

17. "Holding gains in relation to stocks should not be used for payment of dividend." Which one of the following accounting principle is involved in this?
(a) Consistency
(b) Cost
(c) Materiality
(d) Realization

18. If Going Concern Concept is no longer valid, which of the following is true?
(a) All prepaid assets would be completely written off immediately
(b) The allowance for uncollectible accounts would be eliminated
(c) Intangible assets would continue to be carried at net amortized historical cost
(d) Land held as an investment would be valued at its realizable value

19. Ram starts business with ₹90,000 and then buys goods from Shyam on credit for ₹23,000. The accounting equation based on Assets = Capital + Liabilities will be:
(a) 1,13,000 = 90,000 + 23,000
(b) 1,13,000 = 1,13,000 + 0
(c) 90,000 = 67,000 + 23,000
(d) 67,000 = 90,000 - 23,000

20. Window dressing of Accounts means:
(a) Presenting accounts in beautiful manner
(b) Showing more losses to avoid Income Tax
(c) Showing more profits to attract Investment
(d) All of the above

21. Which financial statement represents the accounting equation ASSETS = LIABILITIES + OWNER'S EQUITY
(a) Income Statement
(b) Cash Flow Statement
(c) Balance Sheet
(d) Funds Flow Statement

22. Ram purchased a car for ₹10,000 paid ₹3,000 as cash and balance amount will be paid in three equal installments. Due to this:
(a) Total assets increase by ₹10,000
(b) Total liabilities increase by ₹3,000
(c) Assets will increase by ₹7,000 with corresponding increase in liability by ₹7,000
(d) Both (b) and (c)

23. During life-time of an entity, accountants prepare financial statements at arbitrary points of time as per:
(a) Prudence
(b) Consistency
(c) Periodicity
(d) Matching

24. The Accounting Convention of Matching means:
(a) Profit for the period to be matched with sales revenue
(b) Profit for the period to be matched with investment

(c) Expenses of one period to be matched against the expenses of another period
(d) Expenses of one period to be matched against the revenue of the same period

25. Recording of capital contributed by the owner as liability ensures adherence of principle of
(a) Matching
(b) Going concern
(c) Double entry
(d) Separate entity of business

26. Omission of paise and showing the round figures in financial statements is based on:
(a) Conservatism concept
(b) Consistency concept
(c) Materiality concept
(d) Realization concept

27. Accounting does not record non-financial transactions because of:
(a) Accrual concept
(b) Cost concept
(c) Continuity concept
(d) Money Measurement concept

28. Which of these is not a fundamental accounting assumption?
(a) Going concern
(b) Consistency
(c) Conservatism
(d) Accrual

29. Fixed assets and Current assets are categorized as per concept of:
(a) Separate entity
(b) Going concern
(c) Consistency
(d) Time period

30. The obligations of an enterprise other than owner's fund are known as:
(a) Assets
(b) Liabilities

(c) Capital
(d) None of these

31. Which concept requires that those transactions which can be expressed in terms of money should be recorded in books of account?
(a) Business Entity
(b) Dual Aspect
(c) Money measurement
(d) None of these

ANSWER

1.	(a)	2.	(b)	3.	(c)	4.	(d)	5.	(b)
6.	(b)	7.	(d)	8.	(b)	9.	(a)	10.	(a)
11.	(d)	12.	(b)	13.	(b)	14.	(c)	15.	(b)
16.	(c)	17.	(d)	18.	(d)	19.	(a)	20.	(c)
21.	(c)	22.	(c)	23.	(c)	24.	(d)	25.	(d)
26.	(c)	27.	(d)	28.	(c)	29.	(b)	30.	(b)
31.	(c)								

SHORT PRACTICE QUESTIONS

1. Write Short Notes on
(i) Entity Concept
(ii) Periodicity Concept
(iii) Accrual Concept
(iv) Fundamental Accounting Assumptions
(v) Accounting Conventions
(vi) Materiality Concept

2. Discuss accounting concept based on presumption that do not anticipate profits but provide for all probable losses.
   [Hint: Refer Question 5 Part (x)]
3. What is the importance of adopting consistency concept in preparation of financial statement.
   [Hint: Refer Question 5 Part (xi)]
4. What is a financial statement? Enumerate its characteristics.
   [Hint: Refer Questions 7 and 8]

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

1996 - Nov [5] State with reasons whether the following statement is True or False.

1. In accounting, all business transactions are recorded as having dual aspect. (2 marks)

Answer:

True: Being associated with the system of double entry book keeping, every transaction has a two-fold effect in accounting whereby one account is debited and another is credited by the same amount.

1998 - May [5] State with reasons whether the following statement is true or false:

(7) Accrual concept implies accounting on cash basis. (2 marks)

Answer:

False: Accrual concept implies accounting done on due or accrual basis. It involves the recognition of revenues and costs as they accrue irrespective of the actual receipts or payments.

1999 - Nov [5] State with reasons whether the following statement is true or false:

(iii) Companies can keep their accounts under cash basis. (2 marks)

Answer:

False: It is mandatory for companies to keep their accounts under accrual basis as per the provisions of the Company Law.

2003 - May [5] State with reasons whether the following statements are true or false:

(ii) The value of human resources is generally shown as assets in the Balance Sheet. (2 marks)

(iii) Revenue is matched with expenses in accordance with the matching principle. (2 marks)

(iv) The financial statements must also disclose the relevant and reliable information in accordance with the Full Disclosure Principle. (2 marks)

Answer:

(ii) **False:** The human recourse still cannot be defined in terms of money.

(iii) **True:** The matching concept involves that the revenue earned in an accounting year is matched with the expenses incurred during the same period to generate that revenue.

(iv) **True:** The financial statements must also disclose the relevant and reliable information as per AS-1 i.e. Disclosure of Accounting policies.

2003 - Nov [5] State with reasons whether the following statement is true or false:

(ii) The economic life of an enterprise is artificially split into periodic intervals in accordance with the going concern assumption. (2 marks)

Answer:

False: The economic life of an enterprise is artificially split into periodic intervals in accordance with the Periodicity Concept.

2004 - Nov [5] State with reasons whether the following statements are true or false:

(i) Accounting principles are general rules followed in preparation of Financial Statements. (2 marks)

(ix) Capital is equal to assets less external liabilities. (2 marks)

Answer:

(i) **True:** Accounting principles suggests the rules of action, which are universally accepted by the accountants for the recording of accounting transactions.

(ix) **True:** Capital + Reserves & Surplus (internal liabilities) = All Assets - External Liabilities

2005 - Nov [5] State with reasons whether the following statement is true or false:

(ii) As per the concept of conservatism, the accountant should provide for all possible losses, but should not anticipate income. (2 marks)

Answer:

True: Concept of conservation states that the accountants should not anticipate income and should provide for all possible losses.

2006 - Nov [5] State with reasons whether the following statement is true or false:

(ix) All significant accounting policies adopted in preparation and presentation of financial statements must be disclosed. (2 marks)

Answer:

True: Disclosure of significant accounting policies must form part of the financial statements and these policies must be disclosed separately, at one place in annual report, e.g., policies relating to valuation of inventory, deprecation accounting, etc.

SHORT NOTES

1996 - May [6] Write short note on the following:

(2) Fundamental Accounting Assumptions (5 marks)

Answer:

Fundamental Accounting Assumptions: Fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed. The Institute of Chartered Accountants of India issued Accounting Standard (AS 1) on 'Disclosure of Accounting Policies' according to which the following have been generally accepted as fundamental accounting assumptions:

1. **Going concern:** The enterprise is normally viewed as a going concern, i.e. as continuing operations for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.
2. **Consistency:** It is assumed that accounting policies are consistent from one period to another.
3. **Accrual:** Guidance Vote on 'Terms used in Financial Statements' defines accrual basis of accounting as "the method of recording transactions by which revenue, costs, assets and liabilities are reflected in the accounts in the period in which they accrue". The accrual "basis of accounting" includes considerations relating to deferrals, allocations, depreciation and amortisation. Financial Statements prepared on the accrual basis inform users not only of past events involving the payment and receipt of cash but also of obligations to pay cash in future and of resources that represent cash to be received in the future. Hence, they provide the type of information about past transactions and other events that is most useful to users in making economic decisions. Accrual Basis is also referred to as Mercantile Basis of Accounting.

1998 - Nov [6] Write short note on the following:
(i) Going concern concept. (5 marks)

Answer:

Going concern concept: It means that the business will go on indefinitely i.e. the business is not going to be liquidated in foreseeable future. This concept is fundamental to the accounting theory. The Balance sheet is prepared on the basis of this concept and the prepaid expenses are shown as assets in the B/S because of this concept only. The creditors supply the goods and services expecting the continuation of business for a long period.

2000 - May [6] Write short note on the following:
(a) Periodicity Concept. (5 marks)

Answer:

The life of business is based on going concern assumption and the measurement on the basis of this assumption is not possible for a long period. The owner cannot wait for such a long time, so a small workable fraction of time is selected from an unending life cycle of the business enterprise for measuring the performance and looking at the financial position. Generally, a period of one year is taken for measuring and appraising the performance of the financial position. Thus, the periodicity concept makes the accounting system and the term 'accrual' workable.

2003 - Nov [6] (b) What is meant by Accounting Policies? Give four examples of Accounting Policies? (5 marks)

Answer:

Accounting Policies:

"Accounting policies" means specific methods or principles of accounting adopted by an enterprise for a particular transaction or event in the preparation and presentation of financial statements. While adopting a particular accounting policy, main consideration should be to prepare financial statement so as to represent true and fair view of the state of affairs of the enterprise.

For e.g.

1. Valuation of fixed assets, stock, goodwill, investment, etc.
2. Method of depreciation, amortization.

3. Treatment of goodwill, contingent liabilities.
4. Conversion of foreign currency items.

2004 - Nov [6] Write short note on the following:
(iii) Accounting Convention. (5 marks)

Answer:

Accounting Conventions

Accounting Conventions emerge out of accounting practices, commonly known as Accounting Principles, adopted by various organizations over a period of time. These conventions are derived by usage and practice. The accountancy bodies of the world may change any of the convention to improve the quality of accounting information. Accounting Conventions need not have universal application.

2005 - Nov [6] Write short notes on the following:
(i) Accrual basis of Accounting. (3 marks)
(ii) Qualitative characteristics of Financial Statements. (3 marks)

Answer:

(i) **Accrual basis of Accounting:** Accrual or mercantile basis of accounting refers to a system of recording revenues and expenses whether or not they have been received or paid in cash at the time of recording.

Accounting on accrual basis signifies that owner's equity is affected by the profit earned or loss suffered by an enterprise during the accounting period, and not as money is received or paid.

Therefore, while ascertaining the profit or loss, not only those expenses which have been paid in cash should be considered, but also expenses which have become due though not paid should be taken into account.

Similarly all the incomes earned during the accounting period should be considered whether they have been received in cash or not.

(ii) **Qualitative Characteristics of Financial Statements:** Financial statements have some qualitative characteristics so that they may provide more information to the users. These are the qualitative characteristics of financial statements:

(1) Understandability;
(2) Relevance;
(3) Reliability;
(4) Comparability;
(5) Faithful Representation; and
(6) Completeness.

(1) **Understandability:** Required quality of information should be provided so that financial statements become more understandable for users. For this reason, it is assumed that users have a reasonable knowledge of business and economic activities and they study information with reasonable diligence. Information regarding complicated matters should be included in the statement because of its relevance to the economic decision-making needs of the users and it should not be excluded merely on the ground that it may be too difficult for some users to understand.

(2) **Relevance:** Incorporate that information in the financial statements which is relevant for decision making. Quality of relevance of the information is determined when it influences the economic decisions of users.

(3) **Reliability:** Information must be reliable. Level of reliability of the information is high when it is free from material errors and biased decisions. Information may be relevant but so unreliable in nature or representation that its recognition may be badly misleading.

(4) **Comparability:** Financial Statements should be prepared in such a way that users of the financial statements must be able to compare their information with other information or financial statements in order to identify trends in performance, Cash flows, and financial position.

(5) **Faithful Representation:** Information must be represented faithfully so that its degree of reliability is high.

(6) **Completeness:** In order to present more reliable information in the financial statements, it must be complete within the boundary of materiality and cost. An omission of information may cause information to be false or misleading and therefore unreliable and deficient in terms of relevance.

2006 - May [6] Write short note on the following:
(i) Fundamental Accounting Assumptions. (5 marks)

Answer:

Please Refer 1996 - May [6] (2) on page no. 54

2006 - Nov [6] Write short note on of the following:
(i) Money measurement concept (5 marks)

Answer:

Money measurement concept: Accounting records only those transactions which are expressed in monetary terms. As per this concept, a transaction is recorded in terms of money. Since money is the medium of exchange and the standard of economic value, this concept requires that those transactions alone that are capable of being measured in terms of money are to be recorded in the books of account. Money i.e., the ruling currency of a country provides a common denomination for the value of material objects.

DISTINGUISH BETWEEN

2019 - June [1] (b) Distinguish between Going Concern concept and Cost concept. (4 Marks)

Answer:

Distinction between Going Concern and cost concept

Going Concern Concept :

The financial statements are normally prepared on the assumption that an enterprise is a going concern and will continue operation for the foreseeable future. Hence, it is assumed that enterprise has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such intention exists, the statements will have to prepared on different basis, and, if so, the basis used is disclosed.

Cost Concept :

By this concept, the value of an asset is to be determined on the basis of historical cost, in other words, acquisition cost. Although there are various measurement bases, accountants traditionally prefer this concept in the interests of objectivity. It is highly objective and free from all bias.

CHAPTER

1 Theoretical Framework

Unit: 3 **Accounting Terminology**

SELF STUDY QUESTIONS

Q1. What are the key terms in Accounting Terminology?

Answer:

Acceptance: It is a process through which drawee (i.e. buyer) accepts the bill of exchange of drawer (i.e. seller) by way of signing the bill and giving his assent to an unconditional obligation to pay the same on or before maturity date.

Accounting Policies: Methods and principles used for preparing the financial statements of the enterprise.

Accrual basis of accounting: Recording the income and expenses as and when earned irrespective of the receipt & payment schedule. It is also called as mercantile basis of accounting.

Accrued Asset: It is an unenforceable claim against a person which has accumulated as a result of rendering service or with the passage of time but yet not invoiced.

Accrued expense: It is an accounting expense which is recognised in advance but not payable at present.

Accrued liability: Is an unenforceable claim by a person which has accumulated as a result of receipt of service or with the passage of time.

Accrued Revenue: It is an accounting receipt which has been earned but not received till date.

Accumulated Depreciation: It is the cumulative depreciation on depreciable assets for the period beginning from the date of purchase and ending on the date of reporting in financial statement.

Amortisation: It is the way of allocating the cost of asset which is intangible in native over a period of time which may be prescribed and can be for more than one accounting period.

Annual Report: It is the statement providing information to the shareholders about the financial health of the business. It includes Director's Report, Auditor's Report. Balance Sheet, Profit & Loss A/c and Notes to Accounts and other necessary information as require by statute.

Appropriation Account: It is a section of Profit and Loss A/c where the distribution of Net Profit (calculated in Profit and Loss A/c) for transferring to reserves or distributing as dividend etc. are shown separately.

Asset: Assets are property or legal right which are owned or controlled by an organisation and provides future economic benefits.

Authorised Share Capital: It is the maximum number of shares and par value per share to which company is authorised for issuing at any point of time. It is also called as Nominal Share Capital and is the given in Memorandum of Association. A company cannot issue shares in excess of such authorised share capital.

Average Cost: Cost per unit of item.

It is calculated by:

$$\frac{\text{Total cost of all times}}{\text{No. of items}}$$

Bad debts: Debts owned by the company which cannot be recovered and considered as business loss; hence debited to Profit & Loss Account.

Balance Sheet: It is the statement of assets and liabilities along with owner's equity at a given point of time.

Bills of Exchange: It is an instrument in writing which contains an unconditional order given by the creditor to debtor to pay at sight or after a certain period, a certain sum of money to or to the order of the certain specified person or the beared.

Bonus Shares: These are the shares allotted by the company to its existing shareholders by way of capitalising the existing profits held by the company.

Book Value: It is the value at which various assets and securities are recorded in books of accounts or financial statements of business.

Borrowing Cost: It is the cost of borrowed funds. It includes interest cost and other ancillary cost incurred while borrowing funds for business purpose.

Bond/Debenture: It is a long term security issued by a company yielding fixed rate of interest and to be repaid after the end of issue term.

Call: Demand made by the company to pay a part of whole of the sum payable on shares/debenture allotted by the company.

Called up Share Capital: It is the part of sum demanded by the company to be paid by the shareholders to the company against the shares issued.

Capital: It is the funds invested in company along with accumulated wealth of the company.

Capital Asset: Assets other than those held for sale in ordinary course of business. These include tangible and intangible assets, investments, etc.

Capital = Assets – Liabilities

Capital Commitment: It is the amount of money planned by the company to be spent for capital expenditure for which company has entered into contract with third party.

Capital employed: It is the funds deployed by the company in various assets, investments and working capital required for the business operations.

Capital Profit/Capital Loss: It is profit/loss not earned in the ordinary course of business. It may be earned through sale of fixed assets, investments, premium on issue of shares and debentures. If the profit earned from above is negative, it is called as capital loss.

Capital Reserve: It is the portion of funds set aside by the business for long term investments or expenses and is non-distributable i.e. this reserve cannot be utilised for dividend distribution.

Capital work in progress: Expenses incurred on such assets which are not completed on the balance sheet date. It is separately shown under the head Non-current Assets.

Cash: It is a balance sheet item shown under the head 'Current Assets'. It comprises of cash in hand, cash at bank and demand deposits with banks.

Cash equivalents: These are the short term investments that are readily convertible into cash with negligible risk of change in its value.

Cash Basis of Accounting: Recording of income and expenses on receipt and payment basis irrespective of the period in which they are actually accrued.

Cash Discount: It is an incentive provided by the seller on invoiced price for settling the payment due within the stipulated time.

Cash Profit: Net cash receipt after reducing all cash expenses.

Net Profit
Add: Depreciation
Add: Amortised expenses/Non cash expenses cash profit

Carrying Amount: Cost of Asset
Less: Accumulated Depreciation.

Charge: It is a mortgage or claim on asset done by the lenders for securing the amount of debt. These are of two types:

Fixed charge: Charge against a specific property.

Floating Charge: on company assets as a whole which may crystillise in particular circumstances.

Collateral Security: It is the security other than the principal security offered additionally by borrower to secure a loan.

Cost of Disposal: Incremental expenses directly attributable to disposal of asset.

Contingent Asset: It is a possible asset which may arise out of uncertain future events beyond the control of the entity.

Contingent Liability: It is a potential liability depending on an uncertain future event.

Cost of purchase = Purchase price
+ Freight inwards
+ expenses incurred
(–) Discount/Rebate

Cost of Goods Sold = Opening Stock + Purchases – Closing Stock

Conversion Cost: Cost directly attributable for conversion of raw material into semifinished/finished goods.

Conversion Cost = Direct labour cost + Manufacturing overheads

Convertible Debenture: Debenture having right to be converted wholly or partly into the shares of the company.

Cumulative Preference Shares: A type of preference share where unpaid dividend accumulates against the profit of enterprise and are paid in priority to equity shareholders. Unless specified, preference shares are deemed to be cumulative.

Current Asset: Business assets kept for short-term for the purpose of converting them into cash or for resale in the ordinary course of business-Example Inventory, Debtors, Bank balance, etc.

Current Liability: Liabilities payable in near future (usually within an year). Example-Creditors, Bank overdraft etc.

Depletion: Reduction through periodic write offs, of cost of wasting asset.

Depreciation: It is the fall in value of depreciable fixed assets as a result of normal wear and tear, obsolescence or accident. It is usually spread over the useful life of the asset.

Depreciable amount = Historical value (–) salvage value if any

Depreciable Asset: Asset that provides economic benefits for more than one accounting period but has a limited life and not held for sale in ordinary course of business.

Example: Plant, Machinery, Furniture, etc.

Discount: It is a concession in price offered for enabling prompt payment.

Dividend: Distributable profits or reserves of company paid to shareholders.

Equity Share: They are the ordinary shares carrying voting rights eligible for receiving dividend after the payment of dividend on preference shares.

Exchange difference: Difference resulting from conversion of one unit in one of currency to another currency at different exchange rates.

Expense: Reduction in economic benefits as a result of outflows during an accounting period. It is the cost of carrying business operations.

Extraordinary Items: Income and expenses arising out of infrequent or unusual activities other than those carried in the ordinary course of business.

Expired cost: Expired cost is such portion of cost whose benefit is exhausted at the reporting date.

Fair Value: Exchange price estimated to be received on sale of asset or settlement of liability between willing parties when there is no compulsion on both the parties to buy or sell and both have knowledge about all relevant facts.

Fair Market Value: Exchange price estimated to be received on sale of asset or settlement of liability in an open market when there is no compulsion on both the parties to buy or sell and both have knowledge about all relevant facts.

First Charge: It is a charge on the assets of the principal loan in priority over other charges on that particular asset.

Fixed Assets: Business assets purchased for smooth operation of business activities and not held for resale in ordinary course of business.

Example: Plants, Machinery, Land & Building etc.

Fixed Cost: Production cost fixed in nature in short run and is not affected from change in volume of production. For example - Rent of building, insurance premium, etc.

Financial Instrument: Monetary contracts between the parties that creates financial asset for one enterprise and correspondingly financial liability for another enterprise.

Forfeited Shares: Shares taken back on failure of payment due on calls from shareholders by the directors if authorised by articles of association; the shareholders lose the title on such shares.

Free reserves: Reserves which can be utilised in any manner without any restriction.

Gain: Increase in owner's equity as a result of transaction arising out of other than normal business operations.

General Reserve: Revenue reserves setup for meeting potential future unknown liabilities of the business.

Goodwill: Intangible business asset recorded under Non-current Assets which arises due to reputation, trade name or business connection of the enterprise.

Gross Profit/Gross margin: Difference between total sales revenue earned from sale of goods or rendering of services and the direct cost related to such goods or services.

Gross Profit = Net Sales – Cost of goods

Government Grants: Assistance provided in cash or kind by the government to the business enterprise that requires compliance of certain conditions relating to operations of the business.

Gross Book Value: It is the historical cost of fixed assets as recorded in books of accounts and financial statements of the business.

Income & Expenditure Statement: Financial statement of Non-Profit making enterprises prepared to record the incomes and expenses of the relevant accounting period.

Intangible Asset: It is the asset which cannot be touched i.e. it does not have any physical identity and can only be felt. For example - Goodwill of the business, trademarks, patents, copy rights, etc.

Inventory/stock: It is a tangible asset

- held for the purpose of sale in the ordinary course of business or
- in the process of production of such saleable goods or rendering of services (i.e. raw material or work in progress)
- one used for production of goods and rendering of services (example - stores, spares, etc.)

Investments: Assets held by business enterprises for earning income in the form or dividends, rentals, etc. for future capital appreciation.

Issued Shares Capital: It is the portion of authorised share capital which has been offered for subscription.

Joint Venture: It is a contract executed between two or more parties to undertake an economic activity which is under the control of both the parties.

Liability: Amount that business owes to outsiders (creditors).

Liability = Asset – Capital

Lien: It is the right of one person to satisfy a claim against another by holding or retaining possession of that other assets/property.

Long term Liability/Non-Current Liabilities: Liability whose payment may fall due after twelve months.

Lease: Formal agreement to use the assets for a specified period on payment of lease rentals.

Mortgage: When a loan is advanced in return of immovable property to be treated as security for loan, the property is said to the mortgaged. Security is redeemed only after repayment of such loan.

Net Assets/Net Worth/Shareholders Wealth = Paid up Share Capital + Reserves Surplus

Or

Total Assets – Liabilities
[except fictitious assets]

Net Profit: Difference between total sales revenue including other income and all the cost (whether direct or indirect cost)

Net Profit = Sales Revenue + Other Income
(–) Cost of Goods sold
(–) Indirect expenses

Net Realisable Value/Net Selling Price: Expected sales price minus cost to complete the sale.

Obsolescence: Process of becoming outdated due to change in technology, production methods, etc. and hence no longer used.

Operating Profit: Profit of the business before reducing interest and tax related expenditure.

Paid-up Share Capital: It is the portion of issued and subscribed share capital for which the amount due on shares has been received by the company including bonus shares issued if any.

Preference Shares: These are the type of shares having preferential right in relation to payment of dividends at fixed rates periodically and repayment of capital at the time of liquidation along with participating rights in surplus profits if any.

Preliminary Expenses: Expenses incurred in formation of company. **Example:** Expenses in issue of prospectus, preparation of memorandum of Association and Articles of Association.

Prepaid expenses: Expenses paid in advance, i.e. before the period in which they are actually incurred.

Prime Cost: Direct material + Direct Wages + Direct Expenses.

Prior Period Items: Income and expenses which arise in current period as a result of errors or omission in preparation of financial statement of one or more prior periods.

Profit & Loss A/c: It is a financial statement showing revenue earned and expenses incurred during an accounting period by the business enterprise.

Revenue > Expenses = Profit

Revenue < Expenses = Loss

Prudence: Care and caution that someone shows while making decisions related to recording of financial transactions so as to give true and correct disclosures. It is because of prudence concept, that profits are not anticipated while all known liabilities and losses are provided for in financial statements.

Provisions: Amount retained and set aside by way of providing for any known liability the amount of which may not be ascertainable with reasonable accuracy.

Redeemable Preference Shares: Type of preference shares which are repayable after a fixed period of time.

Redemption: Discharge of liability on account of repayment of preference shares or debentures issued by the company.

Reserve: It is the portion of earning/profits of the business set aside for general or specific purpose other than provisions.

Revaluation Reserve: Reserve created on account of change in estimated replacement cost or market price over the took value of assets.

Residual Value: Salvage value of the asset at the end of useful life after reducing expenses related to cost of disposal.

Revenue: Gross inflow of cash and receivable on account of sale of goods, supply of services or any other income such as interest, dividends, refunds, etc.

Revenue Reserve: Reserves which are not capital reserves and are used to strengthen the financial position of business, distribution of dividends to shareholders, replacement of assets, etc.

Right Shares: Shares offered for allotment to existing shareholders in proportion to their existing shareholding at the time of making fresh issue by the company.

Sales Turnover: Total sales or revenue of total services rendered by the enterprise.

Secured Loan: Loan against security where security comprises of business.

Shareholder's Equity: Difference between total assets and total liabilities of the business also called stockholders equity or networth.

Share Issue Expenses: Expenses incurred by the business enterprise in relation to issue and allotment of charges.

For example: Governmental fee, Professional charges, Cost of printing of prospectus, brokerage, commission, etc.

Share Warrants: Financial instrument that give the right to its holders to acquire equity shares for the enterprise.

Security Premium: Difference between the issue price and face value of shares.

Subscribed Share Capital: It is a portion of issued share capital for which subscription has been made and shares are allotted, including bonus shares issued, if any.

Sundry Creditors/Trade Creditors/Trade Payables: Amount owed by the enterprise on account of credit purchases from parties.

Sundry Debtors/Trade Debtors/Trade Receivable: Amount receivable by the company on account of credit sales made to parties.

Trade Discount: Reduction from list price offered by supplier to promote instant payment of amount due on such supplies. It does not form part of accounting entries as the discount is deducted in the invoice and net amount is recorded in books.

Unexpired Cost: Such portion of cost whose benefit is not exhausted at the reporting date.

Unissued Share Capital: Part of authorised share capital which has not been issued/offered for subscription.

Unpaid Dividend: Dividend declared but not paid to shareholders.

Useful Life: In respect of fixed asset, it is the estimated life for which a depreciable asset could be used by the enterprise or number of units expected to be produced from the use of particular asset in the entire life span of such asset.

Short Practice Questions

1. Define following terms:
   (a) Charge
   (b) Cumulative preference shares
   (c) Fixed assets
   (d) Inventory
   (e) Preliminary expenses
   (f) Contingent asset
2. Differentiate between the following:
   (a) Authorised share capital and subscribed share capital
   (b) Fixed assets and Current assets
   (c) Capital reserve and Revenue reserve
   (d) Preliminary expenses and Prior period expenses

Past Year Questions and Answers

Objective Questions

199* - Nov [5] State with reasons whether the following statement is true or false:
(8) Profit and Loss Account shows the financial position of the concern. (2 marks)

Answer:
False: Profit and Loss Account shows the financial results of a concern for a particular period of time. The financial position of a concern is reflected in the balance sheet.

1996 - May [5] State with reasons whether the following statement is true or false:
(5) Goodwill is not a fictitious asset. (2 marks)

Answer:
True: Goodwill is an intangible asset.

1997 - Nov [5] State with reasons whether the following statement is true or false:
(5) Profit and Loss Account shows the financial position of the concern. (2 marks)

Answer:
False: Profit and Loss Account shows the financial results of a concern for a particular period of time. The financial position of a concern is reflected in the balance sheet.

1998 - May [5] State with reasons whether the following statement is true or false:
(3) Goodwill is a current asset. (2 marks)

Answer:
False: Goodwill is an intangible asset and is classified as fixed asset.

2001 - Nov [5] State with reasons whether the following statement is true or false:
(iv) Goodwill is a fictitious asset. (2 marks)

Answer:
False: Goodwill is an intangible asset and not fictitious.

2004 - May [5] State with reasons whether the following statement is true or false:
(x) Depreciable amount refers to the difference between historical cost and the market value of an asset. (2 marks)

Answer:
False: Depreciable amount refers to historical cost less salvage value.

SHORT NOTES

1995 - Nov [6] Write Short Note on the following:
(1) Trade Discount.

Answer:

Trade Discount:

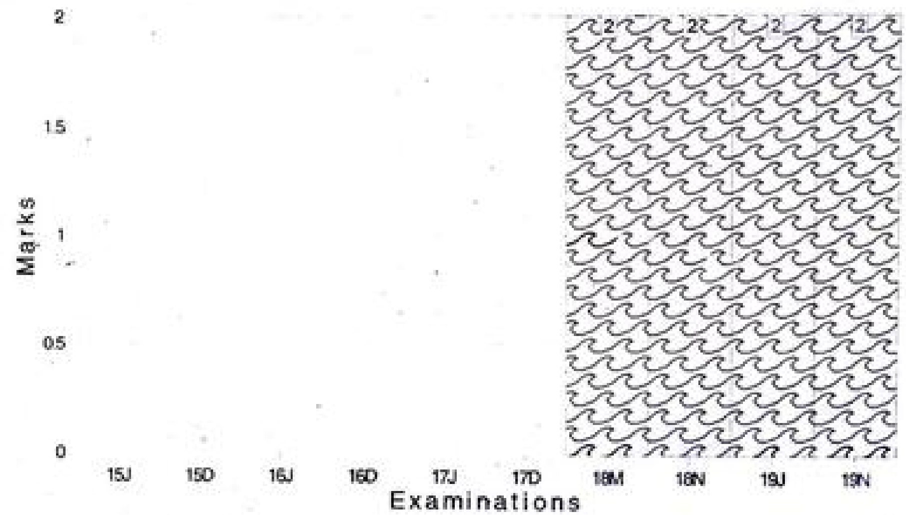
This is a discount given by a manufacturer or wholesale dealer to a retail dealer. This is deducted from the sale price in the invoice itself. The retail dealer is required to sell the goods at a fixed price (catalogue price) and hence this practice is followed. It does not form part of accounting entries as the discount is deducted in the invoice and net amount is entered in books of account.

CHAPTER	
1	**Theoretical Framework**
Unit: 4	**Capital and Revenue Expenditure and Receipts**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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SELF STUDY QUESTIONS

Q1. Why is distinction between Various Expenses Needed?

Answer:

Accounting is ascertaining and presenting of financial results of Enterprise for a particular accounting period. A proper distinction should be made between various expenses and incomes regarding their nature so as to give correct information to the users of accounting statements. While preparing of financial accounts, expenses related to business operations for a particular accounting period must form part of Trading and profit and loss Account as they are of revenue nature. Similarly, expenses which generated benefits and revenue for more than a year must be capitalised and form part of balance sheet and later would be transferred to Profit and loss A/c in the year in which the benefit of such expenses is actually utilised. The distinction between the capital and revenue expenditure or income is based on the time factor.

Q2. What consideration is needed is determining Capital and Revenue Expenditures?

Answer:

1. **Nature of business:**
   Categorisation of capital of revenue depends upon the type of business entity. An item can be capital for entity and revenue for another.
   For example:
   Purchase of machinery is generally a capital expenditure however an entity trading in such machines will theat it as a revenue expenditure.
2. **Recurring nature of the expense:**
   An expense of periodic nature, i.e. recurring in nature is generally classified as revenue expenditure while expenses which are not of periodic nature and are infrequent are classified as capital expenditure.

   For example:
   Amount spent on repairs and white wash of building is required to be done periodically would be treated as revenue expenditure however if cost is incurred for extension of building, the same will be of capital nature because it is non-recurring.
3. **Purpose of expenditures:**
   Purpose is also a deciding factor for treating expenditure as capital or revenue. If any expense is incurred in the ordinary course of business it will be treated as revenue expense and if expense incurred results in creation of new asset, increasing the life beyond original improving the existing system it would be capital expenditure.
   For example:
   Daily repairing and maintenance of office equipments are revenue nature however expense for improvement of electrical wiring system in capital expenditure.
4. **Effect on revenue generating capacity:**
   If the expense incurred results into increase in future benefits of the enterprise it is said to be of capital nature and if the future benefits remain unchanged then the expense is revenue expense.
   For example:
   Expense incurred for increasing the production capacity of a machine so that the number of units produced gets doubled, it will be treated as capital expediture.
   If expense is done for normal wear and tear of machinery, it will be revenue expenditure.
5. **Materiality:**
   The concept of materiality comes into operation while dealing with capital expenditure of low value.
   For example:
   Expenses incurred on purchase of pen drives, calculators, CD, etc although qualify for capital expenditure due to nature of transaction, but still they are treated as expenses and debited in profit and loss A/c.

Q3. What are Capital Expenditures and Revenue Expenditures ?

Answer:

Amount spent by the business enterprise for purchase of assets which are used in business and not meant for resale. It is an expenditure the benefit of which is not exhausted in one accounting year but is spread over a number of years. They are of non-recurring nature i.e. they are infrequently incurred.

Revenue expenditure is the amount spent by business enterprise on day to day operations or such expenditure, the benefit of which is exhausted in the period in which they are incurred i.e. within the same accounting period. They are usually of recurring nature and short period expenses. These expenses do not result in any increment in production capacity or improvement in operations but they are expended to maintain the existing revenue generating capacity of the assets.

Example 1:

State whether the following expenditures are of capital or revenue nature.

(a) A second hand machine was purchase for ₹ 60,000 and installation charges ₹ 10,000.

(b) Cost of Aircondition for the office of CEO.

(c) ₹ 50,000 spent on construction of temporary huts necessary for construction of apartment which were demolished after the completion of construction work.

(d) Compensation paid to workers opted for VRS of ₹ 5 crore.

(e) Customs duty ₹ 18,000 paid on import of machinery for mordernisation of factory.

(f) Repairs of 15,000 necessitated by negligence.

Solution:

(a) Total expense of ₹ 70,000 to be treated as capital expenditure as ₹ 60,000 was expended on capital asset and ₹ 10,000 to make asset ready to use.

(b) Capital expenditure since benefit will available for number of years.

(c) Cost of constructing a temporary structure for main building is a capital expenditure as it was necessary for the construction of apartments.

(d) Revenue expenditure but due to huge amount to be deferred over number of years.

(e) Custom duty on import of machinery for modernisation of factory is a capital Expenditure.

(f) Repairs changes are revenue expenditure as they are incurred for maintenance and not for improvement of asset.

Q4.What are Capital Receipts and Revenue Receipts ?

Answer:

Capital Receipts: Amount received by the business which is not or regular nature i.e. not obtained in the normal course of business such as capital contribution received by the owners at the time of issue of shares, these receipts are of non-recurring nature and do not affect the profits and are shown as liability in balance sheet.

Revenue Receipts: Those business receipts which are earned due to normal business activities in the ordinary course of business. These are recurring and are shown in Trading and profit and loss A/c of the accounting period.

Example:

Dividend income, Revenue from sales etc.

Example 2:

(a) Amount received from Trade debtors ₹ 15,000.

(b) Insurance claim received on machinery destroyed due to fire in factory building.

(c) Term loan taken from bank of ₹ 2,00,000

(d) Share premium received on issued of shares

(e) Compensation received from supplier due to late delivery of goods.

Solution:

(a) Revenue receipt since it is earned in the ordinary course of business.

(b) Capital receipt since it is not any ordinary business receipt.

(c) Securing of loan is not a normal business activity and hence loan from bank is a capital receipt.

(d) Share Premium is a capital receipt and is received occasionally when shares are issued. If is shown on th liability side of balance sheet and not in nature of regular income and hence is a capital receipts.

(c) Dealing in goods is the regular business activity, any compensation received on account of such activities is general to business and hence is a revenue receipt.

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. ₹2500, spent on the overhauling on purchase of second hand machinery:
   (a) Capital expenditure
   (b) Revenue expenditure
   (c) Deferred revenue expenditure
   (d) None of the above
2. Which of the following is a revenue expenditure?
   (a) Freight paid on purchase of plant and machinery
   (b) Legal expenses paid to acquire a property
   (c) Annual white wash of the factory building
   (d) Expenses incurred to reduce working capital requirement
3. Loss caused by theft of cash by cashier after business hours is a :
   (a) Revenue loss
   (b) Deferred revenue loss
   (c) Capital loss
   (d) None of the above

4. Share Premium is a:
   (a) Capital Receipt
   (b) Revenue Receipt
   (c) Deferred Revenue Receipt
   (d) None of these
5. **Assertion:** Damages paid on account of breach of contract to supply certain goods is a capital expenditure.
   Reasoning: Such damages are incurred in the ordinary course of business:
   (a) Both the statements are correct and second is a correct explanation of the first
   (b) Both the statements are correct but second is not a correct explanation of the first
   (c) First statement is correct but second is not
   (d) First statement is not correct but second is correct
6. Amount spent on increasing the seating capacity in a cinema hall is:
   (a) Capital expenditure
   (b) Revenue expenditure
   (c) Deferred Revenue expenditure
   (d) None
7. Capital expenditure provide ________ benefit:
   (a) Short period
   (b) Long period
   (c) Very short period
   (d) None
8. An amount of ₹ 30,000 spent on traveling expenses of the company's director's to a foreign trip for purchase of an asset to be used in the production process. This is a:
   (a) Capital expenditure
   (b) Revenue expenditure
   (c) Deferred revenue expenditure
   (d) None of the above

9. Recovery of Bad debt is a:
   (a) Revenue Receipt
   (b) Capital Receipt
   (c) Capital Expenditure
   (d) Revenue Expenditure
10. Amount spent on unsuccessful patent right is a:
   (a) Revenue Expenditure (Even though the amount is large)
   (b) Deferred Revenue Expenditure (If the amount is large)
   (c) Capital Expenditure
   (d) None of these
11. Capital Receipts are represented in:
   (a) Balance Sheet
   (b) Trading account
   (c) Profit & Loss A/c
   (d) Manufacturing A/c
12. Preliminary Expenses are an example of:
   (a) Revenue Expenditure
   (b) Capital Expenditure
   (c) Deferred Revenue Expenditure
   (d) All of these
13. Brokerage on the issue of shares and debentures is a ______ expenditure:
   (a) revenue
   (b) capital
   (c) deferred revenue
   (d) partly capital partly revenue
14. What is the difference between deferred revenue expenditure and prepaid expenses?
   (a) Accounting treatment
   (b) Estimation of amount
   (c) Benefit for more than one accounting period
   (d) Nature of expenditure

15. Machinery was purchased for ₹ 10,000 and ₹ 500 paid as wages for erection of machinery? The account that should be debited is:
   (a) Wages A/c
   (b) Machinery A/c
   (c) Repairs A/c
   (d) None
16. An old machinery is purchased for ₹10,000. Installation charges of ₹1,000 were incurred. Repairs to the old machinery = ₹7,000 Repairs Account will be debited by:
   (a) ₹7,000
   (b) ₹8,000
   (c) Nil
   (d) None of the above
17. X Limited spent ₹10,00,000 towards construction of office building. It also spent ₹50,000 towards construction of temporary store and used the store for building construction purpose. On completion of building construction the store was dismantled and the materials were sold for ₹20,000. Mr. A, a supervisor was paid ₹60,000 as his salary during the period of construction and he devoted 2/3rd of his time for the building construction. The capitalized cost of office building was:
   (a) ₹10,00,000
   (b) ₹11,10,000
   (c) ₹10,90,000
   (d) ₹10,70,000
18. A truck was purchased and after sometime, the name of the company was painted on it for advertisement purpose for ₹ 1,000 this is:
   (a) Capital Expenditure
   (b) Deferred Revenue Expenditure
   (c) Revenue Expenditure
   (d) None.

19. Medium term loan obtained from bank for augmenting working capital is:
    (a) Revenue Expenditure
    (b) Capital Expenditure
    (c) Revenue Receipt
    (d) Capital Receipt.
20. If repairs of ₹ 100 are done on a machinery then which account will be debited?
    (a) Machinery A/c
    (b) Repairs A/c
    (c) Capital A/c
    (d) Wages A/c.
21. Heavy advertisement expenditure should be treated as:
    (a) Deferred Revenue Expenditure
    (b) Revenue expenditure
    (c) Capital Expenditure
    (d) None of these.
22. Deferred Revenue Expenditure to the extent of not written off, is shown in Balance Sheet under the head:
    (a) Miscellaneous Expenditure
    (b) Capital
    (c) Current Liabilities
    (d) Fixed Assets.
23. 'A' purchased a Car on 1.06.2010 for ₹5,60,000 and incurred ₹25,000 for repairs, etc. He paid ₹10,000 as insurance, ₹1,500 for petrol. What amount should be debited to Car A/c?
    (a) ₹5,60,000
    (b) ₹5,96,500
    (c) ₹5,95,000
    (d) ₹5,85,000

24. XYZ Limited has a house for 3 years. It used it as guest house. Now it incurred an expenditure for ₹2,50,000 for repairing the roof of this house. Expenses incurred on such repairs are:
    (a) Capital Expenditure
    (b) Revenue Expenditure
    (c) Deferred Revenue Expenditure
    (d) None of the above.
25. Which of the following Expenses will not be included in the acquisition of plant?
    (a) Purchase Price of Plant
    (b) Installation Expenses
    (c) Annual Maintenance charges
    (d) Delivery charges of the plant.
26. A new machine was purchased in Delhi and brought to Jaipur factory site for installation. The machine was damaged during transit and repair expenses were incurred amounting to ₹ 20,000. Such repair will be treated as:
    (a) Capital expenditure
    (b) Revenue expenses
    (c) Deferred revenue expenditure
    (d) Reserves
27. Revenue Expenditure wrongly recorded as Capital Expenditure will result in:
    (a) Overstatement of net profit and understatement of assets
    (b) Overstatement of net profit and overstatement of assets
    (c) Understatement of net profit and overstatement of assets
    (d) Understatement of net profit and understatement of assets
28. Which of the following statement is false?
    (a) Expenses in connection with obtaining a licence for running the Cinema is Capital expenditure
    (b) Heavy advertisement expenses to introduce a new product is deferred revenue expenditure

(c) Cost of construction of building including cost of temporary huts for storing building materials is capital expenditure
(d) The cost of Rings and Pistons of an engine changed to increase its fuel efficiency is revenue expenditure

29. Expenditure incurred of ₹ 20,000 for trial run of a newly installed machinery would be:
(a) Preliminary expenditure
(b) Capital expenditure
(c) Revenue expenditure
(d) Deferred revenue expenditure

30. Amount spent on increasing the seating capacity in cinema hall is:-
(a) Capital Expenditure
(b) Revenue Expenditure
(c) Deferred Revenue Expenditure
(d) None of the above.

31. Renewal fee for patent is a:
(a) Capital expenditure
(b) Revenue expenditure
(c) Deferred revenue expenditure
(d) Development expenditure

32. Shivam purchased an old building for ₹50 lakhs. He demolished the building for the purpose of constructing shopping mall on the same site. Demolition cost was. ₹1 lakh. Construction cost of the mall was ₹35 lakhs. He inaugurated it and the inauguration cost was ₹50,000 Capital Expenditure was:
(a) ₹86,00,000
(b) ₹86,50,000
(c) ₹85,00,000
(d) ₹85,50,000

33. Rohit is in real estate business. On 6th June, 2014 he sold a penthouse for ₹4 crores (costing ₹3.5 crores). The amount realised is a
(a) Capital receipt and profit should be transferred to capital reserve.
(b) Revenue receipt and profit should be transferred to Profit and Loss A/c.

(c) Capital receipt and profit should be transferred to Profit and Loss A/c.
(d) Revenue receipt and profit should be transferred to General Reserve A/c.

34. Deepawali advance given to employees is ________.
(a) capital expenditure
(b) revenue expenditure
(c) deferred revenue expenditure
(d) not an expenditure

35. The total of discount column on the debit side of the cash book is, posted in the:
(a) Debit side of discount received account
(b) Credit side of discount received account
(c) Debit side of discount allowed account
(d) Credit side of discount allowed account.

36. If repairs cost is ₹30,000, white wash expenses are ₹5,000, cost of extension of building is ₹3,00,000 and cost of improvement in electrical wiring system is ₹30,000. The amount of Revenue expenditure will be:
(a) ₹65,000
(b) ₹35,000
(c) ₹3,65,000
(d) ₹3,35,000

37. The unexpired portion of capital expenditure is shown in the financial statements:
(a) As an asset
(b) As an income
(c) As a liability
(d) As an expense.

38. Legal expenses incurred in defending a suit for breach of contract to supply goods is a:
(a) Revenue expenditure
(b) Capital expenditure
(c) Deferred revenue expenditure
(d) None of above.

39. Money spent to reduce working/revenue expenses is:
    (a) Revenue Expenditure
    (b) Deferred Revenue Expenditure
    (c) Capital Expenditure
    (d) None of above.
40. If repair cost is ₹30,000, whitewash expenses are ₹6,000, cost of extension of building is ₹3,00,000 and cost of improvement in electrical wiring system is ₹22,800, the amount of expense is:
    (a) ₹3,58,800
    (b) ₹52,800
    (c) ₹36,000
    (d) ₹58,800
41. Insurance claim received on account of machinery damaged by fire:
    (a) Capital receipt.
    (b) Revenue receipt.
    (c) Capital expenditure.
    (d) Business expenditure.

ANSWER

1.	(a)	2.	(c)	3.	(c)	4.	(a)	5.	(d)
6.	(a)	7.	(b)	8.	(a)	9.	(a)	10.	(a)
11.	(a)	12.	(c)	13.	(c)	14.	(b)	15.	(b)
16.	(c)	17.	(d)	18.	(c)	19.	(d)	20.	(b)
21.	(a)	22.	(a)	23.	(b)	24.	(c)	25.	(c)
26.	(b)	27.	(b)	28.	(d)	29.	(b)	30.	(a)
31.	(b)	32.	(a)	33.	(b)	34.	(d)	35.	(c)
36.	(b)	37.	(a)	38.	(a)	39.	(c)	40.	(c)
41.	(a)								

SHORT PRACTICE QUESTIONS

1. Differentiable between Capital expenditure are revenue expenditure

Answer:

Basis	Capital Expenditure	Revenue Expenditure
Purpose	Incurred for acquiring fixed assets to be used in business	Incurred for day to day operations of business
Earning Capacity	Increases	Remains same

Treatment	It is shown in balance sheet	It is shown as a part of Trading and profit and loss A/c
Nature	Non recurring in nature	Recurring in nature
Examples	(i) Cost of fixed assets (ii) Installation expenses	(i) Depreciation of fixed Assets. (ii) Repairs and maintenance of plant and machinery.

2. Define capital receipts
3. Mention the basic consideration in determining capital and revenue expenditures *(Please Refer Question no.2 on page no. 73).*

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

1994 - Nov [5] State with reasons whether following statements are true or false.

(3) Amounts written off from the cost of fixed assets is capital expenditure. (2 marks)

(4) Wages paid to workers to produce a tool to be captively consumed is capital expenditure. (2 marks)

Answer:

(3) False: Amounts 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.

(4) True: Wages paid to workers for the creation of an asset to be used in the business is capital expenditure.

1995 - May [5] State with reasons whether following statement is true or false.

(g) Expenditure which results in acquisition of a permanent asset is a capital expenditure. (2 marks)

Answer:

True: Expenditure which results in acquisition of a permanent asset is a capital expenditure.

1995 - Nov [5] State with reasons whether following statements are true or false.

(2) Sale of Office Furniture should be credited to Sales Account. (2 marks)

(3) Wages paid for erection of machinery are debited to Profit and Loss Account. (2 marks)

Answer:

(2) False: Sales of office furniture should be credited to Furniture Account because it is a capital receipt.

(3) False: Wages paid for erection of machinery is a capital expenditure and hence should be debited to Machinery Account.

1996 - May [5] State with reasons whether following statement is true or false.

(3) Overhaul expenses of a second-hand machinery purchased are revenue expenditure. (2 marks)

Answer:

False: Overhaul expenses are incurred to put a second-hand machinery in working condition to derive long term benefits of enduring nature. So this is capital expenditure.

1996 - Nov [5] State with reasons whether following statements are true or false.

(1) In accounting, all business transactions are recorded as having dual aspect. (2 marks)

(7) Major repair charges including replacement of certain worn-out parts incurred before using a second-hand Car purchased recently is a capital expenditure. (2 marks)

Answer:

(1) **True:** Being associated with the system of double entry book keeping, every transaction has a two-fold effect in accounting whereby one account is debited and another is credited by the same amount.

(7) **True:** These charges were incurred to put a second-hand car in working condition to derive long term benefits of enduring nature. So this is capital expenditure.

1997 - May [5] State with reasons whether following statement is true or false.

(1) The gain from sale of capital assets need not be added to revenue to ascertain the net profit of a business. (2 marks)

Answer:

True: To ascertain the true net business profit, the gain from sale of capital assets should not be considered because it is not due to normal business operations.

1997 - Nov [5] State with reasons whether following statements are true or false.

(1) An expenditure intended to benefit the current period is a revenue expenditure. (2 marks)

(7) Sale of office furniture should be credited to sales account. (2 marks)

(10) Expenditure which results in acquisition of permanent asset of enduring benefit to the business is a capital expenditure. (2 marks)

Answer:

(1) **True:** Revenue expenditure is that expenditure benefit of which does not extend beyond the current accounting period.

(7) **False:** Sale of office furniture should be credited to furniture account because it the capital receipt.

(10) **True:** Expenditure which results 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.

1998 - May [5] State with reasons whether following statement is true or false.

(6) Wages paid to workers to produce a tool to be captively consumed is capital expenditure. (2 marks)

Answer:

True: Wages paid to workers for the creation of an asset to be used in the business is capital expenditure.

1999 - May [5] State with reasons whether following statements are true or false.

(vii) Expenses incurred on white-washing of factory building done after every six months is Revenue expenditure. (2 marks)

(x) Amount spent for replacement of worn out part of a machine is Capital Expenditure. (2 marks)

Answer:

(vii) **True:** Expenses incurred on white-washing of factory building done after every six months are incurred in the course of normal maintenance of the asset and are therefore, revenue expenses.

(x) **False:** Amount spent for replacement of any worn out part of a machine is revenue expenditure since it is part of its maintenance cost.

1999 - Nov [5] State with reasons whether following statements are true or false.

(v) Heavy advertising to introduce a new product is capital expenditure. (2 marks)

(x) Legal fees paid to acquire a property is capital expenditure. (2 marks)

Answer:

(v) **False:** The effect of heavy advertising with regard to the launching of a new product will last generally for more than one accounting period, but it does not create any property of tangible or intangible nature and so the expenditure is spread over the period for which its effect would remain. This type of expenditure is deferred revenue expenditure and not capital expenditure.

(x) **True:** Legal fees paid to acquire a property is part of the cost of that property. It is incurred to possess the ownership right of the property and hence a capital expenditure.

2000 - May [5] State with reasons whether following statement is true or false.

(ix) Travelling expenses of ₹80,000 paid to a technician for the installation of a new machine is debited to Profit and Loss Account. (2 marks)

Answer:

False: The expenditure is a capital expenditure since it has been incurred to put the asset in working condition.

2000 - Nov [5] State with reasons whether following statement is true or false.

(7) Expenditure which results in acquisition of a permanent asset is a revenue expenditure. (2 marks)

Answer:

False: Expenditure which results 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.

2001 - Nov [5] State with reasons whether following statement is true or false.

(ii) Expenditure, which results in acquisition of a permanent asset is a Revenue Expenditure. (2 marks)

Answer:

Please refer 2000 - Nov [5] (7) on page no. 91

2002 - May [5] State with reasons whether following statement is true or false.

(v) Wages paid for erection of machinery are debited to the Machinery Account. (2 marks)

Answer:

True: Wages paid for erection of machinery is a capital expenditure and hence should be debited to the machinery account.

2002 - Nov [5] State with reasons whether following statement is true or false.

(j) An Expenditure intended to benefit the current period is a Revenue Expenditure. (2 marks)

Answer:

True: Revenue expenditure is that expenditure the benefit of which does not extend beyond the current accounting period.

2004 - May [5] State with reasons whether following statement is true or false.

(iii) Sale of office furniture should be credited to sales account. (2 marks)

Answer:

Please refer 2000 - Nov [5] (7) on page no. 91

2004 - Nov [5] State with reasons whether following statement is true or false.

(v) Legal fees paid to acquire a property is capital expenditure. (2 marks)

Answer:

True: Legal fees paid to acquire a property is a part of the cost of that property. Hence it is taken as capital expenditure.

2005 - May [5] State with reasons whether following statement is true or false.

(iii) Amount paid to Management company for consultancy to reduce the working expenses is revenue expenditure. (2 marks)

Answer:

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.

2005 - Nov [5] State with reasons whether following statement is true or false.

(vi) Wages incurred by a factory in manufacturing a part for its plant, is a revenue expense. (2 marks)

Answer:

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.

2006 - Nov [5] State with reasons whether following statement is true or false.

(viii) A heavy advertisement expense to introduce a new product is a capital expenditure. (2 marks)

Answer:

False: Such expenses are treated as Deferred Revenue Expenditure and not Capital Expenditure as the effect of heavy advertisement expense will be lasting for more than one accounting period. Such expenses are spread over the effective period.

2018 - May [1] {C} (a) State with reasons, whether the following statement is true or false:

(i) Expenses in connection with obtaining a license for running the Cinema Hall is Revenue Expenditure. (2 marks)

Answer:

False: The Cinema Hall could not be started without license. Expenditure incurred to obtain the license is pre-operative expense which is capitalized. Such expenses are not revenue and amortized over a period of time.

2018 - Nov [1] {C} (a) State with reasons, whether the following statement is true or false:

(i) Overhauling expenses for the engine of motor car to get better fuel efficiency is revenue expenditure. (2 marks)

Answer:

False: Overhauling expenses are incurred for the engine of a motor car to derive better fuel efficiency. These expenses will reduce the running cost in future and thus the benefit is in form of endurable long-term advantages. So this expenditure should be capitalised.

2019 - June [1] (a) State with reasons, whether the following statement is true or false :

(i) Amount spent for the construction of temporary huts, which were necessary for construction of the Cinema House and were demolished when the Cinema House was ready, is capital expenditure. (2 marks)

Answer:

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

2019 - Nov [1] {C} (a) State with reason, whether the following statement is True or False.

(ii) M/s. XYZ & Co. runs a café. They renovated some of the old cabins. Because of this renovation some space was made free and number of cabins was increased from 15 to 18. The total expenditure incurred was ₹ 30,000 and was treated as a revenue expenditure. (2 marks)

Answer:

False: Renovation of cabins increased the number of cabins. This has an effect on the future revenue generating capability of the business. Thus, the renovation expense is capital expenditure in nature.

SHORT NOTES

1996 - May [6] Write short note of the following:

(3) Capital Receipts and Revenue Receipts. (5 marks)

Answer:

Please refer 1994 - Nov [6] (1) on page no. 95

2004 - Nov [6] Write short note on the following:

(iv) Capital Expenditure and Revenue Expenditure. (5 marks)

Answer:

Capital Expenditure: An expenditure intended to benefit future periods is known as capital expenditure. In other words, if the benefit of an expenditure is not exhausted in one accounting period, but is spread over future periods, the expenditure is known as capital expenditure. For instance, a table or a chair bought during the current accounting period is intended to be used over and over again, so that the benefit of its usage is spread over a number of future accounting periods. The same is true of land, buildings, plant and machinery, etc.

Accordingly, any expenditure incurred in the acquisition of an asset to be used over a number of years is capital expenditure. Similarly, an expenditure on an existing asset, in the form the additions or improvements, with a view to increasing its revenue earning capacity, is also a capital expenditure.

Revenue Expenditure: Revenue expenditure benefits a current period. Accordingly, an expenditure, the benefit of which is exhausted in the period in which it is incurred, is known as revenue expenditure. A revenue expenditure neither results in the acquisition of an asset, nor is it incurred to increase the revenue earning capacity of an existing asset. It is, in fact, incurred to retain the original revenue earning capacity of an asset. As such, the expenditure is of a revenue nature.

DISTINGUISH BETWEEN

1994 - Nov [6] Distinguish between the following:
(1) Capital Receipts and Revenue Receipts. (5 marks)

Answer:

Capital Receipt: These are the money received from the activities other than normal business activities e.g. Issue of shares and debentures, sale of fixed assets. Such receipts are of non-recurring nature. They do not affect profit and are shown as a liability or as a reduction from the assets.

Revenue Receipt: These are the money received in the course of normal business activities. e.g. Sales, interest, dividend, etc. Such receipts are of recurring nature and for general purpose. They are shown on the credit side of profit & loss A/c.

1996 - Nov [6] Distinguish between the following:
(a) Capital Expenditure and Revenue Expenditure (5 marks)

Answer:

Please refer 1994 - Nov [6] (1) on page no. 95.

1997 - May [6] Distinguish between the following:
(4) Capital Expenditure and Revenue Expenditure. (5 marks)

Answer:

Please refer 1994 - Nov [6] (1) on page no. 95.

1998 - May [6] Briefly explain the differences between on the following:
(b) Capital Receipts and Revenue Receipts. (5 marks)

Answer:

Please refer 1994 - Nov [6] (1) on page no. 95.

2001 - Nov [6] Briefly explain the differences between on the following:
(d) Capital Expenditure and Revenue Expenditure. (5 marks)

Answer:

Please refer 1994 - Nov [6] (1) on page no. 95.

2006 - Nov [6] Distinguish between the following:
(iv) Capital Receipts v/s Revenue Receipts. (5 marks)

Answer:

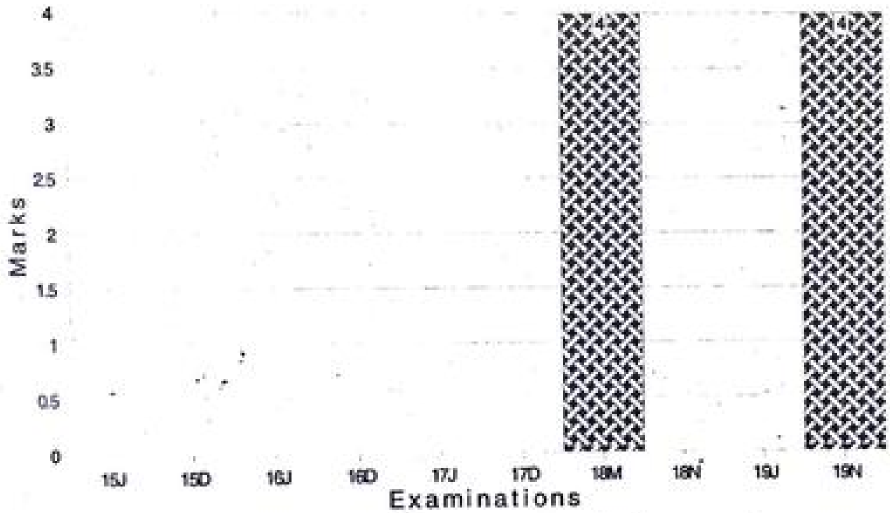
Please refer 1994 - Nov [6] (1) on page no. 95.

CHAPTER	
1	**Theoretical Framework**
Unit: 5	**Contingent Assets and Contingent Liabilities**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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SELF STUDY QUESTIONS

Q1.What are Contingent Assets?

Answer:

A potential economic benefit or a possible asset which arises from the past events but the existence of which will be confirmed on happening or non-happening of one or more future events which are beyond the control of the enterprise. As per AS-29,

Asset to be qualified as contingent must have following characteristics:

- **Possible Asset:** Asset should arise out of past events.
- Existence to be confirmed on occurrence or non-occurrence of one or more-future events.
- The dependent future events are beyond the control of the enterprise. These assets are not recognised in financial statements as a matter of prudence and is disclosed in the Director's report.

Q2. What are Contingent Liabilities?

Answer:

According to AS 29, Accounting Standard on Provision, Contingent Liabilities and Contingent Assets.

A contingent liability is-

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

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not probable that an outflow or resources embodying economic benefits will be required to settle the obligations:

or

(ii) a reliable estimate of the amount of the obligation cannot be made.

Q3. Distinguish between Contingent Liabilities and Liabilities?

Answer:

Basis	Contingent Liabilities	Liabilities
1. **Meaning**	Possible obligation that arises out of past events and confirmed by one or more future events.	Present financial obligation arising out of past events resulting in outflow of resources.
2. **Measurement**	Cannot be measured with sufficient reliability.	Can be measured with sufficient reliability.
3. **Disclosure**	Is disclosed by way of foot note at the end of Balance Sheet as per AS-29.	Forms the part of Balance Sheet.
4. **Examples**	Unacknowledged debts, statutory liabilities in dispute, bills discounted, etc.	Amount due to creditors, tax due, payment of wages to workers, etc.

Q4. Distinguish between Contingent Liabilities and Provisions?

Answer:

Basis	Contingent Liabilities	Provisions
1. **Meaning**	Possible obligation arising out of past events and confirmed by occurrence of one or more future events, hence cannot be measured with sufficient reliability.	Liability which can be measured using substantial degree of estimation.
2. **Recognition**	Is not recognised due to uncertainty.	Is recognised in books of accounts as a reliable estimate can be made.

3. **Disclosure**	Is disclosed by way of foot note as per AS 29.	Is debited to Profit and Loss A/c after adjusting expense paid, addition, deletion as required.
4. **Examples**	Pending litigation, third party guarantees, etc.	Provision for doubtful debts, provision for

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. Present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation, is termed as:
   (a) Provision
   (b) Liability
   (c) Contingent Liability
   (d) None of the above
2. Contingent asset is not recognized in the financial statements on the basis of _____ accounting concept:
   (a) Prudence
   (b) Materiality
   (c) Substance over form
   (d) Going concern
3. Contingent assets usually arise from unplanned or other unexpected events:
   (a) True
   (b) False
   (c) Partly True
   (d) None

4. Provision for contingencies are not made in respect of _____ since they do not relate to situation existing at the balance sheet date:
   (a) Unspecified business risk
   (b) Certain business risk
   (c) Specified business risk
   (d) Uncertain business risk
5. Which of the following is not a contingent liability?
   (a) Uncalled liability on partly paid shares
   (b) Claims against the company not acknowledged as debts
   (c) Arrears of cumulative fixed dividends
   (d) Debts included in debtors which are doubtful in nature
6. Contingent Liabilities are shown:
   (a) As current liability
   (b) As Capital fund
   (c) As footnotes to balance sheet
   (d) As Reserves
7. 'Workmen Compensation under Dispute' is an example of:
   (a) Contingent Liability
   (b) Contingent Asset
   (c) Current Liability
   (d) Current Asset
8. Bill discounted with a bank is _____.
   (a) Contingent liability
   (b) Current liability
   (c) Current Asset
   (d) None of these
9. Which of the following is not a contingent liability?
   (a) Claims against the firm not acknowledged as debts.
   (b) Guarantees given in respect of third parties.
   (c) Amount due to trade creditors which is not disputed.
   (d) Bills discounted from bank.
10. Income tax demand, disputed by a company is _______.
   (a) Contingent liability
   (b) Current liability

   (c) Long term liability
   (d) None of these.
11. Contingent liability if becomes probable then it is __________.
   (a) Provided for in the books of A/c
   (b) Provided in Director's report
   (c) Shown in notes to accounts
   (d) None of these.
12. ________ appear as a footnote below the balance sheet.
   (a) Fictitious assets
   (b) Contingent liabilities
   (c) Current liabilities
   (d) Current assets
13. Which of the following is not a contingent liability?
   (a) Claims against enterprises not acknowledge as debts
   (b) Guarantees given in respect of the third parties
   (c) Liabilities in respect of bills dishonoured
   (d) Penalty imposed by Excise officer for violation of a provision of the Central Excise Act.
14. Which of the following is not a difference between a provision and contingent liability?
   (a) A provision meets the recognition criteria whereas a contingent liability fails to meet the same.
   (b) Provision is a present liability of uncertain amount whereas contingent liability is a possible obligation which arises from past event.
   (c) Provision can't be measured whereas contingent liability can be accurately measured.
   (d) None of the above.
15. In which of the following cases, accounting estimates are needed?
   (a) Employee benefit obligations
   (b) Impairment of losses
   (c) Inventory obsolescence
   (d) All of the above.

16. A contingent asset is:
    (a) Usually disclosed in the Financial Statements
    (b) Usually disclosed in the notes to accounts
    (c) Usually disclosed in the report of the approving authority
    (d) Not disclosed any where
17. Present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation is termed as:
    (a) Provisions
    (b) Liability
    (c) Contingent Liability
    (d) Contingent Assets
18. When outflow of resources to settle the obligation is not probable or the amount expected to be paid to settle the liability cannot be measured with sufficient reliability, it is called ______.
    (a) Provision
    (b) Contingent liability
    (c) Secured loan
    (d) Unsecured loan
19. A company has filed a legal suit against its competitor company claiming ₹ 50 lakhs for in-fringement of patent. However, the outcome of the legal suit is uncertain. The claim may be treated as:
    (a) Income
    (b) Contingent asset
    (c) Provision
    (d) Contingent liability.

ANSWER

1.	(a)	**2.**	(a)	**3.**	(a)	**4.**	(a)	**5.**	(d)
6.	(c)	**7.**	(a)	**8.**	(a)	**9.**	(c)	**10.**	(a)
11.	(a)	**12.**	(b)	**13.**	(d)	**14.**	(c)	**15.**	(d)
16.	(c)	**17.**	(a)	**18.**	(b)	**19.**	(b)		

SHORT PRACTICE QUESTIONS

1. Write short notes on:
   (a) Contingent liability
   (b) Provisions
2. Differentiate between:
   Contingent liability and liability

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

1995 - May [5] State with reasons whether the following statement is True or False:

(d) Contingent liability is an ascertained liability but its amount and due date are indeterminate. (1.5 marks)

Answer:

False: Contingent liability is an unascertained liability and its amount and due date are also indeterminate. A contingency is defined as a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events.

SHORT NOTES

1998 - Nov [6] Write short note on the following:

(iv) Contingent liability. (5 marks)

Answer:

Accounting Standard (AS) 29 on 'Provisions, Contingent Liabilities and Contingent Assets' defines contingent liability as

- a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise, or
- a present obligation that arises from past events but it is not recognised because
  (a) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
  or
  (b) a reliable estimate of the amount of the obligation cannot be made.

A contingent liability should not be recongnised but only disclosed. Also contingent liability should be periodically reviewed by the enterprise.

2001 - May [6] Briefly explain the following:

(d) Contingent Liability. (5 marks)

Answer:

Please refer 1998 - Nov [6] (iv) on page no. 105

2005 - May [6] Write short note on the following:

(iii) Contingent liability. (5 marks)

Answer:

Please refer 1998 - Nov [6] (iv) on page no. 105

DISTINGUISH BETWEEN

1998 - May [6] Briefly explain the differences between the following:

(a) Contingent Liability and Other Liabilities. (5 marks)

Answer:

Contingent Liability and Other Liabilities: Liability is defined as the financial obligation of an enterprise other than owner's fund. They may be classified into current liabilities and long-term liabilities. Creditors, bills payable and outstanding expenses are examples of current liabilities whereas debentures and term loans from banks and financial institutions are examples of long-term liabilities.

Guidance Note on Terms Used in Financial Statements defines contingent liability as "an obligation relating to an existing condition or situation which may arise in future depending on the occurrence or non-occurrence of one or more uncertain future events." Contingent liability may be in respect of bills discounted, pending suits etc. Thus, it is not an actual liability and as such it is not recorded in the balance sheet. It is simply mentioned by way of foot note to the balance sheet.

2018 - May [1] {C} (b) Differentiate between Provision and Contingent Liability. (4 marks)

Answer:

Difference between Provision and Contingent Liability

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

2019 - Nov [1] {C} (b) Distinguish between Provision and Contingent Liability. (4 marks)

Answer:

Please refer 2018 - May [1] {C} (b) on page no. 106

CHAPTER	
1	**Theoretical Framework**
Unit: 6	Accounting Policies

SELF STUDY QUESTIONS

Q1. What do you mean by Accounting Policies?

Answer:

- Accounting policies are principles and methods of applying the various principles in preparation and presentation of entity's financial statements.
- The choice of applying a particular policy required managements judgement on the basis of operating environment of business.
- **Few areas where different accounting policies can be encountered**
  (a) Valuation of inventories
  (b) Calculation of Depreciation
  (c) Calculation of Goodwill
  (d) Valuation of Investments
- For better understanding of financial statements, method adopted must be given in notes to accounts.

Q2. What should be kept is mind while doing Selection of Accounting Policies?

Answer:

- A due care should be given by management while selecting the policy taking into regard the effect on profit statement and performance of business.
- **Characteristics to be considered**
  (a) **Prudence:** Degree of caution for making judgement regarding recording of a particular item of income or expense.

  (b) **Substance overform:** Proper judgement to reflect true essence of transaction rather than its legal form.
  (c) **Materiality:** Financial statements must disclose material facts which are relevant for decision making.

Q3. When can change in Accounting Policies be made?

Answer:

Any change in policies should only be made if:

1. Change is required by statute for compliance with accounting standard.
2. Change would result is more appropriate presentation of financial statement of the business.

Note: Any change during the year must be disclosed in notes to accounts along with the amount by which financial statements are affected.

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. A change in Accounting Policy is justified to:
   (a) Comply with Accounting Standard
   (b) Comply with Law
   (c) Ensure more appropriate presentation of Financial Statements
   (d) All of the above
2. Accounting Policies:
   (a) Are prescribed by AS 1
   (b) Are laid down by Law
   (c) Are same for all concerns
   (d) Change from concern to concern

3. Which of the following is one of the major considerations governing the selection and application of accounting policy:
   (a) Prudence
   (b) Materiality
   (c) Substance over form
   (d) All of the above
4. Accounting principles and policies are to be standardised to achieve:
   (a) Transparency
   (b) Consistency
   (c) Comparability
   (d) All of these
5. Which is not an example of an accounting policy:
   (a) Going Concern
   (b) Valuation of Fixed Assets
   (c) Treatment of Retirement Benefits
   (d) Valuation of Inventories
6. As per AS 1 disclosure should form part of:
   (a) The Final Accounts
   (b) The Auditor's Report
   (c) The Director's Report
   (d) The Books of Accounts
7. Selection of an inappropriate accounting policy may lead to :
   (a) Understatement of Performance
   (b) Overstatement of Performance
   (c) Understatement or Overstatement of Financial Position
   (d) None of the above
8. Selection of appropriate accounting policies is not based on:
   (a) Prudence
   (b) Substance over form
   (c) Amount involved
   (d) Materiality.
9. Which of the following is not an example of change in accounting policy?
   (a) Change in method of providing depreciation on fixed assets.
   (b) Change in the method of providing inventory valuation.

   (c) Adopting double Entry system of accounting in place of Single Entry.
   (d) Change in method of valuation of Investments.
10. The area wherein different accounting policies can be adopted are:
   (a) Valuation of inventories
   (b) Retirement benefits
   (c) Treatment of goodwill
   (d) All of the above.
11. An enterprise has adopted a wrong accounting treatment for valuation of spares and tools. However, proper disclosures are being made in financial statements?
   (a) The disclosure has the effect of rectifying the incorrect valuation.
   (b) This wrong treatment will not effect true and fair view of financial statements.
   (c) This disclosure cannot rectify a wrong or inappropriate treatment adopted by the enterprise.
   (d) Wrong treatment has no relevance as spares and tools are not important to the enterprise.
12. A change in accounting policy is justified:
   (a) To comply with law.
   (b) To ensure more appropriate presentation of the financial statement of the enterprise.
   (c) To comply with accounting standard.
   (d) All of the above.

ANSWER

1.	(d)	2.	(d)	3.	(d)	4.	(d)	5.	(a)
6.	(a)	7.	(c)	8.	(c)	9.	(c)	10.	(d)
11.	(c)	12.	(d)						

Short Practice Questions

1. What are the main considerations in the selection of Accounting Policies?
2. When is change in accounting policy recommended?

Past Year Questions and Answer

Descriptive Questions

2005 - Nov [3] (b) Explain the meaning of Accounting Policies. (3 marks)

Answer:

The meaning of Accounting Policies:

Accounting Standard 1 on "Disclosure of Accounting Policies" defines the nature and significance of accounting policies. The 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 circumstances. The accounting policies followed vary from enterprise to enterprise. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable. The management of each enterprise has to select appropriate accounting policies having regard to the nature and circumstances in which the enterprise is operating.

Some of the areas in which different accounting policies may be adopted by different enterprises are:

(a) Methods of depreciation, depletion and amortisation
(b) Valuation of inventories
(c) Valuation of investments.

CHAPTER

1

Theoretical Framework

Unit: 7

Accounting as a measurement discipline - Valuation Principles, Accounting Estimates

SELF STUDY QUESTIONS

Q1. What is the Meaning of Measurement?

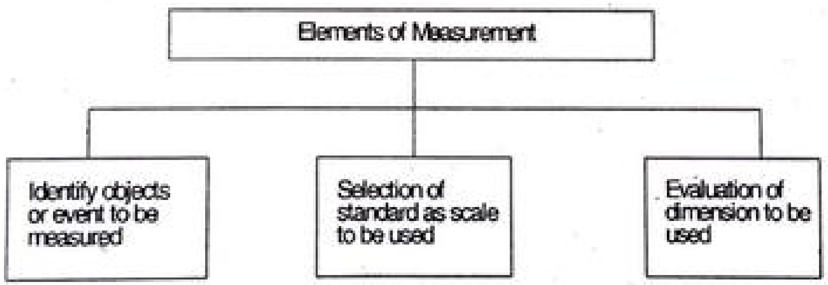
Answer:

Definition: "Measurement is assignment of numbers to objects and events according to rules specifying the property to be measured, the scale to be used and the dimension of the unit".

— Prof. R.J. Chambers

"Measurement is the assignment of a system of ordinal or cardinal numbers to the results of a scheme of inquire or apparatus observations in accordance with logical and mathematical rules."

— Kohler.



Q2. Which Objects or Events are to be measured?

Answer:

- For taking decisions regarding the future prospects of the business, decision makers need suitable information of various business transactions.
- Thus the objects or events to be measured includes measurement of information necessary for decision making.
- The information required can be past and present information which can be relied upon due to its accuracy and future information based on various predictions and logical estimation.

Q3. What is Standard or Scale of measurement?

Answer:

"Standard or Scale of measurement is "money" which can be any currency or denominations. Such as (₹) Rupees; ($) Dollar (£) Pound, etc.

All the transactions and events recorded in financial statement must be measured and presented in monetary currency.

Q4. What should be Dimension of Measurement Scale?

Answer:

Measurement scale should be stable over a time so as to make data comparable of different accounting years.

However money as a measurement scale is unstable due to continuous change in prices, hence having no universal applicability. Hence, cannot be said as an ideal measurement of scale.

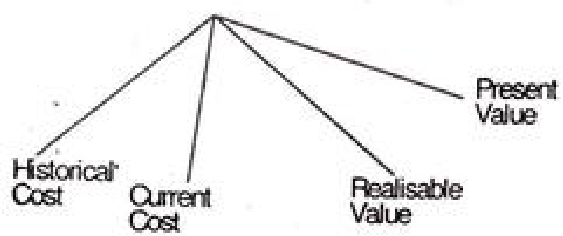
Q5. What do you understand by Accounting as a Measurement Discipline?

Answer:

Measurement is an important aspect of accounting. All the transaction of the business are measured in terms of money and Profit/Loss of the entity is calculated.

Quantitative as well as monetary value of transactions helps to find the financial position of the business and thus measures the performance of the business.

Q6. What are the Valuation Principles?
Answer:



1. **Historical Cost:**
   - It means the cost of acquisition.
   - Assets and liabilities are recorded at the cash or cash equivalent paid/received or fair value of any other consideration paid/received for acquiring the same.
   - This principle does not involve any personal judgement for recording the amount and can easily be cross checked with supporting invoice or other documents.
2. **Current Cost:**
   - It means the cost of asset which will be have to be paid if the same or an equivalent asset is bought currently.
   - Liabilities are carried at undiscounted value as required to settle the obligation.
3. **Realiable Value:**
   - Also known as settlement value, it is the value at which assets are carried at the amount of cash or cash equivalent that can be realised if asset is orderly disposed off.
   - Liabilities are carried at settlement value i.e. undiscounted amount of cash and cash equivalent required to pay them.

4. **Present Value:**
   - This valuation principle considers time value of money.
   - As per concept of present value, a unit of money today is more valuable that same unit in future.
   - Assets and liabilities are recorded at present discounted value of future net cash inflows/outflows that can be generated/required to pay in the ordinary course of business.
   - The process of finding present value for future cash flows is called discounting and process of finding future value for present cash flows is called as compounding.
   - As we know Compound Interest rule $A = P(1 + i)^n$ gives the relation between present money and future money in relation to given principal amount.

     Where P = Principal
     A = Amount
     i = interest
     n = time

   So if A, i and n are given, to find P, we can use the following formula.

   $$P = \frac{A}{(1+i)^n}$$

Example 1:
Mr. X purchase machine 1 year age for ₹ 1,25,000.
Useful life = 4 years Salvage Value = Nil
Price of machine increased by ₹ 50,000 in one year.
Annual cash flows accrued at end of
2^{nd} year = 57,000
3^{rd} year = 46,000
4^{th} year = 70,000
Discount Rate = 10%.
Resale value of machine used for 1^{st} year = ₹ 96,000
Find the value of machine as per
(a) Historical Cost
(b) Current Cost

(c) Realisable Value
(d) Present Value

Solution:

(a) Historical Cost [at the end of 1st year]

Purchase Price	=	1,25,000
Less: Value already used $\left[\frac{1,25,000}{4 years}\right]$	=	31,250
		93,750

(b) Current Cost

Replacement cost of machine [1,25,000 + 50,000]	1,75,000
Less: Value already used $\left[\frac{1,25,000+50,000}{4 years}\right]$	(43,750)
	1,31,250

(c) Realisable value i.e. Resale Value [given] = 96,000

(d) Present Value → $P = \frac{A}{(1+i)^n}$

(n)	(A)		(A × i)
Year end	Amount	Discount factor @ 10% p.a.	Present Value
1	57,000	.909	51,813
2	46,000	.826	37,996
3	70,000	.751	52,570
			1,42,379

Discount factor = $\frac{1}{(1+i)^n}$

Q7. What do you understand by Measurement and Valuation is Accounts?

Answer:

Valuation principles such as historical cost, current cost, realisable value, present value are the means of valuation of objects, abilities, ideas. Here valuation is on cardinal scale in terms of money.

In economics valuation is in terms of utility which cannot be measured by above principles. Economist use ordinal scales to measure utility.

Q8. What are Accounting Estimates?

Answer:

While preparing financial statements of the enterprise accounting standards are required to be followed. Such standards require certain estimates to be made to be recorded in balance sheet and notes to accounts. These estimates are termed as accounting estimates.

Example: Provision for bad and doubtful debts, provisions for income tax, etc.

Accounting estimates can differ from actual, hence any difference must also to account for in financial statements as per AS-5 few instances where there can be revision in estimates:

- Useful life of business assets
- Value realised from bad and doubtful debts
- Providing for employee benefits etc.

As per AS - 5

1. The effect of a change in accounting estimate should be included in determination of net profit or loss in:
   (a) the period of change, if the change affects the period only; or
   (b) the period of change and future periods, if the change affects both.
2. The effect of change in accounting estimate should be classified using same classification in the statement of profit and loss as was used previously for the estimate.
3. The nature and amount of a change in an accounting estimate which has material effect in the current period, or which in expected to have a material effect in subsequent periods, should be disclosed. If it is impracticable to quantity the amount, this fact should be stated.

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. In Accounting Money is the:
   (a) Measurement Value
   (b) Scale of Measurement
   (c) Scale of Social Measurement
   (d) Store of Value
2. Money is a measurement scale and has a universal denomination:
   (a) True
   (b) Partly True
   (c) False
   (d) Can't Say
3. Gross Book Value of a Fixed Asset is its:
   (a) Cost less depreciation
   (b) Historical Cost
   (c) Fair Market value
   (d) Realizable value
4. ABC Ltd. purchased a building by paying ₹ 50,00,000 as on 1st April, 2000. On 1st April, 2007 it found that it would cost ₹ 1,50,00,000 to purchase the similar building. This value of ₹ 1,50,00,000 is known as :
   (a) Historical Cost
   (b) Realizable value
   (c) Current Cost
   (d) Present Cost
5. Change in accounting estimate means:
   (a) Differences arising between certain parameters re-estimated during the current period and actual results achieved during the current period

   (b) Differences arising between certain parameters estimated earlier and re-estimated during the current period
   (c) Differences arising between certain parameters estimated earlier and actual results achieved during the current period
   (d) Both (b) and (c).
6. There are ________ generally accepted measurement bases or valuation principles:
   (a) Two
   (b) Three
   (c) Four
   (d) Five
7. All of the following are valuation principles except:
   (a) Historical cost
   (b) Present value
   (c) Future value
   (d) Realizable value
8. Historical cost concept requires the recording of an asset:
   (a) At its Cost Value
   (b) At its Market value
   (c) At its Net Realisable value
   (d) At its Replacement cost
9. Change in Accounting estimate means:
   (a) Difference arising between certain parameters estimated earlier and re- estimated during the current period.
   (b) Difference arising between certain parameters estimated earlier and actual results achieved during current period.
   (c) Differences arising between certain parameters during the current period and actual results achieved during the previous period.
   (d) Both (a) and (b).
10. Change in accounting estimate means:
   (a) Difference arises between certain parameters estimated earlier and re-estimated during the current period.
   (b) Difference arises between certain parameters estimated earlier and actual result achieved during the current period.

(c) Difference arises between certain parameters re-estimated during the current period and actual result achieved during the current period.

(d) Both (a) and (b).

Answer

1.	(b)	2.	(c)	3.	(b)	4.	(c)	5.	(d)
6.	(c)	7.	(c)	8.	(a)	9.	(d)	10.	(d)

SHORT PRACTICE QUESTIONS

1. What are the valuation principles. Explain briefly.
2. Write shot note on Accounting Estimates.

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

1999 - Nov [5] State with reason whether the following statement is true or false.

(vii) Current cost gives an alternative measurement base. (2 marks)

Answer:

True: Generally, the value of an asset is determined on the basis of acquisition cost. Current cost is another alternative measurement basis according to which assets are carried at the amount of cash or cash equivalents required to be paid if the same or an equivalent asset has to be acquired currently.

CHAPTER 1

Theoretical Framework

Unit: 8 — Accounting Standards

SELF STUDY QUESTIONS

Q1.Write an Introduction on Accounting Standards.

Answer:

The financial accounting process should be carried out under the set guidelines so as to give true and fair view of the affairs of the company. Accounting Standards provide a framework along with standard accounting policies for recording the transactions in the books of accounts so that the financial information presented is in such form which is understandable and comparable with the financial statement of other entities.

According to Kolher:

"Accounting Standards are codes of conduct imposed by custom law or professional bodies for the benefit of public accountants and accountants generally."

Q2. What are the Objectives of Accounting Standards?

Answer:

(a) Harmonising the accounting practices of various entities so as to facilitate inter firm and intra firm comparison of financial statements.

(b) To provide set standards and other disclosure requirements so as to reduce diversified accounting alternatives.

Q3. What are the Benefits and Limitations of Accounting Standards?

Answer:

Benefits:

(a) **Standardisation of alternative accounting treatments:** Uniformity in treatment of transactions.

(b) **Requirements for additional disclosures:** To make accounting statement understandable to the users.

(c) **Comparability of financial statements:** Due to uniform standards followed by all the entities inter firm and intra firm comparison is possible.

Limitations:

(a) **Difficulties in making choice between different treatments:** Some accounting problems may have multiple solutions along with reasons to recommend them, hence the choice between alternative may be come difficult.

(b) **Restricted Scope:** Accounting Standards are mandatory and hence may avoid initiative for better presentation and disclosure, if such initiative is beyond the ambit of the statute.

Q4. Process of formulation of Accounting Standards in India?

Answer:

Please See Next Page

Determination of areas where accounting standards are required.

↓

Constitution of study group of prepare drafts of proposed standards by Accounting Standard Board (ASB)

↓

Preparation and consideration of drafts by ASB and suggest revisions. [Draft of proposed standard must have objective, scope, definitions, recogniti on and measurement principles, presentation and disclosure requirement].

↓

Circulation of draft to council member of ICAI and other relevant specified bodies for comments

↓

Meeting with the representatives of specified bodies for finalisation of the exposure draft of proposed standard for issuance for public comments.

↓

Consideration of various comments received on such draft and make necessary modification and submit for approval to council of the ICAI.

↓

Consideration of final draft by the council of ICAI and modification if required.

↓

Issue of AS

Q5. List down Accounting Standards in India.

Answer:

Sl. No.	Number of the Accounting Standard (AS)	Title of the Accounting Standard
1.	AS 1	Disclosure of Accounting Policies
2.	AS 2 (Revised)	Valuation of Inventories
3.	AS 3 (Revised)	Cash Flow Statements

4.	AS 4 (Revised)	Contingencies and Events Occurring after the Balance Sheet Date
5.	AS 5 (Revised)	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
6.	AS 6 (pursuant to merging with AS 10, Plant and Equipment w.e.f. 1.4.2017)	Depreciation Accounting
7.	AS 7 (Revised)	Accounting for Construction Contracts
8.	AS 8 (withdrawn pursuant to AS 26 becoming mandatory)	Accounting for Research and Development
9.	AS 9	Revenue Recognition
10.	AS 10	Property, Plant and Equipment
11.	AS 11 (Revised)	The Effects of Changes in Foreign Exchange Rates
12.	AS 12	Accounting for Government Grants
13.	AS 13	Accounting for Investments
14.	AS 14	Accounting for Amalgamations
15.	AS 15 (Revised)	Employee Benefits
16.	AS 16	Borrowing Costs
17.	AS 17	Segment Reporting
18.	AS 18	Related Party Disclosures
19.	AS 19	Leases
20.	AS 20	Earnings Per Share
21.	AS 21	Consolidated Financial Statements
22.	AS 22	Accounting for Taxes on Income

23.	AS 23	Accounting for Investments in Associates in Consolidated Financial Statements
24.	AS 24	Discounting Operations
25.	AS 25	Interim Financial Reporting
26.	AS 26	Intangible Assets
27.	AS 27	Financial Reporting of Interests in Joint Ventures
28.	AS 28	Impairment of Assets
29.	AS 29	Provisions, Contingent Liabilities & Contingent Assets

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. The Accounting Standards are mandatory for:
   (a) Companies
   (b) Partnership Concerns
   (c) Charitable Organizations
   (d) Sole Proprietorship
2. Accounting Standards refers to specific accounting:
   (a) Principles
   (b) Methods of applying those principles
   (c) Both (a) and (b)
   (d) None

3. Accounting for Property, Plant and Equipment:
   (a) AS 6
   (b) AS 10
   (c) AS 3
   (d) AS 2
4. Accounting Standards _______ the statue:
   (a) Can over-ride
   (b) Cannot over-ride
   (c) May over-ride
   (d) None
5. IASB stands for:
   (a) Indian Accounting Standards Board
   (b) Indian Accounting Standards Bulletin
   (c) International Accounting Standards Bulletin
   (d) International Accounting Standards Board
6. AS - 8 on Accounting for Research and Development:
   (a) Is replaced by AS - 26
   (b) Is applicable only to listed companies
   (c) Is mandatory for Research Institutions
   (d) Is still in use
7. The purpose of Accounting Standards is to:
   (a) Harmonise accounting policies
   (b) Eliminate the non comparability of financial statements
   (c) Improve reliability of financial statements
   (d) All of the above
8. AS 2 is on:
   (a) Disclosure of Accounting Policies
   (b) Valuation of Inventories
   (c) Revenue Recognition
   (d) Depreciation Accounting
9. Which of the following provide framework and accounting policies so that the financial statements of different enterprises become comparable?
   (a) Business standards
   (b) Accounting standards

   (c) Market standards
   (d) None of the above.
10. Consistency with reference to application of accounting principles refer to the
   (a) All the companies in the same industries should use identical procedures and methods
   (b) Income and assets have not been overstated
   (c) Accounting methods and procedures used have to be consistently applied from year to year
   (d) Any accounting method or procedure can be utilized.
11. Match the following

(A)	AS 26	(i)	Impairment of Assets
(B)	AS 10	(ii)	Property, Plant and Equipment
(C)	AS 28	(iii)	Intangible assets
(D)	AS 24	(iv)	Accounting for Property, Plant and Equipment

   The Correct alternative is:
   (a) (A)-(iii),(B)-(iv),(C)-(ii),(D)-(i)
   (b) (A)-(ii),(B)-(iv) ,(C)-(i),(D)-(iii)
   (c) (A)- (ii),(B)-(iv) ,(C)-(iii),(D)-(i)
   (d) (A)-(iii),(B)-(iv) ,(C)-(i),(D)-(ii)
12. Certain norms, which are followed by accountants while preparing financial statements in order to reduce the vagueness and chances of misunderstanding by harmonizing the varied accounting practices are
   (a) Accounting Regulations
   (b) Accounting concept
   (c) Accounting Standards
   (d) Accounting Principal
13. All the following are benefits of Accounting Standards except_____.
   (a) AS cannot override the statute.
   (b) AS reduce to a reasonable extent confusing variations in the accounting treatments used to prepare financial statements.
   (c) AS may call for disclosure beyond that required by law.
   (d) AS facilitates comparison of financial statements of companies.

14. Match:
    1. Intangible assets (a) AS 28
    2. Joint venture (b) AS 25
    3. Impairment (c) AS 27
    4. Interim (d) AS 26

    (a) 1-(d), 2-(b), 3 (c), 4 (a)
    (b) 1 (d), 2 (c), 3 (a), 4 (b)
    (c) 1 (c), 2 (d), 3 (a), 4 (b)
    (d) 1 (d), 2 (c), 3 (b) 4 (a)
15. AS 22 is related with the following:
    (a) Accounting for Taxes on Income
    (b) Discontinuing Operations
    (c) Interim Financial Reporting
    (d) Financial reporting of Interests in Joint Venture
16. Which accounting standard is applicable on, provisions contingent liabilities and contingent assets?
    (a) AS 30
    (b) AS 29
    (c) AS 28
    (d) AS 12
17. The following are the benefits of Accounting Standards except:
    (a) Eliminate confusing variations in accounting treatment.
    (b) Disclosure of Important Information beyond that required by law.
    (c) Facilitate comparison of financial statements by providing valuation norms and standard accounting policies.
    (d) Choice between justified alternative accounting treatments becomes difficult.

Answer

1.	(a)	**2.**	(c)	**3.**	(b)	**4.**	(b)	**5.**	(d)
6.	(a)	**7.**	(d)	**8.**	(b)	**9.**	(b)	**10.**	(c)
11.	(d)	**12.**	(c)	**13.**	(a)	**14.**	(b)	**15.**	(a)
16.	(b)	**17.**	(d)						

Short Practice Questions

1. Briefly explain the process followed for issuing Accounting Standards in India.
2. What are the Limitations of AS.

Past Year Questions and Answers

Descriptive Questions

2003 - Nov [6] Briefly explain the following:

(a) What is the objective of 'Accounting Standards'? State the advantage of setting Accounting Standards. (5 marks)

Answer:

Objective and Advantages of Accounting Standards: 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. The Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) formulates Accounting Standards to be established by the Council of the ICAI.

The main objective of Accounting Standards is to establish standards which have to be complied with to ensure that financial statements are prepared in accordance with generally accepted accounting principles. Accounting Standards seek to suggest rules and criteria of accounting measurements. These standards harmonize the diverse accounting policies and practices at present in use in India.

The main advantage of setting accounting standards is that the adoption and application of Accounting Standards ensure uniformity, comparability and qualitative improvement in the preparation and presentation of financial statements.

The other advantages are as follows:

(i) Reduction in variations.

(ii) Disclosure beyond that required by law.

(iii) Facilitates comparison.

2006 - Nov [6] Briefly explain the following:

(v) Advantages of Accounting Standards. (5 marks)

Answer:

Advantages of Accounting Standard: 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. 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.

The setting of accounting standards has the following advantages:

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

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

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

(iv) Adoption of accounting standards in the preparation of financial statements has reduced the chances of manipulations, frauds, insufficient disclosures or the use of inappropriate accounting policies.

CHAPTER

1

Theoretical Framework

Unit: 9 **Indian Accounting Standards**

SELF STUDY QUESTIONS

Q1. What is the Need for convergence towards Global Standards?

Answer:

The nation today is moving towards globalisation of economic activities which are prevalent in different countries.

There arises a need for convergence of accounting practices due to increased demand of comparable financial information of various business organisation across the countries.

The world is now getting smaller and can be seen as one market. For better understanding of the financial reports and consistency in accounting policies followed in preparation and presentation of financial data, there was a need to align into one global accounting language. Single set of accounting requirements if applied globally would increase the comparability of different business organisation all over the world and avoids the costly, requirements for reinstatement of financial statements. If an entity is listed on both foreign as well as in domestic market, then convergence is essential for such entity.

Q2. What do you understand by "International Financial Reporting Standards as Global Standards"?

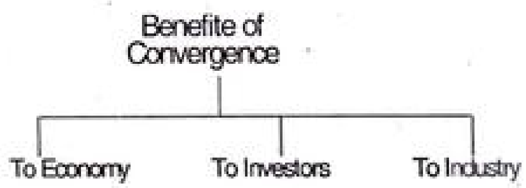
Answer:

- To move towards global reporting, International Accounting Standards Committee (IASC) was formulated to develop International Accounting Standards.

- IASC was a London based group established in June 1973.
- IASC now known an International Accounting Standard Board (IASB) has professional bodies from all around the world including institute of Chartered Accountants of India (ICAI). It has 75 member countries.
- IASC issued International Accounting Standards upto 2001 and word later converted into IASB which issued statements for current and future standards.
- IASB published its standards in a series of pronouncements called as International Financial Reporting Standards (IFRS) which are known to be a 'principle-based' set of standards.
- IFRS at present is being adopted by many nations upto certain extent and is now a compliance requirement for the companies under listing process for statutory reportings, financial reporting obligations, etc.

Q3. What are the Benefits of convergence with IFRS ?

Answer:



Economy:

- Results in growth and development of international trade and business
- Capital formation resulting in creation and maintenance of efficient capital markets
- Promoting Foreign Direct Investment (FDI) in the country.

Investors:

- Investors gets relevant and reliable information as and when required which is also comparable with other organisations of different nations.
- Better understanding of trade and investment opportunities in different markets all over the world.

- Boosts up the confidence of investor group since the financial statements used for investment decisions are accepted globally due to uniform accounting standards followed in its preparation.

Industry:

- Industry can now raise capital from domestic as well as foreign markets resulting in cheaper cost - reduction in burden of financial reporting since the process of preparation of financial statement is simple and accepted globally. Also the cost of reinstatement of financial statement is saved.

Q4. How was Development in Indian Accounting Standards (INDAS)Experienced?

Answer:

First step towards IFRS:

- ICAI in 2014-15 initiated for applicability of IFRS which was later accepted by the Government of India.
- After in depth analysis and discussions, it was decided to converge instead of adopting IFRS already issued by IASB.
- Indian Accounting Standards (INDAS) are formulated in line with IFRS and where essential, departures were made.
- Departure from IFRS were on various basis such as terminology used in law difference economic environment of country and economic environment presumed to be in existence by IFRS.

Q5. What are Indian Accounting Standards (Ind AS)?

Answer:

Ind AS are simply IFRS converged standards formulated by ICAI in consultation with National Advisory Committee on Accounting Standards (NACAS) and issued by Government of India.

Q6. "Government of India – Commitment to IFRS converged Ind AS". Discuss.

Answer:

2014 – Financial Minister of India in his Budget Speech in July, 2014 announced urgently to converge existing AS with IFRS by adopting Ind AS by companies in India.

2015 – MCA issued companies (Indian Accounting Standards) Rules, 2015 vide notification dated 16th Feb, 2015 – a road map to implement Ind AS for companies on voluntary basis [Banking Companies, Insurance Companies and NBFCS were kept out of purview of applicability of Ind AS].

2016 – From 1st April 2016 companies were required to implement Ind AS on mandatory basis.

Separate road maps for implementation of Ind AS were issued for NBFCS and then for Banking Companies and Insurance Companies respectively by Ministry of Corporate Affairs (MCA).

Q7. List down Ind AS.

Answer:

Ind AS	Title of Ind AS
101	First Time Adoption of Indian Accounting Standards
102	Share Based Payment
103	Business Combinations
104	Insurance Contracts
105	Non-current Assets Held for Sale and Discontinued Operations
106	Exploration for and Evaluation of Mineral Resources
107	Financial Instruments: Disclosures
108	Operating Segments
109	Financial Instruments
110	Consolidated Financial Statements
111	Joint Arrangements
112	Disclosure of Interests in Other Entities
113	Fair Value Measurement
114	Regulatory Deferral Accounts
1	Presentation of Financial Statements
2	Inventories

7	Statement of Cash Flows
8	Accounting Policies, Changes in Accounting Estimates and Errors
10	Events after the Reporting Period
11	Construction Contracts
12	Income Taxes
16	Property, Plant and Equipment
17	Leases
18	Revenue
19	Employee Benefits
20	Accounting for Government Grants and Disclosure of Government Assistance
21	The Effects of Changes in Foreign Exchange Rates
23	Borrowing Costs
24	Related Party Disclosures
27	Separate Financial Statements
28	Investment in Associates and Joint Ventures
29	Financial Reporting in Hyper inflationary Economies
32	Financial Instruments: Presentation
33	Earnings per Share
34	Interim Financial Reporting
36	Impairment of Assets
37	Provisions, Contingent Liabilities and Contingent Assets
38	Intangible Assets
40	Investment Property
41	Agriculture

Note: The list o Ind AS given above does not form part of syllabus. It has been given here for the knowledge of students only.

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. The Government of Indian consultation with ICAI decided to.
   (a) Adopt IFRS (b) Notify IFRS in India
   (c) Converge with IFRS (d) All of these.
2. Beneficiaries of convergence with IFRS includes:
   (a) Economy (b) Investors
   (c) Industry (d) All of these.
3. IASC was established in
   (a) 1973 (b) 1997
   (c) 1999 (d) 2001
4. IFRS stands for
   (a) Indian Financial Reporting Standards
   (b) International Financial Reporting Standards
   (c) International Financial Reporting Statements
   (d) International Financial Related Standards

Answer

1.	(c)	2.	(d)	3.	(a)	4.	(b)

SHORT PRACTICE QUESTIONS

1. Write short note of need of convergence towards global standards.
2. Enumerate the benefits of convergence with IFRS.

CHAPTER

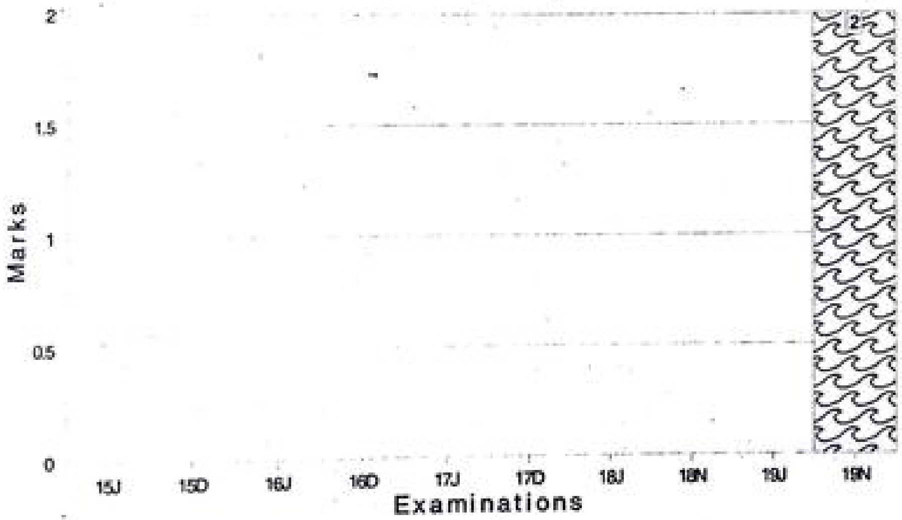
2 Accounting Process

Unit: 1 **Basis Accounting Procedures : Journal Entries**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



For detailed analysis Login at *www.scannerclasses.com* for registration and password see first page of this book.

SELF STUDY QUESTIONS

Q1. What is Double Entry System?

Answer:

- Double Entry System was developed by Luca Pacioli in the 15^{th} century.
- According to this system, every transaction has two aspects and both the aspects should by recorded in books of accounts.
- For every debit there is a equal and corresponding credit and *vice-versa*, hence each transaction affects atleast two accounts.

Example: Purchase of machinery for cash ₹ 20,000.

Accounting entry:

Machinery A/c	Dr.	20,000	
To Cash A/c			20,000
[Being machinery purchased]			

Machinery A/c

To Cash A/c	20,000		

Cash A/c

		By Machinery A/c	20,000

Q2. What are the Advantages of Double Entry System?

Answer:

- Complete record of all transactions.
- Minimises risk of errors and makes their detection easy.
- Facilitates preparation of Profit and Loss Account (to find net profit and loss for period) and Balance Sheet (to know the position of assets and liabilities).
- Ensures arithmetical accuracy of transactions recorded in books of accounts by means of trial balance.

- Provide full particulars of transactions and necessary information for managerial purposes such as control, decision making, etc.
- Financial position of different periods can be compared and reasons for difference may be ascertained.

Q3. What is an Account?

Answer:

Summary of transactions and events of similar nature, recorded sequentially under a particular head is called an account.

Accounts are usually prepared in T-form. A separate account is maintained for every expenses item, revenue item, assets, liability and capital.

Format of an Account:

Dr. Date	Particulars	Ref.	Amount (₹)	Cr. Date	Particulars	Ref.	Amount (₹)

Q4. What is Debit and Credit?

Answer:

In accounting, debit (Dr.) is used to denote the entries entered on the left side of an account and credit (Cr.) is used to denote the entries entered on the right side of an account. These two terms are used to describe two sides of an account.

The term 'Debit' is derived from Latin word 'debitum' i.e. due for date and credit is derived from Latin word 'oreder', i.e. due to that.

The items recorded at debit side of account is said to be debited to the account and balance if any is called as Debit Balance similarly when an item is recorded on credit side of an account is said to be credited and balance if any is called as Credit Balance.

Rules of Debit and Credit:

1. Expenses A/c — Debit → Increase in expenses; Credit → decrease in expenses
2. Revenue A/c — Debit → decrease in revenue; Credit → Increase in revenue
3. Assets A/c — Debit → Increase in assets; Credit → decrease in assets
4. Liabilities A/c — Debit → decrease in liabilities; Credit → Increase in liabilities
5. Capital A/c — Debit → decrease in Capital; Credit → Increase in Capital

Q5. What is a Basic Accounting Equaiton?

Answer:

The basic Accounting Equation is

CAPITAL + LIABILITIES = ASSETS

Examples: State with reason the accounts to be debited or credited in the given case –

		Amount (₹)
1.	Paid wages to Mohan	10,000
2.	Received interest from Arjun	6,000
3.	Bought goods for Cash	15,000
4.	Cash Sales to Vivek	50,000
5.	Borrowed sum from Neha	6,000

Solution :

	Particulars	Accounts affected	Nature of Account	Increase/ Decrease	Debit (₹)	Credit (₹)
1.	Paid wages to Mahan	Wages Cash/Bank	Expenses Assets	Increase Decrease	10,000	 10,000
2.	Received interest from Arjun	Cash / Bank Interest	Asset Revenue	Increase Increase	6,000	 6,000
3.	Bought goods for cash.	Purchase Cash	Expenses Asset	Increase Decrease	15,000	 15,000

4.	Cash Sales to Vivek	Cash Sales	Asset Revenue	Increase Increase	50,000	50,000
5.	Borrowed sum from Neha	Cash/Bank Loan from Neha	Asset Liabilities	Increase Increase	6,000	6,000

Q6. What is Transaction?

Answer:

A transaction is an event or any economic activity of the business which changes its financial position. The change must be capable to be expressed in monetary items evidenced by supporting documents such as invoice, cash memos etc.

A transaction is recorded on basis the of double entry system.

Approaches to Analyse Double Entry
- Accounting Equation Approach
- Traditional Approach

Q7. What is an Accounting Equation Approach?

Answer:

In double entry system, each business transaction has two fold effect on business i.e., it affects the assets, liabilities, capital in a way which equals the basic accounting equation [Equity (E)+ Liabilities (L) = Assets(A)]

At beginning of the year → $E_0 + L_0 = A_0$

(t_0) $E_0 = A_0 - L_0$

At the end of the year → $E_1 + L_1 \rightarrow A_1$

$E_1 = A_1 - L_1$

$E_1 < E_0 \rightarrow$ Loss (t_{01})

If

$E_1 > E_0 \rightarrow$ Profit (t_{01})

Example :

From the following information as on April 1st, 2016 and March 31st, 2017, find the profit earned during the year.

Particulars	As on 1.4.2016	As on 31.3.2017
	(t_0)	(t_1)
Share Capital	1,72,000	??
Trade Payables	7,000	8,000
Other Current Liabilities	4,000	5,000
Plant & Machinery	1,50,000	1,53,000
Non-Current Investment	4,000	–
Inventory	12,000	15,000
Trade Receivables	8,000	10,000
Cash and bank balance	9,000	11,000

Solution:

As we know Equity + Liability = Assets

In the given example

Equity = Share capital

Liability = Trade Payables + Other Current Liabilities

Assets = Plant & Machinery + Non Current investment + Inventory + Trade receivables + Cash and Bank balance

At t_0 –

E_0 = 1,72,000

L_0 = 7,000 + 4,000 = 11,000

A_0 = 1,50,000 + 4,000 + 12,000 + 8,000 + 9,000 = 1,83,000

At t_1

L_1 = 8,000 + 5,000 = 13,000

A_1 = 1,53,000 + 15,000 + 10,000 + 11,000 = 1,89,000

$E_1 = A_1 - L_1$ = 1,89,000 – 13,000 = 1,76,000

Profit for $t_{01} = E_1 - E_0$

= 1,76,000 – 1,72,000

= 4,000

Q8. What is a Traditional Approach?

Answer:

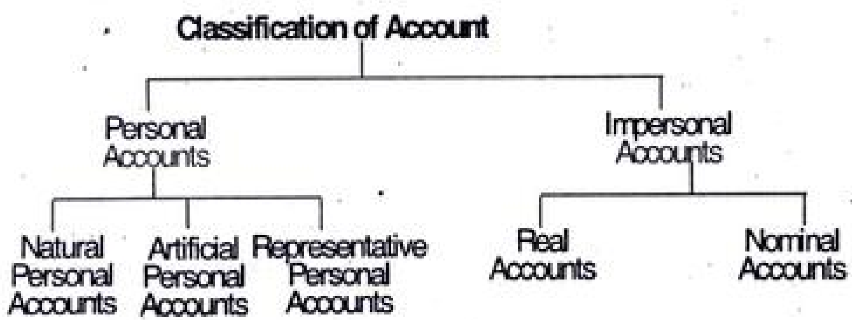
Transactions are recorded in Journal as per the rules of debit and credit.

Transactions can be

- Personal transaction - Those not related to business and may not form part of book of accounts.
- Related to assets and liabilities.
- Those which affect values of Balance Sheet items.
- Related to expenses, losses, income and gains – Those which form part of Profit and Loss Account.

Q9. What are Classifications of Accounts?

Answer:



1. **Personal Accounts:**
   - Accounts which relate to transactions with customers, suppliers, money lenders, owners etc.
   - These accounts are prepared to ascertain balances due to or due from persons or organisations.
   - Categories of Personal Accounts:

     (a) **Natural Personal Account:** Related to individuals or natural person.

     (b) **Artificial (legal) Personal Accounts:** Related to entities recognised as person by law **Example** Banks, Co-operative societies, Companies, etc.

     (c) **Representative Personal Accounts :**Those which represent certain person or a group. **Example** Capital A/c, Drawing A/c, etc.

2. **Impersonal Accounts:**
   - All accounts other than the personal accounts.
   - Categories of Impersonal Accounts.

     (a) **Real Accounts:** Those accounts which represents assets of the firm both tangible and intangible. **Example :** Investments, Fixed Assets, Cash and Bank A/c etc.

     (b) **Nominal Accounts:** Accounts related to income, expenses, gains, losses, etc. These accounts stores data to be shown in Profit and Loss Accounts. These accounts are closed at year end.

     Example: Sales A/c, Selling and Administrative Expenses, Cost of goods Sold etc.

Q10. What are the Golden Rules of Account?

Answer:

1. Personal Account	Debit	→	Receives
	Credit	→	Gives
2. Real Accounts	Debit	→	What Comes in
	Credit	→	What goes out
3. Nominal Accounts	Debit	→	All Expenses Losses
	Credit	→	All Income & Gains

Example: State the nature of account and also show which Account is to be debited or credited.

(i) Rent Paid
(ii) Rent received
(iii) Interest received
(iv) Machine Purchase
(v) Building Sold
(vi) Goods Purchased

(vii) Discount Allowed
(viii) Capital introduced.

Solution:

	Accounts	Nature of A/c	Debit/Credit
(i)	Rent Paid	Nominal	Debited
(ii)	Rent received	Nominal	Credited
(iii)	Interest received	Nominal	Credited
(iv)	Machinery A/c	Real	Debited
(v)	Building A/c	Real	Credited
(vi)	Purchase A/c	Nominal	Debited
(vii)	Discount Allowed A/c	Nominal	Debited
(viii)	Capital A/c	Personal	Credited

Q11. What is the Modern Classification of Accounts?

Answer:

	Type	An increase to the Account	A Decrease to the account	Normal Balance of A/c
1.	Assets A/c	Debit	Credit	Debit
2.	Liabilities A/c	Credit	Debit	Credit
3.	Capital A/c	Credit	Debit	Credit
4.	Revenue A/c	Credit	Debit	Credit
5.	Expenditure A/c	Debit	Credit	Debit
6.	Drawing A/c	Debit	Credit	Debit

Q12. What is a Journal ? Explain Journalising process and advantages of a Journal?

Answer:

The first book of accounts in which transactions are originally recorded is called Journal. It is also called the book of original entry. All the transactions are recorded in a chronological order.

Journalising Process:

Format

Date	Particulars	L.F.	Amount (Dr.) (₹)	Amount (Cr.) (₹)

Date: Date on which the transaction is done.
Particulars: Details of transaction i.e. Accounts to be debited or credited.
L.F.: Ledger folio number where transaction is posted.
Amount: Amount to be debited and credited to the account.
Points to be taken into care while recording a transaction in the Journal.

1. Journal Entry can be of two types –
   (i) Simple Journal Entry/ Single Journal Entry
   (ii) Compound Journal Entry.

Simple Journal/Single Journal entry

Ex.

A A/c Dr.	xxx	
To Cash A/c		xxx
(Being cash paid to Mr. A)		

↑

Single debit and single credit

Compound Journal Entry

Ex.

X A/c Dr.	xx	
To Cash A/c		xx
To Discount Received A/c		xx

↑

Same account debited/credited in more than one transaction on the same date.

Advantages of Journal:

- Complete recording of all transactions in a chronological order.
- Narations written below each journal entry helps to understand the transaction.
- Accounting entries recorded in journal are further posted to various ledger A/c and can be refered with the help of ledger folio number.

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. Capital of business is ₹ 75,000 and liability is ₹ 25,000 then total assets of business would be:
   (a) ₹ 1,00,000 (b) ₹ 15,000
   (c) ₹ 75,000 (d) ₹ 50,000
2. Journal records the transactions of the firm in a:
   (a) Analytical manner (b) Chronological manner
   (c) Periodical manner (d) Summarized manner
3. Bank overdraft account is a:
   (a) Personal account (b) Real account
   (c) Nominal account (d) Representative personal account
4. Outstanding Salary is a:
   (a) Real account
   (b) Personal account
   (c) Representative personal account
   (d) Nominal account
5. DEBIT signifies:
   (a) Increase in Assets account
   (b) Decrease in Liability account
   (c) Decrease in Capital account
   (d) All of the above

6. If two or more transactions of the same nature are journalized together it is known as:
   (a) Compound Journal Entry (b) Separate Journal Entry
   (c) Posting (d) None of the above
7. Goods worth ₹ 10,000 were withdrawn by the proprietor for his personal use. The account to be credited is
   (a) Sales A/c (b) Drawings A/c
   (c) Purchases A/c (d) Expenses A/c
8. General Reserve Account and Dividend Equalisation Fund Account are:
   (a) Personal A/c (b) Real A/c
   (c) Nominal A/c (d) None
9. The rule regarding PERSONAL ACCOUNT is:
   (a) Debit what comes in, credit what goes out.
   (b) Debit all expenses and losses, credit all incomes and gains
   (c) Debit the receiver, credit the giver
   (d) None
10. The Rule 'Debit all expenses & losses and Credit all incomes & gains' relates to:
    (a) Personal Account (b) Real Account
    (c) Nominal Account (d) None of these
11. Unexpired expense is ______ account.
    (a) Real (b) Nominal
    (c) Personal (d) Representative Personal
12. ₹ 1500 withdrawn for personal use should be debited to______
    (a) Expense account (b) Purchases account
    (c) Sales account (d) Drawings account
13. Narration is given along with journal entry:
    (a) To signify the impact of entry on profitability
    (b) To disclose the profit or loss of the transaction.
    (c) To give a precise explanation for proper understanding of the entry.
    (d) To secretly understanding the inner meaning of entries.

14. In case of a debt becoming bad and doubtful, the amount is credited to________?
   (a) Bad debts a/c (b) Creditors
   (c) Debtors a/c (d) Capital a/c.
15. Proprietor's Account is ________ account.
   (a) Real (b) Nominal
   (c) Personal (d) None of these
16. Purchase of second-hand computer on credit by a cloth merchant will be recorded in:
   (a) Journal (b) Cash Book
   (c) Purchase Book (d) None of the above
17. Discount is allowed by Arun to Varun. Which of the following should be the course of action in the books of Arun?
   (a) Credit Varun A/c and debit Discount Allowed A/c
   (b) Debit Varun A/c and credit Discount Received A/c
   (c) Credit Arun A/c and debit Dis-count Allowed A/c
   (d) Debit Arun A/c and credit Dis-count Received A/c
18. Recovery of bad debts written off previously will be?
   (a) Credited to debtors A/c
   (b) Adjusted against provision for doubtful debts
   (c) Debited to debtors A/c
   (d) Cash A/c Dr.
   To B/D. Rec. A/c.
19. ₹ 5,000 received from Ram on 1.1.09 for the old furniture sold to him on 1.06.08 which of the following entry should be passed for recording the transaction in the books of accounts

(a)	Cash A/c	Dr. 5,000	
	To Furniture A/c		5,000
(b)	Cash A/c	Dr. 5,000	
	To Suspense A/c		5,000
(c)	Cash A/c	Dr. 5,000	
	To Bad-debts recovered A/c		5,000
(d)	Cash A/c	Dr. 5,000	
	To Ram A/c		5,000

20. 'A' owed ₹ 25,000 to 'B' 'A' becomes insolvent. 'B' got A's computer valuing ₹ 11,500 in his full settlement. Journal Entry will be passed in the books of 'B'.

(a)	Purchase A/c	Dr. 11,500	
	To A		11,500
(b)	Computer	Dr. 11,500	
	Bad-debts	Dr. 13,500	
	To A		25,000
(c)	Computer A/c	Dr. 25,000	
	To A		25,000
(d)	Computer A/c	Dr. 11,500	
	Purchases A/c	Dr. 13,500	
	To A		25,000

21. Provision for bad-debts as on 1.4.08 ₹ 1,000, during the year 2008-09 there were no bad-debts and debtors as on 31.3.09 were ₹ 90,000. Provision for bad-debts required @ 1% which of the following journal Entry will be passed on 31.3.09?

(a)	P & L A/c	Dr. 100	
	To Provision for doubtful debts		100
(b)	Provision for doubtful debts	Dr. 100	
	To P/L A/c		100
(c)	P & L A/c	Dr. 900	
	To Provision for doubtful debts		900
(d)	No entry will be passed.		

22. "Debit the receiver and credit the giver" is the golden rule for which type of account?
   (a) Real A/c (b) Personal A/c
   (c) Nominal A/c (d) None of these.
23. Journal and Subsidiary books in which transactions and events are first recorded are known as:
   (a) Secondary Books. (b) Memorandum Books.
   (c) Primary Books. (d) Principal Books.

24. Goods given as charity credited to:
    (a) Charity A/c (b) Purchase A/c
    (c) Drawings A/c (d) Sales A/c
25. Capital Account is a ________.
    (a) Real a/c (b) Personal a/c
    (c) Nominal a/c (d) None of these
26. The debt written off as bad, subsequently collected by proprietor in his personal capacity and kept by him. What is accounting treatment for this transaction?
    (a) Debit – Drawings A/c & Credit – Debtors A/c
    (b) Debit – Cash A/c & Credit – Bad debts Recovered A/c
    (c) Debit – Drawings A/c & Credit Bad debts Recovered A/c
    (d) Simply ignore the transaction.
27. If wages are paid for construction of business premises, ________ A/c is credited and ________ A/c is debited.
    (a) Wages, cash (b) Premises, cash
    (c) Cash, wages (d) Cash, premises
28. M/S Stationery Mart will debit purchase of stationery to ________
    (a) Stationery account (b) General expenses account
    (c) Purchase account (d) Stock account
29. Value of goods drawn by proprietor should be credited to:
    (a) Capital Account (b) Sales Account
    (c) Drawings Account (d) Purchases Account
30. "Old or New Machinery sold for ₹ 30,000 on credit." In which subsidiary book this transaction will be recorded?
    (a) Sales Register (b) Cash Book
    (c) Journal (d) No Entry will be made.
31. Which of the following is not a real account?
    (a) Cash account (b) Investment account
    (c) Outstanding rent account (d) Purchases account

32. X is a dealer of electrical goods (such as Refrigerator, Washing Machines, Televisions etc.). He purchased two Air Conditioners and installed in his showroom.
    In the books of X, the cost of air conditioner would be debited in:
    (a) Drawings Account (b) Capital Account
    (c) Fixed asset account (d) Purchase account
33. Which of the following is not an example of nominal account?
    (a) Outstanding liability account.
    (b) Salary account
    (c) Interest paid account
    (d) Interest received account.
34. A diamond ring worth ₹ 1,00,000 was stolen from the shop of M/s Shine Jewellers during the accounting year 2011-12. Insurance claim of ₹ 60,000 was admitted by the insurance company but not disbursed up to the end of the accounting year. In this regard no entry was passed in the books of accounts. The correct journal entry for preparing the final accounts for the year ended 31st March 2012, would be:

(a)	Profit & Loss a/c	Dr.	1,00,000	
	To Purchases a/c			1,00,000
(b)	Insurance claim receivable a/c	Dr.	60,000	
	Loss by theft a/c	Dr.	40,000	
	To Purchases a/c			1,00,000
(c)	Profit & Loss a/c	Dr.	40,000	
	Insurance claim receivable a/c	Dr.	60,000	
	To Purchase a/c			1,00,000
(d)	Insurance claim receivable a/c	Dr.	60,000	
	Insurance company a/c	Dr.	40,000	
	To Purchases a/c			1,00,000

35. A Furniture dealer during the financial year 2010-11, sold furniture of ₹ 25,000 to Mr. Sunil on cash basis. In the books of dealer ________ account will be debited and ______ account will be credited.
    (a) Cash, Fixed assets (b) Cash, Furniture
    (c) Cash, Sales (d) Cash, Sunil's

36. ₹ 1,500 received from Ram which were written off as bad-debts earlier. To record this receipt, cash account will be debited and _______ account will be credited.
 (a) Ram's (b) Bad debts
 (c) Bad debt recovered (d) Sales

37. X Purchased land for ₹ 10,00,000. He gave a cheque of ₹ 2,00,000 and accepts a bill of ₹ 8,00,000 due after 60 days. As a result:
 (a) Total assets increased by ₹ 10,00,000 & total liabilities decreased by ₹ 10,00,000.
 (b) Total assets increased by ₹ 8,00,000 & total liabilities decreased by ₹ 8,00,000.
 (c) Total assets increased by ₹ 8,00,000 & total liabilities increased by ₹ 8,00,000.
 (d) Total assets increased by ₹ 10,00,000 & total liabilities increased by ₹ 10,00,000.

38. Debit the expenses or losses, credit all incomes and gains, is the rule for:
 (a) Real Account (b) Personal Account
 (c) Nominal Account (d) All of the above

39. Goods are distributed as free samples worth ₹ 50,000 for advertisement purpose. Which of the following journal entry would be passed:

(a) Advertisement A/c	Dr.	50,000	
To Purchases A/c			50,000
(b) Purchases A/c	Dr.	50,000	
To Advertisement A/c			50,000
(c) Advertisement A/c	Dr.	50,000	
To Sales A/c			50,000

 (d) None of the above

40. Rent of proprietor's house paid from business account by cash will:
 (a) Decrease the profit
 (b) Increase the profit
 (c) Reduce the capital of business
 (d) Reduce the cash as well as capital of business

41. Fixed assets are held by business organization for _____________.
 (a) Conversion into cash (b) Generating income
 (c) Resale (d) None of the above.

42. Mr. X purchased a computer for ₹ 60,000 by making a down payment of ₹ 10,000 and balance ₹ 50,000 signing the agreement of bills payable due in 50 days. As a result of these transactions.
 (a) Total assets increased by ₹ 50,000 with the corresponding increase in liability ₹ 50,000
 (b) Total assets increased by ₹ 50,000
 (c) Total assets increased by ₹ 60,000 with the corresponding increase in liability by ₹ 50,000
 (d) Total assets increased by ₹ 60,000 with the corresponding increase in liability by ₹ 60,000

43. Changes in the capital account of a proprietor may occur due to:
 (a) Profits earned (b) Losses incurred
 (c) Capital introduced (d) Any of the above

44. Consider the following statements and identify the wrong statement.
 (a) All personal and real accounts ultimately show balance.
 (b) The balances of nominal accounts are transferred to Profit and Loss Account.
 (c) Separate account is opened in ledger book for each account.
 (d) Rent is a personal account but outstanding rent is a nominal account.

45. Interest receivable from Ratan, a borrower account is –
 (a) Artificial Personal Account
 (b) Natural Personal Account
 (c) Representative Personal Account
 (d) None of the above.

46. Which account clarification under "Traditional Approach" is the odd one out?
 (a) Building (b) Purchases
 (c) Sales (d) Trade receivables

47. Morning Tours has a ₹ 70,000 Account receivable from Rahul. On January 20, 2015 Rahul makes a partial payment of ₹ 50,000 to Morning Tours. The journal entry made on January 20, 2015 by Morning Tours to record the above transaction includes:
    (a) A credit to the cash received account of ₹ 50,000.
    (b) A credit to Accounts receivable Account of ₹ 50,000.
    (c) A debit to cash account of ₹ 20,000.
    (d) A debit to Accounts receivable of ₹ 20,000
48. Consider the following statements and identify the wrong statement:
    (a) All real and personal accounts are transferred to Balance Sheet.
    (b) Nominal accounts are transferred to P & L Account.
    (c) Each account is opened separately in ledger.
    (d) Rent is a personal account, outstanding rent is nominal account.
49. Mr. X a dealer in electronic goods (such as refrigerators, air conditioners, washing machines, televisions, etc.). He purchased two air conditioners and installed in his showrooms. In the books of 'X', the cost of these two air conditioners will be debited to:
    (a) Purchases A/c (b) Fixed Asset A/c
    (c) Drawing A/c (d) Capital A/c
50. Decrease in amount of trade receivables results in ______.
    (a) Increase in cash (b) Increase in liabilities
    (c) Increase in capital (d) Increase in loan.

ANSWER

1.	(a)	2.	(b)	3.	(a)	4.	(c)	5.	(d)
6.	(a)	7.	(c)	8.	(b)	9.	(c)	10.	(c)
11.	(d)	12.	(d)	13.	(c)	14.	(c)	15.	(c)
16.	(a)	17.	(a)	18.	(d)	19.	(d)	20.	(b)
21.	(b)	22.	(b)	23.	(c)	24.	(b)	25.	(b)
26.	(c)	27.	(d)	28.	(c)	29.	(d)	30.	(c)
31.	(c)	32.	(c)	33.	(a)	34.	(c)	35.	(c)
36.	(c)	37.	(c)	38.	(c)	39.	(a)	40.	(d)
41.	(b)	42.	(a)	43.	(d)	44.	(d)	45.	(c)
46.	(d)	47.	(b)	48.	(d)	49.	(b)	50.	(a)

SHORT PRACTICE QUESTIONS

1. What are the advantages of double entry book keeping system?
2. Write short note on classification of accounts under traditional approach.
3. Illustration - 2

   Anil had the following transactions:
   1. Commenced business with cash ₹ 50,000.
   2. Purchased goods for cash ₹ 20,000 and credit ₹ 30,000.
   3. Sold goods for cash ₹ 40,000, costing ₹ 30,000.
   4. Rent paid ₹ 500.
   5. Rent outstanding ₹ 100.
   6. Bought furniture for ₹ 5,000 on credit.
   7. Bought refrigerator for personal use ₹ 5,000.
   8. Purchased computer for cash ₹ 20,000.
   9. Cash withdrawn for personal use ₹ 10,000.
   10. Interest on drawings charged @ 5%.

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

Solution:

No	Transaction	Cash	+	Stock	+	Furniture	+	Computer	=	Creditors	+	Rent	+	Capital
1.	Commenced business with cash ₹ 50,000	50,000	+	0	+	0	+	0	=	0	+	0	+	50,000
2.	Purchased goods for cash ₹ 20,000 and credit ₹ 30,000	- 20,000	+	50,000	+	0	+	0	=	30,000	+	0	+	0
	New Equation	30,000	+	50,000	+	0	+	0	=	30,000	+	0	+	50,000
3.	Sold goods for cash ₹ 40,000, costing ₹ 30,000	+ 40,000		-30,000	+	0	+	0	=	0	+	0	+	10,000
	New Equation	70,000	+	20,000	+	0	+	0	=	30,000	+	0	+	60,000
4.	Rent paid ₹ 500	- 500	+	0	+	0	+	0	=	0	+	0	-	500
	New Equation	69,500	+	20,000	+	0	+	0	=	30,000	+	0	+	59,500
5.	Rent outstanding ₹ 100	0	+	0	+	0	+	0	=	0	+	100	-	100
	New Equation	69,500	+	20,000	+	0	+	0	=	30,000	+	100	+	59,400

6.	Bought furniture for ₹ 5,000 on credit	0	+	0	+	5,000	+	0	=	5,000	+	0	+	0
	New Equation	69,500	+	20,000	+	5,000	+	0	=	35,000	+	100	+	59,400
7.	Bought refrigerator for personal use ₹ 5,000	- 5,000	+	0	+	0	+	0	=	0	+	0	-	5,000
	New Equation	64,500	+	20,000	+	5,000	+	0	=	35,000	+	100	-	54,400
8.	Purchased computer for cash ₹ 20,000	- 20,000	+	0	+	0	+	20,000	=	0	+	0	+	0
	New Equation	44,500	+	20,000	+	5,000	+	20,000	=	35,000	+	100	+	54,400
9.	Cash withdrawn for personal use	- 10,000	+	0	+	0	+	0	=	0	+	0	-	10,000
	New Equation	34,500	+	20,000	+	5,000	+	20,000	=	35,000	+	100	+	44,400
10.	Interest on drawings charged @ 10%	0	+	0	+	0	+	0	=	0	+	0	+ -	500 500
	New Equation	34,500	+	20,000	+	5,000	+	20,000	=	35,000	+	100	+	44,400

Balance Sheet of ANIL

Liabilities	₹	Assets	₹
Creditors (including creditor for furniture ₹ 5,000)	35,000	Cash in Hand Stock Furniture	34,500 20,000 5,000
Rent Outstanding	100	Computer	20,000
Capital	44,400		
	79,500		79,500

The accounting equation is the basis for Double Entry System. Total assets of the business unit are provided by the creditors/lenders and the owners. Therefore, at any point of time, the total assets of the business are equal to the total liabilities.

llustration - 20 Journalise the following transactions in the books of Gupta 3ros. :

2010		₹
March 1	Started business with cash ₹ 30,000; goods worth ₹ 15,000 and furniture worth ₹ 20,000	
March 2	Paid into bank	20,000
March 3	Bought goods from Mohan Bros. on credit	7,000
March 4	Sold goods to Goyal Bros. on credit	6,000
March 5	Bought a horse for ₹ 10,000 for delivering goods to customers	
March 7	Received from travelling salesman for goods sold by him after deducting travelling expenses ₹ 150	3,000

March 9	Drawn a cheque for ₹ 800 for personal use	
March 10	Goyal Bros. gave cheque; deposited in the bank	6,000
March 11	Paid to Mohan Bros. by cheque	6,700
	Discount allowed by him	300
March 13	Paid for repairs of furniture	200
March 13	Received an order for goods from Mahesh	5,000
March 14	Sold old newspapers	80
March 15	Interest received from bank	400
March 16	Paid ₹ 300 for expenses on goods sold to Goyal Bros. This amount to be realised from Goyal Bros.	
March 19	Bought goods from Sohan Lal &Sons Paid cartage on these goods	400 50
March 20	Bank intimates that the cheque of Goyal Bros. has been returned dishonoured	
March 21	The horse bought on March 5 died, its carcass was sold for ₹ 500	
March 22	Paid rent by cheque	600
March 23	Salaries for the month of February remain unpaid	300
March 25	Paid Municipal taxes in cash	800
March 31	Depreciation charged on furniture @ 10% per annum	
	Received an order for goods ₹ 5,000 from Shyam and received ₹ 1,000 as advance	

Solut'on:

In the Books of Gupta Bros.
Journal

Date	Particulars	LF	Dr. (₹)	Cr. (₹)
2010 March 1	Cash A/c Dr. Stock A/c Dr. Furniture A/c Dr. To Capital A/c (Being the business started with cash, goods and furniture)		30,000 15,000 20,000	 65,000
March 2	Bank A/c Dr. To Cash A/c (Being the cash paid into bank)		20,000	 20,000
March 3	Purchases A/c Dr. To Mohan Bros. (Being the goods purchased from Mohan Bros.)		7,000	 7,000
March 4	Goyal Bros. Dr. To Sales A/c (Being the goods sold to Goyal Bros.)		6,000	 6,000
March 5	Live Stock A/c Dr. To Cash A/c (Being the purchase of a horse for delivering goods to customers)		10,000	 10,000
March 7	Cash A/c Dr. Travelling Expenses A/c Dr. To Sales A/c (Being the cash received from travelling salesman after deducting travelling expenses)		3,000 150	 3,150

Date	Particulars	LF	Dr. (₹)	Cr. (₹)
March 9	Drawings A/c Dr. To Bank A/c (Being the cheque drawn out of bank for personal use)		800	 800
March 10	Bank A/c Dr. To Goyal Bros. (Being the cheque received from Goyal Bros., Deposited in bank)		6,000	 6,000
March 11	Mohan Bros. Dr. To Bank A/c To Discount Received A/c (Being the payment made by cheque and discount received)		7,000	 6,700 3,00
March 13	Repairs A/c Dr. To Cash A/c (Being the amount paid for repairs of furniture)		200	 200
March 13	In receipt of an order or no placing an order or tender, no entry will be passed, because it is not a transaction.			
March 14	Cash A/c Dr. To Sundry Receipts A/c (Being the cash received by sale of old newspapers)		80	 80
	Total c/f		1,25,230	1,25,230
	Total b/f		1,25,230	1,25,230
March 15	Bank A/c Dr. To Interest A/c (Being the interest received from bank)		400	 400

March 16	Goyal Bros. Dr. To Cash A/c (Being the expenses paid for goods sold to Goyal Bros.)		300	300
March 19	Purchases A/c Dr. Cartage A/c Dr. To Sohan Lal & Sons To Cash A/c (Being the goods purchased from Sohan Lal & Sons and paid cartage)		400 50	400 50
March 20	Goyal Bros. Dr. To Bank A/c (Being the cheque received from Goyal Bros. dishonoured)		6,000	6,000
March 21	Cash A/c Dr. Profit and Loss A/c Dr. To Livestock A/c (Being the cash received by sale of carcass of dead horse)		500 9,500	10,000
March 22	Rent A/c Dr. To Bank A/c (Being the rent paid by cheque)		600	600
March 23	Salaries A/c Dr. To Salaries Outstanding A/c (Being the salaries for the month of February unpaid)		300	300
March 25	Municipal Taxes A/c Dr. To Cash A/c (Being the amount paid for tax)		800	800

March 31	Depreciation A/c Dr. To Furniture A/c (Being the depreciation charged on furniture @ 10% per annum)		2,000	2,000
	Cash A/c Dr. To Shyam (Being the cash received as advance)		1,000	1,000
			1,47,080	1,47,080

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

1995 - Nov [5] State with reason whether the following statement is true or false:

(10) Patent rights is in the nature of Nominal Account. (1 mark)

Answer:

False: Patent Right is an intangible asset. So, it is as item of Real Account.

1999 - May [5] State with reason whether the following statement is true or false:

(iv) Nominal accounts are balanced in the end of the accounting year. (2 marks)

Answer:

False: Nominal accounts are not balanced; the balances in the end are transferred to the profit and loss account.

2000 - May [5] State with reason whether the following statement is true or false:

(iii) Outstanding expenditure is a nominal account. (2 marks)

Answer:

False: Outstanding expenditure represents a liability due to some person, therefore, it is a personal account.

2001 - Nov [5] State with reason whether the following statement is true or false:

(iii) Patent-Right is in the nature of Real Account. (2 marks)

Answer:

True: Patent-right is an intangible asset. So, it is in the nature of real account.

2003 - May [5] State with reason whether the following statement is true or false:

(ix) Equity + LTL – CL = FA + CA. (2 marks)

Answer:

False: The basic accounting equation is given by:
Equity + LTL = FA + CA – CL

2003 - Nov [5] State with reason whether the following statement is true or false:

(v) The balance of an account is always known by the side which is shorter. (2 marks)

Answer:

False: The balance of an account is the difference between the total of debits and total of credits appearing in the account. If the debit side (let hand side) total is higher, it shall be a debit balance and if the credit side (right hand side) total is higher, it shall be a credit balance.

2003 - Nov [5] State with reason whether the following statement is true or false:

(x) Closing entries are recorded in Journal Proper. (2 marks)

Answer:

True : All the closing entries are recorded in journal proper.

2004 - May [5] State with reason whether the following statement is true or false:

(viii) Patent-Right is in the nature of Real Account. (2 marks)

Answer:

Please refer 2001 - Nov [5] (iii) on page no. 169

2005 - May [5] State with reason whether the following statement is true or false:

(ii) Rent paid account is a Nominal Account whereas, rent received account is a Real Account. (2 marks)

Answer:

False : Rent paid and rent received – both are nominal accounts as they relate with expenses and incomes.

2005 - Nov [5] State with reason whether the following statement is true or false:

(i) Salary paid to Ram will be debited to Ram's Personal account. (2 marks)

Answer:

False: Salary paid to Ram will be debited to Salaries account.

2005 - Nov [5] State with reason whether the following statement is true or false:

(v) Cash at Bank is a real account. (2 marks)

Answer:

True: Cash at bank is a real account. Accounts which relate to assets of the firm but not debts are real accounts. Land, Building, investments, cash in hand and cash at bank are examples of real accounts.

2006 - Nov [5] State with reason whether the following statement is true or false:

(i) 'Rent Outstanding' account comes under the category of Nominal account. (2 marks)

Answer:

False: This account is personal account representing landlord.

2006 - Nov [5] State with reason whether the following statement is true or false:

(x) The debit balance in a nominal account shows gains. (2 marks)

Answer:

False : The debit balance in a nominal account shows expenses. The credit balance of a nominal account shows gain or income.

2019 - Nov [1] {C} (a) State with reason, whether the following statement is true or false.

(i) Trade Discount is a reduction granted by a supplier from the list price of goods or services on business considerations for prompt payment. (2 marks)

Answer:

False: Trade discount is a reduction granted by a supplier from the list price of goods or services on business considerations other than for prompt payment.

DESCRIPTIVE QUESTIONS

1997 - Nov [6] (a) Real Account and Nominal Account. (5 marks)

Answer:

Real Account and Nominal Account:

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

1999 - Nov [6] (c) Personal and Impersonal Accounts. (5 marks)

Answer:

Personal and Impersonal Accounts:

Personal accounts relate to persons, debtors or creditors. Examples would be the account of Ram & Co., a credit customer or the account of Jhaveri & Co., a supplier of goods. The capital account is the account of the proprietor and, therefore, it is also personal but adjustments on account of profits and losses are made in it.

Accounts which are not personal such as machinery account, cash account, rent account, etc. are called impersonal accounts. These can be further subdivided as: real accounts and nominal accounts. Accounts which relate to assets of the firm but not debts are real accounts. For example, accounts regarding land, buildings, investments, fixed deposits, cash in hand and bank balances etc. are real accounts in nature. Nominal accounts relate to expenses, losses, gains, revenues etc. like salary account, interest paid account, commission received account. The net result of all the nominal accounts is reflected as profit or loss which is transferred to the capital account. Nominal accounts are therefore, temporary.

CHAPTER	
2	**Accounting Process**
Unit: 2	Ledger

SELF STUDY QUESTIONS

Q1. What is a Ledger?

Answer:

Ledger is the principal book of account. It consists of all the transactions entered in Journal rearranged under various account heads.

It shows account balance of each accounting head.

Specimen of Ledger Accounts:

Dr. Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)

Q2. What do you understand by Posting?

Answer:

Transferring of journal entries to the respective accounts in ledger.

Rules regarding posting of entries in the ledger.

1. Open the respective ledger account for recording entries recorded in Journal.
2. Use of words 'To' and 'By' on Debit and Credit side respectively.
3. If the account debited in journal then the ledger of such account of it will be debited with the reference of the account which has been credited in same entry, on the left side of the account as 'To'.
   Similarly, if the account is credited in journal, then ledger of such account will have reference of entry of the account debited in same entry on the right side of the account as 'By'.

Example :

If an entry in Journal is written as

Cash A/c	Dr. 2,000	
To Commission A/c		2,000
(Being commission received)		

Posting :

Cash A/c

Dr. Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
	To Commission A/c		2,000				

Commission A/c

Dr. Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
					By Cash A/c		2,000

Q3. How is Balancing an Account done?

Answer:

- Total both the sides of account and check which side has greater total.
- Now put the greater total at bottom on both the sides of the account.
- Add all the individual amounts of the side having lesser total and find the difference between the amount calculated and the amount written below.
- If the credit side has higher total then the difference balance is called as credit balance and is written on left side as 'To Balance c/d'. Similarly if debit side has higher total then the difference is called debit balance and written on right side as 'By Balance c/d'.
- In the next period these balances are carried down, debit balance on debit side as 'To balance b/d' and credit balance on credit side as 'By Balance c/d'.
- The balances of nominal accounts are transferred to profit and loss A/c at the end of accounting period and not carried forward.

Example:

Journalese following transaction and Prepare Bank Account.

April 1	Opening Balance	3,000
April 2	Goods sold	1,200
April 10	Purchase of goods on credit from Mr. A	2,000
April 15	Salary paid to staff	160
April 20	Drawings for personal use	400
April 25	Further capital introduced	3,760
April 30	Goods sold on credit to Mr. X	3,200

Solution:

Journal

Date	Particulars	L. F.	Dr. Amount (₹)	Cr. Amount (₹)
April 2	Bank/Cash A/c Dr. To Sales A/c (Being Goods sold for cash)		1,200	1,200
April 10	Purchases A/c Dr. To A's A/c (Being goods purchased from Mr. A)		2,000	2,000
April 15	Salary A/c Dr. To Bank A/c (Being salary paid to staff)		160	160
April 20	Drawings A/c Dr. To Bank A/c (Being cash withdrew for personal use)		400	400

Date	Particulars	L. F.	Dr. Amount (₹)	Cr. Amount (₹)
April 25	Bank A/c Dr. To Capital A/c (Being cash introduced as further capital)		3,760	3,760
April 30	Mr. X A/c Dr. To Sales A/c (Being goods sold on credit to Mr. X)		3,200	3,200

Bank A/c

Dr. Cr.

Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
April 1	To Balance b/d		3,000	April 15	By Salary A/c		160
April 2	To Sales A/c		1,200	April 20	By Drawings A/c		400
April 25	To Capital A/c		3,760		By Balance c/d		7,400
			7,960				7,960
May 1	To Balance b/d		7,400				

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. Ledger Book is popularly known as:
   (a) Secondary book of accounts
   (b) Principal book of accounts
   (c) Subsidiary book of accounts
   (d) None

2. Which of the following accounts may have a debit or a credit balance?
   (a) Partner's Current Account
   (b) Purchase Account
   (c) Commission (Recd) Account
   (d) None
3. The process of transferring the transactions relating to changes in a particular item at one place in the form of an account is called_____.
   (a) Balancing (b) Casting
   (c) Journalizing (d) Posting
4. Ledger records transaction in:
   (a) A chronological order (b) Analytical order
   (c) Both of the above (d) None
5. The miscellaneous expenses account is likely to have:
   (a) Only debit entries (b) Only credit entries
   (c) Both of the above (d) Initially only debit entries and subsequently credit entries
6. Discount Account will always have:
   (a) Only debit balance (b) Nil balance
   (c) Only credit balance (d) Debit or Credit balance
7.

Cash Sales	₹ 50,000
Cash collected from Debtors	₹ 1,30,000
Bad debts during year	₹ 5,000
Debtors at beginning	₹ 10,000

   Total Sales will be:
   (a) ₹ 1,75,000 (b) ₹ 1,70,000
   (c) ₹ 1,80,000 (d) ₹ 1,78,000
8. The credit balance of a personal account shows:
   (a) Cash in hand (b) The amount payable
   (c) Income (d) Amount receivable
9. Which of these Account is debited:
   (a) Income received in advance
   (b) Bank Loan
   (c) Prepaid Insurance Premium
   (d) Reserve for doubtful debts

10. Cash account is a
   (a) Personal account (b) Real account
   (c) Nominal account (d) None of the above.
11. The next step after preparation of Ledger is the preparation of____:
   (a) Trial balance (b) Final accounts
   (c) Cash flow statement (d) Balance sheet
12. Purchase Return Account always shows a ______ balance.
   (a) Debit (b) Credit
   (c) Either (a) or (b) (d) None
13. A opened an account with ₹ 5,000 on 3/12/09. He deposited ₹ 1,000 on 7/12/09. He withdraw ₹ 2,000 on 15/12/09 and deposited a cheque of ₹ 10,000 on 20/12/09. What is the balance on 31/12/09?
   (a) ₹ 18,000 (b) ₹ 14,000
   (c) ₹ 4,000 (d) None
14. Which of the following is known as "Principal Books of Accounts"?
   (a) Ledger (b) Journal
   (c) Trial Balance (d) Balance Sheet
15. What will be the total sales of the year 2008-09 for A Limited, if they provided following information:

Cash sales	₹ 80,000
Cash collected from debtors	₹ 1,50,000
Bad debts during the year	₹ 10,000
Debtor at 1st April, 2008	₹ 15,000
Debtor at 31st March, 2009	₹ 10,000

   (a) ₹ 2,35,000 (b) ₹ 2,30,000
   (c) ₹ 2,40,000 (d) ₹ 2,25,000
16. The value of furniture on 1st April, 2008 is ₹ 80,000. Furniture purchased during the year was ₹ 40,000. During the year some furniture was sold at ₹ 15,000 and a loss of ₹ 5,000 occurred. The value of furniture on 31st March, 2009 was ₹ 70,000.
   Depreciation charged for the year 2008-09 will be:
   (a) ₹ 50,000 (b) ₹ 20,000
   (c) ₹ 30,000 (d) ₹ 40,000

17. Credit balance of ledger is ________.
    (a) a revenue or an asset (b) a revenue or a liability
    (c) an expense or an asset (d) an expense or a liability.
18. Which of the following statement is correct?
    (a) All Entries except cash transactions can be recorded through Journal.
    (b) Ledger is a part of subsidiary book.
    (c) Purchase book records all the purchases whether cash or credit.
    (d) Bank column of cash book always has debit balance.
19. If the owner withdraws amount from the business for personal use, then which A/c is to be debited?
    (a) Capital A/c (b) Drawings A/c
    (c) Owners A/c (d) None of these.
20. Which of the following is a real account?
    (a) Building A/c (b) Capital A/c
    (c) Rent A/c (d) All of these.
21. What will be the Journal Entry when goods purchased are returned?
    (a) Creditors A/c Dr.
    To Purchase Return A/c
    (b) Purchase Return A/c Dr.
    To Creditors A/c
    (c) Creditors A/c Dr.
    To Sales A/c
    (d) None of these.
22. After recording the transactions and events in journal and subsidiary books, they will be transferred to:
    (a) Profit and Loss Account
    (b) Balance Sheet
    (c) Ledger
    (d) Memorandum Books
23. From the following details, find out credit sales during the financial year 2010 – 2011:
    1. Opening balance of sundry debtors on 1.4.10 ₹ 12,000.
    2. Bills receivable accepted by customer ₹ 13,000.

    3. Closing balance of Sundry Debtors on 31.3.11 ₹ 14,000.
    4. Cash received from debtors during the year ₹ 38,400.
    (a) ₹ 39,400 (b) ₹ 27,000
    (c) ₹ 65,400 (d) ₹ 53,400
24. From the following information ascertain the closing balance of debtors: Opening balance of debtors ₹ 32,600; total sales ₹ 1,03,000; cash collected from debtors₹ 70,000; sales return ₹ 1,500; discount on purchases ₹ 1,200; cash sales ₹ 43,000; bad debts ₹ 700 :
    (a) ₹ 19,200 (b) ₹ 20,400
    (c) ₹ 63,400 (d) ₹ 21,900
25. Furniture of book value of ₹ 20,000 was sold for ₹ 6,000 and new furniture of ₹ 20,000 was purchased. Amount debited towards purchase of new furniture will be:
    (a) ₹ 14,000 (b) ₹ 29,000
    (c) ₹ 5,000 (d) ₹ 20,000
26. Goods costing ₹ 5,000 given to a worker towards wages ₹ 5,000. Market price of goods is ₹ 6,000. Journal entry will be
    (a) Wages A/c Dr. ₹ 6,000
    To Sales A/c ₹ 6,000
    (b) Wages A/c Dr. ₹ 5,000
    To Purchases A/c ₹ 5,000
    (c) Wages A/c Dr. ₹ 5,000
    To Cash A/c ₹ 5,000
    (d) None of the above
27. X purchased goods on 90 days credit from Y worth ₹ 20,000. Y has given a trade discount of ₹ 1,000 on the same. Since Y also offered a cash discount of ₹ 500, if payment is made within 30 days, X avails the cash discount and paid the dues to Y. At the end of the year the goods purchases from Y remain unsold and included in the stock. The value of such goods would be:
    (a) ₹ 20,000 (b) ₹ 19,500
    (c) ₹ 19,000 (d) ₹ 18,500

28. 'A' purchased a computer having MRP of ₹ 60,000 for ₹ 45,000 and was offered a cash discount of ₹ 9,000. At what percentage he got trade discount on MRP before getting cash discount?
(a) 15% (b) 10%
(c) 71/2% (d) 25%.

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

30. Salary payable to employees ₹ 50,000 is credited to __________.
(a) Cash a/c (b) Salary a/c
(c) Outstanding salary a/c (d) None of the above.

31. Opening debtor ₹ 15,000
Bad debts during the year ₹ 14,000
Cash received from debtors ₹ 1,60,000
Closing debtor ₹ 7,000
Total Sales will be:
(a) ₹ 1,81,000 (b) ₹ 1,66,000
(c) ₹ 1,74,000 (d) ₹ 1,60,000

32. Journal and ledger records transactions in:
(a) A chronological order only.
(b) An analytical order and chronological order respectively.
(c) A chronological order and analytical order respectively.
(d) An analytical order only.

33. Which of the following statement is incorrect?
(a) All personal and real account ultimately show balances
(b) The balances of nominal accounts are transferred to profit and loss account

(c) Separate account is opened in ledger books for each account
(d) Rent is a personal account but outstanding rent is a nominal account.

34. At the end of the year, a ledger account has credit balance. The credit balance of the ledger is written as:
(a) "To Balance c/d" on the debit side
(b) "By Balance c/d" on the credit side
(c) "To Balance b/d" on the debit side
(d) "By Balance b/d" on the credit side.

ANSWER

1.	(b)	**2.**	(a)	**3.**	(d)	**4.**	(b)	**5.**	(a)
6.	(d)	**7.**	(a)	**8.**	(b)	**9.**	(c)	**10.**	(b)
11.	(a)	**12.**	(b)	**13.**	(b)	**14.**	(a)	**15.**	(a)
16.	(c)	**17.**	(b)	**18.**	(a)	**19.**	(b)	**20.**	(a)
21.	(a)	**22.**	(c)	**23.**	(d)	**24.**	(b)	**25.**	(d)
26.	(b)	**27.**	(c)	**28.**	(d)	**29.**	(d)	**30.**	(c)
31.	(b)	**32.**	(c)	**33.**	(d)	**34.**	(a)		

SHORT PRACTICE QUESTIONS

1. What do you understand by Balancing of an Account?
2. Enumerate the rules of posting in Ledger Account.

PAST YEAR QUESTIONS AND ANSWERS

DISTINGUISH BETWEEN

2001 - Nov [6] (a) Difference between Journal and Ledger. (5 marks)

Answer:

Journal and Ledger:

Transactions are first entered in a book called 'Journal' to show which account should be debited and which credited. Journal creates preliminary records and, is also called subsidiary book. All transactions are first recorded in the journal as and when they occur, the record is chronological, otherwise it would be difficult to maintain the records in an orderly manner. Journal gives details regarding any transaction. Thus Journal tells the amounts to be debited and credited and also the accounts involved.

On the basis of entries made in the Journal, accounts are prepared; the book which contains the accounts is called 'Ledger'. Ledger creates final record and is also known as principle book. Ledger can not give details of any particular transaction. On the basis of the entries recorded in the journal, the postings to the required accounts are done in the ledger. After posting the accounts in the ledger, the trial balance can be prepared to show separately the debit and credit balances.

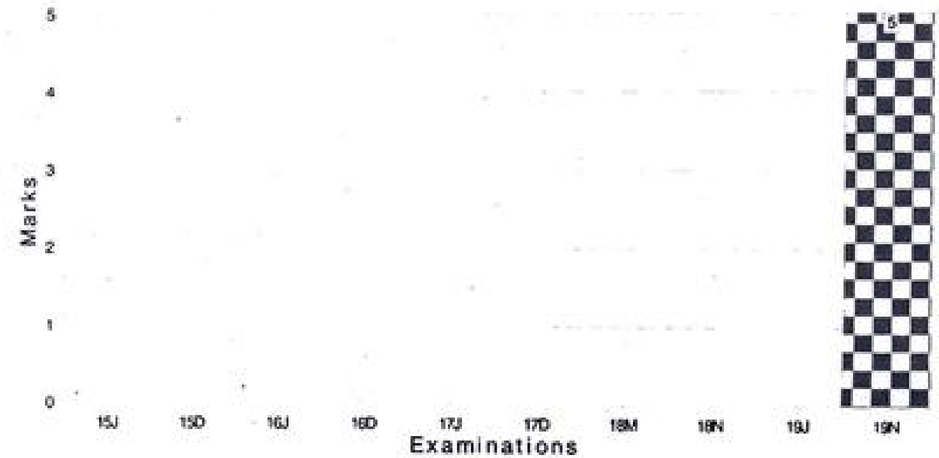
CHAPTER 2 Accounting Process

Unit: 3 Trial Balance

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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SELF STUDY QUESTIONS

Q1. What is a Trial Balance ?

Answer:

A trial balance is the list of all account balances after recording of all transactions in respective ledger accounts. It helps to verify the arithmetical accuracy of the ledger accounts.

In double entry system, each account has two aspects debit and credit. Hence, after recording all account balances both the sides must agree. If there is a difference in two sides, then there exists an arithmetical error in any account balance. Trial balance can not be said as an account. It is simply a list of all account balances.

Q2.What are the Objectives of preparing a Trial Balance?

Answer:

- To check arithmetical accuracy of transactions recorded in books of accounts.
- Helps in preparation of Profit and Loss account and Balance Sheet.
- Acts as a summary of various ledger accounts.

Specimen of Trial Balance

S.No.	Ledger Accounts	L.F.	Debit side	Credit side
			Total	Total
			Amount (₹)	Amount (₹)

Q3. What are the Limitations of a Trial Balance?

Answer:

Agreement of Trial Balance is not a conclusive proof of accuracy. In other words, in spite of the agreement of the trial balance some errors may remain. These may be of the following types:

1. Transaction has not been entered at all in the journal.
2. A wrong amount has been written in both columns of the journal.
3. A wrong account has been mentioned in the journal.
4. An entry has not at all been posted in the ledger.
5. Entry is posted twice in the ledger.

Q4. What are the Methods of Preparation of a Trial Balance?

Answer:

1. **Total Method**

   Total of debit and credit side of each ledger account is straightaway transferred to the Trial Balance it is also called as Gross Trial Balance.

   This method is inconvenient and not popular since financial statements cannot be prepared through it.

2. **Balance Method**

   Differential balance of each ledger account is transferred to Trial Balance. It is also called as Net Trial Balance.

   This method is simple and scientific and helps in preparation of financial statements.

3. **Total and Balance Method**

   Combination of above two methods is called Total and Balance Method.

   Under this method Trial Balance contains 7 columns.

   Example:

   From the following ledger extracts relating to the business of X and Co. as on March 31, 2016, prepare the trial balance as per:

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

Dr. **Cash Account** Cr.

Particulars	₹	Particulars	₹
To Capital A/c	10,000	By Furniture A/c	3,000
To Ram's A/c	25,000	By Salaries A/c	2,500
To Cash Sales	500	By Shyam's A/c	21,000
		By Cash Purchases	1,000
		By Capital A/c	500
		By Balance c/d	7,500
	35,500		35,500

Dr. **Furniture Account** Cr.

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

Dr. **Salaries Account** Cr.

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

Dr. **Shyam's Account** Cr.

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

Dr. **Purchases Account** Cr.

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

Dr. **Purchases Return Account** Cr.

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

Dr. **Ram's Account** Cr.

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

Dr. **Sales Account** Cr.

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

Dr. **Sales Returns Account** Cr.

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

Dr. **Capital Account** Cr.

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

Answer :

1. Total Method

Trial Balance of X and Co. as at 31.03.2016

Sl. No.	Name of Account	Total Debit Items ₹	Total Credit Items ₹
1.	Cash A/c	35,500	28,000
2.	Furniture A/c	3,000	
3.	Salaries A/c	2,500	
4.	Shayam's A/c	21,500	25,000
5.	Purchase A/c	26,000	
6.	Purchase Returns A/c		500
7.	Ram's A/c	30,000	25,100
8.	Sales A/c		30,500
9.	Sales Returns A/c	100	
10.	Capital A/c	500	10,000
		1,19,100	1,19,100

2. Balance Method

Trial Balance of X and Co. as at 31.03.2016

Sl. No.	Name of Account	Debit Balance ₹	Credit Balance ₹
1.	Cash A/c	7,500	
2.	Furniture A/c	3,000	
3.	Salaries A/c	2,500	
4.	Shayam's A/c		3,500
5.	Purchase A/c	26,000	
6.	Purchase Returns A/c		500
7.	Ram's A/c	4,900	

8.	Sales A/c		30,500
9.	Sales Return A/c	100	
10.	Capital A/c	-	9,500
		44,000	44,000

3. Total and Balance Method

Trial Balance of X as at 31.03.2016

Sl. No.	Name of Account	L.F.	Debit Balance (₹)	Credit Balance (₹)	Debit Balance (₹)	Credit Balance (₹)
1.	Cash A/c		7,500		35,500	28,000
2.	Furniture A/c		3,000		3,000	
3.	Salaries A/c		2,500		2,500	
4.	Shayam's A/c			3,500	21,500	25,000
5.	Purchase A/c		26,000		26,000	
6.	Purchase Returns A/c			500		500
7.	Ram's A/c		4,900		30,000	25,100
8.	Sales A/c			30,500		30,500
9.	Sales Returns A/c		100		100	
10.	Capital A/c			9,500	500	10,000
	Total		44,000	44,000	1,19,000	1,19,000

Q5. What is a adjusted Trial Balance (Through Suspense Account)?

Answer:

- If the two sides of Trial Balance do not agree, it implies that there are certain one sided errors in recording of transactions in books of account.
- In such case the difference in Trial Balance is passed in a separate Account called Suspense Account until the errors are located.
- When all the errors are located suspense account automatically closes. Hence, it is treated as a temporary Account created to avoid delay in preparation of statements.

Q6. What are the rules of preparing the Trial Balance?
Answer:

Debit	Credit
↓	↓
Balances of • Assets A/c • Cash and Bank • Expenses A/c • Losses • Drawings	Balances of • Liabilities A/c • Capital A/c • Income A/c • Profits

Example: A bookkeeper extracted the following Trial Balance as on 31st March, 2009:

Heads of Account	Dr. Balance ₹	Cr. Balance ₹
Furniture	20,000	—
Capital	—	2,00,000
Debtors	2,00,000	—
Stock (1st April, 2008)	1,04,000	—
Creditors	—	80,000
Trade Expenses	50,000	—
Sales	—	8,58,000
Wages	30,000	—
Stock (31st March, 2009)	98,000	—
Machinery	—	50,000
Purchases	6,25,000	—
Wife's loan to the business	50,000	—
Discount Allowed	—	4,000
Drawings made by the Proprietor	—	45,000
Motor Van	60,000	—
	12,37,000	12,37,000

You are required to:
(i) State the errors giving reasons;
(ii) Redraft the Trial Balance correctly.

Solution:

(i) (a) Stock on 31st March, 2009, will not appear in the Trial Balance because it has not yet been brought into account.
(b) Machinery is an asset and thus will appear in the debit column.
(c) Wife's loan to the business is a liability. It will appear in the credit column.
(d) Discount allowed, being an expense, will appear in the debit column.
(e) Drawings made by the proprietor is a decrease of capital (i.e., decrease of proprietor's claim from the business). It will appear in the debit column.

(ii) **Trial Balance**
as on 31st March, 2009

Heads of Account	L.F.	Dr. Balance ₹	Cr. Balance ₹
Furniture		20,000	
Capital			2,00,000
Debtors		2,00,000	
Stock (1st April, 2008)		1,04,000	
Creditors			80,000
Trade Expenses		50,000	
Sales			8,58,000
Wages		30,000	
Machinery		50,000	

Purchases		6,25,000	
Wife's loan to the business			50,000
Discount Allowed		4,000	
Drawings made by the Proprietor		45,000	
Motor Van		60,000	
		11,88,000	11,88,000

Notes: At the time of correction of the Trial Balance, students should note the following:

1. All assets and expense account will show a debit balance.
2. All liabilities and income account will show a credit balance.

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. Methods of preparation of Trial Balance are:
   (a) Balance Method
   (b) Total Method
   (b) Total and Balance Method
   (d) All of these
2. Trial Balance is a:
   (a) Statement (b) Account
   (c) Summary (d) Ledger
3. The preparation of trial balance is for:
   (a) Locating errors of commission
   (b) Locating errors of principle
   (c) Locating clerical errors
   (d) All of the above

4. The Trial Balance of M/S RAM & Co. shows closing Stock of ₹ 30,000. It will be recorded in:
   (a) Trading account (b) Profit and Loss account
   (c) Balance Sheet (d) Both (a) and (c)
5. Difference of totals of both debit and credit side of trial balance is transferred to:
   (a) Trading account (b) Suspense account
   (c) Difference account (d) Miscellaneous account
6. Trial Balance under balance method is known as:
   (a) Gross Trial Balance (b) Net Trial Balance
   (c) Simple Trial Balance (d) Trial Balance Appropriation
7. A Trial Balance contains the balances of:
   (a) Only Personal and Real accounts
   (b) Only Real and Nominal accounts
   (c) Only Nominal and Personal accounts
   (d) All accounts
8. Trial Balance is prepared on:
   (a) End of the year
   (b) A particular date
   (c) For the period ending ___
   (d) Both "a" and "b"
9. Balances of the Accounts are transferred to:
   (a) Trial Balance (b) Trading Account
   (c) Profit & Loss Account (d) Balance Sheet
10. A list which contains balances of accounts to know whether the debit and credit balances are matched.
    (a) Balance Sheet (b) Day Book
    (c) Journal (d) Trial Balance
11. Which of the following is not a process in the preparation of a Trial Balance?
    (a) Recording (b) Summarizing
    (c) Classifying (d) Interpretation

12. Which of the following in Trial Balance is contradictory to each other? ________.
   (a) Inventory and Drawings
   (b) Sales and Purchase Return
   (c) Carriage Inward and Outward
   (d) Trade Receivable and Liability
13. Trial Balance creates______ accuracy.
   (a) Principle (b) Arithmetical
   (c) Clerical (d) None.
14. Which of the following will not affect the agreement of Trial Balance?
   (a) An amount of purchase of ₹ 10,000 recorded in Cr. A/c as ₹ 1,000
   (b) Customer account debited with the amount of cash received
   (c) An Entry of debit of ₹ 1,000 was credit with twice the amount.
   (d) An Entry posted twice in the ledger.
15. Bhandari's trial balance was showing difference of ₹ 5,000 (debit side exceeds). While checking of total sales register, he found that the total is over-cast by ₹ 2,000. After correction in sales register what would be the difference in his trial balance.
   (a) Debit side exceeds by ₹ 7,000
   (b) Debit side exceeds by ₹ 5,000
   (c) Debit side exceeds by ₹ 3,000
   (d) Credit side exceeds by ₹ 3,000
16. Closing stock in the trial balance implies that.
   (a) It is already adjusted in the opening stock.
   (b) It is adjusted in Sales A/c.
   (c) It is adjusted in the Purchase A/c.
   (d) None of these.
17. Opening and Closing Balance of Debtors A/c were ₹ 30,000 and 40,000 respectively cash collected from the debtors during the year was ₹ 2,40,000. Discount allowed to debtors for timely payment amounted to ₹ 15,000 and bad debts written off were ₹ 10,000. Goods sold on credit were:
   (a) ₹ 2,55,000 (b) ₹ 2,45,000
   (c) ₹ 2,95,000 (d) ₹ 2,75,000

18. Salaries paid ₹ 4,500 is shown in credit side of trial balance. In the total of trial balance the debit side will be short by __________
   (a) short by ₹ 4,500 (b) excess by ₹ 4,500
   (c) short by ₹ 9,000 (d) excess by ₹ 9,000.
19. ____________ is prepared to ascertain the arithmetical accuracy of posting and balancing
   (a) Cash Book (b) Journal
   (c) Trial Balance (d) Bank Reconciliation Statement
20. Find out the total of Debit side of the Trial Balance from the following list of balances extracted from the books of Mr. Yoshin as on 31st March, 2014.

Particulars	Amount (₹)	Particulars	Amount (₹)
Capital	2,00,000	Discount allowed	820
Debtors	15,200	Discount received	1,030
Creditors	12,960	Rent	14,670
Purchases	92,670	Opening Stock	12,060
Sales	1,16,850	Loans payable	56,000
Interest paid	2,310	Returns Inward	27,430

   (a) ₹ 1,65,160 (b) ₹ 1,65,370
   (c) ₹ 1,37,730 (d) None of the above
21. Agreement of Trial Balance is not a ______ proof of accuracy.
   (a) submissive (b) inclusive
   (c) exhaustive (d) conclusive
22. Trial Balance is a statement which shows the ________ or the ________ of all the accounts.
   (a) opening balances, closing balances
   (b) debit balances, credit balances
   (c) positive balances, negative balances
   (d) balances, totals
23. Ledger balances of M/s Nagarjun traders are as follows: Capital ₹9,00,000, Computer ₹1,30,000, Machinery ₹4,50,000, office furniture ₹1,50,000, Investments ₹3,00,000, salaries ₹2,10,000 sales ₹16,00,000, postage ₹1,20,000, freight ₹1,21,000, Purchases ₹9,15,000, Rent ₹28,000, cash in hand ₹48,000, Bank overdraft ₹20,000, Creditor

₹1,00,000, Debtor ₹1,48,000. The total of Trial Balance will be:

(a) ₹26,40,000 (b) ₹24,99,000
(c) ₹26,20,000 (d) ₹25,72,000

24. All the following statements are correct except ________.
(a) trial balance is a statement not an account.
(b) trial balance is always prepared at the end of the financial year.
(c) agreement of Trial Balance is not a conclusive proof of accuracy.
(d) trial balance will tally even if an entry is posted twice in the ledger.

25.

S. No.	Account heads	Debit (₹)	(Credit (₹)
1.	Sales		15,000
2.	Purchases	10,000	
3.	Miscellaneous Expenses	2,500	
4.	Salaries		2,500
	Total	12,500	17,500

The difference in trial balance is due to:
(a) Wrong placing of sales account.
(b) Wrong placing of salaries account.
(c) Wrong placing of miscellaneous expenses account.
(d) Wrong placing of all accounts.

26. A suspense account facilitates the preparation of ________ even if the ________ has not been tallied.
(a) trial balance, financial statements
(b) ledger, trial balance
(c) trial balance, ledger
(d) financial statements, trial balance.

27. ₹ 2,000 received by way of commission and entered correctly in cash book, is posted to the debit side of the commission account. In the trial balance:
(a) The debit total will be more by ₹ 2000 than the credit total.
(b) The debit total will be more by ₹ 4000 than the credit total.
(c) The credit total will be more by ₹ 4000.
(d) The credit total will be more by ₹ 2000.

28. The trial balance is prepared for:
(a) Locating clerical errors
(b) Locating errors of principle
(c) Locating errors of omission
(d) All of the above.

29. Ram started business with ₹10,000 Cash and ₹2,000 furniture. Sales amounted to ₹50,000 including ₹5,000 cash sales. ₹10,000 Sales were outstanding at the end of the year. Purchase amounted to ₹30,000 including ₹ 10,000 cash purchases ₹15,000 has been paid to suppliers. Expenses paid during the year ₹19,300. Trial Balance total will be:

(a) ₹67,000 (b) ₹57,000
(c) ₹62,000 (d) ₹49,300

30. Given below are the ledger balances of a professional firm: Capital ₹4,00,000, Computer ₹25,000, Air Conditioner and Furniture ₹1,00,000, Fixed deposits ₹2,00,000, Salaries ₹8,00,000, Fees received ₹12,00,000. Traveling expenses ₹1,50,000, Rent and office expenses ₹2,40,000, Cash Balances ₹1,80,000, Bank Overdraft ₹ 95,000. The total of the Trial Balance will be:

(a) ₹16,00,000 (b) ₹16,95,000
(c) ₹14,50,000 (d) ₹15,00,000

31. Suspense Account is used to rectify those errors which have been located:
(a) Before preparation of Trial Balance
(b) After preparation of Trial Balance
(c) Before or after preparation of Trial Balance
(d) After preparation of Final Accounts.

32. Which of the following errors is not revealed by the trial balance?
(a) Wrong amount entered in the books of original entry.
(b) Wrong amount entered in the sales bill.
(c) Complete omission of an entry from the books of original entry.
(d) All of the above.

33. Agreement of Trial Balance ensures arithmetical accuracy, but is not a_______ proof of accuracy.
    (a) submissive (b) inclusive
    (c) exhaustive (d) conclusive
34. If a purchase return of ₹2,000 has been wrongly posted to the debit the sales returns account, but has correctly been entered in the suppliers account, the total of the trial balance would show:
    (a) The debit side to be ₹2,000 more than the credit side
    (b) The debit side to be ₹4,000 more than the credit side
    (c) The credit side to be ₹2,000 more than the debit side
    (d) The credit side to be ₹4,000 more than the debit side.

ANSWER

1.	(d)	2.	(a)	3.	(c)	4.	(c)	5.	(b)
6.	(b)	7.	(d)	8.	(b)	9.	(a)	10.	(d)
11.	(d)	12.	(d)	13.	(b)	14.	(d)	15.	(a)
16.	(c)	17.	(d)	18.	(c)	19.	(c)	20.	(a)
21.	(d)	22.	(b)	23.	(c)	24.	(b)	25.	(b)
26.	(d)	27.	(b)	28.	(a)	29.	(a)	30.	(b)
31.	(b)	32.	(d)	33.	(d)	34.	(b)		

SHORT PRACTICE QUESTIONS

1. What is Trial Balance. Explain any two method of preparing of Trial Balance.
2. Does the Trial Balance prove that the books are absolutely correct?

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

1995 - May [5] State with reasons whether following statement is true false:
(h) A tallied Trial Balance will not reveal compensating errors and errors on account of wrong balancing. (1.5 marks)

Answer:

Partly True and Partly False. A tallied Trial Balance will not reveal compensating errors but the Trial Balance will not tally due to the existence of errors on account of wrong balancing.

1995 - Nov [5] State with reasons whether following statement is true false:
(1) Trial Balance is prepared after preparing the Profit and Loss Account. (1.5 marks)

Answer:

False: Trial balance is prepared before preparation the profit and loss account. Through Trial Balance, all Ledger Balances are put on trial to ascertain whether equality of debit and credit is maintained. This is done before preparation of final accounts.

1996 - May [5] State with reasons whether following statement is true false:
(2) The trial balance checks the honesty of the book-keeper. (2 marks)

Answer:

False: The Trial Balance helps to establish the arithmetical accuracy of ledger books.

1997 - Nov [5] State with reasons whether following statement is true false:
(2) The Trial balance ensures the arithmetical accuracy of the books. (2 marks)

Answer:

True: The Trial Bainnce helps to establish the arithmetical accuracy of ledger balances.

1999 - Nov [5] State with reasons whether following statement is true false:
(ii) Tallying of the trial balance only proves arithmetical accuracy. (2 marks)

Answer:
True: Trial balance helps to establish the arithmetical accuracy of ledger books. A tallied trial balance will not reveal errors of principle and compensating errors.

2000 - May [5] State with reasons whether following statement is true false:
(vi) A tallied trial balance means that the books of accounts have been prepared as per accepted accounting principles. (2 marks)

Answer:
False: Trial balance only checks the arithmetical accuracy of books. Errors of principles and errors of omissions will not affect the agreement of the Trial Balance.

2001 - Nov [5] State with reasons whether following statement is true false:
(ix) The Trial Balance does not ensure the arithmetical accuracy of the books. (2 marks)

Answer:
False: Trial balance helps to establish the arithmetical accuracy of ledger balances. However, a tallied trial balance will not reveal errors of principle and compensating errors.

2003 - May [5] State with reasons whether following statement is true false:
(viii) A Tallied trial balance means that the books of accounts have been prepared as per accepted accounting principles. (2 marks)

Answer:
False: Trial balance only checks the arithmetical accuracy of the books. Errors of principle and errors of commission will not affect the agreement of the trial balance.

2004 - May [5] State with reasons whether following statement is true false:
(ii) The Trial Balance does not ensure the arithmetical accuracy of the books (2 marks)

Answer:
False: Trial Balance helps to establish the arithmetical accuracy of ledger balances. However, a tallied trial balance will not reveal errors of principle and compensating errors.

2004 - Nov [5] State with reasons whether following statement is true false:
(ii) Trial Balance is an absolute proof of the accuracy of the books of accounts. (2 marks)

Answer:
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 effect the agreement of trial balance.

2006 - May [5] State with reasons whether following statement is true false: (2 marks)
(iv) Closing Stock will never appear in the Trial Balance.

Answer:
False: When cost of goods sold or gross profit are given in Trial Balance, closing stock will appear in the Trial Balance.

SHORT NOTES

2006 - May [6] (ii) Objectives of preparing Trial Balance. (5 marks)

Answer:
Objectives of preparing Trial Balance:
The preparation of Trial Balance has the following objectives:
1. Trial balance enables one to establish whether the posting and other accounting processes have been carried out without committing arithmetical errors. In other words, the trial balance helps to establish arithmetical accuracy of the books.
2. Financial statements are normally prepared on the basis of agreed trial balance; otherwise the work may be cumbersome. Preparation of financial statements, therefore, is the second objective.
3. The trial balance serves as a summary of what is contained in the ledger; the ledger may have to be seen only when details are required in respect of an account.

PRACTICAL QUESTIONS

2019 - Nov [5] (a) An inexperienced book keeper has drawn up a Trial balance for the year ended 31st March, 2019.

Particulars	Debit (₹)	Credit (₹)
Provision for Doubtful Debts	250	–
Cash Credit Account	1,654	–
Capital	–	4,591
Trade payables	–	1,637
Due from customers	2,983	–
Discount Received	252	–
Discount Allowed	–	733
Drawings	1,200	–
Office Furniture	2,155	–
Carriage Inward	–	829
Purchases	10,923	–
Returns Inward	–	330
Rent & Rates	314	–
Salaries	2,520	–
Sales	–	16,882
Inventory	2,418	–
Provision for Depreciation on Furniture	364	–
Total	25,033	25,002

Draw up a corrected Trial Balance by debiting or crediting any residual errors to a Suspense account. (5 marks)

Answer:

Trial Balance
as on 31st March, 2019

Particulars	Debit (₹)	Credit (₹)
Provision for Doubtful Debts	-	250
Cash Credit Account	-	1,654
Capital	-	4,591
Trade Payables	-	1,637
Due from Customers	2,983	-
Discount Received	-	252
Discount Allowed	733	-
Drawings	1,200	-
Office Furniture	2,155	-
Carriage Inward	829	-
Purchases	10,923	-
Returns Inward	330	-
Rent & Rates	314	-
Salaries	2,520	-
Sales	-	16,882
Inventory	2,418	-
Provision for Depreciation on Furniture	-	364
Suspense Account (Balancing Figure)	1,225	-
Total	25,630	25,630

CHAPTER

2 Accounting Process

Unit: 4

Subsidiary Books

SELF STUDY QUESTIONS

Q1. What are Subsidiary Books and what are their advantages?

Answer:

In a business organisation, there are innumerable transactions in an accounting period. For recording all these transactions, Journal is subdivided into Books of Original Entries.

These are:

1. Cash Book
2. Purchase Daybook
3. Sales Daybook
4. Purchase Return Book
5. Sales Return Book
6. Bills Receivable Book
7. Bills Payable Book
8. Journal (Proper)

Advantages

1. **Division of work:** Posting of primary records can be assigned to different accounting clerks, hence processing is done faster and accurately.
2. **Specialisation and Efficiency:** Persons entrusted with particular portion of accounting work becomes efficient in handling the same.
3. **Saving of time:** Many persons perform the work at same time, hence the recording is done quickly.

4. **Availability of Information:** All information about particular class of transactions can be kept at a single place.
5. **Facilitates checking:** It makes easy to track transactions with extended details. Also, accounting work can be divided in such manner that the work of one person is automatically checked by another hence errors can easily be found.

Q2. Difference between Subsidiary Books and Principal Books.

Answer:

In subsidiary books all the details of particular transaction are recorded while the principal book will contain only the consolidated entry to facilitate the preparation of final accounts (financial statements)

Various Financial Books	
Principal Books	Subsidiary Books
⇓	⇓
• Ledgers	• Purchase Book • Sales Book • Purchase Return Book • Sales Return Book • Bills Receivable Book • Bills Payable Book • Journal Proper • Cash Book – Simple Cash Book – Two column Cash Book – Three column Cash Book – Petty Cash Book

Q3. What do you mean by Purchases Book/Purchases Journal?

Answer:

It keeps the chronological record of all credit purchases made by the business.

Any property or asset not intended for sale is not recorded in this book.

Format

Date	Particulars			Amount (₹)

Posting the Purchase Book

At the end of a period, the total of Purchase Journal is posted to the debit side of Purchase Account to complete the double entry for all transaction which were earlier credited to Supplier's Account.

Q4. What do you understand by Sales Book/Sales Journal?

Answer:

It keeps the chronological record of all credit sales of goods made by the business.

Cash sales and sale of assets are not recorded in this book. The format of Sales Journal is almost identical to Purchase Journal.

Posting the Sales Book

The amount of every item is posted separately to debit side of customer Accounts and at the end of the period, the total is posted to credit side of sales Account to complete the double entry for all the transactions.

Q5. What do you mean by Sales Return Book or Return Inward Book?

Answer:

It keeps the record of goods previously sold which are returned due to various reasons by the customers. The method of recording is similar to Purchase Journal.

Q6. What do you mean by Purchase Returns or Return Outward Book?

Answer:

It keeps record of goods previously purchased which are returned to the supplier due to various reasons such as defective, wrong supplies, etc.

Posting of the Return Books

Purchase Return Book

↓

Total Returns made to suppliers

↓

Debit - Supplier's Account
Credit - Returns Outward Account

↓

Debit note issued to supplier

Sales Return Book

↓

Total Returns made by customers

↓

Debit Returns Inward Account
Credit - Customer's Account

↓

Credit note issued to customer

Bills Receivable Book

↓

Record of Bill of exchange prepared by the seller of goods and accepted by purchaser. The acceptance so received is bills receivable for seller

↓

Debit – Bills Receivable A/c
Credit – Parties from whom bills are received

Bills Payable Book

↓

Record of acceptance given to the seller. The acceptance so given is Bills payable for purchaser.

↓

Debit – Parties who drew bills
Credit – Bills Payable A/c

Q7. What is the Importance of Journal?

Answer:

For all the residual entries for which no special books are maintained Journal (Proper) is made.

Types of Journal Entries Passed

1. **Opening Entries:** Entries recorded at the beginning of the accounting year. These includes opening balances of business assets, liabilities and capital.

Sundry Assets A/c	Dr.
To Sundry Liabilities A/c	
To Capital A/c	

2. **Closing Entries:** Entries passed at the end of the accounting year to transfer the balance of nominal accounts to Profit and Loss A/c.
3. **Rectification Entries:** Entries passed to rectify the error in books of accounts.
4. **Transfer Entries:** From one account to another.
5. **Adjusting entries:** Adjustment related to Outstanding expenses, Prepaid Expenses, Depreciation, Interest on capital, etc.
6. **Entries on dishonour of Bills:** Journal entry to be passed when the person who earlier accepted the bill has shown inability to pay it.
7. **Miscellaneous Entries:** Other entries such as discount allowed or discount received, transfer of Net Profit to capital A/c, bad debts, etc.

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. The total of the Purchase Day Book is posted periodically to the:
   (a) Debit of Purchases A/c (b) Credit of Purchases A/c
   (c) Cash Book (d) None of these
2. Total of the sales book for March indicates:
   (a) Total sales for the month
   (b) Total credit sales for the month
   (c) Total cash sales for the month
   (d) Total sales less sales return
3. Goods sold for cash ₹10,000 plus 10% sales tax. Sales A/c will be credited by :
   (a) ₹11,000 (b) ₹10,000
   (c) ₹ 9,000 (d) None

4. PURCHASE Book is used to record:
   (a) All purchase of goods
   (b) All credit purchases
   (c) All credit purchases of goods
   (d) All credit purchases of assets
5. A__________ is sent to a customer when he returns goods:
   (a) debit note (b) credit note
   (c) proforma invoice (d) none of the above.
6. Purchase of Fixed Assets on credit basis is recorded in:
   (a) Purchase Book (b) Cash Book
   (c) Journal Proper (d) Journal
7. The source document or voucher used for recording entries in sales Book is:
   (a) Invoice received (b) Invoice sent out
   (c) Credit notes sent out (d) Debit notes received
8. Trade discounts are:
   (a) Recorded in the books
   (b) Not Recorded in the books
   (c) Not used for determining the net price
   (d) Used for specific purposes in accounting
9. Total of Sales Book will be posted:
   (a) In Debit side of Sales Account
   (b) In Credit side of Purchases Account
   (c) In Credit side of Sales Account
   (d) In Debit side of Sales return account
10. A note sent by buyer on return of goods is:
   (a) Debit Note (b) Credit Note
   (c) Return Note (d) None
11. Which of the following is not a subsidiary book?
   (a) Sales Book (b) Purchases Book
   (c) Cash Book (d) B/R Book.
12. Purchase of furniture on credit should be recorded in______
   (a) purchase book (b) sales book
   (c) cash book (d) journal

13. The Balance of Sales Day Book is ₹ 25,000. ₹ 5000 were recovered from debtors. Then balance of Day Book will be transferred by which amount?
    (a) ₹ 25,000 (b) ₹ 5,000
    (c) ₹ 20,000 (d) ₹ 10,000
14. Total of the Purchase Return Book is posted to the _______ side of Purchase Return Account in the ledger:
    (a) Debit (b) Credit
    (c) No where (d) None of these.
15. Debit note issued are used to prepare ________
    (a) sales return book (b) purchase return book
    (c) journal proper (d) purchase book
16. A bill receivable of ₹2,500, which was received from a debtor in full settlement for a claim of ₹2,750 is dishonoured. In which book of original entry, will you record the transaction?
    (a) Purchase return Book (b) Bill receivable book
    (c) Purchase book (d) Journal Proper (General Journal)
17. The following are some of the transactions of M/s. Bahubali and Sons of the year 2013 as per their scrap book:
    Sold to M/s Gupta & Co. on Credit
    30 Shirts @ ₹180 per Shirt
    20 Trousers @ ₹100 per Trouser
    Sold 50 Shirts to M/s Jain Co. @ 190 per shirt for cash.
    Sold 13 overcoats to M/s cheap Co. @ 490 per overcoat on credit.
    Sold furniture to M/s SS Ltd. on credit for ₹1,000/-
    All transactions are subject to 10% trade discount, 2% Cash discount and sales tax charged 10%.
    What will be the total of sales Book?
    (a) ₹13,632.30 (b) ₹22,849.20
    (c) ₹23,828.00 (d) ₹14,632.30

ANSWER

1.	(a)	2.	(b)	3.	(b)	4.	(c)	5.	(b)
6.	(c)	7.	(b)	8.	(b)	9.	(c)	10.	(a)
11.	(c)	12.	(d)	13.	(a)	14.	(b)	15.	(b)
16.	(d)	17.	(a)						

SHORT PRACTICE QUESTIONS

1. Which entries can be passed through Journal?
2. What do you mean by subsidiary books and list out its advantages?

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

1994 - Nov [5] State with reason whether following statement is true or false:
(1) The Sales Day Book is a part of the Ledger. (2 marks)
Answer:
False: Sales day book is a book of prime entry and hence it is a part of the Journal.

1996 - Nov [5] State with reason whether following statement is true or false:
(9) Purchases Book records all purchases of goods. (2 marks)
Answer:
False: Only credit purchases of goods dealt in or of materials and stores used in the factory are recorded in Purchases Book.

2000 - Nov [5] State with reason whether following statement is true or false:
(6) The Purchase Day-Book is a part of the Ledger. (2 marks)

Answer:

False: Purchase Day-Book is a book of prime entry and hence it is a part of the journal.

2001 - Nov [5] State with reason whether following statement is true or false:
(vii) The Sales Day-book is a part of the Ledger. (2 marks)

Answer:

False: Sales Day-Book is a book of prime entry and hence it is a part of the Journal.

2002 - May [5] State with reason whether following statement is true or false:
(4) Purchases Book records all credit purchases of goods. (2 marks)

Answer:

True: All credit purchases of goods dealt in or of materials and stores used in the factory are recorded in purchases book.

2002 - Nov [5] State with reason whether following statement is true or false:
(f) Wrong casting of subsidiary books does not affect the Trial Balance. (2 marks)

Answer:

False: Wrong costing of subsidiary books affects the agreement of trial balance.

2003 - May [5] State with reasons whether the following statement is true or false:

(v) The debit notes issued are to prepare Sales Return Book. (2 marks)

Answer:

False: The source document for this book is credit note. When goods are received along with the debit note, the seller acknowledges the same by sending the credit note to the customer.

2003 - Nov [5] State with reason whether following statement is true or false:

(iv) The return of goods by a customer should be debited to Return Outward Account. (2 marks)

Answer:

False: It is debited to Return Inwards A/c.

2004 - May [5] State with reason whether following statement is true or false:

(iv) The Sales Day-book is a part of the Ledger. (2 marks)

Answer:

False: Sales Day-Book is a book of prime entry and hence it is a part of the Journal.

2005 - May [5] State with reason whether following statement is true or false:

(xi) Where subsidiary books are maintained, journal is not required. (2 marks)

Answer:

False: Journal is required even when subsidiary books are maintained. This is so because many entries such as opening and closing entry, rectification entry etc. are recorded in journal.

2005 - Nov [5] State with reason whether following statement is true or false:

(iii) Sales day book is the summary of both cash and credit sales of the concern. (2 marks)

Answer:

False: The sales book is a register specifically kept to record credit sales of goods dealt in by the firm, cash sales are entered in the cash book and not in the sales book.

2006 - Nov [5] State with reason whether following statement is true or false:

(ii) The transaction of 'Return of goods by a customer' to whom money is refunded immediately will not be recorded in "Sales Return Book". (2 marks)

Answer:

True: The transaction will be recorded in the Cash Book.

2006 - Nov [5] State with reason whether following statement is true or false:

(xii) The total of purchase return-book is posted to the debit side of purchase return account. (2 marks)

Answer:

False: The total of purchase return book is posted to the credit side of purchase return account.

DISTINGUISH BETWEEN

2001 - Nov [6] Briefly explain the difference between the following:

(b) Sales Day-book and Sales Account. (5 marks)

Answer:

The Sales Day-Book is a register specially kept to record credit sales of goods dealt in by the firm, cash sales are entered in the Cash Book and not in the Sales Day Book. Credit sales of things other than the goods dealt in by the firm are not entered in the Sales Day Book; they are journalised. It is a subsidiary book and posting is made from it to the sales account and accounts of the customers. The total of the Sales Day Book shows the credit sales made during any particular day; the amount is credited to the sales account.

Sales Account is a final record and postings are made to it from Cash Book (cash sales) and Sales Day Book (credit sales). Sales Account is maintained in the ledger in the manner, the other accounts are maintained. Sales Account is a nominal account and its balance is used for ascertaining gross profit or gross loss.

CHAPTER 2 Accounting Process

Unit: 5 **Cash Book**

SELF STUDY QUESTIONS

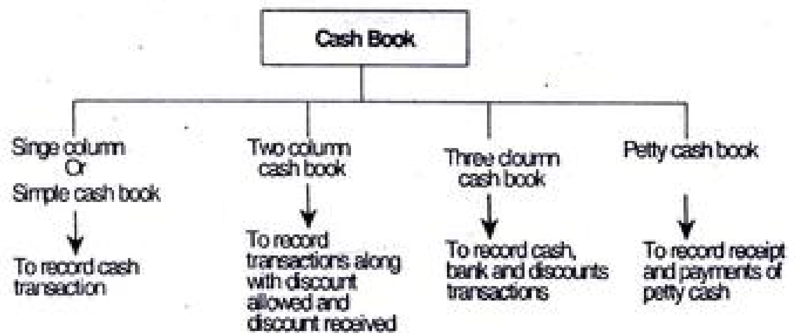
Q1. What is a Cash Book? It is a Subsidiary Book as well as a Principal Book?

Answer:

- It is a book of primary entry in which cash and bank transactions of a business are recorded in a chronological order.
- Cash book acts as a both - a book of original entry and a ledger [Cash A/c and Bank A/c]. It records transactions concerning cash receipts and payments.
- A cash book has two sides-
  - → Debit - Records cash and cheque received,
  - → Credit - Records cash and cheque payments.

Q2. What are the Kinds of Cash Book? How is the posting done in Cash Book?

Answer:



Simple Cash book

- It is known as single column Cash book because it contains only one amount column of cash.

Specimen

Cash Book (Single Column)

Dr. Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount

Two Column Cash book

- It is so called because it has two amount columns on both sides-cash column and discount column.
- Discount column on debit side represents discount allowed which discount column on credit side represents discount received.

Specimen Two Column Cash Book

Dr. Cr.

Date	Particulars	LF	Disc.	Amt.	Date	Particulars	LF	Disc.	Amt.

Three Column Cashbook

It is so called because it contains three amount columns: Discount column, Cash column, Bank column.

Discount: Records discount received and allowed.

Cash: To record cash received and paid.

Bank: Records money deposited and money withdrawn from bank.

When triple column cashbook is prepared there is no need of preparing bank account in ledger.

Specimen Triple Column Cash Book

Dr. Cr.

Date	Particulars	LF	Discount	Cash	Bank	Date	Particulars	LF	Discount	Amount

Concept of Contra Entry:

- Entry which involves both cash and bank transactions is called Contra Entry.
- These entries are posted on both sides of a cash book - one in cash column and other at opposite side in bank column.
- Letter 'C' is written in LF column showing nature of entry as contra entry.
- **Example:** Cash withdrawn from bank ₹ 50,000.

Journal entry:

Cash A/c	Dr.	50,000	
To Bank A/c			50,000
[Being cash withdrawn from bank]			

Posting in Triple Column Cashbook:

Dr. Cr.

Date	Particulars	LF	Discount	Cash	Bank	Date	Particulars	LF	Discount	Amount
	To Bank A/c	C	-	50,000	-		By Cash A/c	C	-	50,000

Posting the Cash Book Entries:

- Transactions recorded on debit side of cashbook are posted to credit of respective ledger accounts.
- Transactions recorded on credit side of cashbook are posted to debit of respective ledger accounts.
- Contra entries are not posted into ledger accounts.

Illustration:

Enter the following transactions of M/s Jingle Trading Company in cash book with triple column, and balance the cash book as on 31st December, 2017.

Date (2017)	Particulars
Dec. 1	Cash in hand ₹ 4,000; Bank overdraft ₹ 1,000.
Dec. 3	Received a cheque from Raj ₹ 200 and allowed him discount ₹ 40.
Dec. 7	Raj's cheque deposited into bank.

Dec. 10	Withdrawn from bank for office use ₹ 800
Dec. 12	Paid Bills payable by cheque ₹ 600
Dec. 15	Chéque received from Chandan ₹ 2,400 against due of ₹ 2,450
Dec. 20	Issued cheque for petty cash ₹ 100
Dec. 26	Paid to Sneha by cheque ₹ 920 Discount Received ₹ 30.
Dec. 28	Cash sales ₹ 900

Solutions:

Cash Book

Dr. Cr.

Date	Particulars	LF	Disc.	Cash	Bank	Date	Particulars	LF	Disc.	Cash	Bank
2017						2017					
Dec. 1	To balance b/d		-	4,000	-	Dec. 1	By Balance b/d		-	-	1000
Dec. 3	To cheque in hand A/c		40	200	-	Dec. 7	By Bank A/c	C	-	200	-
Dec. 7	To Cash A/c	C	-	-	200	Dec. 10	By Cash A/c	C	-	-	800
Dec. 10	To Bank A/c	C	-	800	-	Dec. 12	By Bills Payable A/c		-	-	600
Dec. 15	To Chandan		50	-	2,400	Dec. 20	By Petty Cash A/c		-	-	100
Dec. 28	To Sales A/c		-	900	-	Dec. 26	By Sneha A/c		30	-	920
Dec. 31	To balance c/d		-	-	820		By Balance c/d			5,700	
			90	5,900	3,420				30	5,900	3,420
2018						2018					
Jan. 1	To balance b/d		-	5,700	-	Jan. 1	By balance b/d		-	-	820

Q3. What is a Petty Cash Book?

Answer:

- Petty means small. A book used to record petty cash expenses of the business is called petty cashbook.
- Petty cash book is maintained by petty cashier.
- It is treated either as a part of double entry system or as a memorandum book and balance at the end of year is shown as an asset.
- Impresst system of Petty Cash is followed:
- Under this system, a fixed sum of money is given to petty cashier for meeting expenses for a prescribed period. At the end of this period if entire amount is used for meeting expenses then the same fixed sum will be given to petty cashier for the next period.

Specimen of Petty Cashbook

Amount Received	Date	Particulars	Voucher No.	Total Amt. Paid	Analysis of Payment		
					Conveyance	Postage	Miscellaneous

Advantages of Petty Cash Book

- Time saved of main cashier
- Labour saved to draw cash book and posting in ledger
- Control over small payments.

Illustration:

Prepare Analytical Petty Cash Book on Imprest System from the following data:

2017

Jan. 1	Received ₹ 2,000 for Petty Cash	
Jan. 2	Paid Conveyance	₹100
Jan. 3	Paid Cartage	₹250
Jan. 5	Paid for Postage & Telegram	₹150
Jan. 10	Paid wages	₹700
Jan. 15	Bus fair	₹60
Jan. 20	Stationery	₹300
Jan. 30	Paid auto charges	₹40

Solutions :

Petty Cash Book

Receipts	Date (2017)	Particulars	Voucher No.	Total Amt. Paid	Conveyance	Cartage	Postage & Telegram	Wages	Stationary
2,000	Jan. 1	To Cash A/c	1						
	Jan. 2	By Conveyance A/c	2	100	100				
	Jan. 3	By Cartage A/c	3	250		250			
	Jan. 5	By Postage & Telegram A/c	4	150			150		
	Jan. 10	By Wages A/c	5	700				700	
	Jan. 15	By Conveyance A/c	6	60	60				
	Jan. 20	By Stationary A/c	7	300					300
	Jan. 30	By Conveyance A/c	8	40	40				
				1,600	200	250	150	700	300
		By Balance c/d		400					
2,000				2,000					
400		To Balance b/d							
1,600		To Cash A/c							

Posting The Petty Cashbook

Methods of Posting:

1. Total of various payment columns is to be debited to respective accounts directly.
2. Pass Journal Entry debiting various account in the analysis column and crediting the total cash.

Q4. How are the Entries for Sale through Credit/Debit Cards done?

Answer:

Nowadays, with digitalisation, a concept of Debit-Card and Credit Card has come into existence.

Debit cards are issued by bankers to their account holders to make instant payment; similarly, credit cards are issued on the basis of credit-worthiness of the customers, and subscription fees is collected by Banks.

These cards can be used to make payment to various vendors. The card is swiped and triplicate copy containing description of transaction is made and a copy is countersigned by the customer. Vendor collects copies of all credit sales done during the day and sends to its banker, for crediting his account and debiting th~ account of customers/credit card company.

Accounting entry for sale through credit or debit card:

Bank A/c Dr.
To Sales Account
[Being sale made through debit/credit card]

Commission A/c Dr.
To Bank Account
[Being commission changed]

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. The Balance of Petty Cash is:
   (a) An expense (b) Revenue
   (c) An asset (d) Liability
2. Cash book is a form of:
   (a) Trial balance (b) Ledger
   (c) Journal (d) All of the above
3. Small payments are recorded in a book called:
   (a) Cash Book (b) Small payments book
   (c) Purchase book (d) Petty cash book
4. If the debit and credit aspects of a transaction are recorded in the cash Book it is a:
   (a) Contra entry (b) Simple entry
   (c) Double entry (d) Single entry
5. What rate of commission is charged by the bank issuing the credit card?
   (a) 1% to 3% (b) 3% to 6%
   (c) 2% to 5% (d) 1% to 4%
6. Cheques received but deposited on the next day are recorded in:
   (a) Cash column of the cash book
   (b) Bank column of the cash book
   (c) Both of these
   (d) None of these
7. In petty cash Book, the system followed:
   (a) Accrual System (b) Imprest System
   (c) Cash System (d) None of these

8. Double entry in Cash Book is completed when:
   (a) Salaries are paid by cheque
   (b) Withdrawal of money from bank for personal use
   (c) Deposited cash into bank
   (d) None of these
9. Imprest amount – ₹ 500. What will be the amount of reimbursement if following expenses were incurred by the petty cashier during the month- Telephone = ₹ 150, Tiffin = ₹ 50, small Repairs = ₹ 30 general expenses = ₹ 100.
   (a) 300 (b) 170
   (c) 330 (d) 270
10. Interest received of ₹ 100 was recorded as interest paid. What will be the effect on cash balance?
    (a) Cash will reduce by 100.
    (b) Cash will increase by 200.
    (c) Cash will reduce by 200.
    (d) No effect on cash balance.
11. In three column Cash Book, when does contra entry occurs?
    (a) Withdrawal of cash from bank
    (b) Payment to creditors
    (c) Withdrawal of cash from bank for personal use
    (d) All of the above
12. What will be journal entry when cash is withdrawn from bank for personal use?
    (a) Drawings A/c debit, Bank A/c credit
    (b) Cash A/c debit, Bank A/c credit
    (c) Bank A/c debit, Drawings A/c credit
    (d) Bank A/c debit, Capital A/c credit
13. Rent due for the month of March will appear _________ of the cash book.
    (a) on the receipt side (b) on the payment side
    (c) as a Contra Entry (d) nowhere

14. Where two aspects of a transaction are posted in the Cash Book, such an entry is called
    (a) Double Entry (b) Debit Entry
    (c) Credit Entry (d) Contra Entry
15. Rent due for the month of March will appear_________ in the Cash book.
    (a) on the receipt side (b) on the payment side
    (c) as a contra entry (d) no where
16. Postage stamps purchased for ₹ 30 by business. This transaction will be recorded in:
    (a) Purchase book (b) Cash Book
    (c) Petty Cash Book (d) Journal
17. Petty cash may be used to pay
    (a) The expenses relating to postage and conveyance.
    (b) Salary to administrative staff
    (c) For the purchase of furniture and fixtures
    (d) For the purchase of raw material.
18. While balancing three column cash book, the discount columns are:
    (a) Totaled but not adjusted
    (b) Totaled and also adjusted
    (c) Totaled but not balanced
    (d) Balanced but not totaled
19. The Balance on the debit side of the bank column in Cash Book indicates
    (a) Total amount withdrawn from the Bank
    (b) Total amount deposited in the Bank
    (c) Cash at Bank
    (d) Bank overdraft
20. When two aspects in one transaction are recorded in the Cash Book itself, it is called:
    (a) Debit entry (b) Double entry
    (c) Single entry (d) Contra entry

Answer

1.	(c)	**2.**	(b)	**3.**	(d)	**4.**	(a)	**5.**	(d)
6.	(a)	**7.**	(b)	**8.**	(c)	**9.**	(c)	**10.**	(c)
11.	(a)	**12.**	(a)	**13.**	(d)	**14.**	(d)	**15.**	(d)
16.	(c)	**17.**	(a)	**18.**	(c)	**19.**	(d)	**20.**	(d)

SHORT PRACTICE QUESTIONS

1. What is Petty Cash book? What are the uses and advantages of Petty Cashbook.
2. Why is cashbook called book of Prime entry?
3. State difference between Single Column, Double Column and Triple Column Cash Book.

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

1996 - May [5] State with reasons whether the following statement is True or False:

(4) The balance in the Cash Book shows net income. (2 marks)

Answer:

False: The balance in the Cash Book shows cash in hand.

1997 - May [5] State with reasons whether the following statement is True or False:

(2) Discount account should be balanced in the cash book. (2 marks)

Answer:

False: Discount account is not maintained in Cash Book. But a Cash Book (Double Column or Three Column Cash Book) may have discount columns. These columns are not balanced, they are merely totalled. These totals on the receipt side and on the payments side are entered in the discount allowed account and discount received account respectively in the ledger.

1999 - May [5] State with reasons whether the following statement is True or False:

(iii) The balance in the Petty Cash Book represents the amount spent. (2 marks)

Answer:

False: The balance in the Petty Cash Book represents cash balance lying with the petty cashier.

2000 - May [5] State with reasons whether the following statement is True or False:

(viii) Discount account in Cash-book should be balanced. (2 marks)

Answer:

False: Discount account in Cash-book should not be balanced. Debit total of discount column represents discount allowed and that of credit side represents discount received.

2002 - Nov [5] State with reasons whether the following statement is True or False:

(b) Bank Column of the Cash-book will show only a Debit Balance. (2 marks)

Answer:

False: Bank column of the cash book will show credit balance if the bank account has an overdraft balance.

2003 - Nov [5] State with reasons whether the following statement is True or False:

(iii) If a cheque received is further endorsed, it must be entered on both sides of the Cash Book. (2 marks)

Answer:

True: When a cheque received is further endorsed, it must be entered on both sides of the cash book. The cash book is debited when the cheque is received and it is credited when it is endorsed in favour of somebody.

2005 - May [5] State with reasons whether the following statement is True or False:

(iv) Petty cash is an expense. (2 marks)

Answer:

False: Petty cash is an asset. It is shown on the asset side of the balance sheet under the heading 'Cash and bank balances.'

2006 - May [5] State with reasons whether the following statement is True or False:

(vi) Cash column of a Cash-book may show a debit or credit balance. (2 marks)

Answer:

False: Cash column of a cash book will always show a debit balance. Bank column of a cash book may show a debit or credit balance.

DESCRIPTIVE QUESTION

2006 - Nov [2] (c) State the advantages of Petty Cash-book. (3 marks)

Answer:

In a business, besides large payments, a number of small payments, such as conveyance, stationery, cartage, etc., have to be made. If all these payments are recorded in the cash book, it will become unwieldy. Also the main cashier will be overburdened with the work. Therefore, it is usual for firms to record these small payments, say, below ₹ 250, in a separate cash book known as petty cash book.

The advantages of the petty cash book are as follows:

(i) **Saving of Time:** Saving of time of the chief cashier.

(ii) **Control:** It provides control over small payments.

(iii) **Convenience in preparing Ledger Account:** The totals are only taken to post them into Ledger. No unnecessary details are to be given. Hence, it is convenient to post these directly into ledger.

(iv) **Rectification of mistakes:** The record of petty cash is checked by the head cashier, periodically, so that a mistake, if committed, is soon rectified.

CHAPTER

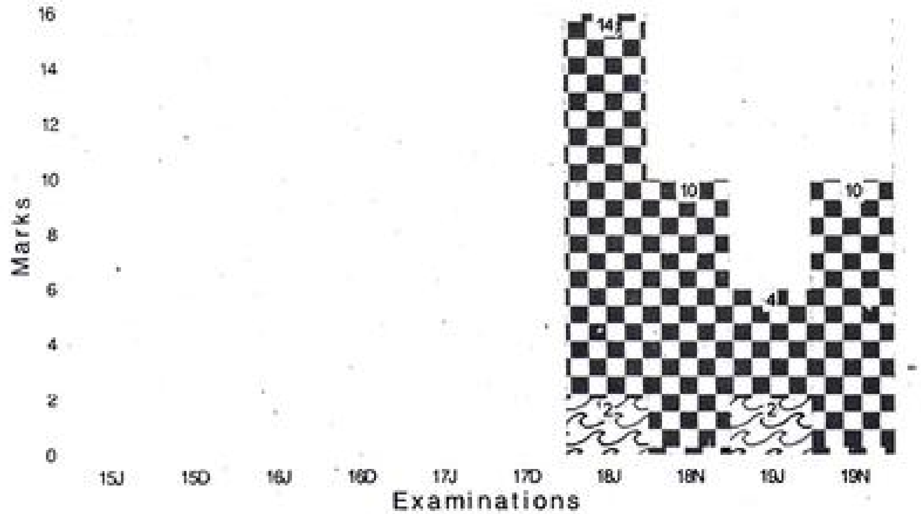
2 Accounting Process

Unit: 6 **Rectification of Errors**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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SELF STUDY QUESTIONS

Q1. What do you mean by Errors in Accounts?

Answer:

— Unintentional omission or commission of amounts and accounts in the process of recording the transactions are commonly known as errors.

— Due to errors, final accounts do not show true and fair view. So these errors need to be rectified.

— There can be many types of errors, some may affect trial balance while others may not. Even if they do not affect the trial balance, there occurrence may distort the true picture of books of accounts.

Illustrative Cases of Errors:

1. **Wrong Entry:** Wrong amount entered in front of entries.
   Example: Credit sales of ₹ 25,250 wrongly entered is sales Day Book as ₹ 25,520.
2. **Wrong Casting of Subsidiary Books:** Wrong totalling of subsidiary books due to various reasons and wrong amount being posted to corresponding ledger accounts.
   Example: Credit purchases ₹ 18,850 wrongly totalled and posted as 18,580 in Purchase A/c.
3. **Wrong Casting of Cash Books:** Wrong totaling may lead to wrong closing balance carried down for subsequent period.
4. **Wrong Posting from Subsidiary Books:** Amount wrongly posted to another side or another account.
5. **Wrong Casting of Ledger Balances:** Independent casting error occurred in cash book in Bank column.
   Example: Wrong totaiing error at one side of the ledger account hence wrong calculation of balance to be carried forward.

Q2. What are the Stages of Errors?

Answer:

- Recording Journal Entries
  - Error of Principle
  - Error of Omission
  - Error of Commission
- Posting in Ledger
  - Errors of Omission
    - Partial Omission
    - Complete Omission
  - Errors of Commission
    - Posting to Wrong Account
    - Posting to Wrong Side
    - Posting of Wrong Account
- Balancing Ledger Accounts
  - Wrong Totalling of Accounts
  - Wrong Balancing of Accounts
- Preparation of Trial Balance
  - Error of Omission
  - Error of Commission
    - Taking Wrong Account
    - Taking Wrong Amount
    - Taking to Wrong Side

Q3. What are the Types of Errors?

Answer:

- Preparation of Trial Balance
  - Error of Principle
  - Clerical Errors
    - Error of Omission
    - Error of Commission
    - Compensating errors

Type of Error	Meaning	Effect in Trial Balance
1. Error of Principle	When there is an error in complying accounting principles. **Example:** Treating capital expenditure as revenue expenditure	No Effect. Trial balance will agree
2. Error of Omission • Complete Omission • Partial Omission	Entry is totally eliminated from being recorded. Entry is recorded partially i.e. one aspect (debit or credit) is not recorded.	No. Effect on Trial Balance Trial Balance will be affected. It will not tally.
3. Error of Commission	Any type of error committed while recording entries **Example:** Writing wrong account — Wrong casting of subsidiary books	Trial balance will be affected. It will not agree

4.	Compensating Errors	When two errors are committed such that one compensates with that of another **Example:** Rahul's A/c was debited with ₹ 100 instead of ₹ 1,000 while Arun's A/c was debited with ₹ 1,000 instead of ₹ 100.	Trial balance will not be affected it will agree

Q4. What are the steps to Locate Errors?

Answer:

- First, check whether the Trial Balance is agreeing, if not, there is an inuication of errors. Even if trial balance has agreed still there may be errors (like compensating errors, errors of principle, etc.)
- Ensure that cash and bank balances have been transferred to the Trial Balance.
- Balance the ledger accounts again and check whether the right totals have been transferred to trial balance.
- Check the totals of subsidiary books again.
- Check opening balances.
- Check the posting of nominal accounts first.

All above points will locate the errors which are to be rectified.

Q5. How is Rectification of Errors done?

Answer:

Errors whether affecting the trial balance or not should be rectified. The process of rectifying errors is culled as rectification of errors.

Stage of error to be rectified:

(i) Before preparation of Trial Balance

(ii) After preparation of Trial Balance but before preparation of final Accounts

(iii) In the next accounting period (i.e. after preparation of final accounts)

Before preparation of Trial Balance: Errors located before preparation of Trial Balance can be one sided error or two sided errors.

In case of one sided errors:

- These errors affect only one side of account either debit side or credit side.

These errors may occur on account of following reasons:

(i) Wrong casting

(ii) Wrong balancing

(iii) Wrong posting

(iv) Wrong carry forward

(v) Omission of an amount in Trial Balance.

Rectification of such errors:

- No. Journal entry is to be passed for its rectification
- Only relevant accounts needs to be credited or debited

Example: Total of Purchase Book was ₹10,000 short.

Answer:

Rectification: Debit Purchase A/c with ₹10,000 with the words "To short total of purchase book"

Example:

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

1. The total to the Purchases Book has been undercast by ₹100.
2. The Returns Inward Book has been undercast by ₹50.
3. A sum of ₹250 written off as depreciation on Machinery has not been debited to Depreciation Account.
4. A Payment of ₹75 for salaries (to Sohan) has been posted twice to Salaries Account.
5. The total of Bills Receivable Book ₹1,500 has been Posted to the credit of Bills Recoverable Account.
6. An Amount of ₹151 for a credit sale to Gopal, although correctly entered in the Sales Book, has been posted as ₹115.
7. Discount allowed to Jai ₹25 has not been entered in the Discount column of the cash book. It has been posted to his personal account.

QR Code for Solution Video

Answer:

1. The Purchase A/c needs a further debit of ₹100. Therefore, Purchase A/c will be debited with the words "To Undercasting of Purchases Book for the month of... ₹100".
2. The Return Inwards A/c needs a further debit of ₹50. Therefore, Return Inwards A/c will be debited with the words "To Undercasting of Return Inwards Book for the month of... ₹50".
3. The sum of ₹250 has been omitted to be posted to the Depreciation A/c. Therefore, Depreciation A/c will be debited with the words "To omission of posting... ₹250".
4. Salaries A/c has been debited twice. Therefore, it has to be credited to rectify this error. Salaries A/c will be credited with the words "By double posting... ₹75".
5. The Bills Receivable A/c has been credited with ₹1,500 instead of being debited. Therefore, now, the Bills Receivable A/c has to be debited with ₹1,500 twice – to nullify the effect of the credit of ₹1,500, and to incorporate the effect of debit of ₹1,500. Therefore, Bills Receivable A/c will be debited with the words "To wrong posting of B/R... ₹3,000".
6. The error has occurred in Gopal's A/c. Instead of debiting Gopal's A/c with ₹151, it was debited with only ₹115. Therefore, Gopal's A/c needs to be debited with the difference, i.e. ₹36. Therefore, Gopal's A/c will be debited with the words "To wrong posting... ₹36".
7. Since the discount allowed has not been posted to the Cash Book, it would not be posted to the Discount Allowed A/c as well. Therefore, Discount Allowed A/c will be debited with the words "To omission of posting... ₹25".

Q6. What is the treatment when errors are detected after Trial Balance but before Final Accounts?

Answer:

When errors are located after the preparation of Trial Balance, they can't be rectified using previous method because now the ledger accounts have already been closed.

In case of One sided errors (errors affecting one Account):

- As the ledger accounts are already closed so one aspect of an entry cannot be rectified by posting it in the respective ledger A/c. For such rectification, suspense A/c is opened.

Suspense Account:

It is not always possible for the accountant to locate the difference in the Trial Balance. But the books cannot be closed with such difference in accounts; so, he transfers the difference in Trial Balance to a newly opened account known as Suspense Account.

In other words, it is an account to keep difference amount temporarily. When the errors are located, Suspense A/c is closed.

Suspense A/c is opened in following cases:

(i) to balance the disagreed trial Balance

(ii) to post uncertain items (e.g. payment received from unknown person etc.)

- This will lead to the agreement of trial balance total and when error is located, the entry will be reversed and suspense A/c will be closed.

In case of two sided errors:

Error will be rectified by passing wrong entry, then right entry and then a rectification entry to nullify the effect of error.

Example:

How would you rectify the following errors discovered after the preparation of the Trial Balance?

(i) A credit sale of ₹10,000 to Rajesh Raj Pandey duty entered in the Sales Book has been credited to his account.

(ii) An item of ₹1,050 for a credit sale to Vaibhav although correctly entered in the book has been wrongly posted to his account as ₹1,150.

Answer:

Journal Entries

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Rajesh Raj Pandey A/c Dr. To Suspense A/c (Being the credit sales wrongly credited to Rajesh Raj, now rectified)		20,000	20,000
	Suspense A/c Dr. To Vaibhav A/c (Being the Vaibhav's Account wrongly posted as ₹1,150 instead of ₹1,050, now rectified)		100	100

Q7. How is correction of errors done in the next Accounting Period?

Answer:

In case of one sided errors, when the errors are detected after preparation of final accounts, they are rectified by the following method:

In case of Real or Personal Accounts, rectification is done through Suspense Account and other concerned account affected by the errors.

In case of Nominal Accounts, since balances are transferred to the Profit and Loss A/c at the year end, next year these accounts cannot be used for rectification.

For this purpose, a new Account "Profit and Loss Adjustment A/c" is opened which substitutes all nominal accounts of the previous year.

For rectification, if nominal account is to be debited or credited then instead of nominal account, Profit and Loss Adjustment A/c is debited or credited.

In case of two sided errors, nominal accounts are rectified through Profit and Loss Adjustment account and other A/cs affected while real and personal accounts are rectified through two or more concerned accounts affected by the error without involving Profit & Loss Adjustment A/c.

To know the correct profit of the previous year —

- If P/L adjustment account shows profit, add it to profit to the previous year.
- If P/L adjustment account shows loss, deduct it from the profit of previous year.

Example:

While closing his books of account OM Pandey finds that the Trial Balance on that date, i.e, 31st March, 2012 is out by ₹ 907 excess debit. He places the difference in a newly opened Suspense Account and prepares his final accounts which reveals a profit of ₹ 14,780 for the year ended 31st March, 2012.

In April, 2012, the following errors were detected in the accounts for 2011-12:

(i) Purchases Book was undercast by ₹1,000.

(ii) Cash received from Mohan Das ₹687 was posted to the debit of Rohan Das as ₹678.

(iii) Discount received ₹7,630 and discount allowed ₹6,873 were not posted to the ledger.

(iv) Schedule of debtors was totaled ₹16,280 instead of ₹16,380. Om Pandey maintains a provision for doubtful debts @ 5%.

(v) Bank Charges and interest ₹115 remained unposted to the debit side of the Nominal Account.

(vi) Depreciation on furniture ₹970 was wrongly recorded as ₹ 790.

Pass the Journal entries to rectify the above mentioned errors, prepare the Suspense Account and profit and loss Account and ascertain the correct amount of profit for the year ending 31st March, 2012.

Solution:

Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	Profit and Loss Adjustment A/c Dr. To Suspense A/c (Being the rectification of error caused by undercasting of Purchase Book for 2011-12 by ₹ 1,000)		1,000	1,000

(ii)	Suspense A/c Dr.	1,365	
	To Mohan Das A/c		687
	To Rohan Das A/c		678
	(Being the rectification of wrong debit of ₹ 678 to Rohan Das and omission to credit of ₹ 687 to Mohan Das, in 2011-12 books)		
(iii) (a)	Suspense A/c Dr.	7,630	
	To Profit and Loss Adjustment A/c		7,630
	(Being the rectification of omission of posting of discount received in 2011-12)		
(b)	Profit and Loss Adjustment A/c Dr.	6,873	
	To Suspense A/c		6,873
	(Being the rectification of omission of posting of discount allowed in 2011-12)		
(iv)	Sundry Debtors A/c Dr.	100	
	Profit and Loss Adjustment A/c Dr.	5	
	To Suspense A/c		100
	To Provision for doubtful debts A/c		5
	(Being the rectification of Schedule of debtors and also rectification of provision for Bad debts Accounts due to wrong basis on which the amount of Bad debts was calculated in 2011-12)		

(v)	Profit and Loss Adjustment A/c Dr.	115	
	To Suspense A/c		115
	(Being the rectification of omission of posting of Bank Charges and Interest)		
(vi)	Profit and Loss Adjustment A/c Dr.	180	
	To Furniture A/c		180
	(Being the rectification of wrong entry for depreciation on furniture)		
(vii)	Capital A/c Dr.	543	
	To Profit and Loss Adjustment A/c		543
	(Being the balance of profit and Loss Adjustment A/c transferred to Capital A/c)		

Dr. **Suspense Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
2012 Mar. 31	To Balance b/d	907	2012 Mar. 31	By Difference in Trial Balance b/d	907
		907			907
2012 April 1	To Mohan Das A/c	687	2012	By Balance b/d	907
	To Rohan Das A/c	678		By Profit and Loss Adjustment A/c	1,000
	To Profit & Loss Adjustment A/c	7,630		By Profit and Loss Adjustment A/c	6,873
				By Sundry Debtors A/c	100
				By Profit and Loss Adjustment A/c	115
		8,995			8,995

Dr. **Profit and Loss Adjustment Account** Cr.

Particulars	₹	Particular	₹
To Suspense A/c	1,000	By Suspense	7,630
To Suspense A/c	6,873	By Capital A/c (Loss) (b/f)	543
To Provision for doubtful debts A/c	5		
To Suspense A/c	115		
To Furniture A/c	180		
	8,173		8,173

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. The goods sold for ₹ 900 but the amount was entered in the Sales Account as ₹ 1,080. On Rectification, suspense account will be:
   (a) Debited by ₹ 180
   (b) Credited by ₹ 180
   (c) Debited by ₹ 1,080.
   (d) Credited by ₹ 1,080
2. ₹ 25,000 received form Aditi, is credited in the account of Prerna. It is an error of:
   (a) Principle
   (b) Commission
   (c) Omission
   (d) Compensatory

3. Wages paid for the erection of a machine debited to Wages A/c is an example of:
   (a) Error of Principle
   (b) Clerical Error
   (c) Error of Omission
   (d) Error of Commission
4. A second hand machinery is purchased for ₹10,000, the amount of ₹1,500 is spent on transportation and ₹1,200 is paid for installation. The amount debited to machinery account will be:
   (a) ₹ 10,000
   (b) ₹ 10,500
   (c) ₹ 11,500
   (d) ₹ 12,700
5. Suspense Account is a:
   (a) Nominal A/c
   (b) Real A/c
   (c) Personal A/c
   (d) Any of the above
6. Sales of ₹1,540 to Mr. X was posted to his account as ₹1,450. To rectify the error, ₹90 will be _____ to X's Account:
   (a) debited
   (b) credited
   (c) ignored
7. An amount of ₹ 6,000 due from Anshul, which had been written off as a bad debt in a previous year, was unexpectedly recovered and had been posted to his personal account. The rectification entry is:
   (a) Anshul A/c Dr. ₹ 6,000
   To Suspense A/c ₹ 6,000
   (b) Suspense A/c Dr. ₹ 6,000
   To Bad Debts Recovered A/c ₹ 6,000
   (c) No entry will be made
   (d) Anshul A/c Dr. ₹ 6,000
   To Bad Debts Recovered A/c ₹ 6,000

8. A cheque for ₹500 received from Yuvraj & Co. was dishonoured and debited to Discount Account. Due to rectification of this error, net profit will:
   (a) Decrease by ₹1,000
   (b) Increase by ₹500
   (c) Increase by ₹1,000
   (d) No change
9. Sale to Mr. Z of ₹3,000 on credit was recorded twice in the sales book. The rectification entry is:
   (a) Mr. Z will be credited
   (b) Mr. Z will be debited
   (c) Sales account will be credited
   (d) None
10. A cheque of ₹1,000 received from Ramesh was dishonored and had been posted to the debit of sales return account. Rectifying journal entry will be:

(a)	Sales return A/c	Dr.	1,000	
	To Ramesh			1,000
(b)	Ramesh A/c	Dr.	1,000	
	To Sales return A/c			1,000
(c)	Sales return A/c	Dr.	1,000	
	To Suspense A/c			1,000

   (d) None of these
11. The beginning stock of the current year is overstated by ₹500 and closing stock is overstated by ₹1200. Effect on profit:
   (a) ₹1700 (overstated)
   (b) ₹1200 (understated)
   (c) ₹1700 (understated)
   (d) ₹700 (overstated)
12. Rectification in next financial year is done through:
   (a) Profit & Loss A/c
   (b) Profit & Loss Appropriation A/c
   (c) Profit & Loss Adjustment A/c
   (d) None of these

13. A Machine was Purchased for ₹3,000 which was wrongly recorded in Purchase A/c. Due to this error:
   (a) Trial Balance will show difference by ₹3,000
   (b) Trial Balance will not show difference by ₹3,000
   (c) Both (a) and (b)
   (d) None
14. Error of commission do not allow:
   (a) Correct totalling of balance sheet
   (b) Trial balance to agree
   (c) Both of these
   (d) None of these
15. When the total of trial balance is not reconciled, the accoun, opened at this juncture is:
   (a) Trading Account
   (b) Suspense account
   (c) Profit & Loss account
   (d) None of these
16. Which type of error occurs when credit sales is wrongly posted to Purchase Day Book:
   (a) Error of omission
   (b) Error of commission
   (c) Compensatory error
   (d) Error of principle
17. A purchase of computer was debited to Office Expenditure Account. This is an error of:
   (a) Commission
   (b) Omission
   (c) Principle
   (d) Compensatory Error.
18. What will be the effect when return inward is wrongly entered as return outward?
   (a) Gross Profit is increased by ₹ 100.
   (b) Gross Profit is decreased by ₹ 100.

(c) Gross Profit is increased by ₹ 200.
(d) Gross Profit is decreased by ₹ 200.

19. Total of sales book was understated by ₹ 200. Rectification entry will be:
(a) Sales A/c Debit, Suspense A/c Credit
(b) Suspense A/c Debit, Sales A/c Credit
(c) Debtor A/c Debit, Sales A/c Credit
(d) Sales A/c Debit, Debtors A/c Credit

20. Sale of old furniture is erroneously entered in sales book. Rectification entry will be:
(a) Debit Sales A/c, Credit Furniture A/c
(b) Debit Furniture A/c, Credit Sales A/c
(c) Debit Debtor A/c, Credit Furniture A/c
(d) Debit Sales A/c, Credit Debtor A/c

21. Sale of old furniture is wrongly transferred to Sales Account. Which type of error is this?
(a) Error of Principle
(b) Compensating Error
(c) Error of Omission
(d) Error of Commission

22. Sales for ₹ 5,000 was entered as purchase. The effect of this error will be:
(a) G.P. will increase by ₹ 5,000
(b) G.P. will decrease by ₹ 5,000
(c) G.P. will decrease by ₹ 10,000
(d) G.P. will increase by ₹ 10,000

23. A trial balance will not balance if
(a) A correct entry is posted twice
(b) ₹ 5,000 received from Harish is posted in the credit side of Hari
(c) Sales on credit basis is credited to sales account and debited in cash account.
(d) Goods of ₹ 2,500 returned to Ram is added into the purchases

24. A Cloth merchant purchased furniture and recorded in purchase day book. It is error of
(a) Omission

(b) Principle
(c) Compensation
(d) Commission

25. Credit sale of ₹ 10,000 made to Sallu was passed through purchase book. The proper entry for rectification was the following:

(a)	Sallu A/c	Dr.	10,000	
	To Sales A/c			10,000
(b)	Sallu A/c	Dr.	20,000	
	To Purchases A/c			20,000
(c)	Sallu A/c	Dr.	20,000	
	To Sales A/c			10,000
	To Purchases A/c			10,000

(d) None of the above

26. A new machine was purchased for ₹ 1,00,000 but the amount was wrongly posted to Furniture account as ₹ 10,000 and cash received from debtors ₹ 11,200 was omitted to be posted to ledger. The difference in Trial balance due to such error will be:
(a) ₹90,000
(b) ₹78,800
(c) ₹1,01,200
(d) ₹1,11,200

27. An amount of ₹ 8,765 paid to M was debited to N's a/c. The rectification of the error will-
(a) Increase the net profit
(b) Decrease the net profit
(c) Increase the assets
(d) Have no effect on the net profit

28. Ram earned a profit of ₹ 1,40,000 for the year 2008-09. But at the time of audit, the auditor found that Ram purchased a scooter on 1.4.08 for ₹ 20,000 and charged it as revenue expenses. The auditor advised him to rectify the error now and to charge depreciation @ 15% on scooter. The correct profit after rectification will be:
(a) ₹1,57,000
(b) ₹1,60,000

(c) ₹1,40,000
(d) ₹1,17,000.

29. 'A' sold goods to 'B' on credit for ₹15,000 but debited to 'C' instead of 'B'. The entry would affect:
(a) Trial Balance
(b) Individual Ledgers
(c) Balance Sheet
(d) Total Debtors

30. Bill accepted by Govinda was discounted with the bank for ₹2000. On the due date the bill was dishonoured. However, there is error of Omission towards Bills dishonoured. Journal Entry for rectification will be:
(a) B/R A/c Dr.
To Bank A/c
(b) Govinda's A/c Dr.
To Bank B/R A/c
(c) Govinda's A/c Dr.
To Bank A/c
(d) Bank A/c Dr.
To B/R A/c

31. Error relating to fundamental aspect of accounting is known as.
(a) Error of Principle
(b) Error of Omission
(c) Error of Commission
(d) Compensating Error.

32. Goods purchased of ₹100 from N was not recorded at all. What will be its effect on the trial Balance?
(a) Will tally
(b) Will not tally
(c) Will have no affect
(d) None of these.

33. Goods purchased from Keshav ₹13,500 has been recorded as ₹13,000 in Purchase Book. The error in this entry is:
(a) Error of Principle

(b) Compensating Error
(c) Error of Commission
(d) Error of Omission.

34. ₹1,000 received as interest, shown as interest paid in cash book. Due to this error the cash balance will be effected by:
(a) ₹2,000
(b) ₹1,000
(c) ₹4,000
(d) None of the above.

35. If One of the cars purchased by a car dealer is used for business purpose and has been debited to goods for resale A/c, then the rectification entry will be:
(a) Debit Drawings A/c and Credit Purchases A/c
(b) Debit office Expenses A/c and Credit Motor Car A/c
(c) Debit Motor Car A/c and Credit Purchases A/c
(d) Debit Motor Car A/c and Credit Sales A/c

36. Which of the following errors will not be revealed by trial balance at the end of the year?
(a) Purchase day book was over cast by ₹100
(b) Purchase of ₹100 in cash was debited to purchase account but omitted to be entered in cash book.
(c) Sales day book was under cast by ₹500
(d) Purchase of material for ₹ 300 used for installation of machinery was debited to purchase account instead of machinery account.

37. Hari charges 10% depreciation on plant and machinery. On 1st April 2011 he debited ₹7,520 paid on installation of plant and machinery to profit and loss account. At the time of preparing final accounts on 31st March, 2012 due to this error,
(a) Net Profit will decrease by ₹6,768
(b) Net Profit will decrease by ₹7,520
(c) Net Profit will decrease by ₹8,272
(d) Net Profit will increase by ₹6,768

38. Mr. Ravi Shankar Iyer is carrying sole proprietorship business. On the occasion of his daughter's marriage he bought a car for ₹5,00,000 to gift it to his son-in-law. To record the above transaction he passed the following journal entry:

Car account	Dr.	5,00,000	
To Cash account			5,00,000

What will be the journal entry to rectify the above journal entry as already passed by him?

(a) Drawing A/c	Dr.	5,00,000	
To Cash A/c			5,00,000
(b) Drawing A/c	Dr.	5,00,000	
To Car A/c			5,00,000
(c) Car A/c	Dr.	5,00,000	
To Drawing A/c			5,00,000
(d) Cash A/c	Dr.	5,00,000	
To Car A/c			5,00,000

39. If purchase of goods amounting ₹ 500 has been wrongly posted to credit side of purchase account. The difference in the Trial Balance would be:
(a) ₹500
(b) ₹250
(c) ₹1,000
(d) ₹1,500

40. Goods worth ₹750 were purchased from S & Co. but while posting wrong debit was given to R & Co. The total of credit side of the trial balance was ₹43,750. Assuming that this is the only error, the total of the debit side of the trial balance was:
(a) ₹43,750
(b) ₹44,500
(c) ₹43,000
(d) ₹45,250

41. Which type of error occurs when credit sale is wrongly posted to purchases book?
(a) Error of commission
(b) Error of omission

(c) Compensatory Error
(d) Error of Principle

42. On scrutiny, an accountant found that
(i) Bad debts recovery of ₹500 was credited to debtors A/c wrongly
(ii) Bank charges of ₹50 was wrongly entered twice in Bank Book
(iii) Purchase return of ₹100 was omitted to be entered in the books of A/c.

What will be the net effect in profit after above rectification?
(a) Increase ₹650
(b) Increase ₹350
(c) Decrease ₹650
(d) Increase ₹550

43. Old office furniture sold to Sethi for ₹2,000 was entered in the Sales Book. The book value of furniture sold was ₹2,500.
Rectification entry would be:

(a) Sales A/c	Dr.	₹2,000	
To Furniture A/c			₹2,000
(b) Furniture A/c	Dr.	₹2,500	
To Loss on sales A/c			500
To Sales A/c			2,000
(c) Sales A/c	Dr.	₹2,000	
Loss on sale of furniture	Dr.	₹500	
To Furniture A/c			2,500
(d) Sethi's A/c	Dr.	₹2,000	
To Furniture A/c			₹2,000

44. Which of the following mentioned error will not affect the Trial Balance?
(a) Purchase book was under cost by ₹ 5,000
(b) White washing charges ₹10,000 were debited to Building Account.
(c) Credit sales of ₹2,000 to P was correctly recorded in sales book but not posted in P's account.
(d) Cash paid to Brij Bihari ₹500 was debited to Brij Bhushan's account by ₹5,000.

45. Rectification entries are first recorded in ________
    (a) ledger
    (b) subsidiary books
    (c) journal proper
    (d) trial balance.

46. Wages ₹ 500 paid for installation of a new machine was wrongly posted to wages account instead of machinery account. It is an error of
    (a) Commission
    (b) Principle
    (c) Omission
    (d) Clerical nature.

47. The following errors were detected in the books of Shreay Ltd. while preparing the final accounts:
    (i) A Cheque received for ₹3,100 from Franc & Co. was dishonoured and debited to discount account
    (ii) The sales account has been totalled short by ₹ 23,000
    (iii) Goods of ₹1,200 returned by Kumar & Sons were included in stock but no entry was made in the books.

    After rectifying above mistakes, net profit will.
    (a) Increase by ₹24,900
    (b) Decrease by ₹24,900
    (c) Not change
    (d) Increase by ₹23,700

48. Which type of error can occur while posting the journal entries in the ledger?
    (A) Error of Principle
    (B) Error of Commission
    (C) Error of Partial Omission
    (D) Error of Complete Omission
    (a) (A), (B), (C) and (D)
    (b) (B), (C) and (D)
    (c) (A), (C) and (D)
    (d) (A), (B) and (D)

49. On Examination of old books of Mr. Rai's firm, a Chartered Accountant found the following mistakes:
    1. Purchase of a cycle was debited to conveyance account ₹3,000. Fixed assets are depreciated at 10% depreciation.
    2. A credit purchase of goods from Mr. X for ₹ 2,500 entered as sale.
    3. Receipt of cash from Mr. A was posted to the account of Mr. B ₹1,500.

    What will be the effect on Capital Account of Mr. Rai after rectifying above mistakes?
    (a) His capital will be debited by ₹2,300.
    (b) His capital will be credited by ₹2,300.
    (c) His capital will be debited by ₹2,700.
    (d) His capital will be debited by ₹3,800.

50. A Sale of ₹637 was entered in sales book as ₹763 and posted to the credit of the customer. This error carried to next accounting period. You are required to give journal entry to rectify the error is next accounting period.

(a)	Profit & Loss Adjustment A/c	Dr.	126	
	Suspense A/c	Dr.	1,400	
	To Customer A/c			1,526
(b)	Profit & Loss Adjustment A/c	Dr.	126	
	Customers A/c	Dr.	1,400	
	To Suspense A/c			1,526
(c)	Suspense A/c	Dr.	1,526	
	To Profit & Loss adjustment A/c			126
	To Customer A/c			1,400
(d)	Customer A/c	Dr.	1,526	
	To Profit & Loss Adjustment A/c			126
	To Suspense A/c			1,400

51. If a purchase return of ₹3,500 has been wrongly posted to the debit of the sales Returns Account, but has been correctly entered in the supplier's account, the total of
    (a) The trial balance would show the debit side to be ₹3,500 more than the credit side.

(b) The debit side of the trial balance will be ₹7,000 more than the credit side.
(c) The trial balance would show the credit side to be ₹3,500 more than the debit side.
(d) The credit side of the trial balance will be ₹7,000 more than the debit side.

52. ₹18,000 received from tenant for rent and entered correctly in the cash book. It is posted to the debit of the rent account. In the trial balance:
(a) The debit total will be greater by ₹36,000 than the credit total.
(b) The debit total will be greater by ₹18,000 than the credit total.
(c) Subject to other entries being correct the total will agree.
(d) None of the above.

53. An error can be deleted at any of the following stages:
(a) Before preparation of Trial Balance
(b) After extracting trial balance but before the Final Accounts are drawn
(c) After the Final Accounts i.e. in the next accounting period
(d) All of the above.

54. Stamp duty on property purchased has been debited to "Legal Expenses" account by the accountant. Which type of error has been committed?
(a) Error of Commission
(b) Error of Principle
(c) Error of Commission
(d) It is not an error at all.

Answer

1.	(b)	2.	(b)	3.	(a)	4.	(d)	5.	(d)
6.	(a)	7.	(d)	8.	(b)	9.	(a)	10.	(b)
11.	(d)	12.	(c)	13.	(b)	14.	(b)	15.	(b)
16.	(b)	17.	(c)	18.	(c)	19.	(b)	20.	(a)

21.	(a)	22.	(c)	23.	(d)	24.	(b)	25.	(c)
26.	(b)	27.	(d)	28.	(a)	29.	(b)	30.	(c)
31.	(c)	32.	(a)	33.	(c)	34.	(a)	35.	(c)
36.	(d)	37.	(a)	38.	(b)	39.	(c)	40.	(d)
41.	(a)	42.	(a)	43.	(c)	44.	(b)	45.	(c)
46.	(b)	47.	(a)	48.	(b)	49.	(a)	50.	(b)
51.	(b)	52.	(a)	53.	(d)	54.	(b)		

Short Practice Questions

1. Why did how's Suspense Account opened?
2. Write short notes on —
(a) Error of Principle
(b) Error of Commission
(c) Compensating errors

Past Year Questions and Answers

Objective Questions

1994 - Nov [5] State with reason whether the following statements are True or False.
(6) Rectification of errors will not necessarily balance a Trial Balance.
(2 marks)

Answer:

False: Rectification of errors will necessarily balance a trial balance. In general, rectification of errors implies rectification of all errors whether affecting a trial balance or not. Therefore, if all errors are rectified, there is no reason for disagreement of trial balance.

1995 - Nov [5] State with reason whether the following statements are True or False.

(8) Any type of error affects the agreement of Trial Balance. (2 marks)

Answer:

False: Any type of error does not affect the agreement of trial balance. e.g. Compensating errors do not affect the Trial Balance.

1996 - May [5] State with reason whether the following statements are True or False.

(9) Purchase of officer furniture has been debited to general expenses account. It is a compensating error. (2 marks)

Answer:

False: Recording the transactions in a fundamentally wrong manner in contravention of accounting principles is an error of principle.

1996 - Nov [5] State with reasons whether the following statement is True or False:

(2) Error of carry forward of totals of Purchase Journal affects two accounts. (2 marks)

Answer:

False: Error of carry-forward of totals of Purchase Journal will affect only one account i.e. Purchases A/c and finally it will result in disagreement of Trial Balance.

1997 - May [5] State with reasons whether the following statement is True or False:

(4) Error of principle involves an incorrect allocation of expenditure or receipt between capital and revenue. (2 marks)

Answer:

Please refer 1996 - May [5] (9) on page no. 257

1998- May [5] State with reasons whether the following statements are True or False:

(5) A tallied trial balance will not reveal compensating errors and errors on account of wrong balancing. (2 marks)

(9) Error of principle involves an incorrect allocation of expenditure or receipt between capital and revenue. (2 marks)

Answer:

(5) Partly True & Partly False: A tallied trial balance will not reveal compensating errors or 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 limited cases where the errors on the account of wrong balancing get fully compensated.

(9) *Please refer 1996 - May [5] (9) on page no. 257*

1999 - May [5] State with reasons whether the following statement is True or False:

(v) If the amount is pasted in the wrong account or it is written on the wrong side of an account it is called error of omission. (2 marks)

Answer:

False: Posting an amount on the wrong side or to a wrong account is called error of commission.

2000 - Nov [5] State with reasons whether the following statement is True or False:

(3) Incorrect allocation of expenditure or receipt between capital and revenue is an error of commission.

Answer:

Please refer 1996 - May [5] (9) on page no. 257

2001 - May [5] State with reasons whether the following statement is True or False:

(3) Compensating errors do not disturb agreement of Trial Balance. (2 marks)

Answer:

True: In case of compensating errors, the effect of errors committed cancel out, and thus these errors do not disturb agreement of trial balance.

1997 - May [5] State with reasons whether the following statement is True or False:

(2) Error of principle involves an incorrect allocation of expenditure or receipt between capital and revenue. (2 marks)

Answer:

Please refer 1996 - May [5] (9) on page no. 257

2002 - May [5] State with reasons whether the following statement is True or False:

(c) Errors of complete omission will be located, if a Trial Balance is prepared.

Answer:

False: Trial balance only helps to check the arithmetical accuracy of the books of accounts. In case of error of complete omission, both debit and credit aspects of an entry are not recorded and therefore, it will not affect trial balance. hence, cannot be located.

2004 - Nov [5] State with reasons whether the following statements are True or False:

(iv) Under or over-casting of a subsidiary book is an example of error of commission. (2 marks)

(x) Rectifying errors in subsequent accounting period always affects the profit or loss of that period. (2 marks)

Answer:

(iv) True: Errors of commission may arise due to wrong amount, wrong entry in accounts, or wrong accounting and wrong entry in account, whether they are in any subsidiary book or in Ledger.

(x) False: If errors are rectified in the subsequent accounting period as prior period items, profit of subsequent period is not affected.

2005 - May [5] State with reasons whether the following statement is True or False:

(ix) Rectification of errors are necessary to tally the trial balance. (2 marks)

Answer:

False: There is no need to rectify the error in order to tally the trial balance. Trial balance can be tallied by debiting or crediting the difference amount to the suspense account.

2006 - Nov [5] State with reasons whether the following statement is True or False:

(iv) 'Rent of Proprietor's residence debited to rent account'; This error will not affect the trial balance.

Answer:

True: This is an error of principle, as Drawings A/c should be debited instead of rent account. The error will not affect the trial commission.

2018 - May [1] {C} (a) State with reasons, whether the following statement is true or false:

(iii) If the effect of errors committed cancel out, the errors will be called compensating errors and the trial balance will disagree. (2 marks)

Answer:

False: If the effect of errors committed cancel out, the errors will be called compensating errors and the trial balance will agree.

2019 - June [1] (a) State with reason, whether the following statement is true or false :

(ii) If the amount is posted in the wrong account or it is written on the wrong side of the account, it is called error of principle. (2 marks)

Answer:

False: If an amount is posted in the wrong account or is written on the wrong side of the correct account, it is case of "errors of commission" and is not "error of principle".

DISTINGUISH BETWEEN

1999 - Nov [6] (b) Briefly explain the difference between the following: Errors of Principle and Errors of Omission. (5 marks)

Answer:

Error of Principle: It is the error which arises when transactions are recorded ignoring the difference being the capital and revenue items. Error of Principle is involved whenever the amount paid or received is not properly allocated between revenue and capital. This error does not affect the trial balance. E.g. Furniture purchased on credit wrongly recorded in purchase Journal instead of Journal proper.

Error of Omission: It is the error which arises when a transaction is partially or completely not recorded in books of accounts. This error may or may not affect the trial balance. E.g. Furniture purchased from Sohan was not recorded anywhere in the books of account.

DESCRIPTIVE QUESTIONS

1997 - Nov [4] (a) Briefly explain 'Suspense Account' appearing in Trial Balance. (5 marks)

Answer:

- The trial balance extracted at the end of the accounting period may not agree, and in spite of the best efforts made to locate the errors, all the errors may not be discovered.
- In such a case, the trial balance is artificially made to agree in spite of errors by opening a new account, called "Suspense Account".
- If the total of the credit column in the trial balance exceeds the total of the debit column, the "suspense account" is debited; it is credited in the other case.
- Thus, "suspense account" is an account to which the difference in the trial balance is put temporarily.
- When errors are traced, entries are made with the help of suspense account.

2001 - May [6] Explain briefly Errors of Principle. (5 marks)

Answer:

Errors of Principle: The error of principle arises when the transactions are recorded ignoring the difference between the capital and revenue items. In other words, it involves a wrong allocation of receipt and expenditure between the capital and revenue items. This error does not affect the Trial Balance. Any wrong allocation would disturb the final result as disclosed by the financial statement, therefore it is necessary that the correct allocation between capital and Revenue items should be done.

E.g. Furniture purchased on credit wrongly recorded in Purchase account.

2002 - May [3] (b) State which type of errors are not disclosed by the agreement of the trial Balance. (5 marks)

Answer:

The types of errors which are not disclosed by the agreement of the Trial Balance may be discussed as follows:

(i) **Error of Omission:** If any transaction is not recorded in the books of original entry, it will not affect the ledger account from which the trial Balance is prepared.

(ii) **Error of commission:** These errors are due to wrong posting, recording or casting etc. these are also known as mis-postings. These errors do not affect the trial balance if debit balances are equal to credit balances.

(iii) **Error of Principle:** If a certain principle of book keeping, while recording a transaction, has not been followed; it will not disturb the trial balance.

(iv) **Compensating Errors:** When two or more errors are committed which may compensate the effect of each other, they are called compensating errors. Such errors compensate each other and they will also not effect the trial balance.

(v) **Error in Subsidiary Book:** An error in the books of original entry will also not affect the trial balance if debit balances are equal to credit balances.

PRACTICAL QUESTIONS

1995 - May [4] A book-keeper while preparing his trial balance finds that the debit exceeds by ₹ 7,250. Being required to prepare the final account he the difference to a Suspense Account. In th next year the following mistakes were discovered:

(i) A sale of ₹ 4,000 has been passed through the Purchase Daybook. The entry in customer's account has been correctly recorded.

(ii) Goods worth ₹ 2,500 taken away by the proprietor for his use has been debited to Repairs Account.

(iii) A Bill receivable for ₹ 1,300 received from Krishna has been dishonoured on maturity but no entry passed.

(iv) Salary ₹ 650 paid to a clerk has been debited to his Personal Account.

(v) A Purchase of ₹ 750 from Raghubir has been debited to his account. Purchases account has been correctly debited.

(vi) 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. (15 marks)

Answer:

Journal Entries

	Particulars	₹	₹
(a)	Suspense A/c Dr. To P& L Adjustment A/c. (Rectification of a credit sale wrongly passed through the purchase day book)	8,000	8,000
(b)	Drawing A/c Dr. To P& L Adjustment A/c (Goods withdrawn for personal use wrongly debited to repairs account, now rectified)	2,500	2,500

	Particulars	₹	₹
(c)	Krishna A/c Dr. To Bills Receivable A/c (Entry for bill drawn on Krishana dishonoured on maturity)	1,300	1,300
(d)	P&L Adjustment A/c Dr. To Clerk's personnel A/c (Salary paid to a clerk wrongly debited to his personal account, now rectified)	650	650
(e)	Suspense A/c Dr. To Raghubir's A/c (Goods purchased from Raghubir wrongly debited to his account, now rectified)	1,500	1,500
(f)	P&L Adjustment A/c Dr. To Suspense A/c (Depreciation of furniture not posted to depreciation account now rectified)	2,250	2,250

Suspense A/c

Particular	Amount ₹	Particulars	Amount ₹
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

Note:

Instead of using Profit & Loss Adjustment Account for the purpose of rectification of errors affecting revenue items, another account namely prior period adjustment account may be opened for this purpose. The balance of the prior period adjustment account is to be ultimately transferred to Profit & Loss Account.

1996 - May [4] The accountant of X prepared the Trial Balance for the year ended 31st March. 1996. But there was a difference and the accountant put the difference in Suspense Account.

Rectify the Following errors found and prepare the Suspense Account:

(i) The total of the Returns outward book, ₹420 has not been posted to the ledger.

(ii) A purchase of ₹350 from Y has been entered in the sales book. However Y's account has been correctly entered.

(iii) A sale of ₹390 to Z has been credited to his account as ₹290.

(iv) Old furniture sold for ₹5,400 had been entered as ₹4,500 in sales account.

(v) Goods taken by proprietor, ₹500 have not been entered in the books at all. (10 marks)

Answer:

Rectified Journal Entries

Transaction	Particulars		Debit (₹)	Credit (₹)
(1)	Suspense A/c	Dr.	420	
	To Purchase Return A/c			420
	(Being rectification of omission of amount not posted to Return Outward Book)			
(2)	Sales A/c	Dr.	350	
	Purchase A/c	Dr.	350	
	To Suspense A/c			700
	(Being rectification of purchase amount entered in the sales book)			
(3)	Z's A/c	Dr.	680	
	To Suspense A/c			680
	(Being rectification of wrong amount and wrong side of account)			
(4)	Sales A/c	Dr.	4,500	
	Suspense A/c	Dr.	900	
	To Furniture A/c			5,400
	(Being rectification of wrongly entered amount)			
(5)	Drawings A/c	Dr.	500	
	To Purchases A/c			500
	(Being recording of the omission of goods taken by proprietor)			

Suspense A/c

Particulars	₹	Particulars	₹
To Difference in trial Balance	60	By Sales A/c	350
To Purchase Return A/c	420	By Purchase A/c	350
To Furniture A/c	900	By Z's A/c	680
	1,380		1,380

1998 - May [4] A book keeper finds the differences in the Trial Balance amounting to ₹1,000 and puts it in the Suspense Account.

Later on he detects the following errors:

(i) Purchased goods from Ravi ₹15,000 but entered into Sales Book.

(ii) Received one bill for ₹25,000 from Arun but recorded in Bills Payable Book.

(iii) An item of ₹3,500 relating to prepaid rent account was omitted to be brought forward.

(iv) An item of ₹2,000 in respect of purchase returns, had been wrongly entered in the purchase book.

(v) ₹25,000 paid to Harish against our acceptance were debited to Harish's Account.

(vi) Bills received from Janki for repairs done to radio ₹2,500 and radio supplied for ₹ 45,000 were entered in the Purchase Book as ₹46,000.

Give rectifying journal entries with full narration and prepare Suspense Account. (15 marks)

Answer:

Rectified Journal Entries

Transaction	Particulars	Debit (₹)	Credit (₹)
(1)	Purchase A/c Dr.	15,000	
	Sales A/c Dr.	15,000	
	To Ravi's A/c		30,000
	(Being rectification of purchases wrongly entered to sales book)		
(2)	Bills Receivable A/c Dr.	25,000	
	Bills Payable A/c Dr.	25,000	
	To Arun A/c		50,000
	(Being rectification of Bills Receivable wrongly recorded in bills Payable Book)		
(3)	Prepaid Rent A/c Dr.	3,500	
	To Suspense A/c		3,500
	(Being rectification of omission of prepaid rent a/c to be brought forward)		
(4)	Customer A/c Dr.	4,000	
	To Purchase A/c		2,000
	To Purchase Return A/c		2,000
	(Being rectification of purchase return wrongly entered in Purchase Book)		

(5)	Bills Payable A/c Dr.	25,000	
	To Harish A/c		25,000
	(Being rectification of Bills Payable A/c wrongly debited to Harish's A/c)		
(6)	Repairs A/c Dr.	2,500	
	Radio A/c Dr.	45,000	
	To Purchase A/c		46,000
	To Janki A/c		1,500
	(Being rectification of the amount wrongly entered in purchase book as 46,000)		

Suspense A/c

Particulars	₹	Particulars	₹
To Balance b/d	1,000	By Prepaid Rent A/c	3,500
To Balance c/d	2,500		
	3,500		3,500

2001 - May [4] (a) On 31st March 2001, 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.

Give Journal Entries to rectify the above errors and ascertain the amount transferred to Suspense Account, assuming that the Suspense Account is balanced after the above corrections. (9 marks)

Answer:

Rectified Journal Entries

Transaction	Particulars	Debit (₹)	Credit (₹)
(1)	Suspense A/c Dr. To A's A/c (Being rectification of amount received from A wrongly debited to his account)	1,00,000	 1,00,000
(2)	Suspense A/c Dr. To Purchase A/c To Purchase Return A/c (Being rectification of purchase return wrongly posted to purchase A/c)	40,000	 20,000 20,000
(3)	Suspense A/c Dr. To Discount A/c (Being rectification of discount received wrongly debited to Discount A/c)	16,000	 16,000
(4)	Motor Car Repairs A/c Dr To Motor Car A/c To Suspense A/c (Being rectification motor car repairs of ₹ 9060 wrongly debited to motor car A/c as 7060)	9,060	 7,060 2,000
(5)	B's A/c Dr To A's A/c (Being rectification of amount paid to B wrongly debited to A)	40,000	 40,000

Suspense A/c

Particulars	₹	Particulars	₹
To A's A/c	1,00,000	By Difference in trial Balance (Bal. fig.)	1,54,000
To Purchase A/c	20,000		
To Purchase Return A/c	20,000	By Motor Car Repairs A/c	2,000
To Discount A/c	16,000		
	1,56,000		1,56,000

2002 - May [3] (a) There was an error in the Trial Balance of Mr. Steel on 31st March, 2002, 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.

Give Journal Entries to rectify the above error and ascertain the amount transferred to Suspense Account on 31st March, 2002 by showing the Suspense Account, assuming that the Suspense Account is balanced after the above corrections. (10 marks)

Answer:

Rectified Journal Entries

Transaction	Particulars	Debit (₹)	Credit (₹)
(I)	Suspense A/c Dr. To Mr. A's A/c (Being rectification of receipt from A wrongly posted to A's Debit A/c)	10,800	 10,800

(II)	Suspense A/c Dr. To Purchase Return A/c To Purchase A/c (Being rectification of Purchase Return wrongly posted to Purchase A/c)	2,000	 1,000 1,000
(III)	Suspense A/c Dr. To Discount A/c (Being rectification of wrong posting of Discount received to debit of Discount A/c)	4,000	 4,000
(IV)	Repairs of Motor Car A/c Dr. To Motor Car A/c To Suspense A/c (Being rectification of Motor car Repairs wrongly debited Motor car A/c)	2,740	 1,740 1,000
(V)	B's A/c Dr. To A's A/c (Being rectification of payment to B wrongly debited to A's A/c)	4,000	 4,000

Suspense A/c

Particulars	₹	Particulars	₹
To Mr. A A/c	10,800	By Difference in Trial Balance	15,800
To Purchase Return A/c	1,000	By Repairs A/c	1,000
To Purchase A/c	1,000		
To Discount A/c	4,000		
	16,800		16,800

2003 - Nov [3] (a) The Trial Balance of ABC Ltd, as on Dec 31, 2002 did not agree. The difference was put to a Suspense Account. During the next trading period, the following were discovered:

(i) The total of the Sales-book of one page ₹6,531 was carried forward to the next pages ₹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 ₹2,7‿0.

(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.

You are required to give 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. (7 marks)

Answer:

Rectified Journal Entries

Transaction	Particulars	Debit (₹)	Credit (₹)
(I)	Suspense A/c Dr. To P & L Adjustment A/c (Being rectification of under-valuation of Sales Book)	180	 180
(II)	P & L Adjustment A/c Dr. To Customer A/c (Being rectification of Personal car expenses wrongly debited to Trade Expenses)	2,400	 2,400
(III)	Drawings A/c Dr. To P & L Adjustment A/c (Being rectification of Personal car expenses wrongly debited to Trade Expenses)	250	 250

(IV)	P & L Adjustment A/c Dr. To Suspense A/c (Being rectification of Sales Return undervalued by ₹2740)	2,750	2,750
(V)	Suspense A/c Dr. To P & L Adjustment A/c (Being rectification of discount allowed wrongly debited to Discount A/c)	100	100
(VI)	P & L Adjustment A/c Dr. To Suspense A/c To Creditors A/c (Being rectification of undervaluation of Purchase Book and wrong posting to suppliers A/c as ₹51)	136	36 100

2006 - May [3] (a) The difference in Trial Balance is kept by Rajesh in Suspense Account. Before preparing the Final Accounts, the following errors were detected by him:

(i) Purchase for ₹1,080 was written in Sales day book, but was posted to the correct side of the Party's account.

(ii) Salary account total ₹25,200 was carried over to the next page as ₹2,520 on the wrong side.

(iii) Interest on Overdraft ₹1,300 was not posted to the Ledger from the Cash-book.

Pass the Rectification entries and prepare the suspense account.

(5 marks)

Answer:

In the books of Rajesh
Rectification entries

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1.	Purchase A/c Dr. Sales A/c Dr. To Suspense A/c (Being purchase was recorded by mistake in sales day book)		1,080 1,080	2,160

2.	Salary a/c (25,200 + 2,520) Dr. To Suspense A/c (Being total of salary a/c Bal. of ₹25,200 written as 2,520 on the wrong side.)		27,720	27,720
3.	Interest on Overdraft A/c Dr. To Suspense A/c (Being posting of entry to the ledger omitted)		1,300	1,300
			31,180	31,180

Dr. **Suspense A/c** **Cr.**

Particulars	₹	Particulars	₹
To Bal. b/d	31,180	By Purchase By Sales By Salary By Interest on overdraft	1,080 1,080 27,720 1,300
	31,180		31,180

2006 - Nov [3] (a) On March 31, 2006, before preparing the final accounts, Mr. A prepared a trial balance, which didn't tally. He put the difference in a newly opened suspense account. The following errors were located. You are required to pass Journal Entries to rectify the errors and prepare suspense account.

(i) Purchase of ₹981 from Ram were posted as ₹918 to the debit side of Ram's account.

(ii) While carrying forward the total of sales-book from one page to the next page, the amount was written as ₹16,857, instead of ₹16,758.

(iii) A purchase of an office table costing ₹2,000 had been posted through purchase day-book.

(iv) The total of return outward book in March, 2006 had been undercast by ₹1,000.

(v) An amount of ₹3,000 received from Vijay was debited to his account.

(vi) A sum of ₹1,300 which had been previously written off as bad debts. was received from Anand, a customer and the same was credited to Anand's personal account.

(vii) A sale of ₹1,200 to Singh & Co. was credited to their account.

(5 marks)

Answer:

	Particulars	Debit (₹)	Credit (₹)
(i)	Suspense Account Dr. To Ram (Purchases of ₹981 from Ram was posted as ₹918 to the debit side of Ram's account, now rectified).	1,899	1,899
(ii)	Sales Account Dr. To Suspense A/c (The excess credit to sale account because of wrong carry forward from one page to next page, now rectified)	99	99
(iii)	Office Furniture Dr. To Purchase Account (The purchase of furniture has been wrongly entered in purchase book, now rectified)	2,000	2,000
(iv)	Suspense Account Dr To Return Outward (Rectification of the error arising due to under casting of return outward books)	1,000	1,000
(v)	Suspense Account Dr. To Vijay (An amount of ₹3,000 received from Vijay was wrongly debited in his account now rectified)	6,000	6,000

(vi)	Anand To Bad Debts Recovered (Recovery of Bad Debts credited to payer's account, error now rectified)	1,300	1,300
(vii)	Singh & Co. Dr. To Suspense Account (Being correction of mistake by which the account of Singh & Co. was credited instead of being debited)	2,400	2,400

Suspense Account

Particulars	Amount	Particulars	Amount
To Ram	1,899	By Balance b/d (Balancing figure)	6,400
To Return Outward	1,000	By Sales Account	99
To Vijay	6,000	By Singh & Co.	2,400
	8,899		8,899

2018 - May [1] {C} (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 Joythy 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)

Q.R. Code for Solution Video

Answer:

Journal Entries

	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	Subham A/c	Dr.	300	
	Furniture A/c	Dr.	2,700	
	To Nigam A/c			3,000
(ii)	Sales Returns A/c	Dr.	5,000	
	To Jyothy A/c			5,000
(iii)	Sales A/c	Dr.	75,000	
	To P & L A/c (Gain on sale of investments)			15,000
	To Investments A/c			60,000
(iv)	Drawings A/c	Dr.	10,000	
	To Trade Expenses A/c			10,000

2018 - May [6] (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 books by a Chartered Accountant next year, the following mistakes were found.

(i) Purchase account was under cast by ₹ 8,000.
(ii) Sale of goods to Mr. Rahim for ₹ 2,500 was omitted to be recorded.
(iii) Receipt of cash from Mr. Asok was posted to the account of Mr. Anbu ₹ 1,200.
(iv) Amount of ₹ 4,167 of sales was wrongly posted as ₹ 4,617.
(v) Repairs to Machinery was debited to Machinery Account ₹ 1,800.
(vi) A credit purchase of goods from Mr. Paul for ₹ 3,000 entered as sale.

Suggest the necessary rectification entries. (10 marks)

QR Code for Solution Video

Answer:

Journal Entries in the books of Miss Daisy

Date	Particulars		Dr. (₹)	Cr. (₹)
(i)	Profit & Loss Adjustment A/c	Dr.	8,000	
	To Suspense* A/c			8,000
	(Purchase account under cast in the previous year; error now rectified)			
(ii)	Rahim's Account	Dr.	2,500	
	To Profit & Loss Adjustment A/c			2,500
	(Sales to Rahim omitted last year; now adjusted)			
(iii)	Anbu's Account	Dr.	1,200	
	To Asok's Account			1,200
	(Amount received from Asok wrongly posted to the account of Anbu; now rectified)			
(iv)	Profit & Loss Adjustment A/c	Dr.	450	
	To Suspense* A/c.			450
	(Excess posting to sales account last year, ₹4,617, instead of ₹4,167 now adjusted)			
(v)	Profit & Loss Adjustment A/c	Dr.	1,800	
	To Machinery A/c			1,800
	(Repairs to machinery was wrongly debited to machinery account, now rectified)			
(vi)	Profit & Loss Adjustment A/o	Dr.	6,000	
	To Mr. Paul Account			6,000
	(Credit purchase of goods from Mr. Paul sale last year, now rectified)			
(vii)	Daisy's Capital A/c	Dr.	13,750	
	To Profit and Loss Adjustment Account			13,750
	(Being balance in P & L Adjustment Account transferred to Daisy's Capital A/c-Refer W.N. 1)			

(viii)	Suspense A/c To Daisy's Capital A/c (Being balance of Suspense A/c transferred to Capital A/c-Refer W.N. 2)	Dr.	8,450	8,450

*Considering that the difference was posted to Suspense account.

Working Notes:

1. **Profit and Loss Adjustment Account**

	₹		₹
To Suspense A/c	8,000	By Rahim's A/c	2,500
To Suspense A/c	450	By Daisy's Capital A/c (Bal. Transfer)	13,750
To Machinery A/c	1,800		
To Mr. Paul's A/c	6,000		
	16,250		16,250

2. **Suspense Account**

	₹		₹
To Daisy's Capital A/c (Balance Transfer)	8,450	By P & L Adj. A/c By P & L Adj. A/c	8,000 450
	8,450		8,450

2018 - Nov [2] (a) The following mistakes were located in the books of a concern after its books were closed and a Suspense Account was opened in order to get the Trial Balance agreed :

(i) Sales Day Book was overcast by ₹1,000.

(ii) A sale of ₹5,000 to X was wrongly debited to the Account of Y.

(iii) General expenses ₹180 was posted in the General Ledger as ₹810.

(iv) A Bill Receivable for ₹1,550 was passed through Bills Payable Book. The Bill was given by P.

(v) Legal Expenses ₹1,190 paid to Mrs. Neetu was debited to her Personal Account.

(vi) Cash received from Ram was debited to Shyam ₹1,500.

(vii) While carrying forward the total of one page of the Purchases Book to the next, the amount of ₹1,235 was written as ₹1,325.

Find out the nature and amount of the Suspense Account and pass entries (including narration) for the rectification of the above errors in the subsequent year's books. (10 marks)

QR Code for Solution Video

Answer:

(i)	P & L Adjustment A/c To Suspense A/c (Correction of error by which sales account was overcast last year)	Dr.	1,000	1,000
(ii)	X To Y (Correction of error by which sale of ₹5,000 to X was wrongly debited to Y's account)	Dr.	5,000	5,000
(iii)	Suspense A/c To P & L Adjustment A/c (Correct of error by which general expenses of ₹180 was wrongly posted as ₹810)	Dr.	630	630
(iv)	Bills Receivable A/c Bills Payable A/c To P (Correction of error by which bill receivable of ₹1,550 was wrongly passed through BP book)	Dr. Dr.	1,550 1,550	3,100

(v)	P & L Adjustment A/c	Dr.	1,190	
	To Mrs. Neetu			1,190
	(Correction of error by which legal expenses paid to Mrs. Neetu was wrongly debited to her personal account)			
(vi)	Suspense A/c	Dr.	3,000	
	To Ram			1,500
	To Shyam			1,500
	(Removal of wrong debit to Shyam and giving credit to Ram from whom cash was received)			
(vii)	Suspense A/c	Dr.	90	
	To P & L Adjustment A/c			90
	(Correction of error by which Purchase A/c was excess debited by ₹90/-, i.e.: ₹1,325 - ₹1,235)			

Suspense A/c

	₹		₹
To P & L Adjustment A/c	630	By P & L Adjustment A/c	1,000
To Ram	1,500	By Difference in Trial Balance (Balancing figure)	2,720
To Shyam	1,500		
To P & L Adjustment A/c	90		
	3,720		3,720

2019 - June [1] (c) Give journal entries (with narrations) to rectify the following errors located in the books of a Trader after preparing the Trial Balance :

(i) An amount of ₹4,500 received on account of Interest was credited to Commission account.

(ii) A sale of ₹2,760 was posted from Sales Book to the Debit of M/S Sobhag Traders at ₹2,670

(iii) ₹35,000 paid for purchase of Airconditioner for the personal use of proprietor debited to Machinery a/c.

(iv) Goods returned by customer for ₹5,000. The same have been taken into stock but no entry passed in the books of accounts. (4 Marks)

Answer:

S. No.	Particulars		Debit (₹)	Credit (₹)
1	Commission A/c	Dr.	4,500	
	To Interest Received			4,500
	(Correcting wrong entry of interest received into commission account)			
2	M/s Sobhag Traders A/c	Dr.	90	
	To Suspense A/c			90
	(Being credit sale of ₹2,760 posted as ₹2,670 i.e. debiting M/s Sobhag Traders A/c less by 90, now rectified)			
3	Drawings A/c	Dr.	35,000	
	To Machinery A/c			35,000
	(Correction of wrong debit to machinery account for purchase of air-conditioner for personal use)			

4	Return Inward A/c Dr.	5,000	
	To Debtors (Personal) A/c		5,000
	(Correction of omission to record return of goods by customers)		

2019 - Nov [2] (b) Correct the following errors (i) without opening a Suspense Account and (ii) with opening a Suspense Account:

(1) The sales book has been totalled ₹2,100 short.

(2) Goods worth ₹1,800 returned by Gaurav & Co. have not been recorded anywhere.

(3) Goods purchased ₹2,250 have been posted to the debit of the supplier Sen Brothers.

(4) Furniture purchased from Mary Associates, ₹15,000 has been entered in the purchase Daybook.

(5) Discount received from Black and White ₹1,200 has not been entered in the books.

(6) Discount allowed to Radhe Mohan & Co. ₹180 has not been entered in the Discount Column of the Cashbook. The account of Radhe Mohan & Co. has, however, been correctly posted. (10 marks)

Answer:

(i) If Suspense Account is not opened:

1. Since sales book has been totalled ₹2,100 short, the Sales Account has been credited short by ₹2,100. The rectifying entry is to credit the Sales Account by ₹2,100 as "By wrong totalling of the Sales Book ₹2,100".

2. Following entry will be passed to rectify the omission:

Particulars	Dr. (₹)	Cr. (₹)
Return Inwards A/c	1,800	
To Gaurav & Co.		1,800
(Being Goods returned by Gaurav & Co. previously omitted from the Return inwards Book)		

3. Sen Brothers have been debited with ₹2,250 instead of being credited. This account should now be credited by ₹4,500 to remove the wrong debit and to give the correct credit. The entry will be on the credit side... "By errors in posting ₹4,500".

4. Instead of debiting Furniture A/c, Purchases A/c has been debited. The rectifying entry would be:

Particulars	Dr. (₹)	Cr. (₹)
Furniture A/c Dr.	15,000	
To Purchases A/c		15,000
(Being rectification of error by which Purchases A/c was debited instead of Furniture A/c)		

5. This is an error of omission. The rectifying entry would be:

Particulars	Dr. (₹)	Cr. (₹)
Black and White Dr.	1,200	
To Discount Received A/c		1,200
(Being rectification of error by which discount received from Black and White was omitted to be recorded)		

6. In this case, the account of the customer has been correctly posted; the Discount Account has been debited ₹180 short since it has been omitted from the discount column on the debit side of the cash book. The discount account should now be debited by the entry: "To Omission of entry in the Cash Book ₹180."

(ii) If Suspense A/c is opened:

Date	Particulars	Dr. (₹)	Cr. (₹)
1	Suspense A/c Dr.	2,100	
	To Sales A/c		2,100
	(Being the correction arising from undercasting of Sales Book)		

2	Return Inwards A/c Dr. To Gaurav & Co. (Being the recording of unrecorded items)	1,800	1,800
3	Suspense A/c Dr. To Sen Brothers (Being the correction of the error by which Sen Brothers were debited instead of being credited by ₹ 2,250)	4,500	4,500
4	Furniture A/c Dr. To Purchases A/c (Being the correction of recording purchase of furniture as ordinary purchases)	15,000	15,000
5	Black and White Dr. To Discount Received A/c (Being the recording of discount omitted to be recorded)	1,200	1,200
6	Discount Allowed A/c Dr. To Suspense A/c (Being the correction of omission of the discount allowed from Cash Book; customer's account already posted correctly).	180	180

Suspense A/c

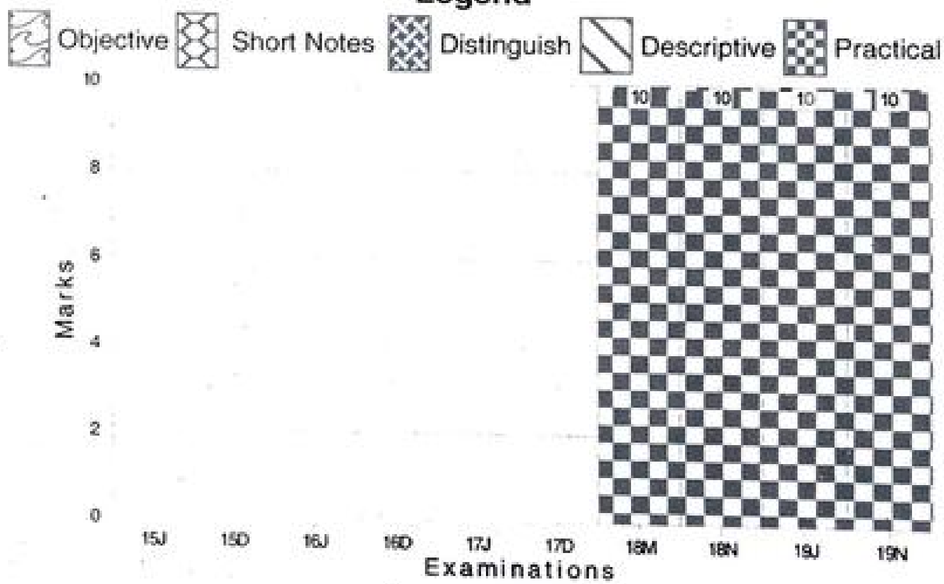
Particulars	₹	Particulars	₹
To Sales A/c	2,100	By Difference in Trial Balance (bal. fig.)	6,420
To Sen Brothers	4,500	By Discount Allowed A/c	180
	6,600		6,600

CHAPTER

3 Bank Reconciliation Statement

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend



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SELF STUDY QUESTIONS

Q1. What is a Bank? What are the Services Rendered by a Bank?

Answer:

An institution which deals with money is known as a bank. Its main business is to accept deposits and lend money.

Services rendered by Banks:

- Accepting deposits
- Granting loans
- Discounting promissory notes
- Making payment of premium on behalf of its clients
- Issuing letter of credit
- Collecting and making payments on behalf of clients

Q2. What is a Bank Pass Book? Give its specimen?

Answer:

- It is a copy of the client's account in bank's ledger which is issued to client.
- It shows all the transactions entered by the client through bank.
- The bank balance as per the bank ledger indicated in the bank passbook is called bank balance as per passbook.
- The credit balance as per passbook is the deposit made by the customer while debit balance as per passbook is termed as overdraft balance of the customer which is withdrawn by customer.

Specimen of Passbook

M/s _____ account with _______ (Bank)

Date	Description	Withdrawal (₹)	Deposit (₹)	Dr./Cr.	Balance (₹)

Q3. What is a Bank Reconciliation Statement?

Answer:

- A statement prepared to reconcile the balance as per cash book and balance as per pass book is commonly known as Bank Reconciliation Statement (BRS).
- Any difference between these two along with reasons are reflected in this statement.
- BRS is prepared at a particular date.

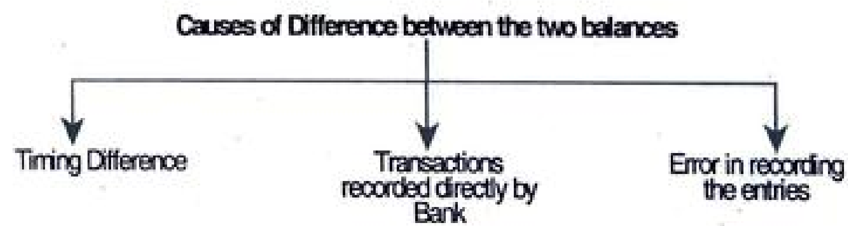
Q4. What is the Importance of Bank Reconciliation Statement?

Answer:

- A BRS highlights the errors or causes of difference so that necessary adjustment can be made.
- Any delay in clearance of cheque can be monitored.
- Reduces chances of fraud and acts as a moral check
- Actual position of balance at bank can be found.

Q5. What are the causes of difference between the two balances of Cash Book & the Pass Book?

Answer:



1. **Timing Difference**
   - When the same entry is recorded in either of the books earlier and in other book later, it is called a timing difference.

   Example:

   Cheque issued but not presented for payment: Here, entry in cashbook is done earlier, while no entry is done in passbook. Hence, passbook balance will be more than that in cashbook.

2. **Transactions recorded directly by Bank:**
Several entries are made by bank by means of software which includes Bank interest, Bank charges, etc. These entries are done without any intimation to the customer, hence balance of cash book would not have effect of such entries.

3. **Errors in recording the entries:**
   - If errors are committed by bank, the balance of passbook will differ from cash book. Similarly if error is committed in cash book, both the books will have different balances.
   - Errors can be due to omission of entry or error in totaling, etc. Some, items that frequently cause a difference are:
     - (i) Cheques issued but not presented for payment.
     - (ii) Cheques paid into bank but not cleared.
     - (iii) Interest allowed by bank.
     - (iv) Interest and expenses charged by bank without prior intimation to customers.
     - (v) Interest and dividends collected by banks on due dates and directly deposited to customers' account.
     - (vi) Direct payment such as insurance premium made by bank.
     - (vii) Direct payment into bank by debtor of the account holder.
     - (viii) Dishonour of a bill discounted with bank along with interest charges.
     - (ix) Bills collected by bank on behalf of customers.
     - (x) Errors committed either by bank in passbook, or by client in cashbook, such as wrong totaling, wrong recording of account, etc.

Q6. What is the Procedure for reconciling the Cash Book balance with the Pass Book balance?

Answer:

Step 1 BRS can be started with either of following balances.

(i) Debit balance of cash book (Favourable)
(ii) Credit balance of cashbook (Unfavourable)
(iii) Debit balance of passbook (Unfavourable)
(iv) Credit balance of passbook (Favourable)

Step 2 Ascertaining the cause of difference if causes are known

1. Starting with favourable balance of cash book [Debit Balance]

- *Add:* Items of diffence which led to decreased cash book balance
- *Less:* Items of diffenece which led to increased cash book balance

2. Starting with unfavourable balance/overdraft balance of Cash Book [Credit Balance]

- *Add:* Items of difference which led to decreased overdraft Cash book balance
- *Less:* Items of differenece which led to increased overdraft cash book balance

3. Starting with favourable balance of pass book [credit balance]

- *Add:* Itmes of diffeence that have led to reduced pass book balance
- *Less:* Items of diffenece the have led to increased pass book balance.

4. Starting with unfavourable balance of pass book (Debit Balance)

- *Add:* Itmes of diffeence that have led to decreased pass book overdraft balance.
- *Less:* Items of diffenece that have led to increased pass book overdraft balance

If causes are not known, compare each and every entry of bank pass book with cash book, those entries which do not match are the reason of differences.

Q7. What are the Various Methods of Bank Reconciliation?

Answer:

Bank Reconciliation statement without preparation of adjusted Cash-Book

Causes of differences	Favorable balance (Dr.) as per Cash Book	Unfavourable balance (Cr.) as per Cash Book	Favourable balance (Cr.) as per Pass Book	Unfavourable balance (Dr.) as per Pass Book
Cheque deposited but not cleared	Subtract	Add	Add	Subtract
Cheque issued but not presented to bank	Add	Subtract	Subtract	Add
Cheque directly deposited in bank by a customer	Add	Subtract	Subtract	Add
Income (e.g., interest from UTI) directly received by bank	Add	Subtract	Subtract	Add
Expenses (e.g., telephone bills) directly paid by bank on standing instructions	Subtract	Add	Add	Subtract
Bank charges levied by bank	Subtract	Add	Add	Subtract
Locker rent levied by bank	Subtract	Add	Add	Subtract
Wrong debit in the cash book	Subtract	Add	Add	Subtract
Wrong credit in the cash book	Add	Subtract	Subtract	Add
Wrong debit in the pass book	Subtract	Add	Add	Subtract
Undercasting of Dr. side of bank account in the cash book	Add	Subtract	Subtract	Add
Overcasting of Dr. side of bank account in cash book	Subtract	Add	Add	Subtract
Undercasting of Cr. side of bank account in cash book	Subtract	Add	Add	Subtract
Overcasting of Cr. side of bank account in Cash book	Add	Subtract	Subtract	Add
Bill receivable collected directly by bank	Add	Subtract	Subtract	Add
Interest on bank overdraft charged	Subtract	Add	Add	Subtract

Final Balance	If answer is positive, then favourable balance (Cr.) as per pass book; and, if negative, then unfavourable balance (Dr.) as per pass book	If answer is positive, then unfavourable balance (Dr.) as per pass book; and, if negative, then favourable balance (Cr.) as per pass book	If answer is positive, then favourable balance (Dr.) as per cash book; and, if negative, then unfavourable balance (Cr.) as per cash book	If answer is positive, then unfavourable balance (Cr.) as per cash book; and, if negative, then favourable balance (Dr.) as per cash book

Methods of Presentation of BRS

1. Balance Presentation
2. Plus & Minus Presentation

Example

From the following particulars, prepare Bank Reconciliation Statement through

(a) Balance Presentation

(b) Plus & Minus Presentation

		₹
(i)	Overdraft as per cash book	1,80,000
(ii)	Overdraft as per pass book	2,13,900
(iii)	Cheque deposited into bank but no entry in cash book	3,000
(iv)	Cheque received and entered into cash book but not sent to bank	1,000
(v)	Credit side of bank column casted short	5,000
(vi)	Insurance premium paid directly by bank under standing order	10,000
(vii)	Bank charges entered twice in cash book	100
(viii)	Cheque received, returned by bank but no entry passed	40,000

(ix)	Cheque issued, returned on technical grounds	3,000
(x)	Bills discounted, dishonoured	4,000
(xi)	Bills receivable directly collected by bank	20,000

Solution:

(a) Balance Presentation

Bank Reconciliation Statement

Particulars	Amount	Amount
Overdraft as per cashbook (Cr.)		1,80,000
Add: Cheque received and entered in cashbook but not sent to bank	1,000	
Credit side of bank column casted short	5,000	
Insurance premium paid directly by bank	10,000	
Cheque received returned by bank	40,000	
Bills discounted, dishonoured	4,000	60,000
		2,40,000
Less: Bank charges entered twice in cashbook	100	
Cheques issued and returned on technical grounds	3,000	
Bills directly collected by bank	20,000	
Cheques deposited into bank but no entry passed in cashbook	3,000	(26,100)
Overdraft as Passbook (Dr.)		2,13,900

(b) Plus minus Presentation

Particulars	Plus Items (₹)	Minus Items (₹)
Overdraft as per cash book		1,80,000
Cheque deposited into bank but no entry the cashbook	3,000	
Cheque received and entered into cashbook but not sent to bank		1,000
Credit side of bank column casted short		5,000
Insurance premium paid directly by bank under standing order		10,000
Bank charges entered in cash book twice	100	
Cheques received, returned by bank but no entry passed		40,000
Cheques issued, returned on technical grounds	3,000	
Bills discounted, dishonoured		4,000
Bills receivable directly collected by bank	20,000	
	26,100	
Overdraft as per pass book	2,13,900	
[2,40,000 - 3,000 - 100 - 3,000 - 20,000]	2,40,000	2,40,000

Q8. How is Bank Reconciliation Statement made after the preparation of adjusted cashbook?

Answer:

Meaning of Adjusted Cashbook: If before preparation of bank reconciliation statement, certain adjustments are made in balance as per cashbook, it is called adjusted cashbook.

- Preparation of Adjusted Cash Book is optional, if reconciliation in done in different months.

- If reconciliation is done at year end, adjusted cash book must be prepared.
- Preparation of BRS using adjusted cash book:

  Step 1 All errors (including wrong/totaling, omission, under/overcasting, bank changes etc.) are corrected by making adjustments in cashbook.

  Step 2 This adjusted Cash Book balance is transferred to BRS.

  Step 3 All other timing differences are directly taken to BRS.

  Step 4 Reconcile the balance of both the books.

Example

On 31st December 2017, Rajesh's cash book showed a balance of ₹1,700 representing cash at bank. At that date, the cashier checked the Bank statement received from bank with cash book and all amounts agreed except:

(a) The bank had paid subscription of ₹50 to a motoring organisation. This amount has not been entered in the cash book.

(b) During the month of December, the bank had debited Rajesh's A/c with ₹30 in respect of bank charges. No record had been made in the cash book

(c) Rajesh's cashier had received a remittance from Rudra sen for ₹1,000 on 31st December and entered the same in the cash book, but this amount was not yet credited by bank.

(d) The following cheques drawn and recorded in cash book on 31st December had not yet been presented to bank for payment:

Sushil ₹500

Lalit ₹800

(e) The bank had credited Rajesh's A/c with ₹200 in respect of dividend on shares, but this had not been entered in the cash book.

You are required to show the adjustments to be made in cashbook and draw up a Bank Reconciliation Statement on 31st December 2017.

Solution

Rajesh's Cash book

Dr. Cr.

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
2017			2017		
Dec. 31	To Balance b/d	1,700	Dec. 31	By Subscription to motoring org.	50
	To Dividend	200		By Bank charges	30
				By Balance c/d	1,820
		1,900			1,900
Jan 1	To Balance b/d	1,820			

Bank Reconciliation Statement

Particulars	Amount (₹)	Amount (₹)
Balance as per cash book (Dr.)		1,820
Less: Cheques from Rudrasen paid into bank but not credited in Bank Statement		(1,000)
		820
Add: Cheques drawn but not presented for payment:		
– Sushil	500	
– Lalit	800	1,300
Bank Balance as per Bank Statement (Cr.)		2,120

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. Bank Reconciliation statement is:
   (a) A part of Pass Book
   (b) A statement prepared by bank
   (c) A cash book related to cash column
   (d) A statement prepared by customers
2. Debit balance as per cash book ₹2000
   Cheques deposited but not cleared ₹100
   Cheques issued but not presented ₹150
   Bank allowed interest ₹50
   Bank collected dividend ₹50
   Balance as per Pass Book will be:
   (a) ₹2,100
   (b) ₹1,950
   (c) ₹2,350
   (d) ₹2,150
3. Unfavourable bank balance means:
   (a) Credit balance in Cash Book
   (b) Credit balance in Pass Book
   (c) Debit balance in Cash Book
   (d) Favourable balance in Cash Book
4. A Bank Reconciliation Statement is prepared to know the causes for the difference between:
   (a) The balance as per cash column of Cash Book and the Pass book
   (b) The balance as per bank column of Cash Book and the Pass book
   (c) The balance as per bank column of Cash Book and balance as per cash column of Cash Book
   (d) None

5. The Cash book showed an overdraft of ₹1,500 but the pass book made up to same date showed that cheques of ₹100, ₹50 and ₹125 had not been presented for payment and a cheque of ₹400 had not been cleared. The balance as per the Pass Book will be:
   (a) ₹1,100
   (b) ₹1,625
   (c) ₹2,175
   (d) ₹1,375
6. When Money is withdrawn from bank, the bank:
   (a) Credits Customers A/c
   (b) Debits Customer's A/c
   (c) Credits and Debits customer's A/c
   (d) None of these
7. The credit balance of ₹2,000 in the bank column of the cash book was carried forwarded as its debit balance. When overdraft as per pass book is starting point:
   (a) ₹2,000 will be deducted
   (b) ₹2,000 will be added
   (c) ₹4,000 will be deducted
   (d) ₹4,000 will be added
8. Which of these types of errors are not detected during Bank Reconciliation':
   (a) Cash embezzlement by cashier
   (b) Cheques deposited but not credited by bank
   (c) Casting mistakes in bank column of cash book
   (d) Interest or commission charged by the bank not accounted in cash book
9. Balance as per Cash Book is ₹5,000. Cheques issued but not presented for payment ₹2,000 and cheques sent for collection but not collected ₹1,500. The Bank had wrongly debited the account of firm by ₹20. Balance as per pass book will be:
   (a) ₹5,580
   (b) ₹5,480

   (c) ₹4,520
   (d) ₹5,520
10. Balance shown by Cash Book ₹10,000
    Cheques issued but not presented for payment ₹4,000
    Cheques deposited but not yet collected ₹3,000
    Balance as per Pass Book will be:
    (a) ₹9,000
    (b) ₹10,000
    (c) ₹11,000
    (d) None
11. Favourable balance as per Cash Book means:
    (a) Debit balance in the bank column of the cash book
    (b) Debit balance in the pass book
    (c) Credit balance in the bank column of the cash book
    (d) None of these
12. In arriving at adjusted cash balance, which of the following is not taken into account:
    (a) Amount deposited by our customer directly in our account
    (b) Errors in the Cash book
    (c) Errors in the Pass book
    (d) All of these
13. If we take balance as per Pass book, which of the following will be deducted to get balance as per cash book:
    (a) Interest given by bank
    (b) Interest charged by Bank
    (c) Cheque deposited but not cleared
    (d) Payment made by bank under standing instructions
14. Bank balance shown in Trial Balance is:
    (a) Balance as per pass book
    (b) Balance as per cash Book
    (c) Balance as per purchase book
    (d) Both (a) and (b)

15. When favourable balance as per cash book is the starting point, wrong debit by the bank to the firm will be:
    (a) Added
    (b) Subtracted
    (c) Both
    (d) None
16. Credit balance as per Cash Book ₹10,000
    Bank charged interest ₹150
    Cheques issued but not presented for payment ₹2,500
    Balance as per Pass Book will be:
    (a) ₹7,650
    (b) ₹12,350
    (c) ₹12,650
    (d) None of these
17. When overdraft as per Cash book is the starting point, a cheque of ₹500 deposited into bank but not recorded in cash book will be:
    (a) Added by ₹500
    (b) Deducted by ₹500
    (c) Added by ₹1,000
    (d) Deducted by ₹1,000
18. Overdraft as per Cash book means:
    (a) Credit balance in the cash book
    (b) Credit balance in the bank column of the cash book
    (c) Decrease in Liability
    (d) None
19. If balance as per Pass Book is the starting point, then uncollected cheques are:
    (a) Added in BRS
    (b) Subtracted in BRS
    (c) Ignored while preparing BRS
    (d) None of these
20. Balance as per pass book ₹20,000 ₹4,000 were directly deposited by a customer into the bank. Then the balance as per cash book is:
    (a) ₹24,000

    (b) ₹18,000
    (c) ₹16,000
    (d) ₹22,000
21. The balance as per Cash Book is ₹10,000 Cheques for ₹2,000 were issued but not presented for payment. What would be the balance as per Pass Book?
    (a) ₹10,000
    (b) ₹2,000
    (c) ₹12,000
    (d) None of the above
22. The balance as per Cash Book (overdraft) is ₹1,500. Cheques for ₹400 were deposited, but were not collected. The cheques issued but not presented were ₹100, ₹125, ₹50. Balance as per Pass Book is:
    (a) ₹1,100
    (b) ₹1,625
    (c) ₹2,175
    (d) ₹1,375
23. If the balance as per Pass Book is the starting point, the treatment of undercasting of receipt side of Cash Book will be:
    (a) Added
    (b) Deducted
    (c) No treatment
    (d) None of these
24. The payment side of Cash Book is undercast by ₹250. If the starting point of BRS is the Overdraft Balance as per Pass Book, then what would be the treatment to reach to Overdraft Balance of Cash Book?
    (a) ₹250
    (b) ₹250
    (c) ₹500
    (d) ₹500
25. Bank Overdraft as per cash book is ₹10,500. Interest debited by bank ₹3,500 for which advice was not received by account holder. Cheques deposited but not credited by bank ₹7,500. Cheques issued but not yet presented ₹9,500. What is the Overdraft amount as per Pass Book?

(a) ₹12,000
(b) ₹16,000
(c) ₹5,000
(d) ₹9,000

26. On 31.3.09, the balance of the cash book is ₹7,074 (credit) and Balance as per Bank statement is ₹3,159 (debit). On scrutiny it was found that the difference was due to cheques issued but yet not presented for payment. The Bank Balance as on 31.3.09 to be shown in Balance Sheet as:
(a) As Bank Overdraft ₹3,159
(b) As Cash at Bank ₹7,074
(c) As Bank Overdraft ₹7,074
(d) As Cash at Bank ₹3,159

27. Favourable balance as per Cash Book is ₹5,000. Debit side of Cash Book under cast by ₹2,000. Cheque deposited into bank ₹3,000 dishonoured, but no entry for dishonour is made in cash book. Balance as per Pass Book is:
(a) ₹4,000
(b) ₹10,000
(c) ₹6,000
(d) None of the above.

28. A trader issued cheques worth ₹7,800 out of which cheques worth ₹ 6,500 only presented into bank; then, on reconciling the Cash Book with the Pass Book, the amount to be added will be:
(a) ₹1,300
(b) ₹7,800
(c) ₹6,500
(d) ₹14,300

29. Debit balance as per cash book of ABC Enterprises as on 31st March, 2012 was ₹1,500. Cheques deposited but not cleared amount to ₹100. Cheques issued but not presented amount to ₹150.
The bank allowed interest amounting to ₹50 and collected dividend ₹50 on behalf of ABC Enterprises. Balance as per Pass Book as on 31st March 2012, should be:
(a) ₹1,600

(b) ₹1,450
(c) ₹1,850
(d) ₹1,650

30. When over draft as per cash book is the starting point, a cheque of ₹ 5,500 was deposited in bank and duly credited by bank, but not recorded in cash book; ________ in bank reconciliation statement.
(a) ₹5,500 will be added
(b) ₹5,500 will be deducted
(c) ₹11,000 will be added
(d) ₹11,000 will be deducted.

31. On 31st March, 2011, the bank statement of M/s Smile Traders showed a credit balance of ₹10,585. However, during the year, the following entries were not found in the cash book of the firm:
(1) The bank had debited ₹35 per month as bank charges
(2) Quarterly interest was credited to the account amounts respectively ₹25, ₹42, ₹39 and ₹57.
The balance of bank account as per the Cash Book of the firm as on 31st March, 2011 was:
(a) ₹10,547
(b) ₹10,713
(c) ₹10,328
(d) ₹10,842

32. Bank overdraft as per Cash Book on 31st May, 2011 was ₹8,720. Cheques deposited on 28th May but not credited until 31st May amounted to ₹690. These were credited on 4th June, 2011. Bank overdraft as per Pass Book is ________:
(a) ₹8,054
(b) ₹8,030
(c) ₹9,410
(d) ₹9,366

33. Bank column of a cash book of a trader shows a credit balance of ₹ 7,900. and the bank statement shows a debit balance of ₹10,300 on a particular date after payments made by the bank as per the standing orders. In the statement of affairs, the bank balance will be shown on:

(a) Assets side ₹7,900
(b) Liabilities side ₹7,000
(c) Liabilities side ₹2,400
(d) Assets side ₹10,300

34. The bank charged ₹1,000 as bank charges to a client and communicated the same to him. The accountant records it in the bank account in books. Later on, the bank realizes that the charges were wrongly charged and reverses the same, but forgot to communicate the same to the client. If the accountant is starting with the debit balance as per bank account in books, what will be the treatment in Bank Reconciliation statement to arrive at balance as per Bank statement:
(a) Reduce ₹1,000
(b) Add ₹1,000
(c) Add ₹2,000
(d) No treatment

35. An amount of ₹5,000 is debited twice in pass book; to prepare Bank Reconciliation Statement, when overdraft as per the cash book in the starting point:
(a) ₹5,000 will be deducted
(b) ₹5,000 will be added
(c) ₹10,000 will be deducted
(d) ₹10,000 will be added

36. The overdraft as per cash book of Mr. X is ₹20,500. One of the customers of Mr. X residing in Mumbai directly remitted ₹50,000 into Mr. X's account, about which Mr. X was not aware. One of the cheques deposited into bank for ₹25,000 was returned unpaid and the advice in this regard is yet to be received by Mr. X. The balance as per Pass book was:
(a) ₹4,500 credit
(b) ₹4,500 overdraft
(c) ₹45,500 credit
(d) None of the above.

37. While preparing bank reconciliation statement with favourable balance as per cash book, which of the following will not be added?

(a) Cheques deposited but not cleared
(b) Cheques issued but not presented to bank
(c) Cheques directly deposited in bank by a customer
(d) Overcasting of Cr. side of the bank account in cash book.

38. ABC Co. has issued a cheque to its suppliers for an amount of ₹10,000, but the accountant of the company by error has recorded the payment as ₹1,000. This error can be primarily identified on preparing ____________.
(a) profit and loss account
(b) trial balance
(c) bank book
(d) bank reconciliation statement

39. The credit balance as per pass book of Mr. X was ₹65,600. Cheques issued but not presented for payment ₹75,800. Cheques deposited by one of the customers of the bank, but wrongly credited in Mr. X account ₹20,600. The balance as per cash book will be:-
(a) ₹30,800 Debit
(b) ₹30,800 overdraft
(c) ₹1,20,800 Debit
(d) ₹10,400 overdraft.

40. On 31.3.13, the balance of the bank book is ₹7,074 (Credit) and balance as per bank statement is ₹3,159 (Debit). On scrutiny, it was found that the difference was due to cheques issued but yet not presented for payment. The bank balance as on 31.3.13 will be shown in the Balance Sheet as:
(a) As Bank Overdraft ₹3,159
(b) As Cash at Bank ₹7,674
(c) As Bank Overdraft ₹7,074
(d) As Cash at Bank ₹3,159.

41. For preparing Bank Reconciliation statement, the documents/statements required are:
(a) Cash column of cash book and bank statement
(b) Bank column of cash book and bank statement

(c) Bank and cash column of the cash book
(d) Bank statement

42. The cash book showed an overdraft of ₹2,000 as cash at bank but the pass book upto the same date showed that cheques of ₹100, ₹150 and ₹175 have not been presented for payments; and the cheque of ₹600 deposited into account has not been cleared. The overdraft as per pass book will be:
(a) ₹2,150
(b) ₹2,175
(c) ₹1,475
(d) ₹1,925

43. From the following particulars, ascertain the balance as per Cash Book as on 30th April 2014:
a. Bank Overdraft as per Pass Book ₹26,500
b. Cheques recorded in Cash Book but not sent to bank for collection ₹11,000
c. Payments received from customers directly by bank ₹4,700
d. Bills of ₹4,000 (discounted with the bank) dishonoured on 20th April and Noting charges paid by bank ₹200
(a) ₹28,600 Overdraft
(b) ₹6,600 Overdraft
(c) ₹16,000 Overdraft
(d) ₹46,400 Overdraft

44. Anuj presented four cheques - ₹23,000, ₹21,000, ₹16,000 and ₹14,000 with the bank on 27th March, 2014. Out of these, cheques amounting ₹ 16,000 cleared on 30th March, 2014. Cheques amounting to ₹23,000 and ₹14,000 were shown in the pass book in the month of April 2014. Cheque of ₹21,000 was unsigned, so it was returned. Which of these cheques would be taken in Bank Reconciliation Statement?
(a) ₹23,000, ₹21,000 and ₹14,000
(b) ₹23,000, ₹21,000, ₹16,000 and ₹14,000
(c) ₹23,000, and ₹14,000
(d) ₹21,000

45. The cash book showed an overdraft of ₹15,000, but the pass book made upto the same date showed that cheques of ₹1,000, ₹500 and ₹ 1,250 respectively had not been presented for payment and the cheque of ₹4,000 paid into account had not been cleared. The bank has been given standing instructions of payment of premium of ₹1,500 directly to insurance company; and bank has collected ₹250 as dividend. The balance as per the pass book will be:
(a) ₹17,500 Dr.
(b) ₹16,250 Dr.
(c) ₹18,000 Dr.
(d) ₹18,750 Dr.

46. A Bank Reconciliation Statement is a part of:
(a) Bank Accounts
(b) Cash Book
(c) Part of accounting reports
(d) None of the above.

47. The Cash Book showed a credit balance of ₹9,000, but the pass book made up to the same date revealed that a cheque of ₹2,000 had not been presented for payment and the cheque of ₹3,000 paid into account had not been cleared. The balance as per the pass book will be:
(a) ₹14,000
(b) ₹ 8,000
(c) ₹ 4,000
(d) ₹10,000.

ANSWER

1.	(d)	2.	(d)	3.	(a)	4.	(b)	5.	(b)
6.	(b)	7.	(c)	8.	(a)	9.	(b)	10.	(c)
11.	(a)	12.	(c)	13.	(a)	14.	(b)	15.	(b)
16.	(a)	17.	(b)	18.	(b)	19.	(a)	20.	(c)
21.	(c)	22.	(b)	23.	(b)	24.	(b)	25.	(a)
26.	(c)	27.	(a)	28.	(a)	29.	(d)	30.	(b)

31.	(d)	32.	(c)	33.	(b)	34.	(b)	35.	(b)
36.	(a)	37.	(a)	38.	(d)	39.	(b)	40.	(c)
41.	(b)	42.	(b)	43.	(c)	44.	(c)	45.	(a)
46.	(d)	47.	(d)						

SHORT PRACTICE QUESTIONS

1. Explain Bank Reconciliation Statement
2. Mention at least 6 items that cause difference between balance as per Pass Book and Cash book.

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

1995 - May [5] State with reasons whether the following statement is true or false:

(i) Bank Reconciliation Statement is prepared to arrive at the Bank Balance (1.5 marks)

Answer:

False: Bank reconciliation statement is prepared to reconcile and explain the causes of difference between bank balance as per cash book and the same as per bank statement as on a particular date.

1996 - Nov [5] State with reasons whether the following statement is true or false:

(3) Interest charged by the bank will be deducted, when the overdraft as per the cash book is made the starting point for making the bank reconciliation statement. (2 marks)

Answer:

False: Interest charged by the bank will be added when the overdraft as per the Cash Book is made the starting point in preparing Bank Reconciliation Statement.

1997 - May [5] State with reasons whether the following statement is true or false:

(5) Interest charged by the bank will be deducted when the overdraft as per pass book is the starting point for preparing the Bank Reconciliation Statement to arrive at the balance as per cash book at the end. (2 marks)

Answer:

True: Interest charged by the bank had resulted in increased overdraft balance as shown by the Pass Book. Therefore, it will be deducted from this balance in bank reconciliation statement to arrive at the balance as per cash book at the end.

1997 - Nov [5] State with reasons whether the following statement is true or false:

(6) Bank Reconciliation statement is prepared to arrive at the bank balance. (1.5 marks)

Answer:

False: Bank reconciliation statement is prepared to reconcile and explain the causes of difference between bank balance as per cash book and the same as per bank statement as on a particular date.

2000 - Nov [5] State with reasons whether the following statement is true or false:

(10) Bank reconciliation statement is not prepared to arrive at the bank balance. (2 marks)

Answer:

True: BRS is prepared to explain the causes of difference between the balance as per cash book and the same as per cash book and the same as per bank statement as on a particular date.

2002 - May [5] State with reasons whether the following statement is true or false:

(6) Bank Reconciliation Statement is prepared to arrive at the bank balance. (2 marks)

Answer:

Please refer 1997 - Nov [5] (6) on page no. 310

2003 - May [5] State with reasons whether the following statement is true or false.

(x) If the balance as per Cash Book and Pass Book are the same, there is no need to prepare a Reconciliation Statement. (2 marks)

Answer:

True: The reconciliation statement is prepared only when any difference in the balances arises.

2004 - Nov [5] State with reasons whether the following statement is true or false:

(vii) Bank reconciliation statement is not prepared to arrive at the bank balance. (2 marks)

Answer:

True: Object of preparation of BRS is to reconcile the pass book balance and the cash book balance in order to find out the causes of difference between these two books on a particular date.

2006 - May [5] State with brief reasons whether the following statement is True or False:

(viii) 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. (2 marks)

Answer:

True: Direct collection received by the bank on behalf of its customer will increase the balance of pass book. as compared to the balance as per cash book, till the customer gets an intimation from the bank.

2006 - Nov [5] State with reasons whether the following statement is true or false:

(xi) Cheques issued, but not presented for payment will have to be deducted from balance as per the Pass book while arriving at the balance as per the Cash book. (2 marks)

Answer:

True: While preparing Bank Reconciliation Statement, cheques issued but not presented for payment will have to be deducted from balance as per Pass book, while arriving at the balance as per Cash book.

SHORT NOTES

2004 - Nov [6] Write a short note on the following: (Maximum limit 150 words)

(vi) Importance of bank reconciliation statement to a industrial unit. (5 marks)

Answer:

Importance of Bank Reconciliation statement to an industrial unit:

Banks are essential to modem society, but for an industrial unit, it serves as a necessary instrument in the commercial world. Most of the transactions of business are done through bank whether it is a receipt or payment, Rather, it is legally necessary to operate the transactions through bank after a certain limit. All the transactions, which have been operated through bank, if not verified properly, the industrial unit may not be sure about its liquidity position in the bank on a particular date. There may be some cheques which have been issued, but not presented, as well as there may be some deposits which has been deposited in bank, but not collected so far. Some expenses might have been debited or bills might have been dishonoured. If it is not known to industrial unit in time, it may lead to wrong conclusions. The errors committed by bank may not be known without preparing bank reconciliation statement. Preparation of bank reconciliation statement prevents the chances of embezzlement. Hence, bank reconciliation statement is very important and a necessity of an industrial unit as it plays a key role in the liquidity control of the industry.

2005 - May [6] Write short note on the following:

(ii) Importance of Bank Reconciliation statement. (5 marks)

Answer:

- Bank Reconciliation Statement (BRS) in prepared to reconcile and explain the causes of difference between bank balance as per cash book and passbook or bank statement on a particular date.
- Generally the two balances do not happen to be equal due to the various reasons of disagreement, so, it becomes necessary to prepare a reconciliation statement for the purpose of ascertaining the correct bank balance which is shown while preparing the Balance sheet.
- It is important to an accountant because the accountant must satisfy that both the balances (i.e. cash book and pass book balance) are identical at a certain point of time.
- It helps to detect any mistake in the cash book or the pass book.
- It helps in prevention of fraud.
- It helps us to know whether there is any undue delay in clearing of cheques.

DISTINGUISH BETWEEN

2000 - May [6] (d) Causes of difference between the balance shown by the Pass-book and the Cash book (5 marks)

Answer:

Theoretically there should be no difference between the balance shown by the Pass Book and the Cash Book. However, on a given date, it is possible that some entries may have been recorded in the cash book but not in the passbook and *vice versa*. As a result, the cashbook and the passbook may show different balances on a given date.

The differences may arise due to:

(1) Cheques issued but not yet presented for payment.
(2) Cheques paid into the bank but not yet cleared.
(3) Interest allowed by bank.
(4) Dishonor of cheques or bills.

(5) An error committed by the bank.
(6) Interest and expenses charged by the bank.
(7) Direct payments by the bank.
(8) Interest and other charges debited by the bank.
(9) Interest and dividend collected by the bank.
(10) Bills collected by the bank on behalf of the customer.

PRACTICAL QUESTIONS

1996 - Nov [4] According to the Cash-book of Gopi, there was a balance of ₹44,500 standing to his credit in bank of 30th June 1996. 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 up to 30th June, 1996.
(iii) A dividend of ₹4,000 and rent amounting to ₹6,000 received by the Bank not entered in the Cash book.
(iv) Insurance premium (upto 31st December 1996) 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 charge ₹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 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:

(a) To make the appropriate adjustments in the Cash-book, and
(b) To prepare a statement reconciling it with the Bank Pass-book.

(15 marks)

Q.R. Code for Solution Video

Answer:

As on 30th June, 1996
Adjusted Cash Book

Particulars	₹	Particulars	₹
To Balance b/d	44,500	By Insurance Premium A/c	2,700
To Dividend A/c	4,000	By Error in totalling A/c	50
To Rent A/c	6,000	By Bank Charges A/c	50
To Bill Receivable A/c	5,900	By Bills Payable A/c	2,000
		By Balance c/d	55,600
	60,400		60,400

Bank Reconciliation Statement

Particulars	₹
Adjusted balance as per Cash Book (Cr.)	55,600
Add: Cheques issued but not presented for payment till 30th June, 1996	60,000
	1,15,600
Less: Cheque paid into bank for collection but not collected till 30th June, 1996	50,000
Balance as per Pass Book	65,600

1997 - May [3] Following are the entries recorded in the Bank Column of the Cash Book of Mr. X for the month ending on 31.3.1997:

Cash Book (Bank Column)

Date	Particulars	₹	Date	Particulars	₹
15-3-97	To Cash	36,000	1-3-97	By Balance b/d	40,000
20-3-97	To Roy	24,000	4-3-97	By John	2,000
22-3-97	To Kapoor	10,000	6-3-97	By Krishnan	400
31-3-97	To Balance c/d	7,640	15-3-97	By Kailash	240
			20-3-97	By Joshi	35,000
		77,640			77,640
				By Balance b/d	7,640

On 31-3-1997 Mr. X received the Bank Statement. On perusal of the statement Mr. X ascertained the following information:

(i) Cheques deposited but not credited by the bank ₹10,000.
(ii) Interest on securities collected by the bank but not recorded in cash book ₹1,080.
(iii) Credit transfer not recorded in the cash book ₹200.
(iv) Dividend collected by the bank directly but not recorded in the cash book ₹1,000.
(v) Cheques issued but not presented for payment ₹37,400.
(vi) Interest debited by the bank but not recorded in the cash book ₹1,000.
(vii) 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.

(15 marks)

Answer:

In the books of Mr. X
Bank Reconciliation Statement
as on 31st March, 1997

Particulars		₹
Balance as per Cash Book (Cr.) (Overdraft)		7,640
Add: Cheques deposited but not credited by Bank	10,000	
Interest debited by Bank	1,000	
Bank charges not recorded in Cash Book	340	11,340
		18,980
Less: Interest on Securities collected by Bank	1,080	
Credit transfer not recorded in Cash Book	200	
Dividend collected by Bank directly	1,000	
Cheques issued but not presented for payment	37,400	39,680
Balance as per Pass Book (Cr.) (Favourable)		20,700

2002 - Nov [3] (a) Prepare a bank reconciliation statement from the following particulars on 31 March, 2002

(i)	Debit balance as per bank column of cash book	3,72,000
(ii)	Cheque issued to creditors, but not yet presented to the bank for payment	72,000
(iii)	Dividend received by the bank, but not entered in the Cash book	5,000
(iv)	Interest allowed by the bank	1,250
(v)	Cheques deposited into bank for collection, but not collected by bank upto this date	15,400
(vi)	Bank charges	200
(vii)	A cheque deposited into bank was dishonored, but no intimation received.	320
(viii)	Bank paid House tax on our behalf, but no information received from bank in this connection.	350

(6 marks)

Q.R. Code for Solution Video

Answer:

Bank Reconciliation Statement
as on 31st March, 2002

Particulars		₹
Balance as per Cash Book (Favourable) (Dr.)		3,72,000
Add: Cheques issued but not presented	72,000	
Dividend received by Bank	5,000	
Interest allowed by Bank	1,250	78,250
		4,50,250
Less: Cheques deposited but not collected yet	15,400	
Bank charges	200	
Cheques deposited, dishonoured	320	
House tax paid by Bank	350	16,270
Balance as per Pass Book (Favourable) (Cr.)		4,33,980

2003 - Nov [2] (b) On 31st March 2003, Pass book of a trader showed a Credit Balance of ₹1,565, but the pass book balance was different for the following reasons from the Cash Book Balance:

(i) Cheques issued to 'X' for ₹600 and to 'Y' for ₹384 were not yet presented for payment.

(ii) Bank charged ₹35 Bank charges and 'Z' directly deposited ₹816 into the Bank account, which were not entered in the Cash Book. .

(iii) Two cheques from 'A' for ₹515 and another from 'B' for ₹1,250 were credited by the bank in the first week of April, 2003 although they were deposited on 25-03-2003.

(iv) Interest allowed by bank ₹45.

Prepare Bank Reconciliation Statement as on 31st March, 2003.

(6 marks)

Q.R. Code for Solution Video

Answer:

Bank Reconciliation Statement
as on 31st March, 2003

Particulars		₹
Balance as per Pass Book (Favourable) (Cr.)		1,565
Add: Bank Charges	35	
Cheques from 'A' and 'B' (₹515 + ₹1,250)	1,765	1,800
		3,365
Less: Cheques issued but not presented (₹600 + ₹384)	984	
Direct deposit by Z into bank	816	
Interest allowed by Bank	45	1,845
Balance as per Cash Book (Dr.) (Favourable)		1,520

2004 - May [3] (a) Prepare a Bank Reconciliation Statement as on 30th September 2003 from the following particulars:

	₹
Bank balance as per the pass-book (credit)	10,000
Deposited into the bank, but no entry was passed in the Cash Book	500
Cheque received, but not sent to bank	1,200
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, dishonored, not recorded in the Cash book	5,200

(9 marks)

Answer:

Bank Reconciliation Statement
as on 30th September, 2003

Particulars		₹
Balance as per Pass Book (Cr.) (Favourable)		10,000
Add: Cheque received but not sent to Bank	1,200	
Insurance Premium paid directly by Bank	600	
Cheque received, entered twice in cash book	1,000	
Bill discounted, dishonoured not recorded in Cash Book	5,200	8,000
		18,000
Less: Deposited into Bank, but no entry in Cash Book	500	
Bank charges entered twice in Cash Book	20	
Cheques issued but not presented to the Bank	500	1,020
Balance as per Cash Book (Dr.) (Favourable)		16,980

2005 - Nov [2] (a) From the following particulars, prepare the Bank Reconciliation Statement as on 30th September, 2005:

		₹
(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 in 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 ₹7,960 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

(10 marks)

Answer:

Bank Reconciliation Statement
as on 30th September, 2005

Particulars		₹
Balance as per Pass Book (Dr.) (Overdraft)		21,494
Add: Cheque deposited not recorded in Cash Book	700	
Debit side of the bank column undercast	100	
Bills collected directly by bank	3,500	
Bank charges recorded twice in cash book	25	
Cheque issued, but not yet presented	1,250	5,575
		27,069
Less: Less credit in Pass Book for a cheque of ₹5,000	4	
Party's cheque returned dishonoured	530	
Bill of ₹8,000 discounted for ₹7,960 returned dishonoured	8,000	
Noting charges	15	
Cheque deposited but not yet collected	2,320	10,869
Balance as per Cash Book (Cr.) (Overdraft)		16,200

2018 - May [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:

(i) A Cheque of ₹1,080 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.

(ii) 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.

(iii) 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.

(iv) 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.

(v) 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.

(vi) A Cheque for ₹1,000 entered in Cash Book but omitted to be banked on 31st March, 2018.

(vii) A Bill Receivable for ₹5,200 previously dishonoured (Discount ₹200) with the Bank had been dishonoured but advice was received on 1st April, 2018.

(viii) 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.

(ix) A Cheque for ₹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)

Q.R. Code for Solution Video

Answer:

In the books of Mrs. Rani
Bank Reconciliation Statement as on 31st March, 2018

Particulars		₹
Balance as per Pass Book (Dr.) (Overdraft)		33,575
Add: Dishonour of cheque of ₹1,080 (Note)	–	
Interest collected by bank	2,800	
Cheques drawn but not encashed	2,500	
Wrong credit by Bank	500	
Rebate not entered in Cash Book	175	

Cheque deposited but omitted to be recorded in Cash Book	2,400	8,375
		41,950
Less: Cheques paid in but not collected	7,500	
Wrong debit by Bank	300	
Cheque omitted to be banked	1,000	
Bill previously discounted, dishonoured	5,200	14,000
Balance as per Cash Book (Cr.) (Overdraft)		27,950

Note: Since the Pass Book was debited on 1st April, 2018, on adjustment is required for (i) as there would be no difference as on 31st March, 2018.

2018 - Nov [4] (b) Prepare a bank reconciliation statement from the following particulars as on 31st March, 2018.

Particulars	(₹)
Debit balance as per bank column of the cash book	18,60,000
Cheque issued to creditors but not yet presented to the Bank for payment	3,60,000
Dividend received by the bank but not entered in the Cash book	2,50,000
Interest allowed by the Bank	6,250
Cheques deposited into bank for collection but not collected by bank up to this date	7,70,000
Bank charges not entered in Cash Book	1,000
A cheque deposited into bank was dishonored, but no intimation received.	1,60,000
Bank paid house tax on our behalf, but no intimation received from bank in this connection	1,75,000

(10 marks)

Q.R. Code for Solution Video

Answer:

Bank Reconciliation Statement as on 31st March, 2018

Particulars		₹
Balance as per Cash Book (Dr.) (Favourable)		18,60,000
Add: Cheques issued but not yet presented	3,60,000	
Dividend received by Bank	2,50,000	
Interest allowed by Bank	6,250	6,16,250
		24,76,250
Less: Cheques deposited but not yet collected	7,70,000	
Bank charges	1,000	
Cheque dishonoured	1,60,000	
House tax paid by Bank	1,75,000	11,06,000
Balance as per Pass Book (Cr.) (Favourable)		13,70,250

2019 - June [2] (a) Prepare the Bank Reconciliation Statement of M/s. R. K. Brothers on 30th June 2018 from the particulars given below:

(i) The Bank Pass Book had a debit balance of ₹25,000 on 30th June, 2018

(ii) A cheque worth ₹400 directly deposited into Bank by a customer but no entry was made in the Cash Book.

(iii) Out of cheques issued worth ₹34,000, cheques amounting to ₹20,000 only were presented for payment till 30th June, 2018.

(iv) A cheque for ₹4,000 received and entered in the Cash Book but it was not sent to the bank.

(v) Cheques worth ₹20,000 had been sent to Bank for collection but the collection was reported by the Bank as under.
  - (1) Cheques collected before 30th June, 2018, ₹14,000
  - (2) Cheques collected on 10th July, 2018, ₹4,000
  - (3) Cheques collected on 12th July, 2018, ₹2,000.

(vi) The Bank made a direct payment of ₹600 which was not recorded in the Cash Book.

(vii) Interest on Overdraft charged by the bank ₹1,600 was not recorded in the Cash Book.

(viii) Bank charges worth ₹80 have been entered twice in the cash book whereas Insurance charges for ₹70 directly paid by Bank was not at all entered in the Cash Book.

(ix) The credit side of bank column of Cash Book was undercast by ₹ 2,000. (10 marks)

Answer:

Bank Reconciliation Statement as on 30th June 2018

Particulars	Amount	Amount
Overdraft as per Pass Book (Dr. Balance)		25,000
Add: Cheques issued but not presented ₹(34,000 - 20,000)	14,000	
Cheques deposited into the Bank by Customer but not entered in Cash Book	400	
Bank charges written twice in Cash Book	80	14,480
		39,480
Less: Cheques received, recorded in cash Book but not sent to the Bank	4,000	
Cheques sent to the Bank but not collected	6,000	
Direct payment made by the bank not recorded in the Cash book	600	
Interest on Overdraft charged by bank	1,600	
Insurance charges not entered in Cash Book	70	
Credit side of bank column of Cash Book was undercast	2,000	14,270
Overdraft as per Cash Book		25,210

2019 - Nov [2] (a) On 30th September, 2018, the bank account of XYZ, according to the bank column of the cash book, was overdrawn to the extent of ₹8,062. An examination of the Cash book and Bank Statement reveals the following:

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

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

(iii) On 29th September, 2018, the bank credited an amount of ₹1,15,400 received from a customer of XYZ, but the advice was not received by XYZ until 1st October, 2018.

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

(v) On 6th September 2018, the bank credited ₹30,000 to XYZ in error.

(vi) A bill of exchange for ₹1,60,000 was discounted by XYZ with his bank. The bill was dishonoured on 28th September, 2018 but no entry had been made in the books of XYZ.

(vii) Cheques issued upto 30th September, 2018 but not presented for payment upto that date totalled ₹13,46,000.

(viii) A bill payable of ₹2,00,000 had been paid by the bank but was not entered in the cash book and bill receivable for ₹60,000 had been discounted with the bank at a cost of ₹1,000 which had also not been recorded in cash book.

You are required:

To show the appropriate rectifications required in the cash book of XYZ, to arrive at the correct balance on 30th September, 2018 and to prepare a Bank Reconciliation Statement as on that date. (10 marks)

Answer:

In the books of XYZ

Adjusted Cash Book (Bank Column Only)

Dr. Cr.

Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)
2018 Sept. 30	To Party A/c	18,000	2018 Sept. 30	By Balance b/d	8,062
	To Customer's A/c (Direct Deposit)	1,15,400		By Bank Charges	280

	To Bills Receivable A/c (₹ 60,000 - ₹ 1,000)	59,000		By Customer's A/c (Bill Dishonoured)	1,60,000
	To Balance c/d	1,75,942		By Bills Payable A/c	2,00,000
		3,68,342			3,68,342

Bank Reconciliation Statement as on 30th September, 2018

Particulars		₹
Balance as per Cash Book (Cr.) (Overdraft)		1,75,942
Add: Cheques deposited but not credited		11,14,000
		12,89,942
Less: Incorrect credit by Bank	30,000	
Cheques issued but not presented	13,46,000	13,76,000
Balance as per Pass Book (Cr.) (Favourable)		86,058

CHAPTER

4 Inventories

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective | Short Notes | Distinguish | Descriptive | Practical

For detailed analysis Login at *www.scannerclasses.com* for registration and password see first page of this book.

Self Study Questions

Q1. What do you mean by Inventories as per AS - 2?

Answer:

According to Indian Accounting Standard (Ind AS) - 2, "Inventory are assets:

(a) held for sale in the ordinary course of business, or

(b) in the process of production for such sale, or
(c) for consumption in the production of goods or services for sale, including maintenance supplies and consumables other than machinery spares, servicing equipment and stand by equipment.

Thus, inventory in business comprises of raw material, work-in-progress, finished goods, stores and spare except those which can be used only in connection with an item of fixed asset having irregular use.

Q2. How is Inventory Valuation done? Elaborate its significance?

Answer:

"Inventories" are a part of business assets, hence, its valuation is necessary as it directly affects the financial position of the business.

Significance of Inventory Valuation:

1. **To estimate income of business** i.e., gross profit

   Gross Profit = Sales – Cost of Goods Sold

   Where,

   Cost of Goods Sold [COGS] = Opening Stock + Purchases + Direct Expenses – Closing Stock

   In case of closing stock, if value of closing stock is more, then the resultant gross profit will be high and *vice versa*.

   Similarly, in case of the opening stock, if value of opening stock is more, then the gross profit will be less and *vice-versa*.

   Hence, it is necessary that valuation is correctly done.

2. **Ascertainment of financial position:** Inventory being a business asset forms part of the Balance Sheet prepared for determining the financial position of the business.

3. **Liquidity Analysis:**

   Liquidity means the company's ability to meet the financial obligations as and when due. Current ratio is used for estimating the financial health.

   $$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current liabilities}}$$

   Where,

   Current Assets = Inventory + Trade Payables + Cash and Cash equivalents

4. **Statutory Compliance:**

   As per Schedule III to Companies Act, 2013, while preparing the Balance Sheet, along with proper classification of inventory (raw material work in progress, finished goods, etc.), mode of valuation of inventory should be stated.

   Also, as per Ind AS 2, the financial statements shall disclose-

   (a) accounting policies adopted is measuring inventories, including cost formula used;
   (b) total carrying amount of inventories and the carrying amount in classifications appropriate to the entity.

5. **Basis of Inventory Valuation:**

   Inventory shall be measured on cost or net realisable value, whichever is lower.

   Cost = Cost of purchase + Cost of Conversion + Other costs

   Where,

Cost of purchase	=	Purchase Price + Expenses related to purchase (freight, taxes etc.) – Discount/ Rebate received (if any)
Cost of Conversion	=	Direct Labour + Production Overheads (fixed or variable)
Other Costs	=	Cost incurred in bringing inventory to the present location and condition)

Q3. What are the Exclusions from Cost of Inventory?

Answer:

- any abnormal loss of material, labour and production cost;
- storage cost (not related to production process);
- administrative overheads (other than those used to bring inventory to present location and condition);
- selling cost.

Q4. What is Net Realisable Value?

Answer:

Net Realisable Value (NRV)	=	Estimated Selling Price - Estimated Cost of Completion - Estimated Cost necessary to make sale.
→ For Finished Goods: NRV	=	Selling Price - Selling and Distribution expenses
→ For Work-in-Progress: NRV	=	Selling Price - Expenses and Overheads for conversion into finished goods - Selling and Distribution expenses.
→ For Raw Materials: NRV	=	Replacement Cost

Q5. What are the "Inventory Recording Systems"?

Answer:

Inventory Record System

- Periodic/Physical inventory system
- Perpetual inventory system

Periodic Inventory System/Physical Inventory System

- Stock taking through actual physical count at a particular date.
- COGS = Opening + Purchases – Closing Stock (Physically Counted)
- Simple and cost efficient method.
- Year end adjustment to determine cost.
- **Limitations:**
  - Multiple stock taking at regular intervals increases cost;
  - Normal operations are suspended during physical count;
  - Inventory control not possible, and difficult to identify loss of stock;
  - Not suitable for medium or large enterprises.

Perpetual Inventory System

- Recording inventory balances after every receipt and issue transaction:
- Inventory ledger have records of goods on continuous basis.
- Closing Inventory = Opening stock + Purchases – COGS
- It includes loss of goods.
- Cost to apply this method is usually high.

Q6. Distinguish between Periodic Inventory System and Perpetual Inventory System

Basis	Periodic Inventory System	Perpetual Inventory System
Basis of Ascertaining inventory	Closing inventory is based on physical count.	Closing inventory is based on accounting records such as purchases made, inventory issued for production process.
Availability of information	At the end of a particular accounting period or at a particular date.	On a continuous basis, i.e., after each purchase or sale.
Inventory Control	Not Possible.	Possible.
Effect on normal operations	Suspended during physical count.	Not affected.
Cost	Less Costly.	Expensive method.
Loss of Stock	Cannot be calculated since goods not found on physical verification are assumed to be sold.	Can easily be calculated as a difference in closing stock as per books and stock taking.

Q7. What are the various Formulas / Methods to determine Cost of Inventory?

Historical Cost Methods

- Specific Identification Method
- First in First Out (FIFO)
- Last In First Out (LIFO)
- Simple Average Method
- Weighted Average Price Method

Answer:

Historical Cost Methods

1. **Specific Identification Method:**
   - It is a method where cost is assigned to each inventory item identified during physical count.
   - Specific purchase price of each lot is multiplied to number of outstanding units in the lot, to get the closing inventory cost.
   - Generally used to ascertain high value stock which are not inter-changeable.
2. **First In First Out (FIFO):**
   - Under this method, stock purchased earlier is issued first for production. Hence, usually the closing inventory comprises of latest purchases for the purpose of valuation.
   - This method of valuation is used in case of perishable goods or items which get obsolete due to frequent change in technology.
3. **Last In First Out (LIFO):**
   - Under this method, goods purchased last are issued first for production. Thus, closing inventory consists of old stock for valuation purpose.
   - Prices paid for earlier consignments are used to value to closing inventory.
4. **Simple Average Price Method:**
   - Under this method, inventory is valued on average price of purchases made at different dates and different rates.
   - It is a simple method to adopt, aggregate of different prices divided by number of prices, the resultant is average price.
5. **Weighted Average Price Method:**
   - Under this methods quantities of material are multiplied by respective rates of purchase and aggregate amount is divided by total of the quantities.
   - Closing inventory is valued on such weighted average price.
   - Weighted Average Price (per unit) = $\frac{\sum \text{No. of units} \times \text{Price per unit}}{\text{No. of units}}$

Example

XYZ Ltd. furnished the following stores transaction for December, 2017.

Dec. 1	Opening Balance	200 units @ ₹10 per unit
Dec. 5	Received	300 units @ ₹12 per unit
Dec. 10	Issued for Sale	400 units
Dec. 15	Received	400 units @ ₹14 per unit
Dec. 20	Issued for Sale	300 units
Dec. 25	Received	200 units @ ₹16 per unit
Dec. 30	Issued for Sale	300 units

Prepare store ledger and determine cost of goods sold as per (a) FIFO (b) LIFO (c) Weighted Averaged using.

(i) Perpetual Inventory System.

(ii) Periodic Inventory System.

Solution :

(a) Stock Ledger (On FIFO Basis):

Date	Receipts			Issues			Balance		
2017	Quantity	Rate	Amount	Quantity	Rate	Amount	Quantity	Rate	Amount
Dec. 1							200	10	2,000
Dec. 5	300	12	3,600				200	10	2,000
							300	12	3,600
Dec.10				200	10	2,000			
				200	12	2,400	100	12	1,200
Dec. 15	400	14	5,600				100	12	1,200
							400	14	5,600
Dec. 20				100	12	120			
				200	14	2,800	200	14	2,800
Dec. 25	200	16	3,200				200	14	2,800
							200	16	3,200
Dec. 30				200	14	2,800			
				100	16	1,600	100	16	1,600

Cost of Goods Sold

1. Perpetual System = 2,000 + 2,400 + 1,200 + 2,800 + 2,800 + 1,600
   = 12,800
2. Periodic System = Opening Stock + Purchases – Closing Stock
   = 2,000 + 12,400 – 1,600
   = 12,800

(b) Stock Ledger (On LIFO Basis)

Date	Receipts			Issues			Balance		
2017	Quantity	Rate	Amount	Quantity	Rate	Amount	Quantity	Rate	Amount
Dec. 1							200	10	2,000
Dec. 5	300	12	3,600				200	10	2,000
							300	12	3,600
Dec. 10				300	12	3,600			
				100	10	1,000	100	10	1,000
Dec. 15	400	14	5,600				100	10	1,000
							400	14	5,600
Dec. 20				300	14	4,200	100	10	1,000
							100	14	1,400
Dec. 25	200	16	3,200				100	10	1,000
							100	14	1,400
							200	16	3,200
Dec. 30				200	16	3,200			
				100	14	1,400	100	10	1,000

Cost of Goods Sold:

1. Perpetual System = 3,600 + 1,000 + 4,200 + 3,200 + 1,400
   = 13,400
2. Periodic System = Opening Stock + Purchases – (Closing Stock)
   = 2,000 + 12,400 – 1,000
   = 13,400

(c) Stock Ledger (On Weighted Average Basis)

Date	Receipts			Issues			Balance		
2017	Quantity	Rate	Amount	Quantity	Rate	Amount	Quantity	Rate	Amount
Dec. 1							200	10	2,000
Dec. 5	300	12	3,600				500	11.2[1]	5,600
Dec. 10				400	11.2	4,480	100	11.2	1,120
Dec. 15	400	14	5,600				500	13.44[2]	6,720
Dec. 20				300	13.44	4,032	200	13.44	2,688
Dec. 25	200	16	3,200				400	14.72[3]	5,888
Dec. 30				300	14.72	4,416	100	14.72	147

Notes:

1. $\frac{(200\times10)+(300\times12)}{200+300} = 11.12$
2. $\frac{(100\times11.12)+(400\times14)}{100+400} = 13.44$
3. $\frac{(200\times13.44)+(200\times16)}{200+200} = 14.72$

Cost of Goods Sold:

1. Perpetual System = 4,480 + 4,032 + 4,416
   = 12,928
2. Periodic System:

Weighted Average Unit Cost $= \frac{\text{Total amount of Purchased}}{\text{Total Units Purchased}}$

$= \frac{3{,}600+5{,}600+3{,}200}{300+400+200}$

$= \frac{12{,}400}{900} = 13.78$

Weighted Average Cost of 1,000 units

$= \frac{12{,}400}{900}\times1000 = 13{,}777.78$

5.2 Non Historical Cost Methods

Non Historical Cost Methods

- Adjusted Selling Price Method
- Standard Cost Method

1. **Adjusted Selling Price Method:**
   - Under this method, cost of inventory is determined by reducing the estimated gross margin as a percentage of sale value of inventory.
   - This method is used in valuation in retail businesses where inventory consists of individual costs which are not readily ascertainable.
2. **Standard Cost Method:**
   - Under this method, standard cost is set for each material and it is used to arrive at cost of inventory for valuation purpose.
   - For correct valuation, it is necessary that standards set must be realistic and reviewed on a regular basis.

Example:
From the following particulars calculate historical cost of inventory using adjusted price method.

Opening Stock	–
Cost of Purchases	5,00,000
Sales	7,00,000
Closing inventory (at SP)	1,00,000

Solution:
Calculation of Gross Margin:

Gross Margin = Sales + Closing Stock – Cost of Purchase
= 7,00,000 + 1,00,000 – 5,00,000

Gross Margin = 3,00,000

$$\text{Rate of Gross Margin} = \frac{\text{Gross Margin}}{\text{Sales + Closing Stock}} \times 100$$

$$= \frac{3,00,000}{8,00,000} \times 100$$

$$= 37.5\%$$

Cost of Closing inventory:

Inventory at SP	= 1,00,000
Less: Profit @ 37.5%	= (37,500)
	₹62,500 Historical Cost

6. **Inventory Taking**
   - It is the physical verification of inventory in stock, done at periodic intervals.
   - If date of inventory taking and closing of book is different, adjustment related to purchase and sale for the balance period must be made to arrive at correct closing stock.
   - Daily operations related to inflow and outflow of inventory needs to be suspended at the time of physical inventory taking.

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. Under Inflationary conditions, LIFO will lead to:
   (a) No change in sale
   (b) Higher Sale
   (c) Lower profit
   (d) Higher profit
2. Calculate the value of purchase through following details:

Opening Stock	₹20,000
Sales	₹1,50,000
Gross Profit Margin 20% of sales	
Closing Stock	₹30,000

   (a) ₹1,30,000
   (b) ₹1,40,000
   (c) ₹1,50,000
   (d) ₹1,60,000

3. Physical Inventory system is also known as:
   (a) Perpetual Inventory System
   (b) Periodic Inventory System
   (c) Inventory Record System
   (d) None
4. Closing stock is generally valued at:
   (a) Cost Price
   (b) Market price
   (c) Cost price or market price whichever is lower
   (d) Cost price or market price whichever is higher
5. What are the consequences of underevaluation of closing stock?
   (a) Under reporting of profit
   (b) Creation of hidden reserves
   (c) Reduction of tax liability
   (d) All the these
6. Particulars

	As on 1st March	As on 31st March
Stock	₹1,80,000	1,00,000

The Company made Purchase of ₹3,40,000 on credit. During March, the company paid ₹3,50,000 to suppliers. The goods are sold at 25% above cost. The Sales for the month of March were:
   (a) ₹4,12,500
   (b) ₹90,000
   (c) ₹5,25,000
   (d) ₹3,15,000
7. Find out value of Closing Stock:

Opening Stock	₹70,000
Purchase	₹4,16,000
Sales	₹5,22,000
Gross profit earned 25% of cost	

   (a) ₹68,400
   (b) ₹36,000
   (c) ₹94,500
   (d) None

8. Which method of inventory valuation is widely accepted by Income Tax Authority:
   (a) LIFO
   (b) FIFO
   (c) Adjusted selling price method
   (d) Specific identification method
9. Damaged inventory should be valued at:
   (a) Cost
   (b) Net realizable value
   (c) Current cost
   (d) Current market value
10. Inventory cost does not include:
   (a) Transit Insurance
   (b) Storage Cost
   (c) Tax and duties on purchases
   (d) Invoice price less discounts
11. Which of these is not an objective of inventory valuation?
   (a) To determine true profit and Loss
   (b) To show true financial position of the business
   (c) To properly value closing stock
   (d) To evade tax liability
12. The following data has been provided by Omega Ltd:

Item No.	Units	Cost per unit	Realization value per unit
1	2	10	11
2	10	5	4
3	2	2	2

The value of inventory on items will be :
   (a) ₹40
   (b) ₹64
   (c) ₹66
   (d) ₹60

13. When closing inventory is overstated, it results in:
    (a) Net income for the period to be overstated
    (b) Cost of goods sold to be understated
    (c) Both (a) and (b)
    (d) None of these
14. Inventory Valuation does not affect:
    (a) Net Incomes
    (b) Cash flow statement
    (c) Tax liability
    (d) Both (a) & (c)
15. Opening stock ₹10,000
    Purchases ₹1,10,000
    Closing Stock ₹20,000
    Find out total sales if profit margin is 30% on cost of sales:
    (a) ₹1,20,000
    (b) ₹1,30,000
    (c) ₹1,10,000
    (d) ₹1,25,000
16. Cost of Goods sold is equal to:
    (a) Opening Stock plus total purchases
    (b) Opening Stock plus total purchases minus closing stock + Direct Costs
    (c) Closing Stock plus total purchases
    (d) Opening Stock minus total purchases plus closing stock
17. Inventories are assets:
    (a) Held for sale in the ordinary course of business
    (b) In the production process for such sale
    (c) In the form of materials or supplies to be consumed in the production process or in the rendering of service
    (d) All of the above
18. On 31st March 2001, the closing stock of X Ltd. was ₹3,45,000. On 1st April 2001, stock of ₹2,25,000 was destroyed by fire. If the Balance Sheet of the company on 31st March 2001 was finalized on 25th April, 2001 then the Balance Sheet will show closing Stock at:

    (a) ₹3,45,000 with no mention of fire
    (b) ₹1,20,000 with no mention of fire
    (c) ₹3,45,000 showing loss by fire in footnote
    (d) ₹1,20,000 showing loss by fire in footnote
19. A businessman purchased goods for ₹25,00,000 and sold 70% of such goods during the accounting year ended 31st March, 2005. The market value of remaining goods was ₹5,00,000. He valued the Closing stock at ₹5,00,000 and not at ₹7,50,000 due to :
    (a) Money measurement
    (b) Conservatism
    (c) Cost
    (d) Periodicity
20. In case goods are manufactured and segregated for specified consumers, the best method for valuation of inventory would be:
    (a) FIFO
    (b) LIFO
    (c) Base Stock
    (d) Specific Identification
21. If average stock is ₹20,000. Closing stock is ₹4,000 more than value of opening stock. Closing stock will be:
    (a) ₹16,000
    (b) ₹18,000
    (c) ₹20,000
    (d) ₹22,000
22. Which method matches current cost with current revenue?
    (a) LIFO
    (b) FIFO
    (c) Weighted Average
    (d) Simple Average.
23. AS - 2 Prescribes the use of which method of stock valuation?
    (a) FIFO
    (b) LIFO
    (c) Weighted Average Cost
    (d) Both (a) and (c) above

24. If Gross profit is 1,00,000 and G.P. Ratio is 25%, find the value of Sales.
(a) 1,00,000
(b) 2,00,000
(c) 4,00,000
(d) 5,00,000

25.

	₹
Opening Stock	40,000
Closing Stock	50,000
Purchases	5,50,000
Return outward	5,000
Return inward	20,000
Carriage inward	5,000

If gross profit is 20% of sales, the gross sales will be:
(a) ₹6,95,000
(b) ₹6,75,000
(c) ₹5,40,000
(d) ₹6,68,750

26. Closing Stock is:
(a) Opening Stock + Purchases –Sales
(b) Purchases – Sales
(c) Opening Stock-Sales
(d) Opening Stock + Sales - Purchases

27. Purchases = ₹1,10,000, Return outward ₹10,000. Goods given away as charity = ₹1,500. Goods distributed as sample = ₹1,000. What is the amount of net purchases?
(a) ₹97,500
(b) ₹1,00,000
(c) ₹1,17,500
(d) ₹1,10,000

28. Stock on 15th April, 2008 is ₹50,000. Purchases made in 2nd week is ₹2,000, sales made in 2nd week is ₹12,000 Gross Profit on Sales is 25%. Closing stock as on 31st March 2008 will be:
(a) ₹75,000
(b) ₹57,000

(c) ₹60,000
(d) ₹50,000

29. What is the amount of purchase when opening stock = ₹3,500 closing stock = ₹1,500, Cost of goods sold = ₹22,000.
(a) ₹20,000
(b) ₹24,000
(c) ₹27,000
(d) ₹17,000

30. In conditions of inflation, which method will lead to the lowest value of stock?
(a) FIFO
(b) LIFO
(c) Average price method
(d) Weighted average pricing method.

31. Calculate Closing Stock using FIFO Method:

Particulars	Units	Rate
Opening Stock	100	₹50
Purchases	50	₹40
Issue	125	

(a) ₹5,000
(b) ₹1,000
(c) ₹1,250
(d) ₹6,250

32. Cost of Goods Sold =
(a) Opening Stock + Purchases - Closing Stock
(b) Opening Stock - Sales + Closing Stock
(c) Opening Stock - Purchases + Closing stock
(d) None of these

33. Opening Stock = ₹6,000
Closing Stock = ₹8,000
Cost of Goods Sold = ₹87,000
Calculate the value of Purchases?
(a) ₹1,01,000
(b) ₹89,000

(c) ₹73,000
(d) ₹85,000

34. The opening stock is overstated by ₹10,000 and closing stock is understated by ₹15,000. The impact of these on net profit for the current year is:
(a) ₹5,000 overstated
(b) ₹25,000 overstated
(c) ₹25,000 understated
(d) ₹5,000 understated

35. The revised Accounting Standard-2 (Valuation of Inventories) permits which of the following method for computation of cost of Inventory?
(a) Last in First Out
(b) Standard Cost Method
(c) First in First Out
(d) None of the above

36. When closing stock represents the latest purchased goods, then the stock has been issued under
(a) LIFO Method
(b) FIFO Method
(c) Average Cost Method
(d) Weighted Average Method.

37. Four Washing Machines are in stock with a dealer

	Model A	Model B	Model C	Model D
Cost	15,000	20,000	22,500	30,000
Realizable Value	13,500	22,000	20,500	32,500

Find out the value of stock for balance sheet as per AS-2
(a) ₹88,500
(b) ₹87,500
(c) ₹92,000
(d) ₹84,000

38. The success of Perpetual Inventory System depends upon:
(a) Placing order for materials on regular intervals.
(b) Exercising control over the issue of materials.
(c) Recording the receipts and issue of materials immediately after transaction.
(d) Recording the receipt of materials at fixed intervals.

39. X & Company, a furniture dealer, due to some business problem could take physical stock taking on April 20 and arrived at the cost at ₹ 5,25,000. Between April 01 and April 20, the firm purchased goods worth ₹3,25,000 including credit purchases of ₹75,000. Goods costing ₹50,000 were not actually received before April 20. Cost of goods held at godown on March 31 was:
(a) ₹2,00,000
(b) ₹2,50,000
(c) ₹1,75,000
(d) ₹2,25,000

40. If the closing stock is increased by ₹5,000 and Gross Profit rate is 10%, then:
(a) Gross Profit will be increased by ₹5,000
(b) Gross Profit will be decreased by ₹5,000
(c) Gross Profit will be increased by ₹500
(d) Gross Profit will be decreased by ₹500.

41. At the time of stock taking conducted on 31st March 2009, there were certain goods costing ₹1,000 that were lying in stock in the godown. These goods were billed for ₹1,200 on March 15, 2009. What should be included for calculating inventory for the year ended on 31.3.2009?
(a) Exclude the goods from calculating Inventory.
(b) Include the goods in Inventory at sales price ₹1,200.
(c) Include the goods inventory at cost price ₹1,000.
(d) None of the above.

42. If cost of goods sold is ₹80,700, opening stock ₹5,800 and closing stock ₹6,000, then the amount of purchase will be:
(a) ₹80,500
(b) ₹74,900

(c) ₹74,700
(d) ₹80,900

43. Find the value of closing stock:

	A	B	C	D
Historical cost	20,000	18,000	24,000	25,000
NRV	18,000	24,000	23,000	26,000

(a) 93,000
(b) 83,000
(c) 84,000
(d) 1,08,000.

44. Opening stock 300 units at ₹8,00,000 purchases 300 units at ₹8,50,000 sold 500 units.
Find closing stock using weighted average method.
(a) ₹3,00,000
(b) ₹2,75,000
(c) ₹2,50,000
(d) None of these.

45. Calculate the amount of gross profit:

Opening stock	-	₹ 24,000
Closing stock	-	₹ 15,000
Sales	-	₹ 6,00,000
Cost of goods sold	-	₹ 4,55,000

(a) ₹1,30,000
(b) ₹1,45,000
(c) ₹1, 54,000
(d) ₹1,06,000

46. If closing stock is undervalued by ₹10,000 and opening stock is overvalued by ₹10,000, then the impact on the gross profit of the business would be:
(a) Gross Profit undervalued by ₹10,000
(b) Gross Profit overstated by ₹10,000
(c) Gross Profit undervalued by ₹20,000
(d) There will be no impact on gross profit

47. A manufacturer purchased an item of raw material in the month of December as detailed below :

Date	Unit	Price (₹) Per unit
1st Dec	500	50
15th Dec	200	60
28th Dec	300	70

Material was issued on 29th December 2011, 600 units as per LIFO Method. Closing stock as on 31st December, 2011 would be:
(a) ₹38,000
(b) ₹27,000
(c) ₹31,000
(d) ₹20,000

48. Following figures have been extracted from the books for the year ended 31st March, 2011 :
(i) Cost of goods sold ₹35,000
(ii) Closing stock as on 31st March, 2011 ₹8,000
(iii) Opening stock as on 1st April, 2010 ₹10,000
(iv) Purchase Return ₹5,000
What would be the amount of gross purchases for the year ended 31st March, 2011?
(a) ₹33,000
(b) ₹38,000
(c) ₹28,000
(d) ₹37,000

49. Mr. A, a dealer of construction material, due to unavoidable reasons took physical stock of inventories on 11th April. The cost of stock was ₹4,20,000 (including goods received on consignment). The dealer received goods costing ₹1,00,000 in March for sale on consignment basis. 20% of the goods had been sold before 31st March and 60% between 1st April & 10th April. What was the cost of stock as at 31st March?

(a) ₹3,20,000
(b) ₹4,00,000
(c) ₹3,40,000
(d) ₹3,60,000

50. Sterling limited revealed the following information as on 31st March 2013:

Stock as on April 01, 2012	₹1,60,000
Purchases during the year	₹3,20,000
Sales during the year	₹4,00,000

The goods worth ₹60,000 were destroyed due to floods. Against the claim, the insurance company accepted a claim of ₹40,000. The company's gross profit on sales has remained constant at 25%, the value of closing stock as on 31st March would be:
(a) ₹20,000
(b) ₹1,20,000
(c) ₹60,000
(d) ₹1,00,000

51. From the following information provided by M/s xyz, calculate the value of inventory:

Item No.	No. of units	Cost per unit	Market price per unit
1	14	100	120
2	15	50	40
3	20	20	20

(a) ₹2,830
(b) ₹2,680
(c) ₹2,550
(d) ₹2,400

52. Opening stock 400 units @ ₹20 per unit. Purchases 200 units @ ₹25 per unit and issued 250 units. Find out the value of closing stock by LIFO method.
(a) ₹8,750
(b) ₹7,000
(c) ₹8,000
(d) ₹7,500

ANSWER

1.	(c)	2.	(a)	3.	(b)	4.	(c)	5.	(d)
6.	(c)	7.	(a)	8.	(b)	9.	(b)	10.	(b)
11.	(d)	12.	(b)	13.	(c)	14.	(b)	15.	(b)
16.	(b)	17.	(d)	18.	(c)	19.	(b)	20.	(d)
21.	(b)	22.	(a)	23.	(d)	24.	(c)	25.	(a)
26.	(a)	27.	(a)	28.	(b)	29.	(a)	30.	(b)
31.	(b)	32.	(a)	33.	(b)	34.	(c)	35.	(c)
36.	(b)	37.	(d)	38.	(c)	39.	(b)	40.	(a)
41.	(a)	42.	(d)	43.	(c)	44.	(b)	45.	(b)
46.	(c)	47.	(d)	48.	(b)	49.	(b)	50.	(b)
51.	(d)	52.	(b)						

SHORT PRACTICE QUESTIONS

1. Write Short Notes on:
   (a) Methods of Stock Taking.
   (b) Significance of Inventory Valuation.
2. Differentiate between Periodic Inventory system and Perpetual Inventory.

Past Year Questions and Answers

Objective Questions

1995 - May [5] State with reason whether the following statement is true or false:

(i) Finished goods are normally valued at cost or market price which ever is higher. (1.5 marks)

Answer:

False: The finished goods are normally valued at lower of cost or net realisable value. Net realisable value is the actual/estimated selling price in the ordinary course of business, less cost necessarily to be incurred in order to make the sale.

2001 - Nov [5] State with reason whether the following statement is true or false:

(i) Finished goods are normally valued at cost or market price, which ever is lower. (2 marks)

Answer:

Please refer 1995 - May [5] (i) on page no. 353

2003 - Nov [5] State with reason whether the following statement is true or false:

(vii) Inventory of by-products should be valued at net realisable value where cost of by-products can be separately determined. (2 marks)

Answer:

False: Inventory of by-products, the cost of which cannot be separately determined, should be valued at net realisable value.

2004 - May [5] State with reason whether the following statement is true or false:

(ix) Damaged inventory should be valued at cost or market price, whichever is lower. (2 marks)

Answer:

False: Damaged inventory should be valued at Net Realisable Value.

2004 - Nov [5] State with reason whether the following statement is true or false:

(viii) The inventory under AS-2 is valued on the basis of cost price or current replacement cost, which ever is less. (2 marks)

Answer:

False: According to AS - 2 on Valuation of Inventories, inventory is valued at the lower of historical cost and net realizable value.

2005 - Nov [5] State with reason whether the following statement is true or false:

(xii) The inventory under AS-2 is valued on the basis of cost price or current replacement cost, which ever is less. (2 marks)

Answer:

False : Under AS-2 "Valuation of Inventories", inventory is valued on the basis of cost price or net realizable value, whichever is less.

2019 - Nov [1] {C} (a) State with reason, whether the following statement is True or False.

(iii) Valuation of inventory at cost or net realizable value is based on principle of Conservatism. (2 marks)

Answer:

True: As per the principle of conservatism, the anticipated losses should be recognised while anticipated gains should be ignored. Therefore, the valuation of inventories at lower of cost or net realisable value is based on the principle of conservatism.

SHORT NOTES

1998 - Nov [6] Write short note on the following:

(iii) First in first out and Last in first out basis of valuation of stock. (4 marks)

Answer:

First in first out and Last in first out basis of valuation of stock:

Under FIFO method of inventory valuation, inventories purchased first are issued first. The closing inventories are valued at latest purchase price and inventory issues are valued at corresponding old purchase prices. In other words, under FIFO method, costs are assigned to the units issued in the same order as the costs are entered in inventory. During periods of rising prices, cost of goods sold are valued at older and lower prices if FIFO is followed and consequently reported profits rise due to lower cost of goods sold.

On the other hand, under LIFO method of inventory valuation, units of inventories issued should be valued at the price paid for the latest purchases and closing inventories should be valued at the price paid for earlier purchases. In other words, under LIFO method, closing inventories are valued at old purchase prices and issues are valued at corresponding latest purchase price. In an inflationary environment, older and hence lower costs remain in the balance sheet as value of inventories under LIFO basis and newer and higher costs are included in cost included in cost of inventories consumed. Thus, during inflation, reported profits fall due to higher cost of goods sold when LIFO method is followed.

1999 - May [6] Write a short note on the following:

(iv) Adjusted Selling Price Method of Valuation of Stock. (5 marks)

Answer:

Adjusted Selling Price Method of Valuation of Stock:

This method is also called retail inventory method. It is used widely in retail business where the inventory comprises of items, the individual costs of which are not readily ascertainable. The historical cost of inventory is

estimated by calculating it in the first instance at selling price and then deducting an amount equal to the estimated gross margin of profit on such stocks. 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.

2002 - May [6] Write short note on the following:

(c) FIFO and Weighted Average price method of Stock Valuation. (5 marks)

Answer:

FIFO method and weighted average price method of stock valuation:

Under the First -in-first-out (FIFO) method of valuation of stock, the actual issue of goods is usually the earliest lot on hand. Hence, the stock in hand will therefore consist of the latest consignments. The closing stock is valued at the price paid for such consignments.

2005 - May [6] Write short note on the following:

(i) Accounting Standard relating to valuation of inventories. (5 marks)

Answer:

Accounting Standard (AS) relating to valuation of inventories:

AS-2 (Revised 2016) specifies the methods of computation of cost of inventories and the method of determination of the value of inventory to be shown in the financial statements. The standard should be applied in accounting for inventories other than (i) work in progress arising under construction, contracts, including directly related service contracts, (ii) work in progress arising in the ordinary course of business of service providers, (iii) shares, debentures and other financial instruments held as stock-in-trade and (iv) producers' inventories of livestock, agricultural and forest products, and mineral oils, ores and gases to the extent that they are measured at net realizable value in accordance with well established practices in those industries.

As per the standard, the cost of inventories should comprise of costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. The principle of valuation is that inventories should be valued at the lower of cost and net realizable value. The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by specific identification of their individual costs. The standard recommends the use of first-in, first-out (FIFO) or weighted average cost formula for determining the cost of inventories where the specific identification of individual costs is not possible. The standard also dispenses with the direct costing method and allows only the absorption costing method for arriving at the cost of finished goods.

DISTINGUISH BETWEEN

2019 - Nov [6] (b) Distinguish between Periodic Inventory System and Perpetual Inventory System. (5 marks)

Answer:

Distinction between Periodic Inventory System and Perpetual Inventory System:

S. No.	Periodic Inventory System	Perpetual Inventory System
1.	This system is based on physical verification.	This system is based on book records.
2.	This system provides information about inventory and cost of goods sold at a particular date.	This system provides continuous information about inventory and cost of sales.
3.	This system determines inventory, and takes cost of goods sold as residual figure.	This system directly determines cost of goods sold, and computes inventory as balancing figure.
4.	Goods which are not physically available are all considered to be sold. Therefore, the goods which are lost, are included in Cost of Goods Sold.	Goods which are not sold are all assumed to be the part of closing inventory. Therefore, the goods which are lost, are included in closing inventory.
5.	Under this method, inventory control is not possible.	Under this method, inventory control is possible.
6.	This system is simple and less expensive.	This system is costlier.
7.	Periodic system requires closure of business for counting of inventory.	Inventory can be determined without affecting the operations of the business.

PRACTICAL QUESTIONS

1996 - May [3] (Or) X, who was closing his books on 31.3.1996, failed to take the actual stock, which he did only on 9th April, 1996, when it was ascertained by him to be worth ₹25,000. It was found that sales are entered in the sales book in the same day of dispatch and return inwards in the returns book as and when the goods are received back. Purchases are entered in the purchases daybook when the invoices are received.

It was found that sales between 31.3.1996 and 9.4.1996 as per the sales daybook are ₹1,720. Purchases between 31.3.1996 and 9.4.1996 as per purchases daybook 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 1996 but goods received only on 4th April, 1996 amounted to ₹100. Rate of gross profit is 33 1/3% on cost.

Ascertain the value of physical stock as on 31.3.1996. (15 marks)

Answer:

Statement of Valuation of Physical as on 31st March, 1996

Particulars	₹	₹
Value of stock as on 9th April, 1996		25,000
Add: Cost of sales during the intervening period		
Sales made between 31.3.1996 and 9.4.1996	1,720	
Less: Gross profit @ 25% on sales	430	1,290
		26,290

Less: Purchases actually received during the intervening period		
Purchases from 1.4.1996 to 9.4.1996	120	
Less: Goods not received up to 9.4.1996	50	70
		26,220
Less: Purchases during March, 1996 received on 4.4.1996		100
Value of Physical Stock as on 31.3.1996		26,120

1999 - Nov [4] (b) 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. Form the following information:

(i) Draw up stock ledger under FIFO method of valuation of stocks.

(ii) Find out the closing stock and cost of materials consumed.

Opening stock 5,000 MT @ ₹22 per MT ₹1,10,000

Purchases:		**Issues:**	
1.6.99	1,000 Mt @ ₹30 per MT	1 - 5.6.99	2,000 MT
5.6.99	2,000 Mt @ ₹35 per MT	6 - 10.6.99	3,000 MT
10.6.99	1,500 Mt @ ₹38 per MT	11 - 20.6.99	4,000 MT
15.6.99	1,500 Mt @ ₹35 per MT	21 - 25.6.99	3,000 MT
20.6.99	2,000 Mt @ ₹32 per MT	26 - 30.6.99	3,000 MT
28.6.99	2,000 Mt @ ₹35 per MT		
30.6.99	1,500 Mt @ ₹30 per MT		

(8 marks)

Answer:

(i)

Navkar Ltd.
Stock Ledger
Under FIFO Method

Date	Receipts			Issues			Balance		
	Units (MT)	Rate ₹	Amount ₹	Units (MT)	Rate ₹	Amount ₹	Units (MT)	Rate ₹	Amount ₹
Opening Balance	5,000	22	1,10,000				5,000	22	1,10,000
1.6.99	1,000	30	30,000				5,000 1,000	22 30	1,10,000 30,000
5.6.99	2,000	35	70,000	2,000	22	44,000	3,000 1,000 2,000	22 30 35	66,000 30,000 70,000
10.6.99	1,500	38	57,000	3,000	22	66,000	1,000 2,000 1,500	30 35 38	30,000 70,000 57,000
15.6.99	1,500	35	52,500				1,000 2,000 1,500 1,500	30 35 38 35	30,000 70,000 57,000 52,500
20.6.99	2,000	32	64,000	1,000 2,000 1,000	30 35 38	30,000 70,000 38,000	500 1,500 2,000	38 35 32	19,000 52,500 64,000
25.6.99				500 1,500 1,000	38 35 32	19,000 52,500 32,000	1,000	32	32,000
28.6.99	2,000	35	70,000				1,000 2,000	32 35	32,000 70,000
30.6.99	1,500	30	45,000	1,000 2,000	32 35	32,000 70,000	1,500	30	45,000
	16,500		4,98,500	15,000		4,53,500			

(ii) Value of closing stock	₹
Under FIFO Method	45,000
(1,500 Mts @ ₹30)	
Cost of Materials consumed (15,000 Mts)	
Under FIFO Method	₹4,53,500

2000 - May [4] (b) 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, 1999. 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 27[th] March, 1999, but the goods were not included in stock.

(iv) In March, 1999 goods of ₹20,000 sold and delivered were taken in the Sales for April, 1999.

(v) Goods costing ₹7,500 were sent on sale or return in March, 1999 at a margin of Profit of 33-1/3% on cost. Though approval was given in April, 1999 these were taken as sales for March, 1999.

Calculate the value of stock on 31[st] March, 1999 and the adjusted Net Profit for the year ended on that date. (9 marks)

Q.R. Code for Solution Video

Answer:

Profit and Loss Adjustment Account

	₹		₹
To Advertisement (samples)	4,000	By Net Profit	60,000
		By Electric fittings	1,500
To Sales (Goods approved in April to be taken as April sales: 7,500 + 2,500)	10,000	By Samples	4,000
		By Stock (Purchases of March, not included in stock)	25,000
To Adjusted net profit	1,04,000	By Sales (goods sold in March wrongly taken as April sales)	20,000
		By Stock (goods sent on approval basis not included in stock)	7,500
	1,18,000		1,18,000

Calculation of value of stock on 31[st] March, 1999

	₹
Stock on 31[st] March, 1999 (given)	37,500
Add: Purchases of March, 1999 not included in stock	25,000
Goods lying with customers on approval basis	7,500
	70,000

2000 - Nov [3] (a) Physical verification of stock in a business was done on 23rd June. 2000. The value of the stock was ₹4,80,000. The following transactions took place between 23rd June to 30th June 2000:

(i) Out of the goods sent on consignment goods at cost worth ₹24,000 were unsold.

(ii) Purchases of ₹40,000 were made out of which goods worth ₹16,000 were delivered on 5th July 2000.

(iii) Sales were ₹1,36,000 which include goods worth ₹32,000 sent on approval. Half of these goods were returned before 30th June 2000, but no information is available regarding the remaining goods.

(iv) Goods are sold at cost plus 25%. However goods costing ₹24,000 had been sold for ₹12,000.

Determine the value of stock on 30th June 2000. (9 marks)

Q.R. Code for Solution Video

Answer:

Statement of Valuations of Stock on 30[th] June, 2000

Particulars	₹	₹
Value of stock as on 23[rd] June, 2000		4,80,000
Add: Unsold stock out of the goods sent on consignment	24,000	
Purchase during the period from 23[rd] June, 2000 to 30[th] June, 2000	24,000	
Goods in transit on 30[th] June, 2000	16,000	

Cost of goods sent on approval basis (80% of ₹16,000)	12,800	76,800
		5,56,800
Less: Cost of sales during the period from 23rd June, 2000 to 30th June, 2000		
Sales (₹1,36,000 - ₹16,000)	1,20,000	
Less: Gross profit	9,600	1,10,400
Value of stock as on 30th June, 2000		4,46,400

Working Notes:

		₹
1. Calculation of normal sales:		
Actual Sales		1,36,000
Less: Abnormal sales	12,000	
Return of goods sent on approval	16,000	28,000
Normal Sales		1,08,000
2. Calculation of gross profit		
Gross profit on normal sales 20/100 × ₹1,08,000		21,600
Less: Loss on sale of particular (abnormal) goods (₹24,000 – ₹12,000)		12,000
Gross Profit		9,600

2003 - May [3] (b) A trader prepared his accounts on 31st March each year. Due to some avoidable reasons, no stock-taking could be possible till 15th April, 2002, on which date the total cost of goods in his godown came to ₹ 50,000. The following facts were established between 31st March and 15th April, 2002:

(i) Sales ₹41,000 (including cash sales ₹10,000).

(ii) Purchase ₹5,034 (including cash purchase ₹1,990).

(iii) Sales Return ₹1,000.

(iv) On 15th March, goods of the sale value of ₹10,000 were sent on sale or return basis to customer, the period of approval being four weeks. He return 40% of the goods on 10th April, approving the rest; the customer was billed on 16th April.

(v) The trader had also received goods costing ₹8,000 in March, for sale on consignment basis, 20% of the goods had been sold by 31st March, and another 50% by 15th April. These sales are not included in above sales.

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

You are required to ascertain the value of inventory as on 31st March, 2002. (9 marks)

Q.R. Code for Solution Video

Answer:

Valuation of stock as on 31st March 2002

Particulars	₹	₹
Stock to godown on 15th April, 2002		50,000
Add: Cost of goods sold after 31st March till stock taking [(₹41,000 – ₹1,000) × 80/100]	32,000	
Cost of stock with customer on approval [(₹10,000 – ₹4,000) × 80/100]	4,800	36,800
		86,800
Less: Cost of goods purchased after 31st March till stock taking is made	5,034	
Stock belonging to consignors (₹8,000 × 30/100)	2,400	7,434
Stock as on March 31 (at cost)		79,366

2004 - May [2] (a) From the following information ascertain the value of stock as on 31st March, 2004 and also the profit for the year:

	₹
Stock as on 1.4.2003	14,250
Purchases	76,250
Manufacturing Expenses	15,000
Selling Expenses	6,050

Administrative Expenses	3,000
Financial Charges	2,150
Sales	1,24,500

At the time of valuing stock as on 31st March 2003, 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. (5 marks)

Q.R. Code for Solution Video

Answer:

Statement of Valuation of Stock as on 31st March, 2004

	₹	₹
Stock as on 31st March, 2003	14,250	
Less: Book value of abnormal stock (₹5,000 — 1,750)	3,250	11,000
Add: Purchases		76,250
Manufacturing Expenses		15,000
		1,02,250
Less: Cost of Sales:		
Sales as per books	1,24,500	
Less: Sale of abnormal item	4,500	
	1,20,000	
Less: Gross Profit @ 20%	24,000	96,000
Stock as on 31st March, 2004		6,250

Statement showing Profit for the year

Gross Profit on Normal Sales		24,000
Add: Profit on abnormal item:		
Sales Value	4,500	
Less: Book Value on 31st March, 2003	3,250	1,250
		25,250

Less: Overhead Expenses:		
Selling Expenses	6,050	
Administrative Expenses	3,000	
Financial Charges	2,150	11,200
Net Profit		14,050

2005 - May [4] (a) V's accounting year ends on 30.06.2004 but actual stock was not taken till 8.7.2004, on which date it is valued at ₹29,700. The following additional information is available:

(i) Sales are entered in the sales book on the date of dispatch and returns inward entered in the credit note register on the day goods are received back.

(ii) Purchases are entered in the purchase book on the day invoices are received.

(iii) Sales from 1.7.2004 to 8.7.2004 are ₹34,400.

(iv) Purchases from 1.7.2004 to 8.7.2004 were of ₹2,640 out of which goods of ₹240 was not received upto 8.7.2004.

(v) Invoices for goods purchased upto 30.6.2004 were of ₹2,000 of which goods worth ₹1,400 were received between 1.7.2004 to 8.7.2004.

(vi) Rate of G.P. 33.33% on cost.

Find out the value of stock on 30.06.2004. (7 marks)

Answer:

Statement of valuation of stock as on 30.06.2004

	₹
Value of stock as on 8.7.2004	29,700
Add: Cost of goods sold from 1.7.2004 to 8.7.2004 (75% of ₹34,400)	25,800
Purchases 'invoiced' upto 30.06.2004 though goods not received till 08.07.2004 (₹2,000 – ₹1,400)	600
	56,100
Less: Cost of goods purchased and received during the period from 1.7.2004 to 8.7.2004 (₹2,640 – ₹240)	2,400
	53,700

2006 - Nov [2] (b) M/s Polypack and Company's financial year ends on 31st March, 2006. Their actual physical stock as on 31st March was ₹6,25,000 (net realizable value ₹6,40,000).

Following information regarding stock are also available:

(i) Goods costing ₹40,000 were damaged badly and it was expected that only ₹5,000 could be realized.

(ii) Goods costing ₹25,000 were sold on sale or return basis for which no confirmation has been received till 31st March, 2006. Invoice value of these goods was ₹30,000.

(iii) Goods were sent on consignment to Mr. B at invoice value (120% of cost) ₹1,50,000 on 31st March, 2006. He informed that half of the material remains unsold.

You are required to ascertain the value of closing stock as on 31st March, 2006 as per AS - 2. (5 marks)

Answer:

M/s Polypack & Company
Calculation of closing stock on 31st March, 2006

		Amount (₹)
Stock as on 31st March, 2006		6,25,000
Add: (a) Goods on sale or return basis	25,000	
(b) Goods unsold with consignee $\frac{1,50,000}{120\%} \times 50\%$	62,500	87,500
		7,12,500
Less: Reduction in value of stock due to badly damaged goods ₹(40,000 – 5,000)		35,000
Value of Closing Stock		6,77,500

2019 - June [6] (c) Raj Ltd. Prepared their accounts for financial year ended on 31st March 2019. Due to unavoidable circumstances, actual stock has been taken on 10th April 2019, when it was ascertained at ₹1,25,000. It has been found that;

(i) Sales are entered in the Sales Book on the day of dispatch and return inwards in the Returns Inward Book on the day of the goods received back.

(ii) Purchases are entered in the Purchase Book on the day the Invoices are received.

(iii) Sales between 1st April, 2019 to 9th April, 2019 amounting to ₹20,000 as per Sales Day Book.

(iv) Free samples for business promotion issued during 1st April 2019 to 9th April 2019 amounting to ₹4,000 at cost.

(v) Purchases during 1st April, 2019 to 9th April, 2019 amounting to ₹10,000 but goods amount to ₹2,000 not received till the date of stock taking.

(vi) Invoices for goods purchased amounting to ₹20,000 were entered on 28th March, 2019 but the goods were not included in stock.

Rate of Gross Profit is 25% on cost.

Ascertain the value of Stock as on 31st March 2019. (5 marks)

Answer:

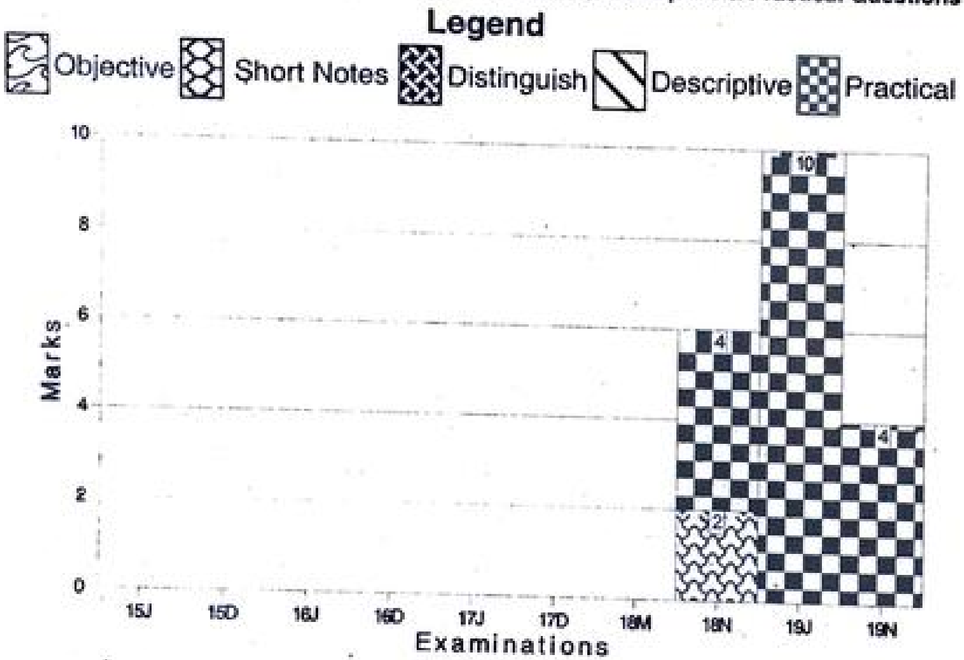
Statement of Valuation of Physical Stock as on 31st March, 2019

	₹	₹
Value of stock as on 10th April, 2019		1,25,000
Add: Cost of sales during the intervening period sales made between 1.4.2019 and 9.4.2019	20,000	
Less: Gross profit @ 20% on sales	(4,000)	16,000
Free sample		4,000
		1,45,000
Less: Pruchases actually received during the intervening period:		
Purchases from 1.4.2019 to 9.4.2019	10,000	
Less: Goods not received upto 9.4.2019	(2,000)	(8,000)
		1,37,000
Add: Purchases during March, 2019 but not recorded in stock		20,000
Value of physical stock as on 31.3.2019		1,57,000

CHAPTER

5 Concept and Accounting of Depreciation

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



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SELF STUDY QUESTIONS

Q1. What is the Concept of Depreciation?

Answer:

Depreciation is a systematic allocation of depreciable amount (i.e. cost of asset reduced by residual value if any) over the useful life of asset. Tangible Assets (Property, Plant and Equipments) having useful life of more than one year generate revenue for business but their value reduces with passage of time.

According to AS 10 - Property, Plant and Equipment,

Property, plant and equipment are tangible assets that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than a period of twelve months.

The annual loss in value of asset is charged against profit of the business.

Q2. What are the Causes of Depreciation?

Answer:

- Physical wear and tear due to continuous use;
- Efflux (passage) of time;
- Physical deterioration;
- Obsolescence (i.e. asset becoming redundant due to technological changes);
- Decrease in market value;
- Accidents (fire, etc.);
- Depletion.

Q3. What are the Factors for Computing Depreciation?

Answer:

- Estimated useful life of the asset, i.e., the period for which asset can be used productively or number of production units which can be obtained from that asset over its entire life;

- Cost of asset, i.e., cash or cash equivalent paid or fair value or any other consideration given for acquisition of asset and recorded in books of accounts as cost of asset;
- Residual value of the asset at the end of its estimated useful life, i.e., amount received from disposal of the asset at the end of its useful life.

Q4. Even Depreciation on components of an asset can be charged. Explain.

Answer:

According to Companies Act, 2013, and Accounting Standards, if property, plant and equipment has separate identifiable components then all such components should be separately depreciated.

Portion of Property, Plant and Equipment identifiable as separate component must have:

- Significant cost, and
- Different estimated useful life or depreciation method from remaining portion of Property, Plant and Equipment.

Q5. What are the Objectives of Providing Depreciation?

Answer:

- To ascertain correct profit/loss of business;
- To show true and fair view of financial statements;
- To show correct value of property plant and equipment;
- To making requisite provision for replacement of assets after its useful life;
- To calculate cost of production correctly.

Q6. What Factors are used in the measurement of Depreciation?

Answer:

Factors in the measurement of Depreciation

As per AS 10 (Revised) the cost of an item of property, plant and equipment comprises of:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;

(b) any cost directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management;

(c) the initial estimate of the cost of dismantling, removing the item and restoring the site on which it is located.

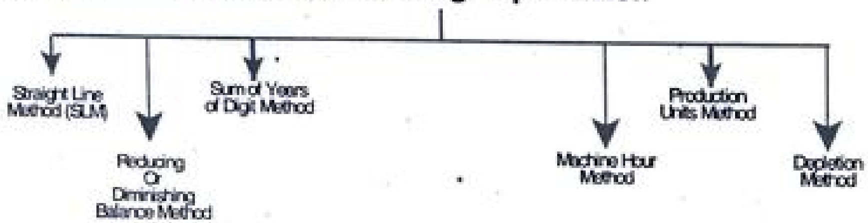
Q7. What are the inclusions and exclusions from determining the cost of an asset?

Answer:

Inclusions	Exclusions
(a) Cost of employee benefits	(a) Cost of opening new facility (ex. inauguration cost)
(b) Cost of site preparation	(b) Cost of introducing new product (ex. sales promotion)
(c) Initial delivery and handling costs	(c) Cost of conducting business in a new location
(d) Installation and assembly costs	(d) Administrative and general overhead costs.
(e) Cost of testing	
(f) Professional fees	

Q8. What are the Methods of Providing Depreciation?

Answer: **Methods of Providing Depreciation**



Straight Line Method (Fixed Installment Method)

- Under this method, a fixed percentage of original cost of asset is written off every year over the estimated useful life.

  $$\text{Amount of Depreciation} = \frac{\text{Cost} - \text{Estimated Residual Value}}{\text{Useful life}}$$

  $$\text{Rate of Depreciation} = \frac{\text{Depreciation}}{\text{Original Cost}} \times 100$$

Advantage

- Complete cost written off in equal installments throughout the useful life.

Disadvantage

- Charge on asset will not be uniform as cost of repairs increases in later years.

Reducing or Diminishing Balance Method

- Under this method, depreciation charged on fixed rate on the diminishing hence decreases in later years.

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

  where,

  n = useful life of the asset

Advantage

- Uniform weight of charge to P/L A/c, as, in earlier years, depreciation is high and repair cost is low while in later years, depreciation will be low and repair cost will be high.

Disadvantages

- Value of the asset can never be reduced to zero;
- There's a danger that too low a percentage may be adopted as depreciation, with the result that over the life of the asset, full depreciation may not be provided;
- If assets are grouped in such a way that individual assets are difficult to identify, the residue of an asset may lie in the asset account even after the asset has been scrapped.

Example:

A company purchased a machinery for ₹80,000 on 1st April, 2010 and decided to write off at 10% annually on the diminishing balance method. On 1st July, 2012, a part of the machinery valued in the books of the firm at ₹16,000 on 1st April, 2010 was sold for ₹10,000.

Show the Machinery Account in the books of the company for the years 2010, 2011 and 2012. Accounts are closed each year on 31st December.

Solution:

Dr. **Machinery Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2010			2010		
April 1	To Bank A/c	80,000	Dec. 31	By Depreciation A/c	6,000
			Dec. 31	By Balance c/d	74,000
		80,000			80,000
2011			2011		
Jan 1	To Balance b/d	74,000	Dec. 31	By Depreciation A/c	7,400
			Dec. 31	By Balance c/d	66,600
		74,000			74,000

Date	Particulars	₹	Date	Particulars	₹
2012 Jan 1	To Balance b/d	66,600	2012 July 1	By Bank A/c (sale)	10,000
			July 1	By Depreciation A/c (Note 1)	666
			July 1	By Profit and Loss A/c (Loss) (Note 1)	2,654
			Dec. 31	By Depreciation A/c (After sale of machinery) (Note 2)	5,328
			Dec. 31	By Balance c/d	47,952
		66,600			66,600

Notes:

1. **Calculation of Loss on Sale of Machinery:**

	₹
Book Value of Machinery (1st April, 2010)	16,000
Less: Depreciation (2010) (₹16,000 × 10/100 × 9/12)	1,200
Book Value of Machinery (1st January, 2011)	14,800
Less: Depreciation (2011) (₹14,800 × 10/100)	1,480
Book Value of Machinery (1st January, 2012)	13,320
Less: Depreciation (2012) (₹13,320 × 10/100 × 6/12)	666
Book Value of Machinery (1st July, 2008)	12,654
Less: Sale Proceeds	10,000
Loss on Sale	2,654

2. **Calculation of Depreciation after Sale of Machinery:**

Book Value of Machinery (1st January, 2011)	66,600
Less: Book Value of Machinery Sold (1st Jan, 2012) (Note 1)	13,320
Bank Value of Machinery after Sale of Machinery (1st Jan, 2012)	53,280

Depreciation = ₹53,280 × 10/100 = ₹5,328

Q9. What is the difference between Straight Line Method and Written Down Value Method ?

Answer:

Basic	Straight Line Method	Written Down Value Method
1. **Depreciation charge**	Depreciation is calculated on the original cost of a fixed asset.	Depreciation is calculated on the diminishing balance or written down value of a fixed asset.
2. **Amount of Depreciation**	The amount of depreciation remains the same for all years.	The amount of depreciation reduces year after year.
3. **Zero Balance**	At the expiry of the working life of the asset, the balance in the asset account reduces to zero.	The balance in the asset account will not reduce to zero.
4. **Cost of Depreciation and Repairs**	The combined cost on account of depreciation and repairs is lower in the initial years and higher in the later years.	The combined cost on account of depreciation and repairs is more or less, equal throughout the period.
5. **Suitability**	This method is more suitable for assets which get depreciated on account of expiry of working life of the asset.	This method is suitable for such assets which require more and more repairs in the later years of their working life.
6. **Calculation Easy or Difficult**	It is easy to calculate the rate of depreciation.	It is difficult to calculate the rate of depreciation.

Q10. What is Sum of Years of Digit Method?

Answer:

- Under this method, annual depreciation is calculated by multiplying the original cost of the asset less its estimated scrap value by the following fraction:

$$\frac{\text{Remaining life of asset including current year}}{\text{Sum of digits of life of Asset}}$$

where,

Remaining life = Individual digits used in life of asset taken in reverse order.

Sum of digits of life of asset = $\frac{n(n+1)}{2}$

Example

M/S Raj & Co. purchased a machine for ₹1,00,000. Estimated useful life and scrap value were 10 years and ₹12,000 respectively. The machine was put to use on 1.1.2000. Show Machinery Account and Depreciation Account in their books for 2005 by using Sum of years digits method.

Q.R. Code for Solution Video

Solution:

In the Books of M/S Raj & Co.

Machinery Account

Dr. | Cr.

2005	Particulars	₹	2005	Particulars	₹
Jan. 1	To Balance b/d	36,000	Dec. 31	By Depreciation A/c	8,000
			Dec. 31	By Balance c/d	28,000
		36,000			36,000
2006 Jan 1	To Balance b/d	28,000			

Depreciation Account

2005	Particulars	₹	2005	Particulars	₹
Dec. 31	To Machinery A/c	8,000	Dec. 31	By P&L A/c	8,000
		8,000			8,000

Working Notes:

1. Total of Sum of digit of depreciation for 2000-2004

$$= (₹1,00,000 - ₹12,000) \times \frac{10+9+8+7+6}{\frac{10(10+1)}{2}}$$

$$= ₹88,000 \times \frac{40}{55} = ₹64,000$$

2. Written down value as on 1-1-2004

= ₹1,00,000 - ₹64,000 = ₹36,000

3. Depreciation for 2005

$$= (₹1,00,000 - ₹12,000) \times \frac{5}{55} = ₹8,000$$

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. Original cost of a machine = ₹1,30,000
   Salvage value = ₹4,000
   Useful life = 6 years
   Depreciation for the 1st year under sum of year's digit method will be:
   (a) ₹6,000
   (b) ₹12,000
   (c) ₹18,000
   (d) ₹36,000
2. An asset was purchased for ₹12,500 and was depreciated under Reducing Balance Method at the rate of 20% p.a. What is the value of the asset at the end of three years?
   (a) ₹8,000
   (b) ₹7,500
   (c) ₹6,400
   (d) ₹5,000

3. The main objective of providing depreciation is to:
   (a) Reduce tax burden
   (b) Provide funds for replacement of fixed asset
   (c) Show true financial position in the balance Sheet
   (d) Comply with legal requirements
4. Original cost of an asset ₹2,52,000, Salvage value ₹12,000 Depreciation for 2nd year @ 10% p.a. under W.D.V method will be:
   (a) ₹21,600
   (b) ₹22,680
   (c) ₹30,000
   (d) ₹28,000
5. Useful life of an asset can be described as:
   (a) The period over which a depreciable asset is expected to be used by the enterprise
   (b) The number of production or similar units expected to be obtained form the use of the asset by the enterprise
   (c) 10 years
   (d) both (a) and (b)
6. Amortization refers to writing off:
   (a) Depleting assets
   (b) Wasting assets
   (c) Intangible assets
   (d) Fictitious assets
7. The W.D.V of an asset after three years of depreciation on the reducing balance method @ 10% p.a. is ₹36,450. What was its original value?
   (a) ₹40,000
   (b) ₹50,000
   (c) ₹45,000
   (d) ₹70,250
8. The cost of a machine having a span of life of 5 years is ₹1,00,000 with a scrap value of ₹10,000. The amount of depreciation under sum of years digit method for the second year will be:
   (a) ₹16,000
   (b) ₹18,000
   (c) ₹12,000
   (d) ₹24,000

9. Cost of an asset ₹75,000. Useful life is 4 years. Find out the depreciation for the 1st year under sum of years digit method:
   (a) ₹30,000
   (b) ₹7,500
   (c) ₹22,500
   (d) ₹15,000
10. On 1st January, 2006, A Ltd. purchased a machine for ₹50,000 and spent ₹4,000 on its carriage and ₹2000 on its installation. Its useful life is 10 years and scrap value is ₹6,000. Depreciation for the year under fixed installment method will be:
    (a) ₹4,600
    (b) ₹5,000
    (c) ₹4,800
    (d) ₹4,500
11. Scrap value of an asset means the amount that it can fetch on sale at the _______ of its useful life.
    (a) beginning
    (b) end
    (c) middle
    (d) none
12. Depreciation is the process of:
    (a) Asset Valuation
    (b) Verification of assets
    (c) Allocation of cost of assets to the period of its life
    (d) Decreasing the value of asset
13. Original Cost = ₹1,26,000
    Salvage Value = ₹8,000
    Useful Life = 6 Year
    What will be the book value of the asset as at the beginning of fourth year: (Under Sum of year's digits method)
    (a) ₹1,03,143
    (b) ₹40,286
    (c) ₹45,987
    (d) ₹99,256

14. Obsolescence means decline in the value due to:
    (a) Fall in the market price
    (b) Physical wear and tear
    (c) Efflux of time
    (d) Innovations and inventions
15. Cost of a machine = ₹1,12,500
    Salvage value = ₹10,500
    Useful Life = 5 Years
    Depreciation for the last year using the Sum of digits method will be:
    (a) ₹6,800
    (b) ₹20,400
    (c) ₹34,000
    (d) ₹27,200
16. Depreciation starts on a machine from the date:
    (a) It is purchased
    (b) It is put to use
    (c) It is installed
    (d) Any of above
17. A trader purchased a machinery for ₹10,000 in Jan 2004. Depreciation is charged @ 25% diminishing balance. At the end of third year it was sold for ₹1,000. Profit or Loss on sale of machine will be:
    (a) Profit ₹2,400
    (b) Profit ₹2,300
    (c) Loss ₹2,406
    (d) Loss ₹3,219
18. Cost of machinery ₹2,52,000
    Salvage value ₹ 12,000
    Useful life 6 years
    Annual depreciation under straight line method will be:
    (a) ₹42,000
    (b) ₹40,000
    (c) ₹15,000
    (d) ₹28,000
19. Which of the following is Depleted?
    (a) Land
    (b) Goodwill

    (c) Machinery
    (d) Coal Mines
20. A machine was purchased on 1st April, 2007 for ₹5,00,000 and 1st October, 2007 for ₹2,00,000. Calculate depreciation @ 20% p.a on written down value method for the year ending 31st March, 2008.
    (a) ₹1,00,000
    (b) ₹1,40,000
    (c) ₹ 40,000
    (d) ₹1,20,000
21. A machinery is depreciated by ₹2,000 every year. Which method is being used to calculate depreciation?
    (a) Written Down value method
    (b) Straight line method
    (c) Sum of Years Digit method
    (d) None of these
22. A purchased a mine for ₹2,50,000 minerals in the mine were expected to be 5,00,000 tonnes. In the first year, 50,000 tonnes of minerals were used. What is the depreciation for the first year?
    (a) ₹20,000
    (b) ₹25,000
    (c) ₹30,000
    (d) ₹35,000
23. Original cost = ₹1,00,000, Life = 5 years, Expected salvage value = ₹ 2,000. Rate of depreciation p.a. = ?
    (a) 19.6%
    (b) 20%
    (c) 19.8%
    (d) 20.8%
24. Price of the computer = ₹50,000
    Residual value = ₹10,000
    Hours worked for the year = 6000 hrs.
    Estimated life of computer = 20,000 hrs.
    Calculate the amount of depreciation
    (a) ₹15,000

(b) ₹12,000
(c) ₹20,000
(d) ₹24,000

25. Which method of depreciation is suitable when expenditure on repairs and maintenance, increases as the machine grows old?
(a) Reducing balance method
(b) Straight line method
(c) Machine hour rate method
(d) Sinking fund Method.

26. A machinery is purchased for ₹10,000. On 1st April, 2005. Depreciation @ 10% p.a. is provided. Calculate the amount of difference in depreciation as per SLM and WDV basis in the year 2006-07.
(a) ₹1,000
(b) ₹100
(c) NIL
(d) ₹200

27. A machine is purchased for ₹1,00,000. Installation charges of ₹10,000 were incurred. Depreciation @ 10% was provided on Straight Line Basis. The machine was sold for ₹60,000 after 5 years. Calculate the profit or loss on sale of machine.
(a) ₹5,000 Loss
(b) ₹5,000 Profit
(c) ₹60,000 Profit
(d) ₹40,000 Loss

28. Which of the following is the meaning of entry stated in the Machinery A/c

Dr. **Machinery A/c (2008-09)** **Cr.**

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
31/3/09	To Depreciation A/c	4,000			

(a) Depreciation provided at the year end ₹4,000.
(b) Depreciation provided reversed to the extent of ₹4,000.
(c) Machinery appreciated by ₹4,000.
(d) None of the above.

29. Depletion method of depreciation is normally applied in case of______ assets.
(a) Intangible
(b) Tangible
(c) Wasting
(d) Current

30. If the rate of depreciation is same, then the amount of depreciation under Straight Line Method vis-a-vis Written Down Value Method will be:
(a) Equal in all years
(b) Equal in first year but higher in subsequent years.
(c) Equal in the first year but lower in subsequent years.
(d) Lower in the first year but equal in subsequent years.

31. Vijay Traders purchased Car on 1.4.08 for ₹3,00,000. They are charging depreciation on written Down Value method. On 31.3.09, they sold the Car for ₹1,65,000 and incurred a loss of ₹75,000. The rate of depreciation p.a. is:
(a) 10%
(b) 15%
(c) 20%
(d) 25%

32. 'A' purchased a computer on 1.4.06 for ₹60,000. He purchased another computer on 1.10.07 for ₹40,000. He charges depreciation @ 20% p.a. on straight line method. What will be closing balance of computers as on 31.3.09?
(a) ₹40,000
(b) ₹64,000
(c) ₹52,000
(d) ₹48,000

33. Depreciation is to be calculated from the date of:
(a) Asset put to use
(b) Purchase order of asset
(c) Receipt of asset at business premise
(d) Invoice of Assets.

34. According to the Income Tax Act, which method of charging depreciation is provided?
(a) **Reducing Balance Method**

(b) Sinking Fund
(c) Annuity Method
(d) Straight Line Method.

35. Which method of depreciation is effective if repairs and maintenance cost of an asset increases as it grows old:
(a) Straight Line Method
(b) Sinking Fund
(c) Annuity
(d) Reducing Balance.

36. Original cost of an asset is ₹1 lacs, WDV = ₹40,000, sold for ₹90,000. What will be the profit on its sale?
(a) Loss of ₹50,000
(b) Profit of ₹60,000
(c) Profit of ₹50,000
(d) Loss of ₹10,000

37. A machine was bought at a cost of ₹5 lacs on 1.1.02. During its life of 10 years, it will be depreciated on SLM basis. On 31.12.08, the machine was sold for ₹50,000. Find out the profit/loss?
(a) Loss of ₹1,50,000
(b) Loss of ₹1,00,000
(c) Profit of ₹1,00,000
(d) Profit of ₹1,50,000.

38. X purchased a machinery on 01.04.2008 for ₹5,00,000. Depreciation is charged at WDV at the rate of 10% p.a. The written down value of the machinery for the year ending 31st March 2011 will be:
(a) ₹4,50,000
(b) ₹4,05,000
(c) ₹3,54,500
(d) ₹3,64,500

39. In case of reducing balance method of charging depreciation, depreciation is charged on the:
(a) Original Cost
(b) Original Cost less Scrap value
(c) Market Value
(d) Written Down Value

40. A machine was acquired on April 1, 2010 at a cost of ₹14,400 and expenses of installation were ₹1,600. It is expected that its total useful life will be 8,000 hours.
During the year 2010 - 11 it worked for 2,500 hours. The depreciation for the year ending 31st March 2011 will be:
(a) ₹3,200
(b) ₹4,500
(c) ₹5,000
(d) ₹6,250

41. A machine was purchased at a cost of ₹5,30,000. Depreciation was charged at 10% p.a. instead of 25% p.a. What would be the rectification entry to correct this error?
(a) Debit Profit & Loss a/c ₹79,500, Credit Provision for depreciation a/c ₹79,500
(b) Debit Provision for depreciation a/c ₹26,500
(c) Debit Profit & Loss Account ₹26,500, Credit provision
(d) Debit Provision for dep a/c ₹79,500, Cr. P/L Account ₹79,500

42. Rate of depreciation under written down value method is 15% p.a. Cost of the machinery is ₹10,00,000. Residual value at the end of useful life is ₹20,000. Depreciation for the first year will be:
(a) ₹1,50,000
(b) ₹1,20,000
(c) ₹1,00,000
(d) ₹80,000

43. Estimated useful life of a machinery is 5 yrs. Depreciation written off in second year under sum of years digit method would be:
(a) 4/15
(b) 3/15
(c) 2/15
(d) 1/15

44. A company purchased a machine on 1/4/00 at ₹3,10,000. Its working life is estimated to be 15 years and the residual value is estimated as ₹10,000. The company charged depreciation on straight line basis till 31/3/10. On 1/4/10, the technology expert recommend that the asset

may be used for another 10 years. Residual value of the machine remains unchanged. What would be the amount of annual depreciation from the accounting year 2010-11 following the relevant accounting standard:

(a) ₹10,000
(b) ₹20,000
(c) ₹11,000
(d) ₹21,000

ANSWER

1.	(d)	2.	(c)	3.	(b)	4.	(b)	5.	(d)
6.	(c)	7.	(b)	8.	(d)	9.	(a)	10.	(b)
11.	(b)	12.	(c)	13.	(b)	14.	(d)	15.	(a)
16.	(b)	17.	(d)	18.	(b)	19.	(d)	20.	(d)
21.	(b)	22.	(b)	23.	(a)	24.	(b)	25.	(a)
26.	(b)	27.	(b)	28.	(b)	29.	(c)	30.	(b)
31.	(c)	32.	(c)	33.	(a)	34.	(a)	35.	(d)
36.	(c)	37.	(b)	38.	(d)	39.	(d)	40.	(c)
41.	(a)	42.	(a)	43.	(a)	44.	(a)		

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

1994 - Nov [5] State with reasons whether the following statements are true or false:

(2) Depreciation cannot be provided in case of loss, in a financial year. (1.5 marks)

(10) Fixed Assets are stated in the Balance Sheet at their market value. (1.5 marks)

Answer:

(2) False: Depreciation is a charge against profit and not an appropriation of profit. Therefore, depreciation has to be provided for even in case of loss in a financial year.

(10) False: Fixed assets are defined as assets held for the purpose of producing goods or providing services and these are not held for re-sale in the normal course of business. Therefore, fixed assets are not to be stated in the balance sheet at their market value, rather, they are shown in the balance sheet at cost less depreciation.

1995 - May [5] State with reasons whether the following statement is true or false:

(e) M/s. Ram & Co. did not provide any depreciation on Plant and Machinery, as its market value is much higher than the cost of purchase. (1.5 marks)

Answer:

False: Plant & Machinery is held with an intention of being used for the purpose of producing goods or providing services and is not held for re-sale in the ordinary course of business. Depreciation is to be charged on Plant & Machinery irrespective of its market value.

1997 - May [5] State with reasons whether the following statement is true or false:

(3) The expressions depreciation is to be charged at 10% and 10% p.a. on furniture and fittings carry the same meaning. (2 marks)

Answer:

False: They differ on the basis of time factor 10% p.a. implies that time factor is to be considered while calculating depreciation on pro-rata basis whereas simply 10% implies that time factor is immaterial for calculation.

1997 - Nov [5] State with reasons whether the following statement is true or false:

(4) Depreciation cannot be provided in case of loss, in a financial year. (2 marks)

Answer:

False: Depreciation is a charge against profit and not an appropriation of profit. Therefore, depreciation has to be provided for even incase of loss in a financial year.

1999 - May [5] State with reasons whether the following statement is true or false:

(ix) Higher depreciation will not affect cash profit of the business. (2 marks)

Answer:

True: It is a non-cash expense and therefore will not affect cash profit of the business.

2000 - Nov [5] State with reasons whether the following statement is true or false:

(8) There is no difference between the written down value method and diminishing balance method of depreciation. (2 marks)

Answer:

True: Both are same methods. The depreciation is computed by applying fixed rate on the diminishing balance which is known as written down value.

2001 - May [5] State with reasons whether the following statement is true or false:

(7) Land is also a depreciable asset. (2 marks)

Answer:

False: Land is not a depreciable asset.

2002 - Nov [5] State with reasons whether the following statement is true or false:

(h) Depreciation need not be provided on Plant and Machinery, as its Market value is much higher than Cost of Purchase. (2 marks)

Answer:

False: Plant and Machinery is held with an intension of being used for the purpose of producing goods or providing services and is not held for resale in the ordinary course of business. Depreciation is to be charged on plant and machinery irrespective of its market value.

2003 - Nov [5] State with reasons whether the following statement is true or false:

(vi) Depreciation is a process of allocation of the cost of fixed asset. (2 marks)

Answer:

True: It is measure of wear and tear of an asset. On charging depreciation, the cost of fixed asset is allocated during the period it is used.

2006 - Nov [5] State with reasons whether the following statement is true or false:

(vii) In a business concern, depreciation need not be provided on building in use, as its market value is higher than book value. (2 marks)

Answer:

False: Building is being used in the business concern and is not held for resale in the ordinary course of business. Depreciation is to be charged irrespective of the market value.

2018 - Nov [1] {C} (a) State with reasons, whether the following statement is true or false:

(ii) Depreciation is a non-cash expense and does not result in any cash outflow. (2 marks)

Answer:

True: Depreciation is a non-cash expense and unlike other normal expenditure (e.g. wages, rent, etc.) does not result is any cash outflow.

SHORT NOTES

1995 - Nov [6] (2) Write short note on Depletion Method of providing for depreciation. (5 marks)

Answer:

This method of depreciation is used in case of the exhaustion of natural resources such as mineral deposits, oil wells, timber stands, etc. The accounting process of conversion of the cost of these resources to expense is called depletion.

Rate of depreciation is calculated by dividing the cost of asset by the estimated available quantity of product. The annual depreciation will be the quantity extracted multiplied by rate per unit.

For e.g.	Cost of the asset	₹30,00,000	
	Estimated Quantity	60,00,000	tonnes
	Output in an accounting year	2,00,000	tonnes

∴ Depreciation rate $= \frac{30,00,000}{60,00,000} =$ ₹0.50 per tonne

& Depreciation to be written off = 2,00,000 × 0.50 = ₹1,00,000

1998 - May [3] (b) Write a short note on 'Depletion Method' of providing for depreciation. (5 marks)

Answer:

Please refer 1995 - Nov [6] (2) on page no. 389

1998 - Nov [6] Write short note on the following:

(ii) Revaluation method of providing depreciation. (5 marks)

Answer:

Under this method, the assets are revalued with the help of experts. The value of the assets is determined at the end of the year and compared with the value at the beginning of the year. The reduced amount is shown as depreciation in the profit & loss A/c. This method is simple and easy; but there is a difficulty in the valuation of old assets. The valuation is done by the experts. While valuation, the experts consider the market value of the asset.

2006 - May [6] Write short note on the following:

(iv) Machine Hour Rate method of calculating depreciation. (5 marks)

Answer:

Machine Hour Rate method of calculating depreciation: Machine hour rate method is useful in case of machines whose life is fixed in terms of hours. Hourly rate of depreciation is worked out by dividing the cost of the machine by the total number of hours for which the machine is expected to be used. Depreciation to be written off in a year will be ascertained by multiplying the hourly rate of depreciation by the number of hours that the machine actually runs in the year:

$$\text{Machine Hour Rate} = \frac{\text{Cost of the Machine}}{\text{Estinated total hours of life}}$$

Depreciation = Machine hour rate × Service hours used during the year.

DISTINGUISH BETWEEN

2002 - May [6] Briefly explain the differences between the following:

(d) Provision for depreciation under Straight Line method and Written Down Value Method. (5 marks)

Answer:

	Straight Line Method	Written Down Value Method
(i)	Depreciation is calculated on the original cost.	Depreciation is calculated on the written down value.
(ii)	The instalment of depreciation is same every year.	The instalment of depreciation diminishes every year.
(iii)	It is easy to calculate depreciation.	It is difficult to calculate depreciation.
(iv)	The balance in asset a/c will reduce to zero at the end of the working life of asset.	The balance in asset a/c will never be zero.
(v)	The cost on account of repairs and maintenance and depreciation is low in initial years as compared to later years.	The Cost on account of depreciation and repairs and maintenance is more or less equal throughout the working life of the asset.
(vi)	It is suitable for the assets which get depreciated more on account of expiry of time.	It is suitable for the assets which required heavy repairs in the later years.

PRACTICAL QUESTIONS

1994 - Nov [4] (Or) ABC Ltd. purchased on 1st January, 1988 second hand Plant for ₹30,000 and immediately spent ₹20,000 in overhauling it. On 1st July, 1988 additional machinery of a cost of ₹25,000 was purchased. On 1st July, 1990, the plant purchased on 1st January, 1988 became obsolete and was sold for ₹10,000. On that date, new machinery was purchased at a cost of ₹60,000.

Depreciation was provided for annually on 31st December, at 10% per annum on the original cost of the asset. In 1991, however, the company changed this method of providing for depreciation and adopted the method of writing off 15% on the diminishing value.

Show the Plant & Machinery Account as it would appear in the books of the company for the years 1988 to 1993. (15 marks)

Answer:

In the books of ABC Ltd.

Plant & Machinery A/c

Date	Particulars	₹	Date	Particulars	₹
1988			1988		
Jan 1	To Bank A/c	30,000	Dec. 31	By Depreciation	6,250
Jan 1	To Bank A/c (Overhauling)	20,000	Dec. 31	By Balance c/d	68,750
July 1	To Bank A/c	25,000			
		75,000			75,000
1989			1989		
Jan 1	To Balance b/d	68,750	Dec. 31	By Depreciation A/c	7,500
			Dec. 31	By Balance c/d	61,250
		68,750			68,750
1990			1990		
Jan 1	To Balance b/d	61,250	July 1	By Bank A/c (Sale proceeds)	10,000
July 1	To Bank A/c	60,000			
			Dec. 31	By Depreciation A/c (W.N.1)	8,000
			Dec. 31	By Profit & Loss A/c (Loss on sale of plant) (W.N. 2)	27,500
			Dec. 1	By Balance c/d	75,750
		1,21,250			1,21,250

1991 Jan 1	To Balance b/d	75,750	1991 Dec. 31	By Depreciation A/c	11,363
			Dec. 31	By Balance c/d	64,387
		75,750			75,750
1992 Jan 1	To Balance b/d	64,387	1992 Dec. 31	By Depreciation A/c	9,658
			Dec. 31	By Balance c/d	54,729
		64,387			64,387
1993 Jan 1	To Balance b/d	54,729	1993 Dec. 31	By Depreciation A/c	8,209
			Dec. 31	By Balance c/d	46,520
		54,729			54,729

Working Notes:

1. **Calculation of depreciation for the year 1990:**

The depreciation on plant sold (₹50,000 × 10/100 × 1/2)	₹2,500
Depreciation on ₹25,000 for one year	₹2,500
Depreciation on ₹60,000 for half year	₹3,000
	₹8,000

2. **Loss on Sale of Plant:**

WDV of Plant sold as on 1.7.1990 (₹50,000 – ₹12,500)	₹37,500
Less: Sale proceeds	₹10,000
Loss on sale	₹27,500

1995 - May [3] Ram Ltd. which depreciates its machinery at 10% p.a. on Diminishing Balance Method, had on 1st January, 1994 ₹9,72,000 on the debit side of Machinery Account.

During the year 1994 machinery purchased on 1st January, 1992 for ₹80,000 was sold for ₹45,000 on 1st July, 1994 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 1st January, 1992. Difference of depreciation upto 31st December, 1994 to be adjusted. The rate of depreciation remains the same as before.

Show Machinery Account. (15 marks)

Answer:

In the books of Ram Ltd.

Machinery Account

Date	Particulars	₹	Date	Particulars	₹
1994 Jan 1	To Balance b/d	9,72,000	1994 July 1	By Bank A/c	45,000
July 1	To Bank A/c (cost of new machinery)	1,50,000	July 1	By Depreciation (for 6 months on machinery sold)	4,000
July 1	To Bank A/c (Installation charges)	8,000	Dec. 31	By Profit & Loss A/c (Loss on Sale - W. Note 1)	15,000
			Dec. 31	By Depreciation (retrospective effect W. Note 2)	12,000
			Dec. 31	By Depreciation (for the year 1994 W. Note 3)	1,19,900
			Dec. 31	By Balance c/d	9,34,100
		11,30,000			11,30,000

Note: In the absence of information, the balance appearing in the machinery account as on 1st January, 1992 is assumed to be the original cost of the machinery for the purpose of calculating retrospective effect of depreciation.

Working Notes:

1. **Loss on Sale of Machinery:**

	₹
Original cost as on 1.1.92	80,000
Less: Depreciation for $2\frac{1}{2}$ years @ 10% as per straight line method	20,000
	60,000
Less: Sale proceeds	45,000
Loss on sale	15,000

(2) **Calculation of book value as at the beginning of 1992:**

Book value of Machinery as on 1.1.94	9,72,000
Add back: Depreciation for 1993 $\left(₹9,72,000 \times \frac{10}{90}\right)$	1,08,000
Book value as on 1.1.93	10,80,000
Add back: Depreciation for 1992 $\left(₹10,80,000 \times \frac{10}{90}\right)$	1,20,000
Book value as on 1.1.92	12,00,000

Depreciation as per straight line method with effect from 1.1.1992:

	₹
Book value of machinery as on 1.1.92	12,00,000
Depreciation @ 10% for two years (i.e. 1992 & 1993) (₹1,20,000 × 2)	2,40,000
Depreciation already charged (₹1,08,000 + ₹1,20,000)	2,28,000
Additional depreciation to be charged in 1994	12,000

(3) **Annual Depreciation for 1994:**

		Old Machinery	New Machinery
		₹	₹
Original cost (i.e. Book Value as on 1.1.1992)		12,00,000	

Original cost as on 1.7.1994	–	1,58,000
Less: Cost of machinery sold	80,000	–
	11,20,000	1,58,000
Depreciation @ 10% for 1 year		1,12,000
Depreciation @ 10% for $\frac{1}{2}$ year		7,900
Total depreciation		1,19,900

Note: As per the Accounting Standard 10 – "Property, Plant and Equipment", retrospective change in the method of depreciation is not possible. Therefore, such a question is not likely to come in the exam anymore. However, if such a question comes, students are advised to follow the solution which is given above.

1997 - May [4] (b) A purchased on 1st January, 1993 certain machinery for ₹1,94,000 and spent ₹6,000 on its erection. On 1st July, 1993 additional machinery costing ₹1,00,000 was purchased. On 1st July, 1995 the machinery purchased on 1st January, 1993 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. But for the above, depreciation shall be provided on time basis. In 1996 however, A 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 1-1-1996.

Show the machinery account for the calendar years 1993 to 1996.

(9 marks)

Answer:

Machinery Account

Date	Particulars	₹	Date	Particulars	₹
1993			1993		
Jan 1	To Bank A/c	1,94,000	Dec. 31	By Dep. A/c	25,000
July 1	To Bank A/c (Erection cost)	6,000		By Balance c/d	2,75,000
	To Bank A/c	1,00,000			
		3,00,000			3,00,000
1994			1994		
Jan 1	To Balance b/d	2,75,000	Dec. 31	By Dep. A/c	30,000
			Dec. 31	By Balance c/d	2,45,000
		2,75,000			2,75,000
1995			1995		
Jan 1	To Balance b/d	2,45,000	July 1	By Bank A/c (Sales Proceeds)	1,00,000
July 1	To Bank A/c	1,50,000	Dec. 31	By P & L A/c (Loss on sale)	60,000
				By Dep. A/c	17,500
				By Balance c/d	2,17,500
		3,95,000			3,95,000
1996			1996		
Jan 1	To Balance b/d	2,17,500	Dec. 31	By Dep. A/c (15% on 2,17,500)	32,625
				By Balance c/d	1,84,875
		2,17,500			2,17,500

Notes:

(1) Calculation of Depreciation

	Machinery I	*Machinery II*	*Machinery III*
(10% per annum on the original cost)			
[Date of Purchase;	1st Jan. 1993	1st July 1993	1st July 1995]
	₹	₹	₹
1993	20,000 ($^{10}/_{100}$ × 2,00,000)	5,000 (1,00,000 × $^{6}/_{12}$ × $^{10}/_{100}$)	—
1994	20,000	10,000	—
1995	—	10,000	7,500 (1,50,000 × $^{6}/_{12}$ × $^{10}/_{100}$)

(2) Loss on Sale:

	₹
Cost (Purchase)	2,00,000
Less: Total Depreciation (on First Machinery)	40,000
W.D.V. on the date of sale	1,60,000
Less: Sale Value	1,00,000
Loss on sale	60,000

1999 - Nov [4] (a) Hanuman Enterprises purchased on 1.4.95 certain machinery for ₹72,800 and paid ₹2,200 on its installation. On 1.10.95 another machinery for ₹25,000 was acquired.

On 1.4.96, 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 1.4.97, 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.

Ascertain the value of machinery as on 31.3.98. (7 marks)

Answer:

The value of machinery as on 31.3.98 can be ascertained by preparing Machinery Account from 1st April, 1995 to 31st March, 1998 as shown below:

In the books of Hanuman Enterprises

Dr. **Machinery Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.95	To Bank A/c (Cost of new machinery)	72,800	31.3.96	By Depreciation A/c (₹7,500 + ₹1,250)	8,750
	To Bank A/c (Installation charges)	2,200		By Balance c/d (₹67,500+ ₹23,750)	91,250
1.10.95	To Bank A/c	25,000			
		1,00,000			1,00,000

1.4.96	To Balance b/d	91,250	1.4.96	By Bank A/c	50,000
	To Bank A/c	45,000		By Profit & Loss A/c (Loss on sale - W.N.1)	17,500
			31.3.97	By Depreciation A/c (₹2,375 + ₹4,500)	6,875
				By Balance c/d (₹21,375+ ₹40,500)	61,875
		1,36,250			1,36,250
1.4.97	To Balance b/d	61,875	31.3.98	By Profit & Loss A/c (W.N. 3)	125
				By Depreciation A/c (₹2,500 + ₹4,500)	7,000
				By Balance c/d	54,750
		61,875			61,875

Working Notes:

1. **Book Value of Machines (Reducing Balance Method)**

	Machine I	Machine II	Machine III
	₹	₹	₹
Cost	75,000	25,000	45,000
Depreciation for 1995-96	7,500	1,250	
Written down value	67,500	23,750	
Sale proceeds	50,000		
Loss on sale	17,500		
Depreciation for 1996-97		2,375	4,500
Written down value as on 31.3.97		21,375	40,500

2. **Book Value of Machines (Straight Line Method)**

	Machine II	Machine III
	₹	₹
Cost	25,000	45,000
Depreciation	3,750 (for 1-1/2 years)	4,500 (for 1 year)
Written down value on 31.3.97	21,250	40,500

3. **Retrospective effect of change in depreciation method for machines II and III (1995-97)**

	₹
Depreciation under Straight Line Method (3,750 + 4,500)	8,250
Depreciation under WDV method (1,250 + 2,375 + 4,500)	8,125
Deficiency arising from retrospective recomputation of depreciation to be charged to Profit and Loss A/c	125

Note: As per the Accounting Standard 10 – "Property, Plant and Equipment", retrospective change in the method of depreciation is not possible. Therefore, such a question is not likely to come in the exam anymore. However, if such a question comes, students are advised to follow the solution which is given above.

2001 - Nov [3] (a) A firm purchased, on 1st January, 1996, certain machinery for ₹19,40,000 and spent ₹60,000 on its erection. On 1st July in the same year, additional machinery costing ₹10,00,000 was acquired. On 1st July, 1998 the machinery purchased on 1st January, 1996 having become obsolete was auctioned for ₹8,00,000 and on the same date fresh machine was purchased at a cost of ₹15,00,000.

Depreciation was provided for annually on 31st December at the rate of 10% per annum on the original cost of the asset. In 1999 however, the firm changed this method of providing depreciation and adopted the method of writing off 20% on the written down value.

Give the Machinery Account as it would stand at the end of each year from 1996 to 2000. (9 marks)

Answer:

Machinery A/c

Date	Particulars	₹	Date	Particulars	₹
1996			1996		
Jan. 1	To Bank A/c (1)	19,40,000	Dec. 31	By Dep. A/c (1) ₹2,00,000 + (2) ₹ 50,000	2,50,000
Jan. 1	To Bank A/c (Erection expense)	60,000			
Jul. 1	To Bank A/c (2) (New machinery)	10,00,000		By Balance c/d (₹18,00,000 + ₹9,50,000)	27,50,000
		30,00,000			30,00,000
1997			1997		
Jan. 1	To Balance b/d	27,50,000	Dec. 31	By Dep. A/c (1) ₹2,00,000 + (2) ₹ 1,00,000	3,00,000
			Dec. 31	By Balance c/d	24,50,000
		27,50,000			27,50,000
1998			1998		
Jan. 1	To Balance b/d	24,50,000	Jul. 1	By Bank A/c	8,00,000
Jul. 1	To Bank A/c (3)	15,00,000	Dec. 31	By P & L A/c	7,00,000
			Dec. 31	By Dep. A/c (1) (₹1,00,000 + (2) ₹ 1,00,000 + (3) ₹75,000)	2,75,000
			Dec. 31	By Balance c/d (2) ₹7,50,000 + (3) ₹ 14,25,000	21,75,000
		39,50,000			39,50,000
1999			1999		
Jan. 1	To Balance b/d	21,75,000	Dec. 31	By Dep. A/c (2) ₹1,50,000 + (3) ₹ 2,85,000	4,35,000
			Dec. 31	By Balance c/d (2) ₹6,00,000 + (3) ₹ 11,40,000	17,40,000
		21,75,000			21,75,000
2000			2000		
Jan. 1	To Balance b/d	17,40,000	Dec. 31	By Dep. A/c (2) ₹1,20,000 + (3) ₹ 2,28,000	3,48,000
			Dec. 31	By Balance c/d (2) ₹4,80,000 + (3) ₹ 9,12,000	13,92,000
		17,40,000			17,40,000

Notes:

	₹
Loss on sale on machinery:	
Cost of purchase (1.1.1996)	20,00,000
Depreciation for 1996 (full year)	2,00,000
	18,00,000
Depreciation for 1997 (full year)	2,00,000
	16,00,000
Depreciation for 1998 (half year)	1,00,000
Written down value	15,00,000
Sale of the machinery	8,00,000
Loss on sale	7,00,000

2003 - May [4] (b) Green Channel Co. purchased a second-hand machine on 1st January, 1999 for ₹1,60,000. Overhauling and erection charges amounted to ₹40,000.

Another machine was purchased for ₹80,000 on 1st July, 1999.

On 1st July, 2001, the machine installed on 1st January, 1999 was sold for ₹1,00,000. On the same date another machine was purchased for ₹ 30,000 and was installed on 30th September, 2001.

Under the existing practice the company provides depreciation @ 10% p.a. on original cost. However, from the year 2002 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 1999 to 2002. (12 marks)

Answer:

In the books of Green Channel Co.

Machinery Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.1999	To Bank A/c	1,60,000	31.12.1999	By Depreciation A/c (₹20,000 + ₹4,000)	24,000
1.7.1999	To Bank A/c (Erection charges)	40,000	31.12.1999	By Balance c/d (₹1,80,000+ ₹ 76,000)	2,56,000
	To Bank A/c	80,000			
		2,80,000			2,80,000

1.1.2000	To Balance b/d	2,56,000	31.12.2000	By Depreciation A/c (₹20,000 + ₹8,000)	28,000
			31.12.2000	By Balance c/d (₹1,60,000 + ₹ 68,000)	2,28,000
		2,56,000			2,56,000
1.1.2001	To Balance b/d	2,28,000	1.7.2001	By Bank A/c	1,00,000
30.9.2001	To Bank A/c	30,000		By Profit & Loss A/c (Loss on Sale- W.N.1)	50,000
			31.12.2001	By Depreciation A/c (₹10,000 + ₹8,000 + ₹750)	18,750
				By Balance c/d (₹60,000 + ₹29,250)	89,250
		2,58,000			2,58,000
1.1.2002	To Balance b/d	89,250	31.12.2002	By Profit and Loss A/c (W.N. 3)	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. Book Value of machines (Straight line method)

	Machine I	Machine II	Machine III
	₹	₹	₹
Cost	2,00,000	80,000	30,000
Depreciation for 1999	20,000	4,000	
Written down value as on 31.12.1999	1,80,000	76,000	
Depreciation for 2000	20,000	8,000	
Written down value as on 31.12.2000	1,60,000	68,000	
Depreciation for 2001	10,000	8,000	750
Written down value as on 31.12.2001	1,50,000	60,000	29,250
Sale proceeds	1,00,000		
Loss on sale	50,000		

2. Depreciation of machines (Written down value method)

	Machine II	Machine III
	₹	₹
Cost	80,000	30,000
Depreciation		
1999	6,000	
2000	11,100	
2001	9,435	1,125
Total depreciation for 1999-2001	26,535	1,125

3. Retrospective effect of change in depreciation method for machines II and III (1999-2001)

	₹
Depreciation under written down value method (₹26,535 + ₹1,125)	27,660
Depreciation under straight line method (₹20,000 + ₹750)	20,750
Deficiency arising from retrospective recomputation of depreciation to be charged to Profit and Loss A/c	6,910

Note: As per the Accounting Standard 10 – "Property, Plant and Equipment", retrospective change in the method of depreciation is not possible. Therefore, such a question is not likely to come in the exam anymore. However, if such a question comes, students are advised to follow the solution which is given above.

2004 - Nov [2] (b) A company had a balance of ₹4,05,000 on 1st January, 2003 in its Machinery account. 10% per annum depreciation was charged by diminishing balance method. On 1st July, 2003, the company sold a part of machinery for ₹87,500, which was purchased on 1st January, 2001 for ₹1,20,000 as a part of it become useless, and on the same date i.e., on 1st

July, 2003, the company purchased a new machine for ₹2,50,000. On 31st December, 2003, the Directors of the company decide to adopt the fixed installment method of depreciation from 1st January, 2001 instead of diminishing balance method. The rate of depreciation will remain the same. Prepare Machinery account in the books of Company for the year ending 2003.
(9 marks)

Answer:

Machinery Account

2003	Particulars	₹	2003	Particulars	₹
Jan 1	To Balance b/d (I) 97,200 (W.N. 1) (II) 3,07,800	4,05,000	July 1	By Cash A/c	87,500
			July 1	By Depreciation A/c (W.N. 1)	4,860
July 1	To Cash A/c (III)	2,50,000	July 1	By Profit and Loss A/c (W.N. 1) (Loss on Sale)	4,840
			Dec. 31	By Profit and Loss A/c (W.N. 3) (Additional Depreciation)	3,800
			Dec. 31	By Depreciation A/c (II) 38,000 (W.N.3) (III) 12,500	50,500
			Dec. 31	By Balance c/d	5,03,500
		6,55,000			6,55,000

Working Notes:

1. **Calculation of written down value (W.D.V.) of machinery on 01.07.2003 and Loss on its sale:**

	₹
Cost of machine on 01.01.2001	1,20,000
Less: Depreciation @ 10% for 2001	12,000
W.D.V. on 01.01.2002	1,08,000
Less: Depreciation @ 10% for 2002	10,800
W.D.V. on 01.01.2003	97,200
Less: Depreciation @ 10% for 6 months	4,860
W.D.V. on 01.07.2003	92,340
Less: Amount received from sale	87,500
Loss on sale	4,840

2. **Calculation of book value of unsold machine on 01.01.2001:**

	₹
If ₹97,200 is the W.D.V. on 01.01.2003 then cost	1,20,000
If ₹3,07,800 is the W.D.V. on 01.01.2003 then cost	$\frac{1,20,000 \times 3,07,800}{97,200}$
	= 3,80,000

3. **Calculation of additional depreciation because of change in method of depreciation:**

	Fixed instalment method (F.I.M) ₹	Diminishing balance method (D.B.M) ₹
Cost of machine on 01.01.2001	3,80,000	3,80,000
Less: Depreciation @ 10% p.a.	38,000	38,000
W.D.V on 01.01.2002	3,42,000	3,42,000
Less: Depreciation @ 10% p.a.	38,000	34,200
W.D.V. on 01.01.2003	3,04,000	3,07,800

Additional depreciation to be charged:

	₹
W.D.V. by D.B.M	3,07,800
Less: W.D.V. by F.I.M	3,04,000
	3,800

Note: As per the Accounting Standard 10 – "Property, Plant and Equipment", retrospective change in the method of depreciation is not possible. Therefore, such a question is not likely to come in the exam anymore. However, if such a question comes, students are advised to follow the solution which is given above.

2005 - Nov [3] (a) A company purchased second hand machinery on 1st January, 2000 for ₹3,00,000, subsequent to which ₹60,000 and ₹40,000 were spent on its repairs and installation, respectively. On 1st July, 2001 another machinery was purchased for ₹2,60,000. On 1st July, 2002, 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, 2003, 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 Installment method. From 1st January, 2002, 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 2000 to 2003.

(ii) Machinery Disposal Account.

Note: The figures are rounded off to the nearest multiple to Rupees ten.

(12 marks)

Answer:

Machinery Account

2000		₹	2000		₹
Jan 1	To Bank A/c (A) – Cost – Repairs – Installation	 3,00,000 60,000 40,000	Dec. 31	By Depreciation (A) By Balance c/d (A)	40,000 3,60,000
		4,00,000			4,00,000
2001			2001		
Jan 1 July 1	To Balance b/d To Bank A/c (B)	3,60,000 2,60,000	Dec. 31	By Depreciation (A) – 40,000 (B) – 13,000	 53,000
				By Balance c/d (A) – 3,20,000 (B) – 2,47,000	 5,67,000
		6,20,000			6,20,000

2002			2002		
Jan 1	To Balance b/d	5,67,000	July 1	By Machinery Disposal A/c (A) (W.N.1)	2,67,320
July 1	To Bank A/c (C)	2,50,000	Dec. 31	By Depreciation (A) – 21,680 (W.N.1) (B) – 36,080 (W.N. 1) (C) – 18,750 (W.N.1)	 76,510
				By Profit and Loss A/c - Short Depreciation (A) – 31,000 (W.N.2) (B) – 6,500 (W.N.2)	 37,500
				By Balance c/d (B) – 2,04,420 (C) – 2,31,250	 4,35,670
		8,17,000			8,17,000
2003			2003		
Jan. 1	To Balance b/d	4,35,670	July 1	By Machinery Disposal A/c (B) (W.N. 1)	1,89,090
			Dec. 31	By Depreciation (B) – 15,330 (C) – 34,690	 50,020
				By Balance c/d (C)	1,96,560
		4,35,670			4,35,670

Machinery Disposal Account

2002		₹	2002		₹
July 1	To Machinery A/c (A) To Profit and Loss A/c (Profit)	2,67,320 32,680	July 1	By Bank A/c	3,00,000
		3,00,000			3,00,000

2003				2003			
July 1	To	Machinery A/c (B)	1,89,090	July 1	By	Bank A/c	2,30,000
	To	Profit and Loss A/c (Profit)	40,910				
			2,30,000				2,30,000

Working Notes:

1.

Machinery	S.L.M Depreciation @ 10% p.a.	Book value	W.D.V Depreciation @ 15% p.a.	Book value
(A) Purchased for ₹4,00,000 on Jan. 1, 2000	40,000	3,60,000	60,000	3,40,000
Year – 2001	40,000	3,20,000	51,000	2,89,000
	80,000		1,11,000	
Year till July, 2002			21,680	2,67,320
(B) Purchased for ₹2,60,000 on July 1, 2001	13,000	2,47,000	19,500	2,40,500
Year – 2002			36,080	2,04,420
Year till July 1, 2003			15,330	1,89,090
(C) Purchased for ₹2,50,000 on July 1, 2002			18,750	2,31,250
Year – 2003			34,690	1,96,560

2. Adjusted Depreciation till 2001

	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)
				37,500	

Notes:

1. As per para 15 of AS 6 'Depreciation Accounting', when the method of depreciation is changed, depreciation is recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method is adjusted in the accounts in the year in which the method of depreciation is changed. Therefore, in the above solution, the retrospective recomputation of depreciation as per new method has been considered.
2. The method of depreciation was changed on 1st January, 2002. Since, Machinery A existed on the date of change in method of depreciation, therefore, retrospective effect has also been given to it.

Note: As per the Accounting Standard 10 – "Property, Plant and Equipment", retrospective change in the method of depreciation is not possible. Therefore, such a question is not likely to come in the exam anymore. However, if such a question comes, students are advised to follow the solution which is given above.

2006 - Nov [3] (b) M/s ABC Limited of India, purchased a machine from U.S. Company for $15,000, on 1st April, 2003 when $1 = ₹40, the entire amount was payable in 5 annual instalments, payable every 31st March. Company charges depreciation @ 15% on WDV of the machine. After 2 years of purchase, due to exchange fluctuation, the revised rate become $1 = ₹50. Calculate depreciation and the revised liability for the financial year 2005-06. (6 marks)

Answer:

Revised liability due to exchange fluctuation:

	$	₹
Original Liability as on 01.04.2003	15,000	6,00,000
Less: Paid on 31.03.2004	3,000	1,20,000
Liability as on 01.04.2004	12,000	4,80,000
Less: Paid on 31.03.2005	3,000	1,20,000

Liability as on 01.04.2005	9,000	3,60,000
Add: Liability increased due to exchange fluctuation $1 = ₹(50 - 40) = ₹10 per $	-	90,000
Revised Liability as on 01.04.2005	9,000	4,50,000

Such increase in long term liability ₹90,000 is to be taken in the Profit and Loss Account and not in the depreciable amount of the asset.

Machinery: Original cost	6,00,000
Less: Depreciation @ 15% for 2003-04	90,000
W.D.V.	5,10,000
Less: Depreciation @ 15% for 2004-05	76,500
W.D.V.	4,33,500
Depreciation @ 15% for 2005-06	65,025

Note: The Revised AS 11 (2003), 'The Effects of Changes in Foreign Exchange Rates' does not require the adjustment of exchange differences in the carrying amount of fixed assets. As per the revised standard, such exchange differences are transferred to Profit and Loss Account. Therefore, the book value of the machinery is not affected by the revised liability and depreciation is calculated on the book value of the machinery as on 1st April, 2005 only.

2018 - Nov [1] {C} (c) A Plant & Machinery costing ₹10,00,000 is depreciated on straight line assuming 10 year working life and zero residual value, for four years. At the end of the fourth year, the machinery was revalued upwards by ₹40,000. The remaining useful life was reassessed at 8 years. Calculate Depreciation for the fifth year. (4 marks)

Q.R. Code for Solution Video

Answer:

Depreciation per year = ₹10,00,000/10 = ₹1,00,000

Depreciation on Sum Basis for 4 years

= ₹1,00,000 × 4 years = ₹4,00,000.

Book Value of Machine at the end of

4th year = ₹10,00,000 – 4,00,000

= ₹6,00,000.

Depreciable amount after revaluation

= 6,00,000 + 40,000

= ₹6,40,000

Remaining useful life as per revised estimate = 8 years

Depreciation for fifth year and

Onwards = ₹6,40,000/8

= ₹80,000/-

2019 - June [2] (b) A Firm purchased an old Machinery for ₹37,000 on 1st January, 2015 and spent ₹3,000 on its overhauling. On 1st July 2016, another machine was purchased for ₹10,000. On 1st July 2017, the machinery which was purchased on 1st January 2015, was sold for ₹28,000 and the same day a new machinery costing ₹25,000 was purchased. On 1st July, 2018, the machine which was purchased on 1st July, 2016 was sold for ₹2,000. Depreciation is charged @ 10% per annum on straight line method. The firm changed the method and adopted diminishing balance method with effect from 1st January, 2016 and the rate was increased to 15% per annum. The books are closed on 31st December every year.

Prepare Machinery account for four years from 1st January,2015.

(10 marks)

Answer:

In the books of Firm
Machinery Account

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Bank A/c	37,000	31.12.2015	By Depreciation A/c	4,000
	To Bank A/c (overhauling charges)	3,000	31.12.2015	By Balance c/d	36,000
		40,000			40,000
1.1.2016	To Balance b/d	36,000	31.12.2016	By Depreciation A/c (₹5,400 + ₹750)	6,150
1.7.2016	To Bank A/c	10,000	31.12.2016	By Balance c/d (₹30,600 + ₹9,250)	39,850
		46,000			46,000
1.1.2017	To Balance b/d	39,850	1.7.2017	By Bank A/c (sale)	28,000
1.7.2017	To Bank A/c	25,000	1.7.2017	By Profit and Loss A/c (loss on sale - W.N.1)	305
			31.12.2017	By Depreciation A/c (₹2,295 + ₹1,388 + ₹1,875)	5,558
				By Balance c/d (₹7,862 + ₹23,125)	30,987
		64,850			64,850
1.1.2018	To Balance b/d	30,987	1.7.2018	By Bank A/c (sale)	2,000
			1.7.2018	By Profit and Loss A/c (loss on sale - W.N.1)	5,272
			31.12.2018	By Depreciation A/c (₹590 + ₹3,469)	4,059
			31.12.2018	By Balance c/d	19,656
		30,987			30,987

Working Note:

Book Value of machines

	Machine I ₹	Machine II ₹	Machine III ₹
Cost of all machinery (Machinery cost for 2015)	40,000	10,000	25,000
Depreciation for 2015	4,000		
Written down value as on 31.12.2015	36,000		
Purchase 1.7.2016 (6 months)		10,000	
Depreciation for 2016	5,400	750	
Written down value as on 31.12.2016	30,600	9,250	
Depreciation for 6 months (2017)	2,295		
Written down value as on 1.7.2017	28,305		
Sale proceeds	28,000		
Loss on sale	**305**		
Pruchase 1.7.2017			25,000
Depreciation for 2017 (6 months)		1,388	1,875
Written down value as on 31.12.2017		7,862	23,125
Depreciation for 6 months in 2018		590	
Written down value as on 1.7.2018		7,272	
Sale proceeds		2,000	
Loss on sale		5,272	
Depreciation for 2018			3,469
Written down value as on 31.12.2018			**19,656**

2019 - Nov [1] {C} (c) X purchased a machinery on 1st January 2017 for ₹4,80,000 and spent ₹20,000 on its installation. On July 1, 2017 another machinery costing ₹2,00,000 was purchased. On 1st July, 2018 the machinery purchased on 1st January, 2017 having become scrapped and was sold for ₹2,90,000 and on the same date fresh machinery was purchased for ₹5,00,000. Depreciation is provided annually on 31st December at the rate of 10% p.a. on written down value. Prepare Machinery account for the years 2017 and 2018. (4 marks)

Answer:

In the Books of X
Machinery A/c

Date	Particulars	₹	Date	Particulars		₹
01-01-17	To Bank A/c (Mach. I)	4,80,000	31-12-17	By Depreciation A/c		
01-01-17	To Bank A/c (Installation Charges)	20,000		Mach. I (10% of ₹ 5,00,000)	50,000	
01-07-17	To Bank A/c (Mach. II)	2,00,000		Mach. II (10% of ₹ 2,00,000×6/12)	10,000	60,000
			31-12-17	By Balance c/d		
				Mach. I (₹ 5,00,000 - ₹ 50,000)	4,50,000	
				Mach. II (₹ 2,00,000 - ₹ 10,000)	1,90,000	6,40,000
		7,00,000				7,00,000
01-01-18	To Balance b/d	6,40,000	01-07-18	By Depreciation A/c		
01-07-18	To Bank A/c (Mach. III)	5,00,000		Mach. I (10% of ₹ 4,50,000×6/12)		22,500
			01-07-18	By Bank A/c (Sale Proceeds)		2,90,000
			01-07-18	By Profit & Loss A/c (Loss on Sale - W. N. 1)		1,37,500
			31-12-18	By Depreciation A/c		
				Mach. II (10% of ₹ 1,90,000)	19,000	
				Mach. III (10% of ₹ 5,00,000×6/12)	25,000	44,000
			31-12-18	By Balance c/d		
				Mach. II (₹ 1,90,000 - ₹ 19,000)	1,71,000	
				Mach. III (₹ 5,00,000 - ₹ 25,000)	4,75,000	6,46,000
		11,40,000				11,40,000

Working Notes:

W. N. 1 - Calculation of Profit/ (Loss) on Sale of Machine I

Particulars		₹
Sale Proceeds		2,90,000
Less: W.D.V. as on 01-07-2018		
W.D.V. as on 01-01-2018	4,50,000	
Less: Depreciation from 01-01-2018 to 01-07-2018	22,500	
(10% of ₹ 4,50,000 × 6/12)		4,27,500
Profit/ (Loss) on Sale of Machine		(1,37,500)

CHAPTER

6

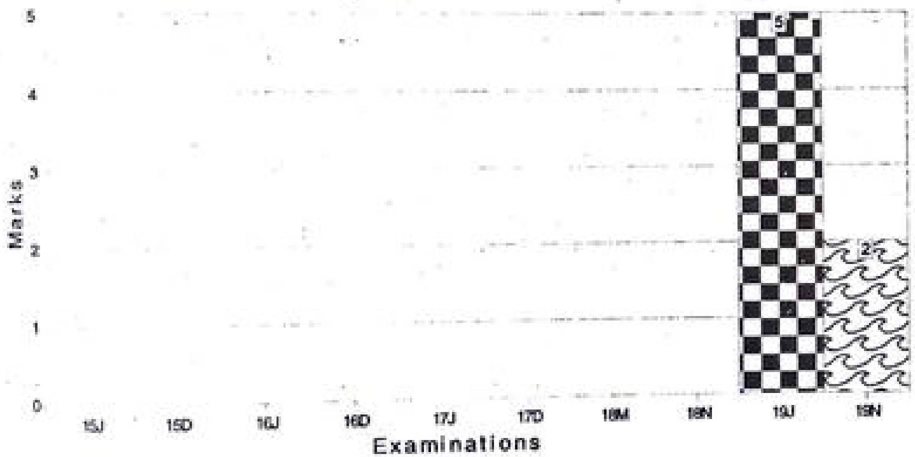
Accounting for Special Transactions

Unit: 1 **Bill of Exchange and Promissory Notes**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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SELF STUDY QUESTIONS

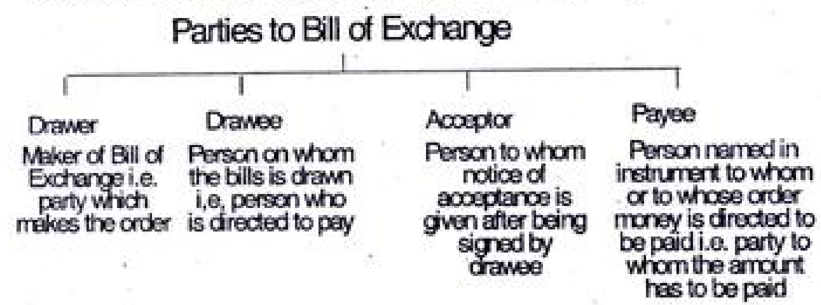
Q1. What do you understand by Bills of Exchange? What are its Characteristics?

Answer:

According to Section 5 of Negotiable instrument Act, it is "an instrument in writing containing an unconditional order signed by the maker directing certain person or to the bearer of the instrument".

Characteristics of Bill of Exchange:

- It must be written.
- It must contain an unconditional order to pay certain sum of money.
- It must be properly signed and stamped.
- Money must be payable to a specific person or to his order or to the bearer.
- The order must be to pay money and money only.



If a bill is drawn for foreign trade operations i.e. drawn in one country and payable in another country it is called a "Foreign Bill of Exchange". According to Section 12 of Negotiable Instruments Act, all instruments, which are not inland instruments, are foreign instruments.

Q2. What are Promissory Notes? What are their characteristics?

Answer:

- According to Section 4 of Negotiable Instrument Act, 1881, "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"
- However RBI Act, restricts promissory note to be payable to bearer of the instrument.

Characteristics

- It must be in writing.
- It must contain express unconditional promise to pay money.
- It must be properly signed and stamped.
- The parties and the sum payable must be specific.
- It does not require any acceptance from another party.

Q3. Difference between Bills of Exchange & Promissory Notes?

Answer:

Basis	Bills of Exchange	Promissory Note
Nature	It contains an order to pay.	It contains a promise to pay.
Parties	There are 3 parties involved namely: • Drawer • Drawee • Payee	There are 2 parties involved namely: • Maker/Promissor • Payee
Liability	Liability of drawer is secondary and conditional, i.e., it arises only if acceptor does not pay.	Liability of maker is primary and absolute.

Notice of Dishonour	Must be given.	Not required.
Conditional	Is unconditional but can be accepted conditionally	Cannot be conditional.
Noting and Protest	In case of dishonour, it must be noted for non-payment.	Not necessary.
Paid to	Can be made payable to bearer.	Cannot be made payable to a bearer.

Specimen of Bill of Exchange

₹5,00,000/-

New Delhi
1st January, 2017

Three months after date pay me or my order the sum of Rupees Five Lacs only, for the value received.

To,

Accepted

A | Revenue Stamp | B

75, Park Street
Kolkata 708001

Specimen of Promissory Note

₹5,00,000/-

New Delhi
1st January, 2017

Three months after I promise to pay 'B' or his order the sum of Rupees Five Lacs only, for value received..

To,

B | Stamp | A

Q4. How do we record Bills of Exchange and Promissory Notes in books of accounts?

Answer:

Record of Bills of Exchange and Promissory Notes

In the books of Drawee

On receipt of Bill

Bills Receivable A/c	Dr.
To Drawee	

On payment of bill by drawee on due date

Cash A/c	Dr.
To Bills Receivable A/c	

If bill is dishonoured on due date

Drawee A/c	Dr.
To Bills Receivable A/c	

If bill is endorsed in favour of other party say Mr. X.

Mr. X	Dr.
To Bills Receivable A/c	

If bill is discounted with bank (before due date)

Bank A/c	Dr.
Discount A/c	Dr.
To Bills Receivable A/c	

Journal Entries in the books of Drawee

On receipt of bill accepted by Drawee

Drawer A/c	Dr.
To Bills Payable A/c	

On payment at due date

Bills Payable A/c	Dr.
To Cash A/c	

If bill is dishonoured on due date

Bills Payable A/c	Dr.
To Drawer A/c	

Q5. Write and describe all terminologies used in "Bill of Exchange"?

Answer:

Term of Bill

(Generally upto 90 days)

- Bill drawn after sight, i.e., term begins from the date of acceptance and ends on the date on which it becomes due.
- Bill drawn after date, i.e., term begins from the date of drawing the bill and ends on the date it becomes due.

Expire/Due date of bill

The date when the bill of exchange drawn come to end.

Days of Grace

Days of Grace are three extra days added to the period of the bill. However grace days are not added in case of instruments payable on demand.

Date of maturity

Date on which the payment of the bill is due also known as Due date. It is calculated by adding the days of grace except in case of instruments payable on demand.

Bill at sight

Bills which are drawn 'On demand' and 'At sight' and are payable on presentation. No grace period is allowed for such type of bills.

Bill after date

Bills which are payable after a specified period or on a specific date or after sight or on happening of event which is certain to happen.

How to calculate due date of a bill

	Cost of Bills		Due date
(i)	When the bill is made payable on specific date	➔	Specific date
(ii)	When the bill is made payable at stated number of month(s) after due date	➔	Date on which the term of bill shall expire.

(iii) When the bill is made payable at stated number of days after due date	→	Date which comes after adding number of days to the date of bill,excluding the date of bill.
(iv) If due date is a public holiday	→	Preceding business day
(v) If due date is an emergency/ unforseen holiday	→	Next following day

Q6. What are Noting Charges in case of Bills of Exchange?

Answer:

- When a Bill of exchange is dishonoured, it is necessary to prove the fact, thus the drawer (or holder) may get the bill noted and protested through officer appointed by the Central or State Government to exercise the power and functions relating to noting and protesting of negotiable instrument named as "Notary Public".
- Noting is the recording of the fact by Notary public which evidences the dishonour.
- Fees paid to Notary Public for this service is known as Noting changes. Journal Entry if noting charges are paid by drawer.

In the books of Drawer

Drawer A/c Dr.
To Cash A/c

In the books of Drawee

Noting charges A/c Dr.
To Drawer A/c

Q7. What do you mean by Renewal of Bill?

Answer:

Sometimes acceptor of the bill may not be in the position to meet the bill at due date. In such a case, he may, with the consent of holder, accept a new bill in place of old bill (after cancellation of old bill). This is known as renewal of bill.

New bill may include interest for extended period or it may be paid separately.

Q8. What do you understand by Retirement of Bills of Exchange and Rebate?

Answer:

When the acceptor agrees to pay the bill much before the due date, it is called Retirement of Bills. In such case holder may allow a rebate of certain amount for premature payment.

Q9. When does Insolvency occur in case of Bills of Exchange?

Answer:

When the acceptor of the bill or maker of the promissory note is unable to meet his liability, he is called insolvent and the instrument should be treated as dishonoured.

The dishonour due to insolvency is recorded in the same manner as in case of dishonour of bill.

Treatment to be given in books of accounts.

In the books of Drawer: To be debited to Bad Debts Account.

In the book of Drawee: To be credited to Deficiency Account.

Q10. What do you mean by Accommodation Bills?

Answer:

- Bills of exchange are drawn to facilitate the business transactions in general i.e. they are meant to finance the purchase or sale of goods.
- However, bills can also be utilised for raising funds, such type of transaction with Bill is known as Accommodation Bill.
- The main purpose of this bill is to assist financial accommodation or arrangement for one or more parties.

There can be two types of accommodation:

(a) If there is only a single bill, proceeds are shared by the drawer and drawee on proportionate basis.

(b) If there are two bills amount drawn be two parties on each other, both the parties will discount their respective bills separately and will keep the proceeds himself.

Accounting entries passed will be exactly as passed for ordinary bills.

Q11. What do you mean by bills sent for collection?

Answer:

- When the receiver of the bill sends the bill to his bank along with the instruction that the same will be retrieved and realised on due date, it is known as **bill sent for collection.**
- In this case, bank on realisation of amount at due date will credit the customer's account.

Accounting Entry to be passed:

(a) For recording the bill sent

Bills sent for collection A/c Dr.
To Bills Receivable A/c

(b) When the amount is honoured/realised

Bank A/c Dr.
To Bills Sent for collection A/c

(c) In case of dishonour

Drawee A/c Dr.
To Bills Sent for Collection A/c

Q12. What are Bills Receivable and Bills Payable Books?

Answer:

Bill Receivable Book A subsidiary book used to record bills receivable in favour of a person.

Specimen of Bills Receivable Book

Date	Voucher No.	From whom received	Name of Acceptor	Date of Bill	Term	Date of maturity	Where payable	Amount	LF	Mode of Disposal	Remark

Bills Payable Book:

A subsidiary book used to record bills payable accepted by the person.

Specimen of Bills Payable Book

Date	Name of Drawer	Payee	Date of Bill	Term	Due Date	Place of Payment	Amount	LF	How to met	Remark

Example:

Journalise the following transactions in the books of Mr. Arun.

2017

Jan 20	Sold goods on credit to Babu	₹8,000
Jan 26	Purchased goods on credit from Chetan	₹4,000
Jan 29	Babu accepted a three month's bill of exchange drawn on him by Arun	₹8,000
Feb 9	Arun accepted a three month's bill of exchange drawn by Chetan	₹4,000
Feb 26	Discounted ₹8,000 bill of exchange from Babu with the bank for	₹7,800
Mar 6	Chetan discounted ₹4,000 bill of exchange from Arun with bank for	₹3,900
May 5	Bank informed Arun that Babu has dishonoured his acceptance for ₹8,000 and that accordingly the current account for Arun has been debited with this amount.	
May 12	Paid the bill originally drawn on Arun by Chetan.	

Solution:

In the books of Arun
Journal Entries

	Particulars	L.F.	Dr. Amount (₹)	Cr. Amount (₹)
Jan 20	Babu's A/c Dr. To Sales A/c [Being goods sold on credit]		8,000	8,000
Jan 26	Purchases A/c Dr. To Chetan A/c [Being goods purchased on credit]		4,000	4,000
Jan 29	Bills Receivable A/c Dr. To Babu A/c [Being bill accepted by Babu to be payable after three months]		8,000	8,000
Feb 9	Chetan A/c Dr. To Bills Payable A/c [Being bill accepted in favour of Chetan to be payable after three months]		4,000	4,000
Feb 26	Bank A/c Dr. Discount on Bills A/c Dr. To Bills Receivable A/c [Being bills receivable from Babu discounted at bank]		7,800 200	8,000
May 5	Babu A/c Dr. To Bank A/c [Being bill accepted by Babu and discounted returned dishonoured]		8,000	8,000

May 12	Bills Payable A/c Dr. To Bank A/c [Being bill accepted in favour of Chetan paid at maturity]		4,000	4,000

Example:

Bhim owned to Arjun ₹60,000 on 1st Jan, 17. On the same date, Arjun drew upon Bhim a bill for the amount at 2 months and B returned the bill duly accepted. A got the bill discounted at his bank @15% p.a. Before the bill was due for payment, Bhim told Arjun that he was not able to pay the full amount and requested Arjun to accept ₹20,000 immediately and drew upon him another bill for the remaining amount for 2 months together with interest @18% p.a. Arjun agreed. The second bill was duly met. Give Journal entries in the books of both Arjun and Bhim.

Solution

In the books of Arjun Journal Entries.

Date	Particulars	L.F.	Dr. Amount (₹)	Cr. Amount (₹)
2017 Jan 1	Bills Receivable A/c Dr. To Bhim [Being bills accepted by Bhim]		60,000	60,000
Jan 1	Bank A/c Dr. Discount of Bill A/c Dr. To Bills Receivable A/c [Being bills discounted from bank]		58,500 1,500	60,000
Mar 4	Bhim A/c Dr. To Bank A/c [Being bill dishonoured for renewal]		60,000	60,000

Mar 4	Bank A/c Dr. To Bhim A/c [Being partial payment received from Bhim in cash]		20,000	20,000
Mar 4	Bhim A/c Dr. To Interest A/c [Being interest due for two months @ 18% p.a. on balance amount i.e. 40,000]		1,200	1,200
Mar 4	Bills Receivable A/c Dr. To Bhim A/c [Being new bill accepted from Bhim for ₹ 40,000 plus interest ₹1,200]		41,200	41,200
Mar 7	Bank A/c Dr. To Bills Receivable A/c [Being amount received of the new bill]		41,200	41,200

In the book of Bhim
Journal Entries

Date	Particulars	L.F.	Dr. Amount (₹)	Cr. Amount (₹)
2017				
Jan 1	Arjun A/c Dr. To Bills Payable A/c [Being the acceptance of Arjun's draft]		60,000	60,000
Mar 4	Bills Payable A/c Dr. To Arjun [Being dishonoured entry passed for renewal of bill]		60,000	60,000
Mar 4	Arjun A/c Dr. To Bank A/c [Being portion of sum due paid in cash as per agreement]		20,000	20,000

Mar 4	Interest A/c Dr. To Arjun A/c [Being the interest due for two months @18% p.a. on amount outstanding i.e. ₹ 40,000]		1,200	1,200
Mar 4	Arjun A/c Dr. To Bills Payable A/c [Being new acceptance in favour of Arjun]		41,200	41,200
May 7	Bills Payable A/c Dr. To Bank A/c [Being payment of the bill due]		41,200	41,200

Example:

Raman sold goods to Ishita on September 1st 2016 for ₹6,000. On September 15th Ishita accepted a bill of exchange drawn by Raman payable at 3 months after sight. On the due date, when the bill is presented for payment, Raman is informed that the bill cannot be paid because Ishita has been declared insolvent.

On January 25th, 2017, the executor dealing with the estate of Ishita pays a final dividend of 50 paisa in the rupee to creditors of the business. Record the Journal entries in the books of Raman.

Solution

In the books of Raman
Journal Entries

Date	Particulars	L.F.	Dr. Amount (₹)	Cr. Amount (₹)
2016				
Sep 1	Ishita A/c Dr. To Sales A/c [Being goods sold on credit]		6,000	6,000

Sep 15	Bills Receivable A/c Dr. To Ishita A/c [Being bills accepted by Ishita to be payable three months after sight]		6,000	6,000
Dec 18	Ishita A/c Dr. To Bills Receivable A/c [Being bill dishonoured on presentation due to insolvency]		6,000	6,000
2017				
Jan 15	Bank A/c Dr. Bad debt A/c Dr. To Ishita A/c [Being dividend of 50 paisa in the rupee received in full settlement and balance amount written off]		3,000 3,000	6,000

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. If due date of a bill is a public holiday, then its due date will be:
   (a) Following day
   (b) Preceding day
   (c) Same day
   (d) One month later
2. On 1.1.05 X draws a bill on Y for ₹20,000. At maturity, Y requests X to renew the bill for 2 months @ 12% p.a. interest. Amount of interest will be:

   (a) ₹400
   (b) ₹300
   (c) ₹360
   (d) ₹380
3. On 1.8.05 X draws a bill on Y "for 30 days after sight". The date of acceptance is 8.8.05. The due date of the bill will be:
   (a) 8.9.05
   (b) 10.9.05
   (c) 11.9.05
   (d) 9.9.05
4. Bill Receivable account is a:
   (a) Nominal account
   (b) Personal account
   (c) Real account
   (d) None
5. The Noting changes levied on dishonour of an endorsed bill by the Notary Public are to be borne by:
   (a) Drawer of the bill
   (b) Holder of the bill
   (c) Endorser of the bill
   (d) Person responsible for dishonour
6. A bill of exchange is drawn on 1st April 2003 payable after 3 months. The due date of the bill is:
   (a) 1st April 2003
   (b) 30th June 2003
   (c) 1st July 2003
   (d) 4th July, 2003
7. A draws a bill on B for ₹50,000 for 3 months. At maturity, the bill returned dishonoured noting charges ₹500. 40 paise in a rupee is recovered from B's estate. The amount of deficiency to recorded on insolvency in books of B will be:
   (a) ₹20,200
   (b) ₹30,300

(c) ₹19,800
(d) ₹19,000

8. On 1.3.2006 X draws a bill on Y for 3 months for ₹20,000 on 4.5.2006 Y pays the bill to X at 12% discount, the Amount of discount will be:
(a) ₹200
(b) ₹400
(c) ₹600
(d) ₹100

9. How long is the period of days of grace in case of a bill:
(a) Three days
(b) Two days
(c) Four days
(d) One day

10. A promissory note does not require:
(a) Noting
(b) Discounting
(c) Acceptance
(d) None of the above

11. Mohan drew a bill on Shyam for ₹50,000 for 3 months. Proceeds are to be shared equally. Mohan got the bill discounted @ 12% p.a. and remits required proceeds to Shyam. The amount of such remittance will be:
(a) ₹24,250
(b) ₹25,000
(c) ₹16,167
(d) ₹32,333

12. A promissory note is drawn by ____ in favour of his ____.
(a) drawer, drawee
(b) maker, payee
(c) payer, payee
(d) drawer, payee

13. On 1st January 2006, Vimal sold goods worth ₹20,000 to Renu and drew a bill on Renu for 3 months. Renu accepted the bill and returned it to Vimal who discounted the bill with, bank on 4th February 2006 @ 15% p.a. The discounting charges will be:
(a) ₹3,000
(b) ₹750
(c) ₹500
(d) None

14. On 1st January Shilpa owes ₹10,000 and accepts a 3 months bill for the amount. On the date of maturity Shilpa was not able to meet the bill. She pays ₹4000 and asks to draw another bill for three months for the balance amount with interest @ 15% p.a. The amount of interest will be:
(a) ₹200
(b) ₹225
(c) ₹500
(d) ₹900

15. The purpose of Accommodation bill is
(a) To finance actual purchase or sale of goods
(b) To facilitate trade transmission
(c) When both parties are in need of funds
(d) None of above

16. Preeti accepted a 90 days bill of ₹10,000 drawn by Jeet on 5.2.2006. On 13.3.2006 Preeti wished to retire the bill. Jeet offered rebate @ 12% p.a. What is the amount of rebate?
(a) ₹150
(b) ₹187
(c) ₹184
(d) None

17. Bill receivable endorsed are debited to:
(a) Debtors A/c
(b) Creditors A/c

(c) Bills payable A/c
(d) Bills receivable A/c

18. On 1.6.07, X draws a bill on Y for ₹25,000. At maturity, Y requests X to accept ₹5,000 in cash and noting charges incurred ₹100 and for the balance X drew a bill on Y for 2 months at 12% p.a. Interest amount will be:
(a) ₹410
(b) ₹420
(c) ₹440
(d) ₹400

19. On 1.1.2005 X draws a bill on Y for ₹30,000 for 3 months. At maturity Y requests X to accept ₹10,000 in cash and for balance to draw a fresh bill for 2 months together with 12% p.a. interest, amount of interest will be:
(a) ₹400
(b) ₹600
(c) ₹480
(d) ₹760

20. Endorsement of bill means:
(a) Transfer of right on the bill from the drawee to the creditors
(b) Transfer of right on the bill from the creditors to the drawee
(c) Transfer of right on the bill from the drawer to the creditors
(d) Transfer of right on the bill from the creditors to the drawer

21. On 1st April, A sold goods worth ₹10,000 to B. B drew a bill for 3 months. A discounted the bill from the bank at 15% p.a. then the amount received on account of bill will be:
(a) ₹10,000
(b) ₹9,625
(c) ₹9,000
(d) ₹8,500

22. Which account is to be credited when an endorsed cheque is dishonoured?
(a) Debtor
(b) Bill Receivable

(c) Endorsee
(d) Payee

23. A draws a bill of ₹50,000 and B accepts it. After this, B becomes insolvent and only 40 paisa in a rupee could be recovered. What is the amount that can be recovered?
(a) ₹20,000
(b) ₹35,000
(c) ₹30,000
(d) None

24. A promissory note is an instrument in writing containing an ______ undertaking.
(a) conditional
(b) unconditional
(c) both (a) & (b)
(d) either (a) or (b)

25. Dishonour of a bill is recorded in
(a) Cash Book
(b) Sales Book
(c) Purchase Book
(d) Bills Receivable Book

26. If the bill is accepted and the amount is given before the due date (i.e. maturity), then the bill is said to be:
(a) Cancelled
(b) Accepted
(c) Retired
(d) Dishonour

27. A bill of ₹12,500 drawn by Shyam is accepted by Ram & Shyam gets it discounted @ 12% p.a. due 3 months hence. The discounting charges borne by Shyam is:
(a) ₹375
(b) ₹1,500
(c) ₹250
(d) ₹1,000

28. A draws a bill for ₹15,000 which is accepted by B. They agree to share the proceeds in the ratio of 3 : 2. A discounts the bill with the bank at 10% p.a., maturity 2 months. What amount will be remitted by A to B after discountingthe bill?
    (a) ₹6,000
    (b) ₹7,500
    (c) ₹5,900
    (d) ₹7,375
29. Ram drew a bill on Shyam on 15th April, 09 Shyam accepted the same on 17th April, 09 for 30 days after sight. What will be the due date of the bill?
    (a) 18th May, 09
    (b) 15th May' 09
    (c) 20th May, 09
    (d) 17th May, 09
30. X draws a bill on Y for ₹5,000 for 3 months. Before the due date Y sends 1/5th of the amount to X. Y requested X to draw a new bill for the balance amount plus interest @ 12% p.a. for 3 month. Find the amount of the new bill?
    (a) ₹5,150
    (b) ₹4,140
    (c) ₹4,120
    (d) ₹5,440
31. A draws a bill for ₹20,000 for 3 months on 1.1.09. Bill was discounted with a banker who charged ₹100 as discounting charges. At maturity, the bill returned dishonoured. With what amount will the bank a/c be credited in the books of A?
    (a) ₹19,000
    (b) ₹20,000
    (c) ₹20,100
    (d) ₹19,900

32. When a bill is renewed, then entry will be:
    (a) No entry will be passed
    (b) Entries for cancellation of old bill and renewal of bill
    (c) Entry for renewal of bill
    (d) None of these
33. A draws a bill for ₹10,000 on B for 2 months. He gets it discounted from bank @ 12%. They agreed to share the proceeds equally. How much amount is received by A?
    (a) ₹5,000
    (b) ₹4,900
    (c) ₹4,000
    (d) None of the above
34. In case of sudden holiday, maturity date falls on:
    (a) Next following day
    (b) Previous day
    (c) On the same day
    (d) None of the above
35. A bill not paid by drawee on due date is called ________.
    (a) noting of bill
    (b) dishonour of bill
    (c) renewal of bill
    (d) discounting of bill
36. Which of the following statements is not true?
    (a) Noting charges are expenses of drawer
    (b) The bill of exchange must contain an order to pay
    (c) The drawer and payee can be same person
    (d) A bill of exchange can be endorsed (i.e. passed on to another person).
37. A draws a bill of exchange on B for ₹15,000 for 3 months on 12th May 2008. What will be the due date?
    (a) 15th August, 2008
    (b) 14th August, 2008
    (c) 16th August, 2008
    (d) 12th August, 2008

38. Kumar draws a bill on Rajat for ₹50,000 for mutual accommodation in the ratio of 3:2. Rajat accepted the bill. Kumar got it discounted for ₹47,500. How much money should Kumar remit to Rajat?
    (a) ₹28,500
    (b) ₹19,000
    (c) ₹30,000
    (d) ₹20,000
39. Who is the acceptor of "Bill of Exchange"?
    (a) Debtor
    (b) Creditor
    (c) Seller
    (d) None of the above
40. "Bills payable discounted in cash by Creditor" will be shown in
    (a) Journal
    (b) Ledger
    (c) Bank book
    (d) No entry required
41. Indian Currency is a
    (a) Bill of Exchange
    (b) Cheque
    (c) Promissory Note
    (d) Bank Draft
42. A' draws a bill on 'B', but 'B' did not accept the same. Which of the following journal entry should be passed in the books of 'A'.
    (a) Bills Receivable A/c Dr.
        To B
    (b) B Dr.
        To Bills payable A/c
    (c) B Dr.
        To Bills Receivable A/c
    (d) No entry will be required/ passed

43. A draws a bill on B for ₹30,000. A wants to endorse it to C in settlement of ₹35,000 at 2% discount with the help of B's acceptance and balance in cash. How much cash A will pay to C?
    (a) ₹4,300
    (b) ₹4,000
    (c) ₹4,100
    (d) ₹5,000
44. "Liability on account of bills discounted with Bank" will be treated as:
    (a) Not a liability
    (b) Current liability
    (c) Deferred liability
    (d) Contingent liability
45. B drew a bill of ₹10,000 for 2 months on A for mutual accommodation. It was decided that the proceeds will be shared equally amongst them. How much amount will be received by A if the bill was discounted @ 12% pa?
    (a) 9,800
    (b) 5,000
    (c) 5,100
    (d) 4,900.
46. If a bill is drawn on 1st Jan, and accepted on 8th Jan. What will be the due date of the bill if the term of the bill is 30 days after sight?
    (a) 7th January
    (b) 10th February
    (c) 11th February
    (d) None
47. If a cheque is dishonoured, then the entry will be passed in ________.
    (a) bank book
    (b) b/r book
    (c) sales book
    (d) purchase book.

48. Rahim draws a bills on Ram. Ram accepts the bill. Rahim endorse the bill to Salim. In books of Rahim which account is to be debited at the time of such endorsement?
(a) Ram
(b) Rahim
(c) Salim
(d) None

49. If a firm usually receives a number of promissory notes, it would be convenient to record the transaction in a seperate book called _____.
(a) bill receivable book
(b) journal
(c) purchase book
(d) sales book.

50. Liability for the bill discounted is a __________.
(a) short term liability
(b) long term liability
(c) current liability
(d) contingent liability

51. When the drawee becomes insolvent, the amount not ultimately paid to the drawer will be credited in the books of drawee to:
(a) Profit and Loss Account
(b) Sundry Creditors Account
(c) Deficiency Account
(d) None of the above.

52. P sold goods to Q for ₹2,00,000. Q paid cash ₹60,000. P allowed 2% discount on balance and Q requested to draw a bill for the balance amount. The amount of the bill will be __________.
(a) ₹1,96,000
(b) ₹1,37,200
(c) ₹1,40,000
(d) ₹1,36,000

ANSWER

1.	(b)	2.	(a)	3.	(b)	4.	(b)	5.	(d)
6.	(d)	7.	(b)	8.	(a)	9.	(a)	10.	(c)
11.	(a)	12.	(b)	13.	(c)	14.	(b)	15.	(c)
16.	(b)	17.	(b)	18.	(d)	19.	(a)	20.	(c)
21.	(b)	22.	(c)	23.	(a)	24.	(b)	25.	(d)
26.	(c)	27.	(a)	28.	(c)	29.	(c)	30.	(c)
31.	(b)	32.	(b)	33.	(b)	34.	(a)	35.	(b)
36.	(a)	37.	(b)	38.	(b)	39.	(a)	40.	(d)
41.	(c)	42.	(d)	43.	(a)	44.	(d)	45.	(d)
46.	(b)	47.	(a)	48.	(c)	49.	(a)	50.	(d)
51.	(c)	52.	(b)						

SHORT PRACTICE QUESTIONS

1. Distinguish Between
(a) Bill of Exchange and Promissory Note
2. What do you understand by days of grace?
3. Write short notes on:
(a) Noting of bill
(b) Date of Maturity of bill

Past Year Questions and Answers

Objective Questions

1996 - May [5] State with reasons whether the following statements are true or false:

(1) A bill given to a creditor is called bill payable. (2 marks)

(8) A promissory note can be made payable to bearer. (2 marks)

Answer:

(1) True: On giving a bill, the debtor has committed for a payment, therefore, a bill given to a creditor is called Bills payable.

(8) False: A promissory note cannot be made payable to a bearer as it is payable on the order of the person who is mentioned in it.

1996 - Nov [5] State with reasons whether the following statement is true or false:

(4) Discount at the time of retirement of a Bill is a gain for the drawee. (2 marks)

Answer:

True: It is a gain for the drawee as he receives an amount over the bill amount.

1997 - May [5] State with reasons whether the following statement is true or false:

(6) No cancellation entry is required when a bill is renewed. (2 marks)

Answer:

False: On renewal of a bill, entries are passed for the cancellation of the old bill and recording of a new bill.

1998 - May [5] State with reasons whether the following statement is true or false:

(10) No cancellation entry is required when a bill is renewed. (2 marks)

Answer:

False. When a bill is renewed, entries are passed for cancellation of the old bill and for recording of the new bill.

2000 - May [5] State with reasons whether the following statement is true or false:

(11) A has drawn a bill on B. B accepts the same and endorses the bill to C. (2 marks)

Answer:

False: A is a drawer and B is the drawee. So B cannot endorse the bill to C, only A can do so.

2000 - Nov [5] State with reasons whether the following statement is true or false:

(9) A promissory note cannot be made payable to bearer. (2 marks)

Answer:

True: A Promissory note cannot be made payable to a bearer as it is payable on the order of the person who is mentioned in it.

2001 - May [5] State with reasons whether the following statement is true or false:

(10) Cancelling old bill and drawing new bill is called renewal of Bill. (2 marks)

Answer:

True.

2001 - Nov [5] (Or) State with reasons whether the following statement is true or false:

(v) A cancellation entry is required, when a bill is renewed. (2 marks)

Answer:

True: On the failure of the payment on the due date by the acceptor, a new bill is drawn on him by canceling the old bill, which is known as renewal of bill. On renewal, the entries are passed for cancellation of old bill and recording of new.

2001 - Nov [5] State with reasons whether the following statement is true or false:

(vi) A bill given to a creditor is called Bills Receivable. (2 marks)

Answer:

False: On giving a bill, the debtor has committed for a payment; therefore, a bill given to creditors is called Bills payable.

2002 - May [5] State with reasons whether the following statement is true or false:

(3) Discount at the time of retirement of a Bill is a gain for the drawer. (2 marks)

Answer:

False: It is a gain for the drawee, as he receives an amount over the bill amount.

2004 - May [5] State with reasons whether the following statements are True or False:

(v) A bill given to a creditor is called Bills Receivable. (2 marks)

(vi) A cancellation entry is required, when a bill is renewed. (2 marks)

Answer:

(v) False: A bill given to a creditor is called bill payable as the debtor commits to pay by giving a bill to creditor.

(vi) True: When a bill is renewed, entries are passed for cancellation of the old bill and for recording of the new bill.

2005 - May [5] State with reasons whether the following statement is true or false:

(vi) Refusal by the acceptor to make payment of the bill on the maturity date is called Retirement of the bill. (2 marks)

Answer:

False: Refusal by the acceptor to make payment of the bill on the date of maturity is called dishonour of the bill.

2005 - Nov [5] State with reasons whether the following statement is true or false :

(vii) A bill of exchange is a conditional order in writing given by a Debtor to a Creditor. (2 marks)

Answer:

False: A Bill of exchange is an unconditional order signed by the maker, directing the debtor to pay a certain sum of money on a certain date or on the demand of the maker i.e. creditor.

2006 - May [5] State with brief reasons whether the following statements are True or False:

(v) A Promissory Note requires acceptance. (2 marks)

(ix) At the time of Renewal of a bill, Interest account is debited in the books of a Drawee. (2 marks)

Answer:

(v) False: Promissory note is a written unconditional promise and it does not require any acceptance. It is drawn and signed by the person to whom credit is granted or by the debtor.

(ix) True: At the time of renewal of a bill, interest account is debited and drawer's account is credited in the books of drawee because interest becomes liability for drawee and it becomes payable to drawer.

2006 - Nov [5] State with brief reasons whether the following statements are True or False:

(v) If a cheque received from a customer is dishonoured, it will be debited to the Customer's account. (2 marks)

(vi) Accommodation bills are drawn, accepted and endorsed for some consideration. (2 marks)

Answer:

(v) True: At the time of receipt of a cheque, Customers A/c is credited and when cheque is dishonoured, reverse entry is made by debiting the Customer's A/c.

(vi) False: Accommodation bills are drawn, accepted and endorsed without any consideration.

2019 - Nov [1] {C} (a) State with reason, whether the following statement is True or False.

(iv) In case of bill of exchange, the drawer and the payee may not be the same person but in case of a promissory note, the maker and the payee may be the same person. (2 marks)

Answer:

False: In case of Bills of Exchange, the drawer and the payee may be the same person, but in case of a promissory note, the maker and the payee cannot be the same person.

SHORT NOTES

1996 - May [6] Write short note on the following:

(5) Renewal of Bill. (5 marks)

Answer:

- When the acceptor of a bill finds himself in financial straits to honour the bill on the due date, he may request the drawer to cancel the original bill and draw on him a fresh bill for another period.
- If the drawer agrees, a new bill in place of the original bill may be accepted by the drawee for another period.
- This is called the renewal of bill.
- In such a case, the acceptor may pay interest for the new period.
- If interest is paid in cash, then the new bill is drawn for the original amount; otherwise the new bill may be accepted for the total amount including interest.

2005 - May [6] Write short note on the following: (5 marks)

(iv) Accommodation bills.

Answer:

- Bills of exchange are usually drawn to facilitate trade transmission, that is, bills are meant to finance actual purchase and sale of goods. However, the mechanism of bill can be utilized to raise finance also.
- Therefore, an accommodation bill is one which is drawn, accepted or endorsed for the purpose of arranging financial accommodation for one or more interested parties. It is not a genuine trade bill.
- Suppose A needs finance for three months. In that case, he may persuade his friend B to accept his drafted bill. The bill of exchange may then be taken by A to his bank and discounted there.
- Thus, A will be able to make use of funds. When the three months' period comes to a close, A will send the requisite amount to B and B will meet the bill. Thus, A is able to raise money for his use.
- If both A and B need money, the same device can be used. Either A accepts a bill of exchange or B does. In either case, the bill will be discounted with the bank and the proceeds divided between the two parties according to mutual agreement. The discounting charges must also be borne by the two parties in the same ratio in which the proceeds are divided. On the due date the acceptor will receive his share from the drawer party. The bill will then be met.
- When bills are used for such a purpose, they are known as accommodation bills.
- Entries are passed in the books of two parties exactly in the same manner as for ordinary bills.
- The only additional entry to be passed is for sending the remittance to the other party and also for debiting the other party with the requisite amount of discount.

DISTINGUISH BETWEEN

1994 - Nov [6] Distinguish between the following:
(5) Bill of Exchange and Promissory Note. (5 marks)

Answer:

Difference between Bills of Exchange and Promissory Note

Sl. No.	Base	Bills of Exchange	Promissory Note
1.	Nature	It is an order to pay.	It is a promise to pay.
2.	Parties Involved	There are three parties involved-drawer, Drawee and payee.	There are only two parties involved promissory (maker) and Payee.
3.	Who draws	It is drawn by the creditor.	It is drawn by the debtor.
4.	Liability	The liability of the drawer of a bill is secondary and conditional	The liability of the maker of a note is primary and absolute.
5.	Contingent Party	In case of bill the drawer and payee may be the same person	In case of promissory note, the maker and payee are not the same person.
6.	For Acceptance	The acceptance of bill is necessary.	The acceptance is not required as it is drawn by the promisor.
7.	Conditionality	A Bill of exchange is unconditional but it can be accepted conditionally with the consent of holder.	A Promissory note can never be conditional.
8.	Notice of dishonor	Notice of dishonour must be given by the holder to the drawer and immediate endorsers.	There is no need of giving the notice of dishonour.
9.	Payable	It may be made payable to a bearer.	It cannot be made payable to a bearer.
10.	Discharge of responsibility	Presentation for payment is required otherwise drawer will be discharged by delay.	Presentation for payment is not required unless the promissory note is payable after sight.

1995 - May [6] Explain the difference between the following:
(ii) Bill of Exchange and Promissory Note. (5 marks)

Answer:

Please refer 1994 - Nov [6] (5) on page no. 449

1997 - Nov [6] Distinguish between the following:
(d) Bill of Exchange and Promissory Note. (5 marks)

Answer:

Please refer 1994 - Nov [6] (5) on page no. 449

1999 - Nov [6] Briefly explain the differences between the following:
(a) Bill of Exchange and Promissory Note. (5 marks)

Answer:

Please refer 1994 - Nov [6] (5) on page no. 449

2000 - Nov [6] Briefly explain the difference between the following:
(b) Bill of Exchange and Promissory Note. (5 marks)

Answer:

Please refer 1994 - Nov [6] (5) on page no. 449

2006 - May [6] Briefly explain the differences between the following:
(v) Trade bill v/s Accommodation bill. (5 marks)

Answer:

Distinction between Trade Bill and Accommodation Bill:

- Trade bills are usually drawn to facilitate trade transmission, that is, these bills are meant to finance actual purchase and sale of goods. On the other hand, an accommodation bill is one which is drawn, accepted or endorsed for the purpose of arranging financial accommodation for one or more interested parties.
- On discount of a trade bill, full amount is retained by the drawer. In an accommodation bill, however, the amount may be shared by the drawer and the drawee in an agreed ratio.
- Trade bill is drawn for some consideration while accommodation bill is drawn and accepted without any consideration.
- Trade bill acts as an evidence of indebtedness while accommodation bill acts as a source of finance.
- In order to recover the debt, the drawer can initiate legal action on a trade bill. In accommodation bill, legal remedy for the recovery of amount may not be available for immediate parties.

DESCRIPTIVE QUESTIONS

2001 - May [3] (a) Explain a Bill of Exchange and the various parties to it. (6 marks)

Answer:

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 to or to the order of certain person or to the bearer of the instrument. When such an order is accepted by the drawee on the face of the order itself, it becomes a valid bill of exchange.

There are three parties to a bill of exchange:

(i) The drawer, who draws the bill, that is, the creditor to whom the money is owing;

(ii) The drawee, the person to whom the bill is addressed or on whom it is drawn and who accepts the bill that is, the debtor; and

(iii) The payee, the person who is to receive payment. The drawer in many cases is also the payee.

2003 - May [6] Briefly explain the following:

(c) Noting charges. (5 marks)

Answer:

Noting Charges:

- It is necessary that the fact of dishonour and the causes of dishonour should be established.
- If there is a fear of dishonour, the bill will be given to the public official known as "Notary Public".
- These officials present the bill for payment and if the money is received, they will hand over the money to the original party.
- If the bill is dishonoured, they will note the fact of dishonour, and the reasons given and give the bill back to their client.
- For this service, they charge a small fee. This fee is known as noting charges.
- The amount of noting charges is recoverable from the party which is responsible for dishonour.

2003 - Nov [6] Briefly explain the following:

(d) Retirement of bills of exchange. (5 marks)

Answer:

Retirement of Bills of Exchange:

- Sometimes, the acceptor of a bill of exchange has spare funds much before the maturity date of the bill of exchange accepted by him.
- He may, therefore, desire to pay the bill before the due date.
- In such a circumstance, the acceptor shall ask the payee or the holder of the bill to accept cash before the maturity date.
- If the payee agrees, the acceptor may be allowed a rebate or discount on such early payment.

- This rebate is generally the interest at an agreed rate for the period between the date of payment and date of maturity.
- The interest/rebate/discount becomes the income of the acceptor and expense of the payee.
- It is a consideration for premature payment.
- When a bill is paid before due date, it is said to be retired under rebate.

PRACTICAL QUESTIONS

1994 - Nov [4] On 1st January, 1994 Vinod drew and Pramod accepted a bill at three months for ₹2,000. On 4th January, 1994 Vinod discounted the bill at his bank at 15% p.a. and remitted half the proceeds to Pramod. On 1st February, 1994 Pramod drew and Vinod accepted a bill at four months for ₹ 1,500. On 4th February, 1994 Pramod discounted the bill at 15% p.a. with his bank and remitted half the proceeds to Vinod. They both agreed to share the discount equally.

At maturity, Vinod met his acceptance, but Pramod dishonoured his bill and Vinod had to pay the bill. Vinod drew and Pramod accepted a new bill at three months for the original bill plus interest at 18% p.a. On 1st July, 1994 Pramod became insolvent and only 50 paise in the rupee was received from him.

Record the above transactions in Vinod's Journal (15 marks)

Answer:

In the books of Vinod
Journal Entries

Date 1994	Particulars		Debit ₹	Credit ₹
Jan 1	Bills Receivable A/c To Pramod A/c (3 months' Bill drawn on Pramod, accepted)	Dr.	2,000	2,000
Jan 4	Bank A/c Discount on bills A/c To Bills Receivable A/c (Bill accepted by Pramod discounted with the bank at 15%)	Dr. Dr.	1,925 75	2,000
Jan 4	Pramod A/c To Bank A/c To Discount on bills A/c (Half of the proceeds of the bill remitted to Pramod)	Dr.	1,000	962.50 37.50
Feb 1	Pramod A/c To Bills Payable A/c (Acceptance of 4 month's bill drawn by Pramod)	Dr.	1,500	1,500
Feb 4	Bank A/c Discount on bills A/c To Pramod A/c (Half of the proceeds of the 4 months' bill received)	Dr. Dr.	712.50 37.50	750
April 4	Pramod A/c To Bank A/c (Bill accepted by Pramod dishonoured)	Dr.	2,000	2,000
April 4	Pramod A/c To Interest A/c (Interest receivable on ₹2,000 @ 18% for 3 months)	Dr.	90	90
April 4	Bills Receivable A/c To Pramod A/c (Fresh 3 months' bill drawn on Pramod accepted)	Dr.	2,090	2,090

June 4	Bills Payable A/c To Bank A/c (4 months' bill honored on maturity)	Dr.	1,500	1,500
July 1	Pramod A/c To Bills Receivable A/c (Bill accepted by Pramod dishonoured on his becoming insolvent)	Dr.	2,090	2,090
July 1	Bank A/c Bad Debts A/c To Pramod A/c (Amount received from the estate of Pramod and balance transferred to bad debt A/c)	Dr. Dr.	920 920	 1,840

Working Note:

Pramod Account

	Amount (₹)		Amount (₹)
To Bank A/c	962.50	By Bills Receivable A/c	2,000.00
To Discount on bills A/c	37.50	By Bank A/c	712.50
To Bills payable A/c	1,500.00	By Discount on bills A/c	37.50
To Bank A/c	2,000.00	By Bills Receivable A/c	2,090.00
To Interest A/c	90.00	By Bank A/c	920.00
To Bills Receivable A/c	2,090.00	(50% of the amount due)	
		By Bad Debts A/c	920.00
	6,680.00		6,680.00

1995 - Nov [3] Mr. David draws two bills of exchange on 1.1.95 for ₹6,000 and ₹10,000. The bill of exchange for ₹6,000 is for two months while the bill of exchange for ₹10,000 is for three months. These bills are accepted by Mr.

Thomas. On 4.3.95, Mr. Thomas requests Mr. David to renew the first bill with interest at 18% p.a. for a period of two months. Mr. David agrees to this proposal. On 20.3.95, Mr. Thomas retires the acceptance for ₹10,000, the interest rebate i.e. discount being ₹100. Before the due date of the renewed bill, Mr. Thomas becomes insolvent and only 50 paise in a rupee could be recovered from his estate.

You are to give the journal entries in the books of Mr. David.

(15 marks)

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Answer:

Journal Entries in the Books of Mr. David

Date	Particulars		Amount (Dr.) ₹	Amount (Cr.) ₹
1995 Jan. 1	Bills Receivable (No. 1) A/c Bills Receivable (No.2) A/c To Mr. Thomas A/c (Being drawing of Bills Receivable No. 1 due for maturity on 4.3.95 and bills receivable No. 2 due for maturity on 4.4.95)	Dr. Dr.	6,000 10,000	 16,000
March 4	Mr. Thomas A/c. To Bills Receivable (No. 1) A/c (Being the reversal entry for bill No. 1 on agreed renewal)	Dr.	6,000	 6,000

March 4	Bills Receivable (No.3) A/c	Dr.	6,180	
	To Interest A/c			180
	To Mr. Thomas A/c			6,000
	(Being the drawing of bill of exchange No. 3 due for maturity on 7.5.1995 together with interest 18% p.a. in lieu of the original acceptance of Mr. Thomas)			
March 20	Bank A/c	Dr.	9,900	
	Discount A/c	Dr.	100	
	To Bills Receivable (No. 2) A/c			10,000
	(Being the amount received on retirement of Bills No. 2 before the due date)			
May 7	Mr. Thomas A/c	Dr.	6,180	
	To Bills Receivable (No. 3) A/c			6,180
	(Being the amount due from Mr. Thomas on dishonour of his acceptance on presentation on the due date).			
May 7	Mr. Bank A/c	Dr.	3,090	
	To Mr. Thomas A/c			3,090
	(Being the amount received from official assignee of Mr. Thomas at 50 paise per rupee against dishonoured bill)			
May 7	Bad Debts A/c	Dr.	3,090	
	To Mr. Thomas A/c			3,090
	(Being the balance 50% debt in Mr. Thomas's Account arising out of dishonoured bill written as bad).			

1997 - May [4] (a) On 1st January, 1997, A sells goods for ₹10,000 to B and draws a bill at three months for the amount. B accepts it and returns it to A. On 1st March, 1997, B retires his acceptance under rebate of 12% per annum. Record these transactions in the journals of A and B. (6 marks)

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Answer:

Journal Entries in the Books of A

Date	Particulars		Amount (Dr.) ₹	Amount (Cr.) ₹
1997 Jan. 1	B's A/c	Dr.	10,000	
	To Sales A/c			10,000
	(Beings sale of goods to B on credit)			
Jan. 1	Bills Receivable A/c	Dr.	10,000	
	To B's A/c			10,000
	(Being the acceptance of bill received)			
Mar. 1	Bank A/c	Dr.	9,900	
	Rebate on Bill A/c	Dr.	100	
	To Bills Receivable A/c			10,000
	(Being retirement of bill by B one month before maturity by giving rebate @ 12% p.a.)			

Journal Entries in the Books of B

Date	Particulars		Amount (Dr.) ₹	Amount (Cr.) ₹
1997 Jan. 1	Purchase A/c	Dr.	10,000	
	To A's A/c			10,000
	(Being purchase of goods from A on Credit)			
Jan. 1	A's A/c	Dr.	10,000	
	To Bills Payable A/c			10,000
	(Being the acceptance of bill given to A)			

Mar. 1	Bills Payable A/c Dr. To Bank A/c To Rebate on Bills A/c (Being the bill discharged under rebate @ 12% p.a.)	10,000	9,900 100

Working Note:

Calculation of Rebate: $10{,}000 \times \frac{12}{100} \times \frac{1}{12} = 100$

1999 - May [4] Shubham draws on Rajendra a bill for ₹45,000 on 1st June, 1998 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. (15 marks)

Answer:

Books of Shubham
Journal Entries

Date	Particulars	Amount (Dr.) ₹	Amount (Cr.) ₹
1998 June 1	Bills Receivable A/c Dr. To Rajendra A/c (Being Acceptance received from Rajendra for Mutual accommodation)	45,000	45,000
June 1	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being Bill discounted)	44,100 900	45,000

June 1	Rajendra Dr. To Bank A/c To Discount A/c (Being one-third of proceeds remitted to Rajendra).	15,000	14,700 300
Sept. 4	Rajendra Dr. To Bills Payable A/c (Being Acceptance given to Rajendra on failure of remittance of the amount due)	63,000	63,000
Sept. 4	Bank A/c Dr. Discount A/c Dr. To Rajendra (Being receipt of Amount from Rajendra and discount amount credited to him.)	11,100 900	12,000
Dec. 7	Bills Payable A/c Dr. To Rajendra (Beings Acceptance to Rajendra dishonoured on insolvency.)	63,000	63,000
Dec. 7	Rajendra Dr. To Bank A/c To Deficiency A/c (Being Amount paid @ 40% and balance credited to Deficiency A/c on failure of payment)	42,000	16,800 25,200

Books of Rajendra
Journal Entries

Date	Particulars	Amount (Dr.) ₹	Amount (Cr.) ₹
1998 June 1	Shubham Dr. To Bills Payable A/c (Being Acceptance given for the bill)	45,000	45,000

June 1	Bank A/c	Dr.	14,700	
	Discount A/c	Dr.	300	
	To Shubham			15,000
	(Being one third of the proceeds of bill after discounting received from shubham)			
Sept. 4	Bill Receivable A/c	Dr.	63,000	
	To Shubham			63,000
	(Being Acceptance received from Shubham to cover the amount due from him)			
Sept. 4	Bank A/c	Dr.	61,650	
	Discount A/c	Dr.	1,350	
	To Bills Receivable A/c			63,000
	(Being Shubham's Acceptance discounted)			
Sept. 4	Bills Payable A/c	Dr.	45,000	
	To Bank A/c			45,000
	(Being own acceptance due on the date met)			
Sept 4	Shubham	Dr.	12,000	
	To Bank A/c			11,100
	To Discount A/c			900
	(Being Amount remitted to Shubham, after getting the bill discounted)			
Dec. 7	Shubham	Dr.	63,000	
	To Bank A/c			63,000
	(Being Shubham's Acceptance dishonoured on insolvency)			
Dec. 7	Bank A/c	Dr.	16,800	
	Bad Debts A/c	Dr.	25,200	
	To Shubham			42,000
	(Beings Amount and bad debts written off in respect of amount due from Shubham)			

Working Note:

Calculation of discount to be borne by Mr. Shubham:

₹15,000 paid to Rajendra out of bill of ₹45,000. As such, ₹(45,000 – 15,000) = 30,000 are due to Rajendra and ₹11,100 are further received from Rajendra. Therefore 30,000 + 11,100 = ₹41,100 are shared by Shubham, out of total ₹61,650. In this proportion, discount is also related to shubham. Discount shared by Shubham.

$$= \frac{41,100}{61,650} \times (63,000 - 61,650) = \frac{41,100}{61,650} \times 1,350 = ₹900.$$

2000 - May [4] (a) On 1st July, 1999, G drew a bill for ₹80,000 for 3 months on H for mutual accommodation. He 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, 1999 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, 1999 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. (6 marks)

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Answer:

Books of H

Date	Particulars		Amount (Dr.) ₹	Amount (Cr.) ₹
1.7.99	G's A/c	Dr.	80,000	
	To Bills Payable A/c			80,000
	(Being Acceptance of bill drawn by G)			
1.9.99	J's A/c	Dr.	90,000	
	To Sales A/c			90,000
	(Being Sales made to J)			

1.9.99	Bills Receivable A/c	Dr.	80,000	
	Banks A/c	Dr.	9,000	
	Discount A/c	Dr.	1,000	
	To J's A/c			90,000
	(Being Acceptance received from J's endorsement of bill received from G for ₹80,000 and ₹9,000 received in full settlement of the amount due)			
1.9.99	Bills Payable A/c	Dr.	80,000	
	To Bills Receivable A/c			80,000
	(Beings Own acceptance received from J's Endorsement, cancelled)			
1.10.99	Purchase A/c	Dr.	1,00,000	
	To G's A/c			1,00,000
	(Being purchase made from G)			
	G's A/c	Dr.	20,000	
	To Bank A/c			20,000
	(Being Amount paid to G after adjustment of ₹80,000 for accommodation extended to him)			

2001 - May [3] (b) Record the following transactions in the Journals of Ram and Hari:

Ram sells goods for ₹1,00,000 to Hari on 1st January, 2001 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, 2001 with his bank at 12% per annum. The acceptance is dishonoured on due date and the bank pays ₹250 as noting charges. (9 marks)

Answer:

Ram's Journal

Date	Particulars		Amount (Dr.) ₹	Amount (Cr.) ₹
2001 Jan. 1	Hari's A/c	Dr.	1,00,000	
	To Sales A/c			1,00,000
	(Being Sale of goods to Hari on credit)			

Jan. 1	Bills Receivable A/c	Dr.	1,00,000	
	To Hari's A/c			1,00,000
	(Being Bill accepted by Hari for the amount due)			
Jan. 4	Bank A/c	Dr.	97,000	
	Discount A/c	Dr.	3,000	
	To Bills Received A/c			1,00,000
	(Being Bill accepted by Hari discounted with the bank @ 12% p.a.)			
Jan. 4	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		Amount (Dr.) ₹	Amount (Cr.) ₹
2001 Jan 1	Purchase Account	Dr.	1,00,000	
	To Ram's A/c			1,00,000
	(Being purchases of Goods from Ram on credit)			
Jan 1	Ram's A/c	Dr.	1,00,000	
	To Bills Payable A/c			1,00,000
	(Being Acceptance given on the bill drawn by Ram)			

April 4	Bills Payable A/c Dr. Trade Expenses A/c Dr. To Ram's A/c (Being Dishonour of the bill drawn by Ram on the due date)	1,00,000 250	 1,00,250

2004 - Nov [3] (a) Anil draws a bill for ₹9,000 on Sanjay on 5th April, 2003 for 3 months, which Sanjay returns 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 moths, which Sanjay discounts 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, 2003.

Pass necessary Journal entries for the above transactions in the books of Anil. (9 marks)

Answer:

In the books of Anil
Journal Entries

Date	Particulars	L.F.	Dr. Amt. (₹)	Cr. Amt. (₹)
2003 5 April	Bills Receivable A/c Dr. To Sanjay's A/c (Being acceptance received for mutual accommodation)		9,000	 9,000
5 April	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Being discounting of bills)		8,820 180	 9,000

5 April	Sanjay's A/c Dr. To Bank A/c To Discount A/c (Being 1/3 proceeds of the bill transferred to Sanjay's A/c)		3,000	 2,940 60
8 July	Sanjay's A/c Dr. To Bills Payable A/c (Being acceptance of bill given)		12,600	 12,600
8 July	Bank A/c Dr. Discount A/c $\left[\frac{6,000+2,200}{12,330}\times 270\right]$ Dr. To Sanjay's A/c (Being amount received from Sanjay against 2nd bill)		2,220 180	 2,400
11 Oct	Bills Payable A/c Dr. To Sanjay's A/c (Being dishonour of bill due insolvency)		12,600	 12,600
15 Oct	Sanjay's A/c Dr. To Bank A/c To Deficiency A/c (Being @ 50% of (₹6,000 + 2,400) paid to Sanjay)		8,400	 4,200 4,200

2006 - Nov [2] (a) Mr. B accepted a bill for ₹10,000 drawn on him by Mr. A on 1st August, 2005 for 3 months. This was for the amount which B owed to A. And on the same date Mr. A got the bill discounted at his bank for ₹9,800. On the due date, B approached A for renewal of the bill. Mr. A agreed on condition that ₹2,000 be paid immediately along with interest on the remaining amount at 12% p.a. for 3 months and that for the remaining balance B should accept a new bill for 3 months. These arrangements were carried through. On 31st December, 2005, B became insolvent and his estate paid 40%.

Give Journal Entries in the books of Mr. A. (9 marks)

Q.R. Code for Solution Video

Answer:

Books of Mr. A Journal

Date	Particulars	L.F.	Dr. Amount (₹)	Cr. Amount (₹)
2005				
August 1	Bills Receivable A/c Dr. To B (Being the acceptance received from B to settle his account)		10,000	10,000
August 1	Bank A/c Dr. Discount A/c Dr. To Bills Receivable (Being the bill discounted for ₹ 9,800 from bank)		9,800 200	10,000
November 4	B Dr. To Bank Account (Being the B's acceptance is to be renewed)		10,000	10,000
November 4	B Dr. To Interest Account (Being the interest due from B for 3 months i.e., 8000 x 3/12 x 12% = 240)		240	240
November 4	Cash A/c Dr. Bills Receivable A/c Dr. To B (Being amount and acceptance of new bill received from B)		2,240 8,000	10,240
December 31	B A/c Dr. To Bills Receivable A/c (Being B became insolvent)		8,000	8,000
December 31	Cash A/c Dr. Bad Debts A/c Dr. To B (Being the amount received and written off on B's insolvency)		3,200 4,800	8,000

2019 - June [3] (b) On 1st January 2018, Akshay draws two bills of exchange for ₹16,000 and ₹25,000. The bill of exchange for ₹16,000 is for two months while the bill of exchange for ₹25,000 is for three months. These bills are accepted by Vishal. On 4th March, 2018, Vishal requests Akshay to renew the first bill with interest @ 15% p.a. for a period of two months. Akshay agreed to this proposal. On 25th March, 2018, Vishal retires the acceptance for ₹25,000, the interest rebate i.e. discount being ₹250. Before the due date of the renewed bill, Vishal becomes insolvent and only 50 paisa in a rupee could be recovered from his estate.

Show the journal entries (with narrations) in the books of Akshay.

(5 marks)

Answer:

Journal Entries In Books of Mr. Akshay

Date	Particulars		Amount (₹)	Amount (₹)
1.1.18	Bills Receivable (No.1) A/c	Dr.	16,000	
	Bills Receivable (No.2) A/c	Dr.	25,000	
	To Vishal's A/c			41,000
	(Being drawing of bills receivable No.1 due for maturity on 4.3.18 and Bill receivable No.2 due for maturity on 4.4.18)			
4.3.18	Vishal's A/c	Dr.	16,000	
	To Bills Receivable (No.1) A/c			16,000
	(Being the reversal entry for bill No.1 an agreed renewal)			
4.3.18	Bill Receivable (No.3) A/c	Dr.	16,400	
	To Interest A/c			400
	To Vishal's A/c			16,000
	(Being the drawing of Bill of Exchange No.3 due for maturity on 7.5.18 together with interest at 15% p.a. in lieu of the original acceptance of Vishal)			
25.3.18	Bank A/c	Dr.	24,750	
	Discount A/c	Dr.	250	
	To Bills Receivable (No.2) A/c			25,000
	Being the amount received on retirement of bill No.2 before the due date)			

7.5.18	Vishal's A/c	Dr.	16,400	
	To Bills Receivable (No.3) A/c			16,400
	(Being the amount due from Vishal on dishonour of his acceptance on presentation on the due date)			
7.5.18	Bank A/c	Dr.	8,200	
	Bad-debts A/c	Dr.	8,200	
	To Vishal's A/c			16,400
	(Being amount received from official assignee of Vishal at 50 paise per rupee and balance w/o as bad-debts)			

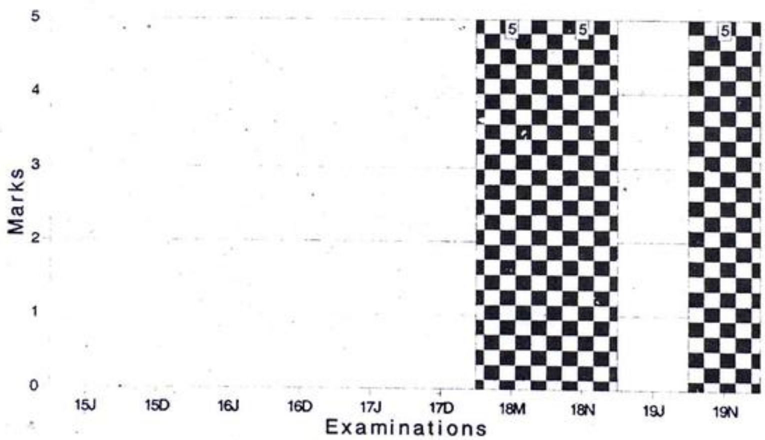
CHAPTER	
6	**Accounting for Special Transactions**

Unit: 2 **Sale of Goods on Approval or Return Basis**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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SELF STUDY QUESTIONS

Q1. What do you mean by "Sale of Goods on Approval or Return Basis"?

Answer:

In order to increase the sales, seller may deliver goods to the customer with an option to return it within a specified period if goods are not as per the specifications as required by the buyer.

Selling goods with such a condition is called as sale of goods on approval or return basis. In such sale, ownership in goods is transferred on the expiry of term specified for return, or if an approval for acceptance of goods is given by the customer.

Now-a-days, online shopping apps provide facility to buy goods and return within the specified short period if requirements are not met. This method boosts up the sales, and hence, the revenue of the firm.

Features of Sale of Goods on Approval or return basis:

(a) Change in possession of goods without change in ownership.

(b) Ownership is transferred after approval is received from buyer for acceptance.

(c) No liability incurred to customer in case of return, since right of refund given by the seller.

- As per Sales of Goods Act, 1930 "When goods are delivered to the buyer on approval or on sale of return" or other similar terms, the property therein passes to the buyer:
  (a) When he signifies his approval or acceptance to the seller or does any act adopting the transaction;
  (b) If he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection, then, if a time has been fixed for the return of goods, on expiration of such time, and if no time has been fixed, on the expiration of reasonable time.

Q2. What are the Accounting Records of sale of goods on approval basis?

Answer:

When the business sends goods casually on sale or return basis

(a) Goods sent on for sale on returns basis

Trade Receivable Dr.
To Sales A/c

(b) If goods are returned

Inwards A/c Dr.
To Trade Receivables A/c

(c) If goods are accepted

– No entry –

(d) If goods are with customer beyond the specified time allowed.

Sales A/c Dr.
To Trade Receivables.

[Being cancellation of original entry passed in respect of goods sent]

Inventories with customer on sale of Returns A/c Dr.
To Trading A/c

[Being cost of goods pending for approval lying with customer adjusted]

- When the business sends goods frequently on sale or return basis

(a) If sale is approved:

Customers' A/c Dr.
To Sales A/c

(b) At year end for stock lying with customer:

Goods with Customers on Sale or Return A/c Dr.
To Trading A/c

- When the business sends goods numerously on sale or return:

In this case, the following books of accounts are kept.

1. **Sales or Return Day Book:** This book is like the sales book. As soon as the goods are sold on "sale or return" basis, they are recorded in this book.

2. **Sold and Returned Day Book:** This book records the goods retained and goods returned by customers out of the goods sent on sale or return. It has separate columns for "goods sold" and "goods returned".
3. **Sale or Return Ledger:** This book contains the following:
   (a) Separate accounts of each of the customers to whom goods have been sent on sale or return basis, and
   (b) Sale or Return Account for total goods sent on sale or return.
4. **Main Ledger:** This is the real ledger of the business. It contains all real, nominal and personal accounts.

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. When a large number of articles are sent on a sale or return basis, it is necessary to maintain:
   (a) Sale Journal
   (b) Goods Returned Journal
   (c) Sale or Return Journal
   (d) Any of these
2. Sale or return day book is a:
   (a) Primary Book
   (b) Principal Book
   (c) Memorandum Book
   (d) None of these

3. A sent some goods costing ₹3500 at a profit of 25% on sale to B on sale or return basis. B returned goods costing ₹800. At the end of year, the remaining goods were neither returned nor were approved by him. The stock on approval will be shown in balance sheet at:
   (a) ₹2,000
   (b) ₹2,700
   (c) ₹2,700 less 25% of 2,700
   (d) ₹3,500
4. In case of sale of goods on approval basis, the sale will take place under which of the following cases?
   (a) When buyer signifies his approval
   (b) When time given to buyer expires
   (c) As soon as buyer takes goods to his home
   (d) All but not (c)
5. At what price goods lying with customers are valued at year ending under sale of approval basis:
   (a) Selling price
   (b) Cost price
   (c) Current price
   (d) Market price
6. Which method is used for "Sale on Approval" basis when the transactions are few in nature?
   (a) Multi Column Journal Method
   (b) Columnar Sale Day Book Method
   (c) Ordinary Sale Method
   (d) Separate Day Book Method
7. What is the objective behind selling goods on approval basis:
   (a) For introducing a new product in the market
   (b) For pushing up sales
   (c) To capture a larger share in the market
   (d) All of these

8. Memorandum records of sale on approval is a part of:
   (a) Management Accounts
   (b) Financial Accounts
   (c) Cost Accounts
   (b) None of the above
9. Sales = ₹1,06,000
   Sales Return = ₹6,000
   Out of ₹1,06,000 goods costing ₹10,000 were sent on approval for ₹ 12,000 which have not been approved yet. Calculate Net Sales.
   (a) ₹1,00,000
   (b) ₹88,000
   (c) ₹1,12,000
   (d) ₹18,000
10. Total sales of Star Limited for the year ended 31st March 2008 was ₹ 5,00,000, which includes goods sold to R for ₹5,500 at a profit of 10% on cost. Such goods are still lying in the Godown of Star Limited at the buyers risk. In the books of Star Limited sales would be shown as:
    (a) ₹5,00,000
    (b) ₹5,05,000
    (c) ₹4,94,500
    (d) ₹4,95,000
11. Mr. X sends the goods costing ₹55,000 on approval basis. Goods of ₹ 5,000 were damaged in transit and claim of ₹3,000 was received. The amount of goods sent on approval to Mr. Y is:
    (a) ₹57,000
    (b) ₹53,000
    (c) ₹52,000
    (d) ₹50,000
12. A sent some goods costing ₹3,500 at a profit of 25% on sale, on sale or return basis. B returned goods amounting to ₹800 at Invoice value. At the end of the accounting period on March 31st 2009, the remaining goods were neither returned nor approved by B. The stock on approval will be shown in B/S as:

(a) ₹2,900
(b) ₹2,700
(c) ₹2,025
(d) ₹3,500

13. Goods sold on "Sale or Return basis" as on 31st March 2011 amounted to ₹1,50,000 for which no confirmation was yet received. How much amount shall be added to closing stock, if goods are sold at cost plus 33-1/3%?
(a) ₹1,12,500
(b) ₹1,50,000
(c) ₹37,500
(d) ₹1,00,000

14. A trader sends out goods to his customer on approval and credits them to sales amount. On 31st March, 2011, sundry debtors include an amount of ₹5,000 for goods sent on approval basis for which no confirmation was received till year end. These goods were sent out at a cost +25%. Physical stock taken on 31st March, 2011 amounted to ₹50,000. The amount of stock appearing is Balance Sheet would be:
(a) ₹45,000
(b) ₹50,000
(c) ₹53,750
(d) ₹54,000

15. Cash Sale of ₹50,000, Credit Sale of ₹3,50,000, Sales Return ₹25,000. Out of sales of ₹3,50,000, goods costing ₹40,000 were sent on approval for ₹50,000 which has not been approved yet. Calculate the net sales:
(a) ₹3,35,000
(b) ₹3,75,000
(c) ₹3,40,000
(d) ₹3,25,000

16. Goods costing ₹1,00,000 sent to customer on sales or return basis at a price of cost plus 30%. During the year 50% of the goods have been accepted. 30% of the goods returned and the balance goods were lying with customer at year end and the specified time limit for approval is yet to expire. Amount of total stock to be shown in the balance sheet would be:

(a) ₹20,000
(b) ₹30,000
(c) ₹50,000
(d) ₹1,00,000

17. A company sells motor bikes on "Sale or return basis". All such transactions are however treated like actual sales and are passed through the sales book. Just before the end of the financial year, two motor bikes costing ₹55,000 each have been sent on "Sale or Return basis" and have been debited to customers at ₹75,000 each, cost of goods lying with the customers will be:
(a) ₹1,10,000
(b) ₹55,000
(c) ₹75,000
(d) ₹1,50,000

18. During the month of June 2014, sales were ₹1,36,000, which include goods worth ₹32,000 sent on approval. Half of these goods were returned before 30th June, but no intimation is available regarding the remaining goods. Goods are sold at cost plus 25%. However, goods costing ₹24,000 had been sold for ₹12,000. Calculate cost of normal sales.
(a) ₹73,600
(b) ₹80,000
(c) ₹1,08,800
(d) ₹99,200

19. When goods are frequently sold on approval or return basis, ________ is prepared.
(a) sales or Return Journal with four columns
(b) sales or Return Ledger with three columns
(c) sales or Return Day Book with two columns
(d) none of the above.

20. A trader has credited certain items of sales on approval aggregating ₹60,000 to Sales Account. Of these, goods of the value of ₹16,000 have been returned and taken into inventories at cost ₹8,000 though the

record of return was omitted in the accounts. In respect of another parcel of ₹12,000 (cost being ₹6,000) the period of approval did not expire on the closing date. Cost of goods lying with customers should be:

(a) ₹12,000
(b) ₹54,000
(c) ₹6,000
(d) None of the above.

21. Elle Ltd. sends out punching machines costing ₹200 each to its customer on sales or return basis. All such transactions are however treated as actual sales and are passed through sales book. Just before the end of the financial year i.e. on December 27, 2014, 300 such punching machines were sent out at an invoice price of ₹280 each, out of which only 90 machines are accepted by the customers at ₹250 each, and as to the rest, no report is forthcoming. What will be the total effect on sales?
(a) Sales will be reduced by ₹61,500
(b) Sales will be increased by ₹61,500
(c) No effect on sales
(d) Sales will be increased by ₹32,500.

22. On 31st March, 2015 goods at a sale price of ₹60,000 were lying with a customer to whom these goods were sold on "sale or return basis" and goods sold were recorded as actual sales. Since no consent has been received from customer, what will be the amount of inventories with customer sent on approval at a profit of cost plus 20% and present market value is 10% less than cost price?
(a) ₹50,000
(b) ₹45,000
(c) ₹43,200
(d) ₹40,500

23. Under sale or return on approval basis, when transactions are few, the seller, while sending the goods, treats them as:
(a) An ordinary sale but no entry is passed in books.
(b) An ordinary sale and entry for normal sale is passed in the books.

(c) Abnormal sale and no entry is passed.
(d) None of the above.

24. A dealer sends his goods on sale or return basis the sends goods for ₹ 10,000 to record as normal sales. The profit on sale is 20%. The value of physical stock taken is ₹50,000, then the value of closing stock appearing in the balance sheet will be:
(a) ₹50,000
(b) ₹57,500
(c) ₹60,000
(d) ₹58,000

25. Goods of ₹800 (Sales Price) sent on approval basis, were included in the Sales Book but approval has not been received. The profit included in the sales was at 25% on cost. At the time of year end, while closing the books, stock will increase by:
(a) ₹600
(b) ₹480
(c) ₹640
(d) ₹580

26. At the end of the year, the balance of trade debtors was ₹1,20,000 which included ₹8,000 goods sent on approval. The specified time limit for approval was yet to expire. Goods were sent on sale or return basis at cost + 25%. What would be the value of inventories with customers on sale or return to be shown in Trading Account?
(a) ₹6,000
(b) ₹6,200
(c) ₹6,400
(d) None of the above.

ANSWER

1.	(c)	2	(c)	3.	(b)	4.	(d)	5.	(b)
6.	(c)	7.	(d)	8.	(d)	9.	(b)	10.	(a)
11.	(d)	12.	(a)	13.	(a)	14.	(d)	15.	(d)
16.	(a)	17.	(a)	18.	(a)	19.	(a)	20.	(c)
21.	(a)	22.	(b)	23.	(b)	24.	(d)	25.	(c)
26.	(c)								

SHORT PRACTICE QUESTIONS

1. What do you understand by sale of goods on approval basis? How is it different from ordinary sales.

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

2006 - May [5] State with reason whether following statement is true or false:

(xi) Sale or Return Account in the Sale or Return Ledger represents the value of goods still lying with the customers for approval. (2 marks)

Answer:

True: The balance in the Sale or Return Account in the Sale or Return Ledger represents the value of goods still lying with the customers for their approval. The balance of this account should tally with the total of the balance of the various personal accounts in the sales or return ledger.

PRACTICAL QUESTIONS

2003 - May [3] (a) 'X' supplied goods on sale or return basis to customers, the particulars of which are as under:

Date of Despatch	Party's Name	Amount	Remarks
10.12.2002	ABC Co.	10,000	No information till 31.12.2002
12.12.2002	DEF Co.	15,000	Returned on 16.12.2002
15.12.2002	GHI Co.	12,000	Goods worth ₹2,000 Returned on 20.12.2002
20.12.2002	DEF Co.	16,000	Goods Retained on 24.12.2002
25.12.2002	ABC Co.	11,000	Goods Retained on 28.12.2002
30.12.2002	GHI Co.	13,000	No information till 31.12.2002

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 31st December, 2002.

Prepare the following account in the book of 'X':

(i) Goods on Sales or Return, Sold and Returned Day Books.

(ii) Goods on Sales or Return Total Account. (6 marks)

Answer:

In the Books of 'X'

Goods on Sales or Return, Sold and Returned Day Books

Date (2002)	Party to whom goods sent	LF	Amount (₹)	Date (2002)	Sold (₹)	Returned (₹)
Dec. 10	M/S ABC Co.		10,000	Dec. 25	10,000	—
Dec. 12	M/S DEF Co.		15,000	Dec. 16	—	15,000
Dec. 15	M/S GHI Co.		12,000	Dec. 20	10,000	2,000
Dec. 20	M/S DEF Co.		16,000	Dec. 24	16,000	—
Dec. 25	M/s ABC Co.		11,000	Dec. 28	11,000	—
Dec. 30	M/s GHI Co.		13,000	—	—	—
			77,000		47,000	17,000

Goods on Sales or Return Total Account

Date (2002)	Particulars	Amount (₹)	Date (2002)	Particulars	Amount (₹)
	To Returns	17,000	Dec. 31	By goods sent on Sales or Return	77,000
	To Sales	47,000			
	To Balance c/d	13,000			
		77,000			77,000

2018 - May [2] (c) Attempt the following

(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 - Goods 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. Badhri assuming that the accounting year closes on 31st Dec. 2017. (5 marks)

QR Code for Solution Video

Answer:

In the books of Mr. Badhri
Journal Entries

Date	Particulars	L.F.	Dr. (in ₹)	Cr. (in ₹)
2017 Dec. 2	Trade receivables A/c Dr. To Sales A/c (Being the goods sent to customer on sale or return basis)		80,000	80,000

Dec. 10	Return Inward A/c (Note 1) Dr. To Trade receivables A/c (Being the goods returned by customers to whom goods were sent on sale or return basis)		35,000	35,000
Dec. 23	Sales A/c Dr. To Trade receivables A/c (Being the cancellation of original entry of sale in respect of goods on sale or return basis)		15,000	15,000
Dec. 31	Inventories with customers on Sale or Return A/c Dr. To Trading A/c (Note 3) (Being the adjustment for cost of goods lying with customers awaiting approval)		12,000	12,000

Notes:

1. Alternatively, Sales account or Sales returns can be debited in place of Return Inwards account.
2. No entry is required for receiving letter of approval from customers.
3. Cost of goods with customers = ₹15,000 × $\frac{100}{125}$ = ₹12,000
4. It has been considered that the transaction values are at involve price (including profit margin).

2018 - Nov [2] (c) Attempt the following:

(ii) Mr. Ganesh sends out goods on approval to few customers and includes the same in the Sales Account. On 31.03.2018, the Trade Receivables balance stood at ₹75,000 which included ₹6,500 goods sent on approval against which no intimation was received during the year. These goods were sent out at 30% over and above cost price and were sent to –

Mr. Adhitya ₹3,900 and Mr. Bakkiram ₹2,600.

Mr. Adhitya sent intimation of acceptance on 25th April, 2018 and Mr. Bakkiram returned the goods on 15th April, 2018.

Make the adjustment entries and show how these items will appear in the Balance Sheet as on 31st March, 2018. Show also the entries to be made during April, 2018. Value of Closing Inventories as on 31st March, 2018 was ₹50,000. (5 marks)

QR Code for Solution Video

Answer:

In the Books of Mr. Ganesh
Journal Entries

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018 March 31	Sales A/c Dr. To Trade receivables A/c (Being the cancellation of original entry for sale in respect of goods lying with customers awaiting approval)		6,500	6,500
March 31	Inventories with Customers on Sale or Return A/c Dr. To Trading A/c (Note 1) (Being the adjustment for cost of goods lying with customers awaiting approval)		5,000	5,000
April 25	Trade receivables A/c Dr. To Sales A/c (Being goods costing worth ₹3,900 sent to Mr. Aditya on sale or return basis has been accepted by him)		3,900	3,900

Balance Sheet of Mr. Ganesh as on 31st March, 2018 (Extracts)

Liabilities	₹	Assets	₹	₹
		Trade receivables (₹75,000 - ₹6,500)		68,500
		Inventories-in-trade	50,000	
		Add: Inventories with customers on Sale or Return	5,000	55,000
				1,23,500

Notes:

1. Cost of goods lying with customers = 100/130 × ₹6,500 = ₹5,000
2. No entry is required on 15th April, 2018 for goods returned by Mr. Bakkiram. Goods should be included physically in the Inventories.

2019 - Nov [3] (b) A firm sends goods on "Sale or Return basis". Customers have the choice of returning the goods within a month. During May 2018, the following are the details of goods sent:

Date (May)	2	8	12	18	20	27
Customers	P	B	Q	D	E	R
Value (₹)	17,000	22,000	25,000	5,500	2,000	28,000

Within the stipulated time, P and Q returned the goods and B, D and E signified that they have accepted the goods.
Show in the books of the firm, the Sale or Return Account and Customer - Q for Sale or Return Account as on 15th June 2018. (5 marks)

Answer:

Sale or Return A/c

Date	Particulars	₹	Date	Particulars	₹
2018 Jun. 15	To Returns To Sales To Balance c/d	42,000 29,500 28,000	2018 Jun. 15	By Sundries as per Sale or Return Day Book	99,500
		99,500			99,500

Q's A/c

Date	Particulars	₹	Date	Particulars	₹
2018 May 12	To Sale or Return A/c	25,000	2018 Jun. 15	By Sale or Return A/c	25,000
		25,000			25,000

CHAPTER

6 Accounting for Special Transactions

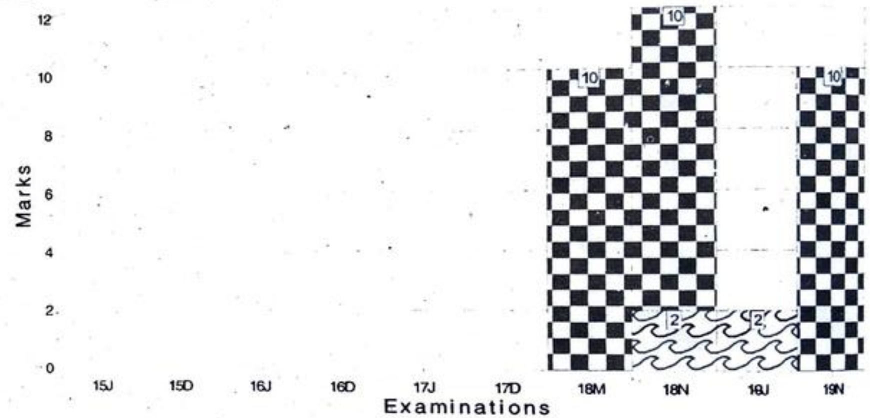
Unit: 3

Consignment

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective   Short Notes   Distinguish   Descriptive   Practical



For detailed analysis Login at *www.scannerclasses.com* for registration and password see first page of this book.

SELF STUDY QUESTIONS

Q1. What do you mean by Consignment?

Answer:

- Since the size of the market is increasing, it is becoming more and more difficult for the manufacturer or wholesaler to come in direct contact with customers living at far off distances.
- Therefore, the manufacturers or wholesalers enter into an agreement with a reliable local trader who can sell goods on their behalf.
- The risk is borne by the manufacturers and wholesalers, and the local trader charges a commission for selling goods on their behalf.
- Such a despatch of goods from one person to another person at a different place for the purpose of warehousing and ultimate sale is termed as "Consignment".
- Goods so sent are termed as "Goods sent on Consignment", the sender is called "Consignor" and the recipient is called "Consignee".

Q2. Who are the Parties in Consignment?

Answer:

Parties to Consignment

Sender of goods [Consignor] Principal

Receiver of goods [Consignee] Agent

- In consignment, goods are transferred without transfer of ownership, ownership is transferred to ultimate buyer when sale is executed.
- A proforma invoice containing information of the goods sent is sent by consignor to consignee.
- Expenses incurred to by consignee are later on recovered from consignor.
- Consignee receives commission on sale of goods at gross sale.

Q3. What types of Commission are there?

Answer:

Commission can be either of the following:

Ordinary Commission: Commission calculated as a fixed percentage on gross sale proceeds. Such commission does not provide for any security for bad debts.

Del credere Commission: Commission paid for bearing risk of bad debts on credit sales. Consignee guarantees for payment in respect to credit sales.

- To record the transactions of the above business a separate account is maintained, known as consignment account.

Q4. Differentiate between Consignment and Sales.

Answer:

Basic of Difference	Consignment	Sales
Ownership and Possession of goods	Possession is transferred to consignee without transfer of ownership.	Both ownership as well as possession is transferred to the buyer.
Risk of loss of goods	Consignor bears the risk of loss or damage of goods.	Risk passes to the buyer with transfer of ownership of goods.
Parties and their relationship	There are two parties involved. Consignor [Principal] Consignee [Agent]	The two parties involved are seller and buyer having relationship of creditor and debtor.
Expenses	Borne by consignee and reimbursed by consignor.	After sales, buyer is required to bear the expenses.
Consideration	Goods sold by consignee are for commission.	Goods sold by seller is for earning profit.

Q5. Differentiate between Commission and Discount?

Answer:

Basic of Difference	Commission	Discount
Meaning	Remuneration paid to agent in return of services related to purchase, sales, bills collection, etc. on amount involved.	Reduction or rebate allowed to buyer of goods on purchase price.
Types	1. Ordinary Commission for making sales.	1. Cash discount for settlement of dues.
	2. Del credre commission for bearing risk of bad debts on credit sales. 3. Overriding commission to promote sales at higher price.	2. Trade discounts for making bulk purchases. It is usually provided on list price or retail price.
Disclosure in Account Books	Both ordinary commission and del-credre commission are recorded in books.	Cash discount is recorded, however trade discount is not shown separately but is deducted from cost of purchases.

Q6. How is Accounting of Consignment done is the Books of Consignor?

Answer:

Accounting for consignment transactions and events in the books of the consignor:

- Separate consignment Account is maintained for each consignment.
- It is a nominal cum personal account and shows profit or loss in respect of transactions incurred.

In the books of consignor
Accounting Entries

(a) **On despatch of goods:**
Consignment A/c Dr.
To Goods sent of Consignment A/c

(b) **Expenses incurred by consignor:**
Consignment A/c Dr.
To Bank/Cash/Supplier

(c) **Advance received from consignee:**
Bank A/c Dr.
To Consignee's A/c

(d) **Receipt of sale proceeds from consignee:**
Consignee's A/c Dr.
To Consignment A/c

(e) **Expenses incurred by consignee:**
Consignment A/c Dr.
To Consignee's A/c

(f) **Bad debts incurred:**
(i) If del credere commission is paid
– No entry –
(ii) If del credere commission not paid
Consignment A/c Dr.
To Consignee's A/c

(g) **For goods taken over by consignee:**
Consignee's A/c Dr.
To Consignor A/c

(h) **Unsold stock:**
Consignment Stock A/c Dr.
To Consignment A/c

(i) **Commission payable to consignee:**
Consignment A/c Dr.
To Consignee's A/c

Q7. How is Valuation of Inventories done?

Answer:

- Cost of market value whichever is lower.
  Where cost = Cost of goods sold + Expenses incurred till goods reached to consignee [Ex. Freight, insurance, octroi, custom duty, etc.]
  Exclusion from cost: Expenses incurred after goods reached to the premises of consignee [Ex. Godown rent delivery changes, selling expenses, etc.]

Q8. Write short note on "Goods invoiced Above Cost".

Answer:

In order to calculate the profit or loss on consignment sales, the effect of loading should be removed from closing stock.

Loading is the amount of unrealised profit included in cost of goods unsold forming part of closing stock.

Accounting Entries:

For bringing down value of goods to its cost:

Goods sent on consignment A/c Dr.
To Consignment A/c

For adjusting the value of closing stock:

Consignment A/c Dr.
To Inventory Reserve A/c

Q9. Explain Normal and Abnormal Loss.

Answer:

Normal Loss:

- Unavoidable loss;
- To be spread on entire consignment;
- Reasons for occurrence of normal loss can depend on the nature of goods ex. Petrol, Gas, etc.

Abnormal Loss:

- Avoidable loss and insurable to an external;
- To be debited in profit and loss A/c of consignor;
- Reasons can be accident, material mishandling, etc.;
  It must be noted that at the time of valuation of closing stock, normal loss is to be considered as a part of cost of balance goods, while abnormal loss is to be ignored.

Q10. Distinguish between Normal and Abnormal loss.

Answer:

Basis of Difference	Normal Loss	Abnormal Loss
Nature	Unavoidable Loss	Avoidable Loss
Reason for occurrence	Nature of goods	Unforseen events such as accident, etc.
Treatment	Spread on remaining goods and forms part of cost of remaining goods	is accounted for immediately and is debited to profit & Loss A/c
Insurance	Non-insurable being unavoidable	Can be insured
Certainty	Almost certain	Uncertain due to unforseen events
Impact on Gross Profit	Since the loss is added to cost of remaining goods, it impacts the gross profit.	No impact of Gross Profit

Accounting Entries

(a) **If Abnormal Loss is recoverable**

From Consignee:

- To book loss:
  Abnormal Loss A/c Dr.
  To Consignment A/c
- To recover:
  Consignee's A/c Dr.
  To Abnormal Loss

From Insurance Company:

- To book Loss:
  Abnormal loss A/c Dr.
  To Consignment A/c
- To Recover:
  Insurance Co. A/c Dr.
  To Abnormal Loss

(b) If abnormal loss is irrecoverable:

To book loss:
Abnormal loss A/c Dr.
To Consignment A/c

Transfer to P/L A/c:
Profit & Loss A/c Dr.
To Abnormal Loss A/c

Q11. What do you mean by Commission? What are the types of Commissions?

Answer:

- Commission is the remuneration which the consignor pays to the consignee for the sales effected by the latter.

Types of Commission

Ordinary Commission

- Paid by principal to agent for sale of consigned goods.
- Based on specific percentage of sale proceeds (Gross).
- Given irrespective of the fact that credit sale is made or not.
- No Protection to consignor against bad debts.

Del-credere Commission

- Paid by principal to agent for making credit sales of consigned goods.
- Calculated on total sales unless anything contrary provided in agreement.
- Given for encouraging credit sales made.
- Protection to consignor against bad debts. Consignee bears the loss of bad debts.

Over-riding Commission

- Additional commission paid by consignor to consignee for promoting sales at higher price or to encourage consignee to launch new product in market.
- Can be calculated on sales or differential sales made at higher price as per the agreement.

Q12. What are the reasons for Return of Goods from Consignee?

Answer:

Reason for return

- Poor Quality;
- Not as per specifications;
- Damaged goods received, etc.

Q13. What do you understand by Accounts Sales?

Answer:

- Account Sales is a document or periodical summary of details of transactions in consignment business.
- It is sent by consignee to consignor.
- **Statement includes following details:**
  - Total sales made;
  - Expenses, changes incurred by consignee on behalf of consignor;
  - Commission earned;
  - Advance payment received if any, balance payment to be remitted;
  - Unsold stock with consignee.

Q14. How is Accounting in the Book of Consignee done?

Answer:

- At the time of making sales:
  Bank A/c /Debtor A/c Dr.
  To Consignor's A/c
- Expenses incurred on behalf of consignor:
  Consignor's A/c Dr.
  To Bank A/c
- Commission received:
  Consignor's A/c Dr.
  To Bank A/c
- For advance paid to consignor:
  Consignor's A/c Dr.
  To Bank A/c
- Bad debts:
  Bad debt A/c Dr.
  To Debtor's A/c
- **For writing off Bad debts**

If Del credere commission is received
↓
Commission A/c Dr.
To Bad debts A/c

If Del credere commission is not received
↓
Consignor's A/c Dr.
To Bad debts A/c

Q15. Explain advance by the Consignee Vs. Security Against the consignment.

Answer:

- In case if consignor requests for advance money from consignee then the same is adjusted against dues in future period. Usually it is in cash or Bills receivable.
- It is the security against the consigned goods and is hence adjusted later on sale of such goods.
  In case of unsold inventory, proportionate security money is carried forward under the goods are sold by consignee.

Example

Mr. X on January 1st, 2017 consigned 500 chairs of ₹350 to Mr. A. He incurred following expenses on consignment:

(a) Cartage ₹500
(b) Freight ₹2,000
(c) Insurance ₹2,500

Expenses incurred by Mr. A were:

(a) Cartage ₹1,500
(b) Unloading ₹1,000
(c) Godown rent ₹2,500

At year end, account sales was received from Mr. A showing 450 chairs were sold at ₹1,000 per chair and unsold stock of 50 chairs. As per agreement, 5% commission on sales will be payable to Mr. A.

Required:

Prepare Consignment A/c showing valuation of closing stock.

Solution:

In the books of Mr. X
Consignment A/c

Particulars	Amount	Particulars	Amount
To Goods Sent on Consignment	1,75,000	By Mr. A By Consignment Stock	4,50,000 18,250

To Bank A/c			
Cartage	500		
Freight	2,000		
Insurance	2,500		
To Mr. A			
Cartage	1,500		
Unloading	1,000		
Godown rent	2,500		
To A's commission (5% of 4,50,000)	22,500		
To Profit & Loss A/c	2,60,750		
	4,68,250		4,68,250

Valuation of closing stock

Cost Price of 50 tables = 350 × 50 17,500

Add: Proportionate expenses of consignor

$500 + 2{,}000 + 2{,}500 = \frac{5{,}000 \times 50}{500}$ 500

Add: Proportionate expenses of consignee

$1500 + 1000 = \frac{2{,}500 \times 50}{500}$ 250

18,250

Illustration

X of Delhi purchased 10,000 mt. of cloth for 2,00,000 of which 5,000 metres were sent on consignment to Mr. Y at selling price ₹30 per metre.

Expenses paid by X.

Freight ₹5,000

Packaging ₹500

Y sold 4000 mt. of cloth at ₹40/ metre expenses paid by Y.

Selling Expenses ₹2,000

As per agreement, Y was entitled to commission of 5% on total sale proceeds and further 20% on any surplus price realised over ₹30/metre. Y sold 3,000 metres at ₹30/metre less expense & commission ₹3000. Due to fall in market price, closing inventory is to be reduced by 10%

Required:

(i) Consignment A/c

(ii) Trading and Profit & Loss A/c

Solution:

In the books of Mr. X consignment A/c

Particulars	Amount	Particulars	Amount
To Goods sent on consignment	1,50,000	By Y's Account (sales)	1,60,000
To Bank A/c		By Goods sent on Consignment	50,000
Freight	5,000	By Inventory on consignment	
Packaging	500	[Refer W.N. 1]	28,990
To Y's A/c			
Selling expenses	2,000		
Commission [Refer W.N. 3]	16,000		
To Inventory Resérve [Refer W.N. 2]	10,000		
To Profit & Loss A/c	55,490		
	2,38,990		2,38,990

Trading and Profit Loss A/c

Particulars	Amount	Particulars	Amount
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 inventory 40,000 (–) 10% 4,000	36,000
	2,26,000		2,26,000
To Expenses and commission	3,000	By Gross Profit b/d	26,000
To Net Profit	78,490	By Consignment A/c (Profit on consignment)	55,490
	81,490		81,490

Working Notes

1. **Calculation of Inventory on Consignment**

Cost of Inventory (1,000 × 30) 30,000

Add: Expenses of consignor

$5{,}000 + 500 = \frac{5{,}500}{5{,}000} \times 1{,}000$ 1,100

31,100

Less: Reduction due to fall in market price

$10\% \text{ of } \left[\left(\frac{2{,}00{,}000}{10{,}000} \times 1{,}000\right) + 1{,}100\right]$ 2,110

28,990

2. **Calculation of Inventory Reserve**

Closing Stock (Qty) = 1,000

Sale Price = 40
Purchase cost = 30
Loading = 10
Loading = 1,000 × 10 = 10,000

3. **Calculation of Commission**

Sales Proceeds 4,000 × 40 = 1,60,000

(a) Commission @ 5% of sale proceeds
1,60,000 × 5% = 8,000

Surplus proceeds about ₹30 per metre.
(40 – 30) × 4000 = 40,000

(b) Commission @ 20% of Surplus
40,000 × 20% = 8,000
Total commission = 8,000 + 8,000 = ₹16,000

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

Multiple Choice Questions

1. Consignment Account is a:
(a) Real Account
(b) Nominal Account
(c) Trading Account
(d) Personal Account

2. A invoiced certain goods so as to show a profit of 20% on invoice price 1/10th of the goods were lost in transit. The cost price of goods lost is ₹ 40,000. The invoice value of goods sent out is:
(a) ₹5,00,000
(b) ₹4,80,000
(c) ₹4,50,000
(d) ₹4,00,000

3. X sends out 400 bags to Y costing ₹200 each, consignor expenses were ₹4,000. Y's non selling expenses were ₹2,000 and selling expenses were ₹1,000. 300 bags were sold by Y. Value of consignment stock will be:
(a) ₹20,400
(b) ₹20,700
(c) ₹22,000
(d) ₹21,500

4. X sends out goods costing ₹3,00,000 to Y at cost plus 25%; consignor's expenses ₹5,000. 1/10th of goods were lost in transit. Insurance claim received ₹3,000. The net loss on account of abnormal loss is:
   (a) ₹27,500
   (b) ₹25,500
   (c) ₹30,500
   (d) ₹38,000
5. P sent out goods costing ₹45,000 to Y at cost + 33-1/3%. 1/10th of goods were lost in transit. 2/3rd of the goods are sold at 20% above IP. The amount of sale value will be:
   (a) ₹54,000
   (b) ₹43,200
   (c) ₹60,000
   (d) ₹36,000
6. Account Sales indicates:
   (a) The net amount due from consignor to consignee by way of commission
   (b) The net amount due from consignee to consignor
   (c) Net sales effected by consignee
   (d) None of these
7. X sends out goods costing ₹2,00,000 to Y. 3/5th of the goods were sold by consignee for ₹1,40,000.
   Commission 2% on sales plus 20% of gross sales less all commission exceeds cost price. The amount of commission will be:
   (a) ₹5,667
   (b) ₹5,800
   (c) ₹6,000
   (d) ₹5,600
8. A sends out goods costing ₹2,00,000 to B. Consignor's expenses ₹ 5,000. Consignee's expenses in relation to sales ₹3,000. 4/5th of the goods were sold at 20% above cost. The profit on consignment will be:
   (a) ₹25,000
   (b) ₹31,000

   (c) ₹25,200
   (d) ₹ 5,000
9. Goods sent on consignment account is a:
   (a) Personal account
   (b) Real account
   (c) Nominal account
   (d) Sales A/c
10. The abnormal loss on consignment is credited to:
   (a) Consignment A/c
   (b) Profit & Loss A/c
   (c) Consignee's personal A/c
   (d) All of the above
11. A proforma invoice is sent by:
   (a) Consignee to consignor
   (b) Consignor to consignee
   (c) Debtors to consignee
   (d) Debtors to consignor
12. X sends out 200 boxes to Y costing ₹100 each. Consignor's expenses ₹4,000. Consignee's non-recurring expenses ₹900. 1/10th of the boxes were lost in transit. 2/3rd of the boxes received by consignee were sold for ₹20,000. The amount of consignment stock will be:
   (a) ₹7,200
   (b) ₹7,500
   (c) ₹7,000
   (d) ₹6,000
13. X sent out certain goods to Y. 1/10th of goods were lost in transit. Invoice value of goods lost is ₹12,500. Invoice value of goods sent out on consignment will be:
   (a) ₹1,20,000
   (b) ₹1,25,000
   (c) ₹1,40,000
   (d) ₹1,00,000

14. Suresh consigned 600 fans to Naresh to be sold at his risk. The cost of each fan is ₹300. Suresh paid ₹6,000 as freight. Naresh paid ₹1,500 for octroi; ₹3,500 for godown rent. 500 fans were sold for ₹1,80,000. Naresh was entitled to 4% commission on sale @ ₹350 per fan and 20% of any surplus price realized Profit on consignment will be:
(a) ₹12,250
(b) ₹12,000
(c) ₹14,000
(d) ₹15,000

15. Commission provided by the consignor to the consignee to promote credit sale is know as:
(a) Ordinary commission
(b) Del credere commission
(c) Over - riding commission
(d) Special commission

16. If no del – credere commission is paid to the consignee,____ account will be debited for credit sale:
(a) Consignment account
(b) Consignee account
(c) Consignor account
(d) Consignment debtors account

17. On 1st Sept. 2006, goods costing ₹33,000 were consigned by X to his agent Y at a proforma price which was cost plus one sixth profit on invoice price. What is the invoice price of goods?
(a) ₹39,000
(b) ₹39,600
(c) ₹40,000
(d) ₹45,000

18. Overriding commission is calculated on:
(a) Cash Sales
(b) Credit Sales Only
(c) Total Sales
(d) Credit Sales less Cash sale

19. X consigns 500 bags to Y costing ₹400 each at an inflated price of ₹450 each. Consignor's expenses ₹4,000. Consignee's expenses freight ₹ 1,000, selling ₹2,000, 400 bags were sold. The amount of stock reserve will be:
(a) ₹5,000
(b) Nil
(c) ₹10,000
(d) ₹10,200

20. What entry is required to be passed to nullify the effect of Loading:
(a) Goods sent on consignment A/c Dr.
    To Trading A/c
(b) Goods sent on consignment A/c Dr.
    To Consignment A/c
(c) Consignment A/c Dr.
    To Goods sent on consignment A/c
(d) None

21. The risk of stock on consignment lies with
(a) Consignor
(b) Consignee
(c) Buyer
(d) Seller

22. X sends out 4,000 boxes to Y costing ₹100 each. Consignor's expenses 10,000. 1/10th of boxes were lost in consignee's godown and treated as normal loss. 2,400 boxes were sold by consignee. The value of consignment stock will be:
(a) ₹1,36,667
(b) ₹1,23,000
(c) ₹1,20,000
(d) ₹1,20,500

23. If the del credere commission is 10%, cash sales is ₹5,000 and credit sales is ₹10,000, calculate the amount of del credere commission:
    (a) 1,500
    (b) 1,000
    (c) 500
    (d) None
24. The Stock lying unsold with the consignee belongs to:
    (a) Consignor
    (b) Consignee as he bears the risk
    (c) Both (a) and (b)
    (d) None of these
25. J of Jaipur sends 500 radios @ ₹200 each to D of Delhi. All the radios are sold by D at a profit of 25% on cost. D is entitled to a commission of ₹25 per radio sold plus 20% of gross sale proceeds as exceeds an amount calculated @ 20% profit on cost. Calculate commission.
    (a) ₹12,500
    (b) ₹13,500
    (c) ₹11,500
    (d) ₹10,500
26. Account Sales includes:
    (a) Sales made
    (b) Stock left with consignee
    (c) Commission earned
    (d) All of above.
27. A sends 1,000 units @ ₹56 to be sold on consignment basis. Consignor expenses amounted to ₹1,000. 50 units were lost in transit. Find the new price per unit. (Loss is unavoidable).
    (a) ₹50 per unit
    (b) ₹60 per unit
    (c) ₹58.95 per unit
    (d) ₹57 per unit

28. A consigned 1,000 litres of coconut oil @ ₹50 per lt. to B. The normal loss is estimated at 5%. The profit was fixed at 14% on the total cost. What is the sale price per litre ?
    (a) ₹57
    (b) ₹60
    (c) ₹70
    (d) ₹55
29. X sends goods to Y on consignment, but 15% of the goods were lost in transit. Such loss will be borne by:
    (a) Consignee
    (b) Consignor
    (c) Both (a) and (b)
    (d) Insurance company
30. Who is owner of the unsold stock left with the consignee?
    (a) Consignee
    (b) Consignor
    (c) Co-venturer
    (d) Both (a) and (b)
31. The Consignor sends___along with the consigned goods to the consignee.
    (a) account sales
    (b) proforma invoice
    (c) both
    (d) none
32. X consigned goods to Y costing ₹30,000 at cost plus 25%. These goods are to be sold at invoice value plus 10%. Y sold a part of the goods for ₹33,000. What will be the value of stock lying with Y that will be shown by X at the closing of accounts?
    (a) ₹8,250
    (b) ₹6,000
    (c) ₹7,500
    (d) ₹8,000

33. Del credere commission is fixed in terms of percentage say 10% and credit sales and cash sales are ₹10,000 and ₹5,000 respectively. Amount of del-credere commission will be?
    (a) ₹1,000
    (b) ₹1,500
    (c) ₹500
    (d) None of the above
34. X sends out 400 bags costing ₹200 each to Y. Sales are to be made at cost +45%. X draws a bill on Y for an amount equivalent to 60% of sales value. The amount of bill will be:
    (a) ₹69,600
    (b) ₹60,300
    (c) ₹61,250
    (d) ₹63,000
35. Goods costing ₹1,00,000, Invoice Price ₹1,20,000, sent to consignee. Goods sold by consignee for ₹96,000 at Invoice Price. Consignee is entitled to a commission of 5% to cost price of sale made and 10% additional commission on difference of invoice price and cost price of sale made. Amount of commission payable to the consignee will be :-
    (a) ₹4,000
    (b) ₹5,600
    (c) ₹1,600
    (d) ₹9,600.
36. Mr. A sold goods amounting to ₹30,000 (cost of goods ₹24,000) received on consignment, during the month of April, 2009. Half of the sales was on credit. He is entitled for 5% commission on sales. In addition to that, he is also entitled for 2% del credere commission. What is the total amount of commission due to Mr. A for the month of April, 2009 ?
    (a) ₹4,000
    (b) ₹1,500
    (c) ₹1,800
    (d) ₹2,100

37. ___________ Commission is given to consignee for his hardwork in introducing a new product in the market.
    (a) del credere
    (b) extra salary
    (c) over riding commission
    (d) commission on total sales
38. If stock is left with consignee at the end of the year, then it will be credited to ___________?
    (a) P/L A/c
    (b) Consignment A/c
    (c) Trading A/c
    (d) None of these.
39. The revenue for the transaction of consignment sales is recognized–
    (a) When the goods are sold to customers by consignee
    (b) When the goods are sent to consignee
    (c) When the advance against delivery is received by consignor
    (d) When consignor receives the payment from consignee
40. X Ltd. sends 5,000 bags of cement on consignment to Y Ltd. The Cost per bag is ₹40. The Carriage Inward is ₹25,000. It is estimated that the normal loss rate is 10%. Calculate the cost per bag?
    (a) ₹45
    (b) ₹45.50
    (c) ₹50.00
    (d) ₹40.00
41. The balance of "goods sent on consignment account" is transferred to:-
    (a) Trading Account
    (b) Profit and Loss Account
    (c) Consignment Account
    (d) Consignee's Account
42. S of Surat sent goods costing ₹3,00,000 to C of Chennai at cost + 20%. Half of the goods sent were sold by C at 10% above the invoice value. The sales value of goods will be

(a) ₹1,98,000
(b) ₹1,50,000
(c) ₹1,80,000
(d) ₹1,65,000

43. Radhika sent goods worth ₹1,20,000 on consignment to Sarika. 1/8th of the goods were lost in transit. No claim was receivable for the same. Sarika sold 2/3 of the goods received for ₹1,00,000. What was the cost of the goods lying with Sarika?
(a) ₹29,000
(b) ₹35,000
(c) ₹29,167
(d) ₹40,000

44. When the del-credere commission is allowed by consignor to consignee, abnormal loss will be borne by:
(a) Consignor
(b) Consignee
(c) Both, consignor and consignee in equal proportion.
(d) Neither consignor nor consignee.

45. 1,000 kgs of vegetables were consigned at ₹18,000 and freight expenses amounted to ₹4,000. During the transit, there is a normal loss of 40 kg. If 800 kgs were sold, what will be the value of stock at the end?
(a) ₹2,880
(b) ₹3,000
(c) ₹3,520
(d) ₹3,667

46. Mr. X paid commission to his consignee Y, ₹25,000, which was @ 5% on sales effected by him. Goods were sold by Mr. Y at a profit of 25% on cost. Stock in hand on 31/3/11 is ₹50,000 at cost. So, cost of goods sent by Mr. X is:
(a) ₹4,50,000
(b) ₹75,000
(c) ₹5,50,000
(d) ₹6,00,000

47. Overriding commission is given by consignor to consignee in order to ________:
(a) to encourage the consignee to overcome bad-debts
(b) to encourage the consignee to promote the sales at a price higher than the specified selling price
(c) to sell the goods sent by consignor
(d) to sell and take care of goods sent by consignor to consignee

48. A loss which is natural and unavoidable is called:
(a) Abnormal Loss
(b) Normal Loss
(c) Contingent Loss
(d) None of these.

49. Periodical statement sent by consignee to consignor is known as ________:
(a) Proforma invoice
(b) Account sales
(c) Bill of Exchange
(d) Hundi

50. Goods sent on consignment at cost of ₹50,000. 1/4th of the goods lost in transit and claim received ₹10,000. The amount of abnormal loss to be transferred to General P & L account is:
(a) ₹12,500
(b) ₹10,000
(c) ₹2,500
(d) None of the above.

51. Del-credere commission is given for:
(a) Sales at higher price than specified.
(b) Speeding up the collection.
(c) Covering the risk of bad debts.
(d) Prompt payment from consignee.

52. At the time of valuation of unsold stock on consignment, which of the following expenses will not be included?
    (a) Insurance of warehouse of consignor
    (b) Carriage
    (c) Loading expenses
    (d) Octroi
53. P of Punjab sent goods costing ₹6,00,000 to A of Aligarh. Goods were to be sold at cost plus 33-1/3%. The consignee had to send advance to the consignor at a fixed percentage of sales value and A sent accordingly ₹ 4,80,000. What is the percentage of such advance on sales value?
    (a) 60%
    (b) 50%
    (c) 45%
    (d) 40%
54. Del-Credere commission is fixed in terms of percentage say 10%. The credit sales is of ₹1,00,000 and cash sales is of ₹50,000, amount of del-credere commission will be:
    (a) ₹10,000
    (b) ₹15,000
    (c) ₹5,000
    (d) None of the above.

ANSWER

1.	(b)	2.	(a)	3.	(d)	4.	(a)	5.	(b)
6.	(b)	7.	(a)	8.	(a)	9.	(b)	10.	(a)
11.	(b)	12.	(b)	13.	(b)	14.	(a)	15.	(b)
16.	(d)	17.	(b)	18.	(c)	19.	(a)	20.	(b)
21.	(a)	22.	(a)	23.	(a)	24.	(a)	25.	(b)

26.	(d)	27.	(b)	28.	(b)	29.	(b)	30.	(b)
31.	(b)	32.	(b)	33.	(b)	34.	(a)	35.	(b)
36.	(d)	37.	(c)	38.	(b)	39.	(a)	40.	(c)
41.	(a)	42.	(a)	43.	(b)	44.	(a)	45.	(d)
46.	(a)	47.	(b)	48.	(b)	49.	(b)	50.	(c)
51.	(c)	52.	(a)	53.	(a)	54.	(b)		

SHORT PRACTICE QUESTIONS

1. Differentiate between Normal Loss and abnormal loss.
2. Differentiate between consignment and sales.
3. Explain briefly commission and its types.

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

1995 - May [5] State with reason whether the following statement is true or false:

(b) 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. (1.5 marks)

Answer:

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.

1995 - Nov [5] State with reasons whether the following statement is True or False:

6. The relationship between the consignor and the consignee is that of Principal and Agent. (1.5 marks)

Answer:

True: The relationship between the consignor and the consignee is that of a principal and an agent. The consignee can act only on behalf of and at the instruction of the consignor. (The consignee is not the owner of the goods sent by consignor for sale).

1996 - May [5] State with reasons whether the following statements are True or False

7. Account Sales is the statement sent by the consignor to the consignee.
10. Del credere commission is normally calculated on total sales

(2 marks each)

Answer:

7. **False:** Accounts Sales is a statement sent by the consignee to consignor, setting out the sales made by the consignee, the expenses incurred on behalf of the consignor, the commission earned by the consignee, any advance given to the consignor and the balance due to the consignor.
10. **True:** Although it arises in relation to credit sales, it is calculated on the total sales, not merely on credit sales.

1996 - Nov [5] State with reasons whether the following statement is True or False:

6. Loss of Stock is said to be abnormal loss when such loss is due to inherent characteristics of the commodities. (2 marks)

Answer:

False: Abnormal loss is usually caused by fire, theft, abnormal spoilage etc. Loss attributable to inherent features of goos is normal loss.

1997 - May [5] State with reasons whether the following statement is True or False:

8. If the consignee is not authorised to get the del credere commission, then he is liable for all losses on account of non-recovery of debts. (2 marks)

Answer:

False: If the consignee is not authorised to get the del credere commission, then he is not responsible for any bad debt that may arise.

1997 - Nov [5] State with reasons whether the following statement is True or False:

3. The relationship between the consignor and the consignee is that of Principal and Agent. (2 marks)

Answer:

Please refer 1995 - Nov [5] (6) on page no. 515

1998 - May [5] State with reasons whether the following statements are True or False:

4. Loss of stock is said to be normal loss when such loss is not due to inherent characteristics of the commodities.
8. The relationship between the consignor and the consignee is that of a Principal and Agent. (2 marks each)

Answer:

4. **False:** When loss is caused by fire, theft, abnormal spoilage etc., loss is said to be abnormal loss. Loss attributable to inherent features of goods is normal loss.
8. *Please refer 1995 - Nov [5] (6) on page no. 515*

2000 - Nov [5] State with reasons whether the following statement is True or False:

5. The relationship between the consignor and the consignee is that of Principal and Agent. (2 marks)

Answer:

Please refer 1995 - Nov [5] (6) on page no. 515

2001 - May [5] State with reasons whether the following statement is True or False:

2. Consignee has no right in the profit on goods sent on consignment. (2 marks)

Answer:

2. **True:** The consignee acts as an agent to the consignment business. He earns only commission for the services he renders to the consignor.

2002 - May [5] State with reasons whether the following statement is True or False:

1. The relationship between the consignor and the consignee is that of a principal and agent. (2 marks)

Answer:

Please refer 1995 - Nov [5] (6) on page no. 515

2003 - Nov [5] State with reasons whether the following statement is true or false:

(viii) The party to whom goods are sent is called 'consignee'. (2 marks)

Answer:

True: The consignee receives goods from the consignor.

2004 - Nov [5] State with reasons whether the following statement is true or false:

(iii) Over-riding commission is calculated on credit sales only. (2 marks)

Answer:

False: In case the sales exceed a specific amount, an extra commission is allowed to consignee. This commission is termed as over-riding commission. It is calculated on total sales, unless specifically agreed between consignor and consignee.

2005 - May [5] State with reasons whether the following statements are true or false:

(vii) The additional commission to the consignee who agrees to bear the loss on account of bad debts is called overriding commission.

(x) Loss of stock is said to be abnormal loss, which is due to inherent characteristics of the commodity. (2 marks each)

Answer:

(vii) False: The additional commission to the consignee who agrees to bear the loss on account of bad debts is called del credere commission.

(x) False: Loss of stock due to inherent characteristics of the commodities like evaporation, shrinkage etc. is said to be a normal loss.

2005 - Nov [5] State with reasons whether the following statements are true or false:

(iv) The consignee has no right in the profit on goods sent on consignment. (2 marks)

(x) Overriding commission is granted to an agent in case of sales exceeding targets. (2 marks)

Answer:

(iv) True: Consignee has no right in the profit on goods sent on consignment. He has the right to take commission only.

(x) False: Over- Riding Commission is paid over and above the ordinary commission. It is generally calculated on the surplus sale proceeds realised as a result of setting the product price over and above the minimum sale price fixed by the consignor.

2006 - Nov [5] State with reasons whether the following statement is true or false:

(iii) The additional commission to the consignee, who agrees to bear the loss on account of bad debts is called overriding commission. (2 marks)

Answer:

False: The additional commission to the consignee who agrees to bear the loss on account of bad debts, is called Del Credere Commission.

2018 - Nov [1] {C} (a) State with reasons, whether the following statement is true or false:

(vi) If del-credere commission is paid to consignee, the loss of bad debts is to be borne by the consignor. (2 marks)

Answer:

False: This additional commission when provided to the consignee gives a protection to the consignor against the bad-debts. After providing this commission, bad-debts is no more the loss of the consignor.

2019 - June [1] (a) State with reason, whether the following statement is true or false:

(iii) In case of consignment sale, ownership of goods will be transferred to consignee at the time of receiving the goods. (2 marks)

Answer:

False: The ownership of the goods, i.e. the property in the goods, remains with the consignor or the principal - the agent or the consignee does not become their owner even though goods are in his possession.

SHORT NOTES

1995 - Nov [6] Write short note on the following:

4. Del-credere commission. (3 marks)

Answer:

Del-Credere Commission

- Del-credere commission is an additional commission paid by the consignor to the consignee for undertaking responsibility of collection of debts.
- Generally, the consignee gets ordinary commission for sales made by him as a percentage of gross sales; over and above, he may get del-credere commission for the additional responsibility of debt collection.

- Sometimes it is agreed that del-credere commission shall be allowed on credit sales only.
- However, in the absence of any such agreement the consignor allows del-credere commission on total sales and not merely on credit sales.
- If the consignee is entitled to del-credere commission, he has to bear the bad debts; if any, arising, out of credit sale of consignment goods.

2004 - Nov [6] Write short note on the following:

(i) Del-credere commission. (3 marks)

Answer:

Please refer 1995 - Nov [6] (4) on page no. 519

DISTINGUISH BETWEEN

1994 - Nov [6] Distinguish Between the following:

3. Consignment and Sale (5 marks)

Answer:

S.No.	Consignment	Sale
1	The ownership of goods remain with the consignor and the possession is transferred to consignee.	The ownership and possession of goods, both are transferred to the buyer immediately.
2	The two parties involved are known as consignor and consignee.	The two parties involved are known as buyer and seller.
3	The relation between them is that of a principal and agent which continues for long period till it is ended.	The relation between them is of buyer and seller, which ends immediately after the delivery and payment of the goods.

4	The risk of loss or damage is of the owner (consignor).	The risk passes with the ownership to the buyer.
5	The consignee sells goods for commission.	The goods are sold for profit against the price.
6	The expenses are borne by the consignor.	After sales, the expenses are borne by the buyer.
7	Consignee sends to consignor account sales from time to time.	The buyer does not need to send any account sales to seller.

1995 - May [6] Explain the difference between the following:

(3) Commission and Discount. (5 marks)

Answer:

Commission and Discount:

Commission:

- Commission may be defined as remuneration, of an employee or agent relating to services performed in connection with sales, purchases, collections or other types of business transactions and is usually based on a percentage of the amounts involved.
- **For example:**
  - Commission paid to selling or buying agents.
  - Commission paid to brokers and bankers for services rendered.
  - Commission paid to property dealers for assistance in renting out properties or for services in connection with purchase/sale of properties.
  - Commission to export/import agent in foreign trade.
- Commission earned is accounted for as an income in the books of accounts, and commission allowed or paid is accounted for as an expense in the books of the party availing such facility or service.

Discount:

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

  - An allowance given for the settlement of a debt before it is due i.e. cash discount.
  - An allowance given to the wholesalers or bulk buyers on the list price or retail price, known as trade discount. A trade discount is not shown in the books of account separately and it is shown by way of deduction from cost of purchases.
  - The excess of par or face value of shares or debentures over the amount paid by subscriber i.e. discount on issue of a security.
  - The amount charged by a bank on discounting of a bill of exchange.

1997 - May [6] Explain the difference between the following:

(1) Commission and Discount. (5 marks)

Answer:

Please refer 1995 - May [6] (3) on page no. 521

1997 - Nov [6] Distinguish Between the following:

(c) Consignment and Sale (5 marks)

Answer:

Please refer 1994 - Nov [6] (3) on page no. 520

1998 - May [6] Explain the difference between the following:

(c) Commission and Discount. (5 marks)

Answer:

Please refer 1995 - May [6] (3) on page no. 521

2000 - Nov [6] Explain the difference between the following:

(a) Commission and Discount. (4 marks)

Answer:

Please refer 1995 - May [6] (3) on page no. 521

2002 - May [6] Distinguish Between the following:

(a) Consignment Sale and Normal Sale. (5 marks)

Answer:

Please refer 1994 - Nov [6] (3) on page no. 520

2002 - Nov [6] Explain the difference between the following:
(a) Commission and Discount. (4 marks)

Answer:

Please refer 1995 - May [6] (3) on page no. 521

DESCRIPTIVE QUESTIONS

2002 - Nov [4] (b) Briefly explain Normal Loss and Abnormal Loss on Consignment (5 marks)

Answer:

Normal loss is essential and unavoidable, it would be spread over the entire consignment while valuing stock. The total cost plus expenses incurred should be divided by the quantity available after the normal loss to ascertain the cost per unit.

Abnormal loss is accidental or unnecessary. In the case of abnormal loss, the correct treatment is to find out the cost of goods thus lost and then to credit the consignment account and debit the profit and loss account - this will enable the consignor to know what profit would have been earned had the loss not taken place.

2003 - Nov [6] (e) Briefly explain the following:
Over-riding Commission. (5 marks)

Answer:

It is an extra commission allowed over the normal commission. This commission is generally offered when an agent is required to work hard either to introduce a new product in the market or to handle the work of supervising the performance by other agents in a particular area. It is the commission paid by the consignor to the consignee for executing sales on consignment at a price higher than the price fixed by the consignor. In other words, it is the surplus commission allowed to the consignee, calculated on the surplus price realised by him.

PRACTICAL QUESTIONS

1995 - May [3] (Or) X of Delhi purchased 10,000 metres of cloth for ₹ 2,00,000 of which 5,000 metres were sent on consignment to Y of Agra at the selling price of ₹ 30 per metre. X paid ₹5,000 for freight and ₹ 500 for packing etc.

Y sold 4,000 metres at ₹40 per metre 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 metre.

3,000 metres were sold at Delhi at ₹30 per metre 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. (15 marks)

QR Code for Solution Video

Answer:

In the Books of X
Consignment Account

Particulars	Amount ₹	Particulars	Amount ₹
To Goods sent on Consignment	1,50,000	By Y Account:	
To Bank Account:		Sales	1,60,000
Freight	5,000	By Goods sent on Consignment	
Packing etc.	500	(Cancellation of loading)	50,000
To Y Account:		By Stock on	
Selling expenses	2,000	Consignment (W. Note 2)	27,000
Com-mission (W. Note 1)	16,000		
To Stock Reserve (W. Note 2)	9,000		
To Trading and P & L A/c	54,500		
(Profit on consignment transferred)			
	2,37,000		2,37,000

Trading and Profit & Loss Account
for the year ended

Particulars	Amount (₹)	Particulars		Amount (₹)
To Purchases	2,00,000	By Sales		90,000
Gross Profit c/d	26,000	By Goods sent on Consignment		1,00,000
		By Stock in hand:		
		Cost ₹	40,000	
		Less 10%	4,000	36,000
	2,26,000			2,26,000
To Expenses & Commission	3,000	By Gross Profit b/d		26,000
To Net Profit	77,500	By Consignment A/c (Profit on consignment)		54,500
	80,500			80,500

In the books of Y
X A/c

	₹		₹
To Cash A/c – Selling expenses	2,000	By Cash A/c – sale proceeds	1,60,000
Commission	16,000		
Balance c/d	1,42,000		
	1,60,000		1,60,000

Working Note:

(1) **Calculation of commission payable to Y**

	₹
Total Sale proceeds of Y	1,60,000
Surplus proceeds realised over ₹30 per meter [4,000 × (₹40 - 30)]	40,000
Commission:	
5% of total sale proceeds (5% of ₹1,60,000)	8,000
20% of Surplus (20% of ₹40,000)	8,000
	16,000

(2) **Stock on Consignment:**

Cost of consignment stock (1000 mtrs @ ₹20)	₹ 20,000
Less: Reduction of 10% due to fall in market price	₹ 2,000
	₹ 18,000
Add: Loading 50%	₹ 9,000
	₹ 27,000

Proportionate expenses incurred by the consignor have not been added to the cost of consignment stock as it has been valued at lower of cost or realisable value.

1996 - May [3] 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 percent on total sales plus a further 20 percent 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 percent.

Prepare the consignment account and the account of M/s Laxman Traders in the books of the consignor. (15 marks)

QR Code for Solution Video

Answer:

In the Books of M/s Ram & Co., Delhi
Consignment Account

Dr. Cr.

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Goods sent on Consignment A/c (12,000 × 240)	28,80,000	By Laxman Traders A/c (10,000 × 250)	25,00,000
To Bank (Expenses)	6,000	By Goods sent on Consignment (12,000 × 40)	4,80,000
To Laxman Traders (expenses)	2,000	By Stock on consignment	4,32,900
To Laxman Traders (Commission)	1,45,000		
To Stock Reserve	72,000		
To Net Profit (Profit on Consignment Transferred)	3,07,900		
	34,12,900		34,12,900

Laxman Traders Account

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Consignment A/c (sales)	25,00,000	By Consignment A/c	2,000
		By Consignment A/c (1)	1,45,000
		By Bank A/c	10,00,000
		By Balance c/d	13,53,000
	25,00,000		25,00,000

Working Note:

1. **Calculation of Commission Payable**

5% on 25,00,000	=	1,25,000
20% on 1,00,000	=	20,000
		1,45,000

2. **Valuation of closing stock on consignment**

2000 sarees @ ₹240	=	4,80,000
Add: Proportionate expenses		
$\frac{6,000 \times 2,000}{12,000}$		1,000
		4,81,000
Less: Reduction in cast by10 %		48,100
Value of closing stock		4,32,900

1997 - May [4] (Or) X of Calcutta on 15th January, 1997 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, 1997 and the selling expenses were ₹500 per television as and when the sale made by Y.

Y sold, on 4th March, 1997, 150 televisions at ₹14,000 per television and again on 10th April, 1997, 75 televisions at ₹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, 1997 by bank demand draft.

You are required to show the consignment account and Y's account in the books of X.

(15 marks)

Answer:

Consignment Account

Dr. Cr.

Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)
1997 Jan 15	To Goods Sent on Consignment A/c	25,00,000	1997 March 4	By Y A/c (Sales)	21,00,000
Jan 15	To Bank A/c	7,000	April 10	By Y A/c (Sales)	10,80,000
Jan 30	To Y A/c (Clearance expenses)	4,500	April 30	By Stock on Consignment A/c (2)	2,51,150
March 4	To Y A/c (Selling Expenses)	75,000			
April 10	To Y A/c (Selling Expenses)	37,500			
April 30	To Y A/c (Commission) (1)	1,63,500			
April 30	To Net Profit	6,43,650			
		34,31,150			34,31,150

Y (Bombay) Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
1997 March 4	To Consignment A/c	21,00,000	1997 Jan 30	By Consignment A/c	4,500
April 10	To Consignment A/c	10,80,000	March 4	By Consignment A/c	75,000
			April 1	By Consignment A/c	37,500
			April30	By Consignment A/c (1)	1,63,500
			April 30	By Bank A/c	28,99,500
		31,80,000			31,80,000

Working Notes :

1. **Computation of commission**

Let Total Commission be x

$x = 225 \times 500 + 1/4[(21,00,000 + 10,80,000 - x - (12,500 \times 225)]$

$x = 1,12,500 + 1/4\ [31,80,000 - x - 28,12,500]$

$x = 1,12,500 + 91,875 - \frac{x}{4}\ ;\ \ x + \frac{x}{4} = 1,12,500 + 91,875$

$\frac{5x}{4} = 2,04,375$

$x = 1,63,500$

Total Commission = ₹1,63,500

2. **Valuation of closing stock**

	₹
25 televisions @ ₹10,000	2,50,000
Add: Proportionate expenses of the consignor $\left(\frac{7,000 \times 25}{250}\right)$	700
Add: Proportionate clearance expenses paid by the consignee $\left(\frac{4,500 \times 25}{250}\right)$	450
	2,51,150

1998 - May [3] (Or) D of Delhi appointed A of Agra as its selling agent on the following terms:

(a) Goods to be sold at invoice price or over.

(b) A to be entitled to a commission of 7.5% on the invoice price and 20% of any surplus price realised.

(c) The principals to draw on the agent a 30 days bill for 80% of the invoice price.

On 1st February, 1998, one thousand cycles were consigned to A, each cycle costing ₹640 including freight and invoiced at ₹800.

Before 31st March, 1998, (when the principal's books are closed) A met his acceptance on the due date; sold off 820 cycles at an average price of ₹930 per cycle, the sale expenses being ₹12,500; and remitted the amount due by means of Bank Draft.

Twenty of the unsold cycles were shop-soiled and were to be valued at a depreciation of 50%.

Show by means of ledger accounts how these transactions would be recorded in the books of A, and find out the value of closing stock with A at which value D will should be there in consequent A/c account for the balance stock.

(15 marks)

QR Code for Solution Video

Answer:

D's Account

Dr. Cr.

Date	Particulars	Amt (₹)	Date	Particulars	Amt (₹)
1998 Feb. 1	To Bill Payable A/c (80% of ₹8,00,000)	6.40,000	1998 Mar 31	By Cash/Bank A/c (820 cycles × ₹930)	7,62,600
Mar. 31	To Cash A/c (Exp.)	12,500			
Mar. 31	To Commission A/c	70,520			
Mar. 31	To Bank A/c	39,580			
		7,62,600			7,62,600

Bills Payable Account

Dr. Cr.

Date	Particulars	Amt. ₹	Date	Particulars	Amt. ₹
1998 March 4	To Cash/Bank A/c	6,40,000	1998 Feb. 1	By D's A/c	6,40,000
		6,40,000			6,40,000

Value of Closing Stock with 'A'

	₹
160 cycles at ₹640 (cost price including freight)	1,02,400
20 Cycles shop-soiled at 50 % of ₹640 i.e. ₹ 320 each	6,400
Value of closing stock with A (net of effect of loading) at which D will account for in his books on 31st March, 1998.	1,08,800

Working Note:

Calculation of Commission

Particulars	₹
7.5% on the invoice price {7.5% of (820 × ₹800)}	49,200
20% of surplus price [20% of {820 × (₹930 - ₹800)}]	21,320
	70,520

1998 - Nov [3] 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 the 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.

You are required to prepare Consignment Account. Calculate the cost of stock at the end, abnormal loss and profit or loss on consignment.

(15 marks)

QR Code for Solution Video

Answer:

Abnormal Loss

	₹
Cost of packet lost during transit	900
Add: Expenses incurred by Y	100
	1,000
Less: Insurance claim received	570
Actual Loss	430

Cost of stock at the end

	₹
59 packets* @ ₹900	53,100
Add: Expenses incurred by Y (59 × ₹100)	5,900
Add: Proportionate (non-recurring) expenses incurred by the Consignee $\left(\frac{59}{799} \times ₹39{,}950\right)$	2,950
	61,950

*Closing stock

Packets consigned	800
Less: Packet lost in transit	1
	799
Less: Packets sold	740
	59

Consignment Account

Dr.	₹		Cr. ₹
To Goods sent on consignment A/c (800 × ₹900)	7,20,000	By Consignee's A/c (Sales: 740 × 100 × ₹12)	8,88,000
To Cash A/c (Expenses: 800 × ₹100)	80,000	By Cash A/c (Insurance claim)	570
To Consignee's A/c:		By Profit and Loss A/c (Abnormal loss)	430
Recurring Expenses	22,500		
Non-recurring Expenses	39,950	By Consignment Stock A/c	61,950
Commission @ 2% on ₹8,88,000	17,760		
Del-credere Commission @ 1% on ₹8,88,000	8,880		
To Profit and Loss A/c (Profit on consignment)	61,860		
	9,50,950		9,50,950

2000 - Nov [4] (a) A of Agra sent on consignment goods valued ₹1,00,000 to B of Bombay on 1st March, 1999. He incurred an expenditure of ₹12,000 on Freight and Insurance. A's accounting year closes on 31st December. B was entitled to a commission of 5% on gross sales plus a del-credere commission of 3 per cent. B took delivery of the consignment by incurring expenses of ₹3,000 for goods consigned.

On 31.12.1999, B informed on phone that he had sold all the goods for ₹1,50,000 by incurring selling expenses of ₹2,000. He further informed that only ₹1,48,000 had been realised and rest was considered irrecoverable, and would be sending the cheque in a day or so for the amount due alongwith the accounts sale.

On 5.1.2000, A received the cheque for the amount due from B and incurred bank charges of ₹260 for collecting the cheque. The amount was credited by the Bank on 9.1.2000.

Write up the Consignment account finding out the profit/loss on the consignment, B's A/c, Provision for Expenses A/c and Bank account in the books oi the consignor, recording the transactions upto the receipt and collection of the cheque. (9 marks)

QR Code for Solution Video

Answer:

Books of Mr. A
Consignment Account

Dr. Cr.

Date	Particulars		Amt (₹)	Date	Particulars	Amt (₹)
1999 Mar. 1	To Goods sent on Consignment A/c		1,00,000	1999 Dec. 31	By B's A/c	1,50,000

Date	Particulars		Amt (₹)	Date	Particulars	Amt (₹)
	To B's A/c					
	Clearance expenses	3,000				
	Selling expenses	2,000				
	Commission @ 5% on ₹1,50,000	7,500				
	Del-credere commission @ 3% on ₹1,50,000	4,500	17,000			
	To Cash A/c		12,000			
Dec. 31	To Provision for Bank charges		260			
	To Profit and Loss A/c		20,740			
			1,50,000			1,50,000

B's Account

Dr. Cr.

Date	Particulars	Amt (₹)	Date	Particulars		Amt (₹)
1999 Dec. 31	To Consignment A/c	1,50,000	1999 Dec. 31	By Consignment A/c		
				Clearance Expenses	3,000	
				Selling Expenses	2,000	
				Commission	7,500	
				Del-credere commission	4,500	17,000
				By Balance c/d		1,33,000
		1,50,000				1,50,000
2000 Jan 1	To Balance b/d	1,33,000	2000 Jan. 5	By Bank A/c		1,33,000

Bank Account

Date	Particulars	Amt (₹)	Date	Particulars	Amt (₹)
2000 Jan. 5	To B's Account	1,33,000	2000 Jan. 5	By Consignment A/c	260
			Jan. 5	By Balance C/d	1,32,740
		1,33,000			1,33,000

2003 - May [2] (a) '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%.

Prepare the consignment Account in the books of 'X' and their account in the books of the agent 'Y' of Agra. (12 marks)

Answer:

In the Books of X

Consignment Account

Dr. Cr.

		Amount (₹)		Amount (₹)
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 (6,000 × ₹20)	1,20,000
To Y - Selling Expenses	1,000			
Commission (W.N. 1)	36,250	37,250		
To Stock Reserve (W.N. 3)		18,000	By Stock on Consignment (W.N. 2)	1,08,450
To Net Profit		75,200		
		8,53,450		8,53,450

In the Books of 'Y' of Agra

X's Account

	₹		₹
To Bank A/c – Expenses	1,000	By Bank A/c – Sale	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:

		₹
1.	Commission Payable 5% on ₹6,25,000	31,250
	20% on ₹(6,25,000 - 6,00,000 = 25,000)	5,000
		36,250
2.	Valuation of Closing Stock on Consignment	
	1,000 sarees × ₹120	1,20,000
	Add: Proportionate expenses ₹3,000 × $\frac{1,000}{6,000}$ =	500
		1,20,500
	Less: 10%	12,050
	Value of Closing Stock	1,08,450
3.	Loading on Closing Stock (Stock Reserve)	
	1,000 sarees × ₹20	20,000
	Less: 10%	2,000
		18,000

2004 - May [2] (b) Mr. Anand consigned 800 packets of soaps, each packet containing 100 soaps. Cost price of each packet was ₹900. Mr. Anand spent ₹100 per packet as cartage, freight, insurance and forwarding charges. One packet was lost on the way and Mr. Anand lodged claim with the 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 soap. He was entitled to 2% commission on sales plus 1% del-credere commission.

You are required to prepare Consignment Account. Calculate the cost of stock at the end, Abnormal loss and Profit-Loss on consignment.

(10 marks)

QR Code for Solution Video

Answer:

Consignment A/c

Dr. Particulars	Amount (₹)	Particulars	Cr. Amount (₹)
To Goods sent on consignment A/c (800 × ₹900)	7,20,000	By Consignee's A/c - Sales (740 × 100 × ₹12)	8,88,000
To Cash A/c - Expenses (800 × ₹100)	80,000	By Profit & Loss A/c (Abnormal Loss)	430
To Consignee's A/c:		By Cash A/c (Insurance Claim)	570
Recurring Expenses	22,500	By Consignment Stock A/c	61,950
Non-Recurring Expenses	39,950		
Ordinary Commission (0.02 × ₹8,88,000)	17,760		
Del-Credere Commission (0.01 × ₹8,88,000)	8,880		
To Profit & Loss A/c (Profit on consignment)	61,860		
	9,50,950		9,50,950

Cost of Stock at the end

	₹
59 Packets* @ ₹900	53,100
Add: Expenses incurred by Mr. Anand (59 × ₹100)	5,900
Add: Proportionate (non-recurring) expenses incurred by the consignee $\left(\frac{59}{799} \times ₹39,950\right)$	2,950
	61,950

*Closing stock

Packets consigned	800
Less: Packet lost in transit	1
	799
Less: Packets sold	740
	59

Abnormal Loss	₹
Cost of packet lost during transit	900
Add: Expenses incurred by Mr. Anand	100
	1,000
Less: Insurance claim received	570
	430

2005 - May.[2] (a) Mr. A of Assam sent on 18th February, 2004 a consignment of 1,000 DVD players 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, 2004, 600 DVD Players @ ₹160 per DVD Player and again on 20th May, 2004, 300 DVD Players @ ₹170.

B is entitled to a commission of ₹25 per DVD Player sold plus 1/4 of 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, 2004.

You are requested to show the consignment account and B's account in the books of A. (10 marks)

QR Code for Solution Video

Answer:

In the books of A

Consignment Account

Dr. Date	Particulars	Amount ₹	Date	Particulars	Cr. Amount ₹
2004 Feb. 18	To Goods sent on consignment account	1,00,000	2004 Mar. 15	By B's account (Sales) (600 × ₹160)	96,000

Feb 18	To Cash account (Expenses)	1,500	May 20	By B's account (Sales) (300 × ₹170)	51,000
	To B's account (Clearance charges)	3,000	June 30	By Consignment Stock (W. N.-2)	10,450
June 30	To B's account (Selling expenses) i.e. (900 × ₹20)	18,000			
	To Commission (W. N.-1)	24,900			
June 30	To Profit and loss account	10,050			
		1,57,450			1,57,450

B's Account

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2004 Mar. 15	To Consignment account (Sales)	96,000	2004 Feb 18	By Consignment account (Clearance charges)	3,000
May 20	To Consignment account (Sales)	51,000	June 30	By Consignment account: Selling expenses	18,000
				Commission	24,900
			June 30	By Cash account	1,01,100
		1,47,000			1,47,000

Working Notes:

1. **Computation of total commission:**

   Let total commission paid/payable be x.

   $$x = 900 \times ₹25 + \frac{1}{4}[(₹96,000 + ₹51,000) - x - (900 \times ₹125)]$$

   $$x = ₹22,500 + \frac{1}{4}[₹1,47,000 - x - ₹1,12,500]$$

   $$x = ₹22,500 + \frac{1}{4}[₹34,500 - x];\ 4x = ₹90,000 + ₹34,500 - x$$

   $$4x + x = ₹90,000 + ₹34,500$$

   $$5x = ₹1,24,500$$

   $$x = ₹24,900$$

2. **Computation of value of the stock:**

		₹
100 DVD players @ ₹100 each		10,000
Add: Proportionate expenses of A	$\frac{(₹1,500 \times 100)}{1,000}$	150
Proportionate expenses paid by B	$\frac{(₹3,000 \times 100)}{1,000}$	300
		10,450

2006 - May [2] (b) 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 consignor. S took delivery of consignment and accepted a bill drawn upon him by M for ₹50,000. S reported as follow :

(i) 3,750 kg. of oil was sold at ₹30 per kg.

(ii) His expenses were — Godown rent ₹10,000; Wages ₹1,000; Printing and Stationery ₹5,000.

(iii) 125 kg. of oil was 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 Abnormal Loss Account in the books of M.

(9 marks)

Answer:

In the books of M

Consignment A/c

	₹		₹
To Goods sent on Consignment Account (5,000 × 20)	1,00,000	By S's Account (Sales) (3,750 × 30)	1,12,500
		By Abnormal Loss Account	3,125

To Bank Account - Freight & Insurance		25,000	By Consignment Stock Account		25,658
To S's Account:			By Loss on Consignment transferred to Profit & Loss Account		5,342
Godown Rent	10,000				
Wages	1,000				
Printing & Stationery	5,000				
Commission (1,12,500 × 5/100)	5,625	21,625			
		1,46,625			1,46,625

S's Account

	₹			₹
To Consignment Account (Sales)	1,12,500	By Bills Receivable Account		50,000
		By Consignment Account		
		Godown Rent	10,000	
		Wages	1,000	
		Printing & Stationary	5,000	
		Commission	5,625	21,625
		By Bank Account (Balancing figure)		40,875
	1,12,500			1,12,500

Abnormal Loss Account

	₹		₹
To Consignment Account (Loss in Transit)	3,125	By Bank Account (Insurance Claim)	2,250
		By Profit & Loss Account	875
	3,125		3,125

Working Notes:

1. **Valuation of goods destroyed in transit**

	₹
Cost Price of 125 kg. of oil @ ₹20 per kg. (125 × 20)	2,500
Add: Proportionate expenses of M (25,000 × 125/5,000)	625
Abnormal Loss	3,125

2. **Valuation of consignment stock**

	₹
Cost Price of 5,000 kg. of oil @ ₹20 per kg. (5,000 × 20)	1,00,000
Add: Expenses paid by Consignor	25,000
Total Cost	1,25,000

Less: Abnormal Loss (calculated as above)	3,125
Value of 4,750 of oil ₹(5,000 - 125 - 125)	1,21,875
Balance of Stock with S = 5,000 kg. - 125 kg. - 3,750 kg. - 125 kg.	1000 kg.

Value of Consignment Stock = ₹1,21,875 × 1,000/4,750
= ₹25,658 (approx.)

2006 - Nov [2] (b) M/s Polypack and company's financial year ends on 31st March, 2006. Their actual physical stock as on 31st March was ₹6,25,000 (net realizable value ₹6,40,000).

Following information regarding stock is also available:

(i) Goods costing ₹40,000 were damaged badly and it was expected that only ₹5,000 could be realized.

(ii) Goods costing ₹25,000 were sold on sale or return basis for which no confirmation has been received till 31st March, 2006. Invoice value of these goods was ₹30,000

(iii) Goods were sent on consignment to Mr. B at invoice value (120% of cost) ₹1,50,000 on 31st March, 2006. He informed that half of the material remains unsold.

You are required to ascertain the value of closing stock as on 31st March, 2006 as per AS 2. (5 marks)

Answer:

M/s Polypack & Company
Calculation of closing stock on 31st March, 2006

		Amount (₹)
Stock as on 31st March, 2006		6,25,000
Add: (a) Goods on sale or return basis	25,000	
(b) Goods unsold with consignee $\left(\frac{1,50,000}{120\%} \times 50\right)$	62,500	87,500
		7,12,500
Less: Reduction in value of stock due to badly damaged goods ₹(40,000 – 5,000)		35,000
Value of Closing Stock		6,77,500

2018 - May [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:

Particulars	₹
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)

QR Code for Solution Video

Answer:

In the books of Shri Ganpath

Consignment to Rawat of Jaipur Account

Particulars	₹	Particulars	₹
To Goods sent on Consignment	7,50,000	By Rawat (Sales)	7,35,000
To Bank (Expenses: 15,000 + 45,000 + 15,000)	75,000	By Goods lost in Transit 50 cases @ ₹1,650 each*	82,500
To Rawat (Expenses: 18,000 + 25,000 + 7,000)	50,000	By Consignment Inventories: In hand 50 @ ₹ 1,695 each	84,750
To Rawat (Commission)	73,500	By Consignment Inventories: In transit 50 @ ₹ 1,650 each**	82,500
To Profit on Consignment trf to Profit & Loss A/c	36,250		
	9,84,750		9,84,750

* Considered as abnormal loss.

** The goods in transit (50 cases) have not yet been cleared. Hence the proportionate clearing charges on those goods have not been included in their value.

Rawat's Account

Particulars	₹	Particulars	₹
To Consignment to Jaipur A/c	7,35,000	By Consignment A/c (Expenses)	50,000
		By Consignment A/c (Commission)	73,500
		By Balance c/d	6,11,500
	7,35,000		7,35,000

Working Notes:

(i) Consignor's expenses on 500 cases amounts to ₹75,000; it comes to ₹150 per case. The cost of cases lost will be computed at ₹1,650 per case.

(ii) Rawat has incurred ₹18,000 on clearing 400 cases, i.e., ₹45 per case; while valuing closing inventories with the agent ₹45 per case has been added to cases in hand with the agent.

(iii) It has been assumed that balance of ₹6,11,500 is not yet paid.

2018 - Nov [4] (a) Raj of Gwalior consigned 15,000 kgs. of Ghee at ₹30 per kg. to his agent Siraj at Delhi. He spent ₹5 per kg. as freight and insurance for sending the Ghee at Delhi. On the way, 100 kgs. of Ghee was lost due to the leakage (which is to be treated as normal loss) and 400 kgs. of Ghee was destroyed in transit. ₹9,000 was paid to consignor directly by the Insurance company as Insurance claim.

Siraj sold 7,500 kgs. at ₹60 per kg. He spent ₹33,000 on advertisement and recurring expenses.

You are required to calculate:

(i) The amount of abnormal loss;

(ii) Value of stock at the end; and

(iii) Prepare Consignment account showing profit or loss on consignment, if Siraj is entitled to 5% commission on sales. (10 marks)

QR Code for Solution Video

Answer:

Consignment Account

	₹		₹
To Goods sent on Consignment A/c (15,000 kg. × ₹30)	4,50,000	By Consignee's A/c - Sales (7,500 kg. × ₹60)	4,50,000
To Cash A/c (Expenses 15,000 kg. × ₹5)	75,000	By Abnormal Loss A/c	14,094
To Consignee's A/c:		(Insurance claim - WN) 9,000	
Advertisement & Recurring expenses	33,000	*Add:* Abnormal Loss (WN) 5,000	14,000
Commission @ 5% on ₹4,50,000	22,500	(Profit and Loss Account)	
To Profit and loss A/c	1,30,190	By Consignment Stock A/c	2,46,690
(Profit on Consignment)			
	7,10,690		7,10,690

Working Notes:

1. Abnormal Loss:

Cost of goods lost: 400 kg.	
Total cost (400 × ₹30)	12,000
Add: Expenses incurred by the consignor @ ₹5 per kg.	2,000
Gross Amount of abnormal loss	14,000
Less: Insurance claim	(9,000)
Net abnormal loss	5,000

2. Valuation of Inventories

	Quantity (Kgs)	Amount (₹)
Total Cost (15,000 kg. × ₹30)	15,000	4,50,000
Add: Expenses incurred by the consignor		75,000
Less: Value of Abnormal Loss - 400 kgs (WN 1)	(400)	(14,000)
	14,600	5,11,000
Less: Normal Loss	(100)	
	14,500	5,11,000

Less: Quantity of ghee sold	(7,500)	
Quantity of Closing Stock	7,000	
Value of 7,000 kgs - (5,11,000/14,500) × 7,000		2,46,690

2019 - Nov [3] (a) Anand of Bangalore consigned to Raj of pune, goods to be sold at invoice price which represents 125% of cost. Raj 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 Anand were ₹12,000. The account sales received by Anand shows that Raj has effected sales amounting to ₹1,20,000 in respect of 75% of the consignment. His selling expenses to be reimbursed were ₹9,600. 10% of consignment goods of the value of ₹15,000 were destroyed in fire at the Pune godown and the insurance company paid ₹12,000 net of salvage. Raj remitted the balance in favour of Anand.

You are required to prepare Consignment Account and the account of Raj in the books of Anand along with the necessary calculations. (10 marks)

Answer:

In the books of Anand

Consignment A/c

Particulars	₹	Particulars	₹
To Goods Sent on Consignment (W.N.1)	1,50,000	By Goods Sent on Consignment (Loading)	30,000
To Bank - Expenses	12,000	(₹ 1,50,000 × 25/125)	
To Raj - Selling Expenses	9,600	By Raj - Sales	1,20,000
To Raj-Commission (W.N.2)	13,125	By Abnormal Loss (W.N.3)	12,000
To Stock Reserve (W.N.4)	4,500	(Insurance Claim)	
		By Abnormal Loss (W.N. 3)	1,200
		(Profit & Loss A/c)	
		By Consignment Stock (W.N. 4)	24,300
		By Profit & Loss A/c - Loss trf.	1,725
	1,89,225		1,89,225

Raj's A/c

Particulars	₹	Particulars	₹
To Consignment A/c - Sales	1,20,000	By Consignment A/c - Selling Expenses	9,600
		By Consignment A/c - Commission	13,125
		By Bank A/c	97,275
	1,20,000		1,20,000

Working Notes:

W.N. 1 - Calculation of Goods Sent on Consignment

Particulars	₹
Abnormal Loss	15,000
This represents 10% of the total consignment.	
Total Goods Sent on Consignment (₹ 15,000 ÷ 10%)	1,50,000

W.N. 2 - Calculation of Commission

Particulars	₹
Invoice value of 100% goods	1,50,000
Invoice value of 75% goods	1,12,500
Simple Commission (10% on Invoice Price)	11,250
Add: Over-riding Commission {25% × (₹ 1,20,000 – ₹ 1,12,500)}	1,875
Total Commission	13,125

W.N. 3 - Calculation of Abnormal Loss

Particulars	₹
Invoice Value of Abnormal Loss (10%)	15,000
Cost of Abnormal Loss (₹ 15,000 × 100/125)	12,000
Add: Proportionate Direct Expenses (10% × ₹ 12,000)	1,200
Total Cost of Abnormal Loss	13,200
Less: Insurance Claim	12,000
Net Abnormal Loss	1,200

W.N. 4 - Calculation of Closing Stock

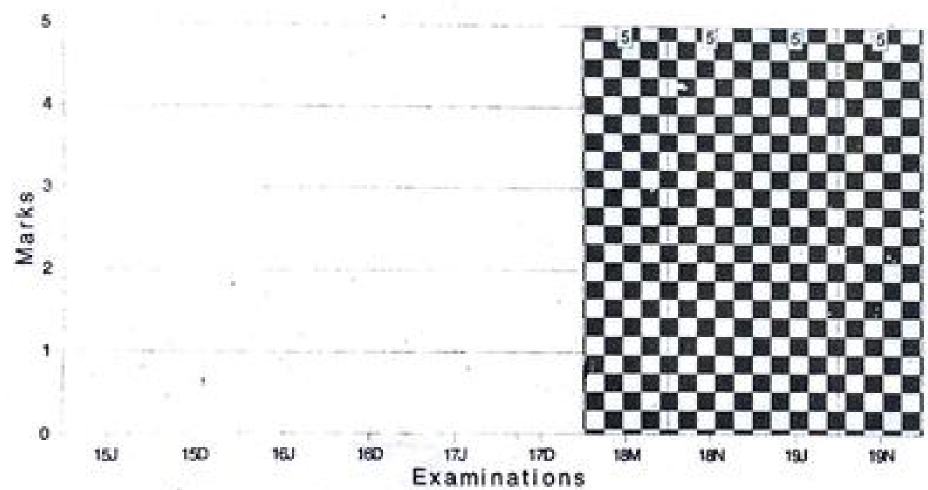
Particulars	₹
Invoice value of 100% Goods	1,50,000
Invoice value of 15% Goods	22,500
Cost of 15% Goods (₹ 22,500 × 100/125)	18,000
Add: Proportionate Direct Expenses (15% × ₹ 12,000)	1,800
Total Cost of Closing Stock	19,800
Add: Stock Reserve (Profit) (₹ 22,500 – ₹ 18,000)	4,500
Invoice Value of Closing Stock	24,300

CHAPTER	
6	**Accounting for Special Transactions**
Unit: 4	**Average Due Date**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



For detailed analysis Login at *www.scannerclasses.com* for registration and password see first page of this book.

SELF STUDY NOTES

Q1. What do you understand by Average due date? What are the steps for calculating it?

Answer:

Average due date is a single equivalent date on which a person can pay all amounts due from him without any loss or gain of interest. It is the weighted average of due dates with equal or unequal amount.

Circumstances where average due date is used:

1. Calculation of interest on drawings in case of partnership
2. Settlement of accounts of principal and agent
3. Cancellation of multiple bills of exchange by settling amount through single payment
4. Settling contra accounts.

Formula:

$$\text{Average due date} = \text{Base date} + \frac{\text{Total of the Products}}{\text{Total of the Amounts}}$$

In case the payment is made at a date other than the average due date, party is entitled to receive interest on delayed payment.

Steps for calculating Average Due Date:

1. Selection of the due date as the base date. Its better to take first due date as the base date.
2. Calculate number of intervening days between base date and due date of every transaction, ignoring the first date and including the last date.
3. Multiply the days calculated in step 2 by respective due amounts.
4. Divide the same by total amount.
5. Add the resultant number of days to the base date to arrive at average due date.

Q2. What do you understand by the terms "Due Date" and "Date of Maturity"? How is the Date of Maturity calculated in different situations?

Answer:

Concept of Due Date/Date of Maturity

The date on which the term of the bill expires is known as the Due Date of the bill. Date of Maturity is arrived at, after adding a grace period of three days to the Due Date. In exams, the terms "Due Date" and "Date of Maturity" are used interchangeably.

Calculation of Date of Maturity of a Bill

Date of Maturity = Due Date + 3 Days Grace

	Case	Date of Maturity
1.	When the bill is made payable on a specific date.	That specific date + 3 Days Grace.
2.	When the bill is made payable at a **stated number of month(s)** after date.	The date on which the term of the bill shall expire. **Note the following examples:**

	Case	Date of Maturity
1.	A Bill is drawn on 30^{th} April payable 2 months after date.	The due date will be 30^{th} June. The date of maturity will be 3^{rd} July.
2.	A Bill is drawn on 15^{th} April payable 3 months after date.	The due date will be 15^{th} June. The date of maturity will be 18^{th} June.
3.	A Bill is drawn on 31^{st} January, 2016 payable 1 month after date.	In this case, one month would technically end on 31^{st} February, but we all know February doesn't have 31 days. In 2016, February had 29 days, so, the due date will be 29th February.

	Case	Date of Maturity
		Adding three days' grace, the date of maturity will be 3^{rd} March.
4.	A Bill is drawn on 31^{st} January, 2017 payable 1 month after date.	In this case, one month would technically end on 31^{st} February, but we all know that February doesn't have 31 days. In 2017, February had 28 days, so, the due date will be 28^{th} February. Adding three days' grace, the date of maturity would be 3rd March.

	Case	Date of Maturity
3.	When the bill is made payable at a **stated number of days** after date.	The date which comes after adding the stated number of days. **Example** – A bill is drawn on 1^{st} April payable 90 days after date. **Solution** – 29 days of April + 31 days of May + 30 days of June = 30^{th} June is the due date. The date of maturity will be 3rd July. **Note – The date of drawing the bill is excluded; that is why, 1^{st} April has been excluded in the above example while calculating the days.**
4.	When the date of maturity is a public holiday.	The working day preceding the public holiday.
5.	When the date of maturity is a holiday due to unforeseen emergency.	The next business day.

Types of Problems

Type 1: Calculation of average due date where one party is involved.

Example:

Janvi owed following sum:

	Due Date	Amount (₹)
1.	20.01.2017	4,000
2.	10.02.2017	3,000
3.	25.03.2017	6,000
4.	18.04.2017	7,000

Calculate the date on which she should make lumpsum payment without any loss or gain of interest.

Solution:

(A) Amount	(B) Due date	(C) No. of days from base date	(D) Product [A × C]
4,000	20.01.2017	0	0
3,000	10.02.2017	21	63,000
6,000	25.03.2017	64	3,84,000
7,000	18.04.2014	88	6,16,000
20,000			**10,63,000**

$$\text{Average due date} = \text{Base date} + \frac{\text{Total of Products}}{\text{Total of Amounts}}$$

$$= 20.01.2017 + \left[\frac{10,63,000}{20,000}\right]$$

$$= 20.01.2017 + 54 \text{ days}$$

$$= 15.03.2017$$

Type 2: Calculation of Average due date where transactions between two parties are involved.

Example:

Mr. Green and Mr. Red had the following mutual dealings and desire to settle their account 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. (28 days in Feb.).

Solution:

Calculation of Average Due Date

Taking 6th January, 2016 as base date

For Green's payments

Due date	Amount	No. of days from the base date i.e. 6th Jan. 2016	Product
2016	₹		
6th January	6,000	0	0
2nd February	2,800	27	75,600
31st March	2,000	84	1,68,000
Total	10,800		2,43,600
For Red's payment			
2016			
6th January	6,600	0	0
9th March	2,400	62	1,48,800
20th March	500	73	36,500
Total	9,500		1,85,300

Excess of Green's products over Red's = ₹2,43,600 - ₹1,85,300 = ₹58,300
= ₹10,800 - ₹9,500 = ₹1,300

Number of days from the base date to the date of settlement is 58,300/1,300 = 45 days (approx.)

Hence, the date of settlement of the balance amount is 45 days after 6th January i.e. on 20th February.

On 20th February, 2016, Green has to pay Red ₹1,300 to settle the account.

Type 3: Calculation of average due date when amount is repaid in instalments:

Example:

Sandy lent to Manish ₹10,000 on Jan 1st, 2015. Calculated average due date @ 15% p.a. assuming loan is repayable in 5 equal annual instalments commencing from 1st Jan, 2017.

Solution

Instalments	Due Date	Year since 1st Jan, 2015
1	1.1.2017	2
2	1.1.2018	3
3	1.1.2019	4
4	1.1.2020	5
5	1.1.2021	6
		20

Average Due Date $= \text{Date of Loan} + \frac{2+3+4+5+6}{5}$

= 1st Jan 2015 + 4 Years

= 1st Jan 2019.

Interest to be charged for 4 years from Jan 1st 2015 to Jan 1st 2019

$= 10{,}000 \times 4 \times \frac{15}{100} = ₹6{,}000$

Type 4: Calculation of average due date for determining interest on drawings.

Example:

Mr. X and Y are two partners of the firm, Mr. X withdrawn following amounts from firm in year ending 30th June, 2016.

Date	Amount
Jan 15	5,000
Feb 10	4,000
Apr 5	8,000
May 20	10,000
June 18	9,000

Interest on drawing is charged @ 10% p.a. Find the average due date and calculate the interest on drawing to be charged on 30th June,2017

Solution:

Calculation of average due date: Base date: Jan 15.

Date	Amount	No. of days	Product
Jan 15	5,000	0	0
Feb 10	4,000	26	1,04,000
Apr 5	8,000	81	6,48,000
May 20	10,000	126	12,60,000
June 18	9,000	155	13,95,000
	36,000		**34,07,000**

Average due date $= 15 \text{ Jan} + \frac{34{,}07{,}000}{36{,}000}$

= 15 Jan + 95 days = 19th Apr, 2017

19th April — 30th June = 72 days.

Interest on drawings:

$= 36{,}000 \times \frac{72}{366} \times \frac{10}{100} = ₹708$

Thus, 710 will be charged from Mr. X on 30th June as interest on drawings.

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. If maturity day is a public holiday, due date will be:
   (a) Following business day
   (b) Base date
   (c) Preceding business day
   (d) Same day in next week
2. Grace days added to bill payable at sight are:
   (a) Zero (b) One
   (c) Two (d) Three
3. If amount is paid before due date:
   (a) Interest is charged (b) Rebate is given
   (c) Either (a) or (b) (d) None of these.
4. In case of emergency or unforseen holiday, due date will be:
   (a) Preceding business day
   (b) Day preceding the previous day
   (c) Next following day
   (d) None of these.
5. A bill was due on 12.8.2017. What will be maturity date including days of grace?
   (a) 14.8.2017 (b) 15.8.2017
   (c) 16.8.2017 (d) 12.8.2017
6. A machine is purchased for ₹5,00,000 on 1st April, 2002 on hire-purchase basis. What is the average due date, if amount is repaid in 5 yearly annual installments starting from 1st April, 2003.
   (a) 1.4.05 (b) 1.4.04
   (c) 1.4.03 (d) 1.4.07

ANSWER

1.	(c)	**2.**	(a)	**3.**	(b)	**4.**	(c)	**5.**	(a)
6.	(a)								

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

1995 - Nov [5] State with reasons whether the following statement is true or false:

(7) If payment is made on the average due date, it results in loss of interest to creditors. (1.5 marks)

Answer:

False: Such payment neither results in loss of interest to the creditors not to the debtors. It compensates the loss or gain of interest.

1999 - May [5] State with reasons whether the following statement is true or false:

(i) Average due date is the median average of several due dates for payments. (2 marks)

Answer:

False: Average due date is an equated date for several due dates of payments.

1999 - May [5] State with reasons whether the following statement is true or false:

(vi) If payment is made on the average due date it results in loss of interest to the creditor. (2 marks)

Answer:

False: Average due date is a 'no loss or gain' date to either party, i.e., neither the debtor nor the creditor stands to lose or gain anything by way of interest.

1999 - May [5] State with reasons whether the following statement is true or false:

(viii) In the calculation of average due date, only the due date of the first transaction must be taken, as the base date. (2 marks)

Answer:

False: Due date of any transaction can be taken as the base date. However, it is preferable to take the due date of first transaction as the base date.

2003 - Nov [5] State with reasons whether the following statement is true or false:

(ix) In the calculation of average due date, only the due date of the first transaction must be taken as the base date. (2 marks)

Answer:

False: While calculating the average due date, any transaction date may be taken as the base date.

DESCRIPTIVE QUESTIONS

2014 - May [7] Answer the following:

(c) Define Average Due Date. List out the various instances when Average Due Date can be used. (4 marks)

Answer:

Meaning of Average Due Date

- In business enterprises, a large number of receipts and payments by and from a single party may occur at different points of time.
- Therefore, to simplify the calculation of interest involved in such transactions, the idea of average due date has been developed.

- Average Due Date is a break-even date, on which the net amount payable can be settled, without causing loss of interest either to the borrower or the lender.

Following are a few instances where average due date can be used:

- Calculation of interest on drawings made by the proprietors or partners of a business firm at several points of time.
- Settlement of accounts between a principal and an agent.
- Settlement of contra accounts, that is, A and B sell goods to each other on different dates.

PRACTICAL QUESTIONS

1995 - Nov [3] (Or) Calculate Average Due Date from the following information:

Date of the bill	*Term*	*Amount* ₹
August 10, 1994	3 months	6,000
October 23, 1994	60 days	5,000
December 4, 1994	2 months	4,000
January 14, 1995	60 days	2,000
March 8, 1995	2 months	3,000

(15 marks)

QR Code for Solution Video

Answer:

Calculation of Average Due Date
Taking 13th November, 1994 as the Base Date

Date of Bill	Term	Due Date	No. of Days from Base Date	Amount ₹	Product
10-8-1994	3 months	13-111994	–	6,000	–
23-10-1994	60 days	25-12-1994	42	5,000	2,10,000
04-12-1994	2 months	07-02-1995	86	4,000	3,44,000
14-01-1995	60 days	18-03-1995	124	2,000	2,48,000
08-03-1995	2 months	11-05-1995	178	3,000	5,34,000
				20,000	13,36,000

$$\text{Average Due Date} = \text{Base Date} + \frac{\text{Total of Product}}{\text{Total of Amounts}}$$

$$= 13.11.1994 + \frac{13,36,000}{20,000}$$

$= 13.11.1994 + 66.8$ days

$= 13.11.1994 + 67$ days

$= 19.01.1995$

1996 - Nov [3] (b) Hari owes Ram ₹2,000 on 1st April, 1996. From 1st April, 1996 to 30th June, 1996 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, 1996. Calculate the interest payable on 30th June, 1996 by the Average due-date method. (5 marks)

Answer:

Calculation of Average Due Date

Due Dates	Amount ₹	No. of Days from April 1	Products
April1, 1996	2,000	0	0
April 10, 1996	5,000	9	45,000
May 16, 1996	10,000	45	4,50,000
June 9, 1996	3,000	69	2,07,000
Total	20,000		7,02,000

$$\text{Average Due Date} = \text{Base Date} + \text{Days equal to } \frac{\text{Total of Product}}{\text{Total of Amount}}$$

$$\text{Average Due Date} = 1^{st}\text{ April} + \frac{7,02,000}{20,000}$$

$= 1^{st}$ April + 36 days

$= 7^{th}$ May, 1996

Interest therefore has been calculated on ₹20,000 from 6th May, 1996 i.e.,

$$\text{Interest} = 20,000 \times \frac{15}{100} \times \frac{55}{366} = ₹450.82$$

1997 - Nov [4] (Or) (b) Calculate Average Due Date from the following information:

Date of the bill			Term	Amount ₹
August	10,	1996	3 Months	6,000
October	23,	1996	60 Days	5,000
December	4,	1996	2 Months	4,000
January	14,	1997	60 Days	2,000
March	8,	1997	2 Months	3,000

(10 marks)

QR Code for Solution Video

Answer:

Calculation of Average Due Date
Taking 13th November, 1996 as the Base Date

Date of Bill	Term	Due Date	No. of Days from Base Date	Amount ₹	Product
10-08-1996	3, months	13-11-1996	–	6,000	–
23-10-1996	60 days	25-12-1996	42	5,000	2,10,000
04-12-1996	2 months	07-02-1997	86	4,000	3,44,000
14-01-1997	60 days	18-03-1997	124	2,000	2,48,000
08-03-1997	2 months	11-05-1997	178	3,000	5,34,000
				20,000	13,36,000

Average Due Date $= \text{Base date} + \frac{\text{Total of Products}}{\text{Total of Amounts}}$

$= 13.11.1996 + \frac{13,36,000}{20,000}$

$= 13.11.1996 + 66.8$ days

$= 13.11.1996 + 67$ days

$= 19.01.1997$

2000 - Nov [3] (b) E owes to F the following amounts:

(i) ₹5,000 due on 10th March, 1999

(ii) ₹18,000 due on 2nd April, 1999

(iii) ₹60,000 due on 30th April, 1999

(iv) ₹2,000 due on 10th June, 1999.

He desires to make full payment on 30th June, 1999 with interest at 10% per annum from the average due date. Find out the average due date and the amount of interest. (6 marks)

Answer:

Calculation of Average Due Date
Taking 10th March, 1999 as the Base Date

Due Date	Amount (₹)	No. of days from the base date i.e., 10th March	Product
10th March	5,000	0	0
2nd April	18,000	23	4,14,000
30th April	60,000	51	30,60,000
10th June	2,000	92	1,84,000
Total	85,000		36,58,000

Average due date $= \text{Base date} + \text{days equal to } \frac{\text{Sum of Product}}{\text{Sum of Amount}}$

$= 10^{th} \text{ March} + \frac{36,58,000}{85,000}$ i.e. 44 days (approx.)

$= 23^{rd}$ April, 1999

Computation of Interest: Interest can be calculated on ₹85,000 from 23rd April, 1999 to 30th June, 1999 at 10% p.a. i.e., interest on ₹85,000 for 68 days at 10%:

$= ₹85,000 \times \frac{10}{100} \times \frac{68}{365}$

$= ₹1,583.56$

2002 - Nov [3] (b) Calculate average due date from the following informations:

Date of Bill	Term	Amount ₹
1st March, 2002	2 months	4,000
10th March, 2002	3 months	3,000
5th April, 2002	2 months	2,000
20th April, 2002	1 months	3,750
10th May, 2002	2 months	5,000

(7 marks)

QR Code for Solution Video

Answer:

Calculation of Average Due Date
(Taking 4th May, 2002 as the base date)

Date of Bill 2002	Term	Due Date 2002	Amount	No. of Days from the base date i.e. May 4	Product
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 months	23rd May	3,750	19	71,250
10th May	2 months	13th July	5,000	70	3,50,000
			17,750		6,11,250

Average Due Date = Base Date + days equal to $\frac{\text{Sum of products}}{\text{Sum of amounts}}$

$= 4^{th}$ May 2002 + $\frac{6,11,250}{17,750}$ i.e. 35 days (approx)

$= 8^{th}$ June, 2002.

2004 - Nov [2] (a) Calculate average due date from the following informations:

Date of Bill	Term	Amount ₹	
16 August, 03	3 months	3,000	
20 October, 03	60 days	2,500	
14 December, 03	2 months	2,000	
24 January, 04	60 days	1,000	
06 March, 04	2 months	1,500	(6 marks)

Answer:

Bill Date (A)	(B) Amount ₹	(C) Term	Due date (D) (Including grace period)	No. of days (Taking (E) 19 Nov 03 as base)	Product (F) = (B) x (E) (₹)
16 Aug, 2003	3,000	3 Months	19 Nov 03	0	0
20 Oct, 2003	2,500	60 Days	22 Dec, 03	33	82,500
14 Dec, 2003	2,000	2 Months	17 Feb 04	90	1,80,000
24 Jan, 2004	1,000	60 Days	27 March 04	129	1,29,000
06 March, 2004	1,500	2 Months	09 May 04	172	2,58,000
	10,000				6,49,500

Average due date = Base date + Days equal to $\frac{\text{Sum of Product}}{\text{Sum of Amount}}$

= 19 Nov, 03 + $\frac{6,49,500}{10,000}$

= 19 Nov, 03 + 65 days (approx)

= 23 Jan, 2004

2012 - May [7] Answer the following:

(a) M/s. Stairs & Co. draw upon M/s Marble & Co. several bills of exchange due for payment on different dates as under:

Date of Bill	Amount (₹)	Tenure of Bill
12th May	44,000	3 months
10th June	45,000	4 months
1st July	14,000	1 month
19th July	17,000	2 months

Find out the average due date on which payment may be made in one single amount by M/s Marble & Co. to M/s Stairs & Co. 15th August, Independence Day, is national holiday and 22nd September declared emergency holiday, due to death of a national leader. (4 marks)

Answer:

Calculation of Average Due Date
(Taking 4th August as the base date)

Date of bill	Term	Due date	Amount ₹	No. of days from the base date i.e. 4th August	Product
12th May	3 months	14th August	44,000	10	4,40,000
10th June	4 months	13th October	45,000	70	31,50,000
1st July	1 month	4th August	14,000	0	0
19th July	2 months	23rd September	17,000	50	8,50,000
			1,20,000		**44,40,000**

Average due date = Base date + Days equal to $\frac{\text{Total of products}}{\text{Total amount}}$

= 4th August + $\frac{44,40,000}{1,20,000}$

= 4th August + 37 days = 10th September

2012 - Nov [7] Answer the following:

(a) T owes to K the following amounts:

₹7,000 due on 15th March, 2012

₹12,000 due on 5th April, 2012

₹30,000 due on 25th April, 2012

₹20,000 due on 11th June, 2012

He desires to make the full payment on 30th June, 2012 along with interest @ 10% per annum from the average due date. Find out the average due date and the amount of interest. Amount of interest may be rounded off to the nearest rupee. (4 marks)

Answer:

Calculation of Average Due Date taking 15th March, 2012 as the base date

Due date	Amount ₹	No. of days from the base date i.e. 15th March, 2012	Product
15th March, 2012	7,000	0	0
5th April, 2012	12,000	21	2,52,000
25th April, 2012	30,000	41	12,30,000
11th June, 2012	20,000	88	17,60,000
	69,000		32,42,000

Average due date = Base date + Days equal to $\frac{\text{Total of products}}{\text{Total amount}}$

$\frac{\text{Days equal to Total of products}}{\text{Total amount}}$ = 15th March, 2012 + $\frac{32,42,000}{69,000}$

= 15th March, 2012 + 47 days (approx.) = 1st May, 2012

Interest amount : Interest can be calculated on ₹69,000 from 1st May, 2012 to 30th June, 2012 at 10% p.a. i.e. interest on ₹69,000 for 60 days at 10% p.a. = ₹69,000 × 10/100 × 60/366 = ₹1,131 (approx.)

2013 - Nov [7] Answer the following:

(d) The following transactions took place between Thick and Thin. They desire to settle their account on average due date.

Purchases by Thick from Thin	(₹)
9th July, 2013	7,200
14th August, 2013	12,200

Sales by Thick to Thin	(₹)
15th July, 2013	18,000
31st August, 2013	16,500

Calculate Average Due Date and the amount to be paid or received by Thick. (4 marks)

Answer:

1. Computation of Products for Thick's Payment (Base date = 9th July)

Due Date	No. of days from base date	Amount (₹)	Product (₹)
(1)	(2)	(3)	(4) = (2) × (3)
9th July	0	7,200	0
14th Aug.	36 (22 + 14)	12,200	4,39,200
		19,400	4,39,200

2. Computation of Products for thin's Payment (Base Date = 9th July)

Due Date	No. of days from base date	Amount (₹)	Product (₹)
(1)	(2)	(3)	(4) = (2) × (3)
15th July	6	18,000	1,08,000
31st Aug.	53 (22+31)	16,500	8,74,500
		34,500	9,82,500

Average Due Date = $\text{Base Date} + \frac{\text{Difference in Products}}{\text{Difference in Amounts}}$

$= 9^{th}\ July + \frac{9{,}82{,}500 - 4{,}39{,}200}{34{,}500 - 19{,}400}$

$= 9^{th}\ July + \frac{5{,}43{,}300}{15{,}100}$

= 9th July + 36 days = 14th Aug. 2013

Thus on 14th August 2013, Thin has to pay ₹15,100 (34,500-19,400) to Thick.

2014 - Nov [7] Answer the following:

(e) Kishanlal has made the following sales to Babulal. He allows a credit period of 10 days beyond which he charges interest @ 12% per annum.

Date of Sales	Amount (₹)
26-05-14	12,000
18-07-14	18,000
02-08-14	16,500
28-08-14	9,500
09-09-14	15,500
17-09-14	13,500

Babulal wants to settle his accounts on 30-09-2014. Calculate the interest payable by him using Average Due Date (ADD). If Babulal wants to save interest of ₹588, how many days before 30.09.2014 does he have to make payment? Also find the payment date in this case.

(4 marks)

Answer:

Calculation of Average Due Date (Taking 5th June as Base Date)

Sale Date	Add	Date	Amt.	Days	Product
26/5	10	5/6	12,000	0	-
18/7	10	28/7	18,000	53	9,54,000
21/8	10	12/8	16,500	68	11,22,000
28/8	10	7/9	9,500	94	8,93,000
9/9	10	19/9	15,500	106	16,43,000
17/9	10	27/9	13,500	114	15,39,000
			85,000		61,51,000

Average Date $= \text{Base date} + \frac{\text{Product}}{\text{Amount}}$

Average due date $= 5.6.14 + \frac{61,51,000}{85,000}$

$= 5.6.14 + 73$ days (app.) = 17.08.2014

Interest if settlement is done on 30.9.14

$85,000 \times 12\% \times \frac{44}{365}$ = ₹1,230 (approx.)

If Babulal wants to save interest of ₹588, then the calculation of days before 30.09.2014 will be:

588/1,230 × 44 days (17.08.2014 to 30.09.2014) = 22 days earlier

Payment date in the above case will be 08.09.2014.

2015 - May [7] Answer the following:

(b) From the following details, find out the average due date:

Date of Bill	Amount (₹)	Usance of bill
29th January 2014	10,000	1 month
20th March 2014	8,000	2 months
12th July 2014	14,000	1 month
10th August 2014	12,000	2 months

(4 marks)

Answer:

Calculation of Average Due Date
(Taking 3rd March, 2014 as base date)

Date of bill 2014	Term	Due date 2014	Amount ₹	No. of days from base date i.e. 3rd March, 2014	Product ₹
29th January	1month	3rd March*	10,000	0	0
20th March	2 months	23rd May	8,000	81	6,48,000
12th July	1 month	14th Aug.**	14,000	164	22,96,000
10th August	2 months	13th Oct.	12,000	224	26,88,000
			44,000		56,32,000

= 3rd March, 2014 + (56,32,000/44,000)

= 3rd March, 2014 + 128 days

Note: 1* Bill dated 29th January 2014 has the maturity period of one month but there is no corresponding date in February, 2014, therefore due date (after adding 3 days of grace) falls on 3rd March, 2014 as the last date of the month shall be deemed maturity date.

2** Bill dated 12th July, 2014 has the maturity period of one month due date (after adding 3 days of grace) falls on 15th August, 2014. 15th August being public holiday due date would be preceding date i.e. 14th August, 2014.

2015 - Nov [7] Attempt the following:

(c) Anand purchased goods from Amirtha, the average due date for payment in cash is 10.08.2015 and the total amount due is ₹67,500. How much amount should be paid by Anand to Amirtha, if total payment is made on following dates and interest is to be considered at the rate of 12% p.a.

(i) On average due date.

(ii) On 25th August, 2015.

(iii) On 30th July, 2015. (4 marks)

Answer:

Amount to be paid:

(i) **On average due date:**

⇒ No interest amount paid as payment made on ADD. So amount paid is ₹67,500

(ii) **On 25th August, 2015**

Interest $= 67,500 \times \frac{12}{100} \times \frac{15}{365} = 333$ (Interest from 10-08-2015 to 25-08-2015)

Total amount paid = 67,500 + 333

= ₹67,833

(iii) **On 30th July, 2015**

Interest $= 67,500 \times \frac{12}{100} \times \frac{11}{365} = 244$ Rebate has been allowed for unexpired credit period of 11 days from 30.07.2015 to 10.08.2015.

⇒ 67,500 - 244 = 67,256

Being rebate allowed for unexpired credit period of 11 days.

2016 - May [7] Answer the following:

(c) X owes Y the following sums of money due on the dates stated:

₹400 due on 5th January, 2016
₹200 due on 20th January, 2016
₹800 due on 4th February, 2016
₹100 due on 26th February, 2016
₹50 due on 10th March, 2016

Calculate such a date when payment may be made by X in one instalment resulting in no loss of interest to either party. Assume base date as 5th January, 2016. (4 marks)

Answer:

Taking 5th January 2016 as base date:

Due Date 2016	Amount	No. of days from base date	Product
5th January	400	0	0
20th January	200	15	3,000
4th February	800	30	24,000
26th February	100	52	5,200
10th March	50	65	3,250
	1,550		35,450

Average due date = Base date + Days equal to (Total of Product ÷Total amount)

$$= 5^{th} \text{ January 2016} + \frac{35{,}450}{1{,}550}$$

= 5th January, 2016 + 22.8 days

= 5th January, 2016 + 23 days = 28th January, 2016

If the payment is made by X in one installment on 28th January, 2016 no loss of interest would arise to any of the parties.

2016 - Nov [7] Answer the following:

(b) A merchant trader having accepted the following several bills falling due on different dates, now desires to have these bills cancelled and to accept a new bill for the whole amount payable on the average due date:

Sl. No.	Date of Bills	Amount ₹	Usance of the bill
1	1st May, 2016	500	2 months
2	10th May, 2016	300	3 months
3	5th June, 2016	400	2 months
4	20th June, 2016	375	1 month
5	10th July, 2016	500	2 months

You are required to find the said average due date.

Any fraction of a day arising from the calculation to be considered as full day. (4 marks)

Answer:

Calculation of Average due date

Date	Due Date	Amount (₹)	Days	Product
1-5-16	4-7-16 Base Date	500	0	0
10-5-16	13-8-16	300	40	12,000
5-6-16	8-8-16	400	35	14,000
20-6-16	23-7-16	375	19	7,125
10-7-16	13-9-16	500	71	35,500
		2,075		68,625

→ Average due date

$= \text{Base Date} + \frac{\text{Total of Product}}{\text{Total of Amount}}$

$= 4.7.16 + \frac{68,625}{2,075}$

$= 4.7.16 + 33.07 = 34$ days

$= 7.8.16.$

2017 - May [7] Answer the following:

(e) Mr. Praveen buys goods on Credit on following dates. 10 days credit is allowed to him after which interest @ 8% p.a. is charged by supplier.

(1)	30th July	₹	12,000
(2)	12th August	₹	25,000
(3)	27th July	₹	18,000
(4)	10th September	₹	7,000
(5)	12th September	₹	21,000

It was agreed to be settled on 30th September. Compute interest payable by him using average due date method. Due Date of earliest purchase shall be taken as base date. (one year = 365 days)

Any fraction of a day arising from the calculation to be considered as full day. (4 marks)

Answer:

Calculation of Average Due Date (Taking 6th August as the base date)

Date of Bill	Due Date	Amount	No. of days from 6th August	Product
30th July	9th August	12,000	3	36,000
12th August	22nd August	25,000	16	4,00,000
27th July	6th August	18,000	0	0
10th September	20th September	7,000	45	3,15,000
12th September	22nd September	21,000	47	9,87,000
		83,000		**17,38,000**

Average Due Date $= \text{Base Date} + \frac{\text{Sum of Product}}{\text{Sum of Amount}}$

$= 6^{th} \text{ August} + \frac{17,38,000}{83,000}$

$= 6^{th}$ August + 21

$= \boxed{27^{th} \text{ August}}$

No. of days after 27th August to 30th September = $\boxed{34 \text{ days}}$

Interest Payable by Praveen on ₹83,000 for 34 days @ 8% p.a.

$= 83,000 \times \frac{34}{365} \times \frac{8}{100}$

= ₹618.52

2018 - May [2] (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 31st March, 2018 together with interest @6% per annum. Calculate the interest by average due date method. (5 marks)

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Answer:

Calculation of Average Due Date

Due Date 2018	Amount (₹)	No. of days from Jan 1	Product (₹)
Jan 1	650	0	0
Jan 15	1,200	14	16,800
Feb 10	850	40	34,000
March 7	1,500	65	97,500
	4,200		1,48,300

$$\text{Average Due Date} = \text{Base date} + \frac{\text{Sum of Product}}{\text{Sum of Amount}}$$

$$= 1.1.18 + \frac{1,48,300}{4,200}$$

$= 1.1.18 + 36$ days

$= 6.2.18$

Interest therefore, will be calculated on ₹4,200 from 6.2.18 to 31.3.18 i.e. for 54 days.

$$\text{Interest} = 4,200 \times \frac{6}{100} \times \frac{54}{365}$$

= ₹37.28 i.e. ₹37/(approx)

2018 - Nov [6] (c) Karan purchased goods from Arjun, the average due date for payment in cash is 10.08.2018 and the total amount due is ₹1,75,800. How much amount should be paid by Karan to Arjun, if total payment is made on following dates and interest is to be considered at the rate of 15% p.a.

(i) On average due date
(ii) On 28th August, 2018
(iii) On 29th July, 2018. (5 marks)

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Answer:

(i) If payment is made on ADD, then no party gains or looses the interest. Hence, payment to be made is ₹1,75,800.

(ii) Payment on 28.08.2018 i.e. after the ADD, Karan will have to pay interest for 18 days.

$$1,75,800 \times \frac{15}{100} \times \frac{18}{365} = 1300.44$$

Total Payment = 1,75,800 + 1300.44
= 1,77,100.44

(iii) Payment on 29.7.2018 i.e. before ADD.
Karan will get a rebate of interest for 12 days.

$$1,75,800 \times \frac{15}{100} \times \frac{12}{365} = ₹866.96$$

Total Payment = ₹1,75,800 – 866.96
₹1,74,933.04

2019 - June [3] (c) Attempt the following:

(i) Two Traders Yogesh and Yusuf buy goods from one another, each allowing the others, one month's credit. At the end of 3 months the accounts rendered are as follows:

	Goods sold by Yogesh to Yusuf (₹)		Goods sold by Yusuf to Yogesh (₹)
April 18	12,000	April' 23	10,600
May 15	14,000	May 24	10,000
June 16	16,000		

Calculate the date upon which the balance should be paid so that no interest is due either to Yogesh or Yusuf. (5 marks)

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Answer:

Taking May 21 as the zero or base date
For Yusuf's Payments

Date of Transactions	Due Date	Amount	No. of days from the base date	Products
(1)	(2)	(3)	(4)	(5)
April 18	May 21	12,000	0	0
May 15	June 18	14,000	28	3,92,000
June 16	July 19	16,000	59	9,44,000
Amount Due to Yogesh		42,000	Sum of Products	13,36,000

For Yogesh's Payments
Taking same base date i.e. May 21

Date of Transactions	Due Date	Amount	No. of days from the base date	Products
(1)	(2)	(3)	(4)	(5)
April 23	May 26	10,600	5	53,000
May 24	June 27	10,000	37	3,70,000
Amount due to Y		20,600	Sum of Products	4,23,000

Excess of Yusuf's products over Yogesh's
= ₹13,36,000 – ₹4,23,000
= ₹9,13,000

Excess amount due to Yogesh ₹42,000 - ₹20,600 = ₹21,400

Number of days from the base date to the date of settlement is:

$$\frac{9,13,000}{21,400} = 42.66 \text{ days i.e. } 43 \text{ days}$$

Hence, the date of settlement of the balance amount is 43 days after May 21 i.e., on 3rd July. Yusuf has to pay Yogesh, ₹21,400 to clear the account.

Note: Due date is calculated after considering 3 day of grace period.

2019 - Nov [3] (c) Attempt the following:

(i) The following amounts are due to X by Y. Y wants to pay on 10th July 2019. Interest rate of 9% p.a. is taken into consideration.

Due dates	₹
10th January	750
26th January (Republic Day)	1,200
23rd March	3,300
18th August (Sunday)	4,100

Determine average due date and the amount to be paid on 10th July 2019. Assume 10th January as base date. (5 marks)

Answer:

Calculation of Average Due Date (Taking 10th January as Base Date)

Due Date (Normal)	Due Date (Actual)	No. of Days from 10th January	Amount (₹)	Product
10th January	10th January	0	750	0
26th January	25th January	15	1,200	18,000
23rd March	23rd March	72	3,300	2,37,600
18th August	17th August	219	4,100	8,97,900
			9,350	11,53,500

Average Due Date = Base Date + Days Equal to $\frac{\text{Sum of Products}}{\text{Sum of Amounts}}$

$= 10^{th}$ January + $\frac{11,53,500}{9,350}$

$= 10^{th}$ January + 123.37 days

$= 10^{th}$ January + 124 days (approx.)

$= 14^{th}$ May

If the payment is to be made on 10^{th} July, interest will be charged from 14^{th} May to 10^{th} July, i.e. for 17 + 30 + 10 = 57 days.

Interest = $9,350 \times \frac{9}{100} \times \frac{57}{365}$ = ₹ 131.41

Total amount to be paid on 10^{th} July = ₹ 9,350 + ₹ 131.41 = ₹ 9,481.41

CHAPTER

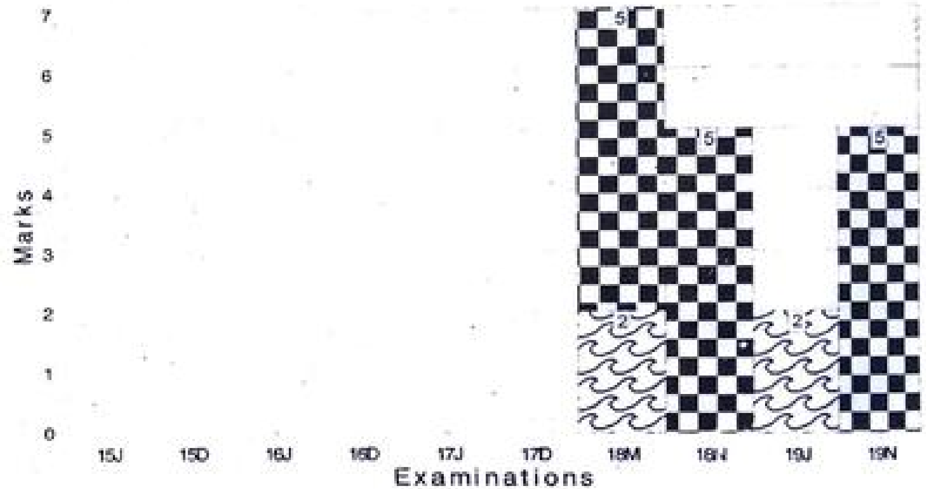
6 Accounting for Special Transactions

Unit: 5 Account Current

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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SELF STUDY NOTES

Introduction

When two parties have numerous transactions between themselves, they exchange statements of accounts to confirm the amounts. Party may charge interest on the amount due. This statement is called as "Account Current".

Parties Involved

1. Who renders the account.
2. To whom the account is rendered.

Preparation of Account Current

There are three methods of preparing an Account Current:

Method 1: With the help of interest table.

Method 2: By means of products.

Method 3: By means of products and balances.

Method 1: Preparation of Account current with the help of Interest Tables – Individual method.

According to this method, all the transactions are arranged in the form of an account. There are two additional columns on both the sides of such account.

1. One column indicates the number of days counted from the due date of each transaction to the date on which the account is prepared. If no specific due date is mentioned, the date of transaction is taken to be the due date.
2. The other column is for writing interest.

Interest due on different amounts at given rates for different periods of time is found out and this is entered against each item separately, The interest columns of both the sides are totalled up and the balance is determined.

Method 2: By means of Products.

- Under this method "interest" column is substituted with "product" column which shows the product of the amount with number of days for which it was outstanding.

- The balance of the product is then multiplied with given interest rate and the resulting figure is entered.

Method of Computing the numbers of days

- **Forward method:** Calculation of days is made from due date to date of closing the account.
- **Backward method:** Calculation of days is made from opening date to the due date of transaction.

Method 3: By means of product of balances in case of banks or Periodic Balance Method.

- Under this method, balance of account is taken after each transaction.
- Product of amount with number of days is entered into product column and the column is totalled.
- Interest rate is applied on each total to ascertain net interest payable/ receivable.

Red Ink Interest:

- Sometimes, due date of a particular transaction may fall after the closing of account current. In such case, interest from date of closing the account till due date was noted with red ink in old times and is now called as Red Ink Interest. It is also called as negative interest.

Example:

Jamal has a current account with partnership firm. It has debit balance of ₹75,000 as on 1.7.2017. He has further deposited following amounts:

Date	Amount
14.07.2017	1,38,000
18.08.2017	22,000

He withdrew following amounts:

Date	Amount
29.07.2012	97,000
09.09.2012	11,000

Show Jamal's A/c in ledger of the firm. Interest is to be calculated @ 10% on debit balance and 8% on credit balance. You are required to prepare account current as on 30.09.2017.

Solution:

Date	Particulars	Dr.	Cr.	Dr/Cr.	Balance	Days	Dr.	Cr.
2017							Product	Product
01.07.17	To Balance b/d	75,000		Dr.	75,000	13	9,75,000	
14.07.17	By Cash A/c		1,38,000	Cr.	63,000	15		9,45,000
29.07.17	To Self A/c	97,000		Dr.	34,000	20	6,80,000	
18.08.17	By Cash A/c		22,000	Dr.	12,000	22	2,64,000	
09.09.17	To Self A/c	11,000		Dr.	23,000	22	5,06,000	
30.09.17	To Interest A/c	457		Dr.	23,453			
30.09.17	By Balance c/d		23,457					
		1,83,457	1,83,457				24,25,000	9,45,000

Working Note of Interest:

On Cr. Product $= 9{,}45{,}000 \times 8\% \times \frac{1}{365} = ₹207$

On Dr. Product $= 24{,}25{,}000 \times 10\% \times \frac{1}{365} = ₹664$

Net interest to be debited = 664 - 207 = ₹457

Example:

From the following particulars prepare an account current, as sent by Mr. AB to Mr. XY as on 31st October, 2018 by means of product method charging interest @ 5% p.a.

Date	Particulars	₹
1st July	Balance due from XY	1,500
20th August	Sold goods to XY	2,500
28th August	Goods returned by XY	400
25th September	XY paid by cheque	1,600
20th October	Received cash from XY	1,000

Solution:

Date	Particulars	Amount	Days	Product	Date	Particulars	Amount	Days	Product
2018					2018				
Jul. 1	To Balance b/d	1,500	123	1,84,500	Aug. 28	By Sales Returns A/c	400	64	25,600
Aug. 20	To Sales A/c	2,500	72	1,80,000	Sept. 25	By Bank A/c	1,600	36	57,600
Oct. 31	To Interest A/c	37			Oct. 20	By Cash A/c	1,000	11	11,000
	((5% of ₹2,70,300)/365)				Oct. 31	By Balance of Product			2,70,300
					Oct. 31	By Balance c/d	1,037		
		4,037		3,64,500			4,037		3,64,500

SHORT PRACTICE QUESTIONS

1. What do you mean by:
   (a) Account Current
   (b) Red ink interest

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

1999 - Nov [5] State with reason whether the following statements are True or False.

(ix) The interest charged by Banker to Customer on Overdrawn account is called Red ink interest. (2 marks)

Answer:

False: When the due date of any transaction falls after the date on which account current is prepared, interest in respect of such a transaction is written in red ink being a negative item. Since it is written in red ink, it is called red ink interest.

2003 - May [5] State with reason whether the following statements are True or False.

(vi) In Account Current, Red Ink Interest is treated as negative interest. (2 marks)

Answer:

True: Red Ink Interest is treated as negative interest. If the due date of a bill falls after the closing date of the account, no interest is charged for that. However, interest from the closing date to such due date is written in Red Ink at the appropriate side of Account Current.

2018 - May [1] {C} (a) State with reasons, whether the following statements are true or false:

(iv) There are two ways of preparing an account current. (2 marks)

Answer:

False; There are three ways of preparing an account current:

(a) With the help of interest tables
(b) By means of products
(c) By means of product of balances.

2019 - June [1] (a) State with reason, whether the following statement is true or false :

(iv) In case the due date of a bill falls after the date of closing the account, the interest from the date of closing to such due date is known as Red-Ink interest. (2 marks)

Answer:

True: In case the due date of a bill falls after the date of closing the account, then no interest is allowed for that. However, interest from the date of closing to such due date is written in "Red-ink" in the Account Current. This interest is called "Red-ink interest".

SHORT NOTES

2005 - Nov [6] Write short notes on the following:

(iv) Account Current. (5 marks)

Answer:

- An account current is a running statement of transactions between parties, maintained in the form of a ledger account, for a given period of time.
- It includes interest allowed or charged on various items.
- It is prepared when transactions regularly take place between two parties.

- An example is of a manufacturer who sells goods frequently to a merchant on credit and receives payments from him in instalments at different intervals and charges interest on the amount which remains outstanding.
- An Account Current has two parties:
  - o one who renders the account; and
  - o the other to whom the account is rendered.
- There are three ways of preparing an Account Current
  - o with the help of interest tables,
  - o by means of products, and
  - o by means of products of balances.

PRACTICAL QUESTIONS

2005 - May [3] (a) Mr. A owed ₹4,000 on 1st January, 2004 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, 2004 Mr. X sold goods to Mr. A	2,230
29 January, 2004 Mr. X bought goods from Mr. A	1,200
10 February, 2004 Mr. A paid cash to Mr. X	1,000
13 March, 2004 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, 2004. Prepare Mr. A in Account Current with Mr. X and ascertain the amount to be paid. Ignore days of grace. (8 marks)

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Answer:

Mr. A in Account Current with Mr. X
(Interest upto 15th March, 2004 @ 10% p.a.)

Dr. Cr.

Date	Particulars	Amount	Days	Product	Date	Particulars	Amount	Days	Product
2004					2004				
Jan 01	To Balance b/d	4,000	75	3,00,000	Jan 29	By Purchase account	1,200	46	55,200
Jan 15	To Sales account	2,230	60	1,33,800	Feb 10	By Cash account	1,000	34	34,000
Mar. 13	To Red Ink product (₹2,000 × 29)			58,000	Mar. 13	By Bills Receivable account	2,000		
Mar. 15	To Interest account $\left(\frac{₹4,02,600 \times 10 \times 1}{100 \times 366}\right)$	110			Mar. 15	By Balance of product			4,02,600
						By Balance c/d (amount to be paid)	2,140		
		6,340		4,91,800			6,340		4,91,800

Note: Interest is charged @ 10% p. a. upto 15th March 2004.

2018 - May [2] (Or) (c) (ii) From the following prepare an account current, as sent by Avinash to Bhuvanesh on 31st March, 2018 by means of products method charging interest @ 5% per annum:

Date	**Particulars**	**Amount (₹)**
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

(5 marks)

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Answer:

Bhuvanesh in Account Current with Avinash for the period ending on 31st March, 2018

Date	Particulars	Amount	Days	Product	Date	Particulars	Amount	Days	Product
2018		₹			2018		₹		
Jan. 1	To bal b/d	1,800	90*	1,62,000	Jan. 15	By Sales Returns	650	75	48,750
Jan. 10	To Sales A/c	1,500	80	1,20,000	Feb. 12	By Bank A/c	1,000	47	47,000
March. 11	To Sales A/c	720	20	14,400	Feb. 20	By B/R A/c (due date: March 23)	1,500	8	12,000
March. 31	To Interest A/c	24			March. 14	By Cash A/c	800	17	13,600
					March. 31	By Balance of products			1,75,050
						By Balance c/d	94		
		4,044		2,96,400			4,044		2,96,400

***Calculation of Interest**

Interest = (1,75,050 × 5%)/365 = ₹24

*Opening day considered in calculation of no. of days.

2018 - Nov [2] (c) Attempt the following:

(i) From the following particulars prepare an account current, as sent by Mr. AB to Mr. XY as on 31st October, 2018 by means of product method charging interest @ 5% p.a.

Date	Particulars	(₹)
1st July	Balance due from XY	1,500
20th August	Sold goods to XY	2,500
28th August	Goods returned by XY	400
25th September	XY paid by cheque	1,600
20th October	Received cash from XY	1,000

(5 marks)

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Answer:

XY in Account Current with AB as on 31st October, 2018

		(₹)	Days	Product (₹)			(₹)	Days	Product (₹)
01.07.18	To Balance b/d	1,500	123	1,84,500	28.08.18	By Sales Return	400	64	25,600
20.08.18	To Sales	2,500	72	1,80,000	25.09.18	By Bank	1,600	36	57,600
31.10.18	To Interest	37			20.10.18	By Cash	1,000	11	11,000
					20.10.18	By Balance of Products			2,70,300
					31.10.18	By Balance c/d	1,037		
		4,037		3,64,500			4,037		3,64,500

Working Note:

$$\text{Interest} = 2,70,300 \times \frac{5}{100} \times \frac{1}{365} = ₹37 \text{ (approx.)}$$

2019 - Nov [3] (c) Attempt the following sub-part:

(ii) Ramesh has a Current Account with Partnership firm. He had a debit balance of ₹85,000 as on 01-07-2018. He has further deposited the following amounts:

Date	Amount (₹)
14-07-2018	1,23,000
18-08-2018	21,000

He withdrew the following amounts:

Date	Amount (₹)
29.07-2018	92,000
09-09-2018	11,500

Show Ramesh's A/c in the books of the firm. Interest is to be calculated at 10% on debit balance and 8% on credit balance. You are required to prepare current account as on 30th September, 2018 by means of product of balances method. (5 marks)

Answer:

Ramesh's Current A/c with a Partnership Firm as on 30th September, 2018:

Date	Particulars	Dr. (₹)	Cr. (₹)	Dr. or Cr.	Balance (₹)	Days	Dr. Product (₹)	Cr. Product (₹)
2018								
July 1	To Balance b/d	85,000		Dr.	85,000	13	11,05,000	
July 14	By Cash A/c		1,23,000	Cr.	38,000	15		5,70,000
July 29	To Self	92,000		Dr.	54,000	20	10,80,000	
Aug. 18	By Cash A/c		21,000	Dr.	33,000	22	7,26,000	
Sept. 9	To Self	11,500		Dr.	44,500	22	9,79,000	
Sept. 30	To Interest A/c	941		Dr.	45,441			
Sept. 30	By Balance c/d		45,441					
		1,89,441	1,89,441				38,90,000	5,70,000
Oct. 1	To Balance b/d	45,441						

Interest Calculation

Particulars	₹
On ₹38,90,000 @ 10% for 1 day {(10% of ₹38,90,000) ÷ 365}	1,066
On ₹5,70,000 @ 8% for 1 day {(8% of ₹5,70,000) ÷ 365}	125
Net Interest to be debited (₹1,066 – ₹125)	941

CHAPTER **7**

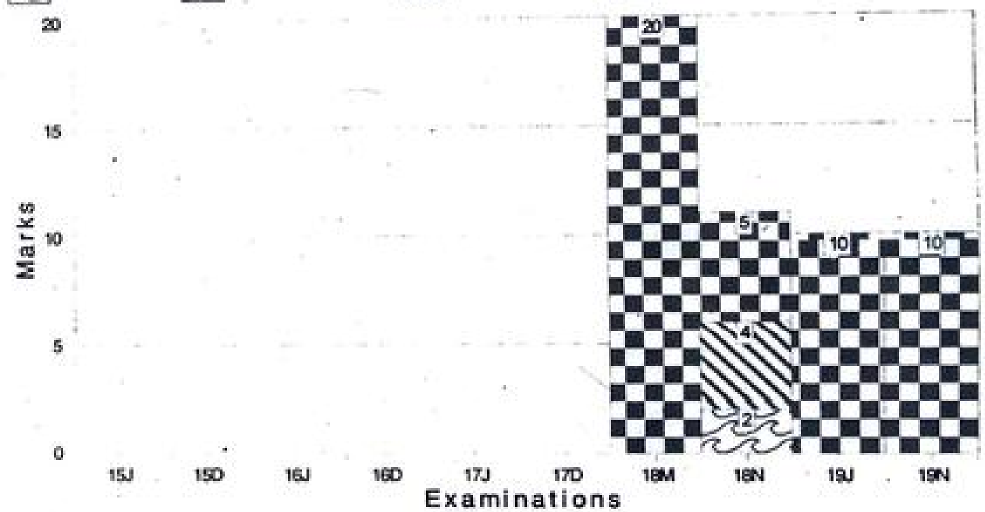
Preparation of Final Accounts of Sole Proprietors

Unit: 1 **Final Accounts of Non-Manufacturing Entities**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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SELF STUDY QUESTIONS

Q1. What are Trading Organisations? What financial statements they prepare?

Answer:

Entities involved in trading of goods without changing the form of goods are known as non-manufacturing entities. To know the result at the end of financial year, they prepare financial statements.

Financial statement comprise of

1. **Income Statement:**
   - Trading A/c to ascertain Gross Profit
   - Profit & Loss A/c to ascertain Net Profit
2. **Position Statement:**
   - Balance sheet to know the net position of Assets and Liabilities.

Since the preparation of these Accounts is the final stage of Accounting, hence, these are called as Final Accounts.

Final Accounts

To Ascertain Profit/Loss → Income Statement or Profit and Loss A/c

To Ascertain Financial Position → Position Statement or Balance Sheet

Q2. Distinguish between income statement and Position Statement.

Answer:

Comparison between income statement and Position Statement

Basis	Income Statement	Position Statement
Purpose	To know the profit/loss for the period	To Known financial position in terms of assets and liabilities.

Sub-parts	It comprises of (a) Trading A/c (b) Profits Loss A/c	It comprises of (a) Balance Sheet (b) Cash flow Statement
Balancing Figure	The balancing figure depicts Profit or Loss for the period.	Position Statement always has a closing balance which is carried forward to the next year.
Time period for preparation	It discloses profit for the year. It starts with "Profit & Loss for the year ended........"	It discloses position as on a particulars date. It starts with "Balance Sheet as on ...."

Q3. What is the main objective of Preparation of Final Accounts ?

Answer:

The main objective of maintaining these accounts is to exhibit true and fair picture of profitability and position of financial assets and liabilities.

Accrual Principle to be kept in mind while preparing Final Accounts.

1. Classification of items of receipt and payment into capital items and revenue items.
2. Income and expenses of current year should be separated from those of another year.
3. Separate heads to record items of similar nature at one place.

Other considerations:

- Personal transactions should not form part of business statement.
- Recording of asset should be done as per accounting principles and requirements of relevant accounting standards.
- Disclosure of all material information separately.
- Transaction of preceding accounting period should be separated from transactions of succeeding period.
- All transactions done before the close of accounting period should form part of final accounts of that period.

Inter-relationship of the two statements

There is a close relation between the two statements:

Example:

1. Expenses of the current period if paid in current year itself and shown in Profit & Loss A/c and, if paid in another accounting year, form part of Balance sheet as outstanding/prepaid expenses.
2. Net Profit/Net loss calculated as the balancing figure of Profit & Loss A/c form part of Reserve and Surplus which is an item of Balance Sheet.
3. Depreciable Fixed Assets are shown 'net' of depreciation in Balance Sheet and depreciation is charged to Profit & Loss A/c.
4. Closing stock in Trading Account also forms the part of Current Assets in the Balance Sheet.

Matching Principle:

According to this principle, all the expenses should be matched to the revenue earned.

For example:

- If revenue is shown as a part of P/L A/c, then all the related expenses paid or not should be charged to P/L A/c.
- Expenses done for which the revenue will be received in another financial year should be charged in another financial year and not in current year.
- Advance received in current year for the work to be done in another year should be recognised as revenue of that particular year and not the current year.

Q4. What is a Trading Account? Explain elaborately with example.

Answer:

It shows the result of buying and selling of goods and services in the form of gross profit or gross loss for a given accounting year.

Features:

(a) It is prepared in the final accounts of trading concern.
(b) It depicts the result of trading activities.
(c) The balancing figure of this account discloses gross profit/loss.
(d) The balance of this account is transferred to Profit & Loss A/c.

Specimen of Trading A/c

Trading Account for the year ended.....

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Opening Stock A/c	.....	By Sales A/c	
To Purchases A/c		*Less:* Returns Inwards	.....
Less: Returns Outward	.....	By Closing Stock A/c	.....
To Direct Expenses A/c	.....	By Abnormal Loss of Stock A/c	.....
To Wages and Salaries A/c	.....	By Gross Loss transferred to P & L A/c	.....
To Freight Inwards A/c	.....		
To Carriage Inwards A/c	.....		
To Octroi A/c	.....		
To Custom Duty on Imported Goods A/c	.....		
To Factory Power and Fuel A/c	.....		
To Factory Expenses A/c (e.g. Rent and Insurance)	.....		
To Gross Profit transferred to P & L A/c	.....		

Trading Account terms:

Accounting Entries

1. **Opening Inventory:** First item of debit side. It is the closing stock of last year.
   If it is the first year of business, then these will be no opening stock.
   Trading A/c Dr.
   To Opening Stock.
2. **Purchases and purchase return:** Material purchased during the year for resale. It includes both cash purchases and credit purchases.
   Purchase return shows the returns made to the supplier. These should not form part of purchases, hence are deducted and net amount is recorded in Trading.

3. **Carriage Inwards:** It comprises of cost of bringing in the material upto the godown and make available for use.
   However, carriage paid on bringing of fixed assets are excluded from Trading A/c.
4. **Wages:** Account paid to workers in return of their services. However, if wages are paid in relation to fixed asset, the same are excluded.
5. **Sales and Sales Return:** Total sale made by the business during the year.
   Sales return are the returns made by the customer.
6. **Closing Inventory:** It is the unsold stock at the end of accounting year. It is helpful for ascertaining gross profit. Closing stock is valued at cost or Net Realisable value, whichever is lower. Closing stock does not appear in the Trial Balance.
7. **Gross Profit/Loss:** It is the balancing figure of Trading A/c. It represents excess of Net Sales over cost of goods sold.

   Example:

   Prepare a Trading Account for the year ended 31st March, 2012 from the following balance as on 31st March, 2012.

	₹
Stock on 1st April, 2011	10,000
Sales Return	5,000
Sales	2,00,000
Clearing Charges	11,000
Purchases	2,00,000
Purchases Return	2,500
Carriage Inwards	1,500
Carriage Outwards	3,000
Freight Inwards	2,500

The closing stock of goods as on 31st March, 2012 is ₹20,000.

Answer:

Trading Account

Dr. For the year ended 31st March, 2012 Cr.

Particulars	₹	Particulars	₹
To Opening Stock A/c	10,000	By Sales A/c 2,00,000	
To Purchases A/c 2,00,000		*Less:* Return 5,000	1,95,000
Less: Returns 2,500	1,97,500	By Closing Stock A/c	20,000
To Carriage Inwards A/c	1,500	By Gross Loss transferred	7,500
To Freight Inwards A/c	2,500	to Profit and Loss A/c	
To Clearing Charges A/c	11,000		
	2,22,500		2,22,500

Note: Carriage Outwards will be charged to the Profit and Loss Account.

Example:

From the following information, prepare the Trading Account for the year ended 31st March, 2012:

Cash Purchases ₹1,50,000, Credit Purchases ₹9,00,000. Returns Inwards ₹20,000, Cash Sales ₹1,60,000, Credit Sales ₹11,00,000, Returns Outwards ₹10,000, Freight Inwards ₹3,000, Carriage Inwards ₹3,000, Wages and Salaries ₹4,000, Opening Stock ₹1,50,000, Closing Stock ₹88,000 but its market value is ₹84,000.

Answer:

Trading Account ....

Dr. for the year ended 31st March, 2012 Cr.

Particulars	₹	Particulars	₹
To Opening Stock A/c	1,50,000	By Sales A/c	
To Purchases A/c		Cash Sales 1,60,000	
Cash Purchases 1,50,000		Credit Sales 11,00,000	
Credit Purchases 9,00,000		12,60,000	
10,50,000		*Less:* Return Inwards 20,000	12,40,000
Less: Return Outward 10,000	10,40,000	By Closing Stock A/c (Valued at cost or market value whichever is less)	84,000
To Freight Inwards A/c	3,000		
To Carriage Inwards A/c	3,000		

To Wages and Salaries A/c	4,000		
To Gross Profit tfd. to P & L A/c	1,24,000		
	13,24,000		13,24,000

Q4. What is a Profit and Loss Account? Explain Elaborately.

Answer:

It is prepared to ascertain the Net Profit/Loss of the business at the end of accounting year. It is prepared on accrual basis.

Specimen of Profit & Loss A/c

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

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Gross Loss transferred from Trading A/c	......	By Gross Profit transferred from Trading A/c	......
To Salaries	......		......
To Rent, Rates and Taxes	......	By Rent Received	......
To Stationery and Printing	......	By Discount Received	......
To Postage and Telegrams	......	By Commission Earned	
	......	By Interest Received	......
To Audit Fees	......	By Bad Debts Recovered	......
To Legal Charges	......	By Income from Investment	......
To Telephone Expenses	......		......
To Insurance Premium	......	By Dividends on shares	......
To Business Promotion Expenses	......	By Profit on sale of fixed Assets	......
To Repairs and Renewals	......	By Miscellaneous Revenue Gains	......
To Depreciation	......	By Net Loss transferred to Capital A/c	......
To Interest	......		......
To Godown Rent	......		
To Sundry Trade Expenses	......		

To Conveyance	......		
To Charity	......		
To Bank Charges	......		
To Interest on loan	......		
To Office Expenses	......		
To Establishment Expenses	......		
To General Expenses	......		
To License Fee	......		
To Brokerage	......		
To Car running and Maintenance	....		
To Electricity Expenses			
To Loss by Fire and Theft			
To Commission	......		
To Loss on sales of fixed assets	....		
To Advertisement	......		
To Freight and Carriage Outwards	....		
To Discount Allowed	......		
To Packing Expenses	......		
To Travelling Expenses	......		
To Distribution Expenses	......		
To Bad Debts	......		
To Provision for bad debts	......		
To Net Profit transferred to Capital A/c			

1. **Drawings:** It is the reduction in capital employed in business by the proprietor. It is directly reduced from capital account and not passed through Profit & Loss A/c.
2. **Income tax:** It is the tax payable one the business income. In case of company, it is an allowable expenditure however, in case of sole proprietorship it is treated as personal expense and reduced from capital A/c.
3. **Discount received and allowed:** It is shown separately in Profit & Loss A/c. It is of two types:
   Trade Discount: Provided on bulk purchase.
   Cash Discount: Allowable to customers if payment is made before due date. It forms part of profit & Loss A/c.
4. **Rebate:** It is the allowance given for making purchases upto a certain figure in an year.
5. **Bad debts:** When customer is unable to pay amount at due date, it is said to be irrecoverable and is loss to the business.

Example:

The following is the Trial Balance of C. Wanchoo on 31st March, 2012. Prepare the Trading and Profit and Loss Accounts for the year ended 31st March, 2012.

Trial Balance
as at 31st March, 2012

Particulars	Dr. (₹)	Cr. (₹)
Capital A/c		10,000
Stock A/c (1st April, 2011)	2,000	
Cash at Bank	1,000	
Cash in Hand	440	
Machinery A/c	6,000	
Furniture and Fitting A/c	1,360	
Purchases A/c	15,000	
Wages A/c	10,000	
Fuel and Power A/c	3,000	

Factory Lighting A/c	200	
Salaries A/c	7,000	
Discount Allowed A/c	500	
Discount Received A/c		300
Advertising A/c	5,000	
Sundry office Expenses A/c	4,000	
Sales A/c		50,000
Sundry Debtors (Amount owing by customers)	8,500	
Sundry Creditors (Amount owing to suppliers)		3,700
	64,000	64,000

Value of closing stock as on 31st March, 2012 was ₹2,700.

QR Code for Solution Video

Answer:

C. Wanchoo
Trading Account
for the year ended 31st March, 2012

Dr. Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Stock A/c	2,000	By Sales A/c	50,000
To Purchases A/c	15,000	By Closing Stock A/c	2,700
To Wages A/c	10,000		
To Fuel and Power A/c	3,000		
To Factory Lighting a/c	200		
To Gross Profit Transferred to Profit and Loss Account	22,500		
	52,700		52,700

Profit and Loss Account
for the year ended 31st March, 2012

Dr. Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Salaries A/c	7,000	By Gross Profit transferred from Trading A/c	22,500
To Discount Allowed A/c	500	By Discount Received a/c	300
To Advertising A/c	5,000		
To Sundry Office Expenses A/c	4,000		
To Net Profit Transferred to Capital A/c	6,300		
	22,800		22,800

Q5. What are various adjustments and their treatments while preparing final accounts?

Answer:

In preparation of final accounts, certain adjustments are made so as to ascertain true Profit/Loss. Entries required to give effect to certain types of transactions, such as:

- Outstanding Expenses
- Prepaid expenses
- Bad debts, etc.

Adjustment	Explanation	Adjustment Entry	Disclosure
1. Closing Stock	The unsold stock of the previous year should be carried forward to the next year.	(a) Closing Stock Dr. To Trading A/c OR (b) Stock A/c Dr. To Purchases A/c	1. Trading A/c and Asset side of B/s 2. Only in B/s as an asset (here closing stock would be appearing inside Trial balance)
2. Accrued or Outstanding Expenses	Expenses which have been actually incurred and benefits have been received but payment has not yet been made.	Expense A/c Dr. To Outstanding expenses A/c OR Expense A/c Dr. To Accrued expense a/c	1. Profit/Loss A/c as an addition to the expense 2. On the Liability side of Balance Sheet.
3. Unexpired or Prepaid expenses	These are the expenses paid in advance (i.e. benefit has not yet been received)	Prepaid expense A/c Dr. To Expense A/c	1. Profit/Loss A/c as a deduction from respective expense 2. Asset side of Balance Sheet
4. Accrued Income	**Accrued** income means the income which has been earned by the business but not yet received.	Accrued income A/c Dr. To Income A/c	1. Profit/Loss Account as an addition to respective income 2. As an asset in Balance Sheet
5. Unearned Income or Income Received in Advance	Income which has been received in advance, or income which is not yet earned, but is received.	Income A/c Dr. To Income Received in Advance A/c	1. Profit/Loss Account as a deduction from respective income 2. Liability side of Balance Sheet
6. Depreciation	Reduction made from the fixed asset over its useful life.	Depreciation A/c Dr. To Fixed Asset A/c	1. Debited in Profit/Loss A/c 2. In Balance sheet as a deduction from asset

7. Bad debts	Debts which cannot be recovered are called bad debts. It represents a Loss to the business	Bad Debts A/c Dr. To Debtors A/c	1. Bad Debt A/c debited to P/L A/c 2. In Balance Sheet, as a reduction from debtors

Note:
If Bad Debt is given in Trial Balance, no adjusting entry is required. It should be directly transferred to P/L A/c

8. Provision for Bad Debts	When bad debts have not actually happened but are likely to occur, the company makes a provision for it, to meet this loss.	Profit/Loss A/c Dr. To Provision for Bad Debts A/c	1. Charge to P/L A/c. 2. Deducted from debtors in the Balance Sheet
9. Provision for discount on debtors	Sometimes discounts are likely to be allowed to debtors which is an expected loss, and hence charged from P/L A/c	Profit/Loss A/c Dr. To Provision for discount on debtors A/c	1. Profit side of P/L A/c 2. In balance sheet as a deduction from debtors.
10. Reserve for Discount on creditors	When the business expects to receive some discount from creditors, it makes a reserve of it.	Reserve for Discount on Creditors A/c Dr. To P/L A/c	1. Credited to Profit/Loss A/c 2. In the Balance Sheet as a deduction from creditors.

Note: Generally this reserve not made due to the principle of conservatism.

11. Interest on Capital	It is the Interest paid to the proprietor for the capital contributed by him. It is an expense for the business.	(i) Interest on Capital A/c Dr. To Capital A/c (ii) P/L A/c Dr. To Interest on Capital A/c	1. Debited in Profit/Loss Account 2. In the Balance Sheet as an addition to capital

12. Interest on Drawings	Business charges interest from the proprietor for the drawings made by him. It is an income for the business.	(i) Capital A/c Dr. To Interest on Drawings A/c (ii) Interest on Drawings A/c Dr. To P/L A/c	1. Credited in Profit/Loss Account 2. In Balance Sheet as a deduction from capital
13. Accidental Loss of an asset	(i) **When asset is not Insured:** When an asset is destroyed due to fire etc and it is not insured, the entire loss is to be borne by the business. (ii) When asset is insured: In this case instead of firm the insurance company will bear the loss.	(a) Accidental Loss A/c Dr. To Asset A/c (b) P/L A/c Dr. To Accidental Loss A/c (a) Insurance Co A/c Dr. To Asset A/c (b) Bank A/c Dr. To Insurance Co. A/c (c) P/L A/c Dr. To Asset A/c (with the amount of loss i.e. difference between book value of asset and amount admitted as claim)	1. Debited in Profit/Loss A/c 2. Reduction from asset
14. Accidental Loss of stock	(i) When stock is fully insured: Entire Loss will be borne by the insurance company. (ii) When stock is not fully insured: Stock not covered	Insurance Co. A/c Dr. To Trading A/c Insurance Co. A/c Dr. Profit/Loss A/c Dr. To Trading A/c	1. Insurance Co. A/c is shown on the credit side of Trading A/c 2. As an asset in the Balance Sheet.

	by insurance policy will be treated as a loss (iii) When stock is not insured: Whole Loss will be borne by the firm.	Profit/Loss A/c Dr. To Trading A/c	
15. Manager's Commission	When manager of the firm is given commission based on fixed percent age on profits	Profit/Loss A/c Dr. To Commission payable A/c	1. Debit side of P/L 2. Liability side of B/s

Calculation of Manager's commission:

(a) If commission is charged as a percentage of net profits before charging such commission then,

$$\text{Manager's Commission} = \frac{\text{Profit before Commission} \times \text{Rate of Commission}}{100}$$

(b) If commission is charged as a percentage of net profits after charging such commission, then

$$\text{Manager's Commission} = \frac{\text{Profit before Commission} \times \text{Rate of Commission}}{100 + \text{Rate of Commission}}$$

16. Goods Distributed as free samples	Sometimes goods are distributed as free samples as a sales promotion activity	Free sample/ Advertisement A/c Dr. To Trading/Purchase A/c	1. Credit side of Trading or deduct from purchases 2. Debit side of P/L as advertisement expense

17. Goods withdrawn for personal use	Sometimes the proprietor may withdraw goods from the business for personal use	Drawings A/c Dr. To Purchase/ Trading A/c	1. Deducted from purchases in Trading or shown on credit side of Trading 2. Deduct from capital on liability side of Balance Sheet.
18. Deferred Revenue Expenditure	Expenditure which is revenue in nature but its benefit is derived for more than one year.	Profit/Loss A/c Dr. To Expense A/c	1. Debit in P/L 2. Deduct from capitalised asset in B/S
19. Goods on sale or approval basis	When goods are sent to customers on approval basis and consent is not received till year end, it cannot be treated as sale hence, it requires adjustment entry. Entry of sale will be reversed.	1. Sales A/c Dr. To Debtors A/c (with sale price) 2. Stock A/c To Trading A/c (at cost)	1. Credit side of Trading A/c as a deduction from sales 2. Added to closing stock at cost in Trading A/c 3. In Balance sheet as a deduction from debtors at sale price 4. In Balance Sheet, added to closing stock at cost in asset side
20. Goods received but not recorded	When goods have been received without invoice or entry has been omitted to be recorded, entry of purchase will be passed as an adjustment entry	Purchase A/c Dr. To Creditors A/c	1. In Trading A/c as an addition to purchases. 2. In Balance Sheet added to creditors.

21. Salary to proprietor	Payment of salary to the proprietor	Prop Salary A/c Dr. To Capital A/c	1. As an addition to capital
22. Reserve Fund	Reserve is created by appropriating profits out of P/L A/c	Profit/Loss A/c Dr. To Reserve Fund A/c	1. Debit in P/L A/c 2. Show Reserve Fund in the liability side of B/S
23. Cash Discount [Allowed] Cash Discount [Received]	In order to receive prompt payment cash discount is allowed to customers. When creditors allow us discount for prompt payment	Cash A/c Dr. Discount A/c Dr. To Debtor Creditor A/c Dr. To Cash A/c To discount A/c	
24. Trade Discount	Discount allowed by the manufacturers on the list price of the goods. It is made as a deduction from catalogue price.	No entry is made for Trade Discount allowed or received.	

Q6. What is a Balance Sheet ? What are its characteristics and formats?

Answer:

It is a statement which shows balance of various items of assets and liabilities on a particulars date.

Characteristics:

- It shows financial position of business at a given time.
- It is prepared after preparation of Trading and Profit & Loss A/c.
- Balance sheet is known as position statement.
- The two sides of Balance Sheet should always be equal.
- The total of both sides must agree because of the equation viz. Assets = Liabilities + Capital.

Arrangement of Assets and Liabilities.

Items of Assets can be grouped in either of the following two ways.

1. **On the basis of liquidity**
   - Items readible convertible in case are placed on top followed by asset items which are difficult to be converted.

B/S

Liabilities	Assets
Bills payable Sundry Creditors .... Capital	Cash in hand Cash at Bank .... Plant & Machinery Land & Building

2. **On the basis of permanence**
   - Items which are kept for long terms and not kept for resale such as fixed assets are placed on top followed by liquid assets.

Classification of Assets and liabilities

Liabilities	Assets
Capital .... Sundry Creditors Bills payables	Land & Building Plant & Machinery .... Cash in hand

Assets

- **Current Assets:** Assets which can be converted into cash easily. **Example:** Inventory, Trade Receivables etc.
- **Non current Assets/Long term assets:** Assets meant for long term use by the business, i.e. for more than one year.
- **Intangible Assets:** Assets not having physical existence.

Liabilities:

- **Current Liabilities:** Liabilities which can be settled within an year.
- **Non current liability/Long therm Liabilities:** Obligations which are not paid in near future.

Specimen of Balance Sheet

Liabilities	Amount	Assets	Amount
Capital A/c		Tangible Fixed Asset	
Opening Stock		Land & Building	—
Add: Net Profit		Plant & Building	—
Less: Drawings		Furniture & fixture	—
Closing capital		Vehicles	—
Long term loans:		Intangible Assets	
Short term loans		Goodwill	—
Current Liabilities		Patent	—
Trade Payables		Long term investment	—
Other current liabilities		Current Assets:	
Provisions		Inventory	
		Trade Receivable	
		Short term investment	
		Loans and Advance	
		Bank Balance	
		Cash in hand	

Example:

From the following ledger balance of Mr. Kamal Singh prepare a Trading and Profit and Loss Account for the year ended 31st March, 2012 and a Balance Sheet as on that date after making the necessary adjustments.

Particulars	(₹)	Particulars	(₹)
Trade Expenses	800	Purchases	82,000
Freight and Duty	2,000	Stock on 1.4.2011	15,000
Carriage outwards	500	Plant and Machinery on	
Sundry Debtors	20,600	1.4.2011	20,000
Furniture and Fixtures	5,000	Plant and Machinery	
Returns Inwards	2,000	(additions on 1.10.2011)	5,000
Printing and Stationery	400	Drawings	6,000
Rent, Rates and Taxes	4,600	Capital	80,000
Sundry Creditors	10,000	Reserve for Doubtful	800
Sales	1,20,000	Debts	
Returns outward	1,000	Rent for Premises sublet	1,600
Postage and Telegram	800	Insurance Charges	700
		Salaries and wages	21,300
		Cash in hand	6,200
		Cash at Bank	20,500

Adjustments:

(i) Stock on 31st March, 2012 was ₹14,000.

(ii) Write off ₹600 as bad debts.

(iii) Provision for Doubtful Debts is to be maintained @ 5%.

(iv) provision for depreciation, furniture and fixtures at 5% p.a. and on Plant and Machinery at 20% p.a.

(v) Insurance Prepaid was ₹100.

(vi) A fire occurred in the godown and stock of the value of ₹5,000 was destroyed. It was insured and the insurance company admitted full claim.

QR Code for Solution Video

Solution:

Trading and Profit and Loss Account
for the year ended 31st March, 2012

Dr. Cr.

Particulars		(₹)	Particulars		(₹)
To Opening Stock A/c		15,000	By Sales A/c	1,20,000	
To Purchases A/c	82,000		*Less:* Returns Inward	2,000	1,18,000
Less: Returns outward	1,000	81,000	By Loss of stock by fire A/c		5,000
To Freight and Duty A/c		2,000	By Closing stock A/c		14,000
To Gross Profit c/d		39,000			
		1,37,000			1,37,000
To Trade Expenses A/c		800	By Gross Profit b/d		39,000
To Carriage outwards A/c		500	By Rent for Premises A/c		1,600
To Depreciation on Furniture and Fixtures A/c		250			
To Dep. on Plant and Machinery A/c					
– ₹20,000 × 20/100	4,000				
– ₹5,000 × 20/100 × 6/12	500	4,500			
To Printing & Stationery A/c		400			
To Rent, Rates and Taxes A/c		4,600			
To Insurance A/c	700				
Less: Prepaid	100	600			
To Salaries and wages A/c		21,300			
To Postage and Telegram A/c		800			

To Provision for Doubtful Debts (closing A/c (₹20,000 × 5/100)	1,000				
Add: Further Bad debts	600				
	1,600				
Less: Provision for Doubtful Debts (opening)	800	800			
To Net Profit transferred to Capital A/c		6,050			
		40,600			40,600

Balance Sheet
as at 31st March, 2012

Liabilities		₹	Assets		₹
Current Liabilities			Current Assets		
Sundry Creditors		10,000	Cash in Hand		6,200
Capital			Cash at Bank		20,500
Opening Balance	80,000		Sundry Debtors	20,600	
Add: Net Profit	6,050		*Less:* Further Bad Debts	600	
	86,050			20,000	
Less: Drawings	6,000	80,050	*Less:* Provision for Doubtful Debts	1,000	19,000
			Closing Stock		14,000
			Insurance Claim		5,000
			Prepared insurance		100
			Fixed Assets		
			Furniture and Fixtures	5,000	
			Less: Depreciation	250	4,750
			Plant and Machinery	25,000	
			Less: Depreciation	4,500	20,500
		90,050			90,050

Example:

Following is the Trial Balance of Shri Arihant as at 31st December, 2011:

Particulars	Dr. (₹)	Cr. (₹)
Capital		14,00,000
Drawings	75,000	
Opening Stock	80,000	
Purchases	16,20,000	
Freight on Purchases	15,000	
Wages	1,10,000	
Sales		25,00,000
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 2009)	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 Oct. 2011)	6,00,000	
Bank Balance	83,900	
Salaries	1,00,000	
	40,93,500	40,93,500

Adjustments:

1. Closing Stock ₹2,25,000.
2. Goods worth ₹5,000 were taken for personal use, but no entry was made in the books.

3. Machinery worth ₹35,000 purchased on 1st January, 2009 was wrongly written off against Profit and Loss Account. This asset is to be brought into account on 1st January, 2011 taking depreciation at 10% p.a. on Straight Line Basis upto 31st December, 2010.
4. Depreciate Building at 2½% p.a., Machinery at 10% p.a., and Furniture at 10% p.a.
5. Provision for Doubtful Debts should be 6% on Debtors.
6. The Manager is entitled to a commission of 5% of Net Profits after charging his commission.

Prepare the Trading and Profit and Loss Account for the year ended 31st December, 2011 and a Balance Sheet as at that date.

Answer:

In the Books of Arihant
Trading and Profit and Loss A/c
for the year ended 31st December, 2011

Particulars		₹	Particulars	₹
To Opening Stock		80,000	By Sales	25,00,000
To Purchases	16,20,000		By Closing Stock	2,25,000
Less: Taken for Personal Use	5,000	16,15,000		
To Freight on Purchases		15,000		
To Wages		1,10,000		
To Gross Profit c/d		9,05,000		
		27,25,000		27,25,000
To Travelling Expenses		23,000	By Gross Profit b/d	9,05,000
To Miscellaneous Expenses		35,000	By Discount Received	14,500
To Printing and Stationery		27,000	By Bad Debts Recovered (of 2009)	6,000
To Advertisement Expenses		25,000	By Interest Accrued on Investment (12% of ₹6,00,000 × 3/12)	18,000
To Postage and Telegrams		13,000		
To Discount Allowed		7,600		
To Provisions for Doubtful Debts (W.N.1)		10,000		
To Depreciation on:				
Building (2.5% of ₹10,00,000)	25,000			
Machinery (W.N. 2)	11,000			
Furniture (10% of ₹40,000)	4,000	40,000		
To Salaries		1,00,000		
To Manager's Commission Payable (5/105 × ₹6,62,900)		31,567		
To Net Profit Transferred to Capital		6,31,333		
		9,43,500		9,43,500

Balance Sheet
as at 31st December, 2011

Liabilities		₹	Assets		₹
Capital	14,00,000		Building	10,00,000	
Add: Net Profit	6,31,333		*Less:* Depreciation	25,000	9,75,000
Machinery Wrongly Capitalised	28,000		Machinery	75,000	
	20,59,333		*Add:* Machinery purchased on 01.01.2009	28,000	
Less: Drawings	75,000			1,03,000	
	19,84,333		*Less:* Depreciation	11,000	92,000
Less: Goods Taken for Personal	5,000	19,79,333	Furniture	40,000	
Creditors		1,60,000	*Less:* Depreciation	4,000	36,000
Manager's Commission Payable		31,567	12% Investments		6,00,000
			Accrued interest on investments		18,000
			Debtors	1,50,000	
			Less: Provision for Doubtful Debts (W.N. 1)	9,000	1,41,000
			Bank Balance		83,900
			Closing Stock		2,25,000
		21,70,900			21,70,900

Working Notes:

W.N. 1 - Provision for Doubtful Debts A/c

Particulars	₹	Particulars	₹
To Bad Debts (₹14,000 + ₹6,000)	20,000	By Balance b/d	19,000
To Balance c/d (6% of ₹1,50,000)	9,000	By Profit & Loss A/c (bal. fig.)	10,000
	29,000		29,000

W.N. 2 - Calculation of Depreciation on Machinery

Particulars	₹
Cost of Machinery purchased on 01-01-2009	35,000
Less: Depreciation for two years (10% of ₹35,000 × 2)	7,000
W.D.V. as on 01-01-2011	28,000
Depreciation for 2011 on this Machinery on SLM (10% of ₹35,000)	3,500
Depreciation on Machinery given in Trial Balance (10% of ₹75,000)	7,500
Total Depreciation on Machinery	11,000

Q7. What is the Sequence of Accounting procedure or the accounting Cycle?

Answer:

Recording in Journal
⇓
Posting in Ledger
⇓
Trial Balance
⇓
Trading and Profit & Loss A/c
⇓
Balance Sheet

Q8. What is an Opening Entry is case of books of accounts?

Answer:

Opening Entry is passed at the beginning of each year. The balances of previous year are brought forward as opening balances.

In case of Assets, "To balance b/d" is written on debit side of asset A/c

In case of Liabilities, "By balance b/d" is written on credit side of liability A/c.

Q9. What do you mean by Provisions and Reserves?

Answer:

Provision means any sum set aside for providing for diminution in value of a particular asset or any known Liability the amount of which cannot be ascertained with certainty.

Example:

- Provision for bad & doubtful debts
- Provision for depreciation.
- It is a charge against profit

Reserves are the appropriation of profits withheld from being distributed and are retained by the firm. It helps to strengthen the financial position and to meet unforseen business losses.

Example:

The following is the Trial Balance of Mrs. S.S. at 31st March, 2009

Particulars	Dr. (₹)	Cr. (₹)
Cash in hand	1,080	
Cash at Bank	5,260	
Purchases	81,350	
Returns Outward		1,000
Sales A/c		1,97,560
Returns Inward	1,360	
Wages	20,960	
Fuel and Power	9,460	
Carriage on Sales	6,400	
Carriage on Purchases	4,080	
Stock on 1.4.2008	11,520	
Building	60,000	
Freehold Land	20,000	
Machinery	40,000	
Salaries	30,000	
Patents	15,000	
General Expenses	6,000	
Insurance	1,200	
Capital		1,42,000
Drawings	10,490	
Sundry Debtors	29,000	
Sundry Creditors		12,600
	3,53,160	3,53,160

Taking into account the following adjustments, pass the necessary Journal entries and prepare the Trading and Profit and Loss Account and a Balance Sheet.

1. Stock at hand on 31st March, 2009 is ₹13,600.
2. Machinery is to be depreciated at the rate of 10% and patents at the rate of 20%.
3. Salaries for the month of March, 2009 amounted to ₹3,000 were unpaid
4. Insurance included a premium of ₹170 for next year.
5. Wages included a sum of ₹4,000, spent on the erection of a cycle shed for employees and customers.
6. A Provision for doubtful Debts is to be created to the extent of 5% on Sundry Debtors.

Answer:

Journal

Date	Particulars	LF	Dr. (₹)	Cr. (₹)
2009 March 31	Depreciation A/c Dr.		7,000	
	To Machinery A/c			4,000
	To Patents A/c			3,000
	(Being the amount written of as depreciation of Machinery [10% on ₹40,000] and on Patents [20% on ₹15,000])			
March 31	Salaries A/c Dr.		3,000	
	To Salaries outstanding A/c			3,000
	(Being the amount still due on account of Salaries)			
March 31	Insurance Prepaid A/c Dr.		170	
	To Insurance A/c			170
	(Being the Prepaid Insurance Premium adjusted)			
March 31	Building A/c (Note) Dr.		4,000	
	To Wages A/c			4,000
	(Being the wages spent on erection on a cycle shed transferred to Building Account)			
March 31	Profit and Loss A/c Dr.		1,450	
	To Provision for doubtful Debts A/c			1,450
	(Being the provision required to be maintained in respect of anticipated bad debts)			

March 31	Trading A/c Dr.		1,24,730	
	To Stock A/c			11,520
	To Purchases			81,350
	To Wages A/c			16,960
	To Fuel and Power A/c			9,460
	To Carriage on Purchased A/c			4,080
	To Returns Inward A/c			1,360
	(Being the various accounts transferred to the Trading Account (debit side)			
March 31	Sales A/c Dr.		1,97,500	
	Return Outward A/c Dr.		1,000	
	To Trading A/c			1,98,560
	(being the accounts transferred to the credit of the Trading Account)			
March 31	Stock A/c Dr.		13,600	
	To Trading A/c			13,600
	(Being the value of the closing stock)			
March 31	Trading A/c Dr.		87,430	
	To Profit and Loss A/c			87,430
	(Being the transfer of gross profit)			
March 31	Profit and Loss A/c Dr.		53,430	
	To Carriage on sale A/c			6,400
	To Salaries A/c			33,000
	To General Expenses A/c			6,000
	To Insurance A/c			1,030
	To Depreciation A/c			7,000
	(Being the various expenses transferred to the debit of the Profit and Loss Account)			

March 31	Profit and Loss A/c Dr.		32,550	
	To Capital A/c			32,550
	(Being the transfer of net profit)			
March 31	Capital A/c Dr.		10,490	
	To Drawing A/c			10,490
	(Being the transfer of the Drawings Account to the Capital Account)			

Note: Wages paid for erection of a cycle shed being capital expenditure should be debited to the Building Account.

Trading and Profit and Loss Account
for the year ended 31st March, 2009

Dr. **Cr.**

Particulars		₹	Particulars		₹
To Opening Stock A/c		11,520	By Sales A/c	1,97,500	
To Purchases A/c	81,350		*Less:* Returns A/c	1,360	1,96,200
Less: Returns	1,000	80,350	By Closing stock		13,600
To Wages A/c	20,960				
Less: Wages spent on Cycle shed	4,000	16,960			
To Fuel and Power A/c		9,460			
To Carriage A/c		4,080			
To Gross Profit transferred to Profit and Loss A/c		87,430			
		2,09,800			2,09,800
To Carriage on Sales A/c		6,400	By Gross Profit transferred from Trading A/c		87,430
To Salaries A/c	30,000				
Add: Outstanding Salaries	3,000	33,000			
To General Expenses A/c		6,000			
To Insurance A/c	1,200				
Less: Prepaid	170	1,030			

Particulars		₹	Particulars	₹
To Depreciation A/c:				
Machinery @ 10%	4,000			
Patents @ 20%	3,000	7,000		
To Provision for Doubtful Debts A/c		1,450		
To Net profit transferred to capital A/c		32,550		
		87,430		87,430

Balance Sheet
as at 31st March, 2009

Liabilities		₹	Assets		₹
Creditors		12,600	Building	60,000	
Outstanding Salaries		3,000	*Add:* Wages spent on cycle shed	4,000	64,000
Capital	1,42,000		Freehold Land		20,000
Add: Net Profit	32,550		Machinery	40,000	
	1,74,550		*Less:* Depreciation	4,000	36,000
Less: Drawings	10,490	1,64,060	Patents	15,000	
			Less: Depreciation	3,000	12,000
			Debtors	29,000	
			Less: Provision for Doubtful Debt	1,450	27,550
			Prepaid Insurance		170
			Closing Stock		13,600
			Cash in Hand		1,080
			Cash at Bank		5,260
		1,79,660			1,79,660

Example:

From the following Trial Balance of Ram Narain as at 31st March, 2009. Prepare the Trading and Profit and Loss Account and a Balance Sheet.

Debit Balances		Credit Balances	
Opening Stock	15,500	Capital	60,000
Land and Building	35,000	Loan from Mrs. Ram Narain	
Machinery	50,000	@ 9%	30,000
Furniture and Fixtures	5,000	Sundry Creditors	9,600
Purchases	1,06,000	Purchases Return	2,100
Salaries	11,000	Sales	2,07,300
General Expenses	2,500	Discount	1,200
Rent	3,000		
Postage and Telegram	1,400		
Stationery	1,300		
Wages	26,000		
Freight on Purchases	2,800		
Carriage on sales	4,000		
Repairs	4,500		
Sundry Debtors	30,000		
Bad debts	600		
Cash in Hand	100		
Cash at Bank	6,400		
Sales Return	5,100		
	3,10,200		3,10,200

The following further information was given:

(i) Wages for March, 2009 amounted to ₹2,100 have not yet been paid

(ii) Included in general expenses is an Insurance Premium of ₹600 paid in advance for the next year.

(iii) A provision for doubtful Debts @ 5% on debtors is necessary

(iv) Depreciation is to be charged as follows:
Land and Building 2% Machinery 10% and furniture and fixtures 15%

(v) The loan from Ram Narain was taken on 1st October, 2008 interest has not been paid yet

(vi) The value of stock at hand on 31st March, 2009 was ₹14,900

(vii) The manager is entitled to a commission of 10% of the net profit after charging such commission.

Answer:

Trading Account

Dr. for the year ended 31st March, 2009 Cr.

Particulars		(₹)	Particulars		(₹)
To Opening Stock A/c		15,500	By Sales A/c	2,07,300	
To Purchases A/c	1,06,000		*Less:* Sales Return	5,100	2,02,200
Less: Purchases Return	2,100	1,03,900	By Closing Stock A/c		14,900
To Freight on Purchases A/c		2,800			
To Wages A/c	26,000				
Add: Outstanding Wages	2,100	28,100			
To Gross Profit transferred to Profit and Loss A/c		66,800			
		2,17,100			2,17,100

Profit and Loss Account

Dr. for the year ended 31st March, 2009 Cr.

Particulars	(₹)	Particulars	(₹)
To Salaries A/c	11,000	By Gross Profit b/d	66,800
To Rent A/c	3,000	By Discount A/c	1,200
To Postage and telegram A/c	1,400		
To Stationery A/c	1,300		

To Repairs A/c		4,500		
To Carriage on sales A/c		4,000		
To General expenses A/c	2,500			
Less: Prepaid Insurance	600	1,900		
To Interest on loan @ 9% A/c		1,350		
To Bad debts A/c	600			
Add: Provision for Bad and Doubtful Debts	1,500	2,100		
To Depreciation A/c:				
Land and Building	700			
Machinery	5,000			
Fixtures and Fitting	750	6,450		
To Commission to Manager (Note) A/c		2,818		
To Net Profit transferred to Capital A/c		28,182		
		68,000		68,000

Balance Sheet
as at 31st March, 2009

Liabilities		(₹)	Assets		(₹)
Current Liabilities			Current Assets		
Sundry Creditors		9,600	Cash in Hand		100
Wages Outstanding		2,100	Cash at Bank		6,400
Manager Commission Payable (Note)		2,818	Sundry Debtors	30,000	
			Less: Provision for Doubtful Debts	1,500	28,500
Mrs. Ram Narain's loan	30,000		Closing Stock		14,900
Add: Interest on loan	1,350	31,350	Unexpired Insurance		600

Capital			**Fixed Assets**		
Opening Balance	60,000		Furniture and Fixtures	5,000	
Add: Net Profit	28,182	88,182	*Less:* Depreciation	750	4,250
			Machinery	50,000	
			Less: Depreciation	5,000	45,000
			Land and Building	35,000	
			Less: Depreciation	700	32,300
		1,34,050			1,34,050

Note: Profit before charging Commission is ₹31,000. Commission payable @ 10% of net profit after charging such commission.

$$\text{Manager's Commission} = \text{Net Profit} \times \frac{\%\text{ of Commission}}{100 + \%\text{ of Commission}}$$

$$= 31{,}000 \times \frac{10}{110}$$

$$= ₹2{,}818$$

Q10. What are the Limitations of Financial Statements?

Answer:

- Financial Statements are prepared on Historical cost ignoring any subsequent change in value of money.
- They only record items which can be expressed quantitatively, ignoring qualitative strengths of business such as expertise knowledge of staff, loyalty of customers, workers, etc.
- The basic assumption while drawing final accounts is perpetual succession and expenses are accordingly differentiated, hence, they may not show true picture of business in any particular period.
- Different firms adopt different accounting policies for recording business transactions giving different financial results; therefore inter firm comparison is not possible.
- There can be different managerial policies for various items of profit & Loss or Balance Sheet.

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. Calculate gross profit if rate of gross profit is 20% on sales and cost of goods is ₹1,20,000:
   (a) ₹24,000
   (b) ₹30,000
   (c) ₹20,000
   (d) None of these
2. Prepaid Rent is shown as:
   (a) Current asset
   (b) Current Liability
   (c) Fixed asset
   (d) Income
3. | | |
   |---|---|
   | Opening Stock | ₹8,500 |
   | Purchases | ₹30,700 |
   | Direct expenses | ₹4,800 |
   | Indirect expenses | ₹5,200 |
   | Closing Stock | ₹9,000 |

   Cost of goods sold will be:
   (a) ₹30,000
   (b) ₹35,000
   (c) ₹32,000
   (d) ₹40,000
4. A company wishes to earn a 20% profit margin on selling price._____ is the profit mark up on cost, which will achieve the required profit margin?
   (a) 33%
   (b) 25%

   (c) 20%
   (d) None of these
5. If Closing Stock appears in the Trial Balance, then it appears in:
   (a) Trading account
   (b) Profit and Loss account
   (c) Balance Sheet
   (d) Profit and loss appropriation
6. Bonus given to employees is recorded in:
   (a) Trading account
   (b) Profit and Loss account
   (c) Profit and Loss Appropriation
   (d) None of these
7. | | ₹ |
   |---|---|
   | Opening stock | 22,000 |
   | Closing stock | 25,000 |
   | Purchase less returns | 1,10,000 |
   | Gross profit margin (on sales) | 20% |

   The sales of the company will be:
   (a) ₹1,41,250
   (b) ₹1,35,600
   (c) ₹1,33,750
   (d) ₹1,28,400
8. Capital introduced in beginning by Ram ₹40,000. Further capital introduced during the year ₹1000. Drawings ₹200 per month and closing capital is ₹53,600. The amount of profit or loss for the year is:
   (a) ₹15,000 profit
   (b) ₹5000 Loss
   (c) ₹20,000 profit
   (d) Can't say
9. Provisions are:
   (a) Appropriation of profits
   (b) Charge against profits

(c) Both
(d) None

10. Sundry Debtors on 31st March, 2006 are ₹55,200. Further Bad debts are ₹200. Provision for doubtful debts are to be made on debtors @ 5% and also provision of discount is to be made on debtors @ 2%. The amount of provision of discount on debtors will be:
(a) ₹1,045
(b) ₹2,750
(c) ₹1,100
(d) ₹2,760

11. A sells goods at 33-1/3% above cost. His sales were ₹10,20,000 during the year. However, he sold damaged goods for ₹20,000 costing ₹30,000. This sale is included in ₹10,20,000. The amount of gross profit is:
(a) ₹1,90,000
(b) ₹2,50,000
(c) ₹2,40,000
(d) ₹2,00,000

12. Bills Receivable discounted but not due till date of final accounts is shown as:
(a) Liabilities
(b) Assets
(c) P & L A/c
(d) Foot notes (contingent liabilities)

13. Bad debts ₹3,000
Provision for bad debts ₹3,500.
It is desired to make a provision of ₹4,000 at the end of the year. The amount debited to P & L A/c is:
(a) ₹4,000
(b) ₹5,000
(c) ₹6,500
(d) ₹3,500

14. The provision for bad debts is made by crediting:
(a) Trading A/c
(b) Profit & Loss Account
(c) Debtors Account
(d) Provision for bad debts account

15. A firm purchased goods of ₹90,000 and spent ₹6,000 on freight towards it. At the end of the year, the cost of goods still unsold was ₹12,000. Sales during the year ₹1,20,000. What is the gross profit earned by the firm?
(a) ₹36,000
(b) ₹18,000
(c) ₹42,000
(d) ₹38,000

16. Sundry debtors of M/S Santosh amount to ₹25,000 and Bad debts ₹ 3,000. They provide for doubtful debts @ 2% and for discount @ 1% The amount of net debtors to be shown in the balance sheet will be:
(a) ₹21,560
(b) ₹22,000
(c) ₹21,780
(d) ₹21,344

17.

Opening Stock	₹ 5,000
Purchases	₹15,000
Direct expenses	₹ 2,000
Closing Stock	₹ 2,500

Cost of goods sold =?
(a) ₹20,000
(b) ₹19,500
(c) ₹21,500
(d) ₹22,000

18. Trading Account is a:
(a) Personal Account
(b) Real Account

(c) Nominal account
(d) None of these

19. Only Personal and Real accounts are shown in:
(a) Trial balance
(b) Balance Sheet
(c) Trading A/c
(d) Profit & Loss A/c

20. The balance in books of X, a sole proprietor were:
Opening Stock ₹17,000, Purchase ₹52,000, Wages ₹46,500 Fuel ₹ 15,000. Sales ₹1,45,000 and Closing Stock ₹25,000 whose Net Realizable value was ₹28,000 Find the Gross profit :
(a) ₹39,500
(b) ₹42,500
(c) ₹54,500
(d) ₹57,000

21. Opening debtors = 3,000
Credit Sales = 80,000
Cash received from debtors = 60,000
Closing Debtors?
(a) ₹30,000
(b) ₹32,000
(c) ₹23,000
(d) ₹20,000

22. A person started a business with capital of ₹50,000 and he takes loan from his relative ₹5,000. Profit for the year is ₹10,000 and drawings ₹ 9,000. What will be the amount of closing capital?
(a) ₹60,000
(b) ₹51,000
(c) ₹56,000
(d) ₹46,000

23. Cost of goods sold = ₹15,00,000, Gross Profit = 20% on sales Calculate the amount of sales.
(a) ₹18,25,000
(b) ₹18,75,000
(c) ₹18,50,000
(d) ₹19,00,000

24. Full claim accepted by Insurance Company on the loss of goods by fire is credited to _________.
(a) Trading A/c
(b) P/L A/c
(c) Insurance company
(d) None.

25. Closing Stock of previous year is overvalued by ₹50,000. Due to this:
(a) Previous year's profit is overstated and current year's profit is understated.
(b) Previous year's profit is understated and current year's profit is overstated.
(c) Previous years profit is overstated and current year's profit is overstated.
(d) Previous year's profit is understated and current year's profit is understated.

26. Opening balance of debtors is ₹35,000 Cash Received from Debtors is ₹30,000 Cash sales is ₹20,000 which is 20% of total sales. B/R Received for ₹40,000 and discount allowed is 1% of cash collection. Find the closing debtors.
(a) ₹15,300
(b) ₹44,700
(c) ₹64,700
(d) ₹35,700

27. Opening Balance of cash = ₹4,000, Closing balance = ₹7,000, Payment to creditors = ₹80,000, B/P matured = ₹6,000, B/R discounted = ₹9,000, Sundry expenses = ₹3,000, Drawings = ₹12,000
What is the amount received from debtors?

(a) ₹95,000
(b) ₹1,01,000
(c) ₹83,000
(d) ₹91,000

28 _______ is a summary of all assets and liabilities on a particular date.
(a) Trial Balance
(b) Profit and Loss Account
(c) Balance Sheet
(d) Funds Flow Statement

29 If the profit is 25% on sales, then what percentage of profit is on cost?
(a) 33 %
(b) 20 %
(c) 40 %
(d) 50 %

30. Sales = ₹3,00,000; G.P. on sales is 20%; Purchases = ₹2,40,000; Opening stock = ₹20,000 Find closing stock.
(a) ₹20,000
(b) ₹24,000
(c) ₹16,000
(d) ₹12,000

31. At the end of Trial Balance, the following adjustments are given: stock destroyed ₹20,000; Insurance claim received ₹16,000. The effect of the above adjustments will be shown in:
(a) Trading Account
(b) Profit and Loss Account
(c) Balance Sheet
(d) All of the above.

32. A surplus of revenue over its cost is known as _______ of business.
(a) Capital
(b) Profit
(c) Asset
(d) None

33. Net profit before the following adjustments ₹1,80,000
Outstanding Salary ...... ₹10,000
Prepaid insurance........ ₹13,000
Calculate profit after adjustments.
(a) ₹1,77,000
(b) ₹1,83,000
(c) ₹2,03,000
(d) none of the above.

34. Find out the corrected net profit:
Profit before taking into account following adjustments was ₹7,00,000
(i) ₹1,00,000 spent on purchase of motor car for business purpose, treated as expense in Profit & Loss A/c.
(ii) ₹15,000 p.m. rent outstanding for the month of February and March not taken into account -
(a) ₹7,70,000
(b) ₹7,85,000
(c) ₹6,15,000
(d) ₹6,30,000

35. Sales = ₹11,000, G.P. = 1/10th on cost. Closing stock before these Adjustments ₹1,00,000. Closing stock after adjustment of sales will be-
(a) ₹1,10,000
(b) ₹90,000
(c) ₹89,000
(d) None

36. Bad debts recovered of ₹2,000 which were previously written off as bad debt will be credited to _______ A/c
(a) Bad debt A/c
(b) Debtor A/c
(c) Bad Debts Recovered A/c
(d) Suspense A/c

37. Selling and distribution expenses does not comprise of:
(a) Godown Rent
(b) Bad Debts

(c) Insurance for Stock of Finished Goods

(d) Carriage Inward

38. There was a stock of ₹5,500 out of which stock of ₹500 was burnt due to fire and was disposed off for ₹200. Remaining goods were sold at 25% above cost price. Find net profit.

(a) ₹250

(b) ₹200

(c) ₹575

(d) ₹950

39. If profit is 25% at cost price then the profit on sale price will be:

(a) 20%

(b) 30%

(c) 33 1/3%

(d) 40%

40. If Purchases Account is not credited in case of goods lost in transit then which account can be credited?

(a) Goods Lost in Transit Account

(b) Purchase Return Account

(c) Trading Account

(d) Sales Account

41. Opening Stock = ₹50,000

Purchases = ₹1,00,000

Purchase Return = ₹29,000

Sales = ₹2,00,000

Find the Gross Profit

(a) ₹1,21,000

(b) ₹79,000

(c) ₹21,000

(d) None of the above

42. Postal Expenses Account is shown in:

(a) P & L A/c

(b) Trading A/c

(c) Balance Sheet

(d) Manufacturing A/c

43. Prepaid Expense of Financial Year relate with:

(a) Previous Financial Year

(b) Following Financial Year

(c) Current Financial Year

(d) None

44. Opening Capital = ₹5,00,000

Profits during the year = ₹1,00,000

Calculate the Average Capital of the year.

(a) ₹5,50,000

(b) ₹3,00,000

(c) ₹9,167

(d) ₹50,000

45. Goods in Transit but not taken in Closing Stock will be credited to:

(a) Purchase A/c or Trading A/c

(b) Supplier A/c

(c) Goods in Transit A/c

(d) Cash A/c

46. The manager of a firm is entitled to a commission of 10% on net profit after his commission. If the net profit of the firm before charging commission is ₹4,40,000, the amount of manager's commission will be:

(a) ₹44,000

(b) ₹40,000

(c) ₹37,000

(d) ₹33,000

47 At the end of the year 2008-09, the ledger of a firm shows following balances; prepare their balance sheet-

Capital	₹2,00,000
Net profit for the year 2008-09	₹1,50,000
Provision for Taxes	₹ 75,000
Liabilities	₹1,00,000

Advance Tax Paid ₹ 60,000
Sundry Assets ₹4,65,000

The total of the balance sheet would be

(a) ₹4,65,000
(b) ₹5,25,000
(c) ₹5,65,000
(d) ₹5,10,000

48. On 31st March, 2009, Ram has loan of ₹50,000 and trade creditors of ₹ 80,000, Fixed assets of ₹72,000, Stock ₹90,000 and cash in hand ₹ 60,000. If he had started business on April 1, 2008 with capital of ₹ 50,000. Compute profit earned by Ram for year 2008-09:

(a) ₹92,000
(b) ₹42,000
(c) ₹1,72,000
(d) ₹52,000

49. The Gross Profit for the year ending 31.03.2009 is ₹1,750, Carriage Inward is ₹150, Bad Debts is ₹120, Proprietors Personal Expenses is ₹750 Carriage Outward is ₹175. The amount of Net Profit will be

(a) ₹1,455
(b) ₹1,305
(c) ₹555
(d) ₹705

50. Calculate the value of closing stock from the following:

Opening stock ₹ 60,000
Purchases ₹ 90,000
Sales ₹1,20,000

Gross Profit on cost 33 1/3%. Due to fire, stock costing ₹15,000 destroyed and insurance claim was accepted for ₹5000

(a) ₹40,000
(b) ₹45,000
(c) ₹55,000
(d) ₹60,000

51. Salaries paid in cash ₹2,00,000. It includes previous year's outstanding ₹10,000 and salary paid in advance for the next year ₹20,000. Salary outstanding for the year is ₹15,000. Salary of _____ shall be debited in the profit and loss account.

(a) ₹2,25,000
(b) ₹1,85,000
(c) ₹2,05,000
(d) ₹1,75,000

52. The fixed asset of a company is double of the current assets and half of capital. If the current assets are ₹3,00,000 and investment ₹4,00,000, calculate the current liabilities assuming that there are no other items in the balance sheet.

(a) ₹2,00,000
(b) ₹1,00,000
(c) ₹3,00,000
(d) ₹4,00,000

53. Total Debtors on 31.12.2009 were ₹48,000 before writing off bad-debts but after allowing discounts. During the year, bad-debts amounted to ₹ 2,000 and discount allowed were ₹100. It is the firm's policy to maintain a provision of 5% against bad and doubtful debts. Find out the amount of provision for Bad and Doubtful debts as on 31.12.09:

(a) ₹2400
(b) ₹2305
(c) ₹2300
(d) ₹2000

54. What will be the treatment of "accrued income" if appearing in the Trial Balance:

(a) It will be shown on the assets side as current assets in the balance sheet.
(b) It will be shown on the liability side as current liability in the balance sheet.

(c) It will be shown on the debit side of trading account as an expense.

(d) It will be shown on the credit side of profit and loss account as an income.

55. Transactions of Aruna Limited for the period 1.4.09 to 10.04.09 are as follows.

Direct Expenses	₹ 80,000
Sales	₹7,50,000
Purchases	₹4,50,000
Stock as on 10.4.09	₹3,60,000

Rate of Gross Profit on sales 12%

The value of stock as on 1.04.09 was:

(a) ₹5,70,000

(b) ₹4,90,000

(c) ₹5,30,000

(d) None of the above.

56. Which of the following statement is not true-

(a) Actual bad-debts are not adjusted against the provision for bad-debts a/c.

(b) Bad-debts could be more than provision for bad-debts

(c) Bad-debts could be less than provision for bad-debts

(d) Provision for bad-debts is shown as a liability in the balance sheet or may be deducted from the debtors in the balance sheet.

Answer

1.	(b)	2.	(a)	3.	(b)	4.	(b)	5.	(c)
6.	(b)	7.	(c)	8.	(a)	9.	(b)	10.	(a)
11.	(c)	12.	(d)	13.	(d)	14.	(d)	15.	(a)
16.	(d)	17.	(b)	18.	(c)	19.	(b)	20.	(a)
21.	(c)	22.	(b)	23.	(b)	24.	(a)	25.	(a)

26.	(b)	27.	(a)	28.	(c)	29.	(a)	30.	(a)
31.	(d)	32.	(b)	33.	(b)	34	(a)	35.	(b)
36.	(c)	37.	(d)	38.	(d)	39.	(a)	40.	(c)
41.	(b)	42.	(a)	43.	(b)	44.	(a)	45.	(a)
46.	(b)	47.	(b)	48.	(b)	49.	(a)	50.	(b)
51.	(b)	52.	(b)	53.	(c)	54.	(a)	55.	(b)
56.	(a)								

Short Practice Questions

1. Differentiate between provisions and reserves.
2. What are the limitations of financial statements?
3. Differentiate between Profit & Loss and Balance Sheet.

Past Year Questions and Answers

Objective Questions

1994 - Nov [5] State with reason whether the following statement is true or false:

(9) Providing depreciation in the accounts reduces the amount of profit available for dividend. (1.5 marks)

Answer:

True: Divided are distributed out of net profits which is obtained after providing for depreciation therefore, depreciation reduces the amount of profit for divided.

1995 - May [5] State with reason whether the following statements are true or false:

(c) A Profit and Loss Account is a point statement whereas a Balance Sheet is a period statement. (1.5 marks)

(f) The proprietor of a shop feels that he has made a loss due to closing stock being zero. (1.5 marks)

Answer:

(c) False: P&L A/c is a period statement as it is prepared for a particular accounting period (for the year ending....) B/S is a point statement because its is prepared as on a particular date (as on -----)

(f) 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.

1995 - Nov [5] State with reason whether the following statements are true or false:

(2) Sale of office furniture should be credited to Sales A/c. (1.5 marks)

(9) The provision for discount on Debtors is calculated before deducting the provision for doubtful debts from Debtors. (1.5 marks)

Answer:

(2) False: It should be credited to Furniture A/c because it is a capital receipt.

(9) False: It is calculated after deducting the provision for doubtful debts i.e. on the balance left.

1996 - Nov [5] State with reason whether the following statement is true or false:

(10) The debts written off as bad, if recovered subsequently are credited to debtors account. (2 marks)

Answer:

False: The debts written off as bad if recovered subsequently shall be treated as gain and be credited to Profit and Loss Account or to Bad Debts Recovered Account.

1997 - Nov [5] State with reason whether the following statement is true or false:

(9) The proprietor of a shop feels that he has made a loss due to closing stock being zero. (2 marks)

Answer:

False: *Please refer 1995 - May [5] (f) on page no. 649*

1998 - May [5] State with reason whether the following statements are true or false:

(1) The provision for discount on debtors is calculated after deducting the provision for doubtful debts from Debtors. (2 marks)

(2) Freight and cartage expenses paid on purchase of goods is added to the amount of purchase. (2 marks)

Answer:

(1) True: The provision for doubtful debts is deducted from the debtors to arrive at the balance of good debtors who might claim discount by making prompt payments. Thus, the provision for discount on debtors is calculated on the balance so arrived which represents good or sound debtors.

(2) True: Freight and cartage expenses paid to bring goods purchased into the business premises/factory are included in the 'Cost of Purchases'.

2000 - May [5] State with reason whether the following statement is true or false:

(vii) Provision for bad debts is debited to Sundry Debtors Account. (2 marks)

Answer:

False: Provision for bad debts is debited to Profit and loss Account, in Balance Sheet it is shown either on liability side or deducted from the head Debtors.

2000 - Nov [5] State with reason whether the following statements are true or false:

(2) Freight paid on purchases of goods is added to the amount of purchases. (2 marks)

(4) Wages paid for erection of new machinery are debited to Machinery A/c. (2 marks)

Answer:

(2) True: Such freight paid on the purchases of goods is included in the cost of purchase.

(4) True: Because it is a capital expenditure.

2001 - May [5] State with reason whether the following statement is true or false:

(1) Land is also a depreciable asset. (2 marks)

Answer:

False: Land is not a depreciable asset.

2002 - May [5] State with reason whether the following statement is true or false:

(10) The debts written-off as bad, if recovered subsequently are credited to debtor's account. (2 marks)

Answer:

False: It will be credited to Bad debts Recovered Account.

2002 - Nov [5] State with reason whether the following statements are true or false:

(a) Provision for discount on debtors is calculated after deducting the provision for doubtful debts from debtors. (2 marks)

(e) Profit on Sale of a Capital asset need not be added to ascertain the Net Profit of a business. (2 marks)

Answer:

(a) True: Provision for discount on debtors is to be calculated on the balance of debtors left after deducting provision for doubtful debts.

(e) 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.

2004 - Nov [5] State with reason whether the following statement is true or false:

(vi) The provision for discount on debtors is calculated after deducting the provision for doubtful debts from debtors. (2 marks)

Answer:

True: The provision for discount on debtors is calculated after deducting the provision for doubtful debts from debtors in order to determine the provision for discount on good debtors who may make their payment promptly after getting the discount.

2005 - May [5] State with reason whether the following statement is true or false:

(i) Goods worth ₹600 taken by the proprietor for personal use should be credited to purchase account. (2 marks)

Answer:

True: Goods taken by the proprietor for personal use should be debited to Drawings Account and Credited to Purchase Account.

2006 - May [5] State with reason whether the following statements are true or false:

(iii) "Marshalling" and "Grouping" have the same meaning. (2 marks)

(vii) Sundry debtors are liquid assets. (2 marks)

Answer:

(iii) False: 'Marshalling' means presentation of assets and liabilities in a Balance Sheet in the order of liquidity or permanency. When similar items are grouped together under a common heading for the purpose of clarity, it is known as 'Grouping'.

(vii) True: Liquid assets are those assets, which are immediately convertible into cash without much loss. Liquid assets are part of current assets and all current assets excluding inventories and prepaid expenses are liquid assets.

2018 - Nov [1] {C} (a) State with reasons, whether the following statement is true or false: -

(iv) If Closing Stock appears in the Trial Balance:
The closing inventory is then not entered in Trading Account. It is shown only in the balance sheet. (2 marks)

Answer:

True: If closing stock appears in the Trial Balance, then closing stock is not entered in the trading account, but only shown in the Balance Sheet. This is because it has already been adjusted to arrive at cost of goods sold.

DISTINGUISH BETWEEN

1994 - Nov [6] Differentiate between the following:

(6) Profit and Loss Account and Balance Sheet. (8 marks)

Answer:

	Profit & Loss A/c	Balance Sheet
1.	It shows the profit or loss made by the business during a particular period.	It shows the financial position of a business on a particular date.
2.	It includes those items, which are of revenue nature.	It includes those items, which are of capital nature.
3.	All the nominal account balances are transferred to Profit and Loss A/c.	It consists of the personal and real account balances.
4.	The accounts lose their identity and are finally closed.	The accounts do not lose their identity and become the opening balance of the next year.

1995 - May [6] Explain the difference between the following:

(i) Trial Balance and Balance Sheet. (5 marks)

Answer:

- A Trial Balance is a statement prepared as on a particular date to check primarily the arithmetical accuracy of ledger balances. A Balance Sheet, on the other hand, is a statement on the financial position of an enterprise as at a given date, which exhibits its assets, liabilities, and equities at their respective book value.
- A Trial Balance may be prepared monthly, quarterly, half yearly or annually but Balance Sheet is prepared annually and in some cases half yearly.
- A Trial Balance lists ledger balances of all accounts irrespective of their nature. A Balance Sheet consists mainly of personal and real account balances.
- Trial Balance is the basis on which financial statements like Profit & Loss Account and Balance Sheet are prepared.

1996 - Nov [6] Distinguish between the following:

(b) Provisions and Reserves. (5 marks)

Answer:

- Provision means "any amount written off or retained by way of providing for depreciation, renewal or diminution in value of assets, or retained by way of providing for any known liabilities of which the amount cannot be determined with substantial accuracy".
- The Following are instances of amount retained in the business out of earning for different purposes that are described as provisions:
  - o Amount provided for meeting claims which are admissible in principle but the amount whereof has not been ascertained;
  - o Amount provided for payment of taxes still to be assessed;
  - o Amount set aside for writing off bad debts or payment of discounts, etc.

Reserve:

- Profit retained in the business not having any of the attributes of a provision is treated as a reserve.
- Also, provisions in excess of the amount considered necessary for the purpose they were originally made, are to be considered as reserve.
- It is thus evident that provisions are a charge against profits, while reserve is an appropriation of profits.

1997 - May [6] Explain the difference between the following:
(2) Trial Balance and Balance Sheet. (5 marks)

Answer:

Please refer 1995 - May [6] (i) on page no. 654

1998 - May [6] Explain the difference between the following:
(d) Trial Balance and Balance Sheet. (5 marks)

Answer:

Please refer 1995 - May [6] (i) on page no. 654

2000 - Nov [6] Briefly explain the difference between the following:
(c) Provisions and Reserves. (5 marks)

Answer:

Please refer 1996 - Nov [6] (b) on page no. 654

2001 - Nov [6] Briefly explain the difference between the following:
(c) Charge against Profit and Appropriation of Profit. (5 marks)

Answer:

Charge against Profit: It means a deduction from the revenue. It may be shown by writing the amount to the debit side of the profit and loss a/c to arrive at the net profit or net loss. It is done before the appropriation of profits.

Appropriation of Profit: It means the distribution of net profit to various heads of the accounts. It may be in any form such as dividend reserves, or distribution of profits. It may be done only if there is earning of profit. It is debit to profit and loss appropriation A/c.

2002 - May [6] Explain the difference between the following:
(b) Trial Balance and Balance Sheet. (5 marks)

Answer:

Please refer 1995 - May [6] (i) on page no. 654

2002 - Nov [6] Distinguish between the following:
(b) Cash Discount and Trade Discount (3 marks)

Answer:

Cash Discount:

- Cash discount is the discount offered by the supplier in consideration of immediate payment.
- It may vary with the period of payment.
- Such discount encourages the debtors to pay within a specified period of time.
- It is usually shown in the financial statements as financial expense or income.

Trade Discount:

- Trade discount is a discount on the selling price payable by customer for bulk purchase.
- This is a discount given by a manufacturer or wholesale dealer to dealer or retail dealer.
- It is also called quantity discount.
- Trade discount is a technique of sales promotion and is offered generally to customers for purchasing above a minimum quantity.
- Trade discount is deducted from the sale price in the invoice itself.
- It does not form part of the accounting entries as the discount is deducted in the invoice and net amount is entered in the books of account.
- The objective of this discount is to help the retailer to earn profit as he sells the goods at a fixed price (catalogue price).

DESCRIPTIVE QUESTIONS

2001 - Nov [3] (b) What is "Balance Sheet"? (5 marks)

Answer:

The 'Balance Sheet' may be defined as "a statement which sets out the assets and liabilities of a firm or an institution as at a certain date". Since even a single transaction will make a difference to some of the assets or liabilities, the balance sheet is true only at particular point of time. Balance sheet is prepared only after preparation of the profit and loss account. A balance sheet consists mainly of personal and real account balances and is generally prepared annually, and in some cases half-yearly or quarterly. Since capital always equals the difference between assets and liabilities and since the capital account will independently arrive at this figure, the two sides of the balance sheet must have the same totals. If it is not so, there is certainly an error somewhere.

2018 - Nov [1] {C} (b) Discuss the limitations which must be kept in mind while evaluating the Financial Statements. (4 marks)

Answer:

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

1. The qualitative factors which may be relevant in assessing the worth of the enterprise don't find place in the accounts as they cannot be measured in terms of money.
2. Balance sheet shows the position of the business on the day of its preparation and not on the future date, while the users of the accounts are interested in knowing the position of the business in the near future and also in the long run, and not for the past date.
3. Accounting ignores changes in some money factors like inflation etc.
4. There are occasions when accounting principles conflict with each other.

5. Certain accounting estimates depend on the sheer personal judgment of the accountant.
6. Different accounting policies for the treatment of same item adds to the probability of manipulations.

PRACTICAL QUESTIONS

1994 - Nov [2] From the following particulars extracted from the books of Ganguli, prepare Trading and Profit & Loss Account and Balance Sheet as at 31st March, 1994 after making the necessary adjustments:

	₹		₹
Ganguli's Capital Account (Cr.)	54,050	Interest Received	725
Stock on 1.4.1993	23,400	Cash with Traders Bank Ltd.	4,000
Sales	1,44,800	Discounts Received	1,495
Sales Returns	4,300	Investments (at 5%) as on 1.4.1993	2,500
Purchases	1,21,550	Furniture as on 1.4.1993	900
Purchases Returns	2,900	Discounts Allowed	3,770
Carriage Inwards	9,300	General Expenses	1,960
Rent	2,850	Audit Fees	350
Salaries	4,650	Fire Insurance Premium	300
Sundry Debtors	12,000	Travelling Expenses	1,165
Sundry Creditors	7,400	Postage and Telegrams	435
Loan from Dena Bank Ltd. (at 12%)	10,000	Cash on Hand	190
Interest Paid	450	Deposits at 10% as on 1.4.1993 (Dr.)	15,000
Printing and Stationery	1,700	Drawings	5,000
Advertisement	5,600		

Adjustments:

(1) Value of stock as on 31st March, 1994 is ₹39,300. This includes goods returned by customers on 31st March, 1994 to the value of ₹1,500 for which no entry has been passed in the books.

(2) Purchases include furniture purchased on 1st January, 1994 for ₹ 1,000.

(3) Depreciation should be provided on furniture at 10% per annum.

(4) The loan account from Dena Bank in the books of Ganguli appears as follows:

	₹		₹
31.3.1994 To Balance c/d	10,000	1.4.1993 By Balance b/d	5,000
		31.3.1994 By Bank	5,000
	10,000		10,000

(5) Sundry Debtors include ₹2,000 due from Robert and Sundry Creditors include ₹1,000 due to him.

(6) Interest paid include ₹300 paid to Dena Bank.

(7) Interest received represent ₹100 from the Sundry Debtors and the balance on investments and deposits.

(8) Provide for interest payable to Dena Bank and for interest receivable on investments and deposits.

(9) Make a provision for doubtful debts at 5% on the balance under "Sundry Debtors". No such provision need be made for the deposits.

(20 marks)

QR Code for Solution Video

Answer:

In the Books of Ganguli
Trading Profit & Loss Account
for the year ended 31.3.1994

Particulars		Amount	Particulars		Amount
To Opening Stock		23,400	By Sales	1,44,800	
To Purchases	1,21,550		*Less:* Returns		
Less: Transfer to			(4,300 +		
Furniture A/c	1,000		1,500)	5,800	1,39,000
	1,20,550		By Closing Stock		39,300
Less: Returns	2,900	1,17,650			
To Carriage Inwards		9,300			
To Gross Profit c/d		27,950			
		1,78,300			1,78,300

To Salaries	4,650	By Gross profit b/d	27,950
To Rent	2,850	By Interest	1,725
To Advertisement	5,600	By Discount received	1,495
To Printing & Stationery	1,700		
To Interest	750		
To Discount allowed	3,770		
To General expenses	1,960		
To Traveling expenses	1,165		
To Fire Insurance premium	300		
To Postage & telegrams	435		
To Provision for doubtful debts (W.N. 1)	475		
To Depreciation on Furniture	115		
To Audit Fees	350		
To Capital A/c (Profit trans.)	7,050		
	31,170		31,170

Balance Sheet
as on 31.3.1994

Liabilities		Amount ₹	Assets		Amount ₹
Capital Accounts:			Furniture	900	
Balance on 1.4.93	54,050		Additions during the year		
Add: Net Profit	7,050			1,000	
	61,100			1,900	
Less: Drawings	5,000	56,100	*Less:* Depreciation	115	1,785
Loan from Dena Bank Ltd.		10,000	Investments		2,500
Interest accrued on Bank loan (W.N. 2)		300	Deposits		15,000
Sundry Creditors		6,400	Interest accrued on Investments & Deposits (W.N. 3)		1,000
			Stock in trade		39,300
			Sundry Debtors	9,500	
			Less: Provision	475	9,025
			Cash with Traders Bank Ltd.		4,000
			Cash in hand		190
		72,800			72,800

Working Notes:

1. **Calculation of provision for doubtful debts:**

	₹
Sundry debtors (opening)	12,000
Less: Sales returns not recorded	1,500
	10,500
Less: Cancellation against sundry creditors	1,000
Adjusted balance of sundry debtors	9,500
Provision for doubtful debts@ (5% on 9,500)	475

2. **Accrued interest on bank loan:**

	₹
Annual interest @ 12%	600
Less: Interest paid to Dena Bank	300
Accrued Interest	300

3. **Interest accrued on Investments and Deposits:**

	₹
Annual interest on investments @ 5%	125
Annual interest on deposits @ 10%	1,500
	1,625
Less: Interest received on Investments and Deposits	625
Accrued Interest	1,000

1995 - May [1] From the following Trial Balance of Hari and additional information prepare Trading and Profit & Loss Account for the year ended 31st March, 1995 and a Balance Sheet as on that date:

Trial Balance as at 31st March, 1995

	Dr. (₹)	Cr. (₹)
Capital	—	1,00,000
Furniture	20,000	—
Purchases	1,50,000	—
Debtors	2,00.000	—
Interest Earned	—	4,000
Salaries	30,000	—
Sales	—	3,21,000
Purchase Returns	—	5,000
Wages	20,000	—
Rent	15,000	—
Sales Return	10,000	—
Bad Debt Written off	7,000	—
Creditors	—	1,20,000
Drawings	24,000	—
Provision for Bad Debts	—	6,000
Printing & Stationery	8,000	—
Insurance	12,000	—
Opening Stock	50,000	—
Office Expenses	12,000	—
Provision for Depreciation	—	2,000
	5,58,000	5,58,000

Additional Information:

(1) Depreciate Furniture by 10% on original cost;
(2) A provision for Doubtful Debts is to be created to the extent of 5% on Sundry Debtors;
(3) Salaries for the month of March, 1995 amounting to ₹3,000 were unpaid which must be provided for. However salaries included ₹2,000 paid in advance;
(4) Insurance amounting to ₹2,000 is prepaid;
(5) Provide for outstanding office expenses ₹8,000;
(6) Stock used for private purpose ₹6,000;
(7) Closing Stock-in-Trade ₹60,000. (20 marks)

Answer:

In the books of Hari
Trading & Profit & Loss Account
for the year ended 31.3.1995

Particulars		Amount	Particulars		Amount
To Opening Stock		50,000	By Sales	3,21,000	
To Purchases	1,50,000		*Less:* Sales Returns	10,000	3,11,000
Less: Purchase Return	5,000		By Closing Stock		60,000
	1,45,000				

Particulars		₹	Particulars	₹
Less: Stock used for private purposes	6,000	1,39,000		
To Wages		20,000		
To Gross Profit c/d		1,62,000		
		3,71,000		3,71,000
To Rent		15,000	By Gross profit b/d	1,62,000
To Printing & Stationery		8,000	By Interest earned	4,000
To Salaries	30,000			
Add: Outstanding for the year	3,000			
	33,000			
Less: paid in Advance	2,000	31,000		
To Insurance	12,000			
Less: Prepaid	2,000	10,000		
To Office Exp.	12,000			
Add: Outstanding for the year	8,000	20,000		
To Provision for Bad Debts (New)	10,000			
Add: Bad Debt	7,000			
Less: Old	6,000	11,000		
To Provision for Dep.		2,000		
To Net Profit		69,000		
		1,66,000		1,66,000

Balance Sheet
As on 31.3.1995

Liabilities		Amount	Assets		Amount
Capital:			Furniture	20,000	
Balance	1,00,000		*Less:*		
Add: Net Profit	69,000		Prov. for Dep.	4,000	16,000
	1,69,000		Stock in trade		60,000
Less: Drawings	30,000	1,39,000	Debtors	2,00,000	
Creditors		1,20,000	*Less:* Prov. for D/D	10,000	1,90,000
Outstanding:					
Salaries	3,000		Prepaid Expenses:		
Office Expenses	8,000	11,000	Salaries	2,000	
			Insurance	2,000	4,000
		2,70,000			2,70,000

Note: It is assumed that stock used for private purpose has been taken from fresh purchases

1995 - Nov [1] The following is the Trial Balance of Hari as at 31st December, 1994:

	Dr. ₹	Cr. ₹
Hari's Capital Account	—	76,690
Stock 1st January, 1994	46,800	—
Sales	—	3,89,600
Returns Inwards	8,600	—
Purchases	3,21,700	—
Returns Outwards	—	5,800
Carriage Inwards	19,600	—
Rent & Taxes	4,700	—
Salaries & Wages	9,300	—
Sundry Debtors	24,000	—
Sundry Creditors	—	14,800
Bank Loan @ 14% p.a.	—	20,000
Bank Interest	1,100	—
Printing and Stationery Expenses	14,400	—
Bank Balance	8,000	—
Discount Earned	—	4,440
Furniture & Fittings	5,000	—
Discount Allowed	1,800	—

General Expenses	11,450	—
Insurance	1,300	—
Postage & Telegram Expenses	2,330	—
Cash Balance	380	—
Travelling Expenses	870	—
Drawings	30,000	—
	5,11,330	5,11,330

The following adjustments are to be made:

(1) Included amongst the Debtors is ₹3,000 due from Ram and included among the Creditors ₹1,000 due to him.

(2) Provision for Bad and Doubtful Debts be created at 5% and for Discount @ 2% on Sundry Debtors.

(3) Depreciation on Furniture & Fittings @ 10% shall be written off.

(4) Personal Purchases of Hari amounting to ₹600 had been recorded in the Purchases Day Book.

(5) Interest on Bank Loan shall be provided for the whole year.

(6) A quarter of the amount of Printing and Stationery Expenses is to be carried forward to the next year.

(7) Credit Purchase Invoice amounting to ₹400 had been omitted from the Books.

(8) Stock on 31.12.1994 was ₹78,600.

Prepare (i) Trading & Profit and Loss Account for the year ended 31.12.1994 and (ii) Balance Sheet as on 31st December, 1994.

(20 marks)

QR Code for Solution Video

Answer:

Trading and Profit and Loss Account of Mr. Hari
(for the year ended 31st December, 1994)

	₹	₹		₹	₹
To Opening Stock		46,800	By Sales	3,89,600	
To Purchases	3,21,700		*Less:* Returns	8,600	3,81,000
Add: Omitted Invoice	400		By Closing Stock		78,600
	3,22,100				
Less: Returns	5,800				
	3,16,300				
Less: Drawings	600	3,15,700			
To Freight & Carriage		19,600			
To Gross Profit c/d		77,500			
		4,59,600			4,59,600
To Rent and taxes		4,700	By Gross Profit b/d		77,500
To Salaries and wages		9,300	By Discount		4,440
To Bank Interest	1,100				
Add: Due	1,700	2,800			
To Printing & Stationery	14,400				
Less: Prepaid (1/4)	3,600	10,800			
To Discount allowed		1,800			
To General Expenses		11,450			
To Insurance		1,300			
To Postage & Telegram Expenses		2,330			
To Travelling Expenses		870			
To Provision for Bad Debts [W.No.(ii)]		1,150			
To Provision for Discount on Debtors [W.N.(iii)]		437			
To Depreciation on Furniture & Fittings		500			
To Net Profit		34,503			
		81,940			81,940

Balance Sheet of Hari
as at 31st December, 1994

Liabilities		₹	₹	Assets	₹	₹
Capital		76,690		Furniture & Fittings	5,000	
Add: Net Profit		34,503				
		1,11,193		*Less:* Depreciation	500	4,500
Less: Drawings:				Sundry Debtors [W.N.(i)]	23,000	
Cash	30,000			*Less:* Provision for bad		
Goods	600	30,600	80,593	& doubtful debts [W.N.(ii)]	1,150	
Bank Loan			20,000		21,850	
Bank Interest Due			1,700	*Less:* Provision for		
Sundry Creditors [W.N.(iii)]			14,200	Discount	437	21,413
				Stock		78,600
				Prepaid Expenses:		
				Printing & Stationery		3,600
				Bank Balance		8,000
				Cash Balance		380
			1,16,493			1,16,493

Working Notes:

(i)	Sundry Debtors Balance as per Trial Balance	24,000
	Less: Due to Ram	1,000
		23,000
(ii)	Provision for Bad & Doubtful Debts: @ 5% on ₹23,000	1,150
	Provision for Discount 2% on ₹21,850 (23,000 - 1,150) =	437
(iii)	Sundry Creditors Balance as per Trial Balance	14,800
	Less: Set off in respect of Ram	1,000
		13,800
	Add: Purchase Invoice omitted	400
		14,200

1997 - May [1] From the following particulars prepare trading and profit and loss account of Mr. R for the year ended 31-3-1997 and a balance sheet as on 31-3-1997:

	Dr. ₹	Cr. ₹
Building	5,00,000	
Machineries	2,00,000	
Furniture	1,00,000	
Cash at Bank	90,000	
Cash on hand	10,000	
18% p.a. loan obtained by Mr. R on 1-6-1996 on mortgage of his building		3,00,000
R's capital		5,20,000
Sundry debtors/Sundry creditors	5,00,000	4,00,000
Stock on 1-4-1996	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 buildings at 5% p.a.; on machineries at 25% p.a.; on furniture at 10% p.a. Provision for bad and 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 31-3-1997 but only on 7-4-1997. Following transactions had taken place during the period from 1-4-1997 to 7th April, 1997. Sales ₹2,50,000, purchases 1,50,000, stock on 7th April, 1997 was ₹1,80,000 and the rate of gross profit on sales 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 31.3.1997.

(20 marks)

Answer:

Trading and Profit and Loss Account of Mr. R for the year ended 31st March, 1997

Particulars		Amount	Particulars		Amount
To Opening Stock		1,20,000	By Sales	32,20,000	
To Purchases	25,00,000		*Less: Return*	1,20,000	31,00,000
Less: Returns	1,00,000	24,00,000	By Closing Stock (1)		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 Provision for doubtful debts		25,000			
To Interest on loan		45,000			
To Depreciation (2)		85,000			
To Manager's Commission (3)		30,000			
To Net profit transferred to Capital Account		3,00,000			
		8,10,000			8,10,000

Balance Sheet of Mr. R (as at 31st March,1997)

Liabilities		Amount	Assets		Amount
Capital Account:			Building	5,00,000	
Opening Balance	5,20,000		*Less:* Dep.	25,000	4,75,000
Add: Profit	3,00,000	8,20,000	Machineries	2,00,000	
18% Mortgage Loan		3,00,000	*Less:* Dep.	50,000	1,50,000
Interest accrued on Loan		45,000	Furniture	1,00,000	
Sundry Creditors		4,00,000	*Less:* Dep.	10,000	90,000
Commission due to Manager		30,000	Closing Stock		2,30,000
			Sundry Debtors	5,00,000	
			Less: Prov. for D/D	25,000	4,75,000
			Bills Receivable		75,000
			Cash at Bank		90,000
			Cash in Hand		10,000
		15,95,000			15,95,000

Working Notes:

			₹
1.	*Value of closing Stock*		
	Stock (As on 7th April 1997)		1,80,000
	Add: Cost of sales		
	Sales (1.4.1997 to 7.4.1997)	2,50,000	
	Less: Gross Profit @20% on sales	50,000	2,00,000
			3,80,000
	Less: Purchases		1,50,000
	Closing Stock		2,30,000
2.	*Depreciation*		
	On Building (5% of 5,00,000)		25,000
	On Machineries (25% of 2,00,000)		50,000
	On Furniture (10% of 1,00,000)		10,000
			85,000
3.	*Manager's Commission*		
	Profit before charging commission		3,30,000
	Commission (3,30,000 × 10/110)		30,000

1998 - May [1] From the following balances and information, prepare Trading and Profit and Loss Account of Mr. X for the year ended 31st March, 1998 and a Balance Sheet as on that date:

	Dr. ₹	Cr. ₹
X's Capital Account	—	10,000
Plant and Machinery	3,600	—
Depreciation on Plant and Machinery	400	—
Repairs to Plant	520	—
Wages	5,400	—
Salaries	2,100	—
Income-tax of Mr. X	100	—
Cash in Hand and at Bank	400	—
Land and Building	14,900	—

Depreciation on Building	500	—
Purchases	25,000	—
Purchases Return	—	300
Sales	—	49,800
Bank Overdraft	—	760
Accrued Income	300	—
Salaries Outstanding	—	400
Bills Receivable	3,000	—
Provision for Bad Debts	—	1,000
Bills Payable	—	1,600
Bad Debts	200	—
Discount on Purchases	—	708
Debtors	7,000	—
Creditors	—	6,252
Opening Stock	7,400	—
	70,820	70,820

Information:

(i) Stock on 31st March, 1998 was ₹6,000.

(ii) Write off further ₹600 for Bad Debt and maintain a provision for Bad Debts at 5% on Debtors.

(iii) Goods costing ₹1,000 were sent to customer for ₹1,200 on 30th March, 1998 on sale or return basis. This was recorded as actual sales.

(iv) ₹240 paid as rent of the office were debited to Landlord account and were included in the list of debtors.

(v) General Manager is to be given commission at 10% of net profit after charging the commission of the works manager and his own.

(vi) Works manager is to be given commission at 12% of net profit before charging the commission of General Manager and his own.

(20 marks)

Answer:

Trading and Profit and Loss Account
(For the year ended 31st March, 1998)

Particulars		Amount	Particulars		Amount
To Opening Stock		7,400	By Sales	49,800	
To Purchases	25,000		*Less:* Sales on Approval		
Less: Returns	300	24,700	Basis	1,200	48,600
To Wages		5,400	By Closing Stock	6,000	
To Gross Profit c/d		18,100	*Add:* Stock with Customer	1,000	7,000
		55,600			55,600
To Repairs to Plant		520	By Gross Profit b/d		18,100
To Salaries		2,100	By Discount on Purchases		708
To Rent		240	By Provision for Bad Debts (W.N. 2)		752
To Bad Debts (200+600)		800			
To Depreciation on:					
Plant & Machinery	400				
Building	500	900			
To Commission to Work Manager (W.N. 3)		1,800			
To Commission to General Manager (W.N. 4)		1,200			
To Net Profit		12,000			
		19,560			19,560

Balance Sheet of Mr. X
as on 31st March, 1998

Liabilities		Amount	Assets		Amount
Capital Account	10,000		Land and Building		14,900
Less: Income Tax	100		Plant and Machinery		3,600
	9,900				
Add: Net Profit	12,000	21,900	Stock in Hand	6,000	
Bank Overdraft		760	*Add:* Stock with Customers	1,000	7,000
Bills Payable		1,600	Debtors (W.N. 1)	4,960	
Sundry Creditors		6,252	*Less:* Provision for Bad Debts	248	4,712
Salaries Outstanding		400			
Outstanding Commission:			Bill Receivable		3,000
Works Manager	1,800		Accrued Income		300
General Manager	1,200	3,000	Cash in hand and at Bank		400
		33,912			33,912

Working Notes:

		₹
(1) Debtors as per Trial Balance		7,000
Less: Debtors on account of goods sold on approval basis	1,200	
Landlord account wrongly taken as debtor	240	1,440
		5,560
Less: Bad Debts Written off		600
		4,960

(2) Provision for Bad Debts Required (Closing Balance):
5% on Debtors ₹4,960 = ₹248

(3) Calculation of Commission of Works Manager:
12% of ₹15,000 = ₹1,800

(4) Calculation of Commission of General Manager:

$\frac{10}{110} \times ₹(15,000 - 1,800)$

$\frac{10}{110} \times ₹13,200 = ₹1,200$

2000 - May [1] The following is the Trial Balance of Shri Arihant as on 31st December, 1999:

	Debit ₹	Credit ₹
Capital	—	14,00,000
Drawings	75,000	—
Opening Stock	80,000	—
Purchases	16,20,000	—
Freight on Purchases	15,000	—
Wages	1,10,000	—
Sales	—	25,00,000
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 deuts of ₹6,000 written off in 1997)	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 1/10/99)	6,00,000	—
Bank Balance	83,900	—
	40,93,500	40,93,500

Adjustments:

(i) Closing Stock ₹2,25,000.

(ii) Goods worth ₹5,000 were taken for personal use, but no entry was made in the books.

(iii) Machinery worth ₹35,000 purchased on 1/1/97 was wrongly written off against Profit and Loss Account. This asset is to be brought into account on 1/1/99 taking depreciation at 10% per annum on straight line basis upto 31/12/98.

(iv) Depreciate Building at 2½% p.a., Machinery at 10% p.a. and Furniture at 10% p.a.

(v) Provision for Doubtful Debts should be 6% on Debtors.

(vi) The Manager is entitled to a commission of 5% of Net Profits after charging his commission.

Prepare Trading and Profit and Loss Account for the year ending 31st December, 1999 and a Balance Sheet as at that date. (20 marks)

Answer:

Trading and Profit and Loss Account of Shri Arihant
(For the year ended 31st December, 1999)

Particulars		Amount	Particulars	Amount
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	16,15,000		
To Freight		15,000		
To Wages		1,10,000		
To Gross Profit c/d		9,05,000		
		27,25,000		27,25,000

To Salaries		1,00,000	By Gross Profit b/d	9,05,000
To Traveling expenses		23,000	By Discount received	14,500
To Miscellaneous Expenses		35,000	By Bad debts Recovered	6,000
To Printing and Stationery		27,000	By Interest on investments	18,000
To Advertisement expenses		25,000	$\left[6,00,000\times\frac{12}{100}\times\frac{3}{12}\right]$	
To Postage And telegrams		13,000		
To Discounts		7,600		
To Provision for doubtful debts (New)	9,000			
Add: Bad Debts (14,000 + 6,000)	20,000			
	29,000			
Less: Old Provision	19,000	10,000		
To Depreciation:				
Machinery (7,500 + 3,500)	11,000			
Furniture	4,000			
Building	25,000	40,000		
To Manager's Commission (5/105 × 6,62,900)		31,567		
To Net profit transferred to capital account		6,31,333		
		9,43,500		9,43,500

Balance Sheet of Shri Arihant
(As at 31st December, 1999)

Liabilities		Amount	Assets		Amount
Capital	14,00,000		Building	10,00,000	
Add: Machinery			*Less:* Depreciation	25,000	9,75,000
Capitalised	28,000		Machinery	1,03,000	
	14,28,000		*Less:* Depreciation	11,000	92,000
Less: Profits	6,31,333		Furniture	40,000	
	20,59,333		*Less:* Depreciation	4,000	36,000
Less: Drawings (75,000 + 5,000)	80,000	19,79,333	Investments		6,00,000
Creditors		1,60,000	Interest Accrued		18,000
Outstanding Commission		31,567	Stock		2,25,000
			Debtors	1,50,000	
			Less: Prov. for D/D	9,000	1,41,000
			Bank Interest		83,900
		21,70,900			21,70,900

Working Notes:

	₹
Machinery purchased on 1.1.97 (wrongly written off to be capitalised on 1.1.99):	
Cost of Machinery as on 1.1.97	35,000
Less: Depreciation for the years 1997 and 1998 @ 10% p.a.	7,000
Value of machinery capitalised	28,000
Depreciation for the current year 1999 @ 10 % p.a.	3,500
Value of Machinery (as on 31.12.99)	24,500
Value of Machinery (₹75,000 + ₹28,000)	1,03,000
Less: Depreciation (₹7,500 + ₹3,500)	11,000
	92,000

2000 - Nov [1] The following is the Trial Balance of K on 31st March, 2000:

	Dr. ₹	Cr. ₹
Capital	—	8,00,000
Drawings	60,000	—
Opening Stock	75,000	—
Purchases	15,95,000	—
Freight on Purchases	25,000	—
Wages (11 months upto 29.02.2000)	66,000	—
Sales	—	23,10,000
Salaries	1,40,000	—
Postage, Telegrams, Telephones	12,000	—
Printing and Stationery	18,000	—
Miscellaneous Expenses	30,000	—
Creditors	—	3,00,000
Investments	1,00,000	—
Discounts Received	—	15,000
Debtors	2,50,000	—
Bad Debts	15,000	—
Provision for Bad 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 31.07.2000)	24,000	—
Bank Balance	1,50,000	—
	34,45,000	34,45,000

Adjustments:

(i) Closing Stock ₹2,25,000.

(ii) Machinery worth ₹45,000 purchased on 1.10.99 was shown as Purchases. Freight paid on the Machinery was ₹5,000, which is included in Freight on Purchases.

(iii) Commission is payable at 2% on Sales.

(iv) Investments were sold at 10% profit, but the entire sales proceeds have been taken as Sales.

(v) Write off Bad Debts ₹10,000 and create a provision for Doubtful Debts at 5% of Debtors.

(vi) Depreciate Building by 2½% p.a. and Machinery and Furniture at 10% p.a.

Prepare Trading and Profit and Loss Account for the year ending 31st March, 2000 and a Balance Sheet as on that date. (20 marks)

Answer:

Trading and Profit and Loss Account of Mr. K for the year ended 31 st March, 2000

Particulars		Amount ₹	Particulars		Amount ₹
To Opening Stock		75,000	By Sales	23,10,000	
To Purchases	15,95,000		*Less:* Sales of Investment	1,10,000	22,00,000
Less: Transfer	45,000	15,50,000	By Closing Stock		2,25,000
To Freight	25,000				
Less: Transfer to Machinery A/c	5,000	20,000			
To Wages	66,000				
Add: Outstanding	6,000	72,000			
To Gross Profit c/d		7,08,000			
		24,25,000			24,25,000

To Salaries		1,40,000	By Gross Profit b/d	7,08,000
To Miscellaneous Expenses,		30,000	By Interest on investments	12,000
To Printing and Stationary		18,000	By Discounts	15,000
To Postage, Telegrams, telephones		12,000	By Profit of sales of invest.	10,000
To Commission on Sales	45,000			
Add: Outstanding	10,000	55,000		
To Insurance	24,000			
Less: Prepaid	8,000	16,000		
To Provisions for D/D (New provision)				
Bad Debts	15,000			
Add: Written off	10,000			
Add: Prov.	12,000			
	37,000			
Less: Old Prov.	8,000	29,000		
To Depreciation: Building	7,500			
Machinery	52,500			
Furniture	4,000	64,000		
To Net Profit		3,81,000		
		7,45,000		7,45,000

Balance Sheet of Mr. K as at 31st March 2000

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	8,00,000		Building	3,00,000	
Add: Profit	3,81,000		*Less:* Depreciation	750	2,92,500
	11,81,000		Machinery	5,00,000	
Less: Drawings	60,000	11,21,000	*Add:* New	50,000	
Creditors		3,00,000		5,50,000	
Outstanding Expenses			*Less:* Depreciation	52,500	4,97,500
Wages Outstanding		6,000	Furniture	40,000	
Commission Outstanding		10,000	*Less:* Depreciation	4,000	36,000
			Debtors	2,50,000	
			Less: Bad Debts	10,000	
				2,40,000	
			Less: Provision for D/D	12,000	2,28,000
			Prepaid Insurance		8,000
			Stock		2,25,000
			Cash ad Bank		1,50,000
		14,37,000			14,37,000

2001 - May [1] Shri Patit Bansali submitted to you the following Trial Balance, which he has not been able to agree. Rewrite the Trial Balance and prepare Trading and Profit and Loss Account for the year ended 31.12.2000 and a Balance Sheet as on that date after giving effect to the undermentioned adjustments:

	Dr. ₹	Cr. ₹
Capital		16,000
Opening Stock	17,500	
Closing Stock		18,790
Drawings	3,305	
Return inward		550
Carriage Inward	1,240	
Deposit with X		1,400
Return outward	840	
Carriage outward		725
Rent paid	800	
Rent outstanding	150	
Purchases	13,000	
Sundry Debtors	5,000	
Sundry Creditors		4,000
Furniture	1,500	
Sales		29,000
Wages	850	
Cash	1,370	
Goodwill	1,800	
Advertisement	950	
	48,305	70,465

Adjustments:

(1) Write off ₹600 as Bad Debts and make Reserve for Bad Debts on Sundry Debtors at 5%.

(2) Stock valued at ₹2,000 was destroyed by fire on 25th December, 2,000, but Insurance Company admitted a claim for ₹1,500 only and paid the sum in January 2001.

(3) Depreciate Furniture by 10%. (20 marks)

Answer:

Trial Balance of Shri Patit Bansali (Rectified)
(as on 31st December,2000)

	Dr. (₹)	Cr. (₹)
Capital		16,000
Opening Stock	17,500	
Drawings	3,305	
Return inward	550	
Carriage inward	1,240	
Deposit with x	1,400	
Return outward		840
Carriage outward	725	
Rent Paid	800	
Rent outstanding		150
Purchases	13,000	
Sundry debtors	5,000	
Sundry Creditors		4,000
Furniture	1,500	
Sales		29,000
Wages	850	
Cash	1,370	
Goodwill	1,800	
Advertisement	950	
	49,990	49,990

Trading and Profit and Loss Account of Shri Patit Bansali for the year ended 31st December, 2000

Particulars		Amount (₹)	Particulars		Amount (₹)
To Opening Stock		17,500	By Sales	29,000	
To Purchases	13,000		*Less:* Return Inward	550	28,450
Less: Return outward	840	12,160	By Stock lost by fire		2,000
To Wages		850	By Closing stock		18,790
To Carriage inward		1,240			
To Gross profit c/d		17,490			
		49,240			49,240
To Carriage outward		725	By Gross profit b/d		17,490
To Rent		800			
To Advertisement		950			
To Bad debts		600			
To Reserve for bad debts		220			
To Loss of stock by fire		500			
To Depreciation on furniture		150			
To Net profit transferred to Capital Account		13,545			
		17,490			17,490

Balance Sheet of Shri Patit Bansali as at 31st December 2000

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	16,000		Goodwill		1,800
Add: Net Profit	13,545		Furniture	1,500	
	29,545		Less: Depreciation	150	1,350
Less: Drawings	3,305	26,240	Deposit with X		1,400
Sundry creditors		4,000	Closing stock		18,790
Outstanding rent		150	Sundry Debtors	5,000	
			Less: Bad Debts	600	

		Prc. for D/D	4,400	
		Less: Reserve	220	4,180
		Insurance claim		1,500
		Cash		1,370
	30,390			30,390

2001 - May [4] (b) Mr. James submits you the following information for the year ended 31.3.2001:

	₹
Stock as on 1.4.2000	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.

Compute the Net Profit of Mr. James for the year ended 31.3.2001.

(6 marks)

Answer:

Statement showing computation of net profit of Mr. James for the year ended 31.3.2001

	₹	₹
Gross profit on normal sales $\left(₹6,20,000 \times \frac{20}{100}\right)$		1,24,000
Less: Loss on sale of damaged goods (₹12,000 - ₹5,000)		7,000
		1,17,000
Less: Overhead expenses		
Administration expenses	18,000	
Selling expenses	33,000	
Financial charges	6,000	57,000
Net profit		60,000

Working Notes:

Calculation of normal sales

Actual sales	6,25,000
Less: Abnormal sales (sale of damaged goods)	5,000
Normal sales	6,20,000

Trading and Profit and Loss Account of Mr. James for the year ended 31st March, 2001

	₹		₹
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 (₹1,24,000 - ₹7,000)	1,17,000		
	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

2003 - Nov [1] The following is the Trial Balance of Mr. 'A' as on 31st March, 2003. You are required to prepare the Trading and Profit & Loss Account for the year ended 31st March, 2003 and Balance Sheet as on that date after making the necessary adjustments:

	₹	₹
Stock 1-4-2002	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 (1-4-2002)	—	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 (1-4-2002)	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 (31-3-2003)	—	10,000
Charges paid against Consignment	80,000	—
	59,99,500	59,99,500

Adjustments:

(i) Stock on 31st March, 2003 was valued at ₹8,00,000 (including stock of stationery ₹800)

(ii) Bill receivable include a dishonoured bill of ₹8,000.

(iii) Trade expenses include payment for stationery of ₹22,500.

(iv) Stock in the beginning include stock of stationery ₹1,800.

(v) Furniture sold was appearing in the Balance Sheet on 31st March, 2002 at ₹13,000.

(vi) Creditors at the end include creditors for stationery ₹3,000 for credit purchases.

(vii) Commission receivable on sale of consignment is ₹40,000.

(viii) Stationery of ₹2,000 was consumed by Mr. 'A'.

(ix) Make provision for bad and doubtful debts at 5% on debtors.

(x) Depreciate furniture at 10% p.a. (20 marks)

Answer:

Trading and Profit and Loss Account of Mr. A for the year ended 31st March, 2003

Particulars		₹	Particulars		₹
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 Purchase	19,25,000		*Less:* Stock of stationery	800	7,99,200
Less: Stationery	3,000	19,22,000			
To Wages & 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 transferred to Capital Account		7,83,900		
		11,41,000		11,41,000

Balance Sheet of Mr. A as on 31st March, 2003

Liabilities		₹	Assets		₹
Capital	8,95,000		Furniture	60,000	
Add: Net Profit of current year	7,83,900		*Less:* Furniture sold (WDV)	11,700	
	16,78,900			48,300	
Less: Drawings	2,000	16,76,900	*Less:* Depreciation	6,000	42,300
Consignor's balance		1,20,000	Debtors	15,00,000	
Creditors for goods		9,29,500	*Add:* Bill receivable dishonoured	8,000	
Creditors for stationery		3,000			
Bills Payable		1,85,000	*Less:* Provision for bad & doubtful debts	75,400	14,32,600
			Bill receivable	2,25,000	
			Less: Bill receivable dishonoured	8,000	2,17,000
			Closing Stock		7,99,200
			Stock of Stationary		800
			Cash in hand & at Bank		4,22,500
		29,14,400			29,14,400

Working Notes:

(i) **Consignor's Account**

	₹		₹
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) **Furniture:** Loss on sale of furniture:

Cost 31.2.2002	₹13,000	
Depreciation 10%	₹1,300	
	11,700	W.D.V. (A)
Sold 31.3.2003	₹10,000	(B)
Loss on sale of furniture	₹1,700	(A - B)

(iii) **Stationery Account**

	₹		₹
To Balance b/d	1,800	By Drawings	2,000
To Cash purchases	22,500	By Profit & Loss A/c (balancing figure for stationery consumed)	24,500
To Credit purchases	3,000	By Balance c/d	800
	27,300		27,300

2004 - May [1] Mr. Neel had prepared the following Trial Balance from his Ledger as on 31st March, 2004:

	Dr. (₹)	Cr. (₹)
Stock as on 1st April, 2003	5,00,000	
Purchases and Returns	31,00,000	45,000
Sales and Returns	55,000	41,50,000
Cash in Hand	2,50,000	
Cash at Bank	5,00,000	
Trader's Capital		22,59,200
Rates and Taxes	50,000	
Drawings	45,000	
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 Inward	10,000	
Carriage Outward	22,000	
Wages	50,000	
Sundry Debtors/Creditors	10,00,000	4,00,000
Total	69,29,200	69,29,200

You are required to prepare Trading and Profit & Loss Account for the year ended on 31st March, 2004 and Balance Sheet as on that date after making the necessary adjustments.

You are provided with the following information:

(i) Closing Stock as on 31st March, 2004 ₹1,45,000.

(ii) Neel had withdrawn goods worth ₹50,000 during the year.

(iii) Purchases include Purchase of furniture worth ₹1,00,000.

(iv) Debtors include ₹50,000 bad debts.

(v) Sales include goods worth ₹1,50,000 sent out to NN & Co. on approval and remained unsold as on 31st March, 2004. The cost of the goods was ₹1,00,000.

(vi) Provision for Bad debts is to be created at 5% of Sundry Debtors.

(vii) Depreciate Furniture and Fittings by 10% and Motor Car by 20%.

(viii) The salesman is entitled to a commission of 10% on total sales.

(20 marks)

Answer:

Trading and Profit & Loss Account
(For the year ended 31st March, 2004)

Particulars		Amount (₹)	Particulars		Amount (₹)
To Opening Stock		5,00,000	By Sales	41,50,000	
To Purchases	31,00,000		*Less:* Returns	55,000	
Less: Returns	45,000			40,95,000	
	30,55,000		*Less:* Goods sent on approval	1,50,000	39,45,000
Less: Furniture	1,00,000		By Closing Stock	1,45,000	
	29,55,000		*Add:* Cost of goods sent on approval	1,00,000	2,45,000
Less: Drawings	50,000	29,05,000			
To Carriage Inward		10,000			
To Wages		50,000			
To Gross Profit c/d		7,25,000			
		41,90,000			41,90,000

To Salaries		95,000	By Gross Profit b/d	7,25,000
To Rates & Taxes		50,000	By Discount received	75,000
To Postage & Telegram		1,05,000	By Net Loss transferred to Capital A/c	5,02,300
To Insurance		90,000		
To Printing & Stationery		95,500		
To Advertisement		1,70,000		
To Discount allowed		50,000		
To General Expenses		65,700		
To Carriage Outward		22,000		
To Bad debts		50,000		
To Provision for Doubtful Debts		40,000		
To Salesman Commission	78,000			
Add: Outstanding	3,16,500	3,94,500		
To Depreciation on:				
Furniture	65,000			
Motor Car	9,600	74,600		
		13,02,300		13,02,300

Balance Sheet of Mr. Neel
(As on 31st March,2004)

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	22,59,200		Furniture	5,50,000	
Less: Drawings	45,000		*Add:* Purchased	1,00,000	
Less: Goods With-drawn	50,000			6,50,000	
			Less: Dep.	65,000	5,85,000
			Motor Car	48,000	
	21,64,200		*Less:* Dep.	9,600	38,400
Less: Net Loss	5,02,100	16,61,900	Stock in hand		1,45,000
Sundry Creditors		4,00,000	Goods sent on Approval		1,00,000
Outstanding Salesman's Commission		3,16,500	Sundry Debtors	10,00,000	
			Less: Goods sent on Approval	1,50,000	
				8,50,000	
			Less: Bad Debts	50,000	
				8,00,000	
			Less: Provision for Doubtful Debts	40,000	7,60,000
			Cash in Hand		2,50,000
			Cash at Bank		5,00,000
		23,78,400			23,78,400

2005 - May [1] The following are the balances as at 31st March, 2004 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
		Printing and Stationery	1,250
Sundry Debtors	1,20,000	Cash in hand	1,450
Sundry Creditors	47,500	Cash at Bank	3,125
		Office Expenses	10,160
		Int. paid on loan	3,000

Additional Information:

1. Purchases include sales return of ₹2,575 and sales include purchase return of ₹1,725.
2. Goods withdrawn by Mr. XYZ for own consumption ₹3,500 included in purchases.
3. Wages paid in the month of April for installation of Plant and Machinery amounting to ₹450 were included in wages account.
4. Free samples distributed for Publicity costing ₹825.
5. Create a provision for doubtful debts @ 5% and provision for discount on debtors @ 2.5%.
6. Depreciation is to be provided on Plant and Machinery @15% p. a. and on furniture and fittings @ 10% p. a.
7. Bank overdraft is secured against hypothecation of stock. Bank overdraft outstanding as on 31.3.2004 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.

Prepare a trading and Profit Loss Account for the year ended 31st March, 2004, and a Balance Sheet as on that date. Also show the rectification entries. (20 marks)

QR Code for Solution Video

Answer:

In the books of Mr. XYZ

Rectification Entries

Date	Particulars	L. F.	Dr. Amount ₹	Cr. Amount ₹
(i)	Return inward account Dr. Sales account Dr. To Purchases account To Returns outward account (Being sales return and purchases return wrongly included in purchases and sales respectively, now it is rectified)		2,575 1,725	 2,575 1,725
(ii)	Drawings account Dr. To Purchases account (Being goods withdrawn for own consumption included in purchases, now it is rectified)		3,500	 3,500
(iii)	Plant and machinery account Dr. To Wages account (Being wages paid for installation of plant and machinery wrongly debited to wages, now it is rectified)		450	 450
(iv)	Advertisement expenses account Dr. To Purchases account (Being free samples distributed for publicity out of purchases, now it is rectified)		825	 825

In the books of Mr. XYZ
Trading and Profit and Loss Account for the year ended 31st March, 2004

Particulars	₹	Amount ₹	Particulars	₹	Amount ₹
To Opening stock		32,250	By Sales	2,13,575	
To Purchases	1,53,100		*Less:* Sales return	2,575	2,11,000
Less: Purchases return	1,725	1,51,375	By Closing stock		
To Carriage inward		1,125	$\left(₹80,000 \times \frac{100}{80} \times \frac{100}{80}\right)$		1,25,000
To Wages		11,715			
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 Bad debts		1,100			
To Carriage outward		1,350			
To Advertisement expenses		4,175			
To Printing and stationery		1,250			
To Provision for doubtful debts 5% of ₹1,20,000	6,000				
Less: Existing provision	3,200	2,800			
To Provision for discount on debtors 2.5% of ₹1,14,000	2,850				
Less: Existing provision	1,375	1,475			
To Depreciation: Plant and machinery	3,000				
Furniture and fittings	1,025	4,025			
To Office expenses		10,160			
To Interest on loan		3,000			
To Net profit		83,800			
		1,39,985			1,39,985

In the books of Mr. XYZ
Balance Sheet of Mr. XYZ (as on 31st March, 2004)

Liabilities	₹	Amount ₹	Assets	₹	Amount ₹
Capital account	65,000		Plant and machinery	20,000	
Add: Net profit	83,800		*Less:* Depreciation	3,000	17,000
	1,48,800		Furniture and fittings	10,250	
Less: Drawings	11,500	1,37,300	*Less:* Depreciation	1,025	9,225

Bank overdraft		80,000	Closing stock		1,25,000
Sundry creditors		47,500	Sundry debtors	1,20,000	
Payable salaries		2,450	*Less:* Provision for doubtful debts	6,000	
			Provision for bad debts	2,850	1,11,150
			Prepaid rent		300
			Cash in hand		1,450
			Cash at bank		3,125
		2,67,250			2,67,250

2005 - Nov [1] From the following Trial Balance of Shri Shivam as on 31st March, 2005, you are required to prepare a Trading and Profit and Loss Account for the year ended 31st March, 2005 and Balance Sheet as on that date, after making the necessary adjustments as mentioned hereunder:

Particulars	Dr. ₹	Cr. ₹
Shivam's capital		1,60,000
Shivam's drawings	24,000	
Furniture and Fixtures	8,000	
Plant and machinery	60,000	
Patents (ten years from 1.4.2004)	40,000	
Stock on 1.4.2004	40,000	
Purchases	1,70,000	
Salaries	14,800	
Wages	30,000	
Sundry debtors	20,400	
Sales		2,64,000
Cash in hand	13,250	
Land	28,350	
Loan from Shyam (at 6% from 1.10.2004)		20,000
Postage and Fax	3,000	
Rent, rates and taxes	7,200	
Bad debts	800	
Sundry creditors		24,000
Discount		1,200
Carriage Inward	400	
Interest on loan	300	
Insurance	1,600	

Travelling expenses	1,000	
Sundry Expenses	600	
Cash at bank	20,500	
Bank overdraft		15,000
Total	4,84,200	4,84,200

Adjustments:

(i) Stock as on 31.3.2005 is valued at ₹30,000.

(ii) A new machine was installed on 1st April, 2004 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.

(iii) 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%.

(iv) Goods costing ₹2,000 were given away as free samples for publicity.

(v) Depreciate Plant and Machinery at 20% per annum and Furniture and Fixtures at 10% per annum.

(vi) 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.

(vii) Goods costing ₹1,000 were sent to a customer for ₹1,200 on 30th March, 2005 on sale or return basis. This was recorded as actual sales. (20 marks)

Answer:

In the books of Shri Shivam
Trading and Profit and Loss Acccount
for the year ended 31st March, 2005

Dr. Cr.

		₹			₹
To Opening stock		40,000	By Sales	2,64,000	
To Purchases	1,70,000		*Less:* Goods sent for approval	1,200	2,62,800
Less: Free samples	2,000	1,68,000	By Closing stock	30,000	
To Carriage inward		400	*Add:* Stock with customer (at cost)	1,000	31,000
To Wages	30,000				
Less: Installation charges	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: Accrued interest	300	600		
To Advertising		2,000		
To Insurance		1,600		
To Loss of machinery by fire		2,000		
To Bad debts	800			
Add: Written off	200			
	1,000			
Add: Provision for doubtful debts	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 transferred to capital account		5,289		
		57,600		57,600

Balance Sheet
as on 31st March, 2005

Liabilities		₹	Assets		₹
Capital account:			Land		28,350
Opening balance	1,60,000		Plant and machinery	60,000	
Add: Net profit	5,289		*Add:* Purchased	3,000	
	1,65,289			63,000	
Less: Drawings	24,000	1,41,289	*Add:* Installation charges	1,000	
				64,000	
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 @ 20%	12,400	49,600
Creditor for machinery		3,000	Patents	40,000	
Bank overdraft		15,000	*Less:* Depreciation @ 10%	4,000	36,000
			Furniture & Fixtures	8,000	
			Less: Depreciation @ 10%	800	7,200
			Closing stock	30,000	
			Add: Stock with customers	1,000	31,000
			Debtors	20,400	
			Less: Goods sent on approval basis	1,200	
				19,200	

	Less: Bad debts written off	200	
		19,000	
	Less: Provision for doubtful debts @ 5%	950	
		18,050	
	Less: Provision for discount @ 2%	361	17,689
	Cash at bank		20,500
	Cash in hand		13,250
2,03,589			2,03,589

2018 - May [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:

Particulars	Debit (₹)	Credit (₹)
Capital A/c		14,11,400
Purchases	12,00,000	
Purchase Returns		18,000
Sales		15,00,000
Sales Returns	24,000	
Freight Inwards	62,000	
Carriage Outwards	8,500	
Rent of Godown	55,000	
Rates and Taxes	24,000	
Salaries	72,000	
Discount allowed	7,500	
Discount received		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
Sundry creditors		62,000
Motor vehicles	1,00,000	
Land and Buildings	5,00,000	
Office equipment	2,00,000	
Furniture and Fixtures	50,000	
Stock as on 31.03.2017	3,20,000	
Sundry debtors	2,80,000	
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:

(a) Depreciate Building by 5%, Furniture and Fixtures by 10%, Office Equipment by 15% and Motor Car by 20%.

(b) Value of stock at the close of the year was ₹4,10,000.

(c) One month rent for godown is outstanding.

(d) Interest on loan from Rajan is payable @ 10% per annum. This loan was taken on 01.07.2017.

(e) Reserve for bad debts is to be maintained at 5% of Sundry debtors.

(f) 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 30.06.21018. (20 marks)

QR Code for Solution Video

Answer:

In books of M/s. Raghuram & Associates
Trading Account for the year Ended 31.3.18

Particulars		Amount (₹)	Particulars		Amount (₹)
To Opening Stock		3,20,000	By Sales	15,00,000	
			– Sales Return	24,000	14,76,000
To Purchases	12,00,000				
– Pur. Ret	18,000	11,82,000	By Closing Stock		4,10,000
To Freight Inwards		62,000			
To Gross Profit c/d		3,22,000			
		18,86,000			18,86,000

M/s. Raghuram & Associates
Profit/Loss Account for the year ended 31.3.18

Particulars		Amount (₹)	Particulars	Amount (₹)
To Carriage Outward		8,500	By G.P. c/d	3,22,000
To Rent of godown	55,000		By Discount received	12,000
+ O/s for interest	5,000	60,000		
To Rate & Taxes		24,000		
To Salaries		72,000		
To Disallowed		7,500		
To Printing & Stat.		6,000		
To Ins. Premium (W.N.2)		4,800		
To Electricity Charges		14,000		
To Gen. Expenses		11,000		
To Bank Charges		3,800		
To Provision for bad debts (W.N.3)		16,200		
To Repair to Vehicle		13,000		
To Interest on loan (W.N.4)		4,500		
To Depreciation:				
Building	25,000			
Furniture	5,000			
Office Equipment	30,000			
Motor Car	20,000	80,000		
To Net Profit c/d		8,700		
		3,34,000		3,34,000

Balance Sheet of M/s. Raghuram & Associates
as at 31.3.18

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	14,11,400		Motor van	1,00,000	
Add: N.P.	8,700		– Dep.	20,000	80,000
Less: Drawings	20,000		Land & Building	5,00,000	
Less: Ins. Premium	42,000	13,58,100	– Dep.	25,000	4,75,000
Loan from Rajan		60,000	Office Equity	2,00,000	
Interest payables on		100	– Dep.	30,000	1,70,000
above loan			Furniture	50,000	
Sundry Creditors		62,000	– Dep.	5,000	45,000
Outstanding rent of godown		5,000	Stock		4,10,000
			Debtors	2,80,000	
			Provision for Bad Debts	14,000	2,66,000
			Prepaid Insurance		1,200
			Cash at Bank		22,000
			Cash in hand		16,000
Total		14,85,200			14,85,200

Working Notes:

1. Outstanding Rent of godown

$\frac{55,000}{11} \times 1 =$ ₹5,000

2. Insurance Premium

Insurance Premium as given in trial balance	48,000
Less: Personal Premium	42,000
	6,000
Less: Prepaid for 3 months $\left(\frac{6,000}{15} \times 3\right)$	1,200
Transfer to P/L	4,800

3. Provision for bad-debts

Bad-debts	12,200
Add: Prov. Req. as on 31.3.18 (2,80,000 × 5%)	14,000
	26,200
Less: Prov. As on 1.4.17	10,000
Transfer to P/L	16,200

4. Interest on loan

$60,000 \times 10\% \times \frac{9}{12} = 4,500$

∴ 100 is payable interest

2018 - Nov [3] (b) Mr. Fazhil is a proprietor in business of trading. An abstract of his Trading and P & L Account is as follows:

Trading and P & L A/c for the year ended 31st March, 2018.

Particulars	(₹)	Particulars	(₹)
To Cost of Goods sold	22,00,000	By Sales	45,00,000
To Gross Profit C/d	?		
	?		45,00,000
To Salaries paid	12,00,000	By Gross Profit B/d	?
To General Expenses	6,00,000	By Other Income	45,000
To Selling Expenses	?		
To Commission to Manager (On Net profit before charging such commission)	1,00,000		
To Net Profit	?		
	?		?

Selling expenses amount to 1% of total Sales.

You are required to compute the missing figure. (5 marks)

Answer:

Trading and P&L A/c
for the year ended 31.3.2018

Particulars	₹	Particulars	₹
To Cost of Goods Sold	22,00,000	By Sales	45,00,000
To Gross Profit c/d (b/f)	23,00,000		
	45,00,000		45,00,000
To Salaries	12,00,000	By G.P. b/d	23,00,000
To Gen. Exp.	6,00,000	By Other Income	45,000
To Selling Exp. (45,00,000 × 1%)	45,000		
To Commission to Manager	1,00,000		
To Net Profit (b/f)	4,00,000		
	23,45,000		23,45,000

% of Commission = 20% (1,00,000/5,00,000).

2019 - June [4] (b) Following particulars are extracted from the books of Mr. Sandeep for the year ended 31st December, 2018.

Particulars	Amount ₹	Particulars	Amount ₹
Debit Balances :		Credit balances:	
Cash in hand	1,500	Capital	16,000
Purchase	12,000	Bank overdraft	2,000
Sales return	1,000	Sales	9,000

Salaries	2,500	Purchase return	2,000
Tax and Insurance	500	Reserve for Bad debts	1,000
Bad debts	500	Creditors	2,000
Debtors	5,000	Commission	500
Investments	4,000	Bills payable	2,500
Opening stock	1,400		
Drawings	2,000		
Furniture	1,600		
Bills receivable	3,000		
	35,000		35,000

Other information:

(i) Closing stock was valued at ₹4,500

(ii) Salary of ₹100 and Tax of ₹200 are outstanding whereas insurance ₹50 is prepaid.

(iii) Commission received in advance is ₹100

(iv) Interest accrued on investment is ₹210

(v) Interest on overdraft is unpaid ₹300

(vi) Reserve for bad debts is to be kept at ₹1,000

(vii) Depreciation on furniture is to be charged @ 10%

You are required to prepare the final accounts after making above adjustments. (10 marks)

Answer:

In the books of Mr. Sandeep Trading Account for the year ended 31.12.18

Particulars		Amount (₹)	Particulars		Amount(₹)
To Opening Stock		1,400	By Sales	9,000	
To Purchases	12,000		*Less:* Sales Return	1,000	8,000
Less: Purchase Return	2,000	10,000	By Closing Stock		4,500
To Gross Profit		1,100			
		12,500			**12,500**

Profit and Loss Account for the year ended 31.12.18

Particulars		₹	Particulars		₹
To Salaries	2,500		By Gross Profit		1,100
Add: O/s	100	2,600	By Commission	500	
To Taxes & Ins.	500		*Less:* Received in adv.	100	400
Add: O/s Tax	200				
Less: Ins. Prepaid	50	650	By Interest on investments		210
To Reserve for bad debts	1,000				
Add: Bad-debts	500		By Net loss (b/f)		2,500
	1,500				
Less: Old Provision	1,000	500			
To Int on Overdraft		300			
To Dep on furniture		160			
		4,210			**4,210**

Balance Sheet as on 31.12.18

Liabilities		₹	Assets		₹
Capital	16,000		Furniture	1,600	
Less: Drawings	2,000		– Dep.	160	1,440
	14,000		Investments		4,000
Less: Net loss	2,500	11,500	Accrued interest on investments		210
Bank overdraft		2,000	Debtors	5,000	
Int. on overdraft unpaid		300	– Res. for B/D	1,000	4,000
Creditors		2,000	Stock		4,500

Bills payable	2,500	Bills receivable	3,000
Salary outstanding	100	Prepaid Insurance	50
Taxes outstanding	200	Cash in hand	1,500
Commission recd. in advance	100		
	18,700		**18,700**

2019 - Nov [5] (c) The balance sheet of Mittal on 1st January, 2018 was as follows:

Liabilities	Amount ₹	Assets	Amount ₹
Trade payables	16,00,000	Plant & Machinery	31,00,000
Expenses payable	2,50,000	Furniture & Fixture	4,00,000
Capital	51,00,000	Trade receivables	14,50,000
		Cash at bank	7,00,000
		Inventories	13,00,000
	69,50,000		69,50,000

During 2018, his profit and loss account revealed a net profit of ₹15,10,000. This was after allowing for the following:

(i) Interest on capital @ 6% p.a.

(ii) Depreciation on plant and machinery @ 10% and on Furniture and Fixtures @ 5%.

(iii) A provision for Doubtful debts @ 5% of the trade receivables as at 31st December 2018.

But while preparing the profit and loss account he had forgotten to provide for (1) outstanding expenses totalling ₹1,85,000 and (2) prepaid insurance to the extent of ₹25,000.

His current assets and liabilities on 31st December, 2018 were: Trade receivables ₹21,00,000; Cash at bank ₹5,20,000 and Trade payables ₹13,84,000. During the year he withdrew ₹6,20,000 for domestic use. Closing inventories is equal to net trade receivables at the year-end. You are required Draw up revised Profit and Loss account and Balance Sheet at the end of the year. (10 marks)

Answer:

Profit & Loss A/c (Revised) for the year ended 31-12-2018

Particulars	₹	Particulars	₹
To Outstanding Expenses	1,85,000	By Balance b/d	15,10,000
To Net Profit	13,50,000	By Prepaid Insurance	25,000
	15,35,000		15,35,000

Balance Sheet as on 31-12-2018

Liabilities		₹	Assets		₹
Capital	51,00,000		Plant and Machinery	31,00,000	
Add: Net Profit	13,50,000		*Less:* Depreciation @ 10%	3,10,000	27,90,000
Interest on Capital (6% of ₹ 51,00,000)	3,06,000		Furniture and Fixture	4,00,000	
	67,56,000		*Less:* Depreciation @ 5%	20,000	3,80,000
Less: Drawings	6,20,000	61,36,000	Trade Receivable	21,00,000	
Trade Payables		13,84,000	*Less:* Provision for Doubtful Debts @5%	1,05,000	19,95,000
Outstanding Expenses		1,85,000			
			Inventories		19,95,000
			Prepaid Insurance		25,000
			Cast at Bank		5,20,000
		77,05,000			77,05,000

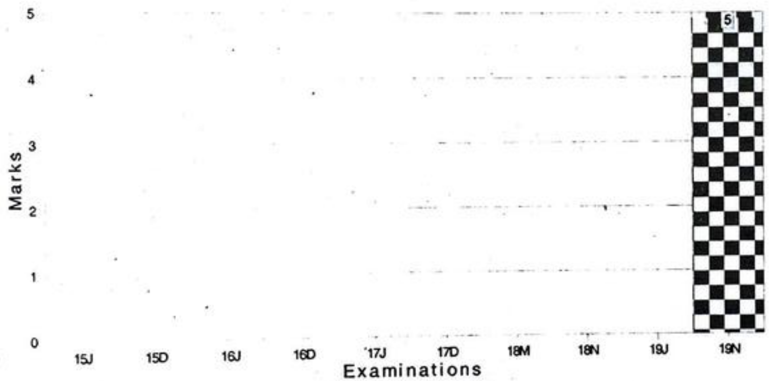
CHAPTER	
7	**Preparation of Final Accounts of Sole Proprietors**

Unit: 2 **Final Accounts of Manufacturing Entities**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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SELF STUDY QUESTIONS

Q1. What do you mean by Trading and Manufacturing Account ?

Answer:

- Trading refers to buying and selling of goods whereas manufacturing is production of goods.
- Since trading A/c does not disclose cost of goods manufactured, hence, for this purpose manufacturing A/c is prepared.

Cost of goods manufactured = Cost of raw material + Expenses incurred of production.

Q2. What is a Manufacturing A/c? Give its specimen and Illustrate?

Answer:

- Manufacturing A/c shows cost of production, Trading A/c and shows the gross profit or gross loss while, Profit & Loss A/c shows the net profit earned or net loss suffered by the organisation during a particular period.
- The cost of goods manufactured calculated from this account is transferred to Trading A/c.
- This account is prepared by manufacturing firms in addition to other final A/c which have studied earlier.
- It shows manufacturing cost in detail for comparison with past years.

Manufacturing Cost

Raw Material Consumed	xxx
Add: Direct Wages	xxx
Direct Expenses	xxx
Direct Cost	xxx
Add: Indirect Expenses	
Manufacturing Overheads	xxx
Total Manufacturing Cost	xxx
Raw Material Consumed	
Opening Stock	xxx
Add: Purchases	xxx
Less: Closing Stock	(xxx)
	xxx

Direct Manufacturing Expenses: Expenses other than direct material, direct labour, which are directly related to the manufacturing/production process.

Example: Factory Rent, Freight, Carriage Inwards, Royalty, hire changes on plant and machinery, etc.

Indirect Manufacturing Expenses or Overhead Expenses:

Indirect Materials	xxx
Add: Indirect Wages	xxx
Add: Indirect Expenses	xxx
	xxx

Expenses which are not directly related to the main business of production or manufacturing.

Example: Salary, Office, Expenses, Carriage Outwards, etc.

By - Products

- Secondary products produced along with the main product.
- Cost of by-product is not ascertainable as it does not require any extra process other than process undertaken in production of main product.
- It is usually a very small percentage of the main product produced.

Examples:

- Molasses & Bagasses produced is sugar factories.
- Butter milk produced in dairy.
- These by products are valued at net realisable value.

Design of Manufacturing Account Specimen

Manufacturing A/c
for the year ended

To Work in progress (opening) A/c		xxx	By Work in progress (Closing) A/c	xxx
To Raw material Consumed A/c			By Sale of scrap A/c	xxx
Opening Stock	xx		By Cost of production of finished goods A/c (transferred to Trading Account)	xxx
Add: Purchases	xx			
Less: Closing Stock	xx			
To Direct wages A/c		xxx		
To Direct expenses A/c		xxx		
To Factory expenses A/c		xxx		
To Dep. on factory building A/c		xxx		
		xxx		xxx

Illustration

From the following particulars prepare manufacturing Account and Trading Account for the year ended 31st March, 2017.

Opening stock of raw material	10,000	Closing stock of raw material	4,000
Opening stock of WIP	7,000	Closing stock of WIP	8,000
Purchases	60,000	Opening stock of finished goods	5,000
Return outward of raw material	500	Purchase of finished goods	20,000
Wages	4,500	Return outwards of finished goods	1,500
Gas & Fuel	1,000	Freight on finished goods	600
Factory Rent	500	Sale of finished goods	1,20,000
Power	600	Return inwards finished goods	2,000
Consumable stores	700	Closing stock of finished goods	8,000
Freight on purchases	1,800		

Solution:

Manufacturing A/c (for year ending 31.3.2017)

Particulars		Amount	Particulars		Amount
To Opening stock:			By Closing stock:		
Raw material	10,000		Raw material	4,000	
WIP	7,000	17,000	WIP	8,000	12,000
To Purchases			By Trading A/c.		
Raw material	60,000		(bf)(cost of finished goods)		73,600
Less: Return outward	500	59,500			
To Wages		4,500			
To Gas & Fuel		1,000			
To Factory rent		500			
To Power		600			
To Consumable stores		700			
To Freight on raw material		1,800			
		85,600			85,600

Trading A/c

Particulars	Amount	Particulars	Amount
To Opening stock (finished goods)	5,000	By Sales 1,20,000 *Less:* Return inwards 2,000	1,18,000
To Manufacturing A/c (Cost of finished goods)	73,600	By Closing stock (finished goods)	8,000
To Purchases 20,000 *Less:* Return outwards 1,500	18,500		
To Freight on finished goods	600		
To Gross Profit	28,300		
	1,26,000		1,26,000

Illustration

From the following particulars, prepare Manufacturing A/c for the year ended 31st December, 2017

Stock (1.1.2017)	32,000
Raw Material	22,200
Purchase of Material	3,01,800
Carriage inwards	8,200
Wages	1,30,000
Factory salary	52,000
Import duty	16,200
Depreciation on machine	50,400
Bad debts	3,400
Sundry Expenses (Factory)	10,600
Stock 31.12.2017	
Raw Material	36,000
Work in progress	18,800

Solution:

Manufacturing A/c

Particulars		Amount	Particulars	Amount
To Opening WIP		22,200	By Closing WIP	18,800
To Raw material Consumed:			By Trading A/c (bf)	
Opening stock	32,000		(cost of finished goods)	5,68,000
Add: Purchases	3,01,800			
Add: Carriage	8,200			
Add: Import duty	16,200			
	3,58,200			
Less: Closing stock	36,600	3,21,600		
To Wages		1,30,000		
To Factory Salary		52,000		
To Deprecation on machinery		50,400		
To Sundry expenses of factory		10,600		
		5,86,800		5,86,800

Notes:

Bad debts of ₹3,400 has not been considered for preparation of Manufacturing Account as it is a financial item and do not form part of cost of production.

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. Sale of the Scrap of raw materials appearing in the trial balance are shown on the credit side of:
   (a) Trading account
   (b) Manufacturing account

(c) Profit and Loss A/c
(d) None of these

2. In books of manufacturing concern, Opening Stock consists of:
   (a) Raw Materials
   (b) Work in Progress
   (c) Finished goods
   (d) All of the above

3. Units produced 5,000 @ 20/- Direct Expenses - ₹5,000 4/5th of the units were sold @ 25/- per unit. What will be the profit?
   (a) 20,000
   (b) 16,000
   (c) Nil
   (d) None of these.

4. From the following information, calculate the cost of raw material consumed :

	(₹)
Purchase of raw material	80,000
Opening Stock :-	
Raw Material	5,000
Work in progress	12,000
Finished goods	8,500
Closing Stock :-	
Raw Material	350
Work in Progress	12,400
Finished goods	4,500

   (a) ₹82,500
   (b) ₹78,250
   (c) ₹78,650
   (d) ₹82,250

5. By products are generally valued at ...., if their costs cannot be separately identifiable.
   (a) Cost of main product
   (b) Cost of main product or net realizable value whichever is less
   (c) Net realizable value
   (d) Production cost

6. Mr. Y gives the following information for the year ended 31.3.15

	₹
Inventory as on 1.4.14	1,60,500
Purchases	4,80,000
Manufacturing Expenses	75,000
Selling Expenses	33,000
Administration Expenses	18,000
Financial Charges	6,000
Sales	7,00,000

   Gross Profit is 20% on sales. Compute the net profit of Mr. Y for the year:
   (a) ₹8,000
   (b) ₹89,000
   (c) ₹83,000
   (d) ₹1,01,000

7. Manufacturing account is prepared to:
   (a) Ascertain the profit or loss on the goods produced.
   (b) Ascertain the cost of the manufactured goods.
   (c) Show the sale proceeds from the goods produced during the year.
   (d) Both (b) and (c)

ANSWER

1.	(b)	2.	(d)	3.	(b)	4.	(c)	5.	(c)
6.	(a)	7.	(b)						

SHORT PRACTICE QUESTIONS

1. Differentiate between direct expenses and indirect expenses.
2. What is the need of preparing Manufacturing A/c?
3. What do you understand by the term 'by product'. Give two example.

PAST YEAR QUESTIONS AND ANSWERS

PRACTICAL QUESTIONS

2019 - Nov [5] (b) Mr. Shyamal runs a factory, which produces detergents. Following details were available in respect of his manufacturing activities for the year ended 31-03-2019.

	₹
Opening work-in-progress (9,000 units)	26,000
Closing work-in-progress (14,000 units)	48,000
Opening inventory of Raw Materials	2,60,000
Closing inventory of Raw Materials	3,20,000
Purchases	8,20,000
Hire charges of Machinery @ ₹ 0.70 per unit manufactured	
Hire charges of factory	2,60,000
Direct wages-contracted @ ₹ 0.80 per unit manufactured	
and @ ₹ 0.40 per unit of closing W.I.P	
Repairs and maintenance	1,80,000
Units produced 5,00,000 units	

Required a Manufacturing Account of Mr. Shyamal for the year ended 31-03-2019. (5 marks)

Answer:

In the books of Mr. Shyamlal
Manufacturing A/c for the year ended 31-03-2019

Particulars		Units	₹	Particulars	Units	₹
To Opening Work-in-Progress		9,000	26,000	By Closing Work-in-Progress	14,000	48,000
To Raw Materials Consumed:				By Trading A/c- Cost of Finished Goods Transferred	5,00,000	19,33,600
To Opening Inventory	2,60,000					
Add: Purchases	8,20,000					
	10,80,000					
Less: Closing Inventory	3,20,000		7,60,000			
To Direct Wages (W.N.1)			4,05,600			
To Direct Expenses:						
Hire Charges of Machine (5,00,000 × ₹ 0.70)			3,50,000			
To Indirect Expenses:						
Hire Charges of Factory			2,60,000			
Repairs and Maintenance			1,80,000			
			19,81,600			19,81,600

W.N.1- Calculation of Direct Wages

Particulars	₹
On 5,00,000 units @ ₹0.80 p.u.	4,00,000
On 14,000 units @ ₹0.40 p.u.	5,600
Total Direct Wages	4,05,600

CHAPTER

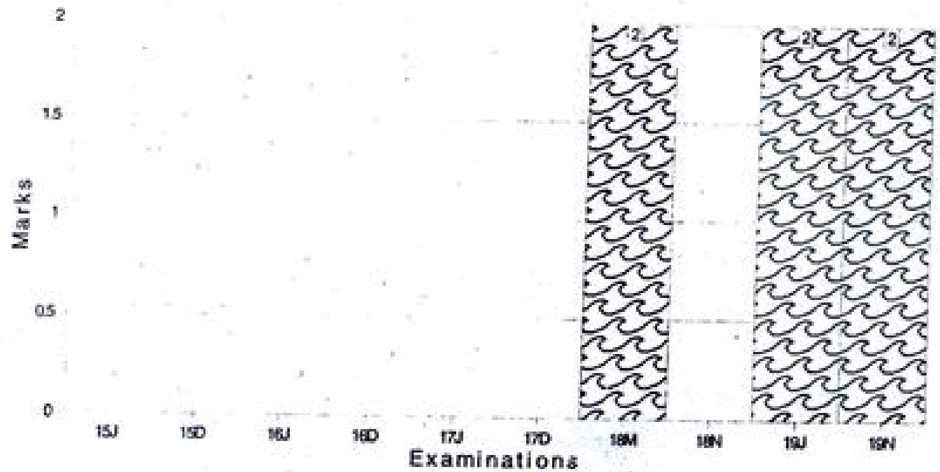
8 Partnership Accounts

Unit: 1 Introduction to Partnership Accounts

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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SELF STUDY QUESTIONS

Q1. Why Partnership is needed?

Answer:

Due to certain limitations of sole proprietorship form of business (such as capital investment, risk, control over affairs of the business etc.), some persons may combine and enter into a partnership for carrying on the business.

Q2. What is the definition of Partnership? What are the features of Partnership?

Answer:

As per **Section 4** of Indian Partnership Act, 1932:

"Partnership is the relationship between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all."

In other words, partnership is an arrangement where by two or more people agree to carry on business together and to share the profits.

Features of Partnership:

(i) There must be an **agreement** between partners.

(ii) There should be **minimum 2 partners.**

(iii) There can be **maximum 50 partners,** as per Rule 10 of Companies (Incorporation) Rules, 2014.

(iv) **An oral or written agreement** must be entered into by the person concerned.

(v) Partnership follows the principle of **mutual agency.** This means that every partner is an agent as well as principle of another partner.

(vi) Person must agree to **profit sharing** in the determined ratio, if any.

(vii) Business should be carried on by all or any one of them acting for all.

Q3. What is Limited Liability Partnership?

Answer:

- It is a new concept to overcome the limitation of Partnership Act, 1932 (according to which the liability of partners was unlimited) by creating a new form of partnership with limited liability.

- Governing Act of this new form of partnership business is Limited Liability Partnership Act, 2008.
- LLP is a separate legal entity having liability of partners limited to their agreed contribution in firm.
- For taxation purpose, LLP falls under the category of Partnership, however, it enjoys other benefits of being a body corporate.

Q4. What is definition of LLP?

Answer:

As per Section 2 of Limited Liability Partnership (LLP) Act, 2008

- "Limited Liability Partnership" means partnership formed and registered under this act.
- "Limited Liability Partnership agreement" means any written agreement between the partners of the limited liability partnership or between the limited liability partnership and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to that limited liability partnership.

Q5. What are Minimum number of partners in case of LLP?

Answer:

- There should be atleast two members. If the limit goes below the minimum requirement, the same must be regularised within six months.
- Following persons are not eligible for being a partners of LLP:
  - ➢ persons of unsound mind
  - ➢ person who is an undischarged insolvent
  - ➢ who has applied to be adjudicated as insolvent.

Q6. What is Distinction between Ordinary Partnership Firm and an LLP?

Answer:

Basis of Difference	LLP	Partnership
Formation	LLP is created by Law	By Agreement
Governing Law	Limited Liability Partnership Act, 2008	Indian Partnership Act, 1932
Registration	Mandatory	Optional
Separate legal entity	Yes	No
Body corporate	LLP enjoys the benefit of body corporate	No
Minimum no. of members	2	2
Maximum no. of members	Unlimited	50
Liability of partners	Limited to the extent of their contribution	Unlimited
Mutual agency	Does not exist partners are agents of firm only	Exists

Q7. What are the Main Clauses and Contents in a Partnership Deed?

Answer:

- Partnership deed is a written agreement between the partners determining the rights and liabilities of partners.

Contents of Partnership deed:

- → Name and address of the firm
- → Name and address of partners
- → Type and nature of business
- → Amount of capital contributed by each partner
- → Details of interest on capital of the partners
- → Details of drawings and rates of interest on drawings
- → Profit sharing ratio
- → Other points such as salary to partners, duration of partnership etc.
- → Method of calculation of goodwill in case of change in constitution of partners.

➠ Basis for determination of share of deceased and method of payment
➠ Preparation of accounts and their audit.

Rules applicable in absence of partnership deed

- It is not compulsory to have a partnership deed.
- If there is a partnership deed, the terms and conditions as mentioned in the deed will be followed.
- If there is no partnership deed, the following rules will be applicable:

(i)	Profit sharing ratio	-	Equal
(ii)	Interest on capital	-	Not allowed
(iii)	Interest on drawings	-	Not charged
(iv)	Salary to partners	-	Not allowed
(v)	Interest on loan	-	Should be paid @ 6% per annum
(vi)	Participation in firm	-	Every partner has right to take part in the business of the firm
(vii)	Admission of a partner	-	New partner can be admitted only with the consent of all other partners.

Note: Even if a firm has a partnership deed but it is silent on any of the above matters, the above rules will be applicable.

Q8.What are the Powers of Partners?

Answer:

Unless otherwise stated contrary in the agreement, partner has following implied powers:

Incase of Trading firm:

- To buy or sell goods;
- To receive payment on behalf of partnership firm;
- Draw, accept, endorse bills of exchange and promissory note on behalf of firm;
- Draw cheques in the name of firm;
- Borrow money with or without pledging inventory in trade in the name of firm;
- Hire workers and other staff for the business of firm.

Cases where third party cannot bind firm for act of individual partner done without mutual consent of all partners.

- Submitting of dispute for arbitration involving firm.
- Withdrawal of suit filed on behalf of firm.
- Acquire any immovable property of the firm.
- Opening of bank account in the name of individual partner on behalf of firms.
- Admit any claim, relinquish any claim in the name of firm.
- Enter into partnership on behalf of firm.

Q9. What do Partnership Accounts involve with respect to preparation of accounts?

Answer:

Partnership accounts involve preparation of:

(i) Partners' Capital Account (fixed and fluctuating)
(ii) Partners' Loan Account
(iii) Profit and Loss Appropriation Account

Profit and Loss Appropriation

- It is an extension of Profit and Loss A/c which shows appropriation of profit among various partners.
- Entries relating to adjustment made from the profits in the form of interest on capital, interest on drawing, etc. are shown in this account.

Q10. What do you understand by Fixed and Fluctuating Capital?

Answer:

In a partnership, every partner has a separate capital account. Amount of capital contribution is shown in this account.

Types of Capital Account

1. **Fixed Capital**
   - Under this system capital account of partners are fixed.
   - Regular earnings or drawings do not effect the fixed capital of partners.
   - Under this system, two accounts are prepared:
     (a) Partners Capital Account
     (b) Partners Current Account

2. **Fluctuating Capital**
   - Under this system, capital accounts need not be kept fixed.
   - Here only one account (Capital A/c) is maintained which contains all entries of capital introduced, drawing, interest, salary, etc.
   - Due to these entries, the amount of capital keeps on fluctuating.

Q11. What do you understand by Interest on Capital?

Answer:

- Firm pays interest on amount of capital contributed by partners in the agreed rate as mentioned in partnership deed.
- Interest is given only when there are profits in the firm.
- It is calculated on time basis (i.e. it takes into account any fresh capital introduced or withdrawn).

Example:

Ajay contributed ₹30,000 as an initial capital on 1st January, 2012. He introduced additional capital of ₹10,000 on 1st July, 2012 and withdrew ₹5,000 on 1st October, 2012. Interest was paid @ 10% p.a. Calculate the interest on capital at the year ending 31st Dec. 2012.

Solution:

Amount of Capital	Duration	Months
1. ₹30,000 2. ₹30,000 + ₹10,000 3. ₹30,000 + ₹10,000 - 5,000	Jan - June July - Sep. October - Dec.	6 months 3 months 3 months

Amount of Interest:

$$30{,}000 \times \frac{6}{12} \times \frac{10}{100} = ₹\ 1{,}500$$

$$40{,}000 \times \frac{3}{12} \times \frac{10}{100} = ₹\ 1{,}000$$

$$35{,}000 \times \frac{3}{12} \times \frac{10}{100} = ₹\ 875$$

₹ 3,375

Example:

A and B are partners sharing the profits and losses in the ratio of 3:2 with capitals of ₹2,00,000 and ₹1,00,000 respectively. Show the distribution of profits in each of the following alternative cases:

Case (i) : If the partnership deed is silent as to the interest on capital and the profits for the year are ₹50,000.

Case (ii) : If the partnership deed provides for interest on capital @ 8% p.a. and the losses for the year ₹50,000.

Case (iii) : If the partnership deed provides for interest on capital @ 8% p.a. and the profits for the year are ₹50,000.

Case (iv) : If the partnership deed provides for interest on capital @ 8% p.a. and the profits for the year are ₹15,000.

Case (v) : If the partnership deed provides for interest on capital @ 8% p.a. even if the firm incurs loss and the profits for the year are ₹15,000.

Solution:

Case (i)

Profit and Loss Appropriation A/c

Particulars	₹	Particulars	₹
To Profit transferred to: A 3/5 30,000 B 2/5 20,000	50,000	By Profit & Loss A/c (Profit for the year)	50,000
	50,000		50,000

Note: If the partnership deed is silent, no interest will be allowed on capitals.

Case (ii)

Profit and Loss Appropriation A/c

Particulars	₹	Particulars	₹
To Profit & Loss A/c (Loss for the year)	50,000	By Loss transferred to: A 3/5 30,000 B 2/5 20,000	50,000
	50,000		50,000

Case (iii)

Profit and Loss Appropriation A/c

Particulars	₹	Particulars	₹
To Interest on Capital: A 16,000; B 8,000	24,000	By Profit & Loss A/c (Profit for the year)	50,000
To Profit transferred to A 3/5 15,600; B 2/5 10,400	26,000		
	50,000		50,000

Case (iv)

Profit and Loss Appropriation A/c

Particulars	₹	Particulars	₹
To Interest on Capital:		By Profit & Loss A/c (Profit for the year)	15,000
A $15{,}000 \times \frac{2}{3}$	10,000		
B $15{,}000 \times \frac{1}{3}$	5,000		
	15,000		15,000

Note: The available profit is ₹15,000 whereas the interest due on capitals is ₹24,000 (i.e. ₹16,000 + ₹8,000). Since, the profit is less than the interest, the available profit will be distributed in the ratio of interest i.e., 16,000: 8,000 or 2:1.

Case (v)

Profit and Loss Appropriation A/c

Particulars	₹	Particulars	₹
To Interest on Capital: A 16,000; B 8,000	24,000	By Profit & Loss A/c (Profit for the year)	15,000
		By Loss transferred to A 3/5 5,400; B 2/5 3,600	9,000
	24,000		24,000

Q12. What do you understand by Interest on Drawings?

Answer:

- Drawings refer to the amount withdrawn by partners for personal use.
- Firm charges interest on amount of such withdrawal from the date of withdrawal at the rate as mentioned in partnership deed.
- Interest on drawing is an income for the firm, hence, it is recorded on credit side of profit/loss appropriation account.

Calculation of drawings

(i) If date of withdrawal is not known - It is assumed that drawings are made evenly throughout the year, and hence, will be charged for 6 months.

$$\text{Amount of drawings} \times \frac{\text{Rate}}{100} \times \frac{6}{12}$$

(ii) When drawings are made at the beginning of every month - Interest will be charged on whole amount for 6.5 months (interest for 6.5 months will be equal to the interest calculated on monthly basis.

$$\text{Amount of drawings} \times \frac{6.5}{12} \times \frac{\text{Rate}}{100}$$

(iii) When drawings are made at end of every month - Interest will be charged on whole amount for 5.5 months (interest for 5.5 months will be equal to the interest calculated on monthly basis.

$$\text{Amount of drawings} \times \frac{5.5}{12} \times \frac{\text{Rate}}{100}$$

(iv) When drawings are made in the middle or at any time during the month. - Interest will be charged on whole amount for 6 months.

$$\text{Amount of drawings} \times \frac{6}{12} \times \frac{Rate}{100}$$

(v) When drawings of equal amount are made in the beginning of each quarter. - Interest will be charged on whole amount for 7.5 months.

$$\text{Amount of drawings} \times \frac{7.5}{12} \times \frac{Rate}{100}$$

(vi) When drawings of equal amount are made at the end of each quarter. - Interest will be charged on whole amount for 4.5 months.

$$\text{Amount of drawings} \times \frac{4.5}{12} \times \frac{Rate}{100}$$

(vii) When drawings of equal amount are made during middle of each quarter. - Interest will be calculated on whole amount for 6 months.

$$\text{Amount of drawings} \times \frac{6}{12} \times \frac{Rate}{100}$$

Note:
- The above method or formulas will be used only & when there are equal monthly or quarterly drawings.
- If the drawings are not equal or are drawn at unequal intervals, then rate of drawing will be calculated using the product method.

➠ **Product Method:**

Step 1: Calculate the product by multiplying drawings with its duration.
Step 2 : Calculate the sum of all products
Step 3 : Calculate interest on drawing as follows:

$$\text{Total of products} \times \frac{Rate}{100} \times \frac{1}{12}$$

Illustration:

Calculate the interest on drawings of Mr. Arjun @ 10% p.a. for the year ended 31st March, 2007 in each of the following alternative cases.

Case (a) : If he withdraw ₹5,000 p.m. in the beginning of every month.
Case (b) : If he withdraw ₹5,000 p.m. at the end of every month.
Case (c) : If he withdraw ₹5,000 p.m.
Case (d) : If he withdraw ₹60,000 during the year.
Case (e) : If he withdraw as follows:

	₹
1st June, 2006	20,000
31st August, 2006	10,000
31st Oct., 2006	18,000
1st Feb., 2007	12,000

Case (f) : If he withdraw ₹15,000 in the beginning of each quarter.
Case (g) : If he withdraw ₹15,000 at the end of each quarter.
Case (h) : If he withdraw ₹15,000 during the middle of each quarter.

Solution:

Case (a) Average Period $= \frac{12 \text{ months} + 1 \text{ month}}{2} = 6\frac{1}{2}$ months

Interest on Drawings $= ₹60{,}000 \times \frac{10}{100} \times \frac{6.5}{12} = ₹3{,}250$

Case (b) Average Period $= \frac{11 \text{ months} + 0 \text{ month}}{2} = 5\frac{1}{2}$ months

Interest on Drawings $= ₹60{,}000 \times \frac{10}{100} \times \frac{5.5}{12} = ₹2{,}750$

Case (c) Assuming that the drawings were made in the middle of every month:

Average Period $= \frac{11.5 \text{ months} + 0.5 \text{ month}}{2} = 6$ months

Interest on Drawings $= ₹60{,}000 \times \frac{10}{100} \times \frac{6}{12} = ₹3{,}000$

Case (d) As the date of drawing is not given, interest will be calculated for an average period of 6 months.

Interest on Drawings $= ₹60{,}000 \times \frac{10}{100} \times \frac{6}{12} = ₹3{,}000$

Case (e)

Date	Amount of Drawing (₹)	Period (months upto 31st March, 2007)	Products (₹)
1st June, 2006	20,000	10	2,00,000
31st August, 2006	10,000	7	70,000
31st Oct., 2006	18,000	5	90,000
1st Feb., 2007	12,000	2	24,000
			3,84,000

Interest on Drawings $= ₹3{,}84{,}000 \times \frac{10}{100} \times \frac{1}{12} = ₹3{,}200$

Case (f) Average Period $= \frac{12 \text{ months} + 3 \text{ months}}{2} = 7\frac{1}{2}$ months

Total Drawings for the year = ₹15,000 × 4 times in a year = ₹60,000

Interest on Drawings $= ₹60{,}000 \times \frac{10}{100} \times \frac{7.5}{12} = ₹3{,}750$

Case (g) Average Period $= \frac{9 \text{ months} + 0 \text{ month}}{2} = 4\frac{1}{2}$ months

Interest on Drawings $= ₹60{,}000 \times \frac{10}{100} \times \frac{4.5}{12} = ₹2{,}250$

Case (h) Average Period $= \frac{10.5 \text{ months} + 1.5 \text{ months}}{2} = 6$ months

Interest on Drawings $= ₹60{,}000 \times \frac{10}{100} \times \frac{6}{12} = ₹3{,}000$

Q13. What do you understand by Guarantee of Minimum Profit?

Answer:

- Sometimes in order to induce a person to join as a partner in the firm, other partners guarantee him certain share of profit.
- It means that the person will get the guaranteed amount of profit even in case of losses.
- For this purpose, firstly the actual profits are divided among partners and then shortfall to the partner is borne by other partners.

  Shortfall = Guaranteed Profit (-) Actual Profit
- Shortfall shall be credited to the new partner and debited to old partners in their mutual profit sharing ratio.

Q14. What is Capital Ratio in case of Partnership?

Answer:

- Sometimes it may so happen that partners may choose to share profits and losses in the ratio of capital contribution made.
- In such case, if they followed fixed capital profit will be shared as per their ratio of capital.
- If there is a fluctuating capital, ratio will be calculated through weighted average method.

Illustration:

Dev, Durgesh and Karan are partners in a firm. They have no agreement in respect of profit sharing ratio, interest on capital, interest on loan advanced by partners and remuneration payable to partners. In the matter of distribution of profits, they have put forward the following claims:

(i) Dev, who has contributed maximum capital demands interest on capital at 10% p.a. and share of profit in the capital ratio. But Durgesh and Karan do not agree.

(ii) Durgesh has devoted full time for running the business and demands salary at the rate of ₹500 p.m. but Dev and Karan do not agree.

(iii) Karan demands interest on loan of ₹2,000 advanced by him at the market rate of interest which is 12% p.a.

How shall you settle the dispute and prepare Profit and Loss Appropriation Account after transferring 10% of the divisible profit to Reserve. Net Profit before taking into account any of the above claims amounted to ₹45,000 at the end of the first year of their business.

QR Code for Solution Video

Solution:

There is no partnership deed. Therefore, the following provisions of the Indian Partnership Act are to be applied for settling the dispute.

(i) No interest on capital is payable to any partner. Therefore, Dev is not entitled to interest on capital.

(ii) No remuneration is payable to any partner. Therefore, Durgesh is not entitled to any salary.

(iii) Interest on loan is payable @ 6% p.a. Therefore, Karan is to get interest @ 6% p.a. on ₹2,000 instead of 12%.

(iv) The profits should be distributed equally.

Profit and Loss Appropriation Account
for the year ended

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Interest on Karan's Loan A/c (₹2,000 × 6/100)	120	By Profit and Loss A/c (Net Profit)	45,000
To Reserve A/c - 10% of ₹ (45,000 - 120)	4,488		
To Share of Profit A/c: Dev ₹13,464 Durgesh ₹13,464 Karan ₹13,464	40,392		
	45,000		45,000

Illustration:

Raj, Ram and Rama 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 drawing will be charged @ 8 percent per annum. (No interest will be charged/allowed on Current Accounts)

The following are the particulars of the Capital and Drawings Accounts of the partner:

	Raj ₹	Ram ₹	Rama ₹
Capital (1.1.2005)	75,000	40,000	30,000
Current Account (1.1.2005)	10,000	5,000	(Dr.) 5,000
Drawings	15,000	10,000	10,000

The draft accounts for 2005 showed a net profit of ₹60,000 before taking into account interest on capitals and drawings and subject to following rectification of errors:

(a) Life Insurance premium of Raj amounting to ₹750 paid by the firm on 30th June, 2005 has been charged to Miscellaneous Expenditure A/c.

(b) Repairs of Machinery amounting to ₹10,000 has been debited to Plant Account and depreciation thereon charged @ 20%.

(c) Travelling expenses of ₹3,000 of Ram for a pleasure trip to UK paid by the firm on 30th June, 2005 has been debited to Travelling Expenses Account.

You are required to prepare the Profit and Loss Appropriation Account for the year ended 31st December, 2005.

Solution:

Raj, Ram and Rama
Profit and Loss Appropriation Account
for the ended 31st December, 2005

Particulars	₹	₹	Particulars	₹	₹
To Interest on Capital A/c:			By Net Profit (Adjusted) (W.N.1)		55,750
Raj	7,500		By Interest on Drawings A/c: (W.N.2)		
Ram	4,000		Raj	630	
Rama	3,000	14,500	Ram	520	
To Partner's Current A/cs: (Share of Profit)			Rama	400	1,550
Raj	21,400				
Ram	10,700				
Rama	10,700	42,800			
		57,300			57,300

Working Notes:

1. Adjusted Profit

		₹
Net Profit as per Profit & Loss A/c		60,000
Add: Drawings by Raj: Life Insurance Premium of Raj charged to Miscellaneous Expenditure A/c of the firm		750
Drawing by Ram: Travelling Expenses in connection with pleasure trip to U.K. charged to Travelling Expenses A/c of the firm		3,000
		63,750
Less: Repairs to Machinery wrongly capitalised	10,000	
Less: Depreciation charged @ 20%	-2,000	8,000
		55,750

2. Interest or Drawings:

	Raj ₹	Ram ₹	Rama ₹
Drawings	15,000	10,000	10,000
Add: Rectification adjustments	750	3,000	–
	15,750	13,000	10,000
Interest @ 8% p.a. for 6 months	630	520	400

Illustration:

On 1st January, 2007 Suraj and Naveen went into Partnership Sharing Profits in the ratio of 3:2. On 31st December, 2007 after preparation of the Trading and Profit & Loss Account. The following balances remained in their books:

		₹
Capital	: Suraj	36,000
	: Naveen	20,000
Drawings	: Suraj	3,600
	: Naveen	2,400
Loan from Suraj		4,000
Stocks		8,000
Debtors		15,000
Creditors		6,400
Cash at Bank		3,500
Net Profit: 2007 (as per Profit and Loss A/c)		9,600
Fixed Assets		43,500

The following has still to be taken into account

(a) Suraj is entitled to 5% loan interest.

(b) Naveen has taken goods worth ₹60 for his own personal use

(c) Interest on capital : Suraj 1,200
: Naveen 900

(d) Interest on Drawings : Suraj 300
: Naveen 200

(e) Naveen is entitled to a salary of ₹600 before profits are shared.

(f) During the year, Naveen introduced certain fixed assets into the business valued at ₹1,800.

You are required to prepare Profit & Loss Appropriation Account Partner's Capital Accounts, Partners' Current Account (where necessary) and Balance Sheet as at 31st December, 2007, under:

(i) Fluctuating Capital Method, and

(ii) Fixed Capital Method

Solution:

Books of Suraj and Naveen
Profit & Loss Appropriation Account
for the year ending 31st Dec, 2007

Dr. Cr.

Particulars		₹	Particulars		₹
To Interest on Capital A/c			By Net Profit b/f from Profit & Loss A/c (9,600 + 60)		9,660
Suraj	1,200		By Interest on Drawings A/c:		
Naveen	900	2,100	Suraj	300	
To Interest on Loan A/c: Suraj		200	Naveen	200	500
To Salary A/c: Naveen		600			
To Share of residue of Profit:					
Suraj (3/5)	4,356				
Naveen (2/5)	2,904	7,260			
		10,160			10,160

(i) Under fluctuating capital method:

Capital Accounts

Dr. Cr.

Particulars	Suraj ₹	Naveen ₹	Particulars	Suraj ₹	Naveen ₹
31.12.07			1.1.07		
To Drawings A/c	3,600	2,460	By Balance b/d	36,000	20,000
To Interest on Drawings A/c	300	200	31.12.07		
To Balance c/d (b/f)	37,656	23,544	By Sundry Fixed Assets A/c	–	1,800
			By Interest on Capital A/c	1,200	900
			By Salary A/c	–	600
			By Share of Residue A/c	4,356	2,904
	41,556	26,204		41,556	26,204
			1.1.08		
			By Balance b/d	37,656	23,544

Note: Drawings of Naveen = ₹2,400 + 60 = ₹2,460

Balance Sheet
as on 31st Dec, 2007

Liabilities		₹	Assets	₹
Partner's Capital:			Fixed Assets (43,500 + 1,800)	45,300
Suraj	37,656		Current Assets:	
Naveen	23,544	61,200	Stocks	8,000
Loan Account: Suraj	4,000		Debtors	15,000
Add: Accrued interest	200	4,200	Cash at Bank	3,500
Current Liabilities:				
Creditors		6,400		
		71,800		71,800

(ii) Under Fixed Capital Method:

Capital Accounts

Dr. Cr.

Particulars	Suraj ₹	Naveen ₹	Particulars	Suraj ₹	Naveen ₹
31.12.07			1.1.07		
To Balance c/d (b/f)	36,000	21,800	By Balance b/d	36,000	20,000
			31.12.07		
			By Sundry Fixed Assets A/c		1,800
	36,000	21,800		36,000	21,800
			1.1.08		
			By Balance b/d	36,000	21,800

Current Accounts

Dr. Cr.

Particulars	Suraj ₹	Naveen ₹	Particulars	Suraj ₹	Naveen ₹
31.12.07			31.12.07		
To Drawings A/c	3,600	2,460	By Interest on Capital A/c	1,200	900
To Interest on Drawings A/c	300	200	By Interest on Loan A/c	200	–
To Balance c/d (b/f)	1,856	1,744	By Salary A/c		600
			By Share of Residue A/c	4,356	2,904
	5,756	4,404		5,756	4,404
			1.1.08		
			By Balance b/d	1,856	1,744

Balance Sheet as on 31st Dec, 2007

Liabilities	₹	Assets	₹
Partner's Capital:		Fixed Assets	45,300
Suraj	36,000	Current Assets:	
Naveen	21,800	Stocks	8,000
Partner's Current A/c		Debtors	15,000
Suraj	1,856	Cash at Bank	3,500
Naveen	1,744		
Loan Account: Suraj	4,000		
Current Liabilities:			
Creditors	6,400		
	71,800		71,800

Notes:

1. Under **fluctuating** capital method, all amounts due to the partners, such as interest on capital, salary, commission, share of profit, are credited to the capital accounts. Likewise, drawings and interest on drawings are debited thereto.
2. Under fixed capital method, all the debits and credits as stated in (i) above are made in the Current Accounts.

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. A draws ₹1,000 per month on the last day of every month. If the rate of interest is 5% p.a. then the total interest on drawings will be:
   (a) ₹325
   (b) ₹275
   (c) ₹300
   (d) ₹350 issuing
2. A and B are partners sharing profits and losses in the ratio of 4 : 1. C was a manager who received the salary of ₹2,000 p.m. in addition to a commission of 5% on net profits after charging such commission. Profits for the year is ₹3,39,000 before charging salary. Find total remuneration of C:
   (a) ₹39,000
   (b) ₹44,000
   (c) ₹43,500
   (d) ₹38,000
3. In the absence of an agreement, partners are entitled to:
   (a) Salary
   (b) Commission
   (c) Interest on loans and advances
   (d) Profit share in capital ratio
4. In absence of any agreement, partners are liable to receive interest on loans at the rate of:
   (a) 12% simple interest
   (b) 12% compounded annually
   (c) 6% simple interest
   (d) 6% p. a. simple interest

5. A and B are partners A's capital is ₹10,000 and B's Capital is ₹6,000. Interest is payable @ 6% p.a.. B is entitled to a salary of ₹300 per month. Profit to the year before interest and salary to B is ₹8,000. Profits between A and B will be divided:
(a) ₹1,720 to A and ₹1,720 to B
(b) ₹2,000 to A and ₹1,440 to B
(c) ₹1,440 to A and ₹2,000 to B
(d) None

6. Ram is a partner. He made drawings as follows:

July 1	₹200
August 1	₹200
September 1	₹300
November 1	₹50
February 1	₹100

If the rate of interest on drawings is 6% and accounts are closed on March 31 the interest on drawing is:
(a) ₹29.75
(b) ₹35
(c) ₹30
(d) ₹40

7. Fluctuating Capital Account is credited with:
(a) Interest on Capital
(b) Profit of the year
(c) Remuneration to the partners
(d) All of these

8. Ram and Mohan, are partners. They draw for private use ₹6,000 and ₹4,000 respectively. Interest is chargeable @ 6 percent per annum on drawings. What is the interest?
(a) Ram ₹180 and Mohan ₹120
(b) Ram ₹360 and Mohan ₹240
(c) Ram ₹30 and Mohan ₹20
(d) None

9. Interest on Partners' capital is:
(a) An expenditure
(b) An appropriation
(c) A gain
(d) None of these

10. A and B are partners having capital of ₹50,000 and ₹60,000 respectively. Interest on capital is given @ 5% p.a. Profits for the year before appropriation is ₹4,600. Provide interest on capital out of profits. Interest allocated to partners is:
(a) ₹3,000 and ₹2,500
(b) ₹2,090 and ₹2,509
(c) ₹2,500 and ₹2,091
(d) ₹600 and ₹300

11. If there is no partnership deed then interest on capital will be charged at .... p.a.
(a) 6 %
(b) 8 %
(c) 9 %
(d) NIL

12. Interest on Drawings is:
(a) Debited to P/L A/c
(b) Credited to P/L A/c
(c) Debited to Capital A/c
(d) None

13. A. B. C are partners in a partnership firm. During the F.Y. 2008-09, firm earned profit amounting to ₹18,000. They distributed the profit in the ratio of 2:2:1. But there is no partnership deed of the firm. Necessary adjustment entry will be:

(a)	P & L Adjustment A/c Dr.	18,000	
	To A's Capital A/c		7,200
	To B's Capital A/c		7,200
	To C's Capital A/c		3,600
(b)	P & L Adjustment A/c Dr.	18,000	
	To A's Capital A/c		6,000
	To B's Capital A/c		6,000
	To C's Capital A/c		6,000

(c) A's Capital A/c Dr. 1,200
B's Capital A/c Dr. 1,200
To C's Capital A/c 2,400
(d) None of the above

14. In the presence of an agreement, interest on capital is to be provided from _________?
(a) Profits
(b) Capital
(c) Partners Personally
(d) None of these.

15. In the absence of an agreement, interest to be allowed on partners' capital is _________?
(a) 8%
(b) 9%
(c) 6%
(d) None of these.

16. Interest on drawings is treated as:
(a) Revenue
(b) Expense
(c) Liability
(d) None of these.

17. A partnership firm consisted of three partners A, B, C. If A pays ₹10,000 against the liability of the firm from his private funds, then what will be the entry in the books of the firm?
(a) No entry
(b) Liability A/c debit, Partner's Capital credit
(c) Partner's Capital A/c debit, Liability credit
(d) None of these.

18. 'Salary ₹5,000 paid to partner'. The above item will appear in _________.
(a) Notes to accounts
(b) Revaluation A/c
(c) Profit & Loss Appropriation A/c
(d) Trading A/c

19. A partner has given a loan of ₹50,000 to the firm. He wants interest @ 15% per annum on his loan. There was no agreement or partnership deed between them. The partner _________.
(a) is entitled for interest @ 15%
(b) is not entitled for any interest
(c) will be given interest @ 6%
(d) will be given interest @ 10%

20. In the absence of any deed of partnership –
(a) Only working partners are entitled to Salary.
(b) Partners are entitled for commission @ 6% of the net profits of the firm.
(c) Partners contributing highest capital is entitled for interest on capital @ 6% p.a.
(d) Interest at the rate of 6% is to be allowed on a partner's loan to the firm.

21. Net profit of the firm is ₹5,000. Interest on capital and interest on drawings still not charged are ₹5,000 and ₹2,500 respectively. Net profit available for the distribution among the partners after charging the above will be:
(a) ₹7,500
(b) ₹5,000
(c) ₹2,500
(d) Nil

22. Insurance Premium paid by the firm on the life Insurance policy of a partner is
(a) Debited to Capital A/c of Partner
(b) Credited to Capital A/c of Partner
(c) Debited to Profit and Loss A/c
(d) Credited to Profit and Loss A/c

23. Ram, Rahim, Singh and John are in partnership sharing profits and losses equally. They mutually agree to change their profit sharing ratio to 2:2:1:1. In this case John's share would decrease by _________ share of profit and loss.
(a) 1/24

(b) 1/12
(c) 1/10
(d) 1/6

24. If opening capital of a partner in the firm is ₹1,00,000 and closing capital is ₹2,00,000. Interest on capital allowed during the year ₹10,000 and interest on drawings charged during the year ₹2,000. If total drawings were ₹20,000, the amount of profit transferred to his capital account by the firm would be:
(a) ₹1,00,000
(b) ₹1,20,000
(c) ₹1,22,000
(d) ₹1,12,000

25. X and Y are partners. Given below is detail of items appearing in the Appropriation Account.

Particulars	X (₹)	Y (₹)
Interest on capital	1,600	1,800
Interest on drawing	500	400
Remuneration to partners	2,000	3,000
Share of profit after Appropriation	8,000	12,000

What was the net profit before appropriation?
(a) ₹17,500
(b) ₹22,500
(c) ₹27,500
(d) ₹29,300

26. Subject to contract between the partners, interest on capital is to be provided out of profits only. In case of insufficient profits (i.e. net profit less than the amount of interest on capital), the amount of profit is distributed:
(a) In equal ratio
(b) In profit sharing ratio
(c) In capital ratio
(d) Restricted to 6% of partner's capital

27. A, B and C are partners sharing profit and losses equally and A paid liability of ₹10,000 out of his private funds. How will you record this in the books of the firm?

(a) No entry will be made in the books to the firm.
(b) A's capital A/c Dr. ₹10,000
To Cash A/c ₹10,000
(c) Liability A/c Dr. ₹10,000
To A's Capital A/c ₹10,000
(d) Liability A/c Dr. ₹10,000
To Cash A/c ₹10,000

28. Aryan and Gauri were partners in a firm sharing profits and losses in the ratio of 2 : 1. Their capital was ₹90,000 and ₹60,000 respectively. They were entitled for interest on capital @ 12% p.a. The firm earned a profit of ₹84,000 after allowing interest on capitals. Profits will be distributed among them will be:
(a) ₹44,000; ₹22,000
(b) ₹56,000; ₹28,000
(c) ₹50,400; ₹33,600
(d) ₹39,600; ₹26,400

29. Kapur and Sharma are partners in a partnership firm. Calculate the interest on drawings made by Kapur and Sharma @10% p.a. for the year ending 31st December 2013. If, Kapur withdrew ₹2,000 per month in the beginning whereas Sharma withdrew same amount at the end of every month.
(a) Kapur - ₹2,400, Sharma - ₹2,400
(b) Kapur - ₹1,100, Sharma - ₹1,300
(c) Kapur - ₹1,200, Sharma - ₹1,200
(d) Kapur - ₹1,300, Sharma - ₹1,100

30. When partnership deed is not registered a partnership firm is
(a) Deemed to be an illegal association and is disallowed to carry on business.
(b) Allowed to carry on business subject to payment of penalty.
(c) Allowed to carry on business subject to certain disabilities.
(d) Allowed to carry on business only with the special permission of the registrar of firms.

31. Karan, Bittoo and Shravan are partners in a partnership firm. Karan withdraws ₹5,000 per month in the beginning whereas Bittoo and Shravan withdrew ₹2,000 and ₹3,000 respectively at the end of every month. Calculate the interest on drawings of Karan, Bittoo and Shravan @ 10% p.a. for the year ending on 31st March, 2014.
   (a) Karan - ₹6,000, Bittoo - ₹2,400, Shravan - ₹3,600
   (b) Karan - ₹2,750, Bittoo - ₹1,300, Shravan - ₹1,950
   (c) Karan - ₹3,000, Bittoo - ₹1,200, Shravan - ₹1,800
   (d) Karan -₹3,250, Bittoo - ₹1,100, Shravan - ₹1,650

32. X and Y are partners sharing profits and losses in the ratio of their effective capital; had ₹1,00,000 and ₹60,000 respectively in their Capital Accounts as on 1st Jan, 2014.
   X introduced a further capital of ₹10,000 on 1st April, 2014 and another ₹5,000 on 1st July, 2014. On 30th Sep, 2014 X withdrew ₹40,000.
   On 1st July, 2014 Y introduced further capital of ₹30,000. The partners drew the following amounts in anticipation of profits:
   X drew ₹1000 p.m. at the end of each month and Y withdrew ₹1,000 on 30th June, 2014 and ₹5,000 on 1st Sept, 2014. Date of closing 31.12.2014. Calculate profit and loss ratio on the basis of their effective capital:
   (a) 1 : 1
   (b) 4 : 3
   (c) 2 : 3
   (d) 5 : 3

33. X, Y and Z are partners in a firm. At the time of division of profit for the year there were dispute between the partners. Profits before interest on partners loan was ₹6000. Y determined interest @ 24% p.a. on his loan of ₹80,000. There was no agreement on this point. Calculate the amount payable to X, Y and Z respectively.
   (a) ₹2,000 to each partner
   (b) Loss of ₹4,400 for X and Z and Y will take home ₹14,800
   (c) ₹400 for X, ₹5,200 for Y and ₹400 for Z
   (d) ₹2,400 for each partner.

34. Suraj, Gulab and Kamal are partners in a firm. They have no agreement in respect of profit sharing ratio and interest on capital. Suraj who has contributed maximum capital demands interest on capital @ 10% p.a. and the share of profit in the capital ratio. But Gulab and Kamal do not agree. In that case how shall you settle the case?
   (a) Interest on capital will be payable @ 10% p.a. and share in profits disfributed equally.
   (b) Interest on capital will be payable @ 6% p.a. and share in profits distributed equally.
   (c) Interest on capital will be payable @ 6% p.a. and share in profits distributed in capital ratio.
   (d) No interest on capital will be payable and share in profits distributed equally.

35. Shukh and Shanti are partners with the capital of ₹50,000 and ₹30,000 respectively. The profit earned by the firm is ₹6,000. Interest payable on capital is 10% p.a. subject to the provisions of Partnership Act. Find the interest on capital for both the partners.
   (a) ₹5,000 and ₹3,000
   (b) ₹3,000 and ₹3,000
   (c) ₹3,750 and ₹2,250
   (d) ₹3,000 and ₹1,800

36. Net profit of Ex Ltd. before allowing remuneration and commission to Mehta, the Manager, was ₹7,C2,000. Mehta was entitled to a monthly remuneration of ₹6,000 plus a commission of 5% of net profits after charging remuneration and such commission. Find out the total amount payable to Mehta.
   (a) ₹72,000
   (b) ₹1,02,000
   (c) ₹30,000
   (d) ₹6,000

37. At the end of the year 2016-17, Aman's capital was ₹5,00,000. The profit for the year was ₹1,00,000. During the year he had drawn ₹ 50,000 from the business for personal use. The interest on opening capital @ 10% for the year should be:
    (a) ₹50,000
    (b) ₹5,50,000
    (c) ₹45,000
    (d) ₹55,000
38. Interest on Capital will be paid to the partners if provided for in the agreement but only from _______.
    (a) Reserves
    (b) Accumulated profits
    (c) Goodwill
    (d) Current profits

ANSWER

1.	(b)	2.	(a)	3.	(c)	4.	(d)	5.	(a)
6.	(a)	7.	(d)	8.	(a)	9.	(b)	10.	(b)
11.	(d)	12.	(c)	13.	(c)	14.	(a)	15.	(d)
16.	(a)	17.	(b)	18.	(c)	19.	(c)	20.	(d)
21.	(c)	22.	(c)	23.	(b)	24.	(d)	25.	(c)
26.	(c)	27.	(c)	28.	(b)	29.	(d)	30.	(c)
31.	(d)	32.	(b)	33.	(c)	34.	(d)	35.	(c)
36.	(b)	37.	(c)	38.	(d)				

SHORT PRACTICE QUESTIONS

1. Differentiate between LLP and Partnership.
2. State the powers of a partner in the business of partnership.
3. What are the characteristics of partnership form of business.

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

2000 - May [5] State with reasons whether the following statement is true or false:

(v) A partner who devotes more time to a business than other partners is entitled to get a salary. (2 marks)

Answer:

False: Unless and until the partnership deed specifically provides for the entitlement of salary, no partner can receive it.

2001 - May [5] State with reasons whether the following statement is true or false:

(4) Partners can share profits or losses in their Capital ratio, when there is no agreement. (2 marks)

Answer:

False: According to the Partnership Act, 1932, when these is no agreement, the partners are to share the profit and loss equally among themselves.

2005 - May [5] Sate with reasons whether the following statement is true or false:

(viii) When there is no agreement among the partners, the profit or loss of the firm will be shared in their capital ratio. (2 marks)

Answer :

False: When there is no agreement among the partners, the profit and loss is shared equally among the partners.

2005 - Nov [5] State with reasons whether the following statement is true or false :

(xi) The business of partnership firm must be carried on by all the partners. (2 marks)

Answer:

False: Accounting to Sec. 4 of the Indian Partnership Act. 1932, partnership can be carried on by all or any one of them acting for all.

2018 - May [1] {C} (a) State with reasons, whether the following statement is true or false:

(v) When there is no partnership deed prevails, the interest on loan of a partner to be paid @ 6%. (2 marks)

Answer:

True: Rule in absence of partnership deed says that interest at the rate of 6% p.a. is to be allowed an a partners loan to the firm.

2019 - June [1] (a) State with reason, whether the following statement is true or false :

(v) Limited Liability Partnership (LLP) is governed by Indian Partnership Act, 1932. (2 marks)

Answer:

False: Limited liability partnership is governed by Limited Liability Partnership (LLPs) Act, 2008.

2019 - Nov [1] {C} (a) State with reason, whether the following statement is True or False.

(v) A Partnership firm cannot own any Assets. (2 marks)

Answer:

True: A partnership firm cannot own any assets. The partners own the assets of the firm.

SHORT NOTES

1995 - Nov [6] Write short note on the following:

(3) Fixed Capital and Fluctuating Capital. (5 marks)

Answer:

Please refer 1994 - Nov [6] (2) on page no. 748

2004 - Nov [6] Write short note on the following:

(ii) Fixed and Fluctuating Capital. (5 marks)

Answer:

Please refer 1995 - Nov [6] (3) on page no. 747

DISTINGUISH BETWEEN

1994 - Nov [6] Distinguish between the following:

(2) Fixed capital and Fluctuating Capital. (3 marks)

Answer :

Fixed Capital System:

- Partners' capital accounts can be maintained either on 'fixed capital system' or on 'fluctuating capital system'.
- In case of fixed capital system, two accounts for each partner i.e. Partner's capital account and Partner's current account are maintained.
- The partner's capital account is credited with the original amount of capital introduced by the partner into business.
- It is to be credited subsequently with extra capital introduced by the partner or debited with the amount of capital permanently withdrawn by the partner.
- No other adjustments are made in this account.
- The partner's current account is maintained for making all entries relating to interest, share of profit, drawings, etc.
- The balance in this account will go on fluctuating but the balance of the capital account will remain fixed; that is why the system is termed as 'fixed capital system'.

Fluctuating Capital System:

- In case of fluctuating capital system, only one account is maintained for each partner. This account is termed as his 'capital account'.

- All entries relating to introduction of fresh capital, drawings, interest, profit etc. are made in this account.
- The balance in this capital account, therefore, goes on fluctuating.
- The system is, therefore, called as 'fluctuating capital system'.

1997 - May [6] Distinguish between the following:
(3) Fixed capital and Fluctuating Capital. (5 marks)
Answer:
Please refer 1994 - Nov [6] (2) on page no. 748

2000 - Nov [6] Briefly explain the difference between the following:
(d) Fixed capital and Fluctuating Capital. (5 marks)
Answer:
Please refer 1994 - Nov [6] (2) on page no. 748

PRACTICAL QUESTIONS

2005 - May [4] (b) A, B and C entered into partnership on 1.1.2004 to share profits and losses in the ratio of 5 : 3 : 2. A personally guaranteed that C's share of profit after charging interest on capitals at 5% p.a. would not be less than ₹30,000 in any year. Capital of A, B and C were ₹3,20,000, ₹ 2,00,000 and ₹1,60,000 respectively.
Profits for the year ending 31.12.2004 before providing for interest on partners capital was ₹1,59,000.
Show the Profit and Loss Appropriation Account. (8 marks)

QR Code for Solution Video

Answer :
Profit and Loss Appropriation Account for the year ended 31st December, 2004

Particulars	₹	₹	Particulars	₹
To Interest on capital			By Net profit b/d (Profit before interest)	1,59,000
A (5% of ₹3,20,000)	16,000			
B (5% of ₹2,00,000)	10,000			
C (5% of ₹1,60,000)	8,000	34,000		
To Partner's capital accounts				
A $\left(\frac{5}{10} \text{ of ₹}1,25,000\right)$	62,500			
Less: Transferred to C	5,000	57,500		
B $\left(\frac{3}{10} \text{ of ₹}1,25,000\right)$		37,500		
C $\left(\frac{2}{10} \text{ of ₹}1,25,000\right)$	25,000			
Add: Transferred from A	5,000	30,000		
		1,59,000		1,59,000

CHAPTER 8

Partnership Accounts

Unit: 2 **Treatment of Goodwill in Partnership Accounts**

SELF STUDY QUESTIONS

Q1. What do you mean by Goodwill?

Answer:

Goodwill means the reputation of the firm. In other words, it is the value of reputation earned by a firm which helps it to yield more than normal profits.

Need for valuation of goodwill:

(i) On admission of new partner
(ii) On retirement or death of a partner
(iii) When there is a change in profit sharing ratio
(iv) When a business is sold or dissolved
(v) When there is amalgamation with another firm

Q2. What are the Factors affecting goodwill of the firm?

Answer:

(i) Location of business
(ii) Quality of goods sold/services rendered
(iii) Reputation of owners of the firm
(iv) Risk involved in business
(v) Efficiency of management
(vi) Trends of profit
(vii) Monopolistic nature of the business
(viii) Possibility of competition
(ix) Government attitude
(x) Possession of special contract for availability of material

Recommendation of Accounting Standard 26 As per AS 26, intangible assets can be recorded only if—

(a) It has characteristics of an asset such as identity, value etc.
(b) If it is capable of providing future probable economic benefits to the business.
(c) It can be measured reliably i.e. its cost can be verified.

Thus, only goodwill for which any consideration in money or money's worth is paid can be recognised in books of accounts.

- Internally generated goodwill should not be recorded into books of accounts.

Q3. What are the Methods for Goodwill Valuation?

Answer:

1. **Average Profit Basis:**

   It is a very simple and widely followed method:

   Formula:

   Value of Goodwill = Average Profit × Number of years of purchase.

   Where,

   Average profits are past profits after adjustments. Following adjustments are made from the past profits:

   - Abnormal income should be deducted
   - Abnormal loss should be added back
   - Income from investments should be deducted as it is not earned from the business.

   Number of years purchase are the years for which the goodwill is expected to remain into the business i.e. the years for which the benefit of goodwill can be taken.

   Weighted average profit method: Under this method weights are multiplied by the profits to get the product which is divided by total weights to get the weighted average profit.

   Goodwill = Weighted average profit × Number of years of purchase.

2. **Super Profit Basis:**

   Under this method, goodwill is calculated on the basis of excess profit earned by a firm over and above normal profits methods for calculation:

(i) **Number of years purchased method.**
Goodwill = Super Profit × Number of years of purchase.
Where,
Super Profit = Actual Profit – Normal Profit
Normal Profit = Capital Invested × $\frac{\text{Normal rate of returns}}{100}$
Actual Profit = Average Profit

(ii) **Annuity Method.**
Under this method goodwill is calculated by taking the present value of a terminal annuity of a super profit for a reasonable period.
Goodwill = Super Profit × Annuity
Note: Annuity is generally given in question.

3. **Capitalisation Basis:**
Under this method goodwill is ascertained by comparing value of whole business (applying normal rate of return) with the actual capital employed of the business. The difference of the above is called as goodwill.

Formula:
Goodwill = Value of whole business (–) Capital Employed
Where,
Value of whole business = $\frac{\text{Average Annual Profit}}{\text{Normal Rate of Return}} \times 100$
Capital Employed = Net Assets (i.e. Assets (–) Liability)

Illustration:
Nirav and Nakul are in equal partnership. They agreed to take Hicks as one - partner. For this, it was decided to find out the value of goodwill. M/s Nirav and Nakul earned Profits during 2002-2005 as follows:

Years	Profits (₹)
2002	1,20,000
2003	1,25,000
2004	1,30,000
2005	1,50,000

On 31.12.2005, capital employed by M/s Nirav and Nakul was ₹5,00,000 Rate of normal profit is 20%.
Find out the value of goodwill following various methods.

Solution:

Average Profit:

Year	Profit	Weight ₹	Weighted Profit ₹
2002	1,20,000	1	1,20,000
2003	1,25,000	2	2,50,000
2004	1,30,000	3	3,90,000
2005	1,50,000	4	6,00,000
		10	13,60,000

Weighted Average Profit ₹= 1,36,000

Method (1) : Average Profit Basis
Assumption: Goodwill is valued at 3 years purchase
Value of Goodwill: ₹1,36,000 × 3 = ₹4,08,000

Method (2): Super Profit Basis

Average Profit	₹1,36,000
Less: Normal Profit	
20% on ₹5,00,000	₹1,00,000
	₹ 36,000

Assumption: Goodwill is valued at 3 years purchase
Value of Goodwill: ₹36,000 × 3 = ₹1,08,000

Method (3): Annuity Basis
Assumptions:
Goodwill is valued at 3 years purchase
Valuation of Goodwill: ₹36,000 × 2.1065 = ₹75,834

Method (4): Capitalization Basis
Normal Value of Capital employed:
$\frac{1,36,000 \times 100}{20} \times 100$ = ₹6,80,000
Capital Employed in M/s. Nirav and Nakul = ₹5,00,000
Goodwill = ₹1,80,000

Hidden or Interred or Implied Goodwill:
At times there may not be a clear disclosure of the amount of goodwill to be shared with new partner. Inspite of this, question may ask for valuation of goodwill. In such case, we need to calculate the amount of hidden goodwill.
Steps:
1. Calculate total capital after admission of partner on the basis of capital brought by new partner for his share in profit.
2. Calculate combined capital of the firm i.e. of old partners and new partner's share.
3. Hidden Goodwill = Step1 (–) Step 2.

Q4. How is Valuation of Goodwill done in case of Admission and death of a Partner? What is its Accounting Treatment?
Answer:
When a new partner is admitted, he had no role in establishment and development of partnership business, however old partners have established the business with hard work and earned good name in the market. Thus, the new partner should bring in some extra consideration over and above the normal contribution. This extra amount is recorded as goodwill.
It is the compensation made for the sacrifice made by old partners to their personal shares in order to admit a new partner.
Accounting treatment of Goodwill in case of admission of a new partner:
- New partner brings his share of goodwill in cash and distributed to old partners in their sacrificing ratio.
  Accounting Entry:
  Bank A/c Dr.
  To Old Partner's Capital A/c
- New partner bring his share in each but withdrawn by old partners.
  Accounting Entry:
  Old Partner's Capital A/c Dr.
  To Bank A/c
  Sacrificing = Old Share (–) New Share Ratio

Accounting treatment of Goodwill in case of change in profit sharing ratio:
Accounting Entry:
(Gaining) Partner's Capital A/c Dr.
To (Losing) Partner's Capital A/c
Accounting treatment of Goodwill in case of Retirement or Death of Partner:
Share of goodwill of retiring partner to be adjusted to the accounts of remaining partners in gaining ratio.
Remaining Partners A/c Dr.
To Retiring Partner's A/c
Illustration:
AB and C are partners in a business, sharing profits and losses equally, C retires on 1st January, 2004, when the Balance Sheet stood as follows:

Liabilities		₹	Assets	₹
Creditors		1,500	Cash	400
Reserve Funds		3,000	Bank	600
Capitals:	₹		Bills Receivable	1,000
A	3,000		Debtors	2,500
B	4,000		Stock	300
C	3,000	10,000	Furniture	800
			Machinery	1,000
			Buildings	7,900
	₹	14,500	₹	14,500

The goodwill of the firm was valued at ₹4,500. Ascertain the amount payable to C on retirement and transfer the same to his Loan Account.
(i) When a Goodwill Account is raised at full value and is allowed to remain in the books of the firm.
(ii) When a Goodwill Account is raised at full value but is written back to the Capital Accounts of the continuing partners.
(iii) When a Goodwill Account is raised by the retiring partner's share thereof and is allowed to remain in the books of the firm.

(iv) When a Goodwill Account is raised equal to the retiring partner's share thereof but is written back to the Capital Accounts of the continuing partners.

Show also the Balance Sheet of the continuing partners in each case at 1st January, 2004.

Solution:

(a) **When Goodwill Account is raised at full value and is allowed to stand in the books of the firm:**

Journal

Date	Particulars	L.F.	₹	₹
2004 Jan. 1	Goodwill A/c Dr. To A/s Capital A/c To B/s Capital A/c To C/s Capital A/c (Being the amount of goodwill credited to Partner's Capital Accounts)		4,500	 1,500 1,500 1,500
Jan.1	Reserve Fund A/c Dr. To C's Capital A/c (Being transfer of C's share of Reserve Fund to his Capital A/c)		1,000[1]	 1,000
Jan. 1	C/s Capital A/c Dr. To C's Loan A/c (Being transfer of the amount due to C to his Loan A/c)		5,500[2]	 5,500

1. Reserve Fund ₹3,000 × $\frac{1}{3}$ = ₹1,000.

2. C's old capital ₹3,000 + ₹1,500 + ₹1,000 = ₹5,500.

Balance Sheet of A and B
(as on 1st January, 2004)

Liabilities	₹	₹	Assets	₹
Sundry Creditors		1,500	Cash	400
C's Loan A/c		5,500	Bank	600
Reserve Fund		2,000[3]	Bills Receivable	1,000
Capital A/cs:			Sundry Debtors	2,500
A	4,500		Stock	300
B	5,500	10,000	Furniture	800
			Machinery	1,000
			Buildings	7,900
			Goodwill	4,500
	₹	19,000	₹	19,000

3. ₹3,000 – ₹1,000 = ₹2,000.

(b) **When a Goodwill Account is raised at full value, but is written back to the Capital Accounts of the continuing partners:** In this case first of all the same three Journal entries will be passed which have been passed in the first case and then the following fourth entry is made:

Journal

Date	Particulars	L.F.	₹	₹
2004 Jan. 1	A's Capital A/c Dr. B's Capital A/c To Goodwill A/c (Being the amount of goodwill written back to the Capital Accounts of the continuing partners)		2,250 2,250	 4,500

Balance Sheet of A and B
(as on 1st January, 2004)

Liabilities	₹	₹	Assets	₹
Sundry Creditors		1,500	Cash	400
C's Loan A/c		5,500	Bank	600
Reserve Fund		2,000	Bills Receivable	1,000
Capital A/cs:			Sundry Debtors	2,500
A	2,250[4]		Stock	300
B	3,250[5]	5,500	Furniture	800
			Machinery	1,000
			Buildings	7,900
	₹	14,500	₹	14,500

4. ₹3,000 + 1,500 goodwill – 2,250 = ₹32,250;
5. ₹4,000 + 1,500 goodwill – 2,250 = ₹3,250

(c) **When Goodwill Account is raised equal to the retiring partner's share thereof, and is allowed to remain in the books of the firm:**

Journal

Date	Particulars	L.F.	₹	₹
2004 Jan. 1	Goodwill A/c Dr.		1,500	
	To C's Capital A/c			1,500
	(Being C's share of goodwill credited to his Capital A/c on his retirement from business)			
Jan.1	Reserve Fund A/c Dr.		1,000	
	To C's Capital A/c			1,000
	(Being the transfer of C's share of Reserve Fund to his Capital A/c)			

Jan. 1	C/s Capital A/c Dr.		5,500	
	To C's Loan A/c			5,500
	(Being the transfer of the amount due to C to his Loan A/c)			

Balance Sheet of A and B
(As on 1st January, 2004)

Liabilities	₹	₹	Assets	₹
Sundry Creditors		1,500	Cash	400
C's Loan A/c		5,500	Bank	600
Reserve Fund		2,000	Bills Receivable	1,000
Capital A/cs:			Sundry Debtors	2,500
A	3,000		Stock	300
B	4,000	7,000	Furniture	800
			Machinery	1,000
			Buildings	7,900
			Goodwill	1,500
	₹	16,000	₹	16,000

(d) **When a Goodwill Account is raised equal to the retiring partner's share thereof, but is written back to the Capital Accounts of the continuing partners:** In this case first of all the same three entries are passed which have been passed in the third case and then following fourth entry is passed:

Journal

Date	Particulars	L.F.	₹	₹
2004 Jan. 1	A's Capital A/c Dr.		750	
	B's Capital A/c Dr.		750	
	To Goodwill A/c			1,500
	(Being the amount of goodwill written back to the Capital Accounts of the continuing partners)			

Balance Sheet of A and B
(as on 1st January, 2004)

Liabilities	₹	₹	Assets	₹
Sundry Creditors		1,500	Cash	400
C's Loan A/c		5,500	Bank	600
Reserve Fund		2,000	Bills Receivable	1,000
Capital A/cs:			Sundry Debtors	2,500
A	2,250		Stock	300
B	3,250	5,500	Furniture	800
			Machinery	1,000
			Buildings	7,900
	₹	14,500	₹	14,500

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. The profits of last five years are ₹75,000, ₹90,000, ₹80,000, ₹1,00,000 and ₹80,000. Find the value of goodwill, if it is calculated on average profits of last five years on the basis of 3 years of purchase:
   (a) ₹85,000
   (b) ₹2,55,000
   (c) ₹2,75,000
   (d) ₹2,85,000

2. Capital employed in a business is ₹ 1,50,000. Profits are ₹50,000 and the normal rate of profit is 20%. The amount of goodwill as per capitalization method will be:
   (a) ₹2,00,000
   (b) ₹1,50,000
   (c) ₹3,00,000
   (d) ₹1,00,000
3. A firm has an average profit of ₹60,000. Rate of return on Capital employed is 12.5% p.a. Total capital employed in the firm was ₹ 4,00,000. Goodwill on the basis of two years purchase of super profits is:
   (a) ₹20,000
   (b) ₹15,000
   (c) ₹10,000
   (d) None
4. Weighted average method of calculating goodwill is used when:
   (a) Profits are unequal
   (b) Profit has increasing trend
   (c) Profit has decreasing trend
   (d) Either (b) or (c)
5. X and Y are partners in a firm with capital of ₹18,000 and ₹20,000. Z was admitted for 1/3rd share in profits and brings ₹24,000 as capital, calculate the amount goodwill:
   (a) ₹24,000
   (b) ₹20,000
   (c) ₹15,000
   (d) ₹10,000
6. Goodwill is to be calculated at 1.5 years of purchase of average profits of last 6 years. Profit earned during the first 3 years is ₹30,000, ₹20,000 and ₹20,000 and losses suffered of ₹5,000, ₹3,000 and ₹2,000 in the last three years. Goodwill will be:
   (a) ₹10,000
   (b) ₹15,000
   (c) ₹20,000
   (d) ₹25,000

7. A firm earned net profits during last 3 years as follows:

2001	₹15,000
2002	₹20,000
2003	₹25,000

The capital investment in the firm is ₹1,00,000. Having regard to risk involved, 15% is the fair return on capital employed. Goodwill on basis of 2 years purchase of average Super profits earned during 3 years is:
(a) ₹8,000
(b) ₹10,000
(c) ₹12,000

8. What do you mean by purchasing years?
(a) No. of years in which goodwill is purchased
(b) No. of years the goodwill is expected to remain
(c) Both of these
(d) None of these

9. What do you mean by Super Profit?
(a) Total profit / number of years
(b) Weighted profit /number of years
(c) Average profit - Normal profit
(d) None

10. The profits of last four years are:

2000	₹40,000
2001	₹50,000
2002	₹60,000
2003	₹50,000

The value of goodwill on the basis of three years purchase of average profits based on last four years:
(a) ₹1,00,000
(b) ₹1,50,000
(c) ₹2,00,000
(d) None

11. Under Capitalization basis goodwill is calculated by:
(a) Average profits × years of purchase
(b) Super profits × years of purchase

(c) Total of the discounted value of expected future benefits
(d) Super profit divided with expected rate of return

12. Goodwill is to be calculated at one and half years purchase of average profit of last 5 years. The firm earned profits during first 3 years as, ₹ 20,000, ₹18,000 and ₹9,000 and suffered losses of ₹2,000 and 5,000 in last 2 years. Goodwill amount will be:
(a) ₹12,000
(b) ₹10,000
(c) ₹15,000
(d) None

13. Extra amount over and above the saleable values of the identifiable assets that could be fetched by selling an existing firm as a going concern is called:
(a) Goodwill
(b) Revaluation Profit
(c) Super Profit
(d) Surplus

14. A firm earned net profits during last 3 years:

2004	₹ 17,000
2005	₹ 20,000
2006	₹23,000

The Capital employed ₹80,000. Return on capital employed 15%. Calculate the value of goodwill on the basis of two years purchase of average super profits earned :
(a) ₹16,000
(b) ₹20,000
(c) ₹30,000
(d) ₹40,000

15. Profits of last three years were ₹6,000, ₹13,000 and ₹8,000. Calculate goodwill for two years of purchase.
(a) ₹81,000
(b) ₹27,000
(c) ₹9,000
(d) ₹18,000

16. An asset which is not fictitious but intangible in nature, having realizable value______
(a) Machinery
(b) Building
(c) Furniture
(d) Goodwill

17. When there is no Goodwill Account in the books and goodwill is raised, _______ account will be debited.
(a) Partner's capital a/c
(b) Goodwill a/c
(c) Cash a/c
(d) Reserve a/c

18. Ravi and Suraj are partners having the profit sharing ratio 3:2 in a firm. They admitted Tarun in partnership, and new profit sharing ratio of Ravi, Suraj and Tarun was decided at 2:2:1 respectively. Tarun brings in ₹ 30,000 as goodwill. What would be the share of Ravi in goodwill?
(a) ₹30,000
(b) ₹18,000
(c) ₹6,000
(d) None of the above

19. If old ratio between A & B is 1:1 & new ratio between A, B & C is 4:3:2, and recorded Goodwill of ₹90,000 appears in B/S. Which accounts will be affected if they decide to write off goodwill immediately?
(a) A A/c and B A/c
(b) A A/c and C A/c
(c) B A/c and C A/c.
(d) None

20. What does not affect the goodwill of the firm?
(a) Better customer service
(b) Location of firms
(c) Personal reputation
(d) None of these.

21. Which of the following statement is false?
(a) Partnership deed in the mutual agreement between partners.
(b) The liability of all the partners is jointly and severally unlimited
(c) In the absence of partnership agreement, partners share profits in capital ratio.
(d) Profit and Loss appropriation account is prepared to show the distribution of profits among partners.

22. What would be the amount of actual average profit if goodwill is valued ₹98,000 at 5 years purchase of super profit, normal rate of return is 10% and average capital employed is ₹5,00,000 ?
(a) ₹69,600
(b) ₹1,48,000
(c) ₹4,40,000
(d) ₹48,000

23. Sacrificing ratio is used to distribute __________ on admission of a new partner:
(a) Goodwill
(b) Reserves
(c) Profits on revaluation
(d) Unrecorded assets

24. On the admission of a new partner, it is decided that goodwill of the firm be valued at 2 years' purchase of average profits for the past 3 years which amounted to ₹8,620, ₹9,430 and ₹11,800 respectively. The value of goodwill is:
(a) ₹19,500
(b) ₹19,900
(c) ₹10,000
(d) None of the above

25. X and Y are partners sharing profits and losses in the ratio of 3 : 1. They admit Z as a partner who pays ₹4,000 as goodwill. The new profit sharing ratio being 2 : 1 : 1. The goodwill will be credited to:
(a) Y's capital A/c by ₹4,000
(b) X's capital A/c by ₹4,000

(c) X's capital A/c by ₹3,000 and Y's capital A/c by ₹1,000
(d) No adjustment will be made.

26. A and B together are sharing 2/3rd of the profits of the firm. C and D are sharing profits in the ratio of 3 : 2. Find the ratio of A : B : C : D.
(a) 4 : 3 : 3 : 2
(b) 7 : 7 : 6 : 4
(c) 2.5 : 2.5 : 3 : 2
(d) 5 : 5 : 3 : 2

27. A and B share profits and losses in the ratio 2 : 1.
C is admitted with 1/4th share in profits.
C acquired 3/4th of his share in profits from A and 1/4th of his share from B. New profit and loss sharing ratio will be:
(a) 2 : 1 : 1
(b) 23 : 13 : 12
(c) 3 : 1 : 1
(d) 1 : 1 : 1

28. Rohan and Sohan are partners in a firm sharing profit and losses in the ratio of 3 : 1. A new partner Mohan is admitted and he brings ₹40,000 as goodwill. New profit sharing after admission is equal. The amount of goodwill to be shared by old partners as :-
(a) Equally ₹20,000 each
(b) Rohan ₹30,000 and Sohan ₹10,000
(c) Rohan ₹40,000 and Sohan ₹Nil
(d) Rohan will receive ₹50,000 and Sohan will pay to Rohan ₹10,000.

29. The total capital of a partnership firm is ₹6,00,000 and annual average profits of the firm are ₹1,50,000. The normal rate of return in the business is considered at 20%. Find out the value of the goodwill at 3 years purchase of super profit.
(a) ₹60,000
(b) ₹90,000
(c) ₹75,000
(d) ₹50,000

30. Capital employed by M/s PQR is ₹5,00,000. Rate of normal profit is 20%. Past four year's profits were as follows:

Year	Profit (₹)
1	1,20,000
2	1,80,000
3	1,50,000
4	2,00,000

Calculate value of goodwill at 2 years purchase using super profit method:
(a) ₹3,25,000
(b) ₹1,62,500
(c) ₹3,12,500
(d) ₹1,25,000

31. A and B are equal partners. They admit C as a partner with 1/7th share. What is the new profit sharing ratio of A and B?
(a) 6/7 : 1/7
(b) 3/7 : 3/7
(c) 4/7 : 2/7
(d) 2/7 : 4/7

32. A and B are in partnership sharing profits and losses in the proportion of 3:1 respectively. On 1.4.2013 they admitted C into partnership on the following terms:
(i) C to purchase one-third of the goodwill for ₹2,000 by paying cash.
(ii) Future profits and losses are to be shared by A, B and C equally.
Set out the entry relating to the above arrangement in the firm's journal:

(a)	Cash/Bank A/c	Dr.	2,000	
	To A's A/c			2,000
(b)	Cash/Bank A/c	Dr.	2,000	
	To Goodwill A/c			2,000
(c)	Cash/Bank A/c	Dr.	2,000	
	B's A/c	Dr.	500	
	To A's A/c			2,500
(d)	Cash/Bank A/c	Dr.	2,000	
	To A's A/c			1500
	To B's A/c			500

33. Radha, Seeta and Laxmi were partners sharing profits and losses in the ratio of 2:3:5. Seeta retired on 1st June, 2013 and Goodwill of the firm is to valued at ₹1,20,000 on that date. Goodwill a/c is to be raised. What will be the treatment for goodwill?
   (a) Revaluation account will be credited by ₹1,20,000.
   (b) Seeta's Capital A/c will be credited by ₹36,000.
   (c) All partner's capital account will be credited by ₹1,20,000 in profit sharing ratio.
   (d) None of the above.
34. When Goodwill is withdrawn by the Partners...... account is credited.
   (a) Cash
   (b) Partner's capital
   (c) Partner's loan
   (d) Goodwill
35. Neeraj and Gopi are partners in a firm with capitals of ₹5,00,000 each. They admit Champak as a partner with 1/4th share in the profits of the firm. Champak brings ₹8,00,000. The Profit and Loss Account showed a credit balance of ₹4,00,000 as on the date of admission. The value of hidden goodwill is:
   (a) ₹14,00,000
   (b) ₹18,00,000
   (c) ₹10,00,000
   (d) Nil
36. A and B are partners sharing profit and loss in the ratio of 3 : 2. They take C as the new partner who is supposed to bring ₹35,000 against capital and ₹15,000 against goodwill. New profit sharing ratio is 1 : 1 : 1. C is able to bring ₹45,000 only. How this will be treated in the books of the firm?
   (a) A and B will share goodwill brought by C as ₹8,000, ₹2,000.
   (b) Goodwill not brought will be adjusted to the extent of ₹5,000 in sacrificing ratio
   (c) (A) and (B) both
   (d) Neither (A) nor (B)

37. Mary and Lary were partners sharing profits and losses in ratio of 5 : 3. Mary was admitted to the firm. Mary gave 1/4th of her Share and Lary gave 1/10th of her share to Harry.
   New profit sharing ratio would be:
   (a) 20 : 15 : 9
   (b) 13 : 8 : 9
   (c) 75 : 48 : 37
   (d) None of the above
38. A partnership firm earns profit of ₹3,72,000 during the financial year 2013-14. The normal rate of return in the same industry is 12%. The value of total assets (Excluding goodwill) and total liabilities are ₹68 lacs and ₹42 lacs respectively. Compute the value of goodwill of the firm according to the capitalization of goodwill method.
   (a) ₹5,00,000
   (b) ₹3,12,000
   (c) ₹60,000
   (d) ₹2,67,360
39. The profits and losses of Mr. Rathore for the last year are 2011-12 profit ₹4,00,000; 2012-13 profit ₹3,60,000; 2013-14 Loss ₹60,000; 2014-15 Profit ₹5,00,000; capital invested ₹15,00,000. The market rate of interest on investment 10%; rate of risk return on capital invested 2%; Remuneration of alternative employment of the proprietor (if not engaged in business) ₹60,000 p.a. Calculate the value of goodwill on the basis of 5 year's purchase of super profit of the business based on the average profits of the last four years:
   (a) ₹4,50,000
   (b) ₹7,50,000
   (c) ₹6,00,000
   (d) ₹3,00,000
40. X and Y are in partnership sharing profits and losses in the ratio of 3:2. They admitted Z as ¼ partner. Find out new ratio.
   (a) 3 : 2 : 1
   (b) 9 : 8 : 3
   (c) 9 : 7 : 5
   (d) 9 : 6 : 5

41. K, L and M are partners. The relative profit sharing ratio between K and L is 3 : 2 and between L and M is also 3 : 2. Find out the profit sharing ratio between K, L and M.
    (a) 9 : 6 : 6
    (b) 9 : 6 : 3
    (c) 9 : 6 : 2
    (d) 9 : 6 : 4
42. A, B and C are partners sharing profits in the ratio of 8 : 6 : 4. D is admitted for 4/18th share of profits and he brings ₹30,000 as his capital and 10,000 for his share of goodwill. The new profit sharing ratio between partners will be 6 : 4: 4 : 4. Goodwill amount will be credited in capital accounts of:
    (a) A only
    (b) A, B and C (Equally)
    (c) A and B (Equally)
    (d) A and C (Equally)
43. Find the goodwill of the firm using capitalisation method from the following information.
    Total capital employed in the firm ₹4,00,000. Reasonable Rate of Return 15%
    Profit for the year ₹6,00,000.
    (a) ₹41,00,000
    (b) ₹6,00,000
    (c) ₹36,00,000
    (d) ₹21,00,000
44. A and B are partner in a firm with capital of ₹5,00,000 each. They admit 'C' as a partner with 1/4th share in the profits of the firm. C brings ₹8,00,000. The Profit and Loss Account showed a Credit Balance of ₹4,00,000 as on the date of admission. The value of hidden goodwill will be:
    (a) ₹14,00,000
    (b) ₹18,00,000
    (c) ₹10,00,000
    (d) None of above.

45. Pee and Que share profits and losses in the ratio of 5:3. They admit A as for 1/5th share of profit. The ratio of sacrifice is:
    (a) 5:3
    (b) 4:3
    (c) 1:1
    (d) 3:5
46. Akash and Vikas are partners with capitals of ₹60,000 each. Mukesh is admitted and he brings ₹80,000 as capital and gets 1/5th share in the firm. What is the inherent goodwill?
    (a) None
    (b) ₹2,00,000
    (c) ₹40,000
    (d) ₹4,00,000
47. A and B share profits in the ratio of 2 : 3. C joined the firm A gives 1/3rd of his share, while B gives 1/4th of his share in favour of C. What is the new profit sharing ratio?
    (a) 17 : 27 : 37
    (b) 12 : 27 : 17
    (c) 17 : 27 : 17
    (d) None of the above.
48. A,B,C and D are partners sharing profits & losses equally. After one year they decided to share profits in the ratio of 2 : 2 : 1 : 1. D's sacrifice is:
    (a) 1/24
    (b) 1/12
    (c) 1/10
    (d) 1/6
49. A, B and C are partners sharing profits in the ratio 2 : 2 : 1. On retirement of B, Goodwill was valued at ₹30,000. Find the contribution of A &C to compensate B.
    (a) ₹20,000 and ₹10,000
    (b) ₹8,000 and ₹4,000
    (c) ₹10,000 and ₹20,000
    (d) ₹4,000 and ₹8,000

50. Radha and Gopi are partners with ₹5,00,000 capital each. They admitted Champa for 1/4th share with ₹8,00,000 capital. The P&L credit balance is ₹4,00,000. Find the amount of hidden goodwill:
   (a) ₹10,00,000
   (b) ₹12,00,000
   (c) ₹8,00,000
   (d) ₹16,00,000
51. Capital employed by a partnership firm is ₹6,00,000. Its average profit is ₹1,05,000. Normal rate of return is 15%. Find the goodwill of the firm using capitalization method.
   (a) ₹1,00,000
   (b) ₹90,000
   (c) ₹1,10,000
   (d) None of the above.

Answer

1.	(b)	2.	(d)	3.	(a)	4.	(d)	5.	(d)
6.	(b)	7.	(b)	8.	(b)	9.	(c)	10.	(b)
11.	(d)	12.	(a)	13.	(a)	14.	(a)	15.	(d)
16.	(d)	17.	(b)	18.	(a)	19.	(a)	20.	(d)
21.	(c)	22.	(a)	23.	(a)	24.	(b)	25.	(b)
26.	(d)	27.	(b)	28.	(d)	29.	(b)	30.	(d)
31.	(b)	32.	(c)	33.	(c)	34.	(a)	35.	(b)
36.	(c)	37.	(d)	38.	(a)	39.	(d)	40.	(d)
41.	(d)	42.	(c)	43.	(c)	44.	(c)	45.	(a)
46.	(b)	47.	(b)	48.	(b)	49.	(b)	50.	(a)
51.	(a)								

SHORT PRACTICE QUESTIONS

1. What are the different methods of calculation of goodwill.
2. Write short note of need for valuation of goodwill in partnership.

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

State with reason whether the following statements are True or False.

2001 - May [5] (5) Goodwill is a fictitious asset. (2 marks)

Answer:

False: Goodwill is an intangible asset.

2006 - May [5] (x) Depreciation can be charged on Goodwill by Fixed Installment method. (2 marks)

Answer:

False: Goodwill is an intangible asset. It is written off over a reasonable period of time and not depreciated as per fixed installment method.

CHAPTER

8

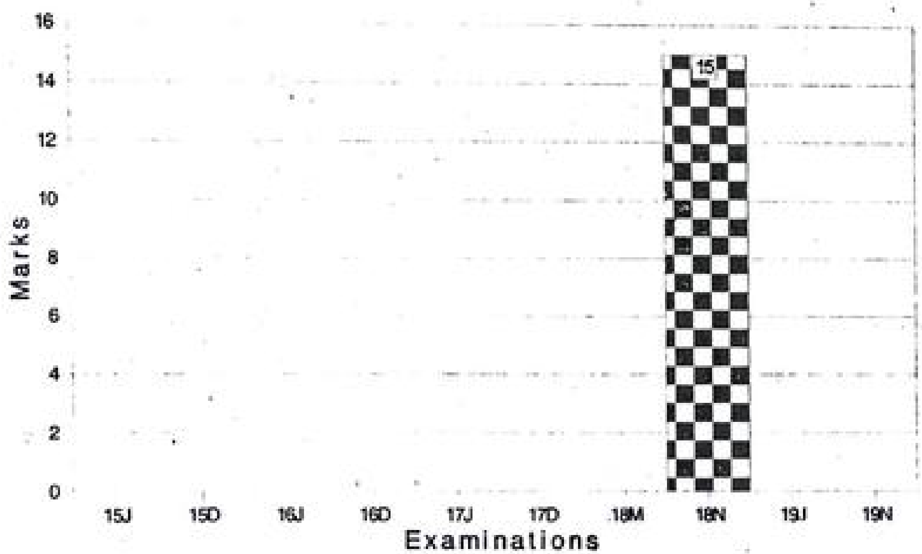
Partnership Accounts

Unit: 3 **Admission of a New Partner**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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SELF STUDY QUESTIONS

Q1. What do you mean by Admission in case of a Partnership?

Answer:

- Admission means when a new partner enters into the business.
- A new partner is needed in the business because of any of the following reasons:
  (i) When firm needs more capital
  (ii) When an experienced and knowledgeable person is needed in the business.
  (iii) For increasing goodwill of the firm by taking any reputed person as partner.
  (iv) Any other reason.

Q2. What do you understand by Revaluation Account or Profit and Loss Adjustment Account?

Answer:

- On admission of a new partner, assets and liabilities of the firm are revalued to their true and fair figures.
- The value of assets and liabilities may have changed over a period of time.
- The new partner is not to bear any part of profit/loss due to change in value of assets and liability.
- For this purpose, the assets and liabilities are revalued on the admission of the partner and the difference or change in value in form of profit/loss shall be distributed among old partner in the old ratio.

Specimen Accounting Entries

(i) **For decrease in value of asset:**

Revaluation A/c Dr.
 To Asset A/c

(ii) **For increase in value of asset:**
Asset A/c Dr.
To Revaluation A/c

(iii) **For increase in value of liability:**
Revaluation A/c Dr.
To Liabilities A/c

(iv) **For decrease in value of liability:**
Liabilities A/c Dr.
To Revaluation A/c

(v) **When revaluation A/c shows profit:**
Revaluation A/c Dr.
To Old Partners' Capital A/c
[In the old ratio]

(vi) **When revaluation A/c shows loss:**
Old Partners's Capital A/c Dr.
To Revaluation A/c
[In the old ratio]

Q3. When are the revised values not to be recognised in the books of accounts?

Answer:

- After the preparation of Revaluation A/c, assets and liabilities appear at revised figures in balance sheet, however partners made decide not to show them at revised figures but to carry on revaluation.
- For this purpose, Memorandum Revaluation A/c is prepared. It has two parts, first part shows entries of revaluation and profit/loss is transferred to old partners in old profit sharing ratio.
- In second part, reverse entries of revaluation are passed so as to keep the value of items of assets and liabilities unchanged. The balance of this part is transferred to capital account of partners in the new profit sharing ratio.
- The net effect of the same will be that assets and liabilities will be shown at original figures and old partners will get the benefit of revaluation.

Q4. What are the Entries in Memorandum Revaluation A/c?

Answer:

(a) Entries of increase/decrease in asset or increase/decrease in liability will be in the same way as in revaluation A/c.

(b) For profit in the first part of memorandum revaluation A/c:
Memorandum Revaluation A/c Dr.
To Old partners's capital A/c
(In old profit sharing ratio)

(c) All entries of assets and liabilities passed in the first part will be reversed.

(d) For profit in the second part of memorandum Revaluation Account.
All Partners' Capital A/c Dr.
To Memorandum Revaluation A/c
[In the new profit showing ratio]
*For loss, the entry will be reversed.

Q5. What is the difference between Revaluation A/c and Memorandum Revaluation A/c?

Answer:

Basis	Revaluation A/c	Memorandum Revaluation A/c
Purpose	To ascertain profit or loss on revaluation with revised figures appearing is new Balance Sheet.	To record the effect of revaluation which is to the transferred to old partners' capital account, keeping value recorded in books unchanged.
Division	No division is made	Account is divided into two parts: 1. For old partners 2. For all existing partners including new partners.
Posting	Net result is transferred to old partners' capital A/c in old P.S.R.	Balance of 1st part is transferred old partners' capital account in old P.S.R. and balance of 2nd part is transferred to all partners in new P.S.R.

Specimen 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 on Revaluation transferred to old partners' capital accounts (in old ratio)		By Loss on Revaluation transferred to old partners' capital accounts (in old ratio)	

Q6. What do you understand by Reserves in the Balance Sheet? What is its treatment?

Answer:

- At the time of admission of partner, any existing accumulated reserves if any, are transferred to existing partners' capital A/c.
- New partner is not entitled to any such benefit or bear any such liability which occurred before his admission.

Journal Entries:

(a) For distributing reserves and accumulated profits:

General Reserves A/c Dr.
Reserve Fund A/c Dr.
Profit/Loss (Cr. balance) A/c Dr.
To Old partners' capital A/c

(b) For transferring accumulated losses:

Old partners' capital A/c Dr.
To Profit/Loss (Dr. bal.)

(c) For distributing surplus of specific funds:

Workmen compensation fund A/c Dr.
Investment fluctuation fund A/c Dr.
To Old partners' capital A/c

Note: All above amounts will be distributed among all partners in the old profit sharing ratio of partners.

Example:

Seema and Geeta were partners in a firm sharing profits and losses in the ratio of 5:3. On 1st Jan, 2007 they admitted Om as a new partner. On the date of Om's admission, the Balance Sheet of Seema and Geeta showed a balance of ₹16,000 in general reserve and ₹24,000 (Cr.) in Profit and Loss Account. Record necessary journal entries for the treatment of these items on Om's admission. The new profit sharing ratio between Seema, Geeta and Om was 5:3:2.

Solution:

Books of Seema, Geeta and Om

Journal

2007	Particulars		₹	₹
Jan. 01	General Reserve A/c	Dr.	16,000	
	To Seema's capital A/c			10,000
	To Geeta's capital A/c			6,000
	(The transfer of the balance of general reserve to old partners' capital accounts in old ratio)			
Jan. 01	Profit & Loss A/c	Dr.	24,000	
	To Seema's capital A/c			15,000
	To Geeta's capital A/c			9,000
	(The transfer of the balance of accumulated profits to old partners' capital accounts in old ratio)			

Q7. When is computation of new Profit Sharing Ratio done?

Answer:

- When a new partner is admitted into the partnership, he acquires his share of profit from existing partners, due to which old partners' share is reduced, hence new PSR should be calculated.
- After admission, future Profits/Losses are distributed in new ratio.

Calculation of New Profit Sharing Ratio:

Case 1: When ratio of new partner is given, then, in absence of any other agreement, it is presumed that all partners will continue to share remaining profit in the old profit sharing ratio.

Illustration:

A, B and C are partners in proportion of $\frac{3}{6}$, $\frac{2}{6}$ and $\frac{1}{6}$ respectively. D was admitted in the firm as a new partner with $\frac{1}{6}^{th}$ share.

Calculate the new profit sharing ratios of the partners.

Solution:

Calculation of new profit sharing ratios:

Let total profit be = 1

Share given to D = $\frac{1}{6}$

Remaining share = $1 - \frac{1}{6} = \frac{5}{6}$

Now, the old partners will share this remaining profit in their old profit sharing ratios:

Hence,

A's share = $\frac{3}{6}$ of $\frac{5}{6} = \frac{15}{36}$

B's share = $\frac{2}{6}$ of $\frac{5}{6} = \frac{10}{36}$

C's share = $\frac{1}{6}$ of $\frac{5}{6} = \frac{5}{36}$

D's share = $\frac{1}{6}$ or $\frac{6}{36}$

Thus, the new profit sharing ratio of A, B, C and D will be 15 : 10 : 5 : 6.

Sometimes, the new partner purchases his share of profit from the old partners equally; in such cases, the new profit sharing ratios of the old partners will be ascertained by deducting the sacrifice made by them from their existing share of profit.

Case 2: When the new partner purchases his share of profit from the old partners in equal ratio.

Illustration:

Old partners A, B and C, old profit sharing ratio 3 : 2 : 1. New partner D is admitted for $\frac{1}{4}^{th}$ share, which he gets equally from all the old partners.

Solution:

In this case, new profit sharing ratio will be calculated as under:

D gets 1/4 share in profits in equal proportion from all partners. Therefore, contribution by each partner will be 1/4 × 1/3 = 1/12.

The new ratio will be calculated by deducting 1/12 from old share of each partner

$A = \frac{3}{6} - \frac{1}{12} = \frac{5}{12}$, $B = \frac{2}{6} - \frac{1}{12} = \frac{3}{12}$, $C = \frac{1}{6} - \frac{1}{12} = \frac{1}{12}$

Therefore, New Ratio of A, B, C and D is

$A = \frac{5}{12}$, $B = \frac{3}{12}$, $C = \frac{1}{12}$, $D = \frac{1}{4}$ or $\frac{3}{12}$ i.e. 5 : 3 : 1 : 3

Ratio of sacrifice by A, B and C is 1 : 1 : 1

Case 3: When the new partner purchases his share from the old partners in a particular ratio.

Illustration:

A and B are partners sharing profits in the ratio of 7 : 3. C was admitted with $\frac{3}{7}^{th}$ share in the profits which he took $\frac{2}{7}^{th}$ from A and $\frac{1}{7}^{th}$ from B. Calculate new ratio of partners.

Solution:

A's share = $\frac{7}{10} - \frac{2}{7} = \frac{49 - 20}{70} = \frac{29}{70}$

B's share = $\frac{3}{10} - \frac{1}{7} = \frac{21 - 10}{70} = \frac{11}{70}$

C's share = $\frac{2}{7} + \frac{1}{7} = \frac{3}{7}$

Thus, the new profit sharing ratio for A, B and C will be

$= \frac{29}{70} : \frac{11}{70} : \frac{3}{7}$ or $\frac{29:11:30}{70}$ or 29 : 11 : 30

Case 4: When the old partners surrender a particular fraction of their share in favour of new partner.

Illustration:

A and B are partners in a firm sharing profits and losses in the ratio of 3 : 2. A new partner C is admitted. A surrenders 1/5th share of his profit in favour of C and B surrenders 2/5th share of his profit in favour of C. Calculate the new ratio of partners.

Solution:

Calculation of profit share surrendered:

A's old share = $\frac{3}{5}$, A surrendered $\frac{1}{5}^{th}$ of $\frac{3}{5}$ in favour of C, i.e.

$\frac{1}{5} \times \frac{3}{5} = \frac{3}{25}$ (It means that A has surrendered $\frac{3}{25}$ out of his share in favour of C)

Calculation of New Ratios:

(i) A's new share after surrendering $\frac{3}{25}$ in favour of C

$= \frac{3}{5} - \frac{3}{25} = \frac{15-3}{25} = \frac{12}{25}$

(ii) B's new share after surrendering $\frac{4}{25}$ in favour of C

$= \frac{2}{6} - \frac{4}{25} = \frac{10-4}{25} = \frac{6}{25}$

(iii) C's share is the total of $\frac{3}{25}$ from A and $\frac{4}{25}$ from B

$= \frac{3}{25} + \frac{4}{25} = \frac{3+4}{25} = \frac{7}{25}$

Therefore, the new ratio of A, B and C = $\frac{12}{25} : \frac{6}{25} : \frac{7}{25}$ = 12 : 6 : 7

Illustration:

K, L and M are partners sharing profit in the ratio of 3 : 2 : 1. They admit N for $\frac{1}{6}^{th}$ share. It is agreed that M would retain his original share. Calculate the new ratio and sacrificing ratios.

Solution:

Calculation of New Profit Sharing Ratio:

N's share = $\frac{1}{6}$; M's share = $\frac{1}{6}$

Remaining Share for K and L = $1 - \left[\frac{1}{6} + \frac{1}{6}\right] = \frac{4}{6}$

This will be divided between K and L in their old ratio i.e. 3 : 2.

Hence, the new share of K = $\frac{3}{5}$ of $\frac{4}{6} = \frac{12}{30}$

New share of L = $\frac{2}{5}$ of $\frac{4}{6} = \frac{8}{30}$

Thus, the new ratio of K, L, M and N = $\frac{12}{30} : \frac{8}{30} : \frac{1}{6} : \frac{1}{6}$ or 12 : 8 : 5 : 5

Calculation of Sacrificing Ratio:

Sacrifice Made by K = $\frac{3}{6} - \frac{12}{30} = \frac{3}{30}$

Sacrifice Made by L = $\frac{2}{6} - \frac{8}{30} = \frac{2}{30}$

Sacrifice Made by M = NIL

Thus, Sacrificing Ratio among K, L and M = 3 : 2 : 0

Sacrificing Partner is a partner whose share in profit is reduced due to admission of new partner.

Sacrificing Ratio = [Old Ratio - New Ratio]

Ratio in which old partners sacrifice their part in share of profit, is known as sacrificing ratio.

Gaining Partner is the partner whose share in profit is increased due to admission of new partner.

Gaining Ratio = [New Ratio - Old Ratio]

Ratio in which partners gain the share of future profits from other partners.

Illustration:

Find out the sacrificing ratio and new ratio in the following cases:

(a) A and B are partners sharing Profits and Losses in the ratio of 3 : 2. C is admitted for $\frac{1}{4}^{th}$ share. A and B decide to share equally in future.

(b) A and B are partners. They admit C for $\frac{1}{4}^{th}$ share. In future, the ratio between A and B would be 2 : 1.

Solution:

(a) Calculation of new profit sharing ratio:

C's share = $\frac{1}{4}$; The remaining share = $\frac{3}{4}$ this is to be shared equally by A and B.

Hence, the new share of A = $\frac{1}{2}$ of $\frac{3}{4} = \frac{3}{8}$, New Share of B = $\frac{1}{2}$ of $\frac{3}{4} = \frac{3}{8}$

Thus, New Profit Sharing Ratio = $\frac{3}{8} : \frac{3}{8} : \frac{1}{4}$ or 3 : 3 : 2

Calculation of Sacrificing Ratio:

Sacrificing Ratio = Old Ratio - New Ratio

Sacrifice made by A = $\frac{3}{5} - \frac{3}{8} = \frac{24 - 15}{40} = \frac{9}{40}$

Sacrifice made by B = $\frac{2}{5} - \frac{3}{8} = \frac{16 - 15}{40} = \frac{1}{40}$

Thus, Sacrificing Ratio between A and B is 9 : 1

(b) Calculation of new profit sharing ratio:

C's share = $\frac{1}{4}$; Remaining Share = $\frac{3}{4}$

This is to be shared by A and B in the ratio of 2 : 1.

Hence, the new share of A = $\frac{2}{3}$ of $\frac{3}{4} = \frac{1}{2}$

New share of B = $\frac{1}{3}$ of $\frac{3}{4} = \frac{1}{4}$

Thus, New Profit Sharing Ratio = $\frac{1}{2} : \frac{1}{4} : \frac{1}{4}$ or 2 : 1 : 1

Calculation of Sacrificing Ratio: Sacrificing Ratio = Old Ratio - New Ratio

Sacrifice made by A = $\frac{1}{2} - \frac{1}{2} = 0$

Sacrifice made by B = $\frac{1}{2} - \frac{1}{4} = \frac{1}{4}$

Thus, the whole sacrifice is made by B.

Illustration:

X, Y and Z share profits in the ratio of 4 : 3 : 2. P was admitted in the firm as a partner with 1/10th share of profits. Calculate Sacrificing ratio of the partners.

Solution:

For calculating the sacrifice ratio, we require old as well as new profit sharing ratios. But in this illustration, new profit sharing ratios have not been given. Therefore, we will have to calculate the new profit ratio of all partners first.

Calculation of new profit sharing ratios:

Let total profit be = 1; P takes = $\frac{1}{10}^{th}$ share out of 1; Remaining profit is $1 - \frac{1}{10} = \frac{9}{10}$

Thus, the old partners will now share $\frac{9}{10}^{th}$ share, which will be divided in their old profit sharing ratio of 4 : 3 : 2.

Therefore, X's new share of profit will be = $\frac{4}{9}$ of $\frac{4}{10} = \frac{4}{10}$

Y's new share of profit will be = $\frac{3}{9}$ of 9/10 = 3/10

Z's new share of profit will be = 2/9 of 9/10 = 2/10

P's share = 1/10

Thus, the new profit sharing ratio will be X : Y : Z : P

$= \frac{4}{10} : \frac{3}{10} : \frac{2}{10} : \frac{1}{10} = 4 : 3 : 2 : 1.$

Calculation of Sacrificing Ratios:

Sacrificing Ratio = Old Ratio - New Ratio

Therefore, Sacrifice made by X = $\frac{4}{9} - \frac{4}{10} = \frac{40-36}{90} = \frac{4}{90}$

Sacrifice made by Y = $\frac{3}{9} - \frac{3}{10} = \frac{30-27}{90} = \frac{3}{90}$

Sacrifice made by Z = $\frac{2}{9} - \frac{2}{10} = \frac{20-18}{90} = \frac{2}{90}$

Therefore, Sacrifice Ratio of X, Y and Z = $\frac{4}{90} : \frac{3}{90} : \frac{2}{90} = 4 : 3 : 2$

Illustration:

A and B are partners with capitals of ₹26,000 and ₹22,000 respectively. They admit C as partner with 1/4th share in the profits of the firm. C brings ₹26,000 as his share of capital. Give journal entries to record goodwill on C's admission.

Solution

Journal Entries in the Books of A and B

Date	Particulars	LF	Amount Dr. ₹	Amount Cr. ₹
	Cash A/c ...Dr. To C's Capital A/c (Being cash brought in as capital)		26,000	 26,000
	C's Capital A/c ...Dr. To A's Capital A/c To B's Capital A/c (Being C's share of goodwill debited to his account and credited to A's and B's capital accounts in their sacrificing ratio, i.e. 1 : 1)		7,500	 3,750 3,750

Working Notes:

(1) Calculation of Hidden Goodwill:

1st Method:

Share of Profit	Capital
1/4	₹26,000
1	$\frac{26{,}000 \times 4}{1}$ = ₹1,04,000 capital of firm

Total capital of all partners = ₹26,000 + ₹22,000 + ₹26,000 = ₹74,000

Hence, Hidden Capital = ₹1,04,000 - ₹74,000 = ₹30,000

2nd Method:

Share of Profit	Capital
1/4	₹26,000
$1 - \frac{1}{4} = \frac{3}{4}$	$26{,}000 \times \frac{3}{4} \times \frac{4}{1}$ = ₹78,000

Capital of A and B = ₹26,000 + ₹22,000
= ₹48,000

Hence, Hidden Capital = ₹78,000 - ₹48,000
= ₹30,000

(2) C's Share in Goodwill = $30{,}000 \times \frac{1}{4}$ = ₹7,500

(3) Calculation of new profit sharing ratio:

Suppose Profit = 1

After C's 1/4 share in profit remaining profit = $1 - \frac{1}{4} = \frac{3}{4}$

Profit sharing ratio of A = $\frac{1}{2} \times \frac{3}{4} = \frac{3}{8}$

Profit sharing ratio of B = $\frac{1}{2} \times \frac{3}{4} = \frac{3}{8}$

Profit sharing ratio of C = $\frac{1}{4}$

New profit sharing ratio of A, B and C = $\frac{3}{8} : \frac{3}{8} : \frac{1}{4} = \frac{3:3:2}{8} = 3 : 3 : 2$

(4) Calculation of Sacrifice Ratio:

Sacrifice ratio of A = $\frac{1}{2} - \frac{3}{8} = \frac{4-3}{8} = \frac{1}{8}$

Sacrifice ratio of B = $\frac{1}{2} - \frac{3}{8} = \frac{4-3}{8} = \frac{1}{8}$

Sacrifice ratio of A and B = $\frac{1}{8} : \frac{1}{8} = 1 : 1$

Hence, A and B sacrifice their ratio equally.

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. X and Y are sharing profits and losses in the ratio of 3 : 2. Z is admitted with 1/5th share in profits of the firm which he gets from X. Find out the New profit sharing ratio?
   (a) 12 : 8 : 5
   (b) 8 : 12 : 5
   (c) 2 : 2 : 1
   (d) 2 : 2 : 2
2. A and B are partners sharing profits and losses in the ratio of 3 : 2. A's Capital is ₹60,000 and B's Capital is ₹30,000. They admit C for 1/5th share of profits. How much C should bring in towards his capital?
   (a) ₹18,000
   (b) ₹24,000
   (b) ₹29,000
   (d) ₹22,500
3. A and B are partners sharing profits and losses in the ratio 5 : 3. On admission, C brings ₹70,000 cash and ₹ 48,000 against goodwill. New profit sharing ratio between A, B, C is 7 : 5 : 4. The sacrificing ratio among A and B is:
   (a) 3 : 1
   (b) 4 : 7
   (c) 5 : 4
   (d) 2 : 1
4. X and Y are partners sharing profits in the ratio 5 : 3. They admitted Z for 1/5th share of profits, for which he paid ₹1,20,000 against capital and ₹60,000 as goodwill. Find the capital balances for each partner taking Z's capital as base capital:

   (a) 3,00,000, 1,20,000 and 1,20,000
   (b) 3,00,000, 1,20,000 and 1,80,000
   (c) 3,00,000, 1,80,000 and 1,20,000
   (d) 3,00,000, 1,80,000 and 1,80,000
5. General Reserve at time of admission of a new partner is transferred to:
   (a) Profit and Loss Adjustment Account
   (b) Partners' Capital Account
   (c) Revaluation account
   (d) Memorandum Revaluation Account
6. A and B are partners sharing profits in the ratio of 7 : 3. C is admitted as a new partner. 'A' surrenders 1/7 of his share and 'B' surrenders 1/3 rd of his share in favour of C. The new profit sharing ratio will be:
   (a) 6 : 2 : 2
   (b) 4 : 1 : 1
   (c) 3 : 2 : 2
   (d) None
7. The balance of memorandum revaluation account (second part), is transferred to the capital accounts of the partners in:
   (a) Capital Ratio
   (b) Old profit sharing Ratio
   (c) New profit sharing Ratio
   (d) Sacrificing Ratio
8. X and Y share profits and losses in the ratio of 4 : 3. They admit Z in the firm with 3/7 share which he gets 2/7 from X and 1/7 form Y. The new profit sharing ratio will be:
   (a) 7 : 3 : 3
   (b) 2 : 2 : 3
   (c) 5 : 2 : 3
   (d) 2 : 3 : 3
9. A and B are partners, sharing profits in the ratio of 5 : 3. They admit C with 1/5 share in profits, which he acquires equally from both 1/10 form A and 1/10 from B. New profit sharing ratio will be:
   (a) 21 : 11 : 8
   (b) 20 : 10 : 4

(c) 15 : 10 : 5
(d) None

10. A firm has an unrecorded investment of ₹5,000. Entry in the firm's journal on admission of a partners will be:
(a) Revaluation A/c Dr. 5,000
To Unrecorded Investment A/c 5,000
(b) Unrecorded Investment A/c Dr. 5,000
To Revaluation A/c 5,000
(c) Partner's capital A/c Dr.5,000
To Unrecorded Investment 5,000
(d) None of these

11. A, B, and C share profits and Losses in the ratio, of 3 : 2 : 1. D is admitted with 1/6 share which he gets entirely from A. New ratio will be:
(a) $\frac{1}{6} : \frac{1}{3} : \frac{1}{6} : \frac{1}{6}$
(b) 3 : 1 : 1 : 1
(c) 2 : 2 : 2 : 1
(d) None

12. A, B, C are partners sharing profits in the ratio of 4 : 3 : 2. D is admitted for 2/9th share of profits and brings ₹ 30,000 as capital and 10,000 for his share of goodwill. The new profit sharing ratio between partners will be 3 : 2 : 2 : 2. Goodwill amount will be credited in the capital accounts of:
(a) A only
(b) A, B and C (equally)
(c) A, and B (equally)
(d) A, and C (equally)

13. A and B are partners of a firm sharing profits in the ratio of 3 : 2. C was admitted for 1/5th share of profit. Machinery would be appreciated by 10% (Book value ₹ 80,000) and building would be depreciated by 20% (₹2,00,000). Unrecorded debtors of ₹1,250 would be bought to books and Creditors of ₹2,750 died and needn't to pay anything. What will be the profit / loss on revaluation?
(a) Loss₹28,000

(b) Loss₹40,000
(c) Profit ₹28,000
(d) Profits ₹40,000

14. Amit and Anil are partners sharing profits in the ratio of 5 : 3 with capital of ₹2,50,000 and ₹ 2,00,000. Atul was admitted and would pay ₹50,000 as capital and ₹ 16,000 as goodwill for 1/5th profit. Find the balance of capital accounts after admission of Atul:
(a) 2,60,000 : 2,06,000 : 50,000
(b) 2,20,000 : 1,82,000 : 66,000
(c) 2,92,500 : 2,25,500 : 50,000
(d) 2,82,500 : 2,19,500 : 66,000

15. X and Y are partners sharing profits in the ratio of 3 : 1. They admit Z as a partner who pays ₹ 4000 as goodwill, the new profit sharing ratio being 2 : 1 : 1 among X, Y, Z. The amount of goodwill will be credited to:
(a) X and Y as ₹3,000 and ₹ 1,000
(b) X only
(c) Y only
(d) None

16. When Balance Sheet prepared after the new partnership agreement, Assets and liabilities are recorded at:
(a) Original value
(b) Revalued figure
(c) At current cost
(d) At realisable value

17. R and S are partners sharing profits in the ratio of 5 : 3. T joins the firm. R gives 1/4 th of his share and S gives, 1/5 th of his share to the new partner. Find out new ratio:
(a) 75 : 48 : 37
(b) 45 : 32 : 27
(c) 13 : 7 : 4
(d) None

18. A, B, C are equal partners, they wanted to change the profit sharing ratio into 4 : 3 : 2. They raised the goodwill to ₹90,000 but want to write it off immediately. The effected accounts will be:

(a) C's Capital A/c	Dr.	10,000	
To A's Capital A/c			10,000
(b) B's Capital A/c	Dr.	10,000	
To A's Capital A/c			10,000
(c) C's Capital A/c	Dr.	10,000	
To B's Capital A/c			10,000
(d) A's Capital A/c	Dr.	10,000	
To C's Capital A/c			10,000

19. A, B, C are partners sharing profits in ratio of 3 : 2 : 1. They agree to admit D into the firm. A, B, and C agreed to give 1/3 rd, 1/6th, 1/9th share of their profit. The share of profit of D will be:
(a) 1/10
(b) 13/54
(c) 12/54
(d) 10/55

20. A and B are partners sharing profits and losses in ratio of 3 : 2.
A's Capital is ₹30,000
B's Capital is ₹15,000
They admit C and agreed to give 1/5th share of profits to him.
How much C should being in towards his Capital?
(a) ₹9,000
(b) ₹12,000
(c) ₹14,500
(d) ₹11,250

21. Reserve appearing in the Balance sheet will be divided among partners during admission in ______ ratio.
(a) Old
(b) New
(c) Sacrificing
(d) Gaining

22. X and Y are partners sharing profits equally. Z was admitted for 1/7th share. Calculate New Profit Sharing Ratio.
(a) 2:3:1
(b) 3:3:1

(c) 6:5:2
(d) 1:1:1

23. A, B, C, D are partners sharing their profits and losses equally. They change their profit sharing ratio to 2 : 2 : 1 : 1. How much will C sacrifice?
(a) $^1/_6$
(b) $^1/_{12}$
(c) $^1/_{24}$
(d) None

24. A and B share profits equally. They admit C with 1/7th share. The new profit sharing ratio of A and B is:
(a) 4/7, 1/7
(b) 3/7, 3/7
(c) 2/7, 2/7
(d) None

25. A and B are partners C is admitted with 1/5th share C brings ₹1,20,000 as his share towards capital. The total networth of the firm is:
(a) ₹1,00,000
(b) ₹4,00,000
(c) ₹1,20,000
(d) ₹6,00,000

26. A and B share profits in the ratio of 3:2. A's capital is ₹48,000 B's capital is ₹32,000. C is admitted for 1/5th share in profits. What is the amount of capital which C should bring?
(a) ₹20,000
(b) ₹16,000
(c) ₹1,00,000
(d) ₹64,000

27. A and B share profits in the ratio of 3:4. C was admitted for 1/5th share. Calculate the new profit sharing ratio.
(a) 3:4:1
(b) 12:16:7
(c) 16:12:7
(d) None of these

28. A and B carry on business and share profits and losses in the ratio of 3:2. Their respective capitals are ₹ 1,20,000 and ₹54,000. C is admitted for 1/3rd share in profit and brings ₹75,000 as his share of capital. Capitals of A and B to be adjusted according to C's share. Calculate the amount refunded to A.
    (a) ₹30,000
    (b) ₹32,000
    (c) ₹15,000
    (d) ₹28,000
29. On account of admission, the assets are revalued and liabilities are reassessed in______ Account.
    (a) Partner's capital a/c
    (b) Revaluation a/c
    (c) Realisation a/c
    (d) Balance sheet
30. The opening balance of Partner's Capital Account is credited with:
    (a) Interest on Capital
    (b) Interest on Drawings
    (c) Drawings
    (d) Share in Loss
31. X and Y shares profit / loss in the ratio of 5:3. Z admitted as partner for 1/5, which he is taking equally from old partners. New profit sharing ratio is:
    (a) 21:11:8
    (b) 20:8:7
    (c) 20:12:8
    (d) 10:5:5
32. A and B are partners. C is admitted with a guarantee profit of ₹10,000 from A with a new profit sharing ratio of 3:2:1. Profit for the year 2009-10 is ₹1,20,000. How much profit C will get?
    (a) ₹10,000
    (b) ₹20,000
    (c) ₹30,000
    (d) None of these.

33. On the admission of new partner, which one of the following lying in the balance sheet should be transferred to the capital accounts of the old partners in the old profit sharing ratio?
    (a) Bank Overdraft
    (b) General Reserve
    (c) Bill payable
    (d) Outstanding Expenses.
34. Which account will be prepared at the time of admission of a new partner for giving effect of revaluation of assets and liabilities without changing the value of assets and liabilities of old Balance Sheet?
    (a) P & L Adjustment A/c
    (b) Revaluation A/c
    (c) Memorandum Revaluation A/c
    (d) Realisation A/c
35. Sacrificing Ratio is computed at the time of _________.
    (a) Retirement of a partner
    (b) Admission of a partner
    (c) Insolvency of a partner
    (d) Death of a partner.
36. Rahul and Bajaj are partners sharing profit and loss in the ratio of 1 : 2. Birla is admitted in partnership for ½ share of profit and their new profit sharing ratio is 1 : 2 : 3. Their sacrificing ratio will be:
    (a) 1 : 3
    (b) 2 : 1
    (c) 3 : 1
    (d) 1 : 2
37. A and B are partners sharing profit and loss in the ratio of 5 : 3. C is admitted and on the date of admission brings in cash ₹70,000 as capital and ₹48,000 as goodwill. New profit sharing ratio of A, B and C are 7 : 5 : 4. The sacrificing ratio amongst A and B would be:
    (a) 1 : 3
    (b) 3 : 1
    (c) 5 : 4
    (d) 3 : 5

38. Which asset is compulsorily revalued at the time of admission of a partner?
    (a) Goodwill
    (b) Land and Building
    (c) Plant and Machinery
    (d) Furniture and Fittings.
39. Angola and Rangoli are partners sharing profits and losses in the ratio of 2:3. Mangola joins the firm, Angola gives 1/3rd of his share and Rangoli gives 1/4th of her share to Mangola. The new profit sharing ratio will be:
    (a) 17:26:17
    (b) 75:38:37
    (c) 16:27:17
    (d) None of these
40. At the time of admission of a partner in a firm, the journal entry for an unrecorded investment of ₹ 30,000 will be:

(a) Revaluation A/c	Dr.	30,000	
To Unrecorded Investment A/c			30,000
(b) Unrecorded Investment A/c	Dr.	30,000	
To Revaluation A/c			30,000
(c) Partner's Capital A/c	Dr.	30,000	
To Unrecorded Investment A/c			30,000
(d) Unrecorded Investment A/c	Dr.	30,000	
To Partner's Capital A/c			30,000

41. If an asset was earlier revalued upward and then later on it was revalued downward, then the downfall to the extent of earlier appreciation is:
    (a) Credited to Revaluation Reserve Account
    (b) Debited to Revaluation Reserve Account
    (c) Credited to Profit and Loss Account
    (d) Debited to Profit and Loss Account
42. A and B are partners sharing profits in the ratio of 5:3. They admitted C for 1/5th share of profits, for which he paid ₹1,20,000 against capital and ₹60,000 against goodwill. Find the capital balances for each partner taking C's Capital as base capital:

    (a) 3,00,000 : 1,20,000 : 1,20,000
    (b) 3,00,000 : 1,20,000 : 1,80,000
    (c) 3,00,000 : 1,80,000 : 1,20,000
    (d) 3,00,000 : 1,80,000 : 1,80,000
43. Depreciation fund at the time of admission of a partner is:
    (a) Not to be transferred anywhere
    (b) Transferred to old partners capital account in old profit sharing ratio
    (c) Transferred to Profit & Loss Appropriation A/c
    (d) Transferred to old partner's capital A/c in sacrificing ratio.
44. Amit and Anil are partners of a partnership firm sharing profits in the ratio of 5 : 3 with capital of ₹ 2,50,000 and ₹2,00,000 respectively. Atul was admitted on the following terms, Atul would pay ₹ 50,000 as capital and ₹16,000 as goodwill for 1/5th share of profit. Find the balance of capital accounts after admission of Atul:
    (a) ₹2,60,000; ₹2,06,000; ₹50,000
    (b) ₹2,20,000; ₹1,82,000; ₹66,000
    (c) ₹2,92,500; ₹2,25,500; ₹50,000
    (d) ₹2,82,500; ₹2,19,500; ₹66,000.
45. X and Y are partners sharing profits and losses in the ratio of 2:1. Their capital on 31st March, 2014 was ₹ 1,05,000 and ₹75,000 respectively. Z was admitted as a new partner on April 1st, 2014 for 1/5th share. He contributes ₹ 20,000 as goodwill. He brings his capital in profit sharing ratio. What will be his share of capital?
    (a) ₹50,000
    (b) ₹45,000
    (c) ₹36,000
    (d) None of the three.
46. P and Q are partner, sharing profits in the ratio 7 : 2. They admit R with 1/5th share in profits which he acquires equally from both i.e. 1/10th from P and 1/10th from Q. Now, profit sharing ratio will be:
    (a) 61 : 11 : 18
    (b) 11 : 61 : 18
    (c) 18 : 11 : 61
    (d) None of the above.

47. P and Q are the partners in a firm sharing profits and losses in the ratio 3:2 with capitals of ₹1,50,000 and ₹1,00,000 respectively. They admitted R as a partner with ₹ 90,000 as capital for 1/4th share in profits of the firm. They adjust the capitals of other partners according to R's capital and his share in the business. How much cash will be brought by P?
    (a) ₹8,000
    (b) ₹9,000
    (c) ₹10,000
    (d) ₹12,000
48. X and Y are in partnership sharing profits and losses at the ratio 3:2. They take Z as a new partner for 1/5th share in profit. Z will receive his share of profit from X only. New profit sharing ratio will be _____
    (a) 12 : 8 : 5
    (b) 2 : 2 : 1
    (c) 2 : 1 : 1
    (d) 1 : 1 : 1
49. Tom and Jerry are partners sharing profits and losses in the ratio of 3:2 (Tom's capital is ₹70,000 and Jerry's capital is ₹50,000). They admitted Shiva and agreed to give 1/5th share of profits to him. How much Shiva should bring in towards his capital?
    (a) ₹24,000
    (b) ₹80,000
    (c) ₹18,000
    (d) ₹30,000
50. Profit or loss on revaluation is shared among the old partners in_____ ratio.
    (a) Old profit sharing
    (b) New profit sharing
    (c) Capital
    (d) Equal

Answer

1.	(c)	2.	(d)	3.	(a)	4.	(c)	5.	(b)
6.	(a)	7.	(c)	8.	(b)	9.	(a)	10.	(b)
11.	(a)	12.	(c)	13.	(a)	14.	(a)	15.	(b)
16.	(b)	17.	(a)	18.	(d)	19.	(b)	20.	(d)
21.	(a)	22.	(b)	23.	(b)	24.	(b)	25.	(d)
26.	(a)	27.	(b)	28.	(a)	29.	(b)	30.	(a)
31.	(a)	32.	(b)	33.	(b)	34.	(c)	35.	(b)
36.	(d)	37.	(b)	38.	(a)	39.	(c)	40.	(b)
41.	(b)	42.	(c)	43.	(a)	44.	(a)	45.	(a)
46.	(a)	47.	(d)	48.	(b)	49.	(d)	50.	(a)

SHORT PRACTICE QUESTIONS

1. Differentiate between revaluation account and memorandum revaluation account.
2. Write short note on:
    (a) Gaining Ratio
    (b) Sacrificing Ratio

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

2000 - May [5] State with reasons whether the following statements are True or False:

(x) Goodwill brought in by incoming partner in cash for joining in a partnership firm is taken away by the old partners in their new profit sharing ratio. (2 marks)

Answer:

False: The goodwill in cash, brought in by the new partner is taken away by the old partners in the sacrificing ratio and not in the new profit sharing ratio.

2001 - May [5] State with reasons whether the following statements are True or False:

(5) Goodwill is a fictitious asset. (2 marks)

Answer:

False: Goodwill is an intangible asset.

PRACTICAL QUESTIONS

1994 - Nov [1] A, B and C are partners in a firm sharing profits and losses as 8:5:3. Their Balance Sheet as at 31st December, 1993 was as follows:

	₹		₹
Sundry Creditors	1,50,000	Cash	40,000
General Reserve	80,000	Bills Receivable	50,000
		Sundry Debtors	60,000
Partners' Loan Accounts:		Stock	1,20,000
A	40,000	Fixed Assets	2,80,000
B	30,000		
Partners' Capital Accounts:			
A	1,00,000		
B	80,000		
C	70,000		
	5,50,000		5,50,000

From 1st January, 1994 they agreed to alter their profit-sharing ratio as 5:6:5.
It is also decided that:

(a) the fixed assets should be valued at ₹3,31,000;

(b) a provision of 5% on sundry debtors be made for doubtful debts;

(c) the goodwill of the firm at this date be valued at three years' purchase of the average net profits of the last five years before charging insurance premium; and

(d) the Stock be reduced to ₹1,12,000.

There is a joint life insurance policy for ₹2,00,000 for which an annual premium of ₹10,000 is paid, the premium being charged to Profit and Loss Account. The surrender value of the policy on 31st December, 1993 was ₹ 78,000.

The net profits of the firm for the last five years were ₹14,000, ₹17,000, ₹ 20,000, ₹22,000 and ₹27,000.

Goodwill and the surrender value of the joint life policy was not to appear in the books.

Draft Journal Entries necessary to adjust the capital accounts of the partners and prepare the revised Balance Sheet (20 marks)

Answer:

M/s. A.B.C.

Journal Entries

Date	Particulars		₹	₹
1994 1. Jan	Fixed Assets A/c To Revaluation A/c (Being Revaluation of Fixed Assets)	Dr.	51,000	 51,000

	Particulars		Dr. (₹)	Cr. (₹)
	Revaluation A/c	Dr.	11,000	
	To Stock A/c			8,000
	To Provision for Doubtful Debts A/c			3,000
	(Being Reduction in the value of stock and Provision @ 5% on sundry debtors created for doubtful debts)			
	B's Capital A/c	Dr.	10,500	
	C's Capital A/c	Dr.	21,000	
	To A's Capital A/c			31,500
	(Being Adjustment for goodwill and joint life policy) (W.N.1)			
	Revaluation A/c	Dr.	40,000	
	To A's Capital A/c			20,000
	To B's Capital A/c			12,500
	To C's Capital A/c			7,500
	(Being Transfer of revaluation profit)			
	General Reserve A/c	Dr.	80,000	
	To A's Capital A/c			40,000
	To B's Capital A/c			25,000
	To C's Capital A/c			15,000
	(Being Transfer of general reserve)			

Balance Sheet (Revised)
As on 1st January, 1994

Liabilities		₹	Assets		₹
Sundry Creditors		1,50,000	Cash		40,000
Partner's Loan A/cs:			Bills Receivable		50,000
A	40,000		Sundry Debtors	60,000	
B	30,000	70,000	*Less:* Provision	3,000	57,000
Partner's Capital A/cs:(W.N. 2)			Stock		1,12,000
A	1,91,500		Fixed Assets		3,31,000
B	1,07,000				
C	71,500	3,70,000			
		5,90,000			5,90,000

Working Notes:

1. **Adjustment for Goodwill and joint life policy**

	₹
Average profit last five years	20,000
Add: Insurance premium per annum	10,000
Average profit before charging premium	30,000
Value of goodwill (3 × ₹30,000)	90,000
Surrender value of joint life policy	78,000
Total amount for adjustment	1,68,000

	A (₹)	B (₹)	C (₹)
Raised in old profit sharing ratio (8:5:3)	84,000	52,500	31,500
Written off in new profit sharing ratio (5:6:5)	52,500	63,000	52,500
Net effect in Capital A/cs	31,500 (Cr.)	10,500 (Dr.)	21,000 (Dr.)

2. **Partner's Capital Account**

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
1994 Jan. 1				1994 Jan. 1			
To A's Capital A/c	—	10,500	21,000	By Balance b/d	1,00,000	80,000	70,000
To Balance c/d	1,91,500	1,07,000	71,500	By B and C's Capital A/c (as per contra)	31,500	—	—
				By Revaluation A/c (Revaluation Profit)	20,000	12,500	7,500
				By General Reserve	40,000	25,000	15,000
	1,91,500	1,17,500	92,500		1,91,500	1,17,500	92,500

1995 - Nov [2] A and B are in partnership sharing profits and losses in the proportion of three - fourth and one- fourth respectively. Their Balance Sheet on 31st march, 1995 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, 1995 they admitted C into partnership on the following terms:

(a) C to purchase one-third of the Goodwill for ₹2,000 and provide ₹10,000 as capital. Goodwill not to appear in books.

(b) Future profits and losses are to be shared by A, B and C equally.

(c) Plant and Machinery is to be reduced by 10% and ₹500 is to be provided for estimated bad debts. Stock is to be take at a valuation of ₹ 24,940.

(d) By bringing in, or withdrawing cash, capitals of A and B are to be made proportionate to that of C on their profit- sharing basis.

Set our entries relating to the above arrangement in the firm's journal, give partner's Capital Account in tabular form and submit the opening balance Sheet of the new firm. (20 marks)

QR Code for Solution Video

Answer:

Journal
As on 1st April, 1995

	Particulars		₹	₹
1	Revaluation Account	Dr.	900	
	To Plant & Machinery Account			400
	To Provision for Bad Debts Account			500
	(Plant & machinery reduced by 10% and ₹500 provided for bad debts)			
2	Stock Account	Dr.	2,940	
	To Revaluation Account			2,940
	(Value of stock increased by ₹2,940)			
3	Revaluation Account	Dr.	2,040	
	To A's Capital Account			1,530
	To B's Capital Account			510
	(Profit on revaluation transferred)			
4	Cash Account	Dr.	10,000	
	To C's Capital Account			10,000
	(Cash brought in by C as his Capital)			

	Particulars		₹	₹
5	Cash Account	Dr.	2,000	
	B's Capital Account	Dr.	500	
	To A's Capital Account			2,500
	(Entry for Goodwill purchased by B and C)			
6	A's Capital Account	Dr.	9,030	
	B's Capital Account	Dr.	10	
	To Cash Account			9,040
	(Cash withdrawn by A & B)			

Capital Accounts

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To A's Capital Account	—	500	—	By Balance b/d	15,000	10,000	—
To Cash	9,030	10	—	By Revaluation A/c	1,530	510	—
To Balance c/d	10,000	10,000	10,000	By Cash	2,000	—	10,000
				By B's Capital A/c	500	—	—
	19,030	10,510	10,000		19,030	10,510	10,000

Balance Sheet of A, B and C as at 1st April 1995

Liabilities	₹	Assets		₹
Sundry Creditors	12,000	Cash (1)		3,960
Bank overdraft	15,000	Sundry Debtors	25,000	
Capital Account		*Less:* Provision for bad debts	500	24,500
A	10,000			
B	10,000			
C	10,000	Stock		24,940
		Plant and Machinery		3,600
	57,000			57,000

Working Notes:

(1) Determination of cash balance as on 31.3.95

Cash Account

Particulars	₹	Particulars	₹
To Balance b/d	1,000	By A's Capital A/c	9,030
To C's Capital A/c	10,000	By B's Capital A/c	10
To A's Capital A/c	2,000	By balance c/d	3,960
	13,000		13,000

(2) Calculation of Goodwill:

C pays ₹2,000 on account of goodwill for 1/3 share of profit/loss. Total goodwill is

₹2,000 × 3 = 6,000

Gaining Ratio:

B : $\frac{1}{3}-\frac{1}{4}=\frac{1}{12}$ C = $\frac{1}{3}$

Goodwill to be paid to A:

By B ₹6,000 × 1/12 =	₹ 500
By C ₹6,000 × 1/3	₹2,000
Total	₹2,500

1996 - May [1] On 31st March, 1996 the Sheet of M/s P, R and S sharing profit and losses in the ratio of 6: 5: 3, stood as follows:

Liabilities	₹	Assets	₹
Sundry Creditors	37,800	Cash	3,780
Bills Payable	12,600	Sundry Debtors	52,920
General Reserve	21,000	Stock	58,920
Capital Accounts:		Furniture	14,700
P	70,800	Land & Buildings	90,300
S	29,100	Goodwill	10,500
R	59,700		
	2,31,000		2,31,000

They agree to admit Q into partnership giving him 1/8th share, on 1.4.1996 on the following terms:

1. Furniture be depreciated by ₹1,840.
2. Stock shall be valued 10% less than the balance sheet value.
3. A provision of ₹2,640 be made for outstanding repair bill.
4. The value of land and buildings having appreciated be brought up-to ₹ 1,19,700.
5. Value of Good will be brought up-to ₹28,140.
6. Q should bring in cash ₹29,400 as his capital.

After making the above adjustments, the capital accounts of the old partners be adjusted on the basis of proportion of Q's Capital to his share in the business by bringing in or taking out cash.

You are required to prepare Revaluation Account, Capital Accounts of Partners, Cash Account and Balance Sheet as on 1.4.1996 after Q's admission. (20 marks)

Answer :

Dr. **Revaluation Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
1996 April 1	To Stock A/c	5,880	1996 April 1	By Land and Buildings A/c	29,400
April 1	To Furniture A/c	1,840			
April 1	To Repairs payable A/c	2,640			
April 1	To Profit on revaluation transferred to capital Account:				
	P	8,160			
	R	6,800			
	S	4,080			
		29,400			29,400

Partners' Capital Accounts

Dr. Cr.

Date	Particulars	P ₹	R ₹	S ₹	Q ₹	Date	Particulars	P ₹	R ₹	S ₹	Q ₹
1996						1996					
Ap.1	To Cash	7,320	6,800	—	—	Ap.1	By Balance b/d	70,800	59,700	29,100	—
Ap.1	To Balance c/d	88,200	73,500	44,100	29,400	Ap.1	By General Reserve	9,000	7,500	4,500	—
						Ap.1	By Goodwill A/c	7,560	6,300	3,780	—
						Ap.1	By Revaluation A/c	8,160	6,800	4,080	—
						Ap.1	By Cash	—	—	2,640	29,400
		95,520	80,300	44,100	29,400			95,520	80,300	4,410	29,400

Cash Account

Date	Particulars	₹	Date	Particulars	₹
1996 April 1	To Balance b/d	3,780	1996 April 1	By P's Capital A/c	7,320
April 1	To Q's Capital A/c	29,400	April 1	By R's Capital A/c	6,800
April 1	To S's Capital A/c	2,640	April 1	By Balance c/d	21,700
		35,820			35,820

Balance Sheet of M/s P, R, S and Q
As on 1st April, 1996

Liabilities		Amount ₹	Assets	Amount ₹
Capital Account			Goodwill	28,140
P	88,200		Land and Buildings	1,19,700
R	73,500		Furniture	12,860
S	44,100		Stock	52,920
Q	29,400	2,35,200	Sundry Debtors	52,920
Sundry Creditors		37,800	Cash	21,700
Bills Payable		12,600		
Repairs Payable		2,640		
		2,88,240		2,88,240

Working Notes:

(1) New Profit Sharing Ratio:

	Old Ratio	New ratio	Sacrificing ratio = Old ratio - New ratio
P	$\frac{6}{14}$	$\frac{6}{14} \times \left(1 - \frac{1}{8}\right) = \frac{6}{16}$	$\frac{6}{14} - \frac{6}{16} = \frac{6}{112}$

R $\frac{5}{14}$ $\quad \frac{5}{14}\times\frac{7}{8}=\frac{5}{16}$ $\quad \frac{5}{14}-\frac{5}{16}=\frac{5}{112}$

S $\frac{3}{14}$ $\quad \frac{3}{14}\times\frac{7}{7}=\frac{3}{16}$ $\quad \frac{3}{14}-\frac{3}{16}=\frac{3}{112}$

Q $\frac{1}{8}$ i.e. $\frac{2}{16}$

	P : R : S : Q
New Ratio	6 : 5 : 3 : 2
Sacrificing Ratio	6 : 5 : 3

(2) Proportionate capital of partners:

Total Capital taking Q's capital as base is

₹29, 400 × 8 = ₹2,35,200

Proportionate Capital of

P : $\frac{6}{16}\times$ 2,35,200 = ₹88,200

R : $\frac{5}{16}\times$ 2,35,200 = ₹ 73,500

S : $\frac{3}{16}\times$ 2,35,200 = ₹ 44,100

1997 - Nov [2] A, B C were in partnership, sharing profits and losses as to A one-half, B one-third and C one- sixth. As from 1st January 1996 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 that 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 investment 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 31.12.1995 was as following:

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 1996 were ₹12,000 and the drawings were: A ₹6,000, B ₹6,000, C ₹3,000 and D ₹3,000.

You are required to journalise the opening adjustments, prepare the opening Balance Sheet of the new firm as on 1st January, 1996 and five the capital account of each partner as on 31st December, 1996. (15 marks)

QR Code for Solution Video

Answer :

Journal Entries

	Particulars	Dr. ₹	Cr. ₹
(i)	Bank A/c Dr. To A's Capital A/c (Being amount paid by D for share of goodwill purchased form A)	8,000	 8,000
(ii)	A's Capital Ac Dr. To Bank A/c (Being amount withdrawn by A)	6,000	 6,000
(iii)	Bank A/c Dr. To D's Capital A/c (Being capital brought in by D)	5,000	 5,000
(iv)	Revaluation A/c Dr. To Investments A/c To Plant A/c (Being revaluation of Investments and plant recorded)	3,600	 2,400 1,200

(v)	A's Capital A/c Dr.		1,800	
	B's Capital A/c Dr.		1,200	
	C's Capital A/c Dr.		600	
	To Revaluation A/c			3,600
	(Being loss on revaluation transferred to old partners in 3: 2: 1: ratio)			

Balance Sheet of New Firm
As on 1st January, 1996

Liabilities	₹	Assets	₹
Capital Accounts:		Plant	5,800
A	12,200	Furniture	2,000
B	6,800	Stock	10,000
C	3,400	Investments	3,600
D	5,000	Debtors	12,000
Creditors	21,000	Cash at Bank	15,000
	48,400		48,400

Dr. **A's Capital Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
1996			1996		
Dec. 31	To Drawing A/c	6,000	Jan. 1	By Balance b/d	12,200
Dec. 31	To Balance C/d	10,200	Dec. 31	By Profit	4,000
		16,200			16,200

Dr. **B's Capital Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
1996			1996		
Dec. 31	To Drawing A/c	6,000	Jan. 1	By Balance b/d	6,800
Dec. 31	To Balance c/d	4,800	Dec.31	By Profit	4,000
		10,800			10,800

Dr. **C's Capital Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
1996			1996		
Dec.31	To Drawing A/c	3,000	Jan. 1	By Balance b/d	3,400
Dec.31	To Balance c/d	2,400	Dec.31	By Profit	2,000
		5,400			5,400

Dr. **D's Capital Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
1996			1996		
Dec.31	To Drawing A/c	3,000	Jan. 1	By Bank	5,000
Dec.31	To Balance c/d	4,000	Dec.31	By Profit	2,000
		7,000			7,000

Working Notes:

(1) Balance Sheet of old firm
As on 31st December, 1995

Liabilities	₹	Assets	₹
Capital Accounts:		Plant	7,000
A	12,000	Furniture	2,000
B	8,000	Investments	6,000
C	4,000	Stock	10,000
Creditors	21,000	Debtors	12,000
		Cash at Bank	8,000
	45,000		45,000

(2) New Profit Sharing Ratio:

	Old Ratio	New Ratio
A	$\frac{3}{6}$	$\frac{3}{6}-\frac{1}{6}=\frac{2}{6}$
B	$\frac{2}{6}$	$\frac{2}{6}$
C	$\frac{1}{6}$	$\frac{1}{6}$
D	$\frac{1}{6}$	$\frac{1}{6}$

1998 - Nov [2] A and B are Partners of X & Co. sharing profits and loses in 3: 2 ratio between themselves. On 31st March, 1998, the Balance Sheet of the firm was as follows:

Balance Sheet of X & Co. as at 31. 3. 1998

Liabilities		₹	Assets	₹
Capital Accounts:			Plant And Machinery	20,000
A	37,000		Furniture and Fitting	5,000
B	28,000	65,000	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 firm 1.4. 1998.

(a) He will introduce ₹25,000 as his capital and pay ₹15,000 at the partners as premium for Goodwill for 1/3rd share of the future profits of the firm.

(b) A revaluation of assets of the firm will be made by reducing the value of Plant and Machinery to ₹15,000, Stock by 10% Furniture and Fittings by ₹1,000 and by making a provision of bad and 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 that the relative ratios of the old partners will be in equal proportion after admission. (15 marks)

QR Code for Solution Video

Answer:

Profit and Loss Adjustment A/c

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
1998 April.1	To Plant and Machinery A/c	5,000	1998 April.1	By Partner's Capital A/c	
	To Furniture and fitting A/c	1,000		Loss on revaluation	
	To Stock A/c	1,500		A	4,950
	To Provision for Bad and Doubtful A/c	750		B	3,300
		8,250			8,250

Partners' Capital Accounts

Dr. Cr.

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To Profit & Loss Adjustment A/c	4,950	3,300	—	By Balance b/d	37,000	28,000	
				By Cash A/c			40,000
To A's B's Capital A/cs	—	—	15,000	By A's Capital A/c (W.N. 2)	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

Balance Sheet of A, B and X
as on 1st April 1998

Liabilities		₹	Assets		₹
Capital Accounts:			Plant And Machinery		15,000
A	44,050		Furniture and Fitting		4,000
B	27,700		Stock		13,500
X	25,000	96,750	Sundry Debtors	20,000	
Sundry Creditors		5,000	*Less:* Provision for Bad and Doubtful Debts	750	19,250
			Cash on Hand		50,000
		1,01,750			1,01,750

Working Notes:

(1) **New profit sharing ratio:**

On admission of X who will be entitled to 1/3rd share of the future profits of the firm. A and B would share the remaining 2/3rd share in equal proportion i.e., 1 : 1

A: $\frac{2}{3} \times \frac{1}{2} = \frac{1}{3}$

B: $\frac{2}{3} \times \frac{1}{2} = \frac{1}{3}$

X: $\frac{1}{3}$

A, B and X would share profits and losses in equal ratio.

(2) **Adjustment of Goodwill:**

X pays ₹15,000 as premium for goodwill for 1/3rd share of the future profits. Thus, total value of goodwill is ₹15,000 × 3 i.e. ₹45,000

Sacrificing ratio:

A: $\frac{3}{5} - \frac{1}{3} = \frac{4}{15}$

B: $\frac{2}{5} - \frac{1}{3} = \frac{1}{15}$

Hence, Sacrificing ratio is 4 : 1

Adjustment of X's share of goodwill through existing partners' capital accounts in the profit sacrificing ratio*:

		₹
A :	₹15,000 × $\frac{4}{5}$ =	12,000
B :	₹15,000 × $\frac{1}{5}$ =	3,000
		15,000

Notes: (1)* Alternatively, full value of goodwill may be raised and credited to existing partners, capital accounts in old profit sharing ratio, and then written off by debiting all partners' capital accounts in new profit sharing ratio.

2000 - Nov [2] Hari and Ram were in partnership, sharing profits and losses equally. On 1st January, 1999, 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 to ₹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 is at 31st December, 1998 was as follows:

Liabilities		₹	Assets	₹
Creditors:		1,05,000	Cash at Bank	40,000
Capitals:			Book Debts	60,000
Hari	60,000		Stock	50,000
Ram	60,000	1,20,000	Investments	30,000
			Furniture	10,000
			Plant	35,000
		2,25,000		2,25,000

The profits for the year ended 31st December 1999 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 December 1999. (15 marks)

Answer:

Journal Entries

Date	Particulars		₹	₹
	Bank A/c	Dr.	40,000	
	To Hari's Capital A/c			40,000
	(Being amount paid by Suraj credited to Hari)			
	Hari's Capital A/c	Dr.	30,000	
	To Bank A/c			30,000
	(Being amount withdrawn by Hari)			
	Sundry Creditors A/c	Dr.	3,000	
	Revaluation A/c	Dr.	15,000	
	To Investments A/c			12,000
	To Plant A/c			6,000
	(Being revaluation of investments, plant and sundry creditors recorded)			
	Hari's Capital A/c	Dr.	7,500	
	Ram's Capital A/c	Dr.	7,500	
	To Revaluation A/c			15,000
	(Being loss on revaluation transferred to old partners in equal ratio)			
	Bank A/c	Dr.	23,000	
	To Suraj's Capital A/c			23,000
	(Being proportionate capital brought in by Suraj)			

Partners' Capital Accounts

Dr. | Cr.

Date	Particulars	Hari ₹	Ram ₹	Suraj ₹	Date	Particulars	Hari ₹	Ram ₹	Suraj ₹
1999 Jan.1	To Revaluation A/c	7,500	7,500	—	1999 Jan. 1	By Balance b/d	60,000	60,000	—
Jan.1	To Bank A/c	30,000	—	—	Jan 1	By Bank A/c	40,000	—	—
Dec.31	To Bank A/c	15,000	22,500	7,500	Jan. 1	By Bank A/c	—	—	23,000
Dec.31	To Balance c/d	67,500	60,000	25,500	Dec.31	By Profit & Loss A/c	20,000	30,000	10,000
		1,20,000	90,000	33,000			1,20,000	90,000	33,000

Balance Sheet as at 31st December, 1999

Liabilities		₹	Assets	₹
Capital Accounts:			Plant	29,000
Hari	67,500		Furniture	10,000
Ram	60,000		Investments	18,000
Suraj	25,500	1,53,000	Stock	50,000
Creditors		1,02,000	Debts	60,000
			Bank	88,000
		2,55,000		2,55,000

Working Notes:

(1) New profit sharing ratio:

	Old ratio	New ratio
Hari	$\frac{1}{2}$	$\frac{3}{6}$
Ram	$\frac{1}{2}$	$\frac{1}{2} - \frac{1}{6} = \frac{2}{6}$
Suraj		$\frac{1}{6}$

(2) Amount of capital brought in By Suraj:

	₹
Capital on 1.1.99	
Hari (1,00,000 - 30,000-7,500)	62,500
Ram (60,000 - 7,500)	52,500
	1,15,000

Let the total capital after admission of Suraj is ₹x.

$₹1,15,000 + \frac{1x}{6} = x$

$\frac{5}{6}x = ₹1,15,000$

$x = 1,15,000 \times \frac{6}{5} = ₹1,38,000$

Suraj's proportionate capital $= ₹1,38,000 \times \frac{1}{6}$

$= ₹23,000$

(3) Cash at Bank on 31st December, 1999

		₹
Cash at bank on 31st December, 1998		40,000
Add: Amount paid by Suraj for goodwill		40,000
Amount paid by Suraj for capital		23,000
Profits earned during the year*		60,000
		1,63,000
Less: Drawings — Hari (30,000 + 15,000)	45,000	
Ram	22,500	
Suraj	7,500	75,000
		88,000

*The amount of profits earned during the year has been taken as increase in Bank Balance.

2001 - Nov [2] The Balance Sheet of A & B, a partnership firm, as at 31st March, 2001 is as follows:

Liabilities		₹	Assets	₹
Capital Account:			Goodwill	14,000
A	26,400		Land and Building	14,400
B	33,600	60,000	Furniture	2,200
Contingency Reserve		6,000	Stock	26,000
Sundry Creditors		9,000	Sundry Debtors	6,400
			Cash at Bank	12,000
		75,000		75,000

A & B share profits and losses as 1 : 2. They agree to admit C (who is also in business on his own) as a third partner from 1.4.2001:

The Assets are revalued as under:

Goodwill — ₹18,000; Land and Building ₹30,000; Furniture ₹6,000. C bring the followings assets into the partnership — Goodwill ₹6,000; Furniture ₹2,800, Stock ₹13,600.

Profits in the new firm are to be shared equally by the three partners and the Capital Account are to be so adjusted as to be equal. For this purpose, additional cash should be brought in by the partner or partners concerned.

Prepare the necessary accounts and the opening Balance Sheet of new firm, showing the amount fo cash, if any, which each partner may have to provide. (15 marks)

Answer:

Dr. **Profit and Loss Adjustment Account** Cr.

Particulars		₹	Particulars	₹
To Partner's Capital A/c			By Goodwill	4,000
A	7,800		By Land & Building	15,600
B	15,600	23,400	By Furniture	3,800
		23,400		23,400

Dr., **Partners' Capital Accounts** Cr.

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To Balance c/d	53,200	53,200	53,200	By Balance b/d	26,400	33,600	—
				By Contingency Reserve	2,000	4,000	—
				By profit & Loss Adjustment A/c	7,800	15,600	—
				By Sundry Assets	—	—	22,400
				By Bank A/c	17,000	—	30,800
	53,200	53,200	53,200		53,200	53,200	53,200

Dr. **Bank Account** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	12,000	By Balance c/d	59,800
To A's Capital A/c	17,000		
To C's Capital A/c	30,800		
	59,800		59,800

Balance Sheet of new firm as on 1st April, 2001

Liabilities	₹	₹	Assets	₹
Capital Accounts:			Goodwill (18,000 + 6,000)	24,000
A	53,200		Land & Building	30,000
B	53,200		Furniture (6,000 + 2,800)	8,800
C	53,200	1,59,600	Stock (26,000 + 13,600)	39,600
Sundry Creditors		9,000	Sundry Debtors	6,400
			Cash at Bank	59,800
		1,68,600		1,68,600

Note: Capital accounts of partners are to be so adjusted as to be equal and therefore, additional cash is to be brought in by the partner or partners concerned. For this purpose, highest capital of the partners is to be taken as base. In this case B's Capital becomes highest, accordingly A is required to bring in ₹17,000 (53,200 - 36,200) and C has to bring in ₹30,800 (53,200 - 22,400).

2004 - May [4] The Balance Sheet of X & Y, a partnership firm, as at 31st March, 2004 is as follows:

Liabilities		₹	Assets	₹
Capital Account:			Goodwill	14,000
X	26,400		Land & Building	14,400
Y	33,600	60,000	Furniture	2,200
General Reserve		6,000	Stock	26,000
Sundry Creditors		9,000	Sundry Debtors	6,400
			Cash at Bank	12,000
		75,000		75,000

X & Y share profits and losses as 1 : 2. They agree to admit Z (who is also in business on his own) as a third partner from 1.4.2004.

The Assets are revalued as under:

Goodwill — ₹18,000, Land and Building ₹30,000, Furniture ₹6,000. Z brings the following assets into the partnership — Goodwill ₹6,000, Furniture ₹2,800, Stock ₹13,600.

Profit in the new firm are to be shared equally by three partners and the Capital Accounts are to be so adjusted as to be equal. For this purpose, additional cash should be brought in by the partner or partners concerned.

Prepare the necessary accounts and the opening Balance Sheet of new firm, showing the amounts of cash, if any, which each partner may have to provide. (15 marks)

Answer:

Profit and Loss Adjustment A/c

Particulars		Amount ₹	Particulars	Amount ₹
To Profit transferred to:			By Goodwill	4,000
To X's Capital A/c	7,800		By Land & Building A/c	15,600
To Y's Capital A/c	15,600	23,400	By Furniture A/c	3,800
		23,400		23,400

Partner's Capital A/c

Particulars	X	Y	Z	Particulars	X	Y	Z
To Balance c/d	53,200	53,200	53,200	By Balance b/d	26,400	33,600	—
				By Profit & Loss Adj	7,800	15,600	—
				By General Reserve A/c	2,000	4,000	—
				By Sundry Assets	—	—	22,400
				By Bank A/c	17,000	—	30,800
	53,200	53,200	53,200		53,200	53,200	53,200

Bank A/c

Particulars	Amount ₹	Particulars	Amount ₹
To Profit transferred to :	12,000	By Balance c/d	59,800
To X's Capital A/c	17,000		
To Y's Capital A/c	30,800		
	59,800		59,800

Balance Sheet of New Firm as on 1st April,2004

Liabilities		Amount ₹	Assets	Amount ₹
Capital Account			Goodwill (18,000+6, 000)	24,000
X	53,200		Land & Building	30,000
Y	53,200		Furniture (6,000 + 2,800)	8,800
Z	53,200	1,59,600	Stock (26,000 +13,600)	39,600
Sundry Creditors		9,000	Sundry Debtors	6,400
			Cash at Bank	59,800
		1,68,600		1,68,600

Working notes:

The capital account of the partners are to be equally adjusted and so the additional cash is to be brought by the incoming partner. For this purpose, the highest capital i. e. of Y is taken as the base and

∴ Y's Total capital = (Y's Capital = profit on Revaluation + general Reserve
= (33,600 + 15,600 + 4,000)
= ₹53,200

∴ X has to bring ₹17,000 (53,200 - (26, 400 + 2,000 + 7,800)
and Z has to bring ₹30,800 (53,200 - 22,400)

2006 - May [4] The following is the Balance Sheet of A, B and C sharing Profits and Losses in the proportion of 6/14, 5/14 and 3/14 respectively :

	₹		₹
Creditors	37,800	Cash	3,780
Bills Payable	12,600	Debtors	52,920
General Reserve	21,000	Stock	58,800
Capital Accounts :		Furniture	14,700
A	70,800	Land and Building	90,300
B	59,700	Goodwill	10,500
C	29,100		
	2,31,000		2,31,000

They agreed to take D into partnership and give him 1/8th share on the following terms :

(i) That furniture be depreciated by ₹1,840.
(ii) That stock be depreciated by 10%.
(iii) That a provision of ₹2,640 be made for outstanding repair bills.
(iv) That the value of land and building, having appreciated, be brought upto ₹1,19,700.
(v) That the value of goodwill be brought up to ₹28,140.
(vi) That D should bring in ₹29,400 as his capital.
(vii) That after making the above adjustments the Capital accounts of old partners be adjusted on the basis of the proportion of D's capital to his share in the business and actual cash to be paid off or brought in by the old partners, as the case may be.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the new firm. (15 marks)

Answer:

Revaluation Account

Particulars	₹		₹
To Furniture Account	1,840	By Land & Building Account	29,400
To Stock Account	5,880		
To Provision for Repairs Account	2,640		
To Profit transferred to			
A's Capital Account	8,160		
B's Capital Account	6,800		
C's Capital Account	4,080		
	29,400		29,400

A's Capital Account

Particulars	₹		₹
To Cash Account	7,320	By Balance b/d	70,800
To Balance c/d	88,200	By General Reserve	9,000
		By Goodwill	7,560
		By Revaluation Account	8,160
	95,520		95,520

B's Capital Account

	₹		₹
To Cash Account	6,800	By Balance b/d	59,700
To Balance c/d	73,500	By General Reserve	7,500
		By Goodwill	6,300
		By Revaluation Account	6,800
	80,300		80,300

C's Capital Account

	₹		₹
To Balance c/d	44,100	By Balance b/d	29,100
		By General Reserve	4,500
		By Goodwill	3,780
		By Revaluation Account	4,080
		By Cash Account	2,640
	44,100		44,100

D's Capital Account

	₹		₹
To Balance c/d	29,400	By Cash Account	29,400

Balance Sheet as on 31st March, 2006

Liabilities	₹	Assets	₹
Creditors	37,800	Cash	21,700
Bills Payable	12,600	Debtors	52,920
Provision for Repairs	2,640	Stock ₹(58,800 - 5,880)	52,920
Capital Accounts		Furniture ₹(14,700 - 1,840)	12,860
A	88,200	Land & Building	1,19,700
B	73,500	Goodwill	28,140
C	44,100		
D	29,400		
	2,88,240		2,88,240

Working Note :

1. **Cash Account**

	₹		₹
To Balance b/d	3,780	By A's Capital Account	7,320
To D's Capital Account	29,400	By B's Capital Account	6,800
To C's Capital Account	2,640	By Balance c/d	21,700
	35,820		35,820

2. Calculation of new profit sharing ratio

D is to get 1/8th share in profit

The remaining profit of the firm = 1 - 1/8 = 7/8

Remaining profit will be shared by A, B and C in their old profit sharing ratio. Thus, the new profit sharing ratio of A, B and C will be calculated as follows:

A $7/8 \times 6/14 = 3/8$

B $7/8 \times 5/14 = 5/16$

C $7/8 \times 3/14 = 3/16$

Therefore, the new profit sharing ratio is 3/8 : 5/16 : 3/16 : 1/8 or 6 : 5 : 3 : 2

3. **Capital of the old partners**

On the basis of D's Capital of ₹29,400, the Capital of old Partners will be calculated as under:

D's Capital for 1/8th share =	₹29,400
Hence, the total Capital of the firm = ₹29,400 × 8/1 =	₹2,35,200
A's Capital in the new firm = ₹2,35,200 × 6/16 =	₹88,200
B's Capital in the new firm = ₹2,35,200 × 5/16 =	₹73,500
C's Capital in the new firm = ₹2,35,200 × 3/16 =	₹44,100
D's Capital in the new firm =	₹29,400
Total Capital =	₹2,35,200

Note: As per para 35 of AS 26 on Intangible Assets, "internally generated goodwill should not be recognized as an asset. Goodwill should be recorded only when some consideration in money or money's worth has been paid for it." Thus, goodwill account should not appear in the balance sheet. However, the goodwill has been shown in the balance sheet as per the requirements of the question. The question requires the raising of goodwill by ₹17,640 (₹28,140 - ₹10,500) which has been credited to old partners in their old profit sharing ratio in the answer. However, it is to be noted that in case AS 26 is followed, the treatment will differ. According to AS 26, the adjustment should be made through partners' capital accounts by debiting new partner's capital account by his share of goodwill (1/8 × ₹17,640) and crediting old partners' capital accounts in the profit sacrificing ratio of 6 : 5 : 3.

The journal entry for adjusting increase in goodwill through partners' capital accounts will be as follows:

		₹	₹
D's capital A/c	Dr.	2,205	
To A's capital A/c			945
To B's capital A/c			787
To C's capital A/c			473

2006 - Nov [4] On 31st March, 2006, the Balance Sheet of P, Q and R sharing profit and losses in proportion to their Capital stood as below:

Liabilities	₹	**Assets**	₹
Capital Account:		Land and Building	30,000
Mr. P	20,000	Plant and Machinery	20,000
Mr. Q	30,000	Stock of goods	12,000
Mr. R	20,000	Sundry debtors	11,000
Sundry Creditors	10,000	Cash and Bank Balances	7,000
	80,000		80,000

On 1st April, 2006, P desired to retire from the firm and remaining partners to carry on the business. It was agreed to revalue the assets and liabilities on that date on the following basis:

(i) Land and Building be appreciated by 20%.
(ii) Plant and Machinery by depreciated by 30%.
(iii) Stock of goods to be valued at ₹10,000.
(iv) Old credit balances of Sundry creditors, ₹2,000 to be written back.
(v) Provisions for bad debts should be provided at 5%.
(vi) Joint life policy of the partners surrendered and cash obtained ₹7,550.
(vii) Goodwill of the entire firm is valued at ₹14,000 and P's share of the goodwill is adjusted in the A/cs of Q and R, who would share the future profits equally. No goodwill account being raised.
(viii) The total capital of the firm is to be the same as before retirement. Individual capital is in their profit sharing ratio.
(ix) Amount due to Mr. P is to be settled on the following basis: 50% on retirement and the balance 50% within one year.

Prepare (a) Revaluation Account, (b) The Capital accounts of the partners, (c) Cash account and (d) Balance Sheet of the new firm M/s Q and R as on 01.04.2006.

(15 marks)

QR Code for Solution Video

Answer:

(a)

Revaluation Account

Date	Particulars		₹	Date	Particulars	₹
2006 April	To Plant & Machinery		6,000	2006 April	By Land & Building	6,000
	To Stock of goods		2,000		By Sundry creditors	2,000
	To Provision for bad and doubtful debts		550		By Cash & Bank- Joint life Policy surrendered	7,550
	To Capital accounts (profit on revaluation transferred)					
	Mr. P (2/7)	2,000				
	Mr. Q (3/7)	3,000				
	Mr. R (2/7)	2,000	7,000			
			15,550			15,550

(b)

Partners' Capital Accounts

Dr. | Cr.

Particulars	P (₹)	Q (₹)	R (₹)	Particulars	P (₹)	Q (₹)	R (₹)
To P's Capital A/c- goodwill	-	1,000	3,000	By Balance b/d	20,000	30,000	20,000
To Cash & bank A/c -(50% dues paid)	13,000	-	-	By Revaluation A/c	2,000	3,000	2,000
To P's Loan A/c -(50% transfer)	13,000	-	-	By Q & R's Capital A/cs - goodwill	4,000		
To Balance c/d	-	35,000	35,000	By Cash & bank A/c - amount brought in (Balancing in figures)	-	3,000	16,000
	26,000	36,000	38,000		26,000	36,000	38,000

(c)

Cash and Bank Accounts

Particulars	(₹)	Particulars	(₹)
To Balance b/d	7,000	By P's Capital A/c - 50% dues paid	13,000
To Revaluation A/c - surrender value of joint life policy	7,550	By Balance b/d	20,550
To Q's Capital A/c	3,000		
To R's Capital A/c	16,000		
	33,550		33,550

(d)

Balance Sheet of M/s Q & R as on 01.04.2006

Liabilities		(₹)	Assets		(₹)
Partners' Capital account			Land and Building	30,000	
Mr. Q	35,000		Add: Appreciation 20%	6,000	36,000
Mr. R	35,000	70,000	Plant & Machinery	20,000	
Mr. P's Loan account		13,000	Less: Depreciation 30%	6,000	14,000
Sundry Creditors		8,000	Stock of goods	12,000	
			Less: devalued	2,000	10,000
			Sundry Debtors	11,000	
			Less: Provision for bad debts 5%	550	10,450
			Cash & Bank balances		20,550
		91,000			91,000

Working Notes:

Adjustment for Goodwill:

Goodwill of the firm	14,000
Mr. P's Share (2/7)	4,000

Gaining ratio of Q & R:

Q = 1/2 - 3/7 = 1/14

R = 1/2 - 2/7 = 3/14

Q : R = 1 : 3

Therefore, Q will bear - 1/4 × 4000 or ₹1,000

R will bear - 3/4 × 4000 or ₹3,000

2018 - Nov [3] (a) Dinesh, Ramesh and Naresh are partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. Their Balance Sheet as on 31st March, 2018 is as below:

Liabilities		(₹)	Assets	(₹)
Trade Payables		22,500	Land & Buildings	37,000
Outstanding Liabilities		2,200	Furniture & Fixtures	7,200
General Reserve		7,800	Closing Stock	12,600
Capital Accounts:			Trade Receivables	10,700
Dinesh	15,000		Cash in Hand	2,800
Ramesh	15,000		Cash at Bank	2,200
Naresh	10,000	40,000		
		72,500		72,500

The partners have agreed to take Suresh as a partner with effect from 1st April, 2018 on the following terms:

(i) Suresh shall bring ₹8,000 towards his capital.

(ii) The value of stock to be increased to ₹14,000 and Furniture & Fixtures to be depreciated by 10%.

(iii) Reserve for bad and doubtful debts should be provided at 5% of the Trade Receivables.

(iv) The value of Land & Buildings to be increased by ₹5,600 and the value of the goodwill be fixed at ₹18,000.

(v) The new profit sharing ratio shall be divided equally among the partners.

The outstanding liabilities include ₹700 due to Ram which has been paid by Dinesh. Necessary entries were not made in the books.

Prepare (i) Revaluation Account, (ii) Capital Accounts of the partners, (iii) Balance Sheet of the firm after admission of Suresh. (15 marks)

QR Code for Solution Video

Answer:

Revaluation Account

2018			₹	2018		₹
April 1	To Provision for bad and doubtful debts		535	April 1	By Inventory in trade	1,400
					By Land and Building	5,600
	To Furniture and fittings		720			
	To Capital A/cs: (Profit on revaluation transferred)					
	Dinesh	2,872.50				
	Ramesh	1,915.00				
	Naresh	957.50	5,745			
			7,000			7,000

Partners' Capital Accounts

Particulars	Dinesh ₹	Ramesh ₹	Naresh ₹	Suresh ₹	Particulars	Dinesh ₹	Ramesh ₹	Naresh ₹	Suresh ₹
To Dinesh & Ramesh			1,500	4,500	By Balance b/d	15,000	15,000	10,000	-
To Balance c/d	26,972.50	21,015	10,757.50	3,500	By General Reserve	3,900	2,600	1,300	-
					By Cash	-	-	-	8,000
					By Naresh & Suresh	4,500	1,500	-	-
					By Outstanding Liabilities (Ram)	700	-	-	-
					By Revaluation A/c	2,872.50	1,915	957.50	-
	26,972.50	21,015	12,257.50	8,000		26,972.50	21,015	12,257.50	8,000

Working Note:

Calculation of sacrificing ratio

Partners	New share	Old share	Sacrifice	Gain
Dinesh	1/4	3/6	6/24	
Ramesh	1/4	2/6	2/24	
Naresh	1/4	1/6		2/24
Suresh	1/4			6/24

Entry for goodwill adjustment

Naresh (2/24 of ₹18,000)	Dr.		1,500	
Suresh (6/24 of ₹18,000)	Dr.		4,500	
To Dinesh (6/24 of ₹18,000)				4,500
To Ramesh (2/24 of ₹18,000)				1,500

Balance Sheet of M/s. Dinesh, Ramesh, Naresh and Suresh as on 1-4-2018

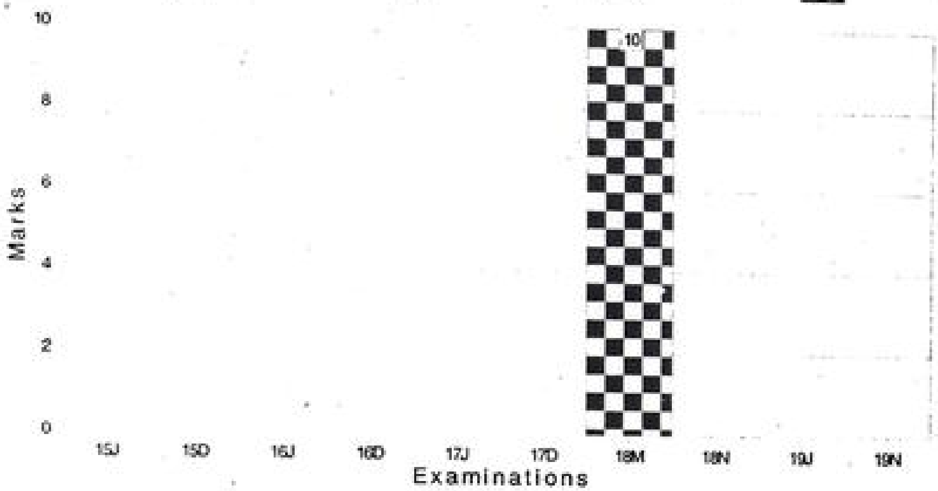
Liabilities	₹	₹	Assets	₹	₹
Trade payables		22,500	Land and Buildings		42,600
Ourstanding Liabilities (2,200 - 700)		1,500	Furniture		6,480
Capital Accounts of Partners:			Inventory of goods		14,000
Mr. Dinesh	26,972.50		Trade receivables	10,700	
Mr. Ramesh	21,015.00		*Less:* Provisions	(535)	10,165
Mr. Naresh	10,757.50		Cash in hand		2,800
Mr. Suresh	3,500.00	62,245	Cash at Bank (2,200 + 8,000)		10,200
		86,245			86,245

CHAPTER	
8	**Partnership Accounts**
Unit: 4	**Retirement of a Partner**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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SELF STUDY QUESTIONS

Q1. What do you mean by Retirement of a Partner?

Answer:

- Retirement of a partner means when a partner leaves the firm.
- A Partner may retire in any of the following ways:
  - (i) with consent of all the partners
  - (ii) in accordance with an express agreement by the partners
  - (iii) where the partnership is at will, by giving notice in writing to all other partners of his intention to retire.

Q2. How do you Calculate the Gaining Ratio?

Answer:

Gaining ratio is the ratio in which remaining partners gain the share of retiring partner.

Gaining Ratio = New Ratio – Old Ratio

Example:

A, B and C are partners sharing profits and losses in the ratio of 4:3:2. B retires and A&C decides to share profit/loss in future in the ratio of 5:4. Calculate gaining ratio.

Solution:

Gaining Ratio = New Ratio – Old Ratio

A's gain = $\frac{5}{9}-\frac{4}{9}=\frac{1}{9}$

C's gain = $\frac{4}{9}-\frac{2}{9}=\frac{2}{9}$

so gaining ratio between A and C is 1:2. This implies that A and C will gain the share of B is the ratio of 1:2

Q3. How is Revaluation of Assets and Liabilities on Retirement of a partner done?

Answer:

– Retirement of a partner is a form of reconstitution of the firm and hence, revaluation of assets and liabilities is required.

- The purpose of revaluation is that retiring partner should get the benefits from the change in the value of assets and liabilities.
- Revaluation of assets and liabilities will be carried out in the same way as in case of admission.
- If value of assets and liabilities have to be changed Revaluation Account is prepared.
- If assets and liabilities are to be shown at original figures then memorandum revaluation accounts is prepared.
- Profit on revaluation will be transferred to old partners in old ratio.

  Revaluation A/c Dr.
  To All partners capital A/c
  In case of loss, entry will be reversed.

Q4. What do you mean by Reserve? How is it dealt with at the time of retirement?

Answer:

- The retiring partner is entitled to the accumulated profits and reserves appearing in he firm.
- At the time of retirement, these reserves should be transferred to all the old partners in the old PSR (Profit Sharing Ratio).

Journal Entries

1. **For distributing reserves and accumulated profits:**

   General Reserve A/c Dr.
   Reserve Fund A/c Dr.
   Profit / Loss (Cr. balance) A/c Dr.
   To All partner's capital A/c [in old ratio]

2. **For distributing accumulated losses**

   All Partners Capital A/c Dr.
   To P/L A/c (Dr. Balance) (in old ratio)

3. **For transferring specific funds.**

   Workmen Compensation Fund A/c Dr.
   Instrument Fluctuation Fund A/c Dr.
   To All Partners Capital A/c

Alternatively instead of transferring full amount to all partners, only the share of profit of retiring partner shall be transferred to his capital A/c.

Reserves and Profit A/c Dr.
To Retiring Partners Capital A/c
[Share of retiring partner]

Q5. How is Final Payment to a retiring partner done? What are its methods?

Answer:

- The mode of payment of the amount due to retiring partner is based on the agreement among the partners.
- However, if agreement is silent on these Terms, the payment shall bo made based on mutual agreement between the partners.

Methods of Payment:

(a) Lump Sum Payment Method:

- This method is applied when the firm has adequate funds.
- The whole amount due shall be paid to the partner at first instance.
- Retired partner capital A/c will be debited & Bank A/c will be credited.

(b) Installment Payment Method:

- This method is applied when the firm is not in a position to pay all the amount due to the partner at once.
- Here, the amount is paid to the partner in installments and till the whole amount is paid, the Capital Account appears as a Loan A/c in the books of the firm.
- Installments may be paid in the following ways–

(i) **Decreasing payment method:**

Here the total amount due is divided in equal installments and amount of installment plus interest on the outstanding balance is paid out.

It is so called because as and when the payment is made the outstanding balance goes on decreasing. Due to this, interest also reduces.

(ii) Equal Payment Method:

Here the total amount to be paid is divided in number of equal installments such that every payment (installment + interest) is equal.

Hence, it is known as equal payment method.

Q6. What do we understand by "Paying a Partner's Loan in Installment"?

Answer:

Sometime, the agreement of partnership may include the term that principal would be repaid in equal installments; in such case, the amount of interest is transferred to Loan A/c and is debited at the time of payment of such amount.

Illustration:

A, B and C are partners in a firm. A retires on 1st January, 1993. On the date of retirement, ₹80,000 is due to him in all. It is agreed to pay him this amount in installments every year at the end of the year. Prepare A's Loan A/c in the following cases.

(i) Four yearly installments plus interest @ 10% p.a.

(ii) Three installments of ₹25,000 including interest @ 10% p.a. on the outstanding balance and the balance including interest in the fourth year.

Solution:

(i) **A's Loan A/c**

Date	Particulars	₹	Date	Particulars	₹
1993			1993		
Dec 31	To Bank A/c (20,000 + 8,000)	28,000	Jan.1	By A's Capital A/c	80,000
Dec 31	To Balance c/d (b/f)	60,000	Dec 31	By Interest on ₹ 80,000 @ 10%	8,000
		88,800			88,000

1994			1994		
Dec. 31	To Bank A/c (20,000 + 6,000)	26,000	Jan 1	By Balance b/d	60,000
Dec. 31	To Balance c/d (b/f)	40,000	Dec. 31	By interest on ₹60,000 @ 10%	6,000
		66,000			66,000
1995			1995		
Dec 31	To Bank A/c (20,000 + 4,000)	24,000	Jan 1	By Balance b/d	40,000
Dec 31	To Balance c/d (b/f)	20,000	Dec 31	By interest on ₹40,000 @ 10%	4,000
		44,000			44,000
1996			1996		
Dec 31	To Bank A/c (20,000 + 2,000)	22,000	Jan 1	By Balance b/d	20,000
				By Interest on ₹20,000 @ 10%	2,000
		22,000			22,000

(ii) **A's Loan A/c**

Date	Particulars	₹	Date	Particulars	₹
1993			1993		
Dec 31	To Bank A/c	25,000	Jan 1	By A's Capital A/c	80,000
Dec 31	To Balance c/d (b/f)	63,000	Dec 31	By interest on ₹80,000 @ 10%	8,000
		88,000			88,000
1994			1994		
Dec 31	To Bank A/c	25,000	Jan 1	By Balance b/d	63,000
Dec 31	To Balance c/d (b/f)	44,300	Dec 31	By Interest on ₹63,000 @ 10%	6,300
		69,300			69,300
1995			1995		
Dec 31	To Bank A/c	25,000	Jan 1	By Balance b/d	44,300
Dec 31	To Balance c/d (b/f)	23,730	Dec 31	By Interest on ₹44,300 @ 10%	4,430
		48,730			48,730

1996			1996		
Dec 31	To Bank A/c	26,103	Jan 1	By Balance b/d	23,730
			Dec 31	By interest on ₹23,730 @ 10%	2,373
		26,103			26,103

Illustration

A, B and C were in partnership, sharing profits and losses in the ratio of 4:3:2. The balances on their Capital Account were.

	₹
A	2,25,000
B	1,50,000
C	1,20,000

On 31st March, 2001, B retired. The partner's agreed to revalue certain assets as follows

	Book Value on 31st March, 2001 (₹)	Revised Value (₹)
Machinery	27,450	22,950
Fixtures & Fittings	1,21,500	1,32,500
Debtors	1,80,000	1,60,000
Goodwill	–	90,000

B's Current Account at the date of retirement showed a debit balance of ₹7,425. Investments of the book value of ₹12,825 were transferred to B in part payment and ₹67,500 was settled in cash at the date of retirement.

According to the partnership agreement, amount outstanding on retirement was to be transferred to a Loan Account and repaid (at the end of each year) in three equal installments plus interest at 8% per annum on the annual balance.

After B's retirement, profits were to be shared in the ratio of 3:2 and all assets (except goodwill) would appear at their revised values.

Show the Partnership Accounts giving effect to these transactions.

Solution:

Revaluation Account

Particular	₹	Particular		₹
To Machinery A/c	4,500	By Fixtures and Fitting A/c		11,000
To Provision for Doubtful Debts A/c	20,000	By Loss on Revaluation		
		A(4/9)	6,000	
		B (3/9)	4,500	
		C (2/9)	3,000	13,500
	24,500			24,500

Capital Accounts

Particulars	A	B	C	Particulars	A	B	C
	₹	₹	₹		₹	₹	₹
To Revaluation A/c-Loss	6,000	4,500	3,000	By Balance b/d	2,25,000	1,50,000	1,20,000
To B's Capital A/c (Goodwill)	14,000	–	16,000	By A's Capital A/c (Good will)	–	14,000	–
To B's Current A/c	–	7,425	–	By C's Capital A/c (Good will)	–	16,000	–
To Investments A/c	–	12,825	–				

	2,25,000	1,80,000	1,20,000

To Cash A/c	-	67,500	-
To B's Loan A/c (b/f)	-	87,750	-
To Balance c/d (b/f)	2,05,000	-	1,01,000
	2,25,000	1,80,000	1,20,000

B's Loan Account

Date	Particulars	₹	Date	Particulars	₹
31.03.01	To Balance c/d	87,750	31.03.01	By B's Capital A/c	87,750
		87,750			87,750
31.03.02	To Bank A/c (₹29,250 + ₹ 7,020)	36,270	1.04.01	By Balance b/d	87,750
	To Balance c/d (b/f)	58,500		By Interest A/c (87,750 × 8%)	7,020
		94,770			94,770
31.03.03	To Bank A/c (₹29,250 + ₹ 4,680)	33,930	1.04.02	By Balance b/d	58,500
	To Balance c/d (b/f)	29,250	31.3.03	By Interest A/c (58,500 × 8%)	4,680
		63,180			63,180
31.03.04	To Bank A/c (₹29,250 + ₹ 2,340)	31,590	1.04.03	By Balance b/d	29,250
			31.03.04	By Interest A/c (29,250 × 8%)	2,340
		31,590			31,590

Working Note:

B's share of goodwill amounting to ₹30,000 (i.e. $\frac{3}{9}$ of ₹90,000) has been credited to B and debited to A and C in their gaining ratio calculated as below:

$$A = \frac{3}{5} - \frac{4}{9} = \frac{27-20}{45} = \frac{7}{45}$$

$$C = \frac{2}{5} - \frac{2}{9} = \frac{18-10}{45} = \frac{8}{45}$$

Gaining Ratio = 7.8

Q7. What do you mean by Joint Life Policy? What is its treatment?

Answer:

- Partners may take joint life policy for in the time of death of partner in case death is before maturity.
- Premium is paid by firm and on death the amount is received from insurance company.

Treatment of JLP

(a) When premium paid is treated as on expense:

(i) **For payment of premium:**

– Joint Life Insurance Premium A/c Dr.
  To Bank A/c

– Profit / Loss A/c Dr.
  To Joint Life Insurance Premium A/c

(ii) **For receipt of policy money:**

Bank A/c Dr.
  To All Partners Capital A/c

(b) When premium paid is treated as an asset and surrender value is taken into account:

(i) **For payment of premium:**

Joint Life Policy A/c Dr.
  To Bank A/c

(ii) **At the year end, the amount in excess of surrendered value is treated as a loss and transferred to P/L A/c:**

Profit and Loss A/c Dr.
  To Joint Life Policy A/c

The balance in JLP A/c is shown as asset in the Balance Sheet.

(iii) **When amount is received from the insurance company:**

Bank A/c Dr.
  To Joint Life Policy A/c

(vi) **Amount received on maturity in excess of surrender value will be distributed among all the partners in their profit sharing ratio.**

Joint Life Policy A/c Dr.
  To All Partner's Capital A/c

(c) When premium is treated as an asset and Life Policy Reserve Account is maintained.

(i) **For payment of premium of Joint Life Policy**

Joint Life Policy A/c Dr.
  To Bank A/c

(ii) **At the year end an amount equal to the premium paid is appropriated and transferred to Policy Reserve Account:**

Profit/ Loss A/c Dr.
  To Joint Life Policy Reserve A/c

(iii) **The balance of Joint Life Policy Account and Joint Life Policy Reserve Account shall be made equal to the surrender value, for this purpose Joint Life Policy Account is credited and Joint Life policy Reserve Account is debited with an amount equal to the difference between balance of Joint Life Policy Account and surrender value.**

Joint Life Policy Reserve A/c Dr.
  To Joint Life Policy A/c

(iv) **When amount is received on maturity**

Bank A/c Dr.
  To Joint Life Policy A/c

(v) **Closing Joint Life Policy Reserve Account by transferring its balance to Joint Life Policy Account.**

Joint Life Policy Reserve A/c Dr.
  To Joint Life Policy A/c

(vi) **Balance remaining in Joint Life Policy A/c is distributed among partners.**

Joint Life Policy A/c Dr.
  To All Partners Capital A/c

Q8. What do you mean by Separate Life Policy?

Answer:

- Sometimes instead of taking joint life policy, policy is taken on life of individual partner, premium paid by firm.
- When partner retires he is entitled to surrender values of all the policies.

Illustration:

Raghav, Madhav and Mohan were in partnership sharing profits and losses in the proportions of 3:2:1. On 1st January, 1993, Madhav retires from the firm. On that date, their Balance Sheet was as follows:

Liabilities	₹	Assets		₹
Trade Creditors	3,000	Cash in hand		9,000
Bills Payable	2,700	Debtors	16,000	
Expenses Owing	4,500	*Less:* Provision	1,000	15,000
Reserve Fund	10,500	Stock		12,000
Workmen's		Factory Premises		22,500
Compensation Fund	4,800	Investment		8,000
Capital:		Loose Tools		4,000
Raghav 20,000				
Madhav 15,000				
Mohan 10,000	45,000			
	70,500			70,500

The terms were:

1. Goodwill of the firm to be valued at 2 times of Average Super Profits of last three years. Taking into consideration the risk of the business normal profits of the firm are estimated at ₹50,000 every year. But actual profits of last three were as 1990 – ₹60,000, 1991 – ₹55,000, 1992 – ₹ 57,500.
2. Expense owing to be brought down to ₹3,750.
3. Investments are revalued at ₹7,200. Raghav took over investments at this value.
4. Factory premises is to be revalued at ₹24,300; and loose tools at ₹ 3,600.
5. Provision for doubtful debts to be increased by ₹1,950.
6. Claim on account of workmen's compensation is ₹1,800.

7. Madhav to be paid ₹5,000 in cash and balance due to him treated as a loan carrying interest @ 6% per annum.

Show journal entry for goodwill adjustment. Prepare necessary ledger accounts and opening balance sheet of the continuing partners.

Solution:

Journal Entry for Goodwill

Particulars		₹	₹
Raghav's Capital A/c	Dr.	3,750	
Mohan Capital A/c	Dr.	1,250	
To Madhav's Capital A/c (W.N. 1)			5,000
(Madhav's share of goodwill adjusted to the accounts of continuing partners in their gaining ratio 3:1)			

Revaluation Account

Particulars	₹	Particulars		₹
To Investments A/c	800	By Expense owing A/c		750
To Loose Tools A/c	400	By Factory premises A/c		1,800
To Provision for doubtful debts A/c	1,950	By Loss transferred to:		
		Raghav	300	
		Madhav	200	
		Mohan	100	600
	3,150			3,150

Capital Accounts

Particulars	Raghav ₹	Madhav ₹	Mohan ₹	Particulars	Raghav ₹	Madhav ₹	Mohan ₹
To Revaluation A/c	300	200	100	By Balance b/d	20,000	15,000	10,000
To Madhav's Capital A/c	3,750	–	1,250	By Reserve Fund A/c	5,250	3,500	1,750
To Investment A/c	7,200	–	–	By Workmen's Compensation fund A/c	1,500	1,000	500
To Cash A/c	–	5,000	–				
To Madhav loan A/c	–	19,300	–				
To Balance c/d	15,500	–	10,900	By Raghav's Capital A/c	–	3,750	–
				By Mohan's Capital A/c	–	1,250	–
	26,750	24,500	12,250		26,750	24,500	12,250

Balance Sheet

Liabilities		₹	Assets		₹
Trade Creditors		3,000	Cash in hand		4,000
Bills Payable		2,700	Debtors	16,000	
Expenses owing		3,750	Less: Provision	2,950	13,050
Workmen's Compensation Claim		1,800	Stock		12,000
Madhav's Loan		19,300	Factory Premises		24,300
Capitals:			Loose Tools		3,600
Raghav	15,500				
Madhav	10,900	26,400			
		56,950			56,950

Working Notes: (i) Calculation of Goodwill:

Average Profits of the Past three years $= ₹\ \frac{60,000 + 55,000 + 57,500}{3}$

$= ₹57,500$

Super Profits $=$ Actual Profits – Normal Profits

$= ₹57,500 - ₹50,000$

$= ₹7,500$

Goodwill at 2 years purchase of Super Profits

$= ₹7,500 \times 2$

Profits $= ₹15,000$

Illustration:

Kamal, Naresh and Saurabh are partners sharing profits in the ratio of 3:2:1. Naresh retired from the firm due to his illness. On that date, the balance sheet of the firm was as follows:

Books of Kamal, Naresh and Saurabh
Balance Sheet as on March 31st, 2007

Liabilities		₹	Assets		₹
General Reserve		12,000	Bank		7,600
Sundry Creditors		15,000	Debtors	6,000	
Bills Payable		12,000	*Less:* Provision for Doubtful	400	5,600
Outstanding Salary		2,200	Stock		9,000
Provision for Legal Damages		6,000	Furniture		41,000
			Premises		80,000
Capitals:					
Kamal	46,000				
Naresh	30,000				
Saurabh	20,000	96,000			
		1,43,200			1,43,200

Additional Information:

(i) Premises have appreciated by 20%, stock depreciated by 10% and provision for doubtful debts has to be made 5% on debtors. Further, provision for legal damages is to be made for ₹11,200 and furniture to be brought upto ₹45,000.

(ii) Goodwill of the firm be valued at ₹42,000.

(iii) ₹26,000 from Naresh's capital account be transferred to his loan account and balance be paid through bank; if required, necessary loan may be obtained from bank.

(iv) New profit sharing ratio of Kamal and Saurabh is decided to be 5:1. Give necessary ledger accounts and balance sheet of the firm after Naresh's retirement. Kamal and Saurabh agreed that revised values of Assets and Liabilities are not be recorded in the books.

Solution:

Memorandum Revaluation Account

Particulars		₹	Particulars		₹
1st Part:			By Increase in the value of Assets and decrease in liabilities:		
To Decrease in the value of Assets and increase in liabilities:			Premises	16,000	
Stock	900		Provision for doubtful debts	100	
Provision for Legal Damages	1,200	2,100	Furniture	4,000	20,100
To Profit transferred to capital A/cs (3:2:1)					
Kamal	9,000				
Naresh	6,000				
Saurabh	3,000	18,000			
		20,100			20,100
2nd Part:			By Reversal of entry for decrease in the value of Assets and increase in liabilities		2,100
To Reversal of entry for increase in the value of Assets and decrease in liabilities		20,100	By Loss transferred to capital A/cs (5:1)		
			Kamal	15,000	
			Saurabh	3,000	18,000
		20,100			20,100

Capital Accounts

Particulars	Kamal ₹	Naresh ₹	Saurabh ₹	Particulars	Kamal ₹	Naresh ₹	Saurabh ₹
To Memorandum revaluation A/c (Profit written back)	15,000	–	3,000	By Balance b/d	46,000	30,000	20,000
To Naresh Capital A/c (Goodwill)	14,000	–		By General Reserve A/c	6,000	4,000	2,000
To Naresh's Loan A/c	–	26,000		By Memorandum Revaluation A/c (Profit)	9,000	6,000	3,000
To Bank A/c (2)(WN2)	–	28,000		By Kamal Capital A/c (Goodwill)	–	14,000	
To Balance (c/d) (b/f)	32,000	–	22,000				
	61,000	54,000	25,000		61,000	54,000	25,000

Balance Sheet
as on March 31st, 2007

Liabilities		₹	Assets		₹
Bank Loan (WN2)		20,400	Debtors	6,000	
Sundry Creditors		15,000	*Less:* Provision for Doubtful		
Bills Payable		12,000	Debts	400	5,600
Outstanding Salary		2,200	Stock		9,000
Provision for Legal Damages		6,000	Furniture		41,000
			Premises		80,000
Naresh's Loan A/c		26,000			
Capitals:					
Kamal	32,000				
Saurabh	22,000	54,000			
		1,35,600			1,35,600

Working Notes:

1. **Calculation of Gaining Ratio for Adjustment of Goodwill:**

Gaining Ratio = New Ratio – Old Ratio

Gaining Ratio of Kamal $= \frac{5}{6} - \frac{3}{6}$

$= \frac{2}{6}$

Gaining Ratio of Saurabh $= \frac{1}{6} - \frac{1}{6}$

$= 0$

Hence, Naresh's share of Goodwill ₹14,000 (i.e. 42,000 × $\frac{2}{6}$) will be debited entirely to Kamal Capital A/c, as he alone has gained on the retirement of Naresh. Entry will be:

Kamal Capital A/c	Dr.	14,000	
To Naresh Capital A/c			14,000

2. **Bank Loan is calculated as under:**

	₹
Bank balance as per Balance Sheet	7,600
Amount required to pay off the balance of Naresh Capital Account in full (as per Naresh Capital A/c)	28,000
Loan obtained from Bank	20,400

Illustration:

On 31st March, 1997, the Balance Sheet of M/s P, Q and R sharing profits and losses in the ratio of 2:3:2, stood as follows:

Liabilities		₹	Assets	₹
Capital Accounts:			Land & Building	1,00,000
P	1,00,000		Machinery	1,70,000
Q	1,50,000		Stock-in-Trade	50,000
R	1,00,000	3,50,000	Sundry Debtors	60,000
Sundry Creditors		50,000	Cash and Bank Balances	20,000
		4,00,000		4,00,000

On 31st March, 1997, Q desired to retire from the firm and the remaining partners decided to carry on. It was agreed to revalue the assets and liabilities on that date on the following basis:

1. Land and building be appreciated by 30%.
2. Machinery be depreciated by 20%.
3. Stock to be valued at ₹45,000
4. Provision for bad debts be made at 5%
5. Old credit balance of sundry creditors ₹5,000 be written back.
6. Joint Life Policy of the partners (not included in the Balance Sheet) surrendered and cash obtained ₹35,000.
7. Goodwill of the entire firm be valued at ₹63,000 and Q's share of the goodwill be adjusted in the accounts of P and R, who share the future profits and losses in the ratio of 3:2. No Goodwill Account being raised.
8. The total capital of the firm is to be the same as before retirement individual capital be in their profit sharing ratio.
9. Amount due to Q is to be settled on the following basis 50% on retirement and the balance 50% within one year.

Pass journal entries and prepare Capital Accounts of partners, Cash Account and Balance Sheet as on 01.04.1997 of M/s P and R.

Solution:

Journal Entries

Date	Particulars		Dr. (₹)	Cr. (₹)
31.03.97	Land & Building A/c	Dr.	30,000	
	Sundry Creditors A/c	Dr.	5,000	
	To Revaluation A/c			35,000
	(Increase in the value of assets and decrease in liabilities)			
31.03.97	Revaluation A/c	Dr.	42,000	
	To Machinery A/c			34,000
	To Stock-in-Trade A/c			5,000
	To Provision for bad debts A/c			3,000
	(Decrease in the value of assets)			

Date	Particulars		Dr. (₹)	Cr. (₹)
31.03.97	P's Capital A/c	Dr.	2,000	
	Q's Capital A/c	Dr.	3,000	
	R's Capital A/c	Dr.	2,000	
	To Revaluation A/c			7,000
	(Loss on revaluation transferred to Capital Account)			
31.3.97	Bank A/c	Dr.	35,000	
	To Joint Life Policy A/c			35,000
	(Amount of policy realised)			
31.3.97	Joint Life Policy A/c	Dr.	35,000	
	To P's Capital A/c			10,000
	To Q's Capital A/c			15,000
	To R's Capital A/c			10,000
	(Transfer of Policy Account to all Partner's Capital Accounts)			
31.3.97	P's Capital A/c	Dr.	19,800	
	R's Capital A/c	Dr.	7,200	
	To Q's Capital A/c			27,000
	(Q's share of goodwill adjusted to the accounts of continuing partners in their gaining ratio 11:4) (W.N.1)			
31.3.97	Bank A/c	Dr.	1,61,000	
	To P's Capital A/c			1,21,800
	To R's Capital A/c			39,200
	(Amount brought in by P and R to bring their capitals to new profit sharing ratio) (WN2)			

31.3.97	Q's Capital A/c Dr. To Bank A/c To Q's Loan A/c (50% amount paid to Q and the balance transferred to his loan account)	1,89,000	 94,500 94,500

Capital Accounts

Particulars	P	Q	R	Particulars	P	Q	R
	₹	₹	₹		₹	₹	₹
To Revaluation A/c	2,000	3,000	2,000	By Balance b/d	1,00,000	1,50,000	1,00,000
To Q's Capital A/c (Goodwill)	19,800	–	7,200	By Joint Life Policy A/c	10,000	15,000	10,000
To Balance(c/d) (b/f)	88,200	1,89,000	1,00,800	By P's Capital A/c (Goodwill)	–	19,800	–
				By R's Capital A/c (Goodwill)	–	7,200	–
	1,10,000	1,92,000	1,10,000		1,10,000	1,92,000	1,10,000
To Bank A/c	–	94,500	–	By Balance b/d	88,200	1,89,000	1,00,800
To Q's Loan A/c	–	94,500	–	By Bank A/c (Balancing figure)	1,21,800	–	39,200
To Balance c/d	2,10,000	–	1,40,000				
	2,10,000	1,89,000	1,40,000		2,10,000	1,89,000	1,40,000

Capital and Bank Accounts

Particulars	₹	Particulars	₹
To Balance b/d	20,000	By Q's Capital A/c	94,500
To Joint Life policy A/c	35,000	By Balance c/d (b/f)	1,21,500
To P's Capital A/c	1,21,800		
To P's Capital A/c	39,200		
	2,16,000		2,16,000

Balance Sheet of P and R as on 1st April, 1997

Liabilities		₹	Assets		₹
Capital Accounts:			Land and Building		1,30,000
P	2,10,000		Machinery		1,36,000
R	1,40,000	3,50,000	Stock-in-Trade		45,000
Q's Loan		94,500	Sundry Debtors	60,000	
Sundry Creditors		45,000	Less: Provision	3,000	57,000
			Cash and Bank balance		1,21,500
		4,89,500			4,89,500

Working Notes:

1. **Calculation of Gaining Ratio on Q's retirement:**

Gaining Ratio = New - Ratio - Old Ratio

P Gains $= \frac{3}{5} - \frac{2}{7}$

$= \frac{21 - 10}{35}$

$= \frac{11}{35}$

R Gains $= \frac{2}{5} - \frac{2}{7}$

$= \frac{14 - 10}{35}$

$= \frac{4}{35}$

Hence, Gaining Ratio between P and R = 11:4

2. **Adjustment of capitals according to new profit sharing ratio:**

Total capital of the firm is to be the same as before retirement which is ₹3,50,000.

Therefore P's Capital in the new firm should be $\frac{3}{5}$th of 3,50,000

P's Existing Capital	=	₹2,10,000
P will bring in	=	88,200
	=	1,21,800

R's Capital in the new firm should be $\frac{2}{5}$th of 3,50,000

	= 1,40,000
R's Existing Capital	= 1,00,800
Hence, R will bring in	= 39,200

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. How unrecorded assets are treated at the time of retirement of a partner?
   (a) Credited to revaluation account
   (b) Credited to capital account of retiring partner only
   (c) Debited to revaluation account
   (d) Credited to partner's capital account
2. A, B and C are partners sharing profits in the ratio of 2 : 2 : 1. On retirement of B, goodwill was valued as ₹30,000. Find the contribution of A and C to compensate B:
   (a) ₹20,000 and ₹10,000
   (b) ₹8,000 and ₹4,000
   (c) No contribution
   (d) ₹15,000 and ₹15,000
3. Outgoing partner is compensated for parting with firm's future profits in favour of remaining partners.
   The remaining partners contribute to such compensation in:
   (a) Gaining Ratio
   (b) Capital Ratio
   (c) Sacrificing Ratio
   (d) Profit sharing Ratio

4. X, Y, Z are partners sharing profits and losses equally. They took a joint life policy of ₹5,00,000 with a surrender value of ₹3,00,000. The firm treats the insurance premium as an expense. Y retired and X and Z decided to share profits and losses in 2 : 1. The amount of Joint life policy will be transferred as:
   (a) Credited to X, Y and Z's Capital accounts with ₹1,00,000 each
   (b) Credited to X, Y and Z's capital accounts with ₹1,66,667 each
   (c) Credited to X, and Z capital accounts with ₹2,50,000 each
   (d) Credited to Y's capital account with ₹3,00,000 each
5. X, Y, Z were partners sharing profits in ratio 5 : 3 : 2. Goodwill does not appear in books, but it is agreed to be worth ₹1,00,000. X retires from the firm and Y and Z decide to share future profits equally. X's share of goodwill will be debited to Y's and Z's capital A/cs in ratio:
   (a) ½ : ½
   (b) 2 : 3
   (c) 3 : 2
   (d) None
6. A, B, C are partners sharing profits in the ratio of 2 : 2 : 1. A's capital is 50,000, B's Capital ₹70,000 and C ₹35000. B retires from the firm and balance in reserve on the date was ₹25,000. If goodwill of the firm was ₹30,000 and profit on revaluation was ₹7,500 then amount payable to B is:
   (a) ₹70,820
   (b) ₹76,000
   (c) ₹75,000
   (d) ₹95,000
7. A, B and C are partners sharing profits and losses in the ratio of 1/2, 3/10 and 1/5. B retires from the firm, A and C decide to share the future profits and losses in 3 : 2. Calculate gaining ratio:
   (a) 1 : 2
   (b) 3 : 2
   (c) 2 : 3
   (d) None

8. A, B, and C are partners with capitals of ₹1,00,000, ₹75,000 and ₹50,000. On C's retirement his share is acquired by A and B in the ratio of 6 : 4. Gaining ratio will be:
   (a) 3 : 2
   (b) 2 : 2
   (c) 2 : 3
   (d) None
9. At the time of retirement of a partner, firm gets _____ from the insurance company against the joint life policy taken jointly for all the partners:
   (a) Policy value for the retiring partner and surrender value for the rest
   (b) Surrender value
   (c) Policy amount
   (d) None of these
10. A, B and C are partners sharing profits equally. A retires and goodwill appearing in the books at ₹3000 is valued at ₹6000. A will get credit of:
   (a) ₹2,000
   (b) ₹3,000
   (c) ₹500
   (d) ₹1,000
11. X,Y,Z are partners sharing profits in the ratio 3:4:3 Y retires, and X and Z share his profits in equal ratio. Find the new ratio of X and Z.
   (a) 1:2
   (b) 2:1
   (c) 3:1
   (d) 1:1
12. X, Y, Z are equal partners in a firm. Z retires from the firm. The new profit sharing ratio between X and Y is 1:2 Find the gaining ratio.
   (a) 3:2
   (b) 2:1
   (c) 4:1
   (d) Only B gains by 1/3
13. A, B and C were partners in a firm sharing profits and losses in the ratio of 2:2:1. The capital balances of A, B and C are ₹50,000, ₹50,000 and ₹25,000 respectively. B declared to retire from the firm on 1st April,

2008. Balance in reserve on the date was ₹15,000. If goodwill of the firm was valued as ₹30,000 and profit on revaluation was ₹7,050, then what amount will be transferred to the loan account of B.
   (a) ₹70,820
   (b) ₹50,820
   (c) ₹25,820
   (d) ₹20,820
14. Hari, Roy and Prasad are partners in the ratio of 3:5:1 respectively. Roy wants to retire. His share is being purchased by Prasad. What would be the new ratio of Hari and Prasad respectively?
   (a) 1:2
   (b) 2:1
   (c) 3:5
   (d) Equal
15. When the goodwill is raised at its full value and written off at retirement of a partner, the remaining partners share goodwill in _____.
   (a) Old profit sharing Ratio
   (b) New profit sharing Ratio
   (c) Gaining Ratio
   (d) Equally.
16. If the firm gets dissolved due to retirement of one the partners, then what amount of JLP will be credited in partner's capital A/c?
   (a) Maturity value
   (b) Surrender value
   (c) Policy value
   (d) None of these.
17. P, Q and R were partners sharing profit and losses in the ratio of 2 : 2 :1 respectively, with the balance of capital ₹75,000, ₹50,000 and ₹25,000 respectively on 1st April 2011. Q decided to retire from the firm on 31st March 2012. On that day the balance in the reserve account was ₹12,000. If the goodwill of the firm was valued as ₹30,000 and profit on revaluation was ₹10,000, then what amount would be transferred to the loan account of Q?
   (a) ₹70,800

(b) ₹95,800
(c) ₹60,400
(d) ₹35,400

18. A, B and C are partners in a firm sharing profits and losses in the ratio of 5 : 3 : 2 respectively. The balance of capital is ₹50,000 for A and B each and ₹40,000 for C. B declares to retire from the firm. The goodwill of the firm is valued at ₹30,000 and profit on revaluation of assets is ₹ 5,000. The firm also has a balance in the reserve account for ₹15,000 on that date. What amount will be payable to B?
(a) ₹15,000
(b) ₹55,000
(c) ₹65,000
(d) ₹75,000

19. A, B and C were partners sharing profits and losses in the ratio of 3 : 2 : 1. On 1st April, 2011 B retired and the new profit sharing ratio between A and C decided to 3 : 2.
On 31st March 2011, there were reserves of firm ₹24,000. This reserve will be divided among partners as:
(a) A – ₹8,000, B – ₹12,000, C – ₹4,000
(b) A – ₹4,000, B – ₹8,000, C – ₹12,000
(c) A – ₹12,000, B – ₹8,000, C – ₹4,000
(d) A – ₹10,000, B – ₹10,000, C – ₹4,000

20. Under ___________ the premium paid is treated as an ordinary expense and joint life policy does not appear as an asset in the Balance Sheet of the firm:
(a) Ordinary business expense method
(b) Surrender value method
(c) Joint life policy reserve method
(d) Sinking fund method.

21. Andy, Tom and Bob were partners sharing profits and losses in the ratio 2 : 2 : 1. Tom died on 1st February, 2014. The firm had taken insurance policies on the lives of the partner, premium being charged to Profit and Loss A/c every years. The policy amount and surrender value as on 1st February, 2014 were as follows:

Policy holder	Policy Amount (₹)	Surrender Value (₹)
Andy	5 Lacs	50,000
Tom	7 Lacs	70,000
Bob	4 Lacs	40,000

Amount payable to Tom's legal representatives regarding insurance policies would be:
(a) ₹7,00,000
(b) ₹2,88,000
(c) ₹6,40,000
(d) ₹3,16,000

22. A, B and C were partners in a firm sharing profit and loss in the ratio of 3 : 2 : 1 respectively. A retired and firm received the Joint Life Policy as ₹1,52,500 appearing in the balance sheet at ₹1,80,000. Joint Life Policy is credited and cash debited with ₹1,52,500, what willbe the treatment for the balance of Joint Life Policy?
(a) Credited to partner's current account in profit sharing ratio
(b) Debited to revaluation account
(c) Debited to partner's current account in profit sharing ratio.
(d) Either (b) or (c)

23. X, Y and Z take a Joint Life Policy. After 3 years, Z retires from the firm. Old profit sharing ratio is 3 : 2: 1. After retirement, X and Y decide to share profits equally. They had taken a Joint Life Policy of ₹5,00,000 with a surrender value of ₹40,000. What will be the treatment in the partner's capital account on receiving the JLP amount if JLP account is maintained at surrender value in the books of the firm?
(a) ₹5,00,000 credited to all the partners in their old ratio.
(b) ₹4,00,000 credited to all the partners in their old ratio.
(c) ₹40,000 credited to all the partners in their old ratio.
(d) None of the above.

24. Rohit, Amit and Sumit were partners sharing profits and losses in the ratio of 2:1:1. Rohit died on 30th September, 2015. The firm had taken out a Joint Life Policy of ₹1,00,000. Besides, the partner had severally

insured their lives for ₹50,000 each, the premium in respect of which being changed to Profit and Loss Account of the firm. The surrender value of the policies were 30% of the face value.
Ascertain Rohit's share in the Joint Life Policy profits:
(a) ₹37,500
(b) ₹1,80,000
(c) ₹1,15,000
(d) ₹90,000

25. A, B, and C are partners in a firm, sharing profits and losses, in ratio of 5:3:2 respectively. The balance of capital is ₹50,000 for A and B each and 40,000 for C . 'B' decided to retire from firm. The goodwill of firm is valued at ₹30,000 and profit on revaluation of assets at ₹5,000. The firm also has a balance in reserve A/c for ₹15,000 as on that date. What amount will be payable to B?
(a) ₹45,000
(b) ₹65,000
(c) ₹55,000
(d) ₹75,000

26. P, Q and R are partners in a firm with capitals of ₹50,000, ₹30,000 and ₹25,000 respectively, sharing profits and losses in ratio of 2:2:1. General reserve ₹15,000. Goodwill ₹30,000, revaluation profit ₹7,050. Q is retiring from the firm amount payable to Q is:
(a) ₹70,820
(b) ₹50,820
(c) ₹25,820
(d) ₹20,820

27. Outgoing partner is compensated for parting with firm's future profits in favour of the remaining partners. The remaining partners contribute to such compensation amount in ________.
(a) Profit sharing ratio
(b) Capital ratio
(c) Gaining ratio
(d) Sacrificing ratio

Answer

1	(a)	**2**	(b)	**3**	(a)	**4**	(a)	**5**	(b)
6	(d)	**7**	(a)	**8**	(a)	**9**	(b)	**10**	(d)
11	(d)	**12**	(d)	**13**	(a)	**14**	(a)	**15**	(c)
16	(b)	**17**	(a)	**18**	(c)	**19**	(c)	**20**	(a)
21	(d)	**22**	(d)	**23**	(d)	**24**	(d)	**25**	(b)
26	(b)	**27**	(c)						

Short Practice Questions

1. What is Joint Life Policy?
2. State different method of Payment made to retiring partner.

Past Year Questions and Answers

Objective Questions

2001 - May [5] State with reasons whether the following statement is true or false:
(6) If a partner retires, then other partners have a gain in their profit sharing ratio. (2 marks)

Answer:

True: If a partner retires, the share of his profit or loss will be shared by other partners in their profit sharing ratio.

PRACTICAL QUESTIONS

1995 - May [2] On 31st March, 1995 the Balance Sheet of M/s. A, B & C sharing profits and losses in proportion to their capitals, stood as follows:

		₹		₹
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	7,00,000	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, 1995, 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 that date on the following basis:

1. Land and Buildings be appreciated by 30%.
2. Machinery be depreciated by 20%.
3. Closing stock to be valued at ₹75,000.
4. Provision for bad debts be made at 5%.
5. Old credit balances of Sundry Creditors ₹20,000 be written back.
6. Joint Life Policy of the partners surrendered and cash obtained ₹ 80,000.
7. 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.
8. The total capital of the firm is to be the same as before retirement. Individual capital be in their profit sharing ratio.

9. Amount due to A is to be settled on the following basis: 50% on retirement and the balance 50% within one year.

Prepare Revaluation Account, Capital Accounts of Partners, Cash Account and Balance Sheet as on 1.4.1995 of M/s. B & C. (20 marks)

QR Code for Solution Video

Answer:

M/s. ABC
Revaluation Account

Particulars		₹	Particulars	₹
To Machinery A/c		60,000	By Land and Buildings	60,000
To Closing Stock		25,000	By Sundry Creditors	20,000
To Provision for bad debts		5,000	By Cash and Bank A/c:	
To Partner's Capital A/cs:			– Joint life policy surrendered	80,000
Profit on revaluation				
A (2/7)	20,000			
B (3/7)	30,000			
C (2/7)	20,000	70,000		
		1,60,000		1,60,000

Partners Capital Accounts

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To A's Capital A/c	—	10,000	30,000	By Balance b/d	2,00,000	3,00,000	2,00,000
To Cash and Bank A/c 50% of dues paid	1,30,000			By Revaluation A/c	20,000	30,000	20,000
To A's Loan A/c balance transferred	1,30,000			By B & C's Capital A/c	40,000	—	—
To Balance c/d	—	3,50,000	3,50,000	By Cash & Bank A/c amount brought in	—	30,000	1,60,000
	2,60,000	3,60,000	3,80,000		2,60,000	3,60,000	3,80,000

Cash and Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	1,00,000	By A's Capital A/c - 50% due paid	1,30,000
To Revaluation A/c: Surrender value of 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 M/s B & C
As on 1st April, 1995

Liabilities		₹	Assets		₹
Partner's Capital A/cs:			Land and Buildings		2,60,000
B	3,50,000		Machinery		2,40,000
C	3,50,000	7,00,000	Closing Stock		75,000
A's Loan A/c		1,30,000	Sundry Debtors	1,00,000	
Sundry Creditors		80,000	Less: Provision for bad debts	5,000	95,000
			Cash and Bank Balances		2,40,000
		9,10,000			9,10,000

Working Notes:

Adjustment for Goodwill:

Goodwill of the firm	₹1,40,000
A's Share (2/7)	₹ 40,000

Gaining ratio of B & C:

$B = \frac{1}{2} - \frac{3}{7} = \frac{1}{14}$

$C = \frac{1}{2} - \frac{2}{7} = \frac{3}{14}$

So B:C = 1:3

Therefore, B should bear = $\frac{1}{4} \times$ ₹40,000 = ₹10,000

and C should bear = $\frac{3}{4} \times$ ₹40,000 = ₹30,000

1996 - Nov [2] 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, 1996 is as under:

		₹		₹
Capital:			Land	10,000
Mr. A	80,000		Buildings	2,00,000
Mr. B	20,000		Plant and Machinery	1,30,000
Mr. C	30,000	1,30,000	Furniture	43,000
Reserves (Unappropriated Profit)		20,000	Investments	12,000
Long Term Debt		3,00,000	Stock	1,30,000
Bank Overdraft		44,000	Debtors	1,39,000
Trade Creditors		1,70,000		
	Total ₹	6,64,000	Total ₹	6,64,000

It was mutually agreed that Mr. B will retire from partnership, and in his place Mr. D will be admitted as a partner with effect from 1st April, 1996. For this purpose, the following adjustments are to be made:

(i) Goodwill is to be valued at ₹1 lakh but the same will not appear as an asset in the books of the reconstituted firm.

(ii) 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 ₹15,000. Provision of 20 percent is to be made on debtors to cover doubtful debts.

(iii) 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.

(iv) The surplus funds, if any, will be used for repaying the Bank Overdraft.

(v) The amount due to the retiring partner shall be transferred to his loan account.

You are to prepare:

(a) Revaluation A/c;

(b) Partner's Capital Accounts;

(c) Bank Account; and

(d) Balance Sheet of the reconstituted firm as on 1st April, 1996.

(20 marks)

QR Code for Solution Video

Answer:

Revaluation Account

Dr. **Cr.**

Particulars	₹	Particulars		₹
To Buildings A/c	10,000	By Investments A/c		3,000
To Plant and Machinery A/c	26,000	By Loss to Partners:		
To Provision for Doubtful Debts A/c	27,800	A	30,400	
		B	18,240	
		C	12,160	60,800
	63,800			63,800

A's Capital Account

Particulars	₹	Particulars	₹
To Revaluation A/c	30,400	By Balance b/d	80,000
To Goodwill A/c	40,000	By Reserves A/c	10,000
To Balance c/d	80,000	By Goodwill A/c	50,000
		By Bank A/c (Bal. figure)	10,400
	1,50,400		1,50,400

B's Capital Account

Particulars	₹	Particulars	₹
To Revaluation A/c	18,240	By Balance b/d	20,000
To Investments A/c	15,000	By Reserves A/c	6,000
To B's Loan A/c	22,760	By Goodwill A/c	30,000
	56,000		56,000

C's Capital Account

Particulars	₹	Particulars	₹
To Revaluation A/c	12,160	By Balance b/d	30,000
To Goodwill A/c	40,000	By Reserves A/c	4,000
To Balance c/d	80,000	By Goodwill A/c	20,000
		By Bank A/c	78,160
	1,32,160		1,32,160

D's Capital Account

Particulars	₹	Particulars	₹
To Goodwill A/c	20,000	By Bank A/c	60,000
To Balance c/d	40,000		
	60,000		60,000

Bank Account

Particulars	₹	Particulars	₹
To A's Capital A/c	10,400	By Bank Overdraft A/c	44,000
To C's Capital A/c	78,160	By Balance c/d	1,04,560
To D's Capital A/c	60,000		
	1,48,560		1,48,560

Balance Sheet of Dowell & Co.
As on 1st April 1996

Liabilities	₹	Assets		₹
Capital Account:		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	1,70,000	Debtors	1,39,000	
B's Loan Account	22,760	*Less:* Provision for Doubtful Debts	27,800	1,11,200
		Balance at Bank		1,04,560
	6,92,760			6,92,760

1997 - May [2] On 31st March, 1997 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:			Land and Buildings	10,00,000
Ram	10,00,000		Machinery	17,00,000
Hari	15,00,000		Closing Stock	5,00,000
Mohan	10,00,000	35,00,000	Sundry Debtors	6,00,000
Sundry Creditors		5,00,000	Cash and Bank Balances	2,00,000
		40,00,000		40,00,000

On 31st March, 1997 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:

1. Land & Buildings be appreciated by 30%.
2. Machinery be depreciated by 20%.
3. Closing Stock to be valued at ₹4,50,000.
4. Provision for bad debts be made at 5%.
5. Old credit balances of Sundry Creditors ₹50,000 be written back.
6. Joint Life Policy of the partners surrendered and cash obtained ₹ 3,50,000.
7. Goodwill of the entire firm be valued at ₹6,30,000 and Hari's share of the Goodwill be adjusted in the accounts of Ram and Mohan who share the future profits & losses in the ratio of 3:2. No Goodwill Account being raised.
8. The total capital of the firm is to be the same as before retirement. Individual capital be in their profit sharing ratio.
9. Amount due to Hari is to be settled on the following basis: 50% on retirement and the balance 50% within one year.

Prepare Revaluation Account, Capital Accounts of Partners, Cash Account and Balance Sheet as on 1-4-1997 of M/s Ram & Mohan. (15 marks)

Answer :

Revaluation Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Machinery A/c	3,40,000	By Land and buildings A/c	3,00,000
To Closing Stock A/c	50,000	By Sundry Creditors A/c	50,000
To Provision for Bad Debts A/c	30,000	By Partner's Capitals A/cs:	
		Ram	20,000
		Hari	30,000
		Mohan	20,000
	4,20,000		4,20,000

Dr. **Partner's Capital Accounts** **Cr.**

Particulars	Ram ₹	Hari ₹	Mohan ₹	Particulars	Ram ₹	Hari ₹	Mohan ₹
To Hari's Capital A/c	1,98,000	–	72,000	By Balance b/d	10,00,000	15,00,000	10,00,000
To Revaluation A/c	20,000	30,000	20,000	By Joint Life Policy A/c	1,00,000	1,50,000	1,00,000
To Cash & Bank A/c	–	9,45,000	–	By Ram's Capital	–	1,98,000	–
To Hari's Loan A/c	–	9,45,000	–	By Mohan's Capital A/c	–	72,000	–
To Balance c/d	21,00,000	–	14,00,000	By Cash & Bank A/c (Bal. figure)	12,18,000	–	3,92,000
	23,18,000	19,20,000	14,92,000		23,18,000	19,20,000	14,92,000

Dr. **Cash And Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	2,00,000	By Hari's Capital A/c	9,45,000
To Joint Life policy A/c	3,50,000	By Balance c/d	12,15,000
To Ram's Capital A/c	12,18,000		
To Mohan's Capital A/c	3,92,000		
	21,60,000		21,60,000

M/s Ram & Mohan
Balance Sheet as on 1st April, 1997

Liabilities		₹	Assets		₹
Capital Accounts:			Land and buildings		13,00,000
Ram	21,00,000		Machinery		13,60,000
Mohan	14,00,000	35,00,000	Closing Stock		4,50,000
Sundry Creditors		4,50,000	Sundry Debtors	6,00,000	
Hari's Loan A/c		9,45,000	*Less:* Provision for Bad Debts	30,000	5,70,000
			Cash and Bank Balances		12,15,000
		48,95,000			48,95,000

Working Notes:

1. Gaining ratio of existing partners:

Ram 3/5 - 2/7	=	11/35
Mohan 2/5 - 2/7	=	4/35

2. Adjustment of goodwill

Total goodwill of the firm	=	6,30,000
Hari's share (3/7 × 6,30,000)	=	2,70,000

Hari's share of goodwill is to be borne by Ram and Mohan is their gaining ratio i.e. 11:4

Ram = 11/15 × 2,70,000	=	1,98,000
Mohan = 4/15 × 2,70,000	=	72,000

1998 - May [2] A, B and C were in partnership sharing profits in the proportions of 5 : 4 : 3. The Balance Sheet of the firm as on 31st March, 1998 was as under:

Liabilities		₹	Assets	₹
Capital:	A	1,35,930	Goodwill	40,000
	B	95,120	Fixtures	8,200
	C	61,170	Stock	1,57,300
Sundry Creditors		41,690	Sundry Debtors	93,500
			Cash	34,910
		3,33,910		3,33,910

A had been suffering from ill-health and gave notice that he wished to retire. An agreement was, therefore, entered into as on 31st March, 1998, the terms of which were as follows:

(i) The Profit and Loss Account for the year ended 31st March, 1998 which showed a net profit of ₹48,000 was to be re-opened. B was to be credited with ₹4,000 as bonus, in consideration of the extra work which had devolved upon him during the year. The profit-sharing ratio was to be revised as from 1st April, 1998 to 3 : 4 : 4.

(ii) Goodwill was to be valued at two years' purchase of the average profits of the preceding five years. The Fixtures were to be valued by an independent valuer. A provision of 2% was to be made for doubtful debts and the remaining assets were to be taken at their book values.

The valuations arising out of the above agreement were Goodwill ₹ 56,800 and Fixtures ₹10,980.

B and C agreed, as between themselves, to continue the business, sharing profits in the ratio of 3 : 2 and decided to eliminate Goodwill from the Balance Sheet, to retain the Fixtures on the books at the revised value, and to increase the provision for doubtful debts to 6%.

You are required to submit the journal entries necessary to give effect to the above arrangements and to draw up the capital account of the partners after carrying out all adjusting entries as stated above. (15 marks)

Answer :

Journal Entries

	Particulars		₹	₹
(i)	A's Capital A/c	Dr.	20,000	
	B's Capital A/c	Dr.	16,000	
	C's Capital A/c	Dr.	12,000	
	To Profit and Loss Adjustment A/c			48,000
	(Being Profit written back for adjustments)			
(ii)	Profit and Loss Adjustment A/c	Dr.	4,000	
	To B's Capital A/c			4,000
	(Being Bonus credited to B's Capital Account)			
(iii)	Profit and Loss Adjustment A/c	Dr.	44,000	
	To A's Capital A/c			12,000
	To B's Capital A/c			16,000
	To C's Capital A/c			16,000
	(Being Distribution of profits in the new ratio)			

	Particulars		₹	₹
(iv)	Goodwill A/c	Dr.	16,800	
	Fixtures A/c	Dr.	2,780	
	To Provision for Bad Debts A/c			1,870
	To A's Capital A/c			4,830
	To B's Capital A/c			6,440
	To C's Capital A/c			6,440
	(*Being Revaluation of asset on A's retirement)			
(v)	A's Capital A/c	Dr.	1,32,760	
	To A's Loan A/c			1,32,760
	(Being Transfer of A's Capital Account to his Loan A/c)			
(vi)	B's Capital A/c	Dr.	36,324	
	C's Capital A/c	Dr.	24,216	
	To Goodwill A/c			56,800
	To Provision for Bad Debts A/c			3,740
	(Being goodwill written off and provision for bad debts raised)			

Partner's Capital Accounts

Dr. | Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Profit & Loss Adjustment A/c	20,000	16,000	12,000	By Balance b/d	1,35,930	95,120	61,170
To A's Loan A/c	1,32,760	–	–	By Profit & Loss Adjustment A/c	–	4,000	–
To Goodwill A/c & and Provision for bad Debts A/c	–	36,324	24,216	By Profit & Loss Adjustment A/c	12,000	16,000	16,000
To Balance c/d	–	69,236	47,394	By Goodwill A/c and Fixture A/c	4,830	6,440	6,440
	1,52,760	1,21,560	83,610		1,52,760	1,21,560	83,610

1999 - Nov [2] K, L and M are partners sharing Profits and Losses in the ratio 5:3:2. Due to illness, L wanted to retire from the firm on 31.3.99 and admit his son N in his place.

Balance Sheet of K, L and M as on 31.3.99

Liabilities		₹	Assets	₹
Capital:			Goodwill	30,000
K	40,000		Furniture	20,000
L	60,000		Sundry Debtors	50,000
M	30,000	1,30,000	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.

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.

Pass necessary Journal Entries and prepare Balance Sheet of M/s K, M, N as on 01.04.99. Show necessary workings. **(15 marks)**

Answer :

Journal Entries

Date	Particulars		Dr. ₹	Cr. ₹
(i)	Goodwill A/c	Dr.	20,000	
	To Profit and Loss Adjustment A/c			20,000
	(Being revaluation of goodwill on L's retirement)			
(ii)	Profit and Loss Adjustment A/c	Dr.	30,000	
	To Furniture A/c			10,000
	To Stock in Trade A/c			20,000
	(Being revaluation of furniture and stock-in-trade recorded)			

(iii)	K's Capital A/c	Dr.	5,000	
	L's Capital A/c	Dr.	3,000	
	M's Capital A/c	Dr.	2,000	
	To Profit and Loss Adjustment A/c			10,000
	(Being net revaluation loss debited to partners capital account on the ratio of 5:3:2)			
(iv)	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 reserve transferred to Partners capital accounts)			
(v)	L's Capital A/c	Dr.	72,000	
	To Cash A/c			36,000
	To N's Capital A/c			36,000
	(Being 50% of the amount due to L paid off in cash and the balance retained in the firm as capital of N)			
(vi)	K's Capital A/c	Dr.	25,000	
	M's Capital A/c	Dr.	10,000	
	N's Capital A/c	Dr.	15,000	
	To Goodwill A/c			50,000
	(Being goodwill written off, as agreed after retirement of L and admission of N in the new profit sharing ratio)			
(vii)	M's Capital A/c	Dr.	14,000	
	To Bank/Cash A/c			14,000
	(Being amount paid to M to make his capital proportionate)			

Balance Sheet M/s K, M N
As on 1st April, 1999

Liabilities		₹	Assets	₹
Capital Account:			Furniture	10,000
K	35,000		Sundry Debtors	50,000
M	14,000		Stock in Trade	30,000
N	21,000	70,000		
Sundry Creditors		20,000		
		90,000		90,000

Working Notes:

Partner's Capital Accounts

Particulars	K ₹	L ₹	M ₹	N ₹	Particulars	K ₹	L ₹	M ₹	N ₹
To Profit & Loss Adjustment A/c	5,000	3,000	2,000	–	By Balance b/d	40,000	60,000	30,000	–
To Cash A/c	–	36,000	–	–	By Reserve	25,000	15,000	10,000	–
To N's Capital A/c	–	36,000	–	–	By L's Capital A/c	–	–	–	36,000
To Goodwill A/c	25,000	–	10,000	15,000					
To Bank (Bal. figure)	–	–	14,000	–					
To Balance c/d	35,000	–	14,000	21,000					
	65,000	75,000	40,000	36,000		65,000	75,000	40,000	36,000

2002 - May [2] 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 30th June 2001 was as under:

Balance Sheet of X and Co. as on 30-6-2001

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 July, 2001. For this purpose, the following adjustments are to be made:

(a) 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.

(b) 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.

(c) 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.

(d) The surplus funds, if any, will be used for repaying bank overdraft.

(e) 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 July, 2001. (20 marks)

Answer:

(1)

Revaluation Account

Dr.		₹				Cr. ₹
2001 July 1			2001 July 1			
To	Building	20,000	By	Investments (25,000 - 22,000)		3,000
To	Planct and machinery	57,000	By	Partners' capital accounts:		
To	Bad debts	13,900		Loss on revaluation		
				A (3/10)	26,370	
				B (2/10)	17,580	
				C (5/10)	43,950	87,900
		90,900				90,900

(2)

Partners' Capital Accounts

Dr.	A ₹	B ₹	C ₹	D ₹		A ₹	B ₹	C ₹	D ₹ Cr.
To Revaluation A/c	26,370	17,580	43,950	-	By Balance b/d	1,04,000	76,000	1,40,000	-
To B's and C's Capital A/cs				60,000	By D's Capital A/c (W.N. 1)	-	40,000	20,000	-
To Investments A/c		25,000			By Bank A/c	12,370		3,950	1,50,000
To B's Loan A/c		73,420							
To Balance c/d (W.N. 2)	90,000		1,20,000	90,000					
	1,16,370	1,16,000	1,63,950	1,50,000		1,16,370	1,16,000	1,63,950	1,50,000

(3)

Bank Account

Dr.			Cr.
To A's Capital A/c	12,370	By Balance b/d (overdraft)	44,000
To C's Capital A/c	3,950	By Balance c/d	1,22,320
To D's Capital A/c	1,50,000		
	1,66,320		1,66,320

(4)

Balance Sheet of M/s X and Co. as at 1st July, 2001

Liabilities		₹	Assets		₹
Capital A/c:			Land		1,00,000
A	90,000		Building	2,00,000	
B	1,20,000		*Less:* Depreciation	20,000	1,80,000
C	90,000	3,00,000	Plant and Machinery	3,80,000	
Long term loan		4,00,000	*Less:* Depreciation	57,000	3,23,000
B's Loan account		73,420	Stock		1,16,000
Trade Creditors		1,93,000	Debtors	1,39,000	
			Less: Bad Debts	13,900	1,25,100
			Cash at Bank		1,22,320
		9,66,420			9,66,420

Working Notes:

1. Adjustment of Goodwill

   Goodwill of the firm is valued at ₹2 lakhs

   Sacrificing ratio:

   A 3/10 - 3/10 = 0

   B 2/10 - 0 = 2/10

   C 5/10 - 4/10 = 1/10

   Hence, sacrificing ratio of B and C is 2 : 1. A has not sacrificed any share in profits after retirement of B and admission of D in his place.

Adjustment of D's share of goodwill through existing partners' capital accounts in the profit sacrificing ratio:

		₹
B : ₹60,000 × 2/3	=	40,000
C : ₹60,000 × 1/3	=	20,000
		60,000

2. Capital of partners in the reconstituted firm

	₹
Total capital of the reconstituted firm (given)	3,00,000
A (3/10)	90,000
B (4/10)	1,20,000
C (3/10)	90,000

2002 - Nov [1] 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 - 2002 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 31.3.2002, the terms of which were as follows:

(a) The Profit and Loss account for the year ended 31.3.2002, 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, 2001.

(b) 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:

	₹
31.03.1998	15,000
31.03.1999	23,000
31.03.2000	25,000
31.03.2001	35,000
31.03.2002	42,000

(c) 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.

(d) 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 lakhs as before to be maintained in the new ratio as between B and C.

You are required to give the necessary entries to give effect to the above arrangements. Prepare Capital Account of Partners, Cash Account and Balance Sheet of B and C after giving effect to the above arrangements on the retirement of A. (20 marks)

Answer:

Journal Entries

Particulars		Dr. ₹	Cr. ₹
(i) A's capital account	Dr.	21,000	
B's capital account	Dr.	14,000	
C's capital account	Dr.	7,000	
To Profit and loss adjustment account			42,000
(Profit written back for making adjustment)			
(ii) Profit and loss adjustment account	Dr.	6,000	
To B's capital account			6,000
(Bonus credited to B's capital account)			

(iii) Profit and loss adjustment a/c	Dr.	36,000	
To A's capital account			12,000
To B's capital account			18,000
To C's capital account			6,000
(Distribution of profits in the new ratio)			
(iv) Goodwill account (56,000 – 40,000)	Dr.	16,000	
Fixtures account	Dr.	9,800	
To Provision for bad debts account			1,800
To A's capital account			8,000
To B's capital account			12,000
To C's capital account			4,000
(Revaluation of assets on A's retirement)			
(v) B's capital account	Dr.	44,700	
C's capital account	Dr.	14,900	
To Goodwill account			56,000
To Provision for bad debts account			3,600
(Written off goodwill and raising provision for bad debts)			
(vi) A's capital account	Dr.	1,49,000	
To B's capital account			1,49,000
(Amount payable to A paid by B)			

Partner's Capital Accounts

Dr. Cr.

	A ₹	B ₹	C ₹		A ₹	B ₹	C ₹
To P&L Adjustment A/c	21,000	14,000	7,000	By Balance b/d	1,50,000	1,00,000	50,000
To Goodwill and provision for bad debts	–	44,700	14,900	By P& L Adjustment A/c	–	6,000	–
To B's Capital A/c	1,49,000	–	–	By P&L Adjustment A/c	12,000	18,000	6,000
To Cash A/c	–	1,300	–	By Goodwill and Fixtures	8,000	12,000	4,000
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

Cash Account

	₹		₹
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, 2002 (after retirement of A)

Liabilities		Amount ₹	Assets		Amount ₹
Capital Accounts:			Fixtures		39,800
B	2,25,000		Stock		1,70,000
C	75,000	3,00,000	Sundry debtors	90,000	
Sundry Creditors		40,000	Less: Provision		
			for bad debts	5,400	84,600
			Cash		45,600
		3,40,000			3,40,000

Working note:

Calculation of goodwill

1. Average of last five year's profits

Year ended on	Profit ₹
31.3.1998	15,000
31.3.1999	23,000
31.3.2000	25,000
31.3.2001	35,000
31.3.2002	42,000
	1,40,000

Average profit = $\frac{1,40,000}{5}$ ₹₹28,000

2. Goodwill at two year's purchase
₹28,000 × 2 = ₹56,000.

2005 - Nov [4] (b) 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. (5 marks)

Answer:

The original ratio is 4:3:2 for A, B and C. B retires, hence his share i.e. 1/3 (3/9) has to be given to A and C.

(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 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 of A = $\frac{4}{9} + \frac{2}{9} = \frac{6}{9}$, and

New share of 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 1/3, 1/6th each will be given to A and C.

Thus, New share of A will be $\frac{4}{9} + \frac{1}{6} = \frac{11}{18}$, and

New share of C will be $\frac{2}{9} + \frac{1}{6} = \frac{7}{18}$

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 of A will be $\frac{4}{9} + \frac{3}{12} = \frac{25}{36}$, and

New share of B will be $\frac{2}{9} + \frac{1}{12} = \frac{11}{36}$

Hence, new profit sharing ratio will be 25 : 11.

(iv) If B gives his share to A only, then

New share of A will be $\frac{4}{9} + \frac{1}{3} = \frac{7}{9}$, and

New share of C will be same i.e. $\frac{2}{9}$

Hence, new profit sharing ratio will be 7 : 2.

2018 - May [4] (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
			Furniture		2,40,000
A	8,00,000		Office equipments		2,80,000
B	4,20,000		Stock		2,50,000
C	4,00,000	16,20,000	Sundry debtors	3,00,000	
Sundry Creditors		3,70,000			
General Reserves		3,60,000	*Less:* Provision for Doubtful debts	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:

(i) Office Equipments revalued at ₹3,27,000.

(ii) Building revalued at ₹15,00,000. Furniture is written down by ₹40,000 and Stock is reduced to ₹2,00,000.

(iii) Provision for Doubtful Debts is to be created @ 5% on Debtors.

(iv) Joint Life Policy will appear in the Balance Sheet at surrender value after B's retirement. The surrender value is ₹1,50,000.

(v) Goodwill was to be valued at 3 years purchase of average 4 years profit which were:

Year	₹
2014	90,000
2015	1,40,000
2016	1,20,000
2017	1,30,000

(vi) 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)

QR Code for Solution Video

Answer:

Revaluation A/c

		₹		₹
To Furniture A/c		40,000	By Office Equipment A/c	47,000
To Stock A/c		50,000	By Building A/c	5,00,000
To Joint Life Policy		10,000	By Provision for doubtful debts	15,000
To Partners' capital A/cs:				
A	2,31,000			
B	1,54,000			
C	77,000	4,62,000		
		5,62,000		5,62,000

Partner's Capital Accounts

	A ₹	B ₹	C ₹		A ₹	B ₹	C ₹
To B's capital A/c	90,000	–	30,000	By balance b/d	8,00,000	4,20,000	4,00,000
To B's loan A/c		8,14,000		By General Reserve	1,80,000	1,20,000	60,000
To Balance c/d	11,21,000		5,07,000	By revaluation reserve	2,31,000	1,54,000	77,000
				By A's capital A/c.		90,000	
				By C's capital A/c		30,000	
	12,11,000	8,14,000	5,37,000		12,11,000	8,14,000	5,37,000

Balance Sheet as on 1.4.2018
(after B's retirement)

Liabilities		₹	Assets		₹
Capital Accounts:			Building		15,00,000
A	11,21,000		Furniture		2,00,000
B	5,07,000	16,28,000	Office Equipment		3,27,000
B's Loan Account		8,14,000	Stock		2,00,000
Sundry Creditor		3,70,000	Sundry Debtor	3,00,000	
			Less: Provision for doubtful debts	(15,000)	2,85,000
			JLP		1,50,000
			Cash at bank		1,50,000
		28,12,000			28,12,000

Working Notes:

Calculation of goodwill:

1. **Average of last 4 year's profit**

$$= \frac{(90{,}000 + 1{,}40{,}000 + 1{,}20{,}000 + 1{,}30{,}000)}{4}$$

$= ₹1,20,000$

2. **Goodwill at three years' purchase**

₹1,20,000 × 3 = ₹3,60,000

Goodwill adjustment

	Share of goodwill (Old ratio)	Share of goodwill (New ratio)	Adjustment
A	1,80,000	2,70,000	90,000 (Dr.)
B	1,20,000	–	1,20,000 (Cr.)
C	60,000	90,000	30,000 (Dr.)

CHAPTER

8

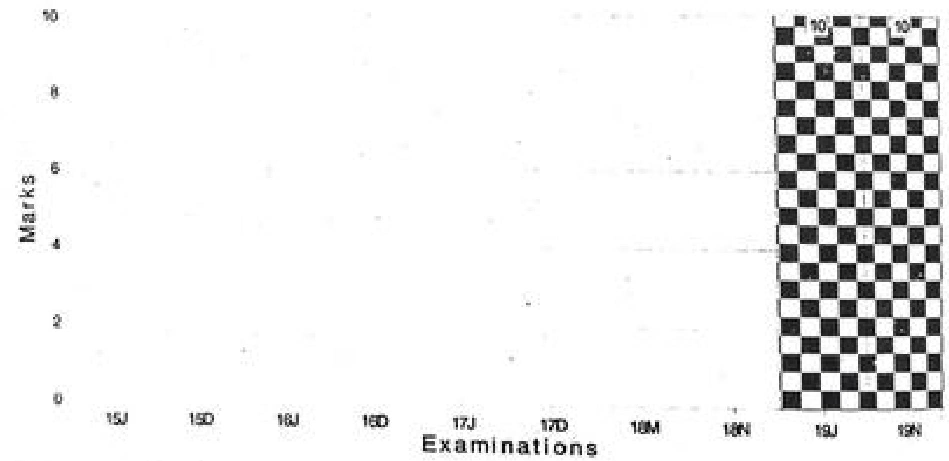
Partnership Accounts

Unit: 5 **Death of a Partner**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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SELF STUDY QUESTIONS

Q1. What are the Consequences in case of Death of a Partner?

Answer:

- When a partner dies, the firm is reconstituted and hence, it requires various adjustments as done in case of retirement.
- On death of a partner, the amount due to him is paid to his legal representatives.

Right of Outgoing partner: Certain cases to share subsequent profits:

- According to the provisions of Indian Partnership Act, the legal representatives of the deceased are entitled to interest 6% p.a. on the amount due from the date it was due till the date of actual payment.

OR

- If no immediate settlement of accounts is done for the share of outgoing/deceased partner, he is entitled to receive a share in future profits for the use of his share of assets of firm till the date of actual payment.

Q2. What will be the treatment of amount payable to legal Representatives of Deceased Partner?

Answer:

- The deceased partner's capital A/c will be credited with his share of profits.
- The deceased partner's legal representative will be entitled to the following :
  - (i) Amount Standing to the credit of Capital A/c
  - (ii) Share in goodwill
  - (iii) Interest on capital if any
  - (iv) Share in revaluation profit
  - (v) Share in undistributed profits and reserves
  - (vi) Share in profit up to the date of death
- All adjustments are done in the same manner as in case of retirement.

Q3. What are the Special Transactions in case of Death related to Separate Life Policy?

Answer:

- Sometimes, instead of taking JLP, Policy is taken on life of individual partners
- When the partner dies, the amount of this policy is received in cash and other policies are shown at their respective surrended values.

Q4. What are the Special Transactions in case of Death related to payment of Deceased Partner's share?

Answer

The amount due to the deceased partner can be paid as follows:

(i) Whole amount in lumpsum; or
(ii) Repayment in installments over of period of time and interest paid on outstanding balance; or
(iii) Amount due is treated as loan to firm; or
(iv) Payment of annuity to the heirs of deceased partner.

Illustration:

A, B, and C were carrying on business with following assets with effect from 1.1.1980. Furniture ₹18,000; Machine ₹72,000, Cash ₹10,000; Debtors ₹20,000. Their profit sharing ratio was 5:3:2. Capital is also shared in the same ratio. B died on 30.6.1980. His son claimed his father's interest in the firm.

The following was the settlement:

1. Allow his capital to his credit on the date of death
2. Give 5% p.a. interest on his capital
3. He had been drawing @ ₹600 per month, which he withdraws at the beginning of each month. He is allowed to retain his drawings as a part of his share of profit.
4. Interest @ 6% p.a. be charged on his drawings.
5. They had separate life policies for which the premium had been paid out of Profit & Loss A/c of the firm;
   A ₹50,000; B ₹60,000; C ₹30,000. The surrender value of A's policy was 50% whereas of C's policy it was 40%

6. Goodwill was evaluated as twice the average of profit which were ₹ 3,600 Prepare B's personal Account

Solution:

(i) Balance sheet of the firm will have to be prepared in order to ascertain the capitals of the partners.

Balance Sheet

Liabilities	(₹)	Assets	(₹)
Capital A/c (Balancing figure) A $1,20,000 \times \frac{5}{10} = 60,000$ B $1,20,000 \times \frac{3}{16} = 36,000$ C $1,20,000 \times \frac{2}{10} = 24,000$	1,20,000	Cash Debtors Furniture Machine	10,000 20,000 18,000 72,000
	1,20,000		1,20,000

(ii) **B's share in life policies:** ₹

Share in own policy $60,000 \times \frac{3}{10}$ = 18,000

Share in A's policy $50,000 \times \frac{50}{100} \times \frac{3}{10}$ = 7,500

Share in C's capital $30,000 \times \frac{40}{100} \times \frac{3}{10}$ = 3,600

Total = 29,100

A's Capital A/c (5/7 of 11,100) Dr. 7,929
C's Capital A/c (2/7 of 11,100) Dr. 3,171
To B's Capital A/c

(B's share in surrender value of A and C's policies debited to A and C's In their gaining ratio i.e. 5:2)

(iii) Goodwill = $3,600 \times 2$
= ₹7,200

B's share of goodwill = $7,200 \times \frac{3}{10}$
= ₹2,160

B's share of Goodwill will be adjusted into the capital accounts of A and C in the gaining ratio of 5:2

(iv) **Interest on B's Drawings:**

On ₹ 600 for 6 month	=	3,600	Products
On ₹600 for 5 months	=	3,000	Products
On ₹600 for 4 months	=	2,400	Products
On ₹600 for 3 months	=	1,800	Products
On ₹600 for 2 months	=	1,200	Products
On ₹600 for 1 month	=	600	Product
	=	12,600	Interests
	=	12,600	× 6/100 × 1/12 = ₹63

B's Capital A/c

Particulars	(₹)	Particulars	(₹)
To Drawings A/c	3,600	By Balance b/d	36,000
To Interest on drawings A/c(6% on ₹3,600 for 3'1/2 average months)	63	By Int. On Capital A/c	900
To B's Executor's A/c (Balance transferred)	68,097	By P & L Suspense A/c	3,600
		By Life Policy A/c	18,000
		By A's Capital A/c (See Note (ii))	7,929
		By C's Capital A/c (See Note (ii))	3,171
		By A's Capital A/c (Goodwill)	1,543
		By C's Capital A/c (Goodwill)	617
	71,760		71,760

Illustration:

A,B, and C are partners sharing profits of 2:1:1 They closed their books on 31st December each year, A died on 28th February, 1991; B and C decided to share future profit in 3:2. On this date, their Balance Sheet was as follows.

Liabilities	(₹)	Assets	(₹)
Creditors	3,790	Cash	20,000
Joint Life Policy Reserve	3,600	Sundry Debtors	3,900
Profit for 2 months (before interest & salaries)	3,110	Loan to A	4,000
		Joint Life Policy	3,600
Capitals:			
A 10,000			
B 6,000			
C 5,000	21,000		
	31,500		31,500

According to the partnership deed:

(a) Interest on capital is allowed @6% p.a. A and B are entitled to salaries at ₹300 and ₹250 p.m.

(b) In the event of death of a partner, goodwill was to be valued at 2 years purchase of the average net profits of 3 completed years preceding death. The net profits for the year 1988, 1989 and 1990 were ₹5,500, ₹ 4,800 and ₹6,500 respectively.

Firm had taken a Joint Life Policy (with profit policy) of ₹10,000. The insurance company admitted a claim of ₹12,600 including bonus.

A's share was paid to his executors, B and C continued the firm.

Prepare Profit & Loss A/c , Partners Capital A/c's, and Balance Sheet of B and C.

Solution:

Profit and Loss Appropriation Account

Particulars		₹	Particulars	₹
To Interest on capital A/cs: (for 2 months)			By Profit & Loss A/c (Being Profit for 2 months)	3,110
A	100			
B	60			
C	50	210		
To Salary (for 2 months)				
A	600			
B	500	1,100		

To Profit transferred to:				
A	900			
B	450			
C	450	1,800		
		3,110		3,110

Capital Accounts

Particular	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To A's Capital A/c	4,000	3,920	1,680	By Balance b/d	10,000	6,000	5,000
To A's Executor's A/c	19,500	–	–	By Int. On Capital A/c	100	60	50
To Balance c/d	–	6,240	6,970	By Salary A/c	600	500	–
				By P&L App. A/c	900	450	450
				By B's Capital A/c	3,920	–	–
				By C's Capital A/c	1,680	–	–
				By Joint life Policy (WN2)	6,300	3,150	150
	23,500	10,160	8,650		23,500	10,160	8,650

A's Executor's Account

Particulars	₹	Particulars	₹
To Bank A/c	19500	By A's Capital A/c	19500

Balance Sheet of B and C
(as at 28th February, 1991)

Liabilities	₹	Assets	₹
Creditors	3,790	Cash (20,000 +12,600 − 19,500)	13,100
Capitals:		Sundry Debtors	3,900
B	6,240		
C	6,970		
	17,000		**17,000**

Working Notes:

1. Goodwill:

Average profits $= \dfrac{5{,}500 + 4{,}800 + 6{,}500}{3}$

$= 5{,}600$

Goodwill at 2 years purchase = ₹5,600 × 2
= ₹11,200

A's share of Goodwill = ₹11,200 × $\frac{2}{4}$
= ₹5,600

A's share of goodwill will be adjusted into the Capital A/cs of B and C in their gaining ratio of 7:3

2. Joint Life Policy Reserve A/c is appearing on the liabilities side at ₹ 3,600 and a Joint Life Policy A/c is also appearing on the assets side at ₹3,600 . Joint Life Policy Reserve A/c will be closed by transferring it to the Joint Life Policy A/c and hence the full amount received from the insurance company, i.e ₹12,600 will be credited to all Partner's Capital Accounts.

Illustration:

X, Y and Z were partners sharing profits and losses in the ratio of 5:3:2 respectively. On 31st December, 1990 their balance sheet stood as under.

Liabilities		₹	Assets	₹
Sundry Creditors		27,500	Goodwill	12,500
Reserve Fund		15,000	Building	50,000
Capital A/cs			Patents	15,000
X	75,000		Machinery	75,000
Y	62,000		Stock	25,000
Z	37,500	1,75,000	Debtors	20,000
			Bank	20,000
		2,17,500		2,17,500

Adjustments:

Z died on 1st May,1991, it was agreed that:

(a) Goodwill be valued at 2½ years purchase of the average profit of last four years, which were-1987 ₹32,500 ; 1988 ₹30,000; 1989 ₹40,000 and 1990 ₹37,500

(b) Machinery will be valued at ₹70,000; Patents at ₹20,000 and Buildings at ₹62,500.

(c) For the purpose of calculating Z's share in profits of 1991, the profits in 1991 should be taken to have been earned on the same scale as on 1990.

(d) A sum of ₹10,500 is to be paid immediately to the executors of Z and the balance to be paid in four equal half yearly installments together with interest @10% p.a.

Prepare journal entries to record the transaction and Z's Capital A/c and Executor's A/c for 1991

Solution:

Journal Entries

1991	Particulars		₹	₹
May 1	X's Capital A/c	Dr.	6,250	
	Y's Capital A/c	Dr.	3,750	
	Z's Capital A/c	Dr.	2,500	
	To Goodwill A/c			12,500
	(Goodwill written off)			
May 1	X's Capital A/c	Dr.	10,938	
	Y's Capital A/c	Dr.	6,562	
	To Z's Capital A/c (WN1)			17,500
	(Z's share of goodwill adjusted into the capital A/cs of X and Y in their gaining ratio of 5:3)			
May 1	Reserve Fund A/c	Dr.	15,000	
	To X's Capital A/c			7,500
	To Y's Capital A/c			4,500
	To Z's Capital A/c			3,000
	(Reserve Fund transferred to capital accounts of partners in the ratio of 5:3:2)			

Date	Particulars		Dr. (₹)	Cr. (₹)
May 1	Revaluation A/c	Dr.	5,000	
	To Machinery A/c			5,000
	(Value of machinery reduced on revaluation)			
May 1	Patents A/c	Dr.	5,000	
	Building A/c	Dr.	12,500	
	To Revaluation A/c			17,500
	(Increase in the value of patents and building)			
May 1	Revaluation A/c	Dr.	12,500	
	To X's Capital A/c			6,250
	To Y's Capital A/c			3,750
	To Z's Capital A/c			2,500
	(Profit on revaluation transferred to partner's Capital A/cs)			
May 1	Profit & Loss Suspense A/c	Dr.	2,500	
	To Z's Capital A/c			2,500
	(Transfer of $\frac{2}{10}$th share of profit upto 1st May ,1991 i.e. ₹37,500 × $\frac{2}{10} \times \frac{4}{12}$)			
May 1	Z's Capital A/c	Dr.	60,500	
	To Z's Executor's A/c			60,500
	(Amount due to Z transferred to his Executor's Account)			
May 1	Z's Executor's A/c	Dr.	10,500	
	To Bank A/c			10,500
	(Amount paid immediately)			

Z's Capital A/c

1991		Particulars	₹	1991		Particulars	₹
May 1	To	Goodwill	2,500	Jan 1	By	Balance b/d	37,500
May 1	To	Z's Executor's A/c (b/f)	60,500	May 1	By	X's Capital A/c (Goodwill)	10,938
				May 1	By	Y's Capital A/c (Goodwill)	6,562
				May 1	By	Reserve Fund A/c	3,000
				May 1	By	Revaluation A/c	2,500
					By	Profit & Loss Suspense A/c (Share of Profit)	2,500
			63,000				63,000

Z's Executer's A/c

1991		Particulars	₹	1991		Particulars	₹
May 1	To	Bank A/c	10,500	May 1	By	Z's Capital A/c	60,500
May 1	To	Bank A/c (1/4th of ₹ 50,00 +interest ₹ 2,500)	15,000		By	Interest A/c (10% p.a. on ₹ 50,000 for 6 months	2,500
Dec.31	To	Balance c/d (b/f)	37,500				
			63,000				63,000

Working Notes :

1. **Valuation of Goodwill:**

Total Profit = ₹32,500 + ₹30,000 + ₹40,000 + ₹37500
= ₹1,40,000

Average Profit = ₹1,40,000 ÷ 4
= ₹35,000

Hence, Goodwill = ₹35,000 × $\frac{5}{2}$
= ₹87,500

Z's share of Goodwill = ₹87,500 × $\frac{2}{10}$
= ₹17,500

Questions for Practice and Conceptual Clarity only (The questions below have been given for building the basics and increasing knowledge of the students)

MULTIPLE CHOICE QUESTIONS

1. B, C, D are partners sharing profits in the ratio 7 : 5 : 4. D died on 30th June 2006 and profits for the year 2005-2006 were ₹12,000. How much share in profits for the period?
   (a) ₹3,000
   (b) ₹750
   (c) Nil
   (d) ₹1,000
2. The balance of joint life policy account as shown in the balance sheet represents:
   (a) Surrender value of a policy
   (b) Annual premium of JLP
   (b) Total premium paid by the firm
   (d) Amount receivable on the maturity of the policy
3. The amount due to the deceased partner is paid to his:
   (a) Father
   (b) Friends
   (b) Wife
   (d) Executors
4. A, B and C are partners sharing profits and losses in the ratio 2:2:1. C dies on 31st March 2007. The profits of the financial year ending 31st March 2007 is ₹64000. The share of the deceased partner in the profits will be:
   (a) ₹9,200
   (b) ₹12,800
   (b) ₹3,100
   (d) ₹6,100

5. A, B, C are partners sharing profits in the ratio 1 : 1 : 2. C died on 30th June 2006 and profits for the accounting year ended on 31st December 2006 were ₹24,000. How much share in profits will be credited to C's account?
   (a) ₹12,000
   (b) ₹6,000
   (c) ₹24,000
   (d) ₹3,000
6. JLP of the partners is a / an ______ account:
   (a) Nominal
   (b) Personal
   (c) Representative personal
   (d) Asset
7. After the death of a partner, amount payable is received by:
   (a) Government
   (b) Firm
   (c) Executors of deceased partner
   (d) None
8. How is the premium paid on the JLP of partners treated? It is _____ to the ______ accounts:
   (a) credited; partner's current
   (b) credited; profit & loss
   (c) debited; partner's capital
   (d) debited; profit & loss
9. A, B, C are partners sharing profits and loss in 5 : 3 : 2. The firm's balance sheet as on 31.3.2007 shows Reserve Balance of ₹25,000. Profit of the last year ₹50,000. Joint Life policy of ₹10,00,000, Fixed, assets of ₹12,00,000. On 1st June C died and on same date assets were revalued. The executors of C will get along with capital:
   (a) Share in Joint life policy
   (b) Share in Reserves
   (c) Proportionate share of profit upto the date of death
   (d) All of the above

10. Joint Life Policy amount received by a firm is distributed in ______.
    (a) Opening capital ratio
    (b) Closing capital ratio
    (c) Old profit sharing ratio of partners
    (d) New ratio of partners
11. A, B and C are partners sharing profits in the ratio of 3:2:1. They had a Joint Life Policy of ₹3,00,000. Surrender value of JLP in Balance Sheet is ₹90,000. C dies. What is share of each partner in JLP ?
    (a) ₹1,05,000; ₹70,000; ₹35,000
    (b) ₹45,000; ₹30,000; ₹15,000
    (c) ₹1,50,000; ₹1,00,000; ₹50,000
    (d) ₹1,95,000; ₹1,30,000; ₹65,000
12. X, Y and Z are the partners sharing profits in the ratio of 7:5:4. On 30th June, 2008, Z died and profits for the year ending 31st March, 2009 were ₹2,40,000. How much share in profits for the period 1st April 2008 to 30th June 2008 will be credited to Z's account assuming the profit occurred evenly throughout the year?
    (a) ₹60,000
    (b) ₹15,000
    (c) ₹20,000
    (d) Nil
13. At the time of death of a partner firm gets ____ from the insurance company of the Joint Life Policy taken jointly for all the partners.
    (a) Policy value
    (b) Surrender value
    (c) Policy value for the dead partner
    (d) Surrender value for all the partners.
14. If a partner dies, then JLP will be reckoned at ________.
    (a) Surrender value
    (b) Maturity value
    (c) Policy value
    (d) None

15. In case of death of a partner, share of goodwill of deceased partner, will be borne by the remaining partners in:
    (a) Sacrificing Ratio
    (b) Gaining Ratio
    (c) Old Profit Sharing Ratio
    (d) Net Profit Sharing Ratio
16. J, K and L were equal partners in a firm. The firm has taken individual life policy of ₹50,000 for each partner. J died on 5th March 2011. The surrender value was ₹2,000 for each policy on the date of death of J. The amount payable to J in respective policies would be __________.
    (a) ₹17,000
    (b) ₹18,000
    (c) ₹50,000
    (d) ₹54,000
17. On the death of a partner, his executor is paid the share of profits of the dying partner for the relevant period. This payment is recorded in Profit and Loss __________ account.
    (a) Adjustment
    (b) Appropriation
    (c) Suspense
    (d) Reserve
18. On the death of a partner, his executor is paid the share of profits of the deceased partner for the relevant period. This payment is recorded in Profit and Loss ________ Account:
    (a) Suspense
    (b) Adjustment
    (c) Appropriation
    (d) Reserve.
19. A, B, C partners sharing profits in the ratio of 7 : 5 : 4. The profits of the firm for the year ended 31.3.2016 were estimated as ₹2,40,000. C died on 30th June 2016. What is share of C in profits of financial year 2015-16?
    (a) ₹15,000
    (b) ₹18,000

(c) ₹24,000
(d) ₹20,000

20. The amount received on maturity from the Insurance Company on Joint Life Policy of partners in excess of its surrender value, if any, should be credited to partners:
(a) Equally
(b) In their profit sharing ratio
(c) In the ratio of capitals
(d) None of the above.

21. On the death of a partner, the amount of Joint Life Policy should be credited to the capital accounts of:
(a) Remaining partners equally.
(b) All partners including the deceased partner in their capital ratio.
(c) Remaining partners in the new profit sharing ratio.
(d) All partners including the deceased partner in their profit sharing ratio.

22. X, Y and Z are the partners sharing profits in the ratio 5:4:3. Z died on 30th September, 2016. Profits for the accounting year 2016-17 is ₹ 40,000. How much share in profits for the period from 1st April, 2016 to 30th September, 2016 will the executors of Z would be entitled? Assuming profits earned evenly during the year:
(a) ₹6,000
(b) ₹5,000
(c) ₹4,500
(d) Nil.

23. As per Section 37 of the Indian Partnership Act, 1932, the executors would be entitled at their choice to the interest calculated from the date of death till the date of payment on the final amount due to the deceased partner at ______ % p.a. :
(a) 7
(b) 4
(c) 6
(d) 12

24. In the absence of proper agreement, representatives of deceased partner are entitled to receive
(a) Profits till date, Goodwill, Joint Life Policy, Interest on Capital and Share in revalued assets and liabilities.
(b) Profit till date, Goodwill, Joint Life Policy, Capital and Share in revalued assets and liabilities.
(c) Capital, Goodwill, Joint Life Policy, Interest on Capital and Share in revalued assets and liabilities.
(d) Profits till date, Goodwill, Capital, Interest an Capital and Share in revalued Assets and Liabilities.

ANSWER

1	(b)	2	(a)	3	(d)	4	(b)	5	(b)
6	(d)	7	(c)	8	(d)	9	(d)	10	(c)
11	(a)	12	(b)	13	(a)	14	(b)	15	(b)
16	(b)	17	(c)	18	(a)	19	(a)	20	(b)
21	(d)	22	(b)	23	(c)	24	(b)		

SHORT PRACTICE QUESTIONS

1. What amounts does legal representative of the deceased is entitled to receive?

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

2005 - May [5] State with reasons whether the following statement is true or false:

(xii) The accounting procedure in case of retirement of partner and dissolution of the partnership firm are same. (2 marks)

Answer:

False: In case of dissolution of the partnership firm, realization account is opened to transfer all assets and liabilities, while in case of retirement of partner, profit and loss adjustment account (revaluation account) is used for revaluation of assets and liabilities. The partners' capital accounts are closed and final payments are made to partners under dissolution of the firm but in case of retirement of a partner, adjustments are made only in partners' capital accounts for transfer of reserve, goodwill and profit or loss on revaluation.

PRACTICAL QUESTIONS

2000 - May [2] The following was the Balance Sheet of Om & Co. in which X, Y and Z were partners sharing profits and losses in the ratio of 1:2:2 as on 31-3-1999. Mr. Z died on 31st December, 1999. His account has to be settled under the following terms:

Balance Sheet of Om & Co. as on 31-3-1999

Liabilities		₹	Assets	₹
Sundry Creditors		20,000	Goodwill	30,000
Bank Loan		50,000	Building	1,20,000
General Reserve		30,000	Computers	80,000
Capital Accounts:			Stock	20,000
X	40,000		Sundry Debtors	20,000
Y	80,000		Cash at Bank	20,000
Z	80,000	2,00,000	Investments	10,000
		3,00,000		3,00,000

Goodwill is to be calculated at the rate of two years' purchase on the basis of average of last three years' profits and losses. The profits and losses for the three years were as detailed below:

Year ending on	Profit/Loss ₹
31-3-1999	30,000
31-3-1998	20,000
31-3-1997	(10,000) Loss

Profit for the period from 1-4-1999 to 31-12-1999 shall be ascertained proportionately on the basis of average profits and losses of the preceding three years.

During the year ending on 31-3-1999 a car costing ₹40,000 was purchased on 1-4-1998 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 31-12-1999 assuming that other items of assets and liabilities remained the same. (15 marks)

QR Code for Solution Video

Answer:

Partners Capital Accounts

Particulars	X	Y	Z	Particulars	X	Y	Z
	(₹)	(₹)	(₹)		(₹)	(₹)	(₹)
To Revaluation A/c	3,600	7,200	7,200	By Balance b/d	40,000	80,000	80,000
To Z's Executor's A/c	—	—	1,12,000	By General Reserve	6,000	12,000	12,000
To Balance c/d	52,400	1,04,800	—	By Goodwill A/c	3,600	7,200	7,200
				By Car Account	6,400	12,800	12,800
				By P & L Suspense A/c	—	—	7,200
	56,000	1,12,000	1,19,200		56,000	1,12,000	1,19,200

Balance Sheet of M/s OM & Co.
(As at 31.12.1999)

Liabilities	₹	Assets	₹
Sundry Creditors	20,000	Goodwill	48,000
Bank Loan	50,000	Building	1,40,000
Capital Accounts:		Car	32,000
X	52,400	Stock	16,000
Y	1,04,800	Computers	50,000
Z's Executor's Account	1,12,000	Investments	6,000
		Sundry Debtors	20,000
		Cash at Bank	20,000
		P & L Suspense Account	7,200
	3,39,200		3,39,200

Working Notes:

(1) Calculation of goodwill and Z's share of profits:

		₹
(a) Adjusted profit (For the year ended 31.3.99)		
Profit		30,000
Add back: Cost of car wrongly written off	40,000	
Less: Depreciation for the year 1998-99 (20% on ₹40,000)	8,000	32,000
		62,000

(b) Average of last three year's profit/losses:

Year ended on:	Profit/(Loss)
31.3.1997	(10,000)
31.3.1998	20,000
31.3.1999	62,000
	72,000

Average profit $\left(\frac{72,000}{3}\right)$ ₹24,000

(c) Goodwill at 2 year's purchase

₹24,000 × 2 = ₹48,000

(d) Z's share of profits (for 9 months)

₹24,000 × $\frac{9}{12}$ × $\frac{2}{5}$ = ₹7,200

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Stock A/c	4,000	By Building A/c	20,000
To Computers A/c	30,000	By Loss transferred to:	
To Investment A/c	4,000	X Capital A/c	3,600
		Y Capital A/c	7,200
		Z Capital A/c	7,200
	38,000		38,000

2019 - June [4] (a) Monika, Yedhant and Zoya are in partnership, sharing profits and losses equally. Zoya died on 30th June 2018. The Balance Sheet of Firm as at 31st March 2018 stood as.

Liabilities	Amount ₹	Assets		Amount ₹
Creditors	20000	Land and Building,		150000
General Reserve	12000	Investments		65000
Capital Accounts :		Stock in trade		15000
Monika	100000	Trade receivables	35,000	
Yedhant	75000	*Less:* Provision for doubtful debt	2,000	33000
Zoya	75000	Cash in hand		7000
		Cash at bank		12000
	282000			282000

In order to arrive at the balance due to Zoya, it was mutually agreed that :

(i) Land and Building be valued at ₹1,75,000

(ii) Debtors were all good, no provision is required

(iii) Stock is valued at ₹13,500

(iv) Goodwill will be valued at one Year's purchase of the average profit of the past five years. Zoya's share of goodwill be adjusted in the account of Monika and Yedhant.

(v) Zoya's share of profit from 1st April 2018, to the date of death be calculated on the basis of average profit of preceding three years.

(vi) The profit of the preceding five years ended 31st March were:

2018	2017	2016	2015	2014
25,000	20,000	22,500	35,000	28,750

You are required to prepare :

(1) Revaluation account

(2) Capital accounts of the partners and

(3) Balance sheet of the Firm as 1st July 2018. (10 marks)

Answer:

Revaluation Account

Particulars	₹	Particulars	₹
To Stock	1,500	By Land and Building	25,000
To Partners: (Revaluation Profit)		By provision for doubtful debt	2,000
Monika	8,500		
Yedhant	8,500		
Zoya	8,500		
	27,000		**27,000**

Partners' Capital Account

Particulars	Monika	Yedhant	Zoya	Particulars	Monika	Yedhant	Zoya
To Zoya	4,375	4,375	–	By Bal b/d	1,00,000	75,000	75,000
To Zoya's Executor	–	–	94,125	By General reserve	4,000	4,000	4,000
To Bal c/d	1,08,125	83,125	–	By Monika & Yedhant	–	–	8,750
				By Profit and Loss Adjustment* (Suspense) A/c	–	–	1,875
				By Revaluation	8,500	8,500	8,500
	1,12,500	87,500	98,125		1,12,500	87,500	98,125

*Profit and Loss Adjustment = [(25,000 + 20,000 + 22,500)/3] × 3/12 × 1/3 = 1,875

Balance Sheet of Firm as on 1.7.2018

Particulars	₹	Particulars	₹
Monika	1,08,125	Land and Building	1,75,000
Yedhant	83,125	Investments	65,000
Zoya Executor	98,125	Stock	13,500

Creditors	20,000	Trade receivable	35,000
		Profit & Loss Adjustment	1,875
		Cash in hand	7,000
		Cash at bank	12,000
	3,09,375		3,09,375

Calculation of goodwill and Zoya's share

Average of last five year's profits and losses for the year ended on 31st March

31.3.2014	28,750
31.3.2015	35,000
31.3.2016	22,500
31.3.2017	20,000
31.3.2018	25,000
Total	1,31,250
Average profit	26,250

Goodwill at 1 year purchase = ₹26,250 × 1 = ₹26,250

Zoya's Share of Goodwill = ₹26,250 × 1/3

= ₹8,750

Which is contributed by Monika and Yedhant in their gaining Ratio

Monika = ₹8,750 × 1/2 = ₹4,375

Yedhant = ₹8,750 × 1/2 = ₹4,375

2019 - Nov [4] (a) Arup and Swarup were partners. The partnership deed provides inter alia:

(i) That the annual accounts be balanced on 31st December each year;

(ii) That the profits be allocated as follows:
Arup: One-half; Swarup: One-third and Carried to reserve account: One Sixth;

(iii) That in the event of death of a partner, his executor will be entitled to the following:

(1) The capital to his credit at the date of death;

(2) His proportionate share of profit to date of death based on the average profits of the last three completed years; and

(3) His Share of goodwill based on three years' purchase of the average profits for the three preceding completed years.

Trial Balance as on 31st December 2018

Particulars	Debit (₹)	Credit (₹)
Arup's Capital		90,000
Swarup's Capital		60,000
Reserve		45,000
Bills receivable	50,000	
Investments	55,000	
Cash	1,10,000	
Trade payables		20,000
Total	**2,15,000**	**2,15,000**

The profits for the three year were 2016: ₹51,000; 2017: ₹39,000 and 2018: ₹45,000. Swarup died on 1st May 2019.

Show the calculation of Swarup (A) Share of profits; (B) Share of Goodwill; (C) Draw up Swarup's Executors Account as would appear in the firm's ledger transferring the amount to the Loan account. (10 marks)

Answer:

Calculation of Swarup's Share of Profits

Particulars	₹
2016	51,000
2017	39,000
2018	45,000
Total Profit	1,35,000
Average Profit	45,000
4 Month's Profit	15,000
Swarup's Share in Profit (2/5 × ₹ 15,000)	6,000

Note:
Profit sharing ratio between Arup and Swarup = 1/2 : 1/3 = 3:2, Therefore, Swarup's share of Profit = 2/5.

Calculation of Swarup's Share of Goodwill

Particulars	₹
2016	51,000
2017	39,000
2018	45,000
Total Profit for 3 Years	1,35,000
Average Profit	45,000
Goodwill – 3 Years Purchase of Average Profit	1,35,000
Swarup's Share of Goodwill (2/5 × ₹ 1,35,000)	54,000

Swarup's Executor's A/c

Date	Particulars	₹	Date	Particulars	₹
2019 May 1	To Swarup's Loan A/c	1,38,000	2019 Jan. 1	By Capital A/c	60,000
			May 1	By Reserves (2/5 × ₹ 45,000)	18,000
			May 1	By Arup's Capital A/c (Share of Goodwill)	54,000
			May 1	By P/L Suspense A/c (Share of Profit)	6,000
		1,38,000			1,38,000

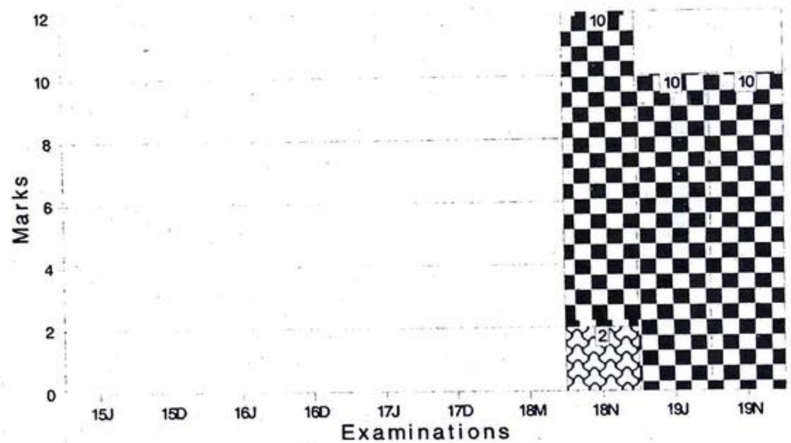
CHAPTER 9

Financial Statement of Non-Profit Organisations

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective | Short Notes | Distinguish | Descriptive | Practical



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SELF STUDY QUESTIONS

Q1. What is a NPO? Given few Examples.

Answer:

- Entities whose main objective is social welfare rather than profit making, are termed as Non Profit Organisations.
- Examples of NPO are:
  - Hospital
  - Schools
  - ICAI
  - Temple
  - Clubs

Q2. What is the Nature of Receipts and Payment Account ? What are its features?

Answer:

- Non Profit organisations prepare their final accounts at year end. Final Account include:
  - (a) Receipts and Payment Account
  - (b) Income and Expenditure Account
  - (c) Balance Sheet
- Receipts and payment account is a record of all cash receipt and payments dispensed during the years.

Features:

The account begins with brought forward cash and bank balances.

All receipts (capital and revenue) are entered on the debit side of the account. All the payment (Capital and revenue) are credited to this account.

- This account is not a part of double entry system.
- The balance of this account represents closing cash position of the organisation.

Specimen of Receipt and Payment Account

Receipts	Amount	Payments	Amount
To Balance b/d		By Salaries	XXX
Cash	XXX	By Rates, Taxes, etc.	XXX
Bank	XXX	By Insurance	XXX
To Subscription received	XXX	By Purchase of fixed Assets	XXX
To Entrance Fees	XXX	By Purchase of newspaper and periodicals	XXX
To Life Membership fees	XXX	By Purchase of food stuff	XXX
To Donation Received	XXX	By Postage	XXX
To Interest Received	XXX	By Printing and stationary	XXX
To Receipt of Price	XXX	By Purchase of Sports Material	XXX
To Interest on Price fund received	XXX	By Prizes awarded	XXX
To Sale of assets	XXX	By Sports material	XXX
To Sale of newspaper and periodicals	XXX	By Other General expenses	XXX
To Sale of refreshment	XXX	By Balance c/d	
To Sale of sports material	XXX	Cash	XXX
To Donation for building fund	XXX	Bank	XXX
	XXX		XXX

Q3. What are the Limitations of Receipt and Payment Account?

Answer:

- It does not show expenses and incomes on accrual basis.
- It does not differentiate between capital and revenue items.
- It does not show true surplus or deficiency.
- It does not show non cash transactions such as depreciation, etc.

Q4. What is an Income and Expenditure Account? What are its features?

Answer:

As per section 8 of Companies Act, 2013, non profit making organisations are required to prepare income and Expenditure Account and Balance Sheet as per Schedule III.

- Income and expenditure account shows revenue items.
- It is prepared on accrual basis.
- It is similar to Profit and loss account prepared for profit making organisations.

Features:

- It records only revenue items.
- Expenses and incomes are prepared for the period on matching principle.
- It records only income and expenditure of current year and excludes figures relating to future years.

Q5. What are the main Sources of Income in case of Income and Expenditure Account?

Answer:

- Income is usually generated in the form of subscription, entrance fees, interest, donations, sale of newspaper, profits on sale of assets, etc.
- However, only revenue receipts are recorded in Income and expenditure A/c; and receipts of capital nature are transferred to Capital fund.

Q6. Differentiate between Receipts and Payments Account and Income and Expenditure Account.

Answer:

Basis	Receipt and Payment Account	Income and Expenditure Account
Meaning	Is an account containing summarised statement all cash transaction made in an accounting year.	Is an account of income and expenditure done in an accounting year.

Cash items	It records only cash items of receipt and payment.	Whole amount of income and expenditure is recorded whether received/paid in cash, or not
Nature of transactions	Records both capital and revenue transactions	Records only revenue transactions.
Closing Balance	Balance can never credit. It is carried to next year.	Its balance may be either debit or credit. It is transferred to Capital Fund.
Opening Balance	It has an opening balance.	It has no opening balance
Preparation	Optional	Mandatory

Q7. What is the process of Preparation of Income and Expenditure Account from Receipt and Payments Account?

Answer:

1. Prepare opening balance sheet and find the opening balance of capital fund.
2. Open ledger accounts for adjusting all accrual and outstandings of various items of income and expenditure.
3. Balances of each ledger account must be transferred to income and Expenditure side to ascertain the total income and expenses for the period.
4. Balance of this account should be transferred to capital fund.
5. Prepare closing balance sheet by adjusting all the left over balances.

Q8.What is Balance Sheet?

Answer:

Balance Sheet is a statement showing position of assets and liabilities of non-profit making organisation on a particular date.

Accounting Equation:

Assets – Liabilities = Capital Fund.

Q9. What is the Accounting Treatment of some Special Items is case of Non Profit Organizations?

Answer:

Donation: Is the money received for meeting the expenses. It can be of either type:

(a) Specific Purpose Donation: Unless utilised it is shown on liability side in Balance Sheet; after utilisation, any surplus or deficit is transferred to Income and Expenditure Account.

(b) General Donation: Credited to income and Expenditure Account.

Entrance and Admission Fees Is a capital receipt.

Subscription

- Current year's subscription should be transferred to Income and Expenditure account.
- Outstanding subscription to be shown in Balance Sheet on Asset side.

Life Membership Fee Is a capital receipt shown on liability side:

- Annual membership fee must be transferred to income and Expenditure Account.
- If a member dies, his subscription must be transferred to accumulated fund account.

Other Concepts

Treatment of Important Items in Not for Profit Organisation.

1. **Legacy:** Is the amount received under a will of deceased. It is a capital receipt shown on liability side in Balance Sheet.
2. **Endowment Fund Donation:** Shown on liability side and deducting all expenses made.
3. **Treatment of Sale of Old Newspaper and Periodicals:** Revenue receipt to be recorded in Income and Expenditure A/c.
4. **Sale of fixed assets:** Capital receipt any profit/loss on sale to be transferred to Income and Expenditure A/c.
5. **Honorarium:** Payment given for professional services rendered to a person other than employee of the organisation.

Q10. How is Preparation of Balance Sheet done? Illustrate with on example.

Answer:

- Prepare opening balance sheet and calculate surplus/deficit i.e. opening capital fund position.
- Cash and bank balances as disclosed at the end of Receipt and Payment Account should be transferred to asset side. In case of overdraft, transfer to liability side.
- Closing value of fixed assets [i.e. Opening value + Purchases - Sales - Depreciation] to be shown on asset side.
- Liabilities after adjusting increase and decrease to be shown on left side of Balance Sheet.

Illustration

The following is the receipts and payments account of a charitable hospital for the year ended 31st March 2002:

Receipts	₹'000	Payments	₹'000
To Balance b/f		By Medicines	1,500
Cash in hand	50	By Honorarium to Doctors	500
Cash at bank	300	By Salaries	1,375
To Subscriptions	2,500	By Sundry Expenses	25
To Donations	725	By Equipments purchased	750
To Interest for full year on investments @ 7% per annum	350	By Charity show expenses	50
To Charity show receipts	500	By Balance c/f	
		Cash in Hand	25
		Cash at Bank	200
	4,425		4,425

Additional Information:

	On 31.3.2001 (₹'000)	On 31.3.2002 (₹'000)
Subscriptions outstanding	25	50
Subscriptions received in advance	50	25
Stock of medicines	500	750

Amounts due to suppliers of medicines	400	600
Value of equipments	1,050	1,500
Value of buildings	2,000	1,900

You are required to prepare Income and Expenditure Account for the year ended 31st March, 2002 and the Balance Sheet as on that date.

Solution:

Income and Expenditure Account
for the year ended 31st March, 2002

(₹000)

Expenditure		₹	Income		₹
To Medicines used		1,450	By Subscriptions		2,550
To Honorarium to Doctors		500	By Donations		725
To Salaries		1,375	By Interest on Investments		350
To Sundry Expenses		25	By Income from Clarity show:		
To Depreciation on:			Proceeds	500	
Equipments	300		*Less:* Expenses	50	450
Buildings	100	400			
To Surplus i.e. excess of income over expenditure		325			
		4,075			4,075

Balance Sheet as at 31st March, 2002

Liabilities		₹	Assets		₹
Suppliers of Medicines		600	Buildings	2,000	
Subscribed Received in advance		25	Less: Depreciation	100	1,900
Capital Fund			Equipments	1,050	
			Add: Additions	750	
Opening Balance	8,475			1,800	
Add: Surplus for the year	325	8,800	*Less:* Depreciation	300	1,500
			Investments		5,000
			Stock of Medicines		750
			Subscription outstanding		50
			Cash at Bank		200
			Cash in hand		25
		9,425			9,425

Working Notes:

		₹'000
(i) **Calculation of subscriptions earned:**		
Subscriptions received during a year		2,500
Add: Outstanding as on 31.3.2002		50
Add: Received in Advance as on 31.3.2001		50
		2,600
Less: Outstanding on 31.3.2001	25	
Less: Received in advance on 31.3.2002	25	50
		2,550
(ii) **Calculation of medicines used:**		
Payments to suppliers		1,500
Add: Due to suppliers on 31.3.2002		600
		2,100
Less: Due to suppliers on 31.3.2001		400
Medicines purchased during the year		1,700
Add: Stock of medicines on 31.3.2001		500
		2,200
Less: Stock of medicines on 31.3.2002		750
		1,450
(iii) **Depreciation on Equipments:**		
Balance on 1.4.2001		1,050
Add: Purchases during the year		750
		1,800
Less: Balance on 31.3.2002		1,500
Depreciation during the year		300

(iv) **Amount of Investments:**
₹350 thousand x 100/7 = ₹5,000 thousand

(v) Calculation of Capital Fund

Balance Sheet as at 31st March 2001 (₹000)

Particulars	₹	Particulars	₹
Subscription Received in Advance	50	Subscription Receivable	25
Creditors for Medicines	400	Stock of Medicine	500
Capital Fund (Balancing Figure)	8,475	Equipments	1,050
		Buildings	2,000
		Investments (350x100/7)	5,000
		Cash in Hand	50
		Cash at Bank	300
	8,925		8,925

5. **Educational Institutions**

Registration

- Registered under society Registration Act, 1860 and Trust Act.

Organizational Pattern

- The affairs of institutions are managed by the head called Principal or Headmaster. They supervise the smooth functioning of institution.

Salient Features

- Financial assistance to meet expenses is received in the form of donation, charities, etc.
- Government also provides assistance to such institutions.

Sources of Fund

- Donation from public.
- Fees in the form of tution fees, term fees, admission fees, etc.
- Grants from Government.

Specific Items

Donation from public in cash or kind for recurring or not recurring purposes.
Capitalisation fees and Admission fees collected from students by the parent body running the institution.
Laboratory and Library Deposit collected from students as a security deposit refundable at the time student leaves the school.

Use of term fees: Term fees can be used for different purposes such as:

- Examination Expenses
- School functions

- Sports and games
- Extra curricular activities
- Audio Visual Education
- School magazines
- Conduction of several inter school and intra school competitions, etc.

Recurring grant: Grants received in parts throughout the year inform of maintenance grants.

Use of grant in aid Various uses can be:

- Staff salaries and Allowances
- Leave Allowance
- Bad climate allowance
- Leave salary
- Expenditure on training of teacher
- Rents Rates and taxes
- Prizen
- Repairs and maintenance
- General Administrative expenses
- Prizes
- Subscription to educational Associations, etc.

SHORT PRACTICE QUESTIONS

1. Define the term Donation also state the treatment in books of account.
2. Differentiate between Income and Expenditure Account and Receipt and Payment Account.
3. List out at least six uses of term fees.
4. Enumerate the features of Receipt and Payment Account.

PAST YEAR QUESTIONS AND ANSWERS

OBJECTIVE QUESTIONS

1995 - May [5] State with reasons whether the following statement is true or false:

(a) Scholarships granted to students out of funds provided by Government will be debited to Income and Expenditure Account. (2 marks)

Answer:

False. The scholarships granted to students should be shown as deduction from the funds provided by the Government for the same purpose in the Balance Sheet.

1995 - Nov [5] State with reasons whether the following statement is true or false:

(5) Receipts and Payments Account is a summary of all capital receipts and payments. (2 marks)

Answer:

False: Receipt and Payments Accounts is a summary of all the cash or bank receipts and payments of both whether of capital or revenue nature.

1996 - May [5] State with reasons whether the following statement is true or False:

(6) The receipts and payments account records receipts and payments of revenue nature only. (2 marks)

Answer:

False. The Receipts and Payments Account records the receipts and payments of both capital as well as revenue nature.

1997 - May [5] State with reasons whether the following statement is true or False:

(10) If there appears a sports fund, the expenses incurred on sports activities will be taken to income and expenditure account. (2 marks)

Answer:

False: Such expenses should be deducted from the sports fund and will not be taken to income and expenditure account.

1997 - Nov [5] State with reasons whether the following statement is true or False:

(8) Receipts and payments account is a summary of all capital receipts and payments. (2 marks)

Answer:

Please refer 1995 - Nov [5] (5) on page no. 937

1999 - Nov [5] State with reasons whether the following statement is true or false:

(vi) Receipts and payments account highlights total income and expenditure. (2 marks)

Answer:

False: Receipt and Payments account is a summary of all cash or bank receipts and payments over a certain period with a cash bank balance at the beginning as well as at the end of the period.

2005 - May [5] State with reasons whether the following statement is true or false:

(v) All receipts and expenses of capital nature are shown in Receipts and Payments Account. (2 marks)

Answer:

True. Receipts and Payments Account records all receipts and payments whether they are of capital or revenue in nature.

2005 - Nov [5] State with reasons whether the following statement is true or false:

(viii) Only revenue items are disclosed in Income and Expenditure account. (2 marks)

Answer:

True: Only revenue items are disclosed in Income and Expenditure accounts.

2018 - Nov [1] {C} (a) State with reasons, whether the following statements are true or false:

(iii) Fees received for Life Membership is a revenue receipt as it is of recurring nature. (2 marks)

Answer:

False: Fees received for life membership is a capital receipt as it is of non-recurring nature. It is directly added to capital fund or general fund.

SHORT NOTES

1999 - May [6] Write short note on the following:

(iii) Income and Expenditure Account. (5 marks)

Answer:

- In the case of professionals, Receipts and Payments Account, Income and Expenditure Account and Balance Sheet are generally prepared to show the results of their activities and their financial position.
- However, some professionals also prepare Receipts and Expenditure Account to show final result of their professional activities.
- As the title indicates, such an account includes all expenses on the basis of mercantile system, i.e., accrual basis, but for recording income, cash system is followed.
- In other words, to find out the profit, all outstanding expenses are taken into account but the fees and charges that are outstanding or the work-in-progress are not considered.
- The reason for this treatment is that professionals consider it imprudent and risky to recognise the outstanding fees.

- Therefore, the difference between the profit as shown by Income and Expenditure Account and Receipts and Expenditure Account arises on account of non-recognition of outstanding fees and charges and work-in-progress in Receipts and Expenditure Account.

2000 - May [6] Write short note on the following:

(c) Receipts and Payments Account.

Answer:

Receipts and Payments Account:

Receipts and Payments Account is an elementary form of account commonly adopted by non-profit making concerns such as hospitals, clubs, societies etc. for recording cash and bank transactions. It starts with the opening cash or bank balance(or an overdraft) and is debited with all sums received and credited with amounts paid out whether or not such receipts and payments relate to that period. All the receipts and payments whether of a revenue or capital nature are included in the account. The balance of this account at the end of year represents the difference between the amount received and paid out i.e., the balance of cash in hand and at bank or bank overdraft..

2003 - Nov [6] Write short note on the following:

(c) Receipts and Expenditure Account for Professional Firms. (3 marks)

Answer:

Please refer on 1999 - May [6] (iii) on page no. 939

DISTINGUISH BETWEEN

2005 - May [6] (v) Distinction between Receipt and Payment Account and Income and Expenditure Account. (5 marks)

Answer:

Non-profit making organizations such as public hospitals, public education institutions, clubs etc., conventionally prepare receipts and payments account and income and expenditure account to show periodic performance for a particular accounting period.

Receipts and Payments Account:

- Receipts and payments account is an elementary form of account consisting of a classified summary of cash receipts and payments over a certain period together with cash balances at the beginning and close of the period.
- The receipts are entered on the left-hand side, and payments on the right-hand side, i.e. same sides as those on which they appear in the cash book.
- All the receipts and payments whether of revenue or capital nature are included in this account.
- The balance of the account at the end of a period represents the difference between the amount of cash received and paid up.
- It is always in debit since it is made up of cash in hand and at bank.

Income and Expenditure Account:

- Income and Expenditure Account resembles a Profit and Loss Account and serves the same function in respect of a non-profit making concern as the latter mentioned account does for a firm, carrying on business or trade.
- Income and Expenditure Account is drawn up in the same form as the Profit and Loss Account.
- Expenditure of Revenue nature only is shown on the debit side, and incomes and gains of revenue nature are shown on the credit side.
- Income and Expenditure Account contains all the items of Income and Expenditure relevant to the period of account, whether received or paid out as well as that which have fallen due for recovery or payment.
- Capital receipts, prepayments of income and capital expenditures, prepaid expenses are excluded.
- It does not start with any opening balance.
- The closing balance represents the amount by which the income exceeds the expenditure or *vice-versa*.

PRACTICAL QUESTIONS

1996 - May [2] From the following Receipts and Payments Account of Excellent Recreation Club for the year ended 31.3.1996 and additional information given, prepare an Income and Expenditure Account for the year ended 31.3.1996 and Balance Sheet as on 31.3.1996:

Receipts	₹	Payments	₹
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 as on 31.3.1995 and 31.3.1996 were as follows:

	31.3.1995	31.3.1996
	₹	₹
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 1.6.1994 and the amount of investments was ₹20,000. Due date of interest 31st March every year. Stock of sports materials on 31.3.1996 were useless and valued at NIL price. (15 marks)

Answer:

Recreation Club
Income and Expenditure Account
(For the year ended 31st March, 1996)

Expenditure	₹	Income		₹
To Secretary's Salary	12,000	By Subscription		17,100
To Salaries to staff	25,000	By Sales of old newspapers		2,500
To Charities	1,000	By Interest on securities	2,000	
To Printing & stationery	600	*Add:* Outstanding	400	2,400
To Upkeep of land	2,000	By Proceeds of sport and concerts		4,020
To Sports materials written off	10,000	By Advertisement in the year book		5,000
To Telephone expenses	3,480	By Excess of Expenditure over Income		24,880
To Postage expenses	120			
To Rates and taxes	1,500			
To Depreciation on furniture	200			
	55,900			55,900

Balance Sheet
Of Excellent Recreation Club
As on 31st March 1996

Liabilities		₹	Assets		₹
Capital Fund Opening balance			Land		10,000
Less: Excess of	36,680		Furniture	2,000	
Expenditure over income	24,880		*Less:* Depreciation	200	1,800
	11,800		Sports Materials	10,000	
Add: Legacies	4,000	15,800	*Less:* Written off	10,000	Nil
Endowment Fund		20,000	Investment in securities		20,000
Subscription received in Advance		400	Subscriptions Receivable		1,000
			Interest Due		400
			Cash in hand and at Bank		3,000
		36,200			36,200

Working Notes:

1. **Balance Sheet of Excellent Recreation Club as on 31st March 1995**

Liabilities	₹	Assets	₹
Capital Fund (Balancing Amount)	36,680	Land	10,000
Subscription Received in Advance	500	Furniture	2,000
		Arrears of Subscription	2,000
		Investments in Securities	20,000
		Cash in hand and at Bank	3,180
	37,180		37,180

2. **Subscription pertaining to the period ended 31st March 1996**

	₹
Subscription received during the year	18,000
Add : Outstanding Subscription on 31.3.1996	1,000
	19,000
Add: Received in advance as on 31..1995	500
	19,500
Less: Outstanding subscription as on 31.3.1995	2,000
	17,500
Less: Received in advance as on 31.3.1996	400
	17,100

1996 - Nov [1] A and B are in partnership practicing as Chartered Accountants under the name and style AB & Co. sharing profits/losses in the manner stated below. They close their accounts on 31st March every year. The following was their Balance Sheet as at 31st March, 1995:

Balance Sheet as at 31st March, 1995

		₹		₹
Partners' Capital:			Furniture	20,000
A	65,000		Office Machinery	15,000
B	40,000	1,05,000	Library Books	8,000

Audit Fees collected in Advance (A's client)		10,000	Car		60,000
Liability for Salary		5,000	Outstanding Audit Fees:		
Provision against outstanding Audit Fees		50,000	A's Client	30,000	
			B's Client	20,000	50,000
			Cash at Bank		15,000
			Cash in Hand		2,000
		1,70,000			1,70,000

The following is the summary of their cash/bank transactions for the year ended 31st March, 1996:

Receipts		₹	Payments		₹
Opening:			Salary Charges		2,60,000
Bank Balance		15,000	Car Expenses		35,000
Cash Balance		2,000	Traveling Expenses		21,000
Audit Fees:			Printing and Stationery		18,000
A's Clients	2,80,000		Postage Expenses		3,000
B's Clients	1,80,000	4,60,000	Telephone		15,000
Fees for other Services:			Subscription for Journals		7,000
A's Clients	50,000		Library Books		12,000
B's Clients	40,000	90,000	Fax Machine		16,000
Miscellaneous Income		4,000	Membership Fees		2,000
			Drawings:		
			A	72,000	
			B	60,000	1,32,000
			Cash at Bank		48,000
			Cash in Hand		2,000
		5,71,000			5,71,000

The following further information is available:

1. Audit Fees Receivable:
   A's Clients ₹30,000
   B's Clients ₹50,000
2. Audit Fees Collected in Advance
   B's Client ₹20,000
3. Outstanding Liability for Salary on 31st March, 1996 ₹20,000
4. Depreciation to be provided on:
   Furniture 10%
   Office Machinery 20%
   Library Books 10%
   Car 20%
5. It has been agreed that 80% of audit fees and 40% 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/Losses to be divided between A and B in the ratio of 2:1 respectively.

You are required to prepare Income and Expenditure Account for the year ended 31st March, 1996 and a Balance Sheet as at 31st March, 1996.

(20 marks)

Answer:

AB & Co.
Chartered Accountants
Income and Expenditure Account
[For the year ended 31st March, 1996]

Expenditure	₹	Income	₹
To Salary charges (2,60,000 + 20,000 - 5,000)	2,75,000	By Audit fees	3,60,000
		By Fees for other services	36,000
To Car expenses	35,000	By Miscellaneous income	4,000
To Travelling expenses	21,000		
To Printing & stationery	18,000		
To Postage expenses	3,000		
To Telephone	15,000		

To Subscription for journals		7,000		
To Membership fees		2,000		
To Depreciation:				
Furniture	2,000			
Office machinery	6,200			
Library books	2,000			
Car	12,000	22,200		
To Profit:				
A's share		1,200		
B's share		600		
		4,00,000		4,00,000

Balance Sheet
As on 31st March 1996

Liabilities		₹	Assets		₹
Partners' Capital: (2)			Furniture	20,000	
			Less: Depreciation	2,000	18,000
A	82,200		Office Machinery	15,000	
B	36,600	1,18,800	*Add:* Addition	16,000	
Audit Fees Collected in				31,000	
Advance		20,000	*Less:* Depreciation	6,200	24,800
Liability for Salary		20,000	Library books	8,000	
Provision against			*Add:* Additions	12,000	
outstanding Audit Fees		80,000		20,000	
			Less: Depreciation	2,000	18,000
			Car	60,000	
			Less: Depreciation	12,000	48,000
			Outstanding Audit Fees:		
			A's clients	30,000	
			B's clients	50,000	80,000
			Cash in Bank		48,000
			Cash in Hand		2,000
		2,38,800			2,38,800

Working Notes:

1. Audit Fees:

	A (₹)	B (₹)
Collections	2,80,000	1,80,000
Add: Outstanding on 31.3.96	30,000	50,000
Add: Received Last year	10,000	—
	3,20,000	2,30,000
Less: Outstanding on 31.3.95	30,000	20,000
	2,90,000	2,10,000
Less: Received in advance on 31.3.96	—	20,000
	2,90,000	1,90,000
Add: Provision (Opening)	30,000	20,000
	3,20,000	2,10,000
Less: Provision (Closing)	30,000	50,000
	2,90,000	1,60,000
80% thereof transferred to income and Expenditure A/c	2,32,000	1,28,000
20% taken to Capital A/c	58,000	32,000
	2,90,000	1,60,000

2. Fees for other services:

	A ₹	B ₹
Collections	-50,000	40,000
Less: 40% thereof transferred to Income & Expenditure A/c	20,000	16,000
60% taken to Capital A/c	30,000	24,000

3. Capital Accounts

Particulars	A ₹	B ₹	Particulars	A ₹	B ₹
To Drawings	72,000	60,000	By Balance b/d	65,000	40,000
To Balance c/d	82,200	36,600	By Audit fees (20%)	58,000	32,000
			By Fees for other services (60%)	30,000	24,000
			By Share of Profit	1,200	600
	1,54,200	96,600		1,54,200	96,600

1997 - Nov [1] From the following Receipts and Payments A/c of Mumbai Club, prepare Income and Expenditure A/c for the year ended 31.12.1996 and its Balance Sheet as on that date:

Receipts	₹	Payments	₹
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:

(1) Subscriptions in arrear for 1996 ₹900 and subscriptions in advance for 1997 ₹350.

(2) Insurance premium Outstanding ₹40.

(3) Misc. Expenses Prepaid ₹90.

(4) 50% of donation is to be capitalised.

(5) Entrance Fees are to be treated as revenue income.

(6) 8% interest has accrued on investment for five months.

(7) Billiard Table costing ₹30,000 was purchased during the last year and ₹22,000 were paid for it. (20 marks)

Answer:

Income and Expenditure Account of Mumbai Club
(For the year ended 31st December 1996)

Expenditure		₹	Income		₹
To Salary		2,000	By Donations	5,000	
To Repair Expenses		500	*Less:* Capitalised 50%	2,500	2,500
To Misc Expenses	500		By Subscriptions	12,000	
Less: Prepaid	90	410	*Add:* Outstanding	900	
To Insurance Premium	200			12,900	
Add: Outstanding	40	240	*Less:* Advance for '97	350	12,550
To Paper, ink, etc.		150	By Entrance Fees		1,000
To Drama Expenses		500	By Interest on Investment		300
To Surplus-Excess of Income over Expenditure		14,150	$\left[100+\frac{8}{100}\times 6{,}000\times\frac{5}{12}\right]$		
			By Interest received from Bank		400
			By Sale of Old Newspapers		150
			By Sale of Drama Tickets		1,050
		17,950			17,950

Balance Sheet of Mumbai Club
As on 31st December, 1996

Liabilities		₹	Assets	₹
Capital Fund			Billiard Table	30,000
Opening Balance	36,000		Furniture	6,000
Add: Surplus	14,150		Investments	6,000
Donations	2,500	52,650	Interest Accrued	200
Outstanding Insurance Premium		40	Prepaid Expenses	90
			Subscriptions Receivable	900
Subscriptions Received in Advance		350	Cash in Hand	2,650
			Cash at Bank	7,200
		53,040		53,040

Working Notes:

Balance sheet of Mumbai Club
(As on 31st December, 1995)

Liabilities	₹		₹
Capital Fund (Balancing Figure) Creditors for Billiard table	36,000 8,000	Billiard Table Cash in Hand Cash at Bank	30,000 4,000 10,000
	44,000		44,000

1998 - Nov [1] The following informations were obtained from the books of Delhi Club as on 31.3.1998, 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 31.3.1998 and a Balance Sheet as at 31.3.1998 on mercantile basis:

(i) Donations received for Building and Library Room ₹2,00,000.

(ii) Other revenue income and actual receipts:

	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:

	Revenue Expenditure	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 31.3.1998. Remaining amount was put in the Bank on 31.3.1998 under the term deposit. Depreciation at 10% p.a. was to be provided for the whole year on Furniture and Library Books.

(20 marks)

Answer:

Delhi Club
Receipts and Payments Account
(For the year ended 31st March, 1998)

Receipts	₹	Income	₹
To Donations for Building and Library Room	2,00,000	By Land	10,000
To Entrance Fees	17,000	By Furniture	1,30,000
To Subscription	19,000	By Salaries	4,800
To Locker Rents	600	By Maintenance of Playgrounds	1,000
To Sundry Income	1,060	By Rent	8,000
To Refreshment Account	16,000	By Refreshment Account	8,000
To Balance c/d:		By Library Books	25,000
Overdraft	1,08,140	By 9% Govt. Bonds	1,60,000
		By Bank Term Deposit	15,000
	3,61,800		3,61,800

Income and Expenditure Account
for the year ended 31st March, 1998

Expenditure		₹	Income		₹
To Salaries	4,800		By Entrance Fees		17,000
Add: Outstanding	200	5,000	By Subscription	19,000	
To Maintenance of			*Add:* Outstanding	1,000	20,000
Playgrounds	1,000		By Locker Rents		600
Add: Outstanding	1,000	2,000	By Sundry Income	1,060	
To Rent		8,000	*Add:* Outstanding	540	1,600

To Depreciation:			By Refreshment Account	8,000
Furniture	14,600		(16,000-8,000)	
Library Books	2,500	17,100		
To Surplus - Excess of Income over Expenditure		15,100		
		47,200		47,200

Balance Sheet of Delhi Club as on 31st March, 1998

Liabilities		₹	Assets		₹
Capital Fund (Surplus)		15,100	Land		10,000
Building & Library Room Fund		2,00,000	Furniture	1,46,000	
Creditors for Furniture		16,000	*Less:* Depreciation	14,600	1,31,400
Creditors for Expenses:			Library Books	25,000	
Salaries Outstanding	200		*Less:* Depreciation	2,500	22,500
Maintenance of Playground	1,000	1,200	9% Govt. Bonds		1,60,000
Bank Overdraft		1,08,140	Bank Term Deposits		15,000
			Subscription Receivable		1,000
			Sundry Income Receivable		540
		3,40,440			3,40,440

1999 - Nov [1] Mahaveer Sports Club gives the following Receipts & Payments Account for the year ended March 31, 1998:

Receipts and Payments Account

Receipts	₹	*Payments*	₹
To Opening Cash & Bank Balances	5,200	By Salaries	15,000
To Subscriptions	34,800	By Rent & Taxes	5,400
To Donations	10,000	By Electricity Charges	600
To Interest on Investments	1,200	By Sports Goods	2,000
		By Library Books	10,000

To Sundry Receipts	300	By Newspapers & Periodicals	1,080
		By Misc. Expenses	5,400
		By Closing Cash & Bank Balances	12,020
	51,500		51,500

Liabilities	As on 31.3.97 ₹	As on 31.3.98 ₹
Outstanding Expenses:		
Salaries	1,000	2,000
Newspapers & Periodicals	400	500
Rent & Taxes	600	600
Electricity Charges	800	1,000
Assets	**As on 31.3.97 ₹**	**As on 31.3.98 ₹**
Library Books	10,000	
Sports Goods	8,000	
Furniture and Fixtures	10,000	
Subscriptions Receivable	5,000	12,000
Investment—Govt. Securities	50,000	
Accrued Interest	600	600

Provide Depreciation on:

Furniture & Fixtures @ 10% p.a.

Sports Goods @ 20% p.a.

Library Books @ 10% p.a.

You are required to prepare Club's opening Balance Sheet as on 01.04.97, Income and Expenditure Account for the year ended on 31.3.98 and the Balance Sheet as on that date. (20 marks)

Answer:

Balance sheet of Mahaveer Sports Club
As on 1st April, 1997

Liabilities	₹	₹	Assets	₹
Capital Fund (Balancing Figure)		86,000	Library Books	10,000
Outstanding Expenses:			Sports Goods	8,000
Salaries	1,000		Furniture and Fixtures	10,000
Newspapers and Periodicals	400		Subscriptions Receivable	5,000
Electricity charges	800		Investment:	
Rent and taxes	600	2,800	Govt. Securities	50,000
			Accrued Interest	600
			Cash and Bank Balances	5,200
		88,800		88,800

Income and Expenditure Account
For the Year ended on 31st March, 1998

Expenditure	₹	Income	₹
To Salaries	16,000	By Subscriptions (W.N. 1)	41,800
To Electricity Charges	800	By Interest on Investments (W.N. 2)	1,200
To Rent and Taxes	5,400	By Sundry Receipts	300
To Newspapers and Periodicals	1,180		
To Misc. Expenses	5,400		
To Depreciation on Fixed Assets (W.N. 4)	5,000		
To Excess of Income over Expenditure (transferred to Capital Fund)	9,520		
	43,300		43,300

Balance Sheet of Mahaveer Sports Club
As on 31st March, 1998

Liabilities	₹	₹	Assets	₹	₹
Capital Fund			Fixed Assets (W.N. 4):		
Opening Balance	86,000		Furniture and Fixtures	9,000	
Add: Excess of Income over Expenditure	9,520		Sport Goods	8,000	
Add: Donations	10,000	1,05,520	Library Books	18,000	35,000
			Investment:		
Outstanding Expenses (W.N.3)			Govt. Securities		50,000
Salaries	2,000		Accrued Interest		600
Newspapers and Periodicals	500		Subscription Receivable		12,000
Electricity Charges	1,000		Cash and Bank Balances		12,020
Rent and taxes	600	4,100			
		1,09,620			1,09,620

Working Notes:

(1) Subscription for the year ended 31st March, 1998:

	₹
Subscriptions received during the year	34,800
Add: Subscriptions receivable on 31.3.98	12,000
	46,800
Less: Subscriptions receivable on 31.3.97	5,000
	41,800

(2) Interest on Investments for the year ended 31st March, 1998:

	₹
Interest received during the year	1,200
Add: Accrued interest on 31.3.98	600
	1,800
Less: Accrued interest on 31.3.97	600
	1,200

(3) Expenses for the year ended 31st March, 1998:

Expenses	Salaries	Electricity Charges	Rent and Taxes	Newspapers and Periodicals
	₹	₹	₹	₹
Paid during the year	15,000	600	5,400	1,080
Add: Outstanding (as on 31.3.98)	2,000	1,000	600	500
	17,000	1,600	6,000	1,580
Less: Outstanding (as on 31.3.97)	1,000	800	600	400
Expenses for the year	16,000	800	5,400	1,180

(4) Depreciation on Fixed Assets:

Assets	Book value (31.3.97)	Additions during the year	Total	Rate of Depreciation p.a.	Depreciation	W.D.V. on as (31.3.98)
	₹	₹	₹		₹	₹
Furniture & fixtures	10,000	—	10,000	10%	1,000	9,000
Sports goods	8,000	2,000	10,000	20%	2,000	8,000
Library books	10,000	10,000	20,000	10%	2,000	18,000
Total					5,000	35,000

Notes:

1. In the given solution, donations have been capitalised. Alternatively, donations may be credited to the Income and Expenditure Account assuming that donations have been raised for meeting some revenue expenditure.
2. It has been assumed in the given solution that the fixed assets were acquired at the beginning of the year. Students may make reasonable assumptions as to the timing of acquisitions of fixed assets and accordingly, provide depreciation on acquisitions on pro-rata basis.

2001 - Nov [1] Summary of Receipts and Payments of Bombay Medical Aid Society for the year ended 31.12.2000 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 collection ₹12,500.

Additional information:

	1.1.2000	31.12.2000
	₹	₹
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

You are required to prepare Receipts and Payments Account and Income and Expenditure Account for the year ended 31.12.2000 and Balance Sheet as on 31.12.2000. (20 marks)

Q.R. Code for Solution Video

Answer:

Receipt and Payment Account of Bombay Medical Aid Society (For the year ended 31st December, 2000)

Receipts	₹	Payments	₹
To Cash Balance (Opening)	8,000	By Purchase of Equipment	15,000
To Subscription	50,000	By Charity show expenses	1,500
To Donation	15,000	By Medical supply	30,000
To Interest	9000	By Honorarium	10,000
To Charity show collections	12,500	By Salaries	28,000
		By Sundry Expenses	1,000
		By Cash in hand	9,000
	94,500		94,500

Income and Expenditure Account
Bombay Medical Aid Society
For the year ended 31st December, 2000

Expenditure	₹	Income		₹
To Medicine consumed (3)	29,000	By Subscription (1)		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			
To Depreciation Equipment	6,000	By Profit on charity show:		
To Depreciation on Building	2,000	Show collection	12,500	
To Surplus	10,200	Show expenses	-1,500	11,000
	86,200			86,200

Balance Sheet of Bombay Medical Aid Society
(As on 31st Dec. 2000)

Liabilities		₹	Assets		₹
Capital Fund (5)			Building	50,000	
Opening Balance	1,80,300		*Less:* Depreciation	2,000	48,000
Add: Surplus	10,200	1,90,500	Equipment	21,000	
Subscription received in advance		700	Add: Purchases	15,000	
Amount due for medicine supply		13,000		36,000	
			Less: Depreciation	6,000	30,000
			Stock of medicine		15,000
			Investments		1,00,000
			Subscription receivable		2,200
			Cash in hand		9,000
		2,04,200			2,04,200

Working Notes:

	₹
1. Subscription for the year ended 31st December 2000	
Subscription receivable during the year	50,000
Less: Subscription receivable on 1.1.2000	1,500
Less: Subscription received in advance on 31.12.2000	700
	47,800

Add: Subscription receivable on 31.12.200	2,200
Add: Subscription received in advance on 1.1.2000	1,200
	51,200
2. Purchase of Medicine	
Payment for Medicine Supply	30,000
Less: Amount due for medicine supply on 1.1.2000	9,000
	21,000
Add: Amount due for medicine supply on 31.12.2000	13,000
	34,000
3. Medicine consumed	
Stock of medicine on 1.1.2000	10,000
Add: Purchase of Medicine during the year	34,000
	44,000
Less: Stock of Medicine on 31.12.2000	15,000
	29,000
4. Depreciation of Equipment	
Value of equipment on 1.1.2000	21,000
Add: Purchase of equipment during the year	15,000
	36,000
Less: Value of equipment on 31.12.2000	30,000
Depreciation on equipment for the year	6,000

5. **Balance Sheet of Medical Aid Society**
As on 31st December 1999

Liabilities	₹	Assets	₹
Capital fund (balance figure)	1,80,300	Building	50,000
Subscription received in advantage	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

2002 - May [1] Smith Library Society showed the following position on 31st March, 2001:

Balance Sheet as on 31st March, 2001

Liabilities	₹	Assets	₹
Capital Fund	7,93,000	Electrical Fittings	1,50,000
Expenses Payable	7,000	Furniture	50,000
		Books	4,00,000
		Investment in Securities	1,50,000
		Cash at Bank	25,000
		Cash in hand	25,000
	8,00,000		8,00,000

The Receipts and Payments Account for the year ended on 31st March, 2002 is given below:

		₹		₹
To Balance b/f			By Electric Charges	7,200
Cash at Bank	25,000		By Postage and Stationery	5,000
Cash in hand	25,000	50,000	By Telephone Charges	5,000
To Entrance Fees		30,000	By Books Purchased	60,000
To Membership Subscription		2,00,000	By Outstanding Expenses paid	7,000
To Sale proceeds of Old papers		1,500	By Rent	88,000
To Hire of Lecture Hall		20,000	By Investment in Securities	40,000
To Interest on Securities		8,000	By Salaries	66,000
			By Balance c/f	
			Cash at Bank	20,000
			Cash in hand	11,300
		3,09,500		3,09,500

You are required to prepare an Income and Expenditure Account for the year ended 31st March, 2002 and a Balance Sheet as at 31st March, 2002 after making the following adjustments:

(i) Membership Subscription included ₹10,000 received in advance.

(ii) Provide for outstanding rent ₹4,000 and salaries ₹3,000.

(iii) Books to be depreciated @ 10% including additions. Electrical Fittings and Furnitures are also to be depreciated at the same rate.

(iv) 75% of the Entrance Fees is to be capitalised.

(v) Interest on Securities is to be calculated @5% p.a. including purchases made on 1.10.2001 for ₹40,000. (20 marks)

Q.R. Code for Solution Video

Answer:

Smith Library Society
Income& Expenditure Account
for the year ended on 31st March, 2002

Expenditure		₹	Income		₹
To Electric charges		7,200	By Entrance fees (25% of ₹30,000)		7,500
To Postage and stationery		5,000	By Membership subscription	2,00,000	
To Telephone charges		5,000	*Less:* Received in advance	10,000	1,90,000
To Rent	88,000		By Sale proceeds of old papers		1,500
Add: Outstanding	4,000	92,000	By Hire of lecture hall		20,000
To Salaries	66,000		By Interest on securities (W.N. 2)	8,000	
Add: Outstanding	3,000	69,000	*Add:* Receivable	500	8,500
To Depreciation (W.N. 1):			By Deficit - Excess of expenditure over income		16,700
Electrical fittings	15,000				
Furniture	5,000				
Books	46,000	66,000			
		2,44,200			2,44,200

**Balance Sheet of Smith Library Society
as on 31st March, 2002**

Liabi8lities	₹	₹	Assets	₹	₹
Capital fund	7,93,000		Electrical fittings	1,50,000	
Add: Entrance fees	22,500		*Less:* Depreciation	15,000	1,35,000
	8,15,500		Furniture	50,000	
Less: Excess of expenditure over income	16,700	7,98,800	*Less:* Depreciation	5,000	45,000
Outstanding expenses			Books	4,60,000	
Rent	4,000		*Less:* Depreciation	46,000	4,14,000
Salaries	3,000	7,000	Investment		
Membership subscription received in advance		10,000	Securities	1,90,000	
			Accrued interest	500	1,90,500
			Cash at bank		20,000
			Cash in hand		11,300
		8,15,800			8,15,800

Working Notes:

1. Depreciation

		₹
Electrical fittings	10% of ₹1,50,000	15,000
Furniture	10% of ₹50,000	5,000
Books	10% of ₹4,60,000	46,000

2. Interest on Securities

	₹
Interest @ 5% p.a. on ₹1,50,000 for full year	7,500
Interest @ 5% p.a. on ₹40,000 for half year	1,000
	8,500
Received	8,000
Receivable	500

2002 - Nov [2] A doctor, after retiring from Government Service, started private practice on 1st April, 2001 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.**

	₹		₹
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, 2002 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, 2002 was valued at ₹9,500.

(15 marks)

Answer:

Capital Account
For the year ended 31st March, 2002

	₹		₹
To Drawings		By Cash/bank	20,000
Motor Car Expenses (one-third of ₹12,000)	4,000	By Cash/bank (Pension)	30,000
Household expenses	18,000	By Net income from Practice (derived from Income and Expenditure A/c)	47,500
Daughter's marriage exp.	21,500		
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, 2002

	₹		₹
To Medicines consumed		By Prescription Fees	52,500
Purchases 24,500		By Gifts from patients	13,500
Less: Stock on 31.3.02 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 (₹10,500 - ₹3,000)	7,500		
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, 2002

Liabilities	₹	Assets	₹
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

2003 - May [1] The Receipts and Payments account of Trustwell Club prepared on 31st March, 2003, is as follows:

Receipts and Payments Account

Receipts		Amount ₹	Payments	Amount ₹
To Balance b/d		450	By Expenses (including Payment for sports material ₹2,700)	6,300
To Annual Income from Subscription	₹4,590		By Loss on Sale of Furniture (cost price ₹450)	180
Add: Outstanding of last year received this year	₹180		By Balance c/d	90,450
	4,770			
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 1.4.2002:-
Furniture ₹1,800; Investment at 5% ₹27,000;
Sports material ₹6,660;
Balance as on 31.3.2003 : Subscription Receivable ₹270;
Subscription received in advance ₹90;
Stock of sports material ₹1,800.

4

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, 2003 and Balance Sheet on that date. (20 marks)

Q.R. Code for Solution Video

Answer:

Trustwell Club
Correct Receipt & Payments Account
For the year ended 31st March 2003

Receipt	Amount	Payments	Amount
To Balance b/d	450	By Expenses	3,600
To Subscription A/c [see work note -1]	4,500	By Sports Material	2,700
		By Balance c/d	90,720
To Other fees	1,800		
To Donation for buildings	90,000		
To Sale of furniture [450-180]	270		
	97,020		97,020

Income & Expenditure Account
(for the year ended 31st March 2003)

Particulars		Amount ₹	Particulars	Amount ₹
To Expenses		3,600	By Subscription A/c	4,590
To Sports Material			By Other Fee	1,800
Opening Stock	6,660		By Interest on Investment (5% of 27,000)	1,350
Add: Purchase	2,700			
	9,360		By Deficiency	3,600
Less: Closing Stock	1,800	7,560		
To Loss on sale of furniture		180		
		11,340		11,340

Balance Sheet
(As on 31st March 2003)

Liabilities		Amount ₹	Assets		Amount ₹
			Cash in Hand		90,720
Prepaid Subscription		90	Outstanding subscription		270
			furniture	1,800	
Donation for building		90,000	*Less:* Sold	450	1,350
Capital Fund	36,000		5% Investment	27,000	
Less: Deficiency	3,600	32,400	*Add:* Intt accrued	1,350	28,350
			Sports Material		1,800
		1,22,490			1,22,490

Working Notes:

Subscription Account

Particulars	Amount ₹	Particulars	Amount ₹
To Outstanding Subscription	180	By Prepaid Subscription	90
To Prepaid Subscription	90	By Cash A/c [Subscription recd. during the year: (Bal. Fig]	4,500
To Income & Expenditure A/c (given)	4,590	By Outstanding Subscript-ion (closing)	270
	4,860		4,860

Balance Sheet
(As on 1st April 2002)

Liabilities	Amount ₹	Assets	Amount ₹
Prepaid Expenses	90	Outstanding Subscription	180
Capital fund (Balancing fig.)	36,000	Furniture	1,800
		5% Investment	27,000
		Sport Material	6,660
		Cash in Hand	450
	36,090		36,090

2006 - May [1] Following is the Income and Expenditure Account of Victoria Club for the year ending 31st March, 2006:

Expenditure		Amount ₹	Income		Amount ₹
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 and Stationary		1,800	Less - Expenses	3,000	3,000
To Annual day Celebration Exp.	6,000				
Less—Donation	4,000	2,000			
To Interest on Bank Loan		600			
To Depreciation on Sports Equipment		1,200			
To Excess of Income over Expenditure		2,400			
		34,000			34,000

Additional Information :

		31.03.05 (₹)	31.03.06 (₹)
(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

(vii) The Club owned a Sports' ground of ₹40,000

(viii) The Club took a loan of ₹8,000 from a bank during the year 2004-05, which was not paid in 2005-06.

(ix) Audit fee of 2005-06 was outstanding, but Audit fees of ₹800 for 2004-05 was paid in 2005-06.

Prepare Receipts and Payments Account for the year ending 31st March, 2006 and a Balance Sheet on that date. (20 marks)

Answer:

Receipts and Payments Account of Victoria Club for the year ended 31st March, 2006

Receipts	Amount ₹	Amount ₹	Payments	Amount ₹	Amount ₹
To Balance b/d (Balancing figure)		5,560	By Salaries and Wages	19,000	
To Subscription	30,000		*Add:* Outstanding as on 31.3.2005	1,600	
Add: Outstanding as on 31.3.2005	2,400			20,600	
Add: Advanced on 31.3.2006	1,080		*Less:* Outstanding as on 31.3.2006	1,800	18,800
	33,480		By Audit Fees (for 2004-2005)		800
Less: Advance received on 31.3.2005	1,800		By Purchase of Sports Equipments (W.N. 2)		1,600
	31,680		By Misc. Expenses	2,000	
Less: Outstanding as on 31.3.2006	3,000	28,680	*Add:* Prepaid Insurance	240	2,240
To Donation		4,000	By Chief Executive's Honorarium		4,000
To Entrance Fees		1,000	By Printing and Stationary		1,800
To Receipts for Annual Sports		6,000	By Expenses on Annual Sports		3,000
			By Annual Day Celebration Expenses		6,000
			By Interest on Bank Loan		600
			By Balance c/d (given)		6,400
		45,240			45,240

Balance Sheet of Victoria Club
as on 31st March, 2006

Liabilities		Amount ₹	Assets		Amount ₹
Salaries outstanding		1,800	Cash		6,400
Audit Fees outstanding		1,000	Subscription outstanding		3,000
Bank Loan		8,000	Sports Equipments:	10,400	
Subscription received in advance		1,080	*Add:* Purchased during the year	1,600	
Capital Fund:				12,000	
Balance as on 1.4.2005 (W.N. 1)	46,160		*Less:* Depreciation	1,200	10,800
Add: Excess of Income over Expenditure	2,400	48,560	Sports Ground		40,000
			Prepaid Insurance		240
		60,440			60,440

Working Note:
1. Capital Fund as on 1.4.2005

Balance Sheet
as on 31st March, 2005

Liabilities	₹	Assets	₹
Bank Loan	8,000	Cash	5,560
Subscription Received in advance	1,800	Sports Ground	40,000
Salaries outstanding	1,600	Sports Equipments after depreciation	10,400
Audit fees outstanding	800	Subscription outstanding	2,400
Capital Fund (Balancing figure)	46,160		
	58,360		58,360

2. Purchase of Sports Equipments

	₹
Balance of Sports Equipments after depreciation on 31.03.2006	10,800
Add: Depreciation of 2005 - 2006	1,200
	12,000
Less: Balance of sports equipments after Depreciation on 31.03.2005	10,400
Purchased during the year	1,600

2006 - Nov [1] Following is the Receipts and Payments Account of M/s Tiptop Club for the year ended 31st March, 2006:

Receipts	₹	Payments	₹
To Cash in hand on 1st April, 2005	9,000	By Payments for cosmetics	15,000
To Subscription	45,000	By Honorarium to Beautician	8,000
To Donation	4,500		
To Interest on Investments at 6% for the year	3,000	By Salaries	18,000
		By Sundry expenses	1,000
To Fashion show proceeds	50,500	By Rent for building	12,000
		By Equipments purchased	13,000
		By Fashion show expenses	34,000
		By Cash in hand on 31st March, 2006	11,000
	1,12,000		1,12,000

Additional information:

	On 1st April, 2005 (₹)	On 31st March, 2006 (₹)
(i) Subscription due	500	2,000
(ii) Subscription received in advance	1,500	1,000
(iii) Stock of cosmetics	10,000	7,000
(iv) Amount due to cosmetics suppliers	8,000	11,000
(v) Rent paid in advance	1,000	1,500
(vi) Salary outstanding	1,500	2,000

(vii) Value of Equipments	21,500	29,000
(viii) Value cf Furniture and Fixtures	40,000	36,000

You are required to prepare Income and Expenditure Account for the year ended 31st March, 2006 and Balance Sheet as on date of M/s Tiptop Club. Show all workings. (20 marks)

Answer:

M/s Tiptop Club

Income and Expenditure A/c for the year ended 31st March, 2006

Expenditure		₹	Income		₹
To Cosmetics Consumed			By Subscription	45,000	
Opening Stock	10,000		*Add :* Due as on 31.03.2006	2,000	
Add: Purchases (W.N.1)	18,000		Advance as on 01.04.2005	1,500	
	28,000			48,500	
Less: Closing Stock	7,000	21,000	*Less:* Due as on 01.04.2005	500	
To Honorarium		8,000		48,000	
To Salaries	18,000		*Less:* Advance as on 31.03.2006	1,000	47,000
Add: O/s as on 31.03.2006	2,000				
	20,000				
Less: O/s as on 01.04.2005	1,500	18,500	By Donation		4,500
To Sundry Expenses		1,000	By Interest on Investments		3,000
To Rent for Building	12,000		By Fashion Show Proceeds		50,500
Add: Prepaid as 01.04.2005	1,000				
	13,000				
Less: Prepaid as on 31.03.2006	1,500	11,500			
To Fashion Show Expenses		34,000			
To Depreciation on Equipment					
Opening Balance	21,500				
Add: Purchases	13,000				
	34,500				
Less: Closing Balance	29,000	5,500			
To Deprecation on Furniture					
Opening Balance	40,000				
Less: Closing Balance	36,000	4,000			
To Surplus		1,500			
		1,05,000			1,05,000

M/s Tiptop Club

Balance Sheet as on 31st March, 2006

Liabilities		₹	Assets		₹
Capital Fund			Equipment	21,500	
Opening Balances (W.N. 2)	1,21,000		*Add:* Purchases	13,000	
Add: Surplus	1,500	1,22,500		34,500	
Subscription Received in Advance		1,000	*Less:* Depreciation	5,500	29,000
Amount Due to Cosmetic Suppliers		11,000	Furniture and Fixtures	40,000	
Salary Outstanding		2,000	*Less:* Depreciation	4,000	36,000
			Investments		50,000
			Subscription Due		2,000
			Stock of Cosmetics		7,000
			Rent Paid in Advance		1,500
			Cash in Hand		11,000
		1,36,500			1,36,500

Working Notes:

1. **Calculation of Purchases:**

Particulars	₹
Amount Paid to Suppliers	15,000
Add: Due as on 31.03.2006	11,000
	26,000
Less: Due as on 01.04.2005	8,000
Purchases during the year	18,000

2. **Calculation of Capital Fund as on 1st April, 2005:**

Balance Sheet as on 1st April, 2005

Liabilities	₹	Assets	₹
Capital Fund (bal. fig)	1,21,000	Equipment	21,500
Subscription Received in Advance	1,500	Furniture and Fixtures	40,000
Amount Due to Cosmetic Suppliers	8,000	Investments (₹ 3,000 ÷ 6%)	50,000
Salary Outstanding	1,500	Subscription Due	500
		Stock of Cosmetics	10,000
		Rent Paid in Advance	1,000
		Cash in Hand	9,000
	1,32,000		1,32,000

2018 - Nov [5] (a) You are provided with the followings:

Balance Sheet as on 31st March, 2017

Liabilities	(₹)	Assets	(₹)
Capital Fund	1,06,200	Building	1,50,000
Subscription received in Advance	6,000	Outstanding Subscription	3,800
		Outstanding Locker Rent	2,400
Outstanding Expenses	14,000	Cash in Hand	20,000
Loan	40,000		
Sundry Creditors	10,000		
Total	**1,76,200**	**Total**	**1,76,200**

The Receipts and Payment Account for the year ended on 31st March, 2018

Receipts		(₹)	Payments		(₹)
To Balance b/d			**By Expenses :**		
Cash in Hand		20,000	For 2017	12,000	
To Subscriptions :			For 2018	20,000	32,000
For 2017	2,000		By Land		40,000
For 2018	21,000		By Interest		4,000
For 2019	1,000	24,000	By Miscellaneous Expenses		4,700
To Entrance Fees		38,000	By Balance c/d		
To Locker Rent		7,000	Cash in Hand		18,300
To Sale proceeds of old newspapers		1,000			
To Miscellaneous Income		9,000			
		99,000			**99,000**

You are required to prepare Income and Expenditure Account for the year ended 31st March, 2018 and a Balance Sheet as at 31st March, 2018 (Workings should form part of your answer). (10 marks)

Q.R. Code for Solution Video

Answer:

Income and Expenditure Account for the year ending 31st March, 2018

Expenditure	₹	Income	₹
To Expenses	20,000	By Subscriptions (21,000 + 6,000)	27,000
To Interest	4,000	By Locker rent (7,000 - 2,400)	4,600
To Misc. Expenses	4,700	By Sale proceeds of old newspapers	1,000
To Surplus	12,900	By Misc. Income	9,000
	41,600		41,600

Balance Sheet as at 31st March, 2018

Liabilities		Amount (₹)	Assets	Amount (₹)
Capital Fund			Land and Building	1,90,000
Bal. as on 1.4.2017	1,06,200		Subscription receivable (2017) (3,800 - 2,000)	1,800
Add: Entrance fee	38,000			
Add: Surplus	12,900	1,57,100	Cash in hand	18,300
Loan		40,000		
Creditors		10,000		
Outstanding expenses (2017) (14,000 - 12,000)		2,000		
Subscription received in advance		1,000		
		2,10,100		2,10,100

Note: Entrance fees have been capitalized in the above solution.

2019 - June [5] (b) From the following information supplied by M.B.S. Club prepare Receipts and Payments account and Income and Expenditure. Account for the year ended 31st March 2019.

	01.04.2018 ₹	31.03.2019 ₹
Outstanding subscription	1,40,000	2,00,000
Advance Subscription	25,000	30,000
Outstanding Salaries	15,000	18,000
Cash in Hand and at Bank	1,10,000	?

10% Investment	1,40,000	70,000
Furniture	28,000	14,000
Machinery	10,000	20,000
Sports Goods	15,000	25,000

Subscription for the year amount to ₹3,00,000/-. Salaries paid ₹60,000. Face value of the Investment was ₹1,75,000, 50% of the Investment was sold at 80% of Face Value. Interest on Investments was received ₹14,000. Furniture was sold for ₹8000 at the beginning of the year. Machinery and Sports Goods purchased and put to use at the last date of the year. Charge depreciation @ 15% p.a. on Machinery and Sports Goods and @ 10% p.a. on Furniture.

Following Expenses were made during the year:

Sports Expenses: ₹50,000

Rent : ₹24,000 out of which ₹2,000 outstanding

Misc. Expenses : ₹5,000 (10 marks)

Answer:

Receipts and Payments Account
for the year ended 31.3.2019

Receipts	₹	Payments	₹
To Balance b/d		By Salaries	60,000
Cash and Bank	1,10,000	By Purchase of sports goods ₹(25,000 - 15,000)	10,000
To Subscription received (W.N. 1)	2,45,000		
To Sale of investments (W.N. 2)	70,000	By Purchase of machinery ₹(20,000 - 10,000)	10,000
To Interest received on investment	14,000		
To Sale of furniture	8,000	By Sports expenses	50,000
		By Rent paid ₹(24,000 - 2,000)	22,000
		By Miscellaneous expenses	5,000
		By Balance c/d	
		Cash and bank	2,90,000
	4,47,000		4,47,000

Income and Expenditure Account
for the year ended 31.3.2019

Expenditure	₹	₹	Income	₹	₹
To Salaries	60,000		By Subscription		3,00,000
Add: Outstanding for 2019	18,000		By Interest on Investment Received	14,000	
	78,000		Accrued (W.N. 5)	3,500	17,500
Less: Outstanding for 2018	(15,000)	63,000			
To Sports expenses		50,000			
To Rent		24,000			
To Miscellaneous exp.		5,000			
To Loss on sale of furniture (W.N. 3)		6,000			
To Depreciation (W.N. 4)					
Furniture	1,400				
Machinery	1,500				
Sport goods	2,250	5,150			
To Surplus		1,64,350			
		3,17,500			3,17,500

Working Notes:

1. Calculation of subscription received during the year 2018-19

	₹
Subscription due for 2018-19	3,00,000
Add: Outstanding of 2018	1,40,000
Less: Outstanding of 2019	(2,00,000)
Add: Subscription of 2019 received in advance	30,000
Less: Subscription of 2018 received in advance	(25,000)
	2,45,000

2. **Calculation of Sale price and profit on sale of investment**
   Face value of investment sold: ₹1,75,000 × 50% = ₹87,500
   Sale price: ₹87,500 × 80% = ₹70,000
   Cost price of investment sold: ₹1,40,000 × 50% = ₹70,000
   Profit/loss on sale of investment: ₹70,000 - ₹70,000 = NIL

3. **Loss on sale of furniture**

	₹
Value of furniture as on 01-04-2018	28,000
Value of furniture as on 31-03-2019	14,000
Value of furniture sold at the beginning of the year	14,000
Less: Sales price of furniture	(8,000)
Loss on sale of furniture	6,000

4. **Depreciation**

Furniture - ₹14,000 × 10%	=	1,400
Machinery - ₹10,000 × 15%	=	1,500
Sports goods - ₹15,000 × 15%	=	2,250

5. **Interest accrued on Investment**

	₹
Face value of investment on 01-04-2018	1,75,000
Interest @ 10%	17,500
Less: Interest received during the year	(14,000)
Interest accrued during the year	3,500

Note: It is assumed that the sale of investment has taken place at the end of the year.

2019 - Nov [4] (b) From the following Income and Expenditure account and the Balance sheet of a club, prepare its Receipts and Payments Account and subscription account for the year ended 31st March 2019:

Income & Expenditure Account for the year 2018-19

Particulars	₹	Particulars	₹
To Upkeep of ground	11,000	By Subscriptions	19,052
To Printing	1,100	By Sale of Newspapers (Old)	286
To Salaries	11,100	By Lectures (Fee)	1,650
To Depreciation on furniture	1,100	By Entrance Fee	2,145
To Rent	1,660	By Misc. Income	440
		By Deficit	2,387
	25,960		25,960

Balance sheet as at 31st March 2019

Liabilities		₹	Assets	₹
Subscription in advance (2019-20)		110	Furniture	9,900
Prize Fund:				
Opening balance	27,500			
Add: Interest	1,100			
	28,600		Ground and Building	51,700
Less: Prizes given	2,200	26,400		
			Prize Fund Investment	22,000
General Fund:			Cash in Hand	2,530
Opening balance	62,062			
Less: Deficit	2,387			
	59,675		Subscription (outstanding) (2018-2019	770
Add: Entrance Fee	715	60,390		
		86,900		86,900

The following adjustments have been made in the above accounts:

(i) Upkeep of ground ₹ 660 and printing ₹ 264 relating to 2017-18 were paid in 2018-19

(ii) One fourth of entrance fee has been capitalized by transfer to General Fund

(iii) Subscription outstanding in 2017-18 was ₹ 880 and for 2018-19 ₹ 770

(iv) Subscription received in advance in 2017-18 was ₹ 220 and in 2018-19 for 2019-20 was ₹ 110

(v) Furniture was purchased during the year (10 marks)

Answer:

Receipts and Payments A/c
for the year ending 31st March, 2019

Receipts		₹	Payments		₹
To Balance b/d (Balancing Figure)		16,126	By Upkeep of Ground	11,000	
To Subscriptions:			*Add:* Paid in 2018-19 related to 2017-18	660	11,660
As per Income & Expenditure A/c	19,052		By Printing	1,100	
Add: Outstanding in 2017-18	880		*Add:* Paid in 2018-19 related to 2017-18	264	1,364
Add: Received in Advance in 2018-19	110		By Salaries		11,100
	20,042		By Rent		1,660
Less: Outstanding in 2018-19	770		By Prizes Distributed		2,200
	19,272		By Furniture:		
Less: Received in Advance in 2017-18	220	19,052	Value as on 31-03-2019	9,900	
To Sale of Newspapers (Old)		286	*Add:* Depreciation during the year	1,100	11,000
To Lectures (Fee)		1,650	By Balance c/d		2,530
To Entrace Fee:					
As per Income & Expenditure A/c	2,145				
Add: Capitalised	715	2,860			
To Miscellaneous Income		440			
To Interest on Prize Fund Investments		1,100			
		41,514			41,514

Subscriptions A/c

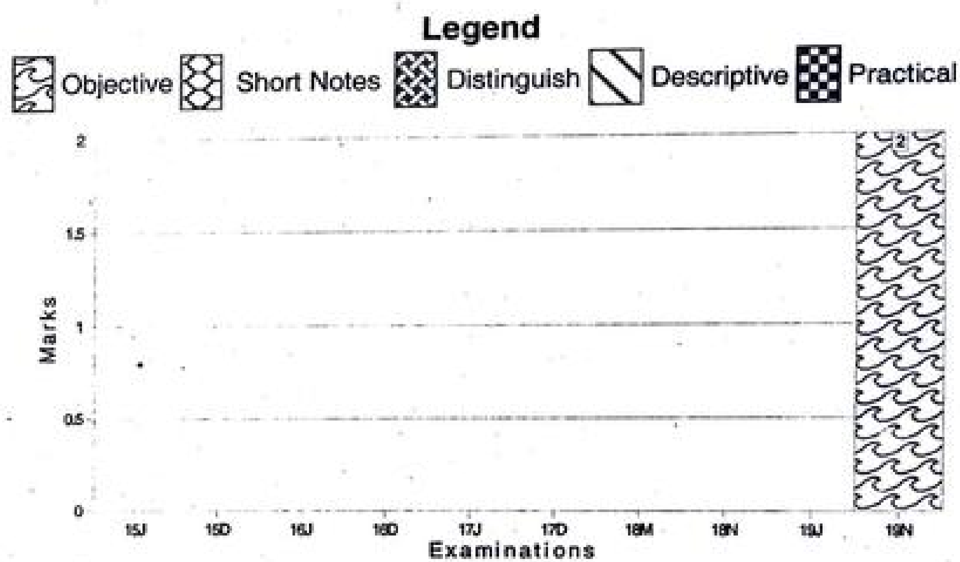
Date	Particulars	₹	Date	Particulars	₹
2018 Apr. 1	To Subscription Outstanding (2017-18)	880	2018 Apr. 1	By Subscription in Advance (2017-18)	220
2019 Mar.31	To Income & Expenditure A/c	19,052	2019 Mar. 31	By Cash (Balancing Figure)	19,052
	To Subscription in Advance (2018-19)	110		By Subscription Outstanding (2018-19)	770
		20,042			20,042

CHAPTER

10 Company Accounts

Unit: 1 **Introduction to Company Accounts**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



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SELF STUDY QUESTIONS

Q1. What is a Company form of Organisation?

Answer:

- The company form of business organisation is an association of persons who contribute money for some common purpose.
- The money so contributed is capital of the company and person who contribute the capital are its members.

Q2. What do you mean by a Company?

Answer:

- The word company is derived from a Latin word "Com" meaning 'with or together' and "Panies" meaning bread.
- It originally referred to association of people taking food together and discussing maths.
- It is a form of business organisation of people to carry on a business.
- Company Law recognises a company as one which is formed and registered under Companies Act, 2013 or under any previous company law.

"Company is an artificial person created by law with a perpetual succession and common seal" **Lord Justice Hanay**

"A corporation is an artificial being, invisible, intangible and existing only in the contemplation of law" **Justice Marshal**

Q3.What are the Salient Features of a Company?

Answer:

(a) Separate Legal Entity
(b) Perpetual Existence
(c) Common Seal
(d) Limited Liability
(e) Separation of Ownership from Management
(f) Not a citizen
(g) Transferability of shares
(h) Maintenance of books as per law
(i) Periodic Audit through Chartered Accountant
(j) Right to access to information by Shareholders.

Q4. What are the Types of Companies?

Answer:

1. **Government Company**
   - It means a company in which not less than 51% of paid up share capital in held by:
     (a) Central Government
     (b) any State Government or Governments
     (c) partly by central government and partly by one or more state governments and includes a company which is a subsidiary company of such a government company.
2. **Foreign Company**
   Foreign company means any company or body corporate incorporated outside India which:
   (a) has a place of business in India, whether by itself or through agent, physically or through electronic mode; and.
   (b) conducts any business activity in India in any other manner.
   Thus, the companies doing business through electronic mode are also termed as foreign company and need to comply with the specified provision.
3. **Private Company**
   A company which has the following features is a private company:
   (a) Restricts the right to transfer its shares;
   (b) Except in case of OPC, limits the number to 200.
   (c) Prohibits any invitation to the public to subscribe for any securities of the company.
4. **Public Company**
   Public company means a company which:
   (a) is not a private company;
   (b) A company which is a subsidiary of a company, not being a private company, shall be deemed to be a public company for the purposes of this Act.

Note:

The paid-up share capital requirement of ₹1,00,000 in private company and ₹5,00,000 in public companies has been done away.

5. **One Person Company**
   - It means a company which has only person as a member. It is considered as a private company. Only a natural person who is an Indian Citizen and resident in India is eligible to incorporate OPC.
6. **Small Company**
   It means a company other than a public company, whose:
   (a) Paid up capital does not exceed ₹50 lakh or such higher amount as may be prescribed which shall not be more than 5 crore.
   (b) Turnover as per last profit and loss account does not exceed ₹2 crore or such higher amount as may be prescribed, which shall not be more than ₹20 crore.
7. **Listed Company**
   Company whose share are listed on any of the recognised stock exchange.
8. **Unlimited Company**
   Company where there is no limit on the liability of its members.
9. **Company Limited by Shares**
   Company where the liability of the member is limited upto the amount unpaid on shares issued.
10. **Company Limited by Guarantee**
   Company where the liability of the member is limited upto the amount guaranteed by partners to contribute to assets of the company in the even of winding up.

11 &12 **Holding Company and Subsidiary Company**

When a company:

(a) Controls the composition of the board of directors; or.

(b) Exercises or controls more than one half of the total share capital either at its own or together with one or more of its subsidiary companies, then it is called as the holding company and the other company is the subsidiary company.

Q5.Write Short Note on Maintenance of Books of Accounts.

Answer:

- As per Companies Act, 2013, books of accounts of the company for each financial year are to be maintained at its Registered Office including that of its branch office.
- Books should be kept on accrual basis and as per double entry system.

Q6.What do you mean by Preparation of Financial Statements?

Answer:

Financial statements are the statements prepared to know the true and fair view of the affairs of the company at the end of a particular accounting year.

It includes:

(a) Balance Sheet

(b) Profit & Loss A/c

(c) Cash flow statement

(d) Statement of changes in equity

(e) Notes to account annexed.

Q7. What are the Requisites of a financial statement? Where are provisions of financial statements applicable?

Answer:

Requisites of a Financial Statement:

- Must give true and fair view

Provision Applicable

- For Companies-Companies Act Schedule III
- For insurance, banking, electricity, specific acts.
  Financial statement must comply to the applicable accounting standards.

Q8. Draw the Specimen a Balance Sheet.
Answer:

Specimen of Balance Sheet

PART-I
Form of Balance Sheet
Name of Company________
Balance Sheet as at ________

(₹in....)

	Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
	1	2	3	4
1.	**Equity and Liabilities**			
	1. Shareholders' Funds			
	(a) Share Capital			
	(b) Reserves and Surplus			
	(c) Money received against share warrants			
	2. Share application money pending allotment			
	3. Non-Current Liabilities			
	(a) Long-term borrowings			
	(b) Deferred tax liabilities (Net)			
	(c) Other Long term liabilities			
	(d) Long term provisions			
	4. Current Liabilities			
	(a) Short-term borrowings			
	(b) Trade payables			
	(c) Other current liabilities			
	(d) Short-term provisions			
	Total			
	Assets			
	1. Non-current assets			
	(a) Fixed assets			
	(i) Tangible assets			
	(ii) Intangible assets			

	(iii) Capital work-in-progress			
	(iv) Intangible assets under development			
	(b) Non-current investments			
	(c) Deferred tax assets (net)			
	(d) Long term loans and advances			
	(e) Other non-current assets			
	2. Current assets			
	(a) Current investments			
	(b) inventories			
	(c) Trade receivables			
	(d) Cash and cash equivalents			
	(e) Short-term loans and advances			
	(f) Other current assets			
	Total			

Q9.What are the General Instructions for preparing the Balance Sheet of a company?
Answer:

1. 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;
   (b) it is held primarily for the purpose of being traded;
   (c) it is expected to be realized within twelve 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 twelve months after the reporting date.

   All other assets shall be classified as non-current.
2. 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.
3. 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;

(b) it is held primarily for the purpose of being traded;
(c) it is due to be settled within twelve months after the reporting date; or
(d) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counter party, result in its settlement by the issue of equity instruments do not affect its classification.

All other liabilities shall be classified as non-current.

4. 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.
5. 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.
6. A company shall disclose all relevant things in the notes to accounts.

Q10. Write Short Note on Share capital.

Answer:

For each class of share capital (different classes of preference shares to be treated separately):

(a) The number and amount of shares authorized;
(b) The number of shares issued, subscribed and fully paid, and subscribed but not fully paid;
(c) Par value per share;
(d) A reconciliation of the number of shares outstanding at the beginning and at the end of the period;
(e) The rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital;
(f) Shares in the company held by its holding company or its ultimate holding company or by its subsidiaries or associates;
(g) Shares in the company held by any shareholder holding more than 5 percent shares.
(h) Shares reserved for issue under options and contracts/commitments for the sale of shares/disinvestment, including the terms and amounts;

(i) Separate particulars for a period of five years following the year in which the shares have been allotted/bought back, in respect of:
- Aggregate number and class of shares allotted as fully paid up pursuant to contract(s) without payment being received in cash.
- Aggregate number and class of shares allotted as fully paid up by way of bonus shares (Specify the source from which bonus shares are issued).
- Aggregate number and class of shares bought back.

(j) Terms of any security issued along with the earliest date of conversion in descending order starting from the farthest such date.

Q11.What do you mean by Reserves and Surplus?

Answer:

(i) Reserves and Surplus shall be classified as:
(a) Capital Reserves;
(b) Capital Redemption Reserves;
(c) Securities Premium Reserves;
(d) Debenture Redemption Reserve;
(e) Revaluation Reserve;
(f) Share Options Outstanding Account;
(g) Other Reserves-(specify the nature of each reserve and the amount in respect thereof);
(h) Surplus i.e balance in statement of Profit & Loss disclosing allocations and appropriations such as dividend paid, bonus shares and transfer to/from reserves.

(Additions and deductions since last balance sheet to be shown under each of the specified heads)

(ii) A reserve specifically represented by earmarked investments shall be termed as a 'fund'.
(iii) Debit balance of Statement of Profit and Loss shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, if any shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative.

Q12. What do you understand by Long-term Borrowings and short term Borrowings/Liabilities?

Answer:

(i) Long-term borrowings shall be classified as:
   (a) Bonds/debentures
   (b) Term loans
      • From Banks
      • From other parties
   (c) Deferred payment liabilities.
   (d) Deposits.
   (e) Loans and advances from related parties.
   (f) Long-term maturities of finance lease obligations
   (g) Other loans and advances (specify nature).

(ii) Borrowing shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.

(iii) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.

(iv) Bonds/debentures (along with the rate of interest and particulars of redemption or conversion, as the case may be) shall be stated in descending order of maturity or conversion, starting form 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.

(v) Particulars of any redeemed bonds/debentures which the company has power to reissue.

(vi) Terms of repayment of term loans and other loans shall be stated.

(vii) Period and amount of default in repayment of dues, providing breakup of principal and interest shall be specified separately in each case.

Other Long-term Liabilities

Other Long-term Liabilities shall be classified as;
   (a) Trade payables
   (b) Others

Long-term provisions

The amounts shall be classified as;
   (a) Provision for employee benefits
   (b) Others (specify nature)

Short-Term borrowings

(i) Short-terms borrowings shall be classified as:
   (a) Loans repayable on demand
      • from banks
      • from other parties
   (b) Loans and advances from subsidiaries/holding company/associates/ business ventures;
   (c) Deposits.
   (d) Other loans and advances (specify nature).

(ii) Borrowings shall further be sub-classified as secured and unsecured Nature of security shall be specified separately in each case.

(iii) Where loans have been guaranteed by directors or others, a mention thereof shall be made and also the aggregate amount of loans under each head.

(iv) Period and amount of default in repayment of dues, providing breakup of principal and interest shall be specified separately in each case.

Other Current liabilities

The amounts shall be classified as:
   (a) Current maturities of long-term debt;
   (b) Current maturities of finance lease obligations;
   (c) Income received in Advance;
   (d) Interest accrued but not due on borrowing;
   (e) Interest accrued and due on borrowings;
   (f) Unpaid Dividends;
   (g) Application money received for allotment of securities and due for refund and interest accrued thereon. Share application money includes advances towards allotment of share capital. The terms & conditions including the number of shares proposed to be issued, the amount of premium, if any, and the period before which shares shall be allotted shall be disclosed. It shall also be disclosed whether

the company has sufficient authorized capital to cover the share capital amount resulting from allotment of shares out of such share application money. Further, the period for which the share application money has been pending beyond the period for allotment as mentioned in the document inviting application for shares along with the reason for such share application money being pending shall be disclosed. Share application money not exceeding the issued capital and to the extent not refundable shall be shown under the head equity and share application money to the extent refundable i.e., the amount in excess of subscription or in case the requirements of minimum subscription are not met, shall be separately shown under 'Other current liabilities'.

(h) Unpaid matured deposits and interest accrued thereon,

(i) Unpaid matured debentures and interest accrued thereon,

(j) Other payables (specify nature).

Q13.What do you mean by Tangible assets and intangible assets?

Answer:

(i) Classification shall be given as:
  (a) Land
  (b) Buildings
  (c) Plant and Equipment
  (d) Furniture and Fixtures
  (e) Vehicles
  (f) Office Equipment
  (g) Others (specify nature)

(ii) Assets under lease shall be separately specified under each class of asset.

(iii) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions and other movements and the related depreciation and impairment losses/ reversals shall be disclosed separately.

(iv) Where sums have been written off on a reduction of capital or revaluation of assets or where sum have been added on revaluation

of assets, every balance sheet subsequent to date of such write-off, or addition shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date therefore for the first five years subsequent to the date of such reduction or increase.

Intangible assets

(i) Classification shall be given as:
  (a) Goodwill
  (b) Brands/trademarks
  (c) Computer software
  (d) Mastheads and publishing titles
  (e) Mining rights
  (f) Copyrights, and patents and other intellectual property rights, services and operating rights
  (g) Recipes, formulae, models, designs and prototypes
  (h) Licences and franchise
  (i) Others (specify nature)

(ii) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions and other movements and the related amortization and impairment losses/reversals shall be disclosed separately.

(iii) Where sums have been written off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to date of such write-off, or addition shall show the reduced or increase as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date therefore for the first five years subsequent to the date of such reduction or increase.

Q14. What do you mean by Non-Current investments?

Answer:

(i) Non-current investments shall be classified as trade investments and other investments and further classified as:
  (a) Investment Property;
  (b) Investments in Equity Instruments;

(c) Investments in Preference shares;
(d) Investments in Government or trust securities;
(e) Investments in units, debentures or bonds;
(f) Investments in Mutual Funds;
(g) Investments in partnership firm;
(h) Other non-current investments (specify nature)

Under each classification, details shall be given of names of the bodies corporate (indicating separately whether such bodies are (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities) in whom investments have been made and that nature and extent of the investment so made in each such body corporate (showings separately investments which are partly paid). In regard to investments in the capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the shares of each partner) shall be given.

(ii) Investments carried at other than at cost should be separately stated specifying the basis for valuation thereof.

(iii) The following shall also be disclosed:
   (a) Aggregate amount of quoted investments and market value thereof;
   (b) Aggregate amount of unquoted investments:
   (c) Aggregate provision for diminution in value of investments;
   (d) Aggregate amount of partly paid-up investments;
   (e) The names of bodies corporate (indicating separately the names of subsidiaries, associates and other business ventures) in whose securities, investments have been made and the nature and extent of the investments so made in each such body corporate.

Q15. What do you mean by Long-term loans advances?

Answer:

(i) Long-term loans and advances shall be classified as:
   (a) Capital Advances;
   (b) Security Deposits;
   (c) Loans and Advances to related parties (giving details thereof);
   (d) Other Loans and Advances (specify nature).

(ii) The above shall also be separately sub-classified as:
   (a) To the extent secured, considered good;
   (b) Others, considered good;
   (c) Doubtful.

(iii) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.

(iv) Loans and Advances due by directors or other officers of 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 should be separately stated.

Q16. What are Other non-current assets is Balance Sheet?

Answer:

Other non-current assets shall be classified as:

(i) Long-term Trade Receivables (including trade receivables on deferred credit terms).
(ii) Others (specify nature)
(iii) Long-term Trade Receivables, shall be sub-classified as:
   (a) • secured, considered good:
       • unsecured, considered good;
       • Doubtful
   (b) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.
   (c) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

Q17. What are Current Investments is Balance Sheet?

Answer:

(i) Current investments shall be classified as
   (a) Investments in Equity Instruments;
   (b) Investments in Preference shares;
   (c) Investments in Government or Trust securities;

(d) Investments in units, debentures or bonds;
(e) Investments Mutual Funds;
(f) Investments partnership firm;
(g) Other investments (specify nature)

Under each classification, details shall be given of names of the bodies corporate (indicating separately whether such bodies are (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entitles)in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly paid). In regard to investments in the capital of partnership firm, the names of the firms (with the names of all their partners, total capital and the shares of each partner) shall be given.

(ii) The following shall also be disclosed:
(a) The basis of valuation of individual investments:
(b) Aggregate amount of quoted investments and market value thereof;
(c) Aggregate amount of unquoted investments;
(d) Aggregate amount of partly paid-up investments.
(e) Aggregate provision for diminution in value of investments.

Q18. Elaborate the heads of Inventories.

Answer:

(i) Inventories shall be classified as:
(a) Ram material;
(b) Work-in-progress;
(c) Finished goods;
(d) Stock-in-trade;
(e) Stores and spares;
(f) Loose tools;
(g) Others (specify nature).

(ii) Goods-in-transit shall be disclosed under the relevant sub-head of inventories.

(iii) Mode of valuation should be stated.

Q19. How do you classify Trade Receivables in Balance Sheet?

Answer:

(i) Aggregate amount of Trade Receivables outstanding for a period exceeding six months from the date they are due for payment should be separately stated.

(ii) Trade receivables shall also be classified as:
(a) To the extent secured, considered good;
(b) Others, considered good;
(c) Doubtful

(iii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

(iv) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

Q20. What are Cash and cash equivalents?

Answer:

(i) Classification shall be made as:
(a) Bank balances;
(b) Cheques, drafts on hand;
(c) Cash on hand;
(d) Cash equivalents-short-term, highly liquid investments that are readily convertible into known amount of cash and which are subject to an insignificant risk o changes in value;
(e) Others (specify nature)

(ii) Earmarked bank balances (e.g., unpaid dividend) shall be separately stated.

(iii) Balance with banks to the extent held as security against the borrowings, guarantees, other commitments shall be disclosed separately.

(iv) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.

(v) Bank deposits with more than 12 months maturity shall be disclosed separately.

Q21. What are Short-term loans and advances?

Answer:

(i) Short-term loans and advances shall be classified as:
   - (a) Loans and Advances to related parties (giving details thereof);
   - (b) Others (specify nature).

(ii) The above shall also be sub-classified as:
   - (a) To the extent secured, considered good;
   - (b) Others, considered good;
   - (c) Doubtful;

(iii) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.

(iv) Loans and Advances due by directors or other officers of the company or any of them either severally or jointly with any other person debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

Q22. What is the heading Other current assets (specify nature) all about in balance sheet?

Answer:

This is an all-inclusive heading, which incorporates current assets that do not fit into any other assets categories.

Q23. How do you classify Contingencies and commitments?

Answer:

To the extent not provided for –

(i) Contingent liabilities shall be classified as:
   - (a) Claims against the company not acknowledged as debt;
   - (b) Guarantees;
   - (c) Other money for which the company is contingently liable

(ii) Commitments shall be classified as:
   - (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 (specify nature).

The amount of dividends proposed to be distributed to equity holders for the period and the related amount per share shall be disclosed separately. Arrears of fixed cumulative dividends shall also be disclosed separately.

Where in respect of an issue of securities made for a specific purpose, the whole or part of the amount has not been used for the specific purpose at the Balance Sheet date, there shall be indicated by way of note how such unutilized amount have been used or invested.

If, in the opinion of the board, any of the assets other than fixed assets and non-current investments do not have a value on realization in the ordinary course of business at least equal to the amount at which they are stated, the fact that the board is of the opinion shall be stated.

Q24. What is the format of profit and loss account?

Answer:

PART II

Form of statement of profit and loss

Name of Company________

Profit and Loss Statement for the year ended________

(₹in....)

	Particulars	Note No.	Figures for the Current reporting period	Figures for the Previous reporting period
I II III iv	Revenue from operations Other Income Total Revenue (I+II) Expenses: Cost of materials consumed Purchases of Stock-in-trade Changes in inventories of finished goods work-in-progress and Stock-in Trade Employee benefits expense Finance costs Depreciation and amortization expense other expenses Total expense			

V	Profit before exceptional and extraordinary items and tax (III-IV)			
VI	Exceptional items			
VII	Profit before extraordinary items and tax (V-VI)			
VIII	Extraordinary items			
IX	Profit before tax (VII-VIII)			
X	Tax expense: (1) Current tax (2) Deferred tax			
XI	Profit (Loss) for the period form continuing operations (IX-X-XIV)			
XII	Profit/(Loss) from discontinuing operations			
XIII	Tax expense of discontinuing operations			
XIV	Profit/(Loss) from discontinuing operations (after tax) (XII-XIII)			
XV	Profit/(Loss) for the period (XI-XIV)			
XVI	Earning per equity share; (1) Basic (2) Diluted			

Q25. What are the General Instructions for Preparation of Statement of Profit and Loss?

Answer:

1. The provision of this Part shall apply to the Income and Expenditure account referred to in sub-section (2) of Section 210 of the Act, in like manner as they apply to a statement of profit and loss.
2. (A) In respect of a company other than a finance company revenue from operations shall disclose separately in the notes revenue from:
   (a) Sale of products;
   (b) Sale of services;
   (c) Other operating revenues;
   Less:
   (d) Excise duty.

   (B) In respect of a finance company, revenue from operations shall include revenue from:
   (a) Interest; and
   (b) Other financial services
   Revenue under each of the above heads shall be disclosed separately by way of notes to accounts to the extent applicable.
3. Finance Costs
   Finance costs shall be disclosed as:
   (a) Interest expense;
   (b) Other borrowing costs;
   (c) Applicable net gain/loss on foreign currency transaction and translation.
4. Other Income
   Other income shall be classified as:
   (a) Interest Income (incase of company other than a finance company);
   (b) Dividend Income;
   (c) Net gain/loss on sale of investments
   (d) Other non-operating income (net of expenses directly attributable to such income).
5. Additional Information
   A Company shall disclose by way of notes additional information regarding aggregate expenditure and income on the following items:
   (i) (a) Employee Benefits Expense [showing separately (i) salaries and wages, (ii) contribution to provident and other funds, (iii) expense on Employee Stock Option Scheme (ESOP), and employee stock Purchase plan (ESPP), (iv) staff welfare expense].
   (b) Depreciation and amortization expense;
   (c) Any item of income or expenditure which exceeds one percent of the revenue from operations or ₹1,00,000. Whichever is higher;
   (d) Interest Income;
   (e) Interest Expense;
   (f) Dividend Income;
   (g) Net gain/loss on sale of investments;
   (h) Adjustments to the carrying amount of investments;

6. Net gain or loss on foreign currency transaction and translation (other than considered as finance cost);
7. Payments to the auditors as (a) audit, (b) for taxation matters (c) for company matters, (d) for management services, (e) for other services, (f) for reimbursement of expense;
8. Details of items of exceptional and extraordinary nature:
   (i) Prior Period Items;
   (ii) (a) In the case of manufacturing companies;
      • Raw materials under broad heads.
      • Goods purchased under broad heads.
   (b) In the case of trading companies, purchases in respect of goods traded in by company under board heads.
   (c) In the case of companies rendering or supplying services, gross income derived from services rendered or supplied under broad heads.
   (d) In the case of a company, which falls under more than one of the categories mentioned in (a), (b) and (c) above, it shall be sufficient compliance with the requirements herein if purchase, sales and consumption of raw material and the gross income from services rendered is shown under broad heads.
   (e) In the case of other companies gross income derived under broad heads.
   (iii) In the case of all concerns having work-in progress, work-in-progress under broad heads.
   (iv) (a) The aggregate, if material, of any amounts set aside or propose to be set aside, to reserve, but not including provisions made to meet any specific liability, contingency or commitment known to exit at the date as to which the Balance Sheet is make up.
   (b) The aggregate, if material, of any amounts withdrawn from such reserves.
   (v) (a) The aggregate, if material, of the amounts set aside to provisions made for meeting specific liabilities, contingencies or commitment.

   (b) The aggregate, if material, of the amounts withdrawn from such provisions, as no longer required.
   (vi) Expenditure incurred on each of the following items, separately for each item:
   (a) Consumption of stores and spare parts
   (b) Power & fuel
   (c) Rent
   (d) Repairs to building
   (e) Repairs to machinery
   (f) Insurance
   (g) Rate and Taxes, excluding, taxes on income.
   (h) Miscellaneous expense,
   (vii) (a) Dividends from subsidiary companies
   (b) Provisions for losses of subsidiary companies
   (viii) The profit and loss account shall also contain by way of 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. Companies 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 if all imported raw materials, spare parts and the component 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 specific mention of the total number of nonresidents shareholders, the total number of shares held by them on which the dividends were due and the year to which the dividends related.

PAST YEAR QUESTIONS AND ANSWER

OBJECTIVE QUESTIONS

2019 - Nov [1] {C} (a) State with reason, whether the following statement is True or False.

(vi) Since company has existence independent of its members, it continues to be in existence despite the death, insolvency or change of members. (2 marks)

Answer:

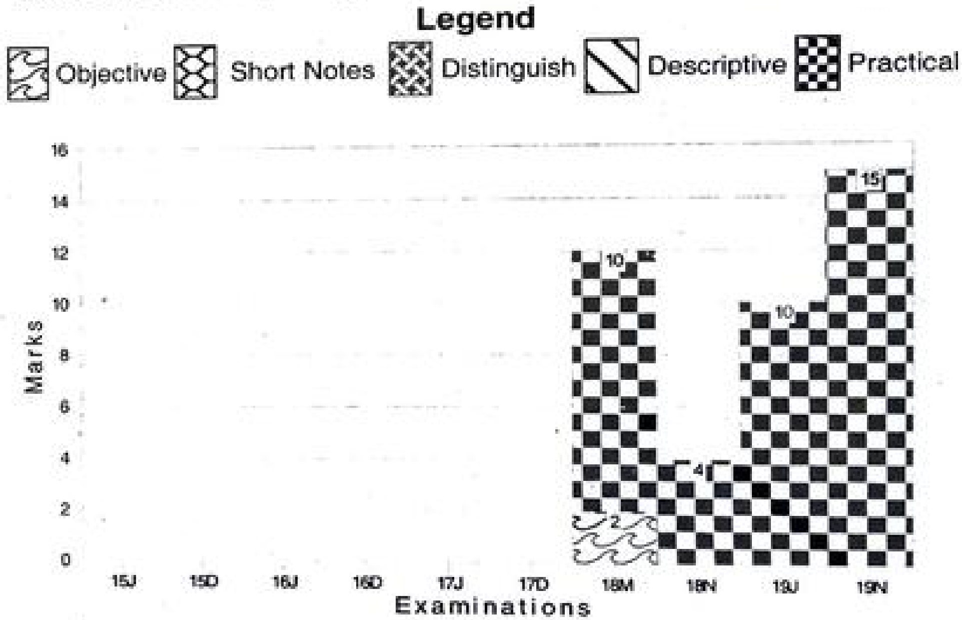
True: A company, being independent from its members, continues to be in existence despite the death, insolvency, or change of members.

CHAPTER 10

Company Accounts

Unit: 2 — Issue, Forfeiture and Re-Issue of Shares

Marks of Short Notes, Distinguish Between, Descriptive & Practical Questions



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SELF STUDY QUESTIONS

Q1. What is Capital and its funding process in various business?

Answer:

Every business organisation requires funds to carry on the business operations for this purpose owners contribute a sum which is introduced is business as capital.

Types of Business organisation and their capital funding process.

	Sole Proprietor	Partnership	Company
(a) Ownership	Proprietor	Partner	Shareholders
(b) Types of capital	Capital	Partner's capital	Share capital
(c) Liability	Unlimited	Unlimited	Limited

Q2.What do you mean by Share Capital? What are its categories?

Answer:

- The total capital of the company is divided into small shares hence it is called as the share capital.
- Every share has a face value or nominal value. Share capital is the sum total of the total face value of all the shares.

Categories of share capital

(i) **Authorised share capital:**
This is the maximum amount of capital mentioned in the MOA of a company, which it can raise during its life time. It is also known as registered capital. In order to increase the limit of authorised capital, MOA should be altered.

(ii) **Issued capital:**
It refers to that portion of the authorised capital which has been offered to the public for subscription

(iii) **Subscribed share capital:**
It refers to that part of the issued share capital which has been subscribed by the public. It also includes the issue of shares for consideration other than cash.

(iv) **Called up share capital:**
It is that portion of subscribed capital which the shareholders are called upon to pay. The amount remaining to be called up i· called as uncalled capital

(v) **Paid up capital:**
It is that portion of called up capital that is paid by the shareholders. The amount that is not paid is known as calls in arrear. This is the actual capital of the company that is included in the balance sheet.
Call -in - advance → portion of un called capital already paid by the shareholder.

(vi) **Reserve capital:**
It is the portion of subscribed capital which is decided by the company to be called up only in the event of winding up of the company.
Company needs to pass necessary resolution in this regard.

Q3. What are Types of shares?

Answer:

(i) **Preference shares**

- Preference shares are those shares which have the following preference rights over the shares:
  Right conferred by Article of Association
  (i) Payment of dividend at a fixed rate or as a fixed amount
  (ii) Return of capital on winding up of a company.
    - The holder of preference shares are called preference shareholders.
    - Preference shareholders do not have a voting right

Types of preference shares

(i) **Commutative preference shares**
The holders of cumulative preference shares have a fixed right to receive present as well as future dividend. This means that even if the company does not have sufficient profit to pay dividend, the dividend of such shareholders keeps on cumulating and will be paid in future in the years of profit.

(ii) **Non-cumulative preference shares**
When the preference shares do not have a right to cumulate their dividend then, these are called non cumulating preference shares.

(iii) **Participating preference shares**
Holders of these shares have a right to participate in the surplus profit if any, after equity shareholders have been paid at fixed rate.

(iv) **Non-participating preference shares**
When shareholders have a fixed right of dividend and not over and above that, even in case of surplus projects then, these are called non-participating preference shares.

(v) **Redeemable preference shares**
When shares are issued with a condition that they will be repaid (redeemable) after a fixed period of time, these are called redeemable preference shares.

(vi) **Non-Redeemable preference shares**
Shares which are not to be redeemed during the life time of the company.
Note: As per Companies Act, 2013, no company can issue non-redeemable preference shares or preference shares redeemable after 20 years (except for infrastructure projects)

(vii) **Convertible preference shares**
Shares which carry an option to get converted into equity shares of the company

(viii) **Non-convertible preference shares**
Preference shares which do not have an option of conversion into equity shares of the company.

(ii) Equity shares

- Shares other than preference shares as are termed as equity shares
- They do not carry a preferential right but has a voting right
- There is no compulsion to pay equity dividend, they are paid dividend only when there as sufficient projects after payment of preference dividends

Q4. How is Issue of shares for cash done?

Answer:

When a company issue shares for cash either full amount is received at once or in installments. The share price is generally received in installment, are known as.

1^{st} Installment	—	Application money
2^{nd} Installment	—	Allotment money
3^{rd} Installment	—	First call money
4^{th} Installment	—	Second call money
5^{th} Installment	—	Final call money

- As per Section 39 of Companies Act, 2013 application money must be at least 5% of the nominal value of shares
- **Minimum subscription:** Amount that should be raised as subscription before allotment of shares.
- A public Ltd. company cannot make allotment of shares unless the amount of minimum subscription is received.
- As per SEBI guidelines a company must receive 90% subscription against the entire issue before making allotment of any shares or debentures.

Q5. What are the Journal Entries for issue of shares for cash?

Answer:

When shares are issued at par:

(i) On receipt of application money:

Bank A/c	Dr.
To Share Application A/c	

(ii) On allotment of shares:

Share Allotment A/c	Dr.
Share Application A/c	Dr.
To Share capital A/c	

(iii) On Receipt of allotment money:

Bank A/c	Dr.
To Share Allotment A/c	

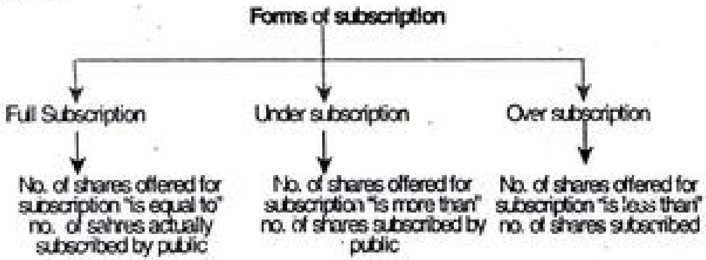
(iv) On call being made:

Share Call A/c Dr.
  To Share capital A/c (with amount due)
Bank A/c Dr.
  To Share Call A/c (with amount received)

Q6. What do you mean by Subscription of Shares?

Answer:

Subscription means the application received from the applicants for issue of shares to them.



1. **Full Subscription:**
   In case of full subscription, accounting entries will be the same as done earlier.
2. **Under Subscription:**
   Under subscription means that the number of shares subscribed by public is less than the number of shares offered for subscription. Allotment can be made in this case only if minimum subscription is received.
   All accounting entries will be same by taking the number of shares actual applied and allotted.

Illustration

In 1st April, 2005, A Ltd. issued 43,000 shares of ₹100 each payable as allows:

₹20 on application
₹30 on allotment

₹25 on 1st October, 2005; and
₹25 on 1st February, 2006

By 20th May, 40,000 shares were applied for and all application were accepted. Allotment was made on 1st June. All sums due on allotment were received on 15th July, those on 1st call were received on 20th October. Journalise the transaction when accounts were closed on 31st March, 2006

Q.R. Code for Solution Video

Solution

A Ltd.
Journal

2005	Particulars	Amount (Dr.)	Amount (Cr.)
May 20	Bank A/c Dr. To Share Application & Allotment A/c (Application money on 40,000 shares at ₹20 per share)	8,00,000	8,00,000
June 1	Share Application & Allotment A/c Dr. To Share Capital A/c (The amount transferred to Capital A/c on 40,000 shares at ₹50 per share, ₹20 on application and ₹30 on allotment as per Directors resolution no ......dated.......)	20,00,000	20,00,000
July 15	Bank A/c Dr. To Share Application and Allotment A/c (The sums due on allotment received)	12,00,000	12,00,000
Oct 1	Share First Call A/c Dr. To Share Capital A/c (Amount due from members in respect of first call on 40,000 shares at ₹25 as per directors, resolution no ......dated.....)	10,00,000	10,00,000

Oct 20	Bank A/c To Share First Call A/c (Receipt of the amounts due on first call)	Dr.	10,00,000	10,00,000
2006 Feb 1	Share Second and Final Call A/c To Share Capital A/c (Amount due on 40,000 share at ₹25 per share on second and Final call, as per Director resolution no........dated......)	Dr.	10,00,000	10,00,000
Mar 31	Bank A/c To Share Second & Final Call A/c (Amount received against the final call on 40,000 shares at ₹25 per share)	Dr.	10,00,000	10,00,000

Q7.What do you mean by shares issued at discount and shares issued at premium?

Answer:

Shares issued at discount:

Section 53 of the companies Act, 2013 provides that the company shall not issue shares at a discount except in case of issue of sweat equity shares. Any share issued by the company at discounted price shall be void.

Shares issued at premium

- When a company issues a share at a price which is more than its face value, it is called issue at premium:
- Premium = Issue price - face value.
- Premium amount is generally called at the time of allotment.
- Amount of premium is credited to a separate account called "Securities Premium A/c."
- Securities premium is not a part of share capital of the company. it is a type of capital receipt.
- Securities premium is shown in the liability side of Balance Sheet under the head "Reserves and Surplus."
- Generally, highly reputed companies or companies with a huge market value issue shares at a premium. A new company cannot issue shares at premium.

- **Accounting Treatment:**

  When allotment money becomes due:

  Share Allotment A/c Dr. (Amount due on allotment ± premium)
  To Securities Premium A/c (Amt.. of premium)
  To Share Capital A/c (Amount of share allotment)

  *Always remember Share Capital A/c will always be shown at face value.

Note: Section 52: Use of Securities Premium:

Securities premium amount can be used only for the following purposes-

(i) For issuing fully paid bonus shares.
(ii) To write off preliminary expenses of the company.
(iii) To write off the expenses of, or commission paid or discount allowed on any securities or debentures of the company.
(iv) For purchase of its own shares or other securities u/s 68
(v) To pay premium on redemption of preference shares or debentures of the company.

Securities premium can never be used for any other purpose.

Note: If Securities Premium amount is utilised for any purpose, other than stated above, then it will attract provisions relating to reduction of share Capital of company [Section 66]

Illustration

Reghunath Ltd. invites application for 10,000 share at ₹10 each, at a premium of ₹2 per share, payable as ₹2 on application, ₹5 on allotment (including premium) and balance one month later. All the shares are subscribed allotted and paid for at due dates. Show journal entries and prepare cash book.

Solution

	Particulars		Dr. (₹)	Dr. (₹)
1.	Share Application A/c To Share Capital A/c (Being share application money transferred to Share Capital A/c)	Dr.	20,000	20,000

2.	Share Allotment A/c Dr. To Share Capital A/c To Security Premium A/c (Being allotment money due on 10,000 share @ 5 per share including share premium @ ₹2 per share)		50,000	 30,000 20,000
3.	Share Call A/c Dr. To Share Capital A/c (Being share call money due on 10,000 share @ ₹5/- per share)		50,000	 50,000

Cash Book (Bank Column Only)

Particulars	₹	Particulars	₹
To Share Application A/c (Application money on 10,000 Shares @ ₹2 per share)	20,000	By Balance c/d	1,20,000
To Share Allotment A/c (Allotment money on 10,000 Shares @ ₹5 per share)	50,000		
To Share Call A/c (Share call on 10,000 Shares @ ₹ 5 per share)	50,000		
	1,20,000		1,20,000

Q8. What do you mean by Over Subscription and Prorata Allotment?

Answer:

- This means when the number of shares subscribed by the public is more than the shares offered for subscription by the company.
- As per the guidelines issued by SEBI the company cannot reject outrightly any application for shares unless it has incomplete information or absence of signature(s) or insufficient application money.

In such case the company adopts the following procedure:

(i) Total rejection of some applications.
(ii) Acceptance of some applications in full.
(iii) Allotment to the remaining applicants on pro-rata basis.

Note : Prorata basis allotment:

- Under prorata basis, no applicant is refused, no applicant is allotted in full.
- They are allotted shares proportionately.
- Here the excess amount received is not refunded but will be adjusted in further calls.
- In case of prorata allotment, the excess amount is not refunded but it is first adjusted towards the amount due on allotment and if the amount is still remaining to be adjusted then it is adjusted from amount due on calls.
- Thus, the excess amount which is adjusted from the calls is called as calls in advance in the case of prorata adjustment .
- However, the company can adjust this amount from calls only if the following conditions are satisfied:
  (i) Acceptance of calls in advance is agreed by the articles of the company
  (ii) The consent of the applicant has been taken either by a separate letter or by inserting a clause in the company's prospectus.
- For adjusting the excess money, the following entry is passed-
  Share Application A/c Dr.
  To Share Allotment A/c
  (Being excess amount received on application adjusted in allotment)

Q9. What do you mean by Calls in Advance and Calls in Arrears? Illustrate.

Answer:

1. **Calls in Advance**
   - When the call is not yet due but the amount is paid by the applicant it is known as Calls in Advance.

- For recording calls in advance the following entry is passed
    1. **For receiving calls in advance:**
       Bank A/c Dr.
       To Calls in Advance A/c
    2. **When that call finally becomes due:**
       Calls in Advance A/c Dr.
       To Particular call A/c
- Since the amount is received in advance by the company, hence it is a liability for the company and shown under the heading namely "Calls in Advance" on the liability side of Balance Sheet.
- Till the call becomes due, the company is liable to pay interest to the applicant. If the articles do not specify the rate, then, such Interest will be charge against profits of the company:
  According to Table A, interest at such rate not exceeding 12% p. a. is to be paid on such advance call money.
- No dividend is paid on calls in advance.

Illustration:

Kriya Ltd. registered with a capital of ₹1,20,000 in equity shares of ₹10 each, offers for public subscription 8,000 shares on 1st July payable as to 2.50 per share on application, ₹4 per share on allotment, and ₹3.50 per share on 1st September. All the shares offered were subscribed for and allotted on 15th July, and the allotment money received except on 100 shares allotted to Ahmed. Besides, Barua and Chandra who subscribed for 200 shares and 30? shares, respectively, paid the final installment of ₹3.50 per share with their allotment installment.

Make the entries in the company's book up to allotment, and show how the capital of the company would then appear in its Balance Sheet.

Solution:

Journal of Kriya Ltd.

Date	Particulars	Dr. (₹)	Dr. (₹)
20 July 1	Bank A/c (8,000 × 2.50) Dr. To Share Application A/c (Application money received for 8,000 shares)	20,000	20,000

July15	Share Application A/c Dr. To Share Capital A/c (Transfer of share application money to Share Capital A/c on allotment of 8,000 shares)	20,000	20,000
3.	Share Allotment A/c (8,000 × ₹4) Dr. To Share Capital A/c (Allotment money of ₹4 per share due on 8,000 shares)	32,000	32,000
	Bank A/c Dr. To Share Allotment A/c (7,900 × ₹4) To Calls-in-Advance A/c (500 × ₹3.50) (Allotment money received on 7,900 shares and calls-in-advance received on 500 shares @ ₹3.50 per share)	33,350	31,600 1,750

(Extract)
Balance Sheet of Kriya Ltd.
as on 15th July....... (Includes)

Particulars	Note No.	Figures as at end of current reporting period (₹)	Figures as at end of previous reporting period (₹)
Equity Liability			
1. Shareholder's funds			
(a) Share Capital			
Authorised		1,20,000	
12,000 equity shares of ₹10 each			
Issued and Subscribed			
8,000 equity shares of ₹10 each			
at ₹6.50 per share called - up 52,000			
Less: Calls-in-Arrear 400		51,600	

2. **Current Liability**			
(a) **Other Current Liabilities**			
Calls-in-Advance		1,750	

2. Calls in arrear

- When the shareholders fail to pay the amount due on allotment or calls it is said to be calls in arrear/unpaid calls.
- Calls in arrear are recorded as follows:
- Calls in Arrear A/c Dr.
  To Share Allotment A/c
  To Share Call A/c
- This amount represents the uncollected amount of capital from the shareholders hence, it is shown by way of deduction from "called up capital" to arrive at paid value of share capital which is shown in the Balance Sheet.
- Since the amount of the call is due hence, the applicants are required to pay interest on the amount due but not paid to the company

If the articles are silent

- According to Table F, interest @ 10% or such lower rate as the board may determine is charged from the date the call becomes due till the date of actual payment.
- However, the directors have a right to waive the interest i.e. the company will not charge interest on calls in arrears.
- Interest on call in Arrears are transferred to P&L A/c at the end of the year.

Illustration:

A limited company, with an authorised capital of ₹2,00,000 divided into share of ₹100 each, issued for subscription 1,000 shares payable at ₹25 per share on application, ₹30 per share on allotment, ₹20 per share on first call three months after allotment and the balance as and when required. The subscription list is closed on January 31, 2006 when application money on 1,000 shares was duly received and allotment was made on March 1,2006.

The allotment amount was received in full but, when the first call was made, one shareholder failed to pay the amount on 100 shares held by him and another share holder with 50 shares paid the entire amount on his shares.

Give journal entries in the books of the company to record these share capital transactions assuming that all amounts due were received within one month of the date they were called.

Books of the Company

Journal

Date	Particulars	L.F.	Debit Amount (₹)	Debit Amount (₹)
Jan 31	Bank A/c Dr. To Equity Share Application A/c (Money received on application for 1,000 shares @ ₹25 per share)		25,000	25,000
March 1	Equity Share Application A/c Dr. To Equity Share Capital A/c (Transfer of application money on 1,000 shares to Shares Capital A/c)		25,000	25,000
March 1	Equity Share Allotment A/c Dr. To Equity Share Capital A/c (Amount due on the allotment of 1,000 Shares @ ₹30 per share)		30,000	30,000
April 1	Bank A/c Dr. To Equity Share Allotment A/c (Allotment money received)		30,000	30,000
June 1	Equity Share First Call A/c Dr. To Equity Share Capital A/c (First call money due on 1,000 shares @ ₹20 per share)		20,000	20,000

July 1	Bank A/c Dr.		19,250	
	Calls-in-Arrears A/c Dr.		2,000	
	To Equity Share First Call A/c			20,000
	To Calls-in-Advance A/c			1,250
	(First call money received on 900 shares and calls-in-advance on 50 shares @ ₹ 25 per share)			

Q10.What is meant by Interest on calls in arrears and call-in-advance?
Answer:

Basis of Difference	Interest on calls-in-arrear	Interest on calls-in-advance
Meaning	Interest on amount unpaid by shareholders which has been called-up by the company	Interest on amount paid in advance by shareholders which was not yet due for payment.
Payable	By shareholders to the company	By company to its shareholder
Rate of Interest	Table F prescribed the max rate of interest as 10%	Table F prescribed the max, rate of interest as 12 %
Period	From due date till the date when actual payment is made.	From the date of receipt till the date when is actually falls due for payment
Treatment in books of accounts by the company	Credited to Profit & Loss A/c, it is an income	It is an expense for the company.

Accounting Entries

Calls in Arrear:

- When interest is receivable on calls-in-arrears.
  Shareholders A/c Dr.
  To Interest on calls-in-arrears A/c
- When interest is received
  Bank A/c Dr.
  To Shareholders A/c

Calls in Advance:

- When interest in due
  Interest on calls-in-advance A/c Dr.
  To Shareholders's A/c
- When interest is paid
  Shareholder's A/c Dr.
  To Bank A/c

Q11.What do you mean by Forfeiture of shares? When can they be issued at premium? Illustrate.
Answer:

- The term forfeiture means taking away a property if a condition has not been fulfilled.
- When shares are allotted to the applicant, a condition is imposed on them that they will have to pay Calls on their due date.
- When the shareholders fail to pay call money, there shares are forfeited by the company.
- Once the shares are forfeited. the shareholders' name is removed from the register of members and he is not entitled to any future claim on such shares.
- The amount already paid on shares will not be refunded to the defaulting shareholder
- A person whose shares have been forfeited shall cease to be a member in respect of the forfeited shares, but shall remain liable to pay the company all the monies which, at the date of forfeiture, were presently payable by him to the company is respect of the shares. He is not

entitled to future dividends and rights of membership. The liability ceases when the company shall have received payment in full of all such monies in respect of such shares.

- For carrying out forfeiture "Share Forfeiture A/c" is opened in the books. It is shown on the liability side of Balance Sheet as an addition to paid up share capital.
- Forfeiture of share is not a cancellation of shares, it is just the cancellation of present membership as the forfeited shares can be further reissued.
- Shares can be forfeited only if it is permitted by the articles.
- The directors must pass a resolution for forfeiting the shares at Board Meeting and send a notice to the members requiring them to pay the amount due alongwith interest within the time specified in the notice. However, the time specified cannot be less than 14 days.

1. **Forfeiture of share issued at par:**

   (a) **When all unpaid calls have been transferred to Calls in Arrear A/c:**

   Share Capital A/c Dr. (No of shares × called up value)
   To Shares Forfeiture A/c (Amount paid-up by shareholders)
   To Calls in Arrear A/c (Amount of unpaid calls)

   (b) **When unpaid calls have not been transferred to Calls in Arrear A/c:**

   Share Capital A/c Dr. (Amount called up)
   To Share Forfeiture A/c (Amount paid)
   To Share Allotment A/c (Unpaid on allotment)
   To Share First Call A/c (Unpaid on calls)
   To Share Final Call A/c (Unpaid on calls)

Example:

Y Ltd. forfeited 200 equity shares of ₹10 each, ₹8 called up for non payment of first call @ ₹2 each. Application money @ ₹2 per share and allotment money @ ₹4 per share have already been received by the company. Give journal entry for forfeiture of shares.

Q.R. Code for Solution Video

Solution:

Equity Share Capital A/c (200 × 8) Dr. 1,600
To Calls in arrear A/c (200 × 2) 400
To Share forfeiture A/c (200 × 6) 1,200
(Being forfeiture of shares, ₹8 called up for non payment of first call of ₹2)

2. **Forfeiture of shares issued at premium:**

   When shares were issued at premium there can be two situations:

   (i) If the premium is not paid by the shareholder-securities premium will be debited to cancel it.

   (ii) If premium has already been received by the company-it cannot be cancelled even if the shares are forfeited in future.

   Share Capital A/c Dr.
   Securities Premium A/c Dr.
   To Share Forfeiture A/c
   To Calls in Arrear A/c
   (Being forfeiture of shares for non payment of calls and premium money)

Illustration

Mukund & Co. forfeits for the non-payment of the share call of ₹7 each on 100 shares of ₹10 each payable as to ₹1 on application, ₹2 on allotment and the balance after a month.

Later the forfeited shares are re-issued. Give necessary journal entries if re-issue is at (i) ₹10 (ii) ₹8 and (iii) ₹11.

Solution

Journal

	Particulars	Dr. (₹)	Dr. (₹)
	Forfeiture of share		
	Share Capital A/c Dr.	1,000	
	To Share Forfeited A/c		300
	To Share Call A/c (Calls - in - Arrear)		700
	(Being forfeiture of 100 shares on non-payment of call @ ₹7 per share)		

(i)	**Re-issue of shares**			
	Bank A/c	Dr.	1,000	
	To Share Capital A/c			1,000
	(Being re-issue of 100 shares at par)			
	Share Forfeited A/c	Dr.	300	
	To Capital Reserve A/c			300
	(Being share forfeited transferred to capital reserve)			
(ii)	Bank A/c	Dr.	800	
	Share Forfeited A/c	Dr.	200	
	To Share Capital A/c			1,000
	(Being re-issue of shares ₹8 per share)			
	Share Forfeited A/c	Dr.	100	
	To Capital Reserve A/c			100
	(Being balance in Share Forfeited A/c transferred to Capital Reserve)			
(ii)	Bank A/c	Dr.	1,100	
	To Share Capital A/c			1,100
	To Security Premium A/c			100
	(Being re-issue of 100 shares at a premium of ₹ 1 per share)			
	Share Forfeited A/c	Dr.	300	
	To Capital Reserve A/c			300
	(Being Share Forfeited A/c transferred to Capital Reserve)			

Note: Section 52 requires the amount of premium to be credited to Security Premium Account. Consequently the amount of ₹100 will not be credited to Capital Reserve. In the Balance Sheet, Capital Reserve and Share or Security Premium will separately appear under the head, "Reserve and Surplus."

Re-issue of forfeited shares:

- This shares forfeited shall be re-issued on some specific terms.
- Forfeited shares can be reissued at par, premium or discount

Note: During the reissue of the forfeited shares, the following things should be kept in mind:

1. The amount receivable on reissue together with the amount already received from defaulting member shall not be less than the face value of shares.
2. Loss on reissue should not exceed the forfeited amount.
3. If the loss on reissue is less than the amount forfeited, the surplus should be transferred to capital reserve in proportion to the number of shares reissued.
4. When shares are forfeited at a loss, such loss is to be debited to Share Forfeiture A/c
5. Even though original shares can not be issued at a discount, but forfeited shares can be issued at a discount.
6. If forfeited shares are re-issued at a discount, the amount of discount can in no case, exceed the amount credited to the share forfeiture account.

1. **Reissue of shares at par:**
   (a) **On reissue of shares:**
   Bank A/c Dr. (Amt. received on reissue)
   To Share Capital A/c (No. of share × amt. received)
   (b) **On transfer of Share Forfeited A/c to Capital Reserve:**
   Share Forfeiture A/c Dr.
   To Capital Reserve A/c

Note: On reissue of shares, if there is any loss then it is made good from the balance in Share Forfeiture A/c. After reissue, the balance in Share Forfeiture A/c becomes a capital profit for the company and is transferred to the Capital Reserve A/c.

2. **Reissue of forfeited shares at a premium:**
   (a) **On reissue of shares:**
   Bank A/c Dr. (amt. received on reissue)
   To Share Capital A/c (paid up value of shares)
   To Securities Premium A/c (Premium received)

(b) **Transfer of Share Forfeited A/c to Capital Reserve A/c:**
Share Forfeiture A/c Dr. (with forfeited amt. on shares reissued)
To Capital Reserve A/c

3. **Reissue of forfeited shares at a discount:**
   - Amount of discount cannot be more than balance in Share Forfeiture A/c
   - Discount allowed will be debited to Share Forfeiture A/c
   - If discount allowed is less than balance in Share Forfeiture A/c, the surplus of Share Forfeiture A/c, will be transferred to Capital Reserve A/c in proportion to the number of shares reissued.

(a) **On reissue of shares:**
Bank A/c Dr. (amt. received on reissue)
Share Forfeiture A/c Dr. (discount allowed)
To Share Capital A/c

(b) **On transfer of balance to Share Forfeiture A/c:**
Share Forfeiture A/c Dr.
To Capital Reserve A/c

Illustration:

The Directors of Success Ltd. decide on 1st January, 2007, to issue 10,000 shares of ₹10 each. ₹2.50 being payable on application and ₹2.50 on allotment.

Applications are received on 2nd January for 12,000 shares. On 3rd January, the Directors reject applications in respect of 2,000 shares, the application money being returned in full. All allotment moneys are received on 6th January.

On 31st March, the Directors make a call of ₹2.50 per share, and all sums due are received by 5th April, with the exception of an amount due from Gulabchand, the holder of 100 shares, on 31st May, these shares are forfeited. On 30th June, the shares are re-issued at ₹7.50 per share to Lalbehari, who is required to pay ₹5 per share, ₹2.50 remaining uncalled. Lalbehari at once pays the amount due from him.

Show journal entries necessary to record these transactions.

Solution

Success Ltd.
Journal

2007	Particulars	L.F.	Dr. (₹)	Dr. (₹)
Jan 2	Bank A/c Dr. To Share Application A/c (Application Money received for 12,000 shares @ ₹2.50 per share)		30,000	30,000
Jan 3	Share Application A/c Dr. To Bank A/c (Return of deposits on 2,000 unsuccessful applications)		5,000	5,000
3	Shares Application A/c Dr. Share Allotment A/c Dr. To Share Capital A/c (Transfer of share application money to Share Capital A/c on allotment of 10,000 shares and ₹2.50 per share due on allotment)		25,000 25,000	50,000
6	Bank A/c Dr. To Share Allotment A/c (Allotment money received on 10,000 shares)		25,000	25,000
	Share First Call A/c Dr. To Share Capital A/c (First call money of ₹2.50 per share due on 10,000 shares)		25,000	25,000
5	Bank A/c ₹25,000 (₹2.50 ×100) Dr. To Share First Call A/c (First call money received on 9,900 shares)		24,750	24,750
	Shares Capital A/c (100 × ₹7.50) Dr. To Share First Call A/c (100 × 2.50) To Forfeited Shares A/c (100 × ₹5.00) (Forfeiture of 100 shares on which first call was due)		750	250 500

	Bank A/c Dr. Forfeited Shares A/c Dr. To Share Capital A/c (Re-issue of forfeited shares credited as ₹ 7.50 per share paid upon payment of ₹5 per share)		500 200	 750
"	Forfeited Shares A/c Dr. To Capital Reserve A/c (Profit on re-issue transferred to capital reserve)		250	 250

Short Practice Questions

1. What is share capital. Explain its various categories.
2. Define Preference shares and its types.
3. Differentiate between Calls-in-Arrear and Calls-in-Advance

Past Year Questions and Answer

Objective Questions

2018 - May [1] {C} (a) State with reasons, whether the following statement is true or false:

(ii) Re-issue of forfeited shares is allotment of shares but not a sale. (2 marks)

Answer:

False: A forfeited share is merely a share available to the company for sale and remains vested in the company for that purpose only. Reissue of forfeited shares is not allotment of shares but only a sale.

Practical Questions

2018 - May [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:

(i) ₹2 per share payable on application, to be received by 1st July, 2017;
(ii) Allotment to be made on 10th July, 2017 and a further ₹5 per share (including the premium) to be payable;
(iii) The final call for the balance to be made, and the money received by 30th April, 2018.

Application were received for 4,20,000 shares and were dealt with as follows:

(1) Applicants for 20,000 shares received allotment in full;
(2) 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.
(3) 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. (10 marks)

Q.R. Code for Solution Video

Answer:

Journal of Piyush Limited

Date 2017	Particulars	Debit (₹)	Credit (₹)
July 1	Bank A/c (Note-1 - Column 3) Dr. To Equity Share Application A/c (Being application money received on 4,20,000 shares @ `2 per share)	8,40,000	8,40,000
July 10	Equity Share Application A/c Dr. To Equity Share Capital A/c To Equity Share Allotment A/c (Note 1 - Column 5) To Bank A/c (Note 1- Column 6) (Being application money on 1,30,000 shares transferred to Equity Share Capital Account; on 2,00,000 shares adjusted with allotment and on 90,000 shares refunded as per Board's Resolution No.....dated...)	8,40,000	2,60,000 4,00,000 1,80,000
	Equity Share Allotment A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Being allotment money due on 1,30,000 shares @ ₹5 each including premium at ₹ 2 each as per Board's Resolution No....dated...)	6,50,000	3,90,000 2,60,000
	Bank A/c (Note 1 - Column 8) Dr. To Equity Share Allotment A/c (Being balance allotment money received)	2,50,000	2,50,000

	Equity Share Final Call A/c Dr. To Equity Share Capital A/c (Being final call money due on 1,30,000 shares @ ₹5 per share as per Board's Resolution No....dated...)	6,50,000	6,50,000
April 30	Bank A/c Dr. To Equity Share Final Call A/c (Being final call money on 1,30,000 shares @ ₹5 each received)	6,50,000	6,50,000

Working Notes:

Calculation for Adjustment and Refund

Category	No. of Shares Applied for	No. of Shares Allotted	Amount Received on Application (1×`2)	Amount Required on Application (2×`2)	Amount adjusted on Allotment	Refund [3-4-5]	Amount due on Allotment	Amount received on Allotment
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
(i)	20,000	20,000	40,000	40,000	Nil	Nil	1,00,000	1,00,000
(ii)	1,00,000	50,000	2,00,000	1,00,000	1,00,000	Nil	2,50,000	1,50,000
(iii)	3,00,000	60,000	6,00,000	1,20,000	3,00,000	1,80,000	3,00,000	Nil
Total	4,20,000	1,30,000	8,40,000	2,60,000	4,00,000	1,80,000	6,50,000	2,50,000

2018 - Nov [6] (a) Give necessary journal entry for the forfeiture and re-issue of share:

(i) X Ltd. forfeited 300 shares of ₹10 each fully called up, held by Ramesh for non-payment of allotment money of ₹3 per share and final call of ₹4 per share. He paid the application money of ₹3 per share. These shares were re-issued to Suresh for ₹8 per share.

(4 marks)

Q.R. Code for Solution Video

Answer:

Journal Entries in the books of X Ltd.

Date			Dr. ₹	Cr. ₹
(a)	Equity Share Capital A/c	Dr.	3,000	
	To Equity Share Allotment money A/c (300 × ₹3)			900
	To Equity Share Final Call A/c (300 × ₹4)			1,200
	To Forfeited Shares A/c (300 × ₹4)			900
	(Being the forfeiture of 300 equity shares of ₹10 each for non-payment of allotment money and final call, held by Ramesh as per Board's resolution No....dated...)			
(b)	Bank Account (300 × 8)	Dr.	2,400	
	Forfeited Shares Account (300 × 2)	Dr.	600	
	To Equity Share Capital Account			3,000
	(Being the re-issue of 300 forfeited shares @ ₹8 each as fully paid up to Suresh as per Board's resolution No.....dated.....)			
(c)	Forfeited Shares Account	Dr.	300	
	To Capital Reserve Account			300
	(Being the profit on re-issue, transferred to capital reserve)			

2019 - June [6] (a) Bhagwati Ltd. invited applications for issuing 2,00,000 equity shares of ₹10 each.

The amounts were payable as follows:

On application	– ₹3 per share
On allotment	– ₹5 per share
On first and final call	– ₹2 per share.

Applications were received for 3,00,000 shares and pro-rata allotment was made to all the applicants. Money overpaid on application was adjusted towards allotment money. B, who was allotted 3,000 shares, failed to pay the first and final call money. His shares were forfeited. Out of the forfeited shares, 2,500 shares were reissued as fully paid - up @ ₹6 per share. Pass necessary Journal entries to record the above transactions in the books of Bhagwati Ltd. (10 marks)

Answer:

In the Books of Bhagwati Ltd.
Journal Entries

		Dr. ₹	Cr. ₹
Bank A/c	Dr.	9,00,000	
To Equity Share Application A/c			9,00,000
(Being the application money received for 3,00,000 shares at ₹3 per share)			
Equity Share Application A/c	Dr.	9,00,000	
To Equity Share Capital A/c (2,00,000 × ₹3)			6,00,000
To Share Allotment A/c			3,00,000
(Being share allotment made for 2,00,000 shares and excess adjusted towards allotment)			
Equity Share Allotment A/c	Dr.	10,00,000	
To Equity Share Capital A/c			10,00,000
(Being allotment amount due on 2,00,000 equity shares at ₹5 per share as per Directors' resolution no....dated...)			
Bank A/c	Dr.	7,00,000	
To Equity Share Allotment A/c			7,00,000
(Being balance allotment money received for 2,00,000 shares at ₹5 per share.)			

Equity Share first and final call A/c Dr. To Equity Share Capital A/c (Being first and final call amount due on 2,00,000 equity shares at ₹2 per share as per Directors' resolution no....dated.....)	4,00,000	4,00,000
Bank A/c Dr. Calls in arrears A/c Dr. To Equity Share first & final call A/c (Being final call received on1,97,000 share)	3,94,000 6,000	4,00,000
Share Capital A/c (3,000 × ₹10) Dr. To Forfeited share A/c (3,000 × ₹8) To Calls in arrears A/c (3,000 × ₹2) (Being forfeiture of 3,000 shares of ₹10 each fully called-up for non payment of first and final call @ ₹2 as per Directors' resolution no......dated...)	30,000	24,000 6,000
Bank A/c (2,500 × ₹6) Dr. Forfeited share A/c (2,500 × ₹4) Dr. To Equity Share Capital A/c (2,500 × ₹10) (Being re-issue of 2,500 shares @ 6)	15,000 10,000	25,000
Forfeited share A/c (2,500 × ₹4) Dr. To Capital Reserve A/c (2,500 × ₹4) (Being profit on re-issue transferred to capital reserve)	10,000	10,000

Working Note:

Calculation of amount to be transferred to Capital reserve Ac

			₹
Forfeited amount per share	= 24,000/3,000	=	8
Loss on re-issue (8-4)			4
Surplus per share			4
Transfer to capital reserve	4 × 2,500	₹10,000	

2019 - Nov [6] (a) B Limited issued 50,000 equity shares of ₹10 each payable as ₹3 per share on application, ₹5 per share (including ₹2 as premium) on allotment and ₹4 per share on call. All these shares were subscribed. Money due on all shares was fully received except from X holding 1000 shares who failed to pay the allotment and call money and Y, holding 2000 shares, failed to pay the call money. All those 3000 shares were forfeited. Out of forfeited shares, 2500 shares (including whole of X's shares) were subsequently re-issued to Z as fully paid up at a discount of ₹2 per share.

Pass necessary journal entries in the books of B limited. Also prepare Balance Sheet and notes to accounts of the company. (15 marks)

Answer:

In the books of B Limited

Journal

Date	Particulars	L.F.	Dr. (₹)	Cr.(₹)
	Bank A/c Dr. To Equity Share Application A/c (Money received on applications for 50,000 shares @ ₹3 per share)		1,50,000	1,50,000
	Equity Share Application A/c Dr. To Equity Share Capital A/c (Transfer of application money to share capital on allotment)		1,50,000	1,50,000
	Equity Share Allotment A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Amount due on allotment of 50,000 shares @ ₹ 5 per share including premium)		2,50,000	1,50,000 1,00,000
	Bank A/c ((50,000 - 1,000) × ₹ 5) Dr. Calls-in-Arrears A/c (1,000 × ₹ 5) Dr. To Equity Share Allotment A/c (Money received on allotment except on 1,000 shares held by X)		2,45,000 5,000	2,50,000

Equity Share First and Final Call A/c Dr.		2,00,000	
To Equity Share Capital A/c			2,00,000
(Amount due on first and final call on 50,000 shares @ ₹ 4 per share)			
Bank A/c [(50,000-1,000-2,000) × ₹ 4] Dr.		1,88,000	
Calls-in-Arrears A/c (3,000 × ₹ 4)		12,000	
To Equity Share First and Final Call A/c			2,00,000
(Money received on call except on 1,000 shares held by X and 2,000 shares held by Y)			
Equity Share Capital A/c (3,000 × ₹ 10) Dr.		30,000	
Securities Premium A/c (1,000 × ₹ 2) Dr.		2,000	
To Share Forfeiture A/c [(1,000 × ₹ 3) + {2,000 × (₹ 3 + ₹ 3)}]			15,000
To Calls-in-Arrears A/c			17,000
(Forfeiture of 3,000 Equity Shares of ₹ 10 each, fully called up, for non-payment of final call money of ₹ 4 on 3,000 shares, and non-payment of allotment money of ₹ 5 including securities premium of ₹ 2 on 1,000 shares)			
Bank A/c {2,500 × (₹10 - ₹ 2)} Dr.		20,000	
Share Forfeiture A/c Dr.		5,000	
To Equity Share Capital A/c (2,500 × ₹10)			25,000
(Forfeited Shares re-issued at a discount of ₹2)			
Share Forfeiture A/c Dr.		7,000	
To Capital Reserve A/c (W.N.1)			7,000
(Profit on re-issue transferred to Capital Reserve)			

Balance Sheet of B Ltd. As on ...

Particulars	Note No.	₹
EQUITY AND LIABILITIES		
Shareholders' Funds		
Share Capital	1	4,98,000
Reserves and Surplus	2	1,05,000
Total		**6,03,000**
ASSETS		
Current Assets		
Cash and Cash Equivalents (Bank)		6,03,000
Total		**6,03,000**

Notes to Accounts

		₹	₹
1	**Share Capital**		
	Equity Share Capital		
	Issued Share Capital		
	50,000 Equity Shares @₹10 each	5,00,000	
	Subscribed, Called Up and Paid Up Share Capital		
	49,500 Equity Shares @ ₹10 each	4,95,000	
	Add: Forfeited Shares (500 shares @ ₹6)	3,000	4,98,000
2	**Reserves and Surplus**		
	Securities Premium (W.N.2)	98,000	
	Capital Reserve (W.N.1)	7,000	1,05,000

Working Notes:

W.N.1 - Calculation of Amount to be transferred to Capital Reserve

Particulars	X	Y	Total
No. of Shares forfeited	1,000	2,000	3,000
Amount forfeited per share (₹)	3	6	
No. of Shares re-issued	1,000	1,500	2,500
Discount per Share (₹)	2	2	
Amount transferred to Capital Reserve per share (₹)	1 (₹3 - ₹2)	4 (₹6 - ₹2)	
Total amount transferred to Capital Reserve	1,000 (₹1 × 1,000)	6,000 (₹4 × 1,500)	7,000

W.N.2 - Calculation of Securities Premium

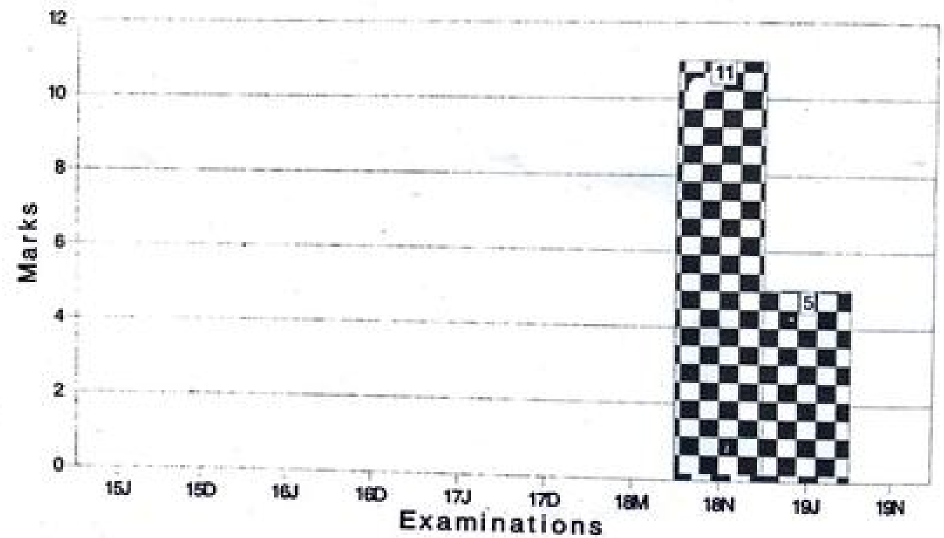
Particulars	₹
Total Amount Receivable (50,000 × ₹2)	1,00,000
Less: Amount reversed on forfeiture (1,000 × ₹2)	2,000
Balance Remaining	98,000

CHAPTER	
10	**Company Accounts**
Unit: 3	**Issue of Debentures**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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Q1.What do you mean by debentures?
Answer:
Debenture is a source of long term borrowing for the company. It is a debt instrument issued by the company for raising funds.

- As per Companies Act, 2013, debenture includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not.
- In other words, it is a bond issued by the company acknowledging a debt and containing provisions for repayment of interest and principal.
- The holders of debentures are known as debenture holders.

Q2. What are the Features of Debenture?
Answer:
(a) It is an instrument acknowledging a debt of the company.
(b) Rate of interest on debentures is fixed and is a charge against the profits of the company.
(c) Interest falls due on specific dates.
(d) Sum is repayable at the end of the term for which it was issued.
(e) May or may not create a charge on assets of the company as security.
(f) Debentures may be issued at par, premium or discount.

Q3. Differentiate between debentures and shares.
Answer:

Basis of Difference	Shares	Debentures
Meaning	Is the owned capital of the company	Is the loan capital of the company
Holder of the instrument	Owners of the company.	Creditors of the company.
Voting right	Carries voting right	Do not have voting right
Payable	Dividend is paid on shares at a variable rate which is an appropriation of profit.	Interest on debentures is paid at a fixed rate and is a charge against Profit.
Types	These are of 2 types • Equity shares • Preference shares	These are of different types such as • Secured/ Unsecured • Convertible/ Non-convertible • Redeemable/ Non-redeemable • Registered/Bearer etc.
Treatment in Books of Amount	Shown in balance sheet under the head "Shareholder's fund"	Shown in balance sheet under the head "Non-current Liabilities"
Repayment	Shareholders are paid at the last at the time of liquidation	Debenture holders are paid-off before share holders

Q4. What are the Type of Debentures?
Answer:
1. **On the basis of Security**
   - **Secured Debentures:** These are secured by any charge on assets of the company.
   - **Unsecured Debentures:** These are not secured by any charge on assets of the company.
2. **On the basis of Convertibility**
   - **Convertible Debentures:** Debentures which have an option of conversion into equity shares at some point of time in future.
   - **Non-Convertible Debentures:** There can never be converted into equity shares.
3. **On the basis of Permanence**
   - **Redeemable Debentures:** These debentures have to be redeemed after a fixed period of time.
   - **Irredeemable Debentures:** Also known as perpetual debentures these are not redeemable and will be repaid only at the time of liquidation.
4. **On the basis of Negotiability**
   - **Registered Debentures:** These debentures are payable only to that person whose name is present in the Register of Debenture holders. These are not transferred by mere delivery.
   - **Bearer Debentures:** Debentures which are transferred by mere delivery and not entered in register are bearer debentures.

5. **On the basis of Priority**
   - **First mortgage Debentures:** These are payable first out of property charged.
   - **Second Mortgage Debentures:** These are payable after satisfying first mortgage debentures.

Q5. What are the Accounting entries for issue of redeemable debentures?

Answer:

(a) Debenture issued at par redeemable at par

Bank A/c Dr.
  To Debentures Application A/c
[Being receipt of application money]

Debenture Application A/c Dr.
  To Debentures A/c
[Being debentures allotted]

(b) Debentures issued at discount and redeemable at par or at a discount

Bank A/c Dr.
  To Debenture Application A/c
[Being receipt of application money]

Debenture Application A/c Dr.
Discount on issue of debenture A/c Dr.
  To Debenture A/c
[Being debenture issued as discount]

(c) Debentures issued at premium and redeemable at par or at discount

Bank A/c Dr.
  To Debenture Application A/c
[Being receipt of application money]

Debenture Application A/c Dr.
  To Debenture A/c
  To Securities Premium A/c
[Being debentures issued at a discount]

(d) Debentures issued at par and redeemable at a premium

Bank A/c Dr.
  To Debenture Application A/c
[Being receipt of application money]

Debenture Application A/c Dr.
  To Debenture A/c
[Being debenture allotted]

Debenture Allotment A/c Dr. [equal to debenture
Loss on issue of debenture A/c Dr. redemption premium]
  To Debenture A/c
  To Debenture Redemption Premium Ac

(e) Debentures issued at discount and redeemable at premium

Bank A/c Dr.
  To Debenture Application A/c
[Being receipt of application money]

Debenture Application A/c Dr.
  To Debenture A/c

Debenture Allotment A/c Dr. [Amount equal to
Discount/Loss on Issue of Debenture A/c Dr. discount on issue of
  To Debenture A/c debenture + premium on redemption]

Bank A/c Dr.
  To Debenture Allotment A/c

(f) Debentures issued at premium and redeemable at premium

Bank A/c Dr.
  To Debenture Application A/c

Debenture Application A/c Dr.
  To Debenture A/c

Debenture Allotment A/c Dr.
Loss on issue of Debenture A/c Dr.
  To Debenture A/c
  To Securities Premium A/c
  To Premium on Redemption of Debenture A/c

Q6. What is the Accounting for issue of debentures payable in instalments?

Answer:

(i) Bank A/c Dr.
    To Debenture Application A/c
[Being amount received on application]

(ii) Debenture Application A/c Dr.
    To Debenture A/c
[Being debenture allotted]

(iii) Debenture Allotment A/c Dr.
    To Debenture A/c
[Being allotment due]

(iv) Bank A/c Dr.
    To Debenture Allotment A/c
[Being allotment money received]

(v) Debenture Calls A/c Dr.
    To Debenture A/c
[Being call due]

(vi) Bank A/c Dr.
    To Debenture Call A/c
[Being call amount received]

Q7.What do you mean by Issue of Debentures as a Collateral Security?

Answer:

- Collateral security means secondary or supporting security
- Debentures can be issued as a collateral security
- When the debentures are given as a security, the lender gets absolute right over the debentures till the loan in repaid
- If on due date, loan is repaid, lender shall release the debentures and if the loan is not repaid then, these debentures become active and lenders gets all the rights of debentures holders
- These are two methods of treating debentures issued as a collateral security

Method 1:

(i) No entry should be passed for issuing debentures as a collateral security.

(ii) Mention the facts in notes to account.

Method 2:

When debentures issued as collateral security are to be shown is books —

On issue of debenture as collateral security:

Debenture Suspense A/c Dr.
    To Debenture A/c

On repayment of loan, release of debentures:

Debenture A/c Dr.
    To Debenture Suspense A/c

Illustration:

X Ltd. obtains a loan from IDBI of ₹10,00,000 given a collateral security of ₹15,00,000, 19% first mortgage debentures. What will be the accounting treatment of above?

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Solution:

Method 1:

Balance Sheet Extract

Particulars	Note No.	Figures at the end of current reporting period (₹)	Figures at the end of previous reporting period (₹)
Equity & Liabilities			
1. **Non-Current Liabilities**			
(a) Long term borrowings			
(i) Secured loan: -			
IDBI Loan		10,00,000	

(ii) Unsecured Loan:- 19% mortgage debentures (Collaterally secured by issue of ₹ 15,00,000, 19% first mortgage debentures)		15,00,000	
Asset			
2. **Current Assets**			
(a) Other current assets:- (issue of 15,00,000, 19% first mortgage debentures)		15,00,000	

Method 2:

Journal

(i) Debenture Suspense A/c Dr. 15,00,000
To 19% First Mortgage Debenture A/c 15,00,000
(Being issue of debentures as a collateral security)

Balance Sheet Extract

Particulars	Note No.	Figures at the end of current reporting period (₹)	Figures at the end of previous reporting period (₹)
Equity & Liabilities			
1. Non-Current Liabilities			
(a) **Long term borrowings**			
(i) **Secured loan: -**			
IDBI Loan		10,00,000	
(ii) **Unsecured Loan:-**			
14% first mortgage debentures		15,00,000	

Asset			
2. **Current Assets**			
(a) **Other current assets:-** (issue of 15,00,000, 19% first mortgage debentures)		15,00,000	

Q8.How is Issue of Debentures is done as consideration other than for cash?

Answer:

Sometimes assets are purchased from vendors and instead of paying them cash, debentures are issued to them:

The following journal entries are passed:

(i) Sundry Asset A/c Dr.
To Vendors
[Being assets acquired]

(ii) Vendor A/c Dr.
To Debentures A/c
[Being debentures issued to vendors at par']
Or
Vendors A/c Dr.
To Debentures A/c
To Securities Premium
[Being debentures issued to vendors at premium]
Or
Vendors A/c Dr.
Discount on issue of debenture Dr.
To Debenture A/c
[Being debentures issued to vendors at discount]

Note:

1. If value of debenture is more than the agreed purchased price-Debit the difference in Goodwill A/c.
2. If agreed purchase price is more than debenture allotted – difference is credited to capital Reserve A/c.

Illustration:

Ashok Ltd. purchased building worth ₹2,50,000 and Plant & Machinery worth ₹ 1,20,000 from Bishop Ltd. for an agreed purchase consideration of ₹ 3,60,000 to be satisfied by the issue of 3,600, 17% debentures of 100 each. Show entries in books of Ashok Ltd.

Solution:

In the books of Ashok Ltd.
Journal

Particulars		L.F.	Dr. Amount	Cr. Amount
Building A/c	Dr.		2,50,000	
Plant & Machinery A/c	Dr.		1,20,000	
To Bishop Ltd. A/c				3,60,000
To Capital Reserve A/c				10,000
[Being purchase of Sundry Assets]				
Bishop Ltd. A/c	Dr.		3,60,000	
To 17% Debenture A/c				3,60,000
[Being issue of debentures to vendors in settlement of purchase consideration]				

Note:

Purchase consideration = ₹3,60,000

Value of assets taken over = ₹3,70,000

Capital Profit = 10,000 is transferred to Capital Reserve A/c.

3.9 Treatment of Discount/Loss on Issue of Debentures:

Discount on issue of debentures being a capital loss must be shown specifically on the asset side under the heading Non-Current Assets. Discount on issue of debentures should be written off as quickly as possible. However, it can be treated as deferred revenue expenditure and written off over the life of the debentures.

Illustration:

Amol Ltd. issued 40,00,000, 9% debentures of ₹50 each payable on application as per the terms mentioned in the prospectus and redeemable at par any time after 3 years from the date of issue. Record necessary entries for issue of debentures in the books of Amol Ltd.

Solution:

Books of Amol Ltd.
Journal

Particulars		L.F.	Dr. Amount	Cr. Amount
Bank A/c	Dr.		20,00,00,000	
To Debentures Application A/c				20,00,00,000
[Being debenture application money received]				
Debenture Application A/c	Dr.		20,00,00,000	
To 9% Debenture A/c				20,00,00,000
[Being application money transferred to 9% debentures account consequently upon allotment]				

3.10 Interest on Debenture:

It is a charge against profit and paid periodically at a fixed rate of interest.

Accounting Entries:

1. **When interest is due:**
   Interest A/c Dr.
   To Debenture holder's A/c
2. **When payment is made and TDS deducted:**
   Debenture holder A/c Dr.
   To TDS Payable A/c
   To Bank A/c
3. **For making payment of TDS:**
   TDS payable A/c Dr.
   To Bank A/c
4. **Transfer interest to Profits & Loss A/c:**
   Profit & Loss A/c Dr.
   To Interest A/c

Short Practice Questions

1. What do you mean by Debenture. What are its features?
2. Differentiate between debenture and shares.
3. Explain different types of debentures.

Past Year Questions and Answers

Practical Questions

2018 - Nov [6] (a) Give necessary journal entries for the forfeiture and re-issue of shares :

(ii) X Ltd. forfeited 200 shares of ₹10 each (₹7 called up) on which Naresh had paid application and allotment money of ₹5 per share. Out of these, 150 shares were re-issued to Mahesh as fully paid up for ₹6 per share. (3 marks)

(iii) X Ltd. forfeited 100 shares of ₹10 each (₹6 called up) issued at a discount of 10% to Dimple on which she paid ₹2 per share. Out of these, 80 shares were re-issued to Simple at ₹8 per share and called up for ₹6 per share. (3 marks)

Answer:

(ii)

Date			Dr. ₹	Cr. ₹
(a)	Equity Share Capital A/c (200 × ₹7)	Dr.	1,400	
	To Equity Share First Call A/c (200 × ₹2)			400
	To Forfeited Shares A/c (200 × ₹5)			1,000
	(Being the forfeiture of 200 equity shares of ₹10/- (₹7 called up) for non-payment of first call @ ₹2/- per share as per Board Resolution No...dated....)			

(b)	Bank Account	Dr.	900	
	Forfeited Shares Account	Dr.	600	
	To Equity Share Capital Account			1,500
	(Being the re-issue of 150 forfeited shares as fully paid up as per Board's resolution No.....dated....)			
(c)	Forfeited Shares Account	Dr.	150	
	To Capital Reserve Account			150
	(Being the profit on re-issue, transferred to capital reserve)			

Working Note:

Balance in forfeited shares account on forfeiture of 150 shares (150 × 5)	₹750
Less: Forfeiture of 150 shares	(₹600)
Profit on re-issue of shares	₹150

(iii)

Date			Dr. ₹	Cr. ₹
(a)	Equity Share Capital A/c (100 × ₹6)	Dr.	600	
	To Equity Share Final Call A/c (100 × ₹3)			300
	To Discount on issue of shares (100 × ₹1)			100
	To Forfeited Shares A/c (100 × ₹2)			200
	(Being the forfeiture of 100 equity shares issued at a discount as per Board's resolution No.....dated.....)			
(b)	Bank Account (80 × ₹6)	Dr.	480	
	Discount on issue of shares (80 × ₹1)	Dr.	80	
	Forfeited Shares A/c (80 × ₹1)	Dr.	80	
	To Equity Share Capital Account (80 × ₹8)			640
	(Being the re-issue of 80 shares fully paid up as per Board's Resolution No....dated...)			

(c)	Forfeited Shares Account	Dr.	80	
	To Capital Reserve Account			80
	(Being the profit on re-issue, transferred to capital reserve)			

Working Notes:

Balance in forfeited shares account on forfeiture of 100 shares (100 × 2)	₹200.00
Forfeited shares balance for 80 shares	₹160
Less: Forfeiture of 80 shares	(₹80.00)
Profit on re-issue of shares	₹80.00

Note: It may be noted that the facts given in the question are not in compliance with Companies Act, 2013. As per Section 53 of Companies Act, 2013 a company cannot issue shares at discount except for in case of sweat equity shares and therefore any issue on discount by the company is void. However, the above answer has been given strictly based on the information provided in the question.

2018 - Nov [6] (b) Pure Ltd. issues 1,00,000 12% Debentures of ₹10 each at ₹9.40 on 1st January, 2018. Under the terms of issue, the Debentures are redeemable at the end of 5 years from the date of issue.
Calculate the amount of discount to be written-off in each of the 5 years. (5 marks)

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Answer:
Total amount of discount comes to ₹60,000 (₹0.6 × 1,00,000). The amount of discount to be written-off in each year is calculated as under:

Year end Ourstanding	Debentures	Ratio in which discount to be written-off	Amount of discount to be written-off
1st	₹10,00,000	1/5	1/5th of ₹60,000 = ₹12,000
2nd	₹10,00,000	1/5	1/5th of ₹60,000 = ₹12,000
3rd	₹10,00,000	1/5	1/5th of ₹60,000 = ₹12,000
4th	₹10,00,000	1/5	1/5th of ₹60,000 = ₹12,000
5th	₹10,00,000	1/5	1/5th of ₹60,000 = ₹12,000

2019 - June [6] (b) On 1st January 2018, Ankit Ltd. issued 10% debentures of the face value of ₹20,00,000 at 10% discount. Debenture interest after deducting tax at source @ 10% was payable on 30th June and 31st December every year. All the debentures were to be redeemed after the expiry of five year period at 5% premium.
Pass necessary journal entries for the accounting year 2018. (5 marks)

Answer:

Journal Entries

Date	Particulars		Dr. ₹	Cr. ₹
1-1-2018	Bank A/c	Dr.	18,00,000	
	Discount/Loss on Issue of Debentures A/c	Dr.	3,00,000	
	To 10% Debentures A/c			20,00,000
	To Premium on Redemption of Debentures A/c			1,00,000
	(For issue of debentures at discount redeemable at premium)			
30-6-2018	Debenture Interest A/c	Dr.	1,00,000	
	To Debenture holders A/c			90,000
	To Tax Deducted at Source A/c			10,000
	(For interest payable)			

	Debenture holders A/c	Dr.	90,000	
	Tax Deducted at Source A/c	Dr.	10,000	
	To Bank A/c			1,00,000
	(For payment of interest and TDS)			
31-12-2018	Debenture Interest A/c	Dr.	1,00,000	
	To Debenture holders A/c			90,000
	To Tax Deducted at Source A/c			10,000
	(For interest payable)			
	Debenture holders A/c	Dr.	90,000	
	Tax Deducted at Source A/c	Dr.	10,000	
	To Bank A/c			1,00,000
	(For payment of interest and tax)			
	Profit and Loss A/c	Dr.	2,00,000	
	To Debenture Interest A/c			2,00,000
	(For transfer of debenture interest to profit and loss account at the end of the year)			
	Profit and Loss A/c	Dr.	60,000	
	To Discount/Loss on issue of debenture A/c			60,000
	(For proportionate debenture discount and premium on redemption written off, i.e., 3,00,000 × 1/5)			

FOR NOTES