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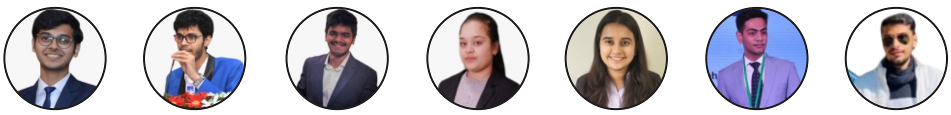

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CHAPTER- 1

THEORETICAL FRAMEWORK

UNIT - 1 MEANING AND SCOPE OF ACCOUNTING

True and False

Q1. There is no difference between book keepings and accounting, both are same.

Ans1. False: Book-keeping and accounting are different from each other. Accounting is a broad subject. It calls for a greater understanding of records obtained from bookkeeping and an ability to analyse and interpret the information provided by bookkeeping records.

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

Q2. Management Accounting covers the preparation and interpretation of financial statements and communication to the users of accounts.

Ans2. False: Financial accounting covers the preparation and interpretation of financial statements and communication to the users of accounts.

Q3. Financial accounting is concerned with internal reporting to the managers of a business unit.

Ans3. False: Management accounting is concerned with internal reporting to the managers of a business unit.

Q4. Customers of business should not be considered as users of accounts prepared by business. They are not interested to know performance of the business

Ans4. False: Customers are also concerned with the stability and profitability of the enterprise because their functioning is more or less dependent on the supply of goods

Q5. Summarizing is the basic function of accounting. All business transactions of a financial characters evidenced by some documents such as sales bill, pass book, salary slip etc. are recorded in the books of account.

Ans5. False: Recording is the basic function of accounting. Summarising is concerned with the preparation and presentation of the classified data in a manner useful to the internal as well as the external users of financial statements

Q6. Balance sheet shows the position of the business on the day of its preparation and not on the future date.

Ans6. True: Balance Sheet is a statement of the financial position of an enterprise at a given date.

Q7. Objectives of book-keeping are complete recording of transactions & ascertainment of financial effect on the business.

Ans7. True: Book-keeping is concerned with complete recording and combined effect of transactions made during the accounting period.

Multiple Choice Questions

Q1. Which of the following is not a subfield of accounting?

(a) Management accounting.

(b) Cost accounting.

(c) Book-keeping

Ans1. (c) Book-keeping

Q2. Purposes of an accounting system include all the following except

(a) Interpret and record the effects of business transaction.

(b) Classify the effects of transactions to facilitate the preparation of reports.

(c) Dictate the specific types of business enterprise transactions that the enterprises may engage in.

Ans2. (c) Dictate the specific types of business enterprise transactions that the enterprises may engage in.

Q3. Book-keeping is mainly concerned with

(a) Recording of financial data.

(b) Designing the systems in recording, classifying and summarizing the recorded data.

(c) Interpreting the data for internal and external users.

Ans3. (a) Recording of financial data.

Q4. All of the following are functions of Accounting except

(a) Decision making.

(b) Ledger posting.

(c) Forecasting.

Ans4. (b) Ledger posting.

Q5. Financial statements are part of

(a) Accounting.

(b) Book-keeping.

(c) Management Accounting.

Ans5. (a) Accounting.

Q6. Financial position of the business is ascertained on the basis of

(a) Records prepared under book-keeping process.

(b) Trial balance.

(c) Balance Sheet.

Ans6. (c) Balance Sheet.

Q7. Users of accounting information include

(a) Creditors/Suppliers

(b) Lenders/ Customers

(c) Both (a) and (b)

Ans7. (c) Both (a) and (b)

Q8. Financial statements do not consider

(a) Assets expressed in monetary terms.

(b) Liabilities expressed in monetary terms.

(c) Assets and liabilities expressed in non-monetary terms

Ans8. (c) Assets and liabilities expressed in non-monetary terms

Q9. On January 1, Sohan paid rent of Rs.5,000. This can be classified as

(a) An event.

(b) A transaction.

(c) A transaction as well as an event.

Ans9. (b) A transaction.

Q10. On March 31, 2022 after sale of goods worth ` 2,000, he is left with the closing inventory of Rs.10,000. This is

(a) An event.

(b) A transaction.

(c) A transaction as well as an event.

Ans10. (a) An event.

Q11. Which of the following is not a business transaction?

(a) Bought a machine of Rs.10,000 for business

(b) Paid towards salaries of employees Rs.5,000

(c) Paid son’s fees from her personal bank account Rs.8,000

Ans11. (c) Paid son’s fees from her personal bank account Rs.8,000

Q12. Which qualitative characteristics of accounting information is reflected when accounting information is clearly presented ?

(a) Understandability

(b) Relevance

(c) Comparability

Ans12. (a) Understandability

Theoretical Questions/ Answers

Q1. Define accounting. What are the sub-fields of accounting?

Ans1. Accounting is the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the result thereof. Various subfields of accounting are listed as: Financial Accounting; Management Accounting; Cost Accounting; Social Responsibility Accounting and Human Resource Accounting.

Q2. Who are the users of accounting information?

Ans2. Users of accounts can be listed as Investors, Employees, Lenders, Suppliers and Creditors, Customers, Govt. and their agencies, public and Management.

Q3. Discuss briefly the relationship of accounting with

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

Ans3. (i) Accounting and Economics: Economics is viewed as a science of rational decision making about the use of scarce resources. It is concerned with the analysis of efficient use of scarce resources for satisfying human wants. This may be viewed either from the perspective of a single firm or of the country as a whole.

Accounting is viewed as a system, which provides data to the users to permit informed judgement and decisions. Some non-accounting data are also relevant for decision making.

Accounting overlaps economics in many respects. It contributed a lot in improving the management decision-making process. But, economic theories influenced the development of the decision-making tools used in accounting.

However, there exists a wide gulf between economists' and accountants' concepts of income and capital. Accountants got the ideas of value, income and capital maintenance from economists, but brushed suitably to make them usable in practical circumstances. Accountants developed the valuation, measurement and decision making techniques which may owe to the economic theorems for origin but these are moulded in the work environment and suitably tempered with reference to relevance, verifiability, freedom from bias, timeliness, comparability, reliability and understandability.

An example may be given to explain the nexus between accounting and economics. Economists think that value of an asset is the present value of all future earnings which can be derived from such assets. Now think about a plant whose working life is more than one hundred years. How can you estimate future stream of earnings? So accountants developed the workable valuation base – the acquisition cost i.e., the price paid to acquire the assets.

At the macro-level, accounting provides the database over which the economic decision models have been developed; micro-level data arranged by the accounting system is summed up to get macro-level database.

Non-overlapping zones of accounting are not negligible. Development of the systems of recording, classifying and summarizing transactions and events, harmonizing the systems by uniform rules and communicating the data is essentially a non-overlapping area of accounting.

(ii) Accounting and Statistics: The use of statistics in accounting can be appreciated better in the context of the nature of accounting records. Accounting information is very precise; it is exact to the last paisa. But, for decision-making purposes such precision is not necessary and hence, the statistical approximations are sought.

In accounts, all values are important individually because they relate to business transactions. As against this, statistics is concerned with the typical value, behavior or trend over a period of time or the degree of variation over a series of observations. Therefore, wherever a need arises for only broad generalizations or the average of relationships, statistical methods have to be applied in accounting data.

Further, in accountancy, the classification of assets and liabilities as well as the heads of income and expenditure has been done as per the needs of financial recording to ascertain financial results of various operations. Other types of classification like the geographical and historical ones and ad hoc classification are done depending on the purpose to make such classification meaningful.

Accounting records generally take a short-term view of events and are confined to a year while statistical analysis is more useful if a longer view is taken for the purpose. For example, to fit the trend line a longer period will be required. However, statistical methods do use past accounting records maintained on a consistent basis.

The functional relations showing mathematical relations of one variable with one or more other variables are based on statistical work. These relations are used widely in making cost or price estimates for some estimated future values assigned to the given independent variables. For example, given the functional relation of total cost to the price of an input, the effect of changes in future prices on the cost of production can be calculated.

In accountancy, a number of financial and other ratios are based on statistical methods, which help in averaging them over a period of time. Several accounting and financial calculations are based on statistical formulae.

Statistical methods are helpful in developing accounting data and in their interpretation. For example, time series and cross-sectional comparison of accounting data is based on statistical techniques. Now- a-days multiple discriminate analysis is popularly used to identify symptoms of sickness of a business firm. Therefore, the study and application of statistical methods would add extra edge to the accounting data.

(iii) Accounting and Law: An economic entity operates within a legal environment. All transactions with suppliers and customers are governed by the Contract Act, the Sale of Goods Act, the Negotiable Instruments Act, etc. The entity itself is created and controlled by laws. For example, a company is created by the Companies Act and also controlled by Companies Act.

Similarly, every country has a set of economic, fiscal and labour laws. Transactions and events are always guided by laws of the land. Very often the accounting system to be followed has been prescribed by the law. For example, the Companies Act has prescribed the format of financial statements for companies.

Banking, insurance and electric supply undertakings may also have to produce financial statements as prescribed by the respective legislations controlling such entities.

However, legal prescription about the accounting system is the product of developments in accounting knowledge. That is to say, legislation about accounting system cannot be enacted unless there is a corresponding development in the accounting discipline. In that way accounting influences law and is also influenced by law.

Q4. Discuss the limitations which must be kept in mind while evaluating the Financial Statements.

Ans4. Limitations which must be kept in mind while evaluating the Financial Statements are as follows:

- The factors which may be relevant in assessing the worth of the enterprise don't find place in the accounts as they cannot be measured in terms of money.
- Balance Sheet shows the position of the business on the day of its preparation and not on the future date while the users of the accounts are interested in knowing the position of the business in the near future and also in long run and not for the past date.
- Accounting ignores changes in some money factors like inflation etc.
- There are occasions when accounting principles conflict with each other.

- Certain accounting estimates depend on the sheer personal judgement of the accountant.
- Different accounting policies for the treatment of same item adds to the probability of manipulations .

Q5. What services can a Chartered Accountant provide to the society?

Ans5. The practice of accountancy has crossed its usual domain of preparation of financial statements, interpretation of such statements and audit thereof. Accountants are presently taking active role in company laws and other corporate legislation matters, in taxation laws matters (both direct and indirect) and in general management problems. There are only a few types of profession in the world which are held in high esteem in public eyes and there is no denying the fact that the accounting profession is one of them. Goethe had called the accountant's profession as 'the fairest invention of the human mind'. At the core of all types of learned profession, there is the desire of public good and of finding the best way to serve society. By the use of the science of accountancy and under the spell of its art, a dynamic pattern which assists business in planning its future is woven by accountants out of the inert mass of non-speaking silent figures. This is what makes their profession an instrument of socio-economic change and welfare of the society.

An accountant with his education, training, analytical mind and experience is best qualified to provide multiple need-based services to the ever growing society. The accountants of today can do full justice not only to matters relating to taxation, costing, management accounting, financial lay-out, company legislation and procedures but they can delve deep into the fields relating to financial policies, budgetary policies and even economic principles. The area of activities which can be undertaken by the accountants is not limited but it can also cover many additional facets.

UNIT – 2 ACCOUNTING CONCEPTS, PRINCIPLES AND CONVENTIONS

<u>True and False</u>

Q1. The concept helps in keeping business affairs free from the influence of the personal affairs of the owner is known as the matching concept.

Ans1. False: Under matching concept all expenses matched with the revenue of that period should only be taken into consideration. In the financial statements of the organization if any revenue is recognized then expenses related to earn that revenue should also be recognized.

Q2. Entity concept means that the enterprise is liable to the owner for capital investment made by the owner.

Ans2. True: Since the owner invested capital, he has claim on the profits of the enterprise.

Q3. Accrual means recognition as money is received or paid and not of revenue and costs as they are earned or incurred.

Ans3. False: Under accrual concept, the effects of transactions and other events are recognized on mercantile basis i.e., when they occur (and not as cash or a cash equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate.

Q4. The Conservatism Concept states that no change should be counted unless it has materialized.

Ans4. False: The Realisation Concept states that no change should be counted unless it has materialised.

Q5. The concept of consistency implies non-flexibility as not to allow the introduction of improved method of accounting.

Ans5. False: The concept of consistency does not imply non-flexibility as not to allow the introduction of improved method of accounting.

Q6. The materiality depends only upon the amount of the item and not upon the size of the business, nature and level of information, level of the person making the decision etc.

Ans6. False: As per materiality principle, all the items having significant economic effect on the business of the enterprise should be disclosed in the financial statements.

Q7. Accrual basis of accounting is the method of recording transactions by which revenues and costs and assets and liabilities are reflected in the accounts in the period in which actual receipts or actual payments are made.

Ans7. False: Cash Basis of Accounting is the method of recording transactions by which revenues and costs and assets and liabilities are reflected in the accounts in the period in which actual receipts or actual payments are made.

Multiple Choice Questions

Q1. (i) All the following items are classified as fundamental accounting assumptionsexcept

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

Ans.(i) (b) Business entity.

(ii) Two primary qualitative characteristics of financial statements are

- **(a) Understandability and materiality.**
- **(b) Relevance and reliability.**

(c) **Neutrality and understandability.**

Ans.(ii) (b) Relevance and reliability.

(iii) Kanika Enterprises follows the written down value method of depreciating machinery year after year due to

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

Ans.(iii) (c) Consistency.

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

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

Ans.(iv) (c) Total assets increased by Rs.4,00,000 with corresponding increase in liabilities by Rs.4,00,000.

(v) Mohan purchased goods for Rs.15,00,000 and sold 4/5th of the goods amounting Rs.18,00,000 and met expenses amounting Rs.2,50,000 during the year, 2022. He counted net profit as Rs.3,50,000. Which of the accounting concept was followed by him?

(a) Entity.

(b) Periodicity.

(c) Matching.

Ans.(v) (c) Matching.

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

(a) Money measurement.

(b) Conservatism.

(c) Cost.

Ans.(vi) (b) Conservatism.

(vii) Capital brought in by the proprietor is

(a) Increase in asset and increase in liability

(b) Increase in liability and decrease in asset

(c) Increase in asset and decrease in liability

Ans.(vii) (a) Increase in asset and increase in liability

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

(a) Conservatism

(b) Matching

(c) Accounting period

Ans.(viii) (c) Accounting period

(ix) A concept that a business enterprise will not be liquidated in the near future is known as :

(a) Going concern

(b) Economic entity

(c) Monetary unit

Ans.(ix) (a) Going concern

Q2. (i) Assets are held in the business for the

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

Ans.(i) (c) Earning revenue.

(ii) Revenue from sale of products, is generally, realised in the period in which

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

Ans.(ii) (b) Sale is made.

(iii) The concept of conservatism when applied to the balance sheet results in

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

Ans.(iii) (a) Understatement of assets.

(iv)Decrease in the amount of trade payables results in

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

Ans.(iv) (c) Decrease in assets.

(v) The determination of expenses for an accounting period is based on the principle of

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

Ans.(v) (c) Matching.

(vi)Economic life of an enterprise is split into the periodic interval to measure its performance is as per

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

Ans.(vi) (c) Periodicity.

Q3. (i) If an individual asset is increased, there will be a corresponding

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

Ans.(i) (b) Decrease of another asset or increase of liability.

(ii) Purchase of machinery for cash

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

Ans.(ii) (c) Retains total assets unchanged.

(iii) Consider the following data pertaining to Alpha Ltd.:

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

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

- **(a) Cost.**
- **(b) Matching.**
- **(c) Accrual.**

Ans.(iii) (a) Cost.

Theoretical Questions/ Answers

Q1. Write short notes on:

(i) Fundamental accounting assumptions.

(ii) Periodicity concept.

(iii) Accounting conventions.

Ans1. (i) Fundamental accounting assumptions: There are three fundamental accounting assumptions: Going Concern; Consistency and Accrual. If nothing has been written about the fundamental accounting assumption in the financial statements then it is assumed that they have already been followed in their preparation of financial statements.

(ii) Periodicity concept: According to this concept accounts should be prepared after every period & not at the end of the life of the entity. This is also called the concept of definite accounting period. As per going concern' concept an indefinite life of the entity is assumed. For a business entity it causes inconvenience to measure performance achieved by the entity in the ordinary course of business.

If a textile mill lasts for 100 years, it is not desirable to measure its performance as well as financial position only at the end of its life.

So, a small but workable fraction of time is chosen out of infinite life cycle of the business entity for measuring performance and looking at the financial position.

Generally, one year period is taken up for performance measurement and appraisal of financial position. However, it may also be 6 months or 9 months or 15 months.

According to this concept accounts should be prepared after every period & not at the end of the life of the entity. Usually, this period is one calendar year. We generally follow from 1st April of a year to 31st March of the immediately following year.

Thus, for performance appraisal it is not necessary to look into the revenue and expenses of an unduly long time-frame. This concept makes the accounting system workable and the term 'accrual' meaningful. If one thinks of indefinite time-frame, nothing will accrue. There cannot be unpaid expenses and non- receipt of revenue. Accrued expenses or accrued revenue is only with reference to a finite time-frame which is called accounting period.

Thus, the periodicity concept facilitates in:

(i) Comparing of financial statements of different periods

(ii) Uniform and consistent accounting treatment for ascertaining the profit and assets of the business

(iii) Matching periodic revenues with expenses for getting correct results of the business operations

(iii) 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.

In the study material, the terms 'accounting concepts', 'accounting principles' and 'accounting conventions' have been used interchangeably to mean those basic points of agreement on which financial accounting theory and practice are founded.

Q2. Distinguish between:

(i) Money measurement concept and matching concept

(ii) Going concern and cost concept

Ans2. (i) Distinction between Money measurement concepts and matching concept

As per **Money Measurement concept**, only those transactions, which can be measured in terms of money are recorded. Since money is the medium of exchange and the standard of economic value, this concept requires that those transactions alone that are capable of being measured in terms of money be only to be recorded in the books of accounts. Transactions and events that cannot be expressed in terms of money are not recorded in the business books.

In **Matching concept** all expenses matched with the revenue of that period should only be taken into consideration. In the financial statements of the organization if any revenue is recognized them expenses related to earn that revenue should also be recognized.

(ii) Distinction between Going concern and cost concept

Going Concern Concept

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

The valuation of assets of a business entity is dependent on this assumption. Traditionally, accountants follow historical cost in majority of the cases.

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. When a machine is acquired by paying Rs.5,00,000, following cost concept the value of the machine is taken as Rs.5,00,000. It is highly objective and free from all bias. Other measurement bases are not so objective. Current cost of an asset is not easily determinable. If the asset is purchased on 1.1.1995 and such model is not available in the market, it becomes difficult to determine which model is the appropriate equivalent to the existing one. Similarly, unless the machine is actually sold, realisable value will give only a hypothetical figure. Lastly, present value base is highly subjective because to know the value of the asset one has to chase the uncertain future.

However, the cost concept creates a lot of distortion too as outlined below:

(a) In an inflationary situation when prices of all commodities go up on an average, acquisition cost loses its relevance. For example, a piece of land purchased on 1.1.1995 for Rs.2,000 may cost Rs.1,00,000 as on 1.1.2022. So if the accountant makes valuation of asset at historical cost, the accounts will not reflect the true position.

(b) Historical cost-based accounts may lose comparability. Mr. X invested Rs.1,00,000 in a machine on 1.1.1995 which produces Rs.50,000 cash inflow during the year 2022, while Mr. Y invested Rs.5,00,000 in a machine on 1.1.2005 which produced Rs.50,000 cash inflows during the year. Mr. X earned at the rate 50% while Mr. Y earned at the rate 10%. Who is more efficient? Since the assets are recorded at the historical cost, the results are not comparable. Obviously, it is a corollary to (a).

(c) Many assets do not have acquisition costs. Human assets of an enterprise are an example. The cost concept fails to recognize such asset although it is a very important asset of any organization.

Many other controversial issues have arisen in financial accounting that revolves around the cost concept which will be discussed at the advanced stage. However, later on we shall see that in many circumstances, the cost convention is not followed. See conservatism concept for an example, which will be discussed later on in this unit.

Q3. Briefly explain the qualitative characteristics of the financial statements.

Ans3. Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The following are the important qualitative characteristics of the financial statements:

1. Understandability: An essential quality of the information provided in financial statements is that it must be readily understandable by users. For this purpose, it is assumed that users have a reasonable knowledge of business, economic activities and accounting and study the information with reasonable diligence. Information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the ground that it may be too difficult for certain users to understand.

2. Relevance: To be useful, information must be relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.

The predictive and confirmatory roles of information are interrelated. For example, information about the current level and structure of asset holdings has value to users when they endeavor to predict the ability of the enterprise to take advantage of opportunities and its ability to react to adverse situations. The same information plays a confirmatory role in respect of past predictions about, for example, the way in which the enterprise would be structured or the outcome of planned operations.

Information about financial position and past performance is frequently used as the basis for predicting future financial position and performance and other matters in which users are directly interested, such as dividend and wage payments, share price movements and the ability of the enterprise to meet its commitments as they fall due. To have predictive value, information need not be in the form of an explicit forecast. The ability to make predictions from financial statements is enhanced, however, by the manner in which information on past transactions and events is displayed. For example, the predictive value of the statement of profit and loss is enhanced if unusual, abnormal and infrequent items of income and expense are separately disclosed.

3. Reliability: To be useful, information must also be reliable, Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.

Information may be relevant but so unreliable in nature or representation that its recognition may be potentially misleading. For example, if the validity and amount of a claim for damages under a legal action against the enterprise are highly uncertain, it may be inappropriate for the enterprise to recognize the amount of the claim in the balance sheet, although it may be appropriate to disclose the amount and circumstances of the claim.

4. Comparability: Users must be able to compare the financial statements of an enterprise through time in order to identify trends in its financial position, performance and cash flows. Users must also be able to compare the financial statements of different enterprises in order to evaluate their relative financial position, performance and cash flows. Hence, the measurement and display of the financial effects of like transactions and other events must be carried out in a consistent way throughout an enterprise and over time for that enterprise and in a consistent way for different enterprises.

An important implication of the qualitative characteristic of comparability is that users be informed of the accounting policies employed in the preparation of the financial statements, any changes in those polices and the effects of such changes. Users need to be able to identify differences between the accounting policies for like transactions and other events used by the same enterprise from period to period and by different enterprises. Compliance with Accounting Standards, including the disclosure of the accounting policies used by the enterprise, helps to achieve comparability.

The need for comparability should not be confused with mere uniformity and should not be allowed to become an impediment to the introduction of improved accounting standards. It is not appropriate for an enterprise to continue accounting in the same manner for a transaction or other event if the policy adopted is not in keeping with the qualitative characteristics of relevance and reliability. It is also inappropriate for an enterprise to leave its accounting policies unchanged when more relevant and reliable alternatives exist.

Users wish to compare the financial position, performance and cash flows of an enterprise over time. Hence, it is important that the financial statements show corresponding information for the preceding period(s).

The four principal qualitative characteristics are understandability, relevance, reliability and comparability.

5. Materiality: The relevance of information is affected by its materiality. Information is material if its misstatement (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information. Materiality depends on the size and nature of the item or error, judged in the particular circumstances of its misstatement. Materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which the information must have if it is to be useful.

6. Faithful Representation: To be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent. Thus, for example, a balance sheet should represent faithfully the transactions and other events that result in assets, liabilities and equity of the enterprise at the reporting date which meet the recognition criteria.

Most financial information is subject to some risk of being less than a faithful representation of that which it purports to portray. This is not due to bias, but rather to inherent difficulties either in identifying the transactions and other events to be measured or in devising and applying measurement and presentation techniques that can convey messages that correspond with those transactions and events. In certain cases, the measurement of the financial effects of items could be so uncertain that enterprises generally would not recognize them in the financial statements; for example, although most enterprises generate goodwill internally over time, it is usually difficult to identify or measure that goodwill reliably. In other cases, however, it may be relevant to recognize items and to disclose the risk of error surrounding their recognition and measurement.

7. Substance over Form: If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form. For example, where rights and beneficial interest in an immovable property are transferred but the documentations and legal formalities are pending, the recording of acquisition/disposal (by the transferee and transferor respectively) would in substance represent the transaction entered into.

8. Neutrality: To be reliable, the information contained in financial statements must be neutral, that is, free from bias. Financial statements are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a predetermined result or outcome.

9. Prudence: The preparers of financial statements have to contend with the uncertainties that inevitably surround many events and circumstances, such as the collectability of receivables, the probable useful life of plant and machinery, and the warranty claims that may occur. Such uncertainties are recognized by the disclosure of their nature and extent and by the exercise of prudence in the preparation of the financial statements. Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses, because the financial statements would then not be neutral and, therefore, not have the quality of reliability.

10. Full, fair and adequate disclosure: The financial statement must disclose all the reliable and relevant information about the business enterprise to the management and also to their external users for which they are meant, which in turn will help them to take a reasonable and rational decision. For it, it is necessary that financial statements are prepared in conformity with generally accepted accounting principles i.e the information is accounted for and presented in accordance with its substance and economic reality and not merely with its legal form. The disclosure should be full and final so that users can correctly assess the financial position of the enterprise.

The principle of full disclosure implies that nothing should be omitted while principle of fair disclosure implies that all the transactions recorded should be accounted in a manner that financial statement purports true and fair view of the results of the business of the enterprise and adequate disclosure implies that the information influencing the decision of the users should be disclosed in detail and should make sense.

This principle is widely used in corporate organizations because of separation in management and ownership. The Companies Act in pursuant of this principle came out with the format of balance sheet and profit and loss account. The disclosures of all the major accounting policies and other information are to be provided in the form of footnotes, annexures etc. The practice of appending notes to the financial statements is the outcome of this principle.

11. Completeness: To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

Thus, if accounting information is to present faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality, not by their legal form. For example, if a business enterprise sells its assets to others but still uses the assets as usual for the purpose of the business by making some arrangement with the seller, it simply becomes a legal transaction. The economic reality is that the business is using the assets as usual for deriving the benefit. Financial statement information should contain the substance of this transaction and should not only record going by legality. In order to be reliable, the financial statements information should be neutral i.e., free from bias. The prepares of financial statements however, have to contend with the uncertainties that inevitably surround many events and circumstances, such as the collectability of doubtful receivables, the probable useful life of plant and equipment and the number of warranty claims that many occur. Such uncertainties are recognized by the disclosure of their nature and extent and by exercise of prudence in the preparation of financial statements. Prudence is the inclusion of a degree of caution in the exercise of judgement needed in making the estimates required under condition of uncertainty such that assets and income are not overstated and loss and liability are not understated.

UNIT – 3 CAPITAL AND REVENUE EXPENDITURES AND RECEIPTS

True and False

Q1. The nature of business is not an important criteria in separating an expenditure between capital and revenue.

Ans1. False: The nature of business is a very important criteria in separating an expenditure between capital and revenue. For example- For a trader dealing in furniture, purchase of furniture is revenue expenditure but for any other trade, the purchase of furniture should be treated as capital expenditure and shown in the balance sheet as asset.

Q2. Expenditure incurred for major repair of the asset so as to increase its productive capacity is Revenue in nature.

Ans2. False: Expenditure incurred for major repair of the asset so as to increase its productive capacity is capital in nature.

Q3. Amount spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the plaintiff's land is Capital Expenditure.

Ans3. False: Legal expenses incurred to defend a suit claiming that the firm's factory site belongs to the plaintiff is maintenance expenditure of the asset . By this expense, neither any endurable benefit can be obtained in future in addition to that what is presently available nor the capacity of the asset will be increased . Maintenance expenditure in relation to an asset is revenue expenditure.

Q4. Amount spent for replacement of worn-out part of machine is Capital Expenditure.

Ans4. False: Amount spent for replacement of any worn out part of a machine is revenue expense since it is part of its maintenance cost.

Q5. Legal fees to acquire property is Capital Expenditure .

Ans5. True: Legal fee paid to acquire any property is a part of cost of that property. It is incurred to possess the ownership right of the property and hence a capital expenditure.

Q6. 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.

Ans6. True: Since temporary huts were necessary for the construction, their cost should be added to the cost of the cinema hall and thus capitalized.

Multiple Choice Questions

Q1. Money spent Rs.10,000 as traveling expenses of the directors on trips abroad for purchase of capital assets is

(a) Capital expenditures

(b) Revenue expenditures

(c) Prepaid revenue expenditures

Ans1. (a) Capital expenditures

Q2. Amount of Rs.5,000 spent as lawyers' fee to defend a suit claiming that the firm's factory site belonged to the plaintiff's land is

(a) Capital expenditures

(b) Revenue expenditures

(c) Prepaid revenue expenditures

Ans2. (b) Revenue expenditures

Q3. Entrance fee of Rs.2,000 received by Ram and Shyam Social Club is

(a) Capital receipt

(b) Revenue receipt

(c) Capital expenditures

Ans3. (a) Capital receipt

Q4. Subsidy of Rs.40,000 received from the government for working capital by a manufacturing concern is

(a) Capital receipt

(b) Revenue receipt

(c) Capital expenditures

Ans4. (b) Revenue receipt

Q5. Insurance claim received on account of

(a) Capital receipt

(b) Revenue receipt

(c) Capital expenditures

Ans5. (a) Capital receipt

Q6. Interest on investments received from

(a) Capital receipt

(b) Revenue receipt

(c) Capital expenditures

Ans6. (b) Revenue receipt

Q7. Amount received from IDBI as a medium term loan for augmenting working capital is

(a) Capital expenditures

(b) Revenue expenditures

(c) Capital receipt

Ans7. (c) Capital receipt

Q8. Revenue from sale of products, ordinarily, is reported as part of the earning in the period in which

(a) The sale is made.

(b) The cash is collected.

(c) The products are manufactured.

Ans8. (a) The sale is made.

Q9. If repair cost is Rs.25,000, whitewash expenses are Rs.5,000, (both these expenses relate to presently used building) cost of extension of building is Rs.2,50,000 and cost of improvement in electrical wiring system is Rs.19,000; the amount to be expensed is

(a) Rs.2,99,000.

(b) Rs.44,000.

(c) Rs.30,000.

Ans9. (c) Rs.30,000.

Theoretical Questions/ Answers

Q1. What are the basic considerations in distinguishing between capital and revenue expenditures?

Ans1. The basic considerations in distinction between capital and revenue expenditures are:

(a) Nature of business.
(b) Recurring nature of expenditure.
(c) Purpose of expenses.
(d) Effect on revenue generating capacity of business.

(e) Materiality of the amount involved.

Q2. Define revenue receipts and give examples. How are these receipts treated?

Ans2. Receipts which are obtained in course of normal business activities are revenue receipts (e.g,. receipts from sale of goods or services, interest income etc.).

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

UNIT – 4 CONTINGENT ASSETS AND CONTINGENT LIABILITES

True and False

Q1. A contingent liability need not be disclosed in the financial statements.

Ans1. False: A Contingent liability is required to be disclosed unless possibility of outflow of a resource embodying economic benefits is remote.

Q2. A Provision fails to meet the recognition criteria.

Ans2. False: A contingent liability fails to meet the recognition criteria.

Q3. A claim that an enterprise is pursuing through legal process, where the outcome is uncertain, is a contingent liability .

Ans3. False: A claim that an enterprise is pursuing through legal process, where the outcome is uncertain, is a contingent asset

Q4. When it is probable that the firm will need to pay off the obligation, this gives rise to Contingent liability.

Ans4. False: When it is probable that the firm will need to pay off the obligation, this gives rise to provision.

Q5. Present financial obligation of an enterprise, which arises from past event is termed as contingent liability.

Ans5. False: Present Financial obligation of an enterprise, which arises from past events is termed as liability,

Multiple Choice Questions

Q1. Contingent asset usually arises from unplanned or unexpected events that give rise to

(a) The possibility of an inflow of economic benefits to the business entity.

(b) The possibility of an outflow of economic benefits to the business entity.

(c) Either (a) or (b).

Ans1. (a) The possibility of an inflow of economic benefits to the business entity.

Q2. If an inflow of economic benefits is probable then a contingent asset is disclosed

(a) In the financial statements.

(b) In the report of the approving authority (Board of Directors in the case of a company, and the corresponding approving authority in the case of any other enterprise).

(c) In the cash flow statement.

Ans2. (b) In the report of the approving authority (Board of Directors in the case of a company, and the corresponding approving authority in the case of any other enterprise).

Q3. In the case of , either outflow of resources to settle the obligation is not probable or the amount expected to be paid to settle the liability cannot be measured with sufficient reliability.

(a) Liability

(b) Provision

(c) Contingent liabilities

Ans3. (c) Contingent liabilities

Q4. 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.

Ans4. (a) Provision.

Q5. In the financial statements, contingent liability is

(a) Recognised.

(b) Not recognised.

(c) Adjusted.

Ans5. (b) Not recognised.

Theoretical Questions/ Answers

Differentiate between:

(i) Provision and Contingent Liability.

Ans.(i) Provision is a present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation. On the other hand, a Contingent liability is a possible obligation that may or may not crystallize depending on the occurrence or non-occurrence of one or more uncertain future events.

(ii) Liability and Contingent liability.

Ans.(ii) A liability is defined as the present financial obligation of an enterprise, which arises from past events. On the other hand, in the case of contingent liability, either outflow of resources to settle the obligation is not probable or the amount expected to be paid to settle the liability cannot be measured with sufficient reliability.

UNIT – 5 ACCOUNTING POLICIES

True and False

Q1. There is a single list of accounting policies, which are applicable to all enterprises in all circumstances.

Ans1. False: There cannot be single list of accounting policies, which are applicable to all enterprises in all circumstances. There would always be different policies chosen by different industries under different circumstances.

Q2. Selection of accounting policy doesn't impact financial performance and financial position of the business.

Ans2. False: Accounting policy has big impact on value of items goes under financial statements, hence it impacts financial performance and financial position of the business.

Q3. A change in accounting policies should be made as and when business like to show result as per their choice.

Ans3. False: A change in accounting policies should be made in the following conditions:

(a) It is required by some statute or for compliance with an Accounting Standard.

(b) Change would result in more appropriate presentation of financial statement.

Q4. Choosing FIFO or weighted average method for inventory valuation is selection of accounting policy.

Ans4. True: An enterprise may adopt FIFO or weighted average method for inventory valuation and the method selected for valuation is called an accounting policy.

Q5. Selection of an inappropriate accounting policy decision will overstate the performance and financial position of a business entity every time.

Ans5. False: It could understate/overstate the performance and financial position of a business entity.

Multiple Choice Questions

Q1. A change in accounting policy is justified

(a) To comply with accounting standard and law.

(b) To ensure more appropriate presentation of the financial statement of the enterprise.

(c) Both (a) and (b).

Ans1. (c) Both (a) and (b).

Q2. Accounting policy for inventories of Xeta Enterprises states that inventories are valued at the lower of cost determined on weighted average basis or net realizable value. Which accounting principle is followed in adopting the above policy?

(a) Materiality.

(b) Prudence.

(c) Substance over form.

Ans2. (b) Prudence.

Q3. The areas wherein different accounting policies can be adopted are

(a) Providing depreciation.

(b) Valuation of inventories.

(c) Both the option.

Ans3. (b) Valuation of inventories.

Q4. Selection of an inappropriate accounting policy decision may

(a) Overstate the performance and financial position of a business entity.

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

(c) Overstate the performance of a business entity.

Ans4. (b) Understate/overstate the performance and financial position of a business entity.

Q5. Accounting policies refer to specific accounting

(a) Principles.

(b) Methods of applying those principles.

(c) Both (a) and (b).

Ans5. (c) Both (a) and (b).

Theoretical Questions/ Answers

Q1. Define Accounting Policies in brief. Identify few areas wherein different accounting policies are frequently encountered.

Ans1. Accounting Policies refer to specific accounting principles and methods of applying these principles adopted by the enterprise in the preparation and presentation of financial statements. Policies are based on various accounting concepts, principles and conventions that have already been explained in Unit 2 of Chapter 1. There is no single list of accounting policies, which are applicable to all enterprises in all circumstances. Enterprises operate in diverse and complex environmental situations and so they have to adopt various policies. The choice of specific accounting policy appropriate to the specific circumstances in which the enterprise is operating, calls for considerate judgement by the management. ICAI has been trying to reduce the number of acceptable accounting policies through Guidance Notes and Accounting Standards in its combined efforts with the government, other regulatory agencies and progressive managements. Already it has achieved some progress in this respect.

The areas wherein different accounting policies are frequently encountered can be given as follows:

(1) Valuation of Inventories;

(2) Valuation of Investments.

This list should not be taken as exhaustive but is only illustrative. As the course will progress, students will see the intricacies of the various accounting policies.

Suppose an enterprise holds some investments in the form of shares of a company at the end of an accounting period. For valuation of shares, the enterprise may adopt FIFO, average method etc. The method selected by that enterprise for valuation is called an accounting policy.

Q2. "Change in accounting policy may have a material effect on the items of financial statements." Explain the statement with the help of an example.

Ans2. Change in accounting policy may have a material effect on the items of financial statements. For example, if cost formula used for inventory valuation is changed from weighted average to FIFO. Unless the effect of such change in accounting policy is quantified, the financial statements may not help the users of accounts.

UNIT – 6 ACCOUNTING AS A MEASUREMENT DISCIPLINE – VALUATION PRINCIPLES, ACCOUNTING ESTIMATES

True and False

Q1. There are four generally accepted measurement bases.

(i) Historical Cost;

(ii) Current Cost;

(iii) Realizable Value;

(iv) Future Value.

Ans1. False: There are four generally accepted measurement bases .

(i) Historical Cost;

(ii) Current Cost;

(iii) Realizable Value;

(iv) Present Value.

Q2. Historical Cost means price paid at time acquisition.

Ans2. Historical Cost means price paid at time acquisition.

Q3. As per future value, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in an orderly disposal.

Ans3. As per future value, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in an orderly disposal.

Q4. At Present value, liabilities are carried at the value of future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

Ans4. At Present value, liabilities are carried at the value of future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

Q5. ABC purchased a machinery amounting Rs.10,00,000 on 1st April, 2001. On 31st March, 2022, similar machinery could be purchased for Rs.20,00,000. Historical cost of machine is 20,00,000

Ans5. ABC purchased a machinery amounting Rs.10,00,000 on 1st April, 2001. On 31st March, 2022, similar machinery could be purchased for Rs.20,00,000. Historical cost of machine is 20,00,000.

Q6. ABC purchased a machinery amounting Rs.10,00,000 on 1st April, 2001. On 31st March, 2022, similar machinery could be purchased for Rs.20,00,000. Current cost of machine is Rs.20,00,000.

Ans6. ABC purchased a machinery amounting Rs.10,00,000 on 1st April, 2001. On 31st March, 2022, similar machinery could be purchased for Rs.20,00,000. Current cost of machine is Rs.20,00,000.

Q7. Change in accounting estimate has to be given retrospective effect.

Ans7. Change in accounting estimate has to be given retrospective effect.

Multiple Choice Questions

Q1. (i) Measurement discipline deals with

- **(a) Identification of objects and events.**
- **(b) Selection of scale.**
- **(c) Both (a) and (b)**

Ans.(i) (c) Both (a) and (b)

(ii) All of the following are valuation principles except

(a) Historical cost.

(b) Present value.

(c) Future value.

Ans.(ii) (c) Future value.

(iii) Book value of machinery on 31st March, 2022 Rs.10,00,000

Market value as on 31st March, 2022 if sold Rs.11,00,000

As on 31st March, 2022, if the company values the machinery at Rs.11,00,000, which of the following valuation principle is being followed?

(a) Historical Cost.

(b) Present Value.

(c) Realizable Value.

Ans.(iii) (c) Realizable Value.

Q2. Mohan purchased a machinery amounting Rs.10,00,000 on 1st April, 2001. On 31st March, 2022, similar machinery could be purchased for Rs.20,00,000 but the realizable value of the machinery (purchased on 1.4.2001) was estimated at Rs.15,00,000. The present discounted value of the future net cash inflows that the machinery was expected to generate in the normal course of business, was calculated as Rs.12,00,000.

(i) The current cost of the machinery is

(a) Rs.10,00,000.

(b) Rs.20,00,000.

(c) Rs.15,00,000.

Ans.(i) (b) Rs.20,00,000.

(ii) The present value of machinery is

(a) Rs.10,00,000.

(b) Rs.20,00,000.

(c) Rs.12,00,000.

Ans.(ii) (c) Rs.12,00,000.

(iii) The historical cost of machinery is

(a) Rs.10,00,000.

(b) Rs.20,00,000.

(c) Rs.15,00,000.

Ans.(iii) (a) Rs.10,00,000.

(iv) The realizable value of machinery is

(a) Rs.10,00,000.

(b) Rs.20,00,000.

(c) Rs.15,00,000.

Ans.(iv) (c) Rs.15,00,000.

Theoretical Questions/ Answers

Q1. Define Measurement in brief. Explain the significant elements of measurement.

Ans1. Measurement is vital aspect of accounting. Primarily transactions and events are measured in terms of money. Three elements of measurement are: (1) Identification of objects and events to be measured; (2) Selection of standard or scale to be used; (3) Evaluation of dimension of measurement standard or scale.

Q2. Describe in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the balance sheet or statement of profit and loss.

Ans2. Alternative measurement bases are: (i) Historical Cost; (ii) Current cost (iii) Realizable (Settlement) Value and (iv) Present Value.

Let us discuss these principles in detail.

(i) Historical Cost: It means acquisition price. For example, the businessman paid Rs.7,00,000 to purchase the machine and spend Rs.1,00,000 on its installation, its acquisition price including installation charges is Rs.8,00,000. The historical cost of machine would be Rs.8,00,000.

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

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

Take another case regarding payment of income tax liability. You know every individual has to pay income tax on his income if it exceeds certain minimum limit. But the income tax liability is not settled immediately when one earns his income. The income tax authority settles it sometime later, which is technically called assessment year. Then how does he record this liability? As per historical cost base it is to be recorded at an amount expected to be paid to discharge the liability.

Companies usually apply historical cost method in case of long-term assets like machinery, furniture, licenses etc.

(ii) Current Cost: Take that Mr. X purchased a machine on 1st January, 2011 at Rs.7,00,000. As per historical cost base he has to record it at Rs.7,00,000 i.e. the acquisition price. As on 1.1.2022, Mr. X found that it would cost Rs.25,00,000 to purchase that machine. Take also that Mr. X took loan from a bank as on 1.1.2011 Rs.5,00,000 @ 18% p.a. repayable at the end of 15th year together with interest. As on 1.1.2022 the bank announces 1% prepayment penalty on the loan amount if it is paid within 15 days starting from that day. As per historical cost the liability is recorded at Rs.5,00,000 at the amount or proceeds received in exchange for obligation and asset is recorded at Rs.7,00,000.

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

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

(iii) Realizable Value: Suppose Mr. X found that he can get Rs.20,00,000 if he would sell the machine purchased, on 1.1.2011 paying Rs.7,00,000 and which would cost Rs.25,00,000 in case he would buy it currently. Take also that Mr. X found that he had no money to pay off the bank loan of Rs.5,00,000 currently.

As per realizable value, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in an orderly disposal. Haphazard disposal may yield something less. Liabilities are carried at their settlement values; i.e. the undiscounted amount of cash or cash equivalents expressed to be paid to satisfy the liabilities in the normal course of business.

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

Realizable value concept is commonly applied in case of inventories. Inventories are measured at the lower of cost and net realizable value.

(iv) Present Value : Suppose we are talking as on 1.1.2022 - take it as time for reference. Now think the machine purchased by Mr. X can work for another 10 years and is supposed to generate cash @ Rs.1,00,000 p.a. Also take that bank loan of Rs.5,00,000 taken by Mr. X is to be repaid as on 31.12.2028. Annual interest is Rs.90,000.

As per present value, an asset is carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present discounted value of future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

The concept of Present Value is common in case of accounting for investments and loans.

UNIT – 7 ACCOUNTING STANDARDS

True and False

Q1. Accounting standards are written policy documents issued by the expert accounting body or by the government or other regulatory body covering the aspects of recognition, measurement, presentation and disclosure of accounting transactions and events in the financial statements.

Ans1. True: Accounting standards are documents covering recognition, measurement, presentation and disclosure of accounting transactions and events in the financial statements.

Q2. Accounting standards can override the statute.

Ans2. False: Accounting standards can never override the statute. The standards are required to be framed within the ambit of prevailing statutes.

Q3. Difficulties in making choice between different treatments is one of the benefits of accounting standards .

Ans3. False: Difficulties in making choice between different treatments is one of the limitation of accounting standard.

Q4. Requirements for additional disclosures is limitation of accounting standards .

Ans4. False: Benefits of accounting standards are:

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

Q5. ASB stands for Accounting standardisation benchmarking.

Ans5. False: ASB stands for Accounting Standard Board.

Q6. There are no limitation to accounting standards.

Ans6. False: limitations of accounting standards

- Difficulties in making choice between different treatments
- Restricted scope

Multiple Choice Questions

Q1. Accounting Standards for Non-Corporate entities in India are issued by

(a) Central Govt.

(b) State Govt.

(c) Institute of Chartered Accountants of India.

Ans1. (c) Institute of Chartered Accountants of India.

Q2. Accounting Standards

(a) Harmonise accounting policies.

(b) Eliminate the non-comparability of financial statements.

(c) Both the above.

Ans2. (c) Both the above.

Q3. It is essential to standardize the accounting principles and policies in order to ensure

(a) Transparency.

(b) Consistency.

(c) Both the above.

Ans3. (c) Both the above.

Theoretical Questions

Q1. Explain the objective of "Accounting Standards" in brief.

Ans1. Accounting Standards are selected set of accounting policies or broad guidelines regarding the principles and methods to be chosen out of several alternatives. The main objective of Accounting Standards is to establish standards which have to be complied with, to ensure that financial statements are prepared in accordance with generally accepted accounting principles. Accounting Standards seek to suggest rules and criteria of accounting measurements. These standards harmonize the diverse accounting policies and practices at present in use in India.

Q2. State the advantages of setting Accounting Standards.

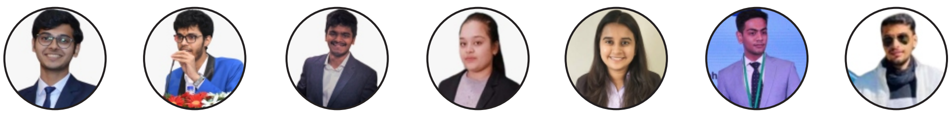
Ans2. The main advantage of setting accounting standards is that the adoption and application of accounting standards ensure uniformity, comparability and qualitative improvement in the preparation and presentation of financial statements. The other advantages are: Reduction in variations; Disclosures beyond that required by law and Facilitates comparison.

NOTES

Practice Notes

Foundation Accounting

Chapter - 2



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CHAPTER- 2

ACCOUNTING PROCESS

UNIT -1 BASIC ACCOUNTING PROCEDURES – JOURNAL ENTRIES

True and False

Q1. In accounting equation approach, equity + Long-term liabilities = fixed asset + current assets – current liabilities.

Ans1. True: As per the modern accounting equation approach- it is the basic formula in the accounting process.

Q2. In the traditional approach a debtor becomes receiver.

Ans2. False: In the traditional approach a debtor becomes giver.

Q3. The rule of nominal account states that all expenses & losses are recorded on credit side.

Ans3. False: The rule of nominal account states that all expenses & losses are recorded on debit side.

Q4. Journal proper is also called a subsidiary book.

Ans4. True: It is one of the book where in the transactions not entered in the other books are entered in this book.

Q5. Capital account has a debit balance.

Ans5. False: Capital account has a credit balance.

Q6. Purchase account is a nominal account.

Ans6. True: As it is considered as an expense.

Q7. All the personal & real account are recorded in P&L A/c.

Ans7. False: All the personal & real account are recorded in balance sheet.

Q8. Asset side of balance sheet contains all the personal & nominal accounts.

Ans8. False: Asset side of balance sheet contains all the personal & real accounts.

Q9. Capital account is a personal account.

Ans9. True: As it is in the name of the proprietor who is bringing in the capital to the business.

Q10. Journal is also known as the book of original.

Ans10. True: As the transactions are entered first in this book as a first hand record.

Multiple Choice Question

Q1. The rent paid to landlord is credited to

(a) Landlord's account.

(b) Rent account.

(c) Cash account.

Ans1. (c) Cash account.

Q2. In case of a debt becoming bad, the amount should be credited to

(a) Trade receivables account.

(b) Bad debts account.

(c) Cash account.

Ans2. (a) Trade receivables account.

Q3. A Ltd. has a Rs.35,000 account receivable from Mohan. On January, 22, Mohan makes a partial payment of Rs.21,000 to A Ltd. The journal entry made on January, 22 by A Ltd. To record this transaction includes:

(a) A credit to the cash received account of Rs.21,000.

(b) A credit to the Accounts receivable account of Rs.21,000.

(c) A debit to the cash account of Rs.14,000.

Ans3. (b) A credit to the Accounts receivable account of Rs.21,000.

Q4. Which financial statement represents the accounting equation -

Assets = Liabilities + Owner's equity:

(a) Income Statement

(b) Statement of Cash flows

(c) Balance Sheet.

Ans4. (c) Balance Sheet.

Q5. Which account is the odd one out?

(a) Office furniture & Equipment.

(b) Freehold land and Buildings.

(c) Inventory of materials.

Ans5. (c) Inventory of materials.

Q6. The debts written off as bad, if recovered subsequently are

(a) Credited to Bad Debts Recovered Account

(b) Credited to Trade Receivables Account.

(c) Debited to Profit and Loss Account.

Ans6. (a) Credited to Bad Debts Recovered Account

Q7. In Double Entry System of Book-keeping every business transaction affects:

(a) Two accounts

(b) Two sides of the same account.

(c) The same account on two different dates.

Ans7. (a) Two accounts

Q8. A sale of goods to Ram for cash should be debited to:

(a) Ram

(b) Cash

(c) Sales

Ans8. (b) Cash

Theory Questions

Q1. Write short note on classification of accounts.

Ans1. a. Accounts are broadly classified into assets, liabilities and capital. The basic accounting equation specifies broad categories, which are as follows:

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

(ii) **Liabilities:** These are financial obligations of an enterprise other than owner's equity namely long term loans, creditors, outstanding expenses etc.

(iii) **Capital:** It generally refer to the amounts invested in an enterprise by its owner(s), the accretion to it or a reduction in it. Since capital is affected by expenses and incomes of revenue nature, there are two more categories of accounts, namely expenses and incomes. The difference between incomes and expenses are taken into capital account.

- **Expenses:** These represents those accounts which show the amount spent or even lost in carrying on operations.
- **Incomes:** These represent those accounts which show the revenue amounts earned by the enterprise.

However, traditionally accounts are classified as follows:

(i) **Personal Accounts:** These accounts relate to persons, institutions, debtors or creditors.

(ii) **Impersonal Accounts:** These represent accounts which are not personal. These can be further sub-divided as follows:

- Real Accounts: These accounts relate to assets of the firm but not debt e.g. accounts relating to land, buildings, cash in hand etc.
- Nominal accounts: These accounts relate to expenses, losses, gains, revenues etc.

Q2. Distinguish between Real account and nominal account.

Ans2. A real account is an account relating to properties and assets, other than personal accounts of the firm. Examples are land, buildings, machinery, cash, investments etc. Nominal accounts relate to expenses or losses, incomes and gains. Examples are: wages, salaries, rent, depreciation etc. The net result of all the nominal accounts is reflected as profit or loss which is transferred to the capital account. Nominal accounts are therefore, temporary. The real accounts are shown in the balance sheet along with personal accounts.

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

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

Ans 1- **Nature of Account**

Sl. No.	Title of Account	Traditional Approach	Accounting Equation Approach
a	Rent Outstanding	Personal	Liability
b	Closing Inventory	Real	Asset
c	Sales	Nominal	Revenue
d	Bank Fixed Deposit	Personal	Asset
e	Cash	Real	Asset
f	Bad Debts	Nominal	Expense
g	Capital	Personal	Capital
h	Sales Tax Payable	Personal	Liability

i	Trade receivables	Personal	Asset
j	Depreciation	Nominal	Expense
k	Drawings	Personal	Capital -Drawings

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

(i) Employees had taken inventory worth Rs.1,00,000 (Cost price Rs.75,000) on the eve of Deepawali and the same was deducted from their salaries in the subsequent month.

(ii) Wages paid for erection of Machinery Rs.18,000.

(iii) Income tax liability of proprietor Rs.17000 was paid out of petty cash.

(iv) Purchase of goods from Naveen of the list price of Rs.2,00,000. He allowed 10% trade discount, Rs.5,000 cash discount was also allowed for quick payment.

Ans 2- **Journal Entries in the books of Gamma Bros.**

	Particulars		**Dr. Amount Rs.**	**Cr. Amount Rs.**
(i)	Salaries A/c To Purchase A/c (Being entry made for inventory taken by employees)	Dr.	75,000	 75,000
(ii)	Machinery A/c To Bank A/c (Being wages paid for erection of machinery)	Dr.	18,000	 18,000
(iii)	Drawings A/c To Petty Cash A/c (Being the income tax of proprietor paid out of business money)	Dr.	17,000	 17,000
(iv)	Purchase A/c	Dr.	1,80,000	

	To Naveen A/c (Being goods purchased from Naveen)			1,80,000
	Naveen A/c	Dr.	1,80,000	
	To Bank To Discount Received A/c (Being amount paid for the goods purchased from Naveen for Rs. 2,00,000. 10% trade discount and cash discount of Rs. 5,000 allowed by him)			1,75,000 5,000

Note:

i. Here wages paid on erection of machinery have been capitalised therefore machinery account has been debited directly instead of wages being recorded as an expenditure.

ii. The students may also note that trade discount is allowed on the list price of goods. It is deducted to compute the invoice amount of the goods to be recorded in the books. Cash discount is a discount allowed in case of early payments to the seller. The entry is made in the books of accounts for cash discount.

3. Calculate the missing amount for the following.

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

Ans3- (a) 12,50,000

(b) 2,25,000

(c) 75,000

(d) 59,80,000

These have been solved using the Accounting Equation:

Assets = Capital + Liabilities

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

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

Also give reasons for your answers.

S. No.	**Increase (+) / Decrease (-) / No Change (0) in Assets**	**Reasons**
(a)	+	Furniture has been purchased making it an increase in assets and also it being purchased on credit it increases liability and there is no outflow of assets like cash or bank.
(b)	+	Cash has flowed in for services provided making it an increase in assets.
(c)	+	For goods sold, it is a decrease in inventory (assets) but

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

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

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

		the year	

Ans 5- Trade Receivable Balance (B) = Sales- Amount received during the year

= Rs. (15,55,000 – 15,00,000)

= Rs. 55,000

Since, we know Assets = Capital + Liabilities

Therefore, balance of assets is also Rs. 14,15,000.

So, total assets:

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

Computation of Closing Capital (D):

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

So, Loan amount (C) = Total Liabilities and capital - Closing Capital - Trade Payables

= Rs. (14,15,000 - 10,65,000 - 1,00,000)= Rs.2,50,000

UNIT 2

LEDGERS

True and False

Q 1. A ledger is also known as the principal book of accounts.

Ans1- True: Since it classifies all the amounts related to a particular account and then it is used as the base for preparing the Trial balance, a ledger is also known as principal books of accounts.

Q 2. Cash account has a debit balance.

Ans2- True: Being an asset under the modern equation approach, cash account has a debit balance.

Q 3. Posting is the process of transferring the accounts from ledger to journal.

Ans3- False: Posting is the process of transferring the balances from journal to ledger.

Q 4. At the end of the accounting year, all the nominal accounts of the ledger book are balanced.

Ans4- False: At the end of the accounting year, all the nominal accounts of the ledger book are totaled and transferred to P&L A/c.

Q 5. Ledger records the transactions in a chronological order.

Ans5- False: Ledger records the transactions in analytical order. But journal records the transactions in a chronological order.

Q 6. If the total debit side is greater than the total of credit side, we get a credit balance as opening balance.

Ans6- False: If the total of debit side is greater than the total of credit side, we get a debit balance as the opening balance.

Q 7. Ledger accounts of assets will always be debited when they are increased.

Ans7- True: The increase to an asset shall be debited since the original balance is also debit.

Multiple Choice Questions

Q1. The process of transferring the debit and credit items from a Journal to their respective accounts in the ledger is termed as

(a) Posting

(b) Purchase

(c) Balancing of an account

Ans1- (a) Posting

Q2. The technique of finding the net balance of an account after considering the totals of both debits and credits appearing in the account is known as

(a) Posting

(b) Purchase

(c) Balancing of an account

Ans2- (c) Balancing of an account

Q3. Journal and ledger records transactions in

(a) A chronological order and analytical order respectively.

(b) An analytical order and chronological order respectively.

(c) A chronological order only

Ans3- (a) A chronological order and analytical order respectively**.**

Q4. Ledger book is popularly known as

(a) Secondary book of accounts

(b) Principal book of accounts

(c) Subsidiary book of accounts

Ans4- (b) Principal book of accounts

Q5. At the end of the accounting year all the nominal accounts of the ledger book are

(a) Balanced but not transferred to profit and loss account

(b) Not balanced and also the balance is not transferred to the profit and loss account

(c) Not balanced and their balance is transferred to the profit and loss account.

Ans- (c) Not balanced and their balance is transferred to the profit and loss account.

Theory Questions

Q1. What do you mean by principal books of accounts?

Ans1- Ledger is known as principal books of accounts and it provides full information regarding all the transactions pertaining to any individual account. Ledger contains all set of accounts (viz. personal, real and nominal accounts).

Q2. What are the rules of posting of journal entries into the Ledger?

Ans2- Rules regarding posting of entries in the ledger:

a. Separate account is opened in ledger book for each account and entries from the Journal are posted to respective accounts accordingly.

b. It is a practice to use words ‘To’ and ‘By’ while posting transactions in the ledger. The word ‘To’ is used in the particular column with the accounts written on the debit side while ‘By’ is used with the accounts written in the particular column of the credit side. These ‘To’ and ‘By’ do not have any meanings but are used to the account debited and credited.

c. The concerned account debited in the journal should also be debited in the ledger but reference should be of the respective credit account.

Practical Questions

Q1. Journalize the following transactions, post them in the Ledger and balance the accounts on 31st December.

1. X started business with a capital of Rs. 20,000

2. He purchased goods from Y on credit Rs. 4,000

3. He paid cash to Y Rs. 2,000

4. He sold goods to Z Rs. 4,000

5. He received cash from Z Rs. 6,000

6. He further purchased goods from Y Rs. 4,000

7. He paid cash to Y Rs. 2,000

8. He further sold goods to Z Rs. 4,000

9 He received cash form Z Rs. 2,000

Ans1- **Journal**

Particulars	L.F.	Debit Rs.	Credit Rs.
Cash A/c Dr. To Capital A/c (Being commencement of business)		20,000	20,000
Purchase A/c Dr. To Y (Being purchase of goods on credit)		4,000	4,000
Y Dr. To Cash (Being amount paid to Y)		2,000	2,000
Z Dr. To Sales A/c (Being goods sold to Z)		4,000	4,000
Bank A/c Dr. To Z (Being amount received from Z)		6,000	6,000
Purchase A/c Dr. To Y (Being purchase of goods on credit from Y)		4,000	4,000
Y Dr. To Cash A/c (Being amount paid to Y)		2,000	2,000
Z Dr. To Sales A/c (Being goods sold to Z)		4,000	4,000
Cash A/c Dr. To Z (Being cash received from Z)		2,000	2,000
TOTAL		**48,000**	**48,000**

Dr. **Cash Account** **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
	To Capital A/c	20,000		By Y	2,000
	To Z	6,000		By Y	2,000
	To Z	2000		By Balance c/d	24,000
		28,000			**28,000**
Feb. 1	**To Balance b/d**	**24,000**			

Dr. **Capital Account** **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
Jan. 31	To Balance c/d	20,000		By Cash A/c	20,000
		20,000			20,000
			Feb. 1	**By Balance b/d**	**20,000**

Dr. **Purchase Account** **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
	To Y	4,000	Jan 31.	By Balance c/d	8,000
	To Y	4,000			
		8,000			**8,000**
Feb.1	**To Balance b/d**	**8,000**			

Dr. **Y's Account** **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
	To Cash	2,000		By Purchases	4,000
	To Cash	2,000		By Purchases	4,000
Jan. 31	To Balance c/d	4,000			
		8,000			**8,000**

				By Balance b/d	**4,000**

Dr. **Z's Account** **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
	To Sales	4,000		By Cash A/c	6,000
	To Sales	4,000		By Cash A/c	6,000
		8,000			**8,000**

Dr. **Sales Account** **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
Jan. 31	To Balance c/d	8,000		By Z	4,000
				By Z	4,000
		8,000			**8,000**
			Feb. 1	**By Balance b/d**	**8,000**

UNIT 3 : TRIAL BALANCE

True and False

1. **Preparing trial balance is the third phase of accounting process.**

Ans1. True: Preparing trial balance is the third phase of accounting process which forms the base for the preparation of the final accounts.

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

Ans2. True: Based on trial balance only, we can prepare financial statement.

3. **Agreement of trial balance is a conclusive proof of accuracy.**

Ans3. False: Agreement of trial balance gives only arithmetical accuracy, there can still be errors in preparing the trail balance.

4. **A trial balance will tally in case of compensating errors.**

Ans4. True: Since compensating errors cancel out due to their compensating nature of the amounts, hence the Trial balance tallies.

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

Ans5. False: A trial balance cannot find the missing entry from the journal.

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

Ans6. False: Suspense account opened in a trial balance is a temporary account.

7. **The balance of purchase returns account has a credit balance.**

Ans7. True: As purchases is debited, any returns shall be credited (treated in opposite way).

Multiple Choice Questions

Q1. A trial balance will not balance if ______________________________

(a) Correct journal entry is posted twice.

(b) The purchase on credit basis is debited to purchases and credited to cash.

(c) Rs.500 cash payment to creditor is debited to Trade payables for Rs.50 and credited to cash as Rs.500.

Ans1. (c) Rs.500 cash payment to creditor is debited to Trade payables for Rs.50 and credited to cash as Rs.500.

Q2. Rs.1, 500 received from sub-tenant for rent and entered correctly in the cash book is posted to the debit of the rent account. In the trial balance ______________________________

(a) The debit total will be greater by Rs.3,000 than the credit total.

(b) The debit total will be greater by Rs.1,500 than the credit total.

(c) Subject to other entries being correct the total will agree.

Ans2. (a) The debit total will be greater by Rs.3,000 than the credit total.

Q3. After the preparation of ledgers, the next step is the preparation of ______________________________

(a) Trading accounts

(b) Trial balance

(c) Profit and loss account

Ans3. (b) Trial balance

Q4. After preparing the trial balance the accountant finds that the total of debit side is short by Rs.1,500. This difference will be ______________________________

(a) Credited to suspense account

(b) Debited to suspense account

(c) Adjusted to any of the debit balance account

Ans4. (b) Debited to suspense account

Q5.

S.No.	Account heads	Debit (Rs.)	Credit (Rs.)
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

Ans5. (b) Wrong placing of salaries account

Theory Questions

Q1. What is the trial balance? And how it is prepared?

Ans1. Preparation of trial balance is the third phase in the accounting process. After posting the accounts in the ledger, a statement is prepared to show separately the debit and credit balances. Such a statement is known as the trial balance.

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

Q2. Explain objectives of preparation of trial balance.

Ans2. The preparation of trial balance has the following objectives:

(i) Trial balance enables one to establish whether the posting and other accounting processes have been carried out without committing arithmetical errors. In other words, the trial balance helps to establish arithmetical accuracy of the books of accounts.

(ii) Financial statements are normally prepared on the basis of agreed trial balance.

(iii) The trial balance serves as a summary of what is contained in the ledgers.

Q3. Even if the trial balance agrees, some errors may remain. Do you agree? Explain.

Ans3. In spite of the agreement of the trial balance some errors may remain. These may be of the following types:

(i) Transaction has not been entered at all in the journal.

(ii) A wrong amount has been written in both columns of the journal.

(iii) A wrong account has been mentioned in the journal.

(iv) An entry has not at all been posted in the ledger.

(v) Entry is posted twice in the ledger.

Practical Question

Q1. An inexperienced bookkeeper has drawn up a Trial Balance for the year ended 30th June, 2022.

	Debit(Rs.)	Credit(Rs.)
Provision for Doubtful Debts	200	–
Bank Overdraft	1,654	–
Capital	–	4,591
Trade payables	–	1,637
Trade receivables	2,983	–
Discount Received	252	–
Discount Allowed	–	733
Drawings	1,200	–
Office Furniture	2,155	–
General Expenses	–	829
Purchases	10,923	–
Returns Inward	–	330
Rent & Rates	314	–
Salaries	2,520	–

Sales	**–**	**16,882**
Inventory	**2,418**	**–**
Provision for Depreciation on Furniture	**364**	**–**
Total	**24,983**	**25,002**

Required:

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

Ans1.

Trial Balance as on 30th June, 2022

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

UNIT – 4 SUBSIDIARY BOOKS

True and False

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

Ans1. True: Since cash purchases are taken to the cash book , it is only credit transactions that are recorded in the purchases book.

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

Ans2. False: Transactions regarding the purchase of fixed asset are not recorded in the purchase book, only the credit purchases of goods are recorded in it.

3. Cash sales are recorded in the sales book.

Ans3. False: Credit sales are recorded in the sales book.

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

Ans4. True: Subsidiary books are maintained as an alternate to the journal.

5. Bills receivable book is a subsidiary book.

Ans5. True: Bills receivable is one of the subsidiary book.

6. Return inward book is also known as purchase return book.

Ans6. False: Return inward book is also known as sales return book.

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

Ans7. False: Purchase of a second hand machinery will not be recorded in purchase book.

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

Ans8. True: Since sales return is reduction from the total sales value, it is debited in the sales account.

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

Ans9. True: When there are numerous transactions then there are subsidiary books like the sales book where there are recorded instead of regular journal entries.

Multiple Choice Questions

Q1. In Purchases Book, the record is in respect of ____________________________

(a) Cash purchase of goods.

(b) Credit purchase of goods dealt in.

(c) All purchases of goods.

Ans1. (b) Credit purchase of goods dealt in.

Q2. The Sales Returns Book records ____________________________

(a) The return of goods purchased.

(b) Return of anything purchased.

(c) Return of goods sold.

Ans2. (c) Return of goods sold.

Q3. The Sales Book ____________________________

(a) Is a part of journal.

(b) Is a part of the ledger.

(c) Is a part of the balance sheet.

Ans3. (a) Is a part of journal.

Q4. The weekly or monthly total of the Purchase Book is ____________________________

(a) Posted to the debit of the Purchases Account.

(b) Posted to the debit of the Sales Account.

(c) Posted to the credit of the Purchases Account.

Ans4. (a) Posted to the debit of the Purchases Account.

Q5. The total of the Sales Book is posted to ____________________________

(a) Credit of the Sales Account.

(b) Credit of the Purchases Account.

(c) Credit of the Capital Account.

Ans5. (a) Credit of the Sales Account.

Q6. In which book of original entry, will you record an allowance of `50 which was offered for an early payment of cash of Rs.1,050 ____________________________.

(a) Sales Book

(b) Cash Book

(c) Journal Proper (General Journal)

Ans6. (b) Cash Book

Q7. A second hand motor car was purchased on credit from B Brothers for `10,000 will be recorded in ____________________________.

(a) Journal Proper (General Journal)

(b) Sales Book

(c) Cash Book

(d) Purchase Book

Ans7. (a) Journal Proper (General Journal)

Q8. In which book of original entry, will you record a bills receivable of Rs.1,000, which was received from a debtor in full settlement for a claim of Rs.1,100, is dishonoured _____________________.

(a) Purchases Return Book

(b) Bills Receivable Book

(c) Journal Proper (General Journal)

Ans8. (c) Journal Proper (General Journal)

Theory Questions

Q1. Which subsidiary books are normally used in a business?

Ans1. Normally, the following subsidiary books are used in a business:

(i) Cash Book to record receipts and payments of cash, including receipts into and payments out of the bank.

(ii) Purchases Book to record credit purchases of goods dealt in or of the materials and stores required in the factory.

(iii) Purchase Returns Book to record the returns of goods and materials previously purchased.

(iv) Sales Book to record the sales of the goods dealt in by the firm.

(v) Sale Returns Book to record the returns of goods made by the customers sold to them earlier.

(vi) Bills Receivable Book to record the receipts of promissory notes or hundies from various parties.

(vii) Bills Payable Book to record the issue of the promissory notes or hundies to other parties.

(viii) Journal (proper) to record the transactions which cannot be recorded in any of the seven books mentioned above.

Q2. What are the advantages of subsidiary books?

Ans2. Advantages of Subsidiary Books

The use of subsidiary books affords the under mentioned advantages:

- **(i)** **Division of work:** Since in the place of one journal there will be so many subsidiary books, the accounting work may be divided amongst a number of clerks.
- **(ii)** **Specialization and efficiency:** When the same work is allotted to a particular person over a period of time, he acquires full knowledge of it and becomes efficient in handling it. Thus the accounting work will be done efficiently.
- **(iii)** **Saving of the time:** Various accounting processes can be undertaken simultaneously because of the use of a number of books. This will lead to the work being completed quickly.
- **(iv)** **Availability of information:** Since a separate register or book is kept for each class of transactions, the information relating to each class of transaction be available at one place.
- **(v)** **Facility in checking:** When the trial balance does not agree, the location of the error or errors is facilitated by the existence of separate books. Even the commission of errors and frauds will be checked by the use of various subsidiary books

Practical Questions

Q1. Enter the following transactions in Sales Book of M/s. Pranat Engineers Ltd., Delhi. 2022

Jan.2. Sold to M/s. Ajanta Electricals, Delhi 5 pieces of Ovens @ Rs.6,000/- each less Trade discount @ 10% .

8 Sold to M/s. Electronics Plaza, 10 pieces of Tablets @ Rs.8,000/- each less trade discount 5%.

15 Sold to M/s. Haryana Traders, 5 pieces of Juicers @ Rs.3,500/- each less trade discount @ 10%.

Ans1.

Sales Book

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

Q2. Post into the ledger, the entries of Sales Book prepared in Question1.

Ans2.

Ledger

M/s. Ajanta Electricals

Date 2022	Particulars	L.F.	Amount (Rs.)	Date 2022	Particulars	L.F.	Amount (Rs.)
Jan. 2	To Sales A/c (From Sales Book)						

M/s. Electronics Plaza

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

M/s. Haryana Traders

Date 2022	Particulars	L.F.	Amount (Rs.)	Date 2022	Particulars	L.F.	Amount (Rs.)
Jan. 15	To Sales A/c (From Sales Book)		15750				

Sales Account

Date 2022	Particulars	L.F.	Amount (Rs.)	Date 2022	Particulars	L.F.	Amount (Rs.)
				Jan. 31	By Sundries (As per Sales Book)		1,18,750

UNIT 5 : CASH BOOK

True and False

Q1. Cash book is a subsidiary book as well as a principal book.

Ans1. True: Since the balance is directly taken to the Trial balance from cash book. Hence, it is a subsidiary book as well as principal book.

Q2. Two column cash book consists of two columns cash column & bank column.

Ans2. True: Two column cash book consists of two columns either cash column & discount column or cash column & bank column.

Q3. Discount column of cash book is never balanced.

Ans3. True: Discount column is totalled and transferred to the discount allowed or received account.

Q4. Contra entry is passed in a two column cash book.

Ans4. False: Contra entry is passed in a three column cash book which includes bank and cash columns.

Q5. If the bank column is showing the opening balance on credit side, it is an overdraft.

Ans5. True: The debit side of opening balance shows a favorable balance, whereas the credit balance is an unfavorable balance and treated as overdraft.

Q6. A cash book records cash transactions as well as credit transactions.

Ans6. False: A cash book records only cash transactions.

Q7. Discount column of cash book records the trade discount.

Ans7. False: Discount column of cash book records the cash discount. Trade discount is not shown in the books of accounts.

Multiple Choice Questions

Q1. The total of discounts column on the debit side of the cash book, recording cash discount deducted by customers when paying their accounts, is posted to the

____

(a) Credit of the discount allowed account.

(b) Debit of the discount allowed account

(c) Credit of the discount received account.

Ans1. (b) Debit of the discount allowed account.

Q2. Cash book is a type of __________ but treated as a ____________ of accounts.

(a) Subsidiary book, principal book

(b) Principal book, subsidiary book

(c) Subsidiary book, subsidiary book

Ans2. (a) Subsidiary book, principal book

Q3. Which of the following is not a column of a three-column cash book?

(a) Cash column

(b) Bank column

(c) Petty cash column

Ans3. (c) Petty cash column

Q4. Contra entries are passed only when ___________________________

(a) Double-column cash book is prepared

(b) Three-column cash book is prepared

(c) Simple cash book is prepared

Ans4. (b) Three-column cash book is prepared

Q5. The Cash Book records ___________________________

(a) All cash receipts

(b) All cash payments

(c) All cash receipts and payments

Ans5. (c) All cash receipts and payments

Q6. The balance in the petty cash book is ___________________________

(a) An expense

(b) A profit

(c) An asset

Ans6. (c) An asset

Q7. If Ram has sold goods for cash, the entry will be recorded ___________________________

(a) In the Cash Book

(b) In the Sales Book

(c) In the Journal

Ans7. (a) In the Cash Book

Theory Questions

Q1. Is cash book a subsidiary book or a principal book? Explain.

Ans1. Cash transactions are straightaway recorded in the Cash Book and on the basis of such a record, ledger accounts are prepared. Therefore, the Cash Book is a subsidiary book. But the Cash Book itself serves as the cash account and the bank account, if bank column is also included; the balances are entered in the trial balance directly. The Cash Book, therefore, is part of the ledger also. Hence, it is also treated as the principal book. The Cash Book is thus both a subsidiary book and a principal book.

Q2. What are the various kinds of cash book?

Ans2. The main Cash Book may be of the three types:

(i) Simple Cash Book;

(ii) Two-column Cash Book;

(iii) Three-column Cash Book.

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

Q3. What are the advantages of a three column cash book?

Ans3. The advantages of three columns Cash Book are that -

(a) The Cash Account and the Bank Account are prepared simultaneously, therefore the double entry is completed in the Cash Book itself. Thus the contra entries can be easily cross-checked in Cash column in one side and the Bank column in the other side of the Cash Book. The chances of error are also reduced.

(b) The information regarding Cash in Hand and the Bank Balance can be obtained very easily and quickly as there is no need to prepare Ledger of the Cash and Bank Account.

Practical Questions

Q1. Shri Ramaswamy maintains a Columnar Petty Cash Book on the Imprest System. The imprest amount is Rs.500. From the following information, show how his Petty Cash Book would appear for the week ended 12th September, 2022:

Rs.

7-9-2022	**Balance in hand**	**134.90**
	Received Cash reimbursement to make up the imprest	**365.10**
	Stationery	**49.80**
8-9-2022	**Miscellaneous Expenses**	**20.90**
9-9-2022	**Repairs**	**156.70**
10-9-2022	**Travelling**	**68.50**
11-9-2022	**Stationery**	**71.40**
12-9-2022	**Miscellaneous Expenses**	**6.30**
13-9-2022	**Repairs**	**48.30**

Ans1.

Petty Cash Book

Date	Receipts	Amount Rs.	Date 2022	Payments	Total Amount Rs.	Stationery Rs.	Travelling Rs.	Misc Exps. Rs.	Repairs Rs.

Sept. 7	To Balance b/d	134.90	7	By Stationery	49.80	49.80			
	To Reimbursement	365.10	8	By Misc. Expenses	20.90			20.90	
			9	By Repairs	156.70				156.70
			10	By Travelling	68.50		68.50		
			11	By Stationery	71.40	71.40			
			12 13	By Misc. Expenses				6.30	48.30
				By Repairs	48.30				
					421.90	121.20	68.50	27.20	205.00
				By Balance c/d	78.10				

UNIT 6 : RECTIFICATION OF ERRORS

True and False

Q1. The method of rectification of errors depends on the stage at which the errors are detected.

Ans1. True: There are 3 different stages when the mistakes are identified and then the rectification depends on the stage of identification of errors.

Q2. In case of error of complete omission, the trial balance does not tally.

Ans2. False: In case of error of complete omission, the trial balance tallies.

Q3. When errors are detected after preparation of trial balance, suspense account is opened.

Ans3. True: In order to balance the difference of balances in the trial balance suspense account is opened.

Q4. When purchase of an asset is treated as an expense, it is known as error of principle.

Ans4. True: Where the accounts being debited is principally incorrect it is termed as error of principle.

Q5. Trial balance agrees in case of compensating errors.

Ans5. True: Compensating errors cancel out each other when Trial balance is prepared as the mistake pertains to the same amount being credited and later debited on account of two different mistakes.

Q6. When amount is written on wrong side, it is known as an error of principle.

Ans6. False: When amount is written on wrong side, it is known as an error of commission.

Q7. On purchase of old furniture, the amount spent on repairs should be debited to repairs account.

Ans7. False: On purchase of furniture, the amount spent on repairs should be debited to furniture account as it is a capital expense.

Q8. 'Profit & Loss adjustment account' is opened to rectify the errors detected in the current accounting period.

Ans8. False: 'Profit & Loss adjustment account' is opened to rectify the errors detected in the next accounting period.

Q9. Rent paid to landlord of the proprietors house, must be debited to 'Rent account'.

Ans9. False: Rent paid to land lord of the proprietors house, must be debited to 'Drawings account'.

Q10. If the errors are detected after preparing trial balance, then all the errors are rectified through suspense account.

Ans10. False: If the errors are detected after preparing trial balance, then all the errors are not rectified through suspense account. There may be principal errors, which can be rectified without opening a suspense account.

Multiple Choice Questions

Q1. Goods purchased from A for `10,000 passed through the sales book. The error will result in

(a) Increase in gross profit.

(b) Decrease in gross profit.

(c) No effect on gross profit.

Ans1. (a) Increase in gross profit.

Q2. If a purchase return of Rs.1,000 has been wrongly posted to the debit of the sales returns account, but has been correctly entered in the suppliers' account, the total of the

(a) Trial balance would show the debit side to be Rs.1,000 more than the credit.

(b) Trial balance would show the credit side to be Rs.1,000 more than the debit.

(c) The debit side of the trial balance will be Rs.2,000 more than the credit side.

Ans2. (c) The debit side of the trial balance will be Rs.2,000 more than the credit side.

Q3. If the amount is posted in the wrong account or it is written on the wrong side of the account, it is called

(a) Error of omission.

(b) Error of commission.

(c) Error of principle.

Ans3. (b) Error of commission.

Q4. Rs.200 paid as wages for erecting a machine should be debited to

(a) Repair account.

(b) Machine account.

(c) Capital account.

Ans4. (b) Machine account.

Q5. On purchase of old furniture, the amount of `1,000 spent on its repair should be debited to

(a) Repair account.

(b) Furniture account.

(c) Cash account.

Ans5. (b) Furniture account.

Q6. Goods worth Rs.50 given as charity should be credited to

(a) Charity account.

(b) Sales account.

(c) Purchase account.

Ans6. (c) Purchase account.

Q7. Goods worth Rs.100 taken by proprietor for domestic use should be credited to

(a) Sales account.

(b) Proprietor's personal expenses.

(c) Purchases account.

Ans7. (c) Purchases account.

Q8. Sales of office furniture should be credited to

(a) Sales Account.

(b) Furniture Account.

(c) Purchase Account.

Ans8. (b) Furniture Account.

Q9. The preparation of a trial balance is for:

(a) Locating errors of commission.

(b) Locating errors of principle.

(c) Locating clerical errors.

Ans9. (c) Locating clerical errors.

Q10. Rs.200 received from Smith whose account, was written off as a bad debt should be credited to:

(a) Bad Debts Recovered account.

(b) Smith's account.

(c) Cash account.

Ans10. (a) Bad Debts Recovered account.

Q11. Purchase of office furniture Rs.1,200 has been debited to General Expense Account. It is:

(a) A clerical error.

(b) An error of principle.

(c) An error of omission.

Ans11. (b) An error of principle.

Theory Questions

Q1. How does errors of omission differ from errors of commission?

Ans1. (i) Errors of Omission: If a transaction is completely or partially omitted from the books of account, it will be a case of omission. Examples would be: not recording a credit purchase of furniture or not posting an entry into the ledger.

(ii) Errors of Commission: If an amount is posted in the wrong account or it is written on the wrong side or the totals are wrong or a wrong balance is struck, it will be a case of "errors of commission."

Q2. What is error of principle and how does it affect Trial Balance?

Ans2. Errors of principle: When a transaction is recorded in contravention of accounting principles, like treating the purchase of an asset as an expense, it is an error of principle. In this case there is no effect on the trial balance since the amounts are placed on the correct side, though in a wrong account. Suppose on the purchase of a typewriter, the office expenses account is debited; the trial balance will still agree.

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

Q3. When and how is Suspense account used to rectify errors?

Ans3. Rectification of errors discussed so far assumes that it was carried out before the books were closed for the concerned year. However, sometimes, the rectification is carried out in the next year, carrying forward the balance in the Suspense Account or even transferring it to the Capital Account. Suppose, the Purchase Book was cast short by `1,000 in December, 2022 and Suspense Account was opened with the difference in the trial balance. If the error is rectified next year and the entry passed is to debit Purchase Account (and credit Suspense Account), it will mean that the Purchases Account for year 2023 will be Rs.1,000 more than the amount relating to year 2023 and thus the profit for year 2023 will be less than the actual for that year. Thus, correction of errors in this manner will 'falsify' the Profit and Loss Account.

To avoid this, correction of all amounts concerning nominal accounts, i.e., expenses and incomes should be through a special account styled as "Prior Period Items" or "Profit and Loss Adjustment Account". The balance in the account should be transferred to the Profit and Loss Account. However, these Prior Period Items should be charged after deriving the profit of the current year. 'Prior Period items' are material income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. Prior Period Items should be separately disclosed in the current statement of profit and loss together with their nature and amount in a manner that their impact on current period profit or loss can be perceived.

Practical Questions

Q1. The trial balance of Mr. W & H failed to agree and the difference Rs.20,570 was put into suspense account pending the investigation which disclosed that:

- **(i)** **Purchase returns day book had been correctly entered and totalled at Rs.6,160, but had not been posted to the ledger.**
- **(ii)** **Discounts received Rs.1,320 had been debited to discounts allowed.**
- **(iii)** **The Sales account had been under added by Rs.10,000.**
- **(iv)** **A credit sale of Rs.1,470 had been debited to a customer account at Rs.1,740.**
- **(v)** **A vehicle bought originally for Rs.7,000 four years ago and depreciated to Rs.1,200 had been sold for Rs.1,500 in the beginning of the year but no entries, other than in the bank account had been passed through the books.**
- **(vi)** **An accrual of Rs.560 for telephone charges had been completely omitted.**
- **(vii)** **A bad debt of Rs.1,560 had not been written off and provision for doubtful debts should have been maintained at 10% of Trade receivables which are shown in the trial balance at Rs.23,390 with a credit provision for bad debts at Rs.2,320.**

(viii) Tools bought for Rs.1,200 had been inadvertently debited to purchases.

(ix) The proprietor had withdrawn, for personal use, goods worth Rs.1,960. No entries had been made in the books.

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

Ans1.

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

Notes:

1. Bad debts will be debited in the profit and loss account.

2. Provision @ 10% of Rs.21,560 i.e. 2,156; Excess provision Rs.164 (2320 - 2156 = 164).

Working Notes:

(i)	Trade receivables as per books		23,390
	Deduction vide item (iv) 270	270	
	Bad Debts	1,560	1,830
			21,560

(ii)

Suspense Account

	Rs.		Rs.
To Return outward Account	6,160	By balance b/d	20,570
To Discount allowed AccountTo	1,320		
Discount Received AccountTo	1,320		
Sales Account	10,000		
To Customers Account	270		
To Vehicles Account	1,200		
To Profit on Sale of Vehicle	300		
	20,570		20,570

Q2. On going through the Trial balance of Ball Bearings Co. Ltd. you find that the debit is in excess by Rs.150. This was credited to "Suspense Account". On a close scrutiny of the books, the following mistakes were noticed:

(1) The totals of debit side of "Expenses Account" have been casted in excess by Rs.50.

(2) The "Sales Account" has been totalled in short by Rs.100.

(3) Supplier account has been over casted by 225.

(4) The sale return of Rs.100 from a party has not been posted to that account though the Party's account has been credited.

(5) A cheque of Rs.500 issued to the Suppliers' account (shown under Trade payables) towards his dues has been wrongly debited to the purchases.

(6) **A credit sale of Rs.50 has been credited to the Sales and also to the Trade receivables Account.**

You are required to

(i) Pass necessary journal entries for correcting the above;

(ii) Show how they affect the Profits; and

(iii) Prepare the "Suspense Account" as it would appear in the ledger.

Ans2.

Particulars		**L.F.**	**Dr. Rs.**	**Cr. Rs.**
Suspense Account	Dr.		50	
To Expenses Account				50
(Being the mistake in totaling of ExpensesAccount, rectified)				
Suspense Account	Dr.		100	
To Sales Account				100
(Being the mistake in totaling of Sales Accounts rectified)				
Supplier	Dr.		225	
To Suspense Account				225
(Being the mistake in posting from Day Book to Ledger rectified)				
Sales Returns Account	Dr.		100	
To Suspense Account				100
(Being the sales return from a party not posted to "Sales Returns" now rectified)				
Trade payables Account	Dr.		500	
To Purchases Account				500
(Being the payments made to supplier wrongly posted to purchases now rectified)				
Trade receivables Account	Dr.		100	
To Suspense Account				100

(Being the sales wrongly credited to Customer's Account now rectified)				

Suspense Account

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

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

	Increased by Rs.	**Decreased by Rs.**
Mistake in totalling in "Expenses" Mistake in totalling in "Sales" Mistake in posting from day book to Ledgerunder "Purchases" Omission in posting under "Sales Returns"	50 100 500	 100
Net Increase	650	100
	550	

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

Q3. Mr. A closed his books of account on September 30, 2021 in spite of a difference in the trial balance. The difference was Rs.830 the credits being short; it was carried forward in a Suspense Account. In 2022 following errors were located:

(i) A sale of Rs.2,300 to Mr. Lala was posted to the credit of Mrs. Mala.

(ii) The total of the Returns Inward Book for July, 2021 Rs.1,240 was not posted in the ledger.

(iii) **Freight paid on a machine Rs.5,600 was posted to the Freight Account as Rs.6,500. 10% Depreciation is charge on this machines.**

(iv) **While carrying forward the total in the Purchases Account to the next page, Rs.65,590 was written instead of Rs.56,950.**

(v) **A sale of machine on credit to Mr. Mehta for Rs.9,000 on 30th September. 2021 was not entered in the books at all. The book value of the machine was Rs.6,750.**

Pass journal entries to rectify the errors. Have you any comments to make?

Ans3.

Journal of Mr. A

Date	Particulars	Dr.	Cr.
		Rs.	Rs.
2022 (i)	Mrs. Mala Mr. Lala	2,300 2,300	
	To Suspense A/c (Correction of error by which a sale of Rs.2,300 to Mr. Lala was posted to the Credit of Mrs. Mala)		4,600
(ii)	Profit and Loss Adjustment A/cTo	1,240	
	Suspense A/c (Rectification of omission to post the total of Returns Inward Book for July, 2021)		1,240
(iii)	(a) Machinery A/c Suspense A/c	5,600 900	
	To Profit & Loss Adjustment A/c (Correction of error by which freight paid for a machine Rs.5,600 was posted to Freight Account at Rs.6,500 instead of capitalizing it)		6,500
	(b) Profit & Loss Adjustment A/c	560	
	To Plant and Machinery A/c (Depreciation @ 10% charged on freight paid on a machine capitalized)		560

(iv)	Suspense A/c	8,640	
	To Profit & Loss Adjustment A/c		8,640
	(Correction of wrong carry forward of total in the purchase Account to the next page Rs.65,590 instead of Rs.56,950)		
(v)	Mr. Mehta	9,000	
	To Plant & Machinery A/c		6,750
	To Profit & Loss Adjustment A/c		2,250
	(Correction of omission of a sale of machine on credit to Mr. Mehta for Rs.9,000)		

Comments

The Suspense Account will now appear as shown below:

Suspense Account

Date	Particulars	Dr. Amount Rs.	Date	Particulars	Cr. Amount Rs.
2022	To Profit and Loss Adjustment A/c	900	2022	By Balance b/d	830
	To Profit and Loss Adjustment A/c	8640	Oct.1	By Sundries Mrs. Mala Mr. Lala	 2,300 2,300
				By Profit and Loss Adjustment A/c	1,240
				By balance c/d	2,870
		9,540			9,540

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

Profit & Loss Adjustment A/c

(For Prior Period Items)

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

Q4. A merchant's trial balance as on June 30, 2022 did not agree. The difference was put to a Suspense Account. During the next trading period, the following errors were discovered:

(i) The total of the Purchases Book of one page, Rs.4,539 was carried forward to the next page as Rs.4,593.

(ii) A sale of Rs.573 was entered in the Sales Book as Rs.753 and posted to the credit of the customer.

(iii) A return to a creditor, Rs.510 was entered in the Returns Inward Book; however, the creditor's account was correctly posted.

(iv) Cash received from C. Dass, Rs.620 was posted to the debit of G. Dass.

(v) Goods worth Rs.840 were dispatched to a customer before the close of the year but no invoice was made out.

(vi) Goods worth Rs.1,000 were sent on sale or return basis to a customer and entered in the Sales Book. At the close of the year, the customer still had the option to return the goods. The sale price was 25% above cost.

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

Ans4.

Journal Entries

	Particulars	Dr. Rs.	Cr. Rs.
(i)	Suspense Account Dr.	54	
	To Profit and Loss Adjustment A/c (Correction of error by which Purchase Account was over debited last year- Rs.4,593 carried forward instead of Rs.4,539)		54
(ii)	Profit & Loss Adjustment A/c Dr.	180	
	Customer's Account Dr.	1,326	
	To Suspense Account (Correction of the entry by which (a) Sales A/c was over credited by Rs.180 (b) customer was credited by Rs.753 instead of being debited by Rs.573)		1,506
(iii)	Suspense Account Dr.	1,020	
	To Profit & Loss Adjustment A/c (Correction of error by which Returns Inward Account was debited by Rs.510 instead of Returns Outwards Account being credited by Rs.510)		1,020
(iv)	Suspense Account Dr.	1,240	
	To C. Dass		620
	To G. Dass (Removal or wrong debit to G. Dass and giving credit to C. Dass from whom cash was received).		620
(v)	Customer's Account Dr.	840	

	To Profit & Loss Adjustment A/c (Rectification of the error arising from non-preparation of invoice for goods delivered)		840
(vi)	Profit & Loss Adjustment A/c Dr.	200	
	Inventory Account Dr.	800	
	To Customer's Account		1,000
(vii)	Profit & Loss Adjustment A/c Dr.	1,534	
	To Capital Account		1,534
	(Transfer of Profit & Loss Adjustment A/c balance to the Capital Account)		

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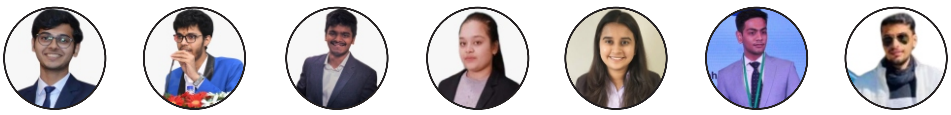
NOTES

Practice Notes

Foundation Accounting

Chapter - 3



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CHAPTER- 3

BANK RECONCILIATION STATEMENT

True or False

Q1. Bank Reconciliation is the process of reconciling cash column of the cash book and bank column of the cash book.

Ans1. False: Bank Reconciliation Statement reconciles bank column of cash book with the balance in the pass book i.e. customer account in the books of bank.

Q2. There are 3 types of differences between cash book and pass book namely Timing, Transactions & Errors.

Ans2. True: These are the three broad categories.

Q3. Adjusting the cash book for any errors and/or omissions before preparing bank reconciliation is optional when the reconciliation is done at the end of the financial year.

Ans3. False: Adjusting the cash book is mandatory when bank reconciliation is done at the end of the financial year.

Q4. Debit balance in cash book is same as overdraft as per pass book.

Ans4. False: Debit balance as per cash book should be represented by credit or favorable balance in pass book.

Q5. Bank charges debited by the bank is an example of timing difference for the purposes of bank reconciliation .

Ans5. False: Bank charges are example of the transactions that bank carries out by itself and the same has not been recorded in the cashbook until statement is obtained from the bank.

Q6. Overcasting of the debit side of the cash book is an example of a difference that is due to error.

Ans6. True: Overcasting is an example of an error.

Q7. When we start bank reconciliation with a debit balance in cash book, then cheques issued but not yet presented should be added back to arrive at the balance as per pass book.

Ans7. True: Since the cheques issued would have been recorded as payments and bank balance was credited in cash book, we need to add it back as the same is not yet deducted from our bank balance.

Q8. The bank charges charged by the bank should be deducted when bank reconciliation statement is being prepared starting from a credit balance of pass book.

Ans8. False: Bank charges should be added when we start with credit or favorable balance in pass book as bank would have debited the charges.

Q9. When the causes of differences between pass book balance and cash book is not known, then the bank reconciliation statement can be prepared by matching the two books and identifying any unticked items in both sets.

Ans9. True: Since, we don't know the causes of difference, matching the two statements are only efficient way to identify the difference.

Q10. While preparing the bank reconciliation statement starting with debit balance as per pass book or bank statement, the deposited cheques that are not yet cleared need not be adjusted.

Ans10. False: Cheques deposited but not yet cleared should be subtracted from debit or unfavorable balance in pass book.

Q11. Cash book shows a debit balance of Rs.50,000 and the only difference from the balance as shown in pass book relates to cheques issued for Rs.60,000 but not yet presented for payment. The balance as per pass book should be Rs.1,10,000.

Ans11. True: Cheques issued but not yet presented should be added back to a debit balance in cash book to arrive at pass book balance i.e. Rs.50,000 + Rs.60,000 = Rs.1,10,000.

Q12. Overcasting of credit side of the cash book shall result in a higher bank balance in cash book when compared with pass book balance.

Ans12. False: Overcasting of credit side means excessive payments are recorded and hence would lower the bank balance.

Q13. A cheque for RS.25,000 that was issued and was also presented for payment in same month but erroneously recorded on debit side of the cash book would cause a difference of Rs.50,000 from the balance in pass book.

Ans13. True: Rs.25,000 payment is recorded as a receipt and hence it will have to be adjusted twice (once to nullify and then once to record actual payment) hence causing the difference of double amount.

Q14. A direct debit by bank on account of any payment as may be instructed by customer should be recorded on credit side of cash book.

Ans14. True: It is an example of a payment instructed by customer to be directly debited by bank, and hence credited in the cash book.

Q15. Bank Reconciliation Statement can be prepared in two formats – "Balance" presentation and "Plus & Minus" presentation.

Ans15. True: Reconciliation statement can be prepared in either of the two formats.

Q16. The difference between cash book & pass book that relates to errors are those mostly made by Bank.

Ans16. False: Bank rarely makes mistakes, and hence differences that relate to errors are generally made in cash book.

Q17. A cheque for Rs.80,000 that was discounted from bank was dishonoured and the bank charged Rs.1,600 as the charges on account of same. While starting with debit balance in cash book for preparing bank reconciliation statement, we need to deduct Rs.78,400 to reconcile with pass book.

Ans17. False: We need to deduct Rs.81,600 (i.e. both cheque returned & charges) from debit balance in cash book to arrive at balance as per pass book.

Q18. Interest on savings bank that is allowed or credited by bank is generally recorded in cash book prior to it being recorded by bank.

Ans18. False: Interest allowed by bank is mostly recorded in cash book after the entry has been made in the pass book or bank statement.

Q19.A regular bank reconciliation discourages the accountants to be involved in any kind of funds embezzlement.

Ans19. True: In absence of any reconciliation, the accountants can misutilize the funds temporarily by recording the entry without actual depositing the cash.

Q20. Timing difference relates the transactions that are recorded in the same period in both cash book and also the bank pass book.

Ans20. False: Timing differences relate to the transactions that are recorded in cash book and pass book in two different periods.

Multiple Choice Questions

Q1. When the balance as per Cash Book is the starting point, direct deposits by customers are:

(a) Added

(b) Subtracted

(c) Not required to be adjusted.

Ans1. (a) Added

Q2. A debit balance in the depositor's Cash Book will be shown as:

(a) A debit balance in the Bank Statement.

(b) A credit balance in the Bank Statement.

(c) An overdrawn balance in the Bank Statement.

Ans2. (b) A credit balance in the Bank Statement.

Q3. When balance as per Pass Book is the starting point, interest allowed by Bank is

(a) Added

(b) Subtracted

(c) Not required to be adjusted

Ans3. (b) Subtracted

4. A Bank Reconciliation Statement is prepared with the help of:

(a) Bank statement and bank column of the Cash Book.

(b) Bank statement and cash column of the Cash Book

(c) Bank column of the Cash Book and cash column of the Cash Book.

Ans4. (a) Bank statement and bank column of the Cash Book.

Q5. The cash book showed an overdraft of Rs.1,50,000, but the pass book made up to the same date showed that cheques of Rs.10,000, Rs.5,000 and Rs.12,500 respectively had not been presented for payments; and the cheque of Rs.4,000 paid into account had not been cleared. The balance as per the pass book will be:

(a) Rs.1,10,000

(b) Rs.2,17,500

(c) Rs.1,26,500

Ans5. (c) Rs.1,26,500

Q6. When drawing up a Bank Reconciliation Statement, if you start with a debit balance as per the Bank Statement, the unpresented cheques should be:

(a) Added;

(b) Deducted;

(c) Not required to be adjusted.

Ans6. (a) Added;

Q7. When drawing up a BRS if you start with a Dr. Balance as per Bank Statement, the following are added:

1. Cheque issued but not presented to bank

2. B/R collected directly by bank

3. Overcasting of the Dr. Side of bank A/c in the cash book.

(a) only 1

(b) only 1& 2

(c) all of the above

Ans7. (b) only 1& 2

Q8. A bank reconciliation statement is mainly prepared to:

(a) Reconcile the cash balance of the cash book

(b) Reconcile the difference between the bank balance shown by the cash book and bank passbook

(c) both a & b

Ans8. (b) Reconcile the difference between the bank balance shown by the cash book and bank passbook

Theory Questions

Q1. Write short note on Bank reconciliation statement.

Ans1. Bank reconciliation statement is prepared as on a particular date to reconcile and explain the causes of difference between the bank balance as per cash book and the same as per savings bank pass book or current account statement. At the end of each month, the bank balance as per cash book and that as per pass book /bank statement should be compared and, if there is disagreement, these balances should be reconciled stating exact reasons of disagreement. The reconciliation is made in a statement called the bank reconciliation statement.

Q2. State the causes of difference between the balance shown by the pass book and the cash book.

Ans2. The difference between the balance shown by the passbook and the cashbook may arise on account of the following:

(i) Cheques issued but not yet presented for payment.

(ii) Cheques deposited into the bank but not yet cleared.

(iii) Interest allowed by the bank.

(iv) Interest and expenses charged by the bank.

(v) Interest and dividends collected by the bank.

(vi) Direct payments by the bank.

(vii) Direct deposits into the bank by a customer.

(viii) Dishonour of a bill discounted with the bank.

(ix) Bills collected by the bank on behalf of the customer.

(x) An error committed in cash book or by the bank etc.

(xi) Undercasting or Overcasting in cashbook.

Practical Questions

Q1. From the following particulars prepare a bank reconciliation statement as on 31st December 2022:

(i) On 31st December, 2022 the cash-book of a firm showed a bank balance of Rs.60,000 (debit balance).

(ii) Cheques had been issued for Rs.15,00,000, out of which cheques worth Rs.4,00,000 only were presented for payment.

(iii) Cheques worth Rs.11,40,000 were deposited in the bank on 28th December, 2022 but had not been credited by the bank. In addition to this, one cheque for Rs.5,00,000 was entered in the cash book on 30th December, 2022 but was banked on 3rd January, 2023.

(iv) A cheque from Susan for Rs.4,00,000 was deposited in the bank on 26th December 2022 but was dishonoured and the advice was received on 2nd January, 2023.

(v) Pass-book showed bank charges of Rs.2000 debited by the bank.

(vi) One of the debtors deposited a sum of Rs.5,00,000 in the bank account of the firm on 20th December, 2022 but the intimation in this respect was received from the bank on 2nd January, 2023.

(vii) Bank pass-book showed a debit balance of Rs.3,82,000 on 31st December, 2022.

Ans1.

Bank Reconciliation Statement as on 31st December, 2022

	Rs.	Rs.
Bank balance (Dr.) as per cash book		60,000
Add: Cheques issued but not yet presented for payment	11,00,000	
Cheques directly deposited by a customer not yet	5,00,000	16,00,000

recordedin cash book		16,60,000
Less: Cheques deposited but not yet credited by bank	11,40,000	
Cheque received and recorded in cash book but not yetbanked	5,00,000	
Cheque dishonoured by the bank; the dishonour entry not yet passed in cash book	4,00,000	
Bank charges not recorded in cash book	2,000	(20,42,000)
Bank balance (Dr.) as per pass book		(3,82,000)

Q2. According to the cash-book of Gopi, there was a balance of Rs.44,50,000 in his bank on 30th June, 2022. On investigation you find that:

(i) Cheques amounting to Rs.6,00,000 issued to creditors have not been presented for payment till the date.

(ii) Cheques paid into bank amounting to Rs.11,05,000 out of which cheques amounting to Rs.5,50,000 only collected by the bank up to 30th June 2022.

(iii) A dividend of Rs.40,000 and rent amounting to Rs.6,00,000 received by the bank and entered in the pass-book but not recorded in the cash book.

(iv) Insurance premium (up to 31st December, 2022) paid by the bank Rs.27,000 not entered in the cash book.

(v) The payment side of the cash book had been under casted by Rs.5,000.

(vi) Bank charges Rs.1,500 shown in the pass book had not been entered in the cash book.

(vii) A bill payable of Rs.2,00,000 had been paid by the bank but was not entered in the cash book and bill receivable for Rs.60,000 had been discounted with the bank at a cost of Rs.1,000 which had also not been recorded in cash book.

Required:

(a) to make the appropriate adjustments in the cash book, and

(b) to prepare a statement reconciling it with the bank pass book.

Ans2.

Cash Book (Bank Column)

Receipts	Rs.	Payments	Rs.
To Balance b/d	44,50,000	By Insurance premium A/c	27,000
To Dividend A/c	40,000	By Correction of errors	5,000
To Rent A/c	6,00,000	By Bank charges	1,500
To Bill receivable A/c	59,000	By Bill payable	2,00,000
		By Balance c/d	49,15,500
	51,49,000		51,49,000

Bank Reconciliation Statement as on 30th June, 2022

	Rs.
Adjusted balance as per cash book (Dr.)	49,15,500
Add: Cheques issued but not presented for payment till 30th June, 2022	6,00,000
Less: Cheques paid into bank for collection but not collected till 30th June, 2022	(5,55,000)
Balance as per pass book	49,60,500

Q3. Prepare a bank reconciliation statement as on 30th September, 2022 from the following particulars:

Particulars	**Rs.**
Bank balance as per pass-book	**10,00,000**
Cheque deposited in the bank, but no entry was passed in the Cash-Book	**5,00,000**
Cheque received, but not sent to bank	**11,20,000**
Credit side of the bank column cast short	**2,000**
Insurance premium paid directly by the bank under the standing advice	**60,000**
Bank charges entered twice in the cash book	**2,000**
Cheque issued, but not presented to the bank for payment	**5,00,000**
Cheque received entered twice in the cash book	**10,000**
Bills discounted dishonoured not recorded in the cash book.	**5,00,000**

Ans3.

Bank Reconciliation Statement as on 30th September, 2022

	Rs.	Rs.
Bank balance as per pass book		10,00,000
Add: Cheque received but not sent to the bank	11,20,000	
Credit side of the bank column cast short	2,000	
Insurance premium paid directly not recorded in the cashbook	60,000	
Cheque received entered twice in the cash book	10,000	
Bills dishonoured not recorded in the cash book	5,00,000	16,92,000
		26,92,000
Less: Cheque deposited into the bank but no entry was passed inthe	5,00,000	
cash book		
Bank charges recorded twice in the cash book	2,000	
Cheque issued but not presented to the bank	5,00,000	(10,02,000)
Bank balance as per cash book		16,90,000

Q4. Prepare a bank reconciliation statement from the following particulars on 31st March, 2022:

Particulars	**Rs.**
Debit balance as per bank column of the cash book	**37,20,000**
Cheque issued to creditors but not yet presented to the bank for payment	**7,20,000**
Dividend received by the bank but not yet entered in the cash book	**5,00,000**
Interest allowed by the bank	**12,500**
Cheques deposited into bank for collection but not collected by bank up to this date.	**15,40,000**
Bank charges	**2,000**

A cheque deposited into bank was dishonoured, but no intimation received	**3,20,000**
Bank paid house tax on our behalf, but no information received from bank in this connection.	**3,50,000**

Ans4.

Bank Reconciliation Statement as on 31st March, 2022

	Rs.	Rs.
Debit balance as per cash book		37,20,000
Add: Cheque issued but not yet presented to bank for payment	7,20,000	
Dividend received by bank not entered in cash book	5,00,000	
Interest allowed by bank	12,500	12,32,500
		49,52,500
Less: Cheques deposited into bank but not yet collected	15,40,000	
Bank charges	2,000	
A cheque deposited into bank was dishonoured	3,20,000	
House tax paid by bank	3,50,000	(22,12,000)
Credit balance as per pass book		27,40,500

Q5. Prepare a bank reconciliation statement from the following particulars on 31st March, 2022 and show the balance as per cash book:

i) Overdraft as per passbook on March 31, 2022, is Rs.3,00,000.

ii) Interest on bank overdraft not entered in the cash book Rs.36,500

iii) Insurance premium of Rs.17,950 was due and paid by the bank but same has not been accounted in the books.

iv) Cheques drawn in the last week of March,2022, but not cleared till date for Rs.13,000 and Rs.23,500.

v) Cheques deposited into bank on February,2022, but yet to be credited on dated March 31, 2022 Rs.56,000.

vi) Amount of Rs.20,500 is wrongly debited by the bank

vii) Interest on Investment Rs.83,800 collected and credited by bank but the same has not been entered in the Cash Book.

Ans5.

Bank Reconciliation Statement as on 31st March, 2022

	Rs.	Rs.
Balance as per bank statement (Overdraft)		3,00,000
Add: Cheques drawn but not cleared	36,500	
Interest collected on investments directly credited by bank	83,800	1,20,300
		4,20,300
Less: Interest on bank overdraft not entered in the cash book	36,500	
Cheques deposited but not yet cleared	56,000	
Insurance premium paid by bank	17,950	
Amount wrongly debited by bank	20,500	1,30,950
Overdraft as per cash book		289,350

NOTES

Practice Notes

Foundation Accounting

Chapter - 4

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CHAPTER- 4

INVENTORIES

True and False

Q1. Inventories are stocks of goods and materials that are maintained for mainly the purpose of revenue generation.

Ans1. True: Inventories refers to stocks of goods and materials that are maintained in business for revenue generation.

Q2. A building is considered inventory in a construction business.

Ans2. True: For a construction business, a building under construction will be inventory. The building is being built in the normal course of business and will eventually be sold as inventory.

Q3. Inventory is valued as carrying cost less percentage decreases.

Ans3. False: Inventory is valued at lower of cost or net realizable value.

Q4. Management has daily information about the quantity and valuation of closing stock under physical Inventory System.

Ans4. False: Under Perpetual Inventory System management have daily information of closing stock.

Q5. Periodic Inventory System is more suitable for small enterprises.

Ans5. True: A periodic inventory system is suitable to small and micro enterprises, where physical counting of inventory is not a tedious process.

Q6. When closing inventory is overstated, net income for the accounting period will be understated.

Ans6. False: When closing inventory is overstated, net income for the accounting period will be overstated.

Q7. Closing inventory = Opening inventory + Purchases + Direct expenses + Cost of goods sold.

Ans7. False: Closing stock = Cost of goods sold - (Opening inventory + Purchases + Direct expenses).

Q8. Cost of inventories should comprise all cost of purchase.

Ans8. False: Cost of inventories should comprise all cost of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Q9. Inventory by-products, should be valued at net realisable value where cost of by products can be separately determined.

Ans9. False: Inventory by-products, should be valued at net realisable value where cost of byproducts cannot be separately determined.

Q10. Abnormal amounts of wasted materials, labour or other production overheads expenses are included in the costs of inventories.

Ans10. False: Abnormal amounts of wasted materials, labour or other production overheads expenses are generally not included in the costs of inventories.

Q11. Perpetual system requires closure of business for counting of inventory.

Ans11. False: Periodic system requires closure of business for counting of inventory.

Q12. Periodic inventory system is a method of ascertaining inventory by taking an actual physical count.

Ans12. True: Under Periodic inventory system actual physical count of inventory is taken of all the inventory on hand at a particular date.

Q13. The value of closing inventory under simple average price method is realistic as compare to LIFO.

Ans13. True: Value of Closing stock as per average method is more realistic then LIFO.

Q14. The value of stock is shown on the assets side of the balance-sheet as fixed assets.

Ans14. False: The value of stock is shown on the assets side of the balance-sheet as current assets. As it is realizable within 12 months .

Q15. Under inflationary conditions, FIFO will not show lowest value of cost of goods sold.

Ans15. False: Under inflationary conditions, LIFO and weighted average will not show lowest value of cost of goods sold.

Q16. Under LIFO, valuation of inventory is based on the assumption that costs are charged against revenue in the order in which they occur.

Ans16. False: Under FIFO, valuation of inventory is based on the assumption that costs are charged against revenue in the order in which they occur.

Q17. Valuation of inventory, at cost or net realizable value, whichever less, is based on the principle of Conservatism.

Ans17. True: The conservatism concept states that one shall not account for anticipated profits but shall provide all prospective losses. Valuing inventory at cost or net realisable value whichever is less, therefore is based on principle of Conservatism.

Q18. Finished goods are normally valued at cost or market price whichever is higher.

Ans18. False: Finished goods are normally valued at cost or market price whichever is lower.

Multiple Choice Questions

Q1. The amount of purchase if

Cost of goods sold is Rs.80,700

Opening Inventory Rs.5,800

Closing Inventory Rs.6,000

(a) Rs.80,500

(b) Rs.74,900

(c) Rs.80,900.

Ans1. (c) Rs.80,900.

Q2. Average Inventory = Rs.12,000. Closing Inventory is Rs.3,000 more than opening Inventory.

The value of closing Inventory = ______.

(a) Rs.12,000

(b) Rs.24,000

(c) Rs.13,500.

Ans2. (c) Rs.13,500.

Q3. While finalizing the current year's profit, the company realized that there was an error in the valuation of closing Inventory of the previous year. In the previous year, closing Inventory was valued more by Rs.50,000. As a result

(a) Previous year's profit is overstated and current year's profit is also overstated

(b) Previous year's profit is overstated and current year's profit is understated

(c) Previous year's profit is understated and current year's profit is also understated

Ans3. (b) Previous year's profit is overstated and current year's profit is understated

Q4. Consider the following for Q Co. for the year 2021-22:

Cost of goods available for sale	**Rs.1,00,000**
Total sales	**Rs.80,000**
Opening inventory of goods	**Rs.20,000**
Gross profit margin on sales	**25%**

Closing inventory of goods for the year 2021-22 as

(a) Rs.80,000

(b) Rs.60,000

(c) Rs.40,000

Ans4. (c) Rs.40,000

Q5. If the profit is 25% of the cost price then it is

(a) 25% of the sales price

(b) 33% of the sales price

(c) 20% of the sales price

Ans5. (c) 20% of the sales price

Q6. Goods purchased Rs.1,00,000. Sales Rs.90,000. Margin 20% on cost. Closing Inventory =?

(a) Rs.20,000

(b) Rs.10,000

(c) Rs.25,000

Ans6. (c) Rs.25,000

Q7. A company is following weighted average cost method for valuing its inventory. The details of its purchase and issue of raw-materials during the week are as follows:

1.12.2022 opening Inventory 50 units value Rs.2,200.

2.12.2022 purchased 100 units @ Rs.47.

4.12.2022 issued 50 units.

5.12.2022 purchased 200 units @ Rs.48.

The value of inventory at the end of the week and the unit weighted average costs is

(a) Rs.14,200 – Rs.47.33

(b) Rs.14,300 – Rs.47.67

(c) Rs.14,000 – Rs.46.66

Ans7. (a) Rs.14,200 – Rs.47.33

Q8. The cost of sales is equal to

(a) Opening stock plus purchases

(b) Purchases minus Closing stock

(c) Opening stock plus purchases minus closing stock

Ans8. (c) Opening stock plus purchases minus closing stock

Q9. Inventory is disclosed in financial statements under:

(a) Fixed Assets

(b) Current Assets

(c) Current Liabilities

Ans9. (b) Current Assets

Q10. Accounting Standards do not permit following method of inventory valuation

(a) FIFO

(b) Average cost

(c) LIFO

Ans10. (c) LIFO

Q11. Which inventory costing formula calculates value of closing inventory considering that inventory most recently purchased has not been sold?

(a) FIFO

(b) LIFO

(c) Weighted average cost

Ans11. (a) FIFO

Q12. Valuing inventory at cost or net releasable value is based on which principle

(a) Consistency

(b) Conservatism

(c) Going concern

Ans12. (b) Conservatism

Q13. Under inflationary trend, which of the methods will show highest value of inventory?

(a) FIFO

(b) Weighted average

(c) LIFO

Ans13. (a) FIFO

Q14. Which of the following methods does not consider historical cost of inventory?

(a) Weighted average

(b) FIFO

(c) Retail price method

Ans14. (c) Retail price method

Theory Questions

Q1. Write short notes on:

(i) Adjusted Selling Price method of determining cost of stock.

(ii) Principal methods of ascertainment of cost of inventory.

Ans1. (i) Adjusted selling method is also called retail inventory method. It is used widely in retail business or in business where the inventory comprises of items, the individual costs of which are not readily ascertainable. The historical cost of inventory is estimated by calculating it in the first instance at selling price and then deducting an amount equal to the estimated gross margin of profit on such stocks.

(ii) The specific identification method, First-In–First-Out (FIFO) and weighted average cost formulae are the principal methods of ascertaining the cost of inventory. The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by specific identification of their individual costs under the specific identification method.

Q2. Distinguish between:

(i) LIFO and FIFO basis of costing of stock.

(ii) FIFO and weighted average price method of stock costing.

Ans2. (i) Under FIFO method of inventory valuation, inventories purchased first are issued first. The closing inventories are valued at latest purchase prices and inventory issues are valued at corresponding old purchase prices. In other words, under FIFO method, costs are assigned to the units issued in the same order as the costs entered in the inventory. During periods of rising prices, cost of goods sold are valued at older and lower prices if FIFO is followed and consequently reported 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 prices paid for the latest purchases and closing inventories should be valued at the prices paid for earlier purchases. In other words, closing inventories are valued at old purchase prices and issues are valued at corresponding latest purchase prices.

(ii) Under the First-In-First-Out (FIFO) method of valuation of stock, the actual issue of goods is usually the earliest lot on hand. Hence, the stock in hand will therefore consist of the latest consignments. The closing stock is valued at the price paid for such consignments.

The weighted average price method is not a simple average price method. Under this method of valuation of stock, a stock ledger is maintained, recording receipts and issues on daily basis. A new average would be calculated on receiving fresh consignment. The average price thus calculated after considering arrival of new consignment with the previous value of stock and dividing the preceding stock value and the cost of new arrival with the total units of preceding and new arrival will give the weighted average price.

Q3. Define inventory. Explain the importance of proper valuation of inventory in the preparation of statements of the business entity.

Ans3. Inventory can be defined as assets held

- for sale in the ordinary course of business, or
- in the process of production for such sale, or

- for consumption in the production of goods or services for sale, including maintenance supplies and consumables other than machinery spares.

The significance of inventory valuation arises due to the following reasons:

(i) Determination of Income

(ii) Ascertainment of Financial Position

(iii) Liquidity Analysis

(iv) Statutory Compliance

Practical Questions

Q1. X who was closing his books on 31.3.2022 failed to take the actual stock which he did only on 9th April, 2022, when it was ascertained by him to be worth Rs.2,50,000.

It was found that sales are entered in the sales book on the same day of dispatch and return inwards in the returns book as and when the goods are received back. Purchases are entered in the purchases day book once the invoices are received.

It was found that sales between 31.3.2022 and 9.4.2022 as per the sales day book are Rs.17,200. Purchases between 31.3.2022 and 9.4.2022 as per purchases day book are Rs.1,200, out of these goods amounting to ` 500 were not received until after the stock was taken.

Goods invoiced during the month of March, 2022 but goods received only on 4th April, 2022 amounted to Rs.1,000. Rate of gross profit is 33-1/3% on cost.

Ascertain the value of physical stock as on 31.3.2022.

Ans1.

Statement of Valuation of Physical Stock as on 31st March, 2022

		Rs.
Value of stock as on 9th April, 2022		2,50,000

Add: Cost of sales during the intervening period		
Sales made between 31.3.2022 and 9.4.2022	17,200	
Less: Gross profit @25% on sales	(4,300)	12,900
		2,62,900
Less: Purchases actually received during the intervening period:		
Purchases from 1.4.2022 to 9.4.2022	1,200	
Less: Goods not received upto 9.4.2022	(500)	700
		2,62,200
Less: Purchases during March, 2022 received on 4.4.2022		1,000
Value of physical stock as on 31.3.2022		2,61,200

Q2. From the following information, ascertain the value of stock as on 31.3.2022:

	Rs.
Value of stock on 1.4.2021	**7,00,000**
Purchases during the period from 1.4.2021 to 31.3.2022	**34,60,000**
Manufacturing expenses during the above period	**7,00,000**
Sales during the same period	**52,20,000**

At the time of valuing stock on 31.3.2021 a sum of Rs.60,000 was written off a particular item which was originally purchased for Rs.2,00,000 and was sold for Rs.1,60,000. But for the above transaction the gross profit earned during the year was 25% on cost.

Ans2.

Statement of Valuation of Stock as on 31st March, 2022

		Rs.
Value of stock as on 1st April, 2021		7,00,000

Add: Purchases during the period from 1.4.2021 to 31.3.2022		34,60,000
Add: Manufacturing expenses during the above period		7,00,000
		48,60,000
Less: Cost of sales during the period:		
Sales	52,20,000	
Less: Gross profit	10,32,000	41,88,000
Value of stock as on 31.3.2022		6,72,000

Working Note:

	Rs.
Calculation of gross profit:	
Gross profit on normal sales 20/100 x (52,20,000 -1,60,000)	10,12,000
Gross profit on the particular (abnormal) item 1,60,000 - (2,00,000 - 60,000)	20,000
	10,32,000

Note: The value of closing stock on 31st March, 2022 may, alternatively, be found out by preparing Trading Account for the year ended 31st March, 2022.

Q3. The Profit and loss account of Hanuman showed a net profit of Rs.6,00,000, after considering the closing stock of Rs.3,75,000 on 31st March, 2022. Subsequently the following information was obtained from scrutiny of the books:

(i) Purchases for the year included Rs.15,000 paid for new electric fittings for the shop.

(ii) Hanuman gave away goods valued at Rs.40,000 as free samples for which no entry was made in the books of accounts.

(iii) Invoices for goods amounting to Rs.2,50,000 have been entered on 27th March,

2022, but the goods were not included in stock.

(iv) In March, 2022 goods of Rs.2,00,000 sold and delivered were taken in the sales for April, 2022.

(v) Goods costing Rs.75,000 were sent on sale or return in March, 2022 at a margin of profit of 33-1/3% on cost. Though approval was given in April, 2022 these were taken as sales for March, 2022.

Calculate the value of stock on 31st March, 2022 and the adjusted net profit for the year ended on that date.

Ans3.

Profit and Loss Adjustment Account

Particulars	**Rs.**	**Particulars**	**Rs.**
To Advertisement (samples)	40,000	By Net profit	6,00,000
To Sales (goods approved in April to be taken as April sales: (75,000 + 25,000)	1,00,000	By Electric fittings	15,000
To Adjusted net profit	10,40,000	By Samples	40,000
		By Stock (purchases of March not included in stock)	2,50,000
		By Sales (goods sold in March wrongly taken as April sales)	2,00,000
		By Stock (goods sent on approval basis not included in stock)	75,000
	11,80,000		11,80,000

Calculation of value of inventory on 31st March, 2022

	Rs.
Stock on 31st March, 2022 (given)	3,75,000
Add: Purchases of March, 2022 not included in the stock	2,50,000
Goods lying with customers on approval basis	75,000
	7,00,000

Q4. Physical verification of stock in a business was done on 23rd June, 2022. The value of the stock was Rs.48,00,000. The following transactions took place between 23rd June to 30th June, 2022 :

(i) Out of the goods sent on consignment, goods at cost worth Rs.2,40,000 were unsold.

(ii) Purchases of Rs.4,00,000 were made out of which goods worth Rs.1,60,000 were delivered on 5th July, 2022.

(iii) Sales were Rs.13,60,000, which include goods worth Rs.3,20,000 sent on approval.

Half of these goods were returned before 30th June, 2022.

(iv) Goods are sold at cost plus 25%. However, goods costing Rs.2,40,000 had been sold for Rs.1,20,000.

Determine the value of stock on 30th June, 2022.

Ans4.

Statement of Valuation of Stock on 30th June, 2022

		Rs.
Value of stock as on 23rd June, 2022		48,00,000
Add: Unsold stock out of the goods sent on consignment	2,40,000	
Purchases during the period from 23rd June, 2022 to 30th June, 2022	2,40,000	

Goods in transit on 30th June, 2022	1,60,000	
Cost of goods sent on approval basis (80% of Rs.1,60,000)	1,28,000	7,68,000
		55,68,000
Less: Cost of sales during the period from 23rd June, 2022 to 30th June, 2022		
Sales (Rs.13,60,000 – Rs.1,60,000)	12,00,000	
Less: Gross profit	96,000	
		11,04,000
Value of stock as on 30th June, 2022		44,64,000

Working Notes:

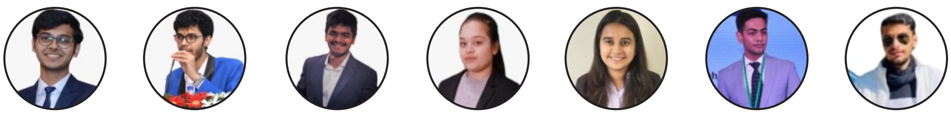
1. Calculation of normal sales:		
Actual sales		13,60,000
Less: Abnormal sales	1,20,000	
Return of goods sent on approval	1,60,000	2,80,000
		10,80,000
2. Calculation of gross profit:		
Gross profit or normal sales 20/100 x Rs.10,80,000		2,16,000
Less: Loss on sale of particular (abnormal) goods (Rs.2,40,000-Rs.1,20,000)		1,20,000
Gross profit		96,000

NOTES

Practice Notes

Foundation Accounting

Chapter - 5

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CHAPTER- 5

DEPRECIATION AND AMORTISATION

True and False

Q1. Increase in market value of a fixed asset is one of the reasons for depreciation being charged.

Ans1. False: It is the decrease in market value as one of the reasons for depreciation. Increase in market value may result in Revaluation.

Q2. Depreciation is a cash expenditure like other normal expenses.

Ans2. False: Depreciation is not a cash expenditure like other normal expenses as it does not result in any cash outflow.

Q3. Cost of property, plant and equipment includes purchase price, refundable taxes & import duties after deducting any discount or rebate.

Ans3. False: Non-refundable taxes & duties form part of the cost.

Q4. Cost of fixed asset should also include cost of opening a new facility such as inauguration costs.

Ans4. False: Inauguration costs shouldn't be part of cost.

Q5. Depreciation is charged with a constant amount under straight line method and charged with a constant percentage under diminishing balance method.

Ans5. True: SLM method results in same amount and diminishing method involves same rate of depreciation.

Q6. In case an item of Property, Plant & Equipment is revalued, whole class of assets to which that asset being revalued belongs should be revalued.

Ans6. True: Revaluation should be done for the whole class of the asset.

Q7. In case the carrying amount of an asset is decreased due to revaluation, such decrease should always be recognized in the Profit and Loss account.

Ans7. False: Any decrease in value of asset on account of revaluation should be first debited to Revaluation Reserve, if any, and then to Profit & Loss account.

Q8. Akash purchased a machine for Rs.12,00,000. Estimated useful life is 10 years and scrap value is Rs.1,00,000. Depreciation for the first year using sum of the years digit method shall be Rs.2,00,000.

Ans8. True: Sum of years digit method depreciation is calculated as 10/55 x (12,00,000 – 1,00,000) = 2,00,000

Q9. Depreciation cannot be provided in case of loss, in a financial year.

Ans9. 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.

Q10. Providing for depreciation also helps in providing for accumulation of funds to facilitate the replacement at the end of its useful life.

Ans10. True: Depreciation being non-cash expense reduces the distributable profits and hence facilitates replacement of asset when required.

Q11. If the equipment account has a balance of Rs.12,50,000 and the accumulated depreciation account has a balance of Rs.4,00,000, the written down value of same shall be Rs.16,50,000.

Ans11. False: WDV = Rs.12,50,000 – Rs.4,00,000 = Rs.8,50,000

Q12. Sum of the years digit method is an example of accelerated method of charging depreciation.

Ans12. True: Higher depreciation is charged in earlier years under sum of the years digit method.

Q13. Over the life of an asset subject to depreciation, the accelerated method will result in less Depreciation Expense in early years and more depreciation in later years of its life.

Ans13. False: It is vice versa as under diminishing balance method; higher depreciation is charged in beginning.

Q14. While depreciating land cost, Straight line method shall give more depreciation than the written down value.

Ans14. False: Land is not depreciated.

Q15. Provision for depreciation account is debited at the time of recording the depreciation on an asset.

Ans15. False: Provision for Depreciation account is credited while charging the depreciation.

Q16. If adequate maintenance expenditure is incurred with relation to running repairs of an asset, we need not charge any depreciation.

Ans16. False: Depreciation is allocation of the cost of an asset over its useful life. Regular repairs may be required during its life are expensed and depreciation has to be charged anyways.

Q17. When a property, plant or equipment is sold then provision for depreciation account is debited, asset account is credited and any gain or loss is recorded to profit and loss account.

Ans17. True: At the time of sale of an asset, respective asset account is credited with provision for depreciation account being debited and any resulting gain or loss being charged to profit & loss account.

Q18. While calculating the depreciation as per diminishing balance method, the salvage value of the asset at the end of its life is reduced from its cost.

Ans18. False: Under diminishing balance method, salvage value is not considered initially as it assumes that at the end of the asset's life the remaining value shall be its salvage value.

Q19. Any change in the estimated useful life of an asset should be accounted for as a change in an accounting estimate in accordance with Accounting Standards.

Ans19. True: Any change in useful life of an asset is accounted for as a change in estimate.

Q20. An intangible asset is a non-identifiable, non-monetary asset.

Ans20. False: An intangible asset is an identifiable non-monetary asset, held for use in production and supply of goods and services.

Multiple Choice Questions

Q1. Original cost = Rs.12,60,000; Salvage value = Nil; Useful life = 6 years. Depreciation for the first year under sum of years digits method will be

(a) Rs.3,60,000

(b) Rs.1,20,000

(c) Rs.1,80,000

Ans1. (a) Rs.3,60,000

Q2. Obsolescence of a depreciable asset may be caused by:

I. Technological changes.

II. Improvement in production method.

III. Change in market demand for the product or service output.

IV. Legal or other restrictions.

(a) Only (I) above

(b) Both (I) and (II) above

(c) All (I), (II), (III) and (IV) above

Ans2. (c) All (I), (II), (III) and (IV) above

Q3. The number of production of similar units expected to be obtained from the use of an asset by an enterprise is called as

(a) Unit life

(b) Useful life

(c) Production life

Ans3. (b) Useful life

Q4. If a concern proposes to discontinue its business from March 2018 and decides to dispose of all its plants within a period of 4 months, the Balance Sheet as on March 31, 2018 should indicate the plants at their

(a) Historical cost

(b) Net realizable value

(c) Cost less depreciation

Ans4. (b) Net realizable value

Q5. In the case of downward revaluation of a plant which is for the first time revalued, the account to be debited is

(a) Plant account

(b) Revaluation Reserve

(c) Profit & Loss account

Ans5. (c) Profit & Loss account

Q6. The portion of the acquisition cost of the tangible asset, yet to be allocated is known as

(a) Written down value

(b) Accumulated value

(c) Realizable value

Ans6. (a) Written down value

Q7. The main objective of providing depreciation is to

(a) Create secret reserve

(b) Reduce the book value of assets

(c) Allocate cost of the assets

Ans7. (c) Allocate cost of the assets

Q8. Original cost of a machine was Rs.25,20,000 salvage value was Rs.1,20,000, useful life was 6 years. Annual depreciation under Straight Line Method

(a) Rs.4,20,000

(b) Rs.4,00,000

(c) Rs.3,00,000

Ans8. (b) Rs.4,00,000

Q9. The cost of a machine is Rs.20,00,000. Two years later the book value is Rs.10,00,000. The Straight-line percentage depreciation is

(a) 50%

(b) 33-1/3%

(c) 25%

Ans9. (c) 25%

Q10. A machinery with original cost of Rs.10,00,000 and Nil Salvage value acquired on 1st April 2019 with 4 years useful life was depreciated using Straight Line Method. It was decided to sell the machinery on 1st October 2021 for Rs.1,20,000. What shall be the gain or (loss) on the sale of Machinery?

(a) Loss of Rs.1,30,000

(b) Gain of Rs.1,20,000

(c) Loss of Rs.5,000

Ans10. (c) Loss of Rs.5,000

Q11. Which of the following assets does not depreciate?

(a) Machinery and equipment

(b) Patents

(c) Land

Ans11. (c) Land

Q12. A company purchased a machinery on April 01, 2017, for Rs.15,00,000. It is estimated that the machinery will have a useful life of 5 years after which it will have no salvage value. The depreciation charged during the year 2021-22 was

(a) Rs.5,00,000

(b) Rs.4,00,000

(c) Rs.3,00,000

Ans12. (c) Rs.3,00,000

Q13. If the equipment account has a balance of Rs.22,50,000 and the accumulated depreciation account has a balance of Rs.14,00,000, the book value of the equipment is

(a) Rs.36,50,000

(b) Rs.8,50,000

(c) Rs.14,00,000

Ans13. (b) Rs.8,50,000

Q14. A plant with original cost of Rs.50,00,000 was revalued after 2 years resulting in credit to Revaluation Surplus account of Rs.4,00,000. Towards the year end of 2019-20, due to COVID-19 the plan value had gone down by Rs.5,00,000 and accordingly management decided to revalue the same. What shall be the impact of this downwards revaluation on the Profit & Loss Account ?

(a) Debit of Rs.5,00,000

(b) Debit of Rs.1,00,000

(c) Credit of Rs.5,00,000

Ans14. (b) Debit of Rs.1,00,000

Q15. In respect of intangible assets, there is a presumption that the useful life of an intangible asset will not exceed

(a) 2 years

(b) 3 years

(c) 10 years

Ans15. (c) 10 years

Q16. A company developed a technology to enhance the battery life of mobile phones. The cost of development have been capitalized as an intangible asset at ₹ 5,00,000. The company estimates the life of the technology developed to be 3 years. The company has forecasted that 50% of sales will be in year 1, 35% in year 2 and 15% in year 3. What should be the amortization charge in third year?

(a) ₹ 2,50,000

(b) ₹ 75,000

(c) ₹ 1,75,000

Ans16. (b) ₹ 75,000

Q17. An intangible asset is an asset

(a) with no physical existence

(b) generated internally by the business

(c) cannot be sold

Ans17. (a) with no physical existence

Theory Questions

Q1. Distinguish between Straight line method of depreciation and Written down value method of depreciation.

Ans1. Under straight line method an equal amount is written off each year throughout the working life of the depreciable tangible asset so as to reduce the cost of the asset to nil or to its scarp value at the end. Under reducing balance method, a fixed percentage is charged on the diminishing balance of the asset each year so as to reduce the value of the asset to its scarp value at the end of useful life. The basic distinction between these two methods are as follows :

Under straight line method, annual depreciation charge is equal throughout the life of the asset; but under reducing balance method, depreciation charge is reduced over the years as the asset grows old.

Under straight-line method, the asset can be fully depreciated but under reducing balance method asset can never be fully depreciated.

Under straight line method the charge for depreciation is constant while repair charges increase with the life of the asset, so the total charge throughout the life of the asset will not be uniform. To the contrary, under reducing balance method, depreciation charges become high in the initial years but generally repair remains low. As the asset grows old depreciation charge reduces but repair expenses increase. Thus under reducing balance method depreciation and repairs are more or less evenly distributed throughout the life of the asset.

Q2. Write short note on Depletion method of depreciation.

Ans2. Natural resources include physical assets like mineral deposits, oil and gas resources and timber. These natural resources exhaust by exploitation.

Depletion per unit is calculated as

$$\frac{\text{Acquisition cost} - \text{Residual Value}}{\text{Estimate life in terms of production units}}$$

Q3. What factors are considered for calculation of depreciation of a plant?

Ans3. The factors considered for calculation of depreciation are as: (i) Cost of asset including expenses for installation, commissioning, trial run etc. (ii) Estimated useful life of the asset and (iii) Estimated scrap value (if any) at the end of useful life of the asset.

Q4. What are intangible assets. Explain with the help of examples.

Ans4. An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Examples of intangible assets include:

(a) Streaming rights of movies / TV shows / web series on platforms like Netflix, Disney Hot Star, Amazon Prime / Sony LIV etc.

(b) Broadcasting rights of events such as the Cricket World Cup, the Indian Premier League, the Pro Kabaddi League etc.

(c) Landing rights / time slots at airports which permit aircrafts to land or take-off during a particular time frame

(d) Patents

(e) Trademarks

(f) Copyrights

(g) Distribution rights for motion pictures in theatres

(h) Long-term customer contracts

(i) Customer data collected by the entities such as customer contact numbers / email IDs and spending data at stores like Pantaloons, Westside etc. could be a major intangible asset for these entities.

(j) Goodwill (purchased)

(k) Computer Software

Practical Questions

Q1. A firm's plant and machinery account at 31st December, 2021 and the corresponding depreciation provision account, broken down by year of purchase are as follows:

Year of Purchase	Plant and Machinery at cost Rs.	Depreciation Provision Rs.
2005	2,00,000	2,00,000
2011	3,00,000	3,00,000
2012	10,00,000	9,50,000
2013	7,00,000	5,95,000
2020	5,00,000	75,000
2021	3,00,000	15,000
	30,00,000	21,35,000

Depreciation is at the rate of 10% per annum on cost. It is the Company's policy to assume that all purchases, sales or disposal of plant occurred on 30th June in the relevant year for the purpose of calculating depreciation, irrespective of the precise date on which these events occurred.

During 2022 the following transactions took place:

1. Purchase of plant and machinery amounted to Rs.15,00,000

2. Plant that had been bought in 2011 for Rs.170,000 was scrapped.

3. Plant that had been bought in 2012 for Rs.90,000 was sold for Rs.5,000.

4. Plant that had been bought in 2013 for Rs.2,40,000 was sold for Rs.15,000.

You are required to:

Calculate the provision for depreciation of plant and machinery for the year ended 31st December, 2022. In calculating this provision you should bear in mind that it is the company's policy to show any profit or loss on the sale or disposal of plant as a completely

separate item in the Profit and Loss Account. You are also required to prepare the following ledger accounts during 2022.

(i) Plant and machinery at cost;

(ii) Depreciation provision;

(iii) Sales or disposal of plant and machinery.

Ans1. Calculation of provision for depreciation of plant and machinery for the year ended 31st December, 2022.

Plant purchased in:		Rs.	Rs.
2005		nil	
2011		nil	
2012			50,000
2013	1/2 year at 10% on Rs.2,40,000	12,000	
	1 year at 10% on Rs.4,60,000	46,000	58,000
2020	10% on Rs.5,00,000		50,000
2021	10% on Rs.3,00,000		30,000
2022	1/2 year at 10% on Rs.15,00,000		75,000
			2,63,000

Plant and Machinery Account (for 2022) at Cost

	Rs.		Rs.
To Balance b/d To Bank A/c	30,00,000 15,00,000	By Disposals account: Scrapped Sold	 1,70,000 3,30,000
		By Balance c/d	40,00,000
	45,00,000		45,00,000

Depreciation Provision Account (for 2022)

		Rs.		Rs.
To Disposal Account :			By Balance b/d	21,35,000
Scrapped - 2011 assets Sold - 2012 assets	1,70,000 90,000		By Profit and Loss Account	2,63,000
Sold - 2013 assets	2,16,000	4,76,000		
To Balance c/d		19,22,000		
		23,98,000		23,98,000

Sale or disposal of Plant and Machinery Account (for 2022)

		Rs.		Rs.
To Plant and Machinery :			By Provision for Depreciation	4,76,000
Scrapped		1,70,000	By Cash-Sales Proceeds	20,000
Sold		3,30,000	By Loss on sales	4,000
		5,00,000		5,00,000

Q2. The Machinery Account of a Factory showed a balance of Rs.19,00,000 on 1st January, 2022. Its accounts were made up on 31st December each year and depreciation is written off at 10% p.a. under the Diminishing Balance Method.

On 1st June 2022, a new machinery was acquired at a cost of Rs.2,80,000 and installation charges incurred in erecting the machine works out to Rs.8,920 on the same date. On 1st June, 2022 a machine which had cost Rs.4,37,400 on 1st January 2020 was sold for Rs.75,000. Another machine which had cost Rs.4,37,000 on 1st January, 2021 was scrapped on the same date and it realized nothing.

Write a machinery account for the year 2022, allowing the same rate of depreciation as in the past, calculating depreciation to the nearest multiple of a Rupee.

Ans2.

Plant and Machinery Account

		Rs.			Rs.
2022			2022		
Jan. 1	To Balance b/d	19,00,000	June 1	By Bank (Sales)	75,000
June. 1	To Bank (2,80,000 + 8,920)			By Depreciation (on sold machine)	14,762
				By Loss on sale	2,64,532
				By Loss on scrapping the machine	3,76,912
				By Depreciation (on scrapped machinery)	16,388
				By Depreciation (Note iii)	1,32,094
				By Balance c/d	13,09,232
		21,88,920			21,88,920

Working Note:

(i) Calculation of loss on sale of machine on 1-6-2022		
		Rs.
Cost on 1-1-2020		4,37,400
Less : Depreciation @ 10% on Rs.4,37,400		(43,740)
W.D.V. on 31-12-2020		3,93,660
Less : Depreciation @ 10% on Rs.3,93,660		(39,366)
W.D.V. on 31-12-2021		3,54,294
Less : Depreciation @ 10% on Rs.3,54,294 for 5 months		(14,762)
		3,39,532
Less : Sale proceeds on 1-6-2022		(75,000)
Loss		2,64,532
(ii) Calculation of loss on scrapped machine		

		Rs.
Cost on 1-1-2021		4,37,000
Less : Depreciation @ 10% on Rs.4,37,000		(43,700)
W.D.V. on 1-1-2022		3,93,300
Less : Depreciation @ 10% on Rs.3,93,300 for 5 months		(16,388)
Loss		3,76,912
(iii) Depreciation		
Balance of machinery account on 1-1-2022		19,00,000
Less : W.D.V of machinery sold	3,54,294	
W.D.V. of machinery scrapped	3,93,300	(7,47,594)
W.D.V. of other machinery on 1-1-2022		11,52,406
Depreciation @ 10% on Rs.11,52,406 for 12 months		1,15,240
Depreciation @ 10% on Rs.2,88,920 for 7 months		16,854
		1,32,094

Q3. The LG Transport company purchased 10 trucks at Rs.45,00,000 each on 1st April 2019. On October 1st, 2021, one of the trucks is involved in an accident and is completely destroyed and Rs.27,00,000 is received from the insurance in full settlement. On the same date another truck is purchased by the company for the sum of Rs.50,00,000. The company write off 20% on the original cost per annum. The company observe the calendar year as its financial year.

Give the motor truck account for two year ending 31 Dec, 2022.

Ans3.

Date	Particulars	Amount	Date	Particulars	Amount
2021			2021		
Jan-01	To balance b/d	2,92,50,000	Oct-01	By bank A/c	27,00,000
Oct-01	To Profit & Loss A/c	4,50,000	Oct-01	By Depreciation on lost assets	6,75,000

	(Profit on settlement of Truck)				
Oct-01	To Bank A/c	50,00,000	Dec-31 Dec-31	By Depreciation A/c By balance c/d	83,50,000 2,29,75,000
		3,47,00,000			3,47,00,000
2022 Jan-01	To balance b/d	2,29,75,000	2022 Dec-31 Dec-31	By Depreciation A/cBy balance c/d	91,00,000 1,38,75,000
		2,29,75,000			2,29,75,000

Working Note:

1. Profit on settlement of truck

	Rs.
Original cost as on 1.4.2019	45,00,000
Less: Depreciation for 2019	(6,75,000)
	38,25,000
Less: Depreciation for 2020	(9,00,000)
	29,25,000
Less: Depreciation for 2021 (9 months)	(6,75,000)
	22,50,000
Less: Amount received from Insurance company	(27,00,000)
	4,50,000

Q4. A Machinery costing Rs.20,00,000 is depreciated on straight line assuming 10 years working life and nil salvage value for four years. At the end of the fourth year, the machinery was revalued upwards by Rs.80,000. The remaining useful life of the machinery

was also reassessed as 8 years at the end of the fourth year. Calculate the depreciation for 5th Year.

Ans4. Depreciation per year for first 4 years = Rs.20,00,000 / 10 = Rs.2,00,000

Thus, WDV of the Machinery at end of the 4th year = Rs.20,00,000 – (Rs.2,00,000 x 4) = Rs.12,00,000

Revalued Amount i.e. New Depreciable Amount shall be = Rs.12,00,000 + Rs.80,000 = Rs.12,80,000

Original remining useful life is (10-4) = 6 Years whereas it is reassessed as 8 Years.

Hence, depreciation for 5th Year = Rs.12,80,000 / 8 = Rs.1,60,000

Q5. Amazing group had Property, Plant & Equipment (PP&E) with a book value of Rs.35,00,000 on 31st December, 2022. The balance in Revaluation Surplus on that date was Rs.3,00,000. As part of their practice of revaluing the assets on yearly basis, another revaluation was carried out on 31st December, 2022. Evaluate the impact of Revaluation if the Fair Value as a result of Revaluation done on 31st December, 2022 was (a) Rs.37,00,000 (b) Rs.33,00,000 and (c) Rs.31,00,000. Also, give the journal entries.

Ans5. (a) Fair Value: Rs.37,00,000

Since this is an upward revaluation and the group had a balance in revaluation surplus (i.e. there was an upward movement earlier), hence this will result in an additional credit of Rs.2,00,000 to Revaluation Surplus and hence the total Revaluation Surplus balance (part of other comprehensive income in Equity) shall increase to Rs.5,00,000. The Accounting journal entry shall be:

Property, Plant & Equipment A/c	Dr	2,00,000	
To Revaluation Surplus A/c			2,00,000

(b) Fair Value: Rs.33,00,000

Since this is a downward revaluation and the group had a balance in revaluation surplus (i.e. there was an upward movement earlier), hence this will result in a reduction or a debit to Revaluation Surplus to the extent of balance therein and any excess shall be debited to Profit & Loss A/c. In this case, there is a reduction in fair value of Rs.2,00,000 (35,00,000 – 33,00,000) and hence the entire amount shall be debited to Revaluation Surplus. Hence, the total Revaluation Surplus balance (part of other comprehensive income in Equity) shall decrease to Rs.1,00,000. The Accounting journal entry shall be:

Revaluation Surplus A/c	Dr	2,00,000	
To Property, Plant & Equipment A/c			2,00,000

(c) Fair Value: Rs.31,00,000

Since this is also a downward revaluation and the group had a balance in revaluation surplus (i.e. there was an upward movement earlier), hence this will result in a reduction or a debit to Revaluation Surplus to the extent of balance therein and any excess shall be debited to Profit & Loss A/c. In this case, there is a reduction in fair value of Rs.4,00,000 (35,00,000 – 31,00,000) and hence the Revaluation Surplus A/c shall be debited by Rs.3,00,000 and the balance Rs.1,00,000 shall be debited to Profit & Loss A/c. Hence, the total Revaluation

Surplus balance (part of other comprehensive income in Equity) shall become Nil. The Accounting journal entry shall be:

Revaluation Surplus A/c	Dr	3,00,000	
Profit & Loss A/c	Dr	1,00,000	
To Property, Plant & Equipment A/c			4 ,00,000

Q6. On April 1, 2019 a firm purchased a machinery for Rs.2,00,000. On 1st October in the same accounting year, additional machinery costing Rs.1,00,000 was purchased. On 1st October, 2020, the machinery purchased on 1st April 2019, having become obsolete was sold off for Rs.90,000. On October 1, 2021, new machinery was purchased for Rs.2,50,000

while the machinery purchased on 1st October 2019 was sold for Rs.85,000 on the same day. The firm provides depreciation on its machinery @ 10% per annum on original cost on 31st March every year. Show Machinery Account, Provision for Depreciation Account and Depreciation Account for the period of three accounting years ending March 31, 2022.

Ans6.

Dr. **Machinery Account** **Cr .**

Date	Particulars	Rs.	Date	Particulars	Rs.
01.04.2019	To Bank A/c	2,00,000	31.03.2020	By Balance c/d	3,00,000
01.10.2019	To Bank A/c	1,00,000			
		3,00,000			3,00,000
01.04.2020	To Balance b/d	3,00,000	01.10.2020	By Bank A/c	90,000
				By Provision for Depreciation A/c	30,000
				By Profit and Loss A/c	80,000
			31.3.2021	By Balance c/d	1,00,000
		3,00,000			3,00,000
01.04.2021	To Balance b/d	1,00,000	01.10.2021	By Bank A/c	85,000
01.10.2021	To Bank A/c	2,50,000		By Provision for Depreciation A/c	20,000
	To Profit and Loss A/c	5,000	31.3.2022	By Balance c/d	2,50,000
		3,55,000			3,55,000

Depreciation Account

Date	Particulars	Rs.	Date	Particulars	Rs.
31.03.2020	To provision for Depreciation A/c	25,000	31.03.2020	By Profit and Loss A/c	25,000
		25,000			25,000

01.10.2020	To Provision for Depreciation A/c	10,000	31.03.2021	By Profit and Loss A/c	20,000
31.03.2021	To Provision for Depreciation A/c	10,000			
		20,000			20,000
01.10.2021	To Provision for Depreciation A/c	5,000	31.03.2022	By Profit and Loss A/c	17,500
31.03.2022	To Provision for Depreciation A/c	12,500			
		17,500			17,500

Dr. Provision for Depreciation Account Cr .

Date	Particular	Rs.	Date	Particulars	Rs.
31.03.2020	To Balance c/d	25,000	31.03.2020	By Depreciation A/c(Rs.20,000 + Rs.5,000)	25,000
		25,000			25,000
01.12.2020	To Machinery A/c (Rs.20,000 + Rs.10,000)	30,000	01.04.2020	By Balance b/d	25,000
31.03.2021	To Balance c/d	15,000	01.10.2020	By Depreciation A/c	10,000
			31.03.2021	By Depreciation A/c	10,000
		45,000			45,000
01.10.2021	To Machinery A/c (Rs.5,000 + Rs.10,000+ Rs.5,000)	20,000	01.04.2021	By Balance b/d	15,000
31.03.2022	To Balance c/d	12,500	01.10.2021	By Depreciation A/c	5,000
			31.03.2022	By Depreciation A/c	12,500
		32,500			32,500

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Chapter - 6

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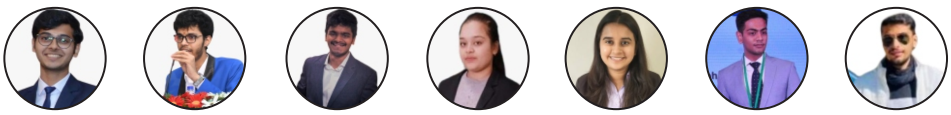

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CHAPTER- 6

BILLS OF EXCHANGE AND PROMISSORY NOTES

True and False

Q1. Bills payable account is a nominal account.

Ans1. False: The bills payable account is a personal account that represents a liability.

Q2. Promise to pay is included in a bill of exchange.

Ans2. False: Bill of exchange contains an order to pay the required amount and not a mere promise to pay.

Q3. Days of rebate are added to the due date to arrive at the maturity date.

Ans3. False:3 Days of grace are added to the due date to arrive at the maturity date.

Q4. Discount at the time of retirement of a bill is a gain for the drawee.

Ans4. True: Discount at the time of retirement of a bill is a gain for the drawee and loss for the drawer.

Q5. Foreign bill is drawn in the country and payable outside the country.

Ans5. True: When a bill is drawn in the country and is payable outside the country it is termed as a foreign bill.

Q6. Promissory note is different from bill of exchange because the amount is paid by the maker in case of former and by the acceptor in the later.

Ans6. True: In case of the promissory note, it is generally the maker who makes the payment, but in case of the bill of exchange, the person accepting the bill shall be liable to make the payment to the holder of the bill.

Q7. A has drawn a bill on B. B accepts the same and endorses the bill to C.

Ans7. False: B cannot endorse the bill to C as he is a drawee. Only A, the drawer can do so.

Q8. A bill given to a creditor is called bills payable.

Ans8. True: A bill given to a creditor is called Bills Payable as the debtor commits to pay by giving a bill to creditor.

Multiple Choice Questions

Q1. On 1.1.2022, A draws a bill on B for Rs.1,20,000 for 3 months' maturity date of the bill will be:

(a) 1.4.2022

(b) 3.4.2022

(c) 4.4.2022

Ans1. (c) 4.4.2022

Q2. On 16.6.2022 P draws a bill on Q for Rs.1,25,000 for 30 days. 19th July is a public holiday, maturity date of the bill will be:

(a) 19th July

(b) 18th July

(c) 17th July

Ans2. (b) 18th July

Q3. PQ draws a bill on XY for Rs.130,000 on 1.1.2022. XY accepts the same on 4.1.2022 for period of 3 months after date. What will be the maturity date of the bill:

(a) 4.4.2022

(b) 3.4.2022

(c) 7.4.2022

Ans3. (a) 4.4.2022

Q4. A draws a bill on B. A endorsed the bill to C. The payee of the bill will be

(a) A

(b) B

(c) C

Ans4. (c) C

Q5. A bill of Rs.120,000 was discounted by Saras with the banker for `1,18,800. At maturity, the bill returned dishonoured, noting charges Rs.200. How much amount will the bank deduct from Saras's bank balance at the time of such dishonour?

(a) Rs.1,20,000

(b) Rs.1,18,800

(c) Rs.1,20,200

Ans5. (c) Rs.1,20,200

Q6. X draws a bill on Y for Rs.300,000 on 1.1.2022 for 3 months after sight, date of acceptance is 6.1.2022. Maturity date of the bill will be:

(a) 8.4.2022

(b) 9.4.2022

(c) 10.4.2022

Ans6. (b) 9.4.2022

Q7. X sold goods to Y for Rs.5,00,000. Y paid cash Rs.4,30,000. X will grant 2% discount on balance, and Y request X to draw a bill for balance, the amount of bill will be:

(a) Rs.98,000

(b) Rs.68,000

(c) Rs.68,600

Ans7. (c) Rs.68,600

Q8. On 1.1.2022, X draws a bill on Y for Rs.5,00,000 for 3 months. X got the bill discounted 4.1.2022 at 12% rate. The amount of discount on bill will be:

(a) Rs.15,000

(b) Rs.16,000

(c) Rs.18,000

Ans8. (a) Rs.15,000

Q9. Mr. Jay draws a bill on Mr. John for ` 3,00,000 on 1.1.2022 for 3 months. On 4.2.2022, John got the bill discounted at 12% rate. The amount of discount will be:

(a) Rs.9,000

(b) Rs.6,000

(c) Rs.3,000

Ans9. (b) Rs.6,000

Q10. XZ draws a bill on YZ for Rs.2,00,000 for 3 months on 1.1.2022. The bill is discounted with banker at a charge of Rs.1,000. At maturity the bill return dishonoured. In the books of XZ, for dishonour, the bank account will be credited by:

(a) Rs.199,000

(b) Rs.200,000

(c) Rs.201,000

Ans10. (b) Rs.200,000

Q11. On 1.1.2022, XA draws a bill on YB for ` 1,00,000. At maturity YB request XA to renew the bill for 2 months at 12% p.a. interest. Amount of interest will be:

(a) Rs.2,000

(b) Rs.1,500

(c) Rs.1,800

Ans11. (a) Rs.2,000

Q12. A bill of exchange is drawn by a

(a) Creditor

(b) Debtor

(c) Debenture holder

Ans12. (a) Creditor

Q13. At the time of drawing a bill, the drawer credits

(a) Bills Receivables A/c

(b) Bills Payable A/c

(c) Debtor's A/c

Ans13. (c) Debtor's A/c

Q14. A promissory note is made by a

(a) Seller

(b) Purchaser

(c) Endorsee

Ans14. (b) Purchaser

Q15. A bill of exchange contains

(a) An unconditional order

(b) A promise

(c) A request to deliver the goods

Ans15. (a) An unconditional order

Q16. A promissory note contains

(a) An unconditional order

(b) A promise

(c) A request to deliver the goods

Ans16. (b) A promise

Q17. The rebate on the bill shows that

(a) It has been endorsed

(b) It has been paid after the date of maturity

(c) It has been paid before the date of maturity

Ans17. (c) It has been paid before the date of maturity

Q18. Notary Public may charge his fee from the

(a) Holder of bill of exchange

(b) Drawer

(c) None

Ans18. (a) Holder of bill of exchange

Theoretical Questions

Q1. Write short notes on:

(a) Accommodation bill.

(b) Renewal of bill.

(c) Noting charges.

Ans1. (a) Bills of Exchange are usually drawn to facilitate trade transmission, that is, bills are meant to finance actual purchase and sale of goods. But the mechanism of bill can be utilised to raise finance also. When bills are used for such a purpose, they are known as accommodation bills.

(b) When the acceptor of a bill finds himself in financial straits to honour the bill on the due date, then he may request the drawer to cancel the original bill and draw on him a fresh bill for another period. And if the drawer agrees, a new bill in place of the original bill may be accepted by the drawee for another period. This is called the renewal of bill.

(c) The charges paid to Notary public for notify the dishonour are noting charges. It is necessary that the fact of dishonour and the causes of dishonour should be established. If the acceptor can prove that the bill was not properly presented to him for payment, he may escape liability. Therefore, if there is dishonour, or fear of dishonour, the bill will be given to a public official known as "Notary Public". These officials present the bill for payment and if the money is received, they will hand over the money to the original party. But if the bill is dishonoured they will note the fact of dishonour, with the reasons 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.

Q2. What is bill of exchange? How does it differ from Promissory Note?

Ans2. A bill of exchange has been defined as "an instrument in writing containing an unconditional order signed by the maker directing a certain person to pay a certain sum of money only to or to the order of certain person or to the bearer of the instrument". When such an order is accepted by the drawee, it becomes a valid bill of exchange. A promissory note is an instrument in writing (not being a bank note or a government currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.

A promissory note needs no acceptance, as the debtor himself writes the document promising to pay the stated amount. Like bills of exchange, promissory notes are also negotiable instruments, and can be transferred by endorsement. In case of bill of exchange, the drawer and the payee may be the same person but in case of a promissory note, the maker and the payee cannot be the same person.

Practical Questions

Q1. On 1st January, 2022, A sells goods for Rs.10,000 to B and draws a bill at three months for the amount. B accepts it and returns it to A. On 1st March, 2022, B retires his acceptance under rebate of 12% per annum. Record these transactions in the journals of B.

Ans1.

Journal Entries in the books of B

Date	**Particulars**		**Debit**	**Credit**
2022			Rs.	Rs.
Jan. 1	Purchases account	Dr.	10,000	
	To A's account (Being the goods purchased from A on credit)			10,000
	A's account	Dr.	10,000	
	To Bills payable account (Being the acceptance of bill given to A)			10,000
1-Mar	Bills payable account	Dr.	10,000	
	To Bank account To Rebate on bills account (Being the bill discharged under rebate @ 12% p.a.)			9,900 100

Working Note:

Calculation of rebate:

Rs.10,000 x 12/100 x 1/12 = Rs.100

Q2. A draws upon B three Bills of Exchange of Rs.3,000, Rs.2,000 and Rs.1,000 respectively. A week later his first bill was mutually cancelled, B agreeing to pay 50% of the amount in cash immediately and for the balance plus interest Rs.100, he accepted a

fresh Bill drawn by A. This new bill was endorsed to C who discounted the same with his bankers for Rs.1,500. The second bill was discounted by A at 5%. This bill on maturity was returned dishonoured (nothing charge being Rs.30). The third bill was retained till maturity when it was duly met.

Give the necessary journal entries recording the above transactions in the books of A.

Ans2.

Journal of A

		Rs.	Rs.
Bills Receivable A/cTo B (Three bills for Rs.3,000, Rs.2,000 and Rs.1,000 drawn on B and duly accepted by him received)	Dr.	6,000	6,000
B To Bills Receivable A/c (Bill received from B cancelled for renewal)	Dr.	3,000	3,000
Cash Account Bill Receivable AccountTo B To Interest Account (Amount received on cancellation of the first bill,50% along with a new bill for 50% of the amount plus interest Rs.100)	Dr. Dr.	1,500 1,600	3,000 100
C To Bills Receivable A/c (A's acceptance endorsed in favour of C)	Dr.	1,600	1,600

Bank A/c Discount A/c To Bills Receivable A/c (Second Bill for Rs.2,000 discounted with the bank @ 5%)	Dr. Dr.	1,900 100	2,000
B To Bank A/c (Second Bill for Rs.2,000 discounted with the Bank dishonoured,noting charges Rs.30 paid by the Bank)	Dr.	2,030	2,030
Bank A/c To Bills Receivable A/c (Amount received on maturity of the third bill)	Dr.	1,000	1,000

Note: It is assumed that the bill for `1,600 has not yet fallen due for payment.

Q3. Journalize the following in the books of Don:

(i) **Bob informs Don that Ray's acceptance for Rs.3,000 has been dishonoured and noting charges are Rs.40. Bob accepts Rs.1,000 cash and the balance as bill at three months at interest of 10%. Don accepts from Ray his acceptance at two months plus interest @ 12% p.a.**

(ii) **James owes Don Rs.3,200; he sends Don's own acceptance in favour of Ralph for ` 3,160; in full settlement.**

(iii) **Don meets his acceptance in favour of Singh for Rs.4,500 by endorsing John's acceptance for Rs.4,450 in full settlement.**

(iv) **Ray's acceptance in favour of Don retired one month before due date, interest is taken at the rate of 6% p.a.**

Ans3.

Books of Don

		`	`
(i)(a)	Ray	3,040	
	Dr. To Bob (Ray's acceptance endorsed to Bob dishonoured ondue date nothing charges paid by Bob Rs.40)		3,040
(b)	Bob	3,040	
		51	
	Dr.		1,000
	Interest Dr. To Cash To Bills Payable A/c (Amount payable to Bob Rs.3,040 settled by cash payment Rs.1,000 and issue of new bill for Rs.2,091 includinginterest Rs.51 for three months on Rs.2,040 @ 10%p.a.)		2,091
(c)	Bills Receivable A/c	3,100.80	
	Dr. To Ray		3,040.00
	To Interest (Bill received from Ray for Rs.3,040 due against earlier acceptance dishonoured plus Rs.60.80 interest for twomonths @ 12% p.a.)		60.8
(ii)	Bills Payable A/c	3,160	
		40	

	Dr. Discount A/c Dr. To James (Cancellation of bills payable to Ralph for Rs.3,160 insettlement of Rs.3,200 due from James)		3,200
(iii)	Bills payable A/c	4,500	
			4,450
	Dr. To Bills Receivable A/cTo Discount A/c (Settlement of acceptance issued to Mr. Singh by endorsement of John's Acceptance for Rs.4,450)		50
(iv)	Bank A/c	3,085.3 0	
	Dr.	15.5	
	Discount A/c Dr. Total Bills Receivable A/c (Amount received from Ray in settlement of Bills Payable, retired one month before due date)		3,100.8 0

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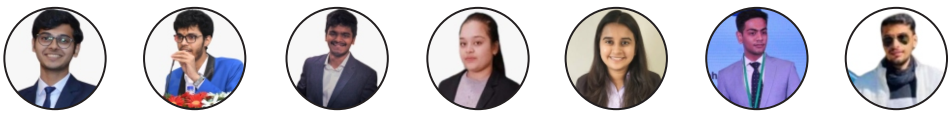
Chapter - 7



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CHAPTER- 7

PREPARATION OF FINAL ACCOUNTS OF SOLE PROPRIETORS

UNIT – 1 FINAL ACCOUNT OF NONMANUFACTURING ENTITIES

True and False

Q1. The income statement shows either net profit or net loss for a particular period.

Ans1. True: Profit and loss account shows either net profit or net loss for a particular period.

Q2. Gains from the sale or exchange of assets are not considered as the revenue of the business.

Ans2. False: Gains from the sale or exchange of assets are considered as the revenue of the business. But this revenue not in the ordinary course of business so it is capital receipts .

Q3. The salary paid in advance is not an expense because it neither reduces assets or nor increase liabilities.

Ans3. True: The salary paid in advance is an asset it is not an expense because it neither reduces assets or nor increase liabilities.

Q4. A loss is an expenditure which does not bring any benefit to the concern.

Ans4. True: A loss is an expenditure of the business which does not bring any gain to the business.

Q5. All liabilities which become due for payment within the year are classified as long-term liabilities.

Ans5. False: All liabilities which become due for payment within one year are classified as current liabilities.

Q6. The term current asset is used to designate cash and other assets or resources which are reasonably expected to be realized or sold or consumed within one year.

Ans6. True: Current assets are all the assets which are expected to be realized or sold or consumed within one year.

Q7. An asset gives rise to expenditure when it is acquired and to an expense when it is consumed.

Ans7. True: When an asset is purchase capital expenditure is incurred and when the asset is put to use expenses are incurred in consumption.

Q8. If the balance of an account on the debit side of the trial balance where the benefit has already expired then it is treated as an expense.

Ans8. True: Debit balance of accounts are treated as expenses whose benefit is already received or expired.

Q9. Sales less cost of goods sold = gross profit.

Ans9. True: Gross profit is obtained by deducting cost of goods sold from sales.

Q10. If the debit side of the trading account exceeds its credit side then the balance is termed as gross profit.

Ans10. False: If the debit side of the trading account exceeds its credit side then the balance is termed as gross loss.

Q11. The provision for bad debts is debited to Sundry Debtors Account.

Ans11. False: The provision for bad debts is debited to debited to Profit and loss Account, in Balance Sheet it is shown either on liability side or deducted from the head Debtors.

Q12. The provision for discount on creditors is often not provided in keeping with the principle of conservatism.

Ans12. True: According to the provision of conservatism provision is maintained for the losses to be incurred in future. Discount on creditors is an income so provision in not maintained.

Q13. The debts written off as bad, if recovered subsequently are credited to Debtors Account.

Ans13. False: The debts written off as bad, if recovered subsequently are credited to Bad Debts Recovered Account and becomes an income .

Q14. The adjustment entry in respect of income received in advance is debit Income received in advance account and credit income account.

Ans14. False: Income received in advance is reduces it from the concerned income in profit and loss account. And, it is shows it as a liability in the current balance sheet under the head Current Liabilities.

Q15. Premium paid on the life policy of a proprietor is debited to profit and loss account.

Ans15. False: Premium paid on the life policy of a proprietor is to be debited to capital account, as it is personal expense.

Q16. Depreciation account appear in the trial balance is taken only to profit and loss account.

Ans16. True: Depreciation is charge on each of the asset on a certain percentage. Depreciation is a charge to profit and loss account and should be debited to profit & loss account by crediting the respective assets. If it appears in trial balance then it is taken only to profit and loss account.

Q17. Personal purchases included in the purchases day book are added to the sales account in the Trading account.

Ans17. False: Personal purchases included in the purchases day book are deducted from the purchases account in the Trading account.

Q18. Medicines given to the office staff by a manufacturer of medicines will be debited to salaries account.

Ans18. True: Any benefit given to the staff is debited to the salary account.

Q19. Goods worth Rs.600 taken by the proprietor for personal use should be credited to Capital Account.

Ans19. False: Goods taken by the proprietor for personal use should be credited to Purchase Account as less goods are left in the business for sale.

Q20. If Closing Stock appears in the Trial Balance, the Closing inventory is then not entered in Trading Account. It is only shown in the Balance Sheet.

Ans20. True: The closing Stock appears in the trial balance only when it is adjusted against purchases by passing the entry. In this case, closing stock is not entered in Trading Account and is shown only in Balance Sheet.

Multiple Choice Questions

(1) A debit to an account may

- **(a) increase expense.**
- **(b) decrease an asset.**
- **(c) increase a liability.**

Ans1. (a) increase expense

(2) Prepayment of insurance premium will appear in the Balance Sheet and in the Insurance Account respectively as:

- **(a) a liability and a debit balance.**
- **(b) an asset and a debit balance.**
- **(c) an asset and a credit balance.**

Ans2. (c) an asset and a credit balance.

(3) Gross profit is the difference between:

- **(a) sales and purchases**
- **(b) sales and cost of sales.**
- **(c) sales and total expenses.**

Ans3. (b) sales and cost of sales.

(4) Payment made to a creditor subject to cash discount will:

- **(a) reduce a liability, reduce an asset and add to expenses.**
- **(b) reduce a liability, add to an asset, and add to revenue.**
- **(c) reduce an asset, reduce a liability, and add to revenue.**

Ans4. (c) reduce an asset, reduce a liability, and add to revenue.

(5) A customer returns goods already charged to him. We should:

- **(a) debit his account.**
- **(b) credit his account.**
- **(c) make no entry on his account.**

Ans5. (b) credit his account.

(6) Capital is the difference between

- **(a) Income and expenses**
- **(b) Sales and Cost of goods sold**
- **(c) Assets and liabilities**

Ans6. (c) Assets and liabilities

(7) The capital of a sole trader would change as a result of:

(a) **A creditor being paid his account by cheque.**
(b) **Raw materials being purchased on credit.**
(c) **Wages being paid in cash.**

Ans7. (c) Wages being paid in cash.

(8) A decrease in the provision for doubtful debts would result in:

(a) **An increase in liabilities.**
(b) **A decrease in working capital.**
(c) **An increase in net profit.**

Ans8. (c) An increase in net profit.

(9) A Company wishes to earn a 20% profit margin on selling price. Which of the following is the profit mark up on cost, which will achieve the required profit margin?

(a) **33%**
(b) **25%**
(c) **20%**

Ans9. (b) 25%

(10) If sales is Rs.2,000 and the rate of gross profit on cost of goods sold is 25%, then the cost of goods sold will be

(a) **Rs.2,000.**
(b) **Rs.1,500.**

(c) Rs.1,600.

Ans10. (c) Rs.1,600.

(11) Sales for the year ended 31st March, 2022 amounted to Rs.10,00,000. Sales included goods sold to Mr. A for Rs.50,000 at a profit of 20% on cost. Such goods are still lying in the godown at the buyer's risk. Therefore, such goods should be treated as part of

(a) Sales.
(b) Closing Inventory.
(c) Goods in transit.

Ans11. (a) Sales.

(12) If sales revenues are Rs.4,00,000; cost of goods sold is Rs.3,10,000 and expenses are Rs.60,000, the gross profit is

(a) Rs.30,000.
(b) Rs.90,000.
(c) Rs.3,40,000.

Ans12. (b) Rs.90,000.

Theoretical questions

Q1. Write shorts notes on:

(a) Balance sheet.

(b) Trading account

(c) Closing entries

Ans1. (a) The balance sheet may be defined as "a statement which sets out the assets and liabilities of a firm or an institution as at a certain date." Since even a single transaction will make a difference to some of the assets or liabilities, the balance sheet is true only at a particular point of time. That is the significance of the word "as at."

(b) At the end of the year, it is necessary to ascertain the net profit or the net loss. For this purpose, it is first necessary to know the gross profit or gross loss with the helps to Trading A/c. Gross Profit is the difference between the selling price and the cost of the goods sold.

(c) Closing entries: The entries that have to be made in the journal for preparing the Trading and the Profit and Loss Account that is for transferring the various accounts to these two accounts are known as closing entries.

Q2. Distinguish between Provision and reserve fund.

Ans2. Provision means "any amount written off or retained by way of providing for depreciation, renewal or diminution in the value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy".

Reserve Fund: It signifies the amount standing to the credit of the reserve that is invested outside the business in securities which are readily realisable e.g., when the amounts set apart for replacement of an asset are invested periodically, in government securities or shares. The account to which these amounts are annually credited is described as the Reserve Fund.

Practical questions

Q1. From the following particulars extracted from the books of Ganguli, prepare trading and profit and loss account and balance sheet as at 31st March, 2022 after making the necessary adjustments:

	Rs.		Rs.
Ganguli's capital account (Cr.) as on 1.4.2021	**5,40,500**	**Interest received**	**7,250**
Stock on 1.4.2021	**2,34,000**	**Cash with Traders Bank Ltd.**	**40,000**
Sales	**14,48,000**	**Discounts received**	**14,950**
Sales return	**43,000**	**Investments (at 5%) as on 1.4.2021**	**25,000**
Purchases	**12,15,500**	**Furniture as on 1-4-2021**	**9,000**
Purchases return	**29,000**	**Discounts allowed**	**37,700**
Carriage inwards	**93,000**	**General expenses**	**19,600**
Rent	**28,500**	**Audit fees**	**3,500**
Salaries	**46,500**	**Fire insurance premium**	**3,000**
Sundry debtors	**1,20,000**	**Travelling expenses**	**11,650**
Sundry creditors	**74,000**	**Postage and telegrams**	**4,350**
Loan from Dena Bank Ltd. (at 12%)	**1,00,000**	**Cash in hand**	**1,900**
Interest paid	**4,500**	**Deposits at 10% as on 1-4-2021 (Dr.)**	**1,50,000**
Printing and stationery	**17,000**	**Drawings**	**50,000**
Advertisement	**56,000**		

Adjustments:

(1) Value of stock as on 31st March, 2022 is Rs.3,93,000. This includes goods returned by customers on 31st March, 2022 to the value of Rs.15,000 for which no entry has been passed in the books.

(2) Purchases include furniture purchased on 1st January, 2022 for Rs.10,000.

(3) Depreciation should be provided on furniture at 10% per annum.

(4) The loan account from Dena bank in the books of Ganguli appears as follows:

		Rs.			Rs.
31.3.2022	To Balance c/d	1,00,000	1.4.2021	By Balance b/d	50,000
			31.3.2022	By Bank	50,000
		1,00,000			1,00,000

(5) Sundry debtors include Rs.20,000 due from Robert and sundry creditors include Rs.10,000 due to him.

(6) Interest paid include Rs.3,000 paid to Dena bank.

(7) Interest received represents Rs.1,000 from the sundry debtors (due to delay on their part) and the balance on investments and deposits.

(8) Provide for interest payable to Dena bank and for interest receivable on investments and deposits.

(9) Make provision for doubtful debts at 5% on the balance under sundry debtors. No such provision need to be made for the deposits.

Ans1.

In the books of Ganguli

Trading and Profit & Loss Account for the year ended 31st March, 2022

	Rs.	Rs.		Rs.	Rs.
To Opening stock		2,34,000	By Sales	14,48,000	
To Purchases	12,15,500		Less: Returns	(58,000)	13,90,000
Less: Transfer to furnitureA/c	(10,000)		By Closing stock		3,93,000
	12,05,500				
Less: Returns	(29,000)	11,76,500			
To Carriage inwards		93,000			
To Gross profit c/d		2,79,500			
		17,83,000			17,83,000
To Salaries		46,500	By Gross profit b/d		2,79,500
To Rent		28,500	By Interest		17,250
To Advertisement		56,000	By Discount received		14,950
To Printing & stationery		17,000			
To Interest		7,500			

To Discount allowed		37,700			
To General expenses		19,600			
To Travelling expenses		11,650			
To Fire insurance premium		3,000			
To Postage & telegrams		4,350			
To Provision for doubtful debts (W.N.I)		4,750			
To Depreciation on furniture		1,150			
To Audit fees		3,500			
To Capital A/c (Net profit transferred)		70,500			
		3,11,700			3,11,700

Liabilities	**Rs.**	**Rs.**	**Assets**	**Rs.**	**Rs.**
Capital account:			Furniture	9,000	
Balance on 1st April,2021	5,40,500		Additions during the year	10,000	

Add: Net profit	70,500			19,000	
	6,11,000		Less: Depreciation	(1,150)	17,850
Less: Drawings	(50,000)	5,61,000	Investments		25,000
Loan from Dena Bank Ltd.		1,00,000	Deposits		1,50,000
Insurance accrued on bank loan (W.N.2)		3,000	Interest accrued on investment & deposits (W.N.3)		10,000
Sundry creditors		64,000	Stock in trade		3,93,000
			Sundry debtors	95,000	
			Less: Provision	(4,750)	90,250
			Cash with Traders Bank Ltd.		40,000
			Cash in hand		1,900
		7,28,000			7,28,000

Working Notes:

Rs.

1. Calculation of provision for doubtful debts:	
Sundry debtors as per trial balance	1,20,000

Less: Sales returns not recorded	(15,000)
	1,05,000
Less: Cancellation against sundry creditors	(10,000)
Adjusted balance of sundry debtors	95,000
Provision for doubtful debts @ 5%	4,750
2. Accrued interest on bank loan:	
Annual interest @12%	6,000
Less: Interest paid to Dena bank	(3,000)
Accrued interest	3,000
3. Interest accrued on investments and deposits:	
Annual interest on investments @ 5%	1,250
Annual interest on deposits @ 10%	15,000
	16,250
Less: Interest received on investments and deposits	(6,250)
Accrued interest	10,000

Q2. Sengupta & Co. employs a team of eight workers who were paid Rs.30,000 per month each in the year ending 31st March, 2021. At the start of financial year 2021-2022, the company raised salaries by 10% to Rs.33,000 per month each.

On October 1, 2021 the company hired two trainees at salary of Rs.21,000 per month each. The work force are paid salary on the first working day of every month, one month in arrears, so that the employees receive their salary for January on the first working day of February etc.

You are required to calculate:

(i) Amount of salaries which would be charged to the profit and loss for the year ended 31st March, 2022.

(ii) Amount actually paid as salaries during 2021-22

(iii) Outstanding Salaries as on 31st March, 2022.

Ans2.

Rs.

(i) Salaries to be charged to profit and loss account for the year ended 31st March, 2022:	
Salaries of 8 employees for full year @ Rs.33,000 per month each	31,68,000
Salaries of 2 trainees for 6 months @ Rs.21,000 p.m.	2,52,000
	34,20,000
(ii) Salaries actually paid in 2021-22	
March, 2021 salaries paid in April, 2021 (8 x 30,000)	2,40,000
Salaries of 8 employees for April 2021 to March, 2022 paid in May 2021 to March 2022 @ Rs.33,000 for 11 months	29,04,000
Salaries of 2 trainees for October 2021 to February 2022 paid in November 2021 to March 2022 @ Rs.21,000 for 5 months	2,10,000

	33,54,000
(iii) Outstanding salaries as at 31st March, 2022	
8 employees @ Rs.33,000 each for 1 month	2,64,000
2 trainees @ Rs.21,000 each for 1 month	42,000
	3,06,000

Q3. You are required, prepare a Trading and Profit and Loss Account for the year ending 31st March, 2022 and a Balance Sheet as on that date from the Trial Balance given below:

Particulars	**Rs.**	**Particulars**	**Rs.**
Debit Balance:			
Trade receivables	**3,50,000**	**Salaries**	**2,20,000**
Inventory 1st April, 2021	**5,00,000**	**Purchases**	**12,50,00**
Cash in Hand	**5,60,000**	**Plant and Machinery**	**15,70,000**
Wages	**3,00,000**	**Credit Balance:**	
Bad Debts	**50,000**	**Capital**	**25,00,000**
Furniture and Fixtures	**1,50,000**	**Trade payables**	**9,00,000**
Depreciation	**1,50,000**	**Sales**	**17,00,000**

On 31st March, 2022 the Inventory was valued at Rs.10,00,000.

Ans3.

Trading and Profit and Loss Account for the year ending 31st March, 2022

Particulars	Rs.	Particulars	Rs.
To Opening Inventory	5,00,000	By Sales	17,00,000
To Purchases	12,50,000	By Closing Inventory	10,00,000
To Wages	3,00,000		
To Gross Profit	6,50,000		
	27,00,000		27,00,000
To Bad Debts	50,000	By Gross Profit	6,50,000
To Depreciation	1,50,000		
To Salaries	2,20,000		
To Net Profit transferred. to Capital A/c	2,30,000		
	6,50,000		6,50,000

Balance Sheet as at 31st March, 2022

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Trade payables		9,00,000	Cash in Hand	5,60,000	
Capital:			Trade receivables	3,50,000	
Previous Balance	25,00,000		Closing Inventory	10,00,000	19,10,000

Add : Net Profit	2,30,000	27,30,000			
			Furniture	1,50,000	
			Plant & Machinery	15,70,000	17,20,000
		36,30,000			36,30,000

Q4. Mr. Kotriwal is engaged in business of selling magazines. Several of his customers pay money in advance for subscribing his magazines. Information related to year ended 31st March 2022 has been given below:

On 1.4.2021 he had a balance of Rs.2,00,000 advance from customers of which Rs.1,50,000 is related to year 2021-22 while remaining pertains to year 2022-23. During the year 2021-22 he made cash sales of Rs.5,00,000. You are required to compute:

(i) Total income for the year 2021-22.

(ii) Total money received during the year if the closing balance in advance from customers account is Rs.1,70,000.

Ans4. (i) Computation of Income for the year 2021-22:

	Rs.
Money received during the year related to 2021-22	5,00,000
Add: Money received in advance during previous years	1,50,000
Total income of the year 2021-22	6,50,000

(ii) Advance from Customers A/c

Date	Particulars	Rs.	Date	Particulars	Rs.
	To Sales A/c (Advance related to current year transferred to sales)	1,50,000	1.4.2021	By Balance b/d	2,00,000
				By Bank A/c (Balancing Figure)	1,20,000
31.3.22	To Balance c/d	1,70,000			
		3,20,000			3,20,000

So, total money received during the year is:

	Rs.
Cash Sales during the year	5,00,000
Add: Advance received during the year	1,20,000
Total money received during the year	6,20,000

Q5. Mr. Birla is a proprietor engaged in business of trading electronics. An excerpt from his Trading & P&L account is as follows:

Trading and P&L A/c for the year ended 31st March, 2022

Particulars	Rs.	Particulars	Rs.
To Cost of Goods Sold	**45,00,000**	**By Sales**	**C**
To Gross Profit c/d	**D**		
	F		**F**
To Rent A/c	**26,00,000**	**By Gross Profit b/d**	**D**
To Office Expenses	**13,00,000**	**By Miscellaneous Income**	**E**
To Selling Expenses	**B**		
To Commission to Manager (on Net Profit before charging such commission)	**2,00,000**		
To Net Profit	**A**		
	G		**60,00,000**

Commission is charged at the rate of 10%.

Selling Expenses amount to 1% of total sales.

You are required to compute the missing figures.

Ans5. A) Computation of Net Profit:

Commission Manager = Rate of Commission X Net Profit before charging such commission

So, Commission to manager = 10/100 X Net Profit before charging such commission

= Rs.2,00,000 = 10/100 X Net Profit before charging such commission

= Net Profit before charging such commission = Rs.20,00,000

=> Net Profit (A) = Rs.(20,00,000 - 2,00,000) = Rs.18,00,000

B) Computation of Selling Expenses:

Total income appearing in P&L A/c = Rs.60,00,000

Total expenses other than selling expenses = Rs.(26,00,000 + 13,00,000 + 2,00,000)= Rs.41,00,000

So, Selling Expenses + Remaining Expenses + Net Profit = Total Income

= Selling Expenses = Rs.60,00,000 –Rs.41,00,000 – Rs.18,00,000

= Selling Expenses = Rs.1,00,000

C) Computation of Sales:

We have been given selling expenses amount to 1% of Sales

So, Sales = $\frac{\text{Selling Expenses}}{1}$ X 100 = $\frac{1,00,000}{1}$ X 100 = Rs.100,00,000

D) Computation of Gross Profit:

In Trading A/c

Particulars	Rs.	**Particulars**	Rs.
To COGS	45,00,000	By Sales (from Cabove)	100,00,000
To Gross Profit (Balancing Figure)	55,00,000		
Total (F)	100,00,000	Total (F)	100,00,000

So, Gross Profit (D) = Rs.55,00,000

E) Miscellaneous Income = Total Income in P&L - Gross Profit

= Rs.(60,00,000 - 55,00,000)= Rs.5,00,000

F) = Rs.100,00,000 (As computed in D above)

G) = Rs.60,00,000 (Total of both sides of P&L is equal after balancing has been done)

UNIT – 2 FINAL ACCOUNTS OF MANUFACTURING ENTITIES

True and False

1. By-products valued at cost or net realizable value whichever is lower.

Answer. False: By-products generally have insignificant value as compared to the value of main product. Therefore, they are generally valued at net realizable value.

2. The manufacturing account is prepared to ascertain the profit or loss on the goods produced.

Answer. False: The objective of preparing Manufacturing Account is to determine manufacturing costs of finished goods for assessing the cost effectiveness of manufacturing activities.

3. If there remain unfinished goods at the beginning and at the end of the accounting period, cost of such unfinished goods is shown in the Manufacturing Account.

Answer. True: Manufacturing account deals with the raw material and work in progress.

4. Raw Material Consumed = Opening inventory of Raw Materials + Purchases – Closing inventory of Raw Materials.

Answer. True: Raw Material consumed is arrived at after adjustment of opening and closing inventory of raw materials and purchases.

5. The Trading Account will show the quantities of finished goods, raw materials and work-in- progress.

Answer. False: The Trading Account will show the quantities of finished goods manufactured and sold and the opening and closing inventory. It will not show the quantity of raw materials or work-in-progress.

6. Overhead is defined as total cost of direct material, direct wages and direct expenses.

Answer. False: Overhead is defined as total cost of indirect material, indirect wages and indirect expenses.

7. Manufacturing A/c is prepared by an enterprise engaged in trading activities.

Answer. False: Manufacturing A/c is prepared by the entities engaged in manufacturing activities.

Multiple Choice Questions

1. Under-statement of closing work in progress in the period will

(a) Understate cost of goods manufactured in that period.

(b) Overstate current assets.

(c) Understate net income in that period.

(d) None of the three.

Answer. (c)

2. Sales is equal to

(a) Cost of goods sold – Gross profit.

(b) Cost of goods sold + Gross profit.

(c) Gross profit – Cost of goods sold.

(d) Net profit + cost of goods sold

Answer. (b)

3. Indirect Manufacturing expenses are also called

(a) Manufacturing overhead.

(b) Production overhead.

(c) Works overhead.

(d) All the three.

Answer. (d)

4. Sale value of the by-product is credited to

(a) Manufacturing account.

(b) Capital account.

(c) Overheads account.

(d) Trading account

Answer. (a)

5. Manufacturing account shows

(a) Total cost of manufacturing the finished products.

(b) It provides details of factory cost.

(c) It facilitates reconciliation of financial books with cost records.

(d) All the three.

Answer. (d)

Theoretical Questions

1. Write short note on by-products.

Answer. By-products generally have insignificant value as compared to the value of main product. They are generally valued at net realisable value, if their costs cannot be separately identified. It is often treated, as "Miscellaneous income" but the correct treatment would be to credit the sale value of the by-product to Manufacturing Account so as to reduce to that extent, the cost of manufacture of main product.

2. Differentiate between Direct Manufacturing Expenses and Indirect Manufacturing expenses.

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

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

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

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

Overhead = Indirect Material + Indirect Wages + Indirect Expenses

Indirect material means materials which cannot be linked directly with the units produced, for example, stores consumed for repair and maintenance work, small tools, fuel and lubricating oil, etc.

Indirect wages are those which cannot be directly linked to the units produced, for example, wages for maintenance works, holding pay, etc.

Indirect expenses are those which cannot be directly linked to the units produced, for example, training expenses, depreciation of plant and machinery, depreciation of factory shed, insurance premium for plant and machinery, factory shed, etc.

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

Practical Questions

1. Mr. Pankaj runs a factory which produces motor spares of export quality. The following details were obtained about his manufacturing expenses for the year ended on 31.3.2022.

			Rs.
W.I.P.	**- Opening**		**3,90,000**
	- Closing		**5,07,000**

Raw Materials	**- Purchases**		**12,10,000**
	- Opening		**3,02,000**
	- Closing		**3,10,000**
	- Returned		**18,000**
	- Indirect material		**16,000**
Wages	**- direct**		**2,10,000**
	- indirect		**48,000**
Direct expenses	**-Royalty on production**		**1,30,000**
		-Repairs and maintenance	**2,30,000**
		-Depreciation on factory shed	**40,000**
		-Depreciation on plant & machinery	**60,000**
By-product at selling price			**20,000**

You are required to prepare Manufacturing Account of Mr. Pankaj for the year ended on 31.3.2022.

Answer.

In the Books of Mr. Pankaj

Manufacturing Account for the year ended on March 31,2022

Particulars		**Amount**	**Particulars**	**Amount**
	Rs.	**Rs.**		**Rs.**
To Opening W.I.P.		3,90,000	By Closing W-I-P	5,07,000
To Raw Material Consumed:			By by products	20,000
Opening inventory	3,02,000		By Trading A/c- Cost of finished	17,81,000

			goods transferred	
Purchases	12,10,000			
	15,12,000			
Less: Return	(18,000)			
	14,94,000			
Less: Closing inventory	(3,10,000)	11,84,000		
To Direct Wages		2,10,000		
To Direct expenses				
Royalty		1,30,000		
To Manufacturing Overhead:				
Indirect Material	16,000			
Indirect Wages	48,000			
Repairs & Maintenance	2,30,000			
Depreciation on Factory Shed	40,000			
Depreciation on Plant & Machinery	60,000	3,94,000		
	23,08,000			**23,08,000**

2. Following are the Manufacturing A/c, Creditors A/c and Trading A/c provided by Ms. Shivi related to 2021-22. There are certain figures missing from these accounts.

Raw Material A/c

Date	Particulars	Amount	Date	Particulars	Amount
	To Opening Stock A/c	**1,00,000**		**By Raw Material Consumed**	**..............**

	To Creditors A/c	....		By Closing Stock A/c	....

Creditors A/c

Date	Particulars	Amount	Date	Particulars	Amount
	To Bank A/c	22,00,000		By Balance b/d	15,00,000
	To Balance c/d	6,00,000			

Manufacturing A/c

Particulars	Amount	Particulars	Amount
To Raw Material consumed	....	By Trading A/c	17,94,000
To Wages	3,50,000		
To Depreciation	2,00,000		
To Direct Expenses	2,44,000		

Additional Information:

1) Purchase of machinery worth Rs.10,00,000 has been omitted. Machinery are chargeable at a depreciation rate of 10%.

2) Wages include the following

Paid to Factory Workers – Rs.3,00,000

Paid to labour at office – Rs. 50,000

3) Direct Expenses include following:

Electricity charges of Rs. 80,000 30% pertained to office.

Fuel Charges of Rs. 20,000

Freight Inwards of Rs.35,000

Delivery charges to customers – Rs. 20,000

You are required to prepare revised Manufacturing A/c, and Raw Material A/c.

Answer.

Manufacturing A/c

Particulars	Amount	Particulars	Amount
To Raw Material Consumed (Balancing Figure)	10,00,000	By Trading A/c (W.N. 4)	18,00,000
To Wages (W.N. 2)	3,00,000		
To Depreciation (W.N.1)	3,00,000		
To Direct Expenses (W.N. 3)	2,00,000		
	18,00,000		**18,00,000**

Raw Material A/c

Date	Particulars	Amount	Date	Particulars	Amount
	To Opening Stock A/c	1,00,000		By Raw Material Consumed (from Trading A/c above)	10,00,000
	To Creditors A/c (W.N. 5)	13,00,000		By Closing Stock A/c (Balancing Figure)	4,00,000
		14,00,000			**14,00,000**

Working Notes:

1) Since purchase of Machinery worth Rs. 10,00,000 has been omitted.

So, depreciation omitted from being charged = Rs. 10,00,000 X 10% = Rs.1,00,000

Correct total depreciation expense = Rs. (2,00,000 + 1,00,000) = Rs. 3,00,000

2) Wages worth Rs. 50,000 will be excluded from manufacturing account as they pertain to office and hence will be charged P&L A/c.

3) Expenses to be excluded from direct expenses:

Office Electricity Charges (80,000 X 30%) 24,000

Delivery Charges to Customers 20,000

Total expenses not part of Direct Expenses 44,000

=> Revised Direct Expenses = Rs. (2,44,000 - 44,000) = Rs.2,00,000

Fuel charges are related to factory expenses and also freight inwards are incurred for bringing goods to factory/ godown so they are part of direct expenses.

Revised Balance to be transferred to Trading A/c:

Particulars	Amount
Current Balance transferred	17,94,000
Add: Depreciation charges not recorded earlier	1,00,000
Less: Wages related to Office	(50,000)
Less: Office Expenses	(44,000)
Revised balance to be transferred	18,00,000

Creditors A/c

Date	Particulars	Amount	Date	Particulars	Amount
	To Bank A/c	22,00,000		By Balance b/d	15,00,000
	To Balance c/d	6,00,000		By Raw Materials A/c (Bal.figure)	13,00,000
		28,00,000			**28,00,000**

3. The following is the trial balance of Mr. Pandit for the year ended 31st March, 2022:

Trial Balance as on 31st March 2022

Particulars	Dr.	Particulars	Cr.
Opening Stock:			

Raw Materials	**1,50,000**	**Sundry Creditors**	**50,000**
Finished goods	**75,000**	**Purchase Returns**	**5,000**
Purchase of Raw Materials	**5,00,000**	**Capital**	**1,00,000**
Land & Building	**1,00,000**	**Bills Payable**	**24,000**
Loose tools	**30,000**	**Long-Term Loan**	**2,00,000**
Plant & Machinery	**30,000**	**Provision for Bad and Doubtful Debts**	**2,000**
Investments	**25,000**	**Sales**	**8,50,000**
Cash in Hand	**20,000**	**Bank Overdraft**	**23,000**
Cash at Bank	**5,000**		
Furniture & Fixtures	**15,000**		
Bills Receivable	**15,000**		
Sundry Debtors	**40,000**		
Drawings	**20,000**		
Salaries	**20,000**		
Coal and Fuel	**15,000**		
Factory rent & rates	**20,000**		
General Expenses	**4,000**		
Advertisement	**5,000**		
Sales Return	**10,000**		
Bad Debts	**4,000**		
Direct Wages (Factory)	**80,000**		
Power	**30,000**		
Interest Paid	**7,000**		
Discount Allowed	**3,000**		
Carriage Inwards	**15,000**		
Carriage Outwards	**7,000**		
Commission Paid	**9,000**		
	12,54,000		**12,54,000**

Additional Information

Stock of finished goods at the end of the year Rs.1,00,000.

A provision for doubtful debts is to be created at 5% on Sundry Debtors. Depreciation on building Rs. 1,000 and Rs. 3,000 on Plant & Machinery to be provided.

Accrued commission of Rs. 12,500 is to be received for the year. Interest has accrued on investment Rs.15,000.

Salary Outstanding Rs. 2,000 and Prepaid Interest Rs.1,500.

You are required to prepare Manufacturing, Trading and Profit and Loss Account for the year ended 31st March, 2022.

Answer.

In the books of Mr. Pandit

Manufacturing Account for the year ended 31st March, 2022

Particulars		Amount	Particulars	Amount
To Opening Stock of Raw Materials		1,50,000	By Cost of Manufactured goods transferred to Trading A/c	8,08,000
To Purchase	5,00,000			
Less: Purchase Return	5,000	4,95,000		
To Carriage Inwards		15,000		
To Direct Wages		80,000		
To Power		30,000		
To Coal and fuel		15,000		
To Factory Rent and Rates		20,000		
To Depreciation on Machinery		3,000		

		8,08,000		**8,08,000**

Trading Account for the year ended 31st March, 2022

Particulars	Amount	Particulars		Amount
To Opening Stock of finished goods	75,000	By Sales	8,50,000	
To Cost of goods transferred from Manufacturing A/c	8,08,000	Less: Sales Return	10,000	8,40,000
To Gross Profit c/d	57,000	By Closing Stock		1,00,000
	9,40,000			**9,40,000**

Profit and Loss Account for the year ended 31st March 2022

Particulars		Amount	Particulars	Amount
To Carriage Outward		7,000	By Gross Profit b/d	57,000
To Discount Allowed		3,000	By Accrued Commission	12,500
To Commission Paid		9,000	By Accrued Interest	15,000
To General Expenses		4,000		
To Advertisement		5,000		
To Salaries	20,000			
Add: Outstanding	2,000	22,000		
To Interest Paid	7,000			
Less: Prepaid	1,500	5,500		
To Provision for Bad & Doubtful Debts	2,000			
Add: Bad Debts	4,000			
Less: Old Provision for	2,000	4,000		

Doubtful Debts				
To Depreciation on Building		1,000		
To Net Profit c/d		24,000		
		84,500		**84,500**

Balance Sheet as at 31st March, 2022

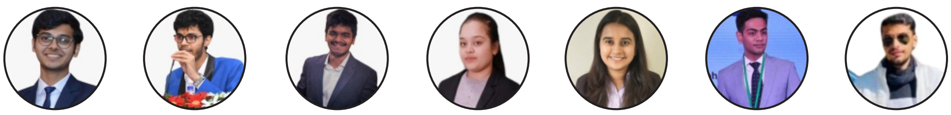
Capital and Liabilities		**Amount**	**Assets**		**Amount**
Capital	1,00,000		Plant & Machinery	30,000	
Add: Net Profit	24,000		Less: Depreciation	3,000	27,000
	1,24,000		Land & Building	1,00,000	
Less: Drawings	20,000	1,04,000	Less: Depreciation	1,000	99,000
Bills Payable		24,000	Furniture & Fixtures		15,000
Sundry Creditors		50,000	Investments		25,000
Salary Outstanding		2,000	Closing Stock		1,00,000
Long-Term Loans		2,00,000	Loose Tools		30,000
Bank Overdraft		23,000	Sundry Debtors	40,000	
			Less: Provision for Bad & Doubtful Debts	2,000	38,000
			Bills Receivable		15,000
			Accrued Commission		12,500
			Accrued Interest		15,000
			Prepaid Interest		1,500
			Cash in Hand		20,000
			Cash at Bank		5,000
		4,03,000			**4,03,000**

NOTES

Practice Notes

Foundation Accounting

Chapter - 8



CH-8

FINANCIAL STATEMENTS OF NOT-FOR-PROFIT ORGANISATIONS

True and False

1. The Receipts and payment account for a non-profit organization follows the accrual concept of accounting.

Ans. False: It depicts the cash system of accounting rather than the accrual system, as the cash receipts and payments pertaining to any year are entered in the Receipts and payments account. The principle of accrual is not followed with regard to the receipts and payments account of a non-profit organization.

2. Both the revenue and capital nature transactions are recorded in the Income and expenditure account.

Ans. False: The income and expenditure account records only the revenue income and expenditure. The capital transactions are being recorded in the Balance sheet.

3. Sale of grass by a sports club is to be treated as sale of an asset.

Ans. False: The grass for a sports club is not a capital item, hence the sale of such grass shall be treated as a revenue receipt.

4. Subscriptions outstanding for the current year are disclosed under the Fixed assets side of the Balance sheet.

Ans. False: They are disclosed under the current assets of the Balance sheet as they will be paid within the next year and not to be treated as non-current assets.

5. Receipts and payments account gives the details about the expenses outstanding for the year.

Ans. False: Receipts and payments account gives information about the expenses paid in cash for the current year, previous or the next year. It is only from the additional information we identify the outstanding expenses.

6. Adjustments in the form of additional information shall be adjusted in the final accounts of a Non- profit organisation only in one place.

Ans. False: Additional information means that information which has been identified just before the preparation of the final accounts. As NPO follows the double entry system of book keeping, there shall be 2 effects for each of the additional information.

7. Tournament expenses incurred are more than the Tournament fund, then the excess to be shown as an asset in the closing Balance sheet.

Ans. False: The excess of expenditure over the tournament fund shall be debited to the income and expenditure account and not taken to the closing balance sheet.

8. For Non-profit organisation, Excess of income over expenditure in the Income and Expenditure account is termed as profit.

Ans. False: The excess of the income over the expenditure is called as Surplus and not profit for an Non-profit organisation.

9. Surplus of non-profit organizations is distributed among its members.

Ans. False: The Non-profit organisation credits the surplus earned in a year to the general fund maintained by it.

10. Tournament fund, building fund, library fund is based on the fund based accounting.

Ans. True: It is Fund based accounting that records the fund balances in the balance sheet.

11. Subscription fees refers to the one-time fees paid by the members to get admission for the benefits of the club.

Ans. False: Subscription is a regular fees paid by the members to keep the membership alive.

12. Token payment made to a person, who voluntarily undertakes a service which would normally be paid in case of profitable organization is termed as Honorarium.

Ans. True: Honorarium refers to the nominal amount paid for the services with a non-commercial intent.

13. An Insurance company is an example of non-profit organization.

Ans. False: Insurance Company has a profit motive; hence it is not a non-profit organization.

14. Part amount of entrance fees which is to be capitalized shall be disclosed in the income and expenditure account.

Ans. False: It shall be shown in the Balance sheet- where it is to be capitalized.

15. Both the income and expenditure of the current and the previous year are recorded in the Income and Expenditure account.

Ans. False: It is only the current year income and expenditure which is recorded in the Income and Expenditure account as per the accrual concept.

16. Amount received as donation by an Non-profit organisation under the will of a deceased person is termed as legacy.

Ans. True: While on the death bed, if there is any will written that the assets of a person

Shall be donated to any NPO- then such a donation to the NPO, is termed as Legacy.

17. Where a Non-profit organisation has a separate trading activity, the profit/loss from the trading account shall be transferred to Income and Expenditure Account at the time of consolidation.

Ans. True: Where in case of the trading activities, the profit /loss from such activity to be transferred to the Income and expenditure account in case of consolidated accounts.

18. Not for profit concerns concentrate their efforts to maximize the profit earning avenues.

Ans. False: The Non-profit organisation has its very existence to serve the members and the society. Profit earning shall never be its motive.

19. All the receipts are of revenue nature in case of Non-profit organisation.

Ans. False: Receipts can be both of revenue as well as capital nature. Receipts of both the nature are recorded in the receipts and payments account.

20. There is opening balance of Income and expenditure account.

Ans. False: It represents a nominal account and is prepared in accordance with the accrual concept, hence there can be no opening balances.

Multiple Choice Questions

1. Scholarship granted to students out of specific funds provided by Government will be debited to

(a) Income and Expenditure Account.

(b) Receipts and payments Account.

(c) Funds granted for Scholarship account.

Ans. (c)

2. In case of NPO, excess of total assets over liabilities is known as

(a) Profits.

(b) Surplus.

(c) Capital Fund.

Ans. (c)

3. General donations and legacies are credited to

(a) Receipts and Payments Account.

(b) Income and Expenditure Account.

(c) Capital Fund.

Ans. (b)

4. Interest on prize funds is

(a) Credited to Income and Expenditure Account.

(b) Credited to Receipts and Payments Account.

(c) Added to prize fund.

Ans. (c)

5. Special aids are

(a) Treated as capital receipts.

(b) Treated as revenue receipts.

(c) Both (a) and (c).

Ans. (c)

6. If there exist a specific sports fund, the expenses incurred in relation to sports activities will be taken to

(a) Income and Expenditure Account

(b) Receipt and Payment Account

(c) Sports fund

Ans. (c)

THEORY QUESTIONS

Ques. Distinguish between Receipt and Payment and Income and Expenditure Account. Distinction between Receipts and Payments Account and Income and Expenditure Account

Ans. Not for profit organizations such as public hospitals, public educational institutions, clubs, Temples, churches etc., conventionally prepare Receipt and Payment Account and Income and Expenditure Account to show periodic performance for a particular accounting period. The distinguishing features of both the accounts can be summarized as: Receipt and Payment 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 cash book. All the receipts and payments whether of revenue or capital nature are included in this account. The receipts and payments pertaining to the current, previous or future periods are also considered here. 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 resembles and is drawn in the same form of a Profit and loss account in case of profit-making organisations. Expenditure of revenue nature is shown on the debit side, income 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 current

Practical Questions

The following is the Receipts and Payments Account of Lion Club for the year ended 31st March, 2022

Receipts	**Rs.**	**Payments**	**Rs.**
Opening balance		Salaries	1,20,000
Cash	10,000	Creditors	15,20,000
Bank	3,850	Printing and stationary	70,000
Subscription received	2,02,750	Postage	40,000
Entrance donation	1,00,000	Telephones and telex	52,000
Interest received	58,000	Repairs and maintenance	48,000
Sale of assets	8,000	Glass and table linen	12,000
Miscellaneous income	9,000	Crockery and cutlery	14,000
Receipts at		Garden upkeep	8,000

Coffee room	10,70,000	Membership fees	4,000
Soft drinks	5,10,000	Insurance	5,000
Swimming pool	80,000	Electricity	28,000
Tennis court	1,02,000	Closing balance:	
		Cash	8,000
		Bank	2,24,600
	21,53,600		**21,53,600**

The assets and liabilities as on 1.4.2021 were as follows:

	Rs.
Fixed assets (net)	5,00,000
Stock	3,80,000
Investment in 12% Government securities	5,00,000
Outstanding subscription	12,000
Prepaid insurance	1,000
Sundry creditors	1,12,000
Subscription received in advance	15,000
Entrance donation received pending membership	1,00,000
Gratuity fund	1,50,000

The following adjustments are to be made while drawing up the accounts:

(i) Subscription received in advance as on 31st March, 2022 was Rs. 18,000.

(ii) Outstanding subscription as on 31st March, 2022 was Rs.7, 000.

(iii) Outstanding expenses are salaries ` 8,000 and electricity Rs. 15,000.

(iv) 50% of the entrance donation was to be capitalized. There was no pending membership as on 31st March, 2022.

(v) The cost of assets sold net as on 1.4.2021 was Rs.10, 000.

(vi) Depreciation is to be provided at the rate of 10% on assets.

(vii) A sum of Rs. 20,000 received in October 2021 as entrance donation from an applicant was to be refunded as he has not fulfilled the requisite membership qualifications. The refund was made on 3.6.2022.

(viii) Purchases made during the year amounted Rs. 15, 00,000.

(ix) The value of closing stock was Rs. 2, 10,000.

(x) The club as a matter of policy, charges off to income and expenditure account all purchases made on account of crockery, cutlery, glass and linen in the year of purchase.

You are required to prepare an Income and Expenditure Account for the year ended 31st March, 2022 and the Balance Sheet as on 31st March, 2022 along with necessary workings.

Ans. Income and Expenditure Account of Lion Club for the year ended 31st March, 2022

Expenditure		Income	

To Salaries	1,28,000	By Subscription	1,94,750
To Printing and stationary	70,000	By Entrance donation	90,000
To Postage	40,000	By Interest	60,000
To Telephone and telex	52,000	By Miscellaneous income	9,000
To Repairs and maintenance	48,000	By Profit from operations	92,000
To Glass and table linen	12,000	By Excess of expenditure over income	
To Crockery and cutlery	14,000	(deficit) transferred to capital fund	30,250
To Garden upkeep	8,000		
To Membership fees	4,000		
To Insurance	6,000		
To Electricity charges	43,000		
To Loss on sale of assets	2,000		
To Depreciation	49,000		
	4,76,000		4,76,000

Balance Sheet of Lion Club as on 31st March, 2022

Capital fund	10,89,600	Fixed assets	4,41,000
Gratuity fund	1,50,000	Stock	2,10,000
Sundry creditors	92,000	Investments	5,00,000
Subscription received in advance	18,000	Subscription outstanding	7,000
Entrance donation refundable	20,000	Interest accrued	2,000
Outstanding expenses	23,000	Bank	2,24,600
		Cash	8,000
	13,92,600		13,92,600

Working Notes:

1. Opening Balance Sheet

Balance Sheet of Lion Club as on 1st April, 2021

Liabilities			
Sundry creditors	**1,12,000**	**Fixed assets**	**5,00,000**
Subscription received in	**15,000**	**Stock**	**3,80,000**

advance			
Entrance donation received in advance	1,00,000	Investments	5,00,000
		Subscription	
Gratuity fund	1,50,000	outstanding	12,000
Capital fund (balance figure)	10,29,850	Prepaid expenses	1,000
		Cash	10,000
		Bank	3,850
	14,06,850		14,06,850

2. **Subscription**

	Rs.
Subscription received during the year	2,02,750
Add: Outstanding subscription on 31.3.2022	7,000
	2,09,750
Add: Received in advance as on 1.4.2021	15,000
	2,24,750
Less: Outstanding subscription as on 1.4.2021	(12,000)
	2,12,750

Less: Received in advance as on 31.3.2022	**(18,000)**
	1,94,750

3. Entrance donation

Entrance donation received during the year	1,00,000
Add: Received in advance as on 1.4.2021	1,00,000
	2,00,000
Less: Entrance donation in respect of ineligible member	(20,000)
	1,80,000
Less: 50% capitalized	(90,000)
Taken to income and expenditure account	90,000

4. Loss on sale of asset

	Rs.
Cost of asset sold	10,000
Less: Sale proceeds	(8,000)
Loss on sale of asset	2,000

5. Depreciation

Fixed asset as per trial balance	5,00,000
Less: Cost of asset sold	(10,000)
	4,90,000
Depreciation on ` 4,90,000 @ 10%	49,000

6. Salaries

	Rs.
Salary paid during the year	1,20,000
Add: Outstanding as on 31.3.2022	8,000
	1,28,000

7. Electricity charges

	Rs.
Electricity charges paid during the year	28,000
Add: Outstanding as on 31.3.2022	15,000
	43,000

8. Interest

	Rs.

Interest on 12% Government securities investment (Rs. 5,00,000 @ 12% p.a.)	60,000
Less: Interest received during the year	(58,000)
Interest accrued	2,000
Interest credited to Income and Expenditure Account	60,000

9. Profit from operations

	Rs.
Cost of goods sold:	
Opening stock	3,80,000
Add: Purchases	15,00,000
	18,80,000
Less: Closing stock	(2,10,000)
Cost of goods sold (A)	16,70,000
Receipts from operations:	
Receipts from coffee room	10,70,000
Receipts from soft drinks	5,10,000
Receipts from swimming pool	80,000

Receipts from tennis court	1,02,000
Total receipts (B)	17,62,000
Profits from operations (B-A)	92,000

10. Insurance

	Rs.
Insurance paid during the year	5,000
Add: Prepaid insurance as on 1.4.2021	1,000
	6,000

11. Sundry creditors

	Rs.
Opening balance as on 1.4.2021	1,12,000
Add: Purchases made during the year	15,00,000
	16,12,000
Less: Payments made during the year	(15,20,000)
Closing balance as on 31.3.2022	92,000

12. Outstanding expenses

	Rs.

Outstanding salaries	8,000
Outstanding electricity charges	15,000
Outstanding expenses	23,000

13. Fixed assets

	Rs.
Fixed assets as on 1.4.2021	5,00,000
Less: Cost of assets sold	(10,000)
	4,90,000
Less: Depreciation	(49,000)
Fixed assets as on 31.3.2022	4,41,000

14. Capital fund

	Rs.
Capital fund as on 1.4.2021	10,29,850
Add: Entrance donation capitalised	90,000
	11,19,850
Less: Excess of expenditure over income	(30,250)
Balance as on 31.3.2022	10,89,600

Ques. 2 During the year ended 31st March, 2022, Sachin Cricket Club received subscriptions as follows:

For year ending 31st March, 2021	**12,000**
For year ending 31st March, 2022	**6,15,000**
For year ending 31st March, 2023 18,000	**18,000**
Total	**6,45,000**

There are 500 members and annual subscription is Rs. 1,500 per member. On 31st March, 2022, a sum of Rs. 15,000 was still in arrears for subscriptions for the year ended 31st March, 2021.

Ascertain the amount of subscriptions that will appear on the credit side of Income and Expenditure Account for the year ended 31st March, 2022. Also show how the items would appear in the Balance Sheet as on 31st March, 2021 and the Balance Sheet as on 31st March, 2022.

Ans. Income & Expenditure Account (An extract) of Sachin Cricket Club for the year ended 31st March, 2022

	Rs.		**Rs.**
		By Subscription **Rs.** (500 members × Rs. 1,500 per member)	7,50,000

Balance Sheet of Sachin Cricket Club as on 31st March, 2021 (An extract)

Liabilities	**Rs.**	**Assets**	**Rs.**
		Subscription	**27,000**

		Receivable (Rs. 15,000 + Rs. 12,000)	

Balance Sheet of Sachin Cricket Club as on 31st March, 2022 (An extract)

Liabilities	**Rs.**	**Assets**	**Rs.**	**Rs.**
Unearned Subscription	**18,000**	**Outstanding Subscription**		
		of 2020-21	15,000	
		of 2021-22 (7,50,000 –6,15,000)	1,35,000	1,50,000

Ques. 3 Summary of receipts and payments of Bombay Medical Aid society for the year ended 31.12.2022 are as follows:

Opening cash balance in hand Rs.8,000, subscription Rs.50,000, donation Rs.15,000 (raised for meeting revenue expenditure), interest on investments @ 9% p.a. Rs. 9000, payments for medicine supply Rs.30,000 Honorarium to doctor Rs. 10,000, salaries Rs. 28,000, sundry expenses Rs. 1,000, equipment purchase Rs. 15,000, charity show expenses Rs.1,500, charity show collections Rs. 12,500.

Additional information:

	1.1.2022	**31.12.2022**
Subscription due	1,500	2,200
Subscription received in	1,200	700

advance		
Stock of medicine	10,000	15,000
Amount due for medicine supply	9,000	13,000
Value of equipment	21,000	30,000
Value of building	50,000	48,000

You are required to prepare receipts and payments account and income and expenditure account for the year ended 31.12.2022 and balance sheet as on 31.12.2022

Ans. Receipts and Payments Account of Bombay Medical Aid Society for the year ended 31st December, 2022

Receipts	Rs.	Payments	Rs.
To Cash in hand (opening)	8,000	By Medicine supply	30,000
To Subscription	50,000	By Honorarium to doctors	10,000
To Donation	15,000	By Salaries	28,000
To Interest on investment	9,000	By Sundry expenses	1,000
To Charity show collections	12,500	By Purchase of equipment	15,000
		By Charity show	1,500

		expenses	
		By Cash in hand (closing)	9,000
	94,500		94,500

Income and Expenditure Account of Bombay Medical Aid Society for the year ended 31st December, 2022

Expenditure		Rs.	Income		Rs.
To Medicine consumed		29,000	By Subscription		51,200
To Honorarium to doctors		10,000	By Donation		15,000
To Salaries		28,000	By Interest on investments		9,000
To Sundry expenses		1,000	By Profit on charity show:		
To Depreciation on			Show collections	12,500	
Equipment	6,000		Less: Show expenses	(1,500)	11,000
Building	2,000	8,000			
To Surplus-excess of income over		10,200			

expenditure					
		86,200			86,200

Balance Sheet of Bombay Medical Aid Society as on 31st December, 2022

Liabilities					
Capital fund:			Building	50,000	
Opening balance	1,80,300		Less: Depreciation	(2,000)	
Add: Surplus	10,200	1,90,500	Equipment	21,000	
Subscription received in advance		700	Add: Purchase	15,000	
Amount due for medicine supply		13,000		36,000	
			Less: Depreciation	(6,000)	
			Stock of medicine		15,000
			Investments		1,00,000
			Subscription receivable		2,200

			Cash in hand		9,000
		2,04,200			2,04,200

Working Notes:

Subscription for the year ended 31st December, 2022:		
Subscription received during the year		50,000
Less: Subscription receivable on 1.1.2022	1,500	
Less: Subscription received in advance on 31.12.2022	700	(2,200)
		47,800
Add: Subscription receivable on 31.12.2022	2,200	
Add: Subscription received in advance on 1.1.2022	1,200	3,400
		51,200
Purchase of medicine:		
Payment for medicine supply		30,000
Less: Amounts due for medicine supply on 1.1.2022		(9,000)
		21,000

Add: Amounts due for medicine supply on 31.12.2022		13,000
		34,000
Medicine consumed:		
Stock of medicine on 1.1.2022		10,000
Add: Purchase of medicine during the year		34,000
		44,000
		(15,000)
		29,000
Depreciation on equipment:		
Value of equipment on 1.1.2022		21,000
Add: Purchase of equipment during the year		15,000
		36,000
Less: Value of equipment on 31.12.2022		(30,000)
Depreciation on equipment for the year		6,000

Balance Sheet of Medical Aid Society as on 1st January, 2022

Liabilities	**Rs.**	**Assets**	Rs.

Capital fund (balancing figure)	1,80,300	Building	50,000
Subscription received in advance	1,200	Equipment	21,000
Amount due for medicine supply	9,000	Stock of medicine	10,000
		Investments (Rs. 9,000 x 100/9)	1,00,000
		Subscription receivable	1,500
		Cash in hand	8,000
	1,90,500		1,90,500

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Foundation Accounting

Chapter - 9

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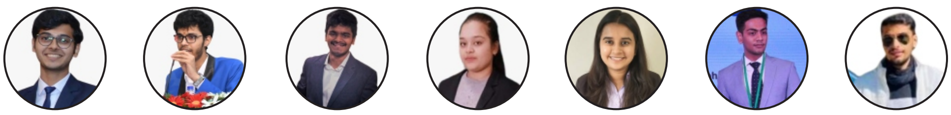

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Ch-9

ACCOUNTS FROM INCOMPLETE RECORDS

True and false

1. A Trial Balance cannot be drawn up from books kept under Single Entry.

Ans. True: Since incomplete records are maintained, trial balance cannot be prepared

2. Nominal Accounts are kept under Single Entry System.

Ans. False: Under the single entry system of bookkeeping, generally cash book and personal accounts of creditors and debtors are maintained, and no other ledger is maintained.

3. Single Entry System can be adopted by small firms.

Ans. True: A single entry system is the one where financial transactions are recorded as a single entry in a log and is usually used by new small businesses

4. Profit under single entry system is always correct and accurate.

Ans. **False:** Profit under single entry system is only an estimate based on available information and correct profits cannot be determined

5. Profits computed under single entry system by different business entities are not comparable.

Ans. True: Since entry system has no fixed set of principles for recording the financial transaction, different organisations maintain records as per their needs. Hence their accounts are not comparable.

Multiple Choice Questions

1. In case of net worth method, profit is determined by

(a) Preparing a trading and profit and loss account.

(b) Comparing the capital in the beginning with the capital at the end of the accounting period.

(c) Comparing the net assets in the beginning with the net assets at the end of the accounting period.

Ans. (b)

2. **Single entry system can be followed by**

(a) Small firms.

(b) Joint stock companies.

(c) Co-operative societies.

Ans. (a)

3. **Closing capital is calculated as**

(a) Opening capital +Additional capital -Drawings.

(b) Opening capital +Additional capital –Drawings + Profit.

(c) Opening capital +Additional capital +Drawings - Profit.

Ans. (b)

4. **Under single entry system, only personal accounts are kept and, in some cases,**

(a) Cash book is maintained

(b) Fixed assets' accounts are maintained

(c) Liabilities' accounts are maintained.

Ans. (a)

5. The closing capital of Mr. B as on 31.3.2022 was Rs.4, 00,000. On 1.4.2021 his capital was Rs.3, 50,000. His net profit for the year ended 31.3.2022 was Rs. 1, 00,000. He introduced Rs. 30,000 as additional capital in February, 2022 Find out the amount drawn by Mr. B for his domestic expenses.

(a) Rs.1, 00,000;

(b) Rs. 80,000;

(c) Rs. 1, 20,000;

Ans. (b)

6. Given information:

Opening capital	60,000
Drawings:	5,000
Capital introduced during the period:	10,000
Closing capital:	90,000

Profit earned during the period ?

(a) Rs. 20,000

(b) Rs. 25,000

(c) Rs. 30,000.

Ans. (b)

Theoretical Questions

Ques: 1 What is meant by Single entry System? What are the types of procedures adopted for this system?

Ans: INTRODUCTION

Many small businesses, like sole proprietorships and partnerships, often neglect double-entry bookkeeping due to reasons such as lack of accounting knowledge or the business's small scale. A grocery vendor or shop owner may only track key transactions like purchases on credit, cash sales, rent/electricity expenses, and customer credit. Incomplete records can result from accidents or unknown figures. Despite the absence of a formal Single-Entry System, this chapter guides on completing accounts using available information. The single-entry system, essentially incomplete records, requires accountants to establish links among cash receipts/payments, personal accounts, and bank statements to determine business profit or financial status.

TYPES OF SINGLE ENTRY SYSTEM

1. Pure Single Entry

- Only personal accounts are maintained.
- Lacks information on cash, bank balances, sales, and purchases.
- Exists on paper but has no practical application.

2. Simple Single Entry

- Maintains personal accounts and a cash book.
- Follows double-entry principles but only posts from the cash book to personal accounts.
- Cash transactions with debtors or creditors are noted on bills.

3. Quasi Single Entry

- Maintains personal accounts, cash book, and some subsidiary books (Sales, Purchases, Bills).

- Discounts are entered into personal accounts.
- Acts as a common substitute for the double-entry system.

Businesses may add subsidiary books like Bills or Sales for tax purposes. For instance, a t-shirt shop issues bills to customers and keeps a purchase book. Additionally, organizations keeping cash wage records obtain worker acknowledgments for payments made.

Ques: 2 Differentiate between Statement of Affairs and Balance Sheet.

Ans:

Feature	**Statement of Affairs**	**Balance Sheet**
Source	Prepared from partially recorded double-entry and single-entry transactions.	Based strictly on double-entry bookkeeping. Can be verified from subsidiary books and evidences.
Capital	Capital is a balancing figure; derived from incomplete records.	Capital is derived from the ledger's capital account, representing the excess of assets over liabilities.
Omission	Difficult to identify and record omitted assets and liabilities from incomplete records.	No possibility of omission; all items properly recorded and easy to locate missing items.
Basis of Valuation	Assets are often valued arbitrarily; no disclosed method of valuation.	Assets are valued on a scientific basis. Fixed assets shown at original cost less depreciation, with any changes disclosed.
Objective	Identify capital figures at the beginning and end of the accounting period.	Ascertain the financial position on a specific date.

Practical Questions

Ques: 1 A Firm sold 20% of the goods on cash basis and the balance on credit basis. Debtors are allowed 1½ month's credit and their balance as on 31.03.2021 is ` 1,25,000. Assume that the sale is uniform throughout the year. Calculate the credit sales and total sales of the company for the year ended 31.03.2022.

Ans. Calculation of Credit Sales and Total sales

Credit Sales for the year ended 2021-22 =Debtors $\times \frac{12\ months}{1.5\ months}$

= Rs. 1, 25,000 $\times \frac{12\ months}{1.5\ months}$

= Rs. 10, 00,000

Total sales for the year ended 2021-22 = Credit sales $\times \frac{100\%}{80\%}$

Rs. 10, 00,000 $\times \frac{100\%}{80\%}$

Rs. 12, 50,000

Ques: 2 Mr. A runs a business of readymade garments. He closes the books of accounts on 31st March. The Balance Sheet as on 31st March, 2021 was as follows:

Liabilities	**Rs.**	**Assets**	**Rs.**
A's capital a/c	4,04,000	Furniture	40,000
Creditors	82,000	Stock	2,80,000
		Debtors	1,00,000

		Cash in hand	28,000
		Cash at bank	38,000
	4,86,000		4,86,000

You are furnished with the following information:

(1) His sales, for the year ended 31st March, 2022 were 20% higher than the sales of previous year, out of which 20% sales was cash sales. Total sales during the year 2020-21 were Rs. 5,00,000.

(2) Payments for all the purchases were made by cheques only.

(3) Goods were sold for cash and credit both. Credit customers pay be cheques only.

(4) Deprecation on furniture is to be charged 10% p.a.

(5) Mr. A sent to the bank the collection of the month at the last date of the each month after paying salary of Rs.2,000 to the clerk, office expenses Rs.1,200 and personal expenses Rs.500.

Analysis of bank pass book for the year ending 31st March 2022 disclosed the following:

	Rs.
Payment to creditors	3,00,000
Payment of rent up to 31st March, 2022	16,000
Cash deposited into the bank during the year	80,000

The following are the balances on 31st March, 2022:

	Rs.

Stock	**1,60,000**
Debtors	**1,20,000**
Creditors for goods	**1,46,000**

On the evening of 31st March 2022, the cashier absconded with the available cash in the cash book.

You are required to prepare Trading and Profit and Loss A/c for the year ended 31st March, 2022 and Balance Sheet as on that date. All the workings should form part of the answer.

Ans: In the books of Mr. A Trading Account for the year ending 31st March, 2022

Particulars	**Rs.**	**Particulars**	**Rs.**
To Opening stock	2,80,000	By Sales (W.N. 3)	
To Purchases (W.N. 1)	3,64,000	Credit 4,80,000	
To Gross profit (b.f.)	1,16,000	Cash 1,20,000	6,00,000
		By Closing stock	1,60,000
	7,60,000		7,60,000

Profit and Loss Account for the year ending 31st March, 2022

Particulars	**Rs.**	**Particulars**	**Rs.**
To Salary (2,000 x 12)	24,000	By Gross profit	1,16,000

To Rent	16,000		
To Office expenses (1,200 x 12)	14,400		
To Loss of cash (W.N. 6)	23,600		
To Depreciation on furniture	4,000		
To Net Profit (b.f.)	34,000		
	1,16,000		**1,16,000**

Working Notes:

Calculation of purchases

Creditors Account

Particulars	Rs.	Particulars	Rs.
To Bank A/c	3,00,000	By Balance b/d	82,000
To Balance c/d	1,46,000	By Purchases (Bal. fig.)	3,64,000
	4,46,000		4,46,000

Calculation of total sales

	Rs.
Sales for the year 2020-21	5,00,000

Add: 20% increase	1,00,000
Total sales for the year 2021-22	6,00,000

Calculation of credit sales

Total sales	6,00,000
Less: Cash sales (20% of total sales)	(1,20,000)
	4,80,000

Calculation of cash collected from debtors

Debtors Account

Particulars	**Rs.**	**Particulars**	**Rs.**
To Balance b/d	1,00,000	By Bank A/c (Bal. fig.)	4,60,000
To Sales A/c	4,80,000	By Balance c/d	1,20,000
	5,80,000		5,80,000

Calculation of closing balance of cash at bank

Bank Account

Particulars	**Rs.**	**Particulars**	**Rs.**
To Balance b/d	38,000	By Creditors A/c	3,00,000

To Debtors A/c	4,60,000	By Rent A/c	16,000
To Cash A/c	80,000	By Balance c/d (b.f.)	2,62,000
	5,78,000		5,78,000

Calculation of the amount of cash defalcated by the cashier

	Rs.	Rs.
Cash balance as on 1st April 2021		28,000
Add: Cash sales during the year		1,20,000
		1,48,000
Less: Salary (Rs. 2,000x12) 24,000	24,000	
Office expenses (Rs. 1,200 x 12)	14,400	
Drawings of A (Rs. 500x12)	6,000	
Cash deposited into bank during the year	80,000	(1,24,400)
Cash balance as on 31st March 2022 (defalcated by the cashier)		23,600

Ques: 3 Ram carried on business as retail merchant. He has not maintained regular account books. However, he always maintained Rs. 10,000 in cash and deposited the balance into the bank account. He informs you that he has sold goods at profit of 25% on sales.

Following information is given to you:

Assets and Liabilities	**As on 1.4.2021**	**As on 31.3.2022**
Cash in Hand	10,000	10,000
Sundry Creditors	40,000	90,000
Cash at Bank	50,000 (Cr.)	80,000 (Dr.)
Sundry Debtors	1,00,000	3,50,000
Stock in Trade	2,80,000	?
Ram's capital	3,00,000	?

Analysis of his bank pass book reveals the following information:

(a) Payment to creditors Rs. 7, 00,000

(b) Payment for business expenses Rs. 1, 20,000

(c) Receipts from debtors Rs. 7, 50,000

(d) Loan Rs.1, 00,000 taken on 1.10.2021 at 10% per annum

(e) Cash deposited in the bank Rs. 1, 00,000

He informs you that he paid creditors for goods Rs. 20,000 in cash and salaries Rs. 40,000 in cash. He has drawn Rs. 80,000 in cash for personal expenses. During the year Ram had not introduced any additional capital. Surplus cash if any, to be taken as cash sales. All purchases are on credit basis.

You are required to prepare Trading and Profit and Loss Account for the year ended 31.3.2022 and Balance Sheet as at 31st March, 2022.

Ans: Trading Account of Ram for the year ended 31st March, 2022

	Rs.		Rs.
To Opening stock	2,80,000	By Sales	
To Purchases	7,70,000	Cash 2,40,000	
To Gross Profit @ 25%	7,70,000	Credit 10,00,000	12,40,000
		By Closing Stock (bal. fig.)	1,20,000
	13,60,000		**13,60,000**

Profit and Loss Account of Ram for the year ended 31st March, 2022

	Rs.		Rs.
To Salaries	40,000	By Gross Profit	3,10,000
To Business expenses	1,20,000		
To Interest on loan (10% of 1,00,000 x 6/12)	5,000		
To Net Profit	1,45,000		
	3,10,000		3,10,000

Balance Sheet of Ram as at 31st March, 2022

Liabilities	Rs.	Rs.	Assets	Rs.
Ram's capital:			Cash in hand	10,000

Opening	3,00,000		Cash at Bank	80,000
Add: Net Profit	1,45,000		Sundry Debtors	3,50,000
	4,45,000		Stock in trade	1,20,000
Less: Drawings	(80,000)	3,65,000		
Loan (including interest due)		1,05,000		
Sundry Creditors		90,000		
		5,60,000		**5,60,000**

Working Notes:

1. Sundry Debtors Account

	Rs.		Rs.
To Balance b/d	1,00,000	By Bank A/c	7,50,000
		By Balance c/d	3,50,000
	11,00,000		11,00,000

2. Sundry Creditors Account

	Rs.		**Rs.**
To Bank A/c	7,00,000	By Balance b/d	40,000
To Cash A/c	20,000	By Purchases (Bal. fig.)	7,70,000
To Balance c/d	90,000		

	8,10,000		**8,10,000**

3. Cash and Bank Account

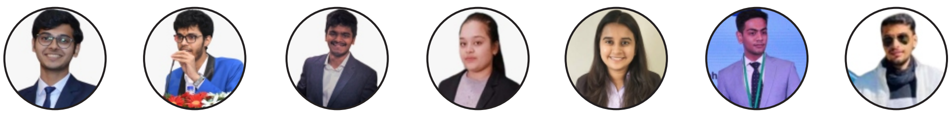
	Cash Rs.	Bank Rs.		Cash Rs.	Bank Rs.
To Balance b/d	10,000		By Balance b/d		50,000
To Sales (bal. fig)	2,40,000		By Bank A/c (C)	1,00,000	
To Cash (C)		1,00,000	By Salaries	40,000	
To Debtors		7,50,000	By Creditors	20,000	7,00,000
To Loan		1,00,000	By Drawings	80,000	
			By Business expenses		1,20,000
			By Balance c/d	10,000	80,000
	2,50,000	9,50,000		2,50,000	9,50,000

NOTES

Practice Notes

Foundation Accounting

Chapter - 10 unit 1



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Ch-10 (Unit-1)

INTRODUCTION TO PARTNERSHIP ACCOUNTS

True and False

1. In absence of any agreement partners share profits of the business in the ratio of their capital contribution.

Ans: False: In absence of any agreement partners share profits equally and not in capital contribution ratio.

2. Profit sharing ratio and capital contribution ratio need not be same.

Ans: True: Profit sharing can be different from the that of the capital introduced by each of the partner. Not necessary that partner contributing more capital should have a higher profit sharing ratio and vice versa.

3. Every partnership firm must register itself with Registrar of firms.

Ans: False: Registration of firms is not compulsory under Indian Partnership Act, 1932.

4. A partner can advance loan to the partnership firm in addition to capital contributed by him.

Ans: True: Where the partnership deed is absent, then the interest shall be paid at 6% per annum. So the interest on the loan to be paid to the partner.

5. A partner can demand interest on capital even if it is not provided in the partnership deed.

Ans: False: Interest on capital can be paid only if it is provided in the partnership deed.

6. If a partner does not take part in day to day business activities of the firm then he is not entitled to any share of profit.

Ans: False: Every partner need not take part in the business. Even if a partner does not take part in the business he is entitled for his share of profit.

7. Interest should be paid @ 6% p.a. on partners' loan even if it is not provided in the partnership deed.

Ans: True: In absence of Partnership deed, Interest at the rate of 6%.p.a is to be allowed on a partner's loan to the firm.

8. Husband and wife cannot be partners in the same firm.

Ans: False: Husband and wife can be partners in the same firm.

9. One senior partner is Principal and other partners are his agents.

Ans: False: There is no senior or junior partner. Every partner is agent/principal of other partners.

10. Partners are the agents of the firm and each other.

Ans: True: Concept of agency applies to every partner and the firm as well. So each partner is a principal to and agent of every other partner and to the firm.

Multiple Choice Questions

1. If a firm prefers Partners' Capital Accounts to be shown at the amount introduced by the partners as capital in firm then entries for salary, interest, drawings, interest on capital and drawings and profits are made in

(a) Trading Account

(b) Profit and Loss Account

(c) Partners' Current Account

Ans: (c)

2. In the absence of any agreement, partners are liable to receive interest on their Loans @

(a) 12% p.a.

(b) 10% p.a.

(c) 6% p.a.

Ans: (c)

3. The relationship between persons who have agreed to share the profit of a business carried on by all or any of them acting for all is known as ....

(a) Partnership.

(b) Joint Venture.

(c) Association of Persons.

Ans: (a)

4. Firm has earned exceptionally high profits from a contract which will not be renewed. In such a case the profit from this contract will not be included in ………

(a) Profit sharing of the partners.

(b) Calculation of the goodwill.

(c) Both.

Ans : (b)

5. In the absence of an agreement, partners are entitled to

(a) Interest on Loan and Advances.

(b) Commission.

(c) Salary.

Ans: (a)

6. Partners are supposed to pay interest on drawings only when ……… by the ………

(a) Provided, Agreement.

(b) Agreed, Partners

(c) Both (a) & (b) above.

Ans: (c)

7. When a partner is given a guarantee by the other partner, loss on such guarantee will be borne by

(a) Partner who gave the guarantee

(b) All the other partners.

(c) Partnership firm.

Ans: (a)

8. A, B and C had capitals of Rs. 50,000; Rs. 40,000 and Rs. 30,000 respectively for carrying on business in partnership. The firm's reported profit for the year was Rs. 80,000. As per provisions of the Indian Partnership Act, 1932, find out the share of each partner in the above amount after taking into account that no interest has been provided on an advance by A of Rs. 20,000, in addition to his capital contribution.

(a) Rs. 26,267 for Partner B and C & Rs. 27,466 for partner A.

(b) Rs. 26,667 each partner.

(c) Rs. 33,333 for A, Rs. 26,667 for B and Rs 20,000 for C.

Ans: (a)

9. X, Y and Z are partners in a firm. At the time of division of profit for the year there was dispute between the partners. Profits before interest on partner's capital was Rs. 6,000 and

X wanted interest on capital @ 20% as his capital contributions was Rs. 1,00,000 as compared to that of Y and Z which was Rs.75,000 and Rs. 50,000 respectively.

(a) Profits of Rs. 6,000 will be distributed equally with no interest on either Capital.

(b) X will get the interest of Rs. 20,000 and the loss of Rs. 14,000 will be shared equally.

(c) All the partners will get interest on capital and the loss of Rs. 39,000 will be shared equally.

Ans: (a)

10. X, Y and Z are partners in a firm. At the time of division of profit for the year there was dispute between the partners. Profits before interest on partner's capital was Rs. 6,000 and Y determined interest @ 24% p.a. on his loan of Rs. 80,000. There was no agreement on this point.

Calculate the amount payable to X, Y and Z respectively.

(a) Rs. 2,000 to each partner.

(b) Loss of Rs. 4,400 for X and Z & Y will take home Rs. 14,800.

(c) Rs. 400 for X, Rs. 5,200 for Y and Rs. 400 for Z.

Ans: (c)

11. X, Y and Z are partners in a firm. At the time of division of profit for the year there was dispute between the partners. Profits before interest on partner's capital was Rs. 6,000 and Z demanded minimum profit of Rs. 5,000 as his financial position was not good. However, there was no written agreement. Profits to be distributed to X, Y and Z will be

(a) Other partners will pay Z the minimum profit and will suffer loss equally.

(b) Other partners will pay Z the minimum profit and will suffer loss in capital ratio.

(c) Rs. 2,000 to each of the partners.

Ans: (c)

Theory questions

Ques:1 Write short notes on:

(a) Features of Partnership

(b) Powers of Partners

Ans: (a) The following four essential features of a partnership, namely:

(i) Partnership is the result of an agreement: It means that the relation of partnership arises from contract and not from status.

(ii) Business: A partnership can exist only in business

(iii) Sharing of profit: The persons concerned must agree to share the profits of the business.

(iv) Mutual agency: It means that the business is to be carried on by all or any of them acting for all. Thus, if the person carrying on the business acts not only for himself but for others also so that they stand in the positions of principals and agents, they are partners.

(b) Powers of partners are the following:

(i) Buying and selling of goods;

(ii) Receiving payments on behalf of the firm and giving valid receipt;

(iii) Drawing cheques and drawing, accepting and endorsing bills of

exchange and promissory notes in the name of the firm;

(iv) Borrowing money on behalf of the firm with or without pledging the inventories-in-trade;

(v) Engaging servants for the business of the firm.

Ques: 2 Distinguish between fixed capital and fluctuating capital.

Ans: In fixed capital method, generally initial capital contributions by the partners are credited to partners' capital accounts and all subsequent transactions and events are dealt with through current accounts, Unless a decision is taken to change it, initial capital account balance is not changed In fluctuating capital method, no current account is maintained. All such transactions and events are passed through capital accounts. Naturally, capital account balance of the partners fluctuates every time. So in fixed capital method a fixed capital balance is maintained over a period of time while in fluctuating capital method capital account balances fluctuate all the time.

Ques: 3 What are the liabilities of designated partners in case of LLP.

Ans: Liabilities of designated partners

As per LLP Act, unless expressly provided otherwise in this Act, a designated partner should be-

(a) responsible for the doing of all acts, matters, and things as are required to be done by the limited liability partnership in respect of compliance of the provisions of this Act including filing of any document, return, statement, and the like report pursuant to the provisions of this Act and as may be specified in the limited liability partnership agreement; and.

(b) liable to all penalties imposed on the limited liability partnership for any contravention of those provisions.

Practical questions

1. Weak, Able and Lazy are in partnership sharing profits and losses in the ratio of 2:1:1. It is agreed that interest on capital will be allowed @ 10% per annum and interest on drawings will be charged @ 8 % per annum. (No interest will be charged/allowed on Current Accounts).

The following are the particulars of the Capital and Drawings Accounts of the partners:

	Weak	**Able**	**Lazy**
	Rs.	**Rs.**	**Rs.**
Capital (1.1.2022)	75,000	40,000	30,000
Current Account (1.1.2022)	10,000	5,000	(Dr.) 5,000
Drawings	15,000	10,000	10,000

The draft accounts for 2022 showed a net profit of Rs. 60,000 before taking into account interest on capitals and drawings and subject to following rectification of errors:

(a) Life Insurance premium of Weak amounting to Rs. 750 paid by the firm on 30th June, 2022 has been charged to Miscellaneous Expenditure A/c.

(b) Repairs of Machinery amounting to Rs. 10,000 has been debited to Plant Account and depreciation thereon charged @ 20%.

(c) Travelling expenses of Rs. 3,000 of Able for a pleasure trip to U.K. paid by the firm on 30th June, 2022 has been debited to Travelling Expenses Account.

You are required to prepare the Profit and Loss Appropriation Account, Current Accounts of partners Weak, Able and Lazy for the year ended 31st December, 2022.

Ans: Weak, Able & Lazy Profit and Loss Appropriation Account for the year ended 31st December, 2022

	Rs.	Rs.		Rs.	Rs.
To Interest on Capital:			By Net Profit (Adjusted)		55,750
Weak	7,500		By Interest on Drawings:		
Able	4,000		Weak	630	
Lazy	3,000	14,500	Able	520	
			Lazy	400	1,550
To Partner's Current A/cs-					
Share of profit :					
Weak	21,400				
Able	10,700				
Lazy	10,700	42,800			
		57,300			**57,300**

Working Notes:

(i) Adjusted Profit

	Rs.	Rs.
Net Profit as per Profit & Loss A/c	60,000	
Add : Drawings by Weak : Life Insurance Premium of Weak charged to Miscellaneous Expenditure A/c of the Firm		
Drawings by Able : Travelling expenses of Able in connection with pleasure trip to U.K. charged	3,000	3,000

to travelling expenses A/c of the firm		
Less: Repairs to Machinery wrongly capitalised	10,000	
Less : Depreciation charged @ 20%	(2,000)	(8,000)
		55,750

Interest on Drawings :

	Weak	**Able**	**Lazy**
	Rs.	**Rs.**	**Rs.**
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

Partners' Current Accounts

	Weak	**Able**	**Lazy**				
	Rs.	**Rs.**	**Rs.**		**Rs.**	**Rs.**	**Rs.**
To Balance b/d	-	-	5,000	By Balance b/d	10,000	5,000	-
To Drawings	15000	10,000	10,000	By Profit &	7,500	4,000	3,000

				Loss App. A/c (Int. on capital)			
To Life Insurance Premium	750	-	-	By Profit & Loss App. A/c(Share of profit)	21,400	10,700	10,700
To Travelling Expenses.	-	3,000	-	By Balance c/d	-	-	1700
To Profit & Loss App. A/c (Int. on drawings)	630	520	400				
To Balance c/d	22,520	6,180	-				
	38,900	**19,700**	**15,400**		**38,900**	**19,700**	**15,400**

2. Ram and Rahim are in partnership sharing profits and losses in the ratio of 3:2. As Ram, on account of his advancing years, feels he cannot work as hard as before, the chief clerk of the firm, Ratan, is admitted as a partner with effect from 1st January, 2022, and

becomes entitled to 1/10th of the net profits and nothing else, the mutual ratio between Ram and Rahim remaining unaltered.

Before becoming a partner, Ratan was getting a salary of Rs.500 p.m. together with a commission of 4% on the net profits after deducting his salary and commission.

It is provided in the partnership deed that the share of Ratan's profits as a partner in excess of the amount to which he would have been entitled if he had continued as the chief clerk, should be taken out of Ram's share of profits.

The net profit for the year ended December 31, 2022 is Rs. 1,10,000. Show the distribution of net profit amongst the partners.

Ans:

Amount due to Ratan as a Chief Clerk

	Rs.
Salary	6,000
Add: Commission 4/104 (Rs.1,10,000 – Rs. 6,000)	4,000
	10,000
Less: Share of Profit as a partner (1/10th of 1,10,000)	(11,000)
Excess chargeable to Ram	(1,000)

Profit and Loss Appropriation Account for the year ended December 31,2022

	Particulars	**Rs.**	**Particulars**	**Rs.**
	Share of Profit A/c By Profit and Loss A/c Ram [3/5 of (Rs. 1,10,000 –Rs. 10,000) – Rs. 1,000]	59,000	By Profit and Loss A/c (Net profit)	1,10,000

	Rahim [2/5 of (Rs. 1,10,000 – Rs. 10,000)]	40,000		
	Ratan [1/10 of Rs. 1,10,000]	11,000		
		1,10,000		1,10,000

3. X and Y are partners. As per terms of agreement interest is allowed on capital at 8% p.a. and charged on drawings at 10% p.a. X withdrew Rs. 40,000 pm at the end of each month and Y withdrew Rs. 120,000 at the end of each quarter. You are required to fill the missing figures in following accounts:

Profit and Loss Appropriation Account for the year ended March 31, 2022

Particulars	**Rs.**	**Particulars**	**Rs.**
To …?		By Profit and Loss A/c (Net profit)	
To Interest on Capital A/c		By Interest on Drawings A/c	
X 160,000		X ?	
Y ?	288,000	Y ?	
To profit transferred to Capital A/c			
X (2/3) ?			
Y (1/3) 280,000	?		

	?		?

Partner's Capital Accounts

Particulars	X	Y	Particulars	X	Y
To ...?	?	?	By ...?	?	?
To ...?	?	?	By Salary A/c	3,60,000	?
To ...?	?	?	By ...?	?	?
			By ...?	?	?
	?	?		?	?

Ans: Profit and Loss Appropriation Account for the year ended March 31, 2022

Particulars	Rs.	Particulars	Rs.
To Salary to X	3,60,000	By Profit and Loss A/c (Net profit)	14,48,000
To Interest on Capital A/c		By Interest on Drawings A/c X 22,000 Y 18,000	40,000
X 1,60,000			

Y 1,28,000	2,88,000		
To profit transferred to Capital A/c			
X (2/3) 5,60,000			
Y (1/3) 2,80,000	8,40,000		
	14,88,000		14,88,000

Partner's Capital Accounts

Particulars	x	y	Particulars	x	y
To Drawing A/c	4,80,000	4,80,000	By Balance b/d	20,00,000	16,00,000
To Interest on on Drawings A/c	22,000	18,000	By Salary A/c	3,60,000	1,28,000
To Balance c/d	25,78,000	15,10,000	By Interest on Capital A/c	1,60,000	
			By Profit and Loss App A/c	5,60,000	2,80,000
	30,80,000	20,08,000		30,80,000	20,08,000

Working Notes:

1. X's Share of Profit 2, 80,000 x 3/1 x 2/3 = 5, 60,000

2. Interest on Drawings

X = 4, 80,000 x 11/2 x 1/12 x 10/100 = 22,000

Y = 4, 80,000 x 9/2 x 1/12 x 10/100 = 18,000

3. Y’s Interest on Capital 2, 88,000 – 1, 60,000 = 128,000

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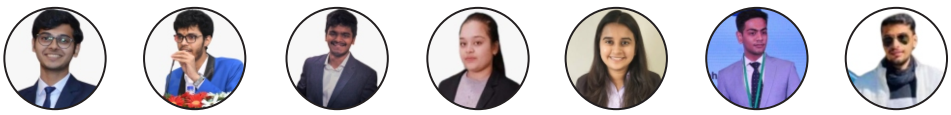
NOTES

Practice Notes

Foundation Accounting

Chapter - 10 unit 2



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CH-10 (Unit-2)

TREATMENT OF GOODWILL IN PARTNERSHIP ACCOUNTS

True and False

1. Goodwill is intangible asset therefore it cannot be valued.

Ans: False: Even though Goodwill is intangible asset it can be valued in terms of money.

2. Goodwill is valued whenever there is change in the profit sharing ratio among then partners.

Ans: True: Goodwill has to be valued every time whenever there is a reconstitution.

3. Goodwill is the value of reputation of a firm in respect of profits expected in future over and above the normal rate of profits.

Ans: True: Goodwill is the brand image the firm has in the market due to which it enjoys an advantageous position over the other players in the market

4. At the time of admission or retirement of a partner, goodwill can be raised in the books of accounts and shown as an asset.

Ans: False: At the time of admission or retirement of a partner, goodwill should not be raised in the books of account of partnership firm because no consideration in money or money worth has been paid for it.

5. Only simple average method can be used for valuation of goodwill.

Ans: False: Weighted average profit method, capitalisation method, super profits methods also can be used for valuation of Goodwill.

6. Super profit means excess of actual average profit over normal profit.

Ans: True: Super profit means excess profit that can be earned by the firm over and above the normal profit usually earned by similar firms under similar circumstances.

7. Normal profit means profit earned by similar companies in the same industry.

Ans: True: The rate of return is considered as an average for the industry, which is applied to the capital employed in the concerned firm.

8. Normal profit depends upon Normal Rate of Return and past profits.

Ans: False: Normal profit depends upon Normal rate of return only and not on past profits.

9. At the time of admission/retirement of a partner, since goodwill cannot be raised in the books of accounts is recorded through capital accounts of the partners.

Ans: True: Generally, the goodwill at the time of admission is adjusted through the capital accounts and not shown in the books of the firm.

10. At the time of admission of a partner, goodwill brought in by the new partner is shared equally by old partners.

Ans: False: Goodwill brought in by new partner is shared by old partners in sacrificing ratio and not equally.

Multiple Choice Questions

1 Goodwill brought in by incoming partner in cash for joining in a partnership firm is taken away by the old partners in their………ratio.

(a) Capital.

(b) New Profit Sharing.

(c) Sacrificing.

Ans: (c)

2. A & B are partners sharing profits and losses in the ratio 5:3. On admission, C brings Rs. 70,000 cash an **(c)** d Rs. 48,000 against goodwill. New profit sharing ratio between A, B and C are 7:5:4. Find the sacrificing ratio of A:B.

(a) 3:1.

(b) 4:7.

(c) 5:4.

Ans: (a)

3. Following are the factors affecting goodwill except:

(a) Nature of business.

(b) Efficiency of management.

(c) Location of the customers.

Ans: (c)

4. Weighted average method of calculating goodwill should be followed when:

(a) Profits has increasing trend.

(b) Profits has decreasing trend.

(c) Either ‘a’ or ‘b’.

Ans: (c)

5. In the absence of any provision in the partnership agreement, profits and losses are shared

(a) In the ratio of capitals.

(b) Equally.

(c) In the ratio of loans given by them to the partnership firm.

Ans: (b)

6. The profits and losses for the last 4 years are 2018-19 Losses Rs. 10,000; 2019-20 Losses Rs. 2,500; 2020-21 Profits Rs. 98,000 & 2021-22 Profits Rs. 76,000. The average capital employed in the business is Rs. 2, 00,000. The rate of interest expected from capital invested is 12%.

The remuneration of partners is estimated to be ` 1,000 per month not charged in the above losses/profits. Calculate the value of goodwill on the basis of two years purchase of super profits based on the average of four years.

(a) Rs. 9,000.

(b) Rs. 8,750.

(c) Rs. 8,250.

Ans: (b)

7. A, B and C are partners sharing profits and losses in the ratio 3:2:1. They decide to change their profit sharing ratio to 2:2:1. To give effect to this new profit sharing ratio they decide to value the goodwill at Rs. 30,000. Pass the necessary journal entry if Goodwill not appearing in the old balance sheet and should not appear in the new balance sheet.

(a) B's Capital Account Dr. Rs. 2,000

C's Capital Account Dr. Rs.1, 000

To A's Capital Account Rs. 3,000

(b) Goodwill Account Dr. Rs. 30,000

To A's Capital Account Rs.15, 000

To B's Capital Account Rs. 10,000

To C's Capital Account Rs. 5,000

(c) A's Capital Account Dr. Rs. 12,000

B's Capital Account Dr. Rs. 12,000

C's Capital Account Dr. Rs 6,000

To Goodwill Account Rs. 30,000

Ans: (b)

Theory questions

1. Write short note on methods for valuation of goodwill.

Ans: There are three methods for valuation of goodwill

(i) Average profit basis - Simple and Weighted

(ii) Super profit basis - Number of Year Purchase, Annuity basis, and Capitalization of Super Profit

(iii) Capitalization basis

2. Explain Accounting treatment of goodwill in case of change in profit sharing ratio.

Ans: In case of change in profit sharing ratio, the value of goodwill should be determined and preferably adjusted through capital accounts of the partners on the basis of profit sacrificing ratio.

3. Distinguish between Super profit basis and Capitalisation Basis.

Ans: Super Profit Basis: In case of average profit basis, goodwill is calculated on the basis of average profit multiplied by certain number of years.

Super Profit=Actual Profit-Normal Profit

Actual Profit is average profit and Normal Profit = Normal rate of Return (NRR)

Capitalization Basis: Under this basis, value of whole business is determined applying normal rate of return. If such value (arrived at by applying normal rate of return) is higher than the capital employed in the business, then the difference is goodwill.

Practical questions

1. Wise, Clever and Dull were trading in partnership sharing profits and losses 4:3:3 respectively. The accounts of the firm are made upto 31st December every year.

The partnership provided, interalia, that:

On the death of a partner the goodwill was to be valued at three years' purchase of average profits of the three years upto the date of the death after deducting interest @8 percent on capital employed and a fair remuneration of each partner. The profits are assumed to be earned evenly throughout the year.

On 30th June, 2022, Wise died and it was agreed on his death to adjust goodwill in the capital accounts without showing any amount of goodwill in the Balance Sheet.

It was agreed for the purpose of valuation of goodwill that the fair remuneration for work done by each partner would be Rs. 15,000 per annum and that the capital employed would be Rs. 1, 56,000. Clever and Dull were to continue the partnership, sharing profits and losses equally after the death of Wise.

The following were the amounts of profits of earlier years before charging interest on capital employed.

	Rs.
2019	67,200
2020	75,600
2021	72,000
2022	62,400

You are required to compute the value of goodwill and show the adjustment there of in the books of the firm.

Ans: Computation of the value of goodwill:

	Average Profit for three years, ending 30th June; before death:		
	Year ending 30th June, 2020:	**Rs.**	**Rs.**
	1/2 of 2019 profits	33,600	

	1/2 of 2020 Profits	37,800	71,400
	Year ending 30th June, 2021:		
	1/2 of 2020	37,800	
	1/2 of 2021 Profits	36,000	73,800
	Year ending 30th June, 2022:		
	1/2 of 2021	36,000	
	1/2 of 2022 Profits	31,200	67,200
	Total		2,12,400
	Average Profits Alternatively it can be calculated as below : 1/2 profit of 2019 + profit of 2020 + profit of 2021 + profit of 2022 = $\frac{33,600+75,600+72,000+31,200}{3}$ = 70,800		70,800
	Average future maintainable profit :		
	Average profits earned		70,800
	Less : Partner's remuneration	45,000	
	Less: 8% on capital employed	12,480	(57,480)
			13,320
(iii)	Goodwill of the firm @ three years' purchase		39,960

(iv)	Wise's share of Goodwill = 4/10 of 39,960 =15,984		

Adjustment entry for Goodwill

Journal Entry

	Dr. Rs.	**Cr. Rs.**
Clever's Capital Account Dr.	7,992	
Dull's Capital Account Dr.	7,992	
To Wise's Capital Account		15,984
(Adjusting entry passed for share of goodwill of Wise through remaining partners' capital accounts in gaining ratio)		

Working Note:

Partner	**New Share**	**Old Share**	**Difference**
Wise	-	4/10	4/10
Clever	1/2	3/10	2/10
Dull	1/2	3/10	2/10

NOTES

Practice Notes

Foundation Accounting

Chapter - 10 unit 3

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CH-10 (unit-3)

ADMISSION OF A NEW PARTNER

1. A newly admitted partner does not have same rights as old partners.

Ans: False: All the partners have same rights at all times, unless contrary is provided in the partnership deed/or agreed by the partners.

2. When a new partner is admitted, old partners have to forego certain share in profits of the firm, this is called as sacrifice ratio.

Ans: True: With every new partner, remaining old partners have to foregone a proportion in their share which is called as sacrificing ratio.

3. Revaluation account is also called as Profit and Loss Adjustment Account.

Ans: True: Revaluation is also called as profit and loss adjustment account.

4. Any appreciation in the value of an asset is credited to Revaluation account.

Ans: True: Increase in asset is an income hence credited to revaluation account.

5. All the partners may decide not to change the values of assets and liabilities in the books of accounts.

Ans: True: This can be done by opening Memorandum Revaluation Account.

6. **New partner is entitled to have share in reserves appearing in the balance sheet prior to his admission.**

Ans: False: New partner is not entitled to have any share in the reserves of the firm prior to his admission. Such reserves are distributed to old partners in their old profit sharing ratio.

7. If revaluation account shows credit balance then it represents profit and therefore it is credited to all partners equally.

Ans: False: If revaluation account shows credit balance then it represents profit and therefore it is credited to all partners in their profit sharing ratio and not equally.

8. New partner brings necessary amount as his capital.

Ans: True: Every incoming partner shall bring in some amount of capital for the firm.

9. New partner is entitled to share in revaluation profit.

Ans: False: New partner is not entitled to profit on revaluation, it belongs to old partners in their old profit sharing ratio.

Multiple Choice Questions

1. A and B are partners sharing profits and losses in the ratio 5:3. They admitted C and agreed to give him 3/10th of the profit. What is the new ratio after C's admission?

(a) 35:42:17.

(b) 35:21:24.

(c) 49:22:29.

Ans. (b)

2. **A and B are partners sharing profits in the ratio 5:3, they admitted C giving him 3/10th share of profit. If C acquires 1/5 from A and 1/10 from B, new profit sharing ratio will be:**

(a) 5:6:3.

(b) 2:4:6.

(c) 17:11:12

Ans: (c)

3. C was admitted in a firm with 1/4th share of the profits of the firm. C contributes Rs. 15,000 as his capital, A and B are other partners with the profit sharing ratio as 3:2. Find the required capital of A and B, if capital should be in profit sharing ratio taking C's as base capital:

(a) Rs. 27,000 and Rs. 16,000 for A and B respectively.

(b) Rs. 27,000 and Rs.18,000 for A and B respectively.

(c) Rs. 32,000 and Rs. 21,000 for A and B respectively.

Ans. (b)

4. A, B and C are partners sharing profits and losses in the ratio 6:3:3, they agreed to take into partnership for 1/8th share of profits. Find the new profit sharing ratio.

(a) 12:27:36:42.

(b) 14:7:7:4.

(c) 1:2:3:4.

Ans: (b)

5. A and B are partners sharing profits and losses in the ratio of 3:2 (A's Capital is Rs.30,000 and B's Capital is Rs.15,000). They admitted C and agreed to give 1/5th share of profits to him. How much C should bring in towards his capital?

(a) Rs.9,000.

(b) Rs.12, 000.

(c) Rs. 11,250.

Ans. (c)

6. A and B are partners sharing the profit in the ratio of 3:2. They take C as the new partner, who brings in Rs. 25,000 against capital and Rs. 10,000 against goodwill. New profit sharing ratio is 1:1:1. In what ratio will this amount will be shared among the old partners A & B.

(a) Rs. 8,000: 2,000.

(b) Rs. 5,000: Rs. 5,000.

(c) Old partners will not get any share in the goodwill brought in by C.

Ans: (a)

7. A and B are partners sharing the profit in the ratio of 3:2. They take C as the new partner, who is supposed to bring Rs.25,000 against capital and Rs.10,000 against goodwill. New profit sharing ratio is 1:1:1. C brought cash for his share of Capital and

agreed to compensate to A and B outside the firm. How this will be treated in the books of the firm.

(a) Cash brought in by C will only be credited to his capital account.

(b) Goodwill will be raised to full value in old ratio.

(c) Goodwill will be raised to full value in new ratio.

Ans: (a)

8. X and Y are partners sharing profits in the ratio of 3: 1. They admit Z as a partner who pays Rs. 4,000 as Goodwill the new profit sharing ratio being 2:1: 1 among X, Y and respectively. The amount of goodwill will be credited to:

(a) X and Y as Rs. 3,000 and Rs. 1,000 respectively.

(b) X only

(c) Y only.

Ans. (b)

9. P and Q are partners sharing Profits in the ratio of 2:1. R is admitted to the partnership with effect from 1st April on the term that he will bring Rs. 20,000 as his capital for 1/4th share and pays Rs. 9,000 for goodwill, half of which is to be withdrawn by P and Q. If profit on revaluation is Rs. 6,000 and opening capital of P is Rs. 40,000 and of Q is ` 30,000, find the closing balance of each capital.

(a) Rs. 47,000: Rs. 33,500: Rs. 20,000

(b) Rs. 50,000: Rs. 35,000: Rs.20,000.

(c) Rs. 40,000: Rs. 30,000: Rs. 20,000

Ans. (a)

10. Adam, Brain and Chris were equal partners of a firm with goodwill Rs. 1,20,000 shown in the balance sheet and they agreed to take Daniel as an equal partner on the term that he should bring Rs. 1,60,000 as his capital and goodwill, his share of goodwill was evaluated at ` 60,000 and the goodwill account is to be written off before admission.

What will be the treatment for goodwill?

(a) Write off the goodwill of Rs. 1,20,000 in old ratio.

(b) Cash brought in by Daniel for goodwill will be distributed among old partners in sacrificing ratio.

(c) Both (a) & (b)

Ans: (c)

Theory Questions

1. Write short note on Revaluation account.

Ans: When a new partner is admitted into the partnership, assets are revalued and liabilities are reassessed. A Revaluation Account (or Profit and Loss Adjustment Account) is opened for the purpose. This account is debited with all reduction in the value of assets and increase in liabilities and credited with increase in the value of assets and decrease in the value of liabilities. The difference in two sides of the account will show profit or loss. This is transferred to the Capital Accounts of old partners in the old profit sharing ratio.

2. What is the difference between revaluation account and memorandum revaluation account?

Ans: Difference between revaluation account and memorandum revaluation account

(i) Revaluation account is prepared to find out the profit or loss on revaluation of assets and liabilities which appear in the new balance sheet at the new or revalued figures. Memorandum revaluation account is also prepared to record the effect of revaluation of assets and liabilities which of course are recorded at their old figures in the new balance sheet.

(ii) Revaluation account is not divided into two parts. But the memorandum revaluation account has two parts: first part for old partners and second part for all partners including the new partner.

Practical Questions

1. The following was the balance sheet of A, B and C who were equal partners on January 1, 2022

Liabilities	**Rs.**	**Assets**	**Rs.**
Bills Payable	3,000	Cash	1,000
Creditors	6,000	*Debtors*	10,000
Capital Accounts :		Stock	12,000
A	20,000	Furniture	5,000
B	15,000	Buildings	25,000
C	10,000	Bills Receivable	1,000

	54,000		**54,000**

They agree to take D into partnership and give him a 1/4 share in the profits on the following terms:

(1) D should bring in Rs. 6,000 for goodwill and Rs.10, 000 as capital;

(2) One-half of the goodwill shall be withdrawn by old partners;

(3) Stock and furniture be depreciated by 10%.

(4) A liability of` 1,300 be created against bills discounted;

(5) The building be valued at Rs. 40,000;

(6) The values of liabilities and assets other than cash are not to be altered.

Give the necessary entries to give effect to the above arrangement; prepare revaluation account and opening balance sheet of the firm as newly constituted.

Ans:

		Rs.	Rs.
Cash Account	Dr.	16,000	
To D's Capital Account			16,000
(Amount of goodwill and capital brought in by D)			
D's Capital Account	Dr.	6,000	
To A's Capital Account			2,000
To B's Capital Account			2,000
To C's Capital Account			2,000

(Goodwill brought in by D credited to old partners in sacrifice ratio)			
A's Capital Account	Dr.	1,000	
B's Capital Account	Dr.	1,000	
C's Capital Account	Dr.	1,000	
To Cash Account			3,000
(Half the amount of goodwill withdrawn by existing partners)			
Memorandum Revaluation Account	Dr.	12,000	
To A's Capital Account			4,000
To B's Capital Account			4,000
To C's Capital Account			4,000
(Profit on revaluation credited to old partners)			
A's Capital Account	Dr.	3,000	
B's Capital Account	Dr.	3,000	
C's Capital Account	Dr.	3,000	
D's Capital Account	Dr.	3,000	
To Memorandum			12,000

Revaluation Account			
(The profit credited previously to old partners written off to all partners including D in the new profit sharing ratio)			

Memorandum Revaluation Account

Stock	1200	Buildings	15,000
Furniture	500		
Liability for bills discounted	1300		
Profit transferred to capital accounts:			
A 4,000			
B 4,000			
C 4,000			
Buildings	15,000		15,000
		Stock	1,200
		Furniture	500

		Liability for bills discounted	1,300
		Loss transferred to capital accounts:	
		A	3,000
		B	3,000
		C	3,000
		D	3,000
	15,000		**15,000**

Balance Sheet of M/s. A, B, C and D

As on 1st January, 2022

Liabilities		**Rs.**	**Assets**	**Rs.**
Bills Payable		3,000	Cash	14,000
Creditors		6,000	Debtors	10,000
Capital Accounts:			Stock	12,000
A	22,000		Furniture	5,000
B	17,000		Buildings	25,000
C	12,000		Bills Receivable	1,000
D	7,000	58,000		

		67,000		**67,000**

2. Gopal and Govind are partners sharing profits and losses in the ratio 60:40. The firms' balance sheet as on 31.03.2022 was as follows:

Liabilities			
Capital accounts:		Fixed assets	3,00,000
Gopal	1,20,000	Investments	50,000
Govind	*80,000*	Current assets	2,00,000
Long term loan	2,00,000	Loans and advances	1,00,000
Current liabilities	2,50,000		
	6,50,000		6,50,000

Due to financial difficulties, they have decided to admit Guru as partner in the firm from 01.04.2022 on the following terms

Guru will be paid 40% of the profits.

Guru will bring in cash Rs. 1, 00,000 as capital. It is agreed that goodwill of the firm will be valued at 2 years' purchase of 3 years' normal average profits of the firm and Guru will bring in cash his share of goodwill. It was also decided that the partners will not withdraw their share of goodwill nor will the goodwill appear in the books of account.

The profits of the previous three years were as follows:

For the year ended 31.3.2020: profit Rs. 20,000 (includes insurance claim received of Rs. 40,000).

For the year ended 31.3.2021: loss Rs. 80,000 (includes voluntary retirement compensation paid Rs. 1, 10,000).

For the year ended 31.3.2022: profit of Rs. 1,05,000 (includes a profit of Rs. 25,000 on the sale of assets).

It was decided to revalue the assets on 31.03.2022 as follows:

Fixed assets (net)	4,00,000
Investments	Nil
Current assets	1,80,000
Loans and advances	1,00,000

The new profit sharing ratio after the admission of Guru was 35:25:40. Pass journal entries on admission, show goodwill calculation and prepare revaluation account, partners' capital accounts and balance sheet as on 01.04.2022 after the admission of Guru.

Ans: Calculation of Profit/ Loss for the year ended

	31.3.2020	**31.3.2021**	**31.3.2022**
Profit/(loss) for the year	20,000	(80,000)	1,05,000
Add/(less): Abnormal items	(40,000)	1,10,000	(25,000)
Net Profit/(loss)	(20,000)	30,000	80,000

Average profit=$\frac{(20,000)+30,000+80,000}{3}$ = Rs. 30,000

Two years' purchase of average profits= 30,000 x 2= Rs.60, 000

Goodwill to be brought in by Guru=Rs. 60,000 x 40%=Rs. 24,000

Goodwill brought in by Guru shared (at the profit sacrificing ratio) by:

	Rs.
Gopal (Rs. 24,000 x 5/8)	15,000
Govind (Rs. 24,000 x 3/8)	9,000
	24,000

Date	Particulars	Dr.	Cr.
1.4.2022	Bank A/c	1,24,000	
	To Guru's capital A/c		1,24,000
	(Amount of capital and goodwill brought in by Guru)		
1.4.2022	Guru's capital A/c	24,000	
	To Gopal's capital A/c		15,000
	To Govind's capital A/c		9,000
	(Amount of goodwill brought in by Guru credited to capital accounts of the old partners in the profit sacrificing ratio 5:3)		
1.4.2022	Revaluation A/c	70,000	
	To Investment A/c		50,000

	To Current assets A/c		20,000
	(Writing down the value of investments to nil and current assets from Rs. 2,00,000 to Rs. 1,80,000 on the occasion of admission of Guru)		
1.4.2022	Fixed assets A/c	1,00,000	
	To Revaluation A/c		1,00,000
	(Writing up the value of fixed assets from Rs. 3, 00,000 to Rs. 4,00,000 on the occasion of admission of Guru)		
1.4.2022	Revaluation A/c	30,000	
	To Guru's capital A/c		18,000
	To Govind's capital A/c		12,000
	(Net revaluation profit credited to the capital accounts of the old partner in the old profit sharing ratio of 60:40)		

Revaluation Account

	Rs.		Rs.
To Investments A/c	50,000	By Fixed assets A/c	1,00,000
To Current assets A/c	20,000		

To Partner's capital A/c:			
(Profit on revaluation)			
Gopal (60%)	18,000		
Govind (40%)	12,000		
	1,00,000		1,00,000

Partner's Capital Accounts:

Gopal's Capital Account

Particulars	**Rs.**	**Particulars**	**Rs.**
To Balance c/d	1,53,000	To Balance c/d	1,20,000
		By Bank A/c	15,000
		By Revaluation A/c	18,000
	1,53,000		1,53,000

Govind's Capital Account

Particulars	**Rs.**	**Particulars**	**Rs.**
To Balance c/d	1,01,000	By Balance b/d	80,000
		By Bank A/c	9,000
		By Revaluation A/c	12,000
	1,01,000		**1,01,000**

Guru's Capital Account

Particulars	Rs.	Particulars	Rs.
To Balance c/d	1,00,000	By Bank b/d	1,00,000
	1,00,000		**1,00,000**

Balance Sheet (after admission of Guru) as on 1st April, 2022

Liabilities		Rs.		Rs.
Capital accounts:			Fixed assets	4,00,000
Gopal	1,53,000		Current assets	3,04,000
Govind	1,01,000	3,54,000	(including bank balance of Rs.1,24,000)	
Guru	1,00,000	2,00,000	Loans & advances	1,00,000
		2,50,000		
		8,04,000		8,04,000

Working Notes:

1. Calculation of profit sacrificing ratio

Profit sacrificed by Gopal=60%-35%=25%

Profit sacrificed by Govind =40%-25%=15%

Sacrificing ratio =25%: 15% or 5:3

2. Bank balance after admission of Guru

Bank Account

Particulars	Rs.	Particulars	Rs.
To Guru's capital A/c	1,24,000	By Balance c/d	1,24,000

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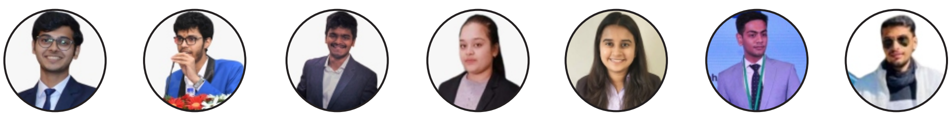

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Ch-10 unit-4

RETIREMENT OF A PARTNER

1. Business of a partnership has to be closed if any one of the partners retires.

Ans: False: Business of a partnership is not closed if any one of the partners retires, remaining partners continue to carry on the business.

2. At the time of retirement of a partner no special treatment is required for any reserves appearing in the Balance Sheet.

Ans: False: At the time of retirement of a partner all the reserves appearing in the balance sheet are transferred to all the partners in their old profit sharing ratio.

3. After retirement of a partner, profit sharing ratio of continuing partners remains the same.

Ans: False: After retirement of a partner, profit sharing ratio of continuing partners does not remain the same.

4. If any partner wants to retire from the business, he must retire on 1st day of the accounting year.

Ans: False: A partner can retire on any day as per his own wish.

5. Retiring partner has to forego his share of goodwill in the firm.

Ans: False: Retiring partner is entitled to his share of goodwill in the firm.

6. If a partner retires in between the accounting year then he is not entitled to any profit from the date of beginning of the year till his date of retirement.

Ans: False: If a partner retires in between the accounting year then he is certainly entitled to the profit from the date of beginning of the year till his date of retirement.

7. **If the firm has taken any joint life policy then it is to be surrendered at the time of retirement of a partner.**

Ans: True: The firm is eligible for the surrender value on the Joint Life Policy taken on the partners at the time of their retirement

8. Any joint life policy reserve appearing in the Balance Sheet is credited to all the partners in their old profit sharing ratio.

Ans: True: As per the surrender policy method, the JLP reserve is distributed to the partners in their profit sharing ratio through capital account.

9. No revaluation account is necessary on retirement of a partner.

Ans: False: Revaluation account is necessary on retirement of a partner.

10. Profit on revaluation is credited to continuing partners, retiring partner is not entitled to any profit on revaluation.

Ans: False: Profit on revaluation is credited to all the partners in their profit sharing ratio.

Multiple Choice Questions

1. **C, D and E are partners sharing profits and losses in the proportion of 1/2, 1/3 and 1/6. D retired and the new profit sharing ratio between C and E is 3:2 and the Reserve of Rs. 12,000 is divided among the partners in the ratio:**

(a) Rs. 2,000: Rs. 4,000: Rs. 6,000.

(b) Rs.5, 000: Rs. 5,000: Rs. 2,000.

(c) Rs.6, 000: Rs.4, 000: Rs.2, 000.

Ans: (c)

2. **A, B and C takes a Joint Life Policy, after five years B retires from the firm. Old profit sharing ratio is 2:2:1. After retirement, A and C decides to share profits equally. They had taken a Joint Life Policy of Rs. 2, 50,000 with the surrender value Rs. 50,000. What will be the treatment in the partner's capital account on receiving the JLP amount if joint life policy premium is fully charged to revenue as and when paid?**

(a) Rs. 50,000 credited to all the partners in old ratio.

(b) Rs. 2, 50,000 credited to all the partners in old ratio.

(c) Rs. 2, 00,000 credited to all the partners in old ratio.

Ans: (a)

3. **A, B and C take a Joint Life Policy, after five years, B retires from the firm. Old profit sharing ratio is 2:2:1. After retirement A and C decides to share profits equally. They had taken a Joint Life Policy of Rs. 2, 50,000 with the surrender value Rs. 50,000. What will be**

the treatment in the partner's capital account on receiving the JLP amount if joint life policy is maintained at the surrender value?

(a) Rs. 50,000 credited to all the partners in old ratio.

(b) Rs. 2, 50,000 credited to all the partners in old ratio.

(c) No treatment is required.

Ans: (c)

4. **A, B and C are partners sharing profits in the ratio 2:2:1. On retirement of B, goodwill was valued as Rs.30, 000. Find the contribution of A and C to compensate B.**

(a) Rs. 20,000 and Rs. 10,000.

(b) Rs. 8,000 and Rs. 4,000.

(c) They will not contribute anything.

Ans: (b)

5. **A, B and C were partners in a firm sharing profits and losses in the ratio of 2:2:1 respectively with the capital balance of Rs.50, 000 for A and B, for C Rs.25, 000. B declared to retire from the firm and balance in reserve on the date was Rs.15, 000. If goodwill of the firm was valued as Rs.30, 000 and profit on revaluation was Rs. 7,050 then what amount will be transferred to the loan account of B.**

(a) Rs.70, 820.

(b) Rs.50, 820.

(c) Rs.25, 820.

Ans: (a)

6. **A, B and C are partners sharing profits and losses in the ratio of 3:2:1. C retires on a decided date and Goodwill of the firm is to be valued at Rs. 60,000. Find the amount payable to retiring partner on account of goodwill.**

(a) Rs. 30,000.

(b) Rs. 20,000.

(c) Rs. 10,000.

Ans: (c)

7. **A, B and C were partners sharing profits and losses in the ratio of 3:2:1. A retired and Goodwill of the firm is to be valued at Rs.24, 000. What will be the treatment for goodwill?**

(a) Credited to Revaluation Account at Rs. 24,000.

(b) Adjusted through partners' capital accounts in gaining/sacrificing ratio.

(c) Only A's capital account credited with Rs.12, 000.

Ans: (b)

8. **Balances of A, B and C sharing profits and losses in proportionate to their capitals, stood as A – Rs. 2,00,000; B – Rs.3,00,000 and C – Rs.2,00,000. A desired to retire from the firm, B and C share the future profits equally, Goodwill of the entire firm be valued at Rs.1, 40,000 and no Goodwill account being raised.**

(a) Credit Partner's Capital Account with old profit sharing ratio for Rs.1, 40,000.

(b) Credit Partner's Capital Account with new profit sharing ratio for Rs.1, 40,000.

(c) Credit A's Account with Rs.40, 000 and debit B's Capital Account with Rs. 10,000 and C's Capital Account with Rs. 30,000.

Ans: c

Theoretical questions

1. Write short notes on:

(i) Calculation of gaining ratio.

(ii) Final payment of a retiring partner.

Ans: (a) On retirement of a partner, the continuing partners will gain in terms of profit sharing ratio. For example, if A, B and C were sharing profits and losses in the ratio of 5:3: 2 and B retires, then A and C have to decide at which ratio they will share profits and losses in future. If it is decided that the continuing partners will share profits and losses in future at the ratio of 3:2, then A gains 1/10th [(3/5)-(5/10)] and C gains 2/10 [(2/5)-(2/10)]. So the gaining ratio between A and C is 1:2. If A and C decide to continue at the ratio 5:2, this indicates that they are dividing the gained share in the previous profit sharing ratio.

(b) The following adjustments are necessary in the Capital A/c: (i) Transfer of reserve, (ii) Transfer of goodwill, (iii) Transfer of profit/loss on revaluation. After adjustment of these items, the Capital Account balance standing to the credit of the retiring partner represents amount to be paid to him. The continuing partners may discharge the whole claim at the time of retirement.

2. What is joint life policy? What is the objective of taking such a policy?

Ans: A partnership firm may decide to take a Joint Life Insurance Policy on the lives of all partners. The firm pays the premium and the amount of policy is payable to the firm on the death of any partner or on the maturity of policy whichever is earlier. The objective of taking such a policy is to minimize the financial hardships to the event of payment of a large sum to the legal representatives of a deceased partner or to the retiring partner.

Practical questions

1. On 31st March, 2022, the balance sheet of M/s Ram, Rahul and Rohit sharing profits and losses in proportion to their capital, stood as follows:

Liabilities	Rs.	Rs.	Asset	Rs.
Capital accounts			Land & building	2,00,000
Ram	3,00,000		Machinery	2,00,000
Rahul	2,00,000		Closing stock	1,00,000
Rohit	1,00,000	6,00,000	Sundry debtors	2,00,000
Sundry creditors		2,00,000	Cash and bank balances	1,00,000
		8,00,000		**8,00,000**

On 31st March, 2022, Ram desired to retire from the firm and the remaining partners decided to carry on. It was agreed to revalue the assets and liabilities on that date on the following basis:-

1. Land and buildings be appreciated by 30%.

2. Machinery be depreciated by 20%.

3. Closing stock to be valued at Rs.80, 000.

4. Provision for bad debts be made at 5%.

5. Old credit balances of sundry creditors Rs.10, 000 be written off.

6. Joint life policy of the partners surrendered and cash obtained Rs.60, 000.

7. Goodwill of the entire firm be valued at Rs.1, 80,000 and Ram's share of the goodwill be adjusted in the accounts of Rahul and Rohit 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 Ram is to be settled as 50% on retirement and the balance 50% within one year.

Prepare revaluation account, capital account of partners: Rahul & Rohit, loan account of Ram, cash account and balance sheet as on 1.4.2022 of M/s Rahul and Rohit.

Ans:

Revaluation Account

	Rs.		**Rs.**
To Machinery A/c	40,000	By Land and Buildings A/c	60,000
To Closing Stock A/c	20,000	By Sundry Creditors A/c	10,000
To Provision for Bad Debts A/c	10,000	By Cash and Bank A/c– Joint Life policy	60,000

		surrendered	
To Partners' Capital A/cs:			
Ram 30,000			
Rahul 20,000			
Rohit 10,000	60,000		
	1,30,000		1,30,000

Partners' Capital Accounts

			Rahul	Rohit				Rahul	Rohit
			Rs.	Rs.				Rs.	Rs.
31.3.2022	To	Ram's Capital A/c	30,000	60,000	31-3-2022	By	Balance b/d	2,00,000	1,00,000
	To	Balance c/d	3,00,000	3,00,000		By	Revaluation A/c	20,000	10,000
						By	Cash & bank A/c – cash brought in by Rahul and	1,10,000	2,50,000

							Rohit		
						By	Balance b/d	3,30,000	3,60,000
			3,30,000	3,60,000	1-4-2022			3,00,000	3,00,000

Ram's Loan Account

		Rs.			Rs.
31-3-2022	To Balance c/d	2,10,000	31-3-2022	By Ram's Capital A/c	2,10,000
		2,10,000			2,10,000
			1-4-2022	By Balance b/d	2,10,000

Cash and Bank Account

		Rs.			Rs.
31-3 2022	To Balance b/d	1,00,000	31-3-2022	By Ram's capital A/c	2,10,000
	To Revaluation A/c joint life policy surrendered	60,000		By Balance c/d	3,10,000

	To Rahul's Capital A/c	1,10,000			
	To Rohit's Capital A/c	2,50,000			
		5,20,000			5,20,000
1-4-2022	To Balance b/d	3,10,000			

M/s Rahul & Rohit Balance Sheet as on 1stApril, 2022

Liabilities	**Rs.**	**Rs.**	**Assets**	**Rs.**	**Rs.**
Capital accounts:			Land and buildings		2,60,000
Rahul	3,00,000		Machinery		1,60,000
Rohit	3,00,000	6,00,000	Closing stock		80,000
Ram's loan account		2,10,000	Sundry debtors	2,00,000	
Sundry creditors		1,90,000	Less: Provision for bad debts	(10,000)	1,90,000
		10,00,000	Cash and bank balances		3,10,000
		10,00,000			10,00,000

Working Notes:

1. Gaining ratio of existing partners:

Rahul 1/2-1/3=1/6

Rohit 1/2-1/6=2/6

2. Total goodwill of firm is Rs.1, 80,000

Ram's share (1/2 x Rs. 1, 80,000)=Rs.90,000

Ram's share of goodwill is to be borne by Rahul and Rohit in their gaining ratios i.e.

Rahul=1/3 x Rs.90, 000= Rs.30, 000

Rohit = 2/3 x Rs.90, 000=Rs.60, 000

Ram's Capital Account

		Rs.			Rs.
31-3-2022	To Cash and Bank A/c	2,10,000	31-3-2022	By Balance b/d	3,00,000
	To Ram's Loan A/c -Transfer	2,10,000		By Revaluation A/c	30,000
		4,20,000		By Rahul's Capital A/c - Goodwill	30,000
				By Rohit's Capital A/c-	60,000

				Goodwill	
		4,20,000			4,20,000

2. A, B, C were in partnership sharing profits and losses in the ratio of 3:2:1. The balance sheet of the firm as on 31.2.2022 was as under:

Liabilities	**Rs.**	**Assets**	**Rs.**
Capital accounts:		Fixtures	30,000
A 1,50,000		Stock	1,70,000
B 1,00,000		Sundry debtors	90,000
C 50,000	3,00,000	Cash	50,000
Sundry creditors	40,000		
	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 as on 31.3.2022, the terms of which were as follows:

(a) The profit and loss account for the year ended 31.3.2022, which showed a net profit of Rs. 42,000 was to be re-opened. B was to be credited with Rs. 6,000 as bonus, in consideration of the extra work, which had devolved upon him during the year.

The profit sharing basis was to be revised and the revised ratio is to be 2:3:1 as and from 1st April 2021.

(b) Goodwill was to be valued at two years' purchase of the simple average profits of five years. Profits for these five years ending on 31st March were as under:

31.3.2018	15,000
31.3.2019	23,000
31.3.2020	25,000
31.3.2021	35,000
31.3.2022	42,000

(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 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 Rs. 3 lakhs as before to be maintained in the new ratio as between B and C.

You are required to give the necessary entries to give effect to the above arrangements. Prepare capital accounts of partners, cash account and balance sheet of B and C after giving effect to the above arrangements on the retirement of A.

Ans: **Journal Entries**

		Rs.	Rs.
1.	A's Capital account Dr.	21,000	
	B's Capital account Dr.	14,000	

	C's Capital account Dr.	7,000	42,000
	To Profit and loss adjustment account		
	(Profit written back for making adjustments)		
2.	Profit and loss adjustment account Dr.	6,000	
	To B's Capital account		6,000
	(Bonus credited to B's capital account)		
3.	Profit and loss adjustment account Dr.	36,000	
	To A's Capital account		12,000
	To B's Capital account		18,000
	To C's Capital account		6,000
	(Distribution of profits in the new ratio)		
4.	Fixtures account	9,800	
	To Provision for bad debts account Dr.		1,800
	To A's Capital account Dr.		2,667
	To B's Capital account Dr.		4,000
	To C's Capital account Dr.		1,333
	(Revaluation of assets on A's retirement)		
5.	B's capital account Dr.	2,700	

	C's capital account Dr.	900	
	To Provision for bad debts account		3,600
	(Raising provision for bad debts)		
6.	A's capital account Dr.	1,62,334	
	To B's Capital account		1,62,334
	(Amount payable to A paid by B)		
7.	B's Capital account Dr.	14,000	
	C's Capital account Dr.	4,667	
	To A's Capital account		18,667
	(Adjusting entry of goodwill passed through partners' capital accounts in gaining/sacrificing ratio)		

Partners' Capital Accounts

	A	B	C		A	B	C
To P & L adjustment A/c	21,000	14,000	7,000	By Balance b/d	1,50,000	1,00,000	50,000
To Provision for bad debts A/c	-	2,700	900	By P & L adjustment account	-	6,000	-

To B's Capital A/c	1,62,334	-	-	By P & L adjustment account	12,000	18,000	6,000
To Cash A/c	-	34,634	-	By Fixtures A/c	2,667	4,000	1,333
To A's Capital A/c	-	14,000	-	By A's capital A/c		1,62,334	
To Balance c/d	-	2,25,000	-	By B and C's capital A/c	18,667		30,234
	1,83,334	**2,90,334**	**87,567**	**By Cash A/c**	**1,83,334**	**2,90,334**	**87,567**

Cash Account

	Rs.		**Rs.**
To Balance b/d	50,000	By B's capital A/c	34,634
To C's capital A/c	30,234	By Balance b/d	45,600
	80,234		80,234

Balance Sheet of B and C as on 31st March, 2022 (after retirement of A)

Liabilities					
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 Notes:

Calculation of goodwill:

1. Average of last five year's profit

31.3.2018	15,000
31.3.2019	23,000
31.3.2020	25,000
31.3.2021	35,000
31.3.2022	42,000
	1,40,000

2. Goodwill at two years' purchase

Rs. 28,000 x 2=Rs.56, 000

3. Calculation for adjustment of Amount of Goodwill

Partner	Old Share	New Share	Gain	Sacrifice
A	$\frac{2}{6}$	-	-	$\frac{2}{6}$
B	$\frac{3}{6}$	$\frac{3}{4}$	$\frac{3}{12}$	-

C	$\frac{1}{6}$	$\frac{1}{4}$	$\frac{1}{12}$	-

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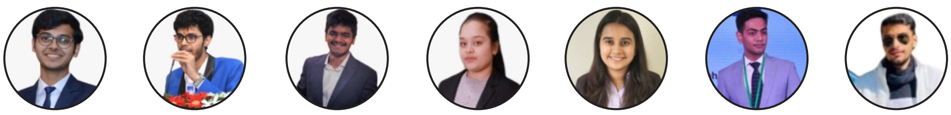

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UNIT – 5

DEATH OF A PARTNER

True and False

1. Business of partnership comes to an end on death of a partner.

Ans: False: Surviving partners continue to carry on the business.

2. Legal heir of a deceased partner automatically becomes partner in the firm.

Ans: False: Legal heirs of deceased partners are entitled to dues of the deceased partner.

3. A revaluation account is opened in the books of accounts on death of a partner.

Ans: True: To find out the actual values of the assets and liabilities, revaluation account is prepared.

4. Any reserve appearing in the balance sheet on the date of death of a partner is transferred to all partners capital account in their profit sharing ratio.

Ans: True: reserves belong to the partners in the same manner the capital contributed by them. Hence it is distributed to them through the capital account.

5. Legal heirs of a deceased partner are entitled to his capital account balance only.

Ans: False: Legal heirs of a deceased partner are entitled to all the dues of deceased partner.

6. It is not necessary to adjust goodwill on death of a partner.

Ans: False: It is very much necessary to adjust goodwill on death of a partner.

7. On death of a partner continuing partners can agree to change their capital contribution and profit sharing ratio.

Ans: True: Yes, it can be continued in the earlier share or in new share- in either case it leads to computing a new profit sharing ratio

8. On death of a partner, the firm gets surrender value of the joint life policy.

Ans: False: On death of a partner the firm gets full value of sum assured of the joint life policy.

9. **Only legal heirs of deceased partner are entitled to amount received from joint life policy.**

Ans: False: All the partners are entitled to amount received from joint life policy.

Multiple Choice Questions

1. In the absence of proper agreement, representative of the deceased partner is entitled to the Dead partner's share in

(a) Profits till date, goodwill, joint life policy, share in revalued assets and liabilities.

(b) Capital, goodwill, joint life policy, interest on capital, share in revalued assets and liabilities.

(c) Capital, profits till date, goodwill, joint life policy, share in revalued assets and liabilities.

Ans: (c)

2. A, B and C are the partners sharing profits and losses in the ratio 2:1:1. Firm has a joint life policy of Rs. 1,20,000 and in the balance sheet it is appearing at the surrender value i.e. Rs 20,000. On the death of A, how this JLP will be shared among the partners.

(a) Rs. 50,000: Rs.25, 000: Rs.25, 000.

(b) Rs. 60,000: Rs.30, 000: Rs.30, 000.

(c) Rs.40, 000: Rs.35, 000: Rs.25, 000.

Ans: (a)

3. R, J and D are the partners sharing profits in the ratio 7:5:4. D died on 30th June 2022. It was decided to value the goodwill on the basis of three year's purchase of last five years average profits. If the profits are Rs. 29,600; Rs.28,700; Rs.28,900; Rs.24,000 and ` 26,800. What will be D's share of goodwill?

(a) Rs.20, 700.

(b) Rs.27, 600.

(c) Rs. 82,800.

Ans: (a)

4. R, J and D are the partners sharing profits in the ratio 7:5:4. D died on 30th June 2022 and profits for the accounting year 2021-2022 were Rs.24, 000. How much share in profits for the period 1st April 2022 to 30th June 2022 will be credited to D's Account?

(a) Rs.6, 000.

(b) Rs. 1,500.

(c) Rs.2, 000.

Ans : (b)

5. Revaluation account is prepared at the time of

(a) Admission and retirement of a partner

(b) Death of a partner

(c) All of the above

Ans: (c)

6. If three partners A, B & C are sharing profits as 5:3:2, then on the death of a partner A, how much B & C will pay to A's executer on account of goodwill. Goodwill is to be calculated on the basis of 2 years purchase of last 3 years average profits. Profits for last three years are: Rs. 3, 29,000; Rs.3, 46,000 and Rs. 4, 05,000.

(a) Rs.2, 16,000 & Rs.1, 42,000.

(b) Rs.2, 44,000 & Rs.2, 16,000.

(c) Rs.2, 16,000 & Rs.1, 44,000.

Ans: (c)

Theory Questions

1. Explain distinction between retirement and death of a partner as relating to finalisation of amount payable.

Ans: The basic distinction between retirement and death of a partner relates to finalisation of amount payable to the Executor of the deceased partner. Although, revaluation of goodwill is done in the same way as it has been done in case of retirement, in addition, the executor of the deceased partner is entitled to share of profit upto the date of death

2. What amount is payable to legal representatives of dead partner?

Ans: When the partner dies the amount payable to him/her is paid to his/her legal representatives. The representatives are entitled to the followings :

(a) The amount standing to the credit to the capital account of the deceased partner;

(b) Interest on capital, if provided in the partnership deed upto the date of death;

(c) Share of goodwill of the firm;

(d) Share of undistributed profit or reserves;

(e) Share of profit on the revaluation of assets and liabilities;

(f) Share of profit upto the date of death;

(g) Share of Joint Life Policy.

Practical Questions

1. The Balance Sheet of Seed, Plant and Flower as at 31st December, 2021 was as under :

Liabilities		**Rs.**	**Assets**	**Rs.**
Trade payables		20,000	Fixed Assets	40,000
General Reserve		5,000	Debtors	10,000
Capital:			*Bills Receivable*	4,000
Seed	25,000		Inventories	16,000
Plant	15,000		Cash at Bank	10,000
Flower	15,000	55,000		
		80,000		80,000

The profit sharing ratio was: Seed 5/10, Plant 3/10 and Flower 2/10. On 1st May, 2022 Plant died. It was agreed that:

(a) Goodwill should be valued at 3 years purchase of the average profits for 4 years.

The profits were:

2018 Rs.10, 000 **2020 Rs.12, 000**

2019 Rs.13, 000 **2021 Rs.15, 000**

(b) The deceased partner to be given share of profits up to the date of death on the basis of the previous year.

(c) Fixed Assets were to be depreciated by 10%. A bill for Rs.1, 000 was found to be worthless. These are not to affect goodwill.

(d) A sum of Rs.7, 750 was to be paid immediately; the balance was to remain as a loan with the firm at 9% p.a. as interest.

Seed and Flower agreed to share profits and losses in future in the ratio of 3: 2. Give necessary journal entries.

Ans:

2022			Rs.	Rs.
May 1	General Reserve Account	Dr.	5,000	
	To Seed's Capital Account			2,500
	To Plant's Capital Account			1,500
	To Flower's Capital Account			1,000
	(General Reserve transferred to Capital Account on the death of Plant)			
	Seed's Capital Account	Dr.	3,750	
	Flower's Capital Account	Dr.	7,500	
	To Plant's Capital Account			11,250
	(Adjustment for goodwill on the death of Plant on the basis of gaining ratio) (Value = 3 × (10,000 + 13,000 + 12,000 + 15,000)/4)			
	Revaluation Account	Dr.	5,000	
	To Fixed Assets Account			4,000

	To Bills Receivable Account			1,000
	(Depreciation of fixed assets @ 10% and writing off of one bill for `1,000 on Plant's death)			
	Seed's Capital Account	Dr.	2,500	
	Plant's Capital Account	Dr.	1,500	
	Flower's Capital Account	Dr.	1,000	
	To Revaluation Account			5,000
	(Loss on Revaluation transferred to capital accounts)			
	Profit and Loss Suspense Account	Dr.	1,500	
	To Plant's Capital Account			1,500
	(Plant's share of four month's profit based on the previous year)			
	Plant's Capital Account	Dr.	27,750	
	To Plant's Executor's Account			27,750
	(Amount standing to the credit of Plant's Capital Account transferred to the credit of his Executor's Account)			
	Plant's Executor's Account	Dr.	7,750	

	To Bank Account			7,750
	(Amount paid to Plant's Executors)			

2. Peter, Paul and Prince were partners sharing profits and losses in the ratio 2:1:1. It was provided in the partnership deed that in the event of retirement /death of a partner he/his legal representatives would be paid:

(i) The balance in the capital Account

(ii) His share of goodwill of the firm valued at two years purchase of normal average

profits (after charging interest on fixed capital) for the last three years to 31st December preceding the retirement or death.

(iii) His share of profits from the beginning of the accounting year to the date of retirement or death, which shall be taken on proportionate basis of profits of the previous year as increased by 25%

(iv) Interest on fixed capital at 10% p.a. though payable to the partners will not be payable in the year of death or retirement.

(v) All the asset are to be revalued on the date of retirement or death and the profit and loss be debited/credited to the Capital Accounts in the profit sharing ratio. Peter died on 30th September, 2022. The books of Account are closed on calendar year basis from 1st January to 31st December.

The balance in the Fixed Capital Accounts as on 1st January, 2022 were Peter Rs. 10,000, Paul Rs. 5,000 and Prince Rs.5, 000. The balance in the Current Account as on 1st January, 2022 were Peter Rs.20, 000, Paul Rs. 10,000 and Prince Rs.7, 000. Drawings of Peter till 30th September, 2022 were Rs. 10,000. The profits of the firm before charging interest on capital for the calendar years 2019, 2020 and 2021 were Rs.1,00,000, Rs.1,20,000 and Rs. 1,50,000 respectively. The profits include the following abnormal items of credit:

	2019	2020	2021
	Rs.	**Rs.**	**Rs.**
Profit on sale of assets	5,000	7,000	10,000
Insurance claim received	3,000		12,000

The firm has taken out a Joint Life Policy for Rs.1, 00,000. Besides the partners had severally insured their lives for Rs.50, 000 each, the premium in respect thereof being charged to the Profit and Loss account. The surrender value of the Policies were 30% of the face value. On 30th June, 2022 the firm received notice from the insurance company that the insurance premium in respect of fire policy had been undercharged to the extent of ` 6,000 in the year 2021 and the firm has to pay immediately. The revaluation of the assets indicates an upward revision in value of assets to the extent of Rs.20, 000. Prepare an account showing the amount due to Peter's Legal representatives as on 30th September, 2022 along with necessary workings.

Ans: In the books of M/s Paul and Prince Executors of Peter Account

	Rs.		Rs.
To Balance c/d	2,91,125	By Peter's capital A/c (W.N.6)	20,000
		By Peter's Current A/c (W.N.7)	2,71,125
	2,91,125		

Working Notes:

		2019	2020	2021
		Rs.	**Rs.**	**Rs.**
1.	Valuation of Goodwill:	1,00,000	1,20,000	**1,50,000**
	Profit as per Profit and loss A/c	2,000	2,000	**2,000**

	Less: Interest on capital @ 10%			
	Abnormal Items:			
	Profit on sale of asset	5,000	7,000	**10,000**
	Insurance claim received	3,000	-	**12,000**
	Insurance premium undercharged	-	-	**6,000**
		90,000	1,11,000	**1,20,000**
	Total profit of three years		3,21,000	
	Average profit		1,07,000	
	Goodwill (2 x Average profit)		2,14,000	
	Peter's share of goodwill (2/4)		1,07,000	

2.	**Peter's share of profit:**	**Rs.**
	Profit for the year 2021	1,50,000
	Less: Insurance premium undercharged	6,000
		1,44,000
	Add: 25% increase thereof	36,000
	Estimated profit for 2022	1,80,000
	Less: Interest on capital *	1,000
	Estimated profit for 2022	1,79,000

	Estimated profit upto 30.9.22	1,34,250
	Peter's Share (2/4)	67,125

*Since Peter was not entitled to interest on capital in the year of death, interest is payableonly to the remaining two partners.

3. Profit on revaluation of assets:

	Rs.
Upward revision in the value of assets	20,000
Peter's share (2/4)	10,000

4. Peter's share in insurance premium undercharged:

Insurance premium undercharged in 2021	6,000
Peter's share	3,000

5. Share of life policy:

Joint life policy	1,00,000
Maturity value of Peter's individual life policy	50,000
Surrender value of individual life policies of Paul & Prince	30,000
(30 % of face value)	1,80,000

Peter's share (2/4)	90,000

6. Peter's Capital Account

		Rs.			Rs.
2	To Executors of Peter A/c (Transfer)	20,000	1.1.22 30.9.22	By Balance b/d	10,000
				By Profit on revaluation of assets	10,000*
		20,000			**20,000**

* This is generally transferred to Peter's current account. But as per the requirement of adjustment No. (v) of question, it is transferred to capital account.

7. Peter's Current Account

		Rs.			**Rs.**
30.9.22	To Drawings	10,000			
	To Insurance premium	3,000	1.1.22	By Balance b/d	20,000

	undercharged				
	To Executor's of Peter's Account (balance transferred)	2,71,125	30.9.22	By Share of goodwill	1,07,000
				By share of profit	67,125
				By Share of life policy	75,000
				By Paul & Prince	15,000
		2,84,125			**2,84,125**

Note: The share of goodwill given to peter would be borne by remaining partners in their gaining ratio, so that goodwill account does not appear in the balance sheet.

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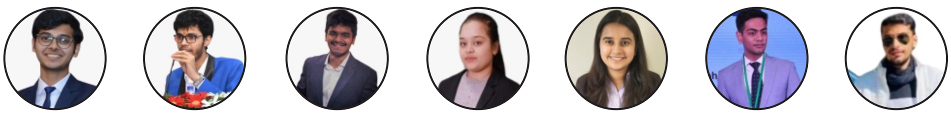
NOTES

Practice Notes

Foundation Accounting

Chapter - 10 unit 6



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CH-10

UNIT - 6

DISSOLUTION OF PARTNERSHIP FIRMS AND LLP

True and False

1. Books of accounts are closed in dissolution of partnership.

Ans: False. Books of accounts are not closed in dissolution of partnership but are closed in case of dissolution of partnership firm.

2. On the dissolution of a partnership, firstly, the assets of the firm are realized. Then the amount realized, is applied first towards repayment of liabilities to outsiders.

Ans: True. On the dissolution of a partnership, firstly, the assets of the firm, are realized. Then the amount realized, is applied first towards repayment of liabilities to outsiders and loans taken from partners; afterwards, the capital contributed by partners is repaid.

3. In event of the dissolution of the firm, the business ceases to end. In event of dissolution of the partnership, the partnership is reconstituted and the business discontinues.

Ans: True. In event of the dissolution of the firm, the business ceases to end. However, in event of dissolution of the partnership, the business continues as usual, but the partnership is reconstituted.

4. Expenses of dissolution on realization of assets are credited to the Realization Account.

Ans: False. Expenses of dissolution on realization of assets are debited to the Realization Account.

5. Revaluation Account is prepared at the time of dissolution of partnership but Realization Account is prepared at the time of dissolution of partnership firm.

Ans: True. Revaluation Account is prepared at the time of dissolution of partnership but Realization Account is prepared at the time of dissolution of partnership firm.

Multiple Choice Questions

1. Partnership could be dissolved because of

(a) Death of a partner.

(b) Insolvency of a partner.

(c) Either (a) or (b)

Ans: (c)

2. On the dissolution of partnership, profit or loss on realization of assets and liabilities should be divided among partners.

(a) In the ratio of their capitals.

(b) In the same ratio in which they share profits.

(c) Equally.

Ans: (b)

3. An unrecorded asset realized at the time of dissolution is credited to

(a) Realization account.

(b) Revaluation account.

(c) Capital accounts.

Ans: (a)

4. A liability taken over by a partner at the time of dissolution is credited to

(a) Profit and loss account.

(b) Partners' capital accounts.

(c) Realization account.

Ans: (b)

5. Realization account is a

(a) Nominal account.

(b) Real account.

(c) Personal account.

Ans: (a)

6. Which of the following method/methods is adopted to ensure that distribution of cash among partners is in proportion to their interest in partnership?

(a) Maximum loss method.

(b) Highest relative capital method.

(c) Either (a) or (b).

Ans: (c)

Theoretical Questions

Q-1 State the circumstances when Garner V/S Murray rule not applicable.

Ans: Non-Applicability of Garner vs Murray rule:

(i) When the solvent partner has a debit balance in the capital account. Only solvent partners will bear the loss of capital deficiency of insolvent partner in their capital ratio. If incidentally, a solvent partner has a debit balance in his capital account, he will escape the liability to bear the loss due to insolvency of another partner.

(ii) When the firm has only two partners.

(iii) When there is an agreement between the partners to share the deficiency in capital account of the insolvent partner.

(iv) When all the partners of the firm are insolvent.

Q-2 W paid a premium to other partners of the firm at the time of his admission to the firm, with a condition that they will not be dissolved before the expiry of five years. The firm is dissolved after three years. W claims refund of premium.

(i) List the criteria for the calculation of the amount of refund.

(ii) Also list any two conditions when no claim in this respect will arise.

Ans: If the firm is dissolved before the term expires, as is the case, W being a partner who has paid a premium on admission will have to be repaid/refunded

The criteria for calculation of refund amount are:

(i) Terms upon which admission was made,

(ii) The time period for which it was agreed that the firm will not be dissolved,

(iii) The time period for which the firm has already been in existence.

No claim for refund will arise if:

(i) The firm is dissolved due to the death of a partner,

(ii) If the dissolution of the firm is basically because of misconduct of W,

(iii) If the dissolution is through an agreement and such an agreement does not have a stipulation for a refund of premium.

Practical Questions

Q-1 P, Q, and R are partners sharing profits and losses as to 2:2:1. Their Balance Sheet as on 31st March, 2022 is as follows:

Liabilities		**Rs.**	**Assets**	**Rs.**
Capital accounts			Plant and Machinery	1,08,000
P	1,20,000		Fixtures	24,000
Q	48,000		*Stock*	60,000
R	24,000	1,92,000	Sundry debtors	48,000
Reserve Fund		60,000	Cash	60,000
Creditors		48,000		
		3,00,000		3,00,000

They decided to dissolve the business. The following are the amounts realized

Particulars	**Rs.**
Plant and Machinery	1,02,000
Fixtures	18,000
Stock	84,000
Sundry debtors	44,400

Creditors allowed a discount of 5% and realization expenses amounted to Rs.1, 500. There was an unrecorded asset of Rs.6, 000 which was taken over by Q at Rs.4, 800. An amount of Rs.4, 200 due for GST had come to notice during the course of realization and this was also paid.

You are required to prepare:

(i) Realization account.

(ii) Partners' capital accounts.

(iii) Cash account.

Ans:

Realization Account

Particulars	Rs.	Particulars	Rs.
To Debtors	48,000	By Creditors	
To Stock	60,000	By Cash A/c (Assets realized):	
To Fixtures	24,000	Plant and Machinery 1,02,000	
To Plant and machinery	1,08,000	Fixtures 18,000	
To Cash A/c (Creditors)	45,600	Stock 84,000	
To Cash A/c (GST)	4,200	Sundry Debtors 44,400	2,48,400
To Cash A/c (Realization Expenses	1,500	By Q (Unrecorded asset)*	4,800
To Profit on Realization			
P 3,960			

Q 3,960			
R 3,960	9,900		
	3,01,200		**3,01,200**

Particulars	**P**	**Q**	**R**	**Particulars**	**P**	**Q**	**R**
	Rs.	**Rs.**	**Rs.**		**Rs.**	**Rs.**	**Rs.**
To Realization A/c (unrecorded asset		4,800		By Balance b/d	1,20,000	48,000	24,000
To Cash (Bal. Fig.)	1,47,960	71,160	37,980	By Reserve fund	24,000	24,000	24,000
				By Realization A/c (Profit)	3,960	3,960	3,960
	1,47,960	**75,960**	**37,980**		**1,47,960**	**75,960**	**37,980**

Cash Account

Particulars	**Rs.**	**Particulars**	**Rs.**
To Balance b/d	60,000	By Realization A/c	45,600

		(Creditors)	
To Realization A/c (Assets)	2,48,400	By Realization A/c (Expenses)	1,500
		By Realization A/c (GST)	4,200
		By P's Capital A/c	1,47,960
		By Q's Capital A/c	71,160
		By R's Capital A/c	37,980
	3,08,400		3,08,400

∗ An unrecorded asset is in the nature of gain hence realization account is credited. Since this asset has been taken over by Q, therefore, his account has been debited.

Q-2 'Thin', 'Short' and 'Fat' were in partnership sharing profits and losses in the ratio of 2:2:1. On 30th September, 2022 their Balance Sheet was as follows:

Liabilities		**Rs.**	**Assets**	**Rs.**
Capital Accounts:			Premises	50,000
Thin	80,000		Fixtures	1,25,000
Short	50,000		Plant	32,500

Fat	20,000	1,50,000	Stock	43,200
Current Accounts:			Debtors	54,780
Thin	29,700			
Short	11,300			
Fat (Dr.)	(14,500)	26,500		
Sundry Creditors		84,650		
Bank Overdraft		44,330		
		3,05,480		3,05,480

'Thin' decides to retire on 30th September, 2022 and as 'Fat' appears to be short of private assets, 'Short' decides that he does not wish to take over Thin's share of partnership, so

all three partners decide to dissolve the partnership with effect from 30th September, 2022. It then transpires that 'Fat' has no private assets whatsoever.

The premises are sold forRs.` 60,000 and the plant for Rs.1, 07,500. The fixtures realize Rs. 20,000 and the stock is acquired by another firm at a book value less 5%. Debtors realize Rs.45, 900. Realization expenses amount to Rs. 4,500.

The bank overdraft is discharged and the creditors are also paid in full.

You are required to write up the following ledger accounts in the partnership books following the rules in Garner vs. Murray:

(i) Realization Account;

(ii) Partners' Current Accounts;

(iii) Partners' Capital Accounts showing the closing of the firm's books.

Ans:

Realization Account

Particulars	**Rs.**	**Particulars**		**Rs.**
To Premises	50,000	By Sundry Creditors		84,650
To Plant	1,25,000	By Bank:		
To Fixtures	32,500	Premises	60,000	
To Stock	43,200	Plant	1,07,500	
To Debtors	54,780	Fixtures	20,000	
To Bank (Creditors)	84,650	Stock	41,040	
To Bank (Expenses)	4,500	Debtors	45,900	2,74,440
		By Loss on Realization transferred to Partners' Current A/cs		
		Thin	14,216	

		Short	14,216	
		Fat	7,108	35,540
	3,94,630			3,94,630

Partners' Current Accounts

Particulars	Thin	Short	Fat	Particulars	Thin	Short	Fat
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Balance b/d	-	-	14,500	By Balance b/d	29,700	11,300	-
To Realization	14,216	14,216	7,108	By Capital A/c	-	2,916	21,608
To Capital A/c				Transfer			
transfer	15,484	-	-				
	29,700	14,216	21,608		29,700	14,216	21,608

Partners' Capital Accounts

Particulars	Thin	Short	Fat	Particulars	Thin	Short	Fat
	Rs.	Rs	Rs.		Rs.	Rs.	Rs.
To Current A/c	-	2,916	21,608	By Balance b/d	80,000	50,000	20,000

To Fat's Capital A/c				By Current A/c (transfer)	15,484	-	-
Deficiency in the ratio of 8:5				By Bank (Realization loss)	14,216	14,216	
To Bank				By Thin Short Capital A/cs			
To Bank	1,08,710	60,682	-				
	1,09,700	**64,216**	**21,608**		**1,09,700**	**64,216**	**21,608**

(ii) Fat's deficiency has been by borne Thin & Short in the ratio of their fixed capitals i.e., 8:5 following the rule in Garner vs. Murray

Q-3 Amit, Sumit, and Kumar are partners sharing profit and losses in the ratio 2:2:1. The partners decided to dissolve the partnership on 31st March 2022 when their Balance Sheet was as under:

Liabilities	**Amount**	**Assets**	**Amount**
Capital Accounts:		Land & Building	1,35,000
Amit	55,200	Plant & Machinery	45,000

Sumit	55,200	Furniture	25,500
General Reserve	61,500	Investments	*15,000*
Kumar's Loan A/c	15,000	Book Debts 60,000	
Loan from D	1,20,000	Less: Prov. for bad debts (6,000)	54,000
Trade Creditors	30,000	Stock	36,000
Bills Payable	12,000	Bank	13,500
Outstanding Salary	7,500	Capital Withdrawn:	
		Kumar	32,400
	3,56,400		3,56,400

The following information is given to you:

(i) Realization expenses amounted to Rs.18, 000 out of which Rs.3,000 was borne by Amit.

(ii) A creditor agreed to takeover furniture of book value Rs.12,000 at Rs.10,800. The rest of the creditors were paid off at a discount of 6.25%.

(iii) The other assets realized as follows:

Furniture - Remaining taken over by Kumar at 90% of book value

Stock - Realized 120% of book value

Book Debts – Rs.12, 000 of debts proved bad, remaining were fully realized

Land & Building - Realized Rs. 1, 65,000

Investments -Taken over by Amit at 15% discount

(iv) For half of his loan, D accepted Plant & Machinery and ` 7,500 cash. The remaining amount was paid at a discount of 10%.

(v) Bills payable were due on an average basis of one month after 31st March 2022, but they were paid immediately on 31st March @ 6% discount "per annum".

Prepare the Realization Account, Bank Account and Partners' Capital Accounts in the books of Partnership firm.

Ans:

Realization Account

	Particulars	**Rs.**		**Particulars**	**Rs.**
To	Land and Building	1,35,000	By	Provision for bad debts	6,000
To	Plant and Machinery	45,000	By	Loan from D	1,20,000
To	Furniture	25,500	By	Trade creditors	30,000
To	Investments	15,000	By	Bills payable	12,000
To	Book debts	60,000	By	Outstanding salary	7,500
To	Stock	36,000	By	Kumar - Furniture taken over (13,500 x .9)	12,150
To	Bank (Realization expenses)	15,000	By	Bank A/c -	
To	To Amit– Realization	3,000	By	Stock Realized 43,200	

	expenses				
To	Bank A/c -		By	Land & Building 1,65,000	
	Bill payable	11,940	By	Debtors 48,000	2,56,200
	D's Loan	61,500	By	Amit (Investment taken over	12,750
	Creditors	18,000			
	Salary	7,500			
	To Profit transferred to partners' capital Accounts				
	Amit 9,264				
	Sumit 9,264				
	Kumar 4,632	23,160			
		4,56,600			**4,56,600**

Bank Account

To Balance b/d	13,500	By Realization A/c (payment of liabilities: 11,940+ 7,500 + 54,000 + 15,000 + 18,000 + 7,500)	1,13,940
		By Amit	79,314
To Realization A/c	2,56,200	By Sumit	89,064

(assets realized)			
To Kumar	12,618		
	2,82,318		**2,82,318**

Partners' Capital Accounts

Particulars	Amit	Sumit	Kumar	Particulars	Amit	Sumit	Kumar
To Balance b/d			32,400	By Balance b/d	55,200	55,200	
To Realization A/c (Investment taken over)	12,750			By Kumar's Loan			15,000
To Realization A/c (Furniture taken over)			12,150	By General Reserve	24,600	24,600	12,300
To Bank A/c	79,314	89,064		By Realization A/c (expense)	3,000		
	92,064	89,064	44,550	By Realization A/c (profit)	9,264	9,264	4,632
				By Bank A/c			12,618
	92,064	89,064	44,550		92,064	89,064	44,550

Working Notes:

1. Payment for Bills Payable

Particulars	Amount Rs.
Bills Payable as per Balance Sheet	12,000
Less: Discount for early payment {12,000 x 6% x (1/12)}	60
Amount Paid in Cash	11,940

2. Payment to D's Loan

Particulars	Amount Rs.
D's Loan as per Balance Sheet	120,000.00
50% of Loan adjusted as below: Plant & Machinery accepted at Book Value (Rs.45, 000) and Rs. 7,500 in cash.	7,500
Balance 50% of Loan adjusted as below: In cash after allowing discount of 10% i.e. Rs.60,000 – Rs.6,000 = Rs. 54,000.	54,000

3. Payment to Trade Creditors

Particulars	Amount Rs.
Trade Creditors as per Balance Sheet	30,000
Less: Furniture of Book Value Rs.12,000 accepted at value Rs.10,800	10,800

	19,200
Less: Discount @ 6.25%	1,200
Amount paid in Cash	18,000

4. Furniture taken over by Kumar

Particulars	**Amount Rs.**
Furniture as per Balance Sheet	25,500
Less: Furniture of Book Value ` 12000 accepted by trade creditors	12,000
	13,500
Less: 10% of Book Value	1,350
Value of Furniture taken over by Kumar	12,150

NOTES

Practice Notes

Foundation Accounting

Chapter - 11 unit 1

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UNIT-1

COMPANY ACCOUNTS

True and False

1. Every public company is a listed company.

Ans: False: Listed companies are those which are listed on the stock exchange. Shares of listed companies are open to general public. Every listed company is a public company but every public company is not a listed company.

2. Shares of a private company are not listed on stock exchange.

Ans: True: Only the shares of public company are listed on stock exchange. Every listed company is a public company.

3. It is not mandatory to incorporate a company under the companies act.

Ans: False: It is mandatory to incorporate a company under the Companies Act. Without such incorporation, a company cannot come into existence.

4. Company is an artificial l, legal person created by law.

Ans: True: Company comes into existence through the operation of law. It is a separate entity distinct from it's members.

5. Death, insolvency or change of members affects the existence of a company.

Ans: False: Company is a separate legal entity created by law. Death, insolvency or change of member does not affect it's existence.

6. If the shares are fully paid-up by the shareholder, he is subject to no further liability.

Ans: True: Liability of shareholders is limited to the extent of the unpaid share capital. So, if shares are fully paid-up, he is subject to no further liability.

7. Public limited company has restrictions on transferability of shares.

Ans: False: Shares of public company are freely transferable. Transferability of shares is restricted in a private limited company.

8. Financial statements of company show the financial position of the business.

Ans: True: Financial statements give a true & fair view of the state of affairs of the company. Financial statements include profit and loss account, balance sheet, etc

9. Schedule I gives proforma of Balance Sheet.

Ans: False: Schedule III Part I explains proforma of Balance Sheet.

10. Schedule III prescribes the format of Directors' Report

Ans: False: Schedule III Part I explains proforma of Balance Sheet and Profit and Loss.

11. Financial statements need to be true and correct as per Companies Act.

Ans: False: As per Section 128, every company shall prepare financial statement for every financial year which give a true and fair view of the state of the affairs of the company.

Multiple Choice Questions

1. Which of the following statement is not a feature of a Company?

(a) Separate legal entity

(b) Perpetual Existence

(c) Members have unlimited liability

Ans: (c)

2. In a Government Company, the holding of the Central Government in paid-up capital should not be less than

(a) 25%

(b) 50 %

(c) 51%

Ans: (c)

3. Which of the following statement is true in case of a Foreign Company?

(a) A Company incorporated in India and has place of business outside India.

(b) A Company incorporated outside India and has a place of business in India.

(c) A Company incorporated in India and has a place of business in India.

Ans: (b)

4. Which of the following statements is not a feature of a private company?

(a) Restricts the rights of members to transfer its shares.

(b) Does not restrict on the number of its members to any limit.

(c) Does not involve participation of public in general.

Ans: (b)

5. Under Schedule III of the Companies Act, assets and liabilities are to be disclosed based on:

(a) Current/ non-current.

(b) Financial /non-financial.

(c) Owned /not-owned.

Ans: (a)

6. Schedule III of the Companies Act prescribes the format and content of

(a) Balance sheet and statement of profit and loss

(b) Auditors' report.

(c) Directors' report.

Ans: (a)

7. A company is required to maintain its books of accounts at

(a) its registered office.

(b) its largest branch office.

(c) Managing Director's residence.

Ans: (a)

8. Cash flow statements are not required for

(a) Private company.

(b) One person company.

(c) Public company.

Ans: (b)

9. The presentation and disclosure requirements of a company are prescribed by

(a) Schedule III.

(b) Schedule II.

(c) Schedule I.

Ans: (a)

10. Following is an example of current assets

(a) Inventories.

(b) Property, Plant & Equipment.

(c) Intangible Assets.

Ans: (a)

11. Earnings per share (EPS) is to be disclosed in which of the following section of the financial statements

(a) Balance Sheet.

(b) Statement of Profit and Loss.

(c) Cash Flow Statements.

Ans: (b)

12. Following is NOT an example of a company under Companies Act, 2013

(a) Small company.

(b) Private company.

(c) Large company.

Ans: (c)

Theory Questions

Q-1 Explain salient features of a company in brief.

Ans: Following are the salient features of a company:

1. Incorporated Association: A company comes into existence through the operation of law. Therefore, incorporation of company under the Companies Act is must. Without such registration, no company can come into existence. Being created by law, it is regarded as an artificial legal person.

2. Separate Legal Entity: A company has a separate legal entity and is not affected by changes in its membership. Therefore, being a separate business entity, a company can contract, sue and be sued in its incorporated name and capacity.

3. Perpetual Existence: Since company has existence independent of its members, it continues to be in existence despite the death, insolvency or change of members.

4. Common Seal: Company is not a natural person; therefore, it cannot sign the documents in the manner as a natural person would do. In order to enable the company to sign its documents, it is provided with a legal tool called 'Common Seal'. The common seal is affixed on all documents by the person authorised to do so who in turn puts his signature for and on behalf of the company. Companies Act, 2013] required common seal to be affixed on certain documents (such as bill of exchange, share certificates, etc.) Now, the use of common seal has been made optional. All such documents which required affixing the common seal may now instead be signed by two directors or one director and a company secretary of the company. Further, every company registered in India are required to obtain unique Corporate Identification Number (CIN) that is assigned by Registrar of Companies**.**

5. Limited Liability: The liability of every shareholder of a company is limited to the amount he has agreed to pay to the company on the shares allotted to him. If such shares are fully paid-up, he is subject to no further liability.

6. Distinction between Ownership and Management: Since the number of shareholders is very large and may be distributed at different geographical locations, it becomes difficult for them to carry on the operational management of the company on a day to- day basis. This gives rise to the need of separation of the management and ownership.

7. Not a citizen: A company is not a citizen in the same sense as a natural person is, though it is created by the process of law. It has a legal existence but does not enjoy the citizenship rights and duties as are enjoyed by the natural citizens.

8. Transferability of Shares: The capital is contributed by the shareholders through the subscription of shares. Such shares are transferable by its members except in case of a private limited company, which may have certain restrictions on such transferability.

9. Maintenance of Books: A limited company is required by law to keep a prescribed set of account books and any failure in this regard attracts penalties.

10. Periodic Audit: A company has to get its accounts periodically audited through the chartered accountants appointed for the purpose by the shareholders on the recommendation of board of directors.

11. Right of Access to Information: The right of the shareholders of a company to inspect its books of account, with the exception of books open for inspection under the Statute, is governed by the Articles of Association. The shareholders have a right to seek information from the directors by participating in the meetings of the company and through the periodic reports.

Q-2 Write short note on:

(i) Foreign company.

(ii) Small company.

(iii) Company limited by guarantee.

Ans: (i) Foreign Company

According to Section 2 (42) of the Companies Act, 2103, "Foreign company" means any company or body corporate incorporated outside India which –

(a) Has a place of business in India whether by itself or through an agent physically or through electronic mode; and

(b) Conducts any business activity in India in any other manner.

(ii) Small Company

Section 2(85) of the Companies Act, 2013 defines "Small company" means a company, other than a public company.

(i) paid-up share capital of which does not exceed four crores rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; or

(ii) turnover of which as per its last profit and loss account for the immediately preceding financial year does not exceed forty crores rupees or such higher amount as may be prescribed which shall not be more than hundred crore rupees.

Provided that nothing in this clause should apply to:

(A) a holding company or a subsidiary company

(B) a company registered under section 8

(C) a company or body corporate governed by any special Act

(iii) Company limited by Guarantee

As per Section 2(21) of the Companies Act, 2013, "company limited by guarantee" means a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.

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UNIT-2

ISSUE, FORFEITURE AND RE-ISSUE OF SHARES

True and False

1. Liability of a holder of shares is limited to the face value of shares acquired by them.

Ans: False: Liability of the holder of shares is limited to the issue price of shares acquired by them.

2. Authorised capital appears in the balance sheet at face value.

Ans: True: Authorised capital is the amount of capital mentioned in 'capital clause' of the 'Memorandum of Association'. Authorised capital is considered only as presentation and not considered in total of balance sheet.

3. The rate of dividend on preference shares may vary From year to year.

Ans: **False:** Rate of preference dividend is always fixed.

4. A company may issue shares at a discount to the public in general.

Ans: False: According to Section 53 of the Companies Act, 2013, a Company cannot issue shares at a discount except in the case of issue of sweat equity shares (issued to employees and directors). Thus any issue of shares at discount shall be void.

5. Sweat equity shares are those which are issued to employees & directors at a discount.

Ans: True: According to Section 53 of the Companies Act, 2013, a Company cannot issue shares at a discount except in the case of issue of sweat equity shares (issued to employees and directors).

6. As per table F, rate of interest on calls in arrears is 12%.

Ans: False: As per table F, rate of interest on calls in arrears is 10%.

7. As per Table F, rate of interest on calls in advance is 10%.

Ans: False: As per Table F, rate of interest on calls in advance is 12%.

8. Non-participating preference shareholders enjoy voting rights.

Ans: False: A share on which only a fixed rate of dividend is paid every year, without any accompanying additional rights in profits and in the surplus on winding-up, is called 'Non-participating Preference Shares. Non-participating preference shareholders do not enjoy voting rights.

9. Forfeited shares are available to the company for the purpose of resale.

Ans: True: Reissue of forfeited shares is not allotment of shares but only a sale.

10. Loss on reissue should exceed the forfeited amount.

Ans: False: Loss on re-issue should not exceed the forfeited amount.

Multiple Choice Questions

1. The excess price received over the par value of shares, should be credited to __________.

(a) Calls-in-advance account

(b) Share capital account

(c) Securities premium account

Ans: (c)

2. The Securities Premium amount may be utilized by a company for __________.

(a) Writing off any loss on sale of fixed asset

(b) Writing off any loss of revenue nature

(c) Writing off the expenses/discount on the issue of debentures

Ans: (c)

3. When shares are forfeited, the share capital account is debited with ________ and the share forfeiture account is credited with __________.

(a) Paid-up capital of shares forfeited; Called up capital of shares forfeited

(b) Called up capital of shares forfeited; Calls in arrear of shares forfeited

(c) Called up capital of shares forfeited; Amount received on shares forfeited

Ans: (c)

4. T Ltd. proposed to issue 6,000 equity shares of ` 100 each at a premium of 40%. The minimum amount of application money to be collected per share as per the Companies Act, 2013

(a) Rs.5.00

(b) Rs.6.00

(c) Rs.7.00

Ans: (a)

5. Dividends are usually paid as a percentage of ______.

(a) Authorized share capital

(b) Net profit

(c) Paid-up capital

Ans: (c)

6**. As per the SEBI guidelines, on issue of shares, the application money should not be less than**

(a) 2.5% of the nominal value of shares

(b) 2.5% of the issue price of shares

(c) 25.0% of the issue price of shares

Ans: (c)

7. G Ltd. acquired assets worth Rs.7,50,000 from H Ltd. by issue of shares of Rs.100 at a premium of 25%. The number of shares to be issued by G Ltd. to settle the purchase consideration = ?

(a) 6,000 shares

(b) 7,500 shares

(c) 9,375 shares

Ans: (a)

8. Securities Premium is presented as a part of

(a) Reserves & Surplus

(b) Share Capital

(c) Liabilities

Ans: (a)

9. Schedule III of Companies Act 2013 prescribes the format for

(a) Financial statements

(b) Directors’ Report

(c) Auditors' Report

Ans: (a)

10. Dividend on _____________ shares have to be paid before dividend on ___________shares.

(a) Equity, Preference

(b) Preference, Equity

(c) Convertible, Non-Cumulative

Ans: (b)

11. Preference shares are ______________ unless expressly stated otherwise.

(a) Non-participating

(b) Convertible

(c) Interest-bearing

Ans: (a)

Theory Questions

1. Write short notes on:

(i) Utilization of securities premium account

(ii) Re-issue of forfeited shares

Ans: When shares are issued at a premium, the premium amount is credited to a separate account called "Securities Premium Account" because it is not a part of share capital. Rather, it represents a gain of a capital nature to the company. Being a credit balance, Securities premium Account is shown under the heading, "Reserves and Surplus". However, 'Reserves and Surplus' is shown as 'shareholders' funds in the Balance Sheet as per Schedule III. According to Section 52 of the Companies Act, 2013, Securities Premium Account may be used by the company:

(a) Towards issue of un-issued shares of the company to be issued to members of the company as fully paid bonus securities.

(b) To write off preliminary expenses of the company.

(c) To write off the expenses of, or commission paid, or discount allowed on any of the securities or debentures of the company

(d) To provide for premium on the redemption of redeemable preference shares or

debentures of the company.

(e) For the purchase of own shares or other securities

(ii)A forfeited share is merely a share available to the company for sale and remains vested in the company for that purpose only. Reissue of forfeited shares is not allotment of shares but only a sale. The share, after forfeiture, in the hands of the company is subject to an obligation to dispose it off. In practice, forfeited shares are disposed off by auction. These shares can be reissued at any price so long as the total amount received (from the original allottee and the second purchaser) for those shares is not less than the amount in arrears on those shares.

2. Distinguish between:

(i) Calls-in-Arrears and Calls-in-advance

(ii) Issue of shares for cash and Issue of Shares for Consideration other than Cash

Ans: Calls-in-Arrears: Sometimes shareholders fail to pay the amount due on allotment or calls. The total unpaid amount on one or more instalments is known as Calls-in-Arrears or Unpaid Calls. Such amount represents the uncollected amount of capital from the shareholders; hence, it is shown by way of deduction from 'called-up capital' to arrive at paid-up value of the share capital.

Calls-in-advance: Some shareholders may sometimes pay a part, or whole, of the amount not yet called up, such amount is known as Calls-in-advance.

(ii) The shares can be issued by a company either for cash or for consideration other than cash. Public limited companies, generally, issue their shares for cash and use such cash to buy the various types of assets needed in the business. Sometimes, however, a company may issue shares in a direct exchange for land, buildings or other asset

3. Can a company issue shares at discount?

Ans: According to Section 53 of the Companies Act, 2013, a Company cannot issue shares at a discount except in the case of issue of sweat equity shares (issued to employees and directors). Thus any issue of shares at discount shall be void.

Practical Questions

1. X Ltd. invited applications for 10 lakhs shares of Rs.100 each payable as follows :

	Rs.
On Application	20
On Allotment (on 1st May, 2022)	30
On First Call (on 1st Oct., 2022)	30
On Final Call (on 1st Feb., 2023)	20

All the shares were applied for and allotted. A shareholder holding 20,000 shares paid the whole of the amount due along with allotment. Journalise the transactions, assuming all sums due were received. Interest was paid to the shareholder concerned on 1st February, 2023.

Ans:

Journal of X Ltd.

2022			Dr.	Cr.
May 1	Bank A/c	Dr.	200	
	To Share Application A/c			200
	(Receipt of applications for 10 lakh shares along with application money of ` 20 per share.)			
May 1	Share Application A/c	Dr.	200	
	Share Allotment A/c	Dr.	300	
	To Share Capital A/c			500
	(The allotment of 10 lakh shares: payable on application ` 20 share and ` 30 on allotment as per Directors' resolution no... dated...)			
May 1	Bank A/c	Dr.	310	
	To Shares Allotment A/c			300
	To Calls in Advance A/c			10
	[Receipt of money due on allotment @ ` 30, also			

	the two calls (` 30 and ` 20) on 20,000 shares.]			
Oct. 1	Share First Call A/c	Dr.	300	
	To Share Capital A/c			300
	(The amount due on 10 lakh shares @ ` 30 on first call, as per Directors, resolution no... dated...)			
	Bank A/c	Dr.	294	
	Calls in Advance A/c	Dr.	6	
	To Share First Call A/c			300
	(Receipt of the first call on 9.80 lakh shares, the balance having been previously received and now debited to call in advance account.)			
2023 Feb. 1	Share Final Call A/c	Dr.	200	
	To Share Capital A/c			200
	(The amount due on Final Call on 10 lakh shares @			

	` 20 per share, as per Directors' resolution no... dated...)			
Feb. 1	Bank A/c	Dr.	196	
	Calls in Advance A/c	Dr.	4	
	To Share Final Call A/c			200
	(Receipt of the moneys due on final call on 9.80 lakhs shares, the balance having been previously received.)			
Feb. 1	Interest on calls in Advance A/c	Dr.	0.66	
	To Shareholder A/c			0.66
	(Being interest on call in advance made due)			
Feb. 1	Shareholder A/c	Dr.	0.66	
	To Bank A/c			0.66
	(Being interest paid)			

Working Note:

The interest on calls in advance paid @ 12% on :	
Rs.6,00,000 (first call) from 1st May to 1st Oct., 2022–5 months	30,000
Rs.4,00,000 (final call) from 1st May to 1st Feb., 2023–9 months	36,000
Total Interest Amount Due	66,000

Q-2 A limited Company, with an authorized capital of Rs. 20,00,000 divided into shares of Rs100 each, issued for subscription 10,000 shares payable at Rs.25 per share on application,Rs.30 per share on allotment, Rs.20 per share on first call three months after allotment and the balance as and when required. The subscription list closed on January 31, 2022 when application money on 10,000 shares was duly received and allotment was made on March 1, 2022. All amounts due were received within one month of the date they were called. The allotment amount was received in full but, when the first call was made, one shareholder failed to pay the amount on 1,000 shares held by him and another shareholder with 500 shares paid the entire amount on his shares.

Give journal entries in the books of the Company to record these share capital transactions.

Ans: **Journal Entries in the Books of the Company**

Date	Particulars	L.F.	Debit	Credit
2022			Amount	Amount
			Rs.	Rs.

Jan. 31	Bank A/c Dr.		2,50,000	
	To Equity Share Application A/c			2,50,000
	(Money received on applications for 10,000 shares @ Rs. 25 per share)			
March 1	Equity Share Application A/c Dr.		2,50,000	
	To Equity Share Capital A/c			2,50,000
	(Transfer of application money on 10,000 shares to share capital)			
March 1	Equity Share Allotment A/c Dr.		3,00,000	
	To Equity Share Capital A/c			3,00,000
	(Amount due on the allotment of 10,000 shares @ Rs.30 per share)			
April 1	Bank A/c Dr.		3,00,000	
	To Equity Share Allotment A/c			3,00,000
	(Allotment money received)			
June 1	Equity Share First Call A/c Dr.		2,00,000	
	To Equity Share Capital A/c			2,00,000
	(First call money due on 10,000 shares @ Rs.20 per share)			

July 1	Bank A/c Dr.		1,92,500	
	Calls-in-Arrears A/c Dr.		20,000	
	To Equity Share First Call A/c			2,00,000
	To Calls-in-Advance A/c			12,500
	(First call money received on 9000 shares and calls-in-advance on 500 shares @ Rs.25 per share)			

3. A Ltd. forfeits 100 shares of Rs.10 each fully called upon. The shareholder failed to pay the first call money of Rs. 4 per share and the second and final Call Money of Rs. 4 per share. Give journal entry to show the effect of this transaction.

In the Books of A Ltd. Journal Entries

Date	Journal Entries Particulars	Rs.	Rs.
	Equity Share Capital A/c (100X10) Dr.	1,000	
	To Share First Call A/c (100X4)		400
	To Second and Final Call A/c (100X4)		400
	To Share Forfeiture A/c (100X2)		200

	(Being share forfeiture of 100 shares as per Board's Resolution No…..dated…)		

Q-4 B Ltd. issued 20,000 equity shares of Rs.100 each at a premium of Rs.20 per share payable as follows: on application Rs.50; on allotment Rs.50 (including premium); on final call Rs. 20. Applications were received for 24,000 shares. Letters of regret were issued to applicants for 4,000 shares and shares were allotted to all the other applicants. Mr. A, the holder of 150 shares, failed to pay the allotment and call money, the shares were forfeited. Show the Journal Entries and Cash Book in the books of B Ltd.

Ans:

Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
	To Equity Share By Equity Share Application A/c	12,00,000		By Equity Share Application A/c (Being excess money refunded on 4,000shares @ Rs.50 each as per Board's Resolution No…dated….)	2,00,000
	(Being application money received			By Balance c/d	23,89,500

	on 24,000 shares @ Rs. 50 each)				
	To Equity Share Allotment A/c (Being allotment money received on 19,850 shares @ Rs.50 each)	9,92,500			
	To Equity Share Final Call A/c (Being final call money received on 19,850 shares @ Rs.20 each)	3,97,000			
		25,89,500			25,89,500

Journal Entries

Date	Particulars	Rs.	Rs.

	Equity Share Application A/c Dr. Dr.	10,00,000	
	To Equity Share Capital A/c		10,00,000
	(Being application money on 20,000 shares @` 50 each transferred to Equity Share Capital Account as per Board's Resolution No…..dated…)		
	Equity Share Allotment A/c Dr.	10,00,000	
	To Equity Share Capital A/c		6,00,000
	To Securities Premium A/c		4,00,000
	(Being allotment money @ ` 50 per share including premium of ` 20 per share being made due as per Board's Resolution No……dated….)		
	Equity Share Capital A/c (150 x Rs.100) Dr.	15,000	
	Securities Premium A/c (150 x Rs.20) Dr.	3,000	
	To Equity Share Allotment A/c		7,500
	To Equity Share Final Call A/c		3,000
	To Forfeited Shares A/c		7,500
	(Being forfeiture of 150 shares for non-payment		

	of allotment money and final call money as per Board's Resolution No….dated…)		
	Equity Share Final Call A/c (19,850 x Rs.20) Dr.	3,97,000	
	To Equity Share Capital A/c		3,97,000
	(Being final call money received for ` 20 per share being made as per Board's resolution No…. dated ……)		

Note: Here, securities premium on forfeited shares has not been realised, so Securities Premium Account will be debited at the time of forfeiture of these shares. Also, alternatively Calls in arrears A/c could have been used in which case following entries would have been passed in place of the entry (given above) for forfeiture:

On non- receipt of allotment money:		
Calls in Arrears A/c Dr.	7,500	
To Equity Share Allotment A/c		7,500
(Being allotment money on 150 shares @ Rs.50 not received transferred to calls in arrears.)		
On non - receipt of Call money:		
Calls in Arrears A/c Dr.	3,000	

To Equity Share Final Call A/c		3,000
(Being final call on 150 shares @ Rs.20 not received transferred to calls in arrears)		
On Forfeiture:		
Share Capital A/c (150 x Rs.100)	15,000	
Securities Premium A/c (150 x Rs.20)	3,000	
To Calls in Arrears A/c		10,500
To Share Forfeiture A/c		7,500
(Being forfeiture of 150 shares for non-payment of allotment money and final call money as per Board's Resolution No….dated…)		

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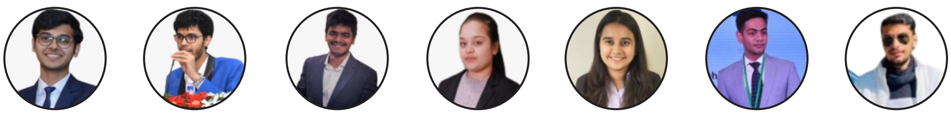

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UNIT – 3

ISSUE OF DEBENTURES

1. Debenture holder are the owners of the company.

Ans: False: Debenture holder are the creditors of the company.

2. Perpetual debentures are payable at the time of liquidation of the company.

Ans: True: Perpetual debentures, also known as irredeemable debentures are not repayable during the life time of the company.

3. Registered debentures are transferable by delivery.

Ans: False: Registered debentures are not easily transferable by delivery. Bearer debentures are transferrable by delivery.

4. When companies issue their own debentures as collateral security for a loan, the holder of such debenture is entitled to interest only on the amount of loan and not on the debentures

Ans: True: In case the company cannot repay its loan & the interest thereon on the duedate, the lender becomes debenture holder & then only he is entitled to interest on debentures.

5. Debentures suspense account appears on liability side of balance sheet

Ans: False: Debentures suspense account appears on asset side of balance sheet under noncurrent asset

6. If a company incurs loss, then it does not pay interest to the debenture holders.

Ans: False: Even if the company incurs loss or earns profit, it has to pay the interest on debentures.

7. At the time of liquidation, debenture holders are paid off after the shareholders.

Ans: False: At the time of liquidation, debenture holders are paid off before shareholders on priority basis.

8. Convertible debentures can be converted into equity shares.

Ans: True: Convertible debentures can be converted into equity share after a certain period of time from the date of its issue

9. Redeemable debentures are not payable during the life time of the company.

Ans: False: These debentures are repayable as per the terms of issue, for example, after 8 years from the date of issue.

10. Debentures can be issued for a consideration other than for cash, such as for purchasing, machinery etc.

Ans: True: Debentures can be issued for a consideration other than for cash, such as for purchasing land, machinery etc.

Multiple Choice Questions

1. Premium on redemption of debentures account appearing in the balance sheet is _______.

(a) A nominal account – expenditure

(b) A nominal account - income

(c) A personal account ______.

Ans: (c)

2. Debenture interest

(a) Is payable before the payment of any dividend on shares

(b) Accumulates in case of losses or inadequate profits

(c) Is payable after the payment of preference dividend but before the payment of equity dividend_______.

Ans: (c)

3. F Ltd. purchased Machinery from G Company for a book value of Rs.4,00,000. The consideration was paid by issue of 10% debentures of Rs.100 each at a premium of 25%.

The debenture account was credited with ______.

(a) Rs. 4, 00,000

(b) Rs.5, 00,000

(c) Rs. 3, 20,000

Ans: (c)

4. Which of the following is not a characteristic of Bearer Debentures?

(a) They are treated as negotiable instruments

(b) Their transfer requires a deed of transfer

(c) They are transferable by mere delivery

Ans: (b)

5. When debentures are issued as collateral security, the final entry for recording the collateral debentures in the books is __________.

(a) Credit Debentures A/c and debit Cash A/c.

(b) Debit Debenture suspense A/c and credit Cash A/c.

(c) Debit Debenture suspense A/c and credit Debentures A/c.

Ans: (c)

6. When debentures are redeemable at different dates, the total amount of discount on issue of debentures should be written off

(a) Every year by applying the sum of the year's digit method

(b) Every year by applying the straight line method

(c) To profit and loss account in full in the year of final or last redemption

Ans: (a)

7. Debentures are issued at discount when

(a) Market interest rate is higher than debenture interest rate

(b) Market interest rate is lower than debenture interest rate

(c) Market interest rate is equal debenture interest rate

Ans: (b)

8. Interest payable on Debentures attract

(a) Tax deducted at source

(b) Goods and Service tax

(c) Fringe benefit tax

Ans: (a)

Theoretical questions

Q-1 Distinguish between debentures and shares.

Ans:

Debentures	Shares
1. Debenture holders are the creditors of the company.	Shareholders are the owners of the company.
2. Debenture holders have no voting rights and consequently do not pose any threat to the existing control of the company.	Shareholders have voting rights and consequently control the total affairs of the company.
3. Debenture interest is generally paid at a pre-determined fixed rate. It is payable, whether there is any profit or not. Debentures rank ahead of all types of shares for payment of the interest due on them.	Dividend on equity shares is paid at a variable rate which is vastly affected by the profits of the company (however, dividend on preference shares is paid at a fixed rate).
4. Interest on debentures are the charges against profits and they are deductible as an expense in determining taxable profit of the company.	Dividends are appropriation of profit and these are not deductible in determining taxable profit of the company.
5. There are different kinds of debentures, such as Secured/ Unsecured; Redeemable/ Irredeemable; Registered / Bearer; Convertible/ Non-convertible, etc.	There are only two kinds of shares– Equity Shares and Preference Shares.
6. In the Company's Balance Sheet, Debentures are shown under "Long Term Borrowings".	In the Company's Balance Sheet, shares are shown under "Shareholder's Fund" detailed in 'Share Capital' of Notes to Accounts.
7. Debentures can be converted into other debentures or shares as per the terms of issue of debentures.	Shares cannot be converted into other shares in any circumstances.

8. Debentures cannot be forfeited for nonpayment of call moneys.	Shares can be forfeited for non-payment of allotment and call moneys.
9. At maturity, debenture holders get back their money as per the terms and conditions of redemption.	Equity shareholders cannot get back their money before the liquidation of the company (however, preference shareholders can get back their money before liquidation).
10. At the time of liquidation, debenture holders are paid-off before the shareholders.	At the time of liquidation shareholders are paid at last, after paying debenture holders, Trade payable, etc.

2. Explain the purpose for raising of debenture by the company. Also give the main features of debentures.

Ans: Debenture is one of the most commonly used debt instrument issued by the company to raise funds for the business. The most common method of supplementing the capital available to a company is to issue debentures which may either be simple or naked carrying no charge on assets, or mortgage debentures carrying either a fixed or a floating charge on some or all of the assets of the company.

FEATURES OF DEBENTURES

1. It is a document which evidences a loan made to a company.

2. It is a fixed interest-bearing security where interest falls due on specific dates.

3. Interest is payable at a predetermined fixed rate, regardless of the level of profit.

4. The original sum is repaid at a specified future date or it is converted into shares or other debentures.

5. It may or may not create a charge on the assets of a company as security.

6. It can generally be bought or sold through the stock exchange at a price above or below its face value.

Practical questions

1. Country Crafts Ltd. issued 1, 00,000, 8% debentures of Rs.100 each at premium of 5% payable fully on application and redeemable at premium of ` 10 Pass necessary journal entries at the time of issue.

Ans:

Journal Entries in the Books of Country Crafts Ltd.

Date	**Particulars**		**Debit**	**Credit**
			Amount	**Amount**
			Rs.	**Rs.**
(a)	Bank A/c		10,500	
	To Debenture Application A/c			10,500
	(Debenture application money received)			
(b)	Debenture Application A/c		10,500	
	Loss on Issue of Debenture A/c		1,000	
	To Securities Premium A/c			500
	To 8% Debentures A/c			10,000
	To Premium on Redemption A/c			1,000
	(Debenture application money			

	transferred to debenture account)			

2. Koinal Chemicals Ltd. issued 20, 00,000, 10% debentures of Rs.50 each at premium of 10%, payable as Rs. 20 on application and balance on allotment. Debentures are redeemable at par after 6 years. All the money due on allotment was called up and received. Record necessary entries when premium money is included in allotment money.

Ans:

Particulars		**Debit**	**Credit**
		Amount (Rs. lakhs)	**Amount (Rs. lakhs)**
Bank A/c	**Dr.**	400	
To Debenture Application A/c			400
(Debenture application money received)			
Debentures Application A/c	**Dr.**	400	
To 10% Debentures A/c			400
(Debenture application money transferred to 10% debenture account consequent upon allotment)			
Debenture allotment A/c	**Dr.**	700	
To 10% Debentures A/c			600
To Securities Premium A/c			100
(Call made on allotment of debenture including premium)			
Bank A/c	**Dr.**	700	
To Debenture Allotment A/c			700
(Money received consequent upon			

allotment)			

3. Kapil Ltd. issued 50,000, 12% Debentures of Rs.100 each at a premium of 10% payable in full on application by 1st March, 2022. The issue was fully subscribed and debentures were allotted on 9th March, 2022. Pass necessary Journal Entries (including cash transactions).

Ans:

Date	Particulars	Rs.	Rs.
2022			
March 1	Bank A/c	55,00,000	
	To Debentures Application A/c		55,00,000
	(Being the money received on 50,000debentures @ Rs. 110 each including premium of Rs.10 each)		
March 9	Debentures Application A/c	55,00,000	
	To 12% Debentures A/c		50,00,000
	To Securities Premium A/c		5,00,000
	(Being the allotment of 50,000 debentures of Rs.100 each, premium @Rs. 10 each transferred to Securities Premium Account as per Board's Resolution		

	No….dated….)		

4. On 1st April 2022 Sheru Ltd. issued 1,00,000 12% debentures of Rs.100 each at a discount of 5%, redeemable on 31st March, 2027. Issue was oversubscribed by 20,000 debentures, who were refunded their money. Interest is paid annually on 31st March. You are required to prepare:

(i) Journal Entries at the time of issue of debentures.

(ii) Discount on issue of Debenture Account

(iii) Interest account and Debenture holder Account assuming TDS is deducted @ 10%

Ans:

(i) Journal in the Books of Sheru Ltd

Date	Particulars	Rs.	Rs.
2022			
Apr 1	Bank A/c	1,14,000	
	To Debenture Application A/c		1,14,000
	(Being debenture application money received for 1,20,000 debentures)		
	Debenture Application A/c	1,14,000	
	Discount on Issue of Debenture A/c	5,000	
	To 12% Debenture A/c		1,00,000

	To Bank A/c		19,000
	(Being application money transferred to debenture account and excess refunded)		

(ii) Discount on Issue of Debenture A/c

Date	Particulars	Rs.	Date	Particulars	Rs.
1.4.22	**To 12% Debentures A/c**	**5,000**	**31.3.23**	**By Profit & Loss A/c**	**1,000**
			31.3.23	**By Balance c/d**	**4,000**
		5,000			**5,000**
1.4.23	**To Balance b/d**	**4,000**	**31.3.24**	**By Profit & Loss A/c**	**1,000**
			31.3.24	**Loss A/c 31.3.24**	**3,000**
		4,000			**4,000**
1.4.24	**To Balance b/d**	**3,000**	**31.3.25**	**By Profit & Loss A/c**	**1,000**

				By Balance c/d	**2,000**
		3,000			**3,000**
1.4.25	**To Balance b/d**	**2,000**	**31.3.26**	**By Profit & Loss A/c**	**1,000**
			31.3.26	**By Balance c/d**	**1,000**
		2,000			**2,000**
1.4.26	**To Balance b/d**	**1,000**	**31.3.27**	**By Profit & Loss A/c**	**1,000**
		1,000			**1,000**

Interest A/c

Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
31.3.23	To Debenture holder A/c	12,000	31.3.23	By Profit & Loss A/c	12,000
		12,000			12,000
31.3.24	To Debenture holder A/c	12,000	31.3.24	By Profit & Loss A/c	12,000

		12,000			12,000
31.3.24	To Debenture holder A/c	12,000	31.3.25	By Profit & Loss A/c	12,000
		12,000			12,000
31.3.26	To Debenture holder A/c	12,000	31.3.26	By Profit & Loss A/c	12,000
		12,000			12,000
31.3.27	To Debenture holder A/c	12,000	31.3.27	By Profit & Loss A/c	12,000
		12,000			12,000

Debenture holder A/c

31.3.23	Debenture holder A/c	10,800	31.3.23	By Interest A/c	12,000
31.3.23	To TDS A/c	1,200			
		12,000			12,000
31.3.24	To Bank A/c	10,800	31.3.24	By Interest A/c	12,000

31.3.24	To TDS A/c	1,200			
		12,000			12,000
31.3.25	To Bank A/c	10,800	31.3.25	By Interest A/c	12,000
31.3.25	To TDS A/c	1,200			
		12,000			12,000
31.3.26	To Bank A/c	10,800	31.3.26	By Interest A/c	12,000
31.3.26	To TDS A/c	1,200			
		12,000			12,000
31.3.27	To Bank A/c	10,800	31.3.27	By Interest A/c	12,000
31.3.27	To TDS A/c	1,200			
		12,000			**12,000**

5. A Limited issued 14% Debentures of the nominal value of Rs.10 each as follows:

(a) To sundry persons 1,00,000 Debentures for cash at 10% discount.

(b) To a vendor for purchase of Inventory worth Rs.1,00,000, 8,000 debentures at 25% premium.

(c) To the banker as collateral security for a loan of Rs.1,00,000 – Rs. 1,50,000 nominal value.

Pass necessary Journal Entries.

Ans:

In the books of A Ltd. Journal Entries

Date	**Particulars**	**Rs.**	**Rs.**
(a)	Bank A/c	9,00,000	
	To Debentures Application A/c		9,00,000
	(Being the application money received on 100,000 debentures @ Rs.9 each)		
	Debentures Application A/c	9,00,000	
	Discount on issue of Debentures A/c	1,00,000	
	To 14% Debentures A/c		10,00,000
	(Being the issue of 100,000 14% Debentures @ 90% as per Board's Resolution No….dated….)		
(b)	Inventories A/c	1,00,000	
	To Vendor A/c		1,00,000
	(Being the purchase of inventories from vendor)		
	Vendor A/c	1,00,000	

	To 14% Debentures A/c		80,000
	To Securities Premium		20,000
	(Being the issue of 8,000 debentures of to vendor to satisfy his claim at premium of 25%)		
(c)	Bank A/c	1,00,000	
	To Bank Loan A/c (See Note)		1,00,000
	(Being a loan of Rs.1,00,000 taken from bank by issuing debentures of Rs.1,50,000 as collateral security)		

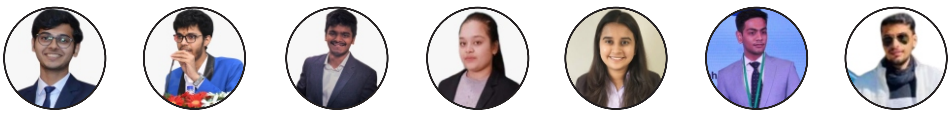
Note : No entry is made in the books of account of the company at the time of making issue of such debentures. In the Balance Sheet due to the fact that the debentures being issued ascollateral security and outstanding are shown under the respective liability.

NOTES

Practice Notes

Foundation Accounting

Chapter - 11 unit 4



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Unit – 4

Accounting for Bonus issue and Right issue

True and false

1. Earning per share gets increased after bonus issue.

Ans: False. Earnings per share gets decreased after bonus issue

2. Issued share capital including issue of rights shares and bonus shares may be more than the Authorised capital.

Ans: False. Issued share capital including issue of rights shares and bonus shares is always less than or equal to Authorised capital.

3. Rights issue of shares results in decrease of market value of per share in comparison to market price before rights issue.

Ans: True. Rights issue of shares results in decrease of market value of per share in comparison to market price before rights issue.

4. Right shares are normally offered at a price more than the cum-right value of the share, causing dilution in its value post-right issue.

Ans: False. Right shares are normally offered at a price less than the cum-right value of the share, causing dilution in its value post-right issue.

Multiple Choice Questions

1. Which of the following cannot be used for issue of bonus shares as per the Companies Act?

(a) Securities premium account

(b) Revaluation reserve

(c) Capital redemption reserve

Ans: (b)

2. Which of the following statements is true with regard to declaring and issuing of Bonus Shares?

(a) Assets are transferred from the company to the shareholders.

(b) A Bonus issue results in decrease in reserves and surplus.

(c) A Bonus issue is same as declaration of dividends.

Ans: (b)

3. Which of the following statement is true in case of bonus issue?

(a) Convertible debenture holders will get bonus shares in same proportion as to the existing shareholders.

(b) Bonus shares may be issued to convertible debenture holders at the time of conversion of such debentures into shares.

(c) Both (a) and (b).

Ans: (c)

4. Bonus issue is also known as

(a) Scrip issue.

(b) Capitalisation issue.

(c) Both (a) and (b).

Ans: (c)

5. The bonus issue is not made unless

(a) Partly paid shares are made fully paid up.

(b) It is provided in its articles of association

(c) Both (a) and (b).

Ans: (c)

6. Bonus issue has the following effect

(a) Market price gets adjusted on issue of bonus shares.

(b) Effective Earnings per share, Book Value and other per share values stand increased.

(c) Markets generally take the action as an unfavourable act.

Ans: (a)

7. ABC Co. Ltd resolved to issue bonus shares. Which of the following is not a pre-requisite for issuance of bonus shares?

(a) Authorization in Articles of Association.

(b) Timely Payment of statutory dues of employees such as PF, Gratuity etc.

(c) Sufficient balance in bank account of company.

Ans: (c)

8. In case of further issue of shares, the right to renounce the shares in favour of a third party

(a) Must include a right exercisable by the person concerned to renounce the shares;

(b) Should include a right exercisable by the person concerned to renounce the shares;

(c) Is deemed to include a right exercisable by the person concerned to renounce the shares (subject to the provisions under the articles of the company).

Ans: (c)

9. A company's share's face value is Rs. 10, book value is Rs.20, Right issue price is Rs.30 and Market price is Rs.40, while recording the issue of right share, the securities premium will be credited with

(a) Rs.10

(b) Rs.20

(c) Rs.30

Ans: (b)

10. A. Right shares enable existing shareholders to maintain their proportional holding in the company.

B. Right share issue does not cause dilution in the market value of the share.

Which of the option is correct?

(a) A-Correct; B Correct

(b) A – Incorrect; B Correct

(c) A - Correct; B – Incorrect

Ans: (c)

11. Ex-Rights price can be calculated by which of these formulas?

(a) (Cum rights value of the existing shares + Rights share issue proceeds)/ (existing number of shares + No. of right shares).

(b) (Cum rights value of the existing shares + Rights share issue proceeds) X (existing number of shares + No. of right shares).

(c) (Cum rights value of the existing shares - Rights share issue proceeds)/ (existing number of shares – No. of right shares).

Ans: (a)

Theoretical Questions

1. What is meant by Bonus issue? Explain its related provisions as per the Companies Act, 2013.

Ans: Bonus Issue means an offer of free additional shares to existing shareholders. A company may decide to distribute further shares as an alternative to increase the dividend pay-out.

Provisions of the Companies Act, 2013

Section 63 of the Companies Act, 2013 deals with the issue of bonus shares. According to

Sub-section (1) of Section 63, a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of—

(i) its free reserves;

(ii) the securities premium account; or

(iii) the capital redemption reserve account:

Provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

Sub-section (2) of Section 63 provides that no company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares under sub-section (1), unless—

2. Explain the financial effects of a further issue of equity shares on the market value of the share.

3. What are the advantages and disadvantages of a rights issue?

4. What is meant by renunciation of rights shares by existing shareholder?

(a) It is authorised by its articles;

(b) It has, on the recommendation of the Board, been authorised in the general meeting of the company;

(c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;

(d) It has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;

(e) The partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up.

(f) It complies with such conditions as may be prescribed.

The company which has once announced the decision of its Board recommending a bonus issue shall not subsequently withdraw the same.

Sub-section (3) of the Section also provides that the bonus shares shall not be issued in lieu of dividend.

As per Para 39 (i) of Table F under Schedule I to the Companies Act, 2013, a company in general meeting may, upon the recommendation of the Board, resolve—

(i) (a) that it is desirable to capitalise any part of the amount for the time being standing to the credit of any of the company's reserve accounts, or to the credit of the profit and loss account, or otherwise available for distribution; and

(b) That such sum be accordingly set free for distribution in the specified manner amongst the members who would have been entitled thereto, if distributed by way of dividend and in the same proportions.

(ii) The sum aforesaid shall not be paid in cash but shall be applied, subject to the provision contained in clause (iii), either in or towards— (a) paying up any amounts for the time being unpaid on any shares held by such members respectively; (b) paying up in full, unissued shares of the company to be allotted and distributed, credited as fully paid-up, to and amongst such members in the proportions aforesaid; partly in the way specified in (a) and partly in that specified in (b) above;

A securities premium account and a capital redemption reserve account may only beapplied in the paying up of unissued shares to be issued to members of the companyas fully paid bonus shares. In other words, securities premium account and capitalredemption reserve cannot be applied towards payment of unpaid amount on anyshares held by existing shareholders.

Q-2 Explain the financial effects of a further issue of equity shares on the market value of the share.

Ans: The financial position of a business is contained in the balance sheet. Further issue of shares increases the amount of share capital as well as the liquid resources (Bank). The amount of share capital issued is the product of further number of shares issued multiplied by issue price. The issue price may be higher than the face value (issue at a premium).

Q-3 What are the advantages and disadvantages of a rights issue?

Ans: Rights issue is an issue of rights to a company's existing shareholders that entitles them to buy additional shares directly from the company in proportion to their existing holdings, within a fixed time period. For advantages and disadvantages of right issue,

Advantages and Disadvantages of Right Issue

Advantages of Right Issue

1. Right issue enables the existing shareholders to maintain their proportional holding in the company and retain their financial and governance rights. It works as a deterrent to the management, which may like to issue shares to known persons with a view to have a better control over the company's affairs.

2. In well-functioning capital markets, the right issue necessarily leads to dilution in the value of share. However, the existing shareholders are not affected by it because getting new shares at a discounted value from their cum-right value will compensate decrease in the value of shares. The cum-right value is maintained otherwise also, if the existing shareholders renounce their right in favour of a third party.

3. Right issue is a natural hedge against the issue expenses normally incurred by the company in relation to public issue.

4. Right issue has an image enhancement effect, as public and shareholders view it positively.

5. The chance of success of a right issue is better than that of a general public issue and is logistically much easier to handle.

Disadvantages of Right Issue

1. The right issue invariably leads to dilution in the market value of the share of the company.

2. The attractive price of the right issue should be objectively assessed against its true worth to ensure that you get a bargained deal.

4. What is meant by renunciation of rights shares by existing shareholder?

Ans: In a situation where existing shareholder does not intend to subscribe to the rights issue of a company, he may give up his right in favour of another person for a consideration. Such giving up of rights is called renunciation of rights.

Practical Questions

1. Following items appear in the Trial Balance of Saral Ltd. as on 31st March, 2022:

Particulars	**Rs.**
4,500 Equity Shares of Rs. 100 each	4,50,000

Securities Premium (collected in cash)	40,000
Capital Redemption Reserve	70,000
General Reserve	1,05,000
Profit and Loss Account (Cr. Balance)	65,000

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 3 shares held. Company decided that there should be the minimum reduction in free reserves. Pass necessary Journal Entries in the books Saral Ltd.

Ans:

Journal Entries in the books of Saral Ltd.

			Dr.	Cr.
2022	Capital Redemption Reserve A/c	Dr.	70,000	
	Securities Premium A/c	Dr.	40,000	
	General Reserve A/c (b.f.)	Dr.	40,000	
	To Bonus to Shareholders A/c			1,50,000
	(Bonus issue of one shares for every three shares held, by utilising various reserves as per Board's resolution dated…….)			
	Bonus to Shareholders A/c	Dr.	1,50,000	
	To Equity Share Capital A/c			1,50,000
	(Capitalisation of profit)			

Working Note- Number of bonus shares to be issued- 4500 / 3 X1= 1500 shares

2. The following notes pertain to Brite Ltd.'s Balance Sheet as at 31st March, 2022:

(1) Share Capital	
Authorised :	
20 crore shares of Rs. 10 each	20,000
Issued and Subscribed :	
10 crore Equity Shares of Rs.10 each	10,000
2 crore 11% Cumulative Preference Shares of Rs. 10 each	2,000
Total	12,000
Called and paid up:	
10 crore Equity Shares of Rs.10 each, Rs.8 per share called and paid up	8,000
2 crore 11% Cumulative Preference Shares of Rs. 10 each,	2,000
fully called and paid up	10,000
Reserves and Surplus :	

Capital Redemption Reserve	1,485
Securities Premium (collected in cash)	2,000
General Reserve	1,040
Surplus i.e. credit balance of Profit & Loss Account	273
	4,798

On 2nd April 2022, the company made the final call on equity shares @ Rs.2 per share. The entire money was received in the month of April, 2022.

On 1st June 2022, the company decided to issue to equity shareholders bonus shares at the rate of 2 shares for every 5 shares held . Pass journal entries for all the abovementioned transactions. Also prepare the notes on Share Capital and Reserves and Surplus relevant to the Balance Sheet of the company immediately after the issue of bonus shares.

Ans:

		Dr.	Cr.
April 2	Equity Share Final Call A/c	2,000	
	To Equity Share Capital A/c		2,000
	(Final call of Rs.2 per share on 10 crore equity shares made due)		
	Bank A/c	2,000	
	To Equity Share Final Call A/c		2,000
	(Final call money on 10 crore equity shares received)		
June 1	Capital Redemption Reserve A/c	1,485	
	Securities Premium A/c	2,000	
	General Reserve A/c (b.f.)	515	
	To Bonus to Shareholders A/c		4,000

	(Bonus issue of two shares for every five shares held, by utilising various reserves as per Board's resolution dated.......)		
	Bonus to Shareholders A/c	4,000	
	To Equity Share Capital A/c		4,000
	(Capitalisation of profit)		

Notes to Accounts

	Share Capital		
	Authorised share capital:		
	20 crore shares of Rs.10 each		20,000
	Issued, subscribed and fully paid up share capital:		
	14 crore Equity shares of Rs.10 each, fully paid up		14,000
	(Out of the above, 4 crore equity shares @ Rs. 10 each were issued by way of bonus)		
	2 crore, 11% Cumulative Preference share capital of Rs. 10 each, fully paid up		2,000
			16,000

	Reserves and Surplus:		
	Capital Redemption reserve	1,485	
	Less: Utilised for bonus issue	(1,485)	
	Securities Premium	2,000	
	Less: Utilised for bonus issue	(2,000)	
	General Reserve	1,040	
	Less: Utilised for bonus issue	(515)	525
	Surplus (Profit and Loss Account) 273		273
	Total		798

3. Following notes pertain to the Balance Sheet of Manoj Ltd. as at 31st March, 2022

Authorised capital:	Rs.
30,000 12% Preference shares of Rs. 10 each	3,00,000
3,00,000 Equity shares of Rs.10 each	30,00,000
	33,00,000
Issued and Subscribed capital:	
24,000 12% Preference shares of Rs.10 each fully paid	2,40,000
2,70,000 Equity shares of Rs.10 each, Rs 8	21,60,000

paid up	
Reserves and surplus:	
General Reserve	3,60,000
Capital Redemption Reserve	1,20,000
Securities premium (collected in cash)	75,000
Profit and Loss Account	6,00,000

On 1st April, 2022, the Company has made final call @ ` 2 each on 2,70,000 equityshares. The call money was received by 20th April, 2022. Thereafter, the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held.

Show necessary journal entries in the books of the company and prepare the extract of the balance sheet as on 30th April, 2022 after bonus issue.

Ans:

Journal Entries in the books of Manoj Ltd.

		Rs.	Rs.
1-4-2022	Equity share final call A/c	5,40,000	
	To Equity share capital A/c		5,40,000
	(For final calls of Rs. 2 per share on 2,70,000 equity shares due as per Board's Resolution dated….)		
20-4-2022	Bank A/c	5,40,000	
	To Equity share final call A/c		5,40,000
	(For final call money on 2,70,000 equity		

	shares received)		
	Securities Premium A/c	75,000	
	Capital redemption Reserve A/c	1,20,000	
	General Reserve A/c	3,60,000	
	Profit and Loss A/c (b.f.)	1,20,000	
	To Bonus to shareholders A/c		6,75,000
	(For making provision for bonus issue of one share for every four shares held)		
	Bonus to shareholders A/c	6,75,000	
	To Equity share capital A/c		6,75,000
	(For issue of bonus shares)		

Extract of Balance Sheet as at 30th April, 2022 (after bonus issue)

Authorised Capital		3,00,000
30,000 12% Preference shares of Rs.10 each		33,75,000
3,37,500 Equity shares of Rs.10 each (refer W.N.)		
Issued and subscribed capital		
24,000 12% Preference shares of Rs.10 each, fully paid		2,40,000
3,37,500 Equity shares of Rs.10 each, fully paid(Out of the above, 67,500		33,75,000

equity shares @ Rs.10 each were issued by way of bonus shares)		
Reserves and surplus		
Capital Redemption Reserve	1,20,000	
Less: Utilised for bonus issue	(1,20,000)	NIL
Securities premium	75,000	
Less: Utilised for bonus issue	(75,000)	NIL
General Reserve	3,60,000	
Less: Utilised for bonus issue	(3,60,000)	NIL
Profit and Loss Account	6,00,000	
Less: Utilised for bonus issue	(1,20,000)	4,80,000

Working Note:

1. Number of bonus shares to be issued- 2,70,000/4 X1= 67,500 shares

2. The authorised capital should be increased as per details given below:

Existing issued Equity share capital	27,00,000
Add: Issue of bonus shares to equity shareholders	6,75,000
	33,75,000

4. A company has decided to increase its existing share capital by making rights issue to its existing shareholders. The company is offering one new share for every two shares

held by the shareholder. The market value of the share is Rs.240 and the company is offering one share of Rs. 120 each. Calculate the value of a right. What should be the ex-right market price of a share?

Ans: Ex-right value of the shares= (Cum-right value of the existing shares + Rights shares x IssuePrice) / (Existing Number of shares + No. of right shares)

= (Rs. 240 x 2 Shares + Rs.120 x 1 Share) / (2 + 1) Shares

= Rs. 600 / 3 shares = Rs.200 per share.

Value of right = Cum-right value of the share – Ex-right value of the share

= Rs.240 – Rs.200 = Rs.40 per share.

Hence, any one desirous of having a confirmed allotment of one share from the company at Rs.120 will have to pay Rs. 80 (2 shares x Rs.40) to an existing shareholder holding 2 shares and willing to renounce his right of buying one share in favour of that person.

5. A Ltd company having share capital of 25,000 equity shares of `10 each decides to issue rights share at the ratio of 1 for every 4 shares held at par value. Assuming all the share holders accepted the rights issue and all money was duly received, pass journal entries in the books of the company.

Ans:

Journal Entry in the books of A Ltd.

		Rs.	**Rs.**
Bank A/c **Dr.**		62,500	
To Equity share capital A/c			62,500
(For rights share issued at par value in the ratio of 1:4 equity shares due as per Board's			

Resolution dated....)			

Working Note:

Number of Rights shares to be issued- 25,000/4x1= 6,250 shares

6. Following notes pertain to the Balance Sheet of Mars Company Limited as at 31st March **2022:**

	Rs.
Authorised capital:	
50,000 12% Preference shares of Rs. 10 each	5,00,000
5,00,000 Equity shares of Rs.10 each	50,00,000
	55,00,000
Issued and Subscribed capital:	
50,000 12% Preference shares of 10 each fully paid	5,00,000
4,00,000 Equity shares of Rs. 10 each, Rs.8 paid up	32,00,000
Reserves and surplus:	
General Reserve	1,60,000
Capital Redemption Reserve	2,40,000
Securities premium (collected in cash)	2,75,000
Revaluation Reserve	1,00,000

Profit and Loss Account	16,00,000

On 1st April, 2022, the Company has made final call @ Rs. 2 each on 4,00,000 equity shares. The call money was received by 25th April, 2022. Thereafter, on 1st May 2022 the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held, it decided that there should be minimum reduction in free reserves.

On 1st June 2022, the Company issued Rights shares at the rate of two shares for every five shares held on that date at issue price of ` 12 per share. All the rights shares were accepted by the existing shareholders and the money was duly received by 20th June 2022.

Show necessary journal entries in the books of the company for bonus issue and rights issue.

Ans:

Journal Entries in the books of Mars Ltd.

2022		**Dr**	**Cr.**
April 1	Equity Share Final Call A/c	8,00,000	
	To Equity Share Capital A/c		8,00,000
	(Final call of Rs.2 per share on 4,00,000 equity shares made due)		
April 25	Bank A/c	8,00,000	
	To Equity Share Final Call A/c		8,00,000
	(Final call money on equity		

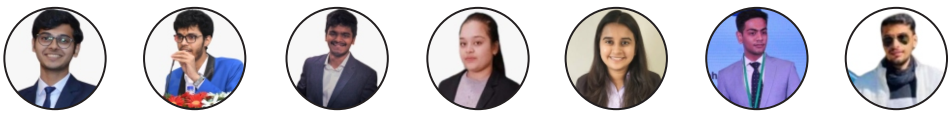
	shares received)		
May 1	Capital Redemption Reserve A/c	2,40,000	
	Securities Premium A/c	2,75,000	
	General Reserve A/c	1,60,000	
	Profit and Loss A/c (b.f.)	3,25,000	
	To Bonus to Shareholders A/c		10,00,000
	Bonus to Shareholders A/c		
	To Equity Share Capital A/c		
	(Capitalisation of profit)		
June 20	Bank A/c	24,00,000	
	To Securities Premium A/c		4,00,000
	To Equity Share Capital A/c		20,00,000
	(Being Rights issue of 2 shares for every 5 shares held as per board resolution dated		

NOTES

Practice Notes

Foundation Accounting

Chapter - 11 unit 5



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CH-11

UNIT-5

REDEMPTION OF PREFERENCE SHARES

True and False

1. When shares are redeemed by utilising distributable profit, an amount equal to the face value of shares redeemed is transferred to Capital Reserve account by debiting the distributable profit.

Ans: False: When shares are redeemed by utilising distributable profit, an amount equal to the face value of shares redeemed is transferred to Capital Redemption Reserve account by debiting the distributable profit.

2. A company who prepares financial statements in compliance with Accounting Standards under Section 133 of the Companies Act, 2013, it cannot utilize securities premium for the purpose of providing for premium on the redemption of Redeemable Preference shares of the Company.

Ans: A company who prepares financial statements in compliance with Accounting Standards under Section 133 of the Companies Act, 2013, it cannot utilize securities premium for the purpose of providing the premium on the redemption of redeemable preference shares.

3. The balance in forfeited shares account can be used for transfer to capital redemption reserve account.

Ans: False: The balance in Forfeited shares account cannot be used for transfer to capital redemption reserve account.

4. Capital redemption reserve cannot be used for writing off miscellaneous expenses and losses

Ans: True: Capital redemption reserve cannot be used for writing off miscellaneous expenses and losses.

Multiple Choice Questions

1. Securities premium cannot be used to _______.

(a) Issue bonus shares

(b) Redeem preference shares

(c) Write-off preliminary expenses

Ans: (b)

2. S Ltd. issued 2,000, 10% Preference shares of Rs.100 each at par on 1.4.2021, which are redeemable at a premium of 10%. For the purpose of redemption, the company issued 1,500 Equity Shares of Rs.100 each at a premium of 20% per share. At the time of redemption of Preference Shares, the amount to be transferred by the company to the Capital Redemption Reserve Account = ?

(a) Rs. 50,000

(b) Rs.40,000

(c) Rs.2,00,000

Ans: (a)1

3. Which of the following cannot be used for the purpose of creation of capital redemption reserve account?

(a) Profit and loss account (credit balance)

(b) General reserve account

(c) Unclaimed dividend account

Ans: (c)

4. According to Section 52 of the Companies Act, 2013, the amount in the Securities Premium A/c cannot be used for the purpose of

(a) Issue of fully paid bonus shares

(b) Writing off losses of the company

(c) For purchase of own securities

Ans: (b)

5. Which of the following can be utilized for redemption of preference shares?

(a) The proceeds of fresh issue of equity shares

(b) The proceeds of issue of debentures

(c) The proceeds of issue of fixed deposit

Ans: (a)

6. Preference shares amounting to Rs.2, 00,000 (already issued on 1.4.2021) are redeemed at a premium of 5%, by issue of shares amounting to Rs. 1, 00,000 at a premium of 10%. The amount to be transferred to capital redemption reserve =?

(a) Rs.1, 05,000

(b) Rs.1, 00,000

(c) Rs. 2, 00,000

Ans: (b)2

Theoretical Questions

1. What is the purpose of issuing redeemable preference shares?
Ans: A company may issue redeemable preference shares to raise finance in a dull primary market. Preference shares may be redeemed when there is a surplus of capital and the surplus funds cannot be utilised in the business for profitable use.

PURPOSE OF ISSUING REDEEMABLE PREFERENCE SHARES
A company may issue redeemable preference shares because of the following:
1. It is a proper way of raising finance in a dull primary market.

2. A company may face difficulty in raising share capital, as its shares are not traded on the stock exchange. Potential investors who may, hesitate in putting money into shares that cannot easily be sold may be encouraged to invest if the shares are redeemable by the company.

3. The preference shares may be redeemed when there is a surplus of capital and the surplus funds cannot be utilised in the business for profitable use.

4. No dividend is required to be paid, if there is loss or no profit, whereas interest is payable on debentures or loans even in case of loss. In other words, preference dividend declared / paid continues to be regarded as an appropriation of profits (similar treatment is given for equity shares), as against interest on debentures, which is a charge against profits. In India, the issue and redemption of preference shares is governed by Section 55 of the Companies Act, 2013.

2. What are the provisions of the Companies Act, 2013 related with redemption of preference shares? Explain in brief.

Ans: Section 55 of the Companies Act, 2013, deals with provisions relating to redemption of preference shares. It ensures that there is no reduction in shareholders' funds due to redemption and, thus, the interest of outsiders is not affected.

PROVISIONS OF THE COMPANIES ACT (SECTION 55)

A company limited by shares if so authorised by its Articles, may issue preference shares which at the option of the company, are liable to be redeemed within a period, normally not exceeding 20 years from the date of their issue. It should be noted that:

(a) no shares can be redeemed except out of divisible or distributable profit, (i.e. out of the profit of the company which would otherwise be available for dividend) or out of proceeds of fresh issue of shares made for the purpose of redemption;

(b) no such shares can be redeemed unless they are fully paid;

(c) (i) in case of such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under Section 133, the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed:

Provided also that premium, if any, payable on redemption of any preference shares issued on or before the commencement of this Act by any such company shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

(ii) in case of other companies (not falling under (i) above), the premium, if any payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

(d) where any such shares are proposed to be redeemed out of the profits of the company, there shall, out of the divisible profits, i.e. the profits which would otherwise have been available for dividends, be transferred to a reserve account to be called Capital Redemption Reserve Account, a sum equal to the nominal amount of the shares redeemed; and the provisions of the Act relating to the reduction of the share capital of a company shall, except as provided in the Section, apply as if the Capital Redemption Reserve (CRR) Account were the paid-up share capital of the company. The utilisation of CRR Account is further restricted to issuance of fully paid-up bonus shares only. From the legal provision outlined above, it is apparent that on the redemption of redeemable preference shares out of accumulated divisible profits, it will be necessary to transfer to the Capital Redemption Reserve Account an amount equal to the amount repaid on the redemption of preference shares on account of face value less proceeds of a fresh issue of shares made for the purpose of redemption. The object is that with the repayment of redeemable preference shares, the security for creditors/ bankers, etc. should not be reduced. At times, a part of the preference share capital may be redeemed out of accumulated divisible profits and the balance out of a fresh issue.

Practical Questions

1. The books of B Ltd. showed the following balance on 31st December, 2023: 30,000 Equity Shares of Rs. 10 each fully paid; 18,000 12% Redeemable Preference Shares of Rs. 10 each fully paid; 4,000 10% Redeemable Preference Shares of Rs.10 each, Rs. 8 paid up (all shares issued on 1st April, 2022).

Undistributed Reserve and Surplus stood as: Profit and Loss Account Rs.80,000; General Reserve Rs.1,20,000; Securities Premium Account Rs.15,000 and Capital Reserve Rs. 21,000. For redemption, 3,000 equity shares of Rs.10 each are issued at 10% premium. At the same time, Preference shares are redeemed on 1st January, 2024 at a premium of `2 per share. The whereabouts of the holders of 100 shares of Rs.10 each fully paid are not known. A bonus issue of equity share was made at par, two shares being issued for every five held on that date out of the Capital Redemption Reserve Account. However, equity shares, issued for redemption are not eligible for bonus. Show the necessary Journal Entries to record the transactions. (Ignore date column)

Ans:

Particulars		**Dr.**	**Cr.**
12% Redeemable Preference Share Capital A/c	**Dr.**	1,80,000	
Premium on Redemption of Preference Shares A/c	**Dr.**	36,000	
To Preference Shareholders A/c			2,16,000
(Being the amount payable on redemption of 18,000 12% Redeemable Preference Shares transferred to Shareholders Account)			
Preference Shareholders	**Dr.**	2,14,800	
To Bank A/c			2,14,800
(Being the amount paid on redemption of 17,900 preference shares)			
Bank A/c	**Dr.**	33,000	
To Equity Shares Capital A/c			30,000

To Securities Premium A/c			3,000
(Being the issue of 3,000 Equity Shares of Rs.10 each at a premium of 10% as per Board's Resolution No……. Dated……)			
General Reserve A/c	**Dr.**	1,20,000	
Profit & Loss A/c	**Dr**.	30,000	
To Capital Redemption Reserve A/c			1,50,000
(Being the amount transferred to Capital Redemption Reserve A/c as per the requirement of the Act.)			
Capital Redemption Reserve A/c	**Dr.**	1,20,000	
To Bonus to Shareholders A/c			1,20,000
(Being the amount appropriated for issue of bonus share in the ratio of 5:2 as per shareholders Resolution No…… dated…)			
Bonus to Shareholders A/c	**Dr.**	1,20,000	
To Equity Share Capital A/c			1,20,000
(Being the utilisation of bonus dividend for issue of 12,000 equity shares of ` 10 each fully paid)			
Profit & Loss A/c	**Dr.**	36,000	
To Premium on Redemption of Preference Shares A/c			36,000

(Being premium on redemption of preference shares adjusted against to Profit & Loss Account)			

Working Note:

(1) Partly paid-up preference shares cannot be redeemed.

(2) Amount to be Transferred to Capital Redemption Reserve Account

Face value of share to be redeemed = **Rs.1, 80,000**

Less: Proceeds from fresh issue (excluding premium) = **(Rs. 30,000)**

= Rs. 1, 50,000

(3) No bonus shares on 3,000 equity shares issued for redemption.

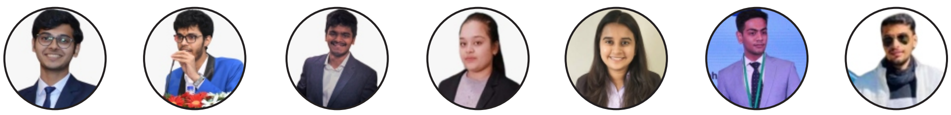
Note: Bonus shares does not result in receipt of cash, and hence the increase in share capital on account of bonus issue cannot be considered in determination of amount sto be transferred to Capital Redemption Reserve

NOTES

Practice Notes

Foundation Accounting

Chapter - 11 unit 6



CH-11

UNIT-6

REDEMPTION OF DEBENTURES

True and False

1. Amounts credited to the debenture redemption reserve may be utilised by the company for any purpose.

Ans: False: Amounts credited to the debenture redemption reserve should not be utilised by the company for any purpose except for the purpose other than for redemption of debentures.

2. All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures need not create any Debenture Redemption Reserve (DRR).

Ans: True: All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures need not create any DRR.

3. Under payment in instalments method, the payment of entire debenture is made in one lot.

Ans: False: under payment in instalments method, the payment of specified portion of debentures are made in instalments at specified intervals.

4. At redemption of debentures, DRR should be transferred to general reserve.

Ans: True: DRR is transferred to general reserve at the time of redemption of debentures.

Multiple Choice Questions

1. Which of the following statements is true?

(a) A debenture holder is an owner of the company.

(b) A debenture holder can get his money back only on the liquidation of the company.

(c) A debenture issued at a discount can be redeemed at a premium.

Ans: (c)

2. Which of the following statements is false?

(a) Debentures can be redeemed by payment in lump sum at the end of a specified period.

(b) Debentures cannot be redeemed during the life time of the company.

(c) Debentures can be redeemed by payments in annual instalments.

Ans: (b)

3. For debentures issued by unlisted companies (other than AIFIs, Banking companies, NBFCs and HFCs), Debentures Redemption reserve will be considered adequate if it is:

(a) 25% of the value of debentures issued through public issue.

(b) 10% of the value of debentures issued through public issue.

(c) 5% of the value of debentures issued through public issue.

Ans: (b)

4. **A company has issued 6% debentures for Rs. 10,00,000, interest being payable on 31st March and 30th September. The company redeems Rs. 10,000 debentures at Rs. 96 (exinterest) on 1st August 2021. The amount of Profit/loss on cancellation of debentures will be**

(a) Profit of Rs. 600.

(b) Profit of Rs.400.

(c) Loss of Rs. 400

Ans: (b)

Theoretical Questions

1. What is meant by redemption of debentures? Explain.

Ans: Debentures are usually redeemable i.e. either redeemed in cash or convertible after a time period.

Redeemable debentures may be redeemed:

- after a fixed number of years; or
- any time after a certain number of years has elapsed since their issue; or
- on giving a specified notice; or
- by annual drawing.

REDEMPTION OF DEBENTURES

Debentures are usually redeemable i.e. either redeemed in cash or convertible to equity shares after a time period.

Redeemable debentures may be redeemed:

- after a fixed number of years; or
- any time after a certain number of years has elapsed since their issue; or

- on giving a specified notice; or
- by annual drawing.

A company may also purchase its debentures, as and when convenient, in the open market. When the debentures are quoted at a discount on the Stock Exchange, it may be profitable for the company to purchase and cancel them.

2. Write short note on Debenture Redemption Reserve.

Ans: A company issuing debentures may be required to create a debenture redemption reserve account out of the profits available for distribution of dividend and amounts credited to such account cannot be utilised by the company except for redemption of debentures. Such an arrangement would ensure that the company will have sufficient liquid funds for the redemption of debentures at the time they fall due for payment.

DEBENTURE REDEMPTION RESERVE

A company issuing debentures may be required to create a debenture redemption reserve account out of the profits available for distribution of dividend and amounts credited to such account cannot be utilised by the company for any other purpose except for redemption of debentures. Such an arrangement would ensure that the company will have sufficient liquid funds for the redemption of debentures at the time they fall due for payment. An appropriate amount is transferred from profits every year to Debenture Redemption Reserve and its investment is termed as Debenture Redemption Reserve Investment (or Debenture Redemption Fund). In the last year or at the time of redemption of debentures, Debenture Redemption Reserve Investments are encashed and the amount so obtained is used for the redemption of debentures.

Practical Questions

1. A company had issued 20,000, 13% debentures of Rs.100 each on 1st April, 2021. The debentures are due for redemption on 1st July, 2022. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debenture holders to convert 20% of their holding into equity shares (Nominal value Rs. 10) at a price of Rs.15 per share. Debenture holders holding 2,500 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the debenture holders exercising the option to the maximum.

Ans: Calculation of number of equity shares to be allotted

	Number of debentures
Total number of debentures	20,000
Less: Debenture holders not opted for conversion	(2,500)
Debenture holders opted for conversion	**17,500**
Option for conversion	**20%**
Number of debentures to be converted (20% of 17,500)	**3,500**
Redemption value of 3,500 debentures at a premium of 5% [3,500 x (100+5)]	**Rs. 3,67,500**
Equity shares of Rs.10 each issued on conversion [Rs.3,67,500/ Rs. 15]	**24,500 shares**

2. Libra Limited (a listed company) recently made a public issue in respect of which the following information is available:

(a) No. of partly convertible debentures issued- 2,00,000; face value and issue price- Rs. 100 per debenture.

(b) Convertible portion per debenture- 60%, date of conversion- on expiry of 6 months from the date of closing of issue.

(c) Date of closure of subscription lists- 1.5.2021, date of allotment- 1.6.2021, rate of interest on debenture- 15% payable from the date of allotment, value of equity share for the purpose of conversion- Rs. 60 (Face Value Rs. 10).

(d) No. of debentures applied for- 2, 00,000.

(e) Interest payable on debentures half-yearly on 30th September and 31st March.

Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 2022 (including cash and bank entries).

Ans :

Date	**Particulars**	Amount Dr.	Amount Cr.
1.5.2021	Bank A/c	2,00,00,000	
	To Debenture Application A/c		2,00,00,000
	(Application money received on 1,50,000 debentures @ Rs.100 each)		
1.6.2021	Debenture Aplication A/c	2,00,00,000	
	To 15% Debentures A/c		2,00,00,000
	(Allotment of 1,50,000 debentures to applicants and 50,000 debentures to underwriters)		
1.6.2021	Debenture Redemption Investment A/c	12,00,000	
	To Bank A/c		12,00,000
	(2,00,000 X 100 x 15% X 40%)		
	(Being Investments made for redemption		

	purpose)		
30.9.2021	Debenture Interest A/c	10,00,000	
	To Bank A/c		10,00,000
	(Interest paid on debentures for 4 months @ 15% on Rs.2,00,00,000)		
31.10.2021	15% Debentures A/c	1,20,00,000	
	To Equity Share Capital A/c		20,00,000
	To Securities Premium A/c		1,00,00,000
	(Conversion of 60% of debentures into shares of Rs. 60 each with a face value of Rs.10)		
31.3.2022	Debenture Interest A/c	7,50,000	
	To Bank A/c		7,50,000
	(Interest paid on debentures for the half year) (Refer working note)		

Working Note:

Calculation of Debenture Interest for the half year ended 31st March, 2022

On Rs.80,00,000 for 6 months @ 15% = Rs.6,00,000

On Rs.1,20,00,000 for 1 months @ 15% = Rs. 1,50,000

Rs.7,50,000

3. **Case Ltd. (unlisted company other than AIFI, Banking company, NBFC and HFC) provides the following information as at 31st March, 2022:**

	Particulars	Rs.
(a)	Shareholder's Funds	
	Share Capital	
	Authorized share capital:	
	45,000 equity shares of Rs.10 each fully paid Issued and subscribed share capital:	4,50,000
	30,000 equity shares of Rs.10 each fully paid	3,00,000
(b)	Reserves and Surplus	
	Profit & Loss Account	1,62,000
	Debenture Redemption Reserve	18,000
	Non-current liabilities	
(a)	Long term borrowings 12% Debentures	1,80,000
	Current Liabilities	
(a)	Trade payables	1,72,500
	Non-current assets	27,000

	Property, Plant and Equipment (Freehold property)	
	Non-current Investment: DRR Investment	
	Current assets	
(a)	Inventories	2,02,500
(b)	Trade receivables	1,12,500
(c)	Cash and bank balances:	
	Cash at bank	2,73,000
	Cash in hand	45,000

At the Annual General Meeting on 1.4.2022, it was resolved:

(a) To give existing shareholders the option to purchase one Rs.10 share at Rs.15 for every four shares (held prior to the bonus distribution). This option was taken up by all the shareholders.

(b) To issue one bonus share for every five shares held.

(c) To repay the debentures at a premium of 3%.

Give the necessary journal entries for these transactions

Ans: Journal Entries in the Books of Case Ltd.

		Dr.	Cr.
Bank A/c Dr.		1,12,500	
To Equity Shareholders A/c			1,12,500
(Application money received on 7,500 shares @ Rs.15 per share to be issued as rights shares in the ratio of			

1:4)			
Equity Shareholders A/c Dr.		1,12,500	
To Equity Share Capital A/c			75,000
To Securities Premium A/c			37,500
(Share application money on 7,500 shares @ Rs. 10 per share transferred to Share Capital Account, and Rs.5 per share to Securities Premium Account vide Board's Resolution dated...)			
Securities Premium A/c Dr.		37,500	
Profit & Loss A/c Dr.		37,500	
To Bonus to Shareholders A/c			75,000
(Amount transferred for issue of bonus shares to existing shareholders in the ratio of 1:5 vide General Body's resolution dated...)			
Bonus to Shareholders A/c Dr.		75,000	
To Equity Share Capital A/c			75,000
(Issue of bonus shares in the ratio of 1 for 5 vide Board's resolution dated....)			
12% Debentures A/c Dr.		1,80,000	
Premium Payable on Redemption A/c (@ 3%) Dr.		5,400	
To Debenture holders A/c			1,85,400
(Amount payable to debentures holders)			

Profit and loss A/c Dr.		5,400	
To Premium Payable on Redemption A/c			5,400
(Premium payable on redemption of debentures charged to Profit & Loss A/c)			
Debenture Redemption Reserve A/c Dr.		18,000	
To General Reserve			18,000
(For DRR transferred to general reserve)			
Bank A/c Dr.		27,000	
To Debenture Redemption Reserve Investment			27,000
(for DRR Investment realised)			
Debenture holders A/c Dr.		1,85,400	
To Bank A/c			1,85,400
(Amount paid to debenture holders on redemption)			