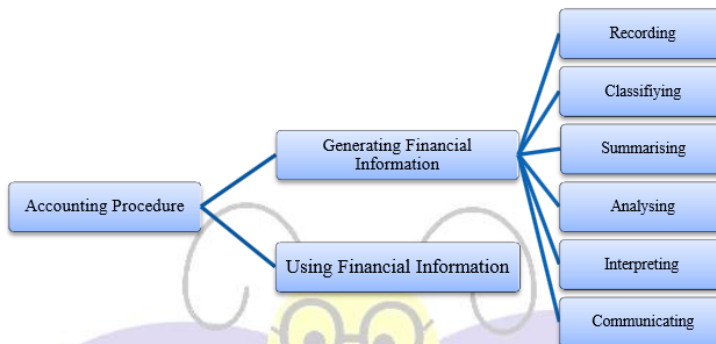




➤ Meaning of Accounting

Traditional Definition: “Accounting is an 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 financial character, and interpreting the result thereof.”

Modern Definition: “Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decision by users of accounts.”



- ✓ **Recording:** All business transactions of a financial character, as evidenced by some documents such as sales bill, purchase bill, bank pass book etc. are recorded in books of account.
- ✓ **Classifying:** Classification of the recorded transactions as to group the transactions of similar type at one place. This is performed by maintaining the ledger in which different accounts like rent, salary, printing etc. are opened to which related transactions are brought to one place by posting.
- ✓ **Summarizing:** Summarization of the classified transactions in a manner useful to the users. It involves the preparation of Financial Statements such as Income Statement, Balance Sheet, Cash flow statement.
- ✓ **Analyzing:** It means methodical classification of the data given in the financial statements. For example all items related to current assets are put together in such a manner that establishes relationship between profit and loss account and balance sheet, which provide basis for interpretation.
- ✓ **Interpreting:** Explaining the meaning and significance of the relationship so established by the analysis. The accountant should interpret the financial statement in a manner useful to the users, so as to enable them to make meaningful judgment about profitability and financial condition.
- ✓ **Communicating:** Transmission of summarized, analyzed and interpreted information to end-user to enable them to make rational decisions. This is done through preparation and distribution of accounting reports, which includes profit and loss account, balance sheet, cash flow and additional information.



As an information system, accounting may be viewed as under:



➤ **Objectives of Accounting:**

1. **Systematic recording of transaction : Book keeping**
2. **Ascertainment of result of above recorded transactions: Profit and Loss account.**
3. **Ascertainment of financial position of the business: Balance Sheet.**
4. **Providing information to the users for rational decision making: Financial Results**
5. **To know the solvency position: Ability to meet liabilities in short run and long run**

➤ **Meaning of Book-keeping:**

Book keeping is a part of accounting and is concerned with record keeping or maintenance of books of accounting, covers following four activities:

1. *Identifying the transactions and events.*
2. *Measuring the identified transactions and events in a common measuring unit.*
3. *Recording the identified and measured transactions and events in proper books of accounts.*
4. *Classifying the recorded transactions and events in the ledger.*

Book-Keeping	Accounting
<i>It is a process of identifying, measuring, recording and classifying the transactions.</i>	<i>It is a process of summarizing, analyzing of the recorded transactions. Communicating the interpreted information to the interested parties.</i>
<i>It constitutes as a base for accounting.</i>	<i>It is considered as a language of the business.</i>
<i>Financial statements do not form part of this process.</i>	<i>Financial statements are prepared in this process on the basis of book-keeping records.</i>
<i>Financial position of the business cannot be ascertained and Managerial decisions cannot be taken with the help of these records as basic objective is to maintain systematic records.</i>	<i>Financial position of the business is ascertained on the basis of the accounting reports. Management takes decision on the basis of these records.</i>
<i>There is no sub-field of book-keeping</i>	<i>It has several sub-field like financial accounting, Management accounting etc..</i>

Relationship between Accounting and book keeping can be viewed diagrammatically:



Sub-fields of Accounting:

1. **Financial Accounting:** *Preparation of Balance-sheet and Profit and Loss account, determination of net result and for the period and financial position as on given date..*
2. **Managerial Accounting:** *The different ways of grouping information and preparing reports for Planning, control and decision making.*



3. **Cost Accounting:** The process of accounting for cost which begins with the recording of income and expenditure or the bases on which they are calculated and ends with the preparation of periodical statements and reports for ascertaining and controlling costs.
4. **Social Responsibility Accounting:** Concerned with accounting for social cost incurred by the enterprise and social benefits created.
5. **Human Resource Accounting:** An attempt to identify, quantify and report investment made in human resources of an organization.

➤ **Users of Accounting Information**

Users of accounting information include present and potential investors, management, employees, lenders, suppliers and other trade creditors, customers and government agencies and public.

Users	Need for Information
Short-term creditors	To determine whether their dues will be paid when due and whether they should extend, maintain or restrict the flow of credit to firms
Long-term creditors	To determine whether their principals and interest thereof will be paid when due and whether they should extend, maintain or restrict the flow of credit.
Investors	To judge prospects of an enterprise and to determine whether they should buy, hold or sell the shares.
Management	To review firms Short term and long term solvency, Activity, Profitability in relation to turn over and investment.
Employees	To assess the ability of the enterprise to pay remuneration, retirement benefits and to provide promotion opportunities.
Customers	To know information about continuation of firm, especially when they have established a long term involvement with or are dependent on the firm.
Government Agencies	Agencies including tax authorities need information to assess the tax liabilities and to regulate activities of the firm.
Public	To know functioning of the firm as it may make a substantial contribution to the local economy in many ways including number of people employed and their patronage to local suppliers.

➤ **Advantages of Accounting**

Accounting Facilitates in following ways:

1. To comply with legal requirements.
2. To ascertain Financial Performance & Position of firm.
3. Users and management to take Decisions.
4. Making a Comparative study.
5. Control over assets.
6. Settlement of tax liabilities
7. Ascertainment of value of Business
8. Raising of Finance for business
9. Acts as Legal evidence

➤ **Limitations of Accounting:**

1. **Ignores the Qualitative Elements:** Since accounting is confined to the monetary matters only, the elements like quality of management, quality of labor force etc. are ignored.
2. **Not free from Bias:** In many situations, accountant can choose method of depreciation, method of stock valuation based on his personal judgment.
3. **Ignores Price level changes:** Since financial statements are prepared on historical cost and not on replacement value which is generally higher in case of assets, analysis of financial statements will not yield strictly comparable result as price level changes are not considered.



4. *Estimated position and not real position: The Financial statements are prepared on going concern basis. Hence, they report only estimated periodic results, true results can be ascertained only on the liquidation of firm.*
5. *Danger of window dressing: when the management decides to enter wrong figures to artificially inflate or deflate the figures of profit, assets and liabilities, Profit and Loss and Balance sheet fails to provide true and fair view of the financial performance and position.*

➤ **Basis of Accounting:**

- A. **Accrual basis of Accounting**
Accrual basis of accounting is a method of recording transactions by which Revenue, Cost, Assets and Liabilities are recognized during the accounting period in which they accrue.
- B. **Cash basis of Accounting**
Cash basis of accounting is method of recording transactions by which Revenues, Cost, Assets and Liabilities are recognized during the period in which Actual receipts and Actual payments takes place.
- C. **Hybrid basis of Accounting**
It is a combination of Accrual and Cash basis of accounting. Under this method, Incomes are recorded on cash basis and expenses are recorded on accrual basis.

MCQ:

1. *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*
 - d. *None of the above*
2. *Accounting covers only the following activities:*
 - a. *Recording and classifying*
 - b. *Recording, Classifying, Summarising and Analysing*
 - c. *Summarising, Analysing and Interpreting*
 - d. *Identifying, Measuring and Communication*
3. *The basic objective of accounting is*
 - a. *to maintain systematic records of financial transactions*
 - b. *to ascertain financial performance*
 - c. *to ascertain financial position*
 - d. *all of the above*
4. *All of the following are functions of accounting except*

a. <i>Decision making</i>	c. <i>Forecasting</i>
b. <i>Measurement</i>	d. <i>Ledger posting</i>
5. *Users of Accounting information includes*

a. <i>Creditors/ suppliers</i>	c. <i>Customers</i>
b. <i>Lenders</i>	d. <i>All of the above</i>
6. *Financial statements do not consider*
 - a. *Assets expressed in monetary terms*
 - b. *Liabilities expressed in monetary terms*
 - c. *only assets expressed in monetary terms*
 - d. *Assets and liabilities expressed in non-monetary terms*
7. *Which of the following is not a sub-field/Branch of Accounting*

a. <i>Cost Accounting</i>	c. <i>Social responsibility accounting</i>
b. <i>management accounting</i>	d. <i>book-keeping</i>

ANSWERS: 1.(a) 2.(d) 3.(d) 4.(d) 5.(d) 6.(d) 7.(d)



ACCOUNTING PRINCIPLES

THEORY OF ACCOUNTING AND PRACTICES ARE FOUNDED ON CONCEPTS, PRINCIPLES AND CONVENTIONS:

➤ **Accounting Principles:**

Accounting principles are body of doctrines commonly associated with the theory and practices of Accounting, based on real assumptions, simple, understandable and explanatory to users and followed consistently. They should be able to reflect future prediction and informational to users.

➤ **Accounting Concepts:**

The word Concepts means idea. Concepts are basic assumption and condition upon which accountancy has been laid. Unlike physical science Accounting concepts are result of broad consensus. The accounting concepts lay the foundation for formulation of accounting principles.

ACCOUNTING IS BASED ON VARIOUS ACCOUNTING CONCEPTS:

a. Entity Concept

Business enterprise is a separate identity apart from its owner. Accountants should treat business as distinct from its owner. Business transactions are recorded in the business books of accounts and owners transactions in his personal books of accounts.

b. Money Measurement concept

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, even if, they affect the results of the business materially, are not recorded if they are not convertible in monetary terms.

c. Periodicity concept

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

d. Matching concept

In this concept, all expenses matched with the revenue of that period should 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.

e. 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 interest of objectivity.

f. Realisation concept

Any change in value of an asset is to be recorded only when the business realizes it. Accountants anticipate decrease in value they count it, but if there is increase in value, they ignore it until it is realized.

g. Dual aspect concept

This concept is the core of double entry book-keeping. Every transaction or event has dual aspect.

1. It increases one Asset and decreases other Asset
2. It increases an Asset and simultaneously increases Liability
3. It decreases one Asset, increases other Asset
4. It decreases one Asset, decreases a Liability.

h. Materiality

According to materiality principle, all the items having significant economic effect on the business of the enterprise should be disclosed in the financial statements and any insignificant item which will not be relevant to the users need should not be disclosed in the financial statement.



i. Conservatism

Conservatism states that the accountant should not anticipate income and should provide for all losses. The golden rule of current asset valuation “cost or market price whichever is lower” originated from this concept. It is prudent to count unrealized gain but it is desirable to guard against all possible losses.

1. Prudence: Judgment about the possible future losses and gains.
2. Neutrality: Unbiased outlook is required to identify and record such possible losses as well as to exclude uncertain gains.
3. Faithful representation of alternative values.

j. Going concern (Fundamental Accounting Assumption)

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 necessity of liquidation or curtailing materially its scale of operations.

k. Consistency (Fundamental Accounting Assumption)

It is assumed that accounting policies are consistent from one period to another. Whatever accounting practices are selected for a given category of transactions, they should be followed on a horizontal basis from one accounting period to another to achieve compatibility.

l. Accrual (Fundamental Accounting Assumption)

Under accrual concept, the effect of transaction and other events are recognized on mercantile basis i.e. when they occur. Financial statements prepared on the accrual basis inform users not of past events involving the payments and receipts of cash but also of obligations to pay cash in the future and of resources that represent cash to be received in the future.

ACCOUNTING CONVENTIONS:

Emerge out of accounting practices, commonly known as principles adopted by various organization over period of time, derived by usage and practice. The accountancy bodies keep changing the conventions to improve quality of accounting information.

➤ Qualitative Characteristics of Financial Statements

1. Understandability: It must be readily understandable by users
2. Relevance : Information must be relevant to the decision making needs of users
3. Reliability: Information must be reliable means free from material error and bias.
4. Comparability: User 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.
5. Materiality: Information is material if its misstatement could influence the economic decisions of users taken on the basis of the financial information.
6. Faithful Representation: Financial statements should represent faithfully the transactions and other events that results in assets, liabilities and equity of the enterprise.
7. Substance over form: It is necessary that financial transactions are accounted for and presented in accordance with their substance and economic reality and not merely their legal form.
8. Neutrality: The information contained in financial statements must be neutral that is free from bias.
9. Prudence: Uncertainties of future events regarding business transactions are recognized by the disclosure of their nature and extent and by the exercise of prudence in the preparation of financial statements.
10. Full, fair and adequate disclosure: The financial statements 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.
11. Completeness: The information in financial statements must be complete within the bounds of materiality and cost



MCQ:

1. Two primary qualitative characteristics of financial statements are
 - a. Understandability and materiality
 - b. Relevance and reliability
 - c. Neutrality and understandability
 - d. Materiality and reliability
2. Revenue from sale of product, is generally, realized in the period in which
 - a. Cash is collected
 - b. Sales is made
 - c. Products are manufactured
 - d. none of above
3. Personal transactions are distinguished from business transactions of an accounting period in accordance with-
 - a. accounting period principle
 - b. Accounting entity principle
 - c. Money measurement principle
 - d. None of these
4. Valuation of the crops at market value is in accordance with—
 - a. Matching principle
 - b. Revenue recognition principle
 - c. Cost principle
 - d. None of above
5. Mr.X valued the inventory on FIFO basis during 2015 and on LIFO basis during 2016. he has violated:
 - a. Conservatism
 - b. Materiality
 - c. Cost concept
 - d. Consistency
6. Mr.X has purchased a building for Rs. 1 lac but at the end of accounting period, the market value of building is Rs.1.5 lacs. He disclosed the building at Rs.1.5 lacs in the financial statement. He has violated:
 - a. Conservatism
 - b. Materiality
 - c. Cost concept
 - d. Consistency
7. Subjectivity involved in
 - a. Cost concept
 - b. Money measurement
 - c. Accounting entity concept
 - d. Prudence
8. All of these classified as fundamental accounting assumptions except—
 - a. Consistency
 - b. Business entity
 - c. Going concern
 - d. Accrual
9. The concept of conservatism when applied to the balance sheet results in
 - a. Understatement of assets
 - b. Overstatement of assets
 - c. Overstatement of Capital
 - d. understatement of capital

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



Accounting Standards

➤ **Meaning of Accounting Standard**

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

➤ **Objective of Accounting Standard**

The main objective of accounting standard is to harmonize the diverse accounting policies and practices at present in use in India. Accounting standards standardize diverse accounting policies with a view to:

1. Eliminate the non-comparability of financial statements and thereby improving the reliability of financial statements
2. Provide a set of standard accounting policies, valuation norms and disclosure requirements

Accounting standards reduce the accounting alternatives in the preparation of financial statements of different enterprises.

➤ **Significance of Accounting Standards**

The adoption and application of accounting standards ensure uniformity, comparability and qualitative improvement in the preparation and presentation of financial statements.

➤ **Advantage of setting Accounting Standards**

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

➤ **Limitations of Accounting Standards**

1. Alternative solutions to certain accounting problems may each have arguments to recommend them. Therefore, the choice between different alternative accounting treatments may become difficult.
2. There may be trend towards rigidity and away from flexibility in applying the accounting standards.
3. Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.

➤ **Accounting Standards Board of India.(ASB)**

Formation of Accounting Standard board – The institute of Chartered Accountants of India, recognizing the need to harmonize the diverse accounting policies and practices at present in use in India, constituted an accounting standard Board (ASB) on April 21, 1977.

➤ **Procedure for issuing Accounting Standards.**

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

Step 2 → Hold a dialog with the representatives of the government, public sector undertakings, industry and other organizations for ascertaining their views.



Step 3 → Prepare and issue exposure draft of the standard for comments by members of the institute and public at large.

Step 4 → Finalize the draft of proposed standard after taking into consideration the comments received.

Step 5 → Submit the final draft to council of the institute.

Step 6 → The council will consider the final draft and modify the same in consultation with ASB. The

Accounting Standard on the relevant subject will be issued under the authority of council.

➤ Accounting Standards issued so far:

S.No.	Title	Mandatory or not	Effective from
AS-1	Disclosure of Accounting Policies	mandatory	1.4.93
AS-2	Valuation of Inventories-revised	mandatory	1.4.99
AS-3	Cash flow statement-revised	mandatory	1.4.2001
AS-4	Contingencies and events occurring after Balance Sheet date – revised	mandatory	1.4.95
AS-5	Net profit or loss for the period, Prior period items and changes in Accounting policies.	mandatory	1.1.96
AS-6	Depreciation Accounting – revised	mandatory	1.1.95
AS-7	Accounting for construction contracts – revised	mandatory	1.1.2003
AS-8	Accounting for research and development	Withdrawn and included in AS-26	
AS-9	Revenue Recognition	Mandatory	1.4.93
AS-10	Accounting for Fixed Assets	Mandatory	1.4.93
AS-11	The effects of changes in Foreign Exchange rates	Mandatory	1.4.2004
AS-12	Accounting for Government Grants	Mandatory	1.4.94
AS-13	Accounting for Investments	Mandatory	1.4.95
AS-14	Accounting for Amalgamations	Mandatory	1.4.95
AS-15	Employee Benefits	Mandatory	1.4.95
AS-16	Borrowing Costs	Mandatory	1.4.2000
AS-17	Segment Reporting	Mandatory	1.4.2001
AS-18	Related Party Disclosure	Mandatory	1.4.2001
AS-19	Leases	Mandatory	1.4.2001
AS-20	Earnings per share	Mandatory	1.4.2001
AS-21	Consolidated Financial Statements	Mandatory	1.4.2001
AS-22	Accounting for Taxes on Income	Mandatory	1.4.2001
AS-23	Accounting for Investments in associates in consolidated Financial Statements	Mandatory	1.4.2002
AS-24	Discontinuing Operations	Mandatory	1.4.2004
AS-25	Interim Financial Reporting	Mandatory	1.4.2002
AS-26	Intangible Assets	Mandatory	1.4.2003
AS-27	Financial Reporting of Interest in joint venture	Mandatory	1.4.2004
AS-28	Impairment of Assets	Mandatory	1.4.2004
AS-29	Provisions, Contingent Liabilities and Contingent Assets	Mandatory	1.4.2004
AS-30	Financial Instrument: Recognition & measurement	Recommended 1.4.2009	1.4.2011
AS-31	Financial Instrument: Presentation	Recommended 1.4.2009	1.4.2011
AS-32	Financial Instrument: Disclosure	Recommended 1.4.2009	1.4.2011



➤ International Financial Reporting Standards(IFRS)

The IFRS foundation is an independent, not for profit private sector organization working in the public interest having following objectives:

1. Develop single set of high quality, understandable, affordable and globally accepted international financial reporting standards(IFRSs) through its standard setting body, International accounting standard board(IASB)
2. Promote the use and rigorous application of those standards.
3. Take account of the financial reporting needs of emerging economies and small and medium sized entities.
4. Bring about convergence if national accounting standards and IFRS to high quality solutions.

➤ **Advantage of IFRS:**

1. **Growth in International Business:** As international Business and investment multiplies, accounting in international dimension broadens.
2. **Globalization of Capital markets:** Companies are going global these days and raising funds thru ADRs, GDRs etc. IFRS helps international investor to analyze the accounts.
3. **Investors:** Investors who wants to invest outside their country, IFRS helps them to compare and analyze and understand the accounts.
4. **Multinational companies:** Due to diversity in accounting standards from country to country, MNC firm faces lot of accounting requirement from the countries in which they operate. Due to adoption of IFRS, there would be fewer burden on their financial reporting structure and consolidating subsidiaries in different countries.
5. **International Auditing Firms:** These firms can serve with their expertise in different countries with adoption of IFRS.

➤ **IFRS in India**

India has not adopted IFRS standards. India has adopted Indian Accounting Standards (Ind AS) that are based on and substantially converged with IFRS standards as issued by the Board.

All companies, including unlisted companies, are permitted to use **Ind AS** for accounting periods beginning on or after 1st April 2015. **Ind AS** is being phased in for listed companies (other than those on SME Exchange) and large unlisted companies in 2016 and 2017.

MCQ:

1. Accounting Standards in India are issued by

<ol style="list-style-type: none"> a. Central Government b. State Govt. 	<ol style="list-style-type: none"> c. Institute of Chartered Accountants of India d. Reserve Bank of India
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2. Accounting standards
 - a. Harmonize accounting policies
 - b. Eliminate the non-comparability of financial statements
 - c. Improve the reliability of Financial Statements
 - d. All of the above
3. How many accounting standards have been issued by ICAI ?

a. 25	b. 20	c. 32	d. 2
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4. It is essential to standardize the accounting principles and policies in order to ensure

a. Transparency	b. Consistency	c. Comparability	d. All of the above
-----------------	----------------	------------------	---------------------
5. All of the following are limitations of Accounting Standards except
 - a. The choice between different alternative accounting treatment is difficult
 - b. There may be trend towards rigidity
 - c. Accounting Standards cannot override the statute
 - d. All of the above

ANSWERS: 1.(C) 2.(D) 3.(c) 4.(d) 5.(d)



Meaning: Accounting Policies refer to specific accounting principles and methods of applying these principles adopted by enterprise in preparation and presentation of financial statements.

➤ Examples of some of the areas in which different accounting policies are adopted by enterprises:

1. Method of depreciation
2. Valuation of Inventories
3. Valuation of Investments
4. Valuation of Fixed Assets.
5. Treatment of contingent liabilities.
6. Treatment of Expenditure during construction period
7. Conversion or translation of foreign currency items
8. Treatment of Goodwill
9. Treatment of retirement benefits
10. Recognition of profit on long term contracts.

➤ **Selection of Accounting Policies**

The major consideration governing selection and application of accounting policies are as under:

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

➤ **Disclosure of Accounting Policies**

According to Accounting Standard (AS-1) issued by The Institute of Chartered Accountants of India:

- a. All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed
- b. The disclosure of the significant accounting policies as such should form a part of the financial statements.

➤ **Change in Accounting Policies.**

A change in Accounting Policies should be made in following conditions:

- a. It is required by some statute or for compliance with Accounting Standards
- b. Change would result in more appropriate presentation of financial statements.

MCQ:

1. The areas wherein different accounting policies can be adopted are
 - a. Providing Depreciation
 - b. Valuation of Inventories
 - c. Valuation of Investments
 - d. All of above
2. Accounting Policies refer to specific accounting
 - a. Principles
 - b. Method of applying those principles
 - c. Both (a) and (b)
 - d. None of the above
3. The major consideration governing the selection and application of accounting policies are
 - a. Prudence, consistency and materiality
 - b. Prudence, going concern and materiality
 - c. Accrual, Substance over form and materiality
 - d. Prudence, Substance over form and materiality
4. Which accounting principle is followed in adopting accounting policy of provision of doubtful debts@5% on debtors:
 - a. Prudence
 - b. Materiality
 - c. Substance over form
 - d. All of these.
5. Selection of inappropriate accounting policy decision may
 - a. Overstate the performance and financial position of a business entity
 - b. Overstate/understate the performance and financial position of a business entity
 - c. Overstate the performance of a business entity



d. Understate financial position a business entity.

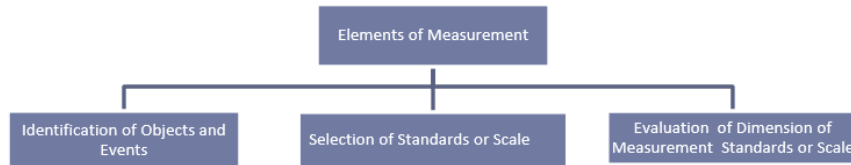
ANSWERS: 1.(d) 2.(c) 3.(d) 4.(a) 5.(b)





ACCOUNTING AS A MEASUREMENT DISCIPLINE

Meaning of Measurement: Prof. R.J.Chamber defined measurement as “Assignment of number to object and events according to rules specifying the property to be measured, the scale to be used and the dimension of the unit”



Objects or Events to be measured:

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

Standard or Scale of Measurement:

1. In accounting, money is the scale of measurement.
2. Money as a measurement scale has no universal application because it takes the shape of currency ruling in a country which differs from one reporting country to another reporting country.

Dimension of Measurement Scale:

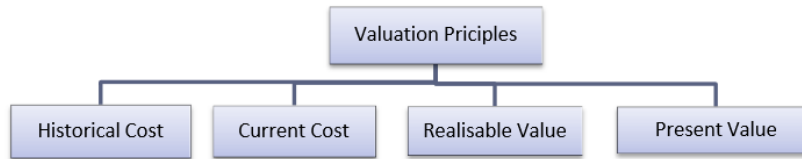
1. An idea measurement scale should be stable overtime
2. Money as a scale of measurement is not stable in the dimension for comparison over time because the same quantity of money may not have the ability to buy same quantity of identical goods at different dates.

Accounting as a measurement discipline

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



➤ **Valuation Principles**



1. *Historical Cost:*

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

2. *Current Cost:*

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

3. *Realizable Value:*

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

4. *Present Value:*

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

➤ **Measurement and Valuation**

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

➤ **Accounting Estimates**

Meaning: The measurement of certain assets and liabilities is based on estimates of uncertain future events. As a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated.

Change in estimates: means differences arising between certain parameters estimated earlier and re-estimated during the current period or difference between earlier estimates and actual result during the current period.

Revision in estimates: If changes occur regarding circumstances on which the estimate was based or as a result of new information, more experience or subsequent developments.

Examples:

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



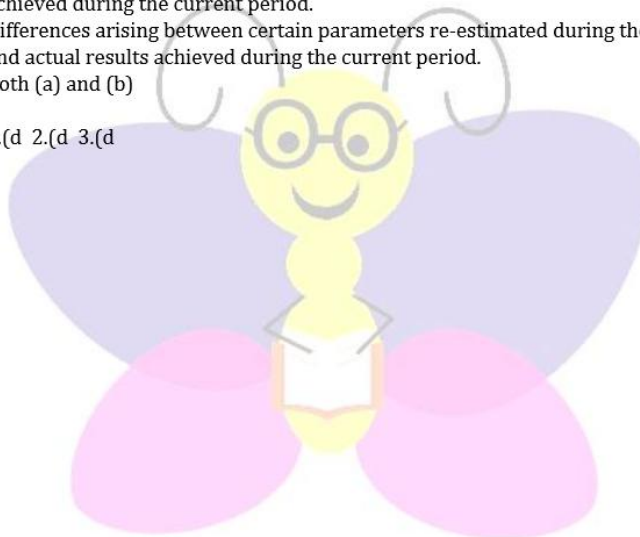
MCQ:

1. Measurement discipline deals with
 - a. Identification of object and events.
 - b. Selection scale
 - c. Evaluation of dimension of measurement scale
 - d. All of the above

2. All of the following are valuation principles except
 - a. Historical cost
 - b. Current cost
 - c. Realizable value
 - d. Future value

3. Change in accounting estimates means
 - a. Difference arising between certain parameters estimated earlier and re-estimated during the current period
 - b. Differences arising between certain parameters estimated earlier and actual results achieved during the current period.
 - c. Differences arising between certain parameters re-estimated during the current period and actual results achieved during the current period.
 - d. Both (a) and (b)

ANSWERS: 1.(d) 2.(d) 3.(d)





Accounting Equation/Double Entry System:

The relationship of Assets with that of Liabilities and Owners Equity in Equation form is known as Accounting Equation. In simple words, when we start any business, we bring assets for running activities out of our own resources or borrowed one but total of resources employed would be equal to all assets. .i.e..

$$\text{Assets} = \text{Capital (Owners Equity)} + \text{Liabilities. (External Equity)}$$



or

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

or

$$\text{Equity} + \text{Long-Term Liabilities} = \text{Fixed Assets} + \text{Current Assets} - \text{Current Liabilities.}$$

This equation is fundamental that gives foundation to the double entry book keeping system.

There is any change in one side of equation, there is bound to be similar change on other side.

Double Entry System recognizes and records both aspects (Debit and Credit) of Transactions.

EFFECT OF TRANSACTION ON ASSETS, LIABILITIES AND CAPITAL

Transaction	Effect on		
	Assets	Liabilities	Capital
1. Capital bought in cash or kind	Increase ↑		Increase ↑
2. Loan taken from Bank	Increase cash ↑	Increase loan ↑	
3. Purchased Fixed Asset in cash	Increase FA ↑ Decrease cash ↓		
4. Purchased Fixed Asset on credit	Increase FA ↑	Increase creditors ↑	
5. Sold Goods on credit at profit	Increase Debtors ↑ Decrease stock ↓		Increase profit ↑
6. Sold Goods on Cash at profit	Increase Cash ↑ Decrease stock ↓		Increase profit ↑
7. Return of Goods by Customer	Decr. in Debtors ↓ Incr. in Stock ↑		Decrease ↓
8. Return of Goods to Supplier	Decrease stock ↓	Decrease Creditors ↓	
9. Payment from Customer	Decr. in Debtors ↓ Incr. in Cash ↑		
10. Payment to Supplier	Decrease Cash ↓	Decrease Creditors ↓	
11. Payment of Expenses	Decrease Cash ↓		Decrease ↓
12. Expense due but not paid		Increase creditors ↑	Decrease ↓
13. Receipt of other Income	Increase Cash ↑		Increase ↑
14. Income due but not received	Increase Accrued Income ↑		Increase ↑
15. Income received in advance	Increase Cash ↑	Increase ↑	
16. Depreciation on Fixed Asset	Decrease FA ↓		Decrease ↓
17. Personal withdrawal	Decrease Cash ↓		Decrease ↓
18. Goods destroyed in fire	Decr. in Stock ↓		Decrease ↓
19. Bad Debts recorded	Decr. in Debtors ↓		Decrease ↓
20. Repayment of Loan	Decrease Cash ↓	Decrease Loan ↓	



MCQ

1. **Which of the following represents the accounting equation(A=C-L):**
 - a. Income Statement.
 - b. Balance Sheet
 - c. Statement of Cash flow.
 - d. None of these.

2. **Which of the following is true?**
 - a. Closing Capital = Op. Capital + Additional Capital- Profit - Drawing
 - b. Closing Capital = Op. Capital + Additional Capital- Drawings + Profit
 - c. Closing Capital = Op. Capital - Additional Capital- Drawings - Loss
 - d. None of these

3. **Mr. Shankar has assets of Rs.10,000/- and Liabilities of Rs.2,000/- . His capital would be**
 - a. Rs.10,000/-
 - b. Rs.12,000/-
 - c. Rs.8,000/-
 - d. None of these.

4. **Goods sold on credit is an example of :**
 - a. Increase in Asset & Owners Liability.
 - b. Decrease in Asset & Owners Liability.
 - c. Increase in Liability & Owners Liability.
 - d. Decrease in Liabilities & Increase in Owners Liability.
 - e. Increase in Liabilities & Decrease in Owners Liability.

5. **Goods destroyed by fire is an example of :**
 - a. No change in Owner's Equity.
 - b. Increase in Asset & Owner's Equity.
 - c. Decrease in Liability & Owner's Equity.
 - d. None of these.

6. **Bad written off is an examples of :**
 - a. Increase in Asset & Owner's Liability.
 - b. Decrease in Asset & Owner's Liability.
 - c. Increase in Liability & Owner's Liability.
 - d. Decrease in Liability & Increase in Owner's Liability.
 - e. Increase in Liability & Decrease in Owner's Liability.

7. **Prepaid Insurance is an example of :**
 - a. Increase in Asset & Decrease in Owner's Liability.
 - b. Increase in Liability & Decrease in Owner's Liability.
 - c. Decrease in Liability & Decrease in Owner's Liability.
 - d. Increase in Asset & Increase in Owner's Liability.

Answers: 1.(b) 2.(b) 3.(c) 4.(4) 5.(a) 6.(b) 7.(d)



Journal, Posting & Balancing

Transactions in the Journal are recorded on the basis of rules of Debit and Credit:

- Debit (Dr.) means enter the amount of transaction on left side of an account and Credit (Cr.) means enter the amount on right side of account.
- Both Debit and Credit represent either increase or decrease depending upon nature of A/c
- Debit in relation to Assets A/c and Exp A/c represents an increase but in relation to Liabilities A/c, Capital A/c and Revenue A/c represent decrease.
- Credit in relation to Assets A/c and Exp A/c represents decrease but in relation to Liabilities A/c, Capital A/c and Revenue A/c represents as increase.

For the purpose of recording, the transactions are classified in three groups.

Personal Accounts	Real Accounts	Nominal Accounts
Relates to Natural persons (e.g. Shankar A/c), artificial /legal persons (e.g. M/s Mahadev & Co.) and Representative persons(e.g. Expenses Payable)	Relates to Tangible Assets (e.g. Land, Building, Machinery, Cash etc.) and Intangible Assets(e.g. Goodwill) of the firm but not debt.	Relates to Revenue, Expenses, Gains, Losses etc. like Sales A/c, Salary A/c, Commission rcvd A/c, Loss by Fire A/c..
DEBIT the Receiver CREDIT the Giver	DEBIT what comes in CREDIT what goes out	DEBIT all expenses and losses CREDIT all incomes and gains
Related to Owner- Capital A/c. Having Dr. Bal- Asset A/c. Having Cr. Bal- Liabilities A/c.	Asset A/c	Related to Income- Revenue A/c Related to Expenses – Exp A/c

Journal :

A Journal is called subsidiary book in which transactions are recorded in the order of occurrence. Recording transaction is called Journalising (passing journal entry).

JOURNAL

Page IV

Date	Particulars	L.F.	Debit(Rs.)	Credit(Rs.)
xx-xx-2016	ABC A/c	Dr.	25,000.00	
	Bank A/c	Cr.		25,000.00
	(chq. Issued to M/s ABC)			

Steps in Journalising:

1. Ascertain the accounts involved in a transaction.
2. Ascertain which rule of Debit and Credit is applicable.
3. Record the date of transaction date column.
4. Write the name of account to be debited and amount in Debit column and write name of account to be credited in next line and amount in credit column.
5. Write narration i.e. brief description of the transaction.
6. Ledger Folio column is filled during posting (transfer of transaction) into the ledger.

Advantage of Journal: Chronological order, Explanation of Transaction & Recording of both aspects.

Limitations of Journal: Time taking (delayed) and Cost consuming, No internal Check and voluminous.



Posting:

After recording the transaction in the journal, next step is transfer of transaction to respective accounts opened in ledger is called posting. Ledger is a principal book which contains all accounts. Ledger account has two sides Debit and Credit, each of Debit and Credit has four columns.

ABC ACCOUNT

page no.XI

Dr.

Cr.

Date	Particulars	Folio	Amt(Rs.)	Date	Particulars	Folio	Amt(Rs.)
xx-xx-2016	By Bank	IV	25000.00				

Posting Rules:

1. Separate account is opened in ledger book for each account and entries posted from journal.
2. While posting transaction in ledger, words '**To**' for debit side of transaction and '**By**' is used for credit side of transaction.
3. Ledger of the concerned account debited in journal should be debited with same amount and reference of page no. of journal is recorded in folio column and reference page no. of Ledger Folio is written in L.F. column in Journal. Same process is followed for credit side.

Balancing:

- Balance of account is the difference between total of debits and total of credits appearing in account which signifies net effect of all transactions posted in account during the period.
- Net effect may be 'debit balance' or 'credit balance' or 'nil balance' depending on debit or credit side is higher.
- If the debit side of total exceeds the credit total, difference called debit balance is written in credit column as 'By Balance c/d' or if credit side of total exceeds the debit balance, difference called credit balance is written in debit column as 'To Balance c/d' taken as closing balances.
- While starting ledger with new period, closing balance of earlier period is carried forward by writing 'To balance b/d' in debit column being opening balance for new period in case of debit balance and 'By balance b/d' in credit column in case of credit balance.

MCQ:

1. 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 profit and loss account.
 - c. Balanced and balance is transferred to Balance sheet.
 - d. Not balanced and their balance is transferred to profit and loss account.
2. Credit means

<ol style="list-style-type: none"> a. increase in Asset b. increase in Liability 	<ol style="list-style-type: none"> c. decrease in Asset d. decrease in proprietor's equity.
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3. Ledger book is popularly known as
 - a. Secondary Book
 - b. Subsidiary Book
 - c. Principal Book
 - d. None of these

4. While balancing an account, the balance of an account is recorded on the side which is –
 - a. Shorter
 - b. Higher
 - c. Equal
 - d. none of these

5. Outstanding salary account is
 - a. Personal a/c
 - b. Real a/c
 - c. Nominal a/c
 - d. None of these

6. Accrued Interest account is
 - a. Personal a/c
 - b. Real a/c
 - c. Nominal a/c
 - d. None of these

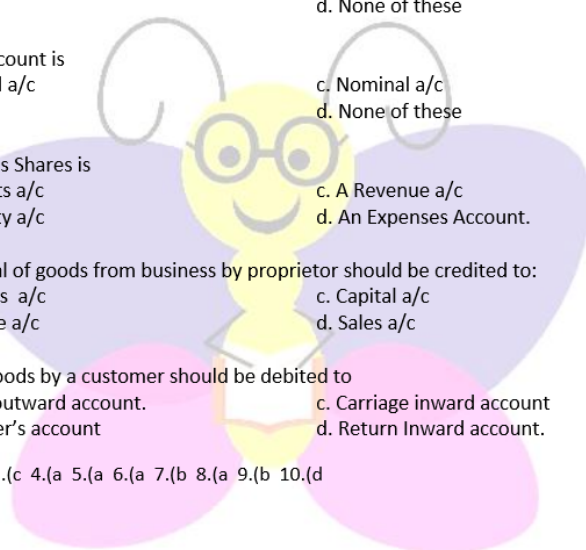
7. Goodwill Account is
 - a. Personal a/c
 - b. Real a/c
 - c. Nominal a/c
 - d. None of these

8. Investment in Shares is
 - a. An Assets a/c
 - b. A Liability a/c
 - c. A Revenue a/c
 - d. An Expenses Account.

9. A withdrawal of goods from business by proprietor should be credited to:
 - a. Drawings a/c
 - b. Purchase a/c
 - c. Capital a/c
 - d. Sales a/c

10. Return of Goods by a customer should be debited to
 - a. Return outward account.
 - b. Customer's account
 - c. Carriage inward account
 - d. Return Inward account.

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





CASH BOOK

The **Cash Book** is a book of original entry is a type of subsidiary book but treated as Principal Book. Cash book is designed in form of Ledger and records cash receipt on debit side and records cash payment on credit side. Cash book is both journal and ledger.

Types of Cash Book	Specific Transactions to be recorded
Single Column Cash Book	Cash Transaction
Cash book with discount column	Cash and discount transactions
Cash book with Bank & discount column	Cash, Bank and discount transactions
Petty Cash book	Petty Cash transactions

1. **Single column Cash Book** : This has one amount column on each side

Single Column Cash Book

Debit side				Credit side			
Date	Particulars	L.F.	Amt(Rs.)	Date	Particulars	L.F.	Amt(Rs.)

2. **Double column Cash Book**: Cash book with discount column has two amount columns, one for cash and other for discount on each side. All cash receipt and cash discount allowed are recorded on the debit side and all cash payments and cash discount received are recorded on the credit side.

Double Column Cash Book

Debit side					Credit side				
Date	Particulars	L.F.	Disc.(Rs.)	Cash(Rs.)	Date	Particulars	L.F.	Disc.(Rs.)	Cash(Rs.)

3. **Three column Cash Book**: Cash has three amount column, one for cash, one for bank and one for discount on each side. All cash receipts, Deposits into bank and cash discount allowed are recorded on the debit side and all cash payments, withdrawals from bank and cash discount received are recorded on the credit side. This cash serves the purpose of Cash account and Bank account, hence there is no need to open bank book account in the ledger.

Three Column Cash Book

Debit side						Credit side					
Date	Particulars	L.F.	Disc. (Rs.)	Cash (Rs.)	Bank (Rs.)	Date	Particulars	L.F.	Disc. (Rs.)	Cash (Rs.)	Bank (Rs.)
x-x-16	Cash withdrawal from bank	C		100000		x-x-16	Cash withdrawal from bank	C			100000
x-x-16	Cash deposited into bank	C			80000	x-x-16	Cash deposited into bank	C		80000	



Posting from main Cash Book:

Cash Book is actually the cash account and the bank column is bank account. Discount columns are memorandum columns which provides information about the total discount allowed and total discount received. The various items appearing on the debit side and credit side of the cash book are posted as follows:

Items appearing on Debit side:

- All the receipts appearing on the debit side are posted to the credit of the respective ledger accounts by writing 'By Cash/Bank' in the particulars.
- All individual entries in discount allowed column are posted to the credit of respective personal accounts by writing 'By Discount Allowed a/c'.
- The total of discount allowed column on debit side is posted to Expenses ledger namely 'Discount allowed a/c' by writing 'To sundries as per cash book' in particulars.

Items appearing on Credit side:

- All the payments appearing on the credit side are posted to the debit of the respective ledger accounts by writing 'To Cash/Bank' in the particulars.
- All individual entries in discount received column are posted to the debit of respective personal accounts by writing 'To Discount received a/c'.
- The total of discount received column on credit side is posted to Income ledger namely 'Discount received a/c' by writing 'By sundries as per cash book' in particulars.

Items appearing as contra on both side:

- All entries of which debit and credit aspect are simultaneously recorded in the cash book are called Contra Entries e.g. cash deposited into the bank or cash withdrawn from bank are ignored while posting from cash book to ledger as both aspect of debit and credit are recorded in cash book itself as shown in format.

4. **Petty Cash Book:** This Book is used by petty cashier for recording payments made in routine. The format of Petty Cash Book may be designed according to the requirement of the business. However, the simple form is given below:

Receipts				Payment									
Date	Particulars	Cash Book Folio	Total (Rs.)	Date	Particulars	Voucher no.	Postage-Telegram	Conveyance/Travelling	Staff Welfare	Carriage/freight	Printing/Stationery	Misc Expenses	Total (Rs.)

Posting from Petty Cash Book:

- The amount of cash received from the main cash book is recorded on the receipt side column.
- The petty cash expenses are recorded on the payment side of book.
- All the column expenses are totaled periodically and posted to debit side of respective ledger account by writing 'To sundries as per petty cash book'.
- Under Imprest System, The Petty Cashier receives reimbursement of expenses totaled periodically from main cash, hence his cash balance remains same in beginning of period.
- Under non-imprest system, The Petty Cashier receives ad-hoc amount equivalent to his periodic expenses by end of every period and balance is carried forward.



MCQ

1. Cash Book is a type of _____ but treated as a _____ of accounts.
 - a. Subsidiary book, principal book
 - b. Subsidiary book, subsidiary book
 - c. Principal book, Subsidiary book
 - d. principal book, principal book

2. Which of following is a kind of cash book?
 - a. Simple column cash book
 - b. Three column cash book
 - c. Double column cash book
 - d. All of above

3. Which of following is not a column of three column cash book
 - a. Cash column
 - b. Bank column
 - c. Petty cash column
 - d. Discount column

4. Which is entered debit side of cash book
 - a. Trade discount allowed
 - b. Cash discount allowed
 - c. Trade discount received
 - d. Cash discount received.

5. Which of the following transaction is posted in ledger
 - a. Cash deposited into bank
 - b. Cash withdrawal for personal use.
 - c. Cash withdrawal from bank
 - d. Cash deposited into bank

6. When a cheque returns dishonoured, it is recorded in
 - a. Cash column on credit side
 - b. Bank column on credit side
 - c. cash column on debit side
 - d. bank column on debit side

7. The balance in petty cash book represents
 - a. Expenses
 - b. Cash-in-hand with petty cashier
 - c. Net income
 - d. None of these

8. Transactions entered on the debit side of the cash book are to posted to
 - a. Debit side of the respective ledger account
 - b. credit side of the respective ledger account

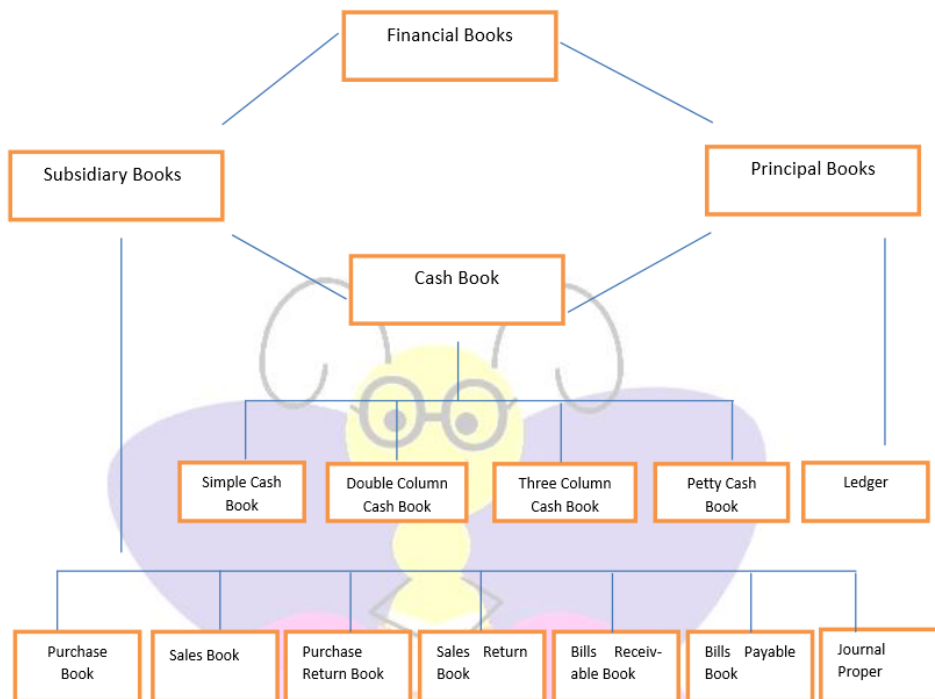
9. Salaries due for the month will appear
 - a. On the receipt side of cash book
 - b. On the debit side of cash book
 - c. as a contra entry
 - d. Nowhere in cash book

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



SUBSIDIARY BOOKS

The books in which transactions are first recorded to enable processing are called subsidiary books. The ledger and cash book are the principal books. The following chart explains difference between subsidiary books and primary books.



PURCHASE BOOK:

Purchase book is used for recording the credit purchases of goods in which enterprise deals in, neither cash purchase of goods, nor purchase of assets are recorded. The entries in the purchase book are made on the basis of Purchase Invoices received from suppliers with the amount net of discount.

Format of Purchase Book:

Date	Purchase Invoice No.	Particulars/Name of Supplier (Account to be credited)	L.F.	Details(Rs.)	Amount(Rs.)

Individual entries are posted date wise to credit of respective suppliers accounts by writing 'By purchase account'. Periodic total of Purchase book is posted to debit of Purchase account by writing 'To sundries as per Purchase Book'.

SALES BOOK:

Sales book is used for recording the credit sales of goods in which enterprise deals in, neither cash sales of goods, nor sales of assets are recorded. The entries in the Sales book are made on the basis of Sales Invoices issued to customers with the amount net of discount.

Format of Sales Book:

Date	Sales Invoice No.	Particulars/Name of Customer (Account to be debited)	L.F.	Details(Rs.)	Amount(Rs.)



JOURNAL (PROPER):

Journal Proper is used for recording of transactions not covered by other subsidiary books like Cash Book, Purchase Book, Sales Book, Purchase Return Book, Sales Return Book, Bills Receivable Book, Bills Payable Book. Following types of transactions are recorded thru journal:

- a. **Opening, Closing and Transfer Entries:** When books are started in new year, Opening balances of all liabilities and Asset accounts are carried forward by way of journal entry. Also when books are closed for the year, all nominal accounts balances are transferred to Profit and Loss account by journal are called closing entries. Entries to transfer amount from one account to another account is called Transfer entries.
- b. **Adjustment Entries:** Adjustment Entries are passed in the journal at the end of the year, for amount of income or expenses received in advance or not yet paid by cash/chq like Outstanding expenses, Prepaid expenses, Interest on capital employed, Depreciation.
- c. **Miscellaneous Entries:** Entries are passed for rectifying errors committed, Capital brought in kind, Purchase and sale of Fixed assets on credit and return of same, Allowance/rebate to be given to customer and cancellation of same, Endorsement of bills receivable to creditors, Dishonour of bills receivables, cancellation of Bills payable, abnormal loss to property or stock by fire, accident or theft, Goods withdrawn by proprietor/partner for personal use, distribution of free samples, transfer of net profit/ loss for the year to capital account etc..

MCQ:

1. Purchase Return book is used to record:
 - a. Return of goods purchased for cash
 - b. Return of goods purchased for credit
 - c. Return of fixed assets purchased on credit.
 - d. Non of these
2. Journal proper is used to record:
 - a. All cash purchases of assets other than goods
 - b. All cash sales of goods other than goods
 - c. Return of fixed asset purchased on credit
 - d. Recovery of amount already return off as bad debts
3. Bills payable is part of :
 - a. Journal
 - b. Ledger
 - c. cash book
 - d. None of these.
4. Total of purchase book is posted to:
 - a. Suppliers account
 - b. Sales account
 - c. Purchase account
 - d. Customers account
5. An Individual transaction of sales book is posted to:
 - a. Suppliers account
 - b. Sales account
 - c. Purchase account
 - d. Customers account
6. Total of Journal proper will be debited to:
 - a. Cash account
 - b. Suppliers account
 - c. Customers account
 - d. None of these
7. Closing entries are recorded in :
 - a. Cash book
 - b. Ledger
 - c. Journal proper
 - d. Balance sheet
8. The source document used for recording entries in Purchase Return book is :
 - a. Invoice received
 - b. Credit Notes sent out
 - c. Invoice sent out
 - d. debit note issued
9. On making a promissory note, the maker records in:
 - a. Bills receivable book
 - b. Journal proper
 - c. Bills payable book
 - d. None of these



Bank Reconciliation Statement

Reconciliation is the process of ensuring that two sets of records (usually the balances of two accounts) are in agreement in accounting books.

Bank Reconciliation statement (BRS) is a statement which reconciles the bank balance as per Cash Book with the balance as per Bank Pass Book/Statement (ledger copy issued by bank to customers as recorded in their books) showing causes of all differences between two. Some entries may have been recorded in Cash Books but do not appear in Bank passbook/statement and vice versa. Hence, on a particular date balance as per Bank and Cash Book may not tally.

Salient features of BRS:

- will show up any delays or timing difference on part of Bank or Cashier in passing entries
- It will bring out any errors or omission that may have been committed either in cash book or in Bank Pass Book.
- It will Show up actual fund position of Firm.

Major Causes of differences:

A. **Timing difference:**

Difference in timing may arise in taking entries to books on account of following-

1. **Cheques issued but not presented for payment:** Entry in bank column of Cash book is immediately made on issue of any payment by chq. however, entry appears in bank only when chq. is presented for payment and cleared by bank.
2. **Chqueques deposited into bank but not cleared:** Entry in cash book is made immediately on deposit of chq. with bank for any payment received by firm, However, bank gives credit to firm's account only when chq. is cleared by issuers bank.
3. **Direct receipt into Bank:** Some customers arrange payment directly to firm's bank account by transfer of funds online. However, entry is made in firms account on receipt of intimation or entry in bank statement/passbook.
4. **Interest Allowed by Bank:** Bank credits interest on deposits/balance to customers account on regular intervals. However, entry is made in firms account only on receipt of intimation or entry in bank statement/passbook.
5. **Interest and charges debited by bank:** Bank debits interest and charges on overdrafts/withdrawal to customers on regular intervals. However, entry is made in firms account on receipt of intimation or entry in bank statement/passbook.
6. **Interest and dividend collected by bank:** These days interest and dividend on investments are directly credited to bank account. However, entry is made in firms account on receipt of intimation or entry in bank statement/passbook.
7. **Direct Payment by Bank:** Standing instruction for direct debits to bank account on monthly/quarterly/annual payment are given in case of repayment of loan, insurance premium, SIP etc. However, entry is made in firms account on receipt of intimation or entry in bank statement/passbook.
8. **Dishonour of Bills discounted with the bank :** If bank is not able to receive payment of bill discounted with them, will debit amount of bill with charges to firms account. However, entry is made in firms account on receipt of intimation or entry in bank statement/passbook.
9. **Bills collected by bank on behalf of firm:** In some case documents are sent thru bank for goods sold. Bank credit the amount of bills on receipt of payment from firm's customer. However, entry is made in firms account on receipt of intimation or entry in bank statement/passbook.



Steps in preparing Bank Reconciliation Statement:

- A. Take a balance as per cash book or pass book as starting point. Understand Debit/credit balances of Cash Book and Bank Book.

<i>Debit balance as per Cash Book</i>	Balance available with bank can still use money.
<i>Credit balance as per Cash Book</i>	Excess money used from bank, account overdrawn.
<i>Debit balance as per Pass Book</i>	Excess money used from bank, account overdrawn.
<i>Credit balance as per Pass book</i>	Balance available with bank can still use money.

- B. Compare the items appearing on the debit side of the cash book with those of credit side of pass book(deposit column).Place a tick mark for items appearing in both the books and note down un-ticked items.
- C. Compare the items appearing on credit side of cash book with those of debit side of pass book(withdrawal column). Place a tick mark for items appearing in both the books and note down un-ticked items.

Format of Bank Reconciliation Statement, we can use any of four alternate depending on starting point used from cash book/pass book balance.

BRS as on date _____

Particulars	Start>Cash Book		Start>Passbook	
	<i>Debit(+) balance</i>	<i>Credit(-) balance</i>	<i>Debit(-) balance</i>	<i>Credit(+) balance</i>
Balance as per Book CashBook/Passbook				
Chq. issued but not presented for payment	<i>Add</i>	<i>Add</i>	<i>Subtract</i>	<i>Subtract</i>
Direct receipt into Bank by customer	<i>Add</i>	<i>Add</i>	<i>Subtract</i>	<i>Subtract</i>
Interest Allowed by Bank	<i>Add</i>	<i>Add</i>	<i>Subtract</i>	<i>Subtract</i>
Bills receivable directly collected by bank	<i>Add</i>	<i>Add</i>	<i>Subtract</i>	<i>Subtract</i>
Chq. Issued but returned	<i>Add</i>	<i>Add</i>	<i>Subtract</i>	<i>Subtract</i>
Wrong credit given by bank	<i>Add</i>	<i>Add</i>	<i>Subtract</i>	<i>Subtract</i>
Chq. Deposited into bank but not cleared	<i>Subtract</i>	<i>Subtract</i>	<i>Add</i>	<i>Add</i>
Chq. Rcvd and recorded but not deposited to bank	<i>Subtract</i>	<i>Subtract</i>	<i>Add</i>	<i>Add</i>
Interest and charges debited by bank	<i>Subtract</i>	<i>Subtract</i>	<i>Add</i>	<i>Add</i>
Direct Payment by Bank(loan repaymt, insurnace	<i>Subtract</i>	<i>Subtract</i>	<i>Add</i>	<i>Add</i>
Chq. Deposited with bank but dishonoured	<i>Subtract</i>	<i>Subtract</i>	<i>Add</i>	<i>Add</i>
Dishonour of Bills discounted with the bank	<i>Subtract</i>	<i>Subtract</i>	<i>Add</i>	<i>Add</i>
Wrong debit given by bank in pass book	<i>Subtract</i>	<i>Subtract</i>	<i>Add</i>	<i>Add</i>
Balance as per Pass Book/Cash Book, if Add(+)> Subtract(-) And If Add(+)< Subtract(-)	<i>XXX</i> <i>XXX</i>	<i>XXX</i> <i>XXX</i>	<i>XXX</i> <i>XXX</i>	<i>XXX</i> <i>XXX</i>

MCQ:

1. A Bank reconciliation statement is prepared with the help of :



2. When the balance as per pass book is the starting point, direct payment by bank are:
 - a. Added in bank reconciliation statement.
 - b. Subtracted in bank reconciliation statement.
 - c. Not required to be adjusted in bank reconciliation statement.
 - d. Neither of above.

3. Credit balance of Cashbook means:

a. Overdraft as per passbook	c. credit balance as per pass book
b. Overdraft as per cash book	d. Neither of these.

4. Difference in balance of both the cashbook and passbook can be because of
 - a. Error in recording entries either in cash book or passbook.
 - b. Omission of same entry in both cash book and passbook.
 - c. Debit balance of cash book is the credit balance of passbook
 - d. None of these.

5. Direct payment received from third party on behalf of the account holder is entered in
 - a. The cash book when amount is received by bank
 - b. The pass book when amount is received by bank
 - c. The cash book when entry is posted in the pass book
 - d. None of these.

6. While preparing bank reconciliation statement taking balance as per cash book as the starting point, dishonor of discounted bills receivable.

a. Added	c. subtracted
b. Not required to be adjusted	d. none of these

7. While preparing bank reconciliation statement taking the balance as per cash book as the starting point. A wrong credit in a pass book is.

a. Added	c. subtracted
b. Not required to be adjusted	d. none of these.

8. When balance as per pass book is the starting point, following is added.

a. Uncollected cheques	c. Unpresented cheques
b. Direct deposit by customer	d. Interest allowed by bank

9. Which of the following item will appear in the bank reconciliation statement, if the balance as per amended cash book is taken as the starting point.
 - a. Bank charges and interest charged by bank
 - b. Interest allowed and direct payment by bank
 - c. Direct payment by our debtors into the bank
 - d. A wrong entry in the pass book.

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



TRIAL BALANCE

1. Trial Balance is a summarized statement in tabular form which shows total amount of Debit items and credit items of all the accounts appearing in books.
2. Objective of Trial Balance is to ascertain the arithmetic accuracy of Ledger accounts. A tallied Trial Balance indicates that equal debits and credits have been recorded in the ledger. If Trial Balance does not tally, it indicates that some error have been committed.
3. A tallied Trial Balance does not necessarily ensure that all entries have been correctly recorded and posted in the ledger to correct side. Error of principal, Compensating Error, Error of omission, Posting in wrong accounts, possible even in Tallied Trial Balance.

Preparation of Trial Balance

Balance method	Total Amount method
<i>Every ledger account is balanced first and those balances are carried forwarded to trial balance.</i>	<i>Every Ledger is totaled and amount of debit side and credit side is transferred to trial balance.</i>
<i>This can be prepared only after closing balances of all accounts are carried down.</i>	<i>This can be prepared immediately after posting taking both debit and credit of all accounts.</i>
<i>It shows net balance of all accounts and normally used in practice for periodic closing. Financial Statements can be made directly from here.</i>	<i>It doesn't show net balance of accounts and normally not used in practice for periodic closing. Financial Statements can't be made directly from here.</i>

Errors and Rectification:

The various unintentional errors can be committed at the stage of collecting financial information/ data or while recording. Errors may occur as a result of mathematical mistakes, mistake in applying policies, misinterpretation of facts or by oversight.

1. Clerical Errors
2. **Error of Omission:** This arises when transaction is partly or completely omitted.
3. **Error of Commission:** This arises due to wrong recording, wrong casting, wrong carry forward, wrong posting, wrong balancing etc..
4. **Compensating Errors:** This arises when two or more errors are committed in such a way that net effect of these errors on the debit side and credit side of accounts is nil.
5. Errors of Principal

This error arises when transaction is recorded in contravention of accounting principle like ignoring differences between capital and revenue expenditure.

Suspense Account:

This is an account in which the amount of difference in the trial balance is parked time being till the time error is located and rectified.

Rectification of Errors:

1. Two sided Error: This can be rectified simply by passing journal entry for transaction which was omitted.
2. One sided Error: This error has effect in two or more accounts. These errors are rectified by passing a journal entry giving appropriate debit or credit to effected accounts or completely reversing wrong entry and passing new correct entry.
3. Rectification of error after Final Accounts are prepared :
4. The errors effecting nominal account like Sales a/c, Purchase a/c, Expense ac/ are rectified with the help of **Profit and Loss adjustment a/c** so that current year's profit/loss is not affected.



MCQ:

1. A tallied trial balance will not reveal –
 - a. Errors on account of wrong balancing
 - b. Errors on account of wrong carry forward
 - c. Errors on account of wrong casting
 - d. Compensating errors

2. Error or commission do not allow-

a. Correct totaling of the Balance Sheet	c. Trial Balance to agree
b. Correct totaling of Trial Balance	d. None of these

3. Which of the following error will not affect trial balance

a. Wrong carry forward of an account	c. Wrong totaling of an account
b. Wrong balancing of an account	d. Omission of account from Trail balance

4. The main object of opening suspense account

a. To tally the trial balance	c. To rectify the errors
b. To avoid delay in preparing Financials	d. none of these

5. Profit and loss adjustment account is used-
 - a. To rectify all the errors in year of occurrence
 - b. To rectify all the errors involving real accounts in the subsequent year.
 - c. To rectify all the errors of nominal a/c without affecting profit & loss a/c of current year.
 - d. None of these

6. Goods costing Rs.10000 distributed as free samples were not recorded. The error will result-

a. In an error of commission	c. will not affect net profit
b. Will affect the trial balance	d. none of these

7. Rs.10000/- paid for repair of newly purchased old machine were debited to repairs a/c

a. Is an error of omission	c. will not affect the profit
b. Will affect the trial balance	d. none of these

8. Sales of office furniture credited to sales a/c

a. Clerical error	c. error of omission
b. Error of principal	d. compensating error

9. Sales of Rs.10000/- to Samir was posted to Rahim a/c

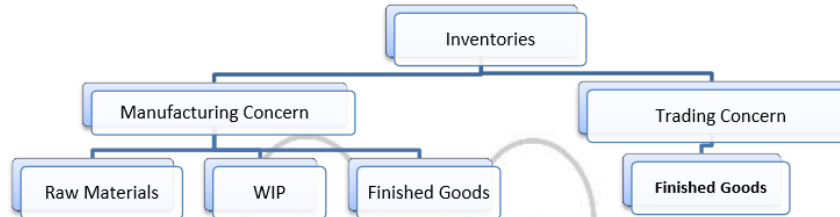
a. Error of omission	c. will affect the profit
b. Will not affect trail balance	d. none of these

ANSWERS: 1.(d) 2.(c) 3.(d) 4.(b) 5.(c) 6.(d) 7.(d) 8.(b) 9.(b)



INVENTORIES

- Inventory is stock-in-trade held for sale ordinary course of business or for use in process of production.
- It includes *Raw Materials, Finished Goods, Work-in-process (WIP), Consumables* but does not include tools and spares for machinery.
- Every Business entity needs to ascertain value of closing balance of inventory at the end of accounting year for having true position of financial performance of business.



Inventory Valuation

Main objective of arriving at value at which inventories are carried in financial statement until finally sold in market and revenues are recognized.

- Inventory valuation is necessary for determination of income earned by business entity during accounting period, which requires matching of revenues with cost of goods sold

$$\text{Cost of Goods Sold} = \text{Opening Inventory} + \text{Purchases} + \text{Direct Expenses} - \text{Closing Inventory}$$
 Hence, Value of Inventory has major impact on determination of Income
 1. If Closing Inventory is overstated, income for the period will be overstated and due to this income for subsequent period will be understated as opening inventory is overstated.
 2. If Closing Inventory is understated, Income for the period will be understated and income for subsequent period will be overstated as opening inventory is understated.

Basis of Inventory Valuation

Inventories are generally valued at lower of *cost* or *net realizable value*.

- **Cost of Inventory:**
 1. *Cost of Purchase:* Purchase price + Taxes & Duties (not recoverable) + direct expenses related to acquisition of goods like freight, unloading charges etc..
 2. *Cost of Conversion:* Direct labour + Power & Fuel + Direct expense incurred in relation to production of goods.
 3. *Other Expenses:* incurred in bringing the inventories to their present condition includes designing for specific product etc..
- **Net Realisable Value:** Estimated Selling price in ordinary course of business less cost of completion and sales related direct expenses.



Valuation Techniques

1. **FIFO(first in first out) method:**

- Goods which are received first are consumed first, inventory on hand therefore consist of last lot received and valued based on price paid for last lot.
- When prices of good are continuously rising, higher income is reported as old cost which had lower rate is matched with revenue.
- When prices of goods are going down, lower income is reported as old cost which had higher rate is matched with revenue.
- Value of closing inventory tends to be nearer to current market price, more realistic.

2. **LIFO(last in first out) method:**

- Goods which are received last are consumed first, inventory on hand therefore consist of earlier lot received and valued based on price paid for earlier lot.
- When prices of good are continuously rising, lower income is reported as old cost which had higher rate is matched with revenue.
- When prices of goods are going down, higher income is reported as old cost which had lower rate is matched with revenue.
- Value of closing inventory tends to be different from current market price.

3. **Weighted Average Price method:**

- This technique of valuation is based on assumption that each issue of good consist of due proportion of earlier lot.
- Evert time new lot for material purchased, new weighted price is calculated.
- $$\text{Weighted Average Price} = \frac{\text{Total cost of material in stock}}{\text{Total quantity of material in stock}}$$
- It averages out effect of price fluctuation, more suitable to continuous process industry.

4. **Base Stock method:**

- This technique of valuation is based on assumption that a minimum quantity of inventory (base stock) must be held all the time in order to carry on business.
- Base inventory stated at cost at which it was acquired and quantity over base stock is valued at any other adopted method.
- Inventory consistently shown in balance sheet at conservative value like fixed asset and nowhere near market price, hence sometimes gives unrealistic picture.

5. **Specific Identification method:**

- This technique is used when goods are not ordinarily interchangeable and manufactured or bought with specific purpose. Specific cost is attributed to this type of goods.

6. **Standard Cost method:**

- Under this method, standard cost is set for all items of inventory and used as basis for pricing the material issue. While determining standard cost, factors like purchase of material, issue, storage, usage, level of consumption etc are considered and standard cost is reviewed and updated on regular intervals to give realistic picture.



Inventories Recording Systems

Periodic Inventory System	Perpetual Inventory System
Inventory is ascertained by physical counting	Inventory is ascertained based on records
Inventory is valued as per valuation method adopted by multiplying actual physical count.	Inventory is calculated as residual figure <i>Closing Inventory = Opening Inventory + Purchases – Cost of Goods Sold.</i>
Cost of Goods Sold is calculated considering physical counting of inventory. <i>COGS= Op. Inventory (known)+ Purchases (known)-Cl. Inventory(physical count)</i>	Cost of Goods Sold is calculated by applying method of inventory valuation adopted. <i>COGS= Op. Inventory+ Purchases-Cl. Inventory</i>
Cost of Goods includes lost or extra consumption of goods, hence provides realistic picture of COGS & Inventory.	Inventory is not checked physically and may include shortage or damaged goods. Sometime gives misleading picture of COGS & Inventory.

MCQ:

1. The inventory of finished goods is valued at
 - a. Cost or market price whichever is lower
 - b. Cost or market price whichever is higher
 - c. Cost or net realizable value whichever is lower.
 - d. Cost or current replacement price whichever is lower.

2. Closing stock is equal to-
 - a. Opening stock + cost of goods sold- Purchases
 - b. cost of goods sold - Opening stock - Purchases
 - c. Opening stock + Purchases - cost of goods sold
 - d. cost of goods sold + Purchases- Opening stock

3. Opening inventory Rs.100000/-, Purchase Rs.400000/-, Sales Rs.300000/- Selling price 1/3 on the cost. Estimated cost of closing inventory.
 - a. Rs.200000/-
 - b. Rs.300000/-
 - c. Rs.275000/-
 - d. None of these

4. Cost of goods available for sale Rs.200000/- Total Sales Rs.160000/- Op. Stock of Goods Rs.40000/- Gross profit margin 25%. Closing stock of goods is :
 - a. Rs.160000/-
 - b. 120000/-
 - c. Rs.80000/-
 - d. Rs.72000/-

5. April 01 Opening stock 50 units @ Rs.44/unit
 April 02 Purchase 100 units @ Rs.47/unit
 April 07 Issued 50 units.
 The value of inventory at the end of week under LIFO method is
 - a. Rs.4700
 - b. Rs.4550
 - c. Rs.4600
 - d. non of these

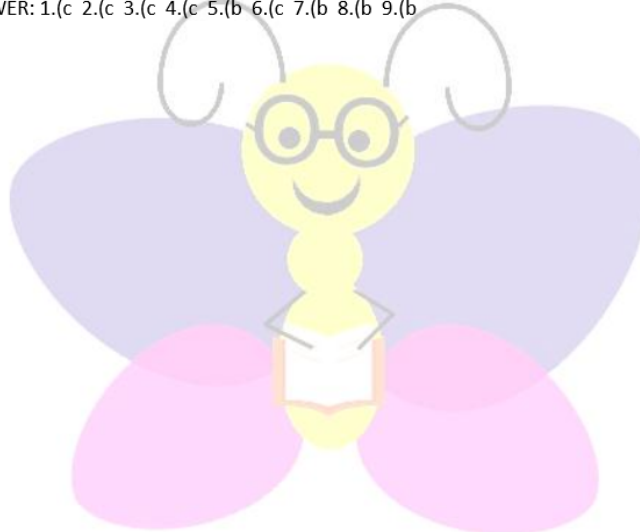
6. If closing stock is overstated-
 - a. Profit will increase and current asset will decrease
 - b. Profit will decrease and current asset will increase
 - c. Both Profit and current asset will increase
 - d. Both Profit and current asset will decrease

7. When FIFO method is followed, during period of rising prices-
 - a. Reported profit fall due to higher cost of goods sold
 - b. Reported profit rise due to lower cost of goods sold
 - c. Inventory is valued at old cost in the balance sheet
 - d. None of these



8. Cost of inventory as per physical verification as on 24th march was Rs.4,00,000/-. Goods are sold at a profit 25% on cost.
On 21st march, goods on the sale value of Rs.100000/- were sent on sale on return basis to a customer, the period of approval being two weeks. He returned 20% of the goods and approved the remaining on 31st march.
The cost of inventory as per books is:
a. Rs.480000/- b. Rs.416000/- c. Rs.428000/- d. none of these
9. Cost of stock as per book is Rs.238000/-
Goods purchased for Rs.10000/- received but omitted to be recorded.
Goods costing Rs.20000/- were sold & delivered but omitted to be recorded
Goods costing Rs.5000/- were returned by customer but omitted to be recorded
Goods costing Rs.3000/- were returned to supplier but omitted to be recorded
The value of physical inventory is –
a. Rs.226000/- b. Rs.230000/- c.Rs.246000/- d. none of these

ANSWER: 1.(c) 2.(c) 3.(c) 4.(c) 5.(b) 6.(c) 7.(b) 8.(b) 9.(b)





DEPRECIATION ACCOUNTING:

- The utility or value of an asset goes down over a period of time mainly due to wear & tear and many other reasons.
- Depreciation is the permanent and continuous decrease in the book value of a depreciable fixed asset due to use, effluxion of time, obsolescence, expiration of legal right or any other cause.
- Depreciation is allocated so as to charge fair proportion of the depreciable amount in each accounting period during the expected useful life of an asset. It includes amortisation of asset whose useful life is predetermined.

Depreciation Accounting is a system of accounting which aims to distribute cost or the basic value of tangible assets less salvage, if any, over the estimated useful life of the asset in a systematic and rational manner.

Objective for charging depreciation:

True Financial Position	<ul style="list-style-type: none"> • Value of Fixed Assets adjusted for depreciation charged in order to get actual financial position. • Matching cost of depreciation with revenue generated during accounting period
True Cost of Production	<ul style="list-style-type: none"> • It is necessary to charge depreciation as an item cost of production for use of assets. • If depreciation is not charged cost records would not show true cost of production.
Funds for Replacement	<ul style="list-style-type: none"> • A portion of profit is set aside in the form of depreciation and accumulate each year. This will provide definite amount at certain future date for replacement of specific assets.

Factors affecting the amount of depreciation:

1. **Historic cost of Assets:** Cost of depreciable asset represents the cost incurred in its acquisition, installation, commissioning and any other expenses for improvement thereof of capital nature.
2. **Expected useful life:** Life of depreciable assets means the period over which a depreciable asset is expected to be used by firm or the number of production or similar units expected to be obtained from the asset by the firm
3. **Estimates Scrap (Salvage) Value:** Scrap value means amount expected to be realized on sale of asset on completion of its useful life. If it is insignificant, it is normally regarded as Nil.

Methods of Charging Depreciation

Straight Line Method (SLM)	Written Down Value(WDV)/Reducing balance
Under this method, an equal amount is charged every year during the life of an asset as to reduce the cost of the asset to nil or its residual value at the end of its life.	Under this method, a fixed percentage of the original cost on the written down value of an asset is charged every year so as to reduce the asset to its break-up value at the end of its life.
<p>Cost of Asset = Purchase price + Expenses incurred</p> <p>Amt of Depreciation = $\frac{\text{Cost of Asset} - \text{Residual Value}}{\text{Expected useful life of asset}}$</p> <p>Rate of Depreciation = $\frac{\text{Amt of Depreciation}}{\text{Cost of asset}} \times 100$</p>	<p>Rate of Depreciation = $\left[1 - \sqrt[n]{\frac{\text{Residual Value}}{\text{Cost of asset}}} \right] \times 100$</p> <p>n= useful life of asset</p>
Annual charge of depreciation remains same from year to year. Simple to apply and gives accurate results in case of Plant & Machinery, leases, patents and copy rights.	Annual charge of depreciation reduces from year to year. Commonly used for plant, fixtures etc. where repairs are high in later years and depreciation would be lower.
<p>Example: Purchase a Car @ Rs.500000 and spent Rs.35000 on registration, insurance etc..useful life 5 years, Residual value Rs.1,10,000</p> <p>Cost of Asset =Rs.5,35,000(5,00,000+35,000)</p> <p>Amt of Depr.=Rs.4,25,000(5,35,000-1,10,000)/5=Rs.85,000</p> <p>Rate of Depr.=Rs.85,000/Rs.5,35,000x100= 15.89%</p>	<p>Example: Purchase a Car @ Rs.500000 and spent Rs.35000 on registration, insurance etc..useful life 5 years, Residual value Rs.1,10,000</p> <p>Cost of Asset =Rs.5,35,000(5,00,000+35,000)</p> <p>Rate of Depr.= $\frac{1 - \sqrt[5]{\frac{1,10,000}{5,35,000}}}{5} \times 100 = \left[\frac{1 - \sqrt[5]{0.2056}}{5} \right] \times 100 = 72.87\%$</p>



➤ *Some of years digit method:*

This method is variation of WDV. Method of calculation is multiplying cost of asset by fraction.

Fraction = Total no. of remaining life of asset / total of all digit of life of asset

Suppose life of asset is 7 years, then first year depr. fraction = $7 / (1+2+3+4+5+6+7) = 7/28 = 1/4$

➤ *Annuity method:*

This method considers interest foregone on capital outlay of asset purchase and total cost of asset is considered with interest for charging depreciation equally over as useful life of asset with help of annuity.

➤ *Sinking Fund Method:*

Systematic investment is made in government securities equal to amount of depreciation charged to assets which is non-cash item, so as to have large sum of money for replacement of asset at the end of useful life of asset. Sinking fund tables readily shows amount by way of depreciation required to be invested for accumulation over life of asset.

➤ *Machine Hour method:*

This method considers actual machine hours running during the year out of total estimated life of working

hour of machine. Amt of Depreciation = $\frac{\text{Cost of Asset} - \text{Residual Value}}{\text{Expected total hours of life}} \times \text{Machine hour run during the year.}$

➤ *Production unit method:*

This method considers actual unit of production during the year out of total estimated production during

life of machine. Amt of Depreciation = $\frac{\text{Cost of Asset} - \text{Residual Value}}{\text{Expected total production}} \times \text{No. of units produced during the year.}$

CHANGE IN METHOD OF DEPRECIATION:

- ➔ If required by Law
- ➔ To Comply with Accounting standards
- ➔ To have more appropriate presentation of Financial Statement of firm.

Depreciation should be re-calculated as per new method from date of asset put to use.

Treatment of deficiency /Surplus: The deficiency in amount of depreciation after re calculation should be charged to Profit and Loss account and similarly any surplus to be credit to profit and Loss account.

REVISION OF THE ESTIMATED USEFUL LIFE OF AN ASSET: There should be periodic review of useful life of the depreciable assets. Whenever there is a revision in estimated life, the unamortized depreciable amount should be charged to asset over revised remaining estimated life of asset.

REVALUATION OF DEPRECIABLE ASSETS: Wherever the depreciable asset is revalued, depreciation should be charged to the revalued amount on the basis of remaining estimated useful life of an asset. If there is upward revision in value of asset, amount is debited to Asset account and credit to revaluation reserve and if there is downward revision in value of asset then Profit and Loss account is debited and Asset account is credited.

MCQ :

1. Depreciation accounting is :
 - a. A process of valuation of fixed assets.
 - b. A process of allocation of cost of assets.
 - c. A method of providing fund for replacement.
2. Fixed assets are stated in balance sheet –
 - a. At cost
 - b. at market valued
 - c. at net realizable value
 - d. at cost less depreciation till date.
3. For charging depreciation, on which of assets, depletion method is adopted?
 - a. Plant & Machinery
 - b. Goodwill
 - c. Land & Building
 - d. Wasting assets like mines & quarries.



4. Which of the following statement is true?
- a. Depreciation process is of discretion of management.
 - b. Depreciation is a charge against profit.
 - c. Depreciation is a provided only when there is a profit.
 - d. Depreciation is a appropriation of profit.
5. The portion of the acquisition cost of the asset, yet to be allocated is known as
- a. Written down value
 - b. Realisable value
 - c. Accumulated value
 - d. Salvage value
6. Which method is followed to have uniform charge for depreciation and repairs & maintenance together:
- a. Written down value method
 - b. Double declining method
 - c. straight line method
 - d. sum of years digit method.
7. Date of purchase of machine 1.4.2012, cost Rs.12,00,000. Rate of depreciation:10% p.a. on written down value basis. On 1.10.2014, new machine was purchased for Rs.80,000. The closing balance of provision for depreciation account as at 31.03.2015 will be:
- a. Rs.1,20,000
 - b. Rs.2,28,000
 - c. Rs.3,29,200
 - d. Rs.3,60,000.
8. Original cost Rs.136000, Salvage value Rs.10000, useful life 6 years, Depreciation for the fourth year under sum of years digit method will be:
- a. Rs.6000
 - b. 12000
 - c. Rs.18000
 - d. Rs.24000
9. For Depreciating goodwill, suitable method is-
- a. Straight line
 - b. WDV
 - c. Depletion
 - d. Annuity method

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



FINANCIAL STATEMENTS

Financial Statements are systematically organized Summaries of detailed information about the financial position and performance/profitability of an enterprise. Traditionally, the term 'Financial Statements' is used to denote only two basic statements:

1. **Balance Sheet** (Position Statement)
2. **Trading and Profit & Loss account** (Income Statement)

PREPARATION OF FINAL ACCOUNTS:

The basic principal to be followed, while preparing Financial Statements are:

1. A distinction should be made between capital and revenue expenditure.
2. Income and expenses related to a period of accounting should only be considered.

TRADING ACCOUNT

- Trading Account shows the result of buying and selling of goods and/or services during an accounting period.
- Trading Account is prepared to know the gross profit or gross loss during the accounting period. The basis for the preparation of this account is the matching of selling prices of goods and services with the cost of goods sold and services rendered.

$$\text{GROSS PROFIT} = \text{OPERATING REVENUE} - \text{DIRECT OPERATING EXPENSES}$$

➔ *Contents on Debit side of Trading Account:*

1. **Opening Stock:** closing stock of unsold goods at the end of previous accounting period.
2. **Purchases:** Goods bought for resale includes cash as well as credit purchases. Following items should be deducted from the amount of total purchase: Purchase returns i.e. goods returned to suppliers, goods withdrawn by proprietor for personal use, goods distributed by way of free samples, goods destroyed by fire, flood, earthquake etc..
3. **Direct Expenses:** Expenses incurred like Freight Inward, Import duty, Octroi, Carriage, wages etc.

➔ *Contents on Credit side of Trading Account:*

1. **Sales:** Sales of goods in which enterprise deals includes cash and credit sales.
 2. **Sales Returns:** goods returned by customers are shown by way of deduction from sales.
 3. **Closing Stock:** Stock of unsold goods at the end of current accounting period. Stock is value at Cost or Net realizable value whichever is lower.
- Trading account is closed by transferring Gross Profit or Gross Loss to Profit and Loss account.

PROFIT AND LOSS ACCOUNT

- Profit and Loss Account shows the **Net Profit earned** or **Net Loss incurred** by an enterprise during the accounting period.
- Net Profit is equal to all operating and non-operating Revenues **less** all operating and non-operating revenues and expenses.
- Operating Profit is equal to all operating Revenues **less** all operating revenues and expenses.
- Operating Activities are principal revenue generating activities of enterprise and does not include Investing or Financial activities.



Contents Profit and Loss Account

<i>Debit side of Profit and Loss Account</i>	<i>Credit side of Profit and Loss Account</i>
Discount Allowed	Discount Received
Commission Allowed	Commission earned
Short-term Loss on Sale of Securities	Short-term gain on Sale of Securities
Loss on sale of Fixed Assets	Profit on sale of Fixed Assets
Interest expense in Loans and Advances	Interest income on loans and advances
Rent paid	Rent received on property
Royalty paid for copyrights, mines etc..	Royalty received on copy rights, mines etc
Loss of stock due to fire, flood, earthquake	Interest/dividend received in investment

- Profit and loss account is closed by transferring balance to Capital account

BALANCE SHEET

- Balance sheet is statement which sets out the assets and liabilities of a firm as at a certain date.
- Balance sheet is true on a particular point of time/on a particular date and not for the period.
- Balance sheet shows nature and value of assets and liabilities.
- An enterprise is considered to be solvent if Assets exceeds external liabilities.
- The debit balances of Personal accounts, Real accounts and fictitious asset accounts are shown on debit side of the Balance sheet
- The credit balances of Personal accounts are shown on credit side of the balance sheet

Contents on Asset side of Balance Sheet:

1. **Fixed Assets:** Assets held for the purpose of producing goods or providing services and are not held for resale in normal course of business. It may be classified as_
 - ➔ **Tangible Assets:** An identifiable non-monetary asset **with physical substance** like Land, Building, Plant, Machinery, Furniture, Computers etc..
 - ➔ **Intangible Assets:** An identifiable non-monetary asset **without physical substance** like Goodwill, Patents, Trade mark etc..
2. **Investments:** These are assets held by enterprise for earning income by way of dividends, interest, rental income or capital appreciation like investment in shares, bonds, debentures, immovable properties etc..
3. **Current Assets:** These assets cash or cash equivalents which are used for production of goods or rendering of services or whose conversion to cash takes not more than 12 months in normal course of business like Cash, Bank balance, stock of finished goods, raw materials, WIP, Debtors, Bills receivable, Accrued income etc..

Contents on Liability side of Balance Sheet:

1. **Non-current Liability:** The liability which is expected to be settled **after 12 months** from date of balance sheet e.g Loan from Bank or Financial Institution, Debentures etc..
2. **Current Liability:** The liability which is expected to settled **within 12 months** from date of balance sheet e.g. Trade creditors, Bills payable, Outstanding expenses, Bank overdraft, Installment of loan payable in 12 months etc..
3. **Capital:** Capital refers to money invested by enterprise or proprietor or partners as the case may be by adding profit earned or deducting loss incurred or amount withdrawn. Capital is excess of Assets over external liabilities.



Contingent Assets & Liability

A **contingent asset** is a potential economic benefit dependent solely on future events that can't be controlled by the firm. Due to the uncertainty of the future events, these **assets** are not placed on the balance sheet. Suppose firm has filed a suit for some property and if same is decided in favour of firm it would be economic benefit to firm.

A **contingent liability** is a potential **liability** that may occur, depending on the outcome of an uncertain future event. A **contingent liability** is recorded in the accounting records if the contingency is probable and the amount of the **liability** can be reasonably estimated. Suppose somebody has filed a suit for damages against firm which it is defending.

CLASSIFICATION OF CAPITAL AND REVENUE

The going concern assumption allows the accountant to classify the expenditure and receipts as Capital, Revenue expenditure, Deferred Revenue Expenditure, Capital Receipt and Revenue Receipt.

Capital Expenditure CAPEX: Money invested by firm to acquire or upgrade fixed, physical, non-consumable assets, such as buildings and equipment or any property, benefit of which last beyond current accounting period.

Revenue Expenditure: Cost incurred for carry out of operating activities of business, by doing so, a business is using the matching principle to link the expense incurred to **revenues** generated in the same accounting period. E.g. Depreciation, Rent, Repairs, Insurance etc..

Deferred Revenue Expenditure: **expenditure** which is **revenue** in nature and incurred during an accounting period, but its benefits are to be derived over a number of following accounting periods. e.g. heavy expenditure of Advertisement for Launch of new product, benefit of which will last for 3 to 5 years. Such expenditure should be written off over a period of 3 to 5 years.

Capital Receipts: Amount received from the sale of assets, shares and debentures. **Capital receipt** is of non-recurring nature. These are credited to respective account of capital nature.

Revenue Receipts: Amount received by sale of goods or services, which arises in the normal course of business. These are credit to respective revenue accounts

Outstanding Expenses: Expenses which are incurred but not paid during accounting period. Like unpaid wages, salaries etc. payable immediately or in near future after close of accounting year

Prepaid Expenses: Expenses which have been paid during the current accounting period, which are related to or benefit of which will accrue in the subsequent accounting period e.g. Insurance Premium, salary paid in advance etc..

Accrued Income: Income already earned, but not received during current accounting period. E.g. Interest on deposits, dividend on securities etc..

MCQ:

1. A prepayment of insurance premium will appear in the balance sheet and insurance a/c –

a. A liability and a debit balance	c. an asset and a credit balance
b. an asset and a debit balance	d. none of these
2. Operating cost is equal to

a. Cost of goods sold+ Operating Cost	c. Sales – Gross Profit
b. Cost of goods sold+ Operating expenses	d. Sales – Operating Profit



3. Trading account is prepared to ascertain-
 - a. Operating Profit
 - b. Cost of Goods manufactured
 - c. Net Profit
 - d. Gross Profit
4. Fixed Assets are disclosed in balance sheet at-
 - a. Original Cost
 - b. Cost or Market value whichever is lower
 - c. Market value
 - d. Cost *less* Depreciation till date
5. Contingent Liability is _
 - a. An ascertained liability but amount and due date are indeterminate
 - b. An ascertained liability but amount and due date are determinate
 - c. An unascertained liability but amount and due date are determinate
 - d. An unascertained liability but amount and due date are indeterminate
6. Provision is –
 - a. An unknown liability but its amount and due date are determinate
 - b. An unknown liability and its amount and due date are determinate
 - c. An known liability and its amount and due date are determinate
 - d. An known liability but its amount and due date are indeterminate
7. While marshalling-
 - a. The most urgent payment to be shown last in order of liquidity
 - b. The least liquid asset is shown first in order of liquidity
 - c. The least urgent payment to be shown first in order of permanence
 - d. The least liquid asset is shown first in order of permanence.
 - e. None of these.
8. Balance sheet shows –
 - a. The financial performance on a particular date
 - b. The financial position at a particular date
 - c. The financial position for an accounting period
 - d. The financial performance for an accounting period
9. Provision for doubtful debts is-
 - a. Debited to sundry debtors account
 - b. Credited to sundry debtors account
 - c. Debited to bad debts account
 - d. Debited to profit and loss account.

ANSWERS: 1.(b) 2.(d) 3.(d) 4.(d) 5.(d) 6.(d) 7.(c) 8.(b) 9.(d)



Accounting for Consignment

Act of **consigning**, the act of giving over to another person or *agent's charge*, custody of any material or goods but retaining legal ownership until the material or goods are sold.

Consignment: Consignment means the transaction of sending goods by one person to another, who will sell goods on behalf of the first person.

Consignor: The person who consigns goods or sender of goods is known as consignor.

Consignee: The person to whom goods are consigned or receiver of goods is known as consignee.



Distinction between consignment and sales:

Consignment	Sale
Relation between consignee and consignor is of principal and agent	Relation between seller and buyer is of creditor and debtor
Only the possession of goods and not the ownership of goods transferred to consignee.	Both possession and ownership of goods is transferred to buyer.
Risk of goods remains with the consignor because ownership of goods remain with the consignor.	Risk is transferred with sale of good from seller to buyer as ownership is transferred to buyer.
Only movable property can be subject matter.	Any property may be subject matter.
The profit/loss on sale of goods sent on consignment is always on account of consignor.	After sale is complete, the profit/loss belongs to buyer.
Expenses incurred by consignee are born by consignor.	Expenses incurred in relation to goods after sales are borne by buyer.
Unsold goods can be returned to consignor by consignee.	Goods sold are property of the buyer and can be returned only if the seller agrees.
Unsold goods lying with consignee is treated as stock of consignor.	Unsold/unused goods lying with buyer are treated as his stock only.

Proforma Invoice: A preliminary bill of sale sent to consignee by consignor of a shipment or delivery of goods. Typically, it gives a description of the purchased items and notes the cost along with other important information, such as shipping weight and transport charges etc..This is helpful for movement of goods and gives idea to consignee about minimum selling price to be realised.



Commission: commission is the remuneration paid to consignee by consignor in consideration of the service rendered by the former in selling the goods consigned. The ordinary commission is paid as fixed percentage on gross sales proceeds. Over and above this depending on agreement between consignee and consignor, consignee gets special commission that can be of two types.

- 1) Over-riding commission: Extra commission is paid if consignee is able to sale at higher price than price fixed by consignor.
- 2) Del-credere commission: This commission is agreed by consignor in special circumstances wherein consignee take risk of bad debts and commission is paid to consignee even if money could not be recovered from customer. However, bad debts is debited to consignee's a/c.

Advance from Consignee: it is common trade practice for consignor to demand some advance money from consignee towards security for the goods given to him. The advance received should not be credited to consignment account or should not be adjusted against sale proceeds.

Account Sales: This is not a Sales Account but statement sent by consignee to consignor periodically. It contains information like: 1) Sales made. 2) Expenses Incurred on behalf of consignor. 3) Commission earned. 4) Advance given. 5) The balance due to the principal.

Valuation of Stock: Stock lying with consignee is to valued at cost price (purchase price + expenses incurred to bring stock to consignees location) or net realizable value (means value which shall be realized if unsold stock with consignee is sold in open market), whichever is lower.

Non-recurring expenses: Expenses incurred by consignee in order to bring inventories to their present location and condition like Custom duty, octroi charges, clearing charges, Carriage inward, transportation up to his godown etc..

Realizable Expenses: Expenses which are required to be incurred in order to dispose unsold goods in stock. e.g. consignee's commission is realizable expenses.

Abnormal Loss: Loss which occurs due to abnormal factors like fire, theft, abnormal spoilage/ leakage/ breakage/ pilferage etc and not due to inherent nature of goods. It is not treated as part of cost and generally recovered from insurance company.

Normal Loss: Loss is an unavoidable loss due to inherent feature of the goods e.g. evaporation, normal leakage, spoilage etc..it is treated as part of cost by inflating the cost per unit.

CONSIGNMENT ACCOUNT

- The consignor prepares a consignment account relating to each consignment in order to ascertain the profit or loss on each consignment.
- It is a nominal account like Trading and Profit & Loss Account.
- Consignment account is debited with cost of goods consigned, expenses incurred by consignor and consignee, commission payable to consignee.
- Consignment account is credited with sale proceeds, abnormal loss, closing stock and cost of goods returned by consignee.
- Excess of credit over debit is regarded as profit and vice versa for loss, consignment account is closed by transferring to Profit & loss account.



Accounting Treatment in the books of consignor:

Event / Particulars	Accounting Entry
1. Security deposit from consignee	Cash/Bank a/c Dr. To Consignee's a/c
2. While sending goods on consignment	Consignment a/c Dr. To Goods sent of consignment a/c
3. Expenses incurred by consignor	Consignment a/c Dr. To Cash/bank a/c
4. Bills receivable(from consignee) discounted	Bank a/c Dr. Discount a/c Dr. To Bills Receivable a/c
5. Goods returned by consignee	Goods sent on consignment a/c Dr. To Consignment a/c
6. Expenses incurred by Consignee	Consignment a/c Dr. To Consignee a/c
7. On Sales being made by consignee	Consignee a/c Dr To Consignment a/c
8. On receiving balance due from consignee	Cash/Bank/Bills receivable Dr. To Consignee's a/c
9. Commission due to consignee	Consignment a/c Dr. To Consignee's a/c
10.Accounting for Bad debts	Bad debts a/c Dr. To Consignee's a/c
11. Accounting for unsold stock with the consignee	Consignment stock a/c Dr. To Consignment a/c
12.Accounting for abnormal loss of goods	1. Profit and Loss a/c Dr.(loss) Insurance company a/c Dr.(claim lodged) To Consignment a/c (total loss) 2. Cash/bank a/c Dr.(claim recovered) To Insurance company a/c
13.Accounting for profit/loss on consignment a/c	1. Consignment a/c Dr.(Profit) To Profit and loss a/c 2. Profit and loss a/c Dr.(loss) To Consignment a/c
14.Transfer goods sent on consignment account	Good sent on Consignment a/c Dr. To Trading a/c
15.On transfer of Discount Account (raised on discounting a bills receivable received from consignee)	Profit and loss a/c Dr. To Discounts a/c

Accounting Treatment in the books of consignee:

Event / Particulars	Accounting Entry
1. Providing security to consignor	Consignor A/c Dr. To Cash/bank/bills payable a/c
2. Expenses incurred on behalf of consignor	Consignor a/c Dr. To Cash/bank a/c
3. On Sales of goods on behalf of consignor	Consignment debtors a/c Dr. To Consignors a/c



4. On receipt of payment from consignment debtors	Cash/Bank Dr. To Consignment debtors Cr.
5. On Non-realisation of books debts 1. When del-credere commission in not given 2. When del-credere commission given	1. Consignor a/c Dr. To Consignment Debtors a/c Cr. 2. Bad Debts a/c Dr. To Consignment Debtors a/c
6. Entry for commission due from consignor	Consignor a/c Dr. To Commission a/c Cr.
7. Transfer of bad debts	Profit & Loss/Commission a/c Dr. To Bad debts a/c
8. Remittance of payment to consignor	Consignor a/c Dr. To Cash/bank Cr.
9. Transfer of commission a/c	Commission a/c Dr. To Profit and loss a/c Cr
10. Discharging bills payable	Bills payable a/c Dr. To Cash/bank a/c

MCQ:

- With reference to consignment, which of the following is correct?
 - Only ownership of goods is transferred
 - Both ownership and possession of goods is transferred
 - Only possession of goods is transferred.
 - None of these
- Over ridding commission is allowed –
 - To effect sales in the normal courses of business
 - To bear the bad debts on account of credit sales
 - To effect sales at a prices higher than the price fixed
 - None of these.
- Stock lost due to inherent characteristic of commodity is-
 - Normal loss
 - Abnormal loss
 - Normal gain
 - abnormal gain
- Consignee does not pass any entry for –
 - Goods sent on consignment
 - Profit/loss on consignment
 - Consignment stock
 - All of the above
- Consignment inventory will be recorded in the balance sheet of consignor on asset side at
 - Invoice value
 - at invoice value less Inventory reserve
 - at lower than cost price
 - at 10% lower than invoice value
- If del-credere commission is allowed by consignor to consignee, the bad debt treatment in the books of consignor-
 - will not be recorded in consignors books
 - Bad debts will be debited in consignor's a/c
 - Bad debts will be charged to General P&L a/c
 - Bad debts will be recoverable in along with credit sales
- In the books of consignee profit on consignment will be transferred to –
 - General Trading a/c
 - General profit and loss a/c
 - Drawings a/c
 - None of these



8. In the books of consignor, the loss on consignment business will be charged to-
 - a. Consignee a/c
 - b. General Trading a/c
 - c. General P&L a/c
 - d. Bank a/c

9. in case of goods returned by consignee-
 - a. Consignment account is debited and consignee's account is credited
 - b. Goods sent on consignment a/c is debited and consignee's account is credited
 - c. Goods sent on consignment a/c is credited and consignee's account is debited
 - d. Goods returned account is debited and consignee's account is credited.

10. Rabin consigned goods for the value of Rs.8,250 to Raj of Kanpur and paid freight etc. of Rs.650 and insurance Rs.400. He drew a bill on Raj for 3 months after date for Rs. 3,000 as an advance against consignment, and discounted the bill for Rs.2,960. Further, he received Account sales from Raj showing that, part of the goods had realized gross Rs. 8,350 and that his expenses and commission amounted to Rs. 870. The stock unsold was valued at Rs. 2750. Consignee wants to remit a draft for the amount due. The amount of draft will be: (DEC'15)
 - (a) Rs. 2,130 (b) Rs. 4,480 (c) Rs. 5,130 (d) Rs. 5,090

11. Overriding commission is generally calculated on: (DEC'15)
 - (a) Cash sale only (b) Total sales exceeding invoice value/cost (c) Credit sales (d) None of the above

11. When Del-credere commission is paid, bad debts will be debited to _____ A/c in the books of consignee (June 16)
 - a) Commission earned b) Consignor c) Credit receivable d) Consignment

13. 5,000 meters of cloth was sent out on consignment basis at an invoice price of Rs. 30 per meter, which were purchased by consignor at a price of Rs. 20 per meter. Consignor's expenses amounted to Rs. 5,500. Consignee's expenses amounted to Rs. 2,000. Consignee sold 4,000 meters at Rs. 40 per meter. He is entitled to a commission of 5% on total sales plus a further 20% of any surplus realized above the invoice price. Due to fall in the market price, the inventory of cloth is to be reduced by 10%. Calculate the profit on consignment? (June15)
 - a) Rs. 54,500 b) Rs. 63,500 c) Rs. 56,400 d) Rs. 55,490

ANSWERS: 1.(c) 2.(c) 3.(a) 4.(d) 5.(b) 6.(a) 7.(d) 8.(c) 9.(c) 10.(b) 11.(b) 12.(a) 13.(d)



JOINT VENTURES

- A **joint venture** is a business enterprise undertaken by two or more persons or organizations to share the cost and profit of a particular business project.
- A joint venture is not a going concern business enterprise like proprietorship, partnership, or company. It is an agreement between parties for a particular purpose and usually for defined timeframe.
- Co-venturers contribute funds and/or resources for running of business and share profit/loss in agreed ratio.

DISTINCTION BETWEEN JOINT VENTURE AND PARTNERSHIP:

Joint Venture	Partnership
Scope in limited to specific venture	Scope in not limited to specific venture
Persons undertaking venture are called co-venturers	Persons undertaking business are called partners
Profit/loss are ascertained at completion of venture	Profit/loss are ascertained annually .
No specific act applicable	Indian Partnership act 1932 applicable
No need to register any firm name	Partnership required registration of firm name.
No need to maintain separate set of books	Separate set of books required to be maintained

ACCOUNTING FOR JOINT VENTURES:

When separate set of books maintained, following accounts are opened:

1. **Joint bank account** : for recording cash / bank transactions
2. **Personal account of co-venturer's**: for recording dealing of co-venturers with joint business and to ascertain the amount due to/from them.
3. **Joint venture account**: A nominal account, used to calculated profit/loss on joint venture.

➤ Accounting Entries:

1. Capital brought in by co-venturer's:

Joint Bank a/c Dr. _____
 To Co-venturers personal a/c Cr. _____

2. Expenses paid out of joint bank account:

Joint Venture a/c Dr. _____
 To Joint Bank a/c Cr. _____

3. Material Supplied by Co-Venturers of Direct Payment by co-venturer's

Joint Venture a/c Dr. _____
 To Co-venturers personal a/c Cr. _____

4. Sale made or payment received in Joint venture

Joint bank a/c Dr. _____
 To Joint venture a/c Cr. _____

5. Sale made or payment received directly by co-venturers

Co-venturers personal a/c Dr. _____
 To Joint venture a/c Cr. _____

6. Profit on Joint venture

Joint venture a/c Dr. _____
 To Co-venturers personal a/c Cr. _____

or Loss on Joint venture

Co-venturers personal a/c Dr. _____
 To Joint venture a/c Cr. _____



When Transaction recorded in books of one co-venturer only, following accounts are opened:

1. **Personal account of co-venturer's:** To record the joint venture transactions affected by other co-venturer's and to ascertain amount due to/from other co-venturer's.
2. **Joint venture account:** A nominal account, used to calculated profit/loss on joint venture.

➤ Accounting Entries:

1. **Capital brought in by other co-venturer's:**

Bank a/c Dr. _____
 To Co-venturers personal a/c Cr. _____

2. **Expenses paid out bank account:**

Joint Venture a/c Dr. _____
 To Bank a/c Cr. _____

3. **Material Supplied by Co-Venturers of Direct Payment by co-ventrer's**

Joint Venture a/c Dr. _____
 To Co-venturers personal a/c Cr. _____

4. **Sale made or payment received in Joint venture**

bank a/c Dr. _____
 To Joint venture a/c Cr. _____

5. **Sale made or payment received directly by co-venturers**

Co-venturers personal a/c Dr. _____
 To Joint venture a/c Cr. _____

6. **Profit on Joint venture**

Joint venture a/c Dr. _____ (total profit)
 To Profit and Loss a/c Cr. _____ (for own share)
 Co-venturers personal a/c Cr. _____ (for co-ventures share)

7. **Loss on Joint venture**

Profit and Loss a/c Dr. _____ (for own share)
 Co-venturers personal a/c Dr. _____ (for co-ventures share)
 TO Joint venture a/c Cr. _____ (total loss)

8. **For settlement of claim** - When payment is due from co-venturer

Co-venturers personal a/c Dr. _____
 To Bank a/c Cr. _____

9. **For settlement of claim** - When payment is due to co-venturer

Bank a/c Dr. _____
 Co-venturers personal a/c Cr. _____

When Transaction recorded in books of all co-venturer's, following accounts are opened:

1. **Joint venture with X account:** To record all expenses incurred, material supplied and profit earned by individual co-venturer is debited here and loss if any credited .
2. **Memorandum Joint Venture Account:** A nominal account, used to calculated profit/loss on joint venture.

➤ Accounting Entries:

1. **Expenses paid out bank account:**

Joint Venture with X a/c Dr. _____
 To Bank a/c Cr. _____

2. **Material Supplied by Co-Venturers of Direct Payment by co-ventrer's**

Joint Venture X a/c Dr. _____
 To Bank a/c Cr. _____



3. Sale made or payment received in Joint venture

bank a/c Dr. _____

To Joint venture with x a/c Cr. _____

4. Profit on Joint venture

Joint venture with x a/c Dr. _____

To Profit and Loss a/c Cr. _____

5. For settlement of claim - When payment is due from co-venturer

Bank a/c Cr. _____

To Joint venture with x a/c Dr. _____

6. For settlement of claim - When payment is due to co-venturer

Joint venture with x a/c Dr. _____

To Bank a/c Cr. _____

MCQ:

1. Which of the following is true?
 - a. A joint venture has a definite life
 - b. A joint venture has a indefinite life
 - c. A joint venture is a partnership under partnership act
 - d. None of these
2. Which of the following statement is true?
 - a. Only one venture bears the risk
 - b. Only one venture can sell the goods
 - c. Only one venture can purchase the goods
 - d. In joint venture, provision of partnership act does not apply
3. For purchase of plant from joint bank a/c, In case of separate set of books.
 - a. Plant a/c is debited and bank a/c is credited
 - b. Joint venture a/c is debited and joint bank a/c is credited
 - c. Plant a/c is debited and venture capital a/c is credited
 - d. Joint venture a/c is debited and plant a/c is credited
4. For purchase of goods by a co-venturer in case of separate set of books
 - a. Goods a/c will be debited and ventures capital a/c will be credited
 - b. Joint venture a/c will be debited and Joint bank a/c will be credited
 - c. Venturer's capital a/c will be debited and Joint venture a/c will be credited
 - d. Joint venture a/c will be debited and Venturer's capital a/c will be credited
5. In memorandum Joint venture account method, each co-venturers records-
 - a. All the joint venture transactions
 - b. Only those which are affected by him
 - c. common joint venture transactions
 - d. None of these
6. For payment of joint venture expenses in case of memorandum joint venture a/c method-
 - a. Goods a/c is debited and cash a/c is credited
 - b. Memorandum joint venture a/c is debited and cash a/c is credited
 - c. cash a/c is debited and Memorandum joint venture a/c is credited
 - d. Other co-venturer's a/c is debited and cash a/c is credited.

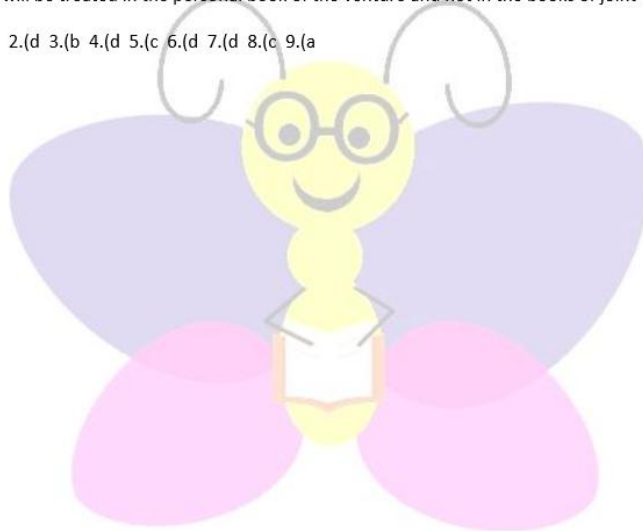


7. For recording of share of profit in case of memorandum joint venture method
 - a. Joint venture a/c is debited and Profit&Loss a/c is credited
 - b. Memorandum joint venture a/c is debited and Profit&Loss a/c is credited
 - c. Cash a/c is debited and Profit&Loss a/c is credited
 - d. Other co-venturer's a/c is debited and profit& loss a/c is credited.

8. On supply of Goods out of own stock for Joint venture business
 - a. Joint venture a/c is credited
 - b. Other co-venturers a/c is credited
 - c. Goods sent on Joint venture a/c is credited
 - d. None of these

9. If any stock is taken over by the venture, it will be treated as an;
 - a. Income of joint venture, hence credited to joint venture account
 - b. Expenses of Joint venture, hence debited to joint venture account
 - c. To be ignored from joint venture transactions
 - d. It will be treated in the personal book of the venture and not in the books of joint venture.

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





Bill of exchange

- > A **bill of exchange** is unconditional order in writing given by creditor to debtor to pay on demand or at a fixed determinable future time, a certain sum of money to or the order of a specific person or the bearer.
- > It is drawn and signed, dated by the person (drawer) who grants credit
- > It is addressed to the person (drawee) to whom credit is granted (debtor) and must be accepted by him.
- > The amount is payable either on demand or at a fixed or determinable future time.
- > The amount is payable to a definite person (payee) or to his order to the bearer.

Specimen of Bill of Exchange

Rs.25000/- only	Mumbai, Aug 28' 2016
Three months after date pay to <u>Mr.Suresh Rajput</u> or order the sum of Rs. Twenty Five Thousand Only For value received. (Payee)	
To,	Stamp
Rajesh Tarachand	Accepted
849, Dadar.	sd/-
Mumbai 400000	(Rajesh Tarachand) (Prasiddha Thakur)
	(Drawee) (Drawer)

Advantage of Bills of Exchange:

1. **Evidence of Indebtedness:** It is acknowledgement of debt
2. **Source of Finance:** It can be used as source of finance by discounting before due date.
3. **Means of Remittance:** Money can be transferred easily from one place to another by means of a bill.
4. **Device of Discharging a Debt:** It acts as a device of discharging a debt since it is a negotiable instrument.

Promissory Note

A **Promissory Note** is an unconditional undertaking in writing given by debtor to creditor to pay on demand or at a fixed or determinable future time.

- > A promissory note is a written unconditional promise.
- > It is drawn and signed, dated by the person to whom credit is granted or by the debtor.
- > It is addressed to the person who grants credit or the creditor
- > The amount payable is certain sum of money.



- > The money is payable to definite person or to his order to the bearer.
- > The person who makes or draws the promissory notes is called the maker and the person to whom the payment is to be made, is called the payee.
- > **Specimen of Promissory Note**

Rs.50,000/- only	Mumbai, July 21' 2016
Three months after date pay to <u>Mr.Suresh Rajput</u> or his order the sum of Rs. Fifty Thousand Only For value received. (Payee)	
To,	Stamp
Suresh Rajput	sd/-
41, Bank Steet	(Prasiddha Thakur)
New Delhi 110005	(Maker)

- > **Accounting Treatment**
- 1. A promissory note or accepted bill of exchange is treated as Bills Receivable by one who is entitles to receive the amount of the Note.
- 2. A promissory note or accepted bill of exchange is treated as Bills payable by one who is liable to pay the amount of the Note.
- > **Distinction between a bill of exchange and a promissory note:**

Bill of Exchange

There are Three parties-Drawer, Drawee and Payee
It contains an unconditional order given by a creditor to a Debtor

Promissory Note

There are two parties- Maker and Payee
It contains an unconditional promise given by a Debtor to Creditor



- **Due date of a bill** : the date on which the term of the bill expires is called as “due date of the bill”
- **Days of Grace**: Every instrument payable other than on demand is entitled to three days grace.
- **Date of maturity of a bill**: The date which comes after adding three days to the due date of a bill, is called the date of maturity.

➤ **Bill at sight**

Bill at sight or instrument payable on demand means the instruments in which no time for payment is mentioned. A cheque is always payable on demand. A promissory note or bill of exchange is payable on demand—

- a. When no time for payment is specified or
- b. When it is expressed to be payable on demand, or at sight or on presentment.

➤ **Bill after date**

Bill after date or time instrument means the instrument in which time for payment is mentioned. A promissory note or bill of exchange is a time instrument when it is expressed to be payable—

- a. After a specified period b. on a specific day c. after sight d. on the happening of event which is certain to happen

➤ **Calculation of due date of a bill :**

- a. **When the bill is made payable on a specific date** : Specific date will be the due date
- b. **When the bill is made payable at a stated number of months after date**: That date on which the term of the bill shall expire will be the due date.
- c. **When the bill is made payable at a stated number of days after date**: That date which comes after adding stated number of days to the date of bill, shall be the due date.
- d. **When the due date is a public holiday** : The preceding business day will be the due date
- e. **When the due date is a emergency/unforeseen holiday**: The next following day will be the due date.

➤ **Calculation of date of maturity in case of time bill**: In case of time or tenor bills, three days (called days of grace) are added to the due date to arrive at the date of maturity.

➤ **Noting charges**: It is necessary that the fact of dishonor and the causes of dishonor 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 dishonor, or fear of dishonor, 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 dishonored they will not the fact of dishonor, with the reasons and give the bill back to their client. For this service they charge small fee which is known as noting charges.

➤ **Accommodation bills:**

Bill 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 utilized to raise finance also without backup of any sale or purchase transaction. Only acceptance of bill by one party and drawn by another party for getting finance is known as accommodation bill.



➤ **Insolvency of the acceptor of bill**

1. When the bill is dishonored due to insolvency of the drawee or acceptor of the bill, either nothing is recovered or some partial amount called dividend in full settlement of the claim is recovered.
2. The dishonor of the bill due to insolvency of the acceptor is recorded in the same manner as explained in case of dishonor of a bill
3. The amount which remains unpaid by the drawee or acceptor is transferred to deficiency account in his books.
4. The amount which remains unpaid by the drawee or acceptor is debited to Bad Debts Account in books of Drawer.

➤ **Dishonor of a bill**

When a bill is dishonored by non-payment, the accounting entries in the books of Drawer, Drawee, Bank and Endorsee are given below:

Case	In the books of Drawer	In the books of Drawee	In the books of Bank/Endorsee
When the bill is retained till maturity	Drawee's A/c Dr. To Bill Receivable A/c Cr. To Cash A/c Cr. (Being the amount of dishonored bill and noting charges debited to the drawee)	Bills Payable A/c Dr. Noting charges A/c Dr. To Drawer's A/c Cr. (Being the amount of dishonored bill and noting charges credited to the drawer)	Not Applicable
When the bill is sent to the bankers for collection	Drawee's A/c Dr. To Bill set for collection A/c Cr. To Bank A/c Cr. (Being the amount of dishonored bill and noting charges debited to the drawee)	Bills Payable A/c Dr. Noting charges A/c Dr. To Drawer's A/c Cr. (Being the amount of dishonored bill and noting charges credited to the drawer)	Customer's A/c Dr. To Bills Receivable A/c Cr. To Cash A/c Cr. (Being the amount of dishonored bill and noting charges debited to customer)
When the bill is discounted	Drawee's A/c Dr. To Bank A/c Cr.	Bills Payable A/c Dr. Noting charges A/c Dr.	Customer's A/c Dr. To Bills Receivable A/c Cr.



➤ **Renewal of a bill**

Meaning: Cancellation of the original bill and drawing a fresh bill for another period on a request from the drawee is called renewal of bill.

Treatment of Interest for extended period: In case of renewal of a bill, the interest for the extended period is either paid in cash or is included in the amount of the new bill. Accounting entries when a bill is renewed:

Case	In the books of Drawer	In the books of Drawee
On cancelling the old bill	Drawee's A/c Dr. To Bills Receivable Cr.	Bills Payable A/c Dr. To Drawer's A/c Cr.
On making due the interest	Drawee's A/c Dr. To Interest A/c Cr.	Interest A/c Dr. To Drawer's A/c Cr.
On receiving the portion of the amount due	Bank A/c Dr. To Drawee's A/c Cr.	Drawer's A/c Dr. To Bank A/c Cr.
On the acceptance of a fresh bill	Bills Receivable A/c Dr. To Drawee's A/c Cr.	Drawer's A/c Dr. To bills payable A/c Cr.

➤ **Retirement of Bill of exchange**

Meaning: Making the payment of a bill before the date of maturity is called retirement of a bill.

Rebate on retirement: As interest allowed by the holder of the bill to the drawee at an agreed rate of interest for the expired period of the bill as a consideration for premature payment is known as rebate.

Nature of Rebate on Retirement of a bill: The rebate on retirement of a bill is an Income for the Drawee and in an Expense for the payee

In the books of Holder(Drawer or Endorsee)	In the books of Drawee
Bank A/c Dr. Rebate on bill A/c Dr. To bills receivable A/c Cr. (Being the payment received on bills retirement before the date of maturity and rebate allowed brought into account)	Bills Payable A/c Dr. To Bank A/c Cr. To Rebate on bill A/c Cr. (Being the payment made on bills retirement before the date of maturity and rebate earned brought into account)

➤ **Bills receivable book:**

Subsidiary book used to record the details of bills receivable in favor of a person who is maintaining the bills receivable book.

- Individual amounts are daily posted to the credit of the accounts of individual debtor from whom the bills are received.
- Monthly total is posted to the debit of 'Bills Receivable Account' in the ledger by writing 'To Subsidiary as per B/R book'

➤ **Bills Payable book:**

Subsidiary book used to record the details of bills payable accepted by a person who is maintaining the bills payable book.

- Individual amounts are daily posted to the debit of the accounts of individual creditor to whom acceptances have been given.
- Monthly total is posted to the credit of 'Bills Payable Account' in the ledger by writing 'By Subsidiary as per B/P book'



MCQ:

- Promissory Note is—**
 - A conditional promise to pay
 - An unconditional promise to pay
 - A conditional order to pay
 - An unconditional order to pay
- A bill of exchange is –**
 - A conditional promise to pay
 - An unconditional promise to pay
 - A conditional order to pay
 - An unconditional order to pay
- The term of a bill after sight commences—**
 - From the date of acceptance of the bill
 - From the date of drawing of a bill
 - from the date of receipt of the accepted bill
 - from the date of receipt of drawn bill
- The term of a bill after date commences—**
 - From the date of acceptance of the bill
 - From the date of drawing of a bill
 - from the date of receipt of the accepted bill
 - from the date of receipt of drawn bill
- Acceptance is necessary in case of –**
 - A Promissory note
 - A Cheque
 - A bill payable on demand
 - none of these
- When the bills is honored at the maturity date, the drawee debits---**
 - Drawer's Account
 - Bills payable Account
 - Cash/Bank Account
 - Holder of bill account{ bank / endoresee
- Discount at the time of retirement of a bill is –**
 - A gain of a drawee
 - A gain of a drawer
 - A loss of a drawee
 - none of these



Goods Sent on Approval or Return Basis

Goods sent on 'approval' or 'on sale or Return' basis means the delivery of the goods to the customers with the option to retain or return them within specified period. According to Sec.24 of the Sale of Goods Act 1893, in respect of such goods, sale will take place or the property in the goods pass to the buyer:

1. When he signifies his approval or acceptance to the seller,
2. When he does some act adopting the transaction. e.g. pledging such goods.
3. If he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection, on the expiry of the specified time or on the expiry of a reasonable time.

Accounting Treatment: There are three methods of accounting Goods sent on Approval or return.

1. **Ordinary Sale Method:** When transactions are few, goods sent on approval or return basis are treated as an ordinary sale.

When goods are sent on 'approval' or on sale or return basis	Sundry Debtors A/c Dr. (With Invoice price) To Sales A/c Cr.
When such goods are returned within the specified time	Sales Return A/c Dr. (With Invoice Price) To Sundry Debtors Cr.
When the customers take the delivery of such goods at a price lower than the invoice price	Sales A/c Dr. (with difference) To Sundry Debtors A/c Cr.
At the yearend:	
a) When such goods are still lying with customers and specified time limit has not yet expired.	Sales A/c Dr. (With Invoice Price) To Sundry Debtors A/c Cr.
b) When such goods are brought into final accounts as closing stock at cost or net realizable value which is lower	Stock with Customer Dr. (With cost or NRW) To Trading A/c Cr.

2. **Multicolumn Journal method:** Where a moderate number of articles are sent out on a sale or return basis, a Multicolumn Sale or Return Journal is maintained to record the deliveries, Sales and the balance of such goods

MULTICOLUMN SALE OR RETURN JOURNAL

Sent on Approval			Goods Returned			Goods Approved				Balance
Date	Particulars	Amt	Date	Particulars	Amt	Date	Particulars	Fol.	Amt	Amt.

- a. When goods are delivered on sale or return basis, entry is made in 'Sent on Approval Column'.
 - b. When such goods are returned, entry is made in 'Goods returned column'
 - c. When such goods are approved or retained, entry is made in 'Goods approved' column and posted to the debit of respective customers account and credited to sales account.
 - d. Value of goods sent on approval but neither sold nor returned till the close of accounting period is shown in "Balance" column and considered as stock lying with the customers on behalf of seller and are valued at 'Cost or Net Realizable value' whichever is lower. Such goods are brought into final accounts by debiting 'Stock with customers a/c' and crediting Trading a/c.
3. **Separate Day Book method.**

When transactions are numerous, a business maintains the following books: a) Sale or Return Day Book and b) Sale or Return Ledger. Ledger contains the accounts of the customers and the 'Sale or Return' Total account. These are memorandum books.

In this case, when the goods are sent to the customers on a sale or return basis, they are recorded in the sale or return day book. Thereafter, in the sale or return ledger, all the customers are individually debited and the Sale or Return Ledger, all the customers are individually debited and Sale or Return Account is credited with the periodical total of the Sale or Return Day Book.



When the business receives information about the acceptance of the goods or no intimation is received within the specified time, they are recognized as sales and are recorded in the Sales Day Book. Periodically, the total of the Sales Day book is credited to Sales Account and debited to the Individual Customers Account. To cancel the earlier entries, individual customers are credited and Sale or Return Account is debited. The entries for the approved goods are shown below:

In the Memorandum Sale or Return Ledger		In the regular General Ledger	
Sale or Return Account	Dr.	Individual Customer's Account	Dr.
To Individual Customer's Account	Cr.	To Sales Account	Cr.

At the year end, in the Sale or Return Ledger, the sum of the debit balance of the individual Customers Account must be equal to the credit balance of the Sale or Return Account. It represents Inventories with customers waiting for approval at invoice price. To adjust the cost of such goods with customers in the Final Accounts, the following entry is passed:

>> **Inventories with customers on Sale or Return A/c Dr. (Cost or NRW whichever is less)
To Trading Account Cr.**

MCQ:

- When large number of articles are sent frequently on a sale or return basis, it is necessary to maintain:
 - Sale journal
 - Goods return journal
 - Sale or return journal
 - None of the above
- Under sales on return or approval basis, the ownership of goods is passed only
 - When the retailer gives his approval
 - If the goods are not returned within specified period
 - Both (a) and (b)
 - None of the above
- Under sales on return or approval basis when the transactions are few and the customers accepts the goods, the accounting treatment will be—
 - No journal entry
 - Entry in Sales or Return Journal
 - Entry in Sales or Return Day Book
 - Sundry Debtors A/c Dr. To Sales A/c.
- Sales or Return Day Book and Sale or Return Ledger are known as
 - Principal books
 - Subsidiary books
 - Memorandum books
 - None of these
- When Goods are returned by the customers within the specified time, they are recorded:
 - In the sale or Returned Ledger thereafter in the sale or Returned Day book
 - In the sale or Returned Day book thereafter in the sale or Returned Ledger.
 - Only in Sale or Returned Day book.
 - Only in Sale or Returned Ledger.
- When Sale or Return Day Book and Sale or Return ledger are maintained and the goods are approved by the customers, these are recorded:
 - In the Sales or Return Day book, thereafter in the sale or Return Ledger
 - Only in Sales or Return Day book
 - Only in Sales Day Book
 - Both in Sales or Return Day Book and Sales Day Book.

ANSWERS: 1.(c) 2.(c) 3.(a) 4.(c) 5.(b) 6.(d)



Accounting for Partnership Firms- Fundamentals

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.

The essential features of partnership are:

1. An association of two or more persons.
2. An agreement entered into by all persons concerned.
3. Existence of a business.
4. The carrying on of such business by all or any one of them acting for all.
5. Sharing of profit/loss of business
6. Unlimited liability of all partners.

Limited Liability Partnership

The Indian Partnership Act provides general form of partnership which is most prevalent form in India. It has inherent disadvantage in it, the most important shortcoming is the unlimited liability of all partners for business debts and legal consequences, regardless of their holding, as the firm is not a legal entity.

→The Limited Liability Partnership (LLP) is viewed as an alternative corporate business proposal that provides the benefit of limited liability but allows its members, the flexibility of organizing their internal structure as a partnership, which is based on a mutually arrived agreement.

→The LLP will be a separate legal entity, liable to the full extent of its assets, with the liability of the partners being limited to their agreed contribution in the LLP which may be of tangible or intangible nature. No partner would be liable on account of the independent or un-authorized actions of other partners or their misconduct. The liabilities of LLP and partners who are found to have acted with intent to defraud Creditors or for any fraudulent purpose shall be unlimited for all or any of the debts or other liabilities of the LLP.

→The main benefit in an LLP is that it is taxed as a partnership, but has the benefit of being a corporate, or more significantly, a juristic entity with limited liability. An LLP has the special characteristic of being a separate legal personality distinct from its partners. The LLP is a body corporate in nature.

Partnership Deed

'Partnership deed' is a written document which contains the terms and conditions of partnership agreed upon by all the partners.

→It is important to have partnership deed in writing to settle any possible dispute with regard to the terms of partnership. It serves as evidence in the court of law.

→Partnership deed must be signed by all partners and stamped as per Indian Stamp Act.

→It is not necessary to have a partnership deed. In absence of deed, relevant provision of the Indian partnership act would be applicable.

➤ The partnership deed usually includes the following particulars:

1. Name and address of the firm and partners.
2. Nature and Place of Business.
3. Commencement and duration of business.
4. Amount of capital to be contributed by each partner
5. Ratio in which profits and losses are to be shared.
6. Interest on loan by a partner to the firm.
7. Salary, Commission etc. if any payable to partners.
8. Method of computation of Goodwill on the reconstitution of a firm.
9. Mode of settlement of accounts in case of retirement/death of a partner.
10. Mode of settlement of accounts in case of dissolution of a firm.

Accounting Treatment

Accounting of partnership is similar to proprietorship. The only difference is Capital and drawings of all partners are separately accounted.

➤ Profit and Loss Appropriation:



➤ Fixed and Fluctuating Capital:

→ Under Fixed capital method, two separate accounts: Capital and Current accounts for each partner are maintained. The transaction relating to introduction and withdrawal of capital are recorded in capital account. Other transactions like interest on capital, drawing, salary, commission, share of profit/loss are recorded in current account.

→ Under Fluctuating Capital method, only one account i.e. Capital account is maintained for each partner. All transactions whether capital or of recurring nature are recorded in this account. Hence Capital account keeps fluctuating.

➤ Interest on Capital:

Interest on capital of partners is calculated for the relevant period for which the amount of capital has been used in the business. In case the profit sharing ratio differs from capital ratio, the provision for interest on capital compensates those partners who contribute capital more than the proportionate capital as per profit sharing ratio. In case of fixed capital accounts, interest is calculated on the balance of capital accounts only and no interest is calculated on the balance of current accounts.

→ Interest on capital is to be provided out of profits only, thus in case of loss, no interest is provided. But in case of insufficient profits, the amount of profit is distributed in the ratio of capital as partners get profit by way of interest on capital only.

➤ Interest on Drawings:

As interest is allowed to capital contributed by partners, also charged on drawings made by partners.

Interest on drawings is basically calculated with reference to the time period for which the money was withdrawn on the basis of product method. However shortcut method may be used in case of Fixed amount is withdrawn at uniform time interval.

1. Short cut method:

If Fixed Amount is Withdrawn	Interest on Drawings
In the beginning of each month	= total drawings $X \frac{\text{rate of interest}}{100} X \frac{6\frac{1}{2}}{12}$
At the end of each month	= total drawings $X \frac{\text{rate of interest}}{100} X \frac{5\frac{1}{2}}{12}$
During the middle of each month	= total drawings $X \frac{\text{rate of interest}}{100} X \frac{6}{12}$
In the beginning of each quarter	= total drawings $X \frac{\text{rate of interest}}{100} X \frac{7\frac{1}{2}}{12}$
At the end of each quarter	= total drawings $X \frac{\text{rate of interest}}{100} X \frac{4\frac{1}{2}}{12}$
During the middle of each quarter	= total drawings $X \frac{\text{rate of interest}}{100} X \frac{6}{12}$

2. Product method: When an unequal amount is withdrawn at different dates, the interest on drawings is calculated: Product = Amount of Drawings X Period of use

Product is calculated for each drawings made and total product is arrived at.

$$\text{Interest} = \text{Total Product} X \frac{\text{rate of interest}}{100} X \frac{1}{12} \text{ (if period is expressed in month)}$$

$$\text{Interest} = \text{Total Product} X \frac{\text{rate of interest}}{100} X \frac{1}{365} \text{ (if period is expressed in days)}$$

➤ Guarantee of minimum profit:

It means assurance given a minimum amount of profit to a partner. A partner to whom guarantee of minimum profit has been provided is called 'Guaranteed Profit'. In such case, allocation of profit is done in a normal way if the share of partner, who has been guaranteed minimum profit, is more than the amount of guaranteed profit.

However, if share of partner is less than the guaranteed amount, he takes minimum profit and the excess of guaranteed share of profit over the actual share is borne by the remaining partners as per the agreement.

There are three possibilities as far as share of deficiency by other partner is concerned:

1. Excess is payable by one of the remaining partners.



Accounting Treatment:

1. In case of actual share is less than guaranteed amount:
 - a. On distributing the profit as if there is no Guarantee arrangement:

Profit and Loss account	Dr.
To All partner's Capital A/cs	

- b. On distributing loss as if there is no Guarantee arrangement:

All partners's Capital A/c's	Dr.
To Profit and loss account	

- c. On charging deficiency to guaranteeing partners:

Guaranteeing partner's Capital A/c	Dr.
To Guaranteed partner's Capital A/c	

2. In case the actual share is more than the guaranteed amount:
 - a. On distributing the profit as if there is no Guarantee arrangement:

P & L appropriation A/c	Dr.
To All partner's Capital A/c	

MCQ:

1. A partner act as _____ for a firm
 - a. Agent
 - b. Third party
 - c. Employee
 - d. None of above
2. In absence of any agreement, partners are liable to receive interest on their Loan@
 - a. 12% p.a.
 - b. 10% p.a.
 - c. 8% p.a.
 - d. 6% p.a.
3. Features of a partnership firm are:
 - a. Two or more persons carrying common business under an agreement
 - b. Sharing profits and losses in the fixed ration
 - c. Business carries by all or any of them acting for all
 - d. All of the above
4. In absence of an agreement, partners are entitled to
 - a. Salary
 - b. Commission
 - c. Interest on Loan and Advances
 - d. Profit share in capital ratio
5. When a partner is given a guarantee by the other partner, loss on such guarantee will be borne by
 - a. partnership firm
 - b. All the other partners
 - c. partner who gave the guarantee
 - d. Partner with highest profit sharing ratio
6. What would be the profit sharing ratio if the partnership act is complied with?
 - a. As per agreement
 - b. Equally
 - c. In capital ratio
 - d. None of above

ANSWERS: 1.(a) 2.(d) 3.(d) 4.(c) 5.(c) 6.(b)



PARTNERSHIP ACCOUNTS – GOODWILL

- Goodwill is the value of reputation of a firm in respect of the profits expected in future over and above the normal profits earned by other similar firms belonging to the same industry. Such excess of future profits over the normal profits is known as super profit earned by a firm may be due to its location advantage, better customer service, possession of a unique patent right, personal reputation of the partner or for similar other reasons. Thus, Goodwill exists only when the firm earns super profit. The necessity for valuation of goodwill in a firm arises in the following cases:
 - a. When the profit sharing ration amongst the partner is changed,
 - b. When a new partner is admitted,
 - c. When a partner retires or dies,
 - d. When the business is dissolved or sold.

- Methods for Goodwill Valuation
 1. **Average profit basis:** As per this method profits of the past few years are averaged and adjusted for any expected change in future. For averaging the past profit, either simple average or weighted average may be employed depending upon the circumstances. If there exists clear increasing or decreasing trend of profit, it is better to give more weight to the profits of the recent years than those of earlier years. If there is no clear trend of profit, simple average should be used.

Step-1: Calculate past profit for each of the relevant years by adding abnormal losses and by deducting abnormal gains and income from non trade investments.

Step-2: Select the weights to be assigned

Step-3: calculate the weighted profit for each of the years by multiplying the simple profit by respective weight.

Step-4: Calculate the total of weights and total of weighted profits.

Step-5: Weighted Average Profit = Total of weighted profit/ total of weight

Step-6: Goodwill=Weighted Average profit X No. of years purchase.
 2. **Super Profit Method:** Super profit means, excess profit that can be earned by a firm over and above the normal profit usually earned by similar firms under similar circumstances. Under this method, the partner who gains in terms of profit sharing ratio has to contribute only for excess profit because normal profit he can earn by joining any partnership firm.

Step-1: Identify the capital employed by the partnership firm

Step-2: Identify the average profit earned by the partnership firm based on past few year figures.

Step-3: Determine normal rate of return prevailing in the locality of similar firms

Step-4: Apply normal rate of return on capital employed to arrive at normal profit.

Step-5: Deduct normal profit from the average profit of the firm. If the average profit of the firm is more than the normal profit, there exists super profit and goodwill.
 3. **Annuity method:** Time value of money is not considered in upper profit method. Although it was expected that super profit would be earned in certain future years, still no devaluation was done on the value of money for the time difference. In fact when money will be received in different points of time, its value should be different depending upon the rate of interest considered for discounting. Under this method, discounted value of total super profit is calculated at certain rate of interest.
 4. **Capitalisation Basis:** The goodwill under this method is ascertained by capitalization the super profit on the basis of Normal rate of return.

Step-1: Calculate super profit

Step-2: Goodwill= Super profit X 100/Normal rate of return
 5. **Capitalisation of Average profit:** The goodwill under this method is ascertained by deducting the actual capital employed in business from capitalized value of the average profit on the basis of normal rate of return.

Step-1: Calculate Average Future maintainable profit by adding each relevant years past profit and dividing the same by no. of relevant years.

Step-2: Capitalised value = Average future maintainable profit/normal rate of return X 100

Step-3: Calculate the value of net assets as on the date of valuation of goodwill:
 Net Assets = All Assets (other than goodwill, fictitious assets and non-trade investments) at their current values less outsiders liabilities.

Step-4: Goodwill = Capitalised value – Net Assets



➤ **Valuation of Goodwill in case of admission of a Partner:**

Whenever there is admission of a new partner the gaining partner whose share has increased must compensate to sacrificing partner whose share has decreased. The new partner who gains by acquiring a right to share future profits must compensate the partner's who has made the sacrifice.

Amount of compensation = Value of Firms Goodwill X Share of profit Sacrificed

→**Situation -1: When incoming partner pays his share of Firms goodwill privately** to sacrificing partners outside the business, no entry is passed in books of firm

→**Situation -2: When the incoming partner bring in his share of firms goodwill in cash:**

Step-1: Write off the existing book value of goodwill appearing in the books of the firm

Old partners Capital A/c	Dr.(in old ratio)
To Goodwill A/c	

Step-2: Record the amount brought in by incoming partner

Cash/ Bank A/c	Dr. (with capital and share of goodwill)
To incoming partner's capital A/c (with capital)	
To premium for Goodwill A/c (with share of goodwill brought in)	

Step-3: Give credit for incoming partner's share of goodwill to sacrificing partners.

Premium for Goodwill A/c	Dr.(with share of goodwill)
To Sacrificing partners capital A/c (in sacrificing ratio)	

Step-4: Record the withdrawal of amount of goodwill by the sacrificing partners.

Sacrificing partner's Capital A/c	Dr.(to the extent of withdrawal)
To cash/bank A/c	

→**Situation -3: When incoming partner brings in his share of goodwill in kind.**

A new partner instead of bringing in cash may bring his share of goodwill in the form of assets. The assets brought in are debited and incoming partner's capital account is credited with capital brought in and premium account is credited with amount of goodwill.

Step-1: Record Assets brought in by the incoming partner

Individual Assets A/c	Dr.
To Incoming partner's capital A/c. (with amount of capital)	
To Premium for Goodwill A/c (with share of goodwill brought in)	

Step-2: Give Credit for incoming partner's share of goodwill to sacrificing partner

Premium for Goodwill A/c	Dr. (with share of goodwill brought in)
To Sacrificing partner's capital A/c (in sacrificing ratio)	

→**Situation -4: when the incoming partner does not bring his share of Firm's goodwill in cash.**

Step-1: Write off the existing book value of goodwill appearing in the books

Old partner's capital A/c's	Dr. (in old ratio)
To Goodwill A/c	

Step-2: Record the amount brought in by incoming partner

Cash / bank A/c	Dr. (with capital brought in)
To Incoming partner's Capital A/c	

Step-3: Give credit for incoming partner's full share of Goodwill to sacrificing partners.

Incoming Partner's Capital A/c	Dr. (with unpaid share of goodwill in case of fluctuating capital)
To Sacrificing partner's Capital A/c (in sacrificing ratio)	

→**Situation -5: When Incoming partner brings in only part of his share of Firm's Goodwill in Cash**

Step-1: Write off the existing book value of goodwill appearing

Old partner's Capital A/c	Dr. (in old ratio)
To Goodwill A/c	

Step-2: Record the amount brought in by incoming partner

Cash / bank A/c	Dr. (with capital & share of goodwill)
To Incoming partner's Capital A/c (with capital brought in)	
To Premium for Goodwill A/c (with share of goodwill brought in)	

Step-3: Give credit for incoming partner's full share of Firm's Goodwill to sacrificing partners.

Premium for Goodwill A/c	Dr. (with share of goodwill brought in)
Incoming Partner's Capital A/c	Dr. (with unpaid share of goodwill in case of fluctuating capital)



To Sacrificing partner's Capital A/c (in sacrificing ratio)

Step-4: Record the withdrawal of amount of goodwill by the sacrificing partners

Sacrificing partner's Capital A/c Dr. (to the extent of withdrawal)
To cash/bank A/c

➤ **Calculation of Hidden Goodwill**

When the value of the goodwill of the firm is not specifically given, the value of goodwill has to be inferred on the basis of the Net worth of the firm as follows:

→ Net worth including goodwill on the basis of capital brought in by incoming partner (Incoming partner's capital X Reciprocal of share of incoming partner)	₹ ***
→ Less: Net worth excluding goodwill of the reconstituted firm (including incoming partner's capital)	*** ---
→ Value of Goodwill	***

➤ **Valuation of Goodwill in case of Retirement/Death of a Partner:**

When an existing partner of a firm decides to retire from the firm, the continuing partner will gain in future profits. The continuing partner who gains by acquiring an additional right to share future profits must compensate the outgoing partner who sacrifices by foregoing his right to share future profits. The amount of compensation must be equal to the proportionate value of firm's goodwill

Outgoing partner's share of Goodwill = Value of Firm's Goodwill X Share of profit sacrificed

Step-1: Write off the existing book value of Goodwill appearing in the books of the firm

All partner's capital A/c's Dr. (in old ratio)
To Goodwill A/c (with existing book value of Goodwill)

Step-2: Give credit for outgoing partner's share of Goodwill to outgoing partner

Gaining partner's Capital A/c's Dr. (In gaining ratio)
To Outgoing Partner's capital A/c (with his share of Goodwill)

Step-3: If any existing partner (other than outgoing partner) is also sacrificing his share, a separate entry to adjust proportionate Goodwill should be passed:

Gaining partner's Capital A/c's Dr. (In gaining ratio)
To Sacrificing Partner's capital A/c (Firm's Goodwill X share sacrificed)

➤ **Calculation of Hidden Goodwill**

If a firm has agreed to settle the account of retiring/deceased partner by paying him a lump-sum amount, then amount paid to him in excess of his capital and share in reserves/revaluation account etc. shall be treated as his share of goodwill.

MCQ:

1. Under average profit basis goodwill is calculated by:
 - a. No. of years purchased multiplied with average profits.
 - b. No. of years purchase multiplied with super profits.
 - c. Summation of discounted value of expected future benefits.
 - d. Super profit divided with expected rate of return

2. Under super profit basis goodwill is calculated by:
 - a. No. of years purchased multiplied with average profits.
 - b. No. of years purchase multiplied with super profits.
 - c. Summation of discounted value of expected future benefits.
 - d. Super profit divided with expected rate of return

3. Under annuity basis goodwill is calculated by:
 - a. No. of years purchased multiplied with average profits.
 - b. No. of years purchase multiplied with super profits.
 - c. Summation of discounted value of expected future benefits.
 - d. Super profit divided with expected rate of return



4. Under capitalisation basis goodwill is calculated by:
 - a. No. of years purchased multiplied with average profits.
 - b. No. of years purchase multiplied with super profits.
 - c. Summation of discounted value of expected future benefits.
 - d. Super profit divided with expected rate of return

5. Following are the factors affecting goodwill except:
 - a. Nature of business
 - b. Efficiency of management
 - c. Technical knowhow
 - d. location of the customer

6. Weighted average method of calculating goodwill should be followed when:
 - a. Profits are uneven
 - b. Profit has increasing trend
 - c. Profits has decreasing trend
 - d. Either 'b' or 'c'.

ANSWERS: 1.(a) 2.(b) 3.(c) 4.(b) 5.(d) 6.(d)





Partnership – Admission of a Partner

Admission of a partner is one of the modes of reconstituting the firm under which old partnership comes to an end and a new one between all partners comes into existence.

A new partner acquires right to share the assets and future profit of the firm.

A new partner brings in his share of Goodwill to acquire the right to share the future profit of the firm.

New profit sharing ratio and sacrificing ratio

When a new partner is admitted, he acquires his share in profits from the old partners. This reduces the old partners share in profit. Hence, profit sharing ratio for old partners have to be calculated.

→ **New profit sharing ratio:** The ratio in which all partners including incoming share the future profits and losses is known as the new profit sharing ratio. The determination of new profit sharing ratio depends upon the ratio in which the incoming partner acquires his share from the old partners. An incoming partner acquires his share from:

- a. the old partners in their old sharing ratio
- b. the old partners in some agreed ratio
- c. one or more of old partners

→ **Sacrificing Ratio:** The ratio in which the old partners have agreed to sacrifice their shares in profit in favor of a new partner is called the sacrificing ratio. This ratio is calculated by taking out the difference between Old profit share and new profit share.

Revaluation of Assets and Liabilities:

At the time of admission of a partner, the assets and liabilities are revalued so that the profit and loss arising on account of such revaluation upto the date of admission of a new partner may be ascertained and adjusted in the old partner's capital accounts in their old profit sharing ratio since it belongs to old partners and not to new partners.

The effect of revaluation of assets and liabilities may be recorded either through 'Revaluation Account' (profit and loss adjustment account) or through capital accounts.

Revaluation account is credited with increase in the value of assets and decrease in amount of liabilities (if it is gain) and debited with decrease in the value of assets and increase in amount of liabilities (if it is loss).

Accounting Entries:

For Increase in the value of an asset	Asset A/c To Revaluation A/c	Dr.
For Decrease in the value of an asset	Revaluation A/c To Asset A/c	Dr.
For Increase in the amount of Liability	Revaluation A/c To Liability A/c	Dr.
For Decrease in the amount of Liability	Liability A/c To Revaluation A/c	Dr.
For Recording an unrecorded Assets	Unrecorded Asset A/c To Revaluation A/c	Dr.
For Recording an unrecorded Liability	Revaluation A/c To Unrecorded Liability A/c	Dr.
For transfer of Balance in Revaluation Account:		
1. If credit side exceeds debit side(gain)	Revaluation A/c To old partner's capital a/c (in old ratio)	Dr.
2. If debit side exceeds credit side(loss)	Old partner's capital a/c To revaluation A/c	Dr. (in old ratio)



Accounting Entries:

For transfer of reserves and accumulated profits	Reserves A/c P & L A/c Workmen compensation Reserves A/c Investment Fluctuation Reserves A/c To Old partner's capital A/c	Dr. Dr. Dr. Dr.
For transfer of Accumulated Losses	Old partner's capital Accounts To Profit and Loss A/c To Deferred Revenue Expenditure A/c	Dr.(old ratio)

Adjustment of Capital

- **Adjusting the capitals of old partners on the basis of the capital of incoming partner when the total capital of new firm is not given.**

Step-1: Calculate new profit sharing ratio

Step-2: Calculate total capital of new firm:

Total capital = New partner's capital X Reciprocal of proportion of share of new partner

Step-3: Calculate the new capital of old partners:

New capital of old partner = Total capital of new firm X new share of old partner

Step-4: Calculate the adjusted old capitals of old partners:

	A	B
Old capital before adjustments	***	***
Share of Goodwill	***	***
Share of Profit/loss on Revaluation	***	***
Share of Reserves and Accumulated Profit	***	***

Step-5: Calculate the shortage/surplus in each of the old partner's capital A/c

Shortage/surplus = New capital – Adjusted old capital

Step-6: Adjustment of shortage in case of adjusted old capital is less than the new capital

Cash A/c or concerned Partner's Current A/c Dr.

To concerned partner's capital A/c

or

Adjustment of surplus in case of adjusted old capital is more than the new capital

Concerned partner's capital A/c Dr.

To Cash A/c or concerned Partner's Current A/c

- **Determining the new partner's capital on the basis of combined capital of old partners:**

Step-1: Calculate the new profit sharing ratio

Step-2: Calculate the adjusted old capitals of old partners:

	A	B
Old capital before adjustments	***	***
Share of Goodwill	***	***
Share of Profit/loss on Revaluation	***	***
Share of Reserves and Accumulated Profit/loss	***	***

Step-3: Calculate the total capital of new firm:

Total capital = Total adjusted old capitals of old partners X Reciprocal proportion of share of old partners.

Step-4: calculate the proportionate capital of new partner

New partner's capital = Total capital X proportion of share of new partner.

- **Admission of a partner during the year:** When a partner is admitted during the year, the profits of the year should be divided between pre-admission period and post-admission period on some



MCQ:

1. A person may be admitted as a partner with the consent of :
 - a. majority of partners
 - b. senior partner
 - c. all the existing partners
 - d. working partners

2. An incoming partner is liable for all the acts of the firm done:
 - a. before his admission
 - b. after his admission
 - c. none of these

3. Which of the following is true?
 - a. Incoming partner acquires his share from all the old partners in their profit sharing ratio
 - b. Incoming partner acquires his share from all the old partners in some agreed ratio
 - c. Incoming partner acquires his share from one or more of old partners in some agreed ratio
 - d. none of these.

4. Unless agreed otherwise, it is presumed that-
 - a. Sacrificing ratio is the same as old profit sharing ratio.
 - b. New profit sharing ratio of old partners is the same as old profit sharing ratio.
 - c. New profit sharing ratio of old partners is equal.
 - d. (a) and (b)

5. Profit/loss on revaluation of assets and liabilities is shared by the old partners in their—
 - a. Capital ratio
 - b. New profit sharing ratio
 - c. Sacrificing ratio
 - d. Old profit sharing ratio

6. Accumulated profit/loss and reserves are shared by the old partners in their---
 - a. Capital ratio
 - b. New profit sharing ratio
 - c. Sacrificing ratio
 - d. Old profit sharing ratio

7. Revaluation account is debited :
 - a. an increase in provision for doubtful debts
 - b. an increase in value of Land and building
 - c. a decrease in amount of creditors
 - d. to transfer loss on revaluation

8. Partner's Capital A/c is debited:
 - a. To record the profit on revaluation
 - b. To record the general reserve
 - c. To record the P&L (dr.)
 - d. To record the shortage of capital brought in

ANSWERS: 1.(c) 2.(b) 3.(c) 4.(a) 5.(d) 6.(d) 7.(a) 8.(c)



Partnership Accounts – Retirement/Death of Partner

Retirement of a Partner is one of the modes of reconstituting the firm under which an old partnership comes to an end and a new one between the continuing partners comes into existence.

A partner may retire---

- >With consent of all other partners
- >In accordance with express agreement by the partners
- >By giving notice in writing, to all other partners of his intension to retire in case of partnership at will.

Gaining Ratio:

The ratio in which the continuing partners acquire the outgoing partners share is called gaining ratio. The ratio is calculated by taking out the difference between new profit share and old profit share.

Unless agreed otherwise it is presumed that, the continuing partners gain in their old profit sharing ratio and hence their gaining ratio is same as their old profit sharing ratio.

Revaluation of Assets and Liabilities:

At the time of retirement of a partner, the assets and liabilities are revalued so that the due share of an outgoing partner in the profit/loss arising from such revaluation may be ascertained and adjusted in his capital account.

Revaluation account or Profit and Loss adjustment account is prepared exactly in the same manner as explained earlier in Admission of Partner. Balances are transferred to all partners in their old profit sharing ratio.

Adjustment for Reserves and accumulated Profit/loss:

At the time of retirement of a partner, any reserves, accumulated profits or losses exists in the books of the firm, these should be transferred to the Capital Accounts of all the partners in their Old profit sharing ratio so that the due share of an outgoing partner in the reserves, accumulated profits/loss up to the date of retirement gets adjusted in his capital account.

Accounting Entries:

For Transfer of Reserves and Accumulated Profit	General Reserve	Dr.
	P&L A/c	Dr.
	Workmen Compensation Reserve	Dr.
	(excess of reserve over liability)	
	Investment Fluctuation Reserve	Dr.
	(Excess of reserve over difference of book and market value)	
	To All partner's Capital A/c (in old ratio)	
For Transfer of Accumulated Losses (Dr. balance of P&L)	All partner's Capital A/c (in old ratio)	Dr.
	To Profit and loss A/c	
	To Deferred Revenue Expenditure A/c	

Adjustment of Capitals:

1. When the total capital of the new firm is given/ not given:

Step-1: Calculate new profit sharing ratio and gaining ratio of continuing partners

Step-2: Calculate the adjusted old capitals of continuing partners as follows:

	A	B	C
Old capital before adjustments	***	***	***



Share of goodwill credited/Debited	***	***	***
Share of Profit/loss on Revaluation	***	***	***
Share of reserves and accumulated profit/loss	***	***	***
Adjusted old capital of continuing partner →	***	***	***

Step-3:

> Calculate the new capital of continuing partners when capital of new firm is given:

= Total capital of new firm X New share of continuing partner

> Calculate total capital of new firm when capital of new firm is not given:

Total Capital of the new firm = Total adjusted old capital of continuing partners

Step-4: Calculate the shortage to be brought in or surplus to be paid off:

= New Capital – Adjusted Old Capital

Step-5:

> In case the adjusted old capital is less than the new capital (shortage to be brought in)

Cash A/c or Concerned Partner's Current A/c	Dr.
To Concerned partner's capital A/c	

OR

> In case the adjusted old capital is more than the new capital (Surplus to be paid)

Concerned partner's capital A/c	Dr.
To Cash A/c or concerned partner's current A/c	

2. When the outgoing partner is to be paid through cash brought by the continuing partners in such a way as to make their capital proportionate to their new profit sharing ratio:

Step-1: Calculate the adjusted old capital of continuing partners after all other adjustments As explained above

Step-2: Calculate total capital of the new firm as follows:

= Total adjusted old capitals of continuing partners + shortage of cash to be brought in by continuing partners in order to make payment to outgoing partner.

Step-3: follow step-3 to step-5 given above

Disposal of the amount due to the retiring partner:

The amount due to the retiring partner is settled in the manner prescribed in the partnership deed. The amount due is either paid off immediately or is paid in installments with or without interest as per agreement. In the absence of an agreement in this regard, the outgoing partner at his option is entitled to receive either interest @6% p.a. till the amount is paid off or a share of the profit which has been earned by using the amount due to him.

Accounting Entries:

> Discharging outgoing partner's claim

Outgoing Partner's Capital A/c	Dr.
To Investment/Asset A/c/	(with agreed value of asset)
To Bills payable A/c	(if B/E is accepted)
To Cash/Bank A/c	(if immediate payment is made)
To Outgoing partner's loan a/c	(if amount is transferred to loan)



>Interest on loan from partner

Interest on Loan A/c	Dr.
To Outgoing partner's Loan A/c	

>Payment of partner's Loan

Outgoing Partner's Loan A/c	Dr.
To Bank/Cash A/c	

Retirement during the Accounting Year:

When a partner retires from the firm during the accounting year, the retiring partner is entitled to the share of profits of the current year up to the date of retirement, In addition to reserve, his share of goodwill and profits on revaluation of assets and reassessment of liabilities.

His share of interim profit is calculated as per the provision of the partnership deed. If the partnership deed is silent, the amount of profit should be calculated in the manner as agreed among the partners. When it is calculated on the basis of last year's profit, profit up to the date of retirement and share of profit of retiring partner is considered.

The share of retiring partner on the basis of the average profit of the past few years is calculated as given below:

Step-1: Take the total profit of the given no. of years

Step-2: Average yearly profit = Total profit/ no .of years

Step-3: Profit up to the date of retirement = Average yearly profit X period up to date of retirement / 12 months

Step-4: Share of retiring partner=profit as per step-3 X share of retiring partner

Death of a Partner:

The basic difference between the retirement and death of partner is that retirement may be planned whereas death may be sudden and may occur at any time during the year.

➤ **Ascertaining the share of deceased partner:**

Deceased partner's share in the firm is calculated in the same manner in case of retiring partner:

Format of outgoing/deceased partner's capital account

Particulars	₹	Particulars	₹
To Goodwill A/c(existing goodwill w/o)	***	By Balance b/d	***
To Drawings	***	By Gaining Partner's Capital A/c (share of Goodwill)	***
To Interest on Drawings	***	By P & L suspense a/c(share of Profit)	***
To Undistributed Losses	***	By Reserves(Share of reserves)	***
To Revaluation a/c(Share of loss on Revaluation)	***	By Interest on Capital a/c	***
To Deceased partner's Executor's A/c(Balancing figure)	***	By Revaluation A/c(Share of profit on revaluation)	***



➤ *Outgoing partner's share in the profit of the year of death/retirement involves two steps:*
Step-1: Calculate the profit from the date of last balance sheet to the date of date/retirement

1. *One time basis:*

>>*Profit from date of last balance sheet to the date of death/retirement:*

Proportionate period for the year up to death /retirement X Previous year's profit or average profit of given past years.

2. *On sale Basis:*

>>*Profit from date of last balance sheet to the date of death/retirement:*

Sales from the date of the last balance sheet to the date of death/retirement / divided by previous year's sales or average sales of a given past years X Previous year's profit or average profit of given past years.

Step-2: Outgoing partner's share in profits

Outgoing partner's share in profit = profit of the firm from the date of last balance sheet to the date of death/retirement X proportion of share of outgoing partner.

Accounting treatment:

1. *Thru profit and loss suspense a/c:*

In case of profit: Profit and Loss suspense a/c	Dr.
To Outgoing partner's capital a/c	

Reverse the entry in case of loss

2. *Thru capital a/c of the gaining partners:*

In case of profit: Gaining partner's capital a/c	Dr.
To Outgoing partner's capital a/c	

Reverse the entry in case of loss.

Special Transactions:

➤ **Treatment of Joint life policy in case of death of partner:**

If joint life policy appears in the balance sheet at surrender value, then the firm will gain on the death of a partner.

Accounting entry:

>> *Policy value received from insurance co.*

Bank A/c	Dr.
To Joint life policy A/c	

>> *Sharing of profit from policy value*

Joint life policy A/c	Dr.
To Individual partner's capital A/c (in their profit sharing ratio)	

➤ **Treatment of separate life policy in case of death of partner:**

The policy of deceased partner will get mature. The legal representative of deceased partner is entitled to get the share of assured value of matured policy and surrender value of remaining partners.

Accounting entry:

>> *Policy value received from insurance co.*

Bank A/c	Dr.
To separate life policy of deceased partner's a/c	



>> Total value of matured policy and surrender value of other partner's policy distributed in profit sharing ratio:

Separate life policy of deceased partner's a/c	Dr. (assured value)
Separate life policy of remaining partner's a/c	Dr. (surrender value)
To Executor's A/c	(Value distributed in profit sharing ratio)
To Remaining partner's A/c	(Value distributed in profit sharing ratio)

MCQ:

1. A partner may retire from an existing firm:

- a. With consent of all partners
- b. As per express agreement
- c. By written notice in partnership at will
- d. all of the above

2. Public notice of retirement must be given :

- a. Only by retiring partner only.
- b. Only by partner other than retiring partner.
- c. By retiring partner or any of the other partner
- d. none of these

3. Retiring partner's share of goodwill is debited to remaining partners in their:

- a. Capital Ratio
- b. New profit sharing ratio
- c. Old profit sharing ratio
- d. Gaining ratio

4. In case Revaluation account is prepared, the assets and liabilities appear in the books of reconstituted firm at their:

- a. Old books values
- b. Market value
- c. Revalued figures
- d. Realizable value

5. Death of the partner has the effect of _____

- a. Dissolving the firm
- b. Result in continuance of the business of the firm
- c. His heirs joining the firm
- d. Computation of profit up to the date of death

6. Claim of the retiring partner is payable in the following form:

- a. Fully in cash
- b. Fully transferred to loan a/c to be paid later with some interest on it
- c. Partly in cash and partly as loan repayable later with agreed interest
- d. All of the above

7. The heirs of the deceased partner

- a. Has a right to become a partner in the firm of the deceased partner
- b. Does not have a right to become a partner in the firm of the deceased partner
- c. Can become partner in the firm of the deceased partner only if the surviving partners give their consent in this regard.
- d. Both (b) & (c)

8. On the death of partner, his executors are paid the share of deceased partner in the profit of the firm till the date of his death. This amount is recorded in profit & loss _____ A/c

- a. Adjustment
- b. Appropriation
- c. Suspense
- d. Reserve

ANSWERS: 1.(d) 2.(c) 3.(d) 4.(c) 5.(a) 6.(d) 7.(d) 8.(c)



Company Accounts – Share Capital

Company: A Company is an incorporated association which is an artificial person created by law, having a corporate and legal personality distinct and separate from its members, perpetual succession and common seal.

- **Registered or Incorporated Company:** Company registered in accordance with the provision of the companies Act 2013 or any existing company formed and registered under any of previous company law.
- A. Private Company:** A Private company means a company which has a minimum paid up capital of Rs.100000/- or such higher paid up capital as may be prescribed, and by its articles—
 - a. Restricts the right to transfer the shares if any
 - b. Limits the number of its members to two hundred and
 - c. Prohibits any invitation to the public to subscribe for any shares in or debentures of the company.
- B. Public Company:** Public company means a company which is either
 - a. Not a private company and has a minimum paid-up capital of Rs.500000/- or such higher paid-up capital as may be prescribed or
 - b. Is a private company which is subsidiary of Public Company
- C. Government Company:** Any company in which not less than 51% of share capital is held by the Central Government and partly by one or more State Governments, an includes a company which is subsidiary company of such a Government company.
- D. Foreign Company:** 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. Conduct any business activity in India in any other manner.
- E. One Person Company:** As per Companies act 2013, a company which has only one person as member.
- F. Small Company:** A company, other than a public company —
 - i. Paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees or
 - ii. Turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees.
- G. Listed Company:** A company which has any of its securities listed on any recognized stock exchange.
- H. Unlimited Company:** Company not having any limit of its members.
- I. Company limited by Shares:** Company having the liability of its members limited of its member limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them.
- J. Company limited by Guarantee:** Company having 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.
- K. Holding Company:** 'Holding Company' in relation to one or more other companies, means a company of which such companies are subsidiary companies.
- L. Subsidiary Company:** A company in which the holding company:
 - a. Controls the composition of the Board of Directors or
 - b. Exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies.

A company shall be deemed to be a subsidiary company of the holding company even if there is indirect control through the subsidiary company. The control over the composition of a subsidiary companies Board of Directors means exercise of some power to appoint or remove all or majority of the directors of the subsidiary company.

SHARE CAPITAL

Share Capital means the capital raised by the issue of shares. The amounts invested by the shareholders towards the face value of shares are collectively known as 'Share Capital' which is quite distinct from the capital put in by individual shareholders.



Authorized Capital: An Authorized capital refers to that amount which is stated in the 'Capital Clause' of the Memorandum of Association as the share capital of the company. This is the maximum limit of the company which it is authorized to raise and beyond which the company cannot raise unless the capital clause in the Memorandum is altered in accordance with the provision of Sec.94 of the Companies Act 1956.

Issued Capital: An issued capital refers to the nominal value of that part of authorized capital, which has been (1) Subscribed for by the signatories to the memorandum of Association (2) Allotted for cash or for consideration other than cash (3) Allotted as Bonus Shares.

Subscribed Capital: It refers to paid-up value of the issued Capital.

Unissued Capital: It refers to that portion of the authorized capital which has not yet been issued.

Reserve Capital: As per section 65 of the Companies act 2013, Company may decide by passing a resolution that a certain portion of its subscribed uncalled capital shall not be called up except in the event of winding up of the company. Portion of the uncalled capital which a company has decided to call only on case of liquidation of the company is called Reserve Capital.

Reserve Capital is different from Capital reserve, Capital reserves are part of 'Reserves and Surplus' and refer to those reserves which are not available for declaration of dividend. Thus, reserve capital which is portion of the uncalled capital to be called up in the event of winding up of the company is entirely different in nature from capital reserve which is created out of capital profit only.

SHARE

A. **Preference Shares:** According to sec 43 of Companies Act 2013 persons holding preference shares, called preference shares, called preference shareholders, are assured of a preferential dividend at a fixed rate during life of the company. They also carry preferential right over other shareholders to be paid first in case of winding up of the company. Thus, they enjoy preferential right in the matter of:

- a. Payment of dividend and
- b. Repayment of Capital

Preference shares are cumulative and non-participating unless expressly stated otherwise.

1. **Cumulative Preference Shares:** A cumulative preference share is one that carries the right to fixed amount of dividend or dividend at a fixed rate. Such a dividend is payable even out of future profit if current year's profits are insufficient for the purpose. This means that dividend on these shares accumulates unless it is paid in full and, therefore the shares are called Cumulative Preference Shares. The arrears of dividend are then shown in the balance sheet as a contingent liability.
2. **Non-cumulative Preference Shares:** A non-cumulative preference share carries with it right to a fixed amount of dividend. In case no dividend is declared in a year due to any reason, the right to receive such dividend for that year expires.
3. **Participating Preference Shares:** Holders of these shares gets right to participate in the surplus profit over and above right to receive fixed dividend. Similarly in case of winding up of company, these shares carries right to receive pre-determined proportion of surplus as well once the equity share holders have been paid off.
4. **Non-participating Preference Shares:** Holders of these shares have right to receive fixed rate of dividend but do not have right in profits and in the surplus on winding-up.
5. **Redeemable Preference Shares:** These are shares that a company may issue on the condition that the company will repay after the fixed period or even earlier at company's discretion. The repayment of these shares is called redemption governed by sec 55 of Companies Act 2013.
6. **Non-redeemable Preference Shares:** Shares with no agreement regarding redemption are called non-redeemable preference shares.
7. **Convertible Preference Shares:** These shares give the right to the holder to get them converted into equity shares at their option according to the terms and conditions of their issue.
8. **Non-convertible Preference Shares:** When the holder of a preference share has not been conferred the right to get his holding converted into equity shares, it is called Non-convertible Preference Shares.



B. Equity Shares: Equity shares are those shares, which are not preference shares. It means that they do not enjoy any preferential rights in the matter of payment of dividend or repayment of capital.

Equity shares can be issued by a company either for cash or consideration other than cash.

- Issue of shares for cash:** Private companies depend upon 'Private Placement' of shares and Public companies is a 'Prospectus' and invite general public to subscribe shares. On the basis of prospectus, application deposited along with the amount payable at the time of application, in cash. First installment paid along-with application is called 'Application Money' which must be at least 5% of the nominal value of shares as per sec.39 of Companies act 2013. Company allots shares only if minimum subscription stated in prospectus is received. As per SEBI guidelines, a company must receive a minimum of 90% subscription against entire issue. Applicants become shareholder of the company if application is accepted by company and are required to pay second installment which is known as 'Allotment Money'. Subsequent installment, if any, to be called by the Company is known as 'Calls'.

First Installment	.....	Application Money
Second Installment	.....	Allotment Money
Third Installment	.....	First Call Money
Fourth Installment	.....	Second Call Money and so on
Last Installment	.....	Final Call Money

➤ Journal Entries for issue of shares:

On Receipt of the application money	Bank A/c Dr. (with actual amount received) To Share Application Account
On Allotment of shares	Share Allotment A/c Dr. (amt. due on allotment) Share Application A/c Dr. (Application amt rcvd) To Share Capital A/c (amt. due on appl. & allotment)
On receipt of allotment money	Bank A/c Dr. (amt. rcvd on allotment) To share allotment a/c
On a Call being made	Share call A/c Dr. (amt. due on call) To share capital A/c
On receipt of call money	Bank A/c Dr. (due amt. rcvd on call) To share call A/c

➤ Subscription of shares

Full Subscription: Issue is fully subscribed if the no. of shares offered for subscription and no. of shares actually subscribed by the public are same.

For application money received	Bank A/c Dr. (application money on allotted share) To Equity share application A/c
At the time of allotment	Equity Share Application A/c Dr. (appl. money on allotted shares) To Equity Share Capital A/c
To record amount due on allotment	Equity Share Allotment A/c Dr. (appl. due at the allotted share) To Equity Share Capital A/c
For Allotment money received	Bank A/c Dr. (Allotment money rcvd from shareholders) To Equity share Allotment A/c
When decision to demand first call is made	Equity First Call A/c Dr. (No. of share X first call per share) To Equity Share Capital A/c
On receiving first and final call money	Bank A/c Dr. (Amt. actually rcvd on a/c of first call) To Equity First Call A/c

Under-subscription: When no. of shares offered for subscription is more than the no. of shares subscribed by the public. Share can be allotted only when minimum subscription is received. Accounting entries remains same as above with only change in calculation of application, allotment and call money is based on no. of shares actually applied and allotted.

Oversubscription: When issue is over-subscribed, some application rejected and application money refunded. Some applications accepted and a part of shares applied may be allotted and the excess amount received can be utilized towards allotment or call money which has fallen due or will soon fall due for payment.



On refund of application money to applicant to whom shares have not been allotted	Share application A/c Dr. To Bank A/c
Part of shares applied for are allotted	Share Application A/c Dr. To Share Allotment A/c To Share Call-in-advance A/c

➤ **Shares issued at discount:**

Shares are said to be issued at a discount, if issue is at an amount less than the nominal or par value of shares. The excess of nominal value over the issue price represents discount on the issue of shares. As per companies act 2013, only employees and directors can be issued shares at discount.

➤ **Shares issued at premium:**

Shares are said to be issued at premium, if issue is at an amount more than the nominal value or par value of shares. Premium is excess of issue price over face value of the security. When the issue is at a premium, the amount of premium mat technically called at any stage of share capital transactions.

When shares are issued at a premium, the premium amount is credited to a separate account called "Share premium account" which is not part of share capital and shown under the head 'Reserves and Surplus'.

According to sec 52 of Companies Act 2013, Share Premium Account may be used by the company:

- Towards issue of un-issued shares of the company to be issued to members of the company as fully paid bonus shares.
- To write off preliminary expenses, write off the expenses of, or commission paid, or discount allowed on any of the shares or debentures of the company.
- To provide for premium on the redemption of redeemable preference shares or debentures
- For the purchase of own shares or other securities.

When shares are issued at premium, the journal entries are as follows:

Premium amt. called with application money	Bank A/c Dr. (total application money+ premium amt) To share application a/c (amount received)
	Share Application A/c Dr. (no. of shares X appl.amt. per share) To Share Prem. A/c (No. of share allotted X prem. per share)
Premium amount called with allotment money	Share Allotment A/c Dr. (No. of share allotted X Allotment and prem. Money per share) To Share Capital A/c (No. of share allotted X Allotment amt. per share) To Share Prem. A/c. (No. of share allotted X prem. Amt. per share)
	Bank A/c Dr. To Share Allotment A/c (money rcvd including premium)

➤ **Over Subscription and Pro-rata allotment:**

The application money received for more than the no. of shares offered to the public by a company. When the shares are oversubscribed, some applications are rejected and the company if it thinks fit, may allot the shares to the applicants on pro-rata basis means allotment in proportion of shares applied for.

Under pro-rata allotment, the excess application money received is adjusted against the amount due on allotment or calls. Surplus money after making adjustment against future calls is returned to the applicants.

When there is a pro-rate allotment, the total application money paid by an applicant is more than the exact amt due on application. The excess amt is treated as advance against allotment or future calls.

Accounting Entry:

- For rejected application:

Share application Account Dr.
To Bank A/c

- For Pro-rata allotment: Excess application money is adjusted against allotment.

Share Application A/c Dr.
To Share Allotment A/c



➤ **Calls in arrears and Calls in advance:**

The total unpaid amount on one or more installments is known as 'calls-in-arrears' or unpaid calls. These are amount due on allotment and not paid by shareholders. 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.

>> Entry for calls-in-arrear:

Calls-in-arrears A/c Dr. (amount of unpaid calls)
 To Share Allotment A/c
 To Share Calls A/c

>> For interest receivable on calls-in-arrears

Shareholders A/c Dr.
 To Interest on calls-in –arrears A/c

>> For receipt of interest

Bank A/c Dr.
 To Shareholders A/c

Some shareholders may sometimes pay a part or whole of the amount not yet called up, such amount is known as call-in-advance. Money received in advance is entitled for receiving interest @12% p.a.

>> Bank A/c Dr.
 To Call-in-advance A/c

When calls become actually due, calls-in-advance account is adjusted at the time of the call.

>> Calls-in-advance A/c Dr. (call amount due)
 To Particular Call A/c

Entry for interest on calls-in-advance

>> Interest on calls-in-advance A/c Dr. (Amt. of interest due for payment)
 To Shareholder's A/c

>> Shareholder's A/c Dr. (Amt. of interest paid)
 To Bank A/c

Forfeiture of shares:

The term 'forfeit' means taking away of property on breach of a condition. Failure by shareholder in paying, allotment or call money, on due date results in forfeiture of shares by company. Any amount paid till date is not refunded by company.

➤ **Forfeiture of shares which were issued at par:**

Share Capital A/c Dr. (No. of shares X called-up value per share)
 To Forfeited share A/c (Amt. already received on forfeited shares)
 To Share Allotment A/c (if Amt. due, but not paid)
 To Share First Call A/c (if Amt. due, but not paid)

Where all amounts due on allotment, first call and final call have been transferred to calls-in –arrear:

Share Capital A/c Dr. (No. of shares X called-up value per share)
 To Calls-in-arrears A/c (Total amount due, but not paid)
 To Forfeited Shares A/c (Amount received)

➤ **Forfeiture of shares which were issued at premium:**

If premium not received on shares:

Share Capital A/c Dr. (Called-up value)
 Share Premium A/c Dr. (Amt. of share premium not received)
 To Share Allotment A/c (If amt. due, but not paid)
 To Share First Call A/c (If amt. due, but not paid)
 To Share Final Call A/c (If amt. due, but not paid)
 To Forfeited Share A/c (Amt. received on forfeited shares)



If premium is received on shares:

Share Capital A/c Dr. (Called-up value)
 To Share Allotment A/c (If amt. due, but not paid)
 To Share First Call A/c (If amt. due, but not paid)
 To Share Final Call A/c (If amt. due, but not paid)
 To Forfeited Share A/c (Amt. received on forfeited shares)

➤ **Forfeiture of fully paid-up shares:**

Fully paid up shares may be forfeited for realization of debts of the shareholder if the articles specifically provide it.

➤ **Re-issue of Forfeited Shares:**

The share, after forfeiture, in the hands of the company is subject to an obligation to dispose it off. Reissue of forfeited shares is not allotment of shares but only a sale or dispose off by auction. These shares can be re-issued at any price so long as the total amount received for those shares is not less than the amount of arrear on those shares.

>> Bank A/c Dr. (Actual amount received)
 Forfeited Shares A/c Dr. (Loss on re-issue)
 To Share Capital A/c
 >> Forfeited Shares A/c Dr.
 To Capital Reserve A/c (profit on re-issue, transferred)

Points of consideration for re-issue of forfeited shares:

- Loss on re-issue not to exceed the forfeited amount, loss if any to be debited to 'Forfeited Share A/c' and surplus if any to be transferred to Capital Reserve
- Forfeited amt on shares not yet reissued should be shown under the heading 'Share Capital'
- If the shares are re-issued at a price which is more than the face value of the shares, excess amt. to be credited to Share Premium A/c, not necessary of re-issue and forfeited amount taken together exceeds the face value of the shares re-issued.

➤ **Issue of Shares for consideration other than cash:**

Company may issue shares in direct exchange for land, building or other assets. Shares may also be issued for service rendered by promoters, lawyer in formation of the company. These shares should be shown separately under heading 'Share Capital'.

>> When assets are purchased in exchange of shares:

Asset A/c Dr.
 To Share Capital A/c

>> When Share are issued to Promoters:

Goodwill A/c Dr.
 To Share Capital A/c

MCQ:

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. Reserve Capital account
 - d. Share premium account
2. The share 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. Payment of dividends
 - d. Writing of the expenses/discount on the issue of debenture
3. When the 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 arrears of shares forfeited
 - c. Called up capital of shares forfeited, Amount received on shares forfeited
 - d. Calls in arrears of shares forfeited, Amount received on shares forfeited.



4. Which type of following shares have the right to receive dividends unpaid in prior years, whenever earnings become adequate?
 - a. Cumulative preference shares
 - b. Participating preference shares
 - c. Convertible preference shares
 - d. Callable preference share

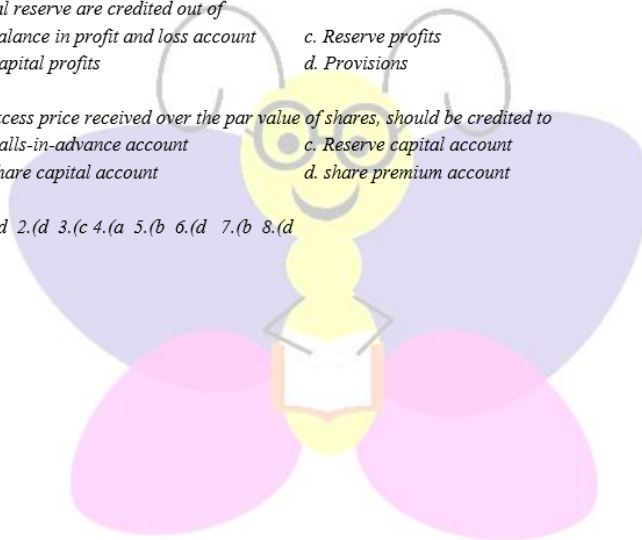
5. If forfeited shares originally issued at par are reissued at a premium, the amount of such premium will be credited to _____
 - a. Share forfeiture account
 - b. Share premium account
 - c. Capital reserve account
 - d. Profit on issue of share account

6. As per SEBI guidelines, on issue of shares, the application money should not be less than
 - a. 2.5% of nominal value of shares
 - b. 2.5% of the issue price of shares
 - c. 25% of nominal value of shares
 - d. 25% of the issue price of shares

7. Capital reserve are credited out of
 - a. Balance in profit and loss account
 - b. Capital profits
 - c. Reserve profits
 - d. Provisions

8. The excess price received over the par value of shares, should be credited to
 - a. Calls-in-advance account
 - b. Share capital account
 - c. Reserve capital account
 - d. share premium account

ANSWERS: 1.(d) 2.(d) 3.(c) 4.(a) 5.(b) 6.(d) 7.(b) 8.(d)





Redemption of Preference Shares

Redemption is the process of repaying an obligation, at prearranged amounts and timings. The redemption date is the maturity date, which specifies when repayment takes place and is usually printed on preference share certificate.

A company may issue redeemable preference shares because of following:

>It's alternate to raise finance when public issue is not advisable due to market conditions, people may invest in preference shares redeemable by company.

>This is perfect instrument when company requires fund for medium term for any project, as can be redeemed whenever there is a surplus funds which is not utilized in business.

➤ Provision of Companies Act.(sec55)

A company limited by shares if so authorized by its articles, may issue preference shares which at the option of the company, are liable to be redeemed.

- a. Company can redeem shares only of profit which would otherwise be available for dividend or out of proceeds of fresh issue of shares.
- b. Only fully paid shares can be redeemed.
- c. Premium if any payable on redemption shall be provided for out of the profits of the company by such class of companies whose financial statements comply with accounting standards under section 133, for any other companies it shall be provided out of the profit or share premium account.
- d. Where shares are redeemed out of profit available for dividends, a sum equal to nominal amount of shares is transferred to Capital Redemption Reserve Account.

➤ *Methods of Redemption of fully paid-up shares*

1. Redemption of preference shares by fresh issue of shares:

A company can issue new equity or preference shares and the proceeds from such new shares can be used for redemption of preference shares. The proceeds from issue of debentures cannot be utilized for the purpose.

When fresh issue is made for the purpose of redemption of preference shares at a premium, Companies act provides that share premium account may be applied by company for premium on the redemption of redeemable preference shares except for certain class of companies whose financial statements comply with accounting standards as prescribed under sec 133 of Companies Act, 2013.

>> A company may prefer issue of new equity shares for redemption purpose when company does not want to repay the whole of amount due to liquidity position and keep capital permanently without having commitment of fixed rate of dividend in case of equity shares.

Advantage: No cash outflow, no capital gain tax for shareholders, may be valued at premium.

Disadvantage: Change in shareholding, further dilution of earnings due to increase in equity.

Accounting Entries:

When shares are issued at par	Bank A/c Dr. To Share Capital A/c
When new shares are issued at a premium	Bank A/c Dr. To Share Capital A/c To Share Premium A/c
When Preference share are redeemed at par	Redeemable Preference Share Capital A/c Dr. To Preference Shareholders A/c
When Preference share are redeemed at premium	Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Pref. share A/c Dr. To Preference Shareholders A/c
When Payment is made to preference	Preference Shareholders A/c Dr.



- Calculation of minimum fresh issue of shares:

For the purpose of redemption of preference shares, the number of shares should be issued without violating the provision of sec 55 of the Companies Act, 2013:

- Ascertain maximum amount of reserves and surplus available for redemption.
- Minimum Proceeds of Fresh Issue of Shares: Nominal Value of Preference shares to be redeemed – Maximum amount of reserve and surplus available for redemption.
- Minimum no. of shares to be issued = Minimum proceeds of fresh issue / proceeds per share

- Minimum Fresh issue for redemption.

Fresh issue is made ensuring compliance of sec55 to provide funds for redemption. Fresh shares to be issued calculated based on amount payable to preference shareholders and fund available for redemption, balance funds to be raised.

- Fresh issue at a Premium:

Premium on fresh issue of share is available for writing off premium on redemption. Assume that profit available for redemption is not required for paying premium on redemption of preference shares. It means that share premium including premium on fresh issue is more than premium on redemption.

2. Redemption of Preference shares by Capitalization of Undistributed Profits.

When shares are redeemed by utilizing distributable profit, an amount equal to the face value of shares redeemed is transferred to Capital Redemption Reserve Account by debiting the distributable profits.

>> Advantage: Surplus funds can be used and there will not be any change in shareholding and no dilution of future earnings.

>> Disadvantage: Reduction in liquidity and capital gain tax liability to preference shareholders.

Accounting Entries:

When shares are redeemed at par	Redeemable Preference Share Capital Account Dr. To Preference Shareholders Account
When Shares are redeemed at a Premium	Redeemable Preference Share Capital Account Dr. Premium on Redemption of Preference Shares Account Dr. To Preference Shareholders Account
When Payment is made to Preference Shareholders	Preference Shareholders Account Dr. To Bank A/c
For adjustment of premium of redemption	Profit and Loss A/c Dr. To Premium on redemption of Preference share account
For transferring nominal amount of shares redeemed to Capital Redemption Reserve Account	General Reserve Account Dr. Profit and Loss Account Dr. To Capital Redemption Reserve Account

3. Redemption of Preference shares by combination of fresh issue and Capitalization of Undistributed Profits.

A company can redeem the preference shares partly from the proceeds from new issue and partly out of profits. In order to fill in the 'gap' between the face value of shares redeemed and the proceeds of new issue, a transfer to be made from distributable profits to Capital Redemption Reserve Account.

Formula:

- | | |
|--|-------|
| Amount to be Transferred to Capital Redemption Reserve | ₹ |
| Face value of shares redeemed | *** |
| Less: Proceeds from new issue | *** |
| | ----- |
| | *** |
- | | |
|---|-----|
| Proceeds to be collected from New Issue | ₹ |
| Face Value of shares redeemed | *** |



4. *Sale of Investment for redemption:*

Companies may have sufficient investments, which can be sold in the market to arrange funds for redemption of preference shares.

➤ Redemption of Partly called-up Preference shares:

Redemption of preference shares can be done only if it is fully paid up. Hence, it is assumed that final call on these shares is demanded and received before preceding the redemption of shares.

➤ Redemption of fully **called but partly** paid-up preference shares

i. When calls-in-arrear is received by the company:

If the amount of unpaid calls is received by the company before redemption, the entry is under:

>>	Bank A/c	Dr.
	To Calls-in-Arrears A/c	

ii. When shares are forfeited:

If the shareholders fail to pay the unpaid calls, the company may decide to forfeit the shares and cancel these shares instead of reissuing because redemption of these shares is due immediately or in the near future.

Note: For replacement of capital, total preference share capital including forfeited and cancelled to be considered, where as for payment of redemption, amount actually payable to shareholders to be considered.

MCQ:

- A company cannot issue any preference shares which is redeemable after the expiry of**
 - 5 years
 - 10 years
 - 15 years
 - 20 years
- Preference shares can be redeemed only of these are:**
 - Partly paid
 - fully paid
 - cumulative
 - participating
- Preference shares can be redeemed out of**
 - Any profits
 - Divisible profits only
 - Divisible profit or Proceeds of fresh issue of shares
 - Divisible profit or Proceeds of fresh issue of shares or debenture
- The premium, if any payable on redemption must be provided for out of**
 - Share premium or any profit
 - Divisible profit only
 - Share premium only
 - Share premium or divisible profits
- Which of the following statement is false?**
 - A company can redeem its preference shares
 - Preference shareholders are creditors of a company
 - The part of the authorized capital which can be called up only in the event of liquidation of a company is called reserve capital.
 - Capital redemption reserve can be utilized for issuing fully paid bonus shares.
- According to sec52 of the companies act, 2013, the amount in the securities premium A/c cannot be used for the purpose of**
 - Issue of fully paid bonus shares.
 - Writing off losses of the company
 - For purchase of own securities
 - W/off commission or discount on issue of shares
- Which of the following can be utilized for redemption of preference shares?**
 - The proceeds of fresh issue of equity shares
 - The proceeds of issue of debentures
 - The proceeds of issue of fixed deposit
 - All of the above
- Which of the following statement is True?**
 - Capital redemption reserve cannot be used for writing off miscellaneous expenses and losses
 - Capital profit realized in cash cannot be used for payment of dividend
 - Reserve created by revaluation of fixed assets are not permitted to be capitalized
 - Dividend is payable on the calls paid in advance by shareholders.
- Which of the following accounts can be used for transfer to capital redemption reserve?**
 - General reserve account
 - Profit prior to incorporation



Issue of Debentures

A debenture is a bond issued by a company under its seal, acknowledging a debt and containing provisions as regards repayment of the principal and interest. If a charge has been created on any or on the entire assets of the company, the nature of the charge and the assets charged are described therein.

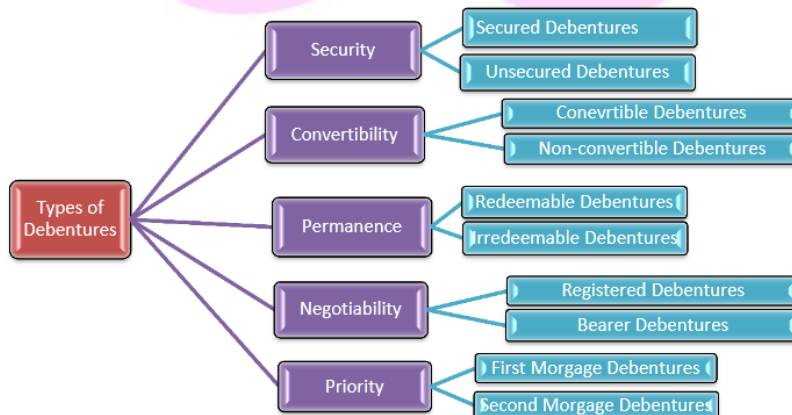
➤ **Features of Debentures**

1. It is a document which evidence 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.

➤ **Distinction between Debenture and Shares:**

Debentures	Equity Shares
Debenture constitutes a Loan and holders are the creditors of the company.	Share is a part of owned capital and holders are the owners of the company.
Debenture holders have no voting rights and consequently do not pose any threat to the existing control of the company.	Shareholders have voting right and consequently control the total affairs of the company.
Debenture Interest is paid at a predetermined fixed rate. It is a charge against profit and payable irrespective of there is profit or not.	Dividend payable to shareholders may vary from year to year depending upon profit. It is appropriation out of profit if available.
Payment of Interest gets priority over dividend and repayment of debentures is made before payment of Share Capital.	Payment of dividend is made after paying interest and payment of share capital only after repaying debentures.
Non-convertible debentures redeemable on or after 18 months are secured by a charge.	Shares are not secured by any charge on company.
At maturity, Debenture holders get back their money as per terms and condition of redemption.	Equity share holders cannot get back their money before liquidation.
Debentures can be convertible to shares	Shares can never be convertible to debentures

➤ **Types of Debentures**





1. **Secured Debentures:** These debentures are secured by a charge upon some or all assets of the company. There are two types: (i) *Fixed Charge* and (ii) *Floating Charge*. A fixed charge is a mortgage on specific assets. These assets cannot be sold without the consent of the debenture holders. The sale proceeds of these assets are utilized first for repaying debentures. A floating charge generally covers all the assets of the company including future one.
2. **Unsecured or 'Naked' Debentures:** These debentures are not secured by any charge upon any assets. A company merely promises to pay interest on due dates and to repay the amount due on maturity date.
3. **Convertible Debenture:** Debenture holders have option to become shareholders and equity shares are allotted either at par or premium or discount after certain period of time from the date of issue.
4. **Non-convertible Debenture:** These debentures cannot be converted into shares in future but repaid as per terms of issue.
5. **Redeemable Debenture:** As per terms of issue, debentures are repayable after certain period of time.
6. **Irredeemable Debentures:** Also known as 'perpetual debentures' and are repaid only at the time of liquidation.
7. **Registered Debentures:** These debentures are payable to a registered holders and can be transferred only as per provision of companies act 2013. Interest is paid to the order of registered holder or bearer of the interest coupons.
8. **Bearer Debentures:** These debentures are transferable by delivery and are negotiable instruments payable to the bearer. Interest is paid to the holder irrespective of identity.
9. **First Mortgage Debentures:** These debentures are payable first out of the property charged.
10. **Second Mortgage Debentures:** These debentures are payable after satisfying the first mortgage debentures.

➤ **Accounting entries for issue of Redeemable Debentures:**

1. **Debenture issued at par redeemable at par:** When debentures are issued at par, the issue price is equal to par value, in this regard the following entries are recorded:

>> For receipt of application money:

Bank A/c	Dr.
To Debenture Application money A/c	

>>For transfer of application money to debenture account:

Debenture Application A/c	Dr.
To% Debenture A/c	

2. **Debenture issued at Discount and Redeemable at par or at discount:** When debentures are issued at discount, issue price will be less than par value. The difference between the two is considered as loss on issue on debentures and is to be written off over the life of debentures. The entries with regards to issue are given below:

>> For receipt of application money

Bank A/c	Dr.
To Debenture Application A/c	

>> At the time of making allotment

i.	Debenture Application A/c	Dr.
	Discount on issue of debenture A/c	Dr.
	To ...% Debenture A/c	



3. **Debenture Issued at Premium and Redeemable at par or at discount:** When debenture are issued at premium, the issue price is more than the par value. The premium is transferred to Share Premium Account.

>> When premium amount is received at the time of application

- a. For receipt of application money

Bank A/c	Dr.
To Debenture Application A/c	

- b. For transfer of application money at the time of allotment

Debenture Application A/c	Dr.
To.... % Debenture A/c	
To Share Premium A/c	

When debentures are issued at par or premium value but redeemed at discount, then it means that the company will gain by paying less. This gain will not be recognized in the books at the time of issue of debentures as per the conservatism concept.

4. **Debenture issued at par and redeemable at a premium:** Where debentures are to be redeemed at premium, an extra entry is to be made at the time of issue and allotment of debentures. This extra entry is to be passed for providing premium payable on redemption. In this case, the issue price is same as par value but the redemption value is more than the par value, therefore redemption premium is recorded as a loss on issue of debentures at the time of allotment of debentures.

>> For receipt of application money:

Bank A/c	Dr.
To Debenture application A/c	

>> At the time of making allotment:

- i. Transfer of application money to debenture account:

Debenture application A/c	Dr.
To ...% Debenture A/c	

- ii. Call made consequent upon allotment:

Debenture Allotment A/c	Dr.
Loss on issue of debenture A/c	Dr.(Equal to Debenture Redemption Premium)
To% Debenture A/c	
To Debenture redemption premium A/c	

5. **Debenture Issued at discount and redeemable at premium:** When the issue price is less than par value but redemption value is more than par value. The difference between the redemption price is treated as discount/loss on issue of debentures.

>> For receipt of application money:

Bank A/c	Dr.
To Debenture application A/c	

>> At the time of making allotment:

- i. Transfer of application money to debenture account

Debenture Application A/c	Dr.
To% Debenture A/c	

- ii. Call made consequent upon allotment of debenture at discount and redeemable at premium.

Debenture Allotment A/c	Dr.
Disc./Loss in issue of debenture A/c	Dr.(disc. on issue of debenture+ prem. on redemption)
To ...% Debenture A/c	
To Debenture Redemption Premium A/c	



>> For receipt of call made on allotment

Bank A/c	Dr.
To Debenture Allotment A/c	

6. When issue price is more than par value and also redemption value is more than par value. The premium received at the time of issue of debenture is credited to Share premium account and premium paid at the time of redemption is a loss to be provided at the time of issue of debentures.

>> For receipt of application money:

Bank A/c	Dr.
To Debenture application A/c	

>> At the time of making allotment:

- i. Transfer of application money to debenture account

Debenture Application A/c	Dr.
To ...% Debenture A/c	

- ii. Call made consequent upon allotment of debenture at premium and redeemable at premium.

Debenture Allotment A/c	Dr.
Loss in issue of debenture A/c	Dr. (Amt. equal to premium on redemption)
To ...% Debenture A/c	
To Share Premium A/c	
To Premium on Redemption of Debenture A/c	

➤ **Accounting for issue of Debentures payable in installment:**

1. Debentures payable in Full on application:

Where the amount due on debentures are payable in full on application, it is usual to open a separate Debenture Application Account for each class of debentures. This accounts record moneys received from the applicants of debentures. At time of allotment of debentures, the amount in Debenture Application Account is transferred to the respective Debenture Account.

2. Debentures Issued at Par:

- a. When Cash is received:

Bank A/c	Dr.
To Debenture Application A/c	

- b. When excess money is refunded

Debenture Application Account	Dr.
To Bank A/c	

- c. When debentures are allotted:

Debenture Application Account	Dr.
To Debenture Account	

3. Debentures Issued at a Premium:

A company issues debentures at a premium when market rate of interest is lower than the debentures interest rate.

The premium on debenture is credited to 'Securities Premium Account' as 'Debentures' are covered in the definition of 'Securities' specified in Securities Contract Act. The restriction of utilization of debentures premium will also be governed by sec 52 of Companies act 2013.

- a. When Cash is received:

Bank A/c	Dr. (nominal value + premium)
To Debenture Application A/c	

- b. When excess money is refunded

Debenture Application Account	Dr.
To Bank A/c	

- c. When debentures are allotted:



- a. If the debentures are redeemable after a certain period of time, say at the end of 5 years, the total amount of discount should be written-off equally throughout the life of debentures.
- b. If the debentures are redeemable at different dates, the total amount of discount should be written-off in the ratio of benefit derived from debenture loan in any particular year.

Accounting entry:

Profit and loss Account	Dr.
To Discount on Issue of Debenture Account	

➤ **Interest on Debentures**

Interest payable in coupon debenture is treated as a charge against the profit and loss account.

Accounting entry:

1. When interest is due:

Interest A/c	Dr.
To Debenture holder's A/c	

2. Payment of interest and TDS

Debenture holder's A/c	Dr.
To Bank A/c	
To TDS payable A/c	

3. Payment of TDS

TDS payable A/c	Dr.
To Bank A/c	

4. Transferring interest to profit and loss account.

Profit and Loss A/c	Dr.
To Interest A/c	

MCQ:

1. Premium on redemption of debentures account appearing in the balance sheet is _____
 - a. A real account
 - b. A nominal account – income
 - c. A personal account
 - d. A nominal account- expenditure
2. Which of the following statement is false?
 - a. A company can issue convertible debenture
 - b. Debentures cannot be secured
 - c. A company can issue redeemable debentures
 - d. Debentures have no right to participate in profits over and above their fixed interest
3. Debenture Interest
 - a. Is payable only in case of profits
 - 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
 - d. Is payable before the payment of any dividend on shares
4. Which of the following is true with respect to debentures?
 - a. They can be issued for cash
 - b. They can be issued for consideration other than cash
 - c. They cannot be issued as collateral security
 - d. Both (a) and (b) above



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 debenture A/c
 - d. Debit Cash A/c and credit the loan A/c for which security is given

6. Which of the following is false?
 - a. A company can issue redeemable debentures
 - b. A company can issue debentures with voting rights
 - c. A company can buy its own shares
 - d. A company can buy its own debentures.

7. When Debentures are issued as collateral security against any loan then holder of such debentures is entitled to ?
 - a. Interest only on the amount of loan
 - b. Interest only on the face value of debentures.
 - c. Interest both on the amount of loan and on the debentures
 - d. None of the above

8. Interest on debenture is calculated on
 - a. Its face value
 - b. Its issue price
 - c. its market price
 - d. its redemption price

9. Discount in issue of debenture is a _____
 - a. Revenue loss to be charged in the year of issue
 - b. Capital loss to be written off from capital reserve
 - c. Capital loss to be written off over the tenure of the debentures
 - d. Capital loss to be shown as goodwill.

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